Vivimed

Vivimed Labs Limited

Actavis SOD facility Acquisition Conference Call

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Management:

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Moderator: Ladies and Gentlemen, good day and welcome to the Vivimed Labs Limited Actavis FDF facility acquisition conference call. Joining us today on this call from Vivimed Labs are Mr. Santosh Varalwar, MD & CEO; Mr. Sandeep Varalwar, Executive Director; Mr. Saurabh S.G., Associate Director, Corporate Strategy and Dr Kumar, Finoso R&D. As a reminder, for the duration of this conference, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during this conference please signal an operator by pressing "*" and then "0" on your touchtone phone. Please note that this conference is being recorded.

Before we begin, I 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 a list of such considerations, please refer to the acquisition press release. I would now like to hand the conference over to Mr. Santosh Varalwar, MD & CEO. Thank you and over to you Sir.

Santosh Varalwar: Good afternoon to all of you and thank you for joining this call. You are aware that at the end of the last week, we announced the acquisition of Solid Oral Dosage (SOD) facility of Actavis Pharma Manufacturing Private Limited (APMPL). This was a plant belonging to the Dutch company Actavis Holdings. This plant is engaged in solid oral dosage medicines, mainly tablets and capsules and this facility has US FDA approval in formulation manufacturing side that provides us with immediate revenue opportunities in regulated markets.

This is a very compelling acquisition from both strategic and operational perspective, and as you would expect, the senior management team has done due diligence in great detail. So, this is important because at this point of time, Vivimed does not have any formulation plant which is US FDA approved. So, it attains significance because of this. The SOD facility acquired is a critical

part to move up the healthcare value chain. In particular it provides our finished dosage formulation (FDF) manufacturing platform with a US FDA approved facility and as I mentioned earlier, immediate access to the regulated market.

There are also compelling forward integration synergies for Vivimed's existing API business and formulation dossier development. Along with the facility, we acquired two commercially valuable marketable ANDAs which will allow us to enter into the regulated market, right away without any further gestation; however, we need to build up our plan over a period of time. So for us, this is a very critical acquisition. From a financial perspective, the transaction has been structured very attractively at a low net cash consideration. Overall we believe this acquisition is an important corporate step in achieving strategic diversification in pharma and focus on profitable growth. In particular, since we are evolving the pharma strategy going forward and in view of our acquisition of Uquifa about one and a half years back, and attaining a reasonable strength for APIs & FDF manufacturing and also intermediate manufacturing.

I would now hand over to Saurabh to go over and give more details on the acquisition.

Saurabh S.G: Thank you Mr. Santosh. Ladies and Gentlemen, let me start with a brief background on the acquired assets. The FDF facility of Actavis Pharma Manufacturing Private Limited, which we acquired, is located at Alathur, Tamil Nadu. The facility as Mr. Santosh mentioned, has been acquired from the parent Actavis Holding Asia BV. Actavis as you may be aware is a leading global generic and specialty pharmaceutical company and Actavis was actually one of the first international generic pharma companies to have a fully integrated operation in India.

So, just about Actavis, its Indian asset base also includes an API plant which was recently divested in addition to the Alathur SOD facility, which we have just acquired. Although the current capacity

of SOD facility is around 1.2 billion SOD per annum, we believe that it can be expanded to a 5 billion capacity given the unutilized land parcels on the site. This is the key part of our facility development plan going forward. As far as the facility goes, it is state-of-the-art in terms of manufacturing expertise, plant design, process engineering framework, analytical equipments and quality certification. We would certainly encourage you to experience this first hand through a site visit as and when you may find it convenient.

On the transaction consideration, it is around INR 1.22 billion in cash, which is being funded through an optimal combination of internal accruals and debt. The structuring is made attractive by the available cash balance in the system and also the appropriate working capital support, which is being provided by the Actavis Group towards the execution of the contract manufacturing agreement, which is concomitant with the share purchase agreement. I would like to further reiterate some of the transaction advantages, which were briefly touched upon by Mr. Santosh earlier.

Firstly in terms of replacement value, we believe as a team that a similar facility would cost over INR 550 million and nearly three to four years gestation in terms of regulatory approvals by the time we are ready to go to market. This acquisition has therefore eliminated the long gestation period needed for the approvals and also provided us with an immediate direct reach in the US market, which has the largest component of the global generic pharma market.

Secondly, the assets quality, we believe is impressive given the previous Actavis ownership period during which the capital investment was a high priority in developing and maintaining the facilities, and the current net assets value of the SOD facility, I believe would be closer to around INR700 million.

Thirdly, we have received two ANDAs, Losartan and Donepezil as part of this transaction and they will be available for immediate revenue monetization by Vivimed and provides the company with

the commercial momentum required to enter the regulated generics market. These two molecules have a decent global market size of respectively US $3.2 billion for Losartan and $2.2 billion for Donepezil.

Finally, as a salient feature of the acquisition, Actavis is also providing us with a manufacturing contract for a defined period of 15 to 18 months. As Actavis will have to continue with the business till the existing volume in the manufacturing side is completed which will take time due to site transfer and capacity creation. Additionally Actavis is committed to purchase whatever demand arises of the current set of products, and for these we will be getting into an arrangement with Actavis and will be catered to by this facility. So, we believe that this could be at least a period of 15 to 18 months, of activity at Alathur.

More strategically during this process we have developed a strong working relationship with the Actavis Group and we look forward to evaluating joint opportunities with them again in the near term. Be it in terms of the world class manufacturing platform which we already have in-house and it can even extend to the ANDA divestment, which Actavis may consider at a later point. So, overall we believe that the transactions comes with these four salient advantages, which we believe we are well positioned to capitalize on going forward as we build our pharma business aggressively for the next 18 to 24 months. With that brief introduction, I would like to open the lines for Q&A.

Moderator: Thank you very much Sir. The first question is from the line of Sanjay Shah from KSA Shares and Securities. Please go ahead.

Sanjay Shah: Hi everybody. Sir, we really value your vision in acquiring APMPL, but all in perspective, I would like to understand that we are already bloating with a huge debt in our balance sheet and our working capital cycle is also not that favourable. Can you throw light on this why we are going so fast on this acquisition and what margins this business can add to our business?

Santosh Varalwar: Nice talking to you again. Well coming back to the debt, I guess, you know the debt that we have today on a consolidated basis and also on working capital. I would still maintain my stance that the working capital exposure to the consolidated revenues is as per the industry standards and they are nothing abnormal or nothing bloated. Coming back to Actavis, APMPL acquisition you are aware that today Vivimed does have three US FDA approved facilities for API Manufacturing (2 in Spain and 1 in Mexico) and we have backward integrated to make our own intermediates, and recently we have also invested in dossier development facility in Hyderabad. Now the missing link to the whole pharma strategy is the USFDA approved FDF manufacturing facility. As Saurabh just explained to you it is long gestation period. We do have land parcel in Hyderabad, which we initiated to do it in, but again, we realized the situation on the ground in terms of getting USFDA approvals and the inspections that were taking time and all kinds of regulatory issues coming in, so it takes at least four to five years gestation, which means in spite of having a very robust manufacturing activity of APIs I can still not go and take advantage of the growing generic market. We all know the value chain, the value that is there in the formulations, and until you go into this burgeoning generic business I guess the pharma business is not fully completed. So, given an opportunity and given the size of the deal and given the situation and also the handholding support that we are getting from Actavis and also as Saurabh explained to you the other benefits that we are getting in terms of partnering with Actavis, whether it is in the terms of supplying APIs or in terms of doing intermediates, I guess this was more of an opportunity for Vivimed and as I also explained in my opening statement, it has been attractively structured in such a way that the debt exposure is not really much and then at the same time, I think, things are under control and the Company has got existing revenues and existing profitability so we have to leverage all the given situations and also the time taken to get into the market, particularly with the Losartan and Donepezil like these two products we can get into the market, and then we also got a strategy already tied up to file further ANDAs, we are using Uquifa

APIs so I guess it is really a good opportunity and to defer this it would not be a great strategy for Vivimed if we look at a great future ahead.

Sanjay Shah: Great Sir. This year actually what is the revenue you target from this Company and what is the EBITDA margin this Company is working on, EBIT margin?

Saurabh S.G.: Just for some perspective, this Company in FY'12 had revenues of around INR121 to 130 Crores and EBIT margins were 15% to 16%, so you have to keep in mind the fact that what this plant earlier was doing was pure captive work for its parent. So the business model as such will now transform because we will be doing of course third party products and we will be trying to fill up our own pipeline. I would be confident to say that over a period of twelve to eighteen months given the nature of the formulations business and the sort of pipeline, which we are working with this facility can give us margins at the EBITDA level in excess of 20% to 25%, which is normal industry band that is achievable in a period of 15 to 18 months ahead.

Sanjay Shah: Today, in this segment actually last year we could achieve a lesser margin, if I am not wrong in healthcare segment around 9.5%?

Santosh Varalwar: Sanjay you are right because healthcare segment for us is nearly 66% of our last year revenues and most of it was the API business. The API business in Spain(Europe) and Mexico and I think we have mentioned on earlier interaction also the profitability for Uquifa was impacted by certain one-off items and on a normalized basis, I think Uqifa the API business, which we have, should do around 14% to 15% sort of margin. Due to some one-off issues specific to one particular product with the shutdown for a period of time, I think the margins have got impacted towards the second half of last year. But I think on a stable basis, our healthcare business should do 14% to 15% and over a period of two to three years with the addition of this facility in our portfolio where we will now capture the complete value as far as the API manufacturing to R&D to finish formulation is

concerned, I think, the margins will be trending up as far as healthcare business is concerned. We believe that this is a quality asset and we will be able to sweat it well going forward over the next couple of years.

Sanjay Shah: Great Sir. Nice hearing from you and due respect to your vision. Wish you good luck Sir.

Santosh Varalwar: Thank you very much Sanjay.

Moderator: Thank you. Our next question is from the line of Sapna Jhawar from Reliance Securities. Please go ahead.

Sapna Jhawar: Good evening all. Thanks for taking my question. Sir, I wanted to ask have we taken any loans also while acquiring this Company?

Santosh Varalwar: Sapna, we have taken a long-term loan for acquiring this Company to the extent of INR45 Crores; however, the size of acquisition as you have seen is about INR122 Crores and the rest of them is structured in a different way, so our exposure in terms of long-term debt has increased by INR45 Crores after this acquisition.

Sapna Jhawar: While acquiring this, would INR122 Crores be paid off with the debt that Actavis already has in its arm or was it a debt free company here?

Santosh Varalwar: Actavis does not have any debt. It is a debt-free company.

Sapna Jhawar: Any kind of Capex that we need do in order to expand this facility or do any kind of modifications to suit our terms in order to synergize our business or would be use it as it is without any Capex?

Santosh Varalwar: At this point of time Sapna the facility is really state-of-the-art with substantial equipment and have a capacity of about 1.2 billion SOD. The capacity utilization at this point is about 50%, which means we still have a scope to take it up to 1.2 billion to its brim so. We would not like to spend anything or no funds would have to be expended for any capacity in the first 12 to 18 months, but as the plan is

clearly there that we would be filing more ANDAs from the site and in the next 12 to 18 months, we will build up a pipeline and as the pipeline builds up then we go into the market, and based on the demand from the market and our capacity utilization situation then we will have to invest into capacity expansion, but as I said again, till FY'15, I guess we do not have to spend any money on Capex there.

Sapna Jhawar: In terms of filings when you say would we be filing for ANDAs with special chronic therapies or any Para-IVs or would they be normal Para-Is and Para-IIs?

Santosh Varalwar: I think the initial strategy would be mainly to leverage our own APIs. We all know that generic business is very cost competitive business so the first steps for Vivimed would be to leverage its own internal strength of APIs, cost competitive APIs that we have. We are going to use our APIs and first go into the market and in the days to come or months to come, we will look at more value added strategies like Para-IVs and other things.

Sapna Jhawar: The agreement that we have entered with Actavis along with sale, would this have some defined term and say this is for five year or three year, eight years or anything specific?

Santosh Varalwar: To begin with it is started with a defined period of first one year and then to be reviewed every year-on-year as the things go on and what value we bring on to the table.

Sapna Jhawar: Do we have any kind of order for this first one-year or would we be producing the products that are only being manufactured within this facility?

Santosh Varalwar: They have already provided and they are already manufacturing few products, so to begin we are going to focus only on those products and the orders for those products have already been taken.

Sapna Jhawar: Right and can you tell us that the gestation period would be somewhere around two to three years that means that we would not account the revenues directly in FY'14 or FY'15, but it will be two years later?

Santosh Varalwar: Yes, FY'14 will have revenues for the balance period what we see right now, but that is mainly coming from whatever Actavis should buy for their own existing products, but when it comes to our own revenues then we have two products where we have ANDAs so we really have to sweat it out and see how we can take them to the market as soon as possible. As far as the company is concerned, we are not factoring any revenues coming this year from even these two products and the real revenue would only come from the next year, next financial year.

Sapna Jhawar: So that means in this year it will only add to our goodwill on the assets, but not in terms of revenues?

Santosh Varalwar: Revenues will come, as I said, Sapna.

Sapna Jhawar: In this year, what I mean specifically for FY'14?

Santosh Varalwar: This year we will see the revenues coming from the existing business. As Saurabh just mentioned, the existing business is in the range of about INR120 to 140 Crores, so if you take the five months, we will have a seven months consolidation, so we will still have a proportionate revenues coming in this year also.

Saurabh S.G.: Just to add to that this year we will be booking revenues which are pertaining to the agreement with Actavis and I think next year FY'15 onwards you will see two additional revenue streams; one is when we start making use of these ANDAs, which we have got with the facility of Losartan and Donepezil we will start selling to our own customers, that is one revenue stream. So, then we will have two revenue streams that is the CMA plus our own ANDAs and then eventually once we get the filing pipeline in place, we will have our ANDAs and as Mr. Santosh mentioned the first target will be where

we are already competitive in APIs so it will be products probably like Cinacalcet Hydrochloride or Acyclovir etc. So we will start filing ANDAs then this will be are third revenue stream, which we expect will be the highest in terms of incremental profitability. So eventually in 18 months' time, we will be having three revenue streams from this plant. I hope that clarifies your question?

Sapna Jhawar: It certainly helps. Thank you. I would like to stretch it a bit. When you say you are going to file ANDAs in FY'15, these ANDAs would take a time of your own, so the actual benefit what we are to incur from them would certainly be after 36 months?

Santosh Varalwar: I will ask Dr. Kumar to talk.

Dr. Kumar: Once you file the ANDA now with the Generic Drug User Act per US FDA they have definite time period, which is about 24 months for ANDA approval. Legally it is mandatory to approve that unless there are huge deficiencies, so we expect and most of the dossiers have already been developed through the internal development arm already, so it is only a question of scaling it up into the plant and generating six months stability and start filing the ANDAs. So typically, if we start new, it will be 18 months to 24 months for filing, but in this particular it will be about eight to nine months for filing and after that it is the mandatory 24 months time period.

Sapna Jhawar: Sir, one last question from my side. Would we hire people to run this facility or through this acquisition do we get the manpower?

Santosh Varalwar: This has been a US FDA approved system for quite some time and they have got a trained manpower and trained skill sets, so the existing manpower whether it is managerial or like at plant level are sufficient enough to continue the business. I do not think we need to hire additional people. The only thing we are going to do is as Dr. Kumar said he is going to look after these new additions two ANDAs. He will be supporting arm to this Company as going forward.

Sapna Jhawar: In that case, how much margins be impacted when we add the manpower as well as some into our expenses as well. I guess, a little of our expenses is going to be increased. So, would that impact our margins by say 0.5% or 1%?

Saurabh S.G.: Sapna, I think, what Mr. Santosh is trying to say is that we would not need to add to manpower because this is already a fully functional operational plant so we will not be hiring anymore manpower in relation to what is already there. As far as impact of margins is concerned, I think, for the first 12 months it will be a neutral sort of a thing and then it will start to turn more lucrative on a consolidated basis as far as margins are concerned. So there is no excessive manpower related expenses, which will start coming into accrued and external margins.

Sapna Jhawar: Thank you so much. That is all from my side.

Santosh Varalwar: Thank you.

Moderator: Thank you. Sir, there are no further questions at this time.

Santosh Varalwar: Thank you Ladies and Gentlemen for being with us this afternoon and patiently listening to the rationale for acquisition and also why Vivimed has taken this bold step of getting into the regulated markets, leveraging its skills, we as management firmly believe that this is absolutely right step going forward and we will push ourselves into a diversified high margin and high value pharma space in terms of pharma and healthcare strategy and we will update you from time-to-time about the progress we make and again come back. Thank you very much.

Moderator: Thank you. On behalf of Vivimed Labs Limited that concludes this conference. Thank you for joining us. You may now disconnect your lines.

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Note: This document has been edited to improve readability

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