DRUG MAKER UNDERGOING MAJOR CHANGES UNDER EREZ ISRAELI

Why a New Expat CEO may be Good News for Dr Reddy's

ET ANALYSIS

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Health Gain

ESG Scores of Leading Indian Pharma Cos

Companies	FY19 ESG Score
Dr Reddys Labs	52.5
Cipla	39.6
Biocon	33.5
Torrent Pharma	30.5
Cadila Healthcare	29.3
Sun Pharma	23.9
Aurobindo Pharma	20.3

Source: **Bloomberg**

DRL has the most diversified board among Indian pharma companies

DRL's Board comprises of

- Two Whole-time Directors
- Two Independent Women Directors
- Two Expat Independent Directors
- Four Independent Directors

Source: **Company**

EREZ ISRAELI,
CEO, DR Reddy's Laboratories

DRL's Consolidated Financials

	Mar '19	Jun '19	Sep '19	Dec '19
Net Sales (₹ cr)	4,017	3,844	4,801	4,384
Total Expenditure (₹ cr)	3,211	3,117	3,749	4,686
Expenditure as % of net sales	79.9	81.1	78.1	76.8
Operating Profit Margin (% of net sales)	20.4	19.3	22.2	23.5

Source: **Capitaline**

ET Intelligence Group: Erez Israeli does not mince his words or masks his moves. The hard-nosed CEO of India's third-largest pharma company, Dr Reddy's Labs (DRL), is slashing cost, changing managers, and getting rid of risky and underperforming businesses. DRL promoters, Reddy and Prasad, the men who hired Israeli — first as COO in April 2018 and later elevated to CEO last August — have given him the free reins. But to Israeli, 52, what matters is not 'who leads the company', but 'what the company wants to achieve'.

The Street is tracking every move of Israeli, the only expat CEO of an Indian pharma company. The DRL stock is up over 28% since he took over. The company posted its highest ever quarterly sales (of ₹4,384 crore) for the quarter to December. It was better than expected — thanks to higher margins and growth across segments. The company also turned net cash surplus (of ₹414 crore) in the quarter.

Under Israeli, DRL is fast changing tack. The sole focus, at least for now, is on improving profitability; the company has shed non-core assets in the US in specialty and proprietary products. Its priority markets are India, China and other emerging markets. Total expenditure as a proportion of revenues has dipped in the past 3 quarters, resulting in higher operating margins. 'Cost optimistion' — as Israeli describes the strategy — 'profitability' dominated his recent conversation with analysts.

"DRL has been a good company even before I came. We had to fine tune the strategy…," Israeli told ET in a heavy West Asian accent. "Earlier, we focussed on the US assets, we are now focussing on India and rest of the world and doing so with less risk," he said. "We divested risky assets, which gave us more opportunities across spaces."

Israeli's long stint with Teva, one of the world's largest generic company which was obsessed with cost control, has prepared him for the job at DRL. Rivals in India are closely watching him. "At DRL, he has brought in the culture of accountability and has taken some sharp decisions like killing the company's specialty business in the US and divesting loss-making units," said the CFO of a leading pharma company. Specialty business is a challenging proposition for traditional generic companies since it involves investment of time and resources over a long gestation period.

Since Israeli took over, DRL became the first Indian company to win a tender to supply drugs in China. Some of its manufacturing plants in India have had a resolution of their regulatory issues with the USFDA. The company has also restructured its domestic business to bring about a positive change in the company's growth trajectory. Its recent cherry-picking of 62 brands from Wockhardt's domestic formulations portfolio has also gone down well with investors. "We want to be the most efficient company on earth in our space and we are very far from there," he told analysts at the last earnings call.

A diversified board, expat directors, and decisive promoters probably made it easier for DRL, compared to other pharma companies, to push through the changes. "If it wants to be a global company, then by design there are certain elements of globalisation that a company must imbibe. If the company doesn't find the capabilities in the country, it can get the requisite talent to achieve the relevant capabilities," says the DRL CEO, slowly, picking his words carefully. Spending most of his time in Hyderabad, where DRL is headquartered, Israeli, who flies to Tel Aviv every fortnight to meet his family, is often surprised similarities between the Indian and Israeli cultures and value systems.

Almost 60% of the analysts have given a 'buy' recommendation on DRL (as per Bloomberg data). Analysts Kunal Dhamesha and Bharat Hegde of SBI Caps Securities have observed that the company has seen a seismic change with 18 of its 25 key managers being replaced in the past one year. They estimate the local business to triple in five years.

At a time when large peers have failed to generate positive shareholder returns, DRL shares have posted 29% gain in the past one year – outperforming the ET Pharma Index and Sensex. But even as stock punters cheer, there is lurking worry: in Erez Israeli's master plan to chase short-term numbers, will DRL lose the plot in the long run? For instance, DRL has pared its US specialty business — an area where rival Sun Pharma is heavily investing. In the medium term, only one of the bets would pay off.