

## Result update – Q4FY11 | 2<sup>nd</sup> June, 2011

**Dr. Reddy's Ltd. (DRL) | CMP: Rs. 1,616, Target Price: Rs.1,824, Upside: 13%**

### Q4FY11 update (Rs. in mn)

Particulars	Q4FY11	Q4FY10	% yoy change	Q3FY11	% qoq change	FY2011	FY2010
<b>Net sales</b>	<b>20,170</b>	<b>16,420</b>	<b>22.8</b>	<b>18,990</b>	<b>6.3</b>	<b>74,693</b>	<b>70,277</b>
Gross profit	10,950	8,640	26.7	10,410	5.1	40,263	36,340
<b>Gross margin (%)</b>	<b>54.3</b>	<b>52.6</b>	<b>170 bps</b>	<b>54.9</b>	<b>(60) bps</b>	<b>53.9</b>	<b>51.7</b>
SG&A expenses	6,130	5,810	5.4	6,370	(3.9)	23,690	22,505
R&D expenses	1,490	950	56.5	1,310	14.2	5,060	3,793
<b>PBIDT</b>	<b>3,330</b>	<b>1,870</b>	<b>77.7</b>	<b>2,740</b>	<b>21.7</b>	<b>11,513</b>	<b>1,437*</b>
<b>OPM (%)</b>	<b>16.5</b>	<b>11.4</b>	<b>510 bps</b>	<b>14.4</b>	<b>210 bps</b>	<b>15.4</b>	<b>2</b>
Interest	(70)	30	(394.1)	50	-	(189)	(3)
Other income	510	240	113	200	155	1,120	570
<b>PBT</b>	<b>3,920</b>	<b>2,090</b>	<b>87.8</b>	<b>2,880</b>	<b>35.8</b>	<b>12,444</b>	<b>2,004</b>
Tax	(570)	(440)	28.8	(150)	273.5	(1,403)	(985)
<b>Net Profit</b>	<b>3,350</b>	<b>1,650</b>	<b>103.6</b>	<b>2,730</b>	<b>22.6</b>	<b>11,041</b>	<b>1,019</b>
Share of profit/(loss) in associate	(4)	20	-	(1)	-	3	48
<b>Reported net profit</b>	<b>3,340</b>	<b>1,670</b>	<b>100.7</b>	<b>2,730</b>	<b>22.5</b>	<b>11,044</b>	<b>1,067</b>
Exceptional items	280	280	(1.8)	-	-	280	8,150
<b>Adjusted PAT</b>	<b>3,070</b>	<b>1,950</b>	<b>57.4</b>	<b>2,730</b>	<b>12.3</b>	<b>10,764</b>	<b>9,217</b>
<b>EPS</b>	<b>19.7</b>	<b>9.8</b>		<b>16.2</b>		<b>65</b>	<b>6.3</b>
<b>Face value (Rs.)</b>	<b>5</b>	<b>5</b>		<b>5</b>		<b>5</b>	<b>5</b>

Source: Company, Ajcon Research, Note: \* indicates adjustment for writedown for goodwill and other intangible assets

### Q4FY11 result update

Net sales witnessed yoy growth of 22.8% in Q4FY11 to touch Rs. 20.1 bn. The global generic markets registered growth of 26.9% on a yoy basis led by growth across the US and Russian markets.

### New product launches driving growth in US market

US market witnessed yoy growth of 67.6% to Rs. 5.9 bn owing to launch of Allegra – D24 (fexofinadine pseudoephedrine) in Q4FY11, first as a prescription product and then later as an OTC (Over-the counter) product on approval. On a yearly basis, US market registered yoy growth of 13% with 11 product launches including tacrolimus, fexofinadine pseudoephedrine and lansoprazole by attaining revenues of US\$446mn. The US market remains quite attractive for the next two-three years because of the large volume of products which are going off patent. DRL has filed 20 ANDAs (Abbreviated New Drug Applications) in FY11. The cumulative ANDA

filings stands at 170, with 75 pending approvals of which 37 are Para IVs and 10 are FTFs. The company was successful in launching 135 generic products. The company has given a guidance of one limited competition opportunity every year for the next few years.

### Russian market growth met expectations, European business remained under pressure in Q4FY11

Russian market witnessed yoy growth of 24%, largely driven by volume growth across existing business and new products contribution. There was significant growth in OTC portfolio representing 25% of overall portfolio. The company's European business (UK and Germany) was under pressure and registered yoy decline of 4.8% on yoy basis. This was mainly on account of its subsidiary "Betapharm" reeling under pricing pressure. On a full year basis, UK has done well and the other markets are also beginning to become significant from an out licensing revenue perspective. We believe, the worst is over for Betapharm. DRL has taken efforts on cost rationalization which has led to reducing of workforce by 200 to 80 people. It also started bidding for high margin tenders to improve its profitability.

### Pricing pressure in domestic formulations segment, management optimistic on future growth

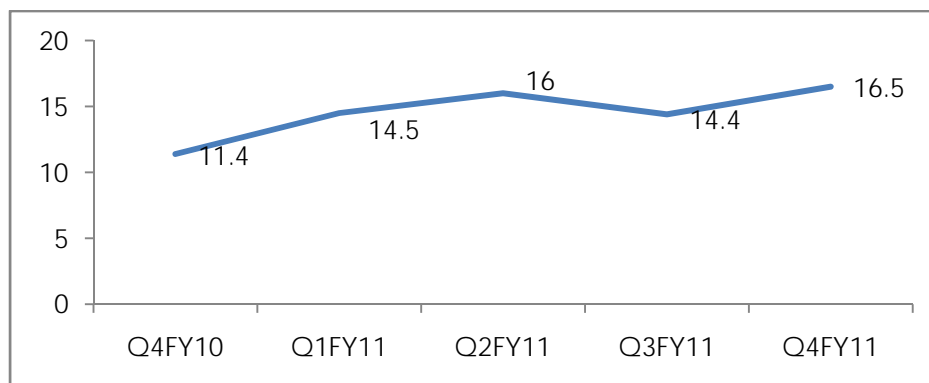
In Q4FY11, domestic market growth was under pressure at 4.9% on a yoy basis. This was mainly on account of increasing competitive intensity leading to price cuts for its products in the domestic formulations segment. On a yearly basis, the company witnessed yoy growth of 15.1%, led by volume growth of 11% and contribution from new product launches of 4%.

In India, 48 new products were launched during FY11, including one biosimilar, darbepoetin alfa under the brand cresp. Going ahead, the management expects the performance in the domestic market to improve significantly on account of field expansion and new product launches (including biosimilars).

### Good operating performance

OPM improved by 210 bps to 16.5% in Q4FY11. This was on account of favourable mix of high margin new products in the North America generics segment.

### OPM (%) trend



### Key highlights of FY11:

- 1) The company has launched 135 new generic products, filed 107 new product registrations and filed 56 DMFs globally.
- 2) DRL is still waiting for approval for Arixtra and expects it to launch on approval.
- 3) Management is optimistic about the prospects in North American generic market for FY12 and FY13.
- 4) It has a market share of 28% in tacrolimus, 9% in lansoprazole and 35% in fexofenadine.
- 5) The company has forayed into many strategic initiatives. Some of the key ones being:
  - a) Acquisition of a penicillin facility to fill its portfolio gap in the anti-bacterial segment in the US.
  - b) Collaboration with Valeant Pharma to market Clodem® Cream in the dermatology space in the US.
  - c) Settlement of the ongoing litigation on esomeprazole with Astra Zeneca.

### Outlook

At the CMP, the stock is valued at 25x at FY11 EPS. With due consideration to factors like: a) strong product pipeline (filed 107 new product registrations and 56 DMF's globally), b) DRL's revenue guidance of US\$2.7bn by FY2013E with a RoCE of 25%, b)uptick in the domestic formulation and Russian markets business, c)increased contribution from GSK's alliance, d) street expectation of company's revenues to witness a CAGR of 13% and adjusted EPS to witness a 22.7% CAGR to Rs. 96 over FY2011-13E, we recommend a 'BUY' with a target price of Rs. 1,824 (19x at estimated FY13 EPS).



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