

Dr Reddy's Labs

Estimate change

TP change

Rating change


Bloomberg	DRRD IN
Equity Shares (m)	166
M.Cap.(INRb)/(USDb)	649.8 / 8.1
52-Week Range (INR)	4100 / 2352
1, 6, 12 Rel. Per (%)	4/62/73
12M Avg Val (INR M)	2478

Financials & Valuations (INR b)

Y/E MARCH	2020	2021E	2022E
Sales	167.4	197.2	213.8
EBITDA	35.3	45.8	48.5
Adj. PAT	20.1	25.5	27.7
EBIT Margin (%)	13.7	16.0	15.9
Cons. Adj. EPS (INR)	121.3	153.9	166.6
EPS Gr. (%)	15.4	26.8	8.3
BV/Sh. (INR)	939.7	1,074.6	1,218.4

Ratios

Net D:E	-0.1	-0.2	-0.4
RoE (%)	13.6	15.3	14.5
RoCE (%)	15.5	14.9	14.5
Payout (%)	16.3	14.8	14.4

Valuations

P/E (x)	32.3	25.4	23.5
EV/EBITDA (x)	17.9	13.6	12.4
Div. Yield (%)	0.4	0.5	0.5
FCF Yield (%)	5.3	2.2	3.2
EV/Sales (x)	3.8	3.1	2.8

Shareholding pattern (%)

As On	Mar-20	Dec-19	Mar-19
Promoter	26.8	26.8	26.8
DII	14.4	15.1	14.5
FII	30.4	30.3	31.1
Others	28.5	27.9	27.6

FII Includes depository receipts

CMP: INR3,911
TP: INR3,775 (-3%)
Neutral

Superior execution in US/EU drives earnings

Controlled opex strengthens profitability

- Besides new launches and market share gains posted in existing products across key markets, Dr Reddy's Lab (DRRD) has benefited from the pre-purchases of medicines by patients in the US market; the company is also making strides in the newer markets in Europe. This has been offset, to some extent, by price erosion in the base business.
- We raise our EPS estimate by 2%/5% for FY21/FY22 to factor a healthy ANDA pipeline for the US market and a growing reach in the Europe markets. We further raise the PE multiple to 22x (from 21x earlier) to factor the resolution of compliance issues at all sites of DRRD. Accordingly, we revise our price target to INR3,775 (from INR3,490 earlier). Maintain Neutral.

Revenue growth + better margins drive earnings

- Revenue grew ~16% YoY to INR44.3b (our estimate: INR44.7b) in 4QFY20, led by all businesses, except Pharma Services and Active Ingredients (PSAI).
- The US business (40% of sales) was up 21% YoY to INR18.1b (USD240m). The Europe business (8% of sales) increased 80% YoY. The India business (15% of sales) was up 5% YoY to INR6.8b. Emerging Markets (18% of sales) expanded 15% YoY to INR8b, led by strong growth in the CIS segment. The PSAI segment (16% of sales) grew at a moderate rate of 6% YoY to INR7.2b.
- The gross margin (GM) improved 130bp YoY to 51.5% owing to a better product mix. Cost optimization (SGA expense was down 320bp YoY, partially offset by a slight increase in R&D spend) led to ~450bp YoY expansion in the EBITDA margin to 22.1%. EBITDA was up ~47% YoY to INR9.4b (v/s est. of INR10b).
- Furthermore, reported PAT was up at a higher rate of 76% YoY to INR7.6 owing to the recognition of MAT and creation of deferred tax assets. Adjusting for the same, PAT came in at INR5.7b for the quarter.
- For FY20, DRRD saw 10% YoY / 21% YoY / 15.4% YoY growth in sales/EBITDA/Adj. PAT to INR167b/INR35b/INR20b, led by strong growth in Europe, an outperforming Domestic Formulation (DF) segment, and the reduced impact of price erosion in the US market.

Highlights from management commentary

- DRRD intends to launch 25 ANDAs in the US in FY21.
- DRRD guided for the gross margin to be in the range of 52–54%.
- Capex would be ~INR10b for FY21, with the focus being on injectables and biosimilars.

Valuation and view

- We expect 17% earnings CAGR over FY20–22, led by new launches in the US, a better reach and increasing offerings in the EU, an outperforming Domestic Formulation segment, exercises in cost control, and improving productivity.
- We raise our EPS estimate by 2%/5% for FY21/FY22 and increase the PE multiple to 22x (from 21x earlier), arriving at a price target of INR3,775 (from INR3,490). We believe the sharp appreciation of ~50% witnessed over the past two months and the current valuation adequately factor earnings potential over the medium term. Hence, we maintain our Neutral stance on the stock.

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Investors are advised to refer through important disclosures made at the last page of the Research Report.

 Motilal Oswal research is available on www.motilalosal.com/Institutional-Equities, Bloomberg, Thomson Reuters, Factset and S&P Capital.

Quarterly performance – IFRS

(INR m)

Y/E March	FY19				FY20				FY19	FY20	Estimates	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q			4QE	% Var
Sales	37,207	37,978	38,500	38,366	38,435	40,809	43,838	44,318	1,52,051	1,67,400	44,656	-0.8
YoY Change (%)	12.2	7.1	1.2	8.5	3.3	7.5	13.9	15.5	7.1	10.1	16.4	
Total Expenditure	29,632	30,575	30,344	31,968	31,168	32,328	33,650	34,912	1,22,938	1,32,058	34,696	
EBITDA	7,575	7,403	8,156	6,398	7,267	8,481	10,188	9,406	29,113	35,342	9,960	-5.6
YoY Change (%)	147.7	11.6	6.4	16.1	-4.1	14.6	24.9	47.0	27.2	21.4	55.7	
Amortization	3,110	2,998	3,108	3,183	3,082	3,339	3,085	2,965	11,980	12,472	3,074	
EBIT	4,465	4,405	5,048	3,215	4,185	5,142	7,103	6,441	17,133	22,870	6,886	
YoY Change (%)	1,623.9	19.2	7.5	29.6	-6.3	16.7	40.7	100.3	53.9	33.5	114.2	
Interest	0	0	0	0	0	1	2	3	1	2	3	
Other Income	542	1,375	757	2,636	4,315	483	823	708	3,510	6,329	533	
One-off income/(expense)				1,800		2,039	-13,200		1,800	-11,168		
Profit before Tax	5,007	5,780	5,805	5,851	8,500	7,663	-5,276	7,146	22,442	18,033	7,415	-3.6
Tax	446	742	953	1,507	1,872	-3,261	423	-500	3,648	-1,466	1,332	
Rate (%)	8.9	12.8	16.4	25.8	22.0	-42.6	-8.0	-7.0	16.3	-8.1	18.0	
Reported PAT	4,561	5,038	4,852	4,344	6,628	10,924	-5,699	7,646	18,795	19,499	6,083	
Minority Interest	0	0	0	0	0	0	0	0	0	0	0	
Adjusted PAT	4,561	5,038	4,852	3,008	4,444	4,042	5,945	5,714	17,459	20,144	6,083	-6.1
YoY Change (%)	671.7	76.8	13.5	-0.5	-2.6	-19.8	22.5	90.0	62.6	15.4	102.2	
Margins (%)	12.3	13.3	12.6	7.8	11.6	9.9	13.6	12.9	11.5	12.0	13.6	

Key performance indicators (consolidated)

Y/E March	FY19				FY20				FY19	FY20
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
INRm										
North America	15,903	14,265	14,832	14,957	16,322	14,265	15,999	18,072	59,957	64,659
YoY Change (%)	6.4	(0.4)	(7.7)	3.2	2.6	0.0	7.9	20.8	0.2	7.8
Europe	2,016	1,915	2,030	1,912	2,404	2,764	3,093	3,446	7,873	11,707
YoY Change (%)	(2.8)	(21.0)	1.2	11.7	19.2	44.3	52.4	80.2	(4.2)	48.7
India	6,074	6,864	6,741	6,505	6,960	7,511	7,636	6,839	26,179	28,946
YoY Change (%)	29.6	7.8	10.0	6.0	14.6	9.4	13.3	5.1	12.3	10.6
Russia & Others CIS	5,000	5,200	5,500	4,800	5,200	5,800	6,699	5,700	20,500	23,400
YoY Change (%)	13.6	26.8	25.0	29.7	4.0	11.5	21.8	18.8	24.2	14.1
Others	1,643	2,292	2,244	2,121	2,100	2,500	2,500	2,342	8,394	9,411
YoY Change (%)	22.0	63.0	49.6	17.8	27.8	9.1	11.4	10.4	36.4	12.1
PSAI	5,409	6,029	5,937	6,765	4,539	7,107	6,906	7,195	24,140	25,747
YoY Change (%)	16.3	6.6	9.2	8.2	(16.1)	17.9	10.0	6.4	9.8	6.7
Cost Breakup										
COGS (% of Sales)	44.3	45.0	46.1	49.8	48.3	48.5	45.9	48.5	46.3	47.8
SG&A (% of Sales)	24.2	24.7	23.2	24.0	23.4	21.8	21.9	20.8	24.3	21.9
R&D Expenses(% of Sales)	11.2	10.8	9.5	9.5	9.4	9.0	9.0	9.5	10.3	9.2
Gross Margins(%)	55.7	55.0	53.9	50.2	51.7	51.5	54.1	51.5	53.7	52.2
EBITDA Margins(%)	20.4	19.5	21.2	16.7	18.9	20.8	23.2	21.2	19.1	21.1
EBIT Margins(%)	12.0	11.6	13.1	8.4	10.9	12.6	16.2	14.5	11.3	13.7

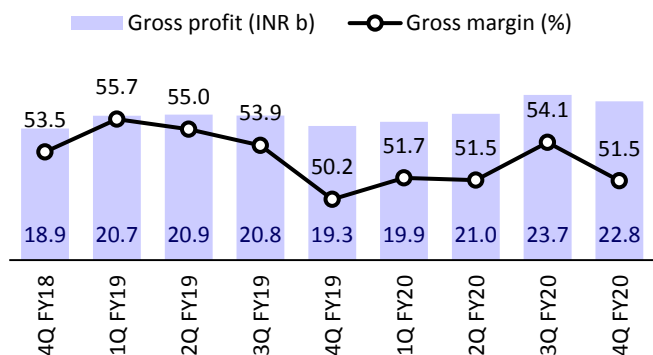


Conference call highlights

- Part of the receivables increase was due to collection issues. These issues are being resolved and collections are gradually improving.
- DRRD remains confident of gaining market share in g-Suboxone.
- A change in the business mix and inventory write-offs had an impact on gross margins for the quarter.
- The deal to acquire the DF portfolio from Wockhardt is expected to close in 1QFY21.

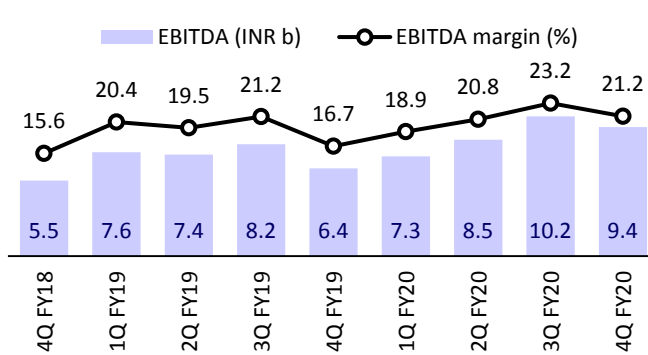
Key exhibits

Exhibit 1: Gross margin up 130bp YoY



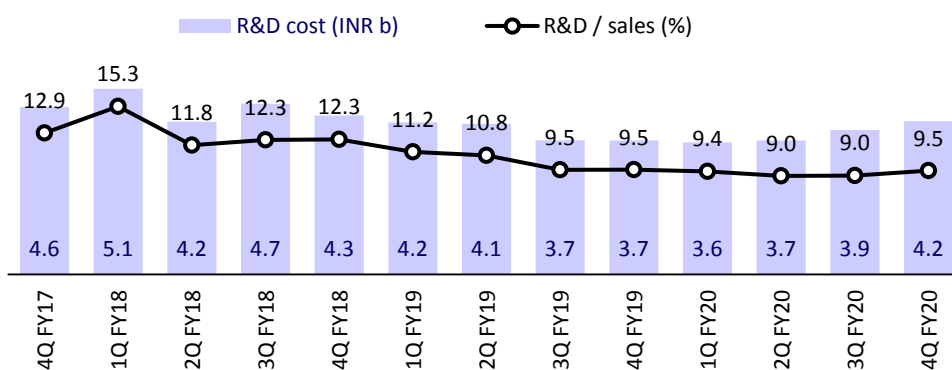
Source: Company, MOSL

Exhibit 2: EBITDA margin expands ~450bp YoY



Source: Company, MOSL

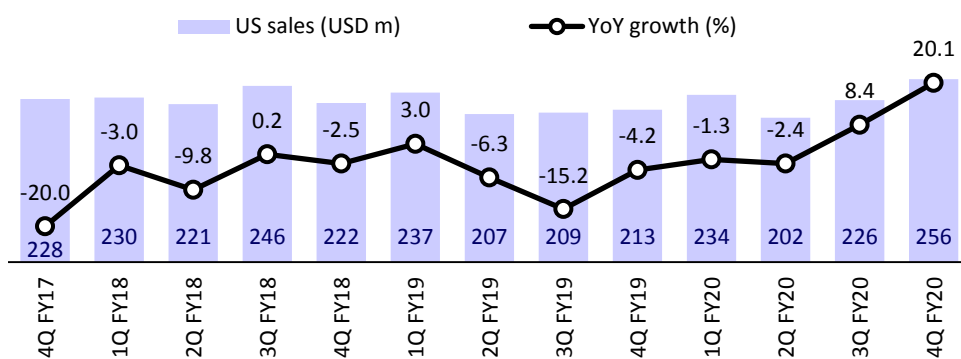
Exhibit 3: R&D expense account for 9.5% of sales, stable on YoY basis



Source: MOSL, Company

Multiple levers drive growth in US for quarter

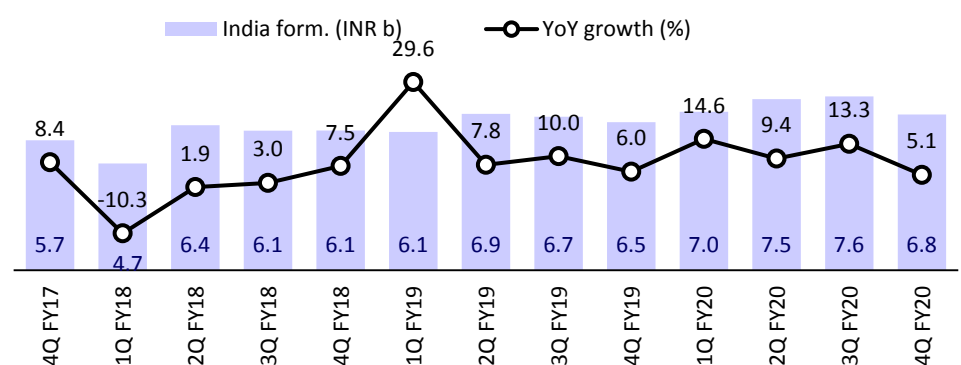
- The US business' revenue grew 21% YoY to INR18.1b (USD240m) in 4QFY20. Revenue increased on account of volume increases and new launches, partially offset by price erosion. Higher volumes in Q4FY20 were also driven by COVID-19-related pre-buying in the US. This has eased in Q1FY21.
- Price erosion has been stabilizing over the years in the US market.
- Particularly, in 4QFY20, DRRD had five new launches.
- At the end of 4QFY20, DRRD had 99 filings (97 ANDAs and 2 NDAs) pending approval. Of the 97 ANDAs, 54 are Para IV filings (30 being FTFs).

Exhibit 4: US sales growth recovers

Source: MOSL, Company

India business posts muted growth due to COVID-19-led supply constraints

DRRD delivered 5% YoY growth in India for 4QFY20, impacted by the country-wide lockdown imposed to curb the outbreak of COVID-19 and the resultant disruption in the supply chain. According to AIOCD, growth in volume/price/new launches stood at 8.7%/7.8%/2.5% on a 12M basis.

Exhibit 5: Subdued YoY growth in India business

Source: MOSL, Company

CIS, RoW sales drive growth in EM

- The overall EM business grew 15% YoY to INR8b.
- Better volume traction, aided by new launches, led to 51% YoY growth in CIS sales to INR1.8b.
- Better realizations and volume growth led to growth of 8% YoY to INR3.9b in Russia.
- RoW grew at 6% YoY to INR2.3b on the introduction of new products and volume traction in existing products, partially offset by price erosion in some key molecules.

Addition of new markets, better traction in existing markets leads growth in Europe

- Europe sales surged 80% YoY to INR3.4b on account of improved volumes in the base business and better off-take of new launches.
- This segment was, to a certain degree, affected by lower realizations in some key molecules that were part of the tender business.

Valuation view

ANDA launch engine intact for US market

- After three years of YoY decline in US sales, DRRD exhibited 5% growth in FY20, led by new launches, better market share, and the reduced impact of price erosion in the base portfolio. DRRD launched 25 ANDAs in the US market. It intends to launch a similar number of ANDAs for FY21 as well, providing almost certain growth visibility over the next two to three years. Overall, based on the robust pipeline of 99 ANDAs pending approval and a better execution pace, DRRD is expected to deliver a 6% sales CAGR to USD1b over FY20–22.

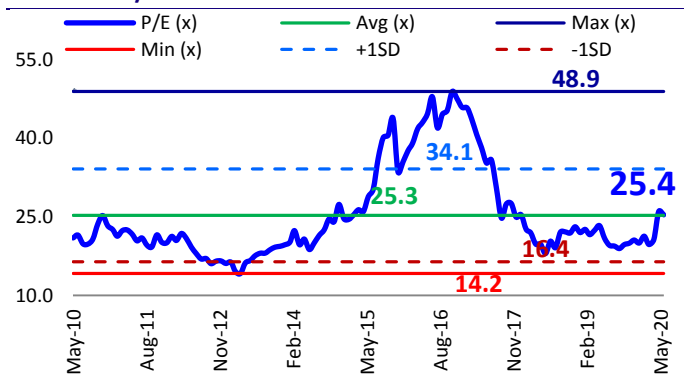
Superior execution on in-house/acquired products to drive outperformance in DF

- We expect changing lifestyles to increase the patient base in chronic diseases. Accordingly, new launches, supported by robust marketing efforts, are likely to drive growth in the Branded Generics business. Particularly, for India, DRRD is actively working on improving the share of the Chronic and Super Specialty categories. The company not only aims to improve the growth rate but also drive sustainability in the business. Around 66% of DF sales (led by the top 50 brands) are growing faster than the industry, driving growth in the India business (up 11% YoY for FY20). Furthermore, building synergies on portfolios acquired from Wockhardt would aid growth prospects over the next 15–18M. Overall, we expect a 21% CAGR in DF sales to INR42b over FY20–22.
- Moreover, DRRD is also extending its portfolio for the China market through participation in the branded/hospitals/GPO, and API spaces. We expect a 12% CAGR in other emerging markets over FY20–22.

Valuation and view

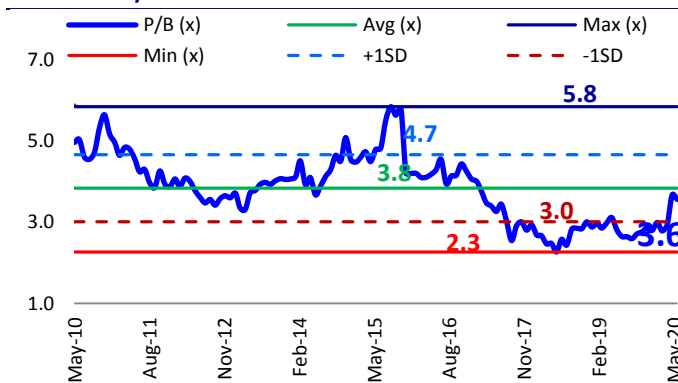
- We raise our EPS estimate by 2%/5% for FY21/FY22 to factor a healthy ANDA pipeline for the US market and increasing reach in the Europe market. We also raise the PE multiple to 22x (from 21x earlier) to factor the resolution of compliance issues at all sites of DRRD. Accordingly, we revise our price target to INR3,775 (from INR3,490 earlier). We believe the sharp appreciation of ~50% over the past two months and the current valuation adequately factor earnings potential over the medium term. Hence, we maintain our Neutral stance on the stock.

Exhibit 6: P/E chart



Source: MOFSL, Company, Bloomberg

Exhibit 7: P/B chart



Source: MOFSL, Company, Bloomberg

Financials and valuations

Income statement								(INR m)	
Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E
Net Sales	1,32,171	1,48,189	1,54,708	1,40,809	1,42,028	1,52,051	1,67,400	1,97,215	2,13,835
Change (%)	13.7	12.1	4.4	-9.0	0.9	7.1	10.1	17.8	8.4
EBITDA	31,699	33,472	39,088	24,155	22,891	29,113	35,342	45,754	48,541
Change (%)	28.0	5.6	16.8	-38.2	-5.2	27.2	21.4	29.5	6.1
Margin (%)	24.0	22.6	25.3	17.2	16.1	19.1	21.1	23.2	22.7
Depreciation & Amort.	7,085	8,103	10,343	11,722	11,762	11,980	12,472	14,199	14,541
EBIT	24,614	25,369	28,745	12,433	11,129	17,133	22,870	31,554	34,000
Net Interest Exp	79	77	334	0	817	1,163	983	603	568
One-off (Gains)/Losses	-329	0	2,374	0	0	-1,800	11,168	0	0
PBT & EO Expense	26,616	28,163	27,140	14,653	14,341	22,443	18,031	32,752	35,232
Change (%)	22.8	5.8	-3.6	-46.0	-2.1	56.5	-19.7	81.6	7.6
PBT after EO Expense	26,616	28,163	27,140	14,653	14,341	22,443	18,033	32,752	35,232
Tax	5,093	5,984	7,127	2,614	4,535	3,648	-1,466	7,205	7,575
Tax Rate (%)	19.1	21.2	26.3	17.8	31.6	16.3	-8.1	22.0	21.5
Reported PAT	21,524	22,179	20,013	12,039	9,806	18,795	19,499	25,546	27,657
Adjusted Net Profit	21,188	22,179	22,577	12,039	10,736	17,459	20,144	25,546	27,657
Change (%)	54.9	4.7	1.8	-46.7	-10.8	62.6	15.4	26.8	8.3
Margin (%)	16.0	15.0	14.6	8.5	7.6	11.5	12.0	13.0	12.9

Balance sheet								(INR m)	
Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E
Equity Share Capital	851	852	853	829	830	830	830	830	830
Reserves	89,950	1,10,450	1,24,845	1,21,792	1,24,886	1,39,406	1,55,158	1,77,547	2,01,423
Net Worth	90,801	1,11,302	1,25,698	1,22,621	1,25,716	1,40,236	1,55,988	1,78,377	2,02,253
Loans	44,742	43,126	33,403	49,075	50,651	34,125	17,836	9,836	8,836
Deferred Liabilities/Tax	-3,310	-4,013	-5,368	-5,164	-3,455	-3,844	-12,179	-12,179	-12,179
Capital Employed	1,32,233	1,50,414	1,53,733	1,66,532	1,72,912	1,70,517	1,61,645	1,76,034	1,98,910
Gross Block	52,958	72,011	81,635	92,605	99,286	1,15,385	1,26,148	1,35,575	1,45,938
Less: Accum. Deprn.	21,213	30,040	35,505	42,324	49,553	61,533	74,005	88,204	1,02,745
Net Fixed Assets	37,814	48,090	52,756	56,376	57,411	53,852	52,143	47,371	43,192
Investments	26,384	38,871	41,854	26,317	28,935	30,769	33,264	33,264	33,264
Goodwill/Intangibles	14,697	16,430	20,596	46,176	46,974	47,393	31,711	31,711	31,711
Curr. Assets	78,664	85,580	82,730	82,512	86,718	88,325	1,02,936	1,21,582	1,52,558
Inventory	23,992	25,529	25,579	28,528	29,089	33,579	35,067	46,861	50,988
Account Receivables	33,037	40,755	41,250	38,196	40,696	39,982	52,015	52,514	61,216
Cash and Bank Balance	8,451	5,394	4,921	3,865	2,638	2,228	2,053	6,430	23,247
Others	13,184	13,901	10,980	11,923	14,295	12,536	13,801	15,777	17,107
Curr. Liability & Prov.	31,936	38,556	44,203	44,849	47,126	49,822	58,409	58,001	62,024
Account Payables	10,503	10,660	9,068	10,569	13,345	13,671	15,248	17,522	18,917
Other Current Liabilities	21,433	27,896	35,135	34,280	33,781	36,151	43,161	40,479	43,107
Net Current Assets	46,728	47,024	38,527	37,663	39,592	38,503	44,527	63,581	90,534
Appl. of Funds	1,25,623	1,50,414	1,53,733	1,66,532	1,72,912	1,70,517	1,61,645	1,76,034	1,98,910

Financials and valuations

Ratios

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E
EPS	124.6	130.2	132.3	72.6	64.7	105.2	121.3	153.9	166.6
Cash EPS	166.2	177.7	193.0	143.3	135.5	177.3	196.5	239.4	254.2
BV/Share	533.8	653.2	736.8	739.6	757.3	844.8	939.7	1,074.6	1,218.4
DPS	18.0	20.0	20.0	20.0	20.0	20.0	16.4	19.5	20.5
Payout (%)	16.6	18.5	20.5	33.1	40.7	21.3	16.3	14.8	14.4
Valuation (x)									
P/E	31.4	30.1	29.6	53.9	60.5	37.2	32.3	25.4	23.5
PEG (x)	0.6	6.4	16	NA	-6	1	2.1	0.9	2.8
P/BV	7.3	6.0	5.3	5.3	5.2	4.6	4.2	3.6	3.2
EV/Sales	5.0	4.4	4.1	4.7	4.7	4.3	3.8	3.1	2.8
EV/EBITDA	20.8	19.4	16.3	27.7	29.2	22.4	17.9	13.6	12.4
Dividend Yield (%)	0.5	0.5	0.5	0.5	0.5	0.5	0.4	0.5	0.5
Return Ratios (%)									
ROIC	23.6	20.9	21.2	8.9	5.8	10.8	19.4	19.4	19.8
RoE	25.9	21.9	19.1	9.7	8.6	13.1	13.6	15.3	14.5
RoCE	16.6	14.2	14.1	6.4	4.8	8.9	15.5	14.9	14.5
Working Capital Ratios									
Fixed Asset Turnover (x)	2.7	2.4	2.0	1.6	1.5	1.4	1.4	1.5	1.5
Debtor (Days)	91	91	97	103	101	97	100	97	97
Inventory (Days)	66	61	60	70	74	75	75	76	84
Leverage Ratio									
Net Debt/Equity (x)	0.0	-0.1	-0.1	0.1	0.1	0.0	-0.1	-0.2	-0.4

Cash flow statement

(INR m)

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E
Op. Profit/(Loss) before Tax	26,616	28,163	27,140	14,653	14,341	22,443	18,031	32,752	35,232
Depreciation	7,085	8,103	10,343	11,722	11,762	11,980	12,472	14,199	14,541
Interest/Dividends Recd.	-2,082	-2,871	1,271	-2,220	-4,029	-6,473	3,856	-1,200	-1,200
Direct Taxes Paid	-5,093	-5,984	-7,127	-2,614	-4,535	-3,648	1,466	-7,205	-7,575
(Inc)/Dec in WC	-5,265	-3,353	8,024	-192	-3,156	679	-6,199	-14,677	-10,136
CF from Operations	21,262	24,059	39,651	21,349	14,383	24,981	29,626	23,868	30,862
CF from Operating incl EO Expense	21,262	24,059	39,651	21,349	14,383	24,981	29,626	23,868	30,862
(inc)/dec in FA	-14,041	-13,502	-21,550	-40,922	-13,595	-8,840	4,919	-9,427	-10,363
Free Cash Flow	7,221	10,557	18,101	-19,573	788	16,141	34,545	14,441	20,499
(Pur)/Sale of Investments	-6,501	-9,617	-1,880	17,757	1,411	2,839	-2,495	0	0
CF from Investments	-20,542	-23,118	-23,430	-23,165	-12,184	-6,001	2,424	-9,427	-10,363
Change in net worth	-247	2,418	-1,512	-11,130	-2,719	-273	-563	623	199
(Inc)/Dec in Debt	8,064	-1,617	-9,723	15,672	1,576	-16,526	-16,289	-8,000	-1,000
Other Items	-1,641	-703	-1,355	204	1,709	1,411	-12,189	1,098	1,098
Dividend Paid	-3,581	-4,095	-4,105	-3,986	-3,992	-4,002	-3,184	-3,780	-3,979
CF from Fin. Activity	2,595	-3,997	-16,694	760	-3,426	-19,390	-32,225	-10,060	-3,682
Inc/Dec of Cash	3,315	-3,057	-473	-1,056	-1,227	-410	7,355	4,382	16,817
Add: Beginning Balance	5,136	8,451	5,394	4,921	3,865	2,638	2,228	2,053	6,430
Closing Balance	8,451	5,394	4,921	3,865	2,638	2,228	2,053	6,430	23,247

NOTES

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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