

**Transcript of the conference call between Pfizer Limited and the analyst community : 27<sup>th</sup> June**

**Moderator:** Good evening ladies and gentlemen, thank you for standing by. Welcome to the second quarter results 2005 conference call of Pfizer Limited. We have with us today Mr. Kewal Handa, Managing Director of Pfizer Limited. At this moment all participants are in a listen-only mode. Later, we will conduct a question-and-answer session. At that time, if you have a question please press '\*1'. I would now like to turn the conference over to Mr. Kewal Handa. Please go ahead Sir.

**Handa:** Good afternoon everybody. I have with me S. Ramkrishna, M. Gundu Rao, K. Subbaraman, Ajay Shukla, Ketan Palkar and Sundaresan. I would look first broadly like to take you through the year 2005. We started the year rather badly with the MRP based excise coming into place, which actually reduced prices of some of the products, which had a direct bearing on our profitability. Then we had VAT coming in the month of March. The impact of VAT was felt in the month of February and March. So in the first quarter results we had some impact, but in the second quarter results we have a major impact of that. The total impact in the month of March - we were down by roughly around about 20 crores or so, as far as sales are concerned our budgeted sales is same. I am very happy to say to you that for the period **seven** we almost at 100% of our budgeted sales. So therefore we have recovered the negative impact of VAT and also recovered the negative impact of the MRP based excise duty that came into picture. Of course the MRP based excise duty has impacted our profitability since otherwise our profitability would have been even better than what has been reflected in the results today. Then we had this field force restructuring done based on therapeutic category which was done in the month of April and it has been very successfully done with the least turmoil or movement of people. We are very hopeful that going forward this is going to be a real strength.

As far as the industry is concerned - the industry concerns in two areas, one of which is IPR and the other is pricing, still remains. On IPR, as you are aware the Mashelkar Committee is sitting on a judgment on what constitutes patents, or patentability, and this committee is likely to give its report and then the parliament would take it forward. But this is a major area you should be aware of,

whereby under the new Patent Act, only new molecules will form part of the patents and I have Ramkrishna with me who will talk more about it. The other thing is about drug pricing, which is now a concern area. Some of you might have read in the newspapers yesterday that a discussion paper has been circulated by the government planning commission incharge - or this is circulated by the Prime Minister's Task Force which is headed by Pronob Sen, Advisor, Planning Commission. To my mind, this is a very draconian paper and it takes you back to almost two decades of price control where you had all sorts of control on all sorts of products. I think a lot of noise has to be made by stake-holders like you on this type of retrograde steps by the government which will take industry totally back and if it is implemented in this way, I do not see any reason why anybody should be in pharmaceutical business in India. So this is something which is very serious to my mind. I know the industry is going to make some noise but something which we need to all understand that if this type of price control comes in and if this type of regulation comes, and if they want to have curtailment on branding, curtailment on selling, on margins, on promotion expenses, God bless the pharma industry. I am sure I will have to also look for another job! So these are two really major, two environmental aspects of the industry, which you and I are all concerned about, and we are doing our best on this and we are hopeful that better sense will prevail and we will have better future.

The other thing that is happening in the industry is that VAT has been implemented in only some of states, and in 7-8 states VAT has not yet been implemented. Though the industry has adapted itself to the new regime of VAT, the moment these states go for implementation, you will definitely see some negative sales during those months when these states announce that they are part of the VAT regime. The results are to be seen, we had this quarter which was as I mentioned to you had a major down-side of almost about 20 crores. But inspite of that I am very happy to say that we were really slightly flat on sales but if you look at the margins and look at the profitability it has improved tremendously mainly on account of our initiatives on reduction of costs, maintaining our operating costs and of course taking appropriate price increases where it is reasonable to do so. Now I am ready to take any questions and I have my colleagues with me to whom you can even ask some direct questions, thank you.

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

**Lalit:** Congratulations Sir on a good set of numbers. Just a small question on 20 crores shortfall you talked about, would we see that being made-up in the next quarter?

**Kewal:** We have already made up in the period seven, so at this point of time I am through with that shortfall.

**Lalit:** Thank you.

**Moderator:** Thank you very much Mr. Nambiar. We have our next question from Ms. Neelam Jumaní of Birla Sunlife. Please go ahead Madam.

**Neelam:** Good evening Kewal. My question to you is, if you see on a half-year basis the sales are more or less flat, that would typically be the case for the industry as a whole. So what is the outlook for the whole year?

**Kewal:** Going forward, you see we have to see our growth based upon two or three factors which you should bear in mind, One is last year we had Protinex sales which we will not have Protinex sales now. The second is whole lot of products came under price control, the impact of which is roughly around about 10 crores, so which is impacted this year on that basis. Third is the MRP based excise duty has impacted us very badly. Now given these factors still we are very hopeful that we will have very positive growth in the second half.

**Neelam:** Okay, and do you see the industry growing as a whole for the whole year by 6-7%, do you see that happening for the whole year?

**Kewal:** I think the first half is not been very good for the industry and hopefully the industry should pick up in the second half and may be we will start somewhere around 7-8%.

**Neelam:** Okay and my second question was on the 100% subsidiary, is there any clarity on that as to where the products will be launched?

**Kewal:** I think we clarified that in earlier meetings also and I would clarify it to you once again. We have said that wherever it makes sense to launch the product, we will launch the product, if for example Pfizer India has the facility of manufacturing and the product needs to be manufactured, then we will launch in Pfizer India. If the products require selling on a mass basis then we will launch the products in Pfizer India Limited. However, if a product is a specialty product it would be launched in lets say a 100% subsidiary. Wherever the complementary is, and wherever the benefits are large, or wherever there is a value recreation taking place - that is where the product will be launched.

**Neelam:** Okay and my next question was on Vfend, how has it picked up?

**Kewal:** Vfend is a product which is a very niche product and is too early to comment on the growth of Vfend, such products do take a long time before it really comes towards some reasonable level of sales.

**Neelam:** Okay, and are there any products launches further expected in this year?

**Kewal:** Yes, we are looking at few products and hopefully in second half we will be able to see whether we can launch few of these products which are under consideration.

**Neelam:** Okay and what is the Gelusil sales for the first 6 months, if you can just...?

**Kewal:** The good news is that Gelusil is really back on track. It has started catching up its market share. The new manufacturing facility is doing pretty well in terms of supply. Both Gelusil and Listerine now are doing very well. We lost a lot of market share last year and if not this year, then early next year we should be in a position to recover most of it. And as far as the sales are concerned we have roughly round about 9 crores+ Gelusil sales.

**Neelam:** Okay, thank you.

**Moderator:** Thank you very much Ms. Jumani. We have our next question from Mr. Ajay Sharma of CLSA. Please go ahead Mr. Sharma.

**Sharma:** Good afternoon Kewal, how are you? I am just taking off from Neelam's question on this 100% subsidiary versus the listed entity, what is the marketing infrastructure in the subsidiary in terms of number of MR and therapeutic...?

**Kewal:** This subsidiary we have inherited from Pharmacia what we are doing specialty products. They have onco division, they have opthal division and there is a small team of almost about 50 people.

**Sharma:** But isn't that too small to launch anything like say **Lipitor** or the combo-products that Pfizer Global...?

**Kewal:** That is what I said, it is a very niche type of product and the segment which I want to describe to you are very niche segment.

**Sharma:** Exactly, because why I am asking is specialty by itself is a huge thing, even at times we refer to cardiac and CNS as specialty. So if I were to just go a little...

**Kewal:** No the cardiac team, the critical team is in Pfizer.

**Sharma:** So would it be fair to assume that those kind of products will still come to the...?

**Kewal:** I guess so.

**Sharma:** Okay, that is point number one, and secondly in terms of margins, now as you launch new products you have seen how Aventis and Glaxo, your peer group has expanded margins to almost 28-29. Do you see yourself achieving that and if yes what time limit are you looking at?

**Kewal:** Well, I share your concern on that and I think we been focusing on that. As you know in the last year we started LEAP initiatives at Pfizer and the MRP price had an impact which was roughly round about \$1½-2.0 million on that profitability and inspite of that we have bounced back and up on the margins. If you look at it the margins

before exceptional items on a YTD basis has gone up from roughly 15% to 22%, which I think is a substantial improvement. My desire of course is to improve it further and take it even at the level where we were much earlier and take the leadership position there.

**Sharma:** So would 28-29% in 2-3 years look reasonable target to you?

**Kewal:** I think that is a too a long period.

**Sharma:** Okay, sounds good, thanks.

**Moderator:** Thank you very much Mr. Sharma. We have our next question from Ms. Neelam Jumani of Birla Sunlife. Please go ahead Madam.

**Gandhi:** This is Jayesh Gandhi here Sir. Just one clarification, you said that you are expecting 7-8% growth, am I to understand that this is the growth for the full year or in the second half?

**Kewal:** That is the industry growth that you are talking about and second I am talking about the annualized growth.

**Gandhi:** So in the first half most of the leading players in the industry have seen degrowth or at the best flat growth. So should we expect in the second half there should be a double-digit growth on industry wide.

**Kewal:** I think so, the industry should be 11-12% in the second half.

**Gandhi:** Okay, and where would you place Pfizer there, Sir?

**Kewal:** Well you know, we should be right now we are on the average and that is almost about 90% of the industry growth and we are hoping that in the second half atleast we should improve our ranking there.

**Gandhi:** Right, and regarding margins we have seen substantial improvement and you said that the two major event impacted, one was the product pricing and the MRP based impact. What would be the quantum of the MRP based impact? Would you be able to quantify that?

**Kewal:** I said it's roughly about \$1.0-1½ million, sorry anywhere between 7-10 crores.

**Sharma:** And so going forward, assuming these impacts not being there I can...

**Kewal:** That is an annualized impact, it is not an one-time impact. Going forward also every month I have that impact.

**Gandhi:** So, going forward where would be the margins expansion coming from, I mean assuming that you would want to grow margins towards the leading player, where do you see the major contribution coming from?

**Kewal:** No, I think the first is the moment we improve our turnover from this base, any improvement on turnover will have a very positive impact on our profitability, given the structure of the cost as it is. That will improve our profitability. Some of it we can offset by whatever price increases we could take on some of the products. And the third is if you see there is tremendous improvement in the operating cost itself, both at the product cost level as well as other operating expenses. So I think it is a combination of all these 3-4 things that will improve the margins.

**Gandhi:** Okay Kewal, thanks a lot.

**Moderator:** Thank you very much Mr. Gandhi. We have our next question from Mr. Prashant Nair of Motilal Oswal. Please go ahead Mr. Nair.

**Nair:** I have two questions, one is how much would Protinex have contributed to your revenues last year? And the second one is what percentage of your current revenues would be covered by the DPCO?

**Kewal:** DPCO I guess should be anywhere between 35-40% and Protinex would have contributed in the last year roughly round about 20 crores.

**Nair:** Okay, thanks a lot.

**Moderator:** Thank you very much Mr. Nair. We have our next question from Mr. Ranjit Kapadia of Tower Cap. Please go ahead Mr. Kapadia.

**Kapadia:** Good afternoon and congratulations for good set of results.

**Kewal:** Thank you Ranjit

**Kapadia:** Thank you so much. Sir I have 3 questions basically. First is the sale of the major brands, if you can share with us what are the sales of the major brands. Second is the personal costs as I see, in the quarter it was 16.9% as compared to the last quarter. So the personal cost has not come down and if you see the first half result, the personal cost has indeed gone up from 15.6% last year to 17.1%. That is 150 basis point rise and if you are expecting an improvement in margins, with the increase in the personal cost in the first half, how the company is in a position to achieve the margin improvement? And my third question is regarding the patented products, the Government has said that they are going to have price negotiations for the patented products to be launched. Under such a scenario how our company is going to react?

**Kewal:** Okay, I will ask the third question to be answered by my friend Ramkrishna.

**Ramkrishna:** Well, actually like Kewal said right in the preamble in the beginning that the whole approach that the government is now toying with, they haven't unfortunately taken any decision. But there are presently, as you are aware, three things in the drug pharma pricing environment. One is the long pending new drug policy, which is in limbo. Recently they have appointed another committee within the Ministry of Chemicals called the Sandhu Committee, Mr. Sandhu is the joint secretary in the ministry. And third is this new approach of the Prime minister's office appointing Dr. Pronob Sen, Advisor in the Planning Commission to also look into access to pharmaceutical products. Now what is emerging from all this is that they are really looking at, unfortunately, further tightening of a price control regime. You mentioned price negotiations, but one of the things in the discussion paper of Dr. Pronob Sen says that price negotiation is the right way to go, however, negotiations cannot be effective without a credible threat of price control. So again this goes back to the fact that at the background they are going to have a fairly widely pervasive price control regime. But since there are so many people trying to cook this whole thing, we are just hoping that they take a long time and some



sense in the meanwhile prevails. So at this point in time I think that is the only comment we can make.

**Kapadia:** And Sir for patented products if there is going to be a cap on the pricing, how the pharma companies who have put a lot of money on R&D, are going to recover from this country?

**Ramkrishna:** Precisely, that is really the logic that we are also telling them, it is not just a question of pharma companies like Pfizer or global companies, it is for the entire industry. In fact the investment into research that the domestic sector is doing is quite significant and the whole patent regime was designed to increase investment levels from very low levels in the domestic sector to close to global level where there is a huge gap. So if the spirit of the Patent Act was meant to not only promote innovation but considering the fact that we have probably the highest number of scientific talent, even globally in our major corporation it is Indian scientists that work there. So recognizing that a good IP regime is meant to be an incentive, but if price control takes away that incentive then you are very right, it will be a self-defeating excise. So therefore what we hear is being discussed in the government, on one hand is a strong voice that there should be some form of price controls over patented medicines but at the same time they are not quite clear as to how to go about exercising that sort of a thing, whether it should be reference, and what kind of a reference, referencing with foreign countries or with therapeutic classes, its still very unclear. But what is scary is that they are seriously looking at price controls over patented products.

**Kapadia:** Okay, thank you.

**Moderator:** Thank you very much Mr. Kapadia.

**Kapadia:** Two more questions are still pending.

**Ramkrishna:** Okay, I think margins I have already responded in quite detail. The other thing is on the sales for the first half, very positive sales except that Corex had a negative sales mainly because of regulatory issues that we faced during the first half, which is now all behind us and that has been resolved. So hopefully we will see positive sales for Corex in the second half.

**Kapadia:** Sir you would like to comment on personal cost?

**Ramkrishna:** Yeah, the personal cost. I think the personal cost really is almost the same - if you see the 2004 level and 2005 level. In fact it has come down slightly by 1 percentage point or so. The other reason is that we have really an additional provision on account of gratuity. This is because mainly the fund amount available for gratuity has come down as the interest rate had come down. So that contribution to the gratuity has been a large amount made during 2005.

**Kapadia:** Thank you so much.

**Moderator:** Thank you very much Mr. Kapadia. We have our next question from Mr.H.R. Gala of Quest Investment. Please go ahead Mr. Gala.

**Gala:** Hi Kewal, congratulations. There were a couple of things I just observed in the results. One is that refreshingly our service income has increased quite well, by 22% in H1 and in this last quarter by 30%. So going ahead what kind of trend do you anticipate?

**Kewal:** You know this service income part of it is coming from clinical research and this all depends upon what kind of research we get in India, because there is a whole lot of competition across the globe. Every country is trying to do the clinical research, China is there, Brazil, Mexico, every body wants it. So it all depend upon the efficiency, the cost and the type of the profile for which the research is suitable. So we had a good income this year and our team is geared up to promote itself and get more business for Pfizer.

**Gala:** Okay, my second question pertains to, there has been increase in depreciation by roughly Rs.2.0 crores in the first half. How much has been capital expenditure in this year?

**Kewal:** I will get back to you on that.

**Gala:** Okay, and my third question is pertaining to the raw material cost in absolute amount has actually fallen quite sharply initial quarters, first quarter, second quarter and because of that in the first half, these are with the fall

in the sales. So what are the reasons do you attribute the, are the prices of the raw materials quite favourable now?

**Kewal:** No, I don't think you should see the raw material in absolute per se. Look at the total cost of materials...

**Gala:** I am saying total cost of materials that is taking into account increase-decrease in stock also.

**Kewal:** Yeah, it has come down, of course as a percentage it has mainly come down, because some of it is just the reflection of the numerator and denominator where the price increases, they are on the topline. So the other reason is some of it has really been savings in terms of procurement costs, that has been reflected there.

**Gala:** Okay, thank you, wish you all the best.

**Kewal:** And then the last one Mr. Gala, just to complete my discussion, is the product mix. Last time we didn't have the products like Gelusil and all which are part of the product mix, because mix makes a lot of difference.

**Gala:** Okay.

**Moderator:** Thank you very much Mr. Gala. We have our next question from Ms. Monica Joshi of Quantum Securities. Please go ahead Ms. Joshi.

**Joshi:** Good afternoon Sir. I just wanted to know any particular reason for this loss that you have shown in the Animal Health Division?

**Rao:** Reply not audible

**Joshi:** so this kind of performance is expected to continue?

**Rao:** It is a one-time expenditure covered at quarter 2.

**Joshi:** What was that amount, if you can put a number on that one?

**Rao:** Amount say it is something about 80-85 lakhs which was charged in this quarter

**Joshi:** 85 lakhs.

**Rao:** Yeah 80-85 lakhs is the amount.

**Joshi:** Okay, thanks a lot.

**Moderator:** Thank you very much Ms. Joshi. Ladies and gentleman for any further questions you are requested to press '\*1'. We have our next question from Mr. Surya Narayanan of Capital Market. Please go ahead Mr. Narayanan.

**Surya:** Sir, one question is that this fringe benefit tax, have you estimated what would be the impact of this fringe benefit tax and future PF?

**Kewal:** Yeah, Mr. Gundu Rao will respond to you.

**Rao:** Surya Narayanan, the total impact for the full year could be around 2 crores and in the first two months we have had an annual business conference at various locations because of that we have estimated around 50 lakhs in this quarter. But an annualized basis the impact would be around 2 crores.

**Surya:** Okay, thank you so much.

**Moderator:** Thank you very much Mr. Narayanan. We have our next question from Mr. Pratik Mehta of ASK Raymond James. Please go ahead Mr. Mehta.

**Mehta:** What would be the cash balance?

**Kewal:** Currently we have about 142 crores on hand.

**Moderator:** Mr. Mehta, are you through with your questions?

**Mehta:** Yeah.

**Moderator:** Thank you. Ladies and gentlemen for any further questions you are requested to press '\*1'. We have our next question from Mr. Satish Bhatt of Motilal Oswal. Please go ahead Mr. Bhat.

**Bhatt:** Hi Kewal, congrats for good set of numbers. I want to know when can we expect first patented product?

**Kewal:** Very good question. I think Ram responded to you last time when we you were there, any idea?

**Kewal:** 2007, says Ram.

**Bhatt:** Okay, thanks.

**Kewal:** Well, if there are no more questions, can I conclude, can you please check?

**Moderator:** Sure Sir. Ladies and gentlemen for any further questions you are requested to press '\*1'. We have our next question from Mr. Nimish Desai of Refco Sify Securities. Please go ahead Mr. Desai.

**Desai:** Good evening, I just wanted to know, lots of pharma companies are setting up manufacturing facilities in excise exempt zones. How is Pfizer trying to counter this as to what will our strategy be to ensure our competitiveness?

**Kewal:** Very good question. We are actually doing some assessment as to what is really the beneficial impact of doing that. You need to understand very carefully that it's not just the facilities but the quality of the facilities which are very critical. And at this point of time we don't have any plans to set up any plants anywhere outside. So therefore we are not contemplating to set up our own facilities.

**Desai:** But would that mean that in future to maintain the competitiveness of the portfolio, you would tend to outsource more from excise exempt zones?

**Kewal:** No, at present also we are outsourcing a lot of our products and therefore we are examining the feasibility and if there are the right type of plants available, capacity available. Mostly our manufacturing guys would consider this phase.

**Desai:** So currently what portion of the production is being outsourced?

**Kewal:** A substantial portion is being outsourced.

**Desai:** And you would expect that trend to continue further.

**Kewal:** Yeah, for the time being that is the way it is.

**Desai:** Okay, and my second question is of the total growth that the company has shown for the quarter and for the half year, could you just break it up into volume growth and value growth?

**Kewal:** I will give it to you for YTD. The YTD growth is (-)2.6, price is positive by 1.8-2.0 and volume by 4.4.

**Desai:** Okay, thanks a lot.

**Moderator:** Thank you very much Mr. Desai. We have our next question from Mr. Surya Narayanan of Capital Market. Please go ahead Mr. Narayanan.

**Surya:** Sir, in fact, what is your outlook about this animal healthcare business?

**Kewal:** You see the animal healthcare business is really relooking at the business and looking at opportunities for growth. I think they are very positive on a few things, and going forward, we should be seeing some positive growth there.

**Surya:** How much growth you see Sir?

**Kewal:** We should see some positive growth there exactly.

**Surya:** Okay, any number, can you tell me what sort of a growth you are expecting because in the previous quarter, the animal healthcare business that reported some loss in the corresponding previous quarter, but again...

**Kewal:** No, YTD basis it is growing at 3.5%.

**Surya:** No, in fact I was just mentioning the growth during the quarter ended February, during that period the segment reported profit from the corresponding loss in the corresponding previous period...

**Kewal:** now they are showing a positive growth.

**Surya:** Okay, so 3-4% growth you are expecting also?

**Kewal:** Yeah.

**Surya:** Okay, fine thank you.

**Moderator:** Thank you very much Mr. Narayanan. We have our next question from Mr. Lalit Nambiar of SBI Capital. Please go ahead Mr. Nambiar.

**Lalit:** Just a quick follow-up question on the depreciation, just to stress things have picked up where we are remaining in that level and what is the reason for that slight pick-up?

**Kewal:** I think that will continue to remain in the same level.

**Lalit:** Okay, thank you Sir.

**Moderator:** Thank you very much Mr. Nambiar. Ladies and gentlemen for any further questions you are requested to press '\*1'.

**Kewal:** Well, if there are no more questions, can we conclude this session?

**Moderator:** Sure Mr. Handa. As there are no more questions I would now like to hand over the conference to Mr. Kewal Handa. Please go ahead Sir.

**Kewal:** I would like to thank all of you for coming here and participating in this conference call. I think this is getting better and better everyday looking at the quality of the questions that are being asked and our endeavor was to give you as much information as is available with us and as much as we know. Hopefully, the two important legislations which is the Patent Act and the pricing issue are managed, and we are able to look at the business positively. If you look at the trend of the middle income level and the people at the higher level, there is a very positive trend where you will see that a lot of people are now in the category of people who can afford good medicines. And once the GMP comes in into pharma sector, you will see there will be a tremendous improvement in terms of the quality of products that will come into the market and there would be less competition from products which keep on biting you at various small regions and which will not have good quality products. We were also very positive that we will have the Counterfeit Act in place and

once that too comes into place there should be some positive growth for the pharma industry. So once again thank you very much for participating and hope to see you in the next quarter, thank you.