“Granules India Limited Q3 FY-19 Earnings Conference Call”

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Moderator: Ladies and gentlemen, good day and welcome to the Granules India Limited Q3 FY19 Earnings 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 telephone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Sumanta Bajpayee. Thank you and over to you, sir.

Sumanta Bajpayee: Thank you. Good evening everyone and welcome to Granules India's earnings call for the third Quarter FY19. To discuss our business performance and future outlook I have with me Mr. Krishna Prasad Chigurupati – Chairman and Managing Director, Mr. Ganesh K. – Chief Financial Officer, Ms. Priyanka Chigurupati – Executive Director of Granules Pharmaceuticals Inc. and Dr. Prasada Raju.

We will begin this call with opening remarks from company's management followed by Q&A session.

Before we proceed with the call, please note some of the statements made in today's discussion may be forward-looking and must be viewed in conjunction with the business risks and uncertainties involved. The safe-harbor language contained in our press release also applies to the conference call. The transcript of this conference call will be made available in our website in due course of time.

With this please let me turn the call over to Mr. Krishna Prasad Chigurupati for his opening remarks. Thank you. Over to you, sir.

Krishna P Chigurupati: Thank you, Sumanta. Good evening, ladies and gentlemen. Thank you very much for attending our earnings call for the third quarter of fiscal year 2019.As we are still in the month of January, I take this opportunity to wish you all a Very Happy and Prosperous New Year. Before I get into operational details, I would like to share with you some aspects of our company's vision and growth strategy for the next three years. We faced a challenging situation in the year 2018, where our performance was impacted due to multiple headwinds. Today we are in a position where we have successfully dealt with these challenges to a large extent and are on a fast track to growth which is reflected in our year-to-date performance.

Fiscal 2018 was a year zero for us where the ground work for our growth trajectory was laid down. Building on this foundation over the next three year period, we are targeting a topline CAGR of around 20% and a bottom-line CAGR of around 25%. The three major growth drivers for this will be, optimal utilization of increased capacities for our core business, scaling up of our US generics business, commercialization of our multiple API and oncology blocks in Vizag.

I will now provide key updates of our financial performance and business for the quarter under discussion. The momentum of strong growth set during the first two quarters continued in the third quarter as well. Year-to-date revenue from operations for the nine months of fiscal ’19 stood at Rs. 1,666 crores, a year-on-year increase of 40%. Q3 revenues were Rs. 632 crores, a year-on-year increase of 54%. The basket of five core molecules grew 33% year-on-year and contributed 82% of our total revenue during the first nine months thereby helping us maintain a global leadership.

Of these five molecules, Metocarbamol and Metformin ER grew manifold as we launched the FD under our own label from our newly formed marketing arm in the United States. We achieved this growth on the back of the inherent stability of the molecules in our portfolio combined with our relentless focus on efficient manufacturing. Dissecting the growth from business segment perspective, the finished dosage segment has seen a growth of 59%, followed by APIs which registered a 46% growth for the first nine months of the fiscal year 2018. PFIs continue to remain stable.

On the geography front, North America’s market has always been a focus area for us and we are growing in this region despite market specific challenges. North America has contributed 47% of our total revenue which is an increase from 38% from the last financial year.

Gross profit. Key raw material prices out of China continued to increase. This combined with increased sale of APIs in the domestic market had led to a decline in gross profit margins on a standalone basis as compared to the corresponding quarter. However if we look at the margins at a group level the increasing contribution from GPI has helped us protect our margins to a certain extent. The prices of some of the key raw materials from China had started to decline in Q4.

We expect to see increasing gross margins in the domestic API business due to this. Regulatory approvals for our expanded Metformin capacity are awaited and once we get them we can see a further increase in our gross profit. With stabilization of raw material prices, regulatory approvals in place and new ANDA approvals at GPI, we expect continuation of the growth momentum to follow in the subsequent quarters.

EBITDA: For Q3 we reported an EBITDA of Rs. 119 crores with 18.9% EBITDA margin and an increase of 59% compared to the same period of the last financial year. This shift in EBITDA is on account of a larger base of operations during this period. This was achieved despite lower utilization of plant capacities and recognition of higher R&D costs in the P&L.

Profit after tax: For Q3 net profit was Rs. 60 crores which was 9.5% of revenue and an increase of 72% over the corresponding quarter of the previous year. This increased number was achieved despite the negligible contribution from our JVs during this period. We expect a substantial contribution from both the JVs in the next quarter which will result in a much improved PAT number.

Debt:: On the debt front, owing to the policy of fiscal prudence that we have adopted, net debt is declining and at the end of Q3 it stood at Rs. 941 crores as compared to Rs.1,008 crores at the end of Q2. This is a reduction of Rs. 67 crores quarter-on-quarter. The debt to EBITDA ratio reduced from 2.6 at the end of Q2 to 2.3 at the end of Q3. Long term debt stood at Rs. 562 crores a reduction of Rs. 32 crores as compared to Q2 and short term debt was Rs. 481 crores, a reduction of Rs. 46 crores as compared to Q2.

I would like to emphasize that we were able to reduce short term working capital debt in spite of an increase in working capital requirements due to increased revenues.

Cash flows: I wish to reiterate that we are firm on our commitment towards building a strong cash flow as we see more projects getting operationalized and reduction in CAPEX requirements.

The cash flow generated during the quarter are utilized primarily to fund our working capital requirement, repayment of short term borrowings, and dividend payment. I am happy to share that we have made progress towards reducing the cash to cash cycle of the company to 124 days compared to 137 days at the beginning of the period. This is a cycle which moves in tandem with business cycles and can be impacted by macro factors and hence would be pursued on a continuous basis to align with the industry and sustain the same.

R&D Expenses: The R&D expenses for Q3 were Rs. 32 crores compared to Rs. 25 crores during Q2. Out of the Rs. 32 crores, expense for the quarter, we have charged Rs. 14 crores in the P&L and the balance has been capitalized. When we look at R&D cost for the nine month period, Rs. 41 crores has been charged to the P&L and Rs. 44 crores has been capitalized. This reflects the increasing R&D expenses being charged to P&L as part of our changed approach to R&D accounting.

Filings: We are expecting the same momentum as last year and as expected we will file 10 to 12 ANDAs and 3 API filings for the US and the EU before the end of this fiscal. Regarding the ANDAs already filed, we have responded to certain queries from the USFDA and expect four products to be approved in the next three to six months.

Update on capex: We are on track for our target for completion of our Onco facility and validation of the Onco APIs is in progress. Onco formulation facility is under qualification and we expect validations to start by end of this quarter. As mentioned in my last call, initially we will be concentrating more on emerging markets, simultaneously working towards filing for Europe and US.

GPI: Our subsidiary in the United States has reported revenue of Rs. 77 crores with EBITDA of Rs. 40 crores and PAT of Rs. 27 crores for the third quarter which shows a significant increase over the preceding quarter.

Joint Ventures: On the joint ventures front, they collectively contributed Rs. 2 crores to profit after tax during the current quarter as compared to Rs. 13 crores in the previous quarter.

This dip in contribution is primarily on account of the annual routine maintenance shutdown of our China facility joint venture facility which was a two-month period shutdown and also the cyclicality of CRAMS business for Granules OmniChem. We expect a major part of revenues from both these facilities and we expect a good Q4 from the JVs.

I am confident we had laid the ground work for a sustained growth and this will be reflected in our performance going forward. We are focusing on achieving the targets we have laid out for ourselves for the next three-year period.

Finally, I would like to acknowledge and place on record my appreciation of the services rendered by Dr. Prasada Raju to the company till date. As you are aware, the Board has accepted his resignation as Executive Director. Due to certain personal issues, Dr. Raju could not continue in a full-time role. However, he will continue to be associated with Granules as a consultant and will continue to play a significant role in shaping the future strategy of the company.

I would also like to share with you that we had started broad basing the Board with members with significant experience and who had helped in the growth of different global pharmaceutical companies. As you are aware, Mr. Arun Sawhney who was with DRL and also the past CEO of Ranbaxy was co-opted into the Board last quarter and Mr. Bob Cunard, the past CEO of Aurobindo USA was co-opted this quarter. We will continue to bring in more talent into the Board as Independent Directors and I am sure under their guidance Granules will witness a great future.

With this ladies and gentlemen, I would like to open the meeting for questions.

Moderator: Thank you very much, sir. Ladies and gentlemen, we will now begin the question-and-answer session.

The first question is from the line of Rashmi Sancheti from Anand Rathi. Please go ahead.

Rashmi Sancheti: First thing is just want the numbers for OmniChem and Biocause for 9 months Sales, EBITDA and PAT?

Krishna P Chigurupati: So let me go with Q3 first. Q3 for Biocause was Rs. 63 crores revenue, EBITDA was 20% EBITDA margin and PAT margin was 16% at Rs. 10 crores and OmniChem for Q3 revenue was Rs. 12 crores, EBITDA margin was negative 15%, PAT margin was minus 48% and if we go back to Q2 revenue for Biocause was Rs. 109 crores, EBITDA was 35%, PAT was 29%. OmniChem in Q2 was Rs. 17 crores revenue, 8% negative EBITDA, 31% negative PAT.

And again, on OmniChem Q1 was Rs. 97 crores revenue, 20% EBITDA and 16% PAT margin. OmniChem we expect this quarter will be repeating Q1 numbers so that will average out to the last year's performance, and Biocause we expect Q4 will be numbers which are better than Q2.

Rashmi Sancheti: Do you maintain your guidance of Rs. 40 crores profit from the JV?

Krishna P Chigurupati: I can very confidently say it will be much better than that.

Rashmi Sancheti: Sir coming to the US, if you can just highlight how many total products you have currently and how much approvals you are expecting in the fourth quarter as well as next year?

Krishna P Chigurupati: We already have about 12 pending ANDAs and we expect I cannot say the fourth quarter because we have already responded to certain queries and but we expect till the next four to six months at least four ANDA approvals.

Rashmi Sancheti: Four approvals, and what about the launches?

Krishna P Chigurupati: Within a month or so after approvals we will be launching the products.

Rashmi Sancheti: Okay so at least four to five launches we can expect next year sorry next six months?

Krishna P Chigurupati: That is right two of those products will be in the Opioid category. We are analyzing the situation carefully in Opioid because there has been a few issue with Opioids, so that launch could get delayed a bit but other two products definitely they will be launched immediately on approval.

Rashmi Sancheti: And how big is that opportunity?

Krishna P Chigurupati: In the Opioids?

Rashmi Sancheti: Yes.

Krishna P Chigurupati: It is very difficult to say what will happen. We never expected a lot of revenue from that because that needs large volume capacity so it should not really affect our plans.

Rashmi Sancheti: Okay and sir how much investment in US pharma vendors we have done till now and when are we expecting returns out of it?

Krishna P Chigurupati: We totally invested about $11 million till date in US Pharma and that is also for licensing fee of the four products we have put in only $1.6 million so far. The rest has been in the facility which US Pharma purchased in the part of equity and loan and this facility has already started

making dermal patches and they are selling under a brand, it has seen some very good uptick and also other dermal patches are under development.

So we see a decent potential, but it is a little too early to say when the actual returns will start. And on the four products that were in-licensed one product was launched already and it is getting some I mean not a very great response on sales front the prasugrel andother three products are still under litigation and as and when the court judgments come through we will be able to launch those products.

Moderator: Thank you. The next question is from the line of Bharat C. from Equirus Securities. Please go ahead.

Bharat C: Sir, I actually had a couple of questions to begin with. I just wanted to know how are market share in Ibuprofen has changed over last one year, whether there has been a drastic change over last one year or how it is?

Krishna P Chigurupati: The market share actually we launched this product just two years ago. The first year was a slow ramp up but I would not be able to place the exact numbers because the IMS numbers are totally not very accurate but I guess we have about close to 30% market share in the United States and that would have been at least 18% up from last year.

Bharat C.: So that is the main reason why Ibuprofen sales have doubled or is it because of the price increase also which has been seen because of BASF exit?

Krishna P Chigurupati: It is both. The market share has increased and also the prices have increased but all I can tell you is the price increase is also due to the price increase in raw material prices and we have been able to protect our margins. But the revenue increase is due to both these factors.

Bharat C: Right. And how does PFIs look like.

Krishna P Chigurupati: Our PFI sales of IBU also have gone up. It is not only the finished dosages.

Bharat C: Right, so is it also because of pricing or it is also because of market share?

Krishna P Chigurupati: Because of both.

Bharat C: Both, and sir how does BASF look like when they are expected to come back to the market?

Krishna P Chigurupati: BASF there was a conference call last night and as per their latest estimates it could be April they would resume production but then they would not go all out. It is going to take quite some time to resume, come back to normal capacities. So we have a strong feeling and a take away from that call was the shortages of Ibuprofen will continue for a while, at least till the fourth quarter of next fiscal.

Bharat C: So is there a shortage still in the market or it is more like Granules has filled up the gap of that shortage which was there in the market?

Krishna P Chigurupati: There is still a small shortage in the market in United States FD space, Granules did fill up some decent volume but there appears to bestill a small shortage.

Bharat C: So is it like we have renewed our contracts with everyone and we will be getting some long term contracts because of that or it is like we have been able to increase the prices and subsequently when some new player comes we have to decrease the prices so I am just trying to figure out whether we have got new contracts because of that or not?

Krishna P Chigurupati: The way the US market operates on the finished dosages there are no long term contracts on prices. As and when a competitor comes and offers a lesser price, we are expected to reduce the price to those levels, we have given the first right of refusal I mean we will have to go along with the market and Priyanka, you want to add something?

Priyanka Chigurupati: Yeah just an addition to this while price plays a major part there is a price attached to the quality and supply security these days so even if a different player comes in with a minimal price reduction I think customers are being a little bit more wise. They are looking at long term supply security over just prices. So to answer your question it really depends on customer and the price that they offer.

Bharat C: Right. So are we able to get some higher commitment or higher volume commitment from the distributor side because of this?

Priyanka Chigurupati: Yes, this product as you know is supplied by one of our partners, they market the product and over the last quarter I believe they have increased the market share by about 4% to 5% and if we can supply more they will go and get more business.

Bharat C: Is that 4% to 5% increase over the last one year or over the last quarter?

Krishna P Chigurupati: It is a quarter Bharat.

Priyanka Chigurupati: Last two quarters we have been seeing these increases so last quarter, yes.

Bharat C: Right and sir. I understood the part that you said that initially you will be supplying onco products to the unregulated markets so just wanted to get a glimpse how it is working on the US side over the regulated market side, so how does the pipeline look like? Have we started developing the products? Where do we stand in Onco for the regulated market?

Krishna P Chigurupati: We have identified certain products in the API space and validation of these products is going on. Each product validation will take quite some time maybe 45 days to 75 days so in a year we will be able to qualify about 8 to 9 products (validate 8 to 9 products). So after we qualify

the APIs we have to start using them into our finished dosages and again develop exhibit batches and validate the process and then do the filing.

So this is going to take at least a 12 month period for the first products and meanwhile we expect we should be able to generate fairly decent revenues in emerging markets though the margins will not be like what we would be able to get in US and Europe. We are also working with certain partners who have existing approvals to do a site transfer of their products into our site both on the EPI front and also the FD front and that should also give us some short-term revenues.

Bharat C: That will be for the unregulated markets only, right?

Krishna P Chigurupati: No, for the regulated market site changes, especially Europe we are working on this.

Bharat C: Right but we do not have a EUGMP, yet, ,right?

Krishna P Chigurupati: What will happen is once we do a site transfer that will trigger off an inspection and the Europeans would come to inspect us.

Bharat C: So what is the usual timeline for the same, how much is the gestation period for overall this project you are referring to?

Krishna P Chigurupati: So for EU approval, it will take at least from the date of the initiation of the site transfer at least a six to eight month period. We have to make batches and then file and then only they will come for an inspection.

Bharat C: Right sir and actually a similar thing we are seeing in the API side also so we had expanded three molecule facilities and yet we have not got the USFDA approval for the same. So I understand that our inspection is yet due for that, so just wanted to get a glimpse and when we are expecting an inspection of the same and when can we start getting clients for the same and after that I suppose you are going to get some you need to do some batch studies also for the client. So how much time does both the things take separately?

Krishna P Chigurupati: Let me explain Bharat what we have done is for the Metformin produced in the new plant we have used this in our own ANDA as a change of source and we have filed I would say an additional source of API and we have filed a CBE30 with US. So normally you make batches, put it on six month stability and then you file with the FDA and SEB30 normally you get in 30 days. The FDA has not taken a stand on whether it is CBE30 or would it be FDA pre-approval.

So they have just held back, we are waiting to hear from them and it could be we could hear from them any day that it is the CBE-30 then everything changes but it all depends on what interpretation they are going to take. And once the Metformin is approved, we will be using it in our own formulations and that will result in increased profitability.

Bharat C: But this will require a USFDA inspection also, right?

Krishna P Chigurupati: If it is a CBE-30 need not, but if it is a PAS they may come in for an inspection. Anyway the plant is due for an inspection because we make other products thereand if it is a PAS it will be coupled with an inspection.

Bharat C: Right and if I talk about Paracetamol also because so far we are not exporting it to the irregulated market - I am referring to the expanded facility. So what is the case there? So we are going to get a USFDA inspection and then validation by the clients or how does it happen over there?

Krishna P Chigurupati: Paracetamol actually technically does not need an FDA approval because Paracetamol is being produced in the same site. Unlike Metformin which was in a different site and we built a new plant, it is just an expansion of Paracetamol capacity but some of the customers needed to validate this new block and they are in the process. Once the customers finish the validations the businesses will start.

Till then like I said in my opening speech we are selling this product in the domestic market, and even in the domestic market because of margin pressures we are not selling a lot. We are not utilizing the full capacity of even the Paracetamol.

Bharat C: I understand sir, so how much time does customers take in validating this study for what sort of time you are expecting?

Krishna P Chigurupati It would be another five to six months. These are all multinational companies and they really operate slow.

Bharat C: Sir actually we referred in our opening remarks that our GPI sales have increased by around sequentially this is around Rs. 30 crores right and our revenues have seen much sharper increase sequentially. So I was just trying to pinpoint, what has actually happened there also. What was the main growth driver in revenues apart from GPI?

Krishna P Chigurupati: It was three launches. There is a product Metherginewhich was launched from GPI in the previous quarters.

Bharat C: But GPI revenues have increased only by Rs. 30 crores our overall sequential increase is almost by Rs. 60 crores. So I was just trying to understand where are the rest Rs. 30 crores came from?

Krishna P Chigurupati: Okay, it is mostly driven by finished dosages sales overall from the core business. Our Metformin and Ibuprofen sales have increased and also the new launches of Methocarbamol and Metformin ER, this also has contributed to the increase in sales.

Moderator: Thank you. The next question is from the line of Raghu Ram from Bestpal Research. Please go ahead.

Raghu Ram: Sir, I just wanted to understand about how you are planning to reduce your pledge on shares because it seems to be an overhang on stock?

Krishna P Chigurupati: Okay Raghu Ram, this continues to be a serious issue for all of us. There was a release of a reduction of the pledge in the last quarter, 75 lakhs shares were released from pledge and the pledge which stood at 60% of the promoters' equity had been reduced to 53% of the promoters' equity as of today.

And going forward we are constantly working on reducing repaying the loan and reducing the pledge and even in the current quarter by the time we get on to the next concall you would have seen another reduction. We are working towards this and by end of next year I think we will have made a substantial reduction and within two years I think we will be totally out of the pledge.

Raghu Ram: So by the end of FY20 we can see there will be substantially reducing the pledge?

Krishna P Chigurupati: That is right.

Raghu Ram: Okay and also can I know about the capacity utilization of the in your API, PFI and FD, sir?

Krishna P Chigurupati: API is 68%, PFI is 55% and FD is 73%.

Raghu Ram: Okay. And sir this 50% growth which we have seen in sales how much would you attribute it to your price increase and how much to the utilization of the new capacities if you want to bifurcate it between those two?

Krishna P Chigurupati: The price increases are basically on Ibuprofen - I would say 70% to 75% is due to capacity utilization and increased sales and about 25% to 30% is due to price increases.

Raghu Ram: And this 25% price increase we have seen in Ibuprofen and or it is Metformin and others?

Krishna P Chigurupati: Yeah a few other products but mostly it is driven by capacity utilization and higher quantity of sales.

Raghu Ram: Okay and like is this is a sustainable price increase or would it be sustainable for the next one to two years or do you see it because of competition coming they would come down?

Krishna P Chigurupati: The price increases were mainly due to increase in raw material prices and as raw material prices come down we expect the sales price also to come down and however we will be endeavoring to maintain our margins whatever happens.

Raghu Ram: So what percentage of sales is attributable to Ibuprofen sir of the revenue?

Krishna P Chigurupati: I think last time we made it clear that we are a little reluctant to share individual product details. It will not be very substantial.

Raghu Ram: Sir, can I also ask you about the ANDA pipe line if you can explain more about it like what like how many are in the pipeline and how many do you expect to get approval in the next one to two years and opportunity size of those ANDAs? If you can just give an overview.

Krishna P Chigurupati: I just explained this to Rashmi a few in the opening. Maybe you missed it. For your benefit we will be filing about 10 to 12 ANDAs this fiscal year and we will continue to do the same next year too and out of the ones that are already filed, we expect about four approvals in the next four to six months.

Raghu Ram: And what is the opportunity size for this molecule, sir?

Krishna P Chigurupati: I mean some of these are really good molecules and let us launch this product and at that time, these keeps changing we cannot really predict everything in the market today. It depends on how many more possible approvals may come through or if there is no approval till then the revenues will be much higher so we will see as we go by.

Moderator: Thank you, the next question is from the line of Mayank Agarwal from Atom Investments. Please go ahead.

Mayank Agarwal: Sir, I just got a couple of questions ready. First one is from a broad industry point of view. So we noted the fundamentals of the generic manufacturing industry across the value chain right from APIs all the way to formulation. They change on providing the highest possible quality at the lowest possible cost, whilst we have seen lot of disruption coming from the regulatory compliance mainly the USFDA my question is on the manufacturing process side.

Do you see a new technology that could possibly come and disrupt the way we manufacture either the APIs or the formulations and could cause severe disruption in the industry?

Krishna P Chigurupati: There is always a possibility Mayank, there is always scope for improvement and people keep working towards different technologies. So disruptive technology in these APIs - I do not think it will be totally disruptive but definitely there is a great scope for improvement.

And also let me explain. We have a R&D facility in Pune in addition to what we have in Hyderabad. We are constantly working towards various possible disruptive technologies, so we are on top of this and if something comes through possibility could be from us.

Let us see how it goes. On the FD space also we are working on certain technologies which could make manufacturing very effective, very low priced and this are all something that may

not happen overnight but we are constantly working on these and one thing Granules always did was working on different areas, we always went on a least trodden path. We try to define our own game. So we are on top of it, that is all I can tell you.

Mayank Agarwal: Sure now that is good to hear. So on the R&D side, I was looking at your past Annual reports. I think about eight to ten years back, you were spending somewhere close to about Rs. 3 crores if I am not mistaken on the R&D.

Your current R&D spend is about fifteen to twenty times of that figure or maybe more right because you said you have capitalized around 40 and P&L has taken 40, 41, so the gross R&D spend for the last nine months in this fiscal is about 80 already and that is a significant jump from where you were say ten years back. Do you expect this run rate to continue or do you find a plateau?

Krishna P Chigurupati: It will continue but though not at this rate Mayank, because we started with almost zero and when we embarked on this new trajectory where we wanted to get into new areas of APIs and hard to manufacture products and niche products, we had to start from zero and R&D had come so far. It will continue to grow but though not at this rate.

Mayank Agarwal: Sure and just one final question on the Oncology side which is a new business area for you. In the Western world, there is a severe pricing sort of pressure because the government and the procuring bodies they want the best possible quality at the cheapest possible cost.

Do you see Granules opening up some sort of a disruption there in the sense that we could produce at a cost which is much cheaper relative to some of the European or the Italian suppliers and we end up because that is what the underlying strategy is on the Oncology side?

Krishna P Chigurupati: Definitely we are confident we can produce at a lower cost but not at a disruptively lower cost. Granules always has been focusing on efficient manufacturing and that is where we had our margins. So I see definitely we will be able to compete in the market and the initial interactions we had with various partners and customers, we get a feeling that we are on the right track.

Moderator: Thank you. The next question is from the line of Varun Basrur from AQF Advisors. Please go ahead.

Varun Basrur: Sir, could you repeat the GPI revenue figures please?

Krishna P Chigurupati: Q3 was Rs. 77 crore revenue, EBITDA was Rs. 40 crores which is 52% margin, PAT were Rs. 27 crores which is 35% margin.

Varun Basrur: Okay and so what I noticed was that the revenue coming from Europe has sort of degrown over the last in this fiscal roughly Rs. 400 crores I think was in FY18 and this year it has been

about Rs. 280 crores of the annualized that is Rs. 380 crores. So just would you like to comment on what our strategy is there?

Krishna P Chigurupati: Europe we have been doing mostly APIs, PFIs and on the finished dosage front it is all CMO business. We do contract manufacturing for other companies. Whereas in the US there are different ways. In addition to selling PFIs, APIs we also sell our own finished dosages where the margins are better than what we would get by contract manufacturing business.

So when we have not really focused on contract manufacturing business. After we establish ourselves in the United States we do not want to take on too much at once, we are working on doing our own filings in Europe and we expect to get into the market ourselves. That is going to take some time.

So as of today our resources are being mostly spent on US and other markets rather than on Europe. And also let me explain one of our on the API front, one of our major customers had a slowdown on their off-take and if that had not happened I think we could have done a little better than what we did last year.

Varun Basrur: About the PFI revenues I have noticed that over the last seven quarters except for one quarter it has usually been between Rs. 90 crores to a Rs. 100 crores. Q3 was a little higher, so what is the strategy there? I believe last call you said in Q4 it would be looking up?

Krishna P Chigurupati: PFIs - what has been happening is some of the customers who have been buying our PFIs have been moving on to finished dosages and only in the developing countries where people in developed countries used to use PFIs but now the PFI market is mainly shifting towards developing countries. It is LATAM mainly and parts of Asia so we do not see a big growth. .

I do not think there will be a huge growth anywhere comparable to the finished dosages. And our aspiration was always to move up the value chain from APIs to PFIs and PFIs to finished dosages. So we have been getting there except that we had some huge addition of API capacities of late.

Varun Basrur: But your capacities are fairly large in PFI, so what would happen there?

Krishna P Chigurupati: We will be needing that for our finished dosages and in addition what we are doing is the capacities in our PFIs we are going to use them for other products. We are targeting pellets - sustained release products and these pellets also will be sold as possible PFIs or we will be converting all that into finished dosages.For one kg of pellet manufactured you would be able to make about 5 kgs, 6 kgs of PFIs but the value addition on pellets is much higher so we are slowly moving towards pellet manufacturing.

We are trying to add value and generate more revenue and profit out of our existing assets whereby improving our return on capital employed.

Varun Basrur: Would there be a significant capital CAPEX required to alter the PFIs capacities for this pellet manufacturing?

Krishna P Chigurupati: No, not at all. These plants when they were designed, they were built for both purposes and there is absolutely no additional requirement. And since we have decided not to grow just by investments. We are trying to alternate methodologies and strategies to keep up our growth without additional CAPEX.

Moderator: Thank you. The next question is from the line of Ashi Anand from Allegro. Please go ahead.

Ashi Anand: Just wanted to understand more from a strategic perspective when we were filing the 10-12 ANDAs in the US what really goes into the product selection I mean are we assigned to accomplish cost leadership, is it backward integration focus, is it complex chemistry. Given the fact that the US has become fairly competitive, how are we kind of confident that the ANDAs we are selecting will actually work?

Krishna P Chigurupati: I think Priyanka will answer that.

Priyanka Chigurupati: I will talk about the overall R&D selection criteria for the company. We have three baskets that we look into. One is high volume products where integration has a big part to play in terms of security of supply. Two, products with low level of competition and by competition I mean from the availability of API, technical expertise, dosage form or just the value of the products.

And three, are controlled substances where there is multiple dosages and sustained release products. So for the US we will focus more on relatively more complex low volume products.

Ashi Anand: If wesee over a 3 to 5 year perspective would it be fair to say we definitely take a 40, 50 kind of basket and do we have visibility of such within the R&D selection criteria that you have?

Priyanka Chigurupati: At this point we are aiming to go above 50 products so yes to answer your question we will definitely hit that number and if it is a combined total, we will definitely go over that number between India and the US.

Ashi Anand: Okay great. Second question on the base business of the legacy molecules that we had, we have had a reasonably large CAPEX expansion which is likely to lead to certain amount of growth which is coming through this year. And again, as we get regulatory approvals there will be certain topline/margin improvement in terms of the benefit of moving from EM towards the developed markets.

Post the bumps we are getting in FY19 and possibly into FY20 would it be fair to say that this part of the business will largely reach kind of steady state and see a lower growth and incremental growth will come from the other markets or is there a growth potential here?

Krishna P Chigurupati: Can you just repeat that question? I think I lost you. The line was cracking up.

Ashi Anand: Sure. Sir, if you see the legacy business of Paracetamol, Ibuprofen, Metformin we are getting a reasonably strong growth coming through this year and I am assuming that some amount of additional growth which will also come through next year because of the capacities that we have added and we will also get the additional growth been able to move from kind of India, EM towards developed markets.

Once this growth kind of plays through, would it be fair to say that this business was likely to have matured and will have lower single digit growth and growth will really come from the new generic strategy onco, etc., or is there still growth potential in this business even for next couple of years?

Krishna P Chigurupati: Yeah, I got it. Okay now if you see our expanded capacities, we are not fully utilizing them neither do we want to utilize like just now the previous question, I said we want to get maximum revenue and profitability out of the existing assets. So instead of doing low cost low margin products with high high volume we are slowly drifting towards value added products even in the existing facilities. So like I said, pellet is one area, sustained release tablets is another area.

Instead of doing normal Metformin tablets or Ibuprofen tablets, the sustained release tablets are going to add lot of value. Many, many times more value and margin compared to these products. So that is where we are drifting with our existing capacities and also the new generics that we are developing in the US and also on the Onco definitely these are going propell growth in coming years. You are perfectly right it is going to come from the new generics and also partly from the existing model.

Moderator: Thank you. The next question is from the line of Punit Mittal from Globalcorp Capital. Please go ahead.

Punit Mittal: Just one question. You suggested that you are expecting about 20% topline and about 25% bottomline growth for next three years. What kind of cash flow from operations do you expect for next three years?

Krishna P Chigurupati: Ganesh, you want to answer that? Okay let me ask, from this growth what is the cash flow, Ganesh?

Ganesh K: Today we actually have funds from operation of something our funds from operation this quarter reached almost close to Rs. 100 crores and on a full year basis going forward we should be expecting a funds from operation in the range of Rs. 500 crores that is for FY19-20.Thereafter we should expect a growth maybe in three years' time we should actually hit a number of anywhere between Rs. 600 crores to Rs. 700 crores of funds from operation.

Punit Mittal: Okay and in terms of CAPEX, we do not expect any major CAPEX when it is three years and so the maintenance CAPEX that you mentioned in the previous call about Rs. 25 crores to Rs. 50 crores does that stillstand at that number?

Ganesh K: We will have two parts, one is for our base business. We will have to spend around Rs. 50 crores to Rs. 60 crores per annum because some of the facilities are little bit depreciated, we may need to replace some of these equipments and we may also go for certain small time capacity expansion in the finished dosage.

In terms of GPI, the US entity, we may have to spend another $10 million for capacity addition because since lot of products are lined up for commercial launch we may need to increase the capacity at GPI. So, in our estimate FY19-20 the total CAPEX would be in the range of Rs. 135 crores.

Punit Mittal: And the two years after that?

Ganesh K: Thereafter,I would call it a normal capital expenditure in the range of Rs. 40 crores to Rs. 50 crores per annum.

Punit Mittal: Okay so if we do the math in that way then are we expecting that we can retire pretty much all the debt in the next three years because we should have the cash flow to basically pay off the debts after that?

Krishna P Chigurupati: It depends on many situations while we may be able to do that, should we do that is another question so we will keep discussing internally and the Board and we will take the right decision at the right time. There could be another opportunity where there is the potential should we take that, or should we retire that is something that we will go ahead. So while we say there is definitely low CAPEX yes we want to bring this under control.

We want to bring down the debt but after a certain level where we feel comfortable where our debt to EBITDA ratios are very much at desirable levels, we may not be totally averse to taking a little more investment. |So we are talking of a three year period. Next year definitely we are sure there is going to be a no CAPEX maybe the year after that also very little but third year we will have to see where we go. Business has to be growing and you just cannot just sit idle.

Punit Mittal: Sure. What is that number where you are comfortable in terms of debt to EBITDA level?

Krishna P Chigurupati: Debt to EBITDA at least 1.5 is where I will start feeling very comfortable and better than that is more comfort.

Moderator: Thank you. The next question is from the line of Ranjit Kapadia from Centrum Broking. Please go ahead.

Ranjit Kapadia: My question relates to Chinese raw material and because of the environmental issues the raw material prices have shot up and there is a shortage of several raw materials. How long is the situation is likely to continue according to you and are the prices have softened or what is the latest update on that?

Krishna P Chigurupati: On major raw material which constitutes about 70% of our imports from China, the price increases have continued till the end of last quarter but starting this quarter we had seen about 8% to 10% reduction and once the decline starts normally of past experience is it will start declining little by little and we see a softening up of prices. On the other material yes there is no decrease but definitely they are not increasing. So that itself is softening and I have a strong feeling the prices are on the decline.

Moderator: Thank you. The next question is from the line of Vaibhav Gogate from Ashmore. Please go ahead.

Vaibhav Gogate: Could you help me understand how GPI revenues would shape up in the next two, three years?

Krishna P Chigurupati: We have certain expectations and if you see this I would say this fiscal, we will be doing about Rs. 230 crores, Rs. 240 crores and definitely next year I mean it will not be below this it will be a little above this, but again like I always said 2021 is going to be the year we will see maximum growth when certain approvals are in place. So at that period I would say Rs. 500 crores is a definite possibility in 2021**.**

Vaibhav Gogate: How does the GPI income statement look for the first nine months this year?

Krishna P Chigurupati: First nine months is revenue of Rs. 135 crores and a PAT of Rs. 36 crores. I think I have that Rs. 47 crores is the PAT and revenue is Rs. 135 crores.

Vaibhav Gogate: And what is the EBITDA looking like?

Krishna P Chigurupati: We had some unusual EBITDA and is 62. I mean these are good EBITDAs I mean I would be happy to have them but I would not be disappointed if the EBITDA falls below this.

Vaibhav Gogate: And how much R&D have we capitalized in GPI this year?

Krishna P Chigurupati: We normally do not talk about individual R&Ds so as a consolidated R&D so far we have capitalized Rs. 40 crores. Rs. 44 crores was charged to P&L and Rs. 40 crores was capitalized.

Moderator: Thank you. The next question is from the line of Charulatha Gaidhani from Dalal & Broacha. Please go ahead.

Charulatha Gaidhani: I wanted to know why other income has increased?

Ganesh K: There is a Forex element of Rs 4 crores that is the only significant line item we have on other income.

Charulatha Gaidhani: Okay. And going forward what tax rate would you expect?

Ganesh K: For GIL it is going to be 33%, consolidated sshould be around 28%.

Charulatha Gaidhani: Because GPI profit will be subject to lower tax?

Krishna P Chigurupati: You are right Charulatha. We are aiming for reduction in effective tax rate and 28% is what we can foresee going forward. I am not saying now maybe next year and year after that.

Charulatha Gaidhani: Okay, now going forward what type of research expenses you expect and what will drive the margin growth - operating margin?

Krishna P Chigurupati: The R&D spend for next fiscal is estimated to be about Rs. 80 crores and what will drive the operating margin is the type of products we have selected and for the core business it is going to be capacity utilizations and for GPI and in Onco business the type of products and the approval timelines. It all depends on when the approvals come through.

Charulatha Gaidhani: Okay but in case of base business, in case there is a price reduction in the molecules in which you are present, then will you be able to maintain the margins?

Krishna P Chigurupati: Yes definitely, Charulatha. If you see for the last many years we were always able to protect our margins in our core business and like I said in my opening speech there is a lot of stability to this product at Granules India. We have developed very efficient manufacturing methods and also our customers depend on us for consistency and security of supply and also regulatory compliance. And like I have always said, we never had any regulatory issues. That is a value which customers give to us and consistent supply is another value. So we always get a little premium on sales price and our manufacturing efficiencies give us an advantage on cost price.

Charulatha Gaidhani: Okay. Now if we divide your business between the base business or existing molecules and new molecules that you are getting into, what type of product mix would you see going forward?

Krishna P Chigurupati: It will always in the revenue side it will always be majority will be the core molecules but on the profitability side slowly we will see a disproportionate increase on the profitability from the new molecules**.**

Moderator: Thank you. The next question is from the line of Srihari from PCS Securities. Please go ahead.

Srihari: I had a few question on the GPI front, could you please first share the numbers for Q2?

Krishna P Chigurupati: Q2 is Rs. 46 crores revenue, Rs. 16 crores EBITDA, Rs. 9 crores PAT which is 35% EBITDA and 19% PAT margin.

Srihari: Okay so is there any profit share element in this spike at the EBITDA level?

Krishna P Chigurupati: Yes there is a profit share element.

Srihari: Is it possible to quantify that?

Krishna P Chigurupati: No,these things are a little confidential. We prefer to keep it that way.

Srihari: Okay so this will be basically for the Q2 sales? The profit share for Q2 sales?

Krishna P Chigurupati: Q2 and Q3. There is a profit share in Q2 and Q3. And obviously there is a little extra profit share in Q3.

Srihari: Okay. So would this spike be predominantly for Methergine?

Krishna P Chigurupati: Of course that is the only product we have today. That is the product we licensed out to another partner. Yes, it is from Methergine.

Priyanka Chigurupati: Just to clarify that. There are two products that we licensed out one is prasugrel and the other is Methergineand we launched the other two on our own label. So the profit share comes from both the products that we licensed.

Srihari: That is prasugrel and Methergine?

Priyanka Chigurupati: Correct.

Srihari: So what is the competitive scenario in prasugrel?

Priyanka Chigurupati: Prasugreltoday there is six players in the market.

Srihari: So do you expect this kind of a run rate to continue?

Priyanka Chigurupati: Yes, we do not see any other player entering the market. There are about nine to ten approvals but because of the market dynamics we do not think anybody else will enter the market any time soon.

Srihari: What is the kind of market share you have right now?

Priyanka Chigurupati: As of now I do not want to get into complete details but we have a little bit over fair share considering six players in the market. So if you calculate it, it is about 20%.

Srihari: Okay and you expect to hold on to this kind of a market share?

Priyanka Chigurupati: We are hoping we will. Again our partner is marketing this product and we are doing everything from a supply point of view to ensure security of supply.

Srihari: So pricing is one variable on which really you would not have much control, is it?

Priyanka Chigurupati: Correct.

Srihari: And secondly, when I look at the other expenditure basically that has of held on despite your good traction on the topline front so is this mainly due to lower manufacturing expenditure?

Krishna P Chigurupati: This is control on different expenditures especially manufacturing. Like I said we are always trying to be more efficient so this is operational control.

Srihari: No, I mentioned manufacturing because your production has been relatively lower?

Krishna P Chigurupati: You are talking about GPI?

Srihari: No, I am talking overall at the consol level?

Priyanka Chigurupati: Can you just repeat your question please?

Srihari: At the consol level your other expenditure was Rs. 106 crores vis-à-vis Rs. 108 crores sequential. So is it predominantly manufacturing expenditure which has declined?

Ganesh K: No, actually like in terms of production we are marginally higher than the Q2. It is more on record, cost control measures we are actually.On our total expenditure it will be more on manufacturing.

Krishna P Chigurupati: We can really go into details and send it to you later on.

Srihari: Yeah sure. On GPI I had another query. What is your amortization policy for GPI?

Ganesh K: On the intangible assets, we take 80 years and on the fixed assets it is going to be in the range of 15 years.

Srihari: Okay so for the intangibles has the write off begun?

Ganesh K: We have already started for **methylergonovine.** Q4 we will be pressing for impairment testing will be done on the entire intangible assets.

Srihari: So there is likely to be a spike there?

Ganesh K: We will have to wait for the results actually.

Moderator: Thank you. Ladies and gentlemen, that was the last question for today. On behalf of Granules India Limited, that concludes this conference call. Thank you for joining us and you may now disconnect your lines.