# Q3 2016 IPCA Laboratories Ltd Earnings Call

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Corporate Participants

* Nitin Agarwal

IDFC Securities Limited - VP - Research

* A.K. Jain

IPCA Laboratories Ltd. - Joint MD

* Harish Kamath

IPCA Laboratories Ltd. - Corporate Counsel & Company Secretary

Conference Call Participants

* Prakash Agarwal

Axis Capital - Analyst

* Anubhav Aggarwal

Credit Suisse - Analyst

* Surya Patra

PhillipCapital (India) Pvt. Ltd. - Analyst

* Anmol Ganjoo

JM Financial - Analyst

* Monica Joshi

Bajaj Allianz Life Insurance - Analyst

* Dheeresh Pathak

Goldman Sachs - Analyst

* Sameer Baisiwala

Morgan Stanley - Analyst

* Manoj Garg

Bank of America Merrill Lynch - Analyst

* Charulata Gaidhani

Dalal & Broacha - Analyst

* Saion Mukherjee

Nomura Securities - Analyst

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Operator [1]

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Ladies and gentlemen, good day and welcome to the IPCA Laboratories Q3 FY2016 Earnings Conference Call, hosted by IDFC Securities 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. (Operator Instructions). Please note that this conference is being recorded.

I now hand the conference over to Mr. Nitin Agarwal from IDFC Securities. Thank you and over to you, Mr. Agarwal.

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Nitin Agarwal, IDFC Securities Limited - VP - Research [2]

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Thank you, Margaret. Hello, good afternoon, everyone and a very warm welcome to IPCA Lab's Q3 FY2016 Earnings Call, hosted by IDFC Securities. On the call today, we have representing IPCA Labs management, Mr. A. K. Jain, Joint Managing Director and Mr. Harish Kamath, Corporate Counsel and Company Secretary.

I hand over the call to the management team to making opening comments and to take the call from there on.

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [3]

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Welcome to the quarter three earning call.

For the quarter, our domestic business has grown by around 11% from INR287 crores to around INR308 crores, overall domestic formulation business. Domestic API business, there is a decline of around 25% from INR37 crore, it's around INR28 crores. Overall, domestic business has grown in this quarter from INR316 crore to around INR336 crore, so there is a -- the improvement of around 6% in domestic business.

Export formulation business in this quarter has declined by around 27% from INR305 crore to around INR221 crore, and API business from INR113 crore -- API export business from INR113 crore, it is around INR116 crore, so around -- improvement of around 3%. So, overall on export business, there is a decline of around 19% from INR418 crore to around INR338 crores. And overall business of the Company in the third quarter is around INR689 crore as against INR747 crore in the same period last year, and there is a decline of around 8%.

And cumulatively for the first nine months of the current year, the overall domestic business growth is around 3%, export decline is around 22%, and overall decline in the business is around 11%, overall for the nine-months period.

If you look at overall numbers of this quarter, there is a overall improvement we have seen in the EBITDA margins from -- in the earlier two quarter, the EBITDA margins was around 11%, 11.5%. This quarter, the EBITDA margin is around 13.5%, and overall for the first nine month of the current year, overall EBITDA margins has come down -- come to around 12%. If we exclude the material cost, which is written off in the quarter, the overall material cost ratio is now improved in this particular quarter to around 33%, as against the overall numbers of nine months of around 38%, and overall EBITDA margin in this quarter excluding that material cost written off comes to around 16.6%. So, there is a -- overall, we see some improvement in the EBITDA margins in the quarter.

Having given the basic number, now, I'll request participants to ask the question.

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Questions and Answers

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Operator [1]

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Thank you very much. We will now begin with the question-and-answer session. (Operator Instructions). Prakash Agarwal, Axis Capital.

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Prakash Agarwal, Axis Capital - Analyst [2]

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Sir, just trying and understanding this revenue, especially the API piece, what really has happened at export API, if I see QonQ has gone down 21%, and in fact even domestic API has gone down, so any specific reason?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [3]

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Export API has not gone down, in fact if you look at nine months figure, the export API figure last year in the first nine months was around INR392 crores, and this year, this export API number is around INR416 crore, so overall there is a --.

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Prakash Agarwal, Axis Capital - Analyst [4]

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For this specific quarter, sir?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [5]

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For this particular quarter, the export API number is, as against INR113 crore, it's INR117 crore. So, overall improvement of around 3% in export API. Domestic API has gone down by around 25% from INR37 crore, it has come down to around say INR28 crore.

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Prakash Agarwal, Axis Capital - Analyst [6]

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Any specific reason?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [7]

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Domestic, [we're still] large amount of anti-malarials and this year, anti-malarials were bad. So that's the main reason for domestic and some part of -- some DMS materials we were supplying in first half of the last year, which is not there in the current year also.

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Prakash Agarwal, Axis Capital - Analyst [8]

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And sir, QonQ decline in the export API, sir?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [9]

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QonQ decline in export API -- I said, nine months, there is a improvement in overall export business.

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Prakash Agarwal, Axis Capital - Analyst [10]

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So, we should not read much into the quarter. Overall, you can continue to grow this piece as --.

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [11]

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Yes. API business will be -- yes.

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Prakash Agarwal, Axis Capital - Analyst [12]

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And on the margins, you talked about the INR24.5 crores, if we adjust for that, our gross margin shoots up to 66%, and EBITDA margin to about 16% plus.

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [13]

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Yes.

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Prakash Agarwal, Axis Capital - Analyst [14]

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So is there any -- apart from this one-off that we excluding, what has really led to this kind of EBITDA and gross margin improvement, because I think domestic business is -- still contributes the way it is?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [15]

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Domestic growth has improved from at least 6%, 7%, it has come to around 11%, and overall trend is better in domestic. So, that's the one contribution factor. Then your promotional market decline was almost around more than 50%. We are still in decline in domestic -- sorry, international export promotional business, but that decline has come to around 19% or so now. So, decline is at lower rate, and that is also leading to the overall -- let's say, because that business is having a higher EBITDA margins overall.

And overall, also whatever efforts we have done in respect of the cost rationalization in domestic market, that has also resulted in overall lower cost on account of marketing, as well as, because there is a lower production, so the variable cost on your factory-related things has gone down. So generally the better cost controls, rationalization in cost particularly on marketing and field side in domestic market, at the same time improvement in domestic business per se, and also the better -- little improvements what we are seeing in the promotional market that lead to the better margins for the quarter.

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Harish Kamath, IPCA Laboratories Ltd. - Corporate Counsel & Company Secretary [16]

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Prakash, also domestic API sale was very less this quarter, compared to same period previous year. So where definitely margins are much lesser, so that has also, in a way, contributed to higher margin.

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Prakash Agarwal, Axis Capital - Analyst [17]

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So better product mix A, for gross margins and cost control, which is other expense, which has come down to under INR200 crores, which is due to marketing and field force rationalization. So, is this a base that we can take and grow the business going forward? Would it be fair to assume this base and then move forward?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [18]

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Overall, we see that domestic improvement will be further better. Branded promotional, I think we were better -- I think at second quarter, we were at the lowest level from these. We are seeing now improvement and we will see further improvement in the fourth quarter of the current year. So overall, these two branded promotional businesses we are seeing much better numbers in time to come. And overall, together with rationalizations overall margins we will definitely have some improvements.

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Prakash Agarwal, Axis Capital - Analyst [19]

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So this margin can be taken as base going forward, sir?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [20]

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Yes. This is a very low margin compared to what kind of margins we used to have. So, definitely -- we'll be moving towards improvement.

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Prakash Agarwal, Axis Capital - Analyst [21]

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Okay. And lastly, before I get back to the queue, sir, on the HCQS, what is the current status in terms of our supplies and our partners being able to launch in big quantities in the US?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [22]

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We have started making shipment to US now, and the partner has selectively started selling, and I think in last quarter there is a -- overall number was around, I think, very small at around 3% market share, so number is not that great now. And as the supply -- more supply reaches, which is going in January -- sorry, February and March large supplies are going. So, thereafter much bigger momentum is expected in HCQS marketing by the partners.

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Prakash Agarwal, Axis Capital - Analyst [23]

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So bigger momentum from April?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [24]

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Once the supply reaches to them, because they wanted at least one year stock to be there, and those all -- the stocks are in pipeline, so before say this year end, at least equivalent to 30% of market share, the stocks will be shifted to -- shipped to the US. So, that will help the partner to improve the -- thereafter to improve the sales in the US.

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Prakash Agarwal, Axis Capital - Analyst [25]

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And you will be able to book revenues from the next quarter, that is April to June and July to September is when you will --.

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [26]

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Normally, transfer pricing revenue is booked immediately, and share of profits normally when the quarter ends, immediately within 20 days, we get the share of profit segment. So we account for in the same quarter in which the sale has happened. So, there is no one quarter lag, it's every quarter's profit share is booked in the same quarter.

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Operator [27]

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Anubhav Aggarwal, Credit Suisse.

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Anubhav Aggarwal, Credit Suisse - Analyst [28]

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Sir, one question on this US FDA warning letter, which you've got recently. Just wanted to check that after going through the warning letter now, which has come more than a year later, does it change the scope of work that you've already done on the remediation side, does it add anything extra?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [29]

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As far as remediation work is concerned, let's say, most of the work has been done, and some more work is required to be done, but as warning letter per se has not change anything. It's -- some more work is required to be done and that is in pipeline.

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Anubhav Aggarwal, Credit Suisse - Analyst [30]

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So, this is as far as, I mean, can that imply that effective it's working as a non-event for us, getting a warning letter just tells us -- makes us more reassured that we have covered everything which has been asked in the warning letter?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [31]

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Yes. That is the process, which we are going through.

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Anubhav Aggarwal, Credit Suisse - Analyst [32]

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Okay. And how much is the R&D expense this quarter. Are you still spending 4.5% of sales about INR30 crores, INR35 crores in R&D per quarter?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [33]

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Overall, if you look at the R&D numbers for the first nine months of the current year, the revenue expenditure in R&D is around INR88.44 crores, as against last year's figure of INR75.62 crores, and together with capital expenditure, I think overall R&D expenditure in first nine months of the current year is around INR96 crore. And that works out to be around 4.44% of the overall top line numbers.

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Anubhav Aggarwal, Credit Suisse - Analyst [34]

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Sure. So that hasn't changed much. Just help me with this one number, the other expenses that's down -- the absolute number has been down, let's say, if I compare to any of the last 10, 12 quarters, what's leading to the INR30 crore, INR40 crore absolute decline? I know as percentage of sales, this number has been actually very volatile?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [35]

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If you look at percentage of sales number wise, then probably percentage is working out to be the same. I think if you look at the percentage wise, it's working out to be around 28.57%, whereas last year also it was around 28.69%. And overall -- so overall number percentage wise it doesn't look to be has gone down, because overall top line has come down.

But, overall improvement, if you look at, is basically we have done some improvement in your marketing expenditures in domestic market, particularly rationalization of the field force and all that, and close to around 400 numbers is reduced in overall in domestic market, by rationalization two particular field force as we explained in the last Q2 call, that has resulted in overall lower marketing costs more particularly on travelling and promotional imports and salaries of these kind of people, and overall marketing costs, so that's one part of it.

Second expenditure reduction is by and large, let's say, your energy cost are low, and also your factory outputs are also low on the lower side, so your particular variable expenditure on factory sides are on lower side, and energy cost has little bit come down. So, not the -- your electricity cost has in fact moved up, it's only the coal and your HSD cost that has come down. So, these are the major two numbers. R&D expenditure continue to -- on revenue expenditure that's the higher side.

And third number, which is by and large reduced is on expenditure side is particularly on export shipments. In last financial year, we had lot of air shipments particularly relating to anti-malarial business, and this year, we don't have those kind of air shipment, and also the freight cost is also lower on the lower side.

So, overall if you look at these numbers, by and large reduction and rationalization in field force cost, that's one, overall your variable cost reductions and energy cost reduction on factory output. These are the two major factors. And third factor is of course the freight drop. So these factors has led to the overall reduction in the absolute numbers, but in terms of percentage, it's still high.

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Anubhav Aggarwal, Credit Suisse - Analyst [36]

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Thanks, sir. That was very comprehensive. That's helpful. One more question on the malaria contracts, can you update that? Have you already started shipment of the anti-malarial contracts to Africa or that is not yet started?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [37]

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Let's say as far as malaria, that business is in two parts. Since -- after the re-inspections of plants by the WHO, and that clearance of shipment to the -- various country shipment has already started. As far as Global Fund is concerned, we have the written confirmation from them that the allocations would be there from Global Fund, and I think they have postponed the allocations to the February end or March first week. So, once they give allocation to everybody, we will also be getting allocation, so that confirmation is already there. We expect that by either February end or March beginning, when the allocations are done for all the companies, we will also be getting allocation.

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Anubhav Aggarwal, Credit Suisse - Analyst [38]

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And this -- when you get this allocation, this is for how long period, sir, I mean --?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [39]

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Normally, they give one year allocations and then they give the -- at the same time, the fund clearances. So fund clearance, they have not specified that for how much period they will give, but there is some changes going to be there and they will be -- some kind of they'll be advancing the fund clearance. So probably it may be happening that -- instead of say quarter-wise, they may give for six-months fund clearances, that's going to be there -- that's our guess.

But they will be -- allocation will be -- firm allocation would be there for a year.

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Operator [40]

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Surya Patra, PhillipCapital.

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Surya Patra, PhillipCapital (India) Pvt. Ltd. - Analyst [41]

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Sir, can you just give the breakup of the revenues for the export formulations?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [42]

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Overall, let's say, your promotional market business was around INR60 crore, as against almost INR74 crores in the third quarter last year, so there is a decline of around 19% on that. On generic business side, it's around INR137.5 crores as against INR148 crore last year, so there is around 7% decline there. Institutional business was around INR24 crore as against INR82 crore last year, so there was a decline of around 71%. So overall, the export formulation business for the Q3 was around INR221 crore as against INR305 crore last year. And overall, for first nine months, this number is around INR673 crore as against INR999 crore. In this quarter, there is a 27% decline in the overall export formulation business, and overall for the first nine months, there is a 33% decline.

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Surya Patra, PhillipCapital (India) Pvt. Ltd. - Analyst [43]

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Okay. And sir, if I just go by the 71% kind of a decline in the institutional sales, so it is sequentially also almost half kind of number?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [44]

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No. It's much lower number. If you look at first nine months, we have done around INR101 crore business as against INR233 crore, what we've done last year, because, major part of the business used to be Global Fund business, it's almost around -- ratio is around two-third kind of business was Global Fund and one-third was other tender business.

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Surya Patra, PhillipCapital (India) Pvt. Ltd. - Analyst [45]

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Yes. But sequentially also, sir, last quarter also there was no Global Fund, but still INR47 crore kind of number that we're reported. And now this quarter --.

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [46]

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That depends on what kind of tenders you are getting, in this quarter the execution was around INR24 crore.

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Surya Patra, PhillipCapital (India) Pvt. Ltd. - Analyst [47]

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Okay. So do you expect a kind of sequential improvement, and that is one? And secondly, whatever business that we have lost because of delay in certification from The Global Fund, will that again come in the subsequent quarter, what earlier that we are indicating?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [48]

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Now the gap is so much, you can't -- we cannot expect that to happen.

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Surya Patra, PhillipCapital (India) Pvt. Ltd. - Analyst [49]

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Okay. And you might have seen some increase in the competition also so far as anti-malarial product after your discontinuation of the business. So, again, can you reach again your kind of the original market share that you used to get in this business?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [50]

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Original numbers is just not possible to achieve, because number one, [attenuation in] prices have significantly come down from $400, it came down to average of $250 and now around $200 -- less than $200 of [attenuation in] prices.

So overall, the treatment cost itself has significantly come down. Also, I think overall procurement by The Global Fund this year on absolute number is also on the lower side. We don't know what kind of allocations would be, because they will be deciding next whole year's allocation now by February end or March first week, so what kind of numbers would be coming. But looking at the trend, overall number of treatment would also be lower and at lower prices. So, overall number would continue to remain lower.

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Surya Patra, PhillipCapital (India) Pvt. Ltd. - Analyst [51]

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Okay. But on that front, do you have any kind of a indication what could be the kind of potential decline from the base?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [52]

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It's too early to estimate the number, because once we get an allocation then we'll be able to give you the right kind of overall projection for next year.

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Surya Patra, PhillipCapital (India) Pvt. Ltd. - Analyst [53]

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Okay. And sir, the inventory write-off what we've done, sir, what is the nature of that?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [54]

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Let's say the inventories, which were produced for Global Fund, which was there in the last year maybe in the month of June, July, that was when the issue happened. And once we were talking to Global Fund about shipment of those inventory, but finally they said that they will be taking the inventories only post inspection clearance. So these inventories, even though they had significant amount of expiry still left, but these inventories cannot now go. And also they were packed on the Global Fund logos and all, so you cannot even ship to the other market, because it require a complete repackagings and re-blistering and that is not allowed by our QA system, because some tablets might get chipped and all that. So that may become difficult, so we thought it fit to write-off the entire inventory this quarter, because the event of -- they are telling that these shipment -- these goods they will not accept has happened in this quarter, so we have decided to write-off the entire inventory.

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Surya Patra, PhillipCapital (India) Pvt. Ltd. - Analyst [55]

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Okay. And can you just update us on the facility wise, what is the kind of update that we are having for the plants, which are under warning letter?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [56]

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As far as some -- US is concerned, there are three plants under warning letter, which is Ratlam plant and like Piparia and Pithampur plant. And as far as Pithampur is concerned, they were last inspected by the MHRA, and that was cleared. Ratlam must have faced more than 125 audits in last one year from various customers and regulators and we are not seen any issue with any other regulators including WHO clearance and including your European agency clearance, and Australia, New Zealand and all other agency clearance.

Now, as far as the US clearance part is concerned, we had given them six update to the FDA, and generally we are in the course and now since the warning letter has been issued by FDA, we are in -- reassessing the whole thing and then once that complete -- reassessment part is complete and what further course of action need to be taken, once that complete we will be in a process of then talking -- taking with the FDA for inspection.

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Surya Patra, PhillipCapital (India) Pvt. Ltd. - Analyst [57]

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Do you have any sense about the re-inspection --?

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Operator [58]

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Sorry to interrupt you, Mr. Patra, may I request you to come back in the queue for follow-up questions?

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Surya Patra, PhillipCapital (India) Pvt. Ltd. - Analyst [59]

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Okay.

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Operator [60]

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Thank you. (Operator Instructions)

Anmol Ganjoo, JM Financial.

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Anmol Ganjoo, JM Financial - Analyst [61]

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I have a couple of questions. First is, is my understanding correct that from a regulatory standpoint, we are now ready to service The Global Fund opportunity, and we have received proper communication from them and whatever, okay. And second is that just purely from an allocation standpoint, the opportunity is not as big as it used to be, that's what the industry read through seems to be suggesting. Would you help us understand what is your sense in terms of what is the size of reduction and what is the eventual pie from which we now expect an evaluation?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [62]

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Let's say allocations would happen in the -- by the end February and -- overall, I'd say, it's only matter of one month, so we will know exactly what kind of reduction, but definitely I think overall there is a less amount of treatments has been procured by Global Fund in last one year. And I think overall, what we understand is that in the similar line, there may not be further reduction, but on the similar line, the overall numbers may or procurement may happen. So, it's only matter of one month, so it's too early to guess, but once that number happens then we'll be able to give you the exact --.

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Anmol Ganjoo, JM Financial - Analyst [63]

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That's helpful. My second question is on HCQ pricing, I know the ramp-up for market share for us has been slow, would a part of it be attributable to the fact that we are competing at a materially different price point now?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [64]

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HCQS, let's say, we started shipping from the second quarter of the last year, so -- in the current financial year, and that too a limited number of batches has gone to the US and the marketing partner wanted that at least some kind of stock built up before they start offering. So aggressively that has still not marketed in the US, and those all shipments are getting completed in the month of February and March. So only thereafter, they will aggressively go in the market.

And prices definitely has come down, let's say hundreds tablet bottle, which used to be around $170, $180, may have come down to around $70, $80 or so. So, prices definitely has come down there, definitely. But these prices are significant compared to the previous prices. We used to sell -- at the end customer, price used to be $6 earlier. So compared to that, the prices are still significant, but from the top level, it has definitely come down.

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Anmol Ganjoo, JM Financial - Analyst [65]

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Okay. That's helpful. Lastly, on the domestic business, you had attributed that there were some organizational changes, the effect of which, in terms of reduced expenditure is reflected in numbers this quarter also. But in terms of that process, is it complete or is it still some distance to go or now it's a new normal from where --?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [66]

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No. That process was completed in the last quarter and now it's normal.

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Anmol Ganjoo, JM Financial - Analyst [67]

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Okay. So this quarter is fairly representative of --.

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [68]

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Yes. But we're fairly representative.

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Anmol Ganjoo, JM Financial - Analyst [69]

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Okay. One last question before I get back into the queue, the warning letter that we got was pretty unusual, because it's very rare to see warning letter be issued after an import alert. Post that have you had a chance of any correspondence with the US FDA, which kind of gives us comfort that there is no additional issue or it's just probably FDA trying to set some part of its process in order which got missed at the first place?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [70]

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Normally, the warning letter comes first and then import alert, so warning letter was required to be issued by FDA, and that got issued now. And as far as the issue is concerned, we had a meeting with FDA on February 3, it was scheduled may be around two months back, and I think before the meeting one or two days before the meeting this warning letter was issued and we had a meeting with FDA.

So generally, we get an essence that by and large the corrective and the preventive actions and all those system changes, and as our understanding from the meeting, it emerged that generally they are in line with expectations the FDA has, but the two important things which we need to now address is, number one is get the third-party audit of all the six systems done now and submit to the FDA and FDA would be talking to those consultants. So we are in process of now appointing third-party to do the whatever remediations we have taken, on that the audit process would happen now. So that's the last leg of the work which we need to do.

And third is in respect of the past risk assessment issues, where we have internally done, so there again we need to do it -- the review by third-party. So that we will be designing some kind of protocols and submitting to the FDA. So, those protocols will be submitted to the FDA based on some statistical methods and all. And if there is any kind of FDA's observations are there on those protocols, those issues will be taken into account and then finally the engagement will be there with third-party consultant on all the risk issues.

And by and large, let's say around normal expiry is around three years, out of which 1.5 year is already over. So for 1.5 year period, those kind of risk assessment with the third-party oversight would be done. But as we understand that it is not necessary that every work has to be completed before we approach FDA. There has to be a substantial progress on that and the process has to be set in right, but once the -- so that process starts and we'll be starting submitting those kind of -- through third-party, those kind of reports. And by and large, let's say it may take three, four months' time to do the third-party audits of all the remediation actions and maybe say then submission of report to FDA. So, it may take around six months' time to do all this kind of work. And thereafter, hopefully we should be ready to invite FDA, so that's going to be generally the timeline.

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Operator [71]

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Monica Joshi, Bajaj Allianz.

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Monica Joshi, Bajaj Allianz Life Insurance - Analyst [72]

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Sir, if you could just speak a little more on the cost reductions that you've done on your field force. So specifically to your global promotional markets including India, so what is the kind of reduction you've done across these markets?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [73]

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We have had -- I think in the second quarter of the current financial year, we had a talk that we have discontinued two marketing divisions and we had given the complete rationales that why we have done that. We have one division, which is addressing -- we have around 650 people, which has by and large addressing the anti-malarial products. And certain products, which are common for the pain, so that was the portfolio like Paracetamol and all. And since overall in last few years, we have seen that malaria numbers are not that great and this therapy has not been growing overall in last few years. Some year, there is some growth, and then there is some decline, and therefore we wanted to do some kind of reshuffling in the overall promotional strategies for anti-malarials. And we have one anti-bacterial division, which was promoted by around 300 people, and so those products we merged with by and large, because the customer -- segment remains the same. And these people, which are promoting anti-malarials by and large, they have large amount of promotional efforts in four, five months of the year, and then rest of the month they have nothing great to promote, because that's not a malaria season. So that rationalization we have done that this 350 people's division, we have merged that with your anti-malarial division, and made those -- the product as a combined division. And there we arrived to rationalize around 300 people, overall.

So, that is one part and that will help my anti-bacterial portfolio also to grow, because all the 650 people as against 350 people. 650 people will promote those kind of anti-bacterial portfolio. So, there'll be reduction in overall promotional cost, and there will be reduction in -- and as far as better coverage of all these anti-bacterial portfolio. So that was one particular purpose.

And secondly, we had three cardiac divisions, and some of the cardiac products, which are required to be there with general divisions, which are more, which has reached to the GP level, so those products have been shifted to the GP divisions, and some which were required to specialized division, they have been given to special -- one cardiac division we're reduced, and we have reduced one anti-bacterial division.

So overall, rationalization of this field force has resulted in reduction in overall of 400 numbers, that's we have talked in the last quarter. And that was completed in last quarter, so last quarter that has also resulted in some kind of disturbance in the business, but now business has started progressing again, and we are seeing now some kind of numbers, better numbers coming from anti-bacterials and all. And that is also helping in terms of reducing the overall cost on domestic market.

Anything else you would like to know? Hello.

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Operator [74]

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Sir, just give me a moment. It seems we've lost the line of Ms. Monica. Just give me a moment. Ms. Monica, can you hear us?

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Monica Joshi, Bajaj Allianz Life Insurance - Analyst [75]

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Yes. I can hear you.

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Operator [76]

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Okay. You may go ahead.

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Monica Joshi, Bajaj Allianz Life Insurance - Analyst [77]

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Sir, are there any more reductions on the CIS-Russia part of the business?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [78]

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No, CIS part, there is no reduction as such in the field force and all, we've not done any reduction in the field force. But overall expenditure has come done, because number one, when the market is declining, at that particular point of time, we have also reduced some kind of promotional costs, but we have not reduced the field force as such. And per se, let's say earlier -- because most of the expenditure happens in ruble there. Our expenditure and our remittances are in dollar terms, so overall there is a -- since the business is also reduced, but your expenditure is also reduced, because your salaries are paid in ruble and everything, so you're getting better number for ruble (technical difficulty) led to some kind of reduction in the promotional cost in Russia.

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Monica Joshi, Bajaj Allianz Life Insurance - Analyst [79]

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Right. So, if I can take this ahead, your Q3 margins have essentially been driven by the gross margins. Your -- the restructuring or the cost reduction exercises have come in through Q3, but they have also created some disturbances on your sales. So, as you go into the next quarter, if these disturbances are kind of ironed out, and the full impact of those cost reductions kick in, you think you have a good comfort zone to expand your margins further?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [80]

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Definitely there'll be expansion in margins and we will see much better numbers on domestic market in the fourth quarter of the current year. And also we will see much better numbers on branded promotional market.

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Operator [81]

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Dheeresh Pathak, Goldman Sachs.

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Dheeresh Pathak, Goldman Sachs - Analyst [82]

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Sir, just to understand when you say we have approval from Global Fund, then why are we writing-off because has it reached expiry, what we have produced so far for them?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [83]

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That's what I made clear that these goods were produced in the month of say July or August last year, and Global Fund has very clearly said that they will be taking the materials only, which are post inspection cleared material. So, therefore these materials cannot be shipped, whatever produced earlier cannot be shipped. And they cannot be redressed also, because all the packing materials used were with the Global Fund logos, including blisters and all the cartons and everything. You can change the cartons, but you can't change the blister, because once you change the blisters, then you're re-exposing the tablet.

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Dheeresh Pathak, Goldman Sachs - Analyst [84]

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Understood. So, what you produced right now for Global Fund, that you can sell, right, because you have the approval.

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [85]

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Yes. It's only the stocks, which were produced pre-inspection, they have not accepted that. So, because of that as this event has happened now, so we have written-off now, even though significant expiries was also -- was still there, but these stocks were not expired stock. So because these stocks cannot be shipped, so we've written-off.

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Dheeresh Pathak, Goldman Sachs - Analyst [86]

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Right. And you will produce now only when you get the firm allocation, so you're not producing?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [87]

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We have started producing for the -- your Global Fund, we have not started producing because -- as the allocation happens, we will produce. But for all other markets, like say tender, wherever we are participating, so those productions are on.

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Dheeresh Pathak, Goldman Sachs - Analyst [88]

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Okay. And for the full year, how many, in terms of treatment deduction has been double digit deduction, mid-single digit, high-single digit?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [89]

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Our numbers are very low, because hardly we have -- this financial year, we have not (multiple speakers).

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Dheeresh Pathak, Goldman Sachs - Analyst [90]

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So not our numbers, what I am saying is the Global Fund spend on anti-malarial business, you said there is a decline in the total treatment, and also on the cost. So, what I am saying in terms of total treatments, number of lives covered or whatever that number is (multiple speakers).

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [91]

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Total treatment cost, let's say $1.3 must have come to around $0.70, $0.80 overall, so treatment cost has significantly come down. And overall number procurement, I don't have exact number, but the teams has been telling me that there is around 10% to 12% reduction in the overall number of treatment procurement. So, both the numbers are lower and as far as per treatment cost is low. So overall, I don't have right now the full numbers, but both the impacts are there on the --.

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Dheeresh Pathak, Goldman Sachs - Analyst [92]

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Okay. And per treatment cost reduction will not impact us much, because we will also get the benefit of raw material reduction, right, so on a per --.

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [93]

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Yes. That's there, margins are not getting impacted with the cost per treatment.

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Dheeresh Pathak, Goldman Sachs - Analyst [94]

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Understood. And can you just give a quick break-up of the branded export business for the quarter?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [95]

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By and large branded export business is around INR60 crores as against INR74 crores, and by and large in all geographies there are 18%, 19%, 20% kind of overall reduction is there. So by and large, numbers, which used to be almost around 50%, 60% reduction, that has come down to around 19% reduction.

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Dheeresh Pathak, Goldman Sachs - Analyst [96]

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Okay. And can you call out the US and Canada business revenue for the quarter?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [97]

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Canada business number was good in this particular quarter, because we've done the significant production, so from INR3 crore, it has gone to around INR18 crore in this particular quarter. But that has impacted by the UK business, because in this market, your [bet sizes] are very small, and so that has impacted that business. And overall, US business was around, say around INR22 crores. So, as against let's say INR6.4 crores, which was there in last year for the fourth quarter on US and Canada, this year it's almost around INR40 crore business.

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Operator [98]

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(Operator Instructions) Sameer Baisiwala, Morgan Stanley.

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Sameer Baisiwala, Morgan Stanley - Analyst [99]

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I just wanted to check on HCQS, when you say that by February, March, you'd have supplied a fair bit, when you supply a 30% market share, will it all go at one -- will you supply all of this at one go in Q4, or do you think you have already supplied that in Q3 as well?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [100]

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Some quantity has gone in Q2, some in Q3 and major is going in Q4.

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Sameer Baisiwala, Morgan Stanley - Analyst [101]

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Okay. And so, when you said that US business is INR22 crores, that captures some part of that?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [102]

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Yes. That captures some part of it. Yes.

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Sameer Baisiwala, Morgan Stanley - Analyst [103]

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And it is entirely HCQS, or it includes the [mandatory exempted] products?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [104]

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Another product shipment will happen in the fourth quarter.

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Sameer Baisiwala, Morgan Stanley - Analyst [105]

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No. So INR22 crores is entirely HCQS, or it includes --.

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [106]

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Entirely HCQS.

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Sameer Baisiwala, Morgan Stanley - Analyst [107]

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Okay. Perfect. Sir, the second question is you mentioned that the prices from the peak of $170, $180 have come down now, this is ex-rebates, is it not? This is at your manufacturer level pricing, (multiple speakers)?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [108]

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No, not that. It's the consumer level pricing.

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Sameer Baisiwala, Morgan Stanley - Analyst [109]

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I thought that was more like $300, no?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [110]

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No. It has come down to (multiple speakers) may be around $70, $80 per 100 bottle.

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Sameer Baisiwala, Morgan Stanley - Analyst [111]

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No. At the peak, was it not $300?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [112]

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No. It was around $200. Peak was around $180 to $200.

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Sameer Baisiwala, Morgan Stanley - Analyst [113]

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Okay. Got you. And so, sir, just if you have to throw a number in the air, what you think would be the -- at this price, at this volumes be the size of the market, and that is a number that has been (inaudible) so far.

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [114]

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Maybe around $300 million to $350 million, it's my guess, it's just a guess work.

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Sameer Baisiwala, Morgan Stanley - Analyst [115]

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Okay. That in your estimate after price erosion, is this current size of the market?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [116]

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Yes.

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Sameer Baisiwala, Morgan Stanley - Analyst [117]

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Okay. And this is at the manufacturer level?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [118]

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Yes.

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Sameer Baisiwala, Morgan Stanley - Analyst [119]

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Okay. So if you were to get 30% market share, you will probably be clocking $100 million?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [120]

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No. That's the consumer level, so, no $100 million is out of question.

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Sameer Baisiwala, Morgan Stanley - Analyst [121]

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Okay, sir. This is very helpful. And second, I think we got dropped off for about 5, 10 minutes, so you might have talked about it, so on the FDA side for the three facilities, when do you think is the earliest that you can be inviting FDA for re-inspection?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [122]

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As I've already said that in the meeting with FDA, what we get and generally understanding -- our understanding based on the meeting is that we are by and large generally in line of expectations as far as the remedial actions are there. But they want the third-party, the certifications of that before we invite, so we are appointing a third-party consultant, that process is on. To do a audit of all the three facilities on, let's say, your GMP compliances of all the six systems, so that work will happen now.

And the second issue, which is there, is relating to the past risk assessment in respect of the -- these issues were there. And we have done the risk assessment and submitted to FDA, but FDA wants that also some kind of third-party audits and others. So that protocols are under working, and we will be submitting the protocols to FDA. If the FDA has any comment to offer, they will offer on those or if they don't offer any comment then those protocols will be finalized, and with the third-party consultants, we'll be working to do the -- some kind of risk assessment in respect of past. But as we understand from the meeting that it's not necessary that 100% has to be completed before we -- in respect of past work that has to be -- the protocol has to be finalized, substantial work should happen and some kind of progress report should go to the FDA, and

GMP audits by and large once the third-party consultant conducts of all the three plant. At that point of time, we should be ready to re-approach FDA.

And we are currently in a process of finalizing third-party for the audits, and also we'll be working out the timeline. And as and when that happens, but overall it can happen -- everything can happen in six months' time, that is what is the preliminary understanding what we are developing, but as we interact with the consultant and all, the final timeline would be decided thereafter.

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Sameer Baisiwala, Morgan Stanley - Analyst [123]

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Okay. So in six months' time, do you think you will get a third-party certification?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [124]

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That's what we hope for, because so far we are not -- we have just started the engagement with third-party, and still not finalized. So once we maybe -- maybe in a week or 10 days' time, all these work would start happening. At the same time within say, next eight, 10 days, and also we need to reply to the warning letter, which is received.

So, right now, team's first priority would be to reply to the warning letter and then finalize all these protocols and protocols with your third-party inspection. So, first is the warning letter reply, and then this work. So, it may take some time, but I think overall maybe -- our initial guess is that it may take around six months' time. But, there could be some slippage here and there depending on, let's say, availability of consultant time and all that for these inspection.

But, maybe I think we will be in a position, maybe after 15, 20 days' time, once we have replied to the warning letter and walked out with consultant, exact timelines that what kind of timelines they will take. In respect of the audit of all the three plants and in respect of your audit of all the risk assessment what we've done, then we'll be in a position to fairly come out with the timeline.

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Sameer Baisiwala, Morgan Stanley - Analyst [125]

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Okay. So, after that then you would be inviting FDA for re-inspection and then hope everything goes well, FDA would give a clearance, so that would be the right understanding?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [126]

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Yes. That would be the right understanding.

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Sameer Baisiwala, Morgan Stanley - Analyst [127]

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And all of this would take -- the second part would take how much time thereafter?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [128]

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Because normally FDA doesn't give the timeline, so it's very difficult to say the timeline, but let's say that within this period we will invite FDA, then FDA thereafter comes, it depends on FDA that if there is inspection schedules then they may visit tomorrow or they may take three months' time. So it's very difficult today to say that how much time they will take to re-inspect and clear. So it's only as the time passes we'll be getting clarity.

Our first priority to see that we conduct the complete remediation, whatever we have done, the audit of remediation from third-party, and also in respect of risk assessment, what we've submitted in respect of past, that also some kind of progress on that, substantial progress on that, number one, that progress would include finalizing the protocol with FDA, then finalizing those protocols with the third-party auditors and then initial some kind of reports, but as we understand in the meeting that it is not necessary that before we approach for inspection, the 100% work in respect of -- that need to be complete, but there has to be some substantial progress with third-party. So that -- then we should be in a position to approach FDA. So that's the two important work now we need to do in next few months' time.

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Operator [129]

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(Operator Instructions) Manoj Garg, Merrill Lynch.

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Manoj Garg, Bank of America Merrill Lynch - Analyst [130]

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Sir, just would like to understand that on this Global Fund anti-malarial business, this used to be around $400 million or $300 million kind of dosage, if I recollected it properly?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [131]

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Yes. More or less in line with that.

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Manoj Garg, Bank of America Merrill Lynch - Analyst [132]

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Okay. And now we are talking about 10% deduction in terms of quantity and maybe 70%, 80% or almost 50% of the prices, what it used to be?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [133]

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Yes. Price reduction in significant.

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Manoj Garg, Bank of America Merrill Lynch - Analyst [134]

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And second, sir, just want to understand about this emerging market branded business, while we have seen that at least, there is a significant reduction in terms of the degrowth, and going forward we are pretty hopeful in terms of growth recovery. How are we hedging our currency risk, because I think currency still is pretty volatile in most of these markets, and how are we hedging our currency risk out there?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [135]

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It's by and large, if you look at -- it all depends on, let's say, by and large because Russia is a commodity kind of country and oil is the major revenue. So with the oil prices move further, then there would be a much better improvement, because our pricings are linked -- currently what pricing we have done is that around say, ruble at around 85 level. And ruble currently is maybe around 75 to a $1, and if there is a further improvement then we may, whatever price reduction, which has happened from here, there can be a further price increase, so that the customer price has remained at the same level.

So, there could be improvement there, if oil prices from current level move again to the level of around $40, $45, $50 level, and that's what the reports were now we are getting that, maybe in the one-year time oil prices could be around $40, $50 level. So, I think the -- but if oil further goes down to maybe around say level of $25 and all, towards that, then there could be some more reduction in the prices, because end product consumer prices we don't want to impact that, because price increase is out of question there. Even though, we can do because, but consumer then they cannot afford the prices there.

So, looking in terms of ruble prices to consumer, currently we have done the pricing at around 85, but as the ruble to dollar, as it keeps on improving, we will keep on improving our dollar prices from here. So that could be a two advantage, one is overall market improvement and other is the price improvement from the current absolutely low level of pricing. So, both advantage could be there if the dollar goes up. But if dollar goes down, then we will -- because our shipments are in dollar terms, so we can't hedge the ruble that we will have to adjust our pricing only.

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Manoj Garg, Bank of America Merrill Lynch - Analyst [136]

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And even in Africa also, we supply through in the dollar term only, or we supply out there on the local currency in African market?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [137]

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No. Everything is in dollar terms.

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Manoj Garg, Bank of America Merrill Lynch - Analyst [138]

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In dollar terms only. But sir, have you seen any reduction in terms of overall demand between the Russia given the economy recession or like the kind of economic status at this point of time. Have you witnessed some kind of slowdown even in the demand also?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [139]

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I think overall market has declined by around 30%. If you look at the overall Russian number that has declined in that number.

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Manoj Garg, Bank of America Merrill Lynch - Analyst [140]

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In terms of volumes like --.

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [141]

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No. At overall market size, the volume decline maybe around 7%, 8%, 10% kind of volume decline.

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Operator [142]

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Charulata Gaidhani, Dalal & Broacha.

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Charulata Gaidhani, Dalal & Broacha - Analyst [143]

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My question relates to the write-off of INR24.75 crores for regulatory matters, any more write-offs that you're planning in the following quarters, and how much will be the total estimate of regulatory cost?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [144]

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Let's say -- I think there is no one-off now left, in overall may be around in this year one-offs maybe in the line of excluding your [pieces], which are paid to the regulators, not regulator, the consultants and remediation cost. But all these write-offs and other things put together, because we have earlier written-off the US related stocks and now Global Fund related stock. There were failure to supply claims and all those kind of thing. So put together, that number could be almost around INR80 crore in the whole financial year, till now.

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Charulata Gaidhani, Dalal & Broacha - Analyst [145]

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Okay. Of which you have written-off --.

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [146]

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Everything we have written-off for close to [around INR80 crore] is the number in first nine-months of the current year. As of now, there is no known matter on which I need to do -- take any write-off in the fourth quarter of the current year. But one-off regulatory, these kind of consultant cost and that would continue and that cost is extra.

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Charulata Gaidhani, Dalal & Broacha - Analyst [147]

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That would be how much roughly?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [148]

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That depends on what kind of work they have done, and so, it's difficult to estimate, but in the current year we must have paid around INR10 crores, INR12 crores already. And before the quarter also a good amount of those [pieces] could be there, and maybe more than that we have paid. I don't have exact number right now, but it's definitely more than INR10 crore.

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Charulata Gaidhani, Dalal & Broacha - Analyst [149]

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Okay. My second question is, what is the percentage of malaria to the total sales?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [150]

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Malaria might -- domestic business has come down to around 13% of overall numbers now, which used to be around 16%, 17%. Last year it was 15%, now it's around 13%. And overall anti-malarials for contribution as a company as a whole is around 14% now. So, if you look at my -- overall if 100 is number, cardiovasculars in my balance sheet contribute almost around 29%, anti-malarial contributes 14% of the overall business. Pain contributes around 27% and others contribute around 30%, that's the broad bifurcation of the Company as a whole, including domestic, API, exports, everything put together.

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Charulata Gaidhani, Dalal & Broacha - Analyst [151]

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Okay. So, the domestic growth that has taken place in which area?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [152]

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The number one area, let's say, if you look at my domestic pipe, overall the malaria has gone down by 2%, and my pain segment has moved up by 2%. All other remains -- in pie it has remained at the same level. So by and large that's the change that 2% malaria business has gone down and 2% pain business has moved up.

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Operator [153]

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Saion Mukherjee, Nomura.

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Saion Mukherjee, Nomura Securities - Analyst [154]

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Just wanted to check if you could help us with the ballpark figure of the remediation costs that you guys have booked in this quarter for the third-party agents that you will be hiring, and whatever remediation costs has been during this quarter?

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [155]

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I don't have those ready numbers, what I have paid for the consultant, but overall cost for the whole year may is more than, I think, INR12 crore, INR13 crore.

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Harish Kamath, IPCA Laboratories Ltd. - Corporate Counsel & Company Secretary [156]

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[We] bill these costs based on the hour work, so every quarter it will change. Okay. They are all hourly billings.

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Saion Mukherjee, Nomura Securities - Analyst [157]

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Okay. Thank you for that and going forward, do you see this to continue at that level only?

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Harish Kamath, IPCA Laboratories Ltd. - Corporate Counsel & Company Secretary [158]

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Yes. That will continue at that level only. Maybe slightly initially it will be more, but then it will taper down thereafter.

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Operator [159]

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Ladies and gentlemen, due to time constraints, that was the last question. I now hand the conference over to Mr. Nitin Agarwal for closing comments.

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Nitin Agarwal, IDFC Securities Limited - VP - Research [160]

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Mr. Jain, you want to add any last comments or we can close the call.

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A.K. Jain, IPCA Laboratories Ltd. - Joint MD [161]

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Let's say, we are fully committed to the -- addressing all the issues and we are generally in that particular process and we are confident in rebuilding of the whole business once again. Thank you for being patient with us and supporting the Company. Thank you.

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Nitin Agarwal, IDFC Securities Limited - VP - Research [162]

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Thank you. Thanks, everyone for taking the time out and participating in the call and thank to the IPCA management team also.

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Operator [163]

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Thank you. On behalf of IDFC Securities Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.