Dr Reddy's prescription to stay ahead of the generic pack

The company has differentiated itself by focusing on internal processes and staying away from costly acquisitions. Now, it has other plans to fend off the competition

B DASARATH REDDY
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The revenues of Hyderabad-based generic drug maker, Dr Reddy's Laboratories, is expected to surpass those of Ranbaxy Laboratories, the largest Indian generic drug company, and now a subsidiary of Japan's Daiichi Sankyo, sometime next year. Barclays Equity Research projects Dr Reddy's revenues for FY14 at ₹12,663 crore, slightly higher than Ranbaxy's (at ₹12,615 crore).

This would be big news for any company battling it out in a challenging industry. However, the generic-drug business is more than just that. It's a fiercely competitive business, driven by volumes and characterised by constantly falling prices and, therefore, steep margins. As a result, product differentiation is minimal, and the only way to drive sales is by lowering prices — which, ironically, threatens the very survival of the business.

BATTLE OF THE GENERICS

As the patent cliff in the US levels off, generic drug makers will face increasing pressure to develop other kinds of products

Revenues in 2011-12 (Actual)

₹ crore ■ Revenue ■ Net profit

	Revenue	Net profit
Ranbaxy Laboratories*	9,977	-2,900
Dr Reddy's Laboratories**	9,674	1,426
Sun Pharmaceutical Industries**	8,006	2,587

*Calendar year 2011, **FY ended March 2012

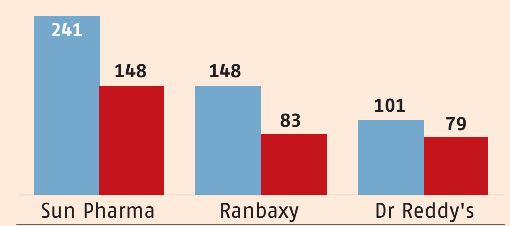
Revenue for top-three Indian Pharma companies

₹ crore ■ 2012-13 ■ 2013-14*

	2012-13	2013-14*
Ranbaxy Laboratories	11,309	12,615
Dr Reddy's Laboratories	11,286	12,663
Sun Pharmaceutical Industries	9,694	11,472

*Estimates

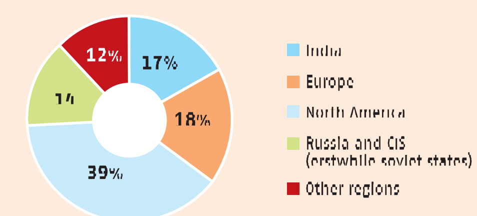
ANDA* pipeline of top-three companies



*Abbreviated New Drug Application

Global pharmacy

Share of consolidated revenues for Dr Reddy's in the year '11-12



US product portfolio (products in numbers)

Ranbaxy	67
Dr Reddy's	64
Sun Pharma	146

USFDA-approved facilities (in numbers)

Dr Reddy's	14
Sun Pharma	11
Ranbaxy	4

Tooth and nail

Generic companies are doing everything in their power to gain a competitive edge. For example, Sun Pharma recently appointed ex-Teva CEO Israel Makov as its chairman, because of his ability to leverage his global expertise to drive growth and tap new markets. Acquisitions and alliances in the industry have also become key to driving sales. Sun's acquisition of Taro, for instance, expanded the company's product base to 148 in the US, besides adding 23 abbreviated new drug applications (ANDAs) to its pipeline; it also provided access to complementary therapeutic areas, like dermatology.

Curiously, Dr Reddy's has done little of both, and that has been its biggest differentiator from the other generic biggies. Says Balaji V Prasad of Barclays Research, "I do not attach much importance to the tags of first and second. But, it is very important for Dr Reddy's to find new sources of revenues. Sun is already planning just that."

Yet, Umang Vohra, executive vice-president and chief financial officer of Dr Reddy's, insists his company's 'defensive strategy' has served it well. "After Betapharm, we came down to the fact that you should make acquisitions that improve the capabilities within the organisation, as against buying a company in some market which increases your turnover. That is defensive," he says. "Second, if you look at the chart of patent expiries, there was a huge amount of potential. In that scenario, we said we would focus more on executing well because there was enough opportunity in the market. When those opportunities begin to die, acquisitions would anyway be available," he adds.

The four smaller acquisitions the company made after Betapharm, including the recent $40-million one of a dermatology brand in the US, were largely done with an intent of getting more capabilities. "After these baby steps, I think we have today reached a situation where we are more confident of an acquisition strategy going forward," he says.

The other difference that sets Dr Reddy's apart is its conscious decision, made a year and a half ago to target more complex products, few are capable of making. Vohra cites the example of Dr Reddy's biologic product, Rituximab, a monoclonal antibody used in cancer and anti-rejection treatments. When the company launched it at 50 per cent of the original price in India, the market expanded 10 times, he says. In 2010-11, the domestic revenues from it grew 75 per cent, to touch ₹40.5 crore.

Vohra believes the company has possibly one of the best-quality product pipelines, which cannot only be measured by the number of ANDAs filed with the USFDA. "I can tell you we never want to be the highest filers in India. Not this year, not in the past and not in the future."

Relying on Uncle Sam

Much like other generic firms, Dr Reddy's relies heavily on selling its drugs all over the world. Its global revenues grew 32 per cent last year to over ₹7,000 crore in 2011-12, driven mainly by the US market, which saw 16 launches. This includes the first-to-file launches of Olanzapine and Ziprasidone, both antipsychotic drugs that had 180-day marketing exclusivity periods. Olanzapine alone had contributed $100 million to its US revenues last year. Launches are critical to the company — a little more than 50 per cent of its US revenues come from new products.

The biggest concern articulated by analysts is that the patent cliff in the US is soon going to level off. The year 2012 was particularly exceptional in terms of small molecule patent expiries worth $44 billion, of which Lipitor accounted for $10 billion. But, Vohra feels the next four years still present ample opportunities — worth over $70 billion, pretty much the same as in the previous four. "Forget about the patent cliff, the opportunity there is still going to be enormous for companies like ours in the US," he says.

There are no blockbuster drugs comparable to Atorvastatin (for high cholesterol) and Clopidogrel Bisulfate (for heart attacks, strokes, and to treat peripheral vascular disease and claudication), both cornered a $6-billion generic opportunity each. But the company still sees a substantial upside from products like Escitalopram (for anxiety disorders) and Esomeprazole (for stomach and duodenal ulcers), scheduled to be launched in the next two years. The company has also put more effort in expanding the over-the-counter (OTC) product portfolio, as this gives a wider reach, compared with prescription drugs.

The road ahead

Maintaining a competitive edge will not be easy for Dr Reddy's. Its alliances — one with GSK for Latin America, with Merck Serono for co-developing and commercialising biosimilar compounds; and a joint venture with Fuji Film to design and develop generic drugs for the Japanese market — and biosimilars have a long way to go before making any meaningful contribution to the top line.

Also, the 180-day marketing exclusivity period is like a very short, exotic vacation that you will never take again. Once this period is over, competition brings down the price to 0-5 per cent of the innovator drug in the US market. The company plans to beat this price erosion by targeting complex generics, with sophisticated formulation processes, and by delayed actions and modified releases.

The company is also betting big on biosimilars, the generic equivalents of biopharmaceutical products, a class of proteins used in treating complex diseases like diabetes and cancer. It expects its biosimilars to start generating substantial revenues from 2017 onwards, coinciding with the patent expiries of the category in the US. Besides the therapeutic areas of gastro-intestinal, cardiovascular, diabetes, oncology and pain management, the company is actively pursuing the dermatology segment.

To survive the onslaught of the coming years, Dr Reddy's needs to drive sales in emerging markets. "They will need to make acquisitions. But, they should stick to the US and Russia and not go anywhere else. They should keep away from Japan, because it is going to be a tough market. At best, they can think of Latin America, which is growing fast," advises Barclays Prasad.

Not surprisingly, Vohra says Dr Reddy's is already looking to increase its presence in Germany, the CIS countries, South Africa and Venezuela through the GSK partnership. Other strategies include diversifying into the OTC segment in some markets and working on cost models to save resources for funding the business of proprietary products. The company, Vohra says, will now look at acquiring properties that have complex products. "We will look for brands in Russia's OTC segment, possibly some brands in India also. We continue to look at opportunities even within the US, But they are strategic, not opportunistic."