

ANNUAL
REPORT

2019
-20



NEULAND

WHERE OPPORTUNITY BECOMES REALITY

CONTENTS

Management Reports

Corporate Information	1
Message from Chairman	2
In conversation with Vice-Chairman & CEO	3
Message from JMD	6
Board of Directors	8
Financial Performance: 10 years track record	11
Management Discussion and Analysis	12

Statutory Reports

Directors' Report	41
Report on Corporate Governance	67

Financial Statements

Standalone Financial Statements	90
Consolidated Financial Statements	139

Corporate Information

Board of Directors

Dr. Davuluri Rama Mohan Rao
Chairman & Managing Director

Mr. Davuluri Sucheth Rao
Vice Chairman & Chief Executive Officer

Mr. Davuluri Saharsh Rao
Joint Managing Director

Mr. Humayun Dhanrajgir
Non-Executive Independent Director

Mr. Parampally Vasudeva Maiya
Non-Executive Independent Director

Dr. William Gordon Mitchell
Non-Executive Independent Director

Dr. Christopher M. Cimarusti
Non-Executive Director

Mrs. Bharati Rao
Non-Executive Independent Director

Dr. Nirmala Murthy
Non-Executive Independent Director

Mr. Homi Rustam Khusrokhani
Non-Executive Independent Director

Mr. Amit Agarwal¹
Chief Financial Officer

Ms. Sarada Bhamidipati
Company Secretary & Compliance Officer

¹Upto March 6, 2020

Audit Committee

Mr. Homi Rustam Khusrokhani, Chairman

Mr. Humayun Dhanrajgir, Member

Mr. Davuluri Sucheth Rao, Member

Mrs. Bharati Rao, Member

Dr. Nirmala Murthy, Member

CSR Committee

Mr. Humayun Dhanrajgir, Chairman

Dr. Davuluri Rama Mohan Rao, Member

Mr. Davuluri Sucheth Rao, Member

Mr. Davuluri Saharsh Rao, Member

Dr. Nirmala Murthy, Member

Nomination and Remuneration Committee

Mr. Parampally Vasudeva Maiya, Chairman

Mr. Humayun Dhanrajgir, Member

Mrs. Bharati Rao, Member

Statutory Auditors

M/s. MSKA & Associates
1101 /B, Manjeera Trinity Corporate,
JNTU, Hitech city Road, Kukatpally,
Hyderabad- 500072

Bankers

State Bank of India, Overseas Branch,
Jubilee Hills, Hyderabad

Bank of India, Large Corporate Branch,
Hyderabad

HDFC Bank Limited
Banjara Hills, Hyderabad

Kotak Mahindra Bank, Somajiguda Branch,
Hyderabad

IndusInd Bank, Begumpet Branch,
Hyderabad

RBL Bank Ltd, Madhapur Branch,
Hyderabad

Stakeholders Relationship Committee

Mr. Parampally Vasudeva Maiya, Chairman

Dr. Davuluri Rama Mohan Rao, Member

Mr. Davuluri Sucheth Rao, Member

Registered Office

NEULAND LABORATORIES LIMITED
CIN: L85195TG1984PLC004393
Sanali Info Park, 'A' Block, Ground Floor,
8-2-120/113, Road No. 2, Banjara Hills,
Hyderabad – 500 034

Listing

BSE Limited (BSE)
National Stock Exchange of India Limited
(NSE)

Internal Auditors

M/s. Ernst & Young LLP
THE SKYVIEW 10,
18th Floor, "Zone A"
Survey No. 83/1, Raidurgam,
Hyderabad- 500032, India

Secretarial Auditors

M/s P. S. Rao & Associates
Flat No-10, 4th Floor, D.No. 6-3-347/22/2
Ishwarya Nilayam, Opp Sai Baba Temple
Dwarakapuri Colony, Panjagutta,
Hyderabad-500082

Registrar and Share Transfer Agents

KFin Technologies Private Limited
(Formerly known as 'Karvy Fintech
Private Limited')
Selenium Tower B, Plot No 31 & 32,
Financial District, Nanakramguda
Serlingampally Mandal
Hyderabad-500032

Message from the Chairman



Dear Friends,

I am glad to share my thoughts regarding this fiscal period which saw your company complete 35 years of commitment to quality manufacturing of APIs. As we discussed in last year's report, external challenges continue to affect the industry and during the last quarter we have seen the unprecedented changes caused as a result of the COVID 19 pandemic. Even so, I can state with confidence that the management team have been better prepared to face the challenges posed to us, than at any time in the past.

My confidence is rooted on the basis of the actions that we have taken to strengthen critical processes. We have taken on board our learning over the last few years and ensured that they were incorporated into our performance for the fiscal year FY20. This has been reflected in our performance which been among the best in our history.

The performance has been primarily driven by the growth in our CMS business whose impact is seen both in the number of projects and more importantly in the revenue. This has been possible as a result of the efforts that management team has put in over the years, and the ability of our R&D team to be able to meet customers' requirements. Even the GDS business has seen good growth of strategic products, which will be essential to the medium and long-term future of the organization.

During the year, we were able to successfully complete two US FDA audits at our facilities, again a testament to our commitment to quality. The team has actively worked towards de-risking our Supply Chain, and we have reduced our dependence on a single geography as well as single sources for key Raw Materials. There is a robust cross-functional effort to optimize costs and focus on technology to improve

margins so that we are not only competitive but are in a leadership position for our products.

The R&D team has been a crucial partner in the growth of the CMS business managing the spike in number of projects while also making significant contribution in terms of Process Improvement & Development (PID) work for the GDS business. A pilot plant has been commissioned at Unit III, which enables our team to further accelerate the process of development of new products. The management team has in a short span of time added to our capabilities by qualifying a CMO facility which will allow us to supply sterile APIs.

Our team is actively working to further our penetration among CMS customers especially in the North American and Japanese markets. We are diversifying our base of customers, even as our reputation as a Quality-focussed Customer-centric API service provider keeps burgeoning. Growth is additionally being driven as a result of our capability to expand at Unit III. Unit III will be a key contributor as we anticipate regulatory approvals which will enable us to manufacture APIs for the Regulated markets.

On the people front, we are actively building a learning organization which is responsive to customers' dynamically changing priorities. The management team at Neuland is continuously evaluating our processes and capabilities internally while being vigilant about changes

in the external environment so that we are an agile and sustainable organization which can capitalize on the opportunities which present themselves while building strategic capabilities for the long-term.

In the light of all that we have done, the capability of our team and the trust posed in us by our customers, I believe Neuland is on a strong platform to become a leading API player not just by reputation but also financial performance.

At this time, I would like to especially mention the efforts of all our employees in helping us deal with the situation arising out of the COVID19 pandemic. I have seen exceptional commitment through the organization to ensure that we rise and meet the needs of society and our customers at this time, through the essential APIs that we produce. The leadership team along with great support from the governing authorities has ensured that we were able to keep going at this critical time. Even as the Company is continuing to serve customers at this time, I want to reiterate we are taking every step to ensure our top priority is the health and safety of our employees.

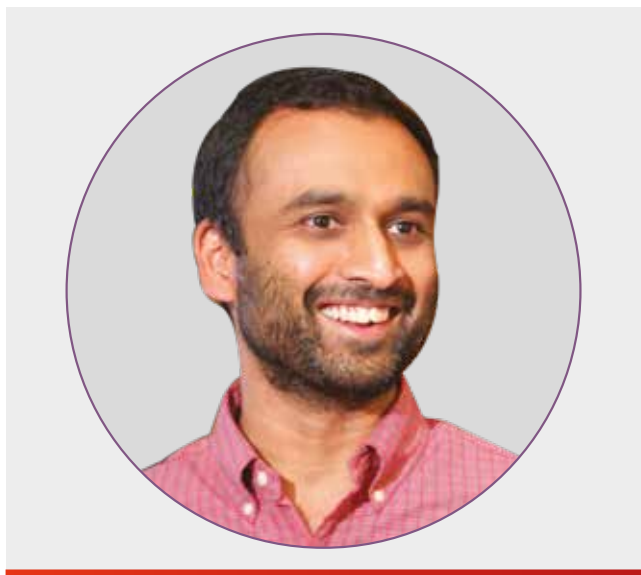
Finally, on behalf of the board of Directors I would like to thank you for your continued trust, confidence and support.

With Best Regards,

Dr. Davuluri Rama Mohan Rao

Chairman & Managing Director

In conversation with Sucheth Davuluri, Vice-Chairman and CEO



Please share your thoughts on the Company performance during the Financial year 2019-20?

It's been a good year for Neuland Labs with the revenue growing 14.4%, led mainly by our CMS business. An improved income mix from the CMS business & certain Specialty products and cost-optimisation measures helped improve profitability. The Company's EBITDA increased 72% over the previous year, while the operating margin was up by 450 bps.

On the balance sheet front, Neuland continued optimizing working capital and managed debt at moderate levels even as we invested in capacity for growth. The return on capital employed – an important measure of business health – reached 7.60% (10.65% excluding good-will) during the year as against 3.89%

(5.61% excluding good-will) in 2018-19. In terms of key liquidity ratios, our Net Debt to EBITDA improved from 3.16 in FY19 to 2.03 in FY20 even as our Current Ratio moved to 1.42 from 1.37.

Over the last 2 years we have brought in consistency in terms of top-line growth and capped it with a stronger push in the last fiscal. This year's performance sets a strong platform for us to grow the business to the next level.

The CMS business reported a decline in 2018-19. What helped it transform into a critical growth driver this year?

Our CMS business started with one RFP several years ago to now executing over 70 projects a year across the life cycle of a molecule from Pre-clinical, Phase-I through to commercial. We are working on several specialty molecules as well as products

in key therapy areas like cardiovascular diseases and metabolic disorders.

This business has been slowly built on trust of the customers, built one project at a time, meeting and exceeding customers' expectations. Until a couple of years ago, the CMS business was still nascent, though the opportunity was high for Neuland. Today we have 76 live projects in our CMS portfolio, with some customers entrusting us with multiple projects. Apart from 15 projects that have already gone commercial, the heartening point to note is that we have around 10 projects in Phase-3 and a further 17 which are in the development phase awaiting commercialization. This brings in a greater degree of certainty in successful launches thereby reducing attrition risk and increasing the revenue potential as the need for API increases as the product goes through the clinical cycle.

This clearly establishes the current strength of our CMS business. In FY20, we saw a surge in both project inflow as well as deliveries. We had significant traction from North America and Japan. We have worked on around 70 projects during the year as against 35 a year ago. Additionally, there has been increased focus on Project Management to reduce lead-times and improve deliveries ensuring we meet customers' expectations both with respect to quality as well as timelines.

The increasing contribution of the CMS business in FY 20 was aided by two factors; increase in number of projects as also commercial products gaining in volumes. While the contribution this year from CMS was 25% of the revenue, we expect the segment to become a third of the business in the foreseeable future. We remain cautiously optimistic about our prospects and our pipeline while we gauge the impact that COVID19 could have on the market especially in terms of funding for new projects.

What factors contributed to the increase in profitability?

Value-addition and cost optimisation contributed in equal measure into firming up business profitability. In 2019-20, our high-margin verticals like the specialty API segment and the CMS business together contributed about 47% to the overall revenue compared to 38% the year before.

We also intensified our focus on cost management. We continued to implement product lifecycle management initiatives at our operating facilities and our R&D unit. We ensured that all our resources are utilised more efficiently – solvent recovery and utilisation, for example. Every department at Neuland invested considerable effort in reducing inefficiencies.

And, all these factors enabled our EBITDA margins to reach 13.7% in 2019-20 from 9.2% in 2018-19.

What are the areas where you feel you could have done better?

There is always room for improvement. However, I would like to draw your attention to three specific areas:

- Scaling products from the R&D to the operating units didn't go as per plan in the GDS space.
- CMS business in the European region didn't go as per plan
- A couple of Prime products didn't perform in line with our expectations

What investments have you made this year?

- Unit III is being operationalized which will add to the capacity and revenues from FY21.
- We commissioned a pilot plant at Unit III for use by the R&D team. It will primarily be used to manufacture engineering/development batches.
- We have created a robust leadership structure across the organization. Neuland is a strong advocate of distributed leadership and unlocking the potential of our team across all levels in the organisation.
- Going Digital. We added an SAP-based online vendor portal for superior material management. An IT solution has been rolled out to automate our quality management systems and processes completely. We have operationalised multiple solutions to streamline our

day-to-day operations.

- Investments in R&D towards expanding our capabilities to meet our customers' requirements.

In a nutshell, these investments have made the organisation more disciplined and agile. This agility will allow us to respond efficiently to the dynamic environment that we operate in.

What are the other major developments that reflect Neuland's preparedness for future?

We have further deepened the culture of compliance at Neuland and strengthened our quality management system in terms of processes as well as developments. As a testament to our capabilities on this front, we secured two US FDA clearances this year without any major observations. This reinforces our commitment to quality, commitment to our customers and to global regulatory agencies in our operations and quality systems.

Our credit rating is A- which reflects the financial stability of the Company. It is a watermark on the success of our business transformation from the standard to a higher level which has accelerated business growth, improved profitability and helped us improve our leverage and optimise interest liability.

Our investment in capacity for certain key products across Units as well as the R&D Pilot plant at Unit III will hold us in good stead for the future.

Over the last year, we have made significant progress in terms of our people processes. We have a robust pipeline of professionals who drive the Company towards the set goals. Over the years, we have worked hard at establishing a culture of Distributed Leadership to drive agility in responsiveness to various situations.

An important aspect on which the top team at Neuland has been working on is strengthening the Enterprise Risk Management (ERM) process. We have seen considerable progress made with respect to certain risks.

- If we consider the Supply chain risk, we have considerably reduced our dependence on Raw Materials on a single geography (from over 50% to less than 30%), and we are actively working towards shortening the supply chain.
- With respect to the risk from Competition, this is being actively monitored at a product level and actions are being continuously taken to ensure that Neuland is among the market leaders for its key strategic products.

- In terms of ensuring that we continue to scale products and projects as per plan, we have increased focus on Project Management as well as strengthened the 'First Time Right' concept.
- As I have mentioned earlier, we have further strengthened our compliance culture to reduce the risks associated with any Regulatory actions. Our Quality Management Review process is robust with close monitoring of key parameters.
- Even with respect to Data Security we have made significant progress with a Data Leak Prevention System deployed and a Security Incident and planned deployment of an Event Monitoring Solution, which provides the health, performance, threat perception of all IT infrastructure on a single dashboard with possible solutions.

What will be your key priorities and growth levers for 2020-21?

The COVID19 pandemic has been an unprecedented crisis causing uncertainty across the world economy and threatening human lives. The speed of proliferation of this virus has been alarming and thus far the timeline of controlling and containing it is unclear. In these challenging circumstances, our priority is ensuring our team is safeguarded. Having said that, this pandemic is bringing about a new normal and we are working on multiple fronts to ensure that Neuland is better positioned in the post-COVID19 world.

Our other priorities would be to commercialize our Unit III which will enhance our capability and flexibility in managing larger volumes – both product and projects – and to intensify our focus on other levers that helped us post a good performance in 2019-20 like project deliveries, cost optimisation, resource utilisation, and fund management.

Our outlook for the CMS business remains positive, especially because the two markets that we are focusing on – Japan and North America – and our opportunity pipeline there looks interesting. The level of confidence our customers pose in us is very encouraging. That notwithstanding, we are closely monitoring the biotech funding space for any possible troughs due to the impact of COVID19.

In the GDS vertical, we expect the speciality segment to make a healthy contribution to profitable business growth. We have developed a strong pipeline of molecules to be launched over the next decade. We expect to see

Our credit rating is A- which reflects the financial stability of the Company.

good traction in some of the products like Paliperidone Palmitate during this year.

What is the one message you would wish to leave for your stakeholders?

We would like to continue on our path of growth and profitability with focus on the CMS segment which will spearhead this momentum. Operational excellence and quality continue to be the cornerstone of our business and we believe this will bring rewards in the long run. We are focussed on building an agile organization with people who will help us achieve our vision of being the leading, reliable, long-term API partner of choice to the Pharmaceutical Industry.

Message from Saharsh Davuluri, Joint Managing Director



The CMS business has made considerable progress and holds the promise to accelerate profitable business growth going forward.

Dear Friends,

I am delighted to write to you at the end of what has been a stimulating and satisfying year. FY2019-20 was a significant year for our organisation as we remained steadfast on our strategy, executed it well and strengthened the organisation. Our performance vindicates the robustness of our business model and our strong resolve to progress despite considerable headwinds.

From a business standpoint, even as the GDS business sustained momentum, the CMS business, after a muted performance in 2018-19, emerged as the key growth driver in terms of both topline and profitability.

GDS Business

The GDS business was largely in line with our plans for the year. The specialty business, which is an important segment of

our GDS vertical, threw up better margins riding on improved products, segment mix and cost structure. The key business drivers were products like Deferasirox, Dorzolamide, Ezetimibe and Donepezil. We filed US DMFs for Sugammadex and Indacaterol, which are exciting specialty products for us. Going forward, I believe that our specialty business will sustain the growth momentum for the Company as we continue to seek interesting growth opportunities in the existing and new geographies.

In the prime segment, key molecules such as Levetiracetam and Labetalol generated substantial volumes. The only visible challenge here is that of the fluoroquinolones, which are degrowing at 6-7% year-on-year globally. This would mean that over the long-term, these products would reduce in contribution. We have factored in this decline in our strategy and are working passionately to enrich our product basket to fill this vacuum. Besides, our unwavering focus on sustaining our cost management endeavour should help in increasing volumes and improving margins as we move forward.

We believe that we are well positioned as a standalone pure API player with strong focus in well-established molecules. It will continue to give us stable growth. We also enjoy a good presence among global formulators for our specialty APIs which, over the medium term, should emerge as an important value-driver for the Company.

Going forward, the core strategy for our GDS business

is attaining growth by fraying into new markets and building new customer base with our extensive portfolio of products even as we continue to handle lifecycle management of all our products actively.

From an action perspective, we are taking specific product-related actions to fuel growth and strengthen profitability.

CMS Business

The CMS business registered growth of around 100% over the previous year. This jump is primarily because our project pipeline became very robust; our CMS projects have jumped from 56 as on March 31, 2019 to 76 as on March 31, 2020.

What is even more satisfying is that the quality of projects has improved. By quality, I mean an increasing number of late-stage projects are entering our pipeline with second source opportunity which is very encouraging. We expect that we should be able to commercialise a few of them in the next 2 to 3 years.

Late-stage opportunities are molecules which are closer to being approved by the regulatory agencies. Hence, these opportunities are highly return-accretive because the molecules have little attrition (from phase III to commercialisation the rate of failure is low), the chances of commercialisation are high, and the cycle time for commercialisation is significantly short when compared to molecules in Phases I and II.

In 2019-20, we added advanced projects for APIs which are likely to get commercial in the next 12 months. This provides considerable growth opportunity. In addition, I believe the increased inflow of late-stage projects adds credibility to our capabilities – Neuland is being increasingly recognised as one of those organisations that is proficient in partnering global players, commercialise new molecules, and manage their lifecycles. This vindicates our painstaking efforts over more than one decade in reaching this position.

Looking ahead, I remain optimistic about the growth of our CMS business which largely depends on 2-3 factors.

One being the new projects that will continue to populate our pipeline on a quarterly or yearly basis. This is slightly circumspect in light of the recent pandemic which, according to economic experts, has played a major role in pushing the global economy to the brink of a recession. This could impact funding for projects in the short-term and could impact the rate at which we add new products. Having said that, I am confident that we will continue to add exciting projects as demonstrated over the last few quarters.

A second factor is the performance of our existing commercial products and their growth & success. Will they become large drugs which will have steady growth or will the demand come in spurts? In this regard, I believe that Neuland is on a solid platform. We have about 15 commercial molecules – 9 intermediates and 6 APIs – of which have 3 APIs which are the base and these products are doing well commercially.

This is important because it reduces the volatility (characteristic of CMS business), but also ensures that we sustain current levels and grow from here.

Thirdly, our ability to add to the commercial pipeline through products which are later in the clinical lifecycle. This is critically important for growth, because as I stated earlier, these are relatively low-risk projects with a probability of high returns. Moreover, since they are close to commercialisation, funding of these projects continues.

We have seen the strengthening of this third factor during FY20. We added 4-5 advanced projects during the year which are expected to get commercialised by our clients in the next 12-36 months. This includes 3 APIs which are in the late stage of development and are likely to get commercialised in the next 12-18 months which could fuel our growth going into the next fiscal.

Outlook

The important takeaway for me from this financial year is that as an organisation we are evolving. The CMS business is showing considerable promise as there is immense growth potential in this business. The specialty business on the GDS vertical is also showing a lot of promise. Further, we continue to put in a lot of efforts to strengthen the margin profile of prime products. So, all these together give us reasonable confidence that the outlook will be positive. Having said that, I would like to qualify my statement by saying that the nature of our business is such that there could be unforeseen risks at

the domestic and global level which could dampen our performance going forward.

Even as I conclude, I am confident that our team will continue to deliver as they have over the last few quarters, and we will be seeing exciting developments both from a commercial and technological perspective.

Warm regards,

Davuluri Saharsh Rao

Board Of Directors



DR. DAVULURI RAMA MOHAN RAO

Dr. Davuluri Rama Mohan Rao (DIN: 00107737), holds a Masters' degree in Science from Andhra University, Postgraduate Diploma in Synthetic Drugs and Fine Chemicals Technology from IIT, Kharagpur. He has done his doctorate in Organic Chemistry from the University of Notre Dame, USA in 1969. He held Research positions at University of Vermont - Burlington, Downstate Medical Centre - New York and Indian Institute of Science - Bangalore. He has 9 publications in International Journals. He is a member of Royal Society of Chemistry. After several years of academic research, he joined Glaxo India in 1973 and held senior positions in R&D, Quality and Manufacturing. He left Glaxo in 1983 and joined an Indian Pharma company for a brief period where he was responsible for a successful USFDA inspection. He promoted Neuland in 1984.



MR. DAVULURI SUCHETH RAO

Mr. Davuluri Sucheth Rao (DIN: 00108880), Vice-Chairman and Chief Executive Officer, has a degree in Mechanical Engineering and holds an Masters in Corporate Finance and Operations Management from University of Notre Dame, U.S.A. He was Production Group Leader in Cummins Inc., U.S.A. and later went on to become a green belt in Six Sigma. He has been actively involved in managing Neuland since 2002, initially as Chief Operating Officer (COO) and then as CEO. He is equipped with broad-based management skills in new business development, sales & marketing and operations management. He has direct P&L responsibility at the board level enhanced by the necessity to comply with high standards of corporate governance for a listed company, Quality related regulations and EHS (Environment, Health & Safety) laws. At Neuland, Sucheth has been responsible for establishing subsidiaries in the US & Japan, increasing Sales from organized markets, strengthening Quality Management Systems, driving Neuland's strategy towards specialty APIs & the CMS Business. He is currently the Executive Trustee of Neuland Foundation.



MR. DAVULURI SAHARSH RAO

Mr. Davuluri Saharsh Rao (DIN: 02753145), Joint Managing Director, is an Electrical Engineering Graduate and obtained his Masters in Management Information Systems from Weatherhead School of Management, Cleveland, Ohio, U.S.A. He also pursued Master of Business Administration from University of North Carolina, U.S.A. He has worked in the past with Sify Limited in various roles in the Sales organization. Saharsh spent some time with a venture fund focused on Lifesciences in the Research Triangle. He joined Neuland in 2007, with responsibility for initiating the Custom Manufacturing Solutions (CMS) business. He is currently responsible for all Marketing, Business Development activities along with oversight of R&D.