

Dr. Reddy's Laboratories

Performance Highlights

Y/E March (₹ cr)	3QFY2013	2QFY2013	% chg (qoq)	3QFY2012	% chg (yoy)
Net sales	2,865	2,881	(0.5)	2,769	3.5
Gross profit	1,967	1,531	28.5	1,658	18.7
Operating profit	429	553	(22.4)	739	(41.9)
Adj. net profit	363	494	(26.4)	513	(29.1)

Source: Company, Angel Research

Dr. Reddy's Laboratories (DRL) reported more or less just-in 3QFY2013 top-line and bottom-line performance. The company's net sales increased by 3.5% yoy (23% adjusted for the base effect). The growth came in on back of 24% yoy (adjusted) in the US and Emerging Markets. On the EBIT margins came in at 15.0% V/s expected 15.8%. Consequently the net profit came in at ₹363cr, a dip of 29.1%, mostly in line with expectations of ₹339cr. **We recommend a neutral on the stock.**

More or less results in line with expectations: DRL reported net sales of ₹2,865cr for 3QFY2013, registering 23.0% yoy growth, which was a tad lower than our estimate of ₹2,700cr. The U.S. and Emerging markets grew by 24% yoy (adjusted) were the key growth drivers for the company. The domestic market reported a strong growth of 12.0% yoy. On the positive side the PSAI segment posted a robust growth of 28.0% yoy during the quarter. The company's EBIT margin came in at 15.0% V/s expected 15.8% and contracting by 11.7%, leading to a dip of 29.1% to ₹363cr during the quarter.

Outlook and valuation: DRL has reinforced its earlier revenue guidance of US\$2.7bn by FY2013E with RoCE of 25%. We expect net sales to report a 9.8% CAGR to ₹11,662cr and adjusted EPS to record a 2.3% CAGR to ₹92.9 over FY2012-14E. **We maintain our neutral on the stock.**

Key financials (IFRS Consolidated)

Y/E March (₹ cr)	FY2011	FY2012	FY2013E	FY2014E
Net sales	7,469	9,674	10,696	11,662
% chg	6.3	29.5	10.6	9.0
Net profit	1,104	1,426	1,420	1,576
% chg	933.6	29.2	(0.4)	11.0
Adj net profit	1,076	1,507	1,420	1,576
% chg	16.8	40.0	(5.8)	11.0
Adj. EPS (₹)	63.8	88.8	83.7	92.9
EBITDA margin (%)	21.0	24.1	20.7	21.0
P/E (x)	29.5	21.1	22.4	20.2
RoE (%)	24.2	29.1	22.4	20.8
RoCE (%)	17.7	20.9	15.0	15.1
P/BV (x)	7.0	5.6	4.7	3.9
EV/Sales (x)	4.5	3.8	3.4	3.0
EV/EBITDA (x)	19.7	14.3	15.1	13.1

Source: Company, Angel Research

NEUTRAL

CMP ₹1,878
 Target Price -

Investment Period -

Stock Info

Sector	Pharmaceutical
Market Cap (₹ cr)	30,841
Net Debt (₹ cr)	3,047
Beta	0.2
52 Week High / Low	1,969/1,528
Avg. Daily Volume	24,879
Face Value (₹)	5
BSE Sensex	19,325
Nifty	5,852
Reuters Code	REDY.BO
Bloomberg Code	DRRD@IN

Shareholding Pattern (%)

Promoters	25.6
MF / Banks / Indian Fls	22.0
FII / NRIs / OCBs	44.3
Indian Public / Others	8.1

Abs. (%)	3m	1yr	3yr
Sensex	4.7	4.9	19.4
Dr Reddy	4.6	10.5	61.8

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Exhibit 1: 3QFY2013 performance (IFRS, consolidated)

Y/E March (₹ cr)	3QFY2013	2QFY2013	% chg (qoq)	3QFY2012	% chg (yoy)	9MFY2013	9MFY2012	% chg
Net sales	2,865	2,881	(0.5)	2,769	3.5	8,287	7,015	18.1
Other income	26	40	(33)	17	-	93	61	-
Total income	2,892	2,921	(1.0)	2,786	3.8	8,379	7,076	18.4
Gross profit	1,967	1,531	28.5	2,019	(2.6)	5,724	4,981	14.9
Gross margin (%)	68.7	53.1	29.2	72.9	(5.8)	69.1	71.0	(2.7)
Other expenses	1,335	801	66.6	1,129	18.2	3,837	3,213	19.4
R&D expenses	203	176	15.2	151	34.2	535	417	28.2
EBIT	429	553	(22.4)	739	(41.9)	1,352	1,351	0.1
EBIT (%)	15.0	19.2	-	26.7	-	16.3	19.3	-
Interest	10	(37)	-	(17)	-	(6)	(7.8)	-
PBT	446	630	(29.2)	772	(42.2)	1,451	1,420	-
Tax	83	139	(40.6)	262	(68.5)	318	337	(5.7)
Net Profit	363	491	(26.0)	510	(28.8)	1,134	1,084	4.6
Share of profit/ (loss) in associates	-	2.8	-	2.6	-	-	-	-
Reported net profit before excep.	363	494	(26.4)	513	(29.1)	1,134	1,084	4.6
Exceptional items	-	86	-	-	-	(27)	-	-
Reported PAT	363	407	(10.8)	513	(29.1)	1,134	1,084	4.6
Adj. Net Profit	363	494	(26.4)	513	(29.1)	1,107	1,084	2.1
EPS (₹)	21.4	29.1		30.2	-	65.3	63.9	-

Source: Company, Angel Research

Exhibit 2: Actual vs. Estimates

(₹ cr)	Actual	Estimates	Variation (%)
Net sales	2,865	2,700	6.1
Other income	26	42	(37.0)
Operating profit	429	429	0.0
Interest	10	-	-
Tax	83	132	(37.3)
Net profit	363	339	7.1

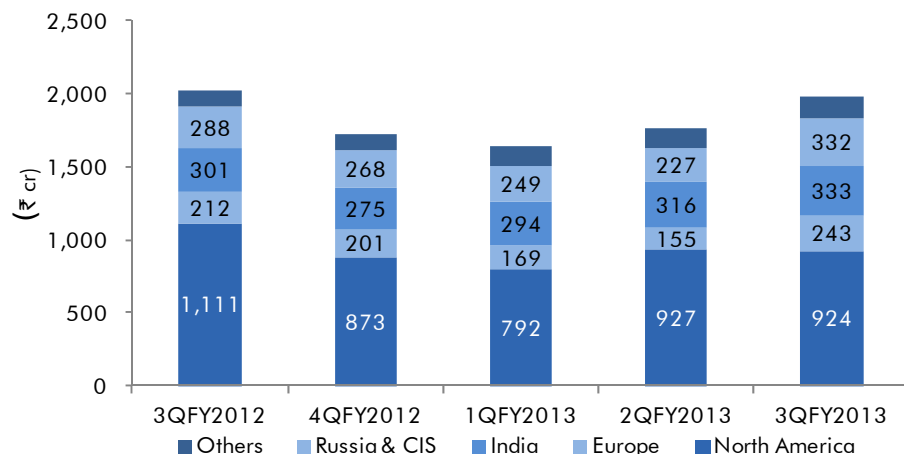
Source: Company, Angel Research

Just-in- line revenue growth: DRL reported net sales of ₹2,865cr for 3QFY2013, registering 23.0% yoy growth, which was a tad lower than our estimate of ₹2,700cr. The U.S. and Emerging markets grew by 24% yoy (adjusted) were the key growth drivers for the company. The domestic market reported a strong growth of 12.0% yoy.

In terms of market performance, the U.S. market reported strong growth of 38.0% (adjusted) yoy, with sales of ₹924.0cr. ROW also registered a robust growth of 42.0% yoy to end the quarter at ₹155.6cr. Russia registered 32.0% yoy growth. The domestic market reported single-digit growth of 12.0% yoy. Sales from Europe de-grow by 20.0% yoy during the quarter.

During the quarter, the company filed 4 ANDAs. The company has 65 ANDAs pending for approval with the USFDA, of which 35 are Para IVs and 8 are FTFs. During the quarter, DRL launched 8 products in the domestic market.

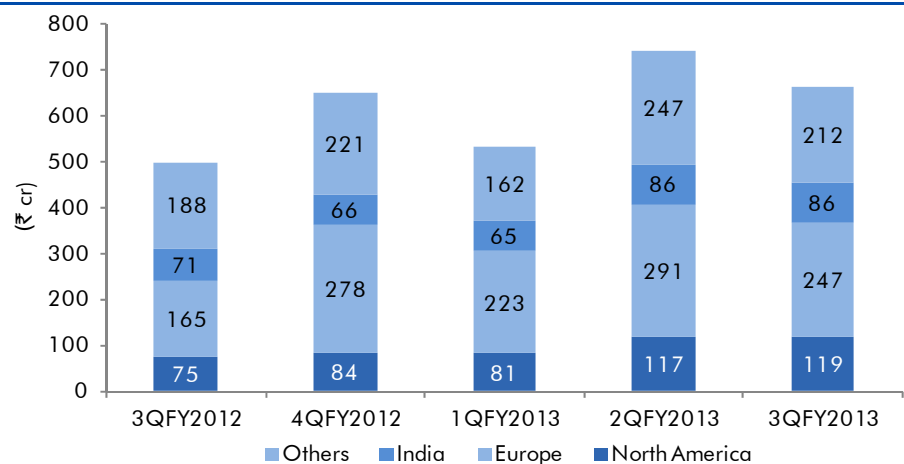
Exhibit 3: Global generic trend



Source: Company, Angel Research

The PSAI segment registered 28.0% yoy growth, majorly led by 50.0% yoy and 47.0% yoy in the Europe and India, respectively. US and ROW grew by 8.0% yoy and 13.0% yoy, respectively.

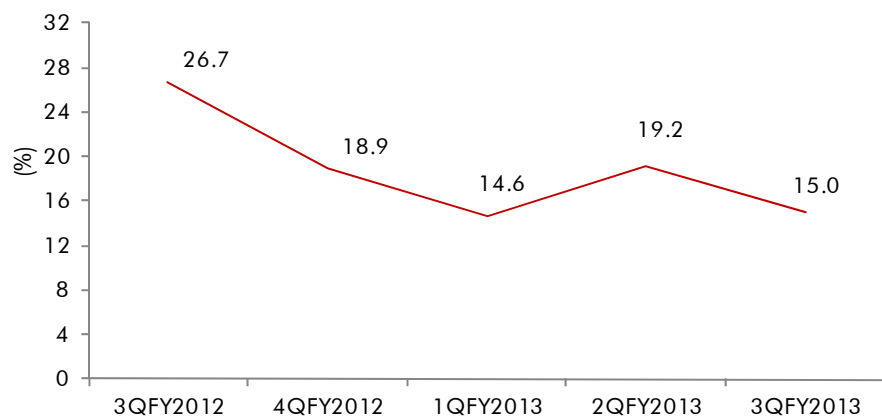
Exhibit 4: PSAI trend



Source: Company, Angel Research

EBIT below expectations : DRL reported gross margin of 68.7% during the quarter. However, the company's EBIT margin came in at 15.0%. The key expenditure areas – R&D grew by 34.2% yoy, while S&GA grew by 12.0% yoy during the quarter.

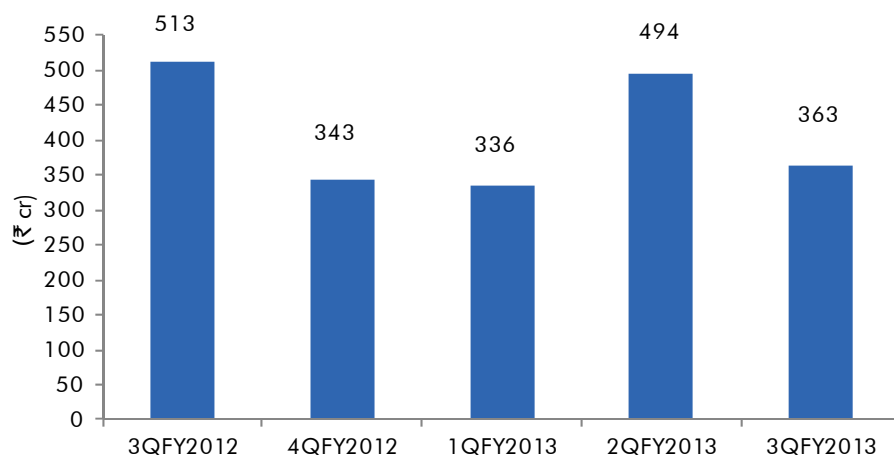
Exhibit 5: EBIT margin trend



Source: Company, Angel Research

Adjusted net profit de-grew by 29.2% yoy during the quarter: DRL reported adjusted net profit of ₹363cr, registering an dip of 29.2% yoy, just-in –line with our estimate of ₹339cr.

Exhibit 6: Adjusted net profit trend



Source: Company, Angel Research

Concall takeaways

- Gross Margins of PSAI is expected to normalize at around 30-35% in coming quarters.
- During 3QFY2013, R&D spend was higher at 7.1% of sales. Management expects similar trend to continue.
- FY2014 capex to be in line with FY2013 capex.
- Tax as a % of PBT is guided towards 20-22%.

Investment arguments

Robust growth in the U.S. ahead: After attaining a critical mass (US\$666mn in FY2012), DRL aims to scale up its business to the next orbit in the U.S. market on the back of a strong product pipeline (80 ANDAs are pending approval, of which 41 are Para IVs and seven are FTFs). Management has guided for robust growth in the U.S., driven by introduction of new products, some of which are also Para IV opportunities. Also, the company has developed its OTC product basket, which now contributes around US\$130mn (FY2012), contributing almost 25% to its overall sales. Overall, we expect the ex-exclusivity U.S. sales to post a CAGR of ~18% during FY2012-14E.

Domestic back in focus: After a below-industry average growth on the domestic formulation front since the last three years, DRL reported modest 11.0% growth in FY2012. Management expects the company's performance to rebound and targets to achieve 15% growth going ahead, driven by a) field force expansion and improvement in productivity, b) new product launches (including biosimilars) and c) focus on brand building.

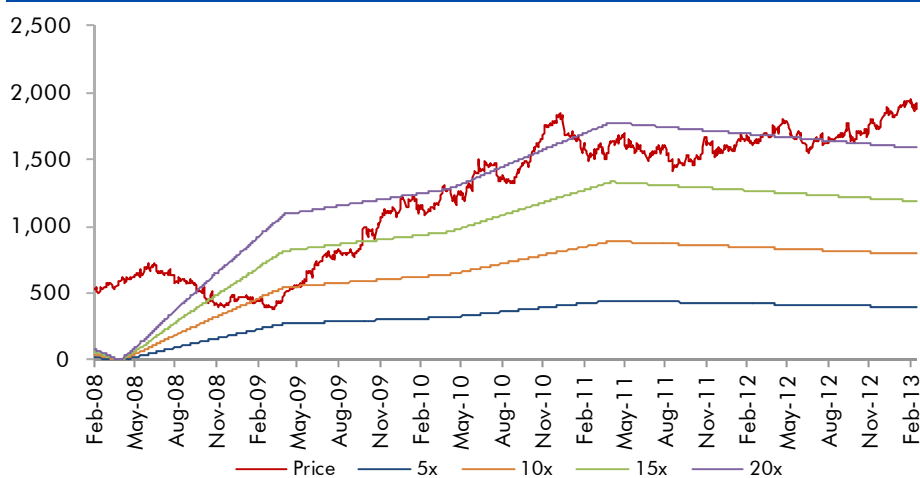
Strategic alliances to provide long-term growth: In order to tap the emerging market opportunities, DRL entered into an alliance with GSK in FY2011 to develop and market branded formulations across emerging markets. On the biogeneric front, the company has developed nine products (four products launched in India) on mammalian cell culture with global brand sales of US\$30bn. The company has also entered into a marketing agreement with Valent Pharma to market *Cloderm* cream in the U.S. market. This deal is expected to provide an impetus to the proprietary products business going forward.

Valuation: We expect the company's net sales to post a 9.8% CAGR to ₹11,662cr and adjusted EPS to record a 2.3% CAGR to ₹92.9 over FY2012-14E. DRL's growth would be driven by the U.S. business, uptick in the domestic formulation and Russian markets. **At the CMP, the stock is trading at 22.4x FY2013E and 20.2x FY2014E earnings. We maintain our neutral view on the stock.**

Exhibit 7: Key assumptions

	FY2013E	FY2014E
PSAI segment growth (%)	1.8	2.0
Generics segment growth (%)	12.0	9.0
Operating margin (%)	20.7	21.0
Capex (₹ cr)	600	600

Source: Company, Angel Research

Exhibit 8: One-year forward PE chart


Source: Company, Angel Research

Exhibit 9: Recommendation summary

Company	Reco	CMP (₹)	Tgt. price (₹)	Upside %	FY2014E			FY12-14E		FY2014E	
					PE (x)	EV/Sales (x)	EV/EBITDA (x)	CAGR in EPS (%)	RoCE (%)	RoE (%)	
Alembic Pharma.	Buy	73	95	28.4	7.7	0.9	5.0	17.1	29.4	30.2	
Aurobindo Pharma	Accumulate	182	208	14.3	13.0	1.3	8.8	69.7	10.7	17.8	
Cadila Healthcare	Accumulate	741	817	10.4	18.8	2.3	12.8	11.5	17.2	24.8	
Cipla	Accumulate	382	419	6.1	18.3	3.2	13.1	23.2	19.1	17.6	
Dr Reddy's	Neutral	1,878	-	-	20.2	3.0	14.1	3.0	15.1	20.8	
Dishman Pharma	Buy	86	155	64.9	5.6	1.1	5.3	48.2	10.4	11.6	
GSK Pharma*	Neutral	2,098	-	-	25.5	5.0	16.1	8.7	38.9	29.0	
Indoco Remedies	Buy	60	78	27.9	7.8	0.9	6.0	24.8	14.6	15.6	
Ipca labs	Accumulate	473	559	16.5	12.7	1.9	9.1	30.6	25.7	26.4	
Lupin	Accumulate	590	655	10.1	18.8	2.7	12.3	27.2	24.9	25.2	
Ranbaxy*	Neutral	413	-	-	12.8	1.4	8.9	50.3	29.7	16.1	
Sanofi India*	Neutral	2,256	-	-	25.7	2.8	17.0	2.7	12.5	14.8	
Sun Pharma	Neutral	779	-	-	26.1	5.3	12.3	0.1	27.6	19.2	

Source: Company, Angel Research; Note: *December year ending

Company Background

Established in 1984, Dr. Reddy's Laboratories is an integrated global pharmaceutical company, through its three businesses - Pharmaceutical Services and Active Ingredients, Global Generics and Proprietary Products. The key therapeutic focus is on gastro-intestinal, cardiovascular, diabetology, oncology, pain management, anti-infective and paediatrics. The Key markets for DRL include India, USA, Russia and CIS, Germany.

Profit & loss statement (IFRS Consolidated)

Y/E March (₹ cr)	FY2010	FY2011	FY2012	FY2013E	FY2014E
Net sales	7,028	7,469	9,674	10,696	11,662
Other operating income	56.9	75.0	76.5	76.5	76.5
Total operating income	7,085	7,544	9,750	10,773	11,739
% chg	2.4	6.5	29.2	10.5	9.0
Total expenditure	5,608	5,903	7,340	8,483	9,210
Cost of revenues	2,978	3,028	3,862	4,291	4,685
SG&A expenses	2,251	2,369	2,887	3,464	3,732
R&D expenses	379.3	506.0	591.1	727.4	793.0
EBITDA	1,420	1,566	2,334	2,214	2,452
% chg	(6.9)	10.3	49.0	(5.2)	10.8
(% of Net Sales)	20.2	21.0	24.1	20.7	21.0
Depreciation & amortisation	416.0	414.7	481.3	522.0	562.7
EBIT	1,004	1,151	1,853	1,692	1,889
% chg	(12.2)	14.6	60.9	(8.7)	11.7
(% of Net Sales)	14.3	15.4	19.2	15.8	16.2
Interest & other charges	37.2	28.3	(16.0)	-	-
Other Income	36.9	9.4	-	-	-
(% of PBT)	3.5	0.8	-	-	-
Share in profit of associates	4.8	0.3	5.4	5.4	5.4
Recurring PBT	1,066	1,208	1,951	1,773	1,971
% chg	6.3	13.3	61.5	(9.1)	11.2
Extraordinary expense/(Inc.)	860.3	(37)	104.0	-	-
PBT (reported)	205.3	1,244.2	1,846.6	1,773.4	1,971.2
Tax	98.5	140.3	420.4	353.6	393.1
(% of PBT)	48.0	11.3	22.8	19.9	19.9
PAT (reported)	106.8	1,104	1,426.2	1,419.8	1,578.0
Exceptional items	815	9	-	-	-
PAT after MI (reported)	106.8	1,104	1,426.2	1,419.8	1,576.0
ADJ. PAT	921.4	1,076	1,506.5	1,419.8	1,576.0
% chg	4.1	16.8	40.0	(5.8)	11.0
(% of Net Sales)	1.5	14.8	14.7	13.3	13.5
Basic EPS (₹)	54.6	63.8	88.8	83.7	92.9
Fully Diluted EPS (₹)	54.6	63.8	88.8	83.7	92.9
% chg	3.8	16.8	39.4	(5.8)	11.0

Balance sheet (IFRS Consolidated)

Y/E March (₹ cr)	FY2010	FY2011	FY2012	FY2013E	FY2014E
SOURCES OF FUNDS					
Equity share capital	84.4	84.4	84.8	84.8	84.8
Reserves & surplus	4,207	4,515	5,660	6,820	8,137
Shareholders' funds	4,292	4,599	5,744	6,907	8,225
Total loans	1,465.6	2,357.2	4,831.2	4,831.2	4,831.2
Deferred tax liability	143.8	143.8	83.3	83.3	83.3
Total liabilities	5,901	7,100	10,659	11,821	13,139
APPLICATION OF FUNDS					
Net fixed assets	1,759	2,478	3,325	4,125	4,925
Goodwill /other intangibles	1,422	1,549	1,353	1,353	1,353
Capital Work-in-Progress	486.7	486.7	520.8	520.8	520.8
Investments	31.0	31.0	1,077	1,077	1,077
Current Assets	4,206	4,832	6,995	7,620	8,770
Cash	658.4	572.9	737.9	730.1	2,037
Loans & Advances	421.7	448.2	580.4	641.8	699.7
Other	3,126	3,811	5,677	6,248	6,034
Current liabilities	2,004	2,276	2,613	2,876	3,510
Net Current Assets	2,202	2,556	4,382	4,744	5,261
Mis. Exp. not written off	-	-	-	-	-
Total Assets	5,901	7,100	10,659	11,821	13,139

Cash flow statement (IFRS Consolidated)

Y/E March (₹ cr)	FY2010	FY2011	FY2012	FY2013E	FY2014E
Profit before tax	1,065.6	1,207.7	1,950.6	1,773.4	1,971.2
Depreciation	416.0	414.7	481.3	522.0	562.7
(Inc)/Dec in Working Capital	(38.0)	(439.0)	(1,661.4)	(369.3)	790.2
Less: Other income	36.9	9.4	-	-	-
Direct taxes paid	98.5	140.3	420.4	353.6	393.1
Cash Flow from Operations	1,308.2	1,033.7	350.2	1,572.5	2,930.9
(Inc.)/Dec.in Fixed Assets	(157.7)	(718.3)	(881.2)	(800.0)	(800.0)
(Inc.)/Dec. in Investments	4.8	-	(1,046.3)	-	-
Other income	36.9	9.4	-	-	-
Cash Flow from Investing	(116.0)	(708.9)	(1,927.5)	(800.0)	(800.0)
Issue of Equity	0.2	-	0.4	-	-
Inc./Dec.) in loans	(482.7)	891.6	2,474.0	-	-
Dividend Paid (Incl. Tax)	123.3	221.1	259.3	259.3	259.3
Others	(734.2)	(1,080.7)	(472.4)	(521.0)	(564.7)
Cash Flow from Financing	(1,093.4)	(410.3)	1,742.3	(780.3)	(824.0)
Inc./Dec.) in Cash	98.8	(85.5)	165.0	(7.8)	1,306.9
Opening Cash balances	559.6	658.4	572.9	737.9	730.1
Closing Cash balances	658.4	572.9	737.9	730.1	2,037.1

Key ratios

Y/E March	FY2010	FY2011	FY2012	FY2013E	FY2014E
Valuation Ratio (x)					
P/E (on FDEPS)	34.4	29.5	21.1	22.4	20.2
P/CEPS	60.6	20.9	16.7	16.4	14.9
P/BV	7.4	6.9	5.5	4.6	3.9
Dividend yield (%)	0.3	0.6	0.7	0.7	0.7
EV/Sales	4.6	4.5	3.7	3.4	3.0
EV/EBITDA	22.9	21.4	15.4	16.2	14.1
EV / Total Assets	5.5	4.7	3.4	3.0	2.6
Per Share Data (₹)					
EPS (Basic)	54.6	63.8	88.8	83.7	92.9
EPS (fully diluted)	54.6	63.8	88.8	83.7	92.9
Cash EPS	31.0	90.0	112.5	114.5	126.1
DPS	5.0	11.0	14.0	14.0	14.0
Book Value	254.2	272.5	338.8	407.3	485.1
Dupont Analysis					
EBIT margin	14.3	15.4	19.2	15.8	16.2
Tax retention ratio	52.0	88.7	77.2	80.1	80.1
Asset turnover (x)	1.3	1.3	1.2	1.0	1.1
ROIC (Post-tax)	9.4	17.5	17.5	13.0	13.7
Cost of Debt (Post Tax)	1.1	1.3	-0.3	0.0	0.0
Leverage (x)	0.3	0.3	0.6	0.7	0.5
Operating ROE	11.6	22.2	27.4	21.5	20.1
Returns (%)					
ROCE (Pre-tax)	16.2	17.7	20.9	15.0	15.1
Angel ROIC (Pre-tax)	30.4	29.4	29.6	19.6	20.5
ROE	21.7	24.2	29.1	22.4	20.8
Turnover ratios (x)					
Asset Turnover (Gross Block)	4.1	3.6	3.4	2.9	2.6
Inventory / Sales (days)	69	71	66	74	75
Receivables (days)	68	72	80	81	82
Payables (days)	50	55	45	50	51
WC cycle (ex-cash) (days)	81	85	105	130	113
Solvency ratios (x)					
Net debt to equity	0.2	0.4	0.7	0.6	0.3
Net debt to EBITDA	0.6	1.1	1.8	1.9	1.1
Interest Coverage (EBIT / Int.)	27.0	40.7	-	-	-

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Disclosure of Interest Statement	Dr. Reddy's Laboratories
1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹1 lakh for Angel, its Group companies and Directors

Ratings (Returns):	Buy (> 15%) Reduce (-5% to -15%)	Accumulate (5% to 15%) Sell (< -15%)	Neutral (-5 to 5%)
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