

Key approvals shifted to 2HFY19E

DRL reported numbers below our estimates as the revenues were lower due to sales disruption impacted in EU and lower channel offtake impacted in Russia, coupled with US pricing pressure and competitive scenario. The company also took tax charge of ₹ 374mn in Q4FY18 due to US tax reforms.

As per the management FY19E could be the year of turnaround for the company depending on Key assets like gSuboxone, gNuvaring and gCopaxone. The company expects to launch over 15 products in US (vs normal run rate of 10-12 products).

Key Assets Status

1) gSuboxone – All queries are responded and depending on the approval, launch of product is at risk (TAD around Jun'18). However, there can be two players entering the market as DRL and Amgen have won the plaintiff in lower court. **2) gNuvaring**- Almost completing the response for pending queries, however, expects to receive 1-2 queries. Launch expected only by end of 2HFY19 (earlier TAD in July'18). **3) gCopaxone**- Expected to file the response in coming couple of month and anticipates a launch on early 1HFY20E.

Compliance status at plants

Srikakulam Data expected to complete by June and then FDA is expected to guide on next course of action (management unsure if it would need next inspection). **Duvadda**- plant to invite USFDA by early July'18. Reinspection expected in Oct – Nov'18.

Sales disruption in Russian channel is expected to normalize from 1QFY19E onwards. Europe sales supplies issues are also expected to normalise. Biosimilar plans are expected to be on track, company plans to bring rituximab to developed markets and registrations are ongoing in other EMs. Company may scout a partner for Rituximab developed market launch plans, especially in US.

Outlook and Valuation

Overall, we expect gSuboxone and gNuvaRing would come in 2HFY19E. This could further reduce FY19E numbers if gSuboxone is not launched early and competition increases. Given the complexity of key assets there is a high chance that earning will be back-ended. The only surprise could be gSuboxone approval during 1HFY19E, apart from that we see remaining all triggers in 2HFY19 only. We have reduced our earnings by ~10% to factor in further delays in gNuvaRing and likely competition in gSuboxone. At the current market price of ₹ 1,953, the stock trades at 19x FY19E EPS of ₹ 101 and 14x FY20E EPS of ₹ 136.

Q4FY18 Result (₹ Mn)

Particulars	Q4FY18	Q4FY17	YoY (%)	Q3FY18	QoQ (%)
Net Sales	35,349	35,542	(0.5)	38,060	(7.1)
Gross profit	18,895	18,182	3.9	21,411	(11.8)
R&D	4,348	4,579	(5.0)	4,667	(6.8)
EBIT	2,647	3,135	(15.6)	5,009	(47.2)
Net Interest	1,101	54	1,939	85	1,195
PBT	3,748	3,189	17.5	5,094	(26.4)
Tax	726	64	1,034.4	2,601	(72.1)
PAT	3,022	3,125	(3.3)	3,344	(9.6)
Gross Profit Margin (%)	53.5	51.2	230	56.3	(280)
Tax Rate (%)	19.4	2.0	1,736	43.8	(2,438)
NPM (%)	8.5	8.8	(24)	8.8	(24)

CMP	₹ 1,953
Target / Upside	₹ 2,450/25%
BSE Sensex	34,345
NSE Nifty	10,430

Scrip Details

Equity / FV	₹ 830mn/₹ 5/-
Market Cap	₹ 324bn
	USD 4.8bn
52-week High/Low	₹ 2,788/1,888
Avg. Volume (no)	575,757
NSE Symbol	DRREDDY
Bloomberg Code	DRRD IN

Shareholding Pattern Mar'18 (%)

Promoters	26.8
MF/Banks/FIs	14.8
FIIIs	44.7
Public / Others	13.7

Valuation (x)

	FY18	FY19E	FY20E
P/E	28.4	19.4	14.4
EV/EBITDA	15.8	11.9	9.3
ROE	9.1	12.6	15.1
ROCE	6.4	9.6	12.4

Estimates (₹ mn)

	FY18	FY19E	FY20E
Net Sales	142,028	156,816	182,171
EBITDA	23,679	31,556	39,964
PAT	11,429	16,747	22,583
EPS (₹)	68.8	100.9	136.04

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Q4FY18 Financial Highlights - Sales stood at ₹ 35.3bn flat YoY. The fall of 4% in global generics was offset by other segments. The company witnessed shift in channel sourcing pattern in Russia. The company had out licensing fee of USD 2.5mn for DFD-06. EBITDA margins contracted 122bps YoY to 16.3%. PAT stood at ₹ 3.0bn, declining 3% YoY. APAT stood at ₹ 3.3bn.

Global Generics

- Sales fell 4% YoY to ₹ 27.8bn as the all the segments but India fell during the quarter.
- Gross margin stood at 59.3% during the quarter (61.6% YoY and 59.5% QoQ)

North America

- Revenues dropped 6% YoY to ₹ 14.5bn in the US, attributing to pricing pressure and increased competition.
- **New Launches in the US** - The company launched 3 products in the market viz. **gAloxi** (palonosetron, USD 446mn), **gXenazine** (tetrabenazine, USD 322mn), and **gXyzal** (levocetirizine, USD 71mn).
- The company has a total of 107 pending ANDA filings with US FDA, of which 63 are Para IV (30 First to File status). Additionally, 3 NDAs are under 505(b)(2).
- The quarter saw sequential decline in sales from Sevelamer with new entrants in the market.

EM

- Sales dropped 9% YoY at ₹ 5.5bn. The management has guided double digit growth in FY19E.
- Russian sales fell 24% YoY to ₹ 2.6bn on the account of lower off take by channel.
- The company expects better performance with new products, entrance in new markets such as Brazil and Colombia.

Domestic

- Indian business grew 7% YoY to ₹ 6.1bn. Normalising for the GST, the growth is 16% YoY.
- Company expects to achieve double digit growth in domestic space

EU

- Sales fell 17% YoY to ₹ 1.7bn due to higher price erosion in few key molecules and temporary supply disruptions.

Pharma Service and Active Ingredients (PSAI)

- PSAI sales grew 16% YoY at ₹ 6.3bn driven by key molecule growth.
- The company filed 5 DMFs in the US during the quarter.
- Gross margin stood at 24.2% during the quarter (21.0% YoY and 23.8% QoQ)

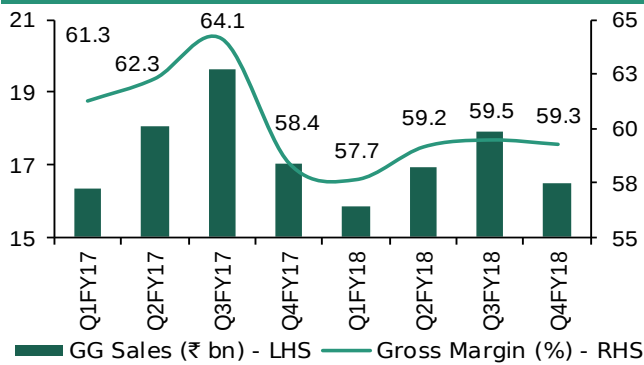
Proprietary products

- Sales grew 26% YoY to ₹ 1.3bn during the quarter.
- The company received USFDA approval of **gImpyoz** (Clobetasol propionate) in Q3FY18. With existing out licensing agreement with Encore Dermatology, this approval triggered milestone award of ₹ 1.5bn.
- The company has NDA filing of **DFN-02** with USFDA and is awaiting grant of PDUFA date (Jan'19 end). Launch is expected in Q1FY20E.

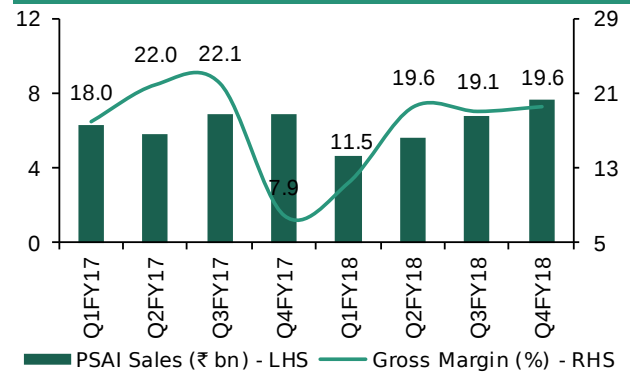
Other key highlights

- The company entered into a settlement agreement with US DoJ related to packaging against a payout of ₹ 319mn.
- R&D expenses stood at ₹ 4.3bn (down 5% YoY), 12.3% of Q4FY18 sales. The management has guided focus on building complex generics, biosimilars and differentiated products pipeline.
- CAPEX stood at ₹ 1.5bn for the quarter, totaling to ₹ 9.2bn in FY18.
- Net Debt: Equity at 0.24x for the quarter.

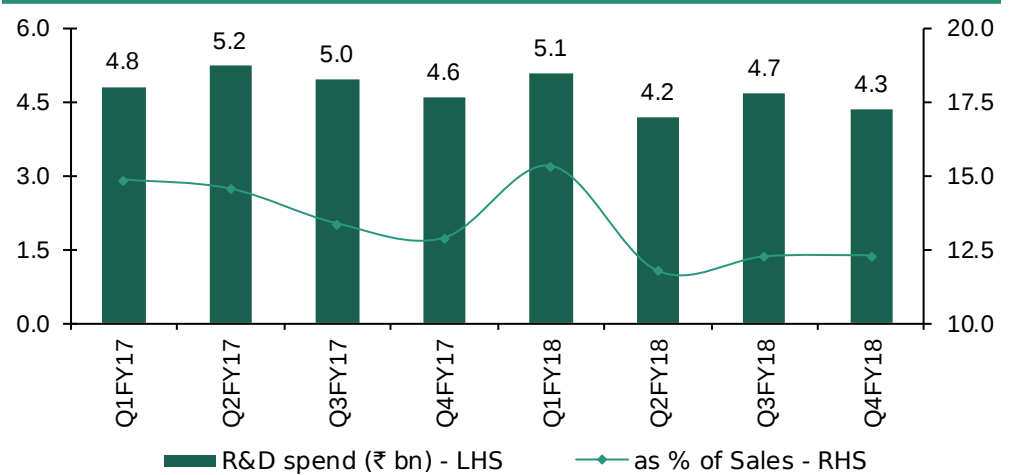
Product	Market size (USD mn)	Status	Comments
gNuvaRing	560	Answering queries. No litigation barrier	Launch expected in 1HFY19
gSuboxone	1100	Queries answered. Litigation fairly strong position	Expected by 2HFY19E
gAloxi	446		Launched in the market
gCopaxone (20mg & 40 mg)	960	Received CRL	Launch expected in 1HFY20E
g Kombiglyze XR	700		
g Tobii	350		
gQsymia	10		Acquired from TEVA
g Zyclara	72		
g Rozerem	70		

Exhibit 1: Global Generics recovering with margin at 59.3%


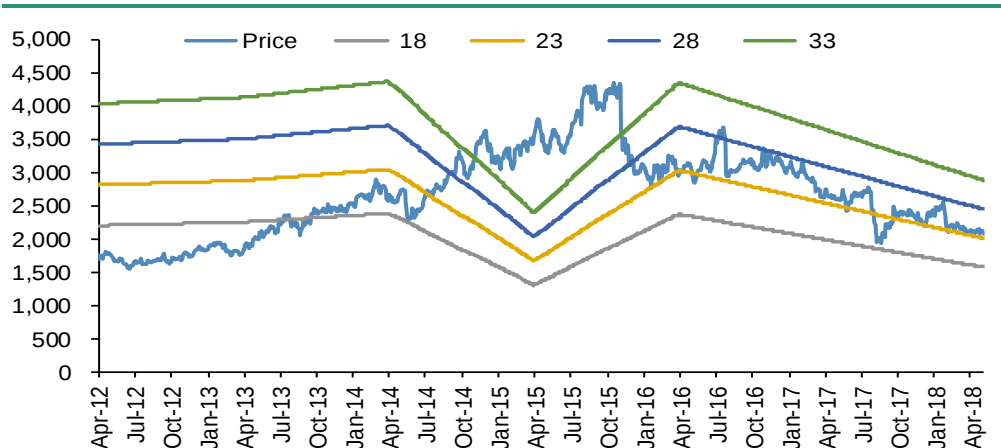
Source: DART, Company

Exhibit 2: PSAL gross margin at 19.6% in Q4FY18


Source: DART, Company

Exhibit 3: R&D expense stood ₹ 4.3bn in Q4FY18


Source: DART, Company

Exhibit 4: PE Chart


Source: DART, Company

Income Statement (₹ mn)

Particulars	Mar17	Mar18	Mar19E	Mar20E
Net Sales	140,809	142,028	156,816	182,171
Growth(%)	(9.0)	0.9	10.4	16.2
Total Expenditure	116,654	119,137	126,111	143,107
Raw material consumed	54,522	57,439	61,158	72,151
Selling & Distribution exp	42,581	43,433	44,693	47,364
R&D expenses	19,551	18,265	20,260	23,591
Operating profit	24,155	22,891	30,706	39,064
Other operating income	1,065	788	850	900
EBIDTA (Excl. OI)	25,220	23,679	31,556	39,964
EBIDTA (Incl. OI)	24,788	23,206	30,740	38,934
Other Income	(432)	(473)	(815)	(1,030)
Interest	(1,587)	(2,897)	(3,270)	(3,487)
Depreciation	11,722	11,762	12,677	13,652
Profit Before Tax	14,653	14,341	21,333	28,768
Tax	2,614	4,535	4,587	6,185
Reported Net Profit	12,039	9,806	16,747	22,583
Adj Net Profit	12,039	11,429	16,747	22,583
Growth(%)	(46.7)	(5.1)	46.5	34.8

Balance Sheet (₹ mn)

Particulars	Mar17	Mar18	Mar19E	Mar20E
Sources of Funds				
Equity Capital	829	830	830	830
Reserves	123,215	125,630	139,057	158,320
Net Worth	124,044	126,460	139,887	159,150
Secured Loans	5,646	25,248	24,651	24,161
Unsecured Loans	43,539	25,466	25,466	25,466
Loan Funds	49,185	50,714	50,117	49,627
Deferred Tax Liability	(7,789)	(7,465)	(7,696)	(7,935)
Total Capital Employed	165,440	169,709	182,308	200,842
Applications of Funds				
Net Block	102,083	102,534	101,857	101,517
Goodwill	3,754	3,945	3,945	3,945
Investments	21,110	22,983	26,312	31,264
Inventories	28,529	29,089	28,618	33,325
Sundry Debtors	38,065	40,617	41,115	47,877
Cash & current investment	3,866	2,638	6,149	8,484
Loans and Advances	262	103	105	107
Other current assets	13,159	15,500	16,978	18,601
sub total	55,352	58,858	64,348	75,070
Less : Current Liabilities & Provisions				
Current Liabilities	40,832	43,915	38,988	40,493
Provisions	4,556	3,785	3,785	3,785
sub total	45,388	47,700	42,773	44,278
Total Assets	165,440	169,709	182,308	200,842

E – Estimates

Cash Flow (₹ mn)

Particulars	Mar17	Mar18	Mar19E	Mar20E
Profit before tax	14,653	14,341	21,333	28,768
Depreciation	11,722	11,762	12,677	13,652
Change in working capital	1,443	(2,522)	(6,443)	(11,594)
Total tax paid	(7,271)	(4,164)	(4,818)	(6,423)
Others	(806)	(2,080)	(2,288)	(2,289)
Cash flow from oper. (a)	19,741	17,337	20,462	22,113
Capital expenditure	(39,048)	(12,213)	(12,000)	(13,312)
Free cash flow	(19,307)	5,124	8,462	8,801
Change in investments	17,221	(1,873)	(3,329)	(4,952)
Others	(907)	(827)	(1,030)	(1,247)
Cash flow from inv. (b)	(22,734)	(14,913)	(16,360)	(19,511)
Equity raised/(repaid)	(15,266)	432	0	0
Debt raised/(repaid)	15,672	1,529	(597)	(490)
Dividend (incl. tax)	(3,523)	(3,320)	(3,320)	(3,320)
Others	5,055	(2,293)	3,325	3,543
Cash flow from fin. (c)	1,938	(3,652)	(591)	(267)
Net chg in cash (a+b+c)	(1,055)	(1,228)	3,511	2,335

Important Ratios

Particulars	Mar17	Mar18	Mar19E	Mar20E
(A) Measures of Performance (%)				
EBIDTA Margin (excl. O.I.)	17.8	16.6	20.0	21.8
Interest / Sales	(1.1)	(2.0)	(2.1)	(1.9)
Tax/PBT	17.8	31.6	21.5	21.5
Net Profit Margin	8.5	8.0	10.7	12.4
(B) As Percentage of Net Sales				
Raw material consumed	38.7	40.4	39.0	39.6
Selling & Distribution exp	30.2	30.6	28.5	26.0
R&D expenses	13.9	12.9	12.9	13.0
(C) Measures of Financial Status				
Debt / Equity (x)	0.4	0.4	0.4	0.3
Interest Coverage (x)	(0.1)	(0.1)	(0.1)	(0.1)
Average Cost Of Debt (%)	(3.2)	(5.7)	(6.5)	(7.0)
Debtors Period (days)	98.7	104.4	95.7	95.9
Closing stock (days)	74.0	74.8	66.6	66.8
Inventory Turnover (x)	4.9	4.9	5.5	5.5
Fixed Assets Turnover (x)	1.6	1.4	1.5	1.8
WC Turnover (x)	0.1	0.2	0.3	0.4
(D) Measures of Investment				
EPS (₹)	72.6	68.8	100.9	136.0
CEPS (₹)	143.3	139.7	177.3	218.3
DPS (₹)	21.3	20.0	20.0	20.0
Dividend Payout (%)	29.3	33.9	19.8	14.7
Profit Ploughback (%)	70.7	66.1	80.2	85.3
Book Value (₹)	748.2	761.8	842.7	958.7
RoANW (%)	9.5	9.1	12.6	15.1
RoACE (%)	7.6	6.4	9.6	12.4
(E) Valuation Ratios				
CMP (₹)	1,953	1,953	1,953	1,953
P/E (x)	26.9	28.4	19.4	14.4
Market Cap. (₹ mn)	323,733	324,123	324,123	324,123
MCap/ Sales (x)	2.3	2.3	2.1	1.8
EV (₹ Mn)	372,656	374,734	374,136	373,643
EV/Sales (x)	2.6	2.6	2.4	2.1
EV/EBDITA (x)	14.8	15.8	11.9	9.3
P/BV (x)	2.6	2.6	2.3	2.0
FCFE Yield (%)	(1.1)	2.1	2.4	2.6
Dividend Yield (%)	1.1	1.0	1.0	1.0

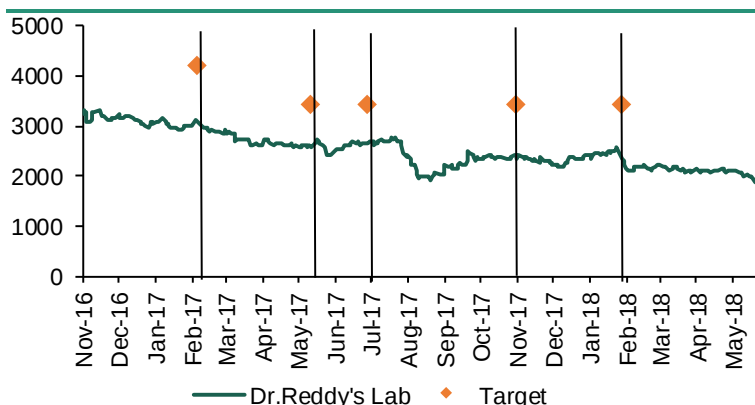
E – Estimates

DART RATING MATRIX

Total Return Expectation (12 Months)

Buy	> 20%
Accumulate	10 to 20%
Reduce	0 to 10%
Sell	< 0%

Rating and Target Price History



Month	Rating	TP (₹)	Price (₹)
Feb-17	Buy	4,200	3,095
May-17	Buy	3,450	2,585
Jul-17	Buy	3,450	2,436
Oct-17	Buy	3,450	2,431
Jan-18	Buy	3,450	2,504

* As on Recommendation Date

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