MANAGEMENT DISCUSSION & ANALYSIS

Economic Overview and Outlook

The global economy continued to grow, with estimated output growth of 3.7% in 2017 as against 3.2% in 2016. Tax reforms in the U.S. should push the economy to grow 2.7% in 2018 vis-à-vis 2.3% in 2017. Emerging economies are projected to rise to 4.9% in 2018 from 4.7% in 2017. (Source: World Economic Outlook Update, January 2018)

The Indian economy witnessed implementation of a series of transformational reforms in FY 2018. It is projected to grow at 6.75% in FY 2018 and edge up to 7-7.5% in FY 2019, thereby regaining the world's fastest growing major economy tag.

Pharmaceutical Sector Overview

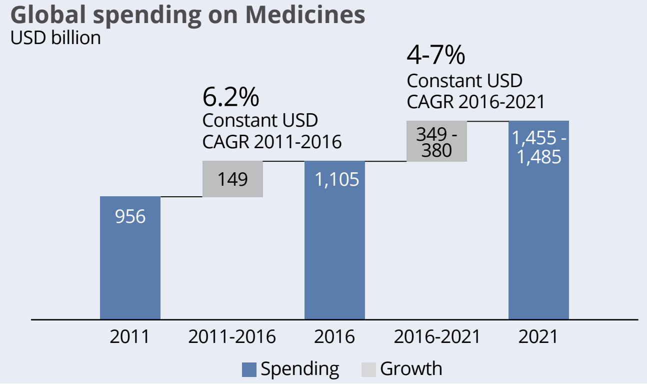
Global

The pharmaceutical industry plays a unique role in improving the lives of patients. It is also one of the world's fastest growing industries and among the biggest contributors to the world economy.

Global spending

According to the Quintiles IMS Institute, the pharmaceutical market will reach nearly USD 1,485 billion by 2021, an increase of USD 350-380 billion from the USD 1,105 billion recorded in 2016. This growth is expected to be driven by market expansion in pharmerging countries and a higher proportion of aged population in developed countries.

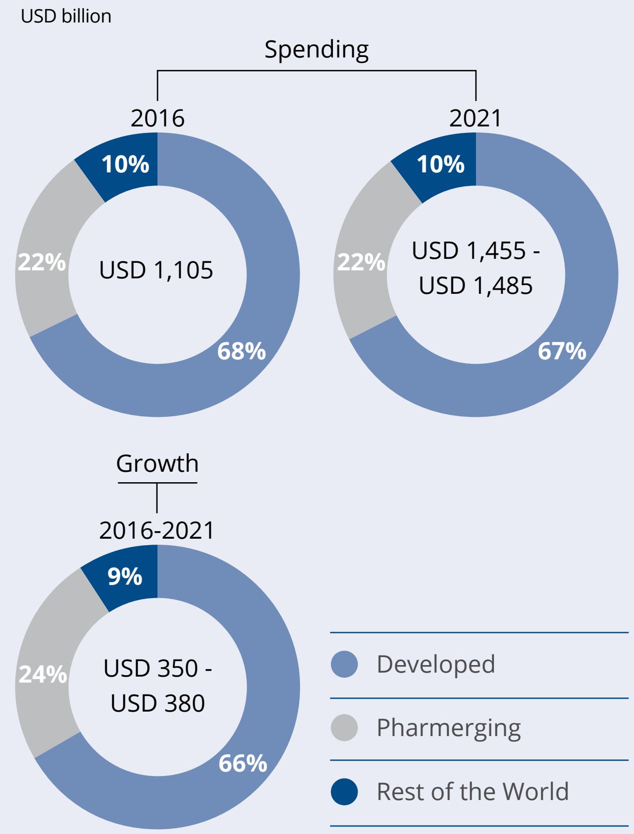
Global spending on Medicines



Spending by geography

USA is expected to continue to be the world's largest pharmaceutical market and its share in global spending is projected to increase from USD 461.7 billion in 2016 to USD 645-675 billion in 2021. The European share of spending will grow from USD 151.8 billion to USD 170-200 billion. Meanwhile, pharmerging countries spend will increase from USD 242.9 billion to USD 315-345 billion in 2021.

Geography-wise Spending



India

The Indian pharmaceutical industry is the 14th largest market in the world by value; in terms of volume it is the 3rd largest. India manufactures 20% of all generics made globally and exports to 200 countries, with USA as the principal market.

While during the year under review, domestic growth slowed down in the wake of implementation of Goods and Services Tax (GST), the outlook remains positive. Increase in the size of middle-class households coupled with the improvement in medical infrastructure and jump in the penetration of health insurance in the country are expected to boost domestic demand for pharmaceutical products. By 2020, India is anticipated to become the top three pharmaceutical markets by incremental growth and 6th largest market globally in absolute size. India's focus on providing complex and speciality products, customer-centricity, regulatory compliance, quality improvement and operational efficiency are expected to enhance exports. Exports from India stood at USD 16.84 billion in FY 2016-17; it is expected to reach USD 20 billion by 2020.

The Indian pharmaceutical industry is well-positioned to reinforce its position as a global pharmaceutical provider. As per industry estimates, India's pharmaceutical industry is expected to expand at a CAGR of 12.89% over 2015–20 to reach USD 55 billion and by 2025 to grow to USD 100 billion.

Emerging Markets

With rising income levels, growing health awareness and better access to healthcare, emerging markets offer significant growth potential for the pharmaceutical industry. In recent times, there is an increase in occurrence of non-communicable diseases such as cardiovascular illnesses, diabetes, and oncologic disorders. It is estimated that incidence of diabetes and oncologic diseases will grow by around 20% by 2030.

The African pharmaceutical industry is the fastest growing in the world. The market size is estimated to be worth USD 40-60 billion a year by 2020. The size of the Francophone (French-speaking) African pharmaceutical market was estimated at more than USD 2.5 billion and is anticipated to grow at close to 10% a year until 2022.

Africa is a crucial market and it has its set of challenges like macroeconomic landscape, political complexities, poverty, lack of health literacy and limited spending by governments for national healthcare due to weak economic growth and a high reliance on donor funding.

USA

The United States alone holds over 45% of the global pharmaceutical market. In 2016, this share was valued around USD 446 billion. Generics continue to enjoy a formidable percentage of USA's pharmaceutical market with more than 88% prescription patterns filled by generic drugs.

India, exports drugs worth USD 16.5 billion to the USA annually which, as per Assocham report, is expected to rise to USD 20 billion by 2020 – a compounded annual growth rate of 30%. This growth is based on several patented drugs going off-patent in USA over the next few years. However, intensification of competition in generics resulting in price erosion, frequent regulatory scrutiny leading to slowdown of exports and channel consolidation impacting manufacturers' ability to charge higher prices are the current challenges being faced in this market.

Growth Drivers

RISE IN GLOBAL SPENDING ON HEALTHCARE

USD **8.7** trillion by 2020

As spends on healthcare (includes service delivery; health workforce; information; medical products, vaccines, technologies, etc.) increases, the pharmaceutical industry will also benefit.

GROWING WORLD POPULATION

9.3 billion by 2050

A growing global population will fuel the demand for pharmaceutical products.

AGEING POPULATION

21 % by 2020

Increase in 60+ age group, means increased cases of age-related diseases, thus higher demand for medicines.

CHANGING LIFESTYLES

642 million by 2040

Higher proportion of number of people affected by diabetes.

INCREASED INCOME

160 million people a year

Rise in number of middle-class population in both emerging and developed markets means more disposable income and expectation of better healthcare solutions.

Company Overview

Ajanta Pharma is a speciality pharmaceutical formulation company engaged in the development, manufacture and marketing of quality finished dosages. The Company is focussed on the branded generics market in India, Asia and Africa, generics market in USA besides Institutional segment in Africa. With revenue being generated from a wide range of products and more than 30 countries, the Company's business is well-diversified and de-risked.

Ajanta Pharma's competitive edge is its strong focus on customised products for every market where it operates. This high level of innovation has been achieved on the foundation of robust infrastructure, strong scientific knowledge base and latest technology. The Company has six formulation manufacturing facilities, (two are USFDA approved) and a state-of-the-art Research & Development Centre spread over 100,000 sq. ft. Over 6,500 employees are engaged worldwide to ensure efficient and seamless business functioning.

Operational Highlights for FY 2018

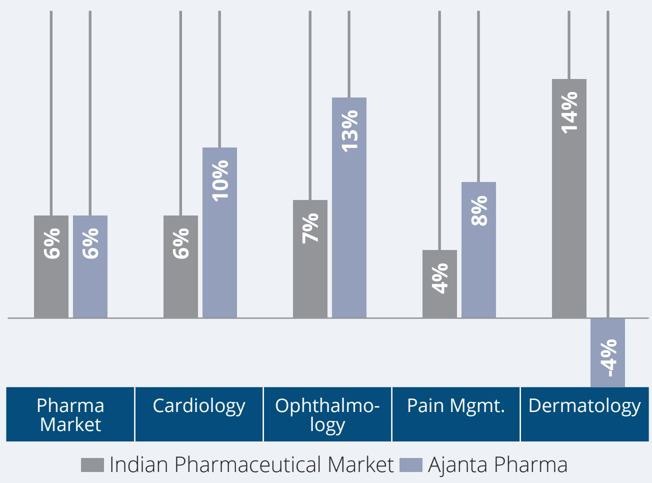
- Consolidated Turnover at ₹ 2,155 cr.
- Consolidated Profit after Tax at ₹ 469 cr.
- Indian Pharma Market ranking improved to 32nd position from 33rd position
- Derma section commissioned at Guwahati
- Enhanced R&D spend to 9% of revenue

Performance Highlights

India

Ajanta Pharma's India business continued to perform well steered by strong focus on high growth speciality segments. While roll-out of the GST impacted operations across the industry, the Company's readiness enabled it to transition seamlessly to the new tax regime. As per IMS MAT March 2018, the Company grew at par with Indian Pharmaceutical Market (IPM) at 6%. Within the speciality segments that the Company operates in, except for Dermatology all segments recorded higher than industry growth. Corrective measures have been taken, and the Company is optimistic about reviving growth in the Dermatology segment. The Company continues to strengthen product portfolio through new launches, many of them being first-to-market products offering significant patient benefits. Apart from new launches, many of the Company's existing products continue to grow their market share.

Segment Performance (% growth)



Source: IMS MAT March, 2018

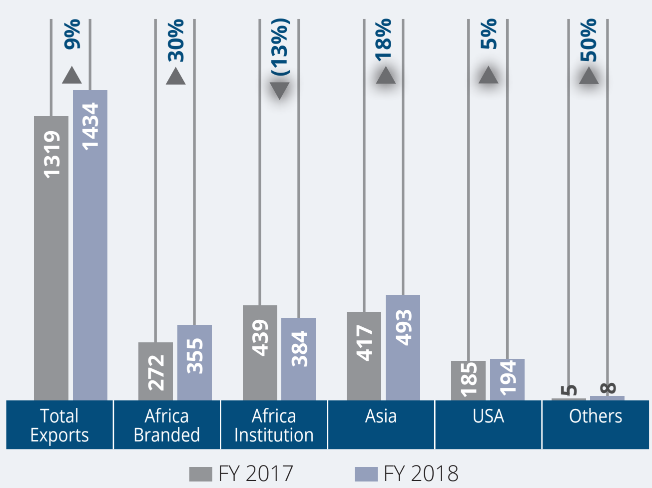
Exports

Notwithstanding a tough industry backdrop, the Company's international business grew by 9% in FY 2018. Growth was primarily driven by strong revival in Asia markets, led by product addition and enhanced market focus. Stable crude oil prices in Asia also helped improve business environment.

In Africa, branded generics business continues to remain on a strong footing; however, with Global Fund business on the decline, institutional sales had seen de-growth.

In USA, greater price erosion due to competition intensification and channel consolidation were the key challenges faced by Indian manufacturers. Even amidst this backdrop, led by new product launches and on the back of existing products, the Company recorded a growth of 5% for FY 2018. With 6 more products commercialised in the year, total number of products commercialised stands at 18. The Company received 4 ANDA approvals in the year, taking cumulative approvals to 19, and 2 tentative approvals.

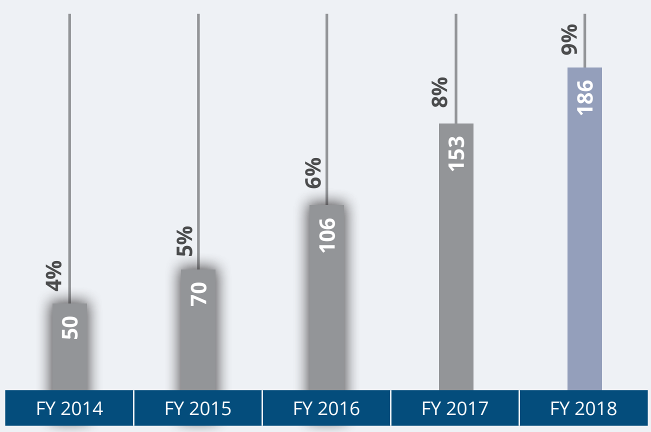
Export Details (₹ cr.)



Research & Development

The Company has strengthened its R&D function, spending about 9% of its total operating income on R&D in FY 2018.

R&D spend and % of Oper. Income (Excluding Capex)



Financial Review

	FY 2018 (₹ in cr.)	FY 2017 (₹ in cr.)	Growth (%)
Income from operations	2,131	2,002	6%
EBITDA	658	699	(6%)
PBT	623	648	(4%)
PAT	469	507	(8%)

Geography-wise Sales for FY 2018

Territory	Sales (₹ in cr.)	Sales (%)
India	629	30%
Africa Branded Generics	355	17%
Africa Institution	384	19%
Rest of Asia	493	24%
USA	194	9%
Others	8	1%

Operational and Financial Performance

Our branded generic business performance in emerging markets has posted healthy growth in line with our expectation, whereas the India business growth has come back after the GST impact in first quarter. Despite the challenging price erosion environment in US market, we have performed well during the year. The focus was on launching new products, enhancing market share of existing products and improving efficiencies.

PROFIT AND LOSS STATEMENT

Revenue from operations

Revenue from operations increased to ₹ 2,131 cr. in FY 2018 from ₹ 2,002 cr. in FY 2017, a growth of 6%, even when our institution business saw a de-growth in Africa. The increase was driven by volume along with new launches of customised and innovative products.

Material costs

Material costs saw a 200 basis point improvement, from 21% in FY 2017 to 19% in FY 2018 on the back of higher proportion of branded generic business.

Employee expenses

Personnel expenses stood at ₹ 376 cr. for the year ended FY 2018 as against ₹ 295 cr. in FY 2017. The increase was on account of full year impact of team members added at different times during FY 2017 and also due to increase in gratuity limit.

Other expenses

Other expenses include manufacturing, marketing, distribution, R&D and administrative expenses which stood at ₹ 690 cr. in FY 2018 as against ₹ 605 cr. in FY 2017. As a percentage of revenue, other expenses have gone up to 32% as against 30% in the previous year, mainly due to higher R&D cost.

Margins

EBITDA stood at 31% in FY 2018 as against 35% in the previous year. Net margins stood at 22% in FY 2018 as against 25% in the previous year. EBITDA was majorly impacted, due to plant expenses of Dahej and Guwahati.

BALANCE SHEET

Non-current assets

This mainly comprises property plant and equipment which has gone up in line with our continued capex investment in manufacturing facilities and R&D which has taken it from ₹ 997 cr. in FY 2017 to ₹ 1,225 cr. in FY 2018.

Current assets

Increase in inventory and trade receivables has mainly taken the current asset level to ₹ 1,224 cr. in FY 2018 as against ₹ 851 cr. in FY 2017. The increase in inventory is the result of commencement of operations at 2 new manufacturing facilities and higher level in US.

Shareholders' funds

Shareholders' funds increased from ₹ 1,568 cr. in FY 2017 to ₹ 2,041 cr. in FY 2018. Earnings per share stood at ₹ 53 in FY 2018 as against ₹ 58 in FY 2017.

Non-current liabilities

The balance under this head increased from ₹ 33 cr. in FY 2017 to ₹ 61 cr. in FY 2018 mainly on account of increase in deferred tax liability and provisions for employee payments.

Current liabilities

Increase in trade payable and provisions resulted in higher current liability at ₹ 346 cr. in FY 2018 as against ₹ 247 cr. in FY 2017.

Human Assets

Ajanta Pharma is powered by rich pool of knowledgeable and proficient employees. People contribution is key to Company's continued success and growth, where strong emphasis is given towards creating a safe, healthy, stimulating and energising workplace.

To empower our people perform and reach their potential, we have in place a well-designed leadership competency framework. Leadership capabilities developed across the organisation also ensures business growth, expertise to drive innovation and agility to respond to a changing environment.

We have aligned our HR policy to the evolving needs of the global pharmaceutical industry. To further augment people capabilities, we are imbibing industry-best HR practices to inspire our team towards excellence. As part of our team-building efforts, we undertake regular activities to promote their mental and physical wellness. These initiatives include promotion of health, sports, hobbies, individual talent, celebrations of special days, etc. Such efforts have helped us bring down attrition of our employees.

Communication and collaboration is encouraged to instil a sense of belonging and pride in working for Ajanta Pharma. Our reward and recognition programme foster a high-performance culture and drives employee engagement.

Risk Management

Ajanta Pharma has established a strong risk mitigation process which entails regular and stringent monitoring of its business activities to identify, evaluate and resolve risks. The top management of the Company and the Board are involved in monitoring of risk assessment and mitigation, thus ensuring a quick resolution mechanism. The Company has a work philosophy of doing business with high ethical standards and topmost integrity. This principle has helped it to pre-empt and ease considerably the risks that came across its way.

During the year, Company established a risk management committee, where Managing Director and Joint Managing Director along with senior management review key internal financial controls and their effectiveness in the form of a risk matrix, inherent risks associated with each function, risk assessment and classification of these risks into different categories. The work of risk management committee is reviewed by audit committee and board periodically.

The following are the key risks faced by the Company and mitigation plans for each of those risks:

Risk	Risk Description	Mitigation Plan
COMPETITION RISK	Company faces competition from pharmaceutical companies from India and other parts of the world. These competitor companies bring new products in the market which can affect the Company's market share and revenue.	Company identifies unmet medical needs of patients, develop those products in R&D and launch innovative and customised products ahead of competition.
REGULATORY RISK	Company has to comply with extant laws and regulations prevailing in the country of its operations. These regulation can affect the development, manufacturing, approval, marketing and distribution of its products. Changes in the country's laws or regulations also throw new challenges of compliance.	Company has established a strong quality assurance mechanism and compliance monitoring network to ensure compliance. It also organises regular training for its employees to update them on new developments.
GLOBAL ECONOMIC VOLATILITY RISK	Company has business dealings in many countries. Each of these markets presents a different economic and political risk along with the ever present threat of natural disasters.	A widespread global presence, with no overdependence on any one region or country, considerably insulates the Company from any uneventful developments in any particular market. Further, strong emphasis is given to regular tracking of the local developments to address these risks.
FOREIGN EXCHANGE RISK	The Company earns a major part of its revenue in foreign exchange, thus exposing it to the volatility in the exchange rates. This can have an adverse effect on its earnings.	The Company does meticulous monitoring of the rate fluctuations. It also follows a robust hedging policy.

Internal Controls and Adequacy

The Company has a comprehensive system of Internal Controls to safeguard its assets against loss from unauthorised use and ensure reliability of financial reporting. It maintains a system of internal controls designed for effectiveness and efficiency of operations, compliance and regulations. All operations are governed through automated internal business controls, centralised global process framework and integrated key support functions. Quarterly tracking of annual quality objectives is done using QMS (quality management software), and any concerns are immediately flagged for effective addressing.

The system of internal controls monitors and ensures process for:

- Prudent financial control
- Accountability and integrity
- Automated control procedures

All transactions are recorded and reported in accordance with the Accounting Standards. The internal auditors for different locations submit reports and updates. The Audit Committee of the Board review reports submitted by the independent internal auditors and monitor follow-up and corrective action.

Cautionary Statement

Statements in the Management Discussion and Analysis describing the Company's objective, projections, estimates, expectations may be forward-looking statements. Actual results may differ materially from those expressed or implied due to various risks and uncertainties. Important factors that could make a difference to the Company's operations include economic and political condition in India and in the countries in which the Company operates, volatility in interest rates, changes in government regulations and policies, tax laws, statutes and other incidental factors. The Company does not undertake to update these statements.