

Dr. Reddy's Lab

Refer to important disclosures at the end of this report

Taking steps in the right direction

CMP: Rs 4,431
as of (September 7, 2020)TP: Rs 4,550 (■)
12 months

Rating: HOLD (■)

Upside: 2.7 %

We present key takeaways from our discussion with DrReddy's team and our view on the gVascepa opportunity

US launch momentum to continue: DRRD noted that its US business, which had recorded muted growth during FY15-19 due to warning letters, has come out of the slow-growth phase and showed good momentum in FY20 with more launches. The momentum should continue as DRRD plans over 25 launches FY21 onward. The price erosion has also tapered compared to the last few years. Injectable demand is lower than pre-Covid levels but picking up MoM. DRRD would continue to develop specialty products and monetize but will not commercialize. DRRD has responded to Copaxone CRL and will respond to Nuvaring CRL by Q3FY21.

gVascepa can be an interesting launch: DRRD along with Hikma recently won the Vascepa litigation in the appeals court against Amarin on invalidity of the patents. The appeals court order upholds a favorable ruling in the district court earlier. Currently, DRRD/Hikma (both have final approvals) and Teva (tentative approval) are FTFs on the Vascepa. Amarin had settled with Apotex (not approved yet) too for an Aug'29 launch but the settlement was subject to Amarin winning the appeals court ruling and hence, may not hold. An imminent launch by Hikma/DRRD will trigger an early launch by Teva (currently set for Aug'29 launch), but the market will still be lucrative enough, given the large market size of US\$570mn+ for the product. gVascepa's launch is not part of our estimates yet and will add around 6-7% annualized EPS (if launched in the near term), assuming a 3-player market initially, 50% price erosion and 15-20% market share for DRRD.

Increasing focus on India: DRRD has increased its focus on branded markets, especially India, in the last few years with several initiatives (leadership change, high R&D focus, additional divisions, etc.). While FY21 is affected by lockdowns, the long-term growth trajectory should continue 100-150bps above industry. Wockhardt's domestic portfolio is non-overlapping and has integrated smoothly despite only virtual communication between the two teams. Led by investments in working capital, DRRD expects to bring the portfolio back on the recovery path.

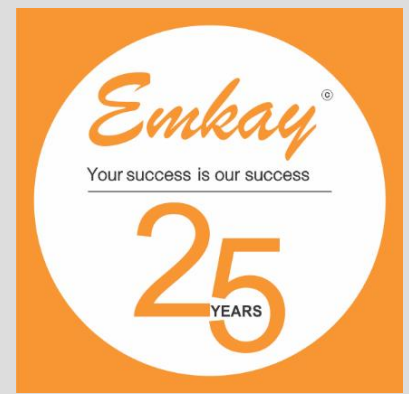
Outlook: DRRD is gradually regaining momentum in the US (with compliance issues behind now) and non-US geographies (increasing focus), which along with tight cost control will ensure strong earnings momentum over FY20-23 (+16% CAGR), strong FCF generation (Rs9.5bn in Q1 pre acquisition cost) and healthy ROCE (~23% in Q1). We are positive on the business but await better entry points, given the sharp outperformance in recent times. We retain Hold and EW in EAP. Our TP of Rs4,550 is based on 25xJune'22E EPS.

Please see our sector model portfolio (Emkay Alpha Portfolio): [Pharmaceuticals \(page 8\)](#)

Financial Snapshot (Consolidated)

(Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
Net Sales	1,49,062	1,63,574	1,80,043	1,95,146	2,07,370
EBITDA	31,782	41,471	46,182	49,336	52,151
EBITDA Margin (%)	20.6	23.7	24.8	24.4	24.3
APAT	19,500	20,260	26,868	29,770	31,603
EPS (Rs)	108.8	122.0	161.9	179.3	190.4
EPS (% chg)	90.7	12.2	32.6	10.8	6.2
ROE (%)	14.7	13.7	16.0	15.6	14.6
P/E (x)	40.6	36.2	27.3	24.6	23.2
EV/EBITDA (x)	23.4	17.4	15.7	14.2	12.9
P/BV (x)	5.2	4.7	4.1	3.6	3.2

Source: Company, Emkay Research



Change in Estimates

EPS Chg FY21E/FY22E (%)	-/-
Target Price change (%)	NA
Target Period (Months)	12
Previous Reco	HOLD

Emkay vs Consensus

EPS Estimates		
	FY21E	FY22E
Emkay	161.9	179.3
Consensus	157.8	188.6
Mean Consensus TP (12M)	Rs 4,505	

Stock Details

Bloomberg Code	DRRD IN
Face Value (Rs)	5
Shares outstanding (mn)	166
52 Week H/L	4,850 / 2,495
M Cap (Rs bn/USD bn)	735 / 10.02
Daily Avg Volume (nos.)	11,18,483
Daily Avg Turnover (US\$ mn)	65.1

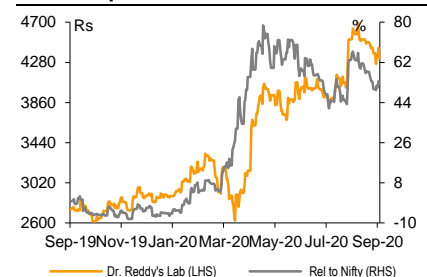
Shareholding Pattern Jun '20

Promoters	26.8%
FIIIs	29.3%
DIIIs	14.6%
Public and Others	29.3%

Price Performance

(%)	1M	3M	6M	12M
Absolute	(3)	10	39	61
Rel. to Nifty	(5)	(2)	35	56

Relative price chart



Source: Bloomberg

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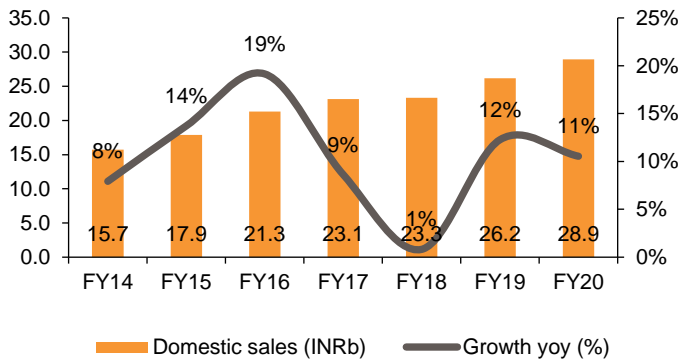
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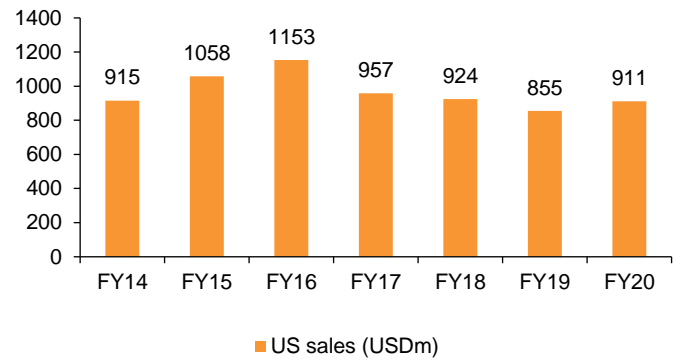
Story in charts

Exhibit 1: India business recovered well in the last two years



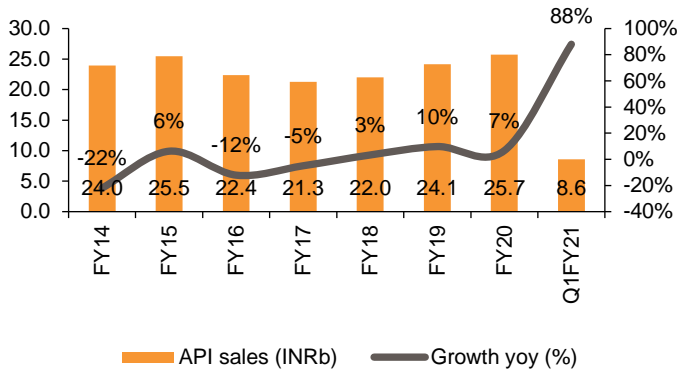
Source: Company

Exhibit 2: US sales picked up in FY20 led by new launches



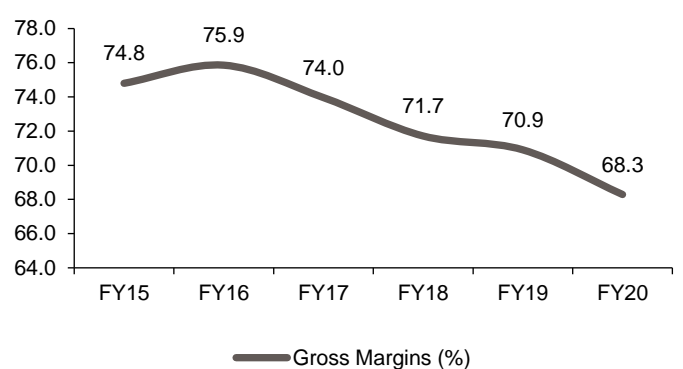
Source: Company

Exhibit 3: API sales saw high growth led by volumes in Q1FY21



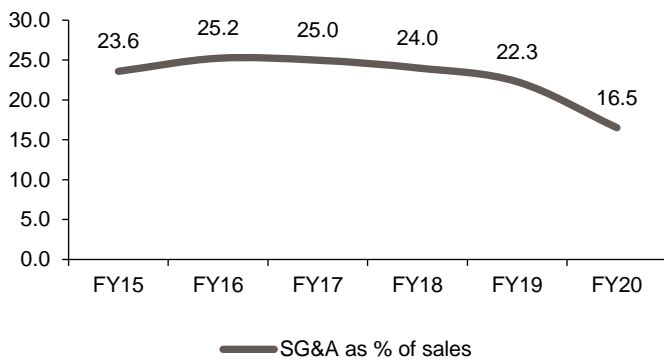
Source: Company

Exhibit 4: Gross margins decline was led by price erosion in US...



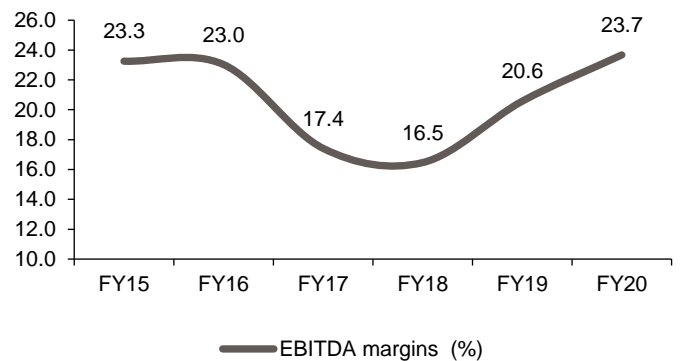
Source: Company

Exhibit 5: ...but tight control on SG&A cost ...



Source: Company

Exhibit 6: ...has led to EBITDA margin improvement



Source: Company

Key takeaways of our conversation with Mr Amit Agarwal (Head – Investor Relations & FP&A) and Mr Narasimhan (Head – Business Finance)

US Business

- During 2015-19, the rate of approvals and launches slowed down due to the warning letters and DRRD's foray into complex generics, which typically have a longer lead time.
- In FY20, the price erosion was mild and the company recorded an increase in the number of approvals. DRRD is confident of good launch momentum over the next few years based on the pipeline of products that are already filed and in the development phase.
- Injectable demand is low compared to pre-Covid levels but is now picking up MoM. DRRD does not expect any price increase opportunity in injectables.
- Initial experience with commercial marketing of Sernivo and Zembrace, and the continued investments thereof prompted DRRD to relook the specialty strategy.
- R&D will remain the key focus for specialty, and the commercialization will be done through outside partners. DRRD believes that its strength lies in the R&D part of the specialty business more than the commercial side. It does not want to risk high investments in developing the commercial arm. Instead, the idea is to use the same capital to reach more number of geographies with a higher number of products.
- Top-5 products in US contribute ~25-30% of total sales.
- For Copaxone, DRRD has submitted a response to CRL one month back and is now waiting for the Goal Date. The company expects approval in Q4 or Q1FY22.
- For Nuvaring, DRRD has received CRL and work is ongoing. It will be submitting the response in Q3FY21. Post submission, the approval will take 8-10 months.

Domestic Business

- With increased focus on India, DRRD created an R&D team dedicated to developing products for the domestic business. It is looking to improve productivity at manufacturing and from the front end.
- DRRD forayed into the exciting Nutraceuticals space last year and launched one product. This year, the company has launched another Nutraceutical product. They are also looking at inorganic opportunities to grow this business.
- It is rationalizing headquarters, which do not make commercial sense, and re-deploying the capital in profitable HQs.
- Senior leadership changes are playing out well for the company. India Business head has recently joined from Abbott.
- DRRD does not have any trade generic business now nor do they plan to do anytime soon. However, they are focusing more on the institutional business in India by participating in Hospitals business and government tenders. This business is equally profitable as there is no SG&A cost involved.
- Currently, per MR productivity is ~4.5-5L/month (pre-Covid). DRRD has 6,000 MRs and the Wockhardt acquisition has added another 2,000.
- The domestic business has seen MoM improvement.
- Wockhardt brands had high potential but due to cash constraints at the company, they were not able to pick up. DRRD plans to leverage this opportunity. Wockhardt's acquired portfolio is equally profitable as DRRD's domestic business.
- There is no product overlap with Wockhardt portfolio. During the acquisition, this portfolio was declining due to lack of investments from Wockhardt. Integration has gone well through virtual meetings, despite no physical connect between the teams.
- Initial focus for DRRD was to ensure the availability of inventory and other required investments and the plant is now running at the full stream. Currently, DRRD's team is working on additional synergies in other areas. There is no plan to rationalize the field force.
- FY21 is likely to underperform industry growth due to the lockdowns and DRRD's acute-focused portfolio. However, the company believes that on a sustainable basis, the India portfolio will outperform industry growth.
- Bigger brands have done well amid the pandemic as they have a high brand recall.

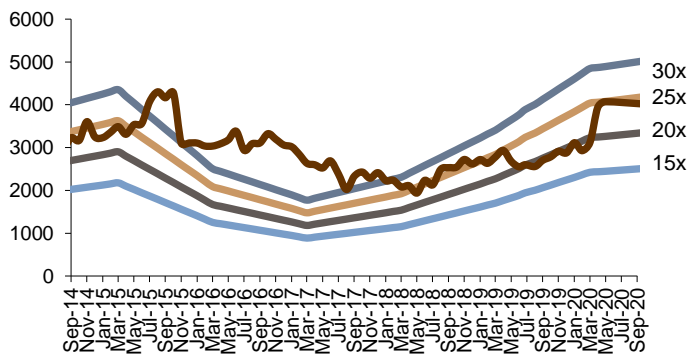
API business

- Q1 API performance did not have any element of price hikes and was largely volume driven. While a part of this is led by upstocking, DRRD believes that the API business will continue to grow strongly over the year. Gross margin expansion in the API space in Q1 was driven by product mix and cost efficiencies. The extremely high volume pattern seen in April-May has more or less normalized.
- DRRD did not take any price hikes. It has sufficient API capacities to cater to any increase in demand for the next 1-2 years.
- Government PLI scheme is not attractive to DRRD as it is not in the fermentation category

Other Highlights

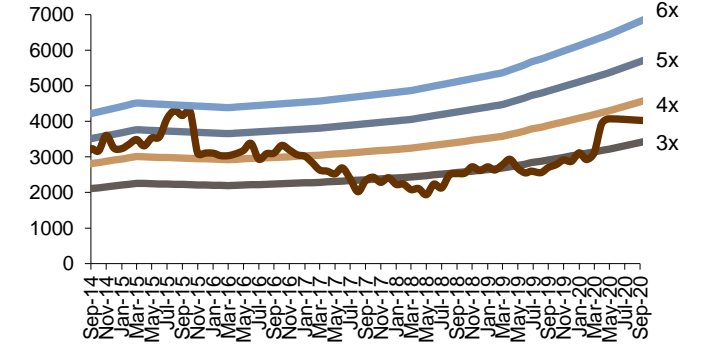
- DRRD believes that lower SG&A spends will continue and there is enough scope for further rationalization.
- **MEIS:** A large part of export incentives is from the MEIS scheme. The industry has made representations and like most other companies, DRRD believe that there will be a compensatory scheme.

Exhibit 7: P/E chart



Source: Bloomberg

Exhibit 8: P/B chart



Source: Bloomberg

Key Financials (Consolidated)**Income Statement**

Y/E Mar (Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
Net Sales	1,49,062	1,63,574	1,80,043	1,95,146	2,07,370
Expenditure	1,22,700	1,33,699	1,40,163	1,52,640	1,62,477
EBITDA	31,782	41,471	46,182	49,336	52,151
Depreciation	8,312	28,398	10,311	10,911	11,511
EBIT	20,434	13,073	32,871	35,424	37,640
Other Income	3,375	6,206	932	1,616	1,717
Interest expenses	889	983	(1,863)	(2,020)	(2,146)
PBT	22,920	18,296	35,666	39,060	41,503
Tax	3,858	(1,403)	9,273	9,765	10,376
Extraordinary Items	0	0	0	0	0
Minority Int./Income from Assoc.	0	0	0	0	0
Reported Net Income	19,500	20,260	26,868	29,770	31,603
Adjusted PAT	19,500	20,260	26,868	29,770	31,603

Balance Sheet

Y/E Mar (Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
Equity share capital	830	831	831	831	831
Reserves & surplus	1,39,406	1,55,157	1,78,115	2,02,996	2,28,733
Net worth	1,40,236	1,55,988	1,78,946	2,03,827	2,29,564
Minority Interest	0	0	0	0	0
Loan Funds	41,355	19,891	19,891	19,891	19,891
Net deferred tax liability	(3,844)	(15,986)	(15,986)	(15,986)	(15,986)
Total Liabilities	1,77,747	1,59,893	1,82,851	2,07,732	2,33,469
Net block	71,910	68,503	83,692	79,780	75,269
Investment	30,522	29,517	28,610	28,610	28,610
Current Assets	88,572	1,02,304	1,09,557	1,42,455	1,76,026
Cash & bank balance	2,228	2,053	2,855	26,803	53,130
Other Current Assets	12,896	14,906	15,827	17,154	18,229
Current liabilities & Provision	42,592	55,782	54,359	58,464	61,787
Net current assets	45,980	46,522	55,198	83,991	1,14,239
Misc. exp	0	0	0	0	0
Total Assets	1,77,747	1,59,893	1,82,851	2,07,732	2,33,469

Cash Flow

Y/E Mar (Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
PBT (Ex-Other income) (NI+Dep)	19,545	12,090	34,735	37,444	39,786
Other Non-Cash items	0	561	475	475	475
Chg in working cap	(3,438)	(12,859)	(7,874)	(4,845)	(3,921)
Operating Cashflow	28,704	30,576	29,510	35,201	38,329
Capital expenditure	(8,208)	(11,007)	(28,500)	(10,000)	(10,000)
Free Cash Flow	20,496	19,569	1,010	25,201	28,329
Investments	(1,523)	1,005	907	0	0
Other Investing Cash Flow	(1,336)	0	0	0	0
Investing Cashflow	(7,692)	(3,796)	(26,661)	(8,384)	(8,283)
Equity Capital Raised	420	1	0	0	0
Loans Taken / (Repaid)	(13,109)	(21,464)	0	0	0
Dividend paid (incl tax)	(4,002)	(3,911)	(3,911)	(4,888)	(5,866)
Other Financing Cash Flow	(3,842)	0	0	0	0
Financing Cashflow	(21,422)	(26,357)	(2,047)	(2,869)	(3,720)
Net chg in cash	(410)	423	802	23,948	26,326
Opening cash position	2,638	2,228	2,053	2,855	26,803
Closing cash position	2,228	2,651	2,855	26,803	53,130

Source: Company, Emkay Research

Key Ratios

Profitability (%)	FY19	FY20	FY21E	FY22E	FY23E
EBITDA Margin	20.6	23.7	24.8	24.4	24.3
EBIT Margin	13.2	7.5	17.6	17.5	17.5
Effective Tax Rate	16.8	(7.7)	26.0	25.0	25.0
Net Margin	12.3	11.2	14.2	14.5	14.5
ROCE	13.7	11.6	20.0	19.2	18.0
ROE	14.7	13.7	16.0	15.6	14.6
RoIC	18.1	11.4	26.4	26.0	27.5

Per Share Data (Rs)	FY19	FY20	FY21E	FY22E	FY23E
EPS	108.8	122.0	161.9	179.3	190.4
CEPS	185.8	293.1	242.0	263.1	277.8
BVPS	844.8	939.7	1,078.0	1,227.9	1,382.9
DPS	24.1	23.6	23.6	29.4	35.3

Valuations (x)	FY19	FY20	FY21E	FY22E	FY23E
PER	40.6	36.2	27.3	24.6	23.2
P/CEPS	23.2	14.7	17.8	16.3	15.5
P/BV	5.2	4.7	4.1	3.6	3.2
EV / Sales	5.0	4.4	4.0	3.6	3.2
EV / EBITDA	23.4	17.4	15.7	14.2	12.9
Dividend Yield (%)	0.5	0.5	0.5	0.7	0.8

Gearing Ratio (x)	FY19	FY20	FY21E	FY22E	FY23E
Net Debt/ Equity	0.1	(0.1)	(0.1)	(0.2)	(0.3)
Net Debt/EBIDTA	0.3	(0.3)	(0.2)	(0.7)	(1.2)
Working Cap Cycle (days)	103.4	92.7	102.5	103.3	103.9

Growth (%)	FY19	FY20	FY21E	FY22E	FY23E
Revenue	7.8	9.7	10.1	8.4	6.3
EBITDA	35.2	30.5	11.4	6.8	5.7
EBIT	60.4	(36.0)	151.4	7.8	6.3
PAT	106.0	3.9	32.6	10.8	6.2

Quarterly (Rs mn)	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21
Revenue	38,435	48,009	43,838	44,318	44,175
EBITDA	7,267	14,081	10,188	9,406	11,129
EBITDA Margin (%)	18.9	29.3	23.2	21.2	25.2
PAT	6,628	10,925	(5,697)	7,642	5,793
EPS (Rs)	39.9	65.8	(34.3)	46.0	34.9

Source: Company, Emkay Research

Shareholding Pattern (%)	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20
Promoters	26.8	26.8	26.8	26.8	26.8
FII	30.7	30.1	30.0	30.2	29.3
DII	13.8	15.0	15.1	14.4	14.6
Public and Others	28.7	28.2	28.1	28.7	29.3

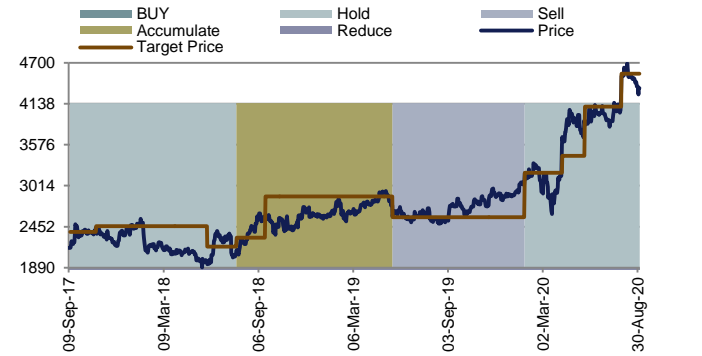
Source: Capitaline

RECOMMENDATION HISTORY TABLE

Date	Closing Price	TP	Period (months)	Rating	Analyst
30-Jul-20	4,517	4,550	12m	Hold	Praful Bohra
21-May-20	3,848	4,100	12m	Hold	Praful Bohra
08-Apr-20	3,683	3,424	12m	Hold	Praful Bohra
27-Jan-20	3,189	3,190	12m	Hold	Praful Bohra
16-Dec-19	2,816	2,580	12m	Sell	Praful Bohra
14-Nov-19	2,734	2,580	12m	Sell	Praful Bohra
01-Nov-19	2,757	2,580	12m	Sell	Praful Bohra
19-Aug-19	2,509	2,580	12m	Sell	Praful Bohra
30-Jul-19	2,560	2,580	12m	Sell	Praful Bohra
20-May-19	2,589	2,580	12m	Sell	Praful Bohra
26-Oct-18	2,405	2,865	12m	Accumulate	Jatin Kotian
19-Sep-18	2,607	2,865	12m	Accumulate	Jatin Kotian
26-Jul-18	2,133	2,300	12m	Accumulate	Jatin Kotian
10-Jul-18	2,322	2,180	12m	Hold	Jatin Kotian
10-Jul-18	2,322	2,180	12m	Hold	Jatin Kotian
29-Jun-18	2,235	2,180	12m	Hold	Jatin Kotian
31-May-18	1,937	2,180	12m	Hold	Jatin Kotian
10-May-18	1,990	2,460	12m	Hold	Jatin Kotian
26-Apr-18	2,077	2,460	12m	Hold	Jatin Kotian
31-Oct-17	2,428	2,460	12m	Hold	Jatin Kotian
11-Sep-17	2,160	2,380	12m	Hold	Jatin Kotian

Source: Company, Emkay Research

RECOMMENDATION HISTORY CHART



Source: Bloomberg, Company, Emkay Research

Emkay Alpha Portfolio – Pharmaceuticals

EAP sector portfolio

Company Name	BSE200 Weight	EAP Weight	OW/UW (%)	OW/UW (bps)	EAP Weight (Normalised)
Pharmaceuticals	4.44	4.44	0%	0	100.00
Aurobindo Pharma	0.37	0.40	9%	3	9.04
Cadila Healthcare	0.16	0.09	-40%	-6	2.09
Cipla	0.59	0.79	33%	20	17.82
Divi's Lab	0.66	0.78	17%	11	17.51
Dr. Reddy's Lab	0.84	0.83	-2%	-1	18.72
Glenmark Pharma	0.11	0.11	-2%	0	2.55
Granules India	0.00	0.51	NA	51	11.43
Ipca Lab	0.22	0.29	29%	6	6.45
Lupin	0.36	0.13	-64%	-23	2.97
Sun Pharma	0.89	0.51	-43%	-39	11.41
Suven Life Sciences*	0.00	0.00	NA	0	0.00
Torrent Pharma	0.22	0.00	-100%	-22	0.00
Cash	0.00	0.00	NA	0	0.00

Source: Emkay Research

* Not under coverage: Equal Weight

■ High Conviction/Strong Over Weight ■ High Conviction/Strong Under Weight

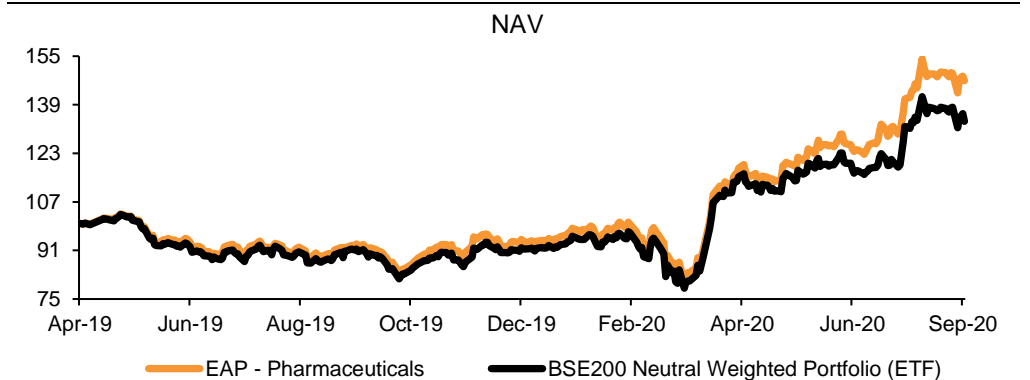
Sector portfolio NAV

	Base					Latest
	01-Apr-19	04-Dec-19	06-Mar-20	05-Jun-20	05-Aug-20	04-Sep-20
EAP - Pharmaceuticals	100.0	94.8	97.5	124.1	143.9	146.9
BSE200 Neutral Weighted Portfolio (ETF)	100.0	92.2	94.2	119.5	133.1	133.5

*Performance measurement base date 1st April 2019

Source: Emkay Research

NAV chart



Source: Emkay Research

Please see our model portfolio (Emkay Alpha Portfolio): [Nifty](#)

Please see our model portfolio (Emkay Alpha Portfolio): [SMID](#)

“Emkay Alpha Portfolio – SMID and Nifty are a supporting document to the Emkay Alpha Portfolios Report and is updated on regular intervals”



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Sector

Pharmaceuticals

Analyst bio

Praful Bohra holds an MBA in Finance and has more than 11 years of experience in equity research. His team currently covers 12 stocks in the Pharmaceuticals space.

Emkay Rating Distribution

Ratings	Expected Return within the next 12-18 months.
BUY	Over 15%
HOLD	Between -5% to 15%
SELL	Below -5%

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Sources for all charts and tables are Emkay Research unless otherwise specified.

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