"Cipla Q1 FY18 Earnings Conference Call"

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MODERATOR: **MR. CHIRAG TALATI – KOTAK SECURITIES**

Moderator: Ladies and Gentlemen, Good Day and Welcome to the Cipla Q1 FY18 Earnings Conference Call hosted by Kotak Securities. 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 '*' then '0' on your touchtone phone. I now hand the conference over to Mr. Chirag Talati from Kotak Securities. Thank you and over to you, Sir.

Chirag Talati: Hi, Good Evening, everyone. This is Chirag from Kotak Institutional Equities. I thank the Cipla Management Team for giving us the opportunity to host this call. From Cipla, we have with us today, Mr. Umang Vohra, MD & Global CEO; Mr. Dinesh Jain, Head, Corporate Finance; and Mr. Alpesh Dalal, Head of Investor Relations at Cipla. Over to you, Sir.

Alpesh Dalal: Thank you very much, Chirag. Good Evening everyone and welcome to the Q1 earnings call of Cipla. Due to some personal family situation, Kedar is unable to join the call today, so we would like you to pardon us for that. On this call, our discussions will include certain forward-looking statements which are predictions, projections, and other estimates about future events. These estimates reflect our current expectation of the future performance of the company. Please note that these estimates involve certain risks and uncertainties that could cause our actual results to differ materially from what is expressed or implied. With this, I would now like to hand over to Dinesh who will take us through the financial details of the quarter.

Dinesh Jain: Thank you, Alpesh and Good Evening to all of you. Welcome to our Earnings Call for the First Quarter of Financial Year 2018. I hope you have received the investor presentation that we have posted on our website. I will now take you through the financials for the quarter. Overall income from operations stands at Rs. 3525 crores declining 3% year-on-year as the domestic Rx business witnessed loss of sales of 20 to 25 days for the month of June due to destocking by the channel in anticipation of GST. Margin after material cost grew to 67% recording an increase of 400 points year-on-year driven by the cost-containment measures and favorable geography in product mix and certain one-time benefits in material cost. During the quarter, we maintained a strong control on the spend with total expenses which included employee cost and other expenses of Rs. 1702 crores declining by 3% on a sequential basis.

Employee cost for the quarter stood at 673 crores, a decrease of 2% year-on-year. The other expenses for this quarter includes R&D, regulatory, quality, manufacturing expenses, and sales promotion stood at Rs. 1029 crores increasing 5% on a year-on-year basis, largely on account of increased production for upcoming launches. Total R&D investment for this quarter stood at 6% of revenue; while the spend for the quarter is on the lower side, we expect to continue our R&D investments in the remaining nine months with certain key product trials expected to begin soon. EBITDA for the quarter has been impacted by Rs. 45 crores on account of one-time GST transactional related charges. Reported EBITDA for the quarter stands at Rs. 646 crores or 18.3% of revenue, an increase of 6% on year-on-year basis driven by significant margin improvement and control spend despite the India business being severely impacted and the Rs. 45 crores charged in the period as mentioned above. The tax rate for the quarter was 23.5%, the effective tax rate for the quarter has seen an increase over the last year due to reduction on weighted deduction of R&D expenditure.

As you may be aware, we completed divestment of animal health business in South Africa during the quarter. We recorded a one-time profit on sale of this business of Rs. 118 crores. Profit after tax stood at Rs. 409 crores or 11.6% of the sales up 21% from last year. Operating cash flow for the quarter stood at Rs. 108 crores. In Quarter-1, we invested approximately 221 crores on CAPEX and we still continue to monitor those investments in the coming quarters. Our average quarterly rate will be approximately Rs. 200 crores. Our long-term debt remains at USD 550 million, which was mainly used to fund the InvaGen acquisition. We also have working capital loans of about USD 92 million, which act as a natural hedge towards our receivables. Total net debt to equity ratio is 0.20, there is slight improvement, outstanding forward contract as a hedge for receivable as of June 30, 2017, are USD 122 million and ZAR 583 million.

During the quarter, we have also hedged a certain portion of our forecasted export revenues. The outstanding forward contract as cash flow hedge as of June 30, 2017, are USD 86 million and ZAR 25 million. Recently, India Ratings and Research affirmed Cipla's long-term issue rating at AAA, which is the highest with stable outlook. I would now like to invite Umang to present the business and operational performance.

Umang Vohra: Thank you, Dinesh. Unfortunately, Kedar is not with us today but he has a family situation and we wish him and his family all the very best in the situation that he is in today. I am happy to announce that we are progressing satisfactorily on our key priorities. US launch plan is progressing smoothly and on target to deliver one differentiated product launch per quarter starting the end of Quarter-2 and early Quarter-3. We have seen strong growth momentum in our key markets. South Africa maintained this leadership position in key therapies this quarter, our growth exceeded the IPM growth in India as well. Our cost-containment initiatives have resulted in significant improvement in margins. We have identified multiple areas of targeted cost savings in direct and indirect spend which will continue to drive a culture of synergy, simplification, and efficiency.

We continue to unlock value in the respiratory space. I am excited about the launch of our flagship respiratory product, FPSM in Australia, our first generic inhaler in the market which will be followed by many more. This continues to reinforce our ongoing respiratory franchise and expansion. Our manufacturing and R&D sites remain in a state of compliance and control, and several of which have been audited in the last quarter. US ANDA pipeline filings continue to improve. We filed three ANDAs of which two are likely to exhibit limited competition. For the quarterly performance of the total revenues of 3525 crores, 36% was contributed by the domestic business, 61% by the international business, and the rest by other operating income.

I will now take you through our business performance starting with our India business. The industry saw significant challenges in Quarter-1 '18 due to the impending launch of GST in July

2017. During the quarter, the business degrew 13% year-on-year primarily on account of primary sales loss in June as the channel destocked in anticipation of GST. Despite this impact as per IMS Q1 FY17 data, Cipla outpaced the market growing at 5.6% versus the IPM at 4.8%. As mentioned earlier, we have further strengthened our diabetic portfolio through strategic partnerships with Janssen and Novartis. With the launch of Prominad, which is Canagliflozin, and Vysov, which is Vildagliptin, we now have a winning portfolio to strengthen our presence in the core diabeto and endo space. This is important as we will continue to build our chronic portfolio in the market. This quarter we will work with the doctors in the channel to drive these stocking to ensure patient access and continue to build on our prescriptions.

Our North America business has registered a growth of 2% compared to last year in dollar terms. As we prepare for our upcoming launches starting the end of the quarter, our base business out of US is now averaging roughly 100 million per quarter. Our efforts on executing new launches and those processes have helped us offset price decline in our portfolio. The quarter saw launch of four new products addressing a total market size of US 390 million and a partnered product. As per IMS MAT June '17, Cipla is the market leader in nine out of 48 marketed products covered under IMS. We are in the top three positions for 28 of the 48 products. As announced earlier, we remain focused on one differentiated launch starting in the end of Quarter-2 and beginning of Quarter-3.

We expect to launch over 10 new products in the remaining part of the year. During the quarter, we filed three products and are on target to file 25 ANDAs in the financial year. As of June '17, we have a total of 96 ANDAs pending for final approval including 26 with tentative approvals. Of these 96, 68 are Cipla InvaGen ANDAs, 11 are partnered and 17 are filed under PEPFAR. We have reorganized our business for synergy, accordingly our South Africa, Sub-Saharan Africa and CGA-based business are now managed together. The overall region recorded a growth of 5% on a year-on-year basis. Our South Africa business delivered 10% growth versus last year. As per IMS MAT, Cipla grew 10.3% in the private market versus 9.2% market growth and maintained its position as the fourth-largest Pharma company at 5.8% market share.

We are also pleased to report that in a recent study performed by Lodestar Marketing Research, Cipla is perceived to have the most effective sales force ahead of our competitors in the region. Amongst other key therapies, Cipla maintained its leadership position in respiratory with over 30% market share with significant incremental growth contributed by **SynchroBreathe.** During this quarter, our Ugandan subsidiary, Cipla QCIL signed an MoU with the government of Zambia for the supplies of anti-malarial and anti-AIDS drugs bolstering Cipla's position as the partner of choice for government institutions.

In Europe as a result of our successful turnaround, the business grew 38% year-on-year driven by strong performance across key markets contributing further towards the profitable trajectory. FPSM sales in the region touched US$ 6 million during the quarter with the UK still expected to ramp up over a longer-term horizon.

In emerging market territories outside of Sub Saharan, Africa, and CGA, our quarterly sales grew 15% year-on-year in dollar terms. The DTM market is performing well in line with the strategic shift we wanted to make. We continue to evaluate in-licensing opportunities to bolster our product portfolio in the region.

For the upcoming quarters, our focus remains on strengthening our priority markets and driving growth. Also we will remain focused on our agenda of cost consciousness while investing for growth and maintaining the filing momentum in the US. We are continuously working towards building a strong specialty portfolio for the US. Upcoming quarters, we will see initiation of the first patient study for the Tizanidine patch that we in-licensed from MedRx. We are also evaluating multiple opportunities in the orphan areas in both Neurology and Respiratory.

During the quarter, Cipla became one of the two companies to partner with American Cancer Society and Clinton Health Access Initiative to expand access to essential cancer treatment medications across various African nations. This is in line with our ethos of improving access and affordability of life-saving medicines. I am happy to share that recently Cipla was ranked as the most respected company in Pharma by BusinessWorld, this is a result of an extremely strong legacy and the passion which all Ciplaites bring to work every day. I would like to thank you for your attention and we will request the moderator to open the session for Q&A.

Moderator: Thank you. We will now begin the question-and-answer session. The first question is from the line of Saion Mukherjee from Nomura. Please go ahead.

Saion Mukherjee: My first question is regarding the gross margin, you mentioned there is a one-time benefit in material cost, will it be possible to quantify the impact there?

Umang Vohra: Approximately, Saion, of the 400 basis points we believe 250 basis points is repeatable and should come quarter on quarter, about 100 to 150 basis points is what is possibly an impact on account of this quarter alone.

Saion Mukherjee: My second question is on Renvela launch, how do you see the competitive landscape through the rest of this fiscal year?

Umang Vohra: I think it is a very exciting opportunity, but I do think that there could be multiple players who are looking to launch and like them, we are also preparing for this launch.

Saion Mukherjee: It will be like 3-4 player market do you think or more?

Umang Vohra: I would not know Saion because it is almost, I would not have any clue on that but we think it is still attractive.

Saion Mukherjee: Umang, just one last question, of the 96 ANDAs which are pending, how many you would classify as limited competition on niche approximately?

Umang Vohra: I do not think we have that level of detail, Saion, except that our trajectory shows that we could have one launch per quarter starting Q2-Q3.

Moderator: Thank you. The next question is from the line of Anmol Ganjoo from JM Financial. Please go ahead.

Anmol Ganjoo: My question is on the domestic market, Umang, before demonetization and then GST hit us, we were working with from 1H FY17 run rate of around 5800 crores of domestic sales which also translated to around 13% to 14% growth over FY16. I know it is early days to quantify the GST impact yet, but given that you have recorded sequential growth for the domestic market, is it fair to believe that the worst impact of GST is behind us and once the dust settles on the Indian domestic market, we are likely to revert to historical or what we have seen before this disruption 12% to 13% domestic growth rates, and if yes, then from what base?

Umang Vohra: For us it may be better if you look at our year-on-year because we are an acute company, we are a company with a very large acute portfolio compared to some of the others who have chronic portfolios so though sequentially we may have grown, on a year-on-year basis, we have actually fallen and that is the impact of GST. Looking at how July has gone, I would like to believe that the situation will significantly improve in this quarter. There are pockets of the country where we are still seeing problems which are typically in UP and Bihar, but I would like to believe that by the end of this quarter, things either would have already normalized or would have significantly normalized on account of GST.

Anmol Ganjoo: Thanks, that is helpful, but basically my question was slightly different what I was trying to understand was that from a market leadership standpoint, you have been having a gap vis-à-vis the market, so do you see kind of any fundamental changes to alter that as a consequence of this disruptions?

Umang Vohra: No, actually we do not and I think the last two or three quarters, we have been showing that we are growing higher than market from a prescription IMS perspective. This quarter because of the destocking, it has hit us harder than it has hit others just because of the share of our acute portfolio, so we have taken a hit this quarter, but we are quite optimistic about how this pans out in the next couple of quarters.

Anmol Ganjoo: My second question is related to your remarks, Umang, you obviously had great success in addressing some of your priority areas, but it so appears that most of the effort or the results thereof have been concentrated on the cost side, we have yet to see meaningful uptakes in core market except South Africa, what is your assessment in terms of given that we have a much leaner cost structure now of the benefits of operating leverage and faster growth reflecting in operating numbers?

Umang Vohra: Let talk about our market, South Africa as you know is growing higher than market, last year India grew higher than market. We are hoping that in the next couple of quarters, India continues to grow higher than market and US we have been guiding that we file products and the launches will hopefully start coming in end of Quarter-2 or early Quarter-3, so those are the three big trajectory drivers, emerging markets will continue to see volatility, and therefore, from a growth perspective it would be these three core areas which will continue to see growth. Also on the cost side we are still working, we are not done with, I think there is some leverage that we can still get on the cost side.

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

Prakash Agarwal: Just trying to understand the gross margin thing better, you did mention about the one-off 100-150 basis points, but still if we see there has been reasonable increase in gross margins and 100 to 250 basis points if we see YOY, and this is despite India business being lower, so is this a result of a good product in US Epzicom or is it South Africa, what is driving this gross margins?

Umang Vohra: It is a mix of couple of factors. The first is obviously we have, I think Kedar mentioned in the previous couple of calls that we have our own program of cost that is going on and I think that has led to this to margin improvement. We have seen mix also and we are working on mix as well in our numbers, so I think it is a mix of these two or three things, it is a cost improvement strategy, it is product mix and how we are trying to make that very optimal, so it is a mix of both of these, and this has also happened despite taking almost a 45 crore hit on account of the GST which are the transitionary recharges on account of GST, so I think margin wise, the 200 to 250 basis is largely on account of procurement, account of mix, and some other factors.

Prakash Agarwal: It would have been higher by 50 crores is what you are saying?

Umang Vohra: No, I am seeing that the 50 crores that we are seeing on account of GST roughly offsets the amount then we are telling you that is not sustainable on the margin side.

Prakash Agarwal: When you say product mix, it is within the geography itself?

Umang Vohra: It is both, mix of geography, mix of product, our rationalization exercises that we did last year in cutting geographies that has helped. Europe has become profitable for us that is helping because the mix there has changed. I think sum of the factors coming together.

Prakash Agarwal: Secondly, on the US, I missed your comment on Renvela and the launches that we expect in terms of what are the kind of launches you expect and the pricing pressure comment, please?

Umang Vohra: We have seen pricing pressure level similar to the others, which is high single to low double-digit type of pricing pressure, we are seeing that as well on our portfolio. I think on Renvela we are just seeing that the opportunity is exciting, but we have no clue on finally how many people show up and when, I think it is difficult to say that right now because the product is quite extensive in the requirements for API and it is difficult to gauge where most people are from an API perspective.

Prakash Agarwal: Actually I missed your comment, when do we expect this for us?

Umang Vohra: We have not guided to it.

Prakash Agarwal: The launches, Sir?

Umang Vohra: Launches, we said starting end Q2, early Q3, we will have one differentiated launch every quarter.

Moderator: Thank you. The next question is from the line of Neha Manpuria from J.P. Morgan. Please go ahead.

Neha Manpuria: Sir, one bookkeeping question first, how much was the InvaGen sales, is it still clocking the 55, 54 million?

Dinesh Jain: Yes, it is approximately in the same range of 54-55 million.

Neha Manpuria: Sir, when do we expect this to ramp up, the differentiator launches that you are talking about, would you see ramp up in InvaGen , there is a pipeline that we still have pending, so should we see ramp up in that InvaGen sales at that point of time?

Alpesh Dalal: Neha, basically Cipla we have been holding this, we have been running this business for more than a year and now as we see it within our Cipla system is there it is part of overall Cipla US business, we have stopped differentiating between InvaGen and Cipla and I think we should look at the business at an overall level. The business has done what we wanted the business to do that was to provide the right kind of base for us and that is helping our overall business, so we should start looking at Cipla's US business as one and not differentiate it between two different pockets of Cipla and InvaGen.

Neha Manpuria: Sir, let me rephrase my question, we have bought InvaGen for the frontend and also because of the value in the pipeline given the increasing competition etc., have we seen the value from the pipeline deteriorate versus our initial expectations one year back?

Umang Vohra: We are on track with our expectations, Neha, the question you asked was that when will we see the 55 moving up and we are saying that the pipeline is both, it will start moving up as the InvaGen pipeline unlocks, so just before we were discussing a product also which came to us from InvaGen, which was Sevelamer, so it really depends on when these products get approved and I think the trajectory will start tracking up once those happens, but I think what we are also telling people is because we are optimizing R&D across locations whether in the US or India we are choosing to look at it as one, but the InvaGen has met our expectations.

Neha Manpuria: What is the R&D spend for the quarter?

Umang Vohra: R&D spend is at 6% of sales.

Neha Manpuria: My last question Sir, there is a comment about we are looking to monitoring our CAPEX number, so have we reduced our CAPEX as we look at it for this year, if you could just update us on the CAPEX guidance?

Dinesh Jain: As earlier we mentioned, we are looking at controlling but at the same time it is just a temporary flip and as I mentioned earlier in my thing 200 crores per quarter will be our trajectory for the current year.

Neha Manpuria: Any specific reason for the change in the CAPEX strategy, are we postponing some of this to next year?

Alpesh Dalal: Neha, this is more of maintenance CAPEX that we need to do now. In last couple of years, we had some expansion CAPEX that was happening, but now it is more of maintenance CAPEX that we would be incurring, so it has settled down at a particular level and in the immediate near-term future we do not require any further expansion CAPEX.

Moderator: Thank you. The next question is from the line of Krishnendu Saha from Quantum Mutual Fund. Please go ahead.

Krishnendu Saha: Did we file any inhalers for the US market this year or this quarter?

Umang Vohra: No, we have not filed and I think those would be fairly big events for us to mention as we file them.

Krishnendu Saha: Could you let us on the timeline as to how, where we are in the case of Proventil and Abraxane, how far are we suppose of getting approvals or the target action based, could you let us know?

Umang Vohra: Target action base towards the end of the year for Proventil and nanopaclitaxel as you know is a litigated product, therefore, it has been the target action date may not have any consequence to the approval of the product.

Krishnendu Saha: Last question, you spoke about one product every quarter, is it possible for you to quantify as to how am I to understand how big the situation is, so any figure which you have is like?

Alpesh Dalal: Krishnendu, we have not quantified what means a significant product, I think the market generally has an understanding what important products are and what it could mean to a company, so we have not gone ahead in quantifying what means a significant product from our perspective.

Krishnendu Saha: Would it be less competition or that is what I am trying to understand?

Umang Vohra: These are niche opportunities, let me put it that way.

Moderator: Thank you. The next question is from the line of Anubhav Agarwal from Credit Suisse. Please go ahead.

Anubhav Agarwal: Dinesh, one question that Umang talked about GST transitioning charges of 45 crores, where would you have recorded that, is that netted of sales?

Dinesh Jain: Some part of it is part of the sales because of the GST there was a lot of talk about the impact being there in the inventory and the additional loss is our channel partner had to bear, so a part of it is sitting on the revenue side, actually most of the part is sitting on the revenue side.

Anubhav Agarwal: Can you give some color that when you talk about 150 basis points one-off in gross margins basically quantum is roughly about 50 crores, so what is the nature of this 50 crore item because of which material costs are lower this quarter?

Umang Vohra: Just to be clear 1.5% that we mentioned is basically items that will not recur in the next couple of quarters, it could be the high sale of one particular product which has a really high margin mix, it could be some inventory movements that is what we called as what will not recur, not something which we have necessarily reversed or anything like that.

Anubhav Agarwal: Umang, if I look at the material cost itself, so that itself is down meaningfully whether I look at sequentially or year-on-year, so that is the reason I was asking what has led to such a low material cost?

Umang Vohra: It is both, it is the amount of cost control we are bringing into the business, it is mix and it is a lot of the other pricing-related decisions we have also made with respect to some, it is rationalization that we did in the previous year so when we said that 150 is not repeatable, it means that we will possibly not have the right mix, the same mix in the next quarter on account of the products that have been sold, etc.

Anubhav Agarwal: Just one question on the 25 target filings that we have for the year, just a very broad sense that how many of this will be orals and how many non-orals, like non-orals 20% what you are targeting or is it like 30%, some broad sense will be helpful in the context, the reason I am asking this is that out of let us say the R&D that we are ascribing to the US right now presuming that majority of it is going towards oral side, what is happening in the market now given the increasing competition in the orals, are you taking a conscious decision to reduce the spend towards oral products now?

Umang Vohra: I dont know if we are taking a conscious decision to reduce spend too orals because you could have the same issue with injectibles or anything else. What we are doing is we are reducing our focus on pure NCE-1 place I think as long as we do not have novel Polymorphs etc. then we are not interested in those type of challenges, so yes we are trying to move our portfolio to limited competition and not necessarily an oral and non-oral, for example we may have a product which is, this is an oral but has a unique technology to make, we will go after that product.

Anubhav Agarwal: Just last clarity, what you expect of the India growth for Cipla for Fiscal 18, very broad sense would be useful?

Umang Vohra: I do not think we are guiding to that, I think if Quarter-2, Quarter-3, Quarter-4, goes back to what we have mentioned at the beginning of the year roughly which is mid-teens growth and we are fine.

Anubhav Agarwal: Do you think next three quarters could be mid-teens?

Umang Vohra: I think we believe so.

Moderator: Thank you. The next question is from the line of Nitin Aggarwal from IDFC Securities. Please go ahead.

Nitin Aggarwal: Umang, on the R&D front on an absolute basis we are spending about 200 crores a quarter nowadays given the fact that we are going for building specialty programs as well as really talking about doing complex products, where do you see these spends really speaking, do you see the need to increase this spends in a material way over the next couple of years or do you think a calibrated growth, increase in R&D will be sufficient for us to meet our R&D objectives?

Umang Vohra: We ideally like, it is difficult to control R&D because of the phasing of the program and how the spends happen, but at no point would we like R&D to be higher than 9% of sales and for us right now, the way we look at our business and we do not have similar business I would say availability as some of the others do, their profit margins are higher than ours and we do not have the wherewithal to invest significantly in R&D, we would love to be investing 12-13% but we do not have that wherewithal today to do it because of our margin profile, so I would not expect this year to be higher than eight and overall in the next one to 2 years I doubt whether we will be significantly higher than 9%.

Nitin Aggarwal: Secondly, we have had fairly volatile gross margins over the last several quarters, now with these even if we adjust for the 150 basis points you talked about, so a 64% sort of gross margin is now like a new normal for us from a profitability perspective or there could be material quarterly variations on these?

Umang Vohra: On a normalized basis, somewhere around that range is what we are looking at, but there could be sudden variations in quarter that is fine, but on a normalized basis, we are looking at the 64-65 range.

Nitin Aggarwal: That is like a material sort of improvement over what you have delivered in the past?

Umang Vohra: Yes.

Nitin Aggarwal: Should that be flowing into your EBITDA guidance also and how should we look at EBITDA now given the fact that we have really elevated our gross margins from a guidance perspective?

Umang Vohra: I do not think it changes because this time what has also happened is that in this quarter because of R&D phasing we are almost a percentage lower, ideally we should have spent 7% on R&D, but some projects have got phased out, so I do not think that materially changes what we are guiding on EBITDA. We will re-invest if we make more but we are keeping R&D also at trying to keep it at 8% of sales.

Nitin Aggarwal: Our big thrust now incrementally is on the US and with the turmoil that the US market per se is going through and the fact that we are relatively new entrant, how do you apart from the side advantage that we have versus a lot of our larger peers, how do you see in your own analysis or assessment has the market opportunity changed any material way over the last few quarters and the time we have been begun to re-invest in this business or rather step up investments in this business?

Umang Vohra: I do not think there are step-up investments because pretty much what we have, we have the front end, we have the R&D, now certainly we are not spending as much as some of the other companies of our gross size are and the reason for that is that we do not have a base as big as them in the US, so for our base I think the level of spending we are doing on R&D is fine, so we do not see this stepping up materially after this year, our infrastructure costs are in. InvaGen is number 9 in the US by volume, both InvaGen and Cipla US, so we are fairly significant to a customer and because the customers have also merged, they are also wanting to diversify their risk across a broader range of players today, but having said that, yes, the erosion is more than what people have expected. It has impacted some of our business case as well, but considering our size, we still see this as an opportunity and as things unfold, we will be better informed about it because I will be the last to admit that there is huge amounts of certainty in the US market, I have seen it pretty up close, so we will have to wait to see how it unlocks, but where we are sitting today, I think there is a good opportunity on $400 million base products.

Moderator: Thank you. The next question is from the line of Sameer Baisiwala from Morgan Stanley. Please go ahead.

Sameer Baisiwala: Question on US pricing erosion, how much that you are seeing for your portfolio is driven by new competition, new product approval on a product by product basis for your portfolio versus the buying consortium coming in anyway asking you to cut prices, I am not sure if this is a good way to think about it, but I think these are two important drivers for price erosion?

Umang Vohra: Sameer, for us we have never split it in that manner, but I think the consortium part, I do not know have the answer to that. We can try and do some workings and come back, I do not want to hazard a guess, but you are right, both will be part of the price equation and today we do not have an answer of whether it is new competition or it is because customers are pushing back.

Sameer Baisiwala: Second question, Umang, is since you have seen US so closely what you think is the basic game over the next three year period, in the sense that how long can manufacturers really take this sort of an assault on pricing where the market leader all the way to the lowest cost producer here in India are sort of getting frustrated and thing that a lot of products actually do not make any money, it is just top five products which get bulk of the profitability from the US portfolio?

Umang Vohra: I do not know Sameer, actually it depends product by product, there could be some products in our portfolio, today also which are selling at margins that we do not want to sell them and just like every other company we would be having the same conversations as well. I just think that the US market the best way to understand it is that it follows the commodity cycle and it is very close to a commodity cycle. I think we saw a situation like this in 2005 to 2007 or 2008, manufacturers exited then prices started going back up and then manufacturers came in and then the prices started going back down, so I think generally it takes a good 2 to 3 years for people to want to exit from product categories, I do not think the exit happens at the same time, so I would think that the current situation could possibly continue for a year and a half to 2 years until there is a shakeup and some companies exit.

Sameer Baisiwala: This is very helpful, Umang, so you think that two years away from 2005 of this cycle?

Umang Vohra: That is what I think, yes.

Sameer Baisiwala: Umang, one final from my side, for your own portfolio side you will launch one niche every quarter and for how long do you think this will continue, is this 3 to 4 launch every year for next 2 to 3 years, is that what you have in mind?

Umang Vohra: Yes, roughly, Sameer.

Moderator: Thank you. The next question is from the line of Girish Bakhru from HSBC. Please go ahead.

Girish Bakhru: Most questions are answered, just couple, Umang on the cost containment, we have seen that going on for couple of quarters, where would you say at what point of the cycle are we, is there still much more room to go, I mean can we extrapolate current quarter, cost control to the full fiscal?

Umang Vohra: Girish, I think it is a mix, I wish Kedar was here to answer that because he has got a better control on that aspect, but I think it is a mix of cost that we are seeing on the margin side as well as the mix of cost that we are seeing on the organization side. I think the control will happen, on the margin side we are still hoping to get some more, but in the subsequent quarters. From a cost planning side, we are where we are on this quarter; on the expenditure side, you could extrapolate this average, obviously it will not be match to match every quarter, but this quarter's average on the expenditure side, yes; on the margin side, we are still hoping to get a little bit more.

Girish Bakhru: On product side, just a bit clarity on Pulmicort, any color you can throw if you could do it as a direct launch in future?

Umang Vohra: We are not commenting on specific product, Girish, I do not know where you got Pulmicort, from

Girish Bakhru: Given it is a high-value inhaler product under partnership?

Alpesh Dalal: Basically, Girish, we have not really commented on any specific product and any specific strategy for any product, so we are not too sure where do you get this kind of detail from.

Umang Vohra: I do not think we have partnered this product and I do not think we have filed Pulmicort inhaler product in the US.

Girish Bakhru: I am talking about the budesonide?

Umang Vohra: Talking about the respules?

Girish Bakhru: Yes.

Umang Vohra: We already have a partner that has been selling for the last two years, we have already partnered that.

Girish Bakhru: My question is, is there is an opportunity like such high-value products which you have under partnership currently, can they be sold through your direct?

Umang Vohra: Yes, there is a possibility that our Direct-to-Market business could sell some of these products as well.

Girish Bakhru: If you could give some color on the FPSM size in Australia?

Umang Vohra: Australia is roughly a 55 million market, we believe we are the only generic now. It is also a market which is fairly brand conscious, so GSK has a good strong hold in Australia, but we are very happy about what we have done in a month and a half so far, it can be quite an interesting opportunity for us.

Girish Bakhru: This is not like a tender driven?

Umang Vohra: No, it is not, it will take time. The market structure is a little between Europe and the US.

Moderator: Thank you. The next question is from the line of Surya Patra from Phillip Capital. Please go ahead.

Surya Patra: Sir, is it fair to believe that the domestic formulation business would be having the highest gross margin compared to other segments, and if yes, then this quarter, domestic business is anyway weak and with the improvement that is what we are anticipating, going ahead we can see improved gross margin even from the current level for the overall business, is that right?

Alpesh Dalal: Surya, the margin profile there might be some possibility of some improvement, but that is an overall business mix, but it is not likely to significantly change, but there is a possibility of slight improvement in the margin when it can go up.

Surya Patra: Domestic is the best gross margin business, that is what is correct?

Alpesh Dalal: We are not providing margins business wise.

Surya Patra: This quarter surprisingly the depreciation amount is significantly low sequentially, last quarter only we had guided about a run rate of 350 odd crores, against that we are currently having 213 odd crores kind of number, any sense that you can provide on that?

Alpesh Dalal: Last time on the March we had an impairment charge was there, but we have not guided for a 350 crore kind of run rate, Surya.

Surya Patra: That means this is what is the realistic number, even that is lower compared to Q3 and Q2 also of last year, so not sure about what would be the run rate or how the depreciation number would be moving here on?

Umang Vohra: It should be reasonable levels going forward, you can use the current quarter, I think in Quarter-2, Quarter-3 of last year because of Ind-AS, we have taken a catch up charge on account of the amortization of the InvaGen acquisition and then in Quarter-4, we impaired which is why you have different numbers, but you can take the current quarter average as an average going forward.

Surya Patra: Just last one question if I can, considering the kind of run rate in the US business and the kind of a guideline means indication that we are providing about limited competition product launches and along with the price challenges scenario there, so is it fair to believe that okay, though this quarter is a kind of flattish number that we are seeing but going ahead in the subsequent quarter, we could see something like double digit kind of a growth in the US front?

Umang Vohra: I am not sure we are providing that level of guidance, there are multiple parts to it, it depends on the function in the US, so sorry we are not making that.

Moderator: Thank you. The next question is from the line of Cinderella Carvalho from Dolat Capital. Please go ahead.

Cinderella Carvalho: Just wanted to understand on Sevelamer, is our API in-house?

Umang Vohra: We would not want to comment on this question, I would just like to say Sevelamer belonged to the InvaGen acquisition and InvaGen did not have an in-house API.

Cinderella Carvalho: Largely all the players are referring to the APIs was the problem and that is the reason wanted a clarification on that.

Alpesh Dalal: It has already been answered.

Moderator: Thank you. The next question is from the line of Saion Mukherjee from Nomura. Please go ahead.

Saion Mukherjee: In South Africa, what would be the growth spread between the tender market and the private market and how should we think about that going forward?

Alpesh Dalal: Saion, I will get back to you a little later.

Saion Mukherjee: On India, is there any significant variation in growth rates between the nonprescription and prescription generics in India, this quarter?

Umang Vohra: There is a difference, the RX business is slightly lower than the generic business, yes, there is a difference in the rate. I think the Rx business has taken a slightly bigger hit, and largely because of the fact that we are more acute, we have taken a larger hit compared to our competition.

Saion Mukherjee: Finally, Umang, how is **Seretide** in UK shaping up, in terms of market share?

Umang Vohra: Right now it is behind our estimates, Saion, this is month three of the launch, it is behind our estimates. We have seen GSK protecting its share quite vigorously, but at the same time I think the efforts that the partners put in is fairly significant and as we said, it will probably take a longer time to ramp up for this and I think we are looking forward to that, so it is not a story that would have unfolded in the 3 to 4 months. It will take long and it is slightly behind our own estimates.

Alpesh Dalal: Saion, on the tender question, I think tender has grown but the prescription business, the private market has grown faster for us than the tender business.

Saion Mukherjee: Tender would be like 40% of South Africa?

Dinesh Jain: Roughly about one-third, 30 to 33%.

Moderator: Thank you. The next question is from the line of Surjit Pal from Prabhudas Lilladher. Please go ahead.

Surjit Pal: Umang, as you said the US market might be following some commodity cycle in terms of price erosion and also given the guidance in terms of approving at least three approvals even in the limited competition drugs, I have question on this aspect is that, do you think first of all the acquisition which you guys made, there is requirement for further impairment from that, and second thing is that, do you think as a macro wise this erosion with this kind of approval already what they have promised if it has been realized, is visible in terms of price growth again?

Umang Vohra: Surjit, I would not rule out price drops, if that is your question, I think these will come continue. On impairment, it really depends on when we evaluate, when we see triggers and we evaluate, it will happen, so I do not think we are shy of trying to put on our balance sheet what we believe is the true recoverable value of the business, for us it did not meet the recoverability test in year one, we impaired it. It was not as if this is just only one year after the acquisition and things like that, there is an accounting standard and literature that we conform to and it is quite likely that if the price erosions is at this level and it goes further etc., if we have to impair, we will impair, but it does not change fundamentally how we look at the business because bringing the business to growth is our responsibility and we are working on that. I think it is really from an accounting perspective, if it has to be done, it will be done.

Surjit Pal: Second question, just few hours back I think Strides said that Cipla will be buying or they will be supplying to Cipla at the end of Q2 of Renvela API, first thing is that could we expect Renvela approval from your side could be Q3 or Q4 or another point is that when you are expecting, a differentiated product including Renvela types product in FY18, do you still maintain your EBITDA margin in mid-teens to high-teens type?

Umang Vohra: Our EBITDA guidance is given considering what we think we can do, I cannot comment on Renvela at this stage simply because I think my guess would be as good as anybody else's at this stage.

Surjit Pal: My query is that when you have so many good products, at least 2 to 3 this fiscal, but you still maintain a similar kind of EBITDA margin should be higher, right?

Umang Vohra: Look, Surjit, if your question is whether there is an upward bias to our EBITDA because fewer people enter Renvela when we launched, most certainly, the answer is yes, there could be an upward bias if less number of people come in when we come in. On the other hand, if we come in after several players come in then our margin profile will be somewhere where we are.

Moderator: Thank you. The next question is from the line of Ashish Rathi from Infina Finance. Please go ahead.

Ashish Rathi: Sir, the context is basically government talking about this whole genericization of the domestic business, and they are taking initiatives on the same, so Cipla is one of the prominent generic supplier, so just wanted to understand from your side, are you seeing significant growth in terms of in this business or higher sourcing from the government for generic products?

Umang Vohra: All I will say is that our generic business has not got the government as the large procurer for the business, so we do not supply the government predominantly, but we supply the rest of the channel, and therefore, the government, we have not seen anything from the government in this part of the business, but it is growing at the same rate that India usually grows at even on the Rx side, average growth for both the businesses is roughly the same.

Ashish Rathi: Sir, can just comment how are the margins for our generic business compared to the branded business and materially lower, any quantification would be of help, any indication, the question is want to understand same in general rather than Cipla in particular?

Umang Vohra: Rx is expected to be slightly higher.

Ashish Rathi: Single digit kind of say the gross margin or?

Umang Vohra: Yes, I do not think we will give that level of guidance, but yes, our Rx business is slightly higher.

Moderator: Thank you. As there are no further questions, I now hand the conference over to the management for closing comments.

Alpesh Dalal: Thank you everybody for your interest in Cipla and attending this call, and if there are any further follow-up questions, we will be happy to answer that through our Investor Relations cell. Thank you very much and have a Good Evening.

Moderator: Thank you. On behalf of Kotak Securities, we conclude this conference. Thank you for joining us and you may now disconnect your lines.