“Caplin Point Laboratories Limited

Q1 FY ’24 Earnings Conference Call”

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Moderator: Ladies and gentlemen, good day and welcome to Caplin Point Laboratories Limited Q1 FY24 conference call hosted by Dolat Capital. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing star then zero on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Ms. Rashmi Shetty from Dolat Capital. Thank you and over to you, ma'am.

Rashmi Shetty: Thank you and good morning, everyone. I, Rashmi Shetty, Healthcare Analyst from Dolat Capital, extend a warm welcome to everyone joining us today to discuss Q1 FY24 earnings con call of Caplin Point Laboratories. On this call, we have with us Mr. C.C. Paarthipan, Chairman, Mr. Vivek Partheeban, COO, Dr. Sridhar Ganesan, Managing Director, Mr. Muralidharan, CFO, and Mr. Sathyanarayanan, Deputy CFO. Over to you, sir.

Vivek Partheeban: Thank you, Rashmi. Hello and good morning to everyone. Welcome to our earnings call to discuss the results of Q1 of 2023 and 2024. Please note that a copy of all our disclosures are available on the investor section of our website as well as on the stock exchanges. And please 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.

The conference call is being recorded and the transcript along with audio of the same will be made available on the company's website as well as the exchanges. Also do note that the audio of this conference call are copyright material of Caplin Point and cannot be copied, rebroadcasted, or attributed in press or media without specific written consent of the company. Now I would like to hand over the floor to our chairman for his opening remarks.

C.C. Paarthipan: Good morning, ladies, and gentlemen. Welcome to our Investors Call. The saying of Brad Gilbert is a good result in the present is not an indicator of good result in future, but a good process. Now, let us look at our sustainable progress and process of our business. Value research report on June 2022 rated Caplin as number one in India for most consistent profitable growth across the last 10 years.

Further, economic times noted Caplin as the second largest wealth creator for the decade ending 2020. Our ROE and ROCE has been unique in the last 10 years compared to our peers. Currently the liquid assets of Caplin Point stands at INR1,540 crores as on 30th June 2023, which includes INR807 crores of cash and cash equivalents. It's not the profit in the book, but cash in the bank. I'm also sure that you'd agree with me, truth does not require maintenance and truth cannot be detraited too.

Our operating manual for longevity with details of what has been completed and what we are currently doing, which is in the form of work in progress and how it will strengthen the company in the years to come. Now, let us look at Caplin Point. We call it as CP1, where we manufacture and export our products to Latin America. Here, we created a second line for Softgel formulation, and we just started to increase the revenues. We also have registered 92 products in Chile using our CP1.

And most of the products in addition to that, more of our products are also in the pipeline. We are moving one of our marketing guys from Central America to Chile to start our warehouse business model in Chile. Now, Caplin Steriles. You are aware that the USFDA inspection is completed successfully after four and a half years. Our phase two will become operational in October and we'll be shipping most of all the terminal sterilized products from phase two.

The state of the art machinery will increase the production multi-fold. The status of phase two and phase three of Caplin Steriles and our creation of US front end and digitalization will be detailed by COO after I complete my speech. Now, we are in the middle of the good growth story and the fundamentals are as follows. First, the ones that are completed and also the one that are work in progress. R&D for API, which is for general API and Onco API.

Second, we will complete our API facilities, the general one in six months and the oncology one in one year from now. R&D for injectable for the US, you are aware that we have been actually filing the documents, we also obtained 18 ANDAs using this R&D. Now, the rest of it will be detailed by the COO. The Onco injectables is a work in progress. It will be completed and at least 25 to 30 products in the next two years from now, both for Onco injectables and Onco OSD in the form of tablet and capsule.

The CRO, which you are aware has already been completed. Currently we're doing these studies for Chile. We'll also do it for Mexico, US, and Chile in future too. Happily, in Onco, the tablet and capsule will be ready in six months from now. And injectables will take one year for the completion. And we already received an order of some $4 million from Latin America, which will run as CMO. And this clearly shows that you have huge opportunities, not only in the regulated markets, but also in the RoW market for the oncology product that we are planning to manufacture in the future.

The product that we received now, although it will be manufactured in a CMO, the testing will be conducted in our QC and QA before export. And the general OSD, the construction is in progress and is about to be completed between 18 to 24 months before we start the commercials. Once we complete the entire activities in two years, Caplin will be unlike any other company in the form of good to great with all segments of pharmaceutical formulations and API, which is vertical integration.

That's what is happening with all the big players in India. Whether you are aware that our sustainability and reasonable scalability is already ensured without all these new initiatives. However, with all these activities that we are about to complete in two years would make a lot of difference. And let me give you the key differentiators as follows. We will have new projects, and most of these projects are for the regulated market, and these are all bigger projects, which are likely to happen as I told you before in 18 to 24 months, some of them in six months, some of them in 12 months too.

And we will move to bigger markets in addition to maintaining our business in the smaller markets. Number three, we continue to be a debt-free company with strong cash flows. For example, we've already invested INR500 crores in the capex the last five years. If you add this INR500 crores with our liquid assets of INR1,540 crores, it will be in the region of 2,040 crores.

This is in addition to the operating costs for the last five years. Our CSL is not just a CMO like most of the companies of our size. We own 18 ANDAs and many more to come. The new normal in our company is in the form of employee engagement. For example, what I have found in Caplin Steriles, I have found actually some of the operators and first-line managers who are coming for the test shoot.

They are from the bottom of the Pyramid. I just checked with some of the people as I'm staying closer to the factory now. I've come to know they all live in actually one-room houses. I asked them, in case if your child, which is two years or three years old, come and actually wake you up, what you need is, will you wake up or continue to sleep? He said, I will not be able to sleep. I will definitely wake up, which means, it will create fatigue for him when he comes to work. When I told them, we are appointing new boys, freshers, most of them are bachelors.

And if you develop these boys, there will be a thought shift and they are very happy to accept it. Now, we are building a hostel for 120 to 130 freshers who will stay here, they'll get three times of the food and accommodation. We're also creating a small playground for them as a recreation also after they complete the work. In addition to that, we will also ensure increments, performance bonus, and attractive ESOPs, which you are aware that we have been actually offering to retain the talent.

Finally, ours is a journey of passion, purpose, and potential for all stakeholders. And it's not the concept of red rubber ball. You throw a ball against a concrete wall, and it just bounces up. It looks pretty and makes noise, but the wall does not move. Our business is not maintaining the status quo. It's a journey for patience for excellence. Thank you. Thank you very much. Now I hand over to COO, I will ask him to give a presentation.

Vivek Partheeban: Thank you, Chairman. Once again, welcome to everyone that is part of the call. I will give you a little update on the regulated markets business and also an insight into the company's digitalization activities going on. So as Chairman said, our USFDA audit has been completed and we are satisfied with the outcome. All of the observations that we have seen were procedural in nature and nothing to do with repeat observations.

In fact, if we were to take a clue from the USFDA website, our status has already been updated as VAI, which is what we were expecting. But of course, officially we need to have the EAR in our hands before we can declare it. So obviously this is a satisfactory outcome for us after not having an audit for the last four years. And it shows that we've been significantly improving our processes, automating our processes, and also creating a good culture of compliance at the company for so long.

An important step for us in our US and regulated market journey is our establishment of a front-end presence over there. As you know Caplin's mantra in the last two decades has been being closer to the customer. So in less-attended markets, in markets where front end presence have been few and far between, we were able to successfully do that in Latin America. The US obviously is a much more mature market, so even though we could have probably done it a little while back, we did not have the right amount of products or the right portfolio of products for us to launch in US.

We feel right now is the time for that and we're in the process of incorporating our company over there and in the next six to eight months we should have all of the licenses in the 50 states for us to launch our own label there. Several years ago, exhibitions such as CPHI, IFEX, etc. bridged the gap between the markets and the manufacturers. Similar to this, there are multiple fares and means that are available in the US that we will start to participate in through our front end, just to understand the unmet needs of the underinsured and uninsured population there.

And sticking true to our pattern, we want to cater to the bottom of the pyramid, also in the largest market in the world. Once we establish our presence over there and then sales start coming in, we expect the profitability to be boosted by this move because we are currently sharing 50% of our profits with our front-end partners. We may still continue to supply existing products and even potentially a couple of the new products to front end because we need to have a hybrid model of making sure that the larger players continue with us, whereas we try and occupy the Tier 1, Tier 2 spaces that we've been doing in Latin America also.

-Coming to numbers, we had a good Q1, and in line with our guidance, we expect good Q2 performance, with much stronger growth in Q3 and Q4 when our additional line 5 comes into operation. Line 5 will be used specifically for terminally sterilized products and today over 70 percent of our products are terminally sterilized, and we will be focusing much more on the commercial products so our output will significantly be boosted in Q3 and Q4 of this year. Please also note that we are continuously doing exhibit batches, which is the last step before filing ANDAs throughout this time as well.

Despite having multiple products that are approved and then in the process of commercializing, many companies may make the mistake of choosing only commercial over what is going to be driving long-term growth, which is the ANDAs that we will continue to find, you know. So in line with that, we have almost 14, 15 products that are under stability right now, which we will file over the next four to five quarters.

Our overall pipeline remains robust with over 55 products that are under various stages of development. This includes injectables, suspension emulsions, bags etcetera. Additionally, we have also done several filings in Canada, South Africa, Mexico, Australia, and Philippines, and this will start to get approved sometime next year and the years after that. As we evolve as an organization in the regulated markets, we are also taking up higher complexity products for development shortly. We shortlisted four to five highly complex drug-device combination for development that we intend to file in the next 10 years.

Being highly complex in nature, we see that there is minimum price erosion in this segment. Once they start to come through, we'll have a very differentiated basket of products comprised in the entire gamut of offerings that are used in the hospital or any critical care segment.

Added to this, our backward integration initiative is starting to pick up steam. We foresee completion of the API projects in the next few quarters, and we will start using the site initially to qualify as a second source API for our existing products and prime resource for our new and more complex formulations. In this day of continuing shortages in the U.S., we feel that having good control over our input materials will certainly hold us in good stead compared to peers of a similar size.

I'll take a couple of minutes to explain our move towards digitalization towards the entire organization. Two years ago, especially during the late stage of COVID, we started to take up overall automation activities at our plants. We implemented LIM systems at Caplin Steriles and also at Amaris Clinical, our CRO. And right now, our quality control microbiology and soon validation activities are all close to being as paperless as possible.

Soon, we will start implementing the process of also having electronic batch manufacturing records and batch packing a record to become a truly paperless facility. All of our training modules, document archival modules, etcetera, are already automated. Our CRO has actually been completely automated from day one. So the fact that we've gotten through three audits without any observation is a testament to the controls that we have in place there.

We've also implemented SAP across all locations, and we start to see the benefit of that as a unique player that is focused on an end-to-end business model, our supply chain strength is the blood line for the company, and this SAP implementation has already started to make our processes more aligned and predictable. As the world moves towards AI and associated evolution, we at Caplin has already started incorporating this shift. Our latest procurement has been towards machines and equipment with AI and Machine Learning enabled. This will be particularly useful in specific equipment related to the visual inspection of the vial leak detection of the bag, testing of prices involved and continuous manufacturing, etcetera.

Overall, we feel that as a company, we are on the cusp of breakout growth with some of the capex and R&D that we're investing in. The next couple of years will be crucial in charting our next trajectory of growth. Most importantly, we are doing all of this with internally accrued funds and not taking external loans, and they are a little within our needs.

And at the end of this, we feel that we will be similar to what the top 15 to 20 companies of India have done before. Our intention is to ensure that we remain cash focused despite this huge capex outflow and our bottom line and cash flow remains a benchmark during this whole process of our next level growth for the company and all stakeholders.

Now I request our CFO, to give us remarks before we open the floor for questions.

D. Muralidharan: Good morning, Mr. Vivek. Good morning to one and all, have taken time to take part in the investors call of Caplin Point Laboratories, discussing the Q1 results of FY '23, '24. We have had a very gratifying quarter. Why gratifying because of the following reasons. The revenues have grown by 13.1% over last year's corresponding quarter.

The EBITDA has grown by 19.3%, and PBT has grown by 20.8%. This evidence that our costs are under control, our gross margins are under growth. And then on all the parameters, we have led some very good ratios in terms of their increase as compared to the last year and the previous quarter as well. The EBITDA is at 34% and PBT was 31.2% and PAT had a significant 25.6%. It is also gratifying for the following reasons.

Whatever our turnover was for the full year 2017, which is INR401.64 crores on an annual basis, is less than the current quarter turnover of INR407.36 crores. That is, the turnover as grown fourfold in the last 5 years. Coming to PBT, our full year PBT of INR122 crores, INR121.78 crores to be precise. It is already achieved in the first quarter of current year, which is INR126.99 crores.

Coming to PAT. Our whole year PAT was INR96.16 crores in 2017, now we are at INR104.23 crores for the quarter and a wonderful 25.6% PAT level, which is a very significant milestone.

And in terms of cash and cash equivalents, which we lay stress on has grown more than five times what we had INR152 crores in 2017 in 2019, we have a INR772 crores, and it has grown to INR807 crores as of June '23. This has been our strength and our Chairman has put it and Mr. Vivek as reinstated, we will always lay focus on our cash and cash flow and then work-in-progress.

So this is from my side. We would be glad to take any questions and over to Mr. Vivek.

Vivek Partheeban: Thank you, sir. So we can open the floor for questions now, please.

Moderator: The first question comes from the line of Sudarshan Padmanabhan from JM Financial PMS, please go ahead.

Sudarshan Padmanabhan: Thank you for taking my question and congrats on great set of number. Sir, my question is on Caplin Sterile. It's been heartening to see that we are INR45 crores, closer to INR50 crores. And the addressable market is $5 billion for the ANDAs we have filed and what we have. My question is beyond the FY24. If I'm taking a 3 year view where do we see this division because we will also see oncology scaling up in terms of scale and profitability.

And how are we looking at investing into this? I mean, I'm talking about investing in the front end because companies as the scale, you invest their resources back into the business to keep profits and improve their own business , just wanted your views?

C.C. Paarthipan: Coming to Caplin Sterile, the most important one is actually our Phase 2 and Phase 3. The reason being, the last 10 years, we have been actually continuing to do business with legacy machines. And everyone when you start the project, especially if he's a non-technocrat, he may not be very thorough actually in terms of selection of machineries and people. Now after having been in this business for so many years, I am next to the factory. And in the position to understand the character and quality of my people, and I'm also in the process of building a culture.

Second, the machines that we have are all state-of-the-art machineries many of them are from Germany and some of them are Italy and the best of the best also from India. So the capacity of the machines are going to be manifold now. So we are very sure that the production capability will increase. And that alone actually can give us a bigger advantage in terms of export. Whenever people say there is a shortage in U.S. market, especially in generics, it is a simple, actually mental arithmetic that when there is a shortage of the product, the price has to go up because the shortage means supply is less than the demand is more. It is true that they say there is a shortage, but the profit doesn't actually increase for the manufacturer.

The reason being the manufacturer has not set up the front end. That's what we are planning to do now. We've already sent a person to create our actually front-end office there and the COO of the company will leave on the 20th. And every 2 months he will spend, 15 days actually in U.S. to understand how exactly we will be in a position to identify the uninsured and underinsured.

In addition to that, currently, we have around 570 people, of which 540 are Latins. And many of them, they have their own groups actually in U.S. And the second largest population in the U.S. is Latin. We already identified some people from our Latin American team to go and work in the market to understand which are the products that moves well.

This will also help us to change . One, we will now be in a position to register a product, which may or may not have scope in future. Next, we will get the information from the market, not in addition to IMS and the other one. Mostly, the data that we see that comes actually not from the bottom of the pyramid more of actually the one which is in the form of tender business are from the one which import actually.

If you look at US, there are three or four major companies that import the product, and the data is separated in IMS. But when we work in the market, when we attend the exhibitions at actually the COO too, that is the time we will come to know what kind of customers you come to the exhibition, what type of information, which is the real knowledge because you know very well information is not knowledge and opinion is not a fact. So all these things will come to know as we enter in the market. This is with regard to Caplin Steriles.

Coming to Caplin Onco. Today, the ROW business is very, very attractive, and we will enter into markets like U.S. and Europe also, but the focus will be on ROW until we get the regulatory approvals. As a token, we in fact we have tried to see how exactly the market response. And this is very important to tell you also that we receive, we have a loan license company with a EU approved facility in the north. And this one, we already registered also 20 to 30 products and some countries even 40 products for which we received a very good order. We are planning to manufacture in the next three months as a CMO.

And in addition to testing in their own lab, as I told you before, we'll also test it in our lab and send it because we always value quality as very important because the reputation, especially the character and reputation in pharmaceutical industry is very, very important. Otherwise, you are aware actually what is happening worldwide today. We don't want those things to happen when we manufacture a product, whether it is an oncology product or any other product that you outsource in India or China.

So the business, as I told you in the course of my talking here, the work in progress is much more actually a bigger opportunity than the current one because the market all six , seven markets put together where we are in Central America as I told before it's not even the population of Tamil Nadu. This is the business which has brought around INR1,200 crores with sufficient cash flow and good profits. The remaining INR300 crores, INR200 crores has come from US and another INR100 crores from West Africa.

And although, we received INR200 crores in US, which is going to be, as this is the gold standard of the international, in the world market. One day, this will definitely be the best market for us, although we are not the early entrant. We may be the last man standing and we assure, we will be the last one to get affected and the least one to get affected. Thank you. I hope I answered your questions.

Sudarshan Padmanabhan: Sure, sir. In terms of scale in three years, sir, the US currently they are running at around INR45 crores a quarter, given that the addressable market for our product is $5 billion.

C.C. Paarthipan: In fact, we have a lot of orders from the US market. As I told you, the phase 2 production will start in October. And whatever machinery I told you will be operational in third and fourth quarter. The machinery, as I told you before, are German machine and the state-of-the-art machine from India and Italy. The machines are capable of doing something extraordinary compared to our legacy machines in our phase 1. So the sale of INR45 crores is not the one which we are going to continue. This will actually, will double from the third and fourth quarter.

Sudarshan Padmanabhan: Sure, sir. And sir, can you talk a little bit on the PFS opportunity in Latin America, sir? The eight products that we have signed?

Vivek Partheeban: Yes, , so similar to the Softgel segment that we had launched a few years ago, which we've seen quite a lot of growth in, quite a lot of profitability coming out of that segment. We realized that this segment is something that is very, very underpenetrated. In fact, outside of the very large, branded companies, almost there is no competition in this space because it's a highly technical area also.

We started out with a couple of products last year and we've seen that there is a significant amount of interest and there is a lot of repeat sales as well you know. So what we typically try and do is wherever there is a product that is available as an ampoules or a vial and it can be administered directly at clinics and stuff, we try to replicate this into the form of a Pre-Filled Syringe. So that you remove one step of the equation.

And number two is, also the fact that many of these products that we have launched also have an oral equivalent option. So that's how we have looked at it. Still very early stages in this segment, but we remain quite positive on the overall profitability of this segment.

Sudarshan Padmanabhan: One final question before I get back to the queue, is on profitability. Already in this quarter, we have seen that below the gross margin, we've seen a good 180 bps expansion, which I would assume is primarily operating leverage and good cost control. Now, given that the base of infrastructure is in place and the growth is just taking off, where do we see the margins expanding even from here? Or do we see that, like you mentioned in the front end that they're going to create infrastructure in the US, that a part of the margins will basically be invested into the front end? Just wanted to understand how the margins effected over the years?

C.C. Paarthipan: Yes, I would like to answer to this question. The margin comes not because of the market, but because of the model. If you look at the companies, most of the companies of our size, they export their product to the importer. If you sell your product to the importer, the importer buys products from many companies of our size. And all of us, even we did the same thing, and we built our bridges, it's a turnaround story. That's how we understood that we should remove the intermediaries.

Whether it is US or some other market, it's okay for the people who entered early, for them actually it was extraordinary. Today, the prices are eroded in every market. There is no market which you can say, like you can come with a product and you are 100% sure of actually making a lot of money. So the models are the one which is going to give you the best returns. Everyone is not your customer. It's here that the concept of what we call an ideal lead comes in. This is a prospect who is interested in what you have to offer.

So if you are offering something to the needy, as you know well, , the only thing we call is permanent is change. In addition to that, there is one more thing which is permanent is poverty. If you have something in a form of a strategy to address actually its pain point then this tool will become your 3D layer and that will give you the profit which we have already experienced in Central America will do the same in the other parts of the world also.

Sudarshan Padmanabhan: That’s all, sir. Thanks a lot. Thank you very much.

C.C. Paarthipan: Thank you very much.

Moderator: Thank you. The next question comes from the line of CA Garvit Goyal from Nvest Analytics. Please go ahead.

CA Garvit Goyal: Hello. Good afternoon, sir. My question is on the API expansion side. So, are API expansion getting delayed quarter-over-quarter? I remember in quarter 1, FY '23 con call, you mentioned about the inorganic facility expansion at Vizag. So at that time you mentioned that the inorganic expansion will become precede in three months and our organic will get completed in 15 months from there. Going forward each quarter you put a delay to the timeline and now we are seeing that the oncology API will get completed by Q1, FY ‘25. And I think, Vizag needs to be refurbished by Q3 FY '24.

What I am not understanding is that why such delays are happening. It is not like some COVID situation is there or any hindrance is there. Because capex are happening across the industries. So why are we not able to execute the projects in a timely manner? I understand one quarter, two quarter delay might be there, but it almost I think two years delay, sir. So kindly put some color on it and give the firm timeline to the investor community by which these extensions will get completed and start contributing to the Revenue?.

Vivek Partheeban: I think the question is on the lines of Vizag API plan. So of course, I'll let Chairman to answer that. I just clarify one point. A couple of years ago, we had the opportunity to acquire a company that was already into manufacturing intermediates and API, but towards the end of that, it fell through because of valuation mismatch and also the fact that we were not very comfortable in terms of turning that around into a regulated market plan. So we had to almost go back to the drawing board. So we lost around one year in that and the rest of the missing timelines, I'll let Chairman answer this.

C.C. Paarthipan: Yes. This is not, as he rightly said, actually, it's not the facility which we told you sometimes back. And here, the one important thing, this is a facility which we are trying to take it to the US market for our formulation injectable. And later, we also found there is an opportunity for us to go for OSD also. That's one of the reasons there's a slight delay in the form of three, four months.

And you're also aware actually, if you're a first-generation entrepreneur and that to a non-technical person, delays are bound to happen, but delays will not actually in the form of actually create issues to the company, which disturbs the bottom line of the company. I don't think this is such a big issue in the form of that affects the bottom line of the company. And moreover, actually, it's not the factory, which we have talked to you earlier.

Vivek Partheeban: Yes, just to supplement Chairman's note, why we mean that this is not going to affect the company adversely or anything like that, these small delays is that we are not derailing our projects or anything. Our R&D continues to go at a very high rate. And wherever we feel that the opportunity is time bound, we actually buy the API from outside and we will use our own API as a secondary source.

Which is why during the course of my speech, I explained most of the initial targets that we'll be focusing on in terms of DMR filing, etcetera, will be on secondary source. So technically we're not really losing any time, even if it gets delayed by another quarter, the API project I'm talking about.

C.C. Paarthipan: One more issue is we don't borrow any money also from the bank, because it has a cost to it, actually in the form of interest or repayment of time loans.

CA Garvit Goyal: Okay. And so, secondly, on the US growth, like in, I know you explained earlier as well, from quarter 3 to quarter 4, I think the value will be double down. But the thing is, is there any specific reason why there is Y-on-Y slower growth on the US side in this particular quarter? Or it's likely we will get the further growth on the Q3 and Q4 for phase 2 and phase 3?

Vivek Partheeban: So as we explained, even prior to this, we've given the guidance that Q3 and Q4 are going to be much stronger compared to Q1 and Q2. This is specifically to do with the fact that we are going to be transferring many of our commercial products as I said, over 70% of our commercial products that are terminal-related products. And we will be transferring them onto this line 5.

Now line 5, individually has higher capacity than all the other couple of lines combined. Right, so number one. And number two, we also do balance our commercial products and exhibit products. So what happens is if you focus only on commercial products, what will happen is in 2025, our pipeline might start to look thin. So we need to make sure that we have our longer horizon aspirations are in place, and we're not missing out on some of these time-bound opportunities that we focus on. So quarter 1 and quarter 2, as we explained before itself, is going to be slightly more moderate compared to quarter 3 and 4.

C.C. Paarthipan: Sir, once again, I would like to repeat what I told you in the course of my speech. A good result in the present is not an indicator of good result in future, but a good process is. So the process which I mentioned, the COO and CFO mentioned, that really matters actually compared to what has actually, is what exactly is missed, which is not something in the form of a big actually impact to the bottom line.

CA Garvit Goyal: Understood, sir. And lastly, sir, on the high cash balance, are you guys considering any kind of buyback to reward the shareholders in the terms of like these high balances are basically generating lower returns than you are generating from the businesses. So overall ROCE is getting depleted sir.

C.C. Paarthipan: So we will discuss it in the board meeting and take a decision.

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

Alisha Mahawla: Hi, sir. Good morning. Thank you for the opportunity. A couple of questions. First question, in our opening commentary, did we mention that we won a tender for $4 million? And if yes, for which market is this?

C.C. Paarthipan: It's actually not a tender. The market is $4 million. It's the business that we received for oncology products. And it's definitely a good business considering the size of actually the countries. And then these are markets which are not regulated. It's a RoW market. That's why I specifically mentioned the volume of the business really matters for a facility which we are planning to complete, say, six months from now, one year from now. That's why I mentioned.

Alisha Mahawla: So this order for Onco products, $4 million RoW market, will we start supplying from H2?

C.C. Paarthipan: Yes, you are right. Some of them will start actually maybe 15 days to 20 days from now also some seven, eight products.

Alisha Mahawla: Okay. And just a clarification on phase 1 and phase 3 for the Caplin Steriles that we refer to. Phase 2 will be the vials and Prefilled syringes facility which is coming, which is commercializing next quarter. And what will phase 3 be?

C.C. Paarthipan: No, we are not commercializing PFS in the phase 2. In fact, by October we are going to start, as I told you before, we are starting line 5 in October. Of course, followed by PFS will start. PFS is one, anything that you start in PFS, you'll have to do the scale up and exhibit. Not that you want to start the commercial there. So that will not create any impact to our bottom line because we'll have to complete the scale up exhibit and then you'll have to keep it in six months and file it and get the registration at a later date.

Vivek Partheeban: Yes, so as Chairman said, phase 2 has two lines, which is line 5, where there'll be direct commercial supply from there. And phase 3, right now, we have one Lyophilization line. It's a high-speed diode line. And we have provision to add another three to five lines over there, which we've not yet decided on what to use because we also want to make sure that we have complete control over the entire operations. We don't want to stretch ourselves too thin. So phase 3, as it stands, we'll have one Lyo line and provision for additional injectable lines.

Alisha Mahawla: Phase three will come in Q4 of FY ’24?

Vivek Partheeban: So right now, the physical completion of the structure is done and we expect overall completion by March to June of next year.

Alisha Mahawla: Sure, and on our Latam business currently, we've been talking since a while entry in Mexico and Brazil, which like you mentioned last time, will probably be some one to two years downline. Is there any update on that? And for the next couple of quarters, will growth only be driven by this new onco order that we have received.

C.C. Paarthipan: Yes, Mexico and Brazil, mainly Mexico. Our focus will be on Mexico in the next two to three years. But the issue with Mexico, these are all markets, which are actually, as you know well, it's a regulated market. Probably next best after US and all. The time for registration, it takes long time. And then what happens, see, this is one country, where when the product goes to the market, they keep the product in the port and get the product tested also. So we have to be very choosy in selecting the products.

On one side, we are filing the dossiers, which we registered in US. On the other side, we are doing actually the market survey. That alone will help us to identify the right product for registration. These are markets, which will take time. When we make it, these are the market which allows you to change. It's going to be a game changer for the company in addition to what we do currently.

Alisha Mahawla: So contribution from new markets is not expected say this year or next year?

C.C. Paarthipan: New markets currently, what we are doing is, we started doing business with smaller geographies like actually in Southeast Asia, Cambodia and Laos. Then we started with Turkmenistan in CIS. And we are also doing business actually in Chile in bits and pieces, but this big business will start once we open our warehouse. And we are also getting some orders from Peru. Peru, we are increasing the number of registrations.

The business which we do, and as I told you before, the maximum amount of business comes from countries, where we have our stock and sale. That's the model, which increases the profitability. That's the model, which gives us actually sustenance and outsource scalability. So we will do business in the bigger geographies after we complete the registration. Smaller geographies, yes.

In some countries, where we do not want to go for actually our own warehouse, the reason being, for example, the import duty in countries like Peru is very high. Then your VAT also is quite high, which means in addition to investing in your own product, you'll have to invest also in duties and other things.

If the profitability is quite high and if your number of registration is very high, then of course what we can do is, we can take the products to a neutral warehouse and then we can supply to the market. So we're working on various methodologies to get into this type of market. So simply doing business, yes, it's very easy to do the business, but that's not going to be lucrative. There the top line will grow, not the cash flow or bottomline.

Moderator: Thank you. The next question comes from the line of Naysar Parikh from Native Capital. Please go ahead.

Naysar Parikh: Yes, Thanks for the opportunity. My first question was, on the emerging market side, can you give a sense of what is the growth in our top three markets? I'm just trying to understand, we are entering a bunch of new markets. So how is that core growth on a like to like basis?

C.C. Paarthipan: See, I told you before, the new markets, mostly the bigger geographies, bigger markets, it takes its own time. Either it is in the form of first selection of products, then of course the registration as it takes time also. Then we start the markets, depends, as I told you, more that the markets with the model that gives you the profit and cash flow than the top line. So what we do is, we will continue to grow the way we are growing for the next two to three years.

Afterwards, our growth will be manifold. That is for sure, because we'll complete our facilities, and then some of the advantages, this facility will create, once we go for a vertical integration here. Even if you participate in CPHI, the visitors who come to CPHI will understand the difference between other companies and us. A company of our size will not have all actually in the form of starting from these starting materials, intermediaries, then formulations, then front end persons in some areas, and also, CROs and everything.

That gives us actually opportunity to choose the customer, even if it is actually not the warehousing model in the form of stock and sale, you can still choose the customer, if he's prepared to buy a quality product and he'll definitely give us actually a better margin compared to some of the generic players. So we will continue to do our homework as the way we have been doing and the growth will be something similar. It's better to give under promise and overachieve, rather than giving numbers and underperforming .

Naysar Parikh: No, sorry, my question is a bit different. What I'm trying to understand is, if we exclude the new markets that you've entered in the last 12 months, what is the growth in your core emerging markets? In your top three, top four emerging markets, what is your growth?

C.C. Paarthipan: Last 12 months, of course, we have not entered in many markets. On the contrary, we increased the product portfolio. The growth has come mainly because of actually, first, soft gels, as I told you in the course of my speech. Second, the growth is happening because of some of the orders, which we are getting actually in the oncology product.

And if you look at actually the one country, where we entered and we did a business of 200 crores is US. And there will be some 40% to 50% increase in US market in the current year. Other than that, our growth is coming mainly from the existing markets.

Naysar Parikh: Got it. And from a distribution perspective, how do you see this share of direct sales increasing in the emerging markets? So where do you want it to be in the next two , three years?

C.C. Paarthipan: You said direct sales, sales from India to direct to the importers. Are you saying?

Vivek Partheeban: I think his question is towards our breakup of sales between wholesalers and distributors and retail. So is that correct?

C.C. Paarthipan: Hello, is it what you're trying to convey?

Naysar Parikh: Yes, it is.

C.C. Paarthipan: No, that of course, this is one thing, we'd like to see. Disclosing everything leads to self-victimization. Because what is important actually, how much is the sales we do that we want to convey. See, when I say, what is the exact sales of actually distributors, retailer, and other things in smaller geographies, like, five, six countries, that will not be like, I don't want to give you those details, which helps some other competitors also.

Your intention may be good, but at the end of the day, I'm sorry, I will not be interested to give that details, please. one thing I'd like to convey, we are increasing the last mile connect. We are increasing the sale of actually retailers because we can remove the intermediaries in the form of importer and distributor. That's how the cash flow gets increased. If I give you the breakup, I don't want to give you something, which is false and it's better to say, no, I don't want to disclose it. Don't mistake me because that's our strategy.

Naysar Parikh: Okay, no, what I was asking is, today you're around 20% is direct sales, right? So what I was trying to understand is that, over the next few years, what is the potential for these direct sales? And when you go direct versus when you go to a distributor, is there a difference in terms of sales?

Vivek Partheeban: See, actually, the truth is that the breakup remains the same and we are not going direct, right? We've always been direct in this market. From day one in Latin America, we've been directly present. So, we need to create the right balance between what we have to do with regards to distributor sales, what we have to do with regards to retail sales.

We don't also want to trade it to each other's parts and then one side becomes lopsided after that. And also some of these places are not the safest places in the world as well, right? So you need to make sure the right amount of balance is struck. We would like to leave it at this stage, please. Like Chairman said, our focus has always been to hit the last mile. And that's something that we continuously work on. That's about it.

Naysar Parikh: And on the mix, which is there between some of your specialty products and Oncology. So, going forward in your emerging markets, what percentage do you see coming from Oncology from high potent APIs? If you could just throw some light over that?

C.C. Paarthipan: Most of the APIs is going to go for our own consumption. We will not be interested actually to commercialize to start with because these are APIs when it adds value to a formulation when you go for your own front end. Usually, we will not chase economies of scale in the form of no manufacturing a huge quantity of APIs. So, it is difficult to quantify it.

Overall, actually, the basket of formulation will get increased. So, APIs play a role in the form of actually captive consumption, that's it.

Moderator: Thank you. Due to time constraints, the last question comes on the line of Rushabh Shah from Anubhuti Advisors LLP. Please go ahead.

Rushabh Shah: Thank you so much for the opportunity. Sir, my question is we will be spending around INR550 crores on capex in the next one and half year. Our FY'23 operating profit is around INR440 crores, which is enough to fund the capex. So, why we are holding INR800 crores of cash in our books which is causing a dent in our ROE form which ROE was roughly 46% in FY'18 and which is 22% in FY'23. So, can't we consider rewarding shareholders in terms of providing a special dividend or buyback?

C.C. Paarthipan: Okay. Anyway, the first question is -- you're right that now we are planning to spend INR550 crores to complete all the projects. The second one, rewarding the shareholders, one is short term and long term also. Short term, of course, I think which is the final dividend will be rewarding somewhere around 225% this year.

And conserving the cash is going to help us in the long run in the form of going for actually inorganic growth. For example, if you find some companies, if you look at most of the companies which have grown, they have grown organically, then they started actually acquiring companies in the form of meaningful fit. So, the money that we consume now, one day it will help, that is going to help the shareholder in the long run.

Rushabh Shah: Okay, but sir, our annual operating profit is sufficient enough to cover the capex?

C.C. Paarthipan: No, but somewhere when I say inorganic actually opportunity, the inorganic opportunity can be in the form of INR100 crores, can be in the form of INR1,000 crores also. It all depends. We don't know what kind of opportunity we get. We'll cross the bridge when we reach there.

When we get an opportunity, that's going to actually double the profit and cash flow more than the sale. You'd prefer to invest more also. That kind of a situation will happen maybe four to five years from now.

Rushabh Shah: So, we are looking for any inorganic growth? There is something in the pipeline?

C.C. Paarthipan: See what will happen now, the balance is to consolidate and expand. Now consolidating, the consolidation in the form of actually completing the project and going for the best of the best talent and then you have to think of inorganic growth also. That's what happens in every industry, especially in pharmaceutical industry.

Rushabh Shah: Okay, okay, understood. And sir, one more question. We have achieved the target that we have guided that 2016 top line will be the bottom line of 2022. Same we have guided for 2028 also that 2022 top line will be the bottomline of FY'28. So, can you share how, what will be the path that we will go through to achieve this targets?

C.C. Paarthipan: See, as we grow actually, to tell you honestly, we will have a very healthy growth and coming to these types of things what happened in the past, it may or may not be repeated, but the growth actually in the form of what we have been growing and CAGR and other things will continue to be there. And it can even go beyond that also after three , four years, that is for sure. So year-on-year, yes.

Rushabh Shah: My question was, the base has also increased, so growing on the higher base?

C.C. Paarthipan: What is that increase sir you said?

Vivek Partheeban: No, he says the base has also increased. So, 2022, of course, was a much larger base.

C.C. Paarthipan: That's what I'm telling you. When the base increases, it's not easy for us to give you a promise in the form of the top line of yester years will become the bottom line of future.

Rushabh Shah: Okay but yet what will be the paths, what are your plans for the next five years?

C.C. Paarthipan: I've already told you in course of my speech.

Rushabh Shah: I might have missed.

C.C. Paarthipan: What we are doing in the current level. See most of them to put it very simply, the smaller geographies are the ones who brought the company where it is today. Now the work in progress is in the form of all kinds of pharmaceutical formulation manufacturing, in addition to API and others.

That means the markets will be larger as we go move forward. The factories will be bigger, and we love the best of the best talent to manage the facilities. Then the markets and models also, which we told you, although the markets are bigger, it is the model of the business that makes us actually more profit and the cash flow also just increase that way. So that's what I told you everything.

Moderator: Thank you. I would now like to hand the conference over to the management for closing comments.

Vivek Partheeban: Yes, thank you everyone for joining the call. Thanks for Dolat Capital also to organize. It was a pleasure interacting with you all and we hope to remain in touch. Thank you very much.

C.C. Paarthipan: Thanks to all of you. Thank you. Thank you very much. Thank you.

Moderator: Thank you. On behalf of Dolat Capital, this concludes the conference. Thank you for joining us today and you may now disconnect your lines.

Notes:

1. This transcript has been edited for readability and does not purport to be a verbatim record of the proceedings