

## Company Flash

13 March 2009 | 6 pages

# Dr Reddy (REDY.BO)

## More Positive News Flow

- More positive news flow** — DRL's ANDA filing for Arixtra (fondaparinux sodium) is another positive newsflow for the company's US business. While we are not sure about the approval timeline (DRL's partner, Alchemia, believes it could be in 6M), the complex nature of the product suggests that this could be a key product for DRL on launch. We expect good traction in the US to help DRL offset the pressures in Germany & Russia/ CIS markets to a large extent.
- About Fondaparinux** — The product is currently marketed by GSK under the brand name Arixtra & has sales of US\$163m in the US (US\$315m globally). Fondaparinux is a fully synthetic molecule used as an injectable anticoagulant for patients undergoing major orthopedic surgery. Alchemia believes that since it is a fully synthetic molecule it will not face the same hurdles as other anti-coagulant drugs such as low molecular weight heparins.
- A niche opportunity** — The key patents for Arixtra expired in 2002; however, there is no generic competition due to the complex manufacturing process for the product. DRL will use a novel, synthetic pathway developed by Arixtra that is patented in the US. Given the limited competition, we expect good market share & profitability for DRL – could add cUS\$50-60m to sales & Rs5-6/sh to earnings (11-13% of FY10E earnings) in first full year of launch.
- Mixed outlook** — Our cautious outlook on the stock reflects the mixed trends that we foresee in DRL's businesses over the medium term. While the US market will remain a key growth driver & India should recover in 2HFY10E, we expect Germany (14% of sales), Russia/CIS (11% of sales) to be challenging on the back of lower pricing & currency volatility respectively.

<b>Hold/Medium Risk</b>	<b>2M</b>
Price (12 Mar 09)	Rs399.30
Target price	Rs547.00
Expected share price return	37.0%
Expected dividend yield	1.1%
<b>Expected total return</b>	<b>38.1%</b>
Market Cap	Rs67,266M
	US\$1,306M

### Price Performance (RIC: REDY.BO, BB: DRRD IN)



### Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2007A	11,097	66.09	712.3	6.0	1.6	34.8	1.0
2008A	5,370	31.93	-51.7	12.5	1.4	12.1	1.1
2009E	9,123	54.25	69.9	7.4	1.2	18.0	1.1
2010E	7,703	45.80	-15.6	8.7	1.1	13.3	1.1
2011E	8,322	49.48	8.0	8.1	1.0	12.8	1.4

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

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<sup>1</sup>Citigroup Global Markets India Private Limited

## Dr Reddy

### Company description

DRL is a leading pharma company in India, with one of the best R&D pipelines. It focuses on value addition by increasing the share of branded formulations and generics exports to regulated markets. After starting as a bulk-drugs player in 1984, it has moved up the value chain and is aiming to become an innovator company. In generics, it is trying to increase the share of sales from regulated markets to boost overall profitability. As part of its inorganic growth strategy, it acquired Betapharm in Germany and is looking at smaller deals going forward.

### Investment strategy

We rate DRL Hold/Medium Risk. The company has evolved a business model that is among the best placed to tackle the changing dynamics of the industry. Near-term growth drivers and investment for the longer-term sustainability of growth makes DRL one of the best Indian pharma companies, in our view. At the same time, DRL's presence in patent challenges and drug discovery implies the potential for positive surprises to earnings and valuations. However, our positive view is tempered by DRL being caught on the wrong foot with its acquisition of Betapharm in Germany, given significant changes in regulations and market dynamics. Although these concerns are not new, the impact on the DRL's earnings power appears to be much higher than we had originally anticipated.

### Valuation

Our target price for DRL is Rs547, which is based on a sum-of-the-parts valuation approach. We use a target multiple of 14x to value sector leaders, which is at a premium of about 50% to the broad market and seems justified given that the sector is IPR driven and has the potential for significant earnings growth despite the economic slowdown. However, we value DRL at a 10% discount to sector leaders due to the near-term uncertainty on earnings and return ratios – especially on concerns in Germany. At 13xDec'09E earnings, we value DRL's base business at Rs498. We value DRL's Para IV pipeline separately at Rs49. For this, we use a success probability of 25% & a discounted cash flow (discount factor 15%) for the opportunities being targeted over the next few years.

### Risks

We rate DRL Medium Risk, which is in line with our quant based risk rating system. Downside risks to our target price include: (1) DRL's ramp-up in sales and distribution in the US entails large investments; (2) Patent challenges are win-lose situations and often cause stock-price volatility; (3) R&D success rates are low. Upside risks include: (1) better-than-expected performance in Germany either due to lower pricing pressure or higher savings on sourcing from India could lead to upside to our earnings estimates and target price; (2) any success achieved in either its NCE R&D program or any of its patent challenges could act as a positive catalyst.

# Appendix A-1

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#### Fundamental Research

Analyst: Prashant Nair, CFA

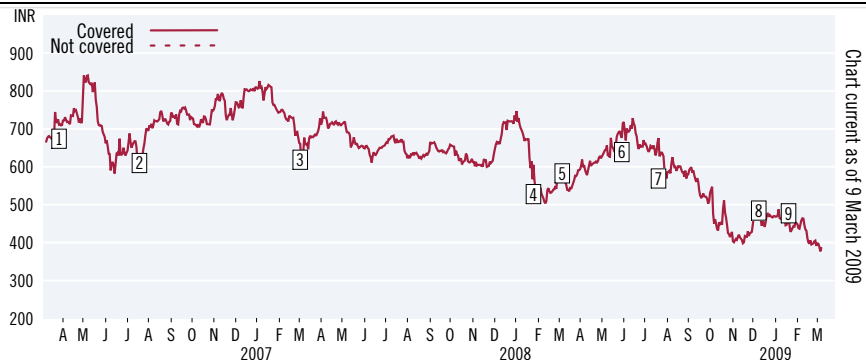


Chart current as of 9 March 2009

Date	Rating	Target Price	Closing Price
1 28-Mar-06	*3M	*758.00	711.20
2 19-Jul-06	*1M	*778.50	610.00
3 2-Mar-07	1M	*803.00	660.60
4 25-Jan-08	1M	*725.00	605.40
5 6-Mar-08	*2M	*642.00	579.90
6 29-May-08	*2L	*708.00	676.45
7 21-Jul-08	*2M	*739.00	675.65
8 9-Dec-08	2M	*535.00	481.20
9 20-Jan-09	2M	*547.00	467.90

\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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