

Unichem Laboratories Limited Q1 FY16 Earnings Conference Call, July13, 2015

Moderator: Ladies and Gentlemen, Good Day and Welcome to the Unichem Laboratories Q1FY16 Earnings Conference Call hosted by Systematic Shares and Stocks. As a reminder, all participants' line will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Jigar Kamdar. Thank you and over to you sir.

Jigar Kamdar: Thank you very much. Good Afternoon Ladies and Gentlemen, and A Warm Welcome to the Conference Call of Unichem Laboratories Ltd. to discuss the Financial Performance for the First Quarter FY16. On behalf of the Systematic Shares and Stocks, we would like to thank the Unichem Laboratories management for taking out time from their busy schedule. Unichem Laboratories management will be represented by Mr. B.S. Dhingra – Chief Executive, Domestic Pharma; Mr. Rakesh Parikh – Vice President Finance and CFO; Ms. Neema Thakore – Head, Legal and Company Secretary; Mr. Monish Shah – Manager, Investor Relations. I would now request Mr. Rakesh Parikh to brief you about the Financial Performance for the First Quarter FY16, and then we will start the Q&A session. So I will now hand over the call to Mr. Rakesh Parikh. Thanks a lot sir.

Rakesh Parikh: Thank you, Jigar and Good Afternoon to you all participants. On behalf of Unichem, I welcome you all to this conference call. At the outset, we are pleased to announce that Ms. Neema Thakore who has joined us as head of our Secretarial and Legal department and has consented to join the call. We had the AGM, which was also conducted by her to consider the audited results consolidated for the year-ended 31st March 2015 on Saturday, and also the board meeting to consider the first quarter results was also held earlier on this Saturday. The Investor Release and the Information about our results has already been circulated and I am sure all you would have received it and gone through. As you will observe, total income from operations for the first quarter has been reported at ~Rs.309 crores, which is much better as compared to the sequential quarter, and also shows a growth over the corresponding quarter last year. This has been driven predominantly by two major growth drivers which are the India Formulations business and the US business. Since Mr. Dhingra – Chief Executive is here I would leave it for him to elaborate more on the performance of domestic business. Before I hand over to him, I will just touch upon a few highlights of the other business.



Against ~Rs.309 crores sales which we have reported, the EBITDA comes to almost about Rs.43 crores and the profit before tax comes to roughly about Rs.39 crores which is same as the first quarter last year and obviously significantly higher than the sequential quarter and the PAT comes to around Rs.29 crores. In revenue mix the India Formulations business accounted for almost 64% of the total company's turnover on a standalone basis. And as far as the International Formulations is concerned it has shown a growth of almost about 12%, which is predominantly been driven by the US business.

As regards the US business I would also like to share with you that there was a surprise inspection by USFDA of three of our plants. As you are aware we have four plants – two API, two formulations – which are approved by the US FDA, and there was a surprise inspection in the last few months for three of these facilities, and we are pleased to announce that this went off without any major or critical observations, and they have permitted continuity of business. This is also backed by our filings, which currently stand at 34 in terms of ANDA and 41 in terms of DMFs. Out of the filings we have around 18 approvals now, 1 being recently received, so now we have 3 tentative approvals. Our US subsidiary continues to show robust growth showing at that subsidiary level almost about a 58% growth.

I will request Mr. Dhingra to take you through a few highlights on the domestic business and post that we can take questions. Over to you Mr. Dhingra.

B.S. Dhingra:

Thank you Mr. Rakesh, and a very good evening to all. I am sure that all of you must have gone through the Q1 Report, which has already been released and you have heard from Mr. Rakesh that overall the Q1FY16 looks to be very positive for the company and as you know that 64% business of Q1 has come from Domestic business which has started showing a positive traction. As Mr. Rakesh has rightly mentioned that domestic has done around ~Rs.194 crores vis-à-vis ~Rs.180 crores in the corresponding quarter last year, so the Domestic business has shown an 8% growth. When I look at the domestic growth it has come from all the three clusters. As you know friends, that we have created Domestic business into three clusters – one is CVD cluster, where there are four Cardio Diabetic divisions, other is the CND cluster, where there are 2 Neuropsychiatry and 1 Derma division, and then there is Acute cluster. So in nutshell, what I am trying to say that all the three clusters and all the divisions across have started showing a positive traction, and therefore in Q1 we are able to show better results.

When it comes to overall operational efficiency as against the last few quarters, there seems to be better things happening. So I am sure that the kind of number and reflection which we are able to see, those numbers and reflections can be better in the coming quarters too. Since a lot of the data is with you, so instead of I speaking, it will be better that you can raise some of your questions and concerns, which can be answered by all of us sitting here. Thank you very much.

Moderator:

Thank you very much. We will now begin the Question-and-Answer Session. The first question is from Hitesh Mahida from Antique Stock Broking. Please go ahead.



Hitesh Mahida:

Wanted to know, now Domestic business has grown at almost 8% during the quarter, but it is still lower than the average Domestic growth of the overall margin of 14-15%. So, can we expect this 8% to go back to that 14-15% margin in the coming quarters? Secondly, what are the major concern areas as far as our Domestic business is concerned as the attrition rate normalized?

B.S. Dhingra:

In Q1 FY16 numbers, which look to be in single digit, are mainly because of the Generic- Generic business. In The same period last year we have done almost ~Rs.12 crores of Generic business, this year we have reduced that Generic business to ~Rs.8 crores, so bringing down the overall value impact to the Q1FY16. When it comes to Formulations business, as I mentioned that we have started doing very well, across divisions there are no major concerns when it comes to the Domestic business. A few initiatives what we took in the last two years was one that how we can improve the performance of the mature basket. As you know that Unichem as a company we have around 50% products which are into mature basket, and they are the face to the customers, be it Losar, Trika, Ampoxin, Unienzyme, or Vizylac. We have undertaken manpower expansion, and last year we have created a dedicated division for Losar, Trika, and TG Tor. And let me be honest in sharing, that we have started doing very well in Losar and Trika. If you look at the AWACS numbers you will find a very positive traction coming for Losar as well as Trika. So that shows that the initiatives in terms of manpower expansion, the cost incurred for manpower has also started paying dividends for the organization. Similarly, when I talk of Acute products, three products, Unienzyme, Vizylac and Ampoxim, all the three products they were doing last year pretty good, and even in Q1FY16 they are doing pretty good. So the initiatives what we took in terms of rationalizing the manpower and creating various divisions in order to promote the products more aggressively in the market has started paying dividends. In the coming quarters we are aiming for double-digit growth in coming quarters.

Hitesh Mahida:

Our margins are now back to 14%, but they are still lower than the (+20%) sort of margins which we used to enjoy a couple of years back. So, when do you expect those we get back to those margins?

Rakesh Parikh:

As Mr. Dhingra pointed out, Though there was an improvement which is noticeable and visible as far as the India Formulations business is concerned one of the reasons is the expenditure base has increased over the last couple of years, as we have been explaining in the earlier periods, mainly because of our other businesses in the international markets and also API have regulatory, R&D costs etc. So these have been the major areas as far as the cost increase is concerned. And as a result of this our expenditure in the last year has gone up by about 20% to 30%, and our topline grew in single digit, and hence the fall in margin.

These expenditures are more in the nature of an investment which we are writing off, but which will start bearing fruit, as the US is already bearing fruit and API too, but in terms of captive consumptions which is not visible in terms of external sales. So it may take a few quarters more, but once the topline starts coming in and especially if the approvals come forth as far as the US is concerned we should be further able to increase our margins.



Moderator: The next question is from the line of Anand Sharma from ICICI Prudential AMC. Please go ahead.

Anand Sharma: Domestic also we have grown 8%. So, how much of it would be due to our NLEM portfolio and how much would be due to the non-NLEM because I am assuming that on 1st April we would have taken price increases, right, corresponding to whether it is NLEM or non-NLEM?

B.S. Dhingra: In the NLEM portfolio the price increase is not much, the government has allowed only ~3.8% price increase, so some of the stocks of that increases floating in the month of June, but in April and May there was no impact of that price increase. Having said that when I look at the NLEM products volume growth, which was the purpose of creating a dedicated vertical for Losar and Trika, is showing very good buoyancy in volume growth. So I am confident that volume growth is going to drive the double-digit growth in coming quarters for Unichem Domestic business

Anand Sharma: So essentially from Q1 onwards we can expect double-digit Domestic growth more or less?

B.S. Dhingra: Yes, we are aiming for at least double-digit growth.

Moderator: We have the next question from the line of Amit Kadam from LIC Nomura. Please go ahead.

Amit Kadam: My question is on your US. Like right now we have almost 34 ANDAs filed. What is our strategy in US? What will be the market size of all these 34 ANDAs we have filed?

Rakesh Parikh: As far as the US is concerned, as explained earlier, we have been a relatively late entrant being an India focused company, from which we moved to emerging markets, and then to Europe and the US. In about 10-years since we first thought of going into the US business, and our subsidiary was formed, looking at our size and risk profile and the market there, and our strengths, the strategy was to focus on those products where we were cost-competitive, and accordingly, around 50 products were identified which were predominantly in the Generic space but they were so-called very good molecule almost like “Gold Standard” products. Though the market for these products is crowded, and the growth in terms of volume may be limited, but where we were cost competitive and Quality and Reliability were assured is what was decided to file for those products initially.

Accordingly, the filings are all of para-3, and out of that 50, 34 have been filed. This is the first stage. In the meantime our R&D has been relocated, we have gone through the learning curve, and having gained experience, we have also identified another 10 to 15 molecules, for which filings will take another couple of years to start, they are more still with our research and development laboratory, and these are somewhere we may not be exactly or necessarily the late entrants and where we can have some interesting opportunities or some slightly complex molecules or different novel etc. But currently, our filings are of the older molecules.



As far as the marketing is concerned, having taken care of the product portfolio, the manufacturing, the quality, and the supply, we have tied up with wholesalers and retail chains there to whom we are selling. So the relationship has been developed, they are already aware of our pipeline and as and when the approvals come, it becomes relatively easier to launch the products.

Amit Kadam: Of this total 34 ANDAs what we have filed, 18 are approved, and of which how many are like totally launched and commercialized?

Rakesh Parikh: Out of 18, 3 are tentative approvals, and out of the 15, 12 have been already launched.

Amit Kadam: So like this quarter we actually grew this US business almost year-on-year by 58, so roughly, what the numbers I have is like somewhere around \$7.5 million is our revenue from the US business. So how do we look at this particular segment as such with the current pipeline or maybe if we had identified 50-products, of which we have already like 34-products, that means down the line two years we have to be filing 16 new products kind of a thing. So, once we are there like almost 50-products are filed, so how do we actually look at the growth from this particular thing, so \$7.5 million of run rate can go up to what?

Rakesh Parikh: If you go back two years down the history, it would be roughly about 7 products and last year in the first quarter we had around 10 products and this year in the first quarter we are having 12 products. Some of the products get launched during the year, so they are available for the full period as far as the financial year is concerned. You will notice that though in the last two to three years, there have been only three launches, our sales have more than doubled, the run rate has been almost about 30 to 40% in terms of growth, that means in other words we have been focusing on trying to ensure that we develop more foothold and we gain market share in some of the products where we can compete. But there will be a limitation as far as increasing the market share alone is concerned, but for the current products which we have filed, we are reasonably confident of maintaining the market share and in order to continue this growth in the US business it will be very important for us to get the approvals. Since some of the products have already crossed more than three years, the moment the approvals come and because of our relationship with our distributors and wholesalers there is a good optimism that we should be able to continue a very decent growth.

Today, if you see from 12 products which have reported ~\$7.5 million in revenues, that means it is coming to almost about US\$30 million if the average rate of the first quarter is annualized. So what happens is there is a limitation to how much we can increase our volumes and market share, but we are trying our best, but the future growth in order to continue 20, 30, 40% growth which we have been doing, it will be important that the approvals come. Since three plants have got recertified, and the time has elapsed for some of the products, we are reasonably hopeful of getting shortly some of the approvals, which will drive our future growth.

Amit Kadam: So the products what we have already commercialized... I am just trying to find out our competitive thing, so how many players are already there in each of the products?



Rakesh Parikh: Typically, if you go to see, there will be at least 10 to 20 ANDA approvals for the products which we have filed, but active players in the market are less than 5, generally there are 3 or 4 who are the larger parties, and they have captured bulk of the market share, in fact in about 3 products we are amongst the top 5 already, though we were very late entrant.

Amit Kadam: Once we have 50 identified products, we will be continuing our work in this particular thing?

Rakesh Parikh: No, it is continuing right now, out of the 50 what we mentioned we are hoping to file at least 1 or 2 ANDAs every quarter. By that time the newer products which are under development, they will also start fructifying the documentation and all will start getting completed. So from 2017 onwards we will start filing for those products also.

Amit Kadam: So roughly 8 or 10 new products or new filings will be there per year kind of that kind of run rate we can...?

Rakesh Parikh: We are talking about 4 to 6 per year.

Moderator: Thank you. The next question is from the line of Monica Joshi from Bajaj Allianz Life Insurance. Please go ahead.

Monica Joshi: You have added some Rs.50 crores of Domestic Formulations business QoQ. But we have not seen that kind of a change in the gross margin as one would have expected? Second question is most of your EBITDA growth is actually coming from your other expenses. So just wanted to check if there is something that is like some sort of a deferment of expenses in this quarter which could happen in the next quarter?

Rakesh Parikh: As far as the gross margins are concerned, it depends on the product mix and the positive contributions from India Formulations, and in the other businesses because of the pricing pressures the margin has got counterbalance effect. But the margins have more or less remained similar if you are comparing YoY. There is in fact any increase in the gross margins which is predominantly driven by the India business, that too because of lower Generic and more on the Ethical and the Branded side.

As far as the other expenses are concerned, I do not think there is any question of deferral. Last year in one or two quarters there were some questions raised as to there was a sudden spurt sequentially on the expenses side. And as we had said it was predominantly because of the regulatory expenses that we incurred at the plants in anticipation of the US audits and

Also, the increasing International business driven mainly by the US has got a much higher distribution cost in terms of freight in our standalone company including air freight, which further adds to the freight cost. However, that is more or less coming down slowly and control in spite of the US growth the freight is not increasing to that extent. So, you can say this is more or less the new kind of a norm if you are seeing the other expenses in the SEBI result for the first quarter, And there should not be any major changes in this.



Monica Joshi: Secondly, on the capacity side, both on the Pithampur API unit and the plant that I believe you have acquired somewhere in Maharashtra, and you are supposed to revamp the whole project, so any updates you would like to share on these two assets?

Rakesh Parikh: Pithampur expansion is going on. As far as the capacity is concerned it is being enhanced and that is happening in different stages, in fact, there are about 3 plants which we are remodeling and expanding. So 1 of them has already been over and the other 2 are expected to get over during the current year by October which will further lead to enhancement in capacity. As far as the new acquisition is concerned for the API plant, we have got certain approvals to transfer the facility because it is an MIDC land and some of the approvals are required and some approvals from the pollution side are pending, after which the work will start in full swing.

Monica Joshi: So when do you expect this plant to be operational?

Rakesh Parikh: This plant was a closed down unit, it has got 1 or 2 plants which can be used for a little bit of Domestic business. So, once bulks of the approvals are in place, we can start production, but the whole idea is that we want to enhance our API capacity and going forward for our International business. So that will involve incurring significant expenditure and expansion and making new plant there which normally takes about 12-15 months and after that we have to go for approvals. So if you are talking of approved facility it can easily take more than upwards of maybe 2-3 years or so.

But initially we can start some work once we get the approvals let us say in another 3-4 months or so, for the non-regulated or certain other markets for our other internal Domestic business, we should be able to start even the expanded plants a little more than a year or so.

Moderator: Thank you. The next question is from the line of Nitin Gosar from Religare Invesco. Please go ahead.

Nitin Gosar: What is the percentage of our Domestic business which is now part of price control?

B.S. Dhingra: Less than 21-22% of branded domestic formulation business.

Nitin Gosar: Predominantly the part which is outside price control would be Chronic and Acute or it would be something else and acute?

B.S. Dhingra: Around 76-77% is getting captured in Chronic as well as net Acute. I do not exactly remember the percentage how much it is in Acute and Chronic, but I think it is a balancing act, because percentage wise it will be balancing, value wise it will be more in Chronic and less in Acute.

Moderator: Thank you. The next question is from the line of Ashish Rathi from Spark Capital. Please go ahead.

Ashish Rathi: Dhingra sir, wanted to check on this distributor to C&F model has it been done with or we are still left with some piece of it?



B.S. Dhingra: Yes, you are right, there are 4 distributors left for conversion. The finance minister is rolling out GST and therefore we kept them on hold. Internally, we are debating when to do those conversions but the distributor sale is around 20% compared to the overall Domestic business. So, we are not much dependent on distributor as of today and it is more of C&F almost 80% sale is happening in C&F.

Ashish Rathi: But, is there any timeline we can see it happening in FY16 or it will be still deferred over a period of two years?

B.S. Dhingra: Depending on what the finance minister will decide and when he will get the GST pass, so based on that we have to rework our numbers and see. So when we learnt, some consultants the other day they made a presentation to us. So we understood that the GST in current form may pose a different challenge into supply chain and distribution. So therefore, we kept on hold till there is a clarity and based on that clarity we will take a call.

Ashish Rathi: Which means as of now we are completely on a standstill on that process?

B.S. Dhingra: As of date yes, but based on GST roll out we will definitely take a call.

Ashish Rathi: Rakesh sir, on the US piece, wanted to understand the profitability part. I believe last time around for the full year we made \$2.8 million PBT for that piece, but obviously this had some air rated shipment has happened this quarter. Firstly, what was the reason for that and do we see the profitability improving and what kind of EBITDA margin from that piece we can expect per se FY16?

Rakesh Parikh: When you look at US subsidiary separately, we follow very conservative transfer pricing policy. So they are governed by the transfer pricing norms of India as well as the US. Now, last year one of the things which I had explained in the concall also, is that the US had become a profitable as a legal entity, they had the deferred tax as per the international accounting standard as well as for India, so there was a write-back of tax, instead of deferred tax being a charge, it was basically an addition, there was a deferred tax income last year which in Indian rupees was almost about 12 crores. That was one of the reasons why it had shown that high profitability.

Coming on the consolidated piece, because the entire US, everything that we are marketing and purchasing, has been manufactured by Unichem here in India. So as we have said is that they are able to recover all the expenses in terms of manufacturing, selling, distribution, administrative and all; however, the R&D expenditure is continuing. And though it is for future, if you apportion or allocate that expenditure to US, then I would say that we are still some distance away from recovering and contributing at the bottom line as far as consolidated in US business is concerned, after R&D.

Ashish Rathi: But last time you said some \$16 on the \$24 was like the variable cost which was there and some fixed cost. So mostly that remaining as it is? What I assumed is that operating leverage



play out very significantly in FY16 once we see incremental US dollar number coming in from US business. Is that a safe assumption or I need to be corrected on that?

Rakesh Parikh:

What is happening is that as far as the US subsidiary is concerned, everything was being outsourced, so it was more on a variable cost model. So now we are relooking and we are renegotiating the cost and that will take some time to consider, maybe we may have to add some fixed cost to reduce those variable costs, because after a certain level it becomes more profitable to take certain things in-house like, today, if you see right now everything right from distribution, marketing, accounting and everything else is being outsourced. So that will enable us to increase our profitability as far as the subsidiary is concerned. As far as the consolidated business and mainly the standalone business is concerned, excluding the product mix, one of the major issues has been what you rightly mentioned is about the air shipment which we have to make because of the sudden unexpected demands and the changes which were happening. As a result of which though our US turnover has increased significantly, the freight component of that has not increased that much, and we are still further working towards it, so that we can optimize it further. So that will further add to the profitability.

Ashish Rathi:

And all the products that we shift to the US are we fully vertically integrated in terms of the APIs?

Rakesh Parikh:

Not all, but I would say about 90%. Basically, there are two or three which we still have outside API.

Ashish Rathi:

Lastly, on the Niche Generics, it has been in news now we have been doing that business and we have the quarterly profitability is like more or less it is losses, what is the strategy call on that piece, how do we look at that business going ahead?

Rakesh Parikh:

Unfortunately, Niche, after having a year plus of profit again it has gone into loss, there were two-three things; one is the management bandwidth because of the EC case which has been there which I am sure you are aware off, that has diverted a lot of attention. Also, the products which are doing well there are basically being serviced by Unichem. In the sense that though only one-third of the products are being sold by the parent company, and those are the ones which are really doing much better and because of our US ramp up and we have backward integration for those same products. Hence, the API requirement also comes up. As a result of which there have been bottlenecks which do get affected on a quarterly basis. If you see in the quarter sales itself has been much lower. Had they achieved the sales of last year then perhaps they would have been very close to breakeven also. Also, what we are doing is that we are planning for a couple of launches. So those launches will able to also help them recover some part of losses. And then, of course, the matter of European issue is there and the pricing pressure which are there in Europe which are also affecting the business. We are still watching closely and trying to see what best efforts we can do to turn it out on a more sustainable basis.

Ashish Rathi:

On the EU pricing case what is the status there?



- Rakesh Parikh:** No, we have gone in for an appeal. .
- Moderator:** Thank you. The next question is from the line of Dheeresh Pathak from Goldman Sachs. Please go ahead.
- Dheeresh Pathak:** Mr. Rakesh, which are the three plants that have been inspected?
- Rakesh Parikh:** One is our Roha API plant, the other two are Formulations that is Ghaziabad and Goa.
- Dheeresh Pathak:** In terms of larger percentage of your sales that comes from the US plant, is it from the Goa plant?
- Rakesh Parikh:** Goa is 100% dedicated to the International business, there is no Domestic sales happening and majority of our US sales are from there as well as the other geographic countries. Ghaziabad also is almost about 95% plus international of which a significant portion is also going to US, but Goa is much, much larger than Ghaziabad.
- Dheeresh Pathak:** And a lot of the vertical integration products that you sell in the US, the API from Roha, is it?
- Rakesh Parikh:** Yes, traditionally it was from Roha, Pithampur was an acquisition done by us in 2005 then it went on stream in 2007, so the newer filings and the latter approved molecules are being serviced from Pithampur, but significant portions which are the earlier approvals which are from Roha.
- Dheeresh Pathak:** Can you also call out 2 or 3 large products in the US for you?
- Rakesh Parikh:** We will take this question offline.
- Dheeresh Pathak:** Any interesting launches that you can highlight for this or next year in US?
- Rakesh Parikh:** Basically we are having filings in areas of CNS and Pain Management and some of the products like generic equivalent of Namenda are there. But all depends on approvals. As I mentioned we are still in that leg of Para-3 filings. But what we feel is that compared to the current pricing prevailing in US, if we get the approvals of these products for us it should be reasonably good and it will only add to our profitability.
- Moderator:** Thank you. The next question is from the line of Viraj Kacharia from Securities Investment Management. Please go ahead.
- Viraj Kacharia:** I had a question on Losar. We are seeing some positive volume growth in this segment for last couple of months. So how much of this is sustainable and what is the road map for this particular segment of us going forward?
- B.S. Dhingra:** If I tell you exact numbers in last year in the similar period we had de-growth while in this quarter we have good growth on Losar. That is already into double digit. As I already shared



with you all that we have a very robust plan to scale this form, because it is a face of Unichem. So we are taking it down to the family physicians from specialists and the acceptance with the family physician vis-à-vis other available molecule is better. And I am confident that the future for Losar is going to be much brighter than what it is today.

Viraj Kacharia:

On the employee cost, you highlighted that we did add a lot of MRs and that is one of the reasons why we had seen a spurt in the employee cost. So what is the plan going forward – are you looking to further expand the team or the kind of a 10% growth which you have seen, just give us some color on that, that will be helpful?

B.S. Dhingra:

If you recall I had mentioned for next 2 to 3-years there is no need of manpower addition in Domestic business. Because in last two years we have done a proper rationalization, we have created a proper therapy focus divisions and now we have adequate number of people sufficient to handle this portfolio. #2, if you look at last year we have done a manpower rationalization. We had two divisions which we were expanding on pan India basis, CVstar division which is working on Unistar and all, those kind of products which were only launched into south and west, then last quarter we have expanded that into North and East.

Similarly, we have Neuropsychiatry divisions which were only into two zones, we have expanded it to another zones, so making it all-India vertical. So now all vertical put together the manpower rationalization has yielded a manpower reduction of almost 100 CBAs. Therefore the incremental productivity is showing a robust growth. So the productivity is growing because of manpower rationalization and also because of the therapy focus created by the proper rationalization.

Viraj Kacharia:

I ask this because despite the rationalization we have seen almost 10% growth in the employee expenses. So wanted to get a sense, how much of this, what is ...?

B.S. Dhingra:

Employee expenses may be a provision for this year increment what we have to give to employees. It is not because of additional manpower, because if you remember in last year we had an additional manpower cost to the tune of Rs.18 crores, and before last year also additional manpower cost, but this year we have taken a conscious decision that whatsoever manpower we are brought in, that is sufficient to handle the current therapeutic basket what we are promoting. And in 11 divisions what we have in domestic are sufficient enough to try the type of growth what we look into Domestic business.

Viraj Kacharia:

On the profitability for US, please correct me if I am wrong when understanding, our thought process is that it will take a bit more time in achieving relatively high profitability, because we had been drifting from almost \$0.6 million to \$0.1 million in last two to three years. So given the kind of R&D investments we are doing, it will take a bit more time for it to contribute meaningfully to the bottom line, is that understanding right?

Rakesh Parikh:

The R&D expenditure is for the future, and we are writing it of now in the standalone company. That is why what you are saying is right, that you do require a scale. We do not



expect the R&D expenditure per se to significantly increase. Top line is increasing, as a result of which US from losses already come into profit at the subsidiary level at the operating level, pre-R&D basis. Going further we will be able to recover more and more R&D cost, in fact, we are aiming to see that even by the end of the year can come to a stage whereby at a point we can recover most of the R&D expenditure.

Viraj Kacharia:

So the kind of \$0.6 million we used to do, at least that can be sustained?

Rakesh Parikh:

What happens is the \$0.6 million what you are talking is at the subsidiary level, it depends on transfer pricing, I think it is more like a marketing or a distribution arm which typically will have a single digit profitability..

Viraj Kacharia:

Yes, but even at the subsidiary level is it something that can be maintained because we have seen good traction in US?

Rakesh Parikh:

In fact that is what we are trying to improve. If they are able to control their cost, earlier as I mentioned, everything was outsourced, so as the volumes improve we can get a better rate for the outsourcing per unit rate as well as we can see whether some things can be taken in-house.

Moderator:

Thank you. The next question is from the line of Shyam Sunder from CIL Securities. Please go ahead.

Shyam Sunder:

My question was predominantly with regard to the UK subsidiary Niche and the issue with the European Commission which you have had last year. Are there any financial liabilities which have been already earmarked or already accrued that is what I wanted to know?

Rakesh Parikh:

We have pointed out in the Annual Report that the company is vehemently denying as far as the case is concerned and we have resorted to a legal recourse which has already been written to the EU, in other words, we have already filed an appeal and as far as a costs are concerned there are two ways; one is the legal cost in EU for the European lawyers and all are quite high and as and when they are provided for. So indirectly it affects the management time especially of our UK subsidiary people who have also to focus and concentrate on this. I think that there is no other earmarking that has what has been done.

Shyam Sunder:

Nothing has been provisioned as yet?

Rakesh Parikh:

No, the provision for fine has not been done.

Shyam Sunder:

Only the legal cost and all that has already written off?

Rakesh Parikh:

Legal, traveling, some admin cost, have been written off.

Shyam Sunder:

What kind of CAPEX programs are lined up including I think I believe you have a lot of maintenance CAPEX goes into the R&D space?



Rakesh Parikh: In our case since our facilities are relatively newer and we continuously keep on upgrading and modernizing them, the maintenance CAPEX is much at a lower key.

Shyam Sunder: What kind of figures are there sir?

Rakesh Parikh: I will give you a broader perspective; we are talking of almost about Rs.300 crores of CAPEX, spent about Rs.75-odd-crores in March '15, about Rs.150 crores in the current year or so and the balance in the 3rd year, this is which will be spread over, the Goa expansion and the API one what I pointed out earlier.

Shyam Sunder: Regarding the product pipeline sir for the Domestic markets do you have some of the exciting products lined up for this year?

B.S. Dhingra: The Domestic market is more or a “me too” market, so in last 2-years we have brought some products to plug the gaps within the therapy across 11 divisions. We are working for some of the products in Derma and Infertility, also we are working with some MNCs to see that how we can bring some new products and enhance our OAD market because that is another segment which is a very buoyant where we are not present. Of the new molecule and new therapy coming in like DPP-IV inhibitors, where as a company we are not doing well, can we address that area more quickly and see that we start doing better there also. But the domestic business has started doing better in terms of growth and productivity.

Shyam Sunder: Regarding the domestic product, there was an earlier perception I believe about Unichem being a leading player in the Anti-Tuberculosis space but is it not the case now because none of the products seem to be there in the top-10 that you have listed in your presentation?

B.S. Dhingra: What happens that every decision sometime is not a right decision or a wrong decision, I think Unichem has taken a right decision to withdraw anti-TB products some 12 years back because today Anti-TB products are in NLEM, a company like Lupin or McLeod which are 1st and 2nd in that segment are also bleeding. I know what the anti-TB market is because after WHO coming in the picture, a lot of DOT program coming in, anti-TB is nowhere anybody is footing.

Shyam Sunder: The reform processes of the world are not...?

B.S. Dhingra: That time management took a decision for anti-TB and enter into some other segments. What we are trying is to drive the future growth from our Chronic segment. Within Chronic we are looking at Hypertensive, Oral Anti-Diabetic drugs, CNS drugs and Derma and Cosmetology and Infertility in young ones. So these are the six therapies per se where we have a visual focus and we are trying to rope in some good molecules either through in-licensing or through 3rd parties within India and see that how we can be first few to launch those molecules and products to create that momentum for which all of you are waiting, including us.



Shyam Sunder: This general perception that lifestyle medicines have a lot of margins also I guess is that right sir?

B.S. Dhingra: Margins are high and then there is a continuity of prescription, a life style product, hypertension product being written to the patient, generally patient continues to take it for 3-months, 6-months for a year it does not change that. So lifestyle drugs even in Cosmetology if you see once the product has been written, the patient continues with it and that product goes through OTX, demand it from over-the-counter.

Shyam Sunder: Losar, for example, with the Rs. 16-17 crores kind of turnover does it figure in the top-50 of the ORG?

B.S. Dhingra: Losar as of now does not figure into top-50, yes, it is a product into top-300 and Losar is a face of Unichem and therefore we have dedicated a division to it with manned by over 300 people.

Shyam Sunder: It is not a single therapeutic group?

B.S. Dhingra: Losar, Trika and TG Tor, which are NLEM products, are in one vertical, we have taken them to the bottom of pyramid so that we have a larger prescriber base and thus creating more volumes and values in coming years.

Moderator: Thank you. The next question from line of Ravi Mehta from Deep Financial. Please go ahead.

Ravi Mehta: In this quarter so can you just guide what could be the effective tax rate?

Rakesh Parikh: Compared to last year the tax rate has gone up, now this includes two components, current where the company still continues under MAT because of the fiscal incentives. In addition to that the deferred tax also adds to the tax charge and considering the fact that we may capitalize plants like Goa and Pithampur expansion expected to be completed during the current year the provision for deferred tax has resulted higher. As you are aware in the budget the MAT was also raised because of increase in surcharge. So this put together the rate which we were earlier guiding at around 23-24% has now come to almost about 25-26%.

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

Sapna Jhawar: In your Annual Report it mentions that certain part of your R&D expenses go towards Biosimilars. Could you just highlight some more details about what kind of Biosimilars are we working on and what are the percentage of the entire R&D expense that goes towards it?

Rakesh Parikh: As you are aware, Bio is an upcoming field, so company also decided to go into it. And without going into too much of the details based on certain leads which we had when we were doing collaborative projects, we decided to put up an R&D center, and that R&D center has come up at Goa, it is approved by the Department of Science and Technology, and we are typically working on recombinant proteins and mono-antyclonal bodies but of the non-cancer



type. So these are the products which we are working. And as a part of the overall R&D it is significantly less may be around 10 to 15% of the total R&D cost would be devoted to Biosimilar.

Sapna Jhawar: So could you update about the stage of these products as in and in which geographies are we looking to launch these products if and may when?

Rakesh Parikh: It becomes totally a different route. At this stage it would be a relatively difficult to comment on the geographies. But the overall plan is what once you have certain positive results which can show a kind of a proof-of-concept then we will be discussing out and we will decide more strategies because the manufacturing, distribution would depend on how to do it and various options are there which we will be exploring it at that time. Right now first we are focusing to see that we have certain leads which can be further developed.

Sapna Jhawar: My second question pertains to a Brazilian subsidiary. Now the past 5-years we have not seen any significant improvement in terms of revenues or any kind of product launches, I think the last we did some pilot testing in those markets. So what our strategy going ahead in Brazil now?

Rakesh Parikh: Currently, only two approved products have been launched. So based on the feedback we have developed reasonable inputs as far as the market is concerned, but unless more products come in it will be difficult to ramp up because with two products it becomes difficult to even sell or even tie-up with some distributor.

Sapna Jhawar: But we understand that we have about 16-odd filings in that geography and we were focusing on certain 8-10 products out there. So have we not received any approvals for them or are we not marketing them?

Rakesh Parikh: What has happened is one product we are not marketing because of cost/profit. And it is a question of approvals and out of the filings five products have come very close to approval. So hopefully in this financial year we will get few approvals and once we have a basket of five to eight products, then it can be meaningful.

Sapna Jhawar: So when do we expect to breakeven because we have been time and again mentioning that we would break even once we receive the approval so this year would be the most probably year?

Rakesh Parikh: Breakeven will not be possible because after 4-months now there are no additional approvals which have come. So there is no point in saying breakeven, but let us say that if we get another 3-4 approvals during this financial year then we can aim to come close to breakeven next year. It would require at least 5 to 7 products in our opinion to break the kind of filings which we have done.

Sapna Jhawar: Now when I see our sales mix with India getting to 63% and then the balance by exports, where are we currently focusing to ourselves in terms of positioning, would we still continue to



be as an India-centric company with some focus on exports or is our target to be there and increase our exports business entirely, so just wanted to understand the company's ideology of how they want to position themselves in these markets?

B.S. Dhingra:

If you look at various Indian Pharma companies they have smaller Domestic business and are aggressively pursuing their expansion into international business. Hence, it should not be a different in mind set for us, in other words what I am saying is that we will have a focus especially into Domestic business which we can definitely consolidate and grow from here much better than what we have done in past, and second, we can also aggressively pursue our US strategy.

Sapna Jhawar:

So, are we looking on for more JVs or in terms to go ahead the expansion in either of the markets be it the US or Europe or Brazil, would that help us to ramp up these geographies much faster?

Rakesh Parikh:

There is no proposal for a JV at a reasonably advanced stage or so. That could be one of the options but right now the model which we have set is where we are having tie-ups with the distributors in the international markets.

Sapna Jhawar:

I am sure with the kind of cash flows that we make we would be able to do so, but do we have set any internal target of the kind of operating cash flows that we need to set into get in that consistent (+15%) sales growth momentum on a Y-o-Y basis?

B.S. Dhingra:

For all business of Unichem, you are talking including Domestic and International?

Sapna Jhawar:

Yes consolidated.

Rakesh Parikh:

I think with the current resources also, it can be possible as what we have explained.

Moderator:

Thank you. Ladies and Gentlemen, we have the last question from the line of Nitin Gosar from Religare Invesco. Please go ahead.

Nitin Gosar:

Wanted to understand your gross margin trend if I were to look for last 15-odd-years have moved it from 50% to 60%... maybe hovering around 62% as of today, but what are you doing to take it sustainably upwards of 65% in medium to long range?

Rakesh Parikh:

That would clearly depend upon the product mix. What happens is that in International business when you have things like contractual business, obviously the gross margin would come less, similarly, in the India business also it depends on the ratio of the Acute to Chronic. Chronic generally has a higher margin especially if it is not in NLEM, same is the case with API. So it is very difficult to predict, but generally as you have rightly said between 60% to 62% remains and may be in medium to long term we will see that whether we can have more profitable products to further increase our gross margin upwards of 65% as you have said.



Nitin Gosar: Let me put it again this question; over a period of say next 2 to 3-year, are you looking an EBITDA margin coming in through gross margin expansion or largely because of operating leverage because you are already sitting on a lot of expenses but the revenues are not flowing through?

Rakesh Parikh: My opinion having incurred all those expenses, because it will be the leverage out of those expenses which will be able to drive the increase in the operating margin, like for example, if you take the India business, the manpower, the divisionalization, the realignment which we have done, has been a major cost which we have written off over 1 or 2-years and slowly now we are seeing the results which it is coming which is being reflected in the gross margin as well as in the EBITDA.

Whereas in the International business also it is similar, primarily the R&D and the regulatory and the manufacturing costs we have incurred and all these are in the other expenses. So once they are able to get as they say like more bang out of the buck, then definitely our margins will improve more than what the gross contribution can contribute. For gross margins to improve, you have to basically have a significant large specialized kind of a product or a one-off opportunity.

Nitin Gosar: And on US front I believe that this 50 filings that we talked about which will be largely plain vanilla, post that we would be working on some kind of Complex Formulations or something, can you throw any perspective about your future pipeline or future R&D investments that you may be working upon?

Rakesh Parikh: Now we have consolidated R&D at a new center at Goa which is now operational for more than a year plus so they are completing the old lot of filing which we have set and they have already started working on. At this stage I do not think we can share or talk much on that, but as time goes by we will see what can be shared.

Nitin Gosar: And we mentioned that there was some one-time cost with regard to R&D last year. Is there any number that you can share upon or was that a part of base and rectification of that base has happened and it will continue to remain part of your base?

Rakesh Parikh: It was not R&D cost, it was more from the regulatory side, plants and the selling, and distribution cost for our International business. We wanted to get our plants in line with the latest requirements of the US FDA and gear them for inspections not only from US but other regulated markets and all that. So for which there happened to be a bunching in particularly for that one quarter and partly in the other quarter. As a result of that the other expenses figure was high.

Nitin Gosar: So if I were to normalize the event then what is the excesses that you paid off in FY-'15 with regard to this...?



- Rakesh Parikh:** What you see in the first quarter this year would perhaps be the norm though we work towards improving further, but it would be the kind of the current norm going forward.
- Nitin Gosar:** So that is basically now part and parcel of our business model, it should not come off from the number that it has taken off?
- Rakesh Parikh:** In terms of absolute number it may not come because of inflation and the higher turnover that will get compensated in the EBITDA.
- Nitin Gosar:** And sir, we mentioned about 6 therapies in domestic market that will be the future focus. Can you repeat those 6 therapies?
- B.S. Dhingra:** Anti-Hypertensive, Oral, Anti-Diabetic Drugs, then I have talked about CNS, Derma and Medical Infertility. So these are the markets which are showing a good growth... even Gastroenterology which is showing a good growth, we are there in Unienzyme. So we are also looking at how we improve on Gastroenterology, we are doing some kind of work there and hopefully in the coming quarters we will be able to post better number there.
- Nitin Gosar:** With regard to US operation we would be roughly doing around say \$25 million in FY-'15. FY-'16 possibly we could be hitting around \$35 million. Would that be the area when we will start reporting positive EBITDA post R&D expenditure or it has to be reasonably upwards of \$50 million to report positive EBITDA post-R&D expenditure?
- Rakesh Parikh:** That clearly depends on the product mix. So even at lower than that it is possible and depending on which products we are able to do well was what would determine that.
- Nitin Gosar:** As of today the kind of product mix that we are having, what is your sense, which number should be the ...?
- Rakesh Parikh:** In between the two.
- Moderator:** Thank you. As there are no further questions, I would now like to hand the floor over to Jigar Kamdar for closing comments. Thank you and over to you sir.
- Jigar Kamdar:** Thanks to the whole team of the Unichem Laboratories Ltd., we are extremely thankful for your time and for discussing facts about the company, and thanks to all the participants.
- Moderator:** Thank you. Ladies and Gentlemen, on behalf of Systematix Shares and Stock Brokers that concludes this conference call. Thank you for joining us and you may now disconnect your lines.