

Investors/Earnings Conference Call (October 26, 2007)

Moderator: Good evening ladies and gentlemen, thank you for standing by. This is Yashashree, the moderator for your conference call today. We welcome you to the conference call of Zydus Cadila. We have with us today Mr. Pankaj Patel, Chairman and Managing Director from Zydus Cadila. At this moment all participants are in a listen-only mode. Later we will conduct a question-and-answer session. At that time if you have a question please press '*1'. I would now like to turn the conference over to Mr. Pankaj Patel. Over to you Sir.

Pankaj Patel:

Good evening and welcome to our post-result tele-conference for the second quarter of 2007-08.

First of all, let me take you through broad financial numbers.

During Q2 07-08 on consolidated basis:

- Total operating income up by 28.4% y-y to Rs. 6097 Mio. from Rs. 4748 Mio. last year.
- Income growth was mainly driven by formulations exports which grew by 122% on the back of sales growth of 123% of US subsidiary, 77% growth in generics business of French Subsidiary, and sales of Nikkho do Brazil of Rs. 479 Mio. Consumer business also posted healthy growth of 37%, with Nutralite registering 71% growth over previous year.
- PBIDT up by 20.5% y-y to Rs. 1317 Mio. from Rs. 1093 Mio.
- PAT up by 13.6% y-y to Rs. 801 Mio. from Rs. 705 Mio.
- In line, EPS up 13.6% y-y to Rs. 6.38 from Rs. 5.61 last year.

During the quarter,

- We launched 3 products in US market, namely Benzonatate, Carvedilol (Day 1 launch) and Amlodipine which helped us register sales of Rs. 624 Mio., up 123% y-y (164% in \$ terms)
- We filed 4 more ANDAs with US FDA, taking cumulative ANDA filings to 66, of which 36 are now pending approval.
- Our French business has also shown strong performance, with sales of Rs. 364 Mio., up 38 % y-y (47% in €terms), and posted positive bottomline of Rs. 24 Mio vis-à-vis loss of Rs. 34 in Q2 last year.
- We filed 3 more dossiers for new products and 9 site transfer applications for French market.
- Continuing with our successful research programme, we filed our fifth IND (Investigational New Drug) application for seeking DCGI's permission for conducting clinical trials for our New Molecular Entity (NME) – ZYH7, a novel drug candidate for treating dyslipidemia and metabolic disorders.

Thank you and we will now start the Q&A session. You may address questions on domestic market, non-regulated markets

and regulated markets to me and on results and finance to Mr. M K Patel.

Over to the co-ordinator for the Q&A.

Moderator: Ladies and gentlemen, we will now begin the question-and-answer session. If you have a question please press '*1' on your push-button phone and await your turn to ask the question when guided by the facilitator. If your question has been answered before your turn and you wish to withdraw your request you may do so by pressing the '#' key. We have our first question from Mr. Kartik from Mann Financial. Mr. Kartik please go ahead.

Kartik: Hi! Can you please tell us the individual sales for the quarter and for the same quarter last year for Altana JV and the US operations, Sir?

Pankaj Patel: I will start with Zydus Altana. The sale for the quarter was Rs. 157 million vs. Rs.207 million last year. Sales of French subsidiary was Rs.364 million against Rs. 263 million last year and in US, sales was Rs. 624 million which was Rs. 280 million last year.

Kartik: You said that the operations of Nikkho had a sale of Rs. 479 million, what would be the other sales of Brazil there?

Pankaj Patel: Rs. 81 million was sales of generics business in Brazil.

Kartik: So it is Rs. 479 million plus Rs. 81 million. Sir, what would be the sales for generics in Brazil in the same quarter in FY-07?

Pankaj Patel: Rs. 38 million.

Kartik: Any particular reason why the sale of Altana would have fallen? Is it something to do with 2 companies having the approval from the FDA for Pantoprazole or is it just a routine thing?

Pankaj Patel: This is a routine thing. If you see for the year we are on target. It is basically a timing issue and not actually the issue on the US market. Lots of people will possibly ask questions on this, so let me give you some more information about it. The global market for Pantoprazol is about 120 tons for Altana. Out of that about 25 tons is only in US. So the worst possible impact of patent challenge for US market, which is not going to happen according to our understanding, but even if it happens, cannot be more than 25 tons of Pantoprazol which represents approximately 20% of overall sales of Pantoprazole and of intermediate of Pantoprazole by Altana Pharma JV from India to Altana Pharma Germany. So first of all we do not believe this to happen but even if theoretically we assume that it is going to happen, then it is not going to impact that significantly so far as FY 07-08 is concerned. However, as a proactive measure. we already have created within the company, what we call it Pantoprozol bridge to ensure that by some strategic initiatives in certain businesses and on certain investments, we achieve the bottomline targets for this year as we always have been doing.

Kartik: So just one more thing was, if you could share the PAT from Altana in this quarter?

Pankaj Patel: The PAT for the quarter is Rs.115 million.

Kartik: What would that be in last year ?

Pankaj Patel: Last year it was Rs.170 million.

Kartik: One last thing was that Sir, what is your thought process on your NCE program, any plans to de-merge the same or when would you think you would actually have a partner to take it ahead?

Pankaj Patel: We would complete our first molecule's phase-2 study somewhere in the first quarter of next year. That's the stage where we would be basically looking for partnering opportunities and we expect that we should have a partner introduced in the next financial year.

Kartik: So that is the first quarter of FY-09, is it right?

Pankaj Patel: That is the time we will complete the phase-2 study. What we expect is that at that stage we would start discussing with partners and during the next financial year we would expect a partner in one of our research programs.

Kartik: Sir, and would you share your thoughts on de-merging the NCE research?

Pankaj Patel: Currently we do not have any plan of de-merging our NCE research.

Kartik: Thank you so much Sir.

Moderator: Thank you Mr. Kartik. Next in line is Ms. Rohita from Enam Securities. Ms. Rohita please go ahead.

Rohita: Thanks for taking my questions Sir. If you could just give us what is the R&D expense for the quarter and profit for the US business, French business and Brazil. Apart from that your gross margins have seen a significant increase if you could also explain the rise in gross margins?

Pankaj Patel: First of all R&D expenditure for the quarter was Rs.288 million vis-à-vis Rs. 251 million last year. Now coming to the US business, the profit for the quarter was Rs.31 million net of minority interest and the profit of French business was Rs.24 million.

Rohita: For US there has been a decline in profit on a q-on-q basis?

Pankaj Patel: Yes, but because of the fact that there is some R&D cost reimbursement which has been given by US subsidiary to the Indian parent during the quarter which is to the extent of Rs.108 million. So net profit is after this reimbursement but before minority interest of US subsidiary was Rs. 44 million, and if you add back this reimbursement of Rs 108 million, profit of US business on consolidated basis was Rs. 152 million before minority interest and Rs. 107 million after minority interest.

Rohita: And can you also explain the rise in gross margins?

Pankaj Patel: The rise in gross margins is because of the fact that the Brazilian subsidiary has a very high margin of almost 80% at gross levels. Consolidated gross margins have increased by about 1.9% of which 1.1% is due to higher gross margins of Nikkho.

Rohita: So can we assume this trend to continue in the coming quarters?

Pankaj Patel: Yes, it should because of the fact that the previous year the Brazilian sale was not included and also Brazilian sale is growing at about 15-20%. So going forward you can assume the gross margins to improve also on a consolidated basis.

Rohita: Okay, fine thank you.

Moderator: Thank you Ms. Rohita. We have a next question from Mr. Rahul Sharma from Karvy Stock. Mr. Sharma please go ahead.

Sharma: Sir I joined in little late, could you just tell me the revenue numbers for Altana and the revenue breakup of Brazil, US and France?

Pankaj Patel: I will repeat that. Starting with Altana first, the sales was Rs. 157 million against Rs. 207 million last year same quarter. For US, sales was Rs. 624 million against Rs. 280 million last year. For France, it was Rs. 364 million against Rs. 263 million last year and for Brazil generic business it was Rs. 81 million against Rs. 38 million last year and newly acquired Nikkho do Brazil registered sales of Rs. 479 million.

Sharma: For France I did not get how much was it?

Pankaj Patel: Rs. 364 million against Rs. 263 million last year.

Sharma: Thank you Sir.

Moderator: Thank you Mr. Sharma. We have our next question from Mr. Shardul Pradhan from ASK Securities. You may please go ahead with your question.

Kirit: Hi! Kirit here, congratulations on a good set of numbers. Just couple of questions, first is about your branded domestic business, if you look at the growth of just like 10% for the quarter. Could you just explain what is the reason why in second quarter which is typically supposed to be the best quarter in terms of formulation, the growth is lower than the industry. Second is about unregulated market export that growth goes to around 8-9% for the quarter. And third is US generic business where for the quarter if I remove the effect of R&D expense for the US subsidiary then you have made a profit of Rs. 15 crore on Rs. 62 crore sales which is almost a margin of 25%. So what is the reason why that such a dramatic change in the profit margin for US business.

Pankaj Patel: I will address the questions one-by-one. I will start with the domestic formulation first. For the quarter the growth of domestic business is just below 10%, but if you see last year we had a very different situation under which we had a jump in the sales because of outbreak of epidemics that's the reason why we had a high sales recorded primarily last year. But if you see the IMS secondary sales data, our business is growing at around 15-16%. So it is basically a timing issue, and we do not see any problems in the domestic market. But for overall year we believe that we would achieve the growth numbers that we have forecasted. The second question was about the US margin and I think that has basically happened because of 2 reasons, one is new product launch and second is the product mix. We have launched 3 new products as I mentioned before and also product mix has improved. Third thing is that we have done significant actions in terms of further reducing cost of products during the quarter. So all the three put together has helped us to have a good margin in the US business.

Kirit: And what about unregulated market export sales?

Pankaj Patel: Yeah Sure, as far as unregulated market is concerned, yes for the quarter we see a growth of 4.4%. Lower growth is mainly attributed to the effect of rupee appreciation. If you see in dollar terms, our growth for the quarter was about 25%.

Kirit: API exports also degrew by 13%. What was the reason for that?

Pankaj Patel: Again it's a only forex which has played a major role here as far as API export is concerned. That's why we have now decided to basically start billing the API either in rupees or in euro currency to attain a long-term stability as far as earning is concerned.

Kirit: Thanks.

Moderator: Thank you for your question Sir. Next inline is Mr. Rahul Khaitan from Capital Market. Mr. Khaitan please go ahead.

Rahul: Good evening Sir. My question first of all would be on CRAMS, can you quantify the CRAMS revenue for the quarter and how many CRAMS contracts you currently have and what is the potential for those contracts?

Pankaj Patel: On the CRAMS front, income for the quarter was Rs, 35 million against Rs. 22 million last year and currently we have total number of 25 contracts with an overall peak potential of \$ 38 million. Apart from that our contract in joint venture format with Hospira Inc. of US, the Zydus Hospira JV has commissioned plant and has also taken the first validation batches during the last week of September and we are expecting to do filing and expecting inspection of our facility in the last quarter of this financial year. So we expect that this JV will also start kicking in the revenues from next financial year.

Rahul: Going forward, if I talk about FY-09 how do you see this CRAMS revenue as of total percentage to the company's revenue?

Pankaj Patel: I don't have that number , I would request my team to give you that number offline.

Rahul: And Sir, can you give what is the forex gain or loss in this quarter?

Pankaj Patel: Yes, during the quarter on our forex loans, there was a gain of about Rs.10 million and on the export realization and import payments, net loss was about Rs.22 million, which has also impacted our EBIDTA margins.

Rahul: So the net sales is down by this figure, around Rs. 22 million?

Pankaj Patel: No, impact on sales will be more because this is the net impact after excluding gain on imports payments. On sales, impact of rupee appreciation was approximately Rs.34 million.

Rahul: Okay, thank you very much.

Moderator: Thank you Mr. Khaitan. Next inline is Ms. Mallika from Sharekhan. Ms. Mallika you may please go ahead.

Mallika: Good afternoon Sir, congratulations on a good set of numbers. Just had a quick question, can you give me a debt and cash position as of September 30th that is one. Second, there is a significant rise in the staff-cost seen in the quarter, what is that due to and what kind of trend can we set going forward?

Pankaj Patel: I will take the staff-cost issue first. The staff-cost numbers are higher mainly because of inclusion of three acquisitions namely Nikkho Brazil, Liva and 50% of Zydus Animal Health. Excluding the numbers of acquired companies, growth in staff cost was in the vicinity of about 12% only.

Mallika: Did you said the growth of 12% excluding the Nikkho impact?

Pankaj Patel: Yes. Excluding impact of Nikkho, Liva and 50% of Zydus Animal Health.

Mallika: And can you just repeat for me the forex thing that you spoke about previous question?

Pankaj Patel: Due to rupee appreciation, we lost on the topline about Rs.34 million because of less realization. The gain on imports approximately was Rs. 12 million and as a result the net impact on the bottomline is about 22 million, which got partly compensated by gain of Rs.10 million on translation of forex loans.

Mallika: And what about the debt and the cash position?

Pankaj Patel: Consolidated debt is Rs. 840 crore, cash is Rs. 25 crores as on 30th Sep 07.

Mallika: Okay, thank you.

Moderator: Thank you Ms. Mallika. Next in queue is Mr. Prashant Nair from Citigroup. Mr. Nair you may please proceed with your question.

Chirag: Good evening Sir, Chirag here. I had a question on the Hospira JV, if you can just throw some light in terms of what is the roadmap in terms of the number of products that you intend to bring to market via this JV and the sort of profitability structure that you envisage in the JV, as you go along?

Pankaj Patel: We are planning to file three products this year and we are expecting inspection in the first quarter of calendar year 2008, that means last quarter of FY-08. The balance product will be filed later in the subsequent months. The total number of products which we plan to file and supply for Zydus Hospira JV is going to be 11 in total. As I mentioned before we have already commissioned the plant, and taken the initial validation batches. We are planning start filings in early January and expecting inspection thereafter. Since these are sight transfers, we expect that we should have quick approvals and our commercial activity should start in FY-09. We do not have exact numbers to share at this moment because this is all contingent upon exactly when we get the regulatory approvals. For FY-2010, we see a significant revenues coming in from this JV. At this moment, I can only give you guidelines that it will offset more than what we earn from Altana JV today in terms of bottom line contribution to Zydus. More details we will provide you once we have clarity on the regulatory approval timeline.

Chirag: And Sir, sitting here today do you have any visibility in terms of increasing the product basket from the 11 products?

Pankaj Patel: We do definitely see that we would need to expand the facility. We have been discussing with Hospira, and they need significantly large volumes than earlier what Mayne was requiring and that's the reason why we might be required to expand the capacity. Currently we are at a very early stage, so we have not decided anything on it. We hope to take the decision about additional products and additional capacity somewhere in the beginning of next financial year.

Chirag: Okay, thank you Sir.

Moderator: Thank you for your questions Sir. We move on to our next question from Mr. Rahul Sharma from Karvy Stock Broking. Mr. Sharma please go ahead.

Sharma: Your API business has contracted quite a bit in this quarter and I believe your formulation exports in rest of the world would have also seen some decline. How are you going to address this issue where by the falling dollar would act as an impediment?

Pankaj Patel: First of all if you look at API, it's not significantly down. We had a very good sale in the month of June and that's why we see this kind of a decline in quarter, though on YTD basis, API exports grew by 13%. However, there is definitely an impact because of rising rupee. So from API front we have taken a decision to basically start quoting in euro or rupee and as a result we should be basically be able to arrest further decline. As far as formulations exports to rest of the world is concerned, I think it is more of a timing issue, because this business also grew by 16% on YTD basis, and growth in dollar terms was approximately 30%, and going forward we should be able to grow it the same way.

Sharma: 16% till date?

Pankaj Patel: Till date yes, in rupee terms.

Sharma: Sir how much you said debt on books?

Pankaj Patel: Rs. 840 crores on consolidated basis.

Sharma: Okay Sir, thank you.

Moderator: Thank you Mr. Sharma. We have our next question from Mr. Nimesh Desai from Motilal Oswal. Mr. Desai please go ahead.

Desai: Couple of questions, actually first one on pantoprazole, do you think that an out of court settlement is a possibility between generic companies and the innovator?

Pankaj Patel: We have not heard anything on that from our partner.

Desai: And if I remember correctly, there was a plan to introduce more products into this relationship. How are we progressing on that?

Pankaj Patel: The discussions are going on well, that is only I can give you a guidance today, we expect to finalize this somewhere in the month of January.

Desai: So supply could begin in FY-09 or should we expect FY-2010 for supply of such additional products?

Pankaj Patel: Supply should begin in FY-2010.

Desai: Will this be significant supply if I compare that with what you are currently supplying to Altana?

Pankaj Patel: Yeah, we are currently discussing on possibility of shifting the manufacturing of the final API of Pantoprazole at the plant of the JV. We are also discussing on the possibility of adding several other products in this plant from Nycomed's product range. Also Altana has 2 suppliers for Pantoprazole - one is the joint venture and the second is a European company. Next year we also expect that the volumes from the European supplier may also be shifted to the JV's plant. As a result we are currently expanding the capacity of the plant.

Desai: And just to reconfirm what you said in your opening remark that in a worst case scenario if generic were to launch Pantoprazole, 20% of your supplies to Altana would be impacted, is that correct?

Pankaj Patel: That is assuming that the same ratio continues between JV and other supplier for US supplies and there is zero sales of Pantoprazol in USA. That is worst case scenario. First of all, that's not going to be the case. Even if generic version is launched in US, volume is not going to be zero in US. So that is the worst-case scenario but it can be much lesser because at least some sales which will be happening in US market.

Desai: Right, plus over and above that you will get a additional volume which the European supplier was supplying.

Pankaj Patel: Correct.

Desai: The other question is on your domestic formulations sales growth. You mentioned on the call that you have not grown well because of the higher base effect of last year due to outbreak of epidemics etc. But if I see your numbers in same quarter last year also you had grown only by about 8%. So is there any disconnect here, I don't see higher base impact.

Pankaj Patel: No, if you see our first quarter last year, our growth was merely 3 percent. Second quarter we came to 8% but that was a Chikungunya effect, otherwise we had a restructuring done last year. So we would have not expected the growth to really happen. That base effect is clearly seen in the pain and antibiotic area where we have basically taken a hit for this quarter.

Desai: And the last question is if you can give us the sales numbers for Carnation, Zydus Animal Health and Liva Healthcare this quarter and same quarter comparable last year?

Pankaj Patel: Sure, for Carnation the sales of this quarter is Rs. 135 million against Rs. 79 million last year. For Zydus Animal Health it is Rs. 275 million against Rs. 131 million last year and for Liva Healthcare it is Rs. 108 million.

Desai: And it was not there last year.

Pankaj Patel: Yes.

Desai: And last year for the full quarter we had the impact of Carnation and the Animal Healthcare business?

Pankaj Patel: For carnation yes, but for Animal Health, it was 50% last year, which is now 100%.

Desai: Okay fine, thank you very much.

Moderator: Thank you Mr. Desai. We have our next question from Ms. Mallika from Sharekhan. Ms. Mallika please go ahead.

Mallika: Hi! I just had a question on the tax rate, it seems to have come down to around 12% during the quarter. What is the reason for this and what kind of trends should we expect going forward?

Pankaj Patel: As we have told you that our yearly estimate is 13%. we will end up making provision of about 13% of the profit before tax.

Mallika: What is the reason of this decline in this quarter, any particular reason for that?

Pankaj Patel: We are making half-yearly provision and from there we deducted first quarter provision. So it has incidentally came down to 12% in this quarter.

Mallika: Okay, thank you.

Moderator: Thank you Ms. Mallika. We have a question again from Mr. Nimesh Desai from Motilal Oswal. Mr. Desai please go ahead.

Desai: Just a follow up question, there were plans for raising some amount of funds, I guess you were taken some approvals also. How are we placed on that?

Pankaj Patel: Currently we are not planning to raise the funds.

Desai: So if I understand this correctly, is it linked to your successfully acquiring some companies that's when the funds will be raised?

Pankaj Patel: That's right.

Desai: Okay fine, thanks a lot.

Moderator: Thank you Mr. Desai. We have our next question from Kesvinder Suri from Stan Capital. Please go ahead.

Suri: Good evening, I don't know if you have mentioned it earlier, I logged on a bit late. Can you give us an update on your R&D side in terms of ANDAs and innovatives please?

Pankaj Patel: As far as ANDA's are concerned, we have filed additional four ANDA during the quarter. So we have totally 66 ANDA filed now. Coming to R&D on the IND front, we have filed one more IND during this quarter. So we have totally 5 INDs, of which our two molecules are in phase-2 clinical trial and 2 more in phase-1 clinical trials. We have 3 molecules in the clinical development, and we hope to file additional two INDs before end of this financial year.

Suri: What's your ANDAs in the market, how many are approved to market?

Pankaj Patel: On the market we have 13 ANDAs and we have 30 approvals.

Suri: Okay, thank you.

Moderator: Thank you Mr. Suri. Please press '*1' to ask a question. We have a question again from Mr. Kesvinder Suri from Stan Capital. Mr. Suri, please go ahead. 37:00

Suri: This is a follow up on Mr. Desai's question about your fund raising, the approvals sort were you in race for an acquisition, which you lost out, or has it just been a blanket approval that you sort?

Pankaj Patel: No we took a blanket approval.

Suri: Okay, thank you.

Moderator: Thank you Mr. Suri. Ladies and gentlemen for any further questions you are requested to press '*1'. We have a next question from Mr. Bhavin Shah from Dolat Capital. Mr. Shah please go ahead.

Shah: Good evening Sir, and congrats on the results. If you could just go through the numbers on the acquisition that we made in Japan on Nippon please?

Pankaj Patel: Yes, for Nippon we have a sale of Rs. 11 million for the quarter.

Shah: Sir if you could share the profit numbers also?

Pankaj Patel: There was loss of Rs. six million.

Shah: Sorry for the repetition if you could just get the numbers for Brazil and for Liva also?

Pankaj Patel: For Brazil the sale is Rs. 479 million from the acquired business and the profit is Rs. 24 million. and for Liva Healthcare the sale is Rs. 108 million and profit is Rs. 2 million.

Shah: Okay Sir, thank you.

Moderator: Thank you Mr. Shah. We have our next question from Mr. Birendra Dalal from Kotak Securities. Mr. Dalal please go ahead.

Dalal: Are you looking at any of your R&D subsidiary, I mean R&D product pipeline and manpower and all that into your subsidiary?

Pankaj Patel: No, we do not have a plan to do that at this moment.

Dalal: Okay, thanks a lot.

Moderator: Thank you. We have a question from Mr. Prasahnt Nair from Citigroup. Mr. Nair please go ahead.

Chirag: Chirag here again, just wanted to know this Brazilian acquisition that you have done, you just mentioned that it has very high gross margin. Can you just take us through the entire cost structure of that acquisition?

Pankaj Patel: Can we do that offline?

Chirag: Yes Sir, sure.

Moderator: Mr. Chirag are you through with the call.

Chirag: Yes, thank you.

Moderator: Thank you. Ladies and gentlemen for any further questions you are requested to press '*1' now. Mr. Patel we do not have any questions in the queue. Would you like to say something.

Pankaj Patel: Thank you very much and look forward to see you during the next quarterly results. Good evening and have a nice day, thank you.

Moderator: Ladies and gentlemen, this concludes your conference for today. We thank you for your participation and for using TATA Indicom conferencing services. You may please disconnect your lines now. Thank you and have a great evening.