



“Cipla Earnings Conference Call”

February 4, 2011



MODERATORS **MR. S. RADHAKRISHNAN**
MR. AJAY LUHARUKA
MR. HEMANT BAKHRU

Moderator Ladies and gentleman, good day and welcome to the Cipla Conference Call hosted by CLSA India Limited. As a reminder all participants' lines will be in the listen-only mode. And there will be an opportunity for you to ask questions at the end of today's presentation. If should you need assistance during the conference call please signal an operator by pressing * and then 0 on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Hemant Bakhru. Thank you and over to you sir.

Hemant Bakhru Thanks. Good evening everyone. I am Hemant from CLSA. We have with us Mr. S. Radhakrishnan and Mr. Ajay Luharuka from Cipla. I will hand over to them for initial comments on the third quarter numbers and then the news for the quarter following which will begin the Q&A session. Please note the call is only for half an hour. So we will stick to that kind of timeframe. Over to Ajay.

Ajay Luharuka Yes, thank you Hemant. Good evening to all of you and welcome to the Cipla call for the third quarter results. We have our whole time director Mr. S. Radhakrishnan on the call. We hope you have all received the third quarter financials and the performance highlights available on our website. We would like to give you an overview of the financials which can be followed by a question and answer session.

During the current quarter income from operations of about 1500 Crores grew by 8%, however, operating margins and profits were lower by about 16% and 20% respectively. This was primarily on account of increased factory overheads in Indore SEZ and the appreciation of Indian rupee vis-à-vis the US dollar. Domestic sales for the quarter grew by about 11% and export sales grew by about 12% which was in spite of a rupee appreciation of 3% to 4%. Material cost has been maintained at similar levels on a year-on-year basis. The increased staff cost of about Rs 46 Crores is due to increase in manpower particularly at Indore SEZ, regrouping of contractual staff at Goa facilities as well as annual increments. Interest cost for the quarter has decreased due to repayment of short term working capital loans availed by the company. Depreciation has increased by about 20 Crores due to addition of fixed assets mainly on the account of commissioning of the Indore SEZ factory. Other expenditure has increased mainly due to increase in selling expenses, factory expenditure in particular at Indore SEZ such as repairs, maintenance, power and fuel, stores and spares, etc. As of 31st December 2010 the outstanding amount of forward contracts is about USD 190 million which substantially covers the outstanding debtors and the company continues to follow the practice of covering net export billing on a month to month basis.

With this overview I would like to leave the floor open for questions. Mr. Radhakrishnan and myself are available to answer any questions that you have. Thank you.

Moderator Thank you, very much sir. Ladies and gentleman we will now begin with the question and answer session. The first question is from the line of Nitin Agarwal from IDFC Securities, please go ahead.

- Nitin Agarwal** I just want to check all what you have been mentioning about the impact of the Indore SEZ commissioning, what is the overall impact if you got to just kind of aggregating on a broad level or that in terms of the cost for the plant in your numbers?
- S Radhakrishnan** The overall impact in terms of the cost of the plant?
- Nitin Agarwal** Yeah I mean, in terms that we are incurring on the plant right now?
- S Radhakrishnan** No, one the CapEx expenditure of the plant which is nearly about 800 or 900 Crores is the capital expenditure that we have incurred in the plant. It is the running cost because Indore is already commercialized for other than regulated markets. Now there because we are still in a gestation period for the regulated markets such as the US and Europe, etc., we are not able to now actually export from there unless regulatory approvals are in place, in fact in the last quarter we have received approval from TGA, from MHRA UK from WHO, from South Africa, etc. So all this will kick in probably the next quarter. So therefore this year there has been a huge gestation for approvals to take place in that although the running cost of Indore are already happening. And that is why you see this mismatch.
- Nitin Agarwal** I understand. I just want to understand from other expense & staff cost perspective. What is the kind of cost that you have been probably incurring in the Indore SEZ plant on a rough basis on an operational basis.
- S Radhakrishnan** Roughly it will be about 25 to 30 Crores per quarter, the operating cost.
- Nitin Agarwal** 25 to 30 crores?,
- S Radhakrishnan** Yes.
- Nitin Agarwal** But on a YOY basis if you look at other expenses it gone by almost 100 crores so I guess what is that it is leading to such a sharp increase in the other expenses?
- S Radhakrishnan** One is itself in Indore SEZ I told you what are the increase is number one. Number two in terms of overall increases I think the overhead of other factories have increased because of the regulatory needs because don't forget all our Cipla plants are regulatory approved. Therefore the maintenance and upkeep for all these plants itself have gone up by 14 Crores, that's the other pocket of increase and also we have about 20-25 Crores increase selling expenses overall both in the domestic and in the export market. So all this is what has lead to the increase in the other expenses.
- Nitin Agarwal** So this is pretty much like a running cost base that we can assume with going forward basis on the other expenses.
- S Radhakrishnan** Yes, more or less it can assume none of it is one time in that yes you are right.

Nitin Agarwal Thanks very much.

Moderator Thank you. The next question is from the line of Ranjit Kapadia from HDFC Securities, please go ahead.

Ranjit Kapadia My question relates to the Indore SEZ, we are said that because of these margins have shrunk to 20.5% EBITDA margin. So if you can throw some light what was the normalized margin when the plant will be operational?

S Radhakrishnan I told you Ranjit I think I dwelled into earlier the 25 Crores is probably what our running cost as of now so and we are now getting any much real turnover from there. So, if next year even it contributes an overall turnover of 10% of Cipla, it is going to make a big difference.

Ranjit Kapadia And when the revenues will start coming which quarter?

S Radhakrishnan I think as I told you already we have many approvals in place so even from this quarter and the next quarter you will find that the business of Indore is happening but I think it will take for all the business to stabilize it will take about a couple of years.

Ranjit Kapadia Couple of years?

S Radhakrishnan Because US will take about year, once only US also in place then you will find which may take one more year. So already one year is passed so one more year by the time it fully optimizes.

Ranjit Kapadia Okay. Thank you and wish you all the very best.

Moderator Thank you. The next question is from the line of Bhavita Nagrani from MP Advisors, please go ahead.

Nimesh Mehta Hi yeah this is Nimesh Mehta from MP Advisors. Can you, let us ask to you are we planning to file ANDAs on our own in the US market or it will again be through the partner and if you can throw some light on the partner?

S Radhakrishnan We are very open in fact we are reviewing internally what is the best strategy for Cipla and all options are open to us because we have the technology, and obviously we are reviewing all options it is not that as if we are closed to having our ANDA. In fact we have about 7 to 8 ANDAs in our own name and these are already available so this options is completely open.

Ranjit Kapadia But have we not concluded anything on that because we are now about to get ANDA approval for Indore and....

S Radhakrishnan Again we are getting US FDA approval from Indore. So but in terms of the projects which are going to be taken up, obviously this option is very much open.

- Ranjit Kapadia** Okay. And second if you can just let us know the branded business sales growth in the domestic market and the generic?
- S Radhakrishnan** No, in the branded sales the domestic, overall domestic I think is gone up by 11%.
- Ranjit Kapadia** Right.
- S Radhakrishnan** 11% to 12% for this quarter.
- Ranjit Kapadia** And of that how much will be the branded growth?
- S Radhakrishnan** About if you ask me roughly it will be about 15% to 16% is a branded and the generic will be little lower. But overall it is about 11% to 12%.
- Ranjit Kapadia** Okay. Thank you very much.
- Moderator** Thank you. The next question is from the line of Jesal Shah from JM Financial, please our ahead.
- Jesal Shah** Yeah, hi. So just to continue on that turnover strategy that you talked about pertaining to the US and there seems to be some shift in terms of the model over there. So if you can just give us some idea about 1) what type of partnerships you have struck in the last lets say nine month or so and also with the change of strategy kind of have any baring on your ex-US export markets as well for example Europe or Africa or some of the other market?
- S Radhakrishnan** No, first of all there will be no new partners signed in the last nine month. We have tie up with about 22 partners in the US market. And that continues and there are about 64 ANDAs approved and another 46 under registration. This pipe line is very much there in the partnership and obviously some of them will achieve the commercial benefit that we desire in the future. Now as compared to the other thing yes we are open depending on.... particularly there we have some very niche segments to see what we can do in the US market directly and that's something which we are exploring. Now same would apply to any other market because it is not only the US while we have partners in place given our strength and technological the products which has high technology base we think that if there is an opportunity where we can probably explore directly we will certainly do that.
- Jesal Shah** So I see you think this will apply equally to even markets like....
- S Radhakrishnan** Yeah, any market absolutely.
- Jesal Shah** Okay. And also on your inhaler front will that apply there also I mean, you would want to take that also on your own at least there you are exploring partnerships.
- S Radhakrishnan** That's what I am saying. When I have talk of high technology inhaler is one such category where obviously we have the technology, we have the sources and what I am saying is we are open to it

and it is not as though we are shut to doing to ourselves because we are big and we can probably take it on if there is a need, but if we find a good partner with a good commercial proposals we are likewise okay with that. So we are open with both options.

Jesal Shah Right. So for the time being at least we should not consider too much of that technology income that we were looking forward to?

S Radhakrishnan What I am saying yes, this is the technology income which basically derive from various projects which were in the pipeline and what we really are looking forward to is the commercialization of these project as we go along. And what we find more and more the commercialization happening and technology income going down.

Jesal Shah Right. Okay, understand. And on the domestic business are you seeing anything specific I mean, if you can just comment on generally whether you are happy with this growth 12% 13% that we are seeing this year. What is happening in the market we are seeing more competition, price erosion happening?

S Radhakrishnan Yeah, competition is definitely there the price erosion yes, basically it is feature of competition because as we, I think in the domestic segment overall Cipla is growing by 11% to 12% again in ORG of last month for example we got over 8% ORG we did for 12% which is probably higher. And so that is something but the scope there is immense apart from what we are doing I think what we really strategizing ourselves to see because again we have very many segments in particularly in respiratory in other areas, in injectable etc.. So we see there is a lot of scope and we really re-strategizing and reformulating our strategies to see how to optimize this with our kind of reach and range of products. And that's what we are focusing and I think we have the potential to do better than what we are doing now.

Jesal Shah Right, excellent. Thank you so much.

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

Girish Bakhru Yeah, hi. Just to continue on inhalers front I wanted to know where are the in terms of the opportunity in Europe in combination inhalers.....

S Radhakrishnan See there are five to six products which we are working on as you are aware and there is various stages of approvals. Now we feel very confident in the next one year some of these products will see the commercialization. But overall for some of the combination product it will be little longer. So in the next two years I think many of these products will reach enough the market place what we feel going by the current timeline. But we can't really put some timeline because it is not completely under our control. It is dependent on the completion of clinical and regulatory approvals. But this is our current understanding.

- Girish Bakhru** Just on the recent rulings like recently even Dutch case Glaxo lost in the Netherlands court so UK and Germany also have revoked patent on the Advair so any color on early generic entry in that?
- S Radhakrishnan** see its like one is the patent fluctuation, but the real issue is the regulatory approval from **MHRA** UK which keeps on changing the norms for approvals, so and that is a another battle that we have to fight all the time. And depending on that obviously we got a very good chance there.
- Girish Bakhru** Okay. And can you just finally update the number of partners that you have in US and Europe?
- S Radhakrishnan** In US as I told you we have about 22 partners.
- Girish Bakhru** Okay.
- S Radhakrishnan** And Europe we have more than about 50 partners.
- Girish Bakhru** Okay. All right. Thanks a lot.
- Moderator** Thank you. The next question is from the line of Sonal Gupta from UBS, please go ahead.
- Sonal Gupta** Sir, thank you for taking my question. Just a couple of question one is on the technology fees can you give us some guidance in terms of where should we expected to be going forward I mean, its been fairly low and do we see any ramp up going forward or will it sort of remain at these levels?
- S Radhakrishnan** Sonal I thought I mentioned this that basically technology fees where a product of milestone achievements on projects which under the pipeline particularly in the regulatory market. Now that already there are about 22 partners and about 60 odd products either approved or under registration. So these are received from those kind of milestones that we completed. Now what we really looking forward and this will as we go along sort of grow lower than what was earlier but really speaking what we are looking for is commercialization of these products and they are resulting the turnover which is where the real objective of achieving this milestone really.... So I think that's what we are looking for, so answer your question yes the technology fees will probably go down as we go along but we would see upside in terms of actual business.
- Sonal Gupta** Right. And in terms of your plans to I think launched Seroflo in some markets like South Africa, etc., have you seen any revenues from there?
- S Radhakrishnan** Yeah, these already started exporting to South Africa in the last quarter and there is something which we will see more in the coming quarter, that's one good development and also we probably will start doing in Russia very soon. So these are some of the upsides.
- Sonal Gupta** But will these be, would you see these are meaningful opportunities?

- S Radhakrishnan** Absolutely meaningful opportunities except the one or two foreign companies they are the originator we do not have any competition there.
- Sonal Gupta** And just my final question on I mean, there is some news regarding Cipla investing in some partners in Africa I think in Uganda.
- S Radhakrishnan** Well that's wrong news because its like this we have a joint venture there in Uganda and we were ourselves surprised with that news item. Its completely incorrect. In fact we sent a mail to our partner and we have said that somewhere it was wrongly reported. They have denied any such thing. I don't think we have investment there.
- Sonal Gupta** So there is no investment that you have there?
- S Radhakrishnan** No investment which are going to happen there, we have got a joined venture in equity taken a factory in Uganda which was only there for the last few years but there is no expansion of the facility.
- Sonal Gupta** And there was also probably taking some stake in 25% stake in Cipla Medpro....
- S Radhakrishnan** That is still going. We have received an offer for a stake in the Durban factory but we are reevaluating it and seeing what is the benefit of Cipla. Right now nothing has happened on that.
- Sonal Gupta** Okay. Thank you so much.
- S Radhakrishnan** Thank you.
- Moderator** Thank you. The next question is from the line of Sameer Baisiwala from Morgan Stanley, please go ahead.
- Sameer Baisiwala** Hi good evening. Radha, is it possible for you to share about the Indore revenue potential and a ramp up?
- S Radhakrishnan** Yes. Sameer what I feel is as we go along normally when plant optimizes it takes about couple of years to really optimize it. This is our experience in Baddi and Sikkim even if tomorrow you take 10% of our total turnover end it would be about 400, 500 Crores in year one. And as we go along I think this will only grow and that's what we are looking forward to from the next quarter onwards and I think in the next I mean, first full year next year at least 10% to 12% of the turnover would be from Indore and that's what we think and going along it could be further increased and that will definitely help us in sort of absorbing the cost that are going to maintaining and the running the factory.
- Sameer Baisiwala** Excellent. And but would you say that you are already locked up for this amount of sales with your customers or do the contracts being signed now or will it get signed in the future?

- S. Radhakrishnan** Its Like this unless the facilities are there, the capacities are there , we can't really lockup the order unless the approvals are in place that is the issue because it is like chicken and egg situation. So and we can't predict how long it will take for the approval so now having seen three or four major approval will be, now working up for many of these businesses and for example we can lockup for Australia, we can lockup for South Africa which we are doing, we can lockup for now, UK happened last week, it will take a month by the time, the approvals are fully formalized. So these can happen only when the approvals are receive, we can't lockup unless that is happening. **Sameer Baisiwala** These are site approvals or product approvals?
- S. Radhakrishnan** These are factory site approvals.
- Sameer Baisiwala** The site approvals.
- S. Radhakrishnan** Yeah, for the site. And obviously the products which were already approved will get transferred.
- Sameer Baisiwala** Okay. I am just thinking about your US business you mentioned about 22 partners about 64 approved ANDAs, so you have got one of the largest number of partners and largest number of approve products that I can think of and you are probably the lowest revenue contribution coming from US, are these partnerships or are these approvals working or are you just satisfied with what they are delivering?
- S. Radhakrishnan** Its Not like this, see if you see the US market its all based on the products and the whole pricing that today US business generic business is completely commoditized, so obviously no one in that sense would be happy what happening based on what potential we thought would be happen. But obviously, it depends on the product but we have certain very good products in the pipeline which will obviously depend on the patent status of that and which can happen in the next couple of years and obviously will yield much better result than what is happening currently.
- Sameer Baisiwala** Can you site couple of these examples are they litigation dependant or...
- S Radhakrishnan** Yeah these are all litigation dependent and patent dependant.
- Sameer Baisiwala** Okay can you name couple of them or?
- S Radhakrishnan** Of course we cannot because these are very sensitive Sameer.
- Sameer Baisiwala** Okay and the other question is about the combination, you know, inhalers for the European market. Have you completed the clinical trial, have you, do you have a dossiers ready or the clinicals are going on?
- S. Radhakrishnan** No in certain cases we have completed and submitted. In certain cases the clinicals are on. It's a mix of both.

- Sameer Baisiwala** No – no I'm specifically asking for Advair, the Seroflo.
- S Radhakrishnan** I cannot give specific information because its very again sensitive but I can just give you broadly this idea.
- Sameer Baisiwala** Okay and can you tell us that of your total inhaler business, how much is domestic and how much in exports?
- S. Radhakrishnan** Yeah roughly 60-40.
- Sameer Baisiwala** Okay 60 is domestic and 40 is exports.
- S. Radhakrishnan** That's right.
- Sameer Baisiwala** Okay and just to understand the depreciation, if you are spending 800 900 CapEx on the Indore is everything commissioned and therefore ...
- S. Radhakrishnan** Yes everything is capitalized yes.
- Sameer Baisiwala** Okay and just final question from my side. How is a top level leadership going in Cipla decision making especially in the absence of Mr. Lulla?
- S. Radhakrishnan** I thought I had covered this aspect when I was in TV sometime back, in the last 6 months after Mr. Lulla has not been available we have strengthen the board. Mr. Kamal Hamied is part of the management team. But more importantly I think the senior and middle management of Cipla is very strong I mean they have been for very long time with Cipla and the average age is about 40-45 years. So that is the real strength of Cipla and they along with the board is really taking it forward at the moment.
- Sameer Baisiwala** So, will you be replacing it with the new deputy managing director or CEO or you will not be replacing that position?
- S. Radhakrishnan** No its like this there may not be a position like this but I think the way forward would be team which will really look after this whole management led by of course the board. I can say about it, it is Dr. Hamied, Mr.Hamied and myself.
- Sameer Baisiwala** Okay. Thank you very much.
- Moderator** Thank you the next question is from the line of Bino Pathiparampil from IIFL please go ahead.
- Bino Pathiparampil** Hi thanks. Just a follow-up, you said you are looking at about 10% of the entire top line coming from the Indore facility. Is that possible given the approvals in place, is that possible in the next couple of quarters?

- S. Radhakrishnan** It will probably happen in the next four quarters.
- Bino Pathiparampil** In the next four quarters okay, four quarter, from now it will start happening. And second just wanted to know if there is any ForEx item in the other expenses or...
- S. Radhakrishnan** There was no Forex loss in other expenses in fact there is a little bit of gain which is there, which is marginal.
- Bino Pathiparampil** Okay. Thank you.
- Moderator** Thank you. The next question is from the line of Abhay Shanbhag from Deutsche Bank please go ahead.
- Abhay Shanbhag** Yeah just wanted to checkup, are your existing older plants working at full utilization, therefore with the site transfer you will be able to have a significant tax related growth going forward.
- S. Radhakrishnan** Its like this, in fact that's why Indore was created because they were all working in close to full capacity particularly in the area of tablets and capsules. And therefore we needed the capacity so yeah while they are working while Indore will really help us to optimize the business.
- Abhay Shanbhag** Okay so, from 8% to 10% revenue growth that we saw in last years, 2010 and 2011 do we see growth accelerating to 18% to 20% going forward?
- S. Radhakrishnan** I can't give you specific numbers because it is very difficult and may not be correct. But I think the potential is there and the products are there, the markets are there and I think there is a big potential to aim for those numbers.
- Abhay Shanbhag** Secondly, in terms of margins also there has been a huge cost inflation. So are you being able to pass on all the cost hikes or that is also impacting your, you know, in addition Indore cost overhead. Is the inflation also impacting your margins?
- S. Radhakrishnan** Right, inflation is impacting number one and obviously you can't pass it on quickly. Number two, Ajay mentioned top line is down by 4% compared to the lat quarter because of the ForEx rates. So both ways it is sort of cutting us and that's why you find may be the operating margins lower than previous quarter.
- Abhay Shanbhag** Okay would it take couple of quarters to take price hike, so do we see our margin that being under pressure for the last two three quarters or we expect them to sort of begin to bounce back as you take price rise immediately?
- S. Radhakrishnan** I think on price rise, what – we looking for is to a good top line growth based and capitalizing on Indore and other potential and that it self will probably help us in – in bettering the operating margins.

- Abhay Shanbhag** Okay and you would expect that to happen, I mean, as you said you are expecting in next four quarter revenues to ramp up. So towards the end of next - second half of next fiscal would we that happening?
- S. Radhakrishnan** We hope so and I think so.
- Abhay Shanbhag** Okay. In terms of tax rate again, 17% to 18% would be your tax rate with the SEZ also ramping up or would we expect the tax rate to go down in future with the SEZ being there.
- S. Radhakrishnan** See it is like this while SEZ is happening Baddi will be out of the tax net so roughly yeah you are right it will be 16-17%.
- Abhay Shanbhag** Okay sir. Thank you.
- Moderator** Thank you the next question is from the line of Nimish Desai from Motilal Oswal please go ahead.
- Nimish Desai** Thanks for taking my question just one clarification, in last two three quarters on and off there has been comments from the management regarding the potential tie ups with innovator companies for supply of products. Could you throw some more light on this as to where we are because last three quarters we been told that negotiations are on but the deal is not yet signed so has there been any progress here, what is the status?
- S. Radhakrishnan** Yeah there has been, I mean, for a company of our size and there will obviously be for certain products, in certain markets we are talking to multinational company as we have talked to anybody else and some of this has happened and some of them are still under negotiations.
- Nimish Desai** Okay but just to understand it little bit more clearly I mean just taking the previous deals signed by some of the other companies as the basis, are we to understand that whenever these deals get signed it would be large multi product, multi geography deals or these are, you are looking more at product specific deals.
- S. Radhakrishnan** It is mix of both, somewhere it may look at a range of markets, somewhere it would be specific products from a specific markets. So it's a mix of both.
- Nimish Desai** Okay – okay and when would you expect these deals or agreements to start contributing to your numbers?
- S. Radhakrishnan** Again anything that we do in these markets particularly again as the whole registration process, it's a couple of years. So by the time it culminates into business, anything in this international business, now a days every market is regulated so it is one to two years.

- Nimish Desai** Okay and the last question is on the domestic formulation growth obviously, we have seen slightly muted growth in some of the quarters, even this quarter its 11%, would you say that now you have reached a particular level of base where this is the kind of growth that will continue for the next few years or.
- S. Radhakrishnan** See because the potential is large, you know. So I wouldn't say that we are in a sort of reached stagnation levels in terms of growth. I think the potential is huge and we are working to really better this and we are very optimistic that we can really improve this fact. I think already we are doing better in the market in the ORG that is another matter but I think going forward the potential is higher and we would like to improve the growth and I think we can.
- Nimish Desai** Okay –okay thanks a lot.
- Moderator** Thank you the next question is from the line of Anshuman Gupta from Citigroup please go ahead.
- Prashant** Sir Prashant here, my questions have been answered.
- Moderator:** Thank you. Ladies and gentlemen that was the last question. I would now like to hand the floor back to Mr. Hemant Bakhru. Thank you and over to you sir.
- Hemant Bakhru** Yeah I would like to thank Radha and Ajay for their time.
- S. Radhakrishnan** Thanks Hemant.
- Hemant Bakhru** Thanks.
- S. Radhakrishnan** Bye.
- Moderator** Thank you sir, thank you members of the management on behalf of CLSA India Limited that concludes the conference. Thank you for joining us. And you may now disconnect your lines.