Dr. Reddy's Laboratories Limited

Q1 FY21 Earnings Conference Call

July 29, 2020

Moderator: Ladies and gentlemen, good day, and welcome to the Dr. Reddy's Laboratories Limited Q1 FY '21 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference, please signal an operator by pressing * then 0 on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Amit Agarwal. Thank you, and over to you, sir.

Amit Agarwal: Very good morning, and good evening to all of you and thank you for joining us today for the Dr. Reddy's earnings conference call for the quarter ended June 30, 2020. Earlier during the day, we have released our results and the same are also posted on our website. This call is being recorded, and the playback and transcript shall be made available on our website soon. All the discussions and analysis of this call will be based on the IFRS consolidated financial statements. To discuss the business performance and outlook, we have the leadership team of Dr. Reddy's comprising Mr. Erez Israeli, our CEO; Mr. Saumen Chakraborty, our CFO and the Investor Relations team. Please note that today's call is a 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 I proceed with the call, I would like to remind everyone that the safe harbor contained in today's press release also pertains to this conference call. Now, I hand over the call to Mr. Saumen Chakraborty. Over to you, sir.

Saumen Chakraborty: Thank you, Amit. Greetings to everyone. During the current challenging times, I hope you all are keeping yourself safe and healthy.

We are going through quite an uncertain and challenging business environment with volatility arising from both demand and supply side. I'm glad that our teams have responded very well to those challenges, and have been able to deliver quite healthy financial performance during this quarter.

The key financial highlights for the quarter are:

1. Strong year-on-year revenue growth of 15%.
2. Healthy gross margin at 56%.
3. EBITDA margin of 26.3% and EBITDA growth of 47%, adjusted for settlement income in last year.
4. PBT margin of 19.9% and PBT growth of 74%, adjusted for settlement income in last year.
5. Strong free cash flow generation of Rs. 925 crore before payout for business acquisition from Wockhardt.
6. Quarter 1 FY '21 annualized return on capital employed of 23.6%.

Let me take you through these in a bit more detail. For this section, all the amounts are translated into U.S. dollars at a convenience translation rate of Rs. 75.53, which is the rate as of 30th June 2020.

Consolidated revenues for the quarter stood at Rs. 4,418 crore, that is $585 million, and grew by 15% on a year-on-year basis and remained flat on a sequential quarter basis. Year-on-year growth has been supported by 88% growth in PSAI, 48% growth in Europe, 9% growth in emerging markets, 6% growth in NAG, with a decline of 10% in India. Sequentially, the sales were impacted due to decline in volumes in our global generics business, which was offset with a growth in PSAI business.

Consolidated gross profit margin for this quarter has been 56%, with an increase of 430 basis points year-on-year and 450 basis points quarter-on-quarter. This increase was driven by favorable forex rate, better product mix and improved productivity. Gross margin for the global generics and PSAI were at 61.4% and 33.4% for the quarter.

The SG&A spend for the quarter is Rs. 1,279 crores, that is $169 million, an increase by 6% year-on-year, 5% quarter-on-quarter. The increase is primarily attributable to higher freight due to shortage of carriers for export.

The R&D spend for the quarter is Rs. 398 crores, that is $53 million, and is at 9% of sales. Most of the product development activities continued during the quarter, including development of a few COVID-19 related products.

The EBITDA for the quarter is Rs. 1,162 crores, that is $154 million, which is 26.3% of the revenue. EBITDA grew by 2% year-on-year on a reported basis and 47% adjusted for settlement income in previous year. Sequentially, EBITDA grew by 16%. The strong growth is reflective of improvement in gross margin and productivity.

Profit before tax for the quarter is Rs. 879 crore, that is $116 million, with a year-on-year growth of 3% on a reported basis and 74% growth adjusted for settlement income in previous year. Sequentially, PBT grew by 23%.

Effective tax rate for the quarter is at 34.1%. The ETR has been impacted due to discontinuation of weighted deduction on R&D and completion of tax holiday for one of our plants. As you know, we are continuing with the old tax rate for India due to availability of MAT credit in our books. We expect the ETR to be in the range of 25% to 27% for the full year.

Profit after tax for the quarter stood at Rs. 579 crores, that is $77 million, which is 13.1% of the revenue. Reported EPS for the quarter is Rs. 34.86.

Operating working capital decreased during the quarter by around Rs. 200 crores, which is $26 million. This decrease is due to reduction in receivables and an increase in trade payables, which have been partially offset with the planned increase in inventory across the market. We invested Rs. 150 crores, which is $20 million, towards capital investment in this quarter.

The free cash generated during this quarter was 925 crores, which is $122 million, before making the acquisition-related payment of Rs. 1,499 crore to Wockhardt. Thus, the net free cash flow for the quarter stood at minus Rs. 574 crore, which is $76 million. Even after the acquisition related payout to Wockhardt, our net debt as on June 30, 2020, was Rs. 336 crores. Our net debt-to-equity ratio is at 0.02 and continues to reflect our strong balance sheet position.

Foreign currency cash flow hedges for the next 9 months in the form of derivatives for U.S. dollars are approximately $260 million, largely hedged around the range of Rs. 73 to Rs. 77 to the dollar. In addition, we have cash flow hedges of RUB 2,600 million at the rate of Rs. 1.045 to the ruble maturing over the next 9 months.

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

Erez Israeli: Thank you, Saumen. Good morning and good evening to everyone. I hope you and your families continue to remain safe and well in the midst of this pandemic. I thank all of our associates across the world whose relentless efforts and hard work has helped to ensure continued availability of medicines for our patients and customers across the geographies.

The strong results of the current quarter in terms of sales growth, improvement in EBITDA margin and healthy cash generation reflects our continued commitment to the organization's purpose while consistently improving our business performance irrespective of the challenging circumstances. While many of our markets have been impacted by reduction in demand due to COVID-19 related lockdowns and economic slowdown, we continue to work towards mitigating the risk through focus on increasing market share, launch of new products and improvement in productivity. Despite current challenges, we continue to progress well to implement our strategy and continue to explore more avenues of growth for each of our business.

During this quarter, we successfully completed acquisitions of select business from Wockhardt, and we are gearing towards reviving these brands back on growth trajectory. We also executed the licensing deals for 2 key products related to COVID-19 treatment, Avigan or Favipiravir tablets and Remdesivir injections. We are actively working towards launching these products to cater to our patients in various markets.

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

Our North America Generics business recorded sales of $ 229 million for the quarter. Sales declined by 2% year-on-year and 8% on a sequential quarter basis. In INR terms, the sales grew by 6% year-on-year. The sequential decline was largely due to forward buying in previous quarter, reduction in new prescriptions, drop in footfalls in retail stores and reduction in elective procedure in the hospitals. We launched 6 new products during this quarter, including Abiraterone Acetate tablets and Colchicine tablets. We are on track to launch more than 25 new products in this fiscal including some niche and limited competition products.

Our Europe business recorded sales of EUR 43 million with a strong year-to-year growth of 30% and a decline of 1% sequentially. The year-on-year growth was seen across market and was driven by improvement in both base business and new product launches. During the quarter, we launched 7 products in Germany, 2 products each in the U.K. and Spain, 4 products in Italy and 1 product in France.

Our emerging markets business recorded sales of Rs. 798 crores with a year-on-year growth of 9%, a decline of 1% sequentially. Within the EM segment, the Russia business declined by 15% in constant currency, both on year-on-year basis and quarter-on-quarter basis. The decline was primarily due to the impacts of COVID-19 related lockdowns, resulting in overall reduction in demand. In rest of the market, we witnessed mixed patterns of sales performance. China, Vietnam, Myanmar and Kazakhstan are among the markets that performed well this quarter. During the quarter, we launched 29 new products across emerging markets.

Our India business recorded sales of Rs. 626 crores with a year-on-year decline of 10% and a sequential quarter decline of 8%. Here again, the sales were negatively impacted owing to reduction in doctor-patients interaction and prescription generation as a result of the COVID-19 related lockdowns. As various parts of the countries are in different levels of reopening, we expect the sales trend to sequentially improve from this quarter onwards. We launched 4 new products in the Indian market in this quarter. We are preparing to launch both Avigan tabs and Remdesivir injection in India in the next few weeks.

During this quarter, we integrated the business acquired from Wockhardt and registered sales for a few days. We are placed at market rank of 12th position as per IQVIA on MAT June '20 basis, an improvement by 1 position after Wockhardt integration.

Our PSAI business recorded sales of US $113 million, with a strong year-on-year growth of 74% and a sequential quarter growth of 14%, with an improvement in order book across markets. We expect this business to positively benefit as various companies globally look for strategic and reliable partner for supply of active ingredients.

On the R&D front, we continue to strengthen our pipeline of products across the markets. During this quarter, we filed 18 formulation products across global markets, including 5 ANDAs in the United States. As of 30th of June 2020, we have 101 cumulative filings pending for approval with the US FDA, including 99 ANDAs and 2 505(b)(2) NDAs. We also filed 16 drug master files globally, including 1 filing made in the U.S. market. We are also working on few molecules related to COVID-19 and doing our part in this global fight.

On our proprietary products business, following the recent approval of oral liquid celecoxib formulation NDA, ELYXYB, we recently secured the approval of our first NCE under 505(b)(1) pathway, XEGLYZE. We are actively working to commercialize both products through partners. Overall, we are making good progress in building and advancing a strong pipeline of high-value, globally relevant assets. We are continuing our efforts to monetize select assets through partnership and licensing transaction that maximize their value.

On biologics front, the Phase III trial for Rituximab is progressing well. In parallel, we are working on the next wave of biosimilar products which are at different stages of development.

Over the years, we have made significant investment in digital capability and see it as one of the major value contributor for us. Our strong digital infrastructure allowed us to seamlessly enable work from home and connecting with doctors and business partner during these times. It also helps us to be more productive and efficient in several of our business operations.

The current business environment remains to be highly uncertain and volatile. However, these challenging times are also unfolding new opportunities to grow our business and improve our productivity further. While the journey in the next few quarters is going to have its own set of challenges, the investments we have made in building the core foundation capability gives me the confidence that we are well equipped to successfully ride through this phase and sustain our growth momentum. We continue to focus on creating more opportunities with less risk and attaining self-sustainability for each one of our businesses.

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

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Rajesh Kothari from AlfAccurate Advisors. Please go ahead.

Rajesh Kothari: My first question is with reference to the new regulations in U.S.A. where details are probably not available, but it would be great if you can give your view on how do you see those rules depending upon your understanding of those rules? And what kind of impact you can think it can happen for your company over medium to long term? And my second question is with related to R&D and SG&A put together, how do you see that number in absolute terms over next FY '21, FY '22, FY '23, whatever way you can give guidance?

Erez Israeli: So as per the U.S. regulations, I'm assuming that you are referring to the localization of production. Is this correct?

Rajesh Kothari: I'm talking about the recent norms, which Trump has been talking about, in which he has talked about the generics and the pricing, and I'm talking about the last 2 weeks back, the news which got broke off.

Erez Israeli: Sure. So in the United States, you have both agenda. One is related to the pricing and the agenda you just have spoken, and the second is about localizations of products. So both discussions are in place. On the first part, I do not envision a big impact on us on both short and long time. We have actually believed that a company like us is actually the solution for that as we are providing access to affordable medicines. And I believe it will be more impactful for the innovative products in the United States. And also the chapters that arise from that, I believe, have certain opportunity to actually increase access for generics even further. So in this respect, no major concerns. On the localization piece, we are actually looking at this situation, we appreciate that there is a certain need to produce certain products in the United States. At the same time, it's unclear what will be the mode of payment or the pricing of those. So as it will fold out, we will evaluate it. But at this stage, we will not have any specific action.

Rajesh Kothari: Okay. And my second question was with relation to SGA and R&D combined, how do you see that total overall expense?

Erez Israeli: So as you know, we are not giving the guidance. In general, and we said it also in previous times, we want more products. And we want them in more countries. So overall, normally over time, we want to spend R&D to develop those. At the same time, we were also asking ourselves to be more productive while doing that. So I believe that this year, we will spend some more money. We are not giving yet guidance for the years after.

Moderator: Thank you. We take the next question from the line of Prakash Agarwal from Axis Capital. Please go ahead.

Prakash Agarwal: Sir, first question on the sustainability of gross margins. I clearly understand product mix as well as currency would have held. Just trying to understand how would the API prices for us in terms of our cost / COGS moving? As I understand, API prices have firmed up further and with rupee dollar moving up, our cost of procurement would also be higher. Could you help us that is this understanding correct?

Erez Israeli: So I'll refer to the API. First, I think that we do see a better sales traction of the API and indeed, the mix is more favorable and help us in partially in this grow in the gross margins. As we discussed in previous times, the gross margin is not a KPI that we are necessarily managed. Of course, we want it to be as high as possible, but we will not say no for a big business if it will come with 50% gross margin just because to manage that KPIs. So for us, it's a result. And give or take, we are within the framework that we have discussed in previous quarters as well. I believe that the more we will sell off the API, naturally, it will favorably impact the gross margin as well because those products tend to have relatively higher gross margins. I do not see a specific trend not on pricing as well as not on procurement prices.

Prakash Agarwal: So my question was actually on re-procuring API at higher prices, could the gross margin will still be sustainable as I understand API prices have firmed up?

Erez Israeli: That's what I tried to answer. I do not see any specific trends on the procurement prices or on our prices. And I believe that, again, with fluctuation we should be in the same level that we are today, it could be a little bit less. So at the time, we said that we are comfortable. It depends, of course, on the mix of the activities between, let's say, 51% and 54%. Now we are a bit higher. I believe that we are still comfortable in the same area. And I believe that this area is sustainable with, of course, can be quarterly fluctuated.

Prakash Agarwal: Understood. Fair enough. Thank you for that. And the second one is on the injectable portfolio that we have in U.S., given the lockdown, how has that behaved? Have the volumes come down or is it at the same level? And also some color on pricing...

Erez Israeli: It is coming up.

Prakash Agarwal: It's coming up, okay. And the U.S. generic pricing some trend and Suboxone. That will be all. Thank you so much.

Erez Israeli: Suboxone is going well and did well also in this quarter for us.

Prakash Agarwal: And U.S. generic pricing some trend, sir? How's it done Q-on-Q?

Erez Israeli: I will answer because I know it's of interest to many people. U.S. prices are more stable at this stage for us.

Moderator: Thank you. We move to the next question. The next question is from Saion Mukherjee from Nomura. Please go ahead.

Saion Mukherjee: Sir, two questions. Firstly, on emerging markets, we are seeing some good traction outside of Russia, CIS. Anything that you would like to point out? Any specific market, which did particularly well this quarter?

Erez Israeli: I mentioned China did well as well as some of the other markets, I mentioned Myanmar, Vietnam. So those markets did fairly well. The markets that are more related to, let's say, the hospital demand or government tenders, did better than those markets that were impacted by patient-doctor demands like India or Russia. And this is very naturally due to the lockdowns in the first quarter.

Saion Mukherjee: And sir, second question on SG&A because you mentioned there is freight charges which have gone up, but your sales promotion expenses would have come down. So how do you see that panning out in the subsequent quarters? And I remember you had a settlement this quarter. Has that been booked as part of SG&A?

Saumen Chakraborty: Which settlement are you referring to?

Saion Mukherjee: There was a $7 million or $9 million settlement that you had announced this quarter.

Amit Agarwal: U.S. settlement that was the last quarter which was announced.

Saumen Chakraborty: So we can take this thing offline. So I'm not being able to directly associate to what settlement we have done to SG&A this quarter.

Amit Agarwal: There is no such charge Saion, in this quarter.

Saion Mukherjee: Sir, can you give some color on, like how the various parts within SG&A is moving? And how should we think about like freight and other elements and anything can help us for the coming quarters?

Saumen Chakraborty: So freight will depend on the rate of the carriers as more air bubbles opening up. We expect things to get normalized in coming quarters. So that will help. So our sales promotion will depend on the kind of sales which we are going to have in the market which is very dependent on sales promotion. Accordingly, we calibrate. Saion, were you referring to the security class action settlement?

Saion Mukherjee: Yes.

Saumen Chakraborty: Okay. So that normally for those kind of things, it comes out of your Director and Officer insurance that you cover. We pay insurance premium every year for those kind of things.

Moderator: Thank you. The next question is from the line of Vishal Biraia from Aviva Insurance. Please go ahead.

Vishal Biraia: So what would have led to the 88% growth in the PSAI business?

Erez Israeli: Sorry, I did not capture the question, what led to the growth you said?

Vishal Biraia: Yes. What were the driving factors to achieve that 90% outgrowth for the API business?

Erez Israeli: It was across businesses and countries. So it was not related to a specific product. I believe that it's a combination of the following: one, that people needed to de-risk themselves as related to lockdowns and to ensure that they have enough inventory of API. Second is the companies that are looking for additional reliable sources if they were dependent on others or we wanted to de-risk it. So we did see big traction of that; API that we sent for launch of product as well as R&D products. So it's a combination of all the above. In general, I do see a very healthy growth of the business. I attribute it to the decision that we made 2 years ago to focus on the API and to make it a significant global business and we are starting to bear the fruits on that.

Vishal Biraia: Sir, do you expect this trend to continue for the coming 2 quarters at least?

Erez Israeli: Without giving guidance, it is absolutely an expectation for this business to continue to grow.

Vishal Biraia: And just one last thing on the CRL, any updates on the CRL of Copaxone and NuvaRing?

Erez Israeli: On the Copaxone, we submitted the CRL. We did not submit yet the CRL for NuvaRing, we are still working on it.

Moderator: Thank you. The next question is from the line of Damayanti Kerai from HSBC. Please go ahead.

Damayanti Kerai: Sir, you mentioned API growth has resulted due to our investment in the segment for last 2 years. So my question is on the India part, like where we are hearing that government is now incentivizing manufacturers to scale up production of certain products. So do you have plans to participate here or not?

Erez Israeli: Not at this stage, these specific products are not in our lines of activity. This is primarily antibiotics and we are not into antibiotics. So at this stage, we do not have plans as such.

Damayanti Kerai: Sure. My second question is, can you talk a bit about your strategy to leverage upon product filing and launches for multiple markets? Say, in the last 3, 4 quarters, how many such products we have developed and filed in multiple geographies?

Erez Israeli: So naturally, we are expanding those products. I believe that I mentioned that we had 29 products, for example, in the emerging markets, 25 new launches that we are going to have in United States etc. This space is also going to be reflected in the R&D. So we are gearing the R&D to enable somewhere between 10 to 25 products per year per geography. And most of these products will be leveraged meaning that we are going to use the same products for multiple markets.

Damayanti Kerai: So 10 to 25 products per year is our target for different markets, right?

Erez Israeli: In general, it depends, of course on the markets and the activity.

Moderator: Thank you. The next question is from the line of Neha Manpuria from JP Morgan. Please go ahead.

Neha Manpuria: My first question is on the gross margin. Now you mentioned 3 things on the gross margin improvement, FX, product mix and productivity. I just wanted to understand which of these factors contributed largely to this, was there disproportionate contribution from one factor versus the other? And how do you view something like a product mix or productivity? Productivity, I can understand, is product mix linked to the fact that we were selling more, let's say, injectable products or hospital linked products in this quarter?

Saumen Chakraborty: I'll take this question. Now our gross margin has improved both year-on-year as well as sequential. So if you take a factor, for example, currency rate. Now the currency rate year-on-year, the contribution to the improvement will be higher compared to the sequential. So if one would have just neutralize the currency impact. I mean sequentially, that mean there would have been more which has come out of other factors such as product mix, such as the productivity and also other things because I have been always maintaining in the past that in our industry and specifically for our company and (Inaudible), there would be fluctuations quarter-on-quarter due to multiple reasons. Sometimes you may take some inventory write-off. There could be some quality problems. There could be some penalty for failure to supply. Many such things can happen. So that's why it is very difficult to have a consistent kind of a gross margin. There will be always fluctuation. Now when you really talk about product mix because what we really ultimately put it is the resultant weighted average. But in terms of the margin, if you go by product, there would be different bucket. There will be bucket which is far higher than the total reported gross margin of Dr. Reddy's and there will be products which is also quite lower than that. So if we are being able to sell products in a particular quarter or products with much higher contribution, then definitely that has an impact in the gross margin. And traditionally, depending on market and also business segment where the margin varies. So that will also have an impact in terms of the business mix on that. Overall, when we really talk about the productivity, it is a leverage that you get with better capacity utilization or with the same manufacturing overhead if we're being able to produce more and that's where the productivity factor comes in and it helps in terms of the gross margin improvement. So that is response to your question, Neha.

Neha Manpuria: Sir, just a follow-up on that. I agree on the FX. Just on productivity, I would have assumed, given the lockdown and volumes coming off, our utilization would have been lower. So I'm just trying to understand, if the product mix was linked to the fact that COVID benefited certain sale of certain type of products or certain bucket of product? Would that be a fair understanding?

Erez Israeli: So not really. First of all, we did not lose much output because of COVID. So our people found a way to make the relevant output almost uninterrupted, almost undisrupted. So relatively to that, and this is, again, I want to thank my colleagues, my associates for doing that. Second, there is no real correlation between COVID and the mix of products, we send to the customers basically what they needed. I think it's more of the fact that we are leveraging more and we are doing it more efficiently.

Saumen Chakraborty: And it always helps if there are more new products. Normally, new product will be with higher contribution. Yes, we can move on.

Moderator: Thank you. The next question is from the line of Anubhav Aggarwal from Crédit Suisse. Please go ahead.

Anubhav Aggarwal: One question on the acquired portfolio from Wockhardt. Just wanted to get some sense. Now you would have had a deeper look at the portfolio. In your first assessment, where do you see this portfolio is lagging? More in promotion efforts? More in distribution reach? Promoted or too many reps? There are 1 or 2 low-hanging fruits in this business**.**

Erez Israeli: I believe that the main opportunities that the brands were not fully utilized or the brand recognition as Wockhardt did not have the means due to their financial issues to invest in them in order to get the full brand recognitions. So the primary low-hanging fruits will be about branding and about investing in them. I believe that there is a strong potential, big potential in those ways.

Anubhav Aggarwal: Okay. So investment brand means, you mean to say, are you referring to, let's say reach, but they are not going to enough doctor because my understanding was the rep was actually may be too many reps are pushing small portfolio. So just can you elaborate on that investment was less in the brand?

Erez Israeli: It's branding. It's a combination of messaging as well as reach. So as these brands, by and large, are complementary for activities that we already did. So naturally, now we can enable higher reach in terms of a number of customers as well as better messaging because we can invest in the branding and the ability to expand this product better and the combination of branding as well as reach.

Anubhav Aggarwal: On the PSAI business, with several of our customers now looking for more additional reliable source of supply trying to de-risk, certainly the opportunity set for us in the products that you're saying has increased. So I was just trying to get, let's say, some measure of how much of our addressable market has increased by, let's say, if the opportunity was x earlier, has it become 2x now, 1.5x etc.? Just trying to understand that kind of metrics? Because I appreciate that in 1 year, we cannot see all kind of growth, but that may translate to our growth in next 2 or 3 years.

Erez Israeli: So it's not working exactly like that. As you know that there is time in which the qualification of products are coming. So I think the way you need to say it on the API is that we will have more and more molecules that will have 2 types of contribution to our strategy. One, that they will gain more market share as we are becoming more efficient. At the same time, we have a better integration and this helped to continue to improve our gross margin. This is the two contributions of the API. As for the de-risk, indeed, there were certain tractions that came, but this is the way we normally do that we are trying to see those areas or those opportunities in which companies have 1 supplier or may be want to de-risk certain products. And then we are trying to qualify an alternate source and this is also in this quarter, and we'll continue to do also in the future. Overall, I think what you are looking for is to know whether this business will grow, and I believe it will.

Moderator: Thank you. The next question is from the line of Susmit Patodia from Motilal Oswal Asset Management. Please go ahead.

Susmit Patodia: Wanted to check a couple of things. Is there any part of the Wockhardt number which is integrated in this quarter because the transactions concluded on the 10th of June?

Saumen Chakraborty: Yes. For 20 days, sales and profits are there in this.

Susmit Patodia: For 20 days, it is there, right?

Saumen Chakraborty: Yes.

Susmit Patodia: And just one request on Wockhardt. Whenever you get the opportunity and time, if you could take us through the Wockhardt portfolio separately on a call will be great, to understand where we are on that journey. That is a just a request from us to the management. And secondly, sir, you said tax rate will be 25% to 26%, while the benefit that has gone away is on a plant. So if you can explain to us how this will come down from the current tax rate of this quarter?

Saumen Chakraborty: So what I gave a guidance of 25% to 27% for the full year. For the quarter, of course, it was at 34.1%. Now the main contributory factor is the weighted deduction on R&D, which used to be there, it is no more available now. Now of course, with the weighted deduction on R&D going away and other tax incentives going away, the government of India has also reduced the tax rate that is the new tax rate. That is an option one could have taken. But for us, it didn't make sense because we had quite a bit of MAT credit available in our book. So we want to wait for utilizing them because this is something with a higher tax implication that you can utilize. Once we utilize, then we will switch over to the new tax rule, which will be (Inaudible). Till that time, you don't get the tax incentive. So one of the major contribution is weighted deduction on R&D gone.

Second is, in one of the plants where we had the time period for which you would have got the tax that got over. So both these factors, combining led to the 34.1% tax rate for the quarter.

Susmit Patodia: So you did use the MAT credit for this quarter, is that correct? Which you will use for the...

Saumen Chakraborty: So it all depends on the year basis, MAT, sometimes there will be a fluctuation. If you recall, last year, overall, our ETR was negative. All the remaining of the year, we said that normally it would have been 21% to 23% in this range we are normally. In the last year, it just happened, that's because of multiple things, it became a negative. So this year, we have started on a higher, but hopefully for the year, we can manage 25% to 27%.

Susmit Patodia: Sir, there are a couple of other companies have reported the first quarter numbers. And the India business margins have gone up significantly because of lower marketing spend. So is it fair to assume that your India business margins would also gone up significantly quarter-on-quarter? And the other expenditure not going down is may be entirely due to the freight cost and services for the quarter?

Saumen Chakraborty: First, we don't report geography-wise, the margin like we report the sales. But it will be fair to say that even though there has been a decline in sales, it didn't necessarily mean a decline in absolute margin that we would have got from India.

Moderator: Thank you. The next question is from Vishal Manchanda from Nirmal Bang. Please go ahead.

Vishal Manchanda: I have a question on Revlimid. Could you share, when is the trial hearing scheduled?

Saumen Chakraborty: We haven't got the dates.

Vishal Manchanda: Right and any sense on how long can the judgment take after the trial hearing?

Erez Israeli: We shall see. We shall see how it will fall out. It’s very hard to tell.

Moderator: Thank you. The next question is from Nitin Agarwal from IDFC Securities. Please go ahead.

Nitin Agarwal: Sir, 2 questions. One is, a) on the COVID drugs that you mentioned, how should we view these opportunities? Are these specifically largely domestic opportunities? Or do you see opportunities for meaningful export opportunity in these 2 products?

Erez Israeli: We are going to have them both domestically as well as emerging markets. How big it's going to be? I don't know. The way we see it, it's a combination of both, our contribution to fight COVID as well as business opportunity. It's hard for me to say how it is going to be because it's primarily a traction of how fast we can effectively register this product in the emerging markets. In the case of Avigan, if we will have a good results on the Kuwait trial, which we will know probably by October, November, then we can register it potentially globally including United States, but we should see the results of this trial first.

Vishal Manchanda: And are you going to raise, would we be supplying to Fuji also for their stockpiling in Japan?

Erez Israeli: Right now, they are making the products for Japan. We are not producing for Japan. But the plan is if this product will pick up well, then we will be the global producer of this product globally. At this stage, we are not making for Japan.

Vishal Manchanda: And my second question is you talked about the opportunities for the PSAI business. From an investment perspective, does it entail for us significantly increasing our investments in PSAI going forward? How are we looking at the CAPEX part of it?

Erez Israeli: So PSAI is absolutely space in which we are investing primarily on R&D. At this stage, we have enough capacities so I don't envision putting more sites or stuff like that. We are looking from time to time for business development, if it is certain capabilities that we do not have. But overall, the main investment in APIs is in R&D.

Vishal Manchanda: If I can squeeze in last associated question on that. What opportunities do you see in the CDMO space in the PSAI business? Is the custom services business which you've now put out it to a separate subsidiary? How has that been performing?

Erez Israeli: It is performing well, and I see it as a growing business for us.

Moderator: Thank you. The next question is from the line of Sameer Baisiwala from Morgan Stanley. Please go ahead.

Sameer Baisiwala: Sir, is it possible for you to update us on the India business and Russia business, like in July, how is it doing versus pre-COVID levels?

Erez Israeli: In both cases, I believe that as certain areas, certain cities are opening up, we see positive tractions on those. On that on both countries, as you know well, the city is the (Inaudible), the provinces are in different shape and form that's related to fighting COVID. Some of them are still in lockdown, some of them opened up. So in those places that have opened up, we see positive traction.

Sameer Baisiwala: And sir, second question is on NuvaRing, when do you expect to do refiling with USFDA?

Erez Israeli: It's going to be within the next few months. We do have a delay in the submission. We are still working on some trials on that.

Sameer Baisiwala: With your permission, sir, one last one from my side. And that is, how are you thinking about more M&A opportunities? Anything that you can outline which geographies, which assets you're looking? And would these be more sizable than Wockhardt or around the same ballpark?

Erez Israeli: So we do see next quarter, we believe we'll go back to a surplus of cash. So we do have a lot of financial capacities in the same lines that we introduced in the last few quarters, which means that we potentially can risk up to a 2x EBITDA if we'll find opportunity for that. The types of transaction that we are looking are primarily in emerging markets, primarily within the emerging markets in India. So the Wockhardt type of a deal is the type of deal that we like, meaning we have the products, we get the assets and integrate it relatively fast into our business. That's the type of businesses we are looking for.

Moderator: Thank you. The next question is from the line of Anmol Ganjoo from JM Financial. Please go ahead.

Anmol Ganjoo: Most of my questions have been answered, but just if I was to have a follow-through on the API business. Most of the factors that you alluded to for the superlative performance for API seemed to be sustainable. We all understand that you can never rule out quarterly aberrations, but is it fair to assume that this quarter, the run rate seems to be some kind of a new base when we look at our API business because whether it's productivity improvement, whether it's customers are de-risking supplies, none of this looks like should disappear in a quarter or two. So are we talking about structurally a business which is 60%-70% higher from where we were last year? And then we have to see our investments and focus on this, we should be able to grow from that base for the next year.

Erez Israeli: So you know I cannot give you guidance, but I do believe that we can have bigger base even in the future and I believe that we will achieve it. So I'm very confident about our ability to grow the API business. And I agree with you that all the trends are sustainable and they are positive for us.

Moderator: Thank you. We will take one last question. The last question is from the line of Surya Patra from Phillip Capital. Please go ahead.

Surya Patra: Two things that I wanted to understand. With the strong cash flow that we are seeing and there is a kind of strong base that we are having, so can you just give some clarity or indications about your future capital allocation either towards the kind of acquisitions or towards kind of a new asset area or new product portfolio, something, some directional indication would be helpful here.

Saumen Chakraborty: Yes. So our main lever for future growth is R&D. And so this is something which we are trying to improve productivity. But at the same time, we will need a very high focus on continuing R&D on multiple markets in terms of leveraging the global portfolio as well as come out with new product. And we have a lot of appetite for inorganic growth and already, Erez has talked about it. If we get a Wockhardt kind of target in India, we will be very interested. But beyond India, also, there are other strategic spaces and specific kind of target that we have. At any point of time, we are doing a lot of diligence, so we'll have to see whether we are being successful or not, but that is a possible area. There is a huge ROI that we can get out of investment on the digital capability and the platform that we have made in the past, and we are continuing to do so even now and in the future. I mean that is another area. CAPEX, I already alluded to earlier that we would be spending more than 1,000 crores for the year for capacity creation in specific areas. For the quarter, the cash outflow was much less, it's only 150 crores. But in a year, we will still have that kind of capital allocation. But there are multiple areas including we have increased our capital allocation for dividend distribution this year. And we also focus on the leadership development. So there are multiple areas on which we plan, but we always review. For us, it is a dynamic allocation depending on our strategy and we want to ensure that we are being able to execute on our strategy and capital allocation doesn't come on the way. Did I respond to your question?

Surya Patra: Yes, greatly, sir. Second question was around, also, the point that you have mentioned about the digital capability, what you're trying to enhance. So whether that will have a kind of meaningful impact on the overall margin scenario for the company, one. And secondly, despite having seen a kind of sequential revenue decline on our branded business like here in India as well as Russia. And also to some extent, sequential decline in the U.S. business because of the COVID factor, the gross margin scenario has sequentially improved, although we have discussed a lot about the gross margin factor. But if the branded businesses are declining, what is really supporting, whether it is the raw material price correction is quite significant because the crude price factor or something else what is helping, and how influential this digital capability for the margin improvement, if you can just talk.

Saumen Chakraborty: Digital helps in multiple ways. Definitely, it helps in productivity improvement and consequently on margin. But digital also helps in better quality and there is so many interlocking that you can do, digital helps in terms of improving your speed and agility. So overall, the whole idea is that how can we be much more lean, agile, how can it connect seamlessly across the value chain and how we optimize end-to-end each and every processes that ultimately create value for the company. So that way, we have been having a lot of platform thinking within the organization. There are a few areas where we have made a significant progress even in the past. There are few areas which we are focusing now. And I believe that this will contribute significantly in terms of our customer facing processes, our new product development processes, our employee satisfaction, agility, speed on every count. So next is on a sequential increase. First, I would like to correct you that our emerging markets, which is primarily branded market has grown. It is only in Russia that you have seen, there is a decline. But both in CIS as well as rest of the world, sequentially it has grown quite a bit. It is not correct that there is a decline, but our overall margin has gone up. But the contributory factors, of course, unlike in year-on-year, the sequential margin increase, we didn't have that much of currency impact. It has more in terms of the product mix, productivity, but also better quality and lesser kind of inventory provisioning and all those things and FTS, combination of many things help in terms of the gross margin. As we have seen in terms of the reported gross margin of global generics and PSAI, the PSAI segment gross margin has gone up significantly; all these contributions.

Surya Patra: Sir, please, can you quantify the Forex gain element in this quarter.

Saumen Chakraborty: That is very easy for you to do that because you know the currency rate and you know our sales and how it would have impacted.

Moderator: Thank you very much. We'll take that as the last question. I would now like to hand the conference back to Mr. Amit Agarwal for closing comments.

Amit Agarwal: Thank you, everyone, for joining us today for the earnings call. In case of any further queries, please reach out to the Investor Relations team. Thanks.

Moderator: Thank you very much. On behalf of Dr. Reddy's, that concludes the conference. Thank you for joining us, ladies and gentlemen. You may now disconnect your lines.