



“Divi's Laboratories Limited Q3 FY21 Earnings
Conference Call”

February 06, 2021



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LIMITED**



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Moderator: Ladies and gentlemen, good day and welcome to Earnings Conference Call of Divi's Laboratories Limited Q3 of Financial Year 2021. 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 Mr. M. Satish Choudhury. Thank you and over to you, sir.

M. Satish Choudhury: Good afternoon to all of you. I am Satish Choudhury, Company Secretary and Chief Investor Relations Officer of Divi's Laboratories Limited. I welcome you all to the earnings call of the company for the quarter ended 31st December 2020. From Divi's Labs, we have with us today, Dr. Murali K. Divi - Managing Director; Ms. Nilima Motaparti - Wholetime Director, Commercial; Mr. L. Kishore Babu - Chief Financial Officer and Mr. Venkatesa Perumallu - General Manager, Finance and Accounts.

During the day, our Board has approved results for the quarter, and we have released the same to the stock exchanges as well as updated the same in our website. Please note that this conference call is being recorded and a transcript of the same will be made available on the website of the company. Please also note that the audio of the conference call is the copyright material of Divi's Laboratories Limited; and cannot be copied, rebroadcasted, or attributed in press or media without specific and written consent of the company.

Let me draw your attention to the fact that on this call our discussion will include certain forward-looking statements, which are predictions, projections or other estimates about future events. The estimates reflect management's current expectations of the future performance of the company. Please note that these estimates involve several risks and uncertainties that could cause our actual results to differ materially from what is expressed or implied. Divi's Labs or its officials does not undertake any obligation to update publicly any forward-looking statements whether as a result of future events or otherwise.

Now I hand over the conference to Dr. Murali K. Divi, Managing Director of the company for opening remarks. Over to you, sir.

Dr. Murali K. Divi: Good afternoon to all of you. I welcome you all for the earnings call of Divi's Laboratories. I hope that all of you and your families are safe and well during this still existent pandemic. We all must be proud that India is producing vaccines for COVID-19 and vaccination program is under progress. Let us hope for buildup of antibodies and thereby benefiting the population. Though vaccination is under progress, we still need a prophylactic or a drug that can be used to stop virus or reduce viral load. ₹ 2,500 crores of CAPEX have been implemented since 2018, and we have seen growth and should see further improvement in sales in the near future. The new major fast-track Custom Synthesis project is proceeding very well. One stream has already just started production and additional streams are under completion.



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Apart from this, we are also venturing in a big way into contrast media APIs. Over the last few months, we have completed the validations of several active pharmaceutical ingredients in both the generic and Custom Synthesis side of the business. The new molecules we have developed on the generic side of the business, we believe we have an edge in the technology, lower raw material costs and high purity of the product. We have started several initiatives in our research activities. One initiative of particular interest is our drive towards green chemistry. We have a group of dedicated scientists at both these facilities who are revisiting the chemistry of our existing products to see possibilities of process efficiency and lowering the costs. The end goal is to minimize wastage, maximize profits and move towards greener chemistry. Now, I ask Nilima to brief on operations. Thank you.

Nilima Motaparti:

Hello and welcome, everyone to Divi's Labs earning call to discuss the unaudited results for the third quarter ended 31st December 2020. I hope that all of you and your families are safe and well during this still existent pandemic. We appreciate you joining us today on this call to discuss Divi's Q3 performance. Firstly, I would like to summarize the current COVID situation in India and impact of it from a global perspective. One year of pandemic and I must say we still have been facing the effects of it on a daily basis. However, most of us have adjusted to the new normal and figured out emerging solutions to carry out our daily lives and business, as it is unpredictable of what the future shall hold. Nevertheless, there has been a decline in the number of COVID cases in India over the past few weeks, and we can hope that the pandemic may be on its last leg and it might not witness a second wave, something that other countries have been grappling with. As a result of the second wave in a few countries, there have been travel restrictions and lockdowns in few parts of Europe. Container shortages, blank sailing, lockdown in Hubie and a few parts of Northern China have impacted in disruption of supply chain and thus affecting the logistic management leading to delivery delays, congestion and higher freight rates across the globe. While the impacts of these have been minimal on our business, we only hope that, with the ongoing COVID-19 vaccination drive and certain promising molecules on the horizon, the world may return to normalcy, enabling normal business travel.

Speaking at an organizational level, ever since the outbreak of the COVID, our main focus has been on the health and safety of our employees and we are ever grateful and continue to applaud our employees' dedication and persuasion during these uncertain times. In addition to the safety of our employees, our focus has always been streamlining our operations, maintaining the steady supply chain and focused execution of strategic investments, which has enabled us to continue uninterrupted supply of APIs to the global market.

Moving on to our Q3 FY 2021 financials, on operations, I am happy to state that we have achieved a consolidated total income of Rs. 1721 crores during the quarter, reflecting a growth of 20% over the corresponding quarter of previous year. Profit before tax for the quarter amounted to Rs. 642 crores, a growth of 32%. We earned a profit after tax of Rs. 471 crores during the quarter, reflecting a growth of 31% year-on-year. Staff costs for the quarter includes an incentive of Rs. 34 crores paid to the employees in appreciation of their relentless work during



the COVID-19 pandemic. We have capitalized assets of Rs. 1,011 crores for the 9 months period, of which capitalization this quarter have been Rs. 181 crores. As of the end of the current period, we have cash on book of Rs. 2,064 crores; receivables, 1,499 crores; and inventories, 1,915 crores. Rupee has been quite volatile for the last 9 months. We have a Forex gain of Rs. 2.5 crores for the quarter and a Forex loss of Rs. 8 crores for the 9 months period. Exports for the quarter accounted to 85%. We continue to have normal business distribution across regions. Europe and U.S.A. accounted to 68% of our revenue. There has been a modest increase in domestic sales, which accounted to 15% for this quarter. Product mix for generics to Custom Synthesis is 60% and 40% of the revenue respectively. Constant currency growth for the quarter has been 11% and 22% for 9 months period. Our Nutraceutical business for the quarter amounted to Rs. 145 crores and Rs. 439 crores for the 9 months period. Thank you.

M. Satish Choudhury: Thank you ma'am. With this, we would request the moderator to open the lines for Q&A.

Moderator: Thank you. We will now begin the question and answer session. The first question is from the line of Damayanti Kerai from HSBC Securities. Please go ahead.

Damayanti Kerai: Sir, can you a bit elaborate more on your new venture into contrast media API, where you just mentioned some projects are already validated? So how soon you can start commercialization of some of these products?

Dr. Murali K. Divi: We are already in the contrast media iopamidol. We have been producing for the last several years and with the opportunities in the other contrast medias and getting into the scale, the possibility is that we could be thousands of tons of these materials. The advantage once you go into the large-scale league is that Iodine can be purchased at the right price, Iodine can be totally recycled and can be efficiently used; because, the contrast media, majority of the costs is Iodine. So, in a small-scale manufacturer or a medium-scale manufacturer, it is difficult to recover Iodine from the organic to the inorganic stage. We were able to do that and achieve in Engineering to commercially recover all of our Iodine that is going into the waste streams, so that our costs will be minimal. We assume that in the Iopamidol, the same thing now we have started implementing in the other contrast media compounds and we are confident that we should be able to get a reasonably good size of the market with the advantages of new technology of recovering Iodine with the benefits of already having experience of making the contrast media and there are very few players in the contrast media in the world.

Damayanti Kerai: My second question is on progress in, Kakinada, a few weeks back, we heard about some local disturbances, so how has been progress there?

Dr. Murali K. Divi: I think you are aware that we have received all the required statutory approvals for starting Kakinada, unit-III. During our initial startup of work, there have been some concerns raised by the hatchery association. Though their concerns have already been addressed during our public hearings, there still seems to be some apprehension about what sea discharge means. Presently,



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the Government of Andhra Pradesh has put in a committee, and the State Pollution Control Board is in discussions with them to address their concerns. We believe these will be resolved very shortly and we will continue our work.

Damayanti Kerai: Sir, so broadly, once we get update here, the construction and other update should continue normally because all other approvals are in place, right?

Dr. Murali K. Divi: That's correct. But what I would like to say is that we are not losing any business because of the delay, what happened in Kakinada. As you know, the Unit-I and Unit-II are on 500 acres each and we still have plenty of land and clearances to grow. Keeping all this in mind, we have also built additional production blocks, also to cater to the requirements of our new businesses. So, we are not losing business; at the same time, as soon as the Committee clears that, we will start construction.

Moderator: Thank you. The next question is from the line of Cyndrella Thomas Carvalho from Centrum Broking Limited. Please go ahead.

Cyndrella T Carvalho: Sir, if you could help us understand the gross margin improvement in a little granularity level would be very helpful?

Dr. Murali K. Divi: I think it is not the volume mass. It is the quality of the mass is the most important thing. I think what it means is that how good is the profit, how profitability is the business. I think that is what it matters. While we are building the volumes, while we are expanding our capacity, it is very important that we do improve our margins and not compromise on the margins. Now, how did we achieve this lower material cost and higher margins? It is not an overnight situation. It is the introduction of new technologies, new designs of equipment by our Engineering department and backward integrations of our old generic compounds and continuous process improvement. This is a combination of all these and at every opportunity, though we make sure that what improvements can be done in making more margins and minimizing waste and achieving more of products. I think this is always the focus right from planning, designing, research and execution. This is the results you are seeing, that in the API industry across, we have been looked at differently that the margins are different. And I think, going forward, we are quite confident that we should be able to maintain good margins.

Cyndrella T Carvalho: Sir, just coming back to our recent Capex, how should we look at the current utilization of the recent brownfields that we have already commercialized to an extent? And what was the Naproxen entire contribution this quarter?

Dr. Murali K. Divi: The investment, I think if we look back, we started investing heavily from 2019. If you take 2018-19, our sales were about Rs.5,000 crores and our PBT was 1,800 crores. Our PAT was about 1,300 crores. So, we started investing from then. In 2019, we invested about Rs.876 crores, in the last 9 months, we capitalized about 1,000 crores and we will be completing the remaining



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500 - 600 crores soon. Some of them are for debottlenecking, some of them are for assurance of supply, some are for introducing new technologies, some are for making our own intermediates. Now, not only we are free from supply threats from China, it also resulted in, as I said, on the normal cost savings. Now we already achieved on the good margins. You have seen this in 3 quarters, 9 months, we already achieved Rs.5,100 crores. What otherwise, it was a full year of income and 1,975 crores of PBT and 1,467 crores of PAT. This is for the 9 months and you can extrapolate to see the growth. And this is just the beginning of the growth and I think, in the coming quarters, the last quarter of this year, as well as from the first quarter of the next year onwards, you will see the growth curve; because it does take time - yes, we did qualify several generic APIs which have a lot of opportunity. We had one set of good generic APIs starting from Naproxen, Dextromethorphan, Gabapentin, all these compounds where we became leaders in the market. Now we have selected the next 10 generic products, just became generic or becoming generic; and that is where we completed qualification of some of them and are waiting for approvals to take the market.

Moderator: Thank you. The next question is from the line of Prakash Agarwal from Axis Capital. Please go ahead.

Prakash Agarwal: Sir, I joined the call a little late, apologies, but I just wanted to understand the sustainability of the gross margins and the EBITDA margins, as these are the new normal, like 41% plus and at the EBITDA level and in a couple of quarters we have seen that given the volume and the margin tailwinds, so are these sustainable over 1- 2 years, 3 years' timeframe given there is a significant amount of investments, so the volume is visible, but on the margin front, if you could just help understand the sustainability at these levels of gross margin and EBITDA margin, sir?

Dr. Murali K. Divi: I am more confident on the margin than the sales; the reason being we are technology people, and the company is technology-driven company. So, we are winning all these margins based on the technological improvements we have made to the process and completing them. It is not just enough to develop a laboratory process or designing a laboratory process. It is very important to translate that into the designs of the equipment in the plant and the installation and making sure that any teething troubles are removed during the production process. This is where we have people experts for the last 20 years. This is where retaining the employees is important. We are able to retain more than a few thousand employees for the last 10, 15, 20 years. As a result, we see always everybody is striving towards how to bring down the costs. That is one target always. So these dedicated employees drive the costs down and I am very confident personally that we should be able to maintain the margins in spite of last quarter's Capex; in spite of introducing a number of products, both generics and also in the custom synthesis; and I think we have good days ahead of us.

Prakash Agarwal: Secondly, sir, on the Capex journey we started 1.5 years back of Rs. 18 billion, how much of that has been achieved? And then we also had announced the new round of Capex, where we are in that as well, if there is a Capex update, sir?



- Dr. Murali K. Divi:** The new round of Capex, I have not discussed till now. The Capex I have talked about is the Capex plan since 2018 and 19 and 20 until now or till March. Now the investments made, either it is for debottlenecking or it is for assurance of supply or backwards integration; they are all complete and some of them have been qualified, already yielding capacities and improved sales; and several more are yet to happen because we are waiting for the clearances of the Agencies, whether it is US FDA or Europe; because some of them are involved with changes in the process for which we need a clearance. The scale-up clearance is not an issue, but if you want a higher yield or if you want some conditions to be changed, the clearance needs to come, which will come very soon. Now talking about the Rs.400 crores of investments, the fast-track projects I have mentioned last time which came all of a sudden as opportunity, they are urgently getting completed. This is what I said in my starting remarks that one of the streams already is into the production out of the 400 crores of investment; and few other streams are yet to be commissioned and the other products investment is happening; and the production will start somewhere in the first half of the next year.
- Prakash Agarwal:** So normally we give a breakup of the custom synthesis business and generics, what was for the quarter? And how is it likely to be next year?
- Nilima Motaparti:** It is about 60% to 40% generics to Custom Synthesis.
- Prakash Agarwal:** 60%, 40%, you said.
- Dr. Murali K. Divi:** It varies between always; I think I will say, 40%, 60%, it could be generics, it could be custom synthesis. I think, in this particular quarter, the generic seems to have taken a lead compared to the Custom Synthesis. You may want to assume that there is more custom synthesis, that is why there is more margin, but I am sorry to say that it is the reverse, we had a higher generic and the profit margins are also higher. I don't think we can link it that way really.
- Prakash Agarwal:** Understood, but what was the percentage? Since we give it every quarter if you can share that number?
- Dr. Murali K. Divi:** I think, as Nilima said, it is about 60% Generics and 40% Custom Synthesis.
- Moderator:** Thank you. The next question is from the line of Girish from Bank of America. Please go ahead.
- Girish:** Dr. Divi, just on the carotenoids business, I think it has been growing pretty well and almost reaching 10% of the top line, if you could give some color on what is the overall market share now the company has in the overall market and is the mix similar to like generics in carotenoids, where 68% is from Europe and US?
- Dr. Murali K. Divi:** The carotenoid business, more than 95% is Europe and US. We have very little business in India. And the market for Nutraceuticals in this carotenoid still is about \$ 1 billion which is still growing. We have been qualified by majority of the customers and feed business of the salmon



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and other feed industry and in the Nutraceuticals for the humans, the business got just started. We are looking the current business is about Rs.600 crores on an annual basis and we have just expanded 100% in capacity. This is part of the expansion we have taken up one year ago and we are geared up to produce 100% more than what we are doing. This is based on the business we can foresee.

Girish: And just to add on that, if you can give some color on whether the margins in Nutraceuticals would be almost like Generics business?

Dr. Murali K. Divi: The margins are, I think, it is just about the same and because the business is distributed into 3 companies still, the DSM, BASF and Divi's. That is where the majority of the business is. And looking at the competition today, if any one of them drops, that is it, the prices are going to be sky high. But we are happy with where we are and the margins are similar because we are very unique compared to the other 2 manufacturers that everything is integrated. For them, the API is made somewhere. It is sent to another country for making the beadlets, then it is sent for consumption somewhere. Here everything is happening at Unit-II under one roof. The API is produced, the beadlets are produced and exported. This gives an advantage to contain the costs.

Girish: And just the second question was on the contrast media market, overall, do you have a number how big the market would be? And how many products are you, let us say, envisaging to do? And if you could also give some color on competitive landscape there?

Dr. Murali K. Divi: The contrast media is about anywhere between a \$4 billion to \$6 billion business because nowadays, with the affordability, every day you are seeing people in queues, having the contrast being done for one thing or the other. Common public can go in and they are able to afford. So the consumption of the contrast media has increased tremendously in the last 2 years or 3 years and it is a question of till now, there are only very few companies survived in this industry because, number one, Iodine dependency; number two, how somebody can recover Iodine and reuse. Otherwise, this is not viable. This is where we have broken that ice and we think we will be the major player in it.

Moderator: Thank you. The next question is from the line of Sayantan from PineBridge Investments. Please go ahead.

Sayantan: So, I heard your comments on green chemistry and I understand we are very efficient, so I just wanted some further details, I mean, in terms of what we are doing in terms of green chemistry and what are our goals in this area? Or what is the potential we expect to see?

Dr. Murali K. Divi: Yes, green chemistry involves conserving materials that can neither be created nor destroyed, because they are limited. So, once we say that, now we keep consuming the regeneration is difficult. That is why the prices keep going up. So, what we are doing here is that developing atom-efficient technologies. That means, if there is a mass, if there is a 10 kilograms mass, we



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will make sure that our wastage is minimal and all the materials we add to make a product, majority of it goes to creation of that, not that we live with 50% yield and losing some 50% into the waste streams without recovery. First, our conversions should be higher, 70%, 80%, 90%; and the remaining, we should be able to recover, recycle, reuse. So, with these new technologies, it is possible that we should be able to work on atom chemistry and be highly efficient and this is possible only when low critical mass. If we just are producing 500 tons of Naproxen or 30 tons of Dextromethorphan, 200 tons of Gabapentin, it is not possible. But with the scale we operate, it is possible to make investments of hundreds of crores to make sure that our yields are the highest, our recoveries are the highest, our wastes are least and the chemistry is becoming more and more greener by conserving less energy, conserving less solvents, less emissions, less wastage to the treatment plants. This is what it will become more and more greener.

Moderator: Thank you. The next question is from the line of Shyam Srinivasan from Goldman Sachs. Please go ahead.

Shyam Srinivasan: I am just looking at the generic API business. I am removing, say, Custom as well as the Nutraceutical number that were shared. So that is about 51% of the total business, has seen good growth at the first 2 quarters, Dr. Divi said, but we have started seeing it slow down, and I am just trying to understand from some of the other competitors that probably the demand that we saw in the first half of this year or even the 9 months is probably starting to plateau or may be fall, so what are you seeing from a generic API maybe even a competitive standpoint? We are hearing that at least trade data seems to be showing that Chinese API exports are also picking up tremendously, so just your thoughts on the generic API, please?

Dr. Murali K. Divi: I understand what you are saying that when you say generic APIs, it is a vast area. Are we talking about antivirals? Are we talking about pain killers? Are we talking about antibiotics? Are we talking about fermentation products? So the products where China is quite strong, in antibiotics, in fermentation, in some of the antiretrovirals and others, yes, probably the competition is happening and when China comes back, probably there will be pricing pressures as well as competition pressures, but we are in products where we have been the leaders prior to the COVID; and since then, we expanded. Since then, we have made our processes more efficient, cost efficient, higher quality and with all regulatory and also, we have strengthened it further by going backward integration to make sure that we are not being dictated by anybody about supply of the material either on the increasing costs or as a shortage. So, we don't foresee at least in the near future, I am talking about in the next 2-3 years or 4 years, any issue at all to our generic business because of two reasons. One, it is not that easy to create the capacities; huge capacities we have in generics, our products; for somebody to invest and get into production, number one. Two, even if somebody does, it takes 3-4 years to get the approvals from the regulatory authorities. That would take time. So, somebody has to make a large investment; wait for 2-3 years after completing the plants for the sales; so somebody should have the staying power of 3 to 5 years after borrowing money. The good thing for us is we don't borrow money. We use our



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reserves wisely, and this is where we are more efficient, and we are continuously investing into the process development to make sure our pencils are sharp.

Shyam Srinivasan: My second question is, in your opening remarks you have talked about the next 10 molecules that you are targeting, so the concern probably is that maybe the mature molecules are now slowing down, like you disclosed top 5 is about 45% of revenues in your annual report, so is there comfort that the next 10 molecules can slowly replace or offset some of the slower growth that comes from the top molecules?

Dr. Murali K. Divi: I do not think so. So, the reason being that, once patients are used to, let us say, Ibuprofen, they continue to use Ibuprofen. Though we have come with Naproxen and we have increased our capacities like 5,000 tons, but Ibuprofen demand did not go down. It is still 15,000-20,000 tons and still growing. So, I think, when a new product comes, it will have some advantage of either in some therapeutic additional advantage, but the original traditional generic API which were used for the last 20 years is not going to disappear. Now, they are all still growing because these are found to be very safe. So, they are still growing, we have seen that in all our generics. Now the new generics or recent generics or the future generics with the large volumes, there are not many. There are, let us say, about 10 of them. Some of them, yes, 1 or 2 of them, are in the same therapy segments where we already have a generic product, but this is a little specialized. It is the difference between having oxygen monitor or oxygen into the nose versus incubator. People needing incubators, they must go to the incubator, people just needing oxygen support, they need that. So, in generics, again, what we are looking at is that the specialized products with volumes which are similar to our generic compounds. I think this is where we have Mr. Kiran Divi, the CEO, has chosen with personal interest and has targeted them; and we developed the process, qualified the process for several of them and they are under regulatory submissions and we should see their growth in the coming years along with our generic products growth.

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

Alankar: Sir, my question is broadly how has pricing for our generic API portfolio moved in the last 1 year? And what are your expectations going forward?

Dr. Murali K. Divi: I think it is 2-way thing that's happening. In general, up-and-down, it keeps happening, some of the generics, the demand is about the same. I think, it all depends upon some shortage of raw materials at some place, or sudden requirements elsewhere, improper planning. That fluctuation will be there. But with us, not only big pharma, the generic, majority of our customers, it's long-term long contracts. It is not spot business where you try to sell 10 tons somewhere at a high price or 5 tons disposing at a lower price. That is not our business model. Our model has been that we are a dependent supplier and assured to our customers. So, the customers sign very long-term, contracts, whereby I think we are not afraid of the fluctuations of pricing.



Alankar: And my second question is, traditionally we have been very strong in high-tonnage products, but over the years, gradually, slowly and steadily we are seeing the tonnage requirements for new molecules coming down, so for the Custom Synthesis business, do you see this as a very long-term risk? And is there any need to tweak our business model in the future?

Dr. Murali K. Divi: I don't think we need to change our business model, number one. Two, the reason is that, when we entered into this business 25 years ago, most of the big pharma's had more than 3 to 5 manufacturing sites for APIs in different countries. Today, most of them do not have even a single API manufacturing unit. Yes, you are right. When we entered, every big pharma was coming out with several APIs, at least 3, 4, 5, every year with decent volumes from their discovery bag. Now, there are more small-volume products coming out and the larger-volume products are 1 or 2. Yes, there is a reduction, but they also cannot find too many API manufacturing sites which can accommodate such large volume requirements of equipment. This is where we are very uniquely positioned, that they also don't have much choice than to go to your preferred supplier like Divi's having a relationship for 20-25 years; for on-time supply; all the time quality maintained; and decent priced. I think this is where the strength still is. Yes, we are also prepared. We have built multi-purpose small-volume plants at both sites, so we are prepared if there are more opportunities. If we need to take 10 molecules of few hundred kilos, we are ready to do that. We also have such designed manufacturing blocks right now.

Moderator: Thank you. The next question is from the line of Chirag from DSP Investment Managers. Please go ahead.

Chirag: Sir, there is a Rs.167 crore increase in inventory in the quarter, is this related to the Custom Synthesis fast track product?

Dr. Murali K. Divi: The increase in inventory, Rs.167 crores..... Every third quarter, if you go back to the historical, every big pharma, every generic house in US, Europe, everywhere, they want to maintain lean inventory and they don't want any huge stock on December 31st. It is a generalizing thing. Maybe it could be the impacts. I think, let me...

Nilima Motaparti: And also, some of the capitalization that we have done, at the 2 SEZs that have come into operations, I think that is the reflection of the inventories from there, that you are seeing the rise.

Dr. Murali K. Divi: What Nilima is saying is that we have 2 SEZs, DC-SEZ, DCV-SEZ, they started activities, they started qualifications, they started their just commercial productions; all those need a lot of raw materials; build-up of inventories; and even the API produced in 1 case and in 2-3 cases; and stocked because until we get the clearance from the regulatory agencies, minor or major, I think we need to hold. Some of them or much are reflected into the stock, yes. So, what Nilima said is right, in addition to what I generalized on that in Q3 year-on-year.

Chirag: Sir, will this lead to higher sales in Q4 because this material will be sold?



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Dr. Murali K. Divi: As I mentioned that one is Q4, I think we don't want in all of you to look at us on quarter-on-quarter. Please look at us on the investments we have made and I have mentioned that you will see some increase in Q4, but I think you should wait for the bigger cake, which is going to be more attractive, in the beginning of the year or end of the year, during next year and follow-on. I think that is where I think is the cake is.

Chirag: And the second question was on Capex for FY '22 and '23, sir. Any plans formed up?

Dr. Murali K. Divi: I think we mentioned last time that the next Capex is for the Kakinada Site, 600 crores; and whenever we start Krishnapatnam as a backup for Kakinada. Otherwise, I think very much we are not seeing much except there are few buildings we built them, production buildings, in 1995; those buildings, I think, are not comparable with the modern systems of automation, modern systems on mechanization, modern systems of gadgets, requiring more manpower than the newer buildings. So this year, we may make a call and say, well, let us go and invest in creating, modernizing these blocks. I think, if at all, that may happen. Otherwise, we are not planning.

Moderator: Thank you. The next question is from the line of Tushar Manudhane from Motilal Oswal. Please go ahead.

Tushar Manudhane: Sir, firstly, on the contrast media aspect, you have highlighted the market size. Could you also elaborate on the volume-wise? Is it like going to be high-volume products or low-volume products?

Dr. Murali K. Divi: I think I already covered it. I mentioned that these are high-volume products because you know that the contrast media is given anywhere from 20 grams to 80 grams to each of the individuals to get a good picture of how is inside bones (of the body) to any everything else is; and so this is high-dose and high-volume business and it is growing also very much in the developing and under-development countries along with the developed countries.

Tushar Manudhane: And sir, secondly: So, we have been for many years into these iodine-based APIs. Any thoughts on the gadolinium-based APIs in this subject itself?

Dr. Murali K. Divi: We have looked at the gadolinium compounds in the past when the innovator was discussing with us quite a long time ago. I am talking about 15 years ago, but we haven't reconsidered them unless as I said, it has to pass our CEO before it comes to me to look at the technology. So, our marketing Vice President and CEO, they need to look at those and revisit. Right now, it is not in my radar.

Tushar Manudhane: And just lastly on, with respect to this contrast media and the new molecules in the API which you alluded to, these would require fresh investments as and when it reaches commercialization?



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- Dr. Murali K. Divi:** The investment is already planned and allocated. The projects are under progress. Some validations have been completed and for some products, they have been even submitted (for regulatory). So, it is a combination. It is within the investment plan already done.
- Moderator:** Thank you. The next question is from the line of Anubhav Aggarwal from Crédit Suisse. Please go ahead.
- Anubhav Aggarwal:** Sir, just one question on your Custom Synthesis portfolio. I just wanted to check over next few years, just as an idea, how many products can come off patent? Is it a risk to us? Or that is very small part of the portfolio for us?
- Dr. Murali K. Divi:** Since we started this custom synthesis, I have been mentioning that we cannot talk about the products; the ratios; how many in Phase-I, Phase-II, Phase-III. We have not been doing that; and I think we would like to be that way so that the commitments we have made with the big pharma by signing the confidentiality agreements can be honored better. So, we don't disclose that, how many projects and which phase and with which company, which regions, or which therapy segment.
- Anubhav Aggarwal:** Yes, sir, so I appreciate that. I did not want any product detail. I was just asking a very high level that, not even asking how many molecules you have right now there, but is there a risk to the overall profitability of that segment that, over next 2-3 years, certain molecules go off patent and that could impact us in terms of growth?
- Dr. Murali K. Divi:** I got your point. Even after patent expiry, we have seen some of the compounds, they did not go down. In fact, this growth still is being there. I think, the newer molecules, they have much tighter impurity profiles and for the generic industry overnight to develop such costs, such impurity profiles with strict quality is getting tougher. We are seeing there is a resistance in the market, in the medical community that for neurological, for example, they don't want to change from the traditional tablets of the big pharma to a generic because even a little variation in the impurities can cause enough of disturbance in the brain, to the neurological, so this still would like to..... the same thing in several others. You have recently seen the impurities of these nitrosamines where the whole world went into upside down in the sartans, in the anti-ulcer compounds. So, the generic industry could not then enter with these impurities and now several lawsuits and what not. So we are not seeing, if your quality is good and if your impurity profile is good, if you are in green chemistry, if you are atom efficient, if you have a manufacturing scale of the world scale, I think you will have a bright future. But if you are happy with the original products of 1995, what the big pharma gave you, it is like enjoying our grandparents, whatever they gave us, then I think it is not possible, we cannot survive. But we have been always improving and we are confident that we will have good opportunities in this Custom Synthesis business without compromising in margins.



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Moderator: Thank you. The next question is from the line of Surya Patra from PhillipCapital. Please go ahead.

Surya Patra: Sir, just pardon me that if possible, they could be repetitive question that I will be asking because I joined a bit lately, so just wanted to have a sense on the margin and the gross margin scenario for the quarter as well as for the future period. See, whether the gross margin expansion is led by improved product mix or it is a cost aspect what has supported the gross margin expansion or it is a realization, can you give some sense on this one, sir?

Dr. Murali K. Divi: In fact, if you look at the expenditures side, we have paid one-month salaries as an incentive of Rs.34 crores to the employees because of their excellent devotion and performance during the pandemic period. Now that also went into the expenditure in spite of that. Now the margins have improved because of, number one, majority of PTA has to eased on the improvement of the processes, improvement of the green chemistry, atom efficiency, whereby our costs of manufacture, the material costs have come down substantially, that is where the majority of it. Yes, the price of the products may have, in some products, slightly increased, but to compensate that, some of the very basic materials like solvents, some of the alkali, some of the reagents have gone up substantially in the last 2 quarters. It is not the Chinese impacts. It is a general impact. It has happened. So that much have compensated, if any, benefits we received in the increase in some of the marginal prices for our APIs.

Moderator: Ladies and gentlemen, that will be the last question for today. I will now hand the conference over to Mr. M. Satish Choudhury for closing comments.

M. Satish Choudhury: Thank you all for joining us today for the earnings call of Divi's Laboratories Limited. In case, you need any further clarification, please reach out to our investor relations. Thank you.

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