May 15, 2017

Rating matrix		
Rating	:	Hold
Target	:	₹ 2610
Target Period	:	12-15 months
Potential Upside	:	-2%

What's Changed?	
Target	Changed from ₹ 3300 to ₹ 2610
EPS FY18E	Changed from ₹ 114.1 to ₹ 106.1
EPS FY19E	Changed from ₹ 154.3 to ₹ 137.3
Rating	Unchanged

Quarterly Performance

	Q4FY17	Q4FY16	YoY (%)	Q3FY17	QoQ (%)
Revenue	3,554.2	3,756.2	-5.4	3,706.5	-4.1
EBITDA	538.3	810.4	-33.6	871.3	-38.2
EBITDA (%)	15.1	21.6	-643.0	23.5	-836.2
Adjusted PAT	302.3	499.6	-39.5	461.2	-34.5

Key Financials

(₹crore)	FY16	FY17E	FY18E	FY19E
Revenues	15470.9	14080.9	15176.9	17301.2
EBITDA	3982.5	2426.5	3424.5	4160.9
Adjusted PAT	2409.5	1169.5	1808.4	2339.1
EPS (Adjusted)	141.4	68.6	106.1	137.3

Valuation summary

	FY16	FY17E	FY18E	FY19E
PE (x)	22.7	37.8	24.9	19.3
Target PE (x)	18.5	38.0	24.6	19.0
EV to EBITDA (x)	11.3	19.1	13.0	10.4
Price to book (x)	3.9	3.7	3.3	2.9
RoNW (%)	20.6	9.4	13.0	14.7
RoCE (%)	17.3	6.3	10.8	13.7

Stock data

Particular	Amount
Market Capitalisation	₹ 44256 crore
Debt (FY17E)	₹ 4919 crore
Cash & cash equivalents (FY17E)	₹ 1165 crore
EV	₹ 48010 crore
52 week H/L (₹)	3690/2555
Equity capital	₹ 82.8 crore
Face value	₹ 5

Price performance (%)

	1M	3M	6M	1Y
Dr Reddy's Labs	-2.4	-13.3	-20.7	-13.1
Sun Pharma	-4.1	0.0	-4.8	-18.5
Lupin	-12.9	-14.5	-14.0	-22.4

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Dr Reddy's Laboratories (DRREDD) ₹ 2671

US performance continues to weigh on numbers…

- Revenues declined 5% YoY to ₹ 3554 crore (I-direct estimate: ₹ 3632 crore) mainly due to 19% decline in US sales to ₹ 1535 crore (I-direct estimate: ₹ 1610 crore) led by increased competition in key products coupled with discontinuance of McNeil contract
- EBITDA margins declined 643 bps to 15.1% (I-direct estimate: 21.3%) mainly due to a sharp decline in gross margins by 549 bps to 51.2% (I-direct estimate: 56%) led by one-offs
- Adjusted net profit fell 40% YoY to ₹ 338 crore (I-direct estimate: ₹ 406 crore) mainly due to lower operational performance

US business passing through rough patch

US business grew 15% to ₹ 6360 crore over FY12-17 mainly driven by new launches. US remains a key driver for the company, contributing ~45% to total revenues. Current US pending pipeline comprises 101 pending approvals (62 Para IV filings and 21 FTFs) including two NDAs. The company has developed a knack for exclusivity/FTF launches on a fairly continuous basis in US. However, warning letter for its Srikakulam API and other facilities besides price erosion in key products has changed equations. We expect DRL's US revenues to normalise from H2FY18 by resolution of warning letter and incremental product launches. We expect US sales to grow at a CAGR of 10% to ₹ 7653 crore in FY17-19E.

Russia CIS provides strong growth, India to provide more stability

Global generics (ex US, Europe) is likely to grow at a steady CAGR of 8% in FY17-19E driven by growth in India as the Russian performance remains volatile. These two markets are more or less identical in nature (branded generics and OTC) with similar growth potential and similar kinds of risks. DRL is well versed with the dynamics in Russia by virtue of being an early mover. We expect strong growth in these markets on the back of stabilise currency, geographical expansion, robust biological portfolio and ramp up in institutional business. For India, growth is expected to be largely from launches in the oncology and biosimilars space, UCB like acquisitions besides an improvement in productivity.

Portfolio realignment eminent

We envisage a fall in share of low margin segments such as PSAI, going ahead. Thus, growth in FY17-19E is likely to emanate from more productive and sustainable segments such as the US, India and biosimilar in emerging markets. Similarly, in terms of product offering, we envisage more launches in the fields of injectables, OTC, complex/limited competition products, proprietary products and biosimilars.

Recovery in US key event to be watched; maintain HOLD

The company witnessed perhaps the worst FY17 performance in recent times wherein revenues were impacted by US warning letter, pricing pressure in the base business, delay in approvals and issues in Venezuela. Profitability was affected due to adverse product mix, higher remedial costs and one-offs. Despite bolstering a sound US portfolio, pricing pressure owning to client consolidation and macroeconomic headwinds along with cGMP issues and delay in product approvals have emerged as major stumbling block. The management expects gradual recovery in the overall performance but remains cautiously optimistic about US prospects. Some hope of US recovery can be attributable to aggressive ANDA filings (13) in Q4. Apart from US, Global Generics (ex US, Europe) growth is expected to recover on the back of stabilise currency, geographical expansion, robust biosimilar portfolio and ramp up in institutional business. We have ascribed a target price of ₹ 2610 based on 19x FY19E EPS of ₹ 137.

Variance analysis

	Q4FY17	Q4FY17E	Q4FY16	Q3FY17	YoY (%)	QoQ (%)	Comments
Revenue	3,554.2	3,631.7	3,756.2	3,706.5	-5.4	-4.1	YoY decline in sales mainly on the back of price erosion and increased competition in key products in the US and Venezuela
Raw Material Expenses	1,736.0	1,596.2	1,628.6	1,516.6	6.6	14.5	
Gross Profit	1,818.2	2,035.5	2,127.6	2,189.9	-14.5	-17.0	
Gross Margins (%)	51.2	56.0	56.6	59.1	-548.6	-792.6	Global generic and PSAI segment gross margins were 61.6% and 21.0%, respectively. Impairment charge recorded at antibiotics manufacturing facility at Bristol (US) and incremental provision of inventory build-up in anticipation of new product launch that failed to materialise has sequentially reduced overall gross margins by 793 bps
SG&A	872.5	871.6	860.0	841.7	1.5	3.7	
R&D Expenditure	457.9	399.5	487.9	495.6	-6.1	-7.6	
Other (income)/expenses	-50.5	-9.1	-30.7	-18.7	64.5	170.1	
EBITDA	538.3	773.5	810.4	871.3	-33.6	-38.2	YoY decline mainly on account adverse product mix. miss vis-à-vis I-direct estimate was mainly due to lower-than-expected gross margins as well as higher SG&A expenses
EBITDA (%)	15.1	21.3	21.6	23.5	-643.0	-836.2	
Finance (income)/ expenses	4.8	-37.0	-166.3	-4.4	-102.9	-209.1	Net forex loss of ₹ 7.4 crore against ₹ 413.3 crore in Q4FY16 primarily related to Venezuela adjustment. Profit from sale of investment increased by ₹ 10.5 crore YoY while interest income declined by ₹ 65 crore
Depreciation	224.8	292.4	303.2	292.4	-25.9	-23.1	
Exceptional Items	0.0	0.0	430.9	0.0	NA	NA	
Forex & EO	-10.2	-5.0	-5.9	-8.9	72.9	14.6	
PBT	318.9	523.0	248.5	592.2	28.3	-46.1	
Tax	6.4	112.5	173.9	122.1	-96.3	-94.8	The lower tax rate primarily due to resolution of certain tax matters pertaining to prior years
Net Profit	312.5	410.6	74.6	470.1	318.9	-33.5	
Adjusted PAT	302.3	405.6	499.6	461.2	-39.5	-34.5	YoY de-growth largely due to weak operational performance
Key Metrics							
US	1,534.9	1,609.8	1,895.0	1,659.5	-19.0	-7.5	YoY decline primarily on account of increased competition in key products and loss of McNeil business
Europe	206.6	193.5	175.9	214.8	17.5	-3.8	YoY growth on the back of new product launches and traction in new markets
India	571.1	579.4	526.7	594.7	8.4	-4.0	YoY growth driven by volume growth and new product launches partly offset by NLEM impact
Russia & Other CIS	450.0	385.6	321.3	410.0	40.1	9.8	Registered 8% constant currency growth YoY in Russia. In Q4, the company has commenced supplies to national tender for rituximab in Russia
RoW	151.2	174.5	158.6	184.8	-4.7	-18.2	YoY growth was impacted by Venezuela. Miss vis-à-vis I-direct estimates was mainly due to lower than expected off take from new geographies and biosimilars portfolio
PSAI	540.1	576.6	576.6	540.0	-6.3	0.0	

Source: Company, ICICIdirect.com Research

Change in estimates

	FY18E			FY19E			
(₹ Crore)	Old	New	% Change	Old	New	% Change	
Revenue	15,857.7	15,176.9	-4.3	18,671.7	17,301.2	-7.3	Reduced mainly due to a higher-than-expected price erosion in base business and delay in product approvals in the US
EBITDA	3,578.1	3,424.5	-4.3	4,490.5	4,160.9	-7.3	
EBITDA Margin (%)	22.6	22.6	0 bps	24.1	24.1	0 bps	
Adjusted PAT	1,955.1	1,808.4	-7.5	2,633.2	2,339.1	-11.2	Changed in sync with EBITDA and change in tax rate as per management guidance
EPS (₹)	114.7	106.1	-7.5	154.5	137.3	-11.2	

Source: Company, ICICIdirect.com Research

Assumptions

			Current		Earlier		Comments
(₹ crore)	FY16	FY17E	FY18E	FY19E	FY18E	FY19E	
US	7,544.5	6,360.1	6,554.3	7,653.4	7,427.1	9,283.8	Reduced mainly due to a higher-than-expected price erosion in base business and delay in product approvals
Europe	773.2	760.5	872.3	959.6	800.6	880.7	
India	2,129.2	2,313.2	2,590.8	2,901.7	2,600.0	2,990.1	
Russia & Other CIS	1,419.1	1,520.0	1,823.0	2,187.6	1,673.9	1,925.0	Increased mainly due to ramp up in biosimilars and institutional business
RoW	940.2	587.1	666.6	760.9	634.4	697.9	Increased mainly due to geographical expansion and better-than-expected ramp-up in biosimilars segment
PSAI	2,238.0	2,127.7	2,170.3	2,213.7	2,207.5	2,251.6	

Source: Company, ICICIdirect.com Research

Company Analysis

Established in 1984, Dr Reddy's Laboratories (DRL) is one of India's pedigreed players having a firm footing in the US and other export markets with deep rooted product and market knowledge across therapies. Like Cipla, DRL also recognised the importance of having good manufacturing practices (GMP) accreditation in the eighties and eventually got USFDA approval (first of its kind approval for a formulation facility in India) in 1987. The company owns 22 manufacturing facilities and four developing centres across the globe. The facilities have been approved by various agencies such as the USFDA, WHO-Geneva, UKMHRA, TGA-Australia, MCC-South Africa, DMA Denmark, Brail ANVISA, among others. Over the years, along with generics the company also established itself in the field of discovery of new chemical entities (NCEs) but with little success.

DRL's business can be classified into three broad segments- 1) Global Generics (GG), 2) Pharmaceutical Services and Active Ingredients (PSAI) and 3) Proprietary Products (PP). Global Generics (82% of revenues) includes branded and unbranded prescription and over-the-counter (OTC) products business. It also includes the operations of the biologics business. This segment comprises formulation sales to regulated markets of the US, Europe and emerging markets such as Russia/CIS, India and RoW.

Pharmaceutical services and active ingredients (15.1% of the revenues) consist of the active pharmaceutical ingredients (API) business and custom pharmaceutical services (CPS) business. Proprietary products (PP, 3% of revenues) consist of NCEs, differentiated formulations and dermatology focused specialty business operated through Promius Pharma.

DRL is one of the few Indian companies to foray into new drug discovery & development (NDDS) and new chemical entity (NCE) research. The company started research operations in 1992 through a non profit organisation, Dr Reddy's Research Foundation, which was later merged into the company. Despite being an early entrant, the company is yet to taste success in it. DRL is also the first Indian company to out-license molecules to big pharma companies.

DRL has spent around 13.9% of the turnover on R&D in FY17 and is likely to be in the range of 11-12%, going ahead. Beside ANDAs it has also filed three new drug applications (NDAs) in the 505(b)(2) route which are awaiting approval.

The company has launched ZEMBRACE SymTouch under 505(b)(2) route in the US. ZEMBRACE SymTouch is a prefilled, low-dose, ready-to-use Sumatriptan. Because ZEMBRACE SymTouch is a subcutaneous injection, it may lead to rapid relief of migraine.

It has also Sernivo, a prescription topical steroid spray, used for mild to moderate plaque psoriasis.

The company entered into a license agreement with XenoPort for exclusive US rights for XP23829 on milestone and double digit royalty basis. DRL plans to develop XP23829 as a potential treatment for moderate-to-severe chronic plaque psoriasis and may potentially develop XP23829 for relapsing forms of multiple sclerosis (MS). In September 2015, XenoPort announced results of a Phase II clinical trial of XP23829 as

a potential treatment for moderate-to-severe chronic plaque-type psoriasis.

The company also entered in to licensing agreement with Eisai for exclusive worldwide development and commercialisation rights (excluding Japan and Asia) for investigational anticancer agent E7777. A Phase II clinical study of the agent in patients with cutaneous T-cell lymphoma or peripheral T-cell lymphoma is currently underway in Japan. Preparations are simultaneously in progress for a Phase III clinical study of the agent in patients with cutaneous T-cell lymphoma in the US

Exhibit 1: Product Pipeline

Compound	Therapeutic Area	Developments	Patents Associated	Current Status
DFD 09	Dermatology	Successful completion of bioequivalence studies.	Patent applications are filed in India.	NDA Submitted
DFN 11	Migraine	Successful completion of three bioequivalence studies.	None.	NDA Submitted
DFD 06	Psoriasis	Non clinical activities are in progress, Phase II studies completed and Phase III studies initiated. Registration batches have been made.	No patents granted.	Phase III
DFD 01	Psoriasis	Phase III studies have been completed and U.S. NDA application has been filed in April 2015.	No patents granted. Patent applications are pending in certain countries.	NDA Submitted
DFD 02	Migraine	Pivotal bioequivalence studies were completed. Patient safety study initiated.	Patents expiring in: US - 2026; Australia and New Zealand – 2029, and South Africa - 2030. Patent applications are pending in certain other countries.	Phase III

Source: Company, ICICIdirect.com Research

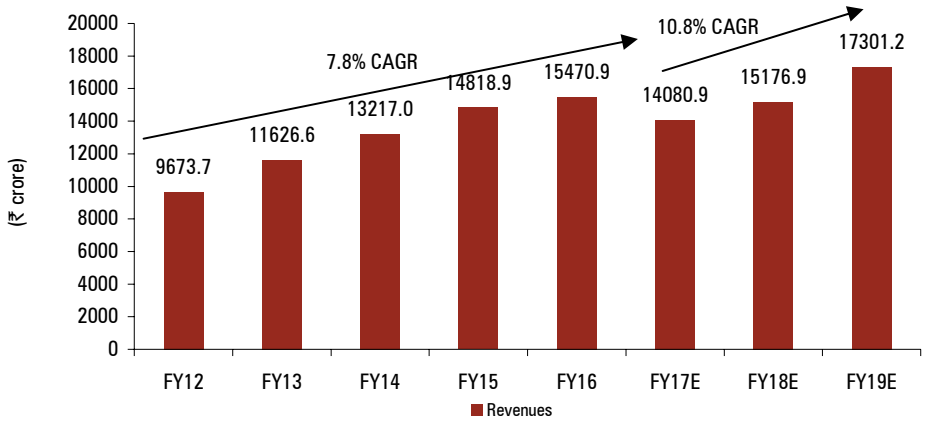
To strengthen its domestic portfolio, in FY16, the company has acquired selected domestic portfolio from UCB in the areas of dermatology, respiratory and paediatrics diseases. The revenues of the acquired business is ~₹ 150 crore in 2014. This acquisition has enhanced DRL's presence into fast growing chronic segments.

In FY15, the company has acquired Habitrol brand, an OTC nicotine replacement therapy transdermal patch, from Novartis Consumer Health Inc as mandated under the competition laws.

In November 2015, the company received a warning letter from the USFDA for three of its manufacturing facilities. These include two API facilities at Srikakulam, Andhra Pradesh and Miryalaguda, Telangana and one oncology formulation facility at Duvvada, Vishakhapatnam.

We expect revenues to grow at a CAGR of 11% to ₹ 17301 crore in FY17-19E. The US is likely to grow at a CAGR of 10% to ₹ 7653 crore during the same period. We expect US revenues to normalise from H2FY18 by resolution of warning letter and incremental product launches. India is showing promising growth as well with a recalibrated approach and the recent acquisition (UCB's India business) bodes well for the future. Russia, RoW and the PSAI segments have also shown strong growth on the back of geographical expansion, robust biological portfolio and ramp up in institutional business.

Exhibit 2: Revenues to grow at CAGR of 11% in FY17-19E



Source: Company, ICICIdirect.com Research

Exhibit 3: Geography wise revenue break up

(₹ crore)	FY12	FY13	FY14	FY15	FY16	FY17E	FY18E	FY19E
US	3188.9	3784.6	5530.3	6473.4	7544.5	6360.1	6554.3	7653.4
Europe	825.9	771.6	697.0	718.1	773.2	760.5	872.3	959.6
India	1293.1	1456.0	1571.3	1787.0	2129.2	2313.2	2590.8	2901.7
Russia & Other CIS	1326.0	1690.8	1981.9	1771.4	1419.1	1520.0	1823.0	2187.6
RoW	390.4	553.3	735.9	1305.7	940.2	587.1	666.6	760.9
PSAI	2381.3	3070.2	2397.4	2545.7	2238.0	2127.7	2170.3	2213.7

Source: Company, ICICIdirect.com Research

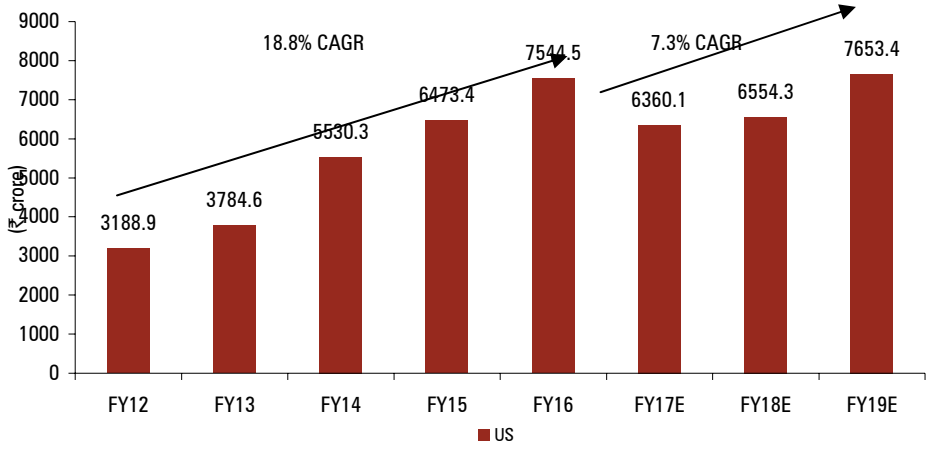
US business expects to grow at CAGR of 10% over FY17-19E

US contribute more than 98% of North American sales while the remaining sales are from Canada. DRL has four USFDA approved formulations facilities including two in the US. The company operates in the prescriptions (Rx) and OTC segments in the US market. The sales are channelled through drug stores, drug wholesalers, health maintenance organisations and pharmacy chains. DRL is also an authorised supplier to the US government. After establishing itself in the US generics space, the focus was shifted to the first to file (FTFs) and AG space.

From FY08 onwards DRL started filing limited competitions/niche products like injections, controlled releases and complex generics in the US market in order to reduce the dependence on plain generics. DRL also owns one of the largest over the counter (OTC) product portfolios in the US.

DRL has a strong product pipeline comprising 76 pending ANDA approvals. Of these, 50 are Para IVs while 18 have first to file (FTF) status. Beside ANDAs, DRL has also filed two NDAs through the 505 b (2) route, which are awaiting approval. We expect the company to file 18-20 ANDAs every year, going ahead. Going by the future pipeline, we expect DRL to launch 10-15 products per annum, which include at least three or four complex products every year besides plain vanilla generic and FTF opportunities. We expect sales from US to grow at a CAGR of 10% in FY17-19E.

Exhibit 4: US sales to be driven by robust pipeline

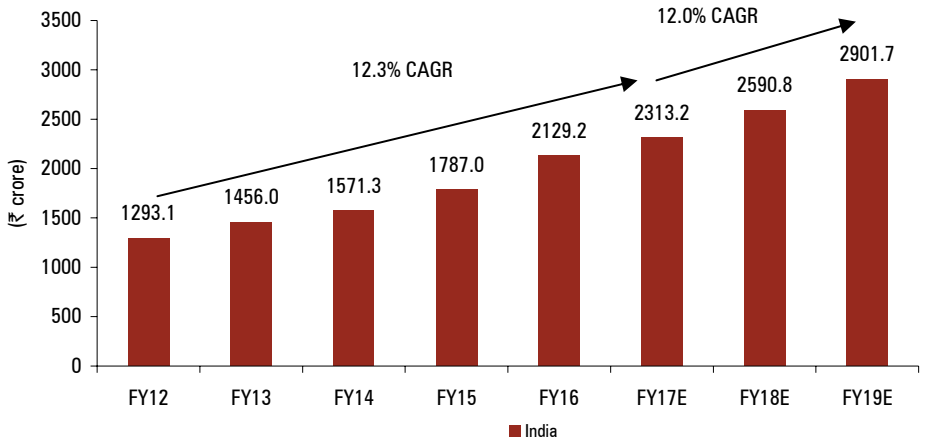


Source: Company, ICICIdirect.com Research

India to provide more stability

DRL ranks seventeenth (in terms of market share, AIOCD, April, 2017) with a market share of 2.3%. The acute, chronic, sub-chronic segments currently are at 49%, 30% and 21%, respectively. Gastrointestinal (GI) is the largest therapeutic group for and the company ranks fifth in this therapeutic group. In many other therapies however it remains a marginal player. The only therapeutic category, where it holds No. 1 position is anti-neoplastics (oncology), which as a therapy remains an important but untapped opportunity. To bolster the domestic franchise, DRL has almost doubled the MR strength from 2250 in FY09 to ~4300 as of H1FY17. In order to push domestic growth, DRL has forayed into the complex biosimilars space, which till date has not witnessed much crowding. At the same time, these products have not witnessed the expected traction either. It launched the first biosimilar oncology product Filgrastim under the brand name Grafeel in 2001. Again in 2007, it launched another oncology product Rituximab a biosimilar of Roche's blockbuster Mabthera under the brand name Reditux. Overall, it has launched four biosimilars till date including these two. The company acquired select portfolio of UCB with revenues of ~₹ 150 crore in Domestic market for ₹ 800 crore.

Exhibit 5: New launches, improved MR productivity to drive domestic growth



Source: Company, ICICIdirect.com Research

Another interesting high growth/low penetration space for DRL is oncology. It owns the branded portfolio of products such as Capibine (Capecitabine), Docetere (Docetaxel) and Cytogem (Gemcitabine).We expect Indian formulations to grow at a CAGR of 12% in FY17-19E. As per

the management, the NLEM 2011 impact is confined to just ~3-5% of domestic sales.

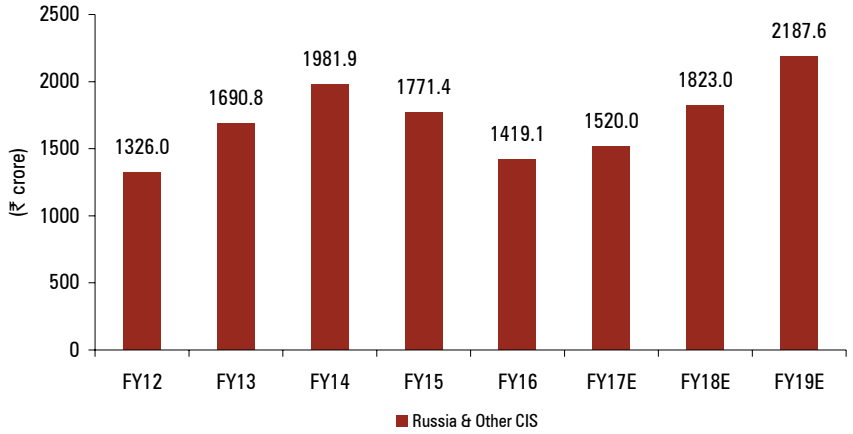
Russia CIS becomes volatile

DRL was the first Indian entrant in Russia and CIS, dating back to 1992. Early entry into these markets has helped the company to get hold of the changing dynamics of these high potential but notoriously volatile territories. The CIS segment includes countries such as Ukraine, Belarus, Kazakhstan and Uzbekistan. Russia comprises ~83% of the overall Russia & CIS (RCIS) segment.

DRL has consolidated its position in the Russian market by focusing on select therapies such as pain management, anti-infectives, gastro-intestinal, respiratory, oncology and cardiovascular encompassing prescription, OTC and hospital sales. The top four brands: Nise, Omez, Ketorol and Cetrine constituted ~60% of overall Russian sales.

DRL has also struck in-licensing deals with other Indian companies such as Cipla and Torrent. However, due to political unrest and sanctions due to Ukrainian invasion the region has lost its safe heaven status for DRL besides Rouble volatility. We expect sales from Russia and other CIS to grow at a CAGR of 20% in FY17-19E.

Exhibit 6: Russia & CIS to witness tempered growth due to regional issues



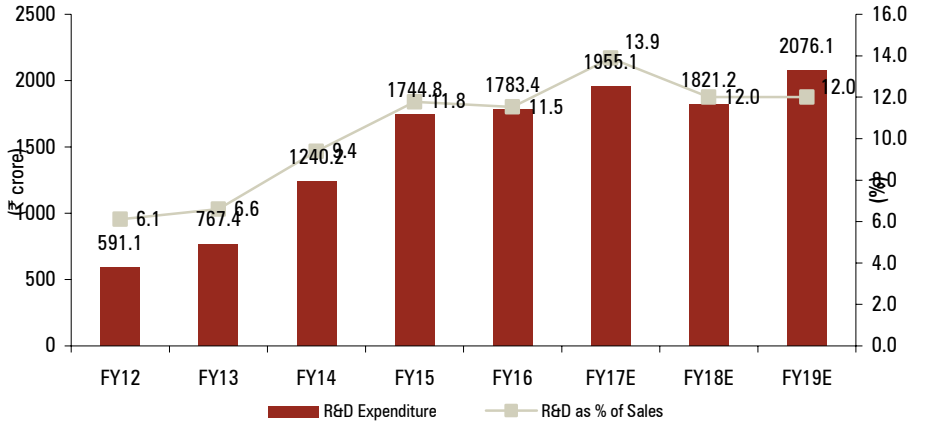
Source: Company, ICICIdirect.com Research

R&D cost to increase further

Dr Reddy's is one of the few Indian companies to foray into new drug discovery & development (NDDS) and new chemical entity (NCE) research with a focus to therapies like dermatology, anti-inflammatory and anti-infectives from CVS and diabetics. DRL is also the first Indian company to launch biosimilars in the domestic market.

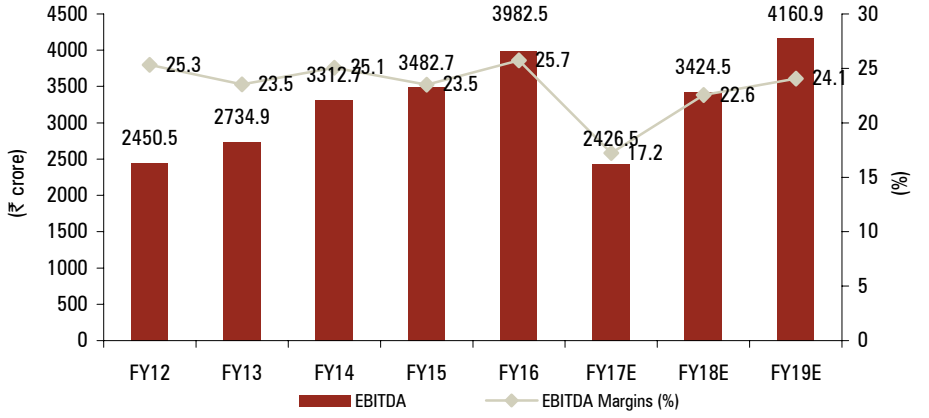
The R&D cost was 14% of turnover in FY17 mainly due to higher spend in (i) complex generic including injectables (ii) biosimilars and novel drug discovery and (iii) higher spend towards the proprietary R&D assets in-licensed from Xenoport and Eisai as well as the acquired ANDA fillings from Teva

Exhibit 7: R&D cost to go up due to complex generics and biosimilars



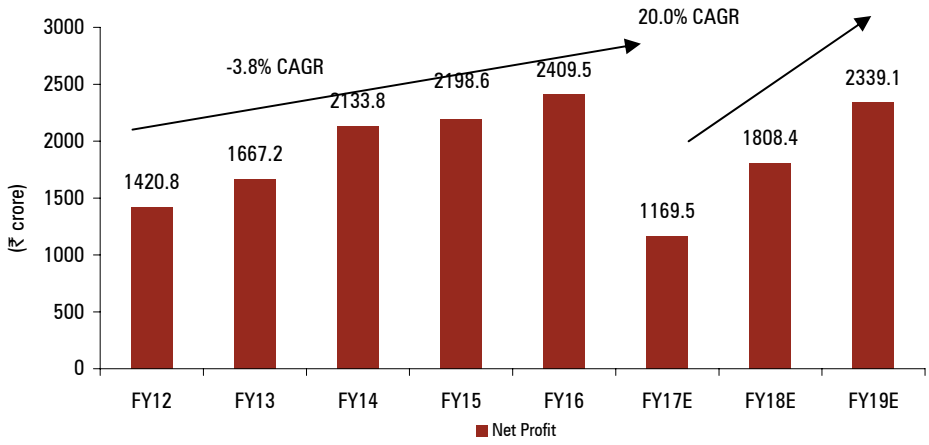
Source: Company, ICICIdirect.com Research

Exhibit 8: Higher R & D and slow US approvals likely to weight on EBITDA margins



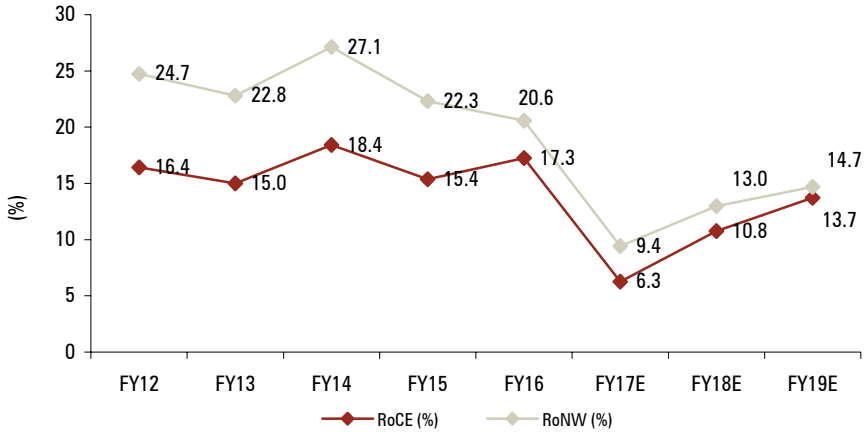
Source: Company, ICICIdirect.com Research

Exhibit 9: Net profit to grow at CAGR of 20% in FY17-19E on low base



Source: Company, ICICIdirect.com Research

Exhibit 10: Trends in Return ratios



Source: Company, ICICIdirect.com Research

Exhibit 11: Trends in quarterly financials

₹ Crore	Q4FY14	Q1FY15	Q2FY15	Q3FY15	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	YoY (%)	QoQ (%)
Total Operating Income	3480.9	3517.5	3587.8	3843.1	3870.4	3757.8	3989.0	3967.9	3756.2	3234.5	3585.7	3706.5	3554.2	-5.4	-4.1
Raw Material Expenses	1488.7	1433.2	1489.3	1607.9	1748.4	1463.1	1542.1	1608.9	1628.6	1416.7	1576.0	1516.6	1736.0	6.6	14.5
% of Revenues	42.8	40.7	41.5	41.8	45.2	38.9	38.7	40.5	43.4	43.8	44.0	40.9	48.8	549 bps	793 bps
Gross Profit	1992.2	2084.4	2098.5	2235.2	2122.0	2294.7	2446.9	2359.0	2127.6	1817.8	2009.7	2189.9	1818.2	-14.5	-17.0
Gross Profit Margins (%)	57.2	59.3	58.5	58.2	54.8	61.1	61.3	59.5	56.6	56.2	56.0	59.1	51.2	-549 bps	-793 bps
SG&A	835.1	880.7	871.6	857.5	794.5	870.5	859.2	926.8	860.0	960.3	886.0	841.7	872.5	1.5	3.7
% of Revenues	24.0	25.0	24.3	22.3	20.5	23.2	21.5	23.4	22.9	29.7	24.7	22.7	24.5	165 bps	184 bps
R&D Expenditure	398.5	387.5	411.3	431.6	514.4	438.7	447.3	409.5	487.9	480.2	521.4	495.6	457.9	-6.1	-7.6
% of Revenues	11.4	11.0	11.5	11.2	13.3	11.7	11.2	10.3	13.0	14.8	14.5	13.4	12.9	-11 bps	-49 bps
Other (income)/expenses	-22.6	-18.5	-26.6	-34.1	-12.5	-12.5	1.2	-12.2	-30.7	-9.6	-27.7	-18.7	-50.5	64.5	170.1
% of Revenues	-0.7	-0.5	-0.7	-0.9	-0.3	-0.3	0.0	-0.3	-0.8	-0.3	-0.8	-0.5	-1.4	-60 bps	-92 bps
Total Expenditure	2699.7	2682.9	2745.6	2862.9	3044.8	2759.8	2849.8	2933.0	2945.8	2847.6	2955.7	2835.2	3015.9	2.4	6.4
% of Revenues	77.6	76.3	76.5	74.5	78.7	73.4	71.4	73.9	78.4	88.0	82.4	76.5	84.9	643 bps	836 bps
EBITDA	781.3	834.7	842.2	980.2	825.6	998.0	1139.2	1034.9	810.4	386.9	630.0	871.3	538.3	-33.6	-38.2
EBITDA Margins (%)	22.4	23.7	23.5	25.5	21.3	26.6	28.6	26.1	21.6	12.0	17.6	23.5	15.1	-643 bps	-836 bps
Depreciation	195.6	187.2	195.7	257.4	213.7	226.8	246.6	277.1	303.2	268.1	291.4	292.4	224.8	-25.9	-23.1
EBITDA	585.7	647.5	646.5	722.8	611.9	771.2	892.6	757.8	507.2	118.8	338.6	578.9	313.5	-38.2	-45.8
Interest	-16.4	-81.1	-42.1	-101.3	23.3	-21.6	-11.6	6.2	-166.3	-44.5	-36.5	-4.4	4.8	-102.9	-209.1
Exceptional Items	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	430.9	0.0	0.0	0.0	0.0	NA	NA
EBT	606.9	733.9	693.8	828.7	593.0	797.8	909.8	758.0	248.5	170.6	383.5	592.2	318.9	28.3	-46.1
Total Tax	125.2	150.5	119.6	254.1	74.2	172.1	187.9	178.8	173.9	44.4	88.0	122.1	6.4	-96.3	-94.8
Tax %	20.6	20.5	17.2	30.7	12.5	21.6	20.7	23.6	70.0	26.0	22.9	20.6	2.0		
Net Profit	481.7	583.4	574.1	574.6	518.8	625.7	721.9	579.2	74.6	126.2	295.5	470.1	312.5	318.9	-33.5
Adjusted PAT	476.8	578.0	569.0	570.0	514.4	620.8	716.3	572.8	499.6	118.9	287.1	461.2	302.3	-39.5	-34.5

Source: Company, ICICIdirect.com Research

SWOT Analysis

Strengths- Seasoned player in the US generic space with proven track record. Strong US pipeline with many FTF / limited competition products. Largest Indian player in Russia / CIS.

Weakness- PSAI and European businesses remain a drag on margins and growth. Higher R&D spends for the future to put pressure on the current margins. The Russian and RoW region has also become volatile and unpredictable due to currency volatility and geo-political unrest.

Opportunities- The US Generics space with scope for complex / limited competition products. Biosimilars space across the globe. Indian franchise is still pretty small for a player of DRL's calibre.

Threats- Increased USFDA scrutiny across the globe regarding cGMP issues, pricing pressure due to client consolidation in the US, pricing probe by the Department of Justice (DoJ) in the US, proposed tightening by the new regime by adapting to the bidding process and imposition of border adjustment tax on imported drugs in the US. Currency volatility in ROW markets and Russia.

Conference call Highlights

- The company currently owns 101 pending ANDA approvals (62 Para IV filings and 21 FTFs) including two NDAs
- In all 26 ANDAs filed in FY17 of which 13 ANDAs filed in Q4 FY17
- The company expects 10+ US launches in FY18
- Guided for 23-25% tax rate in FY18
- In the domestic market, the company growth of 10-12% in FY18
- The company expects gross margins to remain at ~55% (+/- 200 bps)
- The Miryalaguda API facility (which was under the warning letter) has received first USFDA approval in Q1FY18
- Foreign currency cash flow hedges for the next 12 months are ~US$235 million, largely hedged around the range of ₹ 66.78-69.23/US$. In addition, it has balance sheet hedges of ~US$273.5 million. It also has foreign currency cash flow hedges of RUB 150 million at the rate of ₹1.137/RUB, maturing over next three months.
- In April 2017, the company has launched Ezetimibe Simavastatin (gVytorin), which is the first of the eight products acquired from Teva. As per IMS this product had annual brand sales of ~US$ 678 million in the US
- Sharp decline in employee cost (18% QoQ) in Q4FY17 was mainly due to decline in variable pay at the senior level.
- In FY17, the company has faced high single digit to low double digit price erosion in the US
- Over the next three to four years, the company expects positive cash-flows from its proprietary business
- The company has received Complete Response Letter (CRL) from USFDA for NuvaRing (contraceptive; largest product acquired from Teva).
- For its proprietary products Zembrace (CNS) and Sernivo spray (plaque psoriasis), the company expects to reach peak sales of US$30-US$50 million each in the next 3 years

Exhibit 12: Facilities

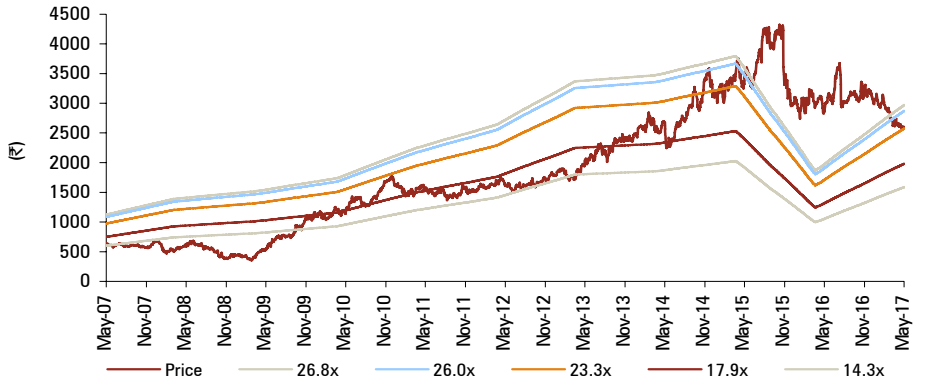
Location	Segment	Regulatory Approvals
API Hyderabad Plant 1	API	USFDA
API Hyderabad Plant 2	API	USFDA
API Hyderabad Plant 3	API	USFDA
API Hyderabad Plant 4	API	USFDA
Nalgonda	API	USFDA
Srikakulam	API	USFDA
Formulations Hyderabad Plant 1	Formulations	
Formulations Hyderabad Plant 2	Formulations	
Formulations Hyderabad Plant 3	Formulations	USFDA
Yanam Plant	Formulations	
Formulations Baddi Plant 1	Formulations	
Formulations Baddi Plant 2	Formulations	
Formulations vizag SEZ Plant 1	Formulations	
Formulations vizag SEZ Plant 2	Formulations	USFDA
Srikakulam Plant (SEZ)	Formulations	USFDA
Biologics	Formulations	
Integrated Product Development Facility	R&D	
Aurigene Discovery Technologies Ltd.	R&D	
Aditi Hyderabad	R&D	
Technology Development Center 1	R&D	
Technology Development Center 2	R&D	
Kunshan Rotam Reddy Pharma		
API Cuernavaca Plant	API	USFDA
Dr. Reddy's Labs (UK)		
API Mirfield Plant	API	
Tech Development Center Cambridge Chirotech	R&D	
Formulations Shreveport Plant	Formulations	USFDA
Formulations Bristol Plant	Formulations	USFDA
API Middleburgh Plant	API	
Technology Development Center Lieden Octoplus N.V	R&D	
Technology Development Center Princeton	R&D	

Source: Company, ICICIdirect.com Research

Valuation

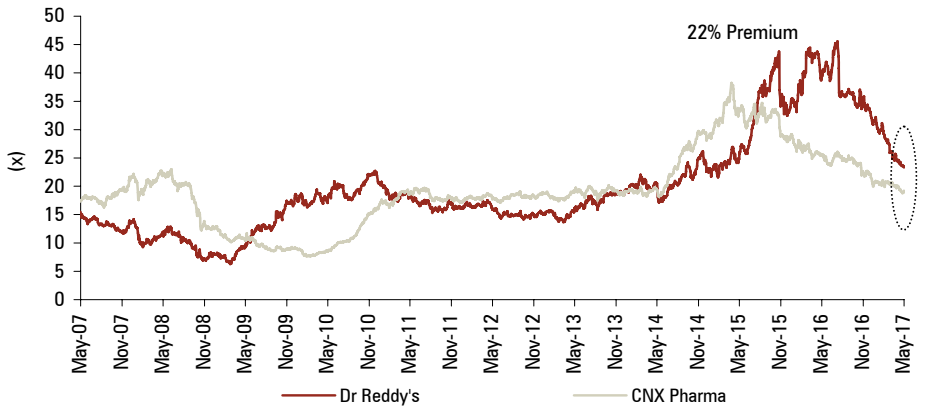
The company witnessed perhaps the worst FY17 performance in recent times wherein revenues were affected by US warning letter, pricing pressure in the base business, delay in approvals and issues in Venezuela. Profitability was affected due to adverse product mix, higher remedial costs and one-offs. Despite bolstering a sound US portfolio, pricing pressure owning to client consolidation and macro economic headwinds along with cGMP issues and delay in product approvals have emerged as major stumbling block. The management expects gradual recovery in the overall performance but remains cautiously optimistic about US prospects. Some hope of US recovery can be attributable to aggressive ANDA filings (13) in Q4. Apart from the US, Global Generics (ex US, Europe) growth expected to recover on the back of stabilise currency, geographical expansion, robust biosimilar portfolio and ramp up in institutional business. We have ascribed a target price of ₹ 2610 based on 19x FY19E EPS of ₹ 137.

Exhibit 13: One year forward PE



Source: Company, ICICIdirect.com Research

Exhibit 14: One year forward PE of company vs. CNX Pharma



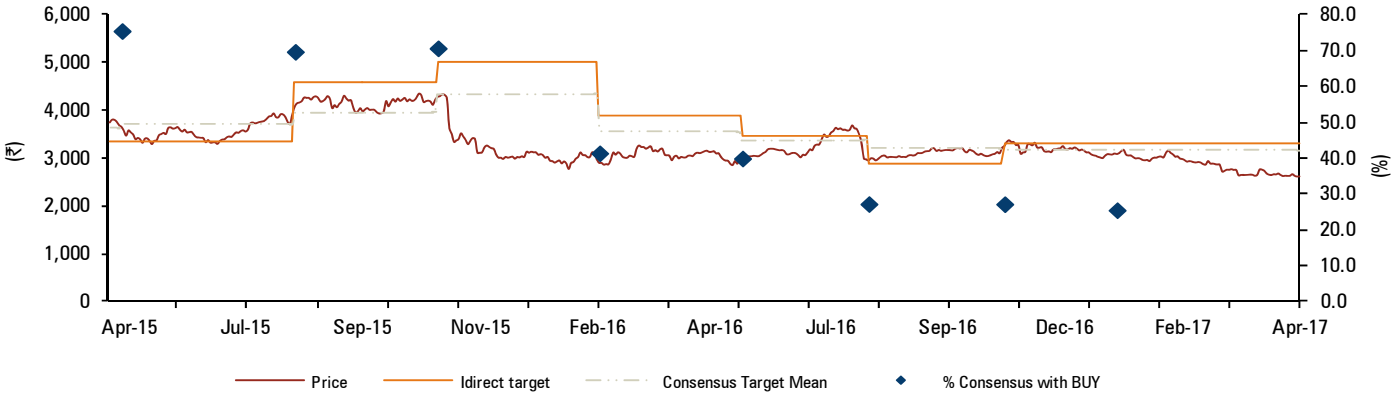
Source: Company, ICICIdirect.com Research

Exhibit 15: Valuation

	Revenues (₹ crore)	Growth (%)	Adj. EPS (₹)	Growth (%)	P/E (x)	EV/EBITDA (X)	RoNW (%)	RoCE (%)
FY16	15470.9	4.4	141.4	9.6	22.7	11.3	20.6	17.3
FY17E	14080.9	-9.0	68.6	-51.5	37.8	19.1	9.4	6.3
FY18E	15176.9	7.8	106.1	54.6	24.9	13.0	13.0	10.8
FY19E	17301.2	14.0	137.3	29.3	19.3	10.4	14.7	13.7

Source: Company, ICICIdirect.com Research

Recommendation history vs. Consensus



Source: Reuters, Company, ICICIdirect.com Research

Key events

Date	Event
Nov-10	Acquires GSK's US oral penicillin facility and product portfolio. Under the agreement, GSK will transfer rights for Augmentin and Amoxil brands
Dec-10	Enters into licensing of technology transfer, manufacturing and marketing agreement with R-Pharm of Russia. The collaboration is in the area of high-technology and will work on a profit sharing model
Jun-12	Dr Reddy's and Merck Serono sign an agreement to co-develop and commercialise a portfolio of biosimilars compounds in oncology
Jul-12	USFDA lifts import alert for chemical manufacturing facility at Cuernavaca, Mexico
Oct-12	Acquires Netherland based specialty injectable company OctoPlus NV
Jun-13	Dr Reddy's and Fujifilm Corporation call off their joint venture. The JV was started in July 2011 for developing and launching generic drugs in the Japanese market
Dec-14	Dr. Reddy's Labs closed the acquisition of Habitrol brand, an over-the-counter nicotine replacement therapy transdermal patch, from Novartis for a consideration of US$ 80 million
Apr-15	Enters a €118 million (₹ 800 crore) definitive agreement to acquire a select portfolio of established products from UCB in India
Nov-15	Receives a warning letter from the USFDA for three of its manufacturing facilities. These include two API facilities at Srikakulam, Andhra Pradesh and Miryalaguda, Telangana and one oncology formulation facility at Duvvada, Vishakhapatnam
Apr-16	Launches USFDA approved ZEMBRACE SymTouch is a prefilled, low-dose, ready-to-use, two-step autoinjector containing 3 mg of sumatriptan. ZEMBRACE SymTouch is a prescription medicine used to treat acute migraine headaches
Jun-16	Launches USFDA approved prescription topical plaque psoriasis Spray Sernivo (betamethasone dipropionate), 0.05% in the US
Aug-16	Acquires portfolio of eight ANDAs from Teva in the US for US$350 million
Mar-17	Duvvada oncology formulation facility receives 13 observations from USFDA post re-inspection
Apr-17	Srikakulam API facility receives two form 483 observations from USFDA post re-inspection
Apr-17	Bachupally formulation plant in Hyderabad receives 11 form 483 observations from USFDA

Source: Company, ICICIdirect.com Research

Top 10 Shareholders

Rank	Investor Name	Latest Filing Date	% O/S	Position ($)	Position Char
1	Dr Reddys Holdings Pvt. Ltd.	13-Jan-17	24.5	40.6m	0.4m
2	Commonwealth Bank of Australia	31-Dec-16	9.8	16.3m	16.3m
3	Stewart Investors	31-Dec-16	4.4	7.3m	-1.5m
4	OppenheimerFunds, Inc.	31-Dec-15	4.4	7.3m	-1.3m
5	Life Insurance Corporation of India	31-Dec-16	3.5	5.8m	3.2m
6	BlackRock Institutional Trust Company, N.A.	30-Apr-17	2.0	3.4m	0.1m
7	GIC Private Limited	31-Dec-16	1.3	2.2m	-0.1m
8	Franklin Templeton Asset Management (India) Pvt. Ltd	31-Dec-16	1.3	2.2m	0.0m
9	Vontobel Asset Management, Inc.	31-Mar-17	1.3	2.1m	0.0m
10	Khazanah Nasional Berhad	31-Dec-16	1.2	2.0m	0.0m

Shareholding Pattern

(in %)	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Promoter	25.6	26.4	26.7	26.8	26.8
Others	74.4	73.6	73.3	73.2	73.2

Source: Reuters, ICICIdirect.com Research

Recent Activity

Buys			Sells		
Investor name	Value ($)	Shares	Investor name	Value ($)	Shares
Commonwealth Bank of Australia	732.7m	16.3m	First State Investments (Singapore)	-152.7m	-3.8m
Life Insurance Corporation of India	144.1m	3.2m	Stewart Investors	-66.8m	-1.5m
Dr Reddys Holdings Pvt. Ltd.	19.0m	0.4m	Lyxor Asset Management	-17.7m	-0.4m
BlackRock Institutional Trust Company, N.A.	3.4m	0.1m	Norges Bank Investment Management (NBIM)	-18.5m	-0.4m
ICICI Prudential Asset Management Co. Ltd.	1.8m	0.0m	Eastspring Investments (Singapore) Limited	-16.3m	-0.4m

Financial summary

Profit and loss statement				₹ Crore
(Year-end March)	FY16	FY17E	FY18E	FY19E
Revenues	15,470.9	14,080.9	15,176.9	17,301.2
Growth (%)	4.4	-9.0	7.8	14.0
Raw Material Expenses	6,242.7	6,245.3	6,599.8	7,266.5
SG&A	3,516.5	3,560.5	3,369.3	3,840.9
R&D	1,783.4	1,955.1	1,821.2	2,076.1
Other (income)/expenses	-54.2	-106.5	-37.9	-43.3
Total Operating Expenditure	11,488.3	11,654.4	11,752.4	13,140.3
EBITDA	3,982.5	2,426.5	3,424.5	4,160.9
Growth (%)	14.4	-39.1	41.1	21.5
Interest	-193.3	-80.6	-91.1	-103.8
Depreciation	1,053.7	1,076.7	1,161.0	1,221.0
PBT before Exceptional Items	3,122.1	1,430.4	2,354.6	3,043.7
Share of profit/ (loss) of equity accc	-22.9	-34.8	-20.0	-20.0
PBT	2,714.1	1,465.2	2,374.6	3,063.7
Total Tax	712.7	260.9	546.1	704.7
PAT	2,001.4	1,204.3	1,828.4	2,359.1
Adjusted PAT	2,409.5	1,169.5	1,808.4	2,339.1
Growth (%)	9.6	-51.5	54.6	29.3
EPS	117.5	70.7	107.3	138.4
EPS (Adjusted)	141.4	68.6	106.1	137.3

Source: Company, ICICIdirect.com Research

Cash flow statement				₹ Crore
(Year-end March)	FY16	FY17E	FY18E	FY19E
Profit/(Loss) after taxation	1,965.2	1,204.3	1,828.4	2,359.1
Add: Depreciation & Amortization	970.5	1,076.7	1,161.0	1,221.0
Net Increase in Current Assets	-183.7	-12.8	-74.3	-1,028.5
Net Increase in Current Liabilities	456.2	166.4	315.9	377.8
CF from operating activities	3,514.7	2,434.6	3,231.1	2,929.4
(Inc)/dec in Fixed Assets	-2,173.1	-3,348.0	-1,100.0	-1,100.0
(Inc)/dec in Investments	70.1	-800.0	-800.0	-800.0
Others	160.9	-23.4	-16.5	10.2
CF from investing activities	-1,942.1	-4,171.4	-1,916.5	-1,889.8
Inc / (Dec) in Equity Capital	0.1	0.0	0.0	0.0
Inc / (Dec) in Loan	-1,198.7	1,566.4	-1,000.0	-1,000.0
Dividend & Dividend Tax	-410.6	-240.4	-292.0	-376.8
Others	-260.0	0.0	0.0	0.0
CF from financing activities	-1,869.2	1,326.0	-1,292.0	-1,376.8
Net Cash flow	-296.6	-410.9	22.6	-337.1
Opening Cash	1,872.4	1,575.8	1,164.9	1,187.5
Closing Cash	1,575.8	1,164.9	1,187.5	850.4
Free Cash Flow	1,341.6	-913.4	2,131.1	1,829.4

Source: Company, ICICIdirect.com Research

Balance sheet				₹ Crore
(Year-end March)	FY16	FY17E	FY18E	FY19E
Equity Capital	85.3	85.3	85.3	85.3
Net Networth	11,615.6	12,319.5	13,855.9	15,838.2
Total Shareholders funds	11,700.9	12,404.8	13,941.2	15,923.5
Total Debt	3,352.1	4,918.5	3,918.5	2,918.5
Deferred Tax Liability	59.2	64.2	69.2	74.2
Other Non Current Liabilities	249.8	253.5	273.2	311.4
Long term Provisions	94.7	112.6	121.4	138.4
Source of Funds	15,456.7	17,753.6	18,323.5	19,366.0
Gross Block - Fixed Assets	15,102.2	18,350.2	19,350.2	20,350.2
Accumulated Depreciation	8,538.8	9,615.5	10,776.5	11,997.5
Net Block	6,563.4	8,734.7	8,573.7	8,352.7
Capital WIP	663.1	763.1	863.1	963.1
Net Fixed Assets	7,226.5	9,497.8	9,436.8	9,315.8
Investments	2,257.8	3,057.8	3,857.8	4,657.8
Inventory	2,579.9	2,852.9	2,530.9	2,885.1
Cash	1,835.8	1,164.9	1,187.5	850.4
Debtors	4,166.7	3,806.5	4,102.8	4,677.1
Loans & Advances & Other CA	1,125.5	1,225.5	1,325.5	1,425.5
Total Current Assets	9,707.9	9,049.8	9,146.7	9,838.1
Creditors	930.9	847.3	913.2	1,041.0
Provisions & Other CL	3,622.8	3,872.8	4,122.8	4,372.8
Total Current Liabilities	4,553.7	4,720.1	5,036.0	5,413.8
Net Current Assets	5,154.2	4,329.8	4,110.7	4,424.2
LT L& A, Other Assets	532.9	582.9	632.9	682.9
Deferred Tax Assets	285.3	285.3	285.3	285.3
Application of Funds	15,456.7	17,753.6	18,323.5	19,366.0

Source: Company, ICICIdirect.com Research

Key ratios				
(Year-end March)	FY16	FY17E	FY18E	FY19E
Per share data (₹)				
EPS	141.4	68.6	106.1	137.3
BV per share	686.7	728.0	818.1	934.5
Operating Ratios (%)				
Gross Profit Margins	59.6	55.6	56.5	58.0
EBITDA margins	25.7	17.2	22.6	24.1
Net Profit margins	15.6	8.3	11.9	13.5
Inventory days	60.9	74.0	60.9	60.9
Debtor days	98.3	98.7	98.7	98.7
Creditor days	22.0	22.0	22.0	22.0
Asset Turnover	0.9	0.7	0.7	0.8
EBITDA conversion Rate	88.3	100.3	94.4	70.4
Return Ratios (%)				
RoE	20.6	9.4	13.0	14.7
RoCE	17.3	6.3	10.8	13.7
RoIC	29.2	11.2	19.4	24.4
Valuation Ratios (x)				
P/E	22.7	37.8	24.9	19.3
EV / EBITDA	11.3	19.1	13.0	10.4
EV / Revenues	2.9	3.3	2.9	2.5
Market Cap / Revenues	2.9	3.2	3.0	2.6
Price to Book Value	3.9	3.7	3.3	2.9
Solvency Ratios				
Debt / Equity	0.3	0.4	0.3	0.2
Debt/EBITDA	0.8	2.0	1.1	0.7
Current Ratio	1.7	1.7	1.6	1.7

Source: Company, ICICIdirect.com Research

ICICIdirect.com coverage universe (Healthcare)

Company	I-Direct Code	CMP (₹)	TP (₹)	Rating	M Cap (₹ Cr)	EPS (₹)				PE(x)				RoCE (%)				RoE (%)			
						FY16	FY17E	FY18E	FY19E	FY16	FY17E	FY18E	FY19E	FY16	FY17E	FY18E	FY19E	FY16	FY17E	FY18E	FY19E
Ajanta Pharma	AJAPHA	1634	1,180	Buy	14375.6	45.4	58.5	61.7	72.4	36.0	27.9	26.5	22.6	42.9	40.6	33.8	31.7	34.2	32.6	27.0	25.2
Alembic Pharma	ALEMPHA	600	615	Hold	11304.4	38.2	21.4	23.4	30.2	15.7	28.0	25.6	19.9	51.5	26.1	22.3	24.7	44.9	21.4	20.0	21.8
Apollo Hospitals	APOHOS	1300	1,440	Buy	18085.6	22.2	22.5	35.2	50.0	58.6	57.7	36.9	26.0	8.2	8.1	11.1	14.7	8.9	8.4	11.8	14.7
Aurobindo Pharma	AURPHA	614	965	Buy	35970.3	33.9	38.7	39.5	49.1	18.1	15.9	15.5	12.5	23.3	23.6	20.9	22.6	28.1	24.6	20.3	20.5
Biocon	BIOCON	1012	1,020	Hold	20230.0	23.1	31.0	25.5	40.8	43.7	32.6	39.6	24.8	9.1	11.4	10.4	15.3	11.4	13.5	10.2	14.5
Cadila Healthcare	CADHEA	488	425	Hold	49938.2	15.0	12.2	16.9	21.5	32.6	39.9	28.8	22.7	26.7	15.2	20.1	23.0	28.6	19.9	22.9	23.8
Cipla	CIPLA	566	575	Hold	45557.6	18.5	17.2	24.3	31.4	30.6	32.9	23.3	18.0	12.0	10.5	13.9	16.4	12.5	10.6	13.2	14.9
Divi's Lab	DIVLAB	624	700	Hold	16570.5	41.8	41.1	42.8	47.8	14.9	15.2	14.6	13.1	30.7	26.8	24.4	23.7	25.9	21.6	19.3	18.6
Dr Reddy's Labs	DRREDD	2671	2,610	Hold	44331.5	141.4	68.6	106.1	137.3	18.9	38.9	25.2	19.5	17.3	6.3	10.8	13.7	20.6	9.4	13.0	14.7
Glenmark Pharma	GLEPHA	715	910	Buy	20182.1	32.2	46.9	47.9	50.5	22.2	15.3	14.9	14.2	16.2	20.6	19.8	19.1	21.2	25.9	21.2	18.4
Indoco Remedies	INDREM	223	235	Hold	2050.8	9.4	8.7	12.7	15.6	23.7	25.5	17.5	14.2	12.9	9.5	13.9	16.1	14.8	12.4	15.8	16.8
Ipca Laboratories	IPCLAB	557	560	Hold	7030.9	10.0	15.0	24.1	31.1	55.6	37.1	23.2	17.9	5.7	9.8	12.7	14.8	5.5	7.8	11.3	13.0
Jubilant Life	JUBLIF	762	810	Buy	12140.4	26.0	37.0	51.1	68.0	29.3	20.6	14.9	11.2	12.0	14.1	15.6	18.5	14.2	17.1	19.4	20.7
Lupin	LUPIN	1285	1,760	Buy	58012.6	50.4	61.7	67.2	83.6	25.5	20.8	19.1	15.4	18.6	20.2	20.8	23.9	20.7	20.9	19.2	19.9
Natco Pharma	NATPHA	934	870	Buy	16286.4	8.5	25.3	14.8	18.2	110.1	36.9	63.3	51.4	16.0	33.0	17.6	19.2	11.9	27.2	14.0	15.0
Sun Pharma	SUNPHA	654	765	Buy	157017.7	23.4	30.3	29.9	35.3	27.9	21.6	21.9	18.5	18.6	19.3	17.3	17.9	18.0	19.4	16.5	16.8
Syngene Int.	SYNINT	448	515	Hold	8953.0	11.1	14.3	14.0	18.4	45.0	34.7	35.5	27.1	13.2	16.8	16.0	19.9	21.0	21.9	17.9	19.4
Torrent Pharma	TORPHA	1300	1,475	Buy	22004.9	107.8	57.0	62.1	77.4	12.1	22.8	21.0	16.8	46.7	21.5	23.7	26.4	53.8	23.5	21.4	22.2
Unichem Lab	UNILAB	263	285	Hold	2393.5	12.3	12.9	17.4	23.5	21.4	20.4	15.1	11.2	13.8	14.3	16.1	18.8	11.7	11.1	13.3	15.6

Source: Company, ICICIdirect.com Research

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