“Aurobindo Pharma Limited Q2 FY17 Earnings Conference Call”

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Moderator: Good Morning, Ladies and Gentlemen, and Welcome to the Aurobindo Pharma Limited Q2 FY-'17 Earnings Conference Call. 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 would now like to hand the conference over to Mr. Santhanam Subramanian – CFO, Aurobindo Pharma Limited. Thank you and over to you Sir.

Santhanam Subramanian: Thank you, Karuna. Good Morning and Welcome Everyone to our Second Quarter FY-'17 Earnings Call. With me we have our Senior Management team represented by Mr. Govindarajan -- Managing Director; Mr. Bob Cunard – CEO, Aurobindo Pharma USA; Mr. Ronald Quadrel -- CEO, AuroMedics Pharma, and Mr. Sanjeev Dani -- COO and Head, Formulations. We will begin this call with opening remarks from the Management followed by an interactive Q&A session.

The company from 1st April, 2016 has adopted the Indian Accounting Standard and hence the financials which we will discuss today are in accordance with that. For comparison purposes, the Q2 FY-'16 numbers are also restated as per IndAS. Please note that some of the matters which we will discuss today are forward-looking including and without limitations, statements relating to the implementation of strategic initiatives and other affirmations on our future business, business development and commercial performance. While these forward-looking statements represent judgment and future expectations concerning the development of our business, a number of risks, uncertainties and other important factors may cause actual developments and results to differ materially from our expectations. Aurobindo Pharma undertakes no obligation to publicly revise any forward-looking statements to reflect future events or circumstances.

Now I will hand over the call to Mr. Govindarajan for his opening remarks. Over to you, Govind.

N. Govindarajan: Thank you, Subbu. Good Morning, Everyone. We are here to discuss the Second Quarter Financial Year '16-'17 Results declared by the Company. During the quarter, the Company registered revenue growth of 12.2% to Rs.3,775 Crores. The EBITDA improved by 19.3% to Rs.929.2 Crores resulting in an EBITDA margin of 24.6%. The profit after tax increased by 32.5% to Rs.602.6 crores during the quarter.

In terms of the business breakdown, Formulations business contributed to 80% of the total gross sales. The gross formulations sales for the quarter stands at Rs.3,004 Crores registering 12.4% growth year-on-year. API business accounted for the balance Rs.768.8 Crores for the quarter. In the Formulations business, the total sales from the US market stood at Rs.1,735 Crores during the quarter. The business registered a growth of 17.8% year-on-year during the quarter. The growth is on account of higher volumes and new launches and the overall

Injectable segment. Aurobindo USA, the company marketing overall products in the USA, has witnessed a growth of around 11% year-on-year during the quarter. We launched seven new products during the period. Aurolife, our US manufacturing arm, continues to grow due to the demand from the Veterans Administration. AuroMedics, the Injectable business, continues its growth momentum during the quarter with sales of US$38.3 Million and growth of 108% year-on-year. We launched four new products during the quarter; however, three of the four products were launched at the very end of the quarter. Under the Injectable segment including Ophthalmics, we have filed total of 85 products as on 30th September 2016, out of which 48 have received approval including 2 tentative approvals and the balance are awaiting approvals. We received five approvals during the quarter. We are progressing our development in Complex products namely Hormones, Oncology, Liposomal and Microsphere Depot Injectables which we plan to start filing from the beginning of next financial year.

Aurohealth, which manufactures and markets Pharma OTC products in the US, continued its customer penetration into several key national retailers as well as select regional accounts. Aurohealth is now shipping to more than 20 customers. Natrol, the acquired branded nutraceutical entity is performing as expected.

The Company as on 30th September 2016 has filed 412 ANDAs on a cumulative basis, out of which 243 have final approval and 41 have tentative approvals, including 21 ANDAs which are tentatively approved under PEPFAR and balance 128 ANDAs are under review.

The unit wise filing and approvals are as follows: From Unit-3- 125 filed, 95 approved; Unit-7 - 155 filed, 68 approved; AuroLife - 26 filed, 14 approved; Unit-4 - 71 filed, 36 approved; Unit-12 - 20 filed, 19 approved; Unit-6 - 11 filed and approved, and Auronext - 4 products have been filed so far. Unit-3, Unit-7 and Auronext manufacture Oral Non-betalactam products, Unit-4 manufactures General Injectable and Ophthalmic products, Unit-6 and Unit-12 manufacture Cephalosporins and Semi-Synthetic Penicillins respectively and Auronext, which has its facility in Bhiwadi in Rajasthan manufactures Penem Injectable products. Europe Formulations sales were at Rs.813.4 Crores in Q2 FY-'16-17 registering 6.4% growth year-on-year. We are transferring manufacturing of one more product from Europe to India during the quarter with a cumulative transfer of 37 products as on 30th September, 2016. Emerging markets Formulations sales were at Rs.177 Crores during the quarter with a growth of 13.3% year-on-year. ARV Formulations sales were rather flat at Rs.279 Crores during the quarter.

In terms of segmental classification, US Formulations contributed 46% of the overall revenues in Q2 FY-'16-'17 vs. 44% in Q2 FY-'15-'16. Share of EU Formulations remains at 22% in Q2 FY-'16-'17 and the share of emerging market remain at 5%. ARV segment sales represents 7% of the total sales in Q2 FY-'16-'17 against 8% year-on-year. API business contributed 20% of the total revenues in Q2 FY-'16-'17. API business has grown at 11.3% year-on-year. Our EBITDA before FOREX for the quarter is at Rs.929.2 Crores representing an operating margin of 24.6% for the quarter, up 23.1% from the corresponding period last year. R&D expenses are

at Rs.148 Crores during the quarter which is 3.9% of the sales. The company generated FOREX gain of Rs.20.2 Crores during the quarter. The closing rupee versus US dollar rate was Rs.66.615 in September 2016 and Rs.67.525 in June 2016. CAPEX for the quarter is around $40 Million. The effective tax rate for the quarter is 27% of PBT. The net debt stood at $484 Million as on 30th September, 2016 against US$525 million on June 30th. The majority of the company's debt is denominated in foreign currency. The cash and bank balance is at US$107 Million. So that is all from our end and we are happy to take questions now.

Moderator: Thank you very much, Sir. Ladies and Gentlemen, we will now begin the Question-and-Answer Session. The first question is from the line of Prakash Agarwal from Axis Capital. Please go ahead.

Prakash Agarwal: First question on the US business. Just trying to understand, you have seen a plethora of launches of approvals. So what would you contribute to the slowing of the US sales by 14% in dollar terms… is it due to base business, pricing erosion or is it due to, as you said, launches have been coming in the fag end despite so many approvals and how do you plan to correct his?

Robert Cunard: This is Bob. Thanks for the question. There are two things going on -- As we talked in the past, the new product launches certainly did not monetize as quickly as we had anticipated and we had outlined those products that we had approvals that would be commercialized later in the fiscal year. If you remember those original 19 we talked about, 4 of these we launched during our fiscal second quarter and the balance will be introduced in the third and fourth quarters as well as new approvals we since gained. The other thing is we have definitely seen increased pricing pressure in the US market… I would not say it is across the whole portfolio, but certainly select products we have seen heightened price competition across the space and we have seen that downstream as well in looking at some of our key customers on the wholesale and retail side, just a very aggressive pricing environment right now. So we did have some additional headwinds in that area. We were able to offset higher-than-expected price erosion on the business with improved volume. So our base business still grew from Q1 to Q2 and we think that remains the case as we go into the third quarter and once again we see acceleration in new product launches to offset that as well.

Prakash Agarwal: So this confidence comes from where, given that you earlier said that Capacity at Unit-7 will get freed up, could you just update on the same?

Robert Cunard : Yes, we have definitely seen that. As a matter of fact, over the past 4-months we have seen a record output from Unit-7 and our on-time and in-full rates have been improving there, and that gives us a lot of confidence that we will be able to commercialize those products. The other thing is we look at this and we talked about it in the past, where we want to make sure that we are maintaining service levels to our customers but also where we do not compromise base business with the introduction of new. So we have done that and we have seen an

improvement in service levels, and that has some benefit too as far as the avoidance of some backend costs with various supply and other customer penalties. So all the factors from Unit-7 as well as our other manufacturing sites are indicating that we are going to be in a good position of to perform and getting those products into the market.

Prakash Agarwal: I was referring to more of the additional capacity that will become free with Unit-XV coming in for Europe and the addition of a new block that you are doing for US. Can you update us on the same?

Robert Cunard: I will defer to Sanjeev on XV and what is happening on the European side but as far as the new block that is commissioned and production has taken place, we have taken validation batches out of there that will be on their way to the US and we have seen expansion in our exhibit batch area as well. So those things are done and underway and the operational improvements continue.

Sanjeev Dani: I will just update on the Europe manufacturing facility, Unit-XV. We received the EU GMP Certification in October . By now we have ramped up and prepared for the manufacturing and we expect to start dispatching the stocks by January 2017.

Prakash Agarwal: So formal sales will commence from the Jan to March quarter?

Sanjeev Dani: That is right.

Moderator: Thank you. The next question is from the line of Kumar Saurav from Motilal Oswal Securities Limited. Please go ahead.

Kumar Saurav: If you can help explain the improvement in margins, if sequentially we see there is almost 100 basis points improvement in EBITDA margin, this is despite 70 basis points increase in R&D expense, so how should we look at this margin expansion and how much of this is sustainable going forward?

N. Govindarajan: This is Govind here Kumar. First of all I would like to measure the EBITDA margin not on a quarter-to-quarter basis but as an average for the full year. Our aim is to maintain at least 24% as an average for the full year. Second thing as far as this quarter is concerned the margin is better because of the mix in business, wherein the US business is more than the European business that would improve the margin and benefit in the raw material cost because of the dollar exchange. So there are few factors which allowed us to maintain better margins compared to the sequential quarter as well, Kumar.

Kumar Saurav: As you mentioned in your opening remarks that you plan to file Depot Injectables from FY18 beginning onwards, so how should we look at your R&D expense?

N. Govindarajan: So, we had maintained in the past also that our R&D expenses would go up in the future. Before we look at the future let us also step back and look at the R&D expenses today. If you really look at the current percentage it looks as if it is low because the Actavis business had added the top line of suddenly the €300 plus million and if we remove it and look at it already we would be beyond 5%. So we clearly believe when the Depot Injection, few more Complex products clinical trials happen, it can reach even around 7-8% for the particular year. But we do not expect that particular percentage to be maintained for ever because we do not expect every year to have all the clinical trials simultaneously. So in all fairness in the short to medium term we are still expected to reach around 5% in terms of R&D expenses, Kumar.

Kumar Saurav: So 5% when you say that, because we are saying that we plan to file Depot from next year and you say that when we do that it may move to 7-8%. Then should we expect that FY18 the R&D expense can move up significantly?

N. Govindarajan: No, on Depot, I would invite Ron to give a timeline. So it would be easy to correlate that way. Ron?

Ronald Quadrel: I would expect that we would start doing our clinical studies sometimes during calendar year '18. So as we proceed through the year that is one of the expenses will start going up.

Kumar Saurav: FY19 will be the year basically…?

N. Govindarajan: That is where we are looking at it, Kumar.

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

Anubhav Agarwal: One question to Ron actually. Ron, if we see the US sales, the product mix this quarter… I am just talking from the trend that we guys can see from IMS, it looks that this quarter the mix at the product level should have been little inferior because the high margin Abilify sales we see declining for everybody. I do not know what has been the impact for us but I am sure that Oxicodone-APAP has been down almost 50% for Aurobindo, I do not know whether that is like an exaggeration or that is reality. Eptifibatide sales maybe lower as well. Would you say that the mix of product in this quarter in the US will be inferior to what we have seen for the last two quarters, March and June?

N. Govindarajan: Let Ron answer about Eptifibatide and then Bob will take the rest of it.

Ronald Quadrel: Eptifibatide sales are continuing to be very strong, they are little bit less than last quarter. One of the reasons being is that Merck has re-entered the market with all their different presentations. One of the contracts that we had was an emergency contract because at the time of our launch there was a complete shortage. This contract has since gone back to Merck. Our results quarter on quarter are very consistent and we expect them to continue that way. One of

our other high margin products Isosulfan Blue is picking up very well also. So I think as we continue through the end of this fiscal year we should see pretty good mix and good pickup on sales also.

Robert Cunard: To your point, looking at the Aripiprazole and Oxy APAP we did see some declining in Aripiprazole and that kind of goes to my earlier comments, where some of the headwinds and some of the pricing pressures we have seen on some of these select products. In Oxycodone APAP we had a nice presence in the marketplace and then we had a couple of very aggressive competitors and some customers that went out to bid and we lost lostsome business. So we have kind of stepped back on that, we have been working with our API supplier and have refined our pricing there and are going out to seek some additional business. So I do not see that we will see an immediate return back to the levels we were at, but we think we will be able to offset that somewhat through the balance of the fiscal year.

Anubhav Agarwal: Govind, just taking this question further, I had the same impression but then I do not understand the gross margin that you guys reported, because I know we cannot see them quarter-on-quarter basis but this is the highest gross margin that we reported in last six quarters. We had a much stronger mix in Q4 and Q1, still our margins let us say if I adjust for excise duty which is impact only in 2Q, our gross margins were up 140 basis points, I know US sales as a percentage of sales from 45% has gone to 47% now but 140 basis points, with this kind of mix, I cannot explain it at least from my end.

N. Govindarajan: Do you want to give some clarity on that, Subbu?

Santhanam Subramanian: Apart from the point which you have said earlier, within the US business skewed towards the better margin segments and better margin products. Apart from that , the overall raw material costs have reduced significantly to the tune of around Rs.10 Crores to Rs.15 Crores, so there is a drop in the variable cost which has also helped in improving the gross margin.

N. Govindarajan: As far as the US is concerned, you also have to appreciate the fact there are certain direct sales and there are certain sales through the subsidiary. From that perspective also we have seen that improvement, Anubhav.

Anubhav Agarwal: So you are saying that the margins that you are getting from indirect sales has improved for you, that is why, direct sales margin would not have improved so much?

N. Govindarajan: No, it could be the other way round as well like indirect sales margin need not be necessarily as good as direct sale. The indirect sale the volume commensurately is less, obviously the overall margins would be better.

Anubhav Agarwal: Subbu sir, we saw that factoring happening in Q1, your result shows factoring amount has increased in this quarter by another $30 Million…?

Santhanam Subramanian: No, it has not increased. It is only $150 Million what we have achieved in the first quarter.

Anubhav Agarwal: But when you show in the balance sheet, it shows in the asset side the receivables from banks, the numbers show it to be $181 Million?

Santhanam Subramanian: Yes, but we have not got the money in September 16 and got some money, in the month of October.

N. Govindarajan: Additional $30 million has happened in October is what Subbu is trying to say.

Anubhav Agarwal: Would you include in your September balance sheet then this number?

Santhanam Subramanian: This is as per the IndAS financials. Because we have exercised the deferred purchase price program which as per the IndAS needs to be classified as a financial asset separately, that is what it has been shown.

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

Neha Manpuria: Did I hear correct that we have launched about 20 new products in the first half and the remaining of the 33 approvals will be in the second half including the new approvals?

Robert Cunard: Maybe we can cleave in two as far as Ron can comment on the Injectables. On the traditional oral side, we have launched 10 products, year-to-date we had 4 in the first quarter and 6 in the second and then we had the Rosuvastatin launch which was through our partnership, so it is around about total of 11 on the Oral side year-to-date. For the balance of the year we have those remaining approvals that we talked about and I think total year will probably be 30 or 35 introductions on our traditional Generic business.

Neha Manpuria: On the Injectable side?

Ronald Quadrel: On the Injectable side we launched 4 this past quarter and I am expecting somewhere I would say between 6 and 7 launches coming between now and the end of the year.

Neha Manpuria: On the Generic pricing side particularly in certain select segments that you have talked about, what is your sense as we go ahead in the next few quarters; is there a sense that that could get worse from where we are and therefore our underlying business improvement may not be as good as we were expecting?

Robert Cunard: I do not know if it gets worse, but I can definitely see continuation of the pricing pressure. So early in the year I anticipated we would see kind of a normal generic erosion rate on base business as, somewhere in the 4% to 6% range. I think that is going to be higher for the year perhaps more likely in the 6% to 8%. We have seen the bid process earlier in the fiscal year

and the impacts from that, but as we were watching some of the announcements around the wholesale side and some other pressures they have been under, and price pressures inin that downstream space as well as the McKesson-Walmart combination and some other things, I think we will see continued price pressure in the market through the fiscal year a little bit stronger than originally anticipated.

Neha Manpuria: On the net debt, we did see some reduction quarter-on-quarter. As we go towards the end of this year, are we still maintaining the number that we gave in the last quarter for debt reduction or could that be higher?

Santhanam Subramanian: No, we have said in last quarter that we will be targeting around 500, but we have already achieved less than 500 ie484, we look forward to improve upon this.

Moderator: Thank you. The next question is from the line of Shyam Srinivasan from Goldman Sachs. Please go ahead.

Shyam Srinivasan: Just the time to tie up the whole thing on the price erosion. I think you talked now about 6% to 8%. Just stepping back and seeing over the last year and a half that we have launched I think 45 products and the US revenues quarterly has gone from anywhere from $220 Million to $260 Million. So I hear you on the 6% to 8% price erosion. But are these products not very meaningful because I am just doing very rough math and I completely could be wrong here. But 45 products and we have had 45 million quarterly increase. So if you can help reconcile whether this value of products are low and the other reason why you are not seeing sequential uptick in the US revenues?

Robert Cunard: I am not sure about the total launches and what period again we are looking at there, because once again we saw 11 this year in our Generic space and they are all unique in some ways, we have seen kind of a typical process in some of the products we have launched late last fiscal year, like Aripiprazole where they come into the market and then we see an ongoing price erosion as it goes through the bid process and things. So some of them have been relatively small products that we have introduced and we are looking at Oxymorphone, Hydromorphone, Extended Phenytoin Phenytoinand some things like that where it is not a huge market to start and there is some uptick to get into that. So each product is unique in that way, but again, I think when we look at this year we definitely had the higher value products on the traditional Oral Solid skewed to the second half of the year, which is still the case. So I think some of that value drives into the third and fourth quarter.

Shyam Srinivasan: Just an update on the Injectable side as well for the product launches… value per product?

Ronald Quadrel: Since end of the fourth quarter last year we have had fairly significant launches in Eptifibatide, Isosulfan Blue, Pantaprazole and as we are moving forward here towards the second half of the year, as I said to one of the questions earlier, we are expecting between 6 to 7 launches through the end of the year- Sevelamer Levetiracetam Bags, Vancomycin, Esomeprazole and

Meropenem, which are for us fairly significant launches. So again we will start ramping up as we move towards the end of the second half of this year.

Shyam Srinivasan: Just my second question is on the Europe business. Can you just highlight what is the state of the business right now which we have seen a slowdown in growth, I think 12% in the last quarter, 6% now, has something changed with respect to the growth rate that we are expecting here? Also, anything on the profitability, what is it currently and can you reiterate what is your guidance for margins on that business?

Sanjeev Dani: First of all, the 12% which you just mentioned was in rupee term, in a constant currency basis it was 6%. So we continue to be on the same course. There is no drop in growth rate for the business. Secondly, in terms of the margin, as you know when we took over it was roughly about (-$20) Million and now actually last year, on a whole year basis, we have turned PAT-positive, our EBITDA margins are at mid-range of single digit%, and we continue to maintain that and are; in fact presently slightly ahead of the curve. I think going forward for FY-'17 we should be on course to what we had projected earlier.

Moderator: Thank you. The next question is from the line of Ranjit Kapadia from Centrum Broking. Please go ahead.

Ranjit Kapadia: My question relates to ARV Formulations' stable growth. Is that correlated with the higher EBITDA margin for the entire company? Second question, if you can give the update on Peptides?

N. Govindarajan: As far as ARV is concerned, Ranjeet bhai, if you remember we have been maintaining that our focus is not in terms of top line, our focus is in terms of maintaining the EBITDA margin as close as possible to the company's EBITDA margin. So from that perspective whenever we bid in the tenders we are happy if we get it, we are not upset in case we do not get it because the capacities can always be utilized for other products. So that is what we have been maintaining. So it has been flat. But, having said that, we are also pretty confident about the future of ARVs with Dolutegravir which can kick in by the second half of next year with some meaningful impact That is as far as ARV. As far as Peptides are concerned, the three DMFs have already been filed, the fourth should be filed any time, and we are targeting to file another three products before the end of this financial year or probably by the beginning of next financial year. Our focus currently is more towards improving the filing rate. We had in fact expanded from the original two modules to two more modules and all the modules we are right now focusing in terms of continuing the development or the validation batches so that we will be able to enhance the filing and we would not currently bother about the commercialization because we would like to enhance the basket as soon as possible and then look at the commercialization. That is the plan as far as Peptides are concerned.

Ranjit Kapadia: If you can give an update on Natrol, I will be thankful.

N. Govindarajan: It is maintaining the same growth momentum, Ranjeet bhai, so no surprises on Natrol both sides, either positive or negative.

Moderator: Thank you. The next question is from the line of Manoj Garg from Bank of America. Please go ahead.

Manoj Garg: Ron, can you give us a bit number in terms of what was the Injectable sales for the quarter and are we on track to achieve somewhere around $150 Million plus kind of Injectable sales for the year as a whole from this fiscal year?

Ronald Quadrel: The quarterly sales were 38.3, so it puts us almost at $73 Million for the half, and I do expect us to pick up even more in the second half, so we are definitely on target.

Manoj Garg: In one of your remarks, you have indicated about launch of Meropenem. I think we have been waiting for quite some time. Any specific reason why there is a delay given the fact that that plant has also gotten cleared now?

Ronald Quadrel: We had one last question from the FDA that we had to answer and we have done that. We are actually expecting approval… I do not want to say 3 or 4-weeks but probably within the next month or month and a half. At this time, we actually are making launch materials as we speak.

Manoj Garg: Govind, just would like to understand about our M&A strategy out here. I think there was an article in the paper talking about bidding for an asset in Portugal. Just want to understand like when we look at the M&A, if you could take us through about your overall strategy out there?

N. Govindarajan: Manoj, as you would appreciate, I would not comment on the specifics, but as we had mentioned in the past also, it is predominantly two large areas -- one is in terms of market expansion and one is in terms of newer platforms in terms of technology. From a market expansion perspective, if we really look at opportunities across the globe, it would be more in Europe than in the US for a simple reason that our pipeline is so strong in the US, I think it would not really allow us to expand in the US; even if somebody wants to exit they would not even consider because there would be humongous amount of overlap. As far as Europe is concerned, we would like to really look at something having better margin because it will improve our overall European EBITDA, which would further improve our overall company's margin. That is how we are looking at, Manoj.

Manoj Garg: Sir, like some of the European markets if you look at, particularly I am talking about the Western European markets and all, the economy itself is in doldrums and when you look at it from margin expansion point of view or overall growth perspective view, how will that obviously gel well with our goal of improving profitability or improving the growth profile in those markets?

N. Govindarajan: So obviously Manoj considering all these aspects including the economic aspects of it if a company is still able to deliver good EBITDA that still would be interesting for us as long as we do our due diligence and believe that it is sustainable.

Manoj Garg: Did I hear correctly that Dolutegravir would be the second half of this fiscal year or next fiscal year sir?

N. Govindarajan: No, I said like Dolutegravir would start from this year itself but it would make more impact towards the second half of next year in terms of numbers because again when you start launching the new product, it would not have major impact in the first few months, Manoj

Manoj Garg: Like now with 24.6% kind of EBITDA margin in this quarter, and clearly the business traction improving more from the Injectable perspective in the US, how do we look at the margins for the next year understanding that R&D will also increase as we move forward, how are we comfortable about next year kind of margin trajectory sir?

N. Govindarajan: I would not like to look at quarter-to-quarter. Overall year we were targeting to do 24% that is what we are aiming for the full year as far as current year is concerned and as we move to the next year we will like to further improve this particular base.

Moderator: Thank you. The next question is from the line of Surya Patra from PhillipCapital. Please go ahead.

Surya Patra: Sir, just an update on Aurohealth. You mentioned that you have already added around 20 odd customers. So what is the business you have so far achieved there and what is the kind of progress that you are anticipating there, at least this quarter what was the contribution from that segment?

N. Govindarajan: I would put it this way; even now the business is not really meaningful because the overall year will still be less than $10 Million as far as AuroHealth is concerned. I think earlier also I had mentioned that towards the end of next year or towards the second half of next year we will start seeing some meaningful business from that particular segment, Surya.

Surya Patra: So, here we are just planning to have some kind of a manufacturing business sort of. Is that correct sir?

N. Govindarajan: We already have the manufacturing assets supporting that like in terms of Oral products, with primary packing in India and secondary packing in the US and the Liquid products from the US itself.

Surya Patra: How is the earning profile or the profit profile of the business would be? Obviously it is kind of a just manufacturing and bulk supplying kind of a thing, but the margin profile would be much below the kind of blended margin of the company or …?

N. Govindarajan: Until and unless you achieve a critical mass, that is how it would look, but once you reached the critical mass, that margin also would be better, Surya, because if we really map and look at the largest OTC company and you see their margins, then you will be really impressed with what can be achieved even in that business.

Surya Patra: Just one question on the European business front. So now a new facility targeting Europe is all set and till last quarter we have already transferred around 43-odd products for manufacturing into India. So like what is the status there and what portion of this European business can be catered in let us say FY18 from the new plant or from the manufacturing base here in India?

Sanjeev Dani: We are counting in terms of the number of products. Obviously, the sales forecast and seasonality will dictate the volume. But we have already transferred 37 products and in the first phase we had a plan for 42 products to be transferred. So now we are banking on this Unit-XV to take us through. Additionally, we have identified another set of 72-products for which we will be filing variation from the new facility. So in all, about close to 114-products that we will be transferring to this new unit and that would be about (+40%) sales.

Moderator: Thank you. The next question is from the line of Greece Wakadu from HSBC. Please go ahead.

Greece Wakadu: Just a question on the US side, so both Bob and Ron maybe can comment. On your assessment basically the delay that we have seen in some of the approvals like Nexium, Vancomycin and Levo, have you seen that these opportunities have kind of changed over time and become less important? More so from the overall outlook of 30-35 launches in the Oral Injectable, how many do you think are meaningful?

Robert Cunard: I will comment on Oral Solid side first; Esomeprazole in particular is one that we had pushed out due to a settlement standpoint and was going to be in the second half of the year. As expected, it is pretty atypical for a generic product to get more attractive over time. So we definitely would prefer it to introduce but I do not think the opportunity will diminish significantly on that one. We are in a good position to have that in the marketplace here in the third quarter and have some business locked up at this point. So, when we look at the balance of the year of those additional probably 15-20 launches there are 4 or 5 that are probably the most significant and Esomeprazole is by far the largest.

Greece Wakadu: On Injectable sides?

Ronald Quadrel: I would say the opportunity has not changed very much for the products that we are expecting approval and launch, because most of these products we are launching there is already two or three or maybe four competitors. The opportunity is still there on the Meropenem, Levetiracetam Bags and, Vancomycin. So from the point of view of looking at the contribution for this year, I would say it is a matter of entering the market with time, recognizing less sales

for this fiscal year but all in all, the overall opportunity as we get to full share over the next say 12 to 15-months will be the same for us.

Participant: I see in the 'launch' you have already launched one strength of Nuchal, which I understand is a very small strength. Do you have other presentations as well and when do you see that launch happening?

Robert Cunard: The one strength we launched is 200 mg that is actually an Authorized Generic that we got from the Teva-Actavis merger. So we acquired that and launched that earlier in the quarter. We do have a filing for the balance of the strengths under our own ANDA and that is anticipated later in the third quarter.

Greece Wakadu: So, is that already AG on 250 Mg?

Robert Cunard: Just the 200 Mg is the product we have in the market now.

Greece Wakadu: On overall margins in the EU business, I just wanted some color, have we seen a significant impact from the Brexit in this quarter?

Sanjeev Dani: No. In fact, our UK business contributes less than 10% of overall Europe business. Apart from the foreign exchange variations, we have not seen any demand-related contraction.

Greece Wakadu: So we are still at say very low single digits margins in the positive territory?

Sanjeev Dani: Yes, in EBITDA terms, I just mentioned that it is in a mid-range of the single digit right now.

Greece Wakadu: Govind, Dolutegravir margin should be better than company average, right?

N. Govindarajan: That is our belief, Girish. Having said that, what is more important is in terms of getting the volume because when the volumes happen at the tender level, you need to be conscious that we cannot have humongous margin there and you have to be moderating it to the level of allowing the penetration to happen.

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

Anubhav Agarwal: In terms of acquisition, I just wanted clarity on the European business now. If I see the business today, we have larger business in France, Germany and Netherlands. My understanding of this business was still sub-scale whereas whatever we have seen so far, we were bidding for UK assets, we were bidding for some assets in Portugal. Why are we not looking to scale up the existing business that we have in France, Germany and Netherlands, is it just the opportunities not available in terms of assets available?

N. Govindarajan: It is not like that, please understand that, obviously like one is in terms of the opportunities which are coming up is what can be looked at. Having said that, it is not that we are averse of looking at it, I will put it that way. Again, one of the aspects which you need to remember is what we are now looking at is more qualitative assets, we are not interested in terms of adding top line, Anubhav, we are more interested in terms of improving the bottom line. So when an asset comes, one of the considerations is in terms of is it really improving our EBITDA rather than like bringing it down even if it is available at a much lesser price. That may not be our interest, Anubhav.

Anubhav Agarwal: No, I was thinking more like if we talk about just France market, in the French market, economies have scaled up happened, right, you can become a larger player and then you can command higher let us say margins from the pharmacies when you deal with them, even the scale there adds to the margin much more, right?

N. Govindarajan: I understand. Sanjeev would be able to answer that. I am not sure whether very many opportunities have come across to us in terms of the French market. Sanjeev?

Sanjeev Dani: If you are talking specifically about France, then obviously we require the products which we do not have in our kitty. That would make sense because noarmally the pharmacies purchase based on the margins that you give. So our existing MA should be sufficient to grab the additional business. But what we are looking for is, if we can get additional Mas. SecondMAs. Second set of opportunity consists of certain countries where early entry would mean higher prices because the prices depend on the order of entry. If you can acquire an MA, with higher reimbursement price, that would make sense. So I think there are different considerations. Overall we want to add to our strengths and our breadth of the portfolio.

Anubhav Agarwal: One more question on DTG. Govind, I know it is early times, but roughly in your expectation, how big is this drug can become as a single drug and as a combination drug eventually, just some ballpark number should be very helpful?

N. Govindarajan: I will put it this way; the simple way of correlating it is I think it should at some point of time capture the majority of the business what Efavirenz is right now having. As far as certain large agencies had projected, cumulatively achieving over a period of next four years reaching even say a couple of Billion dollars.

Anubhav Agarwal: That means in the bull case it can be $500 million drug?

N. Govindarajan: It is possible but please remember the fact that I think it has to be spread across how many players who are coming under the market.

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

Nimish Mehta: A couple of things: For US, if you can just let us know the breakup of direct sales and indirect sales for the quarter and for the year that will be helpful?

S Subramanian: I will get back to you.

Nimish Mehta: The other thing I just missed, you mentioned that Depot Injections clinical trials will start in CY'18, right?

Ronald Quadrel: Probably late calendar '18.

Nimish Mehta: So the filing will be done after that?

Ronald Quadrel: Yes.

Moderator: Thank you. The next question is from the line of Chirag Dagli from HDFC Mutual Fund. Please go ahead.

Chirag Dagli: I see Rs.103 crores increase in inventory by far the largest that we have seen in past many quarters in the P&L. What is this for?

N. Govindarajan: I think I need to subdivide that like in terms of what are products which have been made and ready for launch that is something which we need to look at it. Second thing is as far as our front end is concerned, like Bob would clarify that, we have started improving in terms of keeping the inventory in anticipation of business as well as for increase in the current business. Over to you, Bob.

Robert Cunard: Exactly, that is one of the things that I alluded to earlier as far as service level improvements we have seen on the portfolio and that was lagging in the past, we never really achieved the safety stock levels that were ideal on the US side. So we have been able to actually allow those to grow to more where they need to be which is roughly about two months on hand as an average what we would like to have in the US. So with that improved output and service level, we will be able to drive the safety stocks up.

Chirag Dagli: So this is not specific to a product launch or?

N. Govindarajan: No, we can come back with the specific breakup on that later, but these are the two large reasons – one is the new product launches as well as like the safety stock is a combination, Chirag.

Chirag Dagli: My second question was on Dolutegravir. So how will the substitutions schedule of Dolutegravir over Efavirenz look like in your assessment, will this happen over 2-3-years, if you were to sort of …?

N. Govindarajan: The timeframe what you are considering is a fair timeframe but again let me also tell you that not necessarily 2-3-years will completely replace Chirag. So it can reach a significant portion is what I would say but what is more important is on how fast can we register across the various agencies or the various countries.

Chirag Dagli: This substitution, will this be profit positive for us because it will replace our Efavirenz business as well?

N. Govindarajan: It would be definitely more profitable, Chirag, because the reason is that this is considered as the first line of defence. From a safety perspective, it is better from a dosage perspective, it is replacing 350 Mg Efavirenz with the 50 Mg Dolutegravir.

Moderator: Thank you. The next question is from the line of Dheeresh Pathak from Goldman Sachs. Please go ahead.

Dheeresh Pathak: For Europe, I think you mentioned that about 40% of the sales would be transferred over the next I think one year or so, 37-products already transferred and another 70-products you said you have identified. So how much CAPEX could you have done in India to transfer over time 40% of sales from Europe?

Sanjeev Dani: I do not think we measure in terms of CAPEX because this manufacturing facility, etc., are not dedicated to transferred products only but they are part of general pool. However, if you are asking about the OPEX, this we have answered earlier., It will depend upon the type of variations involved and the type of API sources, changes, etc., so it is very difficult, there is not one number, it can range between €200 to €10,000, but we are mindful about the margins which are generated and we make, as the basis of cost effectiveness decision.

Dheeresh Pathak: But I think you mentioned that you put up some dedicated plant for Europe, some Unit-XV or something?

Sanjeev Dani: Unit-XV how much we spend? But actually we are sourcing Europe products also from other plants and we are going to continue to do so. But Subbu or Govind, do you want to answer how much did it cost for Unit-XV?

S Subramanian: Typically, any unit will be around Rs.200 crores. That is what the number is looking like…ballpark figure.

Dheeresh Pathak: Are there any other dedicated units for Europe?

N. Govindarajan: No.

Moderator: Thank you. The next question is from the line of C Srihari from PCS Securities Limited. Please go ahead.

C Srihari: Two questions in particular: When I look at the R&D gradient that you have vis-à-vis your competitors, it is about 700 to 800 basis points. So can you please explain how that is being managed and do you hope to sustain it over the years? Secondly, when you talk about your EBITDA margins, the figure that you are comfortable with is 24-25%. So what is the best case scenario looking like?

N. Govindarajan: As far as R&D is concerned, currently, our R&D number 3.9% cannot be looked at in isolation because as I was explaining earlier we had added $400-500 million top line suddenly because of the acquisition of Actavis. If we remove it and calculate it, even today it could be in the range of 5-6%. Having said that, please understand the fact that the major portfolio of complex products would come up later like as Ron was explaining about depot and few more products when it comes up, including vaccines and some biosimilars, when it comes up for clinical, I think that particular cost when it gets added up, it would be around 8% percentage is what we are projecting. So I do not think that at this juncture it is comparable. To say that they are lower is also not correct, Srihari. As far as EBITDA is concerned, we are not saying it will be 24-25%, our aim for the current year is to average out in terms of the 24% for the full year, that is what we are working towards and we would like to maintain. When the question was about next year, yes, we would like to improve it further is what we had talked about.

C Srihari: No, EBITDA margin I asked, what is the best case scenario?

N. Govindarajan: We do not give any specific scenario. What we talk about is the overall year what we can achieve, so we never give specific forward-looking statement on that, Srihari.

C Srihari: EBITDA margin expansion, any particular year where do you expect the major traction?

N. Govindarajan: I think every year we keep improving compared to the previous year and that is what has been happening, Srihari.

C Srihari: So it will be kind of roughly 100 basis points accretion year-on-year?

N. Govindarajan: We do not give specific in terms of the future. Let us look at the current quarter, wherein you might have seen at one end there are challenges in terms of higher erosion, with one product having pressure. So with all these things, our first and foremost aim is to ensure that we are able to maintain what we have already achieved. Our aim is to ensure that we are able to maintain the average and keep building on that, Srihari.

C Srihari: On the research front once again, you have mentioned MAT it can be around 7-8% whereas the competitors I can talk about they have guided for maybe 13-14% as well. So…

N. Govindarajan: It is not an apple-to-apple comparison at all, Srihari as you would appreciate because everybody has their own portfolio and the specific platform and depending on that I think the cost could vary is what I would say. So let us look at this way; even when we reach let us say

8-9% and if you suddenly remove the $400-500 million which has come up without any major research cost, ours could have also gone to 10-11% is our assumption.

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

Prakash Agarwal: Sir, just trying to understand the ROW business also. If we see historically, we have been growing very healthy double-digit growth. So what has really led to muted quarter for ROW?

Sanjeev Dani: Actually, if you see, our growth rate for the quarter is 13.3%. So it is obviously a little lower on the side but it is in double digit. You know that some of the economies in ROW are not doing that well. So there is a slight slowdown, but I guess we are confident to maintain about 15% to 20% growth rate, also in view of our relatively small base.

Prakash Agarwal: Which market led to that kind of muted growth sir?

Sanjeev Dani: Brazil and Mexico are little less, but I guess it is stabilized, but some other economies are also not doing well as you are aware.

Prakash Agarwal: If you could give us the USFDA status for all your key plants?

N. Govindarajan: So we had recently three inspections – one for one of the R&D centers and two more API units and it went okay is what I would say and we do not expect any showstoppers , and Aurolife also had an inspection, Bob?

Robert Cunard: Yes, in July this year, Aurolife, our US manufacturing was inspected, there were no observations and we received the EIR.

Prakash Agarwal: Unit-IV and Unit-VII sir?

N. Govindarajan: Unit-IV and Unit-VII got inspected last couple of quarters back itself and we had given the update, Prakash.. So Unit-IV, Ron, got inspected two quarters back?

Ronald Quadrel: Right, and we have actually had two approvals since then, it went well. Actually, Auronext was also inspected in the summer, we got the EIR, and everything was fine on that too.

Moderator: Thank you. The next question is from the line of Ashish Rathi from Infina Finance. Please go ahead.

Ashish Rathi: Sir, the question is on the partnership for marketing in US with Citron and now it goes in a sale to the new acquirer. I understand that partnership deal was signed long back with Pfizer when scale was much lower. But now with this happening, Citron getting sold, did we not have an

opportunities to repeal the partnership contract? My understanding is that it would have been beneficial for us in terms of profitability.

N. Govindarajan: First of all, except for three products which are Para-IV products out of which two have already gotlaunched, the remaining products they are exclusive to us whereas as far as we are concerned, we are not exclusive to them, so if it makes sense for us, we can go aggressively on that. So it does not make any sense for us to go and take it over, Ashish.

Ashish Rathi: How many products do we have with them?

N. Govindarajan: 78-products is what I remember approximately you can take it.

Ashish Rathi: Is it safe to assume that we would not be looking to add any more partners for our US marketing piece?

N. Govindarajan: I will put it this way; there is no hard and fast answer to this, it all depends on the business sense what it can make.

Moderator: Thank you. Ladies and Gentlemen, that was the last question for today. I would now like to hand over the call to Mr. Santhanam Subramanian for his closing comments. Over to you sir.

Santhanam Subramanian: Thank you, all, for joining us. The transcript of this call will be available on our website in due course.

Moderator: Thank you very much. Ladies and Gentlemen, on behalf of Aurobindo Pharma Limited that concludes this conference call. Thank you for joining us and you may now disconnect your lines.