“Dr. Reddy's Q3 FY 20 Earnings Conference Call”

January 27, 2020

Moderator: Ladies and gentlemen, good day, and welcome to the Dr. Reddy's Q3 FY '20 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 31st December 2019. 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. The current quarter financial performance has been quite good, with the highest ever quarterly sales without any one-off item, an improvement in both the gross margin and EBITDA margin and healthy cash generation. However, the profit is impacted by significant amount of impairments taken due to specific triggers occurred during the quarter.

Let me take you through these and other major items in some more detail. Herein, all the amounts are translated into U.S. dollars at a convenient translation rate of Rs. 71.36, which is the rate as of 31st December 2019.

Consolidated revenues for the quarter are at Rs. 4,384 crores, which is $614 million, registering a growth of 14% on a year-on-year basis. The growth has been supported by a good performance across all our businesses. On a sequential quarter basis, our reported revenue declined by 9%. In Q2 FY '20, we had an amount of Rs. 723 crores recognized as revenue towards the sale of 2 neurology brands of our proprietary products business. And adjusted for this, the sequential quarter growth would have been 7%.

Consolidated gross profit margin for this quarter is 54.1% with an improvement of 20 bps on a year-on-year basis. On a quarter-on-quarter basis, while there is a decline of 340 bps in the

reported gross margin, however, after adjusting for the one-offs in Q2 FY '20, the normalized gross profit margin has improved by about 260 basis points. Gross margin for the Global Generics business is at 58.2%, with a quarter-on-quarter improvement of 270 basis points. Gross margin for the PSAI business is 30% with a quarter-on-quarter improvement of 540 basis points.

The SG&A spend for the quarter is Rs. 1,267 crores that is $178 million, which is 28.9% of sales with the leverage benefit being visible on improvement in sales. In this quarter, we have taken an impairment charge of Rs. 1,320 crores, led by specific triggers. In December 2019, there has been a generic launch and an authorized generic launch for the product, NuvaRing, which has led to a considerable erosion in the valuation of this product for us. And accordingly, we taken an impairment charge of Rs. 1,114 crores equivalent to $156.5 million. The balance carrying value of the asset after impairment is Rs. 308 crore equivalent to $43.2 million. In addition to this, considering the current market reality, we have taken an impairment charge of Rs. 206 crore on other intangible assets. R&D spend for this quarter is Rs. 395 crores that is $55 million and is at 9% of the sales for the quarter.

The R&D spend has increased by 8%, both on year-on-year and sequential quarter basis.

And the EBITDA for the quarter is Rs. 1,074 crores that is $150 million, which is around 24.5% of the revenue.

The net tax for this quarter is Rs. 42 crores.

EPS for the quarter is negative Rs. 34.37.

Operating working capital increased by around Rs. 428 crores, which is $60 million. This increase is attributable to an increase in receivables and inventory, partially offset by an increase in payables. The net working capital has increased by 3 days against the last quarter.

We invested Rs. 121 crores, which is $17 million towards capital investment in this quarter. The free cash flow generated during the quarter was Rs. 582 crores, which is $82 million. Consequently, we now have a net surplus cash of Rs. 414 crores as on December 31, 2019. Foreign currency cash flow hedges for the next 9 months in the form of derivatives for U.S. dollar are approximately $210 million, largely hedged around the range of Rs. 70.43 to Rs. 74.34 to the dollar. In addition, we have cash flow hedges of RUB 900 million at the rate of Rs. 1.0789 to the ruble, maturing over the next 3 months.

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

Erez Israeli: Thank you, Saumen. Greetings to all. I'm very pleased with our continued improvement in all of our business spaces and our ability to improve our performance and health metrics this quarter. We have seen strong growth in revenues across our key businesses, coupled with improvement in gross margins, operating expense leverage and achievement of healthy EBITDA margin. During the quarter, we also turned to net cash surplus and further improved the health of our balance sheet as an outcome of sustained and focused efforts around our businesses. We are

progressing well in implementing our strategy across the markets under the guiding principles of creating more opportunities with less risk.

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

Our North America Generics recorded sales of $225 million for the quarter with a growth of 8% year-on-year and 11% on a sequential quarter basis. We launched 5 new products in this quarter, and on a year-to-date basis we launched 22 products, including 4 relaunch of the earlier discontinued products. We expect the new launches momentum to continue to deliver with about 30 product launches during this year. We are gradually improving our market share in gSuboxone sublingual film product and several other recent launches like Carboprost injectable and OTC Guaifenesin Pseudo products. During the quarter, the market for gNuvaRing was formed leading to potential reduction in the size of the opportunity for us. Based on these changing market dynamics, we have taken an impairment charge in the intangible carrying value depending upon the various scenarios expected upon our market entry. We continue to work on responding to the CRL, which is expected to go out in the next few months.

Our Europe business recorded sales of Euros 39 million with a year-on-year growth of 59% and sequential growth of 11%. This strong performance was driven by new product launches and improvement in base business performance owing to stabilization in supplies. The growth was further aided by the increase in contribution from the 3 newer markets, which, include France, Italy and Spain. During the quarter, we launched 2 products in Germany, 3 products each in U.K. and Italy and 1 product in Spain. We expect this steady growth momentum to continue as we are building ourselves in this space.

Our Emerging markets business recorded sales of Rs. 920 crores with a year-on-year growth of 19% and sequential growth of 11%. Within the EM segment, the Russia business grew at 17% in constant currency both year-on-year and sequentially on the back of sustained base business performance, partially supported with the Reditux tender supplies. The overall growth in the rest of the emerging markets was led by higher volume and new product launches, which was impacted partially due to price erosion in few markets. During the quarter, we launched 17 products across these markets.

Our India business recorded sales of Rs. 764 crores with a strong year-on-year growth of 13% and sequential growth of 2%. During the quarter, we launched 8 new brands, including the launch of our first brand, Celevida in the growing nutraceutical space. As per the secondary sales reported by IQVIA, we registered healthy growth of 10.6% ahead of total market growth of 9.6% for the quarter ended December 2019. India is a priority market for us and we continue to focus and strengthen our presence in this market.

Our PSAI business recorded sales of $97 million with a year-on-year growth of 17% and a slight sequential decline of 3%. While there has been good growth in API product sales, we witnessed

a bit of softness in the services components of the business which is expected to improve upon in the future.

During this quarter, we filed 20 formulation products across global markets, including 3 ANDAs in the U.S. market. As of 31st December 2019, we have 101 cumulative filing pending for approval with the USFDA, including 99 ANDAs and 2 505(b)(2) NDAs. We also filed 20 drug master files globally, including 3 filings made in the U.S. We continue to strengthen our pipeline of products across the markets.

On the quality and compliance front, let me provide you a quick update on some of the key manufacturing sites. Last week, the USFDA has initiated the inspection of our API Srikakulam Plant, referred as CTO-VI, which has been under warning letter since 2015. Since the audit is still ongoing as we speak, we will not be able to offer any comments on the status until the conclusions of the audit. On the other sites pending compliance closure post the recent audits in the last few months for FTO-7 and CTO SEZ, we have submitted our response to the USFDA and await to hear back from the agency.

On Proprietary Products business, we have received a goal date of May 2020 for NDA filing related to DFN-15, which is oral celecoxib. The progress on the ongoing R&D program is on track, and we continue to pursue out-licensing opportunities to unlock the value of our product portfolio.

Overall, we continue to make steady progress on our transformation journey. As we continue to reduce our dependency on fewer products or market for growth, we have created multiple growth drivers by expanding and leveraging our pipeline and assets to market across the global markets with limited incremental investment, which provides us a good visibility for a long-term, sustainable growth for the company. In the meanwhile, we continue to focus on productivity improvement across the organization and committed to make it a way of life. Our healthy balance sheet and sustainable cash flow generation will help us to grow faster through efficient capital deployment for both organic strategic initiatives and for inorganic opportunities.

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

Moderator: Sure, thank you very much. We will now begin with the question and answer session. The first question is from the line of Aditya Khemka from DSP Mutual Fund. Please go ahead.

Aditya Khemka: So firstly, on the cost management. So for the past 4, 5 years now, we have been seeing low single-digit growth in most of our cost components, which includes R&D expense and SG&A expenses and I understand this has come from a lot of efficiency and hard work from your end, from DRL's end. Could you sort of give us some flavor on if there was, let's say, 100 is the scale of which cost optimization could have been done when you joined Dr. Reddy's, where are you in that journey to 100? Are you at 50? Are you at 80? Are you at 99? How close are we to sort of achieving the optimal cost structure that you would have desired?

Erez Israeli: I cannot quantify these numbers, but there is still a lot of room to be better. The goal is to be the most efficient company on earth in our space, and we are very far from there. So we will continue to see these efforts also going forward.

Aditya Khemka: Okay. And just in terms of your commentary in some of your calls where you said that the ideal metrics that you want to target is a 25% EBITDA with a 25% ROCE. Do you think that's something which is achievable over the next 2, 3 years? Or you would target that for the next year itself? How would you think about that goal?

Erez Israeli: We achieved already for this quarter, 24.5% on the EBITDA overall. So we are very close and I believe that it's achievable. And I believe that it's achievable basically not just as overall, but it's relevant actually for every activity that we want to do which means that the average can be even higher in the future. I don't have a timeframe or guidance of that because we don't give guidance, but this is the indication.

Aditya Khemka: Fair enough. On the revenue side, if you could just guide us on what the domestic business, we have seen a decent turnaround in terms of the growth that we have been doing now. But what has changed in the domestic business? What have we changed to achieve this superior growth versus the broader market? And how do you see that effort sustaining in the future?

Erez Israeli: We decided that we want to win in this market. I think this is the main change, and we substantiated by putting relevant R&D for those products, by opening TAs, by changing the team leadership, by putting commercial excellence. So it's multiple efforts and multiple activities. But I attribute the main success if you wish for what we do is the fact that we, as a management team, decided that India is a priority for us, and we decided that we want to be in the future Top 5 in India, and we are planning to achieve it.

Aditya Khemka: Sure. Just one last question. So now that your balance sheet is a net cash balance sheet. The outlook on any inorganic opportunities and your priorities on that side?

Erez Israeli: We are always looking for opportunities, and we are very active on this front. The priority is on emerging markets and India in particular because this is where the area of focus. Having said that, we said it in the past, I want to use the opportunity to say it now. We see it as a complementary move, and we don't want to merge both financial risk and business risk, meaning that we will not go more than 2x EBITDA for acquisitions. The primary growth for Dr. Reddy’s will be organic.

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

Vishal Gada: Sir, could you guide us how has the China business performed in third quarter?

Erez Israeli: China did well, and it is growing. And on top of it, we discussed that we won, I think, the first winner, at least outside of China in the product of olanzapine. We are not giving specific numbers

for the market. But overall, I'm very pleased with the performance. China grew this quarter as well.

Vishal Gada: Okay. Could you help us with the kind of launches that you're planning for Europe and EM in the coming few quarters?

Erez Israeli: What we are doing in Europe is primarily taking and leveraging the U.S. portfolio in Europe. So most of the launches in Europe in the future will be primarily injectables. And in the case of Germany, it will be also a solid growth. So the overall expectation and our strategy in Europe is to build a healthy organization with better critical mass based on that leverage. And give or take, whatever we are launching, we'll launch in the U.S., we want also at least portion of it to submit and launch in Europe.

Vishal Gada: Okay. And the last question is, could you help us to understand what helped in containing the SG&A costs?

Erez Israeli: It's primarily the commercial excellence. We are selling more, but we were able to do it with the same or even less resources to sell in all the places. Just, the pure management of a much more stringent focus on KPIs, nothing special. Nothing we do special, it's just more disciplined.

Moderator: The next question is from the line of Prakash Agarwal from Axis Capital. Please go ahead.

Prakash Agarwal: Just one question on the 11 billion write-off that you have taken for the NuvaRing product, and we kept 3 billion pending. So I just wanted to understand, has the value with 1 or 2 players come off that significantly or we are going ultra conservative, some thoughts?

Saumen Chakraborty: So these are all trigger based impairment testing that we do. And given the dimensions, the nature of this thing, we will take an independent evaluator beyond what team management will consider and our statutory auditor. So of course, there will be various scenarios with possible probabilities. So with probabilities attached one takes a decision in terms of the impairment outcome. So pure accounting treatment, we have taken this.

Prakash Agarwal: Okay. And what is our current understanding of the product in terms of we got a CRL in the past. So when do we plan to get this resolved and get an approval?

Erez Israeli: We are planning to submit this in the next few months.

Prakash Agarwal: And any color on the expectation on approval, sir?

Erez Israeli: Then it will go through the review, it is a 6 months without inspection and 10 months out if no additional queries. So from that submission, we need to count that time. But of course, it can go to another cycle. We already had 2 cycles in this one.

Prakash Agarwal: Understood, fair enough. And secondly on, sir, cost, I think, a couple of guys already asked but just one thought here that since we are focusing more on the emerging market, which is India,

Russia, CIS, where the cost is a push model where you need to use your MRs, and we have been rightly growing mid-teens now. So I just wanted to understand, I mean, going forward, high single-digit or early teens should be the right metrics in terms of cost. Or we can still maintain our low single-digit kind of cost escalations, what are the thoughts?

Erez Israeli: Firstly, in emerging markets, part of our model is B2C that's using reps and part of it is B2B. And overall, going forward, B2B is selling directly to account management hospitals around the world, footprint will grow. So part of it is a mix of business model that we have to take into account as well. Overall, there is a room to grow efficiency also in what we have now. So we did not finish the efficiency activities. And in general, the way you should look at it is that bottomline will always grow faster than the topline.

Prakash Agarwal: Bottomline would be always faster than the topline?

Erez Israeli: Will grow faster than the topline.

Prakash Agarwal: That is great. And secondly, just 2 more updates, if you could help us with Copaxone expectation now as well as Revlimid ?

Erez Israeli: We will submit response within the next few months for the CRL.

Prakash Agarwal: For Copaxone?

Erez Israeli: Yes. For Copaxone.

Prakash Agarwal: Okay. And sir, any updates on Revlimid expectations?

Erez Israeli: Yes, we expect it to be an amazing product. I cannot say more than that, I hope you can understand.

Saumen Chakraborty: We can move to the next person.

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

Anubhav Aggarwal: Yes, my question is on the Russian market. It was quite a strong quarter in this geography despite a mild winter and in your release, you mentioned about the volumes and realization both were better in this quarter. So some more explanation will help just in a quarter, what led to such a strong result?

Saumen Chakraborty: This also has been helped by the tender of Reditux that also we got in this quarter.

Erez Israeli: So it's a combination of both. We do better on the retail, and we won the tenders together. And I attribute it primarily to the commercial excellence program that we put in place, and we are achieving better results with less people.

Anubhav Aggarwal: So your comment that the volumes and realizations were better. Largely, that was for Reditux is it, right?

Erez Israeli: It's a combination of both, retail and the rituximab that we won in Russia.

Anubhav Aggarwal: So just to help us, so that we have a better idea. So retail performance, was that out of line with what we've been doing for the last 2, 3 quarters? Or was it much stronger this quarter?

Erez Israeli: I believe that the team performed better. We did not do anything special and there was no single act or single activity that led to that because it was a cause to both. The only one that was singled out was rituximab, which we mentioned already.

Anubhav Aggarwal: Okay. Second question was on the PSAI business. Our topline was largely similar sequentially, September to December quarter, but margins were significantly better. Some color will be helpful. Was it like more API? More custom products? Or within API, a significantly better mix? What was the reason for that?

Erez Israeli: The main reason for that is a combination of product mix. So the mix of the product was more profitable. And second, I think we're doing better on costs also.

Anubhav Aggarwal: Sorry, what was the second reason?

Erez Israeli: That we are doing better on cost. We are more and more cost conscious. And from quarter-over-quarter, we see the benefit of that.

Saumen Chakraborty: Manufacturing overheads he is implying.

Anubhav Aggarwal: Okay. And just 1 clarity on the earlier question on NuvaRing when you responded that you've made several cases and to probability adjust it. So when you do this kind of accounting, do you typically do all probability adjusted scenarios? Or is it just you would tend to be more conservative and select the most conservative one?

Saumen Chakraborty: The accounting standard doesn't allow you to be extra conservative, and it doesn't allow you to be aggressive. So we will have to have a very nice balance. And that's why when it is very significant, you actually go out and get a third-party also to do the same thing to validate the rationales.

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

Neha Manpuria: On the U.S. business, if I remember correctly, other than Ranitidine, there were some logistical issues, which impacted the revenue which should have been resolved in this quarter, given you've had 20-plus launches in the last 9 months, our revenue does not seem to be reflecting both resolution of logistical issue or the launches. Am I missing something in the U.S. performance for the quarter?

Erez Israeli: I don't know if you are missing, you normally don't miss, Neha. So I'll do my best to explain. Firstly, logistical issues are already behind us. Ranitidine event was only last quarter. This quarter, we did not sell Ranitidine, we are still out of the market. And then it's a combination of new products and price erosion. So it's just a mix between the 2 of them.

Neha Manpuria: Sir, is it fair to assume that we're still seeing probably high single-digit price erosion in our portfolio, despite our concentration being much lower because with the both on market share increase and launches, should there not have been an improvement in the U.S. business versus, let's say, the first quarter in FY '20?

Erez Israeli: Our portfolio indeed has a price erosion, if you do year over year, its nice price erosion, it's absolutely inevitable. I do agree with you also that the product mix is much more healthy than it used to be. Naturally, when we launch new products, those products that we launched in the earlier part of the year has also higher price erosion because it's still within the first year. That's always the case. But for new products, the percentage of price erosion is normally higher than mature products.

Neha Manpuria: Understood. And second question on the India business. Sir, if you could give us some color on what is the MR that we have on ground? And are we seeing an improvement in productivity because as per the last reported number of March '19, there's been a reduction in the number of MRs, that we had in India. So have we added, deducted? How the productivity has improved? Just trying to understand the profitability of the India business.

Saumen Chakraborty: Primarily, the salesforce productivity has improved considerably. And what you see, what we report is the topline growth. Our profitability in India has grown much better than the topline growth.

Neha Manpuria: And do you see more scope for improvement sir there?

Erez Israeli: Yes, there is scope for more improvement even in the future. We just started to have fun in India.

Moderator: Thank you. The next question is from the line of Kunal Mehta from Vallum Capital. Please go ahead.

Kunal Mehta: Sir, when you look at your present manufacturing infrastructure, are there any sites where the utilization is below what we would like to have, I mean, below 50% or so?

Saumen Chakraborty: Yes, there are sites where utilization is still low, multiple reasons. So there is, again, a scope to improve our assets capital turnover.

Kunal Mehta: Sure. And sir, second question is sir, the set of actions which we have taken to improve the business has been very commendable. But sir, I would just wanted to understand your view on what sort of precautions are we're taking to make sure that the inspections we go through in the future, would give us satisfactory outcomes because any company we see is just probably one

bad inspection away from affecting their product mix and their growth trajectory. So how are we dealing with that?

Erez Israeli: Since 2015, until to date and increasing every year we took measurements to be compliant, not just with the United States, all over the world. And it's in the forms of a very-very different quality organization than we used to have five years ago, very different digital level, most activities are digitized. All the activities that are related to part 11 are in very-very different level and so is the resources and the awareness of compliance. I personally believe and so far, the track record for the last few, shows that it's working. And one should never be to show off himself and it's something that we always need to be consistent and we're planning to do so. But so far, so good. And luckily for us until now, knock on wood, we're not part of that compliance …inaudible and hopefully, it will continue in the future.

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

Sameer Baisiwala: Sir, just on the U.S. market, you have mentioned in your commentary that you saw price erosion in some of your key molecules. Can you just let us know what is driving this price erosion? I mean, was the new entrants? Or was there some other reason?

Erez Israeli: Primarily new entrants and that they launched after us. And Sameer you know well this market. So when there's a new entrant comes, especially to one of the key customers, then you either defend your share or lose your share and that's the mechanism, and that's what happened to us.

Sameer Baisiwala: Okay. And I'm sure what you're saying is these are mostly new products; they were not the mature products?

Erez Israeli: Also mature products, but let's say, as we started to launch new products after the growth that we had since October last year, those products that we launched in the late last year, in the beginning of this year, naturally got higher erosion percentage than the matured products.

Sameer Baisiwala: Okay, got it. Sir, just deliberating a bit more on this point. Going forward, our understanding is that the North American market pricing environment has got a lot better from mid-teens to high teens has gotten down to single-digit price erosion. Is this something that you would also confirm? And how do you see, as we roll forward to fiscal '21 on price erosion?

Erez Israeli: So we're not giving specific numbers. For us, there is no overall trend. It's more of what portion of our portfolio is seeing this competition. Because per product, per customer is always double-digits. So it now depends on how many of your products under this kind of regime. In our case, we do see a price erosion also this year, but we are not giving specific numbers.

Sameer Baisiwala: Okay, great. And just one more from my side. And sir, most companies in Indian generic space have margins mid-20s and that sort of topping it out at EBITDA level. You're already there and your commentary suggests that you had just started. You've a long way to go. So quite naturally, you expect this EBITDA margin to expand substantially over next 2-year period?

Erez Israeli: I believe that we can do much better on the EBITDA. Yes, absolutely.

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

Nitin Agarwal: Sir, on this Rituximab launch in Russia. This is a one quarter number. It's going to be sporadic? Or this is something that's going to continue through the quarters?

Saumen Chakraborty: No, Reditux we have launched long back in Russia. The way it gets sold is through tendering and the tender happens in a particular frequency. So this quarter, there was tender awarded consequently sales on Reditux is higher, but it is not a new one, but it doesn't happen consistently every quarter.

Nitin Agarwal: Okay. There's going to be a limit of lumpiness to these earnings depending upon the tenders there?

Saumen Chakraborty: The lumpiness is always there on account of this particular molecule.

Nitin Agarwal: Okay. And then just on Reditux per se, this was biosimilar in emerging markets. Beyond Russia, how should we look at this portfolio now?

Erez Israeli: We have Rituximab in many markets. I do not recall it exactly how many, 14, 15 markets, and normally, in Russia, there is a tendering of either by hospital per se or by some government body that buys for the rest of the country. We are now in the middle of the trial for the U.S. market. And the way we look at it, those markets that we like to get the data of the USFDA approval once approved, it will open a new opportunity for us in a place that we have a good go to market, we will do ourselves. And in the place that we do not, we will like to see to others.

Nitin Agarwal: And sir, are there any other products in the biosimilar pipeline beyond Rituximab?

Erez Israeli: We have 11 more in the pipeline.

Moderator: Thank you. The next question is from the line of Surya Patra from PhillipCapital. Please go ahead.

Surya Patra: Sir, just a simple clarification on the gross margin front. Is it fair to believe that there was an element of currency that also played meaningfully for the expansion of the gross margin sequentially this quarter?

Saumen Chakraborty: Constant currency, there has been no impact, either on sales or profit year-on-year basis. Specific currency, it could have happened, but it has neutralized. Overall for the company on a constant currency, it would have been very similar to what is reported growth.

Surya Patra: Okay. And on the kind of a capex trend and the R&D expenses trend, along with the kind of a cost containment pieces that we are seeing a kind of flattish R&D spend. And alongside the

capex also meaningfully has corrected from the last couple of years. So any thought process on the kind of money, free cash flow that we are generating about the usage of those?

Saumen Chakraborty: First on capex, we have spent considerable amount of capex over FY '13, '14, '15, '16. All these years, we have spent considerable amounts. Today, as we told that there are some assets in our networks, which is quite underutilized. But overall, utilization level is also something when we can do much more with the current level of investment or our network that we have created. Having said that, maybe some specific business, for example, service business, if you have to scale up, then we need to make accordingly investments there to scale up. And also for biologics, if we sell more in different markets, we need to increase the capacity. But the level of capex that we need to do, we actually alluded right at the beginning of the year that we will not be spending as much as we would have been spending in the past. R&D on an absolute amount, again, is something which will be to slightly less than may be than what we have spent last year. But of course, the percentage of sales as our sales goes up then R&D as a percentage of sales come down to single digits. Right now, it is around 9% and if we can contain on an absolute level and improve R&D productivity because I always want to emphasize that our focus on R&D is always very high. We have been focusing on developing our pipeline, expanding our pipeline, and we want to continue to focus on that, but just want to improve the productivity so that with same level of investment we can deliver more. In terms of the cash flow, obviously, if our margin is better and if we can improve on EBITDA level, then consequently, the generation can improve. All said and done working capital given in this quarter, we said that our working capital, net working capital has increased by 3 days. Suppose instead of increasing by 3 days, it would have improved by 3 days reduce, then we would have generated more cash flow. So there are always opportunities to what extent we do based on how do we execute on multiple fronts. The good thing happened with this quarter in all the businesses we have, grown something we have different, we haven't put all eggs in 1 basket, there are multiple baskets. In this quarter, all businesses have grown. So that way it is good, but on working capital front this quarter was not that great.

Surya Patra: Okay. Just on the U.S. business front sir, in the opening remarks, you have mentioned that we have relaunched a couple of the discontinued or few discontinued products and also the kind of filing effort that is also picking up. That is what you were mentioning. And simultaneously there is a pricing pressure also that you are witnessing, and also, you're saying that the focus on the anchor product for the dependency that is also, to some extent, is going away. So that way, what would be the ultimate strategy that you are thinking about U.S.? Well, are you thinking that, okay, whether it is the anchor product or it is a common product, everything that you should be launching? And hence, the quality of earnings in the U.S. that is going to deteriorate and that means you're trying to chase growth at the cost of quality, is that the meaning that you were trying to convey?

Erez Israeli: First of all, to the last comment, absolutely we'll not grow on the expense of quality. Quality is not in the equation of, we will meet the quality standards, for so called U.S. market and absolutely, we will not compromise on quality, of course this is one, it's unrelated to quality. So this is a license to build the business on quality. In the case of the product, we will not be

dependent on any single products to grow including United States. With the notion of the past, the company focused on a relatively small number of assets either complex generics or biologics or proprietary products for the growth of the company. This is a strategy that was indeed in the company until 2 years ago. Since then, we've announced a new strategy in which we have multiple spaces which have synergy among them, much more opportunity less risk. So we moved from high risk, high reward to a low-risk, very high reward. That's what we moved and we are not dependent on NuvaRing, not on Copaxone and not on any other big names to grow there. In the United States, we will grow because we want to have 350 products. Now we have commercially 120. And this is including the products that we have in the pipeline, plus the products that are in the pipeline on the R&D, plus additional efforts that will have to number of products. What we want is to give the customers in the United States, the products that they need, not necessarily focused on specific assets. Naturally, when you will have a broad portfolio, some of your products will give you upside. What is important to us is that the products will have a low cost in order to allow the right EBITDA and the right ROCE.

Surya Patra: Okay. But any timeline that you are targeting to achieve double-digit kind of a growth again in the U.S.?

Erez Israeli: I'm not targeting the double-digit growth; I'm targeting EBITDA and ROCE.

Moderator: Thank you. The next question is from the line of Nikhil Mathur from Ambit Capital. Please go ahead.

Nikhil Mathur: My first question in on the SG&A expense. So in fourth quarter and first quarter, you have out licensed your proprietary products. My understanding is that there would have been some cost savings arising from that out-licensing. So have those costs come off in third quarter this year, for that matter in second quarter as well?

Saumen Chakraborty: There will be, suppose you divest in commercial wing, there are also cost associated in terms of separating people so that takes some time to get the complete benefit out of that. So may be next financial year onwards, we can see a full benefit of that kind of a cost saving. But yes, it has contributed to the overall cost savings to some extent that I can clarify.

Nikhil Mathur: Okay. So in FY '21, even if a bit of expense increases because of growth in India and Russian markets, you still do have a lever of this proprietary product cost that kind of benefit you?

Saumen Chakraborty: On the Proprietary Product, earlier what used to have the commercial cost that is going to be beneficial because we are going to continue to focus on the Proprietary Products R&D.

Nikhil Mathur: And second question is on your product launches in FY '21. Can you give some kind of an indication as to what kind of proportion would those be injectable, so some kind of complex launches in FY '21. And the question associated with that would be, I believe that there will be a fair share of launches from your partner sites. So are most of your partner's sites compliant with USFDA currently?

Erez Israeli: I don't have in front of us the segmentation of the product launches, sorry about that I don't know. In general, we are not dependent on a specific supplier or a specific vendor or third-party to launch a product, most of the products will be launched out of Dr. Reddy's facility.

Moderator: Thank you. The next question is from the line of Surajit Pal from Prabhudas Lilladher. Please go ahead.

Surajit Pal: Just 2 to 3 questions. One thing is that, is there any update on Suboxone loss of sales, which you're supposed to receive it from the originator for blocking your launch? That is one. Second thing is that is there any regulatory update on the Duvvada observations? Had it crossed 90 days? And what is the status of the plant currently? And third is that the 30 products, which you have guided out of which 22 already you have launched. Any key products can we expect?

Erez Israeli: So on the first question, Suboxone. In the bonds that we have, we are still in the legal process. And it will be resolved when the legal process will take its place. So far, we have won all the relevant related litigations that we have on that. And so it's still work in progress in that respect. I do not expect that the legal process will end in the next few months, it will probably take more than that. But I don't have exactly the indication of how long it will take. As for Duvvada, it was PAI inspection that was in August. We did not receive any EIR and regarding EIR we don't have any additional information. On that we're just awaiting the EIR. And as for specific big products in the rest of the year, again, I am repeating none of the product per se will be that important. Some of them can bring nice money, some of them not. But nothing special that we can share.

Moderator: We'll be able to take one last question. The last question is from the line of Shyam Srinivasan from Goldman Sachs. Please go ahead.

Shyam Srinivasan: Just first one on China and the second GPO for 32 drugs. I know we didn't win anything here, but just wanted to understand any of the learning that you got from olanzapine in the round 1. How did they play out this time? We see that the price cuts are very high 60%, 70% again in GPO 2. So how does this kind of shape your China strategy? So that's my first question.

Erez Israeli: It's part of the strategy. Just to remind us all, we have 4 different spaces in China. One is branded generic. One is selling generics directly to the hospital. One is this tenders, if you wish, and one that we are selling services like API and other activities to Chinese. On this front of this GPO model, it's still work in progress also for the Chinese authorities. So the next tenders have already different rules. For example, there will be N-1 winners for the next tenders. So there is a high likelihood or higher likelihood to be a player in that. But of course, there will be also more winners. And this is the main learning that I can share. What we do in China is a clear leverage strategy. We are taking U.S. products or products that we submitted for the U.S. that can meet the Chinese criteria, we are submitting them. We're obtaining approval and then participating and do our best to win as much as we can. Even in the case that we will not win, it's a leverage product. So it's not a risky move in our case. That's how we plan to build, but it's very hard to tell which product will win and which products will not and what will be the price. Naturally on

this product on one hand, there is a relatively high price reduction. But on the other hand, you don't need to pay SG&A because you're not promoting those products. It goes to be standard.

Shyam Srinivasan: Yes. Just following up on this. So are you saying even after this price cut, this is a reasonable money to be made? Or you think there is a period of 2 to 3 years, where we have to invest before we start seeing profits come through in China?

Erez Israeli: No, every product that we are launching we are making money. So it's not that period of investment and period of profit, we are making profit as we speak.

Shyam Srinivasan: Got it. Just a follow-up again on China. The coronavirus is making the news, does it impact our Chinese operations? Or on the contrary, does it also benefit us in some form of way? Is there any impact of the virus?

Erez Israeli: Naturally, it did not impact the quarter because it's recent. No, I don't have anything that happens to us in the last few days as of the corona issue and I hope and wish for everybody that nothing will happen.

Shyam Srinivasan: Got it. And my last question is on Revlimid. I know it's a great product. We get that. But the point is on trial dates, our understanding was that the trial has been pushed to second half of calendar year 2020. Could you confirm or just give us details on when are the upcoming dates so that we can look out for this product?

Erez Israeli: I am not aware of a specific date that was scheduled. That's what I know. But from my point of view versus what we want the product and the legal process is continuing in accordance to timelines.

Shyam Srinivasan: Got it, just **…inaudible** here. So is it still is not a near-term opportunity and we still think it's probably sometime out?

Erez Israeli: Yes, I don't see it in the next few months. It's probably will be after that.

Moderator: Thank you very much. We will take that as the last question. I would now like to hand the conference back to the management team 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. Thank you.

Moderator: Thank you very much. On behalf of Dr. Reddy's Laboratories Limited, that concludes this conference. Thank you for joining us.