

Dr. Reddy's Laboratories Limited

Q3 FY12

Earnings Call Transcript

Kedar Upadhye (*Investor Relations*)

Good morning and good evening to all. Welcome to Dr. Reddy's Q3FY12 Earnings Conference Call for the quarter ended December 31, 2011. Earlier during the day we have released our results and the same are also posted on our website. We are conducting a live webcast of this call and the transcript shall be available on our website soon. The discussion and analysis in this call will be based on IFRS consolidated financials.

To discuss the business performance and outlook we have today G. V. Prasad – our Chief Executive Officer, Satish Reddy – our Chief Operating Officer, Umang Vohra – our Chief Financial Officer and the 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 webcast. After the end of the call in case any additional clarifications are required please feel free to get in touch with Raghavender, Milan or myself.

I would now like to turn the call over to Mr. Prasad for his opening remarks.

GV Prasad (*Chief Executive Officer*)

Good evening and good morning to all participants. I welcome you to our Q3FY12 Earnings Call. I am happy to announce that this quarter's results mark our highest ever quarterly sales and profit performance. On the back of the highly anticipated launch of olanzapine 20 mg in the US market this year our revenues have grown by 46% and net profit has grown by 88% over the same period in the previous year. As you are aware the 180-day exclusivity period for olanzapine runs into the fourth quarter of this fiscal as well and we will benefit from its contribution in Q4 but not at the same level as Q3. It has been our target to leverage the limited competition high-margin opportunities consistently in the US markets. These opportunities will be both in the form of 180-day exclusivity as well as difficult to develop and manufacture products, resulting in longer term sustainable revenues streams. Olanzapine launch is a key milestone for us in this journey. Our partnership with Teva for the distribution of olanzapine 20 mg was also beneficial as a result of offering the full range of products to the marketplace.

Over the next six months we also have a number of other important launches lined up for the US market which will fuel our growth for the next fiscal year. The organization including manufacturing, supply chain and commercial teams are adequately geared to tackle the increased business scale as well as the associated challenges. These launches are the result of the sustained R&D efforts and investments made over the last several years. This should also help us in building a growing and sustainable revenue base beyond FY13.

Now I handover to Umang to discuss the quarter's financial performance.

Umang Vohra (*Chief Financial Officer*)

Thank you Prasad. Good morning and good evening to everyone.

Let me begin with the key financial highlights. All the numbers including those of the previous year in my section are covered at the convenience translation rate of Rs. 53 per USD. Discussion in Satish's section will be based on performance in respective markets' local currency.

Our consolidated revenues at \$522 million for the quarter have registered a year-on-year growth of 46%. This includes \$99 million of revenues related to our revenue share from our partner for olanzapine 20 mg. Growth for the nine months of this fiscal is at 29%. Excluding olanzapine the growth in the quarter over the previous year is close to 23%. Year-on-year we have also benefited from the rupee depreciation against most of the foreign currencies. However, this has to be seen in conjunction with the cash flow hedge loss of \$21 million booked in sales primarily in relation to our hedges on account of olanzapine.

Revenues from Global Generics are at \$402 million and grew by 57% for the quarter and 32% for the nine months driven largely by the US market. Revenues from the Pharmaceutical Services and Active Ingredients which we shall refer to as "PSAI" in this call at \$105 million recorded a growth of 12% for the quarter and 16% for the nine months. Consolidated gross profit margin for the quarter is at 60%. Gross profit margin for Global Generics and PSAI are at 66% and 35% respectively.

SG&A expenses including amortization for this quarter are at \$145 million, an increase of 20% over the previous year. This increase is largely attributable to manpower cost increase, higher distribution cost and the effect of rupee depreciation. The sequential increase that we see in these expenses is largely on account of rupee depreciation.

EBITDA at \$174 million is 33% of sale and grew by 127% over previous year. EBITDA for nine months at \$351 million is at 27% to sales and grew by 59% over the previous year. Vis-à-vis Q2, the profit for the quarter has no impact on account forex benefit due to the hedges which were explained earlier.

The effective tax rate of 34% for the quarter is on account of release of olanzapine inventories in US which is at a higher tax jurisdiction rate. As indicated earlier, the effective tax rate for the full year will remain at 23% which is almost the same rate for the nine months in the year. Adjusting for the interest on bonus debentures, profit after tax for the quarter is at \$98 million, 19% of sales

Dr. Reddy's Q3 FY12 Earnings Call Transcript

with a year-on-year growth of 91%. Similarly adjusted profit after tax for nine months is at \$209 million and has shown a growth of 44% over the previous year.

Key balance sheet highlights are as follows:

Increase in operating working capital by \$124 million from the previous quarter is largely due to receivables of olanzapine which are expected to be realized in the next quarter. Capital expenditure for nine months is at \$94 million.

Foreign currency cash flow hedges for the next 18 months in the form of derivatives and loans are approximately at \$638 million largely hedged in the range of Rs. 47 to 48 a dollar. In addition we have balance sheet hedges of \$425 million. Our mark-to-market losses in our hedge reserve account in the balance sheet on account of cash flow hedges are approximately \$85 million as at 31st December 2011. The corresponding amount as of the current exchange rate of end Jan 2012 is much lower at \$29 million. Net debt at \$413 million represents a net debt to equity ratio of 0.42.

As I end, I am happy to report that we were awarded the Golden Shield Award for Excellence in financial reporting in the manufacturing sector. This is the fifth consecutive award from the ICAI that we have received across the various categories of awards.

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

Satish Reddy (*Chief Operating Officer*)

Thank you Umang. I will now cover the business highlights for each of our key markets.

Starting with the US Generics, revenues at \$235 million recorded strong year-on-year growth of 125%. A large part of this growth was driven by olanzapine. The tie up with Teva was beneficial to us as it helped us generate additional cash flows. Base business growth was quite robust driven by products such as fondaparinux, lansoprazole and omeprazole magnesium OTC. I am pleased to see a steady ramp-up in our antibiotics portfolio and also the Shreveport sales in line with our plans. In the next six months we are gearing up with some important launches and we remain optimistic about the long term growth opportunity in the market. During the quarter we filed three ANDAs and now we have 79 ANDAs pending approvals with the US-FDA out of which 40 are Para IVs and 10 are first-to-files.

Moving on to India – revenues for the quarter are at Rs. 333 crores or \$66 million representing year-on-year growth of 11%. This performance is in line with our expectation of a gradual increase in the growth rates and we are hopeful of returning to industry growth in the coming quarters. Our biosimilars portfolio continues to do well and it grew by 25% over the previous year. During the quarter we also launched 6 new products in India.

On Russia, with revenues of \$54 million the growth in rouble terms was flat at 1%. This was largely on account of delayed onset of winter, leading to lower off take and constrained liquidity. We continue to make a conservative approach with our credit management policy from the market and hence the lower sales number. Our growth as per Pharmexpert data, which is a market research agency in Russia, for the quarter of 23%, continues to be higher than the market and our market rank as at December remains at #12. The performance in the third quarter does not worry us too much as we have seen very robust customer orders in the fourth quarter. For example in the month of January 2012, our sales grew by more than 50% year-on-year, which is in line with our expectations, and we also expect February and March to be good months for us.

Talking about Europe Generics – Revenues at €35 million represents a marginal increase of 2% over the previous year. Revenue from Germany at €23 million remained flat compared to the previous year. Revenues from our Rest of Europe business grew at 5%.

Now moving on to the PSAI business. Revenues for the quarter are at \$111 million. The revenues were flat year-on-year due to staggered customer orders over the coming quarter. In third quarter,

Dr. Reddy's Q3 FY12 Earnings Call Transcript

we filed 7 DMFs including 2 each in North America and Europe. With this, the cumulative filings stand at 513 globally.

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

Q&A Session

Ashwin Agarwal Congratulations to the management team on delivering an exceedingly robust performance and the US geography as has been told in the opening commentary has done very well and we expect even FY13 to be very good in terms of market shares gains, new product launches and exclusive products. Could you please add colour to what you said in the opening commentary particularly for the US post FY13, how do you see that business shaping up and growing beyond the \$1 billion tag?

GV Prasad I didn't talk about \$1 billion, but I certainly remain bullish about the US market. FY13 will be another period of good growth based on the pipeline that is unfolding. FY14 we should continue the growth momentum but at reduced rates since the base will be large enough as well as the number of products going off patent is likely to decline in FY14. Medium to longer term in the US market, I think we will have to diversify our portfolio and look at other dose forms, look at specialty generics, biosimilars those kinds of opportunities to drive growth. But the US will likely remain the largest market for Dr. Reddy's for a long time to come.

Ashwin Agarwal Could we expect products such as fondaparinux which are not known going forward in next 1-3 years in the US which could drive reasonably good and sustainable growth?

GV Prasad The effort is to improve our product portfolio from a complexity and technology point of view. So we hope to add more such products to our pipeline.

Nimish Mehta Thanks for taking my question and congrats for a great set of numbers. My first question is - I just missed in the initial commentary you mentioned some partnership revenue from Teva on Zyprexa, if you can repeat that, that will be great.

GV Prasad Teva has all the other strengths; we had the 20 mg and the ODT. There was an authorized generic in the market. So in order to effectively compete with the authorized generic, it was important to have a full

range of the dose strengths. So we collaborated with Teva so that we can effectively compete against the authorized generic and this we believe has led to better than expected revenues.

Nimish Mehta Did you not mention any number as profit from partnership, I thought you did sir?

GV Prasad I think Umang mentioned the revenue, not the profit.

Umang Vohra \$99 million in revenues is what we mentioned.

Nimish Mehta Okay from Zyprexa partnership right?

Umang Vohra That's right.

Nimish Mehta The second question is if you can explain me better as to what is the net impact on let's say EBITDA because of forex, because you have booked at 53 but you would also be having some costs in dollars. So I am trying to understand how do you look at the margins due to foreign exchange?

Umang Vohra So sequentially there should be no effect on account of forex in our EBITDA that is because the forex benefits on account of the depreciation of the rupee will be offset by the hedges that we had taken for olanzapine in the previous year. So the two are setting themselves off - there is no effect of forex sequentially quarter-on-quarter. Versus the previous year yes, there is an effect of forex but that has been seen in even in quarter two and in quarter one.

Nimish Mehta I see but you translated the revenue at 53 so vis-à-vis whatever we had in Q2, despite that there is no impact of foreign exchange?

Umang Vohra So we will translate at 53 but if we have taken hedges which are at rates which are significantly lower than that, that loss will get booked into our sales.

Nimish Mehta I can see that you had booked the forex losses into books. Okay sir is it fair to say the net foreign exchange that you have realized, is at about 46-47?

- Umang Vohra** I would say if you were to look at our P&L and say what is our average booking rate, roughly will be closer to 48 because the average rate for the period let's remember that is also around 50-51 and the closing rate is 53.
- Manoj Garg** Thanks for taking my question and congrats for a good set of numbers. Just would like to understand what was the average price erosion in olanzapine because of the presence of the authorized generic in the market? If you could give some colour on that?
- Umang Vohra** We are not providing details exactly on product level but it has behaved pretty much like any other product which has an authorized generic and a first-to-file. It is in the range of about 40-50%.
- Manoj Garg** The second question is with regard to olanzapine. Again, when we booked the revenue for olanzapine, was it at the same average rate of 47-48 or have we hedged olanzapine at a much lower rate?
- Umang Vohra** The olanzapine rate is much lower because the hedges for that were taken in the previous year and the rate booking for olanzapine is close to 45.
- Sonal Gupta** Thanks for taking my question. Just a couple of questions from my side. I just wanted to understand there is a net forex gain also in the other income within the net finance income. So can you just explain where all are we seeing the impact of forex gains and losses?
- Umang Vohra** That forex gain that you are seeing in the forex line of the P&L is on account of the difference between the invoice rate and the closing rate.
- Sonal Gupta** Okay.
- Umang Vohra** If the average invoicing rate for example was at Rs. 50 for the quarter and the closing rate was at 53, your receivables get restated at 53. So that gives you a gain but as against that, we always take forward and options and I think that is the net effect of that gain.
- Sonal Gupta** And any hedges which were in the balance sheet for this period have been recognized and are in the top line?

Dr. Reddy's Q3 FY12 Earnings Call Transcript

Umang Vohra So there are two types of hedges, one is the receivable hedge which we call a balance sheet hedge - that gets recognized in this line. The other set of hedges are the cash flow hedges which go to the sales line.

Sonal Gupta Just on the financials is that there is increases in both the debt as well as cash in this quarter could you just explain the reason for that?

Umang Vohra We have a couple of debts which are coming up for renewal now and those will be repaid in this quarter as a result of which when we borrowed the \$220 million we were balancing the short term, long term maturity profile of the debt. So the cash from the \$220 million is lying in the bank. It will repay the short term debt that we were running which was slightly higher than what we were comfortable with, so in the next quarter that will even out. Overall net debt has gone down versus the last quarter.

Sonal Gupta And just one final question from my side, in terms of the base business for the US that is ex-olanzapine have we seen any change in revenues quarter-on-quarter given the different realization rates etc. that are being recognized. So in dollar terms, is there a change there on a quarter-on-quarter basis?

Umang Vohra The Forex impact will not affect the dollar numbers that Satish spoke about, but we have seen more or less the quarter being at the same level as the previous quarter excluding olanzapine and that's on account of the fact that there was an off pricing action on tacrolimus, where we saw a new competitor in the market. So the effect of that has been considered and as a result of that, that is at the same level as Quarter 2.

Sonal Gupta So you're saying then it will be roughly at the \$135 million odd level that we saw in the last quarter?

Umang Vohra That's right.

Bino Pathiparampil Congrats on a great set of numbers. Just to follow-up on the prior question, Umang, if I need to calculate your US sales in US dollars, I probably have to take the rupee number you have given and divide it by 47 or 48 whatever is the booking rate, is that correct?

Dr. Reddy's Q3 FY12 Earnings Call Transcript

- Umang Vohra** No, we can give you those numbers. The US numbers- already we have mentioned in Satish's section were at \$235 million that included \$99 million of olanzapine.
- Bino Pathiparampil** And this is at the actual rate?
- Umang Vohra** This is at actual dollar billing.
- Bino Pathiparampil** A follow-up question, like you have hedges for US dollars, do you have hedges for your other markets like Germany, Russia, etc. the impact of which is showing up in the break up that you give in rupee terms?
- Umang Vohra** No because we are not extensive on the euro as a currency. We don't have too much of a net exposure on the euro so we don't take too much of euro hedges. On the rouble, we only do balance sheet hedging because it is difficult to forecast the rates going forward.
- Bino Pathiparampil** Finally, Satish I was just wondering about this product Plavix in the US, if you could give some colour on what you think about when your launch could be, what could be the competitive dynamics around that?
- Raghavender** Bino, we had mentioned this before that we expect to launch this product next year and this would be a highly generic market.
- Bino Pathiparampil** How many people do you expect to be launching on day one?
- G V Prasad** We cannot predict that.
- Umang Vohra** There are fair number of approvals Bino, tentative and there are a lot of filers so it would be behave like a normal generic market but we are first-to-file on one of the strengths.
- Nitin Agrawal** Thanks for taking my question. Congrats for a good set of numbers. Umang my question is largely on the SG&A expenses, if we exclude Zyprexa we are around 27.5-28% of sales and this is sort of inched up over the last couple of years. Where do you see this stabilizing out for us?

Dr. Reddy's Q3 FY12 Earnings Call Transcript

- Umang Vohra** I'd say that if you look at the YTD Q2 rate and the percentage there, YTD Q2 which is the previous quarter that's roughly where we are on SG&A because we have seen an effect of forex which would go away in the next quarter.
- Nitin Agrawal** But 27% odd thereabout is that going to be an optimal level for us? Do you see any scope for reduction optimization on these levels as we go forward?
- Umang Vohra** I think it should because the US revenue is not linear with respect to SG&A so hopefully it would adjust downwards. But right now we are at 26% to 27%.
- Nitin Agrawal** Because this is on the higher side even when we compare the peer group, it makes us wonder and we have been talking that we have done a lot of these one-time investments in Russia and at some stage it will start to come off. That impact hasn't quite been seen yet in the numbers so I was just wondering if we're going to see some dramatic reduction as we go forward on this.
- Umang Vohra** It won't be dramatic but there would be a gradual reduction as we go forward.
- Nitin Agrawal** And on fondaparinux, how has the market share uptake been for us?
- Raghavender** The market share is about 18% on the prescription side.
- Nitin Agrawal** Last question, we talked about these launches coming forward in the quarter and year ahead. Can you throw some more light on and share some information on some of the specific products you're looking to launch and the timelines for the same?
- Kedar** Nitin most of these products are already in public domain. We have spoken about ziprasidone, we have spoken about quetiapine, and we have spoken about the possible launch of atorvastatin, etc. so most of these are in public domain.
- Nitin Agrawal** I guess quetiapine also would be a fairly competitive launch for us, right?

- Kedar** Yes.
- Anubhav Agrawal** Just one question Umang, on your reported gross margin just for the Global Generics segments excluding olanzapine, sequentially there is a decline. Is that only because the DEPB benefit is going away or is there more than that?
- Umang Vohra** Let me answer it in a different way. I'd say it's because of some amount of DEPB going out but it is also because the mix of businesses have changed, so if you see Russia this time has been slightly slower in terms of what Satish also explained earlier on the call and as a result of that the average mix of gross profit is lower than what you would see. But structurally the gross profit in each of the geographies is at the same level as it was in Quarter 2. So it is only the mix of businesses that is giving rise to this.
- Anubhav Agrawal** And the DEPB benefit that you have been quoting in the previous call is around Rs. 50 to 60 crores annually so that is the number that we still hold?
- Umang Vohra** That's roughly what you could hold on to.
- Anubhav Agrawal** Just one question on the net interest cost what you have been recording this quarter is around \$3 million as your net interest cost. You have cash around \$300 million right now and gross debt of around \$700 million, at what rate have you taken the debt and at what rate is the cash invested?
- Umang Vohra** There are two parts to our debt, the first is the long-term debt that we did last quarter, that is \$220 million and we took that at LIBOR plus 185 basis points. We have a long-term debt in terms of bonus debentures which we issued earlier that at a coupon of 9.25% and that's Rs.504 crores, that's the two long-term debts, all the others are short-term debts which are for working capital, which are generally in the dollar currency.
- Anubhav Agrawal** And most of the cash is invested at what levels, approximately 5% plus or less?

Dr. Reddy's Q3 FY12 Earnings Call Transcript

Umang Vohra No it should be more than 5%. But we're not giving exact details on that but it is more than 5%. A large section of that was also invested in India.

Anubhav Agrawal Just last question your R&D has been tracking just around 6 to 6.5% of sales. At least in the first half it was the same range versus what you guided last year was around 7 to 7.5%. So would we expect a higher number next year or is this the trend now going forward?

Umang Vohra I think we will maintain the range of 7 to 8% as a range going forward.

Abhay Shanbagh Can you throw some light on how the Russian market has behaved because you did indicate that the secondary sales are at 23% and otherwise the business was a flat 1% growth? So what exactly has happened? Is there so much of destocking which you have done?

Satish Reddy It is not just the destocking. What happened in FY13 is mainly the issue was the delayed winter season. That's something if you actually keep a weather pattern through any of those public data you can make out that it is delayed. So I am also saying it is not a matter of concern that's why I specifically said about the January number. Normally we do not talk about it, but it is clear that January itself shows 50% increase in sales. All I'm trying to say about distribution is that they had stocked up in anticipation of higher sales and they have also ended up in some kind of a liquidity crunch. So our response in such situation is we have to be very conservative when it comes to receivables and things like that. So we deliberately held back some sales and that's why you can see the higher January number. I'm saying demand is still there.

Abhay Shanbagh So basically from this quarter we could see the sales ramp up being quite robust for one or two more quarters because of delayed season so it should pick up significantly in the current quarter and drive overall margins?

Satish Reddy This growth rate which we have seen in the earlier part of the year will continue that's what I was trying to say.

Dr. Reddy's Q3 FY12 Earnings Call Transcript

- Abhay Shanbagh** The other one was on fondaparinux, you have been saying that volume ramp up should happen, so do we see a significant ramp up in the current quarter with your production constraints largely being addressed?
- GV Prasad** Production constraints are not fully addressed but we now have enough material to slowly ramp up the market share.
- Abhay Shanbagh** One last question on olanzapine, you launched it in late October so the \$100 million is three months of exclusivity, is it two months or is it four months? How do we take that roughly into our numbers?
- Umang Vohra** It is roughly three months Abhay, because there will also be some amount that the partner would have seeded to the channel so it is roughly corresponds to three months of sales.
- Sameer Baisiwala** Satish, I heard you on CNBC talking about OTC portfolio. If I'm not wrong it is now in US \$100 million for nine months?
- Satish Reddy** Yes that's correct Sameer.
- Sameer Baisiwala** And where do we see this by end of fiscal 13 ?
- Umang Vohra** Sameer maybe Quarter 4 of FY13, we could be tracking at the rate of annualized about \$200 million a year.
- Sameer Baisiwala** And the second question is for fondaparinux, when do we expect the hospital segment launch and second when do we expect the production bottlenecks to be fully resolved?
- GV Prasad** I think it will take us another quarter or so, another three months or so to fully resolve all the bottlenecks.
- Sameer Baisiwala** And that's the time when you would be launching for hospital as well?
- GV Prasad** Yeah.
- Sameer Baisiwala** One final question on biosimilars, which are the markets that you find attractive in emerging markets outside of India and secondly where are

we in terms of regulatory filing in those markets for rituxan and filgrastim?

GV Prasad I don't have a complete list of the countries that we're going after readily at this point. But few countries in South America are the focus area now in addition to one or two countries in the Middle East. Collectively they are not huge, maybe third fourth year from now we will see cumulative revenue of about \$100 million from emerging markets.

Sameer Baisiwala For biosimilars?

GV Prasad Yes.

Sameer Baisiwala And this includes India?

GV Prasad Yeah, it includes India.

Sameer Baisiwala And versus this what would be the number for fiscal 12?

Umang Vohra About close to \$30 million.

Sameer Baisiwala And what is the timeline for us to go from \$30 million to \$100 million, a year, two year or what is the timeframe we are looking at?

GV Prasad 2 to 3 years.

Prakash Agarwal The question on fondaparinux, just wanted to get some clarity on the filing status and approval for the European launch?

GV Prasad It is too early to comment on that. We are just in the process of filing this.

Kedar The exclusivity has not yet run out Prakash, after which we would be filing it.

Prakash Agarwal But it would be a FY14 phenomena or could be later as well?

GV Prasad I think filing would be FY13, launch could be a year or so later.

Prakash Agarwal And on the gross margins of PSAI could you share that number?

Dr. Reddy's Q3 FY12 Earnings Call Transcript

- Umang Vohra** 35%.
- Prakash Agarwal** And I just missed on the hedges, if you could repeat what are the outstanding hedges currently?
- Umang Vohra** The outstanding hedges are about \$638 million for the cash flows and \$425 million for the balance sheet hedges.
- Prakash Agarwal** And this \$638 million is spread across how many quarters?
- Umang Vohra** 18 months.
- Prakash Agarwal** These are taken in the range of the present rates at 49?
- Umang Vohra** 47 to 48 a dollar that is the average rate.
- Prakash Agarwal** There was some comment on the DEPB 50 to 60 crores impact, could you please explain that as well?
- Umang Vohra** That's the average level of DEPB that net DEPB deficit that we will have because of the removal of the scheme and it is bottling down to a different scheme. That is for the annual level, the impact is Rs. 50 to 60 crores. So it is not one quarter impact, it is at annual level. So per quarter it will be around 10 to 15 crores or so.
- Prakash Agarwal** And this has already started, this impact?
- Umang Vohra** This has started and it is not significant to our overall margins.
- Bhagwan Chaudhary** One question on olanzapine side, how much market share have we gained there and what we can look forward to, in the next quarter's revenue from this particular molecule?
- Kedar** Bhagwan, market share for the latest week is in excess of 45% and what Prasad remarked is in Quarter 4 we will have the benefit as well because 180 days exclusivity runs till Quarter 4. But obviously we won't be able to comment on the number.

Dr. Reddy's Q3 FY12 Earnings Call Transcript

Bhagwan Chaudhary There was a news some months back that we have some VRS system in Mexico facility, so have we booked some one-time or one-off somewhere from that?

Umang Vohra It was insignificant to our result and we have not even disclosed that as a separate adjustment to our financials. It's a very insignificant amount.

Bhagwan Chaudhary And one final question how can we look at the gross margin level and the operating margins level if we are excluding the olanzapine benefit?

Kedar We don't comment on product wise gross margins.

Ranjit Kapadia Congratulations for a good set of numbers. My question relates to the domestic market except Omez D all other products are showing single digit growth rate and Nise is showing almost 20% de-growth. So how are we going to address this issue and when are you going to aim market growth? We are aiming at market growth for domestic market, so what is the optimum level at which you can expect this growth and how fast can you expect this growth?

Umang Vohra I think Ranjit, the numbers you are quoting are all mass division products which is where I think we had earlier commented in two calls back, that we had a problem with the territory alignment of our field force and that is work in progress. Two quarters back we reported a growth of 5%. The last quarter we reported a growth of 9%, in this quarter we are reporting 11%. We think it will take us a few more quarters, maybe one or two quarters more to get back to at least an industry growth rate but actions have been underway. It is more to do with sales force excellence and that's why in the mass division every product that you would name whether it is a Stamlo, or it is Omez or it is Nise, all our products that go through our mass division and that's where the problem is, so we are correcting them.

Ranjit Kapadia How about the new products introduction in the domestic market we have not mentioned - so are we active or we are slow on that front?

Umang Vohra We are active, we haven't mentioned it this time.

Dr. Reddy's Q3 FY12 Earnings Call Transcript

- Raghavender** We have launched 6 products this quarter and cumulatively this year we have launched about 23 products and good part of this growth has come from new product launches.
- Sonal Gupta** Just on your guidance of FY13 \$2.7 billion, do we still stand by that and do we have a strong visibility in terms of achieving those numbers?
- Umang Vohra** Yes I think we still stand by that and we will be providing further colour to it maybe in May-June post result release. But as of now we stand by that.
- Sonal Gupta** Could you clarify further on R&D spend step up to 7 to 8% which you are keeping for the future, what would drive your expectation on biosimilars related R&D cost etc.?
- GV Prasad** It is a variety of things, we stepped up R&D in generics also. There is also an external partnership driven R&D and of course propriety products and biosimilars.
- Sonal Gupta** Finally could you share what is the capex for this year and what you expect for the next year?
- Umang Vohra** The capex is about \$125 to \$130 million levels, we have already done YTD at \$94 million.
- Ravi Agrawal** Thanks for taking my question and congrats on a great set of numbers. Just a couple of questions, one is the revenues which you have booked from Teva, is there a subsequent adjustment entry which happens afterwards for either charge backs or for any amount which is accruing to Teva or it this is a number which is net to us?
- GV Prasad** It is net to us. But going forward at the end of the 180 day exclusivity period there will be some adjustments. But nothing pertaining to this quarter.
- Ravi Agrawal** So possibly in the first quarter next year we'll be taking some adjustments?
- GV Prasad** Possibly.

Dr. Reddy's Q3 FY12 Earnings Call Transcript

- Ravi Agrawal** Would that be any quantification?
- GV Prasad** It can't be quantified now.
- Ravi Agrawal** As a percentage?
- GV Prasad** No.
- Kedar** Just to clarify the current quarter's revenue will not be adjusted downwards or upwards. It's the final confirmation that we have received from Teva.
- Ravi Agrawal** The second question was, you were mentioning the \$21 million cash flow loss coming into the revenues and I presume this essentially is coming because of the fact that you have taken hedges at a lower rate of 45 as you mentioned. So if I was to look at the revenue numbers on an INR basis for the US, essentially would that imply you take \$99 million at Rs. 45 and reduce that from the Q3 numbers?
- Umang Vohra** If you are converting that to INR yes, you would do that. If you are only looking at dollar then you would not do it because this is largely on account of conversion to INR.
- Ravi Agrawal** Final thing is you have given some OTC numbers in your presentation for Russia. If I could have a like to like numbers for nine months last year if possible?
- Kedar** Ravi we will revert to you after the call.
- Sameer Baisiwala** This is a question on your Fujifilm tie up for the Japanese market; where are we in the transaction. Have you signed the definitive agreement and what are the key milestones that we should look forward to in the next couple of years?
- GV Prasad** We haven't signed the agreement yet; we are still in the process of developing a business plan. The next milestone would be a definitive agreement between them. But I don't think it will happen in the next three months, it will take longer than that.

Dr. Reddy's Q3 FY12 Earnings Call Transcript

- Sameer Baisiwala** On olanzapine, it looks like the innovator has continued to hold a fairly sizeable market share if I'm not wrong it is 25%. So do you think your market share and pricing has pretty much stabilized for the balance part of about 3 odd months or do you think that it will take some more changes over here?
- GV Prasad** Probably stable from now on.
- Prashant** Any update on the alliance with GSK in terms of registrations done or supplies etc.?
- GV Prasad** Nothing of significance. We continue to file and the sales now are very small because only one or two markets, one or two products are opened up. So nothing significant to report today.
- Prashant** And does this form a reasonable part of your fiscal 2013 guidance or will it be very marginal even next year?
- GV Prasad** It will be marginal even next year.
- Hitesh Mahida** Congratulations for excellent numbers. Couple of queries, what were the sales from the antibiotic portfolio in USA and what's your view on the German market, how do you see things shaping up in the future?
- GV Prasad** We don't give product level revenues so we are not giving that breakup of the antibiotics. The German market continues to be a tender driven market with pricing significantly below and that's continuing, there is no new development as such.
- Surjeet Pal** Umang ex-olanzapine if I remove that \$99 million so if I look at it that gives me roughly around for \$422 million vis-a-vis your average in first half is roughly around \$445 million, is it flattish ex-olanzapine?
- Umang Vohra** Yes. Because if you look at Russia and the reason for that is largely driven by Russia and if you look at Russia is largely flattish and that's a pretty significant market. So we are flattish sequentially.

Dr. Reddy's Q3 FY12 Earnings Call Transcript

- Surjeet Pal** You have mentioned the growth driver in US market, one key product which is missing in that list is Allegra-D 24. How Dr. Reddy is's placed presently in that product?
- GV Prasad** We don't share that level of granularity in products and do not share the price.
- Surjeet Pal** But definitely it is not growth driver in current Q3 sales number?
- GV Prasad** It is not insignificant.
- Kaushik Pal** Just want to have colour on RoW growth, it has been very strong this quarter. Earlier you did mention that there is no effect of GSK. So is it the currency or is it something else? What would be the growth in constant currency differential?
- Umang Vohra** It is largely on account of South Africa and also we have seen Venezuela and actually Venezuela had a devaluation in Quarter 3 of last year but from Quarter 4 the rates are the same and therefore most of the growth in RoW is muted on account of the devaluation that happened in the previous year. But this trend in RoW should hopefully hold out because the markets are smaller and they are growing.
- Kaushik Pal** If I basically look at the last four quarters the growth has been pretty muted so on that base over the next 3 to 4 quarters can we expect robust sort of numbers?
- Umang Vohra** Yeah I think we could look at growth in about 15% but not higher than that.
- Kaushik Pal** Secondly on olanzapine in 4th Quarter, I know you cannot share any number but qualitatively what I would really like to understand is there any level of channel stocking in Q3 which can effect on a run rate basis our revenues in Q4?
- GV Prasad** Possibly. There will be some elements of shelf stock adjustments. So can't rule that out.

Dr. Reddy's Q3 FY12 Earnings Call Transcript

- Arvind Bothra** Just a question on the PSAI business, if we look at it on a sequential basis we have a decline of 6% whereas we did see some benefit from currency. Any comment on the outlook going forward as to the recovery?
- GV Prasad** That's B2B business there is bound to be some lumpiness in the business and it is hard to have a smooth curve in a business which is dependent on product launches.
- Arvind Bothra** But on an annualized basis.....
- GV Prasad** It is not a trend, on an annualized basis it will grow.
- Umang Vohra** Arvind you should look at the YTD growth rate for that business and I think that's the number that we are pretty comfortable with.
- Bino Pathiparampil** Just a follow-up on the Glaxo deal. If you remember at the time of signing the deal, we were all expecting it to be a significant contributor to revenue by FY13. So what has slowed down there and what happened to the plans, is it because of GSK's loss of focus or is it some other procedural issue there?
- GV Prasad** Nothing like that and we didn't say it will become significant in FY13. We said we will start having revenues in FY13 and that will still continue. It depends on what we consider significant, certainly will be tens of millions of dollars but it won't be hundred millions of dollars. To be a meaningful on a billion plus revenue of Global Generics; it is going to take some time.
- Bino Pathiparampil** But it would still be tens of millions of dollars?
- GV Prasad** Right.
- Bino Pathiparampil** Second on the biosimilars, your portfolio of biosimilars is probably one of the best in the world but still I get a feeling that you are not that aggressive in going for active development or partnerships for the developed markets. So is it a part of your strategy that you will wait out a little bit more, do something on your own and before going all out in the developed markets or are you really at it?

Dr. Reddy's Q3 FY12 Earnings Call Transcript

- GV Prasad** I think you should wait for announcements when they happen. I can't tell you how aggressive or not aggressive we are, based on what we are doing today. But certainly it is a part of our ambition to be in the regulated markets.
- George Marrow** I wanted to ask regarding Biosimilars, you have been very successful in India in launching rituximab. Could we expect some biosimilars launching in other emerging market countries where currently some innovator drugs do not have patent protection and could that be a driver for Dr. Reddy's in the future?
- GV Prasad** Yes we are in the process of registering Rituxan and other biosimilars in several emerging markets where the regulation allows the registration as well as the patents along with the launch of the product. Like I said earlier we are expecting in the next two to three years revenue of about \$100 million from the portfolio in emerging markets.
- George Marrow** And the strategy would be similar to one in India coming at roughly 50% discount to the innovator price?
- GV Prasad** It depends on the market in some markets if there is competition, if it is driven by tenders it can change and in markets which are branded and retail it could be higher.
- George Marrow** So far the experience in India, how high do you think you may get in terms of market share, in the markets in which you are allowed to compete with the innovator?
- GV Prasad** It again depends on the adoption rate where there are incentives to save money; certainly the adoption rate is fast. In India we have been as successful as the innovator in terms of volumes, so we expect to be successful where the system drives adoption.
- Prakash Agarwal** A follow-up on fondaparinux, just trying to understand this 18% market share is taking into account retail as well as hospitals or only the retail is 40% of market?

Dr. Reddy's Q3 FY12 Earnings Call Transcript

- Kedar** This 18% of the market is for the entire molecule and currently we are only the retail part of the segment.
- Prakash Agarwal** So we have fairly good market share in the retail segment currently?
- Kedar** Yes that's right.
- Prakash Agarwal** And in next three months you expect to come in the hospital segment as well?
- Kedar** Next three months we expect to address our manufacturing issues totally after which the supply will ramp up.
- Prakash Agarwal** The second question on olanzapine, I was just trying to understand the numbers because what I understand is that it's around \$900 million kind of product and if I do the price erosion that we just discussed, market share for around 40%. The total number comes to around \$100-\$120 million and we have already booked around \$99 million. So have we booked too front loaded or is there something missing there?
- Umang Vohra** The market share is about 60%, you're talking only about the 20 milligrams strength right?
- Prakash Agarwal** Yeah.
- Umang Vohra** So the market share is about 60% for our partner.
- Prakash Agarwal** Did I not hear 45%?
- Umang Vohra** That 40 to 45% was the price erosion.
- Prakash Agarwal** So basically 60% market share and possibly it's quite front loaded as well, makes sense?
- Umang Vohra** We don't think so because this is in line with the estimates that we had earlier as well. So we don't think that it is front loaded, it is going as per what we have thought it would pan out to be.
- Prakash Agarwal** So for the next quarter other than the little pricing erosion we don't see much of a diminutive value?

Dr. Reddy's Q3 FY12 Earnings Call Transcript

- Umang Vohra** The only thing I will caveat here is that the little pricing erosion may be quite significant to the shelf stock which is lying in trade because exclusivity expires so we can make an estimate of shelf stock which is in trade.
- Prakash Agarwal** In that case, do you adjust the number and then report?
- Umang Vohra** Yeah we will be reporting net like any other product net of shelf stock adjustments.
- Prakash Agarwal** And just confirming you said the full year tax rate you are expecting around 23%
- Umang Vohra** That's right.
- Prakash Agarwal** And next year you gave a guidance of 20%?
- Umang Vohra** No it will be on the same level.
- Prakash Agarwal** 23% plus?
- Umang Vohra** That's right.
- Prakash Agarwal** So US would continue to be a big chunk of our profits?
- Umang Vohra** That's right.
- Nitin Agarwal** Prasad, I just want to understand - over the next two years from this quarter onwards and I guess for a while to come we will be throwing up a lot of cash. Are there any thoughts about utilization of cash, are we looking at proactively filling in some specific strategic spaces in the roadmap? Or do we see the balance sheet actually accumulating cash as we go along, any thoughts about that?
- GV Prasad** First of all there is some debt. We will pay down the debt. We also have an investment program into clinical development of certain assets so there is necessarily an ambitious expansion program. So I don't see reserving the cash for any inorganic use at this point of time. But we will be watching for opportunities which help us deepen our presence in our

Dr. Reddy's Q3 FY12 Earnings Call Transcript

focus markets. If there is something interesting we will look at it but as of now we don't have a plan for that.

Rahul Sharma I just wanted clarity on the top products market share in the US markets, olanzapine 20mg olanzapine ODT, fondaparinux, Allegra-D24, tacrolimus and lansoprazole.

Raghavender Rahul we'll take the question offline. I could give you the list of market shares.

Kedar Upadhye Thank you all for joining Dr. Reddy's senior management on Quarter 3 FY12 earnings call. In case of any additional clarifications please feel free to get in touch with the Investor Relations team.

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