



“Cipla Earnings Conference Call”

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MODERATORS **MR. S. RADHAKRISHNAN – WHOLE TIME DIRECTOR**
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MR. ANMOL GANJU – ANALYST, KOTAK SECURITIES

Moderator

Ladies and gentlemen good day and welcome to the Cipla conference call hosted by Kotak Securities. Joining us today are Mr. S. Radhakrishnan and Mr. Ajay Luharuka from the Cipla Management. As a reminder for the duration of this conference which is for 30 minutes, all participant lines will be in the listen only mode and there will be an opportunity for you to ask questions at the end of today's presentation. If you should need assistance during the conference call please signal an operator by pressing (*) and then (0) on your touchtone phone. Please note that this conference is being recorded. Now I handover the conference to Mr. Anmol Ganju, thank you.

Anmol Ganju

Good evening everyone. Thank you once again to Cipla Management S. Radhakrishnan for joining us to discuss your Quarter 4 results. I am Anmol Ganju from Kotak Institutional Equities and Mr. Radhakrishnan and Ajay from Cipla are with us today. So with this I will now hand over to Mr. Radhakrishnan and Ajay. Over to you Cipla management.

Ajay Luharuka

Thank you Anmol. Good evening to all of you and welcome to the conference call for the 4th Quarter results. Like Anmol mentioned we have our whole time Director Mr. S. Radhakrishnan on the call with us. We hope you have received the financials and 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 year 2010-2011 income from operations crossed Rs. 6300 crores with a growth of about 12% and profits after tax of Rs. 970 crores were about 15% of overall revenues. During the last quarter the company posted a growth of more than 21% in income from operations and domestic sales grew by 15%, while export sales grew by more there 28%. Operating margins as a percentage to income from operations are lower on a year-on-year basis due to change in product mix and negative contribution of the Indore SEZ factory. Profit after tax are lower by about 22% which is primarily on account of one-time exceptional income of I-Pill sale Rs. 95 crores in the 4th Quarter of last year as well as increased factory overheads at Indore SEZ factory. Material cost has increased by about 3% on a year-on-year basis due to changes in product mix primarily due to higher proportion of anti-retrovirals in formulations exports. The increase in staff costs of Rs. 30 crores is due to increase in manpower particularly at Indore SEZ and annual increments. Depreciation has increased by about Rs. 20 crores due to additions of fixed assets mainly on account of commissioning of the Indore SEZ factory. Other expenditure has increased mainly due to increase in selling expenses and factory expenditure in particular at the Indore SEZ such as repairs and maintenance, power and fuel, store and spare, etc. The increase in selling expenses is in line with increase in export turnover. 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 may have. Thank you.

Moderator

Thank you. Our first question is from the line of Chirag Degli from ICICI Securities, please go ahead.

- Chirag Degli** One question on the Indore SEZ, I remember last quarter you had indicated that there was a 25 crores kind of drain on your profitability for the quarter from the Indore SEZ. Is there a similar number that you can share with us for this quarter?
- S. Radhakrishnan** For the quarter -, roughly the turnover from Indore is 60 crores and the expenditure for the quarter is about 90 crores, so there is roughly a 30 crore differential which has been impacting this quarter. But the good news I think is most of the regulatory approvals are in place. In the next year we believe that at least 10% of the total turnover or so will come from Indore. So that should be able to, therefore, absorb the overheads which are otherwise having an impact on the bottom line.
- Chirag Degli** This is for the full-year of FY 12 is it, this 10% number?
- S. Radhakrishnan** That's right.
- Chirag Degli** On the gross margins front what is the sustainable kind of gross margin that one should factor in for the full-year?
- S. Radhakrishnan u** Gross margin, I would roughly put it between 18% to 20%, if you ask me, as a sustainable number, I mean the operating margin.
- Chirag Degli** No sir, I was talking more about the raw material cost, we have seen a very sharp decline this quarter. I know you have explained that part of it is because of ARV. I just wanted to understand if the product mix does indeed improve
- S. Radhakrishnan** Roughly Cipla's gross margins is about 55%. That I think is something which on an overall annual basis we should be able to achieve.
- Chirag Degli** And for this quarter nothing has changed except for the product mix which kind of explains this sharp decline?
- S. Radhakrishnan** That is right.
- Chirag Degli** Thank you so much and all the best.
- Moderator** Thank you. The next question is from the line of Anubhav Agarwal from Credit Suisse, please go ahead.
- Anubhav Agarwal** On the Indore SEZ, has the USFDA inspected your facility as yet?
- S. Radhakrishnan** No, not yet.
- Anubhav Agarwal** My second question is on the domestic market. What is your field force right now?
- S. Radhakrishnan** Right now we have got a field force of about 6000 people which may expand as we go along.

- Anubhav Agarwal** If I recall your field force a year back was around 5000, right? So when did this expansion taken place from 5000 to 6000?
- S. Radhakrishnan** 5500, so during the year we may have added another 500.
- Anubhav Agarwal** What are your expansion plans when you say that you further want to increase the sales force?
- S. Radhakrishnan** You see there are certain franchise divisions which we are reviewing and seeing what is the feasibility of getting them on board within Cipla because these are large turnover. So that is something which we are examining internally.
- Anubhav Agarwal** But the sales which is there is booked currently as part of your sales. Just that these people are not on the roll so will become part of your roll?
- S. Radhakrishnan** Yeah, maybe.
- Anubhav Agarwal** Second question is, Mr.Hamied also mentioned in the TV interview that you have added some new therapies in the domestic market. Which are the significant ones which you have just started now?
- S. Radhakrishnan** We are looking very closely at onco, we are looking at neuropsychiatry and where we feel there is a huge scope, these are being focused in addition to the current focus that we have
- Anubhav Agarwal** Last question, on the personal cost side though you have increased your field force if I just see the personal cost expense which has been reported, among the last four quarters if I see it has been the lowest. Somehow that expense is not getting reflected in the personal cost.
- S. Radhakrishnan** The employee cost, yes. That is because I think there has been some rationalization of the managerial commission
- Anubhav Agarwal** In the other expenses, is there any ForEx loss included here?
- S. Radhakrishnan** No, in fact there is some marginal gain.
- Anubhav Agarwal** Thanks, I am done with my questions.
- Moderator** Thank you. Our next question is from the line of Sonal Gupta from UBS Securities, please go ahead.
- Sonal Gupta** A couple of questions, one, could you tell us what will be the impact of the DEPB scheme and export incentives because I think that is a very large number for you.
- S. Radhakrishnan** Yeah, I think as of now if you ask me the impact would depend on the product mix because in the case of SEZ and EOUs these are not applicable it is only where we are exporting outside this SEZ. I think the DEPB income for the current quarter was in the range of about 15 crores

and overall it was about 60 crores. That is the overall average we normally book on an annual basis.

- Sonal Gupta** So the SEZ and EOUs are not really impacted by this?
- S. Radhakrishnan** Yeah they are not impacted.
- Sonal Gupta** So do you think that given your production will be increasing at Indore SEZ...?
- S. Radhakrishnan** The impact should be less but I also believe that this is not something which is done yet, there will be representations made because it is obviously going to affect the exporters because they already have a problem with the foreign exchange and I think this is something which might get a relook, I do not know.
- Sonal Gupta** Could you tell us as of Quarter 4 or as of 31st of March how many products partnerships you have for EU and US and how many of these products have been approved and how many are pending and how many have been commercialized?
- S. Radhakrishnan** As far as I understand it is the same as per last quarter's numbers for EU and US.
- Sonal Gupta** I think last quarter you gave for US, I do not think we shared the numbers for EU.
- S. Radhakrishnan** EU we have about 60 partners as of now, in terms of what we are doing and the registration number is about 400 odd products.
- Sonal Gupta** 400 approved?
- S. Radhakrishnan** That's right.
- Sonal Gupta** Could you explain the margin seasonality because there is a huge variation between your 1st Quarter margins every year to your 4th Quarter margins. So does your product mix deteriorate specially in the 4th Quarter, what is the reason for this?
- S. Radhakrishnan** No, it does not deteriorate. Especially this quarter, for example, as I told that this too would have been higher which is why it is as little different. But otherwise, at least this year these margins have been driven by 2-3 factors. One is quantum of Indore expenditure which has been booked. Number two, as I said the product mix itself which has probably in the last two quarters, particularly the ARV tender business which was there was booked. So I think these are a couple of factors which may have affected and little bit skewed the sequential number.
- Sonal Gupta** Thank you so much.
- Moderator** Thank you. Our next question is from the line of Jesal Shah from JM Financial, please go ahead.

- Krishnaprasad** This is Krishnaprasad here. Can you provide us with a breakup of your exports in terms of how much of it was in ARV and how much was for inhalers business? And also if you could provide us with a region-wise split of your exports?
- S. Radhakrishnan** Roughly if you ask me for the quarter, about 30% odd is from the ARV and 10% to 12% is from the respiratory, as far as the breakup is concerned. And region-wise, Africa for the quarter would be highest which is about 40% of our total sales because of the tender business and Europe would be 16%, North America 13% and Latin America is at about 10%. That is the broad breakup.
- Krishnaprasad** In terms of your inhaler business last time you had talked about launching Seroflo in CIS and also you had previously launched this product in South Africa. If you could share with us whether the launch has happened in CIS and how has the performance in South Africa been?
- S. Radhakrishnan** As far as CIS is concerned in Russia this has already been launched and it is in the marketplace and the first month has been very encouraging. As far as South Africa is concerned, the launch has happened but I think it is yet to pick up in terms of giving a significant contribution to the top line.
- Krishnaprasad** For this quarter how much was the ARV sales, the tender business, and how much do you expect for the next year?
- S. Radhakrishnan** See, roughly 30% as I told you of our total formulation is coming from ARV. They are three types of ARV business, one is the tender business, one is ARV in the private market which is fairly okay, similarly ARV for PEPFAR, etc., which is better. So tender business I think would be in about 40% or 50% of the total ARV business which is where the margins are squeezed. So roughly in all the ARV business we are 30% to 35% of which 50% to 60% is tender business which is low-margin.
- Krishnaprasad** Also we have seen the export API grow significantly this quarter. Any specific reason there?
- S. Radhakrishnan** One or two specific products which has helped us to do it.
- Krishnaprasad** And would we see this going forward?
- S. Radhakrishnan** I think, yes, because that is something which we think is promising for the next year as well. So that is something we are very hopeful about.
- Krishnaprasad** Also if you can share your balance sheet information in terms of how much is the CapEx in the receivables, gross debt and cash?
- S. Radhakrishnan** CapEx for the current year is about 750 crores, number one. Number two, as far as the receivables are concerned if you put together domestic & export is 140 Crores.
- Krishnaprasad** So the average is what, do you have a number there?

S. Radhakrishnan 75 is the average.

Krishnaprasad And the gross debt in cash?

S. Radhakrishnan Gross debt is about 350 crores, cash is about 200 to 300 crores, I'm not sure of the exact number, that is roughly the range.

Krishnaprasad Thank you.

Moderator Thank you. Our next question is from the line of Balaji Prasad from Goldman Sachs, please go ahead.

Baneesh Hi this is Baneesh on for Balaji Prasad. I had a couple of quick questions. One, you said that Indore SEZ has received full approvals. So can we expect it to be online probably started off production from this quarter onwards?

S. Radhakrishnan Yeah, in fact I shared with the earlier analyst that except for USFDA's , approvals from all major regulatory markets have been received number one. Number two, starting this quarter I think overall we would expect about 10% of our total income be coming from Indore. So that is how we look at it. So therefore we believe that Indore should break even or do little better in this quarter than in the previous year because obviously it was waiting for approvals.

Baneesh So, if I may get it right, from this quarter onwards the margins would be-, I think you mentioned initially you are expecting about 18% to 20% of operating margins. So the operating margin should start to see an uptake trend going into the next quarter.

S. Radhakrishnan That is what we are saying.

Baneesh I just wanted to ask given that you are hiring people on your domestic side, any other renewed strategy focus which you may have implemented to get on, on your domestic franchise given the renewed focus of your peers also?

S. Radhakrishnan As I told earlier for one of the questions, the answer was that basically we are looking at newer therapies. We are looking at onco; we are looking at neuro psychiatry etc. for renewed focus, which is why we are looking at more people. We are also looking at really expanding the reach because as Dr. Hamied mentioned in the TV that we feel India has no less an emerging market and the huge potential in scope which you can tap. And even our product range and given our leadership in many therapies, I think we have a huge scope and this can be achieved by the large number of the field force that we have. So our whole focus is penetration and that I think will pay dividend. In fact this quarter has been already seeing the uptrend, one quarter which has just gone by. Overall we believe that domestic pharma will become major focus growth area for us because it will become about 50% of our total sale.

Baneesh Thank you so much.

Moderator Thank you. Our next question is from the line of Saion Mukherjee from Nomura Securities. Please go ahead.

Saion Mukherjee Are you giving guidance in terms of growth or margins for the next year?

S. Radhakrishnan Roughly we would think that we should grow our top line on a high base by at least 10% to 12% is what we think at this stage can happen. Bottom line should be sufficiently better because some of the Indore issues should not be there and I think overall, as I told you, the operating margin, we are targeting about 20%. That should give you some idea of what we are targeting.

Saion Mukherjee For Indore SEZ you shared the numbers for Quarter 4, 60 crore top-line and expense around 90 crores. Will it be possible for you to share the same number for the full year FY 11?

S. Radhakrishnan Full-year FY 11, I think overall will be about 110 crores negative because that would be the rough net number.

Saion Mukherjee Sales minus expense minus 110 crores?

S. Radhakrishnan That is right.

Saion Mukherjee You mentioned about the sales breakup geography-wise , 40% Africa, 16% Europe for the quarter that you gave. Is this percentage of overall sales?

S. Radhakrishnan It is percentage of formulation exports , sorry total exports.

Saion Mukherjee Its API plus formulation export?

S. Radhakrishnan Yes, correct.

Saion Mukherjee Do you have the number for full-year FY 11, similar breakup Africa, Europe, North America?

S. Radhakrishnan I think it is not too different because it is some trend which is normally maintained, so I do not think it is different.

Saion Mukherjee Any CapEx guidance for FY 12?

S. Radhakrishnan There are 2-3 projects in the offing which overall will be about 500 crores of increase. Basically as I told you these are API plants because we have not really expanded on API facility. So we are coming out with a facility in Patalganga, Bangalore, and Kurkumbh and that is what will constitute the increase for next year.

Saion Mukherjee What is the sense from the domestic market that you are getting for Cipla? Do you expect to grow ahead of the market? How do you see the growth panning out for Cipla in the domestic formulation?

- S. Radhakrishnan** Obviously as I told that this is a huge business and we are putting a lot of efforts and we are focusing. As I said, India is an emerging market and we think that there is a large scope to achieve and we are getting some positive trends in the last quarter itself in terms of being a little higher than the industry. Going forward also I think there is a good scope for increasing there, particularly we are adding numbers, we are adding therapies, we are adding our reach. So all these I think really speaks of us well for what we can do here.
- Saion Mukherjee** Thanks a lot sir.
- Moderator** Thank you. Our next question is from the line of Amit Shah from Motilal Oswal Securities Limited. Please go ahead.
- Amit Shah** Just a couple of questions, one on the other operating income. We have seen a drop of around 20% to 21% for the full-year FY11. So just want to understand for FY12-13 going forward do you expect to revert back to the earlier other operating income level of around 250-300 cores?
- S. Radhakrishnan** No, we do not because it is like this. These incomes were basically on milestone payment received when we were in development stage for products. These projects have really gone into the top line and therefore going forward I think that technology fees is something which will be more.
- Amit Shah** If I see in this particular quarter, 4th Quarter, as there is a significant increase in API compared to the normalize revenue rates for the previous quarters; also the same is true for the formulation exports. So going forward, do we take this quarter as a kind of best level revenue for formulation exports or there is some one-off element in this quarters formulation exports?
- S. Radhakrishnan** See, as I said, ARV tender is something which is one-off depends on tender to tender otherwise it is consistent.
- Amit Shah** Thanks a lot. That is all from my side.
- Moderator** Our next question is from the line of Nitin Agarwal from IDFC Securities. Please go ahead.
- Nitin Agarwal** My question is on the US business. The US business you mentioned is about 14-15% of your overall export business which is much smaller compared to most of our Indian peers. So, do we see this situation changing because even for Indore SEZ you said right now you do not have an US FDA approval for that so the facility really will not be contributing to US business per se? So how do you see the US business really playing out for you over the next couple of years given the fact that we are probably in the golden period as far as patent expiries in US is really concerned?
- S. Radhakrishnan** Nitin, actually apart from Indore we have 11 facilities which are US FDA approved so it is not as though we are short of facilities for US which is why we are not looking at the moment at Indore because I think we have sufficient capacities for US market for all those firms, number one. Number two, obviously our pipeline with partners as well as our strategy, what we can

maximize there. So, I think in terms of the partners and the projects we are offering and also in terms of what we can do with some of our own ANDAs or what we can do as a strategy for the future, I think we are very much focused on that and obviously we understand that US is also something which is a large contributor for Cipla and that focus is going to be on.

Nitin Agarwal But qualitatively is US going to be much larger driver for growth than it's been for the last couple of years in the next couple of years going forward for us?

S. Radhakrishnan See, US is something where the gestation, the uncertainties, everything is so different so you cannot really say that yes it is going to be. Obviously the effort in terms of strategy and focus is going to be there. There is going to be regulatory legal patent issues which ultimately will decide on how well or not otherwise we really do in the US but obviously these are something which are not certain but our focus and strategy I think is very much in place.

Nitin Agarwal In terms of your partnerships which are there, are there certain products or do you see some large opportunities that you see crystallizing for you where there will be a high degree of certainty which the company has at this point of time?

S. Radhakrishnan Absolutely, that is what I am saying. There are very good opportunities in the offering but obviously these are depending on the litigation in another states.

Nitin Agarwal Lastly, this is a standalone number that you have reported. So are the consolidated numbers going to be much different because typically our standalone consolidated numbers are relatively kind of similar in historical years?

S. Radhakrishnan I think there will be about 4% to 5% incremental at the PAT level.

Nitin Agarwal Thank you very much.

Moderator Thank you. Ladies and gentlemen we will take the last question from the line of Basavraj Shetty from Mirae Assets. Please go ahead.

Basavraj Shetty Actually wanted to know your European filings are around 400 or so you mentioned, are all these launched or this will be launched from Indore?

S. Radhakrishnan Some of them are launched, some of them commercialized, some of them not commercialized for commercial reasons and in the offering there will be about 50 odd products which is in the pipeline. So it is a mix of all.

Basavraj Shetty So around 50 will be launched from Indore?

S. Radhakrishnan No, I am saying 50 in the pipeline, now what will be launched from Indore would be between Indore Facility, Goa Facility. Not everything will be in Indore. It could be the mix of Indore and Goa.

Basavraj Shetty So can you give some color in terms of how many have been launched broadly, at least percentage?

S. Radhakrishnan About 80 to 90 products would have been commercialized roughly.

Basavraj Shetty So around 300 or so could be launched.

S. Radhakrishnan No, of this some of them may not be commercially viable, not every product registered is commercially viable because of the prices.

Basavraj Shetty How many could be launched in that case in the next couple of years?

S. Radhakrishnan In the couple of years about 50 to 60 are in the pipeline, so all of them, we assume would be focused to be launched.

Basavraj Shetty Right and for next year?

S. Radhakrishnan I am talking of the next two years.

Basavraj Shetty In terms of your tender business for this year how much was it?

S. Radhakrishnan Out of 30% of the ARV business about roughly 40% to 50% of the ARV business is tender business.

Basavraj Shetty Thank you.

Moderator Thank you. I would now like to hand the floor over to Mr. Anmol Ganju for closing comments.

Anmol Ganju Thank you everyone for joining us on this call, especially the Cipla management. Thank you Ajay, thank you Radha.

Moderator On behalf of Kotak Securities that concludes this conference call. Thank you for joining us and you may now disconnect your lines.