



“Solara Active Pharma Sciences Limited Q1FY20  
Earnings Conference Call”

**August 13, 2019**



**MANAGEMENT: MR. JITESH DEVENDRA-MANAGING DIRECTOR  
MR. HARIHARAN S. – CFO**

**Moderator:** Ladies and Gentlemen, Good day and welcome to the Solara Active Pharma Sciences Limited Q1 FY20 Earnings Conference Call. 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 ‘\*’ and then ‘0’ on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Abhishek Singhal. Thank you and over to you, sir.

**Abhishek Singhal:** A very good afternoon to all of you and thank you for joining us today for Solara Active Pharma Sciences Earnings Conference Call for the 1<sup>st</sup> Quarter-Ended Financial Year 2020. Today we have with us Mr. Jitesh Devendra – Solara Managing Director and Mr. Hariharan -- CFO to share the highlights for the business and financial for the quarter. I hope you have gone through our results release and the quarterly investor presentation which have been uploaded on our website as well as stock exchange website. The transcript of this call will be available in a week’s time on the company website.

Please note that today’s discussion maybe forward looking in nature and must be viewed in relation to the risk pertain to our business. After the end of this call, in case you have any further questions, please feel free to reach out the investor relation team. I now hand over the call to Jitesh to make the opening comments.

**Jitesh Devendra:** Thanks Abhishek. We welcome you all to Solara’s Q1 FY20 Investor Call. I believe you have received the copy of the Press Release and the Earnings Presentation hence; I would like to move directly to the performance.

It gives me immense satisfaction to begin FY20 on a healthy note. We have had a strong FY19 and I am happy that we could carry that momentum in the new fiscal as well.

From a financial performance standpoint, we reported a 10% year-on-year growth in revenues to 3,345 million with a 42% growth in EBITDA to 663 million from 465 million in Q1 of FY19. This quarter our profit after tax expanded three times as we reported a PAT of 265 million. Due to product mix and focus on CIP, we have been able to realize better gross margin. We are working on improvement to our FY19 gross margins on the year.

We are pleased to note that Ambernath facility is ramping up to our expectations as we roll out new products. Our revenue growth was somewhat offset by the seasonality, but we expect the performance to stay on course for the rest of the fiscal year. Having said this, we are happy to report a few new developments on the CRAMS front this quarter. Our brand building and marketing campaign to make inroads in CRAMS has already begun and we now have a dedicated CRAMS team and the discussions are ongoing on the bids what we have presented to the prospective partners at the beginning of this calendar year. We believe this is an exciting space and a strong manufacturing and R&D strength certainly keep us ahead of the curve.

Coming to the operations:

I am delighted to tell you that our Cuddalore facility cleared an FDA inspection recently and this happens to be the third consecutive FDA inspection for Solara with zero 483 observations. We remain cautious of the changing regulatory regime and we would ensure of highest focus on quality and compliance. In conclusion we continue to see opportunities in the industry and we are hopeful of positive outcomes through our disciplined execution. We believe we are tracking well and we should continue our efforts in achieving growth through efficiencies. Our core focus remains on the continuous improvement programs, market expansion of our products and new product development.

So, thank you and we are now open for the question and answer.

**Moderator:** Thank you very much sir. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Amey Chalke from HDFC Securities. Please go ahead.

**Amey Chalke:** I have few questions one on the seasonality front when we say the seasonality does it reflect in the lower top line per se or is it like the kind of gross margins we have achieved in this quarter is it a seasonal strong quarter when you say or is it a weak quarter that is the first question. Second is the margins which we have reported this quarter how much do you think you would be able to take it ahead and which may not be contributed by the seasonality and contributed by the cost efficiency which we have achieved?

**Jitesh Devendra:** We do have some seasonality on our product portfolio, but as I said year as a whole we are confident that we will achieve the revenue growth compared to the last financial year and our gross margins have also improved because some of the continuous improvement program which has started to kick in and when we look year as a whole we remain confident that we should be able to improve the gross margin better than the FY19. At FY19 we were at about 50% so this quarter we started off well and we remain focus on improving that 50%.

**Amey Chalke:** So, this gross margin would be driven by the improvement in the product mix or it is driven by the improvement in the cost efficiency?

**Jitesh Devendra:** It is a combination of both.

**Amey Chalke:** And second thing is on the CRAMS segment when we have said that we have set up a team for the CRAMS segments because initially there would not be much revenue right from that segment so how much would be the cost impact, will it be a significant one?

**Jitesh Devendra:** No, it is insignificant compared to the opportunities what we have because it is only the sales and marketing team and in my previous calls also I mentioned one of the ways we are going to utilize the funds what we have received from the equity is we are looking at some inorganic opportunities on the CRAMS. So, today the cost on having a dedicated CRAMS team is

insignificant and even in the last call we had presented bids close to \$10 million for which the discussions are ongoing.

**Amey Chalke:** And the net debt numbers what we have given in the PPT does it reflect the money which has come in or it has come after June 19?

**Hariharan S:** The equity fund has come before June. As of 31<sup>st</sup> March 2019, we received the fund, no fund received in the first quarter.

**Moderator:** Thank you. The next question is from the line of Ranjeet Ramagyani an Individual Investor. Please go ahead.

**Ranjeet Ramagyani:** I have two, three questions the first is continuation with the previous speaker asking about CRAMS opportunity, so is there a definite timeline by which you think you are looking at inorganic opportunities and how much have you progressed and the second thing is when I read the annual report we were saying that we want to be in the top 10 in API making, so where do we stand in the current roadmap and how do we plan to reach there and how do we look at that roadmap by this time by doing these things we think we will be in the top 10 and number three when it comes to Solara in comparison with other top 10 players at the moment what is the edge do you see they possess and how do you aim to build that bridge those were three questions?

**Jitesh Devendra:** So, on the first question on the inorganic part of the CRAMS we continue to evaluate opportunities and we are looking at opportunities more in the west because in India we have a good setup both in our manufacturing and R&D facilities. So, we need to move up into the higher value chain of the CRAMS where we can get into the supply chain of the molecules which are already in the clinical phase. So, we are evaluating the opportunities, our goal is at least in this financial year we are targeting to close an acquisition, but I do not have exact timeline because the opportunities are still being evaluated. On the second point about being the top 10 if we look at just a pure play API company with no forward integration into the formulation and on the generic API space we believe that we are already in the top 10 just in the generic API but we definitely need to grow in the other segment and that is what we are also actively looking into the CRAMS space because we have DMFs filed across not just the US but various other countries and we continue to roll out at least 10 new products filings ever year. On the third point about what is niche about Solara, so being in this business I would say the strength what we have in Solara is that we are focused in terms of what our outcomes should be and that is paving the way for the revenue growth as well as in terms of the margin expansion and on the operation side, on the R&D side as well as on the market expansion side. Our relationship with our customer the major customers for our key API has lasted for more than 10 to 15 years.

**Ranjeet Ramagyani:** Only one question on the CRAMS if I remember it correct in the last quarter call you did mention that you were exploring opportunities and you have submitted some proposals to get into CRAMS space and the client would be getting back I mean has that progressed and we have seen any traction moving that the client is giving you the opportunity?

**Jitesh Devendra:** Yes, it is, and we remain confident just not about submitting the bid, but after submitting the bid before we win the bid there is lot of technical discussions as well as the audit of the facility by the customer so that shows that they are interested in pursuing forward. So, these are the activities which have been happening on the technical side as well as the audit of the facility and given that our Cuddalore facility has had a good outcome with the US FDA inspection, we should be able to convert some of those opportunities into business.

**Ranjeet Ramagyani:** And you reckon this might happen in the coming quarter?

**Jitesh Devendra:** We reckon this should happen in this financial year because by the time we win the bid then it goes into the R&D then it goes into the pilot plant and then it goes to the commercial manufacturing. So, the various proposals are in various stages of the activity.

**Moderator:** Thank you. The next question is from the line of Vaibhav Gogate from Ashmore. Please go ahead.

**Vaibhav Gogate:** I just wanted to get a sense on how are you seeing the raw material price environment and volatility especially in China, we are hearing conflicting reports some say that tighter environmental standard continue to keep prices in high and supplies are uncertain other people are telling us that with the latest sort of round of trade disputes with the US is actually forcing China to let up a little bit on the environmental concern and supplies no longer an issue, could you help us understand what you are seeing in China at this point?

**Jitesh Devendra:** So, on the China situation and on the raw material pricing, we have not seen any significant increase in the raw material prices what we have seen in the last financial year. The challenges continue to remain in terms of the supply possibility and that is why we have taken steps of having some of our key intermediates manufacturing in one of our sites, Mysore, as well as we do contract manufacturing with other companies here in India. So, from a pricing point of view we have not seen any significant price increase at all, but yes supply chain remains to be a challenge and we need to be on top of that.

**Vaibhav Gogate:** Would it be fair for me to say that the gross margin improvement that we have seen in Q1 has nothing to do with a temporary mismatch in raw material versus end product supply prices or effects, but it is actually a productivity improvements and hence there is certainty that the gross margin improvement that we have seen will continue to kind of stay.

**Jitesh Devendra:** This goes back to the previous question while we have not seen any significant raw material price increase coming from China in the last quarter, but you never know there could be some volatility in the raw material prices but having said that we are confident because as I said we have introduced, new products from our Ambarnath facility. So, with the new products we expect at least the gross margin improvements compared to the previous financial year.

**Moderator:** Thank you. The next question is from the line of Mehul Savla from RW Equity. Please go ahead.

- Mehul Savla:** I just wanted to know the net debt number on a consol basis?
- Hariharan S.:** Rs. 4,984 million is the net debt on the consolidated basis.
- Mehul Savla:** Sir, when do you see your Ambernath facility breaking even?
- Jitesh Devendra:** So, we do not break out P&L by unit wise, but we are happy to say that at least the revenues have started to roll out from our Ambernath facility.
- Mehul Savla:** Because I believe there is a note in the notes to account which says about the revenue generated from Strides Chemical which I believe is the Ambernath facility?
- Hariharan S.:** Correct.
- Mehul Savla:** There is a PBT loss of around 1.7 crore so on that and obviously it is reduced by half from March so just wanted to get a sense?
- Hariharan S.:** So, this is in line with the compliance with the regulation and we must give details about the revenue and the profitability of the units which has been acquired, In this current year, it will turn out to be breakeven for us. It is a very small loss in the in Quarter 1, but that will all get adjusted.
- Mehul Savla:** There is a significant amount of capital which has been invested by our company, so it drags down the entire returns.
- Jitesh Devendra:** But see this is one of the facilities which will add to the growth as we move forward so you have to invest in capacities and Ambernath by far is one of the major facilities which will help us deliver growth in the medium-term or the shorter-term I would say over the next 12 to 18 months till our Vizag investment starts reaping dividend. So, to that extent Ambernath is very critical and it is pretty much in line with our expectation the way we have anticipated and will roll out going forward.
- Moderator:** Thank you. The next question is from the line of Herin Dedia from PM Securities. Please go ahead.
- Herin Dedia:** I would like to ask that year-on-year and quarterly the cost of material consumed has decreased, so is it due to reduction in price of some specific API commodity or is it due to production efficiency?
- Jitesh Devendra:** Your question is leading to the gross margin expansion?
- Herin Dedia:** Yes.

- Jitesh Devendra:** The gross margin expansion has been a combination of our CIP as well as in terms of our product mix.
- Moderator:** Thank you. The next question is from the line of Neelam Punjabi an Individual Investor. Please go ahead.
- Neelam Punjabi:** I wanted to know what is the current capacity utilization?
- Jitesh Devendra:** So, you know Ambernath of course is in this financial year we look at utilizing most of the capacity from Ambernath on the other Units we are well utilized in terms of our capacity, but we still focus in terms of improving our product mix where some of the products will meet the gross margin what we have kept for ourselves.
- Neelam Punjabi:** I wanted to know your net debt has increased QoQ, so where do we see this number at the end of the year?
- Jitesh Devendra:** We have already committed that net debt will be less than two times of EBITDA.
- Moderator:** Thank you. The next question is from the line of Amey Chalke from HDFC Securities. Please go ahead.
- Amey Chalke:** I just had one or two questions. when we said we have launched new products from the Ambernath unit like in terms of categorization where these products will fall in like as in are these higher volume products or these are driven by the patent expiry which have happened in the US which has given you the opportunity to launch this product and how the margins are compared to our other products?
- Jitesh Devendra:** The products what we have launched from the Ambernath facility so some are already off patent and one which has just recently become genericized and on the volume perspective I would not say these are large volume, but I would say these are low to mid volume type of APIs and the gross margins on these products are of course in line with the expectations.
- Amey Chalke:** But whenever we decide to launch any product or choose any product do we see market size how do you get a sense on how much capacity requirement we need to have for this products and what is typically the minimum target market size. Should it be at least Rs. 1,000 crores or Rs. 500 crores how do we decide on that front?
- Jitesh Devendra:** So, from a new product selection so we look at the opportunity what we have sometimes these opportunities where we are primary source and we can garner just not from a volume perspective, but even from a value point of view and the other product is more from the opportunities where there are limited API suppliers and if we are able to expand this just beyond one market. So, as I said we have a good presence just not in the US, but in Europe as well as in Japan and South Korea and we have made headways also into the China market. So, we look at the market

landscape or geography landscape. So, from a risk mitigation point of view we are not just depended on one particular market or one customer and the third is where we have been successful in Japan market and where we have looked at specific molecules which are still under patent in Japan but are off patent elsewhere and that gives us the opportunity to get into that API and be a primary source.

**Amey Chalke:** And about this Vizag unit what are the timelines for us for like till what time the commissioning will happen and the revenue realization will start?

**Jitesh Devendra:** So, our timelines for the Vizag, we are looking at March 2020.

**Amey Chalke:** So, by March 2020 it would be like the civil work would be done or it is like it would be available for the validation or anything?

**Jitesh Devendra:** Validation, completion and then we will start filing for all the markets. We will start adding Vizag to some of our existing DMFs as well as new DMFs.

**Amey Chalke:** So, should we expect revenue from Vizag in the second half of FY21?

**Jitesh Devendra:** No, I would say given that we focus on the regulated market as well as the approval timeline probably the Q4 of FY21.

**Amey Chalke:** So, Strides is one of the key customers for us and their guidance for the US business is significant one for FY20 they are expecting around \$250 million US revenue they are launching lot of products so are we gaining any traction from that customer as well for our API supplies?

**Jitesh Devendra:** Strides will continue to remain our largest customer because of the existing products as well as the new product launches. So, you are right while Strides is doing extremely well in the North America market, some of the benefit we will also see in Solara.

**Moderator:** Thank you. The next question is from the line of Vaibhav Gogate from Ashmore. Please go ahead.

**Vaibhav Gogate:** Couple of follow up questions what is the CAPEX budget for the current year not including the inorganic CRAMS that you might be looking at just a regular CAPEX that we are looking at?

**Hariharan s:** Existing units we planned around Rs. 80 to 90 crores CAPEX during the current year for the maintenance as well as in expanding the capacity and Vizag we have committed towards Rs. 250 crore CAPEX over a period of 2 years' time.

**Vaibhav Gogate:** And the budget for inorganic acquisition is about \$10 million would that be the right number?

- Jitesh Devendra:** No, the \$10 million was the opportunity what we have presented for the CRAMS not the size for the acquisition.
- Vaibhav Gogate:** In your estimate what could be the size or what would you be willing to go for?
- Hariharan S.:** TPG plus promoter committed nearly Rs. 460 crores of equity infusion within a period of 18 months and already we received nearly Rs. 148 crores. Balance expected between this year end and by September 2020. So, we have cash of nearly Rs. 460 crores and out of that we will be spending some money for the Vizag project and balance amount will be reserved for inorganic acquisition.
- Jitesh Devendra:** So, we are not looking at a very big acquisition, but we are looking at an acquisition which could be a gateway for getting the CRAMS projects and then doing up the commercial manufacturing here in the facilities in India.
- Vaibhav Gogate:** And one last question you know one more company in India had spoken about the increasing supply for Ibuprofen Active. BASF apparently has large new facility which will ramp up through this calendar year and that is probably providing an outlook that Ibuprofen prices could be bit softer going into the next year which is calendar year 2020. This is large product for Solara from what I understand, would you able to sort of provide some outlook that does it represent any risk to your revenue or to your margins would you like to comment on that?
- Jitesh Devendra:** So, first I will answer from a volume point of view even though our competition is talking about putting up new facilities or increasing capacities we have not heard back from a customer going back on that commitment what we have and on the pricing point of view you know as I have eluded earlier also we have sustainable model on Ibu given a long term relationship and the contracts what we have in place with our customers. So, we feel confident that pricing for Ibu what we have considered for the coming years should be a sustainable one.
- Moderator:** Thank you. The next question is from the line of Ranjeet Ramagyani an Individual Investor. Please go ahead.
- Ranjeet Ramagyani:** I would like to continue with the previous question on Ibuprofen and I heard that volumes and all should be fine, but should the customers have to give you the intimation due to increased supply or whatsoever coming up as we progress, how much would be the timeframe would you expect that customer would give you in terms of guidance saying that yes we are expecting some oversupply or whatever that is number one. And second thing is should that scenario happen I am assuming that you would have a strategy to de-risk and if you could elaborate on that. Third is Strides recently I think one of their plant received some audit inspection report and there were some observations which were there is any risk to Solara because of that we being the prominent supplier that is the third question and if you look at this quarter number the top line I think has almost grown 10% to 12% if I am correct do excuse me if I am wrong, but the bottom line has shown very good improvement. So, the question then is I mean in the next three quarters do you

see the traction mode only maintaining the bottom line or you see that you can actually see the top line going forward improve much more in terms of percentage terms because the New Year has just started and probably as we mature the year the customer would have probably giving more kind of orders and last question from my end is in the annual report I see a number of new scientist and the team has really gone up so if you would like to call out in terms of are they specifically for some keeping in mind the increased roadmap of new products and all that, that would help us to understand a bit better?

**Jitesh Devendra:**

So, on the Ibuprofen you know last 18 months has been a difficult time for Ibuprofen whether there was a shortage and the shortage still continuous to exist, but during this time we have handled well in terms of our relationship with our customer where some of our customers where we were secondary source we became the primary source and based on that we also have a volume commitment. So, it is just not about the new capacities are coming in, but at the time when the customer needed us we were able to live up to that expectation and we have been in this business of Ibuprofen for 30 plus years, so we understand how the market works as well as from a pricing point of view. So, there is a lot of history behind Ibuprofen and it is just not one single API because Ibuprofen has different grades of Ibuprofen plus we are into the value added Ibuprofen derivatives and so we are significantly strong player on the Ibuprofen point of view and during the shortages even though we had opportunities in terms of short term supplies we were very focussed in terms of longer term relationship. So, I think that should pretty much answer the question on the Ibuprofen. On the question about how this financial year will look. We are focusing both in terms of the revenue growth as well as keeping in mind the gross margin expectation as well as the EBITDA margin. So, when we were in the last financial year we were in the probably low teens in terms of our EBITDA margins and we kept focusing on improving the EBITDA margin and we are now at high teens. So, the focus is both in terms of the revenue as well as on the margin front. The third point is on terms of the R&D cost expansion. See one of the key things where we can support our customers is in terms of all the deficiency responses. Now last year we filed 9 new DMFs and how quickly we respond to those deficiency is very critical for the customer also to get the approval. So, now that we have filed the DMFs, we have setup a dedicated team for answering all the deficiencies what we could expect coming out of the customer filing as well as having a team for the generic API development and the CRAMS business what we are expecting because once we get the business at that point of time we cannot hire people so we need to be ready for that. So, those are the areas where we have seen the increase in the R&D cost.

**Ranjeet Ramaganyi:**

One last question is when you mentioned a few minutes back that we now in Solara are focusing more on the opportunities where there are limited suppliers and we are able to focus not only on volume but those value and taking these products to newer geographies, so the question is have you started this process is the first question and in terms of geographies where do you see the maximum traction happening and would those be the focus areas in the near term.



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**Jitesh Devendra:** We have started the process and from a geography standpoint we have dedicated teams for different geographies. So, I would say the focus is just not on one particular geography even though China is a new market for us which we have entered in the last year and we have already done some filings and we will continue to do more filings in China, but we have office in the US as well as dedicated team for Europe and in Japan and South Korea. So, our focus markets I mean our key markets and our focus continuous to remain over there.

**Moderator:** Thank you. Ladies and Gentlemen with this I now hand the conference over to the management for their closing comments. Over to you, sir.

**Management:** Thank you all for participating in our investor call. We appreciate the questions and we look forward to having a chat again in our next quarter investor call. Thank you.

**Moderator:** Thank you very much. Ladies and Gentlemen on behalf of Solara Active Pharma Sciences Limited that concludes this conference call. Thank you for joining us and you may now disconnect your lines.