



“Cipla Q2 FY19 Earnings Conference Call”

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Moderator: Ladies and gentlemen, good day and welcome to the Cipla's Q2 FY19 Earning 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 '*' and then '0' on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Chirag Talati from Kotak Securities Limited. Thank you and over to you sir.

Chirag Talati: Good afternoon everyone. On behalf of Kotak Securities, I welcome you all to the Cipla Q2 earning call. I thank the management for giving us the opportunity to host this call today. We have with us today; Mr. Umang Vohra – Global CEO; Kedar Upadhye – Global CFO and Naveen Bansal and the Investor Relations team. Over to you, sir.

Naveen Bansal: Thank you, Chirag. Just as an add-on, we also have Mr. R. Ananthanarayanan. He is our Global Chief Operating Officer. Good evening and a very warm welcome to Cipla's quarter 2 earnings call. I am Naveen from the Investor Relations team.

Let me draw your attention to the fact that 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 future performance of the company. Please note that these estimates involve several risks and uncertainties that could cause our results to differ materially from what is expressed or implied. Cipla does not undertake any obligation to publicly update any forward-looking statement whether as a result of new confirmations, future events, or otherwise. I would now like to request Kedar to take over.

Kedar Upadhye: Thank you, Naveen and good evening to all of you. Best wishes for Diwali festivities to all of you and hope you get to enjoy the week ahead with family and friends. Welcome to our earnings call for the second quarter of fiscal 2019. I hope you have received the investor presentation that we have posted on the website.

Let me start with an overview of our performance in the first half of the year and certain initiatives which we have taken over the last 2 years. The quarter 2 reported performance has year-on-year comparability issues due to the higher base of last year across almost every market. This quarter, we also faced certain internal and external challenges which we will talk about in the call later. Having said that, we are tracking healthy in the first half with key businesses continuing to stay strong. India business maintained its trajectory growing 9% and 13% when adjusted for GST in the first half. South Africa continued its strong private market performance. Substantial improvement in the in-market performance was visible across our DTM markets, in emerging markets and the ramp up of the US sales driven by key new launches.

Over the last 2 years, we also saw significant gross margin improvement across our businesses of India, both prescription and generic business; South Africa, again both private and tender segments; Europe, emerging market and the US DTM business largely due to portfolio momentum and cost optimization along with some marginal benefit on pricing. While this help support margin expansion and growth, we also saw the decline in the US B2B segment, Invagen performance dilution due to the price erosion and the rebasing of our global access business little bit diluting the numbers.

I also wanted to clarify the impact of the recent currency movement on our performance. While rupee depreciation shows up on the topline a bit, overall benefit in the EBITDA line is hardly anything since we are not as dollarized as some of our competitors. In fact, when considered with the impact of commodity and crude price inflation and the escalation in China source supplies, the overall benefit is quite negligible.

With that, let me take up the financials for this quarter. For the quarter, overall revenues from operations are at 4,012 crores. On the first half, it is 7,951 crores, recording year-on-year growth of 5%. As mentioned earlier, the growth was driven by India, South Africa and build-up of the US DTM business with new launches. This was partly offset by challenges in the other parts of the business, such as our global access business and Europe. Gross margin of the material cost stood at 64.8% for the quarter. This reflects the positive impact due to currency partly offset by the impact of commodities inflation in China.

During the quarter, we maintained tight control on the spends. Total spends which include employee cost and other expenses stood at 1898 crores, increasing 6% on a sequential basis. Employee cost for this quarter stood at Rs. 712 crores, flat on a sequential basis. Other expenses for this quarter which includes R&D, regulatory, quality, manufacturing and sales and distribution expenses stood at 1185 crores, increasing 10% on a sequential basis. This increase is largely attributable to sales linked cost in certain markets. Investments towards therapy-shaping initiatives such as our flagship inhalation awareness campaign, Berok Zindagi and ANDA filings. Total R&D investments for this quarter stood at 8% of revenue. This ramp up is on expected lines as we progress on our key assets. EBITDA for the quarter stands at Rs. 753 crores which is 18.8% to sales. If you try to link this up with the SEBI financials that we have published to the stock exchanges, you would have to take into account certain costs which have been factored in the OpEx and R&D line for which we have got a reimbursement in the other income. So, we have given a PBT to EBITDA bridge for your reference.

Tax charge for the quarter stood at Rs. 142 crores. We are tracking at a full year effective tax rate of 28%. Profit after tax stood at Rs. 377 crores. You would recollect over the last 8 quarters, there has been a significant focus on cash generation and this includes taking various strategic decisions including closing open litigations, divestment of certain noncore businesses such as animal health, fructify certain past investments, such as our stake sale in the Chase Pharmaceutical, monetization of the domain ANDA and other dossiers, successful IPO of our Ugandan subsidiary, CiplaQCIL on the Uganda stock exchange and things like that. All these

efforts have cumulatively added over Rs. 800 crores in the last 8 quarters. We will continue to retain this focus as we progress. Our long-term debt now stands at US \$575 million. We also have working capital loans of about \$60 million, which act as marginal hedge towards our receivables. Total net debt to equity ratio stands at 0.15. Outstanding forward contract as hedge for receivables as of 30th September are US \$123 million and South Africa in the rand 855 million. They have also hedged certain portion of our forecasted export revenues. The outstanding forward contract as cash flow hedges as of 30th September is US \$131 million. I am also pleased to share that India ratings have continued to affirm Cipla's Long-term Issuer Rating at IND AAA with a stable outlook. With this, I would now like to invite Umang to present the business and operational performance.

Umang Vohra:

Thank you, Kedar. I wish all of you very happy Diwali. For us, this quarter was modest in terms of both sales and profits. Very clearly, we see three factors that have played out. The first factor, just from a year-on-year comparison, you would note that last year's GST led restocking in both quarter 2 and quarter 3 means, we have a much higher base for domestic businesses apart from a higher base in API. Also last year, we had a strong season that had set in relatively early compared to this year where the acute season is actually only set in the last month of last quarter. This alone is a significant driver of our performance in this quarter versus the previous year's quarter. Secondly, a couple of external headwinds came together in the form of commodity pricing and Forex as well as uncertainty around the funded environment of our global tenders. This has created a more competitive scenario and has constrained performance for the tender markets across the world. Thirdly, we have got some work to do internally from a capacity and serviceability point of view. I think we could have done better here to ensure continued supplies to our global markets and we are realizing that we are losing value on some of these which in the coming months will be fixed. Among these challenges, I am happy to note the continued momentum in our businesses.

Let me begin with an update of our key priorities. On growth across markets, our private market growth across market segments remains very strong both in India, South Africa, emerging markets and US. In India, our business continues to deliver market-beating growth with strong performance across therapies. While we are actively rebalancing our acute portfolio, our chronic therapies have significantly outperformed the market growing over 21% versus the 17% market growth as per IMS in Q2. We continued a strong performance in South African private market with the business growing over double the market growth rate at 14%. In emerging markets, our key DTMs delivered double digit healthy in-market growth. We had a good momentum in our biosimilar franchise development and we are happy to announce that we have signed a deal on Bevacizumab for Sri Lanka and Nepal.

For our US businesses, we are pleased that the business now started seeing a quarter-on-quarter growth of 8% versus the previous quarter with the business delivering 108 million in this quarter. We are happy to report that against the guidance of one limited competition product launch every quarter, we are already tracking ahead. The quarter saw the approval of 7 new products including key ones such as Diclofenac gel, Albendazole and Atazanavir.

Recently, we also announced the approval of Metoprolol, yet another limited competition asset for the year.

On profitability, as our growth trajectory remains healthy, our profitability metrics continue to remain strong. In our US business specifically, we are noticing early signs of revenue build up on new launches which has helped us improve our DTM business gross margins significantly.

We have chosen to play our market sustainably and our plan is to make our businesses more sustainable by focusing on our base DTM and B2B businesses along with responsible tendering. As a result of this factor and the uncertainty around the global funded environment, our CGA business is down 54% and the South Africa tender business is down 20%. Despite this, our profitability held up during the period despite R&D peaking at 8% versus approximately 6.5% in the previous year.

In terms of quality and compliance, we continued to operate our facilities with the highest level of compliance and control. During the quarter, we had audits at our Goa and Medispray facility. I am happy to share that the Medispray audit got completed without any 483s. We had two procedural observations in Goa. We have responded to the FDA and are confident that these will not have an impact on our operations.

I will now take you through a more detailed business performance starting with our India business. Our India business remained largely flat for the quarter on a year-on-year basis due to the higher base of last year and the late onset of season in the current year. On a half one basis, the business delivered a healthy growth of 9% year-on-year with both prescription and generic businesses growing strongly. When adjusted for the impact of GST, the half-one growth stands at 13%. As per IMS Q2, Cipla continued its outperformance growing by 14% versus the 13% market growth. Over years, we have continued our number one position in respiratory, urology and antivirals. Key therapeutic areas delivered above market performance. Cipla gained rank in Cardiology and now stands at the fourth position growing 500 basis points higher than the market at 19%. We also continued our leadership position in Respiratory with significant outperformance versus the market at 23%.

Our Berok Zindagi campaign launched during the quarter is turning out to be a benchmark therapy-shaping initiative to build public awareness about the important topic of inhaler usage. In our quarter 4 FY18 earnings call, we had guided for FY19 sales in India at US \$1 billion. Currency has moved much higher than our budgeted rate of 64; however, we are targeting to reach 6400 crores including our RX, GX and consumer healthcare business in the current year.

Our North America business delivered sales of 108 million, growing 12% year-on-year. As alluded to in earlier call, the US business is undergoing a change in mix as designed with the B2B business coming down sharply as no new products are getting added and the portfolio rationalization that we had initiated. These are impacting the reported sales for the US business as the new DTM product sales increase which is 40% of the Q2 DTM revenues were

contributed by new products launched in the last 12 months. This has helped us drive significant margin improvement in our DTM business in line with our internal estimates. We maintained a strong filing rate with 5 new filings in quarter 2 taking the half-one count to 10 against a full year target of 20 plus filings.

The SAGA region which includes South Africa, Sub-Saharan Africa, and Cipla Global Access businesses declined 25% year-on-year in quarter 2 when reported in US dollars, largely behind the rebasing of the CGA business and the slower offtake in Sub-Saharan Africa and the lower tender sales in South Africa. Our South Africa business delivered yet another quarter of ZAR 1+ billion sales with private market business growing at 14.2% on a year-on-year basis. As per IMS MAT August 18, our South Africa business grew at almost thrice the market growth at 14% in the private market. As per YTD August IMS data, Cipla became the third largest pharma company in the South Africa private market with the 6.3% share.

Our Europe business declined by 14% on a year-on-year basis during the quarter, largely behind supply issues related to certain products and milestone payments in the previous year on account of the FPSM launch. We are working towards structurally resolving these backend issues to ensure our critical products are available for servicing.

In emerging markets outside Africa, quarterly sales were roughly flattish and declined marginally due to some one-offs in the previous year.

We are very excited about a biosimilar franchise in the emerging markets as we move closer to signing multiple deals. We also inaugurated our manufacturing facility in Morocco during this quarter. As we end the quarter 3 and quarter 4, I am excited to see that our momentum in our private market businesses will continue but there are also external headwinds that will impact our reported performance in the short term. These involve items around the continuing commodity and China pricing related issues. The rebasing of the funded environment led business which is the tenders and other businesses in the HIV and malarial segment and the impact of sanctions in some of our markets, which will either come up as tradebarrier or against countries which will face issues in terms of currency and volatility. Despite these challenges, we will continue to invest in the health of our business and expect our momentum to continue.

Our R&D investments are already higher by a percentage versus the previous year and our portfolio is skewing nicely towards more limited competition assets and inhalers. We are tracking well on a target of 1 inhaler launch per year starting next year and one limited competition launch in the US every quarter. We are continuing to invest in our quality systems and maintaining a strong state of control and compliance at our plants. We are also engaged in building our capacity sustainably and balancing it for the long term especially with regards to our sterile portfolio. This activity may take us 2 to 3 quarters and we are working on it in earnest. We have also invested a fair amount of our bandwidth in the previous 2 or 3 quarters

in evaluating multiple assets in the specialty space. We are in advance stages of discussion on some interesting 505(b)(2) assets in the institutional business space.

For the next 2 to 3 quarters, our quarterly profits may not see a materially significant change from this quarter. Considering our long-term aspirations, we are preparing for the next stage and positioning our business for sustainable and profitable growth. Thank you and with this, I would like to thank you for your attention and request the moderator to open the session for Q&A.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question-and-answer session. We would take the first question from the line of Neha Manpuria from JP Morgan. Please go ahead.

Neha Manpuria: My first question is, throughout the call, several times, you have mentioned about supply issues and capacity and serviceability issues impacting businesses, could you give us specifics around which businesses got impacted and roughly what would have been the total impact on the quarter? And follow up on that, how much time would it take for us to actually resolve this fully? When would we start seeing the full upside of operations once this is done?

Umang Vohra: Neha, we are looking at approximately 100 crores a quarter which is the impact of some of our facilities. This is impacting about 1 or 2 of our facilities and it is across market, so it is not for any one particular market, it is across market and we think it is about 100 odd crores per quarter. These are fairly significant margin products that are impacted, so I am not going to give a guidance on what type of business this is, but this is a fairly significant margin businesses impacted across our markets. So, it is about 100 crores a quarter. That is one of the issues that we are facing and it is at our Indian site, it is not InvaGen which has already resolved.

Neha Manpuria: And sir isn't it surprising that because we have all been talking about resolving other supply issues that we had for the US market that this has cropped up now? It seems to be like an ongoing issue when it comes to supply disruption in Cipla at least for the last few quarters?

Umang Vohra: Well, actually the first set of issues were more limited to our InvaGen facilities, this is more we have to pause if we have to grow. This is that line of manufacturing where we will have to take some amends to continue to sustain and supply reliably. So, I think many companies go through this, we are not unique. You have to take a pause for a quarter or slightly longer period than that to rebalance your supply so that you can sustainably supply over a period of time in a strong set of compliance and control. So, I don't believe this is going to be too much longer but at the same time, it is what we have to do. We will have to rebalance it. So, it is not a supply issue because if I look at it, I am not sure that I at least believe in the fact that our business is of our size, has no supply issues at all. I don't think that world exists, there will always be some supply issue or not, the question is how upfront we are about telling you about it and I think

what we are basically just trying to say is that we have this issue in our numbers and it is going to be there for a quarter or so more.

Neha Manpuria: And my second question is on this second half versus second quarter, you are tracking ahead in US in terms of limited competition launches. India, hopefully because the seasonality started late, you should have a better third quarter and your other markets also, you seem to indicate growth momentum being good. Incrementally none of the issues that you mentioned seem to be worsening. Any reason for why we are more highlighting the headwinds significantly for second half impacting our performance?

Umang Vohra: No, I don't think, we just said the commodity pricing will continue. The commodity China Forex related issue will continue. We highlighted that the tender in funded environment issue will continue. Those are not going away. They were there in part of our last quarter, they are going to be there additionally but also remember the Cipla operates in the part of the world where the US related sanctions do make a difference and there is some impact of that, that will additionally come in. So, I think we are highlighting just that and we are saying that our quarterly profits may not show a materially significant change and if they are operating at about 18.5% or upwards of EBITDA, I think we are 18.8% of EBITDA this quarter, I am not sure that we are signalling that this is doomsday, but we are just saying that we are pretty cautious about how we anticipate our future quarters.

Moderator: Thank you. The next question is from the line of Anubhav Agarwal from Credit Suisse. Please go ahead.

Anubhav Agarwal: Just a clarity, Umang. This 100 crore impact you talked about is the sales impact or PBT impact?

Umang Vohra: The 100 crores is sales, but this is very high margin, so I would expect the conversion into PBT to be fairly significant.

Anubhav Agarwal: So, more than 50%, 60% we can expect?

Umang Vohra: Yes, more than that.

Anubhav Agarwal: And now for India business, are you sticking to your sales growth guidance which you talked about 6500 crores thereabout billion dollar at older currency rate?

Umang Vohra: Yes, I read it out in my script. We are holding to 6400 to 6500 between our three businesses.

Anubhav Agarwal: And just one clarity from Kedar, sir this sharp increase in receivable days, very sharp increase, almost like 870 crores increase in receivables and in fact the days also expanded from 75 to 90 days, what was that driven by?

- Kedar Upadhye:** So, Anubhav, I think the September month's billing incrementally is higher than June month, so there is just that month to month difference. None of these receivables is bad and doubtful. We also had an impact in terms of new launches in US, so as you know the gross to net percentage for the US is little bit skewed. The working capital cycle is a bit inverted. Most of the times, you have to pay deductions in advance and after sometime, you collect the gross receipts from the customer. So, we have gone into that cycle this quarter and we will get back to much more decent position by December quarter.
- Anubhav Agarwal:** If I can just ask one more clarity, your DTM sales have increased by \$4 to \$5 million sequentially. So, last quarter when you talked about that all this applies which \$4 to \$5 million sales will come back, all of that has come back in the US business now?
- Umang Vohra:** Not all, but I think the large portion of it is come back and if you look at our delta, just to link your question up with the receivable question, a delta of 8 million is almost a delta of I would like to believe 30 plus million on receivables because that is the value of the gross to netting of the new products that we are launching because we have launched 7 products this quarter as well. So, if you look at the delta of the receivable increase in the US, that is what probably causing that, then you have Forex which should have also caused it.
- Moderator:** Thank you. Next question is from the line of Prakash Agarwal from Axis Capital. Please go ahead.
- Prakash Agarwal:** I missed this number, this 100 crores, this number is the tender number or which number are you referring to?
- Umang Vohra:** The 100 crores was an answer to a question raised by someone on what did we lose on account of capacity issue and that is the number we had mentioned was 100 crores of sales.
- Prakash Agarwal:** So, my question is actually on the tender and the possible loss on the sanctions. Are we sharing what kind in terms of percentage as you said, it is across the markets. What kind of loss in sales are we expecting?
- Umang Vohra:** I am not sure we are going to share that. I just like to tell you that to a large extent, this is part of our numbers in some markets and there will be some additional markets which are seeing, it is not just a sanctioned country that we are talking about. We are talking about the general environment in a lot of the Middle East countries that we operate in where there is extreme amounts of volatility and lack of liquidity. So, it is encompassing not just sanction countries, but it is going even beyond that. So, as a result of that, we expect slight incremental impact quarter-on-quarter, but it is not something which is preposterously large.
- Prakash Agarwal:** And would it be fair to say that these businesses are in line or little lower than the company average margins?

- Kedar Upadhye:** On the tender side, yes Prakash. That is why the overall gross margin and percentage EBITDA has held on to our historical trends.
- Prakash Agarwal:** Fair enough and secondly, why talk about commodity and crude prices being or say getting impacted now. It has been there for last 3, 6, 9 months, the China disruption and actually started to ease off is what I understand from other companies. So, were we hedged earlier and we might see some impact now or how to think about it?
- Kedar Upadhye:** I think consumption of the higher priced goods probably have started hitting in the P&L now. I think first quarter, the impact was quite lower. This quarter, the impact almost doubled compared to first quarter.
- Umang Vohra:** And also we spoke about this in our previous quarter as well. We have actually been talking about this for the past 2 quarters. It is not the first quarter that we spoke about it.
- Prakash Agarwal:** And lastly if I may add one more on the launches that we are doing, so we are getting good approvals, but how are we tracking on the launches? Are we able to take the fair share of the market or are we seeing incremental pressure in the US market?
- Umang Vohra:** No, I think our new product launches, so we have struggled a little bit in the previous one or two quarters with this, but on this quarter, we have seen the uptick. We are getting a fair market share by value for sure and I think our metrics are looking good. We are feeling quite optimistic about the launch thing in the US. So, I think we feel better about the US market today than we did about a quarter or two back.
- Prakash Agarwal:** Sir, any pricing commentary sir?
- Umang Vohra:** I mean if you are asking whether the pricing environment has stabilized, I am not sure, I can say that as yet. Do I think that the overall optimism in the market has increased? Yes, but it is reflecting in the pricing numbers that we see today, I am not sure I can say that.
- Prakash Agarwal:** Sir I meant on the products that you are entering, are you taking a decent haircut to get some market share or are you able to come at similar prices or how is it in the market?
- Umang Vohra:** I do not think we will ever come at the similar. I think the starting point for any price related share in the US is seldom lesser than 15%-20% and that is the minimum.
- Moderator:** Thank you. The next question is from the line of Saion Mukherjee from Nomura. Please go ahead.
- Saion Mukherjee:** Umang, Kedar, the tender part of the business, can you take us through what is the quantum, what is the size of this business and secondly, how much more it can decline, so both global access and tender business. I think you mentioned about South Africa tender being

downwards, is that for the first half or only in this quarter. And is there any reason for the sudden decline there?

Kedar Upadhye: Saion, our emerging market business, about one-third of that is tender. South Africa about 40% is tender and Global Access pretty much is all tender. Your question on the South Africa, I think we saw certain delayed offtake this quarter. So, I think first quarter went okay, but this quarter we saw certain pressure on the South African part. Global Access has been pretty much continuing. I think we have a priority there to strengthen the portfolio because current portfolio is pretty commoditized and emerging market country specific, we sensed certain pressure, so that's how it is played out. We won't want to give at this stage how it could decline further, but I think we are happy that the private market segments across the markets are looking healthy. Market shares are up, ranks are up and we will continue to focus on both, private market and tender in the coming quarters.

Saion Mukherjee: Sir, you are not guiding for, but how much is this revenue of all tenders and Global Access put together last year?

Kedar Upadhye: I can come back Saion with specific numbers. As I said South Africa, you should take about 40%, EM about one third and most of the Global Access is tenders.

Saion Mukherjee: But.

Umang Vohra: So, it should be just overall tenders, Saion, overall tenders for the company could be coming in at something like approximately 400 odd million or thereabouts, not all of it is and large chunk of it is our Global Access business because that is almost more than 50%-60% of that. That depends on the funding environment of the global fund. I would like to believe that that environment is the same for everybody across our competition set as well. The South African tender is like as Kedar mentioned is about 35%-40% of our business, this is the first year we have seen that being impacted and again that is a funded tender by the government. So, what happens is I think when there is a liquidity issue or the funding environment changes, those tenders get impacted.

Saion Mukherjee: And my second question was around US. Umang, so you mentioned you see good launches coming, I am just wondering compared to your expectations because you have got some good launches, but the ramp up is slower may be because of competition, so the kind of traction that you have seen, how much of that will you think or I would say that the number of new launches that you have and the revenue potential, expectation around that has changed over the last few quarters for you given that there are more number of players in the product that you have launched?

Umang Vohra: Good question Saion. I would like to say that we look at our business in 3 parts. We look at our business in the case of InvaGen, we look at our business in terms of the DTM launches that we are doing and we look at our B2B business. So, what we found is that on the DTM

launches, we are possibly about 95, within 95% of our targets. It is not that we are much behind, so I think what we are selecting, launching and this is showing up in the margin pull through. On our B2B business, we have declined a lot faster than we thought we would and the impact for that has come larger and actually in some way that is linked to the general price deflationary impact in the US because when the partner sees the price decline of 15%, we get a large share of that as well. So, I think in the B2B side, we have seen a fairly significant decline possibly more than what we had anticipated and also a large chunk of our supplies also link to this B2B section. Supply related issue was linked to our B2B section in the US, so we have seen a much higher decline in the B2B. On the InvaGen side, frankly we are now stable. We are not seeing the type of decline or anything else. I think we are stable with our business. Quite largely, the portfolio substitution which is happening, so the delta that we are possibly seeing on the DTM is much higher than the 8 million that you are seeing aggregated because the 8 million had captured the fair amount of B2B that has declined within those numbers.

Saion Mukherjee: And finally Umang, you mentioned about initiative on the speciality side where you are in advanced stages on some of the assets. I am just wondering can you share some details about the therapy area and what is the kind of investment that you would be comfortable doing in this space currently?

Umang Vohra: Saion, little early. We will talk more about it in hopefully very near team, but we are looking at the institutional space in the US which could be the hospital areas etc. We are looking at the CNS space and we are looking at Respiratory.

Saion Mukherjee: But you know Umang, your comment suggests that in terms of commercializing, it should be like over the next two years, you are looking at late stage assets, is that right?

Umang Vohra: That's right. We are looking at a mix, but, yes, one or two or some of those assets could be ones that we commercialize within 2 years.

Moderator: Thank you. The next question is from the line of Sameer Baisiwala from Morgan Stanley. Please go ahead.

Sameer Baisiwala: Umang, what is your revenue concentration for the US business? What would you see the top three products account for?

Umang Vohra: What would that be? Approximately, top three, you mean the total not just InvaGen or total US?

Sameer Baisiwala: The total US, Gaba, Pulmi, and Bupropion?

Umang Vohra: I would say closer to 15%-odd.

Sameer Baisiwala: All three put together?

- Umang Vohra:** All three, roughly about 15%.
- Sameer Baisiwala:** I would have thought higher. Second question, Umang, is for Gaba and Bupropion, you have gained a lot, I would say over last 3 to 6 months, anything specific that is going on over there in the market share for these two products which are now your top three?
- Umang Vohra:** I think Gaba, there was an issue of some supply issues in the market. Bupropion, nothing that I have heard of Sameer, nothing from our perspective and also just I would like to caution you most of these products, both Gaba and Bupropion are made in our InvaGen facility, so when we were guiding saying that we had these issues with production, once the production is resumed, they will go back up. So, I think that is probably what is happening in the market.
- Sameer Baisiwala:** And second one, Metoprolol XL approval, do you think this is still a very remunerative product, what exactly can you achieve from this?
- Umang Vohra:** Sameer, I am not sure it is as lucrative as it would have been about 2 years back for sure because there is more number of people in the market. I have a number in mind, but I don't want to give it, but within a range, I think this could be within overall 3% to 4% of our revenue is not higher.
- Sameer Baisiwala:** And that is the challenge Umang because if you are counting this as one of your per quarter complex product launch and if it end up being whatever \$10 to \$15 million drug, then the definition of a complex high value product certainly comes down a lot, is not it?
- Umang Vohra:** It does for sure, but then some of these we can't predict timing, but for example when I look at an Albendazole or I look at a Diclo gel, those are good examples of limited competition. This may not be a great example of a limited competition launch.
- Sameer Baisiwala:** And the next question, Umang is this year is going to be challenging and you are warning the next two quarters, but I guess in therefore we need to look a little beyond that and I don't want to do give us a guidance but just if you can give some colour of what to expect beyond this year as we get into the next one?
- Kedar Upadhye:** So, I think may be some specific thoughts about the next year could be given by the May earnings call. That may be a better time to talk about it, but I would expect one common theme to emerge out of even the guidance that we would give at that point of time. I think the private market segment, be it for India business, be it for emerging market, be it for South Africa that I would expect us to outperform the market. I would expect to do a little bit of work on the cost and to certain extent, I think many of these launches which have happened both quarter 1, quarter 2 and many of this will happen in Q3, Q4, I would expect some kind of annualization impact in the next year. Sameer, I would leave it there at this stage and we could come back specifically.

- Sameer Baisiwala:** So, Kedar, why do you say that it would be business as usual, both on the top end and margins and we shouldn't really be counting on a catch up for what you are losing in this year?
- Kedar Upadhye:** I would tend to think so, like some of the corrections on the tender side unless the portfolio gets significantly rejuvenated on the Global Access or few other tenders. Unless the portfolio gets rejuvenated which we expect to do, we expect to start that work on, but I leave it here Sameer and other specifics will come back later.
- Moderator:** Thank you. The next question is from the line of Surya Patra from Phillip Capital. Please go ahead.
- Surya Patra:** Just further on the tender business and the global access business, all put together, like going ahead, do you have any sense that okay, the share of this entire portion tender business will shrink to a kind of minimal number or something like that in the following year that is what is here, you are looking at or any sense on that front?
- Umang Vohra:** Very difficult to give a view Surya, depends on the funding environment. This year is a very, I would say a severely constraint funding environment. I don't know what happens in the funding environment of next year. We have seen this pattern, you have some odd years and then suddenly it reverses because the number of treatments required goes through the roof, so I think it is what it is and our CGA business has rebased quite significantly actually. We are almost 50% plus down and that is the large amount because this business last year was almost a \$160 million business for us.
- Surya Patra:** All put together?
- Umang Vohra:** All put together. So, you can imagine the annual impact of the rebasing of this business is \$80 million, it is not less and when you look at our top line growth, it is largely on the tender side and this funded environment side that we have seen challenges, whether it is here or in South Africa. While the private market looks very exciting across our 3 businesses, our core businesses and some of the DTMs in the emerging market is very difficult to compensate when you have these types of declines happening in the tender market and the funded environment of the CGA space. The good thing out of all of this is that profitability has stayed intact and we have managed to that and I think we will continue to manage to more profitability and cost initiatives.
- Surya Patra:** In terms of US front, is it possible to have a sense that okay out of the pipeline of whatever 90 odd ANDAs, how many would be part of the DTM portfolio and how many other would be part of the other business?
- Kedar Upadhye:** Surya, incrementally most of the ANDAs that you are filing now are for DTM business and most of the pending ANDA pipeline is also largely for DTM portfolio.

- Surya Patra:** Is it fair to believe that okay, whatever the product filing by this InvaGen is not part of the DTM portfolio?
- Umang Vohra:** InvaGen in fact is largely DTM. Most of InvaGen is DTM portfolio.
- Surya Patra:** And just last one question on the B2B business front. So, now obviously there is a kind of, means it is a planned kind of reduction in the B2B business, but going ahead what is the future of it? Whether it is going to be eliminated completely so that the profit profile of the remaining business would be strong enough and that way the focus would be or what is the?
- Kedar Upadhye:** Surya, we are not killing B2B business. I think by design as we not seeding new molecules into that stream of our revenue. It is fading out. I don't expect that to become zero, but we don't expect that to grow.
- Surya Patra:** And the rationalization of the product portfolio in US, is that over now or anything still pending there on that front?
- Kedar Upadhye:** No, it is done, largely it's done.
- Moderator:** Thank you. The next question is from the line of Nitin Goswal from Invesco Mutual Fund. Please go ahead.
- Nitin Goswal:** Sir, my question is pertaining to the gross margin which has seen improvement year-on-year as well as on quarter-on-quarter basis. How much would be the result of sales mix which is not in favour of the tender business and been in favour of more private business and how much could be linked towards the commentary that you gave in your PPT which is DTM margin improvement in US, overall Europe business, profitability has been positive?
- Kedar Upadhye:** See, some of our tenders are profitable, so I would say most of the gross margin improvement is linked to the product mix efforts taken by us, cost optimization and overall portfolio momentum.
- Nitin Goswal:** And if I have to stretch these thoughts whether FY20, when we move into keeping in mind the kind of current situation we are going through and once the business normalizes ex of tender, the delta flow through which has not currently been from gross margin to EBITDA because of lower top line growth that should get much more visible.
- Kedar Upadhye:** Should be logically.
- Nitin Goswal:** And second question is pertaining to the sanctions related challenges which we may come across, what is our exposure to those kinds of countries, may be in terms of revenue or may be in terms of cash flow receivables?

- Kedar Upadhye:** Actually, some of the challenges relating to tender are not only for sanction countries. I think the whole funding environment etc. is across our businesses. As we said, they are in emerging market, they are in South Africa, so it is throughout our regions. These are not only for sanction markets.
- Moderator:** Thank you. The next question is from the line of Krishnendu Saha from Quantum Mutual Fund. Please go ahead.
- Krishnendu Saha:** This last time when we spoke, we spoke about priorities being one of them being the emerging markets biosimilar like, any progress on that, any update and number two on Proventil, what is the update, should we get any update you can give us on that too if you can please?
- R. Ananthanarayanan:** On biosimilar, I think we clearly had good momentum. We have clearly seen a lot of momentum for the emerging markets and we have actually also announced that we signed a deal in Sri Lanka and Nepal, but the momentum is going strong and we expect that to continue and hopefully we will declare more deals to be signed over the coming quarters.
- Krishnendu Saha:** How many more countries should we address in the next year or in next 1-1/2 or 2 years?
- Kedar Upadhye:** Krishnel, the idea is to obviously monetize across the countries. There will be several countries.
- Krishnendu Saha:** Any market size we can address to this, put a number to this?
- Kedar Upadhye:** Not at this stage, Krishnendu.
- Krishnendu Saha:** And on Proventil, if you can give me some update please?
- Umang Vohra:** Proventil is on track. I think originally, we had guided to say that in half one of FY2019-20, which is next year, there would be a launch. I think we are about a quarter or 4 months delayed from there but on track.
- Krishnendu Saha:** It should be a limited competition product or one or two players?
- Umang Vohra:** We are hoping.
- Moderator:** Thank you. The next question is from the line of Nimish Mehta from Research Delta. Please go ahead.
- Nimish Mehta:** Lot of my questions have been answered. Just two clarifications. You mentioned that the reason for high gross margin is the lower tender, is it right or am I missing something?

- Kedar Upadhye:** So, Nimesh what we said is obviously gross margin will be benefited by several factors. Portfolio momentum in US and business mix and the work which was done on cost optimization, multiple factors have come together.
- Nimeih Mehta:** So, how do you rank further those factors three would be which ones that would help us understand?
- Kedar Upadhye:** May be I would say that large part of the margin improvement should not be attributed to tenders going down.
- Nimish Mehta:** So, if you can tell me what is the large parts attributable to?
- Kedar Upadhye:** Nimesh, maybe we can take it offline, I think there is chart on the US launches which we have spoken and the improvement in that part of the segment of the US is in fact over 2 year period out of 30% points. So, I think all those factors are more important in the margin improvement.
- Nimish Mehta:** And secondly on the tender business, have you seen any particular product or a set of products that got impacted? If yes, is that impact on the pricing as well as on the volumes or only volumes?
- Umang Vohra:** Both, I think it is both. Even volumes are constrained because of the funding environment. The pricing is probably constrained because there are more people bidding for the same tenders and some of those prices have gone to irrational levels, but I do want to say that it is a factor of both and I think it is largely around the ARV and malaria business.
- Nimish Mehta:** But do you think that if the funding issues are resolved, will you be coming back to closer to the original levels?
- Umang Vohra:** I can't comment on that because these are the global funds there, the Unitaid funds id, so I have no clue on when they will be resolved and so that is the reason, we are just being more cautious and saying that this is how we look at our business going forward for the next 1 to 2 quarters.
- Moderator:** Thank you. The next question is from the line of Chandra Mauli from Goldman Sachs. Please go ahead.
- Chandra Mauli:** And the first one is just trying to reconcile the EBITDA number that you put out on the press release as well as the EBITDA number we get to on the exchanges looks like about 50 crores of the other income has been included in the EBITDA. Could you just give us some colours on what those items are? I remember you spoke about R&D and OPEX related stuff but a little more colour and whether it is going to be recurring going forward to the next quarters?
- Kedar Upadhye:** Our EBITDA for the quarter, there is not much nonrecurring benefit. If you take the costs which have been booked in the OpEx and R&D line, so we go by in terms of classification as

per Ind-AS, so sometimes, incomes get booked in other operating income line or other income line but at times, we are not able to adjust the cost which get booked for some of that income. So, I think if you could refer to page 3 of our press release, we have given a bridge from PBT to EBITDA and 753 crores which is about 18.8% for this quarter. That is the percentage of EBITDA which we believe is recurring percentage for this particular quarter. You would also note that multiple companies include finance income, investment income and some of the divestiture related income in their definition of EBITDA and Forex as well. We don't consider that. About 82 crores of all these incomes because of all this 3, 4 reasons that I said, we have excluded from EBITDA. Similarly, this number was about 170 crores in first quarter, even that has been taken out. So, we are at about 18.8% for this quarter, 18.4 for the first quarter.

Chandra Mauli: Second question at this time, the Bevacizumab deal that you signed in Sri Lanka and Nepal, so I remember few quarters back, you were doing your own trials in Australia I think for Bevacizumab. So, is this time deal related to the trials you are doing or is it something that you are in-licensing and marketing in these market?

Umang Vohra: In-licensing and marketing.

Chandra Mauli: And final question is just on Seretide in Europe, so could you just give us a little bit of detail on how that is progressing?

Umang Vohra: So, I think the numbers are rising after we have launched it with the CCG group, after we took back the possession of the asset and we have launched it. I would like to believe we are closer now towards a 10% share or between 7 to 10% share and we are continuing to grow this. The pricing is a little lower than when we started, but we are feeling quite comfortable and confident about where we can take this.

Moderator: Thank you. The next question is from the line of Charulata Gaidhani from Dalal and Broacha. Please go ahead.

Charulata Gaidhani: My question pertains to the India business, why is the India business flat and where do you see it growing for the next two quarters?

Kedar Upadhye: Charulata, if you notice in the press release, we have grown sequentially by 6% point, so I think compared to quarter one, we have grown by almost 100 crores. You would recollect from Y-o-Y comparison, last year was the restocking quarter after the GST implementation and coupled with the fact that this year is the acute season onset was quite delayed. That is why we are flat, but if you take the GST out, we have grown at almost 13% in the first half.

Moderator: Thank you. The next question is from the line of Chirag Dagli from HDFC Mutual Fund. Please go ahead.

Chirag Dagli: Just trying to sort of tie in what we have earlier mentioned as the exit for Q4 at about \$125 million in the US versus 108 in the second quarter. From your commentary, it seems that for most markets, first half has seen a reasonable beating. Then why is it that our profit guidance of similar run rate in the second quarter. What is it that we are building as declines in the base?

Umang Vohra: The 125, I think that we feel good about at an exit level for quarter 4. Please note that in quarter 4, the India seasonality begins to reverse. It is the weakest quarter for the India business in the entire year. So, when we are saying that we are going to come in at not materially significant change in profitability and this quarter we are announcing 18.8, on EBITDA we are announcing about 750 crores on EBITDA. I think we are saying that we are likely to be in that range. It doesn't mean that we cannot be higher than that. It doesn't mean that we can't be marginally lower than that and right now, we have faced with multiple headwinds and the tender, if you just try and understand the tender side of our business, we are losing almost 100, 120 million on a full-year basis because of this and there is an impact on profitability with it.

Chirag Dagli: But sir that is in the base, in the second quarter base.

Umang Vohra: It is there, but it will come even further because we don't know how much of the funding environment will further constrain. Quarter 3, quarter 4, we don't know the impact of volatility on account of sanctions that will come. So, we are just cautioning everyone about it. We are not saying that because of this everything is off from the business and there is no business to run. That is not what we are saying. We are just cautioning that there is an environment of uncertainty and we are giving you a guidance based on what we think is the best outcome in that environment.

Chirag Dagli: And this Q2 push out of the season sir, is this business lost, when you say that and the infective season has been pushed out, is this business lost or will you recover this in the coming months?

Umang Vohra: First of all, I think the season itself in my view has contributed almost 70 to 80 crores lower billing in India in our India business and I think a large portion of this is lost because even if the season comes in the last month, it will not last for so long because the season is driven by the monsoon and factors like that. So, a large portion of that is lost and the impact of that is almost close to 60 to 70 crores this quarter.

Chirag Dagli: And just an ancillary question, on the US business as it stands today at this \$108 million in the US, what is the EBITDA contribution from the business?

Kedar Upadhye: It is negative, Chirag. For this quarter post R&D EBITDA of US is not yet breakeven. We hope that it will get broken off, close to breakeven.

- Chirag Dagli:** And the depreciation number, sir, can you split between amortization and depreciation and comment if this run rate on a quarterly basis is sustainable?
- Kedar Upadhye:** You should take the current run rate, the split we will share offline Chirag.
- Moderator:** Thank you. The next question is from the line of Damayanti Kerai from HSBC. Please go ahead.
- Damayanti Kerai:** Coming back to inhalers, you mentioned like you are doing well on Seretide opportunity in the Europe. So, can you mention how much is the respiratory inhaler sales in total and if you can broadly split that between major market. That will be helpful?
- Umang Vohra:** Damayanti, we can share a table offline. I think the product is there in UK, few countries in Europe, Australia. We will share the table offline.
- Moderator:** Thank you. So, that was the last question for today. I would now like to hand the conference over to the management for their closing comments.
- Naveen Bansal:** Thank you. So, thank you everyone for joining us for the call today. Wish you a very happy Diwali and take care. Good evening.
- Moderator:** Thank you very much. Ladies and gentlemen, on behalf of Kotak Securities, we conclude today's conference. Thank you all for joining us. You may disconnect your lines now.