

Dr Reddy's Laboratories

Performance Highlights

Y/E March (₹ cr)	4QFY2015	3QFY2015	% chg (qoq)	4QFY2014	% chg (yoy)
Net sales	3,870	3,843	0.7	3,481	11.2
Gross profit	2,336	2,431	(3.9)	2,172	7.6
Operating profit	813	884	(8.0)	742	9.6
Adj. net profit	519	575	(9.7)	482	7.7

Source: Company, Angel Research

For 4QFY2015, Dr Reddy's Laboratories (DRL) posted numbers below our expectations. On the top-line front, the company posted a growth of 11.2% yoy to ₹3,870cr V/s an expected ₹4,052cr expected, with global generics posting a growth of 13.0% and PSAI registering a yoy growth of 12.0%. On the operating front, the EBITDA margin came in at 21.0% (V/s 23.2% expected) V/s 21.3% in 4QFY2014. The dip in the EBDITA margin came on back of a 29% yoy rise in R&D expenses, which came in at 13.3% of sales V/s 11.4% of sales in 4QFY2014. The PAT came in at ₹519cr (V/s ₹550cr expected), ie a yoy growth of 7.7%. **We recommend a accumulate rating on the stock with a price target of ₹3,963.**

Results marginally lower than expectations: For 4QFY2015, DRL posted numbers below our expectations. On the top-line front, the company posted a growth of 11.2% yoy to ₹3,870cr V/s an expected ₹4,052cr expected, with global generics posting a growth of 13.0% and PSAI registering a yoy growth of 12.0%. The company's key markets like US, Europe and India, along with ROW, posted a yoy growth of 15%, 32%, 16% and 77%, respectively. Russia & CIS posted a dip in sales of 27%, mainly on back of the currency impact. For the year the region posted an 11% yoy dip in revenues, while on the same currency the region posted a growth of 13.0%. On the operating front, the EBITDA margin came in at 21.0% (V/s 23.2% expected) V/s 21.3% in 4QFY2014. The dip in the EBDITA came on back of 29% yoy rise in R&D expenses, which came in at 13.3% of sales V/s 11.4% of sales in 4QFY2014. The PAT for the quarter came in at ₹519cr (V/s ₹550cr expected), ie a yoy growth of 7.7%.

Outlook and valuation: We expect net sales to grow at a CAGR of 17.0% to ₹20,296cr and adjusted EPS to record a 17.6% CAGR to ₹180.1 over FY2015-17E. **We recommend a accumulate rating on the stock.**

Key financials (IFRS Consolidated)

Y/E March (₹ cr)	FY2014	FY2015	FY2016E	FY2017E
Net sales	13,217	14,819	17,443	20,296
% chg	13.7	12.1	17.7	16.4
Net profit	2,151	2,218	2,669	3,069
% chg	28.2	3.1	20.4	15.0
Adj net profit	2,151	2,218	2,669	3,069
% chg	22.9	3.1	20.4	15.0
Adj. EPS (₹)	126.7	130.2	156.7	180.1
EBITDA margin (%)	23.6	22.2	22.8	22.4
P/E (x)	27.6	26.8	22.3	19.4
RoE (%)	26.3	21.9	21.8	20.8
RoCE (%)	20.2	18.1	19.3	19.4
P/BV (x)	6.5	5.3	4.4	3.7
EV/Sales (x)	4.8	4.2	3.6	3.0
EV/EBITDA (x)	20.2	19.2	15.7	13.5

Source: Company, Angel Research; Note: CMP as of May 13, 2015

ACCUMULATE

CMP	₹3,493
Target Price	₹3,963

Investment Period 12 months

Stock Info

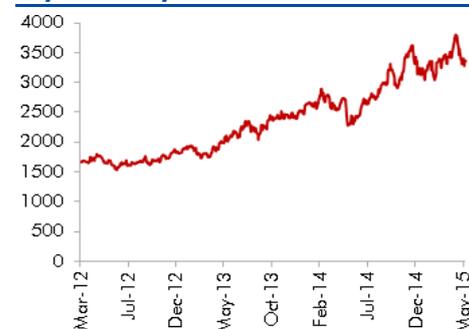
Sector	Pharmaceutical
Market Cap (₹ cr)	59,512
Net Debt (₹ cr)	(396)
Beta	0.5
52 Week High / Low	3,809/2,250
Avg. Daily Volume	24,054
Face Value (₹)	5
BSE Sensex	27,251
Nifty	8,235
Reuters Code	REDY.BO
Bloomberg Code	DRRD@IN

Shareholding Pattern (%)

Promoters	25.5
MF / Banks / Indian Fls	9.7
FII / NRIs / OCBs	57.0
Indian Public / Others	7.8

Abs. (%)	3m	1yr	3yr
Sensex	(6.3)	14.2	67.3
Dr Reddy	4.7	33.8	110.2

3-year Daily Price Chart



Source: Company, Angel Research

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Exhibit 1: 4QFY2015 performance (IFRS, consolidated)

Y/E March (₹ cr)	4QFY2015	3QFY2015	% chg (qoq)	4QFY2014	% chg (yoy)	FY2015	FY2014	% chg
Net sales	3,870	3,843	0.7	3,481	11.2	14,819	13,217	12.1
Other income	(11)	135	(108)	44	-	260	182	42.8
Total income	3,860	3,979	(3.0)	3,525	9.5	15,079	13,399	12.5
Gross profit	2,336	2,431	(3.9)	2,172	7.6	9,288	8,240	12.7
Gross margin (%)	60.4	63.3		62.4		62.7	62.3	
SG&A expenses	1,008	1,115	(9.6)	1,031	(2.2)	4,259	3,878	9.8
R&D expenses	514	432	19.2	399	29.1	1,745	1,240	40.7
EBDITA	813	884	(8.0)	742	9.6	3,284	3,122	5.2
EBDITA (%)	21.0	23.0	-	21.3		22.2	23.6	-
Depreciation	214	196	9.2	179.3	19.2	747.4	659.8	(72.8)
Interest	-	-	-	-	-	-	-	-
PBT	589	824	(28.5)	607	(3.0)	2,797	2,644	(77.1)
Tax	74	254	(70.8)	125	(40.7)	598	509	17.6
Net Profit	515	570	(9.7)	482	7.7	2,199	2,134	3.0
Share of profit/ (loss) in associates	4.4	5.3	(17.0)	-	-	19.5	17.4	-
Reported net profit before exceptional	519	575	(9.7)	482	7.7	2,218	2,151	3.1
Exceptional items (loss) /profit	-	-	-	-	-	-	-	-
Reported PAT	519	575	(9.7)	482	7.7	2,218	2,151	3.1
Adj.Net Profit	519	575	(9.7)	482	7.7	2,218	2,151	3.1
EPS (₹)	30.6	33.8		28.4		130.2	126.7	

Source: Company, Angel Research

Exhibit 2: Actual vs Estimates

(₹ cr)	Actual	Estimates	Variation (%)
Net sales	3,870	4,052	(4.5)
Other income	(11)	44	(124.5)
Operating profit	813	742	9.5
Tax	74	236	(68.5)
Adj. Net profit	519	550	(5.7)

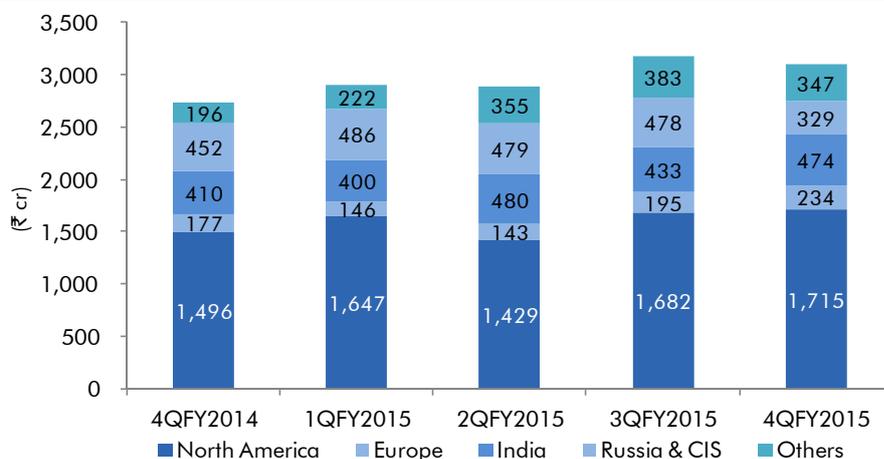
Source: Company, Angel Research

Revenue growth lower than expectation: For 4QFY2015, DRL posted numbers below our expectations. On the top-line front, the company posted a growth of 11.2% yoy to ₹3,870cr V/s an expected ₹4,052cr expected, with global generics posting a growth of 13.0% and PSAI registering a yoy growth of 12.0%. The company's key markets like US, Europe and India, along with ROW, posted a yoy growth of 15%, 32%, 16% and 77%, respectively. Russia & CIS posted a dip in sales of 27%, mainly on back of the currency impact.

In the generic segment (accounting for 80% of sales), the US (₹1,715.4cr) grew by 15.0% yoy, Europe (₹234.1cr) by 32.0% yoy, India (₹474.4cr) by 16.0%, ROW (₹346.5cr) by 77.0% yoy, while Russia & CIS (₹328.9cr) dipped by 27.0% yoy. Revenue from Russia declined primarily on account of the Rouble's depreciation. In constant currency, the growth was ~13% yoy for FY2015, on the back of healthy sales. In the PSAI segment (19% of sales) - US de-grew by 9% and ROW grew by 21%. Europe grew by 36% (in terms of PSAI segment) while India dipped by 32% yoy during the quarter.

DRL filed 13 abbreviated new drug application (ANDA)s during the quarter. The company has 68 ANDAs pending for approval with the USFDA, of which, 43 are Para IVs and 13 are FTFs.

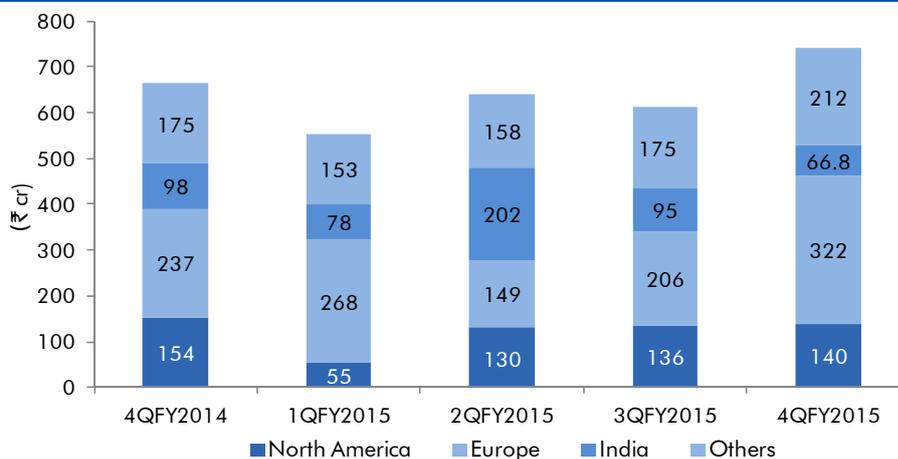
Exhibit 3: Global generic trend



Source: Company, Angel Research

The PSAI segment posted a growth of 12.0% yoy, recording sales of ₹741.5cr, with the US (₹140cr) and ROW (₹212.4cr) growing at (-9)% yoy and 21% yoy, respectively. Europe (₹322.3cr) posted a growth of 36% while sales in India during the quarter dipped by ₹66.8cr.

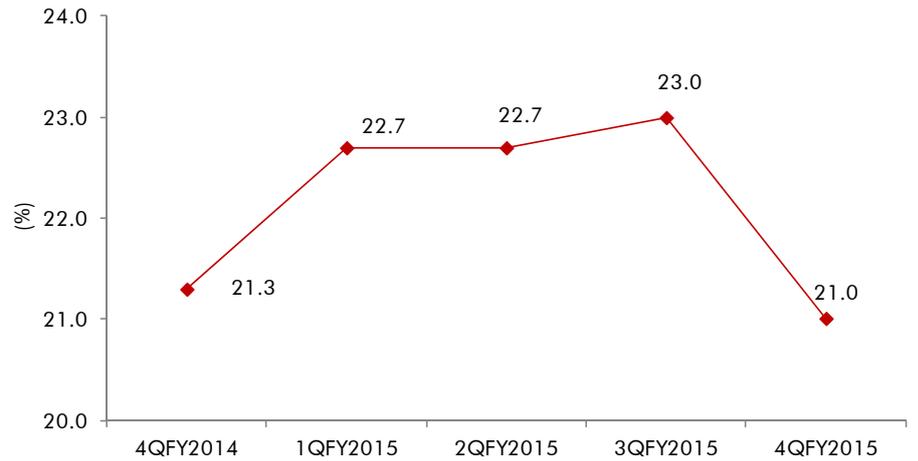
Exhibit 4: PSAI trend



Source: Company, Angel Research

EBITDA dips yoy: On the operating front, the gross margin came in at 60.4% V/s 62.4% in 4QFY2014, a yoy dip of 203bp. This, along with a rise in R&D expenditure (up by 29.1% yoy), led the operating margin to dip by 31bp yoy to 21.0% (V/s an expected 23.2%), for the quarter. R&D expenditure was at 13.3% of sales in 4QFY2015 V/s 11.4% of sales in 4QFY2014. The OPM contraction was restricted, on back of a yoy dip of 2.2% in SG&A expenses.

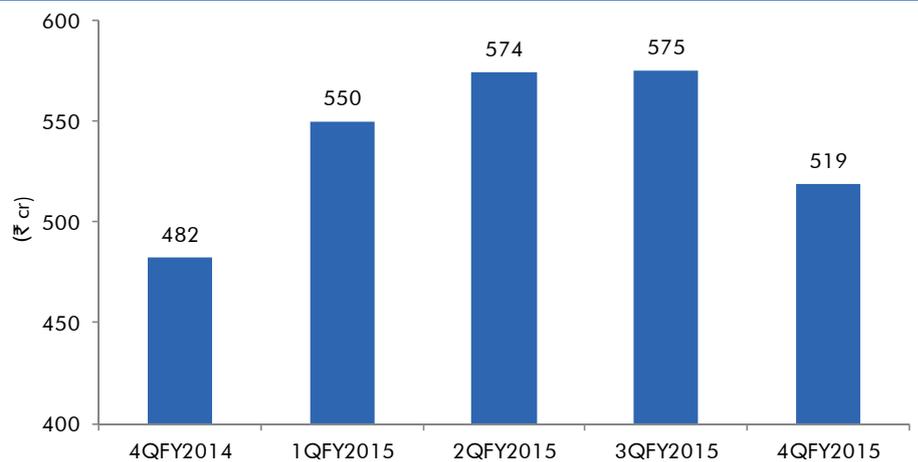
Exhibit 5: EBITDA margin trend (%)



Source: Company, Angel Research

Net profit lower than expected during the quarter: DRL posted an Adj PAT of ₹519cr for the quarter (V/s a profit of ₹482cr in 4QFY2014), a yoy growth of 7.7%. This was against ₹550cr expected for the quarter.

Exhibit 6: Adjusted net profit trend



Source: Company, Angel Research

Concall takeaways

- In Nov'2014, the company received 483s on its API plant in Srikakulam facility. The action plan submitted to the USFDA is on track, but no timelines have been determined for resolution. For expediting approvals, DRL has undertaken site transfers of 3 products (including Nexium) and is targeting CB30 procedure (auto approval if FDA does not raise queries in 30 days). Final resolution may require re-inspection of the facility.
- In Venezuela, the company remains committed to its operations with an intent to make it big in the long term. In February 2015, the government of Venezuela introduced a new Marginal Currency System (SIMADI). The company determined that it is appropriate to use the SIMADI rate (VEF193/USD) to translate monetary assets and liabilities, other than those which qualify for the CENCOEX rate of VEF6.3/USD. Accordingly, it took an ₹84.3cr forex loss on translation of these net assets of VEF88mn.
- R&D expenses are expected to stabilize around 12% going forward. Generics R&D expense to proprietary R&D/biosimilars expense is in the ratio of ~60:40.

Investment arguments

Robust growth in the US going ahead: After attaining a critical mass (US\$1,113mn in FY2015), DRL aims to scale up its business to the next orbit in the US market on the back of a strong product pipeline (68 ANDAs are pending approval, of which, 43 are Para IVs and 13 are FTFs). The Management has guided for a robust growth in the US over the medium term, driven by introduction of new products, some of which are also Para IV opportunities. Overall, we expect the ex-exclusivity US sales to post a CAGR of ~21.2% during FY2015-17E.

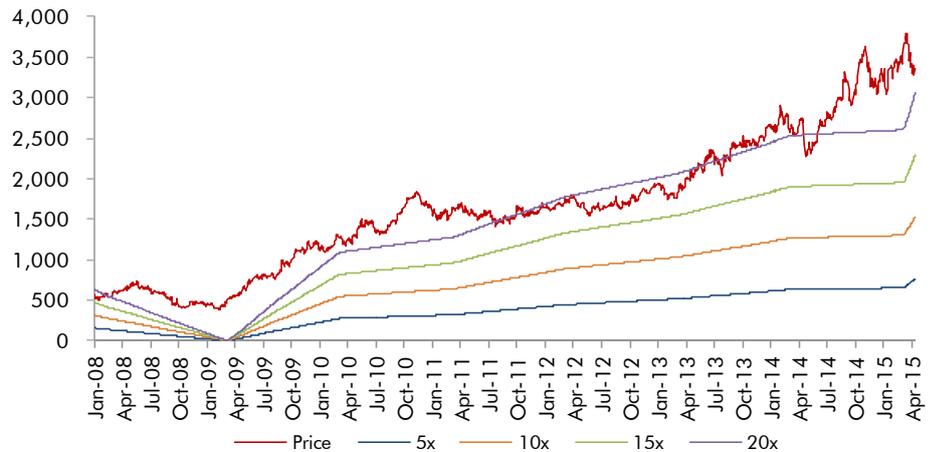
Domestic back in focus: DRL reported a 14.0% yoy growth in FY2015. The Management expects the company's performance to rebound and targets to achieve an above industry growth rate going ahead, driven by a) field force expansion and improvement in productivity, b) new product launches (including biosimilars) and c) focus on brand building. Overall, we expect sales in India to post a CAGR of ~16.1% over FY2015-17E.

Valuation: We expect net sales to grow at a CAGR of 17.0% to ₹20,296cr and adjusted EPS to record a 17.6% CAGR to ₹180.1 over FY2015-17E. **We recommend an accumulate rating on the stock.**

Exhibit 7: Key assumptions

	FY2016E	FY2017E
PSAI segment growth (%)	13.4	13.7
Generics segment growth (%)	20.1	18.1
Operating margin (%)	22.8	22.4
Capex (₹ cr)	1000	1000

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 (%)	PE (x)	FY2017E		FY15-17E	FY2017E	
						EV/Sales (x)	EV/EBITDA (x)	CAGR in EPS (%)	RoCE (%)	RoE (%)
Alembic Pharma.	Neutral	484	-	-	22.0	3.2	15.5	21.1	30.6	30.9
Aurobindo Pharma	Accumulate	1,342	1,502	11.9	17.9	2.7	12.3	13.7	21.4	27.5
Cadila Healthcare	Neutral	1,620	-	-	20.4	2.8	14.3	25.9	23.3	26.9
Cipla	Neutral	677	-	-	23.4	3.2	16.9	20.0	16.4	16.1
Dr Reddy's	Accumulate	3,493	3,963	13.5	19.4	2.8	12.7	17.6	19.4	20.8
Dishman Pharma	Buy	147	219	49.3	5.4	0.7	3.1	42.8	14.8	14.3
GSK Pharma*	Neutral	3,187	-	-	51.2	7.9	38.5	6.9	27.3	26.6
Indoco Remedies	Neutral	357	-	-	23.4	2.1	11.5	30.9	18.9	20.2
Ipca labs	Buy	653	810	24.0	14.5	1.8	9.7	24.3	18.1	19.4
Lupin	Neutral	1,691	-	-	22.8	3.8	14.6	18.3	31.1	24.7
Sanofi India*	Buy	3,175	3,749	18.1	23.7	2.5	15.1	25.1	22.0	22.5
Sun Pharma	Accumulate	955	1,064	11.4	25.1	4.9	15.1	15.4	26.2	24.9

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 & CIS, and Germany.

Profit & loss statement (IFRS Consolidated)

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015	FY2016E	FY2017E
Net sales	9,674	11,627	13,217	14,819	17,443	20,296
Other operating income	76.5	247.9	141.6	91.7	91.7	91.7
Total operating income	9,750	11,875	13,359	14,911	17,534	20,387
% chg	29.2	21.8	12.5	11.6	17.6	16.3
Total expenditure	7,076	8,951	10,096	11,535	13,463	15,754
Cost of revenues	3,598	4,825	4,977	5,531	6,398	7,534.02
SG&A expenses	2,887	3,358	3,878	4,259	5,006	5,825
R&D expenses	591.1	767.3	1,240.2	1,744.9	2,058.2	2,394.9
EBITDA	2,598	2,676	3,121	3,284	3,980	4,542
% chg	65.9	3.0	16.6	5.2	21.2	14.1
(% of Net Sales)	26.9	23.0	23.6	22.2	22.8	22.4
Depreciation & amortisation	745.4	743.7	659.8	747.4	927.4	990.1
EBIT	1,853	1,932	2,462	2,537	3,052	3,552
% chg	60.9	4.3	27.4	3.1	20.3	16.4
(% of Net Sales)	19.2	16.6	18.6	17.1	17.5	17.5
Interest & other charges	(16.0)	-	-	-	-	-
Other Income	-	46.0	40.0	168.2	168.2	168.2
(% of PBT)	-	2.1	1.5	6.0	5.0	4.4
Share in profit of associates	5.4	10.4	17.4	19.5	19.5	19.5
Recurring PBT	1,951	2,237	2,661	2,816	3,332	3,831
% chg	61.5	14.7	19.0	5.9	18.3	15.0
Extraordinary expense/(Inc.)	104.0	68.8	-	-	-	-
PBT (reported)	1,846.6	2,167.7	2,660.6	2,816.3	3,331.9	3,831.1
Tax	420.4	490.0	509.4	598.4	662.5	762.3
(% of PBT)	22.8	22.6	19.1	21.2	19.9	19.9
PAT (reported)	1,426.2	1,677.7	2,151.2	2,217.9	2,669.4	3,068.8
Add: Share of earnings of asso.	-	-	-	-	-	-
Less: Minority interest (MI)	-	-	-	-	-	-
Exceptional items	-	-	-	-	-	-
PAT after MI (reported)	1,426.2	1,677.7	2,151.2	2,217.9	2,669.4	3,068.8
ADJ. PAT	1,496.0	1,750.0	2,151.2	2,217.9	2,669.4	3,068.8
% chg	39.0	17.0	22.9	3.1	20.4	15.0
(% of Net Sales)	14.7	14.4	16.3	15.0	15.3	15.1
Basic EPS (₹)	88.2	103.1	126.7	130.2	156.7	180.1
Fully Diluted EPS (₹)	88.2	103.1	126.7	130.2	156.7	180.1
% chg	38.4	16.8	22.9	2.7	20.4	15.0

Balance sheet (IFRS Consolidated)

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015	FY2016E	FY2017E
SOURCES OF FUNDS						
Equity share capital	84.8	84.9	84.9	85.2	85.2	85.2
Preference Capital	-	-	-	-	-	-
Reserves & surplus	5,660	7,224	8,995	11,045	13,316	15,986
Shareholders funds	5,744	7,309	9,080	11,130	13,401	16,071
Minority Interest						
Total loans	4,831.2	3,676.0	4,474.2	3,954.3	3,954.3	3,954.3
Deferred tax liability	83.3	83.3	(192.9)	(401.3)	(401.3)	(401.3)
Total liabilities	10,659	11,068	13,361	14,683	16,954	19,624
APPLICATION OF FUNDS						
Net fixed assets	3,325	3,781	3,945	4,314	5,314	6,314
Goodwill /other intangibles	1,353	1,402	1,470	1,643	1,643	1,643
Capital Work-in-Progress	520.8	495.2	495.2	495.2	495.2	495.2
Investments	1,077	1,764	2,589	3,811	3,811	3,811
Current Assets	6,995	6,875	7,866	8,558	10,492	12,944
Cash	737.9	513.6	845	539	1,084	2,004
Loans & Advances	580.4	697.6	793.0	889.1	1,046.6	1,217.7
Other	5,677	5,664	6,228	7,129	8,362	9,723
Current liabilities	2,613	3,252	3,006	4,214	4,804	5,586
Net Current Assets	4,382	3,623	4,860	4,344	5,688	7,358
Other Assets	-	-		76		
Total Assets	10,659	11,068	13,361	14,683	16,954	19,624

Cash flow statement (IFRS Consolidated)

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015	FY2016E	FY2017E
Profit before tax	1,951	2,237	2,661	2,816	3,332	3,831
Depreciation	745	744	660	747	927	990
(Inc)/Dec in Working Capital	(1,661)	535	(906)	211	(800)	(750)
Less: Other income	-	46	40	168	168	168
Direct taxes paid	420	490	509	598	662	762
Cash Flow from Operations	614	2,980	1,865	3,008	2,629	3,141
(Inc.)/Dec.in Fixed Assets	(881)	(431)	(164)	(369)	(1,000)	(1,000)
(Inc.)/Dec. in Investments	(1,046)	687	824	1,222	-	-
Other income	-	46	40	168	168	168
Cash Flow from Investing	(1,928)	302	701	1,021	(832)	(832)
Issue of Equity	0	0	-	0	-	-
Inc./(Dec.) in loans	2,474	(1,155)	798	(520)	-	-
Dividend Paid (Incl. Tax)	259	298	358	399	399	399
Others	(1,255)	(2,649)	(3,390)	(4,214)	(1,652)	(1,788)
Cash Flow from Financing	1,478	(3,506)	(2,234)	(4,335)	(1,253)	(1,389)
Inc./(Dec.) in Cash	165	(224)	331	(306)	544	920
Opening Cash balances	573	738	514	845	539	1,084
Closing Cash balances	738	514	845	539	1,084	2,004

Key ratios

Y/E March	FY2012	FY2013	FY2014	FY2015	FY2016E	FY2017E
Valuation Ratio (x)						
P/E (on FDEPS)	39.6	33.9	27.6	26.8	22.3	19.4
P/CEPS	27.3	24.5	21.1	20.1	16.5	14.7
P/BV	10.3	8.1	6.5	5.3	4.4	3.7
Dividend yield (%)	0.4	0.4	0.4	0.4	0.4	0.4
EV/Sales	6.5	5.4	4.8	4.2	3.6	3.0
EV/EBITDA	24.4	23.3	20.2	19.2	15.7	13.5
EV / Total Assets	5.9	5.6	4.7	4.3	3.7	3.1
Per Share Data (₹)						
EPS (Basic)	88.2	103.1	126.7	130.2	156.7	180.1
EPS (fully diluted)	88.2	103.1	126.7	130.2	156.7	180.1
Cash EPS	128.0	142.6	165.5	174.0	211.1	238.2
DPS	14.0	15.0	15.0	15.0	15.0	15.0
Book Value	338.7	430.4	534.7	653.3	786.5	943.2
Dupont Analysis						
EBIT margin	19.2	16.6	18.6	17.1	17.5	17.5
Tax retention ratio	77.2	77.4	80.9	78.8	80.1	80.1
Asset turnover (x)	1.2	1.2	1.2	1.1	1.2	1.2
ROIC (Post-tax)	17.5	14.9	17.4	15.1	16.4	17.1
Cost of Debt (Post Tax)	0.0	0.0	0.0	0.0	0.0	0.0
Leverage (x)	0.6	0.6	0.4	0.4	0.3	0.2
Operating ROE	27.2	23.5	24.7	20.4	20.6	19.9
Returns (%)						
ROCE (Pre-tax)	20.9	17.8	20.2	18.1	19.3	19.4
Angel ROIC (Pre-tax)	29.6	23.1	25.6	22.5	23.7	24.3
ROE	28.9	26.8	26.3	21.9	21.8	20.8
Turnover ratios (x)						
Asset Turnover (Gross Block)	3.4	3.3	3.5	3.6	3.6	3.5
Inventory / Sales (days)	66	63	62	61	63	67
Receivables (days)	80	88	89	90	92	97
Payables (days)	46	44	40	43	42	41
WC cycle (ex-cash) (days)	105	104	97	96	88	89
Solvency ratios (x)						
Net debt to equity	0.7	0.4	0.4	0.3	0.2	0.1
Net debt to EBITDA	1.6	1.2	1.2	1.0	0.7	0.4
Interest Coverage (EBIT / Int.)	-	-	-	-	-	-

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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 (Based on expected returns over 12 months investment period):

Buy (> 15%)

Accumulate (5% to 15%)
Reduce (-5% to -15%)

Neutral (-5 to 5%)
Sell (< -15%)