"Cadila Healthcare Limited Conference Call to have a Discussion on the Transaction of Sale of Animal Health Established Market Undertaking"

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Moderator: Ladies and gentlemen, good day and welcome to the teleconference of Cadila Healthcare Limited which is scheduled to discuss Sale Transaction of Animal Health Established Markets undertaking by the company. As a reminder, all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes.

Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Akhil Gupta from Investor Relations team of Cadila Healthcare Limited. Thank you and over to you, Mr. Gupta.

Akhil Gupta: Thank you very much. Good evening, ladies and gentlemen and welcome to the Cadila Healthcare Limited teleconference to have a discussion on the transaction of sale of animal health established market undertaking.

On today's call we have with us Dr. Sharvil Patel – Managing Director; Mr. Ganesh Nayak – COO & Executive Director; Mr. Nitin Parekh – Chief Financial Officer and Mr. Harish Sadana – Chief Strategy Officer.

With that now I would like to turn the call over to Dr. Sharvil Patel.

Sharvil Patel: Thank you and good afternoon, ladies and gentlemen. I do wish that you and your families continue to remain safe and healthy during this time of the pandemic. At the beginning of this presentation let me talk about our strategy as we had envisaged. So at the beginning of this year 2020 we had initiated a strategy exercise for the group by asking ourselves a few questions. How will Zydus look like in 2030? What will our business composition as we move forward? What geographies we would like to play in? Where we will compete on scale and where we will be looking at customer intimacy?

Also what will be the state and contribution of our various innovation programs that Zydus is betting on? And many other questions around the organization including talent, capital allocation, quality and size of the balance sheet to mitigate any delays and setbacks that may come our way. Coming out of the exercise we concluded that our strategy for the decade of 2021 to 2030 should have the following core elements.

For India geography we are targeting both our human health and consumer wellness businesses to significantly scale their operations while maintaining healthy EBITDA margin. We foresee US geography to be a good mix of generic and specialty going forward. We intent to build a portfolio of assets in branded space both from our own pipeline and the opportunistically taking inorganic bets.

Also we look at some of our emerging markets in Asia and Latin America to scale up and deliver sustainable revenues and EBITDA numbers. We are also advancing our clinical programs for

Saroglitazar for two indications of PBC and NACH in the US market and European markets. We are also working on developing the next wave of biosimilars and intent to take a few of them for the global filing and we are also targeting a large scale up of our vaccines program during this period.

Overall we believe that by 2030 Zydus will look very differently from what the Zydus is of today with a large chunk of revenues coming from new business lines like NCs, Biologics vaccines. Coming to our animal health business, as part of our global strategy and to achieve the next phase of growth for this business line, we transferred it into a separate entity known Zydus Animal Health and Investments Limited in FY20.

The business was divided into two undertakings. One was to focus on India and certain other countries known as Animal health established markets undertakings. The other undertaking namely animal health emerging market undertaking was to work on the new growth avenues in the regulated markets of United States and Europe. This transfer was done to accord specific thrust and greater focus on the animal health business aided by improved customer focus which would help provide greater visibility of the performance of the business and also attract the right talent at the global level.

The aim was also to expand the animal business, health business by exploring strategic choices such as leveraging a strong product pipeline as well as its new manufacturing facility and forging technical and marketing alliances including joint ventures a global regulated market. In a way we were looking at the growth in the similar way as we did for our consumer wellness business in the previous decade both by exploring organic and inorganic opportunities and also inviting the participation in equity from the investors to accelerate the growth journey.

With this objective we have initiated to look for strategic and/or financial partners for our animal health business who share the same values and growth ambitions for the business with an intention to invite them to take equity stakes in ZAHL. Earlier on in the process we have discovered that to valuing these two undertakings separately and independently was a better operational and economic options than valuing the entity as a whole and that is how we advance this exercise wherein at the end of the process the consortium led by multiple alternate asset management has emerged as the more suited partner to take animal health established markets undertakings to its next round of growth.

Accordingly ZAHL has entered in for business transfer agreement and other ancillary agreements to sell and transfer the animal health established markets undertaking on a going concern basis to the consortium led by multiples through an SAV in the name of Zenex Animal Health India Private Limited for a slump consideration of Rs. 2,921 crores on a cash free debt pre basis subject to certain closing date adjustments.

Over the last three decades our animal health business has grown to become a pioneer and market leader in the Indian Animal Health Industry with multiples and its consortium partners committed to growing the business we are sure that it will continue to grow and strengthen its position in the industry. ZAHL will continue with its efforts to invest and build this animal health business in a regulated market of USA and Europe.

We plan to utilize the cash which will be generated from this transaction for pursuing the strategic objectives in India and US geographies and advance our innovation led programs in the NCs, Biologics, vaccines, biosimilars and specialty areas. In the short term the cash will help us deleverage our balance sheet by reducing our debts to below the Rs. 1,000 crores marks. The transaction is expected to be an EPS neutral.

Thank you. And now over to the coordinator for the Question-and-answer session.

Moderator: Thank you very much. We will now begin the Question-and-Answer session. The first question is from the line of Surya Patra from Philip Capital. Please go ahead.

Surya Patra: If you can share what was the kind of EBITDA profile of the business and what is the kind of revenue base that we will be losing with this transaction and also what is the kind of an advantage or disadvantage that the remaining animal business that will be there for the company so what advantage, disadvantage you can see because of this transaction?

Sharvil Patel: So let me answer the second question first. We do have plans to build the US franchise of the animal health business. The US franchise will be more driven towards the companion animal whereas India business is more driven by the live stock and poultry side of the business. So they are very different in the nature of products that get develop. Also we have set up a new facility which has commissioned and has already taken the regulatory batches for filing for the US for something known as ANADA which are very equivalent of ANDAs for the US generics and we have started our efforts on filing that.

So we have a plan in the next three to five years to not only file a good number of ANDAs but also then launch them subsequently in the US market and create our US business out of this. So that is the current strategy and then also we will leverage the same capability to find partners in Europe also if needed for some of these portfolio but my large effort is strongly focused towards the US market where we have the local knowledge the distribution understanding as well as the team that can help us win business.

With respect to India, this business contributes about 3% to 3.5% of our sales and about 4% of our consolidated EBITDA. So it is a meaningful business but it is not very large. In terms of FY21 it is still not audited numbers so we do not have the audit numbers but may be Nitin Bhai or Vishal can add to the FY21 EBITDA and sales.

Management: So 2020 audited sales was Rs. 513 crores and EBITDA was Rs. 88 crores and in 2021 financial year our provisional estimated numbers is the sales of Rs. 600 crores and EBITDA of Rs. 150 crores.

Surya Patra: Since we are transferring asset also and along with it we are transferring the manufacturing plant, can you share what was it at gross block of that and what is it that we are sharing apart from quantitatively?

Management: We can give those numbers later we do not have the numbers handy but it is not a very significant part. For a clarification there is a plant in Haridwar which we have acquired somewhere in 2015 from Zoetis. That plant is cluttering to India and certain emerging markets so that is the part of the transaction but there is another plant which is in SEZ Ahmadabad which is the manufactured products for regulated markets like US and Europe. That is a separate business and we are not taking not part of this transaction.

Surya Patra: My next question is sir, you have mentioned that the money that is getting or the proceeds of the transaction will be utilized for raising the debt and you have mentioned that in the opening remarks it will reduce to kind of Rs. 1,000 crores odd levels of gross debt situation. Is it the case?

Sharvil Patel: That is right.

Surya Patra: Okay so that means we are already at a kind of near about 4,000 odd kind of a gross debt level that we are currently at this venture?

Sharvil Patel: You are talking about net debt levels of that closer to Rs. 1,000 crores.

Moderator: Thank you. The next question is from the line of Kunal Shah from Emkay Global. Please go ahead.

Kunal Shah: Sir, the first question is on the tax implication on the proceeds. So what would be the tax that we have to pay on this transaction on the proceeds?

Sharvil Patel: Yes, so may be Vishal or Nitin Bhai you can answer. I think it will be subject. You can answer that question. I think it will be around 25% tax rate which is what ZHL is subject to.

Kunal Shah: 25% but it would be on the capital gains, right?

Sharvil Patel: Vishal, you may answer that.

Kunal Shah: So would the other tax rate on the capital gains only or like the profit on the share of the business? Then in that case what will be the net asset of the undertaking that we are selling?

Vishal Gor: So we will be paying 25% tax on the gains.

Kunal Shah: And what will be the net asset for the undertaking?

Vishal Gor: Roughly the calculation of tax is about Rs. 200 crores.

Kunal Shah: And the second question is on our second undertaking which will focus on the US and Europe business. What kind of investment you have already put into that undertaking and will it be more investment and when we will start seeing the revenues for that undertaking?

Vishal Gor: So that details we have still not given.

Sharvil Patel: At a suitable time, we will talk about that business. As I said we have a facility that is current so that has already been done. We are building the R&D team that is looking it as well as filing that. As we come closer to our starting plan in a meaningful manner and the commercial plan we will obviously update you about this. But currently it is in the early investment stage.

Moderator: Thank you. The next question is from the line of Ranvir Singh from Sunidhi Securities. Please go ahead.

Ranvir Singh: Sir, a few clarity. You said that animal healthcare business will be total Rs. 600 crores in sales. So what part of it has been sold? So what was the established market proportion of the sale?

Sharvil Patel: All established market proposal is only business that is relevant today. The emerging market undertaking business is under development and no revenue associated with it.

Ranvir Singh: Sorry I missed the word. You said how much?

Sharvil Patel: So the entire sales of Rs. 600 crores is from the business which has been sold.

Ranvir Singh: Okay that seems a little within 9 months itself if you extrapolate the total animal health care business is around Rs. 600 crores if you just annualize the animal numbers. May be Rs. 605 crores or something. So that means the other business is very negligible?

Sharvil Patel: There is no other business. It is only in development stage. It will take 4 to 5 years to start any business in the US.

Ranvir Singh: And secondly that Rs. 150 crores EBITDA we have then how this be EPS neutral?

Sharvil Patel: So gas which will be received will be temporarily used for certain investments. On long term because the industry go various strategic investments it will be EPS accretive but right now for the temporary period we believe that there is not going to be much change in terms of the EPS. It will be almost neutral.

Ranvir Singh: And is there any debt in that animal healthcare business?

Sharvil Patel: No, there is no debt.

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

Prakash Agarwal: Just wanted to understand the thought process better I mean this is to streamline and focus on the key markets which is US and India and better capital allocation strategy. I mean for Cadila we never think that cash is a problem for you to invest in to biosimilars or vaccines. So how do we see this? I mean do we see a fast track R&D going forward and fast track of monetization of the same or how do we see that?

Sharvil Patel: So Prakash, as part of our overall strategy we have obviously very well established businesses and geographies and then we have lot of emerging and developing businesses and some businesses which are very stable and good. Now as part of our next 10 year's vision we see that if we want to make all businesses relevant to the size and scale of what our company should be and the requisite amount of capabilities in terms of talent also. Now when we looked at all of those opportunities we found an opportunity to scale up Zydus Wellness and we were able to do so in the last two years.

We were also looking at similar opportunities in the animal health space. However in the animal space one is this is not such a I mean there are not enough players one is to say and there are not enough opportunities in terms of finding partners. Also the whole purpose of it was obviously that we do not want to be a minority stakeholder. So then we said that the transaction would not make sense that.

However if you take a next 10 year point of view we know that significant revenue and value is going to be driven out of the innovation portfolio that we are developing and so our strong focus is from the Cadila point of view we are going to be driven on that and the value proceeds of this will definitely help us in accelerating our vaccines program, our R&D program also and making sure that we are good in terms of any eventuality. So while one looks for everything as the best case scenario one has to also build for difficult times and I think by this also helping ourselves in terms of insulating that problem.

Prakash Agarwal: So it is more like a 10-year call and streamlining the business where you see the buildup happening going forward?

Sharvil Patel: Yes.

Moderator: Thank you. The next question is from the line of Charulata Gaidhani from Dalal & Broacha. Please go ahead.

Charulata Gaidhani: My question pertains to can you quantify the gross block for animal health?

Nitin Parekh: So as I said right now we do not have the ready numbers. My sense is that the gross block could be less than Rs. 100 crores actually in terms of fixed assets. So it is not a very significant part of the block. As you know we had acquired in 2016 Zoetis with the land building plant and machinery as well as certain products, which was at Rs. 170 crores and there would be depreciation over a 5 year period on that.

Charulata Gaidhani: And any intangibles or R&D spends that would be going in to this business?

Nitin Parekh: Yes, this along with the undertaking all the trademarks, brands associated with this particular business they are also part of the transaction. This business is mainly the business of brands that way. That is the way you should look at.

Charulata Gaidhani: Okay so what will be value of intangibles?

Nitin Parekh: For us it is all value created. So that will then depend on the purchaser in terms of allocation. For us there is no separate sale of any of the components. We have the sale of entire business undertaking consisting all the immovable, movable, tangible, intangible, brands, licenses, contracts everything. So that is the lump sum consideration. This is just lump sale deal and there is no individual values assigned to any of the assets or liabilities.

Moderator: Thank you. The next question is from the line of Sameer Baisiwala from Morgan Stanley. Please go ahead.

Sameer Baisiwala: Sir, can you just brief us on what was the valuation framework which was used to arrive at this deal value?

Nitin Parekh: So this was a bidding process. Moelis & Company acted as the investment advisor to us and formally the process of price discussions. Then we received the non-binding offers and then binding offers from many players. And then after looking at all the offers that we received and further negotiations and considering the credentials and doability of the deal etcetera under various considerations then we found multiple lead considerations to be the best suited partner also to take to the next level of growth for this business.

Sameer Baisiwala: In terms of specifics do you think this deal gets priced on the basis of what DCF or is it price to sales EV to EBITDA just some basic framework that one uses for these kind of deals?

Nitin Parekh: Well, so we do not know how the buyer would have price fixed for us. It was a bidding process. What it ultimately translates if I take my 2021 estimated number of sales of Rs. 600 crores and EBITDA of Rs. 150 crores something like 19 plus times of EBITDA and about 5 times the revenues.

Sameer Baisiwala: And sir, second thing is you have spoken about the areas of focus going forward but would there be any change to your plans now in the sense that now you can pick up 5 more biosimilars in to a global trials, is that the way you are thinking about or could you accelerate some M&A ideas that you were not able to do so far so any thoughts on this?

Sharvil Patel: Well, definitely Sameer, the main one of that will definitely be global biosimilars programs that we are looking for, for the 2025-26 time frame and we have already identified some programs for that. Also acquisitions in the specialty space in the US which we are very keen to do will continue and will get further momentum also from our side.

And by and large and also the large clinical development programs that we have for our specialty business in the US including Saroglitazar will get a further boost in terms of what we want to do and more recently but something that is always been part of our vision is to how do we scale up our vaccines business. So now we are definitely obviously we are doing so on the Covid front but we are looking at how do we scale up our MR typhoid conjugate and the flu vaccine which has become a very critical vaccine in post Covid era as well.

Sameer Baisiwala: And then final question. Now three years forward how would the balance sheet look like in the sense that all that you have spoken of would that be funded through internal accruals or you are thinking of levering it up again and what is your comfort level on that?

Sharvil Patel: So currently we are comfortable with that internal accrual. We do not immediately see the need to do any other leverage.

Moderator: Thank you. The next question is from the line of Harit Ahmed from Spark Capital. Please go ahead.

Harit Ahmed: The numbers you have shared for the divested business top line of around Rs. 600 crores and EBITDA of Rs. 150 crores for FY21. It seems to be a significant improvement in the margin profile of this business in FY21 from around 17% in FY20 to 25% in FY21. So can you give more color around what broke this improvement?

Sharvil Patel: So I think if you have seen post Covid and during this whole trials any companies that had strong operational efficiencies and strong brands have done well. Animal health business has been one of the businesses that has very strong reputed brands in the country. It is among the top 2, 3 companies in the country.

It has a very good reach and distribution and the rural part of the economy also did very well and continue to do well. So all in all I think not only did they do a good job on the sales and profits but also receivables and all of the health parameters. So it has been a very steady and stable business and with strong brand equity which helped during the times of Covid.

Harit Ahmed: And this 25% is more like a new normal base level margins for this business and this is a sustainable levels in your?

Sharvil Patel: Yes. Definitely it is so it has new opportunities in exports and obviously it continues to have better operational efficiencies and scale in India. So it will continue to deliver on that. Our current plan talks about further improvement on that.

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

Prakash Agarwal: My question has been answered. Thank you.

Moderator: Thank you. The next question is from the line of Kunal Randeria from Edelweiss. Please go ahead.

Kunal Randeria: Sir, my first question is if you could share some of the timelines on the investments that you are going to make like the biosimilars phase 3 in regulated markets or Saroglitazar in NACH over the next two to three years and if possible may be share the quantum of investments that would be needed here?

Sharvil Patel: I do not think we can give you that details right now but definitely on the NACH and PBC both trials are underway and already centers have been allocated and we will be starting recruitment very soon. So that is on track in terms of our development. We had said that end of 2023 is where we look for NDA submission on PBC and may be 2025-26 on NACH. So that is what we are still believe we can achieve.

On the biosimilars program beyond India we are looking at developing Indian emerging markets. We are nominating may be two or three biosimilars for the global development which are post 2025-26 kind of launches and some will be later and for that the current plants are under development and as we come closer to a larger investment cycle we will obviously talk about it in our quarterly updates. And beyond that everything is as we have been operating.

Kunal Randeria: So would it be fair to assume that your R&D is likely to go up substantially over the next two or three years?

Sharvil Patel: So R&D in absolute terms will definitely go up. We still believe that with our revenues growing equally we can still believe that we will be around that 8% to sales number for the current foreseeable future.

Kunal Randeria: And Dr. Sharvil, if you can just may be educate us a bit on how this animal health business that you have kept for the US market how does it works I mean what are the filing timelines how does the distribution work in the US and so on? So just trying to understand a bit more the rational of keeping the business with you?

Sharvil Patel: So two things. One is the rational is obviously this business currently does not we do not have any revenues associated with it. So it is in the early stages of seeding. The distribution is very similar. There are handful of distribution points by which you go through it similar to the generics distribution that is there. The filing is like you file NDAs, you file ANDAs which are requiring a little bit more work related to animal studies and others into species and others. So that is a little bit different there.

That is what we are going to do. So I think the whole strategy for us is to make sure we are selecting the right portfolio which can see a good uptick both in the substitution point of view but more also we will create some of our own sort of branding also in the US. For that we have already have a business plan that we are undertaking.

I would say today it will be a little too early to talk about those plans because these are not in the near term. But as we come close in the next two years when we have seen more commercial ready plans we can definitely talk a little more about it. Today it will be little bit too premature to give those kind of strategic details out which we would like to keep under wrap.

Kunal Randeria: Just lastly on this. What is the kind of competition in this space in the year?

Sharvil Patel: So it is less severe than generics but it is a far more evolved market.

Moderator: Thank you. The next question is from the line of Saptarshi Kumar, an individual investor. Please go ahead.

Saptarshi Kumar: Could you share with us what kind of outlay would you have for your vaccine business in the near future?

Sharvil Patel: So currently most of our funding has already been done for our vaccines. The other investments a lot of plants and facilities have been done. But in the next couple of years that we have major cycle of investments we can discuss it but currently by and large current portfolio we have already invested in.

Saptarshi Kumar: So for your upcoming this Covid vaccine also you do not need fresh investment, right?

Sharvil Patel: For the current scale we have invested. If we have to increase that looking at the need of the hour, then we will look at further investments.

Moderator: Thank you. That was the last question. I would now like to hand the conference over to Mr. Akhil Gupta for closing comments.

Akhil Gupta: Thank you everyone for joining the teleconference and for your continued support. We look forward another interaction in investor call for quarter 4 2021 results soon. Wishing for you and your loved ones health and safety at this time. Thank you and have a good day.

Moderator: Thank you. On behalf of Cadila Healthcare Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.