"IPCA Laboratories
Q2 FY2019 Earnings Conference Call"

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ANALYST: **MR. NITIN AGARWAL - IDFC SECURITIES LIMITED**

MANAGEMENT: **MR. A. K. JAIN - JOINT MANAGING DIRECTOR - IPCA LABORATORIES LIMITED**
MR. HARISH KAMATH - CORPORATE COUNSEL - IPCA LABORATORIES LIMITED

Moderator: Ladies and gentlemen good day and welcome to the IPCA Laboratories Q2 FY2019 Earnings Conference Call hosted by IDFC Securities Limited. As a reminder all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call please signal an operator by pressing "*" and then "0" on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Nitin Agarwal from IDFC Securities Limited. Thank you and over to you Mr. Agarwal!

Nitin Agarwal: Thanks Karuna. Good morning everyone and a very warm welcome to IPCA Labs Q2 FY2019 post results earnings call hosted by IDFC Securities Limited. On the call today, we have representing IPCA management, Mr. A.K. Jain, Joint Managing Director and Mr. Harish Kamath, Corporate Counsel. I hand over the call to the IPCA management team to take it forward. Please go ahead Sir!

A.K. Jain: Good morning everyone. Welcome for the second quarter conference call. For the quarter, the business has been in excess of Rs.1000 Crores at Rs.1012 Crores as against Rs.875 Crores which we had in last financial year, so there is a growth of around 16% on that. Exports have moved by around 22% in this quarter. Currency has also helped in that. And the EBITDA before forex loss is around Rs.217 Crores as against Rs.165 Crores, which we had in same quarter last year. In this quarter, we have mark-to-market loss on foreign currency of around Rs.31 Crores as against a loss in the last financial year in the same quarter of around Rs.5 Crores. And overall, the profit before tax is Rs.120 Crores as against Rs.96 Crores in the last financial year.

For the first half of the current financial year, if you look at overall income has gone up by 18% at around Rs.1879 Crores. And overall EBITDA for the first half is Rs.370 Crores as against Rs.188 Crores, which we had in last year. Overall net profits is Rs.185 Crores as against Rs.76 Crores. Last year was impacted because of the GST implementation in the country. And overall EBITDA margin for the first half of the current financial year is 19.66% as against 11.8% that we had in first half in last year.

If you look at again the breakup for the sales for the second quarter of the current financial year, the domestic branded business has grown to around Rs.469 Crores as against Rs.425 Crores, which we had in last year. Last year, the second quarter number was a little better because of the GST implementations and there was inventory destocking in the month of June, so July business was better. This business has gone up by around 10% in the current financial year.

API domestic business is around Rs.52 Crores as against Rs.48 Crores in last financial year. There is a growth of around 7% in that. API international export business is Rs.174 Crores as against Rs.146 Crores. So exports API business has grown by around 19% in the second quarter. So overall, if you look at the numbers for the quarter, the overall domestic business is around of Rs.520 Crores as against Rs.473 Crores. So there is a growth of around 10% in domestic business in this quarter. Export business in this quarter is Rs.462 Crores as against Rs.380 Crores in last financial year, so there is a growth of around 22%. And overall, the sales is Rs.998 Crores as against Rs.865 Crores in last financial year. And including the other income and overall total income is around Rs.1012 Crores as against Rs.875 Crores in last financial year. Having given the basic numbers, now I will request participants to ask questions.

Moderator: Thank you very much Sir. Ladies and gentlemen we will now begin the question and answer session. The first question is from the line of Saion Mukherjee from Nomura. Please go ahead.

Saion Mukherjee: Thanks for taking my question. Sir, my question is around - first is on the gross margin. The material cost to sales seems to have come down quite low. I was wondering because of all the inflationary pressures on the raw material side that we are seeing. What are the reasons for this improvement?

A.K. Jain: Overall we look at the numbers, material cost to sales - in this quarter is around 31% as against 33.7% in last year same quarter. So close to around 2.7% improvement. And if we look at the overall first half number, the material cost is around 31.5% as against 35.3%, so reduction almost of 3.8%. There is a continuous improvement is there in the overall material cost to the sales ratio and to that extent, your gross margins has improved. The improvement in gross margins had by and large, because of the product mix changes which have happened. Let us say in domestic business antimalarials are practically flat and some of the antimalarials, we are losing money and other antimalarials, we have the low margins. So therefore, the business growth has happened in the other therapies we have the margins are far better. Like such therapies in the first half of the current financial year has grown almost by around 27%. Our cardiovasculars has grown by around 17%, 18% and our antibacterial therapy has grown by around 38%. My dermatology has grown by around 36%. Neurology has grown by around 40%. So we have significant growth in some of the key therapies and, there the margin levels are better. So that has helped and overall malaria, as a percentage to domestic sales in first half is around 8% of the sales. So it is significantly down compared to what used to be earlier. And overall for the year, it will further go down because in the second half, malaria sales are hardly any, not much. So overall, as a pie, malaria is on decline. Even though, we are able to maintain or increase the market share in malaria. So that is one thing which has helped. Overall, let us say, European basket earlier businesses say - 90% of business used to be in the U.K. and balance 10% was Europe. Now European businesses are on increase and that is almost around 40% of the overall EU business other than U.K and overall, margin levels they are far better compared to maybe double compared to the U.K. business. So that is also helping us. Then similar way, all other generic markets like Australia, New Zealand or South Africa or Canada, all these businesses are increasing where the margin profiles are far better than we used to get in U.K. So that is also helping in the overall margin improvement. And third is basically, because API businesses are going up, so there is a higher capacity utilization of API. And that is also helping in overall recovery of overheads. And also, we have been aggressive in raising prices on some other product. Even though, we still have some contracts of lower prices supply. But overall, going forward, we see further improvement in margins on the API side. So in spite of the significant increases in the RM prices, we have tried to pass on those prices to the consumers. And where the opportunities were there, we have been a little more aggressive in raising the prices. And that has overall helped in improving the overall margins in the quarter, and it is going to be there in the time ahead.

Saion Mukherjee: Sir, the second question, just on the other expenses, I find it a little bit higher in the quarter. Is there any reason, any penalties or any specific expenses?

A.K. Jain: If you go into the other expenses side, if you look at the first half of the year, the manufacturing other expenses, excluding foreign currency exchange loss, has gone up by around 8%. And if you have excluded the currency fluctuations, which in the first half is around Rs.55 Crores. So if you exclude that, then overall expenditure rises is just 8%. This quarter number, the other expenses has moved up from Rs.228 Crores to Rs.277 Crores, around 21% growth is higher. It is largely because of - whatever additional data which U.S. FDA has asked us in respect of one plant. We have also moved to do same data for all the three plants, so that process is going on. So in this quarter, we have incurred almost close to Rs.25 Crores on this remediation cost practically on data verification. So two plants are completed, third plant is still going on, so there will be some more cost is going to be there in the third quarter of the current financial year. So that has moved overall the other expenses. And second is we do not have currently the U.S. business. So whatever this generic NDA maintenance fees was required to be paid, on prudence basis, we have expensed it out in the current quarter instead of taking into - on the period cost basis to all the four quarters of the current financial year. So that has also increased the overall other expenditure by around Rs.6 Crores. So that these are the two main reasons on which other expenses has increased. I don't foresee plus, if you look at because the currency movement is also there. So like say in this quarter, my fuel cost has moved up by 27% on manufacturing cost side. So these are the basic reasons. And second is, let us say, all overseas offices remittance, it is going at higher rates. So that has moved little expenses. But by and large, first half, expenses are in line, and we do not foresee that except for this kind of exceptional things. This is not much of concern to us currently.

Saion Mukherjee: Okay. Thanks a lot and I will join back.

Moderator: Thank you. The next question is from the line of Dimple Dharmawat from Aurum Capital. Please go ahead.

Niteen Dharmawat: What is the current situation in Chinese chemical industry and pricing of raw materials? Has it improved?

A.K. Jain: Let us say prices has moved on two accounts, one is petroleum which was moving up, so prices were definitely moving significantly higher, as all the solvent, industrial chemicals. And everywhere prices, there was a significant movement in the prices. Second reason was relating to China that because of pollution issues, government was aggressive in closing down the plants, and that has also resulted in the shortages and prices had moved up. But currently, we are observing that there is a little ease in supply side. But the prices are not coming down. And prices are also not moving up significantly, so there is some kind of relief is there on that account.

Niteen Dharmawat: Thanks a lot.

Moderator: Thank you. The next question is from the line of Rashmi Sancheti from Anand Rathi. Please go ahead.

Rashmi Sancheti: Thanks for the opportunity. Just want to understand on the two APIs where you have got exemption in October month on furosemide and chloroquine phosphate. Like what kind of contribution they can give for the entire year and whether we will be supplying only APIs or the formulation part also?

A.K. Jain: Let me say that we were really surprised that on these exemptions because we completely did not get any kind of letter from FDA. And it has come only when we looked at the website, then from website it appears that some exemption has been extended. So we have started working on it. It is too early because, let us say, I cannot produce the formulation so I can only sell API. And for some it is a large-volume product so we have to get - if at all we have to need to commercialize and we would have to get some manufacturers who can really offer very competitive rates because this is a low-value and high-volume kind of products. So we are working on it. There are a few proposals and that is ready. But it is too early to give you the numbers on that, what it will add. And currently, in my own guidelines for the current financial year, I will not be factoring anything on that. So whatever, if at all it comes, it will be extra.

Rashmi Sancheti: Okay. And how much would be the total remediation cost for the entire year? You just mentioned the Rs.25 Crores we have expensed this particular quarter only. So any guidance on for the entire year?

A.K. Jain: First quarter that number was around Rs.6 to Rs.6.5 Crores, and this quarter its is around Rs.25 Crores. Practically, maybe around in the rest of the next six months, the figure can be around another Rs.30 Crores to Rs.35 Crores.

Rashmi Sancheti: Okay. And in FY2020?

A.K. Jain: That will significantly reduce because then there is all - by that time, the overall number may be around Rs.5 Crores to Rs.7 Crores for the whole of the year in respect of certain consultants who are more on the trainings and updating us on the future thinking of FDAs and other issues. But not on - most of these costs are relating to past data verification of past six years.

Rashmi Sancheti: Okay. Thank you. That is it from my side.

Moderator: Thank you. The next question is from the line of Prakash Agarwal from Axis Capital. Please go ahead.

Prakash Agarwal: Thanks for the opportunity. Just taking U.S. forward, so apart from this remediation work that you have been asked to do, what is the current status across facilities? When do we see the resolution taking place?

A.K. Jain: We are also waiting for that to happen any time. But let us say it is too difficult to comment on, say, what the regulators are - but I could say that, yes, so all the three plants we have given the letter to FDA and then subsequently for Piparia, it was the first plant where we have given letter to FDA on reinspection. They have gone through the thing and they have asked for some additional data. This additional data are submitted. Based on that, I think last five, six days back; we have received certain communication from FDA asking for some more clarifications. And those clarifications would be sent to them very shortly. As far as Pithampur plant is concerned, all the data are ready and they are under final drafting of the communications to FDA, so maybe it is only a matter of a few more days to reply to FDA. As far as Ratlam is concerned, the consultants, all these various consultants are sitting at Ratlam and they are reviewing the past data that progress is happening. Hopefully, by December end or maybe earliest by January 15, that work should also get completed completely, and we should be able to submit that also to FDA. So beyond that, it is too difficult to say that what and when FDA will respond and when they will come for inspection. So we are completing all the things from our side. And FDA has appreciated that, yes, you are all work relating to your GMP-related things and whatever reviews and CAPA that is completed that they have acknowledged. So beyond that, I cannot say anything as far as on the regulatory matters.

Prakash Agarwal: Thank you for this and on the institutional business, I do understand the growth is phenomenal on the low base. What we heard from some peers is that on the tender business, there are some funding issues by the global agencies. So what are we feeling on the ground and what is the outlook for this year and next year especially, I assume we have a DT approval also in that.

A.K. Jain: Let us say we have, at the beginning of the year since the Global Fund; things were getting cleared, so we have indeed taken some values on our projections on Global Fund. But it was not significant. Even though the Global Fund has cleared everything as far as supplies are concerned. But we are still hearing that Global Fund has not placed orders and hardly few and we have not received any orders so far. As far as we are concerned, we have made the projections of almost around Rs.180 Crores to Rs.190 Crores. Hopefully, we will surplus that, the overall product portfolio, and because most of our businesses are with the country tenders and other than Global Fund currently. So we are confident that looking at whatever businesses in hand, we should be able to complete the numbers whatever we have guided for in the current financial year. As far as next year is concerned, it is too early to talk about because by the time, hopefully, anything comes from Global Fund, that will be extra for us. So and we will continue to do well on other country tenders. So hopefully, we should be doing better because DT is also there and hopefully, we have also received the communication from WHO that the plant inspection, that process is completed. And it is approved now, injectables, that plant, that inspections and re-inspections of CAPA. That is all completed and that is approved now. So it is only per se some more time before that we get the pre-qualifications for injectables also. So hopefully, that will also add in next year. So we have not yet worked out the guidelines for next year on those kinds of numbers. But hopefully, things would be better than current financial years.

Prakash Agarwal: And how big are these opportunities, Sir, the DT and the injectable?

A.K. Jain: DT, we have started registering, and we have started getting some orders, but it has not build up so far in a big way. But definitely, it will add at least a good amount of business, it should add in next financial year because almost all the 30%, 40% kind of procurement happens on DT. So we will get our market share. So hopefully, that next year, DT will also add some additional business and injectables should also add additional business. In addition to that, I think whatever we get from Global Fund that also will be extra.

Prakash Agarwal: Okay, thank you Sir.

Moderator: Thank you. The next question is from the line of Anik Mitra from Stewart & Mackertich. Please go ahead.

Anik Mitra: Thanks for taking my question Sir. I just wanted to understand the impact of FDC ban. This is one. And if there is an impact, then what would be your corrective strategy? What are the corrective strategies you are planning?

A.K. Jain: As far as FDC ban is concerned, we have zero impact on us because whatever steps are required to be taken that was taken in last financial year itself and these were announced. So there is hardly any impact. Hardly, practically nothing worked except one product where we were hoping, we have done the clinical trial in the countries, multicentric clinical trials. And the product was approved by the DCGI. And that product came in banned list subsequently. So that we are challenged because there is no reason, even all the pharmacovigilance data has been submitted. So after approval, if the pharmacovigilance data is also not showing any kind of adverse reactions and other and we have never defaulted on those kinds of compliances since the date of approval. So that matter is there in Delhi High Court. And hopefully, if we get that, we will be there. But that product was around Rs.10 Crores. So it is not very insignificant compared to the overall, other than that, all measures were taken earlier. We are also hearing that government is again talking of almost around many, many, many more products under FDC. But in my product list, there is hardly anything which does not have those kinds of approvals currently. So I do not think we have any risk on that account, currently.

Anik Mitra: Okay Sir. One, another thing. During last concall, you told that like there is a chance of filing for some hormonal products in U.S., if I am not wrong.

A.K. Jain: I am hesitant about the U.S. because U.S. currently my facility is not approved, not inspected. So it is not about U.S. By and large, let us say, these businesses were for the WHO and other markets. So we have filed one product to WHO. Second product, we have just started bioequivalent studies and others in pipeline. So hopefully, the pipeline building will take one, 1.5 years in the approval time. So there are still some more time before we can restart, not restart, start the business on hormone formulations. The formulation side is ready. The API side is also ready. Both the things are ready but currently, we are incurring cost and that is debited to P&L account and the business, this will take maybe two years' time before we could start recovering the cost and also start making money.

Anik Mitra: Okay. Sir, you had an impact of some - you had some machinery issues in U.K. business like in the last quarter. How the U.K. business was this quarter and how are you looking ahead?

A.K. Jain: U.K., we have a subsidy company. And that company is doing very well. It is in the cramps business. And it is a small operation. I hope we will be able to do around $7 million worth of business there and very reasonable margins are there, very good margins are there on that business. So that is about the U.K. operations. You may be talking about the formulation business from India to U.K. So more than an issue with us, that is the issue with one of our distributor which is a major distributor. So major business come from him. And there is the problem with his QP and U.K. MHRA has raised issues on his QP and therefore, he is not able to test the product even though and some of the product he has outsourced to some other QP. That is a very, very long process. So some product sales has already started but their own QP has not been qualified but we are hearing from that distributor that I think next month there will be inspections and hopefully, it will get resolved. And we will be able to do some kind of faster, again, turnout to the U.K. business.

Anik Mitra: Okay. Sir, fine. That is all from my side.

Moderator: Thank you. That next question is from the line of Ashish Thavkar from Motilal Oswal Asset Management. Please go ahead.

Ashish Thavkar: Sir, could you help us understand your mAb investments in terms of what kind of capex are you planning to do and what are your R&D commitments and the target markets as well?

A.K. Jain: As far as mAb concerned, I think it is only the revenue expenditure on R&D currently we have. We have so far not incurred, on R&D, we have spent close to around Rs.50 Crores of capex in Mumbai. So that is the major cost and then the revenue cost is currently being incurred on product development. We are also tied up with one company in U.S. for certain technology transfers. And overall, I think those costs may be around Rs.25 Crores, Rs.30 Crores. So that is what the overall cost so far we have incurred. We are contemplating to put in a mAb plant and that location which we have finalized is Baroda. But currently, because of some - its location is Baroda in Padra. So there are certain issues in as far as the environmental clearance is concerned, because of even those the mAb does not have any kind of pollution. But Padra policy is under review by Gujarat government, so it is taking some more time, may take around three, four months' time before we get a clearance to start investment there. And overall investment may take around 1.5 years and maybe around Rs.150 Crores.

Ashish Thavkar: Okay, the total investments including the facility?

A.K. Jain: But probably, there will be hardly any expenditure in current financial year.

Ashish Thavkar: Okay. So whatever currently we are, everything is getting expensed now?

A.K. Jain: Everything is expensed. We do not capitalize except the R&D capex is there in the balance sheet, yes. But other than that, revenue expenditure we do not capitalize.

Ashish Thavkar: Okay. And what are the target markets for us?

A.K. Jain: The target market is going to be firstly India and ROW. Then we will think of various others because clinical cost is expensive. So we will take a call thereafter once the facility are ready and we do some - and most products are relating to RA where we have a significant market share in country. So we will like to add good businesses on RA also every molecule in RA we have leadership and RA biologicals also we want to be a serious player.

Ashish Thavkar: Thanks. Next question is on U.S. So apart from two API exemptions that we have got, is there anything on the U.S. API side that you plan to monetize in the coming financial year?

A.K. Jain: Unless we have approval, nothing can be done. So currently, there is nothing in pipeline. But certain small DMFs what we have small product and high-value products, small-volume and high-value; we are in a process of transferring those technology to the new site which we have taken in the U.S., Pisgah. But that is a long process, it takes 6 to 8 months' time before the technology transfer, method transfers and all that, the validations and establishment and all those kind of thing and stability. So hopefully, something will start happening from early next year.

Ashish Thavkar: But supposing the clearance from FDA is sort, then in that case, you need not do a tech transfer, right?

A.K. Jain: No, these are the very niche molecule, very small volumes and if you produce these APIs in U.S., probably we will also be able to get some businesses on, the formulations also from the various government institutions. So we will still like the very high-value and low-volume products, certain products we will like to transfer because that will give us much better advantage. So but not too many APIs and not high-volumes API, fewer APIs out of our basket.

Ashish Thavkar: So you will be transferring these APIs to partner site or...

A.K. Jain: No, our own site because we have bought the company called Pisgah there at that site, yes.

Ashish Thavkar: Okay. Sir, last question on this injectable tenders. Like if you could help us understand what is the market opportunity in terms of number of players and...

A.K. Jain: Currently, there is only one player, which has originated from China. There is no other player. And we do not know who are else is there in pipeline. But we certainly are there and plant is approved. And overall, it can give around maybe we can do business of almost maybe around 6 to 7 million of the vials of that and the pricing could – it is difficult to talk currently. But there are good pricing are there and, hopefully, it should be a profitable business for us.

Ashish Thavkar: Okay, great. Thanks Sir and all the best.

Moderator: Thank you. The next question is from the line of Damayanti Kerai from HSBC. Please go ahead.

Damayanti Kerai: Thank you for the opportunity. Sir, we are seeing a decline in branded promotional sales during the quarter. So how should we look at that part of the business? And what is happening there?

A.K. Jain: Overall, for the year, we will see around 10% kind of growth in branded promotion. But the issue is, by and large, relating to Russian currency that ruble movement has been very sharp. Again, the oil price has come down. So probably ruble has depreciated sharply. And because our distributors they had worked on certain fixed margins, so whenever these kinds of things happen, we have to reduce the prices in dollar terms. Our billings are in dollars so that is impacting a little bit on that site. But overall, we are on track and overall I think for the whole of the year, we should have around 10% growth in overall branded promotion.

Damayanti Kerai: Okay. So apart from Russia, which are the key markets which we are targeting there?

A.K. Jain: We have businesses in Southeast Asia, Middle East, Africa, Latin America and the West Africa. So these are the major markets but major business is in CIS market. Let us say half of this business happens in CIS where the Russia is major. And therefore, anything happening there impacts us more.

Damayanti Kerai: Okay. And sir, earlier you talked about this issue with one of the key distributor in the U.K. So that is the only problem we are facing in the U.K. business, right?

A.K. Jain: Yes, we have no other problem. Whatever regulatory inspection has happened, I think our plants are cleared by MHRA. So we have no issue on regulatory front.

Damayanti Kerai: So say from next fiscal, we should be seeing good traction coming from the U.K. part also?

A.K. Jain: We are also eagerly waiting that our distributor's QP should get cleared because and QP transfer of technologies to other QP is taking very long time because every method has to be transferred by us to the new QP. And it is a very, very lengthy process of training and all the method transfers and establishing that, and that is taking long time. So if their QP gets qualified, then we can do much better business in U.K.

Damayanti Kerai: Okay, that is great Sir. And coming to the tender business, you mentioned you are not facing the funding issues which some of other players have indicated. But obviously like Global Fund, it will come whenever it has to. But on a country tender side, we are not seeing any problems from the funding side, right?

A.K. Jain: Country tender side, there are not much - there are no problems except wherever again, Global Fund is giving them money. So I think some moneys are released from Nigeria, but currently in Nigeria also we are not doing much of the business, so which is a bigger market. So these are more opportunity for us because once the Global Fund opens, there will be additional business. And once they start funding to Nigeria kind of country where there is a huge demand and Global Fund is giving them money. So that will further help in the business what we are currently doing. But our business is mostly the country tenders, and there, we have not faced problems.

Damayanti Kerai: Okay, Sir, lastly, just clarity on Ratlam. You said we are ready with all the required data and all and we should be able to submit whatever FDA asking by December-end or by January, right?

A.K. Jain: Yes. So let us say what I said that we have already submitted the request for inspection there. But based on the other plant where, whatever additional data FDA has asked in respect of my Piparia site, we are preparing for similar data for the Pithampur, which process is completed and Ratlam that process is going on which will complete by, let us say, December-end or even if there is a delay, maybe 10, 15 days here and there. So that is only the process which is going on. That is not asked by FDA, but voluntarily we are doing because similar data may be asked, so we want to proactively submit that data. So that data for Pithampur is completed. It is under review final – it is only a matter of a few days to go send those data. And as far as Ratlam is concerned, those data will take around 1.5 months from now. That is what I have said.

Damayanti Kerai: Okay Sir. Thank you very much.

Moderator: Thank you. The next question is from the line of Mehul Sheth from Phillip Capital. Please go ahead.

Mehul Sheth: Thank you for the opportunity. First question is on some clarification related to your remediation expenses. You have done something like Rs.6 Crores in Q1 and now Rs.25 Crores in Q2. And you are expecting around Rs.30 Crores, Rs.32 Crores in second half. So is this number right? I mean, is it correct?

A.K. Jain: Yes, these numbers are correct.

Mehul Sheth: Okay. And, Sir, on your capacity utilization it was like something like 55% and Mahad at around 50%. So are you seeing any kind of improvement in utilization level in this?

A.K. Jain: The API business has started moving. So capacity utilizations are building up now as far as API is concerned. But Ratlam is still, I would say, is around 60%, 65%, so we have still large amount of unutilized capacity there. As far as formulation plants are concerned, there are two plants which are there. One is Piparia and the other is Pithampur. Piparia capacity utilization may be around 10%, and Pithampur is around 30%. So that is what the current pain we have of these two formation plant, which are - we only build for the U.S. and the other markets, volumes not that large. So those capacities are underutilized currently. In addition to that, there are two Hormones one is API Hormones and API formulation, these two plants are also practically having very low level of utilizations because, right now, we are building up the process of product filings and all. So there are still pain for next two years as far as that is concerned, these two plants are also concerned.

Mehul Sheth: Sir, can you throw some light on your recent acquisition of Bayshore Pharma?

A.K. Jain: Bayshore is a company – it is a marketing company, and they have certain product approvals. They also have tie-ups with the other manufacturers to market their products. And over a longer period of time, we will also need net a front end, and that is a preparation for that.

Mehul Sheth: All right. Revenue contribution from this particular acquisition may be next couple of quarters' time?

A.K. Jain: It is a profitable company and just a beginner. The business was around, I think, $7 million last year and I think, over next three years, they should do around $25 million to $27 million on existing product portfolio what they currently have. That is what we are estimating. And it is a profitable business and it will also help us in, again, whatever production comes out from the approval process and once the plan gets clear. Some of the products then can start marketing through this outlet.

Mehul Sheth: Okay. Sir, one question on API business front. You have seen a significant strong growth in your export APIs. This mean largely related to a better volume demand as well as on pricing front. So how sustainable this pricing scenario is there in...

A.K. Jain: I think the API pricing is definitely on rise everywhere. These are also because of a lot of regulatory changes which are happening whereby all intermediate sites have to be approved and the API side has to be approved. And a lot of issues are relating to there in the Chinese supplies and others. So the Indian API and chemical sector, definitely, will have a good time to come in time to come, and we see good profitability building on API in time to come.

Moderator: We move to the next question from the line of Chirag Dagli from HDFC Asset Management. Please go ahead.

Chirag Dagli: Thank you for the opportunity. For the first half, 21% reported growth for the India business is very strong. What explains this? Is there some element of channel filling or inventory destocking by trade? And what is the GST-adjusted growth for the first half?

A.K. Jain: Let us say these numbers are after adjusting GST only, because there is no GST element in the sales now. In fact, if you look at last year's number, in the first quarter, there was an excise was added to the business. So that figure is around Rs.10 Crores. So, basically, Rs.10 Crores, then, probably, to that extent, basis, then that effect is to be gone, so growth will be little higher. But it is Rs.10 Crores, and it is too small a figure, so that is why we have not talked about that. So that is the number. Otherwise, the sales number does not include the GST. As far as the growth is concerned, definitely, the growth in the first half is higher. And largely, it is because of, let us say, the last year June sales was practically around 20, 25 days sales were disturbed, and therefore, channel filling was also there. But channel filling has not happened, only in the second quarter fully, because it has a progressive thing. So you will not see this kind of growth even in the third quarter. So overall, what we are looking is around domestic business growth in the current year maybe around 16% to 17% kind of growth so we are expecting for whole of the year as against that overall 21% growth what is there in the first half of the year.

Chirag Dagli: Okay, Sir. That is helpful, sir. Did you indicate that the mark-to-market on the forex loan is about Rs.32 Crores, Sir, for the quarter?

A.K. Jain: That is for the quarter. And overall, for the first half, it is around Rs.55 Crores.

Chirag Dagli: All of it is because of foreign exchange loan mark-to-market, Sir?

A.K. Jain: I would just give you the numbers. If you look at first half numbers, overall number is around Rs.55 Crores. Out of it, Rs.51 Crores is relating to mark-to-market on currency, mark-to-market plus actual loss. Rs.12.5 Crores is actual loss on whatever repayments which we have done and Rs.38.9 Crores is provided for in the book side of mark-to-market. So that is around Rs.51 Crores, so out of Rs.55 Crores, Rs.51 Crores is only account of loans. And on business transaction, it is around Rs.4 Crores. So that is overall.

Chirag Dagli: And similarly, for the second quarter?

A.K. Jain: First half, completely. If you look at the quarter number, it is around your own - loan transactions, it is around Rs.28 Crores and on your trade transaction, it is around Rs.2.5 Crores. So overall, it is around Rs.30.5 Crores.

Chirag Dagli: Okay. Understood Sir. And Sir, the ODT opportunity, is it still about $50 million, $60 million, it used to be in the past, or has there been some change in pricing? Or...

A.K. Jain: You are talking about the ODT now?

Chirag Dagli: Yes, Sir, the orally disintegrating tablets.

A.K. Jain: Yes, the prices have definitely gone down with more number of participants coming in. But, currently, we are not there let us say, we do not have any orders on Global Fund. All country tenders we are participating, and the prices are definitely has gone down. But we see that the Artemisinin trend is reversing, the prices are moving up. So in time to come, I think, next year, we may see a much more aggressive pricing from China on Artemisinin, and with that, even your treatment cost will move up.

Chirag Dagli: But the opportunity still remains about $50 million, $60 million, Sir?

A.K. Jain: No, that is overall opportunity. But...

Chirag Dagli: Correct. Of that, we will take some share?

A.K. Jain: Yes, we are working hard on that, how much materialize we will give the guidelines in time to come.

Chirag Dagli: But this Rs.190 Crores country-specific business that we probably do in FY2019, Sir, this number is a sustainable number, right?

A.K. Jain: Yes, this number is sustainable, and this we add on that because DT is just qualified and we have started working there, therefore we will qualify. So definitely, this business will move up.

Chirag Dagli: And Sir, what would be your comment on the margin profile of the malaria business over the last, say, two, three years? With pricing...

A.K. Jain: Let us say, our number, it has gone down - margins has gone by down by around 2%.

Chirag Dagli: That's it?

A.K. Jain: That's it.

Chirag Dagli: Despite this lower scale that we have?

A.K. Jain: Yes. We are backward integrated and every API we are producing also, that has not impacted much for us, here.

Chirag Dagli: So Sir, as we add this business, there has to be a nonlinear improvement in the margin for the malaria businesses, right?

A.K. Jain: Yes.

Chirag Dagli: That is a fair assessment here?

A.K. Jain: Yes, margin definitely will improve because, currently, the injectable plant is ready and I am incurring all costs and debited to P&L account. So not only your margins we will get, but also expense will also add to the margin and injectable plant, these expenses are substantial. So we will see good margins coming back.

Chirag Dagli: This is helpful, Sir. And just one last question, if I can, Sir. This run rate that we have seen in the second quarter for the non-institutional unbranded exports, this is a fairly sharp jump on the quarterly run rate. Is this run rate sort of sustainable or there is some quarterly lumpiness in this?

A.K. Jain: There could be some disturbance because, let us say, currently, we are also facing one disturbance because let us say, all the European countries from January 1st, products will have all the track and trace. So practically, every company is busy with upgrading the software and aligning it with the other software providers who can transfer the data to the European server. So that entire process is going on. And in this process, for every product, there is a stacking material changes there. Because where we ought to put that all these kind of numbers, print those numbers, then there is a change in outlook. So every product, there is outlook change that goes again to the regulatory process of approval from the parties and their regulatory and then process of linking our complete validations and all. So that process is currently going on. We have tested our technologies that is perfectly okay, but we are yet to test the technology of actual transfer from our site to the one U.S. service provider and from U.S. service provider to the European server. So there could be some glitches there. There could be some kind of - we are confident that we will be able to do a good job on that. But still there could be some delay on account of customers not giving in time their artworks and then procurement of materials. So some business disturbance may happen in the third quarter. But more or less, we are on track and all businesses are in line. And another issue is the U.K. when the volume increased, that is the issue. So it is difficult to say that when the distributor might will be able to qualify that. So these are two things are there, but otherwise, all business, like the Canada business is moving well; South Africa Australia business is moving well; Australia, New Zealand that is also moving well. And this businesses also, if you look at last year, we had in the first half almost around Rs.14 Crores worth of share of profit, which is not very currently because the U.S. business is nil. So if you remove that and work out, then growth is still better.

Chirag Dagli: Thank you so much. Best of luck.

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

Dheeresh Pathak: Thank you for the opportunity. Sir, in the institutional business, did you say we are only doing country tenders as of now? Which country is the largest?

A.K. Jain: I do not have right now the country data, but we have practically every country we are doing business. Wherever there, the demands are there, yes. Except Nigeria, where the business is very small, currently, which is a large market. So because there is more funding is from Global Fund. So that business is currently very, very small part.

Dheeresh Pathak: So without specific numbers, like is it skewed towards one or two large countries?

A.K. Jain: No, it is spread across, yes. Plus, also, we do good business with the USAIDs.

Dheeresh Pathak: Okay. So those countries, they funded through their own central and state government funds where you are participating?

A.K. Jain: Yes, those funding either by them or they may be taking bareback funding or some other their own funding. And some Global Fund also may be the some can country tenders they may be financing.

Dheeresh Pathak: Okay. Sir, what is the main reason behind this funding issue of Global Fund? Can you just explain like what happened this year, why the funding is right?

A.K. Jain: Basically, what we understand is more relating to Nigeria problems, because overall, let us say, utilization by Nigeria that has not been in line with whatever the Global Fund was expected to - Nigeria was expected to do as per their agreement. So it is largely relating to that and then donors questioning the overall things. So that is more - Nigeria is a very big market.

Dheeresh Pathak: Sorry, can you...

A.K. Jain: That is what we understand, so I cannot comment beyond that. But that is what we understand from our team.

Dheeresh Pathak: So what I understand is that it is not a funding issue; it is that because of some reasons, Nigeria is not getting funding from Global Fund?

A.K. Jain: Yes.

Dheeresh Pathak: And what is the reason that Nigeria is not getting funding from Global Fund?

A.K. Jain: That is what I explained. That it is basically they have not utilized the funds the way that Global Fund was expecting them to do as per their agreement.

Dheeresh Pathak: Is this a corruption issue? What is the issue?

A.K. Jain: This is what we understand from our team. But nothing official from somewhere it is only – that is our understanding, which is getting from the market.

Dheeresh Pathak: Okay. And Nigeria government does not have capabilities for their own funding. That is...

A.K. Jain: It is too difficult for me to reply that.

Dheeresh Pathak: Okay. Sir, on this branded generic business, Sir; can you just give a region-wise breakup like you have given in the earlier quarters? Rs.83 Crores of revenue.

A.K. Jain: We did around at Rs.38 Crores in CIS, Asia was around Rs.16 Crores, Middle East Africa was around Rs.12 Crores, Latin America was around Rs.11 Crores, and West Africa was around Rs.7 Crores. Overall, that is the number and then last year number, CIS was Rs.36 Crores, Southeast Asia was Rs.11 Crores, Middle East Africa was Rs.15 Crores, and LATAM was Rs.20 Crores. So LATAM is one where we have certain business loss was there and West Africa was around Rs.9 Crores for the quarter.

Dheeresh Pathak: Okay. Thank you Sir.

Moderator: Thank you. Next question is from the line of Charulata Gaidhani from Dalal & Broacha. Please go ahead.

Charulata Gaidhani: My first question pertains to the exports. Is there any opportunity that has been used from the Valsartan shortage?

A.K. Jain: Let us say, we have approval on Valsartan product in Europe. And yes, we cannot do any business right now, so that approval is very, very much in place. And our process is different, we does not have that kind of impurity with many manufacturers from China and the people who are buying those products from intermedia from China and producing in India they were having those kind of problem, we do not have that problem. But unfortunately, we did not have that kind of capacity for Valsartan. So right now, let us say what we are trying to do is we are feeding too many customers the Valsartan product than to do the regulatory filings based on our Valsartan, yes. And currently, let us say, our capacity is around two tonnes per month, which we are increasing it to around 10 tonnes. And that capex should get completed by may be January and/or early part of February. So, practically, nothing can happen there after the entire validations and all that process would happen. From next year onwards, we should be able to do around 8 to 10 tonnes kind of business, depending on how - what kind of approvals, the customers are able to get. So volume building will take certain time, but we have good prospects on that. Valsartan prices have moved up, cost has not moved up. Current selling prices are maybe around 3x of the earlier selling prices, so there is significant opportunities there. And hopefully, we should be able to do something on that the next financial year.

Charulata Gaidhani: Okay. So your current export number does not include any Valsartan sales?

A.K. Jain: It includes something, but not significant.

Charulata Gaidhani: Okay. Not like...

A.K. Jain: On that kind of capacity.

Charulata Gaidhani: Okay. Not like a one-off?

A.K. Jain: No, no, there is no one-off in that, yes. And similar problems are also there in other products like, say, Losartan is very big for us, but I think we are seeing the originators, I think, recalling some Losartan from U.S. market. Because similar issues are there in all these ten, but even that product, our process is different and we do not have those kinds of impurities. We do a large Valsartan, not Valsartan, Losartan exports. Losartan is one of our main products here.

Charulata Gaidhani: Okay. And secondly, I wanted to know the thought process behind the Bayshore acquisition. How do you plan to expand it or scale it up?

A.K. Jain: Bayshore, basically, we said that over a longer period of time, let's say once our agreements with - the marketing partners get over, we will have to build our own distribution network. So it is in relation to that, that yes, we were looking for an entity which we can acquire and then do our distributions and marketing in U.S. So Bayshore has been acquired in relation to that, so it is a preparation for our future U.S. business.

Charulata Gaidhani: Okay, fine. Thank you. All the best.

Moderator: Thank you. The next question is from the line of Surajit Pal from Prabhudas Lilladher. Please go ahead.

Surajit Pal: Good morning everyone. Sir, could you please tell me the exact geography, which country was the biggest for your quite good handsome growth in exports generic?

A.K. Jain: Let us say, currently, the bigger geography for us was Europe, and Europe business is currently is an issue because of the U.K. shipments are hardly any. We used to do almost around Rs.280 Crores kind of business in U.K. earlier. And as against that last year, we did almost around Rs.138 Crores, so significant deductions there. And the numbers are muted even currently, but we are trying to build other businesses like EU, other countries businesses. And in first half of the current year, we did almost around Rs.54 Crores business as against Rs.38 Crores what we did last year there. Australia and New Zealand, also, we are building up. We did around Rs.64 Crores as against Rs.59 Crores last year. Canada, we did around Rs.26 Crores as against Rs.16 Crores last year and South Africa we did Rs.51 Crores as against Rs.35 Crores last year. This is all first half number of various markets which we have done. Last year, also include around Rs.14 Crores worth of share of profit from US. Current year, it is nil because there is no sales.

Surajit Pal: So delta, basically, from across the market, excluding U.K.?

A.K. Jain: Yes.

Surajit Pal: Okay. Second point is that your receivable days increased around 15%, roughly.

A.K. Jain: No, receivables - basically what happens is, you are looking quarterly number because September is normally a peak sales in domestic. And also, September we had a significant exports business. Because of this AS 15 - 115 getting implemented, because now it is not based say that, once I get a BL then those numbers are recognized. So that process took some time. So this business numbers are getting impacted in the month of July, August, and all that. So now the whole process of factory producing and everything has to be, say, if your shipment does not happen by around 15th, 16th of the month, then, practically, you are not able to recognize that. Some time it so happened that we are able to do the shipment, negotiate the bill, everything, money is received, but still you are not recognizing sales because the party has not received, because now recognizing sales is based on receipt by the party. It is not based on just transfer of documents.

Surajit Pal: So, basically, this much of timing.

A.K. Jain: Those issues are there. So your business in September was higher. So when you look at the receivables number, it is basically those receivables are not due.

Surajit Pal: So, basically makes much of timing, okay.

A.K. Jain: And September is normally peak in domestic, peak sales in domestic, so that also is one of the factors. But, overall, I do not have any concern on - as far as my receivables are concerned because not even, well, let us say, 5%, 6% is overdue. So practically, that is a very, very ideal situation for me.

Surajit Pal: Lastly, what is your R&D revenue cost, based on your expenditure?

A.K. Jain: R&D cost has come down. Basically, now, let us say because of uncertainties, we are not doing much work on U.S. So, overall, which used to be 4% has come down to around 2.5% currently, because right now, all works are happening is for the European markets and ROW markets and others. So that cost has come down. In API, we have significant number of API ready for us to be commercialized, because all we were looking from a lot of those U.S. angles and all. And since we have put a hold on, let us say, API capex and therefore, right now, there may be around 15, 20 APIs, which are there, which are yet to be commercialized, which all these processes are ready. So we are also not spending too much money on building that other processes except which to be integrated with our generic baskets and all. So, therefore, overall, the revenue expenditure and our R&D has come down compared to last year by around Rs.10 Crores in first half of the current year.

Surajit Pal: Rs.10 Crores, first half of the current year.

A.K. Jain: Yes.

Surajit Pal: Okay, thank you and wish you all the best.

Moderator: Thank you. The next question is the last question from the line of Rahul Sharma. Due to time constraint, we take the last question from the line of Rahul Sharma from Karvy Stock Broking. Please go ahead.

Rahul Sharma: Sir just wanted more clarity on the CIS business. Do you anticipate this recovering - stabilizing and recovering or is it purely dependent on your ruble-dollar recognition?

A.K. Jain: It is basically ruble-dollar because, say, distributor there get very limited margin because the pricing are fixed by us, their margins are 10%, 12% hardly, and it is all regulated. So that margins are very, very low for them. So they do not have the capacity to behave the exchange loss. So whenever these fluctuations are high, whenever depreciations are there, we have to reduce our dollar billing from here. So that becomes an issue that my dollar relation moved down, yes. That has impacted this business.

Rahul Sharma: So overall, what type of growth are you foreseeing for both your generics and your branded business for the year?

A.K. Jain: Yes. Let us say, overall, for the company as a whole, I think we should be able to do around 14% to 15% kind of growth, and branded will be around 10%.

Rahul Sharma: Okay. Sir, generics will see flat growth in the second half or are you seeing - because of Europe, which you had said?

A.K. Jain: Let us say, the growth number for Q3 may be muted there in Europe because of this - the overall change process, which we are currently going on. That may have some impact on the third quarter. But that number itself is not that big. The European business, overall, may be itself now it is around close to Rs.30 Crores kind of thing. Plus U.K. business also will get impacted because it is all the same system we need to implement; even Russia is implementing the same system. So the process is going on, but some disturbance may be there, here and there. It is quarterly some disturbance here and there. But I do not see any concern on the business from whatever geographies we are currently doing business.

Rahul Sharma: So, branded you are saying you will do around 10% growth on a year-on-year basis?

A.K. Jain: Yes.

Rahul Sharma: Okay. And on the generic side, probably, there will be some gap up which will be there in the Q3. But, overall, are you confident it is a double-digit growth this year or probably you will have single-digit growth?

A.K. Jain: Let us say, even in first half, it is a single-digit growth. So, overall, this number may remain a little around that only because we do not have that - last year's number also includes share of profits and all, so that also gets impacted.

Rahul Sharma: Okay, Sir. And on the capex front, Sir, what is your capex plans for current year and next year, Sir?

A.K. Jain: Current year, maybe around Rs.110 Crores to Rs.120 Crores, much lesser than depreciation. And even next year, overall number will remain around depreciation or maybe biotech project get going then may be around Rs.20 Crores to Rs.30 Crores more than that. So we are not looking at - because we are still having large amount of capacities in the system, currently. Let us say we have built capacities to service almost around Rs.6000 Crores of kind of turnover, only some balancing need to be done because that will be stopped in between. But current businesses, let us say, last quarter, we did Rs.1000 Crores. So a long way to go to, so our capex, by and large, will remain lower in time to come.

Rahul Sharma: Okay. Thank you Sir.

Moderator: Thank you. Ladies and gentlemen, with this, I now hand the conference over to Mr. Nitin Agarwal for his closing comments. Over to you Sir.

Nitin Agarwal: Sir, do you want to add anything to close the call, Sir? Any last comments?

A.K. Jain: Let us say investors has real concerns on our U.S. business. We are committed to do whatever, and we have large amount of corrective corrections already done in the system, processes, trainings and everywhere. And we are confident that when the inspections happen, we should be able to come out of it. That is the confidence management have and that should really once that happens, then our capacity utilizations and overall business could see a very significant jump. Thank you.

Nitin Agarwal: Thank you, Sir. Thanks, everyone for taking out and participating in the call. And thanks to the IPCA management team. Thank you Sir. Have a good day.

Moderator: Thank you very much all. Ladies and gentlemen, on behalf of IDFC Securities Limited that concludes this conference call. Thank you for joining us and you may now disconnect your lines.