

July 20, 2011

Reco	Previous Reco
Accumulate	Accumulate
CMP	Target Price
Rs1,567	Rs1,750

EPS change FY11E/12E (%)	-5 / NA
Target Price change (%)	NA
Nifty	5,567
Sensex	18,502

Price Performance

(%)	1M	3M	6M	12M
Absolute	3	(4)	(6)	9
Rel. to Nifty	(3)	(0)	(4)	5

Source: Bloomberg

Relative Price Chart



Source: Bloomberg

Stock Details

Sector	Pharmaceuticals
Bloomberg	DRRD@IN
Equity Capital (Rs mn)	847
Face Value(Rs)	5
No of shares o/s (mn)	169
52 Week H/L	1,855/1,305
Market Cap (Rs bn/USD mn)	265/5,957
Daily Avg Volume (No of sh)	88926
Daily Avg Turnover (US\$m)	3.1

Shareholding Pattern (%)

	Jun-11	Mar-11	Dec-10
Promoters	25.6	25.7	25.7
FII/NRI	45.4	46.3	48.3
Institutions	14.7	14.0	13.1
Private Corp	5.6	5.5	4.5
Public	8.6	8.6	8.5

Source: Capitaline

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- Q1FY12 revenues were in-line with our expectations. Revenues at Rs19.8bn (up 18%YoY), EBITDA at Rs4.4bn (up 16% YoY), and PAT at Rs2.6bn (up 25% YoY)
- Revenues were driven by 48% growth in North America and 18% increase in Russia & CIS revenues
- Allegra D-24, 4 new launches from the company's Bristol facility and gain in market share in existing products led to robust growth in North American region
- Limited competition opportunities set to drive growth in the North American region. Maintain Accumulate rating with a price target of Rs1750

Q1FY12 revenues grew 18% led by growth strong growth in North American & Russia/ CIS markets

- North American business which contributed 29%, grew by 48% due to new product launches and increase in market share of existing products
 - Launched 9 new products including 4 SKU's from its Bristols penicillin facility
 - Market share gains in key products – Tacrolimus, lansoprazole, omeprazole Rx, Omeprazole Mg OTC & fexofinadine OTC
- Russia & CIS which contributed 15%, grew by 18% on back of significant volume growth in key brands.
- India business which contributed 15%, grew at a lower rate of 6% compared to industry rate of 14%. This is the second consecutive quarter of poor performance in the domestic market for Dr. Reddy.
- Europe & RoW which contributed 14% remained flat by 10% due to continued pricing pressure in Europe

Going forward, growth will come from North American markets

- Growth in US would be triggered by the launch of
 - Fondaparinux – Market size of US\$340mn, got approval in Jul'11
 - Olanzapine – Market size of US\$900mn, expect launch in Oct'11
 - Fexofinadine – Expect increased traction in the OTC market
 - New launches from Penicillin plant acquired from GSK in Sept-Oct'11

Valuation

We expect Dr. Reddy to report 27% revenue growth in FY12E and 11% growth in FY13E. We expect EBITDA margins to move from 19.9% in FY11 to 24.8% in FY12 and 22.4% in FY13. Earnings will grow by 28% CAGR over FY11-13E. We maintain our target price on the stock to Rs1750 (21x base business earnings of Rs79 + NPV of Rs94) with an Accumulate rating. At CMP, the stock is trading at 16.5x FY12E and 16.3x FY13E earnings.

Financials

Rs mn

YE-	Net	EBITDA		EPS	EPS	RoE	EV/			
Mar	Sales	(Core)	(%)	APAT	(Rs)	% chg	(%)	P/E	EBITDA	P/BV
FY10	70,310	15,762	22.4	8,435	50.0	101.9	9.6	31.4	17.3	7.0
FY11	74,233	14,796	19.9	9,989	59.0	10.8	25.6	26.5	19.1	6.6
FY12E	94,570	23,462	24.8	16,030	94.7	18.1	33.9	16.5	11.6	4.9
FY13E	104,857	23,520	22.4	16,292	96.3	60.5	26.7	16.3	11.1	3.9

Key Financials

Rs mn	Q1FY11	Q4FY11	Q1FY12	YoY %	QoQ %
Revenues	16831	20173	19783	17.5%	-1.9%
Base (w/o FTF)	16831	19020	19074	13.3%	0.3%
FTF (Allegra)	0	1153	709	-	-
Raw Material	5035.2	4059	5830	15.8%	43.6%
Manufacturing Cost	2882.3	5165	3303	-	-
Gross Profit	8914	10949	10651	19.5%	-2.7%
Operating Expenses					
SGA	4508.8	5064	5483	21.6%	8.3%
R&D cost	992.9	1491	1197	20.5%	-19.7%
Total operating expenses	5501.7	6555	6680	21.4%	1.9%
EBITDA	3412.1	4394	3971	16.4%	-9.6%
Base EBITDA (w/o FTF)	3412	3933	3688	8.1%	-6.2%
Depreciation	973	1061	1233	26.7%	16.2%
Other exp/ (income)	-186.4	-512	-187	0.3%	-63.5%
Finance exp/ (income)	9	99	-221	-	-
Share of profit/loss	4.7	-4	4	-	-
PBT	2639	3742	2708	2.6%	-27.6%
Extraordinary Items					
VRS	0	0	136	-	-
Forex gain/ (loss)	-225	171	158	-	-
Profit on sale on investment	39	0	17	-	-
PBT after EO	2453	3913	2747	12.0%	-29.8%
Tax	-357.3	-567	-119.4	-66.6%	-78.9%
PAT	2096	3346	2628	25.4%	-21.5%
Base PAT (w/o FTF)	2096	2955	2357	12.5%	-20.2%
EPS	12.4	19.8	15.6	25.4%	-21.5%
Base EPS	12.4	17.5	14.0	12.5%	-20.2%
Adjusted PAT	2257	3201	2591	14.8%	-19.1%
Adjusted EPS	13.4	19.0	15.3	14.8%	-19.1%

				bps	bps
EBITDA margins	20.3%	21.8%	20.1%	-20	-171
Base EBITDA margins (w/o FTF)	20.3%	20.7%	19.3%	-94	-134
PAT margins	12.5%	16.6%	13.3%	83	-330
Base PAT margins (w/o FTF)	12.5%	15.5%	12.4%	-10	-318
Tax Rate	13.5%	15.2%	4.4%	-913	-1074

EBITDA margins remain flat at 20.1% YoY led by

- Presence of one-off Allegra boosted the margins
- However, increase in SGA and R&D cost limited the margin expansion. SGA cost was higher as the company acquired GSKs penicillin facility this quarter. Revenues from this facility was US\$2mn and SGA & manufacturing expense were US\$5mn

Reported PAT at Rs 2,6 bn was up by 24% on account of

- Higher profitable contribution of Allegra
- Lower tax expenses and Forex gains of Rs158million
- Adjusted for extraordinary items, adjusted PAT grew 15% YoY to Rs2.6bn

Revenue break-up

(Rs mn)	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12	YoY (%)	QoQ (%)
Global Generics	11,918	13,667	13,589	14,166	14,424	21.0	1.8
NA	3,897	4416	4765	5918	5756	47.7	-2.7
Europe	1,937	2366	2123	2005	1917	-1.0	-4.4
India	2,778	3160	3007	2745	2936	5.7	7.0
Russia & Other CIS	2,552	2751	2875	2680	3018	18.3	12.6
Others	754	974	819	818	797	5.7	-2.6
PSAI	4,499	4,617	4,980	5,551	4,832	7.4	-13.0
North America	837	814	770	749	842	0.6	12.4
Europe	1,555	1551	1830	2084	1693	8.9	-18.8
India	633	653	622	711	662	4.6	-6.9
RoW	1,474	1599	1758	2007	1635	10.9	-18.5
Proprietary products	415	420	417	453	528	27.2	16.6
Total	16,832	18,704	18,986	20,170	19,784	17.5	-1.9

Drag in India business to continue for few more quarters

Revenues in India grew by 6% compared to 14% industry growth. This is the second consecutive quarter where the company has grown below than industry rate. This was due to –

- Higher attrition rate in field force (at 25%) impacted productivity and growth rate
- Intense pricing pressure in the existing products from MNCs and local players further dragged the overall growth
- Field force expansion and penetration in rural market has not delivered the desired results for the company

Going forward, company expects normalization in sales from H2FY12, however, we think normalization might get delayed to FY13

Opportunities in North American market

North American business which contributed 29%, grew by 48% due to new product launches and increase in market share of existing products

- Launched 9 new products including 4 SKU's from its Bristols penicillin facility. This facility contributed US\$4mn in sales and US\$5mn in cost this quarter. Going ahead, company has guided for US\$60mn in annual revenues from this facility
- The company filed 3 ANDAs this quarter, taking the total filings to 180. Of the 76 pending approvals, 36 are Para-IVs and 11 are FTF's. Management has guided to launch 10 ANDAs in FY12
- The company's Mexican facility which has a Waning Letter from the USFDA has total revenues of US\$60mn. However, Naproxen which is a US\$30mn product is exempt from the ban. The net impact of the ban will be US\$30mn
- **Fondaparinux** – Dr. Reddy got approval for this product in Jul'11 which has a market of USD\$340mn. Of this, 60% is through sales to the hospitals and rest 40% is through retail channel. Company will launch the product in a phased manner and initially will target only the retail market. Moreover an Authorized Generic is also likely to enter the market soon. Even though this is a difficult to make molecule and competition will be limited, but, at the same time it is also difficult to capture the market share
- **Olanzapine** – With US\$900mn in revenues at the innovator level and an FTF status for DRL, we believe Zyprexa to be one of the key opportunities DRL would have in the near future. DRL is expected to launch Zyprexa in the US in H2FY12. DRL's

first-to-file status (on 20mg strength) will result in 180-day exclusivity for the company

Momentum in Russia/ CIS business continues

During this quarter Europe/ CIS business grew by 18% largely driven by

- Significant volume growth in key brands in Russia (contribution increased from 25% in Q1FY11 to 30% in Q1FY12)
- 17% YoY growth in secondary prescriptions

Pricing pressure in European region

During this quarter Europe business grew marginally by 1% due to continued pricing pressure in the region

- Revenues from Germany declined by 9% to Rs1.2bn due to pricing pressures in the tender business, which is likely to continue
- However, revenues from Rest of Europe grew by 15% to Rs710mn

Valuation

We expect Dr. Reddy to report 27% revenue growth in FY12E and 11% growth in FY13E. We expect EBIDTA margins to move from 19.9% in FY11 to 24.8% in FY12 and 22.4% in FY13. Earnings will grow by 28% CAGR over FY11-13E. We maintain our target price on the stock to Rs 1750 (21x base business earnings of Rs79 + NPV of Rs94) with an Accumulate rating. At CMP, the stock is trading at 16.5x FY12E and 16.3x FY13E earnings.

Dr. Reddy's – Domestic Metrics

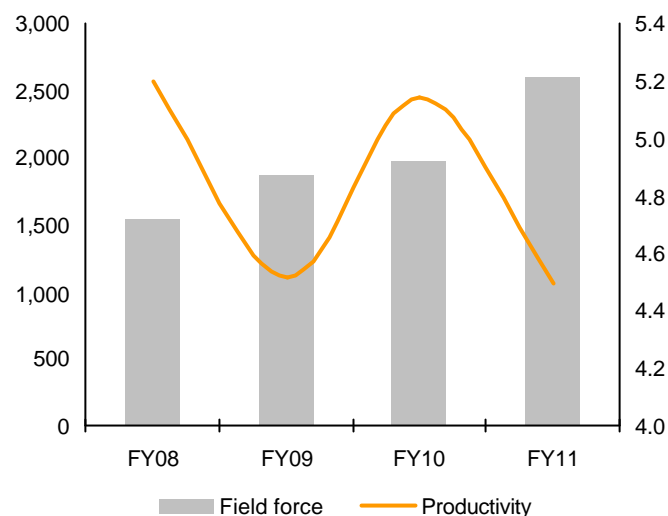
Dr. Reddy's therapeutic growth

Therapies	FY11 % Contribution	MAT Jun'11	MAT Jun'10	YoY Gr. %
Gastro	24.5%	292.3	259.7	12.5%
CVS	19.1%	228.1	208.4	9.5%
Pain Mgmt	11.6%	138.6	140.7	-1.5%
Anti-infective	9.2%	110.4	103.3	6.9%
Anti-diabetic	6.1%	73.0	63.1	15.7%
Respiratory	2.7%	32.6	23.5	39.1%
Dermatology	5.9%	70.3	51.7	36.0%
Gynecology	1.3%	15.1	15.0	0.5%
CNS	0.9%	10.8	10.0	8.2%
Others	18.7%	223.8	206.7	8.3%
Acute	70.0%	837.1	759.3	10.2%
Chronic	30.0%	358.0	322.7	10.9%
Total Sales	100.0%	1195.1	1082.0	10.4%

Jun'11 MAT growth for Dr. Reddy has been lower at 10%

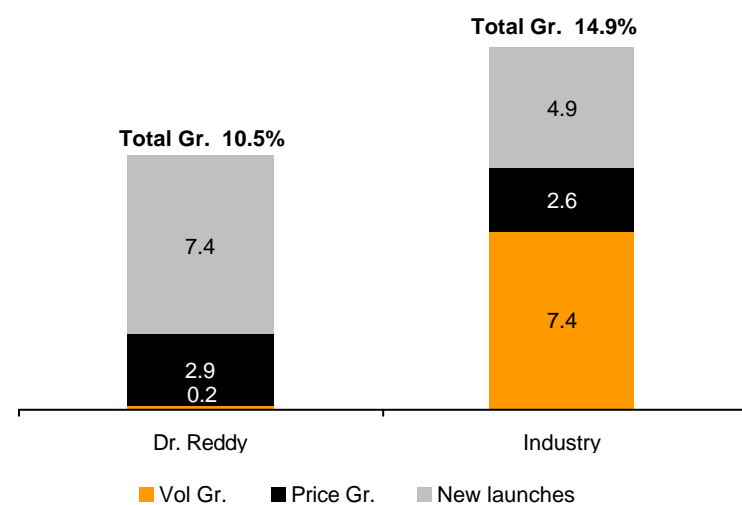
- Acute segment which contributes 70% grew by 10%
- Chronic segment which contributes 30% grew by 11%

Field force productivity



- The company has hired ~600 people during FY11
- MR productivity declined due to higher attrition rate

Growth drivers - Volume/ Price/ New launches



- Dr. Reddy's underperformed industry due to no volume growth in existing brands during MAT Jun'11
- This was mainly due to increased competition and high attrition rate in its field force

Source: AIOCD, Emkay Research

Top 10 brand performance

Rs Cr	MAT Jun'10	MAT Jun'11	YoY Gr.
Omez	106.8	117.4	9.9%
Nise	83.6	75.7	-9.4%
Stamlo	53.8	55.1	2.4%
Omez D	34.7	39.8	14.7%
Stamlo Beta	36.3	38.1	4.9%
Atocor	31.2	34.9	11.6%
Razo	30.8	33.2	7.9%
Mintop	22.6	27.2	20.3%
Clamp	20.6	25.7	24.5%
Econorm	20.7	25.2	21.7%
Total	441.2	472.3	7.0%

- Top 10 brands contribute 41% to the domestic formulation sales
- Competition is expected to increase in the company's top selling brand Omez

Financials

Income Statement

Y/E, Mar (Rs. mn)	FY10	FY11	FY12E	FY13E
Net Sales	70,310	74,233	94,570	104,857
<i>Growth (%)</i>	2.2	5.6	27.4	10.9
Expenditure	54,549	59,437	71,108	81,336
Raw Materials	22,688	21,987	30,161	33,930
SGA	18,179	21,576	23,453	26,471
Employee Cost	10,948	12,786	14,440	17,406
Other Exp	2,734	3,088	3,053	3,529
EBITDA	15,762	14,796	23,462	23,520
<i>Growth (%)</i>	6.9	-6.1	58.6	0.2
EBITDA margin (%)	22.4	19.9	24.8	22.4
Depreciation	4,131	3,981	4,366	4,756
EBIT	11,631	10,815	19,097	18,764
EBIT margin (%)	16.5	14.6	20.2	17.9
Other Income	1,014	1,259	1,360	1,922
Interest expenses	312	246	908	818
PBT	6,183	11,828	19,548	19,868
Tax	2,668	1,839	3,519	3,576
<i>Effective tax rate (%)</i>	43.2	15.5	18.0	18.0
Adjusted PAT	8,435	9,989	16,030	16,292
(Profit)/loss from JV's/Ass/MI	0	0	0	0
Adjusted PAT after MI	8,435	9,989	16,030	16,292
<i>Growth (%)</i>	11.0	18.4	60.5	1.6
Net Margin (%)	12.0	13.5	17.0	15.5
E/O items	-6,150	0	0	0
Reported PAT	3,515	9,989	16,030	16,292
<i>Growth (%)</i>	-138.3	184.2	60.5	1.6

Cash Flow

Y/E, Mar (Rs. mn)	FY10	FY11	FY12E	FY13E
PBT (Ex-Other income)	5,169	10,569	18,188	17,946
Depreciation	4,131	3,981	4,366	4,756
Interest Provided	312	246	908	818
Other Non-Cash items	0	0	0	0
Chg in working cap	4,709	-6,784	-3,909	-2,211
Tax paid	-2,668	-1,839	-3,519	-3,576
Operating Cashflow	11,653	6,173	16,035	17,734
Capital expenditure	-1,709	-12,737	-4,072	-5,300
Free Cash Flow	9,944	-6,564	11,963	12,434
Other income	1,014	1,259	1,360	1,922
Investments	-3,057	3,571	0	0
Investing Cashflow	-3,752	-7,907	-2,712	-3,378
Equity Capital Raised	226	243	0	0
Loans Taken / (Repaid)	-5,133	8,862	-2,000	-2,500
Interest Paid	-312	-246	-908	-818
Dividend paid (incl tax)	-2,216	-2,217	-1,980	-2,969
Income from investments	0	0	0	0
Others	511	-5,757	0	0
Financing Cashflow	-6,924	885	-4,888	-6,288
Net chg in cash	977	-849	8,435	8,067
Opening cash position	5,623	6,600	5,751	14,186
Closing cash position	6,600	5,751	14,186	22,253

Balance Sheet

Y/E, Mar (Rs. mn)	FY10	FY11	FY12E	FY13E
Equity share capital	844	846	846	846
Reserves & surplus	36,924	39,472	53,503	66,825
Net worth	37,768	40,318	54,349	67,671
Minority Interest	0	0	0	0
Secured Loans	9,275	14,394	13,394	11,894
Unsecured Loans	5,568	9,311	8,311	7,311
Loan Funds	14,843	23,705	21,705	19,205
Net deferred tax liability	71	-224	-224	-224
Total Liabilities	52,682	63,799	75,830	86,652
Gross Block	64,469	79,752	84,752	89,752
Less: Depreciation	40,946	45,896	50,230	54,986
Net block	23,522	33,855	34,522	34,766
Capital work in progress	7,622	6,045	5,085	5,385
Investment	3,580	9	9	9
Current Assets	38,202	47,517	61,666	75,004
Inventories	13,394	15,992	17,875	19,919
Sundry debtors	11,599	16,507	18,504	20,520
Cash & bank balance	6,600	5,751	14,186	22,253
Loans & advances	0	0	0	0
Other current assets	6,609	9,267	11,102	12,312
Current lia & Prov	20,245	23,628	25,452	28,512
Current liabilities	16,746	20,188	21,821	24,190
Provisions	3,499	3,440	3,631	4,322
Net current assets	17,957	23,889	36,214	46,492
Misc. exp & Def. Assets	0	0	0	0
Total Assets	52,682	63,799	75,830	86,652

Key Ratios

Y/E, Mar	FY10	FY11	FY12E	FY13E
Profitability (%)				
EBITDA Margin	22.4	19.9	24.8	22.4
Net Margin	12.0	13.5	17.0	15.5
ROCE	23.4	20.7	29.2	25.4
ROE	9.6	25.6	33.9	26.7
RoIC	13.8	17.5	26.1	24.3
Per Share Data (Rs)				
EPS	50.0	59.0	94.7	96.3
CEPS	110.9	82.6	120.5	124.4
BVPS	223.7	238.3	321.2	399.9
DPS	11.3	11.3	10.0	15.0
Valuations (x)				
PER	31.4	26.5	16.5	16.3
P/CEPS	14.1	19.0	13.0	12.6
P/BV	7.0	6.6	4.9	3.9
EV / Sales	3.9	3.8	2.9	2.5
EV / EBITDA	17.3	19.1	11.6	11.1
Dividend Yield (%)	0.7	0.7	0.6	1.0
Gearing Ratio (x)				
Net Debt/ Equity	0.2	0.4	0.1	0.0
Net Debt/EBITDA	0.5	1.1	0.5	-0.1
Working Cap Cycle (days)	77	106	99	99

Recommendation History: Dr Reddy's Lab – DRRD IN

Date	Reports	Reco	CMP	Target
13/05/2011	Dr Reddys Lab Q4FY11 Result Update	Accumulate	1,655	1,750
27/01/2011	Dr Reddy's Lab Q3FY11 Result Update	Accumulate	1,584	1,750
25/10/2010	Dr Reddy's Lab Q2FY11 Result Update	Accumulate	1,616	1,763
23/07/2010	Dr Reddy's Lab Q1FY11 Result Update	Accumulate	1,380	1,543

Recent Research Reports

Date	Reports	Reco	CMP	Target
24/06/2011	Jubilant Life Sciences Company Update	Accumulate	163	208
15/06/2011	Unichem Labs Management Meet Update	Hold	161	167
10/06/2011	Ajanta Pharma Management Meet Update	Not Rated	300	NA
01/06/2011	Torrent Pharma Q4FY11 Result Update	Buy	619	598

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