“Cipla Limited Q3 FY18 Results Conference Call”

February 07, 2018

MANAGEMENT: **MR. UMANG VOHRA – MD & GLOBAL CEO, CIPLA LIMITED**
MR. KEDAR UPADHYE – GLOBAL CFO, CIPLA LIMITED
MR. NAVEEN BANSAL – INVESTOR RELATIONS TEAM, CIPLA LIMITED

MODERATOR: MR. CHIRAG TALATI – ANALYST, KOTAK SECURITIES

Moderator: Ladies and gentlemen, good day and welcome to the Cipla Q3 FY18 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: 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, MD and Global CEO; Mr. Kedar Upadhye, Global CFO and Mr. Naveen Bansal from the Investor Relations team. Over to you, sir.

Naveen Bansal: I am Naveen. A small disclaimer before we begin this call. On this call, our discussion will include certain forward-looking statements which are predictions, projections or other estimates about future events. These estimates reflect management's current expectations of the future performance of the company. Please note that these estimates involve several risks and uncertainties that would cause our actual results to differ materially from what is expressed or implied. I would now request Kedar to walk us through the financials for the quarter.

Kedar Upadhye: Thank you, Naveen and good evening to all of you. Welcome to our earnings call for third quarter of fiscal 2018. I hope you had received the investor presentation that we have posted on our website. I will now take you through some of the key themes which are emerging from our financials of this quarter.

Firstly, on the revenue trajectory, the results of the quarter you may have seen demonstrated very strong momentum across our businesses in India, South Africa, API, Europe and Sub Saharan Africa markets. On the core margins and the quality of earnings, this quarter they reflect improved mix and continued focus on the cost optimization. During this quarter, our core margins expanded by about 230 basis points on a year-on-year basis associated with gross margin expansion and very consistent year-on-year decline across employee and other expenses. Thirdly on the balance sheet health side, it has been improving consistently. Our efforts have benefited in keeping working capital investments under check and the tapering down of capital expenditure. As a result, free cash flows are strong and have increased by about 56% sequentially and 29% on a year-on-year basis. The net debt-to-equity ratio has improved to 0.13 as at December from 0.20 as at March 2017. Net debt to EBITDA also declined from 0.92 at the beginning of the quarter to about 0.68 at the end of this quarter.

Fourthly on the tax side, you need to consider couple of adjustments which I will explain in the balance of the call to get to the effective tax rate for the year, which is in line with what we have communicated which is about 25%. Overall income from the operation stands at about 3,914 crores which indicate year-on-year growth of 7%. If you adjust it for the impact of GST classification, the normalized overall company level revenue growth is about 10%. Gross margin after material cost is about 65%. It improved over 300 basis points sequentially in line with the

comments that we made in the last quarter call. This was on the expected lines and is a result of better geographic mix and product mix at the overall company level. As it is usual to see in the quarter 4, the next quarter ending March 2018, considering seasonality and the geographical mix, we are likely to see some moderations in the gross margins. During the quarter, we also maintained strong control on the spends with total expenses which include employee cost and all other expenses at about 1,717 crores, they declined marginally on a sequential basis.

The employee cost for the quarter stood at about 657 crores. The other expenses for this quarter which include R&D, regulatory, quality, manufacturing and sales promotion expenses, they were about 1,059 crores. They declined marginally on a sequential basis. Total R&D investments for this quarter are 7.6% of revenues, they are up as we are targeting by about 150 basis points. The increase was driven by clinical trial charges among others. With all this, reported EBITDA for the quarter is about 819 crores or 20.9% of revenue. This is an increase of about 21% on a year-on-year basis. You would notice an increase in the depreciation and amortization line which is on account of a drop in the value of our acquired intangible asset for the US generics market due to the evolving pricing environment and delay in launching some of the products. The overall impact of this net of tax is about $27 million. Tax charge for the quarter is negative due to the fact that the deferred tax balances for US business have been suitably adjusted to give effect to the applicable tax rates in the US, post the tax reform.

The full year ETR adjusted for these one-offs continues to be around 25%. The reported profit of the tax is about 401 crores which is 10.2% of sales. As mentioned earlier, if you adjust the PAT for the quarter because of the one-offs related to change in tax rate as well as the impairment of intangibles, the YoY growth is about 25%. Free cash flow after CAPEX for the quarter is about 482 crores. In this quarter, we have invested 142 cores on the capital expenditure which is lower compared to our historical trend and in line with our overall intent of tapering down the capital expenditure. Our long-term debt remains at USD 550 million which was mainly used to fund Invagen acquisition. We also have working capital loan of about USD 107 million which act as natural hedge towards our receivables. Outstanding forward contract as a hedge for receivables as of December 2017 is USD 61 million and South African Rand 750 million.

During the quarter, we have also hedged the certain portion of our forecasted export revenues and the outstanding forward contracts as cash flow hedge as of 31st December is USD 56 million and Rand 125 million. With this, now I would request to invite Umang to present the business and operational performance. He is joining from another location over phone line.

Umang Vohra: Thank you, Kedar. We are progressing quite well on our key priorities for the year. Our key markets continue to deliver strong growth. India business delivered an exceptional growth during the quarter of 22%, when adjusted for GST with both prescription and generic businesses delivering healthy growth. South Africa, API, Europe and Sub-Saharan African markets continued the strong momentum. This quarter we saw the approval and launch of our much-awaited limited competition products, Budesonide and Decitabine. We also launched Sevelamer. However, the pricing in the market has not resulted in the sales uptick so far. We have contracted

a fair share in these products already and we will see ramp up in coming quarters. You would have also seen an announcement of the approval of Tenofovir Disoproxil Fumarate which is generic for Viread. We are targeting to maintain the launch trajectory in the US for the good mix of differentiated products. We remain committed towards establishing a regulated market respiratory franchise and have achieved significant milestones during the quarter in this journey. Happy to share that on generic Advair, we have commenced trials and will soon be dosing in patients. We are also targeting initiation of two more clinical trials for the US in the coming quarters.

In Europe, we have expanded our respiratory franchise with the approval of Beclomethasone in UK, we will be the first generic player in the market. We expect to file over 10 products in quarter 4 for the US FDA taking our financial year filing count to over 20 ANDAs. Our manufacturing and R&D sites remain in a state of compliance and control.

For the quarterly performance of the total revenue of 3,914 crores, 42% was contributed by the domestic business and 56% by the international business and the rest was operating income.

I will now take you through our business performance starting with our India business. We had a very strong quarter with the overall business growing at 15% year-on-year on a reported basis and 22% when adjusted for GST. Going forward, the growth may get moderated marginally as we saw some element of inventory buildup during the quarter, taking our overall inventory days to a normalized level now. During the quarter, Cipla outperformed the market with 12% versus the market growth of 10% and increased market share by 10 basis points to 5.3% as per the IMS in quarter 3 FY18.Key TAs delivered above market performance including our cardiac segment which grew at 12% versus the market of 7%, anti-infectives which grew 14% versus 11% and respiratory which grew 14% versus the market at 12%. Derma also grew higher than market. As you are aware, we have been focusing on leveraging our commercial strength to partner with various MNCs. In the 9 months period so far, we have already launched 6 in-licensed products.

Our North America business had sales of 100 million and moderately lower than what we had expected. Current quarter numbers do not factor much contribution from the recent launches as those are in the process of getting ramped up. Our contracted shares look healthy and we are excited to build a stronger trajectory in the coming quarters. Having said that, we are taking a deeper look into our marketed portfolio at the margin level and the relative burden on our manufacturing and supply chain infrastructure to see whether we need to intervene and rationalize a few of our selling products. The idea is to build a US business with a healthy profitability profile.Coming to the market performance as per IMS MAT December 17, Cipla is the market leader in 13 out of the 48 marketed products. We are in the top-3 position for 65% of our portfolio. Cipla has been consistently ranked among the top 10 most dispensed generic companies in the US. During the quarter, we have filed two new products and are on target to file over 20 ANDAs in the financial year. As of December 17, we have a total of 94 ANDAs pending for final approval including 27 with tentative approvals. Of these 98, 68 are Cipla/Invagen ANDAs, 11 are partnered and 15 are filed under PEPFAR.

The SAGA region, which includes South Africa, Sub-Saharan Africa and Cipla Global Access businesses recorded growth of 11% for quarter 3 on a year-on-year basis when reported in US dollars, impacted favorably by the strengthening of the ZAR-USD versus last year. Our South Africa business delivered yet another record quarter of highest ever quarterly sales of Rand 1.09 billion which translates into 7% growth for quarter 3 versus last year. As per IMS MAT December 17, Cipla grew ahead of the market at 11.1% in the private market versus 10.3% market growth and maintained its position as the fourth largest pharmaceutical company and third position when tender businesses are included. Our partnering effort saw a significant boost in business development agenda with the Anmarate acquisition and a deal with iNova, leading to new launches in South Africa market. During the quarter, we also concluded a deal with Adcock Ingram to commercialize the comprehensive over-the-counter portfolio in Uganda and expand our footprint in Sub Saharan Africa.

Our global access business degrew 13% over last year during the quarter due to tender phasing and challenges in the funding environment. We are increasingly focusing on increasing the access to affordable care in various parts of Africa through global access and our Ugandan subsidiary. QCIL which is an Uganda subsidiary recorded a growth of 59% year-on-year and had its highest ever quarterly sales in quarter 3 driven by strong tender delivery.

Our Europe business continues to show strong performance with quarterly sales up 19% year-on-year basis. We are expanding our respiratory franchise and we received approval for Beclomethasone as we mentioned earlier. We are on track to launch the product through our front end and will be the first generic player in the market.

In emerging markets outside Africa, quarterly sales degrew marginally on a year-to-year basis in dollar terms. The quarter was challenging given the geopolitical uncertainties in several Middle Eastern markets. On the upside, we continue to gain traction on the FPSM launch in Australia and are looking to increase our market share in the coming financial year. We are working on strengthening our business development efforts across these markets to drive future growth.

Our R&D investments are focused towards building a strong growth platform for the US. Amongst the top 50 R&D projects, we are working on 16 Para IV filings in the area of respiratory, oncology and dermatology. These also include 15 plus limited competition opportunity. As alluded to in our earlier calls, we are committed to building a strong specialty portfolio for US. We at this stage are sharing details only about our phase 1 Tizanidine patch and that is progressing smoothly. We are evaluating multiple assets with some in advanced stages of discussion in Neurology and Respiratory.

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

Moderator: Sure, thank you very much. We will now begin with the question and answer session. We have the first question from the line of Manoj Garg from Health Co. Please go ahead.

Manoj Garg: I just have two questions. First on the general trajectory of the US business and then secondly a little bit more specifically on your generic Advair R&D. So first in terms of the US business, the business has been stable for several quarters here at an approximate run rate of about 100 million which is relatively impressive in itself, but just given the number of ANDAs that you have pending since we do not get a lot of visibility into the specific products, what is the magnitude that you think the US business can grow to over the next couple of years? And then a follow one there, Kedar, last quarter you mentioned that given the gross margins on that business that it is not yet able to cover the R&D expense. How large the US business need to grow to at current margins to be able to do that and then I would just ask with generic Advair question as well, so on generic Advair, what is the general timeline that we should assume where you would be ready to file and I am sure you are obviously aware of some of your competitors having some issues essentially with the FDA on their products. So I guess maybe you could help us understand what kind of feedback are you getting from FDA on that product and what the biggest hurdles are?

Kedar Upadhye: Umang, would you like to take the question on the trajectory and Advair?

Umang Vohra: Yes, certainly. So I will speak to the two questions and then Kedar can answer the question on the margins. So in terms of trajectory, I just like to say that I can't give you any specific numbers, but I do believe that this trajectory should begin to improve quite dramatically from where we are now. I think you are right, we are at about a 100 million and over the call, we have reiterated that we tried to absorb as much of price erosion from whatever we were trying to bring to the market and I think as limited competition opportunities open up, we should be able to show growth over the 100 million trajectory. So I think good reference points would be what happens in the next 2 quarters or 3 quarters as these launches come up. On generic Advair, I think at least what we have heard from the FDAs largely around discussion that you have before you initiate a trial. I think those discussions we have been having with, and at the same time I would also like to add that very often in these trials, you sometimes realize that that your pilot studies had some issues and then you have to go back and redo them which is what we are hearing some of our competitors having and the trials are not slam dunk. It is lot of effort. I believe that about 15 to 18 months away from filing.

Manoj Garg: Okay. That is helpful. And Kedar, if you could help us better understand some the US margins?

Kedar Upadhye: Manoj, our current scale of business with the current mix of products, we are barely able to cover the R&D and the manufacturing overheads. Without giving any guidance, we would like to believe that the scale-up of opportunity presented by the products which we have launched in the quarter, next year the trajectory seems much better. The fully loaded profitability of large peers who are about a billion dollar in revenue have upwards of 25%-30% of profitability, but we have some way to get there. Having said that as I said, next year we are quite positive to turn the trajectory upwards.

Manoj Garg: So next year you are quite positive that you should see margin improvement?

Kedar Upadhye: On the US side, yes.

Manoj Garg: And it seems like that there will largely be a function of output from some of this pipeline?

Kedar Upadhye: That is true. When we talk to all of you in our May call after the annual close, we will be better placed to talk about the next year. At that time, whatever I say, it will be more indicative.

Moderator: We have the next question from the line of Kartik Mehta from Deutsche Bank. Please go ahead.

Kartik Mehta: I have two questions. First, Kedar on the operating expense, there has been fairly low increase on that assuming that R&D cost has also increased. So how do we budget this maybe going ahead because on a YoY basis, you guys just mentioned that R&D will increase, ex of R&D, OpEx and other expenses, how do we look at that?

Kedar Upadhye: So Kartik, there is a part of the other expenditure which is fairly variable with sales in various markets. For example, there are data share fees in South Africa, there are sales and marketing spends in other markets. So that part will vary linearly with the revenue growth. The other part as we have been alluding over the several quarters, we are working on cost optimization program and we should continue to see operating leverage going forward.

Kartik Mehta: And on this one itself. How should we assume R&D cost to the next 1 or 2 years assuming that you will be filing more products, you will have something related to Advair or similar products in the respiratory space, where you may need to spend more. So very specifically R&D as a percentage of sales, where should that be?

Kedar Upadhye: See, from a capital allocation standpoint, the generics R&D will be largely funded through P&L and the specialty R&D largely through a balance sheet. That is a philosophy we are looking at. And given that in a particular year, if 2-3 trials get bunched up together, it is fair to say that we will touch about 9% or so. We are currently 7%-7.5%. We don't see the total spend going beyond that, Kartik.

Kartik Mehta: Yes. And the second one I think Umang was alluding that there are certain products in the US or there is some scope for rationalization of the US business. Could you throw some light on this, on that comment on, so which products, will there be more from Invagen's portfolio or anything? So what is the benchmark when you guys decide that there is a need to rationalize any product or any therapies that you are there in the US?

Kedar Upadhye: Yes. So Kartik, this will be both from Invagen and India manufactured portfolio and the idea is to build the US business with very healthy threshold level of profitability, considering the burden on the manufacturing and supply chain infrastructure. So there is no one specific role which says whether the product is in or product is out from the portfolio, but considering a very holistic evaluation and considering some of the burden on the manufacturing infrastructure, considering

the past history of supply penalties, etc. I think we will take a holistic call. It is not going to be very large, but we will need something to give us flexibility in the manufacturing and capacity.

Kartik Mehta: So it will not be related to the pricing pressure of that product, after you would have received the approval, right? It is a call purely on the supply and manufacturing side. Is that right to assume?

Kedar Upadhye: I think you could actually expect the set of products to be from the older portfolio, not from the recently large portfolio, if that was your question.

Kartik Mehta: That was the question.

Kedar Upadhye: Umang, would you like to add anything on it?

Umang Vohra: No, I think Kedar, you covered it. I think it is a mix of products in the older portfolio where we have seen a fair amount of pricing action and where we don't see margins of threshold and profitability being hit. And it is also way for us to juggle our capacity again because if too many of the old products become volume chuggers for our plants, then we have less ability to bring new move products in. So I think it is a mix of these two that will result in this exercise.

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

Neha Manpuria: Just taking the last question forward, given the lot of the larger players in the US are talking about exiting some of the legacy products and we are top 3 in most of the products that we sell in the US. Do you think that presents opportunity for us to gain volumes and is there part of a portfolio where we do not make money or loss making which you think would be the first, that will get discontinued if you were to do a portfolio rationalization exercise?

Umang Vohra: Neha, I think we will continuously evaluate categories where if we believe that we are the most competitive in the market, then it is quite logical that we will expect others to exit. But if we believe that the market is fairly saturated and the product is unviable, then we would also consider exiting some of those categories. So I think it is a mix of those two decisions and then we were evaluating each product. I think the US market today has reached a point where you have to play it comprehensively for value because you could continue to get lot of volume out of categories which others are exiting, but that I am not sure is as financially wise as earlier it used to be, right. They had many options of trying to restructure your value equation on each product where the volumes suddenly a player exited and volume requirements went up. I think those flexibilities exist less in today's market.

Neha Manpuria: Understood, sir. Sir, second on the specialty business, we have mentioned in the presentation that we are in advanced discussion for some neurology products for these specialty businesses. Now that business obviously requires a lot of upfront cost if and when we decide to get these

products in our portfolio, do you think that cost will start flowing through our P&L in FY19 or would that be a more FY20 type event based on how your negotiations are going on for these deals?

Umang Vohra: So FY20 type situation is likely, but at the same time like Kedar outlined, we do not have the flexibility in our P&L today to pay for extensive R&D on specialty and continue the way we are doing on generic because we do not have the flexibility of having a very large profit pool business in the US as yet. So I think we are trying to use an inorganic approach where we use some of our balance sheet for the specialty route and use our P&L for the generic route. So I think that is how we are trying to bifurcate, but we do not have enough flexibility to route everything through the P&L today, but most of the charges on the P&L and when they come will be 20-21 period.

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

Anubhav Agarwal: Umang, question on Decitabine and Pulmicort. When you mention about contracted market share, two things I wanted to check there. One, are we talking about more than 15% contracted share there and secondly, would they start reflecting from next quarter or are you talking about very gradual ramp up over that?

Umang Vohra: I cannot give you specific shares, but yes I would like to believe that both category should be higher than 15 and I think you should see it. I think by the end of this quarter, the ramp up should begin to show.

Anubhav Agarwal: So it should start reflecting from March quarter itself?

Umang Vohra: Yes.

Anubhav Agarwal: And do you still maintain guidance of one key approval every quarter or we already seen 3 approvals coming in and that is what you are referring largely to?

Umang Vohra: Well, actually they all came bunched together. We were hoping that they spread out of it. But yes, we are still trying to keep our guidance for one limited competition and obviously now the clock moves forward to end quarter 4 and early quarter one. So it will start from there and we are maintaining that.

Anubhav Agarwal: That is helpful. And you have given a very good split of your top 50 projects, but for the current 79 pending ANDAs that you have excluding the PEPFAR, can you just talk about something on the complexity or medium complexity on that pipeline because we are going to see really that pipeline coming out in next 2 years, so some guidance will be useful.

Umang Vohra: I do not know if you are providing that as yet, Anubhav, but I think we will take this feedback what you have given and maybe when we come back in May call, we will try and give you final

details on the pending ANDAs as well. So we will include this information in our press release in the May call and also talk about this going forward on a routine basis.

Anubhav Agarwal: Kedar sir, one question on the Invagen write-off. We have almost written out $80-$90 million, which is almost like 15% of the acquisition cost. So last time you mentioned about single digit ANDAs, now perhaps similar number, so when we acquired, they were 30 ANDAs and seems like we have written off value for almost 8-9 ANDAs.

Kedar Upadhye: I think what we have taken this quarter, Anubhav is for about 3 ANDAs and most of what we have taken is in the pipeline category. So I think what we are seeing is the existing business cash flows are fairly protected from the fair value standpoint and the triggers are basically with respect to adverse regulatory development which is basically postponement of the launch or significant drop in the market share. So to summarize, I think they are very product specific triggers, the existing commercial business seems to be protected from a deal case standpoint.

Umang Vohra: I think Kedar to add, I think it would be fair to say that as we launch a product that is in the pipeline and we realize the synergies are not, I mean the value that was in the balance sheet is not playing out the way we wanted to. There will be an impairment evaluation the company will make. So at this point in time since we are communicating that Sevelamer has pricing gone out of the market, it can be reasonably estimated that the fair amount of the charge is also settled in.

Moderator: Thank you. The next question is from the line of Prakash Agarwal from Axis Capital. Please go ahead.

Prakash Agarwal: Just to understand this better, the previous participant. So GAVIS this quarter, I mean impairment of about 1.73 billion, but I mean how much of it mean the acquired values already charged of?

Kedar Upadhye: I think Prakash probably you referred to Invagen because GAVIS is not our acquisition.

Prakash Agarwal: Sorry, Invagen, Yes. Too many results going on, sorry.

Kedar Upadhye: So your question was the 173 crores net of tax that we have charged, can you repeat your question Prakash?

Prakash Agarwal: Yes. So how much, I mean in the past also I think you took some impairment. So how much of impairment has already been taken on account of Invagen?

Kedar Upadhye: So in total the gross impairment that we have taken is about $110 million. Associated with this, there is a release of deferred tax at about 39%. So roughly around 60 million-65 million net of tax have been impaired till now.

Prakash Agarwal: Okay. And this can increase given the fact that Umang spoke about the couple of products, the postponement of launch or reduced opportunity and stuff like that or you think at the moment this is it?

Kedar Upadhye: At the moment given the current projection, this was it. But every quarter the accounting literature mandates us to do this evaluation of what is the fair value of future cash flows vis-à-vis what we have set up on balance sheet.

Prakash Agarwal: And secondly on the US again. So you talked about improving market share in few of the products, but the` Dacogen I see there are already 6-7 players now. I mean from a delta perspective and improving outlook in the US, we need more new approvals. So what kind of launches we are talking about for fiscal 19, any color would help?

Umang Vohra: I am not sure that Dacogen has 6 players selling into the market today. I think there are 6 approvals but possibly not as many who are selling into the market. I think yes, we filed 30 odd products in the previous year and we are likely to file about 20 in this year and I think bulk of those will come over the next two years, some of those will be NCE-1 product which will come later. So I don't know, I think as a trajectory, as general guidance to you, I would say we could think about 10 to 15 launches a year.

Prakash Agarwal: Okay, starting fiscal 19?

Umang Vohra: Yes.

Prakash Agarwal: Okay. And is there any growth number, aspiration number that you are talking about 19-20 in terms of US which has been pretty flat and the good thing is that this is despite huge price erosion, so ballpark number would help.

Kedar Upadhye: So Prakash, we won't like to guide anything at this stage, probably you should expect us to comment more in our May call.

Prakash Agarwal: Okay. And lastly one comment you made on the institutional antimalaria business, so that number had fallen down significantly, I missed that number. But I think the rebidding has happened. So what is the outlook there, are we into the disposables and injectables, if you could help us in terms of what market share we will get in the current bidding?

Umang Vohra: I think there are two factors at play, one is just the fact that there are a lot more people who are back in to the bidding process. So you know if you were to look at, lot of people had left the bidding process because they had FDA issues in their facilities etc., now a lot of them are back in the bidding process, so there is hyper competition. I don't think we are giving details on each bid, but we are also saying that there are challenges in the funding environment because you know obviously it is a lot more difficult now for the global funding of these type of initiatives to happen because America was a fairly large funder and you know the dynamics of that may be

changing. So I think there is a general, I would say reboot of some of the funding on the funding side as well as more competition from others who were not allowed to bid earlier due to their FDA issues coming back on the fray. So I am not going to say what we rebid at whether we won or not, but it is just that it has been a lot more competitive and that is what we had indicated in our commentary.

Prakash Agarwal: And we are in disposables and injectables?

Umang Vohra: I think disposables and injectables are not in the Global Access. So if your question was for the Global Access business, our product range does not, these two products are not in our range.

Moderator: Thank you. The next question is from the line of Pratika Jalan from Narnolia Securities. Please go ahead.

Pratika Jalan: This quarter looking at the South Africa business, it has been very strong for us, any color that whether there is a sustainable trend that we will see going forward?

Kedar Upadhye: If you see the market data for the private market business, we have grown much ahead of the market and our private market business for MAT December is about 11.1%, market was around 10. And we would like to believe we will continue all this outperformance.

Pratika Jalan: Okay. And what is the factor that will drive the growth?

Kedar Upadhye So I think our salesforce engine as well as the tender business which is about 35% of the total country revenue, on both sides we continue to see growth Ritika.

Pratika Jalan: Okay. And can you tell me the CAPEX guidance for financial year 18 and financial year 19?

Kedar Upadhye: Okay. So over the years we have been tapering down our capital expenditure. This year, we are likely to end below about 850-900 crores. We will be able to share our thoughts on the next year in our May call, Ritika.

Pratika Jalan: Till now, what is the CAPEX you have already spent in financial year 18?

Kedar Upadhye I can come back to you, it is about just short of about 550 crores.

Pratika Jalan: Means you have spent about 750 to 800 crores.

Kedar Upadhye: Possibly.

Pratika Jalan: And can you give me the tax rate guidance for financial year 18 only?

Kedar Upadhye So fiscal 18 full year ETR is likely to be around 25% if you take off the one-offs that we mentioned during the call.

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

Sameer Baisiwala: Kedar, just to come to the PBT impact for 173 crores impairment charge which I think you said is net of tax. I should use the same 39% works out 283 crores, does it look okay?

Kedar Upadhye: That is true, so 283 is the gross impairment, Sameer and about 90 crores is the release in deferred tax, so that is 174 crores.

Sameer Baisiwala: The second question is how big is the Beclomethasone in the UK market?

Umang Vohra: It is a much smaller asset, Sameer. It is about $10 to $15 million.

Sameer Baisiwala: Umang, just on your comment on the late advanced stage discussion on the specialty assets, Neurology and Respiratory. So you are looking at buying out phase 3 sort of molecules, is there what you have in mind?

Umang Vohra: Yes, we are trying to look at phase 3, late phase 2 and I think we are in that hunt for respiratory and neurology. We have some internal programs, but they will take time to get there. So I think we want to accelerate our entry there and we are clear we are going to do it through our balance sheet, not so much through our own funding, the P&L funding.

Sameer Baisiwala: And these are necessarily NCEs and so maybe multiple of $100 million deal sort of a thing?

Umang Vohra: Yes and I think we will do one or two, Sameer and then after that wait for, we will have to also create a salesforce infrastructure. So I think we are trying to accelerate our journey. It is something that will play out in the next 2 years or so.

Sameer Baisiwala: And just one final one. On Tizanidine patch, you completed phase 1A. So what is the road going forward and when do you expect ANDA submission?

Umang Vohra: So, we will do a phase 2 shortly and we should be commencing that in about a little bit of time and then there will be a phase 3. So this is not a very extensive long trial. As we are seeing it right now, potentially a filing sometime around 21 end.

Moderator: Thank you. The next question is from the line of Abhishek Sharma from IIFL. Please go ahead.

Abhishek Sharma: Just on the specialty foray, when you say that it is going to be routed through balance sheet, just wanted to understand what would be your preference for capital raising? Would it be debt preference or equity preference?

Umang Vohra: Right now, I think we are quite flexible. We would like it to be more debt. Our balance sheet has the potential to take on a little bit more debt and I do not think we are talking significantly high amount at this stage and I think our balance sheet has the ability to take the leverage there.

We may be slightly innovative, we could be thinking of a private equity partner as well if the investment required a fairly large. So at this stage, we are quite flexible and if it is an asset in the 100-200, then we can pick it up with our balance sheet strength.

Abhishek Sharma: And this capital raising would essentially be linked to the deal that you are doing or are you looking to create some gunpowder there that if a deal comes across, then you would do it?

Umang Vohra: No, I think it will be linked to the deal. I do not think we are going to take debt and wait for the deal to happen because while we are seeing we are looking, these are also highly unpredictable and they are very value centric deal. So we might bid for an asset but people who want to sell the asset, do not think that it at that value, then we do not get it. So it is a one zero game, so it will be linked to final purchases.

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

Nitin Agarwal: Kedar, on the overheads, you talked about the operating leverage possibility still being there. I mean, you've done a pretty credible job in terms of controlling these costs despite increasing R&D costs over the last 2 years. I mean how should we sort of mentally visualize these SG&A and staff cost, ex of R&D going forward, in terms of a run rate basis?

Kedar Upadhye: So I think there will be an inflationary impact on a large part of the spends, but there are opportunities. I think there are specific ideas in manufacturing cost base, there are specific ideas in quality related cost base, repairs and maintenance or administration related costs. So I think we do have several of the ideas which have not been fully yet implemented. So without giving you a specific number based guidance, we will be focused on it in the coming year as well, but as I said the part of the spends is most pretty linearly with the sales of respect to market and balance is where the operating leverage will work out.

Nitin Agarwal: And on the non-U.S. export business, I mean how do we look at that piece now? It has been a relatively less focused piece, there has been a lot of focus on the U.S. But over a 5-year period, which are the pieces that are focus areas for us on this non-U.S. footprint?

Kedar Upadhye: So the non-US export business, Nitin largely comprises our businesses in Middle East, our business in countries like Australia, Myanmar, Vietnam while many of these countries, we continue to be ranked in top 5 and we are growing well, but they are not as high scale to see a reflection in Cipla's overall P&L. And on Middle Eastern markets, we have alluded to some of the geopolitical uncertainties. So probably our focus will continue to be on the US market, if that was your question in terms of growth, structurally some of these markets may not have a liner growth pattern over the years.

Nitin Agarwal: And if I can squeeze in last one. Umang on the domestic market, with government sort of focused on low cost healthcare and all of these things going forward, I mean how do you foresee the

price control regulatory situation in the domestic market going forward. Are there any valid concerns that one should have on the space going forward?

Umang Vohra: No, as a trend, I think two trends would happen. I think the healthcare insurance should increase, should allow more families who were not able to afford their own healthcare to be able to offer care to their families and then here in India, so I think there should likely be volume expansion and healthcare penetration in India becoming deeper. But I also do believe that the government has been quite consistent with what they believe should happen and that is that they would like to keep price controls in the market, so I think we can expect both trends to happen. I think we can expect possibly more robust volume growth. But we could also expect price control to continue.

Moderator: Thank you. The next question is from the line of Manushi Shah from Research Delta Advisors. Please go ahead.

Manushi Shah: Yes, I wanted to know that how many new products are launched by Cipla in their domestic market in past 6 months?

Kedar Upadhye: Manushi, we can come back to you with exact data.

Manushi Shah: Okay. And just one more question, can Prezista launch in US be expected in next two years or is it after that, just rough timeline?

Kedar Upadhye: So at this stage, probably we wouldn't comment on new launches.

Manushi Shah: Okay. And just one more, the 20 products which you talked about for next year filing, so how many of those will be complex injectables or just normal injectables?

Kedar Upadhye: Yes, I think maybe all these questions Manushi, the investor relations team will come back to you separately.

Moderator: Thank you. The next question is from the line of Mehul Sheth from Phillip Capital. Please go ahead.

Mehul Sheth: Sir, one question on depreciation side. Even after adjusting this 174 crores of onetime expense that you have taken like depreciation expenses at around 349 crores or so, is it now new base that we can consider going ahead?

Kedar Upadhye: Mehul, you need to adjust, actually the 285 crores from the amortization and depreciation line as the gross value of impairment. There has been an associated release of def tax in the tax line which makes it 174 on net basis. What you need to adjust is about 285 in the depreciation line.

Mehul Sheth: Okay. And sir one question on interest expenses. So it is like 9 crores in a quarter. So any specific reason means why sudden fall?

Kedar Upadhye: So I think we have repaid some part of our packing credit that is why it is low, but as a trend you should probably take an average of 9 months rather than this quarter's number.

Moderator: Thank you. We will take the next question from the line of Saion Mukherjee from Nomura. Please go ahead.

Saion Mukherjee: Just one question, do you have an update on Albuterol MDI file, can we expect this launch next year?

Umang Vohra: Yes, Saion, our discussions, we know that the FDA is looking at the file. There has been inspection at the site at which Albuterol was to be made. We also believe some clinical trials sites have been inspected and we are in communication with the FDA on their responses to our file. So the FDA is actively reviewing it. We hope to hear from them about the next step soon.

Saion Mukherjee: Okay. Umang, just on Advair generic. Companies have faced issues with the PK profile**.** So is it fair to assume that you crossed that hurdle and that is why you are going to start the trial?

Umang Vohra: Yes, we would like to believe on that we have been able to do it and now it depends on the trial and having said that, I just want to say that there is a fair amount of risk in these trials as well. So Fluticasone is known to be a very troublesome molecule. So we are into the trial period but yes I think on the PK side, we believe that we have crossed that hurdle.

Moderator: Thank you. The next question is from the line of Charu Mehta from Dalal & Broacha. Please go ahead.

Charu Mehta: I wanted to know whether there is any more impairment that has not been taken in this quarter, will be taken in the next quarter?

Kedar Upadhye: Yes, Charu Mehta, we spoke about it in the early part of the call. As we launch each product, quarter by quarter we will have to continue to do this evaluation of carrying value versus fair value and take appropriate charges.

Charu Mehta: And the second question pertains to improvement in gross margins sequentially, what is the reason for that, is it mainly because of budesonide?

Kedar Upadhye: Two factors are largely behind the improvement in the mix. This is a Respiratory season for our prescription business in India and respi is relatively higher margin compared to other therapies. So that has helped. What has also helped is the global fund business that has been lower this quarter and the gross margin of that business is relatively lower compared to others. So this two things are there apart from the cost and the other things that we are working on.

Charu Mehta: Okay, fine. And in case of ARVs, are you seeing a reduction in the volumes because of the changing treatment patterns?

Kedar Upadhye: Yes, so what we have seen in this quarter is an impact of various environmental issues, some aspects in the funding environment, our own execution matters. So I think collectively all of that has resulted into about 13% decline. We will have to continuously keep a watch on this business, work on improving the cost base, the economics and the portfolio in the coming quarters.

Moderator: Thank you very much. We will take that as the last question. I will now like to hand the conference back to the management for any closing comments.

Naveen Bansal: Thank you everyone for joining the call today. In case you have any followup question, please feel free to right to the investor relations team, our contact details are available in the last slide in our deck and I think most of you would have my contact as well. So thank you so much for joining us. Thank you. Good bye.

Moderator: Thank you very much. On behalf of Kotak Securities that concludes this conference. Thank you for joining us ladies and gentlemen. You may now disconnect your lines.