Prabhudas Lilladher
POWERING YOUR FINANCIAL GROWTH

Dr. Reddy's Laboratories (DRRD IN)

Rating: ACCUMULATE | CMP: Rs2,648 | TP: Rs2,997

July 29, 2019

Q1FY20 Result Update

☑ Change in Estimates | ■ Target | ☑ Reco

Change in Estimates

	Current		Previous	
	FY20E	FY21E	FY20E	FY21E
Rating	**ACCUMULATE**		**HOLD**	
Target Price	**2,997**		**2,997**	
Sales (Rs. m)	169,847	189,779	169,847	189,779
% Chng.	-	-		
EBITDA (Rs. m)	39,914	46,496	39,914	46,496
% Chng.	-	-		
EPS (Rs.)	141.9	166.1	142.2	166.5
% Chng.	*(0.2)*	*(0.2)*		

Key Financials - Consolidated

Y/e Mar	FY18	FY19	FY20E	FY21E
Sales (Rs. bn)	143	154	170	190
EBITDA (Rs. bn)	24	32	40	46
Margin (%)	*16.5*	*20.6*	*23.5*	*24.5*
PAT (Rs. bn)	9	20	24	28
EPS (Rs.)	57.0	117.5	141.9	166.1
Gr. (%)	*(26.8)*	*106.0*	*20.8*	*17.1*
DPS (Rs.)	-	-	-	-
Yield (%)	-	-	-	-
RoE (%)	*7.6*	*14.7*	*15.6*	*15.8*
RoCE (%)	*7.3*	*11.7*	*15.7*	*17.2*
EV/Sales (x)	3.3	2.9	2.6	2.3
EV/EBITDA (x)	20.0	14.1	11.0	9.3
PE (x)	46.4	22.5	18.7	15.9
P/BV (x)	3.5	3.1	2.7	2.3

Key Data	REDY.BO | DRRD IN
52-W High / Low	Rs.2,965 / Rs.1,873
Sensex / Nifty	37,686 / 11,189
Market Cap	Rs.440bn/ $ 6,388m
Shares Outstanding	166m
3M Avg. Daily Value	Rs.3650.56m

Shareholding Pattern (%)

Promoter's	27.00
Foreign	30.73
Domestic Institution	13.77
Public & Others	28.50
Promoter Pledge (Rs bn)	-

Stock Performance (%)

	1M	6M	12M
Absolute	3.8	(0.7)	27.1
Relative	8.5	(6.2)	25.9

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Kept hold on overheads, sales growth to follow

DRRD sales were in line with our estimates while adj. EBITDA and adj. PAT missed estimates due to significantly lower PSAI sales, one-off inventory adjustment and price erosion in key generics. Management however maintained tighter control on overhead costs (employee and SGA) with its ongoing program of rationalized assets, products and global presence. Employee costs increased by 2% while SGA and R&D costs decreased by 7% and 1% QoQ, respectively. Its adoption of new strategy with cost-benefit analysis of each operational activity helps to limit the reduction of adj. EBITDA margin only by 110bps QoQ to 19.2%, despite one-off inventory adjustment, adverse forex (USD/INR) and 33% QoQ lower PSAI sales in Q1FY19. Adjusted with one-off income of Rs3,457m, PAT missed our estimates by 28%, mainly due to ensuing effect of lower headline margins.

While launch of selected products in key non-US markets helps in strong growth in ROW sales, we expect current growth is likely to be sustainable with rich pipeline of injectables and biosimilars. Management guided strong comeback of PSAI sales in Q2FY20E on the back of healthy order book and resolution of certain product related issues in an API plant. R&D costs was US$52m and maintain guidance of US$250m in FY20E. Effective tax rate guidance was 22% in FY20E.

- **Valuations: Upgrade to 'Accumulate', increase TP to Rs2,997:** With traction in India formulations and revamped portfolio of US generics along with visibility of launches of key products will bring qualitative improvement in earnings estimates. Price erosion in US due to channel consolidation has been gradually stable for its portfolio of generics. The better visibility of launching gNuvaring and gCopaxone in CY19E-20E will make its risk-return ratio favourable. **We assign PE 18x on FY21E earnings and derive new TP of Rs2,997, improved by 17% over our previous TP of Rs2,558. We upgrade our recommendation to 'Accumulate'**.

- **Benefits from cost control:** Management guided for continuation of its ongoing rationalization of R&D infrastructure, manufacturing sites, product portfolio as well as optimization of manpower resources. It has divested three plants and cash-in three NDA products in US, while bought derma brands those fits its strategic focus in US.

- **Company guidance**: **a)** India formulations expect to maintain growth over IPM growth in FY20E. **b)** filing of large number of ANDAs in US in FY20E as it launched 15 new products in FY19. **c)** USFDA inspection expected soon in Vizag API plant which is key for its injectable in US. **d)** Russia continues to be benefitted from tender business of biosimilar/hospitals and revenues from ROW market to maintain strong growth with strategy of aggressive marketing. **e)** US, India, Russia, China and API sales are to be key growth driver of DRRD.

Exhibit 1: Q1FY20 Result Overview (Rs m)

Y/e March	Q1FY20	Q1FY19	YoY gr. (%)	Q4FY19	FY20E	FY19	YoY gr. (%)
Net Sales	**38,582**	**37,365**	***3.3***	**40,296**	**169,847**	**154,482**	***9.9***
Raw Material	12,069	10,049	*20.1*	12,624	41,188	44,948	*(8.4)*
% of Net Sales	*31.3*	*26.9*		*31.3*	*24.3*	*29.1*	
Personnel Cost	8,615	8,371	*2.9*	8,415	35,668	33,562	*6.3*
% of Net Sales	*22.3*	*22.4*		*20.9*	*21.0*	*21.7*	
Others	10,481	11,257	*(6.9)*	11,068	53,077	44,190	*20.1*
% of Net Sales	*27.2*	*30.1*		*27.5*	*31.3*	*28.6*	
Total Expenditure	31,165	29,677	*5.0*	32,107	129,933	122,700	*5.9*
EBITDA	**7,417**	**7,688**	***(3.5)***	**8,189**	**39,914**	**31,782**	***25.6***
Margin (%)	*19.2*	*20.6*		*20.3*	*23.5*	*20.6*	
Depreciation	2,890	2,787	*3.7*	2,872	11,358	11,348	*0.1*
EBIT	**4,527**	**4,901**	***(7.6)***	**5,317**	**28,556**	**20,434**	***39.7***
Other Income	4,301	504	*753.4*	833	2,531	3,375	*(25.0)*
Interest	298	195	*52.8*	245	920	889	
PBT	**8,530**	**5,210**	***63.7***	**5,905**	**30,167**	**22,920**	***31.6***
Share of Profit of Equity Accountted Investees	163	83		157	350	438	
Total Taxes	1,928	532	*262.4*	1,508	6,938	3,858	*79.8*
ETR (%)	*22.6*	*10.2*		*25.5*	*23.0*	*16.8*	
Reported PAT	**6,765**	**4,761**	***42.1***	**4,554**	**23,579**	**19,500**	***20.9***

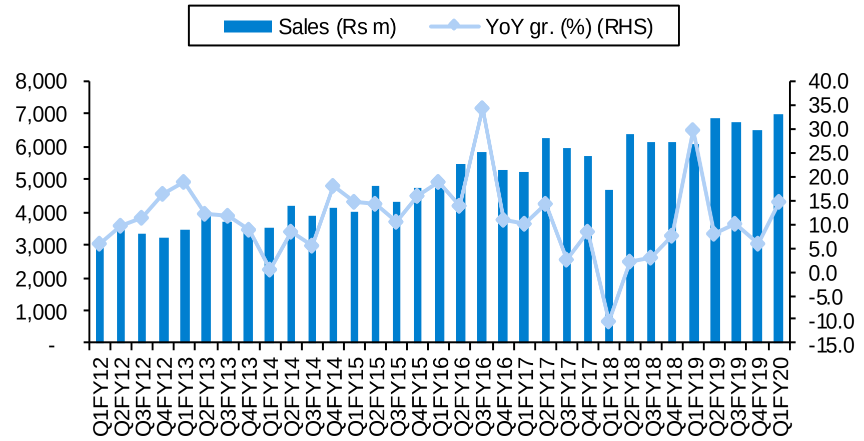
Source: Company, PL

Exhibit 2: Major Sources of Revenue

Major Sources of Revenues	Q1FY20	Q1FY19	YoY gr. (%)	Q4FY19	FY20E	FY19	YoY gr. (%)
PSAI (CPS & API)	**4,539**	**5,409**	***(16.1)***	**6,765**	**27,278**	**24,140**	***13.0***
% of Net Sales	*11.8*	*14.5*		*16.8*	*16.1*	*15.7*	
Branded Formulation	**32,982**	**30,636**	***7.7***	**30,384**	**135,835**	**122,903**	***10.5***
India	6,960	6,074	*14.6*	6,505	29,582	26,179	*13.0*
% of Net Sales	*18.1*	*16.3*		*16.2*	*17.4*	*17.0*	
International	**26,022**	**24,562**	***5.9***	**23,879**	**106,253**	**96,724**	***9.9***
% of Net Sales	*67.7*	*66.0*		*59.5*	*62.6*	*62.9*	
Russia & CIS	5,224	5,000	*4.5*	4,720	23,627	20,500	*15.3*
% of Net Sales	*13.6*	*13.4*		*11.8*	*13.9*	*13.3*	
Europe	2,404	2,016	*19.2*	1,912	8,267	7,873	*5.0*
% of Net Sales	*6.3*	*5.4*		*4.8*	*4.9*	*5.1*	
North America Generics	16,322	15,903	*2.6*	14,957	64,706	59,957	*7.9*
% of Net Sales	*42.5*	*42.7*		*37.2*	*38.1*	*39.0*	
Emerging Mkt Generics	2,072	1,643	*26.1*	2,290	9,653	8,394	*15.0*
% of Net Sales	*5.4*	*4.4*		*5.7*	*5.7*	*5.5*	
Innovative Prod. (Proprietery Prod.)	914	1,162	*(21.3)*	3,017	6,733	6,808	*(1.1)*
% of Net Sales	*2.4*	*3.1*		*7.5*	*4.0*	*4.4*	
Net Sales	**38,435**	**37,207**	***3.3***	**40,166**	**169,847**	**153,851**	***10.4***

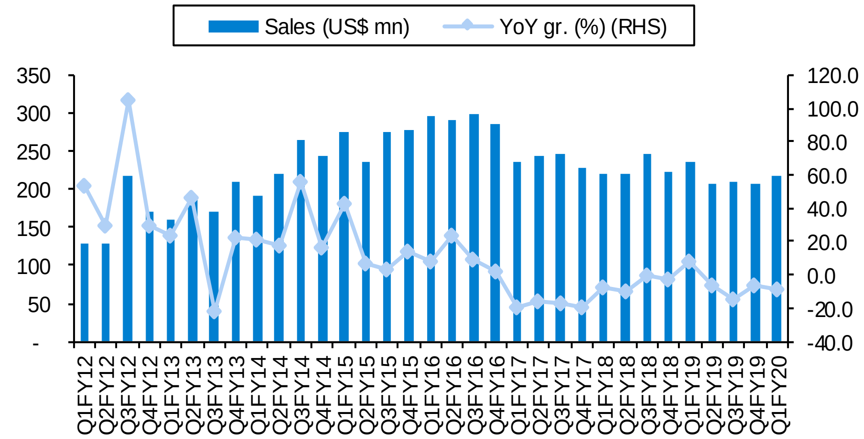
Source: PL, Company

Exhibit 3: India Formulations: Sales & growth



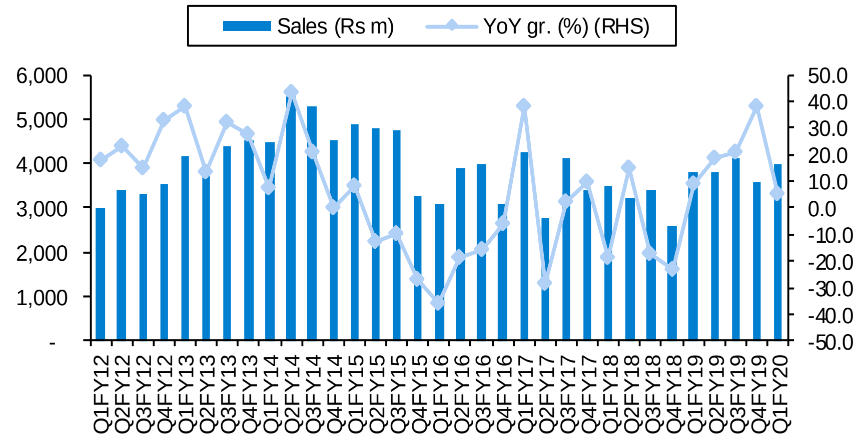
Source: PL, Company

Exhibit 4: US Generics (US$m): Sales and growth



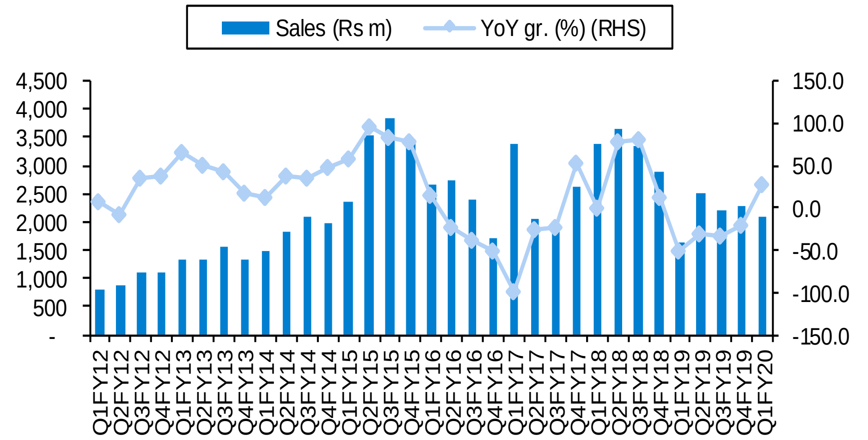
Source: Company, PL

Exhibit 5: Russia and CIS: Sales and growth



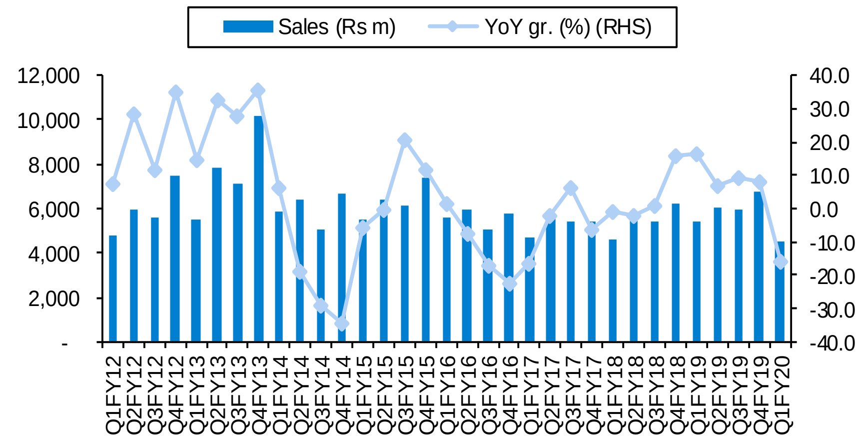
Source: Company, PL

Exhibit 6: Emerging mkt: Sales and growth



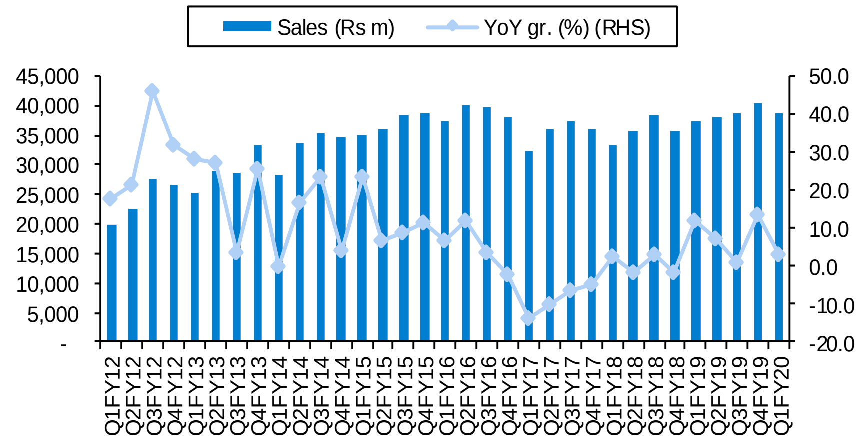
Source: Company, PL

Exhibit 7: PSAI: Sales and growth



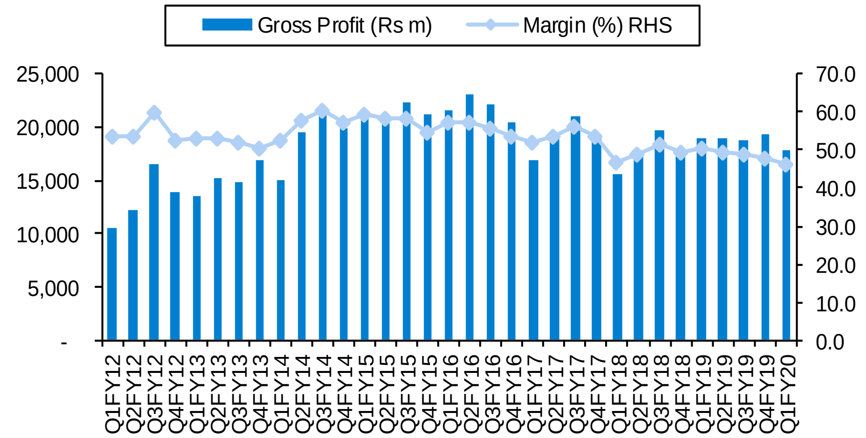
Source: Company, PL

Exhibit 8: Overall Sales and growth



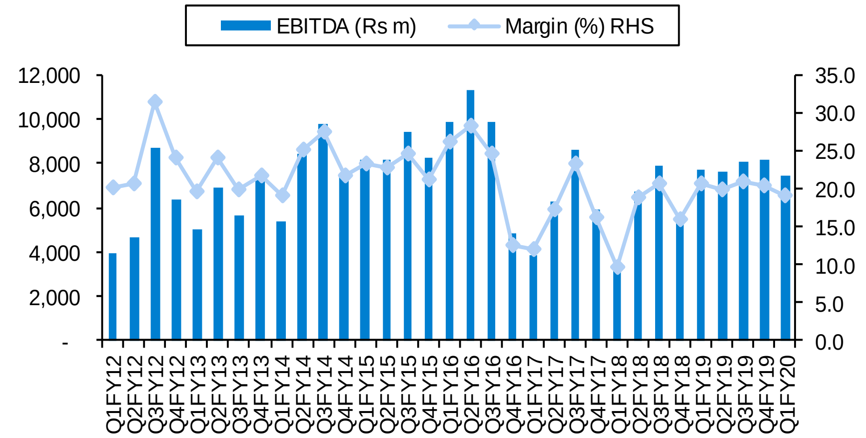
Source: PL, Company

Exhibit 9: Gross profit and margin (%)



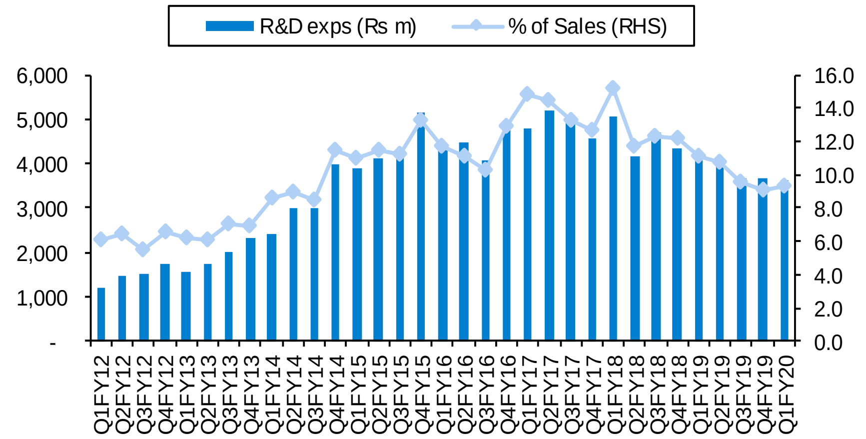
Source: Company, PL

Exhibit 10: EBITDA and margin



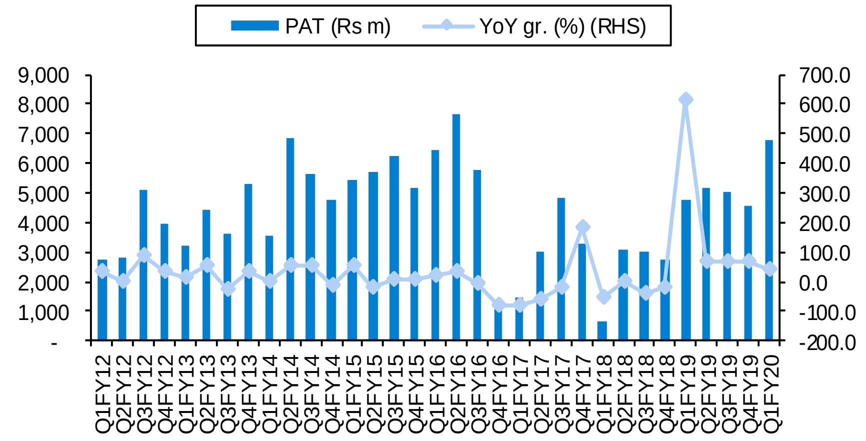
Source: Company, PL

Exhibit 11: R&D expenses and % of sales



Source: Company, PL

Exhibit 12: Adj. Net Profit and growth



Source: Company, PL

Financials

Income Statement (Rs m)

Y/e Mar	FY18	FY19	FY20E	FY21E
Net Revenues	**142,810**	**154,482**	**169,847**	**189,779**
YoY gr. (%)	*0.6*	*8.2*	*9.9*	*11.7*
Cost of Goods Sold	40,395	44,948	41,188	46,021
Gross Profit	102,415	109,534	128,659	143,758
Margin (%)	*71.7*	*70.9*	*75.8*	*75.8*
Employee Cost	32,149	33,562	35,668	37,956
Other Expenses	18,265	15,607	16,985	18,978
EBITDA	**23,512**	**31,782**	**39,914**	**46,496**
YoY gr. (%)	*(4.9)*	*35.2*	*25.6*	*16.5*
Margin (%)	*16.5*	*20.6*	*23.5*	*24.5*
Depreciation and Amortization	10,772	11,348	11,358	12,159
EBIT	**12,740**	**20,434**	**28,556**	**34,337**
Margin (%)	*8.9*	*13.2*	*16.8*	*18.1*
Net Interest	788	889	920	840
Other Income	1,552	3,375	2,531	1,898
Profit Before Tax	**13,504**	**22,920**	**30,167**	**35,395**
Margin (%)	*9.5*	*14.8*	*17.8*	*18.7*
Total Tax	4,380	3,858	6,938	8,141
Effective tax rate (%)	*32.4*	*16.8*	*23.0*	*23.0*
Profit after tax	**9,124**	**19,062**	**23,229**	**27,254**
Minority interest	(344)	(438)	(350)	(350)
Share Profit from Associate	-	-	-	-
Adjusted PAT	**9,468**	**19,500**	**23,579**	**27,604**
YoY gr. (%)	*(26.7)*	*106.0*	*20.9*	*17.1*
Margin (%)	*6.6*	*12.6*	*13.9*	*14.5*
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	**9,468**	**19,500**	**23,579**	**27,604**
YoY gr. (%)	*(26.7)*	*106.0*	*20.9*	*17.1*
Margin (%)	*6.6*	*12.6*	*13.9*	*14.5*
Other Comprehensive Income	-	-	-	-
Total Comprehensive Income	9,468	19,500	23,579	27,604
Equity Shares O/s (m)	**166**	**166**	**166**	**166**
EPS (Rs)	**57.0**	**117.5**	**141.9**	**166.1**

Source: Company Data, PL Research

Balance Sheet Abstract (Rs m)

Y/e Mar	FY18	FY19	FY20E	FY21E
Non-Current Assets				
Gross Block	**136,884**	**151,134**	**170,586**	**190,884**
Tangibles	99,286	110,028	125,713	142,432
Intangibles	37,598	41,106	44,873	48,452
Acc: Dep / Amortization	**72,535**	**83,883**	**95,241**	**107,400**
Tangibles	49,553	60,901	67,586	75,305
Intangibles	22,982	22,982	27,655	32,095
Net fixed assets	**64,349**	**67,251**	**75,345**	**83,484**
Tangibles	49,733	49,127	58,127	67,127
Intangibles	14,616	18,124	17,218	16,357
Capital Work In Progress	34,705	29,335	22,001	16,501
Goodwill	5,331	4,659	3,960	3,366
Non-Current Investments	5,578	4,186	4,072	3,979
Net Deferred tax assets	3,455	3,844	4,299	4,227
Other Non-Current Assets	5,091	3,807	3,617	3,436
Current Assets				
Investments	18,330	22,529	25,908	29,795
Inventories	29,089	33,579	38,674	44,368
Trade receivables	40,527	39,869	44,207	52,514
Cash & Bank Balance	2,638	2,228	2,218	3,190
Other Current Assets	12,762	10,424	10,945	11,492
Total Assets	**225,443**	**224,656**	**238,415**	**259,770**
Equity				
Equity Share Capital	830	830	831	831
Other Equity	124,886	139,406	161,323	187,265
Total Networth	**125,716**	**140,236**	**162,154**	**188,096**
Non-Current Liabilities				
Long Term borrowings	25,089	22,000	16,500	16,005
Provisions	817	793	842	842
Other non current liabilities	2,789	2,079	1,559	1,169
Current Liabilities				
ST Debt / Current of LT Debt	25,562	12,125	9,700	7,275
Trade payables	13,345	13,671	13,314	14,594
Other current liabilities	30,031	33,177	33,668	31,111
Total Equity & Liabilities	**225,443**	**224,656**	**238,415**	**259,770**

Source: Company Data, PL Research

Cash Flow (Rs m)

Y/e Mar	FY18	FY19	FY20E	FY21E
PBT	13,848	23,358	30,517	35,745
Add. Depreciation	10,772	11,348	11,358	12,159
Add. Interest	(213)	(213)	(213)	(213)
Less Financial Other Income	1,552	3,375	2,531	1,898
Add. Other	5,350	1,930	(4,706)	2,244
Op. profit before WC changes	29,757	36,423	36,956	49,935
Net Changes-WC	(8,966)	2,493	(10,058)	(16,089)
Direct tax	(2,761)	(3,858)	(6,938)	(8,141)
Net cash from Op. activities	**18,030**	**35,058**	**19,959**	**25,706**
Capital expenditures	(10,904)	(8,880)	(12,118)	(14,798)
Interest / Dividend Income	274	3,375	2,531	1,898
Others	(4,253)	(2,463)	(3,542)	(4,081)
Net Cash from Invt. activities	**(14,883)**	**(7,968)**	**(13,129)**	**(16,981)**
Issue of share cap. / premium	1	-	-	-
Debt changes	882	(16,526)	(7,925)	(2,920)
Dividend paid	(3,992)	(3,992)	(3,992)	(3,992)
Interest paid	(1,331)	(889)	(920)	(840)
Others	57	-	-	-
Net cash from Fin. activities	**(4,383)**	**(21,407)**	**(12,837)**	**(7,752)**
Net change in cash	**(1,236)**	**5,683**	**(6,007)**	**973**
Free Cash Flow	7,126	26,178	7,841	10,908

Source: Company Data, PL Research

Quarterly Financials (Rs m)

Y/e Mar	Q2FY19	Q3FY19	Q4FY19	Q1FY20
Net Revenue	**38,175**	**38,646**	**40,296**	**38,582**
YoY gr. (%)	*7.2*	*0.8*	*13.4*	*3.3*
Raw Material Expenses	10,517	11,758	12,624	12,069
Gross Profit	27,658	26,888	27,672	26,513
Margin (%)	*72.5*	*69.6*	*68.7*	*68.7*
EBITDA	**7,593**	**8,046**	**8,189**	**7,417**
YoY gr. (%)	*13.4*	*1.5*	*45.3*	*(3.5)*
Margin (%)	*19.9*	*20.8*	*20.3*	*19.2*
Depreciation / Depletion	2,786	2,903	2,872	2,890
EBIT	**4,807**	**5,143**	**5,317**	**4,527**
Margin (%)	*12.6*	*13.3*	*13.2*	*11.7*
Net Interest	208	241	245	298
Other Income	1,282	1,023	833	4,301
Profit before Tax	**5,881**	**5,925**	**5,905**	**8,530**
Margin (%)	*15.4*	*15.3*	*14.7*	*22.1*
Total Tax	807	1,011	1,508	1,928
Effective tax rate (%)	*13.7*	*17.1*	*25.5*	*22.6*
Profit after Tax	**5,074**	**4,914**	**4,397**	**6,602**
Minority interest	(109)	(89)	(157)	(163)
Share Profit from Associates	-	-	-	-
Adjusted PAT	**5,183**	**5,003**	**4,554**	**6,765**
YoY gr. (%)	*69.7*	*65.3*	*67.4*	*42.1*
Margin (%)	*13.6*	*12.9*	*11.3*	*17.5*
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	**5,183**	**5,003**	**4,554**	**6,765**
YoY gr. (%)	*69.7*	*65.3*	*67.4*	*42.1*
Margin (%)	*13.6*	*12.9*	*11.3*	*17.5*
Other Comprehensive Income	-	(1,408)	-	5,535
Total Comprehensive Income	**5,183**	**3,595**	**4,554**	**12,300**
Avg. Shares O/s (m)	166	166	166	166
EPS (Rs)	**31.2**	**30.1**	**27.4**	**40.8**

Source: Company Data, PL Research

Key Financial Metrics

Y/e Mar	FY18	FY19	FY20E	FY21E
Per Share(Rs)				
EPS	57.0	117.5	141.9	166.1
CEPS	121.9	185.8	210.2	239.3
BVPS	757.3	844.8	975.7	1,131.7
FCF	42.9	157.7	47.2	65.6
DPS	-	-	-	-
Return Ratio(%)				
RoCE	7.3	11.7	15.7	17.2
ROIC	6.2	10.2	13.6	15.1
RoE	7.6	14.7	15.6	15.8
Balance Sheet				
Net Debt : Equity (x)	0.2	0.1	0.0	(0.1)
Net Working Capital (Days)	144	141	149	158
Valuation(x)				
PER	46.4	22.5	18.7	15.9
P/B	3.5	3.1	2.7	2.3
P/CEPS	21.7	14.2	12.6	11.1
EV/EBITDA	20.0	14.1	11.0	9.3
EV/Sales	3.3	2.9	2.6	2.3
Dividend Yield (%)	-	-	-	-

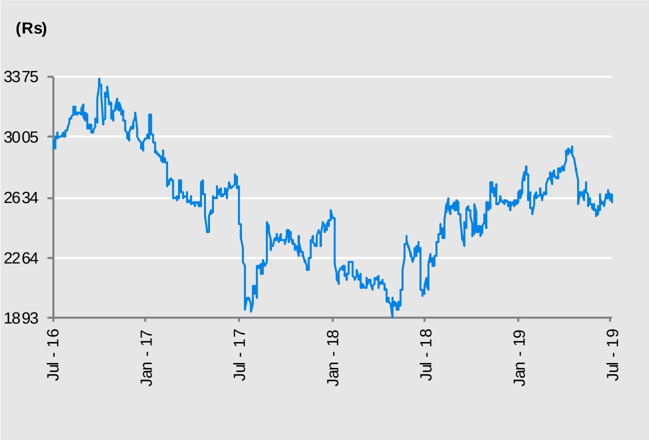
Source: Company Data, PL Research

Key Operating Metrics

Y/e Mar	FY18	FY19	FY20E	FY21E
India Formulations	23,322	26,179	29,582	33,132
US formulations	59,822	59,957	64,706	71,436
Russia	16,500	20,500	23,627	26,819
PSAI	21,992	24,140	27,278	31,370

Source: Company Data, PL Research

Price Chart



Recommendation History

No.	Date	Rating	TP (Rs.)	Share Price (Rs.)
1	4-Jul-19	Hold	2,997	2,602
2	19-May-19	Hold	2,997	2,725
3	5-Apr-19	Reduce	2,558	2,754
4	6-Feb-19	Reduce	2,558	2,821
5	4-Feb-19	Reduce	2,558	2,791
6	7-Jan-19	Reduce	2,170	2,559
7	26-Oct-18	Reduce	2,170	2,405
8	5-Oct-18	Reduce	1,780	2,372

Analyst Coverage Universe

Sr. No.	CompanyName	Rating	TP (Rs)	Share Price (Rs)
1	Aurobindo Pharma	BUY	932	605
2	Cadila Healthcare	Accumulate	341	237
3	Cipla	Reduce	470	552
4	Dr. Lal PathLabs	Accumulate	1,120	1,077
5	Dr. Reddy's Laboratories	Hold	2,997	2,602
6	Eris Lifesciences	Accumulate	812	498
7	Glenmark Pharmaceuticals	Reduce	589	440
8	Indoco Remedies	Hold	137	160
9	Ipca Laboratories	BUY	908	949
10	Jubilant Life Sciences	Reduce	648	496
11	Lupin	Reduce	730	754
12	Sun Pharmaceutical Industries	Reduce	396	392
13	Thyrocare Technologies	BUY	595	466

PL's Recommendation Nomenclature (Absolute Performance)

Buy : > 15%
Accumulate : 5% to 15%
Hold : +5% to -5%
Reduce : -5% to -15%
Sell : < -15%
Not Rated (NR) : No specific call on the stock
Under Review (UR) : Rating likely to change shortly

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