Dr Reddy's to focus on Europe and India markets

Chief executive Prasad says firm investing in capabilities in advance to ensure there are no regulatory problems

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HYDERABAD

Dr Reddy's Laboratories Ltd, India's largest drug maker by sales, said it will focus on fixing its European operations and strengthening its local business, the two major markets where it has underperformed.

"Europe has been through lot of challenges," G.V. Prasad, chairman and chief executive officer of Dr Reddy's, said in an interview on Friday. He took over as chairman in April after the death of father-in-law and founder-chairman K. Anji Reddy.

A chemical engineer from the Illinois Institute of Technology in Chicago, Prasad also holds a master's degree in industrial administration from Purdue University in the US. After a brief stint in his family's construction business, Prasad in 1990 became managing director of **Cheminor Drugs Ltd**, a company involved in the production of bulk drugs. In December 2000, after the merger of Cheminor with Dr Reddy's, Prasad took over as executive vice-chairman and chief executive of the merged entity.

Dr Reddy's European sales declined in the year ended 31 March on account of its struggling German unit **Betapharm Arzneimittel GmbH**, which contributes about 70-75% of revenue in Europe. Dr Reddy's bought Betapharm, the fourth largest German generic drug marketing firm, for €480 million (₹3,750 crore today) in February 2006 but a dramatic shift of policy in Germany to source medicines from the lowest-cost vendor through a tender-based model has hurt the company.

Europe contributes about ₹772 crore, or 9.4%, of total global generic sales of ₹8,256 crore.

For the year ended 31 March, Dr Reddy's reported revenue of ₹11,626.56 crore and a profit of ₹1,677.6 crore.

Despite restructuring operations and cost-control measures such as shifting part of the manufacturing to India and taking part in the tender-based system, Dr Reddy's has found it tough to crack the German market.

"We don't want to compete in this kind of space, we want to add value through innovation so we are going to move towards products which are more sold as brands," Prasad said.

As part of the new turnaround strategy for Germany, Dr Reddy's will launch products outside the scope of tenders and plans to adopt a selective approach of picking its product portfolio.

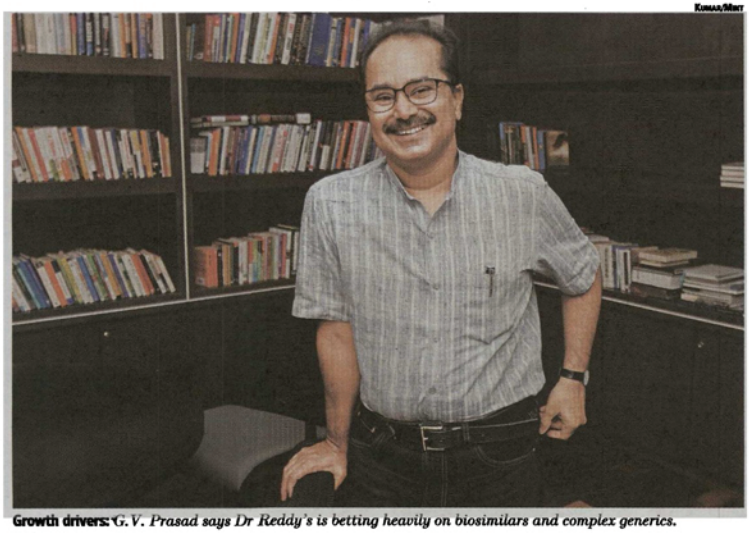
Prasad said the two products launched in the German market under the new strategy are doing reasonably well and it could take at least two-three years for a real turnaround.

India is another important growth market for Dr Reddy's. It still doesn't figure among the top 10 companies in India as far as local sales go, although this increased 13%, faster than the industry's 10.2%.

"We are not so happy about performance in India. We haven't done a great job. So growing in India becomes a very high priority," Prasad said. According to a report by management consultancy **McKinsey and Co.**, India's pharmaceutical market is expected to touch $20 billion by 2015, and is expected to figure among the top 10 globally on account of higher disposable incomes, the expansion of medical infrastructure and greater penetration of health insurance. Ninety percent of India's pharmaceutical market comprises generics.

Dr Reddy's has started concentrating on the Indian market in the past few years. It has appointed an army of sales representatives, refurbished its portfolio and launched new products in therapeutic areas such as gastrointestinal, pain, anti-infectives, dermatology, cardiovascular and oncology.

"The big chunk of the Indian portfolio, the big brands like Nise (anti-inflammatory drug nimesulide) and Omez (gastrointestinal drug omeprazole) are growing slowly or (contracting) in particular areas, resulting in pressure on their topline," said Hemant Bakhru, analyst at Mumbai-based foreign brokerage **CLSA Asia-Pacific Markets**. "They haven't been able to replace those big brands with successful bigger brands."



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Growth drivers: *G. V. Prasad says Dr Reddy's is betting heavily on biosimilars and complex generics.*

Prasad is concerned about the rapid "commoditization of branded generics" in developed markets, especially the US, the world's biggest drug market, as more and more generic companies with "same relative competitive advantages are competing in the same space".

"There is an uncertainty of brands turning commodities—that is the risk you face," Prasad said.

Dr Reddy's makes nearly half of its money from the North American market.

"So companies like us, to maintain growth and to maintain trajectory, we have to differentiate ourselves and we believe we differentiate ourselves through our investments in R&D, investments in manufacturing," Prasad said. "You have seen what's happening to companies through regulatory problems that they face. We don't want to be in that situation, we are investing ahead of time on all those capabilities—that's how we differentiate ourselves as a company."

As part of this Dr Reddy's is betting heavily on biosimilars and complex generics.

A biosimilar is a generic version of a biopharmaceutical drug, an area of considerable interest for pharmaceutical firms, especially generic companies such as Dr Reddy's, as a new driver for growth.

In contrast to conventional chemical medicines, biotech products are impossible to copy precisely, forcing generic companies to develop biosimilars, which are close to the original but need to be sold as separate medicines.

But the landscape is starting to change as patents expire and regulators establish guidelines for developing biosimilar versions of drugs, posing a threat to leading biotech groups such as **Roche Holding AG** and **Amgen Inc**.

Dr Reddy's has an early mover advantage in the biosimilar space, having launched its first such drug called Filgrastim back in 2001. Filgrastim boosts white blood-cell production and is marketed by Amgen under the brand name Neupogen. The most successful biosimilar product of Dr Reddy's is Reditux, a generic version of Biogen Idec Rituximab, a monoclonal antibody used in the treatment of cancer.

Dr Reddy's sells four biosimilars in markets that are less regulated than the US and Western Europe.

The process of launching a biosimilar is as good as introducing a new chemical entity (NCE), which involves high investment and risk.

To derisk biosimilar development, Dr Reddy's partnered with German biotech firm **Merck Serono**, a division of **Merck KGaA**, in June last year. Both the companies will jointly develop and manufacture biosimilar compounds that go off patent to treat cancer.

"We partnered not just because of investment risk. There are other risks also—there is a high investment, the commercial model is not played out, there is the intellectual property battle, then there is the manufacturing at scale to the regulated world requirements in the industry which is just still maturing," Prasad said.

Dr Reddy's plans to spend $200 million, or 7% of its sales, on research and development, and a significant part of this will be devoted to biosimilars.

After the Betapharm debacle, Dr Reddy's is treading a cautious path when it comes to a mergers and acquisitions strategy.

The company has resumed acquisitions but on a small scale; it bought Dutch company **OctoPlus NV** in October 2012, which specializes in drug delivery technologies, for ₹190 crore.

In 2011, the company acquired **GlaxoSmithKline Plc.**'s penicillin facility in Bristol. Prior to that, in 2008, the company acquired **BASF SE**'s formulation manufacturing unit at Shreverport, Louisiana, and **Dow Pharmaceutical Sciences Inc.**'s small molecule business in the US.

"Our strategy for acquisition is very clear," he said. "Either it helps us bring more innovative products to the market or it deepens the market presence in branded markets,"

There are hardly "any negative things I can see in Dr Reddy's strategy" but like all other Indian companies they "should now live up to more vigilant US regulator" in the backdrop of the recent episode involving **Ranbaxy Laboratories Ltd**, said Sarabjit Kour Nangra, an analyst at Mumbai-based **Angel Broking Ltd**.

Ranbaxy had to pay $500 million under a settlement with the US Food and Drug Administration after admitting to felony charges related to drug safety.

Dr Reddy's was one of the first companies in India to enter drug discovery. It was also the first Indian company to license a molecule that it had discovered to another firm to continue with the research needed. The anti-diabetes molecule was licensed to Novo Nordisk of Denmark. The molecule was later withdrawn due to carcinogenicity or cancer causing properties. Meanwhile, another anti-diabetes molecule balaglitazone was found to be commercially unviable. Finding new drugs was a passion of founder Anji Reddy, who began his career as a researcher before turning into an entrepreneur.

"Drug discovery is something we are a little more cautious about than we were under Dr (Anji) Reddy's leadership. We have not given up what he had in mind but we have refined it somewhat. Over time may be we dial it up, but immediately, there is no major shift," Prasad said.