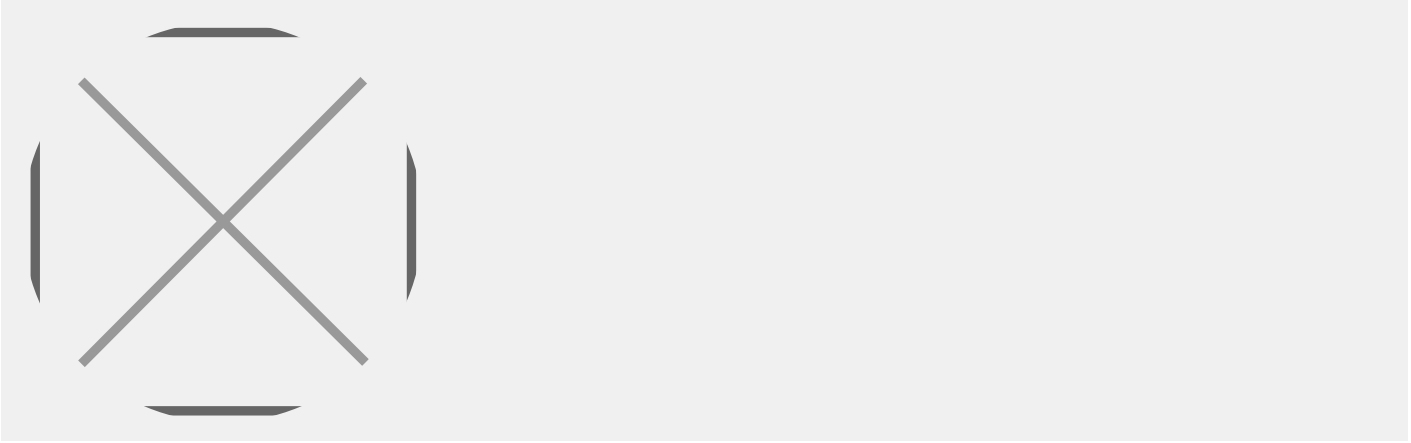
Interview with Ajit Kamath, Chairman & Managing Director, Arch Pharmalabs



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Arch Pharmalabs started its operations in 1999 when you bought a plant in Hyderabad with a turnover of 2Mn USD. 12 years later, you have grown to a 300Mn USD company with 11 manufacturing plants. What triggered the acquisition of the Hyderabad plant, and what have been the main milestones since?

My associates and I were in the financial services industry. We do not have sciences or pharmaceutical background. Though, at this point of time, we have spent more time in the Pharma world than in finance. At that time, we had a financial services company that was engaged in corporate finance and advisory services, revolving around corporate financing and restructuring. One of our assignments was helping a company in Hyderabad that had filed for bankruptcy. We saw a good opportunity. The company had good assets, good people, and an interesting product profile. The only reason the company had filed for bankruptcy was the banking rules of that day and age, which were unfavorable for the industry. Loans had moratorium periods of just 6 months. Since it takes at least 2 years from breaking ground to getting approvals and starting production, the company became financially stressed which is why they came to us for advice. At that time, my associates and I were between 26 and 28, we were not afraid of taking risks, so we decided to look into it more closely, more so becasue, we had mainly a portfolio of pharmaceutical clients. Therefore, we had the social equity, we knew most of the owners of the pharmaceutical companies, and we didn’t shy away. Of course jumping from financial services to the manufacturing world was a big step, but it was not a world we didn’t know. Having done a lot of advisory work before, the people, jargon etc. were familiar to us. So we put all of our savings in this

company in 1999, and we decided to see what we could do with it. It took us 3 years to turn around the company. We formally became owners in 2003 and this is when we got in touch with Private Equity. It was very clear to us this was the right thing to do and we are one of the few companies of our size to have taken this risk. In India usually, owners are very adverse to dilution of their equity. At some point, we had diluted nearly 60% of the shares to private equity! Today, our audited consolidated revenues for 2011 are 307Mn USD. The growth has been essentially though private equity investment, and the willingness to dilute our own equity.

Bringing on private equity at such an early stage is indeed something very unique in India where most businesses are family owned.

Could you tell us more about why you made this choice and how you chose your private equity partners?

It was very clear from the start that we didn't want to be one among the thousands of manufacturing units in India. Once we had made this transition to the pharma and manufacturing world, we wanted to be among the top ten or fifteen. The second reason is also the financial stress. Being first generation entrepreneurs, we didn't get any financial support from our families – it was merely moral support. Now, if you ask me how we chose private equity, I will be very candid: if any entrepreneur, with a new business idea, tells you that he chose private equity, he's lying. Private equity chooses you. It took us 200 presentations before the idea caught on, especially for young guys who didn't have a science background!

What did private equity bring to the table?

With hindsight, the most important thing private equity brought us is corporate governance. From a customer's perspective, and from a corporate perspective, the quality of your board makes a big difference. And this is typically how we made a difference compared to family businesses. We had a board where private equity had majority – which of course for an owner is a tough call to make. But if we wanted to progress, we needed them and their expertise – and we came thus far thanks to them.

To move more specifically to the business, in the last years, you have diversified your portfolio to 100+ APIs and intermediates. We have heard some voices in the industry advocating a focus on niche products with higher added value, especially when faced with growing competition with China. Could you tell us more about the business rationale behind your product portfolio?

Our strategy is very clear. If we want to stand out, our focus has to be on innovation. One of the ways we innovate in the industry is, for example, bringing in private equity as we mentioned earlier. Another one is investing in technology. We have alliances with companies such as Codexis which IPOed recently in the US. We also have an alliance with DSM, with a company based in Chicago

called Orochem Technologies etc. Therefore, thanks to these alliances, we were pioneers for certain products. We were the first to introduce in India and in the generic world technologies such as bio transformation. This is something that we set up on a large scale and we could beat or compete head on with China.

For the first time, people realized that China is not a dragon that can't be beaten: we could do it with the help of technology. The other misconception that most of the industry has is that China can cut costs because the government is subsidizing production costs or incentivising industry unfairly. That's only a way of shying away from investments in technology. And we should also learn from the economies of scale they are capable of. What really matters is the technology, the process and development skills. Therefore, we decided to focus on a few products, back integrate, and bring on the necessary technology. In 2005, when we were not as big as today, we invested a lot in an R&D center with 250 scientists. Then we got into alliances – a lot of people wondered how Arch, such a small company could get into these alliances. Once again, the dilution of equity played a major role, because it enabled us not only to acquire companies, but also to acquire technology.

Most Indian companies which started with APIs have now moved up the value chain and entered the formulations business to the extent that there are very few pure API players left. Is entering the finished dosage segment something you are looking into?

I would say we have migrated from one activity to another. We started off with early intermediates, moved to more advanced intermediates, and now we are finding a foothold around the world in APIs. Along the way we had to look at expanding our regulatory approvals. We are moving from so called less regulated markets with the early intermediates to the highly regulated API space. We now have 3 facilities which are USFDA approved, and we are expecting to have 2 more by the end of the year.

And this has been quite a task, we had to find the people, etc. Therefore, we didn't want to have any distractions before moving to the next level. Are we ruling it out? It's too early to say, but at this point of time, it's not something we are looking into.

The second reason why we didn't move into dosage is a strategy we planned in 2005 when we opened the R&D center. We preferred moving into the CRAMS business, which includes, contract research, custom synthesis and contract manufacturing. We have done quite a bit in the services business already: today, a quarter of our revenues come from the CRAMS business. In that space we are one of the last entrants, but one of the fastest growing.

How do you explain this fast growth despite the late entry?

The people we have invested in, the range of facilities we have -which is one of the best in India – we can take on orders of any scale and of any type – and of course the technology. Last but not

the least, our technology partners who helped us get that crucial foot in the door. The combination of these factors put us on the fast track for our CRAMS business.

In the future, we see each side of the business – products and services – representing an equal part of our revenues. Of course both have their advantages and disadvantages: CRAMS is more volatile, spiky, bumpy, but margins are higher, whereas the API business is more stable despite having lower margins.

The next big step for Arch is the upcoming IPO! Could you tell us more about what you are expecting from becoming a listed company?

The IPO is essentially a facilitating mechanism for the exit of the private equity investors. Not that they are impatient or anxious, but they have already been us for a very long time – seven or eight years. The IPO is the best way to facilitate the exit of 3 different PE investors. And then of course, once we are listed, a whole world of possibilities open up for us – for example we don't only have to look at cash acquisitions. But we do not have specific plans as of yet.

So, if we come back in 2019 to celebrate the 20 years of the company, which target would you like to have achieved?

It would be a cliché if I told you I would like to be a one billion company. Rather, we would like to evolve from an API / intermediate company to gradually become a complete healthcare company.

What would you like your final message to our readers to be?

I'm sure they are interested in the India/China debate. I want to tell them that looking forward the relationship between the two countries is bound to be symbiotic rather than looking at China as competition. Unlike India, China's first ANDA was approved in 2010 whereas our industry has been thriving for at least two decades. We should not look at them as a threat, but as an opportunity. Of course, when you look at the pharma pyramid, we have lost ground in the basic chemical space. We should use the economies of scale that have been built up in China to further our industry and look at more regulated markets and partner more with Big Pharma. In a word, do what we have done in Arch: be with Big Pharma right from the early discovery phase to launch.

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