

Dr. Reddy's Laboratories Limited

Third Quarter Fiscal 2011

Earnings Call Transcript

Kedar Upadhye (*Investor Relations*)

Good morning and good evening to all the participants and welcome to Dr. Reddy's earnings conference call for the third quarter ended December 31, 2010. Earlier during the day, we have released the unaudited consolidated financial results under IFRS 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 in this call will be based on IFRS consolidated financials. To discuss the business performance and outlook, we have on the call today Satish Reddy, our Chief Operating Officer and Umang Vohra, our Chief Financial Officer. Our Chief Executive Officer GV Prasad is traveling today to Davos for a prescheduled engagement in the World Economic Forum after today's Board meeting and Media interaction and hence he has not been able to join today's call. Please note that today's call is copyrighted material of Dr. Reddy's and cannot be re-broadcast 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 meeting also pertains to this conference call and webcast. I would now like to turn the call over to Umang Vohra.

Umang Vohra (*Chief Financial Officer*)

Good morning and good evening to everyone. I welcome all of you on this call today. I will discuss key financial highlights of this quarter. All the figures referred to in this session are translated to US dollars at a convenience rate of Rs 44.8 per US dollars. For the purpose of business highlights in Satish's section, the analysis is based on performance in respective local currencies.

The financial highlights are as follows. Consolidated revenues for the quarter are at \$424 million and represent year-on-year growth of 10% and sequential growth of 2%. Revenues from our Global Generics business stand at \$303 million for the quarter representing year-on-year growth of 16%. Revenues from the Pharmaceutical Services and Active Ingredients segment at \$111 million for the quarter represent a decline of 5% over last year.

Gross profit margin for the quarter is at 55% versus 51% a year back. This improved margin reflects the contribution from new products launched in the US this year in our Generics segment. Gross margins for the Global Generics and PSAI segments are at 65% and 28% versus 60% and 31% respectively in the previous year.

This quarter, expenses include certain items which are non-routine in nature and total up to approximately US \$9 million. These are as follows: a) there are expenses pertaining to our OTC business in Russia. You will recall that we had committed to building a strong OTC portfolio in Russia. This quarter has seen a higher spend on the Top four OTC products from our franchise in line with the season at Russia; b) In addition, we refinanced the betapharm loan in this quarter and as a result had to take a non-cash charge pertaining to debt origination costs which were capitalized on our balance sheet in line with accounting literature at the time of taking the first beta loan; c) Thirdly, Our spend on litigation in the U.S. has been high especially on the Fexofenadine related litigations of which we expect outcomes shortly. Apart from the above, in the India business we have seen an increase in manpower and associated spends on account of field force expansion done over the last one year. Total SG&A expenses including amortization charges for the quarter and the expenses that I had mentioned to you earlier are at \$142 million representing year-over-year increase of 17%. The year-on-year SG&A increase for 9 months is only 5% which again reflects the nature of this quarter having certain one-time expenses.

R&D at \$29 million for the quarter is at 7% of sales and represents year-on-year growth of 46%. This increase is on account of the significant scale up in our R&D activities this year and going forward, this upward bias may continue to a certain extent and we do expect to keep R&D at about 7 to 7.5% of sales.

EBITDA at \$90 million for the quarter is 21% of sales representing year-on-year growth of 10%. EBITDA for the 9 months of this fiscal is \$261 million and also at 21% of sales.

We expect the effective full year tax rate to be approximately 11 to 12%. In this quarter, the higher R&D charge and build up of inventory for new launches in the U.S. had an impact on tax workings which reduced the

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effective tax rate for the quarter. In quarter four, we expect the tax rate to catch up due to the anticipated launches and we expect to end the year at 11 to 12% effective tax rate.

Profit after tax is at \$61 million and represents 14% of sales and year-on-year growth of 19% adjusting for the impairment charges in the previous year. Profit for the 9 months of this fiscal is at \$172 million and is at 14% of sales.

This quarter our operating working capital increased by \$24 million. Capital expenditure for the quarter is \$52 million and \$139 million for the 9 months of the year.

Foreign currency cash flows hedge options for the next 15 months stand at \$540 million as of date, hedged largely in the range of 47 to Rs. 48 to a dollar.

Our current net debt is at \$216 million and net debt to equity ratio is 0.20.

I will now request Satish to please cover the business highlights.

Satish Reddy *(Chief Operating Officer)*

Thanks Umang. Welcome everyone on the call. As mentioned earlier, Prasad is traveling today to Davos, hence he will not be able to join on today's call. Before we talk about the performance for the quarter, I also wanted to share the news that just came in. Dr. Reddy, our Chairman has been awarded one of the highest civilian honors in the country, Padma Bhushan.

Our performance in the 9 months of the current fiscal, I would say is somewhat mixed. We have launched a number of low competition products in the U.S. and delivered strong growth across the key markets of India, Russia and other rest of the world countries in Global Generics. The benefit from these launches and growth was partly offset by decline in PSAI and Germany. During this period, we have been investing for future growth through higher R&D, spends for OTC portfolio in Russia and field force expansion in India. In addition, as announced in November, we have also agreed to acquire GSK's penicillin facility in the U.S.

Our performance for the full year will be shaped to an extent by the developments in Q4 for Fexofenadine Pseudoephedrine higher strength product and Fondaparinux. The case hearing for Fexo-Pseudo is scheduled to start by the end of this month. We remain confident about our non-infringing position and expect to receive the final judgment before the end of this fiscal. On Fondaparinux, the USFDA audits of our partners' facilities scheduled as part of the ANDA review process are complete. We continue to work with the agency for the completion of the balance procedural part of the ANDA review process. While the launches of both these products were delayed compared to our earlier expected launch dates, we are confident that we will benefit from the limited competition opportunity. If we are able to monetize the Fexo-Pseudo opportunity for a part of Q4, then we will be near the upper range of the RoCE guidance range that we had communicated earlier. In case the outcome of the case is unfavorable or uncertain till the year end, we may end up marginally lower than RoCE guidance range.

I will now cover the highlights for each of our focus markets.

Starting with North America Generics, it recorded revenue of \$106 million for the quarter which represents year-on-year growth of 66% and sequential growth of 12%. This has been the fourth consecutive quarter to demonstrate sequential growth of approximately \$10 million each quarter. This growth is a result of market share expansion in our base business as well as new launches and in spite of delays in the launches of Fondaparinux and Fexo-Pseudo referred earlier.

Let me provide more context on our base business in the U.S. In our May 2010 earnings call, we mentioned that our strategy will include gaining share in our key vertically integrated products. We are pleased to see increase in share in several products such as Fexofenadine at 21%, Omeprazole Rx at 16%, and Ciprofloxacin at 22% based on IMS data ending November 2010. For these and several other products, our contracted market shares are higher than reported IMS shares. Also the IMS tracking tends to have a bit of lag factor. We have been also reinforcing our confidence in Omeprazole magnesium OTC despite a slow initial ramp up. We are now pleased

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to observe that in this quarter, this product was amongst our Top three revenue generators and the product still continues to grow. We have launched 7 new products in the fiscal year to date, three of which were late quarter 3 launches including an exclusivity launch of Zafirlukast and second wave launches of Lansoprazole and Valacyclovir. Our initial contracted market share numbers for these products are encouraging and will be reflected in IMS numbers in the coming months. Q4, we will also see full quarter of sales for all these three products. Our launch of Zafirlukast generated lower than expected sales due to the surprise entry of an Authorized generic; however, we continue to hold a high share of volumes in this niche market and additional competitors post the 180 day exclusivity period could be limited. During the quarter, we filed 6 ANDAs and we now have 74 ANDAs pending approval at the USFDA of which 32 are Para-IVs and 12 are fist-to-files. These outcomes in Q3 for US business demonstrate our ability to launch new products successfully and consolidate shares in key molecules.

Moving on to India, revenues for the quarter are at Rs. 300 crores or \$67 million which represents a 14% year-on-year growth. Revenues are lower than Q2 due to expected season effect. The year-on-year growth in the current quarter was led by volume growth of 8% and contribution from new products launched in the last one year of 6%. During this quarter, we have launched 16 new products in India. Year-to-date, the growth for India has been at 18%. Our biosimilars portfolio continues to grow strongly with a year-on-year growth of 18% till date this year. It has been 3 years since we launched Reditux and we are glad that it is now our top 5 brands in India and it is still growing steadily. Our recent biosimilar launch Cresp is also promising especially after a launch in the oncology segment in this quarter. In addition, we expect an approval and launch of our fourth biosimilar in the coming months.

Now moving on to Russia, the revenues are at \$54 million recording year-on-year growth of 11% and sequential growth of 12%. The growth on the high base of the previous year is led by the volume growth across products. Our market rank is 13th as per Pharmexpert data for the year to date November 2010. Our secondary sales growth of 21% in value and 33% in volume terms for the year to date November 2010 exceeded the market growth of 8% in value and 12% in volume terms during the same period. Our launches in the last few quarters have been doing well on the back of effective branding and marketing efforts. Going forward, we expect a higher mix of OTC and in-licensed products in our portfolio.

Europe generics recorded revenues of 35 million euro representing decline of 7%. betapharm recorded revenues of 23 million euro representing year-on-year decline of 24% due to price erosions caused by tenders this year. Our operating profit at betapharm till date is higher relative to previous year largely on account of actions taken for SG&A optimization in the previous year. In December this quarter, the results of the AOK tender in Germany were announced and we could win only 3 products from this tender. While this is disappointing to us, we had in fact bid at prices which are in line with the margin and profitability thresholds that we had set for ourselves. We are also focusing our growth on products beyond the tender now with some launches expected soon.

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Moving on to the PSAI business, revenues are at \$111 million was flat on year-on-year basis due to the sluggishness in our Services segment. The sequential growth of 12% was largely led on the back of new launches and an improved order book status in Active Ingredients business. This quarter, we filed 9 DMFs that include 2 US DMFs, cumulatively the total DMFs stand at 436 and it includes 159 US DMFs.

With this, I would like to end my part of the presentation and thank you all for the attention. We can now begin the Q&A session.

Q&A Session

- Ranjit Kapadia:** My question relates to this settlement with AstraZeneca for these two products Nexium – Esomeprazole and Accolate. Is the supply of API included in the Nexium launch because this launch is 2014 onwards?
- Satish Reddy:** No it is not, it is not included.
- Ranjit Kapadia:** And Zafirlukast we have launched in November 10 at risk and now the product is without the risk. So is there any possibility of getting for this period from November to two months, any compensation to be paid?
- Umang Vohra:** There is no compensation to be paid. The product is no longer at risk.
- Ranjit Kapadia:** Thank you very much and all the best sir.
- Hitesh Mahida:** Just wanted to know how much one time litigation amount have you paid, litigation settlement amount?
- Umang Vohra:** We have not paid any litigation settlement amount as of yet. What I mentioned in the script that we had communicated, the expenditure on our legal litigation has been high in this quarter.
- Hitesh Mahida:** How much was the refinance of betapharm loan?
- Umang Vohra:** The betapharm loan has been refinanced; it was about 120 million Euro earlier. We have refinance it to about \$110 million right now and it has been refinanced at rates which are more attractive than what the earlier Euro loan was. We are not communicating exactly what component of the total cost that I mentioned to you was on account of the beta refinancing, but you could look at the P&L and probably make an impression of it.
- Hitesh Mahida:** And what is our market share as far as tacrolimus is concerned?
- Kedar Upadhye:** It is about 16%.
- Hitesh Mahida:** Okay sir, thanks, that is it from my side.

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- Kartik Mehta:** If you could explain the low tax rate first and we have had several one-off upsides in this year. So if we look at the pipeline with Fondaparinux and D-24 which could be there effectively for the next year entirely. Can you share the YoY growth for the US business for FY12, would it be somewhere between 15 to 20%?
- Satish Reddy:** We would not be able to give specific sales guidance for next year. Having said that, I think next year what we are trying to say is the growth is also led by limited competition products. So you cannot absolutely count it as one off upsides and Umang can you also explain the tax rate?
- Umang Vohra:** So what has happened in this quarter is that we have had much higher R&D element to the expenses and as you know we get a weighted deduction on R&D which is allowed by the Indian Government. Also simultaneously, for the launches that are to take place in the US including the ones that we launched in late Quarter 3 like Lansoprazole, etc., there have been inventories built up in the U.S. and as a result of these inventors being built up in the U.S., there are some tax adjustments that needs to be made in order to eliminate the profit that is lying in these inventories because these are largely inter-company transactions and that makes a difference to the tax rates. Overall for the full year, we are committing to 12% as we said earlier and quarter 4 will catch up as a result of this.
- Kartik Mehta:** So this 12% is for FY12 also?
- Umang Vohra:** FY11 is 12%.
- Kartik Mehta:** And on the capex, I guess that is for the plant acquisition. Can you share what amount of revenues and when would you record that?
- Umang Vohra:** The capex has already been accounted. The revenues from this - since the capex have been incurred for expansion in our existing facilities as well as the SEZs - . depending on where the capex is spent, some of the revenues may come in a shorter period where as the SEZ revenues typically would take about a year or so.
- Kartik Mehta:** No, I was asking in particular about the plant that we acquired in the U.S. So any timeline when that revenue will be recorded or have you started recording anything?
- Umang Vohra:** No, we have not started recording anything. This would be recorded in the next fiscal.
- Kartik Mehta:** Thank you.

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Krishen Sud: Two questions please. One can you shed some more light on Germany, are you expecting a sequential improvement from here. Is the business profitable post these tender losses and the second question is on Lipitor? Are you expecting to be a participant in the U.S. Lipitor market after the 6-month exclusivity?

Satish Reddy: Yes, we will be a participant on the Lipitor post exclusivity that is correct. On Germany, the situation is like this. Although we have talked about the overall sales growth going down and that is the result of what is happening in the market which is post this process of tender that has happened in the market, what we have seen is steep erosion in prices and that is something that we have to live with, the market has been totally unsettled because of that. So quarter-on-quarter, obviously you are seeing that kind of a decline as compared to the previous year; that is the reality. What we have done is over a period of time, we have also taken steps to reduce the SG&A. As a result of which in terms of profit, we are doing ok sequentially as far as the quarter is concerned. For example last year, you would have had seen a higher expense on SG&A because of higher manpower, but we do not have that this year. So lower sales, but it is still a profitable operation. Going forward, I think based on more tender wins or in spite of the disappointing AOK tender result coupled with the fact that we are trying out a few initiatives to also address the non tender market. So this would start driving the growth, but you have to give it a few more quarters for that to materialize.

Krishen Sud: Thank you.

Bhagvan Chaudhary: Can you update on this Allegra-D24, what is the market size that you are expecting and one more product that is Fondaparinux?

Umang Vohra: Allegra-D24 is approximately \$200 million innovator product and at generic prices, this would obviously be lower. The court case starts hearing on the 31st of Jan and we expect that hopefully in this quarter it would get resolved. Fondaparinux is approximately a \$300 million product, again at innovator prices.

Bhagvan Chaudhary: What is the update of this Fondaparinux, by what time are you expecting...?

Umang Vohra: Our partners' facilities have been inspected and we have been in discussions with the FDA; we are awaiting an approval on this product.

Bhagvan Chaudhary: And how many ANDAs have you filed this quarter?

Kedar Upadhye: We have filed about 6 ANDAs in this quarter. Can we please restrict the questions to one or maximum two per participant?

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- Bhagvan Chaudhary:** Thanks.
- Nimish Mehta:** I have two questions. First of all on Nexium, I understand as per the settlement that Dr. Reddy's will be launching the product on the same day on which Ranbaxy also is going to launch. So can you explain as to how this can happen given that Ranbaxy has 180-day exclusivity and Dr. Reddy's does not enjoy 180-day exclusivity?
- Umang Vohra:** We are not going to comment on competition or their part of the settlement. All we can say is that if there is a 180-day exclusivity, then obviously it is implied that we would have to launch after that.
- Nimish Mehta:** So this is subject to the 180-day exclusivity?
- Umang Vohra:** That is right.
- Nimish Mehta:** Okay I understand and when do you expect generic competition in the usual Allegra Fexofenadine because we were expecting from this month, but I understand nothing has come in, right?
- Umang Vohra:** We do not expect generic competition for Fexofenadine-D24 which is Allegra D24...
- Nimish Mehta:** I am talking about usual, it is currently at risk launch and?
- Umang Vohra:** You are talking about base Fexofenadine?
- Nimish Mehta:** Yes.
- Umang Vohra:** So base Fexofenadine which is at risk launch already has generic competition.
- Nimish Mehta:** Already has generic, non at risk competition. And finally on Accolate, you mentioned that you are expecting after 180 day me-too generics to enter, but our understanding was that because it is a non-infringement, maybe others will have to wait. So anything as to comment on where am I missing?
- Umang Vohra:** We do not want to comment on that and we would rather not comment on that please.
- Nimish Mehta:** Okay thank you. I will join back in the queue.
- Bino Pathiparampil:** Just a question on the Russian and domestic markets, despite the higher spend on OTC and marketing, Russia growth seems to have tapered off after several quarters

of stellar performance. So what has happened historically in this quarter, third quarter has been a very strong quarter as well. So what has happened in this quarter, the same with domestic market despite the sales force being ramped up, we see a slowing growth rate there? So what is your expectation for the full year?

Satish Reddy: The two issues are slightly disconnected. The OTC spend that we talked about is to expand on our OTC sales in a much more classic way than what we did before. So which means there will be more marketing spend on advertising and things like that. So that is the OTC spend in Russia and the field force expansion in India is also to do with our therapeutic and geographic expansion, so that is something we got disconnected from the sales issue that was talking about. As per sales are concerned Russia does look low because of the high base that we had last year that is something that is to be noted, but overall if you see in terms of the market growth trends, our growth as compared to the markets, these indicators are looking really good as per the market research data. As far as India is concerned, it is more to do with a seasonal effect like I have also said, if I see the cumulative growth for the first nine months that is at 18% which is definitely above the market growth rate.

Bino Pathiparampil: So the domestic market you think you can maintain a yearly 20% rate, 19 to 20%?

Umang Vohra: Yes, we expect about an 18 to 20% on a full year basis Bino and that has been very consistent with the way we have communicated in the past two-three quarters.

Bino Pathiparampil: And in Russia, is there any lag impact of the price control?

Umang Vohra: No. I think in Russia what happened in quarter 3 of last year on account of what was happening in terms of pricing control etc. that was a fairly large quarter for most companies including us. So we are seeing this growth that you are seeing in this quarter over a very large base of the previous year's quarter.

Bino Pathiparampil: One final question on the exceptional SG&A of the quarter. Do you mean to say that the entire \$9 million is unlikely to, should be taken off from a quarterly run rate going forward?

Umang Vohra: That would be right and we would also say that in every quarter three, it is likely that you will probably have a slightly higher expense curve because that is the season in Russia and that tends to result in increase in the SG&A.

Bino Pathiparampil: Thank you very much.

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- Manoj Garg:** This question pertaining to limited competition products in the US market, just wanted to understand the overall market with regard to Tacrolimus and how the price erosion and kind of market share is, though you have mentioned around 16%. So effectively like if you look at from the branded innovator price, what kind of price erosion you have seen so far in that market?
- Kedar Upadhye:** Manoj, for Tacrolimus, we have seen Watson coming in for one strength and Mylan getting approval for all the strengths. Typically what we have experienced for this product is it takes a bit of time for the new entrant to acquire market shares. So probably for couple of quarters, we could expect a stable market share; however on the pricing point of view, there is not significant erosion.
- Manoj Garg:** Okay, so we when we talk about the 16% market share, is that the market share of the new prescription?
- R Raghavender:** It is the total market share. So the generic market share will be roughly 30%.
- Manoj Garg:** With regard to Omeprazole though we have been inching up quarter after quarter, is it fair to assume that now the quarterly run rate is somewhere in the range of \$10-12 million.
- Kedar Upadhye:** It is approximately in that range Manoj. What happens is from the external data perspective a large part of our customer data does not get captured in the Nielson database. But the run rate could be approximately in the range you mentioned.
- Manoj Garg:** And my last question before I get into the queue. Despite if one adjust the \$9 million one-time kind of an expenditure in SG&A I think if you look at on a sequential basis, the SG&A expenditure is higher by 5-6%. So it is largely attributed to higher expenditure with regard to OTC industry market or is there something more to read there?
- Umang Vohra:** Can you repeat your question please?
- Manoj Garg:** Like if I look at after adjusting this \$9 million from the SG&A, sequentially the SG&A cost has gone up by 5-6%. So is it largely attributed to the higher expenditure for spending on OTC portfolio in the Russia or there is something more to read there?
- Umang Vohra:** If you adjust the \$9 million it is my belief that you will come to roughly the same SG&A percentage as you had in the half one of the year.

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- Manoj Garg:** Like in terms of absolute number if you see that it has gone up from 530 crores to 565 crores.
- Umang Vohra:** So if that is on account of slightly higher expenditure on India as I mentioned in the script that I read out, we have seen an increase in manpower and associated spends on account of field force expansion. Also for India this quarter also has conference spends which are probably slightly higher.
- Manoj Garg:** How many medical reps have you added during the quarter or maybe in the last nine months in India?
- Umang Vohra:** We added roughly 400 in this quarter; I don't believe we have added any reps in the last quarter.
- Manoj Garg:** Okay, that is all from my side. All the best.
- Suryadeep Das:** I have a question on the Russian market regarding the deal that you had with Cipla and Vitabiotics. Just wanted to have some color to whether these deals are already in progress and if yes then what kind of traction or products should seeing right now?
- Satish Reddy:** The sales for the Cipla's products have already started, it has already commenced. This year we will not have the full benefit but next year we will have the benefit of the full year.
- Suryadeep Das:** And what about Vitabiotics products?
- Satish Reddy:** Also I think we have started sales, the sales have just commenced on that.
- Suryadeep Das:** And just wanted to know if you have any tax guidance for this fiscal?
- Umang Vohra:** For tax we are saying it will be about 12%.
- Suryadeep Das:** On an annualized basis?
- Umang Vohra:** That is right.
- Suryadeep Das:** Thanks a lot.
- Prakash Aggarwal:** Question relates to the gas leaks that happened in December. Any updates there?
- Satish Reddy:** No, I think that issue has been somewhat exaggerated in the media, right. So but the issue is clearly that whatever happened that evening that factory inspectorate which

is statutory authority has given us a notice. We have responded to the notice and we expect further to hear from them. So there are no further updates to that.

Prakash Aggarwal: But the production facilities are all functional and there is no...

Satish Reddy: It is all functional. We have only been restricted on that particular clean room not to produce which was the only thing affected there. So beyond that everything is functioning normally, just one clean room. There may be 10-15 clean rooms material just one clean room which is affected.

Prakash Aggarwal: And the second question is on the PSAI segment. We have seen good improvement in margins as well as the decline has been much lower than expected. So clearly in your press release you are mentioning, but any particular products or what has actually happened. Can you elaborate there please?

Umang Vohra: We do not give product guidance, but I can tell you that the order book in the API business has significantly improved and this quarter we have seen a fair number of products which have been added. The second thing is also in the first 9 months, we have decongested capacity in each of these plants which was limiting our off-take. So the capacities in place, the order books improved, some of the new products are tracking well and we are actually expecting API to do also relatively well in quarter 4.

Prakash Aggarwal: And looking at the fluctuation in margins from 31 to 22 and now back to 28. So what kind of margins do we assume going forward?

Umang Vohra: I would tend to think we don't guide for margins, but I think the historical averages in the range of 28-31 would be probably the right averages to look at.

Prakash Aggarwal: And last question on Euro, we just had an update from you on the forex exposure, but that is largely the US. Do we also hedge our euro sales or sales in Germany or they are all in dollar terms.

Umang Vohra: The sales in Germany are in euro terms up till now, we have not had to hedge this because on a net cash basis, we had very little or very marginal exposure due to the interest and debt principal repayments in euro itself. However, now that we moved this debt to dollars, so the dollar leg is not an issue, but the euro leg now will have, we will be taking a look at it from a hedging perspective for our next year strategy.

Prakash Aggarwal: You said it is a dollar denominated debt. So it is LIBOR plus something is it?

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- Umang Vohra:** That is right. It is LIBOR plus 60-90 basis and for us this is a natural hedge with our business.
- Prakash Aggarwal:** Thank you so much.
- Nitin Agarwal:** I just wanted to check on Prevacid, if you can give us some idea of competitive situation out there and how do you see the product really shaping out over the next couple of quarters?
- Kedar Upadhye:** See on Lansoprazole, there are about 4 players now in the market Nitin, 4-5 players in the market and we could expect a stable market share in the next couple of quarters.
- Nitin Agarwal:** What kind of market share have we been able to get in the initial... it is a very early launch, early days yet for launch, but what is the kind of.....
- Kedar Upadhye:** We have launched it in the month of October. So it is early for the IMS to reflect this number, the market share number.
- Nitin Agarwal:** So I guess, in terms of the full impact of the product is yet to be felt in the numbers, Q4 isn't probably the full impact of the numbers are going to be reflected for Lansoprazole?
- Kedar Upadhye:** What Satish referred to is that all the three launches, Lansoprazole, Zafirlukast, and Valacyclovir are sort of late quarter launches in this quarter. So the full benefit of the quarterly sales will get reflected in the quarter 4.
- Nitin Agarwal:** And secondly when you look forward in FY12, we have got about these two products on Fonda as well as Allegra-D24, before we get some visibility as we go along. When we see the full year, the remaining FY12 clearly the next one year forward, which are the other product launches where you are really comfortable or clear about, the visibility set up is very much there on those launches on some of these limited competition products?
- Umang Vohra:** As of now, we are mentioning only Allegra-D24 and Fondaparinux. We do have a few other products in the pipeline, but we have not been public about it.
- Nitin Agarwal:** Thanks very much.
- Sameer Baisiwala:** Just on the US market, I am just wondering if we see sequentially our revenues are up \$7 million, but what we have is Lansoprazole which is fairly a sizable market,

middle of October launch Omeprazole OTC ramping up plus base business market share gains and little bit of Accolate towards the end of the quarter. So all four of these put together translates into just \$7 million sequential revenue growth. How do you explain this?

Umang Vohra: Sameer, we are looking at \$11 million as \$95 million of last quarter to \$106 million in this quarter.

Sameer Baisiwala: The sequential I am talking about?

Umang Vohra: Yes, that is sequential only I am mentioning. We are looking at \$95 moving to \$106 that is about \$11 million. We also had pricing pressure on Amlodipine/Benazepril. So there have been some adjustments even in terms of stock in trade on account of Amlodipine/Benazepril which has reduced the increase that we are seeing.

Sameer Baisiwala: Okay but 7 could surely be 11, but I would have expected with bunching of so many catalysts, the rise still should have been fairly more meaningful. So is that something that we should expect in the fourth quarter?

Umang Vohra: I think it is a valid point Sameer. The issue is that we have launched both Lansoprazole as well as Zafirlukast has been even though we have launched them in October the off-take really taken off only in December on account of stock in the trade and therefore I think you would be able to see a bigger effect of this in quarter 4.

Sameer Baisiwala: And the other question is on Lipitor. You mentioned that you would be launching this post 180-day exclusivity. Is it irrespective of the outcome of your court case in the sense if the court decision is not delivered, would you still be launching it at risk at that point in time?

Umang Vohra: I doubt that there would be.... we won't comment on it, but it would be hard to believe that there would be a launch at risk for such a big product.

Sameer Baisiwala: And the final question is on R&D spend, you are taking it up fairly meaningfully and almost going to 7-7.5% of sales including next year. Which component of the business are we really spending?

Satish Reddy: There are two-three areas. So first obviously is the generic products itself, scale up filings and the products that we are working on. Now the second thing is also on the biologics space because as we start now working towards Regulated Markets and more scale up of the number of products that we are working on that would also see

an increase that is the second part of it. The third is the Proprietary Products. So we also talked about earlier, given indication that at least two INDs is what we will keep filing every year right from the products in the Proprietary Product space. So if we bunch all together, you would actually see this R&D spend which has been somewhat low in the first half reflecting very low, but that is something that getting scaled up as this year concludes and then as we move on to the next year, that is why we think 7 to 8% is what you should expect percentage of sales.

Sameer Baisiwala: Thank you.

Sonal Gupta: Just on PSAI, can you elaborate- you have earlier been guiding for about a single digit sort of a mix, single digit sort of a growth, but things have been fairly slower. So anything in terms of visibility for next year, how do you see this business shaping up for next year?

Satish Reddy: I think the main issue is about the Services part of the segment. API looks alright. We have seen the products gain traction and everything looks fine. Only on the Services side of the business, I think the pickup will take longer than what we anticipated because as you know we serve innovator customers on the pipeline services as well as on product services right. So pipeline services got really hit and by the time we really start building up that side of the business, it could be a slow ramp up. So I am not expecting anything positive to report on that at least for the next few quarters where as on the API side, I think things are looking good as of now.

Sonal Gupta: But should API be majority of your business I think probably predominantly it should be API right?

Satish Reddy: It is about two-thirds of that business.

Sonal Gupta: Thanks a lot.

Akhil Shah: There has been a lot of hue and cry about DPCO flexing its arm in India especially for the multinational companies. If you look at Germany, you are talking about it being a tender market I think UK is also moving to become a tender market plus there have been reports of asking for discounts on list prices and so on and so forth. Is that another form of DPCO which is emerging in those global markets?

Satish Reddy: You are talking about Europe specifically?

Akhil Shah: I would think so and perhaps would this spread to the U.S.?

Satish Reddy: Obviously in Europe, I think there is the issue of also the healthcare reforms that we carried out in Germany because the spends were extremely high and so it is something which the Government undertook and you are right it is spreading to other parts of Europe in the sense that Netherlands also has this kind of a tender system and things like that, but usually generic penetration in some European markets, I think it is steadily increasing over a period of time; Italy, Spain for example would fall into this category. Now I think the U.S. is a slightly different story from what you see in Europe. So I do not anticipate at least in the immediate future that this kind of a thing can happen.

Akhil Shah: Thank you.

Ranvir Singh: Can you give an update on Balaglitazone and other NCE product pipeline?

Umang Vohra: On Balaglitazone, there is no notable progress that we have to report. The status is the same at the end of last quarter. We are looking for a partner. The study results of the phase II trial that we have done are not as we had mentioned earlier, not very significant in terms of claiming a differentiation for that product, but we are still looking for a partner for the territories. On the rest of the NCE pipeline, we still have as Prasad had mentioned in his earlier transcript in the last quarter, there is a Phase-III asset for which the recruitment is ongoing for a phase III trial and there are other differentiated formulations that we are working on which are in Phase-I. Both these products are in the dermatology space and there are several other concepts that are being explored.

Ranvir Singh: And you talked about fourth biosimilar product, so will that product be launched in India or outside India?

Satish Reddy: Launch is for India this quarter.

Ranvir Singh: Another question to your revenue target, we need a high growth to reach at this revenue target. So what exactly would lead you to achieve that USD 3 billion overall?

Satish Reddy: So I think there are several factors to that. One is obviously the growth in the emerging markets which is quite significant and all those initiatives whether it is 4% of OTC in Russia or whether it is the high growth that is seen in that market or whether it is India in terms of all the initiatives that we have taken, one is that leg of the growth. The main one obviously will be the United States right. So with the limited competition products and also some of the opportunities that we have in the next couple of years, we feel fairly confident that we could get to the target like we

also said in the past. So it is something that we are looking at the targeted \$3 billion but it could be a little bit here and there, but obviously there is tremendous growth opportunity and we are quite committed to the figure right now.

Ranvir Singh: Thanks a lot. That is it from my side.

Neelkanth Mishra: Hi, a followup on that 3 billion question. So now that Nexium is likely to be a 2014 opportunity and does it significantly impact your target for FY13?

Satish Reddy: That is why we have not totally taken it on granular detail. We are not talking product by product and adding it up that way. We just looking at overall growth opportunities in each one of these, the new product launches cumulatively and also there will be a little bit of a gap which will obviously fill through certain business development efforts and things like that. So I cannot specifically say that.....

Neelkanth Mishra: The second is on Lipitor, we have been very curious to find out what will happen if Ranbaxy's AIP does not get resolved because its just been announced that Mylan has also settled on Lipitor with Pfizer. You have not settled yet right?

Umang Vohra: No, we have not settled on Lipitor with anyone.

Neelkanth Mishra: So in case Ranbaxy's AIP issue does not get resolved, so what happens to the exclusivity, could you throw some light on that?

Umang Vohra: Neelkanth it is very fluid, your guess will be as good as ours on Lipitor. So I think it is better that we, I think it is very fluid to say anything. So there are too many moving parts to that equation now.

Neelkanth Mishra: Okay thank you.

Arvind Bothra: I am not sure if I missed it earlier, but just wanted to get little bit more color on the GSK alliance. What kind of revenue visibility do we have and can we expect some color on how that is going to shape up?

Satish Reddy: Not much to report right now because what is happening is GSK, all we have said is that number of dossiers filed, it is already about close to more than 100 now, but in terms of anything meaningful to report on sales, you probably have to give it some more time because all these are in the emerging markets where in the branded space, it takes time for the brand to build up. It normally takes about a couple of years before you see the peak sales. So I guess you should just hang on to some more time before you really see something meaningful in terms of numbers.

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- Arvind Bothra:** May be towards the end of fiscal 12 is when we can see some separate numbers from that front?
- Satish Reddy:** Probably that is what I said. It all depends on the number of launches and the kind of markets in which they get launched. So I would hang on for may be year and a half or so at least.
- Arvind Bothra:** Okay fair enough, thank you so much.
- Abhay Shanbhag:** This is Abhay here. Just taking up on an earlier question, typically we generally see that in the first month of a generic launch, 3 to 4 months of sales are generally dumped on to the distribution chain and sales are recorded, but in your case you say that the pickup is a bit slower. So is there any difference that you have done now as compared to what you used to do in the past?
- Umang Vohra:** No difference Abhay. I think what has happened is that we are also seeing action where the trade is fairly full before once the generic enters and it is difficult to capture share on that. There is no change in any practices; I just think this is the market dynamic which is evolving.
- Abhay Shanbhag:** So even for future now typically in the first 1 or 2 months, we may not see too much of a revenue booking happening for most generic companies. So would that be a change. Should we take it going forward for all companies?
- Umang Vohra:** I think on a 12-month basis, it should equate. So it depends on when you start it, but over a 12-month period, it should begin to equate.
- Abhay Shanbhag:** But typically, we generally see companies getting a bit more aggressive in the first few weeks which you are saying is not the case now?
- Umang Vohra:** I want to make a distinction here Abhay. If you see products for which there is already generic competition your time to gain market share is longer, but if you are the first entrant, it is relatively easier to get it. So depending on the product, this dynamic will play out.
- Abhay Shanbhag:** The second thing was on the OTC cost, you did mention that \$9 million is a one-time thing. Typically the belief that we have is that in OTC, marketing cost will be more recurring in nature unlike in the case of Rx where there is a lot of sampling, free samples and all that which has done. So can you just describe why this maybe a bit more one-time cost because it seems to be a pretty large amount, a large part of it seems to be on that side?

Satish Reddy: Abhay what is going to happen is this OTC is not like a new thing that we started right. So it is not a new launch of products or not, not like a new thing that.... in the past, the products that we took through this route was a lot of activity more at the retail levels, its more like products I mean moving from prescription into OTC kind of a thing. What we are talking about now is because we see there is a huge potential for growth in the space, we are more going through the classic route, obviously advertising and those kinds of things that are being done. So these are not done throughout the year. There will be campaigns carried out at different points of time. Cetrizine for example is a seasonal product. So at the allergy season, you would do this kind of a spend. So that is why we are saying that this is not something which is going to recur every year, but this is an initiative that we have taken to ramp up the OTC sales. But we should see more in terms of that light than looking it as a completely new activity which requires huge amount of spends etc.

Abhay Shanbhag: So what I want to know is that the ramp up revenue a lot of big advertisement has been more upfront and which is going to be more seasonal in nature. So to that extent, it may not recur?

Umang Vohra: That is right and also in the beginning of a product lifecycle for an OTC product, advertising tends to be a lot higher and once the brand image is created, it tends to dip a bit.

Abhay Shanbhag: And is this largely on the Russian side or have you started spending something on Allegra OTC also?

Satish Reddy: This is all Russia.

Abhay Shanbhag: Okay fine, thank you.

Chirag Dagli: Just wanted to understand in detail your gross margin, they seem to be fairly robust this quarter, 55 odd percent. Is this kind of number that you think we should model for the years coming forward given that you will have a fairly good US business from the niche products etc.?

Umang Vohra: I think we do not guide on margins, but in a quarter where you had the significant number of launches, margins tend to be higher. So if you look at historical average, it is generally in the range of 55-60. If you look at an average when we are launching new products, it generally moves from 60 to 65%. So depending on the new product launch activity in the quarter, I think the margins fluctuate.

Chirag Dagli: Is there an element of foreign exchange on the inventory in this or?

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- Umang Vohra:** No because there has not been a substantial movement in foreign exchange for the quarter.
- Chirag Dagli:** That would have been adverse I would imagine so- okay that explains. Thank you so much.
- Alok Dalal:** Sir any tax guidance for FY12?
- Umang Vohra:** No, we have not given tax guidance as yet for FY12.
- Alok Dalal:** And would you be looking at a similar capex spend of around 400 crores for FY12 as well?
- Umang Vohra:** We do expect that our capex spend for the next year will be similar to the current year.
- Alok Dalal:** And what is your contribution of OTC business for US sales now?
- Umang Vohra:** We can send that data to you. We do not have it readily with us right now.
- Alok Dalal:** Okay thank you so much.
- Kedar Upadhye:** We thank you all for joining Dr. Reddy's management on this earnings call. I request to get in touch with the IR Desk for any pending queries. Thank you.

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