Transcript

Conference Call of Shasun Chemicals and Drugs Limited

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Presentation Session

Moderator: Good evening ladies and gentlemen. I'm Mohana, 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 Managing Director of Shasun Chemicals and Drugs Ltd and Mr. S. Vimal Kumar; Whole time Director, Shasun Chemicals and Drugs Limited, Mr. Vinod Jain, General Manager, Shasun Chemicals and Drugs 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 keypad. Please note this conference is recorded. I would now like to hand over the conference to Mr. Vimal Kumar.

Vimal Kumar: Good evening ladies and gentlemen, this is Vimal Kumar here, I am sure that you all would have received the analyst pack which Adfactors would have released to you all, giving all the details. Probably, I thought I should highlight few of the points there which may be of much importance and which would generate lot of queries, one is of course the exchange gain which on standalone if you see we have recorded an exchange gain of almost 28 crores. To take you back at the year beginning we had budgeted our P&L at 44 and during May when rupee appreciated sharply, we were left with some hedging position and we ended up the year around 42.50 realization. But what had happened was the sales were booked at the then current spot rate and exchange gains were realized separately. So those matching could not be done and hence this had to be booked separately. Overall from 44 to 42.50 realizations, yes from budget we lost about 8 to 9 crores. That's the one major point that I wanted to highlight. Going forward current year again we have hedged almost about 70% of our exports at Rs.41. This is an unfavourable situation today considering where the current market spot is. So probably we would be booking the exchange loss separately again this year and sales will be booked at higher rate. Then I would be happy to explain further if you all need any more queries on this. The other point which I wanted to raise was SPSL, UK has posted EBITDA profit on its own, on expected lines, without the help of release of negative goodwill. Release of negative goodwill which was around 6.5 million pounds last year, and this year it was a million pounds and profit without release of negative goodwill at the EBITDA level was 600,000 pounds sterling as against 4.5 million pound sterling loss of last year. There is another point of financial interest which relates to insurance claim at UK which has been booked to the extent of 1.45 million pounds which is shown as other income. This basically relates to the plant shutdown which happened in the September and the final claim has been received during the current year although provisions have been made during March year ended. So these are the three major points I thought I should highlight and I will leave the floor now open for the question and answer session now.

Question and Answer Session

Moderator: 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 hash key.

Moderator: First question comes from Mr. Nath Balakrishnan of Spark Capital

Nath Balakrishnan: Hello Vimal Kumar?

Vimal Kumar: Hello Nath.

Nath Balakrishnan: How are you?

Vimal Kumar: Yeah fine Nath, go ahead.

Nath Balakrishnan: Yeah, I have two questions, first on Rhodia and then I will move on to the main business. On Rhodia, I just wanted to check with you in Q4, if one was to exclude the impact of both negative goodwill as well as other income, would we slip in to negative levels of EBITDA?

Vimal Kumar: If you have noted insurance claim booked in other income is GBP 1.45 million, and release of negative goodwill 0.25 mn totalling to 1.70 mn GBP, and which is breaking even.

Nath Balakrishnan: Okay, also wanted to figure out, we have initially guided for a run rate of 13 million pounds on top line at Rhodia, I think the number for the quarter is coming more like close to about 11 million pounds if I am not mistaken. What could explain the slippage in top line?

Vimal Kumar: Nath, overall the projections or the actuals have come down as against projected, we had budgeted around 51, 52 million pounds, overall it has come down. One of the products shipment was deferred in the last quarter on the request of the customer to delay the production.

Nath Balakrishnan: Okay, what has been the contribution of the take or pay contract in FY08 in value terms?

Vimal Kumar: Yeah, just to clarify, this is no longer a take or pay contract, this was the first year of our operation when it was take or pay contract, in the second year that was last year, we had booked a revenue of about almost 7.8 million pounds out of this product which is in phase III now.

Nath Balakrishnan: Sure, so you expect the 7.8 million pounds to be a recurring item in 09 as well?

Vimal Kumar: We expect that to be lower to the extent of around 6 million pounds and the product to be commercialized in 2010 calendar beginning.

Nath Balakrishnan: Calendar beginning, okay.

Vimal Kumar: Yeah, so we don't expect much commercial sales but at the same time phase three trials are on, numbers of patients are almost like 1200 patients and probably with that budget we should still do about 6 million pounds this year of validation supplies.

Nath Balakrishnan: 6 million pounds and because I thought we have the first four years of the patient life of the product, we have exclusive supply right, isn't it?

Vimal Kumar: We still have, although there is no exclusivity by contract, we may enjoy for the first three years of commercial supply the exclusivity status, taking into account the time they would take for approving another source, but as per the contract we will be still the major supplier for this product for the first 6 years.

Nath Balakrishnan: And what would be the revenue potential of this molecule when it hits market?

Vimal Kumar: We see the potential revenue of anywhere from 12 million to 30 million pounds every year.

Nath Balakrishnan: No, that is the revenue opportunity for you; I was looking at in terms of the molecule itself, what could be the revenue potential of the molecule in the market?

Vimal Kumar: Because of the nature of the therapeutic segment it targets and being a novel drug delivery the innovator company definitely expects this to be billion dollar drug, at least by second year of its launch and they expect it to only grow after that.

Nath Balakrishnan: Okay, what would your guidance for FY09 be sir, on Rhodia in terms of revenue?

Vimal Kumar: On Rhodia this year we expect about 10% growth on top line from what we ended up around 48 million pound last year. So we would end up around 52 or so.

Nath Balakrishnan: Okay, but this does not factor in any revenues from likely commercialization of molecule in phase three?

Vimal Kumar: But it factors in about 6 million pounds revenue out of that product.

Nath Balakrishnan: Sure and would the cost structure continue to be similar in terms of contribution margin of close to 70%?

Vimal Kumar: Yeah, contribution margin overall would still be 65%.

Nath Balakrishnan: Okay and the other two costs which are by and large fixed in nature?

Vimal Kumar: Which we are targeting at lowering it and we are sure that we would achieve some reduction in those costs.

Nath Balakrishnan: Okay. Sir, I will jump back into the queue at the moment and let others ask their queries, I will come back again later.

Moderator: Our next question comes from Mr. Nimish Desai of Motilal Oswal securities.

Nimish Desai: Yeah, good evening everybody, can you give us some feel on India business, particularly the traditional business of Ibuprofen, ranitidine, Nizatidine. How those sales are coming through in FY09 plus your comments on how the formulation initiative is going to ramp up in FY09?

Vimal Kumar: Sure Nimish, this is Vimal here again, as far as last year's data is concerned on the matured products like Ibuprofen, the sales was 5% lower than last year. The Ibuprofen derivatives made up for the lower sales which is higher by 40%. Ranitidine grew from Rs 19 cr to Rs 49 crores.

Nimish Desai: Yeah, it was just coming back to normal sales, right?

Vimal Kumar: Yeah, this was in fact little higher than the normal sales, we were normally doing around Rs 43cr to Rs 44 cr. We have ended up at Rs 49 cr but going forward next year I do see sales stabilizing around 40 crores of Ranitidine products. Nizatidine t was down by almost 70% compared to previous year and ended up around 23 4 crores As far as Gabapentin the sales grew by 84%.

Nimish Desai: Okay, but per say actual revenue number for Gabapentin will remain stagnant or you expect some growth there?

Vimal Kumar: I expect about 4% to 5% growth after taking into account the lower sales realization in line with process efficiency. As far as Ibuprofen margins are concerned which is still a major threat to us where most of raw materials recently have shown a big upward increase. We are trying to increase our selling price too and hope to neutralize that impact but there is always a time gap between the two. So we expect that thing…

Nimish Desai: But, on this particularly, let me interrupt and just kind of try and gauge on this thing…how has been your experience in the past. Have customers readily accepted new prices for Ibuprofen or the bargaining power is not very high?

Vimal Kumar: Overall today we see there is a demand for this product. Today I think that there is acceptability for price increase in the market worldwide. So we would not see much issue in raising prices.

Nimish Desai: Okay and the generic formulation initiative, your partnership with two of the generic companies, how are they fairing and what should we expect in FY09?

Vimal Kumar: Your question is on formulation right?

Nimish Desai: Yes formulation.

Vimal Kumar: Nimish, Govind would take that one.

Govindarajan: As such it is going as per plan Nimish; in fact we are expecting t approval of additional three products during the current year.

Nimish Desai: How many products were commercialized in FY08 or rather how many products contributed to your revenues in FY08?

Govindarajan: We commercialized two products for the US market and as far as the European market is concerned we have commercialized four products for more of contract manufacturing. Unfortunately for the US market the second product even though we got the approval that had a switch from prescription to OTC, so that did not resulted in the commercial sale.

Nimish Desai: And what should we expect in terms of revenues for FY09 in this initiative because FY09 onwards we were expecting a reasonable ramp up numbers from this initiative right?

Vimal Kumar: Yeah, we are still. Last year the revenue from formulation unit was Rs 8 crores and this year our target is Rs 60 crores..

Nimish Desai: Hello, could you just repeat that I didn't get you.

Vimal Kumar: Yeah, formulation revenue and including development fees should contribute about 60 crores to the top line. Revenues are skewed more towards the second half as we are in the process of getting approvals in the regulatory markets.

Nimish Desai: Okay and the last question that I have is particularly related your last quarter performance - fourth quarter. I see that on a consolidated basis EBITDA margins are significantly impacted, here I am excluding the impact of goodwill and other income. Is this to do with higher input cost because we see the top line also has kind of de grown as compared to same quarter last year?

Govindarajan: This is typically because of…like we discussed this for SPSL we are looking at the rate of 13 million. If you see last year Q4, it is around 13 million in SPSL as far as current year we talked about a breakeven of sales at 11.3 million pounds and second thing was the overall exchange gain which has been included here, like we said while we estimated the sales would include those exchange gain but because of exchange rate prevailing at those period of time, exchange gain has been booked separately. So as far as Indian operation is concerned, I would suggest that the exchange gain needs to be taken as part of the operating income to give a clear view on the consolidated figure.

Nimish Desai: Okay thanks I am done.

Govindarajan: Thanks Nimish.

Moderator: Next is a follow up question from Mr. Nath Balakrishnan from Spark Capital.

Nath Balakrishnan: I have queries on the domestic business. Sir, I just wanted to understand what the prospects for the domestic CRAMS business are, I think it's a business that has scaled up fairly smartly this year. We have got 76 crores in revenue, what is our outlook for 09?

Vimal Kumar: Sure, we expect at least 40% growth from here this year.

Nath Balakrishnan: And what would predominantly be the nature of the contracts here?

Vimal Kumar: This is again divided into three, custom synthesis, contract research and contract manufacturing. Customs synthesis revenue was $6 million last year, and it is projected to go up to almost $9 million. Contract manufacturing grew mainly due to supply of commercial lots of an intermediate, which started from March 07 for the whole year. It is expected that two more products would get into commercial mode this year in the second half. With all that contribution we are confident of doing better for future years.

Nath Balakrishnan: But are you suggesting this 40% of growth would predominantly be back ended only in the second half of the year?

Vimal Kumar: Yeah, the growth would be more skewed towards the second half.

Nath Balakrishnan: Sure and if I can just go back to what was discussed in the previous conference call, Mr. Govindarajan was mentioning that you are in talks with the customer in the US to do a site variation for six formulation products….

Govindarajan: Yeah, those projects are in track, in fact we are expecting launch of at least two products by October and then another three products between Novembers to March.

Nath Balakrishnan: No, I just wanted to check because Mr. Vimal Kumar mentioned that on the formulation business your guidance is 60 crores.

Govindarajan: Correct.

Nath Balakrishnan: Does this include the site variation contract as well?

Govindarajan: That includes the site variation projects too.

Nath Balakrishnan: Could you actually, if possible give us a break up in terms of what you expect from site variation business alone?

Govindarajan: Not, probably at this juncture I may not be having the break up I can provide it to you later.

Nath Balakrishnan: Sure fine and just from an accounting standpoint I just wanted to understand on the standalone business why is that the depreciation has dropped in Q4 vis-à-vis Q3?

Govindarajan: Just to clarify Mr. Nath, what has happened is I think so is the depreciation which has been accounted is not a straight line method basis and the exercise which has been done is in terms of ensuring that all the assets are already depleted are not provided additional depreciation because of that particular thing if you see the Q4 numbers would appear slightly in lower. This will be the trend going forward so Rs 25 crores would be the base depreciation as we go forward for the current year onwards.

Nath Balakrishnan: As the depreciation and expenses for the year?

Govindarajan: Yes.

Nath Balakrishnan: Okay, can you also give me what is your gross block figure at the end of 08?

Govindarajan: I can just give you that.

Nath Balakrishnan: Sure.

Govindarajan: The gross block as on year end is 340 crores.

Nath Balakrishnan: And what is your debt on the books as the end of 08?

Govindarajan: Average debt was 120 crores. I can just give you the numbers.

Nath Balakrishnan: Yeah, I am looking for consolidated debt at the end of 08.

Govindarajan: Okay, I can just provide that later probably.

Nath Balakrishnan: Sure and just also once again wanted to get clarity on your tax rate guidance because we have seen tax rates being very volatile, we have being finding difficult to get our arms around that. So could you give us some concrete guidance in terms of what your tax rate guidance is for ‘09 for the base business and Rhodia separately?

Govindarajan: As far as the base business in India is concerned we are looking at the tax rate of 11.33% and as far as Rhodia is concerned, it is expected to nil for next 2 to 3 years.

Vimal Kumar: I think last year Nath we had lower tax against MAT mainly due to reversal of deferred tax.

Govindarajan: As far as last year is concerned, the normal tax rate is at mat. There is deferred tax asset which got created during last year and hence net being lower than MAT for Indian operation and as far as UK is concerned we got the R&D tax credit there because of which last year provision was reversed.

Vimal Kumar: Actually the first year provisions were reversed since it was not necessary.

Nath Balakrishnan: Okay fine sir, so what is your likely tax rate for 09 for Rhodia?

Vimal Kumar: We expect that to be again zero tax this year.

Nath Balakrishnan: Okay. Sir, if you could just quickly give us number guidance for FY09 in terms of consolidated top line and bottom line.

Govindarajan: Yeah, we expect around 15% growth on top line and at least 30% growth on bottom line.

Nath Balakrishnan: Okay so I think we are currently at about 16 crores of earnings net of negative goodwill. So we are likely to do about 21, 22 crores, is that correct?

Vimal Kumar: No, my guideline is including negative goodwill of Rs 33 cr to Rs 34 cr.

Nath Balakrishnan: What is the extent of negative goodwill pending to be written off, half a million pounds is it?

Vimal Kumar: It is final amount of 700 to 800 thousand pounds.

Nath Balakrishnan: So which are approximately about 6 crores.

Vimal Kumar: Yes.

Nath Balakrishnan: Okay, so net off it will be about 26, 27 crores is what is guiding for is earnings net of negative goodwill.

Vimal Kumar: Yes.

Nath Balakrishnan: Okay and on the Rhodia business are we hedged there, could you throw some light on that?

Vimal Kumar: There we do is some short term forward covers only alone and the general view is the pound is expected to come down. So we would stand benefited if pound depreciates.

Nath Balakrishnan: Sure but revenues have been booked at an average…what would be the average realization debt for Rhodia for this year?

Vimal Kumar: This year overall we ended up at a pound exchange rate of 1.97 as against budgeted of 1.95.

Nath Balakrishnan: And in opening remarks you said, 70% of your dollar denominated exports are hedged at 41.50 is it?

Vimal Kumar: 41 for Indian standalone.

Nath Balakrishnan: I was just wondering…is there a forward cover when you had taken that?

Vimal Kumar: Yeah the contracts are only in the nature of forward covers.

Nath Balakrishnan: No, I was wondering whether we might let that forward cover lapse and then book revenues at spot rate because you would benefit there.

Vimal Kumar: What happens is when we deliver the dollars to the bank the dates don't match, so we do it as a separate transaction most of the time. Sales are independently booked and exchange gain or loss is independently booked.

Nath Balakrishnan: Okay so your guidance is at 41.50, the 15% that you said you will grow at is assuming dollar revenues are at Rs.41.

Vimal Kumar: Yes, that's right.

Nath Balakrishnan: Okay thanks sir. Thanks a ton for your time.

Vimal Kumar: Thank you.

Moderator: Our next question comes from Ankit Thakkar of Standard Chartered Bank.

Ankit Thakkar: Thank you for taking my question. Sir a small clarification, what would be your currency exposure as in dollar, pound?

Vimal Kumar: Yeah, from India's standalone business we will have about 75 million dollars worth to 80 million dollars worth of exports this year in the current year and about 10 million Euro sale and about 5 million in pound.

Ankit Thakkar: Yeah, that answers my question. Thank you.

Vimal Kumar: Thank you.

Moderator: Next is a follow up question from Mr. Nimish Desai of Motilal Oswal Securities.

Nimish Desai: Yeah, just wanted to know in your comments you mentioned that FY09 performance can get impacted because of the mark to market losses on forex. So your guidance, does it include that impact or excludes.

Vimal Kumar: No, going forward we are not taking into account the mark to market loss which was the view taken by us because almost all the transactions are purely cash flow hedging transactions and which we believe will be able to deliver the dollars at that point of time. So that's the view we have taken that we will not provide for any MTM loss.

Nimish Desai: But, had you gone according to the new accounting standards which has been proposed or I think some companies has been implemented that as well. What would have been the loss for FY08?

Vinod Jain: Nimish, there are two different views which are emerging on this particular topic. What has happened is most of the companies have gone through the list of open position and have just taken one piece of it and then provided it. So it is something which is being applied on each case to case basis. In our case we have also gone through the pending exposure and we have analyzed the exposures and all the exposures are taken purely as cash flow hedges. So all our means are backed by future receivables our future export earnings and since our budget is being based on the rated rate, we don't quote any specific issue in terms of providing for any loss as of 31st March 2008. So the entire transactions have been gone through and since it has been termed as cash flow hedges in all cases, there has been no loss firstly in terms of MTM. So we are compliant with the AS1.

Nimish Desai: But, hypothetically if you were to provide for this even on the cash hedges, what could be the amount because I see that some companies are not making this differentiation, they are going ahead and providing it. So for us to make the numbers comparative probably if you can give us an approximate number at which the provision would have to be made.

Vimal Kumar: It was totally see as per the banker's valuation it came to around 21 crores.

Nimish Desai: And would this again aggravate if the current rupee-dollar rate sustains as on 30th Jun, the closing date for the quarter?

Vimal Kumar: Yeah, it would aggravate because the rupee has only depreciated from then and our forward position like I said is at 41, it will only aggravate.

Nimish Desai: Okay. Fine thanks I have done with my questions.

Moderator: Next question comes from Mr. Amish Kanani of JM financial.

Amish Kanani: I logged in a bit late, so sorry for your time asking a repeated question. I just wanted to understand if you remove the CRAMS business from the total business turnover of last year and the year before then the residuary business seems to have de grown by 3% and largely if you see the sales break up that the presentation is giving shortfall mainly comes from Nizatidine and other products and a bit of…largely these two products. So, one if you could give us some reasons why it is happening and two what is the overall outlook for this business bulk drug business – domestic and formulation business.

Vimal Kumar: Yeah, you are right, see matured products as such where we have not budgeted for much growth Amish and in any case our focus is more towards now CRAMS and definitely that's one and second is formulation business is yet to pick up as we explained to you earlier, which we see ramp up happening this year and we expect that to grow from 12 crores to 60 crores this year. These two would be a major contribution for the growth.

Amish Kanani: Okay and I was wondering whether basically what is the profitability of these products, in the sense is it declining or it is status quo and stuff like that the base business of bulk drugs including Ranitidine and Nizatidine and stuff like that?

Vimal Kumar: Yeah, definitely where as Ibuprofen margin wise is under pressure and continuous to be under pressure, where as ranitidine and nizatidine EBITDA margins are much better. Gabapentin we are able to have at least 16% EBITDA margin, whereas Ibuprofen is down to almost 8% EBITDA margin.

Amish Kanani: And any issues in terms of some intermediate products that we might be importing from China, is there any issue there in terms of increased price which you are not able to pass on and stuff like that?

Vimal Kumar: We don't import intermediates as such but we do import chemicals from China and those are the…yes definitely prices have gone up in recent times especially during last six months. We are seeing a pricing pressure and we are trying to pass it on to our customers wherever we could. While in the first quarter we may not be able to do that but we are sure that we should be able to pass it on to our customers later.

Amish Kanani: And that is largely incorporated in guidance that we spoke about?

Vimal Kumar: Yes.

Amish Kanani: Okay and one more question was this SPSL separately the CRAMS business which is given and if you see the 4th quarter there is a decline of 22%, so is it only the currency effect or there is the base business which has de grown in even the local currency terms there?

Vimal Kumar: No, overall we had budgeted about top line of about 51 to 52 million against which actual was lower. One of the innovator companies had deferred the purchase of a product which had resulted in the short sales. .

Amish Kanani: Okay thanks a lot.

Moderator: Thank you sir. There no further questions, now I handover the floor to Mr. Vimal Kumar for closing comments.

Vimal Kumar: Thanks Mohana, I really appreciate the time taken by all the analysts to be on the conference call. Thank you very much and of course they could reach me or Vinod at any time if they have further queries to be attended to. Thank you very much.

Moderator: 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 evening.

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