



“Indoco Remedies Ltd Q2-FY10 Results Conference
Call hosted by Tata Securities Ltd”

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TATA SECURITIES LIMITED



MODERATORS: **MR. SUNDEEP BAMBOLKAR – DIRECTOR, FINANCE & OPERATIONS, INDOCO REMEDIES**
MS. ADITI KARE PANANDIKAR – DIRECTOR, BUSINESS DEVELOPMENT & HR, INDOCO REMEDIES
MR. GANESH GOKHALE – VP, FINANCE & ACCOUNTS, INDOCO REMEDIES
MR. MILIND BHANGALE – SENIOR ANALYST, TATA SECURITIES

Moderator Ladies and gentlemen, good afternoon and welcome to the Indoco Remedies Q2FY10 results conference call hosted by Tata Securities Ltd. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. If you should need assistance during the conference, please signal an operator by pressing '*' and then '0' on your touchtone phone. Please note that this conference is being recorded. I would like to hand the conference over to Mr Milind Bhangale. Thank you and over to you sir.

Milind Bhangale Good afternoon everybody. This is Milind Bhangale from Tata Securities and on behalf of my organization, I would like to welcome you to Indoco Remedies Q2 Earnings Conference Call. We have with us today Mr Sundeep Bambolkar, Director, Finance and Operations, Ms Aditi Kare Panandikar, Director, Business Development and HR and Mr Ganesh Gokhale, VP, Finance and Accounts. Now I would request Mr Bambolkar to take us through the quarterly results and also if you could brief us on the future outlook for the company. Over to you, sir.

Sundeep Bambolkar Yeah, thank you Milind. Good afternoon ladies and gentlemen and thank you once again for logging onto our call, the second quarter of 2009. I have with me my colleagues Aditi and Mr Ganesh Gokhale and as discussed during the last con-call, after we tightened the credit control and brought in very severe and strict measures, sales have definitely started looking up.

During this quarter, the net domestic formulation sales have grown by over 25% and exports have grown by 15% or so, which is a very encouraging sign. The total top line has grown by 21.4% over the same quarter last year. This definitely indicates that the company's strategy of tightening the credit, the measures taken were very successful and we are in fact very bullish on continuous top line growth in the future quarters to come. The credit control measures also helped in improving the liquidity position and reduce the interest burden substantially. The interest payout this quarter was Rs 66 lakh compared to Rs 146 lakh in the same quarter previous year.

During the current quarter, the profit after tax recorded is Rs 9.25 crore as compared to Rs 2.17 crore during the same quarter previous year, and that

definitely is due to the substantial increase in top line, particularly in the domestic business. The earnings before interest depreciation and taxes as a quantum have taken a 72% jump and definitely there is a huge jump in the net profit after tax. The other expenses have gone up by 80 lakhs and the employee cost is higher due to the marketing increment coming during this quarter, the annual increment. The increase in other expenditure is mainly on account of air freight once again, and marketing expenses compared to last quarter are marginally higher. The company's mark to market position as on September 30 is a loss of 24 lakhs. This is mainly due to the dollar fluctuation during the quarter.

While peeping into the future, we expect that during the quarter October to December the domestic sales will continue the upward growth trend compared to the Dec 08 quarter. Some encouraging news is, we have had a very good CPHI this year and we are very close to signing at least two very good deals, which will be made public in a very short time just after signing. We expect this to be signed either by end of November or around December 15. The management discussion and analysis have already been circulated to all of you a short while ago and I would now like to invite questions from the participants. Thank you.

Moderator Thank you very much sir. Ladies and gentlemen we will now begin with the question and answer session. At this time if you would like to ask a question, please press '*' and '1' on your touchtone phone. Please use only handsets while asking a question. The first question is from the line of Sarbjit Nagra from Angel Broking, please go ahead.

Sushant This is Sushant here. Few questions, on the operating margin front during the quarter reported operating margin of around 13% and this has declined sequentially from 19% in Q1. Any specific reasons you see going forward?

Sundeeep Bambolkar Okay you are comparing.

Sushant Sequentially, quarter on quarter, Q1 versus Q2.

Sundeeep Bambolkar Okay.

- Sushant** Sir, so just wanted to know the reason and the trend going forward.
- Sundeep Bambolkar** Yeah that is as I explained earlier. The employee cost has gone up because of the increments we gave in this quarter. That is one reason. That is accounting for almost more than 2 crores in totality of the employee cost itself, and the second reason is the forex. If you see in the last quarter, there was a forex gain of almost 1.5 crores and this quarter, it is a loss of 1.5 crores. So if you club the two, the difference is 3 crores. So the two things put together, it is almost 5.5 crores. So I think that explains why sequentially the operating margins have gone down.
- Sushant** And sir the trend. Would you be able to maintain these margin levels for the next few quarters.
- Sundeep Bambolkar** There should be an improvement, substantial improvement in the margins during the next two to three quarters. The reason being our dollar booking is now on a much higher side. It is a 50 plus. Even now Euro booking is at 70 plus. So we now expect substantial gain from forex and all other expenses for the December and the March quarter will be under tight control. So that is the reason I am confident that the margins will look up substantially in the next two quarters.
- Sushant** And the second question is on your domestic formulation business. Sir, will you be able to clock such healthy rates what have been seen in Q2?
- Aditi Kare Panandikar** Yeah, yeah we will maintain this and we will possibly do better, going forward.
- Sushant** For FY10?
- Aditi Kare Panandikar** Yeah.
- Sushant** And just a last question from my side. What would be your debtor's day, the domestic debtor's day apparently?
- Aditi Kare Panandikar** The domestic debtors are right now...

- Ganesh Gokhale** As of now the debtors are at 85 level. Domestic and overall it is around 90 days, whereas we are targeting to come to 75 days on the domestic front.
- Sushant:** This would be by when?
- Ganesh Gokhale** By Mar 31, 2010.
- Sushant** Thank you sir. That is it from my side.
- Moderator** Thank you. The next question is from the line of Mr Manoj Garad from Emkay Global. Please go ahead.
- Manoj Garad** I have two questions. One is regarding the CPHI Conference, where you have indicated that you are close to signing two deals. Can you elaborate more whether these are for the API or for the formulation production and for which kind of markets?
- Sundeeep Bambolkar** The two deals are from the formulation side, of course. Aditi will throw more light on the API side. One is a product development deal with a European company. That is all I can say right now. The other is for dossiers with a multinational company, one of the big companies in the world. So giving dossiers for registration in around 20 ROW market. Substantial upfront payment will be received by Indoco on supplies of these dossiers and then once they are registered in all those 20 countries, the manufacturing will come back to Indoco.
- Manoj Garad** Okay, so what could be the timeline. In the sense that whether these products will be developed right from the day one or we already have those products and we will start doing the registration and later on start supplying the APIs.
- Sundeeep Bambolkar** It is a basket of about seven to eight products at this stage. Two or three of them are almost getting ready. The remaining will be ready within 9 months, 12 months.
- Manoj Garad** So, the flow of revenue may start after 12 to 18 months.

- Sundeep Bambolkar** The upfront payments will come in milestones and then commercial supplies will be after 18 months and the second deal, development project time span will be about 24 months. However, we are hopeful of doing it within about 20 months and within these 20 months, these milestones will start accruing.
- Manoj Garad** Okay for the second deal also.
- Sundeep Bambolkar** Yeah, that is the development deal.
- Manoj Garad** Again, this development is basically for the product or is it some technology like in terms of NDDS based platform.
- Sundeep Bambolkar** It is an advanced dosage form, almost like a technology.
- Manoj Garad** Okay. And like what kind of revenue potential, probably estimating with your second deal with ROW, like what could be the potential addressable opportunity?
- Sundeep Bambolkar** Well it is too early to state right now but there will be a substantial upside. That is all that I can say at this point in time.
- Manoj Garad** Okay and how would be the margins in this business sir?
- Sundeep Bambolkar** Well it involves, some of them are in advanced emerging markets. So on the margin front, we could expect EBITDA levels around say 20% plus.
- Manoj Garad** Okay, second thing sir. If I see though in Q2 your domestic business has grown by 25% but on half year basis, it is still like you know more or less flattish. So, for this whole year like what kind of guidance are you building up for the domestic market.
- Aditi Kare Panandikar** We are looking at about 10-15% at the end of the year. 20 by this quarter, despite a 25% rise in second quarter, we are leveling off now.
- Manoj Garad** But normally I think if I go right, or if my memory is right I think June to September quarter is the one quarter which has the maximum revenue for Indoco. Am I right while making the statement?
- Aditi Kare Panandikar** No, it is April to June.

- Manoj Garad** Okay, okay. And how about, you have like tax. Because I think for both the quarters you have taken the MAT credit. So what would be your tax liability at a consolidated level?
- Ganesh Gokhale** No, this MAT credit is we can utilise once we go for the normal tax liability. Now at our Baddi plant, we are getting this benefit of tax exemption to be over in five years. So from 2012-13, we will go on the normal tax liability. I think we can utilise that.
- Manoj Garad** So what kind of tax rate we will build up in our earning model?
- Ganesh Gokhale** Right now we are taking it whatever MAT credit we are paying, means same amount is available as a credit. Right now it is at 15% plus surcharge plus tax, which comes to 16.995%. That whatever MAT credit is there, it is available to us as a credit. The same thing, right now, we already have accumulated around 14 crores. So we go for the normal tax liability. Within one year's time, it covers the entire MAT credit.
- Manoj Garad** So after one year, you probably will be ending up with MAT tax rate of around 17%.
- Ganesh Gokhale** In 2012-13, we will come under normal tax liability where I can utilise this MAT credit.
- Manoj Garad** Fine. That is all from my side. Wish you all the best.
- Moderator** Thank you. The next question is from the line of Mr Urmil from Religare. Please go ahead.
- Urmil Negandhi** Can you just help me with the capex which is expected for this year and next year and average cost of borrowing?
- Sundeep Bambolkar** Yeah, the average cost of borrowing price now is around 6-7% and the capex program, yes we have a substantial capex program coming up because the regulated market sales are doing very well. So we have taken a quick decision to put up an additional plant in Goa for Solid Dosage form. So it is for tablet. This will entail a capex program of around Rs 40 crore. We have invited tenders and the comparisons are going on and the construction is about to

start by the end of November. So within 12 months, we have lined up that the plant should be ready. It is a very ambitious target we have set for ourselves. So that is the main capex program and for this we have gone in for an ECB from Standard Chartered costing us interest rate between 6.5-7%. So that is the main capex plan. The second capex, is ophthalmic line, is being imported from Canada, which will be installed in December in our plant. This is in preparation for a bigger sort of plant for the US market and the European market and this total outlay would be about 10 crores. Earlier, if you recollect, we had gone in for an ECB from Citibank. So the funds for that are already ready. So I think that should answer your question.

Urmil Negandhi

And sir how has the current cash position been on the book?

Ganesh Gokhale

As on today, the cash balance, because we have kept certain money what we have borrowed up on ECB in the fixed deposit, around 25 crores is the cash position, fixed deposit plus cash.

Urmil Negandhi

Okay. Sir any hedges you have done?

Ganesh Gokhale

Hedging, we have done during this quarter for dollars and euros. We are hedged around \$1.5 million during this quarter at 50 rate and Euros of 2 million at 70 rate. And as of today, the hedging position in USD, we are hedged 4.2 million at an average rate of 49.73 and in Euro we are 2.8 million at 69.42. So comparatively considering the current scenario, it is on a higher side.

Urmil Negandhi

That is all from my side. Thanks.

Moderator

Thank you. The next question is from the line of Mr Manish Jain from Axis Holdings. Please go ahead.

Manish Jain

Quick question on the domestic formulation sale. What is the run rate on the primary and the ORG reported sales?

Aditi Kare Panandikar

As you know even when our primaries were not doing well on the secondary front, what we were showing was a very growth of our brand. This month, this quarter, we have shown a 25.5% growth on our primaries and that also we have included but not to that extent. If I am not mistaken, there is

about 15% growth on the secondary front. On coming to our ORG ranking, we have moved up one rank on the MAT level on the SSA Audit. We are ranked 31st now compared to 32nd at that time.

Manish Jain Excellent and the second follow-on question. You will have the Andheri plant available once you will close the plant. What is the development plan and when can we expect cashflows there?

Sundeep Bambolkar Well the plan is to co-develop that property along with building corporation, commercial builders, but we have not yet come to any conclusion as of now. But that is the scenario. I mean, we are talking with two to three parties.

Manish Jain Thanks.

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

Rahul Sharma Just wanted clarity on the dossier development for the markets. When are the milestones you are going to be accruing for us?

Sundeep Bambolkar You are talking about the specific deal which I talked about?

Rahul Sharma Yeah.

Sundeep Bambolkar If that deal is signed by the end of November or first week of December, which is as per our expectation, then there would be an advance of about 15-20% coming in on signing, and then as and when this fulfills our obligations stepwise, the milestones would start flowing in.

Rahul Sharma Okay, these deals are yet not signed. They are in the final stages rather.

Sundeep Bambolkar Yes, they are in the final stage of discussion. They have not yet been signed but the signing is slated to be around one month from today.

Rahul Sharma Okay. Thanks.

Moderator Thank you Mr Sharma. The next question is from the line of Mr Bhavin Shah from Dolat Capital. Please go ahead.

- Bhavin Shah** More of a macro question. Madam, if you could give your view on how things are planning out in emerging markets i.e. specific to exports. And most of the questions are answered in domestic formulation. Just wanted to get a fair idea on how the second half you feel will come out. Would it be more cautious or you are looking at an aggressive strategy?
- Sundeep Bambolkar** Emerging market?
- Bhavin Shah** Yes.
- Sundeep Bambolkar** Yeah, see all of us are aware that there is a severe dollar crunch in emerging economy and as a result you know that market has definitely slowed down for the time being. So we would not be very aggressive in the remaining half of the year. Rather we would focus more on regulated market because we have fixed contracts there and the order book position is very good.
- Aditi Kare Panandikar** However, as Sundeep has expressed, within a month we are going to sign this deal for our dossiers to be taken to the upper end of the emerging market to a very very large company and the whole idea, therefore, is to get the reach that they will give us in our products there and thereafter we are very confident with the molecules for which the dossiers are. The way the molecules have been selected, we will get very good results from that.
- Sundeep Bambolkar** Because those, that deal I think is only ophthalmic right now, a basket of six to seven products and that will be very very exciting.
- Bhavin Shah** And that is kicking off when sir?
- Sundeep Bambolkar** That deal would be signed by end of December.
- Bhavin Shah** Alright. Thank you so much.
- Moderator** Thank you Mr Shah. The next question is from the line of Ms Purvi Shah from Dalal & Broacha. Please go ahead.
- Purvi Shah** My question is in regards to exports. Overall, we have seen a growth of 15.61%. But in the emerging markets, we have seen a decline. I wanted to

understand the reason for that and when do we expect, exports to surpass the growth what we actually are achieving in domestic right now?

Sundeep Bambolkar As I said, I just explained the reason for the de-growth in emerging market. That is, you know, shortage of dollars across the globe in those economies.

Aditi Kare Panandikar Just to clarify that the order book is fine. We are not supplying to clients and countries where we see a possible problem with the default.

Purvi Shah Okay, so do we see a decline. I mean from the next quarter onwards do we see the increase coming back into these emerging markets.

Sundeep Bambolkar Yeah, yeah definitely there will be some increase but not a very large increase. I should say that.

Purvi Shah Okay so overall exports would be growing.

Sundeep Bambolkar Overall exports will provide 20% plus, both reg and semi-reg put together.

Purvi Shah Okay fine. Thank you so much sir.

Moderator Thank you Ms Shah. The next question is from the line of Mr Manish Jain from Axis Holdings. Please go ahead.

Manish Jain Yeah, just a follow-on question on the R&D side. Our run rate on R&D expenses more or less similar to last year. What is it going to be on an annual basis this year and next year?

Sundeep Bambolkar This will steadily go up. It will be flattish but when these deals are signed, it will have to go up because some investment will start occurring. But again they are having substantial income against those deals. So it is not a cause for worry at all.

Manish Jain Right. Yeah, just on the raw material front, we had seen a few of the pharma results which have come out, that materials to sales ratio has declined. Do you all foresee any of that benefit coming to you in the coming quarter?

Sundeep Bambolkar See basically as you are well aware, raw material consumption to net sales is a function of the product mix and at Indoco, the domestic business, the

regulated market and the emerging markets all three put together determine the product mix. So the moment the growth in domestic business starts coming as per this quarter, we will marginally see the percentage improving.

Aditi Kare Panandikar And as such for the time being since we are looking at higher growth in exports to reg markets, where the material contribution is higher and also in APIs where the material contribution is substantially higher, we do not think for Indoco this will come down to a great extent.

Manish Jain Right.

Moderator Thank you. Sir, at this moment there are no further questions. Would you like to add a few closing comments?

Sundeep Bambolkar Yeah sure. Well, I would like to thank all the participants. Ladies and gentlemen it was a pleasure having you with us on this con-call and special thanks to Mr Milind for organising the call. Thank you.

Moderator Thank you very much sir. On behalf of Tata Securities Ltd that concludes this conference call. Thank you for joining us and you may now disconnect your lines.
