



# EARNINGS REVIEW

## Dr. Reddy's Laboratories (REDY.BO)

Buy

### Above Expectations; sustained operational improvement; CL Buy

#### What surprised us

Dr Reddy's 4Q results exceeded our above-consensus revenue estimates by 24% and EBITDA estimates by 10%. However, DRL reported a net loss of Rs5.2 bn for FY09, as it recorded Betapharm related non-cash write-offs on intangibles (Rs3.2 bn/US\$62 mn) and goodwill (Rs10.9 bn/US\$213 mn).

This is the **fourth consecutive quarter of 20% plus revenue growth** (even excluding Imitrex's impact in 3Q and 4Q) and **fifth consecutive quarter of EBITDA margin improvement**, which supports our investment thesis of an operational turnaround and improving margins. We reiterate our forecasts of 10% revenue growth for FY10 (*see our February 25, 2009 note on DRL*), which management guided to in its earnings call today.

#### What to do with the stock

We reiterate our Buy (Conviction List), as we believe that consensus revenue and EPS forecasts are significantly lower than DRL's guidance of 10% sales growth and improved underlying profitability for FY10. We hence **raise our FY10E EPS by 12% to Rs52.9 to reflect the stronger growth prospects and are now 40% (from 27% earlier) above Reuter's consensus EPS forecasts** and raise FY11E EPS by 6%.

DRL trades inexpensively at a **30% discount to peers on one-yr fwd PE** and 22% discount on one-yr fwd EV/EBITDA. Our 12-m DCF based TP of Rs805, yields a potential upside of 34%. Key downside risks include pricing pressure in Germany and strengthening rupee, which could affect exports.

#### Lupin 4QFY09 financial performance: Above expectations

Dr. Reddy's Laboratories	4QFY09	4QFY08	yoy	GS	Actual	FY09	FY08	yoy
In Rs mn	Mar-09	Mar-08		Est.	vs. GS	Mar-09	Mar-08	
Revenues	19,851	13,252	50%	15,974	24%	69,441	49,142	41%
EBIT	1,013	1,250	-19%	189	436%	8,023	4,587	75%
Pretax profits	1,109	1,256	-12%	198	461%	6,861	5,450	26%
Net income	(9,987)	1,028		131	NM	(5,168)	4,381	
EPS - Basic	(59.06)	6.12		0.78	NM	(30.78)	26.09	
Margins	4QFY09	4QFY08	yoy (bps)	GS Est.		FY09	FY08	yoy (bps)
EBIT margin	5.1%	9.4%	(430)	1.2%		11.6%	9.3%	220
PBT margin	5.6%	9.5%	(390)	1.2%		9.9%	11.1%	(120)
Net income margin	-50.3%	7.8%	(5,810)	0.8%		-7.4%	8.9%	(1,640)

Company data, Goldman Sachs Research estimates

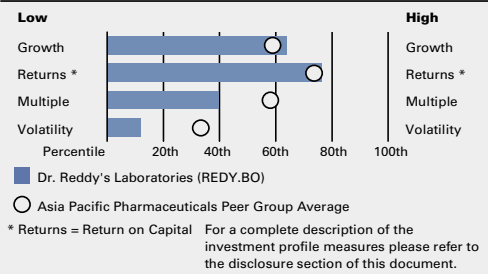
#### INVESTMENT LIST MEMBERSHIP

Asia Pacific Buy List  
 Asia Pacific Conviction Buy List  
**Coverage View: Neutral**

India:  
 Pharmaceuticals

**Vikram Sahu**  
 +91(22)6616-9050 | vikram.sahu@gs.com Goldman Sachs India SPL  
**Balaji V. Prasad**  
 +91(22)6616-9179 | balaji.prasad@gs.com Goldman Sachs India SPL  
**Rishi Jhunjunwala**  
 +91(80)6637-8667 | rishi.jhunjunwala@gs.com Goldman Sachs India SPL

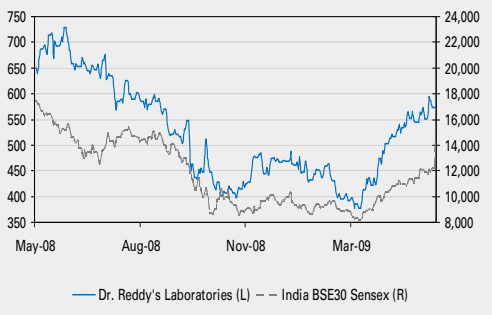
#### Investment Profile



Key data	Current
Price (Rs)	572.80
12 month price target (Rs)	805.00
Market cap (Rs mn / US\$ mn)	96,173.1 / 1,947.6
Foreign ownership (%)	3,044.0

	3/08	3/09E	3/10E	3/11E
EPS (Rs) New	26.09	(30.78)	52.87	64.74
EPS revision (%)	0.0	NM	11.7	5.8
EPS growth (%)	(56.9)	(218.0)	271.8	22.4
EPS (dil) (Rs) New	26.09	(30.78)	52.87	64.74
P/E (X)	22.0	NM	10.8	8.8
P/B (X)	2.1	2.5	2.0	1.7
EV/EBITDA (X)	13.9	4.7	6.9	5.7
Dividend yield (%)	0.8	0.8	0.9	1.0
ROE (%)	10.3	(12.3)	20.6	20.9

#### Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	44.2	43.0	(11.9)
Rel. to India BSE30 Sensex	(9.0)	(10.5)	7.5

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 5/18/2009 close.

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# Dr. Reddy's Laboratories: Summary financials

Profit model (Rs mn)	3/08	3/09E	3/10E	3/11E	Balance sheet (Rs mn)	3/08	3/09E	3/10E	3/11E
<b>Total revenue</b>	<b>49,141.7</b>	<b>69,441.0</b>	<b>76,501.3</b>	<b>86,090.5</b>	Cash & equivalents	7,452.9	6,195.3	11,662.5	17,608.0
Cost of goods sold	(22,752.6)	(37,611.0)	(39,350.3)	(43,852.3)	Accounts receivable	6,521.7	9,215.6	10,152.6	11,425.2
SG&A	(19,330.1)	(19,517.0)	(21,501.4)	(24,196.5)	Inventory	11,018.8	18,214.5	19,056.8	21,237.0
R&D	(3,447.1)	(4,037.0)	(4,447.5)	(5,004.9)	Other current assets	5,349.0	5,349.0	5,349.0	5,349.0
Other operating profit/(expense)	975.2	(253.0)	382.5	430.5	<b>Total current assets</b>	<b>30,342.4</b>	<b>38,974.4</b>	<b>46,220.9</b>	<b>55,619.3</b>
<b>EBITDA</b>	<b>8,605.7</b>	<b>23,549.0</b>	<b>15,027.3</b>	<b>17,341.3</b>	Net PP&E	15,163.2	20,371.2	22,666.3	25,249.0
Depreciation & amortization	(4,018.6)	(15,526.0)	(3,442.6)	(3,874.1)	Net intangibles	26,640.0	11,114.0	11,114.0	11,114.0
<b>EBIT</b>	<b>4,587.0</b>	<b>8,023.0</b>	<b>11,584.7</b>	<b>13,467.3</b>	Total investments	5,006.4	5,030.4	5,030.4	5,030.4
Interest income	755.0	482.0	619.5	1,166.2	Other long-term assets	0.0	0.0	0.0	0.0
Interest expense	(958.3)	(1,668.0)	(1,377.9)	(1,377.9)	<b>Total assets</b>	<b>77,152.0</b>	<b>75,490.1</b>	<b>85,031.7</b>	<b>97,012.7</b>
Income/(loss) from uncons. subs.	(16.7)	24.0	0.0	0.0	Accounts payable	10,274.6	14,518.8	15,995.0	17,999.9
Others	0.0	0.0	0.0	0.0	Short-term debt	688.7	688.7	688.7	688.7
<b>Pretax profits</b>	<b>5,449.6</b>	<b>6,861.0</b>	<b>10,826.4</b>	<b>13,255.7</b>	Other current liabilities	795.6	796.0	796.0	796.0
Income tax	(1,076.9)	(1,173.0)	(1,948.7)	(2,386.0)	<b>Total current liabilities</b>	<b>11,758.9</b>	<b>16,003.5</b>	<b>17,479.7</b>	<b>19,484.6</b>
Minorities	8.7	0.0	0.0	0.0	Long-term debt	18,995.2	18,995.2	18,995.2	18,995.2
<b>Net income pre-preferred dividends</b>	<b>4,381.3</b>	<b>5,688.0</b>	<b>8,877.6</b>	<b>10,869.6</b>	Other long-term liabilities	1,429.0	1,429.0	1,429.0	1,429.0
Preferred dividends	0.0	0.0	0.0	0.0	Total long-term liabilities	20,424.2	20,424.2	20,424.2	20,424.2
<b>Net income (pre-exceptionals)</b>	<b>4,381.3</b>	<b>5,688.0</b>	<b>8,877.6</b>	<b>10,869.6</b>	<b>Total liabilities</b>	<b>32,183.2</b>	<b>36,427.7</b>	<b>37,903.9</b>	<b>39,908.8</b>
Post-tax exceptionals	0.0	(10,856.0)	0.0	0.0	<b>Preferred shares</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>Net income</b>	<b>4,381.3</b>	<b>(5,168.0)</b>	<b>8,877.6</b>	<b>10,869.6</b>	<b>Total common equity</b>	<b>44,968.8</b>	<b>39,062.4</b>	<b>47,127.8</b>	<b>57,103.9</b>
EPS (basic, pre-exception) (Rs)	26.09	(30.78)	52.87	64.74	Minority interest	0.0	0.0	0.0	0.0
EPS (basic, post-exception) (Rs)	26.09	(30.78)	52.87	64.74	<b>Total liabilities &amp; equity</b>	<b>77,152.0</b>	<b>75,490.1</b>	<b>85,031.7</b>	<b>97,012.7</b>
EPS (diluted, post-exception) (Rs)	26.09	(30.78)	52.87	64.74	<b>BVPS (Rs)</b>	<b>267.83</b>	<b>232.65</b>	<b>280.69</b>	<b>340.11</b>
DPS (Rs)	4.40	4.84	5.32	5.85					
Dividend payout ratio (%)	16.9	(15.7)	10.1	9.0					
Free cash flow yield (%)	(0.4)	(1.6)	5.9	6.9					
<b>Growth &amp; margins (%)</b>	<b>3/08</b>	<b>3/09E</b>	<b>3/10E</b>	<b>3/11E</b>	<b>Ratios</b>	<b>3/08</b>	<b>3/09E</b>	<b>3/10E</b>	<b>3/11E</b>
Sales growth	(23.6)	41.3	10.2	12.5	ROE (%)	10.3	(12.3)	20.6	20.9
EBITDA growth	(48.9)	173.6	(36.2)	15.4	ROA (%)	5.7	(6.8)	11.1	11.9
EBIT growth	(64.9)	74.9	44.4	16.3	ROACE (%)	8.8	12.2	17.6	19.3
Net income growth	(54.6)	(218.0)	271.8	22.4	Inventory days	148.3	141.8	172.9	167.7
EPS growth	(57.2)	(218.0)	271.8	22.4	Receivables days	53.2	41.4	46.2	45.7
Gross margin	53.7	45.8	48.6	49.1	Payable days	161.0	120.3	141.5	141.5
EBITDA margin	17.5	33.9	19.6	20.1	Net debt/equity (%)	27.2	34.5	17.0	3.6
EBIT margin	9.3	11.6	15.1	15.6	Interest cover - EBIT (X)	22.6	6.8	15.3	63.6
<b>Cash flow statement (Rs mn)</b>	<b>3/08</b>	<b>3/09E</b>	<b>3/10E</b>	<b>3/11E</b>	<b>Valuation</b>	<b>3/08</b>	<b>3/09E</b>	<b>3/10E</b>	<b>3/11E</b>
Net income pre-preferred dividends	4,381.3	5,688.0	8,877.6	10,869.6	P/E (analyst) (X)	22.0	NM	10.8	8.8
D&A add-back	4,018.6	4,670.0	3,442.6	3,874.1	P/B (X)	2.1	2.5	2.0	1.7
Minorities interests add-back	0.0	0.0	0.0	0.0	EV/EBITDA (X)	13.9	4.7	6.9	5.7
Net (inc)/dec working capital	(2,269.6)	(5,645.4)	(303.1)	(1,447.9)	Dividend yield (%)	0.8	0.8	0.9	1.0
Other operating cash flow	323.2	0.0	0.0	0.0					
<b>Cash flow from operations</b>	<b>4,825.1</b>	<b>4,688.6</b>	<b>12,017.1</b>	<b>13,295.8</b>					
Capital expenditures	(5,085.8)	(5,208.1)	(5,737.6)	(6,456.8)					
Acquisitions	(16,204.2)	0.0	0.0	0.0					
Divestitures	12,537.1	0.0	0.0	0.0					
Others	0.0	0.0	0.0	0.0					
<b>Cash flow from investments</b>	<b>(8,752.9)</b>	<b>(5,208.1)</b>	<b>(5,737.6)</b>	<b>(6,456.8)</b>					
Dividends paid (common & pref)	(736.9)	(738.4)	(812.3)	(893.5)					
Inc/(dec) in debt	(6,074.3)	0.0	0.0	0.0					
Common stock issuance (repurchase)	15.2	0.0	0.0	0.0					
Other financing cash flows	0.0	0.0	0.0	0.0					
<b>Cash flow from financing</b>	<b>(6,796.0)</b>	<b>(738.4)</b>	<b>(812.3)</b>	<b>(893.5)</b>					
<b>Total cash flow</b>	<b>(10,723.9)</b>	<b>(1,258.0)</b>	<b>5,467.2</b>	<b>5,945.5</b>					

Note: Last actual year may include reported and estimated data.  
Source: Company data, Goldman Sachs Research estimates.

## Analyst Contributors

### Vikram Sahu

vikram.sahu@gs.com

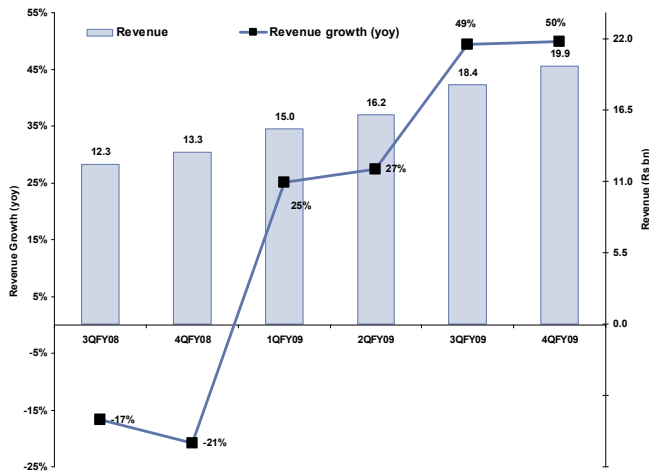
### Balaji V. Prasad

balaji.prasad@gs.com

### Rishi Jhunjunwala

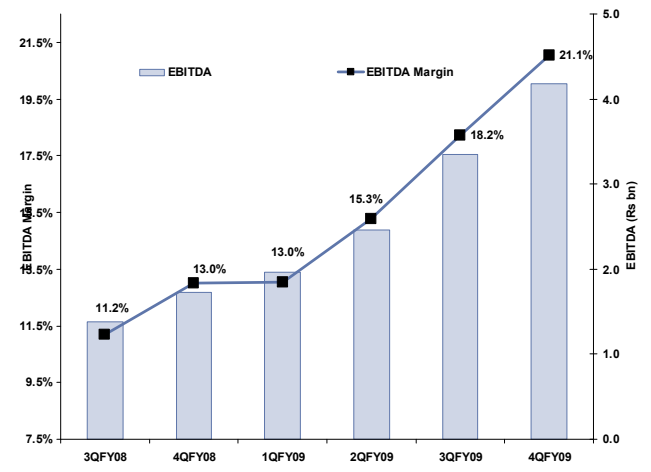
rishi.jhunjunwala@gs.com

**Exhibit 1: Fourth consecutive qtr. of 20% plus sales growth ...**



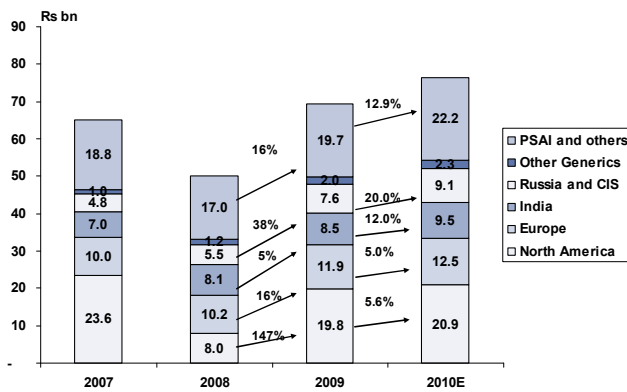
Source: Company data, Goldman Sachs research estimates

**Exhibit 2: .. and fifth consecutive quarter of EBITDA margin improvement**



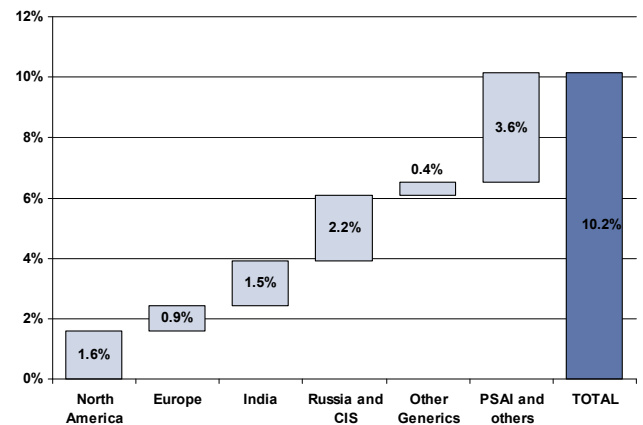
Source: Company data, Goldman Sachs research estimates

**Exhibit 3: Revenue forecasts by geography and business segments for FY10E**



Source: Company data, Goldman Sachs research estimates

**Exhibit 4: Components of 10.2% sales growth for FY10E**



Source: Company data, Goldman Sachs research estimates

## Reg AC

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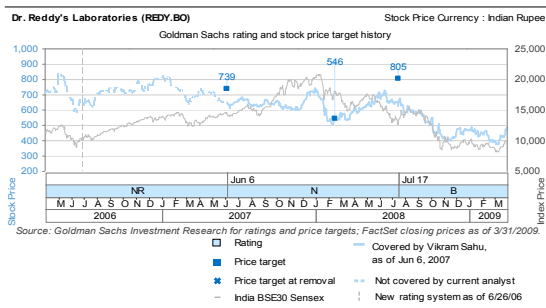
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Goldman Sachs Investment Research global coverage universe

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Global	25%	53%	22%	54%	51%	43%

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