“Sequent Scientific Limited
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Moderator: Ladies and gentlemen, good day and welcome to SeQuent Scientific Limited Q4 FY2018 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 "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to the management. Thank you and over to you!

Abhishek: Good morning all. We have Mr. Manish Gupta, MD, Mr. Sharat Narasapur, our joint MD, Mr. Tushar Mistry, CFO of SeQuent joining this call. I will now handover to the call to Manish to make some opening comments after that we will be in position to take some questions. Over to you Manish!

Manish Gupta: Thanks Abhishek. Good morning and a warm welcome to all of you. Thanks for joining this call so early in the morning. Joining me on this call are my colleagues, Sharat Narasapur, who is our joint managing director and heads all our technical operations including R&D and of course the guy who controls the purse, our CFO, Tushar Mistry.

This is our first earnings call and the plans are to make this a regular habit. I am sure many of you who have joined this call are already aware where we are in our journey, but there might be others who might be hearing us for the first time. So, I will begin with a brief overview of what we are and where we started, the kind of achievements or what we have been able to build over the last three years and then of course giving you a little perspective of our performance for the year gone by followed by a Q&A session. In case I become inaudible at any point of time please let us know.

If you take a step back, about four years back SeQuent was close to Rs.400 Crore business having three business verticals, small Animal health business with about Rs.175 Crores revenue, Human API business of similar size and a small specialty chemicals business accounting for the rest around Rs.50 Crores. We had no distinct strategy and of course very poor financial parameters.

When we reviewed the business at that point of time in the Animal health space, we saw all the things that are close to our heart or vision it is a small niche area of global pharmaceutical business, it has limited Indian competition and of course they were changing regulatory dynamics. That is how the new strategy and vision of SeQuent was framed - to create the first global animal health business from India. As part of this strategy we subsidiarized our animal health business and gave it new or distinct identity Alivira. The human API business was retained for cash and size and everything else that was not relevant to the new strategy was either closed or monetized. So as part of that, we sold off our specialty chemical business to Songwon in Korea.

The animal health business that we had at that point of time was largely an unregulated business. About 75% of that was API, rest were formulations. We operated out of a suboptimal facility near Mumbai at Ambernath. Our initial strategy was to build cost arbitrage business around R&D and manufacturing, as this is prevalent in the pharma sector. As part of the same, we invested at Vizag to build world-class highly scalable veterinary API facility as we saw this as an untapped opportunity.

Let me also give you a broad sense of the animal health industry at this point of time. It is $30 billion industry and provided an exciting opportunity for Alivira. While the industry has two main parts, the companion animal and the production animal, our focus is more towards the production animal vertical because that is where we saw dynamic in the supply chain emerging as historically, application of regulations in that part of the business was poor. Once we got into the business, we soon realized that the animal health industry while it shared a lot of commonality with the pharma sector, it also had a lot of elements of FMCG industry. It had the entry barriers or regulatory barriers of pharma, however, also required the last mile connectivity of the FMCG industry. The industry lacked an IMS or IMS equivalent which also meant limited knowledge about the industry and certainly added to the entry barriers. Last but not the least while India had great talent on the pharma side or human pharma side, it lacked talent on the animal health side of the business and therefore those clearly were our challenges, as also our opportunities.

Therefore, if you notice we focused in our first phase on building the last mile connectivity through a series of acquisitions. Each of these acquisitions not only gave us a foothold in the market, but also gave us an ability to strengthen our own management team.

Some of our acquisitions include:

- We started with Turkey which was our first acquisition sometime in 2015, Provet. We also did a follow-on acquisition in Turkey making us the third largest animal health players in the Turkish market.
- We added that with the front-end acquisition of N-Vet and Fendigo, which brought us into the European markets and gain access to Belgium, Netherland, and Sweden.
- We followed this with the largest acquisition of Karizoo in Spain, which not only bolstered our presence in Europe, but also gave us access to Mexico again a very important veterinary market. This transaction also brought into Alivira fold, an EU approved manufacturing base along with strong R&D capabilities at Barcelona. We also did a small transaction in India to bolster our presence in the cattle segment of the business through acquisition of Lyka's Animal Health Business and
- Followed it up with acquisition of Evance in Brazil, which is the third largest veterinary market in the world, accounting for almost 7.5% of the global animal health market.
- I am glad to say that all these acquisitions not only fitted well into our base business and core strategy but were also integrated well as we went along.
- Of course, building on these successes we recently acquired Bremer in Germany, which focuses on cattle and swine segment, but importantly has an EU GMP injectable facility to Alivira's armory and is going to be a strategic driver of our growth going forward.

The above acquisitions on our part have put together an organization that has a strong formulation business in key veterinary markets of Europe, Latin America, India, Turkey, parts of Africa and parts of South East Asian countries. Today, we sell our products in over 95 countries. At US $150 million which is our current run rate, Alivira is already India's largest animal health business. More importantly business mix, which used to be 75% APIs has now reversed to 75% formulations. Over 90% of our revenues come from outside India and we have manufacturing operations not only in India, but also in Spain, Brazil and Turkey. Our R&D is now carried out in India and Spain.

Our API facility at Vizag recently became the first and the only USA FDA approved veterinary facility in the country. As we have achieved critical size in the animal health business, we of course decided to demerge our human API business into Solara Active Pharma Sciences, Solara should get listed soon. I think all the existing shareholders of SeQuent has already received their respective shares in Solara.

The sum of the last three years has finally crystallized into what you to see today. FY2018 has been a good year for us. The revenues came at around Rs.850 Crores as compared to Rs.689 Crores the previous year. On a like-to-like basis, this reflects an increase of about 23%. More importantly as we benefited from integration, scale benefits as also commercialization of first API in the US markets, our operating margins have improved, and our operating EBITDA has come at about Rs.87 Crores, an increase of close to 51% over the last year. This improvement in margin is a result of our focus on execution and operational efficiency as we focused on integration and of course execution in the key geography of US.

Today we are a team of scientist and intellectuals working both in APIs and formulation space. The R&D team today obviously is going to be very critical for us maintaining this growth going forward and we are working on close to 20 formulations and about 12 APIs under development. We are extremely excited about this business and the opportunities that lie ahead of us. I thank all the shareholders for their continued support and conviction in our unique business model that we are building and of course the patience that they have shown thus far. To our new investors we are certainly happy to be engaged on this because this is a very poorly researched industry. Unfortunately, there are no reports to go by, but we are happy to spend the time that may be required to help each other. We are now ready to take your questions.

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: Hi good morning and thanks for taking my questions. Congratulations on a good set of numbers. So basically, the EBITDA margin improvement that we have seen in this quarter of about 200 bps, would this be sustainable over the year?

Manish Gupta: Certainly, this is not a one-off, it has come across through series of initiatives that we have taken. Clearly, we are sweating our assets now better. I mean one of the key things is of course the commercialization of the first API in US. We also have gained traction through our integration of our acquisitions, cross leveraging of portfolio has been the first big benefit as we drive the revenues in these markets. All these markets have grown faster than the industry growth rates for us and therefore we stay confident of maintaining growth rates both on revenues and EBITDA margins going forward.

Vishal Manchanda: Could you attribute this EBITDA margin improvement to a specific geography that would have primarily led to this or is it across the board?

Manish Gupta: This is both good news and bad news from our perspective. Unfortunately, there are no one or two big drivers in the industry that we operate in. It is a mix of everything that we do. All geographies have done well. All geographies have expanded their margin including the API business that has swung from negative kind of margin to a positive clearly because we replaced lower price business with higher price business in US market and therefore I believe it also helps us to sustain margins going forward.

Vishal Manchanda: Okay Sir you mean the API growth was kind of driven by both price and the volumes in emerging markets or semi-regulated markets were replaced by regulated markets. So basically, you did not add to the business, but you replaced business?

Manish Gupta: That is correct. That is a very core part of our strategy that we do not push scale which requires more investments we'd rather replace businesses.

Vishal Manchanda: Okay and was your Bremer acquisition included in the current quarters?

Manish Gupta: Not at all, Bremer acquisition was completed in April and will be reflected in the quarter going forward.

Vishal Manchanda: Okay from the next quarter onwards we will have Bremer numbers in?

Manish Gupta: That is correct.

Vishal Manchanda: Okay and one more on this, on a sequential basis depreciation and finance expense were lower, so could you explain that and would it be the same numbers throughout the year, so can we take that for the year?

Tushar Mistry: I suppose you can consider this as a sustainable kind of number for the quarter going forward.

Vishal Manchanda: Okay so was it because of…?

Tushar Mistry: While on the finance cost we have some historical debt, which is pretty high cost debt. We are working towards reducing the cost of it. So as and when it happens, we will definitely look towards reducing this cost also going forward.

Manish Gupta: Vishal if I were to further elaborate on this clearly when we started this journey, we inherited a very poor balance sheet and operating parameters, so all our historical debt is being carried at a high interest rate close to even as high as 12% for some of the debt that we have. Last two years' performance has given us an opportunity now to right cost the debt and we are using that. Some benefit has accrued in the last quarter, but the major part of it will start flowing in through the current year as we go along.

Vishal Manchanda: Okay and in your API business, so like we have seen several API players witnessing some input price pressures because of Chinese shutdown and other reasons too. So, are you also witnessing similar pressures in your animal health API business on the import side?

Manish Gupta: I would rephrase your question to saying not pressures, opportunities, because as we see pressure, our customers are also seeing pressure from us. So, I am most excited for our API business in the short run because is the first time in last maybe 10 to 15 years wherein customers are not talking of price reduction, they are talking of securing availability and this is a great opportunity for price increases. I think the markets will change the way they look at API industry going forward.

Moderator: Thank you. The next question is from the line of Aditya Khemka from DSP Blackrock. Please go ahead.

Aditya Khemka: Hi thanks for the opportunity. Sir could you give us some more granularity on the EBITDA margin. So, I guess the full year EBITDA margin has been 10% for FY2018. I had two questions regarding that number, what would your expectation be for FY2019 and 2020? I guess we are looking at an expansion, but how much expansion is the question and secondly, if you were to look at your API and formulation business separately which of these two businesses will you say as achieved with peak EBITDA margin and how much further can the other business scale up in terms of EBITDA contribution?

Manish Gupta: Aditya, see basically splitting EBITDA margins across businesses is very difficult because all businesses are interlinked. So it will boil down to how you are pricing the supplies from one business to other and all that. So we do not want to get into that complexity. Strategically, none of our businesses have peaked, other than in Turkey wherein we really have some leadership position being number three in that market. We still have lot to do in all other markets, the opportunities are immense and therefore I do not believe that any of our businesses have seen peaked margins. We expect to maintain the growth momentum both in terms of revenue as also EBITDA margin expansion that you saw in the last year certainly for the next two to three years. Last quarter performance is a fairly good indicator of what you can foresee going forward. I would refrain from giving very specific answers to this beyond what I have indicated.

Aditya Khemka: So your last quarter margins are 13%, does that imply that I can take the 13% EBITDA margin to be full year margin for FY2019?

Manish Gupta: Basically, what I am suggesting is the improvement in margins that we have displayed in the last quarter because every quarter there is some variation given the spread of our business. We have displayed about a 200 basis points improvement in margin and we believe we should be maintaining that kind of growth momentum going forward on the full year number.

Aditya Khemka: Got it so from 10 to 12 you got your traction indicated.

Manish Gupta: Yes.

Aditya Khemka: Okay and secondly on this entire formulation strategy and acquisition of Bremer. Bremer revenues and Bremer is not a part of your Q4. So I assume whatever debt you might have undertaken or whatever cash you might have paid out to acquire Bremer or the balance sheet of Bremer is also not a part of your numbers right?

Manish Gupta: That is correct.

Aditya Khemka: So in terms of that acquisition of Bremer including the interest cost and the depreciation that you might incurred and amortized whatever value you have paid for Bremer and whatever debt you might have taken for it, will you say that the acquisition would be EPS assertive on year one?

Manish Gupta: Again let me take a step back here. If you look at Bremer acquisition, the consideration that we have paid is about €2 million which is largely backed by the working capital of that business. So it is a very reasonably priced acquisition I believe. Having said that, it was a negative EBITDA margin business when we acquired. Clearly, we are not magicians. It will take of at least six months to fix the negative EBITDA to positive EBITDA. We certainly hope to achieve that during the year, but from a balance sheet perspective or the cost of acquisition perspective it does not have any impact on our balance sheet because that amount of money was already with us.

Aditya Khemka: Understood and the last question if I may please. On the intangible asset on your balance sheet of Rs.270 Crores and the investment on your balance sheet of Rs.220 Crores so how much of this Rs.220 Crores investment is that in Strides and what does the balance account for?

Tushar Mistry: The entire amount of Rs.220 Crores is towards investment in Strides.

Aditya Khemka: Right. So any plans of monetizing this because Strides is not pretty much functioning as a separate entity right?

Tushar Mistry: Certainly, it is important growth capital for us and as and when needed, there is no timeframe for it, but that is something that the board keeps discussing. We will as and when we wish to do something about it, it will be made public. But it clearly is a very important part of our growth capital going forward.

Aditya Khemka: Understood Sir, just another follow-up on this one itself, this Strides stock price has meaningfully declined in the past three to six months. So, is this Rs.220 Crores on your cost or is it on market value?

Tushar Mistry: It is on market value because we have to mark-to-market that investment. There was reduction in the stock prices through our other comprehensive income and does not go to the P&L.

Aditya Khemka: Understood and Sir can you give some colour on the intangible assets please?

Tushar Mistry: Can you repeat your question on the intangible?

Aditya Khemka: We have Rs.267 Crores of intangible assets on your book. What does this pertain to?

Manish Gupta: If you see we have goodwill on acquisition of about Rs.202 Crores.

Aditya Khemka: This is regarding the acquisition?

Manish Gupta: These are pertaining to all the acquisitions that we have been doing since 2014 onwards and the balance is towards some value attributable to the brands and the IPs that we would have acquired in the acquisition.

Aditya Khemka: Understood Sir. I have more questions. I will get back in the queue. Thanks.

Moderator: Thank you. The next question is from the line of Jubbin Shah from BOB Capital Market. Please go ahead.

Jubbin Shah: Thank you for the opportunity. Sir, couple of my questions are already answered. One question that I want to ask you is, regarding the emerging market currencies, they have been on a sharp decline so ranging from around 8% in India to around 20% in Turkey YTD. So how are our hedging policies there and what is the gain in the momentum that we can see from that?

Tushar Mistry: We are pretty conservative on the hedging part. They are pretty volatile currencies so hedging cost and all also ends up to be pretty high, that is one part. Second is Turkey has more business domestically so on the business front, it does not have any currency impact. It is only the conversion impact on the consolidated P&L and on the other businesses, we take some few forward covers for any exposures that we would have.

Jubbin Shah: Okay.

Manish Gupta: Just to add a little strategic element to it; fundamentally, we stay focused on operations. Currency is something we cannot predict so as a policy we stay very conservative on our currency management because we do not want to as a Company be exposed to currency dynamics. Within each of our businesses, individually all these businesses are self-protected because they buy in local currency and sell in local currency.

Jubbin Shah: Right Sir, that was helpful. Thank you.

Moderator: Thank you. The next question is from the line of Krishnanath Munde from Reliance Securities. Please go ahead.

Krishnanath Munde: Thank you for the question. My question is how much peak sale we are expecting from the Vizag plant for the US market over the next two to three years and what is the current sales from the plant?

Manish Gupta: Again numbers speak for themselves. So fundamentally if you look at our API numbers most of it comes from Vizag plant. We have a small facility at Tarapur, which is predominantly an intermediate facility, though it does have a small API business as well. So most of our current API business is from Vizag plant. I always feel challenged to give a peak sale number because the way our business model is, if I am able to sell everything in US whatever volumes I produce, it can be even 3x of my current sales number. Having said that, will we get there in next two years, answer is no. So it all depends on how we build our US business. The good news which I also mentioned to you a short while back is API prices are moving up and we are on the forefront of that. We are negotiating hard in getting our fair share in the value chain that is what I believe as an API player. Clearly at a broad strategic level, it certainly will grow. To what level is very difficult to mention at this point of time. But the opportunities are immense.

Krishnanath Munde: Okay and Sir we get around 75% sales from the formulation where the margin is high, which we believe. Going forward how much contribution from formulation we expect from over the next two to three years?

Manish Gupta: I do not foresee a significant change in our business mix going forward. We will stay about a three fourth formulation business and one fourth of API business, because if you look at it from our strategic perspective, investments are more in the formulation side in terms of R&D as also in terms of any potential acquisitions that also will happen only in the formulation side of business.

Krishnanath Munde: Okay and one last question Sir. Sir how this India animal healthcare business pan out in terms of sales growth and margin profile over the next few years?

Manish Gupta: India is again a very interesting market. Nobody knows the true numbers, but we believe is about Rs.5000 Crore market. We are a very small player because we are a recent entrant and it is a branded generic market. So field force productivity only improves over a period. Last year was a period of inflection for us. That is when we moved into profitability, so any growth going forward will be profitable growth for us. We will stay focused on niche areas. One thing which we may be aware that world over, antibiotics are getting replaced by nutritional products because abuse of antibiotics as growth promoter is getting diminished, either by regulation or by the market pressure and that is where we are in the forefront of leading this change in India. Good news is we do not carry any legacy. Therefore we are able to build it on the new emerging trends in the market.

Krishnanath Munde: Okay but how is the margin profile Sir?

Manish Gupta: As I mentioned we reached at point of inflection in the last year and turned from EBITDA negative to EBITDA positive in that business.

Krishnanath Munde: Okay. Thank you so much Sir.

Manish Gupta: Thank you.

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

Vipul Shah: Congratulations on this very strong set of numbers. One thing, which just wanted to get your colour is despite showing significant improvement in all profitability parameters the significant portion of our earnings after tax is attributable to minority interest. So do you see that mix changing during the year - by higher contribution from consequence wholly owned or the fully owned subsidiaries or by acquiring the remaining minority interest.

Tushar Mistry: Vipul, if you compare annual numbers with the quarterly numbers, you will definitely see an improvement in that parameter as well. The annual number, the profit after tax on the continuing operation is about Rs.10 Crores and non-conforming interest is about Rs.10 Crores as well, whereas on the quarterly numbers, we have profit of about Rs.8 Crores and the non-conforming interest is about Rs.5 Crores, so that is a clear sign of the improvement in that parameter as well. Going forward, we should see further improvement in this parameter as well.

Vipul Shah: So again related to that is, we historically also have shown a high proportion tax to PBT number (ratio). Do you see also that changing and normalizing and what is the normalized level of taxes one should consider?

Tushar Mistry: That improvement will also continue going forward. At this juncture, we cannot clearly predict what would tax rate be, but we assume it should be somewhere between 20% and 25%.

Vipul Shah: And is there a part towards acquiring the balance minority interest?

Manish Gupta: In some cases yes, but if you look at fundamental business model, it is about de-risking and partnership given the nature of industry, it is not about cost arbitrage. So we believe these partnerships are very important for long-term sustainability of business because of the local dynamics, given the branded nature of this industry. So certainly we will be further consolidating our ownership in some of the entities, but it will not be 100%. We do not intend to be there. However, again one more clarification some of our new acquisitions, because now we have built up that management team in Europe will be 100%, like we did Bremer and therefore the minority interest as a percentage of our overall business will keep diminishing as we move forward.

Vipul Shah: If I may squeeze in a couple of questions, Tushar what was your free cash flow during the year and during the last quarter?

Tushar Mistry: Vipul we will get back to you on that question.

Vipul Shah: Last question is I remember there was a piece of debt sitting in Turkey… in the Turkish business and you know where the Turkish Lira is and we hear every day, it is touching new lows. How much of that impact is still yet to play out or what is the debt let me put it this way on the Turkish balance sheet?

Manish Gupta: It is Rs.37 Crores in INR terms, so it is not a very significant debt that we are referring to.

Vipul Shah: So 37 as of March 31, 2018?

Manish Gupta: Yes.

Vipul Shah: Thank you so much.

Moderator: Thank you. The next question is from the line of Akshay Badjate from Rubicon Capital. Please go ahead.

Akshay Badjate: Hi Sir. Thanks for taking my question, I have a couple of them basically on the revenue side, what would be our prorated revenues, given the fact that bulk of our revenues comes from acquisition made where we do not have 100% holdings?

Manish Gupta: I did not understand. You are saying minority interest at a revenue level?

Akshay Badjate: Correct.

Manish Gupta: We will have to work-out that number and get back to you.

Akshay Badjate: But if you could just know a ballpark number...roughly?

Manish Gupta: Roughly it will be, ballpark could be about… 85% to 88% revenues will belong to us.

Akshay Badjate: Will belong to us… understood, okay. So my second question, could you give a broad indication as to what would our organic growth be over the next couple of years?

Manish Gupta: Last quarter and most of the year also, whatever you see is organic growth because our last acquisition was about 20 months back. So except for the first quarter of last year, which was Q1 everything is on like-to-like basis.

Akshay Badjate: Thirdly on your acquisition strategy, how much would we be willing to spend on acquisitions over the next two to three years because I believe inorganic is also a part of a goal to reach our aspirational target by FY2022 of about I think half a billion dollars or something if I am not mistaken. So what strategy are we going to follow while looking at acquisition? What kind of acquisitions are we focusing on and what kind of valuations would we be willing to pay for possible acquisition?

Manish Gupta: This is a very interesting question and while I answer this in part today, I would encourage you to come over and meet us personally because it gives away too much of our strategy.

Akshay Badjate: Sure, I understand.

Manish Gupta: But if you look at our aspirational target, which you have been referring to, I will break that into three parts, a third of it will come as a pure organic strategy, a third will come from our new product portfolio that we are developing and the rest third will come from acquisition, which will be largely front-end acquisitions for presence in some of the missing links in our geographic footprint. US is one, clearly it is too important veterinary market to be ignored, France is another one, which is again a very important market, largest veterinary market in Europe and potentially Australia, again a very important veterinary market.

So these are the three strategic gaps in our front-end presence as we speak and these will be the markets we will be looking at from an acquisition perspective. As far as valuations are concerned, let me put it this way, that given the nature of this industry, we are very smart so far, it is an under-rated industry and you can look at our track record. All our acquisitions are something, which people will be very happy about.

Akshay Badjate: Fine. I have a couple of more questions, but I will join back in the queue.

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

Alankar Garude: Hi Sir. Thanks for the opportunity and congrats on the performance, a couple of questions from my side. Firstly, Sir while you might not want to get into the granular details, but is it fair to say that bulk of the sequential expansion in margins in this quarter would be driven by API and even within API, it is largely got to do with the commercialization in the US?

Manish Gupta: Bulk, I would not agree with the statement bulk, but yes part of it were driven by APIs.. Yes, the US part certainly drove it within API part. That is a fair assumption.

Alankar Garude: So basically bulk of the expansion within API is due to US?

Manish Gupta: That is correct.

Alankar Garude: I understood Sir and secondly, just wanted to understand seasonality in this business for both… if you could break that up into both APIs and formulations that would be really helpful?

Manish Gupta: I would say seasonality in this business is insignificant, so even if you look at Q3 and Q4, our numbers are not very different. Having said that on the API side sometimes a little lumpiness occurs based on order flow. That’s about it, but otherwise you are eating through the year, so animals are getting produced through the year, I would say.

Alankar Garude: I understood Sir, great. Thanks and all the best Sir.

Manish Gupta: Thank you Alankar.

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

Sarvesh Gupta: Thank you Sir for taking my question. On this API formulation unit in Vizag, I understand that you could not give a guidance on the value terms but in terms of volume, what is the current capacity utilization?

Manish Gupta: Let me put it this way that we have sufficient capacity to meet our requirements for the foreseeable future. It is a very futuristic plant that has been built in, we believe it is better than most human API plants in the country; it is a state-of-the-art plant and has all the capacities that are required in the medium term.

Sarvesh Gupta: What is the gross block and the net block for this plant?

Tushar Mistry: The gross block will be about Rs.180 Crores. The net will be I think around Rs.140 Crores.

Sarvesh Gupta: Other question regarding depreciation, so we have a very small gross block of Rs.220 Crores - 230 Crores (net block) and we are showing depreciation of almost Rs.40 Crores, which is like almost upwards of 15% to 20%, so what is the sort of economic depreciation for our fixed assets and what are the maintenance capex level?

Tushar Mistry: So to answer that question, one element of the depreciation is also the amortization and the amortization is on the acquisition of the brands that we have done over the year, some part of it is also tax and some part of that is of deprecation, so…

Sarvesh Gupta: Out of this Rs.40 Crores how much is depreciation?

Tushar Mistry: Depreciation would be about 60:40.

Manish Gupta: 60 depreciation, 40 amortization.

Sarvesh Gupta: So is 10 years sort of economic life for these assets?

Tushar Mistry: For which ones?

Sarvesh Gupta: For your fixed assets?

Manish Gupta: Yes for fixed assets. We have been fairly aggressive on taking depreciation; let me put it this way. This is the matter of which there are no clear answers in terms of what is the right economic life because plants continue to be there for many, many years.

Sarvesh Gupta: Okay and secondly can you explain the Rs.380 Crores exceptional gain?

Tushar Mistry: This is pertaining to the discontinued operation for the API human business. As per Ind-AS we are required to recognize the fair value of the assets that we have transferred and the difference between the fair value of the assets and the book value of the asset is recognized as gain through P&L, so that is the difference that gets fitted in the line there, along with the first half year profit on discontinuing operation on the operational profit agreement. So that is what is the line, I hope that clears the question or…?

Sarvesh Gupta: Yes, what is the balancing entry that you have made again to…?

Tushar Mistry: Similar amount also gets reduced from the securities premium account, so on the net worth side, the effect is minimal, it does not impact the net worth at all, but this is how Ind-AS operates.

Sarvesh Gupta: From a strategic side since this is the first concall while FY2022 you want to become one of the global leaders in animal healthcare, what is the kind of return ratios or some other indicator of the health of the business including margins, etc., that you are targeting because one is size and other is these efficiency and return parameters?

Manish Gupta: If you look at our operating parameters - return on capital employed, we have seen about a 500 basis points improvement and we believe we have just nudged ahead of our cost of capital at about 13% now, the sweating of assets (because of US commercialization) if you look at our investment, it is predominantly in the API facility at Vizag and that is turning around, that clearly will drive as we improve our margins and sweat our assets, the ROCEs will continue to grow.

Sarvesh Gupta: Understood Sir, what is the fixed cost base for our Vizag plant right now, the fixed cost please?

Manish Gupta: Please come over, we will discuss separately because it is too much of competitive information.

Sarvesh Gupta: Thanks and congratulations.

Manish Gupta: Thank you very much.

Moderator: Thank you. The next question is from the line of Sai Kiran Pulavarthi from RW Investment Advisors. Please go ahead.

Sai Kiran Pulavarthi: Thank you all for the opportunity, just what is the capex which you guys are factoring in for the next couple of years excluding the inorganic opportunity?

Manish Gupta: Yes, so if you look at us, we are fairly well invested especially with our key investment in the Vet API Facility at Vizag. We are more or less through with our investment cycle I would say. Most of our capex would be routine, maintenance capex going forward or small de-bottlenecking and others that we incur, it will be less than US $ 5 million each year.

Sai Kiran Pulavarthi: Got it and just one book keeping question extending the conversation what you guys are having on depreciation and amortization when I look at the consol intangible assets, they are more or less flattish, but you are suggesting a substantial portion of amortization is taken in the P&L this year, how can you reconcile this two numbers?

Tushar Mistry: You are comparing the balance sheet numbers, where previous year numbers are not comparable as it has the API human part of business.

Sai Kiran Pulavarthi: So you are suggesting that the human API, which you had divested also had some portion of intangible assets?

Manish Gupta: Yes, that is right because there also we had bought certain DMFs in the past from the market.

Sai Kiran Pulavarthi: Got it, understood and the second question is on the Europe growth, can you just elaborate further, what was driving the growth in terms of the topline especially in the European markets on the formulation. This year it has been almost like 43% growth, how do you see this panning out in the next couple of years, both in terms of drivers excluding the Bremer and also I understand that you explained it will take a couple of quarters before you make it stabilize in terms of Bremer?

Manish Gupta: Yes, so 43% is certainly not the right number to refer because it reflects one quarter wherein Karizoo was not present in the last year, it reflects a nine-month over 12 month kind of thing, so on a like-to-like basis European business grew at about 18%. Clearly there were certain low hanging fruits, cross leveraging of portfolio was one amongst them and that brought this growth. We also are launching a lot of new products in Europe since Spain we have a good R&D centre and they are developing products. Earlier they were commercializing only in Spain and now with our front end in so many markets we are able to commercialize in all the markets, so we are confident of maintaining a double digit growth in Europe, ahead of the industry or the market growth in that space.

Sai Kiran Pulavarthi: That is very helpful.

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

Vishal Manchanda: I have a question on your outlook for FY2019, so could you guide on revenue side, it has been very strong in FY2018, so would it be similar numbers in FY2019, Sir?

Manish Gupta: As I have been mentioning we are right now refraining from giving guidance, but we expect the growth momentum of the last quarters to be maintained going forward. This is not a one-off quarter, it has been built on solid business dynamics and we are confident of maintaining this growth momentum.

Vishal Manchanda: Any colour on how many new approvals you would be getting, new registration you would be getting this year in Europe and other geographies?

Manish Gupta: Certainly we shall be getting a reasonable number of registrations. Unfortunately the veterinary industry is a very small industry, we do not have the large number of products that most of us are used to seeing in the pharma sector, so we are talking of handful of approvals. Also being a branded generic market you cannot launch too many products, because you have to detail and generate demand for each of your product, so it will be always a single digit number that we will be talking of for new product launches each year and that is what we will be getting in Europe this year. We do not foresee any approval or launch in US as far as formulations are concerned for next 12 months.

Vishal Manchanda: So you have made some filings in the US?

Manish Gupta: We are working on that, we shall be making first filings in the current year, but we have not filed yet in US as far as formulations are concerned.

Vishal Manchanda: On your API business, you said the mix will largely be the same, so 25% from API and rest from the formulation, so does this mean both of your businesses would grow on the same line as previous year, so kind of your API business grew 11% and formulation grew 27%, so now would that differential disappear?

Manish Gupta: Yes. As I was mentioning that our API business in the short-term may grow faster than the formulation business, but any inorganic initiatives that we do will happen only on the formulation side of the business and therefore the business mix predominantly will not change, so I cannot go for the last percentage, but broadly it will stay one-fourth and three-fourth.

Vishal Manchanda: Would it be fair to assume your API business growing much faster than how it grew in FY2018?

Manish Gupta: As of now we certainly believe so.

Vishal Manchanda: On your Bremer transaction could you add some more details as to what is your plan to leverage this, how do you intend to leverage this in rest of the facilities you got and you would say the emerging market presence is complementary and how is that going to help you?

Manish Gupta: So obviously we bought Bremer more for EU markets, not so much for emerging market, it was fundamentally for the EU GMP injectable facility that we bought it for; however, the short-term opportunities will be in the emerging market, so again cross selling since we are present in some markets, Bremer's own basic strengths is presence in some of the markets and that will cross leverage for some short-term gain. Eventually the idea is to leverage for EU markets because we have a portfolio of about 20 odd formulations under development, many of which are injectable products. These will be validated or the exhibit batches will be taken out of Bremer and commercialized in EU post approvals.

Vishal Manchanda: Sir any reason like you got it from Zydus Cadila. Any reason why they were not able to operate this profitably?

Manish Gupta: I think that is a question best answered by Zydus Cadila.

Vishal Manchanda: But do you think was it because of suboptimal scale in international geographies?

Manish Gupta: The only reason I foresee is we do not have any human pharma business, so for us animal health business is our bread and butter and for them it was one of the businesses, also Bremer was the only business outside India for them in the animal health space.

Vishal Manchanda: And finally is the Latin America business profitable now?

Manish Gupta: Absolutely. We had acquired a negative EBITDA business in Brazil. It took us about six months to turn it profitable and that profitability has been retained since then.

Vishal Manchanda: So things have just turned around, can we expect further improvements… strong improvement Sir?

Manish Gupta: See, veterinary business is all about scale, given the branded generic nature, so as you grow, the profitability obviously grows faster than the topline. Once you hit a critical size its impact on profitability is quite interesting in this industry.

Vishal Manchanda: So, we are potentially there in the Latin American markets?

Manish Gupta: Absolutely.

Vishal Manchanda: Okay. That is all from my side.

Management: Thank you very much.

Vishal Manchanda: Thank you.

Moderator: Thank you. The next question is from the line of Aditya Khemka from DSP Blackrock. Please go ahead.

Aditya Khemka: Thanks for the follow up, so a couple more. Firstly, Sir, what explains the seasonality of our business through the four quarter, so as I am looking at your four quarters for FY2017 and your four quarters of FY2018, your first quarter seems to be the worst quarters in terms of revenue as well as margins and it improves through the fourth quarter, so what explains this seasonality?

Manish Gupta: They are not comparable because a lot of new launches occur there is no seasonality as I was mentioning earlier. Fundamental seasonality in the business is very, very limited, but the scale of operations are growing through the year and that is why you see that improvement in revenues and profitability as we went along but by nature, the seasonality is very limited, yes there is a bit of seasonality like in India summer months are very poor because the dairy cattle and all are generally left to fend itself. Milk prices also behave in a particular way, so there is an element of seasonality, but it is very, very limited. It is all about new product launches, commercialization of Vet APIs in US, which has happened as we went along during the year.

Aditya Khemka: If I frame my question differently in Q4 FY2017 you had an 11.2% EBITDA margin with a Rs. 22 Crores absolute EBITDA. Then in the first quarter of FY2018 you had Rs.14 Crores of EBITDA and 7.6% margin, so what explains that sequential decline from Q4 to Q1?

Manish Gupta: I will have to look up into that and come back to you.

Aditya Khemka: Okay, that will be helpful Sir and secondly, if I am looking at your gross margins for the full year, so your gross margins in FY2017 were about 48.2, which have come down to 45.6 despite the fact that formulations growth has been 27.6% versus API growth, which has been 11.3%, so formulations have grown faster in this year versus FY2017, but yet your gross margins have actually come off by 250 basis points?

Manish Gupta: There is a bit of mismatch in the two years because as I mentioned Spain business was there only for nine months and also the Brazil business was there for eight months in the previous year, and these two businesses were comparatively lower margin businesses and therefore they dragged our gross margins to some extent in the year.

Aditya Khemka: Would it be fair to assume that the human API business is excluded from the FY2017 numbers they are listed for the human API business?

Manish Gupta: That is correct.

Aditya Khemka: Okay Sir and lastly when do we expect this listing of Solara?

Manish Gupta: From what I understand it should happen, it is imminent, it is about a couple of days away. Obviously it is a regulatory process; it requires approvals from the stock exchanges and authorities. More or less everything is done and it is a matter of days before it gets listed.

Aditya Khemka: Thanks a lot Sir.

Moderator: Thank you. We have a follow-up question from the line of Vipul Shah from Rippplewave Equity. Please go ahead.

Vipul Shah: Thank you so much for the followup, so part of the question was asked by my previous caller, so just wanted to understand a little bit further on the gross margins, do we have any colour today to say that in FY2019, our gross margins as a percentage will sort of trend towards the FY2017 gross margin numbers or higher?

Manish Gupta: There may be a small improvement in the gross margins as we go along, but I do not foresee much change in our gross margins because this business is more about the middle line being a branded generic industry, so as we scale up and as of course our US business grows, I do expect a slight improvement in our gross margins, but it will not be dramatically different vis-à-vis where we are today, but the middle impact will be far more in terms of our margins.

Vipul Shah: Thank you so much.

Manish Gupta: Because that middle line is not going to change much.

Vipul Shah: Okay Sir.

Moderator: Thank you. We will take the last question from the line of Prashant Hazariwala. He is an Individual Investor. Please go ahead.

Prashant Hazariwala: Good morning Sir. Congratulation for good set of numbers, I have one question like…what was your R&D cost for this year and the last year?

Manish Gupta: You want to hear a large number or a small number, I am just joking sorry. As of now we have a little challenge, we have not been able to record this number appropriately because a lot of our R&D is done in Spain and they have not been historically collecting this information, we have put in a system of getting this properly recorded going forward. It is a small number overall. The way I look at it is not as a percentage of sales, but absolute number because the number of molecules is limited. The interesting part of this business is that it does not require significant R&D investment and that is why the margins are – where there are for the leaders of the industry, so R&D number will never be a very big number for us, but how we spend that R&D is what is more important and that is what we control at our end.

Prashant Hazariwala: I want only one clarification, you said there is no Forex loss because of our business model right, but last quarter we have shown some Rs. 5.8 Crores of Forex loss and the explanation given was that that it is because of Turkey Lira appreciation against USD, so what was that?

Manish Gupta: We said that operationally we are not exposed to much of currency exposure because each country operates with the same currency in terms of this revenue and/or expenses, the Forex loss is because of the currency exposure or the loan, which somebody had asked in terms of the Turkish Lira loan in dollars and I had given a number of some Rs.37 Crores, it is on account of that conversion because that loan is in dollar terms for Turkish operation, so to that extent there is an exposure.

Prashant Hazariwala: So we can see another, Rs.4 to 5 Crores of loss because of this because we have seen almost 10% - 15% kind of depreciation of Lira against US dollar in this quarter right, so we can another Rs.4 to 5 Crores of Forex loss?

Manish Gupta: What I am saying is we cannot predict the behavior of Turkish Lira going forward, so whatever be the impact will flow through; however, having said that we are working on a kind of re-financing structure because the cash flows of our Turkish business are very robust to find a way to minimize this exposure.

Prashant Hazariwala: What about the cash flow, you said we will come back with cash flow numbers but you have not come back with cash flow numbers, what was your cash flow…operating cash flow for this year?

Manish Gupta: No we said we will come back because it requires working. We did not say that we will come back within the call.

Prashant Hazariwala: Alright, no problem. Thank you very much Sir. All the best.

Moderator: Thank you. Ladies and gentlemen that was the last question. I now hand the conference back to the management for their closing comments. Thank you and over to you!

Manish Gupta: Thank you gentlemen. Thanks for your time and patience for joining us so early in the morning. As I said we had a very reasonably challenging, but very existing year that has gone by, we continue to stay excited and we are confident on that we have achieved a reasonable part of strategic journey and stay confident of the future. Thank you and thanks again for joining us.

Moderator: Thank you very much. Ladies and gentlemen on behalf of SeQuent Scientific Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines.