"IPCA Laboratories Limited Q2 FY-21 Earnings Conference Call"

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MODERATOR: **MR. NITIN AGARWAL – DAM CAPITAL ADVISORS LIMITED**

Moderator: Ladies and gentlemen, good day and welcome to the Q2 FY21 earnings conference call of IPCA Laboratories Limited hosted by DAM Capital Advisors 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 '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Nitin Agarwal from DAM Capital Advisors. Thank you and over to you, Mr. Agarwal.

Nitin Agarwal: Good morning everyone and very warm welcome to IPCA Lab's Q2 FY21 earnings call hosted by DAM Capital. On the call today we have Mr. A. K. Jain – Joint Managing Director, IPCA Labs and Mr. Harish Kamath – Corporate Counsel. I will hand over the call to Mr. Jain to make his opening comments and we will open the floor for questions thereafter. Please go ahead, sir.

A. K. Jain: Thanks, Nitin. Good morning to all participants and thanks for taking out time and joining us for Q2 IPCA Lab's earnings conference call today. Today's conference call and discussions an answer given may include some forward-looking statements based on our current business expectations that must be viewed in conjunction with the risks that are the business faces. Our actual financial performance may differ from what is projected or perceived. You may use your own judgment on the information given during the con call.

I would like to inform you that company's business and financial performance in Q2 FY21 has been strong inspite of testing times on account of global COVID pandemic. We have used our internals the integrated business capabilities in furthering our global drug formulations and API business. The business and margin growth in Q2 FY21 are largely driven by domestic formulation business and the very good revival in Q2 overall business growth was 6% excluding business from anti-malarial where we had a significant debacle in this particular quarter.

The division had a significant decline. The anti-malarial business division had a significant decline in business in Q2. On the base of Rs. 95 crores the base is now reduced to almost around Rs. 59 crores so a decline of almost around Rs. 36 crores was observed in Q2 in anti-malarial business. The pain and cardiac business that constitute more than 70% of the domestic business of the company in Q2 the pain segment had almost around 10% growth and from last year's base of Rs. 251 crores, the business went to almost around Rs. 276 crores in Q2 of current financial year.

And in cardiovascular also we had 6% growth from the last year's base of Rs. 91 crores business became almost around Rs. 97 crores. And all other businesses also are reviving except the cough and cold where we are still seeing some kind of decline. Anti-bacterials we are seeing some kind of decline but all other businesses their decline was much higher in our newer segments like derma, ophthalmology in first quarter of the current financial year. Second quarter there has been a significant recovery. There are only marginal declines are there in this business in second quarter. We see that all these business will turn to positive growth in the coming quarters.

So domestic had a very good revival in the second quarter except your anti-malarial division where the business decline was on account of the seasonality and all. And also that segment PDA as a segment where the business decline is also continuing. Higher currency realizations on exports almost around 5% has also helped the company in overall growth.

Overall reduced travelling cost and marketing cost has also helped in the overall having a higher business margins continuing for the first quarter ad second quarter. Higher business growth in API are continuing and institutional business in Q2 we had a very good performance also similar to that we had in Q1.

These are slides were somewhat offset by us have not made any provision for the MEIS benefit in Q2. Normally in a quarter that benefit would have been almost around Rs. 12 crores to Rs. 13 crores. But in view of uncertainties and no budget provision still in view of that no provision has been made. So almost around Rs. 12 crores to Rs. 13 crores worth of that earnings are not available in this quarter.

Export freight continues to remain very high in current financial year. We almost paid almost round 61% higher in current year and that trend has continued. Of course the higher percentage has little come down to around 30%. But overall the freight continues to be a hit

Having given the basis presentation, all numbers are there in front of you. So I would request now for question-answer.

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Rahul Jain from Credence wealth. Please go ahead.

Rahul Jain: Just couple of questions. You did mention about domestic business getting into the growth path now. So can we see for the next two quarters growth compared to the last year and any focus areas in terms of therapy which now we are focusing compared to the six months back? Secondly sir, do we have any one-offs like in quarter 1 we had some one-offs or additional business coming from SEQs and government business we did on the domestic side. So in this quarter anything with regards to some kind of business which probably could not be a liquid business?

And lastly sir, on margins front. Our gross margins continue to be around 67%, 67.5% but we have seen a sharp jump in operating margins for this quarter. Probably due to the other expenses operating leverage kicking in. So do we see now the shift going in the next two quarters and the year ahead what kind of sustainable operating margins are we talking about or where do we see the operating margins for next six months or next 12 months to 15 months?

A. K. Jain: I think overall domestic business revival is very good except the anti-malarial business and anti-bacterial and to some extent cough and cold business, these are the businesses which are still having some kind of issues but all other businesses are reviving very fast. The pain segment is more than 50% of our business. In Q2 itself we had more than 10% growth. Cardiovascular continue to remain strong and our other businesses which are upcoming businesses like derma, Europe, CNF kind of business all are now in the growth.

We have seen good growth in the month of October in double digits and we expect that business in the second half would be significantly better than what we had in the first half of the current financial year. And it is possible to achieve almost around 10% plus kind of growth overall in the second half of the current financial year. Looking at the current business expectations and also the performance which we have seen in the month of October and all.

As far as the businesses are concerned I think overall there is one off kind of business in the current financial year in the second quarter of the current financial year. So it is all normal business what we had. So there are no one off as such in the topline except there was almost an earnings of around Rs. 12.5 crores to Rs. 13 crores which was received on account of some contracts relating to a MNC company on supplies which subsequently got cancelled because of the change in the circumstances and we had incurred a higher cost around that time.

So there was a compensation of almost around Rs. 12 crores and Rs. 12.5 crores which we received in the second quarter of the current financial and that has been accounted as a part of the other operating cost, the other operating income. So that is the only exceptional I would say that it is a one time. Other than that we do not have any kind of one off neither on the expense side or nor on the income side. As far as the gross margins are concerned, we had a business growth of almost around 7% in this quarter.

The overall numbers standalone number as against that our material cost has gone down by 1%. And your trend continue to be let say your overall intermediates and is now little softer is there. And the overall your solvents and other things are at much lower prices now. And this trend is likely to continue because petroleum prices are continue to remain at lower end in the cycle and therefore we see that more or less in spite of API business growing higher where the material cost is higher.

Your gross margin levels have gone up and also one of another reason is that in this particular quarter I would say that anti-malarials have declined where we do not make that kind of gross margin. It is basically some of the products are also at a very, very low kind of margins are there. And that business has declined but other businesses are grown where the margins are better. And therefore overall gross margin levels are also good.

As far as the generic businesses are concerned, of course we had some kind of decline in UK but our European business has done much, much better. I think whatever decline we had almost around of Rs. 40 crores from UK that have been compensated by the significant increase in the business from the other European countries. And there also the business overall margin profile has improved because our margins compared to UK is much higher in the other businesses.

So even generic businesses we did better and trend will continue to be good as far as these issues are concerned. And as far as operating cost is concerned, the operating cost will continue to remain in control. Of course with revival of domestic there will be some kind of additional cost will be there but the travel and other costs will continue to remain significantly down and also your other marketing cost there will be some increase is there but will be there in the second half of the year.

But will remain in not a very, very high level so overall the margins levels will remain good and whatever margins we have reported they are sustainable kind of margins what we have reported in the second quarter.

Moderator: Thank you. The next question is from the line of Amar Maurya from AlfAccurate Advisors. Please go ahead.

Amar Maurya: Firstly sir, on the domestic business, if you can clarify like I missed in between I mean what has been recovered and what is still de-growing and when it will recover if you can give the split again for that? And secondly sir, in terms of the API run rate do we expect this kind of API run rate and this kind of pricing to continue for at least next two quarters? So these are two questions from my side.

A. K. Jain: As far as the businesses are concerned I would say that the pain segment is the major business segment for us which include rheumatoid arthritis and osteoarthritis. Both the segments put together has grown by almost around 10% in this quarter. I have said that from base of last year's base of Rs. 251 crores that business has become almost around Rs. 276 crores and you will notice that the pain is now almost more than 50% of our overall business in second quarter.

The cardiovascular had almost around 6% growth from base of Rs. 91 crores. The business was around Rs. 97 crores. And there also recovery is very, very strong. The business recovery has been let us say in the first quarter our neuropsychiatry business was declining. That has also come in the positive growth. Ophthalmology business was declining, that has come in positive growth and the decline in derma business and Euro business was almost around more than 20%, 25%.

That decline has now become almost around 5%, 6%. So overall and we see that this business will have a good growth in the third quarter in current year. The only businesses which are continuing to show decline is number one, the older product portfolio which we have almost around Rs. 80 crores, Rs. 90 crores kind of old product portfolio where we are continuously seeing around 8%, 10% kind of decline.

Anti-bacterials are continuously declining and their decline percent is around 12% or so. And your cough and cold is also having decline which is around 10%, 12% decline is there in cough and cold and anti-malarial. Anti-malarial the base has significantly eroded and normally second quarter have almost around more than 55%, 60% kind of anti-malarial business. This year there was no incidents of malaria practically and practically that business has declined by almost around more than 50%, 55%.

So completely base is eroded as far as anti-malarial is concerned. And overall anti-malarial now in the business is becoming insignificant because overall when yearend we will work out the final pie of the business, I think anti-malarial we become almost around 4% of the business. So now that risk is completely gone. Normal second quarter that is highest base and that base has already declined.

So in future even if anti-malarial something happens it is hardly to going to be insignificant because it is now the overall base of anti-malarials are very, very low. And therefore we are saying that yes, there is a good revival of course that is subject to that if there is a second wave of infections and some lockdown which are unlikely. If it happens then business may again have some kind of issue but otherwise we are seeing that yes, the business growth is likely to be good in domestic in the second half of the current financial year.

As far as the API is concerned, right now we are not there in the US market so there is zero businesses in that kind of segment and there is where most of the stocking and higher pricing and all that things has happened. So as far as we are concerned, it is a business as usual because we do not have any supply to US currently. So the business growth will continue. Of course as we have said earlier that we have capacity constraints continuously we are working to do the debottlenecking. Lot of those kind of initiatives are currently also going on.

So we are creating incremental capacities and with that the business growth is continuing. We have already started work on our Dewas project civil work has already started. All clearances are received so hopefully I think in may be around 14 months, 15 months' time the plant should be ready and thereafter validations and all may take around 17 months, 18 months overall to be ready to do the commercial business from there.

So that is the new thing. Otherwise the API run rates by and large would continue.

Amar Maurya: Sir, if I may ask one more. Sir, anti-bacterial and cough and cold would be how much contribution to the domestic business?

A. K. Jain: Anti-bacterial was almost around 5%, cough and cold is around 4% of the business.

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

Abdul Puranwala: Sir, my first question is again on the API side. So sir, is it possible for you to provide the current utilization at our plant and how confident would we be to for this run rate to continue for next year as well based on the current capacity?

A. K. Jain: As I said that some kind of 10%, 15% capacities we are continuously creating by debottlenecking. So that will continue. The capacity utilizations are currently very high. And its absolute number giving is very difficult because some product may have 8 to 10 steps, some product may have just 2, 3 steps. So volume and all differ. The pricing and everything are different depending on what kind of starting material prices and all of that.

But I would say that plant utilizations are almost around 90% currently. And some kind of incremental capacities creations is in pipeline which is happening now. Our existing plant at Ratlam and others. So that will continue. And overall we are projecting that the business growth in API in the second half will remain around 18% to 20% kind of a figure.

Abdul Puranwala: And sir, my next question would be on any update on from the USFDA side with regards to re-inspection or re-submissions any clarifications they would have seek from us?

A. K. Jain: We are continuously engaging with FDA and till the time anything reaches to the finality I would not like to comment. So I would say that status quo is continuing.

Moderator: Thank you. The next question is from the line of Surya Patra from Philip Capital. Please go ahead.

Surya Patra: Basically, first question is on the **(Inaudible) 20:59** business front. So as the global firm has raised their budget for the block of the current three year almost like 25% more compared to the earlier period in terms of procuring the product whatever products they have been procuring whether it is anti-malarial or whatever all those segments. So they have raised so have you started seeing any benefit that flowing into your supplies, sir?

A. K. Jain: I think overall we have given projections of around Rs. 200 crores to Rs. 225 crores for the current financial year. When you look at the number in the first two quarters we have already done more than Rs. 170 crores.

Surya Patra: Exactly that is why I am asking.

A. K. Jain: And the run rates are very strong. So that this trend will continue so hopefully business growth on institutional front is going to be very good.

Surya Patra: And generally sir, for the general export also like this quarter a marginal kind of sequential decline of course having a kind of robust quarter last in the first quarter. So this is just a kind of sequential kind of an issue that we are seeing and the Year-on-Year 17%, 18% kind of growth that we are seeing, this is the normalized Year-on-Year growth and should continue or this is the quarter which is seeing some kind of moderation and possibly you can see pick up subsequently or your sense on the export front?

A. K. Jain: So I have guided for API business growth of around 18% to 20% in the second half of the current year. Despite the domestic business I have talked about that the growth could be around 10% kind of thing.

Surya Patra: No, general formulation export I am talking about?

A. K. Jain: Formulation export there will be some kind of better business will continue because institutional business is continuously doing very well. Generic are other than UK business is going good and UK will recover in the second half we will see a significant business increase in UK so even generic business growth is going to be good.

Surya Patra: Okay UK was seeing some kind of moderation or anything, sir, or any challenge that during this quarter?

A. K. Jain: Yes, we had some kind of issues with the distributor because there was some OD outstanding were there so account was not regular. So we have to reduce the supply. Now the account has become perfectly in order and we have started accepting the orders now. So UK business in the last financial year Q2 was almost around Rs. 53 crores, Rs. 54 crores. That has come down to around Rs. 12 crores in this quarter.

So almost around more than Rs. 40 crores reduction is there in that. But that is almost around similar kind of from other than EU business which was Rs. 48 crores last year in second quarter. That has become almost around Rs. 83 crores. So significant increase of almost around 70% has happened in the other EU business. So more or less now even in third quarter UK would do well, Europe will continue to do well.

Australia and New Zealand, Canada these businesses are continuously doing very well. So we will see a good growth in generic business also.

Surya Patra: Backward integration aspects whether it is through the PLI schemes, any update on that or the kind of what is the level of now if you are providing the quarterly data points let us say what percent is your formulation is currently integrated? And what is the level, incrementally what is the kind of thought process that you are now having for your case and dedicated side that is the Noble Explochem that you had acquired? So something on these side which will ultimately achieve a kind of better integration for your overall business? So your thought on that?

A. K. Jain: As far as on backward integrations on intermediates side is concerned, we have put up one project at our Aurangabad site and that is a continuous process kind of plant. The deliveries of machines and all which were expected in the month of April or May that got significantly delayed because of COVID, large number of people from suppliers got COVID infections and whole the schedule got upset. I think one part of the system is already received and installed and put to use. The second part of the system is now under installation.

So probably that will become operational. So full automations would happen by December now which were earlier expecting that at first quarter end that could have been happening. So that is a one intermediate for one of our Sartan product that will be produced through this kind of backward integration a continuous operating plant not a base processing kind of plant. One of its kind, that technology is new. All manufacturers are producing that intermediate through the best process kind of thing. And we have put up a continuous manufacturing plant.

And if this experiment succeeds and everything goes well we will further increase the capacities of in-house production so dependence on China on intermediates will then significantly come down. So that is one update on your that thing.

As far as Noble Explochem is concerned, yes, because of again pandemic and the travel restrictions and other things we could not do much on that side. But now we are working on the projects and internal team is working. Hopefully may be in next three, four months we will be applying for environmental clearance and all the environmental impact studies and others will be initiated. So anything happening on ground after that it may take around 6 months, 8 months' time. So no CAPEX would happen in current financial year.

Next financial year, yes, we have lined up almost around 3, 4 intermediates to be integrated at that particular sites after the receipt of your environmental clearance. So that will take still some more time. As far as PIL Scheme is concerned, we are ready with the submissions for the two products on synthetic organic chemistry product, not the fermentation products. So we are not participating as far as fermentations are concerned. But your other API side, the chemistry side we are putting up the application for two products. So that is the update.

Moderator: Thank you. The next question is from the line of Kunal Dhamesha from Emkay Global. Please go ahead.

Kunal Dhamesha: So as you have alluded that most of the CAPEX would be in FY22. So that could include both Noble Explochem and Dewas or will we be doing some CAPEX for Dewas in the FY21 and then some would be spilled over to FY22?

A. K. Jain: As I already cleared that Dewas we are already started construction. So that is going on. So next six months the all sales structures would be ready and installations would start somewhere at the year end of may be early part of the next financial year. And Noble will take some more time. Some capacities are may be around Rs. 100 crores is happening at Ratlam site on API side on debottleneckings and others. So that will become operational by March.

Kunal Dhamesha: And then what would be the CAPEX that we would be doing for Dewas and Noble Explochem?

A. K. Jain: Dewas overall will have almost around Rs. 250 crores. Noble we have yet to workout numbers. So we will not be able to give you anything and Dewas will be around Rs. 250 crores.

Kunal Dhamesha: And the second question is on this continuous manufacturing that we have been talking from last couple of quarters. So how much edge it provides us in terms of the manufacturing cost over let us say batch manufacturing and then we will see that that edge could eventually lead to lot of market share gain in certain products?

A. K. Jain: As far as continuous manufacturing is concerned your operating efficiencies are better. Your CAPEX is high because this continuously consol control kind of plants that everything is automatic. And your reaction outputs are better, your reaction coefficients are far better. So I will not be able to talk much right now till the time we put up the plants and start seeing the benefit. But yes, the piloting and all indicates that significant reduction in the cost.

Kunal Dhamesha: Significant would be 15%, 20% or even higher?

A. K. Jain: Right now I will not give numbers. Let the thing settle.

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

Prakash Agarwal: Sir, if you could elaborate what really went wrong in UK? You said there is the business dropped from Rs. 50 plus crores to Rs. 12 crores? And why you are expecting it to recover? Is the issue is resolved?

Harish Kamath: Yes Prakash, if you see first half of the current financial year, there is a substantial reduction in the UK business. Last year first half we did about Rs. 94 crores versus that this year we have done about Rs. 33 crores. So there is a Rs. 60 crores reduction in the UK generic business whereas Europe end business last year first half was Rs. 75 crores versus that this year first half we have done Rs. 178 crores. So there is a substantial improvement in the EU business almost Rs. 100 crores.

Prakash Agarwal: I wanted to know in UK what has went wrong?

Harish Kamath: UK I will tell you. UK now the account of the distributor is in control. It is online actually so there is no delay and all. So we have started accepting order. You will see a good growth in the UK business in the second half compared to same period last year. So Europe will continue to grow, UK will also grow in the second half compared to same period last year.

Prakash Agarwal: So I understand the growth will come back. I am trying to understand the reason of the decline?

Harish Kamath: I said because there was lot of receivable from the distributor. His account was not up to mark. That is why we stopped accepting the order. So now the account has come up to level whatever we were expecting. Now we have again started receiving orders and manufacturing is happening. That is the only reason, nothing else.

Prakash Agarwal: So now how will it revive?

Harish Kamath: The orders are already there. We have started manufacturing so you will see uptick in the shipment in the third quarter as well as in the fourth quarter.

Prakash Agarwal: And for the years to come because we have this business built on a good platform now?

Harish Kamath: Plus parallely we will be starting our own distribution as we explained last quarter and that work is also happening parallely.

Prakash Agarwal: Secondly, on your commentary on the Sartan opportunity in the API you did mention that growth of 15% to 20%. But how is the pricing competitiveness market share in the Sartan business?

Harish Kamath: There have been not much variance with pricing compared to first quarter and second quarter and we continue to have good order position in Losartan where we are one of the biggest exporters from the country and we believe that things will continue going forward.

Prakash Agarwal: The pricing, market share both are not the issue?

Harish Kamath: Means so far it is not an issue.

Prakash Agarwal: And lastly on the CAPEX. You did mention Rs. 250 crores for Dewas but what is the expectation for second half and next year on an overall company basis?

Harish Kamath: Including our routine maintenance CAPEX this year it will be about Rs. 200 crores. Next year it may increase to around Rs. 300 crores, Rs. 350 crores because most of the CAPEX for Dewas would happen in the next financial year.

Moderator: Thank you. The next question is from the line of Mukesh Shah from Motilal Oswal Asset Management. Please go ahead.

Mukesh Shah: Sir, just one question from my side. You mentioned that the margins of about 28% that you did in this quarter is sustainable. I just wanted to understand is that understanding correct for the second half of this year and going forward into next year should we have built in similar margin structure or should we build a higher margin structure? How should one think about that?

Harish Kamath: See more or less whatever second quarter margin is there more or less that margin will go into continue in the third and fourth quarter of the current financial year based on the presumption that the domestic branded business will improve as we move month-after-month. That is what we are seeing.

Mukesh Shah: And historically we used to always look at margin expansion on a Year-on-Year basis. So is it safe to assume that next year we can build in on 28% or this 28% is where we should sustain?

Harish Kamath: Mukesh, please understand in the first quarter the margin what we had, it is impossible to repeat because of that additional business and all. So let us focus on second, third, fourth quarter whatever margin we are doing that will continue. But first quarter margin if you consider in the overall year it is very difficult to replicate that kind of a margin.

Mukesh Shah: I understand. Sir, my only question was that if you were at 28% margin, should FY22 and FY23 should be about 28%, closer to that range, right?

Harish Kamath: Yes, that is correct. Look Quarter-on-Quarter there will be some variation between 25% and 27% it will fluctuate.

Mukesh Shah: That will still be a very significant jump than what our historical margins were at 19%, 20%.

Harish Kamath: Yes. If you see during 2014 our margins were as good as what we are doing now. Then our US business was ongoing.

Moderator: Thank you. The next question is from the line of Abhishek Sharma from Jefferies. Please go ahead.

Abhishek Sharma: Sir, just two questions on Cartons. First is on the landscape. Do you see any competition on horizon any of your competitors doing CAPEX, any new player trying to install capacity? So just what are you seeing on the market? That is the first one. And second is on the intermediates.

So you said that you are basically brining in one intermediate. I just wanted to check if that is OTBI. How many such intermediates do you plan to bring in and when that process is done would you become the lowest cost producer?

Harish Kamath: Abhishek, Mr. Jain has said this intermediates these for Sartan business. I would not name the intermediates but as far as the Sartan businesses are concerned so whatever guidance we have given, whatever internal whatever guidance our marketing team has given to us we are progressing as per that guidance. And as you now may be aware the API business is now highly regulated so it is not so easy for any consumer to change source from one to another.

So they have to go through lot of processes and all. But as far as we are concerned whatever projections we have given, whatever our expectation is there so Sartan businesses are progressing as per that.

Abhishek Sharma: But do you see any, so I am sure you are doing some landscaping in terms of your competition. People who have gone out of market etcetera, do you see any of them coming back?

Harish Kamath: In any case Abhishek, we are not a big player in Valsartan. The people who went out are mostly for valsartan API. There whatever business I am doing today is plus on whatever I was doing earlier. As far as Losartan is concerned there has been no disturbance. And whatever growth projection we have given to the market, we are moving as per that.

Abhishek Sharma: Right sir, and just on intermediates without naming the intermediates after you have done this entire backward integration exercise, would this make you the lowest cost producer for Sartan?

Harish Kamath: Yes Abhishek, I would say something like this to remain competitive we need to do all these. I would not say anything further than this. So whatever if it works, whatever we are projecting and whatever we are doing if it is successful that will give us further competitive advantage vis-à-vis the other players when it comes to Sartan business.

Moderator: Thank you. The next question is from the line of Naresh Suthar from SBI Life Insurance. Please go ahead.

Naresh Suthar: First one clarity on the margin guidance which you just provided. So second half you were expecting to continue around second quarter level like 28% margins and for the next year and after that you are expecting a range of 25% to 27%. Is it right?

Harish Kamath: Yes, that is next year I said that correct. But if you see historically the second quarter second half margin is lower than the first half margin always because second quarter business in the domestic is always highest if you see our quarter wise domestic business pie but this year because of this COVID situation hardly any malaria business. So going forward our third and fourth quarter will be definitely better than the second quarter domestic business. Based on that the projection what I gave you. It should be in the range of 25% to 27% going forward.

Naresh Suthar: So sir, last year like we had around 20% margins and because of this pandemic we had some cost savings and also benefits in gross margin. So the shift off from 20% to 25% to 27% is 5%, 6% shift, is it higher because of the cost saving in marketing business or is it higher because of the gross margin benefit you are seeing? What is the major benefit?

Harish Kamath: It is because of the gross margin benefit. There is a 100 to 150 basis point improvement in the gross margin.

Naresh Suthar: Sir, that is only 150?

Harish Kamath: Yes, 100 to 150 basis points right.

Naresh Suthar: So another 450 is because of other expense, right?

Harish Kamath: That is correct, right.

Naresh Suthar: So that is mainly because the allied marketing activities which we are doing are?

Harish Kamath: Yes, field operation cost but having said this we have also incurred an additional manpower cost which was COVID allowance. So there we have spent about Rs. 20 crores plus. Another thing which is not there in this quarter is about Rs. 12 crores to Rs. 13 crores MEIS benefit on the export formulation business which we used to get every quarter.

So this quarter because of the government they are moving out of MEIS Scheme and there is no budget provision for paying that. So we have not provided for that. Otherwise this quarter it has been another 100 basis points improvement in the margin.

Naresh Suthar: What I am saying is that in this quarter also have little lesser marketing activities?

Harish Kamath: Compared to first quarter there is an additional expenditure when it comes to marketing activities. So it will get normalized over may be two to three quarters going forward unless there is another something COVID peak and other things.

Naresh Suthar: One more question if I may. Sir, of the India marketing expenses how much is expense related to conferences which you do for doctors? If you are able to share that?

Harish Kamath: Very difficult within marketing cost how much it is and all. So whatever little bit saving is there partly it is offset by whatever the COVID allowances we have given to our workmen in the first quarter.

Moderator: Thank you. The next question is from the line of Nikhil Upadhyay from Securities Investment Managers. Please go ahead.

Nikhil Upadhyay: One clarification. This Rs. 20 crores on employee cost is this booked in this quarter, the COVID allowance or?

Harish Kamath: It was in the first quarter. Most of that was in first quarter.

Nikhil Upadhyay: Secondly sir, on this continuous processing and batch processing, this question could be quite naïve but just to understand now if we go in for a continuous kind of a manufacturing does this create that the facility becomes specific for a product or the product versatility remains in the production process?

Harish Kamath: Most of it is product specific. There will be lot of synergy in the operation, manpower, yield, time cycle. Everything there will be improvement if it works the way we are expecting it because whatever R&D we have done it is working in that R&D space which is something a new concept. So it will take time to understand how it will progress in the commercial scale.

Nikhil Upadhyay: No, where I am coming from is because in case in future the pricing or the market dynamics for that product go bad does this create a risk that because the line would be product specific does it create a risk of impairment of or any of that sort or is it like?

Harish Kamath: No, not necessarily. So there could be some balancing equipment and that way you can work.

Nikhil Upadhyay: And lastly, if you can just help me understand on the subsidiary's performance and how are you looking at that going forward?

Harish Kamath: As far as subsidiaries are concerned Onyx Scientific is doing well.

Nikhil Upadhyay: Can you share the number?

Harish Kamath: Onyx has contributed about Rs. 10 crores profit to standalone in the first half whereas the major losses that is contributing is by ICSA Lab, US where it will continue for another may be three, four quarters because the products are under development then filing will happen, then registration will come. So that pain we have to continue for another three, four quarters. Whether all subsidiaries there are some marginal loss in Ramdev Chemical also because this is a plant which was hardly hit because of this COVID pandemic.

So there was manpower shortages so there were so many other logistic issues but the plant is now again coming back to normalcy. Whereas all other subsidiaries are mostly registration holding companies other than Bayshore which is a pharmaceutical distribution company in the US. So there they have done about Rs. 76 crores business. Marginal loss is there because of depreciation of their product portfolio goodwill. Otherwise business to business there is a small profit they have made.

Moderator: Thank you. The next question is from the line of Sameer Baisiwala from Morgan Stanley. Please go ahead.

Sameer Baisiwala: Sir, you said there was no one off HCQS etcetera in 2Q but I just want my information. I mean did you sell any HCQS at all and if, yes, how much was that?

Harish Kamath: No, whatever regular HCQS business we are having formulation in India in ROW market, API sale in India and rest of the world. Except US that is continuing, Sameer, there is no issue.

Sameer Baisiwala: And can you quantify that if that is possible?

Harish Kamath: Whatever regular business, there is nothing COVID related HCQS business in this particular quarter. They are all for rheumatology whatever use is there in the market.

Sameer Baisiwala: Sir, second question is many people have asked on USFDA and they are not coming but sir, through informal channels is there anything that you are hearing I mean when would inspectors begin inspection I mean are they waiting for vaccination or what really is happening here?

Harish Kamath: No idea, Sameer. As far as we are concerned our facilities are concerned it is status quo. So unless all these things will improve I do not think any inspection would happen so soon.

Sameer Baisiwala: I am just wondering given that now so many plants await there and there is so much of backlog, so even when they do begin how do they chose where to go and then can it be even after they begin can it be await for long tunnel before they come to you for example?

Harish Kamath: No idea, Sameer. Really no idea. But our guidance ex-US whatever we have been guiding market that will continue. As and when US will come as and when it will be plus on to whatever we are talking.

Sameer Baisiwala: And sir, last question is on the India business. Any cake I mean are the doctor consulting, doctor clinics are more or less operational and the patient footfall per clinic in that sense, is it all normalized or do you think we are still calling?

Harish Kamath: Lot of improvement is there. So October was better than September, largely better. Whereas there are few areas like nursing homes, surgeries where there is still lot of issues. Pediatric is another therapy where there is parents are not taking their children to doctor and all, those things are continuing. Otherwise we are seeing good growth. Doctor practicing as well as patient footfall except hospital related business.

Moderator: Thank you. The next question is from the line of Sapna Jhawar from Dolat Capital. Please go ahead.

Sapna Jhawar: So you also acquired Resonance Specialties sometime back. How has that contributing to the business now and what capabilities that it brings to the business or if you could just explain that?

Harish Kamath: Sapna, we have not bought anything Resonance. IPCA is not concerned with Resonance acquisition.

Moderator: Thank you. The next question is from the line of Amar Maurya from AlfAccurate Advisors. Please go ahead.

Amar Maurya: Sir, one clarification. Like if I see the API export business like the run rate was around Rs. 310 crores and Rs. 323 crores kind of run rate. And when we are guiding for 18% kind of a growth in second half, so are we talking that the run rate of this API will come down because if I do the math that it will be around Rs. 277 crores and Rs. 250 crores?

Harish Kamath: Yes, what guidance we are giving 17%, 18% growth is vis-à-vis last year second half and this year second half. See if you consider the run rate first quarter as we already said was very exceptional. That kind of API business we cannot even dream of doing.

Amar Maurya: But your second quarter was also high at Rs. 323 crores capacity perspectives we have capacity and further debottlenecking can actually increase the capacity further by about 10%, then do you see in FY22 going by your full capacity and then debottlenecking it can add back to the growth?

Harish Kamath: But new capacities will take further time, FY22 plant will be theoretically ready then validation, scale up, registration, approvals it takes lot of time. So till all these activities are completed we have to depend on Ratlam only. Whatever little bit CAPEX we are doing and debottlenecking we are doing. In API there are so many possibilities. Number of cycles, prices are also different from one product to another. There is $20 product also, there is $200 product also. All those things come into play and you have a flexibility.

Amar Maurya: Basically at your full capacity, I am talking about the current capacity not the new capacity including debottlenecking do you think the plant can do about roughly Rs. 1,200 crores kind of a revenue that is what basically you are suggesting?

Harish Kamath: No, what we are guiding is going forward the API business in this second half there will be an improvement of 15%, 18% and thereafter our guidance is normal 12% to 13% growth.

Amar Maurya: Sir, the second question is in terms of the EBITDA margins. If I look at last year fourth quarter as well as year before fourth quarter, typically in your fourth quarter margins are lower compared to third quarter and the company average. So what is the typical reason for this?

Harish Kamath: See it is mainly because of the domestic branded business. So if 100% is my business in fourth quarter I do about 18%, 19% out of that. Whereas the 80% gets transferred to other three quarters. This is the main reason.

Amar Maurya: So that basically pulls down your margins to some extend in fourth quarter but despite that?

Harish Kamath: Because our portfolio the January to March period is healthiest for the people not to us.

Amar Maurya: But despite that you are suggesting that this year second half margins you will maintain at second quarter. This is despite fourth quarter typically is a slightly low margin business. So what can be for this?

Harish Kamath: Inspite of the second year business itself is low so we will be growing over that.

Amar Maurya: But in last year fourth quarter there was not much problem in terms of the revenue base, margins were low because it is not that healthy but otherwise revenue was not that bad?

Harish Kamath: I know that. Last year also fourth quarter we have grown 10%, 12% when it comes to domestic branded business. In this year also we will grow compared to what we have done last year.

Amar Maurya: But still margins in last year fourth quarter were lower generally speaking. So I am saying from that perspective?

Harish Kamath: No, that is why I gave a guidance of 25% to 28%. Quarter-on-Quarter it will vary.

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

Rahul Sharma: Just wanted to get some sense of the performance for various regions in the export market for the first half, generics and branded?

Harish Kamath: I have already given, Rahul, EU including UK. So last year first half it was Rs. 169 crores versus that it is Rs. 211 crores this year. Australia and New Zealand from Rs. 60 crores it has become Rs. 89 crores and Canada is become Rs. 56 crores from Rs. 30 crores. So these are the major continents when it comes to generic business. And institutional it is there already in our press release.

Rahul Sharma: So Rs. 56 crores is which region, sir?

Harish Kamath: Canada. Last year it was Rs. 30 crores.

Rahul Sharma: And Rs. 169 crores is in EU, right?

Harish Kamath: No, EU is Rs. 178 crores and UK is Rs. 33 crores.

Rahul Sharma: What about Russia, sir?

Harish Kamath: Russia first half there is a growth of 11%. 92% was last year, this year it is Rs. 102 crores.

Rahul Sharma: Any other traction in any other generic market, sir?

Harish Kamath: Generic market we covered all the territories. It is EU plus Australia and New Zealand, Canada and South Africa, these are the markets.

Rahul Sharma: What sort of growth you are pursuing for the current year in your branded and generic formulation business, sir?

Harish Kamath: See Rahul, company as a whole going forward we are confident we will grow anywhere between 10% to 12% topline growth. So similar number more or less in the domestic branded business. This is comparison to YoY. Whereas generic we are confident it will grow by about 15%, 16% generic business and there will be good growth when it comes to institutional business.

Rahul Sharma: And branded, sir?

Harish Kamath: Branded our guidance is about 10%, 11% growth for whole of the year. Quarter-on-Quarter there will be lot of pluses and minuses depending on shipments and all.

Rahul Sharma: And sir, FY22 can we see a spike in institutional business, is there a possibility?

Harish Kamath: Rahul, our institutional business is only anti-malarial so all depends on season and so many other things. But now we have a range of products. The other two registrations what we got AL dispersible and injectables also we see a lot of traction and orders coming in. But you just cannot see a very big growth and miracle in that kind of a business.

Rahul Sharma: Sir, any outlay on R&D? Is it increasing or any thoughts on that?

Harish Kamath: No, as we said in our earlier con calls our more focus is now ex-US development cycle. Europe and all other generic markets, institutional business and other things, branded ROW market business. So R&D for time being will be in the range of around 3% to 4% but when we are back into US those expenses will improve thereafter.

Moderator: Thank you. We move on to the last question which is from the line of Charulata Gaidhani from Dalal & Broacha. Please go ahead.

Charulata Gaidhani: Sir, can you please repeat the outlook for UK and Russia and the numbers also?

Harish Kamath: Charulata, we said the branded business ROW market whole of the year it will grow around 10%, 11%. That is what is the guidance. And in the branded ROW business, Quarter-on-Quarter there will be always variance because of the shipment and other reasons. So this is the guidance.

So quarter wise it is very difficult to see this quarter we have done so much, next quarter we will do so much. Year guidance we can give when it comes to promotional branded business of ROW market. Generic business, yes, we will continue to grow Quarter-on-Quarter. That is what the guidance we have given.

Charulata Gaidhani: And UK will see higher growth?

Harish Kamath: Because in the first half of the current year, there was hardly any business from UK. Last year it was a Rs. 94 crores first half business UK. This year it is only Rs. 33 crores. So going forward there will be good growth compared to these two quarters as we progress further.

Charulata Gaidhani: Do you see more growth coming from formulations or APIs?

Harish Kamath: The API our guidance is there about 18%. Domestic formulation we should see a growth of anywhere between 10% to 12%. ROW I said around 10% and generic there will be about 15% growth. So overall formulation business growth will be around 12%, 13% and API growth will be about 18%. This is Year-on-Year growth, third and fourth quarters.

Moderator: Thank you. Ladies and gentlemen, that was the last question for today. I now hand the conference over to the management for closing comments.

A. K. Jain: Thank you everybody. We are continuously committed and working very hard to improving our systems on regular basis so that we are back in US business. Management commitment to that is 100%. Hopefully we should be back as and when the inspections and other things happen. Thank you so much.

Moderator: Thank you. On behalf of DAM Capital Advisors Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.