"Sunil Healthcare Limited Q4FY'16 Earnings Conference Call"

June 6, 2016

MANAGEMENT:

MR. ISHAN KHAITAN – SUNIL HEALTHCARE LIMITED
MR. D. GNANASEKARAN – CHIEF EXECUTIVE OFFICER, SUNIL HEALTHCARE LIMITED
MR. PAWAN RATHI – CHIEF FINANCIAL OFFICER, SUNIL HEALTHCARE LIMITED

Moderator: Good Morning, Ladies and Gentlemen. Welcome to the Sunil Healthcare Limited Q4FY'16 Earnings Conference Call. This conference call may contain forward-looking statements about the company which are based on beliefs, opinions and expectations of the company as on the date of this call. These statements are not the guarantee of future performance and involve risks and uncertainties that are difficult to predict. 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 the operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Ishan Khaitan from Sunil Healthcare Limited. Thank you and over to you, sir.

Ishan Khaitan: A very good morning to all and a warm welcome to all participants to our maiden Earnings Call for Sunil Healthcare. I am joined by my CEO – Mr. Gnanasekaran and our CFO – Mr. Pawan Rathi and SGA our Investor Relations Advisor. I hope you had a good look at our 'Presentation' that is uploaded on our exchange.

I hand over for the next part to our CEO – Mr. Gnanasekaran who will just give a short brief on the history of our company. Mr. Gnanasekaran, over to you.

D. Gnanasekaran: Good Morning to you all. As a brief introduction about the organization, Sunil Healthcare Limited has been incorporated in 1973 as a API manufacturer with production of Methyldopa supplier and also Empty Hard Gelatin Capsule manufacturing. Today, we are the second largest producer of the Hard Gelatin Capsules in the country, in fact, I said Methyldopa, after that we have exited from that Methyldopa business and concentrated only on the Capsule business, over 40% of our Capsules being exported to various countries. Over the years we have worked with all the pharma major companies globally like Pfizer, Cadila, Wyeth, GlaxoSmithKline, Intas and many more companies in this category and our strength lies on longevity the business because we have been in the business for the last four decades and well known in all the pharma groups. We have a very good customer base and a good market goodwill and prominent customer base, the customer base as I told you at the beginning, Pfizer, GSK, Abbott and all the pharma majors are our customers and we have a diversified market in terms of both exports and domestic. We are the star export house status been given by the government and we have a large installed capacity to leverage the economies of scale. Currently, we have a 10 billion capacity to manufacture and supply and we have sufficient infrastructure in place already in our factory in Alwar, Rajasthan. We can increase the capacity further with the minimum CAPEX from now onwards.

Also, Sunil Healthcare is innovation-driven company and we have been always improving with our R&D, for example, we are the first to introduce the Double Lock and Triple Lock Capsules in the country. Later on, everybody has followed it.

We have also received lot of recognition for our performance; as I said, recognized as a Star Export House , we won "The Best Use of Six Sigma in Healthcare Award in November 2015", we won the "Business Excellence Award in 2015 in Manufacturing, Research and Distribution for Empty Hard Gelatin Capsule".

Our biggest achievement has been our deep relationship with the clients. We service the Capsules demand from our manufacturing facility at Alwar, as I said 10 billion Capsules capacity, and in fact the previous year was 7.7 billion Capsules and we have grown to 10 billion Capsules last year. We went for the Brownfield expansion and our plants are WHO GMP and USFDA GMO certified with the stringent quality compliance measures adopted for "Zero Defect Capsules". During the year, we have also implemented SAP in our organization.

The Key Highlights for the Year 2015-16: It has been a very good year for us and we achieved a good top line and bottom line growth considering the given export market conditions. In fact, we know the last year the export market has been under grave pressure, a lot of headwinds we have to face through, despite that we could post a good performance in the last year. I would say in all modestly we performed better than the peers in the industry in the last financial year.

On the Capsules business, you see our majority turnover come from the Capsules and the Foods division. Considering the Capsules division, we have increased our sale by 16.52% compared to the previous financial year. It was Rs. 61.9 crores in the previous year and currently we have done Rs.72 crores, which is a good substantial improvement of 16.52% despite the headwinds we are facing in the export market, because our business 40-50% we are exports. Exports was under pressure in Q4 last year, otherwise, would have done even better than this. Our EBITDA margin also increased from the previous year from 17.18% to 19.19%, in absolute terms, it grew from Rs. 124mn to Rs. 156mn.

In 2013 we forayed into Food business where we market our products under the brand name "Sunloc Foods" In this segment, we do marketing of nuts, mainly cashews, contributes to 11% of the revenue. We have no manufacturing CAPEX as it involves only trading with the low capital employed which is a pure play trading margins business with a high ROCE.

Now, I hand over this to our CFO – Mr. Pawan Rathi to give more details on the financial performance.

Pawan Rathi: Thank you and Very Good Morning to all the participants. I will share highlights of our financial performance following which we will be happy to respond to your queries. To begin with Q4FY'16 company registered revenue of Rs.229 million, year-on-year growth of 31% from Rs.175 million in the same last quarter. EBITDA is at Rs.39 million from Rs.34 million in Q4FY'15, growth was 16% year-on-year. Here, I would like to mention that EBITDA of Capsules business is 18% in Q4FY'16. Net profit of Q4FY'16 is Rs.12.29 million with net profit margin of 5.4%, Q4FY'16 profitability was impacted due to increase in depreciation and interest cost on a cost of capitalization as in the new CAPEX in the Capsules division. Cash PAT of Q4FY'16 is Rs.24 million from Rs.22 million in FY'15 which has shown year-on-year growth of 8.2%.

Now, I come to FY'16 Results. Company registered revenue of Rs.816 million for FY'16, year-on-year growth of 12.4% from Rs.726 million in the same period last year. The growth was led by traction witnessed in Capsules division which has recorded 16.5% growth in year-on-year in FY'16. EBITDA during FY'16 is Rs.157 million, growth of 25.5% year-on-year from Rs.125 million, EBITDA margin expanded by 200 basis points to 19.2% whereas the EBITDA of Capsules business was 21% which was 20% in FY'15, margin expanded by 100 basis points itself in Capsules business. Profit before tax for FY'16 is at Rs.80 million, growth of 30.5% year-on-year from Rs.62 million in same period last year. Profit after tax in FY'16 is Rs.52 million, growth of 31.3% year-on-year growth from Rs.40 million in FY'15, profit margin during FY'16 is at 6.4% from 5.5% in the same period last year, margin expanded by 90 basis points. Cash PAT for FY'16 is at Rs.90 million from Rs.80 million in FY'15, growth of 13.3% from year-on-year.

That is, it from our side. Now, we can open the floor for Question-and-Answers. Thank you.

Moderator: Thank you. Ladies and Gentlemen, we will now begin the Question-and-Answer Session. The first question is from the line of Nikhil Garg from BNP Paribas. Please go ahead.

Nikhil Garg: Just a couple of questions: One, on the balance sheet why is the working capital requirement gone up so much this year?

Pawan Rathi: If you see that we have capitalized in FY'16 that is the working capital requirement increase in this last financial year which we can see that it will be rationalized in this financial year '16-17.

Nikhil Garg: Short-term borrowings have gone up from Rs.170 million to Rs.249 million. Why is that?

Pawan Rathi: As we said earlier also, that we have expanded our capacity and do around Rs.18 crores capitalization and this is a combination of short-term and long-term funds, we have about 40% capitalized through internal accruals and 60% through long-term and short-term funds. That is why you have seen that there is an increase in short-term borrowings as well as long-term borrowings also.

Nikhil Garg: Second question is basically on the business itself. So when you have expanded the capacity by 30% and probably the demand is growing at 10-15% which is mentioned in your presentation, so what will make you get more orders to achieve 30% kind of growth, how is the competitive scenario basically?

Ishan Khaitan: Basically, the installed capacity in India is much larger than what we have installed at our works now. As a ballpark estimate, the installed capacity in India is close to 100 billion capsules p.a., of which our installed capacity is 10 billion capsules. So there is tremendous hope in the domestic market to tap into customers who have either not been able to cater to because of capacity constraints or also explore newer markets as far as exports are concerned and grow the demand and grow supplies there as well. So, in terms of sales, there is an ample opportunity to grow both in domestic and in the export markets.

Nikhil Garg: So you had less than 10% market share and you are the second largest player. So I understand the industry would be then very fragmented. So, what is the competitive edge which you guys have over anyone else, who is the number one player and how do you look at them versus yourself?

Ishan Khaitan: To take a second part of your question first,, ACG Worldwide is #1 capsule company in terms of installed capacity in India; of course, they are a distant first as compared to the other players in the space. As far as we are concerned, through this capacity expansion we have built a sizeable lead or a sizeable difference between us and the #3 or #4 players in terms of installed capacity. Our competitive advantage is that we have been in this business for close to four decades. So as in our intro we have mentioned very good relations with all the pharma majors and our customer base is quite healthy and robust. So in terms of gaining more market share, we feel confident that we would be able to meet the enhanced capacity with the requisite sales, in fact, in the last fiscal, our domestic sales have grown by close to 45% which is a testimony to the goodwill that we enjoy with our customers and we hope to see this continuing.

Nikhil Garg: Is this any R&D involved in this in a sense that your presentation also talks about different kind of products which you as are into, so is that also an edge here?

D. Gnanasekaran: Yes, definitely, in fact, as I said in the beginning introduction, it is a continuous R&D we are doing, that is what keeps us very close to the customer, because we understand the customer needs and being customized also sometimes to the customer requirement, our continuous R&D is definitely being appreciable by the customers also and that would be one of the reasons, yes.

Ishan Khaitan: Just to add to that, we are pioneer in the "Locking Mechanism" in the Capsules which has certain added benefits to our customer in terms of improved performance on a filling machine. So yes, R&D is a continuous focus of our company and we continue to focus and invest on that, in fact, this year we are estimating our R&D expense of between 1-1.5% of our net sales.

Nikhil Garg: What is the CAPEX which you did to expand this capacity and how much turnover are you expecting from this?

Pawan Rathi: CAPEX we have done around Rs.17,60,00,000 towards spend on modernization as well as for capacity expansion. This Rs.17 crores includes modernization as well as capacity expansion.

Ishan Khaitan: Turnover from capacity expansion ideally it should be somewhere in the range of Rs.24-25 crores, part of the CAPEX that we have done has gone towards modernization of our facilities since we have been in this business for a while, so continuous upgradation of facilities is required. So, in terms of pure capacity enhancement CAPEX, that is about Rs.12-13 crores has gone into adding capacity. So we expect an asset turn of 1:2, of course, in an ideal market scenario. Currently, there are some challenges we are facing in the export market which will have a bearing on the asset turn, but yes, in an ideal scenario, 1:2 is something that we are looking at purely because we are sufficient in infrastructure already at place at our factory with minimum CAPEX we can get high asset turn.

Moderator: Thank you. The next question is from the line of Harisha Kakera from BOB Capital. Please go ahead.

Harisha Kakera: What is the uniqueness you are maintaining in your product competitiveness as such like you spoke about the capacity and all earlier when it was a question about the competitive edge, like any source uniqueness or any cost effectiveness in your raw materials?

Ishan Khaitan: In terms of our operating performance, we do have an edge, of course, without having too much knowledge of what peers are doing, we are confident about our own abilities in terms of our raw material procurements, we would like to believe that we procure in the most cost-effective manner the best quality raw materials. In terms of power consumption, this is a highly power intensive kind of set up but our performance in terms of power consumption and the cost of power also we have done some work in that and significantly come down over the years. So, yes, it is the raw material in terms of our power consumption and in terms of capacity utilization and ease in throughput, we do enjoy competitive advantage and with new high quality CAPEX that is going on stream, we hope to improve this and our operating parameters should improve going forward.

Harisha Kakera: So you enjoy competitive benefit in terms of your process optimization or something? What is the current plan utility like?

Pawan Rathi: Current capacity utilization is our 85%, it was 81% in the last quarter of financial year but this year it is 85% to 88%.

Harisha Kakera: So going ahead, what is it that you are expecting – the utility to increase?

Pawan Rathi: I already told you that this should be 85% to 88% of our capacity utilization.

Harisha Kakera: Like with the evolving Drug Delivery Systems, how far would your Capsules able to cater like for the growing demand?

Ishan Khaitn: We have added about close to 28% to 30% of our capacity…

Harisha Kakera: It is not about the capacity. So what I am asking is with the evolving Drug Delivery Systems there is a fragment there, there needs to be a specialization and fragmentation in the type of Capsules. So how far are you working towards that?

Ishan Khaitan: We have several SKUs in terms of the different types of Capsules that we offer and that is available on our website, but if you see historically and typically, Empty Hard Gelatin Capsule is the preferred source of the Gelatin Capsules of delivery and we expect that trend to continue in the foreseeable future.

Harisha Kakera: In terms of your manufacturing compliances and all did you get any such warnings from any regulatory authority till date?

Ishan Khaitan: Not at all.

Moderator: Thank you. The next question is from the line of Dhiral Shah from GEPL Capital. Please go ahead.

Dhiral Shah: Sir, I just have questions regarding what is our expectation for FY'17 in terms of revenue as well as profitability growth?

Pawan Rathi: As we said that it should be around 15-18% revenue growth increase from last financial year.

Dhiral Shah: Do you foresee further improvement in margin?

Pawan Rathi: Yes, we foresee but it depends on the market.

Ishan Khaitan: Exports is a big part of our total sales and we are facing some headwinds primarily on currency fluctuation of our emerging markets customers. We are very closely monitoring that and we will keep addressing that as we have been last fiscal and favorable the market scenario will definitely add to tailwinds and we can of course look at margin improvements. At this time, of course, our primary objective is to protect our margins along with increasing capacity utilization and our top line growth of 15% to 18%. Market permitting, yes, we will also hope to see better margins and realizations also.

Dhiral Shah: Any plan for debt reduction?

Pawan Rathi: Whatever we have taken we are repaying on time. We do not think there should be any prepayment.

Ishan Khaitan: To add to that, if you see our debt-equity, it is reasonable and with the higher capacity utilization we expect to see more cash and rationalization of debt as per the agreed terms. So we feel comfortable on that.

Dhiral Shah: You have expanded your capacity from 7.7 billion Capsules to 10 billion Capsules. So any further planning to expand the same?

Ishan Khaitan:: This year from the second half onwards it will further increase; it will become 10.8 billion Capsules.

Dhiral Shah: Actually we are under the pricing cap as per the BSE norms right now. Sir, any plan to list Sunil Healthcare in NSE?

Pawan Rathi: At present there is no plan.

Moderator: Thank you. Ladies and Gentlemen, that was the last question. I would now like to hand the conference over to the management for their closing comments.

D. Gnanasekaran: I thank all the participants for joining the call. I hope we have been able to respond to your queries adequately. For any further information, I request you to get in touch with SGA, our investor relations advisor. Thank you all very much once again.

Moderator: Thank you members of the management team. Ladies and Gentlemen, on behalf of Sunil Healthcare Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.