



Syngene International's Q3 and 9M FY 2016 Conference Call

January 22, 2016

Key Participants from Syngene International

- Mr. Peter Bains: Executive Director and Chief Executive Officer
- Mr. Jonathan Hunt : CEO designate
- Mr. M.B. Chinappa: President, Finance
- Dr. Manoj Nerurkar: Chief Operating Officer
- Ms. Sweta Pachlangiya: Investor Relations

Presentation Session

Moderator: Ladies and Gentlemen, Good Day and welcome to the Syngene International Q3 & Nine Month FY16 Investor Conference Call. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Ms. Sweta Pachlangiya. Thank you and over to you.

Sweta Pachlangiya: Good Afternoon, Ladies and Gentlemen. I am Sweta Pachlangiya from Syngene's Investor Relations Team and I welcome you to Syngene International's earnings call for the third quarter and nine months of Fiscal 2016. We have with us today, Mr. Peter Bains – Syngene's Chief Executive Officer and the senior management team to discuss the company performance and outlook. Before we proceed with this call, I would look like to remind everyone that this call is being recorded and a replay will be available for the next few days immediately after this call. The transcript of this call would be made available in a week's time on the company's website. I would also like to add that today's discussion may be forward-looking in nature and must be viewed in relation to the risk pertaining to our business. The Safe Harbor Clause indicated in our Investor Presentation also applies to this conference call. After the end of this call, in case you have any further questions, please feel free to get in touch with me. Now, I would like to hand over the call to Mr. Peter Bains. Over to you, sir.



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Peter Bains: Thank You, Sweta. Good Afternoon, Ladies and Gentlemen. Thank you for joining us this afternoon and may I first take the opportunity to wish you all a very happy new year. I would like to begin with an overview of Syngene's key financial and operational highlights for Q3 and then update on the nine months year-to-date Performance.

The headline is that Syngene's growth momentum continues and for Q3FY16 our revenues have grown by 23% on the comparable quarter last year to record Rs.281 crore. EBITDA has grown at 20% to record Rs.94 crore and 33% EBITDA margin while profit after tax has grown at 31% to deliver Rs.59 crore and 21% PAT margin. Looking at these results across the year-to-date period, we see Syngene's revenues growing at the rate of 26% and delivering nine-month at Rs.779 crore. EBITDA over the nine-month year-to-date period has grown at 25% to Rs.258 crore and the margin of 33% and on the nine-month basis profit after tax has grown 30% recording Rs.155 crore and PAT margin of 20%.

We are happy with this performance for the quarter and what it perhaps most pleasing is that we see that the growth is broad based and is coming from all three of Syngene's major verticals -- our Dedicated Centers, Discovery Services and Development and Manufacturing Services. In our Dedicated Centers, our growth has been underpinned by expansion of the services that we provide and there are integrated models. In the Discovery Services area we have had very strong traction in the Discovery Biology area in particular, which is in line with the growing interest of the Pharmaceutical and Biopharmaceutical sectors in Large Molecules and within the Development & Manufacturing Services, growth has been led by increasing supplies that we made to support multiple client program in our newly installed capacity.

We continue to maintain overall robust momentum. We have good visibility now for Q4 and are confident of delivering a strong performance for this first fiscal since our IPO last year. Just touching upon a few highlights before I open this to the floor to questions; during the quarter we cleared another US FDA audit inspection of our clinical development services and we cleared this with no 483s or major observations. I would add that this now brings our track record of FDA audits that we have undertaken to five in the last three years and we have cleared all five with no 483s or major observations.

Growth CAPEX investment program continues on track and our New Research Centre also known as the Syngene Research Centre is expected to become operational in the first quarter of fiscal '17 which center which support integrated as well as standalone discovery programs in chemistry and biology. Our additional growth CAPEX in Formulations and Biologics Manufacturing service platforms will come on stream in the course of the next 12 to 18-months.

I am also delighted to confirm our earlier announcement this month of the appointment of Mr. Jonathan Hunt, Syngene's CEO-Designate. Jonathan joins us with over 25-year track record of extensive experience in Global Biopharmaceutical and has a particular record in terms of leading strong operations and transformational change. Jonathan will obtain full responsibility at the

beginning of April this year after my retirement from my position as CEO. I will continue to serve Syngene, sitting on the board of the company as a non-executive director.

In summary, we see favorable tailwinds supporting Syngene's emergence as a leading Contract Research and Manufacturing Organization. These tailwinds include growth in the Global Biopharmaceutical and Life Science R&D spend, continued evolution of externalization of these funds into contract platforms like Syngene, strong traction regarding Syngene differentiated and integrated service model and the advantages of the Indian cost base. We are continuing to expand our capacities and extend our capabilities to leverage these prospects and are confident that we are on track for our fiscal year '18 revenue guidance of \$250 million and look forward to deliver the same value to our shareholders. I would now like to open the floor to questions.

Q & A Session

Moderator: Thank you very much, sir. Ladies and Gentlemen, we will now begin with the Question-and-Answer Session. The first question is from the line of Prakash Agarwal from Axis Capital. Please go ahead.

Prakash Agarwal: I have a question on the YoY growth - On the top line, we have seen 23% growth and at the same time we have also seen currency helping us. So could you share the constant currency growth for Syngene?

Peter Bains: Yes, Prakash, you are quite correct. The currency has contributed to the revenue line to the extent of 6%, so the underlying would be about 17%. What I think I would also add here that while it is good to look at Syngene's performance on a quarterly basis but perhaps we should look at it with a longer time view. I think that in the growth rate of 26% in revenue for nine-month period, there would be a 5% contribution of currency depreciation, so it would be 21% on a constant basis. That is more indicative of the underlying momentum we have in our business.

Prakash Agarwal: Secondly if I look at gross margins QoQ, it has come off by 100 bps. I would have assumed that if currency helps in revenues, gross margin automatically is also cushioned. So could you help us understand the QoQ dip in gross margins?

M.B. Chinappa: Prakash, Chini here. Of the 6% gain in currency, we lost about 3% in terms of hedging cost. So the inflow is impacted by the hedging cost which has brought down currency benefit for the margin.

Prakash Agarwal: Yes, but that will come under other expense, sir?

M.B. Chinappa: That is right, yes.



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Prakash Agarwal: So gross margins?

M.B. Chinappa: Net of material, power cost and staff cost, then our margin was 44% for this quarter versus 45% in the last year.

Prakash Agarwal: If currency helps us normally we have seen gross margins improving..

M.B. Chinappa: Yes, then it is the mix of the business that is having a play. I would suggest that you really look at it on YTD basis and there you will find there is 2% improvement in profitability.

Prakash Agarwal: This could be also due to higher contribution from manufacturing versus the last few quarters?

M.B. Chinappa: Yes, Manufacturing has contributed to the growth, but it has been an all-round growth across all the three verticals.

Prakash Agarwal: On the 4Q commentary that sir made, that we are looking forward for even better growth, just trying and understanding Jan to March quarter typically is a strong quarter for us because we get some orders from our anchor clients, is that right understanding?

Peter Bains: In the past that we have seen pretty robust fourth quarters. And as I said to answer your earlier question in terms of looking at the momentum of the business, it is best looked at on a nine-month basis and that is 26% of top line and that is a good indication of underlying momentum. As you know we are not going to give firm guidance on a year-end but we can see the underlying momentum pretty clearly in the nine months numbers.

Prakash Agarwal: Just trying to understand, as you rightly said, 4Q normally is a higher growth. So that is the trend that we should take into picture for future years as well?

Peter Bains: I can only answer that question in terms of where we sit at nine months. We will not give any guidance on the fourth quarter but the nine months here-to-date are a good indication of the underlying momentum.

Moderator: Thank you. The next question is from the line of Surya Patra from Phillip Capital. Please go ahead.

Surya Patra: Sir, is it possible to share what is the mix of revenue in terms of Dedicated Center, Discovery Services and Manufacturing, if not for the quarter, YTD?

M.B. Chinappa: 34% for the Dedicated Centers.



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Surya Patra: We have indicated something like broad-based growth in across three segments. What I believe is that possibly the Dedicated Center which is like FTE-based model and where large component would be BMS and that is to some extent almost at its peak level it is operating, so that would not be seeing the similar kind of growth rate like other segments, so it would be great if you can share like which segment has seen what kind of growth?

Peter Bains: I think it is difficult to give a direct answer to that question because the growth rates that we are seeing do move around a little bit from quarter-to-quarter. I think it is reasonable to say, that we have been seeing some very strong growth coming out of development in manufacturing services underpinned by the capacity that we installed in the last year. We are beginning to see those being taken up and we are getting some very strong momentum there, and in Discovery Services we are seeing very strong momentum in Biology Services aligned to market interest in Biology Services. The Dedicated Service Centers that we have tend to move in a slightly different way and they can step up and then occasionally they can slow down in their growth. So I think that there is a blend there but we cannot give QoQ guidance on that because that would not give you a good picture.

Surya Patra: At least on the Biologics Services front, I think in the opening remarks you have highlighted a lot many things. So, can you just give some sense why because till last year we were not having any significant kind of contribution from the Biologics Services front and now we are talking something on that front. So, at least some sense on that you can give us some visibility for the future also?

Peter Bains: I think in Biologics, as we have discussed, we have been building credentials, track record and undertaking work for clients would enable us to generate a set of credentials related to for example clinical supplies in the United States and in Europe. As we discussed before, we would expect to see our Biologics business begin to accelerate going forward as we build this track record of delivery and we see more customers looking to take up our services.

Surya Patra: How many clients that we have added so far for the Biologics Services?

Peter Bains: We do not disclose the number of clients in any particular vertical.

Surya Patra: We have talked about the new research center that a portion of the client capacity will be commissioning in the first quarter. So what is the total CAPEX that we have allocated for that R&D center and how progressively that would be capitalized going ahead?

M. B. Chinappa: It is about \$50 million for the Research Center and that we expect to commission in a modular fashion over the next two years – FY17 & FY18.

Surya Patra: Regards Manufacturing Services, last six months what is the kind of progress that we have seen in capacity creation?

Peter Bains: For the commercial manufacturing in Mangalore, as we discussed before, we have earmarked \$100 million to be spent over a period of next three years or so. We have acquired the land in Mangalore. Most of the rest of this fiscal year is being taken up in completing the regulatory, statutory requirements and clearances and we would expect to commence construction early fiscal '17 and then remaining on track to commission at the end of fiscal '18 or beginning fiscal '19.

Surya Patra: Can you update anything on that kind of commercial supply of the patented three molecules what we had indicated some time back on the Manufacturing Services front?

Peter Bains: Yes, we can give an update on that. We are very pleased to say that we have commenced commercial supplies to customers for two of the molecules in question. On the third one we have been advised that due to clinical trial results, the client is stopping progress of the molecule on that front, and hence the commercial contract that we signed in anticipation will no longer go forward. Out of the first three molecules that we were looking at to help us move from clinical to commercial supplies, two out of the three have gone through the development requirements successfully and have now moved into commercial supply and one has not. So about two-third success there and one-third failure. If we take a step back that is a pretty good indicator of the global success rate at Phase-3 trials. So I think it is a good indicator of the sort of success rate that we can expect going forward. We are very comfortable that two of them have now made into market and we have begun supplies.

Surya Patra: So whether we have already seen the launch quantity supply in the last quarter or we will be seeing for those?

Peter Bains: Yes, we are seeing them and currently these supplies are fairly modest and we have no visibility really of how those molecules will perform in the market.

Moderator: Thank you. The next question is from the line of Ujwal Shah from Quest Investments. Please go ahead.

Ujwal Shah: I just wanted a few clarifications in terms of the commercial manufacturing part. So is it that the Mangalore facility would be only catering to patented products or at some point of time just to fill the capacities for a certain period of time we might look at generic products as well?

Peter Bains: I will take a step back here; a vast majority of the work that Syngene undertakes is for New Chemical Entities and we have been working on the pipeline of molecules for a significant number of clients as they go through process R&D, pre-clinical and then into clinical. Our anticipation is that the move into Mangalore will be led by some of these NCEs. Having said that, we will not exclude the opportunity if it should arise to also utilize capacities for potentially generic products.

Ujwal Shah: But in that case, we might have to forego some of the margins because usually generic program contract manufacturing does entail lower margins as compared to NCE?



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Peter Bains: Yes as I said, I think our anticipation is that as our pipeline is filled with NCEs, they would naturally flow through into Mangalore very consistently with the model that we have described. So I think we will be looking to transfer the NCEs, should they make it through the clinical and regulatory into Mangalore and it will be largely an NCE facility.

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

Abdul Puranwala: Sir, I just wanted to know that is there any client contract due in the next 6-months?

Peter Bains: We cannot give any comment on that.

Abdul Puranwala: Why I basically ask this question is that I see a huge drop in the other current liabilities. So I think this is the place where we record advances from the customer as well as the deferred revenues. Can you explain the reason why there was a certain drop in this particular item?

M.B. Chinappa: We received this money in Jan 2015 and that money gets recognized as revenue over each quarter. So you see a big drop from the March '15 quarter to the December '15 quarter and then the money comes back on your books in the March '16 quarter. We received upfront payments in Jan 2016 which will show up in the March balance sheet. So if you compare March-to-March you would not see the dip, but if you compare March to any of the other quarters, you will see a dip.

Abdul Puranwala: The second question was regarding the dip in the cash balances. So was that cash being used for what purpose?

M.B. Chinappa: We have gone from a positive cash balance to negative; we are now Rs.(-105) crore which is the net borrowing and that outflow is largely due to the ongoing CAPEX programs. For the nine-month we have spent Rs.250 crore roughly on CAPEX and expect to end the year with upward another Rs.50 crore totaling to Rs.300 crore for FY16.

Moderator: Thank you. The next question is from the line of Nitin Gosar from Religare Invesco. Please go ahead.

Nitin Gosar: Sir, just wanted to understand the development that is happening in terms of the new CEO coming on with over 25-years in the Biopharmaceuticals. So predominantly, we are indicating that going forward trajectory within this company would be moving towards more of Biopharma vis-à-vis the current chemical entity?

Peter Bains: I think Jonathan's background is in Biopharmaceuticals and that includes comprehensive spread of small molecules as well as large molecules. I think that the strategic framework that Syngene has established in the last 5-years is very much going to be the framework going forward.

Moderator: Thank you. The next question is from the line of Nitin Gandhi from KIFS Securities. Please go ahead.

Nitin Gandhi: There was some guidance that you continue to maintain certain revenue over some period. Can you just reiterate that for me?

Peter Bains: The guidance that we have given is a mid-point of reference is Syngene would deliver \$250 million in fiscal '18 and we remain firmly committed to that.

Moderator: Thank you. The next question is from the line of Harith Ahmed from Spark Capital. Please go ahead.

Harith Ahmed: I just wanted to know the about two molecules for which you have recently started commercial supplies. These would be APIs or is it some key intermediate that you are supplying for these?

Peter Bains: These are intermediates.

Harith Ahmed: On the client addition front, you have disclosed a total number of around 220 clients in March. So, what would that number be as of December?

Peter Bains: Again, we do not give client number updates on a quarterly basis. We will look at that again at the year-end.

Harith Ahmed: On the CAPEX front, I see gross block increase of around Rs.250 crore in the nine months this year. So, can you give some color on what that has gone into?

M.B. Chinappa: We have got three or four large projects underway; one is of course the Mangalore facility to which we have paid money towards the land, that is about \$10 million, then we have invested in the New Research Center which is going to be commissioned next calendar quarter and we have initiated the two other programs which is a Formulations development facility and the Biologics manufacturing plant. So these four projects take a bulk of the CAPEX spend and some amount of expenditure towards the expansion of manufacturing capacities in Bangalore.

Harith Ahmed: Except Mangalore, the ones you mentioned, are they already commissioned or they are yet to come through?

M.B. Chinappa: The Research Center will go up in a modular fashion; Phase-1 will be commissioned in the first quarter of next financial year that is April to June 2016. We expect to complete the Formulations facility by the end of next fiscal and Biologics facility in the first quarter of FY18.

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

Charulata Gaidhani: My question is how much is Discovery Biology as a percentage of sale?

Peter Bains: We do not disclose that level of segmentation; suffice to say as I said in my opening remarks, Discovery Biology has been growing very robustly and it has been doing so for the last two years.

Charulata Gaidhani: How much is the contribution from top ten clients to revenue as a percentage?

M.B. Chinappa: These numbers we tend to report on an annual basis because on a quarterly basis there will be a swing factor, it is best to look at it, but there has been no significant change to the number that we have reported; it was 70% as of end of last year.

Charulata Gaidhani: What is the frequency of your client addition? The numbers that are there; 221 clients, they are pertaining to FY15. So, how often do clients get added?

Peter Bains: Client additions on an ongoing basis, we are continually meeting new clients and we are continually engaged with new clients and as I have said earlier, we look at that on an annualized basis and we will update you then. But the process is spread out pretty evenly over a year, it is not seasonal or anything like that we are continually looking to add clients when they join us on a continuing basis.

Charulata Gaidhani: Then I also wanted to check whether you are facing any impact of consolidation of the Pharma sector on a global basis?

Peter Bains: No, we have not seen any impact to our momentum on that front at all. We have delivered robust and consistent growth over the last 5-years; and in the last 5-years we have seen significant consolidation and from Syngene line of sight, that tends to sort of balance out with, there are areas where it could be some form of exposure to it, but there are others work have been advantage and I think the past is a good indicator of the fact that Syngene's business model is robust and consolidation in the customer market does not have any effect on our underlying momentum.

Moderator: Thank you. The next question is a follow up question from the line of Prakash Agarwal from Axis Capital. Please go ahead.

Prakash Agarwal: Sir, just trying and understanding this Discovery Services Unit of 200,000 sq. ft., of which you mentioned 50,000 sq. ft. would be on line starting 1Q. Did I also hear that it would be spread across two years in terms of total completion?



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M.B. Chinappa: Yes, the entire 200,000 sq. ft. We will look to commission in FY17 and FY18. It will be commissioned in a modular fashion, one floor at a time.

Prakash Agarwal: So the thought process here is once we have reasonable client orders in place and then we build it out or why this such staggered manner if I am not wrong, the plan was to get it operational in fiscal '17 itself?

M.B. Chinappa: The way it will work is that 50,000 sq. ft. will provide room for expansion of our discovery biology Services, then the Chemistry Services we come up on the first floor, then the other two floors will be fitted out based on the traction that we are seeing or integrated services. So the short answer is yes, based on clients demand we will look to fit out the top two floors; the first two floors which has come up in the next 6 months.

Prakash Agarwal: For which we have enough client order visibility?

M.B. Chinappa: There is good visibility...

Prakash Agarwal: Is there a FOREX loss for the quarter? Are there any old FOREX in options or futures still there?

M.B. Chinappa: The hedging cost for this quarter was Rs.7 crore which is under 'other expenses'.

Prakash Agarwal: Are there any other FOREX cover left?

M.B. Chinappa: Yes, actually we have got quite a substantial hedge. We have hedged all of FY17 projected revenue and about 50% to 70% of FY18 and all a long-term fixed price contract. Now, these are hedged with 'put option' contracts. So we have a floor rate protection. Looking at recent rupee depreciation, most hedges for the next 2 quarters are lower than the current market rate.

Prakash Agarwal: That attributes to this Rs.7 crore?

M.B. Chinappa: For this Q3 net of premium we were hedged at Rs.63 and rupee came in towards Rs.66. That Rs.3 difference translates to the Rs.7 crore loss.

Prakash Agarwal: Top line we continue to book at Rs.66-67 and whatever is the hedging loss is covered under other expenses as Rs.7 crore?

M.B. Chinappa: Yes, that is right.



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Prakash Agarwal: You said fiscal '17 we are fully covered, right?

M.B. Chinappa: We are fully covered and our hedge rate is kind of lowered in the current market rate but too much higher than 63.

Prakash Agarwal: So hedge rate is little lower than the current market rate you said?

M.B. Chinappa: Hedge rate, net of the FOREX premium is in Rs.66-67 range.

Prakash Agarwal: For fiscal'18 you said we are covered till 50-70% of our potential revenues and obviously the rates would be higher here, right?

Peter Bains: Yes, that is closer to 70%.

Moderator: Thank you. The next question is from the line of Nirag Shah from Exemplar Investments. Please go ahead.

Nirag Shah: My question was regarding the two molecules for which supplies have started. Basically wanted to understand how many suppliers are there in such initial phase of such molecules? Second, with our existing capacities, are we equipped to supply increasing quantities of such molecules?

Peter Bains: We think that we are well positioned with existing capacities to continue to supply. The supply strategy that our customers are adopting is to have at least dual sourcing of these molecules and we are one of the suppliers there.

Nirag Shah: Such a two-supplier arrangement last for how long as per your experience?

Peter Bains: That is up to the customers but this is a very sort of typical arrangement than just instead of risk mitigation of supply sources to use a dual source supply strategy.

Moderator: Thank you very much. As there are no further questions, I now hand the conference over to Ms. Sweta Pachlangiya for closing remarks. Over to you.

Sweta Pachlangiya: Thank you everybody for joining us on today's conference call. I hope we have addressed all your immediate queries. In case there are any follow up questions please get in touch with me. In the meanwhile, we look forward to hosting you again at the next investor call. Good Evening.



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Moderator: Thank you. Ladies and Gentlemen, on behalf of Syngene International that concludes today's conference call. Thank you all for joining us and you may disconnect your lines now.

Note: This document has been edited to improve readability