"Strides Pharma Science Limited Q3 FY2022 Earnings Conference Call"

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MANAGEMENT:	**1. MR. ARUN KUMAR** – FOUNDER & NON-EXECUTIVE CHAIRMAN
	2. DR. R. ANANTHANARAYANAN – MANAGING DIRECTOR & CEO
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ANALYST:	**MR. ABHISHEK SINGHAL**

Moderator: Ladies and gentlemen, good day and welcome to Strides Pharma Science Limited Q3 FY2022 earnings conference call. As a remainder, 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 this conference is being recorded. I now hand the conference over to Mr. Abhishek Singhal. Thank you and over to you Sir!

Abhishek Singhal: Thank you Faizan. A very good afternoon and thank you for joining us today for Stride's earnings call for the Q3 and nine months ended financial year 2022. Today we have with us Arun Founder and Non-Executive Chairman, Dr. Anand –Managing Director & CEO, and Badree – Executive Director Finance & Group CFO to share the highlights of the business and financials for the quarter. I hope you have gone through our results release in the quarterly investor presentation, which have been uploaded on our website as well as the stock exchange. The transcript of this call will be available in a week's time on the company's website. Please note that today's discussion will be forward-looking in nature and must be viewed in relation to the risks pertaining to our business. After the end of this call, in case you have any further questions please feel free to reach out the investor relation team. I now handover the call to Arun to make the opening comments.

Arun Kumar: Thank you Abhishek. Good afternoon everybody. So we have reported our numbers earlier today and we continue to have a muted performance in Q3 FY2022, however we do see significant green shoots in our business and we are now more than confident for a full recovery in the next couple of quarters. The gross margin compression in Q3 is mainly due to our portfolio and business mix and also the fact we had inventory of increased raw material prices which were being adjusted to the lower realization that we are receiving in the front end in some of our markets. Key this quarter has been that after two quarters of sequential drop in revenues and gross margins our regulated businesses are now steady state and the losses have been arrested in terms of both revenues and gross margins and we are now seeing very significant uptick of the opportunities. In retraction we believe that some of the products that we let go to intense competition is playing to our favor as we are now seeing several rebids on the products and contracts we have lost and we have seen green shoots in opportunities and increased businesses. Key to our success next year is for us to retain and achieve our guidance of the $250 million of revenues up from about $150 to $160 million this year in the US with the add on of the Chestnut Ridge integration which is now going to plan. We are now very confident that our business will be on track to meet $250 million in FY2023 in the US and we are also not seeing too much of linearity headwinds as we see fairly significant pickups of quarterly run rates starting from Q1. Earlier this week we completed the successfully inspection of Chestnut Ridge facility with two minor observations which is great considering that we are just completing our transition and integrating to our IT systems and our internal program. Nonetheless we had a good outcome and we are delighted with the continuous compliance status of that facility. Also now we have got other regulated market business as we call ORM to its previous historical pace as we have seen strong rebound in demand in markets which have opened up for businesses as usual especially in UK and in other parts of Europe.

We have been very focused on cost control. We have seen some of that playing through as early as this quarter and focus is to drive our margins through cost improvement programs and also reducing our opex and copex across the global systems. Recently one small part of the ex-promoter Shasun family requested reclassification which shareholders voted for consequently to ensure that the promoter holding is retained, the family office is committing to invest up to close to 200 Crores in instruments for which we would seek shareholders approval in the next few days. Consequently, we will infuse cash which will also augment the growth strategy for Strides. Stelis after five or six years of incubation finally has achieved its first operational breakeven in Q3 FY2022. None of this is led by any business related to Sputnik this is all with a CDMO business and we had an operating EBITDA for the first time ever which is very pleasing. We believe that we should be able to ride the upsides of this Sputnik opportunity we have received and NOC to export 50 million doses. We are in the process of getting the product tested as per our requirements with the Gamaleya Institute in Russia and once we have those test results which would come in the next three to four weeks, we are confident that we will start invoicing Sputnik starting from this quarter. Of course the COVID opportunity itself is shrinking as we all know, but we believe that the need for vaccines in the under vaccinated countries are significant and we believe that Sputnik's clinical data supports an opportunity to pursue business beyond 50 million doses of Sputnik light while at the same time Sputnik V continues to be a technical challenge like for most of us in the industry. The Russians have also moved their focus to Sputnik light and we hope to be a leading player in their supply chain. Of course, I will be available for questions later part of this conversation. Now I pass the call to Dr. Ananth for his comments and to also give you more granular view of the business.

Ananthanarayanan: Thank you Arun. Good afternoon to all of you. Q3 of FY2022 while we delivered an 8% sequential revenue growth for our business, the operating leverage continues to be subdued as because the regulated markets, we have has seen growth coming back in the regulated market so our regulated market reported $78 million of revenues growing up by 9% sequentially and the regulated market constitutes about 73% of our total revenues. US revenues for the Q3 stood at $38 million up 13% quarter on quarter representing 36% of our consolidated revenues. The integration of Chestnut Ridge commenced in October 21 and is on track. The site contributed to revenues however only for few days in the focus. This facility as Arun mentioned earlier completed a successful FDA inspection on February 8 with two minor observations. We have retained volume market share for key based molecules and the new launches from Chestnut Ridge portfolio will expand product offerings in the coming quarters. We have also completed the divestment of our Florida site at the end of this quarter and the growth plan for manufacturing business including the VA opportunities now consolidated under the Chestnut Ridge facility. The quarter-on-quarter trend for the generic and Rx in the US is showing signs of stability however we believe that full recovery is still two or three quarters away and Chestnut Ridge portfolio will therefore help ramp up new product launches which we have a clear visibility on specific products from Q1 of FY2023. We are optimistic to be on track to achieve our growth outlook of $250 million in US sales during FY2023.

Our other regulated markets also continued to be steady and we had growth of 6% quarter-on-quarter. The other regulated markets reached back to the peak sales that we had in FY2021 of $40 million. Other regulated markets despite the surge in COVID cases due to Omicron variant had given a steady growth and we continue to witness healthy traction across the key frontend markets and partnership business in Europe. We do expect overall growth momentum to continue for the other regulated markets in the coming quarters. Outlook for the established business continues to be robust given a strong order book visibility and product portfolio expansion.

Emerging markets revenue for Q3 FY2022 stood at $29 million up 6% quarter-on-quarter and up 41% year-on-year. The emerging market business represented about 27% of consolidated revenues for this quarter. The institutional business reported revenue up 20% quarter-on-quarter led by better offtake from partners. The Africa business however reported reduction down by 17% quarter-on-quarter, but up 19% year-on-year. The Africa business during this quarter was impacted with several countries reporting a high COVID case leading to lower doctor visits and prescription generation.

In terms of the operating cost, our operating cost for the current quarter includes impact of the Chestnut Ridge for the full quarter while the freight rate continue to stay at elevated levels versus historical levels superior supply chain execution has enabled us a shift towards higher sea shipment thereby helping contain our logistics cost quarter-on-quarter. The logistics cost during this quarter was at Rs.606 million versus Rs.897 million from the previous quarter. Cost initiatives have started yielding results and will continue to drive operating leverage in the coming quarters. With that I will hand it over to Badree for his comments on the financial aspects.

Badree: Good afternoon. I will cover some of the key highlights. Strides overall revenues grew up by 8%. We are seeing growth across all markets and gross margins for the quarter is at 50% for the year-to-date is 51.7% and these revenues include few days of revenues of Chestnut and it also absorbs all the cost during the quarter. So revenue has not been to the full potential, but all costs have been absorbed. The manpower cost increase mainly because of

Chestnut integration and despite the increase in the operating cost because of Chestnut, the cost management program which had also started playing led to improved operating leverage. Depreciation continues to be constant for the base business and the main increase is because of Chestnut facility. Interest is at a similar range. Stelis had a positive EBITDA and correspondingly the benefit is also seen in the equity pickup. The debt is in line with the previous communication we have said that the debt will be at Rs.18 billion in Q3. In the base business there is no increase in the debt and the debt increases is because of the Chestnut ridge acquisition, basically to fund the acquisition as well as working capital. The investment cycle is behind us and with the growth coming with operating leverage playing out we will continuously be focused on the debt reduction. You would have also seen the announcements with respect to the equity infusion this will also help the balance sheet and growth going forward. With this I hand it over to Abhishek to take it forward.

Abhishek Singhal: Faizan can we open for Q&A please.

Moderator: Thank you very much. Ladies and gentlemen we will now begin the question and answer session. The first question is from the line of Omkar an Individual Investor. Please go ahead.

Omkar: Sir very good afternoon. Omkar here just wanted to check as in Q1 you said you acquired Endo and that at least will give the revenue of around 70 million in Q2 you said, later on you said because of pricing pressure at least it will deliver 48 to 50 million per annum so what is the contribution in Q3 from Endo portfolio?

Arun Kumar: Endo consolidation although we have consolidated starting from October, the sales started only from 15 November onwards, about 6 weeks so it is a very small portion that run rates we have indicated to you will happen from Q4

Omkar: Can we expect 12 to 14 million of business for quarter at least, as you have acquired this portfolio you were 48 to 50 million that's what you said in Q2 commentary.

Arun Kumar: Correct, so you will see that in Q4 because the deal closed only in the last few weeks of the last quarter.

Omkar: It means that 20 commercialized products is already on. You don't have to introduce again that I was already on and that business will come in quarter 4.

Arun Kumar: Exactly.

Omkar: Okay, thank you very much.

Moderator: Thank you. We have the next question from the line of Tushar Manudhane from Motilal Oswal Financial services. Please go ahead.

Tushar Manudhane: Sir just on US business while the target of $250 million on the current annual rate of 140-150 mn and on your comment bringing a sense that it would be more of starting with 1Q FY2023. We have already like in mid Feb now. So, this would be more supported with the launches of already approved products or some new approval would ride this to start with.

Arun Kumar: We have over between the Endo portfolio and the Strides portfolio, we have a little over 70 odd products that are not launched but approved. Most of it is coming from the Endo portfolio. A very small portion of that is only depending on new product approvals.

Tushar Manudhane: We would be at the similar gross margins on the existing US business has?

Arun Kumar: Correct.

Tushar Manudhane: Alright, that's it from my side.

Moderator: Thank you. We have a next question from the line of Nitin Agarwal from DAM Capital. Please go ahead.

Nitin Agarwal: Thanks for taking my question. Arun for the business next year we have had over the last two to three quarters fairly choppy gross margins so given what you see in the market what is sustainable gross margin for the business, normalized gross margin for overall business for us going forward?

Arun Kumar: With the price drops and other things, the gross margins should settle closer to the 55% levels that we have indicated earlier, but we still sit on inventory that is coming to us at a greater cost so that adjustment was taken this quarter will also have little impact for the next quarter, but in the next year you should be in that business around 55% in the regulated market, of course the gross margins will come down if the institutional business increases quite significantly.

Nitin Agarwal: Okay 55% for regulated markets and lower margins obviously for the nonregulated market.

Arun Kumar: There are no related SGNA cost to that business.

Nitin Agarwal: Right, Badree on the overhead we have about 210 Crores of overheads including staff cost as the expense of this quarter I think what we understood is Chestnut cost is completely into this overhead so this 200, 210 is number that one can annualize or there is meaningful delta increase on this number so far in the coming quarter?

Badree: You are talking about the cost right, 210.

Nitin Agarwal: Yes.

Badree: From an operating cost standpoint we have started to see the cost management programs playing out mainly in terms of logistics and all other cost and I think it will settle down at the similar levels.

Nitin Agarwal: So Badree is it safe to say just adding the staff cost of about 390 Crores, 395 Crores numbers that we have for quarter that should be our average normalized EBITDA number for the whole of next year.

Badree: That's correct. Only one thing I just want to add here that we started consolidating Chestnut from October 20th maybe 20 days of additional cost can be slight change to that number, marginal.

Nitin Agarwal: Arun on other market businesses we are about $40 million run rate I think we mentioned we achieved previous high pre-COVID high now this is also facing the same sort of challenges as US and what are the dynamics at least in this part of the business.

Arun Kumar: Not really this business is impacted by demand especially in Europe. It clearly comes back for it to get to its numbers I think this could be the base going forward and there you will see improvement from this number going forward.

Nitin Agarwal: Lastly on our institutional business how should we think about this business there has been significant pressure on ARV pricing and sales? This whole year in fact most companies have suffered meaningfully on a Q-o-Q basis has done well still, they have grown our EBIT on a Q-o-Q basis but how should we look at this business given this has become apparently lot more competitive than it has been over the last couple of years?.

Arun Kumar: Yes, it is a competitive business let us say from our perspective it supports the manufacturing cost right so it is an important business for us, but the volatility is very dependent on how much business that we win. The level if you look at the $25, $29 million range has been fairly steady state that is because that's the minimum quantities of business that you will normally get even if we are not very aggressive on the pricing, the gross margins in this business keep shrinking given that most of our companies are depended on key intermediate things imported from China so we do have some challenges today. It is a hard business to predict growth and that is why we are more confident the new numbers around US and others.

Nitin Agarwal: Okay. Thank you.

Moderator: Thank you. We have a next question from the line of Sarvesh Gupta from Maximal Capital. Please go ahead.

Sarvesh Gupta: One thing which is as per the news item that there is a new law proposed in the US wherein US FDA inspections can be done without informing the same about the respective side. So what is the impact that you foresee for us in terms of the compliance cost or in terms of business because of this proposed law?

Arun Kumar: I think Sarvesh to be in this business you have to be every day ready for audit so those costs are already incurred. This regulation is that they will end up in your gate in the morning without informing is not going to change cost upwards or downwards. You are supposed to be ready every day to be audited.

Ananthanarayanan: FDA has been doing this and following it in any case.

Arun Kumar: Yes, even in India in the last one or two years the FDA has landed up in plants without notice I think that is more of threat article but of late we are seeing the audits are all without any written intimation.

Sarvesh Gupta: Understood. On your employee expenses now we understand that Chestnut Ridge has been recently acquired but at the same time your Florida employee expenses would have gone out right so net-net of that what explains the 50% y-o-y increase in your employee cost in such environment.

Arun Kumar: Last year this time our Florida was not there and that is the only reason.

Ananthanarayanan: Also, Florida was lot smaller in size.

Sarvesh Gupta: In terms of your US business guidance you are guiding for almost 50% y-o-y increase starting from Q1 itself and it is supposed to be not backended in H2 of next year. Is that the right understanding?

Arun Kumar: What I am saying is that there would be fair amount of linearity in that $250 million number and it is not going to be back ended into H2 and other things because we are not dependent on product approvals we are dependent on launches which are in our control.

Sarvesh Gupta: At average FY2023 gross margin level of 55% for the company level including all of this impact?

Arun Kumar: In the regulated market.

Sarvesh Gupta: Okay and how do you see the growth pan out in other regulated market for the coming year?

Arun Kumar: I think you can now consider the 40 million as a new base and you will see Q-o-Q growth most quarters there would be one off quarters, but I think 40 x 4 plus standard growth is something that you can build in the model

Sarvesh Gupta: Sir for Stelis we have gone into operating breakeven this quarter, should we expect a PBT level breakeven ex of COVID impact or ex of the COVID vaccine impact next year?

Arun Kumar: See we are CDMO player, we manufacture Sputnik as a CDMO we are not selling that in India with Dr. Reddy's, so as a CDMO you can make any product, the idea is that Sputnik being a large CDMO contract we are calling it out, but we would be dependent on Sputnik sales to commence for us to be PAT positive which we hope to reach soon.

Sarvesh Gupta: Understood, thank you and all the best.

Moderator: Thank you. We have a next question from the line of Tushar Bohra from MK Ventures. Please go ahead.

Tushar Bohra: Thanks for the opportunity. Sir couple of line items in notes or elsewhere mentioned in the filings so one was mentioned that management is in discussion with management team in Arrotex Australia to collect deferred consideration by March 2022 and I think the amount mentioned is Rs.534 Crores. Could you just help understand this better? What is the status or anything around it?

Arun Kumar: Deferred consideration from Arrow transaction for that amount is due in this calendar year so it is due in December we are in negotiations with them to see if we can bring it forward.

Tushar Bohra: Okay, management is hopeful that we should be able to do it.

Arun Kumar: That is right. Contractually it is due in December.

Tushar Bohra: Sir the amalgamation of Vivimed Life with Strides which was essentially approved in October 2020, but you are doing it now any implications or any reasons why it is being done now?

Badree: There are no implications because there are already in a merger process. In the last one year we had to complete the merger of a separate company called Strides Emerging Markets Limited so that amalgamation was going on now that is completed, we have now taken this up

Tushar Bohra: Sure sir for Stelis we did 61 Crores revenue this quarter even other than Sputnik should we be able to annualize at 61 x 4 or do higher next year?

Arun Kumar: You cannot annualize like that right you win contracts and some of them are long term, some of them are short term as far as CDMO operates. All we are communicating is that the business is now delivering, we are bringing in customers, we are producing, we are invoicing, it has taken us five years to get here and we thought it was an important milestone for us to explain to our investors.

Tushar Bohra: Teriparatide so what is our estimate for the plant inspection any kind of visibility we have sir?

Arun Kumar: We had plant inspection from January 10th which got cancelled because of Omicron but I am pleased to tell you that as of this morning we got an intimation of an inspection in March.

Tushar Bohra: Great sir and assuming all goes well in the plant we are looking at what kind of timelines.

Arun Kumar: Within this calendar year.

Tushar Bohra: Thank you very much sir.

Moderator: Thank you. We have the next question from the line of Nitin Agarwal from DAM Capital. Please go ahead.

Nitin Agarwal: Thanks for taking the question again. Arun the vaccine facility in Stelis as you mentioned the COVID opportunity is shrinking, we have spent a fair bit of money in putting that facility together. How are you thinking about leveraging this facility for Sputnik whatever strength can this go to, this opportunity go to and what we do beyond this?

Arun Kumar: As a CDMO we offer multiple capabilities like with this viral, microbial we are at now full services CDMO so it is typical that you build infrastructure ahead of your customer demand. We are in discussion with various customers, the viral platforms work in cell and gene therapy so we are in discussions with the customers we have fairly good funnel of new customers that are auditing facilities remotely or visiting us wherever they can and the idea is to get enough customers to use most of our capacities. Sputnik gives us a tactical opportunity in terms of capacity utilization but having said that considering that we are now at fairly large scale of Sputnik that is up to 2000 liters we believe that we have established good credentials in the CDMO space and we are onboarding customers with various different types of requirements through mabs and microbials or simple viral platforms which are not vaccines.

Nitin Agarwal: Would you have be able to hazard any guess in terms of by when second or third meaningful client additions can happen in this business?

Arun Kumar: We hope we have at least two significant customers to be added this year and with that we believe that we would be on a constant basis (without Sputnik) profitable.

Nitin Agarwal: When you say this year you mean FY2022 or FY2023?

Arun Kumar: Calendar year I am talking about the calendar year.

Nitin Agarwal: Okay, thank you.

Arun Kumar: Thanks Nitin.

Moderator: Thank you. The next question from the line of V.P. Rajesh from Banyan Capital Please go ahead.

V.P. Rajesh: Thanks for the opportunity. Most of my questions have been answered. Just on the debt what is the guidance for this, we ended December 1860 Crores should we expect it to further go up from here or do you think it will start coming down.

Badree With the growth coming back operating leverage should start coming in. Debt w will be in in this range. Our focus will be on the debt reduction.

V.P. Rajesh: Okay, thank you. All the best.

Moderator: Thank you. We have the next question from the line of Aditya Malaiya from SAP. Please go ahead.

Aditya Malaiya: Thanks for the opportunity. Sir my question is on the debt reduction front. In FY2023, what kind of reduction we can expect like at what levels it will come down.

Badree: If we really speak from an overall standpoint we should get the growth and profitability back once we are able to demonstrate in the coming quarters the debt reduction will automatically be a consequential thing. So traditionally you really see that with x EBITDA, debt reduction will be about 0.4 of x, so that’s how it works and that’s what we are aiming for.

Aditya Malaiya: My next question is on the IPO for Stelis Biopharma we heard last year that you will be demerging the business and coming with public offering is there any plan in FY2023 for the same?

Arun Kumar: We have already started engaging with bankers as we explained in the last quarter. No changes from that and we are certainly evaluating the best options and timing and what exactly needs to be done. We have committed ourselves for FY2023, there is no change to that commitment.

Aditya Malaiya: Okay last question is on the stock pledge perspective we see that there was a significant increase in pledge by the promoters in the last few quarters and now the valuations are coming down significantly do we see any risk over here and what is the promoters planned to reduce that stock

Arun Kumar: There is no absolute increase in the promoter family debt related to pledge. This obviously is to do with the fact that the share price correction affected incremental pledges but it is not leading to increase borrowings so we think that this is a comfortable situation for us to be in terms of servicing and we do not see any risks that is we have not seen risks in 15 years so we do not see this to be a problem plus they have obviously just announced commitment to invest more money into the company

Aditya Malaiya: Thanks for the clarification on that. Thank you.

Moderator: Thank you. As there are no further questions from the participants, I would now like to hand the conference over to the management for closing comments.

Arun Kumar: Thank you all for participating today and if you have any questions please feel free to write back to us and we will be happy to engage. Thank you. Good day.

Moderator: Thank you. Ladies and gentlemen on behalf of Strides Pharma Science Limited that concludes this conference call. Thank you for joining us and you may now disconnect your lines.

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