"Strides Arcolab Limited Q2 CY13 Earnings Conference Call"

July 25, 2013

MANAGEMENT: **MR. ARUN KUMAR – VICE CHAIRMAN AND MANAGING DIRECTOR, STRIDES ARCOLAB LIMITED.**
DR. T. S. RANGAN – GROUP CFO
MODERATOR: **MR. NITIN AGARWAL – ANALYST, IDFC SECURITIES**

Moderator Ladies and gentlemen good day and welcome to the Q2 CY13 Earnings Conference Call of Strides Arcolab Limited hosted by IDFC Securities. 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 this conference call, please signal an operator by pressing "*" followed by "0" on your touch tone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Nitin Agarwal from IDFC Securities. Thank you and over to you sir.

Nitin Agarwal Good afternoon everyone and a very warm welcome to Stride Arcolab's Q2 CY13 Post Results Conference Call hosted by IDFC securities. On the call today we have representing Strides Arcolab Management, Mr. Arun Kumar – Vice-chairman and Managing Director and Dr. TS Rangan – Group CFO. The call would be about 40 to 45 min duration and the management will predominantly like to take questions around the pharmaceutical business as well as FIPB process. I hand over the call to Arun to take it forward from here on.

Arun Kumar Thank you Nitin and to IDFC for hosting us as always and appreciate everybody joining in for today's call. Along with me is Dr. Rangan, our Group CFO who will support me in this call as we go on. So today like Nitin in his introduction mentioned we will be focusing predominantly on our retained pharmaceutical business, our Q2 numbers related to that, we will obviously touch upon the FIPB process and the transaction process of the Agila Mylan announcements and we would also reiterate the company's position on the FDA inspections that we had recently and will also take questions around that. Just that everybody participating are aware the management is opted to report standalone financials, which captures the pharmaceutical business, the Global pharmaceutical business. The Agila business is in transition consequent of the sale of the business to Mylan and we will not be discussing the Agila business in this call as we have not in the previous conversations.

Coming to our H1 and Q2 performances – We did have a good quarter in our global pharmaceutical business, it is an in-guided performance both in terms of revenues and in terms of EBITDA. Just to remind listeners that our guidance was for revenues of Rs. 1000 crores and about Rs.200 crores of EBITDA which is approximately . $190 million and $37 million for those who would like US dollar conversion when we guided. Although we have reported today a standalone numbers related to the Indian operations, the pharmaceutical business that we report is consolidated and includes our businesses that operate in Africa, in UK and in Italy. So to touch upon those numbers, the consolidated revenues were Rs. 464 crores which is about 46% of the guided number in terms of revenue and in the first half and EBITDA shared about 50% at an Rs.101 crores. Q2 was particularly impacted with the exchange loss of about Rs.15 crores, adjusted for this we are at about Rs. 116 crores that is a little more 55%- 58% of our guided EBITDA number. Irrespective of the exchange loss, the company is very confident of meeting its guided EBITDA of Rs.200 crores and Rs.1000 crores of revenues for the remaining part of the year consequent to a significant product approval that the company recently received. I will also touch upon the EBITDA impact on exchange here for a minute, it is

because the significant depreciation of the rupee was effective only for one month of the first half whereas all the liabilities were translated at the full exchange rate at the end of the year as it is required from an accounting practice. As the consequence the benefits of exchange gain on our export business will accrue to us in the coming months and obviously we will be able to reverse this exchange loss in the next quarters and that therefore it is the temporary situation but even without that we are halfway through the guided margins. The consolidated pharma EBITDA grew by 30% and it is tracking very well with good revenues coming in from key new markets that we are operating. Most important was the much awaited WHO prequalification of Artemether and Lumifantrine product otherwise called AL during the quarter and we have already commenced receiving businesses around this product and we can see further uptake in product in the coming quarters. We still await some significant approvals of key assets of US markets, generally the US approval processes has slowed down but we're still hopeful that we will receive at least two if not three approvals during H2 of this year. Having said that should these approvals come in there would be a further upswing in our EBITDA numbers but they are still very confident of hitting a guided numbers irrespective.

A few words on a biotech business, this is shaping quite well. Our new R&D center being built in Bangalore while we operate from our older centre which was acquired. We are now in the design phase of our customized biotech facility in the bio-xcell ecosystem in Malaysia and the groundbreaking is scheduled in Q4 2013 in line for first commercial productions in early 2015 as guided earlier.

Coming to other key points that have got the attention of many investors, is obviously the status update on the Agila Mylan transaction. There are three critical approvals that are required for us to have a successful closing of this transaction which was guided to occur end September early Q4 2013. The two of them were related to Indian agencies, one was the Competition Commission for which we received approval on 20th June 2013. The second one was the FIBP approval where I will touch upon and the third one was the FTC approvals from the US. We believe the FTC approvals are on track for an approval process to be in place very soon. Coming to FIPB, the matter was taken up on the July 5th meeting. We have yet not received any formal communication, we or Mylan for that matter there is formal communication on the outcome. There has been a lot of speculation and a lot of press that has been written about the outcome which says that proposal was deferred. Our understanding of the matter in our conversations with concerned officials and concerned people was that the FIPB did take up our matter. They had a favorable view of our application. However, they are awaiting clarity out of the new policies that are expected out of the DIPP which is part of the Ministry of Commerce. Since the DIPP concerns are for companies which have got significant Indian presence, we believe that even if there is a policy that is expected to be out soon that we will be very compliant from that perspective and we do not anticipate any major delays on the FIPB front and we believe that our previously guided timelines of a September closing is intact. We have not heard anything contrary to that and as and when we get update we will inform our investors through communications.

And now come to the final point before I take questions which is about a routine US FDA inspection of one of our facilities in Bangalore. We received as part of the inspection, a 483 which is an observational document which the inspectors leave at the end of the inspection. The company strongly believes, I mean the company has a strong track record of FDA approvals, we have had 15 inspections so far, seven of them had zero 483s, and the rest of them had observations and we have addressed all these observations at all times to the satisfaction of the agencies and that is how we continue to maintain a compliance record. Having said that the 483 and the issues potentially about the 483s has taken mind of a few investors and there has been speculation around the 483s. It is the policy of the company not to address specific 483s because this is a document between the agency and the company but with our past experiences and we are very confident that these 483s will be an addressed in a very diligent manner. I have often received calls from the investors and what my readings of this 483s are and what do I think about them, I just believe that every single 483 the company has received is critical enough for the company to carefully relook at its practices and its people management and that is what we have done, we have addressed within the time frame, we have addressed our response diligently and we believe that we are in sound footings to get a faster conclusion from the agency based upon our responses.

So that is what I have in terms of an opening statement and I will be more than delighted to take calls questions or questions on these matters and like I said we will not answer any questions as we have not from the beginning of the year on the Agila financial or numbers as that is a businesses in transition. Thank you.

Moderator Participants we will now begin the question and answer session. We have the first question is from the line of Hitesh Mahida from Fortune Financials. Please go ahead.

Hitesh Mahida My first query is pharma business has pushed at a YoY de growth in sales, what is the reason behind it?

Arun Kumar I think you need to look at the guidance, we have moved away from a lot of institutional business and we guided the market that we will achieve sales of Rs.1000 crores but focus on an improved EBITDA which is what we have done. So we have exited few businesses, which should not make sense to us in the near term.

Hitesh Mahida Second thing about the 2 to 3 key approvals which we are expecting as far as our Pharma business is concerned, can you throw some light as to whether these are para 4, FTFs or these Vancomycin kind of approvals wherein?

Arun Kumar We don't give product specific as a policy but I can tell you that none of these products are 5O5B-2s or FTFs but there, definitely products, which fit into the Vancomycin categories where we continue to have 35% market share.

Moderator We have the next question is from the line of Jigar Walia from OHM Group. Please go ahead.

Jigar Walia Did we have any license fee income in Q1 and Q2 and when we have given guidance if you can throw some color on the tax rate that could be there for the year for the pharma business?

Arun Kumar Our pharmaceutical business does not have licensing income this year; there is no licensing income as part of our EBITDA guidance.

Jigar Walia And tax rate?

TS Rangan We did not guide anything for this year but we believe that it will be between 20% to 22%.

Moderator We have the next question from the line of Krishna Kiran from ICICI Direct. Please go ahead.

Krishna Kiran In the Q4 CY12 call, where is you were mentioning about Immunosuppressant launches that can they happen in Q2 this year, has this happened this year?

Arun Kumar It is not, I mean, this is where the product approval delays have impacted. So to answer your question we have not been approved.

Krishna Kiran And just want to understand one clarity on the last year similar quarter financial and this, last year we use to report Agila and Pharma separately and that number and whatever previous two years corresponding numbers which you are giving now are something different, so is this whatever we are giving during this quarter is excluding the businesses which we have exited?

Arun Kumar The divested businesses are excluded.

TS Rangan Plus the last year we also had Ascent Pharma.

Krishna Kiran But last year if we look at Q1 and Q2 excluding Ascent Pharma last year sales which we have clocked, our Q2 CY12 we have clocked around Rs. 258 crores and last year Q1 around Rs. 275 crores but in our Q1 financial we have mentioned around Rs. 160 crores of Q1 CY12 sales number, so actually this consolidated pharma which we are reporting during in this Q1 CY13 and Q2 CY13 is something different with the Pharma segment which is in the last year?

TS Rangan I think what I could understand from you is that this Rs. 166 crores is a standalone number, I think the last year you must be referring to a consolidated because they were reporting, always our segment is only pharmaceuticals but 2012 we used to have two divisions, one is a Pharma and specialty with the consolidated numbers, so you need to look at it what you are referring to Rs. 166 crores is a standalone number, like Arun mentioned earlier, we opted for standalone, this is the Indian pharmaceutical business.

Krishna Kiran Just for clarification this quarter Rs. 228 crores Pharma consolidated sales comparative to Rs. 258 crores, is the right way to look at it, last year similar quarter?

TS Rangan Correct.

Moderator We have the next follow up question from the line of Hitesh Mahida from Fortune Financials. Please go ahead.

Hitesh Mahida Just wanted more clarity on the Form 483, just wanted to have we replied to the particular queries of the US FDA and what will be the process like going forward?

Arun Kumar We have responded to the FDA on our Form 483s within the stipulated 15 business days, which is the norm. The FDA can take a view on our response and they will come back to us to say that they are happy or they are not happy or they want us to improve certain commitments that we are making and that is the typical process that occurs. So, there would be some engagements with the agency in terms of whether they are satisfied with our response or not.

Hitesh Mahida Can any adverse event in this particular US FDA front, can it affect our deal, Agila deal going forward?

Arun Kumar We don't believe so, first of all we are confident that the 483 issues will be addressed and secondly we don't believe that an adverse events will lead to the derailment in the transactions.

Moderator We have the next question from the line of Kiran Chheda from Value Quest Research. Please go ahead.

Kiran Chheda These are some balance sheet questions, the debt seems to have increased substantially by Rs.200 crores and on the asset side I see that the current investments have gone up to Rs. 928 crores, so what are these current investments?

TS Rangan I will answer your question on the debt first, debt has gone up by Rs. 150 crores but if you really look at it is more than close to about Rs.50 crores is due to reinstatement that is the all our FOREX loans, we reinstated at Rs.59 crores plus and there are Rs.100 crores of infusion of funds including R&D, biotech, and also for working capital.

Kiran Chheda The current investment is Rs.928 crores and the non-current investments have gone down substantially, so is there a reclassification or what?

TS Rangan The investment is reflective of the investment in Agila transaction, since the deal is expected to close this year, it has become a current investment.

Kiran Chheda So it has been reclassified from non-current to current?

TS Rangan Yes.

Kiran Chheda I see that the cash balance have also increased substantially from Rs.29 crores to Rs.166 crores so while you have infused new funds through borrowings, it is probably still lying as cash?

TS Rangan Yes, it is the timing issue some of the cash also reflects the borrowings towards the end of the quarter, which will be utilized for the CAPEX and also for the growth capital.

Moderator We have the next question from the line of Unmesh Sharma from Macquarie. Please go ahead.

Unmesh Sharma I had a couple of questions, one regarding the FII limit, what timelines can we expect this to be raised to 74% and the second question was regarding the Form 483, is there any specific timeline by which the FDA tends to come back with a response on whether they are happy or not happy or whether they need further action?

Arun Kumar So the FII limit increased to 74% has gone to an EGM for a shareholder vote and we expect to have successful closure of that by 3rd of August after which we have to intimate the RBI of the outcome and assuming that the outcome is positive it is only a notification and then the FIIs can trade effectively from 5th of August is what we expect. The Form 483 there is no set norms in terms of how many days the FDA will come, it depends upon how engaged the agency is with us, there is no set norms on timing but we have instances when 483 has been closed in less than two months and in some cases it has taken as long as 4 to 5 months so it depends upon what goes back and forth here in terms of expectations and what we can commit and what we can do and that is how it works.

Moderator We have the next question from the line of Kartik Mehta from ICICI Securities. Please go ahead.

Kartik Mehta Can you share the product pipeline from the existing business in this year and just wanted to understand, do any of the products for our existing US business, do their approvals in any way get effected in case outcome of the 483 is being actually delayed?

Arun Kumar You know that the company does not disclose the product portfolio.

Kartik Mehta I just want a number, I mean, you expected products to file?

Arun Kumar You are talking about the pharmaceutical business?

Kartik Mehta Yes.

Arun Kumar I have already mentioned that in my opening that we have 46 filings, out of which 19 are PEPFAR, 18 are pending approvals which are non-PEPFAR, they are products that we can launch and our pharmaceutical business is a completely dedicated site, so there is no connection to the current 483 that we have received for one of our injectable site.

Kartik Mehta This is on the finance side, how have we hedged the existing business in terms of the non-rupee debt? Is there any understanding that we would have hedged less in anticipation of actually receiving the money from Mylan maybe in September or in December, so were we un-hedge or were we hedged on the non-rupee debt?

TS Rangan We have not hedged any consideration expected out of this deal because in India you are not allowed unless there is a significant event like FIPB approved actually so we are not allowed rather so we always follow the prudent process and we have not hedged.

Moderator We have the next question from the line of Meeta Shetty from HDFC Securities. Please go ahead.

Meeta Shetty Just wanted to understand your approval on the tender side for the malaria product, so I believe it is the tender market so it is going to be the price competition that will get you market shares there or how exactly will it be?

Arun Kumar Currently including us there are only five approved vendors, it is currently under-supplied so there is a lot of rational pricing in this business so there is really no need for us to take price cut to take market shares simply because the existing vendors as you are probably aware are all doing extremely well with this product and there is a backlog of between 14 to 15 weeks so that is the reason as a new player we can obviously improve that. So we have not actually reduced prices. Prices are typically standard prices for all players and it is based on the availability of supply currently rather than anything else because there are not enough suppliers to meet the demand.

Meeta Shetty I believe there is one more product in the similar segment, so have you also filed for a WHO approval for that product?

Arun Kumar Yes we have.

Meeta Shetty And how soon do we expect the approval to come in?

Arun Kumar We can't mention as yet because it is the WHO process is the lot more efficient but I think it will take 6 months.

Moderator We have the next question from the line of Rajat Budhiraja from Banyan Capital Advisors. Please go ahead.

Rajat Budhiraja My question is related to the Bangalore facility on which we have received 483, so is it contributing anything to the Agila revenues?

Arun Kumar It does, it is about 25% of Agila's revenues.

Rajat Budhiraja My next question is on FIPB approval so there are some concerns from the DIPP side and you are saying in the con call that you are already complying to that, can you please elaborate more on that what is your stand on their take?

Arun Kumar The current policy on which the FIPB is taking approvals is the acquirer needs to make a commitments to continue to invest in R&D and continue to supply drugs which are under the

National essential list of medicines, this is how it is but the current DIPP policy from what we hear talks about two additional points that the company which is being acquired does not have a significant Indian position which will impact pricing because we don't have any Indian business it will not impact that is what I was telling in my opening statements. And two is that we should not be a global competitor of the acquirer, this is the draft, which we believe the DIPP is shooting for and we don't really fit into either of these conditions.

Moderator We have the next follow-up question from the line of Jigar Walia from OHM Group. Please go ahead.

Jigar Walia Just if you can refresh in terms of the timelines for the receipt of money from the Agila deal and shortly I also understand in dollar terms there would be a favorable currency impact whenever it happens?

Arun Kumar Yes, whenever it happens there should be a favorable currency term but currently the deal is expected to close in September or in the first half of October, so we don't have any change in that timeline.

Jigar Walia It would be a bullet receipt in terms of money?

Arun Kumar Yes, it is.

Jigar Walia My second question pertains to your filing plans ANDA for the balance year?

Arun Kumar We have approximately in the Pharma business about 10 odd filings that is the plan for the year some of them have already been filed.

Moderator We have the next follow-up question from the line of Kartik Mehta from ICICI Securities. Please go ahead.

Kartik Mehta Just understanding from the timeline, so the FTC approval is an independent thing and the FIPB is an independent thing, is my assumption, right?

Arun Kumar Yes, you are right.

Kartik Mehta On the part when we sold the business the rupee was at Rs.54 and now it is at Rs.60, is it fair to understand that upsides of that will be also actually distributed or utilized in the same way as was discussed in the last call?

Arun Kumar It is fair to understand on those bases because if you recall on our press release we indicated a dollar amount for distribution so that doesn't change. We did not agree for an Indian rupee distribution, we announced the dollars distribution of $700 million-$800 million.

Moderator As there are no further questions I would now like to hand the floor back to Mr. Nitin Agarwal, for closing comments.

Nitin Agarwal Arun, you want to add any last comments?

Arun Kumar Thanks Nitin once again for the opportunity and also to the participants for listening in, like always please feel free to contact us and we will be more than delighted to answer specific questions that you may have. Thank you again Nitin for hosting us.

Nitin Agarwal Thanks Arun, thanks to all the participants for joining in, thanks everyone.

Moderator Participants on behalf of IDFC Securities that concludes this conference call. Thank you for joining us. You may now disconnect your lines.