"Syngene International Limited Q1 FY'25 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to Q1 FY25 Earnings Conference Call of Syngene International Limited. 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 star then zero on your touchtone phone.

I now hand the conference over to Ms. Nandini Agarwal from Syngene International. Thank you, and over to you.

Nandini Agarwal: Thank you, and good afternoon to everyone. Thank you for joining us on this call to discuss Syngene's first quarter FY 2025 performance. To discuss the financial and business performance for the period, we have on this call today, Mr. Jonathan Hunt, Syngene's Managing Director and Chief Executive Officer; and Mr. Sibaji Biswas, Executive Director and Chief Financial Officer. After the opening remarks, Jonathan and Sibaji will be happy to answer any questions you might have.

Before we begin, I would like to caution that comments made during this conference call today will contain certain forward-looking statements and must be viewed in relation to the risks pertaining to the business. The safe harbor clause indicated in the investor presentation also applies to this conference call. The replay of this call will be available for the next few days after the call and the transcript will be made available.

With this, I would now turn the call over to Managing Director and CEO, Mr. Jonathan Hunt.

Jonathan Hunt: Thank you. Good afternoon, everybody. Thanks for joining us on the call today. I'll start with commenting, I think, on some of the industry dynamics that we think will shape the coming quarters and then Sibaji will provide a more detailed insight into the financials in his remarks.

When we met in April, we set out our guidance for the full year and that predicted a largely flat first half to the year, with momentum building in the second half and that view remains unchanged. We continue to track indicators of two key trends: the return of new funding into the US biotech sector and the interest amongst large biopharma clients looking for alternatives to China as they rebalance their supply chains to mitigate potential risk.

So let's take a look at each of those. On the biotech front, we saw a positive quarter of new capital flowing into the US biotech sector. It's back and holding at pre-pandemic levels. And I think this predicts for an improving demand environment as that new capital flows through to increase client demand for services and expenditure. And it's this dynamic that underpins our view that the second half of this year and into next year is likely to be a better environment.

On the large biopharma side, we're seeing increased client -- increased visits by clients as they look for alternatives to China and it's noticeable that when we talk to these clients and the change in the wording of the Biosecure Act around the timeline to implementation has lessened the urgency in which we're looking for alternatives, but it hasn't changed the direction of travel. What we're seeing most commonly is that these China switches, as we call them, are setting up pilots across a broad range of services, often placing them with a select short list of suppliers.

We then intend to run these comparative pilots through the year and use this as a way of down-selecting to a longer-term partner and here, I think we've made good progress in the quarter. And I get a sense that it sends you winning our fair share of these pilots. Other leading indicators are also turning more positive. Our request for proposals, we're up almost 50% year-over-year in terms of value in the first quarter.

Now admittedly, even the first quarter of last year was a little bit of a low point. So it's coming off a low base. But it is the best quarter for RFPs that -- best first quarter for our RFPs that we've seen in four years. We're also kicking off multiple pilot projects in Discovery Services and have also got the potential to scale into larger contracts over time. And I believe Syngene's in a good position to capture fair share of the upturn in biotech spending in the quarters ahead.

So turning to the fourth quarter numbers, revenue from operations was down 2% over the corresponding quarter last year to INR790 crores. Operating EBITDA was down 20% to INR170 crores and reported profit after tax was down 19% to INR76 crores. And this is coherent with our guidance and the commentary that we gave you with the full year results. While we've been very focused on clients, we are an innovation-based industry and technology is constantly evolving. So we've got to keep – got to continue to keep a close eye on the leading edge of technology and leading engine capabilities.

And recently, we've launched a protein production platform that leverages advanced cell line and transposon-based technology, combining this with our existing capabilities, we can deliver end-to-end cell line development options faster and I think that's a real benefit to customers. So a good step forward technologically in our Biologics business there.

So let me summarize before handing over to Sibaji. Key leading indicators are more encouraging. With biotech funding showing signs of the revamp our assumption is that this should translate into more outsourced projects from biotech as the year progresses. In the large cap Biopharma segment, there was a noticeable shift that companies seek to diversify their operations away from China to mitigate geopolitical and geographical risks.

For now, this is playing out in increased client visits and audits as well as a rising number of pilot projects, and I think it's a healthy indicator for the second half of the year. With these more positive indicators in place and reflecting in the increased flow of interest that we're seeing, the long-term outlook for Syngene in the broader sector, I think, remains optimistic.

So with that, let me hand over to Sibaji.

Sibaji Biswas: Thank you, Jonathan and a very good afternoon to everyone. As you have seen, revenue from operations came in broadly flat as expected for the first quarter. Jonathan has outlined the dynamics, so I won't repeat them here. We believe that revenue is on a positive trend with momentum expected to build in the second half of the year.

Revenue from operations for the quarter was down 2% versus last year and in constant currency terms down 4%. The dedicated centers delivered sustained performance during the quarter and biologics manufacturing continues its growth momentum driven by both commercial and clinical scale projects.

Discovery Services showed our resilient performance. However, it was impacted by the biotech funding issues mentioned earlier. Small molecule development and manufacturing services remains steady with repeat business from existing customers and new opportunities at early stage from both new and existing customers.

Turning to cost, raw materials accounted for close to 30% of revenue from operations compared with 28% in the first quarter last year. The increase is due to the change in revenue mix with a higher proportion of revenue from development and manufacturing services. This is a business which inherently carries higher material cost as a percentage of revenue.

With a more balanced mix of revenue growth going into the year, we expect the full year raw material cost to be around 28% as highlighted earlier. Other direct costs primarily comprising power and utility expenses declined by 8% year-on-year, attributed to an increase in share of green energy consumption compared to the previous year and deployment of energy efficiency measures in-line with our ESG program.

Employee expenses increased by 10% year-on-year, driven by investments in the organization for building commercial and technical capabilities and salary increments during the year, partially offset by a slightly lower headcount as we rebalanced our hiring plan to meet client needs.

With the aim of improving productivity and delivery effectiveness, we continue to invest in automation and digitization programs across the scientific and enterprise domains. We also invested in many parts of our business to ensure that we have ready capacity for our plants.

Our operating expenses increased by 3% year-on-year, reflecting these initiatives. Overall, operating costs that is all operating costs – operating expenses excluding raw materials, while in-line with the run rate in the fourth quarter and about 7% higher compared to the first quarter last year.

The decrease in revenue, combined with increase in costs I just mentioned, resulted in operating EBITDA margins at 22% in the first quarter versus 26% in the same period last year. We believe these investments are growth drivers that will deliver operating leverage and revenue growth returns as expected in the second half of the year.

EBIT from operations was at INR63 crores, lower year-on-year as depreciation increased to INR107 crores compared to INR102 crores in the same period last year. The 5% increase in depreciation is mainly due to new leases and infrastructure coming online in the last year. We continue to maintain a strong balance sheet which enables us to effectively navigate through industry cycles.

After meeting our capex spending for the quarter we have net cash of USD108 million as of June 2024 which is at a similar level to March 2024. During the last year we reduced debt on our books by USD55 million primarily due to repayment of USD50 million of ECB loans. We also fully financed our acquisition of the biologics manufacturing facility from our internal cash.

All this had reduced the cash balance and hence the interest income that we had in the P&L. The underlying interest expenses also reduced due to lower debt, but the reported interest expense is higher on account of the final component of the new leases undertaken during the year. The effective tax rate for the quarter was lower at 21% versus 24% in the same quarter last year due to the change in business mix and the lower interest income.

We expect the effective tax rate for the full year to be around 22% to 23%. Overall profit after tax before exceptional items was INR55 crores. We received INR32 crores as the final settlement from our past insurance claim which has been accounted as exceptional income net of tax. With that, the reported PAT came in at INR76 crores down 19% year-on-year. As indicated at the start of the year the long-term market indicators are positive and our plan is to continue to make strategic investments in capabilities that make us future ready.

We have incurred capex of around USD12 million during the quarter including upgrading the biologics manufacturing facility acquired in financial year 2024 which is on track to start operations in the second half of financial year 2025. Finally, let me say a few words about the guidance. In the current financial year our expectation of improving business growth from the second half remains unchanged and we are on track to hit the guidance range that we provided last quarter.

We expect the EBITDA margin to be in the high 20s for the full year that is similar to last year and implicit within it -- within this is the EBITDA margin with the fact that EBITDA margin will improve sequentially as the revenue grows through the quarter. PAT growth for the full year is expected to be in single digits as previously guided. With that, I suggest that we open for questions. Thank you.

Moderator: Thank you very much. We will now begin the question-and-answer session. We'll take our first question from the line of Surya Patra from PhillipCapital (India) Private Limited. Please go ahead.

Surya Patra: Thanks for the opportunity. My first question is on the margins. In fact, in the opening remarks you have indicated that there is a limited portion of the manufacturing activity and hence there could be -- and because of that there is a decline in the gross margin this quarter. So is it linked to that Mangalore facility utilization and hence improve activities there and that impacted the margin. If that is the case, could you share what is the kind of utilization that we would be currently having for the Mangalore facility right now?

Jonathan Hunt: Well, it's a super question. I'll let Sibaji talk about the margins. The quick answer is no, it's not related to Mangalore. And no we won't give you facility level break up of utilization. Just as a matter of policy in the way we communicate about 2.5 million square foot of lab space if we start the presser breaking it down by site, by operating unit. I think our analyst calls might go on for days.

But giving you a general sense what's driving it I think there is a switch particularly in biologics. So the -- our overall CDMO strategy remember it's not a small molecule strategy. It's a small molecule, large molecule integrated CDMO strategy. Clearly, the large molecule business is leading the way. We're really quite happy with the progress we're making there. It triggered us last year to acquire the site from Stelis because we were running out of headroom for growth in our biologics.

We've fully sold out our capacity for the coming years and that prompted us to move quickly to switch from an organic build-out that we plan to do in the next couple of years and bring it forward by a couple of years through an acquisition. So CDMO overall is doing pretty well, could always do better, but we're fairly happy with the progress and it's led by the biologics piece. Anything else you'd say Sibaji.

Sibaji Biswas: You're on the dot. But Surya what I said is year-on-year for the same quarter. So as you know that over the last year our share of development and manufacturing business has increased and development and manufacturing business carries a higher raw material cost hence you have seen a bit of a shift in the raw material. So that's the only thing, yes.

Surya Patra: Sure, sir. Okay. My second point is that regards the facility that has been acquired from Stelis. So post commercialization which you said that okay possibly that will take around 12 months' time after the acquisition completion to be commercialized. So once it is commercialized what is the gestation period one should think about for really seeing the number implication to the overall financials of Syngene. Just if I add sir I just wanted to understand what preparatory timeline that would be required once the facility will be capitalized and how long -- what time that would be required to really see the benefit of that facility in our numbers?

Jonathan Hunt: Yes, I get the premise of the question. If you strip all of the detail out of the question, essentially asking what is our sales cycle for new plants once again, the answer is no and I get it. It's just I can't predict. We're out there and then the steps we have to go through between now and the end of the financial year we will have made the operating changes, upgraded the facilities, moved pieces of equipment around, replumbed, HVAC vents whatever we need to do to get it to how we want it to be. We would have been through a qualification validation process. So we would have checked that everything is working well is up to standard.

We'll have done all of the environmental stuff that you've got to do and then it will be ready to show the first client as this is the plan that you could use that will happen between now and the end of the year and then you're into a sales cycle and we're confident that there is demand in the marketplace, that it shows well. It's a facility that when you look at it and go around it looks good, looks well designed has some good equipment in there. So I think it's attractive to the eye when clients come and audit it. And after that it's just selling. I'm not going to try and predict in which month, which quarter, which client do whatever.

Sibaji Biswas: Surya, I'll remind you that -- sorry carry on Surya.

Surya Patra: Yes, please, sir. So I just wanted like -- so the business development activity for the Stelis plant will start post the capitalization of the asset or it is already active on that front?

Jonathan Hunt: No. I mean you can soft sell, you can bring it to the client's attention, but in reality for this type of outsourcing one of the key buying steps for any client is sending in an audit team walking literally around the facility and checking it meets their standards. So you've got that step to go through anyway and in any biologics.

And it's actually just inherent in all manufacturing in the industry. So until we finished validating it you can't really -- there's not a lot of benefit in showing clients and their audit teams because they'd have to come back anyway once post the validation.

Surya Patra: Sure. Just last one from my side. Regards the export trend see whether you have found out any kind of challenge because of the availability of container or anything which would have impacted your exports in this current quarter? Or you have not faced anything of that sort?

Jonathan Hunt: No, nothing. But then to be fair, we're not a business that really exports anything by containership in the main. Our research services business, I'm going to oversimplify it to illustrate the point, exports its work product by e-mail and digitally. We create new knowledge. There's not a lot of physical movement of goods. And if there is -- you're talking about FedEx and DHL-type sized parcels, we send things around in gram scales or micrograms. And even on the manufacturing side, it's still airfreighted around the world.

Surya Patra: Even for the biologic…

Jonathan Hunt: Yes. It's not -- it's funny. It's one of those things about pharma. You have this image that everything looks like the inside of a steel plant or a steel foundry that it's big heavy industry. And actually incredibly sophisticated equipment looks like a room full of photocopiers and then the DHL things around the world. Air freights are most common way of moving goods around the world.

Moderator: Next question is from the line of Shyam Srinivasan from Goldman Sachs. Please go ahead.

Shyam Srinivasan: Just the first one is on the comment around dedicated centers and biologic manufacturing services reporting steady growth. So just wanted to get some context around dedicated centers at this point of time. Around the same time, you reported, I think, quarter 4, Bristol also announced a large cut in terms of reduction. So is there something that we need to be mindful of, when we look at the dedicated center business, especially with Bristol around.

Jonathan Hunt: Yes. I mean I need to be careful in my comments. I don't want to be seen to be misspeaking or giving a view on BMS' business and business strategy. So you do need to triangulate back with their IR team on their policy.

But for us, in many ways, they're an organization that continues to globalize that continues to seek new innovation. And I think they've been quite clear if you look at the statements from their management team and their CFO that they are looking to drive cost savings across their operations.

And we already do that for them. I mean the relative cost of the things that we do with BMS in partnership is more cost efficient for them than doing it in other parts of the world. It's not the only reason they do it. It's also because the team that they've got here in India is spectacularly good scientifically, they really do drive innovation and high science. So we're very proud of our Syngene colleagues working at BMS here in India and the local BMS management team do a really good job driving science forward.

So I get the premise of the question. I don't think we'll ever be complacent about that relationship. It's a particularly important one for us. It's been mutually beneficial for both companies. But the environment where they're looking to create operating leverage and drive cost out of that business. I think we've got things we can do to help them. And -- does that get to the heart of your question.

Shyam Srinivasan: Yes, I did get, but just one -- just one follow-up. I remember at the time of renewing the last one, if I remember some of the wordings was it envisaged 40% more scientists, I think additional 50,000 square feet capacity. So we should assume some of that?

Jonathan Hunt: Yes, we've done all of that. It's all being done. Yes. I think we're already at that. We've gone past that. Yes.

Shyam Srinivasan: Understood. That's helpful. Second question is just on the bio manufacturing piece. I was under the impression that it's Librela largely and how have we got growth if I'm assuming Librela remains at the same 50 million per year annual run rate. So are we doing other things other than ex Librela?

Jonathan Hunt: Yes, we are doing. Yes. We have other clients beyond Zoetis, and we make other things both at clinical and other scales beyond Librela. And actually, one of the bits that we've done, our operational efficiency, tighter operations, better yield production is allowing us to create some hidden capacity and that then has helped us during the quarter. And of course, then we're not that far away from the new plant coming online towards the end of this year where we'll have more capacity to take to the market.

Shyam Srinivasan: Just again, clarification. So when you said very little headroom in our biomanufacturing in the original 8K plant, we still were able to squeeze out things to drive this growth. That's how I should interpret it, right?

Jonathan Hunt: That's a good interpretation. It's one of the truisms of running a plant. The busier you are, the more creative people get in operational delivery it's like anything. If you train regularly, you get good at it. And I think the team has done a really nice job over the last 6 months with jiggling some -- finding some hidden capacity by being more operationally efficient.

Moderator: We have our next question from the line of Udit Bokaria from Catamaran.

Udit Bokaria: I just wanted to understand if you can share what has been the client response to the new platform? And how should we think about how big or how many inquiries can we expect because of this development?

Jonathan Hunt: A bit too early to say. That's why I put it in the press release is to put it in the shop window. It's nice technology. We offer, I think, a very competitive gene to GMP or vials to trials is the sort of phraseology that people use. It's about getting biotech clients from their idea to a product they can take into clinical testing as quickly as possible. And this technological platform just shaves some time out of that and in a competitive world, that's beneficial. But we'll let you know how that progresses in the current -- in the coming quarters.

Udit Bokaria: And some of your partnerships, which you had announced last year, like with Cromos or even with ERS Genomics, how has that helped you either win more share with big pharma or attract more number of biotech companies if you can just highlight that.

Jonathan Hunt: What was the first company that you said?

Udit Bokaria: You had an alliance with Cromos Pharma, right?

Jonathan Hunt: Not that I'm aware of. I don't remember making any announcement on that?

Udit Bokaria: Got it.

Moderator: Mr. Bokaria.

Udit Bokaria: Thank you. That's it from my side.

Jonathan Hunt: Udit, if you misremembered, that's okay, if I misremembered, we'll drop your note after.

Udit Bokaria: No, I think I had seen it in the file, in one of your press releases as well. And I think one another thing. I think in your annual report also, you have mentioned that you are also developing some performance and safety materials for EV. So if you can just highlight like how did this opportunity came up? And how should one think about other new industries which Syngene is targeting?

Jonathan Hunt: Okay, got it. Yes, I don't think it's transformational to the investment story. There's a simple way of putting it. So it's some good science, and we're very happy where we've got capability to help in other industries. The core of the business is human life sciences, innovations in medicines for humans. And I think the other bit that we've seen a lot of growth is exactly the same skills applied in the animal health sector. And then beyond that, we're delighted with the other smaller segments that we serve, but those first to human health and animal health really do drive the majority of the business.

Moderator: We have our next question from the line of Harsh Bhatia from Bandhan AMC.

Harsh Bhatia: Just in terms of the guidance, in terms of the earlier commentary, I think you mentioned EBITDA margins towards high 20s. If I'm not wrong, fourth quarter we had mentioned that the EBITDA margins would largely be steady on an adjusted basis. So is there some level of cut to the EBITDA margin guidance probably more to do with the research aspect going down or am I missing something here.

Sibaji Biswas: So this is Sibaji here. So what we also said is that the full year EBITDA margin is expected to be very similar to the previous year. So there is no cut. That's all what we said in the first quarter as well. And essentially, as the year progresses, quarter-by-quarter, we would expect to see the EBITDA margin improving on an average getting in the high 20s, which are also the EBITDA margin of the last year. So very similar to last year, no change in position over there.

Jonathan Hunt: Yes. Harsh, is that clear? So just so nobody misunderstands, no change in any element of the guidance from what we gave at the beginning of the year. And at the end of the first quarter, we're still saying that's our expected outlook whether it be on revenue, the revenue ranges remains the same and then the margin through to PAT, the guidance remains the same.

Moderator: Thank you. Ladies and gentlemen, we'll take that as last question for today. I now hand the conference over to Ms. Nandini Agarwal from Syngene International for closing comments. Over to you.

Nandini Agarwal: Thank you, everybody, for joining today's call. If you have any other further queries, please reach out to us, and we'll be happy to help you. Have a good day, and thanks once again.

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