"Sequent Scientific Limited Q1 FY '20 Results Conference Call"

July 31, 2019

MANAGEMENT: **MR. MANISH GUPTA – MANAGING DIRECTOR, SEQUENT SCIENTIFIC LIMITED**
MR. SHARAT NARASAPUR – JOINT MANAGING DIRECTOR, SEQUENT SCIENTIFIC LIMITED
MR. TUSHAR MISTRY – CFO, SEQUENT SCIENTIFIC LIMITED
MR. ABHISHEK SINGHAL

Moderator: Ladies and gentlemen, good day and welcome to the Sequent Scientific Limited Q1 FY '20 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, please signal an operator by pressing * then 0 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: A very good afternoon and thank you for joining us today for Sequent Scientific's earnings conference call for the first quarter ended financial year 2020. Today we have with us Manish, Sequent's Managing Director; Sharat, Joint Managing Director and Tushar, CFO to share the highlights of the business and financials for the quarter. I hope you have gone through our results release and the quarterly investor presentation, which have been uploaded on our website as well as stock exchange. The transcript of this call will be available in a week's time on the company's website. Please note that today's discussion maybe 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 Relation team. I now hand over the call to Manish to make the opening comments.

Manish Gupta: Thank you, Abhishek. Good afternoon everyone. Thank you once again for joining this call in a very busy season. As Abhishek mentioned, I am joined by our Joint Managing Director, Sharat and our CFO, Tushar. I will quickly give you an an insight into the quarter gone by followed by highlights of the financials and thereafter we will be open for question and answer session.

So, if you look at our performance for the first quarter, it really demonstrates a continued momentum in the business that we have built up in the last 10 to 11 quarters. In fact, our strategy of having multiple growth engines has really played out very well in this very challenging environment. Our business has grown at a little over 22% on a constant currency basis in the period. Our growth is led by our API business which has grown at 46%. This is on the back of increasing penetration with the top 10 customers and also the top 10 products that we have in the animal health industry. Formulations on the other hand have grown at 14.6%. This has been driven by a sharp recovery in Turkey which grew over 82% on constant currency basis. The formulations performance was also bolstered by strong growth in both LATAM and emerging markets which grew at 22% and almost 10% respectively. However, EU, our largest formulations market declined by 2.8% during the quarter partly due to Brexit confusion which continue and also compounded by the inclemental weather conditions that prevailed in Europe.

Our revenue for the quarter was Rs. 278 crores compared to Rs. 235 crores for the corresponding quarter last year with an operating profit of Rs.38 crores. This reflects a 54% increase over last year. Our operating margin at 13.9 was about 330 basis points higher than the previous year and our net profit for the quarter stands at almost Rs. 12 crores, about 3.5x compared to last year.

As mentioned earlier, on the formulations side, we have seen robust growth across Latin America, Emerging markets and Turkey. In Europe, we continue to monitor the situation closely and it is our expectations that we should get back on the growth track in the second half as some of our new product launches start compensating for the general decline that the market is witnessing. You would appreciate that there is a bit of seasonality in formulations business across various geographies and Q2 tend to be slow in Europe and in Turkey due to holiday season. However, we expect strong bounce back in Q3 and Q4 because generally the environment is condusive across all the markets.

On the currency front, while we have benefited from the rupee decline against US dollars in our API business vis-à-vis same period last year, rupee has actually appreciated against all other major local currencies where we operate in our formulations business be it Turkish Lira, EU or Brazilian Reals. We have also started our operations in France and Italy and expenses pertaining to these operations have started hitting our P&L. Needless to say, building of commensurate revenue will take some time given the branded nature of our business. While we expect Italy to breakeven in the second half of the current year, we shall continue to lose money in France for some time. We have also completed our key hiring in US which is for the business manager, the leadership position in the period. He is expected to join us probably in another quarter's time.

On the API side, we continue to expand margins through focus on regulated markets and/or customers and also high value products and therefore are confident of delivering 400 crore plus API business for the year. We continue to make some progress in our R&D program both in API and formulation business and are on track to deliver our strategic objectives which will have significant impact on our financial outcomes starting from latter half of FY21.

In the current environment our focus on financial discipline continues unabated and is delivering rich dividends especially given the tight liquidity. All our balance sheet ratios continue to improve with the key ratio net debt to EBITDA now down to 1.67 on a Q1 annualized basis. More importantly, adjusted for the liquid investments that we have, it is actually lower at 0.66. We now have established banking relations in Europe and will be able to drive down our interest cost going forward leveraging European borrowings.

To conclude, we have started Q1 on the right note and we stay committed to deliver both the strategic and financial objectives that we have set ourselves for the current year despite an increasingly challenging environment both in India and globally. With these few words, let me open the floor to question and answers.

Moderator: Sure. Thank you very much. We will now begin with the question and answer session. The first question is from the line of Allankar Garude from Macquarie. Please go ahead.

Alankar Garude: My first question sir is on the capacity utilization in the API business. If you could give that number and also can you just comment on the peak asset turns in this business which we can achieve?

Manish Gupta: Thank you, Alankar. Basically if you look at current capacity, we certainly have adequate capacities to deliver the outcomes that we have forecasted for the current year and potentially also for part of the next year. Having said that, building up capacities always takes time. So, we will be initiating some additional work for incremental capacity which will help us facilitating the growth from latter half of FY21. Coming to asset turns, I think on a fixed asset basis, we are already above 2. My guess is we should be able to nudge it to about 3 levels on a fixed asset turn basis on current capacity and current product mix basis.

Allankar Garude: Sir my second question is on the formulation business growth. Now, it has been in around mid teens in this quarter and you have shared your guidance for FY20 for the entire business as well. How should we look at the formulations business growth going ahead maybe if you could just comment more from a 2-year perspective that would be really helpful?

Manish Gupta: So, Alankar, as we have been guiding that we are looking at low to mid teens growth in our formulation business in the medium term. This is a collective outcome of various geographies that we operate in,before the growth accelerates from second half of FY21 or early FY22 because that is when really the valuable products that we are developing on our own will start commercializing in US which is clearly the best price market in the world. So, clearly the game changer as far as the formulation business to move us from mid teens to a faster growth will be the launch in US. We should be doing our first filing in US in next couple of months. As I mentioned, we had done our first hiring in US. These are all critical building blocks for facilitating or translating growth in US going forward. So, that is the broad perspective as far as formulation business is concerned.

Allankar Garude: One final question from my side. Now if you look at EBITDA in this quarter 38.5 crores and about 11-12 crores of PAT, do you expect the EBITDA to PAT conversion to improve meaningfully going forward and if yes, then what would be the key drivers going forward because you mentioned about CAPEX possibly increasing perhaps in the second half of FY21. So, any comment on that because this can impact your depreciation and perhaps interest as well.

Manish Gupta: So, let me give you two perspectives here. One is if you look at our middle line, it is largely fixed. So, our depreciation numbers and interest numbers are not going to change very significantly. They will probably go down as far as interest is concerned and the depreciation may marginally inch up. So, therefore any increase in EBITDA will actually flow into increase in PBT and net of taxes will flow into PAT and net of minority interest. Also, we have been very clear in our expectations around that both of them will account between 15% to 20% as far as the respective numbers are concerned. Now if you look at the CAPEX which I am guiding to, these are not very significant CAPEX. These are balancing CAPEX because all our physical infrastructure is already built for potentially about 3x of our current outcomes. So, all, we will be adding is balancing equipment to optimize capacities. These are not very significant CAPEX and would be within the framework of the numbers which we have been guiding.

Moderator: Thank you. The next question is from the line of Sachin Kasera from Lucky Investment Managers. Please go ahead.

Sachin Kasera: Two-three questions. One, a small correction in the gross margins around 40 basis points and in your presentation mentioned that in case of API, we have seen better pricing. So, is it that on the formulation front, we are seeing some pressure on the margins?

Manish Gupta: So, certainly on the formulation side, there was small pressure in margins. As you would have seen that there was a decline in Euro, you would also appreciate that the Euro has declined against the dollar. So, lot of purchases in Europe are made in dollars especially for the APIs that come from China. So, there has been that hit as well. So, certainly in a broad sense while our overall margins have improved, the formulation margins did suffer in some geographies partly compensated by other geographies.

Sachin Kasera: So, how do we see the trend for the remaining quarters sir, do we see the gross margins further improving or they will remain at where we have seen in the first quarter.

Manish Gupta: While very difficult to predict on a quarterly basis especially in the current volatile scenario of currencies that we are foreseeing, but all in all we do expect an improvement in our gross margins at the end of the year as also our EBITDA margins in line with what we have been kind of guiding the market to.

Sachin Kasera: Sir secondly you mentioned that there has been some impact in EBITDA because of the cost towards Italy and France. So, if you could quantify what was the impact in the EBITDA and secondly, what is the revenue potential from these geographies going ahead?

Manish Gupta: Sachin, the numbers on the additional hit coming out of France and Italy is about a crore, but I do not have the financial forecast readily handy about these businesses which I can share with you separately.

Sachin Kasera: And sir this one crore cost will it increase going forward or this is the sort of fixed cost where it should stabilize?

Manish Gupta: It will increase marginally certainly to some extent, but having said that as I mentioned, we expect Italy to breakeven in second half. France will continue to lose money at least for another 12 months. Net-net, I would not see a significant change.

Sachin Kasera: Second question was regarding the balance sheet. Despite healthy cash profits, the net borrowing as we see has gone up by around 12 to 13 crores. So, will you be able to comment a little bit on that?

Manish Gupta: So, if you see, it is backed by working capital increase and you would also notice that there has been a sharp uptake in Turkey business during the quarter. And if you know structurally Turkey is our highest working capital intensive business simply because their collection cycle is through the year and it is not a consistent cycle. So, it is not a standard 60 or 90-day credit period. There, you keep selling and collect it in the latter half of the year. So, it is all timing impact and nothing more than that.

Sachin Kasera: And sir finally on the tax rate, if you can comment a little bit?

Tushar Mistry: So, tax rate as we have been guiding in the past will be in the range of 15 to 20% of PBT and that is where it is for the current quarter.

Moderator: Thank you. The next question is from the line of Vishal Manchanda from Nirmal Bang. Please go ahead.

Vishal Manchanda: On API side, what is the incremental CAPEX, can you quantify that will be required?

Manish Gupta: So, it will be in the region of 25 to 30 crores spread over 2 years.

Vishal Manchanda: And what is the maximum effect on that you can achieve in the API business?

Manish Gupta: I do not think I am the right person to define that, but clearly from our own angle, certainly the incremental CAPEX will deliver a better asset turn always because there was initial CAPEX on land. We are very confident of delivering 3 asset turn in the medium term. In the long run, I honestly do not know. I expect it to improve further, but very premature to comment on how much.

Vishal Manchanda: In the current quarter, the revenues were around 90 crores. So, about 10 crores lower than what it was in the fourth quarter, but in subsequent quarters can we expect you cross the 100 crore run rate and do better than that?

Manish Gupta: So, as I mentioned in my opening remarks, we are very confident of delivering a 400 crore plus full year for API business in the current year. You have to be mindful that this is a B2B business. There is always some orders shifting from one quarter to other, but all in all we are moving in the right direction and very confident of 400 crore plus for our API business.

Vishal Manchanda: On the formulation side, what percentage of revenues is from injectable now?

Manish Gupta: See, we have two types of injectables, some that are produced at our own facilities in Germany and Turkey and some which we outsource from other parties both in India and outside India. Collectively, injectables is a very important part of animal health business and while I do not have a precise number, my very rough estimate would be between 40 to 50% of our formulations business would be coming out of injectables.

Vishal Manchanda: This would be largely share in Turkey, primarily larger part of this would be Turkey?

Manish Gupta: No, not only Turkey, even in India we sell lot of injectables. also, obviously Bremer is also significantly injectable, but even in markets like Spain and Benelux where we do not have our own manufacturing, we sell a lot of injectables which are outsourced from other parties.

Vishal Manchanda: And in terms of your product formulation business, so you have your own manufacturing and you also do a third party distribution right. So, what would be the third party distribution component of the business?

Manish Gupta: Third party distribution collectively would be about 10 to 15% of our formulations business.

Vishal Manchanda: And this would be a low margin business, is that right to assume, lower than the own manufactured product?

Manish Gupta: Vishal, I think once you understand the animal health business, you will realize that the power is in the last mile connectivity with the customer and not so much in manufacturing and you will be surprised to know that actually the third party distribution business or I would call sales and marketing business is more profitable than our own manufacturing business and that is true for all animal health organizations.

Vishal Manchanda: Currently, that is just 10% to 15% of the total formulations business?

Manish Gupta: Yes.

Vishal Manchanda: You are trying to build this up?

Manish Gupta: You do not want to be totally reliant on that because there are certain risks associated with third party businesses. So, you have to have right blend of profitability and also how do you control the value chain. So, we are certainly not going to run away from that business, but as a percentage to sales we do not foresee an increase.

Vishal Manchanda: So, the third party products are registrations owned by you or the registrations are owned by company themselves that you market for?

Manish Gupta: So, it will be a mix of both. In some cases, we own the registration and the IP and they are purely manufacturing organization. And in some cases, there will be IP developed by them, but we may own the local brand. The key is that the customer relationship is owned by us and which is what is the most valuable in the animal health business.

Vishal Manchanda: Can you give the overall progress on the injectable filing. So, you just indicated that you had filed in the US. So, you have filed the first products. Where are we in terms of other product filings? How long can we expect the other products also to be filed?

Manish Gupta: So, right now we can do one validation of an injectable every quarter as far as our German facility is concerned. As we speak, we are building in more capabilities there because finally we have to optimize commercial requirement versus R&D requirement. So, this is work in progress, but as far as current status is concerned, our capacity is one validation per quarter.

Moderator: Thank you. The next question is from the line of Dushant Kishan from Sage One. Please go ahead.

Dushant Kishan: My question is about your filings in the United States. So, couple of conference calls ago, you said that it cost about US $455,000 to file one patent and if you are planning on filing 20 plus patents in the next 3 years, that is about 10 million dollars. How do you plan on paying for them? Are you able to generate free cash flow?

Manish Gupta: So, certainly what you are saying is the biggest bottleneck as far as US is concerned and couple of clarifications. What we are referring to is filing fees for a product and not for a patent. We are not in the patented space. We are filing ANDA equivalent which is called ANADA in animal health industry. The clear challenge is getting the right blend of the product selection as far as US is concerned and this is where we are treading carefully and cautiously as our business outside US is ramping up that is certainly providing us more headroom for filing in US and one thing which is very interesting in US is of course the fee payment for ANADA is not necessarily at the time of filing, but at the time of approval and we certainly will be leveraging that aspect extensively to our benefit. So, to that extent, the cash outflows are deferred and therefore I do not foresee any challenge in our capabilities.

Dushant Kishan: So, you are saying that you only have to pay for the ANADA at the time of approvals?

Manish Gupta: That is correct.

Dushant Kishan: You are pretty confident in being able to do that once the approvals come through that is what you are saying?

Manish Gupta: Not only that, that is more a cash flow management issue. You do not have a choice not to pay once the approval is through. But having said that if you see our cash flows and the way business is ramping up and the contribution which our incremental business will generate is good enough to be able to handle these cash flow requirements of the business because our CAPEX otherwise is very limited.

Dushant Kishan: And the commercialization, so you said in Europe you have already started commercialization in Italy and France, what about in the United States?

Manish Gupta: We are about 2 years away or at least 1.5 years away from our first commercialization in US.

Dushant Kishan: So, we should say by FY22?

Manish Gupta: That is correct.

Dushant Kishan: And you said that the marketing team is set up in the United States.

Manish Gupta: No, we have just done a first key hiring which is the business manager because we need to do lot of strategic groundwork before we start our first commercialization and again as usual in pharmaceutical business, we have to invest way ahead of the time and there are no shortcuts in that sense.

Moderator: Thank you. The next question is from the line of Arif Ali from First Global. Please go ahead.

Arif Ali: My first question is on this promoter pledging thing. When do you expect this to be de-pledged or what is this sort of forecast on that one please?

Manish Gupta: Arif, I think we are a unique company wherein promoter has no role in the running of the company not even on the Board of the company. So, this is a question which has to be addressed at a promoter level and not at the management team level. We are happy to answer anything pertaining to the business, but shareholding is something which we neither control nor influence and that is the way it will stay.

Arif Ali: And the other question is you are on the production animal side, do you see this synthetic meat which is produced in the labs as a sort of credible long-term threat?

Manish Gupta: It is very difficult to answer this but my personal view is I do not see it as a credible threat at all and like with all genetic food, people discover side effects over a period of time. Having said that even if it were to become a credible threat, it is not like EV vehicles and cars which will kind of transition out, change the world very quickly. This is something which will take time. The animal protein is not very expensive for people not to be able to afford it. So, I do not foresee it as a big threat really, but that is a very personal view. I have really not applied my mind in a very strategic perspective in this space.

Moderator: Thank you. The next question is from the line of Prashant Hazariwali who is an individual investor. Please go ahead.

Prashant Hazariwali: I have a question regarding API. Actually you said that we have good margin on this API. So, is this margin sustainable going forward?

Manish Gupta: Again, I want to highlight our differentiated model which is only focused on regulated markets and regulated customers and my definition of regulated business is where the customer cannot negotiate prices so easily. So, obviously while there is always an ability to negotiate, but can they negotiate on a order to order basis, that is how I determine our quality of business. So, I do not foresee any challenges per se in sustaining or actually improving our API margins going forward because what we are seeing is just the beginning of the efforts that we have put in last 3 or 4 years. Some of which have fructified and some of which is yet to fructify.

Prashant Hazariwali: We have a vision of Rs. 2000 crores of turnover and 20% of EBITDA, you think we are on the track, by 2022?

Manish Gupta: As I have been always saying, we will be very disappointed not to outperform those targets.

Prashant Hazariwali: Okay. And what about the CAPEX for next two years?

Manish Gupta: Collectively between maintenance CAPEX and incremental CAPEX, we have broadly two areas of incremental CAPEX. One is at the injectable facility in Germany and also in our API business in Vizag. But collectively put together, it won't exceed 30 crores per year.

Moderator: Thank you. The next question is from the line of Sarvesh Gupta from Maximal Capital. Please go ahead.

Sarvesh Gupta: Sir, first question is, I think on the formulation side in the past two quarters at least we have been having some sort of softness in the growth numbers and you have attributed that to Brexit. So, what is the guidance in terms of how early can these trends change and we can go back to a possibly higher growth number on the Europe side?

Manish Gupta: To be candid, I don't have an answer for you because we are as clueless about Brexit as many others are. I don't have a view nor I want to form a view because honestly we have no ability to influence that outcome. Markets are tough. Lot is happening, trade wars, so many things are happening. I think the beauty of our model comes from having multiple growth engines. So, while we have some view on every market and some budget for every market, what we have been able to display over last 10 to 11 quarters is, while not everything performs according to our expectations, but we are still able to deliver broadly the outcome that we are looking for only because of multiplicity of our growth drivers.

Sarvesh Gupta: Okay. Secondly, on one of the questions which was asked was on US filing related cost and I think what you said was that you have to pay the filing fee of 400,000 USD per filing only when your filing is approved. So, only when your filing is successful, does one need to pay the fees. Is that understanding correct?

Manish Gupta: Yes. That is the understanding that we have. And this is only for animal health products. I am not referring to human health products.

Sarvesh Gupta: So, then in a way it is a sort of a lucrative proportion because you can file as much as you can and only when you will get your filings approved and hence you will see some revenue visibility out of them, the revenue required to pay the fees. So, in that case, it is not sort of a barrier of entry to anybody, in this case yourself.

Manish Gupta: $454,000 is not a small number even for big human pharma companies, forget animal health. You have to also link it to the commercial worth of the product. Every animal health product is a section of a human health product, while the fees structure is double that of human pharma product. So, moment you establish that context, that there are only 9 products worldwide which are 100 million plus and most products are less than $10 million and $20 million opportunities. Then suddenly this fees becomes very considerable or significant and your ability to go wrong diminishes. So, if you file one or two bad products, I think you can get into serious financial situations. On standalone basis, $454,000 may not appear that high, but the risk associated or the IRR or the payback period are fairly challenging.

Sarvesh Gupta: So, what will be the typical IRR or the payback period that you will be looking for when you file these cases?

Manish Gupta: I don't want to disclose that because clearly it is for me a fairly strategic value driver for us. So, I would not give out those kinds of numbers.

Sarvesh Gupta: Understood sir. And sir one more thing, I think because of IndAS there were some leases which were above EBITDA line and now they are below EBITDA line? So, what is the sort of impact in terms of better EBITDA margins for us?

Manish Gupta: I will have Tushar respond to that.

Tushar Mistry: So, the impact on our profitability is minimal. There is in fact no impact on the profitability and that is what is given in the notes as well. So, overall as far as profit and loss is concerned, there is no impact but you will see some impact on the balance sheet side which has been disclosed in the investor communication, slide 13.

Sarvesh Gupta: Understood. And final question sir, again on slide 13. You have given the ROCE number and it is nicely scaling upwards every quarter. By when can we expect it to move to a 20% sort of a number? Any guidance on that?

Tushar Mistry: I think if you go through the guidance that we have been giving and also do the maths around it you will have the answer. I will rather let you do that math and rather than me giving you the answer.

Moderator: Thank you. The next question is from the line of Vipul Shah from R.W. Equity. Please go ahead.

Vipul Shah: Sorry, I missed the previous question where I believe you said that EBITDA reported is comparable and there is no impact of AS 116?

Tushar Mistry: No, significant impact is what we are saying.

Manish Gupta: See, as has been mentioned on the notes to our accounts, obviously there is some impact but it is minimal. There is no material impact as far as the P&L is concerned, but on the balance sheet side there is an impact and that has been set up on slide 13 of the investor deck.

Vipul Shah: That I got sir. Sir, on the earlier question you mentioned about the Italy and France number. So, that one crore is a consol number for both and is it a quarterly number?

Manish Gupta: That is correct.

Vipul Shah: And finally sir, from an ROE perspective, do you have any aspiration of reaching the mid teen ROE or shall I put it sir, do you have any ROE target for this year?

Manish Gupta: I think all of us have done fair bit of finance to know what are the good ROE targets. We also aspire to be there. If you do a maths, as I have been telling, even on ROCE same holds good on ROE that if you build up the model over the next few quarters, you will hit the right numbers that you aspire and what we aspire. I would say there is no difference in your aspiration from us and also our aspirations from ourselves.

Moderator: Thank you. The next question is from the line of Sachin Kasera from Lucky Investment Managers. Please go ahead.

Sachin Kasera: Yes sir, just a follow up on interest in finance charges, so while you mention that there is an increase in debt mainly because of the higher revenue from Turkey so commenting specifically on quarter to quarter say for the full year do we see debt going down compared to last year or we should see some net-net increase?

Manish Gupta: While Tushar will answer more specifically, I don't foresee any net increase in our debt. It will be slightly going down or staying about here. Only small dip in the long term debt will be offset by maybe marginal increase in the short term borrowings which are related to working capital.

Tushar Mistry: So, just to answer that more specifically, we are having healthy cash generations happening now which will definitely aid towards reducing the debt in its normal course of time. But having said that we may have some investments happening on the CAPEX front which as Manish mentioned are not very significant numbers but we may look at funding those through long term loans and that is where we see the debt numbers remaining constant, may not go down significantly it will remain more or less constant.

Sachin Kasera: Sure. And in the intangible asset, the increase is primarily because of the IndAS or is it that there are certain subsidiaries where we have increased our stakes that is why the intangible has gone up this quarter, vis-à-vis March quarter?

Tushar Mistry: No, it is purely because of IndAS 116.

Sachin Kasera: And this increase in depreciation from 11 to 12 Q-o-Q is also because of IndAS or that is because of capitalization of certain assets?

Tushar Mistry: Mostly for IndAS.

Sachin Kasera: And sir last question on this Turkey, you mentioned that we had a very healthy, very strong in fact number in the Turkey. So, is this now a normal, I believe last 4-5 quarters Turkey has been impacted by various quarters**.** So, is this now a more stable run rate kind of basis or is there still some catch up to do before we get to the normalized run rate in Turkey?

Manish Gupta: No. If you look at, see we have been guiding towards a 100 Turkish lira business over a 12-month period and we are well on track of that. Having said that there is some element of seasonality especially in Q2, because Q2 is when Turkey has two Eids, one is the Ramadan Eid which has already gone by and also the Bakri Eid, that is where there are significant holidays.

So, therefore Q2 will certainly be lower and that is a historical trend. Otherwise we are well on track of delivering the financial outcomes that we had set for Turkey for the current year.

Sachin Kasera: And sir this Europe when do we see, to start see some traction, some of the issues will take another 1 or 2 quarters or is it like this year again it is going to be very muted for Europe?

Manish Gupta: See, Europe historically is a muted growth market. I mean that is the nature of the market. 1% and 2% growth is seen as a decent performance typically in that market. Having said that we have been growing in double digit for last two years, since the time we forayed into that market. This has slowed down this year. There are multiple things happening, one there is a Brexit confusion, two, there is poor weather which is spread to big part of Europe and animal health industry specially production animal health is fairly dependent on weather condition. And the third is of course the Euro depreciations against not only INR but also the USD. And one thing unfortunate about EU business is, by design is that they do rely on China for API supplies and they are exposed to Euro Dollar conversion. So, all three have gone against the EUo part of business for the current quarter and maybe for last 2 quarters I see foresee pressure to continue for one more quarter before things improve, but certainly at the end of the year I expect a positive outcome in Europe and not a negative outcome.

Sachin Kasera: At least can you see a mid-single digit because this quarter is like 2%-2.5%, so can we for the full year at least look at like 6%-7% growth or you think that will also be a challenging number to look at full year?

Manish Gupta: See, if you would have asked me this question 3 months back I was very confident of that single digit number. But if you were to ask me today, I am not so certain because clearly the environment is not conducive as much as I would have liked it to be. Having said that given our multiple growth engines, even this growth is 2% less, we are very confident of delivering the financial outcomes irrespective.

Sachin Kasera: Sure. And sir lastly on the R&D, what is the budget for the R&D for the full year?

Manish Gupta: We do not disclose that information. It is highly proprietary.

Sachin Kasera: How much did you spend last year sir, that must be something you can…?

Manish Gupta: Same answer please.

Moderator: Thank you. The next question is from the line of Vishal Manchanda from Nirmal Bang. Please go ahead.

Vishal Manchanda: I just want to understand, looking comparing last year EBITDA, Q1 FY19 to Q1 FY20, the incremental growth in EBITDA, could you guide on what percentage of that incremental growth in EBITDA would have come from the growth in the API business versus the formulation business?

Manish Gupta: Vishal, we won't be able to share this information. Again, highly proprietary and confidential for us.

Vishal Manchanda: Okay. It seems like large part of that is from the API business and the formulation business gradually is not contributing to incremental EBITDA, that is the sense…?

Manish Gupta: Again I won't like to comment on that. For us, both businesses are extremely valuable. Sometimes from a outsider perspective API becomes questionable or sometimes formulations become questionable, for us both are very valuable businesses and our important growth drivers. So, I don't kind of evaluate the businesses in the way you are evaluating but yes, both are equally important is all I can say.

Vishal Manchanda: See, I have an hypothetical question. Assuming that you stop, you don't invest incrementally in new products and new geographies, at what scale of your existing formulation business would you achieve high teen EBITDA margin? Can existing formulation business scale up to new proportions?

Manish Gupta: Certainly, it is a matter of how fast you can grow. If you don't have new products and new things then you may be growing a bit slower than normal growth that you can expect without that. So, it is a branded generic business, you only gain market share gradually and that is what you will do if you do not introduce new product. If you introduce new products, your growth will be only accelerated.

Vishal Manchanda: With your current investments in France and Italy, at what scale can you reach in the next one year in these two geographies?

Manish Gupta: I think I have mentioned in one of the questions earlier, this is something I don't have hand and I am happy to welcome you to our office with more specific information. Having said that both markets are very important. France is the largest market in EU as far as animal health is concerned. Italy is probably the third largest, so they are very important and strategic market in our strategy.

Vishal Manchanda: Could you give a number on how many filings you would have done in France?

Manish Gupta: Again that is not possible to share, we have a blend of distribution and own product model as far as France is concerned which will start playing out from next year. But I won't be able to share specific numbers.

Vishal Manchanda: Okay. When you say distribution, you were in a stage of developing a front end. So, even without a front end you have been able to get distribution right for third party products?

Manish Gupta: Yes. Because, see these are companies for whom we already sell their products in other parts of Europe.

Moderator: Thank you. The next question is from the line of Sarvesh Gupta from Maximal Capital. Please go ahead.

Sarvesh Gupta: Sir, you said that in the formulation business the end part of the chain which is customer focus is the most valuable, so that is where the most value lies in the value chain. So, I wanted to ask you two questions. One is what percentage of products sold by you are manufactured in-house in case of formulations?

Manish Gupta: I think I roughly answered this question a bit earlier that between 10% to 15% of our formulation business would-be third-party distribution kind of product. Rest everything is largely manufactured by us.

Sarvesh Gupta: Okay. And the second question is, in the formulations business, what percentage of our sales come from selling it to the parties who are doing the end customer sales. So, basically we not doing the last leg of the sale process?

Manish Gupta: That is zero.

Sarvesh Gupta: So, everything in our formulation business is ultimately sold to the end customer?

Manish Gupta: We are not in the CMO kind of model as far as formulation business is concerned. Certainly our API business goes to our formulators but formulation business is where we are selling to the end customers.

Sarvesh Gupta: And not to the distributors, like for example in case of human pharma in the US, most companies in India would be selling to distributors in the US and that is a very concentrated play for the distributors, I think. So, are we also selling to such large distributors mostly who are then distributing it further through retailers?

Manish Gupta: Certainly we sell through distributors, but you have to bear in mind that this is branded generic industry and not generic like human pharma. So, in human pharma you don't have to create demand. While in animal health I have to create demand for my products. So, distributor is just to make product available in that market. But demand is generated by us and that is how the demand is fulfilled through the distributor. So, it is like branded generics in India, in human pharma. So, somebody prescribes the Sun Pharma product there will be a stockist and a retailer who is making it available. But they are not influencing the demand per se.

Sarvesh Gupta: So, then in a way you are also influencing the veterinary doctor etc. who is writing on the prescription, your products brand name?

Manish Gupta: Absolutely and that is the most fundamental difference between animal health and human health around the world. The animal health industry operates like India's human health industry around the world. You need field force, you need to go and generate demand. There are very few products under patent. So, everything is done exactly the way you generate a human prescription in India.

Sarvesh Gupta: Okay. So, then your business would be similar to let us say, I don't know maybe an Eris pharma which is only doing domestic and doing a lot of brand generation through the doctor channel?

Manish Gupta: Yes. In a way yes. But of course, Eris does it in India, we do it in multiple geographies.

Sarvesh Gupta: Understood sir. Is it possible to share sort of marketing expense on your formulation side?

Manish Gupta: That will again be highly proprietary.

Moderator: Thank you. We will take the last question from the line of Vishal Manchanda from Nirmal Bang. Please go ahead.

Vishal Manchanda: Just a follow up to the previous question on the distribution norm, just wanted to understand whether are these retail pharmacies that we have procured from or whether they are sold by the distributors to the animal farms, how is it structured?

Manish Gupta: I think it will be a mix of both based on the customer, obviously smaller customers will buy from retail pharmacies and the larger customers will get service in a more direct way. So, market to market, country by country this will be slightly different and how each market behaves is slightly different. But broadly what you are saying is correct. That it will be small customers will be through retail pharmacies and large customers will be directly serviced.

Vishal Manchanda: And would your sales be largely coming from the large farms, animal farms or it is again case by case basis?

Manish Gupta: Yes, it will be case by case basis. We certainly are going to be more retail than more institutional.

Moderator: Thank you very much. That was the last question. I would now like to hand the conference over to Manish for closing comments.

Manish Gupta: Thanks once again to all for taking time and joining us. As we have been mentioning we have been building on strategy through very intensive execution. I was discussing with our team earlier that we are kind of becoming boring (due to execution focus) but somebody said today boring is something now looked down upon. So, we are very happy to be in the space we are. Strategically we have been progressing each quarter. Some of the financial outcomes have just started and as management team we are very confident of delivering, not only our outcomes for the current year but also for the foreseeable future. Thank you once again, thanks for your time and patience.

Moderator: Thank you very much. On behalf of Sequent Scientific Limited, that concludes the conference. Thank you for joining us, ladies and gentlemen. You may now disconnect your lines.