



Dr. Reddy's Laboratories Limited
Q2 FY 2014
Earnings Call Transcript

October 31, 2013

Kedar Upadhye

Good morning and good evening to all of you. Thank you for joining us today for Dr. Reddy's earnings call for Q2 FY 14. Earlier during the day, we have released our results and the same are also posted on our website. We are conducting a live webcast of this call and a transcript shall be available on our website soon. The discussion and analysis in this call will be based on IFRS consolidated financials.

To discuss the business performance and outlook, we have today Satish Reddy - our Vice Chairman and Managing Director; Saumen Chakraborty, President and Chief Financial Officer; Abhijit Mukherjee, President and Head of Global Generics; and Investor Relations team. Please note that today's call is copyrighted material of Dr. Reddy's and cannot be rebroadcasted or attributed in press or media outlet without the company's expressed written consent.

Before we proceed with the call, I would like to remind everyone that the Safe Harbor language contained in today's press release also pertains to this conference call and the webcast. After the end of the call, in case any additional clarifications are required, please feel free to get in touch with the Investor Relations team.

Now, I would like to turn the call over to Saumen Chakraborty – our CFO.

Saumen Chakraborty

Thank you, Kedar. Good morning and good evening to everyone. Let me begin with the key financial highlights. For this section, all the figures are translated to US dollars at a convenient translation rate of Rs.62.58, which is the rate as of 30 September, 2013.

I am happy to report our highest ever quarterly revenues and a healthy margin profile for Q2 FY14. Revenue for the quarter is \$537 Mn and grew by 17% year-on-year. Revenue from our Global Generics segment is \$424 Mn and grew by 32% year-on-year, driven largely by new product launches in US, continued momentum in the Emerging Market territories and benefit of rupee depreciation against multiple currencies. Revenue from our Pharmaceutical Services and Active Ingredient segment is \$102 Mn. While it declined by 19% year-on-year, it grew on a sequential basis vis-à-vis Q1.

Consolidated gross profit margin for the quarter is quite healthy at 58% versus 52.4% for the same quarter of the previous year. Corresponding values for Global Generics and PSAI segments for this quarter are 66.1% and 24.6% respectively. Global Generics gross profit margin has seen significant improvement due to limited competition new product launches coupled with improved contribution from the Emerging Markets. PSAI gross margin declined primarily on account of an unfavorable product mix, nevertheless, on a sequential quarter basis there has been an improvement by almost 600 bps.

SG&A expenses, including amortization, for the quarter are at \$156 Mn and has grown 21% year-on-year. As a percentage to sales, this is higher by approx 100 bps over last year. There has been the impact of normal year-on-year salary increments alongwith select brand building activities in the Emerging market territories. In addition, a major part of our SG&A is denominated in foreign currencies which had the effect of rupee depreciation. Approx 30% of the increase in costs is due to currency movement.

R&D costs for the quarter are at \$48 Mn, representing 9% to revenues versus 6.1% in the previous year. The increase in R&D expenses during the year is in line with our planned scale-up in the activities. EBITDA stands at \$152 Mn and is 28.3% to revenues and registered strong year-on-year growth of 27%. Current quarter EBITDA represents 800bps (to revenues) improvement on a sequential basis. Profit before tax for the quarter at \$123 Mn, is 23% of revenues. While the current quarter's effective tax rate is lower at approximately 10%, the annual effective tax rate for FY 14 is likely to be around 20%.

Key balance sheet highlights are as follows. Our working capital balance increased by \$75 Mn over June 2013. Capital expenditure for the quarter is at \$60 Mn. Foreign currency cash flow hedges for the next 18 months in the form of derivatives and loans are approximately at \$460 Mn, largely hedged around Rs. 56 to Rs. 60 to a dollar. In addition, we have balance sheet hedges of \$561 Mn. Net debt at \$352 Mn represents a net debt-to-equity ratio of 0.28.

With this, I now request Satish to take us through key business highlights.

Satish Reddy

Thank you, Saumen. Good morning and good evening to everybody and I extend a warm welcome to you on this earnings call. Also, I would like to take the opportunity to wish you a very happy Diwali.

I am pleased to announce the highest ever quarterly performance of Dr. Reddy's, backed by strong growth across the key geographies of the Global Generics segment. The recent generic launches of azacitidine, decitabine, divalproex ER and donepezil 23mg in the US demonstrate our ability to build a sustainable limited competition portfolio. These launches have contributed to an increasing customer franchise in the US and have resulted into enhancement of our gross margin and operating margins as well.

On the domestic front, as you would be aware, the Indian Pharmaceuticals market is witnessing one of its most challenging times due to the transition towards the new pricing regime. First half of this fiscal was characterized by market disruptions in various forms. Industry bodies have been in active dialogue with the government authorities and trade representatives to resolve the matter and we hope to see an amicable resolution on most of the issues very soon.

Now, let me take you through some of the business highlights for each of our key markets. Please note that in this section, all references to numbers are in respective local currencies at average exchange rates.

Revenues in North America Generics business for the quarter are at \$220 Mn and grew by 18% year-on-year. This growth is largely attributable to new product launches over the past 12 months and market share gains in select key molecules. During the quarter, we launched 4 new products, namely azacitidine, decitabine, donepezil 23 mg and divalproex ER. As mentioned earlier, these products were in the limited competition space and enjoyed pricing premium for the quarter. These launches have also helped enhance the mix of limited competition products in our portfolio compared to previous quarters. We also increased the market share for some of our top molecules such as fondaparinux, tacrolimus and omeprazole DR. Further, our anti-allergy OTC and antibiotics portfolio are on a gradual improvement on a sequential quarter basis considering the seasonal demand pattern.

For our India business, despite the issues on market disruptions that I mentioned earlier and also lowered pricing due to the new pricing policy for our top molecules, the business has been resilient enough to post Rs. 421 crores of sales with year-on-year growth of 8.5%. Recent IMS numbers also record our above market growth rate on a consistent basis. Our growth for MQT September was 13% as compared to the market growth of 6.3%. On the MQT growth percentage scale, we are the fourth highest growth company. We have launched several initiatives to sustain this momentum, wherein we will be selectively exploiting our current portfolio in the non-prescription channels such as OTC and institutional segments.

On the Emerging Markets front, Russia revenues at \$74 Mn for the quarter, grew by 31% in ruble terms because of the higher offtake in the current quarter as well as due to the low base effect of last year. For the first 6

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months of the fiscal, we have grown at healthy 16% on year-on-year basis. The market sales data for Russia of the recent months indicate reduction in the market growth rate and in some cases negative volume growth due to a variety of reasons. In this scenario, our secondary revenue growth indicates a healthy trajectory. As you are aware, the mix of OTC products in our portfolio is increasing and we have also improved our ranks. CIS markets grew by 24% on a year-on-year basis on the back of new product introductions in Ukraine and growing base in other regions.

European operations are in line with our expectations. As you are aware, we have transitioned our Germany business model to a much leaner and simplified structure with a conscious exit from the tender-based revenue model.

Our PSAI business registered degrowth of 19% on a year-on-year basis. However, sequentially the business has registered marginal growth on the back of improving market dynamics. We hope this trend to normalize over the coming quarters, and as you would have noticed, the gross margin of this business improved by 600 basis points over the first quarter, indicating a slight improvement on the product mix.

As we look forward to the second half of this fiscal, the opportunity in serving patients in various global markets is quite significant and we feel quite excited to deal with the growth challenges in these markets. Outcomes from our global R&D activities in the coming years will help us build a sustainable and growing portfolio. We have seen the needle moving significantly in our development pipeline in terms of greater mix of non-Oral Solid Dosage Forms and high-value Complex Molecules. While we are required to spend higher R&D costs to invest in the associated development, we are also consciously calibrating the resources and prioritizing wherever required.

Our Biosimilars portfolio is a case in point where we continue to focus on the progress of the pipeline. All our regulated and Emerging Market development programs are on track. Preparation for some of the multi-region, clinical trial programs are in advanced stage as well, and we feel good about the progress of the ongoing collaboration on developmental and manufacturing aspects with our alliance partner, Merck Sorono.

With this, I would now like to open the session for Q&A.

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Anant Padmanabhan On generic Vidaza and Dacogen, could you give us a sense of the sustainability through the rest of the year? What is your internal thinking in terms of competition, number of players and how are you seeing pricing in these markets?

Abhijit Mukherjee In Vidaza, including us Sandoz is the authorized generic. Market shares are satisfactory. In Dacogen (decitabine), we are the only generic and sharing the market with the innovator. So it is a two player market in decitabine and a three player market in azacitidine and the prices are in line with the expectations of similar participation amongst competitors. Going ahead, it is a difficult guess. We hear that there is likely competition, but we have not heard signaling from the market as yet.

Anant Padmanabhan Europe continues to do poorly, and so one of your larger global competitors recently discussed divesting some of the Western European assets. A couple of questions related to that. Is this business EBITDA-positive and could you talk about any strategic options you have here?

Abhijit Mukherjee The business is EBITDA positive and we have moved out of commodity play, especially the tenders' play in Germany. Currently, as we speak, although the business has not grown, gross margin for this business has improved because of certain steps taken. We are consciously moving into certain sectors of business. Having said that, there is not any acquisition intention, at the moment.

Sonal Gupta Just want to understand, does this quarter in the US represent some sort of a bonus because you had these big launches coming through? So to understand the sustainability of this \$220 Mn number on a normalized basis, assuming that there are no competitors coming through or the current situation prevails in these products. Any thoughts on that front and anything in terms of how do you see your pipeline for the rest of the year? Could give any outlook for FY15 in terms of the US pipeline, are there more differentiated products that you are expecting in the second half or sometime next year?

Abhijit Mukherjee On Vidaza and Dacogen, as I mentioned earlier, there would certainly be competitors coming in. 'When?', is the big question. We have not heard specifically anything in the market, but it does not take too much time for someone to show up. I am sure it is in development with others and they would come in. Then there would be further erosion. There are other products also which we have launched such as divalproex ER etc, which I think are much more sticky in terms of revenue and sustainability. So all in all, it's been a great quarter. There would be erosion going forward, however we are fairly optimistic on things. Our supply position has improved substantially

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and it has helped in taking some case-specific market share increases. Hopefully this should sustain for a while. However given the nature of the business, for good products there will always be erosion.

Sonal Gupta At the beginning of the year, you talked about 10 to 15 new launches in the US and we have seen a very significant number of those coming through right now. So do you see any more meaningful products in the second half?

Abhijit Mukherjee We have Sirolimus coming up in January. There are a few more coming in, but may not be in the big league.

Sonal Gupta Just want to understand, in Q4 last year, because of Propecia, you had a big number and then in Q1 this year, we saw a decline on that base. So is there a similar cycle here as well that because you just got these approvals and you pushed in a huge amount into the system and next quarter when it normalizes, you will see a little bit of a step down?

Abhijit Mukherjee Not in our view. Not a great deal. There are launches, but as I said, none of them in the big league.

Anubhav Aggarwal Satish, just one question on PSAI business. The order book now that you have for the rest of the year, basically for the next 6 months, how does it compare versus what you had 6 months back?

Satish Reddy Like last quarter there have been changes in terms of the customer inventory holdings etc., however there has been sequential improvement. Outlook still remains the same, whatever is gone we cannot get it back, but certainly in Q3 & Q4 we will see a ramp-up in sales and then we are hoping to normalize things. The issues are quite a few namely customer inventory corrections, lack of significant launches etc and we are waiting for the sales to ramp up now.

Anubhav Aggarwal You are saying on the current base, which you reported in the September quarter you expect a ramp up in the second half?

Satish Reddy Of course, yes.

Anubhav Aggarwal On the Fondaparinux approval in Europe, how close are we or how far are we? Is it still quarters away? Or is it like near-term since you filed last year in Europe and based on the approval cycle, what do you think is the status of the application?

- Abhijit Mukherjee** It is likely to take a couple of quarters more.
- Anubhav Aggarwal** On the gross margin improvement, your average currency, was about Rs.60/\$ this quarter. How much of the Global Generics margin, 66% which you reported this quarter, benefited from the currency? Since it has moved from, about 61.5% in June quarter, to 66% this quarter, can you just roughly indicate how much would have been a benefit of the currency movement there?
- Saumen Chakraborty** There has been some benefits. We will not be able to exactly share how much is the benefit. We cannot expect the kind of gross margin level that we have in Q2 for Global Generics segment to continue. For PSAI, the gross margin can improve but Global Generics, may decline.
- Surya Patra** Wanted to have some more clarity on the US business for next 12 to 15-months period. How many product approvals are you anticipating for the next year? What would be the size of those opportunities? Secondly, out of the 64 pending approvals, what proportion of those would be a different set of generic or injectables or some niche opportunity?
- Abhijit Mukherjee** The number of launches would be more or less similar to the number of approvals coming through in time. The intention and the pipeline are clearly moving towards more complex areas, where limited competition is what we hope for. Having said that, this is our definition of complexity, a lot of generic companies are moving out of me-too products and trying to get to the niche ones. So time will tell whether we are ahead of others in setting these products or not. Overall, we remain optimistic. Very difficult to exactly put on a year-on-year basis how things will move. In Generics business - approval timelines, specific expiry time, patent landscape etc are all very dynamic situations. However one message we are consistently sending through as Satish mentioned in his section is that R&D costs are rising, and we have sent out our thoughts on continually moving the pipeline from plain vanilla to more and more difficult and different types of dosages.
- Surya Patra** Regarding azacitidine, the market share seems to be lower than the anticipated levels, any particular reason for that? Sandoz has garnered a good amount of market there, though they have entered late.
- Abhijit Mukherjee** IMS data will take some time to firm up. We have just launched a month back. Innovator's value prior to our launch was ~\$380 Mn. Sandoz is the AG and we are the only generic.

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- Surya Patra** What could be the key growth drivers for PSAI subsequently, whether it is the Custom Synthesis kind of operation or is it the API business that would really drive from here on?
- Satish Reddy** It would be a mix of both. On the API side of the business, sales in one of the geographies is expected to pick up, which would drive growth and on the CPS front, some of the contracts picking up with innovative companies.
- Surya Patra** The kind of growth we have seen in the recent past, can we again reach the similar kind of growth for the PSAI operations, considering the expanded or enhanced platform because of the OctoPlus acquisition in this space?
- Satish Reddy** Not really. I think the drivers are completely different for this business compared to what OctoPlus presents to us. The simple answer is yes, the growth will normalize. The first 2 quarters were an exception in terms of how they grew compared to the previous year's quarters because of the various things I explained this time and even the last time. In the third quarter we will see the revival of growth.
- Surya Patra** Can you just extend your reply in terms of how many such Custom synthesis opportunities are there or how many Phase-III, Phase-II molecules are there for supply opportunities?
- Satish Reddy** That metric would not be important. Just to give you a flavor of the Custom Synthesis business, there are contracts on which we work with some of these innovators over a period of time. There will be some, which will be at a very early stage, some older products, some which are existing molecules etc. So its a mix of all these things. It would be very difficult to give a flavor of exactly how many.
- Surya Patra** Are we confident enough that the growth momentum will be again reaching to the earlier levels? Is that what you are indicating?
- Satish Reddy** It will be a steady ramp up, I definitely see it happening.
- Surjeet Pal** Lamotrigine ER was supposed to be launched. It is not yet launched in last quarter?
- Abhijit Mukherjee** Yes, it is launched. However, it is not in the same league of the four earlier mentioned.
- Surjeet Pal** OctoPlus N.V. which you have said is a company that has patented technology in Liposome. Does it mean that you can also venture into the two liposome technology

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drug available in US market? Given the current scenario, just a few months back, US FDA has formed a team, which will evaluate all nano-technology drug, could you throw some light on that?

Abhijit Mukherjee The purpose of OctoPlus acquisition was mainly to gain access to their experience and insight into complex injectables. At the moment, that is the main objective. Few assets are being progressed through OctoPlus, specifically 3 or 4, and these are high value assets, most of them very difficult, time-consuming, would be needing training and all are in progress.

Surjeet Pal That is true but the point is that given the kind of profitability as well as the very few competition of the 2 drugs; one is Lipodox and another one is Ambisome, definitely no generic is there. But could you expect so over a period of say 2-3 years Dr. Reddy could be there, is a possibility?

Abhijit Mukherjee Yes, certainly a possibility.

Surjeet Pal What is the status of Vimovo? Have you gotten any unexpected benefit for Propecia, because there is only one guy who has gotten approval unexpectedly?

Abhijit Mukherjee We will get back on the Vimovo piece. It is not a very large asset. On Propecia 1mg, there are two companies who have come in. Actually, there are quite a few assets where we have lost a bit of share Q-o-Q and certainly Propecia is one of them.

Manish Jain I just wondered what is R&D likely to be as a percentage of sales on a steady run rate basis, annually?

Satish Reddy Manish, currently, for the quarter, it is at 9%. Like we indicated, there is a step up in R&D and you are seeing it in reality now. It is also about the kind of spend that we are increasingly putting in on Biosimilars since we have moved into development phase on one of the assets and also on the Proprietary Products. Further there is also an increase in the development of some of the generics through some of the external partners. If you see it on a yearly basis, it will be at the levels that we are talking about for the quarter or even slightly more than that. Having said that it also depends on the sales that we clock.

Manish Jain Can you throw some light on progress of Proprietary Products in the US?

Satish Reddy Not many significant milestones to report at this point of time, because you would have seen in our commentary in the past, there are several assets being progressed,

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but to be specific about which products and what has progressed, it is a bit too early right now.

Sudarshan Padmanabhan When I look into the balance sheet on the long-term debt, I do see Rs.1,250 crores increase, and given the fact that the company is in a position of generating fair amount of cash, would my assumption be right that you would be looking at a short-term acquisition probably in the US or in India?

Saumen Chakraborty At any point of time, we have been evaluating any target that comes our way, which will be in line with our strategic plan, both in Emerging Markets as well as in North America in very specific niche areas. We have taken some long-term borrowing, however not a very significant amount. Out Net debt-to-equity ratio is at 0.28.

Sudarshan Padmanabhan Can you throw some light on your purchase agreement with ecoLogic Chemicals, is it primarily to acquire capacities or is there something else to it?

Saumen Chakraborty ecoLogic actually had a very low-cost technology process for a key intermediate of one of our products, on which we have significant business opportunities in the PSAI segment. We thought acquiring that will give us tremendous advantage over our competitors.

Girish Bakhr Taking you back to azacitidine and Dacogen, can you give some breakup of whether there is more retail component to it or is it more mail order, in terms of channel wise, how is the drug being procured?

Abhijit Mukherjee Both our oncology injectables are clinic-heavy products. There are institutions and and GPOs. We have set up a front end team for taking the injectables, getting the right value out of the injectables, barely about 8 months back and they are slowly building momentum in preparation of these things happening. We are doing justice to both the assets.

Girish Bakhr How much would be GPO if you can give a rough percentage?

Abhijit Mukherjee I do not have that off hand at the moment to hazard a guess but significant part is in the hands of two major institutional players especially in oncology products. Just to have a range approx 50% to 70% of the US market would be in the reach of these players and the rest with the GPOs. However, there is also other complexities here. It is not all about garnering market share, but also the compliance of getting those shares converted to volumes, which is what I was talking about in terms of the front-end team in place on their feet trying to achieve that.

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- Girish Bakhr** When we say gradual pickup, would it be similar to what we have seen in the case of Fonda or would you see a significant chunk coming say in Q3 as well and maybe then nose-diving from there?
- Abhijit Mukherjee** As I said that we have not heard any messaging in the market that anyone is imminent, that is about that, these sort of things can only take your visibility for a month, month and a half, two..., beyond that, it is difficult to predict.
- Girish Bakhr** Another question was on Lunesta.-you had lost the appeals case against Sunovion. Just wanted to get a sense if you have the possibility to reappeal or has it been reappealed or is there a possibility of settlement like many other peers have already settled?
- Abhijit Mukherjee** It is actually not complete, if you read through the judgment, it is not a clear either/or situation, having said that, the percentage probability of our hitting has substantially come down. Re-appealing may not be the best idea, but we are trying to seek other avenues
- Girish Bakhr** The settlement will be one off , right?
- Abhijit Mukherjee** Could be.
- Girish Bakhr** On the capex side, you have already done Rs. 580 crores in the first half, which is close to Rs. 660 crores you did in the last fiscal year. What is the overall guidance there, and where all is this being attributed to?
- Saumen Chakraborty** A part of this is the ecoLogic asset purchase, on account of which the capex has gone up. For the rest of the year, we do not visualize more than Rs. 300 crores or so.
- Bino Pathiparampil** The \$220 Mn in the US that you said, is that actual net invoicing in the US without any impact of hedging or currency translation?
- Kedar Upadhye** That is the dollar invoicing in U.S.
- Bino Pathiparampil** Would you be able to comment on the development of generic Premarin in the US?
- Kedar Upadhye** We would not be able to comment on this product at this stage.
- Bino Pathiparampil** On the biosimilars pipeline development, you have increased your R&D spend, which clearly denotes to some advances in the pipeline I guess. In this case at what

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time will you be able to publicly disclose some of these products in the pipeline and the stages, etc.?

Satish Reddy Right now, very few assets, Bino. Probably in the next couple of quarters or so we can talk more about it.

Bino Pathiparampil Any of them entered or just about to enter final Phase-III trial or so or is it still a bit far away from there?

Satish Reddy Talking about one of the things that I mentioned, yeah, it is the one, which is getting into clinical trials. That is why I said that, yeah.

Bino Pathiparampil Clinical trial as in the pivotal trial or the pilot ?

Satish Reddy This is the Biosimilars, right, so you require that trial.

Sameer Baisiwala For the US market, for Divalproex ER the IMS report survey shows low market share right now, which is under 1% or 2%. I guess yours would be primary sales, so it may come with a lag. However, what was the market share that got digested in the quarterly results for the September quarter?

Abhijit Mukherjee We are probably the fourth meaningful player. The market still has inventories of some of the earlier players. Our market share, being the fourth player is quite fair in our view. Considering the way the US market plays out, as you are aware of, it is a fair market share. Not a whole lot has got reflected in Q2. There is some, but it will start ramping up as we speak.

Sameer Baisiwala Do you expect the current price levels for this product to sustain for the foreseeable future?

Abhijit Mukherjee This would be a little more sticky product than many other products as it is complex. As you know, it has been generic for quite a while with effectiveness going up.

Sameer Baisiwala You launched Vidaza pretty much at a later part of the quarter, September or so. Do you again think the quarter reflected the full impact for the product, or do you think this would be seen as you go forward?

Abhijit Mukherjee Typically in the oncology injectable launches, the first month has certain significant sales even though it is a month of launch. Going ahead in the second half we would see the full benefit, provided of course we do not see more players. As you know, if

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you would have studied this product, this has gone through a different way of justification. There were a lot of hands involved in the approval, and eventually it led to our guidance from FDA as well. So we are cautiously optimistic.

Sameer Baisiwala On Nexium, do you think this would be a meaningful / material opportunity for the next fiscal?

Abhijit Mukherjee Quite early to comment. November next year is a long way to go.

Sameer Baisiwala Since you are going to be a part of the settlement, so you may have some idea how many players to expect over there.

Abhijit Mukherjee As you know, two are already there. Depends on how many more. We do not have any public domain information actually on that hence I would not be commenting on this at the moment too much.

Sameer Baisiwala Looking beyond the traditional markets where Dr. Reddy's has been strong over last few years, which is India, US, Russia, etc., is there some other markets that you are training guns towards and you want to scale up going forward?

Abhijit Mukherjee Not exactly at the moment. I think depth is still the name of the game. We are aggressively looking forward to brand acquisitions in our therapy focused areas in the similar markets and we can still go much deeper in these markets. However having said that, as a strategic initiative at some point in time, we may look into them, but not at the moment.

Saion Mukherjee On the US launches you mentioned about Sirolimus in the fourth quarter. What is the kind of dynamics do you expect in that product?

Abhijit Mukherjee There are two players already in public domain, including us. Having said that, it is a complicated product and not very big as you know. Since these days there are not too many big products as well it should still not be too bad.

Saion Mukherjee Is there any exclusivity kind of situation there?

Abhijit Mukherjee Not to my knowledge.

Saion Mukherjee On Biologics, Satish, you mentioned about this collaboration with Merck Serono. So how are we taking forward some of these big products? Is it like a harmonized kind of an approach both for US, European markets? Are we going to see some more

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launches in India and then take these products to developed markets, any thoughts on that?

Satish Reddy Depending again on the products, some of these products are already launched here, which are also part of the deal with Merck Serono. The attempt there would be to also reach into markets, which we have not launched in before. Obviously, the big thing there will be Europe since that has a very clear pathway. US will still start some time away. The initial focus will be on Europe for a particular product to begin with, and then we will also look at certain other large Emerging Markets, whereas for markets where we are present on our own, we directly go and register these products. If your question was really on the pipeline of Biologics, our intent always is to launch first in India and then take it to emerging markets after that. That is normally the trend.

Saion Mukherjee Any update on the rituximab in Russia or any other key Emerging Markets?

Satish Reddy Nothing specific at this moment.

Abhijit Mukherjee File in progress.

Saion Mukherjee Can you share the cash flow hedge loss or gain that you might have booked in this quarter?

Kedar Upadhye We have booked Rs. 65 crores of hedge loss, in the quarter.

Alok Dalal You mentioned that the market is going through a declining volume phase. So what are the reasons for the volumes declining in Russia?

Satish Reddy There were a couple of reasons. One of the things is clearly the GDP growth, which normally has a reflection on consumption of the pharmaceuticals in the market. Its been a slowdown there. That is one reason at a very macro level. There is also the issue of the seasonal impact. The whole issue of the flu season and the consequent onset of winter and things like that, also tends to play a role, that the impact of which we have seen.

Alok Dalal So in Russia, normally, the December quarter is the strongest quarter because of the onset of winter, is that correct?

Satish Reddy That is correct.

- Alok Dalal** On Russia again, is there a risk of the EDL list expanding in the foreseeable future?
- Satish Reddy** Are you asking about the number of products in the EDI list?
- Alok Dalal** Yes.
- Satish Reddy** I do not see that happening immediately, no.
- Alok Dalal** Sir, what is our market share in Naproxen?
- Abhijit Mukherjee** Are you talking of API or finished dose ?
- Alok Dalal** No, API.
- Abhijit Mukherjee** We are the dominant market shareholder globally in terms of percentage.
- Alok Dalal** On ecoLogic can you provide any color on what is the sales of this company or what is the book value of this company?
- Saumen Chakraborty** Actually, we have put independent valuers to value the company. And based on that, we have purchased assets.
- Alok Dalal** But would you be able to give some number?
- Saumen Chakraborty** We have disclosed in terms of the total value that we have paid in terms of both fixed as well as the current assets.
- Arvind Bothra** On the Russian market, you mentioned that your growth would sustain at current levels and the OTC share is increasing, how much is OTC share right now?
- Abhijit Mukherjee** OTC, of the total percentage of sales, is in the range of 34 - 35%, up from 32% sort of a figure in the last year. A very healthy rapid growth, and we are in top-tier growth companies as per the IMS report on the OTC sector in Russia.
- Arvind Bothra** In the press release, you mentioned that the SG&A increase also includes select brand building activities in Emerging Markets. Does it include some one-off item or something lumpy, which may subside in the coming quarters?
- Abhijit Mukherjee** Not really. With the growth in OTC, we are committed to more of ATL; ATL means television coverage and so on and so forth needed in the OTC sector. These form

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part of the business. Having said that, in the seasonal product markets, the intensity of spend can vary from quarter-to-quarter.

Arvind Bothra On the domestic market, you did a commendable growth in the quarter and the impact of the trade disruption is still not over. How do you see the second half and the year beyond that, especially noting your enhanced efforts to get back to the above industry-level growth?

Abhijit Mukherjee The trade disruption in our view is largely over. There is a general degree of amicable agreement. Going ahead, in the second half, we are much more optimistic than the first half. We saw lots of these one-offs disturbances in the first half but for the second half, we are optimistic, considering the market in September has given those signals to us. More importantly, we are very focused now on what we would do and what we would not do, mainly in terms of mega brands, therapy focus, getting on all channels, including institution channels. We are quietly putting a team to assess the institution channels, from where sales have also started. It is going to take time since India is one of the most competitively difficult markets to be in, but we are on the right path.

Arvind Bothra The operating margins are at 20% were clearly pretty solid. Is this a benchmark we should look at going forward? Of course, we will take into factor the fact that R&D spend may go up and there could be some correction in gross margins, but somewhere directionally, where are we headed?

Abhijit Mukherjee Which one are you talking about?

Arvind Bothra Overall operating margins this quarter, we had 20%. So just wanted to understand how should we look at from a medium-term perspective given our high margin launches are yet to scale up?

Saumen Chakraborty As I earlier also said the Global Generics segment for this particular quarter, we have got a very high gross margin at 66.1%, which is really not sustainable. So there could be some drop in that margin but at the same time, PSAI this quarter is 24.6%, but there is definitely scope of improvement there. So overall, at a company level, gross margin is better than the previous year and we can live there.

Prakash Agarwal The focus clearly has been doing niche segments, R&D. Now incrementally buying ecoLogic chemicals and improving PSAI, does this mean that the normalizing growth factor lies in this acquisition?

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- Satish Reddy** Again, to clarify, this is an asset purchase. The thing is if we were to start ground up, it would have taken us a much longer time for a specific product opportunity in the CPS business which is why we did this. This is more for long term and securing that opportunity to serve the customer. That is how it should be taken at.
- Prakash Agarwal** So this can lead to some benefit on the gross margin, or it would take some time to actually show impact?
- Satish Reddy** It would take some time because this is a huge commitment in terms of an order that we have from an innovator company. It will take time before it plays out. The important thing was to acquire that capability of the intermediate.
- Prakash Agarwal** The kind of good numbers we have, especially on the US with high-margin products, clearly, we would see the next couple of quarters with a good base. However just going 3-4 quarters back, we had a comment from the management saying that FY14 growth could be softer on a higher base of FY13 when we were expecting these products to come in. Do we continue to see equally interesting products in FY15, or on this high base we could see some softer growth?
- Saumen Chakraborty** First we have stopped giving guidance. We are communicating that every year we are expected to launch similar number of products. You can gauge around 10 to 15 products, and the filings are done accordingly. So in terms of specific products, how does it pan out, what is the competitive landscape at that particular point of time when the launch happens, it is very difficult to predict and tell you upfront.
- Prakash Agarwal** Any color on the equally interesting products, could help us there?
- Saumen Chakraborty** So as repeatedly we have been saying, we are increasing our R&D cost to make products which are more complex, more difficult. So definitely, we have a lot of interesting products in our portfolio.
- Abhijit Mukherjee** It will be difficult for us to pen down which year. It is an ongoing journey as I mentioned.
- Prakash Agarwal** On Russia, I missed on that, did we say volume decline, or we expect volumes and value to continue robust growth as we saw in this quarter?
- Satish Reddy** No, not for Dr. Reddy's. The whole market, the units have declined. If you see the value growth in the markets, roughly at a 10% high compared to say maybe a 14% in the past.

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- Prakash Agarwal** Would you have a comment on the already existing players in Russia investing in local manufacturing facilities? Are we also on the plan or it does not take too much time, because I understand seeing Pharma 2020, that one needs to be locally present to have continued growth in future?
- Abhijit Mukherjee** Already in one of the complex products, we are in partnership and in a few other oncology products as well. We have started partnership manufacturing in some of those, not very significant at the moment, but we can certainly scale up at some point in time whenever it is needed. The immediate thought is not to put a Greenfield site or something.
- Prakash Agarwal** On Betapharm, can we have that number, please?
- Kedar Upadhye** At Europe level, we did about €15 Mn.
- Prakash Agarwal** Betapharm specifically?
- Kedar Upadhye** I will revert separately.
- Manoj Garg** Just like to understand, we have been investing into Injectables and Biosimilars as a focus on the limited competition products. Are there other areas also which we intend to invest or we are looking to invest?
- Abhijit Mukherjee** The development is in progress in areas of topicals, patches and one or two partnered C2 products for US
- Manoj Garg** Have we made filing wrt any of these products or still they are in under development stage?
- Abhijit Mukherjee** They are all in development stage.
- Manoj Garg** When do we start seeing the filings happening out of the OctoPlus technology platform, have we started already filing the products or will still take some time?
- Abhijit Mukherjee** These are very specific assets. We would not put a timeframe to this, but advancing well.
- Manoj Garg** Saumen has made a comment that you always keep looking or evaluating the inorganic opportunities, keeping the longer-term strategic intent in mind. Do we have anything in the near term, or they are still in a very, very preliminary stage?

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Saumen Chakraborty We are evaluating, maybe we will be doing due diligence somewhere. Specifically, I will not be able to say whether it is near term or medium term. However there is always a possibility that we are going to acquire any specific asset.

Kedar Upadhye Thank you everybody for joining our senior management for the Q2 FY-14 earnings call. In case of any additional clarifications, please feel free to get in touch with the IR team. Thank you.