Dr. Reddy's Laboratories Limited
Q3 FY 2015
Earnings Call Transcript

Kedar Upadhye:

Good morning and good evening to all of you and thank you for joining us today for Dr. Reddy's earnings call for the third quarter of fiscal 2015. Earlier during the day, we have released our results and the same are posted on the website. We are conducting a live webcast of this call and a transcript shall be available on our website soon. Just a reminder, the discussion and analysis will be based on IFRS consolidated financial statements.

To discuss the business performance and outlook, we have the leadership team of Dr. Reddy's comprising Saumen Chakraborty – our Chief Financial Officer and Abhijit Mukherjee – our Chief Operating Officer and Investor Relations team.

Please note that today's call is copyrighted material of Dr. Reddy's and cannot be rebroadcasted or attributed in press or media outlet without the company's expressed written consent. Before we proceed with the call, I would like to remind everyone that the Safe Harbor language contained in today's press release also pertains to this conference call and the webcast. After the end of the call in case any additional clarifications are required, please feel free to get in touch with the Investor Relations team.

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

Saumen Chakraborty:

Thank you, Kedar. Greetings to everyone and I wish you all a very Happy New Year.

Let me begin with the key financial highlights. For this section, all the amounts are translated to US dollars at a convenience translation rate of Rs. 63.04 which is the rate as on 31st December 2014.

I am happy to announce highest ever absolute sales and EBITDA for this quarter despite Emerging Market currency headwinds relating to Russian Rouble and Ukrainian Hryvnia.

Consolidated revenues for the quarter are at Rs. 3,843 crores or $610 million. We registered year-on-year growth of 9%. Revenues from our Global Generics segment are at $503 million and grew by 8% year-on-year. Emerging Market geographies grew 16% year-on-year even after sustaining the currency pressure particularly driven by Venezuela and Russia. Revenues from our PSAI segment are at $97 million and grew 21% year-on-year.

Consolidated gross profit margin for the quarter is 58.2% and declined by 230 basis points over that of previous year. The gross profit margin for Global Generics and PSAI are 65.9% and 17.2% respectively. This margin decline is largely attributable to unfavorable currency situation in Emerging Market territories.

SG&A spend including amortization but excluding impairment adjustments for the quarter is at $169 million and has increased marginally over the previous year. We are targeting to realize the benefits of operating leverage as well as cost optimization initiatives across our businesses in the coming periods. Consequent to the decline in the recoverable amounts of certain product / customer contract related intangible asset, a non-cash impairment charge of $8 million was recorded during the quarter. You will recall that we had recorded a reversal of impairment charge of $8 million in the last year, so this causes a swing in the year-on-year SG&A by approximately $16 million.

R&D expenses for the quarter are at $68 million is 11.2% to revenues vs 8.4% in the previous year. R&D spend is in line with our planned scale up in activity and follows the sequential trend.

EBITDA for the quarter is at $167 million which is 27.3% of the revenue and grew 5% over the previous year. Tax rate for the quarter is 30.7% and for 9 months it is 23.5%. However as guided earlier, the annual effective tax rate continues to be in the range of 21%-22%.

Key balance sheet highlights are as follows: Our net operating working capital increased by $65 million during this quarter. This is partly due to buildup of stocks for our forthcoming launches and increase in receivables due to higher sales. Our credit period for various markets and the days sales outstanding ratios have remained largely same compared to the sequential quarter. Capital expenditure for the quarter was at $41 million. Our net debt-to-equity ratio remains at 0.1 despite the cash outflow of $80 million to acquire Habitrol.

Foreign currency USD cash flow hedges for the next 18 months in the form of derivatives and loans are approximately at $591 million, largely hedged around Rs. 59 to Rs. 62 to a dollar. In addition, we have balance sheet hedges of $411 million. We also have cash flow hedges of 945 million Roubles at the rate of Rs. 1.50 to a Rouble for FY15.

Considering the exposure to the oil exporting economies, management continues to monitor the macroeconomic situation and maintain a fine balance between optimizing the opportunity and controlling the exposure.

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

Abhijit Mukherjee:

Thank you Saumen. Greetings to everybody and I extend a warm welcome to you on this earnings conference call.

I am happy to report the satisfactory EBITDA performance by the company in this quarter. All of our businesses continue the progress towards the targeted strategic goals while dealing with market specific challenges. Specifically for the US Generic business while the overall pricing environment has been stable till now, we are experiencing delays in approvals compared to the expected timelines. For the emerging market territories, the declining oil prices and the consequent currency movement is exerting pressure. Our presence in these markets is however very deep and strategic, hence our responses to some of these macroeconomic changes will be long term in nature.

Now let me take you through the key highlights for each of our key markets for this quarter. Please note that in the section all references to numbers are in respective local currencies.

Revenues from North America Generics for the quarter are $274 million and grew 17% sequentially. This growth was primarily supported by new product launches, pickup in seasonality driven portfolio and sustained market share of our key molecules. Like in the previous year, the holiday season induced a bit of forward buying as well. During the quarter, we launched Valganciclovir, Sirolimus and Fluconazole from the Rx Portfolio. Also the Habitrol deal got concluded and dispatches from our side have just commenced. We also launched OTC version of fexo-pseudo D-12. This together with Habitrol will significantly widen our OTC portfolio.

On the Emerging Markets front, Russia continues to perform well with the constant currency growth of 27% year-on-year. This growth was on the back of a good season and some price adjustments taken during the quarter. Due to currency movement, there is a decline of 9% in rupee terms. Our team continues to explore the opportunities for a wider portfolio and higher market coverage. As per IMS, YTD 2014, we are growing faster than the market in volume terms in constant currency. As per IMS OTC YTD 2014, we grew by 10% versus market decline of 1% in constant currency. Out of the other emerging market geographies, Venezuela delivered better than expected growth on the back of continuing volume upside. The contribution from Venezuela has been quite meaningful throughout this year while we continue to watch the currency and funds repatriation situation very closely.

India Formulations business posted revenues of Rs. 433 crores and grew by 11% on year-in-year basis. Some of the orders got deferred towards the end of December and after accounting for these, we are in line with our recent trend of healthy market performance. Our growth and ranking in prescription terms is improving. Launches this quarter include Reclimet XR and Telsartan CT in the chronic segment. Reclimet XR is the first generic to be launched in the Indian market.

Our PSAI business grew by 18% year-on-year, though marginally declined on a sequential basis. Considerable efforts are being made to achieve the twin objectives of sales growth and healthy margins. We are also looking at newer technologies and platforms to revamp our product offering and move higher on the innovation scale.

As you are aware, during the quarter US FDA gave us inspection observations in Form 483 for our Srikakulam API plant. We have responded about a month back to the agency in a very comprehensive manner with our clarifications and the corrective and preventive action plans. We will also be sending periodic updates to the agency giving progress on our committed action points. We will work diligently with the agency to resolve the open matters to their satisfaction.

Before I end, I would like to highlight an important milestone reached by our subsidiary, Aurigene Discovery Technologies Limited. It has entered into a multi-program collaboration, license and auction agreement with Curis Inc. to work on immune-oncology and select precision oncology targets. Aurigene has a responsibility for (a) conducting all discoveries and pre-clinical activities in addition to IND-enabling studies and providing Phase I clinical trial supply and

(b) Curis has the responsibility for all clinical development, regulatory and commercialization efforts worldwide. This is a commercially meaningful deal and validates our successes in the discovery led research area.

With this, I now open the call for questions and answers.

Balaji Prasad: Can you provide some updates on your view on the approvability of your Nexium filing and also the first NDA filing on the proprietary side within FY15 about which you mentioned last quarter.

Abhijit Mukherjee: We have filed Nexium ANDA with FDA however, the exact timing of approval is difficult for us to comment on. We would be looking forward to it. It is an important launch for us.

Balaji Prasad: Have you heard back from the FDA on your filing?

Abhijit Mukherjee: The file is in progress with FDA. At the moment till we hear more from FDA, we cannot really comment on that. It is an important launch for us indeed. As mentioned earlier, that probably in next few months we will have two NDAs filed.

Balaji Prasad: Can we also understand how the currency has impacted your business in Venezuela this quarter because looking at the growth numbers you posted, it looks like there has been no impact or has been the constant currency growth has been better than what you have reported?

Saumen Chakraborty: In Venezuela for our category of medicines, the currency remained stable. What we are really monitoring is the repartition of funds from Venezuela and that is why we are calibrating the sales there. The opportunity is quite huge and we are growing there very rapidly. Actually there is a scope to grow even at a faster rate but we are calibrating that in view of how much cash we are being able to repatriate from that country. However, the currency rate remains same as of now and maybe only after the election this year and with the new government there, they may take some view on the official currency rate.

Balaji Prasad: Will this revenue momentum continue in Venezuela?

Saumen Chakraborty: It depends on our risk appetite and we are calibrating that value to ensure that we stay within the company risk appetite and to that extent we will grow.

Neha Manpuria: Russia has seen already impact from currency taken into account. How is the underlying growth? We did see an improvement in constant currency basis but there were also some concerns on how the volume in the market has been? On the price adjustments that we have taken, is this for our entire product, portfolio, or could we see more price adjustments to offset some of the currency pressure?

Saumen Chakraborty: In constant currency there has been good growth in Russia and in terms of the currency impact, its negative. In terms of the cash flow we are hedged for about 30% at a higher rate than the rate prevalent during this quarter. In terms of the price increases, you cannot take price increase across all products. There are categories which are essential products. For example, Omez will come in that category where we cannot take price increase.

Neha Manpuria: Sir just to rephrase my question the price increase that we have taken on products that are not under price control, has all of that flown through or can we expect some more to come through in the current quarter?

Saumen Chakraborty: That will depend on the currency and if there is more opportunity, one can always look at it.

Neha Manpuria: On the SG&A side in your press release, you mentioned about SG&A increasing because of additional manpower deployment. Is this for any specific business that we have done on the sales-force side or is the general manpower deployment?

Saumen Chakraborty: No, there was nothing specific.

Anubhav Agarwal: On Russia of the constant currency growth of 27%, how much will be the volume growth?

Saumen Chakraborty: Largely it will come out of volume growth, Its more from volume growth than from pricing.

Anubhav Agarwal: From a perspective that given there is currency issue for everyone, there may be a chance that other player's maybe receding. Hence, is there a chance that you put extra inventory in the channel in order that you can get a higher market share when others are receding?

Saumen Chakraborty: We from finance always calibrate multiple things including inventory, receivables etc and then try to calibrate what is the right kind of focus to put in.

Anubhav Agarwal: What would have been your secondary growth in this quarter in Russia?

Abhijit Mukherjee: The data on secondary sales is not fully available. Overall looking at the story in totality, in a market where currency has taken a hit, volume growth has been robust for us. Historically if you look at our portfolio, we have been conservative on the pricing side. Our growth in volume terms has always been higher than the market

where for a lot of competition, it was largely price driven growth. There are some adjustments which we are doing now and there is great volume growth. You probably have picked up the hedging point which Saumen mentioned which you have up to a certain period and then the hit would be a little larger than what is visible today. We are excited about overall performance in the market in terms of volume growth. If you leave it at that, I think probably that will give you an idea of how things are.

Anubhav Agarwal: Given the scenario right now what is your understanding of Russian market? On a constant currency what do you think is the outlook here? Can we grow at about 15% kind of growth in constant currency for next 12 months in Russia?

Saumen Chakraborty: You know very well we do not give any guidance.

Abhijit Mukherjee: It is not impossible.

Anubhav Agarwal: With GDP growth in Russia coming down and 40% of your business coming from OTC do you still have a confidence that 15% is possible.

Abhijit Mukherjee: Pharma is at the lower end of getting affected due to such pressures. The first things which get affected are luxury items. As a sector, Pharma comes in far lower down the line. We are not seeing any of those situations at the moment in pharma. Let us see how it pans out.

Anubhav Agarwal: Of the 68 ANDAs pending, how many of those are from the Srikakulam facility? Secondly does the expectation of about 12 to 15 approvals over next 12-month period which you have been indicating still remain the same?

Abhijit Mukherjee: Cannot fully comment on exact numbers. Your main question was whether the Srikakulam issue is going to impact. We have responded to most of the contents of the observations in public domain. I don't want to go through it. We have comprehensively answered all and as we speak, we are about to send an update on the commitments which are broadly in order. Let us see how it pans out and in any case, there are always alternate plans of keeping the file going. So those plans are kicking in, difficult to comment further on this.

Manoj Garg: Can you confirm whether the Nexium ANDA was primarily filed out of the Srikakulam facility and then two, it is our understanding though I have not at an official warning letter that states that the FDA is withholding approvals out of that facility until the 483 is resolved. Can you update us on that?

Abhijit Mukherjee: Yes, the API for Nexium was from that facility. Alternate plans are being progressed as we speak. Specifically on the facility, we made a very comprehensive response. The actions which have been committed to are on the way. Beyond that, I certainly cannot comment anything more because we have not heard from them after we have sent the response.

Manoj Garg: We were a bit surprised given the number of ANDA filers that they were there on Esomeprazole, in the first wave the FDA choose to prove only one. Can you just educate us a little bit about from the difficulties with maybe the API of that product and what could be causing the lag at the agency?

Abhijit Mukherjee: Since we developed the product, we have some insights but we would not be able to get into great details because that would be public domain information. Bioavailability of complex product and hindrances from the API side because of valid patents (earlier issued) are two major reasons. Both of these combined with, the complexity of the API through non-crystalline route, bioavailability of the finished dosage etc created some hindrances for players. However, we do not know and we cannot comment for others. So I guess these would be the probable reasons.

Manoj Garg: I know you do not provide forward guidance but would you expect generic Nexium revenue in fiscal 16?

Abhijit Mukherjee: We would not comment on that. This is an important file which we will be following up on.

Surjit Pal: Could you please throw some light on what is your game plan for Habitrol going forward? Is there any kind of line of product you were looking for to be expanding to that area? Second question is that given the fact that it is also a Transdermal patch, could you expect that Dr.Reddy's is also thinking into that kind of technology-driven generics going forward?

Abhijit Mukherjee: This is a smoking cessation area which is about a billion dollar in US. Out of which, about $600 million are in gums and lozenges. Patch is only about 200 million market size primarily divided between Habitrol, and the GSK counter-brand. As we settle down in Habitrol, we may naturally progress towards the adjacent gums and lozenges in the sector to see whether we can carve out some share out of this.

Surjit Pal: Are you also thinking to get into Transdermal patch technology-driven product in generics?

Abhijit Mukherjee: We already have filed a few and have a few more in the process of development.

Surya Patra: Wanted to have an update on this Propofol product opportunity. The litigation is over and we have already got the positive verdict on that and possibly we are waiting for the FDA approval, when do we expect this to fructify for us?

Abhijit Mukherjee: We are waiting for the FDA approval. Difficult for us to comment actually, however we will track this closely.

Surya Patra: Okay. See impact, it is already few months now after the verdict is out. So should we expecting in the near future that for Propofol?

Abhijit Mukherjee: Verdict has not much to do with the approval speed. Both are two different streams. We would be waiting eagerly.

Surya Patra: On Valcyte when do we expect the competition to come in? Do you think it is gradually we should be seeing or it would be an immediate kind of competition that one should be expecting for this?

Abhijit Mukherjee: Again I would not be able to guess but I would not say that it will be a jail break type of a situation where lot of companies will launch. It would be somewhat gradual.

Surya Patra: In the last call, we were expecting something like substantial improvement on both the growth front and on the margin front for the PSAI business, but things are not in that line with this quarter performance. What was the kind of issue there or when actually we are anticipating a progressive move both on the growth and as well as the margin front? See this quarter, there is a growth of 21% that is for sure but it is on a low base effect.

Saumen Chakraborty: On the margin, there has been some impact of some slow moving inventory provisioning that we took. Expect the margin front to improve in the next quarter.

Surya Patra: Any visibility that you are providing on the growth front and how will be that really coming?

Abhijit Mukherjee: Yes, so we are calibrating this business. We are very conscious that this is an important strength for Dr. Reddy's. We would do the business in a way in which its more value accretive for the company on an overall basis. So we would be seeking growth in the external sales however it will not be as robust as it used to be in the past.

Surya Patra: That means in a way we are changing our earlier indication that possibly second half of FY15 would see a substantial growth or some sequential growth in that business.

Abhijit Mukherjee: You are right.

Girish Bakhru: A question on US again, on Copaxone, what is the view after the ruling? Where do you see the situation if no approval comes till September 2015 expiry?

Abhijit Mukherjee: We have some way to go. Very recently we got first set of questions from the agency and we will need a little time to do the experiments and a few months to respond and then it will go in a progression. It will be difficult to comment on this thing but it is certainly not in the very immediate future.

Girish Bakhru: Sir can we still call it a 2015 product or would it go to the next year?

Abhijit Mukherjee: We will respond accordingly. There could be some more questions and then beyond that it will be difficult to guess.

Girish Bakhru: On the injectable portion which has been doing pretty well, and if I have to look at the quarter-on-quarter movement of the US side, is it again traction on the injectable product, or the Valcyte launch is a big contributor?

Abhijit Mukherjee: Valcyte is a significant contributor, injectables have also done well. Infact all the assets in that space have done well. You have the market shares. Some new launches have picked momentum. Caduet, Imitrex injection so on and so forth. Rapamune has been a good launch. Difficult to comment beyond that on how things will pan out in subsequent quarters.

Girish Bakhru: Getting to the bigger picture in the US. If I have to look at it where the injectables portion will go from the current dollar 250-280 million, run rate in the next 2 years. Are you working at some numbers that you can probably throw some color on?

Abhijit Mukherjee: About a large part of the filings, portfolio and under-development candidates is in the injectables area. It would certainly go higher as a percentage of the total turnover, in years to come and important thing is we have to keep launching products. In the generic market, everything erodes with time and we will have to ensure that we keep launching. Broadly we are bullish on the injectables space.

Sameer Baisiwala: A quick question on Srikakulam. My understanding has been that over the last few years, FDA generally does not stop product approvals with the 483s. It requires a warning letter, so why is it that for you FDA has taken that stance?

Abhijit Mukherjee: I am not fully certain that there is nothing in between a warning letter and some delay in approvals. Beyond that I cannot comment and if your question is a direct question that whether we will be a getting warning letter, I do not know. That is not our expectation. We have responded comprehensively to the nine observations. We are sending an update as we speak and let us see how that pans out.

Sameer Baisiwala: When you say that there is something between 483s and warning letter, you are saying that by your experience in other sites?

Abhijit Mukherjee: No, not necessarily. Delay in approval leading to a warning letter - I am not sure that this statistics is right but certainly I would look into that statistics but to the best of my knowledge that is not a given situation.

Sameer Baisiwala: Is it suggestive of the severity of the observations in any way?

Abhijit Mukherjee: Observations are in the public domain and you would have read these observations. What is not in the public domain are our answers. We have answered quite comprehensively to all these. Areas which we need to improve are documentation control, more of people training in understanding how to deal with some of the implications so on and so forth.

Sameer Baisiwala: So just a personal thought and since it is very important for everyone, so therefore I am just pressing on that. Sir observations such as readings falling out of specifications being recorded as falling within the specifications, does it not really border on the lines of data integrated issues, what is really our internal assessment on observation such as these?

Abhijit Mukherjee: So what is available and you read are the observations by FDA. What you do not have accesses to are the rationale and the reasoning and the answers on this. So what I am telling you is that we have answered fairly comprehensively on most of these. Are not there insights and learning? - Yes there are insights and learning but we have answered fairly comprehensively to most of the observations. Per se if you read the observations it does not give you the full story.

Sameer Baisiwala: You said that you have got alternate plans are being progressed, I am sure you are referring to the site switch and what is the time site switch for the APIs and if that is the case, how much time do you think this could take?

Abhijit Mukherjee: As a matter of abundance precaution, it is indeed in site switch and tech transfers. We have put highest priority to this. I would not give you the exact timeframe but it is not a long drawn affair.

Sameer Baisiwala: Since Nexium is very-very important to you and to us, therefore my understanding here is based on the other companies' experience you would be required to do stability test which probably is with the new samples from the new site which is something that takes up a fair bit of time. So I would say that anywhere from 9 months to 12 months at the minimum, would you not agree with this kind of timelines?

Abhijit Mukherjee: These are regulatory views, I am not an expert firstly. So if you take exactly similar process, scaled up version of that and then certainly it should not take that much time, it should be much lesser.

Sameer Baisiwala: If it is exactly the same process, you probably are referring to your own site?

Abhijit Mukherjee: Yes.

Nitin Agrawal: On Venezuela, Saumen referred about monetary repatriation situation, how should one read it? What is our exposure right now in terms of our receivables which are there which you need to repatriate and how has it grown over the last few quarters?

Saumen Chakraborty: We get repatriated money at the official exchange rate for our category that means for the medicine category. We have been getting till the month of September-October at a fairly good pace. Off late we have been following it up and that is how we have been calibrating a bit and today the exposure will be in the vicinity of around $30 million.

Nitin Agrawal: In terms of the pending money that we do repatriate on?

Saumen Chakraborty: Pending money to be repatriated.

Nitin Agrawal: So you mean to the extent there is recalibration at the exchange rate that amount will be subject to whatever impairment if the need rises?

Saumen Chakraborty: If the official exchange rate changes, then to that extent we will have to take a hit.

Nitin Agrawal: Are we currently booking our sales and we report them at the official exchange rate.

Saumen Chakraborty: Of course.

Nitin Agrawal: On Russia, with the movement that has happened in the quarter, we were partly covered with the Rouble hedges but have we have to take certain impairment translation losses on the uncovered receivables?

Saumen Chakraborty: No.

Nitin Agrawal: How that be if you not covered the entire receivables?

Kedar Upadhye: Receivables are completely hedged. What Saumen was referring to was the future cash flow.

Saumen Chakraborty: When I talked about 30% of the projected cash flow. When we do balance sheet hedging we do complete 100% everywhere across the globe.

Nitin Agrawal: Going forward what you referring is when the extent of the depreciation the Rouble begins to hit us, our sales realizations will begin to come down. There would not be any real exposure or you will not be exposed to any translation losses on the receivables.

Saumen Chakraborty: Yes, because balance sheet we do it on a regular basis. We keep on doing it on a dynamic basis whereas cash flow hedge is something we do it sporadically.

Chirag Talati: On Venezuela, we have seen a lot of companies globally take on big write-offs based on prudent standards and some companies have even gone on to stop reporting their sales given the currency devaluation risk that is there. How would you view that in light of your growth coming out? How should we view this going forward for next quarter? Is it likely that we should build in a 90% decline?

Saumen Chakraborty: Let us put it this way that if we have crossed $100 million in sales in Venezuela already in this financial year and if suddenly there is currency devaluation by 100%, then we come down from $100 million to $50 million in a dollar term. The thing is that we have grown very rapidly in Venezuela in dollar term given that official exchange rate has already contributed to our P&L substantially. Now what is the exposure today we have is whatever is in cash which is lying in Venezuela, which

has not got repatriated. If devaluation happens, then we will have to take a hit to the extent. In a local currency term what happens in this kind of situation that you get tremendous growth in volume and everybody gets accustomed to take your medicine. So when the situation gets back to normal, you get a tremendous base, something which you have experienced in Russia earlier and something in Venezuela where we have been growing tremendously, people are getting accustomed to take our medicine. These molecules are not new product launches, these are actually quite old molecules that we have, the brands which are quite established and we have been seeing unprecedented rate of growth. So with that, it is a very high base of volume and if you want to continue growth on that, it is good for us but in terms of the total dollar sense, it could be subjected to what would be the currency devaluation whenever it gets up.

Chirag Talati: So over the past 2 months, you received the last tranche in September. Over the past quarter, have you got any pushback from the government while converting your Bolivars into dollars?

Saumen Chakraborty: We have not got pushback. A lot of follow up is required and sometimes it helps even if you do it at a bureaucratic level.

Chirag Talati: How much price increase would you have taken in Venezuela in this quarter given the inflationary pressures there?

Kedar Upadhye: We would not be very specific with those. We have taken some adjustments. Product by product those percentages vary, however, not very substantial.

Aditya Khemka: Sir I have two very quick questions. Firstly on Copaxone, so let us say our generic Copaxone you do not get approval till September 2015. Would that mean that whoever player can manage to get an approval of Para III filers for the 2015 patent, if they can manage to get approval in case they have done full scale clinical trials, those people would get approval at that point in time?

Abhijit Mukherjee: Yes. If anyone has done, there is only one player who has done clinical trial. I am not sure whether they have submitted the data for US but the rest of the two filers ahead of us to the best of our knowledge have similar strategy as we have on characterization. It has to be a good job of characterization and depends on who does that well will get the approval.

Aditya Khemka: Basically I wanted to understand was that for the first-to-file exclusivity for the other two players other than you will the exclusivity probably be forfeited in September

2015 because the third player who has done a full scale clinical trial, would get approval in September 2015.

Abhijit Mukherjee: I would not be able to comment on such details. We have to discuss this in greater details. As I said, we have got our first set of deficiencies. We will have to work on this respond and we may be getting a few more questions and we will focus on our own approval because we do not know a lot about others actually. It is not in public domain.

Aditya Khemka: What I wanted to also understand in this case is so these follow-ups that you have gotten from the FDA, are these follow-ups in excess of the selective gene expression studies that the FDA had previously asked you to do or is it just some clarification on these selective gene special studies that FDA had asked you to do?

Abhijit Mukherjee: It is based on characterization. So naturally FDA would be looking at a lot of confidence on robustness of process and characterization and other things. The questions are in and around that and so there is a lot of additional effort which has to be given to answer those questions. Specifics again let us leave it for the time being but in a characterization based approval for a product like this, FDA is looking for a lot of confidence that it would indeed be the similar fingerprint.

Aditya Khemka: My second question is on your SG&A expenses, the Y–o-Y growth that we have seen, is it that our SG&A expenses in Russia would have also decreased because of the Rouble issue? Is it that the Russia expenses have actually fallen Y-o-Y while the rest of the business, SG&A expenses have grown at a normal pace thereby giving us this blended sort of low single-digit growth in overall SG&A expenses. I am talking about excluding the amortization expense.

Saumen Chakraborty: Yes, so you are right to the extent that Russia would have helped us in terms of getting some benefit on SG&A.

Dheeresh Pathak: What percentage of our business in Russia is under price control?

Kedar Upadhye: Almost half of our business is under price control.

Dheeresh Pathak: Okay and in terms of when you are reporting to us the Russia sales and the related costs, now the sales you are reporting at the hedged exchange rate, the costs also then you are reporting at that exchange rate or you are reporting at the spot?

Saumen Chakraborty: No, that will be at spot.

Dheeresh Pathak: Then if it is going to the topline right, costs are being reported at spot.

Kedar Upadhye: Yes, the hedge benefit goes to the topline, (material) costs for a large part of the portfolio is in Indian rupees. It is in rupees anyway.

Dheeresh Pathak: The sales and marketing costs in Russia.

Kedar Upadhye: Yes.

Dheeresh Pathak: So that will be at the spot exchange rate calculation right?

Saumen Chakraborty: Yes certainly, right.

Dinesh Pathak: Okay, second question sir would be Srikakulam API plant, what would be our exposure currently including the PSAI business?

Abhijit Mukherjee: We cannot speak on those things. As we said, let us focus on moving ahead with it. Let us be forward looking rather than what the exposure on things of that sort.

Dheeresh Pathak: In Russia, there have not been any price increases in this quarter but given the depreciation, one would have expected a lot of price increases. So any particular reason that price increases have not happened?

Kedar Upadhye: We have taken some adjustments during the quarter on the nonessential portfolios.

Dheeresh Pathak: When you said 27% growth you said all of it is volume. So I thought there is no price increase.

Saumen Chakraborty: We did not say all. We said major part of it comes out of volume when there was a specific question.

Dheeresh Pathak: Is there any price increase that you have taken towards the end of the quarter which is not fully reflected?

Kedar Upadhye: Could be Dheeresh.

Nimesh Mehta: I am trying to understand the impact of the currency, fluctuations in Russia for the quarter and at the same currency, what should be the outlook because of that?

Saumen Chakraborty: Yes, outlook is very difficult.

Nimesh Mehta: No**,** assuming the same currency I mean.

Saumen Chakraborty: Right now one cannot really think of hedging the Rouble. The forward premium is very high. Which way the Russian currency is going to behave is anybody's guess.

Nimesh Mehta: What is the impact in this quarter like how much hit have we taken and is it like reflective of the entire impact or it is just part of the quarter that has got impacted?

Saumen Chakraborty: Had there been no depreciation of Rouble against Indian rupee, we would have reported at least 100 crores more on profit.

Nimesh Mehta: The 100 crores is the impact this quarter and this is reflective of the full impact for the quarter or it is like because Rouble depreciation happened sometime in the end of the quarter, it is still not full impacted.

Saumen Chakraborty: You are only comparing year-on-year basis.

Nimesh Mehta: Right but on a year-on-year basis, the currency in this quarter had changed significantly right in the start of the quarter and the end of the quarter?

Saumen Chakraborty: Yes.

Nimesh Mehta: So this if the current rate were to be there in the start of the quarter, the hit would have been more than 100 crores, is that a fair understanding?

Saumen Chakraborty: Yes.

Nimesh Mehta: Can I get a sense of how much more it could be?

Saumen Chakraborty: Difficult to give it.

Nimesh Mehta: Okay, fine.

Abhijit Mukherjee: I think Saumen mentioned that there was some hedging, so you can calculate. I think this all he read out in his saying that there was hedging and which gone for a while and beyond a point, it will not be there. So based on that, you will have to make some assumption.

Nimesh Mehta: We were to expect some kind of a launch from our acquired company OctoPlus. Where are we and I just assume that it would be a high value launch, so any outlook on that?

Abhijit Mukherjee: These are very complex injectables and liposomal products. They are in a stage of development where one or two are getting closer to exhibit batches and there is also a clinic to follow these. Something can be smaller and something can be a little longer. If you are saying that is it going to be filed very soon, then NO; may be within a few quarters, YES.

Nimesh Mehta: Earlier we were talking about within next four quarters that is no longer there. So it is like largest like are free about a year away even the filing.

Abhijit Mukherjee: I am not sure exactly what we messaged. I would not be able to comment on that. We are progressing on. These are complex products, each of those have its own challenges of understanding very deeply. One thing we are clear that no, some of these products, others have not cracked which probably gives you an idea of the level of complexity. So as and when we succeed that, this will be much more sustainable than other products.

Nimesh Mehta: Understood, fair enough and are you going to conduct R&D day that you were otherwise telling last quarter?

Saumen Chakraborty: Yes, we will but we have not yet decided the final date. We will communicate with you as soon as we decide.

Anmol Ganju: The secondary sales data for the Russian market is not available but would it be fair to assume that the growth in that market has been accompanied by market share gains because 27% constant currency growth thing is the underlying growth of the market and also given that the price increase has been rather modest. What would you attribute this to in terms of competitive behavior because there has been market share gains at the expenses of someone else? Would it be fair to assume that their risk appetite is slightly different from ours?

Abhijit Mukherjee: Some of the articles have come in public domain as well. When a turmoil of this sort hits Russia and in Russia people have seen, this is not the first time one is seeing a bit of a turmoil, there is some bit of forward buying directly by patients, anticipating price increases and such things. Overall we do not have official data but there is good secondary movement because some of it, how long and how will it sustain, we will have to see. Part of that has been contributed by forward buying by the patients and also our portfolio is very rich in body ache, cough and cold, fever area. Some of the OTC products are very big, some of the Rx products are very big, so these are not at the top-end of high pricing thus it is not that much affected by this devaluation

aspect, so some of those have played out. We will have to wait and see. There are lot of questions in Russia I fully understand. We are also waiting to see how things pan out. So far so good, it is going okay. Of course there is a hit, there is a big hit 34 to 65 who can make up everything. It is no way possible. This will be more and more as we go along with the quarter but overall performance is robust. I think broadly based on that you draw your conclusions.

Anmol Ganju: On R&D we have kind of guided to a broad range of 10%-11% and although marginally, this will be second consecutive quarter of we having reported (+11%) kind of R&D expenditure. Would it be fair to assume that most of our cost calculation along specific programs is now peaking out and that this is the peak in terms of R&D spend relative to sales?

Saumen Chakraborty: No when there is a Rouble depreciation, obviously in rupee terms our sales is coming down compared to what we have planned. To that extent, R&D as a percentage of sales is becoming higher than 11%. It may be difficult to contain it within 11, it could be (+11).

Anmol Ganju: In terms of an absolute number for the full year for R&D, what is it?

Saumen Chakraborty: The absolute number whatever you plan for revenue will be in similar kind of a range, what we planned in absolute R&D number in INR and at the end of the year will be there but because of the currency effect on sales, it could as a percentage of sales by higher that 11.

Abhijit Mukherjee: This is the fag end of the ANDA filings which are likely to happen in the next few months as we had messaged, we are on track. So some of that has also and going to have some impact as well.

Anmol Ganju: You did mention about forward premiums on Rouble being extremely high. In that environment, would you able to kind of completely hedge the balance sheet as you alluded to. So basically I am trying to understand that the translation losses can therefore be completely ruled out because it might involve us buying forward premiums at extremely expensive rates?

Saumen Chakraborty: No, I think we have a different approach for a cash flow hedge and a different approach for a balance sheet hedge. So as far as balance sheet hedging is concerned, globally we do it. We have been always doing it on a very dynamic basis and every month we basically follow like a square it off whereas in a cash flow hedge, we never used to do it for Rouble. We only used to do cash flow hedge for USD. Rouble, we

started doing a few months back and we have only done it for FY15 and now at this point of time I find it very difficult to do anymore cash flow hedge for the next financial year given the current rate and the forward premium rate which is there but balance sheet, overall global and not country specific. We have been doing well, every quarter we have been reporting some forex gain not of our balance sheet hedging which is being done.

Anubhav Agarwal: On Habitrol, very positively surprised only $80 million you got a product which can give you sales of $60 million, on a back of envelop calculation payback period on this product less than 4 years, is it?

Saumen Chakraborty: No Habitrol, there was a mandate to close their deal between two of them. It was mandated to sell. There would be only limited number of players who could have bought it. So payback period will be few years only.

Anubhav Agarwal: Roughly about 4 years or it will be much longer than that?

Saumen Chakraborty: We will not exactly respond to that, but as you have rightly figured it out, it will not be very long on payback period.

Anubhav Agarwal: On Sirolimus product in the US, when do you expect next competition to come?

Abhijit Mukherjee: We have not heard anything in the market to indicate any immediate entry. Beyond that we really do not know if someone is getting approval but otherwise currently we and the AG Greenstone are there.

Kedar Upadhye: Thank you all for joining Dr. Reddy's Senior Management for our Q3FY15 Earnings Conference Call. In case of any additional clarifications, please feel free to reach out to Investor Relations team. Thank you and good day.

Note: Necessary edits have been made in this document to correct for any factual inconsistencies