

Dr Reddy's Laboratories Ltd.

HOLD
CMP Rs1,527
TP Rs1,543

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Import alert to have minimal financial impact

US FDA has now issued an import alert on DRL's Mexican facility resulting in a ban of sales of API to US. With the issuance of import alert ban, DRL is estimated to lose revenue to the tune of USD30mn, which will impact FY12 and FY13 earnings by mere 1.4% and 1.1% respectively. The stock is trading at 23.0x FY12E and 18.8x FY13E recurring earnings. We maintain HOLD on the stock.

Import alert issued on Mexican facility: US FDA, in a surprising move, has now issued import alert on DRL's Mexican facility which comes within 25 days of issuance of warning letter. To recollect, the regulator had issued warning letter on June 3, 2011 which cited four deviations 1) Non-validation of analytical methods used to test APIs, 2) Incomplete validation for non-dedicated manufacturing equipment. 3) Out-of-specification investigations did not include analysis of all available data and 4) Quality unit did not exercise its responsibility to ensure the APIs manufactured were in compliance with CGMP.

Earnings impact minimal: DRL's Mexican facility provides custom pharmaceutical services (CPS) to innovator companies and contributes nearly USD50mn to the revenue (with US region estimated to contribute ~USD30mn) with 10-12% margins. With the issuance of import alert, DRL would now lose revenue to the tune of USD30mn which will impact FY12 and FY13 earnings by mere 1.4% and 1.1% respectively. DRL does not have major DMF filings from the facility as the same was used for CPS.

Outlook and Valuation: As a result, we have revised our estimates downwards and value DRL on a SOTP basis with a target price of Rs1,543 (Rs1,567), valuing the base business now at Rs1,477 (Rs1,501) (20x Sept'12 recurring earnings) and Rs66/share (Rs66/share) for P-IV/ limited competition opportunities. The stock is trading at 23.0x FY12E and 18.8x FY13E recurring earnings. We maintain 'HOLD' on the stock.

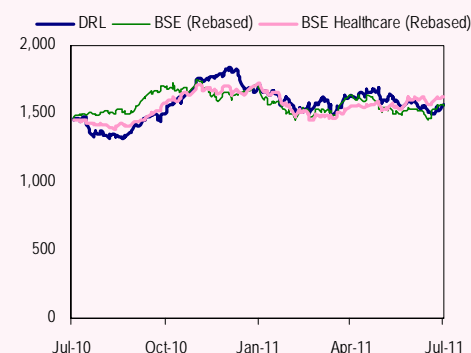
STOCK DATA

Market cap	Rs258bn
Book Value per share	Rs504
Shares O/S (F.V. Rs2)	169mn
Free Float	74.4%
Avg. Trade Value (6 months)	Rs494mn
52 week High/Low	Rs1,855/1,076
Bloomberg Code	DRRD IN
Reuters Code	REDY.BO

PERFORMANCE (%)

	1M	3M	12M
Absolute	(2.9)	(6.8)	5.1
Relative	(4.8)	(2.4)	(1.9)

RELATIVE PERFORMANCE



KEY FINANCIALS (Rs mn)

	FY09	FY10	FY11E	FY12E	FY13E
Recurring Sales	60,979	67,046	71,182	81,172	92,764
YoY Gr.(%)	34.2	9.9	6.2	14.0	14.3
EBIT	5,197	8,296	9,945	12,597	15,577
Recurring EBIT(%)	8.5	12.4	14.0	15.5	16.8
Recurring Net Profit	1,242	9,728	8,985	11,221	13,708
YoY Gr.(%)	(54.3)	683.1	(7.6)	24.9	22.2

KEY RATIOS

Reported EPS (Rs)	-	6.3	67.0	94.9	103.1
ROCE (%)	(3.4)	2.4	15.4	19.6	18.0
RoE (%)	13.4	27.3	23.5	26.3	22.7
PER (x)	-	241.7	22.8	16.1	14.8
EV/ Net Sales (x)	4.3	3.8	3.7	3.2	2.7
EV/EBDITA (x)	50.3	30.9	26.2	20.5	16.1

Year Ended March (Figures in Rs mn based in IFRS)

Income Statement	FY09	FY10	FY11E	FY12E	FY13E
Recurring Net Sales	60,979	67,046	71,182	81,172	92,764
<i>Growth (%)</i>	34.2	9.9	6.2	14.0	14.3
Unique Opportunities	8,461	3,230	4,719	10,771	10,629
Reported Net Sales	69,440	70,276	75,900	91,944	103,393
<i>Growth (%)</i>	38.9	1.2	8.0	21.1	12.5
Recurring EBIT	5,197	8,296	9,945	12,597	15,577
<i>Growth (%)</i>	30.2	59.6	19.9	26.7	23.7
Other Income	1,186	3	-	32	40
Equity loss of affiliates	24	48	-	-	-
Reported EBIT	(4,065)	2,052	12,854	18,637	20,239
Tax Provision	(1,173)	(985)	(1,542)	(2,609)	(2,833)
Reported Net Profit*	(5,238)	1,067	11,312	16,027	17,406
E/o income/(loss)	11,218	10,513	-	-	-
Recurring Net Profit	1,242	9,728	8,985	11,221	13,708
<i>Growth (%)</i>	(54.3)	683.1	(7.6)	24.9	22.2
Reported EPS (Rs) *	-	6.3	67.0	94.9	103.1
<i>EPS Growth (%)</i>	-	-	-	41.7	8.6

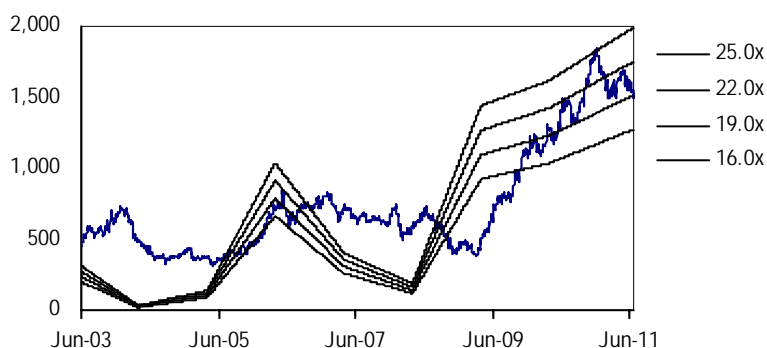
* including unique opportunities

Cash Flow Statement	FY09	FY10	FY11E	FY12E	FY13E
Net Income	(5,238)	1,067	11,312	16,027	17,406
Depreciation	3,814	-	-	-	-
Total Tax Paid	(1,619)	-	-	-	-
Chg in working capital	(8,459)	4,890	(1,930)	(5,055)	(3,607)
Other operating activities	12,082	(601)	(5,104)	-	-
Cash flow from oper (a)	580	5,356	4,278	10,973	13,798
Capital Expenditure	(4,680)	6,629	(7,900)	(7,900)	(4,900)
Chg in investments	4,294	(3,070)	-	-	-
Other investing activities	(3,461)	-	-	-	-
Cash flow from inv.(b)	(3,847)	3,559	(7,900)	(7,900)	(4,900)
Free cash flow (a+b)	(3,267)	8,915	(3,622)	3,073	8,898
Equity raised/(repaid)	5	228	-	-	-
Debt raised/(repaid)	(662)	(4,747)	-	-	-
Change in Minority Int	-	-	-	-	-
Dividend (incl. Tax)	(738)	(874)	(874)	(971)	(1,165)
Other financing activities	(114)	-	-	-	-
Cash flow from fin. (c)	(1,509)	(5,393)	(874)	(971)	(1,165)
Net chg in cash (a+b+c)	(4,776)	3,522	(4,496)	2,102	7,734

Balance Sheet	FY09	FY10	FY11E	FY12E	FY13E
Equity Share Capital	842	844	844	844	844
Reserves & surplus	41,203	42,071	52,509	67,566	83,807
Shareholders' funds	42,045	42,915	53,353	68,410	84,651
Minorities interests	-	-	-	-	-
Total Debt	10,524	5,673	5,673	5,673	5,673
Capital Employed	52,569	48,588	59,026	74,083	90,324
Net fixed assets	43,061	36,432	44,332	52,232	57,132
Cash & Cash Eq.	5,596	6,584	2,088	4,190	11,924
Net Other current assets	8,320	7,982	15,016	20,071	23,678
Investments	262	310	310	310	310
Net Deferred tax Assets	(4,670)	(2,720)	(2,720)	(2,720)	(2,720)
Total Assets	52,569	48,588	59,026	74,083	90,324

Key Ratios	FY09	FY10	FY11E	FY12E	FY13E
Recurring EBIT (%)	8.5	12.4	14.0	15.5	16.8
Net Margin (%)	2.0	14.5	12.6	13.8	14.8
Div. Yield (%)	0.3	0.3	0.3	0.3	0.4
Net debt/Equity (x)	0.1	(0.1)	(0.0)	(0.0)	(0.1)
Net Working Capital (days)	43	40	71	79	83
ROCE (%)	(3.4)	2.4	15.4	19.6	18.0
RoE (%)	13.4	27.3	23.5	26.3	22.7
EV/Net Sales (x)	4.3	3.8	3.7	3.2	2.7
EV/EBITDA (x)	50.3	30.9	26.2	20.5	16.1
PER (x)	-	241.7	22.8	16.1	14.8
PCE (x)	93.7	23.0	24.6	23.0	18.8
Price/Book (x)	6.1	6.0	4.8	3.8	3.0

P/E Band



Key Assumption	FY10	FY11E	FY12E	FY13E
Recurring business (% chng YoY)	9.9	6.2	14.0	14.3
One time opportunities (Rs m)	3,230	4,719	10,771	10,629
Gross Margins on base business (%)	50.7	52.6	53.6	53.7
EBIT (Ex-Onetime) (%)	12.4	14.0	15.5	16.8
Recurring EPS (Rs)	57.6	53.2	66.5	81.2
Recurring EPS growth (%)	680.8	(7.6)	24.9	22.2

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