Vivimed Labs Limited

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Earnings Conference Call

Q1 FY2017

August 17, 2016

Mr. Santosh Varalwar, Managing Director

Mr. Ramesh Challa, Chief Financial Officer

Mr. Saurabh SG, Director – Corporate Strategy

Moderator: Ladies and gentlemen, good day and welcome to the Vivimed Labs Q1 FY2017 earnings conference call. We have with us today on the call Mr. Santosh Varalwar – Managing Director, Mr. Ramesh Challa – CFO and Mr. Saurabh S.G. – Director, Corporate Strategy. As a reminder all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. If you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

Before we begin, we would like to mention that some of the statements made in today's call may be forward looking in nature and may involve risks and uncertainties. For more details on such considerations kindly refer to the earnings presentation. I would now like to hand the conference over to Mr. Santosh, thank you and over to you sir.

Santosh Varalwar: Thank you very much. Good afternoon everyone for joining us on this call today. Hope you have had a chance to go through the Earnings Presentation and Financial Results which are also available on the company website.

Moving to the discussion of the performance for the quarter I will start by providing the overview of our financial performance and strategic initiatives, then I will pass on the call to my colleague, Saurabh to provide you a detailed operational overview.

Our performance in Q1 FY2017 has been very encouraging and is a clear reflection of our focus on consolidating our core strengths last year. During the quarter we registered a topline growth of 10.7% year-on-year to reach Rs. 3,686 million. This improvement was driven by a robust performance of our API business overseas. EBITDA for the quarter was Rs. 668 million representing a marginal decline of 0.6% compared to the same period last year. EBITDA margin was 18.1%, a decline of 205 bps compared to Q1

FY2016. This decline was due to subdued performance at one the Company's subsidiaries.

Finance cost for Q1 FY2017 was Rs. 152 million, a decline of 20.1% compared to the same period last year. This decline was due to scheduled repayment of long term debt. We expect further decline in the finance expense going ahead after the second tranche of the spec Chem sales proceeds come in. Net Profit for Q1 FY2017 was Rs. 279 million up 15.2% versus Q1 FY2016. Net Profit margin increased from 7.3% in Q1 FY2016 to 7.6% in Q1 FY2017. The decline in finance cost benefitted the profitability for the quarter.

As you are aware, in July 2016, Vivimed transferred and sold identified products along with their associated trademarks by its wholly owned subsidiary company Klar Sehen Private Limited to Ordain Healthcare Global Private Limited, which is a subsidiary of Spain based Chemo Espana S.A. As part of the transaction, Klar Sehen will provide contract manufacturing services for the divested products to the buyer for an agreed period of time from its two plants located at Hyderabad and Kolkata. The total consideration for the identified product line was Rs. 730 million. This transaction was in line with managements' strategic decision to exit branded ophthalmic products and continue to focus on CMO and US generic products.

Overall, we believe that this start of the fiscal year has been very exciting and going ahead, we will continue to build on the growth momentum. The various initiatives undertaken by the management coupled with improvement in the financial flexibility will drive our performance in the medium to long term. With this, I now hand over the call to Saurabh. Thank you very much.

Saurabh SG: Thank you, Mr. Santosh. Good afternoon every one and thank you for joining with us on the call today. I will start by providing an overview of the healthcare business, which today is the largest part of our overall revenues. For the first quarter, the healthcare business constituted nearly 78% of our total sales on a consolidated basis. If you would look at the healthcare segment, it has grown nearly 22% year-on-year to reach around Rs. 2,868 million. This growth was primarily driven by improved performance of our API business UQUIFA, which sort of compensated for the muted performance which we saw in the FDF segment in India.

As far as the business dynamics are concerned, our competitive market positioning in the API business, which is UQUIFA has helped us to gain better market share in some of our established generic products and as far as the CMO business is concerned, we have also seen a significant ramp up in the key accounts which we have been servicing for the last 3 years or so.

In terms of the business pipeline, we have a reasonably strong CMO pipeline with new projects from existing clients as well as new customers and we expect that this CMO business will grow to be a larger part of our pharma segment revenues. On the generic side, we believe the Company is on track to meeting our expectations as far as the filing pipeline is concerned and we expect to complete an incremental 5 new files before March 2017.

On the finished formulation segment, the performance remained muted during the quarter compared to same period last year and furthermore as Mr. Santosh mentioned, we strategically exited the branded products business which we had in Klar Sehen and the strategy for the formulation business is quite clear. We are now focusing on the US market and we have 3 products which are already commercial and we expect 2 more products to go commercial before end of this calendar year and we have quite busy pipeline in terms of filing which we intend to accomplish from our Alathur site which is catering the US market. I think more importantly the divestiture of the branded product business which we did also give this whole financial flexibility which will help us transition to the next phase of growth which is what the management team is geared at delivering.

As far as the specialty chemical business is concerned, the revenues were close to Rs. 800 million for the quarter which was nearly 16.5% decline compared to Q1 FY2016. This decline in revenues was primarily due to the ongoing transaction closure which is happening with Clariant and also the fact that over a period of time we have sort of exited the lower value segment within the specialty chemicals portfolio and today we are pretty much focused on what we have which is photochromics, hair dyes, some specialty intermediates which we will continue to make and position for the third party. So I think this chemicals business, we believe in the phase of transition and I think we are at least 2 quarters away as far as seeing the fruits of our initiatives which we have resumed after the Clariant divestiture.

In summary, we are encouraged by the early signs of benefits which we are seeing from the initiatives undertaken by the management over the period of last 12 to 15 months. I think as a team, we are focused to build on this strong growth momentum which we have generated and in addition the prospects across our pharma business look encouraging both on the API side as well as formulations which we believe will start to contribute significantly in the next couple of quarters and as far as the chemical business is concerned, we will continue to focus on a differentiated product mix and we will look to build on opportunities to drive growth in adjacent segments as to where we are already present today. So I would like to take a pause here now and we will open up the floor for Q&A.

Moderator: Thank you very much. Ladies and gentleman, we will now begin the question and answer session. First question is from the line of Sriram Rathi from ICICI securities, please go ahead.

Sriram Rathi: Two questions basically one on the healthcare segment side, we have seen 22% Y-o-Y growth despite muted US performance. Just wanted to check what has been the growth in the API segment that is basically UQUIFA in the quarter?

Saurabh SG: Hi Sriram, thanks for your question. I think most of the growth which you are seeing in the pharma business has come from the API segment, so I think it would be pretty reasonable to say that the growth which you are seeing of (+20%) is coming from that part.

Sriram Rathi: From the API part only? And in US, you mentioned that three products have already been commercialized. Can you share the name of those products?

Saurabh SG: I think we have been selling at least 2 of them for quite some time. So Losartan, Donepezil and Amlodipine, these are the three. We are expecting approval for Metronidazole anytime and we would be going commercial there as well. In fact, we are shipping Metronidazole as we speak.

Sriram Rathi: Okay great and are you still doing the contract manufacturing for some of the other generic players in terms of basically site transfer for ANDAs to your plant?

Saurabh SG: So if you see our Alathur facility, right now we are running at lower than what the ideal capacity utilization and so clearly we believe that these numbers will begin to go up once we have our own products and as far as CMO is concerned, whatever initiatives which we had started in the last year we are continuing with that, so we are working with few companies and we expect that they will start to see some more traction may be towards end of the year.

Sriram Rathi: Any guidance that you can give in terms of your revenue from the Alathur facility let us by the end of this year or next year, what kind of revenue it can generate?

Saurabh SG: I think Sriram we will avoid giving the specific unit related guidance, but I think it is suffice to say that last year we made probably around $5 to $6 million from Alathur and this number we would see significant increase in next 24 months or so.

Sriram Rathi: That is helpful and second, what is the gross debt right now and what is the cash position?

Saurabh SG: So if you look at March, I think if you look at our March balance sheet, we had probably around Rs. 860 odd crores of net debt. So I think by the time we see the first half when we publish the first half balance sheet, we would expect that this number will go down given that we would have the second tranche from Clariant.

Moderator: Thank you. We have the next question from line of Suhani Doshi from Edelweiss. Please go ahead.

Suhani Doshi: I wanted to know after the deal with Clariant is over, what type of annualized revenues would spec chem be having as in what would be the residual revenue because I think the transition has been happening so quarter-on-quarter the figures are fluctuating, so what would be the figure amount?

Santosh Varalwar: Suhani, at this point of time the speciality chemical also represents a part of revenue carry to Clariant because they are still not done the second closing, so we still continue to manufacture the products for them from the same plant and then supply them. However, the transfer price that is being given to them is much less on the original sale price which we used to have, but I guess this will be all over by end of September. So I think post

September, probably it will reflect the exact numbers in terms of the residual specialty chemical business. The residual spec chem business in a consolidated basis will be in the range of about Rs. 250 crores or something, so that is the reflection that probably we will see in the spec chem business. So at least at this point of time we should see more of sales from that and then once this whole business transferred, I think this current year, we will probably see the same number until we have new products approvals coming in.

Suhani Doshi: And the EBIT margin for the spec chem would be in the range of 18-20%, the highest margin?

Santosh Varalwar: So you have seen that even in spite of giving away portion of the business after first tranche we have still seen good margins, so obviously once I think which has gone, that much of overheads related to that will go away. So we will definitely see that the EBIT margins would not go down. There could be a similar range or a little better than that.

Suhani Doshi: And another thing, last concall it was mentioned that the revenues from CIS countries would start coming in this fiscal. So any guidance or any such revenue which has come in the first quarter?

Santosh Varalwar: In the first quarter we did not receive any orders but in the 2nd quarter the current ongoing quarter we already started to receive, we have received two orders now. So I think whatever number we have indicated the CIS revenues this year we should be able to achieve that. We have already received some orders coming in now in this quarter and going forward of course there are couple of more products we are expecting for us to come in, so I think whatever we have budgeted CIS revenues we should be able to achieve that.

Moderator: Thank you. We have the next question from the line of VEC Investments Please go ahead.

Kunal Sabnis: Is it possible to get the gross debt number?

Saurabh S.G. I think we will be able to give that when we publish the audited balance sheet for 1st half.

Kunal Sabnis: Okay and apart from the Rs. 140 crores which got repaid based on the proceeds from the sale, any other debt has been repaid till date from the start of the year?

Saurabh S.G. So basically if you see how the inflow was utilized so large part of it went towards debt reduction and then the numbers which you mentioned around Rs. 135-140 crores and the rest we have done CAPEX in Alathur where we have spent little bit of money. There we have tried to increase capacity. Then we have used little for giving a boost to our new product filing of both formulation side as well as the API. So I think that is it has been largely used so far.

Santosh Varalwar: I think we have sort of said that if you really probably see like for March 2016 till today obviously there has been some inflows and there is a part debt reduction that has happened. So probably you will see the impact of it better when you get a second tranche where at least more than half of that will go towards debt reduction.

Kunal Sabnis: Right, so Clariant deal the second tranche as well as the other sale that happened about Rs. 200 crores is still expected I guess, totally rough numbers. How much of that will go in tax and how much of that will be required for say CAPEX or financing working capital or any other thing?

Santosh Varalwar: Largely what we acknowledge another Rs. 200 and odd crores, so maybe Rs. 180 crore or something 50% of that about Rs. 80-90 crores will go towards debt reduction and about Rs. 30-40 crores would probably go towards your taxation and balance will go for miscellaneous expenses, CAPEX and other things.

Kunal Sabnis: That is helpful. So based on your repayment schedule based on the debt that you have, any repayments are due in next one year and what should be the quantum?

Santosh Varalwar: Post second tranche or something we will be still having a term debt of about Rs. 240 or 250 crores roughly and obviously like we will tell you in last few concalls that we are still expecting to sell the land if that happens then probably before December then that obviously go towards the payment of debt. But I think our commitment of repayment of debt, this Rs. 240 crores probably will get repaid in the next 4 years. So about Rs. 50-60 crores gets repaid every year.

Kunal Sabnis: Right, so one thing is based on how you want to repay. But any other major amount is due to be repaid over next one-year?

Santosh Varalwar: 2 quarters of installments will be due that is December and March quarters when we are due for payment?

Kunal Sabnis: So basically Rs. 50-60 crores per annum is what we should factor in?

Santosh Varalwar: See if you really see whatever we have paid in the current year and what will be left over, so I say about that Rs. 30 crores or something to be paid in the current year till March and subsequently you can say about Rs. 50-60 crores are the repayment if we do not bring down the debt by any other means.

Kunal Sabnis: That is helpful and the finance cost should be around Rs. 15 crores that is the threshold now?

Santosh Varalwar: I mean something in the range of that.

Saurabh S.G. Rs. 15 at consolidated level.

Kunal Sabnis: So this is for any other repayment that should be the level at which the interest cost should be?

Santosh Varalwar: Yes, you are right.

Kunal Sabnis: One question on the PE investor in UQUIFA right? How long that investor, is that investor trying to stay and any plan of how that will be sorted out?

Santosh Varalwar: See with the investor out there he has committed to stay at least for the five years. So end of this year it will be 5 years. So we are working out internally as to see how to get him out. Obviously like there are milestones 1,2,3 which we have to be based on that. So we have actively talking to alternate investors would come and take away their position and we are also exploring other opportunities. But I think we will be in a better position to tell you probably by the end of this quarter, the current quarter will be able to like clarify more better what our actions are going to be now.

Kunal Sabnis: And that was so what proportion, so what outlook do we foresee in December?

Santosh Varalwar: See basically it is a preferred capital. So I think we are still negotiating with them. In case we want to buy them out then obviously we will have to negotiate and find out the price range. They have invested about $12.5 million in November 2011. So we will have to see now, we are really talking to them. But if may be initiate another PE to come in then obviously somebody else will come in and take the position and we will have some leveraging after that.

Kunal Sabnis: But they used to get yearly dividend, is it on this…?

Santosh Varalwar: No, we never give any dividend to anybody because we still higher net debt. Now the debt component slightly has come down. When we acquired this entity we had a term debt of about $25 million which has been repaid over the last 3-4 years and now it has come down something like $8 million.

So we have not paid till there was a debt, there was a covenant not to like pay dividend the investors.

Kunal Sabnis: So their compensation, so the price at which the exit should compensate for not earning any dividend for the last 5 years.

Santosh Varalwar: As per the economy. I tell you we need to be justified when negotiating the prices jump, there is win-win situation for both of us and all said and done I think if you see the business in the last 4 years we would when you take part in business, so this is about $70 odd million, $70-$77 million, EBITDA is about $8-$9 million and now if you really see last year, if you see March 2016 it has almost gone up to $120 million with close to $70 million EBITDA. So obviously business is grown over the year and they are part of the growth so we need to really balance it out carefully.

Kunal Sabnis: So may be rough estimate maybe so rough estimate it may be at least double from what they have…?

Santosh Varalwar: From $8 we are going to $17, so mathematically is right?

Kunal Sabnis: $23-24 million in that.

Santosh Varalwar: Yes.

Kunal Sabnis: So you still are in discussion mode with them. So nothing concrete as to how…?

Santosh Varalwar: Nothing. We have not signed any agreement as yet. Let us hope we come to understanding very soon and then we do that. So that is definitely on top priority for the company as such because there is a lot of products that we have planned.

Kunal Sabnis: You are more keen on some other investor stepping in?

Santosh Varalwar: Maybe we should see the right balancing Kunal, we will be in a better position to tell you and there is no by but I think we have to strike the right balance which is beneficial to the company and the shareholders and of course I would like to benefit the shareholder is going to continue to stay with us, not the ones who go away.

Moderator: Thank you. We have the next question from the line of Ashok Shah from LFC Securities. Please go ahead.

Ashok Shah: So it is around 78% in the current quarter. Do you expect it to reach around 85% in next year or in 18 months?

Saurabh S.G.: So the pharma business has become big part of company now and I think in terms of revenues split it is likely that it would be probably around 80-20 that sort of mix will be there. So we should keep in mind that the chemicals business also the teams are working on different plans of adding certain new product areas, new product lines. So all these we have been start to come to action in the next 6-9 months. But I think it is fair to say that 80-20 or even that sort of split is what we can expect overall.

Ashok Shah: Did you plan to visualize split of this speciality chemical division and pharma division after it stabilize 80-20 ratio?

Santosh Varalwar: Shareholders should tell us if it is the right thing to do or not but I think at this point of time Mr. Ashok Shah we will stay where we are and definitely build up, create value, next 12 months we made our cushion, I think as Saurabh said I think there has been good set of things coming in from API and CMO business and the pharma FDA business that is generic business still left to see number of such is the traction, which will probably come in next 9-12 months' time and once we have that, once we have the robust numbers going from fixed dosage formulations and few more pipeline which is very exciting while going forward and then probably it should definitely contemplate for next future whatever is good for shareholders we would like to do that.

Ashok Shah: And this Klar Sehen divestment is around Rs. 73 Crores, so around what time it is expected and are there any plan to divest some other division or so in future, so are there any negotiation?

Santosh Varalwar: I will give you a little clarity, the Klar Sehen divestment purely was only brand divestment happened, so there are two plants associated this one, one was the subsidiary in Hyderabad and then another subsidiary in Kolkata. So we are likely to own these two facilities, the assets under this Vivivmed will continue to own them and our understanding with the Ordain Healthcare is that we will support them but they do not have ophthalmic manufacturing in India so we will continue to support the manufacturing requirements in both the plants and at this point of time I think we will focus on new product development and try to support the contract manufacturing business as if already been offering to customers I don't think anything else in terms of divestment.

Ashok Shah: Last point, it is not a question but a suggestion, so if the company has already listed more than 10 years So my suggestion is to hold at least one analyst meet per year from current year in Bombay at least. Thank you.

Santosh Varalwar: Thank you Ashok. We will take this suggestion seriously.

Moderator: Thank you. We have the next question from the line of Tushar Manudhana from Anand Rathi. Please go ahead.

Tushar: I just wanted to understand this EBIT trend sale of low margins spec chem business we have now reached 19%, though year-on-year is similar level but sequentially there is an improvement. How much further improvement can be expected and so similarly in the pharma space also how much margin improvement can we expect?

Saurabh S.G.: So I think for the spec chem side, I think we are doing very close to 19% or so. I think that is where you should think that we would be at these levels and on the pharma side the endeavor is to try to improve these margins further. So clearly we have all sequential basis we have increased 82 basis points and as I think the formulation business begin to start contributing more in proportion to the capital employed which is there in the business and start to see that shift happening on the pharma margins as well.

Tushar: So by for the full year if you can give some guidance, pharma?

Saurabh S.G.: I think on a consolidated basis the margins which are seeing in this quarter I think would be able to you keep them at this level, I think do not see too much change on that aspect.

Moderator: Thank you. There is a follow up question from the line of Ashok Shah from LFC Securities. Please go ahead.

Ashok Shah: There was an earlier plan to monetize the SEZ assets for some lands, so are there any development on this area?

Santosh Varalwar: Yes, as we just mentioned a while ago, I think efforts are still going on. We are able to monetize that as the plans companies have changed dramatically last few years but definitely scenario there was bending more towards positive we are getting lot of enquiries. But we have not frozen but we are hopeful that before the end of the financial year we should be able to conclude if not the full divestment of the whole land over there but at least part of it we will be able to monetize.

Moderator: Thank you. We have the next question from the line of Sohani Doshi from Edelweiss. Please go ahead.

Sohani Doshi: Is any trend in the staff expenses, so last year the quarterly expense was Rs. 45 crores which then dipped to Rs. 38 crores for the following 2 quarters and in Q4 of last year and Q1 of this year again it is spiked up to Rs. 50 and Rs. 55 crores. So what would be the right figure for the staff expenses on an annualized basis if it is possible?

Ramesh Challa: In the quarter ending with June it is around Rs. 50 crores and it will more or less continue at the same level for the next 3 quarters also.

Sohani Doshi: Okay. This is an even after the transaction with Clariant gets completed?

Ramesh Challa: After Clariant gets completed there will be some dip in that but it will not be very significant.

Moderator: Thank you. Ladies and gentlemen as there are no further questions from the participants I would now like to hand the conference over to Mr. Santosh for closing comments. Thank you and over to you sir.

Santosh Varalwar: Thank you gentlemen for the patient hearing. As I said I think from our side we are pretty excited. Couple of prospects of our business, yes specialty chemicals downsized but however, I think there is a lot of interesting things in the pipeline. So next one year you would see some products coming in speciality chemical side also. But more so as I said they are lot to come from pharma side, lot of assets that still have to be utilized particularly in FDF generic business where we have invested so far close to about Rs. 150-200 crores we had very muted revenues. You will see the revenues coming in as we grow up more filings. I think that is one significant upside which one should watch out in the next 12-24 months and another significant area I have discussed with you is the API and CMO business. So we seem to be getting very good traction in terms of customers coming back to us for more business and then seeing more pipeline. So I think there are lot of interesting things in pipeline for us and as a company we are all staying focused over there but of course focus on the R&D. The

R&D spend is going up marginally because we tend to file more products and invest more in new products whether it is a DMF or ANDA filings. So I think pharma business we will definitely see some interesting days ahead and I will continue to update you with the latest trends and what is happening and thanks very much for all your questions in here. Thank you.

Moderator: Thank you very much of the management. Ladies and gentlemen, on behalf of Vivimed Labs that concludes this conference. Thank you for joining us and you may now disconnect your lines.

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Note: This transcript has been edited to improve readability