"Alkem Laboratories
Q1 FY2019 Earnings Conference Call"

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Moderator: Good day ladies and gentlemen, and welcome to the Q1 FY 2019 earnings conference call of Alkem Laboratories hosted by Motilal Oswal Securities. As a reminder all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Tushar Manudhane from Motilal Oswal Securities. Thank you, and over to you, Sir!

Tushar Manudhane: Good evening everyone. Thanks for joining this call. From Alkem Senior Management Team, we have with us Mr. Sandeep Singh, Managing Director; Mr. Rajesh Dubey, Chief Financial Officer; Mr. Nitin Agrawal, VP Finance; Mr. Amit Ghare, President, International Business; Mr. Satyen Manikani, VP, Business Development and Strategy; Mr. Gagan Borana from Investor Relations. Over to you, Gagan!

Gagan Borana: Thank you, Tushar. Good afternoon everybody and thank you for taking out time and joining us for the Alkem Laboratories Q1 FY2019 earnings call. I am Gagan from the Alkem IR Team. Earlier during the day, we have released our financial results and the same is also posted on our website. Today in this call, we have the senior management team of Alkem to discuss the business performance and outlook going forward.

Before I proceed with this call, I would like to remind everybody that the call is being recorded, and the call transcript would be made available on our website as well. I would also like to add that today's discussion may include forward-looking statements and the same must be viewed in conjunction with the risks that our business faces.

At the end of this call, if any of your queries remain unanswered, please feel free to get in touch with me. With this, I would like to hand over the call to Mr. Sandeep Singh to present the key highlights of the quarter and the strategy going forward. Over to you, Sir!

Sandeep Singh: Thank you Gagan. Good afternoon everyone. Thank you for taking out time and attending our conference call. The fiscal year 2019 has started on a positive note. We have successfully managed to close the US FDA inspection at our Daman facility with an EIR within four months of inspection. Also the company has delivered a healthy set of numbers in the quarter gone by with India business registering a growth of 47.7% year-on-year adjusted for the change in distribution policy and the US business growing by 43.1% year-on-year.

Before I get into more details regarding some of the key highlights of the quarter, I would like to briefly explain the change that we have brought about in our distribution policy. In the domestic business, the company receives a significant quantum of its orders towards the later half of the month and in particular in the last week, which creates a lot of operating inefficiencies if these orders are executed and supplied in the same month. As the company is in the process of streamlining its distribution practices, it decided to minimise these operating inefficiencies by spreading the execution of the orders received in the last week of the month over the next three to five days, which leads to some of the orders getting executed in the first week of the next month.

Accordingly in the month of June, some orders got executed in the following month and hence were not accounted in the first quarter. This resulted in lower reported growth in the India business, which also pulled down the overall revenue growth and the EBITDA margin during the quarter. Adjusting for this change in the distribution policy, the growth in the India business was more than 40% year-on-year. Also the adjusted overall revenue growth was 41.7%, and EBITDA margin would have been 17.2%. As per IMS data our growth during the quarter was 14.2%, which is higher than the market growth of 10.6%.

Moving to international business, I am happy to share that the US business delivered yet another quarter of 40% plus growth. This growth has come on back of good mixture of new product launches and scale up in the existing products. During the quarter, we invested close to Rs.100 Crores in R&D, which is about 40% more than what we had spend in the same quarter a year ago.

We filed four ANDAs during the quarter and received two approvals, which included one TA. With more than 100 ANDAs already filed with US FDA and with over half of them yet to be commercialised, I am positive about our growth prospects in the US. Apart from US, our key focus international markets of Australia and Chile also recorded healthy growth during the quarter driven by new product introductions and market share gains. As I sum up the performance for the quarter gone by, I would like to add that we have made significant investments over the last two years in our infrastructure, capabilities and people. We are now better prepared to execute and excel in this rapidly evolving pharmaceutical landscape. I expect these investments to significantly contribute to our growth going forward.

Thank you for listening. With this I would like to open the floor for questions and answers. Thank you.

Moderator: Thank you very much. We will now begin with the question and answer session. The first question is from the line of Aditya Khemka from DSP BlackRock. Please go ahead.

Aditya Khemka: Thanks for the opportunity. Hi Sandeep Sir. Sir, on this Chinese inflation in key raw materials and API prices and intermediates how is that impacted business in this quarter and what do you feel would be the trend going forward?

Sandeep Singh: I think the prices have gone up Aditya, but it has not been very, very significant. I think our EBITDA margins as we discussed in the last quarter would get impacted by half a percent I think on an annualised basis and we are not very sure when the supply situation would ease out to be honest, but I see there are some Indian companies are gearing up. So as of now that is visibility we have Aditya.

Aditya Khemka: In terms of the US business growth, if I look at sequentially quarter-on-quarter there has been no significant growth in the US business, is that correct, am I reading the numbers correct.

Sandeep Singh: I think it is correct, yes.

Aditya Khemka: So did we launch any new products in the first quarter and if yes then how much was the base businesses erosion to offset the new launch revenues?

Sandeep Singh: I will let our President, Mr. Amit Ghare comment.

Amit Ghare: So Aditya we did not have too many significant launches during this quarter and therefore that is what has resulted in not very significant sequential growth.

Aditya Khemka: Okay and what was the price erosion you witnessed Amit between fourth quarter and the first quarter, how much was the price erosion?

Amit Ghare: Single digit, lower single digit for us.

Aditya Khemka: Lower single digit and what could that same number be year-over-year, first quarter this year versus first quarter last year?

Amit Ghare: It was single digit for us.

Aditya Khemka: But mid to high.

Amit Ghare: Yes around mid numbers is what I would say.

Aditya Khemka: Amit, as you stand today having received EIR for the facilities what is you sense of how many products would you be able to commercialise in the fiscal of 2019?

Amit Ghare: Our overall annual guidance still remains the same higher single digits and you know last time also if you remember we had talked about it, same Daman situation we knew that is going to delay a little bit from a quarter-on-quarter perspective, but the target for the full year continues to be higher single digit launches.

Aditya Khemka: Okay so if I take that to be 8 to 9 launches how many launches we are doing in the first quarter out of these 8 to 9?

Amit Ghare: I do not remember these specifics Aditya, but certainly the quarter 2, quarter 3, and quarter 4 number will be higher than first quarter.

Aditya Khemka: Alright, just in terms of vertical integration how much of our US revenue is currently is vertically integrated, it is less than 20%?

Amit Ghare: It is less than 20%.

Aditya Khemka: So if the current environment in the US prices are spiralling downward do you feel we may feel some market share pressure because most of our portfolios are not integrated?

Amit Ghare: Not particularly, I would not say that. The situation as you know is one, the pricing pressure coming from the US and we are towards the end of that cycle from a customer consolidation led pricing pressure perspective. The second reason of course has been increase in input prices and there whether you had your own API or you had outside API, I do not think you are really covered there.

Aditya Khemka: No, I am talking more about the competitive pressure, so the products that you had present in, another players with his own API it could probably have more pricing flexibility versus you right?

Amit Ghare: I would not say that again Aditya because at the end of the day we always see how competitive we are compared to our competition and our competition in many cases are vertical and there is competition, which is not vertical.

Aditya Khemka: Sir, last year in the India business side, Satyen if you kindly could answer this. See the last two years in India business has been slightly distorted because of the demonetisation and then GST coming through what in your view would be the Indian pharmaceutical market growth going forward? FY2019 will also be an exceptional growth year because FY2018 sets a low base, but FY2020 over FY2019 would probably the right sort of comparable number to look at, so what would your sense be of the overall market growth for FY2020 or FY2019?

Satyen Manikani: You are talking about market growth right?

Aditya Khemka: Yes.

Satyen Manikani: The market growth, as per our conversation with lot of people it is going to be around 10%.

Aditya Khemka: So what is driving this 10%, how much of this is price, organic volume growth and how much of this will be new product introduction?

Satyen Manikani: Normal volume growth would be around 4%, new products contribute around 3%, price would be around 2%.

Aditya Khemka: Okay that is all you availed that number. For Alkem specific how well are we doing now in our chronic endeavour and are we profitable now, the overall chronic portfolio?

Sandeep Singh: I think we know we outperform the market, that is the least we can say for chronic. I think we have started seeing green shoots, at the last meeting itself we said that EBITDA margins for chronic we have breakeven so yes were are slightly profitable, but we still have a long way to go to match up to the productivity and the profitability of acute business, but just to answer you specifically, the chronic business is not a money losing proposition as of now.

Aditya Khemka: Last question from my side Sandeep. Is your gross margin on the chronic side better than the gross margins on the acute side?

Sandeep Singh: Yes certainly.

Aditya Khemka: Okay. Thanks. I will get back in the queue.

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

Prakash Agarwal: Thanks for the opportunity. Sir one question for you specifically in terms of your role how in the last 6 to 12 months your role has changed in terms of heading also, the India business, and what are the key steps you have taken in terms of growing, improving hygiene is what we saw this quarter, but what are the other steps we have taken or the spots we are working on?

Sandeep Singh: Nothing greatly has changed from the last conference call. We spoke about cost control, productivity. So those kinds of things we are working on, focused on chronic. So the same usual stuff which is strategic for the company continues to be the thing, which I am focusing on.

Prakash Agarwal: Okay, but any leverage we can have from our strong acute portfolio and the doctor connect with GPs on the chronic side as well, would that be not a good idea or we are working already on the same?

Sandeep Singh: That is a good point and we already kind of trying to do something on that front and we have done few things in the last quarter on that front where we have taken some products, which are chronic to the acute side as well.

Prakash Agarwal: Thanks for that and in terms of gross margins if we see when we did similar kind of absolute run rate when adjusting for the change in the policy, we saw 3Q around 64% gross margins, US sales also was not very different, I mean little different, just trying to understand you know gross margin 64% versus 60% in the current quarter.

Sandeep Singh: It is the product mix situation, Prakash. So our ethical business side is doing well and comparing to the last year the generic component is also kind of controlled so overall the margins are looking slightly better, the Indian generic business.

Prakash Agarwal: So how should we look at for the next nine months especially on the gross margin side?

Sandeep Singh: I would hesitate to give to you guidance Prakash, but I think you can draw your conclusion.

Prakash Agarwal: Why I am asking this is because in the last call we did mention about EBITDA margin is around 16% to 17% and that time our Daman facility was not clear so now with that moving out no remediation cost and stuff so we probably could see better EBITDA margins, would that be a fair way to think?

Sandeep Singh: Yes better compared to last year.

Prakash Agarwal: Any range you would like to highlight?

Sandeep Singh: Even when you say better you mean from the current quarter?

Prakash Agarwal: No from last year yes and from current quarter some perspective how should we look at projects?

Sandeep Singh: I think what we said after adjusting EBITDA margins we have 17.2% that is what we should be trying to maintain that for the year.

Prakash Agarwal: Okay, good, that is helpful and last question, we recently good approval generic Ampyra, dalfampridine, so what is the outlook there? Could that be monetizable in the near term?

Sandeep Singh: It could slightly complicated and I will let Mr. Amit Ghare give you some colours on that.

Amit Ghare: So it is in the Federal Circuit Court from a decision perspective and until the Federal Circuit decision comes we do not see any generics really launching. So that is the situation. The Federal Circuit decision, people are expecting will come sometime in first half of 2019.

Prakash Agarwal: Calendar 2019 okay.

Amit Ghare: Yes.

Prakash Agarwal: Okay perfect. I have more question, I will join back the queue. Thank you.

Moderator: Thank you. The next question is from the line of Neha Manpuria from JP Morgan. Please go ahead.

Neha Manpuria: Thank you for taking my question. First on the US business, could you give us some colour I know we do not talk about exact numbers, but in terms of profitability of the US business till about last year I think it was just about breakeven, this year obviously we have not seen as much ramp up, any colour there would be helpful. Have we seen gross margins improved there and therefore how do we look at the EBITDA trajectory?

Sandeep Singh: Neha, you yourself said that we do not really give information neither on the gross margin nor on the EBITDA margin for the US business, I do not think we ever said that we are at breakeven, I do not know exactly what word you used, but we have said in the past that we have passed the breakeven point and I think that is what we have maintained. We talked about pricing pressure and also input cost increases particularly in the current quarter compared to same quarter last year and certainly that have impacted our margin as was expected in a way.

Neha Manpuria: So the profitability overall has not improved so far because of these issues?

Sandeep Singh: Compared to last quarter same year, certainly not.

Neha Manpuria: Okay. Now that you know the Daman is behind us and would probably see improvement in approvals, is it fair to say that as the one launch is improved you could see improvement on the US margins or do you think there is more of the input cost pressure that could come in and offset that margin?

Amit Ghare: No, historically the new launches always are at better margins compared to the existing portfolio so if more new launches come through as we said earlier certainly that should reflect into our margin side as well.

Neha Manpuria: Okay. Sir just to refresh my memory what are the number of launches that you are looking at this year?

Amit Ghare: Eight to nine launches for the full year.

Neha Manpuria: Okay. On the India business, what is the reason for change in the distribution policy. It seems pretty sudden and would it improve you know the margin that we see in the existing business in some way or this is just you used better efficiency essentially of the existing infrastructure?

Sandeep Singh: I think Neha this is more for the latter part it gets much better efficiencies and ease of operation here the cost savings over here might not be much, but this will lead to much better utilisation of resources otherwise your distribution centres and depots primarily operate for just a week rather than for the whole month we have set up for. It all makes it very even over a long period of time and within the year it should not matter so it is just a shift from one quarter to the other quarter.

Neha Manpuria: Fair enough and my last question is on R&D, how should we look at R&D going forward in terms of in absolute number or percentage of sales and if you could just us throw some colour on focussed areas?

Sandeep Singh: Neha as what we said before between 5% and 6% I think that is the guidance, which I think, will stick for the year as well.

Neha Manpuria: Number of filings would be?

Sandeep Singh: Around 12 we have said, we want to file every year at least.

Neha Manpuria: Okay, any specific areas that you are looking at?

Sandeep Singh: Our portfolio has not changed we are still focusing on oral solids by and large most of them would be under oral solids.

Neha Manpuria: You have not seen any change in our R&D pipeline particularly in the US environment seeing more pressure on the oral solid side. We have not changed the strategy in terms of what products we are looking at?

Sandeep Singh: No, what products we certainly would be looking at, but dosage form change we have not kind of done. What we are saying that we are focusing on oral solids, but within oral solids we have picked up more complex products. The proof will come in the next couple of years when you will see some approvals, but oral solids is still our primary driver of India filings.

Neha Manpuria: Okay. Thank you so much.

Moderator: Thank you. The next question is from the line of Abhishek Sharma from the India Infoline. Please go ahead.

Abhishek Sharma: Thanks for taking my questions. Just a couple of them; in the India market, did how many products did we launch in FY2018?

Satyen Manikani: We launched about 38 products.

Abhishek Sharma: Which is significant decline as compared to the 50s and 60s that we were doing in years earlier right?

Satyen Manikani: Yes.

Abhishek Sharma: Any specific is that one time because of the market conditions?

Satyen Manikani: Not really. I think a year before that we had launched few divisions. There were some divisions that we launched that is the reason the number of new products that you had in the previous year was higher.

Abhishek Sharma: We will trend it around this 30-40 number now, is that the understanding?

Satyen Manikani: Our product launches in the current year would be in the range of 30 to 40 products.

Abhishek Sharma: And all these would be in chronic right?

Satyen Manikani: Not necessary in chronic, we have a very strong sales on the acute front so we will have equal number of products for the acute as well.

Abhishek Sharma: Got it prefect. In terms of total field force what is the number now with the addition of this 2000 reps.

Satyen Manikani: We have 8000 people right now in the field.

Abhishek Sharma: So this includes managers as well?

Satyen Manikani: No.

Abhishek Sharma: This is just the reps?

Satyen Manikani: Yes

Abhishek Sharma: So is this net addition of let us say about third of your sales force in last two years is that the reason why the manpower employee cost has moved up sharply in the last two to three years.

Sandeep Singh: Absolutely.

Abhishek Sharma: This is likely to sustain right?

Sandeep Singh: Right.

Abhishek Sharma: In terms of related question would be around the fact that you know you said the distribution policy led to a dip in EBITDA margin. The impact of that would be entirely on the gross level there?

Sandeep Singh: Yes.

Abhishek Sharma: But part of that could get countered by this simple increase in employee cost, right?

Sandeep Singh: Increase in which cost you said?

Abhishek Sharma: Employee.

Sandeep Singh: These employees are already on our roll so because of our distribution policy when it got shifted from this quarter to next quarter and hopefully going forward it may get even out also because our intention is to have not concentrated sales order during last week of the month so we believe we will be following better practises going forward and it will get evened out, but employee cost we do not see immediate any big addition to employee cost we already have full force in place.

Abhishek Sharma: Got it, just the last one which is more longer term in three years what kind of acute-to-chronic mix do you see in you portfolio?

Sandeep Singh: As chronic business we will kind of double every three to four years so that is the internal target.

Abhishek Sharma: Acute would grow at market rate?

Sandeep Singh: No acute we outperformed the market as well very clearly.

Abhishek Sharma: So the mix would change, I mean...?

Sandeep Singh: It will not dramatically, but acute we are very big, but it would start getting better, but it will not make a differences like huge, in three years' time we will be still acute heavy company.

Abhishek Sharma: All right. Thank you.

Moderator: Thank you. The next question is from the line of Damayanti Kerai from HSBC. Please go ahead.

Damayanti Kerai: Thanks for the opportunity. Sandeep Sir can you mention about the progress in OTC portfolio in your market, how we are doing there and what will be the outlook for next two to three years?

Sandeep Singh: Thanks for the question. OTC, as we mentioned last time we are kind of evaluating. In the next few months we will decide how much more capital and focus management bandwidth we need to put on that as of now we are not very, very keen on it, but we will evaluate as we move forward.

Damayanti Kerai: Sometimes back we talked about some focus on growth areas like biosimilars in oncology for India market. So in last few years has there been any changes in focus areas in speciality segment or there has been like still the same?

Sandeep Singh: No, so we are developing some products for the India market, to start off with. It is a long drawn out process and for us to see those fruits will take us sometime.

Damayanti Kerai: In India, our speciality focus area remains the one, which had been focusing earlier like cardiac, diabetic, there have been no changes there.

Sandeep Singh: No change, not at all.

Damayanti Kerai: Just going to US. In US also like when we can start seeing and filing niche segment like right now we are mostly orals but we have targets in some niche areas also right? So when we can start seeing filings and approvals there?

Sandeep Singh: We are evaluating the space because as you know the US landscape is changing we have to be sure where we look at capital because keep in mind that it is not just R&Ds it is the manufacturing also, you will have to do both of them together. In the next year or so we might think of changing our strategy if required, but I do not think so should be pushed in situation where we will pick up any dosage area which is very different from oral solids.

Damayanti Kerai: Okay. That is all from my side, thank you.

Moderator: Thank you. The next question is from the line of Shrikant Akolkar from IIFL Securities. Please go ahead.

Shrikant Akolkar: Thanks for the opportunity, just want to know the acute and chronic revenue split this quarter?

Gagan Borana: It would be about 85:15.

Shrikant Akolkar: Can you also provide acute and chronic MR split during this quarter?

Gagan Borana: Again 75:25, 75 for the acute and 25 for the chronic.

Shrikant Akolkar: Is it possible for you to provide mycophenolate contribution in Q1?

Gagan Borana: We do not give any product specific answers, but as we said in earlier calls none of our products in US contribute more than 20% to our US revenues.

Shrikant Akolkar: Are you seeing any sign of competition picking up in this particular product?

Amit Ghare: No generics have so far been approved, so we will wait, we will only come to know when someone gets approved.

Shrikant Akolkar: Okay. Thank you so much.

Moderator: Thank you. The next question is from the line of Prakash Aggarwal from Axis Capital. Please go ahead.

Prakash Aggarwal: Thanks for the opportunity again. Sir in the past we have seen approvals like different dosage forms also like Xeloda and complex, Nexium as well. So what is the status of launch there?

Amit Ghare: Prakash, obviously we have filed other than oral solids. I think what Sandeep was trying to say was to tell you that majority of our portfolio will be oral solids but we have filed powders, we have filed liquids, we have semi-solids and topicals and all of that. I think that was number one answer. The other question specifically in terms of launching some of the products that are approved obviously we continue to gear up our supply chain and look at the correct time for launching a product, because both the products that you mentioned are already genericized and we are therefore evaluating from an overall cost perspective also and the market perspective also and at the right time we will launch these products.

Prakash Aggarwal: Okay and one more on the US side. So last year we had a very good growth, a) because of launches, b) because of market share so we have in the past said that we gave that 200 plus million dollars we more than achieved it, just trying to understand about three-year period, how do we look at growth from a three-year period? Do we see a similar growth going forward as well?

Amit Ghare: Prakash, if you recall we have always said that there is a large piece of our portfolio, which is yet to be approved and yet to be commercialised and our endeavour is to see how we can continue to maintain per ANDA, average that we are getting, we are slightly on the higher side, even if we normalise it a little bit and we maintain that average for our new launches and for the whole portfolio that is. I think we will get the numbers that we have broadly talked about.

Prakash Aggarwal: Okay and lastly on the capex side. I understand this year capex is relatively lower so what is the number and where we are focusing in terms of spending the same?

Rajesh Dubey: Prakash, if you are talking cash outflow on account of capex, so our estimate is we will be landing somewhere in 550 kind of, Rs. 550 to 575 Crores because there are some carry forward capital expenditure of previous year, which needs to be cashed out. I think otherwise, this year capex is normal capex.

Prakash Aggarwal: Last year, how much?

Rajesh Dubey: Last year, it was Rs. 670 Crores.

Prakash Aggarwal: Broadly, where all we are spending I mean, I think US and Sikkim was largely done right?

Rajesh Dubey: Also we have now Indore in our pipeline and Sikkim expansion is going on, most of these things will get completed in this year.

Prakash Aggarwal: Just to carry forward in fiscal 2020 would that number go down?

Rajesh Dubey: On what, on capex?

Prakash Aggarwal: Yes Sir.

Rajesh Dubey: Capex, normally we feel will be in the range of 350 to 400.

Prakash Aggarwal: Okay, so the free cash flow generation going forward will be much higher.

Rajesh Dubey: We expect that.

Prakash Aggarwal: Okay, and lastly is there any update on that real estate non-current investment that we have in terms of divestment?

Rajesh Dubey: Nothing significant change from what we discussed last time, but we are hopeful this year we will try to come out of real estate part.

Prakash Aggarwal: Thank you so much and all the best.

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

Gagan Borana: Thank you everyone for attending this call. If any of your queries still remained unanswered please feel free to get in touch with me. Thank you.

Moderator: Thank you. On behalf of Motilal Oswal Securities that concludes this conference. Thank you for joining us. You may now disconnect your lines.