

Transcript

Conference Call of Shasun Chemicals and Drugs Limited

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Presentation Session

Moderator:

Good morning ladies and gentlemen. I am Shirley, moderator for this conference. Welcome to the conference call of Shasun Chemicals and Drugs Limited. We have with us today Mr. N Govindarajan, CEO and MD of Shasun Chemicals Limited, Mr. S Vimal Kumar, Wholetime Director, Shasun Chemical Limited; Mr. Vinod Jain, General Manager, Shasun Chemicals Limited; and Mr. Hariharan, Senior Vice President, Shasun Chemicals Limited. At this moment all participants are in listen-only mode. Later, we will conduct a question and answer session. At that time if you have a question, please press * and 1 on your telephone key pad. Please note this conference is recorded. I would now like to hand over the conference to Mr. Vimal Kumar.

Vimal Kumar:

Welcome to you all for the Shasun conference call. Overall the performance in quarter 3 was as expected posting net profit of Rs 11.88 crores as against 11.65 crores in the corresponding quarter of last year. And we are on the track as per the earlier guidance given for the year. As far as SPSL-UK is concerned, they have posted a healthy top line revenue of 15.5 million pounds. As you all remember, they was a shortfall in the second quarter revenue but I would like to remind here that the CRAM business as such in the UK would see revenue dip or revenue growth depending on the order position for every quarter. But for the year as a whole, we are on the track, we are still on 52 to 53 million target and about a million PAT which is feasible and this looks very much positive. As far as the top line for the year is concerned we are looking at somewhere around Rs 920-930 crores as against Rs 810 crores last year and PAT of about Rs 30 to 32 crores as against 52 crores last year. If you take this without negative goodwill, this year's PAT would be about 22 to 24 crores as against loss of 4 crores last year. I would like Govind to add any other points.

N Govindarajan:

Good morning everybody. I just wanted to add, as far as the Indian asset is concerned, we have added one more customer wherein we have got three early phase projects wherein all the

three projects would involve our proprietary technology and also we have added one more innovator company which is the top 10 into our UK asset for phase II products. And over to you Shirley.

Shirley: Thank you Sir.

Question and Answer Session

Shirley: Thank you sir. Ladies and gentlemen, we will now begin the question and answer session. If you have a question, please press * and 1 on your telephone key pad and wait for your turn to ask the question. If your question has been answered before your turn, and you wish to withdraw your request, you may do so by pressing # key.

I request the participants to press * and 1 on your telephone keypads for your questions.

Our first question comes from Mr. Chirag from Citi Group.

Chirag: Good morning Sir. I just wanted to know for this quarter how much have you recorded for the take or pay contract in terms of the top line?

Vimal Kumar: Chirag, just a minute. We will get back to you on revenue recognition for this particular customer.

Chirag: Sure, okay. And the other thing was, in terms of the excluding the take or pay contract in terms of the sort of targets that you would have, do you think the base business can grow to upwards of 15% in the UK operations over the medium term?

Vimal Kumar: Chirag if you remember I had maintained that this year there would be about 7 to 8 million pounds revenue booked on the take or pay contract and this will be protected for the next year as well as per our contract terms which we are negotiating with them although not signed as such, but agreed as such, and we see no issue as far as this product or this project is concerned. So we are confident of booking the same kind of revenue next financial year, whether we get into the commercialization mode or not, if it gets into commercialization mode we should be doing much better growth there; otherwise we see about 10% growth next year for UK business.

Chirag: On the basis?

Vimal Kumar: On this year's target of 52 million pounds.

- Chirag:** Sure, and in terms of your exchange gains that you have in your top line, is any part of this related to the finance costs or liabilities?
- Vimal Kumar:** For the first nine months of 23 crores the re-instatement revenue is about 1.8 crores and the rest of it is related to the forwards cover or realized gains on the date of when received.
- Chirag:** Okay. But nothing of this is related to the financial, I mean...what I am trying to guess is, is any part this related to the finance liabilities that you might have, not related to the operations?
- Vimal Kumar:** That is what. 1.8 crores would be re-instatement of current liabilities or loan liabilities and all that.
- Chirag:** Okay, 1.8 crores?
- Speaker:** Yeah 1.8 crores.
- Chirag:** Okay and in terms of your hedging strategy going forward, do you think now that even the pound seems to be weakening versus the rupee, what is the strategy going forward, because the pound will be a reasonably important currency for your operations?
- Vimal Kumar:** Definitely. As far as UK revenue is concerned, 55% of its revenue are from US dollars and the current year's budget i was around 1.96. So below 1.96, yes it is a comfortable situation. As far as loss due to this exchange fluctuation in UK is concerned, we have lost net about 600,000 pounds compared to our budget and the actual realization so far.
- Chirag:** Okay, thank you so much.
- Vimal Kumar:** Thanks.
- Shirley:** Our next question comes from Mr. Nimesh Desai of Motilal Oswal.
- Nimesh Desai:** Good morning everybody. I just wanted to know the guidance that is being given for FY08, if I compare that with the nine-month performance, it seems that the last quarter you were expecting a significant jump in profits. Is that the right way to look at it?
- Vimal Kumar:** That is true Nimesh? Nimesh, mainly it is coming from UK operations where today the nine-month results stands at 1.1

million pound loss and we are still on target of about 800,000 to 1 million pound profit.

Nimesh Desai:

Without the negative goodwill?

Vimal Kumar:

No, it includes negative goodwill. Negative goodwill so far for the nine months is about 780,000 pounds.

Nimesh Desai:

0.78 million pounds, that is what you are saying?

Vimal Kumar:

Yes. And we expect that to be around 820,000 pounds, 0.82 million pounds by the year end. Including that, yes, we are targeting around 800,000 to 1 million pounds.

Nimesh Desai:

Okay. The other thing that I wanted to know is when you talk of next year, your UK business growing 10%, what is the exchange rate that you would be assuming; the current exchange rate or have you built in any change in exchange rate?

Vimal Kumar:

You mean the consolidated results converting into rupee, Nimesh?

Nimesh Desai:

Yeah.

Vimal Kumar:

We have built in around Rs.81.

Nimesh Desai:

Rs.81? And for the India business?

Vimal Kumar:

India business, we are booked around 40.5 for the next year, almost like 70% of our targeted exports for the next year. So we could safely work, I mean....our budget working would be around Rs.40.

Nimesh Desai:

Okay and you said that 70% you are hedged?

Vimal Kumar:

Yes.

Nimesh Desai:

Okay. The other question I had was, could you update us on the status of the phase III molecule from the UK operations for which we have a take-or-pay contract and related to that, if you can give us some color as to how you intend to grow 10% if there is a delay in the development of that molecule.

Hariharan:

Good morning gentleman. I believe that the project is on track as per the information received from the customer and the final review will be made by the customer and made public during the second week of February that is the indication we got.

Nimesh Desai:

So when is the earliest commercialization expected?

- Hariharan:** As of now, the indication is mid 2009.
- Nimesh Desai:** Okay, fine. Thanks.
- Shirley:** Our next question comes from Mr. Shyam Lawrence of Equity Intelligence.
- Shyam Lawrence:** Sir, my first question comes; you were saying that by mid 2009 the commercialization of this phase III will happen?
- Vimal Kumar:** Yes, this is what is expected as of today as per the indications available as of today.
- Shyam Lawrence:** This is your own biotechnology product right?
- Govindarajan:** This is a customer's product.
- Shyam Lawrence:** Okay, this is the customer's product.
- Govindarajan:** But it is not the Bio...
- Shyam Lawrence:** Not your product?
- Govindarajan:** No, it is not our product. It is the customer's product.
- Shyam Lawrence:** What will be the top line that we are accruing from this?
- Vimal Kumar:** Against Validation lots we have supplied this year, we will be booking 7 to 8 million pounds revenue this year. And going forward as per the contract, because our capacity is ready for the customer and some intermediate conversion would be happening next year we would be protected around 7 to 8 million pounds of revenue for the next year even though the commercial production would not happen in a big way, but we expect that once the launch happens anywhere from 10 to 20 million pounds revenue per annum to generate for us.
- Shyam Lawrence:** That will be yearly.
- Vimal Kumar:** Yearly.
- Shyam Lawrence:** Okay, sir one more thing. Your market-cap seems to be very low when you consider your sales of 1,000 crores. Why is that, is the company taking any initiative for rewarding the shareholders?
- Vimal Kumar:** Probably Shyam, I don't know if you have been watching this stock. The initial news about the nizazidine order loss was one

factor and also the appreciation of the rupee which, although we have been trying to protect through hedging contracts and all that, it had an initial impact for the first two quarters. So that is what has reflected in the share price.

- Shyam Lawrence:** Again, the Vizag plan, when do you expect it to be operational?
- Govindarajan:** We expect it to be operational anywhere between the first and second quarter of 2009, the calendar quarter.
- Shyam Lawrence:** Sir, going forward how do you expect your API division to be contributing to the top line? I mean the B/12 plan aiming at about 4000 crores by 2012, so how do you see your API business growing?
- Vimal Kumar:** Our API business would still have year-on-year 20% growth, because the reason is we are not diluting our focus in terms of our API. We would be still enhancing with certain product pipeline to keep growing that business independently.
- Shyam Lawrence:** And by the closing of this year, how much percentage will CRAMS be contributing to your top line?
- Vimal Kumar:** See in India it will be expected at about 80 crores out of 480 crores, out of a total of 500 crores. And UK, of course, 90% of the revenue that is about 47 million pound revenue is from CRAMS.
- Shyam Lawrence:** Okay, thank you Sir.
- Vimal Kumar:** Thank you.
- Shirley:** I request the participants to press * and 1 for your questions. Our next question comes from Mr. Karthik of Man Financial.
- Karthik:** Hi, can you please tell me the outlook of the API business in terms of realization and what do you expect the sales development in the next quarter and the next year?
- Vimal Kumar:** Thanks Karthik. As far as, probably I can take up the gabapentin issue, so far we have done about 23 crores and we are on target of about 30 crores for the year. And as far as realizations are concerned, ibuprofen we have had marginal improvement and realization but at the same time there were cost increases, so margins are still under pressure. Ranitidine - we did definitely very well this year clocking revenue of about 38 crores with better margins and price realization. And of course there was a big dip in the case of nizatidine, which is about 14

crores as against 61 crores last year. We expect to end it with around 20 to 21 crores this year.

Karthik: Nizatidine is about 27 crores as I see in the... I don't know if I am seeing the right sheet. It is about 27 crores or 5% of your YTD sales I think on a consolidated business.

Govindarajan: I think you need to look at the stand-alone. And the consolidated, I think the particular column should not be looked at. There seems to be some jumbling of numbers.

Karthik: No problem. Okay.

Vimal Kumar: Sorry about that Karthik.

Karthik: No problem. And sir can you share the position of debt and debtors as on date?

Speaker: As on date, the total debts are about 242 crores as against a net worth of 227 crores, which is at 1.06. But by the year end we expect that total debt to be around 260 crores.

Karthik: Sir of this, what would be the rupee denominated, 242 crores?

Vimal Kumar: 242 crores, that includes of course the debt in UK subsidiary too, where SPSL has taken a debt mostly in GBP (sterling pound) and in India we have resorted mainly to US dollar loans. So as far as rupee denominated loan, it will be hardly about Rs 10 crores.

Karthik: Thank your Sir.

Vimal Kumar: Thank you Karthik.

Shirley: Our next question comes from Mr. Balakrishnan from Spa Capital.

Nath: Good morning Sir. This is Nath from Spark Capital. Sir, I will start off with some questions on Rhodia before I move to the base business. Sir, on Rhodia if I am to look at the numbers for Q3, the material cost as a proportion to sales has risen to about 40%. Now, earlier this used to be only in the vicinity of 20% to 25%. Any specific reason why this has gone up so sharply this quarter?

Govindarajan: It is more of a product mix I would say Nath. Because if you really look at the overall year, it would be still okay; but as far as this quarter is concerned, if you compare quarter to quarter it depends on the product mix.

- Balakrishnan:** But you are saying it will again revert to about 20% to 25% going forward, even this year and next.
- Vimal Kumar:** Not 20% to 25%, it will be 35% which we have always maintained. And contribution margin is expected to be 65% this year.
- Balakrishnan:** Okay. Sir, the second question on Rhodia was if I can come to the tax rate now for this quarter I think the tax rate on the Rhodia side of the business is almost negligible. So could we have some guidance on what is the likely tax going to be for the year on Rhodia and the stand alone business?
- Hariharan:** As far as the SPSL in UK is concerned, we don't expect any tax liability. And we have got R&D credit facility there and most of the work is on R&D. We need a basic liability deduction for that, so we don't anticipate any tax provision on that.
- Vimal Kumar:** By the year end we expect no tax position as far as UK revenue is concerned.
- Balakrishnan:** And on the stand alone business, will it be around 10% to 11%?
- Vimal Kumar:** It will be minimum alternate tax of 12%.
- Balakrishnan:** Okay. I just joined a bit late, but I did hear that you were guiding for overall year end profit of 22 crores excluding negative good will? Is that correct?
- Vimal Kumar:** That is correct.
- Balakrishnan:** Yeah. Now year to date, excluding negative good will, I think you are negative 2 crores.
- Vimal Kumar:** That is correct.
- Balakrishnan:** So you are saying that Q4 is going to be exceedingly good. We should see about 24 crores of profit?
- Vimal Kumar:** Yeah. As I was explaining earlier if you take the UK position today, SPSL-UK which is at -1.1 million pounds by December end, and we still expect about 0.8 to 1 million pounds PAT looking at the order book position and other milestone payments, so we are still within that range.
- Balakrishnan:** Okay. So we should end at about 22 crores overall for the year.

- Vimal Kumar:** That is correct. That is without goodwill.
- Balakrishnan:** Yeah, without the negative goodwill.
- Vimal Kumar:** Yeah.
- Balakrishnan:** Sir, and on the take or pay contract, what revenues have you booked in the year to date?
- Vimal Kumar:** Year till date it is 6 million pounds. That is what Chirag also had asked earlier, so this is so far 6 million pounds has been booked.
- Balakrishnan:** Okay, year to date?
- Vimal Kumar:** Yes.
- Balakrishnan:** Sir, the other point was that if we hear from the client about if there are any delays on the side of the FDA in terms of approval or if there is any adverse news flow on this product, would we still be covered for 8 millions pounds of revenue that you mentioned for the next year?
- Vimal Kumar:** 7 to 8 million pounds we are still covered where they will be paying us for idle capacity as well as some intermediate conversion.
- Balakrishnan:** Okay, that is for 2009?
- Vimal Kumar:** 2008-09, yeah for our financial year 2009.
- Balakrishnan:** Okay what is the additional amount of negative goodwill that we would write off in 2008?
- Vimal Kumar:** We expect another 100,000 to 150,000 pounds in this quarter.
- Balakrishnan:** Okay, getting to the base business. If I strip off the effect of the exchange gain that you have booked over the past three quarters and look at the margins, I think the EBITDA margins are about 5% to 6%. Now, would it be reasonable to assume that margins will continue to sustain at these levels or do you think that there could be an upside bias?
- Govindarajan:** As far as these exchange gain is concerned, also yes, our average realization would be around 43.75 for the whole year, at least till December. We are confident of having a booked position of next year fairly at 40.5 average, we are still working at 40. We are looking at a growth of 20% next year as far as the India scene is concerned.

- Balakrishnan:** No, but do we see the possibility of margin expansion if one does not take into account this Forex gain?
- Vimal Kumar:** Yes, we are working at various cost-cutting exercises and improving, especially in gabapentine– improving the costs, improving the process. And nizatidine we are looking at little higher orders next year.
- Balakrishnan:** Okay. Sir, could we have some guidance from your side on what would be likely top line and profitability for 2009?
- Vimal Kumar:** We expect consolidated top line to be 1050 crores and PAT of about 40 to 42 crores.
- Balakrishnan:** Sir, this 40 to 42 crores would include the residual negative goodwill as well?
- Vimal Kumar:** Yes it will. That will be about 500,000, half a million pounds.
- Balakrishnan:** Okay, so that is about 4 crores.
- Vimal Kumar:** That will be about 4 crores, yeah.
- Balakrishnan:** So about 35 to 37 crores is what you are guiding for the next year.
- Vimal Kumar:** That is correct.
- Balakrishnan:** Sir, and in the previous conference call, Mr. Govindarajan was mentioning about one of the deals you had struck with a client in the US for doing a site variation for six formulation products?
- Govindarajan:** Yes.
- Balakrishnan:** Could we have an update on that? In the sense that can we see revenues kicking in from 2009 on that deal?
- Govindarajan:** Yeah, it would actually kick in from 2009 from the third quarter I would say.
- Balakrishnan:** From the third quarter?
- Govindarajan:** Yes.
- Balakrishnan:** Sir, could we have some idea on what would be the revenue potential from this deal?
- Govindarajan:** I would rather provide it as we progress.

- Balakrishnan:** Okay. Thank you for the time for taking the questions. I will jump back into the queue.
- Govindarajan:** Thanks.
- Shirley:** Our next question comes from Mr. Balaji of Sundaram BNP.
- Balaji:** Good morning sir. I joined a bit late. Can you just give an update on the Vizag SEZ Capex for FY09?
- Vimal Kumar:** Come again Balaji, your voice became feeble?
- Balaji:** Sir, I was talking about the Vizag SEZ and also the Capex plans for FY09.
- Vimal Kumar:** Okay. Vizag would be operational; the first phase would be operational by the first calendar quarter 2009. And the total Capex outlay for the next year including UK is in the range of about 70 to 80 crores.
- Balaji:** Okay and sir broadly have you also given any guidance for FY09?
- Vimal Kumar:** Yeah, I just now gave that. We expect the top line to be around 1020 to 1050 crores and bottom line to be around 40 to 42 crores including goodwill.
- Balaji:** Okay Sir. Thanks a lot.
- Vimal Kumar:** Thank you.
- Shirley:** Our next question comes from Ms. Sharmila of Karvy Stock Broking.
- Sharmila:** Good morning Sir. I just wanted to know on a consolidated basis the operating margins declined from the corresponding period of the last year. May I know the reason what could be the major reason behind it, because we could see the staff costs also decreased?
- Vimal Kumar:** Sharmila, like earlier we said that this contribution from UK operations this particular quarter is low, mainly because of the product mix and by the year end, SPSL-UK would still get back to 65% contribution. So that was the major reason for that being dip.
- Sharmila:** Okay. So then what could be the reason for declining staff costs for the quarter on a consolidated basis? This 446 million

was reported in this quarter compared to 460 million was there during the corresponding quarter the last year?

- Vimal Kumar:** Sorry, can you repeat again Sharmila, what exactly you mean?
- Sharmila:** I was talking about the staff cost, there was a decline of 3.15% in staff cost in this quarter compared to Q3FY07. So I just wondering to know what could be the reason for it?
- Govindarajan:** As far as the staff cost is concerned, it is more or less in terms of overall... we had some...during the Q2 in UK we had some green plant issue, because of this the staff cost in UK was slightly lower in Q2.
- Sharmila:** Okay. So do you expect the same kind of trend to continue for the further quarters?
- Govindarajan:** Yeah, the Q3 numbers would remain as such.
- Sharmila:** Okay sir. Thank you.
- Shirley:** Our next question comes from Mr. Vijay of B&K Securities.
- Vijay:** Good morning sir, marketing alliance with Glenmark and Alphama...?
- Vimal Kumar:** See as far as Alphama, the first product was launched in September and few days back we have received the ANDA approval for the second product and soon after the ANDA approval, the innovator company got the product approved as an OTC product, probably Govind, you can explain that.
- Govindarajan:** The innovator has changed the status of the product from prescription to OTC. So we are right now working in terms of changing our packaging and we are expecting to launch the product in the next 45 days to 60 days. And that would occur within this quarter, so the second product.
- Vijay:** What is the name of the product?
- Vimal Kumar:** We don't give out the names on this.
- Vijay:** Can you give some details on this CRAMs business?
- Vimal Kumar:** You want the Indian operations?
- Vijay:** Consolidated operations sir.
- Govindarajan:** Is it UK or is it India?

- Vijay:** On a consolidated basis?
- Vimal Kumar:** As far as UK operations are concerned, 90% of this revenue comes from the CRAM. And as far as Indian operation is concerned, we have booked about 55 crores so far until December and the major has come from one of the intermediate sale to a particular customer which at the year end we would be booking about 28 to 29 crores for that particular product. And for the year as a whole, in India we would be doing about 80 to 82 crores of CRAM business.
- Vijay:** How many customer do you have added in the Rhodia?
- Govindarajan:** As far as the innovator company is concerned in this quarter we have added Innovator Company into Rhodia and one more innovator company into India operations in this quarter. I am not getting into the list of the smaller emerging pharma companies. I am only looking at within the top 10 innovator companies.
- Vijay:** Thank you sir.
- Speaker:** Thank you.
- Shirley:** There are no further questions. Now I hand over the floor to Mr. Vimal Kumar for closing comments.
- Vimal Kumar:** On behalf of the Shasun management I would like to thank all the participants for having taking their time out and spend their time with us. And for further clarifications and queries, of course, you can either get in touch with me or email me the details. Thank you very much and I hand you back to Ms. Shirley.
- Shirley:** Thank you Sir. Ladies and gentlemen, this concludes your conference for today. Thank you for your participation and for using Door Sabha's conference call service. You may disconnect your lines now. Thank you and have a pleasant day.

Note:

- 1.This document has been edited to improve readability.
2. Blanks in this transcript represent inaudible or incomprehensible words.