



# “Granules India Limited Q4FY15 Investor Conference Call”

**April 28, 2015**



**MANAGEMENT:    Mr. C. KRISHNA PRASAD – CHAIRMAN & MANAGING DIRECTOR,  
Mr. VVS MURTHY – CHIEF FINANCIAL OFFICER,  
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FINANCE & INVESTOR RELATIONS**

**Moderator:** Ladies and Gentlemen, Good Day and Welcome to the Granules India Limited Q4FY15 Investor Conference Call. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call please signal an operator by pressing ‘\*’ and then ‘0’ on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Sumanta Bajpayee – Senior Manager Finance and Investor Relations, thank you and over to you Mr. Bajpayee:

**Sumanta Bajpayee:** Thank you, good evening everyone, and thank you for joining us today for the conference call to discuss operating performance and financial results. Yesterday we declared our audited results for the quarter and for the full year ended March 31, 2015, both standalone and consolidated. To discuss our business performance and outlook, I have with me select members of the senior management including Mr. Krishna Prasad – Chairman and Managing Director, Mr. VVS Murthy – CFO, Dr. Prasad Raju – Head of Corporate Strategy.

We will begin this call with opening remarks from the company’s management followed by Q&A session. Before we proceed with the call, I would like to remind everyone that some of the statements made in today’s discussion may be forward looking and involve assumptions and uncertainties, the Safe Harbor Language contained in our Press Release also pertains to the conference call. The transcript of this call will be made available to the website in due course of time. With this please let me turn the call over to Mr. Krishna Prasad for his opening remarks, thank you, over to you Sir.

**Krishna Prasad:** Good evening ladies and gentlemen, and thank you very much for attending our fourth quarter earnings call. The financial year 2014-15 was an encouraging year for us in which we focused on solidifying our core fundamental strengths, integration of businesses and implementing strategies to achieve future growth of the organization. During this year we had achieved many milestones. For our CRAMS JV with Ajinomoto the new plant at Vizag was inaugurated in the month of February 2015. The facility was set up with the objective to manufacture APIs maintaining the highest global standards and for innovative companies. The facility still needs US FDA and EDQM approval and we are working on it. We believe it will take about two and half years for this approval. Till such time we will be supplying intermediates to our JV partner Ajinomoto OmniChem, who will convert them to APIs in Belgium and then supply to the innovator companies and brand leaders. We maintained our standards of being fully FDA compliant with successful completion of inspection at our Gagillapur facility recently. This exemplifies our strengths in following the best practices for quality and compliance and creates confidence in our business partners.

During this year our Jeedimetla and Gagillapur facilities were also certified ISO 14001 for environmental management systems as well as OHSAS 18001 for occupational health and safety systems. Our Bonthapally facility was approved in the past already. Granules as a company created a niche for itself in manufacturing excellence in the 5 core molecules. We are

now putting a lot of energy to channelize the same efficiency to manufacture high value products. To introduce products in our basket last year we had acquired Auctus Pharma through which we now have access to 12 molecules and also we had set up an R&D center at Hyderabad. During this year we have commercialized the sale of Abacavir and another one product. Abacavir as you all know is an antiretroviral drug and is being sold in fairly decent quantities commercially. This API was developed in-house by our internal R&D team. In addition to Abacavir and other products we are expecting to commercialize an additional four to five APIs in the current fiscal year.

We have also started working towards forward integrating some of these select APIs to finish dosages by filing ANDAs and intend to file three to four ANDAs in the year FY16. This is the first full year of operation of Auctus Pharma under the Granules management and we have successfully turned around Auctus Pharma in the fourth quarter of the current fiscal and going forward we will work to improve this business. Throughout the year we had focused on process improvements and also invested to create clean rooms to enhance production capacities. Our PFI expansion at the Gagillapur facility is completed and we expect the unit will be available for commercial production for FY16.

We are also encouraged to see growth in revenue and profit along with improved margins compared to the previous year. During this year our sales grew 18% to Rs. 1,293 crores as compared to the prior year. Operating margins continue to strengthen compared to the previous financial year due to our emphasis on formulations and improved business in regulated markets. I will now hand over the call to our CFO, Mr. VVS Murthy, who will share more insights about our financial performance for the year. Thank you very much.

**VVS Murthy:**

Thank you Sir, good evening ladies and gentlemen, while we have provided financial numbers in our press release let me run you through the key financial highlights. Consolidated revenue grew by 18% to Rs.1,293 crores compared to Rs.1,096 crores in the previous financial year. EBITDA grew by 31% to Rs 213 crores while PAT has grown by 21% to Rs.91 crores compared to the previous year. The EBITDA margins increased by 160 basis points to 16.4%. Sales in Q4 were 12% higher than the corresponding quarter in the previous financial year FY14 i.e. at Rs.355 crores in the current year. The EBITDA and PAT were Rs.52 crores and Rs.22 crores respectively. The company's standalone sales during the year were Rs.1,213 crores, an increase of 21% from the previous financial year. EBITDA and PAT increased by 28% and 18% to Rs.213 crores and Rs.95 crores compared to the last financial year. Profit after tax increased by about 18% compared to the previous year in spite of higher depreciation, finance charges.

As indicated in the third quarter earnings call, Auctus financials merged with Granules standalone financials following the High Court order. We are happy to inform you that Auctus business has achieved breakeven in Q4. For FY15 Auctus contributed a sale of Rs.115 crores with a loss before tax of about Rs.13 crores. During the quarter four we provided Rs 3 crores towards slow moving and non-moving materials.

On full year standalone basis finished dosages sales continued to be largest to the business and constituted 38% of the standalone sales excluding Auctus sales here. PF and API segments contributed 28% and 34% of the sales respectively. On our geographic breakup about 69% of sales are coming from regulated markets that is Europe, US, and Canada. In financial year FY15 Paracetamol contributed 47% of the sales compared to 44% during the previous year. Metformin contributed 28% and remained the same compared to the last year. While, Ibuprofen decreased to 11% compared to the previous 15% in the previous year.

Consolidated long term loans as of 31<sup>st</sup> March 2015 was Rs.362 crores and working capital loans were at Rs.125 crores. With this I would request the moderator to open the lines for questions. Thank you.

**Moderator:** Thank you very much. Ladies and Gentlemen, we will now begin the question and answer session. Our first question is from the line of Runjun Jain from Nirmal Bang. Please go ahead.

**Runjhun Jain:** Sir, my first question is, what is the Abacavir sales for this quarter, for the full year?

**VVS Murthy:** Current quarter Abacavir sales are about Rs.7.98 crores.

**Runjhun Jain:** Rs.7.98 crores, and you said that you have launched one more product during the quarter, which product it is?

**VVS Murthy:** It has just been scaled up; actual commercial sales will start in the current quarter that is why we have not disclosed. We will inform later.

**Krishna Prasad:** Next earnings we will definitely be talking about it.

**Runjhun Jain:** What would be the potential of that product be?

**Prasada Raju:** It also has a similar kind of potential, better than Abacavir. We just completed the scale up. Once we get into the commercial scale then probably we will be in better position to give you the exact number.

**Runjhun Jain:** Sure Sir, you said that you will be filing three to four ANDAs in FY16 that would be from your own portfolio or from the Auctus portfolio, you are talking about?

**VVS Murthy:** Both together.

**Runjhun Jain:** Wanted to know, have you capitalized the PFI expansion and the OmniChem plant expansion?

**VVS Murthy:** We have capitalized new PFI facility in March. Part of the Granules Ominchem project was capitalized in January, balance will be capitalized in the first quarter of current year, FY16.

**Runjhun Jain:** And the balance would be, is it, can you quantify that?

- VVS Murthy:** See out of five production blocks which are there in OmniChem, one production block plus entire utilities and common facilities were capitalized in January, balance will be capitalized in the current quarter i.e. in Q1 of FY16.
- Runjhun Jain:** The CAPEX for FY16, have you finalized?
- VVS Murthy:** Shortly we will finalize. Still discussions are going on.
- Runjhun Jain:** But there will not be any rough estimate for that, how much you want to, and where exactly that would be used?
- VVS Murthy:** Normal CAPEX will be around Rs.30 to Rs.35 crores.
- Krishna Prasad:** That is Operational or maintenance CAPEX, but we are looking at a lot of filings and filings could take up something like Rs.70 to Rs.80 crores and we are also looking at new API creation, expansions, and that could take anywhere from Rs.150 to Rs.180 crores, and we are still working out the details, and it should take us maybe a few more weeks to finalized this.
- Runjhun Jain:** Sure Sir, one more thing, why the EBITDA margins, any particular reason have gone down during the quarter, and what is the outlook for going forward?
- VVS Murthy:** As I told you in my initial remarks, we provided about Rs.3.1 crores towards slow moving and non-moving materials. We also increased our R&D expenditure in Q4, In addition to these two points there is a product mix change, because of these three reasons it has gone down compared to previous quarter, but we expect to maintain whatever YTD December margins we achieved, we expect that will be achieved over the period of next one year, and we are also expecting some improvement over there.
- Runjhun Jain:** Is it right to say that the current R&D run rate, we can take it as a quarterly run rate going forward also?
- VVS Murthy:** Yes, it will increase actually.
- Runjhun Jain:** It would increase on a quarterly basis also?
- VVS Murthy:** As our CMD told, new product, ANDA development we are doing, for that additional expenditure will be there.
- Runjhun Jain:** Sure, any outlook on the sales growth for the next year?
- Krishna Prasad:** On the base business we would see the same thing, like about 15 to 20%, that is the existing five molecules. From the Auctus basket, it could be about, I cannot talk about growth exactly, but about Rs.150 to Rs.160 crores, is what we are expecting as a baseline, but there could be a huge up side, which we will know as we go forward, some of the products which we are

commercializing, are going to have a big up side, but the concentration is going to be more on the bottom-line rather than the topline. We definitely can see a bottom-line increase from the Auctus basket.

**Runjhun Jain:** And this Abacavir product, we have said that we have done almost Rs.8 crores of revenues in Q4, so this is something likely to continue going forward also?

**Krishna Prasad:** It will continue and I also see it increasing.

**Prasada Raju:** It is one of the promising molecules for us.

**Moderator:** Our next question is from the line of G. Vivek from GS Investments. Please go ahead.

**G. Vivek:** Just wanted to ascertain the status of Auctus Pharma amalgamation and the FDI approval for its products turnaround, similarly for OmniChem joint venture and second question was about, there has been some exit from very old investors from the company at the peak recently, so investors or somebody else, they have sold out, any other big names have entered or mostly it has been retail investors only, they have sold out?

**VVS Murthy:** Can you repeat your question. We are not able to hear properly

**G. Vivek:** There were two parts to the question. First question was regarding the status of amalgamation of Auctus and OmniChem, what is the status of their performance and their turnaround?

**VVS Murthy:** One by one, we will answer these things, so that you can ask the next question. There was no proposal to merge Auctus and OmniChem with the company, both are different companies. Auctus was already merged with Granules India Limited. A.P. High Court has given the approval for the scheme proposed by Auctus Pharma, and November 2014, we already merged that company with Granules India Limited, whereas Granules OmniChem is a separate JV with Ajinomoto OmniChem of Belgium, which will continue as a standalone company and we are not going to merge that company with Granules India.

**G. Vivek:** Basically have they broken even, these two companies or still they are under losses only?

**VVS Murthy:** Pardon:

**G. Vivek:** Have they broken even Sir?

**Krishna Prasad:** Auctus incurred a loss in the first three quarters, a loss of Rs.13 crores, but in the last quarter it achieved break even with a small cash profit, and we expect that Auctus would continue to start making profits from now onwards, and regarding Granules OmniChem, there was a very slight loss, because we had very little production,

- VVS Murthy:** Practically there was no production actually; whatever small quantity we sold that was part of trial run production that is why it will be adjusted against the pre-operative expenses, that is part of capitalization.
- G. Vivek:** And FDA approval is still awaited for OmniChem joint venture.
- Krishna Prasad:** I have already said in my opening remarks, we are now currently going to manufacture intermediates for our partner company in Belgium who will convert these intermediates into APIs and supply to innovator companies. Once we get our FDA approval, we will be doing the APIs here itself and supplying to the innovators.
- G. Vivek:** Most of the products which we are making, where we are having a dominant position, but is the opportunity size for those products, whether it is Paracetamol or metformin, is it limited or is it increasing, and the opportunity size for the products being made by Auctus, that will increase the opportunity as a size in overall for our range of products Sir?
- Krishna Prasad:** Metformin as a product is increasing, the growth is very high, and we are also increasing our share of finished dosage we have a very fairly good share in the US market of FD, but whereas products like Paracetamol, ibuprofen, and other things, the growth is in single digits, but due to our regulatory status and our quality, all the innovator companies and the brand leaders are coming to us and our market share is increasing. We are cannibalizing on other customers, and regarding OmniChem, this is a CRAMS business. We manufacture for innovator companies, and whatever they need, we manufacture for them. These are molecules which are in the new stage of developments.
- G. Vivek:** Sir, recently there has been selling at the absolutely peak by very old customers of the company, investors and some other names also, any specific reason they got out and lieu of them basically any other big HNI name or big institution name has entered the company Sir.
- Krishna Prasad:** This was one investor who has invested, maybe about seven to eight years ago, and I am sure he made very, very decent margins, and he was exiting. In fact, to go deeper, even the founder of that company expired some time ago, and the family is not interested in continuing any of these investments, they are selling in the market, and I don't think any big investor has come in; it is all going into the retail space.
- G. Vivek:** Okay, for them it has been 10 bagger or more than that Sir.
- Krishna Prasad:** Sorry.
- G. Vivek:** For them it has been a multi-bagger, so that means it is a 10 bag or 20 bag or what has they have got from our company Sir.
- Krishna Prasad:** I think I would say 10 times, something like that.

- Moderator:** Our next question is from the line of Bhavin Shah from GeeCee Investment. Please go ahead.
- Bhavin Shah:** For the quarter again, for Auctus, what was the revenue and EBITDA?
- VVS Murthy:** Fourth quarter Auctus' revenue was Rs.44.2 crores with a profit of Rs.0.02 crores, as our CMD said, we have just broke even. A nominal profit of 2 lakhs was made in this fourth quarter.
- Bhavin Shah:** So what would be the cash profit for the quarter including depreciation?
- VVS Murthy:** profit before depreciation is about 62 lakhs.
- Bhavin Shah:** And what size would you have Auctus margins comparable to what we are doing standalone today, would it be a substantially big number to reach to that level of margins, or would it be?
- VVS Murthy:** Because we are just breaking even, the margins naturally will be much lower than the Granules margins, but going forward yes, we will pick up and they will match over a period of time it can increase also.
- Bhavin Shah:** At a number of maybe Rs.200 to Rs.300 crores, would you look at Auctus delivering those kind of double digit margins or would it be?
- VVS Murthy:** Exactly I cannot tell you what level it will go, but certainly now onwards it will start improving.
- Bhavin Shah:** Okay, and what would be the export domestic mix of Auctus today?
- Prasada Raju:** About 74% is domestic, and the rest is export. But going forward it will be increased and we are mainly focusing on the export market rather than growing only in domestic, so it is good to say, the growth in export market is higher than the growth in domestic market, these two are equally important to us to have a proper balance between short term to mid-term.
- Bhavin Shah:** If one has to look at a ratio where it would be 50:50, would you be able to do that in the next two to three years?
- Prasada Raju:** Yes. Two to three year it is quite possible. We are expecting that.
- Moderator:** Our next question is from the line of Veena Patel from I Wealth Management. Please go ahead.
- Veena Patel:** Sir, I just missed out on the explanation with regard to the lower operating profit margins, can you just repeat that.
- VVS Murthy:** We provided Rs.3.1 crores towards slow moving and non-moving materials in the fourth quarter, We also increased our R&D expenditure, these are the two major reasons, in addition to this product mix also has contributed to some lower margins in this fourth quarter.



- Veena Patel:** For the entire financial year of FY15 how much was our R&D spend?
- VVS Murthy:** Total R&D spend is approximately about Rs.8.5 crores in revenue expenditure.
- Veena Patel:** Sorry, I did not get the number.
- VVS Murthy:** Rs.8.5 crores revenue expenditure in R&D, around Rs.6.5 crores is the CAPEX expenditure,
- Veena Patel:** Out of this how much went for Q4 Sir. R&D spend.
- VVS Murthy:** The exact number is not with me right now
- Veena Patel:** Not an issue Sir, and there was some issue related to the product mix also, that led to the lower EBITDA margins?
- VVS Murthy:** Depends on product to product and again the destination and the particular SKU it will depend on that.
- Veena Patel:** Okay.
- VVS Murthy:** Everything will not be same margin.
- Veena Patel:** Because our gross margins also have come down, it was because of the increase in the raw material cost, which you already explained, it was because of the inventory write off, that you made on the....
- Krishna Prasad:** One time write off is there.
- Veena Patel:** And apart from that another observation was that there has been an increase in the number of inventory days, is there a specific reason for that?
- VVS Murthy:** Because last year Auctus was not there, that was a separate company all together, one half month it is there. Now a lot of activities are going on plus new products development is going on. So multiple products are there, so that way you have got to keep minimum inventory for each and every product that is the reason for higher inventory. In addition to this, for our US market some of the materials we shift to our US subsidiary, that is also in transit, because of that also inventory has gone up.
- Veena Patel:** As far as our exports are concerned around 25 to 30% goes to the Europe market, was there any impact because of the recent Euro depreciation?
- VVS Murthy:** Not much, because the major customers we have contracts to pass on any increase in forex and key raw materials. That is why we don't expect any major impact because of Euro depreciation.

- Veena Patel:** And for FY15 what was your gross block?
- VVS Murthy:** Gross block, gross net block is Rs.678.58 crores.
- Moderator:** Our next question is from the line of Sangam Iyer from Shubkam Ventures. Please go ahead.
- Sangam Iyer:** I just wanted to understand the revenue breakup for Q4, when we report the standalone numbers, it includes Auctus in it right?
- VVS Murthy:** Right, it includes Auctus also
- Sangam Iyer:** So, first of all the difference between the consolidated and standalone is what is the revenue generated by OmniChem, is that the right reading?
- VVS Murthy:** OmniChem plus another joint venture in China, plus Granules USA, our marketing front end office in US.
- Sangam Iyer:** So OmniChem, how much did it generate in Q4?
- VVS Murthy:** OmniChem, there is no turnover actually, as I told you only one small sale was there, which is part of our trial run production, that is why it was capitalized after reducing the expenditure.
- Sangam Iyer:** In FY15 if I were to look at the base business revenues, and adjust for the Rs.25 crores that Auctus had in Q4 of FY14, the base business has grown by just 7 to 8%, from Rs.1070 odd crores to Rs.1160 odd crores, so just wanted to understand.
- VVS Murthy:** Last year what we did was not Rs.1070, it is Rs.1001 crores .
- Sangam Iyer:** Rs.1001 crores?
- VVS Murthy:** Yes. That has grown by about 10% base business last year plus Auctus the growth.
- Sangam Iyer:** Right, so this 10% growth that we are looking, now guiding for a 20% growth in the next year, could you give us some idea in terms of what would drive this growth in FY16 onwards, ex of Auctus, because that is a base business guidance that we gave right
- VVS Murthy:** Last year we have some constraints of PFI capacity, that new capacity we created, another 4,000 tons capacity we created to so that there will not be any problem of PFI sales, that is number one, number two, previously because of capacity constraints, we are not doing any business development in the last couple of years, pending orders we cleared, last year we started again business development, that is expected to give more business in the current year.
- Sangam Iyer:** When you say business development, it is getting new customers, that kind of thing.

**VVS Murthy:** Either new customers or new products or existing products to new customers.

**Sangam Iyer:** Okay.

**Krishna Prasad:** It was basically result of lack of capacity, which was created now and the capacity is ready to go this year.

**Sangam Iyer:** So in FY15 on an average our PFI capacity utilization was at around 70 to 75% right?

**VVS Murthy:** Yes.

**Sangam Iyer:** And vis-à-vis in FY14 how much was that?

**VVS Murthy:** FY14 it was lower than that.

**Sangam Iyer:** Just wanted to understand, when we are putting the new capacity, PFI capacity, at peak it can go up to what, 80 to 85%, which is why we have put in?

**Krishna Prasad:** It all depends on the product. Some products give us a lesser output and some give us a higher output. Normally our capacity is rated based on one product, so generally on the product mix you can take about 80 to 85% as capacity utilization.

**Sangam Iyer:** Okay, so the increased capacity that comes in, that at what kind of utilization are we factoring in this 15% growth that is the incremental 5% growth that we are factoring in?

**VVS Murthy:** In a year maximum of 60%.

**Sangam Iyer:** At 60% of that.

**VVS Murthy:** Yes.

**Sangam Iyer:** And Sir in Auctus, we have factoring the run rate of Q4 being the annualized run rate for next year, right, that is the assumption here?

**VVS Murthy:** Yes, that is possible, yes.

**Sangam Iyer:** That is how we are arriving at Rs.160 odd crores, Rs.44 crores getting annualized?

**VVS Murthy:** Yes.

**Sangam Iyer:** So at this run rate, what kind of margins can one generate in Auctus at the EBITDA level?

**VVS Murthy:** EBITDA level, next year can be at least double digits will be there.

- Sangam Iyer:** So is it like, you have a threshold of Rs.130 odd crores kind of, or Rs.120 crores of cost, which is why you are able to generate that much kind of EBITDA, because Rs.150 to Rs.160 crores?
- VVS Murthy:** Here, two things are there – one is fixed expenditure, another is variable expenditure. We are attacking mainly variable expenditure, raw material cost reduction by improved process and reducing the cycle times, etc. That work is going on continuously, over a period of time that will give more results than just increasing the top line as well any other introduction of a new products. Introduction of new products will continuously be done, but major focus will be on this reduction of raw material cost. That is going to improve the margin in the short term. Long term, new products introduction and their margins will be added.
- Sangam Iyer:** Okay, in case of Auctus next year predominately it would be through API sales only that we are looking to generate?
- VVS Murthy:** Yes, next 2 years only API sales.
- Sangam Iyer:** Next two years?
- VVS Murthy:** Yes. We will be filing ANDAs in FY16, then afterwards it will take another two years for them to get approval approximately, then only the finished dosages sales will start.
- Sangam Iyer:** Correct, and Sir for OmniChem, what is the kind of revenue and margins that we are looking at in FY16 that is our share?
- VVS Murthy:** As our CMD told, we will be making one intermediates for our joint venture partner. We are yet to get regulatory approvals. We expect sales of (at joint venture level) about Rs.80 crores turnover approximately.
- Sangam Iyer:** And how much of a profit or loss that it would generate?
- VVS Murthy:** We expect around Rs.10 crores loss for Granules, but we are trying to see how you can reduce that loss.
- Sangam Iyer:** This is at EBITDA level?
- VVS Murthy:** At PBT level.
- Sangam Iyer:** At the PBT level, okay, and Sir, when OmniChem's margins can go to our company average margins?
- VVS Murthy:** Once we will get approvals then only it can increase.
- Sangam Iyer:** Once the regulatory approvals, so that would be again two to three years down the line?

- VVS Murthy:** Yes.
- Krishna Prasad:** Some of these intermediaries can possibly generate some better margins, we are working on it, but basically once FDA approvals come in, the whole scenario changes.
- Sangam Iyer:** So our gross block currently includes OmniChem's facility as well, right?
- VVS Murthy:** T Our share of 50% we added to our balance sheet.
- Sangam Iyer:** Finally on the ANDAs – three to four ANDAs we are planning to file because we already have DMFs of the APIs of most of them are there, so how much would be the incremental cost per filing that one should be looking at?
- Krishna Prasad:** If you looking for both development and filing, at an average rate you can consider around Rs.4 to Rs.4.5 crores per product.
- Sangam Iyer:** So total of around Rs.16 to Rs.18 crores per year kind of for ANDA filings?
- VVS Murthy:** Only for this these three to four products.
- Krishna Prasad:** Only for three to four products, the other products continuing to be under development, we expect the expenditure to be more than that.
- Sangam Iyer:** So how much of R&D expenditure are we looking at, can you give us some idea on that?
- Krishna Prasad:** When you include ANDAs and other expenditure on synthesis and other things, we are expecting close to about Rs.30 crores.
- Sangam Iyer:** Rs.30 crores, on an annual basis.
- Krishna Prasad:** That is right.
- Sangam Iyer:** Then because when we guided for the margins to be at the similar levels of Q3, which is at around 17% levels, are we looking at any substantial jump in margins somewhere which would offset this incremental R&D cost because to a large extent our Auctus loss gets compensated by the OmniChem loss, so to extent there is not an incremental benefit that is coming in?
- VVS Murthy:** New product development cost will be capitalized pending revenues from that, and when they start contributing revenues, then we will start writing-off these new product development cost.
- Sangam Iyer:** So how much of this R&D would actually get expensed off any guidance?

- VVS Murthy:** The normal R&D expenditure, and the routine R&D expenditure, we will write-off 100%, new product development will be capitalized and then we will start write-off as and when the revenue starts from that particular ANDA.
- Sangam Iyer:** So basically the ANDA cost would be capitalized?
- VVS Murthy:** Exactly.
- Sangam Iyer:** Currently in the balance sheet how much is the total capitalized cost?
- VVS Murthy:** R&D right now is not much. I think about Rs.9 crores is there, that already we started writing-off over a period of time.
- Sangam Iyer:** My last question is, I was just looking at the fixed assets, in March 2014 there was an intangible asset of Rs.107 crores, which as on March '15 is Rs.88 crores. Can you just help us out the sharp reduction in the intangible; is there any write-off that has been taken or impairment that is being charged?
- VVS Murthy:** There is no impairment. Last year we acquired the Auctus Pharma. Difference between the acquisition cost and tangible assets was shown as intangible assets. Based on the court order we reduced Rs.13 to Rs.14 crores from the intangibles and the same was also reduced from the reserves.
- Sangam Iyer:** Okay that is adjusted against ....
- VVS Murthy:** Adjusted against the reserves of the Auctus.
- Sangam Iyer:** Finally last question on the loans, could you give us a breakup as to how much is against OmniChem, how much is against Auctus, and on the standalone entity of the total 480 crores?
- VVS Murthy:** Exact number is not there, but rough indication I can give you – about Rs.60 to Rs.61 crores loan is from OmniChem out of 362 crores long term loans and balance is Granules.
- Sangam Iyer:** Okay, and the total debt is around Rs.480 crores currently.
- VVS Murthy:** Rs.498 crores including working capital.
- Sangam Iyer:** Once the new line gets commissioned, how much would be the total?
- VVS Murthy:** Right now there is no plan to increase term loan side except the working capital based on the requirement it may increase year-to-year basis. Other long term loans right now there is no plan unless we finalize the CAPEX plans and the funding we have to decide. Whatever loans were sanctioned for the existing CAPEX, we have already drawn that amount. This is the peak

and we already started repaying it, it will come down, but any new big CAPEX plans are there whether we will go through equity or loan, and at that time we will decide.

**Sangam Iyer:** So Sir on the depreciation and interest run rate should one be assuming the marginal increase in the interest cost or next year the interest cost will be higher because of the higher debt?

**VVS Murthy:** Next year also some increase will be there because for example about Rs.44 crores of the term loans we had drawn at the end of the financial year 2015, that amount full year impact will be seen only in FY16, and part of the year also interest on some of the CAPEX e.g. Module E and others, was capitalized because during the construction time we can capitalize the interest. Now the facilities available, ready for production, that amount also will be charged to P&L account, so there will be some increase in the interest expenditure.

**Sangam Iyer:** Can one safely assume somewhere a run rate of around Rs.45-odd crores as an interest cost next year?

**VVS Murthy:** I think it should not increase, it should be a little less than that.

**Sangam Iyer:** It should be less Rs.45-odd crores?

**VVS Murthy:** Yes.

**Sangam Iyer:** And depreciation at around Q4 annualized kind of run rate with a marginal increase.

**VVS Murthy:** Yes.

**Sangam Iyer:** At around Rs.60 odd crores basically.

**VVS Murthy:** Yes.

**Moderator:** Our next question is from the line of C. Sri Hari from PCS Securities. Please go ahead.

**C. Sri Hari:** My first question pertains to the R&D expenses. For Q4 you have written-off Rs.7.5 crores, shall we take that as the quarterly run rate?

**VVS Murthy:** That is what is approximately we indicated, that is including CAPEX, not revenue expenditure only. Development cost will be capitalized, only revenue part will be transferred to P&L account.

**C. Sri Hari:** So effectively that means we will be writing-off Rs.30 crores for FY16?

**VVS Murthy:** No. Rs.30 crores will not be total revenue expenditure that is including the new product ANDA development expenditure which will not be charged off immediately. ANDAs development expenditure will be amortized after we get after approvals from regulatory

authorities that will take about two to two and half years approximately. Only after that we will start charging of that amount to P&L account.

**C. Sri Hari:** So in that case this Rs.7.5 crores figures that you have for the quarter that is not actually the quarterly run rate?

**VVS Murthy:** No, Rs.7.5 including CAPEX that is what I told. About Rs.5 to Rs.6 crores will be CAPEX, balance will be the revenue expenditure in this particular account other than salaries and other things I am talking about.

**C. Sri Hari:** Coming to your gross margins, actually sequentially there has been about 700 basis points decline in your gross margins, even after adjusting for the Rs.3 odd crores provisioning that you mentioned, I think still the decline would be sizable?

**VVS Murthy:** As I told you a couple of factors – one is this material provisioning is there and the other factor is our joint venture with Biocause there also because of some pricing pressure, they faced, there is increase in material cost, that has impacted almost around Rs.6 crores impact is there plus product mix impact is there. Plus whatever material we transfer to our subsidiary for further sale to USA, that material did not reach the destination because of that we have to eliminate the profit and all these increase in the material cost.

**C. Sri Hari:** Has the scenario on ibuprofen improved for your joint venture?

**VVS Murthy:** Right now, this year also, we are not expecting any improvement that will continue I think FY16.

**C. Sri Hari:** So effectively you expect some constraint on the gross margins?

**VVS Murthy:** The contribution is very small, in the next year my budget, it will be insignificant, that is why we don't expect, and that is why 17% margins we achieved up to YTD December we can maintain that.

**C. Sri Hari:** Last year you had given the rough breakup of EBITDA margins for the three verticals; can you share similar numbers for FY15?

**VVS Murthy:** FY15 I have to work out but whatever previous numbers we told that more or less at the same levels will continue.

**C. Sri Hari:** So there is not much change in the EBITDA margins for the three verticals?

**VVS Murthy:** More or less same products, there is not much change.

**C. Sri Hari:** And what would be the outlook for the current fiscal?



- VVS Murthy:** Current fiscal, as I told you that about 17% EBITDA margins will be maintained. We are working for about 100 basis points improvement but as and when things improve quarter-on-quarter basis we can give you more details.
- C. Sri Hari:** That is the blended margin. I was asking vertical wise, I mean do you see any major shift among the three verticals?
- VVS Murthy:** Major shift, yes, we are focusing more FDs and PFIs as we told you this year also.
- C. Sri Hari:** So the 100 basis points improvement should significantly come from these two verticals.
- VVS Murthy:** Product mix and this PFI and FD mix,.
- C. Sri Hari:** Finally, what is the status of the Rs.250 crores QIP that was in the pipeline?
- Krishna Prasad:** We are still yet to finalize our overall requirements, we are working on it and we are being cautious that not to overspending, so we are trying to rationalize our spend in the next one year, one and half years, so as and when we finalize the total requirement, then again we will look at how much debt to go in for, how much QIP to go in for, so that is still to be finalized.
- C. Sri Hari:** So it is still at the blueprint stage, I mean.
- VVS Murthy:** We are working on those details.
- Krishna Prasad:** We took an enabling resolution from the AGM, but we still have not finalized the actual numbers needed.
- Moderator:** The next question is from Dr. MP Bajaj who is an individual investor. Please go ahead.
- Dr. MP Bajaj:** When I was reading about you, I will say that last three to four decades I am using your products, Paracetamol, metformin, ibuprofen, etc., which are very time-tested, and you are creating value out of it, and now are Granules India are buying four companies, Auctus also OmniChem JV, and the new one Granule USA. My question is about Auctus, somewhere in your presentation you had mentioned that the total products is 20 there, but most of the time you are mentioning about 12 products there.
- VVS Murthy:** From the beginning we are telling, we have only 12 APIs, 2 intermediates, what we acquired from previous management and afterwards we introduced one more product.
- Dr. MP Bajaj:** In one of the presentation somewhere it is mentioned 20 products.
- Krishna Prasad:** It is the pipeline. You must have seen the pipeline.

- Dr. MP Bajaj:** Okay maybe. About Auctus my question is this that the total product value is mentioned \$37 billion all over the world, and you want to get the 5% share out of it in the long term.
- VVS Murthy:** In the long term that is overall worldwide market of those molecules.
- Prasada Raju:** If you really look at each product, we usually understand what is the global market value and growth of each product. Some of the products it may so happen that it will not grow further. The number. What we are referring is the actual number global value. Number 2 when you are actually referring the number of products must be between 18 to 22, usually what we do is we have a wish list of products, then we short list, and then introduce the product for the development. When we introduce the product for the development, some of them will be at the R&D stage, some of them will be at a scale up stage, and some of them will be fully commercial. So when we are actually reading the number might be correct, but what we are actually saying is commercial scale are few. At a basket level it can reflect up to 20. We hope we have answered your question.
- Dr. MP Bajaj:** I am a long term investor, say after 5 years what will be your sales figure after 5 years, and what will be the profitability? Just a back of the envelope figure, I don't need the actual figures.
- Prasada Raju:** As our CMD has mentioned at a base level we are pegging for about Rs.150 to Rs.160, but actually hopeful about some up sides which are going to come, so it would be maybe another Rs.30 crores.
- Dr. MP Bajaj:** Rs.30 crores this year or in five years. I am asking for the next five years.
- VVS Murthy:** FY16, he is talking, five year numbers we will have to come back to you. Right now we don't have readymade information with us, we will revert back to you.
- Dr. MP Bajaj:** And about Granules USA?
- VVS Murthy:** Granules USA is only a trading company, we manufacture our products in India, and from here we will export to them, so that they can sell them to the final customers. They don't manufacture on their own. It is a marketing arm of Granules India.
- Dr. MP Bajaj:** With the JV OmniChem, you were mentioning CRAMS so that this is custom research, also on the custom manufacturing there.
- VVS Murthy:** Right now there no custom research as such. Research is done by our joint venture partner, Ajinomoto OmniChem of Belgium. Right now we are only manufacturing, maybe at a later stage, we can look at the custom research also.

- Krishna Prasad:** It is custom manufacturing right now and this is all based on innovator companies, where like I already explained the intermediaries will be made here till the FDA approvals comes through and then the final API is being made in Belgium by our partners today.
- Dr. MP Bajaj:** So right now, no custom research, no custom manufacturing.
- Krishna Prasad:** No research at this stage, but we are doing some research, some base has started in our Hyderabad R&D, there could be a potential for some customer research here too. Not in OmniChem but in Granules itself.
- Moderator:** Our next question is from the line of Aditya Sahani from Adcorp Capital. Please go ahead.
- Aditya Sahani:** Just wanted to know when you guys are going to deleverage your balance sheet and when is the company going to be a free cash flow positive company?
- VVS Murthy:** We are growing company, we need more and more investments to achieve our ambitions. So naturally whatever money is available we will be investing to create new facilities so that we can increase our turnover as well as profits that is why we are not expecting to retain cash as a free cash in the balance sheet in the next few years.
- Aditya Sahani:** Okay, probably from FY-18-19 onwards you can expect this company to be a free cash flow company?
- VVS Murthy:** No, we are not thinking to stop our growth by '18 or 19. We want to grow further.
- Aditya Sahani:** Okay, because you know valuations will not expand if you keep doing CAPEX, right once the business model?
- VVS Murthy:** I don't know how you are going to value, but certainly we are looking for new opportunities to invest without that we cannot grow business which is required. We feel that as long as we invest with opportunities and show the growth and profitability I don't expect any issue in the new investments.
- Aditya Sahani:** Okay, I am sure the management sometime or the other would like to kind of deleverage this Rs.500 crores and kind of have a healthy payout ratio and stuff like that.
- VVS Murthy:** Payout ratio already this year for your information yesterday Board of Directors recommended 50% dividend.
- Aditya Sahani:** No, payout ratio as a part of net profit.
- VVS Murthy:** As on date there is no such policy because we are looking for more and more investments in our new facilities to increase our business and profitability. So as and when a decision is taken we will inform you.

- Moderator:** Our next question is from the line of Ashish Rathi from Spark Capital. Please go ahead.
- Ashish Rathi:** Murthy sir just wanted to check in your opening remarks you mentioned the contribution of Paracetamol, could you just give me that number again?
- VVS Murthy:** Paracetamol on standalone basis with Auctus business together 43% is coming from Paracetamol group and metformin is about 25%.
- Ashish Rathi:** This was last year, how much?
- VVS Murthy:** Last year Auctus was not there for full year, if you want only like-to-like I can give the numbers.
- Ashish Rathi:** Yes, I have adjusted already for Rs.116 crores of Auctus this year.
- VVS Murthy:** Like-to-like means, Paracetamol is about 47%, metformin 28%, and ibuprofen 11%.
- Ashish Rathi:** My numbers are throwing 14% growth in Paracetamol year-on-year, is that a correct assessment.
- VVS Murthy:** Actually compared to last year the business has grown by 3%, actually from 44% to 47% it has grown, Paracetamol.
- Ashish Rathi:** I will just reconfirm this number off line with you, but just wanted to understand how is the pricing environment in this space especially Para and Metformin? Are we seeing any kind of growth happening year-on-year or is there a price decline which is happening?
- Krishna Prasad:** We actually deal with the regulated markets and some of the quality conscious customers and mostly the brand leaders. If you see the biggest brands in the world they buy from us and for them price is not a big issue. And most of our prices are linked with some of our key raw material and FOREX variations. So while we don't see any great increase in profit margins but there is definitely no decrease in profit margins, we maintain our margins. Whereas for metformin in the FD space, we clearly see increases in margins and the same with Paracetamol in the FD space, we see slight improvement in margins too.
- Ashish Rathi:** Why I am asking is because there is a 3% growth in Paracetamol year-on-year as told by Murthy Sir just now, will that be any volume increase there?
- Krishna Prasad:** There will be volume increase, in fact what happened is we are trying to create some spare capacity for our marquee customers, whenever there is a requirement for them, we will have to meet those requirements so that extra capacity which we created instead of selling to long term customers, we try to sell it at spot market and that is one reason, we get a slightly lesser margin there, but we always keep some spare capacity for requirement of our important customers.

- Ashish Rathi:** See within para like the contribution broadly remains the same, but can we assume that there is a shift in the FD contribution and the API contribution with more towards FD this year and that being the increasing trend with para as well.
- Krishna Prasad:** There would definitely be a shift towards FDs as we go by and one initiative which we have taken, which we have not mentioned so far in this conversation is that we used to sell our FDs to a few companies in the United States, who used to repack and supply to the retail chains like the Wal-Marts and the Wall Greens, and this year the biggest change we did was, we did not want to depend on any of these people, we set up our own marketing divisions, and now we have started bidding to the big chains. And in fact we just got our first order from one of the chains, a small of course, not a big thing, about \$4 to \$5 million. But we expect this to grow, and as this grows the Paracetamol market and ibuprofen finished dosage markets will grow and another important point that we should mention and which we have not, one of the reasons for decline in margins in Q4 was this new division which we set up. We have lot of staff there, lot of expenditure going on, lot of exhibitions being attended to. So there is a lot of expenditure going on with no corresponding revenue. The revenue from this investment should start coming in next year and that will automatically lead to an increase in FD requirement and space.
- Ashish Rathi:** We were partnering with someone in the US to you know as an in between channel, is that what you are saying?
- Krishna Prasad:** We partner with our Rx products, in the prescription space we partner with some people. OTC products, we used to sell our products to some companies, who used to repack and supply to the chains. But today instead of selling to a company who will repack and sell it to the chains, we ourselves are bidding for the chains business, and we are making good progress there.
- Ashish Rathi:** Why did this decision come out now and not earlier, is it because of some scale which we have achieved now or how is it?
- Krishna Prasad:** It is scale and also resources, we now had some steady cash flows. These will need some investments in inventories in the US and also the marketing expenditure would be quite high. So we feel now the time has come where we can take it on ourselves and if you see our last quarter margins fell a little bit which does not really bother us, but we could not have done this earlier.
- Ashish Rathi:** A tad bit into the numbers for the quarter, we have a Rs.44 crores contribution from Auctus in this quarter, is that correct Murthy Sir.
- VVS Murthy:** You are right.
- Ashish Rathi:** And on a year-on-year if you look at the difference between the quarters is around Rs.37 crores jump from Q4 last year to this year, which means actually ex-Auctus we are de-growing, is that correct.

- VVS Murthy:** We are not de-growing,
- Ashish Rathi:** Last year we had Rs.318 crores of sales and this year we have Rs.355 crores of sales.
- VVS Murthy:** Last year Rs.317 crores is there on consolidated basis, including about Rs.7 crores sales from Auctus.
- Ashish Rathi:** Which means effectively there is no growth on the base business, ex-Auctus.
- VVS Murthy:** If you remove that, there is a very small 2% growth is there.
- Krishna Prasad:** I will explain here, like I said, we were trying to get in to the US OTC market directly through the chains ourselves and in this process we stopped supplying to other people who were packing our products that is the reason for this. You are right there is not a big increase in growth or a slight de-growth, but that is because we stopped selling to these customers and we are trying to get into the market ourselves where the margins will be slightly higher and the business will be more secure.
- Ashish Rathi:** My only concern remains because if you look at I think the second quarter also and the third quarter, the base business has not grown as much, in the range of say 5 to 7%, and say this quarter it is practically flat. So obviously this year growth looks good because we have Auctus numbers in our business and so we are seeing 18% growth coming in but of course FY16 will have Auctus as a base. And even if you look at say (+20%) growth in Auctus on a consolidated basis, if the base business growth remains similar we are looking at around somewhere between 12 to 15% growth for the full year at the company level, is that a valid concern.
- Krishna Prasad:** It would actually be better because the reason last year we did not grow was we did not have enough capacity in the base business and now we have the new PFI capacity that has come in, that should really propel some growth and it is not only sales of PFIs, lack of PFI capacity, we had finished dosage capacity but without PFI we could not use the FD capacity also. Now FD capacity and PFI sales put together will give us some decent growth this year, I don't see any major problems there.
- Moderator:** Our next question is a follow up question from the line of Runjhun Jain from Nirmal Bang. Please go ahead.
- Runjhun Jain:** Just a clarification Sir, first is, what would be the total Abacavir sales for the full year.
- Prasada Raju:** It is about Rs.14 crores.
- Runjhun Jain:** Rs.14 crores, and Sir in between Mr. Krishna has said about the Rs.88 crores company level revenue and Rs.10 crores loss at PBT level, just wanted to clarify it is for the OmniChem JV you are talking about?

**VVS Murthy:** OmniChem JV, yes, company level that is

**Runjhun Jain:** And for the FY16?

**VVS Murthy:** Yes, FY'16.

**Moderator:** As there are no further questions, I hand over the call conference to Mr. Bajpayee for closing comments, over to you Sir.

**Sumanta Bajpayee:** Thank you for joining us today and we appreciate your valuable questions. Management had shared their views and future outlook about the company. Soon we will upload the updated investor presentation in our website. You are requested to have a look and feel free to get in touch with me for any additional queries. Thank you and we look forward to having you again in our first quarter current fiscal conference call.

**Moderator:** Ladies and Gentlemen, on behalf of Granules India Limited, that concludes this conference call. Thank you for joining us. You may now disconnect your lines.