"Torrent Pharmaceuticals Limited Q2 FY'24 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to Q2 FY24 Earnings Conference Call of Torrent Pharma.

As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Sudhir Menon – Chief Financial Officer and Executive Director, Finance. Thank you and over to you, Sir.

Sudhir Menon: Thank you. Good evening to all of you and welcome to the Second Quarter Earnings Call for FY24.

I am pleased to share the details of our strong performance this quarter across all our focused markets. The branded business contributed to 73% of the overall revenue base this quarter and have grown by 18%. Germany with incremental tender wins over the last three quarters have helped in registering a constant currency high single digit growth. US, we continue to take measures to enhance the cost efficiency in the base business while we await new product approvals will start flowing in the future quarters and they should start adding positively to the overall performance of the company going forward.

During the year, we have discontinued lower margin products in the US and streamlined our back-end processes, optimize resources in order to enhance the operational effectiveness.

Further, we've capitalized the oral oncology facility this quarter in July and have commercialized one product in the US.

In terms of key financial performance highlights for Q2, revenues were Rs.2,660 crores, up by 16% compared to the previous year same quarter. Operating EBITDA for the quarter is Rs.825 crores. Operating EBITDA margin stands at 31%, registering a growth of 22%. Leverage is now at 1.16x and we expect by March '24 it should be below 1x.

I would request Aman to present the performance of India business now.

Aman Mehta: Thanks, Sudhir. India business revenue for the quarter at Rs.1,444 crores grew by 18%. Excluding the acquired business of Curatio, the base business growth was 12% for the quarter against the market growth of 4% as per the AIOCD data set.

Our market outperformance was led by continued double digit growth in chronic therapies, revival in gastro demand, traction in the consumer division and new launch performance.

Our new launches in the chronic business continue to do well. Torrent is ranked #1 amongst the branded generic players in the Sitagliptin market and we continue to gain market share. We expect to clock 100 crores sales on a MAT basis during the coming quarter for our Sitagliptin franchise, which will be our fastest 100 crores launch, mainly on account of field force expansion undertaken last year. The Curatio portfolio continues to deliver robust performance with 17% growth for the quarter, led by the flagship brand, Tedibar. Tedibar continues its growth trajectory upwards of 25% on account of increased activation at pediatricians and more recently digital media and e-commerce platforms.

On the acquisition integration front, we have completed one year since the acquisition of Curatio. EBITDA margins are now 14% higher than pre-acquisition levels, which is also 6% higher than the previous quarter due to enhanced focus on cost synergy execution. We believe there is still significant headroom for margin improvement over the next six to eight quarters, mainly through operating leverage.

The Consumer Health division is progressing well and our flagship brand, Shelcal-500, continue to see increasing sales traction through media and trade activation.

The National Media Campaign for Shelcal-500 was initiated towards the end of Q2, and other brands such as Unienzyme, Tedibar and Ahaglow are now all active on digital media and e-commerce engagement.

At the end of the quarter, Torrent has 20 brands in the top 500 of the IPM with 15 brands more than 100 crores sales as of MAT September 2023.

We expect the India business to continue outperforming the market growth. Our focus during the rest of the year will be to continue improving our market share in our focus therapies, new launch performance and improving field force productivity of the expanded divisions and regions while executing our consumer health national rollout.

I'll now hand over to Mr. Sanjay Gupta for the international business.

Sanjay Gupta: Thank you, Aman. Let me start with our branded generics market of Brazil. In Q2, Brazil had a constant currency revenue of BRL149 million as compared to BRL121 million in Q2 of prior year, registering a 23% growth. Adjusted for Q1 cut over sales, Q2 growth would be at 13%.

As per IQVIA of end of August, Torrent's branded generic growth is 13% versus a branded generic market growth of 8%. IQVIA is showing that almost all of our products are growing much faster than the market.

We have added 26 reps in CNS segment during August '23 and this will bring the total number of Torrent reps in Brazil to 206 in CNS. This will expand our reach and it helps us in balancing our portfolio amongst the two teams. We'll be launching four more products before the end of the financial year; two in CNS and two in cardio diabetes. Our generics business in Brazil continues to show strong momentum.

Moving on to Germany, our German business has registered a growth of 21% this quarter. Constant currency revenue was at €30 million, up by 8%. During Q2, Torrent had good wins in tenders, which will have a positive impact on sales starting in the Q4 timeframe. We also expect the impact of our sales force expansion from 8 to 16 to show in our OTC business by the end of this year. In H1 we have launched five products; three from partners and two in-house.

Going forward, Torrent's focus will include cost optimization to improve the competitiveness in the tender segment, launching new products and developing its OTC business.

In the US, we registered revenues of Rs.248 crores, down by 15%. Constant currency revenue for the US is at 30 million, down by 18%. Adjusted for one-off income in Q2 of the previous year, constant currency degrowth is at 16%. Degrowth was due to loss of low margin business and some short-term supply issues.

As Dahej facility has received the EIR and now we can launch new products from this facility. As Sudhir mentioned, we recently launched our first oncology product from a new oral onco facility at Bileshvarpura, as well as a niche derma CGT product from a derma plant at Pithampur. Customer response has been positive for both these launches.

To conclude, our focus will remain on deepening our presence in branded generic markets while continuing to grow in Germany and returning to profitable growth in the US.

Operator, we can open the call to questions now please. Thank you.

Moderator: We will now begin the question-and-answer session. The first question is from the line of Damayanti Kerai from HSBC. Please go ahead.

Damayanti Kerai: Sir, my first question is on India business. So, while you maintain your outperformance against the market, what we have seen is that the volume trends have been very muted. So, what are your thoughts on that, like how it will dictate the market growth ahead and your growth accordingly? And if you can also split your second quarter India growth into volume, price and new launches?

Aman Mehta: Yes, we think that while external data reflects market growth to be 4% in the case of AIOCD and I believe, 7% in IQVIA, it's somewhere in the middle. Maybe even on the higher range if you take 7%, our view is that market growth is actually around 7% to 8% because otherwise we would not be able to be at 12% kind of a growth. So, our delta has generally been in that range. So maybe we'll give it a few months or quarters for the market reflection to normalize these various kinds of adjustments and normalizations that have been happening. So, I would wait another quarter or so to just see the market reflection. In terms of our growth breakup, so as mentioned, our reported growth is 18%, but the base business growth is 12%. So out of that 12%, roughly 7% is coming from price and rest is from volume and new products.

Damayanti Kerai: If you can specify volume contribution also, I guess that will give us some better insight?

Aman Mehta: Volume would be about 1- 1.5%, new products is about 3.5 to 4%, but new products is practically counted as volume because it's from a zero base. So, we would count in the first year new products in pretty much in the volume and to be seen in the same basket. So, combined, let's say volume growth is about 4%.

Damayanti Kerai: According to you, Like you mentioned market should see normalizing trends few quarters from now, so according to you do you think this muted volume trends which you are seeing that's not structure in nature, right, it's just maybe some temporary adjustment or some -?

Aman Mehta: That's correct, that's what we believe.

Damayanti Kerai: My second question is on Brazil. So, it includes the spillover impact, right, as you mentioned in your opening commentary. So, can you specify the total number of reps, you mentioned for CNS, but if you can specify like total number in the market?

Sanjay Gupta: I'd mentioned this for CNS, and can add the cardio diabetes field force of 113 people to that.

Damayanti Kerai: 206 for CNS and 113 for cardio segment?

Sanjay Gupta: Correct.

Damayanti Kerai: So very broadly, if you can also talk a bit about your expectation for the Brazil market outlook like you have added sales force and then you have been picking up well on generics also, your core segment is doing well. So how should we see this segment?

Sanjay Gupta: So essentially, in Brazil, our primary sales vary from quarter-to-quarter. So, I would suggest that we look at a trend over two or three quarters to get a feel for how the business is performing. So, let me give you figures from IQVIA for last fiscal year and then two quarters and you can get an idea. So, for fiscal year ending March '22, the total market was growing at 14.5 and then Torrent was growing at 22.7, so about 8% point higher. For Q1, the market was at 12. 8 and as per IQVIA we were at 19.7. And currently this quarter, market is at 10 and we are at 17.8. So, over a long term, Brazil market, last six, seven, eight quarters been a double-digit market and the delta that we've been maintaining, while for the full fiscal year and the last two quarters is in the 7% to 8% range. I think I've seen it in the 5% range earlier, so I consider 5% and above to be a very healthy level of growth above the market and I would expect that to continue.

Damayanti Kerai: So, you're broadly done with your sales force addition in Brazil and maybe it's now launches and then better penetration, which can help you sustaining this kind of strong outperformance against the market?

Sanjay Gupta: It's a cycle, right? So, we added sales force, then we add portfolio then two, three years down the line we might add more sales as well, So, it's a virtuous cycle.

Moderator: The next question is from the line of Neha Manpuria from Bank of America. Please go ahead.

Neha Manpuria: Sudhir, on the 75% gross margin, is this a reflection of the portfolio optimization that we have done in the US and therefore we should assume that these are sustainable gross margins or is there any one-off impact in that that we need to consider?

Sudhir Menon: No, there's no one-off impact, Neha. If you remember, last quarter, I think there was the same question which was asked, whether 75% which we registered in Q1 could be sustainable in Q2. And I have said, yes, and part of it is the cost efficiencies which we've tried bringing as far as the US business is concerned, which is panning out positively. So, I think this should remain positive.

Neha Manpuria: Do you think there's more headroom for expansion from here based on what we're doing in the US and the new launches in Brazil and stuff like that?

Sudhir Menon: No, I wouldn't take that for the next two quarters, Neha. I would remain at where we are.

Neha Manpuria: Second question on capital allocation. Torrent has been in the news a fair bit in the last few months. I know obviously you won't comment on the news, but just wanted to understand our M&A priorities, what are the focus area that we're looking at and what's our comfort when it comes to leverage.

Sudhir Menon: No, I think as a policy, we do not comment on any speculative news with respect to any acquisition I would say and we would maintain at that at this point.

Neha Manpuria: Fair enough, Sudhir. I'm not asking you to comment on the news. My question is, when we are looking at asset, now that Curatio is integrated, ramping up well, growth in the base business is good, leverage will be less than one time. So, when we are thinking about a capital allocation or M&A, what's our comfort leverage that we're okay to take on our books? And second, how should I look at priorities -- would this be the US market, the Brazil market or would we focus on the deals that we have done in the past?

Sudhir Menon: No, no, absolutely. So, I think all the past deals we've done more in India, right? I mean, none of the international geographies, we've really done any acquisition for whatever reason it is. Having said that, if let's say if I think of capital allocation in India at Rs.100, possibly if I look at Brazil or some of the other markets, it would not be 100, it will be substantially lower.I mean because India is something which we understand properly and we have a track record of successfully integrating most of our acquisitions which we've done. So, we're more comfortable doing it around India, I would say, that's point #1. I think point #2, on what kind of debt or leverage we would be comfortable at. It all depends upon what kind of cash flows are generated by the company, which we are acquiring, and both put together, what is the comfort which we have in terms of the cash flow generation and the cash flow being used for meeting the financial obligations which are there, still maintaining whatever capital is required for the growth which is required in the business, right? I mean that's the way to look at it. But having said so, I think if you look at the past acquisitions for example Unichem, I think we've gone at that point at the time of acquisition, we were at around 3x of net debt-to-EBITDA, which came down substantially over the two years' time and that's the trend which we believe any branded business acquisition would deliver and therefore I would say if at all some acquisition is happening and we need to look at what we are comfortable at. What I would say is that the starting of 3x is something which should be comforting, provided that over the next two years the leverage is coming down substantially, maybe to 1.5, 2x.

Moderator: The next question is from the line of Abdul Puranwala from ICICI Securities. Please go ahead.

Abdul Puranwala: So just on the US front, this quarterly run rate of 30 million, so would it be possible to quantify the QoQ decline in terms of what was the one-off impact and the impact of you guys exiting in certain low margin products?

Sanjay Gupta: Actually, I prefer not to disclose the exact details, but generally speaking we have single digit price erosion and then we also lost some volumes due to some contracts being lost and some supply-related issues. So, going forward sales should be in the $30 to $35 million range, but I cannot guide you further than that.

Abdul Puranwala: Secondly on India, so, if you could share the outlook of the market first, and how torrent will be able to grow because if we see Q2, the market itself has grown 4% and our organic or the base business growth of 12%, we have significantly outperformed the market, so, if you could just share your thoughts on how the market growth is going to pan out for fiscal '24 or '25? If you could throw some light.

Aman Mehta: So, we mentioned earlier that we believe the real market growth would be closer to around 7% or 8% this quarter. This would be sequentially higher than the previous quarter because some of the acute therapies seem to have increased in contribution, particularly in our case for sub-chronic, there's been a revival in the gastro market. So, from Q1 to Q2, there has been an improvement in the market growth. If we assume that the current market growth is around 7 to 8, we believe the rest of the year should remain at this level and our delta with the market growth should remain similar and we don't really see anything different happening in the next year or two years. Two years is a long time to really comment on right now, but we structurally don't think anything different should be happening. This level of growth should be maintained.

Abdul Puranwala: On the trade generic business, what we had set up some quarters ago, so how has been the traction there because the 1% volume growth which you mentioned, I does that include the trade generic revenues as well and the number what you have reported? Going ahead on the acute side, how do we see some traction building up in this particular segment?

Aman Mehta: No, our volume growth that I mentioned was without trade generics. We don't count the trade generics as part of volume growth in our overall prescription business. Trade generic standalone has grown somewhere between 20% to 25% this quarter for us and where we've consistently been adding new SKUs here. So, I believe we now have about 75 to 80 SKUs. So, both are continuing their own growth trajectory. Obviously, trade generics at a lower base will be growing slightly faster for the next couple of quarters. And then once we reach a certain level of base, it should be at high teens growth is what we believe.

Moderator: The next question is from the line of Shyam Srinivasan from Goldman Sachs. Please go ahead.

Shyam Srinivasan: Just going back again to the capital allocation point, how do you look at the valuation for some of the assets that are in the market which you may be evaluating, may not be evaluating, are valuations at this point of time stretched from whatever 12 months forward kind of a basis, so does it mean, are you reworking some of your payback metrics upwards, if it takes another year or two, because historically if you see Torrent has been very disciplined about when EPS accretion needs to come up with M&A, right? That is One and Point #2 is the size of the deal, right? So historically we have done small deals. Is there a change in philosophy now that there are available opportunities that the board, management are actually thinking for, what kind of assets you will likely go after?

Sudhir Menon: Shyam, I think the comment on valuation on other companies would be quite general, I would say because there would be some positives or negatives playing out for them and that's how the market looks at the valuation for each and every company. Very difficult to comment on how the valuations are looking at this point in time. That's point number one. Point number two, I think at this point whether thinking has changed in terms of aspiration on the acquisition ticket size, I think we are not in a position to comment at this point in time I would say.

Shyam Srinivasan: Sudhir, Just trying to comment on your net debt-to-EBITDA, where you said organically as we stand today, we will go to less than one time on net debt-to-EBITDA, may be historically in the past we have gone up to 3x. So, doesn't mean a change in our PAT, that we are open, there is debt availability, the private equity firms available. And just want to tie in the philosophy here because I sometimes miss that. We already in top ten, then be in top five, is that an ambition to be in India or is it like we want to run systems how they are, and we continue to outperform basic markets, what would be the more dominant philosophy?

Sudhir Menon: I think that's what I answered on the previous question, right. I mean what we would be comfortable with in terms of the leverage and based on the cash flows which would be generated both on the existing business as well as the acquired business, 3x is something which as I said, to start with, could be comfortable provided it goes down substantially to maybe 1.5 or near to 2x if I can put it that way. I think other than that I don't think there's any comment to be made at this point.

Shyam Srinivasan: My last question is just on the digital marketing initiatives that you outlined at the start of the call. This seem to be showing some amount of traction now. So, can you just elaborate on qualitative comment around the digital marketing, what are some of the early successes that have been in the brand and what can we expect going forward?

Aman Mehta: The larger allocation has been on Shelcal, and that's actually more on traditional media and not digital. Digital is a small part of Shelcal's campaign right now. We have initiated digital more on other brands on a pilot basis like Tedibar, Unienzyme and Ahaglow, because they are a slightly different category compared to Shelcal. We want to kind of play a wait and watch game every quarter. The early success or initial signs of positive success in Shelcal drove us to kind of go national for the campaign here, which is what has started and we are seeing that in the media markets where we are present with both enhanced distribution and media visibility we are seeing significantly higher growth compared to the non-media markets. And I think pre-consumerization of Shelcal and now almost three quarters later, we are seeing a very meaningful uptick in the sales of Shelcal-500 and the rest of the brands Shelcal-XT, Shelcal-HD continue their growth trajectory in the prescription segment, which is focused on gynaecologists, physicians, orthos. So that is the broad segmenting that we've done. And as we see more kind of success or failures in Tedibar and other brands, we will scale up or scale down their campaigns accordingly. But we do believe that each of the brands that we have selected have ample potential to grow on each of these Rx plus digital traditional media.

Shyam Srinivasan: Is there any investments that you're calling out for both this traditional push as well as this digital or this is just part of your overall SG&A?

Aman Mehta: So there has been an increase in SG&A and particularly in marketing spend, advertising spend plus field force, which is already reflected in this quarter. It was kind of initiated almost two quarters, three quarters ago and now that cost is fully built in. So, in this financial year, there is a higher increase in our cost base compared to last year, which is more of a one-time exercise. So, we believe that the field force expansion in Rx, which is a prescription business plus consumer require the initial investment which is now stabilized and next year onwards there won't be any additional increase in cost from here. So, this is now the cost that we will be operating at.

Moderator: The next question is from the line of Saion Mukherjee from Nomura. Please go ahead.

Saion Mukherjee: Aman, just wanted to reconfirm your view on India here. So, you mentioned, you think 7% to 8% growth that IQVIA is showing looks credible and you mentioned that's the kind of growth you expect going forward. Actually, this appears to be a slowdown because historically we have seen growth rate somewhere closer to 10%. Now, this seems to be structural in nature given we see many companies launching trade generic, we are seeing the Jan Aushadhi volumes picking up and some pharmacies launching generic medicines and pushing private labels, don't you think these are structural changes which are happening in the industry which is dragging down the overall growth?

Aman Mehta: So, this has been there for quite some time. It's not a very recent development phenomenon. I think the trade generics and Jan Aushadhi substitution risk or threat has always been around for almost several four to five years now. And we've always maintained, I believe that some part of the market will remain generic, some part of the market will remain branded. So, if there is an increased substitution level or increased penetration of generic, we can't really comment any specific numbers, but maybe let's say if we attribute half a percent of IPM growth would be slowed down because of that. But it's not anything beyond that. So, in our view, the risk of trade generics cannibalizing branded generics is overestimated right now. In terms of reflection in growth, again, we mentioned earlier, but there are several factors right now; one, predominantly being that almost half of the IPM is acute contribution and that market based on various reasons where it's seasonality and all has somehow not picked up this year. Rest of the market is on track especially our higher contribution therapies which are chronic. So, we do believe that market should normalize in the next coming quarters. If right now at this 7%, 8% level could be slightly higher from here. But there is no real kind of structural threat that is causing this in our view.

Saion Mukherjee: My second question is on the U.S. market. We have seen sequential drop in sales. So, this rationalization was something specific for this quarter and also you mentioned about onco launch. What kind of cost would have hit our P&L because of this facility commissioning, if you can give some numbers around that?

Sudhir Menon: So Saion, we capitalized in the month of July. So, all the costs pertaining to manufacturing is already captured as part of the gross margin I would say, all the EBITDA margin. Nothing incremental month-on-month going forward from here. Sanjay, do you want to comment on the launch which we have done?

Sanjay Gupta: It's gone well, I mean, we would have a double-digit market share and it's a product called sorafenib. We were the sixth entrant. But it's a good start to our oncology franchise and we've captured already in the first three months double digit market share and let's see how it goes.

Sudhir Menon: Capitalization of oral oncology plan happened around second of July. So, from that perspective, the quarter captures all the cost.

Saion Mukherjee: Sudhir, I was looking at the quantum, if you can quantify?

Sudhir Menon: I don't think it's very significant to be quantified, Saion.

Saion Mukherjee: On the US, actually, I was looking at the sequential fall and I was wondering if any specific thing happened this quarter? And You mentioned like 30- 35 million run rate going forward. So, how should we sort of think slightly longer term when you look at FY25 with new products coming, what should we sort of expect from the US because I remember last call, you mentioned US can go back to 200+ million on an annualized basis, if you can comment on how should we think about US from a slightly longer-term perspective?

Sanjay Gupta: Longer term, I think that's correct. I think we're just waiting for two things. One is for new molecules and new products to get approved from Dahej. So, our pipeline has two types of products, , one which were already gone generic andwe would be late entrant and one where we would go generic on day one. So, it's a both. So, I am waiting for some approvals to come from Dahej. But also, we have a significant number of filings from Indrad. So, I'm waiting for Indrad plant clearance also to be able to launch that. And as you know at Indrad, we've completed all the formalities, we're just waiting for inspection, I don't know, it's a function of approvals as to when we start to get positive sales momentum. In the meantime, we're going to do as best as we can to maintain a base business that is reasonably profitable.

Saion Mukherjee: Is there any change in dynamics in terms of price erosion in the recent past, anything you would like to sort of comment how you see the market dynamics?

Sanjay Gupta: Saion, what happens is when all the companies say, there is no price erosion, the customers come back and then start price erosion in the subsequent quarters. I prefer not commenting upon price erosion. But I would say that generally the trends are pretty much what they were.

Saion Mukherjee: So, year-on-year, like mid-to-high single digit, is that right assumption?

Sanjay Gupta: Generally mid-single to high-single, sometimes depending upon individual product situations and companies could be lower or higher. I've noticed customers are very sensitive to supply issues. So as a lot of players have discontinued products, then suddenly pricing becomes less important than supply continuity.

Saion Mukherjee: I was thinking more at an aggregate level, that dynamic has been playing out for some time. So, I was wondering if anything has changed because mid-single to high-single seems to be pretty much sort of a normal erosion.

Moderator: The next question is from Madhav Marda from Fidelity International. Please go ahead.

Madhav Marda: So just wanted to get your thoughts on, recently when the government tried to push the policy of getting doctors to write generic names on prescriptions, I understand there's a challenge with the quality of infra for testing drugs in India but in case that sort of get built up in the country and there are some initiatives from the government side to ensure better quality, this thing and then they kind of say right generic medicine, fundamentally is that something wrong that doctors write generic names or do you think branded generic is like the way to go longer term for the country? Because when we look at like developed markets, generally it's generics which gets written, right. So just trying to get your thoughts on that.

Aman Mehta: Quality is one part of it and obviously I mean, there's NMC guidelines which govern different set of stakeholders, there's quality guidelines through DCGI. So, there's a lot of different factors at play. But in our view, branded generics would remain even in that kind of a hybrid system and many developed markets also have a branded generic market that continues to exist. So, it's not that all developed markets only run on generics. So, various factors could be at play, but in at least our view, the next couple of years, I mean, as evolution in legal framework comes a lot in India, this basic framework should not change.

Moderator: That was the last question in queue.

Sanjay Gupta: I would like to reiterate that our focus will continue to remain in deepening our presence in branded generic markets, to maintain growth in Germany and also to turn around the US business as we get our plants approved through the system. Thank you for your participation today and this will be the end of our call.

Moderator: Thank you very much. On behalf of Torrent Pharma, that concludes the conference.