



## “Cipla Q3 FY13 Earnings Conference Call”

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**MODERATOR: MR. KRISHNA PRASAD – ANALYST, KOTAK SECURITIES**

**Moderator** Ladies and gentlemen good day and welcome to the Cipla Q3 FY13 Earnings Conference Call hosted by Kotak Institutional Equities. As a reminder all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during this conference call please signal an operator by pressing '\*' followed by '0' on your touchtone phone. Please note that this conference is being recorded. At this time I would like to hand over the conference to Mr. Krishna Prasad. Thank you and over to you, Sir.

**Krishna Prasad** Hi, good evening everybody and welcome to the third quarter Cipla Earnings Call. We have with us Mr. VS Mani, the Chief Financial Officer and Mr. Ajay Luharuka who is the Head of Treasury. I now hand over the call to Mr. Ajay.

**Ajay Luharuka** Thank you Krishna. Good evening to everyone and welcome to the Third Quarter Earnings Call. We hope you have received the financials, the performance highlights and the press release available 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 about 18% in income from operations. Domestic sales grew by more than 10% while export sales grew by about 28% for the quarter. Operating margins have increased by more than 25% and profit after tax at Rs. 340 crores grew by 26% on a year-on-year basis.

Material cost has decreased by about 3% mainly on account of changes in product mix which is higher contribution of antidepressants and anti-allergics segments coupled with increased realizations. As a result operating margins have also correspondingly increased by more than 1%. The increase in staff cost of Rs. 71 crores is due to annual increments as well as increase in manpower. Other expenditure has increased by about Rs. 57 crores for the quarter mainly on account of increased travel expenses, professional charges, etc.

Tax for the current quarter has increased due to higher profits. On the foreign exchange front as of 31<sup>st</sup> December 2012 the amount of forward contracts is about \$210 million which substantially covers the outstanding debtors and for the quarter the company had a gain of Rs. 19 crores on account of foreign exchange movements. With this overview I would like to leave the floor open for questions. Mr. Mani and myself are available to answer any questions you might have. Thank you.

**Moderator** Thank you very much. Participants we will now begin with the question and answer session. We have the first question from the line of Manoj Garg from Edelweiss. Please go ahead.

**Manoj Garg** Ajay like sequentially we have seen almost around 40 crores increase in the other expenditures from 483 crores to around 521 crores, is it all operational or there is one-off element in this other expenditures?

**Ajay Luharuka** Manoj it is mainly operational. There is no major one-off element.

**Manoj Garg** So even on the forward contracts there was no mark-to-market or any Forex loss in this line item?

**Ajay Luharuka** No. In fact like I mentioned there is a gain of 19 crores for the quarter.

**Manoj Garg** Which is in the other income.

**Ajay Luharuka** Yeah.

**Manoj Garg** Another thing is if I look at in terms of other operating income for the last couple of quarters we have been doing anywhere between 35 to 40 crores kind of run rate excluding technology fees; however, for this quarter the other operating income is around 23 crores so again is there something which we are missing out or is it a new norm now?

**Ajay Luharuka** Current quarter it is 39 crores.

**Manoj Garg** This includes technology fees of 16.81 crores.

**Ajay Luharuka** Yes and we had export incentives.

**Manoj Garg** Yeah that is 23 crores.

**Ajay Luharuka** Export incentives for the current quarter is lower than the previous quarter.

**Manoj Garg** Because last couple of quarters we have had a run rate of 35 to 40 crores.

**Ajay Luharuka** Yeah so it is 40 for the quarter but within the 40 also the export incentive component is lower than the previous quarter. That is mainly because as you are aware DEPB has been discontinued so there will be an impact of DEPB discontinuance so that's why you will find other operating income coming down to some extent.

**Manoj Garg** About domestic growth though we have still been able to track the industry growth but it was definitely substantially lower than what we have seen in the previous quarters and even in the last con-call we were indicating that at least in the domestic market we should be able to grow in the range of around 15% to 16%. So do we hold that kind of growth guidance as we move forward?

**Ajay Luharuka** Yeah Manoj if you see for the nine months we have grown at 17% on the domestic segment and if you see the past track record, usually in the third quarter QoQ growth is lower so for the year our guidance still remains that we will hopefully exceed 15% on the domestic side.

**VS Mani** But in any case you will appreciate that IMS growth for the whole industry itself is lower and we are all part of the industry.

**Moderator** Thank you. We have the next question from the line of Chirag Talati from Esprito Santo. Please go ahead.

**Chirag Talati** I have couple of questions. Firstly, is there any milestone income booked from Dymista launch in this quarter?

**Ajay Luharuka** No, not really.

**Chirag Talati** And were there any recurring sales in this quarter from Dymista and also any stocking element that was there in these quarter numbers?

**VS Mani** Dymista forms a very small proportion. We just started shipment so it is not very large.

**Moderator** Thank you. We have the next question from the line of Girish Bakhru from HSBC. Please go ahead.

**Girish Bakhru** Just following on Dymista if you can give an outlook given that now Meda has now a European nod as well and US launch has so far has been very soft. Where do you think this product will go to and how much contribution can it be for Cipla, say, in fiscal 2014?

**VS Mani** European launch will also start in a quarter or two. It looks very promising and there has to be a certain amount of effort put in terms of trying to market this product. But initial things do look good but to give you a number will be very difficult right now.

**Girish Bakhru** And just on the inhaler side if you can just give a growth number, how the inhaler business in the exports market has done in this quarter and from emerging markets like Russia and South Africa?

**Ajay Luharuka** If you don't mind can I get back to you little later with the exact break-up.

**Girish Bakhru** Sure and just lastly how much is the current cash in the books?

**Ajay Luharuka** It is roughly about 1,400 crores.

**Moderator** Thank you. We have the next question from the line of Anubhav Agarwal from Credit Suisse. Please go ahead.

**Anubhav Agarwal** One question on the Lexapro. Was the contribution this quarter substantially lower than the previous quarter or just marginally lower?

**VS Mani** It was substantially lower than the previous quarter.

- Anubhav Agarwal** And still we had a very good strong formulation export sales. So it is ex-Dymista business which has done significantly better?
- VS Mani** Dymista anyway is very small shipments have happened as I explained that's the start and as far as Lexapro is concerned it is a very small proportion compared to the previous quarters. Obviously in spite of that there has been a good growth.
- Anubhav Agarwal** And just one question on the personal cost. You had 38% year-on-year. Could you just slightly give us an idea that how much of this could be attributed to increase in manpower and not incremental? Because we have had personal cost increase in a very rapid pace over the last three quarters.
- Ajay Luharuka** Roughly on account of increase in manpower it will be about 20 – 25 crores of the total increase.
- Anubhav Agarwal** Out of the 71 crores.
- Ajay Luharuka** Yeah.
- Anubhav Agarwal** And just a last question here is on Cipla MedPro offer what is the next step in the sense just one clarity. In South Africa is there any open offer rule or when we say 51% is our intention of acquiring it as a stake, when does open offer kicks in and in terms of approval is there any, probably you can help me with this question, is there any open offer rule in South Africa?
- VS Mani** No, more than that what you have to understand is that our discussions are still on and while it is a very strategic decision what we are still currently looking at is that couple of things have happened in the meanwhile there has been some changes in the senior management out there. The currencies have moved slightly against the local businesses. Then ARV tender which they won don't have such a big margin and regulatory bodies looking at the sudden increase in the stock price there. So these things are going on. We are evaluating various options.
- Anubhav Agarwal** But sir I am just checking in terms of let's say regulatory requirement, I couldn't -understand when you put in the press release you want to acquire 51% stake or close to that.
- VS Mani** There is two ways of doing it. Actually there is a scheme under which you can go and acquire 51% and there is a question of going directly to the shareholders also, so both are available. But normally companies do a scheme of arrangement where you go through the Board and you acquire 51% of the company.
- Anubhav Agarwal** And there is no requirement that 75% of the shareholders have to?
- VS Mani** They have to approve 75% to buy 51% of the shares.

**Moderator** Thank you. We have the next question from the line of Ranjeet Kapadia from Centrum Broking. Please go ahead.

**Ranjeet Kapadia** My question relates to guidance of tax rate for the current year as well as for the next year. And the second question relates to CAPEX. What is the CAPEX for the current quarter and for the next year?

**VS Mani** Okay I will take the question basically on the tax rates. It is about 24% to 25% and that's where it will remain hovering around that because as you know now the benefits of the backward area and all are slowly going down so obviously couple of years we still have these benefits still with us. So these are the rates what one will look at.

**Ranjeet Kapadia** And for next year, the same 24-25.

**VS Mani** Next year, 24-25 will be there for that amount.

**Ranjeet Kapadia** And for the CAPEX what was the amount which was spent during the quarter and for next year?

**Ajay Luharuka** Ranjeet for the year what we are expecting for our CAPEX to build up the API plants and R&D and the routine CAPEX. That will be in the region of 400 crores. In addition to that in the current year there was a need to increase our office space so we have bought an office space in Mumbai itself so that is another 270 crores.

**Ranjeet Kapadia** This is a set up in Peninsula.

**VS Mani** Correct.

**Ranjeet Kapadia** This is Lower Parel.

**VS Mani** Correct.

**Moderator** Thank you. The next question is from the line of Karthik Mehta from ICICI Securities. Please go ahead.

**Karthik Mehta** Can you share the contribution from Indore SEZ? And on MedPro are we to assume that you would be looking at some conditions that you made when you offered that particular price so will it change materially? I mean is there a timeline when there can be an outcome or actually that can be extended.

**VS Mani** No. The timelines can always be extended. It is not a problem. The prices definitely moved up since the mid offer that's why earlier response to whatever I told you what we are evaluating. And as far as Indore goes currently the turnover from Indore for the year so far has been about

400 crores plus but when you view some of the US FDA approvals that we have got we hope to complete at the year-end about 600 crores for the year. I am just giving you guidance forward looking.

**Karthik Mehta** So this 400 is including any sales in the US because we had approval in October?

**VS Mani** No nothing. We just got it in October so we have not got anything.

**Karthik Mehta** Mani, can you please throw some light on the US part of sales which would be from Indore? Anything that could be whether it is in terms of tablet, orals, any particular type of product?

**Ajay Luharuka** Karthik there are about 4 to 5 products which we have already filed. You must be aware on the ANDA front and most of these will come from Indore. So going forward in the next couple of years you will see contribution of these products from Indore.

**Moderator** Thank you. We have the next question from the line of Vivek Agarwal from MP Advisors. Please go ahead.

**Vivek Agarwal** In the last quarter you said that you are filing your own ANDAs in the United States. So I just wanted to know how many ANDAs you have filed in US so far in the quarter and are you targeting any specific therapy areas or any specific technology focused ANDAs?

**Ajay Luharuka** Vivek, so far in the current year we have filed about five ANDAs in the US and of course going forward there will be more products in the pipeline which we will be filing. And this will again be in different therapies and in niche areas where we have expectations of getting better value.

**Vivek Agarwal** Sir what is your CAPEX guidance for FY14?

**Ajay Luharuka** For FY14 there are still some projects which are nearing completion. The CAPEX expected is around 300 to 400 crores. Again that will be towards API and R&D because formulations we are more or less done with the CAPEX.

**Vivek Agarwal** And sir just want to know the impact of pricing policy on your domestic portfolio. What is the percentage of your domestic portfolio that will come under the price control? And how much average price cut are you expecting going forward?

**VS Mani** Obviously this policy will impact the company negatively in a short-term. However, we will know the real impact only when the new drug price order is enacted by the government. And we also believe that policy should be enacted only after the IMS data is verified and certified by the industry.

**Vivek Agarwal** I just want to know how much your domestic portfolio will come under the price control?

**VS Mani** That way they are talking of 348 drugs. Now one has to understand what will be the impact across and what will happen. So we really can't throw a number at you right now. We will wait for the policy to be enacted by the government to really give you really a proper response to that.

**Vivek Agarwal** Ok. And how much growth are you expecting in the domestic market in FY14?

**VS Mani** Current year we have done so far about 17 run rate and we hope we will finish the year close to that.

**Vivek Agarwal** In FY14. So are you expecting to continue that for FY14 and FY15 also?

**VS Mani** Yeah. We have always been doing about 15 plus so we hope to continue that and the number of products we have in the market we hope we can do that.

**Moderator** Thank you. We have the next question from the line of Bino Pathiparampil from IIFL. Please go ahead.

**Bino Pathiparampil** Just following up on an earlier question on MedPro acquisition. Did you say that you are reviewing the exact terms of the deal that was previously announced?

**VS Mani** Looking at all the developments that are happened out there so that's right. What we have discussed or whatever was mainly the understanding, probably part of it remains but only thing we are saying is that there are lot of key changes which were looking at that.

**Bino Pathiparampil** So the Board as well as Cipla has to take a decision now in the same scenario which could take some time now.

**VS Mani** As I told we are in talks with them but at the same time you have to be cognizant of few changes that have happened there so one has to take care.

**Bino Pathiparampil** Would you be able to confirm if you are the API supplier for Truvada generic for Teva?

**Ajay Luharuka** Bino, at this stage we won't be able to confirm because of confidentiality agreements probably at later stage when we are more concrete things in place we will revert to you.

**Bino Pathiparampil** And finally once the MedPro acquisition happens would you be regularly quarterly publishing the consolidated numbers?

**Ajay Luharuka** Bino, like Mani said the talks are ongoing; once the transaction completes let's take a call on that.



**Moderator** Thank you. We have the next question from the line of Alok Dalal from BNP Paribas. Please go ahead.

**Alok Dalal** Sir could you explain where has been the addition in manpower for the quarter? Is it in the field force?

**Ajay Luharuka** Alok it is an overall addition including at head office, admin, field force. It is an overall addition, everywhere.

**Alok Dalal** Field force is about what? 7,000 now.

**Ajay Luharuka** About 7,500.

**Alok Dalal** And sir what could be the reason for the fall in API sales?

**Ajay Luharuka** Alok in the previous year there was one time supply of specific API which was not a very regular feature so that has not happened in this quarter.

**Alok Dalal** And for export formulation is this 38% kind of growth sustainable now for the next two or three quarters?

**Ajay Luharuka** Alok for the year we are saying that we will aim to achieve above 15%.

**Alok Dalal** In export formulations?

**Ajay Luharuka** Yeah.

**Moderator** Thank you. We have the next question from the line of Sonal Gupta from UBS. Please go ahead.

**Sonal Gupta** Sir first question in terms of the Escitalopram like Lexapro impact, I mean, should we take these margin levels as being sustainable levels? Or do you think there is still some one off impact which is there in the numbers?

**VS Mani** I would ideally say 22% would be sort of a correct margin.

**Sonal Gupta** Dymista would be sort of recurring, right.

**VS Mani** In going forward, we feel that there will be few non-recurring items coming again and again or whatever or may be these kind of things which you see is there in most companies but they are not present in us or will be happening. So it is up to you how you take it whether you add it as a part or not. But I am just saying truly speaking some of these one-off figures remove and just look base it will be about 22%. And just keep adding regularly then obviously that's part of our portfolio, right.

- Sonal Gupta** And another thing was in terms of the R&D. What is the R&D spend for the year-to-date or where do you see the R&D because historically your R&D spend is lower so now that you are filing on your own, etc., do we see significant uptick in R&D spend?
- VS Mani** I don't quite believe we were spending low but we stood about 4% and that really still continues. May be it inches up a bit more, may be it goes up by about a percentage or so.
- Sonal Gupta** And any strategic plans that you can update us on in terms of the strategy for the US? I mean how do you plan to scale up in terms of filing?
- VS Mani** You have seen for yourself. We have started our filings out there. We had a senior resource out there. Now we have formed a subsidiary there. So all these are naturally fitting into the scheme of how you see company's progressing naturally towards the market.
- Sonal Gupta** Typically you filed 5 ANDAs till year-to-date?
- VS Mani** That's what we have started in this year. I guess going forward we will look at it and try and file more. And that's why we are getting resources and we are putting up offices and all that is towards that.
- Sonal Gupta** And should we in that case, expect that the other expenses should increase more rapidly.
- VS Mani** I think it is already increased to a large extent. May be a little more may go up here and there but then I think even in the previous quarter we had already given a forward-looking kind of thing saying that going forward some amount of expenses will go up when we start ramping up our operations overseas when you put up front-end. So I guess while we expense all this out these are like to some extent would support us in our endeavors to go into these markets directly and probably help us to sell more.
- Moderator** Thank you. We have the next question from the line of Sameer Baisiwala from Morgan Stanley. Please go ahead.
- Sameer Baisiwala** I am looking at the operating margins sequentially from second quarter fiscal to the third quarter. It looks like it has fallen by about 7% points. Is it all because of Lexapro?
- VS Mani** Good extent would be Lexapro.
- Sameer Baisiwala** And the second question is what has been the feedback from the doctors, etc., in US on Dymista? Has it changed your internal projections before launch and now a couple of months after the launch?

- VS Mani** Sameer I think we have started shipments only in the last quarter and this is not like a typical product. It is more like ANDA type where I think they will need to market. I think initial reactions are good but we keep our fingers crossed hoping that it does well.
- Sameer Baisiwala** And I heard on CNBC, Dr. Hamied talking about Cipla is looking out for acquisition candidate in say Brazil, Turkey and Japan if I am not wrong? Can you just talk a bit more what exactly are you looking for in these markets and what could be the typical deal size?
- VS Mani** Sameer it is difficult to give you a deal size right now. But yes, some of these markets we are keenly looking at. And obviously we feel that it is important that as I said even in the earlier question that we look at frontend so presence in overseas market could be through frontends or through sometimes small-to-medium kind of acquisitions where you get your presence in. So when we look at various markets we look at it. We can't be big bang everywhere obviously. So we will look at presence in these markets. Sameer, to correct it we are already present in all these markets through partners but at some stage we feel that maybe we could be directly present because some of them are becoming quite strategic in nature.
- Sameer Baisiwala** And when I said deals I did not mean exactly the deal size. I am saying is it \$500 million kind of thing or \$100 to \$200.
- VS Mani** I don't think 500 million we can do too much. I mean it could be smaller numbers.
- Sameer Baisiwala** Just one final question if I may. Dr. Hameid has stepped down as MD of the Company. Do you think what could be the possible implication terms of how the business is run day-to-day?
- VS Mani** He has already told also that in his stepped down also he has mentioned very categorically that he is always there like a fatherly figure available for the company and to basically guide us as we go along. And that is the role he is doing in most ways but now it is more a formal process.
- Moderator** Thank you. We have the next question from the line of Nitin Agarwal from IDFC Securities. Please go ahead.
- Nitin Agarwal** Ajay on the US business, can you give us some sense on the ANDAs that have been filed so far? And the numbers that are pending approvals?
- Ajay Luharuka** Nitin, the number of own ANDAs which have been filed so far?
- Nitin Agarwal** Basically what I just wanted to guess is in terms of the potentially commercializable products that you will bring to the market toward a period of time going forward which you can?
- Ajay Luharuka** The number of own ANDAs filed in the current year is 5. And in terms of the total number of ANDAs they are about 76 which were approved so far and there are another 23 which are under registration.

**Nitin Agarwal** Of the 76 ANDAs, how many of them are being marketed by our partners right now?

**Ajay Luharuka** Out of that more than 60% would be marketed.

**Nitin Agarwal** So in terms of the pipeline that we can bring to market it still has 23 products which are awaiting approval with partners plus the 5 that you filed so far and incrementally whatever you file going forward.

**Ajay Luharuka** And out of the 76, which are not been commercialized so far a part of those could also be an opportunity.

**Nitin Agarwal** When I look at FY14 and '15 across these two years on rough basis how many products incrementally do you see bringing to the market?

**Ajay Luharuka** Nitin it will be little difficult to give you a number. But as you have seen that there is a good pipeline of products so whichever product is a good opportunity we will look at commercializing those products.

**Nitin Agarwal** And lastly on the US business with Dymista we have very strong capabilities in the whole inhalers and nasal spray categories. Is nasal spray a sort of niche area that we focused on as far as our current filings are concerned in US? Is it fair to say that?

**Ajay Luharuka** Nitin again on the nasal spray of course it is definitely a specialty area for us but in the US basically we will have to evaluate various options and see what is the best product to be in and if there is an opportunity, yes, we will work on that. At this stage I am not able to share any specific details with you on the product front.

**Moderator** Thank you. We have the next question from the line of Rahul Sharma from Karvy Stock Broking. Please go ahead.

**Rahul Sharma** Ajay just wanted to know out of 99 crores of other operating income, is there any component of FOREX gain? Or is it all included in your other income? How much is it for the nine months?

**Ajay Luharuka** FOREX gains for the nine month period will be around 50 crores plus. I don't have the exact figure but that will be the approximate amount.

**Rahul Sharma** And just wanted to know on the MedPro where we have got two tenders will there be margin decreitive in the sense there is almost 80 million per year?

**VS Mani** No. we are not losing money but obviously you know that ARV tenders donot have so much money.

- Moderator** Thank you. Participants that was the last question. I would now like to hand the floor back to the members of the management for closing comments. Over to you, Sir.
- VS Mani** Thank you very much and we really look forward to your support and we hope to continue to be of assistance and basically answer all your queries. And hope we have better quarters like this. Thank you.
- Moderator** Thank you sir. Ladies and gentlemen on behalf of Kotak Institutional Equities that concludes this conference call. Thank you for joining us. You may now disconnect your lines. Thank you.