



“CIPLA Limited”

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**MODERATORS: MR. AJAY LUHARUKA
MR. V.S. MANI**

Moderator: Ladies and gentlemen good evening and welcome to the Q3 FY'12 Results Call of CIPLA hosted by Kotak Securities Limited. As a reminder for the duration of this conference all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions at the end of today's presentation. If you should need any assistance during the conference call please signal an operator by pressing "*" and then "0" on your touchtone telephone. Please note that this conference is being recorded. At this time I would now like to hand the conference over to the management of CIPLA. Thank you and over to you sir.

Ajay Luharuka: Good evening to all of you and welcome to the third quarter earnings call. We have with us Mr. V.S. Mani our CFO. We hope you have received the financials and the performance highlights which has been uploaded on our website. We would like to give you an overview of the financials which can be followed by a question and answer session. During the current quarter the company posted a growth of more than 13% in income from operations, domestic sales grew by more than 18% and export sales grew by about 11% for the quarter. Operating margins and profits after tax have increased by about 23% and 16% respectively on a year-on-year basis. Material cost has decreased by about 4.7% on a year-on-year basis this is mainly on account of rationalization of product mix and markets. While such measures would result in increased margins, there could be an adverse effect on revenues in the short-term. The increase in staff cost of 52 Crores is due to annual increments as well as increase in manpower and which is in line with the previous quarter. Other expenditure has increased by about 56 Crores mainly due to increase in selling expenses, professional fees and factory expenditure such as repairs and maintenance, power and fuel, etc. The increase in selling expenses is in line with the increase in turnover. The tax for the current quarter has increased mainly due to expiry of tax benefits on EOUs. The total capital expenditure for the quarter is about Rs.130 Crores and we expect the total capital expenditure for the year to end at around 500 to 600 Crores. On the foreign exchange side as on 31st December 2011 the outstanding amount of forward contracts is about \$220 million, which substantially covers the outstanding debtors. During the quarter the company had gained Rs.4.5 Crores on account of foreign exchange gains. With this overview I would like to leave the floor open for questions. Mr. Mani and my self are available to answer the questions that you have. Thank you.

Moderator: Thank you so much sir. We will begin with the question and answer session. We have a first question from the line of Girish Bakhru from HSBC Securities. Please go ahead.

Girish Bakhru: I wanted to ask on the bulk side there has been very strong growth any particular reason for that?

Ajay Luharuka: On the API exports certain API and ARV sales has done very well during the quarter.

Girish Bakhru: What would be the proportion of ARV sales in this quarter?

Ajay Luharuka: Overall ARVs would be roughly about 25%.

- Girish Bakhru:** This forex gain is included where in the P&L item?
- Ajay Luharuka:** It is included in the other operating income.
- Girish Bakhru:** Okay, and lastly on the India business, which has done exceedingly well this quarter, is there any one off to that or this kind of rate is sustainable going forward?
- Ajay Luharuka:** In the domestic segment the generic generic business has done very well, there has been a growth of about 36% and in the branded generic segment there has been a good growth in the Anti-Asthma segment for the quarter.
- Girish Bakhru:** But is this largely sustainable- this trend you would say?
- V.S. Mani:** Yes, in expect this trend to be quite sustainable about like 15% - 16% growth in domestic is something we see at least visibility in the next three quarters.
- Girish Bakhru:** **Ok ok, I will join the queue.**
- Moderator:** Thank you. Our next question is from the line of Bino Pathiparampil from IIFL. Please go ahead.
- Bino Pathiparampil:** I have missed that ForEx gain what you gave.
- Ajay Luharuka:** It is 4.5 Crores for the quarter, a gain of 4.5 Crores.
- Bino Pathiparampil:** Okay, I was wondering given this basically weaker rupee in the quarter compared to the previous one margins should have ideally basically improved over the preceding quarter and plus also given with this good performance in domestic market so overall it looks like the margin has been significantly weakened compared to the prior quarter, what is happening there?
- V.S. Mani:** See if you really look at it- our overall material cost has actually definitely improved vis-a-vis the quarter in the previous year, so that way if we look at it the margin has definitely improved and if you look at the operating margin also it is better than the quarter in the previous year. Vis-a-vis if we look at just purely the last quarter yes it is down by about -2% but that's largely on account of there are other items in spite of the improvements in material cost the operating margins have not corresponding increased largely on account of 2% increase in the staff cost and also reduction in other operating cost due to reduction in technical fees. If you take this about a percent we lost there so taking this 2 and the 1 - 3% that is why the operating margins looks a little weaker as compared to the previous quarter. But on an overall basis if we really look at it as an operating margin or if we look at slightly as a gross margin definitely it has improved.
- Bino Pathiparampil:** Right and also sequentially we are not seeing any growth in the export formulation so as the facilities ramp up and capacity utilization improves so sequentially we were expecting some sequential growth that is over again the 2Q numbers.

- V.S. Mani:** See to some extent we have been doing some rationalization of the product mix and also the markets. Also while in the short-term this may look like it looks a little lower but on a longer-term it would definitely give us a better margin. In addition there were certain segments such as anti-malarials and anti-retrovirals which are tender business and are dependent on availability on fund from the NGOs and global funds.
- Bino Pathiparampil:** **Ok thanks.** One clarification ARV is 25% of what?
- V.S. Mani:** That we have talked about the bulk drug sales.
- Moderator:** Thank you. Our next question is from the line of Krishna Prasad from JM Financial. Please go ahead.
- Krishna Prasad:** Just quickly on if you can provide us with what is the constant currency sales for export formulation the reported number is 9%, if you can give us what are the constant currency growth sales?
- V.S. Mani:** Yes, as we explained it is due to rationalization and also due to basically some of these markets not really picking up well it is a bit flat compared to the previous year so basically it takes into account this rationalization measures that is why it looks a little low.
- Krishna Prasad:** Okay, can you provide us the breakup of the formulation by geography I mean the export formulation by geography?
- Ajay Luharuka:** Yes, Africa it is about 30% to 40%, Europe is about 20%, North and South America will be another 20%, Middle East about 8% to 10%, Asia will be another 10% and Australia about 5%.
- Krishna Prasad:** Okay and in terms of how this would look versus our base period where would the rationalizations have happened significantly?
- Ajay Luharuka:** It is basically if you compare to the last year quarter there would be minor changes here and there but what we should see is on an overall basis for the nine-month period there would not be any significant changes geography wise.
- Krishna Prasad:** No, but for the quarter where would the change for have been significant in terms of the geography?
- Ajay Luharuka:** For the quarter the change would be in certain regions like Europe, Asia, and to some extent Middle East?
- Krishna Prasad:** Where we have done lower for the period?

- Ajay Luharuka:** There could be some areas which are better, some would be lower so it will offset each other. Like I told you for the nine-month period there would not be much changes overall.
- Krishna Prasad:** Okay, and would it be possible to provide the impact of currency on our EBITDA margin as well and in terms of percentage points how much currency would have impacted.
- V.S. Mani:** It would not really impact us that much for the reason being that while the exports are going up again our imports are also offsetting to some extent and also because of this when you take it as a percentage and more or less it comes in line that is how it goes.
- Krishna Prasad:** Okay Thank you, that's it from my side.
- Moderator:** Thank you. Our next question is from the line of Neha Kothari from Standard Chartered. Please go ahead.
- Ravi:** Just one question actually so far the last couple of years we have seen that our margins have been really held up by in the gross margin side when do we actually begin to see some beneficial impact of all these fixed cost in terms of the operating leverage given to the company. If I guess from a gross margin perspective we are pretty much there in terms of what the essentially our peers are doing, so when do we see that operating leverage not coming in to the company.
- V.S. Mani:** See over the last couple of quarters even in our SEZ or commercial facilities there have been certain amount of ramp up so I guess if we look at Indore assets earlier last year it was not much this quarter we have done about 130 Crores looking at the year about 600 to 700 Crores so I guess maybe in a couple of quarters we should be able to definitely see the benefits of the ramp up slowing down to the OPMs also increasing.
- Ravi:** See just on a like-to-like comparative.
- V.S. Mani:** But you must have definitely noticed one thing that our gross margins have improved much more than compared to the previous margin.
- Ravi:** One comparison going to need from our Q3 last year was there a forex gain or loss in the last year numbers?
- Ajay Luharuka:** Yes, there was the forex gain in the last year numbers.
- Ravi:** And what was that?
- Ajay Luharuka:** About 3.4 Crores last year.
- Moderator:** Thank you so much sir. Our next question is from the line of Sameer Baisiwala from Morgan Stanley. Please go ahead.

- Sameer Baisiwala:** Is it possible to share what is the growth outlook for formulation exports it is not a quarter-to-quarter it is just going out for six quarters.
- V.S. Mani:** We are looking at a growth of about 10% year-on-year basis.
- Sameer Baisiwala:** Okay, and on the Indore facility is it possible to share how much we are doing from oral versus the other forms such as topical injectables and others?
- V.S. Mani :** I will have to get back to you on that I will definitely note that and come back to you on that.
- Moderator:** Thank you. Our next question is from the line of Nitin Agarwal from IDFC Securities. Please go ahead.
- Nitin Agarwal:** When we talk about the rationalization of the export business so what are the sort of businesses are we looking to rationalize primarily?
- Ajay Luharuka:** Nitin when you talk of rationalization what we have mean to say that each business and each market and major product segments are being reviewed in terms of the arrangements which we have with our customers and what we are doing is that we are reviewing the arrangements and renegotiating and wherever we feel that the profit margins are not reasonable again we are taking a conscious call as to whether to continue or not. Like we said earlier in the ARV segment we have already done a similar approach we are continuing to other segments and other markets as well.
- Nitin Agarwal:** So is it possible to get some handle on or assume for the year for the nine-month what would have been sort of business that you would have discontinued as a result of this conscious policy?
- V.S. Mani:** It is an overall portfolio so it will be difficult to isolate, if you notice the results you can see an improvement in the material cost on account of this rationalization but yes we have also seen the effect on the turnover as well. So it is reflecting already in the results.
- Nitin Agarwal:** But, will this rationalization sort of have any beneficial impact on our overheads also or is it not going to help us?
- V.S. Mani:** It would definitely help our overheads also so all this would help us to improve our facilities better and obviously look at more profit margin.
- Nitin Agarwal:** When do you think the base effect of the rationalization would be behind us as far as the numbers are concerned export formulation numbers?
- Ajay Luharuka:** It is difficult to say but they are it could take about two to three quarters.

- Moderator:** Thank you. Our next question is from the line of Ranjit Kapadia from Centrum Broking. Please go ahead.
- Ranjit Kapadia:** My question relates to ARV business we have achieved a 25% growth in API business is it possible for you to split in the volume and value terms or what is the outlook for this business?
- Ajay Luharuka:** Ranjit just to clarify the growth in API business it is 18% and what we mentioned was that ARV is around 25% within the API business itself.
- Ranjit Kapadia:** Okay, ARV is 25% of API sales. I just wanted to know what is the outlook for this business and are we facing stiff competition in terms of pricing or it is all the volume driven growth?
- V.S. Mani :** Some of these sales are to niche parties and key markets while I will not be able to give you the names but then we are looking at profitability rather than look at these numbers.
- Moderator:** Thank you. Our next question from the line of Amit Thakkar from Amba Research. Please go ahead.
- Amit Thakkar:** Two questions, number one on the domestic formulations you did talk about 38% growth from the generic-generic business. How much there is account for generic-generic business in this quarter?
- Ajay Luharuka:** Generic-generic would be roughly about 15 to 20% of domestic revenues.
- Amit Thakkar:** In this quarter or would it be for the nine months?
- Ajay Luharuka:** Yes for the nine months.
- Amit Thakkar:** The other one was- if I look at your previous quarter you had fairly hefty growth in formulation 750 Crores and it has now come down to 700 where you did state rationalization in the second quarter did you have some one off sales happening that quarter or what is it has fell sharply and it is now down despite a help by rupee?
- V.S. Mani:** **One,** Quarter to quarter also there are some slight variations in the cycles also secondly as I said some of the products like say in formulation especially anti-retrovirals and anti-malarials they depend upon what kind of facility you get in terms of global NGO or whatever it is, so sometimes there are sales that keep moving between quarters so it is possible to that extent there is a marginal effect, you might feel better in the next quarter.
- Amit Thakkar:** But one thing because last quarter we also had margins being quite good so we had these additional sales coming in with better margins whereas this quarter the last rationalization happening yet margins on sequential basis coming a bit of a lower side so is there anything that we should look at?

- V.S. Mani:** No you look at it that way if you look at gross margin they continue to be where they were, it is only at the you at the net margins level where you look at EBITDA levels where you find it little lower where you explain that actually it partly due to the staff cost and basic reduction in the technical fees you know these two put together pulled it down by about 2 to 3% so I guess some of these over a period of 2 to 3 quarters we expected to be sort of streamlined and in line.
- Amit Thakkar:** The rupee, the sharp depreciation of almost 15% in the December quarter itself it has not substantially benefited you in anyway is it?
- V.S. Mani:** Not substantially because 40% again is imports and then net when you really take out and look at it if you take the benefit of that as a margin of the top line it really does not give that kind of a benefit. So that why is more or less?
- Amit Thakkar:** Yeah how much has been the Indore formulations 130 Crores in the quarter?
- Ajay Luharuka :** Yes 130 Crores for the quarter.
- Moderator:** Thank you. Our next question is from the line of Kartik Mehta from Daiwa Capital. Please go ahead.
- Kartik Mehta:** Can you explain us the elasticity of the ARV business- is it actually seasonal or do you actually have a aggressive bidding- when you think that the dollar is actually favorable because and also if you can of the total exports what is the ARV including API or formulation?
- Ajay Luharuka:** Like we mentioned earlier ARV business is dependent on basically it is tender business so it is dependent on getting the tender number one and number two it is also dependent on the availability of funds from various NGO's. So on a quarter to quarter basis there would be fluctuations in ARV's and anti-malarials where these are external factors which affect the business and not really under our control. And the total ARV sales what we mentioned earlier is for the quarter, the proportion of ARVs to total exports it was about 23 to 25% for the quarter.
- Kartik Mehta:** In a normal situation what is the tenure do you have to actually complete all of it in one particular quarter or is it for a period of year?
- Ajay Luharuka:** That depends on the tender terms and conditions, certain tenders could be deliverable immediately, certain tenders will have staggered delivery.
- Moderator:** Thank you. Our next question from the line of Aditya Khemka from Nomura. Please go ahead.
- Aditya Khemka:** Just a small question on the generic-generic business- we have seen some very good growth in generic-generic business so could you just tell us in brief what could be the drivers in this business and what are the margins like because if I understand the business correctly there is not enough promotion expenditure that goes behind the business but at the same time the margins for

the distributors and the pharmacists are higher in this business. So what do the margins look like compared to the branded formulation business and what is driving growth there?

V.S. Mani: Off course that is the different kind of a business where there is a basket of products you know and as you said very rightly there is not too much of promotion going on and overall the margins are definitely slightly bit lower than what you get overall. We would not be in a position to give the exact margin but it is slightly lower than normal.

Aditya Khemka: And what is driving growth in the business exactly what are we doing differently to get this kind of growth?

V.S. Mani: See there are different kinds of- this quarter there have been good business of you know slightly on the exports trends and on the antibiotics and those kinds of thing anti-inflammatory couple of products have done so as I said that is more of a basket of products that are sold.

Moderator: Thank you. Our next question from the line of Adi Narayan from Bloomberg. Please go ahead.

Adi Narayan: This is not exactly related to the earning itself but with the US FDA coming out with new guidelines for dealing with biosimilars just wondering if you could give me an update on the deal that you had with us to biosimilars companies MabPharm, BioMab and Desano.

Ajay Luharuka: The joint ventures which we have for biotherapeutic products, the current status is that the work on clinicals and regulatory work for India has already started and depending on the regulatory approvals, the product may be ready for launch in the next two to three years.

Adi Narayan: And this is for MabPharm or BioMab.

Ajay Luharuka: MabPharm.

Adi Narayan: With BioMab is Desano Company is that still also in progress?

Ajay Luharuka: This company is based in China and that is also in progress.

Adi Narayan: And any visibility on that like which drugs are working on with them or what kind of therapies you are working on with them?

Ajay Luharuka: These are basically anticancer products and again I mean it will take 2-3 years for any launch from either of the facilities.

Adi Narayan: Any name which one, cancer products these are?

Ajay Luharuka: No we would not be in a position to divulge the details because of confidentiality agreements.

- Moderator:** Thank you. Our next question is from the line of Saion Mukherjee from Nomura. Please go ahead.
- Saion Mukherjee:** I have a couple of questions- first you talked about rationalization this quarter we have seen us strong sales in bulk ARV at the same time you mentioned about ARV one segment which is rationalized out , I am just confused as to what are you indicating by rationalization?
- V.S. Mani:** Basically what we indicated was the ARV sales in the formulation side there we had done some amount of rationalization.
- Saion Mukherjee:** So the bulk ARV sales?
- V.S. Mani:** We could basically sell to some niche parties but we definitely got good realization.
- Saion Mukherjee:** And in response to one of the earlier questions you talked about your expectation of export formulation growth of 10%, year-on-year basis, I mean is this in line with your original expectation or this expectation is a bit toned down?
- V.S. Mani:** It is more or less in line give and take a few points here and there it is more or less in line.
- Saion Mukherjee:** Are you seeing any issues on the receivable sides?
- Ajay Luharuka:** No we do have no such issues on the receivable side. Our receivables are under control in fact if you compare to last year it has improved and right now it will be about the overall receivables will be about 95 days of turnover including exports.
- Saion Mukherjee:** Will it be possible for you to share the level of R&D expenditure for the nine months or an indicative growth rate over last year?
- Ajay Luharuka:** It will be the roughly about 3 ½ to 4% for the full year and you know nine months will have a similar trend.
- Moderator:** Thank you. We have our final two questions second last from the line of Prakash Agarwal from RBS. Please go ahead.
- Prakash Agarwal:** A question on inhalers could you give an update on the filings and the approval status, European and the filing status for US?
- Ajay Luharuka:** On the European side as mentioned earlier there are about 11 inhalers which we are working on for the European market and so far we have received approvals for four products in certain markets and the other products are in various stages of regulatory approvals and what we believe is that in the next two years some of these approvals are likely to be received and would get commercialized.

- Prakash Agarwal:** These include combination products.
- Ajay Luharuka:** Yes these include combination products as well.
- Prakash Agarwal:** And in the US have you filed for the combinations, or you are in this process?
- Ajay Luharuka:** Prakash this will be in the process but right now we cannot really divulge any details of US filings.
- Prakash Agarwal:** No but have you filed or you are in the process of filing that is what I want it to understand?
- Ajay Luharuka:** Again this will be in various stages of approval so we would not be able to mention the exact status.
- Prakash Agarwal:** Any update on the US FDA approval on your facilities?
- Ajay Luharuka:** Indore for certain dosage forms the process is under way but as you know US FDA will take some time.
- Prakash Agarwal:** So any time line you expected on your middle the year or something?
- Ajay Luharuka:** May be a year or two maximum.
- Prakash Agarwal:** And lastly on the margins front I just wanted to understand basically the contribution of margins in domestic should be better and exports margins are comparable to domestic or would be lower than your average margins clocked in by in the quarter?
- V.S. Mani:** May be marginally lower but more or less in line with each other.
- Prakash Agarwal:** The domestic is definitely superior given your product?
- Moderator:** Thank you. We have our final questions from the line of Sudarshan Dhamal from Allard Partners. Please go ahead.
- Sudarshan Dhamal:** This is mainly to get a macro view on the domestic market regulation part. What is happening on the draft pharma policy, any timeline which has been decided that the policy will go through the group of ministers the cabinet and finally through the parliament because Supreme Court is involved this time and any comments on expected final draft based on recommendation given by obviously by various parities.
- V.S. Mani :** I think it is in discussion stage so people are waiting for the comments, as of now I do not think there is much to say beyond what has already been discussed.

Moderator: As there are no further more questions at this time I would like to hand the call over to the Management for any closing comments.

V.S. Mani : Thank you for attending the call.

Moderator: Thank you so much on behalf of Kotak Securities Limited that concludes this conference.