

“Cipla Limited Q1 Financial Year 2016 Results Conference Call”

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Moderator: Ladies and gentlemen, good day and welcome to the Cipla Limited Q1 FY 2016 Results Conference Call, hosted by Kotak 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. Should you need assistance during the conference call, please signal an operator by pressing the “*” then “0” on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Chirag Talati from Kotak Securities. Thank you, and over to you Sir!

Chirag Talati: Good evening everyone. This is Chirag here from Kotak Institutional Equities. I thank the Cipla Management for giving us the opportunity to host this call. From Cipla, we have Mr. Sudhanshu Priyadarshi, Global COO, and Mr. Anant Atal, Head of Investor Relations, Partnership Business for Emerging Markets along with their colleagues. I will now hand over the call to Mr. Sudhanshu Priyadarshi for opening Remarks. Over to you Sir!

Sudhanshu Priyadarshi: Thank you Chirag, and good evening to all you, and welcome to our first quarter full-year 2015-2016 earning call. I am joined here by my colleague Anant Atal, who heads our Investor Relations and also the partnership business. I hope you have received the brief investor summary that we have posted on our website. I will walk you through some of the key highlights of our performance this quarter.

We had a very strong first quarter this fiscal year. This has been both the highest revenue quarter, as well as the highest profit quarter in Cipla's 80-year history. We continue our transformational journey and are focused on creating a strong foundation from which to grow across our direct-to-market, B2B and institutional business.

Our income from operations stands at Rs.3853 Crores and we grew at 41.6% versus last year. We are maintaining the strong momentum from Q4 full-year 2014-2015, where we grew in excess of 20%. The profit after tax at Rs.651 Crores is up 121% last year and PAT percentage is at 16.9%, a growth of 6.1% compared to last year. All the business units, especially North America and South Africa, have shown a strong growth. Our India business has grown by 8.4% this quarter. We have successfully launched Sofosbuvir, and are already touching 3000 patients and prescribers in just three months post launch.

Since the establishment of my Global Chief Operating Officer role within the organization in January 2015, we have created a structure to ensure we have the right balance and focus on delivering day-to-day performance as well as driving the overall strategic agenda for the business. This structure has enabled simplification and single point of accountability for

end-to-end operational delivery of the business. This has helped deliver strong operational performance over the last two quarters.

Over the last six months, we have focused on the fundamentals of our operational backbone and business. Our manufacturing and supply chain teams have ensured optimal usage of capacities and achieved strong dispatches month-on-month. This has resulted in our export business growing at 75.2% during the quarter. This has been consistent with the very strong performance of our export business in Q4 full-year 2015. Our US go-live is currently on track as per our plan with shipments to key new customers underway.

EBITDA margin for Q1 full-year 2016 is at 27%, (Rs.1039 Crore), a growth of 91.8% over last year. This was helped by a positive product market mix and a significant contribution from esomeprazole opportunity. We will continue to ensure the smooth supply of esomeprazole and Budesonide Respules for the USA.

On the licensing and partnership front, the Morocco JV with Cooper Pharma and Pharmaceutical Institute went live successfully on June 1. We now have established front-ends in 25 plus countries across Asia, Africa and Europe. We have entered into definitive agreement to acquire a 51% stake in Quality Chemicals Limited, Uganda (QCL) from the existing shareholders of QCL. Our partnership with Serum Institute is starting to bear results on ground, with the launch of Nasovac, which is the only nasally administrated flu vaccine in India.

In South Africa, we continue to strengthen our partnership with Teva, and in-licensing sales momentum continues to build. We have got the US FDA tentative approval for the world's first pediatric Lopinavir and Ritonavir oral pellets for the treatment of AIDS in infants and young children. This innovative way of drug delivery through oral pellets for some of the society's youngest AIDS sufferers reiterates our commitment to provide access to life-saving medicines in the fight against HIV-AIDS. We will start commercializing this product in the near future. We are closely monitoring the situation in Yemen and Nepal, and have taken the necessary steps to mitigate the impact on our people, customers and partners.

Our new venture business is scaling up fast. To create the right focus in the exciting consumer healthcare business, we announced its spin-off into a new subsidiary. Consequently, the Company's Board has approved an investment by Fidelity Growth Partners India and US-based Fidelity Biosciences in Cipla's recently launched consumer healthcare business. The investment is subject to execution of definitive agreement and regulatory approval. This division has launched its first product Nicotex, a gum, which helps smoker quit the habit. This product is a switch from our prescription business and has

had a very successful launch in the south of the country. We look to further invest in our pipeline and innovative technology. We have over 200 formulation development projects underway at the moment. Our R&D expenses increased significantly this quarter and we expect R&D expenses to continue to ramp up over the course of this financial year.

On the organizational front, Mrs. Samina Vaziralli has been appointed as an Executive Director on the Board. Samina has played a significant role in the Company's ongoing transformation journey and has a strong understanding of both operating levers of the business today, and key drivers of future growth and sustainability. She has been responsible for successfully incubating and shaping Cipla's consumer healthcare business. She has also recently taken on an expanded role leading global strategic alliances and enabling Cipla's people strategy and leadership development.

Overall, the outlook for full-year 2015-2016 is strong. And we expect to have a growth rate of approximately 20% for the year. We are evaluating reinvestment options in R&D, consumer healthcare and biologics, while at the same time maintaining Cipla's high standards of quality, affordability and safety.

To summarize, we have built a solid foundation for the future, while maintaining the business momentum and our efforts will allow us to fulfill our mission for the patients we serve. As we complete the 80th year of Cipla's founding, we will strive to build a stronger, more sustainable business.

I would like to thank you very much for the interest in Cipla. With that we hand over to you, Chirag.

Moderator: Thank you very much. We will now begin the question and answer session. The first question is from the line of Aditya Khemka from Ambit. Please go ahead.

Aditya Khemka: Good evening Sir and thanks for taking my question. To begin with, on the export front, if we look at the last Q1 to Q3 of FY 2015 we were doing between Rs.1200 to Rs.1300 Crores of export sales formulations. And then in Q4, I believe by the virtue of this one off product in US, our sales ramped up to Rs.1700 crore. Would it be a fair statement to make that from Q3 FY 2015 of sales of Rs.1275 Crores to Q1 2016 export formulation sales of Rs.2174 Crores, 90% plus of this growth has driven by nexium?

Anant Atal: I will address that question in a couple of ways. What we have said at the last call Aditya was that we had faced some manufacturing and supply chain bottlenecks in the early part of last financial year, and a lot of the work that we did in terms of smoothing our operations

yielded significant benefits in terms of growth in Q4. In fact, what we had also stated was that the impact of Nexium in Q4 was extremely small because the profits that we accrue on esomeprazole would actually be reported with a one-quarter lag.

So, impact of the one-off in Q4 was extremely low, and I would say actually almost negligible. A significant component has come in Q1 of FY 2016. Again, we cannot disclose the exact financial impact of esomeprazole due to contractual obligations. But what we can say is that our organic business growth rate has been very strong. And specifically, the international and South Africa businesses have shown very strong growth for this quarter.

Aditya Khemka: That would be double digit?

Anant Atal: Yes. It would.

Aditya Khemka: In INR terms?

Sudhanshu Priyadarshi: Yes. In INR terms.

Aditya Khemka: That is very helpful. Can you just elaborate a little bit on the improvements that you spoke and also on the growth that you saw in the fourth quarter of FY 2015 or third quarter of FY 2015, that incremental Rs.300 Crores or Rs.400 Crores of sales in exports? What were those improvements, if you can just repeat yourself, and how sustainable are those improvements if you will?

Anant Atal: I will answer the second question first. I believe they are extremely sustainable, and as we progress, the manufacturing team is actually working on several operational efficiency-driving projects. So I would say a bulk of it was driven by manufacturing efficiency and effective use of the assets that we have. In addition to that, the second key element was systems and processes that we put in place from an integration of front-end and back-end. We have strengthened our supply chain backbone in terms of the forecasting process and by going live with SAP in Q4. So a lot of visibility on order status got created across the organization. We integrated 39 legacy systems into one. So just from the operational efficiency and supply chain efficiency point of view, a lot was released in Q4 and then of course the manufacturing part, which I spoke about.

Aditya Khemka: I understand, but my confusion lies is that regarding our operational efficiencies and our manufacturing improvements, how is that enabling us to sell more in some markets? We have to gain market share right? We need to have demand in some of these markets to push the product there. I understand that through this efficiency, we may be able to produce

more. What I am unable to sort of gauge here is that which of these markets are we really being able to sell more because of this efficiency?

Sudhanshu Priyadarshi: Aditya, this is Sudhanshu. So, as we have said in our Q4 call, we had lot of front-end deals integration in Q3 and Q4. So, obviously when you integrate the company and you are buying mostly distributor businesses, you need to change the IP and dossiers all has to come under Cipla's name. So there was a supply bottleneck, and we have resolved all that by the end of Q3. And by Q4, we have released the number by business units and segments and you saw the growth which was happening in Europe, US, API, South Africa, International, Rest of the World and that same growth momentum is continuing in Q1 also for us.

So we are very optimistic the way things are going. We are capturing the front-end value chain and that is helping us sell more. In South Africa, we had the Teva in-licensing deal that has shown results in Q4, and this will continue for the year. So we believe that the growth we saw in Q4 is sustainable across all the markets from Europe to API to South Africa and international. So we're seeing the same kind of growth what we saw in Q4 in those segments in Q1.

Anant Atal: And just to summarize, there was a lot of backlog of orders and the demand was there. We are working really hard to debottleneck our processes and systems to actually deliver that demand. Some of it came through in Q3, a lot came of it in Q4 and now of course, we continue to do a lot of that work. So, hopefully through this financial year, we will not face a lot of, say, capacity constraints or procurement-related issues or just planning-related issues. We have had to fix a lot of systemic issues to ensure that the backlog gets serviced as well as making sure that the order book continues to flow in.

Moderator: Thank you. Next question is from the line of Prakash Agarwal from Axis Capital. Please go ahead.

Prakash Agarwal: Thanks for the opportunity. I was just trying to understand the India business. We have seen 8% growth. In the past, we have talked about this is one of the initiatives or the transformational journey that we speak about that we have achieved a goal where we can sustain 15% plus growth. Now, we have seen 8% growth, so is there any specific therapy area or is there some inventory correction that we have seen or if you could specify certain reasons?

Sudhanshu Priyadarshi: Thanks Prakash. So, the Rx or prescription growth has been in line with industry growth as per IMS estimates. We have experienced a slowdown in our generics business, and the main drivers for this is that we have rationalized some products and we have seen some seasonal

impact also due to the sporadic monsoon. But we are confident of delivering our normal growth in India, which is around 16% to 18%. We have been delivering quarter-after-quarter, year-after-year and we are confident that those things will net out and for the year, we will be able to deliver those numbers.

Prakash Agarwal: What percentage is the generic as a part of domestic?

Anant Atal: The general rule of thumb is about 20% to 25%, Prakash.

Prakash Agarwal: Okay Sir, second question is on your guidance. You have talked about 20% growth guidance and just trying to see numbers there, so you have already achieved 43%, so this growth guidance is ex of the Nexium impact, right?

Anant Atal: No, the growth guidance that we are giving right now, Prakash, factors in the latest line of site we have for esomeprazole as well as organic growth rate. It factors in both.

Prakash Agarwal: I am failing to understand because it would be a single-digit kind of growth or if you take 20% growth. So, I am not able to understand how our next nine months are going to pan out especially when Mr. Sudhanshu said that the India business going to be double-digit growth going forward? So what are we missing?

Anant Atal: I do not think you are missing anything, basically there are two effects. Our organic business will continue to perform strongly. Going forward, the impact that we are factoring in of esomeprazole is not going to be significant because we believe that most of the value has already been captured in the first set of sales that Teva made into the market. So there is, in our view quite a lot of stock in the market. Depending on how the market shapes up and how some of the esomeprazole sales may shape up. At this point of time the guidance we are giving is largely based on organic growth. If some additional esomeprazole upside happens, then again we will course correct after Q2.

Prakash Agarwal: Thanks very much. I will join back the queue.

Moderator: Thank you. Next question is from the line of Manoj Garg from DSP Merrill Lynch. Please go ahead.

Manoj Garg: Good evening to all of you. Thanks for taking my question. Anant, if I take your comments on Q4 FY2015, you say that while there was a minimal contribution at the bottom or in the bottomline because of Nexium, but there was some contribution on the topline. If you really see now the sales from Q3 to Q1, there is almost an increase of \$120 million, and even

when we look at in terms of your raw material cost which has moved between Q4 and Q1, there is hardly any raw material cost increase. That means a greater part of this incremental sale has come from a product which has a very, very high margins. So, can you give some more clarity on this?

Anant Atal: In Q4, again maybe just to be clear, we did not have any profit share from Nexium. We only had the normal supplying of the product, which we have stated, which was actually a small number. We cannot state the exact number, but it is a small number and that was reflected in our North America business breakdown that we had given at the time of Q4. So, the number that you saw there was about \$150 million that included whatever impact of Nexium had for the full-year. The impact of Nexium from profit share was really in Q1, which is why you are probably saying that the gross margins has not changed significantly. There is a topline, but then there is organic growth as well and material cost has increased quarter on quarter.

Manoj Garg: Okay, and the second question I just would like to understand is about Budesonide Respules. Have we launched all the strength in the market or have we only launched the higher strength?

Anant Atal: As far as we are aware right now Sandoz has launched one strength.

Manoj Garg: Any likely timeline on the other strengths?

Anant Atal: We cannot comment on that Manoj. I think that's Sandoz's prerogative.

Manoj Garg: Fair enough. I have more questions. I will get back to you.

Moderator: Thank you. Next question is from the line of Chirag Dagli from HDFC Mutual Fund. Please go ahead.

Chirag Dagli: Thank you for the opportunity. Would ex of Nexium formulation exports have grown quarter-on-quarter, i.e fourth quarter versus the first quarter?

Anant Atal: Yes.

Chirag Dagli: Significantly? As in higher than your overall sales otherwise?

Anant Atal: They would have grown at a rate higher than what you saw in quarter four.

Chirag Dagli: Higher than what you saw at?

- Anant Atal:** That what we saw in Q4 as well.
- Chirag Dagli:** Sir, second question was on the staff cost. It seems to have jumped meaningfully both quarter-on-quarter as well as YoY. And our key takeaway from last concalls was that substantial part of our fixed cost is sort of in already. So, can you explain what is happening there?
- Anant Atal:** There are really 4 effects which are driving employee cost. One is that it is a new financial year, so there is increase in Cipla domestic cost on account of increments and also bonus payouts. Second, there is an increase on account of Medpro and Cipla USA. There has been a little bit of ramp up. Then Medpro saw new the financial year and the increments there. Third, there is a consolidation impact of acquisitions in new front ends such as Yemen, Okasa, Sri Lanka and a few such deals, which came in. And lastly, there was some incremental hiring in the functional side in R&D, quality, and manufacturing. So it's really these four effects.
- Chirag Dagli:** Is this quarterly run rate sustainable? Is this what we should pencil in as the base?
- Anant Atal:** As in the absolute number? Yes.
- Chirag Dagli:** Thank you so much.
- Moderator:** Thank you. Next question is from the line of Anubhav Agarwal from Credit Suisse. Please go ahead.
- Anubhav Agarwal:** Good evening Sir. Can you throw some more light on the statement in which you said that you are evaluating reinvestment options in R&D consumer healthcare and biologics. I have not understood what exactly does this mean.
- Anant Atal:** It means two things. One is that we are intending on fast-tracking certain R&D projects. As per our schedule, we had certain projects planned from an execution point of view this year. Given we do have some buffer, what we are trying to do is bring some milestones closer and putting in some additional items, which are maybe scheduled for FY 2017 into FY 2016..
- The second is related to our biologics strategy which is about six months to eight months from prime time. What we are evaluating very actively right now is fast-tracking some of the allocations or investments in that business, and pushing that into this year. The third is on the consumer health business. That is again something we are evaluating. You are aware

that we have spun it off into a separate subsidiary. At this point of time, there is one product, which is in that business, and there was a certain budget that the business had. We are evaluating accelerating options. So that means some additional investment cost in the consumer health space as well.

Anubhav Agarwal: So, regarding the last one. Consumer healthcare, when you report that number, would that lead to higher capex or higher R&D? See in all the three, would it relate to higher R&D?

Anant Atal: It will show up in our opex.

Anubhav Agarwal: All three in opex. Just a related question: what was R&D in the quarter and what is the guidance for the year?

Anant Atal: We do not give quarterly breakdown of R&D expenses, but what we have stated is that last year we closed at about 6.2%. Over the next two, three years, we will probably get to the 6% to 8% of sales level. Assume the organic run rate towards the 8% number over the next few years.

Anubhav Agarwal: The purpose of asking this question is that since you are fast tracking some of these projects, will it have meaningful impact on the R&D number?

Anant Atal: I think it is a little early to give the exact number, but I would say it could go 100 to 200-basis points actually. Once we do have a little more clarity on some of those after evaluating, we will get back to you.

Anubhav Agarwal: My second question was on the South Africa market. You mentioned that you have had double-digit growth in the prescription market. What was the growth?

Anant Atal: We have grown significantly faster than the market rate of growth.

Anubhav Agarwal: I was confused because some of your peers reported very weak growth in this market. So, I do not know how much the market grew on the prescription side in this quarter.

Anant Atal: It was in the mid-single digits that the market grew at, actually closer to the 7% to 8% kind of level, as per my understanding. But we have grown significantly faster than that in the private market.

Moderator: Thank you. Next question is from the line of Nimish Mehta from Research Delta Advisors. Please go ahead.

- Nimish Mehta:** Thanks for my taking question and congrats for great numbers. I have two questions. Firstly, if you can just clarify on our tie-up with Salix on Rifaximin? Valiant has got an approval for irritable bowel syndrome with diarrhea, so will we be getting the royalties based on those sales?
- Anant Atal:** Nimish, unfortunately I cannot give details on this one. You will need to direct that question to Salix because we have a very strict agreement with them on commenting on this agreement. So, I would request you ask Salix and see how they comment.
- Nimish Mehta:** If you can just let us know whether any of this money has been received in this last quarter?
- Anant Atal:** It is not related to this, and again I am not commenting. Last quarter we had disclosed that we have received two milestone payments from Salix.
- Nimish Mehta:** After that we are not receiving anything, okay. The other thing I just wanted to know was on the possible timeline for the launch of Truvada and Atripla, where I guess we are partnered with Teva and we have FTF exclusivity?
- Anant Atal:** Again, I do not know the exact timelines Nimish, but I know it is not in this financial year. I believe there is the patent expiry timeline question there. So we are looking at it probably several years out. I do not have the exact year of launch and in any case, that would be in our partner's hands.
- Nimish Mehta:** Understood. And finally on the other expenses, I mean I understand the staff expenses will remain the same, the other expenses also has kind of grown by Rs.40 Crores on a quarterly basis, is that something which we continue to be the base effect?
- Anant Atal:** In the other expenses relative to Q4, we have seen about Rs.30 Crores increase, which is a 3% increase. The three key elements resulting in the increase are the increase in R&D expenses, which we have had in Q1. There are some increases due to front-end building in new markets and of course the normal manufacturing sales promotion and freight-related expenses. So, I think this is a reasonably fair kind of run rate to assume for the rest of the year.
- Nimish Mehta:** Why I am asking this is because in Q4 we mentioned that three-fourth of the entire year's R&D expenses were booked in Q4 FY15. So, we are talking about further hike over that.
- Anant Atal:** Yes absolutely. That is correct.

- Nimish Mehta:** Thank you very much.
- Moderator:** Thank you. Next question is from the line of Sameer Baisiwala from Morgan Stanley. Please go ahead.
- Sameer Baisiwala:** Thanks, Good evening everyone. Is it possible to update us on your combination inhalers for the European market?
- Anant Atal:** Yes. There are really two updates. One is that we have launched the product in a new market - Romania. Last quarter we had two new markets for Hungary and Belgium. So this quarter, we have launched in Romania. Our market shares continue to increase. Last time we had mentioned that on average we are talking about 15%. So, we have gone north of that and we are between the 15% to 20% market share for the addressable market that we are playing in. Again, I think beyond that, we are keenly awaiting approvals from certain key markets. And there are other markets where we have approvals for and we are just awaiting pricing reimbursement approvals. Hopefully within the next quarter, we will have a few more markets added.
- Sameer Baisiwala:** What is the dossier status in terms of for the UK market?
- Anant Atal:** It is filed and awaiting approval.
- Sameer Baisiwala:** You see that launch happening in current fiscal?
- Anant Atal:** It is very difficult to say Sameer. We would like to have it in FY 2016. I think it is not necessarily in our control at this point of time.
- Sameer Baisiwala:** This whole basket, how much is its revenue contribution? Is it now a significant part of your international formulation or is it still a small amount?
- Anant Atal:** The way you should think about respiratory Sameer is the following. As of FY 2015, our respiratory business was in the range of about \$300-350 million. Over the next five years, we expect that to triple. So we are talking about say \$1 to 1.1 billion. As you look at that growth, about 50% of that growth is likely to come from existing markets of India, South Africa and emerging markets. So those three, where Cipla is already present, we will continue to grow market share as well as launch new products. Of the remaining 50% of the growth, about two-thirds as per our plan is likely to come from the North American markets and only one-third will come from Europe. That is the way to think about from where you are today to over the next five years. Currently, US and Europe are very negligible

respiratory sales in that \$350 million number. Again, we would not give the exact figure, but it is less than 10% currently.

Sameer Baisiwala: This is very helpful. My second question is related to Nexium. You mentioned that a lot of this upside has been booked in Q1 based on whatever Teva had sold and it had sold a lot of stuff in the channel. Now in the Q2, we are in middle of August, how have the supplies been for this quarter and how does it compare from what you have done a quarter back? What have you done and what orders do you have on hand? I mean, are they comparable or are they a lot lower or higher?

Anant Atal: They are lower than what we did earlier. We are supplying as and when Teva is requiring us to supply and we are maintaining the supplies as per their schedules. But it is lower than what we had experienced in the previous quarter.

Sameer Baisiwala: Okay. This is quite helpful. And I am not quite sure whether you have a view on this, but would you have an idea how much inventories in the system in terms of weeks or months?

Anant Atal: Unfortunately not. I think Teva would probably be best placed to answer that because they are one step closer to the customers and hence they would have a view.

Sameer Baisiwala: Yes, but they would not tell us. Okay. Sir, just one final question if I may. On the margins, from what you were doing two quarters back 16% to 19% and what you have done this quarter is about 27%, 28% at operating level. So, what is the sustainable rate that you expect if you fast-forward whatever to two full quarters and Nexium is kind of more diminished?

Anant Atal: The way we are trying to look at it, Sameer, is we want to get to mid-20s kind of EBITDA margin levels. That is our medium-term aspiration. Now, at current absolute levels, we see our fixed cost base as kind of more or less stable. They will of course be some of the inflation-linked increases. And again, quarter-on-quarter margins can vary significantly due to the lumpy nature of certain costs and specifically R&D if we fast track certain expenses in bio and the consumer health business. The way to think about it is we closed last year at 19%. We are going to move through mid-20s over the next three to five years. Our guidance is 100 basis point to 150 basis point improvement, which is what we are actually staying with at this point of time because we want to take the conscious decision on how best to reinvest. This is what we are sticking with at this point of time for FY 2016. If we have better line of sight in Q2 then we may come back and revise it.

- Moderator:** Thank you. Next question is from the line of Saion Mukherjee from Nomura Securities. Please go ahead.
- Saion Mukherjee:** Good evening, and thanks for taking my question. Sir, it would be helpful on the export formulations if you can share revenues for some of the key markets?
- Anant Atal:** Unfortunately, Saion, we have debated this point and we will not be sharing that on a quarterly basis. Directionally all our regions have demonstrated strong growth. I think the weakest was India at 8.5% level. You have seen what our API growth rate is as well in the disclosures, so that is also strong. Of course, you can assume North America is strong because of the Nexium impact. That leaves International, South Africa and Europe, all three of which have also been very strong from an organic base point of view.
- Sudhanshu Priyadarshi:** And Saion, this is Sudhanshu. We have said that we are maintaining the growth rate that we had in Q4. We have given you the breakdown. We are seeing the sustainable growth, so you can work your model there. We do not break it by market, in the quarterly results.
- Saion Mukherjee:** On the tender side of the business, can you throw some light as to how big that is a contributor on the export formulation in this quarter?
- Anant Atal:** Actually there has been a bit of a slowdown on the tender side of the business in Q1. And so again there may be a bit of a pickup in H2. But in Q1, there was a relative slowdown.
- Saion Mukherjee:** Okay. And just one clarification on Nexium the way you would book revenues on the profit share side. So when you say that revenue, the profit share that you booked this quarter, is that linked to whatever supplies you did in Q4?
- Sudhanshu Priyadarshi:** Yes.
- Saion Mukherjee:** Okay. So the Q1 supplies, whatever you have done would be booked in Q2?
- Sudhanshu Priyadarshi:** That is correct.
- Saion Mukherjee:** Okay and what you are saying is the supplies in Q1 is lower than what you supplied in Q4?
- Anant Atal:** Directionally, yes.
- Moderator:** Thank you. Next question is from the line of Chirag Dagli from HDFC Mutual Fund. Please go ahead.

- Chirag Dagli:** Sir, can you share a light on LOTRONEX, which is Alosetron, if this is a product where we are supplying the formulation or the API, because I understand you have been sued along with generic company or partner?
- Anant Atal:** I am unfortunately not aware of this issue, Chirag, and I do not think anyone in this room is actually aware of this. So if there is any disclosure to make, we will make a public disclosure.
- Chirag Dagli:** Okay. And on Budesonide, we are supplying full product and the profit share should be similar to what we have been having in the past. I mean, is there anything out of the ordinary for this agreement per se?
- Anant Atal:** we cannot comment on the kind of agreement that we have.
- Chirag Dagli:** But all I am asking is if there is anything out of the ordinary in this agreement per se?
- Anant Atal:** Unfortunately, we are not in a position to comment on that, Chirag. We are manufacturing the product, you see it on the label. They have launched the 1 mg. We will be supplying all three strengths and we cannot comment on the timing of launch of the other two strengths. We cannot at this time disclose the financial impact or the nature of commercials, because it is not the straightforward kind of agreement.
- Chirag Dagli:** Okay. I understand. And Sir just lastly, just a clarification. Did you indicate the kind of margin guidance for FY 2016?
- Anant Atal:** Yes, we have said that 100 basis points to 150 basis points improvement, unchanged from what we had said at the start of the year.
- Chirag Dagli:** Thank you Sir.
- Moderator:** Thank you. Our next question is from the line of Fatema Pacha from ICICI Prudential Life Insurance. Please go ahead.
- Fatema Pacha:** Sir, congratulations for a great set of numbers. I am sure that a lot of Q1 profit were also because of what you have supplied in Q3 and Q4 combined as well. So maybe it is more than quarter of profit that you have done. But is it fair to say that Q1 supplies would be like 30% lower than Q4, or is it like half of Q4, or you think it is only 30% of Q4?

- Anant Atal:** So again, we did not supply anything in Q3 of last year because the situation only got resolved in February. And again, we cannot comment. What we have said earlier is that it is lower, but I am not going to comment on whether it is 30% or 50% lower.
- Sudhanshu Priyadarshi:** And it is also linked with the inventory levels at Teva, and what they are keeping in US. So we will not be able to comment on that level or on the strategy that they're planning to do. So it is better to ask them.
- Fatema Pacha:** Is it fair that you started supplying from February mid or February end? So you just had one month of supply in Q4 is it?
- Sudhanshu Priyadarshi:** We have been supplying every month. It is like a normal order pattern. And regarding their strategy of how much inventory they want to build and what they are trying to do there, we will not be able to comment.
- Fatema Pacha:** Okay, fair enough. And Sir, secondly on the fixed cost, obviously employee cost in the last four years have more than tripled, but just wanted to understand that, on generally the entire fixed cost structure, what is the percentage it is at? This quarter we have new, because you have got like a lot of companies have a good margin, so they will do a lot of investments in that quarter. Or this is both employee cost and other opex is like a sustainable number, and Q2, Q3, may or may not have next year, but these numbers are here to stay?
- Sudhanshu Priyadarshi:** Yes. As you see the Q4 number, we had 514 Crores and then in Q1 we did it on 620 Crores. This was some driven by giving the regional bonus payouts and all, so this is the level of expense we will continue.
- Fatema Pacha:** Bonus would not be a quarterly number, right?
- Anant Atal:** It won't be a quarterly number but it was a reasonably smaller amount. If you look at the employee cost plus other expenses bucket together, that is a fair base that you can assume for the rest of the year.
- Fatema Pacha:** Fair enough. And this is how you have built your FY 2016 margin guidance that the cost will remain here. And nexium, may or may not continue. So, in that sense, margin is some 27% now. Again by end of Q4, it would be flattish to last year Q4?
- Sudhanshu Priyadarshi:** Yes.
- Fatema Pacha:** Thank you.

- Moderator:** Thank you. Next question is from the line of Nitin Agarwal from IDFC Securities. Please go ahead.
- Nitin Agarwal:** Thanks for taking my question. Can you share some experience in the German market, on the Salmeterol launch and how has it played out, the combination launch, in terms of market share gains you have had since the time you launched it?
- Anant Atal:** Yes, It has been a lot of hard work. We have been very prudent in that market and we did not build a lot of fixed cost in terms of headcount. We have gone with a kind of managed contract sales force model. We have had to invest a lot in education with the doctors, with the sick funds and have had to create a lot of pull at the doctor level. What we are seeing is two things, one is that the number of new patients continues to increase month-on-month. Second, we are seeing more and more traction with tenders as they are coming up in every quarter. Overall there is good traction and again, not just in Germany, which has probably been amongst the slower growing markets relative to the rest of Europe.
- Nitin Agarwal:** But in your experience, when you sort of launched your product across markets, you have seen the innovator fighting back more hard in some of the larger markets compared to some of the smaller markets where the market share gains have been far more aggressive?
- Anant Atal:** I would say yes. They have definitely engaged more with the sick funds and the buyers per se. And that was expected.
- Nitin Agarwal:** And secondly on the OTC business, when you have done this structure, so what value does affidavit investors would have bring to the table? And I am really surprised in the sense, what really curious to understand is, because you have only one product in the business right now as you mentioned if I got it right. So it is in such a nascent stage. So how does getting investors at this stage, financial investors at this stage, how does it really help us?
- Anant Atal:** There are a couple of things. One is that Fidelity globally does have experience in this field. So they can bring some learnings from other areas. You understand why we spun it off. But there is also an element of derisking and diminishing the impact on our financials in the short, medium term. We have spun it out, to attract and develop the expertise, which is more FMCG oriented, and to create the operational independence. You also have more flexibility with respect to unlocking value and getting access to funding. And over the long term it is not just going to be one product. There will be more products that will come into the pipeline. So if I do need to invest more money then I have access to additional capital and am not constrained with my own balance sheet, because I have other areas to invest whether it is in R&D or biologics.

- Nitin Agarwal:** Thanks very much.
- Moderator:** Thank you. Our next question is from the line of Mehul Bhatt from HSBC AMC. Please go ahead.
- Mehul Bhatt:** What I want to understand is as you extinguish external distribution around many of these countries and create your own beachhead in these markets, how does that impact revenue and costs? How does one understand this impacting the P&L for Cipla both quantitatively and qualitatively?
- Sudhanshu Priyadarshi:** So all of these deals are obviously margin accretive for us, because you capture the front-end value. But the biggest risk in pharma is the product, and here we are making the product. So we are capturing the front-end value. We are capturing all the IPs and dossiers in our name. So in a way, we are derisking the business from the distributor. And we have done it in 20 to 25 markets and all of those markets, we have payback of less than four, five years. And you will see some higher people cost, but higher gross margin also because you are capturing the front-end value. But net-net is all marginal profit accretive for us.
- Anant Atal:** The way to think about it, Mehul, is twofold. One is that there are certain markets where we will continue to operate B2B. And when I say B2B, I mean with my existing contract manufacturing and supplying model. But I will also do a front-end in that market. So I will have both models operating in that country. Then when you think of my direct to market model, think of it as two ways. One is that I have already been present in that market for several years. And that is where Sudhanshu's point on it becomes margin accretive on day one, but then there are some other markets, maybe certain European markets where I am actually creating new infrastructure from scratch. It is new revenue I am creating.
- Mehul Bhatt:** Right. Sure. There were a lot of questions on the cost structure, so I do not want to repeat the question, but as you see it today, has that been more or less captured in today's P&L or is there more to go?
- Sudhanshu Priyadarshi:** More or less all of the fixed costs have been captured, but obviously R&D investments will continue
- Mehul Bhatt:** That I understand. Thanks.
- Moderator:** Thank you. Our next question is from the line of Manoj Garg from Healthco. Please go ahead.

- Manoj Garg:** Good evening. I have a set of questions on Nexium. First, one on the impact from Mylan's introduction last week. Two, on authorized generic. And then three, just a little bit of a product related question. But the first one since you are not necessarily willing to give specific product guidance or product numbers or inventory levels, can you at least share what impact you have seen from the Mylan introduction in terms of price? I recognize it is probably a little bit early to make any assessment on market share, but how about on price?
- Anant Atal:** I think it is very early, Manoj. We have not actually seen the impact as yet. I think we will probably get that visibility only over the next month.
- Manoj Garg:** Okay. And then two, I think Teva did an excellent job to maximize profitability by keeping their market share at around 50% and keeping authorized generic from Astra off the market. But now with the introduction of the Mylan product, are you hearing any rumbling of authorized?
- Anant Atal:** Again, we know that there are many other players in the queue and it is very difficult to say who else is going to launch and exactly when specifically the authorized generic will enter. We may have actually expected it to come earlier. So we will monetize it while things are the way they are.
- Manoj Garg:** Okay, great. And my last question is just a product-based question. So if I look at the Omeprazole market, the racemic mixture, I think I see about 13, 14 companies that are in that market in the US. So I was wondering if you could educate me a little bit about what is it to go from the racemic mixture to isomer that is causing the hold up for the other companies. Or is it something else beyond just the science of going to the isomer that you think is causing the hold up?
- Anant Atal:** I am unfortunately not technically qualified to respond to that Manoj. But I think what we do know is that there are up towards 10 or 11 players in the queue. So we would expect over the next six to nine months the market to get pretty competitive in the way you have seen for Omeprazole. That is pretty much the extent I would be technically qualified to comment unfortunately.
- Manoj Garg:** Do you guys have a general sense as the API being supplied by potentially some companies that are having compliance issues and maybe that is causing the hold up?
- Anant Atal:** We would not know that. I do not think so. But we wouldn't necessarily know that for some of the others.

- Manoj Garg:** Congrats on that product opportunity. I mean I do not think very many people expected it to be an exclusivity situation. And even now, with a two or three player market, it could be pretty healthy tail for you guys for some time.
- Anant Atal:** Thank you. I think we are more or less out of time are we?
- Moderator:** Yes, Sir. I now hand the floor back to you, sir, for closing comments.
- Sudhanshu Priyadarshi:** We have mentioned that we are looking forward for a great year. We have had a good last six months and we have been maintaining our organic momentum. And we look forward to speaking to you next quarter.
- Moderator:** Thank you very much. Ladies and gentlemen, on behalf of Kotak Securities Limited, that concludes this conference call. Thank you for joining us. You may now disconnect your lines.