Dr Reddy's may sell stake in domestic formulations biz

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Hyderabad-based Dr Reddy's Laboratories (DRL) is exploring the option of demerging its domestic formulations business and unlocking value. Several multinational drug firms have already begun talks on a potential deal for the Rs 1,000 crore business.

The promoters have a 25.7 per cent stake in DRL and investment bankers said they were expecting a significant premium to the current sales
The move comes about a month after US-based Abbott acquired the domestic formulation business of Piramal Healthcare for $3.7 billion.

Anji Reddy-promoted Dr Reddy's is a 26-year-old integrated drug company and is involved in almost all aspects of generic drug business, like bulk drugs and formulations, and even research. It had a turnover of Rs 7,000 crore in the year ended March 2009, and is now the second largest Indian drug company.

A DRL spokesperson said the company would not comment on market speculation, but investment bankers familiar with the development said talks are on, though valuations are still proving a stumbling block.

"Expectations of Indian promoters are rather high after the Abbott-Piramal deal," said a banker familiar with the development and multinational companies may find it tough to match that expectation.
The talks are believed to have started about three months earlier.

Many industry analysts dismiss the over-valuation argument. Analysts say DRL has a very attractive business proposition, as their corporate culture is similar to multinationals in terms of governance, manufacturing systems and practices.

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* Formulation business generates about Rs 1,000 crore revenue
* Dr Reddy's to hive off the business into a separate company
* It will also be able to focus on its generic game plan for US and Europe
* GSK will emerge as the number two company in India after the buyout

“For such assets, they do not mind paying even valuations like nine or 10 times of the turnover, as happened in the case of Piramal Healthcare,” said a leading industry analyst.

The market is abuzz with Glaxo Pharmaceuticals being in the fray, though the company said it has no such plan. Glaxo is among the top five players in domestic business and can scale up its business to the second spot after the Abott-Piramal healthcare combine, if it could succeed in acquiring the domestic business of DRL.

GSK and Dr Reddy’s have a long-standing relationship in business and better understanding of the systems of both companies. Last June, GSK had entered into an exclusive long-term outsourcing agreement with DRL to supply a diverse portfolio and future pipeline of more than 100 branded pharmaceuticals in the fast growing therapeutic segments such as cardiovascular, diabetes, oncology, gastroenterology and pain management.

On at least two earlier instances, DRL and GSK had explored a strategic equity partnership, investment bankers said. The first was in 2006-07, when talks even included 100 per cent of the company. Again last year, GSK was given an option to pick up 25 per cent equity in the holding company of Dr Reddy’s, but the talks failed due to differences over valuation.

Dr Reddy's has at least half-a-dozen branded generic drugs that are among the top selling drugs in the domestic market. These include Omez, which treats an upset stomach, pain killer Nice, heart disease drugs such as Stamlo and Atocor, one of the first indigenously developed biosimilar drug named Revitex and anti-baldness drug Mintof.

Hiving off the domestic business will also help DRL better focus on its US generic game plan and geographies across Europe and other emerging markets, analysts said.
"It is a call the management of Dr Reddy's need to take, whether they want to continue business without major business activities in the domestic market", said Ranjit Kapadia, vice-president, institutional research, HDFC Securities.