"Cipla Q1 FY13 Earnings Conference Call"

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MANAGEMENT: **MR. V. S. MANI – CFO, CIPLA**
MR. AJAY LUHARUKA, CIPLA
MODERATOR: **MS. PRITI ARORA – ANALYST, KOTAK SECURITIES**

Moderator Ladies and gentleman good evening and welcome to the Q1 FY13 earnings conference 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 and there will be an opportunity for you to ask questions at the end of today's presentation. If you should need any assistance during this conference call please signal an operator by pressing * and then 0 on your touch tone telephone. Please note that this conference is being recorded. A general reminder to all our participants also, this conference is only for 30 minutes. I would now like to hand the conference over to Ms. Priti Arora from Kotak Securities Limited. Thank you and over to you ma'am.

Priti Arora We have with us Mr. Mani and Ajay Luharuka from the Cipla Management team. As earlier the call will last 30 minutes and I would request Ajay to start the call by giving us the quarterly update.

Ajay Luharuka The financial results and the performance highlights are 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 quarter the company posted a growth of 24% in income from operations and income from operations crossed Rs.2000 crores. Domestic sales for the quarter grew by more than 30% and export sales grew by about 18% for the quarter. Operating margins have increased by more than 47% and profits after tax crossed Rs.400 crores with a growth of about 58% for the quarter. Material cost has decreased by about 5% on a year on year basis which is mainly on account of changes in product mix that is lower proportion of antiretroviral and high contribution of anti depressant segment which is the export of Escitalopram in US and coupled with increase in realizations. As a result operating margins have also increased by corresponding 5%. The increase in staff cost is due to annual increment as well as increase in manpower. Other expenditure has increased on account of increase in marketing expenses, professional fees travel expenditure etc. Tax for the current quarter has marginally increased mainly due to higher profits. The capital expenditure front, the CAPEX for the current quarter is about 80 crores and on the forward contract, as on 30th June the outstanding forward contract is $220 million which substantially covers the outstanding debtors. During the quarter the company had gained about 23 crores on account of foreign exchange gains. With this overview, I would like to leave the floor open for question. Mr. Mani and myself are available for any questions that you have. Thank you.

Moderator Thank you. We will now begin with the question and answer session. Our first question is from the line of Monika Joshi from Avendus Securities, please go ahead.

Monika Joshi Just on your annual reports if you could just throw some light on what was the nature of holding and investment in **Desano** roughly about a 350 crore exit that you are talking about. So will this investment be sold to a group company or is being sold outside and as a follow up what is the nature of your investment in BioMab and Jiangsu, what is the philosophy if we could understand in pursuing these investments primarily in China and Hong Kong.

Ajay Luharuka The investment in BioMab with reference to the bio-therapeutic product which we are working jointly with them and basically there are certain products, we are working with them in clinical trials are expected in the couple of years. This is jointly with our Chinese partner where the development work is done by them and the commercial launch is expected in the next 2 – 3 years.

Monika Joshi About the Desano actually Mr. Luharuka is what we wanted to know. You have mentioned an exit from this investment. So would you clarify whether it is to a group company or it will be sold to a third party, to an outsider?

V. S. Mani Basically it is like a partial exit. So that is how it is.

Monica Joshi You expect to get that entire $70 – 80 million?

V. S. Mani Yes we should get.

Monika Joshi Just one book keeping question, the 23 crores of FOREX gain is included in which line item?

Ajay Luharuka **I**t is in other income.

Monika Joshi of 50 crores. A part of that is.

Ajay Luharuka Yes it is part of the 53 crores of other income.

Moderator Thank you. Our next question is from the line of Anubhav Aggarwal form Credit Suisse, please go ahead.

Anubhav Aggarwal The forward contract of $220 million, can you just specify what rate it is at?

Ajay Luharuka It will be at an average of 54 – 55 because as you are aware that we follow a policy of hedging our exports on an ongoing basis. So we get the benefit of any further depreciation. Right now the average will be around 54 – 55.

Anubhav Aggarwal Last year your export sales did show the split that African sales only grow at 5% because of ARV but Middle East sales were down 14%. Has the Middle East sales now started growing back?

Ajay Luharuka Quarter-on-quarter there could be fluctuation but on an overall basis, there will not be much of change.

Anubhav Aggarwal What is use of cash that you are planning to do? You almost have $200 million cash sitting with you at the end of the balance sheet and now the cash generation will be much higher than the CAPEX that we will be doing every year.

V. S. Mani Well I think the cash has been accumulated during the last one year. So obviously we will use it as and when we require for anything strategic that we won't require. So we will definitely inform you accordingly.

Anubhav Aggarwal But the CAPEX plan remained as it is what you have?

V. S. Mani CAPEX plan does not go up much. It remains there only. So we will come back on that.

Moderator Thank you. Our next question is from the line of Monaj Garg from Edelweiss, please go ahead.

Manoj Garg Yes the domestic growth of 30%, can we have a split between over the branded or the prescription growth?

V. S. Mani To give you the break up, the domestic branded would be roughly around 23 – 24% and the rest would be largely the generic-generic.

Manoj And generic is 9-10% of the overall domestic sales, am I right?

V. S. Mani Yes roughly around that.

Manoj Do we see this 23 – 24% kind of growth now in the domestic market is sustainable because historically we have been growing in the range of 14 – 16% though we have indicated in the past that we are more focused in the domestic business but are we confident enough to sustain this?

V. S. Mani A growth of 23 would be a tough call. I think it would as time goes by it would taper a bit. So it could be may be slightly better than 16 – 17 what we were always doing may be even better than that. But to keep the pressure on at 23 may not be something that I could predict.

Manoj Was there any one off element?

V. S. Mani No there are no one off elements. On the whole, sales has done well. If you look across the industry number of good companies have done around 20% or people have done better than what they normally did.

Manoj But surprisingly like respiratory which is our key franchise in the domestic market, in the month of June the season was bit low. And despite that I think the growth of 23 – 24% is remarkable.

V. S. Mani But respiratory did well in the first quarter. I do not see much of an issue on that.

Manoj What is the contribution of now ARV as a percentage sales in the overall export business?

Ajay Luharuka Barring Escitalopram it will be more or less the same. There will not be much of a change. In terms of contribution, but yes compared to the last quarter we have come down.

Manoj ARV has further come down.

V. S. Mani Yes.

Manoj So is it now 15 – 16% which was there in the last quarter?

V. S. Mani May be slightly lower than that.

Manoj In the balance sheet you have made a provision of around 36 crores, for the bad debts and even your written-off 54 crores among the bad debts, can we understand it almost like coming out from 3 – 4% of your overall receivables?

V. S. Mani What is this 54 crores I am not clear.

Manoj It is provision on bad debt accounts which you have made, around 36 crores and in other expense line item you have written off from 54 crores.

V. S. Mani See over the years we had seen what is our position of our debts. So it was like more or less like a clean up over 2 – 3 years. It is not something that is going to recur too much in the future.

Manoj Even in last year it was around 69 crores.

V. S. Mani Appreciate I mean that's why we are talking of rationalization and all this. So that we are sort of taking care.

Moderator Thank you. Our next question is from the line of Dhiresh Pathak from Goldman Sachs, please go ahead.

Dhiresh Pathak Can you give the growth in the domestic anti asthma and antibiotic therapy again for this quarter?

Ajay Luharuka Anti asthma has grown by more than 15 – 20%. And antibiotic has performed equally better. 20% plus.

Dhiresh Pathak 23 crores FOREX gain in the other income, this is both realized and unrealized.

Ajay Luharuka That is right.

Dhiresh Pathak And in the EBITDA would there be an element of realized FOREX gain as well?

V. S. Mani It will percolate down.

Dhiresh Pathak Could you quantify that benefit that would have come from the currency depreciation?

Ajay Luharuka Roughly see out of 23, 50– 50 it could be the break up between realized and unrealized.

Dhiresh Pathak This is coming below the EBITDA line but in the EBITDA, there will also be benefit of FOREX, that comes from better realization in the foreign denominated currency when you covert them into rupee because of the rupee depreciation.

Ajay Luharuka When we account for sales, the sales is accounted at the prevailing exchange rates. So that takes into account the exchange rates and the entire 23 crores is the fluctuation, the difference in fx fluctuation which gets accounted in the other income.

Dhiresh Pathak Did you not figure out what were the benefit, what could have been the EBITDA on a cost and currency basis and what is the EBITDA now and what is the impact because of currency depreciation?

V. S. Mani No that would not work because anyway as and when we book the sale, we are taking on the rate on that day. So as and when any benefit or anything comes, it will be there.

Moderator Thank you. Our next question is from the line of Ravi Agarwal from Standard Chartered please go ahead.

Ravi Agarwal Our first question on the export formulation business, clearly if I look at it from Q4 to Q1 on a constant currency basis it seems to be down by almost $20 – 25 million and it seems a bit surprising to me considering the fact that we have had Lexapro for coming in this quarter as well as in a rupee basis we would have some currency benefits. If you could just explain some part of it and going forward when Lexapro will now presumably not come in further quarter, what should be the trend rate to look at from an export formulation basis?

V. S. Mani 2 – 3 things are there, first of all it is not very correct to compare Q4 versus Q1. Historically if you look at it, most of the time our Q4 are there. Q4 has been higher even in the previous year and the current year and also when we are looking at tender businesses in Q4 we may have had more. it is not necessary that it goes across all quarters. So you may get a lot of tender business in one quarter and next quarter you may not have so many, again it may come in. So we do not look at it that way, if you really take it based on business aspect if you look at it, anti retroviral is down to some extent, tender business was little more in Q4. So this quarter looks a little lower compared to that. But if you look at it vis-à-vis a previous year obviously there is benefit sitting there.

Ravi Agarwal If I compare it against the average dollar of last year versus, whatever we would booked last year was $120 – 130 – 140 million, how much was it dollar million this year?

V. S. Mani It would be definitely marginally better than last year.

Ravi Agarwal Cipla Aspen JV if you could just share some more light about what exactly that is and what is the kind of revenue. What is the kind of time frame one is looking to that and any investments in terms of what is funding required for that?

Ajay Luharuka & V. S. Mani The Cipla-Aspen JV it is again a joint venture for marketing. Right now there is no major immediate transactions happened in that. While the plans are good, we have not yet really taken off on that. So that's something that one would look forward in the future.

Ravi Agarwal Any timelines to when one would expect something?

Ajay Luharuka It will depend on the regulatory approvals and the clinical work which would happen for the Australian market.

Ravi Agarwal 2-3 should be a fair estimate?

Ajay Luharuka We wouldn't like to put a number to it. It would totally depend on regulatory approvals.

Ravi Agarwal The average export realization rate for this quarter please.

Ajay Luharuka Again like I mentioned earlier we do cover foreign exchange on a regular basis, so whatever we cover earlier it used to settle the realizations in the quarter. So on an average if you see rupee has been hovering around 53 – 54, for the last 6 months. So you can work out accordingly.

Moderator Thank you. We have the next question from the line of Nitin Agarwal from IDFC, please go ahead.

Nitin Agarwal On the domestic business is there some inflexion point which came through in this quarter when we see the growth really picking up or just a base which was playing out I mean the increase in the growth rate has been very substantial in the current quarter?

V. S. Mani I think you can say partly it could be both reason. One obviously the amount of effort that has gone in and also there were good sale pick ups in the respiratory and antibiotics and cardiovascular. So I think all played on. but if you really look at it even in the last year baring the first quarter if you really look at it the other 3 quarters we have been growing quite well. I mean if you look at it overall for full year on year we did about 16 – 17% in our domestic, the first quarter was not that good. So if you look at it it's a culmination quarter-on-quarter, we are giving to do well.

Nitin Agarwal It's like a trajectory which is improving and given the lower base it is a little.

V. S. Mani But saying all that fine but at the end of the day to say you maintained at 24% every quarter may be a tough call.

Nitin Agarwal When you say 9% of your growth was in a generic business but generic business is a very small component. So it is a business on itself grew very fast.

V. S. Mani When the business on itself wants to grow quite well, no doubt about that.

Nitin Agarwal But that will be a very large amount because if the business contributed 9 – 10%, 7-8% of your growth

V. S. Mani If you really look at you put it as may be 10 – 12% of my total turnover in domestic. So obviously it did grow well.

Nitin Agarwal Because I am little confused when we say that in 23% of growth was contributed by branded business.

V. S. Mani Absolutely.

Nitin Agarwal And if the 7% of the growth was something which contributes 10% of the business it has to grow much faster.

V. S. Mani Yes, it grew much faster no doubt about that.

Nitin Agarwal How material would Escitalopram would have been in the current quarter formulation, Escitalopram formulations?

V. S. Mani We are bound by agreement, we cannot give a number to that.

Nitin Agarwal And that probably will continue only for 1 more quarter and the after that exclusivity ends out .

V. S. Mani Definitely.

Nitin Agarwal And are there any other opportunities that we are looking at the current year?

V. S. Mani Yes you must have heard about Dymista and all those so some of the other opportunities would come up. Let us see as the time goes by.

Nitin Agarwal **Ok, thank you.**

Moderator Thank you. Our next question is from the line of Abhay Shanbhag from Deutsche Equities, please go ahead.

Abhay Shanbhag Couple of questions on export formulations growth of 33% of Lexapro and Vancomycin coming in, what sort of growth number do we expect going forward?

V. S. Mani I think for the next 1 – 2 quarter you look at numbers which are around these levels.

Abhay Shanbhag Lexapro Teva launched in March and technically there would have been channel filling so do we have another quarter for exclusivity or it is royalty in the June quarter itself?

V. S. Mani You could expect one more.

Abhay Shanbhag The other one was in terms of margins this quarter we had very good growth 23 – 24% in the branded business India and Lexapro and Vancomycin were high margin products. So do we see these current margins continuing at the operating levels?

V. S. Mani This quarter Vancomycin was not too much .

Abhay Shanbhag What about Escitalopram formula?

V. S. Mani It was okay.

Abhay Shanbhag And India formulations also, 23 – 24% partly because of the low base last year but the growth rates would normalize a bit. So do we see the operating margins in the current quarter continuing?

V. S. Mani In the quarter going forward?

Abhay Shanbhag Yes.

V. S. Mani It would be around those levels but as a year goes by, may be it would taper off a bit but yes definitely better that last year.

Moderator Thank you. Our next question is from the line of Sameer Baisiwala from Morgan Stanley, please go ahead.

Sameer Baisiwala Just taking a step back and looking at the bigger picture. If I look at last 10 quarters not 1 or 2, then your average growth for the domestic business is roughly about 13%. 12.8, to be very precise versus this quarter where you are showing 30% growth. And if I again take a step back and look at operating margins for last 10 quarters it is set for about 21.8% and this quarter it is 27%. So it seems like this is quite an outstanding quarter. So is there something unusual about this that we need to bear in mind and you seem t be guiding much of this is going to recur as to go forward.

V. S. Mani While you are right, this is an exceptional quarter, when you look at the domestic growth yes, may be last 10 quarters we grow at 13% but if we look at the last 3 quarters definitely it is ramping up and is doing much better than what it was doing in the past. While this quarter of 23% we also again have put a question that it is not necessary this could sustain but yes, it is definitely better than 13% what you were growing at . Similarly somebody questioned me whether the next quarter will look like this. I said possibly but going forward again there it will taper. There is an affect of Escitalopram in this margin when I said 27% so that would not sustain. So to that extent yes it would come off.

Sameer Baisiwala Are you making any changes to your full year guidance specially you guided towards 10% sales growth?

V. S. Mani I think it would definitely around 12 – 15%, it would be higher.

Sameer Baisiwala On full year guidance I think last call you mentioned for 10 – 15% in a growth in a net profit for Fiscal '13.

V. S. Mani So I think that also would be higher. It would definitely be higher than that.

Sameer Baisiwala And final question on Indore SEZ, is it possible for you to share with us the capacity utilization and the sales that we did from there.

Ajay Luharuka It would be broadly in line with last year.

Sameer Baisiwala About 45 – 50%, about 190 crores?

Ajay Luharuka For the year we expect Indore to contribute us in 8 – 10% of export formulations.

Sameer Baisiwala I mean to say for the quarter how much percent?

Ajay Luharuka For the year that will be the trend, for the quarter it would be plus minus.

Sameer Baisiwala Can you just repeat that number?

Ajay Luharuka I am saying for the year it will be 8 – 10%.

V. S. Mani The quarter it will be similar to the last quarter

Sameer Baisiwala Which is 190 crores and 45 – 50%.

V. S. Mani Close to that or lower than that or whatever.

Sameer Baisiwala And do we expect this to ramp up for the balance 3 quarters order book that you have on hand.

V. S. Mani It would be pretty much similar tolast year, so I do not see it going out too much right now.

Sameer Baisiwala Any specific reason for this. This is operating way frankly at a reasonably low level,

V. S. Mani I appreciate but we are doing enough so I think may be you will have to wait a year or so and see definitely it would be better.

Moderator Thank you. We have a next question from the line of Bino Pathimparambil from IIFL, please go ahead.

Bino Pathimparambil First just following up from the previous question, I understand that we are cutting down on the low margin businesses, which is a good thing and move in the right direction, but is that the right strategy to follow when we have so much underutilized capacity lying with us. Ideally you should think of that kind of strategies when you are close to full capacity utilization and you can improve profitability

V. S. Mani That would exactly be the way to look at it because the capacities are made of different dosages. Even in Indore if you really look at it, the tablets and capsules are definitely ramped up under much higher. So when I look at it that way if you say what you are rationalized, they are more of those kind of dosages as against that what we might say underutilized could be other dosages.

Bino Pathimparambil So for dosage forms of ARV you mean to say Indore capacity utilization would be as high as 80 – 90%.

V. S. Mani Depends, its seasonal and cyclical I mean it depends on what tender I get, what I do not get.

Bino Pathimparambil Is there an updates on combination inhalers in Europe especially Advair generic. Earlier I believe that was some thought you might possibly look at an approval toward the end of the 2012?

Ajay Luharuka The timelines for the inhalers are still the same. It is unchanged and we are awaiting regulatory approvals. So there is no major change in the guidelines as of now.

Bino Pathimparambil Can we know if there has been a filing I believe for entire Europe there is an EMEA filing, so what is the status of that?

Ajay Luharuka In Europe the filings will be made country wise. So for certain products the filing has been done. Once those approvals are received then we will be filing in the other countries as well.

Bino Pathimparambil Does not this EMEA approval process for that encompasses all countries in Europe. Doesn't that apply to this product?

Ajay Luharuka There are different strategies which different companies follow. Right now we have followed a different strategy to file these products.

Bino Pathimparambil And did you say that the Escitalopram upside can continue for one more quarter?

Ajay Luharuka It probably would continue for one more quarter.

Bino Pathimparambil To the same extent or lower?

Ajay Luharuka We can't say. That totally depends on the net realizations of our partner.

Bino Pathimparambil Can I have the latest CAPEX estimate for this year and next year?

Ajay Luharuka The total year CAPEX will be roughly around 400 – 500 crores. This is on account of the API and the R&D facilities which are under construction and these facilities are expected to be completed under current year.

Bino Pathimparambil And next year?

Ajay Luharuka The next year there is no major CAPEX plan as of now. So the routine CAPEX and the expansions would be there, there is no major CAPEX planned as of now.

Bino Pathimparambil What would be the figure in normal CAPEX?

Ajay Luharuka It's difficult to put any figure right now. But there is no major project planned as of now. Unless some new opportunity comes, nothing really is planned on a project basis.

Moderator Thank you. We have the last and final question from the line of Praful Kumar from Principle Mutual Fund, please go ahead.

Praful Kumar I am not sure I got it right or not. The foreign exchange gain part is in other income or other operating income.

Ajay Luharuka Other income, if you see the results format as per the Schedule-6, its included in other income.

Praful Kumar And this is net because you would have derivatives since you book at prevailing rate. You would also have some losses from the derivative side.

Ajay Luharuka We do not have derivatives. We have forward contracts. So this is net of forward contract yes.

Praful Kumar To understand it directionally excluding the Lexapro gross margins, do you think that substantial improvement in gross margin as compared to last year would sustain and because of getting some benefit it may improve or this quarter is exceptional kind of thing?

V. S. Mani We can't really answer the question on Lexapro. But we are definitely the margins are better than last year. To give you a break down would not be possible.

Praful Kumar No I am not asking break down.

V. S. Mani Definitely it has improved compared to last year.

Praful Kumar And is this sustainable?

Ajay Luharuka It will also depend on rupee realization, it will depend on how the product mix going forward works out because for example in this current quarter we have lower contributions from ARVs which helped us better margins so it is a combination of factors.

Praful Kumar As you have stated that you want to get out of these, lower margin of ARV.

Ajay Luharuka Let me clarify. We do not want to get out of it basically we are present in each of these segments, will be reviewed and wherever you feel it is not reasonable for the company we will obviously not participate.

Praful Kumar Can I say that the overall objective is to now at least maintain gross margins at these levels?

V. S. Mani Yeah it would be in and around these levels.

Praful Kumar If I ask you differently when you do a product strategy it's obviously not for the quarter. You would be thinking from may be 1 year or 2 year, 3 year perspective and then I am talking about the continuing business part of it. So, why you cannot give a clear cut perspective on how your gross margin will behave? I am not asking about the number I am asking directionally. You are still hesitant to say, let us forget currency and all that part but if you go by your own….

V. S. Mani Let me tell you directionally we are definitely looking at slightly better but to tell you what will be the number it will be difficult for me. Directionally yes, it looks better. As I told you that once Escitalopram happened, we told you Dymista people are asking questions on inhalers so all this looks good. Directionally it is better, but to give you a number not possible.

Praful Kumar As I told you I am not asking you a number.

V. S. Mani I think you got the answer right?

Moderator Thank you. That was the last question. I would now like to hand the conference over to the management of Cipla for closing comments.

V. S. Mani Thank you very much. We hope this continues.

Moderator Thank you so much. On behalf of Kotak Securities Limited, that concludes this conference. Thank you for joining us.