"Torrent Pharmaceuticals Limited Q2 FY 2021 Earnings Conference Call"

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Moderator Ladies and gentlemen, good day. And welcome to Torrent Pharmaceuticals Limited Q2 FY 2021 Earnings Conference Call. We have with us today Mr. Sanjay Gupta – Executive Director, International Business; Mr. Sudhir Menon – Executive Director, Finance and Chief Financial Officer; and Mr. Aman Mehta – Chief Marketing Officer, India Business.

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 to conference over to Mr. Sajay Gupta. Thank you. And over to you, sir.

Sanjay Gupta: Thank you. Good evening, everybody. Welcome to our Q2 FY 2021 Earnings Call. I would like to begin by commenting on current market trends. We are seeing a strong recovery in our branded generic markets. In India, the field activities are back to 70% to 80% of normal levels, with doctors spending higher in-clinic time due to increase in patient footfall. Q2 IPM growth recovered to (+1%) from (-6%) in Q1. We continue to see strong growth in the chronic segment of the market and a recovery in the sub-chronic and acute segments.

In Brazil also, 75% of the doctors have started working either through patient visits or telecommunications. As per IQVIA, Brazil BG market grew at 5.9% in Q2 versus 1% growth in Q1. Looking forward, we expect the IPM to grow at 3% to 6% in H2, while IQVIA now expects Brazil branded generic market to grow between 3% to 6% in calendar year 2020.

In our two major generic markets, we saw divergent trends in the U.S. and in Germany. U.S. Q1 growth in the generics market was (-6%), and we saw rates of (-2%) and 0% in July and August. In Germany, Q1 generic market degrowth was at (-4%), and while July and August were respectively at (-3%) and (-7%).

Coming now to Torrent's performance during the quarter: Revenues were up to Rs. 2,017 crores, up by 1% on a year-on-year basis. India's contribution was 48%, U.S. contribution was at 16%, Germany at 13% and Brazil at 6%. EBITDA was at Rs. 641 crores, up by 12% on a year-on-year basis, while net profits were at Rs. 310 crores, up by 27% on a year-on-year basis. In our largest market, India, revenues were at Rs. 963 crores, up by 7% on a year-on-year basis. This compares to an IPM growth of 1%.

Our growth drivers continued with the concentration of chronic products in our portfolio, our continued focus on brand building and field force productivity. The share of chronic and sub-chronic product in H1 was at 77% versus 72% in FY 2020. PCPM at Torrent now stands improved at Rs. 8 lakhs. Torrent has 16 brands in the top 500 brands of IPM, with 10 brands doing more than Rs. 100 crores. New launches have also witnessed an uptick in Q2 with a total of new launches in H1. Torrent continues to gain market share in four high potential launches in the cardiovascular space.

Brazil sales were at BRL 91 million, up by 5%. Torrent has been reducing focus on tender business. Adjusted for the tender business, growth was at 10%. As per IQVIA, June to September growth for Torrent branded generics was at 6.4% versus a market growth of 5.9%. Again, as per IQVIA MAT August, Torrent has eight brands with annual revenues higher than BRL 25 million, and we have gained market share in seven of these brands. We are also launching two new products in Q3, which would help in strengthening growth from Q4 onwards.

In the U.S., Q2 FY 2021 sales were at $43 million versus $52 million in Q2 FY 2020, and $47.4 million in Q1 FY 2021. U.S. growth was impacted due to a temporary discontinuation of our Sartan products, absence of new launches, and price erosion on the base portfolio.

For Indrad and Dahej, while we have completed all the CAPAs and submitted the closure report, we continue to await the guidance from the USFDA on the next steps. Our Levittown plant construction is complete, and we would be relaunching our first product in March of 2021. In Q2, two ANDA approvals were received, one was for Erythromycin IR and Nystatin TCA. And in the current month of October, we also received another ANDA approval for Aprepitant. Erythromycin and Aprepitant are products from our external collaboration, while Nystatin TCA is from our Pithampur derma plant.

In Germany, Q2 FY 2021 sales were at $30 million. Sales are flat on a Q-on-Q basis and they are down 7% on a year-on-year basis. Resolution of quality control issues is on track. And by the end of Q2, 94% of product issues have been resolved. We have also recovered the market share that was lost since the quality issue started. In September 2019, our market share was at 7%. Latest IQVIA data for end of August shows that Torrent's market share in Germany is back to 6.9%.

I would like to conclude by highlighting that there was visible recovery across all the markets, and we expect to continue to grow faster than the market in our BG countries, and to return to our historical growth rates in Germany by March of 2021.

Operator, we can now open the call to questions, please.

Moderator: Thank you. Ladies and gentlemen, we will now begin with the questions-and-answer session. The first question is from the line of Anmol Ganjoo from JM Financial. Please go ahead.

Anmol Ganjoo: A couple of questions to begin with. So one is that if you look at the domestic growth, how would you like to spread it in the usual variables, price, product and volume; new introductions?

Aman Mehta: So the Torrent growth for the quarter as per AIOCD is 1%. The breakup is; volume is (-7.8%), price is 7% and new products is 2%.

Anmol Ganjoo: Also, last quarter, you had characterized the growth that chronic, sub-chronic and acute segments had seen vis-à-vis our growth. If you could just quantify that to like the last quarter, that would be helpful.

Aman Mehta: So the chronic growth has more or less remained in the same range. The reflection for the quarter in AIOCD is showing a 5% chronic growth, (-9%) for acute and 6.3% for sub-chronic. But we would like to point out that there does seem to be some reflection issue in these datasets. So I think the more accurate dataset seems to be the September growth therapy-wise is showing more accurate numbers. So this may not give the perfect picture. But qualitatively, we can point out that internal sales have shown that quarter-on-quarter there is a pretty good recovery in acute and sub-chronic, whereas chronic has maintained its growth.

Anmol Gandhi: And my last question before I get in the queue. So basically, what we have seen is that we have grown faster than categories that we are present in during this whole of this COVID period. So it would have come on the back of significant market share gains. As we move towards normalization of the trade channel, how much of these gains do you expect to hold on to? And this is directional, you don't need to share an explicit number. But obviously, you have been able to consolidate market share in individual therapies. So just wanted to get a sense that this lead, which you have gained, is it sustainable on a full year basis from a market share standpoint? Because when the market recovers, then do you continue to grow faster than the market?

Aman Mehta: Well, a good part of the above-market growth is owing to the chronic contribution. That would certainly have helped us continue the growth momentum. Incremental growth has come from some of the larger brands like Shelcal, Losart. Due to the high market share and reach, these are the brands that have benefited. So when brands at that scale are growing much, much faster than the market, that's adding to the incremental growth. So I think we should expect the brand-wise growth that we have seen in Q2 to continue as well for the next few quarters.

Moderator: Thank you. The next question is from the line of Vishal Biraria from Aviva Insurance. Please go ahead.

Vishal Biraria: Sir, a question on the base portfolio of the U.S. Could you elaborate a bit more on the price erosion piece as to how it has been? Is it more than what you saw in the last quarter? And what is your view on the coming ANDA in the upcoming quarters?

Sanjay Gupta: So the price erosion, unfortunately, we are impacted by it a lot because of lack of new products. So we are only commercializing our base portfolio in the U.S. So I would say that the price erosion was muted during the peak of the COVID times, so in the March, April, May time frame. But after May, supplies have normalized, and the fear of suppliers has kind of a little bit muted. As a result of which, we see, what we would consider to be back to business-as-usual level of price erosion, which is mid to high single-digit on an annualized basis across the broad portfolio.

Vishal Biraria: Fair enough. Sir, one question on the overhead expenses that we have reported of Rs. 465 crores for the quarter. So this is a decline sequentially also, I mean, what is driving this saving and what proportion of this would be sustainable? Some perspectives on this. Becausewe didn't expect a sequential decline.

Sudhir Menon: So I think the only thing which I can tell you here is, quarter one had some higher cost for one or two items which are nonrecurring in nature. For example, the freight expenses were very high in quarter one. And quarter two, we are seeing some moderation happening on the freight expenses. So that's something in terms of saving, which has come in quarter two. The other was, if you remember, there was a FOREX loss of around Rs. 16 crores to Rs. 17 crores in other expenses in quarter one, which is not there in quarter two. And the third factor could be there was some donation contribution, which was made to PM CARES Fund for COVID in quarter one, which is not there in quarter two. So I would say, quarter two expenses, which you see, should be the base going forward.

Vishal Biraia: And just one last question. On the 3% growth in revenues from other countries, last quarter this was very strong. So what impacted this quarter, some views on this?

Sudhir Menon: So I think last quarter we had said, because the growth was significant and we had made a comment saying that there is some amount of pipeline filling which we see happening in the ROW business, which would get moderated in quarter two. So that's exactly what we saw.

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

Prakash Agarwal: Just a follow-up on what was asked on the other expenses. So you said it's the base, so I think with the opening up and in Q3, Q4 it would further open up, traveling will increase, so the cost Q-on-Q is most likely to increase, would that be fair to understand? Or you have some more cost savings stored in for you?

Sudhir Menon: No, Prakash. I think your hypothesis is correct. Because quarter two with respect to promotional and field expenses, we saw some increase happening. So you are right, as the economy opens up and the working normalizes more, you will find these expenses going up in quarter three and quarter four.

Prakash Agarwal: So, the question actually for EBITDA margin, so you had good cost savings here also. But your gross margin Q-on-Q has gone down a bit. So could that be due to the Brazil currency? Or there is cost inputs have gone up or how should we think about the gross margins for this quarter and going forward?

Sudhir Menon: So I think this quarter the inventory provisioning is higher. Because what we did is, we looked at what could be sold, I mean, as far as the current inventory is concerned and what could not be sold based on our understanding how the demand is going to pick up. So there is a higher provisioning which has been taken this quarter. So whether that's going to continue in quarter three, quarter four, the answer is no.

Prakash Agarwal: But where is Brazil currency impact hitting?

Sudhir Menon: Not really, Prakash. Because I think what we are saying is Brazil is contributing to only 6% of the total business in quarter two. So I wouldn't say that's the major factor for gross margin going down. Gross margin has gone down because there is an additional inventory provisioning, which we have taken.

Prakash Agarwal: And secondly, on the gross debt and net debt and there is a new item which has come up, current investments. If you could just explain what is the reduction and what has led to this reduction?

Sudhir Menon: So on a net debt-to-EBITDA, we are at 1.7x, I would say.

Prakash Agarwal: Net debt is how much, sir?

Sudhir Menon: Net debts would be close to Rs. 4,200 crores kind of a number.

Prakash Agarwal: Okay. But there is a sharp drop, right?

Sudhir Menon: Absolutely. So I think the net debt number was close to Rs. 5,000 crores, which has come down to Rs. 4,200 crores kind of a number.

Prakash Agarwal: And any color you would like to give what has led to this? So free cash flow is improvement in working capital or is it just the operating improvement?

Sudhir Menon: So two reasons. So one is Rs. 440 crores of repayments which have happened in H1. And there is a good amount of free cash flows which has got generated in H1. And H2, we are looking at higher repayments. And therefore, some part of these free cash flows, which are generated and sitting in investments and cash and bank balances would be utilized towards repayment. So net and net, if you look at a net debt-to-EBITDA number, standing on 30th September 2020, it's 1.7. And I think for the full year, we should be lower than that, I would say. So we are on track as far as deleveraging is concerned.

Prakash Agarwal: Okay. And what was the current investments, Rs. 560 crores?

Sudhir Menon: It is the cash generation and surplus cash we invest in short-term investment opportunities. So these are basically the funds which are parked in liquid funds.

Prakash Agarwal: Liquid funds. Okay. Fair enough. And one more, if I may. On the resolution, I missed your point. So Levittown, you are saying expecting by March 2021, but what about Indrad and Dahej? The resolution is complete? The last time we said we are expecting desktop inspection, is there any update?

Sanjay Gupta: No. What I had said last time was that we had not heard back. So we have asked the FDA if it is possible to do desktop inspection. And so we are waiting for the response, and there is no update on that.

Prakash Agarwal: But from our side, we are done with the CAPA?

Sanjay Gupta: Yes, yes, long time back. So the last closure report was sent in June.

Moderator: Thank you. The next question is from the line of Shanti Patel from SK Investment. Please go ahead.

Shanti Patel: My question is, who are the main competitors for us? And secondly, where we stand in the various segments in which we are.

Sanjay Gupta: Which market are you referring to?

Shanti Patel: Yes. I will repeat the question if you want. Who are the main competitors? And secondly, where we stand in the various segments in which we are as far as the Indian Territory is concerned, not export, only local.

Aman Mehta: Okay. That's a pretty broad question, but I will try to answer it as best I can. So as per the AIOCD Dataset, Torrent is ranked eighth out of all the pharma companies in India. We are 77% only contribution portfolio, and we have had nine launches this year, and we plan to have about four to five more launches this year, which we expect to be our future growth drivers. So historically, we have been growing a few percentage points above the market growth, and we expect to continue to do the same. That's our current standing.

Shanti Patel: Sir, who are the main competitors in the line in which we are, I mean, the products which we are manufacturing?

Aman Mehta: There are many companies in the space that we are.

Shanti Patel: Can you name a few, first three?

Aman Mehta: Top three in terms of market share, I guess, would be Sun Pharma, Cipla, Abbott, they are among the top five companies.

Shanti Patel: Who are competitors of our products?

Aman Mehta: Yes, you are right.

Moderator: Thank you. The next question is from the line of Damayanti Kerai from HSBC. Please go ahead.

Damayanti Kerai: Sir, my question is firstly on the U.S. business. So, since we are waiting for the FDA to revert back, till the time we hear back from them and then we get approval, should we take second quarter as a kind of base?

Sanjay Gupta: So, I mean, essentially, we are commercializing a series of product portfolio, which is from 2019 and it is base business in the U.S. is intrinsically a price deflationary business. So year-on-year, there is usually a price erosion of, say, anywhere close to 5% to 8%. And the price erosion comes from the arrival of new competitors. So for example, on many of our key products during our Q1 and Q2, during H1, we saw new companies receive ANDA approval and submit competing bids to our customers. So I would say that treating Q2 as a base business is fine, provided the competition scenario remains constant. I am not able to predict as to how many more competitors will come on our key products. But for now, this is what we have to sell, plus the portfolio that we are now getting approvals from our external R&D project. So as I mentioned in the opening remarks, we have got two interesting approvals recently. And then going forward, from March onwards, we will have the liquids business which would start to get commercialized.

Damayanti Kerai: Okay. And sir, you mentioned sartan which we have discontinued. So are we planning to enter that market or what is your plan there?

Sanjay Gupta: So, we took a call that we need to reconfigure a little bit our manufacturing facilities in order to become a bigger player in the sartan. So we are in the process of doing that. So yes, not in the coming months, but in the medium-term we would be back in sartan business. But it will not have an impact this fiscal year.

Damayanti Kerai: Okay. And my last question is, if you can slightly elaborate on your thoughts about Brazil market, that would be helpful. Like say three, four quarters down the line or I think near-term, say, one to two quarters how do you see business moving up there?

Sanjay Gupta: Brazil, I think I don't see a problem in the market in terms of Brazilian reals. So the Brazil market has intrinsically been a double-digit growth market. So, I was just seeing that the market actually has grown on an overall basis and more than 10% for the last four years. So overall, ethical market growth rate in 2017 was 13%; in 2018 was 9.6%- 10%; in 2019 was 10%. And even MAT September 2020 is at close to 10% on an overall ethical market perspective. But unfortunately, all this growth in dollar terms boils down to zero. Because what has been gained in the market locally is lost in the currency devaluation. So that for me is a big problem. I don't see the market trends changing. It is a little bit of a similar market to India. And because the need just so high the population is large, and as the economy grows, pharma market is a durable, double-digit growth market. But unfortunately, due to currency impact, the dollar value of the market remains constant, almost stable.

Damayanti Kerai: Okay. And sir, one final question, if I may. On the India part, price has played imported role in the COVID part. So I think last two to three quarters we are seeing price contribution of around 7%, 8%. So this should sustain, right? Or if you can comment anything on the pricing part of new business.

Aman Mehta: Yes. We maintain that our pricing is well in range in the next two to three quarter, and we expect price growth should continue.

Moderator: Thank you. The next question is from the line Kunal Mehta from Vallum Capital. Please go ahead.

Kunal Mehta: Sir, the first question I have is on the India business. So we are now doing a PCPM of around Rs. 8 lakhs, which is a very good figure, probably one of the top five in industry. So just, sir, from the next, I would say, for the next two years, sir, where do you address on that? I mean, I am sure it is a function of how the portfolio does and what happens once things start accruing. But I am sure you also control by adding new MRs. So any plans to add new MRs? I am talking from two to three-year perspective. And so where would you peg this number at?

Aman Mehta: No, there is no immediate plan to add MRs as of now. We are quite confident of achieving our PCPM of Rs. 10 lakhs in the near future. And that would be driven by portfolio growth and productivity enhancements. We do undertake a portfolio restructuring on an annual basis. And we focus on the high-growth markets and we defocus the low growth markets. So that would be an annual exercise.

Kunal Mehta: Understood. And the second thing I wanted to understand was that I think the major near-term event which we are facing right now is the equation of this price control list. So firstly, just any thoughts on this would be very helpful. And secondly, if I look at the last year's the list 5, which was revised five years back, I can see that the majority of the names on the list are single active ingredients. And for us, the majority of the revenue comes from combinations, especially in the top 20 brands. So would it be fine to say that if the same trend continues going ahead, even for this cycle of price revisions, whereby only single active ingredient products are brought into the purview of pricing control, then we would be able to get through this relatively unaffected? Or is it the case that if in a combination to both the active ingredients separately in the price control list and the combination by design is also under the price control, would you help me understand this?

Aman Mehta: Yes. So historically, what we have seen is that whenever there are new additions to the NLEM list, the definition of essentiality means that it has to be, I mean, an essential list. So it can't have multiple products in the same class of drugs. So, if something goes in, usually something else may come out. So overall, there might be some impact, but it won't be anything significant. So we do not expect any major impact of this broad portfolio.

Kunal Mehta: Sure. Because we have a lot of high-value brands where revenues are north of Rs. 100 crores. And these brands, in line with the market, they are enjoying good volumes and good pricing, essentially because they are chronic, and they are well placed. So you are confident that this pricing on a net basis would not harm us to the extent when you see two, three years down the line as this drifts to South. Is it the correct judgement?

Aman Mehta: In the current regulatory framework, we expect no significant impact. Yes, that's correct.

Kunal Mehta: Sure. By the current you mean the previous list which was announced in 2015, right. I mean the one which is going to come out in 2021 is something we will have to wait and watch, right?

Aman Mehta: Yes, that's correct.

Kunal Mehta: Okay. And just an observation on the balance sheet. I was just wondering, so when I look at finance costs which we have, and when I compare it to our peers even just like, I would say, Dr. Reddy's and all, so I mean, the finance cost which you have is on this rupee denominator debt is far-far higher than what our peers are having. And our peers, we also have a U.S. business of $200 million where we have FOREX entity on that part of the business. So any plans to refinance this debt at a cheaper rate? And any foreign currency which will build a natural hedge and solve both problems? And if I am not wrong, cost is more expensive as compared to other peers?

Sudhir Menon: So, I think I will answer this question in two parts. So one is, you said the cost of financing looks very high compared to some of our competition, right? So the only clarification from that perspective is, while the competition will have a lot of foreign currency loans, we don't have much of foreign currency loan, it's all INR denominated loans. And what we understand in terms of our financing costs, it's quite competitive, I would say. It's not very high compared to the competition. The other part of the question is, why don't we look at the refinancing in terms of taking foreign currency loans, right, and think about certain natural hedging thing which can be worked out.

So two things here. So one is, we have a policy of hedging 100% on the receivables side. So there is a natural premium, which we get when we hedge the receivables, right? In terms of natural hedge, what happens is, you have to give away this premium, assuming that it will set off against any depreciation which can happen. So while you see the competition, you will see only the cost in terms of foreign currently walking in the finance cost. But as far as we are concerned, there is the premium which we accrue as part of the FOREX gain loss. So both put together, it would be more or less similar, I would say, in terms of foreign currency loans. And we would continue the same way, because our Board approved policy is to hedge 100% on the receivables side and also 100% on the foreign currency loan, if it is there for the entire tenure. And because our foreign currency loans are not very high, it's only in terms of the premium gains, which we see on the receivables side. So both put together, you'll see the cost possibly better than competition, I would say.

Moderator: Thank you. The next question is from the line of Nitin Agarwal from IDFC Securities. Please go ahead.

Nitin Agarwal: Sudhir, on the other expenses, we were at 27% - 28% of revenues till about last year. At the current run rate we have about 23% or so of revenues. So is there anything to structurally change in the business with the way probably we are doing things now in the new environment, which has sort of brought the other expenses down to this level? Because you were alluding it is just like more of a sustainable number going forward.

Sudhir Menon: No, Nitin, I would not say that, because the only thing what we are saying is that 65% of my business is branded generic business. That's point number one. Point number two, what we are saying is that the activity level in quarter two is still at 75% to 80%, which was not the case in quarter one, right? So in terms of promotional expenses and field expenses, I mean, I would say it's lower than the normal, which should happen. And what we have said is, as the economy opens up, as the working gets normalized, let's say, over quarter three and quarter four and we reach that 100% normalization level, you will see those expenses coming back. So there is no structural change, I would say. It's only related to the level of activity which has happened in quarter one and quarter two.

Nitin Agarwal: But I guess, to sort of push the point, because it's a very sharp reduction we are talking about here, but I mean, you don't see any sustainable sales coming out on the various aspects of other expenses. The way you are doing things now is just you are seeing just disappointing this match at this point of time. And we will still probably go back to 24% - 28% of revenues?

Sudhir Menon: Absolutely. I would think so, Nitin. If not in quarter three, not in quarter four, at least, quarter one of next year, we will see the economy really opening up and the second wave not coming, and things normalizing in a major way, it should come back to that level.

Nitin Agarwal: Okay. And secondly, an associated point, our staff expense growth also has been on the lower side. Obviously, we are not adding field force in the domestic market. So how should one look at that sort of cost aspect from a modeling perspective?

Sudhir Menon: Yes. That's compared to quarter one you are talking, right?

Nitin Agarwal: As a Y-o-Y number I am saying, on a Y-o-Y basis?

Sudhir Menon: So Y-o-Y 358 is becoming 363. So there are two or three things here, Nitin. So one is, the currency translation which plays a very important role. For example, if you see in case of Brazil, the employee benefits are very high, is what we keep on saying, right, I mean, it's 10x of what we see in India. So when you convert that into INR, so that expenses will reduce, because the conversion multiple is down because of the BRL-USD depreciation, which has happened. So that's one factor which is there. Otherwise, I think in terms of normal increments, we are there with the average increment which we have been doing in the previous year, a little lower this year, I would say. Additionally, quarter one, there has been a onetime incentive, which have been given at the manufacturing facilities because we had to keep it running, right? And therefore, there were some incentive schemes which were floated for all the employees who were there in the manufacturing facilities. So yes, I mean, 363 is something I think going forward you will see a similar number.

Nitin Agarwal: And one thing on the India business, how should we look at this new product launch engine going forward? And what kind of revenue, from a growth contribution perspective how should we see this segment playing out over the next, say, couple of years?

Aman Mehta: If you look at the contribution so far, it's around 2% that the new products have added to the growth. As the markets are opening up now, we are seeing that these brands are in pretty large, fast-growing markets. So the contribution should increase. And these would be the future growth drivers for us in cardiac, in diabetes, in gastro. So the current 2% may increase by 1% - 1.5% in the coming quarters. That's what we hope.

Nitin Agarwal: And lastly, Sanjay, on the U.S. business, how are we looking at, rather given the way the construct of the FDA is, how should we look at incremental growth in the U.S. from the current quarter?

Sanjay Gupta: So as of present, I would say that with a few launches, ones and twos here and there from either our derma plant or from an external portfolio, at best, I would say, we can hope for a relative stability to a very low level of decline.

Sudhir Menon: Nitin, before you go off, I just wanted to highlight one more thing in terms of the salary cost. So last year, October, there was a rationalization also which happened. So that is also adding to that growth number.

Moderator: Thank you. The next question is from the line of Anubhav Aggarwal from Crédit Suisse. Please go ahead.

Anubhav Aggarwal: Sudhir, one question on the balance sheet. The last two, three quarters, your inventory days have been pretty high. Now one could think of this maybe the reason of security that everybody was unsure about the supply, and therefore, you were keeping higher inventory. With things getting more normal, so first, what is the right reason for inventory days increasing over the last two or three quarters? And what is the stance now, is it now the time to normalize the inventory days? And additionally, when you answer, payable days also have been very high. So is it that payable terms were good and that's why you were keeping higher inventory? Some clarity will be useful.

Sudhir Menon: No, absolutely. It's a combination of both, I would say, Anubhav. So there was a conscious call taken to increase the API inventory, let's say, from a six to seven months level to almost 12 months level for all the critical APIs. So that's a call which we had taken. And there is an increase because of that in inventory days. And also most of this has happened in quarter two. And that's exactly the reason why you see the payables also going up because, yes, I mean, to a certain extent, some favorable credit terms were received for these inventories, which has gone up.

Anubhav Aggarwal: When do you see this normalizing?

Sudhir Menon: So I think we will have to wait for a couple of quarters more, Anubhav. Because we don't know, because people are already talking about the second wave coming in by November, December. So I think till December, at least, we will continue with the same strategy of having a 12 months kind of an API for all the critical products we have. Post that, if we see that situation is normalizing, then yes, we will start de-risking the inventory from that time.

Anubhav Aggarwal: Sure. That's helpful. Second question was on what Nitin asked on other expenses. So can we say safely that if sales force was not 75% - 80%, but it was 100%, roughly, very ballpark, other expenses would have been higher by Rs. 35 - 40 crores in this quarter? Would that be a number to key forward? Or, let's say, it would be like Rs. 15 crores, Rs. 20 crores or Rs. 60 crores, Rs. 70 crores? Some ballpark would be useful.

Sudhir Menon: No. I think it's very difficult for me to give you a ballpark. But I really don't know. Because the moment I will start talking in terms of percentage number, you will be able to gauge what kind of expenses we incur on promotional and field expenses. And it's something which I would not like to share as a policy of the company. But surely, I think these expenses would capture 75% to 80%

level of working, which is already seen in quarter two. So yes, I mean, to a certain extent, it will start going up, if situation is normalizing beyond the 75% to 80% in quarter three and quarter four.

Anubhav Aggarwal: And what is the rate that you are seeing right now in October? Is it still the same or has it improved?

Sudhir Menon: Aman, you want to answer that?

Aman Mehta: Are we talking about rate of marketing expenses?

Anubhav Aggarwal: Yes. So 75% to 80% ratio of field activity. Because we are almost end of October right now.

Aman Mehta: So September was more than 90%.

Anubhav Aggarwal: And Aman, how is it in October now?

Aman Mehta: October is pretty similar, maybe a few 1% or 2% more. So close to 95% is what we probably expect in Q3.

Anubhav Aggarwal: Okay. So then Q4 should be maybe very likely if nothing happens, should be a normal quarter for us. But one last question for Sanjay. On Brazil market, you mentioned that lower focus on tender business, what is the reason for that? Has the margin gone down incrementally? Because capacity-wise we guys don't have issues. So is the EBITDA so low that we don't want to do this business?

Sanjay Gupta: The underlying core problem was that the Brazil government, so it's basically tender businesses for three types of hospitals; municipal hospitals, state hospitals and federal hospitals. So a couple of years ago there was a severe budget crunch. So we manufactured the goods to supply the government, but the government did not buy for last two years. And if we don't supply, we have penalties, so we have to be prepared to supply 100%. But there is no obligation on the government to purchase. So whenever they have budgetary issues, they cut down on their purchases. And as a result of which, we have important write-offs to our inventory. So net-net, the gross margin that we make from this government tender business is not sufficient to compensate for the kind of shocks that we go through in this business. The volumes are very large. The margins are not as big as in the branded generic business. Plus, we have these unexpected costs from this inventory write-offs due to the diversity in the government policy. As a result of everything put together, we decided that it was not worth our while to allocate not only manufacturing capacity, we need warehousing capacity in Brazil. And we also need to release these products in Brazil from our quality control lab. So all in all, there is a lot of infrastructure that gets blocked for this tender business. Hence, the decision to decrease and progressively phase it out.

Anubhav Aggarwal: And just my last question. How large was this business for you, guys? I mean, this was tail end of Brazil sales.

Sanjay Gupta: No, no. At its peak, it was about 6% and today down to 2%.

Moderator: Thank you. The next question is from the line of Hiten Boricha from Sequent Investments. Please go ahead.

Hiten Boricha: Sir, my first question is on the margin side. May be I have missed it in your opening remarks. So like there is a very good improvement in the margin in quarter two. So what are the expectation of the margins in H2 of this year? And maybe you can throw some light on the revenue guidance for FY 2021 and 2022?

Sudhir Menon: So I think as a policy of the company, we don't comment on any guidance for future.

Hiten Boricha: Sir, any like ballpark, are these margins sustainable at least for H2, like second half of this year?

Sudhir Menon: We really don't know how the normalization is going to happen in quarter three and quarter four. So we will have to wait and see.

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

Tushar Manudhane: Just on the Germany business, now that 94% of the resolution has been done and we are, any which case, at the peak levels in terms of the quarterly run rate. Given that we have, any which case, grown at a single digit even in the past, pre this issue, so any outlook you would like to throw up on for this business?

Sanjay Gupta: So the problem started in November of 2019. So obviously, we had an impact on Q3, Q4 sales in the last fiscal year. As a result of which, you would see, I would say, unusual growth rates in Q3 and Q4 of this year. But on a full year basis, we would be on the positive zone in FY 2021, I would say somewhere in the single-digit positive growth zone. Historically, we feel confident about our German business in terms of a high single-digit or almost a double-digit growth rate. So our objective for the next fiscal year would be to get back to our historical trends.

Tushar Manudhane: Got it. And just if you could repeat the reason for this discontinuation of sartan for the U.S. market?

Sanjay Gupta: Yes. So a call has been made by our technical team that we need to reconsider our manufacturing tool in order to kind of have a dedicated line. I don't know if you guys followed it, but there was another impurity discovered in the sartans in the last few months. And so the issue is becoming, I would say, it's not getting simplified in our view. So what we decided is to play in this market, we would like to have a kind of a dedicated line to manufacture sartan to minimize or to eliminate the risk of any potential cross-contamination of the nitrosamine. And we are in the process of doing that. It will just take a few months, so we expect to be back. I can't give you a firm timeline, hence, this discontinuation.

Tushar Manudhane: So this is not like a part of a remediation measure. It's more of the new impurity, which has led to this planning of the new line in your plant?

Sanjay Gupta: Yes, it's overall risk mitigation plan to avoid this nitrosamine issue coming back again. And since we had already kind of stopped a lot of the sartan business, what we had remaining, it was worthwhile to stop that also and to kind of reconfigure and to operate in a new way in this market. So that was, I would say, a risk-benefit call that our management took.

Tushar Manudhane: Thirdly, while you have alluded for the debt repayment continuing for the remaining part of the year, but what level would you be comfortable? And then so the reason to ask is the cash flow from operations is definitely much more sustaining. And then maybe two quarters down the line, there will be further cash available. So what do we intend to do with that?

Sudhir Menon: So what we said is, as at 30th September, the net debt-to-EBITDA is 1.7.

Tushar Manudhane: Which is already in a very comfortable zone?

Sudhir Menon: Yes. So by 31st March 2021, we should be lower than that is what is the expectation.

Tushar Manudhane: Okay. And just lastly, the number of MRs. And have you increased or it's more or less steady?

Aman Mehta: Number of MRs in India is the same at 4,000.

Moderator: Thank you. The next question is from the line of Neha Manpuria; from JPMorgan. Please go ahead.

Neha Manpuria: So Sanjay, on business, in your opening comment, did you mention that the growth rate of business is expected to be 3% to 6% in the second half or did I hear that incorrectly?

Sanjay Gupta: No. What I mentioned was that IQVIA now expects the Brazil branded generic market to grow between 3% to 6% in the calendar year 2020.

Neha Manpuria: Understood. Okay. But our growth should improve to what we have seen in the second quarter, right, as the activity level in the branded market picks up?

Sanjay Gupta: Right. We would expect to be higher than the market growth rate, yes.

Neha Manpuria: Okay. My second question is on the tender business discontinuation. Was that gradually over the last two quarters, because if you look at the second half sales, BRL110 million, BRL120 million, so what we are doing now, is it fair to assume that, that discontinuation started in the early part of this year rather than in this quarter?

Sanjay Gupta: So essentially,, we have been defocusing on it for about four quarters now. And the contract is for a two-year period, so when you sign a deal with the government, it's for a two-year period. So how we discontinue it is that for new tenders we raise the minimum gross margin threshold, which any new tender has to meet in order for us to take that. So this is how it has been decreasing. So the pace of decline is actually linked to the expiry of the existing tenders.

Neha Manpuria: Okay. Sir, if these tenders continue to roll over, we will see impact for a couple of more quarters. That is a fair assumption?

Sanjay Gupta: Correct. My current assumption is that by September of 2021, I will be able to bring it back down to zero.

Neha Manpuria: Okay. Perfect. And my second question is on the India business. I think you mentioned that India, we are back to about 95% activity. Therefore, when you look at, let's say, more second half probably over the next one or two years. In the last few years, Torrent has been supported by price growth, improvement in productivity in MR. What will be the growth drivers for Torrent over the next two years to go ahead of the market? Would it still be dependent on pricing?

Aman Mehta: No. We definitely have seen a good increase in volume trends. In many of the top brands, we expect that once the market situation improves, which is near the pre-COVID levels, that is where the volume growth for the Torrent portfolio should also be significantly higher than what we have seen. But as of now, it's unclear when that level would be really seen. We expect that at least for Q3, September data is a fairly accurate picture. September AIOCD data shows a growth of 4% for the market. Against that Torrent is at 8%. So as this trend continues, we expect to continue the higher than market growth rates.

Moderator: Thank you. The next question is from the line of Girish Bakhru from Bank of America. Please go ahead.

Girish Bakhru: First one, again, on the branded promotion activity that you said is resumed by 80% to 85%. Sorry to ask general, is that even relevant for the industry overall?

Aman Mehta: I would not be able to comment on that, but I think generally clinics and hospitals have seen a greater increase in activity of medical reps overall. So that's definitely the case in this quarter.

Girish Bakhru: And by that logic, you would also say patient footfalls have also resumed to that extent?

Aman Mehta: Yes. Patient footfalls have gone up compared to Q1 as well. I would say that maybe patient footfall could be roughly speaking at about 75% to 80% of pre-COVID levels.

Girish Bakhru: Right. And in case still second wave, then, of course, we would probably also see another similar trend, what we have seen in first half, where promotion activity declined. That's a possibility, right?

Aman Mehta: If lockdowns do happen again, then yes.

Girish Bakhru: No. I mean, I am saying, let's say, if the lockdowns do not happen, but there are, of course, second waves like seen in many other countries that are happening, winter wave attacks, then in that case, one can expect similar level of decline in promotional activity?

Aman Mehta: In that case, obviously, safety of employees would come first. So it would depend on how severe the situation is.

Girish Bakhru: Sure. And just related question on India market. Have you launched Dapagliflozin?

Aman Mehta: That's still an ongoing case. So we will have to wait and watch.

Girish Bakhru: So is there any timeline on when the companies play here on the case?

Aman Mehta We expect sometime this quarter that there should be some kind of an order on that.

Girish Bakhru: Okay. And just last one, on the U.S. side. Sanjay, I mean, you guys have been saying that there is a possibility of desktop auditing. Probably FDA is taking its own sweet time. Is there any game plan should that not happen, let's say, for another two or three quarters, I mean, are we seeing more options in terms of contracting opportunities or things like that?

Sanjay Gupta: So I think I will just correct one thing that we have been saying that we don't have visibility here. So we have made our request, but we have no visibility. And I think we are not alone in this boat. Quite a few of our fellow companies from India are in the similar situation. In terms of game plan, so in the best of circumstances to change manufacturing sites for approved product is a lengthy process that requires a bit of investment. But to change manufacturing sites for products which are not approved is even more, I would say, onerous and time-consuming as well as resource consuming. So it's a call not to be made lightly. It's an option that we have studied and we continue to study. But quite honestly, before this COVID, it did not make sense. But now given what is going on and the uncertainty, it is certainly something that is back on the table.

Girish Bakhru: But is there an optionality like, I mean, while, let's say, next, suppose, six months go like this, and there are no material desktop audits, then can we utilize these assets significantly higher for other markets or things like that?

Sanjay Gupta: No, without a doubt. So these products are already being used to other markets. Because the way our R&D works is initially the products are developed for the U.S. market, but subsequently the same adaptations are made for Europe or for Latin America or for rest of the world. So the R&D operates in a normal situation like that. So that process is ongoing. But I was specifically referring to the investment that was made to develop the ANDA for the U.S. market. So it's quite a kind of hard spot to be in. Because the investments required to, let's say, to commercialize these products without having your facilities approved is very high as well as the time frame.

Moderator: Ladies and gentlemen, that was the last question. I now hand the conference over to Mr. Sanjay Gupta for his closing comments.

Sanjay Gupta: Thanks, everyone, for joining in today. I hope we answered questions to your satisfaction. And if there are any further questions, please don't hesitate to call us. Thank you. Bye, bye. Have a good day.

Moderator: Thank you. Ladies and gentlemen, on behalf of Torrent Pharmaceuticals Limited, that concludes this conference call. Thank you for joining us. And you may now disconnect your lines. Thank you.