

Dr Reddy's Laboratories (DRREDD) ₹ 2750

Cost rationalisation to the fore in tough times

- Q3FY19 results were higher than I-direct estimates on profitability front while revenues were lower mainly due to lower US sales. Revenues were muted at ₹ 3864.6 crore (I-direct estimate: ₹ 4015 crore). Growth of 10% in domestic market to ₹ 674.1 crore (I-direct estimate: ₹ 674 crore) and 25.0% YoY growth in Russia & CIS to ₹ 550 crore (I-direct estimate: ₹ 550 crore) were largely offset by 7.7% fall in US sales to ₹ 1483.2 crore (I-direct estimate: ₹ 1600 crore)
- EBITDA margins remained at 20.8% YoY but came in 212 bps higher than I-direct estimates mainly due to lower R&D spend. EBITDA grew 1.5% YoY to ₹ 804.6 crore
- Net profit grew 65.3% YoY to ₹ 500.3 crore (I-direct estimate: ₹ 417 crore). Delta vis-à-vis EBITDA was due to ₹ 42.3 crore income from sale of API unit and lower tax rate (17.1% vs 46.2% in Q3FY18)

US business going through rough patch but promising launches ahead

The US business grew a mere 2% to ₹ 5982 crore in FY14-18 mainly due to the warning letter for its Srikakulam API & other facilities besides price erosion in key products and loss of market share. Despite challenging years, US remains a key driver for the company, contributing ~42% to total revenues. The company has a strong pending pipeline comprising 103 (59 Para IV filings and 33 FTFs) including three NDAs under 505 (b)(2) route. We expect US sales to grow at a CAGR of 7.5% to ₹ 7433 crore in FY18-21E on the back of new launches.

Russia CIS provides strong growth, India to provide more stability

Global Generics (ex US, Europe) is likely to grow at a CAGR of 1.8% in FY18-21E due to adverse currency movement and geography wise issues. 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 of Russia by virtue of being an early mover. We expect strong growth in these markets on the back of a stabilising 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, biosimilars space, UCB like acquisitions besides an improvement in productivity.

Portfolio realignment eminent

Growth in FY18-21E is likely to emanate from more productive and sustainable segments such as the US, Russia, 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.

Growth normalisation, margin improvement to support positive vibes

Despite pricing pressure in the US, the company has maintained margins due to effective cost rationalisation. We expect EBITDA margins to improve in FY19-21 due to key launches in the US (gSuboxone, gNuvaring, gCopaxone in the next 18 months), control on overheads and likely reduction in the regulatory spend. The company has launched 10 products in Q3FY19. We expect this type of aggression in product launches to persist. This can mitigate the pricing pressure in the US. Key growth drivers in the near term would be key launches in the US and clearance of Duvvada and Srikakulam API plants besides strong growth Global Generics (ex US, Europe). However, resent sharp run up in the stock has largely factored in the near term upside in the stock. We arrive at our new target price of ₹ 2870 based on 18x FY21E EPS of ~₹ 159.5.

Rating matrix		
Rating	:	Hold
Target	:	₹ 2870
Target Period	:	12-15 months
Potential Upside	:	4%

What's Changed?		
Target	Changed from ₹ 2700 to ₹ 2870	
EPS FY19E	Changed from ₹ 97.1 to ₹ 107.1	
EPS FY20E	Changed from ₹ 129.9 to ₹ 128.6	
Rating	Changed from Buy to Hold	

Quarterly Performance					
	Q3FY19	Q3FY18	YoY (%)	Q2FY19	QoQ (%)
Revenue	3,864.6	3,834.1	0.8	3,817.5	1.2
EBITDA	804.6	792.7	1.5	759.3	6.0
EBITDA (%)	20.8	20.7	14.5	19.9	93.0
Adjusted PAT	500.3	302.7	65.3	518.3	-3.5

Key Financials				
(₹crore)	FY18	FY19E	FY20E	FY21E
Revenues	14281.0	15327.5	17143.1	18975.8
EBITDA	2351.2	3067.1	3591.3	4235.1
Adjusted PAT	946.8	1777.8	2135.4	2647.1
EPS (Adjusted)	57.0	107.1	128.6	159.5

Valuation summary				
	FY18	FY19E	FY20E	FY21E
PE (x)	48.2	25.7	21.4	17.2
Target PE (x)	50.3	26.8	22.3	18.0
EV to EBITDA (x)	20.6	15.1	12.5	10.1
Price to book (x)	3.5	3.1	2.8	2.5
RoNW (%)	7.2	12.2	13.1	14.2
RoCE (%)	6.1	9.5	11.9	14.7

Stock data	
Particular	Amount
Market Capitalisation	₹ 45642 crore
Debt (FY18)	₹ 4265 crore
Cash & cash equivalents (FY18)	₹ 1138 crore
EV	₹ 48770 crore
52 week H/L (₹)	2878/1887
Equity capital	₹ 83.0 crore
Face value	₹ 5

Price performance (%)				
	1M	3M	6M	1Y
Dr Reddy's Labs	5.8	13.5	20.5	30.7
Sun Pharma	-5.3	-28.2	-29.7	-25.2
Lupin	3.0	0.4	-3.7	1.4

Research Analyst	
Siddhant Khandekar	siddhant.khandekar@icicisecurities.com
Mitesh Shah	mitesh.shah@icicisecurities.com

Variance analysis

	Q3FY19	Q3FY19E	Q3FY18	Q2FY19	YoY (%)	QoQ (%)	Comments
Revenue	3,864.6	4,015.2	3,834.1	3,817.5	0.8	1.2	Strong growth in emerging markets including in India was largely offset by decline in the US
Raw Material Expenses	1,175.8	1,124.2	1,036.7	1,051.7	13.4	11.8	A 339 bps YoY decline in gross margins to 69.6% was mainly due to price erosion in some of key molecules in the US
Gross Profit	2,688.8	2,890.9	2,797.4	2,765.8	-3.9	-2.8	
Employee expenses	805.4	875.3	818.1	872.2	-1.6	-7.7	
Other expenses	1,078.8	1,264.8	1,186.6	1,134.3	-9.1	-4.9	R&D spend declined 260 bps YoY to 9.6%
EBITDA	804.6	750.8	792.7	759.3	1.5	6.0	
EBITDA (%)	20.8	18.7	20.7	19.9	14.5	93.0	YoY growth due to lower R&D spend
Other Income	102.3	56.2	43.0	128.2	137.9	-20.2	Included gain of ₹ 42.3 crore on account of sale of API manufacturing unit located at Jeedimetla, Hyderabad
Interest	24.1	20.8	17.2	20.8	40.1	15.9	
Depreciation	290.3	278.7	271.5	278.6	6.9	4.2	
PBT	592.5	507.5	547.0	588.1	8.3	0.7	
Tax	101.1	101.5	252.8	80.7	-60.0	25.3	Lower rate due to 1) reduction of Fed tax rate in the US, 2) favourable resolutions of earlier tax matter led to reversal of tax and 3) claim of deduction of certain items for tax purpose
Net Profit	500.3	416.9	302.7	518.3	65.3	-3.5	
Adjusted PAT	500.3	416.9	302.7	518.3	65.3	-3.5	Delta vis-à-vis EBITDA and I-direct estimates mainly due to lower tax rate and one-off gain
Key Metrics							
US	1,483.2	1,599.9	1,607.3	1,426.5	-7.7	4.0	YoY decline and miss vis-à-vis I-direct estimates due to higher-than-expected price erosion in base business
Europe	203.0	196.6	200.6	191.5	1.2	6.0	New products and volume uptake largely offset by higher price erosion in some key molecules
India	674.1	673.9	612.6	686.4	10.0	-1.8	YoY growth on the back of new launches and improvement in the base business performance
Russia & Other CIS	550.0	550.0	440.0	520.0	25.0	5.8	YoY growth primarily driven by new launches, improvement in base business, marginally offset by unfavorable forex
RoW	224.4	225.0	150.0	229.2	49.6	-2.1	YoY growth driven by new markets (primarily Brazil) and volume traction in China & other countries
PSAI	593.7	598.0	543.6	602.9	9.2	-1.5	YoY growth was largely driven by custom pharma services segment

Source: Company, ICICI Direct Research

Change in estimates

(₹ Crore)	FY19E			FY20E			
	Old	New	% Change	Old	New	% Change	
Revenue	15,399.7	15,327.5	-0.5	16,962.6	17,143.1	1.1	
EBITDA	2,933.0	3,067.1	4.6	3,583.3	3,591.3	0.2	
EBITDA Margin (%)	19.0	20.0	101 bps	21.1	20.9	-15 bps	Changed mainly due to better-than-expected margins in Q3FY19
Adjusted PAT	1,609.7	1,777.8	10.4	2,156.8	2,135.4	-1.0	
EPS (₹)	97.1	107.1	10.3	129.9	128.6	-1.0	Change mainly in sync with EBITDA and reduction in tax rate guidance

Source: Company, ICICI Direct Research

Assumptions

(₹ crore)	Current				Earlier		
	FY17	FY18	FY19E	FY20E	FY19E	FY20E	
US	6,360.1	5,982.4	6,021.9	6,769.5	6,122.3	6,719.8	
Europe	760.5	821.6	792.9	872.2	790.5	869.5	
India	2,313.2	2,332.1	2,655.4	2,974.0	2,655.1	2,973.7	
Russia & Other CIS	1,520.0	1,650.0	2,023.6	2,327.1	1,979.6	2,177.6	Changed mainly due to strong growth in base business, new launches and favorable macro economic factors
RoW	587.1	614.7	845.9	1,005.6	846.5	1,006.3	
PSAI	2,127.7	2,199.2	2,393.9	2,513.5	2,370.9	2,489.5	

Source: Company, ICICI Direct 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 (80% 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 (16% of revenues) consist of the active pharmaceutical ingredients (API) business and custom pharmaceutical services (CPS) business. Proprietary products (PP, 4% of revenues) consists 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 ~13% of the turnover on R&D in FY18 and is likely to be in ~11% going ahead. Beside ANDAs, it has also filed three new drug applications (NDAs) in the 505(b)(2) route that 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. As ZEMBRACE SymTouch is a subcutaneous injection, it may lead to rapid relief of migraine.

It also has 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 into a 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 under way 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.

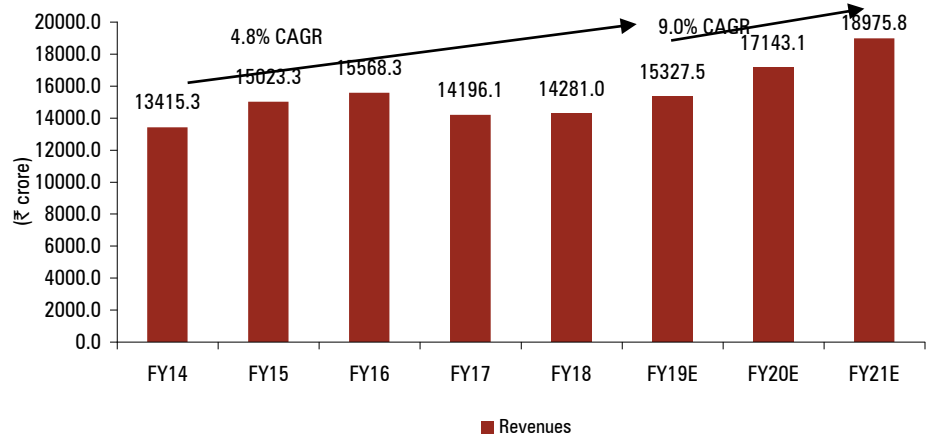
To strengthen its domestic portfolio, in FY16, the company acquired a select domestic portfolio from UCB in the areas of dermatology, respiratory and paediatrics diseases. The revenues of the acquired business are ~₹ 150 crore in 2014. This acquisition has enhanced DRL's presence in the fast growing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

In FY15, the company 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 10% to ₹ 18976 crore in FY18-21E. The US is likely to grow at a CAGR of 7.5% to ₹ 7433 crore on the back of new 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 PSAI segments have also shown strong growth on the back of geographical expansion, robust biological portfolio and ramp up in institutional business.

Exhibit 1: Revenues to grow at CAGR of 9% in FY18-20E



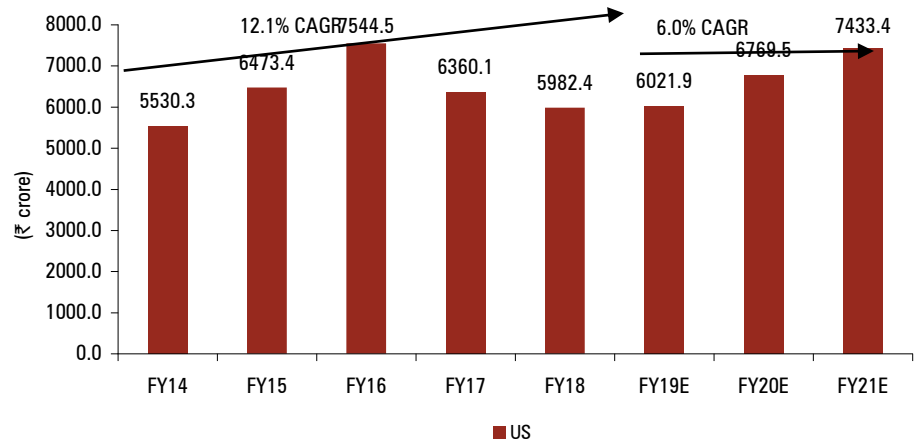
Source: Company, ICICI Direct Research

Exhibit 2: Geography wise revenue break up

(₹ crore)	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
US	5530.3	6473.4	7544.5	6360.1	5982.4	6021.9	6769.5	7433.4
Europe	697.0	718.1	773.2	760.5	821.6	792.9	872.2	959.4
India	1571.3	1787.0	2129.2	2313.2	2332.1	2655.4	2974.0	3330.9
Russia & Other CIS	1981.9	1771.4	1419.1	1520.0	1650.0	2023.6	2327.1	2676.2
RoW	735.9	1305.7	940.2	587.1	614.7	845.9	1005.6	1156.5
PSAI	2397.4	2545.7	2238.0	2127.7	2199.2	2393.9	2513.5	2639.2

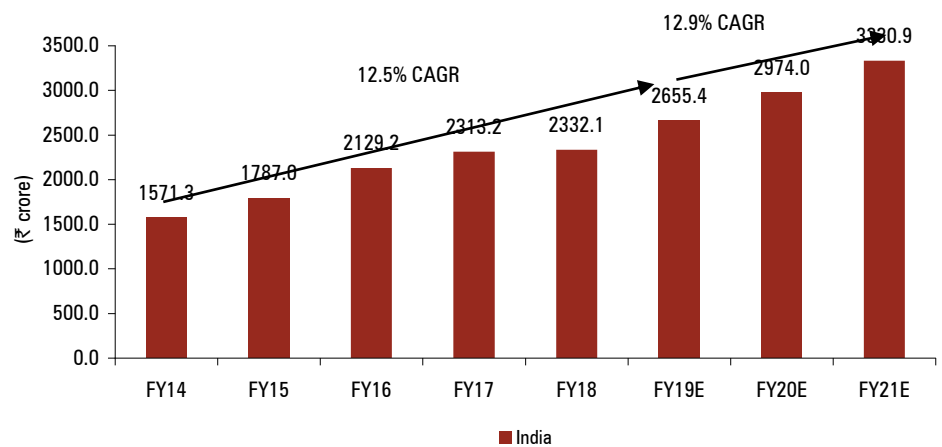
Source: Company, ICICI Direct Research

Exhibit 3: US sales to be driven by new launches



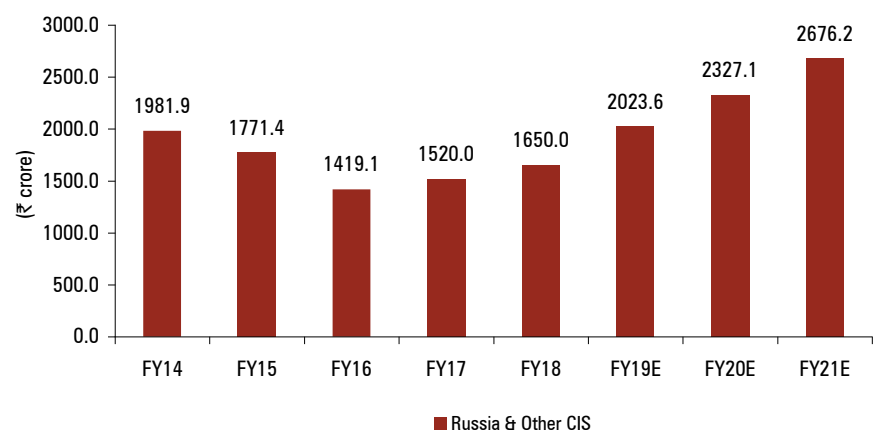
Source: Company, ICICI Direct Research

Exhibit 4: New launches, improved MR productivity to drive domestic growth

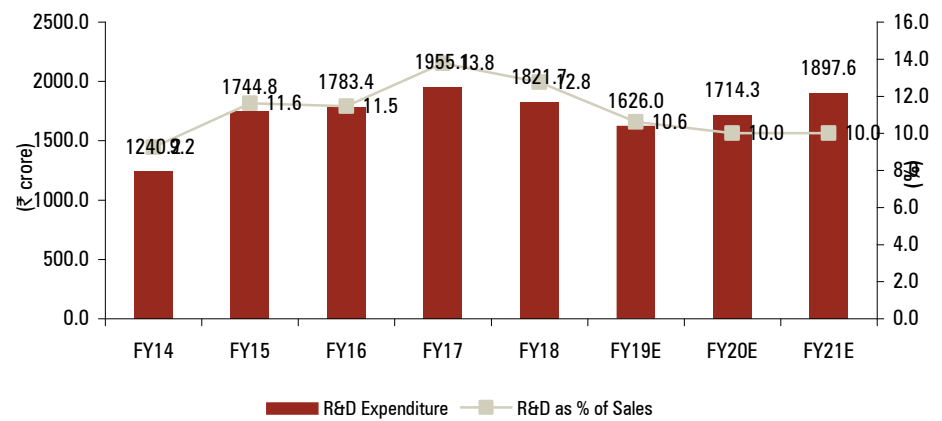


Source: Company, ICICI Direct Research

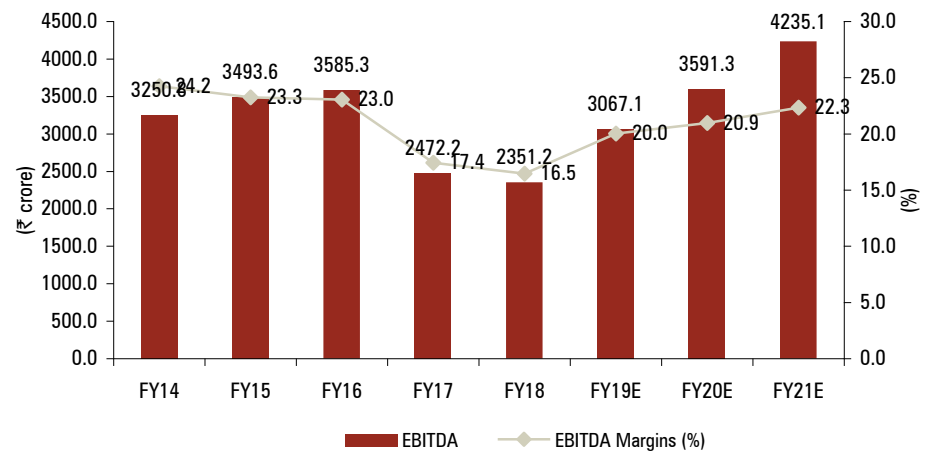
Exhibit 5: Russia & CIS to witness tempered growth due to regional issues



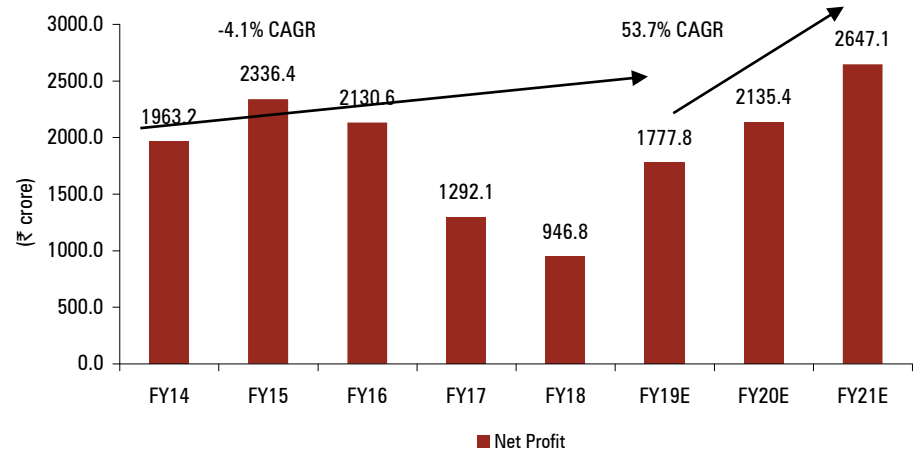
Source: Company, ICICI Direct Research

Exhibit 6: R&D trend


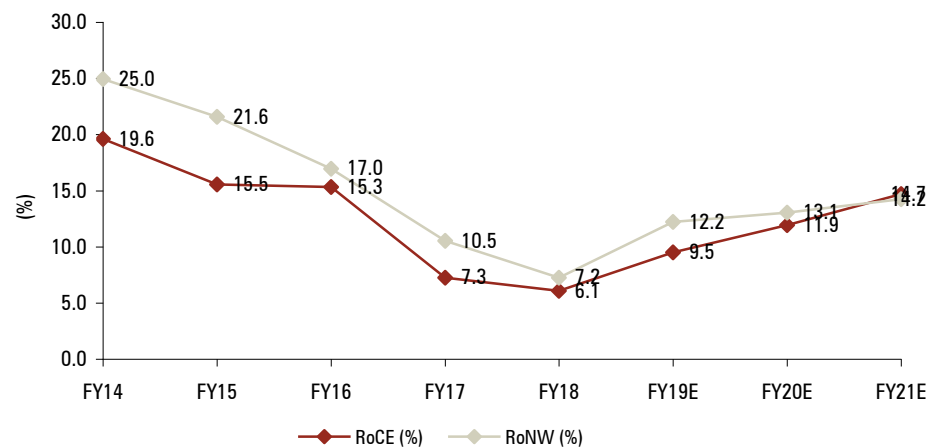
Source: Company, ICICI Direct Research

Exhibit 7: Higher R&D, slow US approvals likely to weigh on EBITDA margins


Source: Company, ICICI Direct Research

Exhibit 8: Net profit to grow at CAGR of 54% in FY18-20E on low base


Source: Company, ICICI Direct Research

Exhibit 9: Trends in return ratios


Source: Company, ICICI Direct Research

Exhibit 10: Trends in quarterly financials

₹ Crore	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19	YoY (%)	QoQ (%)
Total Operating Income	3979.7	3795.0	3244.7	3616.3	3723.2	3611.9	3333.2	3559.8	3834.1	3553.9	3736.5	3817.5	3864.6	0.8	1.2
Raw Material Expenses	980.3	964.9	756.4	867.4	815.9	1005.2	959.2	1036.9	1036.7	1006.7	1004.9	1051.7	1175.8	13.4	11.8
% of Revenues	24.6	25.4	23.3	24.0	21.9	27.8	28.8	29.1	27.0	28.3	26.9	27.5	30.4	339 bps	288 bps
Gross Profit	2999.4	2830.1	2488.3	2748.9	2907.3	2606.7	2374.0	2522.9	2797.4	2547.2	2731.6	2765.8	2688.8	-3.9	-2.8
Gross Profit Margins (%)	75.4	74.6	76.7	76.0	78.1	72.2	71.2	70.9	73.0	71.7	73.1	72.5	69.6	-339 bps	-288 bps
Employee expenses	789.3	790.9	805.0	816.1	814.6	671.1	807.3	789.0	818.1	800.5	837.1	872.2	805.4	-1.6	-7.7
% of Revenues	19.8	20.8	24.8	22.6	21.9	18.6	24.2	22.2	21.3	22.5	22.4	22.8	20.8	-50 bps	-201 bps
Other expenses	1226.1	1557.5	1293.1	1305.8	1228.2	1345.1	1243.5	1064.5	1186.6	1183.1	1125.7	1134.3	1078.8	-9.1	-4.9
% of Revenues	30.8	41.0	39.9	36.1	33.0	37.2	37.3	29.9	30.9	33.3	30.1	29.7	27.9	-303 bps	-180 bps
Total Expenditure	2995.7	3313.3	2854.5	2989.3	2858.7	3021.4	3010.0	2890.4	3041.4	2990.3	2967.7	3058.2	3060.0	0.6	0.1
% of Revenues	75.3	87.3	88.0	82.7	76.8	83.7	90.3	81.2	79.3	84.1	79.4	80.1	79.2	-14 bps	-93 bps
EBITDA	984.0	481.7	390.2	627.0	864.5	590.5	323.2	669.4	792.7	563.6	768.8	759.3	804.6	1.5	6.0
EBITDA Margins (%)	24.7	12.7	12.0	17.3	23.2	16.3	9.7	18.8	20.7	15.9	20.6	19.9	20.8	14 bps	93 bps
Total Depreciation	NA	276.7	243.6	262.2	266.5	254.3	259.2	270.2	271.5	276.3	278.7	278.6	290.3	6.9	4.2
EBITDA	NA	205.0	146.6	364.8	598.0	336.2	64.0	399.2	521.2	287.3	490.1	480.7	514.3	-1.3	7.0
Interest	16.0	17.0	14.8	12.6	16.4	19.6	21.5	22.3	17.2	17.8	19.5	20.8	24.1	40.1	15.9
Exceptional Items	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	NA	NA
EBT	NA	188.0	131.8	352.2	581.6	316.6	42.5	376.9	504.0	269.5	470.6	459.9	490.2	-2.7	6.6
Total Tax	153.3	156.3	52.6	95.6	138.5	9.7	23.7	112.3	252.8	49.2	53.2	80.7	101.1	-60.0	25.3
Tax %	NA	83.1	39.9	27.1	23.8	3.1	55.8	29.8	50.2	18.3	11.3	17.5	20.6		
Net Profit	647.5	31.7	79.2	256.6	443.1	306.9	18.8	264.6	251.2	220.3	417.4	379.2	389.1	54.9	2.6
Adjusted PAT	647.5	122.6	153.5	308.9	492.3	337.6	66.6	305.4	302.7	272.1	476.1	518.3	500.3	65.3	-3.5

Source: Company, ICICI Direct 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. The biosimilars space across the globe. Indian franchise is still pretty small for a player of DRL's calibre.

Threats- Industry specific- Pricing pressure due to client consolidation in the US, pricing probe for the industry by the Department of Justice (DoJ) in the US, proposed tightening by the new regime by adapting to the bidding process, Currency volatility in ROW markets and Russia

Threats- Company specific- Pending Srikakulam and Duvvada warning letter resolution

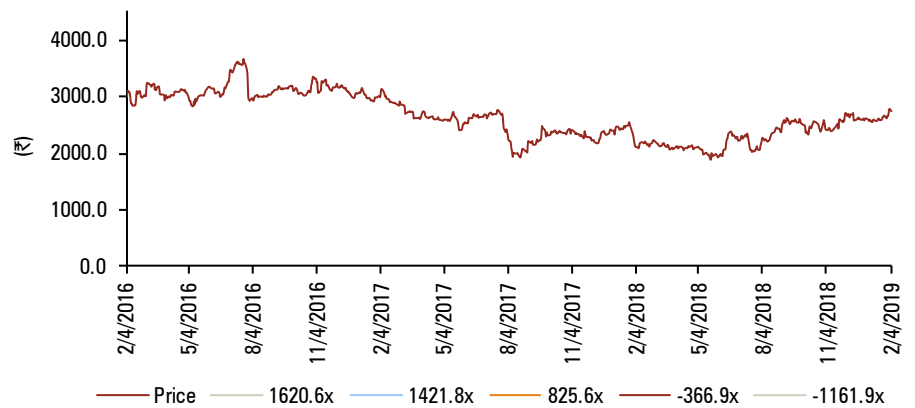
Conference call Highlights

- The management has guided for recalibration of R&D spend with yearly run rate to be in the range of US\$250-300 million. Total 60% of R&D is likely to be earmarked for generics and the remaining 40% for proprietary products / biosimilars
- PSAI GPMs were higher during the quarter due to higher component of PS (pharmaceutical services)
- Receivables were lower during the quarter due to factoring of some receivables in the US
- **Regulatory status- Srikakulam API-** the company has been asked by the USFDA to carry out certain detailed investigations and analyses to which it has submitted the results of the investigations and analyses in October 2018. The company responded to all queries in January 2019 and is awaiting re-inspection by the USFDA. **Oncology manufacturing facility –Duvvada-** In October 2018, the re-inspection by the USFDA was completed and the USFDA issued Form 483 with eight observations. The company has responded to these observations identified in November 2018 and awaiting to hear from the USFDA.
- The company launched 10 products in the US during the quarter including Colesevelam (g Welchol; cardio diabetic), Sevelamer (gRenvela; kidney disease) sachet & unit dose, Aspirin & Dipyridamole XR and Omeprazole (GI) OTC tabs. It filed three ANDAs during the quarter
- As of December 31, 2018, cumulatively 103 generic filings are pending for approval with the USFDA (100 ANDAs and 3 NDAs under 505(b)(2) route). Of this, 59 are Para IVs, and 33 have 'First to File' status as per company's perception
- Capex for the quarter was at ₹ 153 crore while for 9M it was ₹ 520 crore
- The company generated FCF of ₹ 1512 crore and ₹ 1713 crore for the quarter and 9MFY19, respectively

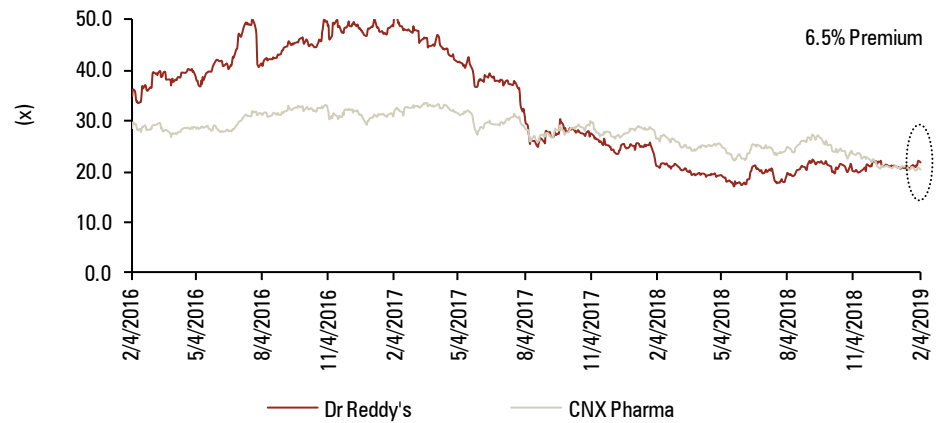
Exhibit 11: Facilities

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, ICICI Direct Research

Exhibit 12: One year forward PE


Source: Company, ICICI Direct Research

Exhibit 13: One year forward PE of company vs. CNX Pharma


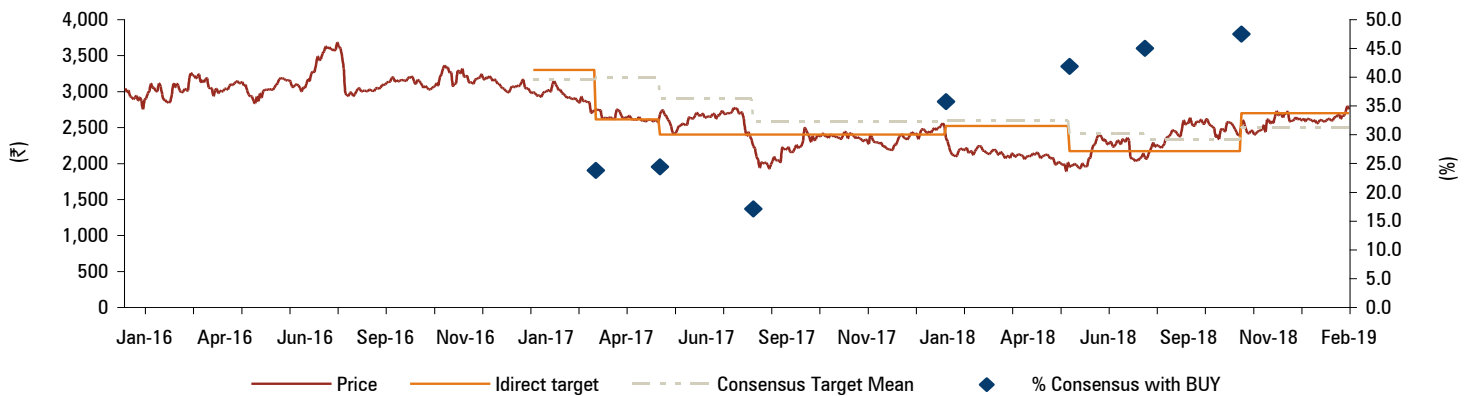
Source: Company, ICICI Direct Research

Exhibit 14: Valuation

	Revenues (₹ crore)	Growth (%)	Adj. EPS (₹)	Growth (%)	P/E (x)	EV/EBITDA (X)	RoNW (%)	RoCE (%)
FY18	14281.0	0.6	57.0	-26.7	48.2	20.6	7.2	6.1
FY19E	15327.5	7.3	107.1	87.8	25.7	15.1	12.2	9.5
FY20E	17143.1	11.8	128.6	20.1	21.4	12.5	13.1	11.9
FY21E	18975.8	10.7	159.5	24.0	17.2	10.1	14.2	14.7

Source: Company, ICICI Direct Research

Recommendation history vs. Consensus



Source: Reuters, Company, ICICI Direct 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
Oct-19	Duvvada oncology formulation facility receives 8 observations from USFDA post re-inspection
Jan-19	Receives USFDA approval for novel drug Tosymra' spray to treat acute migraine with or without aura in adults

Source: Company, ICICI Direct Research

Top 10 Shareholders

Rank	Investor Name	Latest Filing Date	% O/S	Position (\$)	Position Char
1	Dr Reddys Holdings Pvt. Ltd.	30-Sep-18	0.2	41.3253 (\$)	0.1m
2	Commonwealth Bank of Australia	31-Dec-18	0.1	12.824555 (\$)	12.8m
3	Stewart Investors	30-Sep-18	0.1	9.416134 (\$)	0.2m
4	Life Insurance Corporation of India	30-Sep-18	0.0	7.361709 (\$)	0.0m
5	Franklin Templeton Asset Management (India) Pvt. Ltd	30-Sep-18	0.0	5.751727 (\$)	-2.8m
6	Aditya Birla Sun Life AMC Limited	30-Sep-18	0.0	3.995771 (\$)	-0.2m
7	Reliance Nippon Life Asset Management Limited	30-Sep-18	0.0	3.468968 (\$)	-0.8m
8	BlackRock Institutional Trust Company, N.A.	31-Dec-18	0.0	3.360942 (\$)	0.0m
9	First State Investments (U.K.) Ltd	30-Jun-18	0.0	2.605509 (\$)	0.3m
10	SBI Funds Management Pvt. Ltd.	31-Dec-18	0.0	2.293817 (\$)	0.2m

Source: Reuters, ICICI Direct Research

Shareholding Pattern

(in %)	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
Promoter	26.8	26.8	26.8	26.8	26.8
Others	73.2	73.2	73.2	73.2	73.2

Recent Activity

Buys			Sells		
Investor name	Value (\$)	Shares	Investor name	Value (\$)	Shares
Commonwealth Bank of Australia	482.4m	12.8m	Franklin Templeton Asset Management (India) Pvt. Ltd.	-98.0m	-2.8m
SBI Funds Management Pvt. Ltd.	8.7m	0.2m	Reliance Nippon Life Asset Management Limited	-27.8m	-0.8m
Stewart Investors	6.0m	0.2m	ICICI Prudential Asset Management Co. Ltd.	-19.8m	-0.5m
Unigestion	5.4m	0.1m	Franklin Advisers, Inc.	-10.3m	-0.3m
Schroder Investment Management (Hong Kong) Ltd.	4.1m	0.1m	Templeton Asset Management Ltd.	-8.7m	-0.2m

Source: Reuters, ICICI Direct Research

Financial summary

Profit and loss statement					₹ Crore
(Year-end March)	FY18	FY19E	FY20E	FY21E	
Revenues	14,281.0	15,327.5	17,143.1	18,975.8	
Growth (%)	0.6	7.3	11.8	10.7	
Raw Material Expenses	4,039.5	4,421.7	5,002.8	5,542.8	
Employee expenses	3,214.9	3,327.3	3,577.6	3,767.5	
Other expenses	4,675.4	4,511.5	4,971.5	5,430.4	
Total Operating Expenditure	11,929.8	12,260.4	13,551.9	14,740.7	
EBITDA	2,351.2	3,067.1	3,591.3	4,235.1	
Growth (%)	-4.9	30.4	17.1	17.9	
Interest	78.8	86.7	72.4	55.7	
Depreciation	1,077.2	1,137.9	1,202.7	1,254.7	
PBT before Exceptional Items	1,350.4	2,057.1	2,624.8	3,264.4	
Share of profit/ (loss) of equity accc	0.0	0.0	0.0	0.0	
PBT	1,350.4	2,057.1	2,624.8	3,264.4	
Total Tax	438.0	316.3	525.0	652.9	
PAT	946.8	1,777.8	2,135.4	2,647.1	
Adjusted PAT	946.8	1,777.8	2,135.4	2,647.1	
Growth (%)	-26.7	87.8	20.1	24.0	
EPS	57.0	107.1	128.6	159.5	
EPS (Adjusted)	57.0	107.1	128.6	159.5	

Source: Company, ICICI Direct Research

Balance sheet					₹ Crore
(Year-end March)	FY18	FY19E	FY20E	FY21E	
Equity Capital	83.0	83.0	83.0	83.0	
Net Networth	12,982.8	14,476.7	16,271.1	18,495.4	
Total Shareholders funds	13,065.8	14,559.7	16,354.1	18,578.4	
Total Debt	5,065.1	4,265.1	3,465.1	2,665.1	
Deferred Tax Liability	195.0	202.8	210.9	219.3	
Other Non Current Liabilities	293.3	305.0	317.2	329.9	
Long term Provisions	81.7	85.0	88.4	91.9	
Source of Funds	18,700.9	19,417.6	20,435.7	21,884.7	
Gross Block - Fixed Assets	16,903.2	17,703.2	18,503.2	19,303.2	
Accumulated Depreciation	10,468.3	11,606.2	12,808.9	14,063.6	
Net Block	6,434.9	6,097.0	5,694.3	5,239.6	
Capital WIP	3,470.5	3,570.5	3,670.5	3,770.5	
Net Fixed Assets	9,905.4	9,667.5	9,364.8	9,010.1	
Goodwill	533.1	533.1	533.1	533.1	
Investments	2,298.3	2,598.3	3,098.3	3,598.3	
Inventory	2,908.9	2,518.3	2,816.7	3,117.8	
Cash	263.8	1,137.6	1,315.1	1,969.4	
Debtors	4,052.7	3,779.4	4,227.1	4,679.0	
Loans & Advances & Other CA	1,440.0	1,497.6	1,557.5	1,619.8	
Total Current Assets	8,665.4	8,932.9	9,916.3	11,385.9	
Creditors	1,334.5	892.8	998.5	1,105.3	
Provisions & Other CL	2,508.9	2,609.2	2,713.6	2,822.1	
Total Current Liabilities	3,843.4	3,502.0	3,712.1	3,927.4	
Net Current Assets	4,822.0	5,430.9	6,204.2	7,458.5	
LT L& A, Other Assets	601.6	625.7	650.7	676.7	
Deferred Tax Assets	540.5	562.1	584.6	608.0	
Application of Funds	18,700.9	19,417.6	20,435.7	21,884.7	

Source: Company, ICICI Direct Research

Cash flow statement					₹ Crore
(Year-end March)	FY18	FY19E	FY20E	FY21E	
Profit/(Loss) after taxation	1,074.3	1,777.8	2,135.4	2,647.1	
Add: Depreciation & Amortization	1,077.2	1,137.9	1,202.7	1,254.7	
Net Increase in Current Assets	-754.3	606.3	-805.9	-815.3	
Net Increase in Current Liabilities	-142.3	-341.4	210.1	215.3	
CF from operating activities	1,803.0	3,267.3	2,814.7	3,357.5	
(Inc)/dec in Fixed Assets	-1,090.4	-900.0	-900.0	-900.0	
(Inc)/dec in Investments	-425.3	-300.0	-500.0	-500.0	
Others	34.0	-22.9	-23.8	-24.8	
CF from investing activities	-1,481.7	-1,222.9	-1,423.8	-1,424.8	
Inc / (Dec) in Equity Capital	0.1	0.0	0.0	0.0	
Inc / (Dec) in Loan	88.2	-800.0	-800.0	-800.0	
Dividend & Dividend Tax	-399.2	-283.9	-341.0	-422.8	
Others	-133.1	-86.7	-72.4	-55.7	
CF from financing activities	-444.0	-1,170.6	-1,213.4	-1,278.4	
Net Cash flow	-122.7	873.8	177.5	654.3	
Opening Cash	386.5	263.8	1,137.6	1,315.1	
Closing Cash	263.8	1,137.6	1,315.1	1,969.4	
Free Cash Flow	712.6	2,367.3	1,914.7	2,457.5	

Source: Company, ICICI Direct Research

Key ratios				
(Year-end March)	FY18	FY19E	FY20E	FY21E
Per share data (₹)				
EPS	57.0	107.1	128.6	159.5
BV per share	787.1	877.1	985.1	1,119.1
Operating Ratios (%)				
Gross Profit Margins	71.7	71.2	70.8	70.8
EBITDA margins	16.5	20.0	20.9	22.3
Net Profit margins	6.6	11.6	12.5	13.9
Inventory days	74.3	60.0	60.0	60.0
Debtor days	103.6	90.0	90.0	90.0
Creditor days	34.1	21.3	21.3	21.3
Asset Turnover	0.8	0.9	0.9	1.0
EBITDA conversion Rate	76.7	106.5	78.4	79.3
Return Ratios (%)				
RoE	7.2	12.2	13.1	14.2
RoCE	6.1	9.5	11.9	14.7
RoIC	11.3	18.5	22.5	27.6
Valuation Ratios (x)				
P/E	48.2	25.7	21.4	17.2
EV / EBITDA	20.6	15.1	12.5	10.1
EV / Revenues	3.4	3.0	2.6	2.3
Market Cap / Revenues	3.2	3.0	2.7	2.4
Price to Book Value	3.5	3.1	2.8	2.5
Solvency Ratios				
Debt / Equity	0.4	0.3	0.2	0.1
Debt / EBITDA	2.2	1.4	1.0	0.6
Current Ratio	2.2	2.2	2.3	2.4

Source: Company, ICICI Direct Research

ICICI Direct coverage universe (Healthcare)

Company	I-Direct Code	CMP (₹)	TP (₹)	Rating	M Cap (₹ Cr)	EPS (₹)				PE(x)				RoCE (%)				RoE (%)			
						FY17	FY18	FY19E	FY20E	FY17	FY18	FY19E	FY20E	FY17	FY18	FY19E	FY20E	FY17	FY18	FY19E	FY20E
Ajanta Pharma	AJAPHA	955	1,225	Buy	8405.8	57.4	53.0	43.1	50.5	16.6	18.0	22.2	18.9	41.3	30.0	21.6	21.7	32.3	23.0	16.4	16.8
Alembic Pharma	ALEMPHA	589	620	Hold	11104.5	21.2	21.9	30.4	27.1	27.8	26.9	19.4	21.8	25.3	18.0	19.9	17.2	21.0	18.6	21.4	16.6
Apollo Hospitals	APOHOS	1283	1,440	Buy	17849.1	15.9	8.5	26.6	48.2	80.8	151.7	48.2	26.6	6.1	6.3	9.8	13.7	6.0	3.6	10.4	16.4
Aurobindo Pharma	AURPHA	768	915	Buy	45018.2	38.8	41.6	42.6	53.1	19.8	18.5	18.0	14.5	24.4	20.0	18.0	16.7	24.2	20.7	17.8	18.4
Biocon	BIOCON	652	760	Buy	39132.0	8.5	6.2	12.8	17.3	76.9	105.1	51.0	37.7	9.4	8.1	13.1	15.4	10.5	7.2	12.8	15.0
Cadila Healthcare	CADHEA	317	415	Buy	32473.1	14.5	17.5	16.5	18.9	21.8	18.1	19.2	16.8	13.1	16.7	14.2	13.1	21.4	20.5	16.8	16.8
Cipla	CIPLA	507	510	Hold	40879.6	12.5	18.3	17.5	23.1	40.6	27.7	28.9	22.0	7.7	9.6	11.0	13.9	8.0	10.4	9.2	11.0
Divi's Lab	DIVLAB	1605	1,700	Buy	42614.3	39.9	33.3	55.0	65.5	40.2	48.2	29.2	24.5	25.3	20.0	26.8	26.3	19.8	14.9	20.7	20.5
Dr Reddy's Labs	DRREDD	2749	2,870	Buy	45642.5	78.0	57.0	107.1	128.6	35.3	48.2	25.7	21.4	7.3	6.1	9.5	11.9	10.5	7.2	12.2	13.1
Glenmark Pharma	GLEPHA	645	660	Hold	18190.0	42.2	28.5	32.9	36.8	15.3	22.6	19.6	17.5	19.5	14.6	16.0	15.2	26.5	15.6	14.9	14.5
Indoco Remedies	INDREM	180	195	Hold	1655.5	8.4	4.8	-1.8	7.4	21.5	37.2	-98.5	24.2	8.7	6.5	-0.1	8.3	11.8	6.6	-2.6	9.4
Ipca Laboratories	IPCLAB	740	845	Buy	9350.1	15.4	19.0	32.4	42.3	48.0	39.0	22.8	17.5	8.7	9.1	13.8	17.1	7.9	8.9	13.5	15.4
Jubilant Life	JUBLIF	725	920	Buy	11539.9	36.9	41.3	62.5	76.6	19.6	17.6	11.6	9.5	13.8	14.9	19.4	21.3	16.8	15.7	19.4	19.4
Lupin	LUPIN	852	870	Hold	38530.8	56.7	20.8	27.6	39.1	15.0	41.0	30.8	21.8	16.6	10.4	10.4	12.4	19.0	6.9	8.6	11.0
Narayana Hrudalaya	NARHRU	191	270	Buy	3903.3	4.1	2.5	2.3	6.6	46.3	76.3	82.2	29.0	12.5	6.3	7.1	12.0	8.8	4.9	4.4	11.1
Natco Pharma	NATPHA	687	860	Buy	12683.7	26.3	37.7	41.7	24.9	26.1	18.2	16.5	27.6	33.6	27.4	26.6	14.8	29.5	22.7	21.2	11.6
Sun Pharma	SUNPHA	411	460	Hold	98621.9	29.0	13.0	14.7	21.1	14.2	31.7	28.0	19.4	20.3	9.8	10.2	13.3	19.0	8.2	8.8	11.5
Syngene Int.	SYNINT	597	675	Buy	11938.0	14.4	15.3	16.3	17.5	40.8	38.4	35.9	33.5	16.0	15.9	16.8	16.5	20.3	17.7	16.1	14.8
Torrent Pharma	TORPHA	1835	2,175	Buy	31051.4	55.2	40.1	52.3	64.9	33.3	45.8	35.1	28.3	18.9	11.2	14.2	17.1	21.5	14.7	16.7	17.9

Source: Company, ICICI Direct Research

RATING RATIONALE

ICICI Direct endeavours to provide objective opinions and recommendations. ICICI Direct assigns ratings to its stocks according to their notional target price vs. current market price and then categorises them as Strong Buy, Buy, Hold and Sell. The performance horizon is two years unless specified and the notional target price is defined as the analysts' valuation for a stock.

Strong Buy: > 15%/20% for large caps/midcaps, respectively, with high conviction;

Buy: > 10%/15% for large caps/midcaps, respectively;

Hold: Up to +/-10%;

Sell: -10% or more;



Pankaj Pandey

Head – Research

pankaj.pandey@icicisecurities.com

ICICI Direct Research Desk,
ICICI Securities Limited,
1st Floor, Akruiti Trade Centre,
Road No 7, MIDC,
Andheri (East)
Mumbai – 400 093
research@icicidirect.com

ANALYST CERTIFICATION

We /I, Siddhant Khandekar CA-INTER, Mitesh Shah MS (Finance) Research Analysts, authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report. It is also confirmed that above mentioned Analysts of this report have not received any compensation from the companies mentioned in the report in the preceding twelve months and do not serve as an officer, director or employee of the companies mentioned in the report.

Terms & conditions and other disclosures:

ICICI Securities Limited (ICICI Securities) is a full-service, integrated investment banking and is, inter alia, engaged in the business of stock brokering and distribution of financial products. ICICI Securities Limited is a Sebi registered Research Analyst with Sebi Registration Number – INH000000990. ICICI Securities Limited Sebi Registration is INZ000183631 for stock broker. ICICI Securities is a subsidiary of ICICI Bank which is India's largest private sector bank and has its various subsidiaries engaged in businesses of housing finance, asset management, life insurance, general insurance, venture capital fund management, etc. ("associates"), the details in respect of which are available on www.icicibank.com

ICICI Securities is one of the leading merchant bankers/ underwriters of securities and participate in virtually all securities trading markets in India. We and our associates might have investment banking and other business relationship with a significant percentage of companies covered by our Investment Research Department. ICICI Securities generally prohibits its analysts, persons reporting to analysts and their relatives from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover.

The information and opinions in this report have been prepared by ICICI Securities and are subject to change without any notice. The report and information contained herein is strictly confidential and meant solely for the selected recipient and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ICICI Securities. While we would endeavour to update the information herein on a reasonable basis, ICICI Securities is under no obligation to update or keep the information current. Also, there may be regulatory, compliance or other reasons that may prevent ICICI Securities from doing so. Non-rated securities indicate that rating on a particular security has been suspended temporarily and such suspension is in compliance with applicable regulations and/or ICICI Securities policies, in circumstances where ICICI Securities might be acting in an advisory capacity to this company, or in certain other circumstances.

This report is based on information obtained from public sources and sources believed to be reliable, but no independent verification has been made nor is its accuracy or completeness guaranteed. This report and information herein is solely for informational purpose and shall not be used or considered as an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. ICICI Securities will not treat recipients as customers by virtue of their receiving this report. Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to your specific circumstances. The securities discussed and opinions expressed in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient. This may not be taken in substitution for the exercise of independent judgment by any recipient. The recipient should independently evaluate the investment risks. The value and return on investment may vary because of changes in interest rates, foreign exchange rates or any other reason. ICICI Securities accepts no liabilities whatsoever for any loss or damage of any kind arising out of the use of this report. Past performance is not necessarily a guide to future performance. Investors are advised to see Risk Disclosure Document to understand the risks associated before investing in the securities markets. Actual results may differ materially from those set forth in projections. Forward-looking statements are not predictions and may be subject to change without notice.

ICICI Securities or its associates might have managed or co-managed public offering of securities for the subject company or might have been mandated by the subject company for any other assignment in the past twelve months.

ICICI Securities or its associates might have received any compensation from the companies mentioned in the report during the period preceding twelve months from the date of this report for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory service in a merger or specific transaction.

ICICI Securities or its associates might have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the companies mentioned in the report in the past twelve months.

ICICI Securities encourages independence in research report preparation and strives to minimize conflict in preparation of research report. ICICI Securities or its associates or its analysts did not receive any compensation or other benefits from the companies mentioned in the report or third party in connection with preparation of the research report. Accordingly, neither ICICI Securities nor Research Analysts and their relatives have any material conflict of interest at the time of publication of this report.

Compensation of our Research Analysts is not based on any specific merchant banking, investment banking or brokerage service transactions.

ICICI Securities or its subsidiaries collectively or Research Analysts or their relatives do not own 1% or more of the equity securities of the Company mentioned in the report as of the last day of the month preceding the publication of the research report.

Since associates of ICICI Securities are engaged in various financial service businesses, they might have financial interests or beneficial ownership in various companies including the subject company/companies mentioned in this report.

ICICI Securities may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report.

Neither the Research Analysts nor ICICI Securities have been engaged in market making activity for the companies mentioned in the report.

We submit that no material disciplinary action has been taken on ICICI Securities by any Regulatory Authority impacting Equity Research Analysis activities.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject ICICI Securities and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.