"Glenmark Life Sciences Ltd. Q1-FY23 Earnings Conference Call"

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Moderator: Good morning, ladies and gentlemen, and a and warm welcome to the Q1 FY'23 Earnings Conference Call of Glenmark Life Sciences. 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 touch tone phone. Please note that this conference is being recorded. I now hand the conference over to Ms. Soumi, General Manager, Corporate Communications, Glenmark Life Sciences. Thank you and over to you.

Soumi Rao: Good morning, everyone. I welcome you all to the Earnings Call of Glenmark Life Sciences Limited for the quarter ended June 30, 2022.

From Glenmark Life Sciences, today we have with us Dr. Yasir Rawjee – our M.D. and CEO and Mr. Tushar Mistry – our CFO.

Our board has approved the results for the quarter ended 30th June 2022. And we have released the same to the stock exchanges, as well as updated it on our website.

Please note that the recording and transcript of this call will be available on the website of the company.

Now, I would like to draw your attention to the fact that some of the information shared as part of this call, especially information which with respect to our plans and strategies may contain certain forward-looking statements that involve risks and uncertainties. These statements are based on current expectations, forecasts and assumptions that are subject to risks and uncertainties, which could cause actual outcomes and results to differ materially from these statements, depending upon the economy conditions, government policies and other incidental factors. Such statements should not be regarded by recipients as a substitute of the exercise of the judgment. The company undertakes no obligation to update or revise any forward-looking statement, whether as a result of new information, future events, or otherwise. Our actual results may differ materially from those expressed in or implied by these forward-looking statements.

With that, I invite Dr. Yasir Rawjee to say a few words. Thank you. And over to you Dr. Rawjee.

Dr. Yasir Rawjee: Soumi, thank you, and welcome everyone to our first quarter earnings call. I hope everyone's doing well. So, before I dive into Glenmark, Life Sciences, let me just give you a little brief in terms of how the industry is looking.

Basically, if we go back a little bit two years, right, there was a lot of opportunity on the COVID drug side. And we did pretty well in terms of the COVID drug supply, mainly Favipiravir. Now, of course, COVID drugs have gone, thankfully, right, we are happy about that. There was also in this period some stockpiling from customers on account of supply chain insecurity. And we are seeing a bit of that rationalization happening now.

The good news for us is that, we have almost three-fourths of our business in the regulated market. And that market continues to deliver in a very steady fashion. And even the relative price pressure is lesser, barring one or two markets like the US.

Now, coming to the supply side challenges, we have seen supply chain disruptions on account of a lot of things. There was energy, there was COVID, more recently, we had the Shanghai port shut down… Shanghai port was shut down for close to two months from the end of March to close to the end of May. And so, all this has also led to some uncertainty on the supply chain with materials. There was also a hope that prices would drop on raw materials. Now, while we've seen that in a few raw materials, on an overall basket, the slide down in prices is very slow. And that's something we'll have to probably deal with over this year and probably even the next year.

Coming to Glenmark Life Sciences, I think our performance has been pretty good. Ex-COVID, we've grown at 6.5%. And between generic and CDMO business we've had 7.1% growth year-on-year if we exclude COVID products.

Regionally, Latin America, India and RoW have done exceedingly well and have driven the growth.

And from a portfolio perspective, we continue to drive down the path of cardiovascular, CNS, pain and diabetes. And this has helped us because it's all chronic and the demand remains extremely stable.

Now coming to CDMO, like I said earlier is not something we can repeat every quarter, but on a year wise basis, we expect that CDMO will continue to deliver about 8% to 9% to our revenue basket.

Now, coming back to the generic side, we've had launches last quarter. And the nice thing is, these launches have gone very well. So, much so that we've also started supplying commercial quantities on two of these launches to our customers, so which means that their business has also taken off pretty nicely.

This quarter, we filed three new DMFs in the major markets, and we plan to file eight to 10, new DMFs in this financial year. So, we would be having a strike rate of about three, maybe even four filings each quarter.

Now, R&D continues to deliver extremely well between our new APIs and our CIPs, we've got 26 APIs in the pipeline. And it also includes a fair amount of complex work that we're doing both on the iron complex side. We delivered one commercially if you recall, and two of the iron complexes are in the pipeline now. And on oncology, we've got seven APIs in the pipeline, three of them are in advanced stages. And as soon as our Dahej onco block comes on line, we'll be able to start producing commercially.

So, since I spoke about Dahej, let me talk a little bit on the way that CAPEX is getting used up when the new capacity is coming on line. So, Dahej has slowed down a little bit. If you recall, there was a strike in Gujarat on account of certain raw materials. And so, we slowed down by a few weeks, which will basically get Dahej on line in this Q2, and we should have two pharma blocks and one intermediate block coming on line, which will give us 240 kilo liters of capacity coming on line in Dahej. The onco block should also be ready by the end of this Q2.

On Ankleshwar, we had, if you recall, embarked upon a 400 KL capacity on intermediates and backward integration. That has also been impacted by this raw material strike and so we have seen a delay by a quarter. And this capacity will come on line by the end of Q3 of this year.

So, the idea here is that, we backward integrate on some key molecules in order to secure the supply chain as well as keep our margins consistent rather than deal with raw material fluctuations, which will hit our margins as well as probably the supply chain as well.

So, coming to our new expansion, which is Solapur. Solapur is going a little slow because we've been applying for permissions and so on. But the good news is that we got environmental clearance from Delhi for 1,000 KL to build a 1,000 KL plant on this 40-acre site. And now we have applied for some state approvals, mainly CFE, CFO, and once CFE is in place, we can then start the construction work in Solapur.

So, all in all, I would say that things are going pretty well on track. There have been a few delays here and there on account of external factors, but we keep on track all this expansion that we planned and it's well in line with our business expansion.

So, I think I will end there, but before I do, I would like to introduce a new member to our team. Tushar Mistry joined as a CFO on June 1st. He's been here with us for now a couple of months. And he's a very strong finance professional who comes with a pharma background, having worked earlier in Wockhardt and then was CFO of Sequent. I welcome Tushar to the team and he'll be briefing you on the performance of the company as well. So, Tushar, over to you.

Tushar P. Mistry: Thank you, Dr. Yasir. Hello, and good morning, everyone. Welcome to our Q1 FY'23 Earnings Call. I am happy to update you on the financial performance for the quarter. I'd like to briefly touch upon the key performance highlights for the quarter-ended 30th June 2022 and then we'll open the floor for questions and answers.

We registered a revenue from operations of Rs.490 crores for Q1 FY'23. So, you're seeing a year-on-year degrowth of 6.7% as compared to Rs.525 crores for Q1 FY'22. Last year Q1 had COVID-related products of around Rs.65 crores. If you exclude COVID sales and compare the numbers, the business has grown by 6.5% on a year-on-year basis. Gross profit for the quarter was at Rs.261 crores. Gross profit margins for the quarter were at 53.3%, an expansion of 270 basis points on year-on-year basis and 290 basis points on a sequential basis.

I'd like to highlight here that the input prices continue to be at an elevated level driven by crude price as well as supply chain issues. We have been able to pass on the incremental costs to some of our customers as mentioned in previous earnings calls. And we continue to engage with our customers regularly to understand where we can pass on the costs and where we need to support them. Our continued focus on cost improvement measures coupled with a better product mix has helped us in safeguarding our margins. One of the major reasons for expansion in gross margins for the quarter was also the PLI scheme benefit which we have booked for the quarter.

I'd like to highlight that we are very confident in getting the PLI incentive and whatever numbers we have taken, they are taken conservatively. Even if you remove the PLI impact, our gross margins are at 52% which is an improvement on year-on-year as well as on a sequential basis.

EBITDA for the quarter was at Rs.166 crores. EBITDA margins at 31.9%. Profit after tax was at Rs.108.7 crores in Q1 FY'23, registering a growth of 7.7% year-on-year and 9.9% on a sequential basis.

Coming to segmental results: Generic API revenue for the quarter was at Rs.445 crores, registering a degrowth of 7.4% on a year-on-year basis. However, as Dr. Yasir mentioned in his opening remarks, the generic API business we were at 7.1% on year-on-year basis ex-COVID products. The growth in generic API portfolio was driven by India, LATAM markets as well as emerging markets which grew by 24% on a year-on-year basis ex-COVID products.

Europe sales are muted during the quarter, driven by supply chain hurdles. We believe Europe will kick up in the coming quarters.

Therapy wise, CVS and CNS, APIs led the growth with overall 20 portfolio contributing around 73% to the top line.

For the quarter, the CDMO business was down by 38% on year-on-year basis registering revenue of Rs.24 crores. This was mainly on account of inventory rationalization at the customers end.

The captive business for the quarter was at around 35% of sales. We believe it will stay at this level and will continue to grow at a steady rate. Our key growth lever in coming quarters and years will be the external business which we will see growing faster comparatively.

CAPEX for the quarter was around Rs.41 crores and for the full year we expect to deploy around Rs.200 crores for the various CAPEX projects that are ongoing.

R&D expenditure for the quarter was at Rs.154 million, about 3.1% of sales and we believe R&D expenditure to stay around 2.5% to 3% range for the year.

On the working capital side, our working capital days for Q1 were at 160 days. This was mainly driven by our strategy to intentionally stock up on raw material inventory to mitigate the supply chain issues. We believe the inventory to stay at this level for a short period as this will help us right through the supply chain volatility.

We continue to remain debt-free company with the cash and cash equivalent of Rs.478 crores on the balance sheet.

Overall, we are witnessing an improvement in the demand environment and with new capacities coming on line to support our growth in the coming quarters anchored by a strong balance sheet.

With that being said, let us open the floor for Q&A. Thank you.

Moderator: We will now begin with the question-and-answer session. The first question is from the line of Neha Manpuria from Bank of America. Please go ahead.

Neha Manpuria: My first question, sir, is on the generic API business. I think in the opening remarks, you mentioned that there was price adjustment that we have done in the quarter. So, if I were to look at the ex-COVID growth, how much of that growth is volume versus let's say pricing that has flown through, and have we been able to take price hike in a substantial part of our portfolio?

Dr. Yasir Rawjee: Neha, the growth is mainly volume growth. But the good news is that we've been able to pass quite a bit of price increase to some of our customers on some APIs. So, it's a sort of judgment call in terms of what we are passing on and what we are not passing on. So, wherever a customer is facing a lot of front-end competitive pressure, we've kept away from increasing prices, and businesses sustain nicely. But wherever the customers have a much better grip at the front end, there, we passed it on, and this has been done mutually. So, growth is volume-driven, but, in terms of customers, we've sort of taken a judgment call on the APIs as well.

Neha Manpuria: Given that there has been some amount of delay in the CAPEX, as we look at the rest of the year, does that limit our ability to meaningfully increase the revenue momentum that we've seen in the generic API business this quarter, roughly Rs.450 crores number that we've seen in this quarter, with that now, therefore, the increase be pushed out to FY'24?

Dr. Yasir Rawjee: No, Neha, the good news is that these are all Brownfield expansions, right. So, essentially, Dahej once the capacity comes on line, which we expect to happen by the end of August, we just have to do some internal validation work at the product level and we can start supplying to the market. So, effectively, that capacity will be utilized right away, giving us more capacity to service the business from Dahej. This also is applicable to the oncology piece, right, because we are waiting on supplying, validating three APIs in onco and then start supplying commercially. So, that should get us on line right away. The delay has an impact, but not very significant. I mean, we would have hoped to utilize some of that capacity in Q1. But coming in Q2, I think it comes at the right time for us to be able to leverage that capacity increase.

Neha Manpuria: And the last one on the generic API business. From a customer inventory point of view, you said that we have started seeing the higher customer inventory rationalizing in the quarter. Are we done, are you seeing end market demand improving, or is that rationalization process still ongoing?

Dr. Yasir Rawjee: No, I think we are tapering off on that rationalization. It's not very significant. On the CDMO side, we've seen a little bit of that in one of the APIs. The whole thing is about doctors and patients. And this is US market. You recall, Omicron did hit the US. And again, there was a bit of a slowdown in the US with doctors and patients interaction. So, that coupled with the fact so the front end demand going down a little bit plus stocking up, has led to a little bit of slowing demand for the API. But it's tapering off. I believe there'll be a little bit in Q2, and then Q3, Q4, whatever we are seeing from a demand perspective is pretty solid.

Neha Manpuria: My last question is on the raw material cost pressure. Could you give us a little bit of context on what is the improvement that we're seeing in pricing? You mentioned that it's fairly slow. Will it help improve margins or you think it's unlikely to be meaningful enough to move the gross margins?

Dr. Yasir Rawjee: Neha, you saw that our margins have gone up compared to last quarter. Even if we take away the PLI piece, right, our margins on the material side have gone up. And this has mainly been driven by softening solvent prices. So, solvent prices have come down on a large number of solvents, not to regular levels, but from the peak that they had gone to. This has certainly impacted us positively from a margin perspective. Some raw materials continue to be stubborn. The ones that are driven by lithium, sodium. Lithium, as it's used in the battery market, it's a big demand. We are also seeing issues related to iodine-related raw materials. And so some of them remain at a high, there's a slight decline in some others. So, we will see some benefit I think of this slow decline also in the coming quarters.

Moderator: The next question is from the line of Shyam Srinivasan from Goldman Sachs. Please go ahead.

Shyam Srinivasan: Just one on the therapy mix and how that has evolved. I think you talked about CVS and CNS being the growth drivers. But just looking at your disclosure, and then just backing out what the CVS revenue, it still declined YoY this quarter. So, I'm just trying to see what are some of the dynamics at least on the CVS per therapy basis? And if I were to look at others, I think that's the one that's declining. I'm assuming FabiFlu is being booked in that others line I presume. So, that's where the biggest decline is. So, just those two therapy areas, please.

Dr. Yasir Rawjee: Yes, so Shyam, others, you're absolutely right, it's Fabi that's gone down and so that explains that. Coming to CVS, see, we've got a pretty big basket. So, your thing about last quarter versus this quarter, sartans, I had explained are under a little bit of pressure from the demand side, especially the US market. So, that's where we see bit of a decline, but then there are new launches that have happened and that is pushing it up. I mentioned that, we've already started the post-launch supply in this quarter, and that's going very well. Apart from many other CVS drugs, that are the non-sartan category that are doing very well. So, all in all, CVS is driving things pretty nicely for us and CNS as well.

Shyam Srinivasan: So, it's like two quarters of decline. and this is flat this quarter, I'm just backing it out. So, you foresee that, because looks like this needs to start growing for us to grow the rest of the business? Are there launches or do you thinking you are having additional contracts, that gives you the comfort on just the therapy area, is your largest?

Dr. Yasir Rawjee: You are referring particularly to CVS here, right?

Shyam Srinivasan: Yes.

Dr. Yasir Rawjee: I think sartans will also pick up. It's a matter of time. It's a couple of customers of ours that sort of went slow because of the macro issues and so on. But then there are other customers that are picking up the slack. And given a sort of positioning on price as well as supply ability, I think we are well positioned to even come back into sartans and it will drive it forward in the next coming quarters.

Shyam Srinivasan: My second question is just going back to the margin point. I think I'm just excluding even the PLI benefit. It seems to be 130 basis points. So, what still explain some of the margin resilience, if I can use the word, because we have seen overall a decline in top line, so what are some of the measures? I looked at I think other expenses below the GM line is also something that seems to have stood out. So, if you could highlight some of the cost measures, and are there more such efforts coming through or do you think we have reached a base of cost savings?

Dr. Yasir Rawjee: So, let me ask Tushar to answer the financial side on the other expenses. I'll come back to you on the first part of the question.

Tushar P. Mistry: The other expenses as you would have seen that it's a growth of about 8% year-on-year basis. While we have seen some cost increases in the utilities cost compared to last year, the prices of power and fuel have been going up. But there have been constant effort on cost control measures as well, especially on the contract labor cost perspective and some of such other costs, which have kind of settled the impact of the utilities cost. We expect these levels to go ahead to remain at that level. There might be a few fluctuations on a quarter-on-quarter basis, but on an overall year basis, we don't see any significantly high costs increases. It would be in line with our inflationary increases that we would see.

Shyam Srinivasan: Tushar, when you meant other expenses, excluding R&D, because R&D has driven the largest increase. If I were to remove R&D and just look at other expenses is actually down, right. So, you're attributing it to what key reasons?

Tushar P. Mistry: The lower cost on account of the contract laborers, which we have engaged lesser in the current quarter.

Dr. Yasir Rawjee: To your first question, essentially, the margins improvement has happened, because see, price erosion has kind of flattened out for us, plus, we were able to pass on certain price increases that happened a few quarters back to the customers finally, that improved. And then on the cost reduction, Tushar explained that, on the operating side, we got some benefit with utilities and so on. But solvents played a big role in terms of reducing cost on the materials side. So, I think these two factors have essentially led us to improve plus there was a bit of a mix impact, because I told you about the post-launch supplies that we've made, so those have also come in at a much better margin. So, overall, mix, price erosion flattening out, cost reduction going very well has improved the margin, and this is likely to sustain because none of these are going to go away. So, we expect we'll keep this going.

Shyam Srinivasan: Any guidance you want to share either for the full year or the rest of the nine months in terms of either top line growth and margins where they could be?

Dr. Yasir Rawjee: Shyam, let me answer this a little differently. So, basically, you know our business is between captive and external business, we are about one-thirds, two thirds, right. This quarter captive was down to 35%, mainly on account of the lower Favipiravir sales, this is something that will continue. On the external side, given the sort of regional spread we have, and a very good sort of geographic mix, we are seeing demand extremely strong in the next couple of quarters. So, no challenge there and external will grow at a very good clip. Captive, we also expect will grow similarly, but then there are no COVID drugs this year hopefully. So, let's see how that pans out. But given the fact that we've still got three quarters going, we should still come through with around 12% growth for the year.

Shyam Srinivasan: For the top line you're saying right?

Dr. Yasir Rawjee: Yes, for the top line and margins. See, as far as we see things, I think the worst is over rather the worst is already baked in so to speak. We've already dealt with higher prices on energy, on solvents, on raw materials, and we've put enough mitigation in place which continues to be able to keep those margins intact.

Moderator: The next question is from the line of Krish Mehta from Enam Holdings Private Limited. Please go ahead.

Krish Mehta: So, I just had a question basically on the working capital. If you could provide the absolute amount for the quarter and if you could guide going forward with inventory normalizing how you see this at the end of the year?

Tushar P. Mistry: So, Krish, as we mentioned that the working capital is at 168-days. On an absolute number basis, it is about Rs.960 crores. A significant part of that being from the inventory, which is at around Rs.600 crores. And as we mentioned earlier, we have been building some strategic inventory to mitigate the supply chain challenges.

Krish Mehta: And how would you guide for this going forward with inventory normalizing say over the next 12 months or 18 months?

Tushar P. Mistry: We would to see this levels remain at this level for the near term is how we would look at it.

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

Tarang Agrawal: Two questions from my side. One, in terms of launches, just wanted to get some sense in terms of which markets were these launches and which therapeutic segments were they in? And the second, you alluded to the nitrosamine issue still impacting the sartans business in North America. I would believe that should be in your favor, right, I mean, because of inability of other players to supply. So, little perplexed on that.

Dr. Yasir Rawjee: So, the launches were in the US and they were in the CNS and cardiovascular segment. Coming to sartans business, see, it's the customer taking a call whether they want to continue with sartans given the regulatory challenges that they face also. As an API supplier, you're right, we're clean. But a couple of our top customers have gone a bit slow on that business. One of them has decided to exit. But luckily, when that kind of vacuum gets created in the market, we had other customers who took up more of the business. So, it sort of levels off for us, I mean, there was a bit of a dip there, like I pointed out to my answer to Shyam. So, we've got multiple customers on sartans. Our sartans are clean API. But some customers have taken a different call, whether to continue that business or not.

Tarang Agrawal: Would that possibly open you up to maybe a stronger business going forward, because end demand for the product is unlikely to come off, right? So, if some of your customers have decided to vacate, that should naturally flow into through some of your other customers, would that be the right way to look at it?

Dr. Yasir Rawjee: Yes, but that would depend on our other customers taking the incremental market share, because we don't supply to everybody, right, I mean, there are other API suppliers that are also in the market for sartans, and they would have their customers to whom they supply. So, it depends on who takes the market at the front end. So, we are lucky here, because a couple of our customers jumped in and said, okay, we'll take more business, not knowing that, one of our other customers was actually exiting, right, but we know that.

Moderator: The next question is from the line of Vikas Sharda from NT Asset Management. Please go ahead.

Vikas Sharda: Couple of questions. First, is on the PLI benefit side. So, how does the benefit work -- is it based on an estimate or you've actually received it? And how recurring is it? And which plant or expansion is it linked to?

Dr. Yasir Rawjee: Vikas, basically, PLI was a scheme that the government rolled out, and Glenmark qualified in Group-A as part of an overall Glenmark application. The way how it works is that there is a base here in FY'20 and we had to basically submit the number of APIs where we saw that there would be a growth. So, we submitted a list of 85 APIs where we could see growth coming in the next five years vis-à-vis FY'20. Now, the calculation is quite straightforward. So, basically, on the basis of the delta between FY'20 and FY'23, that incremental sales that we are able to get on the 85 APIs, not all of them at the same time, but as and when we get that incremental sales, we then get 10% of that in year one and year two, and then it goes down to I think 7%, 8% in year three, four, and then 5%, 6% in year five and six, roughly. I mean, that's, how the scheme works. As far as our positioning with 85 APIs, we are in a very strong position. We've done an extremely conservative calculation in terms of the benefit. And then after having done a conservative calculation, we've taken only a subset of the benefit to accrue in Q1. So, this is likely to continue given our visibility on the growth of these APIs. And the scheme is pretty clear. Our auditors did review it, and they cleared it based on all the conditions that the government had put out. So, this will continue. I don't see any challenge here.

Vikas Sharda: So, would you book it every quarter or one-off?

Dr. Yasir Rawjee: No, it would be booked every quarter, because we've taken it on this quarter sales and then next quarter the same thing will happen, right. It may happen for a slightly different set of APIs depending on how our sales goes. Your question on the investment in relation to CAPEX. We do have to ensure that the capacity build up that is happening, can be linked to these APIs. That is something that is a condition and only wherever that has been applicable, we have taken the benefit accordingly.

Vikas Sharda: Is it based on estimate? When would you expect to receive it?

Tushar P. Mistry: Let me just answer that, Vikas. It is based on Q1 sales, or compared to Q1 of FY'20. So, we have gone on a quarter-on-quarter basis. We'll continue doing this on a quarter-on-quarter basis on actual sales on a YTD basis, and keep on accruing it over the year.

Vikas Sharda: When would you expect to receive it actually?

Tushar P. Mistry: Next year.

Vikas Sharda: And my second question is on the full year guidance. So, given the fact that this quarter has been YoY decline and next quarter also you will have a base of Fabi, some part of it. So, how realistic is this guidance? And secondly, this currency depreciation also, how does that affect your guidance…how much are you building that in?

Dr. Yasir Rawjee: Like I said, the external side of the business is very clear to us. But given the fact that the captive side of the business had a strong Fabi component. There's still growth like I mentioned in my opening remarks, right, even without the Fabi drug. So, that growth is there, but we need to see how that pans out. But we are holding 12% I think it should come.

Vikas Sharda: It would imply that in the second half, you'd have to grow like closer to maybe 20% or so?

Dr. Yasir Rawjee: Yes, Q2 two is also looking pretty strong and the second half we would have one big advantage and that is the new capacity would be completely available to us to be able to service the bigger demand in the business.

Vikas Sharda: But compared to beginning of the year, the currency has depreciated. So, that benefit also, we are now building that in or how does it work? Indian rupee has depreciated since the beginning of the year. When you were expecting the growth certain percentage at the beginning of the year, now, that should benefit right from the currency side.

Tushar P. Mistry: You are right, Vikas, because in Q1, we have seen on gross margin about 50 basis points of benefit coming only from exchange which is net of what we have got on the realization as well as what we have paid on our inputs, right. So, that benefit is there in Q1 to some extent. We expect that to continue…it will depend on how it will go going forward. I'm trying to give you what impact we have seen in Q1 for that.

Moderator: The next question is from the line of Naman Bhansali from Perpetuity Ventures LLP.

Naman Bhansali: My first question is on the dependency like how much was the portion coming from the parent company Glenmark? Pharma?

Dr. Yasir Rawjee: Your question is on margins?

Naman Bhansali: On the revenue side.

Dr. Yasir Rawjee: 35% came from Glenmark Pharma this quarter.

Naman Bhansali: My second question is on the CDMO side. So, you mentioned that you are in talks with some additional players for the business. So, what can we expect in the coming quarters in the CDMO side…can we expect a revenue run rate again at the levels of 45 crores to 50 crores?

Dr. Yasir Rawjee: The way how CDMO works is, the project gestation takes one to one and a half year to bring it in. The current one, the fourth project that is not yet commercial, is already with us, and the customer has already filed in 57 markets. So, that visibility is there with us. The only thing is that regulatory approval delays are leading to this probably coming on line by Q4 of this year. So, that will add very significantly to our CDMO bucket. On the newer projects, we're in discussions. That will certainly not come this year, I mean, we don't expect, but next year, we could see some upturn there on the new projects that are currently in discussion.

Moderator: The next question is from the line of Harsh Deuskar from HD Investment LLC. Please go ahead.

Harsh Deuskar: Dr. Yasir, my question was regarding the oncology block. Once we're fully operational, what's the percentage of top line that we see this therapy area contributing? And is it a safe assumption that we will have better margins in the oncology APIs?

Dr. Yasir Rawjee: Yes, so, Harsh, generally, our margins are much better. Of course, from a contribution perspective, because these are relatively small volume high value APIs, it's a little difficult to say what exact percentage of the revenue it will bring. But like I said, we have three projects already ready to be commercial. So, I would say that it will be meaningful taking off.

Harsh Deuskar: My next question is, do we expect any FDA inspections in the current year?

Dr. Yasir Rawjee: All three of our sites are already beyond the three year window. So, we expect that we should get an inspection probably this year itself.

Harsh Deuskar: My final question is, we've seen an aggressive launch from our parent company in the Sitagliptin space in India as well as globally also Januvia went off patent. Do we have any exposure to that? And do you see any growth opportunity there?

Dr. Yasir Rawjee: Yes, so Sita is in our bucket. We have already supplied Sita to customers. And this will definitely contribute going forward.

Harsh Deuskar: My last question if I were to squeeze in is, are you seeing solvent prices decline now in the current quarter, and what's your outlook going forward for solvent prices?

Dr. Yasir Rawjee: Solvent prices like I indicated earlier, have softened. THF, methylene dichloride, methanol have softened. But things that are directly related to petroleum like toluene and hexane are still very much up there. There's a slight decline. But given the geopolitical issues, we could see it will be a mixed bag I think in terms of solvent. So, we are happy with what we got in last quarter. And fingers crossed. If it continues, then it will certainly have a positive impact.

Moderator: The next question is from the line of Tushar Manudhane from Motilal Oswal Financial Services. Please go ahead.

Tushar Manudhane: So, just one question from my end. In the previous comments, you had referred to building up of the inventory from a strategic point of view. So, you still see the logistics or the raw material availability/pricing to be higher? And that's the reason why you're building the inventory, or this is more product-specific and hence more Glenmark-like specific?

Dr. Yasir Rawjee: Tushar, the inventory question, right, it's reacting to a general. If you look at the situation with slowdowns, we keep implicating China here, but there is slowdown from Europe as well. It makes a lot of sense for us, given that our demand side is very strong to have a little bit of extra inventory with us, so that servicing is not a challenge. So, that's an overall answer. Is it specific to products? Yes, certainly, we are not taking that call across the board. Wherever we feel that we could have a challenge on inventory because of supply delays that we've seen in the past, we have taken a call to build that out. So, that's the way we are going. Plus, we have this mix of India, China. So, our vendors are on the India side, there, we have one a little more lesser inventory. And on China and Europe side, overall, we built up a little more.

Tushar Manudhane: So, you're not seeing that scenario changing in terms of availability of the raw material, which has been impacted maybe on account of COVID or global turmoil, that still not seem to be changing on the ground?

Dr. Yasir Rawjee: No, that impact is there, right, especially where the supply base has narrowed. So, there is a narrowing of the supply base for some things and there are price increases. So, yes, there's a supply issue, plus there is a price issue. So, again it makes sense to build out a little bit of inventory so that we don't run into a supply challenge.

Moderator: The next question is from the line of Gagan Thareja from ASK Investment Managers Private Limited. Please go ahead.

Gagan Thareja: So, first one is around the salience of Chinese key starting materials for your basket of APIs, which you supply. If you could give us some idea? And also some flavor of what's the status of pricing on keys and availability on key starting materials and intermediates?

Dr. Yasir Rawjee: So, there are two things here with respect to China. There is dependence on percentage of supply, right? So, percentage of supply is at 40%. But dependence is much low. We keep the supply going, because we got all relationships with vendors. These guys have supplied us extremely regularly, good quality material, and they have their challenges too. So, we see that we've got to sort of work together to keep that supply going. So, it's 40%, but dependence is lower in case we have to turn to other geographies for the supply mainly India. So, that is the situation. As far as pricing goes, like I said, certain things that are driven by metals like lithium, sodium, phosphorus, more recently iodine is on fire, I mean, it used to be $30 a kilo, it went up to $60. We thought it would level off there, but it's now hovering around $70, $75. So, those materials that are driven by these raw material price increases are under cost pressure for us. And we're just dealing with it.

Gagan Thareja: Any ballpark number you could give us to what portion of the inputs would be based on lithium, sodium, iodine, and I forget to mention one more.

Dr. Yasir Rawjee: Phosphorus. So, see, it's difficult because they don't apply to a single API, but in our Last couple of quarters, We were hit to the extent of our EBITDA margin tracking down by 1.5% to 2%. That fortunately has improved, mainly on account of solvents improving, and some raw materials becoming a little better. So, all in all, that pressure remain. But, I said earlier that I think we've seen the worst already and mitigated for it. So, we should be alright from managing these shocks on the price side.

Gagan Thareja: Extending the same line of questioning, you are also prioritizing your backward integration. As and when it kicks in, what could be the gross margin impact when it becomes operational and what timeframe do you see that benefit materializing for you?

Dr. Yasir Rawjee: Gagan, the way how that's working out is that, like I said, backward integration capacity will come on line end of Q3 of this year, right. And we expect to see a couple of products getting backward integrated, there will definitely be a margin improvement. How much that will be on those two APIs, remains to be seen, but it's definitely going to add, and to the overall bucket, how much it will add, again, very difficult to say at this point, but we are pretty bullish on the technology, and our ability to control both supply as well as improved margins. So, let's see. It's only going to be a positive, right, it's not going to go any differently. I mean, that's the whole idea of making that investment on the BI.

Gagan Thareja: Let's even put it this way that, to what degree would insourcing increase for you once you have that facility, right now, you source 40% of your maybe KSMs, and intermediates, I really don't know to what extent that is outsourced, but what could be the swing for your inputs with this?

Dr. Yasir Rawjee: I think it's a very specific answer that you would need. And at this point, I'm not able to give it to you. But given the fact that these are two large volume APIs, it would be very meaningful to our overall supply. So, see, I want to put one thing on the table here and that is, we do not look at backward integration as a sort of panacea. It's not something that we will do right regardless. It's a very strategic choice of that we will play, rather we will play it very tactically. While we built the capacity as well as have the technology in place already, it's a tactical thing. Let me put it differently. If we had to backward integrate for all the APIs that we supply commercially, we would need to build five times the capacity that we have now. Would we do that? Obviously, not, right. I mean, it would not make sense. But to have some backward integration capacity, basically allows us the ability to backward integrate wherever we need to. Because if the market starts supplying us at a good price, again, we'll take it from the market. Why should we take all the headache of the extra working capital and so on to be able to backward integrate? We are only doing it very tactically. So, while the technology is being built up, it's not going to be the holy grail for Glenmark Life Sciences. We're going to do it tactically, and that's why we are building out that capacity for it, and continue to work on technology for other molecules as well. I hope that gives you a sense in terms of how we are looking at backward integration.

Gagan Thareja: It does. If Tushar could sort of add in by giving us some idea on what's the investment pool for backward integration, and what would be the return on capital employed for that at good optimal utilizations compared with what you're earning now, would it be a different sort of segment, it would really help if you could give some idea there?

Tushar P. Mistry: Yes, Gagan, let me answer that. So, as Dr. explained, the backward integration program is a strategic program for us. From a margin expansion perspective, it will definitely help us expand margins from probably 80 to 100 bps kind of an improvement is what we can see. However, having said that, all our investments that we have done in the past or that we'll do going forward, will be all ROIC or ROC driven, right. So, that's why you will see that we are not doing a backward integration project, which is like a very large project. It's a meaningful product that we are taking only for few select products, where we see that we need to support our customers, and the sustainability of that product remains on a long-term basis. So, from that perspective, we have mapped the volumes of our products for next five to six years, looked at what volume sales going to do for those products, and accordingly, build this capacities, and that way the ROCs over next four to five years' time should remain constant at where it is today.

Gagan Thareja: If I look at your business from maybe a three to five-year perspective, you've got various strategic initiatives, one coming on backward integration, you've got new capacities coming onstream. You've probably seen the worst of the input and supply chain impacts that could have been. Hopefully, it doesn't get any worse from here. But with a five-year view and plus the PLI benefits coming in, where do you see your business from a top line perspective basis the capacity addition? And also, with the margin levers you have in place, let's assume inputs are set wherever they remain where they are, exactly the case, what sort of benefits you see accruing from these initiatives, both on the top and EBITDA?

Dr. Yasir Rawjee: So, this is a lot of assumptions here. But like I said, right, given the sort of portfolio mix that we are working on, plus the geographic expansion, CDMO, and then the newer molecules, the more complex molecules, right, so growth over the next four to five years is going to be pretty solid. I've indicated numbers earlier. On the margin side, this is where we'll have to assume that things are not going to go wild… out of control in terms of raw material shortages, leading to price increases and so on. Assuming that things keep at this new normal, then, given all the efficiency measures that we have planned on solvent recovery, on energy, price reduction, going into an alternate fuel from gas to briquettes, or even coal, right, we should keep our operating costs well under control, plus bring in efficiency on the manufacturing side in terms of material utilization, and the various schemes and so on. That should all lead to in a positive direction as far as margin improvement goes. I'm extremely wary of putting out a number in terms of where that would go. But, you can figure this out, right, that within a short period of time, with slightly increase in improvement in solvent prices, we've been able to improve the margins from the last couple of quarters to this quarter. So, Gagan, I think you should be able to sort of make that leap of faith yourself, right, instead of us coming out and giving you any kind of number projection at this point for the long-term on the margin side.

Moderator: As that was the last question for today, on behalf of Glenmark Life Sciences, that concludes this conference. Thank you for joining us and you may disconnect your lines.