



“Cipla 2QFY18 Earnings Conference Call”

November 07, 2017



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November 07, 2017

Moderator: Ladies and gentlemen, good day and welcome to the Cipla Q2 FY'18 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: Good Evening, everyone. This is Chirag from Kotak Institutional Equities. I thank the Cipla management team for giving us the opportunity to host this call. From Cipla, we have with us today, Mr. Umang Vohra – M.D. & Global CEO; Mr. Kedar Upadhye -- Global CFO; and Mr. Naveen Bansal – Manager, Investor Relations at Cipla. Over to you, sir.

Naveen Bansal: Naveen Bansal this side. A small disclaimer before we begin the call: On this call, our discussion will include certain forward-looking statements which are predictions, projections or other estimates about future events. These estimates reflect management's current expectation of the future performance of the company. Please note that these estimates involve several risks and uncertainties that could cause our actual results to differ materially from what is expressed or implied. I would now request Kedar to walk us through the "Financials for the Quarter."

Kedar Upadhye: Thank you, Naveen, and good evening to all of you. Welcome to our Earnings Call for the Second Quarter of Financial Year 2018.

I hope you have received the 'Investor Presentation' that we have posted on our website.

I will now take you through the Financials for the Quarter: The Results for the quarter demonstrate strong growth in our India business post destocking related to GST in Q1, benefit of operating leverage and continued focus on cost controls. The quarter also saw strong momentum across our businesses in South Africa, API, Europe and other emerging markets. Overall income from operations stands at Rs.4,082 crores, delivering strong quarter-on-quarter growth of 16% and year-on-year growth of 9%. Post the GST implementation, as you are aware, our sales are net of GST versus the earlier grossing up of excise. This classification of indirect taxes and the pricing together has reduced our reported sales for the quarter by about Rs.100 crores or so. This will change our margin percentages in P&L at various levels. Adjusted for this, the overall company level revenue growth stands at 11.4% on year-on-year basis and 18% sequentially. You would notice that this quarter saw this Domestic Formulations business growing at 30% on a quarter-on-quarter basis. Gross margin after material cost in the quarter has been impacted due to the adjustments related to GST as mentioned above. In addition to that, there have been higher number of batches which we have executed for future filings and certain inventory charges and mix impact. For the classification of excise component within GST, there will be a contra in other expenses and hence we should compare EBITDA per cent for a like-to-like sequential margin comparison. During the quarter, we maintained strong control on the spend with total expenses which include employee cost and other expenses at Rs.1,725 crores, declining by 1% over last year. Employee cost for this quarter stood at Rs.661 crores, a decrease

November 07, 2017

of 2% year-on-year. The other expenses for this quarter which includes R&D, regulatory, quality, manufacturing and sales and marketing spends stood at Rs.1,064 crores, increasing marginally on year-on-year basis. Total R&D investment for this quarter stood at 6% of revenues. We expect ramp-up in our R&D investments in the upcoming quarters with certain clinical trials expected to begin soon. Reported EBITDA for the quarter stands at Rs.804 crores or 19.7% of revenues which is an increase of 18% on year-on-year basis. You would notice an increase in the depreciation and amortization line which is on account of a drop in the value of our acquired intangibles for the US market due to delay in launching and other reasons. Linked to this, you would also notice an increase in other income line which is a negotiated settlement amount which we have received as compensation. Both these amounts are approximately \$11 million. The tax rate for the quarter was about 24% and full year effective tax rate would continue to be around 25%. Profit after tax stood at Rs.423 crores, 10.4% of sales, up 19% from last year. On a sequential basis, our EBITDA has grown at 24% and PAT if you adjust for the one-time Animal Health income received in the first quarter, it has grown at 32%. Free cash flow for the quarter after capital expenditure is quite healthy at about Rs.309 crores. In Q2, we invested Rs.169 crores on capital expenditure, much lower compared to historical trends and in line with our overall target of tapering down. We will continue to monitor these investments in the upcoming quarters as well. Our long-term debt remains at US\$550 million which was mainly used to fund InvaGen acquisition. We also have working capital loans of about US\$187 million which act as natural hedges towards our receivables. Total net debt-equity as on 30th September is about 0.18. Outstanding forward contract as a hedge for receivables as of 30th September are US\$14 million, South African Rand 255 million and Euro 6 million. During the quarter, we have also hedged certain portion of our forecasted export revenues. The outstanding forward contract as cash flow hedges as of 30th September 2017, are USD108 million and South African Rand 252 million.

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

Umang Vohra:

Thank you, Kedar. I am pleased to announce that we are tracking quite well on our key priorities for the year.

One, we have started receiving our much-awaited product approvals in the US and target to ramp up the launch trajectory strongly in the current and upcoming quarters with the good mix of differentiated launches.

Second, our key markets continue to deliver strong growth. India business delivered exceptional growth during the quarter with the prescription business showing clear signs of recovery post the GST implementation. South Africa, API, Europe, and other emerging markets delivered healthy double-digit growth in the quarter.

Third as announced, during the last quarterly call, we have expanded our regulated market Respiratory franchise with the launch of FPSM in Australia. The product has been received well in the market and has witnessed strong uptick.

Fourth, our US ANDA pipeline filings trajectory continues to improve. We filed five ANDAs during the quarter, of which two are likely to be limited competition opportunities.

Fifth, our Manufacturing and R&D sites remain in a state of compliance and control.

For the quarterly performance of the total revenue of Rs.4,082 crores, 41% was contributed by the Domestic business, 57% by the International business and the rest by other operating income.

I will now take you through our business performance starting with our India Business: The industry saw significant challenges at the start of Q2 due to GST. Despite this, overall India business grew by 12% year-on-year basis and 30% on a sequential basis. When normalized for the impact of GST as Kedar has mentioned, India business grew at 19%. During the quarter, Cipla has performed at par and better than market in several therapies. We have maintained the market share of 5.1% as per IMS. Key TAs that delivered above market performance include Cardiac, where we grew by 9% versus the market at 3%; Urology where we grew at 8% versus the market at 4%; Respiratory Inhalation where we grew at 6% versus the market at 3% and CNS where we outgrew the market.

We have improved our portfolio in Oncology/Urology with the launch of Onco-BCG through a strategic partnership with Serum Institute of India. We continue to serve patients with various awareness initiatives and programs which include early screening of disease, education and capacity building of doctors in areas of Respiratory and Cardio Metabolic among others. Our focus in the upcoming quarters will be to continue to drive the ecosystem and the awareness of therapies in India, stronger prescriptions and partnering with the channel as they restock.

Our North American business has registered a marginal decline during the quarter. As alluded in the last quarterly call, our base business out of US is now averaging about \$100 million per quarter. As per IMS MAT September '17, Cipla is the market leader in 10 out of the 47 marketed products under IMS. We are in Top-3 positions with about 64% of our portfolio. Cipla has been consistently ranked among the top-10 most dispense generic companies in the US with the recent IMS showing us at #8.

As announced earlier, we are confident of ramping up our launch trajectory with the good mix of limited competition products. During the quarter, we filed five products and are on target to file 25 ANDAs in the financial year. As of September'17, we have total on 98 ANDAs pending for approval including 27 with tentative approvals. Of these 98, 71 are Cipla/InvaGen ANDAs, 11 are partnered and 16 are filed under PEPFAR. The under approval ANDAs include over 12 first-to-file opportunities including sole and shared first-to-file targeting a total brand size of \$20 billion.

Coming to Africa: As announced in our last call, we have reorganized our business in Africa for synergy under a unified leadership. We will now report our South Africa, Sub-Saharan Africa and Cipla Global Access business together as a SAGA region. The overall region recorded a

November 07, 2017

growth of 9% for Q2 and 7% for half one on a year-on-year basis when reported in USD. Our South Africa business delivered its highest quarter sales in history of over a billion rand which translates into a 10% growth for Q2 versus last year in local currency.

As per IMS MAT September '17, Cipla grew ahead of the market at 11.3% in the private market versus the 9.5% market growth. We maintained our position as the Fourth Largest Pharmaceutical Company and Third Position when we include Tender Businesses as well.

Our Global Access business also grew 7% over last year during the quarter. We are increasingly focusing on partnering with other regional governments to increase the access to affordable care and parts of Africa through global access and our Ugandan subsidiary Cipla QCIL.

Our Europe business is on track on the growth trajectory with quarterly sales growth of 18% year-on-year basis in dollar terms. Expanding our Respiratory franchise in Europe further we launched FPSM in Ireland during the quarter. The coming quarters will see the launch of FPSM in other parts of Europe including Sweden and Finland.

In emerging market territories outside of Africa, our quarterly sales grew 12% year-on-year in dollar terms with double-digit in-market sales growth in some of our key DTM markets. We launched SPSM in Australia as well. We will continue to focus on deepening our Respiratory franchise to other markets within the emerging markets territory.

We are continuously working towards building a strong specialty portfolio for the US. The quarter saw the completion of the Phase-1A study for Tizanidine Patch that we in license from MedRx. The results of the study are under analysis. We are also evaluating inorganic opportunities in Neurology and Respiratory. Emphasis is on finding niches with well articulated medical needs and useful innovative solutions that are payer-friendly.

Our R&D investments are focused towards building a strong portfolio and growth platform for the US. We are currently working on Complex Generics in areas such as Peptides, Complex Injectables, Ophthalmic, Hormonal, Derma, Nasal Sprays as also the Inhalers. We are investing to strengthen our capabilities and technologies related to Auto Injectors and Liposomal and other all Oil-based Injectables. Our focus going forward will be to disproportionately grow our US business with key limited competition launches as a result of these investments.

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

Moderator:

Thank you very much. We will now begin with the "Question and Answer Session." We have the first question from the line of Manoj Garg from Healthco. Please go ahead.

Manoj Garg:

Two quick questions; first on the US environment. Are you able to provide color on the (-3%) revenue in terms of value versus price, just want to get a better sense of what you are experiencing

November 07, 2017

with price erosion in the US? Then secondly, you have spoken extensively about the US pipeline and further R&D investments there. From the existing ANDAs that are filed, are there any specific that you would like to highlight as being higher value opportunities?

Umang Vohra:

So Manoj, let me try and answer to the best we can. We do not provide product-specific guidance but our objective is to have at least in the next two to three years good share of our product launches coming from limited competition opportunities. In the US, our base is not very big. We also have a portfolio that is already priced out. So if you really look at it, the 3% decline for us is really 2 million or 3 million at most in our revenue and that could be out of phasing, last year could have been higher on a particular product versus the current year because we might have been amongst two or three players at that time and now amongst six or seven. So for us price compression is not really a very big item right now just because our base is lower and because most of the products that we deal with are priced out. We do not have the price volume the thing that you asked for, but I do not think the volume growth will be fairly significant and therefore what you are probably seeing is marginal decrease in pricing from an erosion perspective.

Manoj Garg:

Do you provide any sort of color on margins in the US?

Kedar Upadhye:

So Manoj, currently, large part of the portfolio is heavily commoditized and the scale of R&D that we are incurring means that the gross margins do not pay for the R&D. So a sort of breakeven at overall EBITDA level and henceforth each launch will incrementally add to our margins.

Moderator:

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

Prakash Agarwal:

Just trying to understand this gross margin comment. What would be the normalized gross margin if we remove the inventory charges and what are these charges and the batch quantities which I assume are for Sevelamer?

Kedar Upadhye:

Firstly, there is this classification of indirect taxes. There is a contra in other expenses. So it would get offset there. There is certain pricing that we have taken off in line with the NPPA guidelines and we have taken quite higher number of batches for future filings in this quarter. So if you adjust for all these elements, do not take it as guidance but we could touch upwards of 63.5-64% subject to product and business mix in the coming quarters.

Prakash Agarwal:

So the question actually is last quarter we were at 65.7% and this quarter we have seen as you said (+30%) jump in India business which I assume is much higher gross margin. So even if we adjust for that, I am just trying to figure out how come we are seeing such a big drop and what would be the normalized for this quarter given high India business, I understand you have given for next two quarters 63.5-64%?

Umang Vohra:

If you remember the last quarter's call, we had told you of the delta of 450 basis points approximately, 150 to 200 basis points will not be recurring, we said two-third of the margin

November 07, 2017

improvement in our gross margin will be there and one-third will not be there. This time there are two things that have happened and which is why Kedar is guiding you back to the range of about 64% which is consistent with what we said last time. This time two items have happened – One, the reclassification of GST has resulted and we believe that is about a percent or slightly higher than that from a margin perspective taking the margin down and additional R&D batches which gets reported in gross margins because for any filing that we need to finish by the end of the year, the second quarter is the last is the time when most of the batches have to be taken. So as a result of those two activities, I think we are about 200-250 basis is the impact of both these actions put together. So if you adjust for this, you are going to come back to the 64% range that Kedar is saying now and what we guided from last time's quarter where we said that only two-thirds of this will be sustainable and one-third will not be sustainable of the margin gain.

Prakash Agarwal: Given the fact that we already launched Sevelamer, so is it not fair to assume that gross margins would actually go up, the numbers do not add up if we are normalized to 63, 64% now, so with this launch we should actually see a larger delta in the gross margin?

Umang Vohra: So I cannot give you information specific to a single launch, I can only guide you to say that Sevelamer is now a fairly competitive market. There have been three approvals or four approvals which have come in a very short span of time. So I think in 30-days we have had three approvals in that product market along with an AG launch. So it is not as if that market is operating with gross margins of over 90%, the market is highly competitive at this stage. So I think for us it will be all incremental whatever we get out of Sevelamer, but not necessarily one that will dramatically improve our margin profile from here.

Prakash Agarwal: Any color you can give on the pricing erosion that you have seen?

Umang Vohra: We are not guiding to that, we do not give guidance by product level.

Prakash Agarwal: Secondly, on the R&D, you talked about in the second half one is likely to see a sharp increase and what kind of clinical trials have already begun leading to this?

Umang Vohra: So we are just about initiating our trials for Respiratory products. So I think that is the increase that you will see in the balance half of the year.

Prakash Agarwal: That would be upwards of 8%?

Umang Vohra: We could be close to those levels, I do not think we will be upwards of 8%. I think we will definitely be higher than the current quarter, but not upwards of 8%.

Moderator: Thank you. We take the next question from the line of Saion Mukherjee from Nomura Securities. Please go ahead.

Saion Mukherjee: My first question is related to the strength we have seen in the API business. Can you throw some light, you mentioned it is related to the US, is this related to the ARV sales happening there?

November 07, 2017

- Umang Vohra:** Yes, you are right, Saion, it is to the ARV sales.
- Saion Mukherjee:** Are there like high margin revenues that you are booking and how sustainable are these going forward?
- Umang Vohra:** These are regular API sale, Saion. I will not say that the margin profile is dramatically different but we sold a little bit more than usual this quarter but it is not as if the margin profile is very different.
- Saion Mukherjee:** Kedar, if you can comment on receivables and other current assets, they seem to have moved quite significantly from the March quarter levels?
- Kedar Upadhye:** That is true, Saion. Our sales in the month of September is very high compared to the sales in the month of March. If I go geography-by-geography, in the days sales outstanding, there is not an increase. So the quality of receivable is fairly strong and it is just the impact of the recent month sales which is causing this bump up. We do see this cycle of increase of working capital in the middle of the year, it gets towards the end of the year it gets normalized to earlier levels. So India business sales for August and September have been much higher than what it was in February and March. In addition, we have the remodeling of the Yemen business. So both these factors have contributed to this increase.
- Saion Mukherjee:** Other current asset, is it some receivables on account of GST which is sitting there?
- Kedar Upadhye:** Partly, yes.
- Moderator:** Thank you. Next question is from the line of Neha Manpuria from JP Morgan. Please go ahead.
- Neha Manpuria:** Sir, if I were to look at specifically the South Africa and the others now in South Africa, both have been very strong for us, particularly the other South Africa business. Any color there sir -- is this a sustainable trend that we will see going forward or is there some one-off tender volumes in the Cipla Global Access business that help the sales this time?
- Umang Vohra:** Let us breakup your question into two parts; let us say, South Africa maintain its strong trajectory, it is a strong business for us and we have shown quarter-on-quarter growth I would say that is maintainable. Global Access is the question of tenders, it is a question of supply and offtake by the regional government. There is no significant billing that we have done in this quarter, it is just that it might be slightly higher than the previous quarter, but that is the function, not of a specific supply but just an offtake pattern by the government.
- Neha Manpuria:** There is a little bit of a timing issue between quarters?
- Umang Vohra:** Yes, there is.

November 07, 2017

- Neha Manpuria:** Sir, my second question is on the Seretide launch in UK. How is that ramping up -- are we satisfied with the market share that we have seen?
- Umang Vohra:** Not as yet, I cannot say that we are satisfied with the market share we have seen. I think we had forecasted that this will be a long trajectory for us and it is playing out exactly to the way we forecast. As a contrast, Australia which has been a recent launch has been a fantastic trajectory for us. Pretty much they are the same product, it is the nature of the market and the level of competition. So I think we will have to take some more time in UK for us to ramp up. I do not think ramp up is there and I cannot say that we are satisfied with where we have reached so far.
- Neha Manpuria:** Would this be a couple of quarters or are we talking probably longer to get the market share?
- Umang Vohra:** It is at least two to three quarters out for us to get the market share. Also while we are speaking about it, I think on an overall product at FPSM as an overall franchise for Cipla, I think now that has become a fairly sizeable franchise across Australia, across Europe, across everywhere, but the UK will take a few quarters for the market share to come.
- Moderator:** Thank you. The next question is from the line of Anubhav Agarwal from Credit Suisse. Please go ahead.
- Anubhav Agarwal:** One question on some of the partner products like Viread, Atripla, Truvada. Just wanted to understand that do we have profit sharing on this product or these are just API or Formulations supplied to the partners?
- Umang Vohra:** I cannot answer in specific, I think there could be combinations of things, we will have our own products in all three, I will put that up, but there could be deals where we could have API supply, there could be deals where we could have profit share.
- Anubhav Agarwal:** But Umang, my basic question was that when the partner gets an exclusivity, do we benefit from profit sharing there or not?
- Umang Vohra:** Wherever we signed agreements in that manner, yes, we benefit. Wherever the agreements are more in terms of higher supply prices for API, yes, we get the benefit.
- Anubhav Agarwal:** Second was about the India business. How is the channel inventory now at the end of 2Q or let us say November-November pre-GST level, AIOCD show some number, but the essence of the question is that second quarter was great for us but first half growth was muted because of the channel inventory. Is that probably behind us or in second half will we see a tailwind of channel inventory level increasing and therefore our growth could be boosted actually?
- Umang Vohra:** So we are about 8 to 10-days short from pre-GST to where we are right now on channel inventory. So we do not think that it will go back, the full-10-days will be recovered, I think there is a chance that you could recover about four or five-odd days out of these 10-days.

November 07, 2017

- Anubhav Agarwal:** Then is it the first half growth for us too low because the like-to-like if we look at first half growth for us was about 3%. So if you lose about 10-days in a period of 180-days, that is impact of 4-5%, right, versus the normal rate of double-digit, so this growth seems low in first half?
- Umang Vohra:** Yes, first half growth is also lower because I do not think the market is readjusted completely to pre-GST level, that is one. Second, I think in Q1, we have had some delays because of our transformation exercise which is now being resolved. So we had also done an India-based restructuring exercise which played out in Q1. I think there could have been some impact of that to our overall numbers that is now finally behind us and resolved.
- Anubhav Agarwal:** You see second half for you going back to 14-15%?
- Umang Vohra:** There is a good chance that we could be at those numbers or even higher.
- Moderator:** Thank you. The next question is from the line of Nimesh Mehta from Research Delta Advisors. Please go ahead.
- Nimesh Mehta:** Just to clarify, you mentioned about the API supply. So this is for the US market to the partner, right?
- Umang Vohra:** It could be to US or to Europe, but yes, it is to a partner.
- Nimesh Mehta:** I am trying to understand, you also mentioned about Viread, Atripla and Truvada where you are again a partner. So you will be supplying the API or the Formulations?
- Umang Vohra:** We are not going into that level of detail. I mentioned that we have contracts where we could be an API supplier, we could be a Formulations supplier, we could have profit share or we could have higher API price. So we have not said that we are definitely there on all three of these. So it could be one product out of three but I do not think I can tell you that in all three products we are there and all three we have profit shares, it is not like that. I think there might be a product where we could have some of these characteristics.
- Nimesh Mehta:** You are alluding to high value launch every quarter. If I get some of them would be HIV product as well if that is what you can tell us that would be great? How many high value are we expecting in the next two quarters?
- Umang Vohra:** I do not think we will guide to that, but yes, there could be some HIV-related launches as well in our overall high value launch program.
- Moderator:** Thank you. We have the next question from the line of Sameer Baisiwala from Morgan Stanley. Please go ahead.
- Sameer:** This is Sameer here. Maybe it is more for Kedar. Where do we stand now in the overall cost efficiency and cost cutting effort especially if you look at Q2?

November 07, 2017

- Kedar Upadhye:** Sameer, our target to get to let us say 100 basis points of EBITDA improvement through cost improvement YoY that stands.
- Sameer:** No, what I mean to say here is that if I look at the P&L for 2Q, do you think you have reached where you wanted to or do you think if we go into fiscal '19 when there is more cost efficiency that you can release?
- Kedar Upadhye:** In fact, a large part of the cost savings will accrue in H2 of FY'18 and full year of FY'19. So this is the program which pans across various categories, in materials, in maintenance items, in other line items. So there are several categories and most of the ideas have been implemented by now. You could see greater benefit coming in H2 and full year of FY'19.
- Sameer:** Since this is going to be pretty material, is it 100 basis points, 300 basis points, how do you think about it?
- Kedar Upadhye:** We would not guide for that, Sameer, but as a target from the point of view of continuous improvement, I think each year improving our EBITDA by about 100 basis points purely based on cost saving is something that we have taken.
- Sameer:** Just on this, when I look at the employee cost for last five quarters, it has been more or less flat, you call it Rs.650 crores, so I just wanted to think what is your bonus policy and why do we not see lumpiness in any quarter?
- Umang Vohra:** Bonus will be accrued, Sameer, so the Rs.650 crores you are seeing is including the accrual of bonuses. So we will not have lumpiness because we will follow accruals for bonus.
- Sameer:** Umang, you talked about Renvela, it is an incremental now. Just for our benefit, the four approvals. If there are five players, does it take the overall market pricing down by 80% more or less or a ballpark?
- Umang Vohra:** Sameer, let me put it this way; I think if this launch had been staggered a lot more, which means that player-2, player-3 and player-4 had come every three months, we would have had a different outcome, but this launch has been with player-2, 3, 4, all coming in within 35-days and then AG launching. I would think that the market at this stage is exhibiting characteristics of a five-player market already and because of the entry I think it could be closer to six-player market in terms of overall pricing.
- Sameer:** Do you think the entire market is addressable because I think there is a good 30%, 40% chunk which is lying with the renal centers?
- Umang Vohra:** Yes, with the clinics. I think that part of the market has possibly not opened up as much as the retail has.
- Sameer:** But you expect that to open in sometime or?

November 07, 2017

- Umang Vohra:** Yes, clinic side of the market takes a little longer to open up. So I think it will open up but, I do not think that the pricing in that segment of the market will be vastly different than where the retail market already is in terms of pricing.
- Moderator:** Thank you. The next question is from the line of Surya Patra from Phillip Capital. Please go ahead.
- Surya Patra:** Wanted to have some sense of the numbers. Can you tell me what is the one-off element that is there in the amortization or depreciation and in other income part?
- Kedar Upadhye:** Surya, we spoke about it, there is a drop in the value of our acquired intangibles for the US market to delay in the launching. So that we have booked in the amortization line. Linked to it there is an increase in the other income line. That represents a negotiated settlement that we had signed for a compensation.
- Surya Patra:** So that means that element will be out in subsequent period?
- Kedar Upadhye:** Yes, yes, below EBITDA both these amounts approximately get canceled out.
- Surya Patra:** Secondly, on the margin front, we are talking about enhancing our R&D activities in the second half. So currently in the first half, it is in the range of around 6%-odd of the sales and for the full year we had guided about 8% level, so that means in the second half we could see a kind of meaningful improvement there. So despite the fact we can see a kind of sequential improvement what we have been observing is from 1Q to 2Q?
- Kedar Upadhye:** I do not think what we said is full year will be 8%, we said in the second half R&D could bump up to between 7% to 8%.
- Surya Patra:** So the guidance was not for the entire year?
- Kedar Upadhye:** No-no, it was only for the second half.
- Surya Patra:** Just one more question on the US. While we are positive about the improved momentum on the approval flow, but the kind of price challenges what we have been seeing, either it is because of more and more approval or it is because of consolidation or whatever, so considering these two facts, what is the kind of assessment about your US business, one and Secondly, when can you see incremental revenue, means, your own business revenue will be more than the InvaGen revenue in the US revenue mix?
- Umang Vohra:** Today, they are roughly half-half, Surya. So I think within a year definitely our out of India revenues will be higher than InvaGen.
- Surya Patra:** That should have a positive impact on the overall earning efficiency, right?

November 07, 2017

- Umang Vohra:** Yes.
- Surya Patra:** This pricing concern along with approval flow, whether they are neutralizing each other or you are seeing kind of expectation what you had earlier that is still there?
- Umang Vohra:** We have not launched anything significant so far in the first two quarters. Therefore, the pricing is showing some marginal decline and 2-3% is only 2 million for us if you look at it. So it is not significant enough for us to be worried about it as of now. But yes, the market in the US is very-very competitive and if we were to look at our own trajectory, I think every \$5 million matters for us because that \$5 million could be Rs.15 crores or Rs.20 crores of incremental profit per quarter. So our starting point is very different than the others.
- Moderator:** Thank you. The next question is from the line of Chirag Dagli from HDFC Mutual Fund. Please go ahead.
- Chirag Dagli:** Sir, on the other expenses, if I back out the R&D and add back about Rs.100 crores for the GST adjustment, it seems like the other expenditure has gone up QoQ by about Rs.100 crores. Just trying to understand was going on there and is this Rs.100-odd crores kind of number sort of sustainable, is this what we sort of bake in?
- Kedar Upadhye:** Chirag, it is linked to the increase in sales. If we see sequentially we have moved up from Rs.3500 crores to about Rs.4100 crores at a company level. So some of this increase is linked to sales scale up, freight, there is commission, there are certain data share fees and things like that.
- Umang Vohra:** India Generic business.
- Chirag Dagli:** For the full year how should we think about the other expenditure line item?
- Umang Vohra:** I think the similar equation would work, the excise would get knocked off and there would be sales related increase, other items have been largely capped.
- Chirag Dagli:** Just on the depreciation, just to be clear, from Q3 onwards, the amortization goes back to the Q1 level or...?
- Kedar Upadhye:** You are right, you should take out approximately Rs.70-75 crores out from both amortization and other income line.
- Moderator:** Thank you. The next question is from the line of Nitin Agarwal from IDFC Securities. Please go ahead.
- Nitin Agarwal:** Umang, on the domestic business, there has been a fair amount of news flow around government's intent of tighten regulations across different aspects. A), what is your take on in terms of how does the domestic market really play out from a profitably perspective? B), There

November 07, 2017

was a newspaper notification on printing the ex-factory price on medicines. So where does that leave the generic-generic business as a construct?

Umang Vohra:

I do not know whether there is enough after the government notification at what activities have taken place for the ex-factory price notification, so I cannot comment on that. The Generic business fulfills two obligations – One, it goes deep into areas in the country where there is not enough distribution. So I think one is to just say Generic business but the other is to see that there is a huge investment in the distribution and making sure the distribution reaches patients in tier-3, tier-4 class cities which today does not happen with conventional distribution norm. I think even if one was to say that the ex-factory price could be printed, I am not so sure that just doing that will make sure that the Generic business will be unviable because the Generic business goes into distribution pockets that regular businesses do not reach and it is our estimate that majority of our sales come from that side of the market. On the rest of the items of the government initiatives, I think we are waiting for next draft of the pharma policy and that will decide where India is headed.

Nitin Agarwal:

Secondly, on the global access business, where does it stand in the overall sort of priorities – is it the focus business still for us in the context of the focus on profitability that we have?

Kedar Upadhye:

Nitin, it continues to be area of focus for us, at annual level last year it did about 150 million, we hope to grow it this year based on the additional tenders and additional molecules. We are operating at a threshold level of profitability and return on capital employed on this. So yes, it is an area of focus for us.

Moderator:

Thank you. The next question is from the line of Karthik Mehta from Deutsche Bank. Please go ahead.

Karthik Mehta:

Can you share the CAPEX that you would allocate in FY'18 and FY'19?

Kedar Upadhye:

It could be around Rs.800-850 crores for FY'18, FY'19 we could share in our May call but this year we have taken a target to taper it down substantially.

Karthik Mehta:

Is this largely for the US, any color in that?

Kedar Upadhye:

It is mixed, large proportion of this could be for US, but it is for across the geographies.

Karthik Mehta:

On the M&A side, do you feel that with pricing being an issue in the US, maybe you would look at other geographies to add more assets there and is now US not as viable as it would have been maybe a year ago, your comments?

Kedar Upadhye:

It is a speculative question, where do we acquire, what kind of target. But you are right, having acquired InvaGen and having integrated with Cipla's infrastructure, the future acquisitions could relate to other geographies, brands, niche capabilities, etc.,

November 07, 2017

- Karthik Mehta:** What prompted in this increase in the amortization – is it an annual test, is it to do with the cash flow value maybe you would estimate because it is a very substantial number for a quarter, is it like annual impairment that you are doing and if you could also help us that in the future if this amount has to occur, will there be proportionate increase in other income always?
- Kedar Upadhye:** No, sir, the linkage with other income is only one-time and for this quarter. To answer your first question, it was as part of our closure process, you have to do a fair valuation of what we are carrying on the balance sheet. So it is a trigger-based fair valuation that you have to do and compare your carrying values with fair values. We said it is because of the delay in launching and similar other reasons which result in a drop in the value of our acquired intangibles.
- Karthik Mehta:** Would this amount have been lower if the pricing pressure in the US would not have been as intense as it has been in the last six months?
- Kedar Upadhye:** It is all put together -- pricing, delay, competitive headwinds. We would not like to specify anything.
- Moderator:** Thank you. Due to time constraints, we will be able to take the last two questions. The next question is from the line of Vishal Manchanda from Nirmal Bang. Please go ahead.
- Vishal Manchanda:** On Albuterol filing, have you heard from the US?
- Umang Vohra:** We do not give specific commentary but yes, we have heard from the US and there is dialogue on the file.
- Vishal Manchanda:** Kind of will it be delayed, or we can expect that?
- Umang Vohra:** I cannot give that level of information and I cannot speak for the FDA because it really depends on their review timelines as well.
- Vishal Manchanda:** Among the limited competition launches that you are expecting, any one which is basically confirmed launch and not contingent on USFDA approval times?
- Umang Vohra:** We have a few of those and I think hopefully we will start seeing some of those come through in our trajectory.
- Vishal Manchanda:** Basically would this happen this financial year or it could be...?
- Umang Vohra:** Let me say near-term, I think that would probably give you some comfort and at the same time gives me some comfort.
- Vishal Manchanda:** Finally, one on Seretide. In the UK, what is actually stopping you from gaining market share because this is actually a substitutable market at the pharmacy level, so why is that not shaping up?

November 07, 2017

- Umang Vohra:** So the manner in which it is detailed there, the product maybe substitutable but it is also detailed by a brand name. So the market is a hybrid market where there is a very little which can be immediately switched and there is some which is detailed by a brand name. So that is the reason.
- Vishal Manchanda:** You would need to detail with the physicians for them to prescribe your brand?
- Umang Vohra:** That is right.
- Moderator:** Thank you. The last question is from the line of Krishnendu Shah from Quantum Mutual Fund. Please go ahead.
- Krishnendu Shah:** Just want to understand on the margin front. When you acquire InvaGen, all the products were being distributed by a third party. So has all the contracts run out on the books and has there any margin improved because of that?
- Umang Vohra:** Yes, all of the sales are now made by Cipla, they are not made by a third-party and even earlier when InvaGen was there the sales were made by the earlier owners of InvaGen through their distribution.
- Kedar Upadhye:** If that was your question, yes, there is a label change.
- Umang Vohra:** That label change is happened in complete.
- Krishnendu Shah:** Does it come with an improvement in margin or the label change is just a label change?
- Umang Vohra:** Largely margin-neutral.
- Moderator:** Thank you very much. That is the last question. I would now like to hand the conference back to the management for any closing comments.
- Kedar Upadhye:** Thank you for joining Cipla management team for this Q2 FY'18 earnings conference call. In case of any additional queries, please feel free to reach out to Investor Relations team. Thank you and good evening.
- Moderator:** Thank you. On behalf of Kotak Securities, that concludes this conference. Thank you for joining us and you may now disconnect your lines.