"Laurus Labs Limited

Q3 FY '23 Earnings Conference Call"

January 30, 2023

MANAGEMENT: **MR. SATYANARAYANA CHAVA – FOUNDER AND CHIEF EXECUTIVE OFFICER – LAURUS LABS LIMITED**
MR. V. V. RAVI KUMAR – EXECUTIVE DIRECTOR AND CHIEF FINANCIAL OFFICER – LAURUS LABS LIMITED
MR. VIVEK KUMAR –INVESTOR RELATIONS – LAURUS LABS LIMITED

MODERATOR: **MR. MONISH SHAH – ANTIQUE STOCK BROKING**

Moderator: Ladies and gentlemen, good day and welcome to the Laurus Labs Limited 3Q FY '23 Earnings Conference Call hosted by Antique Stock Broking. 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, 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. Monish Shah from Antique Stock Broking. Thank you, and over to you, sir.

Monish Shah: Thank you, Vikram. Good evening and welcome to Laurus Labs 3Q FY '23 Results Conference Call. We thank the management for giving us the opportunity to host this call. Today, we have with us Dr. Satyanarayana Chava, Founder and CEO, Mr. V.V. Ravi Kumar, Executive Director and CFO, and Vivek from the IR team.

I will hand the call over to Dr. Satya for his opening comments. Thank you, and over to you, sir.

Satyanarayana Chava: Thank you, Monish. Thank you for joining us for our Q3 and 9M FY '23 results conference call. We are pleased to have this opportunity to update you on our business progress and answer your questions.

Now let me share quick thoughts on our performance. Our business has continued to perform well, both during the quarter and also on a nine-month basis, reflecting a sustained momentum across our key growth drivers.

We are all well-positioned to close the year with strong double-digit revenue growth with steady margins. We remain firmly focused on our strategic priorities, to diversify, drive growth and delivering long-term sustained value to our customers, partners and our stakeholders. In addition, we'll continue investing in mechanization, automation and digital initiatives, to boost operational efficiency.

We also like to update that recently, Laurus Labs has been selected as a panel supplier by the global fund for ARV drug procurement, and the contract will run for a period of three years. For over a decade, our company has been committed directly and indirectly to the cause of HIV. And this tender offers us, again, a great opportunity to make HIV treatment accessible to more than 150 countries through global fund and other multilayer agencies. During this quarter, Unit-5 received EIR from US FDA.

Moving on to our financial results, we are pleased to report that we achieved a healthy topline and bottom line growth for both quarter and nine months. We made additional advancements in our R&D initiatives, pipeline enhancement, diversification and new capacities qualified and ready for commercial production. We are confident in the underlying demand for our portfolio and scale as we continue to see momentum in our business.

We have achieved INR 1,545 crores revenues for the quarter, showcasing a 50% growth year-on-year. And for nine months, we track revenues of INR 4,660 crores, a growth of 33%, year-on-year. Our strong results are driven by exceptional growth in our Non-ARV revenues, especially CDMO and the APIs other than ARVs.

Our growth was also supported by much-anticipated recovery in ARV formulations and, which is expected to continue further. Our profitability margins have sustained despite ongoing disruption in business environment caused by inflationary headwinds and also geopolitical business.

To begin, I would like to share key updates on our Formulation business. Our Formulation division has sequentially recorded 67% growth and reported overall revenues of INR 747 crores for nine months with a decline of 46% year-on-year. If you look at our Q3 revenue, although there is a degrowth of 33%, but it has seen a healthy recovery over Q2 base, and we expect it to further normalize during the next few quarters.

Coming to the LMIC business, while broader demand environment in ARV have continued to stay softer, our business has shown some respite off Q2 low base. But pricing has largely remained depressed. We remain optimistic over a gradual stabilization in the volume off-take ahead. This will be partially supported from open orders and visibility from new global fund HIV tender. During nine months, we launched two products, lopinavir and ritonavir, abacavir and lamivudine combinations. Additionally, we are awaiting for few more product approvals, which should help us in stabilizing business in coming quarters. As articulated in the past, we will continue to evaluate our portfolio choices in this business and play selectively for value over volume.

Coming to developed market. We continue to perform well across our broader US portfolio despite higher competitive industry. We continue to get good market share on select products and also increasing volumes for our recently launched products. We continue to leverage our front-end presence in the US market for new product launches. During the quarter, we filed two ANDAs, taking the total filings to five ANDAs for the nine months in the current financial year. We intend to make a few more filings in the current quarter. And cumulatively, we have a total of 37 ANDAs to date. Of these, we have a total of 14 final approvals and 12 tentative approvals.

In Canada, we received two approvals during the Q3 FY '23, taking total approvals to 13, of which we have launched eight products, and we intend to launch at least one product every quarter for the next few quarters. For EU markets, we have validated three products as part of the contract manufacturing partnership. We expect a significant upside from these products in the coming quarters. We have a basket of 11 approved products in Europe, of which we have already launched six, and we will be launching a few products shortly.

Based on a healthy product pipeline progress, we continue to invest in our Non-ARV FDF infrastructure, with the total commissioned capacity of 10 billion units. We anticipate that these Brownfield capacities that we have added recently should start to get better utilized during the course of next year as we begin to see better demand visibility in ARV business, scale up visibility in the partner portfolio and also key product approvals.

On the R&D front, we continue to make good progress and invest in portfolio, with product-specific approach based on complexity and economies of scale. We are pleased to share that we filed our first NDA for HIV pediatric product during Q3. We believe this unique drug product delivery form for pediatric HIV treatment should complement our existing offering. And we continue to do further developmental work on orally disintegrating film platform, which can be leveraged to create innovative pipeline in other therapeutic areas.

Our sterile R&D labs, which has already started working on priority projects, and we expect to complete development phase for at least three products in the next few quarters. Overall, R&D spending to sales for the quarter was at 3.2%. We have a total of 64 products in the R&D pipeline, either development or under review, having an addressable market of over $40 billion brand sales. So far, we have filed 37 ANDAs in the US, 12 dossiers in Europe, 19 products in Canada, 9 with WHO, 5 dossiers in South Africa, 20 dossiers in India and 22 products filed in various rest of the world markets. Of the 37 ANDAs filed in US, we have 16 PARA IV filings and 11 First to File opportunities, having a sizable market. From the beginning, our approach remains product-specific and not market-specific.

Coming to the Generic API business, our antiviral API sales for this quarter is at INR 376 crores. As indicated earlier, we expect volumes and pricing are going to stabilize around the current levels. We continue to maintain a leading market share in the current product pipeline and also expect increase in our supplies to developed market.

Onco API business declined 13% during Q3, but improved sequentially, 45% and we achieved INR 74 crores sales for the current quarter. For nine months FY '23, the segment has seen a decline of 14%. As you're aware, Laurus labs have one of the largest high-potent API capacity in India. We're also expanding the high potent API manufacturing capabilities in Unit-4 to meet continued demand for such products.

Our other API segment sales, which include cardiovascular, diabetes and asthma products, have seen steady ramp up, both for the quarter and nine months. For the Q3, we achieved a sales of INR 182 crores, growing at 33% year-on-year. For nine months, the growth is very robust at 65%, supported by new contract supplies.

During the Q3, we filed 3 DMFs, all in Non-ARV category. With this, total number of DMF filed today is 77. We initiated validation of few APIs, and I expect to see good potential over coming years. We are also working on CMO opportunities with few global generic companies, and some of them are in advanced stages of implementation.

When it comes to Synthesis business, which has continued to sustain robust growth of over 200% year-on-year for the quarter, and we achieved sales of INR 642 crores. During the nine months FY '23, our CDMO business have grown of over 2.5x to INR 1,939 crores. This growth is driven by robust underlying demand from both new and existing clients and our ability to do strong commercial execution. We remain quite excited about this division as we are focused on both commercial execution as well as expanding our pipeline projects in various clinical phases.

We continue to work on over 60 active projects at different stages, ongoing commercial supplies for about 10 products, including APIs as well as several intermediaries. Our Greenfield investments towards building a dedicated R&D center for this division at Genome Valley and two manufacturing units in Vizag is progressing as scheduled. New sites for Synthesis division, we now have capabilities to handle, animal health as well as agro. The facilities will have dedicated blocks for steroids, hormones and high potent molecules apart from large value products. We expect to qualify one of the dedicated animal health manufacturing site by mid of next fiscal.

Laurus Bio revenues were largely muted at INR 22 crores due to unplanned downtime, resulting to some production deferments during Q3. This has been rectified and brought online. For nine months, Bio sales grew by about 22%. We do anticipate pick up with the ramp-up of new capacities with our large-scale CDMO partners in the coming quarters. We have completed scheduled expansion at R1, including new R&D block, along with balancing equipments. We initiated process for acquiring land for R3 Greenfield expansion near Mysore. We believe that the new site should further strengthen our Laurus Bio capabilities in offering CDMO services in animal-origin-free proteins as well as growth factors.

We believe global opportunity in alternative food proteins is in exciting phase, and will be a fast-growing segment in the long term. Our focus is to have a right scale, cost and functionality, which will drive our technology references.

With that, I would like to hand it over to Mr. Ravi Kumar to share financial highlights.

V. V. Ravi Kumar: Thank you, Doctor. And a very warm welcome to everyone for our quarter 3 and nine months earnings call. Total income from operations for the nine months is INR 4,660 crores as against INR 3,511 crores showcasing an 33% growth. During the quarter, we have done at INR 1,545 crores against INR 1,029 crores with a 50% growth. Gross margin for the first nine months is at 55.4%. Our EBITDA for nine months is INR 1,307 crores with EBITDA margin of around 28%, whereas for Q3, our EBITDA was 404 crores with a margin of 26.1%. The lower margin is due to the negative operating leverage. Our diluted EPS for the nine months INR 12.70, not an annual basis with a 14% growth. Our ROCE is at 26% on an annualized basis on the back of sustained operational leverage across units, of course, despite of investments into the capex.

On the capex front, we invested around INR 200 crores for the quarter and slightly more than INR 600 crores for the nine months. We have guided INR 2,000 crores capex in the FY '23 and FY '24. I think we are still committing to around that number for this year and next fiscal. And we believe our capital allocation framework, including commitment towards diversification and strengthening of Non-ARV portfolio, building niche capabilities, invest in disruptive technologies, backward integration programs and improving operational efficiencies will continue to be in force in creating a long-term value.

With this, I would request the moderator to open the lines for the Q&A. Thank you.

Moderator: We have a first question from the line of Sajal Kapoor, an investor.

Sajal Kapoor: Two questions. Given that our CDMO synthesis business will be self-reliant in about two years' time, is it fair to expect that management would disclose gross and operating margins, balance sheet and cash flows in CDMO synthesis separately in FY '25? That's one.

And secondly, my sense is that once significant CDMO synthesis capex at Vizag is complete, there will be time consumed in validation batches. There will be an extended qualification period for regulatory audits and US FDA, plus other approvals. So there will be a lag before we actually start commercial shipments in a meaningful way. But on the presentation, Slide 14, it says and expect to qualify dedicated animal health unit by mid-2023. So can you help us understand the anticipated commercial shipment time lines for all three new facilities currently under construction?

Satyanarayana Chava: Thank you, Sajal. So the two facilities for CDMO, which are on construction, one is for animal health, the one we will also start construction for agrochemicals. We want to update you. For agrochemicals, we already completed construction of a pilot plant for registration batches long back. So registration batches already produced in the agrochemical plant.

When it comes to animal health plant, currently, one NCE program, validation was done in a dedicated block in one of the other manufacturing of the parent company. Once the new site is qualified, this will be a new site to be added into the file. And there are some products in some markets, the approval times are shorter. So this site will cater to the global markets, not just US market for animal health. And that is answering over qualification of the plants

When it comes to the separate balance sheet and P&L numbers for synthesis division, I'll leave it to Ravi Kumar to answer.

V. V. Ravi Kumar: Right now, we are using the same common facilities, and it is very difficult to segregate a balance sheet and P&L account. So whatever we can segregate, the revenue only can be segregated. That's how we are showing only the revenue breakdown. Probably in the next three to four years when we have a separate infact we have a separate subsidiary you will know the balance sheet and P&L separately.

Sajal Kapoor: Thanks, Dr. Satya, for your qualification and the commercial shipment response. Mr. Ravi Kumar, the reason investors are interested in knowing more about the economics of our CDMO synthesis is that the economics of this division are significantly better than the rest of our businesses. So when we say that we will have an independently self-sustaining business in two years' time that is FY '25, it should also mean that we'll have enough room in the balance sheet to raise external resources if required.

But otherwise, our operating cash flows adjusted for working capital should be able to sustain the growth momentum of this business going forward because as we understand, the CDMO synthesis business has a very long runway of growth ahead. And the way team Laurus has executed in the last seven, eight years, I mean, we were just INR 100 crores, including the ingredients and the innovator synthesis back in 2016. So we have come a long way, but we are still scratching the surface. So it would really help all investors to have a better color on the economics of this business, not immediately, but yes, as I said, two to three years out.

V. V. Ravi Kumar: I appreciate that point, but the only challenge is because there is a common facility, the segregation is very difficult. But over a period of time, we will see what best can be done.

Moderator: We have next question from the line of Bharat from Quest for Value Capital.

Bharat: Yes. Sir, in many forums in the past, you said that ARV business, both API and Formulation combined, will be less than 1/3 by FY '25. Do you still think that you can achieve this by FY '25?

Satyanarayana Chava: If all our diversification plans goes as we are thinking, it is possible. As you see for nine months, our ARV APIs is 22% of our revenue. And our ARV Formulation is about 10% of our revenue for nine months. So that is 35% of revenue came from ARVs both APIs and Formulations in nine months period. So we do anticipate rest of the divisions will grow faster than ARVs. We are hopeful that by FY '25, the ARV business will be 1/3 of our business.

Bharat: And currently, we have around 5,000 employees, and revenue contribution per employee is around INR 1.2 crores. In one of the recent interview, you said that you have vision to double the number of employees that is from 5,000 to 10,000 and also have a revenue contribution per employee from INR 1.2 crores to INR 2 crores per employee. May I know, like, by when you want to have this vision to be achieved?

Satyanarayana Chava: I think we didn't put a time line to that. But currently, we have close to 6,000 team size. And we have added about 20% new colleagues in this current financial year and about 25% new capacities in APIs. 50% new capacities of Formulations were added during the current year. I think we can't give you a specific time line when we will be 10,000 team size.

Bharat: And regarding this global fund allocation, which we got for the period '23 to '25, may I know if the volumes allocated is more than the previous allocation, and also like how much price erosion was there compared to the previous allocation?

Satyanarayana Chava: We can't give you the price erosion in absolute terms, or volume in absolute terms. We got fair share of business. We are not the lowest bidders in the tender. That much I can tell you. Yes.

Bharath: Okay. I think that's helpful. And also sir, there is sharp jump in number of active projects in CDMO, in Q2 presentation, it was mentioned as 50. And now in the latest presentation it's 60. So there's increase of 10. May I know what led to the sharp increase in the number of active projects?

Satyanarayana Chava: We got awards for clinical supplies. And we expect this number will continue to grow. Yes.

Bharath: Okay. And my last question is -- you have increased the API capacity by 1 million, I guess, in Q3, and also plan brings this other 1 million in Q4. That's almost 2 million increase in API capacity. May I know which division will use this additional 2 million liter. Is it for non-ARV API or for captive FDF or for CDMO?

Satyanarayana Chava: It's a very interesting question. Most of the increased capacity we use for non-ARVs.

Bharath: Non-ARV API, you mean the other API, is it?

Satyanarayana Chava: Yes, other APIs and CDMO.

Bharath: And CDMO?

Satyanarayana Chava: Yes.

Bharath: Okay. Okay. And one more question, if I may. So I see that in the investor presentation that there is new capacity planned for Laurus Bio adjacent to R2. So I mean is it a brownfield expansion of R2, you're talking about here?

Satyanarayana Chava: See in R2, Laurus Bio, we had a mismatch of downstream processing when it comes to upstream processing. So we are debottlenecking that. We have taken land adjacent to R2. So with that, our output will go up. Our upstream capacity is much larger, downstream is less. So we're removing that mismatch because we know what products from the CDMO partners. We have a better visibility, how much downstream is needed. We are doing that.

Our real expansion will happen in R3 where we have identified and paid the advance for land near Mysore. So that will be the real expansion where, eventually, that site will have a 2 million liters of fermentation capacity.

Bharath: Exactly. So this R3...

Moderator: Your next question from the line of Nikhil Mathur from HDFC Mutual Fund.

Nikhil Mathur: I have a couple of questions. My first question is on the Formulation business. In 9 months, the business has roughly declined by around 45%. Can you give some understanding how much of this decline is attributable to ARV Formulations and how much of this attribute to Non-ARV Formulation?

Satyanarayana Chava: Close to 2/3rd is the ARV. 1/3rd is non-ARV.

Nikhil Mathur: Okay. What is the reason behind the decline in Non-ARV Formulation, I mean although many other export-oriented companies are also been reporting soft numbers, is it something to do with destocking or more competition in the market? What are the reasons can you pinpoint why the Non-ARV business is also under pressure in the Formulation side?

Satyanarayana Chava: Our Formulation contribution from Non-ARVs was around 20%, 25%. Because of the ARV revenues were less, the percentage-wise Non-ARV contributed to 1/3rd. But otherwise, we didn't see a decline in Non-ARV Formulation in absolute terms.

Nikhil Mathur: Okay. Okay. So this entire decline is basically the ARV Formulation piece then?

Satyanarayana Chava: Yes. Yes.

Nikhil Mathur: Okay. Understood. Also in your investor presentation, you have mentioned that the FY '25-'26 goal is to have more than 25% revenues from Synthesis. I'm not sure what was 25% means, that it could be 25%, 30%, it could be more than 30% as well. But it does seem that from 42% for the 9 months FY '23, this number is going to decline. This is a contribution. So the question here is that what happens to margins in this case if your custom Synthesis contribution will go down over the next couple of years. Because the broader understanding is that Custom Synthesis is usually the higher-margin business. So does it imply that the margins could be in some sort of a pressure over the next couple of years?

Satyanarayana Chava: So when we are looking at our investor presentation outlook slide that was the goal, over 25 doesn't mean it will come down to 25. So that is the goal we wanted to keep for internal. You can consider that the goal is achieved much earlier than FY '25. This goal we put when our Synthesis revenues were contributing 18% to our revenues last year.

Nikhil Mathur: Okay. Yes. But sir, intuitively, I mean, this is a very strong year for the Synthesis business in FY '23. I'm not sure if you're calling out the level of unsustainability in this scale in FY '22. The absolute contribution should only go down in '24 and '25 right? So wouldn't that imply that margins should be under pressure next couple of years?

V. V. Ravi Kumar: Are you there in the line?

Nikhil Mathur: Yes, I am there.

V. V. Ravi Kumar: Okay. So in FY '25, when we say 25%, so it is on the increased revenue of FY '25, right? So it's an absolute number. This will be much higher than what it is today.

Moderator: We have next question from the line of Krish Mehta with Enam Holdings.

Krish Mehta: I just had two questions. One is what is the absolute ARV revenue for this quarter?

Satyanarayana Chava: Absolute ARV for this quarter, API is INR 367 crores and INR 140 crores for the Formulations, about INR 516 crores. About 1/3rd revenues came from ARVs, both APIs and Formulations.

Krish Mehta: Okay. And what is ARV FDF for this quarter?

Satyanarayana Chava: 140 crores.

Moderator: We have next question from the line of Surya Patra with PhillipCapital.

Surya Patra: Just wanted to understand the freight cost or to understand the cost equation better. Sir, what is the share of freight in the overall cost? And what would be the rise in the energy cost for this quarter over last year? If you can share that.

V. V. Ravi Kumar: Freight cost, I think at an overall level, it could be very insignificant. It's not very significant.

Surya Patra: Okay. Any specific reason, sir? I think generally, freight cost is around mid-single digit kind of number. And last year, the way it has appreciated, so that has become a kind of important number. Or I'm reading it slightly differently?

V. V. Ravi Kumar: Most of the export sales happen by sea. If it is by air, actually, I agree with you that the costs are too high. So it will impact. Most of the sales happens through by sea.

Surya Patra: Even the sea-based freight cost had gone up

Satyanarayana Chava: Yes its Gone up significantly. But when it comes to percentage to revenues, it's not very high. You were asking about the power cost increases. During the First quarter, we have seen significant rise in the energy cost. Because of lack of power in our industrial zone, we did buy from private power, which was expensive at that time. But now situation improved, and we are not buying any private power higher than the grid power asset.

Surya Patra: Okay. Sir, if I just compare the FY '22 energy cost number versus FY '21. So then during '21, it was 2% of revenue was energy cost, which became 4% in the FY '22. And it is believed that FY '23 numbers are much higher, obviously, than FY '22. So that is why I was trying to understand whether it is now around 5%, 6% of the total cost.

V. V. Ravi Kumar: No. The energy cost, not only power, actually, the coal cost also there. Within the coal cost, coal prices have also shoot up. And then now the coal prices also become normal. So I think that kind of a substantial increase is not there, but definitely increase is there. But if you need any specific percentage, actually, we will let you know...

Surya Patra: My ultimate question was that even this quarter performance, if you see, the gross margin has sequentially come down, although you have indicated that the product mix would have, to some extent, impacted. But if you see the revenue mix, there is not much change sequentially. And there is a 2% kind of gross margin erosion. And on the other expenses front if I see from the pre-COVID level, now it is almost like 4% kind of rise. So these two things I wanted to understand a bit. If you can elaborate, that is fine.

Satyanarayana Chava: Yes, we'll try to answer your question. So when it comes to the decline in gross margin that was primarily driven by the ARV, APIs and Formulations. But we don't expect to further decline in ARV, APIs and Formulations, as the revenue from other divisions increased. So the margins will continue to grow. We don't expect the margins will come down further.

Surya Patra: Okay, other expenses, if you...

Satyanarayana Chava: Other expenses higher because of several new capacities were qualified in API as well as in Formulations. As you know, company's philosophy is to expense all preoperative expenditure. There was an operational deleverage.

Moderator: We have next question from the line of Tushar Manudhane with Motilal Oswal Financial Services.

Tushar Manudhane: Just extending previous questions of how much would be the operational costs related to this expanded Formulation facility of 5 billion

Satyanarayana Chava: We can give you the new block has about 300 colleagues right now. So we can't give you the specific number, but I can reiterate the company's philosophy to expense all those.

Tushar Manudhane: Okay. And sir, just secondly, given that we are sort of exploring CDMO across three plants, pharma, agrochemical and animal health, if you could elaborate what kind of asset turns, margins or the return ratios, you would have sort of thought about when utilizing let's say, the capital allocation for CDMO across these different spaces?

Satyanarayana Chava: Based on our current understanding, the animal health and human health CDMO have similar return ratios, whereas agro, asset turnover is higher but the margins are a little lower when compared to this. But when you multiply asset turnover and margins, I think return ratios could be similar.

Tushar Manudhane: And in terms of opportunities, in terms of the developments happening across animal health or the agrochemical in particular?

Satyanarayana Chava: Animal health is a fixed portfolio right now. We know what to make, how much to make, what price and all. It is with one customer animal health the entire program. Whereas agro, we already have limited portfolio right now, we are exploring further, yes. We'll give you more details as and when we are in a position to share.

Tushar Manudhane: Sir, and just lastly, while you've said that the margin would be stable. So given that 9 months, we have 28% roughly, Q3, in particular we are down to roughly 26%. So does it mean that we would be expecting a good uptick in the margins for the fourth quarter?

Satyanarayana Chava: This year will be closer to 28 probably. But next year, because the one reason why we are confident is we don't expect further price drops in ARVs APIs and formulations and we don't expect significant growth also. The segment, which are growing are of higher margin than ARVs, APIs and Formulations. That's the reason our belief is that the margin should improve.

Moderator: We have next question from the line of Devvrat Mohta with Capital International Inc.

Devvrat Mohta: I had one question. I wanted to just follow up on margins. If you look at the export data until Q2, there had this big benefit from certain intermediates, which you are supplying, which it seems like the intermediate probably demand for that will probably fall off significantly as we go forward. And if I look at the numbers, roughly INR 400-odd crores of revenue from that one intermediate. And if I work with a 40% EBITDA margin assumption on that single product, I mean, that basically means that the underlying business was probably low 20s EBITDA margin this quarter. So what gives you confidence, if that product goes away as well that your margins hold up at 30% versus the underlying margin kind of low 20s now?

Satyanarayana Chava: As you might have seen, the active projects have increased from 50 to 60, and we expect that number will go further. So there are projects, which are not one-off in our CDMO. So that will drive our growth.

V. V. Ravi Kumar: What was negative operating leverage, which was pulled down the margin this year And when we have a better operating leverage next year that also will improve the EBITDA margin.

Moderator: We have next question from the line of Harith Ahamed with Avendus Spark.

Harith Ahamed: You mentioned in your presentation that you've been selected as a panel supplier in the global fund tender. So what exactly does it mean being a panel supplier?

Satyanarayana Chava: See, they allocate majority of their procurement. So we know how much percentage we are getting global procurement for '23, '24 and '25. So this panel supplier will have assured quantity from global fund.

Harith Ahamed: Okay. And then would you be able to share the percentage allocation?

Satyanarayana Chava: No, no. We can't share those numbers.

Harith Ahamed: Okay. So last quarter, you had after revising your revenue guidance for FY '23, you had lowered that number to around INR 6,500 crores. Do we still maintain that guidance for FY '23 revenues?

Satyanarayana Chava: We're working towards that.

Harith Ahamed: Okay. And this NDA that you filed for this ODF technology-based product, is it a PEPFAR filing? Or is it a normal NDA for the US market?

Satyanarayana Chava: I think eventually, we will sell that in developed markets as well. Yes. See, right now, this oral film is not there in the guidelines for WHO. So they will put into the guidelines once we get an approval from FDA. Yes.

Harith Ahamed: Last one from my side. The supplies under the purchase order. Can you share some directional sense versus 2Q? Was it maintained at the same level? Or do you see a very sharp decline in the supplies? And how we should think about the fourth quarter and FY '24 for this particular contract?

Satyanarayana Chava: We can't share detailed on the contracts.

Moderator: We have next question from the line of Ananda Padmanabhan with PGIM India Mutual Fund.

Ananda Padmanabhan: I couldn't understand your response to the question of the earlier participants with regard to the guidance for the full year basis. So what is the current visibility that Laurus has based on whatever contracts that are in hand in terms of achieving that guidance of INR 6,500 crores on full year basis?

Satyanarayana Chava: We're hopeful to meet that.

Ananda Padmanabhan: And with regard to the CDMO business, you said even though that one contract for those supply of intermediate you have other contracts which you see good visibility. So how should we look at the current run rate? So if I look at the average CDMO run rate, it comes to around INR 650-odd crores. So should this be taken as the base business run rate for the CDMO business going forward for FY '24 or one should work with a much lower number?

Satyanarayana Chava: CDMO business for anyone is a lumpy business. Yes.

Ananda Padmanabhan: So on a full year basis.

Satyanarayana Chava: What you have to see is - Are we getting new partners into CDMO? We have added two new big partnerships in this current year. And a number of active partnerships gone up from 50 to 60. And we are building dedicated capacity for CDMO. And we are building a dedicated R&D for CDMO. All those should clearly indicate that we have a very high focus on this segment. And all the investments happening in the company to support this sustained growth.

Ananda Padmanabhan: And final question with regard to the margins. So when you come to the next year, you would see that the contribution from ARV business would go up as your ARV formulation revenue picks up, the CDMO while that could be lumpiness. But probability is CDMO as a percentage of revenues will start coming down. Inherently, the business mix would be inching towards more lower margin business than what it is currently.

So should we work with much lower margins for FY '24 than what we have achieved in the first 9 months of FY '23? Or you are of opinion that the current margins of FY '23 on a 9-month basis, whatever we have achieved is something that is still sustainable.

Satyanarayana Chava: I think we'll give some flavour during our next financial results. We can't give you any guidance right now.

Ananda Padmanabhan: But from a longer-term basis, beyond FY '24, if all your projects workout, you are confident that you would be able to maintain the margins

Satyanarayana Chava: That's for sure. Yes.

Moderator: We have next question from the line of Nitin Agarwal with DAM Capital.

Nitin Agarwal: Sir, on the CDMO business, in your assessment, animal health and the crop protection business can comprise of what proportion of our CDMO business over the next 3, 4 years? Only I presume all our CDMO businesses on human health only?

Satyanarayana Chava: Our CDMO business is also very diversified, Nitin. So we have a portfolio of steroids and hormones. That business is very stable right now. And our human health side is growing very well with NCE programs. And we also have CDMO for dietary supplement and cosmetic ingredients also. That is also growing very well. And animal health, we are seeing very small base right now. But once the facilities are qualified, that business will grow. And crop protection, serious revenues will come only in FY '26 actually.

Nitin Agarwal: These two segments have the potential to be, what, 1/3 to half of your CDMO business or will continue to dominate by human health only?

Satyanarayana Chava: It's too early to give a number in that direction, itself. Yes.

Nitin Agarwal: And sir, secondly, on the new developments that have happened on the ARV tenders, I mean, how do you look at your INR 3,000 crores per annum guidance for ARV, Formulation and APIs. I mean are we in a position to exceed that or it's going to be an optimal number where we'll be operating the business at?

Satyanarayana Chava: We lowered that number to 2,500 crores both APIs and Formulations. I think we are pretty on targets for that.

Nitin Agarwal: And so even on a going on basis, you don't see increase happening to that much number, beyond this?

Satyanarayana Chava: If growth comes, we are okay. Even if the growth doesn't come, we are okay because we are not adding any capital allocation to the ARVs, both either APIs and Formulations. We are putting more focus on high-margin, high-growth business rather than trying to run around the business, which is stabilized. And there's not much growth, even we are not anticipating.

Nitin Agarwal: And sir, when you talk about this ARV business guidance, do you take into account the new NDA that you filed over the last 2 quarters? I mean do have a potential to add meaningfully to these numbers or they will be part of this overall mix only?

Satyanarayana Chava: I think depending on how WHO put guidelines for the paediatric treatments, we are also developing a portfolio of films, not just ARVs and other therapy areas also. I think this platform is very exciting. We're adding more products there.

Nitin Agarwal: And then lastly, on the other API segment, I mean, you've had pretty strong growth in the last 2 quarters in particular. Any particular reasons -- any one-offs, any non-recurring elements in this number? Or this is like a new base on which the business goes on from here?

Satyanarayana Chava: This is based on our product portfolio. Our diversification efforts are giving results. Yes.

Moderator: We have next question from the line of Kunal Dhamesha with Macquarie.

Kunal Dhamesha: First one on the global fund allocation that we have got. So while we have some clarity, some sort of volume allocation for the next few years. The pricing at which it would have happened, would it remain stable going forward? Or there will be annual revision on that?

Satyanarayana Chava: Prices will be stable. Yes.

Kunal Dhamesha: So whatever prices you would have bid would be the price that would continue to 2025? Or that would that be like next round of bidding, which will happen maybe 1 year down the line?

Satyanarayana Chava: The pricing already depressed. We don't expect prices will go down further on this.

Kunal Dhamesha: And second question, given my belief is that API facilities are generally fungible, except for a very different chemistries, and given that the ARV, API seems to be going down probably in terms of pricing, and hence, the return ratios or whatever capacity that we employ would also be going down. So why then go for new capacities for CDMO business and why not just utilize rationalize some of the ARV portfolio where we are not making that much return and utilize that kind of API capacity?

Satyanarayana Chava: It's a good question. But if you look at the size of the ARV business both API and FDF is not small. It is significant. So we don't want to divert the ARV facilities to CDMO. CDMO we are building anyway. Yes.

Kunal Dhamesha: So whatever capital we would have invested in ARV business. Would have we got that back by now in terms of the payback, or let's say, over the next few years that will happen

Satyanarayana Chava: Just to give you overview of capacity utilization of ARV, it's pretty good actually.

Moderator: We have next question from the line of Jeevan Patwa with Sahasrar Capital.

Jeevan Patwa: So I think Dr. Satya, what's happening is basically, I just want to understand whether we'll be able to maintain the gross margin at a 54% level and above for next year and onwards when we basically start the new FDA Formulation contracts, both ARV, Non-ARV. Because if you are able to maintain 54% gross margin, I think we will be able to maintain the EBITDA once we get the operating leverage. So the question would be, will you be able to maintain the 54% kind of gross margin and above?

Satyanarayana Chava: Currently, where the operational deleverage is happening. Once the operational deleverage is over, then the margins profile will improve

Jeevan Patwa: Basically, I just give you the overview where I'm coming from. So if I just look at the best quarter that we had Q4 FY '21, we had similar gross margin of 54%. But that time, our employee cost was 6%, and our other expenses were 14%, and that's how we actually reported 34% EBITDA margin. Now what is happening is our employee cost has gone up to almost 9.5%, and other expenses gone up to 18.5%. And that's where our EBITDA margin is down. So once we have the operating leverage and we are able to utilize our capacity better. So if we are able to do run rate of, say, INR 2,000 crores, a quarterly run rate, I think we'll get back to that EBITDA margin again. But we need to maintain the gross margin of 54%. So that's why the question is whether we'll be able to maintain a gross margin of 54%, gross margin, I would say?

V. V. Ravi Kumar: I think it all depends on the product mix and then the business division mix also, right? So it all depends.

Jeevan Patwa: So we are starting new orders next year, right, both ARV and Non-ARV Formulation orders. We'll be able to have this kind of gross margin?

Satyanarayana Chava: Jeevan, your point is well taken. The employee benefit expenses was FY '21 was 9%. For the current 9 months is 10%. Whereas other expenses, it's 14% and current it's 18%. Yes. So there's a lot of deleverage is there, and we appreciate your view. But if leverage starts kicking in, even the gross margins are stable, EBITDA percentage will go up.

V. V. Ravi Kumar: He is talking about gross margin.

Satyanarayana Chava: Gross margin remain same, leverage kicks in, then EBITDA will go up.

Jeevan Patwa: So the question basically, we'll be able to maintain the gross margin of 54% and above?

Satyanarayana Chava: Yes. Hopefully. Yes.

Moderator: We have next question from the line of Hussain Kagzi with Ambit Asset Management.

Hussain Kagzi: So sir, my question is with regards to our Non-ARV Formulation division. If I see that we must have done roughly INR 278 crores in the first 9 months. And I remember that most of our capacity, what we have, 10 billion, out of that, I think, around 2/3 is towards Non-ARV Formulation with further capacity or brownfield addition of 5 billion possible. So sir, I just wanted to get a sense of the division between how much of this revenue what we are doing currently is CMO based and how much would it be on the basis of the ANDAs, which we have signed.

This is because mainly, I wanted to understand the strategy going ahead that, will we be focusing more on CMO side or probably go more after the ANDAs, which we are filing? So yes, that's the question. Yes.

Satyanarayana Chava: Current capacity utilization is over 50%, but maybe I'm saying number, 10 billion is qualified. Currently, we are at 6 billion usage out of that 1.5 billion is CMO.

Hussain Kagzi: Sorry, you said 1.5 billion CMO?

Satyanarayana Chava: Yes, 25% of capacity is used for CMO.

Hussain Kagzi: And is this what going ahead, will we focus more on the CMO part? Or is it more on the, say, launching our own products in the market? I mean how do we distinguish between that strategy going ahead?

Satyanarayana Chava: I want to clarify one point here when we are saying CMO of Formulations. We are not offering CMO for Formulations unless we make the API. So for the Formulations, we also make API Even the CMO.

Moderator: We have next question from the line of Palak Shah with Infina Finance.

Palak Shah: Just one from my end on your Synthesis business. Given the number that we have reported, does that have any new contract that we have recently won in the last 2 quarters? So the contribution despite of one-off project going off, it's still at INR 650 crores.

Satyanarayana Chava: We have a healthy pipeline in our CDMO. Several new active projects kicked in. And that looks very promising. We can give you that details.

Palak Shah: If I clarify a bit, would that mean that the quarterly run rate of INR 120 crores to INR 150 crores previously, actually jumps to INR 350 crores to INR 400 crores now or even above that?

Satyanarayana Chava: I go back to my statement, a lot of active projects, we can't give you a specific number right now.

Moderator: We have next question from the line of Sajal Kapoor, an Independent Investor.

Sajal Kapoor: Question on sterile injectable. Last year, we commissioned our sterile injectable R&D labs, and we started working on a few priority projects. So as a broad long-term vision, where can we go in the sterile injectables in terms of commercial scale over the medium term of, say, 3-4 years? That's one.

And then a quick question on Laurus Bio. So I heard about this debottlenecking at R2 to enhance the downstream and resolve the mismatch between the upstream and the downstream, which is a common phenomenon in biotechnology. So what is the anticipated sort of timeline for this completion of debottlenecking on in the next sort of plant or land that we have acquired? And on R3, are we still on track to get to 1 million new capacity by FY '25?

Satyanarayana Chava: I think I will answer the last question first. So in the Bio, debottlenecking at R2 will be completed in the next 6 to 9 months, yes. Construction already started. When it comes to R3, we will do instead of 2 Phases, we'll plan to do 3 Phase to go to 2 million. Probably we'll do less than 1 million in Phase 1, maybe around 650,000 litres. So 3 Phases -- 3 equal Phases, 650,000 each to go to 2 million liters. That's the current plan in R3. We are in the design finalization Phase right now with R3. Once the construction starts, we are expecting it will take between 18 and 24 months to go commercial.

Sajal Kapoor: And on the sterile injectable, if you could just share some colour around the medium term.

Satyanarayana Chava: We started several projects in R&D. And we are yet to start the construction of commercial facility for sterile products. We have taken land, but construction not started yet.

Sajal Kapoor: And in terms of the commercial scale, I mean, 3, 4, 5 years out, I mean, do we have sort of a rough sketch in terms of how big we want to be in this area over the medium term?

Satyanarayana Chava: We have a plan in place. Yes. We will give more details when we complete R&D stability and then ready to go for commercialization.

Sajal Kapoor: And we have always followed that approach, R&D first and commercial manufacturing later. Really happy to have all those responses, Dr. Satya. Wish the entire team very best.

Moderator: Thank you. Ladies and gentlemen, due to time constraint, that was the last question. I'd now like to hand the conference back over to the management for closing comments. Over to you, sir.

Satyanarayana Chava: Thank you, Monish, for organizing this call, and thank you, the participants, investors for your active participation and very insightful questions. Thank you.

V. V. Ravi Kumar: Thank you.

Moderator: Thank you, sir. Ladies and gentlemen, on behalf of Antique Stock Broking, that concludes this conference. Thank you for joining us, and you may now disconnect your lines.