


News monitored for: Dr. Reddys



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Dr. Reddy's Rejuvenation After a bad fall, Dr. Reddy's Laboratories is headed for a turnaround **36**



Gireesh GV for Forbes India

36 Dr. Reddy's Returns

The image is a preview of a magazine page. It features a portrait of a man in a white lab coat, identified as Gireesh GV. The text above the portrait discusses Dr. Reddy's Laboratories' turnaround, and the text below the portrait is a large, bold number '36' followed by 'Dr. Reddy's Returns'.

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Corporate Account

BOARDROOM

Audacity pushed it from its perch as one of India's top drug makers. Realism is helping it make a comeback

by T. Surendar

At Dr. Reddy's Laboratories factory in Bachupally on the outskirts of Hyderabad, a lot of green cover is giving way to brick and mortar. A Leadership Academy — with a large 300-seater Harvard-like classroom, multiple conference rooms, a board room and residential quarters — is getting finishing touches. A steel and glass structure coming up nearby will house the biologics facility, the fulcrum of future growth. Later this year, the company will move its headquarters to Banjara Hills, where the city's rich and influential live. It won't be difficult to assume India's No.5 drug maker is firing on all cylinders. In fact, the company's stock was among the best performers in the stock market last year.

For a company that posted a huge loss just 18 months ago — an after-effect of an expensive acquisition gone wrong in Europe — it is a turnaround of sorts. In 2009, the company lost more than 50 percent of the money it made in the preceding five years. It was no longer among the top 10 players in the domestic market, having failed to quickly launch new drugs compared to Mumbai-based Cipla and Sun Pharmaceuticals. Coming months after the sell-off of India's largest domestic company Ranbaxy to Japanese firm Dai-ichi Sankyo, Dr. Reddy's predicament seemed to foretell a bad prognosis for the domestic pharmaceutical sector.

But all that is in the past. Dr. Reddy's, which had vied with Ranbaxy India's drug market sweepstakes in the heady

DR. REDDY'S REJUVENATION

days before the 2008 crisis, is making a comeback: It has launched a sustained effort to rationalise costs, eliminated unviable markets and stepped up new product launches. Revenues and profits have been climbing and a new thrust on biogenerics is taking shape. And it is feeling like the old days again.

Dr. Reddy's renewed charge signals a new hope for the domestic drug industry. In recent times, the government has been considering new regulations for foreign direct investment (FDI) in domestic pharma companies. Mumbai-based Piramal and the Singh brothers of Delhi-based Ranbaxy Lab-

Photographs: Gireesh GV for Forbes India

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U-Turn Satish Reddy, along with his brother-in-law Prasad, has managed to move beyond the company's bad acquisition

oratories sold their businesses citing an exploding investment opportunity in sectors like real estate and finance, implying that the growth phase for the pharma industry was over. But Dr. Reddy's resurgence is proof that there is a lot of steam left in the local market. G.V. Prasad, vice chairman and CEO of

Dr. Reddy's, says, "The entire premise of Indian companies being a globally competitive generic player is not going away in a hurry."

In scripting the turnaround, Satish, MD and CEO, and Prasad have been benefiting from each other's strengths. Prasad, who drives a Mercedes, exem-

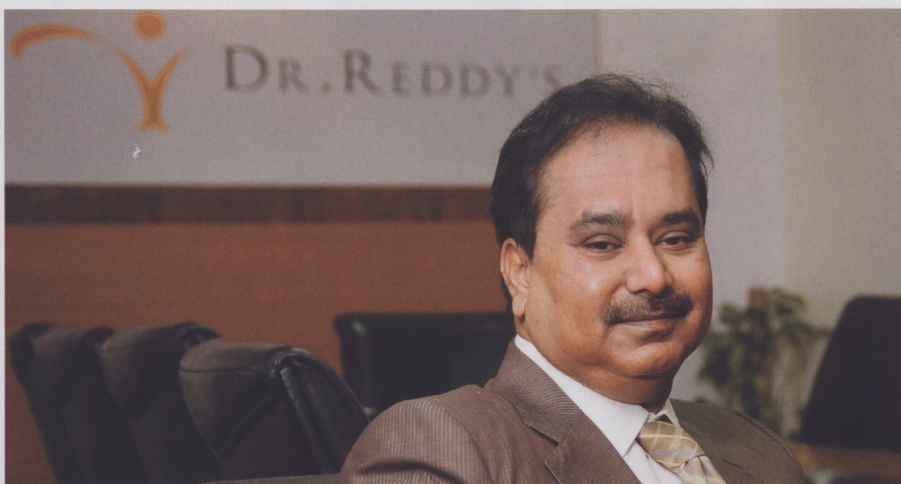
plifies the conservative German car — he is considered the 'thinker'. Satish Reddy who cruises in the sporty BMW is the 'executor'. Together, they have infused a healthy dose of realism into a company that had aggressively pursued growth and spread itself too thin until the day the crisis hit.

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I Think Therefore I Am G.V. Prasad, who drives a Mercedes, is considered to be the thinker in the company

The Failure

In 2006, at a time when Indian corporates were making mega acquisitions, Dr. Reddy's acquired German generic drug maker Betapharm for \$560 million. Despite reports that the German government was about to change regulations to force down prices of drugs, Dr. Reddy's took a risky bet, out-bidding competitors like Ranbaxy in a hotly contested battle. The new regulations, which came after the takeover, said that generic drugs could be sold only on a tender basis rather than as branded products as it was done till then.

Two years after the acquisition, Dr. Reddy's was forced to write down nearly half its investment in losses. It had a reported over \$1.5 billion in sales in 2007 and \$220 million in profits; it posted a loss of \$200 million in 2009. Reddy says, "The lessons from the wrong acquisition forced us to re-think everything we knew about running the business."

As a business strategy, the deal did make sense. The German market was

the second largest generic market after the US. Often patents for drugs expired much ahead of the expiry date in the US. The margins in the German market were also better. Like in India, generics could be branded and detailed to doctors through medical representatives.

But by late 2007, it was evident that the acquisition had been a blooper. "We have no one to blame for the deal but ourselves," admits Reddy. He and Prasad made a call — instead of putting their efforts in merely fixing the acquisition, they decided to overhaul everything they did. And they began taking the hard decisions.

They re-looked at everything from overall costs, to supply chain, the geographical spread and the way management time was being used in the company. Everything was taken a hard look at. Satish says, "It made us realise that we were cost competitive but not cost conscious." Prasad adds, "It is a lesson that we should be present in the market when we are committing such a large investment."

And the Redemption

First on the renewal agenda was, of course, the German operations. The worker strength at Betapharm was slashed from 400 to 80 and the monthly operational costs were brought down from \$5 million to \$1.5 million. About the same time, multinational players like Sandoz set up arms to fight in the new tender-driven system in Germany. Betapharm had already won several tenders, especially for products like anti-ulcer drug Omeprazole, in which it is one of the lowest-cost manufacturers in the world. Prasad says that as the German market settles to the new changes, Betapharm will turn around in two years.

The axe also came down on several markets. In 2006-2007, when everything seemed to be just fine, the company had expanded to 40 countries, including Trinidad and Tobago and Haiti, apart from large emerging markets like Brazil and Japan. In 2008, 30 countries were taken off this list. Even large potential markets like Brazil and Mexico faced the axe.

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A combination of strong local players who understood the supply chain, presence of multinationals in strength and the long gestation period to establish itself in that market meant that Dr. Reddy's management would have to spend a disproportionate amount of time to grow the business.

The company also had an early bad experience when Sanofi-aventis and Eli Lilly fought pitched legal battles to block Dr. Reddy's from launching its drugs in Brazil after getting local approvals. Satish says, "Fighting legal battles for generics in the US is a part of the business model, whereas the Brazilian battle was an unknown risk factor."

Now the focus is to go deeper into the markets the company is present in. In the past three years, sales from Russia have increased from \$60 million to \$150 million. The company has 800 people on the rolls.

Prasad maintains that the company has a good mix of own brands, in-licensed and over-the-counter products to build upon. By 2014, Prasad expects Russian sales to touch \$300 million. Similarly, Venezuela and CIS countries, where Dr. Reddy's has built profitable businesses, will see more focus. "Russia is turning out to be a good story for Dr. Reddy's," says Nimish Shah, pharma analyst with Mehta Partners.

New Genesis

There is one other folly that the company is correcting with a vengeance. In 2002-03, Indian pharma companies had to make a tough choice in the domestic market — between focussing on a few branded drugs and flooding the market with a large number of generic products. Reddy and Prasad reckoned that the advent of product patents would close the window for copycat drugs and chose the first strategy. But Dr. Reddy's rivals such as Cipla and Sun Pharmaceuticals chose the latter strategy. Later developments favoured the rivals and Dr.

Reddy's lost out on the domestic opportunity. (The opportunity to launch copies of old drugs is expected to last a few more years.)

As a result, the company's growth dipped to single digits as against over 20 percent for competitors. Once among the top 10 local firms, Dr. Reddy's was now close to 20th in the pecking order.

At a time when multinational companies are paying top dollar for Indian companies with a large local presence, Dr. Reddy's is now beefing up its domestic strategy. The country's high-growth drugs market is an escape outlet for foreign firms operating in saturated markets.

As part of the speeding-up plan, Dr. Reddy's launched 50 products. This year too, it will launch about as many. It has added over 1,000 people to its field force and is running a pilot to extend

In India, large MNCs may focus on expensive drugs for cities, leaving big gaps for local firms

coverage to rural areas. In the year ending March 2010, Dr. Reddy's India sales grew more than 20 percent to over Rs. 1,000 crore for the first time, but it is still at 40 percent of Cipla in size. Last year Ajay Piramal had said, "For valuation purposes, this is perhaps the best time to have a great domestic play." Piramal has sold his company, Piramal Healthcare, to US-based Abbott Laboratories for \$3.7 billion.

In the US, where it figures as a tiny me-too generic firm, Dr. Reddy's wants to become a large mid-tier company. The plan is to take sales to \$1 billion from the current \$350 million. In the late 1990s, Dr. Reddy's was the original action hero in taking on the large multinationals head-on and launching generic version of their products. It was also the early one to start the

trend of settling with multinationals to arrive at a middle ground to launch drugs. That strategy continues, but says Prasad, "This doesn't mean we won't be aggressive in litigious Para IV filings to launch new drugs."

The New Game Plan

Back in India, the fight is getting only more intense. Reddy says that there is bound to be a power shift from local companies as the multinationals have deep pockets in invest and buyout markets. He, however, feels that these large companies will focus largely in the metros with drugs costing Rs. 40 per tablet and above eventually. Indian companies will operate in several areas within these markets. Going by the increasing health care expenditure, Satish expects that there will be 10-15 large Indian companies. A pharmaceutical expert with a Mumbai-based management consultant says, "The distribution and manufacturing skills of local companies will hold them out against the multinationals."

As an additional differentiation, Dr. Reddy's is increasing its focus on bio-generics, an area not many large companies are focussing on. It already has three products though it competes with Roche, the innovator company of the drugs. Satish explains that the move to capture the biogenerics space is similar to what the company did in the early 1990s to capture the formulations space. Dr. Reddy's has also tied up with Glaxo to put its product skills to better use. Under an agreement, Glaxo will sell Dr. Reddy's products in markets other than India through its global marketing network. With its fully backward-integrated manufacturing facility, Dr. Reddy's offered products like Omeprazole and antibiotic Ciprofloxacin at very competitive prices. That helped it build big brands like anti-ulcer Omez early. Says Satish, "These are some of our flanking strategies to differentiate ourselves." ■