

Q4 FY06 Results - Investors/Analysts Conference Call (April 28, 2006)

Moderator

Good evening ladies and gentlemen. I am Parimala, the moderator for this conference. Welcome to 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 like to hand over to Mr. Pankaj Patel of Zydus Cadila. Thank you and over to you sir.

Pankaj Patel

Good evening and welcome to our post results teleconference for the fourth quarter of the financial year 2005-06.

You must have heard that the board of directors of the company has recommended a bonus in the ratio of 1:1.

Before I get into details of the results and the numbers let me recap the achievement of 2005-2006.

The year 2005-2006 will be remembered in our history as a remarkable year in which the company has forayed into the US market, started the contract manufacturing business, and also made unprecedented progress in R&D front.

Broadly during the year 2005-2006, the Zydus Group has,

- Started its operation in US, profitable in the very first year, also started operation in Brazil and South Africa. This is the year in which our investment in developmental activities particularly in the developed generic markets made over last 3 years have started yielding results.
- We sold off our branded generic business, of French subsidiary to have a total focus on pure generic business, and have signed an agreement with Evolupharm, a large buying group representing over 2250 pharmacies in France. Supply to France from India has also started.
- We have restructured our domestic formulation business aimed at improving yield per person, cost effective marketing and optimal size of marketing divisions We have also launched over 34 new products last year.
- We started the global contract manufacturing business, and signed over 11 contracts during the year with innovators and generic companies, having a peak revenue potential of \$ 23.6 million. During the year the income from the global contract manufacturing was Rs. 92 million.
- We have filed 2 more INDs during the year, ZYH2 and ZYI1 The first IND ZYH1 successfully completed phase 1 clinical trial and has received the permission to start phase 2 trials.
- We acquired 30.7% stake now in Carnation Nutra-Analogue Foods Limited, the manufacturer of Nutralite, which is India's largest selling Margarine, currently enjoying market share of over 60%.
- We have turned around the operations of our joint venture Sarabhai Zydus Animal Health Limited, from a loss of Rs. 16 million last year to profit of Rs. 66 million during the year, with the improvement in margins and reduction in expenses.

We now expect steady performance of Zydus Altana till the patent expiry of Pantoprazole after streamlining sales terms and increasing the manufacturing capacity.

Start of US and Brazil operation, income from global contract manufacturing, , higher growth of business in French market, growth in other non-regulated markets and growth in the domestic formulations and consumer business which were partially due to restocking of VAT, fueled our overall revenue growth during the year and helped to improve the profits.

Coming to the specific details of the performance of financial year 2005-2006 on a standalone basis,

The net sales has increased by 17% year-on-year to Rs. 1246 crores from Rs. 1063 crore last year. The top line growth was mainly driven by domestic formulation growth of 16%, growth of 102% of exports formulation, and growth of 28% of

consumer products. I have already explained the reasons of growth in above markets, however, API business continued to face stiff competition and severe pricing pressure on both domestic and international markets.

PBIDT were up by 18% to Rs. 2820 million from 2396 million last year. This was in spite of increase in R&D spend of 15% year-on-year and lower dividend from Altana compared to last year.

The PAT was up 26% to Rs. 1649 million from Rs. 1314 million last year, and the PAT margins were up from 11.5% to 12.5%.

In line the EPS increased by 26% to Rs. 26.26 from Rs. 20.93 last year.

During the quarter four on a standalone basis,

The net sale was up by 43% year-on-year to Rs. 2,768 million from Rs. 1,933 million in the quarter four last year. As you all are aware domestic formulation business in quarter four last year was badly hit by implication of VAT, which adversely affected the results not only of the quarter but also entire year. Positive impact of the same has been seen in the first quarter of the current year. Lower sales base of quarter four of last year is one of the reasons for higher growth of the domestic formulation and consumer business of 37% and 33% respectively and overall sales growth of quarter four in current year. Apart from this, sales of US \$188 million and API exports growth of 22% year-on-year contributed to overall sales growth.

The PBDIT increased by 32% to Rs. 503 million from Rs. 380 million last year.

The PBT margins have increased to 10% from 7.9% last year.

The PAT was up by 40% to Rs. 223 million from Rs. 159 million last year. In line, the EPS also was up by 40% to Rs. 3.55 from Rs. 2.53 last year.

Let me now give you the highlights of consolidated results for year 05-06.

Net sales was up 19% year-on-year to Rs. 14453 million from Rs. 12123 million last year. The top line growth was mainly driven by sales growth of domestic formations by 15%, sales growth of French subsidiary by 78%, start of sales in US, Brazil, and growth in exports to other emerging markets by 29%.

The PBDIT was up by 27% year-on-year to Rs. 2913 million from Rs. 2298 million, mainly due to,

- higher profit of standalone operations,
- profit of the US subsidiary of Rs. 4 million against loss of Rs. 91 million last year,
- the losses of French subsidiary being lower compared to last year, and
- profit of Sarabhai Zydus of Rs. 33 million against a loss of Rs. 8 million last year,

The PBDIT margin was up by 1.2% to 19.6% against 18.4% last year, and the PAT was up 46% year-on-year to Rs. 1524 million from Rs. 1047 million last year.

Coming to consolidated results of quarter four,

Net sale was up 47% year-on-year to Rs. 3364 million from Rs. 2297 million last year. Top line growth was mainly driven by domestic formulation growth of 40%, sales growth of French subsidiary by 53%, and start of sales in US and Brazil.

PBDIT was up by 100% year-on-year to Rs. 647 million from Rs. 323 million last year mainly due to

- higher profits of standalone operation, up by 32% year-on-year,
- profit of US subsidiary of Rs. 40 million against a loss of Rs.24 million last year, and
- losses of French subsidiary being lower compared to last year.

PBDIT margins were up 5.6% to 18.7% against 13.1% last year, and the PAT was up 377% to Rs. 306 million from Rs. 64 million last year.

Apart from sale of branded business of French subsidiary, agreement with Evolupharm, and acquisition of 30.7% stake in Carnation, which I have covered above, other achievements in quarter four were,

- We filed the third IND for NME ZYH2, a novel agent for treatment of diabetes.
- We received permission from DCGI to conduct phase II clinical trials on the NME ZYH1 after successful completion of phase I clinical trials.
- We received 2 more ANDA approvals from US FDA, taking total approval to 10 for the year and 12 approvals cumulatively. Subsequently, we also have received one more approval. We filed 6 more ANDAs, taking total to 12 ANDA filing for the year, aggregating to total filing of 36, 23 of which are still awaiting approval.
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- We filed application for 5 more drug master files, taking total filings of drug master file to 12 for the year and cumulative filings to 40.
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- We filed 3 dossiers of new product for the French market, taking the total filing to 6, and we have also done several site variation filings during the quarter.

Thank you, and now we will start the Q&A session. You may address questions on business operations and R&D to me and Mr. Ganesh Nayak here, and on results and finance to Mr. M. K. Patel. Over to you coordinator. Thank you very much.

Moderator

Thank you very much sir. We will now begin the Q&A interactive session. Participants who wish to ask questions please press *1 on the 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 a question. To ask a question please press *1 now. First in line we have Mr. Shreyans Jain from ShareKhan. Over to you sir.

Shreyans Jain

Hi, thank you. I have a couple of questions, first of all you said that, there was a news that you have made another deal with one of the buyer groups, so how will that affect your French operation? When do you expect that to turn around? Secondly, can you tell me what will be the debt on the books right now? And thirdly, what are the products that your sending in US as of now and what do you plan to launch the marketing in the next 3-4 months?

Ganesh Nayak

I will take the first the third question, and second on finance will be taken by Mr. M. K. Patel after I finish. Evolupharm is the second largest distributor group there in France and they have 2250 pharmacies whom they cater to. Considering that we were managing the same with our own field force and also considering that we are a new entrant into the French market, we were not able to exploit our strength in terms of distribution. Being in the generic arena it was very important for us to have this support of a strong player. With Evolupharm we will be able to achieve that.

Shreyans Jain

So when do you think the French business will turn around, in FY07 or..?

Ganesh Naik

In fact, it is turning around, breaking even in FY 07-08.

Shreyans Jain

07-08, okay. About the products in US that you are selling right now?

Ganesh Naik

Currently we have atenolol, metformin, promethazine, and Ribavirin. We have 13 approvals so far, we have launched 5 products. In this year, we would have at least 6-8 more products launched.

Shreyans Jain

Okay, and about the debt on the books.

M. K. Patel

Total debt on the books is Rs. 443 crores.

Shreyans Jain

Rs. 443 crores, okay thank you very much.

Moderator

Thank you Mr. Shreyans. Next we have Mr. Rajesh Vora from ICICI Securities. Over to you sir.

Rajesh Vora

Hi, good evening gentlemen and congratulations for pretty good set of numbers and the bonus announcement. If Mr. Pankaj Patel can address question on investments that have been making in the last two years in building robust generic business with specific focus on US, how do you see the pay off coming through? We have seen some signs of that coming through in FY06 with significant ramp up likely over the next couple of years. If you can throw some more light on that and how is the pricing environment that you are witnessing?

Pankaj Patel

Over the last few years we have basically ramped up the US market through careful selection of products and aggressive filing of drug master files, and now we have approvals, we have come into the market with a very unique thing, and I would like to highlight some of the very important facts here. First is, we were the only company from India which filed 12 ANDA in the very first year of filing. We are the only company who have a very unique distribution model in US wherein we sell product directly and also through a partner under a label of Zydus. Third is that we are the only company which has basically turned around and made operation profitable in a very-very short period. In the very first year, which is basically approximately 7 months sales, we have clocked a sale of about Rs. 50 crores in US with a profit of about Rs. 4 million. So clearly, over the period of last three years, we have now ramped up 36 filings. We have very good product approvals expected in near future. With launch of those all products, we expect this year our sale to clock \$30 million, and we hope to even better that number depending upon some additional product approvals, and with that we are clearly seeing that the US business will become not only profitable but also on a very-very high growth rate for the next year.

Rajesh Vora

And in terms of pricing environment currently.

Pankaj Patel

On the pricing environment, US markets continues to remain under high margin pricing pressure, we have been aware of this and that is the reason why we have selected products where we know that we could have better margins and we don't have to really face problems with respect to pricing pressure. We are basically backward integrated in most of these products. We also have a very good manufacturing synergy available of India and we believe that in spite of pricing pressure we will continue to achieve the number and also profitable sales in US.

Rajesh Vora

Thank you very much and all the best gentlemen.

Moderator

Thank you very much sir. Participants who wish to ask questions may please press *1 now. Next, we have Mr. Nimesh Mehta from Edelweiss. Over to you sir.

Nimesh Mehta

Good evening everybody. I just have a couple of questions. First, when do you expect the approval for Simvastatin? And second, at what rate do you expect the European products to be sourced from Indian manufacturing facilities?

Pankaj Patel

I cannot give any guidance on the approval process and timings because that is not right thing to do on my part since this is all depending on the FDA. We expect approval to come any time, but we cannot say exactly when it will happen. With respect to the French business, we have already started supplying few products now. By next 2-3 years, we expect significant portion of the products are going to be supplied from India, that would be something close to about 60% of the products which will be coming out from India.

Nimesh Mehta

Okay, and I understand the transfer of this product to India is only going to trigger turnaround right?

Pankaj Patel

The transfer of product will improve the margins, but because the top line is growing faster, we have created a structure under which our marketing cost from a fixed is becoming to a variable cost, that is the reason why we believe that next year we should be able to break even and make slight profit in the French operation.

Nimesh Mehta

Okay, thank you very much.

Moderator

Thank you Mr. Mehta. Next we have Mr. Ravi Agarwal from JP Morgan. Over to your sir.

Jaisal

Hi, this is Jaisal here. First question is, if you can give me the breakup of fourth quarter export formulation business?

Pankaj Patel

The forth quarter of formulation was total of Rs. 654 million, US was Rs. 250 million, France was Rs. 160 million, Brazil was Rs. 62 million, and rest of the world was Rs. 182 million.

Ravi Agarwal

Second question is on the margins in the Altana business for fourth quarter.

Pankaj Patel

For fourth quarter the Altana sales was Rs. 229 million and the profit was Rs. 186 million. This is our part of 50%.

Ravi Agarwal

Okay. Then for the French business in the new arrangement that you have with Evolupharm what is your anticipation in terms of the movement on gross margins, meaning, what the gross margins that you are enjoying currently, to what extent do you think that will be impacted when you have this arrangement with Evolupharm?

Pankaj Patel

See what happens is that now we will move towards a kind of a structure, wherein every additional sale would not require any fixed marketing spend, but actually for every additional euro sold there will be a marketing cost involved, and basically for every euro there is a kind of net margin available in theory. This would become fully effective next year because currently we ourselves sell, and we sell through Evolupharm but eventually we will have our all marketing spend become variable, so we would have fixed margin. So we expect that in the process, the operation becomes clearly a profitable operation.

Ravi Agarwal

Right, but because now you will be selling through a partner versus currently where you are selling on your own...

Pankaj Patel

That is not going to happen during this year, this will happen from January 1, 2007. Currently, we are basically selling through Evolupharm and also through our own marketing infrastructure. By end of this year we would then move to 100% Evolupharm. So this is a transition period, which we have taken between that, and that is the time we will be able to basically move to that complete variable structure.

Ravi Agarwal

But don't you anticipate that your current gross margins will get kind of reduced because you will have to sell through a partner?

Pankaj Patel

No, we don't expect that to reduce because this partner already has existing sales force, so their cost will be lower. So if you look at just pure gross margin based on the cost of goods and the net selling price, I would tend to agree with you, but actually the overhead goes down significantly so actually the margins at net level become better and more attractive.

Ravi Agarwal

I see, but there is a reduction at the gross margin level, the sale minus COGS?

Pankaj Patel

Yes. That is not significant, I can tell you that that margin reduction at gross level is not significant.

Ganesh Nayak

See another thing has happened, this is Ganesh Nayak, the discounts which were unlimited to the pharmacist earlier, the new legislation has come into force which limits the amount of discount that you can give to the pharmacist. Of course, now there are other ways being found out to compensate for that but the margins which were being given to the pharmacist have come down by an extent of almost 10% which now goes into the pockets, or the kitty of the manufacturers. So even that has come to our aid in terms of this total margins which you are talking about.

Ravi Agarwal

Okay, the last question is on the domestic business, if you could tell us what is the extent of price growth in FY06?

Pankaj Patel

Price growth?

Ravi Agarwal

Yeah.

Pankaj Patel

I don't have the number available in front of me but we would send you that information.

Ravi Agarwal

Right, and also if you have some information on products launched in the last two years, how much they contribute to sales?

Pankaj Patel

Again I don't have in front of me, we will send you this information as well.

Ravi Agarwal

Okay, thanks so much. I will get back to you.

Moderator

Thank you very much sir. Participants who wish to ask questions may please press *1 now. Next in line we have Ms. Rohita Sharma from Alchemy Research. Over to you mam.

Rohita Sharma

Hi, I am Rohita from Alchemy. I do not know if I have missed out this, could you repeat the loss for the France subsidiary and the profit figure for the US subsidiary for this year?

Pankaj Patel

Okay, for the year, the French subsidiary had a loss of Rs. 238 million. The US subsidiary made a profit of Rs. 4 million.

Rohita Sharma

Okay fine, thanks.

Moderator

Thank you mam. Next we have Mr. Sameer Baisiwala of Morgan Stanley. Over to you sir.

Sameer Baisiwala

Sir can you update us on the simvastatin, your preparedness once the market opens up, for the US market?

Pankaj Patel

When market opens we are prepared to enter if we have approval.

Sameer Baisiwala

Yeah exactly on that point, do you expect the approval on day one, your facility being inspected and stuff like that...?

Pankaj Patel

Well, it is very difficult to say when FDA will give approval. FDA never gives you guidance on when exactly they are going to give approval. Based on the current developments in tFDA, we expect, it is our hope, that we should get the approval but it is very difficult to commit that, yes, we would have the approval before that, We can tell you only when FDA gives us the results.

Sameer Baisiwala

No, I understand, but my question specifically is..

Pankaj Patel

We are prepared to launch if the approval is in place. Did you say facility approval?

Sameer Baisiwala

Inspection, yeah, for simvastatin manufacturing.

Pankaj Patel

Yeah, everything is approved. We are doing everything at approved facility, so that is not a problem. Question is that when actually the product approval comes in, current indication what we received from FDA whatever they have asked for and the stage we see from our past experience, we should have approval in time, but we don't have approval in hand at this moment, so I can't say if approval will be there before the date or not. However, if the approval comes before that we are fully prepared to launch the product.

Sameer Baisiwala

Fair enough, and am I right in assuming that you are procuring lovastatin as one of the inputs for simvastatin manufacturing, or you are not doing it in-house?

Pankaj Patel

I don't think we should give you much data at this moment for competitive reasons, but we are well placed as far as simvastatin is concerned.

Sameer Basiwala

Okay, thank you so much.

Moderator

Thank you very much sir. Next we have Mr. Prashant Nair of Citigate. Over to you sir.

Prashant Nair

Hi. I just had a couple of questions, one was, could you give us the revenue numbers for France what you done this year?

Pankaj Patel

For the French subsidiary we did this year Rs. 623 million.

Prashant Nair

Okay, and how is the performance on the Brazilian front, sir can you throw some light?

Pankaj Patel

Brazilian business did Rs. 115 million this year.

Prashant Nair

Sir, can you just repeat that?

Pankaj Patel

Rs. 115 million.

Prashant Nair

In sales?

Pankaj Patel

Yeah.

Prashant Nair

And at the bottom line?

Pankaj Patel

At the bottom line there was a loss of Rs. 16 million.

Prashant Nair

Okay sir. Thanks a lot sir.

Moderator

Thank you very much sir. Next is a followup question from Mr. Ravi Agarwal of JP Morgan.

Ravi Agarwal

Yeah, its me again. Just to followup on those contract manufacturing business, if you can give us some idea about the kind of deals that you have entered, you know, what does it normally entail, and what is your game plan for the next couple of years on this?

Pankaj Patel

I In contract manufacturing, we are focused on working on a value added deal which would basically involve anything from product development, registration approvals, supply agreements, to some very pure contract manufacturing deals. As I mentioned before we have 11 deals signed up till now with a peak revenue of 23 million dollars there. And going forward we see clearly that we would continue signing more deals. We expect some 1 or 2 big deals happening as we have done in past with in case of Zydus Mayne, our joint venture, we expect some deals of that magnitude also to happen during the next year.

Ravi Agarwal

So your focus in terms of getting these kind of deals is more on the innovator products which are currently doing clinical studies or is it more products which are....

Pankaj Patel

It is a mix of basket, so there are projects which are sort of new projects and there are projects which are maybe a change of source kind of a thing. So we are doing all kinds of things basically, so I cannot say specifically that there is only one thing happening. We are doing also some work with innovator companies, we are also doing some work with sort of large generic companies or large companies who want to change the source of raw materials or finished dosage forms.

Ravi Agarwal

Thank you.

Moderator

Thank you very much sir. Participants who wish to ask questions may please press *1 now. I repeat participants who wish to ask questions may please press *1 now. Next we have Ms. Kavita Pandit from Finance Insight. Over to you mam.

Kavita Pandit

Yeah thanks. Good evening gentlemen. Just some data points I require, could you give us figure of your API sales from Altana JV?

Pankaj Patel

The total sale?

Kavita Pandit

That is your total bulk drug sales and exports is Rs. 55 crores right?

Pankaj Patel

Yeah.

Kavita Pandit

So out of that how much is from Altana JV?

Pankaj Patel

Rs. 229 million.

Kavita Pandit

Rs. 229 million, right.

Pankaj Patel

Yeah.

Kavita Pandit

And I just missed out on a few data points, that is your revenues from French, US...

Pankaj Patel

The revenue from France was Rs. 623 million, the US revenue was Rs. 500 million, the Brazilian revenue was Rs. 115 million.

Kavita Pandit

All right, and Altana was Rs. 229 million right?

Pankaj Patel

Yeah.

Kavita Pandit

Okay, and same for profits, during the quarter, that is French...?

Pankaj Patel

You want quarter's numbers?

Kavita Pandit

Yeah.

Pankaj Patel

You want sales number or profit number?

Kavita Pandit

Both of them would be great.

Pankaj Patel

Quarter sales for France was Rs. 160 million.

Kavita Pandit

Okay.

Pankaj Patel

US was Rs. 250 million.

Kavita Pandit

Okay.

Pankaj Patel

And Brazil was Rs. 62 million.

Kavita Pandit

Right.

Pankaj Patel

And quarter profit numbers for France was Rs. -83 million.

Kavita Pandit

Okay.

Pankaj Patel

US was Rs. 40 million and Brazil was break even.

Kavita Pandit

Okay. Thanks sir.

Moderator

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

Pankaj Patel

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