

Dr. Reddy's Laboratories

Performance Highlights

Y/E March (₹ cr)	2QFY2013	1QFY2013	% chg (qoq)	2QFY2012	% chg (yoy)
Net sales	2,881	2,541	13.4	2,268	27.0
Gross profit	1,531	1,761	(13.1)	1,221	25.4
Operating profit	553	370	49.5	353	56.8
Adj. net profit	494	336	47.0	308	76.8

Source: Company, Angel Research

Dr. Reddy's Laboratories (DRL) reported a just in line top-line and bottom-line performance for 2QFY2013. The company's net sales increased by 27.0% yoy, led by a 25.0% yoy and 33% yoy growth across the global generics and proprietary products businesses, respectively. **We recommend Accumulate on the stock.**

Results in line with expectations: DRL reported net sales of ₹2,881cr for 2QFY2013, registering a 27.0% yoy growth, which was in line with our estimate of ₹2,800cr. The US and ROW formulations were the key growth drivers for the company, registering a strong growth of 47.0% yoy and 50.0% yoy, respectively. The domestic market reported a strong growth of 12.0% yoy. On the positive side the PSAI segment posted a robust growth of 33.0% yoy during the quarter. The company's EBIT margin expanded by 365bp yoy to 19.2%, resulting in adjusted net profit growing by 76.8% yoy to ₹494cr during the quarter.

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 9.8% CAGR to ₹11,662cr and adjusted EPS to record a 2.3% CAGR to ₹92.9 over FY2012-14E. **We maintain our Accumulate rating on the stock with a target price of ₹1,859.**

Key financials (IFRS Consolidated)

Y/E March (₹ cr)	FY2011	FY2012	FY2013E	FY2014E
Net sales	7,469	9,674	10,696	11,662
% chg	6.3	29.5	10.6	9.0
Net profit	1,104	1,426	1,420	1,576
% chg	933.6	29.2	(0.4)	11.0
Adj net profit	1,076	1,507	1,420	1,576
% chg	16.8	40.0	(5.8)	11.0
Adj. EPS (₹)	63.8	88.8	83.7	92.9
EBITDA margin (%)	21.0	24.1	20.7	21.0
P/E (x)	27.0	19.4	20.6	18.5
RoE (%)	24.2	29.1	22.4	20.8
RoCE (%)	17.7	20.9	15.0	15.1
P/BV (x)	6.3	5.1	4.2	3.6
EV/Sales (x)	4.1	3.4	3.1	2.7
EV/EBITDA (x)	19.7	14.3	15.1	13.1

Source: Company, Angel Research

ACCUMULATE

CMP	₹1,723
Target Price	₹1,859

Investment Period	12 months
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Stock Info

Sector	Pharmaceutical
Market Cap (₹ cr)	29,260
Net Debt (₹ cr)	3,047
Beta	0.2
52 Week High / Low	1,818/1,501
Avg. Daily Volume	23,131
Face Value (₹)	5
BSE Sensex	18,431
Nifty	5,598
Reuters Code	REDY.BO
Bloomberg Code	DRRD@IN

Shareholding Pattern (%)

Promoters	25.6
MF / Banks / Indian FIs	23.1
FII / NRIs / OCBs	42.9
Indian Public / Others	8.4

Abs. (%)	3m	1yr	3yr
Sensex	7.5	3.5	15.9
Dr Reddy	6.0	3.1	70.7

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Exhibit 1: 2QFY2013 performance (IFRS, consolidated)

Y/E March (₹ cr)	2QFY2013	1QFY2013	% chg (qoq)	2QFY2012	% chg (yoy)	1HFY2013	1HFY2012	% chg
Net sales	2,881	2,541	13.4	2,268	27.0	5,422	4,246	27.7
Other income	40	24	67	12	-	62	40	-
Total income	2,921	2,564	13.9	2,280	28.1	5,483	4,286	27.9
Gross profit	1,531	1,761	(13.1)	1,221	25.4	2,885	2,276	26.7
Gross margin (%)	53.1	52.6	1.1	53.8	(1.3)	53.2	53.6	(0.7)
SG&A expenses	801	1,234	(35.1)	722	11.0	1,629	1,397	16.6
R&D expenses	176	157	12.0	146	20.6	332	266	25.1
EBIT	553	370	49.5	353	56.8	923	613	50.6
EBIT (%)	19.2	14.6	-	15.6	-	17.0	14.4	-
Interest	(37)	21	-	5	-	(16)	9.6	-
PBT	630	373	69.0	360	75.0	1,001	644	-
Tax	139	37	276.2	82	69.3	221	144	53.9
Net Profit	491	336	46.2	278	76.6	780	500	55.9
Share of profit/ (loss) in associates	2.8	-	-	1.3	-	4.7	1.7	-
Reported net profit before excep.	494	336	47.0	279	76.8	784	502	56.3
Exceptional items	86	-	-	(29)	-	97	(69)	-
Reported PAT	407	336	21.3	308	32.4	687	571	20.5
Adj. Net Profit	494	336	47.0	279	76.8	784	502	56.3
EPS (₹)	29.1	19.8	-	16.5	-	46.2	29.6	-

Source: Company, Angel Research

Exhibit 2: Actual vs Estimates

(₹ cr)	Actual	Estimates	Variation (%)
Net sales	2,881	2,800	2.9
Other income	40	42	(6.5)
Operating profit	553	548	0.9
Interest	(37)	21	-
Tax	139	63	120.6
Net profit	494	507	(2.6)

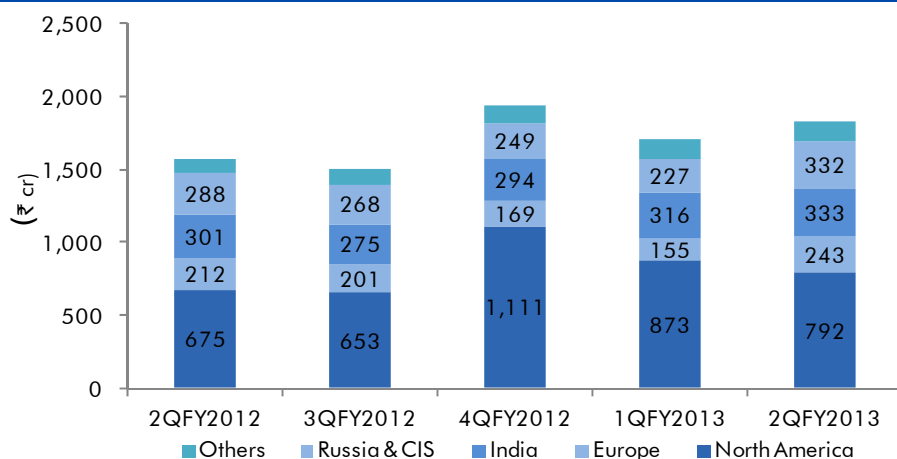
Source: Company, Angel Research

Just-in- line revenue growth: DRL reported net sales of ₹2,881cr for 2QFY2013, registering a 27.0% yoy growth, which was just- in-line with our estimate of ₹2,800cr. The global generics market registered a growth of 25.0% yoy, led by growth across the US and ROW markets.

In terms of market performance, the US market reported a strong growth of 47.0% yoy, with sales of ₹927.0cr. ROW also registered a robust growth of 50.0% yoy to end the quarter at ₹133.6cr. Russia registered a 14.0% yoy growth. The domestic market reported a single-digit growth of 12.0% yoy. Sales from Europe de-grew by 16.0% yoy during the quarter.

During the quarter, the company filed 4 abbreviated new drug applications (ANDAs). The company has 63 ANDAs pending for approval with the USFDA, of which 33 are Para IVs and 7 are first to file (FTFs). During the quarter, DRL launched 4 products in the domestic market.

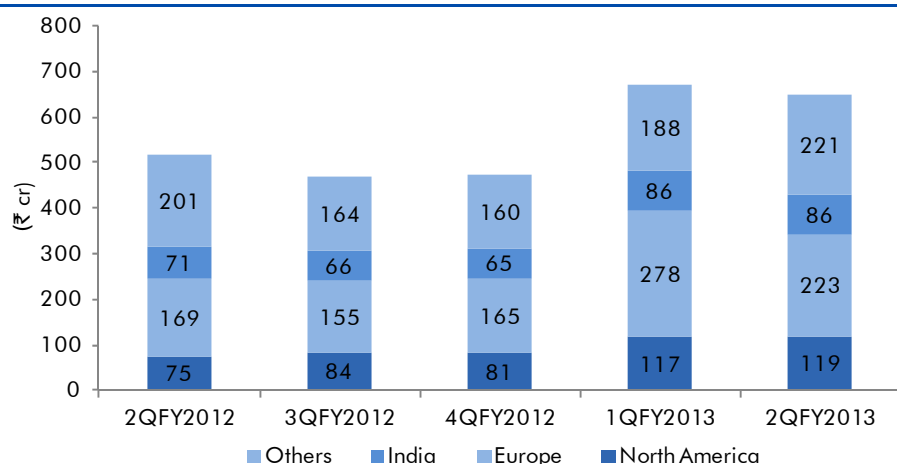
Exhibit 3: Global generic trend



Source: Company, Angel Research

The PSAI segment registered a 33.0% yoy growth, majorly led by 27.0% yoy growth and 26.0% yoy growth in the US and Europe, respectively. India and other regions grew by 53.0% yoy and 36.0% yoy, respectively.

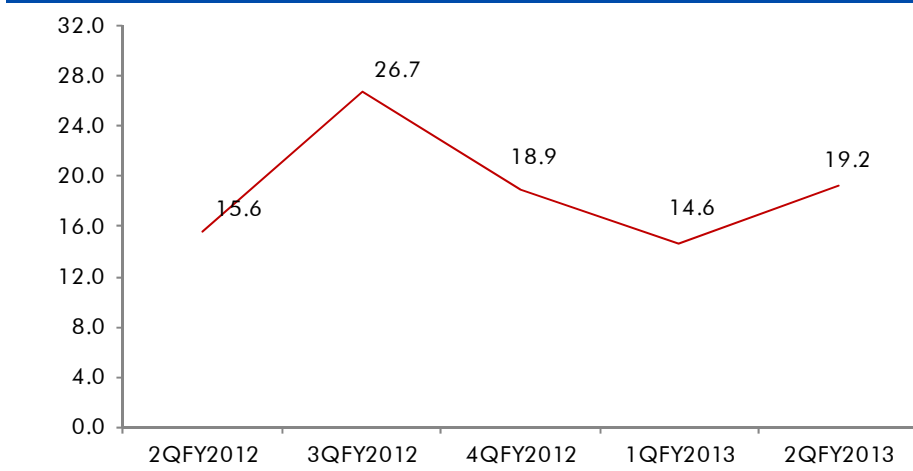
Exhibit 4: PSAI trend



Source: Company, Angel Research

EBIT margin expands on a yoy basis: DRL reported gross margin of 53.0% during the quarter. However, the company's EBIT margin came in at 19.2%. The key expenditure areas – R&D grew by 20.6% yoy, while S&GA grew by 11.0% yoy during the quarter.

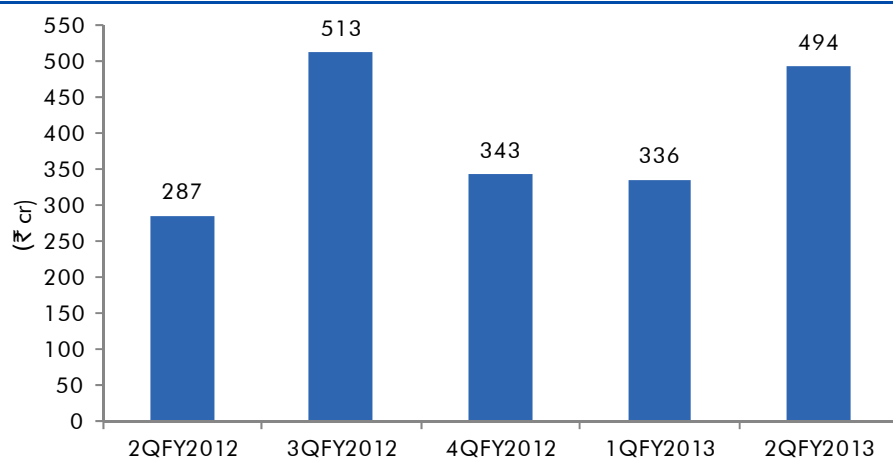
Exhibit 5: EBIT margin trend



Source: Company, Angel Research

Adjusted net profit grew by 76.8% yoy during the quarter: DRL reported an adjusted net profit of ₹494cr, registering an increase of 76.8% yoy, just-in –line with our estimate of ₹507cr.

Exhibit 6: Adjusted net profit trend



Source: Company, Angel Research

Concall takeaways

- The management reinforced its FY2013 revenue guidance of US\$2.7bn, with RoCE of 25%.
- The top-line growth in FY2014 is to be muted.
- Gross margins of 53% guided for FY2013, with the global generic gross margins coming in at 59-60%.
- Capex is guided to be around US\$150mn for FY2013, of which a major portion would go towards the SEZ facility for formulations and biologics.
- Tax as a % of PBT is guided towards 18-22%.

Investment arguments

Robust growth in the US ahead: After attaining a critical mass (US\$666mn in FY2012), DRL aims to scale up its business to the next orbit in the US market on the back of a strong product pipeline (80 ANDAs are pending approval, of which 41 are Para IVs and seven are FTFs). The management has guided for a robust growth in the US, driven by introduction of new products, some of which are also Para IV opportunities. Also, the company has developed its OTC product basket, which now contributes around US\$130mn (FY2012), contributing almost 25% to its overall sales. Overall, we expect the ex-exclusivity US sales to post a CAGR of ~18% during FY2012-14E.

Domestic back in focus: After a below-industry average growth on the domestic formulation front since the last three years, DRL reported a modest 11.0% growth in FY2012. The management expects the company's performance to rebound and targets to achieve 15% growth going ahead, driven by a) field force expansion and improvement in productivity, b) new product launches (including biosimilars) and c) focus on brand building.

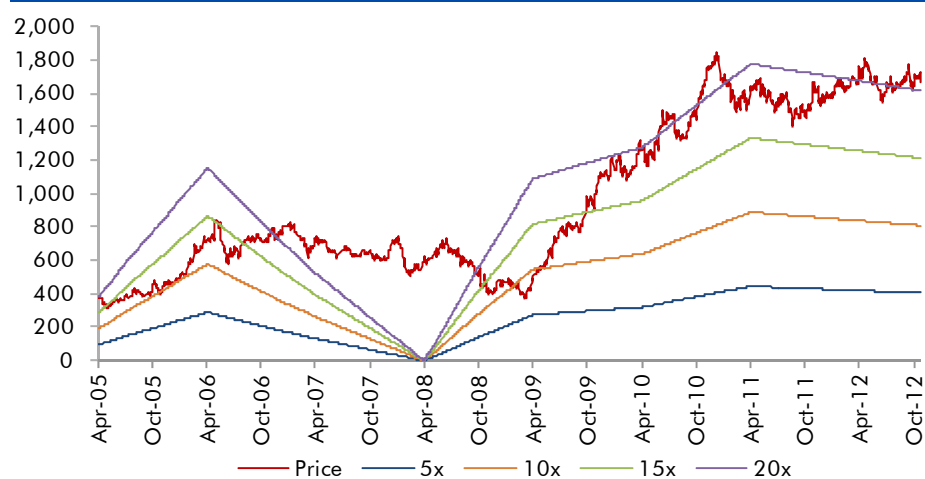
Strategic alliances to provide long-term growth: In order to tap the emerging market opportunities, DRL entered into an alliance with GSK in FY2011 to develop and market branded formulations across emerging markets. On the biogeneric front, the company has developed nine products (four products launched 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 maintained its revenue guidance of US\$2.7bn by FY2013E, with RoCE of 25%. The growth would be driven by the US business, an 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 9.8% CAGR to ₹11,662cr and adjusted EPS to record a 2.3% CAGR to ₹92.9 over FY2012-14E. **At the current market price, the stock is trading at 20.6x FY2013E and 18.5x FY2014E earnings. We maintain our Buy view on the stock with a target price of ₹1,859.**

Exhibit 7: Key assumptions

	FY2013E	FY2014E
PSAI segment growth (%)	1.8	2.0
Generics segment growth (%)	12.0	9.0
Operating margin (%)	20.7	21.0
Capex (₹ cr)	600	600

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 %	FY2014E			FY12-14E		FY2014E	
					PE (x)	EV/Sales (x)	EV/EBITDA (x)	CAGR in EPS (%)	RoCE (%)	RoE (%)	
Alembic Pharmaceuticals	Buy	67	91	35.2	7.4	0.8	5.0	14.8	29.4	30.0	
Aurobindo Pharma	Neutral	161	-	-	12.8	1.2	8.0	61.1	10.4	16.4	
Aventis*	Neutral	2,196	-	-	21.0	2.8	18.1	12.0	16.1	17.0	
Cadila Healthcare	Accumulate	859	953	10.9	18.6	2.5	12.7	20.5	20.2	26.8	
Cipla	Accumulate	355	399	12.5	17.8	3.1	13.7	18.4	16.8	16.6	
Dr Reddy's	Accumulate	1,723	1,859	7.9	18.5	2.7	13.1	2.3	15.1	20.8	
Dishman Pharma	Neutral	95	-	-	8.4	1.1	5.9	26.6	8.9	10.0	
GSK Pharma*	Neutral	1,998	-	-	24.3	4.7	15.1	8.7	38.9	29.0	
Indoco Remedies	Buy	63	92	46.0	7.1	0.9	5.8	32.8	15.5	17.0	
Ipca labs	Accumulate	450	485	7.7	12.1	1.8	8.5	30.6	26.1	26.0	
Lupin	Accumulate	566	647	14.2	18.2	2.5	12.7	26.5	22.5	24.7	
Orchid Chemicals	Neutral	104	-	-	4.7	0.8	5.5	27.8	11.5	7.9	
Ranbaxy*	Neutral	521	-	-	17.5	1.9	11.8	44.8	15.8	28.9	
Sun Pharma	Neutral	682	-	-	24.1	4.7	11.4	0.1	26.7	18.8	

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 key therapeutic focus is on gastro-intestinal, cardiovascular, diabetology, oncology, pain management, anti-infective and paediatrics. The key markets for DRL include India, USA, Russia and CIS, and Germany.

Profit & loss statement (IFRS Consolidated)

Y/E March (₹ cr)	FY2010	FY2011	FY2012	FY2013E	FY2014E
Net sales	7,028	7,469	9,674	10,696	11,662
Other operating income	56.9	75.0	76.5	76.5	76.5
Total operating income	7,085	7,544	9,750	10,773	11,739
% chg	2.4	6.5	29.2	10.5	9.0
Total expenditure	5,608	5,903	7,340	8,483	9,210
Cost of revenues	2,978	3,028	3,862	4,291	4,685
SG&A expenses	2,251	2,369	2,887	3,464	3,732
R&D expenses	379.3	506.0	591.1	727.4	793.0
EBITDA	1,420	1,566	2,334	2,214	2,452
% chg	(6.9)	10.3	49.0	(5.2)	10.8
(% of Net Sales)	20.2	21.0	24.1	20.7	21.0
Depreciation & amortisation	416.0	414.7	481.3	522.0	562.7
EBIT	1,004	1,151	1,853	1,692	1,889
% chg	(12.2)	14.6	60.9	(8.7)	11.7
(% of Net Sales)	14.3	15.4	19.2	15.8	16.2
Interest & other charges	37.2	28.3	(16.0)	-	-
Other Income	36.9	9.4	-	-	-
(% of PBT)	3.5	0.8	-	-	-
Share in profit of associates	4.8	0.3	5.4	5.4	5.4
Recurring PBT	1,066	1,208	1,951	1,773	1,971
% chg	6.3	13.3	61.5	(9.1)	11.2
Extraordinary expense/(Inc.)	860.3	(37)	104.0	-	-
PBT (reported)	205.3	1,244.2	1,846.6	1,773.4	1,971.2
Tax	98.5	140.3	420.4	353.6	393.1
(% of PBT)	48.0	11.3	22.8	19.9	19.9
PAT (reported)	106.8	1,104	1,426.2	1,419.8	1,578.0
Exceptional items	815	9	-	-	-
PAT after MI (reported)	106.8	1,104	1,426.2	1,419.8	1,576.0
ADJ. PAT	921.4	1,076	1,506.5	1,419.8	1,576.0
% chg	4.1	16.8	40.0	(5.8)	11.0
(% of Net Sales)	1.5	14.8	14.7	13.3	13.5
Basic EPS (₹)	54.6	63.8	88.8	83.7	92.9
Fully Diluted EPS (₹)	54.6	63.8	88.8	83.7	92.9
% chg	3.8	16.8	39.4	(5.8)	11.0

Balance sheet (IFRS Consolidated)

Y/E March (₹ cr)	FY2010	FY2011	FY2012	FY2013E	FY2014E
SOURCES OF FUNDS					
Equity share capital	84.4	84.4	84.8	84.8	84.8
Reserves & surplus	4,207	4,515	5,660	6,820	8,137
Shareholders' funds	4,292	4,599	5,744	6,907	8,225
Total loans	1,465.6	2,357.2	4,831.2	4,831.2	4,831.2
Deferred tax liability	143.8	143.8	83.3	83.3	83.3
Total liabilities	5,901	7,100	10,659	11,821	13,139
APPLICATION OF FUNDS					
Net fixed assets	1,759	2,478	3,325	4,125	4,925
Goodwill /other intangibles	1,422	1,549	1,353	1,353	1,353
Capital Work-in-Progress	486.7	486.7	520.8	520.8	520.8
Investments	31.0	31.0	1,077	1,077	1,077
Current Assets	4,206	4,832	6,995	7,620	8,770
Cash	658.4	572.9	737.9	730.1	2,037
Loans & Advances	421.7	448.2	580.4	641.8	699.7
Other	3,126	3,811	5,677	6,248	6,034
Current liabilities	2,004	2,276	2,613	2,876	3,510
Net Current Assets	2,202	2,556	4,382	4,744	5,261
Mis. Exp. not written off	-	-	-	-	-
Total Assets	5,901	7,100	10,659	11,821	13,139

Cash flow statement (IFRS Consolidated)

Y/E March (₹ cr)	FY2010	FY2011	FY2012	FY2013E	FY2014E
Profit before tax	1,065.6	1,207.7	1,950.6	1,773.4	1,971.2
Depreciation	416.0	414.7	481.3	522.0	562.7
(Inc)/Dec in Working Capital	(38.0)	(439.0)	(1,661.4)	(369.3)	790.2
Less: Other income	36.9	9.4	-	-	-
Direct taxes paid	98.5	140.3	420.4	353.6	393.1
Cash Flow from Operations	1,308.2	1,033.7	350.2	1,572.5	2,930.9
(Inc.)/Dec.in Fixed Assets	(157.7)	(718.3)	(881.2)	(800.0)	(800.0)
(Inc.)/Dec. in Investments	4.8	-	(1,046.3)	-	-
Other income	36.9	9.4	-	-	-
Cash Flow from Investing	(116.0)	(708.9)	(1,927.5)	(800.0)	(800.0)
Issue of Equity	0.2	-	0.4	-	-
Inc./(Dec.) in loans	(482.7)	891.6	2,474.0	-	-
Dividend Paid (Incl. Tax)	123.3	221.1	259.3	259.3	259.3
Others	(734.2)	(1,080.7)	(472.4)	(521.0)	(564.7)
Cash Flow from Financing	(1,093.4)	(410.3)	1,742.3	(780.3)	(824.0)
Inc./(Dec.) in Cash	98.8	(85.5)	165.0	(7.8)	1,306.9
Opening Cash balances	559.6	658.4	572.9	737.9	730.1
Closing Cash balances	658.4	572.9	737.9	730.1	2,037.1

Key ratios

Y/E March	FY2010	FY2011	FY2012	FY2013E	FY2014E
Valuation Ratio (x)					
P/E (on FDEPS)	31.6	27.0	19.4	20.6	18.5
P/CEPS	55.6	19.2	15.3	15.0	13.7
P/BV	6.8	6.3	5.1	4.2	3.6
Dividend yield (%)	0.3	0.6	0.8	0.8	0.8
EV/Sales	4.3	4.1	3.4	3.1	2.7
EV/EBITDA	21.0	19.7	14.3	15.1	13.1
EV / Total Assets	5.1	4.3	3.1	2.8	2.4
Per Share Data (₹)					
EPS (Basic)	54.6	63.8	88.8	83.7	92.9
EPS (fully diluted)	54.6	63.8	88.8	83.7	92.9
Cash EPS	31.0	90.0	112.5	114.5	126.1
DPS	5.0	11.0	14.0	14.0	14.0
Book Value	254.2	272.5	338.8	407.3	485.1
Dupont Analysis					
EBIT margin	14.3	15.4	19.2	15.8	16.2
Tax retention ratio	52.0	88.7	77.2	80.1	80.1
Asset turnover (x)	1.3	1.3	1.2	1.0	1.1
ROIC (Post-tax)	9.4	17.5	17.5	13.0	13.7
Cost of Debt (Post Tax)	1.1	1.3	-0.3	0.0	0.0
Leverage (x)	0.3	0.3	0.6	0.7	0.5
Operating ROE	11.6	22.2	27.4	21.5	20.1
Returns (%)					
ROCE (Pre-tax)	16.2	17.7	20.9	15.0	15.1
Angel ROIC (Pre-tax)	30.4	29.4	29.6	19.6	20.5
ROE	21.7	24.2	29.1	22.4	20.8
Turnover ratios (x)					
Asset Turnover (Gross Block)	4.1	3.6	3.4	2.9	2.6
Inventory / Sales (days)	69	71	66	74	75
Receivables (days)	68	72	80	81	82
Payables (days)	50	55	45	50	51
WC cycle (ex-cash) (days)	81	85	105	130	113
Solvency ratios (x)					
Net debt to equity	0.2	0.4	0.7	0.6	0.3
Net debt to EBITDA	0.6	1.1	1.8	1.9	1.1
Interest Coverage (EBIT / Int.)	27.0	40.7	(115.8)	-	-

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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%)