“Cipla Q4 FY16 Earnings Conference Call”

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MANAGEMENT: **MR. UMANG VOHRA (GLOBAL CHIEF OPERATING OFFICER), CIPLA**
MR. ANANT ATAL (HEAD-INVESTOR RELATIONS), CIPLA

MODERATOR: **MR. CHIRAG TALATI (RESEARCH ANALYST) – KOTAK INSTITUTIONAL EQUITIES**

Moderator: Ladies and Gentlemen, Good Day and Welcome to Cipla Q4 FY16 Earnings Conference Call hosted by Kotak Securities Limited. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' 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 Team for giving us the opportunity to host this call. From Cipla we have with us today Mr. Anant Atal – Head, Investor Relations and Mr. Umang Vohra – Global Chief Operating Officer.

I will now hand over the call to the Cipla Management Team for their remarks. Over to you, sir.

Umang Vohra: Good evening to all of you, this is Umang Vohra, we welcome you to our 4th Quarter and full year 2015-16 earnings call. I hope you have received the investor presentation that we have posted on our website. Our results this quarter include several one-off charges that we will cover in the commentary in detail.

As we review our strategy and plans I would like to highlight some key priorities critical to delivering the next phase of growth. Our first priority is to enhance the scale of our US direct to market presence through a seamless integration of our own structure with InvaGen and Exelan and the increasing momentum of launches from our internal pipeline. As we scale our US business this year, we will target a launch of almost 5-7 products through the InvaGen pipeline and 8-10 products from Cipla's pipeline including some limited competition area opportunities. We expect to file 20 to 25 ANDAs in 2016-17 including some respiratory and oncology filings. In parallel, we will continue to build on our successful partnerships for launch of first-to-market and differentiated generics such as Nexium and Pulmicort. Contribution of the US business post acquisitions is approximately 20% of Cipla's sales and over the medium-term contribution from the US business should only increase further.

Our second priority will be to enhance our leadership position in key emerging markets such as India, South Africa and some of the recently established front-ends. Our India growth plans target above-market rate of growth with focus on in-licensing and new product introductions. In South Africa we look to retain momentum from this year and continue to focus on building our private market share. For the international emerging markets, we are proactively simplifying our business, rationalizing markets where necessary and ensuring focus only on high growth markets where we hold a leadership position. We continue to evolve our business model in Europe with the intention of balancing our advantage portfolio with the best commercial and profit options for our business.

We are choosing to and continue to invest in our pipeline and over 80% of our top 50 projects are on track with respect to filing timelines. In addition to the ramp up of filing intensity in the US, we have made substantial progress with our in-house biosimilars pipeline. Bevacizumab, our first product has completed proof-of-concept studies, demonstrating biosimilarity and animal efficacy, and recently received approval for a first human trial. A second product is scheduled to enter development by quarter two of FY17. We expect significant cost of goods reduction as well as plant investments 60% lower than our original estimates. We are also targeting some specialty portfolio products for development. This will drive our R&D spend to 8%+ in the steady state. Overall, our general guidance for the medium-term is mid-teens top-line growth with absolute base business EBITDA growth of between 15% to 20%.

I will now request Anant to walk you through some of the key financial highlights for this quarter.

Anant Atal: Thank you, Umang. Our overall income from operations stands at Rs.3,267 crores this quarter registering a year-on-year growth of 5.6%. Domestic sales gained strong momentum and grew 15.9% this quarter closing at Rs.1,258 crores. Our sales outside India were relatively muted and grew at 2.8% with absolute sales closing at Rs.1,948 crores. This quarter our International, South Africa and API business has declined relative to Q4 2014-15. You may recollect that Q4 of the previous financial year was a very strong quarter for exports driven by resolution of several operational supply chain issues.

As we make progress on our initiatives to streamline operations and reduce complexity, we have incurred several one-offs that have impacted our reported EBITDA which now stands at Rs.219 crores. While reported EBITDA is at 6.7% this quarter, there are several moving parts that have impacted EBITDA as compared to last year which we would like to highlight.

First, we incurred onetime cost associated with restructuring and rationalizing in emerging markets and Europe to the extent of 2.1%. Second, write-off of non-moving inventory and the result of change in opening and closing inventory have impacted us to the extent of 1.3% and 2.1% respectively. Third, the impact of changes in legislations such as the Payment of Bonus Act is 1.3%. Lastly, as we invest for the future our total project R&D spend has been rising steadily, it increased 68% year-on-year for this quarter resulting in a 2.2% impact to EBITDA. Excluding the impact of these one-offs and the incremental R&D spend, our base business EBITDA margin for the quarter stands at between 15% to 16%.

Consequent to the impact of one-offs and reported EBITDA this quarter, profit after tax stands at Rs.81 crores, a decrease of 68.9% year-on-year, tax expense for the current year is net of minimum alternate tax credit of Rs.56.2 crores. Our CAPEX is approximately 8% of sales, total debt-to-equity ratio is 0.44, this factors in the bridge financing for our recent US acquisition for which we have taken a debt of $550 million at LIBOR plus 35 to 85 basis points per annum. Outstanding forward contracts as a hedge for receivables as of 31st March, 2016, are $36

million at Rs.69.35 and ZAR520 million (South African Rand) at around 4.45. We have working capital loans of USD170 million which act as natural hedges towards our receivables.

For the full year, our consolidated revenue stands at Rs.13,678 crores, a growth of 20.6% over last year driven by strong growth of 36.4% in export market. Our EBITDA for 2015-16 grew at 16% year-on-year and stands at Rs.2,501 crores at approximately 18.3% of sales. Profit after tax for the year stands at Rs.1,506 crores reflecting a growth of 27.5% year-on-year. PAT as a percentage of sales is at 11% for the year and improvement of 60 basis points over last year.

Now I will request Umang to take you through our business performance for the year where our growth has been above industry in almost all markets we operate in.

Umang Vohra: Thank you, Anant. Our India Rx business has performed strongly this year growing at 16% relative to the market growth of 14% as per the IMS MAT March 2016 data. We grew faster than the market in four of our top five therapies – respiratory, anti-infectives, gastro intestinal and urology. Our respiratory business saw strong uptick with over 20% growth in the COPD portfolio. The contribution from new introductions continues to increase, from 3.2% of sales in FY15 to 4.5% this year. The impact of the DPCO and FDC ban is in the range of 2% to 3% of sales.

On the portfolio front, we saw significant in-licensing traction with six deals executed in high value segments such as oncology, respiratory, and dermatology. We look to leverage our excellent reach in sales, marketing and distribution to replicate our sofosbuvir success story for these products. We also initiated five incremental innovation projects this year with three of them slated for commercialization in this year. Our India generics business saw a weak first half but regained its growth momentum in the last two quarters of the year.

Our North America business doubled in revenue growing almost 117% year-on-year in local currency terms, driven in large part by strong Esomeprazole sales that are now stabilized to base levels. We achieved average monthly market share of 10%, 12 months' post launch for the first five products launched through our own front-end in the US. Cipla US is now among the top three in 19 of the 33 products it sells on its own. We are happy to report that our recent launches in the US are picking up, this quarter we launched Celecoxib and Nadolol. As we scale our US business next year we will target launch of five to seven products in the InvaGen pipeline and eight to ten products from Cipla's pipeline, including some in limited competition areas. We expect to file 20 to 25 ANDAs in 2016-17 including some respiratory and oncology filings.

Our South Africa business has shown strong growth across both private market and tender business with FY16 sales growing by 25% compared to last year in local currency terms. We saw a strong uptick in the tender business this year with 60% growth year-on-year, we maintained our place among the top three generic companies in South Africa with a private market share of 5% and leadership position in respiratory, oncology and CNS segment. We

continue to strengthen our status as "partner of choice" through alliances and players such as Teva and Serum Institute of India.

In our International business we have registered a sales growth of 14% in local currency terms driven by strong growth in front-end markets. We have also regained momentum in our B2B markets with an 8% growth year-on-year compared with a decline in the previous year. Cipla Global Access business grew at 12% despite competition and price pressures. Looking ahead, we will continue to focus on simplifying our business across emerging markets and prioritizing our investments in high growth markets where we hold a leadership position.

In Europe, 2015-16 sales have grown by 30% year-on-year in local currency terms driven by strong top-line growth across both B2B and DTM markets. We have enhanced the depth of our respiratory offering this year with new product launches for Fluticasone Salmeterol, Mometasone, Fluticasone, Ipratropium Salbutamol Respules and Ipratropium MDI across multiple markets in Europe. We also received approval for Salmeterol Fluticasone in Italy in quarter four. As mentioned during our last quarterly call, we continue to evolve our business model in Europe with the intention of balancing our portfolio with the best commercial options.

On the portfolio front, we have over 200 formulation development projects underway at the moment of which our top 50 projects address a market size of 30 billion based on innovator sales; of these, the US accounts for 26 projects. Further, inhalation and injectable delivery forms account for 25 of the 50 top projects. Our formulation filings in 2015-16 stand at seven for North America, 19 for Europe and over 700 for international markets. Like we said earlier, we expect to file four to six products per quarter in the US going forward from quarter two of this year and have a good line of sight to file between 20 to 25 products in the US this year with some potential First-to-File opportunities.

To summarize, while growth remains on track we are choosing to invest in our R&D pipeline with a focus on differentiated generics and specialty products for the US market. We are looking to accelerate the scale up of our US business and enhance our leadership position in key emerging markets by continuing our growth above industry-average growth rates. Our priority for the next year is going to be on simplification and focus on a set of core 15 to 20 markets. We need to substantially simplify the way we do business which will entail making choices on our geographic focus, business model, organizational structure, and resource allocation.

I would like to thank you very much for your interest in Cipla. And with this, Chirag I hand the call back to you.

Moderator: Thank you very much. Ladies and Gentlemen, we will now begin the question-and-answer session. Our first question is from the line of Kumar Saurav from Motilal Oswal Securities. Please go ahead.

Kumar Saurav: It would be great if you can throw some more light on what kind of inventory reduction, this is for which geography we have taken? And also this restructuring and rationalization expense, this would be towards what, as in how it would impact our future performance going forward?

Umang Vohra: So the inventory reduction is, really, if you look at our inventories from December to March they have gone down by about Rs.500-odd crores and this includes the overhead absorption of inventory which gets released to the P&L. So as a result of this fall in inventory this has happened. The market rationalization is around markets in emerging markets of the world and Europe where we are changing our business model. In Europe it is largely a change from direct-to-market to business-to-business and some of the emerging markets are more around decisions to not operate in them due to the size and the complexity involved. So in terms of business going forward these are accruals made largely for market conversions as well as for market exits. So it is unlikely that you will continue to see these charges coming in the quarters and going forward.

Kumar Saurav: So correct me if I am wrong, is it something that we have let go of certain people and this is for VRS and all?

Anant Atal: That is right, it is inventory provisions as well as provisions with regards to people, etc.

Kumar Saurav: And your midterm revenue and EBITDA guidance, will the trend hold true even for FY17 or FY17 would be a different year?

Umang Vohra: No, I think it should hold true, the only thing that I would request you to consider is that we have mentioned guidance based on the fact that this will be on base revenues. So there is a certain amount of base revenue, it would not be on top of the Esomeprazole top-up that we had got this year.

Kumar Saurav: And just a housekeeping question, this R&D expense for the full year, how much was the R&D expense this year when we are talking about 8% for next year let us say?

Umang Vohra: So this year I think they ended up with roughly about 7% or 7.2% but let us just confirm what was the exact number. Sorry, it is 6.5% this year, versus next year will be 8% to 8.5%.

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

Anubhav Agarwal: Umang, I had some questions on InvaGen acquisition. I just want to understand that for the existing products that the Company was selling, have you already transitioned those products from Camber to Cipla?

Umang Vohra: Most of them have been transitioned, there are few which are still going through the transition on account of just the inventory etc, but most of the products have got transitioned to our label and we have retained most of the customers with us on that.

Anubhav Agarwal: So when you report quarter one sales you expect that run rate which InvaGen, like analyzed run rate of $250 million to sustain for us?

Umang Vohra: Yes, we would expect that run rate to roughly continue.

Anubhav Agarwal: And for the products which are under pipeline, the pending ANDAs, did the Company have any product where there was exclusive supply arrangement which cannot come to us or all will be transitioned to us?

Umang Vohra: No, most of the pipeline products from what we know, none of them are partners, if that is your question, they will all be sold through Cipla later.

Anubhav Agarwal: Just couple of more questions on this acquisition, so what is the amortization on the product intangibles we will carry to the P&L in FY17?

Umang Vohra: See, as of now the acquisition is as per, most of this is lying in goodwill, so goodwill is not amortized right now but as per the IFRS IndAS adaption of the balance sheet some portion of the goodwill will go to intangibles and that is currently being worked out, but it would not be a huge amount. So bulk of this will continue to sit as goodwill.

Anubhav Agarwal: Just one more question on this, so can you give us, this is first time sir, can you give us some idea about the concentration of sales at InvaGen, top three products will be what percentage of the sales of this $250 million?

Umang Vohra: So top three, we can send it to you Anubhav, but I think broadly speaking the top three products would be roughly about 30% to 35%.

Anubhav Agarwal: And just one last question, this South Africa, I know it is tough but you had a fantastic year in South Africa, what kind of growth now you expect on this base with high ARV sales always sitting in South Africa?

Umang Vohra: So if we were to adjust for last year was a little odd because there were ARV tenders that were out and a couple of our competitors were either not bidding or were not in the race because of various issues. So if you were to take it out we are still expecting private market growth to be pretty strong in South Africa to the tune of almost, I would say, low teens. Low double-digit growth in the private market business should continue.

Anubhav Agarwal: So this is 60% of market for you, but 40% you will expect a decline or flattish?

Anant Atal: No, I think we will expect it to be flattish and possibly marginally positive.

Moderator: Thank you. Our next question is from the line of Fatema Pacha from ICICI Prudential Life Insurance. Please go ahead.

Fatema Pacha: Sir few questions, on the US revenue I think we had launched two products in 4Q right, plus InvaGen I think I do not know how many days have got added on to 4Q numbers, so is this the base one should work with because I was just wondering have you had a material decline from 3Q to 4Q on Nexium as well?

Umang Vohra: Let us answer the three questions that you have asked. The first is do our numbers include InvaGen? Yes they do, to the extent of 40 days they include InvaGen, but realistically the 40 days is more equivalent because of roughly about 20 or 25 days for this quarter period, and the reason for that is that there was some stock in the channel etc, so realistically we have booked about 20-odd days of InvaGen sales in this quarter. This is therefore not the base that you should expect going forward for InvaGen. The Nexium revenues will continue at roughly the same level that we have seen in quarter three and quarter four, we have been suggesting that it is not at base level, more competition has entered so it is going to be at the same level.

Fatema Pacha: Sir any reason why our US revenue is practically flattish?

Umang Vohra: So in quarter four of the previous year…

Fatema Pacha: Q3 to Q4 I am saying, I am asking from Q3 to Q4.

Umang Vohra: No, Q3 to Q4 is slightly flattish because even though we signify base, there has been a little bit of impact on account of Esomeprazole and others. Also our mainline products, I think quarter three we had a slightly higher uptick.

Fatema Pacha: And can you just tell me your employee cost this quarter had one-off is it or is this the number one needs to work with going forward?

Umang Vohra: No, it had one-offs, there were two one-offs that we called out, one was almost an impact of roughly about Rs.25-odd crores due to the Payment of Bonus Act catch up for the year which was a regulation change that was made and we had to accrue for the current year, so all of that got accrued in the quarter, plus there is severance cost built into it for the markets that we are transitioning.

Fatema Pacha: Our adjusted margin this quarter is 15.8, right, versus in 3Q I think your adjusted margin was 18, so any reason for the sequential drop in margins?

Umang Vohra: So it is seasonality and I think this quarter we had higher R&D as well.

Fatema Pacha: So I think 8% was there in 3Q as well, that is what you had guided us and this quarter also you are saying 8%?

Umang Vohra: Yes, so broadly, there is a little bit, I mean, R&D is slightly higher, though we are rounding it off to eight it would be 7.8 and 8.2 or something like that, so it is about 0.4%-odd there. But it

is also seasonality, I think even on the revenue side domestic and other markets have been lower than what we had expected.

Moderator: Thank you. Our next question is from the line of Girish Bakhru from HSBC. Please go ahead.

Girish Bakhru: Just on the US side, on the DTM if you could just give some color, has that business reached any material size and when you talk of adding more products what exactly is the plan where this business will go in terms of the proportion to the US?

Umang Vohra: So Girish the current DTM business in US was roughly about $50-odd million business.

Girish Bakhru: This is for this number of 321.5 DTM you are saying.

Umang Vohra: No, so just to answer, on a full year basis the DTM business is about 50 million which is Cipla's own DTM. You add about 240-odd million on a full year basis of InvaGen.

Girish Bakhru: And when you talk of say launching some limited competition products, I know it is difficult to give a color but are you saying these are products where typically players would be less than five or are they complex products, what kind of limited competition products are you looking at?

Umang Vohra: So they are complex products, we do expect that for not all of them but at least for some of these products that there will be less than five entrants in the market and all of them are fairly attractive products.

Girish Bakhru: And in terms of the pipeline 78 pending, how much portion would be injectibles and respiratory products?

Umang Vohra: We can come back to you on that data.

Girish Bakhru: But in terms of respiratory, I think in the last call you had commented it is a very miniscule number, is that correct or has that kind of run rate picked up in terms of filing?

Umang Vohra: So I think what we commented on the last call Girish was that we are in a place where we have to initiate trials etc. for some of these products which is why the number was miniscule because we are talking about filings in this year. But the real respiratory top-up in filings will happen in the next year, because I think this year is more around clinical trials and things like that.

Girish Bakhru: So just related to that last question Umang, what is the color on the Advair trial, when do you see that really taking shape?

Umang Vohra: I am not commenting on it Girish, it is a very specific question, I would just comment saying that we are in that category but we do not want to talk so much about the trials and things like that at this stage.

Moderator: Thank you. Our next question is from the line of Nimish Mehta from Research Delta Advisors. Please go ahead.

Nimish Mehta: Just a little bit of more clarification on the guidance you had given, firstly just correct me if I am wrong, you have mentioned mid-teens sales growth and 15% to 20% EBITDA margin or 15% to 20% EBITDA growth?

Umang Vohra: EBITDA growth. So we think profit growth is going to be higher than top-line growth, top-line growth is mid-teen and base business EBITDA growth is going to be 15% to 20%.

Nimish Mehta: And this you have said on FY17 will be kind of ex of Nexium, but will this be including InvaGen or this is again ex of InvaGen, how should we look at it?

Umang Vohra: So the base business growth that you are seeing will ideally include InvaGen but on the medium term trajectory that we are guiding to you, that will include as if InvaGen was there as well as we go forward.

Nimish Mehta: And FY17 we are not including InvaGen is what you mean to say?

Umang Vohra: No, look we are saying base business, so for base business we will include just the business that was there before InvaGen. But once InvaGen gets amalgamated the same thing will also go ahead for InvaGen as well.

Nimish Mehta: So FY17 would be more or less, the guidance that you had given would be more or less without InvaGen, but in FY18 that guidance will be above InvaGen is what I understand?

Anant Atal: Yes, I think there are two components to it, so Umang is saying immediate FY17 guidance and there is a more medium term guidance which we have given which is mid-teens growth and 15% to 20% EBITDA growth, so that is one part. And the short-term is more about on the base business we would look to have top-line growth but we will look to grow EBITDA higher than our top-line even for the base of the business.

Nimish Mehta: And second, if you can comment on the UK inhaler launch last quarter you mentioned, Advair Inhaler that it is around the corner, so where are we now, when can we expect?

Umang Vohra: I am not sure we said around the corner, we said that we are still a few quarters away, we said it will happen but it is not imminent immediately in a quarter. I do not think we said around the corner but we will provide an update on it.

Anant Atal: What we said is that there were queries which had come from the MHRA, we were responding to those queries, and beyond that it is a question of waiting for the actual approval which is not necessarily in our control.

Umang Vohra: So we have responded now to all queries that were received from the MHRA and now we are waiting for their next set of response, if any.

Moderator: Thank you. Our next question is from the line of Manoj Garg from Bank of America Merrill Lynch. Please go ahead.

Manoj Garg: Umang, just want to understand, have we started any clinical trials on the respiratory product, particularly on the MDI in the US market last quarter?

Umang Vohra: So I do not want to give you visibility, I mean we will not like to provide visibility product by product, but it is likely that we will have a clinical trial and a filing for an MDI product this year, I will just stay at that.

Manoj Garg: And just want to understand from a little bit strategic point of view, basically your strategy on the Advair side, are we working on a Advair or a partnership route or we probably will like to have our own filing for the AB rated generic advisors?

Umang Vohra: So we would like our own filing for an AB rated generic.

Manoj Garg: And the last question Umang from my side, I think probably we are bit confused about the guidance, since you have spoken about mid-term kind of revenue and margin guidance. But if you have to look at for FY17 are you giving any specific guidance for FY17 as well?

Umang Vohra: No, we are not providing that guidance for FY17 because this is the first year for us for InvaGen, our model is changing in Europe and therefore we think it is more appropriate for us just to give you a medium-term zero to three-year guidance.

Manoj Garg: And when we are talking about the base business what should be that base which we should take into consideration because it is important for us to understand the base business level so that we would be able to modulate for the next two to three years.

Umang Vohra: So I think even on the last call and this call, I think on the last analyst call we said we reported a base business EBITDA according to us which was close to 18, this quarter we are reporting a base business of close to 16. So I think somewhere in that range is probably what we think our base business EBITDA is.

Manoj Garg: But Umang, like this R&D cost is going to be a recurring one, so when we are adjusting for the base business of 18 or 16 we are also adjusting this 2% kind of R&D, right?

Umang Vohra: Yes, that is right but I think our last quarter when we had given you a base EBITDA of 18 that included the R&D as well. So I would like you to take a range of 16 to 18 which would be the base business EBITDA range.

Manoj Garg: With 8% R&D kind of guideline?

Umang Vohra: That is right.

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

Sameer Baisiwala: Umang, I must say that your guidance is reasonably confusing, especially if we have to think about fiscal 2017, and very frankly 16% to 18% EBITDA margin is also pretty wide range. So I am not quite sure, if I have to take an absolute number of EBITDA for fiscal 2016 as a base and you say you will grow at 15% to 20%, from that EBITDA also do I exclude Nexium and then do the math or how do we do it?

Anant Atal: I think we reported EBITDA of about Rs.2,500 crores for the year, Umang's point is from that Rs.2,500 crores you exclude an element of one-offs. Again we have not specifically guided what that Nexium number was but I think you can come up with a rough estimate. On that base business – so Rs.2,500 crores less Nexium fundamentally – on that business we look to get kind of mid-teens growth rate and on that we will have base business EBITDA margin of at 16% to 18%.

Sameer Baisiwala: So if I take the Nexium number out of Rs.2,500 crores then do I also add back the one-offs that you are having in Q4?

Anant Atal: Yes.

Sameer Baisiwala: So now here is the question, if I look at your fiscal 2016 total sales and total EBITDA, this implies about 19% EBITDA margins.

Anant Atal: We reported about 18.7% and that 18.7% would include a big element of Nexium.

Sameer Baisiwala: Yes, but it also includes lot of one-offs, so if I can add then we are back to your 18% normalized level, so the point is should I grow this Rs.2,500 crores by 15% to 20%, is this what it would mean?

Umang Vohra: Sameer, I do not think we want to give guidance for 2017 but let me broadly outline what we are saying. Out base EBITDA is somewhere in the range of 16 to 18 of the revenue for the full year, right. Now that base EBITDA we are saying over a medium terms grows by 15% to 20% and it will be higher than the revenue growth. I think this is pretty specific and 16 to 18 is a range based on one-offs etc, it is not a wide range so we are saying of the top-line our base EBITDA is somewhere between 16 to 18 with the 8% R&D spending and that is going to grow at the rate of 15% to 20% over the medium term. This will be higher than the top-line growth which will be mid-teens.

Sameer Baisiwala: Okay, we will try to work with this. And the second question, I am still not very clear or I probably missed a bit of this, for the US market for Advair most companies have announced clinical, they are in the clinicals and they will be filing the dossiers as the time goes by. Now I

cannot see your clinical trials on the government website, so what is holding us back given the fact that we have had many years of actually headstart over many players, so what is really holding you from starting your clinical trials, having it registered on the government website?

Umang Vohra: Sameer, I cannot answer to whether we are in trial or not, but what I can answer to is that we are trying to make sure from the knowledge that Cipla has of this product over the past couple of years, that we submit the package that is deemed substitutable on the day that we submit it, or AB rated, if I were to say and I think that is what we are just making sure that even though it is taking us a little longer we are just making sure that our package is AB rated to the main product. Just to add again, we do not believe that by virtue of a mere submission that there is enough confirmation and evidence that the package that anyone would submit could be AB rated and therefore I think there is a lot of work that is going into just making sure that it is an AB rated package.

Moderator: Thank you. Our next question is from the line of Deep Master from Enam Holdings. Please go ahead.

Deep Master: Most of my questions were answered, I just wanted to know the absolute R&D spend this quarter, was it 8% of sales for the quarter?

Umang Vohra: Yes, I think you could probably take that, it is 8.2% for the quarter.

Deep Master: So now in percentage terms we would broadly remain in this range going forward?

Umang Vohra: Yes, broadly yes.

Moderator: Thank you. Our next question is from the line of Nitin Agarwal from IDFC Securities. Please go ahead.

Nitin Agarwal: Umang, when we look at our business on a broader basis at about excluding R&D investment that we have made, for the quarter probably more like 14% EBITDA margin with a reasonably high component of domestic business, we have been through a three to four year round of restructuring or a reorganization of the business. Where do we stand post the journey that we have had, I mean the results seem to be still reasonably sub-optimal when we look at around in the peer group as far as profitability or the revenue growth that you have achieved over the last three or four years are concerned, I mean how do we see this business really moving forward because our guidance which is there, given a very low base it is still reasonably conservative. So despite a very high component of presumably very high margin domestic business, so it is a little confusing in terms of the way the mix is really playing out for us.

Umang Vohra: So the only thing I would say, I think it is a fair question, the only thing I would say is that the peer set is higher because the US business mix is higher and that is a fact, I mean if you were to compare India to an India business or an international to an international business, the impact of mix of US high-EBITDA business is not trivial in the results of our competitors. Cipla is

repositioning its US business, even though the journey of the last three to four years has finally culminated in Cipla acquiring InvaGen which was an acquisition in the last quarter and from there it is trying to build a pipeline of filing 20 to 25 products, launching about 10 to 15 products, and quite honestly and from the experience at least that I have, the EBITDA margins of every launch that you make on US going forward are fundamentally very different compared to the business mix that Cipla operates in today. So the journey of three to four years has started with de-risking and opening up international markets. I think in the US, which is the highest EBITDA mix business the journey has just started, it started with almost a $300 million business now and launches will add to that. And we all know that US businesses operate with EBITDA margins which are almost twice as high as where the domestic businesses operate. So as that mix begins to change for Cipla the EBITDA trajectory will improve.

Nitin Agarwal: And honestly on that count, given where our R&D spends today are at about Rs.1,000-odd crores, rough give or take, given the fact that we are coming off fairly late in this whole process, not sure whether it is a right comparison with peers but the peer set is essentially outspending us by almost 2:1 ratio at this point of time. So do we see a material ramp up in R&D really going through over the next three to four years, much beyond the 7% to 8% that we are looking at right now?

Umang Vohra: No, I would not think so, I think that competition has a billion dollars of business to grow or $2 billion of business to grow from, in terms of R&D, and Cipla does not have 1 billion or 2 billion business in the US, it has basically a $300 million business. So I do not think this will dramatically alter, I think the way to look at Cipla's R&D journey is possibly to look at our $300 million business growing and what were the comparative R&D percentages of companies who were in the $300 million to $500 million range till about three years or four years back. Because frankly the R&D intensiveness of an India business or an emerging market business is not as high which is essentially what Cipla's core revenue mix today is.

Nitin Agarwal: And if I can squeeze in one last one, on the international business as you just mentioned we have worked hard to open a lot of these international markets over the last three to four years, so what has been the big change in thought process in terms of when we are looking to rationalize some parts or pretty chunky parts of that business going forward?

Umang Vohra: We have not rationalized chunky parts of the business, the markets that we have opened are continuing to be there and they are going to be growing, so there is no change in our stand with respect to a lot of the large international markets whether it is Sri Lanka or it is Uganda or it is Yemen, there is no change absolutely in that, it is only the smaller fringe markets that we are cutting out which do not add materially to revenue and we are cutting them out because quite frankly this will improve the increased complexity for Cipla at the backend, especially now if it has to service the US business. So it is really simplifying our business model.

Moderator: Thank you. Our next question is from the line of Neha Manpuria from JP Morgan. Please go ahead.

Neha Manpuria: Sir, first on the EBITDA, is it right to assume, I know you mentioned that part of this change in the structure that we are bringing about is probably just the impact which is this quarter, but is it fair to assume that some of these changes could continue to impact our margins in the first half before we see the full benefit of this coming into the second half of FY17?

Umang Vohra: No, so the second half of FY17 will be better for Cipla, there is no doubt about it. I do not think we are seeing any one-offs to continue going forward in the next two quarters.

Neha Manpuria: So basically all the restructuring, etc, all of that cost that you assume this quarter will be restricted only to this quarter?

Umang Vohra: That is right, and most of those provisions have been created this quarter and so therefore any of those provisions are not likely to be created in the subsequent quarters.

Neha Manpuria: Second question on our South Africa business, the year-to-date growth that we showed in the third quarter was pretty strong and that seems to have come down significantly in the fourth quarter, which implies literally year-on-year ZAR decline in the fourth quarter. Was there something that impacted the South Africa business in the fourth quarter?

Umang Vohra: So it is an accounting entry, there was a gross to net recognition which has no impact on profitability, but there was a gross to net re-class issue in South Africa to the extent of ZAR70 million, so basically it got re-classed from one item to another and therefore it showed up in the sales growth.

Neha Manpuria: And my last question on Europe, did I hear correctly that we are also trying to look at our portfolio in Europe and rationalize that or bring about some change in the European business?

Umang Vohra: So in Europe we are basically trying to see what is the mix where we continue DTM markets and what are the areas where we change to B2B, but the portfolio side I do not think we are changing too much, we are going to continue to compete with respiratory, with oncology, etc, it is just that we are structuring the business models such that we make a lot more profit than running pure DTM businesses.

Moderator: Thank you. Our next question is from the line of Anmol Ganjoo from JM Financial. Please go ahead.

Anmol Ganjoo: Most of my questions have been answered but just a couple, see you spoke about the US being a big driver for business growth hereon and the consequent impact that can have on EBITDA margins, so what then explains us being very conservative and guarded as far as the margin trajectory pickup is concerned, so I think you yourself explained that EBITDA margins for incremental US business can be twice, it should be helped by launches, we finally got the US game right. So in that case I think the EBITDA pickup should have been much faster or steeper relative to what you have been guiding us to.

Umang Vohra: So I do not know how to react, I mean if you are saying that our guidance is conservative, I mean we are saying EBITDA growth of 15% to 20% year-on-year for the next three years at a CAGR level, I think we feel comfortable with that guidance.

Anmol Ganjoo: And my second question is, obviously you spoke about the $300 million being a new base, obviously you try to grow our US business, but from an attractiveness quotient of the US market relative to the peer group hasn't it worsened meaningfully in the last three, four years?

Umang Vohra: I am not sure about that, I do not know any of our peers who have First-to-Files. I think they get a lot out of the US business even today with a base of 1 billion or 2 billion, so I do not think the attractiveness of the market has gone down. I think the compliance burden of that market has gone higher. So I think the market is equally attractive and actually maybe more attractive now considering all the shortages and the quality issues that people are having. But having said that the compliance burden of trying to get this business right has significantly gone up.

Anmol Ganjoo: So you think that the three year lag we have is pretty much bridgeable?

Umang Vohra: Yes. And I also think it is because of the type of products that are coming off. I think some of them play to Cipla's natural advantages like the HIV set of products or the respiratory set of products or the oncology set of products, I think they play to Cipla's advantage in terms of development and manufacturing.

Moderator: Thank you. Our next question is from the line of Aditya Khemka from DSP Blackrock. Please go ahead.

Aditya Khemka: So I have three questions Umang. The first question is, you said the compliance burden has increased for the US market and truly so, in case of Cipla though you have some 483 outstanding at your Indore plant if I am not mistaken, for some time, and you have not seen any approvals from there, so what is the status there, are you in dialogue with the FDA because frankly if we see companies off late which have got 483 for a long time and not got an approval from that plant, those companies are getting warning letters. So I think the real worry is, is there a warning letter pending at Cipla from Indore?

Umang Vohra: So I think the way I would answer that is that our final update was due to the FDA this month and we have already sent it across. Since most of these 483s are now public documents, I think the quality of the points that have been raised in the Cipla inspection in Indore, I believe are materially different than the inspection points raised in several other sterile facility inspections that the FDA has covered. So although there is no way I can tell you that I believe that there is no warning letter as I believe this is really the FDA's decision, but as a team we do feel that we have a good confidence in the response that we have given.

Aditya Khemka: And on the second part, we have seen many of your peers who are into oral solids or who are into more commoditized nature of generics, we have seen them sort of facing a lot of pricing erosion channel consolidation wise or competition wise. On InvaGen's portfolio how has that

been playing out, I know you are just consolidated for 40 days so far but you will be consolidating for the full quarter and I am sure you guys are hand deep there already. So how is InvaGen's portfolio looking in terms of price erosion and competitive pressure?

Umang Vohra: See, InvaGen has barely one odd product where the market is still little limited competition, every other product category that InvaGen operates in has more than eight to 10 competitors. So other than maybe one or two products at maximum which have limited competition I do not think InvaGen's portfolio is at risk on account of new players entering the market or severe pricing cuts happening there. So as a result of that I do not think we see a risk to that portfolio today but we are hoping to add to it with new launches that come in the near future.

Aditya Khemka: So since you have taken over there has been literally no uptick or downtick in the InvaGen portfolio EBITDA margins?

Umang Vohra: No, none that we are aware of and no major thing, we have retained all our customers and we have not seen any pricing erosion and it is largely because we are operating in hyper competitive categories rather than maybe one or two products.

Aditya Khemka: And you mentioned that the top three products would be 30% - 35% of the InvaGen portfolio, so would these top three products be those where there is scope for competition or are these three products competitive yet big for InvaGen due to market share or overall market size?

Anant Atal: Two of these three are hyper competitive, in one of these there are three players or four players and maybe one or two could enter more.

Aditya Khemka: And the last question Umang is from the perspective of, if you look at where Cipla is today in evolution, you are doing a fine balancing act, so on the one end you have got to build the pipeline, you have got to do the R&D, you have got to invest capital for future growth. On the other end if you look at the return on capital employed that is suffering continuously because we are continuing to make investments in high gestation period projects be it inhalers, be it front-ending in Europe or be it front-ending in the American market. So when you do this exercise in the board room, do you guys have a target ROCE or a target ROI in your mind that this is the threshold, beyond this we would not make investments or else our consolidated ROI or consolidated ROCE falls below x%. So do you have such a threshold, I do not want to know the threshold but I want to know if the thinking process involves a threshold?

Umang Vohra: So I do not know whether we would call it a threshold or not but there is a discussion on how the trajectory for the said indicators would improve and based on what and how that is balanced out to get an eventual ROIC outcome.

Moderator: Thank you. Our next question is from the line of Alok Dalal from CLSA. Please go ahead.

Alok Dalal: I believe InvaGen had certain outstanding observations, so any update on that?

Umang Vohra: We believe those are closed, I think those observations are closed.

Alok Dalal: And Umang, what was the CAPEX spend for FY16?

Anant Atal: What we have disclosed is about 8% of sales.

Alok Dalal: And what is the number you are looking at for FY17?

Umang Vohra: At a kind of very similar level as this year.

Moderator: Thank you. We will take the last question from the line of Prakash Agarwal from Axis Capital. Please go ahead.

Prakash Agarwal: Sir, my first question is on the exports business, sorry to miss the opening remarks, so I could see just a 3% growth and what I learned is that South Africa business was fairly weak. If you could just highlight broad counters in terms of what led to a very weak export formulations?

Anant Atal: I think there are two points here Prakash, one is, if you compare the base of Q4 2014-2015, Q4 itself was a very-very big quarter for us last year, so I think there is one element which is a base effect. I think the second point which Umang mentioned was on the South Africa business, and I think what we mentioned there is just a gross to net reclassification of about ZAR70 million which therefore results in our South Africa business growth looking a little bit lower. I think this is kind of how we would respond to that question.

Prakash Agarwal: And ex of these would be upwards of 15% - 20%?

Umang Vohra: I think for the full year exports have grown at over 25% in local currency terms or wherever they have gone, but consolidated I think about 13% or 14%.

Prakash Agarwal: And second question sir on the US business, just trying to understand this better and extrapolating for 2017 and 2018, so given the fact there was a large Nexium piece and you are adding up the InvaGen acquisition, so there will be a big element of Nexium going out, so trying and understanding what kind of base, so $450 million kind of range and then since your new products keep on coming and you talked about some limited competition opportunity, that to grow about 10% - 15%, is that the right way of thinking?

Umang Vohra: We said that our base EBITDA is about 16% to 18% of the top-line we reported, and we are saying that is going to grow 15% to 20% over a medium term period with an 8% R&D burden.

Prakash Agarwal: Sir the question was with respect to US based business.

Umang Vohra: That level of guidance I am not sure we are going to provide.

Prakash Agarwal: Just directionally what you know.

Anant Atal: Probably, one we have said is that you have got a $300 million DTM business and as of 2015 we had about a $150 million B2B business, so you are talking about that as a kind of base, and then anything above that would be considered as a one-off. On that business we are not giving any specific guidance with respect to what the growth next year would be.

Prakash Agarwal: And you still maintain your $1 billion guidance for 2019-20?

Anant Atal: For?

Prakash Agarwal: For the US.

Anant Atal: I think again there is no formal guidance of $1 billion in the US, the aspiration is grow mid-teens overall at a company level, grow EBITDA at high level, US today 20% of sales, we are not quite sure where it will be, but the objective is to grow the business higher than the overall company level of growth.

Moderator: Thank you very much. Ladies and Gentlemen, due to time constraints that was the last question. I now hand the conference over to Mr. Chirag Talati for closing comments.

Chirag Talati: We thank the Cipla Management for giving us the opportunity to host the call. Over to you, Anant.

Anant Atal: Thanks Chirag and thanks to everyone who joined. If there are any questions please do reach out to me and the IR team and we will do our best to respond. Thank you.

Moderator: Thank you. Ladies and Gentlemen, on behalf of Kotak Securities Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines.