

Dr Reddy's Laboratories Ltd

Adjusted for one-off expenses, results in line

Dr Reddy's Laboratories (DRRD) reported below-expected profits for Q3FY11. However, the results were in line after adjusting for non-recurring expenditure of US\$ 9mn. While growth momentum in the US market is encouraging, numbers from the German business were disappointing. We see further traction in the US business driven by new drug launches. The growth in India and Russia is also expected to improve, going ahead. We thus reiterate a BUY on the stock.

Revenues up 10%: DRRD reported a 10% growth in its Q3FY11 revenues, mainly led by a strong 66% growth in the US market. Growth from the Indian/CIS and Russian markets came in at 14%/ 8% for the quarter. However, the German market disappointed with an 18% decline. The PSAI segment too remained under pressure with a 5% decline.

One-off expenses impact reported numbers: DRRD reported a non-recurring expenditure of US\$ 9mn in Q3FY11, which was related to (a) non-recurring promotional expenses for the Russian OTC business, (b) non-cash charge related to loan refinancing in Betapharm, and (c) higher litigation costs (mainly for D-24). This impacted reported numbers. Adjusting for this, PAT was in line with estimates (Rs 3bn).

Concall highlights: (a) D-24: The case is posted for hearing on 31 Jan '11 and the final decision is expected before Q4FY11-end. (b) Fonda: USFDA has visited the facility of DRRD's partner. The timeline on the approval is unclear. (c) *Omeprazole* OTC: DRRD has seen an improvement in market share. (d) US base business: The company has reported a higher market share for *fexofenadine* (base), *Omeprazole* (prescription) and *Ciprofloxacin*. (e) Betapharm: While revenues from the German market disappointed, the situation was not so bad at the absolute profit level, thanks to DRRD's earlier cost-cutting initiatives. (f) India: This quarter's 14% growth is expected to move up to 18–20% in the coming quarters. (g) Russia: Secondary prescription sales are >20% compared to the market growth of 8%. Growth is expected to pick up from hereon. (g) The company has a hedged position of US\$ 540mn spread over the next 15–18 months at a rate of 47–48 Rs/USD.

Reiterate BUY: The stock is trading at a PER of 21.8x/17.1x FY12E/13E base business earnings. Our Dec '11 target price of Rs 2,030 is based on (a) a base business valuation of Rs 1,930 (22x Dec '12 earnings) and (b) a NPV of Rs 100 for limited competition/niche product opportunities in the US. We roll forward our target price from Sep '11 to Dec '11 (from Rs 1,920 to Rs 2,030) which now offers a 28% upside from current levels. Reiterate BUY.

Financial highlights

(Rs mn)	FY10	FY11E	FY12E	FY13E
Revenue	70,277	73,825	89,512	110,886
Growth (%)	1.2	5.0	21.2	23.9
Adj net income	11,190	11,263	17,713	25,625
Growth (%)	11	1	57	45
FDEPS (Rs)	66.3	66.6	104.7	151.5
Growth (%)	11.4	0.5	57.3	44.7

Profitability and return ratios

(%)	FY10	FY11E	FY12E	FY13E
EBITDA margin	18.6	18.2	24.4	28.6
EBIT margin	16.5	16.1	22.6	26.8
Adj PAT margin	14.1	13.3	18.9	22.5
ROE	23.3	20.5	27.6	30.5
ROIC	17.9	18.0	26.6	34.0
ROCE	17.1	16.6	24.3	28.1

What's New? Target Rating Estimates

CMP	TARGET	RATING	RISK
Rs 1,579	Rs 2,030	BUY	HIGH

BSE	NSE	BLOOMBERG
500124	DRREDDY	DRRD IN

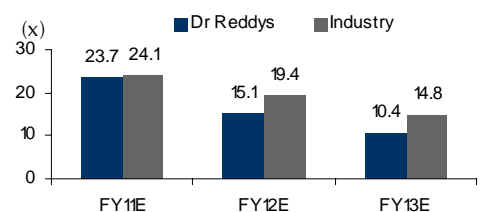
Company data

Market cap (Rs mn / US\$ mn)	267,052 / 5,846
Outstanding equity shares (mn)	169
Free float (%)	74.3
Dividend yield (%)	0.4
52-week high/low (Rs)	1855 / 1066
2-month average daily volume	395,929

Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
Dr Reddys	1,579	(6.2)	(3.6)	15.6
BSE HC	6,451	(2.0)	(1.5)	14.6
Sensex	18,969	(5.5)	(6.6)	4.6

P/E comparison



Valuation matrix

(x)	FY10	FY11E	FY12E	FY13E
P/E @ CMP	23.8	23.7	15.1	10.4
P/E @ Target	30.6	30.5	19.4	13.4
EV/EBITDA @ CMP	21.2	20.6	12.7	8.8





Result highlights

Fig 1 - Actual vs estimated performance

(Rs mn)	Actual	Estimate	% Variance
Revenue	18,985	19,042	(0.3)
EBITDA	3,444	3,678	(6.4)
Adj net income	3,090	2,990	3.4
FDEPS (Rs)	18.3	17.7	3.4

Source: RCML Research

Fig 2 - Quarterly performance

(Rs mn)	Q3FY11	Q3FY10	% Chg YoY	Q2FY11	% Chg QoQ
Revenue	18,985	17,298	10	18,704	2
Expenditure	15,541	14,436	8	15,380	1
Operating profit	3,444	2,862	20	3,324	4
Other income	199	262	(24)	274	(27)
Interest	94	97	(3)	42	124
Depreciation	307	374	(18)	317	(3)
PBT	3,242	2,653	22	3,239	0
Tax	152	(777)	(120)	327	(54)
PAT	3,090	3,432	(10)	2,915	6
EBITDA margin (%)	18.1	16.5	160bps	17.8	37bps
FDEPS (Rs)	18.4	20.4	(10)	17.3	6

Source: Company, RCML Research

Adjusted for one-off expenses, Profits came in line with estimates

Topline grew 10% YoY mainly led by strong growth in the US market



Consolidated financials

Profit and Loss statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Revenues	70,277	73,825	89,512	110,886
Growth (%)	1.2	5.0	21.2	23.9
EBITDA	13,064	13,443	21,856	31,663
Growth (%)	0.9	2.9	62.6	44.9
Depreciation & amortisation	1,479	1,536	1,656	1,917
EBIT	11,585	11,906	20,200	29,746
Growth (%)	1.2	2.8	69.7	47.3
Interest	354	178	176	183
Other income	984	1,159	1,200	1,300
EBT	12,215	12,887	21,224	30,863
Income taxes	1,073	1,638	3,523	5,251
Effective tax rate (%)	8.8	12.7	16.6	17.0
Extraordinary items	10,009	274	-	-
Min into / inc from associates	48	14	12	12
Reported net income	1,181	10,989	17,713	25,625
Adjustments	10,009	274	-	-
Adjusted net income	11,190	11,263	17,713	25,625
Growth (%)	11.4	0.6	57.3	44.7
Shares outstanding (mn)	168.2	168.2	168.2	168.2
FDEPS (Rs) (adj)	66.3	66.6	104.7	151.5
Growth (%)	11.4	0.5	57.3	44.7
DPS (Rs)	5.0	5.0	5.0	5.0

Cash flow statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Net income + Depreciation	1,348	11,109	18,571	26,890
Non-cash adjustments	9,518	1,878	798	651
Changes in working capital	(3,008)	(3,413)	(5,680)	(5,379)
Cash flow from operations	7,858	9,574	13,689	22,163
Capital expenditure	(3,056)	(5,543)	(5,544)	(6,044)
Change in investments	-	-	-	-
Other investing cash flow	-	-	-	-
Cash flow from investing	(3,056)	(5,543)	(5,544)	(6,044)
Issue of equity	-	-	-	-
Issue/repay debt	(3,500)	(3,933)	(3,482)	-
Dividends paid	(988)	(989)	(989)	(989)
Other financing cash flow	676	-	-	-
Change in cash & cash eq	991	(891)	3,674	15,129
Closing cash & cash eq	6,584	5,692	9,366	24,495

Economic Value Added (EVA) analysis

Y/E March	FY10	FY11E	FY12E	FY13E
WACC (%)	8.9	8.9	8.9	8.9
ROIC (%)	17.9	18.0	26.6	34.0
Invested capital (Rs mn)	51,363	58,321	67,888	77,394
EVA (Rs mn)	4,626	5,343	12,023	19,449
EVA spread (%)	9.0	9.2	17.7	25.1

Balance sheet

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Cash and cash eq	6,584	5,692	9,366	24,495
Accounts receivable	11,960	12,925	16,566	20,522
Inventories	13,371	14,473	16,384	20,144
Other current assets	6,156	6,771	7,448	8,193
Investments	262	262	262	262
Gross fixed assets	29,504	35,004	40,504	46,504
Net fixed assets	18,137	22,101	25,945	30,028
CWIP	4,322	4,365	4,409	4,453
Intangible assets	13,973	13,511	13,511	13,511
Deferred tax assets, net	(3,411)	(3,411)	(3,411)	(3,411)
Other assets	204	204	204	204
Total assets	71,557	76,893	90,684	118,401
Accounts payable	6,642	6,779	7,674	9,435
Other current liabilities	9,168	8,301	7,956	9,276
Provisions	-	-	-	-
Debt funds	12,482	8,549	5,067	5,067
Other liabilities	350	350	350	350
Equity capital	841	841	841	841
Reserves & surplus	42,074	52,073	68,797	93,432
Shareholder's funds	42,915	52,914	69,638	94,273
Total liabilities	71,557	76,892	90,684	118,401
BVPS (Rs)	255.2	314.6	414.1	560.6

Financial ratios

Y/E March	FY10	FY11E	FY12E	FY13E
Profitability & Return ratios (%)				
EBITDA margin	18.6	18.2	24.4	28.6
EBIT margin	16.5	16.1	22.6	26.8
Net profit margin	14.1	13.3	18.9	22.5
ROE	23.3	20.5	27.6	30.5
ROCE	17.1	16.6	24.3	28.1
Working Capital & Liquidity ratios				
Receivables (days)	69	62	60	61
Inventory (days)	148	150	147	141
Payables (days)	70	72	69	66
Current ratio (x)	2.4	2.6	3.2	3.9
Quick ratio (x)	0.8	0.9	1.1	1.1
Turnover & Leverage ratios (x)				
Gross asset turnover	2.5	2.3	2.4	2.5
Total asset turnover	0.9	1.0	1.1	1.1
Interest coverage ratio	32.7	45.3	118.7	234.8
Adjusted debt/equity	0.3	0.2	0.1	0.1
Valuation ratios (x)				
EV/Sales	3.9	3.8	3.1	2.5
EV/EBITDA	21.2	20.6	12.7	8.8
P/E	23.8	23.7	15.1	10.4
P/BV	6.2	5.0	3.8	2.8



Quarterly trend

Particulars	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11
Revenue (Rs mn)	17,298	16,421	16,832	18,704	18,985
YoY growth (%)	(6)	(17)	(7)	2	10
QoQ growth (%)	(6)	(5)	3	11	2
EBITDA (Rs mn)	2,862	2,551	2,728	3,324	3,444
EBITDA margin (%)	17	16	16	18	20
Adj net income (Rs mn)	3,432	2,253	2,322	2,915	3090
YoY growth (%)	4	(48)	(24)	20	(10)
QoQ growth (%)	41	(34)	3	26	6

DuPont analysis

(%)	FY09	FY10	FY11E	FY12E	FY13E
Tax burden (Net income/PBT)	90.9	83.4	83.1	83.1	83.0
Interest burden (PBT/EBIT)	96.6	102.2	99.5	100.8	101.1
EBIT margin (EBIT/Revenues)	16.5	16.5	16.1	22.6	26.8
Asset turnover (Revenues/Avg TA)	87.4	93.3	99.5	106.8	106.1
Leverage (Avg TA/Avg equity)	178.3	177.4	154.9	136.7	127.6
Return on equity	22.6	23.3	20.5	27.6	30.5

Company profile

DRRD is the third-largest company in the Indian pharma sector in terms of market capitalisation. It was the first Indian player to invest in innovative research and it is the only Indian company to take its NCE candidate (*Balaglitazone*, anti-diabetic) to phase-III clinical trials. Further, DRRD is involved in challenging patents (Para-IV, FTF) in the US generics market.

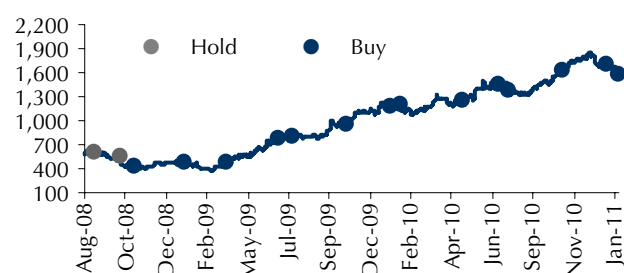
Shareholding pattern

(%)	Jun-10	Sep-10	Dec-10
Promoters	25.7	25.7	25.7
FIs	46.0	44.6	48.3
Banks & FIs	16.2	15.7	13.1
Public	12.1	14.0	13.0

Recommendation history

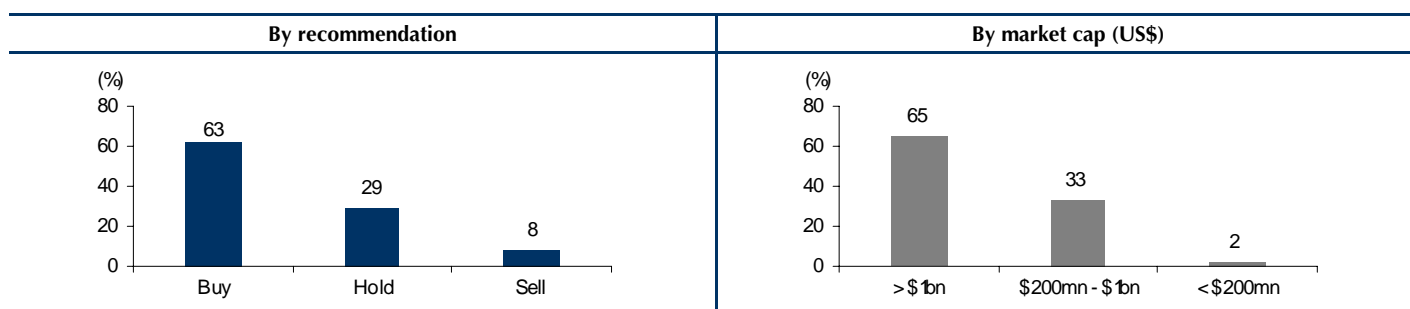
Date	Event	Reco price	Tgt price	Reco
21-Aug-08	RHH Compendium	585	668	Hold
6-Oct-08	Quarterly Preview	550	607	Hold
27-Oct-08	Results Review	425	607	Buy
20-Jan-09	Results Review	470	607	Buy
6-Apr-09	Quarterly Preview	480	590	Buy
2-Jul-09	Quarterly Preview	778	758	Buy
21-Jul-09	Results Review	789	842	Buy
24-Oct-09	Results Review	960	1,147	Buy
6-Jan-10	Quarterly Preview	1,170	1,356	Buy
20-Jan-10	Results Review	1,201	1,356	Buy
6-May-10	Company Update	1,243	1,525	Buy
5-Jul-10	Company Update	1,451	1,690	Buy
22-Jul-10	Results Review	1,381	1,690	Buy
24-Oct-10	Results Review	1,610	1,870	Buy
4-Jan-11	Strategy	1,684	1,920	Buy
25-Jan-11	Results Review	1,579	2,030	Buy

Stock performance





Coverage Profile



Recommendation interpretation

Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and -5%
Sell	Less than -5%

Recommendation structure changed with effect from March 1, 2009

Expected absolute returns are based on share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

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