



“Cipla Limited Q2FY13 Results Conference Call”

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

- Moderator** Ladies and gentlemen good day and welcome to the Cipla Q2FY13 Earnings Conference Call hosted by Kotak Securities Limited. As a reminder for the duration of the conference, all participants' lines will be in the listen only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during the conference call, you may signal an operator by pressing '*' and then '0' on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Krishna Prasad of Kotak Securities, thank you and over to you sir.
- Krishna Prasad** Good Evening everyone. Welcome you all to the second quarter FY13 Cipla Earnings Conference Call. From the management side, we have with us Mr. V. S. Mani – Chief Financial Officer and Mr. Ajay Luharuka. Ajay, over to you now.
- Ajay Luharuka** Welcome to the second quarter earnings call. We hope you have received the financials and the performance highlights available on our website. We would like to give you an overview of this financials which can be followed by a question and answer session. During the current quarter the company posted a growth of about 24% in income from operations. Domestic sales grew by about 14% and export sales grew by more than 33% for the quarter. Operating margins have increased by about 58% and profits after tax crossed Rs. 500 crores with a growth of 62% on a year on year basis, material cost has decreased by about 4% on a year on year basis mainly on account of changes in product mix that is lower proportion of antiretrovirals and higher contribution of antidepressant segment coupled with increased export realizations. As a result, operating margins have also increased by more than 6%. The increase in staff cost of Rs. 55 crores is due to annual increments and increase in manpower. Other expenditure has increased by 42 crores for the quarter which is on account of increase in travel expenses, marketing expenses and professional charges. Tax for the quarter has marginally increased due to higher profits. The capital expenditure for the quarter is around 110 crores and as on 30th September, the outstanding amount of forward contract is about \$200 million, which substantially covers the outstanding debtors. During this current quarter, the company has gained Rs. 26 crores on account of foreign exchange gain. With this overview, I would like to leave the floor open for questions. Mr. Mani and myself are available for any questions that you have.
- Moderator** We will begin with the question and answer session. Our first question from the line Kartik Mehta from ICICI Securities. Please go ahead.
- Kartik Mehta** On the Indore SEZ can you share the revenues for this quarter and also actually for the first half? The second question is you mentioned in the press release that the overall material cost has reduced and the third item in that particular paragraph is increased realizations, should we assume increased realizations only on Escitalopram or is it on account of the currency?
- V. S. Mani** I think you have put quite a few things. When we say that our material cost has decreased and it is on account of a couple of things. Obviously one will be the benefit of Escitalopram, but

the other thing is also on account of changes in the product mix. As we have been telling you all for quite some time that there has been some sort of rationalization that we have looked at and we have looked at the proportion of ARVs and other kind of therapeutic segments where we felt which are more dependent on global funding and tenders, so while we still look at the profitable ones and we work very hard towards those, there would be some of those where we may not really look at those tenders and therefore accordingly our profitability would have improved on account of those. And that was on account of the increased export realization and I think that covers your material cost also. And as far as Indore goes, in this quarter we have done about 150 odd crores and put some similar number in the last quarter, so overall we are around close to about 300 crores from Indore in this first half.

- Kartik Mehta** What could be the normalized EBITDA margins so that one should actually look at and actually what happens to the top line guidance that we had now?
- V. S. Mani** Top line guidance, we had said that it would be about 12 to 15%. We would say that it will be about in excess of 15%, EBITDA has definitely gone up. Due to confidential reasons, we cannot give you the Escitalopram number, but definitely it is much better than what it was last year.
- Moderator** Thank you. Our next question from the line of Sonal Gupta from UBS Securities. Please go ahead.
- Sonal Gupta** Just wanted a breakup of the other income, other than the given FX is 26 crores, but what else is there?
- Ajay Luharuka** Other income includes mainly two components, one is the return on our investments, which is the mutual funds which we have is roughly about 26 crores and another 26 crores is from exchange gain, so that is the major component of other income.
- Sonal Gupta** The operating expenses that is not really showing any meaningful increase or more like a low single digit increase year on year, so just wanted to understand as to what is happening there, why is that component not really growing
- Ajay Luharuka** Are you talking about the other expenditure line?
- Sonal Gupta** Other expenses, other than staff cost? That is up about 10% year on year.
- Ajay Luharuka** There are not any major one off expenditure, so that is why you will not see any major increase in other expenditure.
- Sonal Gupta** Has there been any cost rationalization as well?

Ajay Luharuka There will be, on a routine basis the company would do cost rationalization, but if you see the most important part is on the top line and the material cost, there has been a lot of improvement. That is what is driving the improvement and margins in the bottom line.

Sonal Gupta Can we start expecting you to give a consolidated quarterly as well? Do you think there is not going to be?

V. S. Mani There will not be any major change in our consolidated quarterly. So far we don't have any major operating sub outside, so even if we look at our annual accounts between the stand alone and consolidated, there is hardly any difference.

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

Bino Pathiparampil I know that you cannot give the Escitalopram number, but I was wondering if we look at last year's last 2 or 3 quarters of the gross profit, the material cost was roughly about 40 to 43% of the top line, so has that materially changed mainly because of Escitalopram and rupee depreciation contributes only a small amount or is it more because of the overall product portfolio?

Ajay Luharuka It is a combination of improvement change in the product next which is basically the component of ARV. The second part is price realizations and third is currency. Fourth is of course Escitalopram like you mentioned. So there are four components and all these four contribute to this improvement.

Bino Pathiparampil From your export formulations, if we keep Escitalopram apart at constant currency roughly what kind of growth rate is it, is it still growing or is it flat?

Ajay Luharuka Unfortunately we will not be able to give you any guidance because of this Escitalopram issue.

Bino Pathiparampil FOREX gain, what was that number?

Ajay Luharuka 26 crores for the quarter.

Bino Pathiparampil It is in other income?

Ajay Luharuka Yes, other income.

Moderator Thank you. Our next question from the line of Sachin Kasera from Lucky Securities. Please go ahead.

Sachin Kasera On the export side, could you just tell us which are the geographies which give majorly for the first 6 months or for the quarter?

- Ajay Luharuka** Overall if you see the mix would not have changed significantly barring Escitalopram, so Africa is one major continent. Then you have the Americas, which is North and Latin put together and we have Europe, so these are the major regions which contribute significantly.
- Sachin Kasera** Most the regions have grown in line with the overall export growth?
- Ajay Luharuka** That's right.
- Sachin Kasera** On the domestic side, what was the growth in branded and the nonbranded?
- V. S. Mani** Well, both are the same, the branded and nonbranded grew at about 14% each.
- Sachin Kasera** Post exclusivity of Lexapro, can you just elaborate how does the situation look like in terms of margin erosion, just give us some color on what is happening?
- V. S. Mani** We feel the margins are definitely better than last year. Last year we had a margin of about 22, it will be much higher than that, well Lexapro obviously gave us a big kicker in the last two quarters, but as you can see, even last quarter there was Lexapro and this quarter also there is Lexapro and it is quite similar, so in spite of that this quarter is much better than last quarter, so I am sure it indicates to you that quarters have been increasingly better. I would assume that going forward also we should be better because of all the efforts that have gone in terms of trying to drive the rationalization and the business growth put together, I would see better margins.
- Sachin Kasera** Any update on Dymista?
- V. S. Mani** I think we just started exporting, so we should see more visibility in the next quarter.
- Moderator** Thank you. Our next question from the line of Sameer Baisiwala from Morgan Stanley. Please go ahead.
- Sameer Baisiwala** Can you update us on your tie up with Aspen for the Australian market and when does the sale begin for this?
- Ajay Luharuka** The registration process is still on in Australia, so currently we are working with our other partners in Australia for certain products, so with Aspen specifically it is still some time away. We will have to wait for the regulatory process to complete?
- Sameer Baisiwala** Which could be what about a year?
- Ajay Luharuka** It will be a year to two years.

- Sameer Baisiwala** Second is just quick clarification on Indore SEZ, if I am not wrong, you mentioned in the previous quarter that is June quarter that you had done 190 crores. Now you are saying that it was 150 taking the first half to 300s, so do we need to change that number?
- V. S. Mani** I think around 300 is the right number; I think we should take that.
- Sameer Baisiwala** And at Indore SEZ for tablets and capsules, what would be the capacity utilization at 300 crores?
- V. S. Mani** Capacity utilisation would be roughly about 70% for only tablets and capsules not the rest.
- Sameer Baisiwala** And off 300 crores how much would be tablets and capsules?
- V. S. Mani** I don't have that granular breakup right now. I could give it to you.
- Sameer Baisiwala** Just on the Lexapro, you cannot disclose the number, my only question to you is I think in March quarter, you had very little of that, in June you had and in September you had, so just comparing September versus June, is it at the same level higher or lower, just qualitative, I don't want the numbers?
- V. S. Mani** Marginally higher.
- Sameer Baisiwala** Final question on tax rate, what should we expect for fiscal 13?
- V. S. Mani** Similar rates what you are currently having, around 24%.
- Moderator** Thank you. Our next question from the line of Aditya Khemka from Nomura. Please go ahead.
- Aditya Khemka** What was your CAPEX for the first half?
- V. S. Mani** About 200 crores.
- Aditya Khemka** In terms of the rationalization of the low margin portfolio that you have been doing over the past, which has helped us improve our margins, so do you think that the rationalization procedure is like almost over or do we see further improvement coming from that part of strategy.
- Ajay Luharuka** The rationalization process have started sometime back about two three quarters back, while the significant part has been done, it is an ongoing process, so there will still be some effect going forward, but yes, the major part of it has already been done that is why you see the improvements in margins.
- Moderator** Thank you. Our next question is from the line of Anubhav Agarwal from Credit Suisse. Please go ahead.

- Anubhav Agarwal** Can you give the inhaler sales what you do in Europe today, you can mention the number of what you did in FY12?
- Ajay Luharuka** Sorry we don't have the breakup right now; probably we can have it later.
- Anubhav Agarwal** Second question is the clarification from the AGM, Mr. Hamied mentioned that contribution from Dymista could be \$25 to \$30 million to Cipla, just missed out the time period he was talking about, would it be peak years of Dymista contributing to that \$30 million for Cipla or would it be like next year sales?
- Ajay Luharuka** As we had mentioned earlier that Dymista has just been launched, and this combination is not in the US, so we will have to really wait and watch and see how the realizations come across.
- Anubhav Agarwal** Just getting an idea, whenever Dymista reaches its peak sales, could the contribution of \$25-\$30 million correspond to peak sales of Dymista?
- Ajay Luharuka** What I can give you an indication is that the mono product has a sale of \$500 million at innovative prices. You can derive some indication from that figure.
- Anubhav Agarwal** Because my confusion was more with the unknown part is of course the partnership what Cipla has with Meda here, so even if we let us say, Dymista reaches the same part of what the Mono has, so my question lies that, if Dymista peak sales are even half of this, even \$250 million, would at peak sales Cipla lies at \$25-\$30 million top line from Dymista?
- Ajay Luharuka** Hopefully yes.
- Moderator** Thank you. Our next question from the line of Girish Bakhru from HSBC Securities. Please go ahead.
- Girish Bakhru** On Dymista front again, has there been any milestone income booked in the quarter or previous quarter?
- V. S. Mani** No, there are no milestones as yet booked on Dymista.
- Girish Bakhru** But there was a milestone link to the launch, upfront payment from Meda, when would that be booked then?
- Ajay Luharuka** We will have to get back because these are again confidential, so we cannot really give you much details, but we will definitely let you know later, if there is something.
- Girish Bakhru** On the Indore SEZ, has US FDA approval been obtained on that facility?
- Ajay Luharuka** That was very recent, just a week back.

Girish Bakhrui	So how would the trajectory save us kind of numbers pan out from that in fiscal '14 or something like that?
V. S. Mani	It is too early to say, just give us a little while. It just happened now. We could work out and understand, which are the products that are going to go through from there.
Girish Bakhrui	Any update on the EU fillings, given that Perrigo has also been filing inhalers and being sued, Cipla has so far not been sued any combination products so far, where are we with our filings on inhalers?
Ajay Luharuka	In the Europe again, the work is in progress and it is as per our timeline, so that work is still on.
Girish Bakhrui	But you would say that some of the launch that you have been indicating in fiscal '14 that would be there in European market?
Ajay Luharuka	If everything goes well and we get our approvals in time, yes we can see something in fiscal '14, but as you are aware a lot depends on regulatory approvals.
Moderator	Thank you. Our next question from the line of Arvind Bothra from Bank of America. Please go ahead.
Arvind Bothra	Your CAPEX spent on a quarterly run rate has come down a bit, so our full year CAPEX guidance, would you maintain similar in it around 400-500 crores?
Ajay Luharuka	Roughly around same level, 500-600 kind of levels.
Arvind Bothra	On export, on a sequential basis, we have seen 24% growth, of course part of it is due to Lexapro growth being higher, and can you just entail few other drivers of export growth on a sequential basis?
Ajay Luharuka	Various segments have done well including antiretrovirals, asthma, malarial, so all these segments have really done well on a sequential basis also.
Arvind Bothra	Apart from Lexapro, which of course exclusivity is behind, the rest of the business can maintain this run rate?
V. S. Mani	On a sequential basis, quarter-to-quarter, last quarter vis-à-vis this quarter.
Arvind Bothra	Just your thoughts on the impending clarity on the new pharma policy, whether is it cost based or market based what is your thought is or the impact on the company in terms of exposure?

Ajay Luharuka The government is yet to announce the final policy and it is has not yet been placed before the cabinet, so we would assume it is a bit premature to assess the impact of the policy and it would be really amount to speculation if we give any numbers.

Arvind Bothra Irrespective of the pricing mechanism, just on the exposure of Cipla's portfolio to the essential medicine list, to what extent does it affect your portfolio in terms of coverage?

Ajay Luharuka We would really prefer to wait and let the policy be announced and then let us see the impact.

Moderator Thank you. Our next question from the line of Jesal Shah from JM Financial. Please go ahead.

Jesal Shah Just a question on your US filing strategy, can you update us with how many ANDAs you have filed in the first half and what is your plan is for this year and next year?

Ajay Luharuka Filings with our partners what we have done earlier that is any way happening and whatever we can commercialize out of that continues, apart from that we have filed about 4 ANDAs on our own in the last six months.

Jesal Shah Is there any kind of target for next year?

Ajay Luharuka It will all depend on the opportunities, so depending on each opportunity we will decide whether to file on our own or through our partner, but obviously most of it will be on our own, so really we are not having any specific target which we can disclose to you as of now.

Jesal Shah Just a follow up on the margin thing, I understand you talked about 4 drivers, but I could not really understand fully the price increases that you talked about, are there any particular segments where you have taken price increases and do you see kind of follow through of that in the following quarters or do you think margins have really peaked and once Escitalopram has taken now, then the margins will actually decline in the following period?

V. S. Mani While Escitalopram when it grows up, obviously the margin will come down, but what we are trying is say that compared to the previous periods, our margins are much better and what we are trying to say is that we are just not saying just because there is a currency movement or because you are just taking price increases, what we are trying to say that in the context the product mix is undergoing a change, earlier some of the growth used to come from a lot of tender business which are depend on global funding, today our dependence on those are much lower. Obviously the quality of sales has improved much better, so that is one of the key reasons.

Jesal Shah The price increases, are they from any particular markets, or is it like across?

Ajay Luharuka It will be across market, across therapies and markets.

Moderator Thank you. Our next question from the line of Perin Ali from Edelweiss. Please go ahead.

Manoj If we look at sequentially where the operating margins have gone up from 27.6% to around 30.9%, which is almost the increase of 330 bps, and if you look at the factor like, the currency was more or less the same Escitalopram continuation was more or less same, so whatever the increase which we have seen on the sequential basis is largely because of operational improvement, so can we say that whatever improvement we have seen is sustainable and going forward except the currency and Escitalopram?

Ajay Luharuka Yes, one can infer that.

Manoj The second thing is that as you say that domestic because obviously like second quarter was little low because of poor respiratory season or may be delay onset of action, but how do you see domestic market going forward, do you expect growth to be in line with the industry growth?

V. S. Mani I think this 14% is also in line with the industry growth. The first two months were bad for most companies, that is our sense, because rains were not good, but still if you look at it sequentially, quarter-to-quarter, our sale in this quarter is pretty close to what we did in the last quarter in numbers, so going forward we look when at 17 to 18% growth happening, we don't see that going down.

Manoj If you have to take over the 2 to 3 years kind of a view, particularly for the export formulation business, what kind of growth you see would be sustainable?

Ajay Luharuka For the year we are guiding an overall growth of in excess of 15%, going forward the growth will depend on again various factors, so we are not really giving any guidance for the next year.

Moderator Thank you. Our next question from the line of Ranjit Kapadia from Centrum. Please go ahead.

Ranjit Kapadia My question relates to the Lexapro, what was the price drop after 180-day exclusivity and have we to take some write-off after this 180 day exclusivity?

V. S. Mani We don't have any write-off as such. We are going through our partners, so we only have a share of profit that is it.

Ranjit Kapadia What was the price drop in the generic?

V. S. Mani Don't go by that. Ours is the floor price that which we sell and we get a share of the profits, so obviously if the floor price is very small proportion in the total sales, so it doesn't really matter how much the price falls.

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

Rahul Sharma Could you share the number of Vancocin, we had around 5% of market share, our partners had, so just wanted to know if you could share that number?

Ajay Luharuka I am sorry we cannot share again because of these agreements which are confidential.

V. S. Mani Vancomycin is not very substantial.

Rahul Sharma What about other operating income, can you give the breakup for other operating income for the quarter?

Ajay Luharuka Basically it is made up of export incentives, which is about 24 crores, there is some processing fees of 10 crores, technical knowhow of 5 crores, that is the major breakup.

Rahul Sharma In actual numbers could you give the breakup of your domestic formulations, branded and generic-generic?

V. S. Mani Both are 14% growth over the last year.

Rahul Sharma You give one, probably we can derive the other because it is not adding up, if I do the math.

Ajay Luharuka Generic-generic will be roughly 15% of domestic sales.

Moderator Thank you. Our next question from the line of Nitin Agarwal from IDFC. Please go ahead.

Nitin Agarwal On Lexapro during the quarter, we would have recognized some of our profit share from the sale that you have done in previous quarters and the current quarter?

Ajay Luharuka Usually there will be a lag in the profit share.

Nitin Agarwal I guess whatever that we have sold in the previous two quarters some part of the profit shares may have come into the current quarter numbers?

Ajay Luharuka Partly yes, there could be some lag.

Nitin Agarwal I guess some of the current sales may still spill over in the coming quarters, as and when the accounting happens?

Ajay Luharuka It depends again, we cannot really comment on that.

- Nitin Agarwal** On the export business, if you look forward the next 2 to 3 years, apart from the US business, which we clearly are focusing on, which could be the other major growth drivers for us over the next 2 to 3-year periods in the export market?
- V. S. Mani** If you look at it obviously Europe would be one of those markets with inhaler and all the strategy that we have been talking about and definitely some of the sections of the African markets would also be one of those which we would focusing on.
- Nitin Agarwal** We have seen a significant increase in the cash equivalence during the first half, what is the intent as far as uses of cash is concern going forward?
- V. S. Mani** I am sure we would have definitely planned and use it for a good reason and it would be strategic, so as of now we definitely do not have any visibility of how to do it, but definitely as and when we have a good requirement we would use that.
- Moderator** Participants we will take the last question from the line of Ravi Agarwal from Standard Chartered Securities. Please go ahead.
- Ravi Agarwal** First question was on Indore, now that you have US FDA approvals, just wanted to understand what are the timelines for filing an approval, do we now start filing for the products or the filing would have already started before?
- V. S. Mani** A few of the product filing would have started and they could have triggered it off, but ongoing obviously if you are looking long term and we need to use the SEZ well, obviously that would be a push.
- Ravi Agarwal** Any sense we could get about, how many products we have already filed from Indore and how many are we planning to file this year or next year?
- V. S. Mani** It will be a couple of products. Going forward there will be more.
- Ravi Agarwal** The second question is on the export business, on a QoQ sequential basis it is up by around 230 crores roughly around \$40 to \$45 million and you were mentioning that Lexapro is more or less constant in both the quarter, and you also mentioned that the mix across each of your markets have more or less remained the same, so am I to assume that all your markets are essentially contributed to this 38% growth, is that a fair assumption on that?
- V. S. Mani** I don't think you have got it right. What we have said barring the Lexapro, the rest of the margins have improved because the product mix on a whole has changed over the last couple of quarters that is what is driving it up.
- Ravi Agarwal** I am actually talking about the revenues. If you look at the revenue numbers for the export formulation business that is up by around \$40 odd million from Q1 to Q2 and I think earlier

you were mentioning that the mix across each of your markets has also remained the same and you have a 38% kind of reported growth, A) this 45 million what drives this \$40 to \$45 million dollars on a QoQ basis and B) if the mix remains the same, then are we assume that the market growth for each of these geographies has been around 38%?

V. S. Mani Yes, some of the geographies have been good.

Ravi Agarwal Is this margin improvement due of 350 basis point or on a sequential basis that I presume is going to be an improvement which is going to remain excluding even the currency and excluding even the fact that you have got Lexapro benefits this quarter, right?

V. S. Mani Some of it would definitely be there.

Moderator I would now like to hand the conference over to Mr. Krishna Prasad for closing comments.

Krishna Prasad Thanks everyone for attending the call.

Moderator Participants on behalf of Kotak Securities that concludes this conference. Thank you for joining us. You may now disconnect your lines. Thank you.