"Neuland Laboratories Limited's Q2 FY22 Earnings Conference Call"

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Diwakar Pingle: Good evening friends. We welcome you to the Q2 FY22 earnings call of Neuland Laboratories Limited. To take us through the results and answer your questions, we have the top management from Neuland, represented by Mr. Saharsh Davuluri – Vice Chairman and Managing Director; Mr. Deepak Gupta – CFO; Mr Sundar Narshiman – Senior Vice President Supply Chain and Mr. Sajeev Emmanuel Medikonda - Head, Corporate Planning and Strategy.

We will start the call with brief overview of the financials by Deepak, then Saharsh will give broad highlight of the general business trends and what he is observing in the market and then will open floor to Q&A. With that the standard safe harbor clause applies as we start the call. With that said I am handing it over to Deepak. Over to you Deepak.

Deepak Gupta: Good evening and very warm welcome to our Q2 FY22 earnings call. I hope all of you are safe and healthy. I wish you have seen the presentation which Diwakar was mentioning. It was put on our website as well as it is uploaded on both BSE and NSE exchanges. As always any comments on the content, that we have presented would be highly appreciated and we will do our best to give additional data points which will be helpful for you to analyse the future.

I will briefly update you on the financials. Total income for this quarter was Rs.258.1 crores as against Rs.242 crores in Q2FY21. Our EBITDA for the quarter was Rs.43.1 crores with EBITDA margin of 16.7% which is a decrease of 40 basis points on year to year basis and 10 basis points increase on sequential basis. I would like to give some context on the EBITDA margin, there was an impact on rising raw material prices. We have incurred higher shipping cost, logistic costs and supply chain delays have been observed in this quarter, recognizing this we have stocked up some inventories to account for any likely disruptions which can arise due to these delays. Part of the impact was also an account of higher employee costs due to more recruitment has happened in Unit III as we continue to invest for the future, as well as we expect more volumes to come from Unit III going forward. Profit After Tax was Rs.20.3 crores as compared to Rs.21.3 crores last year, due to the reasons as stated above, has also had high depreciation coming in from Unit III commercialization. This quarter EPS is at Rs.15.8. On a half yearly basis, our total income stands at Rs.461.1 crores which is an increase of 2.9% from the same period last year. With regards to EBITDA it is Rs.70.7 crores as against Rs.75.8 crores in H1 FY21, the EBITDA margin came in at 15.3% as compared to 16.9%, the year earlier, for the reasons which we have already discussed just now and the consequence of the performance in Q1. The cash and cash equivalents as on the date of the balance sheet stands at Rs.32.4 crores. We continue to make investment in the business, the capex of around Rs.57 crores which has been done in H1FY22. Our capex is on track and with more business opportunities coming in we foresee CMS division doing good and which will also help us to improve the realizations going forward. I would like to mention that even though we have made substantial capex till date, our gearing ratio continues to be low. As now stands at 0.23 on a year to year basis. With that I would like to hand over the call to Saharsh for his remarks. Thank you.

Saharsh Davuluri: Thanks, Deepak. Good evening friends and thank you for joining this call. On top of what Deepak said I'll just add a few thoughts on the current performance and then we can open up for Q&A. In terms of the prime business we had a slightly muted quarter, although we did have products like Mirtazapine, Labetalol and Levofloxacin performing well. They were one or two products that didn't perform to our expectations which are largely owing to customers delaying their orders and hopefully we'll be able to get those orders soon. On the specialty side we did really well. Products like Paliperidone Palmitate, as well as Dorzolamide and Donepezil have done well. Paliperidone Palmitate is a very exciting product for us because it's a very complex generic and we had completed validation for this product recently, it's still in development stage so the genericization of the product has not happened but something that has still contributed significantly because of sale of development revenues going forward depending on the patent landscape, we expect commercialization of this product. Coming to the CMS business, as we had alluded to in the previous quarter there were some delays in the previous quarter which resulted in projects getting delayed but as we had indicated, those projects have completed and that has led to a sequential spurt and you can see that in the CMS revenue split, you're seeing that the development revenues have actually gone up and this is something that we expected and it is reflected in the numbers. These projects that we talked about are close to commercialization and our pipeline gives us further confidence that we will deliver in the coming quarters as well. However, given the nature of the CMS business and the fact that these molecules are still not commercialized, we expect certain level of lumpiness on a quarter to quarter basis. But I think on an overall annual basis we still expect to have good growth on the CMS business.

On the Unit III aspect we are seeing very healthy ramp up on a quarter to quarter basis. We have been hiring significant manpower which also has contributed to a part of the bump in the Operating Expenses for this quarter. But this is what is needed for getting that facility up and running for future businesses well, and in terms of EBITDA margins, they are a factor of both the business mix as well as input costs. The business mix is something that is a consequence of, what kind of GDS and CMS business we're delivering in the quarter. The input costs, besides higher operating expenses due to Unit III ramp up of manpower and other costs, we're also seeing certain signals, driving up costs from a raw material perspective. So I'm also happy that our head of supply chain, Sundar Narshiman, is on this call. And maybe as we open it up for Q&A, we can hear from Sundar also in terms of his thoughts on how we expect raw material prices to move and what kind of impact it will have for us in the coming quarters. So I think that maybe Diwakar open it up for Q&A.

Diwakar Pingle: Yeah, thanks Saharsh. Before I start basic rules, I think people who would like to ask a question you can put up your raise hand, I'll call them basis the order that they come in, kind request, if you can state organization that you represent, if possible. And as far as possible, don't put in your questions on the chat board, please. We'd rather take it through the Q&A mode. Thank you so much. The first question comes from the line of Rajat Srivastava from Incred AMC. Please go ahead, unmute yourself and speak.

Rajat Srivastava: Thanks for taking my question. So my question is to Saharsh. So, like we are seeing the entire industry battling through the raw material prices and especially for the API players we have seen huge impact, but somehow you guys have managed to mitigate that price impact. In fact, your gross margins are up YoY. So can you throw some color light what gone differently or is it just that you've benefited from the inventory built up, and the impact will be more visible in the next quarter?

Saharsh Davuluri: Thanks for the question, Rajat. With regards to the raw material costs, I think we've been following the commentary from other players. I think for us, the impact has not been very significant this quarter and that's why our margins are more or less in line with our expectations. But this is something that we do anticipate going forward, depending on the situation and maybe ask Sundar to add to my response over here. We do expect things to probably go unfavorably and one thing that maybe perhaps differentiates us is that given that most of our business comes from specialty and CMS, we are also in a position to pass on input cost increases to our customers. We are seeing indications like, for example, solvent costs are going up because of various issues globally and we have, proactively started reaching out to our customers letting them know that, there is an increase in input costs and products where we are the only supplier or maybe we are one of the two suppliers, where we are the preferred supplier, we are trying to negotiate and try to get you know compensated for that. So that's what's going on. So it did impact us but perhaps not as much and to whatever extent we did also try to mitigate it by talking to our customers for price increases, but we don't think that we are on top of the problem. We think we need to handle it continuously and maybe Sundar any quick comments from you?

Sundar Narsimhan: Just a couple of lines from my side is I think like what Deepak said, we have had the benefit of some of the contracts that we had booked late last year and then those have helped us through last five months and some of the contracts are all expiring and it is becoming more difficult because of the huge volatility in the market. You know, they're offering short term contracts now. So, we will see probably some of the impact coming in the future, primarily driven by the contracts, the benefit of the contracts that we have done in the past. This is how we've been having the benefit of better costing for the Q2.

Rajat Srivastava: Alright, thanks. And secondly, Sir you've already mentioned that we have seen some spillover, we lost some revenue on the commercial CMS side in first quarter. So has the entire spillover been done because earlier you had said that the spillover will be throughout the years, so any thoughts on that?

Saharsh Davuluri: Most of the spillover has been completed, they might be a small part of it that might flow forward, but we were able to close the projects for most part.

Rajat Srivastava: Okay and what happened on the development side. We clocked revenues of Rs 13 crores I think and we were trending around Rs 21 crores in the previous two quarters.

Saharsh Davuluri: You mean the on commercial side

Rajat Srivastava: No, on the development side

Saharsh Davuluri: No, I think our development side the revenues have gone up Rajat and that's what's reflecting of the conversation. On the commercial side, we've actually had a dip because some of the commercial orders we expected did not come through and those are orders which we are expecting in the subsequent quarters.

Rajat Srivastava: Okay, my bad. Thanks

Saharsh Davuluri: No problem.

Diwakar Pingle: Thank you Rajat**.** The next question comes from the line of Keshav Kumar from RakSan Investors. Keshav you can go ahead.

Keshav Kumar: So sir we've on boarded more of development molecules in the past two years or so. So firstly, I wanted to know whether this would constitute molecules for which an ANDA or equivalent is being filed or yet to be filed.

Saharsh Davuluri: For some of the development molecules the ANDA has already been filed Keshav but we are yet to be added to that filing. There are some development molecules where the ANDA is not yet filed. So I think we have maybe, half a dozen or so development molecules which we closely track because they are the high value contributors for Neuland's future and out of these half a dozen two of them the ANDA's have been filed and Neuland has been qualified. One of them ANDA has been filed but Neuland is yet to be qualified and two of them the ANDA are not yet filed. This is just you know, approximate information from the top of my head.

Keshav Kumar: Okay, sure. So I wanted to understand that what would be the reasons to onboard a CDMO at the clients end, at such a late stage, like would we be a secondary tertiary supplier? I mean, it's absolutely terrific for us but trying to understand from the client's perspective, what would be the reasons to go for such for the late stage, tech transfer and all that extra regulatory stuff that comes with it?

Saharsh Davuluri: We work with a lot of small to midsize companies Keshav and these are usually biotech companies and when they start their clinical journey in Phase I, they typically start with a CDMO who they find easy to work with or probably someone that's closer to home for them. And as they're going through Phase II, Phase III and they see clinical success and they're gearing up for commercialization, there they get business development folks on board, they get salespeople on board who actually start forecasting quantities, prices, simulating the cost of the tablets and things like that. That's when companies actually formulate a strategy of what kind of an API partner they need, what kind of batch sizes they need, what kind of annual output of API they need. And in many cases, when they have that strategy, they realize that their first source is not up to the task for doing that and that's why usually they go for the right kind of CMOs. So in many of these cases, it's a great opportunity for us, as you said, but it's also because, you know, a lot of these drug discovery companies don't know whether they will get commercialized so they don't really you know, qualify someone who is suitable partner for them for commercialization. They go with someone who's suitable for them for their Phase I and Phase II.

Keshav Kumar: Okay, sure sir. Sir, in your experience what shift have you seen due to COVID on CDMO space and was like after the 2009 crash, there was a shift in quality over quantity at the innovator end and then more was spent on less number of molecules. I read a report recently that though the clinical activity has remained high during the last one year, but the development productivity has been historically low due to increasing product and regulatory complexity, so could you give some insight on this.

Saharsh Davuluri: See, again, Keshav, none of us are experts in looking at that landscape but I think whatever information that we understand from conferences and what our customers tell us is that because of the pandemic, there has been a drastic slowdown in clinical trials, because hospital beds, doctors, investigators were not available. As a result of that there has been a major slowdown and therefore there has been a certain change in the pace in which projects have been coming. There's a comment that I had made in one of our previous calls, and I'm happy to repeat that, again, the number of new projects we have added in the CMS business in the last 12 months is lesser than the number of new projects we added in the previous 12 months. So we are actually seeing a reduction in the number of new projects coming our way. But we are also in a stage of evolution where we are focused more on the quality of the projects than the quantity of projects. So what we do and as a CMO focused in trying to attract these kinds of projects, is we focus on certain therapeutic areas, we first focus on building relationships with innovators who are still developing drugs in the clinic despite the pandemic. So, one of the things that we have realized, we have a very good recognition among CNS in the CNS space, not because there is a specific chemistry but for some reason, historically our CMS portfolio has had a lot of CNS molecules. So, we tend to focus in that area and we try to use our relationships with existing CNS companies to build new relationships. In terms of capabilities been trying to do is focus a little bit more on modern chemistry, green chemistry, and try to understand what the pipeline of newer drugs are looking like. So we see that a lot of new drugs under development are peptides. We also see deuterated molecules coming up. So those are areas where we've tried to focus on and that are kind of what we are going through as a journey.

Diwakar Pingle: Again, a kind request. Please take two questions, and then please come back in the queue. There'll be time and enough for more let's follow this order, please. Next question comes from the line of Mr. Sunil Kothari from UNIQUE AMC, go ahead, sir.

Sunil Kothari: Hi, thanks for opportunity. Saharsh thanks a lot for detailed qualitative answers and clarification. I'm following this company since last 2-3 years and am a shareholder of this company. Basically, my question is, generally I would like to understand is, during last 2-3 years we have invested roughly between Rs 200-250 crores and current first half also cash outflow seems to be Rs 50 plus crores and we have not yet able to, I mean, generate the revenue matching with the investment we made. I understand it takes time but want to understand from you that we have invested in fixed assets, we are adding employees and our employee costs in this first half compared to last year first half has substantially gone up. So, when do you think the matching revenue generation should start and what is the existing capability of revenues generation. So if you can talk some numbers about capability of revenue, capability to generate margin, may not be during any timeline but by when you feel this investment will start reflected in numbers.

Saharsh Davuluri: Thanks for the question. Sunil, it's a very valid question. I think from the management's perspective, we've been very prudent in deploying capital into our business, not just in Unit III, but whether it's for R&D or any other purposes. And as we are deploying capital, what we have been very careful in doing is trying to make sure that we are visualizing the business that will utilize those capacities. So, whatever production areas we have built in Unit III, which has actually taken up a lot of this capital has gone into very specific molecules either on the CMS side or on the GDS side. Now, to answer your question on, when will we start seeing a utilization of all this infrastructure and when will we see that optimum margins and growth in business? It's hard to put a timeline to it, but we are starting to see it. So for example, even if you look at Unit III, utilization of Unit III in a year ago was almost zero versus the utilization a quarter ago versus the utilization today. I think it's ramping up. We are validating new products in Unit III for which we had created those capacities but as you know, our business and the kind of both on the GDS side and the CMS side and the fact that there are a lot of regulatory restrictions and there's also the customer uptake of volumes, those become very important factors. What we have seen typically, and you may have seen these in other API business it could take anywhere from, one year to two and a half years for us to fully utilize an asset. What we would like to assure you is that whatever assets we have created, we have created with a clear product in mind, and we have also made sure that there are backups for each of those products so that no plant that we create will actually be idle because a product did not take up. So, that's the philosophy behind it. I think for us the utilization and reflected in better margins is something that I think it's a matter of time, you know, we don't expect it to take too long, but it's very hard to give us an indication. So even if you look at this quarter's performance I had mentioned in my opening remarks that they were one or two GDS prime products where we didn't get orders and because we didn't get orders, had we got those orders, we would have probably done well. And i we had the capacity for it, we probably would have had a couple of percentage points of higher EBITDA. But, it's the journey of growing business where we need to keep validating these products commercializing them and create a portfolio of products which is diverse enough that base keeps getting stronger. So that's kind of slightly longish response to your question, but we won't be obviously able to give you a timeline saying that by this time we will be at this percentage EBITDA margin or this is when, we will see the assets being fully utilized.

Sunil Kothari: And my second question is, what is the area where you feel you are satisfied with the performance from inside the company and when you feel you are lacking somewhere and you would like to either invest or you would like to utilize or you like to change, if you can share some thought. That is my last question. Thank you.

Saharsh Davuluri: So, maybe just from top of my mind, not saying it just because Sundar is sitting here but I think the way we have managed our supply chain has been really very effective. I think, as he had indicated, having those contracts with the right vendors, not just for, you know, specialized but even like commodity type products. I think it gave us one assurance of supply; it also took care of, controlling costs. So, we're very happy with the way we've been managing our supply chain. The way we've been deploying our capex, we are very satisfied with that. We know it's actually very stressful to go through that cycle of putting Rs 1,500 crores in a plant and then waiting for that plant to get utilized but I think the way we deployed that is very good. And our connect with customers both on the CMS side and the GDS side, has been really good, despite the pandemic and one and half years of no face to face meetings. We've not lost any customers; we've been able to manage difficult negotiations on price increases, delays and things like that. So, I think these are the three areas where I think we've done well. The one area where we can do a lot better and I think that's something that I did indicate even in the last quarter call is our ability to work together in cross functional teams and deliver projects, that's a capability that we are still building and we've gotten a lot better than where we were, say two years ago. But to become a project focused company from a product focused company requires a change in mindset, requires a need for strong project management systems and a need for different departments to work in a matrix environment, which is difficult for us traditionally because we are a 37 year old company that has a more traditional way of running departments. So that's the journey that we are going through and that is something that both Sucheth and I have been taking a keen level of interest in.

Sunil Kothari: Thanks a lot and wish you good luck.

Diwakar Pingle: Thank you Kothari. Next question comes to the line of Rakesh Kumar, Individual Investor. Rakesh, please go ahead.

Rakesh Kumar: Hi, good evening. My question is, over our CMS journey have we built deeper relationships with some clients and on boarded more molecules, may be become a preferred partner? And is our clientele more bent towards big pharma or the smaller midsized innovators also?

Saharsh Davuluri: Sajeev will answer that question.

Sajeev Medikonda: So, Rakesh, in terms of the customers that we have had over the years, we have seen that we have built very good relationships, but as we have mentioned in the past that lot of relationships, a lot of the customers that we have targeted and built a base around are mostly customers who are venture backed biotech companies who usually have just one or two molecules, what we are actually seen on that front is the depth of our relationships, as Saharsh was mentioning about the fact that we have good traction amongst CNS companies, it is the fact that people move companies, and they continue to refer Neuland as a partner of choice and I think that is not just about the companies that we are working with currently, but it's also the people that we are working with, the credibility that we have in our relationships with them. So even though we may not have a big pharma, which can give us 5-10 projects a year, but still our model, is quite sustainable in terms of ensuring that we continue to attract new customers who give us new molecules.

Rakesh Kumar: Okay, understood. Please elaborate some words from the point of view of overall health of our facilities. Do you foresee any significant outlays apart from current maintenance capex run rate for meeting the technological edge required to stay competitive in the business? Whether we'll need to set up or convert more to low occupational exposure limit facilities? I mean, do we have high potency API capabilities to future proof ourselves, would we have to go through another up gradation, accretion or something?

Deepak Gupta: Thanks, Rakesh, for this question. So we do have three manufacturing units, Unit I, II and III, Unit III being the newest one in our portfolio. So Unit I and Unit II, we are upgrading those facilities on a regular basis. So there is no significant capex other than the replacement capex that we foresee for the next couple of years from now. Unit III is where we are building new facilities, new blocks based on a customer, new projects which are coming in and we are evaluating that, so most of the investment which is going is into building the Unit III facilities and also some maintenance or replacement capex which are just kind of routine maintenance capex for the other two units. So we are well maintaining our both the old units and I don't see any significant capex requirements coming in from the Unit I and Unit II. So Unit III is based on the project to project basis that we will spend on capex going forward.

Saharsh Davuluri: And our business plan we really haven't made plans of going into high potency and onco products Rakesh because I think the visibility we are getting doesn't really make a business case for it, but it's something that we will keep reviewing time and again.

Diwakar Pingle: The next question comes from the line of Manish Jain, Moneylife Advisory Services. Manish please go ahead.

Manish Jain: Thanks for the opportunity. First question is how has been the CMS pipeline evolving? And what kind of traction are we seeing in this segment?

Saharsh Davuluri: The traction continues to go well would probably respond to that question in into tears. One is the progress we are making with our existing CMS customers whom we have some projects with, I think in that front, we've seen molecules advancing into the clinic, getting into commercialization phase, we're also seeing customers come back and increase their engagement with Neuland, so we've seen for example, in this quarter a customer, whom we've been working on one molecule which is a ANDA molecule, they've come back to us with two new molecules that they had recently in licensed from another American company. So these are good examples of building traction with existing customers, either for existing projects or for new projects. In terms of new project engagement, for us we are seeing good traction on the US front, we are still not seeing the desired level of traction from Japan and Europe but it's not a major concern as of now. I think it's just because the way the markets are operating over there. We think it will take you know a few more months for us to start seeing these markets open up and see new CMS opportunities coming from there.

Manish Jain: Okay, secondly, how do you see the demand scenario going forward for specialty in GDS segment.

Saharsh Davuluri: It depends on a product to product basis Manish. Some of the key products we talked about this, like this quarter on the specialty side, I think these were long awaited, so Paliperidone contributing this quarter is actually a good indicator and it's a major milestone for us within the organization that we were able to ship out decent quantities of products but from prime products point of view, we are seeing very good traction on Mirtazapine, Labetalol and Levofloxacin. We think some of the other products like Levetiracetam, we are strong in the markets that we are in but we're not seeing, very strong spurt over there but these are also the cycles that you have for these products. So I think on an overall basis, we've maintained in the past that collectively we expect the GDS business to have a healthy growth rate but it's going to be a combination of individual products, performances.

Diwakar Pingle: Thank you Manish. The next question comes from the line of Rupesh Tatia, IntelSense Capital. Please go ahead.

Rupesh Tatia: So, I am looking at FY21 CMS revenue split and I see 136 crores is from commercial and then in that deck I see 17 commercial molecules so roughly it is like an Rs.8 crores per molecule on an average. So would it be fair to say that the 3-4 molecules really contribute majority of this commercial revenue and rest of the molecules are not like very high volume at our customer end, and subsequently they are not a big molecules for them. Would that be a fair understanding?

Sajeev Medikonda: Thanks. Your assessment on that front is basically I think, we have mentioned also in the past that when it comes to the commercial revenue from the CMS business, it basically consists of three significant projects which contribute to most of the revenue on a consistent basis especially on a annual basis, there are other molecules too, but they are not very significant in terms of that impact.

Rupesh Tatia: So then, then as a strategy, we are strong on CNS or one or two more therapies, so what kind of we can do to go after or move this inflow in such a way that 2-3 blockbuster molecules we can get at a very decent probability and then that changes the trajectory of the CMS business for us over the next three to five years.

Saharsh Davuluri: I think, that's something that is a very important thought Rupesh and it's at the core of our desire as well. So to be able to make molecules which would be those billion dollar blockbuster molecules and a lot of companies, grow on the back of one or two such products. For us, we do believe that, although not in the past but in the current and in the future, we do have molecules which have that capability. And therefore as we see these molecules where we have that belief get commercialized, we think there is a realistic possibility that we will have a very healthy growth. We tend to be very careful in either characterizing those molecules, identifying those molecules or talking too much about those molecules because you don't know a blockbuster until it actually becomes one. So I had in my earlier comments also mentioned that, we have other than the molecules we have already commercialized in CMS. We have half a dozen or so molecules which are likely to get commercialized in the next two years. Now, we believe that some of those candidates in that half a dozen do have the potential to be blockbuster, but we are also being very careful and almost paranoid not to talk too much in terms of what value they could bring in because if they do happen, then you will see that in our performance, and if they don't happen, at least there is no disappointment because we have not set those expectations. I think that's the way we are looking at these opportunities. But also I will add that as we keep our head down and execute on the CMS business, we are also finding ourselves attracting those opportunities. So for example, in the last two years, the kind of high value molecules in terms of potential that we have received we have probably not received in the seven years before that. So somewhere there is a snowball effect in terms of our ability to attract these right opportunities but the opportunity will become reality only when we actually get those orders and deliver that material and till that time, we want to be careful in terms of how we give outlook about our business.

Rupesh Tatia: That is good to know and then the second question is, with Unit III we have a 1,500 crores kind of revenue potential, whenever it happens to us. So specialty chemical or specialty API look like a good margin, good ROCE business, so do you see that business kind of going Rs 400-500 crores kind of run rate in next 2-3 years and what are the key levers for that happening, some molecules or therapies or customers if you can talk about it?

Saharsh Davuluri: I will give a very guarded outlook, I think in terms, of is there a potential for hitting a run rate like that? See, I think we did about Rs 270 crores of CMS business last year, that Rs 270 crores includes, commercial products of about Rs 130 crores and maybe development products about Rs 140 crores. Now, there is indeed potential for the development products as they become commercial to contribute more and more and yes, we expect that Rs 270 crores to grow significantly over the years to come. So, maybe in the near future getting to Rs 500 crores or above is possible. When and how is something you're asking about and if you want to know what could be the factors that could drive that growth, I think the most important factor is the molecules which are moving from development to commercial. One factor is how fully the will these drugs be in the end market. And second is how well is Neuland executing these projects, and that's why one of the comments I'd made earlier is the need for Neuland to be able to execute these projects well, scale them up without any issues and deliver them in the right quality. Now that is something that we are very strong at, we are good at because we understand operations, we understand quality, but the factor that's not in our hands is how well the drug does and I think that is definitely one of the key points to do. And if we have a couple of blockbusters in that pipeline, then we should see a good growth in the CMS business.

Diwakar Pingle: Thank you Rupesh you need to come back in the queue. Next question comes from the line of Rishabh Kochhar, Edelweiss.

Rishabh Kochhar: Good evening, everyone. I have two questions. First one, so within the CMS is the revenue of the development segment is reoccurring or does it include upfront payments for the project we have gained in this quarter.

Deepak Gupta: So, it doesn't include any upfront payments. So those are advanced payments for the orders which are not considered as revenue and unless until we invoice those projects or delivery sent to the customers.

Rishabh Kochhar: So is it reoccurring, like can we expect the reoccurrence in every quarter?

Saharsh Davuluri: No, just to clarify, what we said is that the development revenues you saw are project based revenues, which means that we would have made validation quantities and shipped out those validation quantities and that is what we call as development revenues or we are done some R&D work, and we would have built it as R&D service and that's what you would have seen as development revenues. What Deepak was clarifying is that sometimes we get advances for buying raw materials for a future shipment, that's not included in the development revenues is what Deepak was saying. With regards to your follow up question of are these development revenues recurring? It really depends and, a lot of times you will have maybe 2-3 orders over, you know, a year or two years, and then the drug either fails and it doesn't come back or the drug becomes commercial. So it's either or, but there is a level for a development business, a set recurring pattern, you may get 1 or 2 or 3 orders and then you will wait for the drug to become commercial and then you will get commercial orders and then be classified as commercial revenue or you will not get orders and the project is over.

Rishabh Kochhar Okay understood. And the second question is, as you mentioned earlier that the few of the contracts have become, short term in nature. So, in that perspective, are we facing any competition or can you just elaborate more on the competitive landscape due to be volatile environment, we are in right now.

Sajeev Medikonda: So Rishabh, just to clarify your question, seeing the competitive landscape in terms of the supply itself, because the short term contract situation was with reference to the contracts we have with our suppliers.

Rishabh Kochhar: Okay. So, are we facing the same challenge in terms of customer or like our contracts are diminishing in terms of, we have long term contract with our customers.

Sajeev Medikonda: So when it comes to the GDS business, most of our customers in the regulated market have as one of the one or two main suppliers on their filing. So more often than not, it is necessarily a contract but we are bound on an annual basis, customers have to come back unless they've qualified someone else, which usually takes 12-18 months in the regulated market. So from that perspective, I don't see that is a very big concern, what could possibly be an issue and I think we are referred to is, the fact that they may experience certain delays when it comes to their logistics or inventory build up by their end or some market dynamics at their end. But from a competition perspective, I don't see that being very significant for the business.

Diwakar Pingle: Thank you Rishabh. The next question comes from the line of Pratik Kothari, Unique Asset Management LLP. Pratik please go ahead.

Pratik Kothari: Hi, good evening and thank you for the opportunity. So my one question again, this year we had guided that we'll be doing some Rs 100 crores of capex and we’ve already spent about Rs 50 crores. So this is largely to replace the machinery in Unit III and maintenance.

Deepak Gupta: We have done Rs 57 crores of capex in this half year and this is mostly for building up the Unit III. So I can say just roughly half the capex has gone for Unit III ramp up.

So, apart from that, there are certain maintenance capex that we have undertaken this half year. Anything specific you have in mind you want to ask?

Pratik Kothari: No. So, after this year's capex, I believe we would have invested about what Rs 300 crores in Unit III since our acquisition?

Deepak Gupta: So far roughly we have invested close to Rs 260-270 crores of capex in Unit III including the initial acquisition cost.

Pratik Kothari: So, basically just to clarify whatever we spending this year in Unit III is not for capacity addition, it is just to replace the old machinery because this is an old plant.

Deepak Gupta: No, we are building a new block. So, for that we are investing fresh capex in Unit III.

Saharsh Davuluri: There's not a lot of investment going in for replacement in Unit III because Unit III is technically not an old plant, it was a small unused plant and we are creating additional production areas in that unit. So a lot of the capacity is actually only going for creating production capacities or for creating other ancillary capacities like waste management, infrastructure and things like that which were nonexistent in that facility earlier.

Pratik Kothari: So where would our capacity go to from the 860 kilolitres last year capacity go to this year end?

Sajeev Medikonda: So Pratik, we will just get back on the exact number what it will be but when those facilities are initiated, we will be adding in the presentation and you will get to know.

Diwakar Pingle: We'll take the next question from the line of Aman Vij, Astute Investment Management. Aman, please go ahead.

Aman Vij: My name is Aman, I am from Astute Investment Management. So my first question is on the Unit III utilization level for quarter as well as quarter three and quarter four. What are we targeting? And at what utilization levels in Unit III, Will that plant achieve the same kind of margins like company level? This is the first question.

Deepak Gupta: So for this quarter Unit III utilization is somewhere between 20-30% and with the new investment we hope to ramp it up further in the second half of the year.

Aman Vij: At what utilization in Unit III, can we achieve similar kind of margin as we have for our company level?

Saharsh Davuluri: Yeah, because I think the business mix of Unit III will be similar to the business mix of the other units. So we think that it will be in line and what will add on is as Unit III gets commercialized and fully operationalized we will also see more operating leverage kick in. So it will also be more favorable in terms of you know, EBITDA margins and things like that as Unit III goes towards higher utilization.

Aman Vij: So, you talked about 50% kind of exit utilization level at the end of quarter 4 FY22, so are we on track of achieving that.

Saharsh Davuluri: We had broadly mentioned that we expect to have 40 to 50% kind of utilization by the end of this year. I think we are more or less on track for that but, where we are fully on track is that the capacities have been installed and created, our ability to deliver those orders, regulatory clearances, things like that. As of now we think it's possible but as in when every quarter we will give you an update.

Diwakar Pingle: The next question comes from the line of Sanjay Sathpathy, Ampersand. Sanjay please go ahead.

Sanjay Satpathy: Hi, congratulations for bouncing back from a relatively difficult quarter or two earlier. So my question is that one, are you still sticking to your overall expectation that annually we'll continue to go somewhere between 15-20% without assuming strong benefit of some new product, getting blockbuster product successful?

Saharsh Davuluri: What we mentioned is on a 4-5 year horizon an average growth of 15-20% is realistic, not assuming that we will have blockbuster carriers. What you've said is absolutely right. I think what we've done is, using all the different products that we are commercializing, or we expect to commercialize we've taken conservative estimates based on probabilities as such and look at our growth and that's the number that we have. Obviously, the numbers don't pan out on a year to year basis. So for example, last year we grew more than 20% doesn't mean that every year we will grow at that percentage. So, we have to take that into consideration, but I think your hypothesis is accurate from our perspective.

Sanjay Satpathy: Thanks and prior to these disturbances on your supply and cause you had steadily delivered about 20% kind of margin. Of course, there is a cyclical recovery here in this current quarter, but it is still well below that 20% kind of margin. So when do you think you will be able to go back to that kind of a number?

Saharsh Davuluri: I think the answer to that question is two factors. The business mix, so I had mentioned that we did fewer lesser business on the prime side than what we expected to do. Input costs we did mention that we have some challenges which were unexpected. Now hypothetically, if we didn't have those two challenges, we were perhaps would have been better than what we had in the past. So, the question of bouncing back is also, how these factors play in but not withstanding these factors play in, we think our businesses naturally growing, because more products are getting scaled up and commercialized. So difficult question to answer, Sanjay, but we think it will happen in the future. We just have to be careful in giving you a concrete estimate just because there are factors here that we may not be able to foresee.

Diwakar Pingle: Thank you, Sanjay. The next question comes from the line of Pramesh Parekh, Anand Rathi Insurance Brokers Limited. Pramesh go ahead.

Pramesh Parekh: My question to you is, what are the significant risks you see on the CMS development side, which will derail or something like that, any significant risk that comes to your mind as a top of the mind record?

Saharsh Davuluri: I think one important risk could be that we work with a finite number of customers from where we have significant business expectations. And if those customers don't do well, their drugs don't do well or they get a black box warning or something adverse happens, then that could be significant risk for us. I think that's the one top risk that comes to mind. Any anything else you want to add to that Sajeev?

Sajeev Medikonda: When it comes to the CMS business, in line with what Saharsh mentioned, we work with a limited set of customers and also we are not completely in control of what happens in the end market. The time that it takes for a product to actually be successful and the execution capabilities on the marketing side of some of our customers, those could be possible risks, especially because we work with venture backed biotech companies, which probably are not as strong when it comes to commercialization, some of the big pharma. So that could be a risk, even though the molecules that we have in our portfolio actually are quite exciting in terms of their potential.

x Key risk

Pramesh Parekh: Thank you very much and wish you all the best for super blockbuster molecule that you may discover very soon.

Diwakar Pingle: Thanks Pramesh. We'll take the next question from the line of Ashutosh, Individual Investor. Please go ahead.

Ashutosh: Hi, thanks for giving this opportunity. I have a very simple question. Where do you see our company in next five years?

Saharsh Davuluri: We see ourselves you know a large API player who is very widely recognized, who will be a preferred source for all the specialized generic API as well as CMS projects. We see ourselves having, very strong EBITDA margins well above 20%. And possibly, in one of the top three or top five CMOs worldwide, that's kind of a vision, if we have to just say.

Diwakar Pingle: Thank you Ashutosh. We'll take the last question from the line of Srinivas, Individual Investor. Shrinivas, please go ahead.

Srinivas: Thanks for the opportunity. So this question is regarding China plus one, is really playing out in the chemical industry and how are you seeing the quantum of shipment?

Sundar Narshiman: Can I ask the clarification question, when you say China plus one, you are saying if you have a source of raw material or an intermediate in China, you are developing an alternate source out of China is that what you're referring to as China plus on strategy?

Srinivas: Yes. This is playing out in chemical industry. I know this strategy takes time.

Sajeev Medikonda: So, to answer your question and as we have mentioned in the past, most of our customers are based in the regulated markets and the products that we have mostly been working on, most of our competition, even in the past has mostly been Indian and European API suppliers. So we haven't directly seen an impact of this China plus one strategy in terms of the API's that we are working on. So, that probably answers your question, hopefully.

no china +1

Srinivas: Thank you.

Diwakar Pingle: Thank you. At this point, I'd like to kind of hand over the Saharsh for final closing comments.

Saharsh Davuluri: Thank you, everyone for joining this call and really, thanks to Diwakar Pingle, Ravi and Christensen team for organizing it. From an outlook perspective, we continue to be highly optimistic about our business. We do keep you know seeing challenges in terms of project deliveries, input cost increase, delays in receiving the right kind of orders. But despite having those challenges, we felt like it was a good quarter we performed reasonably well. If things were more favorable, it would have been perhaps a much better quarter but going forward, our goal as management is to keep adding layers of strong businesses under our fold so that even if we face headwinds, we'll still be able to come out with good performances and even if we have to reflect back compared to several years ago to today, we feel that we are far more resilient as a company we've been able to withstand the pandemic, both the first wave the second wave, we've been able to manage complex raw material sourcing, overcome logistics issues, execution of projects. Despite lot of these uncertainties we've been able to build and strengthen our relationships with our customers, despite not being able to meet them or have them come over for audits. We've been on top of our compliance with regards to GMP guidelines. So, it's been a fairly satisfactory journey so far and we expect brighter things to come. So thank you everyone, and look forward to talking to you again in the future.

Diwakar Pingle: Thank you so much Saharsh and the complete management from Neuland. Wishing all the participants a happy festive season and in case if you have any further questions or want to setup meeting with team, write to Ravi or I and we will be happy to setup a call for you post the festive season.