"SeQuent Scientific Limited

Q4 FY 2023 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day, and welcome to SeQuent Scientific Limited Q4 FY '23 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing star then zero on your touchtone phone. Please note that this conference is being recorded.

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

Abhishek Singhal: Thank you, Neerav. A very good morning and thank you for joining us today for SeQuent Scientific's Earnings Conference Call for the Fourth Quarter and Full Year Ended Financial Year 2023. Today, we have with us Mr. Rajaram, SeQuent's Managing Director; Mr. P.V. Raghavendra Rao, CFO, to share the highlights of the business and financials for the quarter.

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

I now hand over the call to Mr. Rajaram to make the opening comments.

Rajaram Narayanan: Good morning, everyone, and a very warm welcome to our Quarter 4 and Full Year '23 Earnings Call. Joining me on this call is Mr. Raghavendra Rao, our Chief Financial Officer. We are at a very important juncture in the journey of this company and I'm happy to address this forum as we take some decisive steps towards building this company as a major player in animal health. I'll start with an overview of the company.

We are the largest animal health company from India and amongst the top 25 in the world. We have a presence across nearly 100 countries and about two thirds of our revenue comes from regulated markets. We have a unique combination of strength in the formulations area, we have a front-end presence in key animal health markets of the world. And at the same time, we are the only company in India to have set up a U.S. FDA-approved greenfield veterinary API facility. So, that's a set of strengths, which stand with us as we build our next few years.

Last quarter, we had indicated that we are initiating steps to improve our margins and adjust our plans so that we are well prepared in this fast-changing environment globally and in India. And as part of this strategic shift, some of the actions we have taken in this quarter's results are reflected and they prepare us for an accelerated growth to profitability in the next 2 to 4 quarters, while setting the foundation for long-term competitiveness.

As a broader background on the global market situation, I'll comment on 2 areas. One is the macro environment. This remains challenging. Inflation and other consequences of geopolitical developments continue to put pressure on costs and consequently on demand. In our case, some markets like Turkey and parts of Europe are impacted, but we are also seeing silver linings as these situations tend to create opportunities for exploring new business models.

Second, the industry we operate in. Although, the year gone by has been difficult due to the impact of agri commodities and feed costs, which in turn affect the economies where they keep food-producing animals, the animal health industry overall continues to hold long-term promise. The underlying drivers for long-term growth of the industry, which is focused on is the animal protein, adoption of pets and the growth of emerging market continues to remain intact. While Raghav will talk in detail on the quarters and full year financials, let me share some highlights of our overall results.

Our revenues in the quarter have been a mixed bag. Overall, the quarter 4 revenues have declined year-on-year by 4.4%. But however, within that, our formulations business has grown by 2.6% year-on-year, and we are seeing in constant currency terms. And in some markets of Europe and emerging markets, we actually are seeing high growth, in fact, in double digits.

The business in Turkey, of course, has been impacted by the disruptions caused on account of the devastating earthquake. While our people and facility were not affected, it has, in fact, impacted some of the demand. At the same time, we also see important developments in our product portfolio, and we have launched a range of formulations for gut health of animals in Europe, which, in a short span has actually crossed EUR3 million of sales.

On the API front, our revenues have been a bit muted because we expect some of the customer orders to spill over into the next quarter. At the same time, we have continued to file for new products with 8 new filings this year and we have started the commercialization of new products as part of our long-term contract with a leading animal health player in the world. We have also invested in expanding our R&D capacity as we anticipate a fast-growing requirement for new products in the next 3 to 5 years.

As we navigate this mixed environment, we are taking some decisive steps to make sure that we are future resilient by operating in areas, which offer the best opportunities for growth and profitability. And in this regard, we have taken a few major initiatives this quarter, those benefits will start showing in the coming year and beyond. First, our manufacturing operations in Germany have been facing challenges for a while in terms of operating costs due to the prevailing economic environment.

And after assessing our options, we have decided to close the manufacturing facility. This will translate quickly into accretive and sustainable margins for the company. We will continue to serve our customers through alternative partners and CMO entrants. There is a one-off charge in the results due to this strategic shift.

Our API business is unique. It has 72% of its revenues from regulated markets and the top 10 customers account for nearly 60% of the business. But as we grow, we will need to be more competitive. Therefore, we have initiated a large-scale cost transformation and margin improvement project, which is internally called Project Pragati across the business, and this will start showing in our margin profile in the next 2 quarters.

On formulations, we are bullish about India and Brazil. We intend to accelerate our organic growth through new launches and expanded reach. At the same time, we are reshaping our portfolio and operations in markets like Turkey and parts of Europe to focus on growth segments and also improve our profitability. And finally, across the group, we have intense efforts on costs and working capital and we are already beginning to see the results in this quarter itself.

Before I hand over to Raghav, I would like to emphasize the following. We are a unique company in a unique industry. The environment, however, requires us at times to adjust our plan so that we remain competitive in the long term. With the actions outlined, we expect to be better prepared for the opportunities ahead and do so profitably and responsibly.

On one hand, we are cutting costs where we see little long-term value. But on the other hand, we are investing in capacity, in R&D, in quality and in people because we believe that in the next 3 to 4 quarters, we would be well placed to ride the recovery in our industry.

I will now hand over this to Raghav for more details on the financial performance.

P.V. Raghavendra Rao: Thank you, Raja. Good morning, everyone. I will now briefly update on this key financial metrics for Q4, as well as for the full year '23. I will start with the formulation revenues. Formulations business contributed INR255.9 crores to the top line with a 2.6% year-on-year growth and down by 1.1% Q-on-Q on reported terms. On constant-currency terms, formulation has grown by 2.9% year-on-year. Europe business continues to grow and clocked a revenue of INR114.6 crores, which is a growth of 9.1% quarter-on-quarter and 11.9% year-on-year. The API business revenue is at INR94.1 crores.

Total revenue for the quarter is INR366.7 crores, down 4.4% year-on-year and down 2.3% Q-o-Q. For the full year FY '23, the revenue is at INR1,420.9 crores, which is 0.6% growth year-on-year and 2.2% growth in constant-currency terms. This is despite the headwinds that we faced across multiple businesses. Europe clocked a sale of INR414.7 crores for the year, which is a growth of 1.7% in constant-currency terms.

Emerging Markets segment clocked a sale of INR480.7 crores, which is 7.8% year-on-year growth and a robust 15.9% in constant-currency terms. India clocked revenue of INR105.5 crores, which is a growth of 3.5% over the previous year. The API business contributed INR380.8 crores to the revenue on a full year basis.

Overall, gross margins for the quarter is at INR39.5 crores compared to INR42.1 crores in the previous quarter. We have taken multiple actions in controlling the working capital. There is a significant reduction, particularly in material inventory on account of these actions. The impact on gross margins on account of this is about 1.5% in the current quarter. Our full year gross margin is at 41.3%.

In spite of the inflationary pressures, we have managed to control our operating costs. Our operating expense at a full year level is at INR288.6 crores compared to INR279.1 crores during the previous year. In Q4, EBITDA, excluding ESOP cost stood at INR12.8 crores. And on a full year basis, EBITDA pre-ESOP of INR75.6 crores, ended at 5.3% of revenue.

During the quarter, we have had an exceptional EBITDA of INR61.6 crores, driven by closure of plant operations in Germany and also impairment impact on sourcing because of the prevailing account situation in Turkey. This is -- other than the INR5.6 crores hyperinflation-related impact that we have taken because of the conditions in Turkey.

Exchange loss for the quarter is at INR2 crores. This is mainly driven by the movement in Turkish lira and euro. For the full year, impact on account of exceptional items is INR65.8 crores. This includes other than costs that I just mentioned about, which are relating to the closing down of Germany operations and Turkey impairment, this also includes a loss due to fire at Vizag, which is taken in Q1 not FY '23. We also have INR15.8 crores impact on account of hyperinflation adjustments on a full year basis on the P&L. We continue to work on bringing efficiencies due to the operations across the globe.

Our working capital has reduced by 11 days over the previous quarter and now stands at INR426.1 crores as compared to INR480.4 crores as on December-end. The capital expenditure in FY '23 was approximately INR86 crores, which is -- significant of it being utilized for capacity enhancement in our Vizag facility, increasing demand. Net debt is at INR366.1 crores against INR363 crores in December more or less response.

I thank you all for your support. I wish us for the forum to be now open for Q&A.

Moderator: Thank you very much. We now begin the question-and-answer session. The first question is from the line of Vishwas, an Individual Investor. Please go ahead.

Vishwas: I had a couple of questions. And my first question is relating to the API plant. So, how much is the utilization there right now? And are we planning to add more capacity for API business? And what are the products we have in our pipeline relating to that? And what are the revenue, which we can get from these new APIs? So, this is my first question.

Rajaram Narayanan: Thank you for asking this question. So today, our capacity utilization of our API business is between 70% to 75%. And going ahead, of course, we will have requirements, but there are 2 components to increasing capacity. One is the debottlenecking the capacity which we have right now. And as I did indicate in my call, one of the big initiatives we have is on improving productivity and margins. So, we will be debottlenecking some capacity.

And of course, we are investing in capex to increase our capacity because we have some new products and some new partnerships, which are coming up with leading players. And therefore, we will add capacity as those requirements come in. You had some -- another -- some more question on the API, which was...

Vishwas: I just wanted to know how much revenue or any indication which we can get from these new APIs, any broad view?

Rajaram Narayanan: So, we expect that we will be adding 1 to 2 products immediately in terms of new products and probably going up to 6% to 7% in the next 3 years. And typically, we should expect about 8% to 10% of our revenues to come from new products in the next 2 years.

Vishwas: My second question is on the actions you are taking in Europe, like closing a factory which you indicated, so can you elaborate some more reasons on the -- like behind the scenes and what benefits can we expect from these actions on the performance of the company?

Rajaram Narayanan: So, we have a factory in Germany, which is the injectables plant. It also makes some other liquids for animal health. And the markets for this plant are some markets in Europe, some in East Europe and emerging markets in Africa. But being located in Germany, it's an old plant. We had plans of putting in capex and modernizing this plant to be able to take the products outside of Europe like the U.S.

But there has been a significant change in the operating environment in Europe. The operating costs have gone up quite substantially in terms of both energy, utilities as well as labour costs. And at the same time, it will take us also more investment to be able to upgrade the plant.

So, we felt that since we've been incurring a loss from this plant for the last few years, there were no alternative options a couple of years ago. But now there are alternatives to actually get these products manufactured at more competitive CMO than third parties.

And that's the reason why we want to close the operations in that plant and that will help us conserve currently the burn, which is happening in that factory, and we should be able to get the benefit coming in about a quarter from now. As far as the quantum of the benefit, I think we've indicated it -- Raghav, what could it roughly be about?

P.V. Raghavendra Rao: It could be about -- annualized basis, about INR22 crores to INR24 crores.

Rajaram Narayanan: Yes, so we should take about INR20-odd crores would be the annualized basis of it. But as when we sort of implement it, it should actually start somewhere around next quarter.

Vishwas: And lastly, one question on the Turkey side. So, what is the situation there in our business there?

Rajaram Narayanan: Do you have any more questions? Or is this the last one?

Vishwas: I have just one question on Turkey business. So, what is the situation there? And how is the business there? What is the situation with respect to hyperinflation? So, these are the broad questions.

Rajaram Narayanan: So, I'll answer the first part. Turkey is a very important animal health market. It is in the top 10 markets of the world. And we also, as a company, have a very strong presence. We are in the top 5, in fact, now in the top 3 of the ruminant cattle animal health business. And the brands are very strong. So, it's an important market. Unfortunately, in recent times, the country has gone through an economic challenge because of which there has been high amount of inflation and also the rise in agri prices have meant that there is a reduction in the demand for some of the animal meat and animal protein.

And therefore, it is beginning to impact the business performance. But we have taken actions in that regard in terms of aggressive pricing in terms of looking at our portfolio, reducing some of our costs. But we have to wait and watch because these actions in recent times has not been adequate to compensate for the level of inflation. But we do see other opportunities in Turkey, which we are getting into action now, which is to use Turkey as a potential export location because when you have this degree of -- it will also become more competitive as a cost base for supplying to some markets in Europe, etcetera. We also make injectables in that plant, which is one of the few plants, which makes injectables. It's Europe GMP-certified facility.

So, all those things put together require us to adjust our own business because we have a strong presence there, but we are conserving costs and we are doing everything to make sure that we remain profitable in Turkey. So, that's really the situation. Of course, there has been a devastating earthquake which did not impact our facility or our employees but did impact the market where the earthquake incident took place, which was about -- which is about 10%, 15% of the Turkish business. And that trickle down has impacted the current demand, but we do expect that things could change. In any case, our actions are to make sure we are profitable in that regard. On the macro hyperinflation, I'll probably ask Raghav to comment and explain what the principles are.

P.V. Raghavendra Rao: So, if you see the face of the P&L, we have taken for the current year an impact of almost INR16 crores for the full year. And there is another INR2.8 crores, which have impacted the EBITDA, other EBITDA.

Moderator: The next question is from line of Siddhant, Individual Investor. Please go ahead.

Siddhant: I just had a couple of questions. Sir, my first question is, as you mentioned, there has been a large exceptional item during this quarter. So, is this the end? Or do you expect more of it going further?

Rajaram Narayanan: So clearly, because this is exceptionally large, the idea was that this was it's like to be taken now and it was the right time to rebase some of our operations and actually act so that we can take advantage of the accretive margin and the lower cost base as we begin to go ahead. So, I don't expect any more exceptional items in this regard in the coming quarters.

And that's the reason why we've decided that even though it is large, and it is -- it does impact the results of the quarter, we would rather take the charge one shot in this quarter itself. So, that we can sort of go on a clean sheet moving ahead.

Siddhant: Sir, in the presentation, it was mentioned that inventory reduction has affected the gross margin. So, can you comment why such -- like why it has led to losses this year?

Rajaram Narayanan: Raghav?

P.V. Raghavendra Rao: Yes. So, like I said, we have been working on bringing new efficiency into our overall working capital. So, actions on inventory were aligned to that step up. So, what happens when you do actions on the inventory, there are a couple of pieces that come into your gross margin. One is that you make -- you liquidate some inventories.

You make closing credits. More importantly, when you reduce your inventory, some of the overhead sitting on inventory also impact your -- impact your overall gross margin for the period.

So roughly, broadly, as I indicated earlier, it's about 1.5% impact on the gross margin for the quarter.

Rajaram Narayanan: So, it's the right direct thing to do, which is to reduce your inventory, but you do end up having an accounting charge, which comes on the P&L. So, I think from a health of the business operation, it's absolutely the right direction to go ahead and reduce inventories. But in terms of an accounting charge, it can come your -- that's what has really happened.

Siddhant: Sir, one last question. Like historically, you have mentioned that the company is going under restructuring, but the employee costs have been more over the same or latest increasing. Can you point out any reason for this?

Rajaram Narayanan: So, we really don't have a significant increase. I would comment, but just before that, let me say that some of the impact of the restructuring, which we have just spoken about, some of these will obviously trickle in, in the margin improvement as it comes in, in the coming quarters. The second part of it is that some of the increase in employee cost trajectory, because of annualization of when you recruit them in hiring as well. But in terms of our headcount, we are directionally going lower than what we have. But Raghav, anything else in this?

P.V. Raghavendra Rao: Nothing -- so, you are right in the sense that we had -- we are taking in some of the restructuring impacts from the -- on the manpower line, sorry, on the employee benefit line. But what we have to also remember is that there will be increments and there may will be replacement cost that will come on this line. So -- and I believe that it is more or less stable between the 2 quarters, between December and in March.

Moderator: Next question is from the line of Pranav, Individual Investor. Please go ahead.

Pranav: So, I have a couple of questions. So, what are the company's plans for acquisitions in the future for growth? And how is the importance of India in this plan?

Rajaram Narayanan: So, we clearly, will look for any attractive assets, which we can acquire, but it will be done in terms of responsible funding for this, and it should be an asset that adds value to the business and where we also can add value. So, we are completely open. We are also, at all points of time in engagement with different potential assets for acquisition. Obviously, from a market point of view, India is attractive, but we also see some interest in one or two assets outside of India, but largely that interest is in India at this point of time.

Pranav: Another one of my questions is regarding the sales in margin growth. So, what is the expectation that the management is having for the next few years?

Rajaram Narayanan: As I said that there is clearly a lot of initiatives, which we have started, some of it due to reshaping restructuring, but also the growth that we are seeing in some of the markets in the short and medium term. We really don't take this as any kind of guidance, but what we expect some of our initiatives and to deliver and split it into two horizons.

One is that in the short term, it would be really the exit of FY '24. We should expect the exit margins to begin to come into double digits. And that's something that is on our plan. And as far as we look at medium term, which would be about 24 to 36 months, we should expect our margins to come to late teens. So, roughly in a short term, which is the next 12 months, we should expect the exit margin of the company to be somewhere in double digits. And in 3 years, we should be in about late teens in terms of our margins.

Moderator: The next question is from the line of V.P. Rajesh from Banyan Capital Advisors. Please go ahead.

V.P. Rajesh: One on the EBITDA side, you are saying, your sort of adjusted EBITDA is INR110 crores for the year. If you can share the corresponding number for the Q4?

Rajaram Narayanan: Corresponding, Raghav, Corresponding numbers for Q4.

P.V. Raghavendra Rao: So, I'm just thinking about we had exited Q4 at a reported EBITDA of about INR12.8 crores. So in this, you can add a couple of amounts, particularly the INR6 crores inventory is Q4 item as well as about INR1.1 crores on the hyperinflation is a Q4 item. You can add about INR5.5 cores for the discontinued operations. So, it will come -- roughly it comes to about INR21 crores, INR22 crores, Rajesh.

V.P. Rajesh: INR22 crores, okay. So, how should one think about? Is it the new basis of INR88 crores, if I analyse Q4 or INR110 crores? Like what is your jump-off point in terms of how the EBITDA will start to improve from here?

Rajaram Narayanan: So, I think you should look at more from exit to exit than to look at it because some of the actions of these don't follow 1/4 for a quarter. So, I think on a -- you should look at a base -- my sense is on a more like INR22 crores kind of update on which we should see us as going in line with the kind of direction which I have given. On an annualized basis, I think it would be about INR110 crores. Yes?

P.V. Raghavendra Rao: Yes. So, what you have to remember Rajesh, is not all impacts are injected into Q4. So therefore, it is better to make of it on an annualized basis.

V.P. Rajesh: Right. That's why I was saying that one should think of INR110 crores is the number that is sort of on a...

Moderator: Sorry, you are not audible.

Rajaram Narayanan: I think you are not audible. But if you're asking, I think you should -- whether we should take a quarter as a reference or should we take the annualized adjusted INR110 crores as a reference, I would say that you should take the annualized as a reference, yes, on this.

V.P. Rajesh: And then one quick question on the inventory side. When you have taken the markdown in this quarter, is it actually a cash loss? Or is it just accounting entry you have taken and then you liquidate that inventory, and you may get some write-back from that? How should one think about that?

P.V. Raghavendra Rao: The way inventory works Rajesh, it's not entirely a markdown. There is a very small element of actually markdown. It is actually what happens is when there is a drastic change between your working inventory and your present inventory for a period, there's a lot of overheads sitting in the inventory in the balance sheet to the P&L. So, it has a significant impact and particularly, if the period is only 1 quarter, it appears significant. So, that is the major impact on inventory.

Moderator: Next question is from the line of Ankush Mahajan from Axis Securities. Please go ahead.

Ankush Mahajan: Most of my questions have been answered, sir. Just on the -- my question is catering to margin that you already have answered. Just trying to understand, sir, if we could -- we have closed these operations in Germany and what kind of impact we can see in terms of quantitative impact in the upcoming quarters?

P.V. Raghavendra Rao: So yes, Ankush, I anyway answered that as well. So, I think over an annualized basis, INR21 crores to INR24 crores equities to the profit in margin.

Ankush Mahajan: Do you mean that's EBITDA margins?

P.V. Raghavendra Rao: Yes.

Moderator: Next question is from the line of Giriraj Daga from Visaria Family Trust. Please go ahead.

Giriraj Daga: Just few clarifications first. About Germany, API unit or formulation unit? And what percentage of API was there if APA was there?

Rajaram Narayanan: So, Germany is a formulation unit. It's not an API unit. It is where we make some injectable products where we buy APIs from other suppliers, and it's marketed to within Europe and to some other markets.

Giriraj Daga: Second, when you look at your capacity utilization number of API to 70% to 75%, like what percent of API goes for our internal consumption?

Rajaram Narayanan: Very little of our API is used for probably 2% to 3% maybe at best and that too at times because most of our APIs are -- as you know, most of our APIs are for regulated markets in the U.S., we don't have U.S. operations. So, between U.S. and Europe, most of our customers will be purchasing this. So, it's not for internal consumption.

Giriraj Daga: So, when we look at like last quarter, 4Q, we had revenue of INR127 crores. This quarter, it's INR94 crores, and you're talking 70%, 75%. Like we were operating at more than 100% in fourth quarter or is the price reduction such drastic that volume is intact, and prices have crashed?

Rajaram Narayanan: So, there are two parts to it. When I say 75%, it's our mean plant, which is there in Visakhapatnam that operates at about 70%, 75%. We have another plant, which is a non-U.S. FDA plant, which is in Mahad, which is in Maharashtra, which is at about 55% to 60%, but that largely makes albendazole.

So, that is one. I think the second part of it is that last year, at the same time when we saw a large base of INR127 crores, there was a substantial amount, which was a spill over from quarter 3 of that year, which was almost to the extent of about INR14 crores to INR15 crores, which came in as a spill over because the December ending of that year could not -- there were a lot of issues around shipping, etcetera, and it couldn't be sent.

The third part of it from a capacity is that we also use CMOs for some of our requirements. And therefore, while our own plants may be occupied at about 70%, 75% in Vizag and about closer to 60% in Mahad, we utilized our CMO capacity also for some products.

Giriraj Daga: Two more questions. One on the margin. When you mentioned double-digit margin exit rate, late teens margin, you're talking about the adjusted margins, not after the ESOP cost, right?

Rajaram Narayanan: No, I think all our discussion is on EBITDA margin pre-ESOP, because ESOP is a non-cash item, we don't sort of tell, but it's pre-ESOP operating margin.

Giriraj Daga: So practically, like if I add the INR20 crores, INR24 crores to INR110 crores this year, we're anywhere at INR130 crores, INR135 crores, right, on a revenue of INR1,400 crores. So, we're already close to 9.5% already. So, the improvement like -- are we not expecting any material improvement from here up to quarter 4?

Rajaram Narayanan: Yes. As I said, we do expect it. And I think we have a big variation in the margins this year. And therefore, the indication is that we will do double-digit, nearly double teen margin as we exit the year.

Giriraj Daga: My question is that INR110 crores should be like even if I add this additional INR20 crores, should become INR130 crores, right? So ideally, we should be looking at INR150 crores, INR160 crores minimum to start with for FY '24 full year adjusted number?

P.V. Raghavendra Rao: Giriraj, I'm not sure what integer you are adding.

Giriraj Daga: Germany operation cost, INR21 crores to INR24 crores, you mentioned, right?

P.V. Raghavendra Rao: That is basically in the INR110 crores, that is basically in the INR110 crores. So, the way if you see, this INR110 crores over INR1,400 crores, is not 10%. So, we will move close to the -- we will move into the early double-digit as we move into the end of the year.

Giriraj Daga: Last question on the capex. So this year, we have some step-up in the capex, some INR86 crores. What was that pertaining to, which facility and other things? And what is the capex outlook for '24 and probably some visibility on '25?

P.V. Raghavendra Rao: It could be somewhat of a similar number for FY '25 as well and the many investments, predominantly in the capacity expansion in Vizag.

Giriraj Daga: No, sorry, like, if we look at our revenue for the last 2, 3 years, it's like flat broadly, right? And we will have some asset turnover of almost 2.5x, 3x, if I'm not wrong. So, then why do you need capex for this year also for INR86 crores, somewhere like INR85 crores to INR90 crores?

P.V. Raghavendra Rao: So, this capex, Giriraj is basically -- I mean, we have line of sight of business expansion, where we are trying to lock new customers, new projects. So, it is more in line with our -- with what we want to do in the future as we move ahead.

Giriraj Daga: And location would be?

P.V. Raghavendra Rao: Like I said, predominantly Vizag, as of now.

Rajaram Narayanan: It will be in India, largely in our U.S. FDA plant.

Moderator: Next question is from the line of Darshan Shah, Individual Investor. Please go ahead.

Darshan Shah: Sir, can you hear me?

Rajaram Narayanan: Yes, Darshan, go ahead.

Darshan Shah: So, I just wanted some updates on what are our growth prospects in Brazil, like?

Rajaram Narayanan: So Brazil is one of the world's, it's in fact, in the top 5 market as far as animal health is concerned. We have been growing well in the last couple of years in Brazil. It is -- we think that we -- it's a market where we should grow in double digits, partly because the -- we've also made an entry into companion animals last year because we have acquired a small company to sort of make the entry into companion animals.

And this year, we will be expanding the range and the reach and the impact of that team. So, it's an attractive market, which should give us double-digit growth. But we have to make sure that it is profitable also, it is right now profitable, but there are some sort of headwinds in terms of agriculture and commodity prices, hopefully, they will be managed, and we should be able to see double-digit growth there. But for us, it's a strategic market going ahead.

Darshan Shah: And any updates on Nourrie?

Rajaram Narayanan: So we've done the integration of that team. We have put in a new sort of, expanded the team now to be able to go to more the OTC and kind and veterinary doctors who are there because this was more of a nutrition kind of a portfolio. So, we are also expanding our portfolio. I think we should begin to see the results by quarter 4 this year of Nourrie because it will be annualized by then.

Moderator: Next question is from Kaustav from BMSPL. Please go ahead.

Kaustav: So, if I observe from your calls that you did a few years ago, you kept talking about the potential U.S. FDA approval for formulations. And since then, over the last few quarters, we haven't really spoken about this. So, I was just trying to understand what happened over there? And what is our plans to eventually enter this U.S. market in formulations?

Rajaram Narayanan: Thanks for this question. So, the entry into U.S. for formulation has two parts to it. The first is in the development of the product itself and the validations which are required and then there is manufacturing and then there is the eventual launch. The manufacturing of this was planned in Germany. The R&D for it and the development of the product and the registrations are all driven out of India in our R&D. We are completely on track on the registrations and filings, which we had planned.

However, the upgrade, which we had planned in Germany is the one which we are now discontinuing for U.S. FDA upgrade. But instead, we have arrangements right now to be able to manufacture these products at CMOs, so that we don't miss the timeline, which we have with us on that. So, it's only the manufacturing location for validation and eventual supply, which will change because a few years ago, it was not available. But today, there are CMOs with strong manufacturing capabilities for the U.S., which are available. The more important thing is to have the registration and the filing for that.

Kaustav: No. So, my question being that -- okay, so the arrangement is changed, but when do we plan to enter this market? And are we going to enter this market anytime soon given we've got so many other geographies to focus on and to still scale in? I mean, could you just speak a little bit about this whole thing and as to where you -- no, that's it. Yes, I think you got my question.

Rajaram Narayanan: We are not scaling back on the current route to get there because we have about close to 8 products and then eventually 12 for which we are developing the necessary dossiers. So, that process is going on right now. I think we'll be able to probably get a clarity once we sign up formally the arrangements with the manufacturing. We don't see too much of it, but a typical plant should be anywhere in about 24 months.

Moderator: Next question is from the line of Vignesh from Harmoney Wealth Advisory. Please go ahead.

Vignesh: I just wanted to understand that full year ESOP cost, which we need to put in for the financial year.

Rajaram Narayanan: It's not very clear Vignesh, can you just repeat your question? It's not very clear.

Vignesh: So, I just want to understand the full year ESOP cost we need to tap in for the current year?

Rajaram Narayanan: It's not clear.

P.V. Raghavendra Rao: Your voice wasn't clear, so can you just repeat once again?

Vignesh: I just want to understand the full year ESOP cost for the current year.

P.V. Raghavendra Rao: It is about INR35 crores, Vignesh. Current year, it's INR35 crores and we expect it to come down as...

Vignesh: For the financial year FY '24?

Rajaram Narayanan: FY '24, it will be lower.

P.V. Raghavendra Rao: It will be lower. It will be significantly lower, yes.

Vignesh: And then on the API side, in the last 4 years has been muted. So, some colour on the API business and I mean, some update on the pricing pressure if there are reductions in the pricing pressure or some colour on the API business.

Rajaram Narayanan: So, I think every year has been a little different because the last 4 years, if you take, we've had a couple of years of COVID as well. So, from that point of view, the steady state is really what we should look at, which is perhaps this year. In terms of the pricing, yes, the pricing pressures do continue across.

And partly, it is led by the fact that there's a reduction in demand in some of the end products for our customers. And there are people who are sort of supplying the APIs. So, there is going to be that pressure and that is the reason why we should do the kind of initiatives, which we are doing in terms of improving our margins and cost competitiveness. That's how we retain our customers.

Having said that, we have nearly 70% our business, which is with customers in regulated markets and that, while it may not give us the immediate opportunity to increase prices because that tends to be more dependent on when your contracts end and get renewed. We definitely don't have a downward pressure on prices when with some of these regulated market customers. Yes, in the less regulated markets, where it is what we call spot trading of products, there is obviously a pressure both from suppliers in other emerging markets as well as some in India as well.

Having said that, we should also remember that there was a big spike in costs some time ago, but in the last 5 to 6 months, there is also some softening in terms of input prices. And therefore, we should be able to move towards protecting our margins even if there is a slight pressure on pricing because of the initiatives both in terms of the kind of stuff, which we are doing as well as the softening of input prices.

Moderator: Next question is from Prashantkumar, an Individual Investor. Please go ahead.

Prashantkumar: Sir, my question is like how long we have to bear this ESOP cost? How many more years to go for it?

P.V. Raghavendra Rao: Prashant, it will continue next couple of years, at least, where it will come down significantly later.

Prashantkumar: In FY '23, we had cost around INR35 crores, like what can be the -- what can be the for-instance cost, like any tentative number? I'm not looking for the numbers.

P.V. Raghavendra Rao: It could be approximately about 18% to 22% lower than this, next year?

Prashantkumar: 18% to 20% lower, right? So, around INR25 crores to INR28 crores, kind of, right?

P.V. Raghavendra Rao: Yes, yes, approximately, yes.

Prashantkumar: So, are we planning -- another question is, are you planning to enter into the Chinese market?

Rajaram Narayanan: Into China?

Prashantkumar: Yes.

Rajaram Narayanan: We have no immediate plans to enter into China. I think from a formulation point of view. From an API point of view, at this point, it doesn't really play out because China is a manufacturer for most of the APIs.

Moderator: Thank you. I now hand the conference over to the management for closing comments.

Rajaram Narayanan: Thank you very much for -- to all of you for joining this call and I hope you've had an opportunity to answer your questions as well as give you clarity on the results of the recent quarter as well as more importantly, the direction which we are taking in terms of substantially improving the competitiveness of our business as well as the near and long-term -- medium-term forecast that we have for our growth as well as for our margin profile. Thank you very much.

P.V. Raghavendra Rao: Thank you.

Moderator: Thank you very much. On behalf of SeQuent Scientific Limited, that concludes this conference. Thank you for joining us. You may now disconnect your lines. Thank you.