Dr Reddy's Laboratories REDY.NS DRRD IN

HEALTH CARE & PHARMACEUTICALS

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Highlights of our meeting with Dr Reddy's CFO

Quick Note

June 28, 2012

Rating Remains	**Buy**
Target price Remains	INR 1918
Closing price June 27, 2012	INR 1609

We met with with Dr Reddy's CFO Mr Umang Vora. The CFO sounded positive on the company's FY13 outlook and expects Dr Reddy's to achieve at least US$2.5bn in revenues. With some product approvals and market share gains, the turnover could reach US$2.7bn in FY13. Management expects the growth momentum to pick up from Q2 onwards, and Q1 may remain relatively weak due to lack of new launches. The US remains the most important growth driver with the potential for positive surprise from undisclosed products. The company expects to launch 15-20 products in the US every year until FY17, with 1-2 low-competition complex generics. These new launches are likely to contribute US$100-200mn in revenue in the first year of launch. The focus remains on hard-to-characterise and complex chemistry products (Arixtra approval and Copaxone DMF filing are indications). Going forward, growth in Russia is expected to be at 15-20% and is likely to be characterised by interesting differentiated product launches such as Rituximab and partnership products. In India, growth is back on track and is expected to grow in line with the broader market. We believe through internal development programs and partnerships (like GSK and Merck Serono) the company is putting in place a sustainable growth platform and at the same time managing risks. The valuation at 16x FY13 is attractive, in our view. We maintain our Buy rating with a 12-month target price of INR1,918. Below, we present highlights of our meeting with management.

- **Sustainable growth in US until FY17**: The company expects 15-20 launch every year in the US until FY17. One or two products each year are likely to be limited competition opportunities. The new launches are expected to add US$100-200mn in revenues in the year of launch, with the potential to grow further in subsequent years on full-year impact and market share gains. The opportunity set will vary from year to year, and FY14 is possibly the leanest over the next five years. However, the company doesn't expect de-growth in the US business in FY14. Management believes the growth rate is likely to revive starting FY15.
- **US pipeline surprises remain a possibility:** There could be 1-2 interesting product opportunities in FY13 over and above what has been already disclosed. The company expects to launch Propecia with 180 days exclusivity in FY13. Dr Reddy's expects to be the sole generic player during exclusivity.
- **Focus on complex generics:** Relying on its strength on characterisation and complex chemistry, the company continues to focus on limited competition opportunities. Difficult to characterise products like Arixtra are being pursued. We note that company has recently filed a DMF on Glatiramer Acetate (copaxone) which is another difficult to characterise product.

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- **Russia growth likely to be in mid to high teens with interesting differentiated product launches:** Russia growth has been strong, at a 25% CAGR over the past five years. Dr Reddy's is ranked third in terms of volume and 13th in terms of value in the marketplace. The growth, to an extent, has been driven by price increases, which the company may not be able to sustain. Even in terms of volume, Dr Reddy's has outgrown the pharmaceutical market. Dr Reddy's recorded volume growth of 12% against market growth of just 1% in FY12. On a high base, growth is likely to slow going forward to the mid to high teens. Dr Reddy's intends to leverage the scale and the front end through partnerships (such as with Cipla and Merck) and differentiated products including biosimilars. The company is already pursuing the biosimilars opportunity and has partnered with a local partner to pursue the Provision of Supplemental Medicines, or DLO business. Rituximab, which is a US$170mn product in Russia, loses patent protection next year and is an opportunity that could unfold over the next two years. Besides these differentiated products, over-the-counter (OTC) medicines will continue to remain an important growth driver. OTC products, which accounted for 29% of Russia revenues in FY12, are likely to increase further to 40-45% over time. The new launches should help lower dependence on a few brands in the market. Management also highlighted that the receivables cycle is high at ~120 days in Russia, but it has been kept under control.
- **India business growth reviving:** Growth is reviving and is likely to be in line with the broader market. Initiatives such as sales force realignment are now complete.
- **PSAI segment growth linked to patent expiries:** The API growth in FY13 is likely to remain strong, as the segment growth is highly linked to patent expiries. The segment is likely to record relatively strong performance starting 2QFY13. Beyond FY13, the segment growth is likely to be at ~10%.
- **Pursuing growth with retaining RoCE at 22-25%:** The company retains its ROCE guidance of 25% for FY13. The company is happy pursuing growth by maintaining RoCE between 22% and 25%. We believe there is no appetite for large front-end acquisition at this stage. The company is, however, likely to pursue acquisition of technologies that can assist develop complex generics.
- **Consistent hedging policy:** The company maintains a consistent hedging policy of hedging 60% of the net dollar exposure for the next 18 months. There is approximately US$400-500mn of hedges corresponding to FY13 cash flows. Hedges are at a INR/USD rate of 50-51. Hedges for the first six months of FY14 are also now in place at a INR/USD rate of 54-55.
- **Capex likely to remain at US$100-150m**n **in the years ahead.**

Appendix A-1

Analyst Certification

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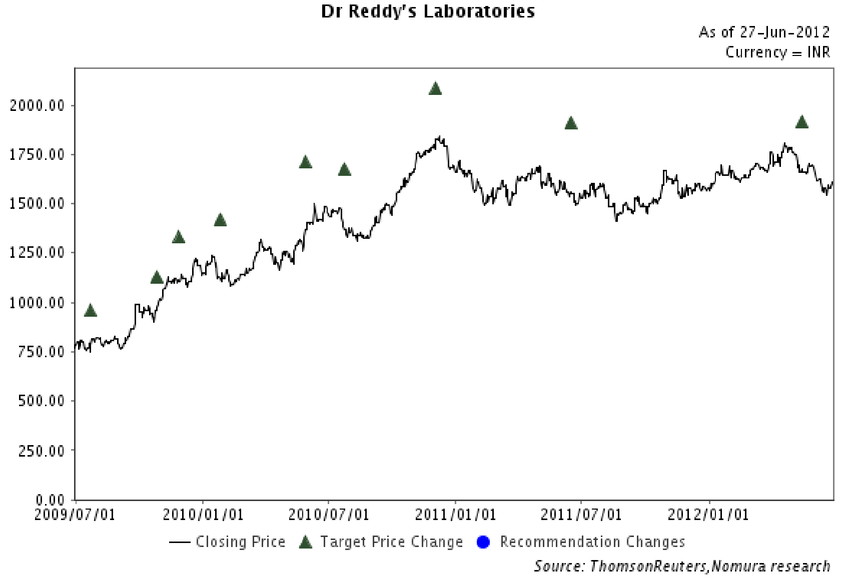
Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Dr Reddy's Laboratories	DRRD IN	INR 1609	27-Jun-2012	Buy	Not rated	

Previous Rating

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

Dr Reddy's Laboratories (DRRD IN) **INR 1609 (27-Jun-2012)** Buy (Sector rating: Not rated)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
14-May-12		1,918.00	1,671.95
15-Jun-11		1,911.00	1,555.60
03-Dec-10		2,084.00	1,827.95
23-Jul-10		1,677.00	1,365.30
28-May-10		1,709.00	1,370.10
25-Jan-10		1,418.00	1,121.90
27-Nov-09		1,329.00	1,109.05
26-Oct-09		1,131.00	975.60
22-Jul-09		957.00	751.05

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

Valuation Methodology We value Dr. Reddy's at 18x FY14F earnings of INR106.6/sh. We expect front line generic companies to trade at 18-20x FY14 ests. We attribute lower multiple to account for relatively higher dependence on the US business and expected slowdown in growth post FY14.

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) delay in key product approvals in the US; c) further drop in volumes and pricing in Germany; d) substantial INR appreciation and e) substantial increase in high risk innovation.

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STOCKS

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STOCKS

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Explanation of CNS rating system for Thailand companies under coverage published from 2 March 2009:
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Recommendations are set with a 6-12 month horizon unless specified otherwise. Accordingly, within this horizon, price volatility may cause the actual upside or downside based on the prevailing market price to differ from the upside or downside implied by the recommendation.

A "Buy" recommendation indicates that potential upside is 15% or more.
A "Neutral" recommendation indicates that potential upside is less than 15% or downside is less than 5%.
A "Reduce" recommendation indicates that potential downside is 5% or more.

Explanation of CNS rating system for Thailand companies under coverage published prior to 28 February 2009:
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Recommendations are set with a 6-12 month horizon unless specified otherwise. Accordingly, within this horizon, price volatility may cause the actual upside or downside based on the prevailing market price to differ from the upside or downside implied by the recommendation.

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A "Buy" recommendation indicates that upside is between 10% and 20%.
A "Neutral" recommendation indicates that upside or downside is less than 10%.
A "Reduce" recommendation indicates that downside is between 10% and 20%.
A "Sell" recommendation indicates that downside is more than 20%.

Sectors: (No change)
A "Bullish" rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a positive absolute recommendation.
A "Neutral" rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a neutral absolute recommendation.
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