

# DR.Reddy's Laboratories Limited

**BUY**

**CMP: Rs.1110.00**

**Date: November 25, 2009**

**Target Price: Rs.1277.00**

**Market Cap. : Rs.187301.40mn.**

## Key Ratios:

Particulars	FY09 (12 m)	FY10E (12 m)	FY11E (12 m)
OPM (%)	20.31	24.01	24.48
NPM (%)	7.91	12.69	13.11
ROE (%)	15.47	21.45	19.89
ROCE (%)	21.69	26.65	25.21
P/BV(x)	5.30	4.17	3.34
P/E(x)	34.27	19.45	16.81
EV/EBDITA(x)	13.34	10.28	9.00
Debt Equity ratio	0.18	0.16	0.13

## Key Data:

Sector	Pharma
Face Value	Rs.5.00
52 wk. High/Low	Rs.1146.00/357.00
Volume (2 wk. Avg.)	70267
BSE Code	500124

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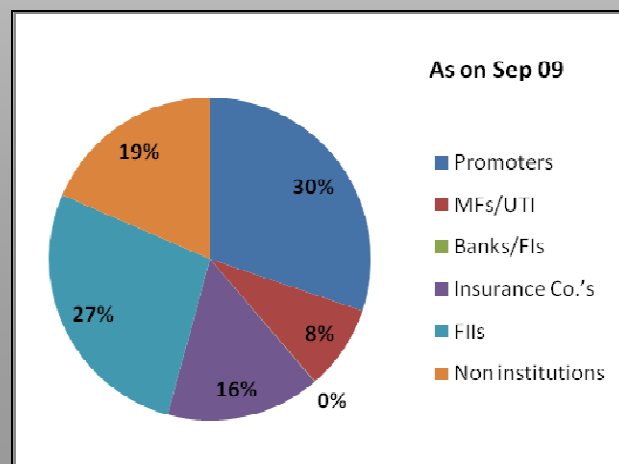
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## SYNOPSIS

- Dr. Reddy's is the fastest growing company in prescription terms, and is the third fastest growing pharma company overall. 45 of its brands are in the top three in their respective segments, with six brands in the top 300 brands in the country.
- Dr Reddy's Laboratories, an emerging global pharmaceutical company, has charted plans to come up with about seven new generics in the United States in the current fiscal.
- Dr Reddy's has filed an abbreviated new drug application (ANDA) to US Food and Drug Administration for marketing a generic version of Pfizer's cholesterol-lowering drug Lipitor in the US.
- Pharma major Dr Reddy's Laboratories has made an entry into transdermal patch segment through the introduction of Finrid in the domestic market.
- During the quarter, the company launched 24 new generic products, filed 22 new generic product registrations and filed 4 DMFs globally.
- The company's top line and bottom line is expected to grow at a CAGR of 20% and 37% over FY08 to FY11E.

## Share Holding Pattern:



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## Investment Highlights

- **Q2 FY10 Result Update**

Drug maker, Dr Reddy's Laboratories has posted a rise of 2.77 times in the net profit of Rs 2,398.50 million for the quarter ended Sep. 30, 2009 as compared to Rs 866.40 million for the quarter ended September 30, 2008. In the same quarter, total income of the company increased 15.81% to Rs 18,872.50 million for the quarter ended Sep. 30, 2009. During the quarter, EPS of the company is raised by 176.28% to Rs.14.21.

Quarterly Results - Consolidated (RS in mn)			
As At	Sep-09	Sep-08	%change
Net sales	18,580.40	16,203.10	14.67
Net profit	2,398.50	866.40	176.84
Basic EPS	14.21	5.14	176.28

- **Files ANDA for marketing generic version of Pfizer's Lipitor**

Dr Reddy's has filed an abbreviated new drug application (ANDA) to US Food and Drug Administration for marketing a generic version of Pfizer's cholesterol-lowering drug Lipitor in the US. The company has filed for atrovastatin and notified Pfizer in view of that.

- **Joins GCI Pharmaceutical Roundtable as associate member**

Dr Reddy's Laboratories has joined the Green Chemistry Institute Pharmaceutical Roundtable of the American Chemical Society (ACS) as an Associate member. The Pharmaceutical Roundtable is an affiliation between the ACS Green Chemistry Institute and leading global pharmaceutical-related companies, which was founded in 2005 with an aim to promote innovation while catalyzing the integration of green chemistry and green engineering in the pharmaceutical industry. The Roundtable mainly focuses on strategic priorities like informing and influencing the research agenda, defining and delivering tools for innovation, educating leaders and collaborating globally.



- **Introduces Strea C10, Strea A15 in India**

Dr Reddy's has launched Strea C10 (pure topical vitamin C 10%) and Strea A15 (pure topical retinol 0.15%) in India. Both products use microsphere technology and are available in vegicap soft gel capsules form. These products, in-licensed from Vermont Italia, Italy, are used in the treatment of wrinkles, age spots, melasma, hyperpigmentation, photoageing, post procedure inflammation and as an adjuvant to sun screens. These products are available through dermatologists, cosmetologist and plastic surgeons across the country.

- **Allots 56422 equity shares under ESOS**

Dr Reddy's has allotted 56,422 equity shares of Rs 5 each to its employees on exercise of Employees Stock Option Scheme (ESOS 2002) and Employees ADR Stock Option Scheme, 2007.

- **Voluntarily withdraws 4 drugs from US market**

Dr Reddy's (DRL) announced a voluntary withdrawal of four drugs from the US market, stating that the recall was a precautionary measure as some lots of the drugs were seen to contain over-sized tablets. The lots of the brands being recalled include Citalopram (anti-depressant) tablets in 40 mg strength in bottles of 100 tablets, Fexenadine (anti-histamine) in 180 mg strength in bottles of 500 tablets, Pravastatin (anti-cholesterol) in 10 mg strength in bottles of 90 and 500 tablets and Risperidone (psychiatric drug) in 25 mg strength in bottles of 500 tablets.

- **Plans to launch seven new generics in the US this fiscal**

Dr Reddy's Laboratories, an emerging global pharmaceutical company, has charted plans to come up with about seven new generics in the United States in the current fiscal. Among new launches would be Omeprazole, a generic version of AstraZeneca PLC's Prilosec, which the company intends to start selling in the US by early next quarter. The drug is indicated for the treatment of stomach ulcers and acid reflux.

- **Launches Stera Professional in the domestic market**

Dr Reddy's Laboratories has forayed into aesthetics segment in India through the launch of Stera Professional. This is the first Bi-phasic superficial peel for specific imperfections available in the domestic markets. Stera Professional helps remove blemishes, lightens pigmented spots, effaces wrinkles as well as helps improve the luminosity of the skin. It can be used by people who are prone to developing acne. It comes in three variants viz, Stera Professional Acne, Stera Professional Dyschromia and Stera Professional Forte.



- **Introduces Finrid in the domestic market**

Pharma major Dr Reddy's Laboratories has made an entry into transdermal patch segment through the introduction of Finrid in the domestic market. Finrid is used in the management of severe to moderate pain and provides continuous systemic delivery of fentanyl, a potent opioid analgesic for upto 72 hours. It delivers dosages of 25 mcg/hr and 50 mcg/hr depending on the patch used. This is the first opioid transdermal patch to be delivered in India.

- **Launches Execare in India**

Dr. Reddy's Laboratories, an emerging global pharmaceutical company has launched Execare (Halometasone Cream 0.05%) in India. Used in the treatment of acute/chronic steroid responsive dermatoses and vitiligo, Execare is a potent steroid and is recommended as an alternative to Betamethasone Dipropionate and Mometasone Furoate. With this launch, Dr. Reddy's becomes the first company to introduce this molecule in India.

- **Launches Bispec for management of OAB**

Dr. Reddy's Laboratories has launched Bispec (Solifencin Succinate) in India. The drug is used in the management of Over Active Bladder (OAB) and is the best-in-class for OAB and has lesser incidence of dry mouth and constipation.

- **GSK likely to pick up 5% stake**

GlaxoSmithKline (GSK) is in talks to pick up a 5% stake in Dr Reddy's Laboratories (DRL) in order to strengthen its association with the Dr Reddy's with whom it had signed a marketing alliance four months ago.

It is believed that the deal may be priced around USD 150 million and could be clinched in two months, if talks stay on track. The lines of the discussion suggest that the foreign company (GSK) may acquire fresh shares of DRL, which will impact the promoters shareholding marginally, and it may reserve the right of first refusal should the promoters decide to sell their stake in future. The Reddy family, the promoters, holds a 26% stake.



## Peer Group Comparison

Name of the company	CMP(Rs.) (As on November 25,2009)	Market Cap. (Rs. Mn.)	EPS (Rs.)	P/E (x)	P/BV (x)	Dividend (%)
DR.REDDY'S	1110.00	187,301.40	40.55	27.37	3.56	125.00
SUN PHARMA	1451.90	300,712.30	48.57	29.89	5.84	275.00
CIPLA	326.10	261,832.70	12.38	26.34	6.02	100.00
LUPIN	1330.10	117,871.20	51.28	25.94	8.53	125.00

## Key Concerns

- Recession in global economy
- Fluctuations in exchange rates
- High competition from global players
- Loss of marketing alliance(s), which could impair profitability
- Company is facing temporary problems with third party suppliers to both its German subsidiary.
- The company should address worst performance in Germany, probably over in terms of further margin pressures by migrating production of an increasing number of formulations to facility in India.



## Financials

### Results Update

#### 12 months ended Profit and Loss A/C (Consolidated)

Value(Rs. in million)	FY08	FY09	FY10E	FY11E
Description	12m	12m	12m	12m
<b>Net Sales</b>	<b>49141.70</b>	<b>69006.30</b>	<b>75906.93</b>	<b>85015.76</b>
Other Income	2812.80	994.10	1143.22	1257.54
Total Income	51954.50	70000.40	77050.15	86273.30
Expenditure	-41527.90	-55987.00	-58827.87	-65462.14
<b>Operating Profit</b>	<b>10426.60</b>	<b>14013.40</b>	<b>18222.27</b>	<b>20811.16</b>
Interest	-958.30	-971.50	-466.32	-512.95
Gross Profit	9468.30	13041.90	17755.95	20298.21
Depreciation	-4018.60	-4977.60	-4380.29	-4818.32
Profit before Tax	5449.70	8064.30	13375.67	15479.89
Tax	-1077.00	-2608.30	-3745.19	-4334.37
<b>Net Profit</b>	<b>4372.70</b>	<b>5456.00</b>	<b>9630.48</b>	<b>11145.52</b>
Equity Capital	840.90	842.30	843.70	843.70
Reserves	44128.00	34419.00	44049.48	55195.00
Face Value (Rs)	5.00	5.00	5.00	5.00
Total No. of Shares	168.18	168.46	168.74	168.74
<b>EPS (Rs)(before Exceptional Items)</b>	<b>26.00</b>	<b>32.39</b>	<b>57.07</b>	<b>66.05</b>



**Quarterly ended Profit and Loss A/C (Consolidated)**

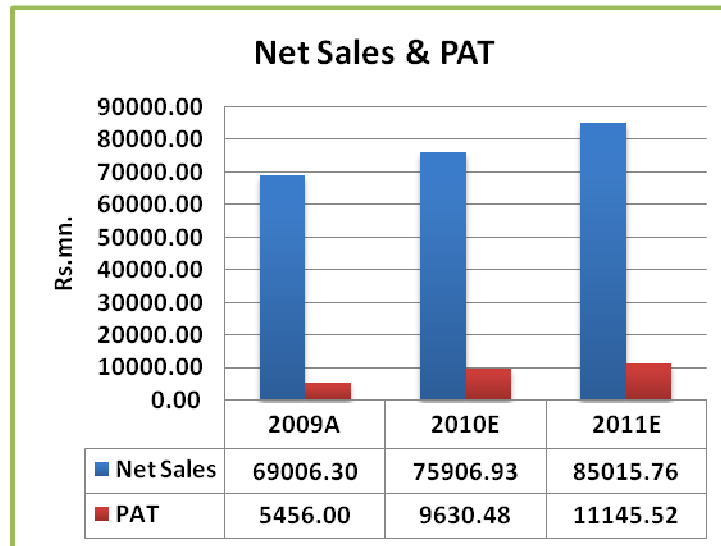
Value(Rs. in million)	31-Mar-09	30-Jun-09	30-Sep-09	31-Dec-09E
Description	3m	3m	3m	3m
<b>Net Sales</b>	19021.00	18208.00	18580.40	19323.62
Other Income	654.00	185.50	292.10	321.31
Total Income	19675.00	18393.50	18872.50	19644.93
Expenditure	-14395.00	-13867.50	-14983.70	-15458.89
<b>Operating Profit</b>	5280.00	4526.00	3888.80	4186.03
Interest	-207.00	-122.30	-68.60	-72.03
Gross Profit	5073.00	4403.70	3820.20	4114.00
Depreciation	-1336.00	-1031.40	-993.90	-1013.78
Profit before Tax	3737.00	3372.30	2826.30	3100.23
Tax	-1659.00	-983.40	-427.80	-620.05
<b>Net Profit</b>	2078.00	2388.90	2398.50	2480.18
Equity Capital	842.30	843.30	843.70	843.70
Face Value (Rs)	5.00	5.00	5.00	5.00
Total No. of Shares	168.46	168.66	168.74	168.74
<b>EPS (Rs) (before Exceptional Items)</b>	12.34	14.16	14.21	14.70



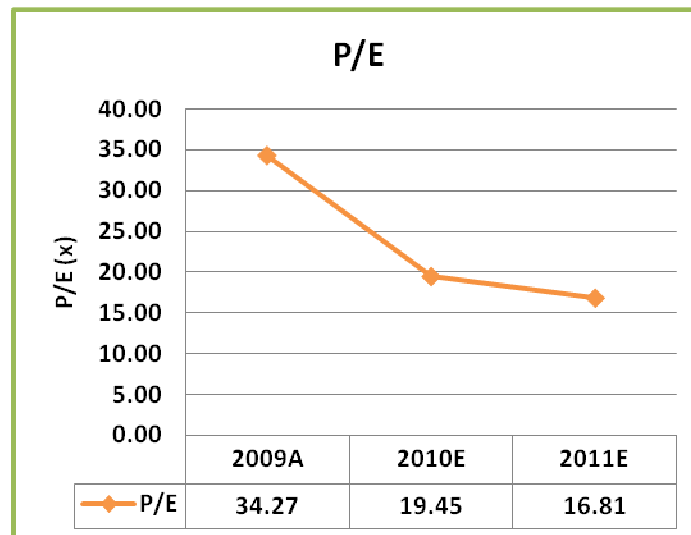


## Charts

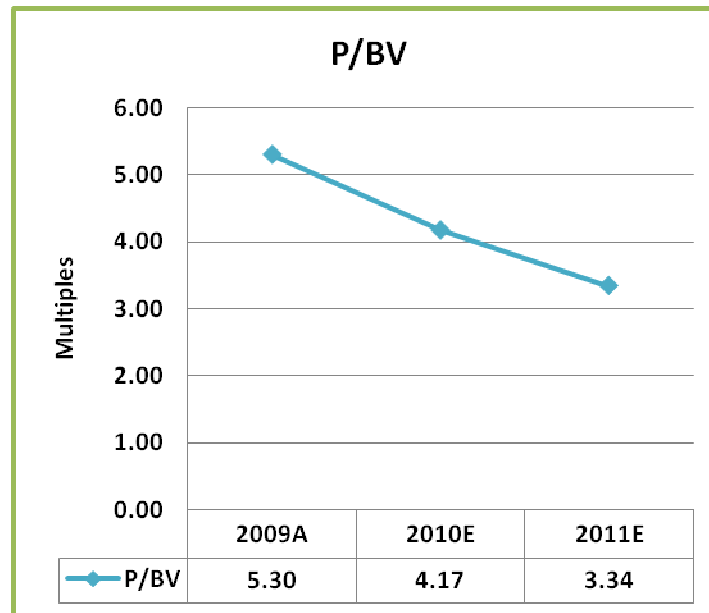
- Net sales & PAT



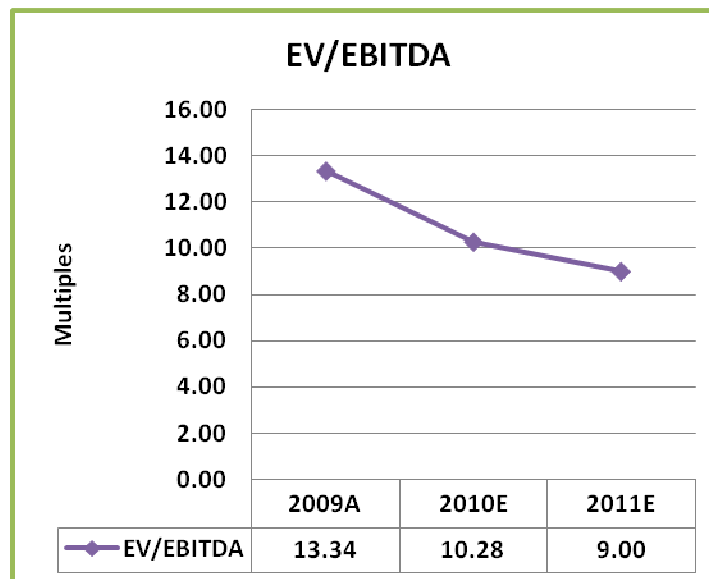
- P/E Ratio (x)



- P/BV (X)



- EV/EBITDA(X)



## 1 Year Comparative Graph



Dr.Reddy's

BSE SENSEX

## Outlook and Conclusion

- At the market price of Rs.1110.00, the stock is trading at 19.45x and 16.81x for FY10E and FY11E respectively.
- On the basis of EV/EBDITA, the stock trades at 10.28x for FY10E and 9.00x for FY11E.
- Price to book value of the company is expected to be at 4.17x for FY10E and 3.34x for FY11E respectively.
- EPS of the company is expected to be at Rs.57.07 and Rs.66.05 for the earnings of FY10E and FY11E respectively.
- The company has received final approval from the US Food & Drug Administration (USFDA) to manufacture and market Nateglinide tablets, in strengths of 60 mg and 120 mg.
- Dr Reddy's Laboratories, an emerging global pharmaceutical company, has charted plans to come up with about seven new generics in the United States in the current fiscal.
- According to the company, the growth was largely driven by sumatriptan and by the key markets of North America and India. Excluding revenues from Sumatriptan, the YoY growth is at 7%.
- During the quarter, the company launched 24 new generic products, filed 22 new generic product registrations and filed 4 DMFs globally.



- Dr Reddy's strong Q2FY10 numbers on the back of robust base business performance reiterates our stance of the base business gaining momentum over the next few years. While change in market dynamics in Germany and cautious operating environment in Russia have impacted DRL in these geographies, strong growth momentum in US business and recovery in India have compensated effectively. Base business growth across all verticals (ex Betapharma) coupled with improved operating performance, will translate into 48% earnings growth over FY09-11E.
- On the back of strong base business performance, we recommend **'BUY'** this stock with a target price of **Rs.1277.00** for medium to long term Investment.

## Industry Overview

- ❖ The Indian Pharmaceutical Industry (IPI) today is in the front rank of India's science-base industries with wide ranging capabilities in the complex field of drug manufacture and technology.
- ❖ Accounting for two percent of the world's pharmaceutical market, the Indian pharmaceutical sector has an estimated market value of about US \$8 billion. It's at 4th rank in terms of total pharmaceutical production and 13th in terms of value. It is growing at an average rate of 7.2 % and is expected to grow to US \$ 12 billion by 2010.
- ❖ From simple headache pills to sophisticated antibiotics and complex cardiac compounds, almost every type of medicine is now made indigenously. The Indian Pharmaceutical sector is highly fragmented with more than 20,000 registered units. It has expanded drastically in the last two decades. The leading 250 pharmaceutical companies control 70% of the market with market leader holding nearly 7% of the market share. It is an extremely fragmented market with severe price competition and government price control.
- ❖ Over the last two years the pharmaceutical market value has increased to about US \$ 355 million because of the launch of new products. According to an estimate, 3900 new generic products have been launched in the past two years. These have been by and large launched by big brands in the pharma sector. And in the year 2005 Indian pharmaceutical companies captured around 70% of the domestic market. With the Product Patent Act, which came into action in January 2005, this industry is able to attract big MNCs to India. Earlier these big firms had apprehensions in launching new drugs in the Indian market.
- ❖ As in the present scenario, only a few people can afford costly drugs, which have increased price sensitivity in the pharmaceutical market. Now the companies are trying to capture the market by introducing high quality and low price medicines and drugs.



- ❖ At present, a large number of Indian pharmaceuticals companies are looking for tie-ups with foreign firms for in-license drugs. Contract research and pharmaceutical outsourcing are the new avenues in the pharmaceutical market. Contract manufacturing is growing at a very fast pace and is estimated to grow to US \$30billion, whereas contract research is estimated to reach US\$6-10 billion.
- ❖ Indian multinational companies like Dr.Reddy's Lab, Cipla, Ranbaxy, Wockhardt etc have created awareness about the Indian market prospects in the international pharmaceutical market. Approvals given by Foods and Drugs Administration (FDA) and ANDA (Abbreviated New Drug Application)/DMF (Drug Master File) have played an important role in making India a cost-effective and high quality product manufacturer. Furthermore, the changes that took place in the patent law, change of process patent to product patent, have helped in reducing the risk of loss for intellectual property.
- ❖ The changing dynamics of the global pharmaceutical industry especially that of the regulated markets like USA and Europe have presented a number of opportunities for IPI to capitalize on. Some of the major concerns facing the global pharmaceutical industry are higher healthcare costs, competition from generics, patent expiries of blockbuster drugs, drying R&D pipelines and increasing R&D costs. These translate into a significant growth opportunity for IPI in the form of exports of generics to regulated markets and contract manufacturing/ research for global pharmaceutical companies.
- ❖ The investment in R&D is also on the rise as it has become important for Indian companies to start innovating new drugs in order to ensure long term sustainable growth and remain competitive at the global level. Indian companies have invested in New Chemical Entity (NCE) research and are scouting for global partners for pursuing collaborative research. The availability of large patient base, skilled manpower and lower costs of carrying out clinical trials has made India a favorable destination for R&D outsourcing.

### **Industry Strengths**

- **Capital Investment in Technology:**

Owing to the availability of advanced technology at low costs, the companies can produce drugs at lower costs.

- **Cost Effective:**

The filing cost of ANDAS and DMFs is comparatively low for the Indian companies.



- **Manpower:**

There is a large pool of technical experts available at modest salaries.

- **Contract Research & Contract Manufacturing:**

There is a good scope for contract research and contract manufacturing.

- **Infrastructure:**

There is a well-developed infrastructure for the pharmaceutical industry.

- **Generic Drugs:**

In the last few years, the generic drug-manufacturing segment has received huge investments, in the process making it more competitive and efficient.

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