

Dr. Reddy's Labs

Strong beat, positives in the price

Dr. Reddys' Q1 results beat expectations led by robust growth in PSAI and Europe business along with strong gross margin (56%, +430bps YoY). The growth outlook for PSAI business has improved as customers seek global diversification of supplies, stock higher inventories and look for reliable partners. On the gross margin front, while large part of improvement is likely to sustain, we factor some normalisation (owing to product mix variations and currency) over FY21/22. On the flip side, approval timelines for key products (gNuvaring, gCopaxone) continue to remain uncertain. The company's tax rate has inched up from 22% to 25-27% (discontinuation of R&D deduction benefits and tax holiday on one of the plant). We increase our EPS estimates for FY21/22 by 11%/4% to factor the above. The stock trades at 27x/22x FY21/22 EPS which leaves limited room for execution miss. We maintain Reduce rating with a revised TP of Rs3,940 based on 20x FY22 EPS.

- All round beat:** Revenues grew at 15% YoY at Rs44.1bn as strong growth in PSAI (+88% YoY, new launches, currency benefit, higher volumes), Emerging markets (+54% YoY, China, Vietnam led), Europe (+ 48% YoY, new launches, currency benefits) offset weakness in India (-10% YoY) and Russia (-9% YoY) due to Covid. EBIDTA margins improved to 25.5% (+576bps YoY, +386bps QoQ) largely on back of higher gross margins (56%, +437bps YoY, +457 QoQ, currency, product mix, productivity).
- 50%+ US growth hinges on two key product approvals:** We forecast the US business to register 12% revenue CAGR over FY20-22e. More than 50% of the growth in this period is dependent on two assets - gNuvaring and gCopaxone. The CRL for gCopaxone is filed and for gNuvaring is delayed by few months. We factor gCopaxone launch in 2HFY21 and gNuvaring in Q4FY21. Any delay in approval/launch timelines will impact our estimates.
- Key call takeaways:** a) Price erosion in US – more stable; b) gRevlimid – no visibility on trial date yet; c) India – absolute EBITDA contribution has been stable, Wockhardt business is complementary to existing portfolio; d) Net debt: Rs3.3bn, ETR at 34%; e) Guidance: Capex: Rs10bn in FY21, Tax rate - 25-27%; f) M&A opportunities – Emerging markets particularly India.

Financial Summary

(Rs bn)	1QFY21	1QFY20	YoY (%)	4QFY20	QoQ (%)	FY19	FY20	FY21E	FY22E
Net Sales	44,175	38,435	14.9	44,318	-0.3	153,851	167,371	192,035	219,087
EBITDA	11,247	7,570	48.6	9,574	17.5	30,672	34,546	47,762	55,641
Reported PAT	5,793	6,628	-12.6	7,642	-24.2	21,492	19,497	26,873	32,763
EPS (Rs)	34.8	39.8	-12.6	45.9	-24.2	129.1	117.1	161.4	196.8
P/E (x)						33.3	36.7	26.6	21.8
RoCE (%)						11.3	16.0	13.7	14.6

Source: Company, HSIE Research

Change in Estimates

	FY21 Old	FY21 Revised	YoY	FY22 Old	FY22 Revised	YoY
Revenues	186,396	192,035	3%	211,066	219,087	4%
EBITDA	41,201	47,762	16%	50,121	55,641	11%
PAT	24,406	27,123	11%	31,391	32,763	4%
EPS	146.6	162.9	11%	188.6	196.8	4%

Source: HSIE Research

REDUCE

CMP(as on 29 July 2020)	Rs 4,302
Target Price	Rs 3,940
NIFTY	11,203

KEY CHANGES	OLD	NEW
Rating	REDUCE	REDUCE
Price Target	Rs 3,770	Rs 3,940
EPS %	FY21E	FY22E
	+11%	+4%

KEY STOCK DATA

Bloomberg code	DRRD IN
No. of Shares (mn)	166
MCap (Rs bn) / (\$ mn)	715/9,574
6m avg traded value (Rs mn)	4,024
52 Week high / low	Rs 4,336/2,351

STOCK PERFORMANCE (%)

	3M	6M	12M
Absolute (%)	10.9	36.7	62.1
Relative (%)	(5.5)	44.2	61.1

SHAREHOLDING PATTERN (%)

	Jun -20	Mar-20
Promoters	26.74	26.75
FIs & Local MFs	16.21	14.35
FPIs	29.33	30.15
Public & Others	27.72	28.75
Pledged Shares	0.00	0.00

Source : BSE

Bansi Desai, CFA

bansi.desai@hdfcsec.com

+91-22-6171-7341

Disclosure:

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HDFC securities Limited, I Think Techno Campus, Building - B, "Alpha", Office Floor 8, Near Kanjurmarg Station, Opp. Crompton Greaves, Kanjurmarg (East), Mumbai 400 042 Phone: (022) 3075 3400 Fax: (022) 2496 5066 Compliance Officer: Binkle R. Oza Email: complianceofficer@hdfcsec.com Phone: (022) 3045 3600

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Unit No. 1602, 16th Floor, Tower A, Peninsula Business Park,

Senapati Bapat Marg, Lower Parel, Mumbai - 400 013

Board: +91-22-6171-7330 www.hdfcsec.com