"Eris Life Sciences Q3 FY19 Results Conference Call"

January 29, 2019

MANAGEMENT:	**MR. AMIT BAKSHI – CHAIRMAN & MANAGING DIRECTOR, ERIS LIFESCIENCES**
	MR. SACHIN SHAH – CFO, ERIS LIFESCIENCES
MODERATOR:	**MR. PRAKASH AGARWAL – ANALYST, AXIS CAPITAL LIMITED**

Moderator: Ladies and gentlemen, good day and welcome to the Eris Lifesciences Q3 FY19 Earnings Conference Call hosted by Axis Capital Limited. 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 '*' and then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Prakash Agarwal from Axis Capital. Thank you and over to you, sir.

Prakash Agarwal: Thanks. I welcome you all on behalf of Axis Capital for the Q3 FY19 Eris Lifesciences conference call represented by the senior management team. Over to you, sir.

Amit Bakshi: Thanks once again for all of you are getting on the call. I will quickly start with the numbers and since this is the first 12 months when we had acquired Strides, so we thought it would be useful to give some amount of colour on how things have shaped up over the period of time. So the headline numbers which we have put up is the total revenue of 252 crores, sales of 249 crores within EBITDA of 93 crores and growth of around almost 21% and PAT of around 80 crores vis-à-vis 75 crores of last year. EBITDA as I said 93.5 crores compared to 81 crores, around 15%-16% growth in EBITDA.

Now, here I would like to break these numbers and so that we are able to get a better colour. So the base business without Strides and the subsidiaries in the third quarter has grown by 15.7%, roughly 16% and Strides for the third quarter had an average of 14 crores a month. The base business in the third quarter has grown by 16% and Strides has a run rate of 42 crores and both these businesses put together are hitting an EBITDA margin of 40% which are there in the standalone business. So, the standalone business**,** we are hitting an EBITDA of close to 39% specifically. Also, at the subsidiary level, Aprica has grown by around 19%-20% and Kinedex for the third quarter has degrown by almost 30%. So these are the numbers. We can take the call now.

Moderator: Thank you very much. We will now begin with the question and answer session. The first question is from the line of Rashmi Sancheti from Anand Rathi. Please go ahead.

Rashmi Sancheti: Just wanted to know that all your other businesses are growing, so what kind of challenges have we seen in the Kinedex portfolio and what are the strategies that we are taking to overcome such kind of degrowth. Also, second question is related to other income. This time it is pretty high during the quarter. So if you can just give the breakup or you can let us know why it is high?

Amit Bakshi: So the second part will be answered by Sachin*-our CFO. The first part, I will answer. So Kinedex specifically for this quarter has not done well and we had more of some inventory issues and that is how there was some realignment in the portfolio and there were some products which we had to readjust ourselves with the FSSI guidelines. So that is where we got some disruption. It is not as bad as it looks in this quarter, but in the coming quarter this will do well. Having said that, we have not done what we thought of achieving in Kinedex. I think it is one more quarter that it starts reflecting the kind of growth which we expect. And regarding other income, Sachin is going to tell.

Sachin Shah: Rashmi, the other income basically we do mark-to-market on the treasury. So this time there was a benchmark rate upswing in this quarter that has impacted on the entire portfolio. So basically the last quarter before this was a lower one and the entire impact of the upswing is on this quarter. So that is the effect of the rate going up.

Rashmi Sancheti: Sir, if you can say how much growth has been witnessed in Kinedex portfolio during 9 months. I think that would give the better picture.

Sachin Shah: Yes, you are right. So 9 months period Kinedex has degrown by 18%.

Moderator: Thank you very much The next question is from Anubhav Aggarwal from Credit Suisse. Please go ahead.

Anubhav Aggarwal: Just trying to understand Amit bhai this disclosure you had given, 42 crores Strides. So if I take the standalone numbers, you reported 231 crores subtract 42 crores of Strides from there, does the way to get the core business right , which gives almost like 189 crores as the core business sales and which you said has grown by 15.6%. If I apply that, then the last year number comes out to be 163-164 crores whereas the reported number last year was 182 crores.

Amit Bakshi: So there is one caveat that last year we had Strides in December, we billed for the first time in the first week of December and then again at the end of December. So that is the caveat. While everything remains the same, all the difference is coming from Strides.

Anubhav Aggarwal: So the maths suggests let take your number, so what Strides like as high as 18-20 crores in the base quarter?

Amit Bakshi: Yes.

Anubhav Aggarwal: So that 18-20 crores has gone to 42 crores right now, so, but do not you think that is a very high number because that was only 2 weeks or 3 weeks of sales?

Amit Bakshi: No, Anubhav, we had shifted this to our own stockist term. So we actually took away a limited number of stockists from them and this was given to our own stockist. So that was the one time flushing for availability across our chain.

Anubhav Aggarwal: So 18-20 crores was the number, I understood. And some more clarity, when the base business had grown above 15%-16%, how was the cardiac, can you just split this rough numbers for cardiac and diabetes portfolio, how they have done?

Amit Bakshi: I can give you a rough number. Cardiac, diabetes has overgrown actually. So if you look at the presentation, there we have AICD numbers. So AICD numbers clearly suggest that Eris and Strides which are around 93% of the entire numbers have grown by (+15%) and the acute business which is Kinedex and some other acute has not done as well. So cardio-diabeto has clearly been on the higher side.

Anubhav Aggarwal: So when you say total margin is now 39% which you have reported on standalone, so before we acquired Strides, the core portfolio margin was about 41%. So Strides have already close to 37 or 35% plus margin trajectory now.

Amit Bakshi: Yes, precisely because all put together ,it is 39%, so it is very logical.

Anubhav Aggarwal: And just one clarity, you have added about 85 reps in this quarter, which divisions have they gone about, some details there will be useful.

Amit Bakshi: Anubhav, look, it will be difficult because there are vacancies also happened. So at a 2000 level, if you take some 20-25% attrition, so their vacancy happens and that is not timed as per the quarter. We take once in a quarter or anytime have a recruitment drive, so that changes, but largely if you ask me which business they have gone. So I can pinpoint one business where we have taken people that is the nutrition business which has just kind of taken on, but that number is only 25-30.

Anubhav Aggarwal: No, it ties up because FY18 closing, we had 1917 reps, the addition of another 20-25 by 2020 so it is largely okay. Just last clarity from Sachin is that the standalone number, the depreciation has been going up each quarter, it was 6 crores in the first quarter, 7 crores in second and 8.5 crores now.

Sachin Shah: Yes. Depreciation is given more capitalization this time. Every time we have assets which we capitalize on a quarter-on-quarter basis, so that impact the depreciation. So this time the more contribution was from software and all these things that we have bought into , that we have capitalized.

Anubhav Aggarwal: These are the tangibles because we have not added anything on the fixed asset side.

Sachin Shah: Nothing on the plant side as of this moment and if you see last year to this year, major impact is because of the Strides portfolio being depreciated. Last time, it was only one month. This time, it is 3 months.

Moderator: Thank you very much The next question is from Aditya Khemka from DSP Mutual Fund. Please go ahead.

Aditya Khemka: Just a couple of questions. Can you break up the growth in the Eris legacy portfolio, the 15.6% you mentioned. Can you split it between volume growth, new product introductions and price growth?

Amit Bakshi: We have not done that, Aditya. So I can say that largely there is not much of a new product or a price hike. So you can consider that largely it is a volume growth.

Aditya Khemka: So therein lies the worry, Amit sir**,** because and correct me if I am wrong, but is the scope for introducing new products materially declining given the situation in the market where there are very few newer products now getting launched globally and therefore the opportunity to introduce new products is fewer for companies like us which are focused more on certain therapy areas.

Amit Bakshi: Aditya, largely this has been the case for quite some time, the global pipeline had not been as robust as it used to be, but for people like us who have a market share of 1%, there is never a dearth of adding a new product. It is very strategic that, what can we do and how much can we digest and what can we make bigger. And as I have said that if you remember, our portfolio still largely remains in the growth area. I do not have the latest figure, but I am quite sure that more than 70% of the portfolio would be in the growth area. So in that case the challenge for us of seeking growth from new product is really not very high. So that is the reason we are little choosy and strategy when it comes to new product. So at a very broad level what you are saying is right, but is it pinching us today, the answer is no.

Aditya Khemka: And when you say growth area, you mean largely cardio-diabeto or there is any…

Amit Bakshi: I say that all my portfolio is still very largely on the growth side.

Aditya Khemka: Which is again the two segments of cardio and diabeto.

Amit Bakshi: So the cardio-diabeto and these vitamins, they are more than 75%. So**,** largely these are all in the growth areas.

Aditya Khemka: On this Medtronic tie-up, so seems very interesting to me in terms of Medtronic is a largest device maker globally and they have this continuous glucose monitoring system which you have sort of..so what is the structure of the transaction. So they would give you the distributor fee for the Indian market, you would install the products in clinics and hospitals and therefore get the doctor to prescribe Eris drugs. Where does the synergy really lie in that?

Amit Bakshi: So one must not view in that fashion, so this is the technology which has just come in. We think it is a great technology and it will help a large number of patients to really achieve their targets and understand their disease better and fortunately when we are speaking, I have put the guardian on myself and I am just going through how sugar behaves during the day. But that's besides the point. The idea is that we would like this to be a revenue model, but that will happen over a period of time. Right now, we are just testing the product. We are just making sure that there is enough experience on the ground and once that phase is over, then we would like to commercialize this. So that is the broad idea.

Aditya Khemka: So basically you are the in-licensee/distributor for Medtronic in India?

Amit Bakshi Yes, you are right.

Aditya Khemka: And the contract/agreement is only for this CGM product for now, can it expand to further Medtronic products in the future or is it just for one product?

Amit Bakshi: No, right now it stands for one product, so one mother product. So we have one more kind of CGM in this, but if we do well, yes it could expand. If we really bring that value in the table, it could expand and that is what we will like to happen.

Aditya Khemka: What is the sort of economic so do you get like a royalty on sales, 5%, 10%, 20% or do you get a profit share post distribution cost, how is the economic structure?

Amit Bakshi: It is very simple, we buy it at a cost as a distributor would buy and then sell and make whatever money we can.

Aditya Khemka: So in the pharma business, the distributors make only 10%, right. So is that a fair number to be?

Amit Bakshi: It is a principal to principal arrangement. It is not being distributed from the sense you are coming from. All the margins will be kept by us. So it is more of a B2B kind of a thing.

Aditya Khemka: But we are not disclosing the exact margin, we will make on the sales?

Amit Bakshi: We have not started selling it, Aditya. Maybe, April to June first quarter is something when we will test the market, that is the time when I will give you a colour on that.

Aditya Khemka: What is the local competitor landscape for the Guardian Connect device in India? So in my experience I have not seen anything in the hospitals or nursing homes**,** which would do a CGM for the patient. So is there any other product already available on the market which you would be competing with or is it the first to be launched in India?

Amit Bakshi: This kind is the first globally wherein you get your sugars on your phone all the time. So it directly speaks to your phone and it measures the blood sugar from the intrathecal liquid and you can see it at all the times. So this per_se is a new thing which has no competition, but this if you talk about this domain of continuous glucose monitoring, yes, there are **a** couple of products in India who are into this domain.

Aditya Khemka: Any idea of the market size Amit sir of those two products which currently are selling in India, what is the sales of those products?

Amit Bakshi: We have not tried that, but while we were in the meeting with Medtronic, it seems**,** and I may stand corrected on this, but it seems that globally this is now close to $2-$3 billion. So it caught up big time in developed countries.

Aditya Khemka: Yeah, I can understand that . I was just trying to assess…

Amit Bakshi: In India, I do not have any data.

Aditya Khemka: And recently we had this shareholder resolution where we changed the articles of association for medical device distribution and there were other business lines also included in articles of association. So the Medtronic agreement clearly sort of goes through the medical device distribution line included in the articles of association, but there were other business items also mentioned, there are other sort of businesses. So could you talk about what other allied businesses are you venturing into or exploring when it comes into this healthcare business?

Amit Bakshi: I remember I told you that there is another company which sells the most validated blood pressure monitors in the world, it is called Microlife. We have had an agreement in Microlife also and we are in the process of setting up the field force and the commercial launch of blood pressure meters because we think that the blood pressure meter is far bigger market than a blood glucose meter, but unfortunately enough work has not been done in the country because people suffering from hypertension are much more than people suffering from diabetes. Just for a reference point and there was an absence of a blood pressure device which was very well validated. Today, I am very happy that we have a blood pressure device which is the most validated device in the world and that is what we are going to launch very soon.

Aditya Khemka: And Amit sir, just your perspective on the upcoming NLEM. So correct me if I am wrong, but earlier when we had discussed, you had said that if all your major larger products were to come under NLEM, the potential impact could be 22 crores on the EBITDA. Has that number changed? If yes, what is the new number there?

Amit Bakshi: What is the new thing?. I have not seen the new thing, what are you referring to?

Aditya Khemka: No, I am referring that in 2020 we might get a new NLEM coming to the market and there would be new drugs probably included in the NLEM and price controlled. So I am just asking from Eris perspective. You had mentioned earlier that..

Amit Bakshi: Yeah, I maintained the same thing. Nothing has changed as of now. I had said this we have done with Strides internally that if everything comes in, what will be the impact. So that is where you are. Nothing changes there.

Aditya Khemka: The 22 crore number is still unchanged?

Amit Bakshi: Roughly.

Aditya Khemka: And your thoughts on what is happening on the regulatory side in India. So if I am not mistaken, again the ministry has recently formed a committee which will do the price regulation of drugs regardless of whether those drugs are a part of NLEM or not and NPPA basically stands stripped of its powers. Would you view this as a positive development given that NPPA was hyperactive earlier or would you view this as a negative development because now the subcommittee or this committee is allowed to regulate almost any drug price regardless of whether this is in NLEM or not?

Amit Bakshi: So Aditya, look, there has been some disruption from the last couple of years. For example even in the last quarter, our base sale, which grew by 16% could have grown slightly more or substantially more, but we had one triple drug combination which came into ban a quarterback. So that had an impact on this quarter. So there had been some or other things which have been, but every time these are things which are making us better from a regulatory standpoint. I think a good sense is prevailing across and whatever has been done, NLEM formula as such is a fair formula and things like this are welcomed by the industry and I think the whole industry has made this point quite clear.

Aditya Khemka: And last question from my side, Amit sir. On the new list of FDCs, 900 odd product list if I am not wrong, what is the exposure that we have to the new list. I do not know whether the new list will be acted upon it etc. but just from a perspective of potential risk from the new list.

Amit Bakshi: So I had checked with my regulatory guys. Prima facie, they said that we are not impacted, but the detail exercise has not yet been done because we are unsure. But we will take that exercise and then will give you a more clear answer next time.

Moderator: Thank you . The next question is from Mr. Prakash Agarwal from Axis Capital. Please go ahead.

Prakash Agarwal: Just the question on growth in the chronic business. Last time we spoke that we being challengers and the market not seeing enough growth, we are getting impacted. So Q3, we had seen some growth coming back. Just wanted to have some sense on **(of)**the outlook for the calendar 19.

Amit Bakshi: So Prakash, look the market has stayed between 9%-10% throughout, but there has been instances where the chronic has grown by 13%, 14%, 15% also. So typically because we represent more of diabetes and hypertension, the growth there has come back, but the overall numbers have not really been impacted because once chronic climbs up, the acute has shrinked a bit. So that is how it is playing out at this point of time, but if you look at my market, these are headline numbers, the 9% growth is a headline number. But if you get close to my market, my market more from a chronic side has overgrown, has outperformed the broader market. So that is why the sales have come back, the markets have opened up.

Prakash Agarwal: I understand that. As a data point, I was giving that reference, but I am looking more from an outlook,**,** perspective, do we see this, 250 crores of base and then 15% plus growth in the calendar year?

Amit Bakshi: At this point of time, I think there is nothing which takes away the growth because these are chronic growth. Once they tick in, they generally make a trend upward. So even if you look at external data, you will find that month on month it has formed an upward trend and generally speaking, these trends do continue in chronic therapies.

Prakash Agarwal: And secondly on other expenses, normally 3Q is softer in terms of expenses as seen by most companies. Now, we have this nutrition launch and other launches also planned. So these other expenses would be at similar levels or this would go on line or greater than in line with the revenue growth going forward?

Amit Bakshi: So we work on our budgets. We have budget for everything. Till the end of third quarter, we are meagrely 2% more than what we had planned for this year which we will kind of curtail. But reference to the last year is little difficult because I have maintained that last year the disruptions were so high that we thought it is better to hold back till the time we settle down at the ground. So that is the reason the last year reference might look little sparkling, but otherwise this is more or less the trend.

Prakash Agarwal: And lastly on the new introduction nutrition, so which is an initiative to own the therapy across and get connected to the doctors as well as unique selling proposition to the doctors and the patients. So what other key therapy areas which we could be venturing into apart from the key ones that you said cardio, diabeto and CNS. Preparation is part of I would say an extended of diabetes and cardio, but any other key therapies we are aiming at?

Amit Bakshi: So we have also started IVF and that is one therapy**,** which is quite voluminous where we think we will be able to add volumes and as I told Aditya that we will be launching blood pressure monitors, the devices, that will also happen soon and end of the day, that is a cosmetology part. So we have signed the MoU and we hope the goodwill arrive in India by the end of March or April. So these are three businesses which we will take off, but these three businesses are not going to be large field force, they will all be restrained between 25 to 40 people and that is through a very super specialty metro kind of an approach.

Moderator: Thank you very much The next question is from Rashmi Sancheti from Anand Rathi. Please go ahead.

Rashmi Sancheti: Sir, if you can explain related to Aprica and Kinedex portfolio, what kind of margins are we making here and especially during 9 months if you can give and also gross debt and cash on books?

Amit Bakshi: Aprica is approximately 20% margin and Kinedex is approximately 8% to 10% EBITDA margin. This is the ballpark figure and I think the net debt positive is 72 crores as of today.

Rashmi Sancheti: Net debt you said?

Amit Bakshi: Positive net debt is 72 crores. As of today, we had 22-25 crores of debt as of 31st December, we have paid 25 more after December and January. So we have a debt as of today of 200 crores. We are net cash positive by 73 crores.

Moderator: Thank you very much The next question is from the line of Ashish Thakker from Motilal Ostwal Asset Management. Please go ahead.

Ashish Thakker: So the last quarter we were expecting a sequential improvement in EBITDA, but there have been some slippages to that extent because if I go to see the Q-on-Q EBITDA, it is lower this quarter. So what is our view going forward? Can we expect a sequential improvement in EBITDA going forward?

Amit Bakshi: Ashish, typically it is relative to the quarter. Typically, the third quarter is full of festivals and holidays. So that is the time when the inventory level typically falls. We have Dussehra, Diwali, Onam and all these festivals. So if you typically have a look, third quarter is generally soft from that side and once you get over that, then everything normalizes.

Ashish Thakker: So, since fourth quarter is also mostly softer for all the pharma companies, the sense is that quarter one FY20 should see a better sales run rate. Is that the right understanding?

Amit Bakshi: Absolutely.

Ashish Thakker: And when can we see most of the products be taken inhouse at Guwahati? And can there be a substantial delta on the gross margin?

Amit Bakshi: So that is a very intelligent question, Ashish. We are kicking off that in the next one month. We are starting the whole thing. We are kicking off the process in the next one month. We feel that 2-3 quarters will be the time when our additional capacities will be ready. So that is the time when the whole delta will start kicking in.

Ashish Thakker: So even from current gross margins what we are reporting, there should be an improvement.

Amit Bakshi: There can be improvement, but from the tax rate point of view, it will be more efficient.

Moderator: Thank you very much The next question is from Aditya Khemka from DSP Mutual Fund. Please go ahead.

Aditya Khemka: Firstly, what is our current NLEM portfolio, what percentage of sales?

Amit Bakshi: Less than 10%.

Aditya Khemka: And secondly, you mentioned Amit that prices are not a major component of our growth that we are reporting, but when you speak to other pharma companies given the inflation in raw material prices from China, given the limited scope of increasing prices in NLEM, most of the companies tell us that they are taking significant price increases in the non-NLEM portfolio. Are they significant meaning less than 10%, but in the range of let us say 5, 8, 10% product to product. So what is your thought process on that? Are we taking that or are we not taking it, why not? Could you explain that?

Amit Bakshi: So Aditya, look while the reality is that it is WPI based and it can be taken like that, but the bigger reality on the ground is the competition. So competition is more potent in price decision than the available headroom. So it depends upon brand to brand, how do you figure it out, which lap you are already in and that is the process which almost everybody would be following. So you do not want to become less competitive at any point of time. So it happens from brand to brand, market to market consideration.

Aditya Khemka: And what is your current utilization at Guwahati and you mentioned that in 2-3 quarters the capacity will be ready, what do you mean by that?

Amit Bakshi: Right now, it is 60% and additionally we had told you in last time that they are thinking of commissioning incremental facilities for the Strides portfolio to get in because there was a leverage there and that is the process which we are now starting in.

Moderator: Thank you very much. As there are no further questions, I would like to hand the conference back to the management team for closing comments.

Amit Bakshi: Thank you for taking out time and I hope we have answered everything. The presentation is already up for you guys to see. If there is anything, we will be available offline. Thank you and have a good evening.

Moderator: Thank you . On behalf of Axis Capital that concludes the conference. Thank you for joining us. Ladies and gentlemen, you may now disconnect the lines.