

Syngene International's Q2 FY 2019 Conference Call

October 25, 2018

Key Participants from Syngene International

- Mr. Jonathan Hunt: Chief Executive Officer
- Mr. M.B. Chinappa: Chief Financial Officer
- Mr. Karthik: Investor Relations

Moderator: Good day ladies and gentlemen and welcome to the Syngene International Q2 FY2019 Financial Results Conference Call. At this time all participants' are in the listen-only mode. Later we will conduct a question and answer session and instructions will follow at that time. Should you need assistance during the conference call, please signal an operator by pressing "*" and then "0" on your touchtone phone. As a reminder this conference may be recorded. I would like to hand the conference over to Mr. Karthik who will coordinate the call on behalf of Syngene International relations group. Thank you and over to you Sir!

Karthik: Good afternoon. On today's call we have Mr. Jonathan Hunt, Syngene's Chief Executive Officer and members of Syngene's management team to discuss the financials and business performance for the Q2 FY2019. After our prepared remarks, we would welcome your questions.

Before we begin, I would like to caution you that comments made during this conference call today October 25, 2018 will contain certain forward-looking statements and must be viewed in relation to the risk pertaining to our business.

The safe harbor clause indicated in our investor presentation also applies to this conference call. The replay of the call will be available for the next few days immediately after this call and a transcript will be made available in a week's time on the company's website.

With that I will turn the call over to Syngene's CEO, Mr. Jonathan Hunt. Over to your Sir.

Jonathan Hunt: Thanks, Karthik, and good afternoon, ladies and gentlemen. Thanks for joining us on the analyst call today to cover Syngene's second quarter and half year performance for FY 2019.

I am going to start my comment for giving you an overview of the quarterly financials, and then follow-up with operational updates. I am then going to invite Mr. Chinappa, our CFO, to give you a little more detail on our financials for the quarter in his address. So let us start with 2Q performance. I am happy to report that Syngene registered 24% growth in revenue during the second quarter that is with our reported revenue growing from Rs.352 Crores in the same quarter last year to Rs.437 Crores this quarter.

Overall, that growth was well balanced across the business, with both our small molecule Discovery Services at Discovery Chemistry and Discovery Biology as well as our dedicated centers showing good traction. As you may recall, over the last few quarters, we did enhance the renewals of our ongoing collaborations with BMS and Baxter, and we are now starting to see that reflected in the growth within the business.

Turning briefly to profitability. EBITDA for the quarter was up 12%, to Rs.145 Crores and that compares with Rs.130 Crores in this quarter last year. Looking at the reported PAT line for the quarter, that was up marginally, about 1% taking into Rs.78 Crores compared to Rs.77 Crores in the last year, and this is in line with our plan. I think it reflects pretty much the investments, the continued investments, we are making in enhancing our safety, quality and systems in our sales and marketing activities as well.

So let me turn quickly now just for some of the highlights for the first half. Revenue is up 31% to Rs.862 Crores, while EBITDA was up 12% and PAT was up by 4% at the half year. I am not going to go into more details around the financials; I will leave

Chini to cover that in his comments. So just looking now at the operational updates for the quarter. Sure, you are all familiar Syngene's business is broadly categorized into 3 verticals, Discovery Services, Development Services and then the Dedicated R&D Centers. In our Dedicated R&D Center vertical, we see that really the differentiated business model that allows us to provide integrated drug discovery and development services to our clients by setting up dedicated research facility.

Teams of Syngene scientists then work side-by-side with our client's R&D teams around the world, within the new dedicated facilities, and we do that to deliver drug discovery in development projects. So currently Syngene has got 4 of those dedicated centers, one each with BMS, Baxter, Amgen, and Herbalife. As I mentioned, over the last few quarters, we have been particularly good for this vertical, with the renewal and expansion of our ongoing collaborations with BMS and Baxter. I am happy to share then we are making good progress on those expansions.

We inaugurated and commissioned a new dedicated facility for BMS during the quarter, so that is now up and operational. Also, on the operational front, we are making good progress on our investments, focused on improving and strengthening our safety and quality systems. And we really see these investments as a source of differentiation in the market, and something at real value to our clients. Syngene's growth over recent years has really led us to invest a lot in people. And as we have seen our business grow, we have seen our employee base increase proportionately.

During this quarter, we made some further additions to our leadership team with 2, I think, significant appointments, Alok Mehrotra joined us as Chief Quality Officer. He can be responsible for Syngene's quality function and will spearhead our initiatives to further strengthen Syngene's track record and regulatory compliance. Alok comes with 25 years or more experience across multiple industries, including a real depth of experience in pharmaceuticals and pharmaceutical manufacturing. Harry Jose joined us as Head of Marketing. He will be responsible for our strategic marketing and brand building initiatives. He joins us from Infosys, and I think his experience is really going to help improve our overall brand identity.

So in closing, from me, we are making good progress, I think, on our strategic plans. Our ongoing investments to improve operational efficiency are already starting to show some results. And I think it is really going to position us well for the second half of the year and to continue to provide great value to our clients. So with that, let me turn over to Chini to share a little bit more on our Q2 financials.

M.B. Chinappa: Good afternoon, everyone. Over the next 5 minutes or so, I shall share more details around Syngene's Q2 revenue, the profitability and update you on the ongoing capex program. During the quarter, we delivered 34% growth at Rs.437 Crores as compared to Rs.352 Crores in the same period last year. As Jonathan mentioned, the growth for the quarter was well balanced across all verticals, with very good traction in Discovery Services and Dedicated R&D Centers. We also had a 7% benefit on account of the currency move.

Gross margins for the quarter, and the gross margins I mean total revenues, less material costs, less employee cost and less power cost, is 46% so the gross margin for the quarter is 46%. This is in line with our full year FY2018 reported gross margins. Our EBITDA for the second quarter is at Rs.145 Crores. This reflects a 12% increase as compared to Rs.130 Crores in the same period last year.

The lower growth in EBITDA is reflective of investments towards commercial activities as well as strengthening our safety and compliance initiatives. Our profit after tax at Rs.78 Crores is a notch higher than the net profit reported during the same period last year. And as we may recollect, it reflects the twin effects of increase in depreciation and increase in income tax.

Our EBITDA margins at 33%, and PAT margin is at 18%, respectively. It is as per our expectations indicated earlier in the year. I would also like to call out here that our reported revenues for the quarter include the interest income of Rs.18 Crores, associated with this, our finance charges of Rs.8 Crores and income tax of Rs.6 Crores. If you exclude the impact of interest income, the revenue growth for the quarter is

25%, and our adjusted EBITDA and PAT margins for Q2 FY2019 are 30% and 18%, respectively.

A quick comment on the effective tax rate, as we have commented in the past, the effective tax rate for H1 FY2019 has increased and is now at 20% compared to 19% in H1, FY2018. This is due to the unwinding of the SEZ tax holiday benefits in some parts of our business.

I will now turn to forex and impact of the currency movement. As you are aware, our revenues are predominantly invoiced in U.S. dollars, while our reporting currency is in INR. During the quarter, we had a forex loss of Rs.5 Crores compared to a gain of Rs.12 Crores in the same period last year. This reflects a difference between the hedged rates versus the prevailing spot rates. As you have fully hedged for the second half of FY2019, at around Rs.70 per \$, we do not expect any gain from the recent rupee depreciation to impact profits over the next two quarters.

I will now quickly touch base on some of the balance sheet items. We have spent approximately Rs.300 Crores towards the ongoing capex programs. As a result, we have reported a net debt position of Rs.1 Crore as of September 30, 2018, compared to a net cash position of Rs.320 Crores as of March 2018. We have committed an additional \$10 million in the first half of this year against the total capex commitment of \$200 million. With this, our totally committed investment stands at \$118 million as at September 30, 2018. This includes \$78 million for expansion of facilities in Bangalore and USD 40 million towards the upcoming commercial API manufacturing facility at Mangalore, which is scheduled to be operational by the end of FY2020. As we have mentioned in the last quarter, we have reinstated the first phase of the upgraded S2 unit, and we expect the second phase to be operational by the end of this fiscal year. With regards to the insurance claim, we have so far received Rs.81 Crores, and we expect to receive the balance proceeds over the next 12 months.

Finally, to summarize, it's been a good quarter, and revenues are in line with expectation. We expect to maintain the momentum for the rest of the year. With this, I will now conclude my financial overview and open the call for questions.

Moderator: Thank you very much Sir. Ladies and gentlemen, we will now begin the question and answer session. We have the first question from the line of Nitin Gosar from Invesco Mutual Fund. Please go ahead.

Nitin Gosar: You mentioned about the hedging? There was some comment on the hedging part currency hedging and if I get it right then FY2019 and you are adequately hedged and you may see the INR depreciation benefit, which currently is happening? In that case would FY2020 when the contract gets renewed or reprised do you see some kind of readjustment and then finally the INR depreciation will start flowing down to your bottom line how should we look at it?

Jonathan Hunt: Okay. So just to rephrase that, Chini, it is a, I think, the question overall on our hedging policy. Can you maybe go back to the beginning, why do we hedge, how do we hedge, what's our P&L dimensions are in the policy. And then maybe you can comment on the specifics of where we are, given the current sort of market movements?

M.B. Chinappa: Okay. Nitin, as we had commented in the past, our hedging policy tends to look at fully hedged over the first 12 months and a partial hedge over the next 12 months. And at the same time, all our long-term fixed rate contracts are due to hedge completely, just to kind of not have forex fluctuation on the book impacting the profitability of the contracts or the abuse, in particular, so in this thing that's hedged over the years. We average out the impact of the rupee actual movement. If you recall, in FY2017, the rupee averaged at about Rs.65, at which point we realized close to Rs.67 to the dollar and deposited about Rs.23 Crores of hedging gain. In FY2018, the rupee actually appreciated to 64 level; however, we realized Rs.68 to the dollar, and that is reflected in the Rs.73 crores hedging gain for FY2018. This year, we are hedged in the Rs.69 to Rs.70 level. And as of the first half, we have recorded

a Rs.5 Crores forex gain, but had Rs.10 Crores gain in the first quarter and a Rs.5 Crores loss in the second quarter. Going into the next year, similar to our previous hedging policy, we are hedged at a rate, which is higher than this year and closer to the prior remaining quarter.

Nitin Gosar: Okay. Sorry, just harping on it further, so the Rs.69, Rs.70, where we hedged ourselves and current rate being Rs.73, so after 12 months, which is probably around maybe around April or may be around June, next year, that is when you will start seeing the actual real rate or the refreshed freshly hedged rate getting reflected into your numbers?

M.B. Chinappa: Yes.

Nitin Gosar: Okay. And Sir my second question was pertaining to the dollar-denominated growth. So from here on, the growth, which we are witnessing in second quarter, should we consider that growth to be the momentum to go by, keeping in mind the scale at which we are seeing in the dedicated service segment?

M.B. Chinappa: We will again take you back to the guidance that's given at the start of this fiscal. We had said that we are looking at FY2019 growth to be a notch higher than the revenue growth that we reported for FY2018, which was 17%. And this growth will be despite the lowering of tax incentives and the interest income in FY2019. So the core sales growth, as you see, will be higher than what we had presented than what we delivered last year.

Nitin Gosar: Fair point Sir. Thank you.

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

Charul Gaidhan: My question pertains to the increase in material cost there is 38% increase whether you expect it to continue at this rate or is it temporary phenomenon?

M.B. Chinappa: Charulata, again, as I mentioned in my commentary, look at our gross margin as a net of employee cost, material cost and power cost. So if you look at that, we are at 46%. Our gross margins are at 46%, and that is in line with Q1, in line with last year's full year average. When you look at Q2 of last year, there was something that we had this additional export incentive that played out, and that gave us higher revenue and a higher margins last year. But if you really look at our full year average, 46% is our current run rate. So sometimes when deposits involve a higher rate, the development work that we do tends to have a higher material cost. In Discovery Services, we do have a higher employee cost, but blended combined cost is about 54%.

Charul Gaidhan: My second question pertains to the investments in building capabilities. Safety symptoms, I think FY2018 it has tapered off so far, but further investments and building capabilities will it lead to a further pressure on profits?

Jonathan Hunt: If you step back I think, the narrative that we have given throughout the year is that one of the reasons that Syngene does well, particularly with what I think is a marquee international clientele, is that we stand out in the marketplace and we are positioned as a premium service provider. And that is going to putting them in the sense of pricing. It is premium in the sense of the quality of the infrastructure that we have, the training and capability levels of the staff, the quality of the science and the innovation that we deliver to our clients; and also, the systems and processes. And in a regulated industry, like ours, with clientele, they put a great deal of store about on those issues. Investments are ongoing, I think, continual, and they are constantly needing to be pushing to make sure we maintain our position as being strongly differentiated on those attributes. So for me, it is not a won and done. I think it is a constant need to make sure that we operate at very highest levels. But parenthetically, that is an investment in future growth, so the reason we are growing at 24% in the quarter is precisely because we would not need mandates from marquee clients. And they do that because they have a trust in our systems and quality and our operations. So it is a virtuous circle but I hope we continue to invest in because it is one of the things that is creating value. So that is a sort of contextual

answer to your question. I think there is more to be done, and therefore, I would expect at least for a period in the future that you would see us to continue to invest. Now of course, at some point, you expect to see the operating leverage come through as a benefit from that, but I am not going to give a specific point estimate, when in time, you will see that. But every direction, the travel is clear. Hopefully that helps you with some context during the question rather than the specific modeling answer?

Charul Gaidhan: Right, but you think it would pan out in a year or two?

Jonathan Hunt: Well, as I said, I don't think at this stage, I am going to call a particular quarter for you.

Charul Gaidhan: Fine thanks.

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

Surya Patra: Sir, thanks for the opportunity. Sir, on the growth front, this quarter we have seen stronger growth, sure and that is largely coming from the Dedicated Center vertical side, also, the development and manufacturing side. But can you just give some more clarity? See, we have seen some of the developments on the dedicated centers vertical front but on the manufacturing and development front, and the Discovery Services front, if you can give some clarity about the growth? Or what are the key drivers of the growth in the subsequent period, then that would be useful?

Jonathan Hunt: Okay. I will see what we can do to help. As you know, we do not breakout vertical-by-vertical segmental reporting. So you have to forgive me, if I talk around the subject rather than, sort of, list of specifics. If you look at the quarter, the 24% growth, I think, actually one of the key drivers of that actually was the performance within the Discovery Services vertical, and that has got 2 elements to it. It has got what we are doing in chemistry, so Discovery Chemistry; and what we do also in Biology. Now if you go back, and I can call out, say, for one example with the

client, we told you some time ago that we won a new mandate with GSK. A lot of that is in bulk chemistry, a little bit in biology that started to gain some traction there. But in general, I would not call you to a particular client win. It is actually more broad-based than that. It is just a general uplift amongst the number of our client relationships where we are doing a little bit more work for them, whether it be fee-for-service or on an FTE basis. So broadly doing well. I think biology, this is an 18-month, narrative that we talk to you about. We have, I think, in our Biology capability a really differentiated team. I am not sure if there is anybody else in the Asian region that really has the depth and breadth of experience or the scale that we have in Discovery Biology. And that then is a very attractive proposition for many of our clients around the world, a depth of talent and a great operating cost environment, which means that we can be both productive but also very cost conscious on their behalf. So I think those are the things that say we are in the Discovery Services. We called out that we are seeing some good traction in the dedicated centers, but I would not really break it apart beyond that. On the manufacturing side, I think we all know where we are. We have ambitions, and we had good plan to forward integrate into manufacturing. But as of today, it is not a major driver necessarily to the organization. There is a large amount of capex going into our API commercial manufacturing investments over Mangalore that is still under construction. So actually manufacturing is not the majority driver of the business today, but it is a strategically important set of capabilities that we are building for the long term. The one area where we have put capex in the last couple of years, it is now up and operational, it is manufacturing, it is in the Biologic's piece. We have a reasonably sized Biologics capability. It is a new entrant into that market. And it sits in that sweet spot between the clinical development scale and manufacturing and small-scale commercial. And that's come online in the last couple of quarters, and you can see that starting to contribute to revenue growth, but there is a lot more to begin. We are still a relatively new entrant in that marketplace. Thank you for the question.

Surya Patra: If I just ask something more on the biologics services front, what are those incremental trends that you are observing, Jonathan? See, like, currently, I

believe it is only 10% to 15% of the Biologic services that are outsourced. So what is the current trend that you are witnessing? And where you are progressing on the Biology front?

Jonathan Hunt: Yes. And then actually, if you step back, it does not need to be a massively complex analysis. If you look at, say, Human Life Sciences or Pharmaceuticals and Biotechnology and you actually look at the industries' pipeline, it is sort of 50-50. If you look across any of the major pharma or biotech companies, half of their projects will be traditional sort of small molecule chemistry based, half of them will be Biotechnology, often Biologics, and within that, often monoclonal antibodies. So the industry has moved to a strategy that is almost sort of platform technology neutral. It is just about the best tool for the job. And then unsurprisingly, almost the lagging indicator, the CRO, CMO industry is matching there. And you can see, if you look at some of the giants in that sector, Lonza, Samsung, 1 or 2 others are putting in an awful lot of capacity, and they are doing it in a strategic partnership model with many, many companies around the world. So I think that the market size is large. And there is a shortage of high-quality available capacity. So if you can meet that, if you can meet people's quality requirements, if you can meet the flexibility they need to have immediate capacity available, I think there is some good opportunities and that's really for us to execute and make sure we do that well.

Surya Patra: Thanks for that. Just couple of questions relating with the financials, Sir, you, just in the opening remarks, indicated about Rs.18 Crores of some one-off number that is there in the top line. Can you just please clarify that?

M.B. Chinappa: It is Rs.18 Crores of other income, which is the interest income, Surya.

Surya Patra: Okay. That is one. And secondly, on the gross margin front, Sir, sequentially there is a meaningful improvement obviously because of the last quarter's one-off treatment what we had witnessed, but what is coming? I mean, Sir,

what portion of this swing, positive swing, is coming from the rupee depreciation? And what is the course that you have really funded the margins?

M.B. Chinappa: So on the revenue front, as I mentioned earlier, we had a 7% swing because of the headwind. If we look down to the EBITDA margin, since we were hedged with the key rupee moved, it should have shown up as forex gain. Now instead of having forex gain, we have higher revenue and a forex loss in the expense line. Ind-AS and EBITDA margin, similar. As the rupee moved a notch, our EBITDA margins would have been quite similar.

Surya Patra: Okay. But sir, if my understanding is please correct me, see with the increasing kind of asset utilization for the new capabilities what you have recently opened. I think, with the increasing utilization, your margins would also improve because the unobserved cost what it is when the issue that will gradually come down.

M.B. Chinappa: That will play out in the subsequent quarters. As the revenues pickup, we will start to see that benefit flow through. But of course, as Jonathan said, we continue to invest into the business to build stronger capabilities that can drive long-term growth and profit.

Surya Patra: Okay. And just last one question on the BMS part, Sir. So now with the expanded and extended relationships, what is the scope of team building capability that we are having. Say, for example, we are currently having around 500 odd FTEs for dedicated for BMS. So with the expanded and extended relationships, what is the scope there one should really consider?

M.B. Chinappa: When you sign the expansion contract, we did give the numbers around the expansion. It was a 15% growth.

Surya Patra: 15% growth annually Sir?

M.B. Chinappa: No, 15% growth in the numbers, and then there are slight adjustments, etc.

Surya Patra: Thank you. Wish you all the best.

Moderator: Thank you. The next question is from the line of Ananda Padmanabhan from Renaissance. Please go ahead.

Ananda Padmanabhan: Thank you for taking my question. Just wanted some bit of clarity on your guidance, on your margin guidance. I understand that you have guided that the FY2019 margins would be in line with Q4 FY2018 margins. Now if I look at your H1 margins, which is around 30% if I adjust for the last quarter's one-off, this implies that H2 should see substantial uptick in your EBITDA margins. So could you give some light on what could be the key drivers of this margin?

M.B. Chinappa: Yes. Anand, this is something similar to what I just answered to Surya's questions, saying that, overtime, revenues will grow on the same asset base that will give us a higher margin. So typically, H2 you mean, April of each year, our fixed cost goes up to reflect the wage inflation. Over the year as the revenues build up, the margin expansion tends to happen as it covers up for that fixed cost increase.

Ananda Padmanabhan: Basically your personal cost and your SG&A cost would more or less maintain the same run rate as of now? The rest of the revenue will continue to increase?

M.B. Chinappa: Yes. It would not grow in proportionate to sales and that will give their benefit on the margin expansion in H2, which will then bring us closer to that item.

Ananda Padmanabhan: Okay. And in your SG&A, in the last couple of quarters, there has been steady uptick. What is trend? Or are there any specific items? Or could you give some more colors on what's driving this uptick in your other expenses?

M.B. Chinappa: Q2 has been slightly lower and the overall increase in the SG&A is reflective of what we discussed earlier is the increase in investment into the business

as we are looking to build capabilities as well as strengthen our infrastructure out phase the quality.

Ananda Padmanabhan: Okay. But this line item will continue to grow further in remaining quarters as well?

M.B. Chinappa: If we are still in the upward trajectory, at which point the benefits will flow through, and we don't want to give that point guesstimate on that.

Jonathan Hunt: But Chini, just as sort of recap in terms the overall guidance on where we expect to be over the course of a year or multiple years, on EBITDA and PAT. And then from there, I leave it to the analyst itself to, like, what is going to happen each quarter. But that thing will give a fairly good route map, where we are going over the long-term. And then in general, both the EBITDA and PAT line for the sort of company we are and for the industry we are in, we are in an upper quartile margin business. And we think that reflects the fact that we also differentiated high-quality services to the global clientele. So if we could just sort of recap where we thought we would be indicatively on EBITDA on PAT. And then that gives both ends for everybody else to be able to work out, what is in the past year and the quarters will be.

Ananda Padmanabhan: Thank you Sir. That answers my question.

Moderator: Thank you. The next question is from the line of Mayank Hyanki from Axis Mutual Fund. Please go ahead.

Mayank Hyanki: Can you give details about the expansion plan? In the sense that what all has been incurred of the \$200 million? And what all is yet to come? And beyond that, have we put any figure of how much do we spend beyond a \$20 million plan, which we had here, from FY2016 to FY2019?

Jonathan Hunt: Yes, just to recap, Chini, as I recall \$200 million is our overall capex plan covering 2 or 3 years for the business. The first phase of that were investments

here in our headquarters campus in Bangalore. So much of that is now invested, completed and it is operational...

Mayank Hyanki: Sir, just sorry to interrupt. So I am at Page #29 of the presentation where you have the detail of the presentation, right, and the written capex investment area. So I assume that these are the areas, which was there in the \$200 million plan. So if you could just highlight, which of these have been completed and commercialized and which of these are yet to come? The Page 29 of the presentation.

M.B. Chinappa: Yes, it is largely divided between these three groups, right, basically, biologics, the formulations and the R&D center. All of them are operational. But they are in the first \$100 million capex. All of them are operational. And as we scale up, there is an additional investment that we will make up to full capacity. So that is around these 3 centers. So all are operational, but all have some additional investment to go.

Mayank Hyanki: Okay. So most of these 3 areas, and you say, the research center, formulation center, API plant, NCE, most of these are operational, but there will be some expansion that keeps on happening in these plants?

M.B. Chinappa: That is right, yes. And the second bit is the Mangalore, the second \$100 million in Mangalore, which we said was invested over the rest of the year and FY2020, to be completed by end of FY2020.

Jonathan Hunt: Operator will arrange to move on to the next question.

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

Prakash Agarwal: Thanks for the opportunity. A question, just trying to understand the current capacity utilization that from the existing facility in Bengaluru on an overall basis?

Jonathan Hunt: Okay. I will ask could you be more specific which particular business you are thinking about? Discovery Services, product development, formulations, manufacturing?

Prakash Agarwal: I mean, if you could help us with all 3 that would be great? Or even a blended would work?

Jonathan Hunt: Okay. Well, it is going to be difficult to do. We do not actually have a single unifying utilization number. On the basis, if you think about business it would be difficult to calculate that. So the majority of what we do is human-based, sort of, work product. It is scientist delivering innovation for our clients. So it is often on an FFF or FTE basis. And in general, I find all of our scientists, sort of 100% occupied. So if you think about the key utilization rate we are looking for in an FTE business is the productivity day-to-day of your research staff and that is the majority operating model across Syngene. On the other two areas, we are looking at in-depth formulation development, and we are looking at chem development and biologics. We just do not publish the metric, but as you can see from the sort of productivity, profitability of those businesses, we are reasonably efficient.

Prakash Agarwal: Okay. I was just trying to understand, like, in the last six quarters, we have added a lot of capacity. So would that have been gone full blown and fully utilized? Or there is enough or more capacity for the next couple of years within this expanded additions that we have done?

Jonathan Hunt: It would be unusual to bring online new manufacturing capacity and have it running at 100% occupancy. So there is headroom for growth. So that is exactly what the business case is, it is to put that in. And again, can tell sure, but the quicker we are looking to have to invest more capital to help you indicate, we are getting our strategy right, around matching services to demand. So I look forward to having to expand our manufacturing capacity to full. But in general terms, particularly on the biologics, I think there are reasonably healthy.

Prakash Agarwal: Understood. And lastly, on the cost front, there have been several questions and answers. I was just trying to understand like with the senior hires of chief quality and marketing, you think the large part of the cost is behind, and now this is the base and we would see probably a high single-digit or low double-digit early teens kind of growth on that number? Would that be fair to assume?

Jonathan Hunt: Well, I do not think the appointment of 2 individuals is the driver of our cost base, given that we have obviously 4500 staff. So I would not single those 2 out. I think actually the reason for mentioning them is that more an indicator of the areas which we think what we can gain value by investing further in some strong quality system, FDA compliance, global regulatory compliance, automating and information in those systems and really making sure we maintain what we do today, which is operating at very best standards globally, and we keep that as a differentiator. I think it is important. So I think you can expect us to continue to be willing to invest in those areas. On the commercial side, we have got a couple of things over the last couple of quarters. We set up a U.S. subsidiary, which is effectively a sales and marketing venture. We have hired seasoned sales professionals in those regions in the U.S. We are doing some of the things in Europe also to get closer to our customers. Now it is an investment. It is a small drag in the shorter term on the business, but it is not a transformational sort of level of cost investment for business of our size. So we will continue to do that.

Prakash Agarwal: Understood. Thanks for the detailed discussion. Just to clarify, I mean, I was meaning that large part of our hiring is largely done is what I meant, not about the 2 individual moving of the cost? Would that be fair to assume that large part across quality, across marketing and other functions is largely done? I mean, ongoing normal growth continues, but a large part is done. Would that be fair to say over the last 6 quarters?

Jonathan Hunt: No, I think we will continue to hire talented people to create value in those areas, but it's quite small numbers in comparison to our overall scale. I mean, if you build a large marketing team in a business like ours, what's it going to be? 5

people. I do not know. But it is very, very small in comparison to an organization and scope of almost 4500 staff. So I get the premise of the question. I just do not think that the hiring in those particular areas is a strategically important driver of our cost base. It may be the important investment in our revenue growth though.

Prakash Agarwal: Understood great. Thank you and all the best.

Moderator: Thank you. The next question is from the line of Krishna Prasad from Franklin Templeton. Please go ahead.

Krishna Prasad: Thanks for taking my question. So if I look at the second quarter, we have had Rs.5 Crores forex loss. Given where the rupee is today or maybe at the end of the second quarter, can you just talk about what will be the forex loss for, let us say, the second half of FY2019?

Jonathan Hunt: Okay. So Chini, it is very similar to the earlier question, where you sort of reprised our hedging approach and policy. So do you just want to maybe summarize that again?

Krishna Prasad: No I do not want the policy. I just want to know are we expecting similar level of losses or will the losses go up as we go into the second half of the year?

Jonathan Hunt: As Chini sort of thinks about the answer to that, partly if you understand the policy, you could maybe predict that.

M.B. Chinappa: We have actually given an indication in our opening commentary that we are hedged around Rs.70 to the \$. So depending where the rupee trades, that will be the gain or loss. Our hedge rate is Rs.70. If the rupee is at Rs.73, there will be Rs.3 loss.

Krishna Prasad: What is the total outstanding hedge amount that you have or the entire sales is hedged?

M.B. Chinappa: The matter is what is the hedge for the next two quarters. Roughly if the net exposure so it tends to be in about 50 million per quarter.

Krishna Prasad: \$50 million a quarter. Okay. Got it. Okay. And if I look at the balance sheet and I see that there is a net derivative liability of about Rs.133 Crores, which used to be a profitable number until March, I mean that is primarily because of currency movement, I guess. So this Rs.133 Crores of net derivative liability will get paid out over which period? I mean, is there a broad time line that you can talk about?

M.B. Chinappa: It goes up to 2026. About Rs.2 per dollar.

Krishna Prasad: Okay. Up to 2026. I mean, most of it happens at what point? Or I mean is there some broad sense of that?

M.B. Chinappa: It varies. It is effective hedge which is linked to certain contracts etc., is really what it is.

Krishna Prasad: Just very quickly what is your capex number for FY2019 or FY2020 if you can just give the specific number that will be useful?

M.B. Chinappa: I will just get back to you, but by and large we will look to complete the \$200 million.

Krishna Prasad: But if you can just give the number that is easier because it is a little bit more confusing to understand?

M.B. Chinappa: I will just get back to you with more exact numbers, because FY2020 there will be additional capex that will come on board. So I will get back to you, for certain, in the next investor call. We will update on what are the 2019 and FY 2020 numbers look like.

Jonathan Hunt: Operator I think we have got time for one more question.

Moderator: It is from the line of Rohan Advant from Multi-Act. Please go ahead.

Rohan Advant: Thanks for the opportunity. Sir, my first question is that in the last quarter, you called out Rs.40 Crores amount that was in the revenue and had a pass-through of RM. So is there any similar amount in this quarter?

M.B. Chinappa: No Rohan. I did not call that out in the opening commentary. The revenues and costs do not have any one-off line items in Q2.

Rohan Advant: Okay. Sir, and on the derivative liability that is on the balance sheet, does that pertain to our foreign borrowings?

M.B. Chinappa: It is like the effective hedge on our net forex flows, foreign cash flows, which is adjusted for revenues and borrowings.

Rohan Advant: Okay. Because you said it is up to 2026. So I mean, that would be for borrowings right?

M.B. Chinappa: No, we have contracts, revenue contract, also that has gone up.

Rohan Advant: Sir, and just lastly, what was our average USD-INR rate at which revenues were booked in this quarter?

M.B. Chinappa: Our average is close to Rs.70 that translated to that 7% currency gain that we have.

Rohan Advant: Thanks for taking my questions. Thank you.

Moderator: Thank you. Ladies and gentlemen that was the last question. I would now like to hand the conference over to Karthik for his closing comments.

Karthik: Thank you everyone for joining today's call. I hope we have answered all your queries. If you have any questions, please feel free to get in touch with me. Have a good evening.

Moderator: Thank you very much Sir. Ladies and gentlemen, on behalf of Syngene International that concludes this conference call. Thank you for joining us. You may now disconnect your lines.