"Neuland Laboratories Limited Q1 FY19 Earnings Conference Call"

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MANAGEMENT: **MR. SAHARSH RAO DAVULURI - JOINT MANAGING DIRECTOR, NEULAND LABORATORIES LIMITED**
MR. AMIT AGARWAL – CFO, NEULAND LABORATORIES LIMITED

Moderator: Ladies and gentlemen, good day and welcome to the Neuland Laboratories Limited Q1 FY19 Earnings Conference Call. As a reminder, all participant lines will be in 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 this conference is being recorded. I now hand the conference over to Ms. Shivangi Bubna from Christensen IR. Thank you and over to you, Ma'am.

Shivangi Bubna: Thanks Vikram. Good evening and thank you for joining the first quarter earnings call of the new financial year for Neuland Laboratories. Please note that we have already mailed out the press release to all of you and you can also view the same on our website as well as the stock exchanges. To take us through the financial performance of this quarter and to answer your questions, we have with us the top management from Neuland Laboratories represented by Mr. Saharsh Rao Davuluri - Joint Managing Director and Mr. Amit Agarwal, the CFO. We will start the call with Amit updating us on the financial performance for the quarter followed by a brief overview of the business by Saharsh. After that we will be ready to take up your questions and open the floor to the Q&A.

I would like to remind you that everything that is said on this call, which reflects any outlook for the future or which can be construed as forward-looking statement, must be viewed in conjunction with the uncertainties and risks that we face. These uncertainties and risks are included but not limited to what we have mentioned in the prospectus filed with SEBI and subsequent annual report which you can find on the website. That said, I will now hand over the call to Amit. Over to you, Amit.

Amit Agarwal: Thank you. Good evening, friends. A very warm welcome to all of you for joining this call. I will first touch upon the financials followed by Saharsh talking about the business highlights after which we will open it for Q&A. I would like to present you the Q1 financial performance. The total revenue for Q1 stood at Rs. 165.1 crores as compared to Rs. 119.7 crores in the corresponding period of the previous year, implying an increase of about 30%. EBITDA stood at Rs. 10 crores as compared to about 10.6 crores during the same period last year. EBITDA margin for the quarter stood at Rs. 6.5% compared to 8.9%. The net profit stood at Rs. 41 lakhs for Q1 FY19 as compared to Rs. 65 lakhs in the same period last year. Looking at the financial performance sequentially total revenue for the quarter stood at Rs. 165.1 crores over Rs. 160.5 crores in the preceding quarter, a decrease of about 3%. EBITDA came in at Rs. 10.1 crores as against Rs. 19.1 crores in the previous sequential quarter. Net profit stood at Rs. 41 lakhs for Q1 FY19 as compared to Rs. 8.05 crores in Q4 FY18.

I would like to bring to your notice that the Company is taking cost optimization efforts and working towards reducing its operating as well as its variable expenses. This is reflected in our financials quarter-on-quarter as well as year-on-year. As you would be aware we have raised around Rs. 125 crores though QIP during the quarter. The QIP's funds have largely been used for temporarily parking it in borrowings, which gives us headroom to invest in our future growth. In terms of our balance sheet, we feel we have the relevant strength now to take forward our growth with debt equity ratio at 0.35 total outside liability to tangible net worth at 1.12 and current ratio at 1.4.

I would now request Saharsh to give us the business highlights.

Saharsh Rao Davuluri: Thanks Amit. Good evening everyone. I am just to try add some perspective to the numbers that Amit had just shared. We continue to maintain the momentum in the revenue performance that we delivered in the last quarter of the previous fiscal. We are encouraged by the growth and order flow that we have seen this quarter which also indicate that we have addressed the issues around revenue growth which arose in the last financial year or at least for the major part of the last financial year. The revenue growth in the quarter was driven by good performance from the prime category products like Levofloxacin, Mirtazapine, Sotalol and Levetiracetam. We have also resolved the capacity constrains issues to a great extent and now there are no significant back orders which is also reflecting in higher sales and volume growth of products like Sotalol. However, the same is not reflected in our margins and the challenges are that we need to address on this front.

The low margin is primarily on account of 2 factors. One is the increase in raw material prices especially of the prime segment products and two is the low contribution from the CMS business this quarter. The lower contribution of CMS business is actually more of a reflection of the lumpy nature of that business, we talked about it in the past as well. We are confident of the pipeline of the products that we have and the traction of the business in general and therefore we foresee significant improvement of this business in the coming quarters and also in the coming years. As you might be aware the raw material price increases has been a cause of concern and this is largely due to actions taken by the Chinese government. We are tackling this raw material pricing pressure as well as supply consistency problems from various angles to ensure that it does not continue to affect our business in the mid to long term. Some of the operational measures being taken are, first is backward integration for the key intermediates at our own facility. Second is developing local alternate vendors for the products that we are relying only from China and third is to work closely with our customers on revising the prices for some of these affected APIs.

Besides this in terms of other highlights or other perspectives, in the GDS niche category we expect products like Deferasirox, Sugammadex to pick up in the coming quarters as we have seen volume ramp ups over here. We are foreseeing very good traction in the CMS business and we have a few projects which are initiated which are actually in the late stages of the clinical cycle. During this quarter we also file one US DMF for Posaconazole; which is an antifungal product. This which you recall is an addition to 4 DMFs that we filed last quarter and we further expect to file another 5 to 7 DMF during the current financial year. So, over a 15 months period we would have filed close to about 12 to 13 DMFs. The integration of the Unit-III facility the site which we acquired in December last year from Arch Pharma Labs is ongoing and in the long run it will serve as a base for new products which cannot be mapped into our other 2 facilities Unit-I and Unit-II. It will also we used as an alternate site for some of the key APIs with large volumes that are already being produced at near full capacity in Unit-I and Unit-II.

We expect to scale up in addition 2 to 3 new APIs from CMS and GDS category in this new facility towards the end of this financial year. The backward integration of some of the key intermediates in Unit-III which is an important risk mitigation and raw material price mitigation strategy is also underway. And we have scaled up 2 intermediates in this facility already and it is operational at this point. We expect that this facility will contribute to the bottomline of the company in the subsequent quarters. As was the practice in the previous quarters, we have also provided you with the CMS pipeline and we can monitor the progress of these projects over the quarter as I said before the numbers are self-explanatory but in case you have any questions we are happy to take them up in the Q&A as well.

Just to kind of summarize our thoughts, some Management perspective we see that the sales especially of the prime products the volumes are back. We continue to be sensitive to our expenses and are keeping our operating expenses under control. The Unit-III which was the acquisition which we did last year is now operational and getting integrated for supporting future growth. The business mix, especially involving new GDS products as well as CMS is evolving, and we see that as a solution towards long term improvement of profitability. RM issues are a concern, but we feel that we are addressing them as we speak and should have significantly lower impact as we go forward. In general, we feel that we are on the right track. So, having said this, I would be happy to open up the session for some Q&A and Amit and I would try to respond to the best extent that we can.

Moderator: Thank you very much, sir. Ladies and gentlemen, we will now begin the question and answer session. We have a first question from the line of Giriraj Daga from KM Visaria. Please go ahead.

Giriraj Daga: First of all, I have like one point to make because when we look at numbers you put in press release, we are observing is like this quarter if I see last quarter we had given prime revenue was about 61% for the fourth quarter. But this time we had restated the number to 56%. So, there is some restatement keeps going on in numbers, so we are not able to any which way getting hand that which number we should take up. So, there is some restatement keeps on happening on the segment wise numbers. So, this time now we had reported that 67% is come from prime versus 56% in the fourth quarter while we look at the fourth quarter press release that had mentioned about 61% revenue had come from the prime segment revenue. So, what is your thought there like? Why there is this restatement keeps on happening?

Saharsh Rao Davuluri: So Girirraj, I understand that there has been some classification related confusion in terms of how we have categorized this products and we understand that there has been some challenges in trying to reconcile what we have stating this quarter versus last quarter. I think, some of the reasons for doing that was I think, post the amalgamation of the 3 companies gave a certain part of the business like selling of impurities, etc. which were being categorized as prime and I think as part of our efforts to refine the whole process we have readjusted some of those numbers. But I think, in terms of absolute numbers prime this Amit maybe you can just respond in terms of what is the absolute number of prime this quarter versus what is the absolute number of prime of the last quarters. So, that we able to reconcile what we can also do post the call is we will also clarify exactly what the split is, so that this confusion does not arise again in the future quarters.

Giriraj Daga: Quarter number I will take it offline but if you can give me what is the total based on the latest representation? What is the total number for FY18 basis? What is the prime revenue, niche revenue, CMS revenue?

Saharsh Rao Davuluri: Giriraj, maybe what we can do is we just come back and answer that question later in the call. I am just having a colleague just open that spread sheet.

Giriraj Daga: My next question is if I look at the gross margin. So, there has been a significant dip there. One of the reasons I can witness is the contribution of prime has gone up which will mention was the low margin product and the second was that obviously the cost impact from the China API thing. So, where do you see this number settling for the rest of the year or let us say for FY19 average? Where they expect this number to settle down?

Saharsh Rao Davuluri: So your question is, on how do you see this the gross margins for FY19 how do you see this movement …

Giriraj Daga: Correct That it was actually related question that how do we see the segment moving for FY19 and then how do you see the gross margins settling down?

Saharsh Rao Davuluri: So, I think broadly speaking, Giriraj the prime product contribution this quarter has been significantly higher as we spoke. I think compared to the first quarter of last year it has almost 20%-25% increase in terms of value as well as volume. This unfortunately has also had a negative impact in terms of gross margins because prime product is where we are actually facing a lot of these raw material pressures. In a general sense, our gross contribution for the prime category or for the GDS category has been historically at about, maybe around 50%. I think, we have been talking about the gross margin for the overall business which has been around 50%. But I think, in Q1 it has been at around 40%. But going forward, as I mentioned in the opening remarks based on the mitigation steps we are taking we expect that we should get back closer - if not to 50%, we should get back closer towards 50%. So, for the overall year itself it should be a mix between what we have done in first quarter and over the next 3 quarters. So maybe, I will invite Amit to just share some more clarity on that.

Amit Agarwal: If I look at my EBITDA margins for the quarter, it is about 6.5% and …

Giriraj Daga: Actually I am placing more on the gross margin which was the 44%.

Amit Agarwal: Yes, so I agree. There related products I will answer in terms of the gross margins as well. In terms of gross margin also as Saharsh pointed out that last year we had significantly higher gross margin of about 55%-60%. This year it is about 43%-44%. Now, there are two things that are going to happen from this quarter and as we go forward. One, see the raw material prices which are high we do not expect them to come down very significantly in next 1 or 2 quarters. However, we should be able to or we are being able to pass on the cost increases to the customers. So, that should lead to even out of the raw material price impact that is point number one. Second challenge that we face in the quarter was that there was higher percentage of GDS product which, GDS prime essentially which essentially has a lower margin, right or be a little lower than 40%. So, therefore this also will get corrected with CMS kicking in between second and more so, in third and fourth quarter. So, I think for the year as a whole we do see our gross margins is not at 55%-60%, we do see them at least it should definitely cross 50%.

Giriraj Daga: Second, what is the gross debt and gross cash as of now?

Amit Agarwal: So, the gross debt if you ask me as on date it is about 220 crores.

Giriraj Daga: And gross cash level?

Amit Agarwal: Gross cash as on date will be close to about 30 crores.

Giriraj Daga: We have repaid the debt in the QIP money?

Amit Agarwal: Yes, we paid close to about 110 crores.

Giriraj Daga: My last question is related to the CMS pipeline looks very impressive because we have improved on quarter-on-quarter basis. So, from 32 we are now going to total 44, so if you can just give the first data point the segment wise revenue in the next guidance including the CMS? So, where we see this number going since the CMS pipeline looks very strong. That is all from my side, thank you.

Saharsh Rao Davuluri: I think, the CMS pipeline as you observed has continued to increase because we have seen that influx of projects happening over the quarters. I think, what you would have seen in that dash board that we have changed is some of the late stage opportunities have increased and that is what gives us an indication that there are a few commercial or near commercial opportunities in our pipeline. However, it is a little difficult for us to project how much revenue impact and by when we will have. But I think, over the next 2 to 3 years we expect at least 3 or 4 molecules from this pipeline to get into a commercial phase. And those should help us significantly drive the revenue growth besides the molecules that are already there in the pipeline. I think, it would be very difficult for us to indicate what will be the impact in FY19 itself but as I had mentioned in the opening remark, towards the end of FY19 we are expecting to scale up 2 molecules, which could get into commercialization. But commercial revenue itself will take perhaps another 2 years. So, that is the clarity that we can provide on CMS pipeline itself.

Amit Agarwala: And I would just like to make one remark in terms of the margin as well. Now, these are our best estimates, you really the way business will pan out and the way things are today. So, it is not, it is only a guideline. I do not think we are really committing to that number is more of our sense and our belief that we should be able to achieve that.

Moderator: Thank you. We have a next question from the line of Rashmi Sancheti from Anand Rathi. Please go ahead.

Rashmi Sancheti: Just wanted to know on the raw material cost like how much is the impact, total impact from the increase in raw material prices on gross margins?

Saharsh Rao Davuluri: So, see you are asking for absolute in terms of, the absolute number …

Rashmi Sancheti: No, not absolute number even if you can tell me in percentage or anything which you can quantify like you have given 2 reasons for your lower gross margins, lower CMS segment and hike in raw material prices. So, just wanted to know that whether 50%-60% or what kind of impact is coming mainly from raw material prices?

Amit Agarwal: Sure, the impact of raw material prices is close to about 10 crores, right on this quarter profitability. Hope that answers your question

Rashmi Sancheti: Yes and so, basically you have said that in the subsequent quarters the gross margins would come back to like 50% and all, right?

Amit Agarwal: They should improve definitely from these levels. So, these reasons that I quoted now whether it will be 50% more or less it is difficult to say at this stage but definitely there will be better than what they are at this stage.

Saharsh Rao Davuluri: I think the margin coming back is the factor of the business mix as well as the raw material situation in China itself. So, while we have certain actions in place to bring the raw material cost back on track, the business mix which is the contribution of CMS and the niche products also will have an impact. I think what Amit had indicated as a response to the previous question is kind of a general sense of where we are.

Rashmi Sancheti: And basically what is the time lag between passing on to the customer?

Saharsh Rao Davuluri: I think this is something that kind of unusual experience that we had. I think, for us it taken us close to about 4 to 5 months to work with customers and provides that clarity with data, with enough time for them to do their own due diligence. And at the end point is also not that we are able to pass on the cost 100% to them because these are prime products, these are high volume products where the customers are also having their own challenges. So, what we are practically ending up is probably somewhere mid-way. We still have not to absorb some of the cost and pass on some of the cost to the customers. But, yes the whole process is taking as about 4 to 6 months to get the customers to empathize with the situation and then pass on whatever benefits they are willing to give us.

Rashmi Sancheti: And my second question is related to your new facility. When are we going to start API production from that facility and basically just want to know like how much new CAPEX would we spend on that particular facility? So, you can just tell me the new CAPEX as well as the total CAPEX for FY19 and 2020?

Saharsh Rao Davuluri: So, let me answer the first part and request Amit to answer the second part. Right now, this facility as I had indicated there has been used largely for intermediate manufacturer. But we have plans make API there as well. Largely it will be used for 2 kinds of API, one is where we already have the APIs in Unit-I, Unit-II but the APIs required additional capacity and therefore we will also have to file Unit-III as a site that is the one category. The other category is the new products, both in the CMS as well as in the GDS category whatever new products we are now planning to scale up including may be some of the future DMF that we will file we would be doing that from Unit-III. However, we do not currently have the necessary clean rooms or the designated spaces for doing the final stage of the API, that is where we would need some CAPEX and that is something Amit will comment on. In terms of timeline, we have already initiated plans to create a clean room in the Unit-III facility we expect one clean room to be ready perhaps by the end of this calendar year and maybe start operationalizing it by the last quarter of the year. And if we are able to bring our other projects also close to scale up by the end of this year and next financial year we will be creating more clean rooms as well. So, between now and in the next 18 months, we really be would like to scale up at least 3 to 4 APIs in that new facility.

Rashmi Sancheti: And the CAPEX part?

Amit Agarwal: Yes so, on CAPEX based on our current visibility of products in next 12 to 18 months we should be incurring close to about 80 crores to 100 crores.

Rashmi Sancheti: 80 crores to 100 crores which is spread over FY19 and 2020?

Amit Agarwal: Yes.

Rashmi Sancheti: And the additional CAPEX, I mean if you can give the bifurcation like out of this 100 crores how much will be on this new facility?

Amit Agarwal: As I said between FY19 and FY20 this 80 crores to 100 crores will be entirely on the new facility.

Rashmi Sancheti: Then what is the total CAPEX?

Amit Agarwal: There will be some maintenance CAPEX which will be there in Unit-I, Unit-II which is anywhere between ballpark 30 crores, 20 crores to 30 crores.

Rashmi Sancheti: 30 crores on an annual basis, right?

Amit Agarwal: On annual basis, yes.

Moderator: Thank you. We have a next question from the line of Amey Chalke from HDFC Securities. Please go ahead.

Amey Chalke: I just have 2 questions one is related to raw material cost. Just if you can clarify how much of the sale is on the fixed contract basis and how much were you can negotiate with your current customers in the prime API segment?

Amit Agarwal: So, see on open orders where we have already closed the contract, there we cannot negotiate, and those contracts also are not long-term contracts. They are in the 2 to 3 months, 4 months contract. In all the other cases we can negotiate.

Saharsh Rao Davuluri: I think, our arrangement both on the, especially on the GDS front Amey is that the prices are generally negotiated in the previous financial year. But we do not have any kind of a contract that binds us to the pricing. And before as Amit had said whatever open orders are there in the system that is where generally companies would be very reluctant to cancel and putting new orders at higher prices. Which is also to the previous question that was asked by the previous participant I had mentioned that it has taken as 4 to 6 months to bring them out, the price increases only because the customers want us to first clear the open orders at the pre-agreed prices. On the CMS front there are price contracts but then we do not have this challenge on the CMS front because the cushion is our better over there and we have other mechanisms to protect us against such spikes.

Amey Chalke: But if you can quantify, because typically these issues have been faced by many other API players as well. But what they are guiding is that some of the orders are formula based where in the price hike is there in the one of the key raw material which contributes significantly to the total cost. Then they have that leverage to take the price hike in the API side. So, if you can give some color, if any of our top 4 molecules which are there in the CMS side where we can have such kind of arrangement?

Saharsh Rao Davuluri: See, I think we in our experience do not have such formula based agreement. We are familiar with such terms in fact I think we know some of our customers would do that with other products and those have been contemplated in the past. But I think, given the specific molecules that we are dealing with we have not seen any raw material price connectivity in our contracts. They are a few products where critical raw materials are actually purchased and supplied by our customer directly. And those are pass through expenses for us. So, we are not even sensitive to the movement of raw material prices on those. And those also we agreed on that because that was our way of mitigating any volatility that might come out of that. But having said that most of our prices are based on the general trend in the market and our costs and the efficiencies of the process and like I said they are subject to negotiation based on such uncertainties hitting us.

Amey Chalke: My second question is related to CMS segment. How much of the total revenue from the CMS segment is coming from the commercial quantities which we give out to our customer?

Saharsh Rao Davuluri: On an annualized basis, I think few one numbers it will be difficult to give you that insight but if we look at FY18 or even the FY17 console numbers approximately 60% to 65% of the total revenue that we see which is reported under CMS is largely coming from commercial stable molecules. Molecules where we have been doing business for anywhere between 2 to 6 years, the remaining 30% to 35% business comes from initiating projects or second time projects which are still not commercial. And that is what forms that dashboard that we keep publishing every quarter. So, for Q1 it is largely from the base line numbers those stable recurring molecules are what have contributed to revenue in Q1. From a timing perspective actually we were not really willing to any significant billing of any of the projects that come in the non-recurring natures in Q1. So, that is the clarity that I can give at this point.

Amey Chalke: So, you see any ramp up in the existing commercial molecules or in terms of the orders you all are getting for the FY19? Or any color which you are getting from your customer side?

Saharsh Rao Davuluri: See, our CMS business which that 65% which I am referring to which is the base is comprise largely of 4 to 5 molecules. And these 4 to 5 molecules for different markets and they have different proportions within that pipeline. They all has been fairly steady for the last several years. There is one of them is a newer molecule that got launch couple of years ago. And we still have a lot of uncertainty in the ramp up and volume movement of that molecule. But the short answer to your question is we are seeing only steadiness at this point. There has been one molecule which has been actually growing at 20%-25% over the last 3 years and that is continuing to grow. The newer molecule which came in is very volatile, so there are quarters where we have orders, there are quarters where we do not have orders. But that is a molecule that we are also expecting should give us good revenues going forward. But at this point we cannot really give any kind of outlook or guidance on that base.

Amey Chalke: So, is it fair to assume that going ahead whatever growth we are expecting from the CMS segment is largely driven by the new customer acquisition on new orders which we expect to do?

Saharsh Rao Davuluri: Absolutely. If the 5 molecules continue to be the only molecules in our pipeline, then the CMS business will only grow at maybe 10% to max 20% that is our estimate. Again some of these molecules are new, so we could be pleasantly surprised but at least that is what our budgets and all that are saying. I think, the growth is largely going to come from the pipeline that we have because there are product categories like peptides, etc., where there are some high-value opportunities also which are entering the system and the growth that we will see from those molecules will definitely overshadow whatever growth these molecules will give us.

Amey Chalke: Have we been able to close the peptides molecule contract in the commercial stage or do you think it is still sometime away?

Saharsh Rao Davuluri: We have couple of projects without getting to specifics, all the projects are continuing as per plan. There has been nothing that either has dropped off or created any kind of negatives for us. But yes, I think, these projects are kind of in the ramp up phase, so we expect commercialization to happen maybe starting from next year.

Moderator: Thank you. We have next question from the line of B. V. Bajaj from Bajaj Shares and Securities. Please go ahead.

B. V. Bajaj: Now, my first question is the CAPEX is under way for Unit-III and also we had expansion of equity. So, with the borrowings which are more than 515 crores as on ending 31st March, do you expect all this will allow us for a good margin because the first quarter Q1 margins have fallen though our revenue has gone up to 155 crores in that result in introspection do we have good margins for the whole year? That is one question. Second one is, sir I had about the Chinese supply and de-risking raw material supplies for existing products. So, how long the contracts are, which are open and are they are valid for 3 months or 6 months? So, that later we can have price escalation accordingly we can have the margins better. Otherwise with the old quoted revenue pricing will be continuing this problem and the validation of intermediates that API which are underway for 12 numbers for commercial, how you identify them as a deriving commercial growth for our, this financial year?

Amit Agarwal: On the first part on the debt just to give you the correct number we ended March with a debt of 319 crores and currently we are at a debt of 220 crores, which I stated at the beginning of the call as well. So I think, the debt levels are not impacting any kind of margins right now. That is point number one. Second in terms of our margins being low right now and how are they expected to improve going forward which is what we answered to the first participant. It is essentially that one – since we support in our big way on account of increased raw material prices as the contracts with the customers as they are maturing. We are re-negotiating the prices and customers have been accepting the price rise because they understand that it is gross industry scenario. However, we are not able to pass the entire cost to the customer, yes but then last quarters the cost is being passed on to the customer which should contribute to improvement in the margins going forward. Along with that our product mix also will improve because this quarter our product mix was heavily stood on the prime GDS category which we expect it should get better as we move forward in Q2 and primarily in Q3, Q4. So therefore, I thin k that is the step or that is the action plan we have in mind to be able to improve our margins. I think that answers your first 2 questions. Your third question, I think was about the pipeline that we have and how it contributes to the revenue and commercial going forward which I request Saharsh to answer that.

Saharsh Rao Davuluri: So, I think on the pipeline of growth I was also trying to respond to the gentleman, Amey who had asked the similar question. For us today I think the CMS business is still in its early stages. I think, the base of the business is still small and therefore there is some volatility from that business. But we recognize that is in a highly profitable business and it is contract basis business. So, there is a lot of certainty in the business. For us our strategy on the CMS business has been to try to align with a late stage molecules which are either just commercialized or about to get commercialized. Today our excitement with this business is that there are several opportunities actually precisely speaking about 8 molecules in development stage. And about 11 molecules in Phase-III stage which are all candidate for future commercial revenue for the company. So, today the company is putting in lot of efforts to do the development work on time and work with the customers, so that we are able to secure the commercial contracts for the molecules. Of course, because these are molecules which are still not approved or maybe just still getting into the market there is also an element of uncertainty whether the drug will get approved or not. But not with standing that external uncertainty within Neuland we feel that we are in a very good position because that pipeline of 8 opportunities in development and 11 in Phase-III is the highest we have had. And we want to keep adding to that because it is almost like a portfolio strategy. The more we have the better chances we have of having more successfully commercial molecules and now that we have the new facility also ready and that we intend to create the API spaces for that. We will be able to ramp them up without any operational constrains, etc. So, while it is difficult for us to give any revenue guidance, we think that the CMS business will definitely drive the overall growth of the business. So, I hope that gives some clarity to you.

Moderator: Thank you sir. We have a next question from the line of Ranveer Singh from Systematix Shares & Stock. Please go ahead

Ranveer Singh: You say other expenditure during this quarter has been lower. So, what was the reason, if I see the sequential of previous quarters the run rate has reduced? So, any particular thing there?

Amit Agarwal: As we mentioned in the beginning of the call that Company has been taking measures for reduction of expenses. So, without really getting into any specific item, I think it is an overall reduction that we have been able to manage in our other expenses which would include expenses like the legal expenses, the consulting expenses and things like that. I think, they have seen a reduction but it does not mean that the reduction will be like if you see the reduction is close to about 4 crores vis-à-vis sequential quarter. So, we are not saying that we will have a similar reduction in the next quarter as well. But yes, that is a directional thing that we are reducing the operating expenses.

Ranveer Singh: No, so that will continue that run rate …

Amit Agarwal: That will continue but it may not continue at the same rate. Overall for the year you will find that our operating expenses will be lower than the last financial year.

Ranveer Singh: And secondly on debt side, where do you see your debt going by end of FY19?

Amit Agarwal: See, from the current levels we expected to rise depending on how the capital expenditure moves. So, the debt reduction initially has happened from the QIP proceeds largely and the QIP was done largely to fund our future growth. So, as we invest in our capital expenditure the debt will rise. So, as I mentioned that over next 12 to 18 months we should be spending about 80 crores to 100 crores. So, my sense is if not the entire amount but large part of this funding of 80 crores to 100 crores will come from debt.

Ranveer Singh: And what could be the cost of debt currently?

Amit Agarwal: Currently a blended cost of debt, long-term, short term put together it is close to about 9%.

Moderator: Thank you sir. We have a next question from the line of Nimish Mehta from Research Delta Advisors. Please go ahead.

Nimish Mehta: If you can just let us know for which API the raw material price has seen an increase and now by how much percent? And second, you mentioned that you are likely to either manufacture it or locally source it**,** how much of this will you be manufacturing it?

Saharsh Rao Davuluri: So, Nimish, I think with regards to which APIs the raw material prices have gone up. This price increase of raw materials has been in the prime category of APIs and the prime category of APIs are some of our large volume products that information is already been shared. Within this product category, we have more than 20 products which contribute significant revenue not every products raw material has gone up. But of course some of the top 5 products that we operate in have had some impact or the other. We would not like to get in to the specific details of which product raw material has gone up versus not but we can only indicate that the increase has happened across more than 3 to 5 APIs. So, it is a general trend that we have observe and we have also observed that this trend is there also for many APIs where Neuland is not even involved where we are seeing it happen from with our peers in the industry. With regards to our future strategy or continuing to manufacture these APIs, I think as a strategy we would like to continue making these APIs because if you go back and look at what is Neuland's strategy we are largely operating only in the regulated market, where our customers are also using Neuland as the only or maybe 1 or 2 sources.

Nimish Mehta: Sorry to interrupt, but I am asking what is strategy to manufacture the intermediate? So, like of this what do you think let us say, I mean hypothetically assuming that you would have 5 APIs raw materials is got to impacted, I mean 5 more sensitive. Of that do you think we will be able to manufacture most of it or you think we will be just some ballpark understanding? How much will manufacture or so, how much will outsourced? And actually the real …

Saharsh Rao Davuluri: Thanks for interrupting and clarifying. So, our strategy would be a on a case-to-case basis, Nimish. So, what we have been doing and we have been doing these activities since November since we got the first indications that there are some plant closures in China. We have identified all these critical raw materials and we trying to ascertain what would be the right strategy for each of these raw materials. There are few raw materials which actually would be very valuable for Neuland to manufacture in our Unit-III facility and we have identified those raw materials and we have also developed processes and we are in the process of scaling up these raw materials. There are a few raw materials which we believe are not suitable for our facilities and we would actually lose value. If we produce them in our facility and for products like that our strategy is to qualify a competent local manufacturer as an alternative to the Chinese. And there are a few raw materials where we are perhaps not still able to secure local raw material manufacturers but we are diversifying our supplier base by qualifying other raw material supplier even if they are from China and in those cases, we are as I had indicated earlier passing on the increase in prices to the customer. So, I think it is really a case-to-case basis where only a few of them fitting to the backward integration strategy.

Nimish Mehta: And last related to that is also wanted to know, so let us say this quarter you had mentioned the Rs. 10 crores is the increase with our raw material increase. So, if hypothetically if you have been able to either manufacture it on your own and been able to offset some another alternative site or local or whatever. How much do you think of the 10 crores you will be able to sale because it is almost impossible to get back to the previous prices that which you must be importing the products. So, what will be that roll back do you think, you can give me a range again there?

Saharsh Rao Davuluri: I think it is a slightly difficult question to answer Nimish because for us some of these raw materials in that 10 crores are we will not have the competence to be able to manufacture at the same cost that our suppliers are. Some of them we may not want to do it because they would be other, they would be value loss, etc. from other products. I think, the short answer to that is there would be a few products where we think we will be able to add value and we should backward integrate even if the situation from China were not to happen. I think, those are the kind of products were we would like to backward integrate and may be if we were to do that and we were able to protect value maybe we would have protect it to the 3 crores out of that. But again this is a very intuitive answer and I would ask not to hold me against that and I do not know, Amit you want to add any perspective there?

Amit Agarwal: I think, one with this raw material issue coming up, I think it is not something which will sustain for very long. So, putting in money except for the strategic cases where we want to grow volume. There as a strategic case, I agree with you and that is what Saharsh said but not for every item because once the prices are going up the other manufacturers who are trying to ramp up their capacity looking at that opportunity. So, probably it might become a business case today but maybe 2 or 3 quarters down the line, it may not be a business case. So, I think we have to be very guarded in that as well. So, might as well face some difficulties upfront then having a long-term loss. I think we are taking a firm decision, so as Saharsh said that we will look into the backward integration for products which over the long-term we are wanting to grow and yes that is way you would want to do a backward integration.

Moderator: Thank you, sir. We have a last question from the line of Ashi Anand from Allegro Capital Advisors. Please go ahead.

Ashi Anand: You have an interesting pipeline in terms of the niche APIs, however now the value to us as Neuland would really be a function of one the volumes then the pricing on the API and what kind of market share we could actual get? First, the question really was when looking at FY19 and FY20 what would be the 2 or 3 larger opportunities in terms of potential revenues in Neuland? And over 3 to 4 years per timeframe, what percentage of revenues you actually see coming from this APIs?

Saharsh Rao Davuluri: So, I think from a near term perspective FY19 to FY20 we expect maybe 20% to 25% of our business coming from niche APIs. Our niche API basket is actually quite diverse we have talked in the past about this molecules Salmeterol all that something that we believe is extremely exciting but also it is little frustrating because the approvals of this molecule especially in the large market of the US are still pending. And we still believe that once those approvals start coming in it will be a flood gate and if that happens then that category will be driven by Salmeterol. But not withstanding that we have other molecules like Sugammadex, Posaconazole, Brinzolamide, Dorzolamide other molecules in this category which are also increasing in volumes as they are all either coming up pattern soon or have come up pattern in the recent year. These products are something that will drive the growth of the niche segments in the near term. And their market size and growth prospects are slightly uncertain for us because they determine largely by the success of our customers and the penetration of the generics in those respective markets. Having said that even on the prime category molecules like Labetalol, molecules like Levetiracetam, Levofloxacin or Sotalol as we mentioned, I also mentioned molecules like Mirtazapine these are all molecules on the prime category which have also been growing in terms of volumes. So, we would, if we are really looking at FY19-20 perspective growth will come from niche category as I explained. Some volume growth we are seeing which is actually a pleasant surprise for us on the prime category from products like Sotalol, Levetiracetam, Mirtazapine, Levofloxacin I think that will also drive near term growth. The third and very importantly is on the CMS front, some of these new pipeline molecules that we have talked about and responded to some of the participants on the earlier question, I think when volume ramps up of those molecules happen we could see some significant impact in FY19 towards the end of it and FY20 also. But we want to be a little bit conservative and careful in terms of guiding how much revenue contribution will coming from such products. But these are largely the line items that we think will drive the growth of the business in the next 1 to 2 years.

Ashi Anand: If I could just ask one follow up. When we are looking at this something like Salmeterol, I think, it is high price but low volume kind of a product something like Propofol or Donepezil would be high volumes and lower prices and for us how should we really look at this? Should we be looking at our potential competitive kind of market shares we could earn on it or would a higher price kind of a molecule be higher margin and therefore more interesting opportunities? Just want to understand how to look at this?

Saharsh Rao Davuluri: Sorry, your question is about how we define niche molecules in Neuland or is it more about how we select molecules in Neuland?

Ashi Anand: More in terms of, so I am looking complete Propofol, right as on the API market seems to be a larger market something like Salmeterol because it is that much higher volume drug? However, that also be higher in terms of competitive intensity because volumes are higher therefore more people may be interested in that? I just trying to understand from that kind of perspective which are larger opportunities was in terms of overall revenues in EBITDA or the overall kind of niche basket is chosen as places where we would be very competitive and we able to get high market shares?

Saharsh Rao Davuluri: I think, it is a very pertinent question and I think, the way we are looking at products today we would look at small volume and mid to large volume products as well. And while it might seem like a very broad strategy what important for us is the chemistry the underlying chemistry. Now whether it is a Donepezil or a Propofol or a Salmeterol, what is the common thread that connects the 3 products is that all 3 molecules are recently complex in nature and therefore, they are not too many API suppliers out in the market. Volume wise there is a lot of diversity within our product profile and therefore our facilities including the new facility the way we are designing them and integrating them we want them to be multi product facilities and we want them to be diverse in terms of volumes. What we will not like to do is make products which are very straight forward chemistry and largely operational driven. Some of the large products like Sartan, some of the antibiotic molecule where the chemistry is reasonably sorted out it is more about execution and the plan that determines the efficiency and the profitability. So, that is how we are looking at products and products like Ciprofloxacin or even maybe even Levetiracetam which we currently have enough product portfolio maybe in the future we would resist picking up products like that because the reality is that the chemistry of this molecules are straight forward unlike the Propofol or a Salmeterol chemistry.

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

Saharsh Rao Davuluri: Thank you so much for all the participants who joined the call. We believe all the questions are extremely focused and relevant. I think, there were several insightful comments made by the participants as well. From the management's perspective, as I had said in my opening remarks we feel very focused. We are also very excited because our sales volumes are looking very positive that gives us the confidence to build on it. Our operations are now completely streamlined. We do not see the kind of challenges that we had last financial year. Our Unit-III we are very excited about that getting that integrated and operational would mean that we would be able to add new business seamlessly without adding any operational constraint. Our business mix while not evident in the current quarter's performance is definitely evolving. I think, that is quite evident in the CMS pipeline data that we shared and the kind of DMFs that we are filing. We are very excited about the fact that our DMF filing has increased after the gap of about 3 to 4 years we are now back to a good speed in terms of filing DMF which is also an indicator of future growth. The raw material issues are real and those are something that we feel we have in control while it may not bounce back immediately we feel that we gone through the worst face and therefore we will be able to still have a very financial year. And I think in summary, we are definitely on the right track. So, thank you for again your interest in participating this call and look forward to having you joined us in the next quarters call again. Thank you very much.

Moderator: Thank you very much, sir. Ladies and gentlemen, on behalf of Neuland Laboratories, that concludes this conference call. Thank you for joining with us and you may now disconnect your lines.