"Solara Active Pharma Sciences Limited Q1 FY2021 Earnings Conference Call"

August 03, 2020

MANAGEMENT: **MR. JITESH DEVENDRA – OUTGOING MD - SOLARA ACTIVE PHARMA SCIENCES LIMITED**
MR. BHARATH SESHA – MD & CEO - SOLARA ACTIVE PHARMA SCIENCES LIMITED
MR. HARIHARAN – CFO - SOLARA ACTIVE PHARMA SCIENCES LIMITED
MR. ABHISHEK SINGHAL – SOLARA ACTIVE PHARMA SCIENCES LIMITED

Moderator: Ladies and gentlemen, good day and welcome to the Solara Active Pharma Sciences Limited Q1 FY2021 Earning Conference Call. As a reminder all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Abhishesk Singhal. Thank you and over to you sir.

Abhishek Singhal: Thank you. A very good afternoon to all of you and thank you for joining us today for Solara Active Pharma Sciences earnings conference call for the first quarter ended financial year 2021.

Today we have with us, outgoing MD Mr. Jitesh; MD & CEO, Mr. Bharath Sesha, and Mr. Hariharan, the CFO to share the highlights of the business and financials for the quarter. I hope you have gone through our results release and the quarterly investor presentation, which have been uploaded on our website as well as the stock exchange website.

The transcript of this call will be available in a week's time on the company's website. Please note that today's discussion maybe forward-looking in nature and must be viewed in relation to the risks pertaining to our business. After the end of this call, in case you have any further questions please feel free to reach out to the Investor Relations team. I now hand over the call to Jitesh to make the opening remarks. Over to you Jitesh.

Jitesh Devendra: Thanks Abhishek. Good afternoon everyone, welcome you all to first quarter FY2021 Solara Results. I hope all of you are keeping safe and healthy. As you may have already read our announcements and in line with our communications last year, I formally step aside from my role at Solara to pass on the baton to Bharat, who now takes over as the new Managing Director and CEO of Solara.

I feel delighted to be part of this exciting journey at Solara, a company that we set up from its beginning and have transitioned to a global API platform which is unique and highly adept to serving the global markets.

This revolution has been exciting, and I believe in this short period we have had significant outcomes and many first for us as a company. The incident related to Cuddalore OAI status has been an unfortunate one, in otherwise a very successful track record of previous audits of Cuddalore as well as our other facilities.

We are closely working with the US FDA on the CAPAs we have submitted, and we are confident on the reclassification of OAI status. My colleague Bharat Sesha will update in detail during his note.

Over the last 8 months, I have been working along with Bharat, and now it gives me enough confidence that Bharat is on top of things, and he along with the leadership team, are well equipped to take Solara to newer heights.

I feel it is important for me to express my gratitude over this earnings call as I sign off this exciting and remarkable journey at Solara. I must thank the founders and the board members, who repose their trust in me in driving outcomes of Solara.

I also take this opportunity to thank my colleagues for working with me to deliver on the commitments. Clearly a bright future lies ahead of us in Solara and I firmly believe that Bharat and his team would continue to deliver and continue to create value for all our stakeholders. I wish the best for Solara as they embark on the next phase of growth and success. Thank you and over to you Bharat.

Bharath Sesha: Thank you very much Jitesh, not just on my behalf, but on behalf of everyone at Solara. Your efforts in building Solara into a global company and do this in a very short time is very greatly appreciated by all of us. I also want to extend my personal gratitude and thank you for guiding me through this period of transition.

Hello everyone and thank you for joining the call today. All of us are living in what I would call unique things that we have never experienced before. I wish you good health, safety, not just for you, but for you and your loved ones.

Coming to Solara, I am delighted to state that Solara has made a strong come back from a very challenging quarter in Q4 FY2020. Some of the reasons why we have made this very strong comeback are first and foremost our passionate and engaged employees who showed exemplary skills and commitments to meet the needs of customers even in these tough times, but not to forget the society at large.

We have delivered our highest ever quarterly EBITDA, EBITDA percentage and PAT in the history of the company. An EBITDA of Rs.863 million, an EBITDA margin of 24% and a PAT of 423 million. This despite very tenuous start to the quarter where we had to take shutdowns across all our facilities in keeping full adherence to government regulations and guidelines.

We have also used the opportunity of this quarter to further cement our differentiation in the minds of our customers, to do with supply reliability. If I were to talk about some of the underlying performance drivers that led to this quarter there has been a very robust demand for our base products, but also a strong growth, an acceleration in growth of our new products.

Our new products contributed 11% to our revenues in Q1, which was an improvement from Q4 where it was around 7%. Solara's business model has always been one of working with our customers strategically, working on a long-term basis creating mutual value. Now we see that strategy is yielding tremendous results across markets as we gain more share wallet of existing customers and our reliability and working on a strategic basis, which is helping us win new customers with our products.

The market leadership that we have in many of our base products has been reinforced in the last quarter as our customers have trusted us to deliver an increasing share of their needs. We have also focused on portfolio maximization and we have extended some of our existing products to new markets.

We also mentioned that the cost improvement mindset that we have in Solara is pretty much in our DNA, and there has been strong delivery of cost improvements, efficiency related initiatives continue to support our growth and our profitability. Our plans to file 10 new DMFs this year is very much on track.

Let me also talk a little bit about our CRAMS business, as we have been mentioning it every quarter, our pipeline on the CRAMS business continues to grow healthily. Our current pipeline has grown by about 20% in Q1 FY2021 compared to the Q4 FY2020, and we start to see some big wins coming in from the CRAMS pipeline and this is going to build a very strong foundation as we build our CRAMS business in the future.

Let me also share with you that the phase I of our Vizag expansion is complete, it is a Greenfield facility that we have built in record time and it is going to be a multipurpose state of the art facility in Vizag. As we have announced in our press release, in Phase I Solara would have access to additional 3600 tons per annum of Ibuprofen capacity, taking our total capacity across the company to 8400 tons per annum.

Also delighted to say that we have now very firm customer interest and contracts for the volume of Ibuprofen that we will be making in Phase I at Vizag. We will be servicing our global customers from Vizag as and when regulatory and customer audits, which are normal are completed, so we hope this site to have full capacity in the next 12 months or so, when all these customary regulatory audits and customer audits are completed.

There is a phase II for Vizag which will cater to both large volume, and niche APIs, and the way we have designed the facility makes it adaptable to have efficiencies, expansion and flexibility. This will enable us to have a multipurpose API block that can cater to both small and mid volume APIs. We are targeting to file one new DMF this year from this block in Vizag.

We also have space to expand further, and we can build additional blocks to cater to new growth opportunities that we may have and new product filings that we may do. We do have an ambition for the Vizag site to become a flagship facility in the time to come.

Let me also mention here an update on the Cuddalore inspection. As we have announced before, the US FDA has classified Cuddalore under OAI, Official Action Indicated. Post the inspection results, we setup a dedicated team of both internal and external experts, who are working on a mission mode collaboratively with the agency to resolve the observation.

I want to reiterate that Solara is strongly committed to address the observations raised by the agency and we continue to be committed to the highest level of quality and compliance and want to again reemphasize that our quality systems are robust. The observations that we have from the FDA does not have an impact on any other APIs which we manufacture or supply from Cuddalore.

With the favorable macros that we continue to see, our strong performance driven tailwinds that we experienced, I see Solara continuing its momentum in the coming quarters and we can reconfirm our guidance of over 25% year-on-year growth in Revenue and EBITDA for FY2021.

I now request Hari to share some details of the balance sheet and key ratios for the quarter.

Hariharan: Thanks Bharat. Good afternoon to all. We are happy that our financial ratios have continued to improve on back of a consistence performance barring one-off Q4 occurrence, which is a unique one. We would like to share now that there is no outstanding of any ICDs on our books as of 30th June as this is in line with our commitments given at the last quarter call, this has been received with interest and the same has been kept in a fixed deposit.

Our net debt as of 30th June is Rs. 592 Crores, after adjusting the cash of Rs. 115 Crores. While our net debt to EBITDA ratio is comfortable at 1.7 times our annualized return on capital employed is under high teens. A further infusion of capital of Rs. 288 Crores by subscription to warrants from our anchor investors - promoters and TPG will take place in the month of September and this will be a fresh equity infusion and will reduce the net debt to Rs.300 Crores level in quarter two.

With the healthy balance sheet and a fresh infusion of capital and abundant opportunities, Solara is positioned exceptionally well for the future. Thank you so much for all your support.

Moderator: Thank you. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Ashwini Agarwal from Ashmore Investment Management. Please go ahead.

Ashwini Agarwal: Many congratulations to Jitesh, Bharat, Hari and the rest of the team for such a wonderful set of numbers and the commentary, I wish Jitesh the best in whatever he chooses to do next and I for one will miss him, but Bharat welcome and good to hear your comments at the open. Two or three big questions, one is that while margin performance has been strong and your outlook is pretty strong, I mean, on the revenue front how would you provide more insight into the quarter gone by, I mean, was it more price led, was it more volume led, what would be your estimate of revenue lost on account of shutdown, is there an efficiency loss that you are experiencing because of social distancing at work etc. If you could provide some insights, please?

Bharath Sesha: Ashwini, thank you very much for your kind comments. So, let me address the first question on revenue. So, as I have said earlier because of the COVID related shutdown that we had to take in the early part of the quarter for about three weeks we were in a mode of allocating our capacity to products which gave us a higher margin. So, there was a focus on gross margin led growth in Q1, so that is one of the reasons why you would find that probably our margins are solid and some of the consequences of that of course is that the product portfolio tilts more towards those type of products. In terms of how much time we lost as I indicated earlier there was about 3 weeks of production stoppage in Q1 and if I were to address the question you had, we are not finding any inefficiencies because of social distancing etc., we have actually managed that quite well, we do not see any inefficiencies, we have taken care to make sure that all the norms that need to be followed at facilities, at our offices are all as per guidelines issued by the government. So far, we have not seen any impact in terms of efficiencies or inefficiencies let us say that have crept in because of these steps that we have taken to keep our employees healthy.

Ashwini Agarwal: So, it is a portfolio reallocation of sorts that you are in where given the capacity constraint you focused on more profitable product. How is the order book looking, I mean, do you have visibility for the next three quarters of close to peak production or how are things looking at this point?

Bharath Sesha: So, there are couple of factors that are driving a very positive momentum for us in the coming quarters, first one is that, if you look at the strength of general demand that we see and that I mentioned in my opening remarks about our existing customers who were really appreciating our differentiation in supply reliability and we are able to increase our share wallet there, but also the growth that we are getting with the newer products and newer customers, we see quite good solid demand picture for the coming period Ashwini. So, we see a robust demand picture going forward, and just to point out on the revenue side, Vizag is still not factored in and as we have already shared with everyone that we will see that kick off revenue to happen in the second half of the year. So, if I were to consider the fact that we did not produce or ship for 3 weeks in Q1 and Vizag will come on-stream, and we will start seeing the impact of that in the second half, I see that we should be well on track to meet our revenue guidance.

Ashwini Agarwal: Last question is on CRAMS. You made small reference to the fact that CRAMS revenues grew by 20% in Q1 quarter-on-quarter and you are confident of growing this. I mean, what are the plans, you had been looking at opportunities for inorganic growth and I am telling this into Hari's comments saying that the money that comes in from warrants will probably go to with reducing the net debt. So, have you kind of given up the inorganic growth opportunities and build this business organically?

Bharath Sesha: So, two clarifications before I answer the question. First, I have said the pipeline has grown by 20%, so the size of the opportunities that we have in our pipeline has grown by 20%, so that is the first. The second Hari's comment was more to say that with the inflow of capital from the anchor investors, the net debt at that time will be there, of course we have not given up on the inorganic. I just wanted to clarify that Ashwini. So let me address both questions, on the CRAMS piece, we are starting to win some big contracts which I mentioned also in my opening speech and size of our inquiry basket or the opportunity pipeline increasing also shows that we are starting to gain credibility with some of the bigger customers and that is very crucial as we all know for the CRAMS business to grow we also know it is a long cycle business so from the time we get an opportunity to the time it comes to function, it is a period of a few months, and so we are in that process of engaging with our customers, COVID is not helping because a lot of this just to do with visits and discussions along scientific lines, so we are on track it is an incubation business, for us that is how we look at it, it is tracking really well, the opportunity pipeline is going in a positive direction, we are having the right discussions with our customers. So, we see it trending in a right direction and we hope that it will continue to do that in the coming period, and we see that has been growing at a very healthy trip over the course of the next coming years. Then coming to the inorganic question that is still our strategy and it is very clearly articulated also and we continue to reemphasize we are looking to make an inorganic move and of course the capital will enable that opportunity to come to provision and that is still the plan, that is still the strategy we are continuing to look actively for inorganic growth in the CRAMS business.

Ashwini Agarwal: Thank you, all the best. I will come back with more questions in the queue.

Moderator: Thank you. The next question is from the line of Madhu Kela from MK Ventures. Please go ahead.

Madhu Kela: Hi! Bharat and the team, fantastic show, glad to be part of this company. Bharat, if you can just give us a little on medium, longer-term view on your Capex plans and what kind of Capex is possible over the next two, three years and when do you think that company becomes FCF positive?

Bharath Sesha: Maybe Hari you can address it then I will add color to it.

Hariharan: We have already started putting around 250 Crores in our Vizag facility and last year we spent around 165 Crores of that balance amount will be spent in the current year in phase I expansion and for all others units we are marking around 100 Crores Capex for every year, around 40 Crores is for the maintenance Capex and balance 60 Crores is for the debottlenecking and capacity expansion in each unit. You know that recently the government has announced various incentive schemes for the API industries and various products making as far as the case of making, and we want to take advantage of that and there is no restriction on the Capex amount, we have a good free cash flow generation from the business that will used for the expanding the facilities on need basis on the Capex.

Madhu Kela: No, so this is what precisely I am asking that when do you seeing the company because given your such strong numbers on EBITDA when do you see the company to sit on cash?

Hariharan: It is an ongoing activity Madhu and there is no specific range for the Capex because it is based on the business deals and for new products, we will be keep on investing and so each unit has got capacity to increase and also we have got an additional land in Mysore where currently that unit is only making the intermediates, we can expand the capacity there. It depends upon the growth opportunity and there is no restriction on any Capex for us, for the business growth we are willing to invest any money on that.

Madhu Kela: And is it fair to assume that our absolute debt number will not rise over means three years and which we able to fund that Capex based on our cash flow?

Hariharan: Yes, we do not expect any increase in the debt compared to the current level.

Madhu Kela: My last question is being you guys looking at any inorganic opportunity in the near-term in the next 12, 18 months wherein we are seeing some target for acquisition?

Hariharan: Yes, as Bharat indicated that we are looking at opportunities, inorganic opportunities in CRAMS plus other business area. Once that appropriate decision is made, we will come back to the market to inform about that.

Madhu Kela: But will that mean the debt will go up because of the inorganic acquisition?

Hariharan: It will be within that approved limit, in case of the inorganic opportunity, it will be our self-reliant basis only that investment will be made. Further, the acquired business will be able to support the additional EBITDA and additional interest payment in case it is a good acquisition.

Madhu Kela: Thank you so much, all the best, god bless you thank you.

Moderator: Thank you. The next question is from the line of Bharat Hedge from Motilal Oswal. Please go ahead.

Bharat Hedge: I wanted to ask on Ibuprofen overall what is the demand of the industry and your capacity addition or anything else would impact the prices in the Ibuprofen?

Bharath Sesha: It is difficult for us to give a comment on the overall demand, our capacity we have stated also that it is with the addition of Vizag it is now 8400 tons per annum. Our Ibuprofen presence is very strong, we are one of the global leading players there and our business is based on long-term contracts with big customers, so we are very confident of our Ibuprofen position in the market and we are very confident that we will continue to see that business grow in a profitable basis.

Bharat Hedge: Just another question on the profitability EBITDA margin if you see you also commented that your margins, you had higher margin products in the first quarter so are you expecting over the rest of the year the EBITDA margins and EBITDA to go down a little bit as compared to Q1?

Bharath Sesha: So, if I were to talk on a gross margin basis as I said because of the portfolio choices we made with limited capacity, I mean, we were talking in the order of magnitude of plus, minus 2% percentage points in our gross margin basis, so, that is the kind of range that we are talking about. The structural fundamental issues are still strong, but that is the variation level that we would see if the portfolio normalizes to a typical one.

Bharat Hedge: Thanks a lot, that is great.

Moderator: Thank you. The next question is from the line of Rahul Veera from Abakkus Asset Management. Please go ahead.

Rahul Veera: Just wanted to understand, Sir usually we have seen that Ibuprofen keeps moving around $12 to $18 depending on the demand supply mismatch at any point of time. So, at $12 what would be the gross margin we can expect from this product?

Bharath Sesha: So, we cannot typically answer on product level details. Hari you want to add anything?

Hariharan: No that is what, I am alluding to what you say, the product wise details sorry we will not be able to share at this point and being a long player in Ibuprofen and we have around 30 years of manufacturing experience and, we are very strong in costing them for the process on that. So, we will be most competitive in the marketplace.

Rahul Veera: So I just wanted to understand like because like a IOL come up with the capacity in the last year, this year we have come in with the capacity, overall Ibuprofen demand supply over the past 10 years has been plus or minus 2% growth at max and with only one of the competitors plant going off largely the delta of pricing has been gone that at $12 levels it has been very difficult for anybody to make huge margins on this it has not been a very high gross margin product overall. So just was understanding the overall investments that will made what kind of payback can we expect from this product?

Bharath Sesha: So again, not getting into the financial of this but generally again to reemphasize our positioning on Ibuprofen is based on long-term contracts with customers who have also very secured needs in terms of volumes etc. Number two we are also a leading player on Ibuprofen derivatives which is the market segment that is fast growing across many other regulated markets where we have a dominant presence in terms of our customer share of wallet. So, we are very confident, and we are very clear about the fact that we can add value to our customers on Ibuprofen portfolio that we have, and we do not see any reason to kind of see this trend go anywhere different in the coming years.

Rahul Veera: So, sir after Ranitidine do you think Ibuprofen will be one of the largest products in the top three?

Bharath Sesha: So again, we do not particularly get into product level details, it is one of our key products that is all I can say.

Rahul Veera: Sure, fair point Sir. I will come back in the queue Sir. Thank you.

Moderator: Thank you. The next question is from the line of Kunal Mehta from Vallum Capital Advisors. Please go ahead.

Kunal Mehta: I wanted to understand, this year, you mentioned that you missed at least 20 days of production so and closing in that the volumes would have been lower by at least 12% to

15%. So, wanted to understand that the price will be margin improvement we are seeing, it is the price increase across the portfolio or there are certain products where there has been largely a proportionate increase in prices?

Bharath Sesha: In certain products we have seen positive momentum on pricing with our customers.

Kunal Mehta: Second question is on the Vizag facility we have phase I coming online in the next few quarters I wanted to understand what was the net addition absolute tonnage across all products what is the net addition to capacity in phase I and just a connected question on this one that right now the plant is under qualification for the developed markets especially for the US players and the European clients. So could you please tell us the investment and what products are you going to file to going to pass on with that to the customers from that side are you going to do the base business products which you have and then you would add new products in phase II or are these also need to be new products completely new product range which you are looking at?

Bharath Sesha: So phase I is Ibuprofen in Vizag that is our Greenfield facility so in phase I is what we have now started the validation for, phase II will be the facility which will cater to multiple products both large volume, but niche APIs the design is adaptable as I said earlier so phase II we will expect to validate that somewhere towards the end of this calendar year. So that is kind of the plan end of this calendar year early next year is when we will validate phase II plant. For now the phase I is the Ibuprofen Greenfield facility that we are in the process of validation and to your question on regulatory market sales, as I had indicated earlier the timelines for our customer/regulatory authority have come and visit and audit the facility is a little bit tough of question mark given the COVID situation but we anticipate that in about 4 quarters the site should have most of the customary regulatory and partner approvals for qualification completed.

Kunal Mehta: That you are referring that to for phase I?

Bharath Sesha: Yes phase I.

Kunal Mehta: Okay and phase I is on the Ibuprofen right sir?

Bharath Sesha: Correct.

Kunal Mehta: And phase II the market sales would be 12 months from this validation completion so that means we are looking at FY2022 calendar year revenues starting to coming from phase II?

Bharath Sesha: Yes from FY2022 having said that some of the products, we are still finalizing the product portfolio on phase II with the new products and some of the existing products that we may do a site transfer so the qualification timelines depends on those things, but you can say that FY2022 is when phase II will start contributing revenue to the company.

Kunal Mehta: Sure, thank you for answering my questions. Thank you.

Moderator: Thank you. The next question is from the line of Aditya Shrimankar from Equisearch. Please go ahead.

Aditya Shrimankar: I have a question regarding raw materials, I know you have already answered this question that you guys have had a better product portfolio sale. So last year the gross margins were 50% and this year in Q4 FY2020 it increased about 54% has now about 63% so I wanted to know what is the Gross margin% when we make apple-to-apple comparison had the raw material prices moved in any way for the product that we sold?

Hariharan: In Q1 of last year our gross margin was 54% it is nearly 54.3% and current quarter it is about 57% and it is due to that operational improvement and product mix only mainly.

Aditya Shrimankar: So, there has been no change, not much change in the raw material prices?

Hariharan: Yes.

Aditya Shrimankar: Okay alright thanks.

Moderator: Thank you. The next question is from the line of Ashit from Dron Capital. Please go ahead.

Ashit: Congratulations on a great Q1. In your opening remarks you elaborated the fact that about 11% of your topline was contributed from new products, so in this context what is your definition of new products when you say new, does that mean they were commercialized in the past 12 months?

Bharath Sesha: So, products that we have commercialized in last three years is what we call new products typically, so the filings been done, and we started commercialization process.

Ashit: And I have another question regarding API prices, could you just shed some light on if you have seen any increase in API prices in Q1 and then the price volatility persists in this quarter, if you could just comment specifically on ibuprofen and Gabapentin, please?

Bharath Sesha: So, as I said our Ibuprofen business is on the strength on long-term agreements we have with customers and what we have in terms strength of demand from them. So, there is always price volatility in every product, we see that we were in a strong position with regards to our long-term agreements and our customer relationships, so we are looking at that as the way that we stably build this business. On the general API price volatility, I mean there are of course every quarter there are variations in pricing that we experience across our portfolio products as I had said to earlier some of our products we see some pricing strength in this quarter and it has driven by demand and capacity. So, we continue to see those trends for some of these products in the coming period.

Ashit: So, this includes products such as Gabapentin as, well right?

Bharath Sesha: Again, not going into specific products so I am just saying generally that we do see this trend pricing power in some of the products that is in our portfolio.

Ashit: Just one more from my side. You have mentioned that you are targeting about 25% YoY topline growth, but I heard you mentioned that the Vizag facility will only contribute to the revenues from FY2022, so where exactly is this extra revenue coming from is there some unused capacity in the remainder of your plants that have not been utilized?

Bharath Sesha: So, let me clarify FY2022 is Vizag phase II, phase I we expect will start contributing revenues from the second half of this year. So that is what we think will also add boost to our revenue growth.

Ashit: And so, 250 Crores odd Capex you have done for the Vizag facility that is phase I and phase II combined?

Bharath Sesha: Yes, it is phase I and phase II combined.

Ashit: Okay thanks that is all from my side. Thank you and good luck for the coming quarters.

Moderator: Thank you. The next question is from the line of Viraj Mahadevia, an Individual Investor. Please go ahead.

Viraj Mahadevia: Congratulations on building a fantastic API business. Just at a very high level I was trying to understand how you are doing such exceptionally strong margins in products that are generally viewed as more commoditized like Ibuprofen etc., are not generally very high margin products, so what do you think has been your secret sauce or winning secret here, is it process improvements, is it structural changes in the market is it better pricing I mean what is happening and how you are generating these disproportionate margins?

Bharath Sesha: So overall our margin profile has impacted by two strong and significant actions we have been taking and we continue to take and they have already what you have said and indicated in your question so one on the pricing side of course we see stability in growth and pricing in some of our products and that is driven by again what I said earlier is that we are allocating capacity to those products in the Q1 and saw some of the margin improvements second the cost improvement focus that we have in Solara is pretty much part of our DNA and we consistently delivered yield efficiency improvements, Opex improvements across quarter-on-quarter and that still continues to be the engine that continues to motor on with good speed and momentum. So, on the cost side we continue to see positive actions and we continue to see and implement those and on the revenue side we see pricing power in some of the products, we see pricing strength in some of the products. So of course, both put together is what is driving the margin performance that you had asked about.

Viraj Mahadevia: Typically, in these product categories has China been typically a large supplier and any benefits of tailwinds coming in from sort of China plus one sourcing from our end clients?

Bharath Sesha: So on a general basis this trend is very visible and accelerating and we see definitely conversations with our customers who are looking to derisk their supply chain, multiple geographies to source from and that is driving quite some traction for some of our products so generally that trend is visible and accelerating and of course we have seen that impact also with Solara, for sure that is the trend that is happening.

Viraj Mahadevia: And just last point on housekeeping, good to see on page #5 you highlight that the ICD has been cleared so I guess good to see that from a shareholder point of view regarding the pledge shares of the promoter group when can we expect those to be cleared as well to remove any kind of overhang out there?

Hariharan: As a company we cannot give an answer for that, we do not get much detail about that we just get the information it is a promoter office only you may have the contact regarding that, it does not come under our control.

Viraj Mahadevia: Sure, I mean, I think it is awkward for shareholders to reach out to the promoter office given that you all represent the promoter and the company, but nonetheless thank you.

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

Ranvir Singh: Sir, question relates on your raw material for top products just wanted to understand the level of integration, so whether we are integrated up to KSM level or we are still importing KSM from other countries specifically China so there if you could give some insight on that side?

Hariharan: I think nearly around 32% of our imports are from China it is for KSM and basic chemicals and so we must depend upon that, and balance is our 58% of the material is procured from Indian source.

Bharath Sesha: And just to add to that wherever there is an opportunity to backward integrate strategically or get a key starting material in-house or from a source that is more local we do that on a structural basis we continue to do that every quarter, but as of now this is the situation.

Ranvir Singh: And as far as supplies are concerned were the supplies reduced from China or during this COVID that we have faced any disruption there.

Bharath Sesha: No, we have not faced any disruption we had acted proactively when we started first hearing about some supply chain risks in China to strategically build stock or work with our suppliers, so we have not seen any disruption because of COVID from China. So, we were in a good shape there.

Ranvir Singh: And second one on balance sheet, so where we see our debt level, what is the current debt and where we see by end of FY2021?

Hariharan: That is our net debt is 600 Crores level and we expect that equity infusion money coming in the next quarter, it may dip down to 300 Crores by next quarter, but there will not be a much increase in our gross debt compared to what level we are in, we are constantly reducing the term loan by repayment on a monthly basis.

Ranvir Singh: Sir cash flow is obviously getting much stronger, so apart from that regular repayment we have serial wise are we going to pay off anything addition to that, so we can see some significant reduction there?

Hariharan: Yes, actually about 50% of around 380 Crores is the working capital which is incurred to support the operation and we have around 335 Crores of term loan and we will see that it depends upon the strategic decision what will be taking that whether you want to go for a inorganic acquisition for this cash we have it will be a constant therapy between the effective utilization of the accounts and the return on the investment based on that we will take a decision.

Ranvir Singh: That is, it from my side and all the best.

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

Om Prakash: What is your utilization currently because I think based on your gross block of around 850 Crores you have been doing a turnover of around 1350 Crores so is it safe to assume that even with the fresh Capex the asset turnover will be around 1.5 times or so?

Hariharan: Our current total capacity utilization is around 70% and during the COVID situation we expect that 1.75 is our asset turnover ratio we aim at, 1.75 to 1.9.

Om Prakash: It is more of a function of product mix also maybe, or typically you can take a benchmark of 1.75 for this kind of a business?

Bharath Sesha: Yes sir.

Om Prakash: And based on this new thrust of API by the government are you bringing anything on the drawing board you think what will be our opportunity your scope or and is there any possibilities of you can also do some Brownfield expansion in your current plant?

Hariharan: See if we have remained that entire scheme announced by the government wherein the process of our working towards that and there are some player and our own manufacturing APIs are in the list and we are in the process of making our drawing board visibility for the same and we have got a land in Mysore, as well as in Vizag for future expansion and we will be taking a proper decision on that.

Om Prakash: So, what kind, what could be that size of opportunity which we are pledging on that?

Hariharan: It will take some more time. Yes, it will take, and the government has given time within that time we will be deciding on that.

Om Prakash: Thank you.

Moderator: Thank you. The next question is from the line of Kunal Mehta from Vallum Capital Advisors. Please go ahead.

Kunal Mehta: I wanted to understand when you mentioned 70% capacity utilization you are referring to the first quarter only right, not the normal capacity quarter?

Hariharan: It was for first quarter, that is what he was asking, first quarter capacity utilization is 70% Kunal.

Kunal Mehta: And secondly wanted to understand this whole trend rise in prices because of higher demand so I am sure your customers are seeing increased demand from their customers and that is why we have registered higher volume demands for our products. So, could you please give us and understanding of this trend how do we see the longevity of these sort of prices maintaining themselves, so do we expect these price levels to maintain for next I would say 3, 4 quarters because your customer have increased their stocking requirements?

Bharath Sesha: So we see now the trend is clearly showing stability of this pricing levels for the period to come I mean it is difficult to give there is already as volatility quarter-to-quarter but the strength in pricing we see quite some visible trends for the coming period of time, what is driving this of course one is stocking but what we also see is generally the supply chain derisking that I talked about earlier from multiple sources giving a premium for supply reliability, increasing procurement of certain product at a higher percentage from a more reliable supplier all of these are driving trend so I would say there is multiple contributing factors to why we see demand strength, some of it is very specific to Solara I mean the supply reliability point is very specific to us so I think that is what is driving the strength and we continue to be a reliable supplier and so I see this strength in demand for Solara to continue as I see the visibility for the coming few months and quarters ahead.

Kunal Mehta: Just final question, do you actually expect increase in prices from China to increase if we are able to improve the margin I am sure somebody supplying to it also want a share of this, so do you expect pricing to, do you expect raw material pricing to stay at the same or will increase to a good extent going forward?

Bharath Sesha: Again, that is a little bit of a volatile situation right but what we have seen and what we continue to see is no more major changes in pricing upwards from our raw material suppliers and we do not see that trend at all.

Kunal Mehta: Understood Sir. Thank you for answering the question Sir and thank you for your time. Thank you.

Moderator: Thank you. The next question is from the line of Aman Banerjee from Indgrowth Capital. Please go ahead.

Aman Banerjee: Sir when you mentioned that you have this 70% capacity utilization in Q1 FY2021 I am assuming that you have excluded the 21 days the lockdown was there from the denominator as well is that a correct assumption?

Bharath Sesha: Correct.

Aman Banerjee: So, and my second question is I really did not catch our Capex guidance figure so can you please repeat that again?

Hariharan: Just to clarify the Capex we have got 250 Crores for the Vizag phase I expansion, in that we already spent 165 Crores in the last financial year balance we will be spending in the current year and also all other units 100 Crores is our Capex plan and 40% being for the maintenance 60% for the debottlenecking and capacity expansion and when there is a new opportunity comes for anything that we have a good free cash flow in our hand we will be investing on business need purpose for growth.

Aman Banerjee: Given that our phase I Vizag facility is complete but obviously it is not generating revenue as of now so are there some costs that we are incurring in terms of the fixed cost of having the facility and the people and other such cost and are we passing that through the P&L or are we capitalizing that?

Hariharan: No, we are all passing through the P&L and it is not being capitalized. Whatever costs allowed to capitalize as per accounting standard has been capitalized.

Aman Banerjee: What would the quantum of this be let us say for quarter or the cost which are not producing any revenue?

Hariharan: That is a unit wise specific information we will not able to share with you but that is a good amount of expenditure we must incur to maintain the facility.

Aman Banerjee: Fair enough you are not able to give that information, okay fine. Thank you.

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

Amar Maurya: Sir last year in financial year 2020 I believe we did the Capex of around 269 Crores right?

Hariharan: Yes.

Amar Maurya: So how much time does it take for Capex to reach to its full utilization level like two years, three years?

Hariharan: No, no, see out of Rs. 269 Crores, Rs. 165 Crores is for Vizag, balance Rs. 100 Crores is for the normal capex for other units and every year we will be incurring the Capex for the growth of the business and for the maintain of the asset in a good condition we will be incurring the Capex on a continuous basis for the growth of the business.

Amar Maurya: Sir when you guide for 25% kind of a growth wanted to understand, do, we have that capacities with us to deliver 25% growth in 2021 that is basically my question?

Hariharan: Yes, we have a capacity to deliver that kind of growth that what Bharat has indicated in the current business as well as the current investment as well as the phase I capacity in Vizag will be used for the growth driver for the business.

Amar Maurya: And when the Vizag phase I will hit,

Hariharan: In the second half that is what we are aiming at.

Amar Maurya: Thank you.

Moderator: Thank you. The next question is from the line of Himesh Shah from Capita India. Please go ahead.

Himesh Shah: My question is on the inorganic opportunity and the money that is going to come in next month. So, I did not get the clarity on that, so are you going to pay back the debt or are you just going to keep the money in the bank and wait for the inorganic opportunity to come?

Bharath Sesha: So there are efforts already ongoing to identify the right inorganic opportunity and we are looking at it on two aspects we are looking at it as inorganic opportunity that could significantly lead for our CRAMS business as far as we are looking at having access to a field of science or we are looking at both science and scale which means that the size of the business is sufficient to add heft to us and we have got differentiation when it comes to growth. So, we are actively in the process of looking at an inorganic growth opportunity so there is the capital that we talked about and what was mentioned by Hari earlier is going to go into funding that inorganic opportunity that we yet to identify but we are working actively on. So, the moment we identify that we will be using the capital for an inorganic opportunity.

Himesh Shah: So are you in talks with some companies or are you still trying to find out whether there is any inorganic opportunity have identified.

Bharath Sesha: As you would appreciate it is difficult for us to get into that level of detail of any of these types of topics I again reemphasize that is an integral part of our growth strategy and it is critical for our CRAMS business and we continue to look at that very, very actively on an ongoing basis.

Himesh Shah: And one more question is on the guidance that we had given 25% revenue growth guidance and 25% EBITDA right. So, you have done around 6% revenue growth in the first quarter, but the EBITDA is up around 30% so are you expecting margins to go down in the next 3 quarters.

Bharath Sesha: So as I had said earlier it is a good question again we had done a portfolio maximization in the first quarter given that we had capacity that was limited because of the shutdown that we had on COVID related matters that has added some heft to the gross margin number also as Vizag will kick in, in the second half of the year so that is also going to help us with the revenue growth. So, as we normalize our product portfolio over the course of the year could be plus, minus 2% percentage points variation in a gross margin but that is kind of the trend that we see going forward.

Himesh Shah: Thank you so much Sir, congratulations on the great set of numbers.

Moderator: Thank you. The next question is from the line of Alankar Garude from Macquarie. Please go ahead.

Alankar Garude: Sir my first question is on the Cuddalore OAI, considering that we have had a pretty strong regulatory track record so far can you just throw some more light on what exactly were the issue sited but the US FDA is there anything difference which we could have done and approximately how much time do you think it would take for the remediation to take place?

Bharath Sesha: Let me address the second part first, so we are already address since the notification came from the FDA we have setup the task force of both internal and external experts who are working on it, we had agreed on a time bound response plan to the FDA and we are on track to do that and we are very confident that whatever commitments we have made to the FDA will be met on time as we have committed to them, so that process is ongoing and we are confident that we will be able to adequately address all the issues that were raised by the inspection so that is one. Coming to the first part of your question as I have emphasized again none of the observations were to do with the quality system or our compliance systems I do not want to go necessarily into the details of the observation, but needless to emphasize again that they were to do with specific protocols regarding testing communication etc., none of them were to go with the core quality systems or the compliance systems that we have in Cuddalore.

Alankar Garude: So, can you share the timeline which you have communicated to the FDA?

Bharath Sesha: So, we will be submitting all our responses this month.

Alankar Garude: So, the final response is from your side, right?

Bharath Sesha: Yes.

Alankar Garude: And secondly Sir how important that this facility in terms existing sales contribution as well as future filings?

Bharath Sesha: So, I will allow Hari to comment on existing sales contribution. On the future filings we have at least have a strategy where we look at risk mitigation by looking at alternate sites or mirror sites as well call them. We are in the process of implementing that strategy for the key products that are made from Cuddalore and we will be successful in completing that exercise in the next three to six months, so beyond that we do not see a risk at all in terms of ability to source from Solara for regulatory markets for these products. Maybe Hari can comment on the first question in terms of the sales importance of Cuddalore.

Hariharan: Yes see we do not give a specific detail about our sales unit wise, but we not only supply to US market we also supply to various markets from that facility one of the major products which is Ranitidine which had an issue other than that there is no restriction and we continue to sell the goods to the various customers and various part of the world.

Alankar Garude: But any color on the percentage any broad range that would also suffice in terms of current contribution to US?

Hariharan: Sorry that we will not able to share at the unit wise data as a policy we will not be able to share that data.

Alankar Garude: Okay Sir fair enough that is all from my side thanks and all the best.

Moderator: Thank you. The next question is from the line of Saket Mehrotra from Beta to Alpha. Please go ahead.

Saket Mehrotra: The first question is regarding the DMF filing with the FDA so I believe as on June we have around 86 filings and I think that puts us almost in the top quartile of API manufacturing so in terms of the road ahead how many filings are we looking at and do we have any strategy to keep maintaining those leadership position and the second question I believe somewhere we had clarified that right now 32% of your imports are coming from China so is there any way of reducing this or do you see any risk around this in terms of the ongoing prices or the ongoing balance of power that is going on?

Bharath Sesha: So on the first question we plan to file 10 DMFs this year and that we are on track to do that and we will continue to do that in the following year, see again our objective is not per se the number of DMFs, but the quality of DMFs so the product selection is a very integral part of our growth story, particularly organic growth story so we are very focused on choosing right products and filing the right markets for us to and have the growth in the future. So, this year as a fact the ten we will do but the quality is what we are focusing on also this year and beyond. Coming to China sourcing yes that is an actively monitored and managed metric that we look at in terms of import of our raw materials from China, wherever possible we do alternate source from other geographies and we have done that already for a few over the course of the last couple of quarters, we intend to continue that exercise for the coming quarters so on an ongoing basis we expect to risk mitigate now just to clarify it could be very possible that we have an alternate source, but just from a commercial perspective for that particular quarter we have not bought from that source so while 32% was the imports from last quarter the risk adjusted of that 32% could be few percentage points lower where we have alternate sources we have chose in commercially not to buy from them so that will be an ongoing effort as I also said earlier we will look to do alternate source wherever there is a possibility to do so and it is also strategic.

Saket Mehrotra: Secondly on the CRAMS side I believe there were some commentary around it is beginning Q4 that you are receiving a lot of enquiries even I believe in your Q1 presentation also you have spoken about it. So, in terms of how much of this mix say you are targeting say in the next 5, or 10 years in terms of maybe contributing to your topline and as well as your margin expansion?

Bharath Sesha: So it is an incubation business for us as I said so we are in the process of kind of focusing on growth here I do not want to hazard a guess now or to give you an estimate now we are focused on as we should be on an incubation business of growing the pipeline, enabling our differentiation just improve our customer base, making sure our customer base is right and making sure that what we offer as a service kind of product to our customers is differentiated and something that excites them, so a lot of the attention and focus is on the building blocks right now and our ambition is to grow to a significant nature on the coming period I think I would desist from giving you an exact estimate at this stage given that the stage of the business is an incubation stage for us.

Saket Mehrotra: Final question any updates on the Ranitidine ban or is there any material impact because of that because I believe we have off set that through a mix of CRAMS and other products but just some color on that?

Bharath Sesha: So all the impact of Ranitidine was already captured fully in Q4 so there is no financial impact that we have seen from the Ranitidine issues of Q4 and we from a strategy perspective for the capacity we have looked at it three ways so one is where we see increased growth of existing products that we make in Cuddalore we have used that capacity for that, second is we have looked at new products that we can do in that facility and third is of course the CRAMS business all three are important levers and pillars in which we are looking at derisking Ranitidine sales from the Cuddalore facility.

Saket Mehrotra: Thank you so much.

Moderator: Thank you. Ladies and gentlemen due to interest of time that was the last question. I would now like to hand the conference over to Mr. Bharat for closing comments.

Bharath Sesha: Thank you everyone for joining today's call and once again from all of us at Solara we wish you the best in health, safety for you and your loved ones. We look forward to participating and joining you in future calls in the coming quarters. Thank you very much, have a safety and a healthy day.

Moderator: Thank you very much Sir. Ladies and gentlemen, on behalf of Solara Active Pharma Sciences Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.