



“Cipla Ltd. Q4 FY17 Earnings Conference Call”

**May 25, 2017**



**MANAGEMENT: MR. UMANG VOHRA – MANAGING DIRECTOR &  
GLOBAL CHIEF EXECUTIVE OFFICER  
MR. KEDAR UPADHYE – GLOBAL CHIEF FINANCIAL  
OFFICER  
MR. ALPESH DALAL – HEAD, INVESTOR RELATIONS**

**MODERATOR: MR. CHIRAG TALATI – KOTAK  
SECURITIES**

**Moderator:** Good Day, Ladies and Gentlemen and a Very Warm Welcome to the Cipla Limited Q4 FY'17 Earnings Conference Call hosted by Kotak Securities Limited. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '\*' followed by '0' on your touchtone phone. I now hand the conference over to Mr. Chirag Talati from Kotak Securities. Thank you and over to you, sir.

**Chirag Talati:** Hi, Good Evening, everyone. This is Chirag 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. Umang Vohra – M.D. and Global CEO; Mr. Kedar Upadhye – Global Chief Financial Officer; and Mr. Alpesh Dalal – Head of Investor Relations at Cipla.

I now hand over to the call to Cipla management team for their opening remarks. Over to you, sir.

**Alpesh Dalal:** Thanks a lot, Chirag. Good Evening, everyone. This is Alpesh Dalal here. Just before we start our commentary about the quarter and the year, wanted to highlight a disclaimer that on this call, our discussion will include certain forward-looking statements and which are only predictions, projections and other estimates about certain future events. So these statements are only management's current expectations of the future performance of the company and these estimates involve a number of risks and uncertainties that could cause our actual results to be different or to differ materially from what is expressed or replied.

So with that disclaimer, I would hand it over to Kedar who will take us through the Financials for the Quarter and for the Full Year.

**Kedar Upadhye:** Thank you, Alpesh. Good Evening all of you. Welcome to our Fourth Quarter and Full Year 2016-'17 Earnings Call. I hope you have received the 'Investor Presentation' that we have posted on our website.

I will now take you to the Financials for the Quarter and the Full Year. Our results this quarter includes certain one-off charges which I will cover in my commentary. Coming to the Quarter: Overall income from operations stands at Rs.3,582 crores which grew 8% YoY. The sales and profits trend on YoY basis would not be fully comparable due to the full contribution of our US acquisition from this year, Esomeprazole revenues last year and certain one-offs. This quarter margin after material costs grew to 63% and excluding the impact of last year's one-offs, this margin actually increased by 300 basis points which was driven by cost containment measures and a healthy product mix. Total expenses which include employee cost and other expenses for the quarter stand at Rs.1,760 crores which is an increase of only 2% YoY. Employee cost in this quarter Rs.639 crores decreased by 3% YoY. The increase in employee expenses due to consortium impact of acquisition was offset by the saving attributable to business model change in Europe and policy change driven decrease in leave encashment. Excluding the impact of InvaGen employee expenses actually declined by 10%. Other expenses for this quarter which

include R&D, regulatory, quality, manufacturing and sales promotion expenses stood at Rs.1,121 crores, increase 8% on a sequential basis. This had about 2% due to FOREX volatility. The increase YoY of 5% was largely on account of increased investments in R&D and growth enabling capacity expansion and sales and marketing investments for our key markets. This quarter we have invested significantly; we have stepped up our R&D investment to about 8.6% of revenues. The spend for this quarter increased by about 160 basis points as compared to 9-months and it was in line with our expectations. We continue to pursue aggressive development plans for US and other key markets. Reported EBITDA this quarter stands at Rs.506 crores which is 14% of revenues which is lower on a sequential basis. If you adjust it for certain one-time inventory charges and step up in R&D, we are within our targeted 16-18% range that we had alluded. As we have spoken in the earlier quarters, the depreciation and amortization line now includes the amortization of intangibles post our US acquisition.

As you are aware, Cipla via its wholly-owned subsidiary, Cipla Biotech has been working on developing Biosimilars. We have noticed early signs of cost disruptions in the production of Biosimilars and will still require further investments to achieve the scale benefits. Considering the extensive resource requirements, the gestation period, scale of investment and associated risks in the Biosimilars program, we are repositioning our business to explore new business development opportunity including in-license to derisk our future investment in this segment without solely relying on our in-house development.

Going forward, the capital allocation will be repositioned to provide greater impetus to our Specialty and Respiratory development efforts. In view of this, during the quarter, we have taken a one-time provision for loss on certain assets for about Rs.57 crores. Separately for InvaGen due to a mild reflection of the litigation and regulatory developments for certain specific assets, we have recorded a one-time net of tax impairment charge of USD32 million. This amount is approximately 6% of the overall value of the acquisition.

The effective tax rate for the full year excluding some of these adjustments is 20% and it is in line with our target. For the quarter, the tax rate is negative because of the write-back of the deferred tax liability against the impairment charges booked earlier. The loss reported this quarter is Rs.62 crores; however, if you adjust for the non-cash charges, PAT is about Rs.209 crores. Operating cash flow for the quarter stood at healthy level of Rs.389 crores. Our CAPEX is now 6% of sales. As alluded in our last quarterly calls, we went through very heavy capital investment cycle over the last 2-3 years and will see tapering down in the coming year. During this quarter, we invested Rs.202 crores of CAPEX taking the full year investments to about Rs.1100 crores.

We have continued on our focus on operational efficiencies and it has resulted in the improvement in our cash flow position significantly. During the year, we have paid back debt of almost with Rs. 1,000 crores. Our net debt-equity as of March '17 saw significant improvement to 0.21 compared to 0.32 as at March '16. Our long-term debt stands at USD550 million which is the loan used to fund our US acquisition. We also have working capital loans of \$85 billion.

They act as a natural hedge towards our receivables. Outstanding forward contracts as a hedge for receivables as of 31, March is \$66 million, about ZAR450 million and €5.5. million.

For the full year, our consolidated revenue stands at Rs.14630 crores which is growth of 6% over the last year. Our EBITDA for the year stands at Rs.2,476 crores which is approximately 17% of sales. Profit after tax for the year stands at Rs.1,006 crores, got impacted by one-offs as explained earlier.

I would now like to invite Umang to present the Business and Operational Performance.

**Umang Vohra:**

Thank you, Kedar. This financial year, our focus remained on strengthening our core through consolidation, complexity reduction and deepening our presence in priority markets. The key highlights for the financial year include: We had guided to an EBITDA guidance range of 16-18% which has been met. The Q4 EBITDA numbers are subdued due to lumpiness in R&D and certain one-time provisions and Kedar has explained with that Q4 is also in the range of 16-18% when adjusted for these. We had guided to growth of the India business and despite regulatory headwinds and impact of demonetization, the India business had grown by 10% for the full year against the IPM growth of 9%. We have entered into an important in-licensing arrangement and recently launched three products like Azmarda, Histamine and Bolstran in India which are under patent cover. We will continue to explore and grow the in-licensing opportunity.

I am extremely pleased to announce that we also filed 32 ANDAs. We had guided that our filing trajectory will improve and it has. We have significantly over-exceeded our guidance range of 20-25 ANDAs. This includes decent portion of limited competition products like Albuterol MDI, Nanopaclitaxel, Fenofibrate Capsules, Esomeprazole DR Cap and Tablets and several others.

We integrated our US acquisition of InvaGen as indicated on our previous call. We have successfully integrated all the major operational aspects of InvaGen with Cipla global.

As per IMS MAT March 17, Cipla is ranked as the #9th Dispensed Company amongst Prescriptions and also the fastest growing.

InvaGen has met all our internal targets excluding, if we were to exclude Sevelamer which is a delayed launch now considering the market reality.

In terms of our quality focus, we continue to operate our facilities with the highest level of compliance and all time audit readiness. During this financial year, we received an EIR from US FDA for our Indore and Goa sites. In the month of March, the US FDA also inspected our InvaGen plant. We have already received an EIR for that inspection as well.

We have also taken a goal of enhancing our Specialty segment. As you are aware, we monetized our first specialty aspect in the CNS space by divesting our 16.7% stake in Chase to Allergan. To further enhance our progress and focus on the CNS space, we have recently signed a

worldwide licensing agreement with MEDRx to develop and commercialize Tizanidine patch for the management of spasticity.

As you are aware, we have also filed our first MDI Albuterol in US this financial year and we are on track to start clinical trials in some of our key pipeline projects. With the approval of FPSM in UK, we now have launched our flagship product across 11 markets in Europe.

I am also pleased to announce that Cipla launched its first innovator Breath Actuated Inhaler Device SynchroBreathe in South Africa and it has done remarkably well.

I will now turn to the Quarterly Performance: For the quarterly performance, the total revenue was Rs.3582 crores registered a growth of approximately 8%, and 35% of Rs.3582 crores is for the domestic business and 63% in the international business, the rest is the operating income.

I will now take you through our Business Performance starting with our India business. Despite being hit the hardest amongst all major players on account of pricing control norms announced by the government in the previous year, our domestic business recorded a healthy growth of 10% declining marginally in Q4. When adjusted for the impact of policy change last year and the impact of demonetization and supply side disruptions, we are broadly in line with growing higher than market on year-to-year basis even in Q4. Our brands continue to out-perform the market with 14 out of 22 Cipla brands in top 300 IMS brands growing more than the respective markets. In Q4 FY'17, Cipla surpassed the market growth rate in key therapy areas of Respiratory, Cold, Cardiac and Urology.

Our North America business has registered a growth of 7% compared to last year in dollar terms. We have successfully averted the price decline in our portfolio for new product introductions. As per IMS MAT March '17, as we mentioned, Cipla is currently the market leader, is in the top three positions in 35 of the 45 products that we sell.

During the quarter, we launched four new products taking the full year count to 18 launches. During the year, we also launched a couple of products which exhibit limited competition behavior such as Bupropion XL, Feno and Fenofibrate Tablets Trichol. We look forward to some exciting launches in the coming quarter starting with the end of Q2. We have few limited competition launches planned from Q2 onwards and have a visibility of one such launch every quarter.

Our South Africa business continue to show growth across both private market and tender. This quarter four sales growing 26% compared to last year's in local currency terms. As per IMS MAT, Cipla achieved a growth of 14.7% in the private market versus 6.4% market growth and was the fastest growing company in the top ten companies. During the year, Cipla has improved its overall ranking in South Africa from 6th to 4th largest pharmaceutical company.

As mentioned by Kedar in Europe, we have successfully implemented the business model change and the business is back on the profitability curve. We have launched Seroflo in the UK through our partner Kent and a recording gradual uptick.

In emerging market territories, outside of the global access business, our quarterly sales degrew by 4% YoY in dollar terms driven by political uncertainties and FOREX fluctuations. However, we focused on reducing complexity and improving in-market performance throughout the year.

For the upcoming quarters, we hope to rely on sales-led margin profile expansion and cost consciousness considering significant volatility in the external environment including challenges related to the implementation of GST in India, Significant movement in currency in an uncertain regulatory environment, we do not wish to issue any formal guidance for FY'18. Having said that our internal targets assume near double-digit revenue growth on the back of new launches in US and India and market meeting growth in each of our home markets.

We expect to maintain our filings momentum with 20-25 plant filings and focus on investing towards building a Specialty franchise through mix of in-house development and in-licensing opportunities.

I would like to thank you for your attention and we will request the moderator to open the session for Q&A.

**Moderator:** Thank you very much. Ladies and gentlemen, we will now begin the Question-and-Answer Session. We will take the first question from the line of Saion Mukherjee from Nomura Securities. Please go ahead.

**Saion Mukherjee:** On the India business we have seen a decline and you mentioned it is about destocking. So, I was wondering whether it is driven by the branded business or the non-promoted generic business there, and if you can give a split for FY'17 between these two businesses?

**Umang Vohra:** So Saion, it is both the businesses, we have seen some impact of destocking in the thing. Just to remind you in Q3 we had 18% growth, in Q2, we had 16% growth. If you normalize that in Q4, we have seen a delayed impact of destocking. That is one. We also saw some supply side disruptions in our business which has now been resolved. So if we were to adjust for all of these, internally we believe we have had a growth which is in line with our full year growth of 10%. So the business is back, and of course, depending on how GST pans out and the destocking in the channel, I think we are looking quite optimistic for our India business going forward.

**Saion Mukherjee:** So the non-promoted generics would still be around 20% of your total India sales for fiscal '17?

**Umang Vohra:** Yes.

**Saion Mukherjee:** Regarding South Africa you mentioned strong growth in both private market and tender. So, can you just help us with the proportion of tender business now in South Africa in fiscal '17?

- Kedar Upadhye:** Saion, the tender business is about 30-35% of the overall business in South Africa.
- Moderator:** Thank you. We will take the next question from the line of Prakash Agarwal from Axis Capital. Please go ahead.
- Prakash Agarwal:** A question on US business. In your fiscal '18 priorities last slide you talk about disproportionately grow US and you talk about 20 plus filings. In terms of number of product launches and approvals, if you could give some broad level color and what are these some big products that you are expecting?
- Umang Vohra:** So I do not think we are going to guide product level, all we are going to say is that we will have one significant limited competition type launch almost every quarter starting Q2. There will be several other beyond the limited competition launches as well, but we unlike our peer set ,for us, we see the US as an opportunity considering just our size and scale. When we say growing disproportionately really about the launches. So if we did 32 filings in the year before, I think these 32 we will eventually launch. But we have a fair number of launches planned for the next year and exceeding almost 10 or 11 in all.
- Prakash Agarwal:** This excludes Sevelmar, just confirming, as you said you continue to like other peers is a delayed one?
- Umang Vohra:** No, I said it was delayed and without the effect of the Sevelamer delay, Invergen hit all its numbers and targets for the previous year. Sevelamer could come this year as well depending on when we are granted approval.
- Prakash Agarwal:** A very broad level like, what is the number of products in the market today and was the average revenue per product for you and how do you think given the significant launches which are coming in next couple of years, how do you see they are shaping?
- Umang Vohra:** So average numbers can be given by Kedar. Broadly, we have about, I think 45 or 50-odd products we sell in Invagen and average revenue profile is somewhere between \$200-230-240 million range, it is about 6-7 million per product range. But I think our new launches will be higher than that, and in some cases, significantly higher than that.
- Prakash Agarwal:** On the generic-generic model, the government is proposing, how do we see this really being implementable or the big challenge is being quality supply, so what do you think are the big challenges and do you think how would it shape up please?
- Umang Vohra:** I think I will say two things, maybe the quality aspect of this is very important for the government to address and the IPA I believe is working with the government in this regard, which is to make sure that most companies in India have the same quality footing. So that is one. I think Cipla is advantaged in a certain way because it already has a trade generic business and that business is possibly closest to what the government wants in terms of pure generic play.

- Prakash Agarwal:** Have we started to see some impact on the ground in terms of doctors already started to write generics-generics?
- Umang Vohra:** Some of them have, but it will catch up over time.
- Moderator:** Thank you. We will take the next question from the line of Narottam Garg from CWC Advisors. Please go ahead.
- Narottam Garg:** I just wanted to understand the inhalation space in USA better. So what we understand is that the market in Europe has quite a lot of generic competitors, where in US it has not happened till now because of patents and regulatory concerns. But now that patents on some of the key devices are expiring and the fact that the FDA has started providing much clearer guidelines for getting the products through. How much time do you expect that the market for Inhalation in USA may become as genericized as it is in Europe?
- Umang Vohra:** It is different. I think the condition in Europe is not for extensive PD study, the condition in the US is for extensive PD study. So we believe that itself will reduce the competitive profile in the US vis-à-vis Europe. But having said that most patents expire in the time period of 2019-2023. So the market will begin to form there. There are some product categories where there are no patents, for example, Albuterol and the category that we filed, and it really depends on when we get approval to begin to form the market there.
- Moderator:** We will take the next question from the line of Anubhav Agarwal from Credit Swiss. Please go ahead.
- Anubhav Agarwal:** Umang, on personnel cost side, we have done a very good job. Just wanted to see that how much scope further is there to get some more cost saving? With this question, can you also elaborate when you mentioning slight organization wide job description is getting exercised, what is that initiative about?
- Kedar Upadhye:** Anubhav, I think among various categories starting from maintenance cost, starting from API, some of the indirect procurement categories like intermediates recipients, we believe there is good scope and we are working on a cost project which has ambitious target and some of that will reflect in our quarterly P&Ls in the coming period.
- Umang Vohra:** On the other side, Anubhav, what we are also trying to do is that considering our cost base and the organization structures, important to establish the relevance of grades and people to the task that they do. That is how we have done the job handling exercise and overtime hopefully this exercise will also help us to be more productive as an organization going in the future.
- Anubhav Agarwal:** But just a clarity on that Kedar on your comment, most of the things you talked about will be reflected as a cost saving in the other expenses rather than personnel cost, right?

- Kedar Upadhye:** Yes, it will be across material cost, It will be across other expenses and going forward we could relook at people cost as well.
- Anubhav Agarwal:** Just two or three more clarity: One is on CAPEX you mentioned Rs.1,100 crores. What kind of reduction intensity are you talking about, let us say next two years, can we be Rs.700, 800 crores CAPEX or what kind of level you are talking about?
- Kedar Upadhye:** The kind of footprint we have, Anubhav, globally, I think annually, we would need somewhere between Rs.700 crores to Rs.900 crores. I think incrementally, we could relook at releasing anywhere between Rs.200-250 crores into the cash flow in the coming 2-3 years.
- Anubhav Agarwal:** This will start reflecting to us in fiscal '18 onwards?
- Kedar Upadhye:** Yes, it will be a gradual release...each year there will be improvement that you see.
- Anubhav Agarwal:** On R&D, so this quarter was high, but fiscal '18, you are expecting it to be around 7% to 8% or 8% to 9% band?
- Kedar Upadhye:** It will be in the 8-8.5% band.
- Anubhav Agarwal:** If that is the run rate, then this quarter is not abnormal?
- Kedar Upadhye:** For the first nine months, we were around 6.6%, 6.7%. I think in Q4, we have stepped it up. On full year basis, next year subject to again the timing of the trials, this would vary on quarterly basis, but it will settle somewhere in between 8-9%.
- Anubhav Agarwal:** How many ANDAs are impacted from InvaGen charge that you have taken?
- Umang Vohra:** Not many, there are very few, and it is a mild charge that has been taken just to reflect the pricing environment and some litigation outcome that have seen in the portfolio that some of this is in the current portfolio, some of it is in the portfolio in the future. So it does not change our operational thesis for the business, it is a very mild charge we have taken just to reflect the true value on the balance sheet.
- Anubhav Agarwal:** Would you say low-single digit number?
- Umang Vohra:** Yes.
- Moderator:** Thank you. We will take the next question from the line of Surya Patra from PhillipCapital. Please go ahead.
- Surya Patra:** Sir, just wanted to have a sense about the kind of general consolidation that we are currently seeing in US and likelihood of the impact of that on our portfolio? Is it fair to believe that since

our portfolio is a limited size portfolio, so we can have a larger impact of this channel consolidation is price erosion compared to larger established players?

**Umang Vohra:** So it is a mix of both though it is interesting that Cipla from value and volume perspective plays very differently in the US. If you look at volumes, Cipla is 9<sup>th</sup> largest. So we are very relevant to any customers portfolio in the US and therefore though consolidation is there and there is news of another consolidation happening right now, but I do not think that materially changes how we operate because if you are among the top ten volume wise, you are very relevant to any customers operations in the US.

**Surya Patra:** The GST, are you seeing any kind of impact on the distribution of the generic business generics in the domestic market for some time which could have adverse impact for the overall growth in the domestic formulations business in FY'18?

**Umang Vohra:** So I think we are seeing destocking in the channel, there has been a fair amount of destocking and I think this will continue possibly till the time GST is announced. So I think we have to give it about a month, month and a half more until the normalcy returns, but yes, we are seeing this.

**Moderator:** Thank you. We have the next question from the line of Neha Manpuria from JP Morgan. Please go ahead.

**Neha Manpuria:** Kedar, if I heard your comment correctly, you said adjusted for one-offs in the last fourth quarter, our EBITDA margins improved about 200 basis points YoY. Would that imply that there is a certain amount of one-off even in this quarter?

**Kedar Upadhye:** Yes, there have been because towards the end of March, the rupee appreciated significantly. So we had booked certain FOREX loss, there have been certain adjustments in inventory, not very high but if I put all this together for the quarter, we are in that 16-18% growth, and compared to last year, same quarter, in fact, the margin expansion on the base business is more than 400 basis points.

**Neha Manpuria:** Then what is this 200 basis points essentially?

**Kedar Upadhye:** Reported versus adjusted. So I think we are reporting...

**Moderator:** Thank you. We will take the next question from the line of Nitin Agarwal from IDFC Securities. Please go ahead.

**Nitin Agarwal:** Kedar, just a housekeeping. On the depreciation charge, can you explain is there additional charge which is there, even if we adjust for the two charges you mentioned, the depreciation charge is pretty high for the quarter. So how should we look at that, and what implication does it have for full year numbers going forward?

**Kedar Upadhye:** Nitin, you should take out Rs.400 crores which is noncash impairments for Indigo and Biotec.

- Nitin Agarwal:** That is about 270 right the numbers that you provided us?
- Kedar Upadhye:** So that is net of tax. So I think in the impairment line, we have booked about Rs.350 crores for Indigo and Rs.57 crores for Biotec. If we take this Rs.410 crores out, you get a normal depreciation and amortization expenditure of somewhere around to Rs.220-230 crores. That is something you should consider.
- Nitin Agarwal:** On the R&D, we had about 7%, 7.5% of revenues as you mentioned earlier. Umang, how do we see this thing going forward in the context of our ambitious plans for moving in Complex as well as Specialty and where does that leave us with respect to levers for expanding our margins from the current 16% to 18% level that we have let us say next two to three years?
- Umang Vohra:** So I think the margin expansion story will continue. I think it may not be as rigorous as we have done it in the previous year because the R&D is now beginning to peak out a bit but we are definitely going to show EBITDA growth higher than sales growth year-on-year.
- Moderator:** Thank you. We will take the next question from the line of Saion Mukherjee from Nomura Securities. Please go ahead.
- Saion Mukherjee:** The losses in the new venture business, how should we think about that going forward? I think you had made Rs.130-140 crores this year, right? So how that we should think about going forward?
- Kedar Upadhye:** Saion, you are referring to the segments results table? I think for the full year, we have booked about Rs.120 crores of the loss in **new ventures** segment. That actually has Rs.120 crores of income from Chase Pharmaceuticals and about Rs.57 crores of the Biotec loss that we have booked. So if we adjust this somewhere Rs.180-200 crores for this year, and as we alluded going forward, I think we would be repositioning the Biotech business and from capital allocation standpoint, we are rotating back towards our Complex Generics and Specialty investments. Specialty space in new ventures, Complex Generic is part of the Pharmaceuticals segment.
- Saion Mukherjee:** So this number of Rs.200 crores would come down or at least will not go up, that is what you are saying?
- Kedar Upadhye:** Yes, subject to investments in Specialty, but unlikely that will go up from these levels.
- Saion Mukherjee:** Umang on the US filings and launches, have you received any communication or target action date with respect to FDA and Nanopaclitaxel filings?
- Umang Vohra:** Yes, for both, we have that.
- Saion Mukherjee:** : So it is expected in this fiscal year?

- Umang Vohra:** Yes, both are expected in this fiscal year, but Nanopaclitaxel, just to tell you is also an IP challenge.
- Saion Mukherjee:** In terms of your guidance for the US of substantial launches, is it possible for you to quantify, like when you say substantial, in excess of like \$6 million to \$7 million that you are looking at or any color on the nature of the products, etc., would be helpful?
- Umang Vohra:** So right now, Saion, we do not want to provide that, but I can just say that each of the launches we have planned in the limited competition categories will be significantly higher than the 6-7 million profile per year.
- Saion Mukherjee:** When you look at a slightly long-term, Umang which is FY'19, do you see that accelerating... how is the pipeline?
- Umang Vohra:** Very significantly because we are again hoping to file more than 20-25 this year and does this year and 32 were filed in the previous year. So yes, the launch profile will accelerate quite significantly.
- Moderator:** Thank you. We will take the next question from the line of Nimesh Mehta from Research Delta Advisors. Please go ahead.
- Nimesh Mehta:** I actually have a question more broadly for the Indian market. If I am not wrong we have seen some new quality norms thereby every company will have to conduct trial on the product. So first of all is that understanding true and if yes, do you think any significant increase in overall costs for the Indian business not just for you but for everybody, and what do you think would be the overall impact for companies like Cipla especially for you?
- Umang Vohra:** No, I do not think there is big impact. I would like to say that for new products now, it will be mandated to do clinical trials. I think in any case most of the new products that were being launched, significant large share of them for the top companies were being done through clinical trial. So I think this equate the feel for everybody else in the market other than the large players as well. So, I do not see very significant impact on account of this. I think the impact could be that new launches could be delayed a bit on account of finishing the clinical trials and just amount of lag, how much of lag is created before the government to approve these clinical trials.
- Nimesh Mehta:** But this new product when we say we are talking about US, those products which might be already in the market, but for the company, it might be new. So to that extent the number of competition per brand will decrease. Is that a right assumption?
- Kedar Upadhye:** So Nimesh, actually not sure whether the timing for clinical trials would be a barrier for entry. In our view, probably not. It might delay launch by a few months. But we do not think it is going to be a significant barrier for entry.

- Nimesh Mehta:** Next one on US. You mentioned that you are likely to have a very robust launch pipeline next year. So given that our EBITDA margin is about 16-18% in this year, that should significantly increase, I mean, it may not just be simply higher than the sales growth, is not that fair assumption given the kind of US launch pipeline you have?
- Umang Vohra:** I think we have just said that we have a launch pipeline which we believe is the launches are significantly higher than the revenue profile of 6-7 million per product, right? It will mean that our EBITDA will expand, but we are reinvesting in almost 100-150 basis back into EBITDA for that. So I think it will expand, but at the same time, please understand that the GST will pretty much take out one quarter of growth out of India, and it is just the destocking, it is just like last year, we lost a little bit due to demonetization, this year we will lose a little bit out of GST, and I think you have to factor those things into effect when you take a look at the financial year for next year.
- Moderator:** We will take the next question from the line of Sameer Baisiwala from Morgan Stanley. Please go ahead.
- Sameer Baisiwala:** Umang, just because the niche launches next year are pretty important from P&L perspective, greater than six can be anything, so let me take a shot at it. Is it something like between \$30-50 million, those kind of substantive products or is it less than that?
- Umang Vohra:** Sameer. I am tempted to answer you, but I do not want to. In the sense I cannot say that they are \$30-\$50 million launches, I think it is a mix, some are lesser than that, some could be in that range. So I do not think this is an average that every launch will be 30-50 for us.
- Sameer Baisiwala:** Umang I would have expected much better margin outcome, because you continue to focus on cost, you continue to take cost containment, some of these niche launches seems to be pretty largish in size. Even if you have to invest back 100, 150 basis points and even if there is some, I would say very modest impact of GST, given India is not all that bigger portion of, so I would have thought that your margin expansion story could have been much significant considering where you are right now which is about 17%.
- Umang Vohra:** Sameer, I think we are saying that we will grow margins higher than sales. We would like it to be significantly higher than sales. I think GST is going to be modest, I think the impact of GST, I am not sure, we can call it modest and for Cipla, India's 35% of the portfolio.
- Sameer Baisiwala:** 35%, if I just take it one quarter and then you lose a growth on that one quarter, if you do the number, it is not too much?
- Umang Vohra:** But let me stop you there, I agree with where you are going, but look at our Q4, Sameer, that is a great example, right? In Q4, our India business reported a number which was flat or marginally degrowing, right, and that created 15-16% EBITDA charge. So, it is very responsive to how India grows for us at this stage. Now, maybe one year later than the way we comment and the commentary could be very different depending on how the US pans out. But for the next year,

yes, India is still a large part of Cipla's performance and I do not think that GST is a modest impact. One quarter in a year is 3-4% of growth.

- Sameer Baisiwala:** Sevelamer, how much do you think is getting delayed?
- Umang Vohra:** I would like to believe that we could see this as a Q3 launch, but based on some commentary that I have read of other competitors and their TAD dates, etc., I would think somewhere around Q3, Q4 is possibly how we are looking at it right now.
- Moderator:** We will take the next question from the line of Kartik Mehta from Deutsche Bank. Please go ahead.
- Kartik Mehta:** Just trying to understand what is the hedging policy of the company in terms of the US business?
- Kedar Upadhye:** We do cover the net exposure on the balance sheet at a particular point of time for both dollar and ZAR since these two currencies are prominent for us. At this stage, we do not have a cash flow hedging policy, but we are going to relook at that soon considering the strengthening of the rupee.
- Kartik Mehta:** Maybe this is for Umang also. You have strong rupee, your other peers they seem to be very negative on the US filing side, both from the channel consolidation and maybe new players entering because of faster GDUFA, which is linked to approvals. So how do you look at your profitability in the US business in terms of the next two years or even next one year? I am not asking for a number, I am just asking for color based on the macro environment... the rupee and approvals?
- Umang Vohra:** We see our business scaling up both profitability wise and as a portion of Cipla. There are two-three reasons for this. Cipla US as it stands today is a completely hedged operation, if you really look at it because most of our costs are in dollars, bulk of our Invagen sales are all dollar-based expenses, and the product that they launch out of India, out of our pipeline here will contribute to a surplus. So right now we have a good hedge between our cost and our revenue because all the products for InvaGen are sold out of manufacturing in the US. So we really do not have the issue for us to be too worried about hedging for this moment other than for translation which Kedar has explained. Actually, from our perspective, commensurate with where we are in our size, we believe that we are among those new people who are getting approved because we have challengers right now, we are not people who are mature like some of our peers in this market. So it is really about how the story unravel in the marketplace from a US launch perspective. So while the pressure in the market are there, and it depends completely on our launch calendar like you have said, but I do not think it is the same applicability to Cipla as it is to the rest of the universe.
- Kartik Mehta:** The profitability if bulk of these products are filed from a non-Indian facility, would also be low, right, Umang, so I am just...?

- Umang Vohra:** But we are not saying that, we are saying bulk of our existing business today is out of Invagen manufacturing and Invagen sales.
- Kartik Mehta:** The new launches?
- Umang Vohra:** The new launches will be a mix of the two, so which is why for us hedging from the forward perspective is more important than it is for how our current business is set up today.
- Moderator:** Thank you. The next question is from the line of Prakash Agarwal from Axis Capital. Please go ahead.
- Prakash Agarwal:** Just trying to understand the R&D comment better. You mentioned the Biosimilar initiative you are exploring with the partner or something and not in your main R&D center. Is that right?
- Kedar Upadhye:** Prakash, what we are saying is till now the biosimilars whole effort was in terms of organic development and organic manufacturing which we are sensing to be quite resource-intensive and it sort of squeezing our future targeted investments in Respiratory and Specialty. We would have BD/In-licensing model for Biotec and the organic development route for Specialty and Respiratory gets more priority.
- Prakash Agarwal:** So this 8-8.5% is excluding this number or including?
- Kedar Upadhye:** That is all
- Prakash Agarwal:** That include Biosimilar initiative but in a different style is what you are saying?
- Kedar Upadhye:** No-no, 8.6% include the current scale of our investments in Biotec. For the next year, it does include the investments in the area.
- Prakash Agarwal:** This 32 filings that you have done, broad color because you have been talking about Injectables, Oncology and stuff. So, if you could give a broad color how many are plain vanilla ones and how many are some niche categories?
- Kedar Upadhye:** We can take it offline, Prakash.
- Prakash Agarwal:** Last comment on what previous question about the generic-generic model which has started to see on the ground. I am just trying to understand the profitability you do business in generics model, but how is the profitability, it would really impact the profitability, just some thoughts there would really help?
- Kedar Upadhye:** The kind of cost structure, the kind of very lean field force for the Generic business is not far away from our Prescription segment today.

- Moderator:** Thank you. The next question is from the line of Vishal Manchanda from Nirmal Bang. Please go ahead.
- Vishal Manchanda:** Just trying to get a better sense on US pricing. So if you could guide like for some of the mature products in US that there is significant generic competition, are the prices comparable to those in Europe or in India?
- Kedar Upadhye:** We have to do a product-by-product assessment, but my view is US prices would be higher than European prices.
- Vishal Manchanda:** So even for the most competitive products, they would be still higher?
- Kedar Upadhye:** Even for the most competitive commodity products, the US prices, my sense is would be higher than the European prices.
- Vishal Manchanda:** Any sense on how high kind of 50%, 20% or maybe twice or thrice of the European prices?
- Kedar Upadhye:** It could vary product-by-product, but like what you know the innovative prices in Europe itself was about one-third or 40% of the innovator prices in US and some of that could translate into generics as well.
- Vishal Manchanda:** One question on Chase Pharma. So the milestone payments that you are expecting, are all these related to regulatory milestones?
- Kedar Upadhye:** Yes, there are various kind of milestones related to trials, patient dosing.
- Alpesh Dalal:** There is not just one milestone, there are a number of milestones and they could be related to regulatory as well as commercial.
- Moderator:** Thank you. The next question is from the line of Charulata Gaidhani from Dalal & Broacha. Please go ahead.
- Charulata Gaidhani:** My question pertains to you have commissioned the plant in Sikkim. Is that the reason why your depreciation is higher?
- Kedar Upadhye:** The depreciation on that plant is there only for a quarter. I think the reason the depreciation is higher, Charulata, is what we explained earlier, that some of the non-cash charges are booked in that line for the quarter which are not recurring. So you need to take out about Rs.400 crores from the depreciation line. That is the gross of tax amount of this non-cash charges.
- Charulata Gaidhani:** The government has been talking of medical devices coming under price control. So do you think it would include the Inhalers also?
- Umang Vohra:** Yes.

- Charulata Gaidhani:** How do you see decrease in prices because of that or are your prices at the lower side already?
- uUmang Vohra:** MDI is also under price control.
- Moderator:** Thank you. The next question is from the line of Anmol Ganjoo from JM Financial. Please go ahead.
- Anmol Ganjoo:** My question is for Umang. You have obviously made tweaks to the capital allocation philosophy. It has been time and you have had a hard look at most of the capital allocation decisions. Is it fair to assume that whatever tweaks were necessary are now broadly behind us from a capital allocation standpoint, whether it is getting out of Biotech to Specialty Generics and so on and so forth?
- Umang Vohra:** By and large, yes.
- Anmol Ganjoo:** My second question is, you spoke about 16% adjusted EBITDA margin. What is the exact amount of R&D cost that you are adjusting when you...?
- Kedar Upadhye:** No-no, compared to nine months, Anmol, the R&D in Q4 is about 160 basis points higher, there have been certain charges on FOREX, there have been certain inventory adjustment. So we are just saying that if you add all these three put together, you are in the 16-18% zone.
- Anmol Ganjoo:** But, this in the context of next year is not an abnormality given that we are going to be reinvesting a part of our margin gains back into R&D as you explained right?
- Kedar Upadhye:** Yes, next year the investment to do R&D goes up and hopefully that gets funded by margin, material cost, increase revenue, then cost control in other expenses line.
- Anmol Ganjoo:** My last question before I get back into the queue. Kedar, you made a comment that the margin differential between our generic-generic business and branded-generic business is not that much. So a logical extension of that argument would be that, should the market move towards being more generic-generic in the context of India, the volume gains that business like ours should have will offset whatever we lose in terms of value. So the worst case scenario for the overall industry might not pan out to be that bad for Cipla. Is that a correct understanding?
- Kedar Upadhye:** No, I was just saying the net margin of the generics business are not far away from the prescription business...there is some gap, but the scale is quite different. In Generics business, there is only 18-20% of the overall India for us. So I think to get to scale with that kind of margin is going to be certainly tough.
- Anmol Ganjoo:** Just an extension of this. What is the various kind of scenario that you are working with in terms of the disruption, maybe on account of GST, maybe regulation in the Indian domestic market, because based on the commentary, it seems that you are probably the only company amongst your peers which seems more confident on export growth as opposed to the domestic?

- Kedar Upadhye:** So I think on the GST, Anmol, we are trying to do whatever possible in terms of IT, in terms of connect with vendors, connect with trade channel internally and we believe we are quite confident in being able to do that within time for the implementation. Getting a handle on the disruption is quite tough. We are trying to do everything possible to connect with trade to give them assurance on the compensation for the differential duty on the stocks held on the transition date. So all those efforts are on, we are trying to do our best to mitigate the disruption.
- Moderator:** Thank you. The next question is from the line of Krishna Prasad from Franklin Templeton. Please go ahead.
- Krishna Prasad:** Just following on the GST, do you expect any material impact on your India margins because of GST implementation, some other are cyclical and could that sustain even after the implementation?
- Kedar Upadhye:** Krishna, I think the impact on margins is not expected to be quite high because that simulation of various changes in terms of duty credits, in terms of pricing, does not suggest a significant impact on the margins.
- Krishna Prasad:** Second question is last quarter you had spoken about some capital raising plans. Any update on that?
- Kedar Upadhye:** So currently we have enabling resolution from the board, not very active at this stage in terms of capital raising, but we are watching for the opportunity.
- Alpesh Dalal:** Even in the last quarter, we did mention that this is only an enabling resolution that we have taken, not that we are going ahead with any active plans, so the status continues.
- Moderator:** Thank you. The next question is from the line of Surya Patra from PhillipCapital. Please go ahead.
- Surya Patra:** In fact query is that throughout FY'16 possibly we have done all those business restructuring activities or rationalizing our portfolio and all that or exiting out of the non-contributing regions. So whether that has started contributing to the margins or earning efficiency and all that? Can that further continue in expanding the margin in the subsequent period because it is in the range only, so some sense on that would be useful?
- Umang Vohra:** Surya, there have been certain offsetting adjustments every quarter, but all the three things that you mentioned, Euope, Biotec, complexity reduction exercise, all these we have significantly benefited from operations standpoint and from P&L standpoint. Europe, for example is very significant the improvement in profitability in the Europe region, the change in business model from direct to market to B2B, that is quite significant in terms of the P&L contribution.
- Surya Patra:** Again, we do not have any handle on the kind of fluctuating currency impact on the emerging markets business which is a kind of significant portion. Any thought on that?

- Kedar Upadhye:** The overall P&L, Surya, is not very sensitive to FOREX because India cash flows are a significant component out of our total cash flows, so P&L is not highly sensitive to FOREX fluctuations, but yes, once a while countries like Yemen impact our FOREX gain and loss.
- Moderator:** Thank you. Due to time constraints, we will take the last question from the line of Krishnandu from Quantum Mutual Fund. Please go ahead.
- Krishnandu:** This question is for Umang. You spoke about beginning Q2 one limited competition launch. Just wondering how long will that last – maybe two quarters, three quarters or a full year?
- Umang Vohra:** Depends on the product, Krishnendu. Right now we cannot guide. It also depends on when the others will come in. so it may not also be a product category where Cipla is first, we maybe actually launching third or fourth in that category but the market may have already formed for it. So I do not think we are guiding to how long it will last, we are just saying that we believe that these are significant opportunities starting in Q2 end.
- Krishnandu:** Significant opportunities last around three, four quarters. Is that a fair understanding?
- Umang Vohra:** I cannot guide to that as an average because it is a range of products.
- Krishnandu:** But what is the range of products you are saying, how many numbers?
- Umang Vohra:** We said we will have at least one every quarter, that is what we are looking at.
- Moderator:** Thank you. Ladies and gentlemen due to time constraints, that was the last question. I now hand the conference over to the management for their closing comments.
- Alpesh Dalal:** Thanks for your interest in Cipla and your participation. If there are any other follow on questions, we will be happy to take it offline as part of the IR Team. Thanks a lot.
- Moderator:** Thank you. Ladies and gentlemen, on behalf of Kotak Securities, that concludes this conference call for today. Thank you for joining us and you may now disconnect your lines.