

Dr. Reddy's Laboratories

Performance Highlights

Y/E March (₹ cr)	3QFY2017	2QFY2017	% chg (qoq)	3QFY2016	% chg (yoy)
Net sales	3,707	3,586	3.4	3,968	(6.6)
Gross profit	2,475	2,294	7.9	2,606	(5.0)
Operating profit	845	596	41.9	992	(14.9)
Adj. net profit	470	295	59.4	579	(18.8)

Source: Company, Angel Research

Dr. Reddy's Laboratories (DRL) posted lower than expected results for 3QFY2017. In INR terms, the consolidated revenues came in at ₹3,707cr (v/s. ₹4,000cr expected) v/s. ₹3,989cr in 3QFY2016, down 6.6% yoy, mainly driven by pressure on the generic market. The global generic market with sales at ₹3,064cr (down 9.0% yoy), was mainly lead by Europe (₹214.8cr, up 11% yoy) and Emerging market (₹594.8cr, a yoy dip of 7%). The PSAI segment posted sales of ₹540cr, up 6.0% yoy. On the operating front, the EBIT margin came in at 9.7% (v/s. 17.1% expected) v/s. 18.8% in 3QFY2016. Consequently, the PAT came in at ₹470cr (v/s. ₹536cr expected) v/s. ₹579cr in 3QFY2016, a yoy de-growth of 18.8%. **We maintain our Neutral rating.**

A subdued quarter: Dr. Reddy's Laboratories (DRL) posted results lower than expected. In INR terms, the consolidated revenues came in at ₹3,707cr (v/s. ₹4,000cr expected) v/s. ₹3,989cr in 3QFY2016, down 6.6% yoy, mainly driven by pressure on the generic market. The global generic market with sales at ₹3,064cr (down 9.0% yoy), was mainly lead by Europe (₹214.8cr, up 11% yoy) and Emerging market (₹594.8cr, a yoy dip of 7%). The PSAI segment posted sales of ₹540cr, up 6.0%. On the operating front, the EBIT margin came in at 9.7% (v/s. 17.1% expected) v/s. 18.8% in 3QFY2016. Consequently, the PAT came in at ₹470cr (v/s. ₹536cr expected) v/s. ₹579cr in 3QFY2016, a yoy de-growth of 18.8%.

Outlook and valuation: We expect net sales to grow at a CAGR of 3.4% to ₹16,542cr and adjusted EPS to post flat growth to end the period at ₹130.9 in FY2018E. **We recommend a Neutral rating on the stock given the valuations.**

Key financials (IFRS Consolidated)

Y/E March (₹ cr)	FY2015	FY2016	FY2017E	FY2018E
Net sales	14,819	15,471	14,444	16,542
% chg	12.1	4.4	-6.6	14.5
Net profit	2,218	2,001	1,342	2,233
% chg	3.1	(9.8)	(33.0)	66.4
Adj net profit	2,218	2,357	1,342	2,233
% chg	3.1	6.3	(43.1)	66.4
Adj. EPS (₹)	130.2	138.2	78.6	130.9
EBITDA margin (%)	22.2	24.6	18.0	23.0
P/E (x)	22.3	21.0	36.9	22.1
RoE (%)	21.9	19.7	10.1	15.2
RoCE (%)	18.1	18.7	9.7	15.3
P/BV (x)	4.4	3.9	3.6	3.2
EV/Sales (x)	3.3	3.2	3.4	3.0
EV/EBITDA (x)	14.9	12.8	18.9	12.9

Source: Company, Angel Research; Note: CMP as of February 21, 2017

NEUTRAL

CMP	₹2,899
Target Price	-

Investment Period	-
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Stock Info

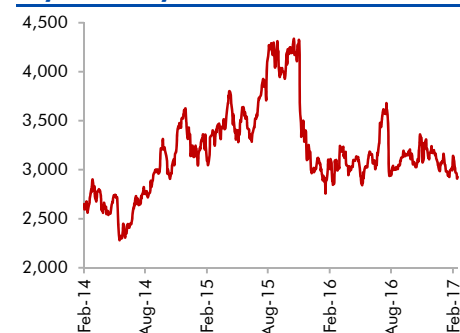
Sector	Pharmaceutical
Market Cap (₹ cr)	48,047
Net Debt (₹ cr)	(663)
Beta	0.5
52 Week High / Low	3,689/2,804
Avg. Daily Volume	32,443
Face Value (₹)	5
BSE Sensex	28,762
Nifty	8,908
Reuters Code	REDY.BO
Bloomberg Code	DRRD@IN

Shareholding Pattern (%)

Promoters	26.8
MF / Banks / Indian Fls	10.7
FII / NRIs / OCBs	54.0
Indian Public / Others	8.5

Abs. (%)	3m	1yr	3yr
Sensex	10.8	21.3	38.9
Dr Reddy	(7.5)	(5.3)	6.2

3-year Daily Price Chart



Source: Company, Angel Research

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Exhibit 1: 3QFY2017 performance (IFRS, consolidated)

Y/E March (₹ cr)	3QFY2017	2QFY2017	% chg (qoq)	3QFY2016	% chg (yoy)	9MFY2017	9MFY2016	% chg
Net sales	3,707	3,586	3.4	3,968	(6.6)	10,421	11,715	(11.0)
Other income/(loss)	23	64	-	12	-	269	57	-
Total income	3,730	3,650	2.2	3,980	(6.3)	10,690	11,772	(9.2)
Gross profit	2,475	2,294	7.9	2,606	(5.0)	7,565	7,821	(3.3)
Gross margin (%)	66.8	64.0		65.7		72.6	66.8	
SG&A expenses	1,134	1,177	(3.7)	1,204	(5.8)	3,437	3,407	0.9
R&D expenses	496	521	(4.9)	410	21.0	2,413	1,276	89.2
EBDITA	845	596	41.9	992	(14.9)	1,716	3,138	(45.3)
EBDITA (%)	22.8	16.6		25.0		16.5	26.8	
Depreciation	285	285	0.0	246.6	15.5	790.5	720.4	9.7
Interest	-	-	-	-	-	-	-	-
PBT	583	375	55.5	758	(23.0)	1,194	2,475	(51.8)
Tax	122	89	38.1	179	(31.7)	270	539	(49.8)
Net Profit	461	287	60.9	579	(20.4)	924	1,936	(52.3)
Share of profit/ (loss) in associates	(8.4)	(8.4)	-	-	-	-	8.8	-
Reported net profit before exceptional	470	295	59.2	579	(18.9)	924	1,945	(52.5)
Exceptional items (loss) /profit	-	-	-	-	-	-	-	-
Reported PAT	470	295	59.4	579	(18.8)	924	1,945	(52.5)
Adj. Net Profit	470	295	59.4	579	(18.8)	924	1,945	(52.5)
EPS (₹)	27.7	17.4		34.1		54.4	114.6	

Source: Company, Angel Research

Exhibit 2: Actual Vs Estimates

(₹ cr)	Actual	Estimates	Variation (%)
Net sales	3,707	4,000	(7.3)
Other income	23	20	15.5
Operating profit	845	970	(12.9)
Tax	122	169	(27.8)
Adj. Net profit	470	536	(12.3)

Source: Company, Angel Research

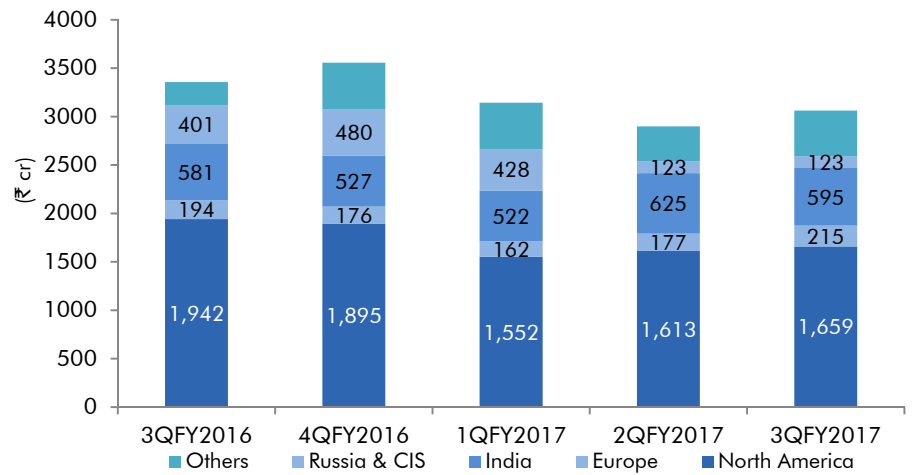
Revenue lower than expectation: In INR terms, the consolidated revenues came in at ₹3,707cr (v/s. ₹4,000cr expected) v/s. ₹3,968cr in 3QFY2016, down 6.6% yoy, mainly driven by pressure on the generic market.

The global generic market with sales at ₹3,064cr (down by 9.0% yoy), was mainly lead by the Europe (₹214.8cr, up 11% yoy) and Emerging markets (₹594.8cr, a yoy dip of 7%). Other key markets like US dipped by 15% yoy to ₹1659.5cr, whereas, India grew by 2% yoy to ₹594.7cr.

Revenues from North America declined 15% yoy, primarily on account of increased competition in valgancyclovir and injectable franchise coupled with continuing pricing pressure.

The PSAI segment posted sales of ₹540cr, up 6.0% yoy. The growth came in on the back of US (₹125.9cr, a yoy growth of 21%), Europe (₹182.8cr, a yoy dip of 6.0%), India (₹40.9cr, a yoy dip of 34%) and ROW (₹190.4cr, a yoy growth of 29%). As of December 31, 2016, 92 generic filings are pending approval with the USFDA, including 59 Para IVs (of which 20 are FTFs). Of these 90 ANDAs, 59 are Para IVs out of which we believe 20 have 'First to File' status. Further, these 90 ANDAs include 7 ANDAs, acquired from Teva, of which 6 are Para IVs.

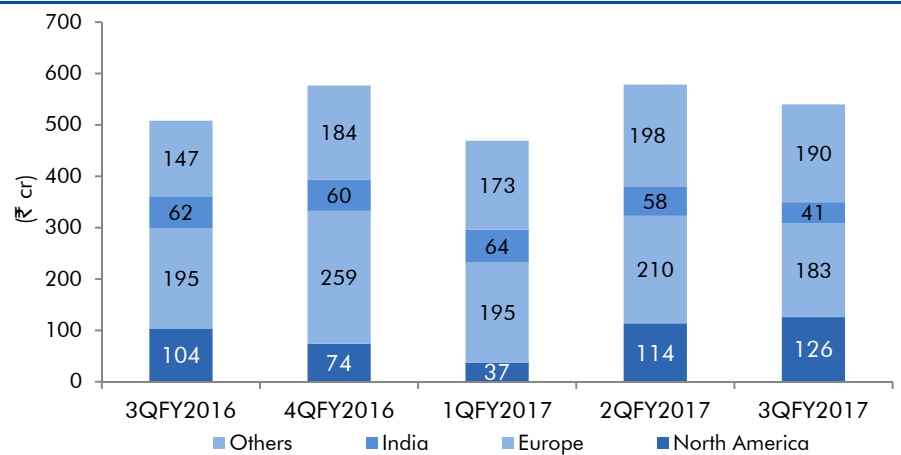
Exhibit 3: Trend in Global generics



Source: Company, Angel Research

In the PSAI segment (15% of sales), the US grew by 11% yoy; while ROW, Europe, and India de-grew by 4%, 13% and 29% yoy respectively during the quarter. Proprietary Products & Others (₹102.7cr) posted a yoy de-growth of 5%.

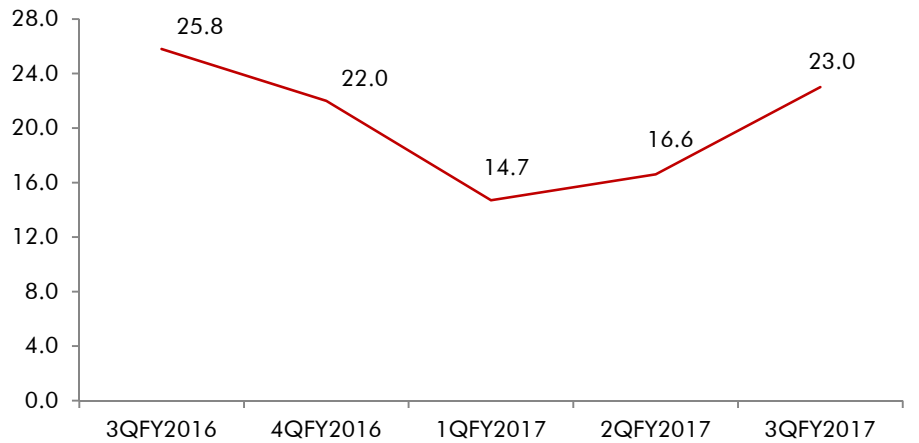
Exhibit 4: PSAI trend



Source: Company, Angel Research

EBITDA margin dips yoy: On the operating front, lower sales led the EBIT to come in at 9.7% (v/s. 17.1% expected) v/s. 18.8% in 3QFY2016. The EBITDA margin came in at 16.6% (v/s. 17.2% expected) v/s. 25.8% in 3QFY2016, which was hurt on account of lower sales and 5.8% yoy growth in SG&A expenses. R&D expenditure for the quarter amounted to 13.4% of sales (v/s. 10.3% in 3QFY2016).

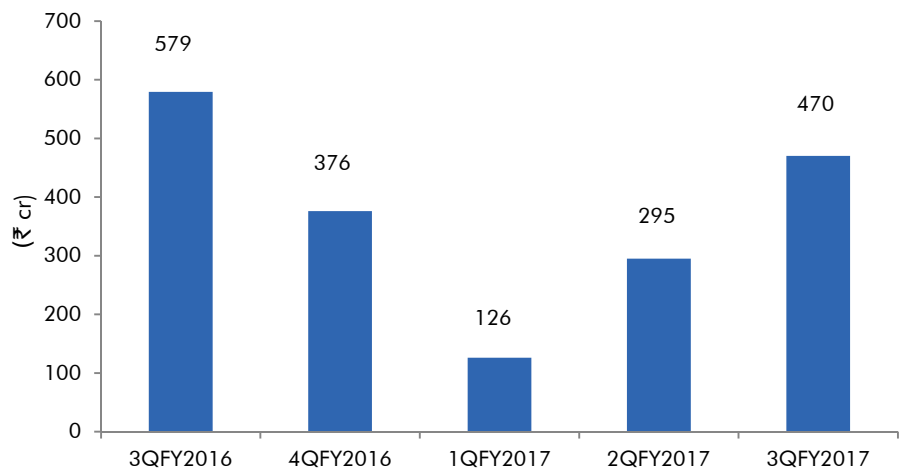
Exhibit 5: EBITDA margin trend (%)



Source: Company, Angel Research

Net profit lower than expected: Other income for the quarter came in at ~₹23cr (v/s. ₹12cr in 3QFY2016). The net profit stood at ₹470cr (v/s. ₹536cr expected) v/s. ₹579cr in 3QFY2016), a yoy de-growth of 18.8%.

Exhibit 6: Adjusted net profit trend



Source: Company, Angel Research

Concall takeaways

- Remediation process over; Inspection at all three facilities are expected in Feb/ Mar'2017.
- DRL expects 15 ANDA launches in FY2018 (including 4-5 meaningful launches).
- Plans to file 25 US ANDA's in FY2017.
- Effective Tax rate to be 20-22% of PBT in FY2017.
- The company incurs 12-15% of its total R&D spends on bio-similar research.

Investment arguments

Robust growth in the US going ahead: After attaining a critical mass (US\$1,139mn in FY2016), DRL aims to scale up its business to the next orbit in the US market on the back of a strong product pipeline (92 ANDAs are pending approval, of which, 59 are Para IVs and 20 are FTFs). The Management has guided for a robust growth in the US over the medium term, driven by introduction of new products, some of which are also Para IV opportunities. Owing to the import alert on the three facilities of the company, in a worst case scenario, we expect the exclusivity US sales to post a flat growth during FY2016-18E.

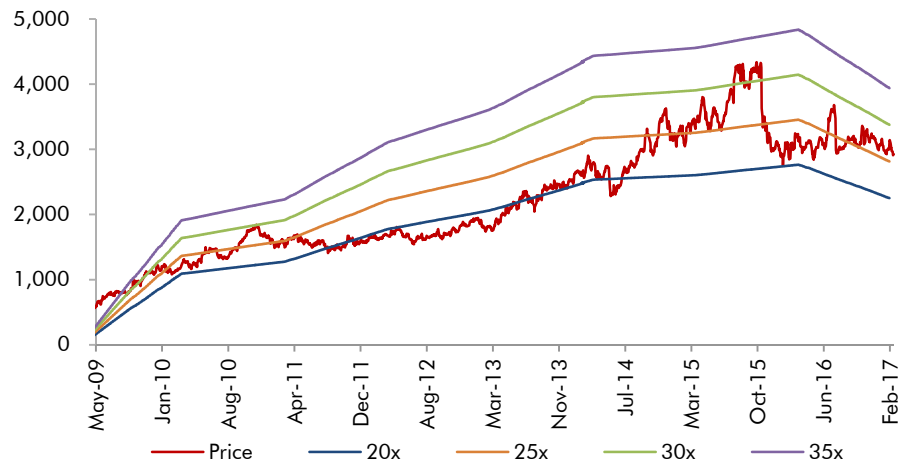
Domestic back in focus: DRL reported a 19.0% yoy growth in FY2016. The management expects the company's performance to rebound and targets to achieve an above industry growth rate going ahead, driven by a) field force expansion and improvement in productivity, b) new product launches (including biosimilars), and c) focus on brand building. In 4QFY2015, DRL had acquired UCB's India portfolio and has completed the integration process of these brands in 1QFY2016. UCB's India business had registered ~₹150cr sales in CY2014 and has a branded portfolio of 21 products focusing on Allergy, Respiratory, Dermatology and Pediatric space. The acquisition had been successfully integrated by 2QFY2016. Thus, we expect sales in India to post a CAGR of ~7.8% over FY2016-18E.

Valuation: We expect net sales to grow at a CAGR of 3.4% to ₹16,542cr and adjusted EPS to post flat growth to end FY2018 at ₹130.9 over FY2016-18E. The stock has been severely beaten down post the import alert from the USFDA. However, considering the valuations, **we recommend a Neutral rating on the stock.**

Exhibit 7: Key assumptions

	FY2017E	FY2018E
PSAI segment growth (%)	(4.2)	(0.5)
Generics segment growth (%)	(8.0)	17.0
Operating margin (%)	18.0	23.0
Capex (₹ cr)	1200	1200

Source: Company, Angel Research

Exhibit 8: PE chart


Source: Company, Angel Research

Exhibit 9: Recommendation summary

Company	Reco.	CMP (₹)	Tgt Price (₹)	Upside (%)	FY2018E			FY16-18E	FY2018E	
					PE (x)	EV/Sales (x)	EV/EBITDA (x)	CAGR in EPS (%)	RoCE (%)	RoE (%)
Alembic Pharma	Neutral	593	-	-	19.5	2.6	12.2	(10.8)	27.5	25.3
Aurobindo Pharma	Buy	686	877	27.9	14.5	2.4	10.1	18.1	22.5	26.1
Cadila Healthcare	Neutral	440	-	-	22.9	3.6	16.6	13.5	23.6	27.1
Cipla	Sell	593	465	(21.5)	24.2	2.7	16.3	14.2	12.2	13.9
Dr Reddy's	Neutral	2,899	-	-	22.1	2.6	11.4	(2.7)	15.3	15.2
Dishman Pharma	Neutral	229	-	-	20.3	2.3	10.0	13.3	10.3	10.9
GSK Pharma*	Neutral	2,683	-	-	44.5	6.8	32.8	16.9	37.5	34.5
Indoco Remedies	Reduce	272	240	(11.8)	17.0	2.0	10.9	33.2	19.1	20.1
Ipca labs	Accumulate	554	613	10.7	28.1	1.9	12.7	36.5	8.8	9.4
Lupin	Buy	1,469	1,809	23.1	21.2	4.0	13.1	17.2	24.4	20.9
Sanofi India	Neutral	4,186	-	-	24.3	3.2	17.4	22.2	25.6	28.8
Sun Pharma	Buy	673	847	25.8	19.1	4.0	12.2	26.5	18.9	20.1

Source: Company, Angel Research; Note: *December year ending

Company Background

Established in 1984, Dr. Reddy's Laboratories is an integrated global pharmaceutical company, through its three businesses - Pharmaceutical Services and Active Ingredients, Global Generics and Proprietary Products. The company's key therapeutic focus is on gastro-intestinal, cardiovascular, diabetology, oncology, pain management, anti-infective and paediatrics. The company's key markets include India, USA, Russia & CIS and Germany.

Profit & loss statement (IFRS Consolidated)

Y/E March	FY2013	FY2014	FY2015	FY2016	FY2017E	FY2018E
Net sales	11,627	13,217	14,819	15,471	14,444	16,542
Other operating income	247.9	141.6	91.7	87.4	87.4	87.4
Total operating income	11,875	13,359	14,911	15,558	14,532	16,630
% chg	21.8	12.5	11.6	4.3	-6.6	14.4
Total expenditure	8,951	10,096	11,535	11,669	11,851	12,744
Cost of revenues	4,825	4,977	5,531	5,315	5,423.20	5,630.35
SG&A expenses	3,358	3,878	4,259	4,570	4,261	4,632
R&D expenses	767.3	1,240.2	1,744.9	1,783.4	2,166.7	2,481.4
EBITDA	2,676	3,121	3,284	3,802	2,593	3,799
% chg	3.0	16.6	5.2	15.8	(31.8)	46.5
(% of Net Sales)	23.0	23.6	22.2	24.6	18.0	23.0
Depreciation & amortisation	743.7	659.8	747.4	927.4	990.1	1,052.8
EBIT	1,932	2,462	2,537	2,875	1,603	2,746
% chg	4.3	27.4	3.1	13.3	(44.2)	71.3
(% of Net Sales)	16.6	18.6	17.1	18.6	11.1	16.6
Interest & other charges	-	-	-	-	-	-
Other Income	46.0	40.0	168.2	(270.8)	-	-
(% of PBT)	2.1	1.5	6.0	(10.0)	-	-
Share in profit of associates	10.4	17.4	19.5	22.9	22.9	22.9
Recurring PBT	2,237	2,661	2,816	2,714	1,714	2,856
% chg	14.7	19.0	5.9	-3.6	(36.9)	66.7
Extraordinary expense/(Inc.)	68.8	-	-	508.5	-	-
PBT (reported)	2,167.7	2,660.6	2,816.3	2,714.0	1,713.6	2,856.4
Tax	490.0	509.4	598.4	712.7	372.0	623.4
(% of PBT)	22.6	19.1	21.2	26.3	21.7	21.8
PAT (reported)	1,677.7	2,151.2	2,217.9	2,001.3	1,341.7	2,233.0
Add: Share of earnings of asso.	-	-	-	-	-	-
Less: Minority interest (MI)	-	-	-	-	-	-
Exceptional items	-	-	-	-	-	-
PAT after MI (reported)	1,677.7	2,151.2	2,217.9	2,001.3	1,341.7	2,233.0
ADJ. PAT	1,750.0	2,151.2	2,217.9	2,357.0	1,341.7	2,233.0
% chg	17.0	22.9	3.1	6.3	(43.1)	66.4
(% of Net Sales)	14.4	16.3	15.0	12.9	9.3	13.5
Basic EPS (₹)	103.1	126.7	130.2	138.2	78.6	130.9
Fully Diluted EPS (₹)	103.1	126.7	130.2	138.2	78.6	130.9
% chg	16.8	22.9	2.7	6.1	(43.1)	66.4

Balance sheet (IFRS Consolidated)

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016	FY2017E	FY2018E
SOURCES OF FUNDS						
Equity share capital	84.9	84.9	85.2	85.3	85.3	85.3
Preference Capital	-	-	-	-	-	-
Reserves & surplus	7,224	8,995	11,045	12,748	13,691	15,525
Shareholders funds	7,309	9,080	11,130	12,834	13,776	15,610
Minority Interest						
Total loans	3,676.0	4,474.2	3,954.3	3,661.9	3,661.9	3,661.9
Deferred tax liability	83.3	(192.9)	(401.3)	(423.0)	(423.0)	(423.0)
Total liabilities	11,068	13,361	14,683	16,073	17,015	18,849
APPLICATION OF FUNDS						
Net fixed assets	3,781	3,945	4,314	5,396	6,596	7,796
Goodwill /other intangibles	1,402	1,470	1,643	1,969	1,969	1,969
Capital Work-in-Progress	495.2	495.2	495.2	495.2	495.2	495.2
Investments	1,764	2,589	3,811	3,833	3,833	3,833
Current Assets	6,875	7,866	8,558	8,465	7,997	9,205
Cash	513.6	845	539	492	200	282
Loans & Advances	697.6	793.0	889.1	928.2	866.7	992.5
Other	5,664	6,228	7,129	7,045	6,930	7,931
Current liabilities	3,252	3,006	4,214	4,193	3,982	4,557
Net Current Assets	3,623	4,860	4,344	4,273	4,015	4,649
Other Assets	-		76	106	106	106
Total Assets	11,068	13,361	14,683	16,073	17,015	18,849

Cash flow statement (IFRS Consolidated)

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016	FY2017E	FY2018E
Profit before tax	2,237	2,661	2,816	2,714	1,714	2,856
Depreciation	744	660	747	927	990	1,053
(Inc)/Dec in Working Capital	535	(906)	211	24	(35)	(552)
Less: Other income	46	40	168	(271)	-	-
Direct taxes paid	490	509	598	713	372	623
Cash Flow from Operations	2,980	1,865	3,008	3,224	2,297	2,734
(Inc.)/Dec.in Fixed Assets	(431)	(164)	(369)	(1,082)	(1,200)	(1,200)
(Inc.)/Dec. in Investments	687	824	1,222	22	-	-
Other income	46	40	168	(271)	-	-
Cash Flow from Investing	302	701	1,021	(1,331)	(1,200)	(1,200)
Issue of Equity	0	-	0	0	-	-
Inc./Dec.) in loans	(1,155)	798	(520)	(292)	-	-
Dividend Paid (Incl. Tax)	298	358	399	399	399	399
Others	(2,649)	(3,390)	(4,214)	(2,047)	(1,789)	(1,851)
Cash Flow from Financing	(3,506)	(2,234)	(4,335)	(1,940)	(1,389)	(1,452)
Inc./Dec.) in Cash	(224)	331	(306)	(47)	(292)	82
Opening Cash balances	738	514	845	539	492	200
Closing Cash balances	514	845	539	492	200	282

Key ratios

Y/E March	FY2013	FY2014	FY2015	FY2016	FY2017E	FY2018E
Valuation Ratio (x)						
P/E (on FDEPS)	28.1	22.9	22.3	21.0	36.9	22.1
P/CEPS	20.3	17.5	16.7	16.9	21.2	15.1
P/BV	6.7	5.4	4.4	3.9	3.6	3.2
Dividend yield (%)	0.5	0.5	0.5	0.5	0.5	0.5
EV/Sales	4.4	3.8	3.3	3.2	3.4	3.0
EV/EBITDA	18.9	16.1	14.9	12.8	18.9	12.9
EV / Total Assets	4.6	3.8	3.3	3.0	2.9	2.6
Per Share Data (₹)						
EPS (Basic)	103.1	126.7	130.2	138.2	78.6	130.9
EPS (fully diluted)	103.1	126.7	130.2	138.2	78.6	130.9
Cash EPS	142.6	165.5	174.0	171.7	136.7	192.6
DPS	15.0	15.0	15.0	15.0	15.0	15.0
Book Value	430.4	534.7	653.3	752.3	807.5	915.0
Dupont Analysis						
EBIT margin	16.6	18.6	17.1	18.6	11.1	16.6
Tax retention ratio	77.4	80.9	78.8	73.7	78.3	78.2
Asset turnover (x)	1.2	1.2	1.1	1.0	0.9	0.9
ROIC (Post-tax)	14.9	17.4	15.1	14.3	7.8	12.2
Cost of Debt (Post Tax)	0.0	0.0	0.0	0.0	0.0	0.0
Leverage (x)	0.6	0.4	0.4	0.3	0.2	0.2
Operating ROE	23.5	24.7	20.4	18.3	9.7	15.1
Returns (%)						
ROCE (Pre-tax)	17.8	20.2	18.1	18.7	9.7	15.3
Angel ROIC (Pre-tax)	23.1	25.6	22.5	22.9	11.7	18.0
ROE	26.8	26.3	21.9	19.7	10.1	15.2
Turnover ratios (x)						
Asset Turnover (Gross Block)	3.3	3.5	3.6	3.2	2.4	2.3
Inventory / Sales (days)	63	62	61	60	58	59
Receivables (days)	88	89	90	96	84	85
Payables (days)	44	40	43	59	39	42
WC cycle (ex-cash) (days)	104	97	96	89	95	90
Solvency ratios (x)						
Net debt to equity	0.4	0.4	0.3	0.2	0.3	0.2
Net debt to EBITDA	1.2	1.2	1.0	0.8	1.3	0.9
Interest Coverage (EBIT / Int.)	-	-	-	-	-	-

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Dr. Reddy's Laboratories

1. Financial interest of research analyst or Angel or his Associate or his relative	No
2. Ownership of 1% or more of the stock by research analyst or Angel or associates or relatives	No
3. Served as an officer, director or employee of the company covered under Research	No
4. Broking relationship with company covered under Research	No

Ratings (Based on expected returns over 12 months investment period):

Buy (> 15%)

Accumulate (5% to 15%)
Reduce (-5% to -15%)

Neutral (-5 to 5%)
Sell (< -15)