"Solara Active Pharma Sciences Limited's Q2 FY'22 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the Solara Active Pharma Sciences Limited Q2 FY'22 Earnings Conference Call. As a reminder, all participants' lines will be in listen-only mode and there will be an opportunity to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing star then zero on your touchdown phone. Please note this conference is being recorded. I now hand the conference over to Mr. Abhishek Singhal. Thank you and over to you sir.

Abhishek Singhal: Thanks, Vikram. 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 Second Quarter and Half Year ended the financial year 2022. Today we have with us, Raj – Executive Director and Vice Chairman; Bharath – M.D. and CEO and Subhash -- ED and CFO to share the highlights of business and financials for the quarter.

I hope you've gone through our results release and quarterly investor presentation which have been uploaded on our website as well as the stock exchanges website. The transcript for this call will be available in a week on the company's website. Please note that today's discussion may be forward-looking in nature and must be viewed in relation to risks pertaining to our business. After the end of this call in case you have any further questions please feel free to reach out to the investor relations team. I now hand over the call to Bharath to make the opening remarks.

Bharath R Sesha: Thank you, Abhishek. Good afternoon, everyone. Thanks for joining the call today. As always, I want to start by wishing you and your families a lot of safe health and happiness.

Before I go to the business aspects, I would like to share with you that I'm very proud to say that nearly 100% of our employees and our contractor partners are now fully inoculated with the first dose of the COVID-19 vaccine and more than 67% of our employees and contractors are already inoculated with the second dose. We continue to adhere to all safety and health protocols and we will pay close attention to make sure there is no impact of COVID on our operations business and above all our employees and their families.

Let me go to the business aspects:

The business outside of Ibuprofen has done well and is trending in the right direction. So, what I would like to do is to address the Ibuprofen business conditions upfront and then move on to other performance drivers. I would like to start by framing the context of our Ibuprofen business, so we're all on the same page in terms of the context in which we operate. We have as Solara's nearly three-decade legacy in this business in this product in this molecule. It is underpinned by strong customer relationships, long-term contracts, and cost leadership. During the upcycle of Ibu prices, we have made a conscious choice not to ride the upside on pricing with strategic customers. In prior calls, I had emphasized this and I said at a time that we expect this to stand us in good stead when the business cycle turns in the other direction.

In the last quarter, we've seen some of the benefits of the strategic approach from a pricing perspective as our key long-term customers have not given us the same price erosion that is seen in the broader market. We've been able to mitigate to a large extent the pricing challenges on Ibuprofen, particularly with our strategic customers.

The other key business characteristic of the Ibuprofen business is nearly 60% of the product that is made in our Pondicherry facility is underpinned by long-term contracts. So, the current challenge on Ibuprofen for Solara is mainly due to demand and a demand drop situation.

A key factor behind the stress in demand on Ibuprofen is to do the fact that the prescription and OTC sales have fallen significantly as the general need for pain or flu medication has dropped. This impact is potentially due to the fact that there are better social norms on masking, social distancing, etc., and also that there is the limited resumption of day-to-day activities in the prior couple of quarters. This impact is especially pronounced in the regulated markets. To put it in perspective, the regulated market demand for Ibuprofen we estimate has dropped by more than 40% and it's very, very safe to say that this is neither sustainable in terms of this level of steep drop nor is it normal. Many of our strategic customers reacting to this situation, have asked for us to defer shipments of Ibuprofen in the quarter. As we've indicated in our presentation, we see a deferred demand in the order of magnitude of 600 to 650 MT just in Q2. We anticipate that the destocking process across the value chain to continue albeit with less intensity for at least another quarter and we see that the normalization of demand for Ibuprofen will happen in the next six months.

Now acting with alacrity to this situation, we have repurposed our Vizag facility. As a reminder we had indicated that our phase-I in Vizag facility was dedicated for Ibuprofen, we have repurposed this facility as a multi-purpose plant that will be able to make multiple products while preserving the capability to manufacture Ibuprofen as the demand recovers.

Let me re-emphasize, the situation on Ibuprofen demand we believe is transient and we don't see any long-term impact on Ibuprofen demand worldwide.

I need to point out again that Solara continues to maintain a share of the wallet with all our key customers and we are very well positioned to benefit when demand recovers.

Also, important to note that we see strong traction on our Ibu derivatives business. As we all know derivatives are various salts of Ibuprofen, which provide different patient benefits. And this for us is an added competitive advantage and will enable us to come faster into the normal demand situation for Ibuprofen.

While all other levers of our business continue to do well, the strong headwinds on Ibuprofen have impacted our results this quarter. Our revenues currently stand for the quarter at INR4049 million and an EBITDA of INR736 million, the EBITDA margin of 18.2%. That has led to a PAT of INR 297 million.

The continued pressure and volatility on the raw materials prices have also impacted our margins. We have seen some raw material prices escalate to extremely high levels in the quarter. This situation has still not abated and we see some continued RM cost challenges still playing through. In addition to this, there have also seen as we all know worldwide increase in logistics cost and that has also had an impact on margins in Q2 FY'22.

At Solara we're taking all measures possible on both of these aspects including the strategic buildup of short-term inventory on key raw materials at attractive pricing and optimizing logistics costs wherever possible. While the situation with regards to Ibuprofen demand and the raw materials is less than optimal I'd like to emphasize we have done very well in all other parts of the business.

A few salient points to consider: Molecules other than Ibuprofen have performed well in the quarter. We've seen an expansion in EBITDA margins for these molecules and this has not been a one-off trend if we were to look at the medium term of the last two to three years, we've seen consistent growth and expansion both on revenue and on EBITDA for molecules other than Ibuprofen.

Our operational excellence initiatives continue to deliver and we see a lot of opportunities to continue to enhance this and get more efficient as the quarters go by.

As I mentioned earlier, in record time, we have repurposed our Vizag facility to a multi-product facility and we've already commercialized a couple of products from here and we continue to have the capability to make Ibuprofen here in this facility as and when demand recovers.

The backward integration for Ibuprofen is on track as I had indicated in the last call. We will be operationalizing it in Q3 and the scale-up will happen in Q4. The market share that we have gained in the less regulated markets has continued to improve while historically this segment of the market has not been our focus. Our renewed efforts to balance our revenue for a few products across all markets are taking hold and getting anchored well.

Another bright spot for us in this quarter has been our CRAMS business which is having a stellar year. We have grown more than 40% year-on-year and our margins are much higher than in our generic business.

What is particularly pleasing in the CRAMS business is the “business build” metrics such as enquiry conversion ratio, the ticket size, new customer additions, and customer stickiness were all at record levels in Q2. Our momentum on CRAMS will continue and we will have a year of record growth with solid margins in this business vertical. Our DMF filings are also on track to meet our commitment of 10 to 12 DMFs this year.

And as I have been updating you regularly in these calls our proof-of-concept for two technology platforms which are both enablers for generics and CRAMS business, are on track to be completed by the end of this financial year.

All in all, I have shared with you a picture where the execution of our strategy is going exceptionally well; however, we are dealing with a very unique situation with regards to global Ibuprofen demand which is under significant stress. However, as the situation remedies in the next two to three quarters we will be well on track to deliver on all our long-term goals.

I would now request Raj to get his perspective on how we are addressing the future opportunities at Solara. Thank you.

Rajender Rao Juvvadi: Thanks, Bharath. Good afternoon, everybody. While we have seen a muted performance in the last quarter as Bharath has just outlined, we focus a lot of our actions and strategic areas of developing non-Ibuprofen product portfolio, CRAMS business, and new customer addition across the board both in Ibuprofen, Ibuprofen derivatives, and non-Ibuprofen products as well. And these are giving us an additional customer base. We are working on anchoring customer partnerships, especially in regulated markets while leveraging market leadership in niche product variants. Our R&D velocity continues to improve, leading to the development of new products and market extensions filings. We've been foraying in the new technologies and this will lead to several new streams of future business potential. Differentiated product offerings, coupled with street-to-market, this is what we're aiming for.

In the CRAMS business, we've been focusing on science-based differentiation by additional capabilities on technology and transitioning it from incubation to fast-growing businesses. We are leveraging the existing innovator customer base for rapid selling.

From our operational focus standpoint, the multi-product facility at Vizag is ready and during this month, we are starting validations of a couple of products, helping us to probably trigger the regulatory inspections which have not been happening for quite some time because of the COVID conditions. This multipurpose product facility will help us cater to increase future demand, cost efficiencies, and increase the number of validations that we do as we go by.

We're also making good headway in implementing manufacturing improvement programs, leading to better utilization of capacities and lower OPEX. We have taken aggressive targets and are streamlining our operations. As we continue to navigate through the current situation and work towards accelerating all the levers of our strategy, we remain confident in delivering long-term value to our stakeholders.

On merger, we have significantly completed our exercise of identifying synergies including manufacturing, R&D efficiencies, procurement, cross-selling opportunities, and OPEX efficiencies such as productivity. The implementation will begin in the coming quarters and the full impact will flow in the next 12 to 14 months. Thanks a lot.

Request Subhash to share some details on the balance sheet and key ratios.

Subhash Anand: Thanks, Raj. As communicated by Bharath and Raj, we continue to see demand pressure on some of our base products and a shift of share of business towards LRM markets. In fact, contribution from LRM markets went up from 20% to more than 60% on YoY basis in Q2. This has resulted a change in our key financial ratios. Let me talk about a couple of them:

Our working capital is up by INR1,335 million from INR6517 to INR7852 million. Mainly contributed by inventory, which is up by INR1246 million, from INR3706 million to INR4952 million, primarily from building the inventory as planned for expected COVID-related business. Increasing key KSM and raw material inventories to offset the volatility in prices as well as the uncertain environment because of China's situation and partly deferred offtake of contractual quantity by a few customers. All these three things have impacted and led to the increase in inventory level at Solara.

Another element of shift in business from the regulated market to less regulated markets, had an impact on our receivables which went up from INR6297 million to INR7010 million.

The company is actively taking initiatives to right-size the working capital, taking various initiatives like adjusting the production in line with demand. COVID inventory is expected to be sold in Q3 and focused to improve the sales mix from distributor to end customers in LRM markets. With all the actions already planned, the above trend are expected to normalize over the next couple of quarters.

An increase in working capital had an impact on our overall debt level which went up from INR5250 million to INR6915 million in the course of last quarter.

CAPEX for the year stands at INR1,166 million continue to reflect our focus on growth-led investment. Asset turns are at 1.7x. Net debt-to-EBITDA stands at 2.1x and debt-to-equity is 0.5x.

With this, I hand over to the moderator to open the forum for Q&A. Thank you.

Moderator: Ladies and gentlemen, we will now begin the question-and-answer session. We have a first question from the line of Tushar Manudhane from Motilal Oswal Financial Services. Please go ahead.

Tushar Manudhane: Sir, in your opening remarks, you alluded to inventory buildup on account of COVID-related business. Can you elaborate on what product, what kind of opportunity are you seeing on this?

Bharath R Sesha: We have products that are currently made in our Vizag facility converted into the multi-purpose facility, and produced both Favipiravir and also the intermediate for Molnupiravir. Raj can add further color to this.

Rajender Rao Juvvadi: As the intermediate, we have tied up with at least two or three of the licensees. So, we expect significant traction on the Molnupiravir intermediate, and on Favipiravir we have one or two customers who are selling in markets where the product is approved. So, we expect a significant ongoing sale of Favi even after the approval of Molnupiravir as well. So, these two products for us continue to be going on in Q3 and Q4 as well for us.

Tushar Manudhane: With this new Pfizer drug, do you see the threat for the opportunity?

Rajender Rao Juvvadi: See, a lot of people ask me the question but even after Molnupiravir was approved or was indicated a couple of months ago in April, May it's taken so many months for an approval. So, I'm sure it will take a similar time or lesser time depending on the situation in the market but the product gets an approval, correct. So, we don't know how much time that product would take an approval like you got about the Molnupiravir six months from the time of indication in March or April in the current year.

Tushar Manudhane: Just a clarification here. So, this business would be starting 3Q onward?

Rajender Rao Juvvadi: Yes.

Tushar Manudhane: And secondly. equity value as per the proposed scheme was about 6,926 crores which has now increased to Rs.7,845 crores. Any particular reason for this?

Subhash Anand: The last valuation was done in April and based on the prevailing SEBI price formula the price was much lower for valuation purposes. Now the Latest weighted average of last 26-weeks it's much higher, resulting a higher multiple and higher valuation. But if you see the number of shares issued, the number of shares issued from Solara for this merger to Aurore has come down adjusting the value of APPL. The earlier split between Solara to Aurore was 73% to 27% which means Aurore shareholders were getting 27% of the shares of Solara as a merged entity. Now with this new modified scheme, they will be getting 24%. So overall number of shares allocated as a part of the scheme has come down by 3%. The method of valuations and comparables are same as used earlier. The independent valuer has gone ahead and followed the same approach which was followed when we went with the initial April approval process.

Tushar Manudhane: What is the scope of increasing the asset turn or what can be the peak asset turn for the kind of products we have in the pipeline, at Aurore, Solara, combined level?

Subhash Anand: We are currently at 1.7x if you see last year we have gone to 1.8, 1.9 also. The way we see this once the capacity utilization improving and all our plants are up and running we have an opportunity to go and touch up to 2x of an asset turn.

Moderator: We have the next question from the line of Aejas Lakhani from Unifi Capital. Please go ahead.

Aejas Lakhani: I wanted to understand, Bharat, a couple of things. One is how do you look at the gross margins going forward for the second half of the year?

Bharath R Sesha: As I said, there are two underlying factors that are playing through and particularly I'm talking about the coming few months. And one of this is the raw material pricing which we've seen that been able to mitigate some of the impact by some advanced purchasing, some smart contracting. Those are still playing through. And the second is the sales mix. While I indicated earlier on some of the products we've been able to pretty much hold our line on pricing in the regulated markets with the long-term customers, as the sales mix evolves that will also have an impact on the margins depending on whether there is less regulated market sales. So, I think these two are factors that we need to keep in mind. In the medium to long term, we are still confident of 53, 55 range of gross margin. Maybe the next quarter will be a bit of a softer ratio on that, but it will stabilize as we go towards Q4.

Aejas Lakhani: Also, as per the new scheme of the arrangement after the Aurore merger, the financials will be effective 1st October right, earlier it was 1st April, is that understanding correct

Subhash Anand: That's right. Since the entire merger process is now delayed by more than six months and we will be filing a fresh merger scheme with SEBI and other regulatory bodies. So, we have moved the effective date from 1st April to 1st October.

Aejas Lakhani: Since investors do not have any understanding of Aurore and we know that Aurore had a COVID portfolio that they benefited from, I'm just looking for a trajectory of how the business is doing because we do not know how to evaluate the business on a YoY basis. So, could you throw some color on the same?

Rajender Rao Juvvadi: We had continuous business on Favi because in the markets where we were the first guys to get approved in markets like Thailand, Indonesia and a couple of other markets where others are not approved. So, we had continuous sales ongoing in the last two quarters as well. And as we speak even in the current quarter we have significant traction on the Favi. For Molnu, we are waiting for an approval. We are in trial stage with a lot of people and we also would be continuing to have our intermediate business of this product (which we did last year also), even in the current year as well.

Aejas Lakhani: Is it fair to say that the business sales momentum and EBITDA would continue to accelerate in FY'21 for Aurore as well?

Rajender Rao Juvvadi: We are consolidating like last year. I think we will be able to maintain.

Aejas Lakhani: Is it possible to call out the CRAMS number for the quarter?

Bharath R Sesha: The best way to look at it is if you look at our April presentation we had indicated CRAMs business of around Rs.70 crores in Solara standalone. I have said that we are anticipating growth of somewhere around 40%-plus for the year. So, you can do the math, it's around that. In the first half of the year, we've grown roughly at 40% but it's not like split half and half. So, I would say look at it from an annual perspective, FY'22 you can take into account 40%-plus growth on a base of somewhere around Rs.70 crores

Aejas Lakhani: From your Rs.1,600 crores of Solara sales last year what was the entire COVID portfolio, if it is possible to quantify it as a value and how do you look at it for '22?

Bharath R Sesha: We have virtually no sales that came from core COVID products in FY'21.

Aejas Lakhani: And the same for Aurore is a different story but that's already quantified, alright.

Moderator: We have the next question from the line of Pallav Garg / Alankar Garude from Macquarie. Please go ahead.

Alankar: Sir, if we assume a $12 per kg pricing for Ibuprofen or the impact of the deferral which you mentioned comes to about 55, 60 crores, so is this number broadly correct, and do you expect this quantum to come down in subsequent quarters?

Bharath Sesha: So I think $12 is roughly the average price across regulated and less regulated, maybe a little bit lower than 12. I would say broadly there, maybe a bit upside to what you're saying. Your calculation in terms of the deferred demand then comes to around the same numbers that you indicated. As I said there will be destocking that will happen in Q3. Intensity may be a bit lower. I see some green shoots… I don't want to call them green shoots yet but some initial signs that some of this inventory destocking may be coming closer to an end as we approach Q4 we would be probably getting back to the restocking. So that's kind of how we see the picture now. So Q4 is when we will see the normalization process again.

Alankar: If you see gross margins, they are down to 60 basis points sequentially. How much of that would you attribute to Ibuprofen?

Subhash Anand: Although we don't talk on category wise gross margin but the drop is mainly contributed by Ibuprofen as Bharath spoke, rest of the business is performing better than the last year . So, the majority of this impact is coming from Ibuprofen both from a front end pricing as well as raw material impact.

Alankar: Secondly, you had mentioned in the last call about a much improved second half. Bharath sir just mentioned about Ibuprofen recovering gradually in third quarter and then normalization process from the fourth quarter. So, would you be revisiting your guidance for FY'22 and also given that Aurore the merger has been delayed by six months, can you just reiterate the long-term guidance as well?

Bharath R Sesha: So, the long-term guidance, we can absolutely reiterate, we are well on track for that, we see everything trending in the right direction. On FY'22 as I have alluded to earlier there is this uncertain picture in terms of the restocking and the normalization of demand, so it would not be prudent on our part right now to give any further indications of what FY'22 could be. But again, re-emphasizing the long term we don't see any risks to what we had indicated earlier. We're trending all in the right direction. So that's how I would see it.

Subhash Anand: On the Aurore side, as Raj communicated on H2, they will be able to perform and will be delivering in line with the expectations. We don't see a major impact coming from that side.

Alankar: You've spoken about Vizag Phase-1 being repurposed. So, does this mean that our Ibuprofen capacity is lower than what it was said till last quarter? So basically, just checking whether this is a temporary strategy till we get the USFDA approval, and can you comment on page two as well?

Bharath R Sesha: Absolutely bang on. It is a strategy or I would say a tactics that we have employed to make sure that we are able to address any potential under-recoveries that will happen in Vizag. In terms of the story on phase-2, we will continue to have it as a multi-purpose facility and that is also what our plan is in terms of going forward.

Subhash Anand: As Raj indicated earlier, this is we have just converted it into a multi-purpose. Whenever we see a demand revival of Ibu, we can switch back and continue to produce IBU from vizag plant

Alankar: The facility is ready or the work is still yet to be done?

Subhash Anand: Phase 1 is already operational. We expect the multi-purpose facility to be ready by end of Q3 or early Q4. It's almost ready. Just a last few leg which is pending in that facility.

Alankar: Is it possible to comment on the extent of under-recovery from this plant currently?

Subhash Anand: I'll say, there are some amount of under-recovery, would not like to quantify but with our efforts of putting few more products like COVID related product and we have plans to transfer some of the other products in this facility to ensure we continue with our part of making sure we minimize the under-recoveries.

Rajender Rao Juvvadi: Vizag facility is a new facility. The cost of manufacturing is lower than the other existing sites because they're all old sites. So, for us it will be more optimal while we transfer a few of the products from the other site into this site, one, it covers the under-recovery, two also it makes us better margin because this side is slightly lower cost than compared to the other sites for us.

Alankar: Is the process already complete or it would be in progress, right?

Rajender Rao Juvvadi: We just started.

Moderator: The next question is from the line of Bhaskar Bukrediwala from Arthya Investments. Please go ahead.

B Bukrediwala: You mentioned that there was unprecedented raw material and logistic cost. While in the non-Ibuprofen business margins are fairly intact. What I wanted to understand is that when the Ibuprofen demand was good and the pricing was good, you didn't take any major pricing action with your customers and they're fairly balanced is what you mentioned. Now when things are a little rough, are your customers not willing to sort of support you given that in good times you did not sort of took the market pricing and were more balanced, how have they reacted in terms of supporting in rough times like this?

Bharath R Sesha: So, let me clarify that. I tried to frame that in my opening address. What you said absolutely happened in terms of support from our customers. Wherever we've had long-term strategic customer relationships on Ibuprofen we have seen that pay back to us in this tough time. Our price erosion or any challenge on pricing from our long-term strategic customers have been benign. We've been able to mitigate to a large extent what we see in the broader market in terms of pricing from our long-term strategic customers. The challenge there is not the pricing, the challenge there is the volume and the volume is a direct link to the end-market demand. So, your question is bang on. Our strategic approach which we have believed in and which we have implemented for the last many years is absolutely paying dividends when the markets in a tough situation with regards to Ibuprofen.

B Bukrediwala: You mentioned somewhere in the call that this whole Ibuprofen demand is more transient and not structural. So just wanted to reconfirm that there are no other formulations or any other drug which is sort of impacting the demand for Ibuprofen, is that understanding correct?

Bharath R Sesha: Your understanding is correct. Again, I'll add one more data point to make this even stronger in terms of underpinning this substitution story. If you look at the global per capita of Ibuprofen consumption, there are about 60 countries in the world which have lower than global per capita consumption of Ibuprofen today. So, the potential for this market is actually higher than lower and we have not seen any substitution effect and I have this confirmed from all our key customers that they have not seen any substitution of the product by other competing therapies.

B Bukrediwala: So, it's just a stocking issue that is happening which is expected to normalize in maybe a quarter or two?

Bharath R Sesha: Exactly.

B Bukrediwala: You mentioned that around Rs.116 crores is the CAPEX that you have done in H1. What would be the CAPEX guidance for H2 and next year? If you could help understand the breakup of this CAPEX let's say between CRAMS and non-Ibuprofen generics and maintenance CAPEX?

Subhash Anand: As we guided earlier, our CAPEX for this year will be in the range of 225 to 250 crores and we will continue to maintain that range. This softness what we see is situational and transitional, not structural. So, we are going ahead and making sure our long-term growth plans are intact and getting ready for the same. Most of our CAPEX are against growth initiative or backward integration and we continue to hold to our belief and we'll continue to invest on all the growth initiatives that we have at this point of time.

Bharath R Sesha: Just one data point to add. If you look at the export of Ibuprofen from India, Q2 was about 30% lower than the average of the previous eight quarters. I'm just trying to give you an order of magnitude of why this is not a sustainable level in terms of the dip. No molecule can survive when you starve the market of this level of product. So that's why we've seen every data point, we see points to the fact that there has been continuously destocking, but I just wanted to lay out another data point for this to be communicated.

B Bukrediwala: Next year what would be our CAPEX? This year you mentioned 225 to 250 crores.

Subhash Anand: We are at a stage when we are firming our next year's plan. We will have a better guidance in the coming quarter calls but as we spoke even in earlier calls also, we continue to see our growth CAPEX story and we are not willing to compromise or go slow on our growth CAPEX. So, whenever we have a business case to support our growth, we'll continue with CAPEX.

Moderator: We have next question from the line of Nitin Agarwal from DAM Capital. Please go ahead.

Nitin Agarwal: Two questions: one is a) just a housekeeping one to start with, so on Aurore by when do you think you'll be in a position to start sharing a slightly more granular details of the business financials performance?

Subhash Anand: As we spoke earlier, the moment we have shareholders' approvals, we will start sharing the consolidated numbers. We may need to wait for a couple of quarters, Somewhere in Q4, we expect this approval to be in place.

Nitin Agarwal: So, when we look at the business today between Aurore and Solara, so the COVID component of the business, how meaningful is this component for a combined entity at this point of time and I guess with COVID eventually at some stage that piece of the business sort of slowing down, how do you see the other parts of the business are making up for the potential business loss that may happen?

Rajender Rao Juvvadi: See, some part of the COVID business is going to be continuous is what we feel because it becomes a regular medication to a lot of people, stock up in pharmacies and all. At this point of time, it is significant in Aurore, also a lot of capacity utilization for that product in Aurore. In Solara, it just starts now. So, depending on how the approvals come from Molnupiravir in this quarter you will see a lot of traction on this. It's difficult to quantify how big the business would be because we have to wait and see for the approval. We are pretty hopeful that it's very meaningful for the Q4 FY22 for us.

Nitin Agarwal: I understand. My point is when we look out say maybe a few quarters out and this piece of the business begins to slow down, how are we thinking about making up for it?

Rajender Rao Juvvadi: So, we have a lot of products that we are doing filings here in the current year. We are also getting a lot of approvals; in fact, we got around seven to eight approval CEPs in Aurore itself in the last six months. So, there are a lot of new product approvals. There is a lot of capacity that the extra customer market that we're generating for even the existing products. So, I think from deep dive for each product getting additional customers to each product plus the new filings and the approvals that are coming in, a lot of the capacity would go towards those.

Bharath R Sesha: So just to add one point to Raj said, this is Bharath here, Nitin. In every year there will be opportunities like what we have currently with the COVID portfolio that we can benefit from because now we have multiple multi-product facilities but the strategic intent in terms of how we drive the businesses ourselves is based on our filings on the new product velocity, the R&D traction, etc., So those continue and those are going really well and trending in the right direction. This year we have seen the demand situation on Ibuprofen. We expect that as Raj said meaningful contribution from the COVID portfolio in Q4. So, I think this is always going to be the case where we will have a mix of tactical products and strategic products. We are well on track to deliver our strategic product goals and tactical products depending on the year maybe a bit higher or a bit lower. And we need to make sure that we manage both of these well. And what we've learned over the last few months is this agility to be able to transfer quickly and pivot to repurposing the Vizag facility, qualifying products part, that was something that we had not to do so far. So, I think this skill set that we have developed and that's also coming from a lot of the interactions we've had with Raj and the Aurore team it's something that's going to stand us in good stead as we go forward to deliver our strategy.

Nitin Agarwal: Now the Rs.8,400 tons or thereabout capacity that we have on Ibu, by when in your assessment do you think you'll start utilizing it entirely going forward?

Bharath R Sesha: So, I think there are two driving factors to answer this question. One is the regulatory approvals and that's a little bit of a black box for all of us, not just for Solara, I think all of us are in the same boat when it comes to the timing of that. And the second is the overall demand recovery in the regulated markets. Because of the fact that we have also the demand not there in the regulated markets, we're able to use our Pondicherry facility even for the less regulated markets. When the demand comes back strongly, we would re-look at Vizag for the less regulated markets production of Ibuprofen. So, we're playing it a little bit flexible, and the fact that we have converted that facility to multi-product, enables us to have this strategy.

Nitin Agarwal: Has there been any meaningful change in the supplier landscape on Ibu in terms of any new guys who've come in with meaningful capacities which may have upset the landscape?

Bharath R Sesha: I hear the contrary. I think like every other player in the industry, I think a lot of players are hunkering down on capacity. We don't see any major investments coming. On the contrary, we see some rationalization. We hear of some rationalization happening on capacity across the world. So, we don't see meaningful capacities coming onboard for the foreseeable future on Ibuprofen. And just one point to add is the Ibuprofen derivative business. I think that's very important to keep mentioning it. In Vizag, we have the capability to make a particular grade of Ibuprofen which has a strong margin profile, good growth opportunity, and great customer stickiness. So, we're just maintaining our presence in those markets and growing it quite well. In fact, the derivative business had a 40% growth in this Q2. So, I think those are small bright spots that we will continue to build on going forward.

Moderator: We have the next question from the line of Ranvir Singh from Sunidhi Securities. Please go ahead.

Ranvir Singh: Sir, on the Ibu front, the average price realization for us, how this has changed versus last year if we take all customers together?

Bharath R Sesha: So, I think the better way to look at is the market mix change because the meaningful answer to that question will come from the fact that the pricing erosion in the regulated markets for us is much lower than the market and much lower than in the less regulated markets. The change in market mix has been material. So, we've really had much higher sales of Ibuprofen in the less regulated markets. So, on an average, the pricing pressure that we have mentioned in our commentary also has come because of the sales mix, not so much from a particular contract or a particular customer. And in the regulated markets, as I said earlier, we've been able to kind of hold the line to a large extent on our price.

Ranvir Singh: How has been this change for the industry in general?

Bharath R Sesha: Not to put words in my competitor's mouth, but I think there has been an erosion in pricing on a continual basis for the last two, three quarters, and I hear anywhere between 15% - 20%, erosion that's happened.

Ranvir Singh: In the Ibuprofen market you alluded the overall market demand is likely to sustain because still, this is a less penetrated market, but I believe last year because the COVID induced the demand and that gave actually a hefty rise in terms of volume also and prices also. So, do you believe even the normalization would be slower traction in industry growth or even the company's growth would be a little bit slower the way we saw if compared with the last three, four years?

Bharath R Sesha: So, I think we've already seen that. We've expected some sort of let's say recovery to happen somewhere in Q3. Now we're seeing maybe it's a bit longer than that and I think it's a lot to do with the fact that it's hesitancy to restock, less to do with the fact that the demand will not come back. I think as and when things normalize and it's all a relation of how society goes to the gym, walks, gets infected, unfortunately, that's what happens when people resume activities. I think a lot of those drivers are what will lead to eventually the speed of restocking. And what we see in very-very early signs that some of these things are starting to happen particularly in the regulated markets. So yes, it's been a bit slower than what we expected. Will it gain rapid momentum or will it continue in this phase with a little bit unknown at this stage? We see some signs that things are a little bit different in this quarter than they were in last quarter.

Ranvir Singh: In working capital, the inventory buildup happened in COVID products, that Molnupiravir and Favi. I just wanted to understand because the overall demand scenario has also contracted. So, is there a scope that we need to write it off going forward or we will be able to liquidate it in the next two to three quarters?

Rajender Rao Juvvadi: I don't think that would be the case for us because we have specific customer requests and as we are speaking right now, we are exporting a lot of quantity even today. So, for us, we have some set customer profiles and a base. We won't have to get to look at writing off this at all.

Ranvir Singh: And the last one on Aurore acquisition. Because we have now split the acquisition in two phases, apart from shareholders' approval what other approval is needed to complete this?

Subhash Anand: It will go through a normal process of approval; starting with stock exchange and SEBI to get NOC, post that we will approach NCLT which will direct us for shareholders and other creditors approval, post that it will be an NCLT final approval. So, it will pass through all the stages as the normal merger process goes through.

Ranvir Singh: So that should take at least six months from now?

Subhash Anand: Yes, in fact, we indicated this process to get over somewhere in Q2 FY'23.

Moderator: We have the next question from the line of Bharat Sheth from Quest Investment. Please go ahead.

Bharat Sheth: This year we expect CRAMS business to clock around three-digit number. So, if we have to take from two, three years perspective only Solara, how do we see and what kind of traction we are building and where do we like to be this business in next couple of years?

Bharath R Sesha: So, I think what we said is this year we will see somewhere in the 40% growth, and organically speaking CRAMS should continue to grow above the rate of the company. So, in the last call on a long-term basis we had indicated a revenue CAGR of somewhere around 25% over the next three, four years. On the CRAMS business, we will grow faster than that. So, you can say that we will estimate to grow on a CAGR basis over the next three years 30%-plus.

Bharat Sheth: The margin profile will be substantially different than our whole company level?

Bharath R Sesha: Yes, absolutely. It typically is somewhere in the five to eight percentage higher on an average basis over the generics API, not on every contract but on a broader average basis.

Bharat Sheth: Bharat, we had indicated in the last call or earlier call that we are doing some kind of backward integration for Ibuprofen and now at Vizag. So, since we have changed this to a multi-purpose plant so will it have any impact on the whole CAPEX scenario?

Bharath R Sesha: So, we continue with our backward integration plans. We will be operationalizing it actually in Q3 and scale-up will be in Q4. So, there is no stopping of that because that's an essential part of our proposition to our customers both from supply reliability and from cost leadership.

Subhash Anand: This backward integration plant is a separate facility in the same complex in Vizag independent to multi-purpose plant , so no change to backward integrated strategy part, that continues as per our plan.

Bharat Sheth: But that is specifically for only Ibu, is that a correct understanding?

Bharath R Sesha: It's the correct understanding.

Bharat Sheth: How much do you think we will be able to save the cost on account of this backward integration and overall, I mean kind of some broader number if you can share?

Subhash Anand: We would not like to put a number to the overall savings, but if you see the overall cost of Ibu, it's a sizeable contribution or a material contribution that we expect will be saved by going for backward integration. And also, once the demand come back it also brings lot of supply sustainability in terms of making sure we don't lose on uncertainty of supply chain which we have seen in last couple of quarters because of various global issues.

Bharat Sheth: This backward integration will start contributing from Q4 onwards, correct?

Bharath R Sesha: Correct.

Bharat Sheth: How do we see this working capital, when do we expect this whole cash flow which is negative that again should be normalized?

Subhash Anand: In fact, focus is only on two drivers i.e. receivable or inventory, a lot of initiatives have already started on this front. Since we expect some more time to shift share of business from less regulated market to a regulated market, so receivables are expected to be at a slightly higher side for some more time, but it will see an improvement from where we are currently because a lot of focus even in the less regulated market we are putting to move from distributor-led market to a end customer-led market. On Inventory as we spoke very earlier, we have a plan to optimize production, cut the inventory level, and go in line with the demand. A lot of COVID inventory which we build we have a clear line of sight to get this sold in this quarter. Thus we expect all the initiavies that we are taking at this point of time will start showing a result in the coming quarters; not much of it in Q3 but definitely, Q4 will have more visible impact on working capital.

Bharat Sheth: Last question on Aurore. We had a revenue of around 544 crores during FY'21 and an EBITDA of around 32%. So how much revenue will be moving out of this because of this revised scheme?

Subhash Anand: If you go through the presentation which we have already put on the site, Aurore standalone revenue in FY'21 was Rs.519 crores and EBITDA of Rs.159 crores excluding APPL.

Bharat Sheth: After this negotiation with the minority shareholders do we expect that also to get it merged in the second phase?

Rajender Rao Juvvadi: Yes, so as shareholders who have merged ALS with Solara the same shareholders have 67% of APPL, correct. So, we are committed to making this happen as a merger with Solara. We would like to resolve the issue with the minority shareholders and then at 67% shareholding we are committed to our merger into Solara.

Moderator: We have the next question from the line of Bhaskar Bukrediwala from Arthya Investments. Please go ahead.

B Bukrediwala: One question on again Ibuprofen market. Sir, as you said that demand is expected to normalize probably in a quarter or two. What I understand is next year there are some supplies that are further coming in the industry from a couple of your competitors. So, would that worry you because further on a muted demand environment if a couple of more supplies come in do you think that this whole softness in pricing could therefore even if the demand revivals could continue a bit longer than what we are anticipating?

Bharath R Sesha: That's a very good question. I think there are two ways to answer it. One, given that it's a global phenomenon, many of the people in the industry are revaluating, bringing on new capacities because at this stage probably has the same concern that they would have on demand if they're going to bring in new capacity. More Solara strategy part of this answer is that we are very comfortable when it comes to our positions with all our customers in the regulated market. We've seen similar entries of competition before we've held our own, our contracts are, and our relationships even more important in long term, in some cases stretching beyond a decade and a half. So, our positions are well anchored, our share of wallet continues to be very strong. So, while there will always be competitors who will enter and exit, we are very-very well positioned and very strong. Again, reemphasize the point I made about derivatives earlier. We are one of the largest players of the Ibu derivatives if not the largest in the world and as and when our customers expand their portfolio and we see all the large customers continue to expand their portfolio, it is for them ease of doing business with a player who has the entire portfolio of Ibuprofen. And once we complete the backward integration in the next few months we will be probably the only player in the world at this stage who can all the way from backward integration to Ibuprofen derivatives at scale be a solution provider for our customers. There's no one else who brings that value proposition. So, there are many positives that we bring, many unique propositions that we bring to our customers and we're very, very confident that these will be very strongly anchored, so we're not going to face any sort of major issues because other capacity is coming.

B Bukrediwala: For you the demand revival and given that your relationship with your customers is strong should be a good point for you to sort of get back to growth? Sorry, I am a little new to pharma. When you say Ibuprofen derivatives what exactly do you mean, what is that?

Bharath R Sesha: So, there are various salts of Ibuprofen like a sodium salt or a lysine salt that we make using the base Ibuprofen molecule, they are used for different patient benefits like some can be used for migraine, some is used for dental pain. So, they are derivatives of Ibuprofen where salts of Ibuprofen that are used by our customers for different indications of the patient both in Rx and in OTC. So that's what we mean by Ibuprofen derivatives. There is also a direct compressible grade of Ibuprofen which we call DC Ibuprofen which brings efficiency to our customers by eliminating unit operations for them. So those are some of the customer benefits and patient benefits that we bring with the derivative set of molecules.

Moderator: We have the next question from the line of J Shroff from CSK Capital. Please go ahead.

J Shroff: My question is on receivables. So, you explained that the receivable situation is actually deteriorated as we moved from regulated to less regulated market. So, are the terms of trade in the less regulated market have always been so bad that we've had to have a receivable of 150-days plus?

Subhash Anand: This is how the less regulated market operates. Solara as a company if you see three quarters back, our forte always was a very strong in regulated markets. Since the demand in the regulated market has seen a softness, we moved our surplus capacity to less regulated market and a quick strategy for us to enter in that was to get to a distributor model to enter into this market very fast. Yes, the way this business model operates, it always calls for higher receivables, and anybody who operate in less regulated markets will have this kind of receivables. Now since we have established, we are reaching out to converting more to end customers even in the less regulated market to improve on our DSO and go back, not the same level but at least a much-improved level of DSO and a improvement in working capital.

J Shroff: Just a continuation of that. So, since we are entering a relatively new field for us in the less regulated market and in any case the receivable dates are so high, do we expect any impairment going ahead?

Subhash Anand: Most of the customers which we interact or do a business, have a strong financial background and with the company for a long and not the new distributors and all are with the company for a much longer time and participated or contributed to our growth story. it's only the nature of business which has led us to the higher receivable.

Moderator: Ladies and gentlemen that was the last question. I would now like to hand the conference over to the management for closing comments. Over to you, sir.

Bharath R Sesha: Once again thank you everyone for joining the call. Want to emphasize a few key points. The transient situation that we face in Ibuprofen particular to demand has led to an impact on our results in the quarter along with the impact on raw material pricing. The broader theme that we would like for you to keep in mind as we conclude this call is that all levers at Solara are all intact and trending really positively, be it to do with the molecules other than Ibuprofen or the CRAMS business and we continue to reiterate, we see very positive progress towards delivering our longer-term commitments on both revenue and profitability as we had outlined in the last investor call. Once again thank you everyone for joining. Stay safe, take care.

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