"Solara Active Pharma Sciences Limited
Q3 FY'24 Earnings Conference Call"
February 14, 2024

MANAGEMENT: **MR. ARUN KUMAR -- FOUNDER AND PROMOTER– SOLARA ACTIVE PHARMA SCIENCES LIMITED**
MR. POORVANK PUROHIT – MANAGING DIRECTOR AND CHIEF EXECUTIVE OFFICER – SOLARA ACTIVE PHARMA SCIENCES LIMITED
MR. PV RAGHAVENDRA RAO – CHIEF FINANCIAL OFFICER – SOLARA ACTIVE PHARMA SCIENCES LIMITED
MR. ABHISHEK SINGHAL – INVESTOR RELATIONS – SOLARA ACTIVE PHARMA SCIENCES LIMITED

Moderator: Ladies and gentlemen, good day, and welcome to the Solara Active Pharma Sciences Limited Q3 FY '24 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 star then zero on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Abhishek. Thank you, and over to you, sir.

Abhishek Singhal: Thanks, Manuja. 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 third quarter and 9 months ended financial year 2024. Today, we have with us Arun, Solara's Founder and Promoter; Poorvank, MD and CEO; and Mr. Raghavendra Rao, CFO to share the highlights of the business and financials for the quarter.

I hope you've gone through our results release in the quarterly investor presentation which have been uploaded on our website, as well as stock exchange's website. The transcript for this call will be available in a week's time on the company's website. Please note today's discussion may be forward-looking in nature and must be viewed in relation to the 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 Arun to make the opening remarks.

Arun Kumar: Thank you. Thank you, Abhishek. Thank you all for joining. And it's not normal for me to be on a call related to Solara as we as a family have been invested in this company. Having said that, we have taken several decisions across companies that we own, both listed and unlisted, to take very significant operative roles. Consequently, and consequent to the fact that we have announced a very difficult quarter results, including a very promising reset strategy, I thought it appropriate for me to be leading this call.

So, I have with me, as Abhishek rightly said, my colleagues, Poorvank; and Raghavendra Rao, who is our CFO.

So, before I start, I must say that Q3 has been difficult. We have had a fairly strong track record on compliance and safety. Unfortunately, we had a fire incident caused by a freak accident in our Pondicherry plant, which is our mainstay plant. And that resulted in a significant, in fact, a temporary impact of our business.

Unfortunately, for us, it also resulted in 2 precious loss of lives. Although the company has done anything that it should do in these circumstances, we are still obviously concerned about what impact that this issue has caused the families. I'm also glad to confirm that everybody else who've been injured have fully recovered and have been rehabilitated either in the company or through other operations.

And we worked very diligently with the regulators, both from the regulators from the licensing standpoint but also from the safety standpoint. And we were able to get permission to restart manufacturing in Pondicherry.

Considering that we've kind of diversified our product customer base, and especially in ibuprofen post-COVID, to an emerging market play which was not so strategic, we were able to move inventories that we have had in stock to ensure that our regular, 15-20-year-old, long-standing big pharma customers were not impacted.

So consequently, this quarter has got 2 big events. One is obviously related to the fire and the adjustments around that. And also, after we have taken this decision to take an active strategic role and an operational role, helping the management, or guide them or mentor and guide them, manage them to get to very significant outcomes.

We have completed several iterations on how we should be conducting our business and how do we get back to our historical 20-odd percent EBITDA business. Running an EBITDA business in the last 2 years at single-digit EBITDA is not sustainable and is not desirable. So, we put our heads together and we have come with a very significant reset where we expect Solara to get back, within the next 5 quarters, to historic highs in terms of gross margins and EBITDA. And we are very confident of doing that in a very organized manner.

As a result of this, we have taken very aggressive provisioning of various receivables that we may think -- which are during the COVID era which we think are doubtful. We don't -- we are not yet ready to provide -- to write off many of them. But while we still work with these parties to get paid, it's a function of adequate caution and precaution that we have taken so that the reset is not impacted by any further one-off events.

Consequently, several line items have been articulated in our detailed deck which explains the impacts of our reset. Of course, Abhishek and the rest of the team will be more than happy to address specific questions that -- on the line items. But I would now want to pivot the conversation to what we think would be an exciting new Solara in the next few quarters.

First of all, we are now confident enough to guide that, within the end of next financial year, we would get back to our historical 20% to 22% EBITDA run rate, which is what we used to achieve in FY '21 and '22. This will come through and like I said, Q3 was a one-off situation. So, we have guided back for a reasonably strong Q4 at INR400 crores of revenues. But we are still not happy with the EBITDA that we achieved, which will go back to the historical INR40 crores per quarter.

Therefore, I just want to reassure our investors and stakeholders that this Q3 is a temporary one-off situation. We'll come back to what we are as early as this quarter. But what is more important is for us to focus our attention to our FY '25 guidance.

Considering that we have reset the business, it is obvious that we've had a slightly longer view on our performance for the next year. And based on a stronger order book and reset playing through the quarters, we expect a quarterly improvement from Q1 on our quality of growth, of gross margin expansion and our profitability and flow-through.

Importantly for us, our focus is on our balance sheet. We have also simultaneously announced the firming up of our rights issue. Our bankers have been appointed, and we are awaiting for the exchange approvals before the rights issue committee of independent directors will be formed. And we will then announce the rights.

Additionally, in this avatar, we as promoters are not only subscribing to our rights but are also willing to underwrite any unsubscribed portion simply because we believe that the post-COVID events leading to the poor performance of Solara is not necessarily a long-term situation. We are very confident of a very strong course correction and a reset. And we're very confident that, with Poorvank and the rest of this leadership team, we will help deliver these numbers.

So, we are now boldly presenting a guidance for FY '25 where our focus is actually doubling our EBITDA from Q4 FY '24 to our exit run rate in FY '25 to double. And we are very strongly focused on portfolio maximization, new market entries, customer acquisitions, cost improvements and rightsizing of our manufacturing network. All of this will flow through in a calibrated manner and the full flow-through of that will be visible by Q4.

We will also focus on debt reduction. We are committed to use most of our rights issue proceeds for our debt rightsizing. We do not intend to spend too much capital on capex as we have significant new capacities that are currently underutilized. So, network optimization and capacity utilization will be a key focus as a company. And cost improvement, to be a cost leader, we are only as good as your cost in the API business. And that would be another function that we will focus on.

We are not necessarily proud of our 2 years of R&D flow-through in terms of the money we spent to the outcomes we have got out of them. That will be another area of focus, where we would focus on very sharper R&D spend, and also to revive several of our dormant DMF. The company has got a very significant portfolio of API DMFs which are not commercialized. And we will now focus on ensuring that we are able to maximize these assets.

Part of our reset and leading to the -- leading to the following news that I will in a minute, is that we are quite dispersed as leadership teams. We are spread out in Chennai, Bangalore, and Hyderabad. And consequent to our reset actions, we have decided to shrink our corporate operations between Bangalore and Chennai, which are traditionally our corporate office. And therefore, we have decided to close down our Hyderabad operations.

Leading to this decision, unfortunately, we will -- Raghavendra, who's been our CFO for a very short period of time, who was originally brought in to be based in Hyderabad, has kindly understood the need for our actions and have decided to move on from Solara. And we will make the necessary stock exchange disclosures later in the day. We do -- we are now in the process of restating this critical role. We believe that we have enough internal talent, and we will shortly make those announcements.

And apart from this, we also want to highlight that, while we have provided for the business losses related to the Pondicherry incident, we are fully covered for business losses through our insurance policies. None of that potential income has been accrued in our statements today, in our P&Ls today.

I believe I've covered a fairly significant part of our presentation. Both Poorvank and I am operating from different sites today. But Poorvank, if you would like to say a few words? And Raghavendra, I would also, apart from thanking you for your service, would also like to take this opportunity to wish you good luck.

But also say a few words on what your impressions is, for both Poorvank and Raghavendra, before we take up questions.

Poorvank Purohit: Thank you, Arun. So, thank you, everyone, for joining the call today. Like Arun already mentioned, I think we have broadly covered all the points together.

But I think Q3 2024 has been a difficult quarter for Solara, majorly impacted by the fire incident. That's what we spoke about. And this fire incident occurred at our Puducherry facility. And the resultant fire caused injuries to 14 workers, 12 workers were recovered and discharged, but 2 have succumbed to injuries despite best efforts put to recover them.

The fire also caused damage to our existing plant and equipment and inventories. There was disruption in the production at the Puducherry facility for a brief period. And post corrective actions, permission to commence production was already accorded by end of December 2023. We resumed supply to regulated markets in Jan 2024. The losses arising on account of fire incident have been accounted under exceptional items, like Arun rightly pointed out, the insurance claims have been made and no deferred income is considered in our results.

Our revenues have definitely seen a reduction during Q3 2024, majorly impacted by the production disruptions post the fire incident. And intended shipments for the quarter were deferred to Q4 because we had to do lot of compliance with respect to CAPA, corrective and preventive action, which actually allowed us to comply with the customers. And the sales shifted to Q4. And then, of course, our gross margins were impacted.

One-off impact, the reset strategy to discontinue a few products and optimize inventory. One of the most important themes that I would also like to emphasize and talk about is about the Solara reset strategy which we are looking at. I think that's the vision over the next 4, 5 quarters on how we deliver on that. And that is something we are actually looking at.

And we are looking at all the parameters very aggressively, whether it's in terms of gross margin improvement, wherein we are looking at EBITDA per KL improvement. Where the second part is, of course, on the network optimization. The third is, of course, on OpEx reduction through various measures. So, all the measures have been taken into account so that we get back to our historical levels, what we spoke about.

So, with significant headwinds behind us and with our reset strategy in place, we aim to turn around and deliver 20% to 22% EBITDA margin by Q4 2025 and that's what the plan and we'll aspire to go to that level.

Arun Kumar: So, thank you, Poorvank.

P V Raghavendra Rao: Thank you, Poorvank. Thank you, Arun. I have nothing more to add from the quarter on numbers perspective. But I would like to extend my heartfelt thanks to all of you and the management here at Solara for giving me this opportunity. It's been a short stint, but eventful stint. And my best wishes to Solara as the company embarks on what is for sure an exciting journey ahead. Thank you.

Abhishek Singhal: Thank you. Manuja we can take the questions now.

Moderator: The first question is from the line of Vishal Manchanda from Systematix Shares.

Vishal Manchanda: I have a question with respect to your guidance. You are expecting INR1,500 crores in top line in FY '25. So, if I kind of adjust the FY '24 numbers for the fire incident, you're probably looking at flattish numbers on a Y-o-Y basis. So, if you could explain, why are we not expecting any growth here?

Arun Kumar: Yes. So, Vishal, thank you for the question. Like I said in my opening statement, our focus for the next 4 quarters is on margin expansion. Growth will come. It's not that we are not seeding new customers and new products. I think a lot of the growth in the last 2 years has come at the cost of margins because we were busy on utilizing all the networks that we had, which effectively means we are producing more than what we should be, and then we were creating demand which was not necessarily margin focused.

So, the idea is growth will happen in H2, but margin expansion will start almost immediately starting from Q1.

Vishal Manchanda: Okay. And with respect to the margin expansion that you've guided for, about 500 basis point margin expansion. So, will that be an outcome of largely cost savings and not product mix? Is that how we should read?

Arun Kumar: You're right. To a large extent, there will be cost savings, but there will be also a flow-through of the cost improvement programs that we have on several products that are ongoing.

Vishal Manchanda: Okay. So, if you could share. So, anything on the raw material side that you hope to see? So gross margin expansion, meaningful gross margin expansion, that you are expecting here?

Arun Kumar: Yes. We need to have a meaningful gross margin expansion of at least 600 basis points for us to increase our EBITDA by 600, 700 basis points, right? So, we are looking at taking our margins from now in the mid-40s to the closer to the historical 51%, 52%.

Moderator: The next question is from the line of Devyanshi Dave, an individual investor.

Devyanshi Dave: My question is partly answered, but I have 2 questions. Firstly, if you could please highlight the details of the one-off impact of INR100 crores. And what was that related to? If you could share some clarity on that.

And secondly on the gross margin side. So, while our gross margins were depressed due to provisions and fire, have you seen some improvement in the margin, given the input costs have eased up across the industry? And when do we expect it to go back to the 50% gross margin levels that we used to have in the past?

Arun Kumar: So, the individual line items leading to the INR100 crores one-off is part of our disclosures. And the company will be more than happy to set up time with you to discuss that in more details.

Coming to your question on gross margins. We expect the exit EBITDA to be 20% to 22% in Q4 of '25, which is about 5 quarters from now, a little less than that. The gross margin expansion from the current 42%, 43% or 44%, to 52% will be a gradual process.

You're right that the input costs have eased. But the time we actually solve for our inventories that we have and enjoy the benefits of improved cost of goods and also our cost improvement programs going through, we will not see that happening almost immediately. So, it will be calibrated Q-on-Q. But you will see quarter-on-quarter growth in gross margins starting from Q1 of next year. And that's something that we are very confident of.

Moderator: The next question is from the line of Siddhant Chaturvedi, an individual investor.

Siddhant Chaturvedi: So, I have 2 questions. My first question is on the rights issue that how much are we planning to raise in this rights issue? And what will the funds be primarily used for?

My second question is on the working capital days. What measures are we taking to bring the overall working capital days down? And what will be the ideal working capital days for the business?

Arun Kumar: Yes. So, the rights issue approval the Board has taken is up to INR450 crores. We don't believe we need INR450 crores, so it will be more like a INR350 crores to INR400 crores, in that ZIP code. We are just waiting for our reset plan and the total cash needs to be decided, including our debt reduction plan, to be decided before we fix the actual number. So, we should be able to give you that update in the next couple of weeks. If you're following us, there will be some publications around it.

All of the rights issue, like I said, is none of the rights issue proceeds are going towards anything but to reduce the size of the balance sheet. So basically, most of it will go to reducing our bank debt, that is the idea, apart from free cash generating.

The ideal working capital cycle time in this business is between 130 to 150 days. We are far away from that because we are holding a lot of inventory, and that is why our free cash generation will be higher, because we will start releasing a lot of that inventory with all the reset actions we have taken. And I think by the end of the year, next financial year, if we get to those 125 to 135 days, we'll be in a very good spot.

Moderator: The next question is from the line of Subrata Sarkar from Mount Intra Finance Private Limited.

Subrata Sarkar: So, my question is precisely to -- like one is like regarding our right issue. Sir, like what I mean to say is like, will that entire amount will be repaid back just to reduce the debt? Number one.

Number two, like what will be our recurring capex? Because I suppose there won't be any new capex in this time period, for at least a year or so. What is our recurring capex requirement? And what kind of like cash flow we are supposed to generate in the next year? So that like you need to erase INR300 crores to INR400 crores of debt. Then based on the cash flow, like what we are targeting? And how -- what is our plan with that?

Arun Kumar: So, like I emphasized earlier, most of the rights issue proceeds will go towards debt reduction because we do not have any need for new capex. Our recurring capex is between INR40 crores to INR50 crores per year. Our free cash generation on INR250 crores will be including the fact that we do have inventory liquidation plan. So almost be 75% of our EBITDA. So, we expect almost INR150-odd crores of free cash generation next year, which will also accelerate the debt reduction plan. And that's why we have guided for a debt-to-EBITDA of under 3. Ideally, we would be at 2.5.

Moderator: The next question is from the line of Rohit Suresh from Samatva Investment.

Rohit Suresh: Sir, I had a question on ibuprofen. If you could elaborate the global scenario right now, what kind of demand are you seeing? The prices have been pretty low the last 1.5 years, so how do you see that going forward?

Arun Kumar: Can you please speak up?

Moderator: Rohit sir, can you repeat your question again?

Rohit Suresh: Yes. Sir, I wanted to know on the ibuprofen part, what I've been reading is that the prices have been pretty low for the past 2 years. The demand scenario also overall has been pretty much on the lower side, inventories have been on the higher side. So, going forward, do you see this that this is the absolute low in terms of prices and inventory? And by when do you see the overall market recovery?

Arun Kumar: Yes. So, you're right that there is -- there has been a lot of stocking up of ibuprofen globally, especially with big pharma's pre-COVID. I think that, therefore, supplies are significantly greater than demand. Significant new supply capacities have come into play. All of this has resulted in a depression of the pricing.

Solara to some extent is insulated by the fact that a large part of our business is in the regulated markets. But we do not deny the fact that the competition is intense. And our overall focus on cost improvements and other actions and onboarding other customers in other geographies is playing through but will take time.

To answer your specific point. We strongly believe that the pricing has bottomed out. But I don't think there's going to be the pre-COVID price points on ibuprofen. Our actions for margin expansion are over a lot of other products that we have, and network optimization and other cost control measures. That is the reason why the margin expansion should happen.

Rohit Suresh: Great, sir. Sir, just one, what will be the prices right now for ibuprofen, the blended prices?

Arun Kumar: I won't be able to make that statement in a public setup.

Moderator: The next question is from the line of Aman Bahaghil, an individual investor.

Aman Bahaghil: Sir, firstly, I would like to offer my condolences to the 2 workers who lost their lives.

Arun Kumar: Thank you.

Aman Bahaghil: Sir, my question is, could you please provide insights into the approach you used to develop the forecast for FY '25? I'm curious about whether it leans towards a conservative or aggressive outlook.

Arun Kumar: Reset is always aggressive. But as a group, we have a policy of ensuring we meet our guidance. So, you could say that it is positioned in a manner that we will deliver these results.

Moderator: Thank you very much. As there are no further questions, I would now like to hand the conference over to the management for closing comments.

Arun Kumar: Thank you very much. Thank you, everybody, and thank you for your support. Like I said, this has been a difficult quarter, but we are very focused on bringing Solara back to its past glory. And appreciate your confidence. And if you have any questions, please do write to Investor Relations or to Abhishek. Thank you all.

Abhishek Singhal: Thank you.

Moderator: On behalf of Solara Active Pharma Sciences Limited, that concludes this conference. Thank you for joining us, and you may now disconnect your lines. Thank you.