"Sequent Scientific Limited
Q4 FY2019 Earnings Conference Call"

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Moderator: Good day, ladies and gentlemen and a very warm welcome to SeQuent Scientific Limited Q4 FY2019 earnings conference call. As a reminder, all participant lines will be in the listen-only mode. 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 "*" 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: Very good afternoon and thank you for joining us today for SeQuent Scientific earnings conference call for the Q4 FY2019. 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 "Result Release" and the "Quarterly Investor Presentation," which have been uploaded on our website as well as stock exchange website. The transcript for 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 an opening remark.

Manish Gupta: Thank you Abhishek. Good afternoon everyone. Thanks for joining us for this call. As Abhishek mentioned, I have Sharat our Joint Managing Director and Tushar our CFO with me for this call.

I will give you a very quick overview including some of the highlights of our performance for this quarter and the year that has just gone by followed by Q&A session. So, if you take a step back, at the beginning of the current fiscal we had committed to a high teen revenue growth and the EBITDA improvement of close to 200 basis points.

It is a validation of our unique business model as also our execution capabilities that despite the headwinds in Turkey which suffered both regulatory and currency headwinds for a large part of the year and also supply chain challenges in the Eurozone especially in light of the Brexit uncertainty we ended the year with the revenue of over ₹1000 Crores at ₹1040 Crores, this reflects in a growth of 22% over last year and our EBITDA margin improved by a over 250 basis points of 12.8% with a five and half times growth in our profitability over last year.

All of us are aware that any strategic investment in pharmaceutical business has a gestation period of close to 5 years. We made our strategic investment in Vizag in 2014 and I am happy to state that the current year performance is a strong validation of this investment. The key driver for the revenue growth for the current year was from our API segment, which grew a lower 48% on the back of increasing penetration with our top 10 customers. This quarter also marks a milestone of SeQuent achieving over 100 Crores revenue from our API business for a single quarter alone.

From a geographical perspective, we saw a second product commercialization in US, as also saw a small beginning in Japan with registration of two products. On formulation side, our business grew a over 14%, which was actually way ahead of the industry growth rate. The growth could have been better, but for the headwinds in Turkey that I explained, which was on account of regulatory and currency matters. In constant currency terms actually, Turkey did reasonably well and grew at 7% and we expect a much faster growth this year, much more than double digits.

Our Turkish facility also received EU GMP during the current year. Further West Europe had supply chain challenges especially in the second half partly on account of Brexit and also because of API shortages that were prevalent in this industry. Our European business grew at 7% slightly lower than our expectations, but well ahead of the industry growth rates, driven by 18 new launches during the year. Strategically, we have strengthened our investments quite sharply in new product development over the last two years and this is something we believe will drive growth in the future.

Again, as I pointed out any pharmaceutical investment has a long gestation period and our NPD development in formulation side just started 2 years back. We have significantly scaled our capabilities during FY2019 with the addition of an injectable manufacturing in EU, which is the Bremer facility and also expanding our formulation R&D capabilities both in India and Spain. Strategically, we have designed our business around multiple pivots of growth ensuring that the corporate outcomes are not compromised in the event there is strong headwind in any part of the business.

We have also bolstered our leadership team with the induction of the Mr. Sirjiwan Singh who has managed a very successful injectable business over the last 15 years. He has joined us as Head of our Technical Operations and will provide strategic insight into our injectable business as we take it to the next level.

We also are in the process of inducting a key leadership position in the US market because that would be one of our significant growth drivers from FY2021 onwards. We believe a capable and robust management bandwidth is one of the key determinants of our ability to deliver robust performance as committed and pride ourselves with the global management team that we have built.

The pipeline in the formulations segment looks robust with over 35 products at various stages of development. The stage is set for 20 new filings in the regulated markets over next 3 three years with approximately an addressable market size of a over a billion dollars. Feather in our cap for the current year has been the validation of the world’s largest injectable product at our Bremer facility, which is one of the handful of products in the animal health segment with sales in excess of $100 million.

Lastly, a quick word on our financials and balance sheet; what you see today is a result of years of financial and operational discipline. All ratios are improving as we benefit from scale. Our asset turnover ratio is now close to 2 and our net debt to EBITDA is down to 1.8 on an annual basis and in fact 1.5 on a Q4 annualized basis. What is also heartening is our cash flows from operations, which we were a over 115 Crores for the period more than double of last year.

All of this has resulted in an upward revision of our credit rating, which has been obviously from a credit rating perspective this has been a very challenging period for many companies. We actually got an upgrade in this tough environment to A minus. All these developments do provide us the necessary impetus to approach FY2020 with continued optimism and rigor. We believe that we can maintain the revenue momentum in the current fiscal while improving the margins by another 200 basis points.

To conclude our performance in 2019 and our visibility for near term does give us the confidence to emerge as a global player in the animal health space in the medium term. With those few words let me throw the floor open for Q&A.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Vishal Manchanda from Nirmal Bang. Please go ahead.

Vishal Manchanda: Thanks for taking my question. Just on the formulation side, emerging market has been one of the best performers for Sequent this year, what are the drivers for this segment?

Manish Gupta: Vishal, thank you for this question. Basically, if you look at animal health business, it is a branded generic business and you need time to build up this business. What you are seeing in the emerging markets is again fruit of what we put in 2 years back, so we have been working on multiple products registrations and also building up ground footprints in some of the key markets that we had targeted, some of which has started delivering this year and that is what you see as an outcome in terms of the growth rate that you see.

Vishal Manchanda: Which are the largest geographies in EM, Is India a bulk of the emerging markets or there are other important markets?

Manish Gupta: There are multiple important markets within that space both in South East Asia, in parts of Africa.

Vishal Manchanda: How much that could be India in emerging markets?

Manish Gupta: Less than one-third of this emerging market will be India.

Vishal Manchanda: Another question during the year, there was a 220 basis point improvement in the gross margin, while if we look at the EBITDA margins they have improved 250 basis points, so it seems the operating leverage is not too much because what one would have expected is the gross margin of 220 BPS improvement yielding into much better improvement in EBITDA margin, but that never happened, is it because you are investing into new geography that has diluted the potential improvement that has happened?

Manish Gupta: You are absolutely bang on as far as this observation is concerned. In any business you need in the way I look at business is 80% has to be stable operations and another 20% would be growth operations. So every year we get into certain territories like last year we launched Alivira France. In any branded business you will lose money for initial period. Same is the case on R&D formulations. We have significantly scaled up our R&D investment especially on the formulation side including doubling of our R&D team, so all these operating costs obviously will go and hit the P&L and are effectively investments for future growth of the business. That is the reason the difference between improvement in gross margins has not fully reflected in the operating margins.

Vishal Manchanda: Could you guide on what could be that, so much we will be moving on an account of your investments in France and scaled up investments in R&D?

Manish Gupta: While I do not have the full year number handy, but in France in Q4 alone we lost close to between €250,000 and €300,000, which is effectively our investment for the future sales because we have setup a field force to drive a business going forward. Similarly, on the R&D front while we come back to you with more specific numbers, but on a broad basis our R&D investments would gone up by close to 40% during the year.

Vishal Manchanda: One more, the Turkish facility got a new GMP approval, so how does that help you in your future business?

Manish Gupta: Turkey enjoys certain privilege relationships especially with the Eastern European markets, which is what we will leverage coming out of the Turkish facility. The Western European markets will continue to be serviced out of Bremer.

Vishal Manchanda: So, that would allow you to basically get revenue from Eastern Europe too?

Manish Gupta: That is correct.

Vishal Manchanda: Currently, you would not be having a large exposure to Eastern Europe?

Manish Gupta: Very limited exposure we have currently. Having said that Vishal, I again would like to reiterate that this being a branded generic business and not a generic generic business, the built up in formulation business in animal health is slow and steady. We cannot expect significant growth in the immediate future.

Vishal Manchanda: So, it will not help immediately, but it is making as a term driver?

Manish Gupta: Every growth engine that we are talking about will drive a growth in the medium term. It does not swing needle individually in a particular quarter and/or particular year.

Vishal Manchanda: Thank you. That is all from my side.

Moderator: Thank you. The next question is from the line of Tushar Bohra from MK Ventures. Please go ahead.

Tushar Bohra: Thank you so much for the opportunity and congratulations to the management for an excellent set of results. Sir, I wanted to understand, you had a good year in terms of API, we had a very robust growth as was guided by the management earlier, how much do you think that the current basis sustainable and whether we can continue to enjoy strong growth on API from here and if you can qualitatively give a little bit more understanding about what is driving this growth in the segment?

Manish Gupta: If you take again step back in what we have been guiding is clearly we had achieved that inflection point as far as our API business was concerned. We almost had flat API sales for 3 years prior to this year and it was only this year onwards as we started commercializing especially in the key market of US, the growth has started. It is also partly accentuated by the current events in China, which has started unfolding over last 12 to 18 months, which has obviously accelerated some of the growth initiatives, which we had been working on. Having said that, we expect our API business to continue to outgrow our formulation business certainly for the next 2 years and our API business should grow at 30% odd over the next 2 years on a year-on-year basis. Having said that, our formulation business while the growth rates looks smaller in terms or in comparison with the API business, but at 14% or little over 14% is not insignificant, it is a fairly significant growth, we expect to maintain mid-teen growth rate on our formulation business for the next 2 to 3 years. Thereafter, we expect a faster acceleration of this business as our new product pipeline kicks in and we get into more specifically the US market, which incidentally like in pharma is the largest animal health market as well.

Tushar Bohra: Sir, you have mentioned about the API growing much higher than formulations, in terms of margins API continues to be a high margin segment for you or is the margin much higher in formulations?

Manish Gupta: If you have asked me this question last year, my answer was different, if you ask me today, probably the answer is different and in one-year time maybe the answer will be different, see in the long sustainable basis both businesses can command similar and good margins. Our API business historically was losing money as we had put up our investment for a high quality asset for regulated markets though our business was in emerging markets that changed in the current year as we commercialized more of our business in US and certainly in the current year our API business has been the key contributor to the improved margins. Having said that, our formulation margins are not poor. They are inline with the corporate margins and as we benefit from the faster product commercialization's coming out of our portfolio they actually will be far more profitable in the years to come compared to the API part of business.

Tushar Bohra: Sir, the 200 BPS improvement in margins overall that you have guided so clearly the operating leverage as you indicated would play out, but is it only operating leverage, is there a specific cost side initiatives that you have taking that yield results, I believe you had earlier indicated some cost saving initiatives in some of the earlier call, so if you can throw light on that and whether is it possible for us to in fact look at higher than 200 BPS improvement as we go along for this year?

Manish Gupta: The current environment is fairly dynamic I would say and therefore predicting the full outcome is very difficult. There are supply chain challenges and when I say challenges every challenge in an opportunity in the world we live in, so right now while we are confident of guiding you towards 200 BPS improvement certainly there are some additional opportunities that come up. We will certainly have a better view of that as we go along. However, in the long-term we are confident of maintaining the 200 BPS improvements not only for the current year, but certainly for the medium terms.

Tushar Bohra: So year-on-year for at least let us say next 2 to 3 years, we think that kind of improvement is possible and they will be reach may be 18% to 20% margin levels that is our fair assumption?

Manish Gupta: Yes, may be even longer than that. We have worked out 5-year perspective and we are confident of maintaining this improvement over 5 years. The benefit we have in our industry is obviously it is a more stable industry vis-à-vis the standard Indian pharmaceutical generics.

Tushar Bohra: Sir, just continuing with the previous question, at a particular scale, what is the kind of optimum margin levels in this business would you say?

Manish Gupta: The industry is too small to be able to give this answer, but I think the operating margins of the industry leaders, so it is good indicator or what a well-managed business can deliver in this industry.

Tushar Bohra: Thank you and just one last question very quickly, if you can give highlight on your M&A strategy going forward? Is there any specific thing that you are still looking at and whether you are happy with the progress that you have made on integration of your recent acquisitions?

Manish Gupta: Strategically, every M&A that we have done thus far has worked or added to our strategy and has delivered the outcomes that we have looked for, some very quickly, some has taken little longer. We will continue to add specific geographies from M&A perspective because that is the only way to fast track growth in certain markets, as I mentioned to you we have done a Greenfield in France and by design we will be losing money, so any Greenfield approach is going to be expensive from a financial perspective, so M&A will continue to be a strategic driver. Having said that, this is an under bent industry, there would be a bit of opportunistic approach also to M&A. Right now targets are markets in US, bits of UK and Australia would continue to be our focus as far as M&A is concerned.

Tushar Bohra: Thank you, Sir.

Moderator: Thank you. The next question is from the line of Alankar Garude from Macquarie. Please go ahead.

Alankar Garude: Thank you for the opportunity. Sir, my first question is on the US, on the formulation side, can you just help explain, how the market is likely to play out as far as US formulations are concerned may be not in the near term, but more from 3 to 5 years' perspective?

Manish Gupta: Just like human pharma, US is obviously a very important part of animal health business. It accounts for almost 40% of the global animal health market. It is also very limited competition market in a way. So, unlike human pharma wherein there are 100s of companies, there are very few companies in animal health. Again, it is a highly consolidated distribution structure, 3 companies account for more than 90% of the distribution as far as this market is concerned. The prices that prevail in US are shocking, I mean they are kind of a multiple of prices that prevail in

EU and/or in the other markets, so there is no way you can ignore US as far as this market is concerned. Having said that, the entry barriers in US in this market are very high starting with the filing fee. Every ANDA in US cost $425,000, which is almost double than typical ANDA fee. Now, for a market, which is much smaller it obviously is an exorbitant cost, so you have to be very careful and have a calibrated approach to US. It was for this reason we had gone slow in US till we really got our strategy right. At $425,000 as filing fee, you cannot really file too many misfiring products, so we have to really identify right products for filing, which is what we have done in last 2 years, our first product validation is completed, which I mentioned in Bremer facility, we should be filing that in the next quarter and that would be the beginning of our US generic. We hope to have an organization in place in US organically during the current year as we start preparing ourselves for commercializing our first product in FY2021. Having said that, if there is a right opportunity for acquisition we will certainly go for it.

Alankar Garude: Understood Sir. That is really very helpful. Sir, my second question is regarding the pipeline of 35 plus products, which you have given in your PPT, globally 19 products, EU 14 and US only 2 products, so can you just help us understand as to what are the timelines you are looking at as far as these products are concerned, which amongst these products are likely to be the key ones, not specific names, but more from a geography wise, if you could just give some idea as to what is the market opportunity split between EU, global and these US only products?

Manish Gupta: Alankar, this will entail a lot of engagement and my request to you is if you come over and we can spend time on this because again animal health does not have IMS kind of information, so we have done a lot of work internally, we are happy to give to you some perspective, but it would be better if we meet up on that.

Alankar Garude: Sure, Sir I will do that, great. Thanks and all the best.

Moderator: Thank you. The next question is from the line of Piyush Agarwal an Individual Investor. Please go ahead.

Piyush Agarwal: Sir, first of all congratulations for the great set of numbers. Sir, I have a few questions, first one is why has the Turkey growth been so subdued like the overall industry growth in Turkey such or that like it just for our company?

Manish Gupta: Turkey was a unique year. Historically that business has always grown more than 15% for us. This was the first year of single digit growth in local currency terms and the key reason for that was the two key regulatory changes that Turkey adopted towards the beginning of the year, both were kind of to control the abuse or misuse of antibiotics, one was e-prescription and the other was pertaining to tracking, so right from purchase of API to the consumption of API there is a complete system that they have implemented of tracking the API, both were fairly radical changes for that market and that obviously kind of course corrected, a lot of inventory that was in the system in the country that lead to some kind of slowdown of growth; however, even in that scenario the local currency growth was 7% however in the translation given that post-Trump events or tweeting they were big shakeup of Turkish leader that obviously reflected into almost 17% of decline in our Turkish business in INR terms. We expect the growth to be normalized this year and expect at least 15%

to 20% growth in Turkish business going forward. On a constant currency basis, currency we have obviously no control.

Piyush Agarwal: Sir one more question. What is the capacity utilization for your API business and like how much total capacity investment has been done in the API business?

Manish Gupta: Tushar, can you respond to the last part first in terms of total investment in API?

Tushar Mistry: Total investment in API in the range of about Rs.200 Crores that we have invested already for all the facilities put together.

Manish Gupta: Across all the three facilities our gross investment would be in the region of 200 Crores. For the growth we are expecting to double our API revenues in the foreseeable future and that entails not to very significant capex but more of balancing and some rightsizing of certain equipment. Collectively it would not exceed maybe between $10 to $12 million over the next three years.

Piyush Agarwal: Thank you.

Moderator: Thank you. The next question is from the line Giriraj Daga from KM Visaria Family Trust. Please go ahead.

Giriraj Daga: So my first question regarding the capex part, so what is the like capex guidance for the next year, and if you can also get the run rate for the next two to three years and if you can get into growth capex and maintenance capex?

Manish Gupta: See fundamentally our API business is well capitalized. Most of the building blocks are in place. We will run between $3 and $4 million or between 20 and 25 Crores as a run rate of capex, which will include both maintenance capex, and growth capex on a per year basis. That is largely on API. Coming to formulations we will have two types of investments here. One is in the facility part which will not be significant excepting in Bremer where in we are looking 4x scaling of capacities and that will cost us about 2 million Euros over next two years other than that there are no significant capex as far as formulation is concerned but there will be lot of filing fee and all which will not be in a way capex, will hit P&L.

Giriraj Daga: So we tied this filing based on P&L, we do not capitalize it?

Manish Gupta: Yes.

Giriraj Daga: Just follow up that. International growth would be like 50:50 in API or should be 60:40?

Manish Gupta: Very difficult to differentiate. Close to 50:50.

Giriraj Daga: My second question is related to the margin guidance of 200 BPS improvements. If you can just let us know that what are risks which you are envisaging or which you believe might hit and we might have to revise it or downward some point of time. What is the risk of your monitoring as of now, which can challenge this 200 BPS margin improvement guidance?

Manish Gupta: Largely, I would say it a pure execution risk and nothing else. As I have been highlighting in my opening speech, our business is not built around a few pivots of growth, we have multiple pivots of growth. Whether it is in terms of products or in terms of geographies or in terms of customers, so it is very well balanced portfolio, every year something fires, something misfires, so last year Turkey misfired, Europe obviously slowed down in the second half, but we still delivered the outcome, so whatever we are guiding you towards is something we are very confident of achieving even if there are some head winds in some parts of business.

Giriraj Daga: That is good. Thanks a lot.

Moderator: Thank you. The next question is from line of Dushyant Mishra from SageOne Investments Advisors. Please go ahead.

Dushyant Mishra: My question is on a couple of fronts, number one is the tax rate, could you please explain why it is significantly lower this year?

Tushar Mistry: On the taxes front, in the current year we have seen some reversal for the past taxes and in some of the geographies, so mainly in Brazil and Turkey where in Turkey while we have spent and we had whatever excess provisions got reversed. In Brazil actually we were having past tax liabilities on the balance sheet which were cleared under one of the schemes that was introduced in Brazil and we cleaned up our old tax liabilities in the balance sheet to that scheme and that is the reason this one-off is seen. The amounts and all had been disclosed in the notes to the financials, which can guide you as to what those amounts are. But on an overall basis from a guidance perspective our tax rates will be within the range of 15% to 18% of the profit before tax.

Dushyant Mishra: And this is one off event you said right. There is not possibility of this happening yes.

Manish Gupta: Yes, that is right.

Dushyant Mishra: So my question was on the raw material cost so in your consolidated balance sheet, cost of material consumed has gone up from 107 Crores to 152 Crores, why that happened when you even your revenues from operations have not changed as much so 50% increase essentially?

Tushar Mistry: . So in that you have to actually club three line items that is cost of material consumed, purchase of stock and material in inventory and then look at how the increase is, so in that scenario it will be seen to be in range as what the previous numbers are.

Dushyant Mishra: No I understand that, but I am curious as to is there is something you expect lot of volatility in prices of material consumed or is there a stock piling for future. What is the purpose of having this 50% increases is my point?

Tushar Mitry: That is what I am saying that if you compare with those changes in inventories because it all depends upon whether the finished goods are lying in stock or have been sold and accordingly the numbers will differentiate. So you have to look at all the three lines put together and then evaluate

Dushyant Mishra: Okay got it and in your presentation you said there are 35 products that are in the pipeline, right, 35 plus products in the pipeline. What can be the products and developments are? What is your time guidance for this likely one can be start seeing these in the market and how long is it going to take for each of them to rollout?

Manish Gupta: Yes, so when we are guiding towards 35 odd products under development which is on formulation side we are targeting between 10 to 12 products filings each year in the regulated markets. Obviously total number of filings will be much more because each product can give more than 1 filing but we are guiding towards the 10 to 12 product filing. Typically, filing to approval is between 12 and 14 months though FDI is guiding towards a 9-month approval for animal health space, but in the model that we are working on we are targeting between 12 and 15 months as our approval timelines.

Dushyant Mishra: Okay and you said that these are going to be under regulated market, so you are making 10 to 12 filings a year, how many of these are in the United States because that is where your cost is really high, right $425,000 you said?

Manish Gupta: Yes. So if you look at that split of products we had two products and 19 products I think 19 where global products which means US included, plus two were US only so 21 products out of 35 will certainly get filed into US. Of course what you have to bear in mind and I cannot share more information is some of these products may not have a filing fee based on the categorization of the product.

Dushyant Mishra: Some of them you may not have to pay the $425000?

Manish Gupta: That is correct.

Dushyant Mishra: One last question, just really quick, so at the cost of product in the United States is about $425000, what is there in the UK?

Manish Gupta: In Europe they are typically three ways of filing. There is a national filing, then there is a DCP filing and there is centralized registration. Typical fees would be between 25000 Euros and 30000 Euros per country basis.

Dushyant Mishra: US business is significantly higher that is why it just taken a lot longer to get deeper integrated into it?

Manish Gupta: See you have to appreciate that animal health does not have much of information and you have to generate or create lot of information ourselves before we dive into. There is no readymade information like IMS, which can identify products for you, so we had to go about building this business in a very difficult way and gain knowledge over a period. Also you cannot afford to go wrong, with the filing fee of $425000 you cannot misfire, so one single product can set you back, so we have been careful in selecting our products both from a knowledge perspective and also from opportunity perspective has taken us time to build up and that in my view is the beauty of this market, because while it has taken us time to reach where we are, it will take as many years for others as well and that is the reason why this industry does not have that intense competition like you see on the human pharma side.

Dushyant Mishra: Thank you very much.

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

Arif Ali: Thanks for the opportunity. I have got a couple of questions. First one is you have a long-term objective of getting into the top 10 global animal pharma which probably means hitting revenues of somewhere around 4000 Crores on an annualized basis. Given where you are currently and where you aim to be over the next four or five years, you would have to take a significant inorganic growth because organic growth could be about 20%-25% at the high end and maybe 15% at the low end so the majority of this gap between where you are today and where you aim to be has to be via the inorganic growth right?

Manish Gupta: What you are saying is certainly correct. We have never guided to 4000 Crores business. We have been guiding towards a 2500 Crores. Yes, we started with an intention of being amongst of global 10. A lot has happened in this industry and obviously with the consolidation at the Big Boys maybe the 300 million target or 350 million target we started with may not bring us to top 10, but our current business plan is towards 2500 Crores which is achievable with all the growth engines that we have within the framework. Having said that inorganic continues to be an element of strategy for us. You cannot forecast or build a number around inorganic which is not what we have done as well. Anything that get added will obviously help us achieve at least closer to 3000 mark if not closer to 4000 mark.

Arif Ali: Right, so this 2500 is pretty much all in the plan that you have for the organic growth?

Manish Gupta: That is correct. That is based on current products & current markets we are working on.

Arif Ali: Correct. Is that kind of foreseeable in the next four years or what is the internal? I am just trying to calculate the CAGR growth here?

Manish Gupta: Yes. We are generally working on a rolling four-year perspective so what you are saying is correct.

Arif Ali: Thank you for that and next question is how much free cash flow have we generated this year and what sort of guidance can you give on that on the CAGR basis. Is it possible because I presume you have a low base on free cash flow so you should be growing free cash at a pretty rapid phase over the next 3-4-5 years, right?

Tushar Mistry: Last year the cash generated from operation was 54 Crores compared to that in the current year it is 115 Crores that we have generated, so that is almost more than double growth in the current year and yes you are right, going forward looking at how we are seeing the momentum in our growth, the cash generation has to be better going forward as well.

Arif Ali: See Tushar 115 Crores is the operating cash, right, so what about the free cash because you are in a capex mode as well right and I heard it is about 25 Crores in an annualized basis both included the maintenance and the gross capex?

Tushar Mistry: That is what is spend in the last year.

Manish Gupta: See if you look at our balance sheet numbers, which are disclosed as well in the analyst pack, we have been managing our working capital fairly efficiently. In fact, our working capital days have come down, not that we will be able to reduce with the same pace going forward and also our fixed assets base also not increasing significantly so maybe and I am just hazarding a guess. About 70% of our operating cash will convert to free cash is my broad thumb rule.

Arif Ali: Right I think 70% of 115 does give the sort of projection if you take care of growth and the maintenance capex so I think we can take that working assumption on an ongoing basis that whatever an operating cash flow is reported 70% of that will be a free cash?

Tushar Mistry: Yes. From operations what you are saying is correct, but then if you account for interest and taxes okay.

Arif Ali: Let me rephrase free cash I was just talking in terms of whatever is available for the shareholders either as dividend or maybe as a growth capex, may be we should not be including growth in the free cash, so whatever is available to take the business forward, whatever cash that you do not need to just keep this lights on in the factory. Right?

Tushar Mistry: Probably a 50% would be a better way, because we do have as I said we have to pay for taxes and we have to also pay for the interest at least in the medium term till we become debt free coming out of our operations and then yes the rest 50% should be available in a way either as dividend or as growth capital for future growth of the business.

Arif Ali: Understood and finally your return on capital employed is low and I suppose while reading the transcript last time around you mentioned that you would aim to get it closer to 20% ROCE over the next 3-4-5 years maybe, is that still on track and what ROCE have reported in FY2019?

Manish Gupta: Yes. It is explained in the investor deck again, for the Q4, annualized basis, we are now little over 15% in terms of our return on capital employed and on a full year basis, I think it is 11.8%, so we are moving in the right direction, lot of journey has been covered. We have reached our cost of capital level kind of situations especially on Q4 annualized basis and we hope to keep moving in the right direction in the foreseeable future as well.

Arif Ali: Sure, can you just quickly remind us what your current cost of capital is and where do you see that heading to which direction?

Manish Gupta: Direction I can certainly say. It is going to improve because fundamentally we are extremely operationally disciplined organization but Tushar would you have any idea of what would be. On cost of capital can we come back to you?

Arif Ali: Yes sure, I heard that Q4 you reported ROCE 15% and assuming that as the new base, can we aim for some improvement on that ROCE number by end of FY2020?

Manish Gupta: Certainly I think that I mean the change cannot be that dramatic as we have seen in the current year but it will continue to hit north.

Tushar Mistry: Arif the 200 basis point a better margin guidance or outlook that we are guiding to plays out. It is fairly easy to do the numbers but the trajectory would be on the upward direction.

Arif Ali: I was just trying to set the floor so if 15% on user of floor going forward as far as ROCE is concerned.

Tushar Mistry: The 15% number is 4^{th} quarter annualized to correct you so that could be the base because the base for the whole FY2019 was around 13%.

Arif Ali: So FY2020 ROCE for the full year should be 15% at least if not better?

Tushar Mistry: Fair assumption.

Arif Ali: Thank you so much. All the very best. I will fall back in the queue now. Thank you.

Moderator: Thank you. The next question is from line of Manish Gupta from Solidarity Advisors (SA). Please go ahead.

Manish Gupta (SA): Good evening. Could you explain in some more color the nature of contract in the API business. What I am trying to understand is how much are the margin on the API business benefiting from the situation in China and now the tensions between China and the US vis-à-vis what component of that is very structural in terms of margin profile?

Manish Gupta: In pharmaceutical industry what happens between Trump and China or Trump and Xi has no impact on business directly because it is not a spot business. You need to put in efforts a couple of years back to gain benefit of it today, so this fight has no impact for our current business at all. Whatever we are seeing today is an outcome of our efforts a couple of years back and what has changed of course is that people are right now more anxious to develop alternates out of China, rather than being solely dependent on China and that has more to do with the pollution issues in China and therefore the unreliable supply chain and not to do with the current tensions between the two governments, so that is one part of the questions.

Manish Gupta (SA): Whatever margin we see in API those margin sustained or you think that you know you are benefiting a little bit from just a desperateness of buyers to secure supply chain and hence this is little bit more you know buffer in margins that you have?

Manish Gupta: Not at all. In fact I expect our API margins to improve as we scale up because it is a structural shift as far as our business is concerned from not so regulated market to regulated market, so we are diverting capacity as part of our strategy as more business gets built in both US and Europe, which for the same molecule gives us much better pricing vis-à-vis the emerging market. Whatever you are seeing today is a part of a very structured design, which started in 2013 by investing at Vizag. It is just that the environment has also helped in the current situation, but none of our margins are flowing out of the current environment. They are all part of the structure or design of the business.

Manish Gupta (SA): The next question was our tax rates you know are the tax rates we pay. Are we benefiting from tax benefits in some legal entity? When will these normalize to full tax rate?

Tushar Mistry: As I guided earlier the right way to look at taxes from an overall perspective would be 15% to 18% of PBT going forward. Currently from the India geography perspective, we continue to enjoy the MAT credit, we are still under MAT and we take the MAT credit on tax provisions. On all the other geographies we are pretty much stable now. We do not see any one offs coming in future. And all other geographies our tax rate is already the peak tax rate.

Manish Gupta (SA): When do you expect to get out of MAT in India to full tax rate?

Tushar Mistry: Another three years.

Manish Gupta (SA): Thank you. Congratulations on very good numbers.

Moderator: Thank you. The next question is from line of Sajan Didwania from Frontline Capital Services. Please go ahead.

Sajan Didwania: Thank you Sir. Thank you for giving me opportunity. Sir I would just looking this same revenue figure. I am seeing this API business Q over Q as it started slowing. It is 13.33% growth Q-o-Q. We were 23% in Q2, 20.68% in the Q3, and 13.33% in the Q4 and same way formulation is marginally negative Q-o-Q. There is no growth almost flat. So are seeing a saturation of full capacity utilization in API and what is the reason for that?

Manish Gupta: I do not think pharma business can be measured in that way. There is an element of seasonality across all businesses. API business again and very difficult to do a Q-o-Q kind of growth rates in our industry; we are again guiding towards a 30% annualized growth for our API business in the medium term and it will taper down thereafter while our formulation business will continue to grow mid teens for the short to medium term before accelerating to a much faster growth rate thereafter. Collectively, we are looking towards a 18% to 20% growth rate for the company in the medium term and as I mentioned the API will grow faster in the first two years and the formulation drives that growth thereafter. So I think on an annualized basis we are confident with those kinds of guidance but quarter-on-quarter built up is simply not possible because there are so many moving parts of business. It is impossible to predict that.

Sajan Didwania: Okay, so basically we can say that the capacity utilization scenario in the API is there is no bottleneck?

Manish Gupta: Certainly, in business you always have to plan capacities ahead of the demand and sometimes you can never lose or you should lose business for capacity by design.

Sajan Didwania: How much is API from US out of 101?

Manish Gupta: It is still very small.

Sajan Didwania: So it is basically mainly from Europe and emerging market?

Manish Gupta: Yes. We just started selling in US last year. US would be less than 10% of the overall API number as a business and see one of our key criteria for growth is we are not going to chase volumes. We are going to replace emerging markets with US and better price business, so for us capacities are in a way meaningless.

Sajan Didwania: Pricing front you are not seeing any pressure on that?

Manish Gupta: Not in our business model.

Sajan Didwania: Thank you. That is all from my side.

Moderator: Thank you. We will take the last question from the line of Manish Gupta from Solidarity Advisors. Please go ahead.

Manish Gupta (SA): Sir could you just share what is your capacity utilization in API at present?

Manish Gupta: I will have Sharat to respond to that.

Sharat Narasapur: It is about currently 70% to 80%.

Manish Gupta (SA): Thank you very much.

Manish Gupta: Thank you.

Moderator: Thank you. As there are no further questions, I now hand the conference over to the management team for your closing comments.

Manish Gupta: Thank you all for joining this call this afternoon. The year gone by was a year of inflection for Sequent. As we achieve critical scale both in our business, but more importantly in our capabilities. We look at future with confidence as we continue our journey in a road less travelled. Please feel free to connect with anyone of us for any follow-up question. Thank you once again and have a very good evening.

Moderator: Thank you very much. Ladies and gentlemen on behalf of Sequent Scientific Limited that concludes the conference call for today. Thank you for joining us. You may now disconnect your lines.