

Dr. Reddy's Laboratories Ltd.
Q4 FY20 Earnings Conference Call

May 20, 2020

Moderator: Ladies and gentlemen, good day, and welcome to the Dr. Reddy's Q4 FY20 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Amit Agarwal. Thank you, and over to you, sir.

Amit Agarwal: 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 and Full Year Ended March 31, 2020. Earlier during the day, we have released our results and the same are also posted on our website. This call is being recorded, and the playback and transcript 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. To discuss the business performance and outlook, we have the leadership team of Dr. Reddy's comprising Mr. G.V. Prasad – our Co-Chairman and Managing Director, Mr. Erez Israeli - our CEO, Mr. Saumen Chakraborty - our CFO, and the Investor Relations team.

Please note that today's call is a 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 I proceed with the call, I would 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. G.V. Prasad. Over to you, sir.

G.V. Prasad: Thank you, Amit. Good evening, good afternoon and good morning to all the participants. I do hope that you and your families continue to remain safe and healthy during these unprecedented times. Let me quickly provide you with an update on the current situation and how we, as an organization, are playing a part within the overall healthcare system in these extraordinary times.

Our foremost priority is to ensure the health and safety of our employees, patients, healthcare professionals, customers, suppliers and community at large. We have enhanced the safety requirements across all our working locations, enforced physical distancing norms, mandated use of protective gear and enabled remote working across all our global office locations. We have accepted the new reality and swiftly implemented an effective business continuity plan across the functions and have been able to ensure that our operations continue right through the pandemic situation without compromising on the health and safety of our employees.

From a supply perspective, together with the inventory on hand and the continued manufacturing support, we have been able to address the enhanced product demand across various markets. We launched several new products, overcame logistical barriers and through effective customer engagement have continued the business. In the branded markets, we've been able to effectively leverage the virtual connect model to support healthcare professionals, patients and our people.

Overall, we are truly inspired to see how colleagues across the company have risen to the occasion and overcome every obstacle in the way to fulfill our mission, which is to ensure continued supply of medicines to patients and doctors under safe conditions. We are also playing our part of being an effective, socially responsible corporate citizen and have extended support to the communities through various initiatives, such as supporting the healthcare workers, staff and police and other public servants by providing them with PPE kits, masks, sanitizers, gloves as well as food assistance to the marginal sections and migrant worker families.

With this, I hand over the call to Saumen for taking you all through the financial performance of the company.

Saumen Chakraborty:

Thank you, Prasad. Greetings to everyone. The current year financial performance has been quite good with the highest ever Sales and EBITDA and a strong free cash flow thereby turning net cash surplus. Let me take you through the key financial highlights for the quarter and FY20. For this section, all the amounts are translated into U.S. dollars at a convenient translation rate of Rs. 75.39, which is the rate as of March 31, 2020.

Consolidated revenues for the quarter stood at Rs. 4,432 crore, that is \$588 million, and grew by 10% on a year-on-year basis and by 1% on a sequential quarter basis. The year-on-year growth has been supported by good performance in North America Generics, Europe and emerging markets. Sequentially, while there has been good growth in NAG and Europe, our branded market had lower sales.

The revenues for FY20 stood at Rs. 17,460 crores, that is \$2.32 billion, and grew by 13%. The growth has been primarily supported by improvement in the base business volumes, new product launches and proprietary product out-licensing income, however, partially impacted due to price erosion.

As regards to COVID-19-related impact, while we saw some incremental sales in certain markets, that is U.S., Europe and Russia, due to increase in panic buying, our sales got impacted or deferred in PSAI, India and few emerging markets, albeit, on an overall basis, there is no major impact on Q4 or FY20.

Consolidated gross profit margin for this quarter has been 51.5% with a decline of 90 basis points on year-on-year basis and a decline of 260 basis points quarter-on-quarter. The sequential quarter decline has been primarily on account of, (a) impact of changes in the business mix, and (b) increase in inventory provision or write-offs related to this quarter. Gross margin for the Global Generics and PSAI were at 55.9% and 28.4% for the quarter.

Gross margin for FY20 has been 53.8% against 54.2% in FY19. Gross margin for Global Generics was 56.8% and PSAI was 24.1% for the full year.

The SG&A spend for the quarter is Rs. 1,218 crores, that is \$162 million, and declined by 1% year-on-year and by 4% quarter-on-quarter. The SG&A spend for the year is Rs. 5,013 crores,

that is \$665 million and has grown by 3%. The SG&A cost as a percentage to sales declined from 31.6% in FY2019 to 28.7% in FY20, indicating the leverage benefit on improvement in sales.

The R&D spend for the quarter is Rs. 419 crores, that is \$56 million, and is at 9.5% of sales. The R&D spend for the FY20 is Rs. 1,541 crores, that is \$204 million. R&D as a percentage to sales stood at 8.8% for FY20 against 10.1% in previous year.

Other income for the year includes an amount of Rs. 346 crores arising out of the settlement income received in quarter one.

The EBITDA for the quarter is Rs. 1,001 crores that is \$133 million, which is around 22.6% of the revenue. The EBITDA for the year is Rs. 4,643 crores that is \$616 million, and around 26.6% of the revenue.

Profit before tax for the quarter is Rs. 714 crores with a year-on-year growth of 22%. PBT for the full year is Rs. 1,803 crores, a decline of 20% over FY19. This decline was due to the impairment charges of Rs. 1,677 crores taken during the year. Adjusted for this, the PBT would have grown by a healthy 55%.

Profit after tax is higher than PBT during the quarter and full year due to recognition of MAT credit and creation of deferred tax assets, in line with the requirements of accounting standards. We expect that the ETR would be around 22% for the next year.

The reported EPS for the quarter is Rs. 46.01 and for the full year is Rs. 117.40.

Operating working capital increased during the quarter by around Rs. 439 crores, which is \$58 million. The increase is primarily attributable to an increase in receivables due to higher sales and delay in certain collections, which we expect to normalize in the current year. Net working capital days, however, have remained in line with last quarter, supported by reduction in inventory levels. We invested Rs. 150 crores, which is \$20 million, towards capital investment in this quarter.

The free cash flow generated during this quarter was lower at Rs. 7 crores, which is around \$1 million, mainly constrained by an increase in receivable, which we expect to improve from current quarter. The free cash flow generated during FY20 is healthy at Rs. 2,313 crores and made us to now have a net surplus cash of Rs. 397 crores as on March 31, 2020. Our net debt-to-equity ratio is at negative 0.03 and reflects our strong balance sheet position.

Foreign currency cash flow hedges for the next seven months in the form of derivatives for U.S. dollars are approximately \$265 million, largely hedged around the range of Rs. 72.0 to Rs. 76.3 to the dollar. In addition, we have cash flow hedges of RUB 1 billion at the rate of Rs. 1.0283 to the ruble, maturing over next 10 months.

With this, I now request Erez to take through the key business highlights.

Erez Israeli:

Thank you, Saumen. Good morning, good evening to everyone. I am very happy with the way we have adapted and continued our focus on execution even during these challenging times. We made good progress to implement our strategy toward diversification, creating more opportunities with less risk and attaining self-sustainable business model for each one of our businesses.

The FY20 has been a very good year for us, which is reflected through the following:

- a. successful in obtaining the VAI status for CTO-VI after five years and desired outcome for all other site inspection by the U.S. FDA;
- b. PBT growth of 55% adjusted for impairment charge taken during the year;
- c. EBITDA growth of 36% and improvement in the EBITDA margin;
- d. improvement in the ROCE, adjusted for impairment charge taken during the year;
- e. healthy cash flow generation, leading to much stronger balance sheet;
- f. turn-around performance for our North America Generics and our Europe business;
- g. healthy double-digit growth in branded markets;
- h. continued traction toward development of product pipeline across business; and
- i. productivity improvement seen across manufacturing, marketing and R&D.

Let me now take you through the key business highlights for each of our businesses. Please note that all the reference to the numbers in this section are in respective local currencies.

Our North America Generics business recorded sales of \$250 million for the quarter, with a strong growth of 17% year-on-year and 11% on a sequential quarter basis. The quarter witnessed an overall increase in demand driven by pantry loading by patient and inventory built up by customers due to COVID-19 lockdowns. Further, we also benefited from continued activity on new product launches coupled with favorable market share gains across some of key products, including gSuboxone.

In all, we launched five new products in this quarter, including our second CGT product, naloxone hydrochloride injection, first-to-market generic launch for gVimovo and gDaraprim. On a full year basis, we launched 27 products, including four relaunch of the earlier discontinued products. We expect the new launches momentum to continue during the year with about 25 product launches lined up despite uncertainty due to COVID-19. On a full year basis, the sale has been \$910 million, a growth of 6% over the previous year, signifying the strong reversal in decline witnessed over prior three years.

Our Europe business recorded sales of 43 million euros, with a strong year-on-year growth of 81% and sequential growth of 10%. On a full year basis, the sales are 148 million euros and has grown at a phenomenal rate of 53%. This performance is driven by improvement in base business, new product launches and ramp up in three new markets: France, Italy and Spain. During the quarter, we launched one product in Germany, three products in UK, two products each in France, Italy and Spain. The current year has reset a new base for this business, and we look forward to continued growth from here on.

Our emerging markets business recorded sales of Rs. 804 crores in Q4, with a year-on-year growth of 15%, however, a sequential quarter decline of 13%. On a full year basis, emerging market sales has been Rs. 3,281 crores and grew a healthy rate of 14%. Within the EM segment, the Russia business in Q4 grew at 9% in constant currency on a year-to-year basis, but a decline of 17% quarter-on-quarter on the back of high base in Q3, owing to on-time supply of Reditux tender volumes. In FY20, Russia grew by 9% in constant currency. The overall growth in emerging markets was led by higher volume and new product launches, which was partially impacted due to price erosion in few markets. During the quarter, we launched 10 new products across these markets.

Our India business recorded sales of Rs. 684 crores with a year-on-year growth of 5%, however, a sequential quarter decline of 10%. The growth was impacted due to logistics-related disruption caused by COVID-19 lockdowns. On a full year basis, our sales was Rs. 2,895 crores and grew by 11%. As per the secondary sales reported by IQVIA, we registered steady growth of 11.4%, ahead of total market growth of 10.8% in month March 2020.

Our PSAI business recorded sales of \$99 million with a year-on-year growth of 3% and sequential quarter growth of 2%. Here too, the growth was impacted due to the logistics-related disruption. On a full year basis, the sales were \$362 million and grew by 4%. We continue to witness a very healthy order book for the business and are hopeful of a good growth coming year.

On the quality and compliance front, we have turned a new leaf with the resolution of pending issues for all of our sites. The recent audit outcome for all of site inspections have been positive. Quality continue to remain a key focus area and priority for the company going forward.

During this quarter, we filed 54 formulation products across global markets, including three ANDAs in the U.S. market. As of 31st of March 2020, we have 99 cumulative filings pending for approval with the U.S. FDA, including 97 ANDAs and two 505(b) 2 NDAs. We also filed 59 drug master files globally, including 7 filings made in the U.S. We continue to strengthen our pipeline of products across the markets. We are also working on a few molecules related to COVID-19 disease.

On our Proprietary Products business, recently, USFDA approved our NDAs for oral liquid celecoxib formulation named ELYXYB. It is the latest product emerging from Dr. Reddy's portfolio for acute migraine treatment. We are actively working to commercialize this product through partners. Overall, we are making good progress in building and advancing a strong pipeline of high-value, globally relevant assets. We are continuing our efforts to monetize select assets through partnership and licensing transactions that maximize their value.

The Rituximab Phase III trial is progressing as per plan. And in parallel, we are working on multiple other biosimilar products, which are at different stage of development.

Currently, we are going through a phase of uncertain business environment wherein the possibility of volatility remains high. However, there are certain structural tailwinds also for us, such as opportunities for improving our market share across multiple markets and ramping up relevance in our global API business. Overall, we remain hopeful to continue to grow and emerge as a much stronger company, meeting the expectations of all of our stakeholders.

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

Moderator: Thank you very much sir. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Yash Gupta from Angel Broking. Please go ahead.

Yash Gupta: Thank you for giving me an opportunity sir. My first question is on the domestic business. How you're looking at the Indian domestic business for the next two quarters as the MRs productivity will come down and number of prescriptions maybe come down in the near future?

Erez Israeli: So we don't know, how the market will evolve. I cannot predict it, we cannot predict it. Naturally, there is going to be an impact on the fact that patients could not visit physicians. And there will be a certain impact on that. On the other hand, we do see also a place in which demand is higher. So I believe that once the lockdown will be over, India will eventually ramp up toward normal consumption. When exactly it will be, I wish I knew.

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

Anubhav Aggarwal: One question is when we look at the IQVIA data, it shows that the U.S. generic market volumes were down in the last 45 days in April and May. Just wanted to check how has been the primary sales trend? Have we seen that, that impact is largely at the secondary sales? Or have the primary sales been impacted as well?

Erez Israeli: Right now, we see a healthy demand coming from the customers. So we see the IQVIA numbers as well. Right now, what we see is normal activities on our side.

Anubhav Aggarwal: Okay. That's helpful. Second question is on generic Suboxone. So earlier, you have mentioned that you have enough capacity that you could double your market share, the authorized generic has almost exited the market. Our market share has gone up, let's say, 15% to 20%. But given our capacity size, we could have got much higher market share. So I just wanted to understand what was the constraint here. The reason I am asking is innovators still have 40% share. So just trying to understand our ability to take market share here.

Erez Israeli: We are able to take more market share, yes.

Anubhav Aggarwal: No. But we haven't done as well as we could have done, like Sandoz, who exited, had 25% share, we could only take 5% share out of that.

Erez Israeli: You ask if there is a constraint? I don't see a constraint on our side.

- Saumen Chakraborty:** So there is always a lag between a contracted and actual reported sales.
- Anubhav Aggarwal:** Okay. You mean to say that you have taken higher share, it will reflect in the future. Is that what you're meaning, Saumen?
- Saumen Chakraborty:** No, I don't want to imply that. But I'm just saying there is always a lag, which is there between the two. That also you need to keep in mind. I am not implying anything.
- Moderator:** Thank you. The next question is from the line of Neha Manpuria from JP Morgan. Please go ahead.
- Neha Manpuria:** My first question is on the India business. I know that the Wockhardt deal is still pending, but what's the thought process post the completion of that acquisition? What are the key areas that we want to focus on in that business?
- Saumen Chakraborty:** So right now, we are looking for the closure because a definitive agreement was signed, but the closure is contingent to completion of all the conditions precedent. And along with the closure, we'll have the full integration plan, and then we can give a full response to your question. Right now, it is too premature.
- Neha Manpuria:** And by when do we expect the closure, sir, of the deal?
- Saumen Chakraborty:** It should be happening during this quarter. We'll get back to you whenever it happens.
- Neha Manpuria:** My second question is on generic Vascepa. Post litigation win at the district court, just wanted to get a sense on where we are in terms of the product with the FDA?
- Erez Israeli:** So it's a great win for us. And we believe that this is a product with a lot of potential. And right now, and as you know, there is still a legal process in there, and we are working towards exploiting the potential of this one.
- Neha Manpuria:** But do we have a target action date on this? Or is there a CRL on this from an FDA perspective?
- Erez Israeli:** There is no regulatory issue on this one.
- Moderator:** Thank you. The next question is from the line of Prakash Agarwal from Axis Capital. Please go ahead.
- Prakash Agarwal:** Sir, just one statement you made on the U.S. business, COVID-related stocking in the U.S. So can you quantify that roughly? And also, the stocking continues? Or the previous participant asked that volumes have come down and you mentioned your volumes are okay. So are you the beneficiary of some shortages in the market? If you could clarify that as well. Thank you.

- Erez Israeli:** So in the end of March, indeed, there was some piling up of inventories in the U.S., preparations for the COVID-19 situation. This is not happening anymore. Now it's a normal trend of activities. There is nothing special now.
- Prakash Agarwal:** Okay. But sir, you mentioned that your sales are okay. I mean you're not seeing a drop. So I was just thinking if this onetime COVID restocking not happening, are volumes going up due to some shortages or some new launches are taking that share? If you could just clarify that.
- Erez Israeli:** First, we have new launches and we launched also in the end of March, and we continue to launch also in this quarter. This is absolutely helping us. We have some products to gain market share, and we expect also to get more. Overall, like I mentioned, so far, it is normal, I would call it normal way of doing business in the United States.
- Prakash Agarwal:** And lastly, if you could give any guidance in terms of number of product launches like you gave last year in the U.S. and also outlook on PSAI business? Thank you, sir.
- Erez Israeli:** So, I mentioned in my script, it was about 25 products for the U.S.
- Prakash Agarwal:** And outlook for PSAI business? Since you mentioned you have been filing a lot DMFs, how should we say since in the past, it has been like single-digit growth with muted margins, how do we see this business scaling up over next 12 to 24 months?
- Erez Israeli:** It will be a great business going forward. We are not giving guidance as you know.
- Moderator:** Thank you. The next question is from the line of Nithya Balasubramanian from Sanford Bernstein. Please go ahead.
- Nithya Balasubramanian:** So, the first question is on the U.S. pricing environment. So can you tell us a little bit about what you're reading right now post COVID, if pricing is better because supply is more important right now than pricing. And my second question was around SG&A and productivity improvement. You've obviously done really well in the recent past. So is this right now at an optimum level? Or do you think there are more efficiencies to be extracted?
- Erez Israeli:** So, on the first question, the pricing situation in the U.S. got stabilized over time, and every year is getting better. So naturally, there will be continue to be price decrease in the U.S. This is the business model, but it got stabilized versus the years before.
- Nithya Balasubramanian:** But do you think COVID still specifically is helping or...
- Erez Israeli:** Maybe, but it's yet to see. We need more time for that to see the pattern. Right now, I cannot comment on COVID-19, I really don't know. On the productivity, it is not cost, it's productivity. We were able to make and generate the growth actually without adding to our infrastructure costs, even including the inflation and this is primarily by leveraging the activities in our sites, in our R&D, in our marketing, to do more at some place, some place to do more with less. We are not yet at the productivity level that I expect to be. So there is more potential for productivity

improvement in the company going forward; in some areas, even much more. We have a quest to be the most productive organization in what we do, and we are on the way there.

Nithya Balasubramanian: Are there specific areas that you can highlight? Is it sales force productivity or manufacturing, cost optimization, what specific levers do you think you will be focusing on going forward?

Erez Israeli: First, it's about to leverage the activity globally. It means that if we have one product, we want to sell it in many markets, and to give that service to as many markets as we can from one operation center. Then the manufacturing to do it to be modernized, digitized facilities that will be able to do it in the most efficient manner, then the time to market, the cycle time of the activities and of course, also the other, it means lean SG&A, including the markets. So productivity is everywhere. But the primary cost that we have is naturally on the back end, which is the stuff that we are buying plus the sites that we have.

Moderator: Thank you. The next question is from the line of Vishal B from Aviva Insurance. Please go ahead.

Vishal B: The higher growth in Europe that we saw in this quarter was mainly led by some large tenders? Or I mean, any other important aspects that you would like to point out here?

Erez Israeli: It was a better performance of the European teams in five countries, but primarily in Germany, plus new markets that we entered primarily with injectable products, meaning Spain, France and Italy. So, it's a combination of the few, it's not just one product in the market. It's an overall activities, better performance of our European team.

Vishal B: Okay. And what would be your guidance for the whole year of 2021 in terms of growth in Europe that you see, some qualitative view?

Erez Israeli: We are not sharing guidance, sorry.

Vishal B: On the receivables, could you elaborate a bit more as to what led to the increase in receivables and what would lead to the increase?

Saumen Chakraborty: Part of the receivables is in line with the increase in sales, but part of the receivables was because of some collection, which we saw in the recent months, we have been able to do it. So that's why I say that temporarily what got increased in the quarter ending March will get normalized in the quarter going forward.

Vishal B: This increase was primarily in India or...

Saumen Chakraborty: Overall, it is both in India as well as some other markets. But overall, our cash cycle remains in line with what it was in the previous year.

Vishal B: Okay. And lastly, some qualitative perspectives on Suboxone film as to how do you see the pricing, the competition shaping up? Any perspective on this?

- Erez Israeli:** It's going to continue to be a great product for us.
- Moderator:** Thank you. The next question is from the line of Kunal Dhamesha from Systematix. Please go ahead.
- Kunal Dhamesha:** So, my first question is related to capital deployment. Now that we are net cash surplus and we are kind of generating 2,000-plus crore of cash every year, I think the Wockhardt acquisition that we have done would largely be paid through the cash accrual only. So post that, what are our priorities, given the COVID challenges, are we seeing enough opportunities in India to invest or whether share buyback is on the cards?
- Saumen Chakraborty:** So, in terms of deployment categories, our primary lever for growth has been always on the R&D side. So R&D and technology along with innovation will be one area of deployment. And as I already mentioned that in next year, we would like to even spend more on R&D with an absolute amount. So that will be there.
- Inorganic growth, we have been focusing, but very strategically, with the articulation which Erez has already done earlier in the past. We have chosen specific spaces where we want to attain leadership. In line with those specific spaces, we are thinking strategically about inorganic growth. And we are very comfortable in terms of our balance sheet, so it should not be difficult for us if we get right kind of target to move on in that particular area. We are deploying quite a bit of resource. I will go beyond capital in terms of overall resource even in terms of capability building, including the digital, because this is one thing which we feel will help us, both in terms of improving productivity and creating real differentiation.
- So there have been certain platforms where we have taken some early advantage, but there are many platforms where we really want to build end-to-end digital capabilities, and that includes even application of AI, machine learning as well as all the analytics. So there have been, as I talked in my media presentation earlier during the day, that the cash outflow has been less during FY20, but there were projects which were approved, so further investment will be there, mostly in injectable area and also our biosimilar capacity expansion. So that will be another area of capital deployment, which would be there. Beyond that, in terms of our organic expansion, whether it is in terms of marketing, brand building, and also in some of the new markets within the emerging markets area, there also we'll be deploying our resources. Does it respond to your question?
- Kunal Dhamesha:** Yes partly. So on capex side, how much we are planning to put for biosimilar and injectables? And what would be our maintenance and basically the development capex for, let's say, this year or maybe next couple of years?
- Saumen Chakraborty:** So granular details, I will not be able to give you. But overall, the capex for FY21 could be in excess of 1,000 crores.

- Kunal Dhamesha:** And my second question is related to the launches, let's say, in Germany, France, Spain, Italy, so the new product launches that we are doing, are we launching the same product that we have in the portfolio, like you have said that you will be leveraging whatever product portfolio we have, or as of now we are launching new products?
- Erez Israeli:** Yes. Now, that's exactly there. If you recall in previous discussions, we said that we want to leverage our portfolio globally. And the products that we launched are primarily products that we have also in the United States, or we will have in the United States, depends on the time of launch.
- Kunal Dhamesha:** And based on that I'd say, believe we have a long runway to go in terms of product launches, because we have 100-plus products in the U.S.?
- Erez Israeli:** Yes. And we will have much more in the U.S., and we will have much more in Europe. We just started to open in Europe.
- Moderator:** Thank you. The next question is from the line of Sameer Baisiwala from Morgan Stanley. Please go ahead.
- Sameer Baisiwala:** Is it possible to update us on generic Copaxone and NuvaRing in terms of timelines to resubmit data with the FDA?
- Erez Israeli:** Yes. So, we are working on both CRLs, and planning to submit it within the next few weeks to months.
- Sameer Baisiwala:** Would this be getting to market in the current fiscal year?
- Erez Israeli:** I don't know. I learned from these two products after we got multiple CRLs, so they're better not to predict. Once we will get approval, we will launch it.
- Sameer Baisiwala:** My second question is can you update us on the business plan for China in terms of where are we in terms of product filings and how do you see the ramp up going forward?
- Erez Israeli:** China is a very important market for us, and we ramped up our activities there. So we are not sharing yet specific numbers for China. But let's say, the strategy that I communicated in the last meeting in San Francisco is still valid.
- Sameer Baisiwala:** Okay. And one final from my side. In terms of your capacity utilization now, how is it versus pre-COVID across your network?
- Erez Israeli:** We never stopped working. We had some bumps for a couple of weeks, but we never stop working. And overall, there will be no impact that is related to COVID-19 production.
- Moderator:** Thank you. The next question is from the line of Kishore N from Motilal Oswal. Please go ahead.

Kishore N: Just would like to understand the gross margin, is there any inventory-led write-off if adjusted for that, then what would be the gross margin implied for the quarter?

Saumen Chakraborty: I cannot get into that finer level of details. I say that normally, the price erosion, which happens that impacts gross margin. We have been always trying to improve productivity and various other measures to contain that. But there was a specific sequential decline, I said the inventory write-offs as well as the change in the business mix because you've seen there are certain business, for example, Europe has grown tremendously. And if the branded market sequentially has declined, it has its consequential impact on the overall gross margin for the organization.

Kishore N: Understood. So would you like to call out for like FY21 range of gross margin?

Saumen Chakraborty: See I have earlier also said the way we put our business model, it is we deliver a gross margin, which is north of 50%. If we look at how we have done over various quarters across several years, it fluctuates, but it could be fluctuating from quarter-to-quarter with some specific events in that quarter. Normal expectation range will be between 52% to 54%.

Kishore N: And similarly, on R&D as a percentage of sales?

Saumen Chakraborty: Difficult to predict. It will depend on how much will be the sales. But R&D on an absolute, as I said, will increase. You can take it up 9% to 10% of sales maybe on R&D.

Kishore N: Sure. And just lastly, at least on the India side, where it seems the supply side issues are very much resolved whether it be in terms of capacity utilization or in terms of the distribution of the product. But is the willingness of patient to reach out to doctors, if that takes time, then would it mean that we just continue to change the system, the channel, but ultimate sales would get delayed by 3-4 months?

Erez Israeli: So naturally, there will be an impact on the market because of that reason that you mentioned and it will also impact us. And all of the channels in our case will stay open, and we will continue to serve any customers that we may be. I believe that it will improve in the future once the lockdown will be over.

Moderator: Thank you. The next question is from the line of Nikhil Mathur from AMBIT Capital. Please go ahead.

Nikhil Mathur: I just have one question. Since this COVID outbreak, we have seen that a number of plants, be it for the Dr. Reddy or for the industry, as a whole, a number of plants have been given clearances by the USFDA. But the clearance status that has been given is largely voluntary action indicated and very less plants have been given an action that's no action indicated. So my simple question here is, does the voluntary action indicated leave room for FDA to come back and cite certain noncompliant issues at a particular facility? Or are you confident enough that even with the VAI status, the issue that a facility requires resolve from a 12 to 15 months' horizon?

- G.V. Prasad:** So VAI does not mean they'll come back. It means that the action plan that we submitted is acceptable and the site is clear. NAI is applicable only when there is no action at all necessary. That means there is no 483 at all. So I don't think it has anything to do with COVID, but it's more about GMP status of the action plan and the acceptability of that.
- Moderator:** Thank you. The next question is from the line of Damayanti Kerai from HSBC. Please go ahead.
- Damayanti Kerai:** Sir, can you quantify how much of sales were impacted due to logistic disruption in the quarter? And are we remain confident about recovering most of the sales, which were delayed?
- Saumen Chakraborty:** So we are, again, not giving granular details of how much has been impacted due to logistics. It has been like, particularly in India, we said that. Otherwise, we have been growing very well during the year. Last quarter, in the last fortnight of March, there was a genuine problem in terms of dispatching, and we can only recognize revenue subject to the proof of delivery being there at the end of our distributors. So in terms of recovery, it all depends on how this whole COVID-19 pans out. So we cannot predict at this point of time. But whatever could not have been dispatched due to logistics, when it opened up, they've got dispatched, if that is your question.
- Erez Israeli:** Also to make sure, all the sales that we were not able to recognize in March, naturally, we could recognize when it reached the customer level, that's what Saumen is trying to say.
- Damayanti Kerai:** Sure. My second question is, how you are looking India in terms of launches planned. So last year, obviously, it was very strong year in terms of launches. So how you are planning for next one or two years in terms of new launches for India market?
- Erez Israeli:** It's going to continue to be strong for us as well.
- Damayanti Kerai:** Okay. Similar like 25, 30 launches a year, that's a range we should look at?
- Erez Israeli:** We are not giving guidance on that. It's going to be very, very healthy.
- Moderator:** Thank you. The next question is from the line of Alok Dalal from CLSA. Please go ahead.
- Alok Dalal:** Just one question on the injectable pipeline for the U.S. So your last update says about 30 injectable products awaiting approval. How do you see the launch pipeline for FY21?
- Erez Israeli:** It's the same as last time was discussed. Still a big portion of our portfolio in values is in injectables, and it will continue to be like this also going forward.
- Alok Dalal:** Can you guide, as to out of 25 new launches, how many could be injectable?
- Erez Israeli:** We are not giving this kind of information.
- Moderator:** Thank you. The next question is from the line of Aditya Khemka from DSP Mutual Fund. Please go ahead.

- Aditya Khemka:** So Saumen, did I hear you correctly, so the R&D budget for FY21 you are saying around 10% of sales?
- Saumen Chakraborty:** I didn't say that. I only said on absolute amount will be higher than FY20. It all depends on sales. But I say, approximately, it could be 9% to 10% of sales. That's what I mentioned.
- Aditya Khemka:** Okay.
- Saumen Chakraborty:** But i cannot be accountable for that as a guidance.
- Aditya Khemka:** No, fair enough. And secondly, you also guided towards a capex of over 1,000 crores for FY21. Safe to assume a similar run rate for FY22 as well?
- Saumen Chakraborty:** Too premature to comment on that. I said some of the projects that we've started and approved in FY20, some of that is going to spill over to FY21. So for FY21, I could tell; FY22, we cannot talk anything right now.
- Aditya Khemka:** Right. So my question really is that if you see on your costing side, be it R&D or your capital expenditure, I see slightly you know more higher amounts dedicated to R&D and capex versus six months earlier when we spoke or three months earlier when we spoke. So what is driving this optimism in terms of R&D investments and capital expenditure? Are you guys seeing more demand for which you need more capacity or more opportunities for which you need higher R&D? What is driving this higher expenditure on both R&D and capital expenditure?
- Erez Israeli:** When we discussed our strategy, our strategy suggests that leadership in the spaces that we discussed in the past. So in the past, the main investment was throughout the United States, now we are doing for a more diversified space. So first of all, we have more products through more countries that will require more quantities. The primary investment is that we are going to ramp up to develop more products and more differentiated, so it's a combination of both. On the capacity side, it's primarily more investment in injectable products.
- G.V. Prasad:** And I'd like to add to that, we are also investing in modernizing some of our older plants, and that will require some level of investment.
- Aditya Khemka:** Got it, Prasad sir, thank you. Just one follow-up on that. So we had earlier alluded to an aspirational target of achieving 25% EBITDA margin by FY22. In the wake of the higher capital expenditure and the slightly higher R&D budget that we are speaking about, do you think that's still an achievable target?
- Erez Israeli:** First, I never said FY22. I did say 25% and I believe that is achievable, and we will achieve it.
- Moderator:** Thank you. Ladies and gentlemen, we take the last question from the line of Saion Mukherjee from Nomura. Please go ahead.

Saion Mukherjee: Sir, just on the biosimilar bit, you mentioned about capex there. Is it more to do with the regulated markets or the opportunity you see in the emerging markets? Can you give some more color on the biosimilar business?

Erez Israeli: So the capacity is for overall markets because we are using the products for all the spaces that we are in. We are not dedicating capacity for a specific market. And our products are, by and large, global. So it's a capacity for each one of the relevant spaces that we have, especially on if you remember that we discussed the space of the hospital product. This is a global process for us in which we want potentially to sell to every country that wants to have affordable products with high quality. So this is a truly global business. And as for the biologics, again, it's a global market, in which we will be self-sustained for the United States and Europe with a couple of products in which we will have, hopefully, partnerships that will help us to market those products in those areas and to finance our R&D.

Moderator: Thank you. Ladies and gentlemen, that was the last question. I now hand the conference over to Mr. Amit Agarwal for closing comments.

Amit Agarwal: Thank you everyone for joining us today for the earnings call. In case of any further queries, please reach out to the Investor Relations team.

Moderator: Thank you very much, sir. Ladies and gentlemen, on behalf of Dr. Reddy's, that concludes this conference. Thank you for joining us, and you may now disconnect your lines.