Dr Reddy's Laboratories DRRD IN

BUY

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NOMURA STRUCTURED FINANCE SERVICES PRIVATE LIMITED, INDIA

COMPANY QUICK COMMENT

Slowdown in domestic business on rising competition and falling sales of Nise has been a concern area in the recent past. Further, disruption in API production unit due to striking contract worker didn't help boost sentiment. Our interaction with the company suggests, though negative, these developments can well be countered by the strength in the US business. Seroquel, Zyprexa, Allegra can present upsides. On our current estimates the stock is trading at 15.4x FY12 and 14.3x FY13 est. Maintain Buy. We present key takeaways from our interaction.

Price target: 1911.0 INR **Price (19 Aug 2011): 1412.15 INR**

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Traction in US to offset domestic slippages

We interacted with Dr Reddy's IR desk to obtain an update on various businesses. Following are the key takeaways from the interaction.

1. US products update
   a. Allegra D-24 is expected to be launched over the next few days.
   b. Traction in Allegra OTC is satisfactory and company expects to more than make up for prescription sales last year. We expect Dr Reddy's to achieve sales of US$20-25m from the product.
   c. Among the launches in the recent past, the company is positively surprised by pricing of Gemzar and expects the product to deliver above average sales. Other launches – Levaquin, Femara, Aricept and Effexor XR are not likely to be meaningful.
   d. Dr Reddy's has entered into an agreement with Teva for Zyprexa exclusivity. As per the agreement Teva will now market all strengths of Zyprexa during exclusivity including Dr Reddy's 20mg tabs. In return, Teva will share a fraction of the upsides on all strengths. The rationale is to effectively compete with the Authorised generic which is likely to launch all strengths. Dr Reddy's expects the deal to be positive at the margin.
   e. Dr Reddy believes Seroquel can be interesting low competition opportunity. The product has annual sales of US$4.4bn and expects competition to be limited to ~4 players. The patent expires in Mar 2012.
   f. Arixtra generic is gradually gaining traction and authorized generic by Apotex is not disruptive yet. In fact there is very little AG presence in the channel at this stage.

2. Slowdown in India: The Company is seeing some slowdown in the domestic market particularly in acute therapies. Increased competition is also impacting growth, given that Dr Reddy's products are currently at ~25-30% premium to the market.

3. Nise sales in India stabilizing: The sale of Nise was adversely affected in the previous two quarters post ban by the Govt for pediatric use in Feb 2011. Dr Reddy's has not been selling the pediatric suspension but the ban had some adverse impact on the main brand. Nise contributed 6% of domestic revenues in FY11. As per company sales have now stabilized after the initial adverse reaction post ban. The recent review by the European Medicines Agency which concluded that benefits outweigh risks for treatment of acute pain is a positive development. The company doesn't see an imminent risk of Nise in CIS/Russia. Nise accounts for 26% of sales in Russia as of FY11.

4. Not selling any banned drugs: On the recent media reports that Dr Reddy's has been sent a "show cause" notice by the DCGI (Drug Controller General of India) on selling banned drugs, the company maintained that no banned products are sold by the company, but some products might have remained in the channel.

5. Disruption in API plant in Vizag: The contact workers at Dr Reddy's API Vizag facility have gone on strike, demanding higher wages. As per company production is partially affected to the tune of ~30-40%. The plant caters primarily to internal requirements with limited external sales.

Valuation Methodology and Investment Risks: We value the base business at 22.5x one-year forward earnings of INR81.4/sh, in line with the current sector valuation, to calculate INR1,831/share for the base business. We add value of INR80/share for one off opportunities. This gives us a TP of INR1,911/share.The key risk to our call are: a) adverse impact of pricing pressure/ price control in India, Russia; b) further delay in key product approvals in the US than what is currently built into estimates; c) drop in volumes and pricing in Germany; d) substantial INR appreciation and e) substantial increase in high risk innovation.

Note: Ratings and Price Targets are as of the date of the most recently published report (http://go.nomuranow.com/research/globalresearchportal) rather than the date of this email.

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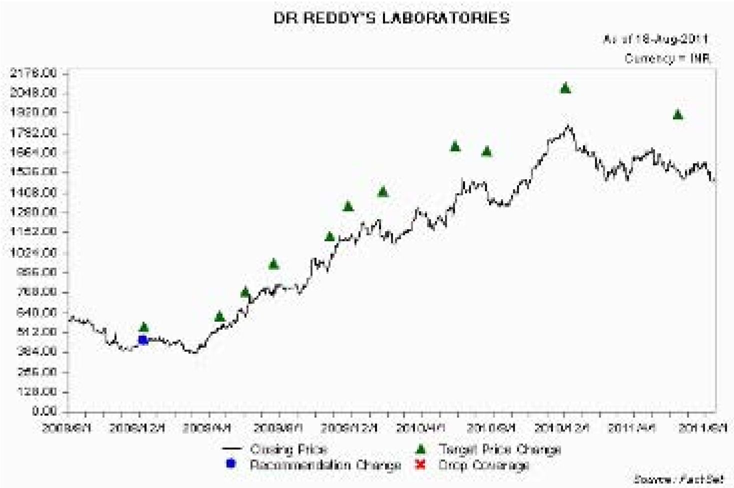
Issuer name	Ticker	Price	Price date	Stock rating	Disclosures
Dr Reddy's Laboratories	DRRD IN	1412.15 INR	19 Aug 2011	Buy	

Previous Rating

Issuer name	Previous Rating	Date of change
Dr Reddy's Laboratories	Not Rated	11 Dec 2008

Dr Reddy's Laboratories (DRRD IN) **1412.15 INR (19 Aug 2011)** Buy

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
15-Jun-2011		1911.00	1555.30
03-Dec-2010		2084.00	1826.45
23-Jul-2010		1677.00	1364.90
28-May-2010		1709.00	1362.50
25-Jan-2010		1418.00	1122.70
27-Nov-2009		1329.00	1110.00
26-Oct-2009		1131.00	975.65
22-Jul-2009		957.00	750.50
02-Jun-2009		781.00	617.10
20-Apr-2009		620.00	543.00
11-Dec-2008		549.00	460.05
11-Dec-2008	Buy		460.05

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We value the base business at 22.5x one-year forward earnings of INR81.4/sh, in line with the current sector valuation, to calculate INR1,831/share for the base business. We add value of INR80/share for one off opportunities. This gives us a TP of INR1,911/share.

Risks that may impede the achievement of the target price The key risk to our call are: a) adverse impact of pricing pressure/ price control in India, Russia; b) further delay in key product approvals in the US than what is currently built into estimates; c) drop in volumes and pricing in Germany; d) substantial INR appreciation and e) substantial increase in high risk innovation.

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Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published from 30 October 2008 and in Japan from 6 January 2009

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