"Caplin Point Laboratories Limited Q4 FY22 Earnings Conference Call"

May 12, 2022

MANAGEMENT: **MR. C. C. PAARTHIPAN – CHAIRMAN**

MR. VIVEK PARTHEEBAN – COO

DR. SRIDHAR GANESAN – MANAGING DIRECTOR

MR. D. MURALIDHARAN – CFO

MR. SATHYA NARAYANAN – DEPUTY CFO

MODERATOR: **MR. SHRIKANT AKOLKAR – ASIAN MARKETS SECURITIES LIMITED**

Moderator: Ladies and gentlemen, good day and welcome to the Caplin Point Laboratories Limited Q4 FY22 Earnings Conference Call hosted by Asian Markets Securities Limited.

As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touch-tone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Shrikant Akolkar from Asian Markets Securities Limited. Thank you and over to you, sir.

Shrikant Akolkar: Good afternoon everyone. On behalf of Asian Markets Securities, I would like to welcome you all for Q4 FY22 Earnings Conference Call of Caplin Point Laboratories Limited.

From the management, we have with us Mr. C. C. Paarthipan, the Chairman; Mr. Vivek Partheeban, Chief Operating Officer; Dr. Sridhar Ganesan, Managing Director; Mr. D. Muralidharan, CFO; and Mr. Sathya Narayanan, Deputy CFO. I now hand over the call to Mr. Vivek for his opening remarks. Thank you and over to you, Vivek.

Vivek Partheeban: Thank you Shrikant. Good evening everyone. I am pleased to welcome you all to our earnings call to discuss our Q4 and FY22 results. Please note that a copy of our disclosures are available on the investor section of our website as well as on the stock exchanges. And do note that anything said on this call which reflects our outlook for the future, or which could be construed as a forward-looking statement must be reviewed in conjunction with the risks that the company faces.

With that, I hand over the floor to our Chairman, Mr. C. C. Paarthipan for his opening remarks.

C. C. Paarthipan: Thank you. Good evening ladies and gentlemen. I welcome you all to the investor's call. At the outset, you are aware that our company has been growing at a healthy clip. Cash and cash equivalents stand at Rs. 694 crores with healthy gross margins, EBITDA, and PAT. Our CAGR has been at 26% in the last 5 years. Now, let me highlight the status of our projects. First, Caplin Steriles Limited, where we have phase I, we now have 2 lines of injectable and 1 ophthalmic line. The 4th line which is our bag line to be commissioned in the next month. In the sense, it is going to be operational in the next month. We also have phase II where the civil work is started, and we are likely to complete our PFS commissioning by July 2023. The 6th and 7th line in the form of lyo and liquid injectables will be completed by September or October of 2023.

Coming to our Oncology facility, the machineries for OSD have already arrived from Germany. The civil work is about to be completed in a month or two and the project will be ready in 6 months' time from now. Onco injectable will be commissioned in October or November of 2023. We also have plans to get into General Category OSD and the construction will start in the near future in the 18 acres land that we have purchased in the industrial estate which is next to our

Caplin Steriles Limited. Further, we are all set to buy an API facility in Vizag, and we are planning to go for 2 Kilo labs: one for general injectables API for the US market and the other one for the Onco products API for the US market II. Further, our focus is all on our registrations in the bigger geographies such as US, Mexico, Brazil, and South America. The status of our US business will be briefed by our COO. We now have plans to enter into the European markets and the market study is completed by one of our executives for the relevant product and the executive would join also shortly to start the registrations in Europe.

Another major development is the Russian market. As you are aware, 63% of the western products is out of the market now. Keeping that in mind, we have appointed 2 executives who have been working in this part of the world in CIS market and both of them are leaving on the 17th of May and we will be in a position to understand what sort of opportunities are available in Russia. Arms race dynamics helps arms manufacturers, but it also helps companies which could find an opportunity in adversity and Caplin also found opportunities in war zones. Hopefully, we may find some opportunity in the Russian market too. Our current key priorities are, 1) Maintain the cash flow to complete the projects without any debt. 2) Manage the OpEx for the next 3 years for the new entities, especially the 3 entities which I have told you without any debt which means the internal accruals will ensure a smooth sailing. 3) The implementation of SAP which we started recently. Covid war and the war in CIS devastated the life and business in many parts of the world. The path forward for our company may or may not be the road less travelled which we will decide when we reach the markets after registrations. But one major thing that is happening in the business world today is that the larger companies chasing and creating monopoly are near monopoly status in technology and markets. In this context, a mid-sized company like ours should always create a differentiation. The key differentiators which we feel are, a) Sustainable cash flow to handle the CAPEX and OpEx without any debt as I reiterated before. b) Projects and the operations to be handled effectively by attracting right talent. c) Completion of registrations in bigger geographies for increase in our exports like any another big player in the market. Thank you.

Vivek Partheeban: I will be giving a little bit on Caplin Steriles business specifically that is to do with the US. Despite all the macroeconomic challenges that the whole world has faced, especially such as Covid and the issue in Ukraine and also some of the lockdowns in China, etc., we grew revenue by 44% and in addition to all of these, we also had line 1 shut down for almost 4 months last year and line 2 not being operational because it was not qualified for close to 8 months. Despite all of that, we have almost grown by close to 44% to 45%. I think that is a fairly commendable number. If we took away the money we are spending on filing products, I think we would be very close to breaking even right now, but because we expense out our R&D figures and also expense out our product filing figures, we still have some way to go for break-even which we feel could happen this financial year.

Going forward, we have 2 fully functional commercialized vial lines. We also have an ophthalmic line that we are using specifically for exhibit batches. We also have a pre-mixed bag line, like Chairman said, which will be operational from next month onwards and that will be ready for taking exhibit batches. Basically, exhibit batches are what you do as a final step before we need to file a product in about 6 to 7 months' time. In terms of number of ANDAs, we have filed 21 of which 18 are approved and out of that 18, 13 are in Caplin's name and 15 products are commercial right now for us in the US with the next two to be commercialized within July and the last one by the quarter after that. We are also expecting the other 3 approvals to come through within the next 2 to 3 quarters. Right now, we are on track to file 9 products before the end of this calendar year and our overall target for this financial year is 12 products. Out of these 12 ANDAs, it comprises of 2 products that would come under the complex category, 5 ophthalmics, and 2 or 3 bag products. We have a split of around 70% to 75% of our revenues coming in from product sales and the next 25% to 30% from milestones and profit share. Going forward, we see this number to remain somewhat similar, on a higher base obviously. When it comes to front-end plans, we have had conversations with a company that we have been discussing with. Basically, we have a choice between buy or build and we are sort of leaning towards this opportunity that is presenting itself where there is a company in the US that is specifically into distribution of injectable products and it is small enough that we could potentially take a majority in the company. Those discussions are ongoing, and we expect some sort of resolution on that in the next 2 quarters. Phase II, as Chairman said, we are expecting that to be completed and operational by September of next year by which time our capacities will be 3 times than what it is today. Post the expansion, we feel that our capacities are going to be similar to some of the larger Indian MNCs. In fact, I would say that apart from the larger Indian MNCs, no one else would have similar types of capacities once our expansion is completed by next year. So, obviously, our current hybrid model of filing our own products and attracting contract manufacturing will continue until May and we will also be targeting ex-US markets like we are already doing. Today, the reliance is obviously more than 90% to 95% on US markets, but we expect that to scale down slightly in the coming years with our additional capacity being put to use. As we speak, we are sitting on orders worth of Rs. 160 crores from our partners that has been forecasted to be completed before the end of this financial year. If we consider a similar kind of absolute numbers in terms of profit share and milestone revenues coming in, we have a fairly decent target for this financial year and if we execute well, I think we will achieve break-even from this site which is a good milestone for us to target. Finally, I would also say that when it comes to audit readiness and automation, in the last 2 to 3 years, we have focused quite a lot of our energy and resources into automating multiple processes and systems of the plant. I would say that when it comes to quality areas and documentation areas, we are at a very high level of automation today, and in the next 18 months, our target is to go as close as possible to being a paperless facility because we feel that when it comes to machines, there is obviously a lot more transparency and trust factor for anyone walking in compared to everything being on manual systems. With that, I would like to hand over the floor to our CFO for a quick update on the numbers for the last year.

D. Muralidharan: Good afternoon and welcome you all for this investor's conference call. I would take a couple of minutes to highlight the financial results of the current year. Actually, a couple of years back when we assembled in the same hall, some had apprehensions about the subsidiaries and the market partners coming into our fold. The forethought of our Chairman bringing them into our fold and keeping inventory closer to the customer and then quick sales turnaround has helped in these challenging times. When other competitors did not have inventory, we had inventory closer to the customer and the results are already shown. It has been a very gratifying year in the challening times when the ocean freights have gone up 3 to 4 times, difficulty in availability of vessels, and then the transit time elongating by more than 50%. So, the strategy to keep the inventory closer to the customer has helped us acheiving all the parameters. The sales growth contribution margin has been brought back to the original level. Even though the expenses have gone up, they are contained as a percentage of the total income and that is reflected in the PAT margin which is 23.6% for the current year and all the parameters as our Chairman has rightly put it, the CAGR we have one of the CAGRs which is enviable in the market. The cash flow from operations a couple of years back was only Rs. 40 crores - Rs. 44 crores; today, it is close to Rs. 360 crores. The cash and cash equivalents of Rs. 694 crores what we said. This is after investment of about Rs. 91 crores in the CAPEX which are the ongoing projects in CSL phase II and Caplin Onco vendors and certain equipment, as Chairman has pointed out, already reached the destination. The things have fallen in place and we are in good wicket in terms of taking further optimization in terms of cost and as Chairman was saying, SAP will be a good tool for us to have a wholistic view of the entire business across the various subsidiaries and we will be having a better control on the expenses as well as on the product realization. If there are any questions, we would be too glad to answer them.

Moderator: We will now begin the question & answer session. We will wait for a moment while the question queue assembles. The first question is from the line of Anika Mittal from Invest Research. Please go ahead.

Anika Mittal: Last quarter, we had given a recognition that the inorganic opportunity which is the API site at Vizag will be completed by March. Now, it has been pushed over to June. Any reason why?

C. C. Paarthipan: Last year, we were talking of an API facility which was totally a different one. We were about to buy a facility which is from Chennai, and in the last minute, there were some developments. One of the formulations of this company got registered and they found that is going to be a very important product for them. In the process, in the last minute, they backed off. The API facility that I am talking to you is the recent development. Due diligence for technical, financial, and legal areas have been completed. We are all set to buy this one actually, hopefully in the next month. So, these are 2 different facilities. What we mentioned in last year is different from the one which we are planning to acquire now.

Anika Mittal: Sir, my next question is what is our growth guidance for the next 2 to 3 years in the sense of operational and financial aspect?

C. C. Paarthipan: The growth, as I told you in course of my discussion, the priority is to give thrust more on the cash flow which we are 100% sure we will focus on the cash flow. We will continue to maintain the PAT and cash flow the way in which it has been happening for the last 5-6 years or more.

Coming to growth, we are sure of actually having growth of 15% to 20%. It can even exceed which I am not in a position to tell you now because of 2-3 reasons. a) Covid: During Covid, we were not in a position to travel which you are aware. b) Internationally, there are issues in the form of war in Ukraine. This actually where it will affect or how it will affect and whom it will affect, we don't know. c) The third issue is the lockdowns that are happening in China. These are the issues which are more of a threat. As you know well, threats cannot be predicted. So, we will not be in a position to tell you something which may not be practical and then it is better to rather underpromise and overachieve. That's why I say it will be in the region of 15% to 20%.

Anika Mittal: Sir, my next question is from strategic point of view. Our plan is to enter into Russia. Is there any change in our strategy after the Russia-Ukraine war?

C. C. Paarthipan: Any war has got its own opportunity in disguise or adversity in disguise. There were opportunities which we have seen many a times in war-zone countries and we converted it as an opportunity, the challenges we converted as an opportunity. Life is more of a pattern of facts, things which happen in your life and business. The patterns that happened in our life, mostly we made our money in the toughest part of the world. Be it in the form of the toughest part of Africa or the toughest part of Central America, 5-6 smaller countries put together, our 90% of the business comes today.

Russia is an area, as you know well, now there are a lot of issues in the form of not much of medicines available because the market if you look at it, 63% of Russian market was in fact controlled by the western companies. They are not in that country now. Hence, there is an opportunity for some of the important injectables. We ourselves have identified some key injectables which not many companies manufacture in India too except some 1 or 2 big players. This has been told to our people whom we have appointed and they said there will be a very good opportunity for this type of products. So, we are very sure that we will be in a position to find some opportunity as long as there are ways and means to repatriate our money from the country.

Moderator: The next question is from the line of Sachin Kasera from Svan Investment. Please go ahead.

Sachin Kasera: Vivek, could you give us some more details regarding the US in terms of the EBITDA and the PAT for the current year.

Vivek Partheeban: From the US side, on gross margin levels, we are very similar to the overall company's numbers – the parent company's numbers. As discussed during my speech, we are not capitalizing any of our R&D expenditure or the product filing expenditure which is why our bottom line will get bruised for some more time until our revenue goes up, but when you are looking at gross margins, yes, it is similar to our parent company's numbers.

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Sachin Kasera: Secondly, you have mentioned that you have entered a few more markets in the developed market this year. They are all addressed through Caplin Steriles or they are being addressed through the parent company?

Vivek Partheeban: Any market that we are talking about where mostly it is into injectables, I think we will be doing this through Steriles even though we do have an injectables section in our Pondicherry plant which belongs to Caplin Point, but I think most of these newer markets where we are working for injectables or ophthalmics, we might be doing this through Caplin Steriles.

Sachin Kasera: This year, I think you have grown at 44%. What type of targets are we looking for FY23-24 for Caplin Steriles based on the current visibility that we have?

Vivek Partheeban: On the targets, as I discussed, I think we can expect a good number this year. The most important thing is there is no dearth of orders or anything like that. In fact, like I said, we are sitting on orders worth Rs. 160+ crores as we speak. Now that we have both the vial lines up and running, we need to make sure that we execute properly, but if all goes well, we will go very close to achieving break-even or we will go past break-even which is around Rs. 180-190 crores.

Sachin Kasera: When you say break-even, you mean EBITDA or net break-even?

Vivek Partheeban: At that level, we will go for net break-even. We will be net breaking even at that level.

Sachin Kasera: How are we funding this CAPEX that is ongoing in Caplin Steriles? Is it from the loan from the parent company?

Vivek Partheeban: That's correct, yes. We have taken a loan. In fact, it is already in progress. We have been given a loan of Rs. 220 crores over the next 1.5 years which will be consumed.

Sachin Kasera: You have mentioned that the capacity will become 3x post the current expansion. So, by when do you expect this enhanced capacity to be fully utilized? And at that point of time, what type of revenue can we expect Caplin Steriles to deliver?

Vivek Partheeban: When it comes to capacity utilization, we are at a stage where it is slightly more difficult to judge because we are doing a balance between exhibit batches and also commercial, but once the new lines come in, I think we will be very very comfortable at least for the next 3 to 4 years. We don't foresee us requiring any further CAPEX until '26 and beyond. The public statement that we have made, we continue to stick to that which is by 2026, we expect this to be a $100 million business. That continues to remain.

C. C. Paarthipan: I would like to add a little more here. Once we have 7 lines, it will be in the form of 5 buckets: three in the solution injectable area, one ophthalmic, one bag line, one lyophilized, and one PFS. And in addition to our own commercials and exhibit batches, this will open up opportunities for

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contract manufacturing for multinational and other big company also. As you know well that there are not many companies, especially even big companies are not into injectables in a big way although they are big in all other areas. There are hardly 2-3 facilities with 6 and 7 segments of injectables. So, we are very sure that we will be in a position to actually balance the economies of scale once we complete all these in the next year.

Sachin Kasera: Of these Rs. 440-450 crores of CAPEX how much have been incurred till date and how much you plan to spend in the current financial year and next financial year.

D. Muralidharan: As I mentioned, out of Rs. 91 crores of CAPEX, Rs. 40 crores in CSL, i.e., Steriles, and Rs. 35 crores of CAPEX have been incurred in Onco, very small amount in the parent company. So, out of Rs. 400 crores what we talked about, Rs. 75-80 crores have already been committed in terms of cash. The remaining will get consumed over the next 12 to 18 months' time.

Moderator: The next question is from the line of Hardik Shah from Taurus Mutual Fund. Please go ahead.

Hardik Shah: My first question is to Vivek sir. Please correct if my understanding is wrong. Today, our US business is negative, but after maybe in 2-3 years as soon as the US business will start gaining a little bit of size, can we expect our overall EBITDA margin to move in excess of 35%? because I believe that just if I separate out the US numbers from the total numbers, our LATAM EBITDA margin will be in excess of 36%.

Vivek Partheeban: Yes, you are absolutely right in that our overall consolidated numbers do get dragged down a little bit because of the losses at Caplin Steriles. So, once break-even is achieved over there, automatically you will start to see that move up. The absolute numbers of course we don't have any prediction on that right now, but obviously you will start to see the parent company's numbers go up once the cash flow break-even and overall net break-even is achieved in Caplin Steriles, yes.

Hardik Shah: Sir, what I want a little bit more clarity on is that can we expect continuous small sequential improvements in EBITDA margin going forward in the next say 10-12 quarters?

C. C. Paarthipan: As I told you, we will not be in a position to tell you in a wholistic way. Every quarter is difficult to predict at this juncture as I told you before. We haven't started our journey to the markets. Once we go to the markets, we will be in a position to actually tell you what will happen in the next quarter and the following quarter. We will do well. That's what we would like to say. As I told you before, 15% to 20% is a very conservative estimate. Once again, I would like to reiterate let me under-promise. If it happens, we will overachieve.

Hardik Shah: Sir, my second question is to the Chairman sir. We have outperformed on all parameters except for one thing which is the dividend payment. I would like to understand a bit more in detail how do you intend to create value for investors? And a small follow-up for the CFO sir that as on today, we have around Rs. 690 crores of cash. I think 45% or slightly higher than 45% of our net worth is cash. This high amount of cash, is it not a big drag on our ROE? Your thoughts on the same would be helpful.

C. C. Paarthipan: I would like to answer to your question. First, all 3-4 projects put together, the total amount which is available now, what will happen in the current year, because so far, we have invested only Rs. 90 crores as has been told by the CFO. Current year, most of the machineries from Germany and Italy would come and the next year also, we will be getting most other things which means around Rs. 300-400 crores we will be deploying in the projects and then it's better to keep some money. It is always better because we will not be able to understand what will happen and when because of the war and the other issues. So, we would like to keep some money for any eventuality. On the contrary, if we see definitely, we are giving as we have already announced 100% now – Rs. 2 per share – don't you feel that is reasonably good? But let us not connect this with the cash which is available in the kitty because one is, as I told you also in person when we met, the most important one is the growth in terms of medium to long term, that can give you enormous return on investment, than 1 or 2 dividends. This is how I look at it.

D. Muralidharan: You are right, because ROCE in the current, is taking a smaller beating if you may recall, but as one of my colleagues was mentioning the other day, in times of war, we should have a war chest to fight the war. That's what he was mentioning. So, keeping extra cash in kitty for any other Acquisition. not only the project what Chairman outlined or Vivek outlined are all on hand, but we are not keeping our eyes and ears closed. We are looking for opportunities either organically or inorganically. As they come along, we will evaluate them and then take necessary steps. But the ROCE what is reported is on par with many of the peers, if not better. So, the perseverance would definitely pay and in the next 2-3 year, the numbers would definitely look better.

C. C. Paarthipan: Once again, I would like to add one more thing. The priority I think you would agree with me is growth. Growth comes only when we put your money into projects, not into dividends. Am I right my son? because I told you this already when we met up in our factory.

Hardik Shah: Yes sir, you are right, but I just want one more bookkeeping number if you don't mind. At the best, we will be spending around Rs. 600 crores of cash in the next 2 years. Is that correct?

C. C. Paarthipan: Yes, as I mentioned in the course of my speech, I will tell you also this way. One project the second phase as has been told by the COO, Rs. 220 crores of which Rs. 90 crores is spent and the Onco facility also will cost us another Rs. 120 crores. And the API which we will acquire, the cost of acquiring actually is not high, but 2 Kilo labs which is for US FDA general injectable, other one for Onco injectable for again US FDA. That means another Rs. 100 crores. Then, there is a slight expansion for softgel capsules that would cost another Rs. 15-20 crores. OSD also would cost around Rs. 60-70 crores. What we will do? We won't do it in such a way that it could create issues. We will balance between consolidation and expansion. That's the reason I said 2 years. In 2 years', time, all this which I told you will be invested, and we also need to have some cash to take care of the operations, the reason being in a ROW market, the registration happens faster. In markers such as US or other regulated markets, registration takes a long time. That too, during this period, there are so many variables which we are not in a position to control. For example, if one machine is ready and for want of one particular part, the machinery may be also delayed. The same way, some of the raw material which we have come to know now – of course, since we have 300 to 400 products for the ROW market that don't pose any major issues, but some of the raw materials for want of intermediates or key starting material, they have not been in a position to supply. These are the things only as an entrepreneur we understand. That's the reason we would request you to look for the long term rather than expecting the dividend to go on a higher level.

Moderator: The next question is from the line of Ashish Kacholia from Lucky Investment. Please go ahead.

Ashish Kacholia: Sir, my question is basically pertaining to our future expansion plans in Mexico and Brazil. What I understand is that these are markets which are tender driven and hence may not be very very good for our margin profile. Anything you would like to share on what will be our business model. Will we be investing in a branded formulations kind of a business in these markets, or we will be also participating in the tender markets?

C. C. Paarthipan: Of course, branding business we are doing in West Africa; we would like to start in the smaller geographies of Central America which is easier for us to control because, for example, suppose if we go for ophthalmic product, there will be very few ophthalmologists; if I go for oncology, there will be very few oncologists; if I go for CNS products, there will be very few CNS doctors; if I go for a hospital business for injectables, there will be very few private hospitals. To start with once the borders are open – 1 or 2 countries have opened; still there are issues for us to travel to this part of the world. So, we will do brand marketing in the smaller geographies where we are already there in Central America.

Coming to Mexico, it's a mix of government and private market. As you rightly said, the government takes 140 to 150 days. The credit periods are very elongated. So, we are working various methodologies. If the products are very lucrative, if the profitability is good, then we will go through some distributors, we will fund them, and we will get our cash much faster. Or if we have to do it on our own, then we will look at the amount of profits which we will be able to generate. Then, the second most important one is the private market. The private market in Mexico is something totally different when compared to other countries because this is the only country where you will see the doctors sitting inside the pharmacy, which means any generic that you market is like a brand actually to the patient because it is being prescribed by the doctor who sits in the pharmacy. So, the private market is going to be the lucrative one. But the only issue is, these are the countries where it takes now 12 products we have already filed, 12 dossiers. I think only 1 product we have it. Hopefully, in the 8 to 9 months, we will get the other 11 products. We will also file another 20-30 products parallelly. We also have certain methodologies where once we buy our API plant, we will give APIs to some other factories where they are not able to get at a good price and enter into an agreement with them and try and market their products in Mexico. All these things will happen only when we go there and study the market, especially the private market and position ourselves in a space where the opportunity is very high and is more of a differentiator. So, getting into this type of an uncontested place is possible only when we go to the market and understand the vagaries of the whole thing.

Coming to Brazil, Brazil takes a minimum of 2 years for registration. We have just started that process. So, it will take another 2 years to complete; maybe 2 years, sometimes 2.5 years also to complete the registration. 1) Brazil private market is very difficult because the geography is very huge, the land is very huge. If we try and do the private market, distribution will be the biggest challenge in Brazil. We have to focus more on the tender business, but advantage in Brazil is if we can get into injectables and Onco products, the competition is few and far between compared to any other country. 2) You don't see any smaller companies or mid-sized companies like ourselves in Brazil which means we are definitely positioned in the better way once we complete our registration in Brazil.

Ashish Kacholia: Just to reconfirm, we will not be investing in a formulation business in either Mexico or Brazil. Is that my correct understanding? Formulation means the prescription business where you will be having your representative.

C. C. Paarthipan: Yes, prescription business in the bigger geographies, as you rightly said, we will not be getting into prescription business. That's because any country for that matter, we need deeper pockets, and when we can find some niche, if we can create the differentiation compared to other Indians and Chinese who are present there, our business model will become a brand. That's what has happened in Central America. As you are aware, today we are doing well not because of the size or the brand marketing but because of the business model differentiation. That the reason again and again I am telling we have to make a trip which will happen anytime in the next 6 months or after the registration or before the registration. That's the time we will decide how to position ourselves in this particular country. Mexico is going to be our future target like US.

Ashish Kacholia: Are there any restrictions on the travel arrangements as of now? From what I understand, people are travelling to Mexico very comfortably as of now.

C. C. Paarthipan: Yes, there is no restriction to Mexico now. We are all set for an US FDA inspection. So, readiness for the US FDA inspection is happening in the company. I would rather prefer to be here and complete the inspection and then make a trip.

Moderator: The next question is from the line of Alisha Mahawla from Envision Capital. Please go ahead.

Alisha Mahawla: Sir, I just wanted to understand have we filed for any registrations in Russia?

C. C. Paarthipan: No. The issue that is happening in Russia is more of scarcity for many products. As I told you before, 63 % of the market in Russia was dominated by the western companies and most of them have left. There are even factories which are not in a position to run due to lack of know-how and raw materials. This is what we are given to understand by our friends from Russia and other neighboring CIS countries. Registration used to be very tough in the previous years where it used to take 2 years and sometimes 3 years. Even for injectables, they used to go for BE/BA studies. Now, things are getting changed but the picture is not very clear. That's the reason our executives are leaving on the 17th and they will stay for 30 to 45 days and they will give us the clear picture how long it would take for us to complete the registration or if there is a company which has already registered the product and they are not in a position to manufacture for want of know-how or for want of a partnership, for want of API or something, then probably we will also fit into that space provided we need to understand how we would be able to repatriate the money to India.

Alisha Mahawla: Also, what you were explaining earlier with respect to Mexico and Brazil, we don't expect either of these geographies to start contributing meaningfully before '24 or '25 because they are still awaiting approvals, registrations, and thus it will take time, etc.

C. C. Paarthipan: Yes. The only thing which I didn't mention in course of my answer to the other gentleman, there are some emergency purchases. My son who takes care of the business in Central America has gone to Mexico. Yesterday, he told me some few products which we already, there is a tender called UNOPS. This UNOPS tender, they have already awarded 2 products and then another 6 products they said if we are in a position to supply at that price, then they are ready to buy. So, there will be opportunities which will not be sustainable the way in which we are doing in Central America or in West Africa. We may get it; during Covid also, we got some opportunities in Mexico and Brazil. This will continue for some more time. Earlier, it was Covid; now, war in CIS countries; then cold war, propaganda war; so many things are happening now as you all know well. So, we will have opportunities, but we will not be able to predict it when and how and what could be the volume. Definitely, it will happen, and we will know only when it happens what is the size of the business that we will be in a position to do it.

Alisha Mahawla: Are we selling anything in Sri Lanka?

C. C. Paarthipan: No. Lucky we are not into that country. If you look at our business, we are neither in English speaking countries nor in countries which are closer to India.

Alisha Mahawla: The next question I had was with respect to our R&D expenses. What will that be for FY23?

Vivek Partheeban: In terms of absolute numbers, we feel that the R&D expense is going to be similar to the last 2 years. As we get into slightly more complex products, the number of products that we will be working on might reduce a little bit, although the complexity and the costs of these products might increase. Having said that, we are also getting into Oncology right now. That is quite fresh as we speak. So, in absolute numbers, we feel that it is going to be similar to last year or probably going to be slightly higher than last year. The one thing is the R&D CAPEX we are pretty much done with any major CAPEX and most of it is going to be R&D product expenses from hereon.

Alisha Mahawla: So, in the range of Rs. 60-65 crores.

D. Muralidharan: Current year, we are at Rs. 60 crores. As Mr. Vivek put it, it will be hovering around that in terms of revenue expenditure. CAPEX expenditure, as he said, is almost done and it will be very marginal.

C. C. Paarthipan: There was a small mistake in my answer when I told you about the Sri Lanka. We are not into the English-speaking countries except US.

Alisha Mahawla: Just one last question. While over the last 1 year, we have highlighted our revenue aspiration over the next 5 years, any aspirational ROE target that we want to reach?

D. Muralidharan: Madam, just to answer your question, a couple of years back when we assembled in this room for the questions, cash flow from operations was a boiling issue. We had Rs. 44 crores which was one of the worst ever we reported and gross margins were the issues and OpEx were the issues. We guided them over in the last couple of years. As I said, through the strategy of our Chairman that we brought all the channel partners into our fold as subsidiaries that is paying good dividends in the current year and then probably in the years to come. As we are in the process of expanding and then investing heavily on CAPEX, as he has said, there are uncertainties in timelines of completion of the projects, getting the product registration, getting them commercial, and then becoming break-even and these things are farfetched. So, currently, our Fixed Asset Turnover of 4.5 to 4.8 which is pretty good. The ROE and the ROCE will improve. We have come back to normal line. As I said, we have compared ourselves with our peers and we are either on the same levels or better off many of them which are comparable with our line of activity and turnover. So, a couple of years from now, it will go up and we will see better. The dust has settled down in terms of gross margin, OpEx, and CFO. This will definitely settle down in respect of ROE and ROCE in a couple of years from now.

Alisha Mahawla: Just a clarification. Are we expecting US FDA inspection soon?

C. C. Paarthipan: This is something which is very difficult to say because they may come anytime and they may or may not come also. It depends upon their choice, but at the same time, the readiness of the inspection is the most important thing. We always maintain the integrity and the rest of the things in the form of transparency, quality, and all other measures, we have to keep it intact.

Vivek Partheeban: At this point, obviously there is a long backlog for the FDA. While there is no written guideline on which facility they are going to be prioritizing, from what we understand, the last few inspections have all happened in the facilities where there was some sort of a warning letter or any other OAI kind of status, but as our Chairman said, we need to be anytime ready. At the Steriles plant, we haven't had an inspection in the last couple of years. So, we might get one or another school of thought is we have had a very clean record over the last few years. So, we might be de-prioritized also. So, we don't know right now and just ready for any inspection that's happening.

Moderator: The next question is from the line of Harshal Patil from Sharekhan. Please go ahead.

Harshal Patil: Sir, just I have 1 or 2 questions; most of them have been answered. One was with perspective to the gross margins. If we see over the past 2 quarters, i.e., Q3 and Q4, it has been like 55-56% of a level that we have been clocking around. Do you see this as a base going ahead for let us say 23-24? And if you could just elaborate a bit on that, how should we look at gross margins?

Vivek Partheeban: As another gentleman had also asked, our margins are at a very acceptable level for us internally, and overall, the bottom-line figures are going to go up once the US facility starts to achieve net break-even, but in the worst case as well, we don't foresee these numbers dragging down from here. We expect these numbers to stay stable or go up from here.

Harshal Patil: Sir, just one more clarification. Probably 2 quarters back or so, we had alluded to some growth guidance ahead and you did kind of spell it out some time back also, for US, we are eyeing about $100 million of a top line, let us say over the next 4-5 years, and for the LATAM revenues also, we were expecting it to be doubling over the same period. Should we still stick by that?

C. C. Paarthipan: Yes, the LATAM revenue will definitely go up considering the size of the market. For example, out of the 6 countries that we are currently operating in Central America, Guatemala is the biggest populated country with almost 16 million population whereas Mexico is 10x of Guatemala and is 1 hour from Guatemala. Most of the products that are sold in Mexico is something similar to what is sold in Central America, with a difference, Mexico is a regulated market. So, I am sure over a period of time, the business will go up in Latin America many folds.

Moderator: The next question is from the line of Naushad Chaudhary from Aditya Birla Sun Life AMC. Please go ahead.

Naushad Chaudhary: Just one balance sheet question. Just wanted to understand in terms of your working capital cycle if I see post peaking out 2 years back, it is gradually improving from last 2 years. What is your comment on this from here on and do you see there is still scope for improvement and how should we look at in the next 2 to 3 years your working capital cycle?

D. Muralidharan: As we said, 2 things have paid great dividends for us. Having inventory closer to the market; the inventory level of 220 crores-250 crores what we are having today, it will be on the same levels to continue. As we mentioned in the past also, the transit time has elongated as compared to the last couple of years. What used to take 45 to 60 days is taking anywhere between 75 and 90 days today. So, these inventories, definitely, though the quantum is going up, in terms of number of months, it will not go very alarmingly. And also, closer to the market if we have goods, we are able to cash in on the opportunities that come by. That is one thing. And the receivables also are closer to 90 days. Our focus is on cash flow. Cash flow will not happen unless we collect the receivables from the customers. We have brought it down to 92-93 days and then it will definitely hover around that same number of days. The quantum may go up here and there, but we will try to maintain the number of days around that level. The transit time has also contributed to these reasons. By the time the goods reach the customer, it is almost 90 days and difficult to contain the receivables below 90 days. The trade payable also has helped us. Trade payable we have is about 1 quarter consumption. That has also helped us contain the working capital cycle. In our opinion, barring any major change in the product mix or market dynamics, this will continue for time to come.

C. C. Paarthipan: Here I would like to add one more. As we increase our business in the US, then of course the dynamics will change. In the US, there is nothing in the form of huge credits. What is important actually is to complete the registration and we need to have the capacity to export the products and then if you have the capacity the way in which we said, once we complete these 7 lines, that will also open up CMO (contract manufacturing opportunities). When we go for contract manufacturing, there is nothing in the form of that we have to give credit to the people. On the contrary, they will pay money upfront also.

Moderator: The next question is from the line of Sachin Kasera from Svan Investment. Please go ahead.

Sachin Kasera: Sir, you have mentioned about winning a tender of around $21 million. Can you tell which markets we have received this from and what is the type of margins we can expect in this tender business?

C. C. Paarthipan: The tender business has come from 2 major markets; one is Ecuador and the other one is El Salvador. The silver line in these markets is the currency which is dollar. So, any war or whatever happens will not affect the currency as you know well. On the contrary, this will help us because you know what dollar to rupee conversion is also. The one which has come in the form of $13 million or $13.5 million or something is from Ecuador and the rest has come from El Salvador.

C. C. Paarthipan: The margins are very good. The only thing which I didn't tell you is here in Ecuador, this is for 2 years; in El Salvador, this is for 1 year. The margins are very good. If the margins are low, we don't participate in any tender because that will affect our bottom line which we know. One thing which we always give importance is the cash flow. If the cash flow gets affected, even if we have extraordinary plans, we will not be able to implement them. Overall margins and the cash flow are always good because otherwise, we will not participate in any business, especially in Central America.

Sachin Kasera: You had alluded to the fact that the new market that you are entering like Mexico, Chile, and Brazil, they are much much larger than the existing markets. Sir, when can we start seeing some good contribution from these markets? And over the next 3 years, what type of revenue contribution you are seeing from these new markets of Brazil, Mexico, and Chile.

C. C. Paarthipan: We will do good business after 3 years. That is for sure. The amount in fact is very difficult for me to give you a figure. The reason is, as I told you before, in the last 2.5 to 3 years almost, I have not been to this part of the world. 2019, I have been traveling in China. When we were about to do something, the Covid came. Then, 2 years we were out of traveling. And we will start traveling maybe in 4-5 months from now. After that, we will be in a position to understand what could be the size of the market, where and all we are going to position ourselves. Then, we will be in a position to collect our money faster. Of course, top line business is easier to do, but what will happen then, the profit will be, as you know well, will only be in the books, not in terms of cash. So, we don't want to do that kind of business. At the same time, anything that we do, as I told in the course of my speech, we want to complete not only the CAPEX but also the OpEx of future without any working capital or any other debt. So, it is very difficult to project what would be the exact numbers 3 years from now because of the various issues that you also know well; 2 years of Covid, now the war started, and some of the crises. There are economies, countries going bankrupt which you know very well, I don't have to say. So, we have to be very very careful in choosing our targeted markets and the kind of business that we want to do. All these things, one has to go and see. Nothing like seeing, seeing is believing. Today, I can go by the words of my own people, but I don't want to leave it to an area in the form of no, it will lead to doing is easy, repairing is difficult. Yes, we have to depend on the professionals and in spite of which we will have to also take care of the ground reality at this juncture, the reason being as I told you again and again, these variables which have happened in the form of threats and other things, not easily predictable. So, we have to go and see the markets and take a decision.

Sachin Kasera: Secondly, the lockdowns in China will it have any impact in terms of our sourcing?

C. C. Paarthipan: What we do is, we have been exporting formulations from China to South America. This is like any other South American. It's not like an Indian who imports the API and converts the formulation and do it. We haven't faced any issues. What will happen is maybe 1 or 2 issues in the such as there is certain friction in the border and other things, getting visas or getting work permits in China may be difficult for Indians. Even for that, we have some ideas. We are planning to start something in the borders of China, some small entity which will also generate revenue for the company. Of course, we will take a decision after visiting this country, and if our people Indians go there and take work permit, they will take visa based on their work permit in that country and move to China.

Sachin Kasera: Lastly, what type of revenue we can expect from this CAPEX that you doing, especially the capacity expansion and as well as the Oncology CAPEX that you doing?

C. C. Paarthipan: Revenue will be good. I would like to convey the message like this. Any company which is of our size, what is important as you know very well, first is the cash flow. We have seen the cash flow. That's the reason one of our shareholders wanted it to be given in the form of more dividend. Second, we are putting this money in the right projects. If you look at any big company, they will have an injectable plant, they will have OSD plant, they will have Onco plant, and they were also into the bigger geographies. That's what we are planning to do also now. The only thing which we are not able to predict the reason is all these big companies have gone to these countries much much earlier. At that point, there was no Covid. There was no war also. Now when these 2 things are happening, if you ask me also to predict something, that will be crystal gazing. So, I am sorry to say that we will not be in a position. After 3 years, we will do extremely well. That is for sure as long as there are no huge wars and other kind of stuff which is going to affect the mobility of the people. Otherwise, we will do extremely well. The reason is, if a company of our size can have something which is unique, as you know well, the best company is the No. 1; unique is the only one. Any company of our size may not have all the fundamentals which we will have in the next 3 years. At that point of time, our OS will not be as big as a big company. That means a big company can choose and price a product definitely higher than us which means we will have a radical edge to price even in tenders. And when I quote a better price in tender, the only issue which I have to face like other companies is tenders they don't pay on time. Then, I will have to go for a model – some locals who are ready to fund the tenders, they will expect some 5% to 10% means, if my profit is more, I will pay that one and get my money faster. All these things are possible provided we will have to make a trip and understand the ground realities in these countries.

Moderator: The next question is from the line of Chirag Fialoke from RatnaTraya Capital. Please go ahead.

Chirag Fialoke: Just 2 short questions. One is on the Caplin Steriles business. Could you confirm the EBITDA and the PBT numbers for the year that we have closed? Could you provide that to us? Is that possible?

Vivek Partheeban: I am not sure if we declared the breakdown.

D. Muralidharan: We will be uploading the same in our website. Once the results are out, we will be publishing the same in our website.

Chirag Fialoke: The second question is a clarification question on Chairman sir's comment. Sir, you mentioned that you will be targeting between 15% to 20% growth and being more precise than that is difficult in the current situation. Could you just help us clarify is that 15% to 20% on the overall level or for our standalone business other than Steriles?

C. C. Paarthipan: I meant it's overall only.

Chirag Fialoke: Including Steriles that is?

C. C. Paarthipan: Today, I am not in a position to give an absolute statement. I am telling something which is a relative statement. It may go up and there is a possibility. But definitely, that 15% to 20% actually is one which is definitely possible.

Moderator: In the interest of time, I now hand the conference over to Mr. Vivek Partheeban for closing comments.

Vivek Partheeban: Thank you everyone for your continued interest in our company and also thanks to Shrikant and your company and also the moderator, E&Y. Thank you everyone for attending our earnings call. Thank you.

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Moderator: On behalf of Asian Markets Securities Limited, that concludes this conference. Thank you for joining us, and you may now disconnect your lines.

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