MAY 2011 – NEWSLETTER 2ND JUNE, 2011

The month of May 2011 was under pressure on account of slower economic growth, concerns like persisting inflation, hike in interest rates and higher oil prices. In addition to this, Q4FY11 results from large cap like SBI were way below market expectations. Poor Q4FY11 results of SBI led to a decline in Banking stocks. Increased contribution of 38.8% by state-owned upstream companies to the fuel subsidy led to decline in oil and gas stocks. ONGC declined by 7.47% during the month.

The month also witnessed Q4FY11 GDP growth of 7.8%, as compared to 8.3% in Q3FY11, which were below market expectations. The growth was subdued on account of pressure in mining, manufacturing, construction, trade, hotels, transport and communication. However, on an annualized basis, GDP registered a growth of 8.5% in FY11 as compared to 8% in FY10.

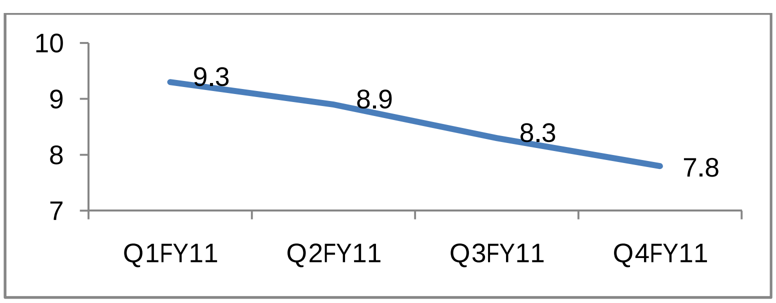
We believe, Q1FY12 GDP numbers too would remain under pressure on account of expected diesel price hike and expected increase in interest rate of 25 bps by RBI in its next policy on 16th June, 2011.

% Growth in GDP

Particulars	**Q4FY10**	**Q3FY11**	**Q4FY11**
Agriculture and allied	1.1	9.9	7.5
Mining and quarrying	8.9	6.9	1.7
Electricity, gas and water supply	7.3	6.4	7.8
Manufacturing	15.2	6	5.5
Construction	9.2	9.7	8.2
Trade, hotels, transport and communication	13.7	8.6	9.3
Financing, insurance, realty & services	6.3	10.8	9
Community, social and personal	8.3	5.1	7
Total	**9.4**	**8.3**	**7.8**

Source: Central Statistical Organisation, Ajcon Research

Trend of GDP growth (%)



Source: Central Statistical Organiation, Ajcon Research

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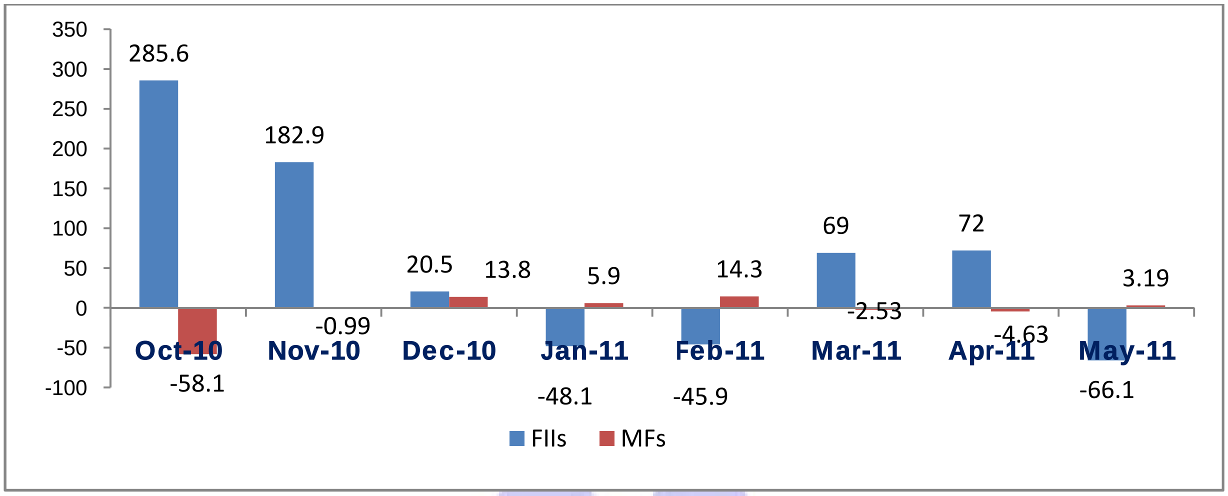
On account of the above factors, FIIs turned sellers and sold worth Rs. 66.1 bn in May 2011. On the other hand, Mutual Funds bought worth Rs. 3.19 bn.

Trend in FII and MF activity in equity (Rs. bn)



Source: SEBI, Money control

Monthly indices

Index	31st May, 2011	29th April, 2011	% change
Dow Jones	12,569.7	12,810.5	(1.9)
FTSE	5,989.9	6,069	(1.3)
Hang Seng	23,684	23,720.8	(0.15)
Nikkei	9,693.7	9,945.5	(2.5)
Nifty	5,560.1	5,749.5	(3.3)
Sensex	18,503.2	19,135.9	(3.3)
BSE -Midcap	6,910.2	7,094.2	(2.6)
BSE-500	7,233.8	7,427.1	(2.6)

Source: Ajcon Research

Ajcon's view

We believe, the market lacks key positive triggers and faces headwinds like high oil prices, inflationary concerns and liquidity tightening. We believe, market is looking for ques that can add a spark, to ignite a bullish trend. Good monsoons and positive outcome from the credit policy scheduled in the second week of June 2011 may add the much needed support. Globally, US and European events would be watched closely for any cues especially the monetary stance from the US Federal Reserve which would affect the commodity prices. We advice investors to concentrate on value stocks. We advice, investors with a horizon of 9-12 months to accumulate value based stocks on dips. We prefer companies like Central Bank and ICICI Bank as they are trading closer to their book values, Dr. Reddy's owing to strong Q4FY11 results and good product pipeline, BHEL on account of its strong order book (BTB of 4x TTM revenues) and healthy margins.

In this newsletter, we have touched upon the Pharma Sector. Please find a brief study on the pharmaceutical sector below

Pharmaceutical Sector

Global Scenario

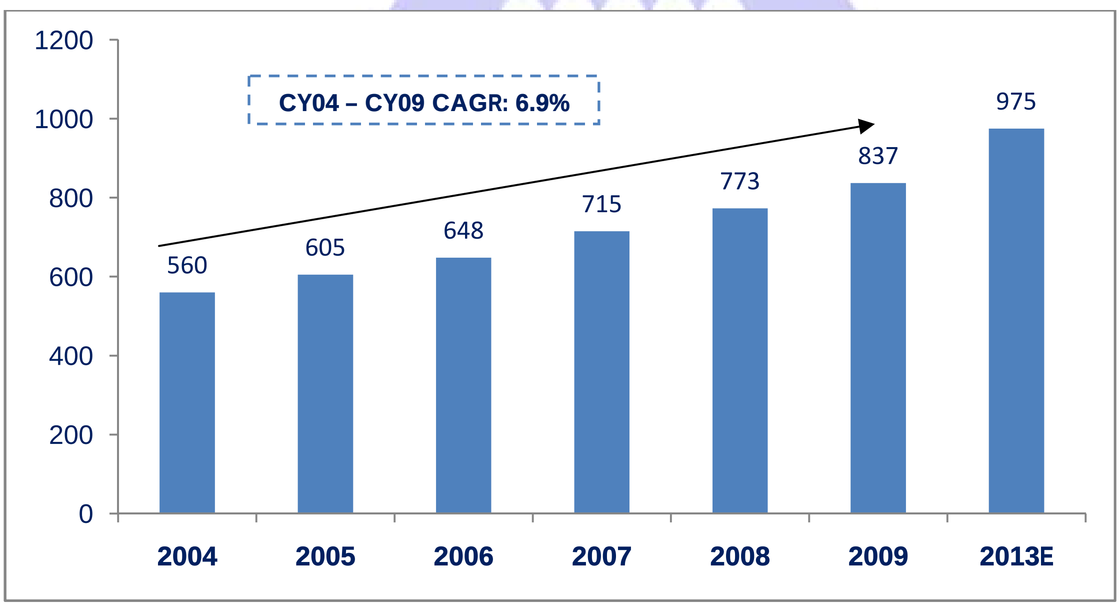
The global pharmaceuticals market can be classified in two categories:

a) **Regulated:** These markets are primarily governed by stringent government regulations such as intellectual property protection, including product patent recognition. As a result, regulated markets have greater stability for both volumes and prices while a drug is under patent protection.

b) **Unregulated/Semi Regulated:** These markets are characterized by lower entry barriers in terms of regulatory requirements, hence are highly competitive, with industry players primarily competing on the basis of price.

Globally, US, Japan and Europe constitute about 86% of the global pharmaceutical market registering a growth of 4% on account of loss of exclusivity, lesser new product approvals and price erosions due to generic competition.

Size of Global Pharmaceutical Market (US$ bn)



Source: IMS Health, Ajcon Research

On the other hand, pharmaceutical sector in emerging economies like India, Brazil and Mexico are growing at a much faster rate of 12-16% per annum driven by improved per capita income, strengthening of healthcare infrastructure and growing awareness of modern medicines.

Indian Scenario

The Indian pharmaceutical industry can be classified based on products manufactured like Active Pharmaceutical Ingredients (APIs) or bulk drugs and formulations. Based on the markets catered, these can be further classified into domestic and exports. Further, exports can be made to regulated or developed markets like US, Europe, Japan, and semi-regulated/non regulated or emerging markets like Asia, Africa and Latin America.

Bulk drugs comprises of medicinally active ingredients that are converted into formulations or dosage forms. APIs are either manufactured in – house by formulation companies or can be outsourced to third party API manufacturers. Formulations involve developing a preparation of the drug (from APIs and other ingredients) which is both stable and acceptable to patient. This usually involves incorporating the drug into a tablet, capsules, injectibles, syrups, etc. The formulations are administered to or taken by the patient and are available either by prescription or over the counter.

A prescription drug is a licensed medicine that is regulated by legislation to require a prescription (usually from a doctor) before it can be obtained. The term is used to distinguish it from over the counter drugs which can be obtained without a prescription.

The Indian Pharmaceutical sector is highly fragmented industry with more than 20,000 registered units, having expanded drastically in the last two decades. India has the highest number of USFDA (120) plants outside US.

India's pharmaceutical industry characterized by severe price competition and government price control is presently the third largest in the world in terms of volume (Source: Ministry of State for Chemicals and Fertilisers, Government of India (GOI) and stands 14th in terms of value. India accounts for 8 per cent of global pharmaceutical production. Indian firms produce about 60,000 generic brands across 60 therapeutic categories. In addition, Indian firms manufacture approximately 500 different active pharmaceutical ingredients (APIs). Manufacturing costs in India are approximately 35 to 40 per cent of those in the US due to low installation and manufacturing costs.

Of the overall DMF filings to the US FDA, the proportion of filings by Indian players is much high as compared to Chinese players. Although a DMF filing does not necessarily result in business, it provides an indication about the capabilities of players. According to IMS Health India, which tracks drug sales in the country through a network of nationwide drug distributors, estimates the healthcare market in India to reach US$ 31.59 billion by 2020. As per the Department of Industrial Policy and Promotion (DIPP), the drugs and pharmaceuticals sector has attracted FDI worth US$ 1.8 bn between April 2000 and January 2011.

Generic opportunity…

In next three years, ~26 blockbuster medicines, worth over US$96 bn are going off patent in US. This presents Indian companies like Dr. Reddy's, Sun Pharma, Glenmark Pharma and Lupin with a big opportunity. In this newsletter, we have given a brief overview on Dr. Reddy's and Glenmark.

Dr. Reddy's Ltd. (DRL) | CMP: Rs. 1,616, Target Price: Rs.1,824, Upside: 13%

Q4FY11 update (Rs. in mn)

Particulars	Q4FY11	Q4FY10	% yoy change	Q3FY11	% qoq change	FY2011	FY2010
Net sales	***20,170***	***16,420***	***22.8***	***18,990***	***6.3***	***74,693***	***70,277***
Gross profit	10,950	8,640	26.7	10,410	5.1	40,263	36,340
Gross margin (%)	**54.3**	**52.6**	**170 bps**	**54.9**	**(60) bps**	**53.9**	**51.7**
SG&A expenses	6,130	5,810	5.4	6,370	(3.9)	23,690	22,505
R&D expenses	1,490	950	56.5	1,310	14.2	5,060	3,793
PBIDT	**3,330**	**1,870**	**77.7**	**2,740**	**21.7**	**11,513**	**1,437***
OPM (%)	**16.5**	**11.4**	**510 bps**	**14.4**	**210 bps**	**15.4**	**2**
Interest	(70)	30	(394.1)	50	-	(189)	(3)
Other income	510	240	113	200	155	1,120	570
PBT	**3,920**	**2,090**	**87.8**	**2,880**	**35.8**	**12,444**	**2,004**
Tax	(570)	(440)	28.8	(150)	273.5	(1,403)	(985)
Net Profit	**3,350**	**1,650**	**103.6**	**2,730**	**22.6**	**11,041**	**1,019**
Share of profit/(loss) in associate	(4)	20	-	(1)	-	3	48
Reported net profit	**3,340**	**1,670**	**100.7**	**2,730**	**22.5**	**11,044**	**1,067**
Exceptional items	280	280	(1.8)	-	-	280	8,150
Adjusted PAT	**3,070**	**1,950**	**57.4**	**2,730**	**12.3**	**10,764**	**9,217**
EPS	**19.7**	**9.8**		**16.2**		**65**	**6.3**
Face value (Rs.)	**5**	**5**		**5**		**5**	**5**

*Source: Company, Ajcon Research, Note: * indicates adjustment for writedown for goodwill and other intangible assets*

Q4FY11 result update

Net sales witnessed yoy growth of 22.8% in Q4FY11 to touch Rs. 20.1 bn. The global generic markets registered growth of 26.9% on a yoy basis led by growth across the US and Russian markets.

New product launches driving growth in US market

US market witnessed yoy growth of 67.6% to Rs. 5.9 bn owing to launch of Allegra – D24 (fexofinadine pseudoephedrine) in Q4FY11, first as a prescription product and then later as an OTC (Over-the counter) product on approval. On a yearly basis, US market registered yoy growth of 13% with 11 product launches including tacrolimus, fexofinadine pseudoephedrine and lansoprazole by attaining revenues of US$446mn. The US market remains quite attractive for the next two-three years because of the large volume of products which are going off patent. DRL has filed 20 ANDAs (Abbreviated New Drug Applications) in FY11. The cumulative ANDA filings stands at 170, with 75 pending approvals of which 37 are Para IVs and 10 are FTFs. The company was successful in launching 135 generic products. The company has given a guidance of one limited competition opportunity every year for the next few years.

Russian market growth met expectations, European business remained under pressure in Q4FY11

Russian market witnessed yoy growth of 24%, largely driven by volume growth across existing business and new products contribution. There was significant growth in OTC portfolio representing 25% of overall portfolio. The company's European business (UK and Germany) was under pressure and registered yoy decline of 4.8% on yoy basis. This was mainly on account of its subsidiary "Betapharm" reeling under pricing pressure. On a full year basis, UK has done well and the other markets are also beginning to become significant from an out licensing revenue perspective. We believe, the worst is over for Betapharm. DRL has taken efforts on cost rationalization which has led to reducing of workforce by 200 to 80 people. It also started bidding for high margin tenders to improve its profitability.

Pricing pressure in domestic formulations segment, management optimistic on future growth

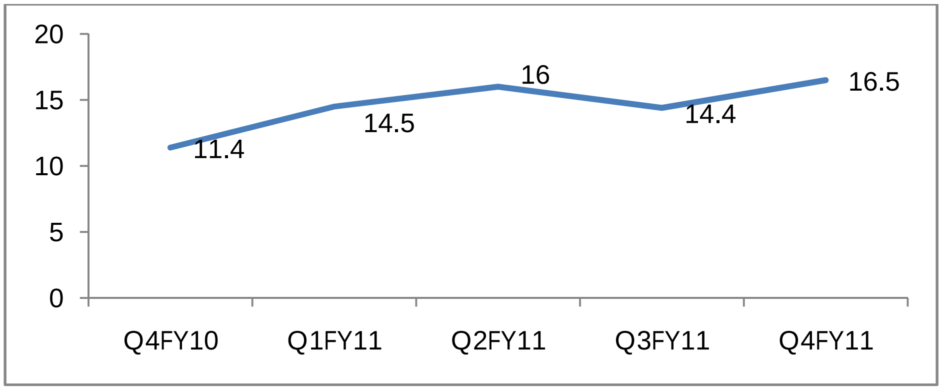
In Q4FY11, domestic market growth was under pressure at 4.9% on a yoy basis. This was mainly on account of increasing competitive intensity leading to price cuts for its products in the domestic formulations segment. On a yearly basis, the company witnessed yoy growth of 15.1%, led by volume growth of 11% and contribution from new product launches of 4%.

In India, 48 new products were launched during FY11, including one biosimilar, darbepoetin alfa under the brand cresp.Going ahead, the management expects the performance in the domestic market to improve significantly on account of field expansion and new product launches (including biosimilars).

Good operating performance

OPM improved by 210 bps to 16.5% in Q4FY11. This was on account of favourable mix of high margin new products in the North America generics segment.

OPM (%) trend



Key highlights of FY11:

1) The company has launched 135 new generic products, filed 107 new product registrations and filed 56 DMFs globally.

2) DRL is still waiting for approval for Arixtra and expects it to launch on approval.

3) Management is optimistic about the prospects in North American generic market for FY12 and FY13.

4) It has a market share of 28% in tacrolimus, 9% in lansoprazole and 35% in fexofenadine.

5) The company has forayed into many strategic initiatives. Some of the key ones being:

a) Acquisition of a penicillin facility to fill its portfolio gap in the anti-bacterial segment in the US.
b) Collaboration with Valeant Pharma to market Cloderm® Cream in the dermatology space in the US.
c) Settlement of the ongoing litigation on esomeprazole with Astra Zeneca.

Outlook

At the CMP, the stock is valued at 25x at FY11 EPS. With due consideration to factors like: a) strong product pipeline (filed 107 new product registrations and 56 DMF's globally), b) DRL's revenue guidance of US$2.7bn by FY2013E with a RoCE of 25%, b)uptick in the domestic formulation and Russian markets business, c)increased contribution from GSK's alliance, d) street expectation of company's revenues to witness a CAGR of 13% and adjusted EPS to witness a 22.7% CAGR to Rs. 96 over FY2011–13E, we recommend a 'BUY' with a target price of Rs. 1,824 (19x at estimated FY13 EPS).

Glenmark Pharma I *CMP: Rs.304, Target Price: Rs.385, Upside: 27%*

About Glenmark Pharmaceuticals Ltd.

Glenmark Pharmaceuticals Ltd. (GPL) is a research-driven, global, integrated pharmaceutical company headquartered at Mumbai, India. It is a leading player in the discovery of new molecules both NCEs (new chemical entity) and NBEs (new biological entity). Glenmark has eight molecules in various stages of clinical development and is primarily focused in the areas of Inflammation [asthma/COPD, rheumatoid arthritis etc.], Metabolic Disorders [diabetes, obesity, etc.] and Pain [neuropathic pain and inflammatory pain]. The company has a significant presence in branded generics markets across emerging economies including India. GPL along with its subsidiary has twelve manufacturing facilities in four countries and has five R&D centres.

Q4FY11 update

Gross sales breakup (Rs. in mn)

Particulars	Q4FY11	Q4FY10	% yoy change	Q3FY11	% qoq change
Formulations					
US	2,243	*1,852*	*21.1*	*2,041*	*9.9*
Latin America (Brazil and others)	492	*346*	*42.2*	*528*	*(6.9)*
Latin America (Argentina)	168	*80*	*108.8*	*43*	*290.4*
Semi regulated markets	1,299	1,370	(5.1)	1,154	12.6
Europe (Specialty)	517	459	12.5	448	15.4
Europe (Generics)	134	98	37.5	154	(12.7)
India*	**2,381**	**2,184**	**9.0**	**2,390**	**(0.4)**
APIs	**1,188**	**703**	**69.1**	**750**	**58.4**
Total	**8,421**	**7,091**		**7,508**	**12.2**

Note: * Q4FY11 India sales increased by Rs. 500 mn to adjust for VAT

Sales witnessed yoy growth of Rs. 8.4 bn (adj. for Rs. 500 mn due to VAT on domestic sales). This was mainly account of growth across geographies. Export formulations registered yoy growth of 23% to Rs. 6 bn. Good performance in US markets led to yoy growth of 21.1% to Rs. 2.2bn in Q4FY11. Management expects US performance to improve in the coming quarters. The company had received four approvals in Q4FY11 and filed six ANDAs. Latin America (Brazil) clocked yoy growth of 42.2% on account of improved performance. On the other hand, Argentina market registered an impressive growth of 109% on yoy basis. Overall European market (specialty and generics) grew by 17% in Q4FY11. This was attributed to in licensing opportunities. However, semi regulated markets remained were under pressure and declined by 5.1% on yoy basis. This was offset by robust yoy growth of 69.15 in API sales.

Strong product pipeline

Molecule	Indication	Phase of development
Crofelemer	HIV associated diarrhea	Phase III
Meloglipitin – GRC 8200	DPP IV	Completed Phase IIb
Revamilast – GRC 4039	PEDIV	Phase II
Tedalinab – GRC 10693	Neuropathic Pain/ Osteoarthritis	Completed Phase I/Entering Phase II
GRC 15300	Neuropathic Pain/ Osteoarthritis	Completed Phase I/Entering Phase II
GRB 500	Monoclonal antibody – Multiple Sclerosis	Phase I

Source: Company, Ajcon Research

Licensing agreement with Aventis

The company has entered into a licensing agreement with Sanofi Aventis for the development and commercialization of GRC 500, a novel (first-in-class) monoclonal antibody to treat Crohn's disease and other autoimmune disorders. It has completed Phase I studies in the US and has been well tolerated with a good pharmacokinetic profile.

About GBR 500

GBR 500 is an antagonist of the VLA – 2 (alpha2-beta1) integrin. It is a first-in-class therapeutic monoclonal antibody and has established proof of concept in animal models across a range of anti – inflammatory conditions. Glenmark has completed Phase I dosing of GBR 500 in the US and the drug has been well tolerated with a good pharmacokinetic profile. Plans are in place to initiate clinical proof of concept studies in Crohn's disease. GBR 500 would address a significant gap, in treating inflammatory diseases which would be of huge benefit to patients.

Terms of the agreement

Under the terms of the agreement, Glenmark will receive US$50 mn, of which US$ 25 mn will be paid upon the closing of the transaction and US$ 25 mn, which is contingent upon Sanofi's positive assessment of certain data to be provided by Glenmark. In addition, Glenmark could receive potential success-based development, regulatory and commercial milestone payments. The total of these payments could reach US$ 613 mn.The company is also eligible to receive tiered double-digit royalties on sales of products commercialized under the license.

What does Sanofi gets?

Sanofi will have exclusive marketing rights for North America, Europe, Japan, Argentina, Chile and Uruguay. Sanofi and Glenmark will co market in Russia, Brazil, Australia and New Zealand. Glenmark will retain exclusive marketing rights in India and other countries in the rest of the world.

Income Statement (Rs. in mn)

Particulars	FY10	FY11
Operating income	**25,006**	**29,536**
Operating expenses	18,521	23,568
EBITDA	**6,486**	**5,968**
EBITDA margin (%)	**25.9**	**20.2**
Other Income	199	1,359
Depreciation	1,206	947
EBIT	**5,479**	**6,381**
Interest	1,640	1,566
PBT	**3,839**	**4,816**
Tax	529	237
PAT	**3,310**	**4,578**
PAT (%)	13.1	14.8
EPS	12.3	16.9
Face Value (Re.)	1	1
ROE (%)	16.7	20.8
ROCE (%)	11.7	14.5

Source: Company, Ajcon Research

Outlook

We believe, GNP's outlicensing deal for GRB-500 validates Glenmark Pharma's drug discovery capabilities. This is GNP's second GNP's second consecutive deal with Sanofi Aventis and first biological deal candidate to be licensed out to a development partner. At the CMP, the stock is valued at 18x at FY11 EPS. With due consideration to factors like a)strong product pipeline, b)licensing agreement with Sanofi Aventis, c) healthy return ratios, d)expected topline CAGR and earnings CAGR (street estimates) of 17% and 12.3% respectively, over the period FY11-FY13E, we recommend a 'BUY' with a target price of Rs. 385 (18x FY13 EPS).

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