

Q3 FY06 Earnings/Investors Conference call (January 30, 2006)

Moderator

Good morning ladies and gentlemen. I am Monali, the moderator for this conference. Welcome to the Zydus Cadila Healthcare conference call. For the duration of the presentation, all participants' lines will be in the listen-only mode. I will be standing by for the question and answer session. I would now like to hand over to Mr. Pankaj Patel of Zydus Cadila Healthcare. Thank you and over to you sir.

Pankaj Patel

A very good morning and welcome to the post results teleconference for the third quarter of 05-06. At the outset let me say that over the last several years, approximately 3 years, we have been investing in developmental activities, particularly for the developed markets and R&D, and this is the quarter which is going to be remembered as first quarter in which those investments have started paying off.

Let me begin with results itself, highlighting the key numbers. On the consolidated basis, the total income has gone up by 17% to Rs. 3822 million. The top line growth was mainly driven by growth in domestic formulations, sales growth of French subsidiary by 86%, start of sales in US of approximately Rs. 188 million, Brazil Rs. 15 million, and export sales growth in the rest of the world by 38%. The PBIDT margin went up by 37% year-on-year to Rs. 777 million, and the net profit is up by 36% to Rs. 396 million.

Coming to the standalone numbers for the quarter three, the total income grew by 14% to Rs. 3335 million. The top line growth was mainly driven by the domestic formulation sales growth of about 12% and growth of export of formulation by 119%. The PBIDT margin went up by 21% to Rs. 734 million, and the PBDIT margin as a percentage of total income is up to 22% from 21% last year. The profit after tax also is up by 8.6% to Rs. 429 million.

During the quarter we set up a JV with Bharat Serum and Vaccines, one of the top 10 biotech companies in India to develop, manufacture, and market a non-infringing proprietary novel drug delivery system of an approved anticancer product for global market.

As far as our US operations are concerned, we received 3 more ANDA approvals during the quarter from US FDA; Ribavirin capsules, Promethazine tablets, and tentative approval of Gatifloxacin tablets, taking the total approval to 10 products now. So far we have launched 5 products in US and the response has been very encouraging. We have also filed 3 more ANDAs during the quarter, taking total filing to 30, and 20 are pending for approval. On the DMF front, we have now reached to a number of 35. We also got first approval from the French regulatory authority AFSSAPS for the new product Sertraline capsules. Supply to France from our Moriya plant has also commenced during the quarter.

To update you on the progress made on contract manufacturing activity, during the quarter we signed additional three more contracts with the peak revenue potential of about \$2.7 million. The cumulative number of contracts signed during this year, in the three quarters, are about 11 excluding the joint venture with Mayne Pharmaceuticals and has a peak revenue potential of \$ 23.6 million in total.

On the research front, as I mentioned in previous quarter, we have successfully completed in-house phase-1 clinical trial for ZYH1. We will seek permission for phase-2 trials very soon. As I committed we have also filed one more IND for compound code name ZYI1, a novel agent for treatment of inflammatory disorders, which will go in phase 1 clinical trials early next year. We expect to file one more IND during the next financial year.

Thank you, and we will now start the Q&A session. You may address questions on domestic market, non-regulatory market, and regulatory markets to me and Mr. Ganesh Nayak; and on results and finance to Mr. M. K. Patel. Over to the coordinator for Q&A. Thank you.

Moderator

Thank you very much sir. We will now begin the Q&A interactive session. Participants who wish to ask questions may please press *1 on your telephone keypad. On pressing *1 participants will get a chance to present their questions on a first-

in-line basis. Participants are requested to use only handsets while asking questions. To ask a question please press *1 now. First in line we have Mr. Pavan from Kotak.

Pavan

Hi, good morning. First, congratulations, very good set of numbers. My question is more for Mr. Patel. Can you address your outlook on the domestic business we have been seeing very good numbers across the board in terms of growth in the domestic formulations market, any particular reason, and what is your outlook for next year?

Pankaj Patel

I think the domestic market, after the problems we have faced during the last year because of VAT and also the overall economic scenario which is improving has started looking up in a better way. The market is growing at better number, approximately 3-4% more than the last year, and going forward we clearly see this trend to continue because of more and more healthcare awareness, more and more use of medicine because of higher income levels of people, and increasing compliance should see the market even the next year to continue to grow at the similar numbers.

Pavan

Okay. So you would be comfortable with this 10-12% growth for yourself for next year?

Pankaj Patel

Yes.

Pavan

Okay. And what about your consumer business, do you see strong growth even there?

Pankaj Patel

Our consumer business currently is growing at about 30% plus and we are confident that we will continue growing that business at the similar number.

Pavan

Okay fine. Third question is on your manufacturing contract, you said you signed three more deals, \$3 million potential; 11 in total, \$24 million. This is going to be similar to the, I mean, basically you are going to book processing fee, which is going to be part of other operating or other income, or is it going to be part of top line and...?

Pankaj Patel

This is going to be part of the other income.

Pavan

Okay. So it is basically just conversion that we are doing?

Pankaj Patel

Yes, it could be also supply of raw material included in that, but all of this income will be considered as other income in our P&L account.

Pavan

Okay fine. And what is the outlook in terms of, basically when do these revenues begin or when do we start...?

Pankaj Patel

These revenues have already started coming in, it has been already reflected in every quarter, and we are clearly seeing that going forward we will have more contracts every quarter, and as we have started this trend, every quarter we will give you update on what progress we have made.

Pavan

Okay, good. Thank you.

Moderator

Thank you very much sir. Participants who wish to ask questions may please press *1. Next is Mr. Yogesh from Brics Securities.

Yogesh

Good morning to the management. I just had one question, now with VAT to be implemented in 6 more states, do you see any sort of effect on your sales, domestic sales, in the next quarter because of this particular development?

Pankaj Patel

First of all let me say that it is not still confirmed whether 6 states or 4 states will come out with VAT, but it is possible that 4 states or 6 states can come out with VAT, which represent about 35% of the overall market of the country. You know that last year we already had an impact for the last quarter for the VAT. So when you are going to compare the numbers, the numbers are not going to be bad. We also have learnt some basic lessons during the last years of VAT regime, VAT problems, and we have taken some preemptive measures because of which we believe that it should not impact our numbers next quarter.

Yogesh

So, when you say preemptive measures, can you just specify, clarify on this?

Pankaj Patel

It is difficult to give you exact details for commercial reasons but we have taken some preemptive measures to ensure that VAT should not impact us.

Yogesh

Sir, what is the kind of year-on-year growth that we can expect in the next quarter?

Pankaj Patel

It will not be relevant because last year we had significant dip in sales because of VAT and this year the sale will be normal, so I would say that growth is not going to be relevant in my opinion. The growth will be like a funny number and that is not a number sustainable. It could be very high growth you can expect.

Yogesh

Okay. So basically you don't see a big impact because of VAT in the next quarter?

Pankaj Patel

We are not expecting any impact, yes.

Yogesh

Okay, thank you very much.

Moderator

Thank you very much sir. Participants who wish to ask questions may please press *1. Next is Ms. Visalakshi from DSP Merrill Lynch.

Visalakshi

Thank you for taking my question. I had two questions, #1 on Altana, could you give us an update as to what is the kind of revenues you have registered in this quarter? #2 is on the French business again, an update in terms of what is the cumulative losses right now? So these are the two questions.

M. K. Patel

Visalakshi, sales of Altana JV for the quarter was Rs. 15.5 crores, and bottom line was Rs. 11.3 crores. This is 50% our share, so you have to double it for total sales and total profitability.

Visalakshi

Can you give us the corresponding number for the previous same quarter?

M. K. Patel

Previous quarter was Rs. 15.1 crores on top line and Rs. 13.4 crores on bottom line. Same way you have to double it like this.

Visalakshi

15.1 and...?

M. K. Patel

13.4.

Visalakshi

And what is the outlook on Altana revenues, are we likely to see some kind of pick up going forward, can you give us some status?

Pankaj Patel

Yes, we will see some pickup because last year we had certain changes in the plant reconstruction and expansion of capacity, and we lost some sales, etc. So we expect for the next year, that is, calendar year again, we expect profit to be normalized and our share should be in line with our previous numbers which is approximately Rs.60 crores.

Visalakshi

Okay. Another thing on Altana again, can you also give me the 9 month numbers?

M. K. Patel

Altana 9 month sales was Rs. 42.4 crores and bottom line is Rs. 27.4 crores. This is 50% again.

Visalakshi

And again the corresponding previous..?

M. K. Patel

Corresponding was Rs. 43.2 crores and Rs. 37.8 crores.

Visalakshi

Okay, thank you. Secondly and update on the French business, what is the outlook right now?

Pankaj Patel

First of all, the numbers for the quarter of French business is good. I just want to tell you that the French business has improved significantly in terms of market share, from an earlier market share of below 1%, we have now more than 1% market share. We have been clocking a sale of over million Euros per month in last quarter, and going forward we clearly see the sale to further improve. We also have recently signed an agreement with a buying group to distribute our product, which would further help us to sell more in the market and as a result we see the calendar year 06 number significantly higher and losses significantly lower as a result of all these initiatives. More details we will provide you in course of time.

Visalakshi

And what is the kind of cumulative loss that you would have registered in the first nine months in the French business?

Pankaj Patel

Rs. 15.5 crores in nine months.

Visalakshi

Okay. So you are saying next year you will break even or you will have some profit?

Pankaj Patel

No, next year we will not break even. We are now hoping because of this new contract which we have signed with a major buying group, which represents more than 10% of the pharmacies present in France, we should be able to break even one year earlier. Earlier I was giving you three year's guideline, now I can say that because of this new success we should be able to break even in two year's time. That means in 07 we should see break even.

Visalakshi

In December 07?

Pankaj Patel

December 07, yes.

Visalakshi

Okay. And finally in terms of say the tax savings from the new facility, could you quantify as to what is the kind of saving that you will see on excise duty in coming year?

M. K. Patel

Saving on the Baddi plant?

Visalakshi

Yes.

M. K. Patel

Baddi plant, Visalakshi, as of now government is talking about...

Pankaj Patel

She is asking what is the saving... Visalakshi, can we provide you this information offline?

Visalakshi

Okay.

Pankaj Patel

Thank you.

Visalakshi

Thank you.

Moderator

Thank you very much mam. Next is Mr. Manish from Deutsche Bank.

Manish

First of all congrats on the excellent performance. Three questions, one is on R&D, second one is continuing on France, and third is on US. On R&D just wanted to get a feel as to what can be the R&D charge for next financial year and how much of that will be on clinical trials? Second is on France as to what is the kind of loss you expect in current financial year and next year? And what is the kind of sales which we can expect from France next year? And lastly US, what is the kind of sales current year and next year?

Pankaj Patel

I think let us start with R&D first, Manish, on the R&D front the total expenses next year we are expecting about Rs. 120 crores, and because we are doing clinical development in India and not outside India we would not expect significant cost on clinical development. On the question on the French business, the loss this year expected is approximately 4 million Euros, the next year going forward this should become half. And, I didn't pick up your last question for US...

Manish

The US thing is, I wanted to know what is the sales aspiration for current year and next year, and what can be the loss there?

Pankaj Patel

First of all, we are actually expecting approximately \$30 million sales for the next year, which is FY 06-07, and we expect the profit of the US subsidiary of approximately \$3 million.

Manish

Thank you.

Moderator

Thank you very much sir. Next is Mr. Nimesh Mehta from Edelweiss Capital.

Nimesh Mehta

Hi, good morning everybody and congratulations on a good set of numbers. I just want a bit of information on CRAMS, what is the current income that you have registered for the quarter and for the nine months, and whether does this reflect Zambon (Italy) JV in which way?

Pankaj Patel

For the current quarter the CRAM income is approximately Rs. 5 million, and up to the year it is Rs. 77 million. Zambon is not JV actually, Zambon is a contract, so Zambon income will appear as part of other income only.

Nimesh Mehta

Okay. So if you can just throw some more color on that, meaning will it anyway result in the CRAMS opportunity or no..?

Pankaj Patel

Which one, Zambon?

Nimesh Mehta

Yes.

Pankaj Patel

Yes, there are CRAM opportunity. Already we are constructing a plant for manufacture of a particular kind of dosage form which should be commissioned by first quarter next financial year, and which should significantly add revenues, and we are already in discussion for further increasing the capacity in this plant.

Nimesh Mehta

Okay, thank you.

Moderator

Thank you very much sir. Next is Mr. Rahul Sharma from Karvy.

Rahul Sharma

What type of US numbers are we looking at in the current year, and how much of CRAMS income is reflected in our other income YTD, and what will be for the current year sir?

Pankaj Patel

For the current year, now I am talking about FY06, we expect US revenue in line with our expectations which is \$10 million. The CRAM income..., we would give you offline the number, I don't have the number in front of me.

Rahul Sharma

Okay sir. Thank you.

Moderator

Thank you very much sir. Participants who wish to ask questions may please press *1. Next is Ms. Rohita from Alchemy.

Rohita

I have a couple of questions, if you could give me consolidated debt in your book, and what is the R&D expenditure for the quarter?

Pankaj Patel

Sorry, could you please repeat the question.

Rohita

If you could give the consolidated debt in your books, and what is the R&D expenditure for the quarter?

M. K. Patel

Consolidated debt on our balance sheet will be in the vicinity of 410 crores, and so far as spending on R&D, are you talking about Q3?

Rohita

Q3 would be sufficient.

M. K. Patel

Q3 is Rs. 15 crores on revenue, and about Rs. 10 crores on capex.

Rohita

Fine. And what is the capex that you plan for the next year?

M. K. Patel

Capex for next year will be in the vicinity of again 100-120 crores. We have not finalized the budget but it will be in the vicinity of 100-120 crores.

Rohita

Okay fine. Thanks.

Moderator

Thank you very much mam. Next is Mr. Sameer from JM Morgan Stanley.

Sameer

Hi, good morning everyone. The first question is, how does the pipeline look for your business in different geographies?

Pankaj Patel

We will just give you some number as far as US is concerned that we have as of today 30 filings, 10 approvals, 20 pending approvals...

Sameer

How many in the calendar 2006?

Pankaj Patel

We expect at least 10 approvals in 2006, that is calendar year again, and which would help us to achieve our revenue numbers. On the front of Europe, we already have a big pipeline available which is being sold currently and we have filed for every important product going off patent going forward. So we are confident with respect to that is concerned.....

Sameer

How many launches again in calendar 2006?

Pankaj Patel

In 2006, in France we are expecting 4 launches for the products going off patent, and also we are expecting about 10 additional products which are old products coming to the market.

Sameer

Okay. Anything you can tell me about these four new launches, what is the addressable market, and...?

Pankaj Patel

I don't have the number, but if you could come to Mr. Nayak later on, Mr. Nayak can give you the data on that.

Sameer

Okay. And also your pipeline for the domestic market?

Pankaj Patel

Domestic market, next year we plan to launch close to 50 products through various divisions and everything is very well planned to achieve this number.

Sameer

When do you think you will be feeling the heat of the new patent regime for your domestic pipeline?

Pankaj Patel

Currently as we see, we do not see any hassle, we have of course plan worked out till 2010, and till 2010 we should not see any issues.

Sameer

Of these 50 products that you mentioned, how many are new molecules?

Pankaj Patel

That is a very interesting question, I don't have the number in front of me, so I would not like to dare to give you but we could give you offline this data.

Sameer

Okay. Just switching gears for the US market, for the 5 launches that you have done, in terms of market share how have you fared and any take on the pricing over there?

Pankaj Patel

We have done well. We have got market shares from 10% to 24% on different products.

Sameer

Okay. And what is take on the pricing environment in US right now?

Pankaj Patel

The US market continues to be under price pressure, and we have been reasonably comfortable with the market share and the prices at which we are selling. We do not see margin pressure impacting adversely to us.

Sameer

The current profitability that you are having in US at gross level, is it better or worse than the overall company number?

Pankaj Patel

It is too short a period to really give you the number because you know we really started, this is the first quarter where we have started showing our US revenue. So it would not be fair for me to compare at this level. I think after a year's operation this question would be more relevant.

Sameer

Okay. Just one last question, in terms of your debt, are there any plans, is there any timeline that you are looking at to bring down this 410 crores?

Pankaj Patel

We would always like to keep some debt on our balance sheet, reason being that it is a better option than raising capital. So we do not see any reduction in debt, however, we want to bring down our debt equity ratio in line with the industry standard to 0.5, and that we want to achieve over the next two years period.

Sameer

Okay fine. Thank you very much.

Moderator

Thank you very much sir. Participants who wish to ask questions may please press *1. Next is Mr. Nishant Bhargava from ICICI Securities.

Rajesh

Hi, Rajesh here. If Mr. Pankaj Patel can tell us little bit more about next two years in terms of US new product launch activity which has been pretty robust with two new approvals being received in the last quarter, and in terms of the dynamics of the market over the next couple of years?

Pankaj Patel

Plan for the calendar year 2006 is to launch 10-12 products, and from the pipeline perspective we expect to file additional ANDA, and this being the last quarter as you all are aware we are best in last quarter as far as ANDA filing is concerned, so we expect substantial number to be filed during this quarter. With that healthy pipeline already in place, we expect that next year we should be looking at 15-17 launches on calendar year 2007. We clearly see that our US market is giving us better market share than what we had originally expected, as you are aware our goal was to achieve about 10% market share, but we are happy to note that in some products we have gone as high as 24% market share, and this is a very short period in which we have achieved this. The most interesting part which really encourages us is that some of the key accounts which usually take a long time with a very small product basket to offer beginning with 5, we have been able to crack them and able to start developing supply relationship with them, and sign some contracts with them. So big chains and distributors have already been roped in as far as distribution of our products are concerned. So I am very confident about success of US market and I am seeing US market really growing very rapidly now. Again to repeat, you know, I mentioned at the beginning of my call that whatever investment we have made over the last three years in terms of developing US, European market actually have started paying results now, and we have seen for very first quarter where we really have a full quarter of US revenue coming up, we have achieved a sale of Rs. 18.8 crores and we clearly see that going forward we should be able to achieve our goal of \$30 million sale for the FY 06-07. I hope I have answered your question.

Rajesh

Yes, thank a lot. Any view on pricing pressure and increased competition?

Pankaj Patel

I think pricing pressure will continue, can little bit ease because of several new launches coming up in the second quarter of this calendar year, but pricing pressure will continue, more and more players are coming into US, and I think one has to live with this pricing pressure. You know, we had sometime back an interesting program called Prism, these program learnings we have now mimicked into the US program in order to make sure that we also continuously work on reducing the cost of

goods and basically be prepared for pricing pressure. One can say 95-97% price erosion when generic version of a brand is launched has become almost a norm now in USA, and I believe that would continue going forward unless there is some exclusivity.

Rajesh

Thank you so much and all the best.

Moderator

Thank you very much sir. Next is Mr. Rakesh from Mehta Partners.

Rakesh

Good morning, and thanks for taking my question. I have a question on Mayne Pharma, earlier in the year you had announced that you are going to have a partnership with them for supply of oncology products. Can you provide me update on that please?

Pankaj Patel

We have now started constructing the plant, we expect the plant to be completely ready and validated by calendar year 2006, and we should start the commercial operation in calendar year 2007.

Rakesh

Okay. And can you provide some numbers in terms of what kind of contribution this deal would add to the top line?

Pankaj Patel

I am not going to give you specific numbers at this moment, but I can only say that this joint venture in 2010 should add to the contribution in line with what we are currently earning from Altana.

Rakesh

Okay. Thank you.

Moderator

Thank you very much sir. Next is Mr. Nimesh Mehta from Edelweiss Capital.

Nimesh Mehta

Hi. I am sorry I missed out on the US sales number for the 9 months and for the quarter, if you can repeat that please.

Pankaj Patel

The US sale for the 9 month is Rs. 250 million and for the last quarter it is Rs. 188 million. Actually we really started the operations in this quarter.

Nimesh Mehta

Okay. And this 188 million reflects about 5 products right?

Pankaj Patel

Correct.

Nimesh Mehta

Okay, thank you.

Moderator

Thank you very much sir. Participants who wish to ask questions may please press *1. Next is Mr. Manish from ING.

Manish

Hi, good morning. One query I have got on the business model. How is business model or the revenue stream would look like maybe in 2008 or 2010 in terms of your domestic sales, in terms of your overseas sales and in terms of your CRAMS?

Pankaj Patel

I would say that in 2010 the domestic sale should be approximately 50% of our total revenue. The exports should represent approximately 35%, and CRAM should represent about 15% of our revenues. However on the profit front it could be different because we would have lot of profit entries coming from the joint venture which could be in higher numbers and I do not have the numbers, the same breakup for profits, but we could provide you offline this because we already have this numbers available.

Manish

And the last question, what was your bottom line from the US operation in this quarter as well as for nine months?

Pankaj Patel

For the quarter the bottom line, we have made a profit of a million rupees, and for the nine months there is a loss of Rs. 36 million.

Manish

Thank you.

Moderator

Thank you very much sir. Next is a followup from Ms. Visalakshi of DSP Merrill Lynch.

Visalakshi

Thanks. I didn't catch the R&D spend for the quarter, the revenue spend?

M. K. Patel

R&D revenue spend for the quarter was 15.3 crores.

Visalakshi

15

M. K. Patel

Yes.

Visalakshi

Okay, thanks.

Moderator

Thank you very much mam. Next is a followup from Mr. Rakesh of Mehta partners.

Rakesh

Hi, can you please provide update on your R&D initiatives. You had four early stage molecules in your pipeline and you were to submit an IND this year sometime, can you please give some update on this and how you are going to take this program forward and what kind of alliances or out-licensing initiative you plan to seek for this program. And two is, are you focussing on bio-similars also, and if yes, can you tell me what kind of molecules you are looking there?

Pankaj Patel

First, on the R&D program, we have been basically focussing on taking the India advantage to move our R&D program. Given the fact that the limited resources we have resolved to do all our development work in India, and with that we want to build up a robust pipeline of products as per our vision statement. Currently as I mentioned we have one product which has completed phase 1, the second molecule we have just filed IND in the month of December. We expect to start the clinical phase of that also. We expect to file one more IND next year, and we have several leads in about three or four areas. We expect that these leads would result into INDs over the next 12 months or so. So we are clearly seeing that our plan on R&D is moving as we like to do it. Our strategy is basically to develop the product at least up to phase IIA preferably to phase IIB before we look for development partner. So we do not want to initiate any licensing discussions before that. We would basically be looking for initiating licensing discussions in calendar year 2007 onwards, and look for partners to develop the product further to phase III for other markets, particularly the developed markets. I hope I have answered your question.

Rakesh

And my question was also on your focus on bio similars..?

Pankaj Patel

Bio-similars, we have some program. However, currently we are not giving any further data on this. At appropriate time we would come out with specific data on this. Currently we are not giving any market guidance or information on this.

Rakesh

Okay. What kind of development or what kind of progress you have made on your unlisted companies?

Pankaj Patel

Sorry?

Rakesh

You have couple of investments, you have holding in Onconova right?

Pankaj Patel

Yes.

Rakesh

And what kind of progress the research has done there?

Pankaj Patel

The compound is, as you might be aware, in phase 1 clinical trial. The clinical trial has been moving very satisfactorily and it is moving towards getting into phase II maybe over the next year. We see the compound has very promising results in few patients but it is too early to comment more about it. The company has also done additional work in some newer areas where we expect to move forward in terms of filing INDs. We also have a bio protection program compound, which is basically radiation protection program, which we intend to develop along with the US army and the US government. The company is progressing well and we expect this company to be very successful in oncology area.

Rakesh

Okay. And final question here, obviously you have a keen focus on oncology drugs and to that extent I want to know whether you have holding in any of the other unlisted onco program companies also?

Pankaj Patel

No, but we have as you are aware we signed recently an agreement with Bharat Serums and created a Joint Venture to develop a novel drug delivery for a known oncology compound.

Rakesh

Okay, thanks and wish you well for your work.

Moderator

Thank you very much sir. Participants who wish to ask questions may please press *1. Participants who wish to ask questions may please press *1. At this moment there are no further questions from participants. I would like to hand over the floor back to Mr. Pankaj Patel for final remarks.

Pankaj Patel

Thank you very much for joining our conference call and I look forward to meeting you again in the next conference call. Thank you.

Moderator

Ladies and gentlemen, thank you for choosing WebEx conferencing service. That concludes this conference call. Thank you for your participation. You may now disconnect your lines. Thank you and have a nice day.
