

Dr. Reddy's Laboratories Ltd.

BLOOMBERG: DRRD IN EQUITY | BSE: 500124 | NSE: DRREDDY

Cementing its foothold in Russia

DRRD, in line with its strategy to expand presence in the fast-growing Russian market, has acquired the prescription business of JB Chemicals & Pharmaceuticals (JBC) for ~US\$ 35mn. According to our estimates, the valuations could be in the range of 2.5x–3x sales and would add ~6–7% to DRRD's total sales in Russia and ~1% to its total base business sales. We believe these valuations are reasonable for deals in emerging markets. Moreover, the deal is unlikely to strain DRRD's balance sheet, which would remain healthy even after this acquisition. **Maintain BUY.**

❖ **The deal:** DRRD has acquired the prescription portfolio of JBC in Russia & other CIS (RCIS) markets for ~US\$ 35mn. The deal comprises a total of 20 products with *Metrogyl* (a ~US\$ 10mn brand) and *Jocet* being the key brands. The products find application across therapeutic areas, including the hospital segment (~5% of DRRD's sales in Russia), thereby strengthening the company's position in this space. DRRD will also get access to several hospital products which are in the pipeline, of which a few are expected to be first-time generic launches. While *Jocet* gives DRRD access to Russia's cold-and-cough market, we note that this segment is dominated by another brand, *Doktor Mom*, which JBC sold to Johnson & Johnson recently.

❖ **Russian market remains attractive:** The Russian pharma market (currently valued at ~US\$ 18bn) has grown at a healthy 15%+ CAGR over the past 4–5 years. While the market faces headwinds in the form of high working capital requirements and long-term pricing pressures, we note that it still remains attractive in terms of volume growth and offers reasonable margins. DRRD's vertical integration also supports its presence in this market.

❖ **Reiterate BUY:** We remain positive on DRRD in view of the exciting product launches lined up in the US over the next 1–2 years and strong traction being seen in its Russia business. The stock is currently trading at a PER of 23.2x/17.4x FY12E/13E base business earnings, which we believe is attractive given the company's anticipated growth trajectory. **Maintain BUY.**

Financial highlights

Year End: 31 Mar	FY09A	FY10A	FY11E	FY12E	FY13E
Revenue (Rs mn)	69,440	70,277	74,695	89,024	99,048
EBITDA (Rs mn)	12,946	13,064	13,104	20,201	22,771
Adj. PAT (Rs mn)	10,024	11,142	11,183	16,137	18,513
Adj. EPS (Rs)	59.5	66.3	66.1	95.5	109.6
Growth (%)	163.7	11.4	(0.2)	44.4	14.7
DPS (Rs)	5.0	5.0	5.0	5.0	5.0
ROIC (%)	22.2	22.7	20.8	25.7	25.6
ROE (%)	23.8	26.2	23.6	27.4	24.9
P/E (x)	19.3	25.1	23.7	16.4	14.3
EV/EBITDA (x)	15.7	21.8	20.5	13.0	11.2
P/BV (x)	4.6	6.5	5.1	4.0	3.2

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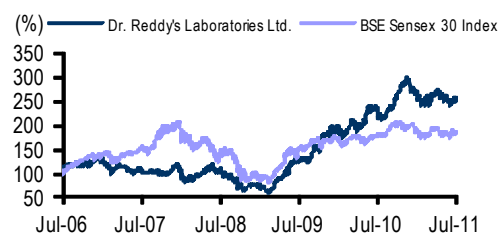
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CMP	Rs 1,570
Target	Rs 2,030
Previous	Rs 2,030
Rating	BUY
Previous	BUY
% Upside / (Downside)	29%
+ Dividend yield	0%
Total return	30%

Company data

Market cap (Rs mn / US\$ mn)	264,005 / 5,931
Outstanding equity shares (mn)	168.2
BVPS (Rs)	308
Free float (%)	74.3
52-week high / low (Rs)	1,842 / 1,314
2-month avg. daily vol (mn)/ value (US\$ mn)	0 / 15
ADR/GDR premium (%)	NA

Stock performance



Profit and Loss statement

Y/E 31 Mar (Rs mn)	FY09A	FY10A	FY11E	FY12E	FY13E
Total revenue	69,440	70,277	74,695	89,024	99,048
EBITDA	12,946	13,064	13,104	20,201	22,771
EBIT	11,442	11,585	11,918	18,806	21,146
Interest	(858)	(354)	(181)	(527)	(423)
Other income/(Expense)	466	984	761	1,086	1,300
Exceptional items	0	0	0	0	0
EBT	11,050	12,215	12,498	19,365	22,023
Income taxes	(1,026)	(1,073)	(1,315)	(3,229)	(3,510)
Extraordinary items	(15,539)	(10,009)	(145)	39	0
Min int./Inc. from associates	0	0	0	0	0
Reported net profit	(5,515)	1,133	11,038	16,176	18,513
Adjustments	15,539	10,009	145	(39)	0
Adjusted net profit	10,024	11,142	11,183	16,137	18,513

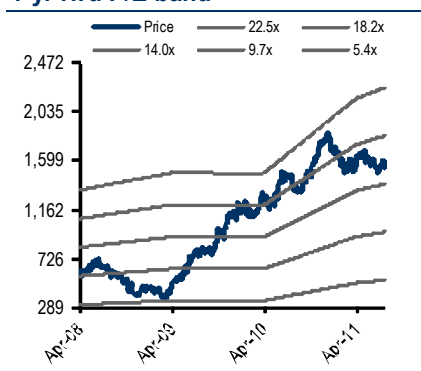
Balance sheet

Y/E 31 Mar (Rs mn)	FY09A	FY10A	FY11E	FY12E	FY13E
Accounts payable	5,987	6,642	6,886	7,513	8,603
Other current liabilities	14,758	9,168	8,397	7,835	8,652
Provisions	0	0	0	0	0
Debt funds	15,982	12,482	8,549	5,067	5,067
Other liabilities	350	350	350	350	350
Equity capital	841	841	841	841	841
Reserves & surplus	41,204	42,074	50,889	65,102	81,652
Shareholder's funds	42,045	42,915	51,729	65,942	82,493
Total liabilities	79,122	71,557	75,912	86,708	105,165
Cash and cash eq	5,593	6,584	4,035	5,266	14,379
Accounts receivable	14,592	11,960	13,077	16,476	18,331
Inventories	13,226	13,371	14,702	16,041	18,367
Other current assets	5,596	6,156	6,771	7,448	8,193
Investments	262	262	262	262	262
Net fixed assets	16,603	18,137	22,396	26,501	30,876
CWIP	4,279	4,322	4,365	4,409	4,453
Intangible assets	22,179	13,973	13,511	13,511	13,511
Deferred tax assets, net	(3,411)	(3,411)	(3,411)	(3,411)	(3,411)
Other assets	203	204	204	204	204
Total assets	79,122	71,557	75,912	86,708	105,165

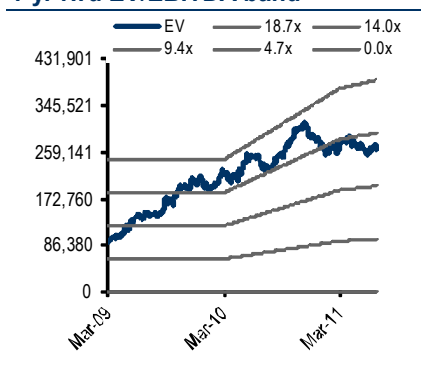
Cash flow statement

Y/E 31 Mar (Rs mn)	FY09A	FY10A	FY11E	FY12E	FY13E
Net income + Depreciation	(4,011)	2,612	12,224	17,571	20,139
Interest expenses	(858)	(354)	(181)	(527)	(423)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(5,318)	(3,008)	(3,590)	(5,350)	(3,019)
Other operating cash flow	16,789	7,978	66	(16)	(439)
Cash flow from operations	6,602	7,228	8,519	11,677	16,258
Capital expenditure	(13,092)	(3,056)	(5,543)	(5,544)	(6,044)
Change in investments	4,732	0	0	0	0
Other investing cash flow	466	984	761	1,086	1,300
Cash flow from investing	(7,894)	(2,072)	(4,782)	(4,458)	(4,744)
Issue of equity	0	0	0	0	0
Issue/repay debt	(1,745)	(3,500)	(3,933)	(3,482)	0
Interest expenses	(858)	(354)	(181)	(527)	(423)
Dividends paid	0	(988)	(2,226)	(1,979)	(1,979)
Other financing cash flow	2,090	676	0	0	0
Cash flow from financing	(513)	(4,166)	(6,340)	(5,988)	(2,401)
Change in cash & cash eq	(1,804)	991	(2,604)	1,232	9,112
Closing cash & cash eq	5,593	6,584	4,035	5,266	14,379

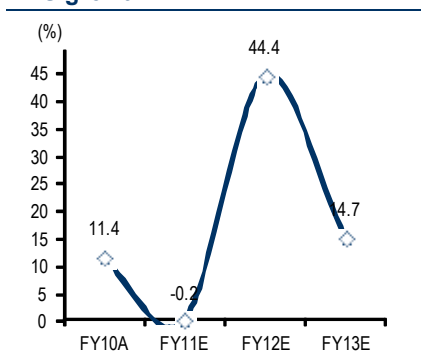
1-yr fwd P/E band



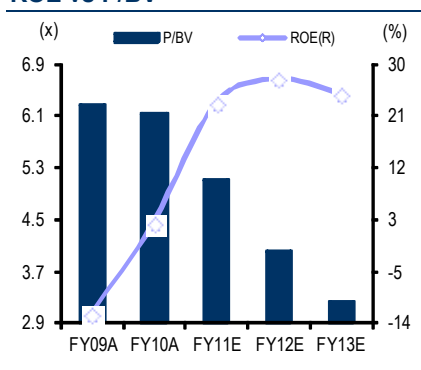
1-yr fwd EV/EBITDA band



EPS growth



ROE vs P/BV



Per share data

Y/E 31 Mar (Rs)	FY09A	FY10A	FY11E	FY12E	FY13E
Reported EPS	(32.5)	7.0	65.3	95.7	109.6
Adjusted EPS	59.5	66.3	66.1	95.5	109.6
DPS	5.0	5.0	5.0	5.0	5.0
BVPS	250.0	255.2	307.6	392.1	490.5

Valuation ratios

Y/E 31 Mar (x)	FY09A	FY10A	FY11E	FY12E	FY13E
EV/Sales	2.9	4.1	3.6	3.0	2.6
EV/EBITDA	15.7	21.8	20.5	13.0	11.2
P/E	19.3	25.1	23.7	16.4	14.3
P/BV	4.6	6.5	5.1	4.0	3.2

Financial ratios

Y/E 31 Mar	FY09A	FY10A	FY11E	FY12E	FY13E
Profitability & Return ratios (%)					
EBITDA margin	18.6	18.6	17.5	22.7	23.0
EBIT margin	16.5	16.5	16.0	21.1	21.3
Net profit margin	14.4	15.9	15.0	18.1	18.7
ROE	23.8	26.2	23.6	27.4	24.9
ROCE	17.9	18.6	18.4	23.9	22.4
Working Capital & Liquidity ratios					
Receivables (days)	77	69	61	61	64
Inventory (days)	147	148	149	149	146
Payables (days)	66	70	72	70	68
Current ratio (x)	1.5	2.1	2.5	2.9	3.4
Quick ratio (x)	1.0	1.4	1.5	1.9	2.4
Turnover & Leverage ratios (x)					
Gross asset turnover	2.6	2.5	2.3	2.4	2.3
Total asset turnover	0.9	0.9	1.0	1.1	1.0
Interest coverage ratio	13.3	32.7	65.8	35.7	50.0
Adjusted debt/equity	0.4	0.3	0.2	0.1	0.1

Quarterly trend

Particulars	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12
Revenue (Rs mn)	16,832	18,704	18,986	20,173	19,783
YoY growth (%)	(7.5)	1.8	9.8	22.8	17.5
QoQ growth (%)	2.5	11.1	1.5	6.3	(1.9)
EBITDA (Rs mn)	2,728	3,324	3,445	3,607	3,139
EBITDA margin (%)	16.2	17.8	18.1	17.9	15.9
Adj PAT (Rs mn)	2,283	2,915	3,090	2,898	2,223
YoY growth (%)	(25.6)	19.6	(10.0)	28.6	(2.6)
QoQ growth (%)	1.3	27.7	6.0	(6.2)	(23.3)

DuPont analysis

(%)	FY09A	FY10A	FY11E	FY12E	FY13E
Tax burden (Net income/PBT)	90.7	91.2	89.5	83.3	84.1
Interest burden (PBT/EBIT)	96.6	105.4	104.9	103.0	104.1
EBIT margin (EBIT/Revenue)	16.5	16.5	16.0	21.1	21.3
Asset turnover (Revenue/Avg TA)	87.8	93.3	101.3	109.5	103.2
Leverage (Avg TA/Avg equity)	188.2	177.4	155.8	138.2	129.3
Return on equity	23.8	26.2	23.6	27.4	24.9

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.

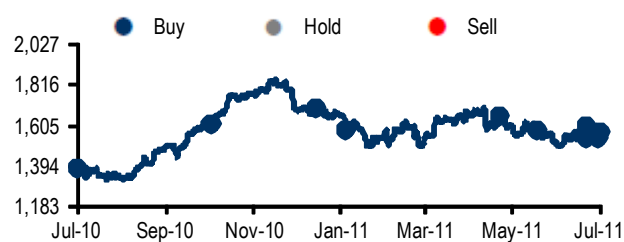
Shareholding pattern

(%)	Dec-2010	Mar-2011	Jun-2011
Promoters	25.7	25.7	25.6
FIs	27.2	25.9	24.8
Banks and FIs	13.1	14.0	14.7
Public	34.0	34.4	34.9

Recommendation history

Date	Event	Reco price	Tgt price	Reco
24-Oct-09	Results Review	960	1,147	Buy
6-Jan-10	Quarterly Preview	1,208	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	Sector Report	1,461	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	1,696	1,920	Buy
25-Jan-11	Results Review	1,579	2,030	Buy
13-May-11	Results Review	1,652	2,030	Buy
8-Jun-11	Company Update	1,577	2,030	Buy
12-Jul-11	Company Update	1,543	2,030	Buy
13-Jul-11	Alert	1,596	2,030	Buy
21-Jul-11	Results Review	1,540	2,030	Buy
22-Jul-11	Company Update	1,570	2,030	Buy

Stock performance



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Recommendation Interpretation	
Recommendation	Expected absolute returns (%) over 12 months
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