

Strong quarter led by APIs, bullish commentary

Dr Reddy's reported a strong 1Q beating estimates across led by superlative performance in the API segment (up 88% YoY) as clients opt to de-risk supplies. This coupled with favourable pricing, better product mix (we believe higher realization in APIs and improved productivity) led to gross margins of 56% in turn leading to healthy EBITDA margins of 26.3%. While management hinted of some fluctuation in gross and EBITDA margins going ahead, it remained confident about the sustenance of its API segment performance and EBITDA margins, which we believe is a little stretched. We are concerned about the extrapolation of this quarters' trend as expenses rise in 2HFY21. Besides, with seasonality sales (1H is the strongest) lost in India due to partial lockdown and rise in spends, performance of 2H vs 1H would be more crucial.

Given Dr Reddy's' sustained launch momentum in the US (guided 20+ new launches in FY21), the company is on track to exceed US\$1bn in US revenue by FY22 even as expectations in gNuvaring & gCopaxone are now muted. Management hinted on inorganic growth avenues through product/asset buyouts in the branded generics space, specifically India. Capital allocation towards digital enhancement and increased dividend distribution. With all facilities compliant, renewed API base and improving domestic formulations and strong balance sheet, we believe, Dr Reddy's will continue to trade at a premium vs its 5-year average and hence we increase our valuation multiple to 25x from 23x earlier. Maintain Accumulate.

Our Assumptions

- The company has delivered on several fronts since past 2 years - ex-US business growth, cost optimization, reducing cash burn from proprietary portfolio, strong API base. We assume EPS of Rs139.2/181.8 in FY21/22E.
- We build in gross margins at 53% and 54% for FY21E and FY22E respectively while our EBITDA margins assumptions of 23.5% and 24.5% resp. factor in higher spends from 2HFY21.
- Gross margin of the branded business is likely to be higher than the company's Global Generics business and therefore, increasing contribution from this segment should help offset impact from base business erosion or lack of large value launch in the US. We assume ex-US generic business growth of 11% over FY20-22 with revenue contribution increasing to 44% by FY22 (36% in FY19).

Q1FY21 Result (Rs Mn)

Particulars	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
Revenue	44,293	38,737	14.3	44,486	(0.4)
Total Expense	34,372	32,365	6.2	35,897	(4.2)
EBITDA	9,921	6,372	55.7	8,589	15.5
Depreciation	2,120	2,124	(0.2)	2,080	1.9
EBIT	7,801	4,248	83.6	6,509	19.8
Other Income	605	393	53.9	435	39.1
Interest	(306)	(239)	28.0	(100)	206.0
EBT	8,712	8,337	4.5	7,037	23.8
Tax	2,996	1,872	60.0	(500)	(699.2)
RPAT	5,793	6,628	(12.6)	7,642	(24.2)
APAT	5,793	3,171	82.7	7,649	(24.3)
			(bps)		(bps)
Gross Margin (%)	56.2	52.0	411	51.6	451
EBITDA Margin (%)	26.3	20.5	579	22.6	372
NPM (%)	13.1	17.1	(403)	17.2	(410)
Tax Rate (%)	34.4	22.5	1194	(7.1)	4149
EBIT Margin (%)	17.6	11.0	665	14.6	298

CMP	Rs 4,302
Target / Upside	Rs 4,721 / 10%
BSE Sensex	38,030
NSE Nifty	11,203

Scrip Details

Equity / FV	Rs 831mn / Rs 5
Market Cap	Rs 713bn
	US\$ 10bn
52-week High/Low	Rs 4,336/Rs 2,351
Avg. Volume (no)	1,086,190
NSE Symbol	DRREDDY
Bloomberg Code	DRRD IN

Shareholding Pattern Jun'20(%)

Promoters	26.8
MF/Banks/FIs	14.4
FII	30.2
Public / Others	28.8

Valuation (x)

	FY20A	FY21E	FY22E
P/E	36.6	30.8	23.6
EV/EBITDA	15.6	16.7	13.6
ROE (%)	24.6	14.1	16.1
RoACE (%)	21.6	13.2	15.4

Estimates (Rs mn)

	FY20A	FY21E	FY22E
Revenue	178,890	181,261	206,596
EBITDA	45,232	41,877	50,184
PAT	19,498	23,131	30,180
EPS (Rs.)	117.6	139.5	182.0

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- We believe US revenue at US\$230mn as base (20 launches planned in FY21, 5 in Q1) and continuation of strong trend in API shall support revenue growth over next few quarters. While we agree that the CRL on gNuvaring does mean earliest possible launch in FY22 (with higher probability of competition), we believe Dr. Reddy's launch pipeline should help offset base business erosion and help maintain gross margins of the US business. We expect US revenue of \$900/1100mn pa in FY21/22E.

Exhibit 1: Revenue mix

(Rs mn)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ%	FY20	FY19	YoY (%)
Global Generics								
North America-generics and OTC	17,282	16,322	5.9	18,072	(4.4)	64,659	59,957	7.8
Europe	3,551	2,404	47.7	3,446	3.0	11,707	7,873	48.7
India	6,260	6,960	(10.1)	6,839	(8.5)	28,946	26,179	10.6
Emerging markets	7,982	7,296	9.4	8,042	(0.7)	32,811	28,894	13.6
Total global generics	35,075	32,982	6.3	36,399	(3.6)	138,123	122,903	12.4
% of total	79.4	85.8		82.1		79.1	79.9	
Total PSAI	8,553	4,539	88.4	7,195	18.9	25,747	24,140	6.7
% of total	19.4	11.8		16.2		14.7	15.7	
Proprietary products and others	547	914	(40.2)	724	(24.4)	10,730	6,808	57.6
% of total	1.2	2.4	(47.9)	1.6	(24.2)	6.1	4.4	38.9
Total	44,175	38,435	14.9	44,318	(0.3)	174,600	153,851	13.5

Source: Company, DART

Key Concall Highlights

- **US:** Dr Reddy's booked sales of US\$228mn in 1Q (down US\$11mn QoQ) due to higher stocking in Q4. Company launched 5 products in 1Q and has guided for 20+ launches in FY21E. While Suboxone continues to perform well, it is presently working to address the issues highlighted in the **CRL for Nuvaring. It has already submitted CRL response for Copaxone.** No date received yet for Revlimid trial.
- **India formulations:** Q1 had 20 days of Wockhardt sales. Sales were down 10% Yoy impacted by lockdown. Dr Reddy's is working towards building a stronger domestic business with improved execution and mega brands. Launched 4 new products in India.
- **China** – leveraging the global portfolio as the change in regulatory scenario to aid growth. Amongst the RoW markets, China has done exceedingly well. Company believes it can bring 100 of its 130 approved drugs to China over the next few years.
- **PSAI** – In a bid to de-risk their global supply chain, customers across are looking for reliable source of supply where Dr Reddy's clearly has an edge. This led to strong Q1 with sales of Rs.8.5bn, up 88% YoY. The gross margins for PSAI also spiked to 33% from 7% YoY.
- **R&D spend:** R&D spend at 9% of sales was in-line with its annual guidance of 9-9.5%.
- **Other financials** – tax rate guided at 25-27% for FY21; net debt of Rs3.3bn

Profit and Loss Account

(Rs Mn)	FY19A	FY20A	FY21E	FY22E
Revenue	155,806	178,890	181,261	206,596
Total Expense	122,518	133,658	139,384	156,412
COGS	61,965	71,951	75,237	85,752
Employees Cost	0	0	0	0
Other expenses	60,553	61,707	64,147	70,660
EBIDTA	33,288	45,232	41,877	50,184
Depreciation	12,400	12,472	13,341	14,229
EBIT	20,888	32,760	28,536	35,955
Interest	1,163	983	0	0
Other Income	2,718	3,022	2,305	2,247
Exc. / E.O. items	0	0	0	0
EBT	22,443	34,799	30,841	38,202
Tax	3,648	(1,466)	7,710	8,022
RPAT	18,795	36,265	23,131	30,180
Minority Interest	0	0	0	0
Profit/Loss share of associates	0	0	0	0
APAT	19,259	19,498	23,131	30,180

Balance Sheet

(Rs Mn)	FY19A	FY20A	FY21E	FY22E
Sources of Funds				
Equity Capital	830	831	831	831
Minority Interest	0	0	0	0
Reserves & Surplus	139,367	154,157	173,134	199,160
Net Worth	140,197	154,988	173,965	199,991
Total Debt	34,125	17,745	16,745	15,745
Net Deferred Tax Liability	3,528	(5,279)	(6,500)	(7,844)
Total Capital Employed	177,850	167,454	184,210	207,892

Applications of Funds

Net Block	98,455	79,991	94,921	90,407
CWIP	3,902	3,994	4,739	4,514
Investments	4,401	5,672	5,930	6,214
Current Assets, Loans & Advances	114,501	130,370	134,744	165,484
Inventories	33,579	35,067	36,522	42,903
Receivables	39,869	50,278	45,652	49,504
Cash and Bank Balances	2,228	2,053	4,480	19,223
Loans and Advances	360	1,105	1,127	1,150
Other Current Assets	15,936	18,180	20,907	24,043
Less: Current Liabilities & Provisions	43,409	52,573	56,125	58,727
Payables	14,553	16,659	18,741	19,801
Other Current Liabilities	28,856	35,914	37,383	38,926
<i>sub total</i>				
Net Current Assets	71,092	77,797	78,619	106,757
Total Assets	177,850	167,454	184,210	207,892

E – Estimates

Important Ratios

Particulars	FY19A	FY20A	FY21E	FY22E
(A) Margins (%)				
Gross Profit Margin	60.2	59.8	58.5	58.5
EBIDTA Margin	21.4	25.3	23.1	24.3
EBIT Margin	13.4	18.3	15.7	17.4
Tax rate	16.3	(4.2)	25.0	21.0
Net Profit Margin	12.1	20.3	12.8	14.6
(B) As Percentage of Net Sales (%)				
COGS	39.8	40.2	41.5	41.5
Employee	0.0	0.0	0.0	0.0
Other	38.9	34.5	35.4	34.2
(C) Measure of Financial Status				
Gross Debt / Equity	0.2	0.1	0.1	0.1
Interest Coverage	18.0	33.3		
Inventory days	79	72	74	76
Debtors days	93	103	92	87
Average Cost of Debt	2.7	3.8	0.0	0.0
Payable days	34	34	38	35
Working Capital days	167	159	158	189
FA T/O	1.6	2.2	1.9	2.3
(D) Measures of Investment				
AEPS (Rs)	116.2	117.6	139.5	182.0
CEPS (Rs)	190.9	192.8	220.0	267.8
DPS (Rs)	20.0	25.1	25.1	25.1
Dividend Payout (%)	17.2	21.3	18.0	13.8
BVPS (Rs)	845.6	934.8	1049.2	1206.2
RoANW (%)	14.1	24.6	14.1	16.1
RoACE (%)	11.1	21.6	13.2	15.4
RoAIC (%)	11.8	19.2	16.5	19.5
(E) Valuation Ratios				
CMP (Rs)	4302	4302	4302	4302
P/E	37.0	36.6	30.8	23.6
Mcap (Rs Mn)	713,305	713,305	713,305	713,305
MCap/ Sales	4.6	4.0	3.9	3.5
EV	722,673	705,310	699,514	681,165
EV/Sales	4.6	3.9	3.9	3.3
EV/EBITDA	21.7	15.6	16.7	13.6
P/BV	5.1	4.6	4.1	3.6
Dividend Yield (%)	0.5	0.6	0.6	0.6
(F) Growth Rate (%)				
Revenue	9.1	14.8	1.3	14.0
EBITDA	40.6	35.9	(7.4)	19.8
EBIT	75.3	56.8	(12.9)	26.0
PBT	56.5	55.1	(11.4)	23.9
APAT	96.4	1.2	18.6	30.5
EPS	96.4	1.2	18.6	30.5

Cash Flow

(Rs Mn)	FY19A	FY20A	FY21E	FY22E
CFO	27,602	32,691	37,535	30,708
CFI	(8,789)	6,024	(29,209)	(11,036)
CFF	(19,223)	(38,890)	(5,899)	(4,929)
FCFF	18,813	38,715	8,326	19,672
Opening Cash	2,638	2,228	2,053	4,480
Closing Cash	2,228	2,053	4,480	19,223

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 (Rs.)	Price (Rs.)
Jun-20	Accumulate	4,000	4,124

*Price as on recommendation date

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