



“CIPLA Ltd. Q2FY14 Earnings Conference Call”

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Mr. ANANT, INVESTOR RELATION

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Moderator

Ladies and gentlemen good day and welcome to the Cipla Limit Q2FY14 Earnings Conference Call hosted by Kotak Securities Limited. As a reminder, all participants' 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, please signal an operator by pressing the "*" then "0" on your touchtone telephone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Krishna Prasad of Kotak Securities, thank you and over to you sir.

Krishna Prasad

Hello, good evening everyone and on behalf of Kotak Institutional equities, we welcome you all to the 2QFY14 Cipla Earnings Conference Call. We have with us today the senior management of Cipla, Mr. Rajesh Garg who is the Global CFO, VS Mani, who is the Head of Finance and Anant from the IR team. I now hand over the floor to the management.

Rajesh Garg

Good evening to all, I am Rajesh Garg, the Global CFO and welcome to the second quarter earnings call. As Krishna rightly said I have on call along with Mr. Mani and Mr. Anant. I hope you have received the financials and the performance highlights. They are now available on our website. But what I will do is very briefly along with Mr. Mani go over the overview for the financial for the quarter and then we can have our Q&A session.

So, during this quarter the company posted a growth of over 13% in income from operations. Sales within India grew by over 11% and for all our international markets they grew by over 15%. The previous year results included the one-time profit share revenues from Escitalopram through our US partner. If we were to exclude that our underlying growth would have been in mid-teens.

Our operating margins for the quarter are 23% and excluding the oneoffs of the previous year, it would have been a decrease of 1% to 2% on a year-on-year basis. Underlying profit after tax was Rs.358 crores and again if you would exclude the oneoffs it's flat year-on-year. I will now ask Mr. Mani to go over some more granular details.

VS Mani

Thank you Rajesh. Good evening everybody. A little more insight into some of the financials. Basically, the material cost has increased by about 4% over the previous year, largely on account in the previous year as Rajesh has already mentioned. There was oneoffs from Escitalopram. The increase in the staff cost is about Rs.100 crores, this is mainly due to basically increasing manpower that we are having hiring senior talent and also setting our front end in US and EU, and also annual increments, and also this is a consolidated financial results. So, that would include Cipla Medpro as well.

Other expenditure has increased by about Rs.140 crores for the quarter mainly on account of increase in some of the sales promotion expenses, professional charges, etc. Tax for the quarter is inline in the average tax for the previous year, that's about 24% to 25%. The CAPEX for the quarter including Cipla Medpro about Rs.100 crores. As you would recollect for

the FY13-14 we have given a guidance that it could be about Rs.400 crores, and also there could be a rollover of the previous year CAPEX of about Rs.150 crores to Rs. 200 crores.

The major projects of the company is executing right now are in the R&D facility at Vikhroli and the API facility at Patalganga. As of 30th September 2013 the outstanding amount of forward contracts is about \$240 million with an average rate in excess of 61, which substantially covers the outstanding debtors. During the quarter, the company had gained about Rs.40 crores on account of foreign exchange gains. With this overview, I would like to leave the floor open for questions. Mr. Rajesh Garg and myself are available to answer any questions that you have. Thank you.

Moderator	Thank you very much sir. Ladies and gentlemen we will now begin the question-and-answer session. Our first question is from Saion Mukherjee of Nomura. Please go ahead.
Saion Mukherjee	The first question is regarding the Forex gain of Rs.40 crores; can you just elaborate as to where this gain is booked?
VS Mani	It is booked in the other income.
Saion Mukherjee	Second question regarding your filing of combination inhalers in Europe and any work that you might have done for US. Can you give us an update on those programs please?
VS Mani	See basically this is a little bit of a price sensitive information, so as of now we would not comment on this.
Saion Mukherjee	Okay, but in terms of your filings in Europe, can you give us an update?
VS Mani	So basically as we have said in the past, we have about 10 filings in Europe so it stays there.
Saion Mukherjee	So, this includes your combination inhalers as well?
VS Mani	Yes, sure.
Moderator	Our next question is from Prakash Agarwal of CIMB. Please go ahead.
Prakash Agarwal	Question on the a) the domestic business, I mean, we have seen the mix changing now earlier last quarter it was 49% now 42% largely because of the consolidation of Medpro despite that we have healthy margin of 22.5%. Just wanted to understand that, my understanding was South Africa as of now would be lower margin than the company levels and as commented on CNBC that it would be margin accretive from next year onwards. So, just wanted to understand what would be the margin levels of Cipla Medpro at the moment and do we expect margin escalation going forward?

- VS Mani** Historically, Medpro's margins have not been too far behind the total Cipla group, it's about 18%, 19%. So, it's around those levels.
- Prakash Agarwal** Are we expecting margins, you know, South Africa margins to come to our company level margin in the near future and the total margins to increase thereon?
- Rajesh Garg** Essentially there is obviously a big playoff mix all across. So, I think, it's very difficult to just to hold on to the South Africa Margins, product mix is quite dramatic. Overall, as you heard on CNBC our expectation is that we are actually in investment mode and we are open to few points of margins getting diluted overall. I am not saying that Medpro or whatever because that is not driving the overall shape of the business that we are managing for right now but clearly we believe we need to have the flexibility to take couple of points of overall margin erosion to help build the business for the future.
- Prakash Agarwal** If I understood it correctly from 22.5% you further see some margin erosion from here because of the investments?
- Rajesh Garg** Yes, less than couple of points probably, yes.
- Prakash Agarwal** Okay, understood. So, basically domestic business, I mean, I see some restatement from 2Q last year to this year by Rs.30 crores. Could you explain that please?
- VS Mani** Can you elaborate on your question.
- Prakash Agarwal** So, if I see 2Q13 which is the similar quarter last year there were Rs.960 odd crores and now this year press release you are saying Rs.930 crores so growth of 12%. On our old numbers it was coming around 8%?
- VS Mani** So when we do consolidation obviously some of the domestic subsidiaries are also there in place so to that extent it gets negated.
- Prakash Agarwal** And given the softness in the market, I mean, what extra initiatives apart from the retail disruption that we have agreed to what extra initiatives you have taken despite the slowdown in anti-infectives?
- Rajesh Garg** Overall, you know, our whole business as part of the transformation that's going on within the India team, I mean, you know, we have got quite an excellent program going on to really put metrics in place better tracking of our sales force, productivity and in also managing the portfolio more aggressively. So, which is how despite the whole DPCO shutdown, we believe in our sales force were able to deliver and help us deliver the 11% growth which at the outset of the whole, you know, and DPCO obviously had knock on effect into not just items under the 348 but overall there was the whole much larger portfolio products was being effected and on top there was the whole

stop of business by AICOD. We obviously were the first one really in the interest of all about patient access and making sure people have access to medicines. We were the first ones to go back to the right margins but I think overall our sales force has really delivered to give us this kind of growth despite all the challenges.

Prakash Agarwal

Have you added on the sales force? How many sales force you are having?

Rajesh Garg

No, we have not added it. It's under the same sort of number of total sales strength of 10,000, which includes the head office staff and there has been no real increase of, it's just the regular attrition and normal hiring that just keeps going on.

Prakash Agarwal

Last question before I enter the queue for more questions. This goodwill on consolidation in the balance sheet so is this going to be tested every year or how are we going to account for this?

VS Mani

Yes, this will be tested for impairment every year.

Prakash Agarwal

Okay. So, South Africa being branded generics market, so when we see some change in the market we could see some amortization to start, right or how would we plan to account for this?

Rajesh Garg

So, obviously yes. Branded generics market but also remember Cipla there is over-the-counter an actual brand in the market with a very strong portfolio and overall. So, I think it's much more beyond just a generics market for us in South Africa.

Moderator

Next question is from Sonal Gupta of UBS Securities. Please go ahead.

Sonal Gupta

Just confirming, you said that the margins in EBITDA would have been sort of flattish if without the oneoff of last year?

VS Mani

Yes, it would have been pretty close to last year or maybe earlier I elaborated it would be a percentage or so a little lower.

Sonal Gupta

The other thing was, I think, Mr. Mani last quarter on the con-call you had mentioned that ideally because of the rupee depreciation we should see a couple of points in margin expansion. So, any thoughts there, is that delayed or do we still expect something or that benefit has already come through?

VS Mani

Yes, part of that benefit has come through but in any case as last time also we had articulated while some of the benefits may come, some we have to really part with our partner so net net, if you look at it that's why our EBITDA margins more or less remained close to our historical limits.

Sonal Gupta

Just in terms of the hiring, I understand that there has been a lot of hiring within the company so I mean, just from a strategic standpoint, I just want to understand why you are setting up front end

etc, are these sort of like with a certain 2 to 3 year objective or are we hiring as in terms of a demand outlook because I am just concerned that do we end up bloating our cost structure and without having enough of a pipeline right now, I mean, like in the US you don't really have much of a pipeline, so if we are investing in a lot of SG&A ahead of the curve. So, if you could just point out in terms of how you are thinking on this thing?

Rajesh Garg

So clearly as we said, we are open for couple of points of erosion due to both accelerating our R&D pipeline investment as well as the front-end but I think it's more beyond just product registration and all that enough room across the world. So, okay put US alone where it's so easily visible what you have on, what authorization you have and what you don't but if you take the globe as a whole, I think we see a lot of opportunities. Of course, we are cognizant that as you put in new teams it can take some time to get them to understand what are the strengths of Cipla, what are the product pipelines portfolio. So, right now we are going through all the kind of on boarding of several of these new key talent. The good thing is they actually are all experienced pharmaceutical sales and marketing and business development people, so they are all, you know, are not just starting from scratch. So, we believe that yes, its couple of year to really fully start extracting the value out of them but I think they have already seen in overall uptick in business. So at least from a pipeline of business, not pipeline of products but in terms of sales pipeline of business, I think we are very confident and very pleased so far.

Sonal Gupta

My last question. Any color that you can give on your US pipeline right now, how many ANDAs do you have and what is your expectation margin?

VS Mani

So, as of now we have about 77 approvals both what has come back to us some partners as a partner approval. About 30 are there which are basically under approval.

Sonal Gupta

So 30 are pending and these belong to you or to the partner?

VS Mani

To partner as well as us.

Sonal Gupta

Just on R&D spending if you could just tell us if anything, I mean, for this quarter or for the full year, how are you looking at the R&D?

VS Mani

So, as you see historically our R&D spends have anywhere between 3.5% to 4%. So, as we already articulated it could go upto a percentage but as of now it's pretty close to the levels what you are seeing historically.

Moderator

Next question is from Bino Pathiparampil of IIFL. Please go ahead.

Bino Pathiparampil

Couple of more questions. Would you be able to share the Medpro revenue for the quarter?

VS Mani Medpro had revenue of about in excess of \$50 million. Bino, it's very difficult to really because it was about two and a half months since we have really taken the company. So it's not a full quarter results.

Bino Pathiparampil Okay, sure. But for the quarter in the books is \$50 million?

VS Mani Yes. And you also need to understand that about 90% of their sales come from production Cipla India. So, when you consolidated as a whole there will be contra effect that will take care of it.

Bino Pathiparampil Second, on the domestic market you were the earliest company to give a higher margin to the trade and probably you benefited from that because much of your competition was out of market. Despite that we are seeing only 11% growth which is a little weak by historic standards. So, is that something what we should look at in the...

VS Mani No, I don't think, Bino, that's a very correct assessment because 11% is after all the challenges that you had in terms of DPCO coming into effect, the boycotts that were there, and also while we may have decided to go ahead with what it is but I am sure there are couple of other guys also jumped onto the same frame. So, I don't think that it was too behind.

Rajesh Garg And I think just to add Mr. Mani the impact is in the current quarter so the real shift of after everything opened up and is present in quarter two is going to reflect now hopefully.

Bino Pathiparampil Okay, so you are expecting an improvement in growth rates there?

VS Mani Sure, yes.

Bino Pathiparampil Finally I was wondering if you can give a little more clarity or rather granularity about the initiatives that you are taking apart from the top management hire which we hear about. The only thing probably we know about the transformation in Cipla at a granular level is the number of ANDA filings in the US. So, apart from that could we get some more granularities on each market what exactly you are doing?

Rajesh Garg Sure, I think, it's probably more a) just hiring people itself doesn't solve it so there is a whole, you know, function by function, transformation underway vis-à-vis org structure, vis-à-vis how they are organized, you know how support functions work with the various front-end markets and you know, so that kind of whole organizational pieces. It's pretty large number of initiatives, it's not about just hiring people. Then obviously there is another initiatives to really make sure all our, you know, the R&D pipeline, you know, rationalizing it, better understanding, better focusing that. So, that's just general line, you would expect that to be happening anyway but I think we are just had part of refresh we believe we are able to now have a much better line of sight in that and finally I would say there is a overall sort of managing of cost to make sure that, you know, we walk and chew gum at the same time. So, we are able to constantly monitor that and we are putting better

controls and systems in place. We are as part of that whole exercise, we are right now implementing SAP which is a very large enterprise wide, you know, perhaps one of the largest SAP implementation in India because we are going straight from 40 legacy systems to full blown SAP and then the final initiative that we plan to launch not done yet is also looking at part of the org structure in terms of what elements can be in shared services.

Bino Pathiparampil

Just to add to that have you started recruitment of ground level medical reps in any market? Or do you plan to do that in the next two quarters?

Rajesh Garg

So, look not the kind of numbers that you would expect but its small numbers. Obviously South Africa has a reasonable number and then few other markets there are reps but these are, if you compare them to India these are real in the 10s and 20s because of the nature of the market you don't need very large sales force.

Bino Pathiparampil

But I guess that was supposed to change with the new model, etc, right?

Rajesh Garg

Yes, but lot of times even the front end actually means B-2-B selling it is not necessarily walking into influence doctors. In some markets that is happening though.

Moderator

Next question is from Chunky Shah of Credit Suisse. Please go ahead.

Chunky Shah

Hi, this is Chunky Shah. Can you quantify what was R&D spend this quarter. I remember in the June quarter it was about Rs.70 crores to Rs.72 crores?

VS Mani

This would be roughly in about Rs.90 crores.

Chunky Shah

Second question was just on the US market and previously you have mentioned that you prefer to grow organic in this market but with few products, I am just slightly confused won't it be better to build a basket, acquire a smaller company and be more meaningful to the channel because, I mean, thinking that if you have about 5-6 products last year if I will add another 10-15 now, probably three years down the line you will have that many products to start with, what's your thought here.

VS Mani

So, as we put it like there were about 20 odd products that came back from the partners. We have been filing now and going forward obviously as we already signaled there is going to be an increase in the R&D cost, obviously there will be filings more. So, we are working pretty much on the US market. So, probably going forward we will come to more clarity whether we really need to do any kind of inorganic or so. If the opportunity is right, we will look at that but as of now we probably believe that we have the technological capability and this to go on our own.

Chunky Shah

Just clarity of the product which has come from the partner. You are not looking to license them further; you are just keeping with you?

VS Mani	Yes, obviously at some stage as we already said that we are more interested in the front-end model we will probably use those as building blocks to build out business there.
Moderator	Next question is from Girish Bakhru of HSBC. Please go ahead.
Girish Bakhru	Just wanted to check if the sales form European market has started for Dymista and if they are material now?
VS Mani	Yes, they have started for the European markets but as of now we can't probably we do the CDA that we have we can't really divulge the amount.
Girish Bakhru	Because last quarter you had mentioned some number of \$6 million?
VS Mani	As of now obviously because of the newer agreement, etc we can't really, but it has started.
Girish Bakhru	Just on the India side, just wanted to check from the data it visible that some of the brands like Mifepristone have seen a big decline, is it just NLEM impact, like this has reduced from Rs.130 crores to...
VS Mani	No, I don't think that was basically not NLEM effect if you look at it, it is not just for us it was across the board so there was basically a crackdown from the FDA on some of these. I think we have taken proper course and probably we don't want to be pushing that too much.
Girish Bakhru	Is there some common ban coming on the product or?
VS Mani	No nothing, there is nothing of that sort but obviously there are great channels that push certain products, obviously it depends on the company how you do that but obviously apart from that we have our number of products in the org top 300 list so I don't think that really probably dense anything in our sales group.
Girish Bakhru	Any sense on Herceptin opportunity which may be opened in next Fiscal like your peers are talking about it that India could be a big launch are you prepared for that launch?
VS Mani	We will come back to you on that. I don't think as of now we are really commenting on that.
Moderator	Our next question is from Ranjit Kapadia of Centrum Brokng. Please go ahead.
Ranjit Kapadia	My question relates to biotechnology products. We have started some two years back this initiative so if you can give some update on this?
Rajesh Garg	See we obviously launched Etaccept and that is doing quite well. I mean it is ahead of our plan. So, we are very happy with how the rheumatologists have taken up to it. The rest we have active plans

as of now there is nothing concrete that I can share with you. But definitely we are actively building our capability and you know, we have an eye on that part, the change in how the world is expecting a bigger shift towards bios.

- Ranjit Kapadia** My second questions relates to R&D. How many scientists are working and what is the major area of research?
- Rajesh Garg** Pretty much the area of research is very reflective of our wide therapy areas, right. So, pretty much in all across and I think which is also part of how, you know, over the next few months as we go through the transformation we hope to better focus them to clearly try and have a more sort of scientific way to prioritize. Actually you can never do it but I think we have very good systems and methodologies now in place with several of the new team members being much better at portfolio management.
- Ranjit Kapadia** How many scientists are working approximately?
- VS Mani** We will have about 1000 scientists.
- Ranjit Kapadia** And this 10,000 will include the reps of Cipla Medpro also?
- Rajesh Garg** Cipla Medpro is few hundreds.
- VS Mani** Just to clarify the number of reps is 7,000.
- Rajesh Garg** The rest are head office sales and marketing teams and the total strength is 10,000 for the India domestic sales and marketing.
- Moderator** Next question is from Arvind Bothra of Religare. Please go ahead.
- Arvind Bothra** Question on the antiretroviral market, what's the strategy or take from the company side and what is the outlook for the tender business in Africa?
- VS Mani** The tender business in the current quarter has been quite okay. So, going forward obviously as you know we were the pioneers in terms of becoming "a dollar a day" kind of business. So, we also have been working, and now if you look at Medpro also they had a large order that they got last year and we have been supporting them in that. So, we look at that business with lot of respect and we feel that that's a growing business.
- Arvind Bothra** Second thing on this quarter other expenses which has gone up, are there any lumpy or one-time expenses related to the acquisitions something like professional fees or something which we should ignore from the coming quarter perspective?

- VS Mani** There is no lumpy or anything of professional fees or anything of the nature. Just to keep people in caution, I mean, since we already have been supplying goods to Medpro in the past so obviously there is a little bit of stock reserve that was there. So that probably was reduced from the profit.
- Arvind Bothra** And finally on the depreciation side, I mean, of course this quarter has not seen the full inclusion of Medpro but this number is the benchmark to be taken Rs.90 crore to Rs.95 crore on a quarterly basis?
- VS Mani** Yes, Rs.90 crores is the right one and Medpro anyway will not have too much of depreciation. They don't sit on too many assets.
- Arvind Bothra** And finally tax rate, do you see the normalized tax rate around 25% or 27% in this quarter is more reflective?
- VS Mani** I think 25% would be the right one.
- Moderator** Ladies and gentlemen due to time constraints that was the last question. I know hand the floor back to Mr. Krishna Prasad of Kotak Securities for closing comments.
- Krishna Prasad** Thank you all for attending the Cipla Conference Call. I just hand over the call now to the management for their closing thoughts.
- Rajesh Garg** Thank you very much for your time and I would like to say that we will continue to be on course the whole plan that has been laid out along with the arrival of our new CEO Mr. Subhanu Saxena and the team around him. So, I think we are all very excited and you know, but obviously cautioned that this is not a sprint, it's a marathon, and we are very much on it. So, thank you so much, Mr. Mani any comments.
- VS Mani** No, thank you very much Krishna.
- Moderator** Thank you very much. Ladies and gentlemen on behalf of Kotak Securities Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines.