"Indoco Remedies Limited Q2 FY24 Earnings Call"

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MODERATOR: **MS. RASHMI SANCHETI SHETTY – DOLAT CAPITAL**

Moderator: Ladies and gentlemen, good day and welcome to the Indoco Remedies Limited Q2 FY24 Earnings Call Hosted by Dolat Capital.

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 this conference, please signal an operator by pressing '*' and then '0' 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. Over to you, ma'am.

Rashmi Shetty Sancheti: Thank you, Dovin. Good afternoon, everyone. I, Rashmi Sancheti Shetty, on behalf of Dolat Capital, welcome you all to the Q2 FY24 Earnings Concall of Indoco Remedies.

I would like to thank the management of Indoco Remedies for giving us this opportunity to host the call. Today from the management team, we have with us Ms. Aditi Panandikar – Managing Director, Mr. Sundeep Bambolkar – Joint MD and Mr. Pramod Ghorpade – CFO.

I now hand over the call to the management for their opening remarks. Over to you, sir.

Management: Thank you, Rashmi. Good afternoon, everyone. Thank you for joining this call today.

Let me draw your attention to the fact that on this call, our discussion will include certain forward-looking statements which are projections or estimates about our future events. These estimates reflect the management's current expectations of the future performance of the company. Please note that these estimates involve several risks and uncertainties that could cause our actual results to differ materially from what is expressed or implied. Indoco does not undertake any obligation to publicly update any forward-looking statement, whether as a result of new confirmation, future events or otherwise.

Over to you, ma'am, for your opening comments.

Aditi Panandikar: Yes. Good afternoon, everyone and thank you for joining us today.

We closed the 2nd Quarter of FY2023-24 with a consolidated sale of Rs. 465 crores, of which domestic formulation business has contributed Rs. 228 crores. International formulation business has contributed Rs. 195 crores. API business has contributed Rs. 36 crores and shown a growth of 95.6% over same period last year. The remaining Rs. 6 crores have come from contract research and analytical business, which are the small service businesses of the company. For the 2nd Quarter, we have recorded an EBITDA of Rs. 72.4 crores.

Before we start the call, I would like to update all members regarding an update that we have just sent to the Stock Exchange. A PAI or pre-approval inspection was conducted at Goa Plant

I for 2 ANDAs. The inspection was conducted between 12th to 18th October and at the closure of this audit late last evening, four 483s have been issued to the plant. Our plant quality assurance and corporate compliance teams will be working very closely with the FDA to resolve any queries that they may have regarding quality issues at the site.

Now to come back to today's call:

At our organization, we have been continuously adopting new technologies aiming for higher productivity in a systematic manner and therefore aiming for volume and value growth. Some of those worth mentioning are at our Baddi Unit I formulation site, we have received a GMP certification from EU Health Authorities in July 2023. This certification is a testimony to the fact that we are committed to remain CGMP compliant and ensure supplying quality products to our customers and patients across the globe.

Our Waluj plant has undergone expansion recently to accommodate volume demand from emerging and India markets. Our API facility at Patalganga has been upgraded recently to include a larger quality control laboratory facility. AnaCipher CRO in Hyderabad, a new business of pharmacovigilance is being contemplated. Various IT related projects are being undertaken with a broader road map spanning HR, operations, sales and GMP related quality assurance concerns. This is being done at various manufacturing sites. Across many of our sites also, projects are underway to increase batch size, improved yield and overall bring down overheads, specifically those involving human capital. These initiatives will eventually improve efficiency at our site and make our products more competitive.

With all the process improvements underway, expansion programs both Green and Brownfield under execution at many of our sites, new product launches and continuous increase in our ANDA filing endeavors. The organization is rightly positioned to achieve its targets going ahead.

This is from me. I will now hand over to Mr. Sundeep, who will take you through the financial highlights of quarter 2.

Sundeep Bambolkar: Thank you, Aditi. Good afternoon everyone. Hope you all are doing fine. Let me first begin with the business highlights.

Net revenues of the company for the 2nd Quarter FY23-24 grew by 15% at Rs. 465 crores compared to Rs. 405 crores. In the first half of the year, revenues grew by 9.9% at Rs. 878 crores as against Rs. 799.5 crores. EBITDA to net sales for the quarter is 15.6% at Rs. 72 crores compared to 21.7% at Rs. 87.8 crores. EBITDA to net sales for the first half is at 15.4% at Rs. 135.3 crores compared to 19.9% at Rs. 159 crores. Profit after tax to net sales for the quarter is 7.1% at Rs. 32.9 crores compared to 12% at Rs. 48.7 crores. PAT to net sales for the first half is 6.7% at Rs. 58.6 crores compared to 10.8% at Rs. 86.2 crores. Earnings per share for the quarter is 3.60 compared to 5.39 for the same quarter last year. EPS for the first half is 6.41 compared to 9.56. Above numbers are on standalone basis.

We have declared results with consolidation which includes results of subsidiaries. The Indian pharma market is valued at Rs. 55,718 crores, registering a growth of 7% during the 2nd Quarter of FY23-24 as against similar 2nd Quarter of last year.

In the IPM, Indoco ranked 30th position in the 2nd Quarter with a market share of 0.61%. The source is IQVIA July, August 23.

Domestic formulation business, revenues from this business for the quarter grew by 9.4% at Rs. 228 crores as against Rs. 208.5 crores. For the first half, revenues grew by 8% at Rs. 441 crores as against Rs. 408 crores. Major therapeutic segments, namely cardiology, ophthalmology, vitamin and stomatology performed well during the quarter as compared to same quarter last year.

Now on the international formulations business front:

Revenues from international formulation business witnessed growth of 11.9% at Rs. 195 crores compared to Rs. 174 crores same quarter last year. For the first half, revenues grew by 0.9% at Rs. 354 crores as against Rs. 351 crores. Revenues from reg markets for the quarter grew by 1.2% at Rs. 149.5 crores against Rs. 147.6 crores and for the first half, revenues degrew by 3.9% at Rs. 283.9 crores against Rs. 295.3 crores. Revenues from US business for the quarter grew by 17.5% at Rs. 81.4 crores as against Rs. 69.3 crores and for the first half, revenues degrew by 1.2% at Rs. 132.6 crores against Rs. 134.2 crores. Revenues from Europe have degrown by 15% at Rs. 63 crores as against Rs. 74.7 crores and for the first half, revenues degrew by 6% at Rs. 143 crores against Rs. 152 crores.

Revenues from South Africa, Australia and New Zealand are at Rs. 4.7 crores against Rs. 3.7 crores and for the first half at Rs. 8.5 crores against Rs. 8.7. Revenues from emerging markets for the quarter grew by 71.6% at Rs. 45.4 crores as against Rs. 26.5 crores. For the first half, revenues grew by 26.1% at Rs. 70.7 crores against Rs. 56.1 crores.

Coming to APIs:

The business for the quarter has grown by 95.6% at Rs. 35.8 crores against Rs. 18.3 crores and for the first half, revenues are grown by 127% at Rs. 71.5 crores against Rs. 31.6 crores. Revenues from other businesses, such as AnaCipher CRO and Indoco Analytical Solutions for the quarter grew by 73.6% to Rs. 6.4 crores against Rs. 3.7 crores and for the half year by 41% at Rs. 11.2 crores as against Rs. 7.9 crores.

That's all about the business highlights for the 2nd Quarter. And I now request all the participants to put up their question. Thank you.

Moderator: Thank you. We will now begin the question and answer session. The first question is from the line of Deepan Sankara Narayanan from TrustLine PMS, please go ahead.

Deepan S. Narayanan: Firstly, from my side, management had guided for domestic business for 11% to 12% for FY24. So, if by growing by that, H2 we need to grow by 14%-16%, so are we confident of achieving that kind of growth in domestic business in H2?

Aditi Panandikar: Yes.

Deepan S. Narayanan: So, majorly this growth will come from this stomatology division, ma'am?

Aditi Panandikar: Not necessarily. For the current quarter, our sub chronic therapies, specifically stomatological, ophthalmics and some others have done very well. This is simply because the 2nd Quarter, which is otherwise a season quarter, the season impact did not come in because of rains which came late. So, to some extent the products which otherwise do well in the season anti-infectives, anti-cold, respiratory, they will also pick up in current Q3 because of the push forward of season and therefore I expect the second half of the year to give a growth of minimum 15%.

Deepan S. Narayanan: And also, in terms of Europe business, we were expecting some Rs. 90 crores to Rs. 95 crores totally run rate, but we are doing around Rs. 70 crores currently. So, what is the reason for the same and are we expecting strong growth now from here on?

Sundeep Bambolkar: Yes. One of our products which we supply to UK got heavily overstocked during COVID and the following years. And as a result, the orders for the last 3 months have been very, very minimum, practically zero, but the situation will improve from now onwards. We have started receiving orders once again, so that was one of the main reasons for this setback.

Deepan S. Narayanan: So, we are still holding that Rs. 380 crores – Rs. 400 crores kind of Europe business for this year?

Sundeep Bambolkar: Yes, 375 to 380 definitely and we may do better.

Deepan S. Narayanan: And lastly from my side, so what are the margin drivers we are looking at to improve the margin from here on to 17% to 18% for FY24?

Aditi Panandikar: Yes. So, if you have seen the performance this quarter, you must have seen the cost of goods. We have shown good of improvement. We've also shown a sustained or marginal drop in employee costs as percentage to sale. So, fundamentally, things are on the right track. There have been some additional one time or short term expenses that have come in other expenditure because of which our margins have got impacted this quarter. Otherwise, we would have definitely shown a much better performance. When these are shorter term kind of expenses, I would not call them one-off, but definitely not perennial. So, therefore we believe that the margins will improve. Also as you might have heard in my opening remarks, there are a lot of initiatives being undertaken to actually bring down the cost of operations across all our sites. So, I feel very confident that going ahead we'll be able to deliver better margins.

Deepan S. Narayanan: Ma'am, can you quantify this one time increase in that other expenses you were referring to?

Aditi Panandikar: Yes. Rather than quantify, I can tell you the nature of those expenses. As you know, we got OAI for Goa Plant-II 6 months ago actually and we started remediation actions. So, there are some costs of remediation. There are also certain costs which have come at the site to improve certain equipment layouts, so you would have seen the plant machinery repairs having gone up this quarter.

Moderator: Thank you. The next question is from the line of Sudarshan Padmanabhan from JM Financial PMS. Please go ahead.

Sudarshan Padmanabhan: I'm just continuing from the previous participant on the remediation costs, I mean, given that we are looking at around 17% is what we were initially looking at in terms of run rate for this year, given that we had some kind of a I would say, not necessarily one-off in this quarter, but because of the spend towards remediation, one, is there a change in your guidance and how do we see the margins in the second half and the spend towards remediation and some of these costs getting rationalized?

Aditi Panandikar: So, in the 2nd Quarter this year, a couple of things are going to happen. A) We expect international formulations to do much better than it did in the first half. Also, a lot of the season products in India business, their incremental sales did not come in in Q2 the way it was expected. So, we do expect that in the second half, our margins will be much better, helping us come close to our guidance. Agreed that in the first half and probably when we made the guidance or gave the guidance, the remedial cost and their impact may not have been fully understood, but every endeavor will be done for us to try and match the 17%.

Sudarshan Padmanabhan: Would there be more cost ma'am on the remediation side in that quarter or some of these costs to continue and how much would it be in contrast to this quarter?

Aditi Panandikar: We expect for one more quarter to have some impact of the remediation cost.

Sudarshan Padmanabhan: Sure, ma'am. Actually US business, it looks like this quarter has been pretty strong. Just to understand was there quantum contribution in terms of profit sharing in this quarter? If you can quantify it, it would be great, but just to understand going forward, should we see the similar run rates continue or what is the kind of run rate that we are in?

Aditi Panandikar: So, in terms of value, yes, we are confident of continuing this kind of topline deliverance on US numbers and even better. Regarding profit share etc., I think you will agree that with our customers, there are several confidentialities. So, we don't feel free to discuss this thing now in the calls. But yes, since our model is of cost and profit share, our model is of certain amount of dossiers to be sold, there will always be some amount of dossier income or profit share in our US sales element.

Sudarshan Padmanabhan: But in this quarter, was it much higher than usual ma'am?

Aditi Panandikar: Not really.

Sudarshan Padmanabhan: And one more question from my side is you know if I look at interestingly the balance sheet, we have higher cash, but we've also taken higher long term loans. I mean interestingly not, are we looking at any kind of M&A, we take loans and cash levels remain higher. Is it because of M&A or is it just the closing of the….

Sundeep Bambolkar: So, if you see the cash, one is about certain investments we have made while our CAPEX, if you see over a period of last year and this year and certain investment, strategic investments such as investment into US, we have incremental funding on the other side. We have taken an ECB basically to cover up the certain cash requirement for the acquisition. The drawdown of the ECB temporarily is parked for usage for future requirement. So, temporarily you may be seeing some cash on hand.

Sudarshan Padmanabhan: Ma'am, so if we are looking at M&A, what is the priority that we would be looking at and then use it, will it be pulling up India brand, would it be looking at more of assets towards the international markets?

Aditi Panandikar: I don't think we said we are doing any M&A, but we are always looking for one to be very honest. So, regarding M&A, you mean acquisition. So, in India, we've always been scouting for good brands. And internationally, we are keen to look at good facilities, but neither comes cheap and neither is available, to be honest.

Sudarshan Padmanabhan: Ma'am, one final question before I join the queue is this quarter, you mentioned that **22:09___** has been encouraging on sub chronic side and if I look at, we have built whatever the investments that are to be made and whatever that has to be done in terms of investments towards faster growth has already been made. Can you talk a little bit more in terms of what is driving this growth, are we seeing more prescriptions coming in from specialist as compared to that of GPs in this segment. So, some color on this and where do we see this proportion of segments in the next…?

Aditi Panandikar: Yes. So, thank you for that question. You know, we are ranked 20th among in the industry when it comes to the number of prescriptions we generate. And you'd be surprised that we are couple of ranks above Glenmark as well for the absolute number of prescriptions we generate. At the same time, we are ranked 30th when it comes to our achievement in rupee terms in the market. That simply means that the percentage of acute contributing to our total topline is skewed very heavily in our case compared to many other companies. So, we do generate prescriptions, but typically they are for one strip of Cyclopam, one strip of Febrex Plus amongst other things. Going forward, this category of sub-chronic that has been developed by us that is prescriptions coming from other than general practitioner as in pediatrician, ENT, ophthalmologist, dentist, gynaecologist. These are called mass specialists and when they write acute products, they write the product for a longer time usage because beyond treating symptoms, they actually want to treat causes as well. So, that has been the orientation of the organization to have a better contribution comes from other than general practitioners and from mass specialists, and we see that reflected in the performance especially in the last 2 years when because of COVID at times acute did very badly and other times it did very well, but the returns coming from categories such as stomatological, ophthalmics are quite stable throughout and that gives a good indication of the kind of work we are doing with these specialties in the market. And we believe because of this going forward, we will be able to derisk ourselves from the 30% odd contribution we have to topline, 30% to 40% that comes from anti-infectives and respiratory. I hope that answers your question.

Sudarshan Padmanabhan: One final question, if I can squeeze in. With respect to the European markets, which has probably seen a temporary decline in this quarter, just want a little clarity given that part of this is tender through AOK. And of course, a part of this is also fixed volume contracts, would that be a right assumption that there might be variants between this quarter, but you have a fair amount of stability in terms of the full year delivery, so as I think you mentioned earlier on.

Aditi Panandikar: Yes.

Sudarshan Padmanabhan: Basically there will be catchup going forward.

Aditi Panandikar: Yes, there's good visibility for orders ahead. This was a little bit unanticipated by us as well as the front end client.

Moderator: Thank you. We have the next question from the line of Rashmi Shetty from Dolat Capital. Please go ahead.

Rashmi Shetty Sancheti: So, one question is that since you have lost the order in the European business and we do have a good order visibility. What kind of guidance you give for the Europe business this year because earlier we were anticipating that we will be able to do around 18% to 19% sort of growth in Europe?

Sundeep Bambolkar: Yes, Rashmi, we have not lost any orders. It's just that this fast moving product was overstocked for a continuous thing by our front end partner in anticipation that it would be flying off the shelves, which did not happen from July, August, September and October. Now we have started receiving orders, which will be manufactured in November and dispatched in December, so we have not lost any tender or any orders. It's just overstocking. Just to clarify, the AOK tender is going on properly, but just out of abundant precaution, I said that we would do somewhere around Rs. 375 crores.

Rashmi Shetty Sancheti: And in the US business of Rs. 81 crores, have we recognized any profit share this quarter?

Aditi Panandikar: Yes, there is always some element.

Rashmi Shetty Sancheti: But from the Brinzolamide and all what we were anticipating, has that profit come in, if you can quantify and if you can say that in quarter 3 - quarter 4, will that be sustainable?

Aditi Panandikar: I will answer the second part first. Yes, in quarter 3 and 4, it will be sustainable. On the first question, as I said earlier because of certain strategic confidentialities with our front end customers, we are not now free anymore to disclose numbers on this.

Rashmi Shetty Sancheti: Got it, ma'am. And what is the R&D guidance because in first half you all have done around 5.5% of sales as you have spent as R&D expenses. So, any particular guidance if you can give for the entire year?

Aditi Panandikar: It will be around the same, Rashmi, 5%-5.5%.

Rashmi Shetty Sancheti: And my next question is related to debt. Whatever debt we have taken up, is there any repayment scheduled or for next 2-3 years the debt more or less number would remain same?

Sundeep Bambolkar: Yes. So, Rashmi, we have yes term loan which is repayable on quarter-on-quarter basis. So, this particular year in second half we have repayment close to about Rs. 24 crores and next 2 years in the range of about Rs. 45 crores to Rs. 50 crores each year.

Rashmi Shetty Sancheti: So, debt would be reduced by that extent?

Sundeep Bambolkar: Yes.

Rashmi Shetty Sancheti: And in terms of the domestic business, while I can understand that we have not shown growth in anti-infective and respiratory segment, but I'm also seeing that there is no growth in antidiabetic and pain management. So, if you can explain what is the reason for that and how can we ensure that in next two quarters from where the growth will be driven around 14% to 15%?

Aditi Panandikar: Yes. So, on pain specifically, Rashmi, you might be aware that I've never spoken of pain as a therapy area of focus for any of our division. So, if pain has done well for us, it is probably because of a portfolio which is being supplied by our institution division which caters to armed forces, railways, ESI and those. It just gets reclassified under therapy is doing well or not, it is not specifically from any of our ethical divisions, okay.

Rashmi Shetty Sancheti: Yes. And finally on the EBITDA margin front, you said that there will be one more quarter where we will be seeing this remediation cost coming up and in the first half, we have done around 14.6%. So, to achieve around your guidance number, we will have to do around 20% EBITDA margin in second half. So, is that achievable or you feel that it is bit challenging given the remediation expenses and R&D and everything will be high?

Aditi Panandikar: So, Rashmi, we are strategized to do the kind of value sale which can allow us to do those percentage margins. But of course, there are always challenges, so I specifically said we will be trying to achieve the 17%.

Moderator: Thank you. As we have no further questions, I would now like to hand the conference over to the management for closing comments. Over to you, ma'am.

Aditi Panandikar: Yes. Thank you everyone for your active participation and have a good weekend. Thank you very much.

Moderator: Thank you. On behalf of Dolat Capital, that concludes this conference. Thank you all for joining us. You may now disconnect your lines.