

Key data	
Sector	Pharma
Market Cap	Rs102.8bn/US\$2.6bn
52 Wk H/L (Rs)	840/580
Avg. daily vol. (6 month)	582,027

BSE Code	500124
NSE Code	DRREDDY
Bloomberg	DRRD IN
Reuters	REDY.BO

Sensex	19,243
Nifty	5,702

Shareholding pattern (%)		
	30-Jun-07	30-Sep-07
FII's NRI, ADR/GDR	43.7	43.6
MFs and institutions	16.0	17.1
Promoters	25.2	25.2
Others	15.1	14.2

Absolute returns (%)			
	1mth	3mth	12mth
Dr Reddy's	(4.3)	(8.2)	(14.0)
Sensex	13.7	22.0	51.5
BSE Pharma	5.3	2.6	7.8

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Dr Reddy's

Hold
Current Price: Rs615
Target price:737
Results were below our estimates / consensus
Figure 1: Actual Vs Religare Estimates

	Q2FY08A	Q2FY08E	Difference (%)	Consensus
Net sales	12,670	12,871	(1.6)	12,433
EBITDA	1,462	1,576	(7.2)	1,911
EBITDA margins (%)	11.5	12.2	(71bps)	15.4
Adj. PAT	1,170	1,277	(8.4)	1,492
Adj. PAT margins (%)	9.2	9.9	(69bps)	12.0

Source: Religare Institutional Equity Research, Bloomberg

Financial highlights

- Net sales** for Q2FY08 declined by 36.8%YoY on account of a 64%YoY decline in generics sales (higher base effect and lower Betapharm revenues). CPS business revenues also declined by 31%YoY.
- EBITDA** declined by 65.4%YoY. EBITDA margins contracted by 950bpsYoY to 11.5% and 620bps QoQ. This was driven by a 1510bps increase in SG&A costs and 440bps increase in R&D expenditure.
- Amortization** increased by a mere 2%YoY during the quarter.
- Adj. PAT** grew by 58%YoY. Adj. PAT margin contracted by 480bps to 9.2%YoY and 600bps QoQ. Adj PAT decline is lower than the EBITDA decline because of a lower tax outgo.

Valuations and Recommendation

We are downgrading Dr Reddy's FY08E and FY09E earnings by 2.4% and 17.4% respectively on account of a) Lower growth and margin pressure in Betapharm (Germany) and CPS (Mexico) business. b) Higher SG&A and R&D costs. The key trigger – revival of its earnings growth is about six months away. However, the stock is trading at a PER of 16x one year forward earnings, which is towards the lower end of its band. Hence, we are downgrading our recommendation from a Buy to a **Hold**.

Figure 2: Quarterly Performance

Y/e Mar Rs mn	FY07				FY08		(Rs mn)	
	1Q	2Q	3Q	4Q	1Q	2QA	FY07	FY08E
Net Sales	14,049	20,039	15,434	15,573	12,018	12,670	65,095	51,683
<i>Change %</i>	151.3	245.2	160.4	123.3	(14.5)	(36.8)	168.2	(20.6)
EBITDA	2,210	4,220	2,464	5,470	2,132	1,462	14,361	7,596
<i>EBITDA margin (%)</i>	15.7	21.1	16.0	35.1	17.7	11.5	22.1	14.7
<i>Change (%)</i>	392.6	435.8	417.9	-	(3.5)	(65.4)	761	(47)
Depreciation	388	402	330	451	351	410	1571	1597
Other Income	-279	-264	-269	234	227	368	-456	701
Interest exp/(inc)	-	-	-	-	-	-	-	-
PBT	1,543	3,554	1,865	5,253	2,008	1,420	12,334	6,699
<i>PBT margin (%)</i>	11.0	17.7	12.1	33.7	16.7	11.2	18.9	13.0
<i>PBT growth (%)</i>	280.8	310.0	102.0	-	30.1	(60.1)	677	(46)
Extraordinary exp/(Inc)	(63)	-	-	1,770	-	(1,500)	1,770	(1,500)
Tax	208	737	-27	260	181	252	1,177	902
<i>Effective tax rate (%)</i>	13.5	20.9	(1.4)	4.9	9.0	17.7	9.6	13.5
PAT reported	1,398	2,798	1,879	3,252	1,834	2,670	9,328	7,280
Adjusted PAT *	1,335	2,798	1,879	5,022	1,834	1,170	11,098	5,780
<i>Adj PAT margin (%)</i>	9.5	14.0	12.2	32.2	15.3	9.2	17.0	11.2
<i>Change (%)</i>	284.5	214.5	199.0	-	37.4	(58.2)	794	(48)
Equity Capital (Rs mn)	838	838	838	838	838	838	838	838
Adj EPS	8.0	16.7	11.2	29.9	10.9	7.0	66.2	34.5

* Excluding extraordinary

Other business highlights

- Betapharm revenues declined by 25%YoY on the back of supply constraints. The company has transferred 6 products for manufacturing in India and these will be launched in months to come.
- Dr Reddy's lead R&D molecule – Balaglitazone (anti-diabetic) has entered into Phase-III clinical trials. This development will not have a significant impact on earnings.

Figure 3: Earnings revision table

(Rs mn)	Earlier estimates			Revised estimates			Upgrade/(downgrade) (%)		
	FY07	FY08E	FY09E	FY07	FY08E	FY09E	FY07	FY08E	FY09E
Net Sales	65,095	52,755	61,926	65,095	51,683	58,493	-	(2.1)	(5.9)
EBITDA	14,361	7,771	11,454	14,361	7,596	9,756	-	(2.3)	(17.4)
EBITDA margin (%)	22.1	14.7	18.5	22.1	14.7	16.7			
PBT	12,334	6,860	9,913	12,334	6,699	8,444	-	(2.4)	(17.4)
Adj PAT	11,098	5,919	8,389	11,098	5,780	7,146	-	(2.4)	(17.4)
Adj PAT margin (%)	17	11	14	17.0	11.2	12.2			
Adj EPS (Rs)	66.2	35.3	50.0	66.2	34.5	42.6	-	(2.4)	(17.4)

Future outlook

- The turnaround of the German operations and recovery of the Mexican CPS business will be the key trigger for future performance.

Figure 4: Valuation summary – Pharmaceuticals

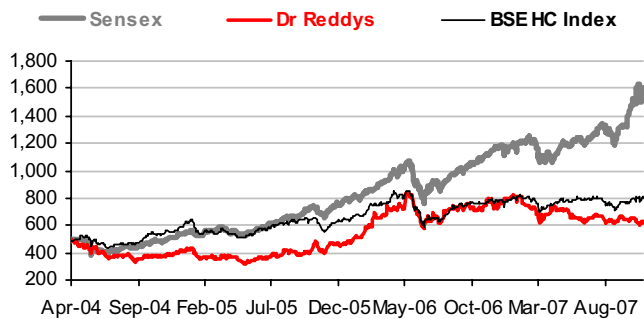
Company	Price (Rs)	Rating	Target Price (Rs)	Mkt Cap (Rs mn)	Sales		EBITDA		Adj PAT		Adj EPS		FY08E		FY09E	
					Q2FY08E (Rs mn)	YoY (%)	Q2FY08E (Rs mn)	YoY (%)	Q2FY08E (Rs mn)	YoY (%)	Q2FY08E (Rs)	YoY (%)	Adj EPS (Rs)	P/E (x)	Adj EPS (Rs)	P/E (x)
Aurobindo*	580	Reduce	678	31,169	6,012	25.3	966	39.8	599	9.6	11.2	9.5	40.1	14.5	42.9	13.5
Biocon	506	Reduce	512	50,600	2,820	13.3	840	27.3	540	20.0	5.4	20.0	22.2	22.8	27.6	18.4
Cipla	185	Reduce	198	143,799	10,984	22.6	2,240	(1.6)	1,906	5.7	2.5	5.7	7.6	24.5	9.0	20.6
Dr Reddy's	615	Accumulate	737	103,315	12,670	(36.8)	1,462	(65.4)	1,170	(58.2)	7.0	(58.2)	34.5	17.8	42.6	14.4
Glenmark	430	Buy	422	104,896	3,554	43.9	1,042	73.3	639	59.0	2.7	59.0	21.2	20.2	26.3	16.3
GSK Pharma	1064	Reduce	1,357	90,124	4,208	5.4	1,366	6.5	1,091	10.1	12.9	10.1	46.3	23.0	51.2	20.8
Sun Pharma	1016	Buy	1,265	202,359	6,528	24.8	2,309	35.2	2,140	14.8	11.1	14.8	45.9	22.1	55.5	18.3
Sector				726,262	46,776	(2.5)	10,225	(10.7)	8,085	(8.7)			20.2		16.9	

Source: Religare Institutional Equity Research, Bloomberg, Biocon, Cipla, Dr Reddy's, Sun and GSK Pharma numbers are actual.

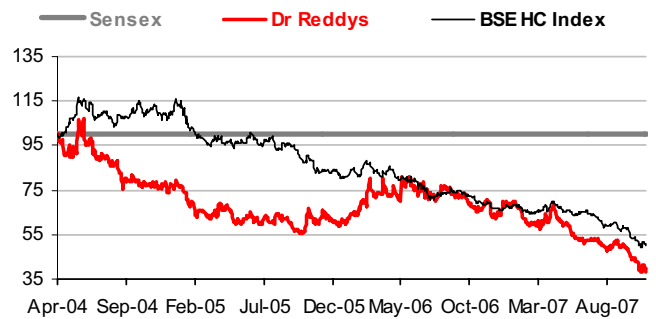
Stock performance

Dr Reddy's

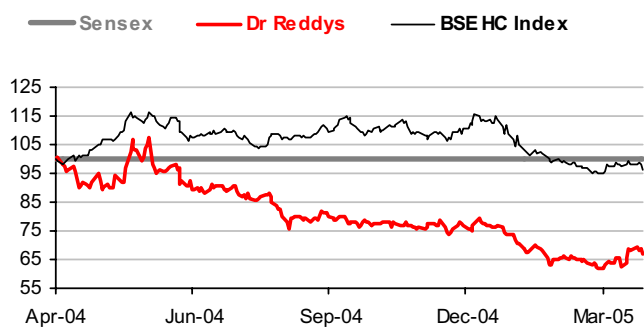
Absolute Perf. From Apr 04



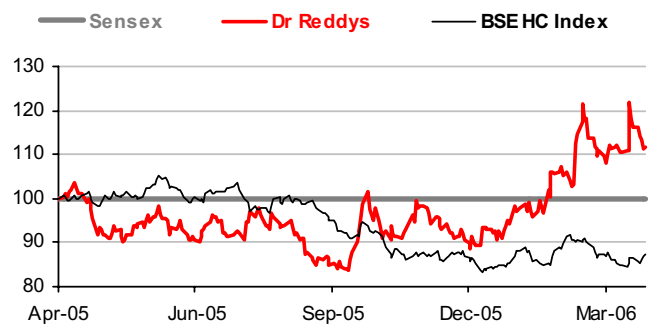
Relative Perf. From Apr 04



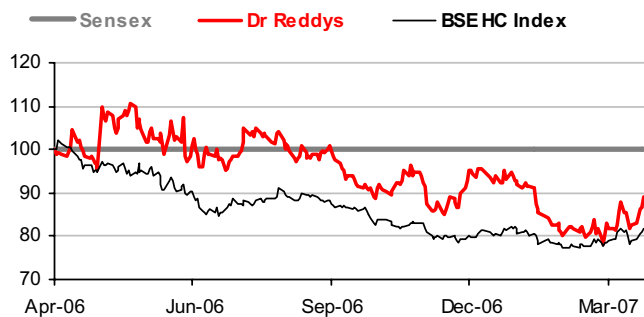
Relative Perf. From Apr 04 to Mar 05



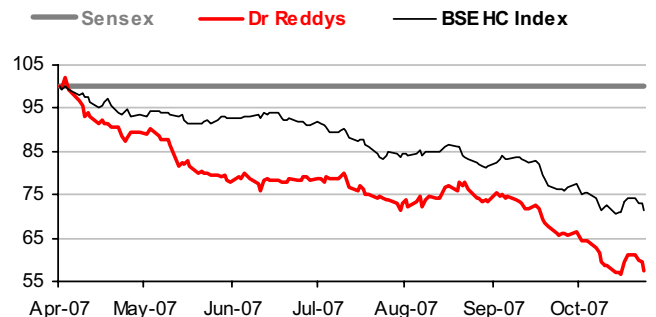
Relative Perf. From Apr 05 to Mar 06



Relative Perf. From Apr 06 to Mar 07



Relative Perf. From Apr 07

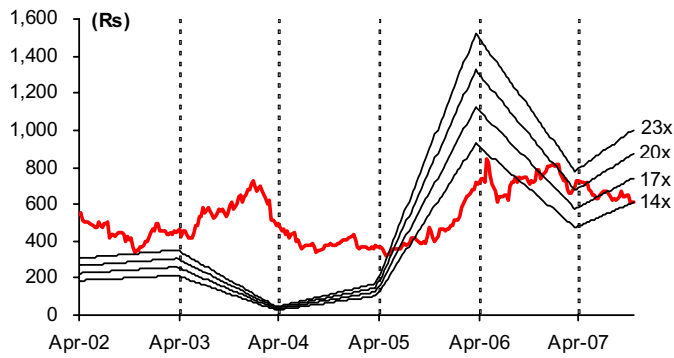


Source: Bloomberg, Religare Institutional Equity Research

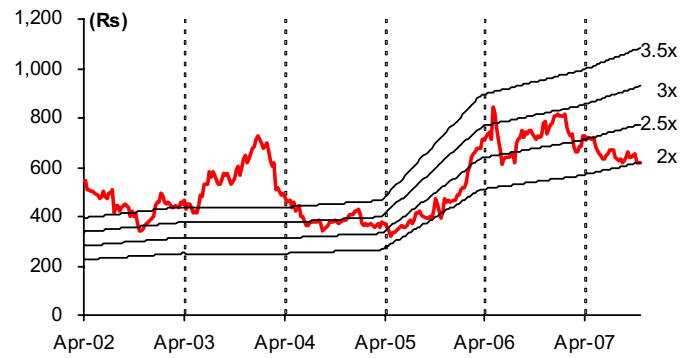
12 month forward rolling band charts

Dr Reddy's

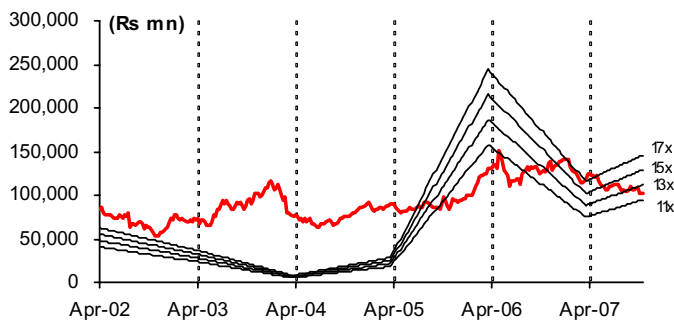
P/E Band



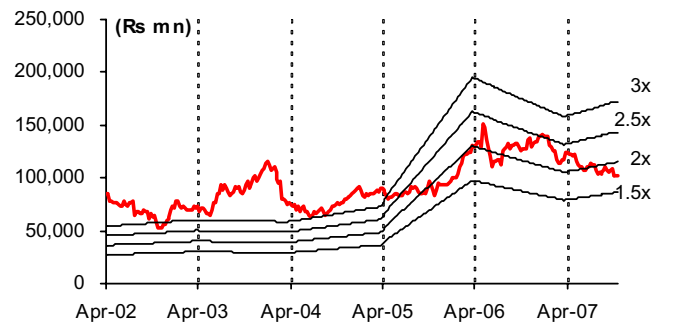
P/BV Band



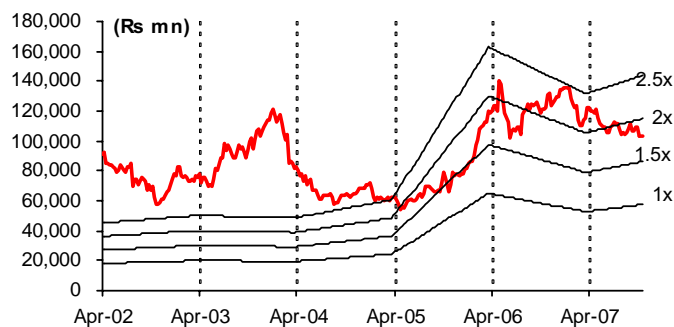
EV/EBITDA Band



EV/Sales Band



Mkt cap/Sales Band



Financials

Income statement

(Rs mn)

Y/E, 31st March	FY05	FY06	FY07	FY08E	FY09E
Net sales	19,472	24,267	65,095	51,683	58,493
EBITDA	473	1,668	14,361	7,596	9,756
EBITDA margin (%)	2.4	6.9	22.1	14.7	16.7
Depreciation / Amortization	350	420	1,571	1,597	1,673
EBIT	43	1,248	12,790	5,999	8,084
Other income	43	340	(456)	701	360
Interest Exp/(Inc)	-	-	-	-	-
PBT (operating)	166	1,588	12,334	6,699	8,444
PBT margin (%)	0.9	6.5	18.9	13.0	14.4
Extra ord (inc)/exp	-	(388)	1,770	(1,500)	-
Taxes	(94)	258	1,177	902	1,262
Minority interest	(10)	-	(4)	-	4
PAT(Reported)	328	1,630	9,328	7,280	7,146
Less: Extra ordinary (income) / Expense	-	(388)	1,770	(1,500)	-
Adj PAT	328	1,242	11,098	5,780	7,146
Adj PAT margin (%)	1.7	5.1	17.0	11.2	12.2

Quarterly – Financials

(Rs mn)

Y/E, 31st March	Q1FY07	Q2FY07	Q3FY07	Q4FY07	Q2FY08
Net sales	20,039	15,434	15,573	12,018	12,670
Changes (%)	245.2	160.4	123.3	(14.5)	(36.8)
EBITDA	4,220	2,464	5,470	2,132	1,462
Changes (%)	435.8	417.9	-	(3.5)	(65.4)
Margin (%)	21.1	16.0	35.1	17.7	11.5
PAT	2,798	1,879	3,252	1,834	2,670
PAT adj	2,798	1,879	5,022	1,834	1,170
Changes (%)	214.5	199.0	-	37.4	(58.2)
Margin (%)	14.0	12.2	32.2	15.3	9.2
EPS adj (Rs)	16.7	11.2	29.9	10.9	7.0
EPS dil (Rs)	16.7	11.2	29.9	10.9	7.0

Ratios

Y/E, 31st March	FY05	FY06	FY07	FY08E	FY09E
Growth					
Net sales (%)	(3.0)	24.6	168.2	(20.6)	13.2
EBITDA (%)	(78.3)	252.6	761.0	(47.1)	28.4
PAT adjusted (%)	(87.2)	278.7	793.6	(47.9)	23.6
EPS adjusted (%)	(87.2)	278.7	716.3	(47.9)	23.6
EPS diluted (%)	(87.2)	278.7	753.8	(50.2)	23.6
EPS Consl and diluted (%)	(87.2)	278.7	753.8	(50.2)	23.6

Valuations

P/E (x)	287.6	76.0	8.9	17.9	14.5
P/BV (x)	4.9	4.6	2.4	2.2	1.9
EV/EBITDA (x)	204.4	78.2	7.9	14.0	10.1
EV/Sales (x)	5.0	5.4	1.7	2.1	1.7

Profitability

EBITDA margin (%)	2.4	6.9	22.1	14.7	16.7
Adj PAT margin (%)	1.7	5.1	17.0	11.2	12.2
RoE (%)	1.6	7.5	28.7	16.1	14.1
RoCE (%)	0.6	3.5	21.0	8.0	9.9
RoIC (%)*	0.6	2.9	17.2	7.4	10.3

B/S ratios

Inventory days	65.6	103.7	75.0	90.0	90.0
Creditor days	55.1	107.0	70.0	70.0	70.0
Debtor days	67.2	72.2	50.0	50.0	50.0
Working Capital days	75.7	93.3	47.6	71.2	73.8
Net debt/equity	(0.3)	1.2	0.3	0.1	(0.1)

* RoIC is calculated on post tax basis

Balance sheet

(Rs mn)

Y/E, 31st March	FY05	FY06	FY07	FY08E	FY09E
Liabilities					
Equity share capital	767	767	840	840	840
Total Res. & Surplus	20,571	21,888	41,968	46,783	52,965
Total Shareholders' fund	20,953	22,272	42,806	47,622	53,804
Convertible Debt	-	-	-	-	-
Others Debt (long term liabilities)	2,827	30,995	33,529	33,209	23,766
Total Loans	2,827	30,995	33,529	33,209	23,766
Deferred tax liability (net)	-	-	-	-	-
Total liabilities	24,509	60,081	85,045	90,810	89,502

Assets

Net fixed assets & others	6,352	8,178	9,464	9,408	9,359
Capital WIP & others	706	909	1,052	1,045	1,040
Total non-current assets	7,058	9,086	10,515	10,453	10,399
Total investments - non current	1,176	1,223	1,223	1,223	1,223
Current assets					
Inventories	3,500	6,895	13,376	12,744	14,423
Sundry debtors	3,587	4,802	8,917	7,080	8,013
Cash & cash equivalents	9,288	3,713	22,760	30,265	28,748
Cash	6,502	2,599	15,932	21,186	20,123
Liquid investments	2,786	1,114	6,828	9,080	8,624
Other current assets	1,978	4,681	9,202	7,726	8,475
Total current assets	18,353	20,090	54,254	57,815	59,658
Total current liabilities	4,780	8,687	21,562	16,073	17,723
Total provisions	4,780	8,687	21,562	16,073	17,723
Net current assets	13,573	11,403	32,692	41,742	41,935
Misc. expenditure	-	-	-	-	-
Total assets	24,509	60,081	85,045	90,810	89,502

Cash flow

(Rs mn)

Y/E, 31st March	FY05	FY06	FY07	FY08E	FY09E
Cash from operations					
PBT	166	1,976	10,564	8,199	8,444
Tax paid	94	(258)	(1,177)	(902)	(1,262)
Dep & amortization	1,309	1,567	3,142	3,159	3,227
Working capital changes	71	(1,958)	(6,095)	(251)	(1,628)
Others	-	-	-	-	-
Net cash from operations	2,292	1,643	9,649	10,268	10,390
Cash from investments					
Capital expenditure	(1,749)	(1,873)	(3,000)	(1,500)	(1,500)
Sale/purchase of inv & others	2,382	(32,651)	0	0	0
Net cash from investments	633	(34,524)	(3,000)	(1,500)	(1,500)
Cash from financing					
Issue of shares & share premium	0	74	10,296	0	0
Dividend paid	(344)	(431)	(943)	(964)	(964)
Debt change	2,363	27,914	2,534	(320)	(9,443)
Others	-	-	-	-	-
Net cash from financing	1,987	27,306	12,398	(1,263)	(10,407)
Net change in cash	4,912	(5,575)	19,047	7,505	(1,517)

Per share data

Y/E, 31st March	FY05	FY06	FY07	FY08E	FY09E
EPS adjusted	2.1	8.1	66.1	34.4	42.6
EPS diluted - wtd	2.1	8.1	69.1	34.4	42.6
EPS Consl and diluted	2.1	8.1	69.1	34.4	42.6
CEPS	7.7	14.2	75.6	43.8	51.9
Book value	125.0	132.8	255.3	284.0	320.9
Dividend	4.0	5.0	5.0	5.0	5.0
O/s shs.-actual (mn)	153.4	153.4	167.9	167.9	167.9
O/s shs.-diluted (mn)	153.4	153.4	167.7	167.9	167.9
O/s shs wtd / diluted (mn)	153.4	153.4	160.5	167.8	167.9

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Rating definition

Buy	: > 15% returns relative to Sensex	Accumulate	: +5 to +15% returns relative to Sensex
Sell	: > (-)15% returns relative to Sensex	Reduce	: (-) 5 to (-) 15% returns relative to Sensex
Hold	: Upto + / (-) 5% returns relative to Sensex		

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