



Leadership through partnering

“Strides Arcolab Limited Conference Call”

December 10, 2013



Leadership through partnering



MANAGEMENT **MR. ARUN KUMAR – VICE CHAIRMAN AND MANAGING
DIRECTOR, STRIDES ARCOLAB LIMITED.
MR. BADREE KOMANDUR – CFO**

MODERATOR **MR. NITIN AGARWAL – ANALYST, IDFC SECURITIES**

Moderator Ladies and gentlemen, good day and welcome to Strides Arcolab's Conference Call hosted by IDFC Securities. As a reminder, for the duration of this conference, all participants' lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this conference, please signal an operator by pressing '*' and then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Nitin Agarwal from IDFC Securities. Thank you. And over to you Mr. Agarwal.

Nitin Agarwal Good afternoon, everyone, and a very warm welcome to the conference call with Strides Arcolab hosted by IDFC Securities. The purpose of the call essentially is to provide an update on Strides Arcolab and to discuss the way forward post the closure of the Agila divestment. On the call today, we have representing Strides management Mr. Arun Kumar – Founder and Group CEO and Mr. Badree Komandur – CFO. I hand over the call to the Strides management team to take it forward. Please go ahead, Arun.

Arun Kumar Thank you, Nitin, and thank you once again and IDFC for hosting us as usual. Good evening, friends. This is Arun, and I have Badree – CFO and other colleagues to support this call, I thank you for joining this call today.

As you are aware on 5th December we concluded the sale of Agila to Mylan. This has been a long drawn process. As all of us know we announced this transaction in February, we ran a process 5 to 6 months before that, so it has taken almost 12 to 14 months to conclude what we think was a satisfying end result. In the next few minutes, I will take you through the transaction headlines. There have been certain amendments to the transaction consequent to events that occurred in the run up of the transaction closing. And for everybody's benefit, we would strongly recommend that we use the AGM guideline numbers which was the last number that we came up post the deal announcement which was on 10th of June for easy reference and comparison. So since we announced the deal in February, we did further fine tuning of the transaction cost, tax planning and we came up with the detailed split up of anticipated expenses in the AGM which is also on our website. We think we have guided some numbers today. So, using these two reference points, we will get a better handle of things.

Before I start, I am also pleased to have for the Board to have recommended Rs. 500 a share which resulted in a cost of \$525 million. And if I may say with happiness we believe that this is amongst the highest distribution in corporate India which I think is very satisfying and humbling at the same time.

We also today decided on a shift of financial year to 15 months. This is in line with the new Companies Act guidelines that financial year should commence from April. So we found it appropriate to use this opportunity to extend our financial year from December to March, and so we will probably guide when we announce the Q3 numbers and additional quarter numbers

for our Legacy business, but we will not be touching upon that today, and I will now get straight into the transaction details.

For those of you who remember the transaction when it was announced there was a base price of \$1600 million and there was a contingent payment of \$250 million. We had anticipated an expense of \$125 million to meet those obligations in that contingent payment. I am pleased to report that we concluded that with a spend of \$100 million which was a lower end of our range, and as a consequence there is a \$25 million additional payout from that initially determined amount of \$250 million. There has been a saving of approximately \$66 million on the transaction. This is mainly through renegotiations of minority interest and transaction cost, reduction of employee incentives, and reduction in capital expenditure -- all this has resulted in \$66 million saving, and if you add that to the \$25 million saving that we have on the contingent cost, that takes it to about \$91 million as total savings. And on the tax we have \$50 million saving from \$280 million forecasted to \$230 million. That is a \$180 million to be paid now at closing and \$50 million on release of the hold back in full within 2014 more towards H2 and there will be a \$50 million additional tax payment taking total tax to \$230 million. If we consider all this; there is a total saving of around \$140 million on the transaction. Having said that, when we announced the closure of the transaction, we indicated there is an additional spend of \$150 million both in terms of remediation cost and also towards certain additional contingent payments that we agreed with Mylan as we faced the warning letter situation, and we were very focused on ensuring that the deal closes, so we agreed to take some additional cost. But I am happy to say that with this renegotiation of cost and reduction of tax, we have more or less mitigated \$150 million additional spend. So net-net we do not see any big difference, difference to the total consideration that could be received. Having said that there is a new regulatory contingent of \$250 million directly related to the warning letter situation for one of the Agila facilities, and that is something which will be a hold back. As some of you would have read Robert Coury's interviews in business papers in India both Mylan and Strides very strongly believe that we should be able to resolve the FDA matters fairly quickly. We have made significant new commitments with the FDA and we strongly believe that more towards H2, we would have achieved a successful result with remediation. So we agreed for hold back of \$250 million which will be received by us towards sometimes 2014, and we hope at that time we should be able to distribute this \$250 million back to shareholders. In addition to the \$250 million there is \$40 million regulatory escrow that we believe will not be used because in the \$150 million we have already budgeted cost of remediation but for any reason those costs are not contained within that estimate and the resolution takes much longer, then there is a possibility that the \$40 million in escrow could also be used up. At this time, we do not believe so and therefore we are guiding that \$250 million of the contingent payment and the \$40 million of the regulatory escrow will both be released sometime in 2014. At this stage, I must tell you that the company has got no inorganic strategies, no acquisition targets in place, and we are strongly believe that our existing pipeline and strong delivery on our Legacy business would take us to the next level of value creation. So there are no acquisition projects

that we are targeting, and for now investors should assume that all the \$290 million on receipt would be available after taxes will be available for distribution. Obviously, we will give you updates as time goes both in terms of remediation and in our confidence level of how that influence as time goes. But, as we speak, we have engaged with the regulatory agencies -- we met up with the FDA, we have had cordial and productive meetings that we believe that the FDA is satisfied to a large extent with what we have made commitments for. We are working hard along with Mylan to ensure that those commitments are met. And we believe that we should be able to address the situation. Mylan and the erstwhile Agila have already commenced shipments as decided to the US markets. There is nothing the warning letter escalated to something more critical. We believe that things are in control and we should be able to address this matter quickly and put it behind us as we focus on our Legacy business.

The foreign exchange impact on this transaction was the foreign exchange was at 62, exchange benefit in rupee terms has been passed on to shareholders completely. Because we were eager or we wanted to maximize the distribution and you will appreciate that 88% of total free cash has been distributed back to shareholders, we decided to retain \$50 million of low cost debt and reduce the cash originally budgeted at \$100 million to \$75 million to facilitate dividend which would cost the company \$525 million reflecting in a round number of Rs. 500 per share. Had we decided to be completely debt-free we obviously would have to reduce dividend to that extent but we decided that the business could easily handle the debt from the cash flows and take care of it in the next 2 to 3 years. So that is headline in terms of the transactions.

In terms of the hold back just a summary we have a growth capital of \$75 million. We have a tax escrow, which will be released in four years for \$100 million. We have regulatory escrow for \$40 million that should be released in a year and we have a \$ 250 million hold back, totaling to \$465 million, and then there is a tax liability of \$50 million on that which will bring the total potential net cash available over time to be about \$415 million, of which we expect the escrow on tax to be released after 4 years, and \$290 million on regulatory escrow and regulatory contingent hold back will be available to us in the next 12 months. So that is the headline summary. I am more than happy to take questions, and please feel free to ask the specifics between Badree and me and we should be able to address them, thank you

Moderator

Thank you very much sir. We will now begin the question-and-answer-session. The first question is from the line of Ranjan Jain from Nirmal Bang Securities. Please go ahead.

Ranjan Jain

Can you just repeat the last sentences which you said about the money which you are supposed to get in future, and the \$75 million cash or something which you have in your remaining business, is it right?

Arun Kumar

\$75 million of cash is retained in the business as of today. We will receive \$100 million in tax escrow which gets released in four years, and this \$290 million of hold back and regulatory escrows which should be released sometime in 2014.

- Ranjan Jain** Just wanted one question, you think quite confident that you would be able to clear the regulatory hurdles in 2014, my question is has Mylan put any deadline in terms of like it needs to be completed in 2014 else this money will not be given to you?
- Arun Kumar** No, there are no such guidelines.
- Ranjan Jain** Because as I am aware, normally, these things take lot of time to get cleared. So you do not have any such contingent liability on that, right?
- Arun Kumar** No, we do not.
- Ranjan Jain** So if it gets shifted to 2015, still you are able to get that money?
- Arun Kumar** You are right.
- Moderator** Thank you. The next question is from the line of Hitesh Mahida from Fortune Equity Products. Please go ahead.
- Hitesh Mahida** Just to run through the deal, as of now we have received 1.5 billion from Mylan? And we will be paying \$180 million of tax, \$ 150 Mio expenses and \$250 million of debt, and we have already paid \$525 million of dividend. So even after doing all these deductions, we are still left with close to \$250 million of...?
- Arun Kumar** You got the total amount paid wrong. Out of the \$1750, there is a \$250 million hold back and there is a \$140 million escrow.
- Hitesh Mahida** So even after doing that we will be left with something around \$100 million of cash, is my understanding correct?
- Arun Kumar** Yes.
- Hitesh Mahida** Even after making a remediation cost of \$150 million?
- Arun Kumar** Yes.
- Hitesh Mahida** So will that be also paid as dividend in future or?
- Arun Kumar** We have committed that when the contingent is released we will distribute that to shareholders either as dividend or as a buyback.
- Hitesh Mahida** Just to confirm again, total debt paid was I think \$250 million, right?
- Arun Kumar** Debt and debt-like items is about \$292 million.

- Hitesh Mahida** Has there been any impact of the pricing policy on domestic business which is part of the remaining business?
- Arun Kumar** It is very small domestic business and none of the major products are under this.
- Hitesh Mahida** We were expecting a couple of big approvals as far as the remaining unsold business are concerned. Can we expect it before the end of the year or we...?
- Arun Kumar** No control over this. We were hoping that we should have received these approvals by now, but unfortunately not only for us but for the bulk of the industry, the approval delays are hurting and it is the same case for us. At this time we do not have any guidance on when we would get these approvals.
- Hitesh Mahida** How confident are we to resolve the warning letter, when can we expect this USD 250 million hold back?
- Arun Kumar** We are very confident that the warning letter will be resolved and we expect that the hold back to be released in H2 of 2014.
- Moderator** Thank you. The next question is from the line of Carson Yost from Yost Capital. Please go ahead.
- Carson Yost** Could you please walk us through us some of the milestones that you need to achieve for the FDA? I have read the warning letter; it seems pretty mild beginning rubber glove, sticks etc., And how the process works?
- Arun Kumar** Basically post the warning letter was received by the company we made certain information to the FDA in mitigating some of the observations that were raised in the 483s and subsequently in the warning letter. These were obviously time-consuming as in we have given certain commitments to the FDA, and on our own we appointed third party consultants to ensure that those commitments are independently verified and audited. So these consultants are already on board in the company and we work very closely with Mylan to achieve a satisfactory closure here. We expect responses to be made based on the timelines that we have committed. The FDA would then come and reinspect the facility, and if they are satisfied, we expect the warning letter to be lifted.
- Moderator** The next question is from the line of Rahul Salvi from IIFL. Please go ahead.
- Rahul Salvi** I had 3 set of questions. One was regarding the total debt which has been retired. So as from the June 10 AGM Report, which we are seeing we had total debt of around \$225 million long term debt and \$70 million of debt like. So it makes around \$295 million. Before sometime you

said that \$292 million of debt plus debt likes have been retired. So can I say that the whole debt has been retired except this new ECB of \$50 million, am I right?

Arun Kumar Yes, basically this transaction has taken us almost 6 months greater than what we had anticipated. So the company had borrowed additional funds also for growth capital and stuff like that for its Legacy business, and also we had commitments in Agila itself to continue to make investments because we could not stop any of those. So since the transaction got delayed, the debt that is originally anticipated in February increased by about \$50 odd million.

Rahul Salvi And the tax which you have paid that is shown as \$230 million, of this \$180 million has been paid right now and \$50 million is yet to be paid upon when the hold back money comes, am I right in this?

Arun Kumar Yes, right.

Rahul Salvi The dividend payout is \$525 million pre tax. So is it pre-tax as in pre-dividend, distribution tax, I did not get exact wording?

Badree Komandur No, the total distribution is \$525 million.

Rahul Salvi It is post dividend distribution tax, right?

Badree Komandur Post dividend distribution tax, if you take the Rs. 500 per share, it will come to almost \$478 million and the tax is about \$49 million net.

Rahul Salvi \$49 million of tax and \$478 million?

Badree Komandur The total distribution is about \$525 million.

Rahul Salvi The growth capital has been reduced from \$150 million to \$75 million, is it right?

Arun Kumar From \$100 million to \$75 million.

Rahul Salvi The CAPEX remains same \$50 million?

Badree Komandur \$ 32 million is the capex.

Moderator The next question is from the line of Jigar Walia from OHM Group. Please go ahead.

Jigar Walia First, primary clarification that the additional \$290 million before tax is just the dividend distribution tax, right, not the \$50 million that we are holding or the other income tax?

Arun Kumar Yes.

- Jigar Walia** Any revised guidance for the balance business, we are having about Rs.1000 crores and Rs.200 crores?
- Arun Kumar** No revised guidance
- Jigar Walia** Why is the EBITDA at just 20%, while in the first half we have done much more?
- Arun Kumar** Like we have a significant business in last quarter which got shifted to this quarter. So it is just a pick and value situation in a particular quarter. We should be alright by the end of year meet those guidance in terms of EBITDA and top line.
- Jigar Walia** Any targeted ramp up in terms of product files because I think in terms of the unapproved ANDA
- Arun Kumar** In February, we will give you guidance of the Pharma business when we announce our Q4 results. We give guidance when we will give you a little better colour in terms of product approvals because we think that by then we should have better clarity on product approval status.
- Jigar Walia** Given that there have been certain amendments in the deal, any non-compete clause which is still there or is it removed or something like that?
- Arun Kumar** There are non-compete clause. as approved by the CCI and we do not intend to be in Injectables business.
- Jigar Walia** Just a clarification, that even if there is no 1-year deadline that if the warning letter takes a little longer to get results, there are still \$250 million comes, just it is in an escrow and it is contingent in terms of the time and not in terms of the eventuality?
- Arun Kumar** If the events escalate beyond the warning letter, there are challenges. But the challenge for the company is to ensure that in the worst case, remains as a warning letter and the best case the warning letter is lifted.
- Jigar Walia** Some couple of more questions. The capital that you are retaining is only \$75 million. In your last statement that you mentioned for distributing the further dividend and buyback, there is also an option of growth. So is it that the \$75 million ...?
- Arun Kumar** We will probably retain some money for growth because as you will appreciate that the \$75 million is lower than the \$100 million, so we will top it up maybe to \$100 million that is why we also added growth, but we are not looking at any acquisitions or any big ticket spend, bulk of the money will go back to the shareholders.

- Jigar Walia** Last question, in terms of the \$150 million additional remediation cost which includes consultants as well. The Part-II mentions of acquisition of certain assets from a B2B partnership in the US, if you can just explain this a little more?
- Arun Kumar** We are not giving any split up between the costs. When there is a warning letter issued, obviously product approvals are not issued till the warning letter is released. So that effectively meant that there would have been some impact on future revenues for Mylan that was mitigated to a large extent by this acquisition of assets that we got which kind of made up for the potential losses. So between that and remediation cost, we expect the spend to be \$150 million.
- Jigar Walia** In terms of timing, this \$150 million would have already been incurred?
- Arun Kumar** Some of it has, it is ongoing.
- Moderator** The next question is from the line of Bhagwan Chaudhary from India Nivesh. Please go ahead.
- Bhagwan Chaudhary** Just one clarification, it is on the dividend outgo, you have mentioned that \$525 million is pre-tax and will there be additional dividend tax outgo from the balance sheet of the company?
- Badree Komandur** No, what we are saying is that the total dividend outflow is dividend including the tax is about \$525 million, out of which for us to give Rs.500 per share that outgo is about \$478 million, the balance \$47 million represents the taxes which is a combination of the money which is used in India as well as from abroad.
- Bhagwan Chaudhary** One thing on that escrow account side you said that \$150 million expenses you have incurred, how much you have incurred and how much is lying with you and when you are saying that \$75 million is cash with you, you are left with \$75 million of the cash after all these transactions, so you are excluding the entire \$150 million out of that?
- Arun Kumar** Yes, \$150 million is not considered as part of the cash or anything. So that is already provided for in our discussions today.
- Bhagwan Chaudhary** One last thing that you said additional \$40 million in escrow account?
- Arun Kumar** Yes.
- Bhagwan Chaudhary** For what it is mainly for?
- Arun Kumar** We are anticipating a certain amount of spend on remediation, but in case this spend is greater, we agree to have \$40 million extra amount retained. But we do not believe that the spend will be greater than what we have already provided in the \$150 million estimate.

- Bhagwan Chaudhary** And it will be clear by what time?
- Arun Kumar** **Hopefully it** will be clear by H2 of 2014.
- Bhagwan Chaudhary** Once again when we are saying that we are left with \$75 million, we are including \$180 million for the transaction tax or \$230 million?
- Arun Kumar** \$180 million.
- Bhagwan Chaudhary** If I am calculating as per this entire, the remaining is coming to \$233 million, you should be left with this kind of cash. So other than this where we are spending the remaining?
- Arun Kumar** I think you should go offline and discuss with Badree or one of his colleagues because obviously this is not the forum to reconcile the numbers. Please feel free to call Badree and he will address your concerns.
- Bhagwan Chaudhary** Lastly, can you tell me that how much we are excluding for the employees and this minority, etc.?
- Arun Kumar** The employee payout what was budgeted in the AGM was \$50 million have been reduced to \$38 million.
- Bhagwan Chaudhary** Including the minority?
- Arun Kumar** Minority and transaction cost was \$90 million that has now come down to \$57 million.
- Bhagwan Chaudhary** \$57 million and \$38 million?
- Arun Kumar** Yes.
- Moderator** Thank you. The next question is from the line of Alok Dalal from Motilal Oswal. Please go ahead.
- Alok Dalal** Most of my questions were answered, I have just one. This balance in escrow of 4 years that is \$100 million, can you explain what that is for and after 4 years is it accrue to us without any condition?
- Badree Komandur** As you know Agila is an international business, so we have given the tax warranties across all the jurisdictions and this is what traditionally all the assessments of the prior years will generally take a long time to complete. So what we have done is we have given an escrow for \$100 million, which covers all the jurisdictions put together. So there are no conditions attached to this, and if there are no claims arising out of this escrow, this entire amount will come back to us.

- Alok Dalal** Is there a possibility that we might receive less than \$100 million at the end of 4 years?
- Arun Kumar** At this point of time we do not think so.
- Alok Dalal** Just to clarify, this is separate from the \$230 million tax liability that we are currently assuming?
- Arun Kumar** That is correct.
- Moderator** Thank you. The next question is from the line of Kumar Saurabh from Macquarie Securities. Please go ahead.
- Abhishek Singhal** This is Abhishek Singhal. Just one clarification, in your opening statement you talked about net cash being left at around \$415 million. So \$250 million is the contingent payment and \$140 million is escrow that becomes around \$390 million. You have to pay \$50 million of tax that \$230 million to \$180 million. I am not able to reconcile how you came to that \$415 million number? If I do that I am coming to around \$340 million.
- Arun Kumar** Growth capital at \$75 million which you miss.
- Moderator** Thank you. The next question is from the line of Jigar Walia from OHM Group. Please go ahead.
- Jigar Walia** On the \$140 million tax escrow, would we continue to receive interest on that?
- Arun Kumar** No.
- Jigar Walia** An unrelated question if I may. Shareholders have approved on the FII stake hike. Any feedback that you got from RBI.
- Arun Kumar** In the last cabinet meeting, it was decided that FII limit and foreign ownership in Pharma is not relevant. So we are expecting the DIPP to issue notification to RBI and we expect the normal bureaucracy to take the next two to three weeks, but we should have approvals then.
- Moderator** The next question is from the line of Amish Kanani from JM Financial. Please go ahead.
- Amish Kanani** I just wanted to understand the debt like item that you mentioned, one, what were the nature of those items and has it paid back, is it in the balance sheet now?
- Badree Komandur** As far as the debt like items is concerned, there are few customer contracts with change of control clauses. This is the amount payable to them as a part of the contract which are shown part of the debt like items. Plus there are also some working capital adjustments which we have factored in the debt like items because we have to maintain certain level of the working

capital and the exact working capital mechanics has worked out and the difference was adjusted in the consideration.

Amish Kanani You are saying some customer payments which were more like debt items?

Badree Komandur Yes, that is right.

Amish Kanani Financing from the customer is what you are saying which had to be paid back?

Badree Komandur That is right.

Moderator As there are no further questions, I would now like to hand the floor back to Mr. Nitin Agarwal. Over to you.

Nitin Agarwal Arun, you want to make any final comment?

Arun Kumar Thank you Nitin for hosting us as always. It is a pleasure having spoken to everybody today and feel free to contact me or Badree or any of my colleagues, we will be more than happy to address any questions that may be there. Thank you all and have a good day. Thanks Nitin.

Nitin Agarwal Thanks Arun and thanks to everyone for participating in the call and thanks to entire Strides management team.

Moderator Thank you. On behalf of IDFC Securities that concludes this conference. Thank you for joining us and you may now disconnect your lines.