

DR REDDY'S LAB - Growth to Slow Down on Higher Base, Margins to Remain Under Pressure

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Date: February 2013

Pages: 7

Price: US\$ 140.00 (Single User License)

ID: D08CDC6469CEN

Abstracts

Dr Reddy's Q3FY13 result was below our estimates as EBITDA margin was down by 400 bps (at 21%) compared to previous quarter. EBITDA margins were adversely impacted by higher SG&A expenses (up by 12% yoy, and 28.5% of total sales) due to promotional expenses towards OTC portfolio and pricing pressures in Germany coupled with higher R&D expenses (up by 34% yoy, and 7.1% of total sales) due to investment in complex technologies. Excluding Olanzapine in Q3FY12, US sales grew by 23%, driven by limited competition products. Domestic and Russia grew by 12% and 35% respectively.

Going forward in FY14 growth will be driven by full year impact of Toprol XL, ramp up of Fondaparinux (hospital segment) and Amoxil. We expect Dr. Reddy may participate in Vidaza opportunity which is due any time as an API supplier. Besides the company is also expecting to receive approval of 2-3 niche products anytime Overall growth rate would be contained (10 - 11%) due to additional competition in Ziprasidone (27% market share) and Tacrolimus (42% market share, launch by Panacea). In US, company is focusing to shift its portfolio towards complex products (complex injectable, difficult to characterize, biologics and peptides), however it will happen only in the long term. In the near term it will result in higher R&D spending, putting pressure on margins. Margins will also remain sensitive to higher SG&A spending due to marketing expenses towards OTC in US and Russia.

We reiterate our market perform rating on Dr Reddy's and retain out target price of Rs.1929.

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