

Dr. Reddy's Laboratories

Performance Highlights

Y/E March (₹ cr)	2QFY2012	1QFY2012	% chg (qoq)	2QFY2011	% chg (yoy)
Net sales	2,769	2,268	22.1	1,899	45.9
Gross profit	1,658	1,221	35.8	1,041	59.2
EBIT	738	353	109.1	273	170.4
Net profit	513	307	66.7	273	88.2

Source: Company, Angel Research

Dr. Reddy's Laboratories (DRL) reported higher-than-expected 3QFY2012 results. Net sales increased by 45.9% yoy, led by 57% yoy and 12% yoy growth across the global generics and proprietary products businesses, respectively. This aided an expansion of the operating margins and subsequently a higher net profit growth during the period. Management has reinforced its FY2013 guidance of US\$2.7bn, with RoCE expected to come in at 25%. **We maintain our Buy rating on the stock.**

Results much above expectations: DRL reported net sales of ₹2,769cr (₹1,899cr) for 3QFY2012, registering 45.9% yoy growth, which was higher than our estimate of ₹2,301cr. The US market reported strong growth of 122% yoy, led by new product launches like olanzapine 20mg and higher market share in its key markets. Sales from Russia grew by 15.2% yoy during the quarter. The domestic market reported single-digit growth of 15.8% yoy.

Outlook and valuation: DRL has reinforced its earlier revenue guidance of US\$2.7bn by FY2013E with RoCE of 25%. We expect net sales to report a 13.3% CAGR to ₹9,584cr and adjusted EPS to record a 22.7% CAGR to ₹96.0 over FY2011-13E. **We maintain our Buy recommendation on the stock with a revised target price of ₹1,920.**

Key financials (IFRS Consolidated)

Y/E March (₹ cr)	FY2010	FY2011	FY2012E	FY2013E
Net sales	7,028	7,469	8,721	9,584
% chg	1.2	6.3	16.8	9.9
Net profit	107	1,104	1,565	1,620
% chg	-	933.6	41.8	3.5
Adj net profit	921	1,076	1,565	1,620
% chg	4.1	16.8	45.4	3.5
Adj. EPS (₹)	54.6	63.8	92.7	96.0
EBITDA margin (%)	20.2	21.0	26.5	25.4
P/E (x)	30.6	26.2	18.0	17.4
RoE (%)	21.7	24.2	29.9	24.9
RoCE (%)	16.2	17.7	24.3	21.8
P/BV (x)	6.6	6.1	4.8	3.9
EV/Sales (x)	4.1	4.0	3.4	3.0
EV/EBITDA (x)	20.4	19.2	12.9	11.9

Source: Company, Angel Research

BUY

CMP	₹1,671
Target Price	₹1,920

Investment Period	12 months
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Stock Info

Sector	Pharmaceutical
Market Cap (₹ cr)	28,310
Beta	0.7
52 Week High / Low	1716/1387
Avg. Daily Volume	27,432
Face Value (₹)	5
BSE Sensex	17,605
Nifty	5,326
Reuters Code	REDY.BO
Bloomberg Code	DRRD@IN

Shareholding Pattern (%)

Promoters	25.6
MF / Banks / Indian Fls	13.8
FII / NRIs / OCBs	46.1
Indian Public / Others	14.5

Abs. (%)	3m	1yr	3yr
Sensex	0.7	(4.6)	92.4
Dr Reddy	1.9	4.4	281.5

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Exhibit 1: 2QFY2012 performance (IFRS, consolidated)

Y/E March (₹ cr)	3QFY2012	2QFY2012	% chg (qoq)	3QFY2011	% chg (yoy)	9MFY2012	9MFY2011	% chg
Net sales	2,769	2,268	22.1	1,899	45.9	7,015	5,452	28.7
Other income	17	23	(28)	20	-	57	60	-
Total income	2,786	2,291	21.6	1,918	45.2	7,072	5,512	28.3
Gross profit	1,658	1,221	35.8	1,041	59.2	3,933	2,931	34.2
Gross margin (%)	59.9	53.8	11.2	54.9	9.1	56.1	53.8	4.3
SG&A expenses	768	722	6.4	637	20.5	2,165	1,756	23.3
R&D expenses	151	146	3.8	131	15.6	417	357	16.8
EBIT	738	353	109.1	273	170.4	1,351	817	65.3
EBIT (%)	26.7	15.6	-	14.4	-	19.3	15.0	-
Interest	(17)	5	-	5	(449.4)	(8)	26.2	-
PBT	772	371	108.1	288	168.3	1,416	851	-
Tax	262	63	314.6	15	1,622.2	337	84	302.9
Net profit	511	308	65.8	273	87.3	1,079	768	40.5
Share of profit/ (loss) in associates	2.6	-	-	-	-	4.3	0.7	-
Reported net profit	513	308	66.7	273	88.2	1,083	769	41.0
Exceptional items	-	-	-	-	-	-	-	-
Adjusted PAT	513	307	66.9	273	88.2	1,083	769	41.0
EPS (₹)	30.3	18.2	-	16.1	-	63.7	45.3	-

Source: Company, Angel Research

Exhibit 2: Actual vs. Estimates

(₹ cr)	Actual	Estimates	Variation (%)
Net sales	2,769	2,301	20.3
Other income	17	22	(25.0)
Operating profit	738	365	102.3
Interest	(17)	10	-
Tax	262	146	79.2
Net profit	513	320	60.2

Source: Company, Angel Research

Better-than-expected revenue growth: DRL reported net sales of ₹2,769cr (₹2,301cr) for 3QFY2012, registering 45.9% yoy growth, which was higher than our estimate of ₹2,301cr. The global generics market registered growth of 56.6% yoy, led by growth across the US and Russian markets.

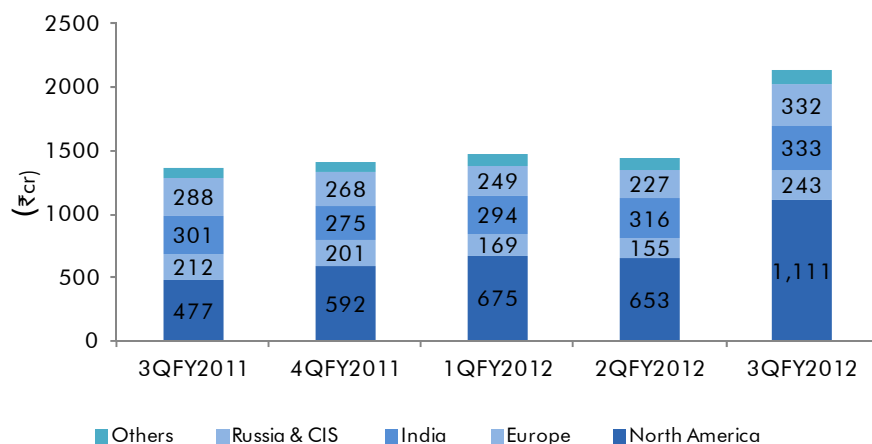
In terms of market performance, the US market reported strong growth of 133.2% yoy with sales of ₹1111.4cr (₹476.5cr), led by market share improvement in key products and new product launches including olanzapine 20 mg and olanzapine ODT. Russia registered 15.2% yoy growth. The domestic market reported single-digit growth of 11.1% yoy.

Sales from Europe grew in single digits growing by 14.2% yoy during the quarter, as Betapharm business continued to reel under pricing pressure. During the quarter, sales from Germany were at ₹1,500cr.

During the quarter, three ANDAs were filed. Cumulative ANDA filings as of December 31, 2012, stood at 187. The company has 79 ANDAs pending for approval with the USFDA, of which 40 are Para IVs and 10 are FTFs.

During the quarter, DRL launched six products in the domestic market, which grew modestly by 11.1% yoy. The biosimilar market reported growth of 22% yoy, representing 25% of the company's sales.

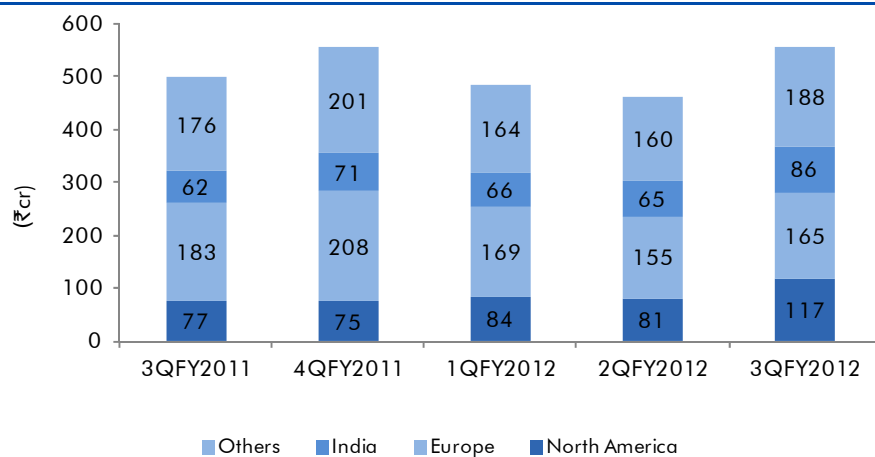
Exhibit 3: Global generic trend



Source: Company, Angel Research

The PSAI segment registered 11.7% yoy growth, majorly led by 9.9% yoy decline in the European market. North America posted 51.9% yoy growth. India, on the other hand, grew by 38.6% yoy during the quarter.

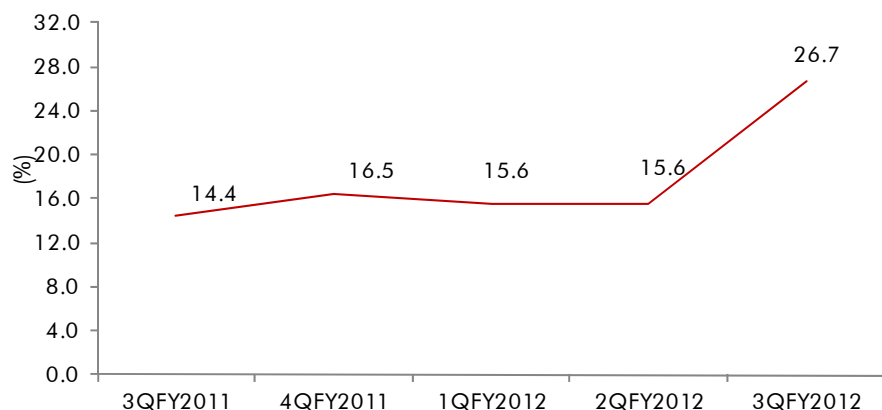
Exhibit 4: PSAI trend



Source: Company, Angel Research

EBIT margin higher than expected: DRL reported gross margin of 59.9% (54.9%) during the quarter. The company's EBIT margin came in at 26.7% (14.4%), higher than our estimate. The key expenditure areas – R&D and S&GA grew by 15.9% and 20.5%, respectively.

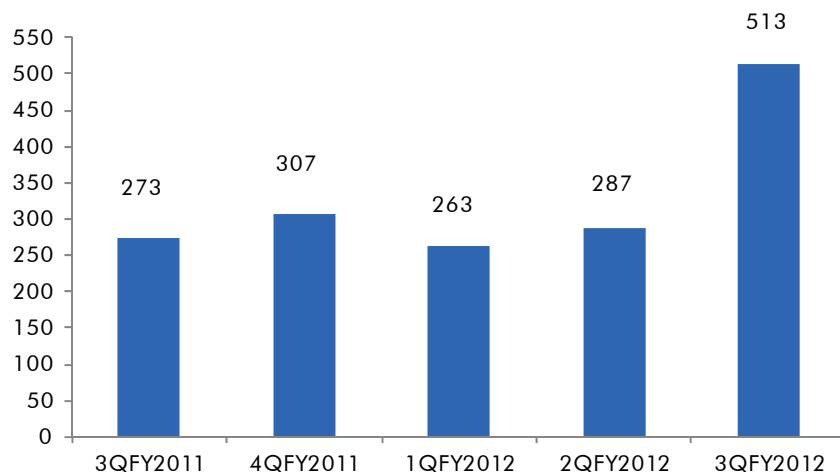
Exhibit 5: EBIT margin trend



Source: Company, Angel Research

Net profit grew by 87.7% yoy during the quarter: DRL reported net profit of ₹513cr (₹273cr), registering an increase of 87.7% yoy, much higher than our estimate of ₹320cr. This was on account of higher gross and operating margins. Tax as a percentage of PBT stood at 34% vis-à-vis 5.0% in 3QFY2011.

Exhibit 6: Adjusted net profit trend



Source: Company, Angel Research

Concall takeaways

- Management reinforced its FY2013 revenue guidance of US\$2.7bn, with RoCE of 25%.
- Guided for higher R&D costs (7%-8%, up from current 6.5% of total sales) on account of biosimilar trials for regulated and ROW markets and filings of complex molecules in US.
- Proprietary products attained \$100mn in sales during 9MFY2012 which is expected to double by FY2013.
- Management indicates that growth from biosimilars will accelerate over next 2 to 3 years to an estimated \$100mn.

Investment arguments

Robust growth in the US ahead: After attaining a critical mass (US\$426mn with 11 new product launches in FY2011), DRL aims to scale up its business to the next orbit in the US market on the back of a strong product pipeline (75 ANDAs are pending approval, of which 36 are Para IVs and 11 are FTFs). Management has guided for one limited competition opportunity every year for the next few years. The US market is expected to be one of the key growth drivers, with strong revenue expected to come in from fexofenadine OTC, Olanzapine and *Arixtra*.

Worst is left behind in the German market: Post the Betapharm acquisition, the German market has become a tender-based market, leading to significant price erosions. In order to remain competitive, DRL has managed to reduce its workforce by 200 to 80 employees currently, and 60% of its products at Betapharm are now vertically integrated. The company is taking several conscious efforts such as reducing work force and bidding for high-margin tenders to improve its profitability.

Domestic back in focus: After a below-industry average growth on the domestic formulation front since the last three years, DRL reported modest 15.1% growth in FY2011. Management expects the company's performance to rebound and targets to achieve 18-20% growth going ahead, driven by a) field force expansion (field force stands at 3,800MRs as of FY2011) and improvement in productivity, b) new product launches (including biosimilars) and c) focus on brand building.

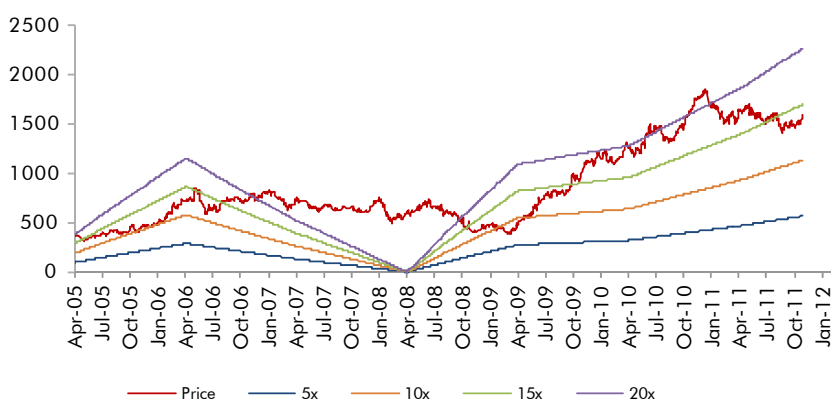
Strategic alliances to provide long-term growth: In order to tap the emerging market opportunities, DRL entered into an alliance with GSK in FY2011 to develop and market branded formulations across emerging markets. On the biogeneric front, the company has developed nine products (four products launched in India) on mammalian cell culture with global brand sales of US\$30bn. The company has also entered into a marketing agreement with Valent Pharma to market *Cloderm* cream in the US market. This deal is expected to provide an impetus to the proprietary products business going forward.

Valuation: DRL has revised its earlier revenue guidance of US\$3bn to US\$2.7bn by FY2013E with RoCE of 25%. Growth would be driven by the US business, uptick in the domestic formulation and Russian markets and increased contribution from GSK's alliance. We expect the company's net sales to post a 13.3% CAGR to ₹9,584cr and adjusted EPS to record a 22.7% CAGR to ₹96.0 over FY2011-13E. **At the CMP, the stock is trading at 18.0x FY2012E and 17.4x FY2013E earnings, we maintain our Buy view on the stock with a target price of ₹1,920.**

Exhibit 7: Key assumptions

	FY2012E	FY2013E
PSAI segment growth (%)	4.0	3.6
Generics segment growth (%)	21.5	12.0
Operating margin (%)	26.3	25.1
Capex (₹ cr)	700	300

Source: Company, Angel Research

Exhibit 8: One-year forward PE chart


Source: Company, Angel Research

Exhibit 9: Recommendation summary

Company	Reco	CMP (₹)	Tgt. price (₹)	Upside %	FY2013E			FY11-13E		FY2013E
					PE (x)	EV/Sales (x)	EV/EBITDA (x)	CAGR in EPS (%)	RoCE (%)	RoE (%)
Alembic Pharma.	Buy	39	77	97.0	5.1	0.7	4.9	30.6	26.6	37.0
Aurobindo Pharma	Buy	117	166	42.0	8.5	1.0	6.8	9.9	10.2	15.0
Aventis*	Sell	2,245	1,937	(13.7)	25.0	3.1	20.6	15.4	15.7	17.1
Cadila Healthcare	Buy	658	965	46.6	13.6	2.1	11.1	19.4	25.2	31.1
Cipla	Accumulate	340	369	8.6	18.4	3.3	15.8	23.8	16.6	18.2
Dr Reddy's	Buy	1,635	1,920	17.4	17.4	3.0	11.9	22.7	21.8	24.9
Dishman Pharma	Buy	52	68	30.3	4.5	1.3	7.2	5.7	7.9	9.2
GSK Pharma*	Neutral	1,963	-	-	22.6	5.1	14.4	14.6	41.0	30.7
Indoco Remedies	Buy	430	583	41.6	7.8	1.0	6.3	15.6	14.2	16.9
Ipca labs	Buy	323	393	21.7	9.9	1.3	6.1	25.2	25.9	27.8
Lupin	Buy	474	593	24.9	16.0	2.6	13.0	23.9	24.8	28.6
Orchid Chemicals	Buy	174	270	55.2	4.7	1.1	5.1	29.0	12.0	23.0
Ranbaxy*	Neutral	456	-	-	8.6	1.4	5.9	21.8	27.7	30.0
Sun Pharma	Neutral	543	-	-	21.0	5.9	16.7	21.4	22.4	22.4

Source: Company, Angel Research; Note: *December year ending; #Calculations based on recurring EPS

Profit & loss statement (IFRS Consolidated)

Y/E March (₹ cr)	FY2009	FY2010	FY2011	FY2012E	FY2013E
Gross sales	6,833	6,883	8,451	9,830	11,443
Less: Excise duty	42.2	31.6	50.7	59.0	68.7
Net sales	6,944	7,028	7,469	8,721	9,584
Other operating income	(25.4)	56.9	75.0	75.0	75.0
Total operating income	6,919	7,085	7,544	8,796	9,659
% chg	-	2.4	6.5	16.6	9.8
Total expenditure	5,418	5,608	5,903	6,413	7,148
Cost of revenues	2,913	2,978	3,028	3,125	3,430
SG&A expenses	2,102	2,251	2,369	2,695	3,067
R&D expenses	403.7	379.3	506.0	593.0	651.7
EBITDA	1,526	1,420	1,566	2,308	2,435
% chg	-	-6.9	10.3	47.4	5.5
(% of Net Sales)	22.0	20.2	21.0	26.5	25.4
Depreciation & amortisation	381.4	416	415	494	547
EBIT	1,144	1,004	1,151	1,814	1,888
% chg	-	(12)	15	58	4
(% of Net Sales)	16.5	14	15	21	20
Interest & other charges	166.8	37	28	36	44
Other Income	48.2	37	9	9	9
(% of PBT)	4.8	3	1	1	0
Share in profit of associates	2.4	5	0	0	0
Recurring PBT	1,003	1,066	1,208	1,863	1,929
% chg	-	6.3	13.3	54.2	3.5
Extraordinary expense/(Inc.)	1,402.3	860	(37)	-	-
PBT (reported)	(399.6)	205	1,244	1,863	1,929
Tax	117.2	99	140	298	309
(% of PBT)	-29.3	48.0	11.3	16.0	16.0
PAT (reported)	(516.8)	107	1,104	1,565	1,620
Add: Share of earnings of asso.	-	-	-	-	-
Less: Minority interest (MI)	-	-	-	-	-
Exceptional items	-	815	9	-	-
PAT after MI (reported)	(516.8)	107	1,104	1,565	1,620
ADJ. PAT	885.5	921	1,076	1,565	1,620
% chg		4.1	16.8	45.4	3.5
(% of Net Sales)	-7.4	1.5	14.8	17.9	16.9
Basic EPS (₹)	52.6	54.6	63.8	92.7	96.0
Fully Diluted EPS (₹)	52.6	54.6	63.8	92.7	96.0
% chg		3.8	16.8	45.4	3.5

Balance sheet (IFRS Consolidated)

Y/E March (₹ cr)	FY2009	FY2010	FY2011	FY2012E	FY2013E
SOURCES OF FUNDS					
Equity share capital	84.2	84	84	84	84
Reserves & surplus	4,120	4,207	4,515	5,766	7,062
Shareholders' funds	4,205	4,292	4,599	5,852	7,149
Total loans	1,948.3	1,466	2,357	1,814	2,215
Deferred tax liability	341.1	144	144	144	144
Total liabilities	6,494	5,901	7,100	7,809	9,508
APPLICATION OF FUNDS					
Net fixed assets	1,660	1,759	2,478	3,173	3,467
Goodwill /other intangibles	2,238	1,422	1,549	1,183	1,183
Capital Work-in-Progress	427.9	486.7	486.7	491.6	496.5
Investments	26.2	31.0	31.0	31.0	31.0
Current Assets	3,901	4,206	4,832	5,405	7,009
Cash	559.6	658	573	247	1,339
Loans & Advances	416.6	422	448	523	575
Other	2,925	3,126	3,811	4,635	5,095
Current liabilities	1,759	2,004	2,276	2,475	2,681
Net Current Assets	2,142	2,202	2,556	2,930	4,328
Mis. Exp. not written off	-	-	-	-	-
Total Assets	6,494	5,901	7,100	7,809	9,508

Cash flow statement (IFRS Consolidated)

Y/E March (₹ cr)	FY2009	FY2010	FY2011	FY2012E	FY2013E
Profit before tax	1,002.7	1,066	1,208	1,863	1,929
Depreciation	381.4	416	415	494	547
(Inc)/Dec in Working Capital	(826.7)	38	(439)	(700)	(306)
Less: Other income	36.8	37	9	9	9
Direct taxes paid	117.2	99	140	298	309
Cash Flow from Operations	403.4	1,384	1,034	1,349	1,852
(Inc.)/Dec. in Fixed Assets	(450.7)	(158)	(718)	(700)	(300)
(Inc.)/Dec. in Investments	437.7	5	-	-	-
Other income	36.8	37	9	9	9
Cash Flow from Investing	23.8	(116)	(709)	(691)	(290)
Issue of Equity	-	0	-	-	-
Inc./(Dec.) in loans	(66.2)	(483)	892	(544)	402
Dividend Paid (Incl. Tax)	73.8	(123)	(221)	(313)	(324)
Others	(573.8)	(1,775)	(1,081)	(128)	(548)
Cash Flow from Financing	(566.2)	(1,169)	(410)	(985)	(470)
Inc./(Dec.) in Cash	(139.0)	99	(86)	(326)	1,092
Opening Cash balances	699	560	658	573	247
Closing Cash balances	560	658	573	247	1,339

Key ratios

Y/E March	FY2009	FY2010	FY2011	FY2012E	FY2013E
Valuation Ratio (x)					
P/E (on FDEPS)	31.8	30.6	26.2	18.0	17.4
P/CEPS	-	54.0	18.6	13.7	13.0
P/BV	6.7	6.6	6.1	4.8	3.9
Dividend yield (%)	0.3	0.3	0.3	0.3	0.3
EV/Sales	4.3	4.1	4.0	3.4	3.0
EV/EBITDA	19.4	20.4	19.2	12.9	11.9
EV / Total Assets	4.5	4.9	4.2	3.8	3.1
Per Share Data (₹)					
EPS (Basic)	52.6	54.6	63.8	92.7	96.0
EPS (fully diluted)	52.6	54.6	63.8	92.7	96.0
Cash EPS	-	31.0	90.0	122.0	128.4
DPS	5.0	5.0	5.0	5.0	5.0
Book Value	249.7	254.2	272.5	346.7	423.5
Dupont Analysis					
EBIT margin	16.5	14.3	15.4	20.8	19.7
Tax retention ratio	0.0	52.0	88.7	84.0	84.0
Asset turnover (x)	1.0	1.3	1.3	1.2	1.2
ROIC (Post-tax)	0.0	9.4	17.5	21.8	20.3
Cost of Debt (Post Tax)	0.0	1.1	1.3	1.4	1.8
Leverage (x)	0.3	0.3	0.3	0.3	0.2
Operating ROE	0.0	11.6	22.2	28.5	23.9
Returns (%)					
ROCE (Pre-tax)	17.6	16.2	17.7	24.3	21.8
Angel ROIC (Pre-tax)	35.0	30.4	29.4	35.0	30.5
ROE	21.1	21.7	24.2	29.9	24.9
Turnover ratios (x)					
Asset Turnover (Gross Block)	4.2	4.1	3.6	3.1	2.9
Inventory / Sales (days)	70	69	71	72	74
Receivables (days)	77	68	72	79	82
Payables (days)	40	50	55	52	53
WC cycle (ex-cash) (days)	83	81	85	97	107
Solvency ratios (x)					
Net debt to equity	0.3	0.2	0.4	0.3	0.1
Net debt to EBITDA	0.9	0.6	1.1	0.7	0.4
Interest Coverage (EBIT / Interest)	6.9	27.0	40.7	50.6	43.1

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Disclosure of Interest Statement

Dr. Reddy's Laboratories

1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹1 lakh for Angel, its Group companies and Directors

Ratings (Returns):

Buy (> 15%)

Reduce (-5% to 15%)

Accumulate (5% to 15%)

Sell (< -15%)

Neutral (-5 to 5%)