

July 23, 2010

ACCUMULATE

Price Target Price
Rs 1,380 Rs 1,543

Sensex 18,113

Price Performance

(%)	1M	3M	6M	12M
Absolute	(2)	18	23	84
Rel. to Sensex	(4)	14	16	51

Source: Bloomberg

Stock Details

Sector	Pharmaceuticals
Reuters	REDY.BO
Bloomberg	DRRD@IN
Equity Capital (Rs mn)	844
Face Value (Rs)	5
No of shares o/s (mn)	169
52 Week H/L (Rs)	1,515/696
Market Cap (Rs bn/USD mn)	233/5,105
Daily Avg Vol (No of shares)	568788
Daily Avg Turnover (US\$ mn)	17.0

Shareholding Pattern (%)

	J'10	M'10	D'09
Promoters	25.7	25.8	25.8
FII/NRI	46.0	43.5	42.4
Institutions	16.2	18.0	18.5
Private Corp	3.4	3.8	4.2
Public	8.7	8.9	9.1

Source: Capitaline

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Disappointing result; downgrade to Accumulate

- Muted performance in US and decline in PSAI segment impacted operating performance
- Branded formulation markets such as India and CIS reported strong traction
- 13% growth in recurring APAT is driven by higher other income and lower tax provision
- Maintain our base business earnings for FY11E and FY12E; Downgrade to Accumulate with a price target of Rs1543

Revenue growth is impacted by US performance despite good show in CIS and Indian markets

Despite 36% and 16% growth in CIS and Indian markets, 5% (12% in CER) growth in recurring revenue was largely impacted because of a) Muted performance in the US (1% decline ex-imitrex), b) 8% decline in PSAI segment (flat at CER) and c) 8% decline in European markets on the back of 6% reduction in Betapharm sales. The higher growth in CIS market is mainly aided by re-stocking and volume expansion. Going forward, the growth in the CIS business is critical as 50% of its portfolio comes under reference prices. Though in order to de-risk this, company is focusing more on OTC products and also looking to launch the bio-similar portfolio in this market. In domestic market, DR Reddy has outpaced the industry growth by 200bps and grew by 22% (June MAT ORG IMS). Slower ramp-up in few of the limited competition products and INR appreciation has impacted the overall performance of the US market. However going forward, company expect its US business to ramp-up on the back of a) Gradual improvement in the revenue of Omeprazole-OTC and generic Prograf (currently there is only one more generic company, 2nd generic competition for 5mg strength is expected in next few days), b) Recovery in the lost market share of generic Allegra over the next few quarters and c) 3-4 new limited competition launches (less than 3 players) in 2HFY11E.

Revenue break-up

Revenue Mix by Segment	Q1FY10	Q110 (Ex. Imitrex)	Q2FY10	Q3FY10	Q4FY10	Q1FY11	YoY (%)	QoQ (%)
Global Generics	13,020	10,932	12,888	11,724	10,351	11,918	-8.5	15.1%
North America	6,026	3,938	4,285	2,974	3,500	3,897	-35.3	11.3%
Imitrex	2,088		507	300	-	-		
NA (wo Imitrex)	3,938	3,938	3,778	2,674	3,500	3,897	-1.0	11.3%
Europe	2,109	2,109	2,849	2,579	2,106	1,937	-8.2	-8.0%
India	2,393	2,393	2,520	2,632	2,613	2,778	16.1	6.3%
Russia & Other CIS	1,871	1,871	2,347	2,769	2,132	2,552	36.4	19.7%
Others	621	621	887	770	-	754	21.4	
PSAI	4,870	4,870	5,375	5,238	4,921	4,499	-7.6	-8.6%
North America	995	995	1,150	722	805	837	-15.9	4.0%
Europe	1,371	1,371	1,761	2,152	1,369	1,555	13.4	13.6%
India	629	629	629	607	781	633	0.6	-19.0%
Others	1,875	1,875	1,835	1,757	1,966	1,474	-21.4	-25.0%
Proprietary products + Others	300	300	287	336	345	415	38.3	20.3%
Total	18,190	16,102	18,550	17,298	16,239	16,832	-7.5	3.7%
Base Business	16,102	16,102	18,043	16,998	16,239	16,832	4.5	3.7%

Financials

YE-Mar	Net Sales	EBITDA (Core)	EBITDA (%)	APAT	EPS (Rs)	EPS % chg	RoE (%)	P/E	EV/EBITDA	P/BV
FY09	68,830	14,749	21.4	7,571	45.0	126.9	18.9	33.3	18.1	7.2
FY10	70,312	15,761	22.4	8,434	50.1	11.4	23.1	29.9	16.5	6.7
FY11E	81,940	18,581	22.7	11,828	70.2	40.2	27.7	21.3	13.8	5.3
FY12E	98,974	23,865	24.1	16,237	96.4	37.3	29.6	15.5	10.3	4.1

Despite higher contribution of branded formulations, PSAI segment impacted operating performance

Despite higher contribution from high margin branded formulation business in India and Russia and incremental contribution of limited competition products such as Omeprazole OTC and generic Prograf, the OPM for the recurring business (ex-imitrex) contracted by 210bps mainly because of higher fixed overhead in PSAI business (gross margin in PSAI business has come down from 31% to 19% in Q1FY11) and 170bps increase in raw material cost. Going forward, we believe that reduction in SGA cost in Betapharm (cost has come down from 4-5mn euro/ month to 1.5mn euro/month) and higher uptake of products like Omeprazole OTC and generic Prograf coupled with strong momentum in India will improve the operating performance of the company.

13% growth in APAT (ex-one offs) is driven by higher other income and lower tax provision

APAT for the quarter declined by 21% to Rs2.28bn. Ex-imitrex, APAT grew by 13% mainly driven by higher other income (up by 113%) and lower interest cost (down by 84%). The company has already hedged 70% of its net forex exposure at an average rate of US\$45.5. Despite muted performance, management has re-iterated its guidance of US\$3bn revenue and 25% ROCE by FY13E.

Maintain earning estimates, downgrade to Accumulate

Though on the operational front, numbers have disappointed but given the fair visibility from the existing limited competition products and potential launch of 3-4 limited competition products in 2HFY11E and upside from GSK deal in emerging markets as well as strong tractions in branded generic markets such as India and Russia, we maintain our base business earning estimates of Rs60.8 and Rs73.3 for FY11E and FY12E respectively. Due to limited upside opportunity from the current level (11%), we downgrade our rating one notch to Accumulate. We maintain our price target of Rs1543 (20x FY12E and Rs77/ Para IV NPV). At CMP of Rs1380, the stock is trading at 17.8x FY12E (adjusted to NPV of Para IV).

Key Financials - Quarterly

Rs mn	Q1FY10	Q110 (Ex. Imitex)	Q2FY10	Q3FY10	Q4FY10	Q1FY11	YoY (%)	YOY (%) Base	QoQ (%)	YTD'10	YTD'09	YoY (%)
Revenue	18,189	16,091	18,368	17,296	16,424	16,831	(7.5)	4.6	2.5	16,831	18,189	(7.5)
Expenditure	13,873	13,139	15,619	14,436	13,870	14,104	1.7	7.3	1.7	14,104	13,873	1.7
<i>as % of sales</i>	76.3		85.0	83.5	84.4	83.8				84	76	
Consumption of RM	8,017	7,283	9,649	8,487	7,784	7,918	(1.2)	8.7	1.7	7,918	8,017	(1.2)
<i>as % of sales</i>	44.1	45.3	52.5	49.1	47.4	47.0				47	44	
Employee Cost	4,871	4,871	5,007	5,057	5,133	5,194	6.6	6.6	1.2	5,194	4,871	6.6
<i>as % of sales</i>	26.8	30.3	27.3	29.2	31.3	30.9				31	27	
Other expenditure	985	985	963	892	953	993	0.8	0.8	4.2	993	985	0.8
<i>as % of sales</i>	5.4	6.1	5.2	5.2	5.8	5.9				6	5	
EBIDTA	4,316	2,952	3,358	2,860	2,554	2,727	(36.8)	(7.6)	6.8			
Depreciation	507	507	329	374	269	288	(43.2)	(43.2)	7.1	288	507	(43.2)
EBIT	3,809	2,445	3,029	2,486	2,285	2,439	(36.0)	(0.2)	6.7	2,439	3,809	(36.0)
Other Income	134	134	125	220	238	285	113.0	113.0	19.9	285	134	113.0
Interest	307	307	36	53	-26	51	(83.4)	(83.4)	(296.2)	51	307	(83.4)
PBT	3,636	2,272	3,118	2,653	2,549	2,674	(26.5)	17.7	4.9	2,674	3,636	(26.5)
Total Tax	726	249	595	265	510	390	(46.3)	56.8	(23.5)	390	726	(46.3)
Adjusted PAT	2,910	2,023	2,523	2,388	2,039	2,284	(21.5)	12.9	12.0	2,284	2,910	(21.5)
(Profit)/loss from JV's/Ass/MI	0		0	0	20	-4.7				-5	0	
APAT after MI	2,910	2,023	2,523	2,388	2,019	2,288	(21.4)	13.1	13.3	2,288	2,910	(21.4)
Extra ordinary items (Net of Tax)	465	465	365	7605	-474	193		(58.6)	(140.6)	193	465	
Reported PAT	2,445	1,559	2,158	(5,217)	1,668	2,096	(14.3)	34.5	25.6	2,096	2,445	(14.3)
A EPS	16.8	11.5	14.2	14.1	11.8	13.5	(19.2)	13.1	14.8	14	17	(19.2)
Margins (%)							(bps)	(bps)	(bps)	0	0	(bps)
EBIDTA	23.7	18.3	18.3	16.5	15.6	16.2	(752)	(214)	65	16.2	23.7	(752)
EBIT	20.9	15.2	16.5	14.4	13.9	14.5	(645)	(70)	58	14.5	20.9	(645)
EBT	20.0	14.1	17.0	15.3	15.5	15.9	(410)	176	36	15.9	20.0	(410)
PAT	16.0	12.6	13.7	13.8	12.3	13.6	(240)	102	130	13.6	16.0	(240)
Effective Tax rate	20.0	10.9	19.1	10.0	20.0	14.6	(539)	364	-542	14.6	20.0	(539)

Financials

Income Statement

Y/E, Mar (Rs. mn)	FY09	FY10P	FY11E	FY12E
Net Sales	68,830	70,312	81,940	98,974
Growth (%)	38.1	2.2	16.5	20.8
Expenditure	54,081	54,551	63,359	75,110
Materials Consumed	23,223	23,113	26,785	32,033
Employee Cost	9,920	10,949	12,700	14,733
Other Exp	20,938	20,490	23,874	28,344
EBITDA	14,749	15,761	18,581	23,865
Growth (%)	71.4	6.9	17.9	28.4
EBITDA margin (%)	21.4	22.4	22.7	24.1
Depreciation	4,977	4,131	4,537	4,914
EBIT	9,772	11,629	14,044	18,951
EBIT margin (%)	14.2	16.5	17.1	19.1
Other Income	783	1,015	700	895
Interest expenses	972	312	494	284
PBT	9,584	12,332	14,251	19,563
Tax	2,608	2,668	2,423	3,326
Effective tax rate (%)	27.2	21.6	17.0	17.0
Adjusted PAT	7,571	8,434	11,828	16,237
Growth (%)	126.9	11.4	40.2	37.3
Net Margin (%)	11.2	12.3	14.7	16.7
(Profit)/loss from JVs/Ass/MI	-	-	-	-
Adjusted PAT After JVs/Ass/MI	7,571	8,434	11,828	16,237
E/O items (net of Tax)	16,147	4,920	-	-
Reported PAT	-9,172	3,514	11,828	16,237
Growth (%)			236.5	37.3

Cash Flow

Y/E, Mar (Rs. mn)	FY09	FY10P	FY11E	FY12E
PBT (Ex-Other income)	-7,347	5,168	13,551	18,667
Depreciation	4,977	4,131	4,537	4,914
Interest Provided	972	312	494	284
Other Non-Cash items			-	-
Chg in working cap	(4,681)	4,711	(4,201)	(3,037)
Tax paid	-2,608	-2,668	-2,423	-3,326
Operating Cashflow	-8,687	11,654	11,958	17,502
Capital expenditure	3,266	(1,709)	(5,929)	(5,413)
Free Cash Flow	-5,421	9,945	6,030	12,088
Other income	783	1,015	700	895
Investments	4,298	(3,058)	-	-
Investing Cashflow	5,081	-2,043	700	895
Equity Capital Raised	172	0	0	0
Loans Taken / (Repaid)	292	(5,136)	(5,000)	(5,500)
Interest Paid	(972)	(312)	(494)	(284)
Dividend paid (incl tax)	(1,232)	(1,379)	(1,576)	(1,970)
Income from investments				
Others	256	-98	0	0
Financing Cashflow	-1,483	-6,926	-7,070	-7,754
Net chg in cash	-1,824	977	-340	5,230
Opening cash position	7,447	5,623	6,600	6,260
Closing cash position	5,623	6,600	6,260	11,490

Balance Sheet

Y/E, Mar (Rs. mn)	FY09	FY10P	FY11E	FY12E
Equity share capital	842	842	842	842
Reserves & surplus	34,419	36,923	46,806	61,073
Net worth	35,261	37,765	47,648	61,915
Minority Interest	0	0	0	0
Secured Loans	14,043	12,043	7,543	3,043
Unsecured Loans	5,933	2,797	2,297	1,297
Loan Funds	19,976	14,840	9,840	4,340
Net deferred tax liability	539	70	127	173
Total Liabilities	55,775	52,674	57,614	66,427
Gross Block	65,027	69,566	75,159	80,266
Less: Depreciation	35,757	42,596	47,133	52,047
Net block	29,270	26,970	28,026	28,219
Capital work in progress	4,296	4,174	4,510	4,816
Investment	523	3,581	3,581	3,581
Current Assets	38,798	38,200	43,213	56,141
Inventories	13,250	13,393	15,622	18,831
Sundry debtors	14,406	11,599	13,633	16,502
Cash & bank balance	5,623	6,600	6,260	11,490
Loans & advances	5,519	6,608	7,699	9,319
Other current assets		-	-	-
Current lia & Prov	17,112	20,249	21,401	26,062
Current liabilities	15,118	16,746	18,908	22,873
Provisions	1,994	3,503	2,494	3,189
Net current assets	21,686	17,952	21,812	30,079
Misc. exp	-	-	-	-
Total Assets	55,775	52,676	57,928	66,695

Key Ratios

Y/E, Mar	FY09	FY10P	FY11E	FY12E
Profitability (%)				
EBITDA Margin	21.4	22.4	22.7	24.1
Net Margin	11.2	12.3	14.7	16.7
ROCE	18.8	24.2	26.6	31.5
ROE	18.9	23.1	27.7	29.6
ROIC	25.6	13.8	24.0	29.7
Per Share Data (Rs)				
EPS	45.0	50.1	70.2	96.4
CEPS	74.5	74.6	97.2	125.6
BVPS	209.4	224.3	282.9	367.7
DPS	6.3	7.0	8.0	10.0
Valuations (x)				
PER	33.3	29.9	21.3	15.5
P/CEPS	20.1	20.1	15.4	11.9
P/BV	7.2	6.7	5.3	4.1
EV / Sales	3.9	3.8	3.2	2.5
EV / EBITDA	18.1	16.5	13.8	10.3
Dividend Yield (%)	0.4	0.5	0.5	0.7
Gearing Ratio (x)				
Net Debt/ Equity	0.4	0.1	(0.0)	(0.2)
Net Debt/EBIDTA	0.9	0.3	(0.0)	(0.4)
Working Cap Cycle (days)	85.6	59.6	69.8	68.9

Recommendation History: Dr Reddy's Lab – DRRD IN

Date	Reports	Reco	CMP	Target
07.05.2010	Dr Reddy Q4FY10 Result Update	Buy	1,218	1,400
21.01.2010	Dr Reddy Q3FY10 Result Update	Buy	1,202	1,409
26.10.2009	Dr Reddy Q2FY10 Result Update	Buy	960	1,070
11.09.2009	Dr Reddys Laboratories Initiating Coverage	Buy	821	956

Recent Research Reports

Date	Reports	Reco	CMP	Target
21.07.2010	Panacea Biotec Q1FY11 Result Updat	Hold	194	209
09.07.2010	Jubilant Organosys Event Update	Buy	378	455
02.07.2010	Dr Reddy's Management Meet Update	Buy	1440	1543
01.07.2010	Divis Lab Management Meet Update	Buy	779	852

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