“IPCA Laboratories Limited
Q1 FY2021 Earnings Conference Call”

August 11, 2020

ANALYST: **MR. NITIN AGARWAL - IDFC SECURITIES LIMITED**

MANAGEMENT: **MR. A.K. JAIN - JOINT MANAGING DIRECTOR - IPCA LABORATORIES LIMITED**
MR. HARISH KAMATH – CORPORATE COUNSEL & COMPANY SECRETARY - IPCA LABORATORIES LIMITED

Moderator: Ladies and gentlemen good day and welcome to IPCA Laboratories Limited Q1 FY2021 Earnings Conference Call hosted by IDFC Securities Limited. 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 now hand the conference over to Mr. Nitin Agarwal from IDFC Securities. Thank you and over to you Sir!

Nitin Agarwal: Thanks Steven. Good morning everyone and a very warm welcome to IPCA Laboratories Q1 FY2021 earnings call, hosted by IDFC Securities. On the call today, we have from IPCA management Mr. A. K. Jain, Joint Managing Director; and Mr. Harish Kamath – Corporate Counsel. I hand over the call to IPCA management team to make some opening comments and then we will open the floor for questions. Please go ahead Sir!

A. K. Jain: Thank you Nitin. Good morning. Thanks for taking out time and joining us for Q1 FY2021 earning call. Today's call and discussions and answer given may include some forward looking statement based on the current business expectation that must be viewed in conjunction with risk our business faces or actual future financial projections performance may defer from what is projected and perceived. You may use your own judgment on the information given during this concall.

We would like to inform you that company's business and financial performance for Q1 FY20202 has been strong in spite of testing time on account of global COVID pandemic. We have used our integrated business capabilities in favoring our global API and drug formulation business.

The business and margin growth in FY2021 is largely driven by the business opportunities due to COVID-19 on account of chloroquine and hydroxychloroquine API and formulations. Higher currency realizations on exports, improved productivity and lower cost of operations reduced travelling and marketing cost, spillover sales from previous quarter due to lockdown for promotional branded formulation business.

These upsides were to some extend offseted by COVID-19 lead to the lower India branded formulation business growth due to the reduced patient footfall. Additional attendance and incentives payments made to the plant workmen and staff during the period the figure was almost around 20 Crores and increased freight cost. Having given the opening remarks, now I will request participants to ask questions.

Moderator: Thank you very much. The first question is from the line of Rahul Jain from Credence Wealth. Please go ahead.

Rahul Jain: Thanks for the opportunity and congratulations for wonderful set of numbers. Sir with regards to our Q1 results, we understand hydroxychloroquine has almost contributed about 250 Crores, 260 Crores in this quarter. So leaving aside one of business in Q1 can we understand what is the sustainable business or how much business should we could attribute to one of in Q1, which may not be again repeated?

A. K. Jain: Overall hydroxychloroquine and Chloroquine business relation to COVID what we had done in Q1 is almost around 259 Crores on consolidated basis and that has also contributed a significant margins to overall to the company, that is basically is an incremental business over the last financial year on these products particularly on account of COVID and so this is how you can say that some of these businesses could be one time business out of that and there are no other exceptional other than the significant business what we have done on Chloroquine and hydroxychloroquine, rest is all normal operations. Apart from that this also includes whatever institutional business on Chloroquine and hydroxychloroquine what we had done in India, so it includes all promotional markets, generic market, whatever additional API business what we have done on hydroxychloroquine and Chloroquine so it includes everything. It is a basically incremental business over last one and half first quarter. So that is by and large an opportunity on account of COVID and that has helped us to pertaining good quarter.

Rahul Jain: Sir with regards to the guidance in quarter, the previous quarter you had given a guidance of about 14% to 17% for topline and improvement in margins by about 150 BPS. So with the quarter gone by can we understand that we can improve our guidance for the full year or in both topline and margin part?

A. K. Jain: COVID related business opportunities have significantly come down now. We have not seen that of incremental business relating to that from Europe and other geographies except some API business are currently happening from Latin American medical markets and all, and mostly the people bought the higher quantities in the first quarter itself. So they are still carrying the stock, so I do not foresee that there will be any kind of further additional businesses in these geographies. US has already withdrawn the emergency for prices as far as Chloroquine and hydroxychloroquine as concerned so and therefore we do not see any kind of further business coming from there also, so the business of hydroxychloroquine now henceforth is likely to be more or less the normal business which we used to do earlier and that business opportunity may not be there to that an extent and almost around 50% of our business is India formulation business. Currently there are challenges are there. In first quarter of the current financial year of course it has grown by around 8% but that includes the government business what he had and if we exclude them then I think overall India formulation business of that will be around 4% only, which also include hydroxychloroquine business, so there are challenges on India formulation business of course, the global recoveries are happening each month is better than the previous month, but we are still to reach to the full potentials or maybe even to the that kind of level. Still we feel that patient footfall is very low, certain therapies like antibacterials and derma and ophthalmology and all we are still seeing some kind of decline. We are also seeing that malaria season which normally happens around July to September which is a peak period, we did not find the much of the malaria cases currently happening and looking all that taking into account our growth projections for the next quarter maybe around overall growth maybe around 10% and maybe in the next two quarters we may start growing by almost around 12% or so. Overall, growth of the company for the whole of year will be little higher than what projections we have given earlier of around 14% to 17%, it may touch 18% to 19% kind of growth is possible, but it all depends how the recoveries happen because 50% of our business is domestic formulations business and how recoveries happen in Indian market that is very crucial for driving the growth.

Moderator: Mr. Jain sorry to interrupt but for any follow-up request you reach on the queue please.

Rahul Jain: This is just about that margin part which was not been answered, so I just wanted to understand on the margin part. Very simple Sir in the balance three quarters I am not asking. We have been generally reporting around 20% margin for last four, five quarters somewhere around 20% to 21% for the last four, five quarters. Of course 38% margins are not sustainable, but for the balance nine months can we expect the margins to be around 20% to 21% on a normalized basis?

A. K. Jain: We will continue to have some kind of margin improvement. The overall cost prices are down, material cost pressures has come down significantly now and overall operating cost are also in control. Of course there will be now, the first quarter we did not pay any kind field operating cost, there are 5000, 6000 people who continues to travel and their daily allowances and their travel cost and all those cost was significantly lower in the first quarter. Of course, that cost is going to be there down the line, but since business is also at a reduced level, so even there will be some kind of reduction in the promotional cost would be there, but I do not think so there will be a significant amount of reduction in those kind of cost but margin certainly is likely to be better than what we have earlier talked about.

Rahul Jain: Thank you so much. That is from me.

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

Prakash Agarwal: Good morning. Just on the 259 Crores that you mentioned so this is across which line items would it be formulations, API, India formulations or the API domestic which is also increased manifolds?

A. K. Jain: It includes everything in fact what we have done is what hydroxychloroquine and Chloroquine relating to export business. I have not taken Chloroquine normal business of the India, so hydroxychloroquine business last year and business in this, so incremental figure is taken of all the businesses and whatever Chloroquine export related businesses additionally done, so that is added to that and mostly the India API business what you are looking that is also significant increase figure what you are looking is also relating to Chloroquine for US exports.

Prakash Agarwal: Okay and you have baked into these 259 Crores is what you are saying?

A. K. Jain: Everything is included in 259 Crores, yes.

Prakash Agarwal: Okay India API as well as exports is already baked in this 259 Crores?

A. K. Jain: Domestic formulations, institutional sales and domestic, promotional market, additional business on hydroxychloroquine, generic market additional business on hydroxychloroquine, local API business on hydroxychloroquine additional business, export API business of hydroxychloroquine and also Chloroquine for US exports which we have sold to the India for US exports, so put together everything is included in 259 Crores.

Prakash Agarwal: Okay fair enough and second question is on the gross margin side. Is 900 basis points improvement, you clearly mentioned part of it currency, part of it this one off, so if you could just help us understand what will be normalized gross margin going ahead given that HCQH you are saying had higher gross margin so we exclude that and assuming currency at 75?

A. K. Jain: Let us say overall if you look at our financial year our material cost to sales ratio for the whole of financial year was almost around 33% and a year prior to that it was little lower because there was a some kind of material cost increases were there, first quarter it was almost, last year was around 35% and then started 33%, 32%, that is a kind of overall material cost ratio were there. We see that these ratios are going to be down in the next two, three quarters and it may be around 32% to 31.5% that is kind of ratio is going to be there, so there will be improvement in overall gross margins in the current financial year.

Prakash Agarwal: This would be lead by what Sir?

A. K. Jain: It is a lower material cost.

Prakash Agarwal: Thank you.

Moderator: Thank you. The next question is from the line of Surya Patra from PhillipCapital Mutual Fund. Please go ahead.

Surya Patra: Congrats on the great set of numbers Sir. Sir just on that 259 Crores one small clarification just wanted. First is that you said on the domestic business side you also got the impact of this COVID and disruption in all that, so see this is the incremental number obviously for the exquisite supply, but the business impact what you have seen, can you quantify that?

A. K. Jain: I have already said that overall business growth domestic was almost around, overall business growth is around 8% out of which 4% has come because of institutional business and otherwise overall business growth is around 4% so if you take hydroxychloroquine out from that that practically there will be around 2% kind of growth.

Surya Patra: I was trying to understand what is the revenue that you lost in the quarter because of the COVID impact?

A. K. Jain: At the beginning of the year we were looking for around 15% to 16% kind of downstream business so business growth and there was projections for institution, as against that we have got 4% growth so around 12 business is lost.

Surya Patra: Okay and this recoverable or how is it Sir?

A. K. Jain: The patients who are not treated that business is lost once and for all.

Surya Patra: My next question if you can just these are like a relatively long-term orientation oriented questions, like, see, you have already mentioned about filing few of products, DMF through Pisgah in US. So what is the update on that? How many products that you have filed? How many that you are having in the pipeline to file? That is one. And secondly, on the KSM manufacturing thought process you have said earlier, and you want to create a dedicated site at your acquired asset or acquired new company site of Maharashtra. So what is the outer timeline during which you can achieve that KSM manufacturing for your strategic products?

A. K. Jain: As far as KSMs are concerned, we have very integrated business of API and KSM production is lot of KSMs are ins and out, lot of starting materials we import from China and some of the KSMs also we import from China for most of our larger products KSMs are produced in-house only. Some of like say product like Losartan. We have the BSFIs and other material which is largely was imported earlier from China which we are develop now certain indigenous suppliers for that. We are working on a continuous process which under installations and hopefully by September that plant will start operating and BCFI we will internalize and that will also give a substantial cost reduction, those conversion ratios are likely to be far-far better and cost reductions are going to be much better that will favour once our **(audio cut) 17:34** and by and large for all larger APIs using KCM as for as your Nagpur sites are concerned because of lockdown and other issues and COVID issues and all, we have really not taken any kind of effective step on that. Our first priority is to setup a plant at Dewas which we have already received now on this period last three month lockdown period the environmental clearance has already come, it has come at the end of the quarter so we will be after say this monsoon period of August September we will start the construction there and build the API facility there. API capacity constraints are currently there and those we will be resolving through our Dewas facility and thereafter the priority will come on lot of those kind of other scaling up of the KCMs and all for which. We are really looking for more such continuous operations so the R&D and piloting team are continuously working on that part at least five, six products will be in a pipeline in time to come on that.

Surya Patra: Okay. About US filing, Sir?

Ajit Jain: About US filing, I think, the 2 DMF work is done, and we are awaiting inspection there. And once that happens, then probably these 2 DMFs will be but they are all very high value and the small volume kind of products are there because there Pisgah does not have very large capacity. It is more of like a CRAMS kind of facility, and they have this all these narcotic products also they have licensed now.

Surya Patra: Scope for a scale-up of this, Sir?

Ajit Jain: There, we are really not looking for much of API production in U.S. currently.

Surya Patra: Thank you Sir. Wish you all the best.

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

V.P. Rajesh: Thanks for the opportunity. Sir, my first question is regarding your expenses below the gross profit. So last year, we had about Rs.2100 Crores of expenses. Is there any guidance for that, given the some of the items you called out in your introductory comments about higher employee expenses, etc?

Ajit Jain: As far as this quarter is concerned, overall, let us say, your personnel cost has gone up by around 18%. Largely, it is because of around Rs.20 Crores additional we have spent on giving incentives to the particularly the staff and workers of the plants because it was very necessary to keep all the site operational. And around that time, a lot of fear factor was there in the mind of people. So a lot of activities we did not did to avoid those kind of reduce those kind of fear. At the same time, announced the incentive so that people come and we are we should be because there was a huge amount of pressure from government. We needed to supply a huge amount of tablets, almost around 12 Crores tablet we supplied to the central and state government within a period of 45 days, plus we had to cater to the domestic, ROW, all those and increased production of hydroxychloroquine and chloroquine was required around that time. So, we that is the additional cost which we incurred. Otherwise, in this particular quarter, there were some reductions in the marketing cost because promotional cost was low. And also, there was your travel cost is low. So these two costs have come down. Overall cost and on manufacturing side, our operating cost has just gone up by 2%, except your on manufacturing and other expenses. Whereas, in marketing hike, there is a reduction in the overall cost. But I do not foresee any marketing cost reductions are not likely to be that much. There will be some reduction because there will still be your restricted travels and all will continue to be there. And more digital activities are likely to be there from the senior management of marketing and sales, their traveling and others. And also a lot of those kind of the knowledge sharing and those kind of activity, which keeps on happening. So those costs is likely to be lower, but field operations are now continuing. In the first quarter, we have saved cost on that almost around 5000 medical reps and their managers' traveling costs and their daily allowances and all that is was not there practically a very small part of that was there because a lot of those period, the people were not operating, they were so those costs were lower and promotional cost was also lower. So going forward, these costs will also increase now.

V.P. Rajesh: What will be the cost once you take all these increases, what is the expectation of the cost for the next two to three quarters, basically?

Ajit Jain: Let us say, HR cost, if you look at, it will be likely to grow around 8% to 10%. It is not going to grow to that an extent. And on other expenditure side, your plant operating cost may have around 5%, 6% kind of growth. And on marketing side, there will be some cost reduction and some increases. So maybe around some 5%, 6% kind of overall cost rise would be there compared to last year with because freight cost is also is high and still it is high. So those costs are going to continue in the time to come. So overall, we see that cost will be at a lower side, yes.

V.P. Rajesh: You earlier said the cost of material will be around 32%? Or was it or did you say some other number? I am sorry; I did not catch that properly.

Ajit Jain: Yes, overall numbers is going to be because there is a tendency of the material prices going up significant in last financial year, which has come down.

V.P. Rajesh: Right. And what is the number you said for the remaining three quarters? It is going to be around 32% or lower?

Ajit Jain: It is around 32%. Yes.

Moderator: Thank you. The next question is from the line of Tarang Agarwal from Old Bridge Capital. Please go ahead.

Tarang A: I have two questions. One, what were your capacity utilizations for Q1 FY2021 across all facilities? And the second question is, when I look at your overall revenue, it is almost up by Rs.500 Crores. Out of which, you said almost about Rs.260 Crores is on account of HCQS and maybe another Rs.40 Crores in the domestic formulations business. So the balance Rs.200 Crores, where did it come from? And how much of it is sustainable going forward?

Ajit Jain: I would say that, Sir, your generic businesses, your API exports, your promotional market businesses, all those businesses, plus institutional businesses have done well. So all those numbers has come from these kind of businesses what we have seen in the Q1 of the current year.

Tarang A: So would it be fair to, therefore, presume that this is a sustainable sort of a market from where these revenues came?

Ajit Jain: What we had talked about earlier that we have projected, I think, your institutional business growth of around that business around to be almost more than Rs.200 Crores. So that is perfectly achievable. The number of first quarter is seen that we have done significant, then second quarter number is likely to be good. So overall, we are we expect that, that business will be good. As far as the promotional market business is concerned, overall, for the whole of the year, we have projected around 17%, 18% kind of growth, also taken into account those kind of spillover shipments which we had in the first quarter of the current year. So that business growth is also good. API business growth is overall for the whole of the year is also likely to be in the region of around 20% kind of thing. So, overall business growth is expected to be good for current financial year.

Tarang A: Sir, your utilizations in Q1?

Ajit Jain: Utilizations is a relative term. If I would say that as far as, we have produced a higher amount of hydroxychloroquine and chloroquine from our those facilities, some of the other APIs which we are producing, some of those shipments or some of those capacities got impacted because of additional production of those certain other plants. So those products could not be produced. But otherwise, I would say that API capacity is almost at full capacities, we are currently running. As far as your domestic plants are concerned, for formulations, maybe it is around 75% kind of running. And on generic formulations, on my particularly Athal plant, which is applying to for most of the generic market, their capacity utilization may be around 75% or so.

Moderator: Thank you. The next question is from the line of Cyndrella Carvalho from Centrum Broking. Please go ahead.

Cyndrella C: Congratulations on a great set of numbers. Sir, you mentioned about the continuous manufacturing and that leading to cost reduction going ahead. If I have understood this correctly, if you could give us a little more where you have said that you are adding four to five more products on a continuous manufacturing basis. So if we look at over two to three years timeframe, how should this benefit us overall? And looking forward, do you think that industry would also shift to these kind of things and overall cost could come down? Is this a possibility?

Ajit Jain: See, we are an integrated player. So we continuously keep on working on the key starting materials. And normally, we like to produce key starting material either ourselves or give the technology to the smaller peoples and get it manufactured under our control. So that has been our business philosophy. Currently, I said that one product we have already set up a plant, which is likely to be operational in the is under installation currently and which is likely to be operational by September end or so. So a quarter thereafter, we will start seeing some kind of advantage. Other products are working and other products are in R&D. And as far as piloting is concerned, we have yet to order the certain plants on that. So as and when these operate R&D and other piloting work and everything is over, then we will also be going for going forward for more kind of those kind of automation plants. As far as the industry is concerned, it is very difficult to say that which company has what kind of strategy now. And we are also not tracking which company is also producing from what technologies and others so except looking at patents and all that kind of thing. So it is very difficult to know that what is their manufacturing practices and all those are there in terms of but I would say that very few plants are there in India which are on continuous process as far as API and intermediates are concerned. On chemical industries, I would say, it happens, but not much on API side in India.

Cyndrella C: Okay. Would that continue our benefit on the gross margin side as and when this comes in our base, as you are saying, so that should help us on the gross margin side? That is a clear understanding?

Ajit Jain: Yes, that happens because your reaction efficiencies goes up. Your shipping cost also goes down because number of people employed is also in handling and all everything get reduced because it is continuous operating plants where person sitting in your control rooms, he manages all the kind of operations.

Cyndrella C: Okay. And Sir, on the export institutional side of business, if you could help us understand apart from HCQS and chloroquine, what else is driving it?

Ajit Jain: By and large, most of our institutional business is relating to malaria because we are not there in either in AIDS or TB or those kind of products are there. So it is only the antimalarial products, and that is what is currently driving that kind of business on institutional side here.

Cyndrella C: So the seasonality thing, we can say?

Ajit Jain: It is all different countries, different seasons are there. So by and large, it is more or less throughout the year that kind of business happens.

Moderator: Thank you. The next question is from the line of Charulata Gaidhani from Dalal & Broacha. Please go ahead.

Charulata G: Sir, first, congrats for the amazing results. My question pertains to the increase in the scale-up in institutional business. You have mentioned that it is particularly in malaria. So do you expect it to sustain going forward at the same level?

Ajit Jain: See, in the last few years, we have added, you say, on Artemether/Lumefantrine dispersible tablets, we have added injectables. The injectable now plant is running at full capacities and all. So that is also helping us in overall business. As far as the global front supply chains are concerned, we are now a very strong supplier now when taking again, the more market share therein. And that is helping us in overall our institutional because we are a backward-integrated company as far as all these antimalarial products are concerned because we are leaders in antimalarial. So that is our strength area. And that is helping us in the overall institutional business.

Charulata G: Okay. And second, the scale-up of the generics business in exports, do you see that continuing at the same level?

Ajit Jain: Generic business, we are, let us say, earlier, we used to have U.S. business. Right now, it is not there. We wish to be there on that market. And once that starts happening, then business will further grow. In Europe, we are now penetrating in more number of markets, but it is all through the distributors in those markets. We are not having any kind of setup. First, we are now really looking for having a setup in U.K., to start with. And I think that operations may start happening somewhere maybe on third quarter or little that kind of period. A lot of activities are currently happening. And we have already got a lot of approvals, so we will be commercializing that. So that is the journey which will be there. And European generic business and currently, generic business are being done in Europe, Australia, New Zealand, South Africa, Canada, so these all market in most markets, we have good growth currently.

Moderator: Thank you. The next question is from the line of Surajit Pal from Prabhudas Liladher. Please go ahead.

Surajit Pal: Sir, I have two questions. One question is that in your insti business, you earlier gave some kind of very good guidance and given the kind of growth we are seeing this quarter, is it mainly again from HCQS and CQ or some normal business cropped up?

Ajit Jain: So there are no hydroxychloroquine, chloroquine business in institutional business. It is 0.

Surajit Pal: Right. So this kind of growth will happen in every quarter? Or do you think that this is just one or two quarters and after that it will be normalized?

Ajit Jain: See, institutional business, you cannot say that same kind of number will get repeated. Sometimes there are country tenders. Country tenders comes at different, different level, different intervals and all. In this quarter, maybe one of country tenders were there, they may not be there in third quarter. Maybe there are some in Q4. So some fluctuations keep on happening there. But overall, I have guided that in current year, our institutional business is going to be more than Rs.200 Crores.

Surajit Pal: Rs.200 Crores. And it will be growing at 20% in FY2022 also as a result of...

Ajit Jain: FY2022 is difficult to say now. But yes, we have other products in the pipeline for prequalifications and all. So this business will have some growth in FY2022 also. But we do not see that this business is going to go to Rs.400 Crores ore and all because it is only antimalarial kind of business which is there and it is a forward integration of our API basket. And we are really not looking for institutional business to be there in those other kind of products like TB and AIDS and all. Of course, we are filing the products on hormones and others. And for prequalification, one product is already prequalified, another product is filed. We are waiting for prequalification. But more such products in times to come. Largely, these products, again, goes in institutional business.

Surajit Pal: So bottomline you are saying is Rs.200 Crores plus you were guiding for this year. And mainly it is driven this year by injectables and next year could be by dispersible tablets?

Ajit Jain: Yes, yes. So next year's guidelines we will give in next financial year.

Surajit Pal: Okay. Second question is that regarding your European business, which you were again saying, European generic-generic business is mainly driven by HCQS also. But if you can recall that last year, your major growth come from API as well as generic, mainly from sartans in European market as well as you have now two partners in U.K., I believe there are some issues from the partner side. Can you throw some light on these 2 aspects, please?

Ajit Jain: Partner side, we do not have two partners. We have only one partner there, and we will be starting our own also there as far as U.K. is concerned. And partner was facing some kind of delays on payments to us. And therefore, we have put some break till the time, again the account come in order. So there will be some kind of your lower business may be it is also there in the first quarter current year and second quarter, there will be some lower business. But now things are again normal, and the business will start back on normal level.

Surajit Pal: And sartans?

Ajit Jain: As far as sartan businesses are concerned, yes, it is an important part of our businesses, and we are continuously doing well. We are producing losartan, valsartan; these are the two major products we have. And we are continuously we will be further increasing our capacities on those kind of products in time to come.

Moderator: Thank you. The next question is from the line of Sudhir Kedia from Principal Mutual Fund. Please go ahead.

Sudhir Kedia: Sir, I have one question regarding your raw material. So in the current quarter, your raw material cost has gone up by only 6%. So could you give us some idea in terms of how is the volume and price breakup of the 6%?

Ajit Jain: Let us say, the incremental business relating to COVID has come at very high margins. So when you work out the ratios and all, that number you will not be able to because of higher topline, that will appear to be on the lower side. I have guided that overall; our material cost in the whole of last financial year was around 32% to 33%. More or less, there will be some reduction in the next three quarters by around 1% or so, but because of overall soft prices are there. But these numbers are likely to be in that region only.

Sudhir Kedia: No Sir, what I was trying to understand that including your COVID-related sales, the overall sales have gone up by Rs.450 Crores, while at the same point of time, the raw material cost has gone up by only Rs.25 Crores. So we may have seen a significant reduction in raw material prices or is something else? I am just trying to understand that part. And how much of this raw material decrease, if any, is sustainable in nature? Or this is one-off in your view?

Ajit Jain: That is what I have replied that in coming quarters, the material cost ratio, which used to be 33% or so, there could be a reduction of 1%, 1.5% in that. But that is the overall number likely to be there as far as material cost is concerned. This quarter, because we have a significant higher promotional business where the margin levels are higher and also though other businesses where the margins were high change and exchange gains were also there because we have used the materials which were imported earlier, maybe at around Rs.69 to Rs.70 level and realizations were almost around Rs.76 level or so. So the higher exchange realizations have also helped in that. So when top line is higher and your consumptions are at materials, which are with a lower cost, so that has helped in overall lower cost of material costs. But in future, it is likely to be on a level which was there earlier, a little less than that.

Sudhir Kedia: Sure. Sir, one more question. The total increase in sales about Rs.450 Crores and if I reduce the COVID-related sales, which is about Rs.300 Crores including the domestic part. So the rest of the sales have gone up by Rs.150 Crores. And at the same time, we have also mentioned that we have lost a significant part of the sales because not enough prescription has been given and similarly, the infection rate related with malaria and all is lower. Just to understand that?

Ajit Jain: See, a lot depends on your product mix profile. There are products where there are high material costs; there are products where lower material costs. In this particular quarter, businesses have happened where the margins are high.

Sudhir Kedia: Yes, that I understand. I was just trying to understand, this Rs.150 Crores, how much of sales you would have lost due to COVID in our normal business, that is what I was trying to understand? This Rs.150 Crores would have been how much if the things could have been...

Ajit Jain: Our domestic business growth, if you look at last five to six years, it has been around 14% -- 13% to 15% kind of range is there. And we have been always growing around, last seven to eight years, by almost around 1.5x the overall market growth. Current quarter, it is only around the, say, if you exclude your all the additional business of hydroxychloroquine and also government business in the first quarter, our domestic business growth net will be around 2% only after excluding additional business of hydroxychloroquine and also institutional business. So on that domestic business, you have lost almost around 12% kind of growth.

Moderator: Thank you. The next question is from the line of Kunal Dhamesha from Systematix. Please go ahead.

Kunal D: First question is on the API PLI scheme. But I think now the more details are out, and we are also planning to do Capex on increasing our KSM production, so is it possible for us to participate in the scheme and bring our export as well as the domestic consumption in under one plant? I mean how do you think about that scheme? And what are some of the molecules which is looking attractive? Because I think sartans are also there. So are we looking to participate in the scheme?

Ajit Jain: We are certainly looking to participate in this kind of scheme, which we will do. But as far as the scheme is concerned, the incentive, what government announced is purely only on the domestic sales, not on export sales. And also the larger incentive parts are there on fermentations, not on the other products. Each company-wise annual incentive could be around Rs.2 Crores or so for each participant, something like that which government has said. So incentive is not going to be that great. But yes, in spite of that, it is the Government of India program, and we also have those kinds of products in our pipeline and all. So we will be applying for under PLI scheme for certain products. But it all depends that given certain metrics on price and also on what kind of volume you want to produce and all that certain so on that, they will be deciding which company they want to award that. The incentive, I would say, it is not because of incentive that we will be going for PLI because we want to produce those kind of products and also at a competitive cost to take a larger market share in India and international market. Those will be the considerations to go for it. Incentive will never be a consideration to go for a kind of investment.

Kunal D: Okay. And is it possible for us to bring the manufacturing for the export as well as domestic consumption under one roof or we have to follow different processes for, let us say, export markets, which are more regulated like Europe or U.S. and then domestic, the processes would be different and then hence, the compliance costs, etc, could be different or we can just bring our export volume and domestic under one roof, although we will only get incentive on the domestic consumption?

Ajit Jain: See, at a particular plant, it is all your what kind of capacities you are set up for which plant. Under that plant, if there are certain kinds you can expand there, then on those plants, you can put those kinds of products which government has announced. So like, say, we have plants which is the upcoming plant at Dewas, and we have plants which is there in Gujarat. So some of these products, we will take it up there. So it is not except Dewas which we are planning as a new site, the other site is an existing site. And as far as the pharma industry is concerned, your one roof question, I did not understand because we have large number of plants. Some plants are producing a different kind of doses form, some producing tablets, some producing injectables, some producing your orals. So all these plants are different and at different, different sites. Then we have API plants. So in my Ratlam itself, we have around 22 API plants. And then we have other plants like Indore. So these plants are going to stay. So how I did not understand that what do you mean by bringing under one roof?

Kunal D: Yes. So the question is, let us say, you get a machinery to produce valsartan, but let us say, valsartan manufacturing process that you have to follow for the U.S. or Europe could be different from what you could do in India for the domestic consumption?

Ajit Jain: It does not go that way, what you are talking about. When you do a regulatory filing, there are different kind of processes. And if a customer has approved you from a particular process, then you have to continue to supply till the time he shifts on different processes. So each customer specifications are different, and you continue to keep on improving the processes. So you have filed process one, process two, process three. So some customer may be on process three and some customer is old customer, he is not willing to shift, he may be on process 1 also. So API industry is highly, highly regulated. Till the time he takes the regulatory approval for process one to shifting to process three, he cannot shift. He will continue to buy the material from process one. So that kind of harmonization is not possible till the time. Either you lose that customer. Okay, if you do not want to supply process one, then you will lose that customer. So it all depends on economics and other things.

Moderator: Thank you. The next question is from the line of Nikhil Upadhyay from Securities Investment. Please go ahead.

Nikhil Upadhyay: Congratulation on a good set of numbers. Sir, one bookkeeping question. So earlier for our regulated plants, which were under import alert, we were making, so they were having a negative impact on our P&L. So if I am correct, that was around Rs.70 Crores, Rs. 80 Crores, right?

Ajit Jain: It is around Rs.60 Crores, yes.

Nikhil Upadhyay: So now with the HCQS production, which we have done, so probably that contribution would also be there in the EBITDA margins of this quarter so and if you can just help me with what is the utilization now?

Ajit Jain: Let us say, there are two plants which are still there on formulation side. One is our SEZ Indore plant. And another plant is at Piparia, these are 2 formulation plants which are largely dedicated to U.S. And then capacity utilization is at a lower level. Let us say, Piparia plant, utilization is further lower. There, we have produced some kind of hydroxychloroquine for other markets also. But as far as the SEZ Indore plant is concerned, we have not produced anything for U.S. from that plant. And there, capacity utilization is on the lower side, and we continue to have some kind of losses on these two plants.

Nikhil Upadhyay: Okay. And secondly, Sir, on the margin side, if I just want to understand, because if we see last year whole year, we had that Rs.50 Crores and Rs.60 Crores of one-off costs, which included the Forex and the impairment charges which we have taken in the last quarter, which itself was around 1%, 1.5% of impact on the overall cost margin. Secondly, on the gross margin also, you mentioned that we are getting a benefit of around 100 basis point because of the lower RM cost, which should flow us for the next two to three quarters, which means for the full year, the margin improvement and overall other expenses as the number which you have mentioned, it is all under around single digit as compared to the sales growth of 17%, 18%. So if we just add do a back-of-envelope calculation, that itself had 250, 300 basis points to the EBITDA margins. Am I missing something here or...

Ajit Jain: No. You have to also see the quarter-to-quarter. See, what we have guided, the first quarter numbers are exceptional.

Nikhil Upadhyay: No, Sir, I am just taking on so if you leave the first quarter, just the next three quarters because first quarter was abnormal quarter and whatever numbers we have to see, we have to adjust and then see those numbers.

Ajit Jain: Yes.

Nikhil Upadhyay: So just on the next three quarters, based on the guidelines which you have given and based on the one-off costs which were there, if you just add back those numbers, that itself means that for the full year, even on a normal basis, we would have like 200, 250 basis point of margin improvement. So I am just trying to understand, am I missing something? Or is it like the cost escalation could be much higher?

Ajit Jain: Cost escalations, I have already guided on cost escalation that overall manufacturing costs are not going to go up that much. Your HR cost is going by around 8% to 10% kind of cost, which is there currently in the system. And overall cost pressures are not going to be that much. But yes, if you look at your domestic market, in the first quarter, almost around field staff practically were at home. So those traveling and those costs was lower. In the next quarter, those kind of costs are again going to be there. And also the promotional cost, of course, that may not be at that level. But yes, at a lower level, the cost will be there. It depends. So those savings are not going to be that much.

Moderator: Thank you. The next question is from the line of Naresh Suthar from SBI Life. Please go ahead.

Naresh Suthar: Sir, my question is around this guidance again for revenues. Sir, if we exclude the benefits of HCQS for the full year, if you can give guidance as of this opportunity for FY2021 for revenue?

Ajit Jain: See, we have given the guidelines for the next three quarters that overall growth is going to be around 10% to 12% in next 3 quarters, which includes the HCQS also, but HCQS now is more or less a normalized business. There is nothing to exclude further because whatever additional business was to be done, that has been done in the first quarter. And I also said that the European and other customers have bought an additional materials and they are already having. So in the subsequent quarter, there could be some kind of lower shipment also compared to last year of hydroxychloroquine. As far as India is concerned, yes, hydroxychloroquine business is more or less 10% to 12% additional compared to last financial year, so it is in a month-to-month basis. So it is not a very big number as such on hydroxychloroquine currently. So whatever opportunities was there that was there in the first quarter, and we are not seeing any kind of significant rise in that number in the next quarter. So what we have projected for next three quarters is around 10% to 12% kind of growth, and it also depend on how the Indian market revival happens. So a lot depends on that also. That is the one kind of risk factor which we have because almost around 50% of that business comes overall business come from India basically.

Naresh Suthar: Sir, one question on API side. We have been seeing the peers talking about the API side, they are talking about getting benefited from the increased activity in terms of shift from China to India or any other place. So many players have announced capexes and they are benefiting out of that. So can you share some outlook for next two to three years, how you are looking at the business and the capex over there, particularly from this trend of shifting from China to India? And your revenue trajectory which, I think, used to be a 10%, 12% kind of growth, which can be in mid-teens kind of growth, can we say that?

Ajit Jain: API business growth is good. Current year also, we are talking of almost around 20% kind of growth on API business. So that business is going to be good in the current year. But I also said that we have a lot of capacity constraint, and which we need to resolve in order to take up this business forward. We are continuously doing debottlenecking of capacities which is aiding the capacities and allowing us to do the higher business. In first quarter, a lot of API business, other drugs has suffered because of certain additional productions we had to take out from existing plant on producing the KSMs and also for the additional production of hydroxychloroquine. So those businesses also we will try to recover. So overall, API businesses are going to be around 20% kind of growth in whole of the year.

Naresh Suthar: No, Sir, so my question is more of a longer term to ask because of the increased inquiries, are you, I mean, seeing more capex over the next two to three years?

Ajit Jain: We are already in a process of setting up new plant. We will take care of that.

Moderator: Thank you. The next question is from the line of Sameer Baisiwala from Morgan Stanley. Please go ahead.

Sameer B: Congrats, it was great numbers. So just on the quarter how is the pricing for your products, both branded and APIs? And was there a material change, quarter-on-quarter?

Ajit Jain: No, there is not much of change, except I think the Russian ruble has a little devalued compared to the earlier number. So that realizations are on lower side. Other than that, the pricing part has not changed much on other products.

Sameer B: Okay. Great. And Sir, for this Rs.259 Crores of COVID sales, if I reverse engineer, looks like this must have come at 80% or so gross margins and that then flows down to PBT levels. Would that be a fair assessment?

Ajit Jain: Yes, that assessment is fair, yes.

Sameer B: Okay, Sir. And then final question, how much was the spillover of sales from 4Q to 1Q?

Ajit Jain: It was almost around Rs.26 Crores or so.

Moderator: Thank you. The next question is from the line of Anubhav Sahu from MC Research. Please go ahead.

Anubhav Sahu: A couple of questions. First, regarding capex, now since we have got the environmental clearance for Dewas facility, could you specify timeline for commissioning here?

Ajit Jain: I think we will start construction maybe in the month of October or so. We are in process of finalizing the contracts and other. And overall, the Dewas project will be almost around Rs.250 Crores. Rs.250 Crores, if you add further capacity, it can go to around Rs.300 Crores. And overall, timeline would be around 15 months on that. Implementation period will be around 15 months, the plant to be ready, yes.

Anubhav Sahu: Okay. Sir, one clarification. You mentioned 75% capacity utilization. So this is for the formulation part, right?

Ajit Jain: Yes.

Anubhav Sahu: Does it exclude all the one-off items which we did for this quarter?

Ajit Jain: In capacity utilization, there is no one-off.

Anubhav Sahu: No. I mean, the additional production which we did for hydroxychloroquine and those kind of things?

Ajit Jain: But that only additional cost was Rs.20 Crores what we have paid as a onetime incentive to the staff and workers of the all plants. So that is a one-off additional cost.

Harish Kamath: Not substantial. The Rs.20 Crores that we had is not a very big.

Anubhav Sahu: Capacity. Yes, yes.

Ajit Jain: This you are asking on the normal business.

Anubhav Sahu: Capacity utilization. Yes. Yes, for the normal business. Sir, for the formulation business, what is the normal or the average capacity utilization which we have right now?

Ajit Jain: Formulation capacity utilization let us say, two two plants, capacity utilizations, which are there for exports are very, very low. One is Piparia plant and one other is Sitapur plant, and these plants still continue to have some kind of losses there. These plants were, by and large, built for the U.S. and once U.S. start and some generic business we have started taking from these businesses, but still capacity utilizations are low. Other plants are relating to what, by and large, for the domestic formulation business and all those kind of international businesses of Europe, Canada, Australia, New Zealand, South Africa and all those markets. There, the capacity utilization is around 75%, yes.

Anubhav Sahu: Okay. That goes well for the Sikkim plant also. I think that is mainly for the domestic formulation?

Ajit Jain: Yes, Sikkim plant, yes, also for domestic formulation, yes.

Moderator: Thank you. The next question is from the line of Cyndrella Carvalho from Centrum Broking. Please go ahead.

Cyndrella C: So Sir, one question I wanted to understand from a product expansion perspective, so what are the key products which we would be looking forward to expand our basket domestically and in export business? The second question is on the Krebs side of fermentation-based facility, what PLI benefits that we should expect? And the third is on the US, any discussion, any understanding from the FDA agency?

Ajit Jain: As far as the CRAMs are concerned, we are not there in all those kind of products which are antibacterials and which is very large investment, and we are not a very strong player as far as antibacterials are concerned. So we are really not looking for those kind of opportunities. But there are certain products out of that PLI schemes on fermentations, which we have done the backward integration. Forward integration is still pending. So we are looking for whether we can go and participate in that kind of scheme for one particular product on fermentation. So that is there in the plan. And other than that are all steroid kind of products are there, we do not have much currently, neither we have those technologies to forward integrate those products. So right now, we are not looking for participating on that on PLI scheme.

Cyndrella C: Sir, on the US FDA side, anything? And on the future product basket expansion?

Ajit Jain: As far as US FDA is concerned, we have done our remedial actions, and we have already informed to FDA, and it all now depends on them when they will be coming. They do not say to us that when they will be coming. And in the COVID period, probably they are not traveling. So only after some things get normalized that travel may happen. So it is very difficult to give any kind of timeline on that.

Cyndrella C: So basically, we have not heard anything from them?

Ajit Jain: No, we have regular meetings with them, and we are discussing, but we have not heard so far anything on that.

Cyndrella C: Okay. And Sir, future product basket expansion in domestic and export-related areas?

Ajit Jain: We do not add too many products. In a year, we have it on one product or so in every division or so. Sometimes we add in two years, one product. Because we do not want too many baggages in the system. Whatever product we take, we take seriously and we do brand building. So for our kind of size, we have very, very less amount of products. So our business philosophy is to not to add too many products because in a division, you have around three to four power brands and some kind of supporting brands. So you cannot have more than that. We do not get add many products. As far as API is concerned, yes, we have a good number of APIs in our product basket. But right now, since we have capacity constraints, so those products are not being taken up for further exploitation. So once the further capacities are added at Dewas and all, we will further commercialize more number of APIs.

Moderator: Thank you. We take the last question from the line of S. Mukherjee from Nomura. Please go ahead.

Saion Mukherjee: Sir, on the API side, I just wanted to check on Dewas expansion. I think that is critical for future growth. How large is the capacity? And how much it adds to your current capacity, just if you can give that context?

Ajit Jain: We will be spending almost around close to Rs.300 Crores on that plant, and that will add almost production capacity of around maybe 300 tonnes of overall API. So that is the overall number going to be there.

Saion Mukherjee: How does it compare to your current, Sir, in terms of tonnage that you are currently doing with 100% utilization?

Ajit Jain: Maybe around 20% kind of capacity we will add.

Saion Mukherjee: Sir, do you think this is enough or you need to add more capacity going forward, given the strength that you see in the API business?

Ajit Jain: No, we will be adding more capacity in time to come. But still not crystalized, so I will not be able to talk on that, yes.

Saion Mukherjee: Okay. Sir, would it be fair to assume that since the capacities are full, the growth can be a bit subdued in the near term and then when this capacity comes on stream, you said 15 months, maybe in a couple of years, the growth would accelerate. Would that be a fair assessment of the API business?

Ajit Jain: So we continuously to do debottleneckings. So right now, except one or two products, we are losing business. We could have doubled the business, but since capacities are not there. But incremental businesses are coming from those kind of debottlenecking, which is coming at a much lower operating cost and also much lower capex.

Saion Mukherjee: Sir, you talked about this continuous plant for API and intermediate. I mean this is for a specific product that you are looking at or there are more than one product for which you want to put this?

Ajit Jain: I said, we are working on almost around five to six products. One product, we have already in the process of installation, that plant is under installation; balance is at R&D and piloting stage. So as and when these products start coming in, but we are working on five to six products to make them continuous process, yes. And by and large, these are intermediates, not APIs.

Saion Mukherjee: Okay. Intermediate. Sir, one last question, Sir, if you can really help get a split of the API business. So when you look at the export plus domestic, the overall API pie, how much is sartan and how much is like chloroquine, hydroxychloroquine? Any kind of breakup that because you focus on a very few segments? So just if you can help us understand that profile of the API business currently?

Ajit Jain: Largely, let us say, the major part of business comes from cardiovascular, antimalarials, pain. These are the three main segments that we have. Yes. So major businesses come from these segments because we have been strong players on beta-blockers, and now we have added the strength on sartans and all that kind of things, plus we also have a lot of these diuretic products. So cardiovascular is a major basket we have. On antimalarial, practically everything we produce. So the good basket is there on antimalarial. On pain side, we produce hydroxychloroquine, allopurinol, etodolac, serratiopeptidase. So those kind of products are there.

Saion Mukherjee: So these three segments would be more than 75%, 80%, would that be a fair assumption?

Ajit Jain: Yes. Cardiac segment is the biggest one out of that.

Moderator: I now hand the conference over to the management for closing comments.

Ajit Jain: Thank you, everybody, for participating. And as far as the US is concerned, our continuous commitment is there to resolve all the issues and then come out of it and then again start our US. Business because that is very, very important for us. And in our overall business scheme, where we want to be a very strong player on products what we have, US is important to us, and we are definitely working on that on continuous basis. Thank you so much.

Moderator: Thank you. Ladies and gentlemen, on behalf of IDFC Securities, that concludes this conference. Thank you all for joining us, and you may now disconnect your lines.