“Neuland Laboratories Limited Q4FY’16 Earnings Conference Call”

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MANAGEMENT: MR. D. SUCHETH RAO – CHIEF EXECUTIVE OFFICER & WHOLE TIME DIRECTOR, NEULAND LABORATORIES LIMITED
MR. D. SAHARSH RAO – PRESIDENT & WHOLE-TIME DIRECTOR, NEULAND LABORATORIES LIMITED
MR. ANIL KUMAR – CHIEF FINANCIAL OFFICER, NEULAND LABORATORIES LIMITED

MODERATOR: MR. DIWAKAR PINGLE – CHRISTENSEN IR

Moderator: Ladies and Gentlemen, Good Day and Welcome to the Neuland Laboratories Q4FY'16 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 '*' and then '0' on your touchtone phone. Please note this conference is being recorded. I now hand the conference over to Mr. Diwakar Pingle from Christensen IR. Thank you and over to you, sir.

Diwakar Pingle: Thank you. Welcome Everyone and Thanks for Joining the Q4FY'16 Earnings Call for Neuland Laboratories Limited.

Please note that the 'Results' have been mailed to you and you can also view this on the website at www.neulandlabs.com

To take us through the 'Results of this Quarter' and to answer your questions, we have with us today Mr. Sucheth Rao – CEO and Whole Time Director; Mr. Saharsh – President and Whole-time Director; and Mr. Anil Kumar who is the CFO.

We will be starting this call with an Overview providing brief the Company's Performance which will then be followed by Q&A Session.

I would like to remind you that everything said on this call that reflects any outlook for the future which can be construed as forward-looking statement, must be viewed in conjunction with the uncertainties and the risks that we face. These uncertainties and risks are included but not limited to what we have mentioned in our prospectus filed with SEBI and subsequent 'Annual Report' which you can find on our website.

That said, I now turn the call over to Mr. Saharsh Rao. Over to you, sir.

D. Saharsh Rao: Thank you, Diwakar. Good Evening, Everyone. A Warm Welcome to All of You who have logged on to this call.

Given that this is the Full Year Results, I will first briefly touch upon the Full Year numbers and then look into the Quarter Financials. For the full year 2016, total operating income was approximately Rs.510 crores for FY'16 compared to Rs.469 crores in FY'15 which represents an increase of about 9%. EBITDA margin stood at 16% for FY'16 as against 14.3% for FY'15, which is an improvement of 167 basis points. Net profit stood at Rs.26.4 crores for FY'16 compared to Rs.15.8 crores in FY'15. Basic EPS stood at Rs.29.74 as against Rs.18.47 in FY'15.

For the Fourth Quarter ended 31st March 2016, the total operating income was approximately Rs.135 crores compared to Rs.123 crores in Q3FY'16 which represents an increase of about 10%. EBITDA margin stood at about 15.5% for the quarter as against 15.8% for Q3FY'16. Net profit stood at Rs.6.68 crores for Q4FY'16 compared to Rs.6.28 crores for Q3FY'16.

In the past, during our interactions with analysts and investors, actually we have seen some feedback to improve the quality of our disclosures that would actually help them understand the business better and therefore we have this time around enclosed the 'Presentation' with the 'Press Release' which attempts to do that. In this 'Presentation' you will see that we have actually split up the businesses into two distinct areas – First being the Generic Drug Substances or GDS which is the definition we have given to the Generic API business and the CMS business which is something you have been familiar in our past descriptions as well which refers to the Contract Manufacturing business. The GDS business segment which is a Generic API has been further segregated into Prime Products and Niche Molecules. Prime Products refers to the more larger volume relatively undifferentiated products whereas the Niche molecules is very obvious in its name itself. We hope that these are steps in the right direction and our efforts would be to keep on improving on these metrics as we move towards achieving excellence in transparency and disclosure norms.

So if you quickly take a look at this "PowerPoint Page #4" you would actually observe that CMS contribution in this quarter has been at about 24% compared to 16% in the previous quarter and there is an excel piece of interesting information which we have shared for the first time and we will continue to share going forward is in Page #5, we have actually shared the number of molecules both in Clinical and Commercial which are contributing to revenue in this quarter.

Now, talking about the quarter itself, one of the main reasons for the revenue increase from Rs.123 crores to Rs.135 crores is largely because is driven by the CMS business, on a full year basis the CMS business has increased by about 400 basis points to 17% in FY'16. Also, the contribution of the Prime products on an annualized basis has dropped to 57% from 65% in FY'15. From an operational perspective, I would say that this is another great quarter for us as we scaled up two molecules in the CMS space – one is actually a slightly larger volume, late life cycle project and the other is a higher volume batch for a New Chemical Entity for one of our US clients.

In addition, I would also like to mention in the Niche molecules category of our Generic business, we would have probably recorded a higher revenue if it was not for a few orders which actually spilled into Q1, and I just wanted to add that could have otherwise further improved our margins for the quarter.

So just to summarize, we have had a fairly good FY'16 both in terms of financial and operational terms; however, we still believe that a lot has to be done in terms of scaling up the business which is really when we will start seeing consistent performance and profitability. Certain other operational aspects of the business for the full year have been highlighted in the 'Press Release' which also has been shared with all of you, but in the interest of time I will request you to go through the same.

So, I would like to throw the floor open to Q&A. Thank you, again.

Moderator: Thank you, sir. Ladies and Gentlemen, we will now begin the Question-and-Answer Session. We have our first question from the line of H R Gala from Panav Advisors. Please go ahead.

H R Gala: I just wanted to know, there has been a remarkable improvement in the EBITDA margin as you have explained. To what extent is this due to say higher contribution from the Custom Manufacturing space from 13% to 17%?

D. Sucheth Rao: I think it is a good question. Just to clarify something we have even mentioned earlier is I think as far as the margins are concerned, we look at both Generic APIs as well as the Custom APIs to give us higher margins, I think we have mentioned clearly that our entire product selection process, whether it is on the Generic side or the Contract Manufacturing side, is to ensure that it grows the overall margins of the business. So, I think whatever improvement or sustainability of margins that you are seeing is coming from both sides of the business.

D. Saharsh Rao: Just to refer back to what I have just said in the opening remarks, we have also mentioned that the Prime products which are really the volume APIs which have been our older products, their contribution actually this year has dropped, because both the Niche Generic APIs as well as CMS business have increased. So, I think that is the key response to your question. I think it is both the segments which are really driving up the margins of the business but within these two segments it is very hard for us to differentiate which is higher margin, which is not, because there are wide variety of products in both the categories with different ranges of margin.

H R Gala: In terms of the manufacturing capabilities that we have, up to what level of revenue do you think we can go without any major capital expenditure?

D. Sucheth Rao: Another good question, but based on the product mix, it could go up to Rs.750 crores plus/minus the variability based on actual product mix. So we cannot give you a exact number but a range and it could be…

H R Gala: Any major capital expenditure going ahead either in this year or next year?

D. Sucheth Rao: Yes, I think we mentioned earlier that we do have five years strategic plan where we are constantly estimating, evaluating how much capital expenditure we require. This current year…

Anil Kumar: Actually, if you look at the numbers for FY'16, we spent almost like Rs.22 crores on CAPEX, this includes a lot of maintenance CAPEX; however, going forward for FY'17, we are not looking at a major expansion but we would continue to spend money on maintenance of the CAPEX, we would spend about close to say Rs.20-22 crores on maintenance CAPEX.

H R Gala: Oh! That is all. So that is not much?

D. Sucheth Rao: Yes, there will be CAPEX the following year, but again that is under constant evaluation, so the numbers have not been crystallized yet.

H R Gala: When you enter into any deal in the Contract Manufacturing space say at an initial stage of research, I think probably the volume will not be high but the margin will be substantially higher and then as you scale up I think it will move the other way round. So, by and large the molecules that we have in the CMS space, at what stage of R&D process they are being supplied to the players?

D. Sucheth Rao: As far as the Contract Manufacturing is concerned, the opportunities are all over the space, right, we have molecules which are in Phase-II Clinical trials, we have molecules which are in Phase-III, and also molecules which are already Commercial. So we are targeting business from this entire space. So we will have specific projects which come to us which kind of meet the criteria that you said but have an initial margin which is higher, then when it becomes Commercial, but at the same time we also get projects where the molecule is already Commercial which give us high volume. So it will really depend on the mix and we cannot comment on any specific molecule as such.

H R Gala: Would you like to give some guidance as to where do we go in FY'17 in terms of revenue growth and margin profile?

D. Saharsh Rao: I think we have said it in the past also that we never give guidance in terms of revenue especially FY'17, but if you look at our previous investor calls or whatever interactions we have had, we have always maintained that given the potential of the business and the kind of strategy we have in place, we are aspiring on a long term basis at 20-25% revenue growth, but it is very difficult for us to comment whether this kind of growth will be linear or how it would be achieved.

H R Gala: How do you see the margin profile from say current level of 16%?

D. Saharsh Rao: I think again in line with what I have said, over time we have seen the potential of this business to take us to 20% EBITDA margin and we clearly see that happening as our revenue will continue to grow and we get better operational leverage out of our facilities. I think as Sucheth has commented the moment we are able to deliver more revenue from the same facilities, we see that having a direct impact on the EBITDA percentage. Again, in terms of specific guidance, we really cannot comment on when this will be specifically achieved but if you track the company over the next few quarters you should definitely be able to see trends of us moving forward.

Moderator: Thank you. The next question is from the line of Pritesh Chheda from Lucky Investment Managers. Please go ahead.

Pritesh Chheda: Just wanted to understand, the mix and gross margin seem to have played out in Q4 but the mix and the EBITDA margin has not played out, there are these other expenditures and manufacturing expenditures which have gone up. So some comments there? The mix and margins did not play out in FY'15 but the mix and the margin did play out in FY'16. So if you could analyze these two years separately for us?

Anil Kumar: As you can see the margins have actually grown from EBITDA of about… last year we were about 14.3%, current year we are about 16%, so you can see that the margins have grown in comparison with sales growth for the current year; however, there is a certain line like other expenses, last year full year we were at almost like 11%, current year we are at about 12.5%. So there is a marginal increase in terms of other expense line and you can see also the EBITDAs have grown over last year.

Pritesh Chheda: Actually, my question was Q4 if you check the extent of mix change is substantial. Is there anything to read in the manufacturing and the other expenses line, any exceptional which are there or this is a normalize number?

Anil Kumar: Other expenses again last year if you look at it we are at about 11%, current year we have become at 12.5% and even on a going forward scenario, you can look at a similar range of about 12.5-13%.

Pritesh Chheda: I could understand the mix and the margin expansion in FY'16, but in FY'15 also the mix was richer. So mix had improved in FY'15 over FY'14, but margins did not play out. So any comments we have for FY'15 or…?

D. Sucheth Rao: Last time we had clarified that we had a couple of events especially in Q3 of last year, we took an unscheduled maintenance for the plant, so we ended up losing revenue during the shutdown period and that was the reason why the mix completely did not play out. So if you look this year and Saharsh was mentioning earlier that our margins over the quarter has been consistent, the EBITDA margins have been consistent, the EBITDA itself, the top line has been consistent. So, I think the organization has been able to establish a sustainable margin which we did not last year. So other than that, I think the rest of the comments and the mix that we have been predicting has played out.

Pritesh Chheda: Last quarter you had highlighted a receipt of new large orders. Would you like to comment on the size and the delivery schedule for that order? I think it was a CMS order.

D. Saharsh Rao: We cannot really comment on the size of the order, but it is actually an order which we are still executing, it will probably get delivered over the year FY'17.

Pritesh Chheda: It is a one-year order?

D. Saharsh Rao: It is actually an order for doing validation of the product and since it is a CMS project, it is fairly large and fairly complex in nature. So it takes time for us to actually complete the execution of it. So, it is more a validation order, so it is not really a time bound order.

Moderator: Thank you. The next question is from the line of Ranvir Singh from Systematix Shares. Please go ahead.

Ranvir Singh: Sir, just wanted to understand the way we have classified our revenue. So certain is Niche, another is Prime. So unless we know the name of the products which is under Niche, because whether we have fixed up some threshold for margin basis to classify this or this is just certain products have been put under the Niche and older…so unless we know actually the list of the products in Prime and Niche it will be difficult to track quarter-on-quarter?

D. Saharsh Rao: We can also broadly share and we maybe even try to put some details along with the 'Presentation' but the key products would be the products which are older, been Generic for a long time and typically less differentiated, products like Ciprofloxacin and Laprol, Mirtazapine Ramipril, Levetiracetam, Levofloxacin are all part of the Prime products. Products which are niche are products which are like Salmeterol, Dorzolamide, Brinzolamide. Products which are more differentiated …and just to kind of again take a step back and help you understand, Niche products are products which are typically more complex in nature either because they are difficult to make or they go into difficult formulations where we are in a relatively less competitive market, not too many suppliers out there, Prime products are products where typically there is competition, they are volume-driven products maybe not very high value but again relatively speaking we do have competitive edge in this space but we do see a meaningful reason in keeping them in two different buckets.

Ranvir Singh: Secondly, what is our revenue from Salmeterol in this quarter or a year?

D. Saharsh Rao: Last quarter I know Sucheth said is that it has been higher than expected in terms of our expectations, and I think for the whole year also Salmeterol has been higher than our expectations.

Ranvir Singh: Salmeterol launch what is your assessment when we can get into US?

D. Sucheth Rao: It is hard to say, when exactly it will happen, it is going to be a very complex filing and the timelines for approval could significantly vary, so we do not have an estimate at this time.

Ranvir Singh: Any CAPEX guidance for FY'17?

Anil Kumar: I will actually have answered that question a little bit earlier to the earlier participant; we spent in the current year about Rs.22 crores on CAPEX for FY'16, largely comprising of maintenance

CAPEX; however, next year also we would be spending almost close to that Rs.20 - 22 crores CAPEX on maintenance in FY'17.

Moderator: Thank you. The next question is from the line of Darshit Shah from Nirvana Capital. Please go ahead.

Darshit Shah: If I look at the financials of our company, like in FY'14 also from where till FY'16 we see dramatic increase in Niche and CMS revenue contribution because it is Prime, but if I look at the revenues and margins, we are almost close to around 10% from what we did in FY'14 and margins were almost at around similar levels, even in FY'14 was around close to 16% and even in the profitability we are at the same levels. So despite the contribution of CMS and Niche increasing which went to 44%, can you just throw some light on the disparity?

D. Sucheth Rao: It is a good question. I think what is important to note is even when we embarked on the strategy of developing more Niche APIs, focusing on the Contract Manufacturing or the CMS business, we knew that the growth or the stability in margins or the increase in margins would not be linear. We always expected that it would be volatile, it could change from quarter-to-quarter. So from that point of view this year has established that stability going forward because we have a large number of products, the share of revenues from the Prime products is actually reduced, Niche products have started to contribute significant, the CMS business as you can see has gone from negligible in Q1 to a significant portion in Q4. So all these developments are in a positive direction. They also established a long-term sustainability of the business which we did not have earlier. So if you looked at the company from an FY'12 to FY'16 we went from EBITDA margin of 11% to 13% to 15.7% down again to 14.3% up to 16%. So as you can see there has been a continuous and robust increase in the EBITDA margins which you can establish a clear trend; however, we did expect that it will be volatile and it may not be consistent, but you will see that consistency in the long run.

D. Saharsh Rao: Just to add to Sucheth's comment, given the fact that from now onwards we have also improved the quality of our disclosures, we are now going to give breakdowns of the CMS, the Niche, APIs along with the Prime products, you will also be able to see that the past flat line revenue is the result of the reasons that Sucheth explained but the growth of the businesses, the Niche, APIs as well as the CMS business, will actually continue to add to the top line which is where we really think that the margin improvements will happen.

Darshit Shah: I think earlier in the Q2 conference call you had suggested that the capacity can be fully utilized by FY'17, in full capacity we can kind of do Rs.700-750 crores. At the current juncture, do you think that this is a possibility?

D. Sucheth Rao: Just like we mentioned earlier, we had that whole arrangement with API… see that we talked about in the previous call, which gives us additional capacity for our products, there is also an improvement obviously in the product mix which means that we are able to use our current capacity which was at one-time occupied by lower value products, with products which are of higher value, so all these actually contribute to be able to use the current capacity to reach revenue targets. So it is a combination of increasing product mix, capacity becoming available and also taking some capital investments for debottlenecking of our existing plant as well. So, all of these three actions put together are able to give us the capacity to reach our targets.

Darshit Shah: So we think that this would be fully utilized by the end of FY'17?

Anil Kumar: We are not giving any revenue projection. So obviously that assurance we cannot give you.

D. Sucheth Rao: We only said that with the current capacities and the debottlenecking and maybe with a little bit of outsourcing we will be able to reach Rs.750 crores or higher.

Darshit Shah: Any clarity on the APIC asset transfer front? You said probably you will give some highlights this quarter.

D. Saharsh Rao: Last quarter we had mentioned that we were in the process of negotiating this asset transfer with APIC. So as of now we have been able to successfully complete the negotiation and we had in fact ended into an agreement with them. So as of February end, the asset was transferred to Neuland's books and now that facility is completely in Neuland's control. I would also add that the relationship with APIC is continuing as it is we are jointly exploring lot of opportunities to work together but the important point to note is the facility is now available for Neuland, in fact, one of the gentlemen earlier had asked a question about one of the CMS projects for which I responded saying that the current validation campaign is going on and it will continue through the year, that validation campaign is actually happening in this facility that we transfer from APIC. So that is all I would like to share at this time.

Darshit Shah: Any details on the kind of how much we pay to APIC?

D. Saharsh Rao: We will not disclose the financial aspects of this transaction because of our confidential agreement we had with them.

Darshit Shah: But the deal is done?

D. Saharsh Rao: Yes, deal is done.

Darshit Shah: Anil Kumar, why is the tax rate been so high?

Anil Kumar: If you look at taxation, taxes for the year is at about 36%; however, this is slightly higher than the normal tax rate of say 34.3%, this is largely because there is a one-time line effect about disallowance of about 2.3% which is pertaining to previous year, we have the benefits of DSIR expenditure, so there is a disallowance which is the one-time hit which has happened to us. So that is why we had an additional tax burden of almost like 2.2% coming on account of previous year transaction.

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

Nikhil Upadhyay: Two questions: First was the mix on a year-on-year basis. If we look at Niche and CMS, so the one-time product validation order which we have in CMS and Salmeterol would they be the major contributor which would have moved the needle from 22 and 13% to 27 and 17% or is it a mix of combination of new product as well as growing demand from our older products?

D. Saharsh Rao: Yes, it is actually a combination of various projects in the additional disclosures that we shared…we have actually also given you an indication of how many molecules are contributing to this. So that should answer your question. You can check out Slide #5 in the 'Business Indicators' information that was also shared to you.

Nikhil Upadhyay: On sequential basis if we look at it, so last quarter we did top line of Rs.130 crores and this quarter also broadly we are in the same range and you mentioned that the improvement in the margins which we have seen large part has been due to the change in product mix. Two questions here: One is how do you see this Rs.135 crores of top line moving to the next level – would it be larger demand from our Salmeterol or the CMS products? What would be the type of contribution which you are looking at over three years period among the three products segment? Secondly, in terms of operating leverage which you mentioned that which is still not kicking in, so how much of a fixed cost do you see that can be covered up over a period which can provide us improvement in our EBITDA margin?

D. Sucheth Rao: There has been a growth in the top line and as I was saying earlier I think more importantly it helped us establish consistently much higher margins than what we have actually demonstrated previously. So if you look at last year, our overall margin was about 14.29%, if you take FY'16, our EBITDA margin was actually 16%. I think that is the important one to note. Going forward, as the business continues to scale up and as Harsh was mentioning earlier that we project that the business should grow at an overall 20-22%, that is what we expected to grow, I think you will also see the overall EBITDA improve based on the overall drive in sales growth.

Nikhil Upadhyay: That would be led by two parts – one is the changing product mix. So how do you see that…?

D. Sucheth Rao: I understood your question. I think it would be led by the Generic API business as well as the Niche API. It will also be led by the CMS business. So given that we are 500-odd crores in sales, there would not be any single product that will contribute to it. Today, our product portfolio has approximate about 65-70 API, about 45 APIs are already Commercial. So it is a fairly large market of products and we expect that several products will contribute to the growth and it will not be one or two products that will contribute.

Nikhil Upadhyay: On the operating leverage part which you mentioned, so how do you see that moving ahead as the sales growth happens, so how much of a cost advantage do you have there?

D. Sucheth Rao: So like we were saying earlier, I think with the current asset base, we could reach total top line of about Rs.750 crores. So that means that operationally that is a significant leverage. Beyond that we will actually need to invest in capital equipment for further growth.

Nikhil Upadhyay: Basically on the debt part if we look at it, the long-term and the short-term borrowing has been flat. So how do you see the deleveraging part of going forward?

D. Sucheth Rao: That is a good thing, right, that is where we are actually getting the operating leverage from, because we have been able to keep our debt under control. So going forward we will need to borrow working capital. Typical industry benchmark for net working capital is around 25-30%, I think we will be around that range. Anil has worked out our CAPEX plans. Like I was mentioning earlier that has not been fully crystallized yet because we are still in the process of estimating how much capital expenditure we will need to invest in based on the product mix, but of course, it will be a combination of borrowings as well as internal accruals to be able to fund our future growth.

Anil Kumar: To be just a little bit more specific on next year, as I said, the CAPEX is looking close to about Rs.20 - 22 crores. So we would not look at a fairly higher term loans, it will be very nominal and of course for the increase in revenues, we would look at working it through the working capital borrowings from the banks.

Nikhil Upadhyay: Probably depending upon the cash generation which we have for next year we can see some amount of deleveraging then if our CAPEX is only Rs.20 crores because our EBITDA for this year only itself it is Rs.80 crores?

D. Sucheth Rao: We do not expect any deleveraging. We expect to keep debt under control.

Moderator: Thank you. The next question is from the line of Siddharth Bhattacharya from Suyash Advisors. Please go ahead.

S Bhattacharya: One question on the CMS business wherein your presentation you have shown six molecules in the fourth quarter. Just wanted to understand the visibility that you have on the Commercial molecules, how exactly can one extrapolate the fourth quarter revenues into FY'17 performance, even including FY'18 just shall we say a broad stroke of how the business will evolve and what is the pipeline looking like?

D. Saharsh Rao: To be very honest, I would like to be very cautious in delving too much into the numbers that we have shared. The reason is that we are taking the small steps in increasing the disclosure. So what I would rather do is I will just kind of explain to you what data we have presented here and

I will refrain from trying to give you any specific direction in terms of what this translates to in the future. But what this actually means is the Q4 numbers of six molecules in Commercial and three molecules in Clinical is these refer to molecules that actually have been manufactured in the plant. So there was either one or more campaigns in the fourth financial quarter which involve Commercial Molecules and three Clinical Molecules. Now, it does not mean that the campaign was complete in the quarter, it could have meant that the campaign was complete, it could have meant that the campaign started but did not complete or it could also mean that the campaign had started in the previous quarter and completed in Q4. All these possibilities have been captured in this data point. The reason why we wanted to share this data is because we believe that over the long term… not over the short term, it would give you a general insight into whether Neuland is progressing in the CMS business or not. At least from current perspective, our idea is not to give you any more insight, it is only to give you a sense over time on whether our CMS Molecules are increasing or not. I would ask you to limit your analysis of this data to that point.

S Bhattacharya: Would it be too much to infer that there are six distinct Commercialized Molecules on which you are working or would that also be…?

D. Saharsh Rao: No, six distinct.

S Bhattacharya: Are these fairly early stage molecules in terms of Commercialization?

D. Saharsh Rao: In this case there is one late life cycle molecule as well, our CMS business also includes businesses where we try to become the second source of a molecule that is already Commercial.

S Bhattacharya: These are still under patent, is that the correct understanding?

D. Saharsh Rao: Mostly they are under patent, but sometimes we also do contract manufacturing exclusively for maybe Specialty Generic company or someone else in which case technically it maybe a generic molecule but margins are equally higher and every way it is a contract manufacturing business for us.

S Bhattacharya: What I meant by visibility basically was that is there a clear delivery commitment or are these very short term contract, is there a slightly drawn out term contract for example?

D. Saharsh Rao: So I will leave that to your instance, but I will explain this; so Commercial are actually molecules which are either getting commercialized New Chemical Entity or already Commercial, you understand that. You also know that we operate in only what we call as “Regulated Markets” Europe, North America, Japan. So, I think it is very fairly easy to infer that usually when you are in this space you are not going to be dealing with a lot of one-time projects especially if it is Commercial.

Moderator: Thank you. The next question is from the line of Viraj Mehta from ValueQuest Capital. Please go ahead.

Viraj Mehta: Just two questions: One, when you say Rs.20-22 crores of CAPEX, is it only maintenance CAPEX because looking at the gross block of our company, that is like close to 6-7% of the gross block or would that also include some debottlenecking?

Anil Kumar: It will also include a little bit of debottlenecking, it will be a combination of both, at least for FY'17, we are not targeting too much of higher CAPEX, it will be a combination of both debottlenecking and maintenance.

Viraj Mehta: Can you give me the cash flow from operations post tax for this year?

D. Sucheth Rao: Can you call maybe Anil after the call or maybe subsequently?

Moderator: Thank you. The next question is from the line of Sarvanathan Viswanathan from Unifi Capital. Please go ahead.

S Viswanathan: This mid-term vision of reaching Rs.1,000 crores and 20% EBITDA margin by FY'18, so which means either we will have to do some acquisition or we should have started some CAPEX in FY'17. So can you comment on this?

D. Sucheth Rao: I think we look at our capacities three ways, right; we look at either debottlenecking, some organic investment such as building farmer areas, more intermediate capacity, either outsourcing some non-critical intermediates or processes, as well as any inorganic acquisition of capacity. So, we believe that going forward it will be a combination of all these three to accommodate our growth plan. So we have not ruled out any inorganic option, if there is something good, it is something that we will make use of. I think as far as the number of Rs.1,000 crores we have not given any specific guidance either in terms of the number or the year that we will actually get there.

Moderator: Thank you. The next question is from the line of Naisar Shah from Capital 72 Advisors. Please go ahead.

Naisar Shah: Sir, you are saying in all your three businesses will grow – CMS, Niche and Prime. So just maybe a few years down the line, roughly, what could be the rough contribution of say Prime to your overall sales when you aspire to achieve that number and 20% CAGR?

D. Saharsh Rao: CMS, Prime and Niche businesses have their own character. That is why we have defined them in three categories. When it comes to the Prime business, the Prime business by itself will not have the same kind of growth opportunities that the Niche or the CMS business will have, because these molecules have been Generic for several years now and they have a saturated market and our market shares in these markets also are either at a fairly dominant position or reasonably comfortable position. We do have strategy to increase the market share for these products, but the growth is as a result of that in the Prime products will be quite relatively limited. Coming to the Niche and CMS, that is really where we see the growth coming into the business going forward. With regards to the opportunity itself, the CMS business by nature of how it is defined is really Custom Manufacturing and therefore the market itself is quite large. I think just for a small molecule Contract Manufacturing, the report which suggests anywhere between $30 to 40 billion and since we do Custom Manufacturing we can theoretically go after this entire market. Any customer of us who has a molecule that they would like to manufacture, we could manufacture it in our facilities and therefore the market is quite large. When it comes to Niche Molecules, we have shared what we consider as Niche Molecules and I think our strategy for the Niche Molecules, they contribute a very high margin as well just like the CMS business and I think we are at least for the future of the Generic API business, we are seeing that the Niche APIs will actually drive the growth. What actually strengthens our confidence about the Niche Molecule is that we have a very-very strong pipeline of Niche Molecule. If you actually look at the last two or three years and if you look at the two or three years going forward, every year there has been at least one Niche molecule which has been a successful launch for us and for all these molecules we are actually seeing active growth, and that is why this category itself is growing in combination.

Naisar Shah: But any rough range what could be the contribution of Prime to overall sales say maybe 4-5-years down the line?

D. Saharsh Rao: We have also shared in our past calls that we expect CMS business to be around 30-35% of our top line over time, Niche will also be around 30-35% and I think it is safe to assume that Prime will probably be at around 30-35%.

Moderator: Thank you. The next question is from the line of Jasdeep Walia from Infina Finance. Please go ahead.

Jasdeep Walia: I was looking at your numbers from fiscal year '12 to '15, so there has been a significant increase in working capital in three years close to around Rs.90 crores whereas your sales have increased by just Rs.40-50 crores. So what is this increase in working capital on account of?

Anil Kumar: If you look at the working capital cycle, normally for Pharma industry API, you will find that it is in the range of about 27-28% and we are not very off, if you look at FY'16, we are at about close to 30% in terms of working capital cycle, a typical cycle would be like 30% which will have say 90-100 days working capital requirement, I am not very sure we are off the industry, we are very close to the industry.

Jasdeep Walia: So sir your product mix has been improving over the years from fiscal year '12 onwards which is reflected in margins. But on the other hand your return on capital employed is pretty much the same. So what are your thoughts on this number going forward and why has it remained the same over the last couple of years?

Anil Kumar: If you look at the return on capital employed, that also has moved up, it is almost close to about 18% in the current year.

Jasdeep Walia: FY'16 it has improved, but from FY'12-15 it did not improve. So what are your thoughts on this number going forward?

D. Saharsh Rao: I think the return on capital employed going forward we think will only increase only because of the reasons we have explained in the past, I think the improved operational leverage using the same two facilities our ability to increase the revenue potentially towards Rs.750 crores level without actually having to put in significant capital expenditure. I think keeping the same working capital levels that Anil had mentioned in the previous call, we actually see the return on capital employed improving going forward.

D. Sucheth Rao: Yes, 18%, we believe that this is a good benchmark to have in terms of return on capital employed. So…

D. Sucheth Rao: Just to give you the numbers; in FY'15 we were at about 14.9%, current year we are at 17.85%.

Jasdeep Walia: So this year it has improved …?

D. Sucheth Rao: Not this year, Anil just gave you the comparison between '15 and '16, improved to about 18%.

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

Dhiresh Pathak: In your earlier comments you said in the CMS business where you also do vendor as a second source for your clients. Can you just talk about the process and the time and the money it takes for your client to add you as a second source?

D. Saharsh Rao: In the CMS business, yes, I think being a second source for innovator company is actually very key part of our strategy. As part of that, usually in the CMS business the innovator usually has the new drug application which is something for which they do not usually ask us as manufacturer to file a DMF. What we typically do in this case is having understood the customers, quality requirements or the specification of the products, what we do is either we do a tech transfer of the process from the customer site or we develop the process ourselves, keeping in mind the customer specifications and with that process we actually do what we call as product validation. So we would produce several batches of API and then put it on stability and once we put that on stability we would generate data about the process as well as the stability and then we would put that information in what you call as a CTD format. This documentation normally in the Generic business we would file a DMF but in the CMS business we would hand over the documentation to the innovator and the innovator would actually make it as a secondary filing in their CMC documentation. So that is the whole process. The cost of validation typically could be for the customer. They would pay us anywhere between as less as Re.1 crore per project to all the way up to like maybe 15 or 20 crores, it really depends on the nature of the molecule and the kind of scale that we are operating in. So that is kind of how it goes.

Dhiresh Pathak: The time it takes would be 6 to 9 months, is it?

D. Saharsh Rao: In terms of doing the work of validation could be anywhere between 6 to 12 months but then for the filing to have and yet to get accepted could take 2 years.

Dhiresh Pathak: Even though it is already in the market for FDA to approve you as a second source it could take 2-years?

D. Saharsh Rao: Yes, it could and I would conservatively like to say what is the outer limit.

D. Sucheth Rao: It takes two years from the initiation of the opportunity, not two years once we file it, so from the conceptualization the fact that we could be a second source, to actually getting commercial approval would be two years which is a fairly deep in timeline.

Dhiresh Pathak: So would be fair to say that once the customer does it he would be a sticky customer because it has taken two years and he spent quite amount of money?

D. Saharsh Rao: That is a strength of our business because we operate only in these regulated markets, it becomes very unproductive for the customer to change source, it becomes very expensive. So it is typically very sticky.

Dhiresh Pathak: You said Unit-II was inspected. This is the same unit which you made for APIC, right?

D. Saharsh Rao: Yes, it is the same site, APIC facility is just one block whereas this is a large site which has several production blocks along with the APIC facility. So, the FDA inspection happened actually for some products which were manufactured in some of the other production areas in that same site.

Dhiresh Pathak: But, how was the inspection? In the last call you mentioned that some other facility had also had 483. Can you just give a comprehensive summary of your FDA approved facility and what is the compliant status?

D. Sucheth Rao: Actually, for the last inspection we did not have 483, it was no action indicated, so there were no observations. For the inspection before that there were minor observations for which we answered and we also got the Establishment Inspection Report which classified our facility as acceptable. As far as all our facilities are concerned, all have been inspected and are currently under approved status with no outstanding issues.

Dhiresh Pathak: How many units do you have which FDA approved to?

D. Sucheth Rao: We have a testing facility as well as two manufacturing facilities.

Moderator: Thank you. Ladies and Gentlemen, due to paucity of time, that was the last question. I now like to hand the floor over to the management for closing comments. Over to you, sir.

D. Sucheth Rao: Once again I would like to thank all of you for such active participation on the call and also all the questions you have asked us. I would also like to mention that it is credit to your feedback in your questions that we have brought a lot more clarity and meaning to our reporting. So as you have seen this time we have actually broken up our revenues into Prime, Niche, APIs as well as our CMS business, so that it gives you further insight into how our business is developing and what you can expect in the future. Please continue to ask us questions, please feel free to reach out to us between calls, please reach out to Christensen with any questions you have. It is our privilege to answer your questions and clarify anything you might need to understand about the organization. We also thank Christensen and the organizers for making this call happen and we look forward to speaking to you again. Thanks very much.

Moderator: Thank you, sir. Ladies and Gentlemen, on behalf of Neuland Laboratories, that concludes this conference. Thanks for joining us and you may now disconnect your lines.