# “Cipla Q2 FY17 Earnings Conference Call”

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**Moderator:** Ladies and Gentlemen, Good Day and Welcome to the Cipla Q2 FY17 Earnings Conference Call, hosted by Kotak Securities Limited. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Chirag Talati from Kotak Securities. Thank you and over to you, sir.

**Chirag Talati:** Hi, good evening, everyone. This is Chirag here, 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, Kedar Upadhye – Global Chief Financial Officer and Alpesh Dalal – Head of Investor Relations at Cipla. I now hand over the call to Cipla Management Team for their opening remarks. Over to you, sir.

**Alpesh Dalal:** Thanks for that, Chirag. This is Alpesh Dalal here. Good evening, everybody. On this call, our discussion will include certain forward-looking statements which are predictions, projections or other estimates about our future events. These estimates reflect management's current expectations of Cipla's future performance. Please note that these estimates involve a number of risks and uncertainties that could cause our actual results to differ materially from what is expressed or implied.

I now hand it over to Kedar for the performance update.

**Kedar Upadhye:** Thank you, Alpesh. Good evening to all of you. And welcome to our Earnings Call for the Second Quarter of Fiscal 2017. I hope you have got a chance to go through the investor presentation that we have posted on our website. I will walk you through some of the key financial highlights of our performance this quarter.

As you are aware, Cipla had initiated the complexity reduction exercise last financial year and had taken a conscious decision to deepen our presence in some priority markets which include India, South Africa, US and our key businesses within the emerging market territories. Some of these initiatives, along with our efforts on cost containment, have started showing results with Q2 FY17 witnessing revival in base business profitability. We will remain focused to build on this performance trends for the balance quarters as well. A select portfolio with mix of acquired entities of InvaGen and Exelan and internal pipeline has helped us offset the challenges in other businesses such as API, Europe and emerging markets.

Coming to the quarter, our overall income from operation stands at Rs. 3,751 crores, growing by 9% year-on-year despite a very meaningful contribution from Esomeprazole profit share in the same quarter last year. As you are aware, the sales and profit stream on a year-on-year

basis would not be fully comparable due to the significant contribution of Esomeprazole, as well as benefit of the US acquisition for this year.

We continue our focus on operational efficiencies, which have resulted in the improvement in our cash flows. Operating cash flows for the quarter stood at Rs. 679 crores on account of good control over inventory levels. Our efforts on product and geography mix have resulted in improvement in base business EBITDA, as we alluded earlier, which has grown by 18% before R&D and over 10% after R&D in first half of this fiscal year. As a reference, base business for us denotes the performance from our core operating markets, without the benefit of acquisitions and excluding investments in new ventures as well as certain non-recurring items. Reported EBITDA for the quarter stands at Rs. 681 crores or 18.1% of revenues, despite continued impact of pricing regulations in India, currency volatility in our key emerging markets, ramp up of R&D investments, consumerhealthcare, and biologics expenses.

Total expenses for the quarter stand at Rs. 1,740 crores, an increase of 19% year-on-year, including 75% increase in total R&D expenses. Employee cost for the quarter is Rs. 675 crores, which is an increase of 16% year-on-year, largely attributable to consolidation impact of the acquisitions. Excluding this impact of InvaGen, employee expenses have grown by only 7%. Other expenses for the quarter, which include R&D, regulatory, quality, manufacturing and sales promotion expenses have increased from Rs. 877 crores last year to Rs. 1,065 crores this quarter.

Our R&D spend this quarter has increased by 75% year-on-year, as mentioned earlier. Total R&D expense for us is now 8% of revenue as compared to 5% last year same quarter. This increase is in line with our intent of building a differentiated portfolio for US and other geographies.

Among other matters, as you are aware, on the legal front in the month of October Honorable Supreme Court decided in favor of Union of India in an appeal filed against Cipla and others arising out of the judgment of the Honorable Allahabad High Court. Various other petitions filed in the Bombay High Court are on completely separate set of grounds and are sub-judice. Please refer to a detailed note on this matter contained in our filing to the stock exchanges as a part of Q2 results.

In accordance with IndAS adjustment, the Company has recognized certain provision amounts relating to acquisitions and have restated the financials for the earlier periods specific for this matter. Please refer to the reconciliation which is available in our consolidated results for more details. A large part of this adjustments relates to amortization of intangibles towards our US and other acquisitions. The amortization of intangibles post business combination accounting under IndAS stands at Rs. 65 crores for this quarter.

Our reported profit after tax is Rs. 355 crores, down 35% versus last year, again due to significant contribution last year from Esomeprazole. Adding to that is the InvaGen amortization considered during this quarter. The PAT percentage for the quarter is 9%. Our EBITDA margin guidance for the fiscal year continues to be within the range of 16% to 18%. Our CAPEX stands at 8% of sales. The last two-year period, as you are aware, we went through a very heavy capital investment cycle. And hopefully we will see a tapering down from subsequent quarters. During this quarter, we have invested Rs. 300 crores on CAPEX. Our long-term debt stands at US$572 million which is mainly used to fund the US acquisition. We do also have working capital loans of $135 million, which act as a natural hedge towards our receivables. Total net debt-to-equity ratio is 0.25 as of September 2016 as compared to 0.32 as of March 2016. Outstanding forward contracts as a hedge for receivables as of September 30 is $32 million and ZAR428 million.

With this, I would now like to invite Umang to present the quarterly business operational performance.

**Umang Vohra:** Thank you, Kedar. Welcome to all of you on the call today. I would like to start today by recapitulating some of the key priorities we set for ourselves at the beginning of this financial year, and the progress so far.

Our first priority was to grow our home markets and I am proud and happy to report that the India business has shown a very significant growth with most therapies outpacing the market growth and retaining leadership positions. We have also grown our Rx business at 16%, which we believe is significantly higher than IPM and higher than most other competitors in the market space.

We have given an EBITDA guidance of 16% to 18%. We are happy to report that our EBITDA margin has expanded in the second quarter. We are now at 18% versus 17% in Q1, and we are in line in half one with our guidance, and we are actually on the higher side of our guidance range. This is despite the 8% that we said committed we would spend on R&D. The R&D scale up has happened, as you have noticed our spending has gone up to 8% to revenues and the filing rate has improved, we have almost filed 12 ANDAs this year against a total of five in FY16. We are also investing significantly in the development of complex and differentiated products, and trying to find the right balance between Para-IV and limited competition opportunities. We are on track as for the full year guidance to file 20 to 25 ANDAs,that would include a decent portion of limited competition products.

Our InvaGen integration is on track with all milestones, top and bottom line in the first half of the year, as well as with the integration timeline that we had for ourselves. And we are continuing to operate our facilities in the level of compliance and control and this was another priority we had outlined. You would have heard of our Indore EIR and at the same time we were also audited in Goa during the quarter and the FDA concluded its audit with four observations across our three manufacturing sterile facilities in Goa. We have already

responded to these observations and believe all of the observations are procedural. And we continue to operate our facilities at the high level of compliance and control.

So these were the few goals that we had right at the beginning of the year that we are on track to achieve so far.

I will now turn to the quarterly performance:

At the total revenue of Rs. 3,751 crores, 40% was contributed by the domestic business and 60% by the international business. Our domestic Rx and Gx business of quarter 2 stood at Rs. 1,467 crores and registered a strong year-on-year growth of 21% with most therapies growing in healthy double digits, despite the continued impact of pricing regulations under DPCO.

The international sales, which reflects sales of all regions outside of India have grown marginally as compared to the previous year's quarter, and the absolute amount is at Rs. 2,150 crores. We faced some headwinds in emerging markets on account of currency volatility and liquidity. And we have also seen decline in Europe as we repurposed our model to become a business-to-business model from a direct-to-market model. This has been offset with very strong performance across the markets including South Africa, the base business in North America and the inclusion of InvaGen Pharmaceuticals and Exelan in this year.

So, I will now take you through our business performance, starting with our India Rx business:

Our Rx business registered a healthy growth of 16% year-on-year, with most therapies retaining leadership position and growing strongly. Cipla brands continue to outperform the market with 13 of our 23 brands in the Top 300 IMS brands growing more than the respective markets. Our respiratory, anti-infective, urology and dermatology portfolios have grown double digits. As for IMS MAT data, our anti-infective, gastro and urology portfolio has outperformed the market and has grown significantly higher than the market, and our Respiratory portfolio is at market.

We continue to build our portfolio through innovative launches and high-end critical care segments and also evaluating in-licensing opportunities to further strengthen our chronic care segment. Our generics business had a really good quarter aided by the season and grew by 45%. And we continue to focus on large volume products and the right level of incentive schemes for the stockiest.

Going on to North America, that business has registered a growth of 34% compared to last year in dollar terms. With the labeling transition now nearing completion, we are on track with the integration of InvaGen and Exelan.

During the quarter, we have launched six new products in the market. Many of these products are already at double-digit market shares and we believe we have reached fair market share

for several of our product launches. Of our 35 DTM products covered under IMS, 18 are in the Top-3 position in the market. We are targeting to launch another nine products in the remainder of the year between InvaGen and the Cipla launches. We believe these launches will have an interesting mix of products which include limited competition opportunities.

We are in line with our full year guidance of 20 to 25 ANDA filings for the US. We filed six products in this quarter and have got acceptance for the technologically complex Nano Paclitaxel product. We believe this will be a limited competition opportunity and depending on the time that Cipla would launch would be a lucrative proposition for us. We are likely to be filing Albuterol pMDI, our first MDI in the US in this quarter and that will strengthen our respiratory portfolio.

Our South Africa business continued to show growth across both private market and tender business with Q2 sales growing at 8% compared to last year in local currency terms. As per IMS MAT, Cipla achieved a growth of 15.4% in the private market versus 8.3% market growth, and it was the fastest growing company amongst the Top-10 companies in the market. We continued our leadership position in focused therapies like respiratory, CNS, oncology and the musculoskeletal system and have over 30% market share in each segment. We are pleased to report that we have closed the Actavis deal in South Africa with the Competition Commission approval effective 27th September. With this partnership, Cipla has significantly broadened its portfolio offering and will market Actavis product portfolio, and leverage its strong relationship with healthcare professionals and pharmacies in the region.

In Europe, we have reached the advanced stages of our business restructuring process. As a result, our sales in the region have de-grown by about 30% year-on-year, but our operations have reached breakeven. We have recorded significant ramp up in FPSM volumes in the region and are attempting to launch our FPSM products in key markets in this quarter and the next.

In emerging markets, our sales de-grew by 18% in dollar terms, this is largely on account of local currency depreciation in most markets. Our Cipla Global Access business experienced a growth of 13% year-on-year on account of tender base.

To summarize, while the current quarter has recorded strong profitability, we remain focused on building on these performance trends for the upcoming quarters. We will continue our impetus on strengthening our operations, resulting in robust revenue growth and bring efficiencies in our cost structure while continuing our investments in R&D.

I would like to thank you for your attention to Cipla, and I will request the moderator to open the session for Q&A.

**Moderator:** Sure. Thank you very much. We will now begin the question-and-answer session. Our first question is from the line of Kumar Saurabh from Motilal Oswal Securities. Please go ahead.

**Kumar Saurabh:** First of all, thanks for improving the disclosure. The presentation is quite detailed. Couple of questions from my side. First, the API business has shown considerable decline year-over-year. Just wanted to understand that is this because of higher focus on our own formulations or there is some of other reason for that?

Secondly, the US business. How should we look at the US business growth? We have said that base business also has grown at 34%, whereas the total business also year-over-year has grown at 34%. So is it something that the Nexium impact has been exactly been offset by the InvaGen ramp up?

**Umang Vohra:** I think you have a very good second question, Kedar will answer that. On API, specifically, I think there are two aspects. You raised the issue of API being repositioned to be an internal captive business, and I think increasingly this will happen as Cipla ramps up for US filing. But last year, we also had shipments of lamivudine to a customer in the US, who has since launched. And I think those revenues were booked in first-half. And the delta of that amount is quite significant in the API numbers.

**Kedar Upadhye:** Kumar, on US revenues, InvaGen revenues booked in this quarter is $50 million. If you adjust this revenues and last year's Esomeprazole, the base has grown at 34% in this quarter.

**Kumar Saurabh:** So, because your total business has also grown. So then basically $50 million was in Nexium sales, and then $50 million is InvaGen?

**Kedar Upadhye:** You could make estimates, but yes.

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

**Prakash Agarwal:** Sir, you mentioned there has been cost reduction across and you did mention about Rs. 65 crore item which I missed, because my observation is margin expansion is largely due to the better revenue mix which has led to gross margin expansion, and operating expense continues to be on the higher side. If you could give us more details there, that would be helpful.

**Umang Vohra:** Kedar will answer this question. I think your question pertains to overall costs?

**Prakash Agarwal:** Yes, other operating expenses.

**Umang Vohra:** And you mentioned something about 60%, what is that?

**Prakash Agarwal:** That Rs.65 crores, I missed. There was a mention by Kedar I think, is it sitting under other operating expense?

**Kedar Upadhye:** That is amortization. So what we have done is we have completed purchase price allocation accounting for our InvaGen acquisition, under IndAS and this quarter's amount as well as for InvaGen as well as for all acquisitions put together, is Rs.64 crores. You are right, yes.

**Prakash Agarwal:** So where is it sitting, sir?

**Kedar Upadhye:** That sits in other expenses.

**Prakash Agarwal:** And this we will continue for as many years until unless this is knocked off, right?

**Kedar Upadhye:** This is part of depreciation and amortization line. And typically the useful life for assets like this is 12 years.

**Prakash Agarwal:** Just a clarification, you said other expenses, now you said should ideally be in depreciation and amortization, right?

**Kedar Upadhye:** Within that line, yes.

**Alpesh Dalal:** So it sits below EBITDA, Prakash.

**Prakash Agarwal:** Understood. But my question was why the other operating expenses higher, sir?

**Kedar Upadhye:** So that that pertains to R&D, regulatory, quality, manufacturing and sales promotion, everything put together, Prakash. And R&D, we have stepped up, like what we said, which was 5% of sales to last year, which is almost 8% now, that is one big component.

**Alpesh Dalal:** On the expenses side, the total expenses also include InvaGen, which wasn't there last year in the same quarter.

**Umang Vohra:** So I think what we should give as commentary here is that total operating expenditure, if you exclude InvaGen, you exclude R&D, because R&D we are explaining separately and you exclude the sales-related impact of Esomeprazole. So total operating expenditure that we are showing as an increase is below 5% in the first half of the year compared to the previous year. So base costs are under control. If you add the InvaGen cost, then the cost percentages begin to vary. But if you were to look at our business without InvaGen and without any of the one-offs in this quarter, in this first half, excluding all of that cost increases are less than 5% versus the previous year.

**Prakash Agarwal:** Thanks for the detailed explanation. I was just trying to understand the QoQ jump is largely due to the higher R&D?

**Kedar Upadhye:** Yes, Prakash.

**Prakash Agarwal:** And secondly on the US business, if I see QoQ, we are flat and you did talk about that the transition is getting over. So what's the expectation in terms of new launches and how we see this picking up on a QoQ basis for the outlook for the next six months and the fiscal 2018?

**Umang Vohra:** So, I think it is going to be Prakash, dependent on launches in this market. I think most of our launches were penciled in for late Q3 early Q4, now knowing the US market, they could be delayed by a quarter or not. But as of now, we are sticking to this run rate going forward.

**Prakash Agarwal:** And lastly some color on the inhalers for the UK market, where do we stand, what is pending and what are the timelines we are looking at?

**Umang Vohra:** We are still hoping to see a launch in this financial year in the UK, but obviously this is dependent on the approval by the authority. But our confidence in terms of being able to launch in this financial year has increased.

**Prakash Agarwal:** And any data points you can give us, what is helping us to increase the confidence?

**Umang Vohra:** Well, we have been in discussions with the agency. We believe that filing has progressed quite significantly.

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

**Girish Bakhru:** Again a question on the cost control. It is pretty significant and in terms of the drivers, I believe one of course major driver would be the shift to the model in the Europe business. Has that resulted basically full impact is visible in the quarter or is there more from that side?

**Umang Vohra:** Europe is done, Girish. I think the full impact has come. We are showing half of the quarter with the full impact, the full impact will come in the next quarter onwards. I think a large portion of the cost control has to also do with people and people costs have been monitored and tracked very closely in this year.

**Girish Bakhru:** So, in line of that is there no room to increase the margin guidance given that you are already touching 18% on EBITDA margin the quarter?

**Umang Vohra:** We would like to stick with the same range, because we believe that R&D may go up slightly more depending on timing, etc and that will be offset. So we'd like to stay with that. Also please keep in mind that this has been a season quarter for India as well. So therefore we are sticking to the margin guidance range.

**Girish Bakhru:** And on the US business, if I actually exclude InvaGen and just take your direct sales with 35-odd products, on a fully loaded R&D basis, would that business be breaking even currently?

**Umang Vohra:** No, it would not because our investment in R&D has increased significantly right now. So it would not, not our business excluding InvaGen.

**Girish Bakhru:** On the R&D side, with one filing planned in next quarter, I am just trying to understand where this R&D actually will go to from 8%, you have eight respiratory filings planned for next two years. What kind of number should one work with on a per-trial basis, if you could give some color on that?

**Umang Vohra:** So Girish, I do not know where you are picking up the eight respiratory filings. I think overall respiratory we will track, try and complete our portfolio to the maximum over the next two to three quarters, but we have guided for this year to be 20 to 25 ANDA filings and we are half way there. Now, as we begin to start clinics for some of the respiratory products, that will come up in the second half of the year. And therefore R&D may inch up slightly from where it is right now.

**Girish Bakhru:** No, I am just talking from the presentation you had made last time, where you had shared Top 50 R&D projects, of them eight are respiratory filings. And a lot of these are probably for US market in next two years. That is correct, right, number?

**Umang Vohra:** Yes. So not all eight are US, some are also for Europe. But yes, out of 50, eight are respiratory.

**Girish Bakhru:** And would you say a large chunk of costs will be mainly for the Advair trial, or will the other products also take trial?

**Umang Vohra:** Advair will obviously be there, but it will be a mix.

**Girish Bakhru:** And just lastly, if you could give some color on the Nanopaclitaxel filing. What is the market currently like, and if there are other players?

**Kedar Upadhye:** So, market is approximately beyond $700 million, Girish now. We have to find about the competition.

**Umang Vohra:** We believe there is a first to file and it is possibly Actavis, and now Teva. So there is the first to file and we think this category will stay limited because of the nanotechnology involved in this.

**Moderator:** Thank you. We have the next question from the line of Nimish Mehta from Research Delta Advisors. Please go ahead.

**Nimish Mehta:** Yes, thanks for taking my question. On the US business last quarter you mentioned that we are likely to see higher number of launches in the second half and some of this could be niche launches, if you can just elaborate whether we are on track and what are the kind of high value launches we are likely to see?

**Kedar Upadhye:** Yes, Nimish, I think overall number we could still be within the target that we have. But couple of these niche launches we might have a quarter's delay or so, not fully predictable.

**Umang Vohra:** So, product related details we are not giving. But I think broadly if we were to give ourselves plus/minus one quarter, I think we are on track with most of that.

**Nimish Mehta:** So what is the run rate we are looking at in terms of launches next in the second half?

**Umang Vohra:** We have mentioned this I think in our speech. I think it was somewhere around six to nine products.

**Nimish Mehta:** And with one quarter here and there, we are still looking at what, couple of niche launches?

**Umang Vohra:** Yes, hopefully.

**Nimish Mehta:** And the next question is actually on the Europe business, you mentioned there was some, you changed the business model there. So are we breaking even in Europe?

**Umang Vohra:** Yes, we are now breaking even in Europe. The model has been changed from DTM to B2B. As a result of this change, the revenue gets booked obviously by our partner. But from a profitability perspective, we are lot more profitable than what we were in Europe in about six or eight months back. So now we are breakeven.

**Nimish Mehta:** And this being said, sales force that we had is kind of no more as of now, right?

**Umang Vohra:** You are right.

**Nimish Mehta:** And lastly on the India business, we had seen great quarter because of the season we have. But how do you see other therapies, the non-infectious therapies performing and what do you think could be the outlook from here on, assuming a normalized season?

**Umang Vohra:** We have market growth in gastro, we have beaten market growth in urology, we are on growth in respi. So chronic portfolio, I think other than cardio for us has done well and anti-infective has done well as well. So I think Cipla is trying to build a very sustainable chronic therapy in the domestic market and our efforts will continue to do that.

**Nimish Mehta:** You will be beating the market, because this is generally something that we can take it for granted?

**Umang Vohra:** Well, yes. I think one or in some quarters, obviously some therapies will beat some therapies may not. But overall on the yearly basis, that is our overall guideline, that we want at least in all our home markets, whether it's South Africa, it's India, and some of our emerging markets, we would like to beat market.

**Nimish Mehta:** Finally, if I may squeeze one more, can you give any guidance on the launch of Tamiflu in US?

**Umang Vohra:** We are not commenting on that level of detail. We would choose not to comment on it at this stage.

**Moderator:** Thank you. We have the next question from the line of Sameer Baisiwala from Morgan Stanley. Please go ahead.

**Sameer Baisiwala:** Umang, is it possible to give us some color on the UK Seretide opportunity?

**Umang Vohra:** In terms of?

**Sameer Baisiwala:** In terms of economic size or, the ramp-up would be quick, ramp-up may take time, any color on that? My understanding is about $400 million, already a generic there. So just your thoughts, how meaningful can this be for you?

**Umang Vohra:** So, I think the generics of what we understand, Sameer, have captured about 15% or 20%, in terms of share. Directionally, over the period of time, because this market will not substitute as quickly as the US, I think for the next three quarters or so. Directionally, we through our partners and ourselves will try and hit somewhere around 10% to 15% share on this.

**Sameer Baisiwala:** And how is the pricing at the moment with one player in the market?

**Umang Vohra:** It is still attractive, Sameer. I think the overall price discount does not seem to have fallen off significantly because the generic who launched did not go after a wide range of the market, and it has only taken 15% to 20% cover.

**Sameer Baisiwala:** And the arrangement between you and your front-end partner would be like 50-50 or something, I mean broadly speaking?

**Umang Vohra:** So that level, we would not give, Sameer. But it will be I think, ballpark it would mimic the type of transactions we have done in the past.

**Sameer Baisiwala:** And secondly, just to make sure if I heard it correctly, you mentioned in the context of respiratory clinical trials for the US, you mentioned that Advair too would be one of those. Earlier you were not sharing detail on this product.

**Umang Vohra:** So I had mentioned, Sameer, I think last time that it is likely that we will be after most respiratory products including Advair. So the clinical trial is still a while away, it is not as if we are going to start it in this quarter.

**Sameer Baisiwala:** Okay. So do you think you will be in time for the first wave of launches, or we are maybe three to four years away?

**Umang Vohra:** So I think we will not be in the first wave, for sure, because I think the market is there, but it is an interesting situation now with the CP environment created in the US . We have always

believed that when it is a product like Advair or any of the other complex respiratory things, it is not just the filing, but it's also sustainable manufacturing and process controls for this product. So we are not surprised with the type of CP that Sandoz has filed. And these are fundamentally difficult products to prove bioequivalence or clinical, you could end up failing a clinical study as well. So we do not know what's going on exactly with the files in there, but we will not be the first wave of launch and we do not even today expect more than four or five players in this category on a sustainable basis.

**Sameer Baisiwala:** And Umang, just as a side point, the initiative by the Prime Minister yesterday on the cash side, I am sure it does not impact maybe pharma industry so much, but just your thoughts. And what I hear is that within the trade channel, there is lot of cash, especially from the small time pharmacist and organized sector back into stockiest. So do you think at any level, your sector can be impacted by this?

**Umang Vohra:** Kedar will probably have a more refined answer. But, I think from our perspective we are seeing possibly a week or 10 days of slow buying, but then resuming over time, but I would defer to Kedar on this.

**Kedar Upadhye:** I think Sameer, we have heard some murmurs from the trade exactly on the same counts like what you have alluded, but we will have to wait and watch. I think in the long term, our view is things would settle. Ignore the temporary disruption for payments like Octroi and things like that, in the long term things would settle down.

**Moderator:** Thank you. We have the next question from the line of Manoj Garg from Bank of America Merrill Lynch. Please go ahead.

**Manoj Garg:** One, this is regarding your nanotechnology product. The innovator has started working on the improved version of that product. So do you see that that may have a material impact in terms of the end market size for that opportunity?

**Umang Vohra:** Could have. It depends on when the generics enter the market. I think right now the first filer has already initiated suit with the innovators. So it really depends on timing of course. If they launch three, four years later, then I think the market opportunity will be difficult for them to convert, because by that time the first filer could enter the market. On the other hand, if they are able to introduce this product a lot before that, then obviously some portion of the market would shift.

**Manoj Garg:** And the second question basically on this gross margin side, Kedar, is it like, sequentially we have seen around 200 bps kind of improvement on the gross margin. Is it largely being led by the higher contraction from the domestic business or there was some improvement in terms of procurement and all those things? And is there any further scope in terms of improving the gross margins?

**Kedar Upadhye:** So, currently Manoj, I think for us to retain at this level would be a good target to take. There might be a few non-recurring items, but largely this has come because of product mix, geography mix, a bit of control on inventory and subject to how the additional coverage of DPCO, the full effect of that, it could be little bit of a downward bias, but yes, for us to retain at the current level would be a good target to take.

**Manoj Garg:** But when you look at yourself vis-à-vis your peer set, do you see that there is definitely a scope in terms of overall improvement in the gross margins, maybe over the next two years to three years kind of time horizon?

**Kedar Upadhye:** So, that scope, yeah, that scope exists, but that's a function of our procurement, that's a function of our where-to-play choices, our geography mix and several factors. So that scope certainly exists, Manoj.

**Manoj Garg:** And just one last question on the housekeeping like, in terms of tax rate, what should we build in the model, during the first half year, it has been in the range from 14.5% to 15% kind of range?

**Kedar Upadhye:** I think we should build around 19% to 21%.

**Moderator:** Thank you. We have the next question from the line of Nitin Agarwal from IDFC Securities. Please go ahead.

**Nitin Agarwal:** Hi. Thanks for taking my question. Umang, we have a pretty articulated strategy for the coal markets of India, South Africa and U.S. I mean there is still a chunky portion of emerging markets for us in the RoW piece of the business, which has been struggling for some time now. I mean how – and this is almost like one-third of –one quarter to a third of our business. I mean how do we see this piece going forward strategically and I mean how are we looking at it.

**Umang Vohra:** So I think unlike some of our competition I think one of the advantages that Cipla has on this piece is that no market is concentrated. Maybe South Africa is the most concentrated market, but the rest of the emerging markets are not concentrated. They are smaller markets, Cipla's highest sales in any market could not be more than $30 million to $35 million at best. So the concentration risk is not very strong in these markets. But however, the risk of pricing and currency is not something that we can control. The only thing we can do is make our models in the front ends more asset light and that's what we're trying to do. I think we will begin to see a flattening of growth, rather than a decline in growth in the second half of the year compared to the previous year. I think we had really good quarters in quarter one, quarter two of last year and then there was some kind of an abatement and slight fall in quarter three and quarter four of the previous year. So I think we will see that we will not be de-growing in the next half of the year, but at the same time, there will not be radical growth that would be coming in our emerging markets.

**Nitin Agarwal:** And over a two-to-three-year period, where do you see this piece precipitating in your strategy?

**Umang Vohra:** So, this piece will be there because we like the optionality of these markets to our overall strategy. These are growth markets, maybe their time is not exactly in the next two to three years, but these markets will keep growing bigger in their regular level of growth. And therefore we believe these are great options, we had an option to grow Sri Lanka which is today $30 million market or Yemen or you know some of the other markets that we have, Australia is $30 million market. So if we have options to growth these markets higher with the respiratory range of launches, I think those are options we would like to retain. So it would not, just the entire emerging market because of the pricing compression and the currency crisis will not be high growth markets. So I think we would expect very steady growth, maybe single digit to moderate double-digit growth in these markets over a three-year period.

**Nitin Agarwal:** And lastly on the South Africa piece, with the economic turmoil and various other issues the country has been growing with, is that in any way change your fundamental outlook on the market vis-a-vis with lack of investment that you made in the business?

**Umang Vohra:** No, I think the business has grown from strength. South Africa business is actually is grown in strength in South Africa. The currency crisis does mean that again we will be very judicious with the use of capital for expansion in South Africa. But between last year and this year, the business has actually improved its trajectory of EBITDA to offset some of the currency crisis, and I think we are continuing to follow the strategy where the business stays relevant for us in our overall mix and at the same time, it begins to focus on accreting EBITDA and not necessarily just top-line.

**Nitin Agarwal:** And just last one, generally speaking how do you see H2 for you on a profitability front compared to H1 for the different parts of the business?

**Umang Vohra:** So I do not know if we want to answer that right now other than probably just maintaining that overall, we will be in the 16 to 18 range.

**Moderator:** Thank you. We have the next question from the line of Bharat Celly from Emkay Global. Please go ahead.

**Bharat Celly:** I just want to ask one of the products that is Travatan Z. I just wanted to know whether you hold 180-day exclusivity in this product and you have already have a - your partner already has a tentative approval. So wanted to know when you can launch this product?

**Kedar Upadhye:** Which product Bharat?

**Bharat Celly:** Travoprost, that is Travatan Z.

**Umang Vohra:** I think it is something for the partner to decide.

**Bharat Celly:** Can you share whether it is in FY18 or FY19, any ballpark if you can give?

**Umang Vohra:** I am not sure we want to give that guidance. There is a form of Travoprost already in the market, which is sold by another partner of us.

**Bharat Celly:** Yes, right. But you already have a tentative approval, that is the reason I am asking.

**Umang Vohra:** Yes. I am not sure we want to give that guidance right now.

**Moderator:** Thank you. We have the next question from the line of Kartik Mehta from Deutsche Bank. Please go ahead.

**Kartik Mehta:** Just trying to understand on the depreciation side. So it has been fairly volatile over the quarter, so what is the number we should actually run with in terms of the increase which was there in this quarter, can you elaborate on the nature of it? Thanks, bye.

**Kedar Upadhye:** So Kartik, probably you should model the current quarter's number. It will go up whenever the new products get launched and the corresponding depreciation for those products get booked in P&L. But as far as the existing products portfolio of InvaGen is concerned and various other acquisitions, the current quarter's depreciation number is something that you can model.

**Kartik Mehta:** Okay, because it was about Rs. 240 crores in Q4, Rs. 161 crores in Q1. So I understand Q1 was the first quarter when we consolidated InvaGen, and we have about Rs. 230 crores now. So I am just confused that what has happened over Q2 to Q1 to see a substantial increase in the depreciation?

**Kedar Upadhye:** We alluded in the last call, Kartik. In the quarter one, we had not completed the purchase price allocation accounting. The accounting for InvaGen has been done for the first time in September this quarter. So this quarter's numbers is more representative of what's going to follow except wherever as I said new products get launched, corresponding product specific depreciation will get booked in P&L.

**Kartik Mehta:** Is there any number you would want to talk about on InvaGen, Exelan for FY18, FY19 on how you think this will scale up?

**Kedar Upadhye:** It is early enough, Kartik, for us to talk about from a guidance standpoint.

**Moderator:** Thank you. We have the next question from the line of Alok Dalal from CLSA. Please go ahead.

**Alok Dalal:** Umang, just one question on the US market in general. If you take the next three years, then most likely Cipla will remain the mid-size company in the US. What could be the future of a mid-size company like yours, given the challenging environment in the US today and probably things are not looking as if they will improve quite quickly? So what are your thoughts on being a mid-size company in the US three years from now?

**Umang Vohra:** So, I have always answered for the US in a very different manner, which is that I think your success in the US really depends on a couple of products where you maybe mid-sized, but you are among the few to compete in. So for example, there are five customers in the US and if you have products where you are one among the three who sell, you will get enough shares irrespective of whether you are mid-size or not. So our choices are going to be very deliberate, our choices are going be around the portfolios of respiratory and oncology in the US. We see a growth there, HIV is a great platform for us as well. So I do not think we necessarily mind being a mid-sized player as long as we have assets where we are differentiated and we are playing a game where not too many can play.

**Alok Dalal:** But Umang, if you see the commentary of other companies, most people are talking about differentiated products in the form of complex generics, largely same categories. So do you feel all will succeed, because ultimately the market is niche and maybe the market may not be large enough to accommodate everyone?

**Umang Vohra:** Could be. But I also at the same time do not believe that everybody else who is talking about it is necessarily talking about the same category of products, right. That is one. Secondly, I do not think everybody will succeed in every product that they are doing, including Cipla. So, I just think that there is this opportunity and the profile of products has become more complicated now. I do not think that respiratory products can be done by everyone. I think there will be a few that even Cipla may not succeed with in respiratory. At the same time, I do not think that, I think some of those positions on HIV have already been taken, because those markets were formed earlier. And I think a product like nanopaclitaxel, etc, there may be filers but we do not think there will be as many. So I think there is a play for everyone and all companies, obviously companies which are bigger than us in the US have established this for themselves. We have a reputation to establish for ourselves and that's the journey we are on. But yes, generally, if your question is, is the US going to be a lot more competitive, it will be and all for the right reasons.

**Moderator:** Thank you. We have the next question from the line of Shyam Srinivasan from Goldman Sachs. Please go ahead.

**Shyam Srinivasan:** Just one on the generic pricing environment. If you look at the InvaGen portfolio, can you just guide us to what is the kind of deflation that you are seeing in the base business? And I believe you said the numbers $50 million for the quarter, right? Kedar said that, is that right?

**Kedar Upadhye:** Yes. For the quarter, it's about $50 million. So Shyam I think either for InvaGen or for Cipla's portfolio in US, I think we will always factor as part of our operations plan some price erosion year-on-year. So I do not think it is become disruptive but our operating plans would always assume an erosion. We are subject to obviously who enters, whether the new player is from India or from abroad, what kind of API cost advantage the player has, et cetera. So there are product-specific factors, but I think it's, from a target-setting perspective, our operating plans do factor generic pricing erosion.

**Shyam Srinivasan:** Yes. So is that like mid-single digits or high, any color that you can add in the quantum, it will be very helpful.

**Kedar Upadhye:** It is product specific, Shyam. Overall, at the portfolio level, mid-to-high single-digit would work.

**Shyam Srinivasan:** Okay. And the second question I think, the disclosure on slide eight, it is quite useful to tell us, there are about 50 ANDAs that are approved for InvaGen. How many of those have actually been launched, at this point of time?

**Kedar Upadhye:** We will have to come back to you, Shyam. We will connect offline.

**Moderator:** Thank you. Our next question is from the line of Anubhav Aggarwal of Credit Suisse. Please go ahead.

**Anubhav Aggarwal:** A question to Kedar, sir. Just wanted to understand gross margin a little bit more. This quarter benefited in India a lot from generic sales where you mentioned like almost 45% growth. And in the past you mentioned generic is almost 20% total in net sales. And last quarter, you mentioned that incrementally this quarter, India business will have Rs. 25 crore to Rs. 30 crore of incremental pricing impact. Given these two things where lot of, and I am assuming generic business will have a lower gross margin. In that respect, how do you explain this delta is pretty sharp, almost 300-basis-point in terms of gross margin sequentially?

**Kedar Upadhye:** Anubhav, there have been several factors, be it product mix, be it geography mix, be it control on inventory, and some of the procurement savings, I think all of that have helped us absorb this incremental DPCO hit. It is not concentrated because of any one specific reason, it is split across multiple reasons. And like what initially in one of the questions we alluded, it could be good target for us to retain the current gross margin.

**Anubhav Aggarwal:** You also mentioned to earlier response that there was some non-recurring part in this as well. Is that…?

**Kedar Upadhye:** Yes, I think there is always a bit of profit share and things like that. Those could vary quarter-on-quarter. And this mix could improve or worsen in future. But like what I said, it would be a good target for us to retain the current levels.

**Anubhav Aggarwal:** But this quarter had the full impact of pricing, would you talk about incremental Rs. 25 crore, this was present in this quarter.

**Kedar Upadhye:** Yes, yes.

**Anubhav Aggarwal:** And just lastly, this non-recurrent part, would that be substantial portion or just various less than 50 basis points or more than 50 basis points?

**Kedar Upadhye:** Yes, somewhere around that.

**Moderator:** Thank you. We have the next question from the line of Surya Patra of Phillip Capital. Please go ahead.

**Surya Patra:** Again on the amortization front, by now, we have already factored those products. This has already been there in the market for InvaGen. So with the new launches, what kind of incremental depreciation or amortization that we should see over the next few quarter, Kedar?

**Kedar Upadhye:** So Surya, it would be tough to compute. So what we have done is, like what I said we have done, allocation of the purchase price for InvaGen into various assets. So depending upon each asset, the depreciation would get charged in the P&L roughly over the period of 12 years.

**Surya Patra:** Okay

**Kedar Upadhye:** So, we would assume that these sales and the gross margins from the respective product would more than absorb the respective depreciation for that particular asset.

**Surya Patra:** And any update that we are providing about Sevelamer, because for InvaGen I think that could be one of the important asset or which can really drive growth.

**Kedar Upadhye:** Surya, we would avoid getting into product label details at this time.

**Surya Patra:** Fine. So can you provide some update like what are the kind of growth visibility that we are having for the InvaGen why because from the point of acquisition, we are seeing a kind of lower quarterly run rate for InvaGen business in US.

**Alpesh Dalal:** Surya, Kedar did mention that it would be a little early for us to provide any guidance on InvaGen.

**Surya Patra:** Just one more question. Can you just repeat what is the kind of CapEx number that you have indicated, why because something the Rs.350 crores odd number that I believe you said.

**Kedar Upadhye:** So, it is about Rs.300 crores for the quarter. And we said that we went through a very heavy capital investment cycle for the last two years, and we hope to see a tapering down from the subsequent year.

**Moderator:** Thank you. Due to time constraints we will be able to take one last question. Our last question is from the line of Chirag Dagli from HDFC Mutual Fund. Please go ahead.

**Chirag Dagli:** Sir, can you give us some sense of the kind of OPEX growth that we can see as we look into FY18 once the InvaGen piece is sort of well digested? Post that, what sort of OPEX growth should we sort of see for Cipla?

**Kedar Upadhye:** Chirag, it should be moderate. We would look at our entire spend base, be it people cost, be it manufacturing, be it procurement, be it sales and marketing.

**Chirag Dagli:** So certainly lower than sales growth, sir, is that a fair assumption?

**Kedar Upadhye:** Yes, that would be a good assumption to take. I would exclude R&D from that, because R&D is a function of the kind of portfolio, the kind of filings, clinical trial calendars. I would take out R&D, but for all other expenses, I think what you said would work well from a modeling standpoint.

**Chirag Dagli:** Sure. And sir, second question was on the US business, as again as we look at FY18-FY19, how should we think about some of these product launches, both within the partnered bucket as well as the Cipla own label bucket. Beyond getting into numbers, how should we think about this business growing?

**Kedar Upadhye:** So Chirag, why don't we come back to you probably towards either February or May in terms of the precise visibility of the launches and filings. It would be a bit early now to talk about next year's launches.

**Moderator:** Thank you. That was the last question. I would now hand the conference back to the management for any closing comments.

**Kedar Upadhye:** So, thank you all for joining Cipla's senior management for this call. In case of any additional clarifications, please feel free to revert to Invester Relations team. Thank you and good day.

**Moderator:** Thank you very much. With this we conclude the conference. Thank you for joining us, Ladies and Gentlemen. You may now disconnect your lines.