



# “Alembic Pharmaceuticals Limited Q2 FY-18 Earnings Conference Call”

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**Moderator:** Ladies and gentlemen, good day and welcome to the Alembic Pharmaceuticals Limited Q2 FY18 Earnings Conference Call. We have with us today Mr. Pranav Amin – Managing Director; Mr. R.K. Baheti – Director-Finance and CFO; Mr. Mitanshu Shah – Senior Vice President-Finance and Mr. Ajay Kumar Desai – Senior Vice President -Finance and Company Secretary. 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. Should you need assistance during the conference call, please signal an operator by pressing \* and then 0 on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. R. K. Baheti – Director -Finance & CFO. Thank you and over to you sir.

**R. K. Baheti:** Thank you very much. Good evening everyone. Thank you all for joining the second quarter conference call. Most of you would have received the results by now; however, let me briefly take you through the numbers for the quarter ended 30<sup>th</sup> of September 2017.

During the quarter, our total revenue de-grew by 10% to 789 crores. EBIDTA however was better at 179 crores, is 23% of the sales. Pre R&D EBIDTA is about 32% of sales and net profit after tax went up by 1% to Rs. 120 crores.

During the half year, total revenue of course is lower by 11% to 1,437 crores. EBIDTA is at 281 crores which is 20% of sales. Pre R&D EBIDTA is about 32% of sales for the half year and net profit after tax was 186 crores, 16% lower than the previous corresponding half year. EPS for the quarter is 6.45 per share for the quarter which is marginally up from 6.36 of the previous year. CAPEX for the quarter including the capital advances are about 278 crores which have been funded through accruals as well as some borrowings. I will hand over the discussion to Pranav on International and Domestic businesses.

**Pranav Amin:** Thank you Mr. Baheti. Starting with the International, let me start with the Orit acquisition, as you know we announced last week. We have acquired Orit through our 100% subsidiary Alembic Pharmaceuticals Inc. This increases Alembics US product portfolio with 7 approved ANDAs and 4 ANDAs pending approval. This acquisition also increased Alembic's breadth in capabilities on the US market with a competent R&D team which brings complementary skillsets and soft gelatin based oral solids and oral liquids. We expect this acquisition to be accretive in one year.

Coming to the R&D in the second quarter, we have spent 98 crores in R&D which is approximately 12% of sales. For the first half, we have spent 192 crores which is about 13%. We filed 3 ANDAs and 3 DMFs during the quarter.

Our projects are progressing well. The oncology facility, the oral solid part of the oncology facility was inaugurated in July. The Derm facility will be ready in the second half of this

financial year whereas the general injectable and new oral solid dosage will be completed next financial year. All our plants continue to remain in compliance as well.

As per approvals and launches, we have received four approvals during the quarter. With this, cumulatively, we have 62 ANDA approvals which include 8 tentatives. We also launched one new product in the quarter which brings us to about 6 new launches for the year. I have given guidance about 8 launches or so for the financial year and think we should be on target to achieve that.

On the Algerian JV, we had informed that we had fire and our manufacturing facility was destroyed. The team is working on reconstructing the facility as well as exploring use of third party facilities to bring our products to the market expeditiously.

As per business, the international formulations business de-grew by 26% to 262 crores for the quarter compared to 352 crores last year. This is largely due to price erosion of some key products. However our new products and new launches continue to gain traction in the market.

The US market has sales of 190 crores, the API business de-grew by 13% to 142 crores for the quarter compared to 164 crores last year.

Talking about the Branded India business, the performance in the quarter witnessed partial recovery in the inventory holding by the trade channel post GST transition. The India formulations business revenue for the second quarter was 385 crores as compared to 363 crores last year. Year-on-year, there is a growth of 6%. Post GST transition, revenues is reported lower to the extent of the GST component; however, it is a profit neutral adjustment. Normalizing for this and some other transition adjustments, the comparable year-on-year growth would be about 13%. However, you would observe that the sequential Q-on-Q growth of revenues is massive of 63%.

Let us move to Q&As and I open the floor for any questions that you may have.

**Moderator:** Thank you very much sir. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Anmol Ganju from JM Financials. Please go ahead.

**Anmol Ganju:** Now for a full year if we try to understand the margin structure and some of the rationalizations which at least in percentage terms on cost items looks like a difference from last quarter. How should we be thinking about it especially R&D on a full year basis?

**R. K. Baheti:** Anmol, you are right, Q2 margins are good. But I must also say that margins are largely because of recovery in the domestic branded business. On a full year basis, I think we will still stay with about 20% plus-minus margins. And R&D, I think our run rate is likely to stay similar. I think we should be doing about anything between 400 crores and 450 crores.

- Anmol Ganju:** Okay. So there is no change as far as the absolute R&D spend amount is concerned. Is that understanding correct?
- R. K. Baheti:** Correct.
- Anmol Ganju:** Okay. And my second question is on US. Now we understand that pricing pressure has been quite severe, but sequentially we continue to see a decline notwithstanding some of the launches. So any thoughts around that?
- Pranav Amin:** Thanks, Anmol. There has been pricing pressure now. For us you have to see that we do have a component of one or two big products and one as we all know is Aripiprazole which I think is coming down. So that whole erosion has happened for us which is still trailing up into last year. So that is one product and overall basket we have grown, while there has been pricing pressure. If we adjust for some of those big products, I think we picked up good market share in some of the new launches and we continue to add traction in those as well.
- Anmol Ganju:** And my last question, this is probably to Shaunak before I get back in the queue. As far as the domestic market disruption is concerned, do we see in a post normalized demon, GST where any impact to be lasting in terms of any permanent market share shift etc. in some of the key products or we should grow in line with market and market share should remain pretty static and everyone has been impacted equally.
- R. K. Baheti:** I will go with the second. I would go with the second statement. we will stay with the market, both in terms of growth and in terms of market share. That is on a broad category. Within that, obviously there will be some improvements in some molecules and probably some slippages on some molecules.
- Moderator:** Thank you. Our next question is from the line of Bharat Celly from Equirus Securities. Please go ahead.
- Bharat Celly:** Just wanted to understand overall relevance of aripiprazole ODT version in your USA. Is it still big or how should we look at it?
- Pranav Amin:** So there is two aripiprazole. One is an ODT bit and the other one is plain Aripiprazole. ODT, we are the only ones in the market right now, but it is a much smaller molecule, I mean the fraction of the big aripiprazole. And on the big aripiprazole, as you know there is now more than 10-11 players, so there has been lot of price erosion over there.
- Bharat Celly:** So talking about ODT itself, I believe since you have mentioned that you are the only one considering that is it a big portion of your US sales or it is a very insignificant part? Could you give us a little bit of sense?

**Pranav Amin:** We don't give product wise breakups for our products. It is very tough for me to answer that question.

**Bharat Celly:** Actually I am not asking for a number, but actually any qualitative view also will be also helpful?

**Pranav Amin:** It is not as big for us.

**Moderator:** Thank you. Our next question is from the line of Harisha Kakera from B&K Securities. Please go ahead.

**Harisha Kakera:** Sir my question is regarding the split of API like domestic versus exports?

**R. K. Baheti:** So virtually the entire business is export centric only. We sell to domestic companies, but we sell to domestic companies essentially for their overseas markets. So while it is classified as domestic sales, the entire business valuation for us is like international. So we negotiate in dollars, its linked with the overseas market dynamics.

**Harisha Kakera:** Sir, can you just give me the numbers like the split?

**Pranav Amin:** It is about 15% or so.

**Harisha Kakera:** Domestic. Sir, one more thing like the JV, the fire at the facility, has it impacted our revenues this quarter?

**R. K. Baheti:** Sure, it has because we were just picking up the market and it happened at the most unfortunate time. Government of Algeria has been very helpful. They are giving us some expeditious approvals for third party manufacturing sites and we are exploring making our products at third party sites. But you know in pharmaceutical business all this will still take a while. So we have lost at least couple of quarters of sales.

**Harisha Kakera:** Sir, is it possible for us to quantify what could be the appropriate...?

**R. K. Baheti:** It was not a big number in any case. It was just picking up. It was not a big number.

**Pranav Amin:** I think with Algeria what is happening is we have just started picking up some momentum in terms of prescriptions and revenue. In terms of numbers, it was still a very number. So it doesn't mean much in the whole scheme of things.

**Harisha Kakera:** And one more thing like on the ANDA approvals, can you please repeat the cumulative ANDA approvals?

**R. K. Baheti:** We have 62 ANDA approvals including the tentatives.

- Harisha Kakera:** So what is the final approval that we have?
- Pranav Amin:** 62 ANDA approvals which has 8 tentatives, so 54.
- Harisha Kakera:** Okay. And we have got one new approval this quarter, isn't it sir?
- Pranav Amin:** We had 4 approvals this quarter. Out of that, two are tentative and two are final approvals and we have launched one product.
- Moderator:** Thank you. We will take the next question from the line of Kumar Saurabh from Motilal Oswal. Please go ahead.
- Kumar Saurabh:** Sir on margin side, Bahetiji you mentioned that for the full year we should be at around 20% EBIDTA margins. Also this quarter I believe we did close to similar kind of margins we delivered and this would include more than 90 days of domestic sales because of channel refilling. So how should we look at the second half numbers, as in you know that operating leverage the additional benefit which we got in second quarter should not be there in the third and fourth quarter. So is it because that in US you expect some kind of pickup and momentum and because of that margin should hold up, how should we look at the margins?
- R. K. Baheti:** No, margin actually if you look at in absolute number from 23% it would go down. What I said is that we are looking to maintaining about (+/-20%) margins. So Yes, from Q2 in absolute percentage it will go down to about 20%.
- Kumar Saurabh:** Fair enough. And Pranav you mentioned that the Orit acquisition will be EPS accretive in a years' time if you can provide some more light that what is our strategy with this acquisition. Is it for the existing products we have acquired this product or the pipeline product or something more which we can develop in and around this?
- Pranav Amin:** Good question, but I think for both. Few things, one they have couple of products in the market already which are through partners which over the next few months we will bring back to sell on the Alembic labels, so that is first part of it. Second part, we will take some manufacturing in-house and thirdly as we mentioned there are some approvals that we believe should happen within the next 12 months, that is what will drive this. Apart from that, they have a R&D team also which is going to start developing some products for us.
- Kumar Saurabh:** So there is a product Benzonatate where the market is pretty much concentrated in around one or two players. Is there any scope basically where now given the fact that you will do your own manufacturing and can do your own marketing. There could be pickup in that product, contribution for you guys?
- Jesal Shah:** So like you rightly pointed out the market is already concentrated. We are not anticipating too much change in the market situation. It has just started a transition from one marketing

company which industries might have picked up. So it will transit to our own marketing engine. Overall market share we are not anticipating that to change too much.

**Kumar Saurabh:** Okay. And will you guys be sharing in terms of numbers how big this acquisition is or small this acquisition is from a shareholder perspective?

**Jesal Shah:** We are not sharing detailed numbers, but I think what we are saying is that, it is not a big acquisition for us. So it is relatively pretty small in the overall scheme of things.

**Kumar Saurabh:** And Pranav just last question on the strategic level, how you are looking at US. So we have heard mixed statements up till now. Couple of companies have highlighted that FY19 in terms of base price erosion could be better off compared to FY18, whereas some companies still maintaining that FY19 could be equally painful as like FY18. How are we looking at?

**Pranav Amin:** I don't know FY18-19 but basically if you see the US market, are there some challenges? There are some issues happening in the market right now. However, I still think we are okay. We believe that we are still seeing some opportunities moving forward as and when we file our products as and when we get approvals, we hope to get more market share and build up. Again you have to realize Kumar, that we are on a much smaller base compared to lot of the larger players. So we do see lot of opportunities. I think supply chain wise, we have been able to pick up good market share, not just the new products but old products as well. So we are seeing a decent amount of opportunities.

**Kumar Saurabh:** And Pranav we are investing roughly around between CAPEX and R&D, in 2-3 years' time period basically 2,500 to 3,000 crores. In US, historically we are seeing that companies have made 25% plus kind of ROEs. How should we look at? This is a big investment especially for company of our size, how should we look at in terms of return on investments, what we are doing...

**R. K. Baheti:** Our hurdle rate is also around the same number what you mentioned. So we are looking at opportunities only if it meets our hurdle rate of 20%-25%. But there would always be transition period. So currently we are in investment phase where we are building our facilities, it will take at least 2 to 3 years for our filings to get approval and then our launch into the market. But over a period of time, if you look at the DCF method, I mean if you are not making 20%-25% of the ROCE, then we are not doing justice to the job.

**Moderator:** Thank you. Our next question is from the line of Prakash Agrawal from Axis Capital. Please go ahead.

**Prakash Agrawal:** So just trying to understand this better. So this has the liquid and the soft gels and you said the R&D team. So the R&D team specializes in these two areas or do we think that it would add to the overall scheme of things where we are developing our oncology basket, injectable basket. How should we look about value addition on the R&D team?

**Jesal Shah:** So I think it brings us really the portfolio of products which are already filed and some products which are already in the market. So that is the main attraction here. In addition, the team because they have already vast experience in formulation development and they have done filings in oral liquids and soft gel space. So I think that gives us some additional type of skill sets to look at. So I would say that these are the two twin advantages here. So it is both the portfolio existing filings as well as some additional skill sets in the other two responses.

**Prakash Agrawal:** And of the 7 products you mentioned which have got approval already, so not much juice left is what my understanding is, how should we look about the 4 products which are pending approvals?

**Jesal Shah:** Not much juice, I do not know what you mean by that, but I think there is still opportunity in the existing set of products because as you would have noticed they are not marketing on their own, they were currently partnered out. So there is some opportunity to take the margins up as we shift it to internal marketing engine plus there will be some opportunity to as Pranav mentioned, initiated to do site transfers for some products too and that will enable us to launch those products. And then there is of the 4 products, there are some products which are of interest.

**Prakash Agrawal:** On the pipeline side?

**Jesal Shah:** Yes of the 4 products.

**Prakash Agrawal:** Which should be into these dosage forms only?

**Pranav Amin:** Yes, oral solids.

**Prakash Agrawal:** And on the US business, so we have seen some plateau now and as you mentioned, Abilify is behind us. So whereas there is also comment on pricing erosion. So do we start seeing growth or there is sometime still left on the base of \$30 million?

**Pranav Amin:** I believe we still had some tail of sales of aripiprazole and which is quite large and I believe in Q3 also, I will have to check. But once that goes, then we will see it is touching growth again.

**Prakash Agrawal:** Which is from next quarter onwards?

**Pranav Amin:** No, as Q3 last year had aripiprazole.

**Prakash Agrawal:** Post which you are saying?

**Pranav Amin:** Yes.

- Prakash Agrawal:** And one more question on the comments on the CAPEX that we are doing. Firstly, you mentioned that oncology OSD and is complete now. So we start filing from now on or what is the plan here?
- Pranav Amin:** The facility is ready. So we will start doing some batches and filings from that facility right now. The oncology injectables are still going to be about 6 months. So it still takes a little bit of time.
- Prakash Agrawal:** So how should we look on the cost ramp-up with these facilities coming on stream. So we have seen good cost efficiencies across and now with these facilities coming and obviously there is a lead lag on cost and revenues coming in. How should we look about that?
- R. K. Baheti:** Once these are completed, then I think all these salaries and other costs which are currently clubbed as preoperative expenses will be charged off to revenue. So the cost of base will go up.
- Prakash Agrawal:** This is post getting completed or getting first approval?
- R. K. Baheti:** Post getting completed.
- Prakash Agrawal:** So overall oncology will start seeing the expense from next quarter?
- R. K. Baheti:** Yes.
- Prakash Agrawal:** And lastly on India business.
- R. K. Baheti:** Also, I think you did not ask and Pranav did not respond, but the Aleor JV facility that is also ready and there also, we have started taking the exhibit batches. So that filing should happen in H2.
- Prakash Agrawal:** And with GDUFA-2 filings happening, so the first approval hopefully will start seeing from fiscal 20?
- R. K. Baheti:** That I do not know because it will trigger the USFDA inspection and post that, we will get approval.
- Prakash Agrawal:** And lastly on the India business, so clearly we have started to see the growth recovery now. So there was a mention of growing as per industry growth, but do you expect the industry growth to improve here on because what I hear from trade channels that still somewhere not GST ready, there is still some improvement that can happen in the system. So could this move to higher single digit or early double digit?

- R. K. Baheti:** There are still stockist led and trade inventory channel. There are still GST issues. Hopefully in next 3-6 months, that should get settled.
- Prakash Agrawal:** Next 3-6 months?
- R. K. Baheti:** Yes.
- Moderator:** Thank you. Our next question is from the line of Nimesh Mehta from Research Delta Advisors. Please go ahead.
- Nimesh Mehta:** My question again is on the margin side. I see that two expenses, one is other expenditure and other is R&D which has come down drastically. So in R&D, you guided that and if I am not wrong, just correct me that you will end up with about 450 to 500 crores of total R&D spent in the year. If that is true, then there is no question on that. The question I have actually is other expenditure why has that been so much low and what do we take it going forward from here?
- R. K. Baheti:** You are right. Other expenditure of Q2 was lower and that was largely because of restricted promo spend or marketing spend within the domestic branded business because of all this confusion and volatility of GST. So it will be ramped up in Q3 and Q4. As far as R&D is concerned, I said we will do around 450 plus minus crores for the full year. So we are on track as far as the R&D program is concerned.
- Nimesh Mehta:** So on the other expenditure, you said last quarter also you mentioned that you have cut down on the promotional expenditure because of the uncertainty in the domestic market, but I guess the retail sales has continued and so to that extent, are not you required to kind of keep up the marketing expenditure and I am just trying to understand how does it because I thought that it is more related to company to stockists, the sales disruption is because of that and not related to the retail sales. How do we take that?
- R. K. Baheti:** The entire business was impacted between May-July period. So nobody was spared, the retailers, stockists and the company. Now sanity is coming back to the market.
- Nimesh Mehta:** Then coming on to the other comment that you mentioned that the EBIDTA margin can be around 20% and I think so far in H1, we have clocked about 19%. Other expenditure and R&D both were to go up significantly. I assume that other expenditure at least would go up to the levels of the last year. Are not we looking at lower margin than H1, H2 will not be lower than H1?
- R K Baheti:** Actually, if you compare Nimesh last year then last year we had a bad quarter because of demonetization. So on a last year basis, I think we should do better, meaning not we, almost everyone would do better in H2 just because of the base effect as far as domestic business is concerned. So I think the expense will get spread out.

- Nimesh Mehta:** I am trying to compare the H1 of this year with H2 of this year. So where I am trying to understand is that...
- Pranav Amin:** So you are right that H2 for this year would be higher than H1 of this year as far as expenses are concerned. That is why to one of the questions I said that the margins would not stay at 23%, will come back to 20% plus minus.
- Nimesh Mehta:** We have clocked about 19% in H1. So I am just trying to understand it is more down to...
- Pranav Amin:** Again, H1 is not a very comparable number, Nimesh because Q1 was a washout and that is why Q2 was a slightly better quarter.
- Nimesh Mehta:** We should compare it with the second quarter.
- Moderator:** Thank you. Our next question is from the line of Kunal Randeria from Antique Stock Broking. Please go ahead.
- Kunal Randeria:** Coming to Orit, I guess around 4 pending ANDAs and around 6 to 7 projects in pipeline. So could you share some details and the kind of projects they are the market size, the therapy or the competitive landscape?
- Pranav Amin:** I think what we have said there are 7 approved ANDAs and rest 4 in the pipeline. We have not disclosed what is in the pipeline so far.
- Kunal Randeria:** So I guess Orit website had a presentation which had some, I guess 6-7 projects in pipeline four are in tablet form and one is SGC and one XR. So I was just wondering if you can throw some light on those?
- Pranav Amin:** I think we have not shared anything on that. I will just have to see what they got on the website, but what we have said is basically the 7 approved ANDAs are about 4 pending approvals.
- Kunal Randeria:** And the debt has gone up around 285 crores. So is it because of the acquisition?
- Pranav Amin:** No, as we mentioned, acquisition is a small acquisition. The debt is mainly because of the capability addition that we are doing with all our facilities.
- R. K. Baheti:** The new projects which we are adding. Also, this acquisition was done in October. These results are up to September.
- Kunal Randeria:** And just quickly last on R&D. So I guess the guidance that you had given in the earlier calls was around 500 crores. So is it just that some of the projects are delayed or just pushed back FY19?

- Pranav Amin:** What we try doing is we try rationalizing our pipeline every now and then, we try evaluating the projects, see what is happening. So some may have got delayed, some we may have chosen to drop it, some in early stage we might not been successful. So it is a combination.
- Moderator:** Thank you. Our next question is from the line of Deepak Gupta from Progress India Opportunities Fund. Please go ahead.
- Deepak Gupta:** Taking forward from the previous question, I just wanted to understand what is the medium term to long-term plan on having leverage on the balance sheet. It is long time that you have taken some debt on your balance sheet, that is a long-term debt. So what was the thought process on it?
- R K Baheti:** I have been saying for some time that for these new projects, we would need to do some borrowing and I think we are still very comfortable because the leverage is hardly significant. I think at the peak when we complete all the projects by H2 next year, our peak borrowing would be not more than 600-700 crores which would be less than 0.25 of our network.
- Moderator:** Thank you. Ladies and gentlemen, that was the last question. I would now like to hand the conference back to Mr. R. K. Baheti for closing comments.
- R. K. Baheti:** Good interacting with you as always and look forward to again talking to you post Q3. Thank you everyone once again for attending the call. Thank you.
- Moderator:** Thank you. Ladies and gentlemen, on behalf of Alembic Pharmaceuticals Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines.