



CHEMNOR DRUGS LIMITED

Annual Report 1998-99

Meeting the challenge

fulfilling the promise



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Board of Directors:

- | | | |
|----|-------------------|---|
| 1. | Dr. K. Anji Reddy | Chairman |
| 2. | P. N. Devarajan | |
| 3. | Kamlesh S. Gandhi | |
| 4. | S. Ragothaman | |
| 5. | G. V. Prasad | Managing Director |
| 6. | K. Satish Reddy | |
| 7. | S. K. Rao | Nominee of ICICI |
| 8. | Cameron Reid | |
| 9. | Paul Kleutghen | Nominee of Schein Pharmaceutical, Inc., |

Auditors:

M. R. Devineni & Co.
Chartered Accountants

Bankers:

State Bank of India
State Bank of Mysore
Allahabad Bank
Global Trust Bank Ltd.

Registered Office:

7-1-27, Ameerpet
Hyderabad - 500 016.

Factory Addresses:

Plot No. 9/A & 9/B
Phase III, I.D.A.
Jeedimetla, R. R. District
Hyderabad, Andhra Pradesh

Peddadevulapalli
Tripuraram Mandalam
Nalgonda District
Andhra Pradesh

Pydibheemavaram Village
I.D.A., Ranastal Mandalam
Srikakulam District
Andhra Pradesh

Bachepally Village
Qutbullapur Mandalam
R. R. District
Andhra Pradesh

“ In 1997-98 we promised

- Downturn is temporary and Cheminor will bounce back.
- Cost-cutting and cost control will be a company-wide commitment
- The need to manage the short term focus adequately in addition to the long term goals and gameplan
- Naproxen will be a major contributor to the performance
- Turnover to be around Rs. 2250 million
- Emphasis on producing more – and with less : through higher capacity, higher operational efficiencies
- No increase in debt-equity ratio – beyond 2
- Filing of several ANDAs
- Exports to contribute over 80% of the total sales
- Finally, an improved return on investment to shareholders”

“Timely development of premium quality products, at competitive costs to meet specific customer needs”

“When it comes to outsourcing key intermediates for drug development, cGMP production of mature products, chemistry matters...”

1998-99 was a promising year

Global capacities

Ranitidine and Naproxen – major contributors

Sustainable dollar earnings

Yesterday's hard work is paying off now. Our long gestation projects have started bringing in the promised returns.

Over the last four years, we had invested over Rs. 150 crores in such projects. The intention was to create global capacities, which in turn would help us in :

- *Offering a distinct price advantage to our buyers*
- *Increasing our profits by the successful leveraging of our economies of scale.*

The results are there to see. Our revenue touched Rs. 227 crores, net profit grew to Rs. 20.89 crores – a handsome 324% increase over 1997-98.

From our global capacity plants, we were able to cater to the regulated markets in the USA and First World countries. We focused on products which were having a high demand in these regulated markets. Ranitidine and Naproxen were our frontrunners. While Ranitidine contributed to 26% of our turnover, Naproxen stood at 23%.

Even more encouraging was our growth in exports to First World countries. We achieved Rs. 80.70 crores – an increase of 81.8% over the year 1997-98. Exports to these countries augurs well for the company, as it now rests on sustainable dollar earnings rather than volatile rupee earnings.

- Turnover grew by 38.8% over the previous year.
- Net profit after tax was Rs. 20.89 crores against Rs. 4.81 crores the previous year.
- Cheminor's formulations manufacturing facility was inspected by United States Food and Drug Administration (USFDA) and tentative approval from the said authority received for Ranitidine 75mg.
- Formulations Plant ready for commercial production with effect from March 01, 1999. However, Cheminor awaits the expiry of the patent extension of six months given to the original holder to begin sales of Ranitidine 75mg.
- Cheminor along with its US marketing partners filed six Abbreviated New Drug Applications.



Post Balance Sheet Developments

- Results of Q1 of 1999-2000:
 - A 31% increase in turnover. Sales touched Rs.5502.5 lakhs (Rs.4194.5 lakhs in Q1 1998-1999).
 - PAT increased by 423% to Rs.660 lakhs (Rs.126 lakhs in Q1 1998-1999).
 - An 87% increase in sales to the US market, Rs.2229 lakhs (Rs.1192 lakhs in Q1 1998-1999).
 - Aggregate exports increased by 40% to Rs.4075 lakhs (Rs.2914 lakhs in Q1 1998-1999).
 - Share of exports stood at 74% of the total turnover.
 - Domestic sales stood at Rs. 1428 lakhs (Rs.1280 lakhs in Q1 1998-1999).
 - Sales of anti-inflammatory drugs Ibuprofen and Naproxen increased by 90% and 44% respectively, when compared to the corresponding period in the previous year.
 - Capacity utilization of Ibuprofen increased by 118% in the current year as compared to the first quarter of the previous year.
 - Naproxen, Ranitidine and Ibuprofen contributed to 70% of the turnover during the quarter.
- Four new products launched. Quinapril and Carvedilol are indicated in the treatment of hypertension and congestive heart failure, while Nizatidine belongs to the anti-ulcerant category and Olanzapine is a new antidepressant. Nizatidine and Quinapril are intended for the US market.
- On the formulations front, Cheminor expects to commence sales of Ranitidine 75mg in the US market in December 1999.
- Cheminor continues to enhance the value of its generic pipeline for the finished dosage market through the filing of three ANDAs during the next quarter. Till date, Cheminor has filed four Abbreviated New Drug Applications (ANDAs) in US.
- Till date registrations filed for three products in South Africa, Europe and Australia .
- Five filings are expected in Europe, Australia and Canada in Q2 1999-2000 .
- Cheminor went live with the Enterprise Resource Planning package – SAP, moving over from Oracle Financials.
- Cheminor's manufacturing facility at Jeedimetla was successfully inspected by USFDA authorities for Doxazosin Mesylate and Ibuprofen.
- Astra Zeneca filed a complaint in the Federal District of New Jersey against Cheminor in connection with submitting an Abbreviated New Drug Application for Omeprazole capsules.
- Shop floor initiatives comprising of the Japanese techniques of 5-S, POKA-YOKE introduced at Jeedimetla Plant.



Cheminor

The people company

As Cheminor faces the new millennium, I see significant challenges ahead for this company. The successful launch of our generic formulations in the US will mark, not the end, but the beginning of a new growth phase for our company. Growth, while desirable, brings with it a new set of challenges. For example, our growth in the marketplace has to be matched by organizational growth in order for us to negotiate the complexities of the

global business environment. This means, we will have to compete with other global corporations for the scarcest resources on the planet in the coming century – people!

The importance of good people for the success of an organization like Cheminor cannot be overemphasized. As we compete in the most technologically advanced markets of the world, we must have the people



resources to solve the technical and commercial hurdles placed by the competition and the marketplace. This can involve everything from developing a new and patentable synthetic process for a molecule to facing up to numerous legal challenges. The kind of people Cheminor must have will represent the full gamut of pharmaceutical knowledge domains—chemists, formulation specialists, lawyers, patent specialists, drug development scientists, analytical scientists, chemical engineers, environment scientists, regulatory specialists and others.

These specialists must be supported by a full suite of functional experts from finance, marketing, business development, human resources, information technology etc. But that is not all. Each functional domain must have a basic understanding of what is going on in the other domains. The marketing person must know chemistry, the chemist must know about patent drafting, the IT person must know something about regulatory affairs and so on and so forth.

While we already employ some of the most talented people in the industry, we need to be seen outside as a great place to work so that we can continuously attract fresh talent and retain the people we have already invested in. The starting point for this would be to create a sense of purpose

in the workplace supported by a framework of values. But we have to look beyond this to see how the people of Cheminor can grow, learn and feel in control in the workplace. The investments made by Cheminor in IT and workplace learning should be seen as a step in this direction. We also need to progress beyond system and process driven mechanical orientation to a people and imagination driven view that looks at the workplace from the perspective of the individual. What

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do they need to grow? What do they need to feel satisfied and involved? What do they need so that they

can feel passionate about their work?

Designing the workplace around people will imply that we have to take into account, wherever possible, the specific needs and aspirations of individuals. We cannot stereotype job requirements, merely keeping the organization side of the equation in mind. While, admittedly, we are quite a distance from accomplishing much of this, I see no alternative, if we are to grow and become strong. The importance we must give to these issues is central to our growth and continued success. People have choices, organizations don't.

Dr. K. Anji Reddy, Chairman



G.V. Prasad, Managing Director

The upside potential for the patent challenge products is very significant

All our efforts are focused at creating conditions where the customer will buy from us on a long term continued basis to ensure sustainability of the business

We have built a generic pipeline consisting of ANDAs already filed and in terms of ongoing development work of several blockbuster drugs with a potential sale of 15 billion US Dollars at innovator prices



You delivered what you promised in 98-99. How do you foresee growth from now on?

The growth of our bulk business continues to be robust. I see the quality of our bulk business changing positively. Our efforts to focus on the most profitable and quality conscious customers have started paying off. Going forward, we see strong near term growth from the bulk business. In the generics business, we have built a significant pipeline of patent challenge products, which should provide a major increase in revenues from 2001-2002 onwards. The upside potential for the patent challenge products is very significant, while the worst case scenario continues to be very favorable also.

What were the key factors that helped you significantly improve profitability?

The opening up of the US market for our core products Naproxen, Ranitidine and certain niche products such as Doxazosin helped increase the operating margins. The price realizations for these products have significantly improved as a result of our single-minded pursuit of the most profitable customers both in the generic and innovator segment.

Naproxen, Ibuprofen and Ranitidine are virtually commodities? How sustainable are your profits and what kind of lifecycle do you expect these products to have?

Again, our strategy of trying to maximize our share of the most profitable customers in the generics and innovator segment enables us to obtain stable long-term business with a higher net realization. We have created capabilities in servicing the unique needs of these customers in terms

of quality, sustainability, service levels and technology within Cheminor. We believe these set of capabilities cannot be replicated easily across the value chain by most of our competitors. While focusing on the high end of the customer profile, we have also aggressively focused on cost improvement. We have set up teams to improve the processes of all our core products on a continuous basis. We aim to achieve the lowest cost position on all our products, while creating systems and capabilities to service the most profitable customers. All our efforts are focused at creating conditions where the customer will buy from us on a long term continued basis to ensure

sustainability in the API business?

While it is true that prices do tend to drift lower even in the regulated markets in the initial few years of launch, the prices are still significantly higher than in the other markets. We intend to continuously refresh our product portfolio to manage the growth and profitability of the business. We now have very strong technical teams with unique capabilities in bringing value to our customers and over the years we have established relationships with our customers, which gives us their continued support. We also plan to enter the innovator segment of the business through our newest business unit, Custom Chemical Services.



sustainability of the business.

While the products mentioned are all in their mature phase, we believe that we have the cost as well as the market position to continue making profits on these products for the next 4 to 5 years. For instance if we have to evaluate today's situation, Ibuprofen Naproxen and Ranitidine comprise about 64% of our sales. This is a reasonably long-term horizon in this business. The product pipelines that we have already built and are building should continue to generate growth and profits in a sustainable way.

The price trends even in the regulated markets seem to be following the typical downslide. How do you foresee

This business aims at working with innovator companies to develop processes and supply advanced and key intermediates as part of developing new chemical entities. This business has the potential to diversify our business risk and also improve the quality of earnings.

You have mentioned that the formulations business is expected to take off during this current year? How do you foresee growth in revenues?

The generics business will start in December, '99 through the launch of our Ranitidine (75 mg) tablets in the US. We already have the approvals in place and are awaiting patent expiration, sales of some of