



“Cipla Limited Conference Call”

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**MODERATORS: MR. HEMANT BAKHRU
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MR. S. RADHAKRISHNAN**

Farah: Ladies and gentlemen good evening and welcome to the Cipla conference call, hosted by CLSA India Limited. All participants' lines will be in the listen-only mode and the conference is expected to last for duration of 30 minutes. There will be an opportunity for you to ask questions at the end of today's presentation. If you need any assistance during the conference call you may signal an operator by pressing "*" and "0" on your touchtone telephone. Please note that this conference is being recorded. At this time I would like to hand the conference over to Mr. Hemant Bakhru from CLSA India Limited. Thank you and over to you, Sir.

Hemant Bakhru: Thanks Farah. I am Hemant from CLSA. Good evening everyone. We have Mr. S. Radhakrishnan and Mr. Ajay Luharuka from Cipla. I would like to hand over the call to them for initial comments on third quarter results and possibly on the news for the quarter following which we will begin the Q&A session. Over to you Ajay.

Ajay Luharuka: Thank you Hemant. Good evening to all of you and welcome to the Cipla call for the third quarter results. Like Hemant mentioned we have on the call our CFO Mr. S. Radhakrishnan. We hope you have received the third quarter results and the performance highlights available on the website. We would like to give you an overview of the financials which can be followed by a question and answer session. During the quarter income from operations of about Rs.1450 Crores grew by more than 7%, operating margins of Rs.380 Crores increased by about 29% and profit after tax of about Rs.290 Crores is up by 30%. Domestic sales for the quarter grew by about 14%, exports of APIs and others grew by more than 10% whereas formulations have declined by about 2.5%. The lower growth in formulation exports is primarily due to the lower sales of anti-retroviral products particularly in the case of tender business. The reduction in volume is mainly due to the conscious policy of the company to be more cost effective in such type of business. As a result while there has been adverse impact on turnover, the margins have improved. Material cost as a percentage to income from operations has marginally decreased during the quarter due to changes in product mix and operating margins have improved mainly due to a decline in other expenditures such as selling expense and foreign exchange loss. There has been a decrease of about 8% in other expenditures of about Rs.30 Crores mainly on account of lower foreign exchange loss, which was Rs.24 Crores this quarter as compared to Rs.43 Crores on a year-on-year basis as well as decrease in selling expenses of about Rs. 27 Crores. The foreign exchange loss is mainly on account of debtors which are partially unhedged. Interest costs had decreased by about Rs.7 Crores due to repayment of short term working capital loans as well as fixed deposits availed by the Company.

As on December 31, 2009 the outstanding amount of forward contract is about \$120 million and the Company continues to follow the practice of hedging all loans and covering net export billing on a month-to-month basis. The total capital expenditure during the first nine months of the current financial year is about Rs.445 Crores. This is mainly towards the Indore project and upgradation of other facilities.

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.

Farah: Thank you, very much Sir. We will now begin with the question and answer session. The first question comes from the line of Bino Pathiparampil from IIFL. Please go ahead.

Bino Pathiparampil: Congrats on the set of numbers. Just a couple of questions on the capacities that are coming up. Where do we have these capacities coming over the next one year or so, the new capacities?

S Radhakrishnan: Basically Binu we are going to setup the Indore, will be commissioned early next year and that would be basically an SEZ project mainly for exports where the facility will include manufacture of aerosols, liquid orals, PFS, etc., so that will be a huge capacity which comes in next year and early part of next year which will substantially have a lot of capacity re formulation. The API as I told you we are looking at two factories which will come over the next one to two years, one at probably Patalganga and the other one at Bangalore. Now these are the capacities which are being enhanced in the near future.

Bino Pathiparampil: And the existing capacities especially the Sikkim and the Goa plant what kind of capacity utilization are they running at?

S Radhakrishnan: Sikkim is now substantially occupied so overall if you take the company as a whole the capacity would be utilized currently, without considering Indore, at 65% to 70%.

Bino Pathiparampil: Right. And just one more question regarding inhalers; earlier I heard on CNBC, Mr. Lulla talking about launched inhalers in Europe. You already have a few approvals in the few countries in the Europe. Have you already launched there or what is the play in launching there?

S Radhakrishnan: We have already launched some of the earlier products, but currently we have just launched or launching Salbutamol, which is expected to be billed in the fourth quarter, otherwise we already have Budesonide in Portugal and we have Salbutamol MDI in

Denmark and Budesonide in Germany. So this has been done earlier but currently we are just launching Salbutamol in UK.

Bino Pathiparampil: Okay right. I will join back in the queue. Thank you.

Farah: The next question comes from the line of Saion Mukherjee from Nomura Securities. Please go ahead.

Saion Mukherjee: What is the Capex for nine months so far and how much are you going to spend this year and Capex in the next year?

S Radhakrishnan: So far we have spent about Rs. 445-450 Crores in CapEx in the nine months essentially the bulk is for Indore, which is about 260 Crores, rest is in the existing plant which are modernized and upgraded. We hope to end this year in the region of Rs 600 Crores Capex for the current year.

Saion Mukherjee: And for the next year?

S Radhakrishnan: Going forward we may be in the region of another 500 Crores is what is needed and this is particularly as I told you there are two bulk factory that we are looking at in the next year, and an R&D facility in Vikhroli, is going to be completed. All that is a capital expenditure of about 500 Crores.

Saion Mukherjee: What kind of reduction you are seeing in the ARV business year-on-year?

S Radhakrishnan: Roughly about 10% in the topline is what we have seen year-on-year.

Saion Mukherjee: So 10% drop in the ARV business?

S Radhakrishnan: Yes, in the ARV segment.

Saion Mukherjee: Okay. And what is the receivable position and debt on cash on books? The receivable debt outstanding and cash position as of December?

S Radhakrishnan: The receivables is roughly down from 200 days outstanding to six months. 180 days is the rough receivable in the export front. In the domestic, the number of days should be above 25 to 30 days. That is the general receivable in terms of number of days and the cash surplus currently would be about Rs.250 Crores, which is available.

Saion Mukherjee: Okay, thanks a lot.

Farah: Thank you. The next question comes from the line of Sonal Gupta from UBS Securities. Please go ahead.

Sonal Gupta: Good evening. Just had a couple of questions; I understand the ARV business, you say it has declined say about 10%, but overall what is its historical growth rate, the exports seemed to have slowed down considerably so any other reasons for that?

S Radhakrishnan: Yes, one is last time, if you remember we had a problem in the availability of gas which had little bit affected our inhaler business, but that has sort of made up, but not for this quarter, but in overall basis that deficit still remains. That is number one. So that segment has therefore not grown as it would have normally grown in Cipla because of that gas shortage for some period in the first two quarters. ARVs yes, it has made a 10% decline and ARV was about 20% or 25% of the total formulations business, so that has declined. So these two are the major contributing factors why we are not able to grow. The other factor, which of course will also be a small factor in terms of volume is the overall appreciation of Rupee as compared to the last year, which has affected volume. That would be my analysis of why we have not done as well as we normally do for the first nine months.

Sonal Gupta: Even if I adjust for the currency, I think, in dollar terms also your growth is pretty slow at least on the formulation side.

S Radhakrishnan: That is why I said, two main reasons for formulation would be the ARV for this quarter as well as on an overall basis the inhaler business.

Sonal Gupta: Given that the SEZ facility comes up from April next year, what should we expect, obviously for tax reason it would make sense to start from next year, but do we expect a sharp ramp up once that is online or will it be a gradual process in terms of the exports. Are there some exports which you currently have the orders, but do you want to start it say six or three months down the line?

S Radhakrishnan: Yes, there are certain dosage forms which we can straightaway enhance because of Indore coming in which otherwise is not available because of capacity, so that will help in the volume, but overall if you look at Indore I think Indore will gradually happen because all the regulatory approvals will take place in the next one to two years. By that time Indore will be fully commercialized, so for Indore per se will not be a ramp up because it has to have the gradual approval process that happens which will take about one or two years.

Sonal Gupta: So which regulators have been approved off the major ones?

S Radhakrishnan: The approval process will start when the plant is commissioned. So that will start from virtually once we start. So in the next one year we imagine a lot of regulatory approvals initiated in place.

Sonal Gupta: Okay and Sir, could shed some light on the margin? Is the margin improvement primarily because of the ARV mixed thing or is it the product mix of what the other things you are supplying, also changing which is helping in terms of marketing?

S Radhakrishnan: You are right. It is both. One is obviously the product mix, including ARV which is helpful, it has helped us to improve the margins which is consistently now over 25 from around 20 previous period and obviously we bought certain efficiency in procurement and purchases which has helped us in terms of reducing the material cost overall in the nine months period. So these two factors have definitely helped us and also this quarter lot of this expenditure in terms of selling expenditure has been reduced which again has been you know, helpful in increasing the overall operating margins.

Sonal Gupta: Right if you could explain the reason for the decline in selling expenditure?

S Radhakrishnan: Obviously our OTC brand's expenditure this quarter was not there as in the past previous quarters which has substantially reduced, one factor and generally the selling cost in the export particularly has come down.

Sonal Gupta: Okay, Sir. Thanks a lot. I will get back in the queue.

Farah: Thank you, Mr. Gupta. The next question comes from the line of Girish Bakhru from JM Financial. Please go ahead.

Jesal: This is Jesal. Just a question on your export business, typically about 35% of your exports comes from let us say Africa and then you have about 17% coming from let us say Europe and South America and a small percent like 10% coming from US. So can you give us some idea about the first nine months, how is the situation with respect to these markets. Are all the markets not growing or are there some markets which are growing and some which are declining which is why you have overall say flattish formulation business?

S Radhakrishnan: Basically Africa had this problem, because ARVs are typically sold to Africa, so that has declined almost by about 20% and the other area which is not growing as I told you before is the inhaler business is Latin America, so these two markets have not grown, otherwise rest of the markets have shown growth for us, Australia has been growing, Middle East has been little flat of course, America has been fine, so basically two major markets of ours is the one because of ARVs and the other because of overall sort of

plateauing of ARV business because of the first six months. So that is the position is the geographical lone wise exports.

Jesal: Thanks and the second question is on the inhaler business, you mentioned that you have launched Budesonide in Germany and Portugal and you are currently in the process of launching Salbutamol in UK. Can you give us some idea for Budesonide, which has been launched? What kind of market share would you have captured? What kind of numbers are they really contributing?

S Radhakrishnan: Number wise I may not be able to give you a specific feel of what is the value but I can tell you the overall market of inhalers is about 1800 million euros for all the inhalers and particularly the combination products and that is what will give us the volume which we expect will happen probably sometime next year.

Jesal: No, sorry, what I meant was this Budesonide what you have already launched would you have some idea about you know what kind of market share you would have captured, like in India obviously you have significant share like 65%, 70% may be more – so how is it in lets say in Europe and Germany. Is the competition intense, the same as in India or is it different?

S Radhakrishnan: Budesonide is approved in Germany, but we are yet to market in Germany because of certain legal issues. Salbutamol what I said is being launched in UK this quarter which is when we will know the market share once we have that in place.

Jesal: Okay and how big is this market in UK?

S Radhakrishnan: Which one?

Jesal: Salbutamol.

S Radhakrishnan: I think overall it would be in the region of about 300-400 million pounds.

Jesal: Okay. Fine and just one last thing, can you give us the receivables number, it would be very helpful?

S Radhakrishnan: I thought I had given the numbers.

Jesal: You had given in terms of number of days, but if you have some absolute rupees, million, billion Crores whatever, I mean that will be helpful?

S Radhakrishnan: You can convert it. I don't have it right on hand.

- Jesal:** Thanks.
- Farah:** Thank you, Mr. Bakhru. The next question comes from the line of Rajesh Vora from ICICI Securities. Please go ahead.
- Rajesh Vora:** Good evening gentlemen. Mr. Lulla on TV was talking about lowering the guidance for the ongoing year from 10%-15% to 8%-10%, so is that what we take for the year?
- S Radhakrishnan:** I think it would be fair to take 8%-10%.
- Rajesh Vora:** 8%-10% for the year and anything you are talking about FY'11?
- S Radhakrishnan:** What Mr. Lulla said was we would try to maintain the same guidance for the next year.
- Rajesh Vora:** So we take that number as 8%-10% for FY11 as well?
- S Radhakrishnan:** I think so.
- Rajesh Vora:** Okay and secondly on ARV business, the conscious decision of walking away from the ARV tender business does that mean the departure from the earlier strategy or is it tactical only for the quarter?
- S Radhakrishnan:** I think Cipla's commitment to make this available at reasonable prices continuously remain. What we are saying is that it cannot be at a loss to the company. So that strategy is something which we are looking at and particularly with the movement of appreciation of Rupee etc., wherever we find that it is not profitable, probably at a little bit or in a loss making basis we are not doing, but I do not think there is any departure from the strategy.
- Rajesh Vora:** Okay. So if there is a cut off margin level, if you get, you would be happy?
- S Radhakrishnan:** Absolutely, because substantially even today it has degrown by 10%. Obviously we are still very much in the business and lot more combination products are happening so that all is happening, but we are more conscious on the margin front, which is showing in fact.
- Rajesh Vora:** So for the quarter and for the year-to-date what is the portion ARV total business to the dosage form exports roughly?
- S Radhakrishnan:** Roughly about 20%.
- Rajesh Vora:** 20% both for nine months and third quarter?

- S Radhakrishnan:** I think I would imagine so. It won't be too different.
- Rajesh Vora:** Okay. And last question on the Indore SEZ will also have inhaler capacity?
- S Radhakrishnan:** Yes, of course.
- Rajesh Vora:** What is the capacity in terms of million PCS as of now for inhalers for the overall company?
- S Radhakrishnan:** Rajesh can I mail you?
- Rajesh Vora:** No problem. If you could, Ajay you could give me later on. No problem.
- S Radhakrishnan:** Certainly Rajesh.
- Rajesh Vora:** Not a problem. Thanks. All the best.
- Farah:** Thank you, Mr. Vora. The next question comes from the line of Manoj Garg from Emkay Global. Please go ahead.
- Manoj Garg:** Sir you just said that our total potential market for aerosol is 1800 million. Are you talking about ex-US market or overall global market?
- S Radhakrishnan:** We are talking of European market only.
- Manoj Garg:** and would you like to give us some update in terms of regulatory process for combi inhalers?
- S Radhakrishnan:** I think Mr. Lulla mentioned it is more likely to be towards next year.
- Manoj Garg:** And that would be a Pan-European launch or starting with one or two?
- S Radhakrishnan:** That will gradually happen because the good part on the regulatory is when one country approves then in the whole through Europe it becomes more easy.
- Manoj Garg:** The kind of price competition, which we are seeing in the ARV are we seeing the similar kind of price in the domestic market also in terms of ARV therapy?
- S Radhakrishnan:** ARV, yes in the domestic market the scene has completely changed because it is available free of cost through Nato and other places. So there is a complete change in the area market and domestic as well.

- Manoj Garg:** Okay. Thanks. That is all from my side.
- Farah:** Thank you, Mr. Garg. The next question comes from the line of Puneet Adhia from MP Advisors. Please go ahead.
- Puneet Adhia:** This technology fees is increasing quarter-on-quarter since last three quarters, so can we take the same run rate of grow forward?
- S Radhakrishnan:** I think this is very difficult to predict for it depends on what kind of billings we have done, but if you notice next quarter is a huge base last year, so I am not sure how much for the last quarter, but I think on an average basis we should maintain this for atleast this year in terms of technology.
- Puneet Adhia:** And next year?
- S Radhakrishnan:** See it is like this, in technology know-how what happens is once the products culminates into business, so lot of such technology income which is based on our milestone payments are now getting commercialized, so that therefore there will be some reduction in those products, but equally some of the other projects we have taken get the increase. So we would imagine even next year we are hoping that this kind of trend should continue.
- Puneet Adhia:** And on the margin front for next year, similar margins will be there?
- S Radhakrishnan:** I think yes, we are aiming to get these margins particularly, with now Indore coming in we will get more efficiencies there, although there will be little bit of cost impact there because, by the time it gradually you know production happens there will be some time before the costs are amortized, but I would imagine on the operating front we should be able to consistently maintain some quarters this kind of margin, going forward we believe we can do that as well.
- Puneet Adhia:** This is even if the Rupee will be around 42-43 levels?
- S Radhakrishnan:** No. Rupee at 42-43 could change the picture, because it will have an impact, but the net impact will not be as much because while we will probably have a little bit of a reduction in the export margins until we do this change in pricing, imports will be that much cheaper for us, so overall it could have some impact if Rupee goes to 42 levels.
- Puneet Adhia:** Thanks a lot.

- Farah:** Thank you. The next question comes from the line of Neelkant Mishra from Credit Suisse. Please go ahead.
- Neelkant Mishra:** Hi, congratulations on great numbers. My question is on the UK market inhaler, are you approaching it via the private market or approaching it rather primary care trust. Basically should we expect a very gradual increase in market share or...?
- S Radhakrishnan:** What we are doing first off all we are in the regulatory stage where we are getting the regulatory approvals in place, then what we are doing we are tying up with big pharma companies to market to market these products through the private market. So that is what we are doing.
- Neelkant Mishra:** So it would be a marketed product where it will be branded, so it will have to be promoted to doctors and then it will be a steady gain in market share.
- S Radhakrishnan:** The marketing will be done by some of these companies.
- Neelkant Mishra:** So it would not be wise to say that primary care trusts where they give instructions to doctors and then automatically you have a very large jump in volumes. That does not happen?
- S Radhakrishnan:** It can happen that way too. But what I am trying to say is the marketing portion will be handled by these big pharmas based on their own network and supply chain.
- Neelkant Mishra:** Sir, how many of these partners do we have right now?
- S Radhakrishnan:** We have at least about five to six partners in these regions.
- Neelkant Mishra:** That is in the UK?
- S Radhakrishnan:** About four to five partners we have all over Europe. In UK we have one partner of course, but I am saying the whole of Europe we have at least four to five partners.
- Neelkant Mishra:** I understood and coming to the domestic market, what kind of growths should we be building in going forward some of the sales force additions that you had will they lead to jump in volumes sometime soon?
- S Radhakrishnan:** We have not had any addition, it is additions of mainly last year, but this quarter overall we have done 14% this quarter which is enough and which is good and the overall for the nine months is 11% going forward we believe next three months can be equally good, so in the domestic front, I think we will end up somewhere in the region of 12%

for the year and going forward I think we can maintain that kind of growth in the domestic sector.

Neelkant Mishra: That is the market growth you expect to grow along with it?

S Radhakrishnan: Market growth is little lower overall.

Neelkant Mishra: Okay. Thanks very much.

Farah: Thank you, Mr. Mishra. The next question comes from the line of Abhay Shanbhag from Deutsche bank. Please go ahead.

Abhay Shanbhag: Couple of questions; number one when you talked about the market potential of \$1800 million in Europe, how much of that market are you addressing right now and a year from now how much of that market you will be addressing?

S Radhakrishnan: Substantially these markets would be more on the combination products, Abhay, so which will be at least 60% to 70% will be addressing once some of these combinations are approved.

Abhay Shanbhag: How long will it take? When we are saying in a year or two years will we able to address most of our market or will it take longer for you to address that market?

S Radhakrishnan: The MDI portion will be in the first stage and the DPI will come later, so the whole addressing will happen in the next two to three years.

Abhay Shanbhag: Okay, so in about three years time you will have the ability to address the entire \$1800 million market?

S Radhakrishnan: Yes.

Abhay Shanbhag: And in terms of what is the agreement that you have with your partners as you have indicated it is branded products, is it a profit share or how does it work in terms of marketing arrangement with your partner?

S Radhakrishnan: See I cannot give you specific information, but normally the way it works is that it is supply for the products and the profit share at some stage. It has both components.

Abhay Shanbhag: And you said one of the companies whom you would be having the front end tie up is the TEVA, while IVAX has its own supplies, so will you be supplying the same products which IVAX has in the market or would it be a different sort of products?

- S Radhakrishnan:** Obviously, different set of products.
- Abhay Shanbhag:** Any timelines in terms of when you would be looking for US market now that Europe seems to be under control in terms of getting approvals?
- S Radhakrishnan:** I do not think we are foreseeing in the next two years.
- Abhay Shanbhag:** But are you working on it, are any filings happening for US or going forward to say next six months or a year or will it take longer?
- S Radhakrishnan:** The regulatory process has already started but we would imagine that it would take a couple of years by the time these are formularized.
- Abhay Shanbhag:** Okay, you have been having a lot of CapEx in the last couple of years, resulting in our asset turn being low and now that you are looking at reducing focus on low margin products, would it be fair to say that for the next three to four years you may not require CapEx?
- S. Radhakrishnan:** Only thing that I told you a little earlier we are not really looking at too many expansions, because we have substantially built it up. Where we need to still we are doing the process of the API, which is going to happen next year. See after that I think there will be some optimization in the next couple of years at least for us to built on and work and utilize our capacities. This I am not including of course the biotech segment where you know if something happens there, there will be additional Capex there.
- Abhay Shanbhag:** And one more question, in terms of exports, as you said you are slowly getting out of the low margin anti-aids, do we see exports stagnating for another three or four quarters or it has reached a certain level where it can start showing growth again?
- S. Radhakrishnan:** It is like this. I do not think to reach a stage is going to stagnate, it will show growth, probably next quarter itself should show growth overall, but the growth would also depend upon on what kind of Rupee levels are there and such things but overall I do not think we should see stagnation on this.
- Abhay Shanbhag:** How much is the hedging now, which you have done as of say December 31?
- S. Radhakrishnan:** 120 million is what Ajay mentioned during the call, which is what we are doing now is we are hedging the billing for the last three four months so that we are protected. What was open was the receivables part of it and the appreciation of the Rupee has lead to a little bit of a decline there, but otherwise at the moment 120 million is what we have covered, which is part of the outstanding of net about 300 million.

- Abhay Shanbhag:** Okay fine. Thank you.
- Farah:** Thank you. The next question comes from the line of Nitin Agrawal from IDFC SSKI. Please go ahead.
- Nitin Agarwal:** Good evening Sir. I wanted to check on the inhalers bit when you look are we away from the US and the European markets, how much do you think as an opportunity have you really tapped or is there still a lot of opportunity that you see in those markets where through partnerships or through alliances you can still make a substantial impact on your India business?
- S. Radhakrishnan:** That is on because outside this the markets are substantial in each year because we are gaining market share in that segment outside the regulatory segment, but as I told you in the first two quarters we lost a little bit of business in Latin America particularly because of change over from CFC-free to CFC. But overall I think we are growing each of these markets as we are outside Europe and US and that will continue to happen.
- Nitin Agarwal:** I was just curious to know the potential which is there, addressable markets which are there outside of US and Europe for the inhalers?
- S. Radhakrishnan:** I would not know, but don't forget we are probably the largest or the second largest producer of these kinds of drugs world over, so I think we have the potential to turn and capture market share for each of these countries.
- Nitin Agarwal:** But in terms of coverage would it be fair to say that there is still a lot of geographies where you are not present and there is a scope for you through alliance with partnerships we enter a lot more of these geographies with these products?
- S. Radhakrishnan:** Not fair to say that we will expand the geographies which we have already initiated and have in the market, because the market is growing there and our share is still low, so I think we have the potential to grow in each of these markets that we are already present.
- Nitin Agarwal:** Okay. Thank you, very much.
- Farah:** Thank you. The next question comes from the line of Sonal Gupta from UBS Securities. Please go ahead.
- Sonal Gupta:** Thanks. Just a followup question on the technology fees is this fee only linked to US and EU market or is it also for the emerging markets like Brazil, etc?

- S. Radhakrishnan:** This is substantially linked, Sonal to US and Europe.
- Sonal Gupta:** Okay, very minimal for emerging markets?
- S. Radhakrishnan:** That is right.
- Sonal Gupta:** Okay. Thank you.
- Farah:** Thank you. Ladies and gentlemen, that was the last question. I would now like to hand the conference over to Mr. Hemant Bakhru for closing comments.
- Hemant Bakhru:** Thanks. I would like to thank Mr. Radhakrishnan and Ajay for their time.
- S. Radhakrishnan:** Hemant thank you for hosting this for us.
- Hemant Bakhru:** Thanks. Bye.
- Farah:** Thank you very much. On behalf of CLSA India Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines.