Unichem Laboratories Limited
Investor/ Analyst Conference Call
October 21, 2013

Moderator: Ladies and gentlemen, good day and welcome to the Unichem Laboratories Limited, Q2 and H1 FY'14 earnings conference call, hosted by Edelweiss Securities. As a reminder, all participants' 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 this conference call, please signal an operator by pressing "*" followed by "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to the Perin Ali. Thank you and over to you!

Perin Ali: Thanks. Good afternoon and a warm welcome to all of you on briefing of Unichem Laboratories Limited results for Quarter ending September 30, 2013. We at Edelweiss welcome the Unichem management team. Today, we have Mr. B.S. Dhingra- CEO of the Domestic business, Mr. Rakesh Parikh- VP, Finance and CFO, Mr. M. Gundu Rao- EVP, Corporate Affairs and Mr. Monish Shah- Manager, Investor Relations. I hand over to the management for the opening remarks. Over to you, Mr. Rakesh! Thanks.

Rakesh Parikh: Good afternoon Ladies & gentlemen, and welcome to the conference call. The Board meeting concluded on Saturday and today in the morning we have circulated our Investor release and I am sure you would have gone through it by now. I would like to recapitulate that despite the challenging environment, which has been there in the Indian Pharma market as most of you would have seen in the AWACS report. We have still managed to end up with total revenue of Rs. 269.57 Crore against Rs. 264.25 Crore compared to corresponding quarter in the previous year. This has shown a low single digit growth in the domestic branded formulation, net of the impact of NLEM both on the price angle as well as on the volume angle. Despite all the trade issues Unichem has still been able to show positive growth compared to the corresponding quarter last year.

The international formulation business recorded revenues of Rs. 63.35 Crore, compared to Rs. 58.10 Crore in the corresponding quarter and on a sequential also the growth is about 12.5%. The API business has remained more or less in line with what we have been discussing though the volumes have been much higher predominantly for our captive consumption whereas the external sales have remained at around Rs. 28.9 Crore, as against around Rs. 30.95 Crore which has been there in there in the last quarter last year.

As far as the margins are concerned, we had mentioned earlier that Unichem has undertaken various initiatives and actions in order to improve the margins, and this was offset by the impact of NLEM. The new prices were implemented in the end of June 2013, and also during July 2013 for some of the products as far as we are concerned. The impact has been slightly higher and also the old stocks, which were there in the pipeline, have also got back to us, as a result of which we have had a higher NLEM impact. Net of that impact our margin for the second quarter are down by about 50-basis point and if you see the first half of the year it has been better compared to the same period last year and the Q2FY14 is also better compared to the same quarter last year. Our endeavor continues to see what best we can do, so that we are able to show further improvements in margin in the following quarters and to maintain the margin profile in spite of the NLEM impact. As a result, the profit after tax is recorded at Rs. 36.21 Crore, compared to Rs. 35.07 Crore, last year with PAT margins at slightly more than 13%. I would now like to request the moderator to open the floor for questions.

Moderator: Ladies and gentlemen, now we will begin with the question and answer session. The first question is from the line of KC Suri from Pan Capital. Please go ahead.

KC Suri: Firstly on the SEZ plant sale to Mylan, has the transaction been fully consummated and has the money come in?

Rakesh Parikh: The transaction has not been fully consummated. The two parties involved are Unichem and Mylan, and both the companies have completed all their formalities in terms of getting the various approvals. This has already been submitted to the lawyers and now the minor formality of getting a formal letter from the government authorities is pending.

KC Suri: The whole money will come in at one shot?

Rakesh Parikh: Yes. In fact the money is already lying with the escrow agent. We are just waiting for one letter from the government.

KC Suri: On your US market business, could you throw some more light in terms of filings we have now and approvals status etc?

Rakesh Parikh: I am sure, you have gone through the investor update where you can see the US business has seen good traction, but this traction is without any new additional approvals. This traction is purely the organic growth of the molecules, which were launched during the course of last year and earlier. As a result, if you see US business has shown INR growth of around 30% to 40%, but as far as the ANDAs are concerned, we have 28 ANDAs have been filed and 15 have been approved. As you are aware that our R&D has shifted to Goa, and now that stabilization has happened and aligned. There were some small regulatory changes that the USFDA had conferred as far as the number of batches required for filing of the ANDAs. As a result of which there was a slight delay of about a few months after our shifting has been completed. We should be back on track and we hope to file average one or two ANDAs each quarter going forward for the next two to three years.

KC Suri: Post GDUFA fee, are all your 28 filings still commercially viable or can we see a scenario where you might even want to withdraw any of those?

Rakesh Parikh: There are two of them, which perhaps may not be viable.

KC Suri: Of the 15 approved right now, you have already launched 13?

Rakesh Parikh: Out the total 15 approvals we have got, 2 are tentative approvals. And 10 products have been already launched, commercialized in the US and the balance one will get done in this quarter.

KC Suri: We spoke about having a 200-basis point EBITDA margin improvement year-on-year and even if we normalize the loss on account of NLEM, which you said was about Rs. 14 Crore for you on an annualized basis, you think do you have a scope to have a better EBITDA margin reported this year or will you be close at last year's EBITDA margin only?

M. Gundu Rao: What we had mentioned earlier, this year the EBITDA margins would be more or less in line with the last year because of the impact of NLEM. What we continue to maintain is that 18.5% margin what we delivered for the full year of last year and hence we may maintain at the same level this year despite the impact of NLEM hitting the P&L.

KC Suri: Thank you and all the best.

Moderator: Thank you. The next question is from the line of Sudarshan Padmanabhan from Sundaram Mutual Fund. Please go ahead.

Sudarshan P: With regards to the domestic business we had taken an impact in this quarter. Have we taken a full impact or is there going to be a little bit more impact in the coming quarter as far as the inventories are concerned? And how do you see the domestic business vis-à-vis the distributors and how the products especially that products under NLEM are, I heard that there is not much of acceptance on the products under NLEM, so how do you see the landscape now and when do you see the things actually spanning out in a positive direction from here?

Bhagwat S. Dhingra: Can you please clarify your first question what you asked about?

Sudarshan P: The entire products, which are under NLEM for Unichem, the entire new inventories, has there been or have we, put it in place?

Bhagwat S. Dhingra: Yes. You are right.

Sudarshan P: There is no spill out on that space?

Bhagwat S. Dhingra: If you look into NLEM, Unichem as a Company has got 100% impact of NLEM in the Q2 FY14. Therefore if you see the impact in terms of value, it has been around Rs. 5.34 Crore and this has been accounted for all the products under NLEM. The second list, which came, does not have any Unichem products, therefore in Q2FY14 we have a big impact of NLEM, which many other competitors may not have. Secondly, in our domestic business we have realigned our acute portfolio and we have created more specific verticals in terms of focusing on life care business which is more into Criticare business and life saving drugs along with this there is increased focus on Dermatology and Gynecology which are fastest growing therapy areas. The alignment of acute business has started paying off and I believe that the second half of the financial year is going to see the fruits of this alignment both in terms of our topline and bottom line.

Coming to our chronic business, I am sure you must have seen the product list, where we have the NLEM impact, which has majorly come into our chronic business especially where we have our mega brands like Losartan, Alprozolam, Metoprolol and Atorvastatin. Now the challenge is to improve volume growth of these impacted products. We are currently working to see that how we can pull up our volumes of these products and I am sure that second half the financial year will be much better in terms of volume as well as value growth.

Sudarshan P: What we were earlier as far as the field force and strategies and now looking at the key brands are completely different. So, what is going to be our strategy vis-à-vis the field forces, are we looking at adding more field force or looking at focusing on productivity? How is that going to play out?

Bhagwat S. Dhingra : If you look at last year in the month of February and March, we have undertaken major expansion in field force. We have realigned our acute portfolio and which has led to around 200+ medical representative being recruited, because we wanted to focus on the therapies which are showing buoyancy and probably showing a double-digit growth in the market. As you know around 43% of the product basket of Unichem is into mature phase and therefore getting growth from the mature product is difficult. Hence, the challenge was to align, the field force in a manner in which we start focusing more on the growing basket. And that was the reason we had taken an expansion in field force in order to focus smartly on the right customer as well as on the right products. Owing to these measures our growth should be more buoyant and better in months and quarters.

Sudarshan P: Thanks a lot Sir.

Moderator: Thank you. The next question is from the line of Nishith Sanghvi from CIMB. Please go ahead.

Nishith Sanghvi: On the domestic business in the last call you had mentioned that this was the lowest domestic growth rate we have seen and probably this quarter also we had finished at a lower domestic growth. On the quarterly run-rate in the domestic formulations will we be able to maintain Q2FY14 levels or how will the QOQ business improve? Because the base effect will keep the growth rate for the domestic business but QOQ how do you see the growth in the domestic formulations front?

Bhagwat S. Dhingra: If you look into our Q2 FY 14 it is with NLEM. As you are aware that there were two important factors, which has affected us which were previously mentioned. The NLEM list, which was announced, Unichem got impacted in the very first list because of which all our major product have come under NLEM. So, what has happened is that the major impact on value and volume has come in Q2 FY14. As a result we have lost around Rs. 5.34 Crore in terms of value. Further to that, because of the trade related issue, which industry is currently facing we got burnt there and based on our estimates we have lost almost around Rs. 7.5 Crore in inventories at market place. So, if I look into net-net Q2 FY 14 loss comes to around Rs. 13 Crore for us, including inventories as well as the impact of NLEM products.

Now looking forward to Q3 FY 14, we have done lot of realignment into our acute business and the impact of NLEM loss in Q2FY 14 may not be equivalent to what we may have in Q3 FY 14. We are looking at buoyancy and value growth in Q3 FY 14 compared to Q2 FY 14. So there are three to four challenges in front of us.

First and foremost is that how we can increase our volume growth of NLEM impacted products because the NLEM impact on those products in terms of our value growth is very high. If we have to compensate value growth we have to improve our volume growth. The second is currently new product contribution to our growth is hardly 2.5 to 2.6%. To tackle this issue we have undertaken many steps in Q2FY14 to introduce new products which can help us to put us into a driving seat. Further to that, in our chronic business we have introduced nine products and in acute business we have introduced six products in Q2 FY 14, the estimated growth numbers are built for in Q3 and Q4 FY 14. I believe that these new products will also add substantial value to overall business in Q3 FY 14.

Nishith Sanghvi: On the margin front, this year also we are expecting to finish at around 18.5% odd so next year onwards how much improvement you are seeing in the EBITDA margins?

M. Gundu Rao: What we have been communicating is that minimum 200-basis point improvement in margins every year. So, for this year we are going to expect like last year, about 18.5%, next year i.e 2014-15 we can easily estimate it could be 20% plus. And the drivers would be productivity that is field force productivity, the second one is how can we salvage the price erosion which we have undergone in the NLEM products and the third one also looking at the efficiencies in the manufacturing side. These three would contribute minimum 200-basis points.

Nishith Sanghvi: Are we confident to take price hikes in certain products next year?

M. Gundu Rao: There are three or four things, one by the time next year in May-June we will take on NLEM products a price increase based on the inflation rates, which the government is going to indicate. The second one is, there are non-NLEM products wherever there are opportunities for the price increases, and we certainly will take the price increase. Third one is field force productivity as Mr. Dhingra has mentioned that would give us at least a few basis points improvement, plus on the manufacturing side, which includes the sourcing aspect as well as in the conversion aspect we are looking at what are the best things which we can do. These are the normal things, which are ongoing, and essentially all these factors in two years time would lead us back to about 23% to 24% EBITDA margins.

Bhagwat S. Dhingra: Adding to Mr. Gundu Rao's comments, the overall operating margin depends upon product mix. We had a mature basket, which is contributing to around 43% of our business; once we introduce new products along with right product mix it will further give fillip to our EBITDA margins in the coming years.

Nishith Sanghvi: That answers my question. Thank you.

Moderator: Thank you. The next question is from the line of Hitesh Mahida from Fortune Financial. Please go ahead.

Hitesh Mahida: On the domestic market front, have we seen the resolution between distributors and Pharma companies as far as margins are concerned on NLEM products?

Bhagwat S. Dhingra: As of now there is stalemate, neither trade is pressing too much on us nor we are interested in giving too much to them. Companies like Cipla and Mankind have already announced that they are going to give 10% and 20% to the trade effective September 22, 2013 onwards. Having said that, we are the part of IPA and OPPI so we are working in tandem with these organizations and we have made a representation to DoP on this issue and we got an assurance that they will also intervene. Because after NLEM impact the margins have already shrunk in NLEM products, and on top of that to give more margins to retailer and wholesaler will further bleed us, and also the industry from the overall operating margin perspective.

Keeping that in mind, we are not looking to increase the margins for retailers and stockists unless there is a clear directive from DoP. Just to reiterate on what I mentioned earlier, we had lost around Rs. 7.5 Crore due to the inventory in last quarter, and inventory levels have come to around 24 to 25 days, I believe, we will be able to pull up inventory by around Rs. 2.5 Crore in this quarter, post that we will have respectful inventory levels of around 30 days to operate in the marketplace.

Hitesh Mahida: As far as Niche Generic is concerned, this is the third straight quarter of profit and also we have posted a good topline growth. So what is our view on that subsidiary going forward?

Rakesh Parikh: If I can correct you this is the fourth consecutive quarter of profits in Niche Generic. Of course in the last four quarters there was some extraordinary in the case of some shortages of some products, which we could capitalize on, but subsequently there are other things which are paying off, because of that we have seen the profit in the second quarter plus I would like to add that there is a top line growth in GBP terms. As I mentioned earlier we have been very cautious about the performance but the moment the after the cash flow and the profitability starting to improve, the focus is shifting on the top-line growth. So, right now the indications are that the second quarter results performance should continue for the balance quarters and at the same time we are trying to see how we can increase the topline in GBP terms.

We can do that by having new geographies or new customers, but now we are also trying to see certain newer products whether they can be launched, and for which they are seeking approvals. Once that happens then there will be traction for the entire international business and then the next stage is to see how much of that can be sourced in-house on a consolidated level to improve margins.

Hitesh Mahida: As far as US is concerned, we have seen an improvement in growth despite of no new launches, so, what is your view going forward?

Rakesh Parikh: There are two aspects to this. One is that last year with a few launches we ended the year with about 10 products commercialized. So to that extent some of the products were not available in the last year, so in the first and the second quarter the benefit of that has come. But in addition to that my existing products especially in the pain management and the cardiovascular side have shown good organic growth. So, to that extent it has helped us though it has come at the cost of slightly lower gross margin, as a result of which the profitability has not improved commensurate with topline. Hence, it is necessary that the new products approval should come so we are able to launch it, our endeavor continues, to see how we can further improve market share in the existing products, which already we have successfully done and see whether we can do it at a slightly better realizations.

Hitesh Mahida: Do we have enough capex going forward as far as export business is concerned considering that now we have sold of our Indore SEZ to Mylan and so for the next 12 to 18 months, do we have enough capacity? Secondly what would be our capex plan for FY'14?

Rakesh Parikh: The capacity part can be bifurcated into two segments, one is the formulations and one is the API. As far as the formulation is concerned, we have already expanded our Goa plant since almost about two to three quarters. In addition to that, the Mylan sale was predominantly because of a temporary surplus in capacity. So we have already got the next plots of land in Goa where the expansion is going to start. The plans and drawings have been made and we are on the verge of submitting it to GIDC from Goa for approval purpose. Once that happens we will be able to add new capacity in next 18 odd months. This is the scenario as far as formulation is concerned.

As far as API is concerned, yes we are facing constraints in terms of capacity. Because Roha is running at 100% capacity, and Pithampur is already come up to 60% to 70% plus capacity utilization. We are expanding the Pithampur capacity where the expansion is possible, but that would be on a limited scale and that would be ready in another six months. However, looking at slightly medium term we feel that we may face a constraint immediately in API. To tackle that one of the actions which the company is taking is to acquire an API facility for which advanced discussions are going on. If we acquire it we will have to upgrade it if it is not an approved facility. In another year or year plus we are aiming to have the API capacity also in place to meet our requirement at least for the next three to five years.

Hitesh Mahida: Q1 was pretty bad quarter for the contract manufacturing business, so have things improved from Q2 onwards or the concerns continue?

Rakesh Parikh: It may have been marginally improved, but that is why if you see sequentially my export formulation growth is hardly about 12% in spite of my US and sales to niche as well as emerging markets doing well. The off take with parties has not gone up to what we had seen last year and more so in US where the margins are anyway quite limited. The moment they see the appreciation of the Dollar, they come back to the table for negotiating the price. Pricing is becoming an issue. As far as Unichem is concerned with respect to CRAMS, our model is very clear that unless we have a reasonable margin, we would not like to do it.

Hitesh Mahida: Thank you and all the best.

Moderator: Thank you. The next question is from the line of Ashish Thavkar from Asian Market Securities. Please go ahead.

Ashish Thavkar: Since the 100% NLEM impact was there itself in Q2 FY 14, could you put a number as to how much of the growth we would lose?

Bhagwat S. Dhingra: Because of NLEM?

Ashish Thavkar: Yes.

Bhagwat S. Dhingra: Around Rs. 5.4 Crore and trade impact of around Rs. 7.5 Crore.

Ashish Thavkar: So, if I annualize this number going forward in FY'15, we should easily be doing 10% to 12% growth in the India business?

Bhagwat S. Dhingra: For second half?

Ashish Thavkar: For FY'15

Bhagwat S. Dhingra: Definitely we are even thinking for more, but the figure that we just spoke we will definitely look into that.

Ashish Thavkar: At the industry level there has been increasing efforts by the government to curb the approval of fixed dose combinations and now the government is also asking for clinical safety data on FDCs that were approved in the past. So, any comment on that front?

Bhagwat S. Dhingra: In market a lot of companies have taken the state government approval for fix dose combinations, but there was a ruling from High Court in Himachal Pradesh around 10 days back where High Court has said that if state licensing authorities which are also part of DCGI, and if they are giving the licenses to various companies then why should there be any objection from the government, but on the other hand, when we look at Unichem we have majority of fixed dose combination which are having an approval of DCGI and where we do not have approvals, we have already submitted the safety data to the government of India.

We are waiting from government for the other things they may ask from us. It can be a BA/BE studies or maybe in some cases they may ask us to do clinical trials, so we are prepared to handle the issue and seeing that how the benefit of fixed dose combinations reaches to masses. If you see the fixed dose combination are not banned, they are being used world over and today lot of companies are getting approval from USFDA for fixed dose combination.

As you know when a patient suffering from chronic disease he is being given a lot of pills, it becomes difficult for the patient to continue, therefore the trend of fixed dose combination will continue. But government's concern was in terms of its bioavailability and bioequivalence so that the patient gets the desired benefit of those fixed dose combination. I am sure that industry has scaled up, their quality parameters to that level and I am sure that in coming months and years the fixed dose combination will continue to play a vital role in terms of deciding the growth trajectory for the industry.

Ashish Thavkar: That was good, but supposing if we were to conduct those additional trials, wouldn't that be too higher cost for us?

Bhagwat S. Dhingra: No, I think so BA/BE studies costs between around Rs.8 to Rs.10 lakh and CTs depending upon the molecule may vary from Rs.25 to Rs.40 lakh. And it is not necessary to do the CT and BA/BE for all the SKUs in pharma since each product has around four to five SKUs. So, even if you do for one SKU it becomes automatically applicable for other SKUs.

Ashish Thavkar: We have a growing proportion of exports in totality are we planning to take any hedges or we still prefer to keep our receivables open?

Rakesh Parikh: The Company is following a policy of risk mitigation strategies, which predominantly involves the forward covers, though we take it for a short-to-medium term. Basically we are not leaving it open because the volatility has further increased and it is becoming very unpredictable. Only thing is what proportion to cover and whether to take on a net basis or a gross basis, because we do have imports even though we are net exporters.

Ashish Thavkar: Can we have the number for forward covers and at what rate?

Rakesh Parikh: Typically we are taking around medium term, when I say medium term it can be as low as 15 days to maximum of three to four months. That is the kind of the time horizon for which the forward covers have been taken. Once the visibility is very high then only we take the cover and current scenario you can say that about 60% to 70% of our dollar exposures are covered, and on Euro almost around 80% is covered.

Ashish Thavkar: At what rate the dollars are covered?

Rakesh Parikh: The premiums have been ranging from 5% to 6% per annum and since we take our cover of rupees we would have done it over various time periods because my credit period varies from 60 days to about 120 to 155 days. The range if you were to consider, the lower end would be at 60 to 63 whereas the higher ones are at almost 71 or 72.

Ashish Thavkar: Great. That was all from my side. All the best.

Moderator: Thank you. The next question is from the line of Runjhun Jain from Nirmal Bang Securities. Please go ahead.

Runjhun Jain: Wanted to summarize what you have been discussing till now. What is the kind of growth you are expecting for this year and for the next year? We have already talked about the margins, just the growth, sales growth?

Bhagwat S. Dhingra: Are you asking for the domestic business?

Runjhun Jain: Overall business

Rakesh Parikh: About 65% of the company's standalone business comes from India Formulation; roughly about 9% to 10% comes from API, and the rest from International Formulations. As we have been saying domestic business is almost about 65% of our turnover, we are putting all our efforts for growth and trying to see how much better we can do compared to market and we have guided to grow above 2% higher than the market growth. So whatever the market growth comes in the current year we will be able to match to that.

In terms of the international business, emerging markets formulation business continues to do well growing over 10% and 20% and we are also showing similar performance in US. And places where I am directly selling there also we are doing well. Niche Generic has grown at almost about 16% in GBP terms and maybe 20% to 25% in rupee terms but nevertheless this kind of a growth rate is expected to continue. However, as far as US is concerned, the future continuance of growth at even 20% plus would highly depend on the approvals coming in. There have been delays in approvals whereas Unichem is fortunate in terms of the capacities which we have, we have got the accreditations and we have not had any problems, as most of these facilities have been re-inspected and re-certified, several times but on the approval side there is very little which we can do and with the US government shutdown we are not sure whether there is further timeline delays, the same thing is in Brazil as well. So, these are going to be the future drivers and if the approvals come then the growth can further kick up.

As far as the API is concerned, the volume growth is quite high, more than 20% but it has not been reflected in numbers because we are having capacity restrictions and we would prefer to divert the APIs for our own captive consumptions where the overall margins and the prospects are much better. So, based on that I am sure you can arrive at what you feel the growth rates can come.

Runjhun Jain: Do you think a similar thing for the next year also?

Rakesh Parikh: Next year what will happen is there is one positive trigger, which will come in terms of India business because one year of NLEM will be over. In addition to that all the measures that are taken in-house will also start yielding results, which was highlighted by Mr. Gundu Rao in terms of the productivity. So that should further add as a kicker to the growth. Also, in countries like US, Brazil and all we have much better footing and which will help us and yes the emerging markets, and in niche we expect it to do better because Europe has already started showing signs of improvement.

As far as API is concerned, we will continue to focus as per the current strategy but the expansion of Pithampur, which is happening in addition to that the capacity, may come in by end of next year that can also help us to increase our growth rates.

Runjhun Jain: Is it right to say that in addition to increasing the captive usage of your API you are also trying to increase the market share or business in API?

Rakesh Parikh: As far is API is concerned, the focus has been where we are cost competitive and therefore we are predominantly focusing on the regulated markets. Already my sales are about 75% to regulated markets and that too we have restricted ourselves to Europe. However, we have started the business development activities as far as the other regulated markets like the US are concerned. So, once my capacity and other internal issues are sorted out over the next one to two years, by the time my business development also would have progressed and I will go on and increase my DMF filings and the business will also start.

Runjhun Jain: Next year you have the NLEM benefit and other benefits, which we talked about, right now and you are saying for FY'14 that 2% range with the industry average. So is it safe to say that next year that range should increase?

Bhagwat S. Dhingra: Definitely, because when we are doing all the things necessary in the domestic business the fruits of all actionable which have been taken within the organization are going to help us to bring better growth as compared to what we are getting this year.

Runjhun Jain: Thank you Sir.

Moderator: Thank you. The next question is from the line of Dhiresh Pathak from Goldman Sachs. Please go ahead?

Dhiresh Pathak: Wanted to know the book value of the Indore SEZ, which has been sold to Mylan?

Rakesh Parikh: It could come somewhere between Rs. 110 and Rs. 115 Crore.

Dhiresh Pathak: What is the age of the plant?

Rakesh Parikh: Age of the plant is new. We have just capitalized it about five to six months back, and it has gone into commercial production.

Dhiresh Pathak: What is the market value of the land that is underlying the plant?

Rakesh Parikh: This is basically the leasehold plant. So the market value does not come into the picture. It is a slump sale which we have made and technically, I am not selling the land. I am just selling the unit and the land is shown as return back to the MPAKVN, which is the lessor, who in turn will reallot the land to Mylan.

Dhiresh Pathak: This consideration does not include the value of the land because the land is on lease?

Rakesh Parikh: It includes the consideration of the leasehold rights which we are going to transfer as per the agreement with Mylan, but because of our agreement with MPAKVN, what happens is we are supposed to surrender the leasehold and then they in turn will allot to Mylan. This is typically how it works in all the government approved industrial estates. As far as the price is concerned, we have negotiated with Mylan the entire unit which I am selling to them and Rs. 160 Crore includes everything like land, buildings, structures, movables, immovables and everything.

Dhiresh Pathak: The other thing was the export formulation revenues of Rs. 120 Crore for the first half. CRAMs business would be roughly 60% of that, right?

Rakesh Parikh: Yes, almost that much.

Dhiresh Pathak: The balance roughly Rs. 50-odd Crore would be your sales that you are doing through your subsidiaries, which you mentioned separately?

Rakesh Parikh: Both, it will be half-half. Half will be to the emerging markets, which we are directly doing it, and the balance half would be what I am supplying to my subsidiaries for sales in US and Europe.

Dhiresh Pathak: So, the sales of ANDA linked product that you do in US gets captured in that export formulations in the standalone revenues?

Rakesh Parikh: That is right, but at my transfer price.

Dhiresh Pathak: Thank you Sir.

Moderator: Thank you. The next question is from the line of Rahul Sharma from Karvy Broking. Please go ahead.

Rahul Sharma: What would be the proceeds which would come in from the Mylan sale? What would the capex? Because you are planning the new API plant, which you probably be starting this year. Secondly on the domestic front you have lost more than Rs. 5 Crore of sales due to NLEM. How are you looking at it going ahead? Do you foresee the loss to be lower in terms of on these NLEM products in the second half?

Rakesh Parikh: On your first question sale proceeds are Rs. 160.5 Crore as approved by the shareholders and the agreements entered.

Rahul Sharma: What about the tax that we should be paying on this?

Rakesh Parikh: It being a slump sale, the difference between our book value and incidental cost minus the realizable value will be subject to MAT, which is around 21%. And even capital gains are around 20% for slump sale. Basically you can say 20% of the capital gains will be our tax liability as far as the deal is concerned. And in terms of capex we are looking at around Rs. 200 Crore in the next 2 years which predominantly will include the Goa facility, which we are putting up so that two years down the line, we have a similar capacity at least equal to the SEZ which we have sold right now. To back that up and my requirements of API where we are planning an acquisition and after which we will have to go in for modernization and revamping so that it gets approved if it is not an approved plant. The third one will be on the biosciences side, based on the certain leads as part of the long-term strategy of the company has already put up a pilot plant, the civil work of which is over and equipments are being ordered. Right now we are also expanding our Pithampur API, which is also a part of the capex in the coming year, so put together under normal capex which we talk off it will come to about Rs. 200 Crore or so. About Rs. 125 Crore in the first year and the balance in the second year.

Rahul Sharma: Rs. 125 Crore will be consummated in FY’14, am I right in assessing?

Rakesh Parikh: Financially if you want to see yes, it would come almost close to that in the current financial year.

Rahul Sharma: Part of the proceeds, which are coming through this sale of unit, would be utilized for sale of the plant?

Rakesh Parikh: The sale of the unit also would be utilized for that over the next year plus at the same time we are having accruals also to finance, so far all our capex financing is done by internal accruals, which has been varying between Rs. 80 and Rs. 100-odd Crore. As far as NELM is concerned the notifications came somewhere in the end of first quarter. They got implemented and by the time they were implemented it happened from July onwards so the brunt of it has come in the second quarter.

The second part is that there was the issue where there were certain products already available in the pipeline and those could have been returned. What has happened is that there have been some of the returns which have come and we have to replenish it and maybe relabel it and again sell it at a lower price; because of this the impact is slightly on the higher side. The next is this is a basic impact as far as the difference in prices are concerned, but what Mr. Dhingra was also saying is that what we are making all efforts to see how the volumes of this can be increased. So some extent the adverse impact of this NELM downward revision in prices should get offset by the increase in volumes of these products. So, the net effect could be lower.

Rahul Sharma: What are the tax rates you are looking at the current year standalone?

Rakesh Parikh: 21% is as I have said and as far as the deferred tax is concerned, 1% to 2% depending on the capitalization. So that is why if you notice already it has been slightly lower in the second quarter compared to the first because no major capitalization per se happened, but now the Pithampur and the Bioscience we will be capitalized in the second half, anywhere around 22% to 23% seems to be a reasonable rate to assume.

Rahul Sharma: Can I get some clarity from Mr. Dhingra on NELM?

Bhagwat S. Dhingra: As Mr. Parikh has already briefed you that the impact of NELM in the Q3FY14 and Q4FY14 will not be to the extent of what we had in Q2FY14, but on the other hand we are putting efforts to see that can we increase the volumes of NELM products and that is one through which we will plough back whatever loss we had in the Q2FY14, but because overall impact of NELM this year comes to around Rs. 13.5 to 14 Crore. We have already in Q2FY14 incurred a loss of around Rs. 5.5 Crore and the balance we have divided between Q3FY14 and Q4FY14, but on the other hand if we recover through some volume growth I am sure that the net-net impact will be less in Q3FY14 and Q4FY14.

Rahul Sharma: What about non-NELM products? What type of growth you are looking at?

Bhagwat S. Dhingra : As I shared to some of the questions earlier that in non-NELM products we have some mature basket and therefore in Q2FY14 we have put in efforts to see that how this can add fillip to our growth in chronic or acute business. In month of April, we have realigned the total acute business. Which has started showing a very positive growth within the organization and I am sure that H2FY14 will also see a good growth compared to H1FY14.

The new product addition in acute and chronic will give fillip not only the new products but also to the non-NELM products. Some of the products what we have introduced in the market are the combination products having existing growth drivers with us. So, I am sure that the non-NLEM basket is going to grow better than the market because our targeted goals are that can we grow 2% better than the market.

Rahul Sharma: Have you introduced about 15 products in domestic business till date, am I right?

Bhagwat S. Dhingra : In Q2FY 14, around nine products in chronic and six products in acute. I have four verticals dealing in chronic business and there we have introduced nine products and I have around five verticals to deal in acute and there I have introduced six products. In acute this year we have aligned, so people and team is busy into refocusing on realignment which has started giving us dividend in terms of our internal growth and therefore the new introduction in the acute business will happen in second half of this financial year.

So, when I say that, it means in the month of December, January and February we will introduce some of the new products for acute business so that acute business next year can get the benefit of those new introduction.

Rahul Sharma: You are looking at what type of market growth in second half of the current year?

Bhagwat S. Dhingra : Overall IPM you are talking about?

Rahul Sharma: Overall IPM

Bhagwat S. Dhingra: Overall IPM there is trade related issue and some of the major companies are going to have an impact of NELM in Q3FY14 as we had a major impact in Q2FY14. I do not think in this year the market is going to show a double-digit growth by the end of March.

Rahul Sharma: Thank you.

Moderator: Thank you. The next question is from the line of Purvi Shah from Dalal and Broacha. Please go ahead.

Purvi Shah: Thank you so much. All my questions have been answered and all the best.

Moderator: Thank you. The next question is from the line of Krishna Kiran from ICICI Direct. Please go ahead.

Krishna Kiran: In next one-year timeframe, how many of our US FDA approved facilities will be reinspected?

Rakesh Parikh: Recently of course two got approved. I mean there is no cycle as such. USFDA has opened their office in India and I think they have got staff of around 25. They can even walk into any facility anytime they feel like and the kind of things which we have seen where a lot of these big names have come under scanner anything is possible. But typically they take about three years is what an average time they take for recertification.

In Our case two facilities have already been re-certified over the course of last year, and for the balance two, we never had any problems in recertification. All our four facilities have been recertified at least twice some of more than three times.

Krishna Kiran: Regarding the Brazilian market, where we stand in terms of product registrations or how many are so far approved. Can you just share some light on it?

Rakesh Parikh: Total products applied for registration are 16 products and two products we have test launched, which are primarily meant for test launch, but the real benefit will come in only if we get approvals out of the balance filings. As you are aware and as we mentioned earlier also that in the last few months no new approval has come and some of the products have crossed more than three years, so hopefully the approval should come soon.

Krishna Kiran: If you look at in the first six months our tangible assets have grown up more than Rs. 40 to Rs. 50 Crore , which plant or which facility has been commissioned in the six months?

Rakesh Parikh: Are you comparing with March?

Krishna Kiran: Comparing with March, net block has moved up more than Rs. 50 Crore?

Rakesh Parikh: One of the major facilities, which have been capitalized in the current half of this year, is the SEZ facility. It was in work-in-progress stage in the month of April. This is one which has been capitalized and of course the new R&D center, COE had already come last year before March. The SEZ what I mentioned earlier is Rs. 110 Crore roughly is about that capitalization.

Krishna Kiran: Is it possible for you to share our contract manufacturing business numbers and corresponding previous numbers, which is to understand?

Rakesh Parikh: In the current year the contract manufacturing has not been commensurate with last year contract manufacturing; our model is such that we only pursue contracts where reasonable margin is available. Because we are not having any kind of a pure contract manufacturing the way people say, ours is on principal to principal, it is only the marketing and distribution and the intellectual property owned by them for which we are making it on a fully completed basis and just selling the material to the buyer.

As a result of the appreciation of the dollar the prices come under the downward revision stage and that is something which we do not really want to do and the option of getting a new product would easily take at least about three to six months before the site variations and all can be done. As a result of which the contractual business in the current year has been on a low key compared to the last year though my other regulated markets like Europe and Canada and all that are continuing to show the same kind of level of business.

Krishna Kiran: If we have two to three products in the US, which we are expecting to get approval in the second half, and if we launch those products, will the US subsidiary breakeven with that or how much time it will take for your subsidiary to breakeven?

Rakesh Parikh: As a legal entity, if two to three products approval comes in then the subsidiary should breakeven, but on a consolidated basis since all the products sold by US are manufactured here by us, we are already breaking even pre R&D and substantial portion of the R&D is being recovered. But yes, I am not recovering all my costs, typically the cost is slightly increased because of that GDUFA which has come in and as per our accounting policy we are writing off all those costs in the year.

Krishna Kiran: Just to understand on the API business, export API business during this quarter witnessed a degrowth and we were explaining that we have higher internal consumption, do you see this kind of de-growth, or recovery will happen in export API front, because we are going to use higher internal consumption?

Rakesh Parikh: It all depends on what is the timeframe we are talking of, short-term, medium-term or long-term. In the short-term this kind of thing is there and we mentioned at the time of the first quarter as well. If you have seen the growth, which US and niche are showing, obviously all those APIs have to be supplied by me. So there is an impact. If you take my entire plant as a production unit what they are doing they are talking of almost 25% growth, for which the throughput has increased by 25% in volume terms, so in the short-term yes.

Pithampur expansion is going on, which should be ready in about three to six months time and by the time if the approvals do not come unfortunately then I will have a capacity available for exports also. In the medium-term we are actively looking for an acquisition for API and there are advanced discussions going on, so the moment that happens maybe little more than a year down the line we will have that plant ready in an approvable stage.

As a result of which we will be able to further expand my API for which the business development activities in other regulated markets like US have already started. So that a year or two down the line API will also start showing good growth.

Krishna Kiran: Want to get more clarity in terms of contract manufacturing, but have we seen a de-growth of last quarter in the contract manufacturing because last quarter we think we have seen a strong double-digit degrowth we have seen in the contract manufacturing?

Rakesh Parikh: In terms of contractual manufacturing, contractual business year-on-year formulation part of it we have reported a de-growth, yes.

Krishna Kiran: Thank you very much.

Moderator: Thank you. Ladies and gentlemen due to paucity of time, we will be taking the last question from Shravan Viswanathan from UNIFI Capital. Please go ahead.

Shravan Viswanathan: The two or three US ANDA approvals that you are expecting from US FDA have they been filed from the facilities that have been recertified in the last one year or the other two which are yet to be recertified.

Rakesh Parikh: Yes, they have been filed from that recertified facilities only.

Shravan Viswanathan: Recertified facilities, so it is only the delay from the US FDA end?

Rakesh Parikh: Yes, that is right. We have just crossed about 30-odd months for the oldest filing. This time it has already gone up to 33 months. There is a further increase and maybe in a couple of months down the line we should get one more approval.

Shravan Viswanathan: Is there some communication going on between you and them?

Rakesh Parikh: There was. That was already referred by us and after that there has been no further communication for the last two months.

Shravan Viswanathan: Do you have any formal way of asking them the status or something like that?

Rakesh Parikh: I do not think so unless you want to have an RTI like what we have in India. Right now I do not think there is any formal communication, which is possible.

Shravan Viswanathan: All the best.

Moderator: Thank you. I now hand the conference over to Mr. Monish for his closing comments. Over to you Sir!

Monish Shah: Thank you. I would like to thank everyone for attending the call. We welcome any queries or questions you may have. We will be happy to answer that. Thank you.

Moderator: Thank you very much. Ladies and gentlemen on behalf of Edelweiss Securities that concludes this conference. Thank you for joining us.