Dr. Reddy's Laboratories Limited's
Q2 FY24 Earnings Conference Call

October 27, 2023

MANAGEMENT: **MR. EREZ ISRAELI : CHIEF EXECUTIVE OFFICER**
MR. PARAG AGARWAL : CHIEF FINANCIAL OFFICER
MS. RICHA PERIWAL : HEAD - INVESTOR RELATIONS & CORPORATE ANALYTICS

Moderator: Ladies and gentlemen, good day, and welcome to the Dr. Reddy's Q2 FY24 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, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Ms. Richa Periwal. Thank you, and over to you, ma'am.

Richa Periwal: A very good morning and good evening to all of you and thank you for joining us today for the Dr. Reddy's Earnings Conference Call for the quarter ended September 30, 2023.

Earlier during the day, we have released our results, and the same is also posted on our website. This call is being recorded, and the playback and transcripts shall be made available on our website soon.

All the discussions and analysis of this call will be based on the IFRS consolidated financial statements. The discussion today contains certain non-GAAP financial measures or a reconciliation of GAAP to non-GAAP measures, please refer to our press release.

To discuss the Business Performance and Outlook, we have our CEO, Mr. Erez Israeli; and our CFO, Mr. Parag Agarwal, along with the Investor Relations team.

Before I proceed with the call, I'd like to remind everyone that the safe harbor contained in today's press release also pertains to this conference call.

Now, I hand over the call to Mr. Parag Agarwal. Over to you, Parag.

Parag Agarwal: Thank you, Richa, and a warm welcome to our Q2 FY24 earnings call, and a 'thank you' to everyone joining today.

We have built on our positive momentum and delivered another strong quarter of financial results, with highest ever sales and record profitability. In the financial overview section that I will cover today, all the amounts are translated into US dollar at a convenience translation rate of 83.08, which is the rate as of 30th September 2023.

Consolidated revenues for the quarter stood at Rs. 6,880 crores, that is US$ 828 million and grew by 9% on year-on-year basis and by 2% on a sequential basis. The growth was driven by the generics business, mainly in US and Europe.

Consolidated gross profit margin for this quarter has been 58.7%, a decrease of around 40 basis points over previous year and broadly flat sequentially. Gross margin for the Global Generics and PSAI business were 63.6% and 17.8%, respectively.

The SG&A spend for the quarter is Rs. 1,880 crores, which is US$ 226 million, an increase of 13% year-on-year and increase of 6% quarter-on-quarter. The year-on-year increase is primarily on account of investments in sales and marketing, digitalization and other business initiatives. The SG&A cost as a percentage to sales was 27.3% and is marginally higher by 106 basis points year-on-year and 105 basis points quarter-on-quarter.

The R&D spend for the quarter is Rs. 545 crores, that is US$ 66 million and is at 7.9% of sales. Our R&D investments are driven by ongoing clinical trials on differentiated assets as well as other developmental efforts to build a healthy pipeline of new products across our markets for both small molecules and biosimilars.

The EBITDA for the quarter is Rs. 2,181 crores, that is US$ 263 million, and the EBITDA margin is 31.7%. Our profit before tax for the quarter stood at Rs. 1,913 crores, that is US$ 230 million, an increase of 19% year-on-year and 4% over previous quarter. The net finance income for the quarter is Rs. 123 crores.

Effective tax rate has been at 22.6% for the quarter. The effective tax rate was lower than the previous year mainly due to adoption of corporate tax rates under Section 115BAA of the Income Tax Act of India. We expect our normal ETR for the year to be in the range of 24% to 25%.

Profit after tax for the quarter stood at Rs. 1,480 crores, that is US$ 178 million. Reported EPS for the quarter is Rs. 88.8.

Operating working capital reduced by Rs. 598 crores, which is US$ 72 million against that on June 30, 2023, mainly due to decrease in receivables. Our capital investment stood at Rs. 322 crores, which is US$ 39 million in this quarter.

The free cash flow generated before acquisition-related pay out during this quarter was at Rs. 1,447 crores, which is US$ 174 million. Consequently, we now have a net surplus cash of Rs. 5,906 crores, which is US$ 711 million as on September 30, 2023.

Foreign currency cash flow hedges in the form of derivatives for the US dollar are approximately US$ 648 million, largely held around the range of Rs. 82.9 to Rs. 84.5 to the Dollar, RUB 2,475 million at the rate of Rs. 0.98 to Ruble and AUD 2.7 million at the rate of Rs. 58.06 to Australian Dollar, maturing in the next 12 months.

With this, I now request Erez to take us through the 'Key Business Highlights'.

Erez Israeli: Thank you, Parag, and a warm welcome to everyone participating in our earnings call today. As always, we appreciate your interest in our company.

We are pleased to report a quarter with the highest ever revenue, EBITDA, profit before tax and profit after tax. We saw growing momentum in our products and businesses. Our geographic diversification and productivity improvement in operations enabled operating margin delivery. We continued strategic progress on our various key initiatives to ensure that we are well positioned for differentiated and competitive growth.

Let me take you through some of the key highlights of the quarter.

Sales for Q2 grew 9% and EBITDA grew by 13%, reflecting the portfolio strength and continued momentum in US and Europe. We generated healthy EBITDA at 32% and annualized RoCE at 39%. High cash generation leading to net cash surplus of more than US$ 712 million at the end of the quarter.

A few developments in our global biosimilars journey in the quarter includes receiving of GMP certificate indicating closure of inspection by the UK MHRA for our Bachupally biologics facility. A pre-approval inspection by the US FDA of our biologics facility based in Bachupally was concluded with nine observations. We will address them within the stipulated timeline. The CAR-T asset DRL-1801 was approved for clinical trials in India.

The leading financial publication, Financial Express and E-Cube, in a joint study, have named Dr. Reddy's as a leading company in ESG in India across sectors. The company received SA8000, a multi-site certification which includes six CTO units and 10 formulation units in biologics, and has been successfully audited and awarded compliance to ISO 20400:2017. This demonstrates the organization’s commitment towards our social goals and accountability. We were conferred with the prestigious Golden Peacock Award for Excellence in Corporate Governance, 2023.

Now, let me take you through the ‘Key Business Highlights for the Quarter’. Please note that all references to the numbers in this section are in respective local currencies.

Our North America Generics business recorded sales of US$ 384 million for the quarter, with strong year-on-year growth of 9%, while being broadly flat on a sequential basis. The growth was supported by market share expansion in certain existing key products and complete integration of Mayne portfolio, which more than offset price erosion. We launched four new products during the quarter.

Our Europe business recorded sales of € 59 million this quarter, with a year-on-year growth of 12% and a sequential increase of 4%. The contribution from new product launches and improvement in base business volumes more than offset price erosion. We launched a total of 20 products across markets during this quarter.

Our Emerging Markets business recorded sales of Rs. 1,216 crores, a marginal year-on-year decline of 1% and a sequential increase of 5%, primarily impacted by seasonality and unfavourable forex. While we may experience QoQ volatility, full year outlook is on track. We

launched 32 new products during the quarter across various countries of the Emerging Markets. Within the Emerging Markets segment, the Russia business grew by 4% on a year-on-year basis and 9% on a sequential basis in constant currency.

Our India business recorded sales of Rs. 1,186 crores and reported year-on-year growth of 3% and a sequential increase of 3%. Excluding loss of revenues from NLEM-related price reduction, India business grew in mid-single digit. Our focus on profitable growth, coupled with sales and marketing execution have led to gradual improvement in business performance.

We further made following strides to access new growth levers and drive differentiation. We signed an in-licensing deal with Hengrui's NCE, Pyrotinib. We launched 'Nerivio' in India, our first digital therapeutic products addressing the unmet need of migraine patients. We launched a direct-to-consumer platform, 'celevidawellness.com' for serving the needs of diabetic patients in India.

India remains our priority market and we will continue to strengthen presence in the generic business, while investing and building the innovation spaces.

Our PSAI business recorded sales of US$ 85 million, with year-on-year growth of 5% and a sequential increase of 4%. We expect sales to improve over the next couple of quarters on the back of increasing volume pickup and strategic collaborations with regional and global players.

We invested 7.9% of our revenue to empower and enhance our R&D competencies. Our efforts are focused on developing value-accretive products, including several generic injectables and biosimilars, where there is a patient need. We have done six global generic filings, including two ANDAs and one NDA filing in the United States during Q2 of FY24 and are on track to accelerate on this in the balance of the year FY24.

We remain focused on building best-in-class capabilities and commercial infrastructure to leverage our portfolio to expand further. Our ability to adapt, strong execution and financial muscle will enable us to grow our core business and build pipeline of products to meet patient needs.

I'm pleased with the progress that we have made so far this year and we have a clear plan in place to move forward at the pace to deliver on our key objectives and support the overall growth ambitions of the company.

With this, I would like to open the floor for questions and answers.

Moderator: Thank you very much. We will now begin the question and answer session. Anyone who wishes to ask a question may press '*' and '1' on their touch-tone telephone. If you wish to remove yourself from the question queue, you may press '*' and '2'. Participants are requested to use handsets while asking a question. Ladies and gentlemen, we will wait for a moment while the

question queue assembles. The first question is from the line of Balaji Prasad from Barclays. Please go ahead.

Mikela: Hi, this is Mikela, on for Balaji. Thanks for taking our question. Given India remains a priority market for you, could you just provide an outlook on your Indian market and just elaborate a bit more on the evolution in your India focus?

Erez Israeli: The focus and the main effort is licensing and collaborating with the partners to bring innovation to India. This is the most important initiative that we have for India. In addition to that, we identified a focused portfolio, in which we are growing, and indeed, our biologics focused portfolio is growing very, very nicely. The overall performance of the portfolio that we have today is growing in mid-single digit. Part of it is also because we have obviously Cidmus that has a price erosion in line with the plans. While it meets our expectations from a business case, but naturally it has contributed to this decline. If you wish the portfolio that we are focusing on actually grows in double digit, then actually that's what you're going to see - quarter-over-quarter that we are actually improving our performance.

Mikela: Great, and just one follow-up, if I can. What kind of innovations and therapeutic areas are you targeting? And just how willing are partners to launch in India, when you approach them about these deals?

Erez Israeli: There is actually enthusiasm. Naturally, India is an important country, everybody understands that. There is always a concern about the price point, about the adoption of India and certain requirements that are relevant to localize the product - whether its local production or local trials or maybe different position of this product. But, in general, people understand that India is an important market, an important country, and they want to have a presence here, and they want to go very much with a reputable company, and we are one of them. Sorry, I lost the first part of the question.

Mikela: Just what kind of innovations and therapeutic areas specifically are you targeting?

Erez Israeli: Yes. Sorry about that. We are targeting primarily areas like cardiovascular, diabetes, CNS, oncology, especially in an area in which we can find standard-of-care or something that is better from the current standard-of-care. So, what is driving us is primarily if we see an innovation that are addressing those areas. This is also the area in which, at least in our analysis, we find the utmost unmet needs.

Moderator: The next question is from the line of Kunal Dhamesha from Macquarie.

Kunal Dhamesha: Hi, thank you for the opportunity. So, the first one is on the nine observations for the biologics plant that we have received. Can you please elaborate on what is the nature of these observations and whether we will need to undertake some corrective preventive actions there?

Erez Israeli: I believe that those observations are addressable. We are going to address all of them in the beginning of November. Some of them will require us to create a CAPA, which means we need to produce certain product for a certain period of time in order to show certain consistency of data, which will take us to January. But overall, I believe that this is addressable.

Kunal Dhamesha: Sure. And second one is on the PSAI business. So, if I look at the gross margin for that business, it has gone down. Obviously, there's some growth on a quarter-on-quarter basis and year-on-year basis. But, is it primarily due to the unfavourable pricing environment? And if that is the case, do we get the benefit of lower API prices in our global generics business, if that is like more widespread pricing decline in APIs?

Erez Israeli: I don't see such a decline in the API like it was in previous years. Most of the growth is coming when new products and launches that likely to happen by the customer for API or PSAI business. So, if you wish, we are now selling the API that will serve them in the next quarters. What we see now is the impact of the new portfolio that we worked on in the last couple of years, which is replacing the old portfolio from the decade before. And as time will go by, we will launch more and more of these products, and you'll see acceleration in growth because of that.

Kunal Dhamesha: The gross margin for this business, will it also improve? Because it has come down to now around 13%?

Erez Israeli: So, as we grow the sales, we normally grow the gross margins because it kind of has a relatively higher level of fixed cost. So, as you grow, you're also increasing your margin. That's what is likely to happen.

Parag Agarwal: Kunal, to clarify, the gross margin for this business, we have reported is 18% during the quarter, not 13%.

Kunal Dhamesha: Sure, I'll check. Lastly, you know, we have mentioned price erosion in US as a growth drag, at least on a quarter-on-quarter basis, perhaps. Now, this price erosion in this quarter, is it limited to a few large products such as Vasopressin or it is more broad-based price erosion that you are witnessing?

Erez Israeli: The price erosion always affects certain products that went into either a bid or RFP or competitive situation in that particular quarter, it's never broad. But, let's say, relatively to other years, this year its more moderate than we are used to in other years.

Kunal Dhamesha: Lastly, on the same thing, the shortage situation and then some of the short-term contracts, etc., are those opportunities continuing into Q2 and probably in Q3, that is what the trend you are seeing?

Erez Israeli: Yes, absolutely, the focus in the US is on continuity, service and sustainability of supply.

Moderator: The next question is from the line of Neha Manpuria from Bank of America. Please go ahead.

Neha Manpuria: Thanks for taking my question. First is on the Mayne acquisition. When we announced this acquisition, it had a revenue base of about US$ 65 to 70-odd million. Post clearly five, six months of integration into the Reddy's portfolio, have we seen traction in terms of our ability to gain more volume in the product because we don't see that in products like NuvaRing, which is stuck in that 2% - 3% market share. How should we look at the acquired portfolio going forward?

Erez Israeli: Each one of these products have different timing in which customers are putting their RFP or open for those kinds of discussions. I believe that this will grow and will pick up volumes as these timelines will be there. Most of those discussions are likely to happen in the second half of the year. So far, I'm happy with this deal. Its meeting our expectations and likely that you will see growth in the next two quarters.

Neha Manpuria: On NuvaRing, sir, any reason why its stuck at about 2%-3% market share despite the launch in Feb?

Erez Israeli: Timing of the discussions with customers.

Neha Manpuria: Ok. Understood. My second question is on the India business. We have guided to wanting to grow higher than the market, double-digit in this business. But, for several quarters now, that hasn't been the case, at least if you look at the market data. When do we think we get to that growth trajectory? And the collaborations and licensing that we talked about, when do you actually see that materialize and flow through numbers?

Erez Israeli: Likely, that we are going to see it already this fiscal. In terms of the innovation, what we see now is the launch of deals that we signed a year ago. So, it takes about 12 to18 months from the time that you sign a deal until you get your product approval. Naturally, you need to go through the regulatory process. In some of the cases, we need to do clinical trials and then regulatory process and then it takes a bit longer. This is also, right now, the main efforts in terms of building the portfolio in India. In each one of them, it's about - to bring the products that are either going to be the standard-of-care or better than the current standard-of-care. In addition, the products that we are focusing on, in India, are growing in double-digits and likely, that they will be more dominant in the future in that respect.

Neha Manpuria: Just to understand this correctly, we are saying that we will be able to achieve double-digit growth in India this year?

Erez Israeli: I believe that in the end of the year, we should see double-digit growth and continue in the quarters after.

Neha Manpuria: How many of the licensing deals have been completed in India so far, just to get a broad sense? Is there any monetary value that we can attach to this, you know, this is the potential market opportunity or market size of these deals?

Erez Israeli: So, I hope I'm giving you the right numbers, but it should be around 10. We are normally going for a product, which will be at least Rs. 100 crores and of course, some of them can be much more than that.

Moderator: The next question is from the line of Saion Mukherjee from Nomura. Please go ahead.

Saion Mukherjee: Ya, thanks. Can you tell us on biosimilar Rituximab, what's the timeline you're looking at now for the US and European markets?

Erez Israeli: We submitted it in April. We just got the pre-approval inspection. So, we will answer it by November. So, now we hope that it will stay on course and let's say, if everything will be okay, we will be able to launch it in the beginning of FY25.

Saion Mukherjee: Ok. If I look at quarter-on-quarter revenue in the US, which is sort of flattish, can you just share the dynamics with respect to Mayne contribution, Revlimid and the base business, how each of these buckets have moved quarter-on-quarter?

Erez Israeli: Most of the growth came from volume growth and the Mayne portfolio.

Saion Mukherjee: Ok. And finally, on the US, how many launches we are expecting for the full year? How much we have done so far in the first half? How should we think about material launches from your pipeline, if you can guide something in terms of timeline, where you could expect some material launches to happen?

Erez Israeli: Sure. So, this year, we are still on track with the 25 to 30 launches, and we have identified a group of between, something similar, 25 to 30 products, which are material that will be launched in FY25, in FY26 and FY27.

Saion Mukherjee: How many, sir, 25 products you are saying across these three years?

Erez Israeli: 25 to 30 because there's some uncertainty about time of approval. So that's what we can guide.

Saion Mukherjee: When you say material, what kind of revenue potential typically a product with the material contribution would contribute?

Erez Israeli: It has to be at least with a single digit in millions of dollars of sales.

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

Surya Patra: Thanks for the opportunity, sir and congrats for the great set of numbers. Sir, first, a clarification about the government grants. In fact, in the previous year, we have seen something around Rs. 300-odd crores, in the first half, it is more than Rs. 200 crores that we have already booked. So, what is the visibility here and how long this can sustain and this is relating to the PLI only or something else?

Parag Agarwal: So, this includes PLI, but it also has the other export incentives that we are entitled to. Overall, our PLI scheme and the other export incentives this year, would be marginally higher than last year. But quarter-on-quarter, there is always a fluctuation because we have to recognize this in line with the entitlement, sales growth that we show, as per the scheme. So, there are quarter-on-quarter fluctuations. But for the year as a whole, it will be higher than last year.

Surya Patra: But this is sustainable, sir?

Parag Agarwal: Yes, it is, for the next several quarters, we expect it to be meaningful.

Surya Patra: Ok, fine. My second question is about the sustainability of the US business. So basically, having seen the run rate of around US$ 380 - 390 million kind of quarterly run rate and kind of the ramp up what we have witnessed in terms of our Revlimid. So, can we see a kind of a progressive performance in the overall US business going ahead? I'm saying progressive because I believe in terms of the volume limit condition, whatever that is there in case of Revlimid, every 12 months that should see a kind of upward move. So, considering that, how should we see the US business going ahead in terms of the quarterly run rate and all that?

Erez Israeli: The quarters can fluctuate. We discussed it in the past, because in the quarter, it very much depends on the ordering patterns of this product. But overall, you should see growth.

Surya Patra: Ok, fine, sir. And my second question is about this European business. So, in the first half both the quarters we have seen a kind of very strong growth, more than 20% kind of growth. What is driving that? Is it the launch of the biosimilars, introduction of new products or any improvement in the pricing scenario there, demand situation improving? Could you give some sense about Europe, why is it delivering this kind of growth and whether it is sustainable even in the subsequent period?

Erez Israeli: So, it's primarily new product launches. There is also some volume growth of the base business. And just more markets that we are participating in, more tenders. Most of our growth is coming from injectables and just winning tenders.

Surya Patra: Since we are now seeing progress in the regulatory point of view as well as the launch point of view in terms of biosimilars, so, is it possible to share some update about the Pegfilgrastim success in the US and non-US market or even generally for biosimilars? What is the, let's say, annual or quarterly run rate that we are currently having? If you can give some sense, that would be really helpful, sir.

Erez Israeli: So just to remind, Peg is not our product. It is a product that was part of the arrangement that was done many years ago with Merck Serono, after that was brought to Fresenius. So, they are selling it, we are getting only royalty. So, by design, its not a big amount. Most of our activities in the biosimilars, today, are in emerging markets, primarily Rituximab and in fact, other products, so India, Russia and other emerging markets. We are ramping up that activity. It is very important to us. We are going to have in the next two years or so, about five Phase-III of

biosimilars to be launched globally, including the United States. The main ramp-up in biosimilars for us will be probably from FY27 onwards.

Surya Patra: Last one question, sir. Obviously, there is kind of a strong cash flow that we have been seeing, also supported by Revlimid or whatever the case be. We have been seeing a quarterly run rate of, let's say, Rs. 1,500 crores kind of free cash flow and already, we have Rs. 6,000-odd-crores kind of cash in books. So, could you give some sense of what incremental growth this fund can add to the overall visibility of our growth for next, let's say, one or two years or over a period of three years?

Erez Israeli: The beauty of that is we can use this money for deals. Now, it depends on what deals we want to have and in what multiples we will have them. I hope I understood the question right. So, what we want to do with this money is to primarily use it for inorganic activities, which can serve us both in the short-term, like we did with Mayne as well as in the longer-term, for example, to acquire assets or products that we can launch in the years after. Absolutely, this is the main use of the money, and this should help us to generate growth. But the timing of it, of course, is not certain because we don't know what type of deal and when it will impact us.

Moderator: Next question is from the line of Aman Vij from Astute Investment Management. Please go ahead.

Aman Vij: Ya, good evening sir. The question is on our diabetic portfolio. So, if you can talk about how well are we placed as a company to take the advantage of the upcoming GLP-1 opportunity? So, I believe we have some FTF filings in that. So, in terms of launch, are we ready whenever the expiry happens, we'll be there? Do you think this product category can be like a US$ 300 to 500 million kind of category for the next five years?

Erez Israeli: So, we're going to be there, definitely day one. And as for the size, I don't know. But obviously, I have a great belief in this category.

Aman Vij: In terms of the important dosages, are we present in all of them, if you can talk about the same?

Erez Israeli: I don't want to discuss specifics, because we did not make it public. But, we should have all the relevant ranges, depends on the geography and depends on the country. But we see this category as a global category for us to launch in all the markets that we have a presence.

Aman Vij: You are saying we are ready in terms of whenever expiry happens, if we have FTF filed we can launch in the next day itself?

Erez Israeli: We are ready.

Aman Vij: My second question is on this other biosimilar, which I think we have on the osteoporosis side. If you can talk about the opportunity in US, because I believe there is a patent expiry coming up, so are we planning to launch in the US market? And if yes, do you think we can?

Erez Israeli: Which product?

Aman Vij: Yes, I was talking about osteoporosis, teriparatide and there are one or two more products that we have. So, I was trying to understand that US patent expiries are coming up. So, do you think we can have a good market share in US markets with our biosimilars?

Erez Israeli: So, I'm not calling teriparatide, a biosimilar. For me, these are still equivalent to small molecules. Biosimilars are normally for products that are bigger like the mABs, etc., But specifically for this product, absolutely, I believe that it will be very nice for us, and we will be ready to launch it, when its possible.

Aman Vij: On the timeline, so I believe it will be in the next few months only, right, on the US launch of this product?

Erez Israeli: I don't want to speculate on time, at this stage.

Aman Vij: But we are ready to launch whenever it happens?

Erez Israeli: We will be there.

Moderator: The next question is from the line of Tushar Manudhane from Motilal Oswal Financial Services. Please go ahead.

Tushar Manudhane: Just on this e-commerce foray, so would like to understand what is the strategy behind it, what kind of investment are we thinking in this particular foray?

Erez Israeli: Investment in e-commerce, it's not a big investment, but it allows us additional channel for our products as well as other nutraceuticals. I believe that it's very nice in other channels in other part of the capabilities that we have now in India. But it’s not a big investment.

Tushar Manudhane: But in addition to the typical nutraceutical products, would we be also having this prescription-based product on this platform?

Erez Israeli: No. The specific platform is direct-to-consumer that you mentioned, which means nutraceuticals and products that do not require prescription - OTC.

Tushar Manudhane: Sir, secondly, just on the trade receivables, there have been reasonable reductions, if I compare quarter-on-quarter. Any read-through over there?

Parag Agarwal: It is normal, there's nothing unusual. I think it depends on the credit period, the cycle and the receipt of orders. So, we obviously keep a very tight track of all our receivables and collect on time. So, nothing unusual in this.

Moderator: The next question is from the line of Devang Sarawgi, an individual investor. Please go ahead.

Devang Sarawgi: Sir, are we looking at any 505(b)(2) opportunities in the US market?

Erez Israeli: For which product, sorry?

Devang Sarawgi: In general.

Erez Israeli: 505(b)(2) that requires sales force, we will not do. 505(b)(2) that is interchangeable, we would love to do.

Devang Sarawgi: Ok. And what would be the price erosion for the quarter?

Parag Agarwal: Price erosion, we are finding the trends to be stable. So, if we look at the last few quarters, we have seen price erosion moderating, and we are now seeing it around the same level. But from one quarter to another, it will typically fluctuate between say high single digit to low double digits.

Devang Sarawgi: Ok. And are we going to see any price increases as many suppliers are going out of the market?

Erez Israeli: We are not building on that.

Devang Sarawgi: Or it will be product-specific?

Erez Israeli: Its normally product-specific, and we are not building on that. If there is a shortage situation, we will supply, but we are not building into our models any price increases.

Parag Agarwal: Yes, whenever there's an opportunity. Opportunistic, not strategic.

Moderator: The next question is from the line of Damayanti Kerai from HSBC. Please go ahead.

Damayanti Kerai: My question is on India business. So first of all, can you tell us how much India sales is currently contributed by chronic therapies? And then second part of my question is how many sales representatives you have for your India business and do you have plans to expand on it?

Erez Israeli: Chronic is about 35% of the business. And as time goes by, because most of what we will launch, would be more chronic in nature, this will grow. As for the numbers of salespeople, if I remember correctly, its a little bit more than 6,000 people and we will grow as we will bring the innovations. So, accordingly, we would adjust the numbers.

Damayanti Kerai: But right now, you do not have any particular need to expand your sales force. As you said, you're focusing more on innovative products as in when you launch you will decide accordingly.

Erez Israeli: I don't see a need to increase, and its more about the productivity of the team and the coverage of this team. But its not so much about the numbers of the people but if we need more, we will add more.

Damayanti Kerai: I think this question was already discussed. So, India, despite many efforts from your end, we have been seeing sales largely remain range bound, somewhere say Rs.12 billion a quarter or so. So, when we can see a significant step up coming up? So any timeline, if you can indicate because, I guess for the last six to eight quarters, sales were broadly in this range?

Erez Israeli: I think you are going to see an improvement already this year. Indeed, we took two decisions about India just to remind, and this is the effect that it comes with it. One, we decided to focus, and we actually made quite a few deals of divesting brands. So, we kind of trimmed down the base portfolio, because we do not believe that, of course, the changes that will happen with all the challenges of branded generics we have in India, this plan is likely to be successful and we felt that it was a good deal for us. And second, we also acquired a brand, for example, Cidmus™, which we knew at the time that we will face price erosion. It matched the business case that we had on it. I believe that already the brands that we are focusing on are growing double-digit plus. We are going to launch more and more innovation and have more and more collaborations. So, you will start to see this year. And as we will add products to the portfolio, it will continue to grow. Its a focus market for us, its a strategic market for us and we will grow it.

Damayanti Kerai: My second question is, if you can talk a bit about your progress for the China market. How many approvals you have got and what kind of filings have been done so far?

Erez Israeli: We are actually very pleased with the progress over there, especially since April, where the number of approvals start to pick up. I think that we had four approvals, and this quarter, I think we got additional two approvals, so six altogether. And we are also filing more than 15 products a year now. I think we can get even to 18, if everything will go well. And most of our products are along the first wave and normally among the first three. So, it's a very interesting area for us in China. At the time we thought that the ramp-up will be earlier than what I communicated in the past, but COVID and also our own execution may be late, but now it's absolutely bearing fruits.

Damayanti Kerai: So, with this portfolio build-up, should we assume China portfolio could start contributing meaningfully from next fiscal or it will be a bit long-term in nature?

Erez Israeli: No, no, from next fiscal, absolutely.

Damayanti Kerai: And my last question is how should we look at your R&D spend going ahead as you focus more on differentiated products for your global segments?

Erez Israeli: Likely that it will grow because we are investing more and more in biosimilars. We will continue, of course, to invest in the new molecules. So, you're going to see a moderated growth. But also, the sales will grow. So, let's say, in terms of percentage, it should be give or take in the range that we are today, maybe a bit higher.

Moderator: The next question is from the line of Gagan Thareja from ASK Investment Managers.

Gagan Thareja: The first question is on the India business. If you knock out the discontinued products, what would have the India sales growth being year-on-year for the quarter?

Erez Israeli: So, without these products and without NLEM, we are about mid-single digit for the quarter.

Gagan Thareja: For US, from 1Q to 2Q, would there have been a material difference in the Revlimid sales for you?

Erez Israeli: I cannot discuss the quantities of Revlimid.

Gagan Thareja: I don't want you to enumerate the number. I'm just asking, would it be a reasonable assumption or inference that there wouldn't have been a material change in Revlimid sales from the first quarter to the second?

Parag Agarwal: Most of the growth, like Erez said earlier, has come from the base business and also the Mayne portfolio.

Gagan Thareja: Is it a correct to summarise that you're saying that India you will exit FY24, that's Q4 you'll be able to do a double-digit sort of growth rate and you will probably be improving from 2Q to 3Q and from 3Q to 4Q, is that a correct inference?

Erez Israeli: That's what we are trying to do, absolutely.

Moderator: The next question is from the line of Saion Mukherjee from Nomura. Please go ahead.

Saion Mukherjee: You mentioned about inorganic activities. The cash balance is significant, and it could continue to rise. If we look at the acquisitions and deals that you've done, they are much smaller in size. The question is are you looking at larger deals going ahead? Is there more activity that you are seeing on the M&A side? And related to that, what's the level of leverage that as a company you would be comfortable with?

Erez Israeli: So, we are looking for all deals, small and bigger than usual, for us as needed. But we are not in a rush. It has to be a good deal. It has to be something that will match our strategy, something that we believe can contribute to our growth, is there products that we want or capability that we are missing. We are not in a rush to spend this money. In that respect also, the money is yielding very nicely now by investing it. As we speak, we are participating in quite a few processes and we will see what will yield. Likely, that we will spend eventually this money. But, it's important for us that it will be the right strategic deal for us. We are not looking for transformative deals. We are looking for complementary activities for our organic strategy.

Saion Mukherjee: Any view on leverage, Parag, as to what level of leverage you would be comfortable with?

Parag Agarwal: I would say 2x EBITDA is what we will be willing to go for. Beyond that, we would not like to take a financial risk.

Moderator: The next question is from the line of Neha Manpuria from Bank of America. Please go ahead.

Neha Manpuria: Parag sir, on the SG&A expense, that seems to have inched up quarter-on-quarter. I just wanted to get a sense on where are we investing and how should we look at that number over the next few quarters and probably FY25?

Parag Agarwal: So overall, Neha, the increase in SG&A, if you see year-on-year, I think we've gone up by 13%. Apart from the normal inflation, its largely because of investments behind our brands. Also, we are investing in digitalization, I have spoken about it a few times, extensively both in the front end as well as in R&D and in our manufacturing facilities. Like last year, FTO3 was named as 'Digital Lighthouse'. We are now working on getting more facilities certified as 'Digital Lighthouse' because we believe that in the medium-term, this digitalization is going to make a big impact by improving quality, reducing quality incidents, improving productivity and costs and so on. So, these are the areas where we are investing. If you look at overall quarter-on-quarter, we'll see fluctuation. But in aggregate, SG&A as a percentage of sales, a few years back we were at 30%, 31%, and we have been gradually dropping to 29%, 28% kind of a range. So, I wouldn't like to comment on quarter-on-quarter, but for the full year I would say that's the range we'll be around.

Moderator: The next question is from the line of Kunal Dhamesha from Macquarie. Please go ahead.

Kunal Dhamesha: The first one is on the in-licensing innovation deals that we are doing for India. Can you highlight what is the typical payback period for these kinds of deals?

Erez Israeli: So, normally, the pay-out is very good because we hardly put in down payments for that. And so most of the deals have very small down payments. And normally, we are getting healthy margins that enable us to buying a transfer plus investment. So normally, the pay-out will be within the first three years, taking into account the time that it takes to build the brand. So, most of the investments is actually not because of the pay-out to the partner but rather, the investment in building brands in a country like India, which normally takes about three years.

Kunal Dhamesha: Let's say, for markets like India, are these deals some of these innovators would be doing it more on a profit share basis or are they more interested in, let's say, upfront payment and then some royalties?

Erez Israeli: So, most of the deals will be certain milestones and some royalties, and giving us the flexibility to market it in places we want and with the right mix of SG&A. So, that normally will be the case, but we will also have cases in which it will be a profit sharing.

Kunal Dhamesha: Second question is on the biosimilar business. Now, that we are kind of close to launching our first biosimilar in the US, probably somewhere in FY25. What type of front-end investment would we be looking for, for sales force or the formulary access personnel and how much drag it could be on our SG&A?

Erez Israeli: So, Rituximab that will be launched in the US will not be launched by us. So, this is a sales force that is with our partner. The products that we will launch will be from FY27 onwards and for that we will have to build the sales force.

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

Surya Patra: Sir, just one clarification I wanted to have. In terms of the margin profile, let's say, for India business and the base US business, let's say, excluding Revlimid. So, what could be the differential in terms of the margin profile of these two businesses?

Parag Agarwal: We don't disclose geography-wise margins, but I can confirm that the margin profile of India business would be better than our North American business.

Surya Patra: Even Russia would be similar to India or slightly lower than India?

Parag Agarwal: Russia is also a branded generics market, and therefore, it's margin profile is also quite healthy.

Surya Patra: So, that means Russia is in between of India and US, that is how we should think?

Parag Agarwal: I'm not ranking the market. I'm just pointing out that both Russia and India are branded generics business, and therefore, their margin profile is better than the unbranded businesses in US and Europe.

Moderator: We have no further questions. I would now like to hand the conference over to Ms. Richa Periwal for closing comments. Over to you, ma'am.

Richa Periwal: Thank you all for joining us for today's evening call. In case of any further queries or clarifications, please do not hesitate to get in touch with the Investor Relations team. Thank you once again.

Moderator: On behalf of Dr. Reddy's Laboratories Limited, that concludes this conference. Thank you all for joining us. You may now disconnect your lines.