



“CIPLA Limited Conference Call”

August 5, 2011

Moderator: Ladies and gentlemen good evening and welcome to the Q1FY'12 earnings conference call of CIPLA hosted by Kotak Securities Limited. As a reminder, all participant lines will be in the listen only mode. There will be an opportunity for you to ask questions at the end of today's presentation. If you should assistance during this 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 Ms. Priti Arora from Kotak Securities. Thank you and over to you Madam.

Priti Arora: Thanks for joining in for the call and thanks very much to the CIPLA management team for having this call. As before Ajay will provide us an update on the results and then we will open up for Q&A.

Ajay: Thank you Priti. Good evening to all of you and welcome to the first quarter earnings call. We hope you have received the financials and the performance highlights available on our website. We would like to give you an overview of the financials, which can be followed by a question and answer session. During the current quarter, the company posted a growth of more than 9% in sales and 8% in income from operations. Domestic sale grew by about 10% and export sale grew by more than 8%. Operating margins have increased substantially or in sequential basis, which is mainly due to better utilization of Indore SEZ factory as well as changes in product mix. The profits after tax were more or less flat mainly due to the following reasons: 1. Increase in depreciation of about Rs.15 Crores, which was due to additions to fixed assets mainly on account of the Indore SEZ factory. 2. On account of higher tax outflow of Rs.11 Crores mainly due to expiry of tax benefits at certain EOUs and 3. Mild increase in interest cost of about Rs. 4 Crores on working capital loans and Rs. 4 Crores on decrease in other income. Material costs for the quarter decreased by about 4% on year-on-year basis due to changes in product mix primarily due to lower proportion of antiretrovirals and formulation exports. Excise duty on sales has increased by about Rs.10 Crores due to increase in duty rate by about 1% and increase in dutiable clearances. The increase in staff cost of about Rs.34 Crores is due to annual increments and increase in manpower. Other expenditure has increased mainly due to increase in selling expenses and factory expenditure such as repairs and maintenance, power and fuel, stores and spares, etc. The increase in selling expenses is in line with the increase in turnover. The capital expenditure which includes routine CapEx for the quarter is about Rs.120 Crores and as of 30th June 2011 the outstanding amount of forward contracts is about \$170 million, which substantially covers the outstanding debtors. With this overview I would like to leave the floor open for questions, Mr. Radhakrishnan and myself are available to answer any questions that you have; thank you.

Moderator: Thank you very much. We will now begin the question and answer session. The first question is from Chirag Dagli from ICICI Securities; please go ahead.

- Chirag Dagli:** How do we explain the sharp improvement in the gross margins for this quarter, is there any element of exclusivity sales to customers for the quarter?
- S. Radhakrishnan:** There is no element of exclusivity customers. Basically this is explained by the first case the product mix was better, we had a good increase in the gross margin itself which was relevant and number 2, little better utilization of Indore which was in the last year was still in the formative stage but now the first quarter it has been better than earlier so that has sort of resulted in little better increase in the operating margins.
- Chirag Dagli:** What is the proportion of ARV formulations to the overall dosage exposure?
- S. Radhakrishnan:** About 22%.
- Chirag Dagli:** So this has decreased from 30% sequentially last quarter to almost 22% now.
- S. Radhakrishnan:** That is the product mix change.
- Chirag Dagli:** Right and other bit was in terms of the inhaler sales. Last time you mentioned in the last quarter that there was 12% of the overall exports piece, is there a similar number that you can share for this quarter?
- S. Radhakrishnan:** Yes, around the same number because 12%-15% is normally the respiratory component in our overall formulations sales.
- Chirag Dagli:** So, when you look at the sequentially last two quarters, the March quarter and the June quarter for your business, the dramatic improvement in your business has been predominantly the better utilization of Indore SEZ, is that how you put it?
- S. Radhakrishnan:** That is number one and a better product mix. API business has been much better, in fact API business has shown a 22% growth, which is the third highlight and the domestic is still 10% plus. So these are the three-four major factors, which gave us a little bit of a better performance.
- Chirag Dagli:** In the India market, are you witnessing any slowdown in the anti-infective segment, most Competitors have indicated of a slow down in sales, would appreciate any colour specifically on CIPLA, both on respiratory as well as the anti-infective market in India.
- S. Radhakrishnan:** Overall there is a huge competition, it being so fragmented obviously it has the impact on the top line of most companies and yes, in some of the acute therapy there is a pressure. Having said that CIPLA is about 50%-60% in the chronic therapy like respiratory where things are different, where CIPLA's strengths are better utilized and there we see much less issues as compared to the acute segment.
- Chirag Dagli:** So, growth should be better than what you saw in the coming quarters?

- S. Radhakrishnan:** I think obviously yes, there is a scope to do better and I think we feel that there is a potential which we can better capitalize in the next few quarters.
- Chirag Dagli:** Last question again, sorry to delve into this gross margin bit but this gross margin do you think is sustainable?
- S. Radhakrishnan:** I think it is because consciously we are looking at our profitability and ensuring that the business is in that sense profitable, number one and number two the overall Indore issues will only be improving from now on so that is favorable, so I think overall we can still maintain this kind of a pretty margin going forward.
- Chirag Dagli:** So, in the last two quarters, March quarter versus the June quarter as far as Indore sales are concerned which is the bit where you have seen the maximum growth or a strong improvement? Is it inhaler, which region or any colour that you can give us in terms of where does the higher utilization of Indore come from?
- S. Radhakrishnan:** Oral dosage because it is easy in terms of to get results and in terms of approvals and regulations, oral dosage has been one immediate contributing factor in the Indore which has helped us to have better top line from there.
- Chirag Dagli:** Any specific markets that you can indicate, export market?
- S. Radhakrishnan:** From Indore we are only supplying to some of these, regulated and semi-regulated market, right from Australia to UK to Europe, I think, these are the markets, which cater from Indore.
- Moderator:** The next question is from Manoj Garg from Edelweiss; please go ahead.
- Manoj Garg:** Despite the higher capacity utilization in Indore, the export percentage growth for the quarter was just 5%. Can you put some more light on this?
- S. Radhakrishnan:** That is right because it is only the antiretroviral business and now consciously we have rationalized some of which is why you see better product mix and better material cost operation, that has been one factor where we have rationalized and try to get maximum value for what we sell.
- Manoj Garg:** If I can understand this in more detail because sometime we do say that, we really want to forgo this low margin antiretroviral business and sometime again it comes back, so are we consciously taking this decision not to pursue this antiretroviral business?
- S. Radhakrishnan:** No, it is not only antiretroviral. What we are looking at is that, obviously we have to look at the profitability and the bottom line and whenever we find that whether it is anti-retroviral or otherwise in term, if it is not really giving us what we think is the appropriate profitability then we are reviewing, so if we get adequate margins, obviously margins in antiretrovirals are lower

than other therapies, it is not as though we want to give up this therapy. Obviously this has been our major front running business and CIPLA is well known in various African markets for what it has done in this area, so therefore, obviously we will only be surely ensuring that from a commercial perspective we get a decent margin so that they can be invested, but I do not think there is a conscious decision is say no to any therapy including ARVs.

Manoj Garg: And the last question before I get into the queue sir, in the last concall you have indicated that consciously we are expanding our focus into the domestic market and getting into neuropsychiatry and oncology, field force also, has any of that initiative you feel has started some yielding some result and we do believe that going forward the growth in the domestic market would be better than what we are witnessing right now.

S. Radhakrishnan: Yes, we have seen positive results in some of these areas that we have started focusing, both in the neuro area as well as the onco area and I think going forward yes, the focus will help us in getting the potential better because we too see in India, like any other emerging market today, huge scope area only it is segmented and that is what the competition issues are more than any other market but having said that given CIPLA's name and CIPLA's reach I think we will capitalize and try to get a better performance in the domestic market.

Moderator: The next question is from Kaushik Pal from Kotak Mutual Fund; please go ahead.

Kaushik Pal: What was your forex gain or forex loss component this quarter?

Ajay: It was about Rs.14 Crores of gain for the quarter.

Kaushik Pal: And correct me if I am wrong, last year was Rs.15 Crore gain last quarter and this quarter Q2?

Ajay: There was a loss of about Rs.10-12 Crores.

Kaushik Pal: If you can give some market-wise color of how the exports sort of panned out, is it that more or less everything grew at 8%-10% or some markets did well, some markets did badly?

Ajay: Overall in terms of the country wise, Africa was around 35%-40%, the European continent was about 20%, that was better than last year and the rest of the markets yes, it was more or less in line.

Kaushik Pal: Is it that rest of the markets declined because the growth is only 8%?

Ajay: The growth in Africa actually has been lower because of the antiretroviral portion, where we said the proportion of antiretrovirals is lower. That was mainly because of the African region and what has done better was Australia and Europe.

Kaushik Pal: Australia and Europe has done well, the percentage of the gain was the percentage to sales?

- Ajay:** Yes.
- Kaushik Pal:** How has US done?
- Ajay:** US is also fine, it has also done well; about an 8% growth in US.
- Moderator:** The next question is from Nalinakanthi from Sundaram Mutual Fund; please go ahead.
- Nalinakanthi:** If you could just help us with the current utilization at Indore, what is the current level at which we are operating the facility and how much of this would be incremental and how much of that would come from transferring our existing production?
- S. Radhakrishnan:** Basically at the current rate, as mentioned earlier, the Oral dosage form has been better utilized, I really do not have percentage numbers in terms of capacity because these are still early days, that is only about 8%-10% of our overall turnover and obviously our long-term aim would be to get much higher percentage of business from Indore. Having said that in terms of whole of last year if we had done about Rs.100 Crores, this is Rs.140 Crores.
- Nalinakanthi:** And what was the spend in terms of total fixed and variable cost?
- S. Radhakrishnan:** Overall in Indore in terms of fixed and variable cost is about, excluding material it is about Rs.50-60 Crores in the quarter roughly.
- Nalinakanthi:** So have we broken even this quarter?
- S. Radhakrishnan:** Yes, we are in this quarter breaking even.
- Nalinakanthi:** That is at cash level including depreciation or?
- Ajay:** Including depreciation.
- Nalinakanthi:** That is great. This Rs.50-60 Crores would include depreciation also and this is excluding material cost?
- S. Radhakrishnan:** Yes.
- Moderator:** The next question is from Jesal Shah from JM Financial; please go ahead.
- Jesal Shah:** One on minority interest, this associate income, if you can tell us, do you have that number?
- S. Radhakrishnan:** No, this is a standalone result because in quarterly basis we don't publish, this is a standalone result.

- Jesal Shah:** So should we take as last year look at on a quarterly basis...
- S. Radhakrishnan:** Yes, if you have the annual report then you can on that basis estimate for the quarter.
- Jesal Shah:** There should not be too much of a growth over there, right?
- S. Radhakrishnan:** I think so.
- Jesal Shah:** Okay and what are the associates that you are having, if you can just tell us what are these companies and what is the logic of these associates, the China holdings and others?
- S. Radhakrishnan:** Joint venture in China, which for us is an opportunity. There are three types of joint venture, one is the APIs, where it helps us source materials for production here and CIPLA has a 49% stake at the moment in Desano which is API and intermediate, so that is one joint venture in China. We also have the Biotech joint venture in China with the same group, so that is number two. Number three we have similarly a joint venture in Uganda for supply, they formulate and we supplying either API or technology to them to sell in Uganda and may be rest of Africa, so that is the third joint venture.
- Jesal Shah:** In the last year you have talked about the slight change in strategy for the international market for CIPLA, can you help us understand what progress you have made in terms of pursuing the new path in terms of you got some new people, how that is all happening, you are building some teams, you are building some skill sets, if you can help us understand that bit?
- S. Radhakrishnan:** Yes, we are looking at every market and seeing what options are available and how to get the best commercial value for CIPLA and in fact that is one of the reasons why you find that as we go long, we are able to get a better product mix, better productivity, may be better commercials, that is the company's focus and we are looking at each market and seeing what are the options available for CIPLA and trying to see given our strength and given our mindset, what is best to be done. So, that is a continuously ongoing thing and that is going to take some time to really take shape because these cannot be done overnight in terms of what they can do in the market but I think it is a good beginning.
- Jesal Shah:** Right, so what is your staff strength now and in the domestic market how many people you have?
- S. Radhakrishnan:** Field force is roughly about 6,500 to 7,000 people.
- Jesal Shah:** And total staff strength?
- S. Radhakrishnan:** Total staff strength of the company is about 20,000 employees.
- Moderator:** The next question is from Ashish Thakkar from Emkay Global; please go ahead.

- Ashish Thakkar:** In the domestic market going forward, are we still looking to getting into new therapies; adding more people or are we looking for consolidation?
- S. Radhakrishnan:** Obviously at this stage after we have done all that, now we look at more therapies, we obviously have to get more productivity, consolidate and optimize what we are doing, so that would be the strategy going forward in domestic.
- Ashish Thakkar:** Can we expect there would be no MR addition going forward?
- S. Radhakrishnan:** Yes, we have optimized that and obviously there is a huge scope now to get better productivity but we think from an overall perspective I do not think there will be a substantial significant additions to the field force in the near future.
- Ashish Thakkar:** Could we have more color in this sense, how many products we are going to launch going ahead and what is our strategy in the domestic market, what kind of growth are we looking at?
- S. Radhakrishnan:** Domestically normally we launch about 20 to 35 products every year and that trend will continue, respiratory is a huge focus area for us and also in that some of the speciality chronic therapy areas that we have strong head win and continue to get focus, I think that strategy will continue and going forward there is a scope here because we feel that CIPLA name as I said before we can capitalize and ensure that we get a decent topline between 15 to 20% as we go along.
- Ashish Thakkar:** Could we have guidance on the tax side?
- S. Radhakrishnan:** 20%, higher than MAT.
- Ashish Thakkar:** Around 20%, this is what we can assume going forward. Okay thanks.
- Moderator:** The next question is from Girish Bakhru from HSBC; please go ahead.
- Girish Bakhru:** Wanted more color on the domestic, have we seen any significant market share say in respiratory or other big therapies overall in our inhalers portfolio in the domestic market with advent of many companies launching their inhalers?
- S. Radhakrishnan:** No, CIPLA continues to be leader, we have a 70% market share in the inhaler segment, and we see a lot of potential there to grow because still there are lot of areas where inhalation therapy has still not traveled and I think from an opportunity perspective this continues to be one of the major focus areas for CIPLA as we go along, given that we have been more than 30 years in this area and have every dosage form and device available to optimize. I think CIPLA is in a very good vintage there to really get the best out of this market.
- Girish Bakhru:** Any update on the inspection of the Indore facility for US?

- S. Radhakrishnan:** We have not yet applied for US, right now the other regulatory agencies have inspected us and approved us but not yet the US.
- Girish Bakhr:** So, this 15%-20% topline guided does not include any significant contribution for the US market, right?
- S. Radhakrishnan:** Right.
- Moderator:** The next question is from Bino Pathiparampil from IIFL. Please go ahead.
- Bino Pathiparampil:** Physical capacity utilization perspective, where is Indore currently now and how does that compare to Q4 FY'11?
- S. Radhakrishnan:** I thought I answered this question in the beginning, it was raised by somebody else and we said that we have done much better in terms of, I do not know percentage numbers, but I think this was answered earlier.
- Bino Pathiparampil:** There is no percentage capacity utilization again?
- S. Radhakrishnan:** I do not have, as I said these are early days, and still on about 8%-10% of the total turnover comes from Indore and the capacities are high and the overall we have a capacity to reach up to 20%-25% of the overall turnover, these are early days and but the good thing is that we are optimizing that.
- Bino Pathiparampil:** This high API sale, does it include olanzapil to US?
- S. Radhakrishnan:** I cannot really reveal those information but there are several good product mix with various partners in the world which has helped us.
- Bino Pathiparampil:** Which line is the forex gain being included?
- Ajay:** It is in other operating income.
- Moderator:** The next question is from Anubhav Agarwal from Credit Suisse; please go ahead.
- Anubhav Agarwal:** A question on the personal cost, looking versus the March quarter, your personal cost is up 30%, where is the incremental, excluding the increase in salary, where is the incremental field force deployed, is it only in the domestic market or in the export market?
- S. Radhakrishnan:** No, it is all in the domestic market, there is no field force so far in the export market.

Anubhav Agarwal: I mean, field force was one example, when your total personal cost increases by 30% sequentially is that just the impact of the field force or is it increase in the number of people employed in the Indore facility also factoring there?

S. Radhakrishnan: As we are optimizing in Indore you have to have more employees there, so that is number one, moreover technical areas in the factory areas there have been certain increases, overall if you ask me 50% of the total increase is attributable to the salary wage increases and rest of it because of addition in employees.

Anubhav Agarwal: The second question, can you break down your 10% growth rate into chronic versus acute for this quarter?

S. Radhakrishnan: For this quarter, 10% growth rate would substantially come from chronic, less from acute.

Anubhav Agarwal: Okay, would acute be low single digit growth rate for you then?

S. Radhakrishnan: I do not have it, but my gut feeling is it will be may be 70:30.

Anubhav Agarwal: For launching combination inhalers in Europe, you earlier mentioned that you have around four to five partners, just wanted to get a color that why such a strategy of multiple partners for Europe?

S. Radhakrishnan: No, I have not mentioned there are four or five partners. In Europe generally for other products we have but not for these inhalers.

Anubhav Agarwal: Ok, Not for combination inhalers.

S. Radhakrishnan: No.

Anubhav Agarwal: So for combination inhalers you will go for single partner for entire Europe?

S. Radhakrishnan: We have to have our own strategy for that, it is still in the regulatory pathway, so still CIPLA is open to doing what it needs to optimize this. I think at the moment we are open.

Moderator: The next question is from Sonal Gupta from UBS Securities; please go ahead.

Sonal Gupta: On the staff spend, is there any one off in this quarter, any director fees or anything that has been paid which is causing the sharp jump quarter-on-quarter?

S. Radhakrishnan: No, normally in the first quarter bonuses are paid which could be one off which are included there which will not probably figure in the next three quarters.

Sonal Gupta: So, could you quantify it?

- S. Radhakrishnan:** In terms of quantification, it could be around Rs.4 or Rs.5 Crores if I may say so.
- Sonal Gupta:** Only Rs.4 or Rs.5 Crores.
- S. Radhakrishnan:** That's right
- Sonal Gupta:** Ok., and just coming back to the question of gross margins, your margins this quarter are much better than even anything last year. Do we expect to sustain this sort of an improved gross margin or is there a special one off?
- S. Radhakrishnan:** There is a conscious effort to do this and at least this quarter we have succeeded for two reasons, one is our product mix, we are very conscious in terms of what we realize and the impact on cost and also the product mix in terms of the ARV wherever it is not profitable we are reviewing and re-tendering when we have the best value and given all this I think we hope and with Indore also optimizing compared to the last year it was not this trend is something which we believe can continue.
- Sonal Gupta:** What is the sales growth guidance for the year?
- S. Radhakrishnan:** Going by the first quarter and going by the base, our guidance can be again about 10%.
- Sonal Gupta:** We have seen a very substantial ramp up in sales force for the last couple of years, but somehow the India growth has not really kept pace with that, so is there a different strategy we are following, are we going more rural where we have a higher sales force increase versus a topline increase, can you just elaborate on that?
- S. Radhakrishnan:** Our focus as I said earlier is to consolidate and get a better productivity of our field force. We have now entered some of the newer segments which has been refocused such as Neuro, Onco and such like therapies and not only the rural, there are other opportunities in the hospitals, in the nursing homes, and we are trying to see how to now rationalize and get the best productivity for them and that is the focus and we see as I said a lot of opportunity helps to maximize our growth.
- Sonal Gupta:** I understand the opportunity but any reason why the field force increases probably much higher than the overall revenue growth in India. Productivity is dropping.
- S. Radhakrishnan:** Obviously because when you are adding large numbers that aspect like any other, even adding a facility that trend would be in that manner for the first two years but the optimization will happen as we go along and that is the investment CIPLA is making.
- Moderator:** The next question is from Abhay Shanbag from Deutsche Bank; please go ahead.
- Abhay Shanbag:** In terms of optimization of low margin profits ARVs are still 22% of your export formulations, do we expect them to go down going forward?

- S. Radhakrishnan:** There will be no such conscious effort to reduce anything, obviously we look at each business by its own merit and ensure that if it is as per the norm and it is profitable, obviously we will take it and there is no such policy of either reducing or increasing this business and that would be true for any other segment. ARV being a large segment obviously it shows up but I think the focus will be to ensure that we get a better commercial gain for all our products.
- Abhay Shanbag:** No, because we have been stressing that in all those improvements and product mix, we are just trying to figure out whether this improvement in product mix will that continue going forward or is it largely Indore and your vertical integration which is really helping you, we have not been able to figure out as you said the marginal improvement has been quite significant coming in on a quarterly basis, so just trying to get a feel for those sort of numbers.
- S. Radhakrishnan:** No, as I said before, this is a conscious effort to ensure that our product mix and profitability is better and commercially we are getting a better deal and it is a conscious strategy. Indore is also one of the reasons why the operating margins were better, so both these factors will continue to help us in time to sustain this kind of a margin.
- Abhay Shanbag:** The other one was in terms of operating leverage, with Indore coming in the belief was that higher revenues will increase profitability but as compared to fourth quarter and now you have lower revenues but better margins, so just not been able to relate to it as significantly. Is it largely the change in product mix or in fourth quarter you had some higher cost also being the reporting quarter?
- S. Radhakrishnan:** As I told you fourth quarter Indore was substantially low productivity, so obviously there was lot of unabsorbed cost from Indore there, which were not there and that has shown up.
- Moderator:** The next question is from Prakash Agarwal from RBS; please go ahead.
- Prakash Agrawal:** Wanted to know about the inhaler filings and approvals current status in Europe and when do we expect the combination?
- S. Radhakrishnan:** We have recently got an approval for Salmeterol in UK, Germany and other parts of Europe, so that launch will happen sooner than later. Going forward we believe that further combination, there is still the regulatory pathway and the other legal issues to be cleared being clear which we believe is still a year or year-and-a-half away, so at the moment the good news is that we are on the track and one other product has got approved and therefore which we can capitalize and then wait for the combinations to happen.
- Prakash Agrawal:** When you say combinations, you already had indicated Russia and South Africa approval, so any more markets?

- S. Radhakrishnan:** Right now there will be no additional market but Russia has started to perform in terms of the market and we see good potential there and going forward there are the other markets which will happen more quicker than Europe in the near future and that also will give it a boost.
- Prakash Agrawal:** In terms of total filings and approvals including the single and combo can you give us the number in the European market, how much filings and how much approvals you have got?
- S. Radhakrishnan:** In the European market our filings overall is for about 11 inhaler products of which 7 are under process and 4 products are approved.
- Prakash Agrawal:** In terms of revenue growth, I am not sure whether I missed out that. First there was a mention of 15%-20% of revenue growth expected for the year?
- S. Radhakrishnan:** No.
- Prakash Agrawal:** So we are currently in the guidance of 10%-12% as stated in the Q4 call?
- S. Radhakrishnan:** Yes, I said 10%, at the moment, that is what I said little earlier.
- Prakash Agrawal:** For the Indore SEZ the contribution, which was around 8%-10% contribution of the export formulation or could it be a higher 15%-20% for the year ending?
- S. Radhakrishnan:** Yes, overall year ending should be a little higher, that is the target.
- Prakash Agrawal:** And US FDA, you said we have not applied for the US, so are we in the process or what is the strategy there for the US?
- S. Radhakrishnan:** At the moment we have enough capacities in Goa to cater to US and if we need we will take on US later subsequently this year. At the moment we are waiting to ensure that we optimize in Goa.
- Prakash Agrawal:** We are on track with the margin expansion that we have seen, this would continue for the year?
- S. Radhakrishnan:** That is the hope and the wish that happens.
- Moderator:** Ladies and gentlemen that was the last question. On behalf of Kotak Securities Limited that concludes this conference call.