"Cipla Limited Q4 FY15 Earnings Conference Call"

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Moderator: Ladies and Gentlemen, Good Day and Welcome to the Cipla Limited Q4 FY15 Earnings Conference Call hosted by Kotak Securities. As a reminder, all participant lines will be in the listen-only mode. There would 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 here from Kotak Institutional Equities. I thank the Cipla management for giving us the opportunity to host this call. From Cipla we have Mr. Rajesh Garg – Global CFO, Mr. Anant Atal – Head of Investor Relations, Partnership Business for Emerging Markets along with their colleagues. I will now hand over the call to Mr. Rajesh Garg for opening remarks. Over to you sir.

Rajesh Garg: Thank you Chirag. Good evening to all of you and welcome all to our fourth quarter earnings call. I am joined by my colleagues Sudhanshu Priyadarshi – our Global Chief Operating Officer as well as Anant Atal who leads Investor Relations.

I hope you have received the presentation that was posted on our site. I know some of you have just joined in, given the previous call that was going on. I am going to kick off by taking you through some of the salient points of our performance for the last quarter as well as some highlights on the full financial year.

So during the last quarter, sales have increased by 22% with exports growth gaining momentum and growing at 23%. If you recall, year-to-date till the end of quarter three international sales were pretty much flat, so we are quite happy with the momentum coming back. India business has grown 20% versus an estimated industry growth of 12%. This revenue growth converted into a similar growth of 24% in EBITDA and EBITDA margin increased by 30 basis points compared to the same period last year.

Absolute PAT has also remained flat, but PAT as a percent to sales declined 1.9% mainly driven by the change in the depreciation rules and we will talk some more about it.

For the full year, our income from operations is Rs. 11,345 crores which is an increase of 11.5% versus last year. Our India business continues to perform very well and grew by 18%. Absolute EBITDA increased by 130 basis points, our EBITDA margins have declined by 190 basis points mainly driven by higher R&D investments as well as building of front ends such as Yemen. PAT at Rs. 1,181 crores declined by 15% versus last year primarily driven by the adverse impact of the change in depreciation treatment.

Moving on to business strategy, during the year we saw significant in-licensing traction with a few notable deals being Darbepoetin, Raltegravir, Dolutegravir and TAF as well as Sofosbuvir and the Teva collaboration in South Africa.

We are making head waves with our de-risking strategy. Integration of operations is on track where we are managing each of these countries such as Yemen, Iran, Sri Lanka via dedicated integration management teams.

We have also had tender wins in South Africa on Respiratory and ARV as well as newer areas such as mental health and cardiovascular. This firmly establishes ourselves as one of the key anchor partners of the government.

This year also marked the launch of Salmeterol Fluticasone in seven European markets- Croatia, Germany, Sweden, Slovakia, Czech; and recently in Belgium and Hungary. Over the next 12 to 18 months we expect to have a presence in more European markets. We are ramping up steadily and in five months we are happy to say that we have now reached around 15% volume share in some of the markets.

On the operational performance front, our SAP implementation has stabilized and we have retired 39 legacy systems. We have made good progress on debottlenecking our supply constraints that we spoke of in the third quarter, which is obviously now reflected with the momentum in the sales. Our implementation of a long term network optimization and capacity planning process is also on track. Further during the last quarter we became more vertically integrated for our respiratory business through the acquisition of a majority share in Jay Precision. Now with design and manufacturing, Cipla will be fully integrated across the value chain of respiratory devices.

On R&D, our expenses were at 6.2% of sales, this is the investment we have said we need to do and continue to ratchet it up. Since last year this was about 5.2%. We have more than 200 formulation projects underway and our filing intensity has also increased with 12 filings in North America, 78 in Europe and more than 1800 in International. We also had 36 DMFs filed during the year. Further, our joint venture with Manipal Group's Stempeutics filed with DGCI for its lead product Stempeucel. This has also received the ATMP certification from EMA as well as there has been granted process patent in China and North America. Overall in terms of quality, we are now in continuous improvement mode to be ahead of CGMP and any regulatory standards.

Moving on to some of the key highlights on business unit by business unit, let's take India. According to IMS, India business grew at 20%, much above the industry average of 12% and this is now reflected in the market share of our branded generics which is

now at 5.3%. India business contributed 42% of the sales last year with new products making up 3.5% of sales. We continue to focus on field force productivity and this across the year has resulted in about 18% improvement. We have also said we are open for in-licensing opportunities to leverage our excellent sales and marketing and distribution reach across India and the prime example of that is the launch of Sofosbuvir in March 2015 under the brand name of Hepcvir. This has acquired more than 1500 patients of Hepititis-C and 250 prescribers in just 45 days.

Our International business unit contributed 25% of sales with a very strong quarter four where they recorded 33% growth and 9% for the full year. We have now built front ends in 17 markets, some of the key ones as you have hear- Yemen, Iran, Sri Lanka, Myanmar, Morocco, and Algeria. In addition to the front ends, we continue to focus on our B2B or the partner driven market.

Cipla Global Access is now fully integrated business unit and it continues to be at the forefront of winning tenders. As a recap, the global fund ARV tender win which established Cipla as a panel supplier, the global fund ACT tender and the licensing agreement with the Medicine Patent Pool to allow generic manufacture of TAF and Dolutegravir. And also finally the licensing agreement with Gilead for manufacturing and distributing Sofosbuvir, Ledipasvir and GS-5816 in 91 countries.

Our South Africa business contributed 14% of sales registering a growth of 4% on a like for like basis. The private market within that contributed 73% of the sales. Also during the year, the Durban manufacturing facility was revamped and it has led to a significant improvement in utilization and enhanced efficiencies. We also won tenders in ARV, respiratory and some of the other newer areas. Also worth mentioning is the progress which is being made much faster than what was expected in our business case vis-à-vis the TEVA in-licensing agreement.

In North America, which contributed 8% to our total sales, we grew by 20% versus last year. There were 12 filings made during the year as I just mentioned with a focus on respiratory, oncology and anti-infectives. So overall we have filed 147 ANDAs and received approvals on 79. Another key highlight for the business during the year was the out licensing deal with Salix for the Rifaximin complexes. We also achieved a very big milestone last quarter with the launch of our own label products, some of them being Meloxicam, Topiramate, Valacyclovir, and Doxycycline. As you all are well aware, Teva has launched esomeprazole magnesium delayed release capsules in the US and it stands as the only approved generic so far and Cipla is the sole supplier of that.

Europe contributed 4% of total sales and saw a 24% decline in sales. This drop was primarily driven by the absence of one-off which was present last year, as well as a decline in partner base business and some supplier issues. We already talked about the respiratory business progress for Europe, we also secured a partnership with BioQuiddity to sell post-surgical pain management products and we also progressed with the Serum Institute of India partnership we have for pediatric vaccines and we expect the commence filing this year. We also initiated emergency supplies in Greece and Spain for OncoBCG, a therapeutic product indicated for treatment of bladder cancer.

Finally on our last segment which is APIs and Veterinary, they contributed 6% to sales but registered a decline of 18% for the year. Now this was primarily due to the growth in captive requirements for API but we are also evaluating capacity augmentation in APIs so that we can service our B2B partners while servicing our captive demand. We continue to drive cost efficiencies and process improvement initiatives and as I said earlier we filed 36 DMFs particularly in anti-retroviral, gastrointestinal, respiratory, neurology and oncology segments. We now have more than 200 APIs in our portfolio.

I will now invite my colleague Sudhanshu Priyadarshi, our Global COO to close out with his comments on the priorities for the next year.

Sudhanshu Priyadarshi: Thank you Rajesh and good evening everyone. Now as you have noticed we have just completed the second year of our transformation, we continue our focus on delivering a robust financial performance specifically when we look at to drive strong revenue, EBITDA and cash flow growth. We will execute our respiratory and Cipla Global Access business strategy and continue to look out for cost optimizing opportunities. We believe we have the right organization build now and our focus for the coming year would be on reaping benefits of the investment made in the recent years be it in terms of leveraging SAP to drive efficiency and effectiveness, rolling out of our other systems such as LIMS, SFA- Sales Force Automation, or reducing business complexity. We continue to maintain highest standard for quality and safety and strengthening of our operations back bone.

Lastly, we will continue to invest in our portfolio and pipeline, enhance our front end presence and focus on strengthening our foothold in our priority home markets.

In terms of guidance for the coming year, we see top line growth in mid-teens region with a 100 to 150 basis points improvement in margin. We also expect to push up CAPEX spend to run 8% of sales to help us add capacity for the increased sales trajectory.

With that I would like to thank you for your continued interest in Cipla and for your valuable time to listen to us.

Rajesh Garg: Yes, back to Chirag. Thank you.

Moderator: Thank you very much sir. Ladies and Gentlemen, we will now begin the question-and-answer session. Our first question is from the line of Girish Bhakru from HSBC Securities. Please go ahead.

Girish Bhakru: Just first on the inhalers front, you said volume share is around 15% in the markets, can you comment on the average price discount for the products in the European market?

Anant Atal: Average price discount that we have disclosed earlier is about 40% to 50%.

Girish Bhakru: That has not changed in terms of like more markets? Are there markets where the competition maybe higher with certain local players already present where you may need to discount further?

Anant Atal: No, at this point it is at that level.

Girish Bhakru: Right. Second one was on the US launches, some products are of course directly selling under Cipla's label, so are these products newly filed or were they part of the products that were kind of sent back from the partners?

Anant Atal: These were products that we bought back from our partners.

Girish Bhakru: And from economic perspective, where would you say these products would contribute from the margin front, are they like at company average margin or below?

Aannt Atal: It depends product by product and the margin structure will be specific in the US business. What we mentioned before is that these products are in markets where there are already several generic players, so relatively the pricing and the margins are lower. I think the objective really is to ensure full integration of our supply chain, get the door open with some of the key buyers in the US, establish our credibility from a supplier end point of view and then build from there over three to five years.

Girish Bhakru: Right. And just lastly on Rifaximin, would you get further milestone income with approval in the US?

Anant Atal: Yes, there will be further milestone payments and then upon launch there will be some sharing of revenue or profit, we cannot share the specifics but it is a milestone plus royalty model.

Girish Bhakru: So that will appear in the next quarter I would assume, right?

Anant Atal: It will appear when they achieve a certain milestone from their development point of view or when they launch the product. That's a question to be asked to Salix.

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

Anubhav Agarwal: Hi. Just first question on Nexium you said you have launched, so formulation sales have risen very sharply sequentially, is that largely driven by Nexium? Are we also booking profit sharing in this quarter?

Rajesh Garg: No, not in this quarter Anubhav. We have a quarter's lag. Quarter four was essentially just the sales of the standard mark up on COGS and then we basically book a quarter lag for the profit share.

Anubhav Agarwal: So what is leading to this sharp increase in export formulation growth sales, sequentially or year-on-year whichever way.

Rajesh Garg: In quarter three we had a little bit of supply constraint which is why our quarter three was a bit muted but now we have managed to overcome that and it is just overall, all the various markets in international they are now under lot of momentum.

Anubhav Agarwal: Rajesh, which market you are saying supply constraint, like one supply constraint for example South Africa you guys were facing problem, but can you give some idea about the market share you are talking about where you saw such a sharp change in the sales?

Anant Atal: Anubhav there were really two markets which were majorly impacted which we mentioned last time which were Europe and what we call International which is really the emerging markets business. There was a small impact in South Africa but now that we have got the Durban facility up and running, that is handled independently. So it is basically Europe and International which had a bit of an impact and now that backlog is being cleared and we will see the momentum going into the next year.

Anubhav Agarwal: So just to understand you are saying that quarter three was impacted because of Europe and International and this quarter is a more normalized sales with both the markets coming back to the normal level?

Anant Atal: Quarter two and quarter three were impacted, for quarter four, you can assume that it has a component of backlog built in as well. From a growth point of view we go back to that mid-teen guidance, that's the target we are striving for on a steady state basis. Now for quarter-on-quarter you may have some ups and downs but that mid-teens is a growth rate we are guiding for.

Anubhav Agarwal: And just one more question here that when you talk about supply constraint this is reflecting to some one large facility or this was reflected to some common product between Europe and International market?

Anant Atal: It is largely due to common product which resulted in some trade-off as well as some capacity bottlenecks of manufacturing capacity in terms of orders that lines can handle. So we have gone through a process of operating efficiency improvement and additional CAPEX, brown field enhancements for the additional capacity.

Anubhav Agarwal: Okay, thank you. Second question is on the guidance, the guidance of EBITDA margin improvement 100-150 basis points in sales excludes nexium as an opportunity right?

Anant Atal: I will let Rajesh comment on it specifically but the point is we are not giving specific guidance on the Nexium impact as it is early days. We cannot quantify the impact of that right now. Based on the best visibility we have we are guiding to make the growth at 100 to 150 basis points improvement in margins. As there is more clarity and more visibility on that impact and across our portfolio we can revise it accordingly.

Anubhav Agarwal: Sorry, still a confusion. Does the number that you are mentioning out, does it include Nexium or it does not?

Anant Atal: Yes, it does.

Anubhav Agarwal: It does to the extent you have visibility, so mid-teen sales growth guidance includes Nexium sales?

Anant Atal: Yes.

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

Sameer Baisiwala: Quick question on generic Nexium, is there a reason why your market share has stagnated, as I may say about 35% odd even though your partner Teva is the only player in the market right now?

Anant Atal: Sameer that is a question really for Teva. Teva is y giving us orders for specific batches which we are manufacturing and supplying. Now if Teva has a strategy of maintaining that market share, I think it is best up to them in terms of why 40 and not 50 or 60.

Sameer Baisiwala: Let me put it this way, if there were far more orders, say doubling it, do you have capacities to service that?

Anant Atal: Yes, we do have capacity but it is a question of how much volume. So therefore this is a question of timing. We are currently at 40% share, and we may currently already have capacity to go above that. It will take a bit of time - that is all.

Sameer Baisiwala: Sorry, I missed the last part.

Anant Atal: It is likely to take bit of time to add on capacity. We may have some buffer capacity right now but beyond that there might be a trigger for an additional packaging line or some specific item in the manufacturing chain which you will need to unlock through a quick fix it may take a month or two or more.

Sameer Baisiwala: Right, okay. And the second question sir is about getting generic Seretide approval in the key market which is the UK I presume, any visibility there?

Anant Atal: There is no more visibility than last quarter. We got two new markets in Belgium and Hungary; and there are likely to be a few more markets that will have either Seretide or other respiratory products launched in Q1. And again, we are optimistic that by next year we should have approval in most markets across Europe.

Sameer Baisiwala: Next year, you are referring fiscal 2017?

Anant Atal: Yes, so work with 12 months from where we are today.

Sameer Baisiwala: Okay. Sir one final question, you said you have about 15% market share in Europe for your inhalers, where do you say this settle over next say year or so in the same product, same country that you are there right in.

Anant Atal: The 15% is a number which we had mentioned for some of the smaller markets which were Slovakia, Croatia and Czech Republic which are maybe more price sensitive, or quicker to get market share. What we have mentioned earlier was over a 18 to 24 month period, we would like to get to aspirational 30% level, but then again, each market has its own behavior, so depending on how the uptake happens, what the competitive landscape is, that is the kind of internal target one is working towards.

Sameer Baisiwala: Sorry, I missed the percentage. In 18 to 24 months, what is your aspirational number?

Anant Atal: About 30%.

Moderator: Thank you very much. Our next question is from the line of Falgun Shah from Argonaut Pvt. Equity.

Falgun Shah: In the initial comments you had mentioned about change in the depreciation policy, can you please explain that?

Rajesh Garg: So basically under the new Company's Law from 1st April you essentially need to do an actual life. So as we have done a complete computation for our entire asset base that has resulted in about 120 crores of impact.

Falgun Shah: Sir, 20 crores is the incremental depreciation?

Rajesh Garg: Yes, incremental depreciation that we have taken a hit of.

Falgun Shah: Okay. And my next question is on the management changes, two years ago we had seen a new Cipla emerging under leadership of Kamil with a front ending strategy. And now after Kamil having moved out of the company and today's press release is also saying that Mr. Rajesh is also quitting, so how do investors view with each and every management, the new management member falling out of the team and how we look at Cipla strategy or who will be the torch bearer of the current strategy in years to come?

Sudhanshu Priyadarshi: Basically Cipla was always a professionally managed company, professionalization is successfully embedded in the company and there is a team that will continue to lead and drive Cipla. We have Rajesh leaving or Kamil leaving, these instances are quite normal in dynamic organization. In some cases such changes are driven by changes in personal interest as well. The organization is supposed to adapt and change depending on circumstances. Company went through a phase of bringing talent from the outside and the company now has enough talent within to grow and develop internal bench. And its visible in the sales momentum of quarter 4 and the guidance we are giving you in the next few months and the full year, the transformation is in place.

Moderator: Thank you very much. Our next question is from the line of Fatema Pacha from ICICI Prudential Life Insurance.

Fatema Pacha: Hello sir, you have done a great job on the sales but as we have always seen that when a company goes through a high cost structure, a high sales growth generally leads to a high EBITDA growth and leads to operating leverage benefit. But like in this quarter

and I think even in your guidance had said that this year your margins will be better than last year, at least equal to last year but we have actually had a drop of around 200 bps year-on-year for the full year and 4th quarter particularly is absolutely a big drop sequentially despite a big boost in revenues. Any particular reason- either the gross margins or the other expenses, any one-offs or anything that you would like to highlight?

Rajesh Garg: Sure. So well, one of the key things as you mentioned, as we have built the whole organization, we have gone out and said let's get the best talent, let's get the whole infrastructure, the best system, SAP and we have established front end. As you go through all those to integrate them and then make them run at the pace at which you want, so I think we have really, this is still a build-out phase, and hence the full leverage of that expense is not yet visible. But in particular, one of the things as I talked a bit earlier was that we have raised the R&D investment by 1% from 5.2% to 6.2%. Then the other part is obviously as the whole integration acquisition, the full year impacts of South Africa, Uganda and then recently Yemen and Sri Lanka. Yemen is clearly going through a little bit of tough phase right now and we are nowhere near the potential that it represents for us. So those are the two and in fact we actually had a margin improvement which offset some of those increases. So overall the 1.9% was 1% through R&D, 2% from the all the acquisitions and the new front end, offset partly by improvement in mix which essentially is South Africa where the direct-to-market business brought a margin increase. The North American business has seen a margin increase and also within the tender business as a mix in South Africa the tender is less. So overall we are actually pleased that we have seen a margin increase. But you are right, right now it is not visible that the sales growth has not translated but that is basically what we have factored in our trajectory. You should see that in the coming year.

Fatema Pacha: Okay. And would you share what is your Advair sales in Europe right now? Would it be around Euro 10 - 12 million for this year?

Anant Atal: Sorry, could you repeat that?

Fatema Pacha: Your Europe sale for Advair, would it be Euro 10 - 12 million?

Anant Atal: So we are not giving the specific number of a product Fatema. With respect to product in the market, generally what guidance we have given is that respiratory as a whole is about 15- 20% of our sales. So you can assume that in Europe that percentage is a bit higher.

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

Chirag Dagli: Just a broad color on the guidance that you are giving out sir. When I look at the individual blocks, India is growing ahead of mid-teens while Europe has declined. But on this low base I do not know how growth will look next year but it should do better than a decline, US is growing higher than mid-teens. So what I am trying to understand is that when you give this overall growth of mid-teens in sales and when some of the larger pieces are growing ahead of that number, how is it that we will conclude to this mid-teens kind of a number?

Anant Atal: So again, Chirag like you mentioned, again, this is based on the best visibility that we have across our entire portfolio. So for example this year you did see Europe and the API business declining, but you also saw good growth in India and in North America. So I think again as a portfolio when we look at it, this is a fair assumption of mid-teens that we are coming up with. There will be upsides and downsides in the overall portfolio, like you mentioned India will have strong growth, North America should have strong growth. As a portfolio across we need to see whether there has been less than 15% or plus or minus that range. So really there is likely to be upside and downside, this is the best visibility we have. If things change, we will guide upwards or downwards accordingly.

Chirag Dagli: Okay. And sir on the US business, when you look at these two large drivers, one is the partnership product and the other is your own products, over the next say two to three years what are the sort of key milestones that we should look at in terms of your partner products, how many launches if you can, like some of your peers actually give us clarity in terms of launches of how many launches we could probably do over the next 12, 24 months. And of course it is dependent upon a lot of things and which we appreciate but some color on how many product launches were they from the partner bucket or from the Cipla's own bucket that should be helpful actually.

Anant Atal: Specific launches is a little bit difficult Chirag because while we can speak for ourselves, it is very difficult to speak for a partner and say when actually they are going to launch and what the timing of commercialization will be. What we have always said is that for North America, over the next two to three years, the business will grow at an organic rate of 15- 20%. That is going to be a combination of direct-to-market and the partner business. As a share, our direct-to-market business will increase over the next two to three years but it won't be a dramatic shift, for example it won't be 50% of our business. More like 20- 25% of the business. So that is really the way to think about it. In terms of our own launches we have got five products in market, and it is fair to

assume a similar kind of launch rate between five plus or minus a few products every year of our own for the next two to three years.

Chirag Dagli: And just a clarification, do you include Dymista sales in the US bucket or do you classify somewhere else?

Anant Atal: Dymista sales will show in the respective geography.

Chirag Dagli: And roughly $148 million business that we have done, this should be spread across how many products in market whether through partners or on our own sir?

Anant Atal: We have five products of ours, and I think a total of about 50 products which have been commercialized.

Chirag Dagli: 50 have been commercialized, so 45 with partners and 5 on our own?

Anant Atal: Yes, right.

Moderator: Thank you very much. Our next question is from the line of Akshay Rai from Premji Invest. Please go ahead.

Akshay Rai: Some of my questions have been answered, just one question, can you just explain the sequential increase in other expenses, it is almost 30%. I understand the part about R&D going up, that it seems to account for a large part of that. So is there any one-off in this?

Rajesh Garg: So basically sequentially other expenses have gone up from Rs. 716 cr. to Rs. 911 cr. Now pretty much half of it is coming from the full year impact of QCIL as well as the regulatory expense in all the foreign subsidiary. Then a big chunk is coming from Yemen and Sri Lanka.

Akshay Rai: Okay. So should we consider this as a recurring number or should we look at the annual number and then wok?

Rajesh Garg: I think it is close, obviously there are some items are one-offs in there but it is in that ballpark.

Akshay Rai: Okay, understood. And is this quarter from a sales perspective representative, how things should be going forward on international sale or again, is there more one-offs there?

Sudhanshu Priyadarshi: There is no one-off here. Obviously as Anant and Rajesh said we integrated all the front-end business. We had some challenges, now it is ramping up and you see in the Q4 we have the momentum, but there is no one-off but obviously you have a different quarters, in international market the quarter starts Jan-Feb-March whereas India it is December. So you will have those mix-shift but we are confident with the guidance that is given.

Akshay Rai: And more from international revenues perspective, is this a sustainable number you think?

Sudhanshu Priyadarshi: Yes it is sustainable.

Akshay Rai: Yes, because then I am struggling to understand the guidance with effect, if the international piece is going very well, India we are say in the 15% to 20% change, I mean are we being slightly overcautious on the guidance given because of how things were in the last couple of years or exactly why is there a worry that will only grow at mid-teens despite such strong top line numbers this quarter?

Sudhanshu Priyadarshi: As we said, as we integrate those front end business that we acquired of which you see some improvement in the beginning because you had the supply issue. So those issues will get, not it is becoming part of the business. So depending on how our US business does, if we feel that if we have upside we will give you a subsequent guidance in future quarters.

Akshay Rai: Okay, understood. And if you could just outline the respiratory strategy for US, say two three years and how you expect that to pan out?

Anant Atal: Our Respiratory strategy is going to pan out over the next three to five years. The guidance we have given, from a respiratory portfolio point of view, is to look at 2018 and beyond for some of the interesting products to be launched. Now again, over the next few years you may have one or two, products that are launched either on your own or through a partner and that will establish some traction. But the real impact from a new portfolio point of view and respiratory, not just respiratory even oncology and anti-infectives in North America, will be 2018 and beyond. And I think the other point to note is that from a strategic point of view we will like to go-to-market directly ourselves, but in certain cases where we need to balance risk and return, you may choose to go with the partner. This is when either the investment cost is too high or predicting commercial success is a little difficult.

Akshay Rai: Sir reason I am asking this is lot of your peers have started commenting on respiratory opportunities in the US and they seem also to be talking about a two, three year view on this opportunity. So do we feel that the gap and we're a pioneer in this segment at least from the emerging market companies, so are we seeing that gap closing and maybe running a risk of not really being in the first wave of launch in this segment in the US?

Anant Atal: We are not going to comment on peers and their timing. Our strategy is to be amongst the earliest entries in the market for the products that we do chose to be playing in. Another thing to note is that, respiratory unlike a lot of other therapies is unlikely to become a 15 player or a 10 player or even a 7 or 8 player game. You are talking about 5 or less players. So there is a big enough pool and it is really going to be about getting the right product, scalable product, a robust product to market and if you are able to do that you will be able to capture the opportunity. So right now it is really less about competition, it is more about product, getting it to market and ensuring we get commercial success and the product well accepted in the market. One of the ways is of course to be first-to-file or first to market.

Akshay Rai: So there is no change in that year that we will be among the earlier launchers in the segment or do you see a risk to that?

Anant Atal: No, I think that is our aspiration.

Moderator: Thank you very much. Our next question is from the line of Lalit Kumar from Nomura. Please go ahead.

Saion Mukherjee: Hi sir, this is Saion here from Nomura, thanks for taking my question. Sir my question is on R&D spend, we have seen an increase, going forward can you guide us given the product filing you are planning for the US, how should we think about R&D spend?

Anant Atal: Currently we are at 6.2% level, what we have said is over the next three years you could see R&D expense in the 6- 8% range.

Saion Mukherjee: Okay. Sir also on this other expenditure, I have not really fully understood because this is a very significant increase QoQ, I mean you mentioned something regarding Yemen and Sri Lanka, I did not really get that sir.

Rajesh Garg: Yes, see one is obviously this includes all the manufacturing expenses. So given the huge sales push, it has resulted all your manufacturing consumables, energy, and third party processing charges. There was also quite a big chunk in the filing expenses and

innovator samples. So some of our R&D expenses that were budgeted which make up a part of the 6.2% on the annualized basis, it was a timing impact that they appeared a lot more in the last quarter versus earlier part of the year. And then there is obviously sales promotion which is linked to pushing the various sales especially in India for example, so those expenses are also showing up there to support the sales momentum.

Moderator: Thank you very much. Our next question is a follow-up question from the line of Chirag Dagli from HDFC Mutual Fund. Please go ahead.

Chirag Dagli: Sir, can I get a split of the international markets between branded and B2B for the full year.

Anant Atal: Yes, the way you should think about it is that across direct-to-market, Cipla Global Access and the B2B - approximately a third each in each segment, now it may go up and down on a seasonal basis but that is the kind of rough estimate you can take.

Chirag Dagli: Okay. And sir, the minority interest seems to have gone up this quarter, what is going on there?

Rajesh Garg: Yes, so the biggest piece in there is the impact of Yemen which is now fully consummated and that was a big increase. The second one is, Uganda where we made much better profits so obviously they show up above EBITDA and then you will see them go out in the minority interest. So those are the two big items that have seen that jump.

Chirag Dagli: So going forward the annual number is how we should look at the sustainable level?

Rajesh Garg: This is just a start, so the Uganda piece is pretty much the annual number, but in Yemen this is just the start, so it is quite a shift of moving from three quarters being independent company and one quarter being with us. So I would not be able to say that this is a stabilized number for that, but partly it will be probably in that range.

Chirag Dagli: And sir last question was in answer to one of the earlier questions, did you mention that 2% of the margin hurt is because of this front-ending strategy and which markets was this, was this including South Africa as well?

Rajesh Garg: So a big chunk of that is the impact of annualization of Medpro and Uganda and then obviously some part driven by Yemen and Sri Lanka acquisitions.

Chirag Dagli: But the 2% of margin hurt is correct number?

Rajesh Garg: In the mix of, yes. Within that whole delta in a bridge form that is what it impacted us for the full year and then this obviously partly got offset by improving the margin with the product mix.

Chirag Dagli: No, on a net basis just to make sure that I understand this correctly, we have done about 11000 crores of sales and what you are saying is that because of this front-ending we have broadly lost about 225 crores of net negative impact on EBITDA. Is this understanding correct sir, this is what you are indicating?

Rajesh Garg: Correct. So obviously now Medpro is a very large organization, so that and QCIL, the Uganda piece and then also remember there is also the whole US and Europe, the foreign subsidiaries also on account of expansion, all those costs are also sitting there in Yemen and Sri Lanka.

Chirag Dagli: Sir I am just curious, when you front-end a market, would not your sales go up because then you are also keeping the distributor level of sales?

Sudhanshu Priyadarshi: Yes, it will, but remember it is the beginning right and in several markets where we are just sort of swapping out and then starting to realize the benefits of all the filings we have, increased product portfolio, you go through the whole integration management cost, some of those are fitting there which obviously will not remain. But yes, so it is early days, I mean you cannot digest an acquisition and expect it to sort of be on firing on all cylinders overnight.

Chirag Dagli: So then 2017 is when we will really start seeing the benefit of some of this coming through at the EBITDA line, is that understanding correct sir because you are guiding to not very aggressive EBITDA margin expansion for FY16.

Rajesh Garg: Yes, so I think we are being prudent and these acquisitions are in such a large variety of geographies so I think as time goes this year we should see some of those benefits and then clearly by 2017 it should be all out.

Chirag Dagli: So when you make these decisions to sort of acquire the front-end sir, if you can just try and explain to us how do you financially look at this, is there a payback hurdle that you have or in your assessment do you look at breaking even on the EBITDA level in how many years or whatever thought processes on a financial metric standpoint that you pass some of these acquisitions through?

Sudhanshu Priyadarshi: Two things we have here – most of these acquisitions were our distributor partnership. So the reason or the rationale for doing the acquisition was to de-risk that business,

now like in Yemen it is JV for us. So we have de-risked the business and are investingin products. The pipeline what we are investing in we can bring those product in that country and the payback we are assuming at three to four years, we should payback all those deals. But right now it is just a full year effect of those number because now it is a subsidiary, even if you have to have a 100% of the cost, even if you have 51% of the real profit comes out but the payback is three to four years and the key strategy rationale was to de-risk those businesses and we have de-risked around $500 million to $700 million business in last two years.

Moderator: Thank you very much. Our next question is from the line of Nimish Mehta. Please go ahead.

Nimish Mehta: Sir you mentioned that the high other expense is lot because of lumpy R&D spend, so can you just let us know of the total R&D that we spend in the year, how much is part of Q4?

Rajesh Garg: You are talking the total R&D expense, what percent has happened in Q4?

Nimish Mehta: Yes, I am just trying to understand the lumpiness in this quarter and then the rest is because of Yemen and Sri Lanka is what I understand.

Rajesh Garg: I think it was about 35% of the full year versus let's say 25%, so I think that would be a rough guestimate while the team is just looking through. I think it is about 33%.

Nimish Mehta: It is about 33% of the total year?

Rajesh Garg: Yes.

Nimish Mehta: So to that extent we can normalize the other expense, right, for the quarter?

Rajesh Garg: Yes, I think look, R&D as we have said this year is 6.2% and we are hoping to inch it up as Anant said a bit earlier to steady state over the next few years to go up to seven and then slightly up probably to eight. So every year we are working hard to actually increase it by 1%. So yes, the quarter is probably not a reflection, it is not about the annualized number that you should look at.

Nimish Mehta: The annualized other expense number we should look at?

Rajesh Garg: No, I am saying R&D.

Nimish Mehta: R&D number, okay. And how would you guide us for the annualized other expense number, I mean shall we take this Rs. 915 cr odd as a run rate for the quarter?

Rajesh Garg: I would say you should look at the full year number because we are managing our whole line items as a percent of sales quite closely now. So I would look at that as a annual number as well, not to get distracted by the quarter.

Nimish Mehta: Okay. The other question is actually on this product known as Pulmicort Respules, the Budesonide Respules, I understand that Cipla has filed for that product in the US market, very recently some three four Para-IV filers, I mean all the Para-IV filers got a favorable ruling, so are we a partner to one of those and to that extent are we launching this product or have launched this product.

Anant Atal: We cannot comment on that at this point of time unfortunately.

Nimish Mehta: But are we targeting it?

Anant Atal: Yes, we are targeting it, we cannot share details though.

Nimish Mehta: Okay. And sir are we among this three four launches that are likely to happen?

Anant Atal: Again, I cannot comment at this point of time.

Nimish Mehta: Okay. Can we expect this in this year, if that is all what you can tell me?

Anant Atal: You are asking the same question in three different ways, sorry, but again we are in the race for that product but I cannot comment on the specific timing.

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

Sameer Baisiwala: Sir, a quick question on the US generic Advair, how do you see your device, is your device ready to start your work for the US market and is this device going to be same that you are using for the Europe and other emerging markets?

Anant Atal: At this stage the device will likely be the same for US and Europe. From a timing point of view you are looking at filing over the next 18 months or so and having the file in time for approval around 2019.

Sameer Baisiwala: And have you started the clinical trials for this in US?

Anant Atal: If we are going to disclose it you will see it on clinicaltrials.org.

Sameer Baisiwala: And we cannot see that, so therefore the question. And if not there, then would you be in the position to do the filing in 18 months?

Anant Atal: The point is about getting the device right first time and making sure that clinical trial happens very smoothly. So we have a certain approach that we are going with, and again, timelines on these are difficult given the complexity of product. But I think we are working with the mindset that if not the first then amongst the first few for having this product in the market. So yes, internally we are very much on track with what our filing target and what our internal milestones are. What that translates to is over the next year and half we should have some of these key filings in place.

Sameer Baisiwala: Sorry, to persist just one point on this. How much time will it take for you to do the clinical trials? I mean starting from patient enrolment to all the way to completion?

Anant Atal: You can assume somewhere in the 6 to 9 months kind of timeframe.

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

Prakash Agarwal: Just one clarification here, you started by saying that we have completed the second year of transformation, just wanted to get a clarification here, when you started this transformation it was for three years or four years, I mean how many years still pending in terms of getting to the steady state and having a robust R&D pipeline?

Anant Atal: From a robust R&D pipeline point of view, you know what the number of filings we are making so over the next three years we will have most of the filings in and approvals will start coming from 2018-19 onwards. That's when we will have some of the products in market. From a transformation point of view, this is effectively the third year of the transformation. We said it is a three year transformation and we finished two years of it. You should start seeing some of the operating leverage starting from this year onwards.

Prakash Agarwal: Okay. So in terms of spike in the cost base, probably we are there or we have the third year which could see an incremental step up in the cost base if you could?

Anant Atal: Yes, I will let Rajesh take the point specifically, but on the fixed cost base we are reasonably stable. Of course we will have an inflationary impact. And again, you will obviously have certain milestone based costs which will come in as we front-end more in Europe, North America or certain international markets. So then we trigger costs. The objective however, is to show a positive margin trajectory now.

Prakash Agarwal: Okay. So just adding up what we discussed, given a 100-150 bps expansion margin guidance, is it not very-very conservative because you have Nexium coming up, then you have this operating leverage to play out and again, your India and there emerging market, all these business are showing mid-teen growth. So again the same question but if you could explain a little better.

Anant Atal: This is the best visibility we have right now that we can share. If at the end of Q1 we have a better picture of esomeprazole or other key launches, then we will change the guidance. As of now we are staying with 100 to 150 basis points improvement.

Prakash Agarwal: Okay. And lastly on the CAPEX side, what was the number this year and what we are looking for the next year?

Rajesh Garg: So this year is 600 crores, and about 6% of sales. And next year we are looking to take that up to about 8% because we have got a few new greenfield and brownfields being added up as part of the whole network optimization work that we have done. And given the time lag that it takes, and with the kind of growth trajectory we are on in several of the key dosage firms we are already sort of hitting the ceiling and right now we are managing with sort of three shifts and making sure we sweat everything we have. But we clearly see that we need to now embark on multi-year capacity rationalization as well as augmenting the capacity. So we are looking at around 8% CAPEX for 2015-16.

Moderator: Our next question is from Anubhav Agarwal from Credit Suisse. Please go ahead.

Anubhav Agarwal: A clarification, Yemen and Sri Lanka, in this quarter what kind of top line we are talking about, we have included?

Sudhanshu Priyadarshi: Are you talking about Quarter 4?

Anubhav Agarwal: Yes.

Sudhanshu Priyadarshi: For quarter four we have around $20 million, $22 million.

Anubhav Agarwal: From both the markets?

Sudhanshu Priyadarshi: Yes.

Anubhav Agarwal: And for the year?

Sudhanshu Priyadarshi: See we only consolidated that in Q3 and Q4, for the full year both markets combined will be around $50 million to $55 million for last year.

Anubhav Agarwal: And when you talk about that good part, some part of other expenses were also because of Yemen and Sri Lanka. So the EBITDA margin in both the regions will be lower than the corporate average which is 16% in this quarter?

Sudhanshu Priyadarshi: No, it will be higher on those but since in quarter four, you have asked question more about Q3 to Q4, so when you consolidated in Q4 it was not there in Q3, that is what the sequential improvement was.

Anubhav Agarwal: No, just to get it right. I was just trying to understand that why other expenses moved so much high, so you are trying to say in absolute basis Yemen and Sri Lanka has contributed to other expenses but when the corporate average margin is 16% in this quarter, they are not diluted to the margin they are accretive to the margin.

Sudhanshu Priyadarshi: Yes, agreed.

Anubhav Agarwal: Is that so, okay. And this second thing is Nexium, when you book the profit sharing from Teva in the next quarter, is there any associated costs or is it like what you booked in the top line from the profit sharing directly goes to the EBITDA line?

Sudhanshu Priyadarshi: Yes, most of them will go to the EBITDA line.

Anubhav Agarwal: It should be 100% right?

Sudhanshu Priyadarshi: 100% should go unless there are some other adjustments we need to make but most likely 100% will go to the EBITDA line.

Anubhav Agarwal: Okay. And can you just quantify what was the absolute R&D number this quarter, you gave a 33% number but what is like absolute number this quarter?

Rajesh Garg: Around Rs. 250 crores.

Moderator: Thank you very much. Ladies and Gentlemen, we will take our last question now which is from the line of Rahul Solanki from Edelweiss. Please go ahead.

Anshuman: Hi, this is Anshuman. Sir just wanted a clarification on the guidance, so firstly when you say mid-teens growth in revenue do you include Nexium also?

Anant Atal: As of now yes, based on whatever visibility we have.

Anshuman: And even EBITDA margin expansion also includes Nexium, right?

Anant Atal: As of now, yes.

Anshuman: Secondly on the vaccines business, can you give us more flavor on how do you see the opportunity over the next two three years panning out for Cipla?

Anant Atal: The Vaccines business is split into two parts, one part which is in Europe where we are just commencing filings. You will have a series of filings this year, which is pediatric vaccines. You will really start seeing revenues only two, three years down the line after you actually get approvals. So that is the first part. The second part is India where vaccines are being manufactured by Serum Institute and Cipla will be marketing it, you should see that launch in India over the next couple of quarters.

Moderator: Thank you very much. Ladies and Gentlemen, that was our last question. I now hand the conference over to management of Cipla for closing comments, over to you.

Rajesh Garg: So thank you very much for your questions. I will just probably ask Sudhanshu to give comments for the priorities for the next year.

Sudhanshu Priyadarshi: So as I said in the beginning, we have the momentum in the sales and we have our priorities laid out as I opened the call. And we thank you for your continued interest in Cipla and for taking the time to listen to us and we look forward to talking to more often. Thank you.

Moderator: Thank you very much. Ladies and Gentlemen, on behalf of Kotak Securities that concludes the conference call. Thank you all for joining us and you may now disconnect your lines.