Prabhudas Lilladher
POWERING YOUR FINANCIAL GROWTH

Dr. Reddy's Laboratories (DRRD IN)

Rating: ACCUMULATE | CMP: Rs2,757 | TP: Rs2,910

November 1, 2019

Q2FY20 Result Update

☑ Change in Estimates | ☑ Target | ■ Reco

Change in Estimates

	Current		Previous	
	FY20E	FY21E	FY20E	FY21E
Rating	ACCUMULATE		ACCUMULATE	
Target Price	2,910		2,997	
Sales (Rs. m)	170,067	176,666	169,847	189,779
% Chng.	*0.1*	*(6.9)*		
EBITDA (Rs. m)	39,966	36,128	39,914	46,496
% Chng.	*0.1*	*(22.3)*		
EPS (Rs.)	168.8	124.5	141.9	166.1
% Chng.	*19.0*	*(25.0)*		

Key Financials - Consolidated

Y/e Mar	FY19	FY20E	FY21E	FY22E
Sales (Rs. bn)	154	170	177	190
EBITDA (Rs. bn)	32	40	36	39
Margin (%)	*20.6*	*23.5*	*20.5*	*20.8*
PAT (Rs. bn)	20	28	21	23
EPS (Rs.)	117.5	168.8	124.5	138.6
Gr. (%)	*106.0*	*43.7*	*(26.2)*	*11.3*
DPS (Rs.)	-	-	-	-
Yield (%)	-	-	-	-
RoE (%)	*14.7*	*18.3*	*11.8*	*11.7*
RoCE (%)	*11.7*	*15.0*	*11.5*	*11.9*
EV/Sales (x)	3.0	2.6	2.5	2.3
EV/EBITDA (x)	14.7	11.2	12.1	10.9
PE (x)	23.5	16.3	22.1	19.9
P/BV (x)	3.3	2.7	2.5	2.2

Key Data	REDY.BO | DRRD IN
52-W High / Low	Rs.2,965 / Rs.1,873
Sensex / Nifty	40,165 / 11,891
Market Cap	Rs.458bn/ $ 6,459m
Shares Outstanding	166m
3M Avg. Daily Value	Rs.3140.68m

Shareholding Pattern (%)

Promoter's	27.00
Foreign	30.05
Domestic Institution	14.99
Public & Others	27.97
Promoter Pledge (Rs bn)	-

Stock Performance (%)

	1M	6M	12M
Absolute	2.5	(6.0)	12.0
Relative	(2.2)	(8.7)	(4.0)

Surajit Pal
surajitpal@plindia.com | 91-22-66322259

US continue with teething problems: Long list of launches to drive growth over price erosion

DRRD sales and adj. PAT were in line with our estimates while adj. EBITDA marginally beat estimates by 2% due to strong control on overheads especially in R&D expenditures. Management maintained guidance over control on overheads with its ongoing program of rationalized assets, products and global presence. Employee and SGA costs decreased by 2% and 1% respectively, while R&D costs increased only by 1% QoQ. Its adoption of new strategy with cost-benefit analysis of each operational activity helps to limit the reduction of adj. EBITDA margin only by 20bps QoQ to 19.2%, despite one-off inventory adjustment, adverse forex (USD/INR), price erosion in core US generis and recalls of Ranitidine. Adjusted with one-off income of Rs7.2bn and one-off expenditures of Rs4.7bn, PAT of Rs8.6bn was in line with our estimates.

With launch of selected products in key non-US markets along with pipeline of injectable and biosimilars, we expect current growth of ROW sales is likely to be sustainable. Management continue to guide current growth in PSAI sales for H2FY20E on the back of healthy order book and resolution of certain product related issues. R&D costs were US$52m and maintain guidance of US$200-240m in FY20E. Effective tax guided lower to 10% from 22% in FY20E with review of deferred tax post amendment in new corporate tax rate.

- **Valuations: Maintain 'Accumulate', TP marginally decrease to Rs2,910:** 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 FY21E will make its risk-return ratio favourable. **We assign PE 21x on FY22E earnings and derive new TP of Rs2,910, decrease by 2% over our previous TP of Rs2,997 to reflect the teething problems in individual products. We maintain our recommendation 'Accumulate'**.

- **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 13 new products in H1FY20 and guided for more than 30 products in FY20E. **c)** USFDA inspection expected soon in Srikakulam 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. China business is currently growing at double digit.

Exhibit 1: Q2FY20 Result Overview (Rs m)

Y/e March	Q2FY20	Q2FY19	YoY gr. (%)	Q1FY20	H1FY20	H1FY19	YoY gr. (%)
Net Sales	**40,899**	**38,175**	***7.1***	**38,582**	**79,481**	**75,540**	***5.2***
Raw Material	14,011	10,517	*33.2*	12,069	26,080	20,566	*26.8*
% of Net Sales	*34.3*	*27.5*		*31.3*	*32.8*	*27.2*	
Personnel Cost	8,255	8,722	*(5.4)*	8,615	16,870	17,093	*(1.3)*
% of Net Sales	*20.2*	*22.8*		*22.3*	*21.2*	*22.6*	
Others	10,497	11,343	*(7.5)*	10,481	25,705	22,600	*13.7*
% of Net Sales	*25.7*	*29.7*		*27.2*	*32.3*	*29.9*	
Total Expenditure	32,763	30,582	*7.1*	31,165	68,655	60,259	*13.9*
EBITDA	**8,136**	**7,593**	***7.1***	**7,417**	**10,826**	**15,281**	***(29.2)***
Margin (%)	*19.9*	*19.9*		*19.2*	*13.6*	*20.2*	
Depreciation	3,131	2,786	*12.4*	2,890	6,021	5,573	*8.0*
EBIT	**5,005**	**4,807**	***4.1***	**4,527**	**4,805**	**9,708**	***(50.5)***
Other Income	540	1,282	*(57.9)*	4,301	4,841	1,786	*171.1*
Interest	303	208	*45.7*	298	601	403	
PBT	**5,242**	**5,881**	***(10.9)***	**8,530**	**9,045**	**11,091**	***(18.4)***
Share of Profit of Equity Accountted Investees	117	109		163	280	192	
Total Taxes	(3,207)	807	*(497.4)*	1,928	(1,279)	1,339	*(195.5)*
ETR (%)	*(61.2)*	*13.7*		*22.6*	*(14.1)*	*12.1*	
Reported PAT	**8,566**	**5,183**	***65.3***	**6,765**	**10,604**	**9,944**	***6.6***

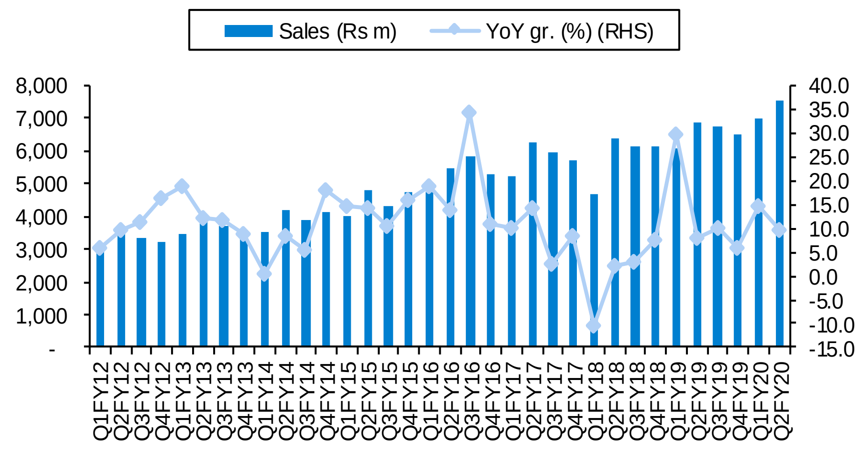
Source: Company, PL

Exhibit 2: Major Sources of Revenue

Major Sources of Revenues	Q2FY20	Q2FY19	YoY gr. (%)	Q1FY20	H1FY20	H1FY19	YoY gr. (%)
PSAI (CPS & API)	**7,107**	**6,029**	***17.9***	**4,539**	**11,646**	**11,438**	***1.8***
% of Net Sales	*14.8*	*15.9*		*11.8*	*13.5*	*15.2*	
Branded Formulation	**32,816**	**30,536**	***7.5***	**32,982**	**65,798**	**61,172**	***7.6***
India	7,511	6,864	*9.4*	6,960	14,471	12,938	*11.8*
% of Net Sales	*15.6*	*18.1*		*18.1*	*16.7*	*17.2*	
International	**25,305**	**23,672**	*6.9*	**26,022**	**51,327**	**48,234**	*6.4*
% of Net Sales	*52.7*	*62.3*		*67.7*	*59.4*	*64.2*	
Russia & CIS	5,800	5,240	*10.7*	5,224	11,024	10,240	*7.7*
% of Net Sales	*12.1*	*13.8*		*13.6*	*12.8*	*13.6*	
Europe	2,764	1,915	*44.3*	2,404	5,168	3,931	*31.5*
% of Net Sales	*5.8*	*5.0*		*6.3*	*6.0*	*5.2*	
North America Generics	14,265	14,265	-	16,322	30,587	30,168	*1.4*
% of Net Sales	*29.7*	*37.6*		*42.5*	*35.4*	*40.1*	
Emerging Mkt Generics	2,476	2,252	*9.9*	2,072	4,548	3,895	*16.8*
% of Net Sales	*5.2*	*5.9*		*5.4*	*5.3*	*5.2*	
Innovative Prod. (Proprietery Prod.)	**8,086**	**1,413**	***472.3***	**914**	**9,000**	**2,575**	***249.5***
% of Net Sales	*16.8*	*3.7*		*2.4*	*10.4*	*3.4*	
Net Sales	**48,009**	**37,978**	***26.4***	**38,435**	**86,444**	**75,185**	***15.0***

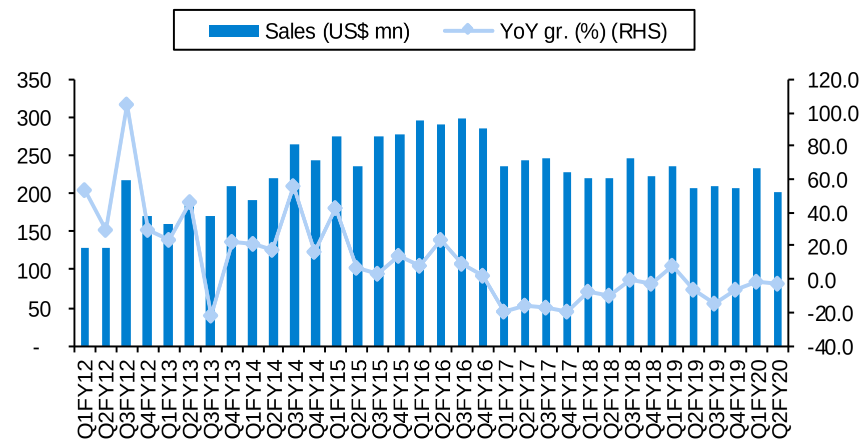
Source: PL, Company

Exhibit 3: India Formulations: Sales & growth



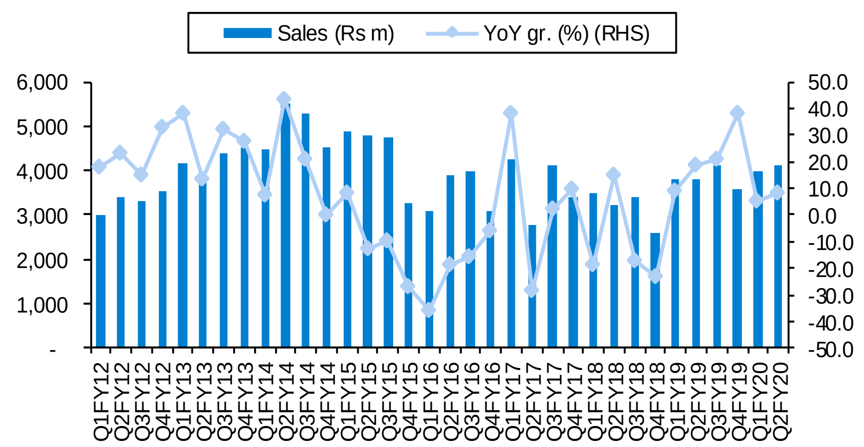
Source: PL, Company

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



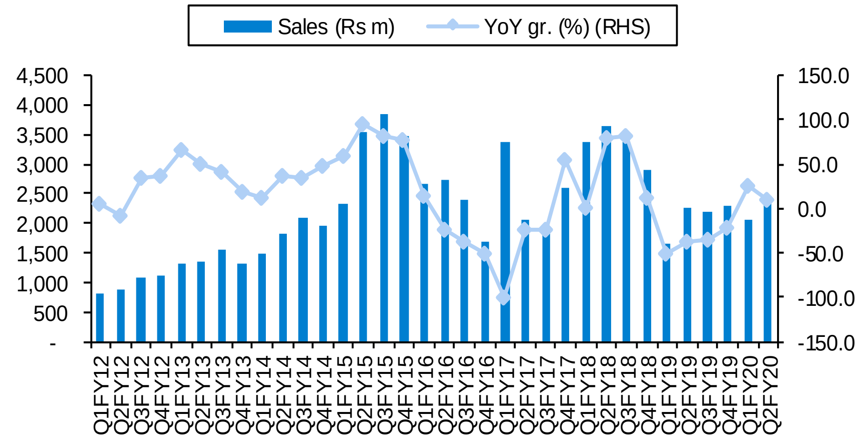
Source: Company, PL

Exhibit 5: Russia and CIS: Sales and growth



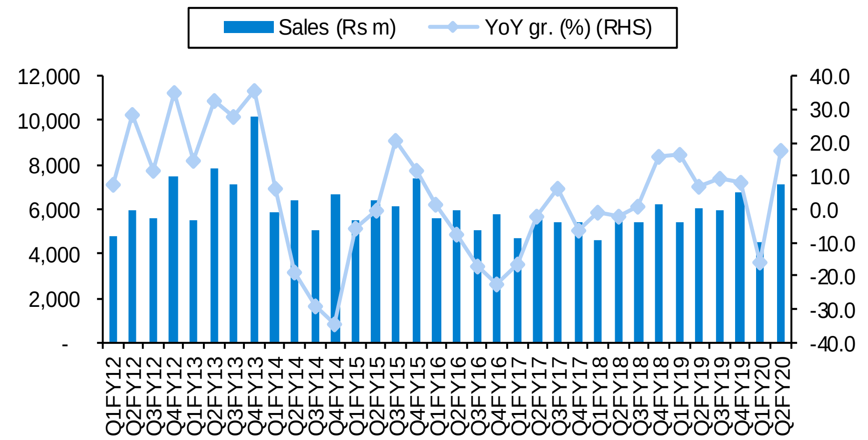
Source: Company, PL

Exhibit 6: Emerging mkt: Sales and growth



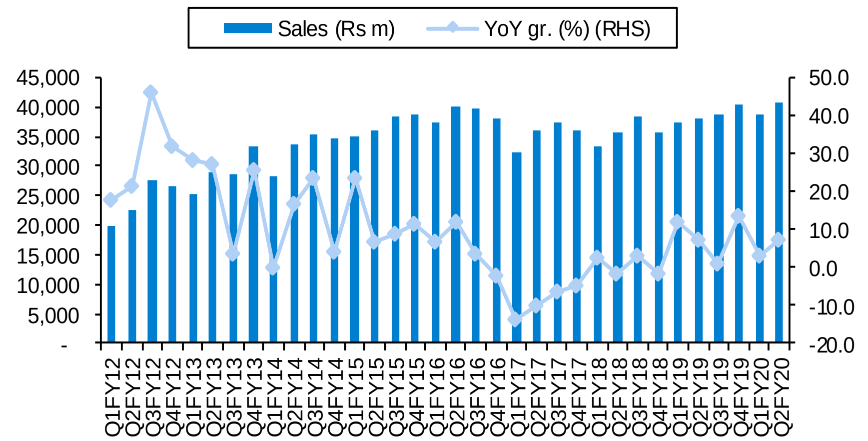
Source: Company, PL

Exhibit 7: PSAI: Sales and growth



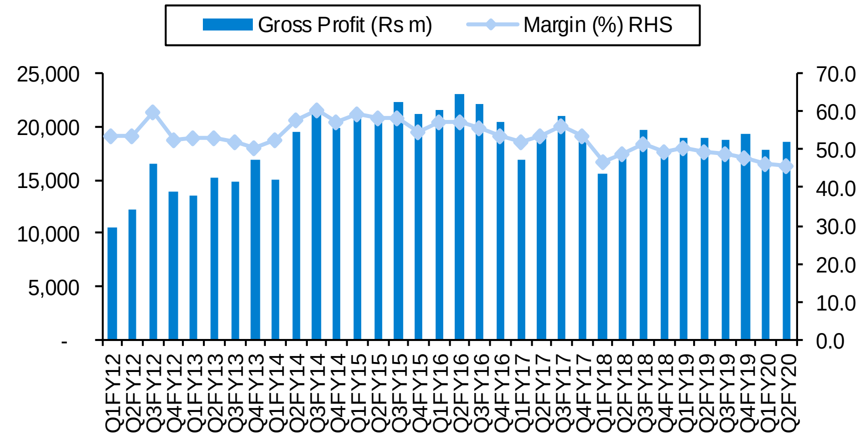
Source: Company, PL

Exhibit 8: Overall Sales and growth



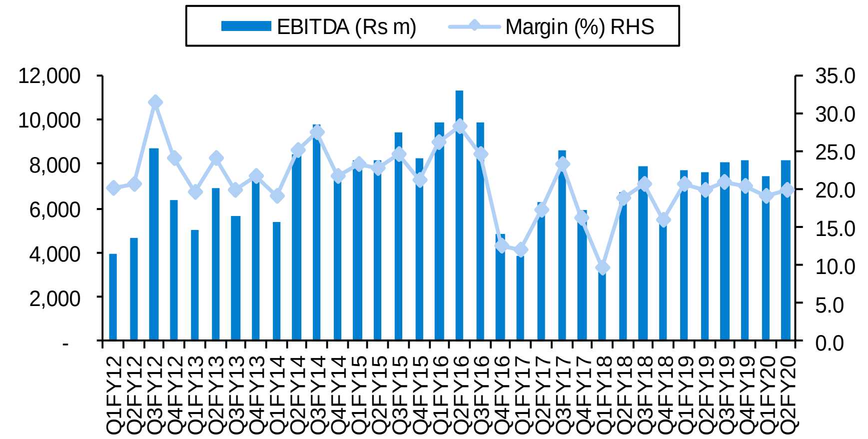
Source: PL, Company

Exhibit 9: Gross profit and margin (%)



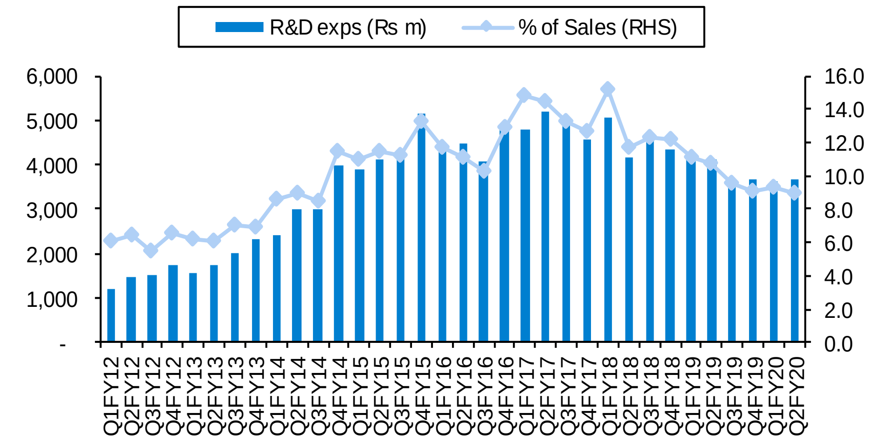
Source: Company, PL

Exhibit 10: EBITDA and margin



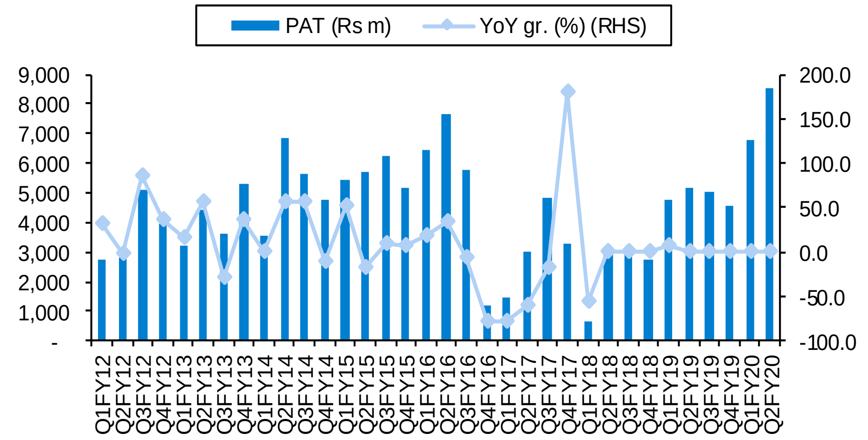
Source: Company, PL

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	FY19	FY20E	FY21E	FY22E
Net Revenues	**154,482**	**170,067**	**176,666**	**190,326**
YoY gr. (%)	*8.2*	*10.1*	*3.9*	*7.7*
Cost of Goods Sold	44,948	44,217	52,028	56,146
Gross Profit	109,534	125,849	124,638	134,180
Margin (%)	*70.9*	*74.0*	*70.6*	*70.5*
Employee Cost	33,562	35,714	37,277	39,493
Other Expenses	15,607	16,156	15,017	16,178
EBITDA	**31,782**	**39,966**	**36,128**	**39,493**
YoY gr. (%)	*35.2*	*25.7*	*(9.6)*	*9.3*
Margin (%)	*20.6*	*23.5*	*20.5*	*20.8*
Depreciation and Amortization	11,348	12,375	13,166	14,114
EBIT	**20,434**	**27,590**	**22,962**	**25,378**
Margin (%)	*13.2*	*16.2*	*13.0*	*13.3*
Net Interest	889	1,280	1,120	1,000
Other Income	3,375	6,851	2,400	2,600
Profit Before Tax	**22,920**	**33,162**	**24,242**	**26,978**
Margin (%)	*14.8*	*19.5*	*13.7*	*14.2*
Total Tax	3,858	5,637	4,121	4,586
Effective tax rate (%)	*16.8*	*17.0*	*17.0*	*17.0*
Profit after tax	**19,062**	**27,524**	**20,121**	**22,392**
Minority interest	(438)	(526)	(578)	(636)
Share Profit from Associate	-	-	-	-
Adjusted PAT	**19,500**	**28,050**	**20,699**	**23,028**
YoY gr. (%)	*106.0*	*43.8*	*(26.2)*	*11.3*
Margin (%)	*12.6*	*16.5*	*11.7*	*12.1*
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	**19,500**	**28,050**	**20,699**	**23,028**
YoY gr. (%)	*106.0*	*43.8*	*(26.2)*	*11.3*
Margin (%)	*12.6*	*16.5*	*11.7*	*12.1*
Other Comprehensive Income	-	-	-	-
Total Comprehensive Income	19,500	28,050	20,699	23,028
Equity Shares O/s (m)	**166**	**166**	**166**	**166**
EPS (Rs)	**117.5**	**168.8**	**124.5**	**138.6**

Source: Company Data, PL Research

Balance Sheet Abstract (Rs m)

Y/e Mar	FY19	FY20E	FY21E	FY22E
Non-Current Assets				
Gross Block	**151,134**	**171,603**	**192,908**	**215,205**
Tangibles	110,028	126,730	144,456	163,353
Intangibles	41,106	44,873	48,452	51,852
Acc: Dep / Amortization	**83,883**	**96,258**	**109,425**	**123,539**
Tangibles	60,901	68,603	77,329	87,226
Intangibles	22,982	27,655	32,095	36,313
Net fixed assets	**67,251**	**75,345**	**83,484**	**91,666**
Tangibles	49,127	58,127	67,127	76,127
Intangibles	18,124	17,218	16,357	15,539
Capital Work In Progress	29,335	22,001	16,501	12,376
Goodwill	4,659	3,960	3,366	2,861
Non-Current Investments	4,186	4,072	3,979	4,256
Net Deferred tax assets	3,844	4,299	4,227	4,155
Other Non-Current Assets	3,807	3,617	3,436	3,264
Current Assets				
Investments	22,529	25,908	29,795	34,264
Inventories	33,579	35,280	38,813	43,571
Trade receivables	39,869	42,382	44,100	47,655
Cash & Bank Balance	2,228	10,922	10,963	9,247
Other Current Assets	10,424	10,945	11,492	12,067
Total Assets	**224,656**	**241,900**	**253,574**	**269,078**
Equity				
Equity Share Capital	830	831	831	831
Other Equity	139,406	165,794	184,831	206,197
Total Networth	**140,236**	**166,625**	**185,662**	**207,028**
Non-Current Liabilities				
Long Term borrowings	22,000	16,500	12,375	9,281
Provisions	793	842	842	842
Other non current liabilities	2,079	1,559	1,169	877
Current Liabilities				
ST Debt / Current of LT Debt	12,125	9,700	7,275	5,456
Trade payables	13,671	12,329	14,461	15,852
Other current liabilities	33,177	33,668	31,111	29,060
Total Equity & Liabilities	**224,656**	**241,900**	**253,574**	**269,078**

Source: Company Data, PL Research

Cash Flow (Rs m)

Y/e Mar	FY19	FY20E	FY21E	FY22E
PBT	23,358	33,687	24,820	27,614
Add. Depreciation	11,348	12,375	13,166	14,114
Add. Interest	(213)	(213)	(213)	(213)
Less Financial Other Income	3,375	6,851	2,400	2,600
Add. Other	1,930	(8,666)	2,022	1,373
Op. profit before WC changes	36,423	37,183	39,796	42,889
Net Changes-WC	2,493	(5,825)	(6,485)	(9,840)
Direct tax	(3,858)	(5,637)	(4,121)	(4,586)
Net cash from Op. activities	**35,058**	**25,721**	**29,189**	**28,463**
Capital expenditures	(8,880)	(13,135)	(15,805)	(18,171)
Interest / Dividend Income	3,375	6,851	2,400	2,600
Others	(2,463)	(3,542)	(4,081)	(4,703)
Net Cash from Invt. activities	**(7,968)**	**(9,826)**	**(17,486)**	**(20,275)**
Issue of share cap. / premium	-	-	-	-
Debt changes	(16,526)	(7,925)	(6,550)	(4,913)
Dividend paid	(3,992)	(3,992)	(3,992)	(3,992)
Interest paid	(889)	(1,280)	(1,120)	(1,000)
Others	-	-	-	-
Net cash from Fin. activities	**(21,407)**	**(13,197)**	**(11,662)**	**(9,905)**
Net change in cash	**5,683**	**2,698**	**41**	**(1,716)**
Free Cash Flow	26,178	12,585	13,384	10,292

Source: Company Data, PL Research

Quarterly Financials (Rs m)

Y/e Mar	Q3FY19	Q4FY19	Q1FY20	Q2FY20
Net Revenue	**38,646**	**40,296**	**38,582**	**40,899**
YoY gr. (%)	*0.8*	*13.4*	*3.3*	*7.1*
Raw Material Expenses	11,758	12,624	12,069	14,011
Gross Profit	26,888	27,672	26,513	26,888
Margin (%)	*69.6*	*68.7*	*68.7*	*65.7*
EBITDA	**8,046**	**8,189**	**7,417**	**8,136**
YoY gr. (%)	*1.5*	*45.3*	*(3.5)*	*7.1*
Margin (%)	*20.8*	*20.3*	*19.2*	*19.9*
Depreciation / Depletion	2,903	2,872	2,890	3,131
EBIT	**5,143**	**5,317**	**4,527**	**5,005**
Margin (%)	*13.3*	*13.2*	*11.7*	*12.2*
Net Interest	241	245	298	303
Other Income	1,023	833	4,301	540
Profit before Tax	**5,925**	**5,905**	**8,530**	**5,242**
Margin (%)	*15.3*	*14.7*	*22.1*	*12.8*
Total Tax	1,011	1,508	1,928	(3,207)
Effective tax rate (%)	*17.1*	*25.5*	*22.6*	*(61.2)*
Profit after Tax	**4,914**	**4,397**	**6,602**	**8,449**
Minority interest	(89)	(157)	(163)	(117)
Share Profit from Associates	-	-	-	-
Adjusted PAT	**5,003**	**4,554**	**6,765**	**8,566**
YoY gr. (%)	*65.3*	*67.4*	*42.1*	*65.3*
Margin (%)	*12.9*	*11.3*	*17.5*	*20.9*
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	**5,003**	**4,554**	**6,765**	**8,566**
YoY gr. (%)	*65.3*	*67.4*	*42.1*	*65.3*
Margin (%)	*12.9*	*11.3*	*17.5*	*20.9*
Other Comprehensive Income	(1,408)	-	5,535	-
Total Comprehensive Income	**3,595**	**4,554**	**12,300**	**8,566**
Avg. Shares O/s (m)	166	166	166	166
EPS (Rs)	**30.1**	**27.4**	**40.8**	**51.6**

Source: Company Data, PL Research

Key Financial Metrics

Y/e Mar	FY19	FY20E	FY21E	FY22E
Per Share(Rs)				
EPS	117.5	168.8	124.5	138.6
CEPS	185.8	243.2	203.8	223.5
BVPS	844.8	1,002.6	1,117.1	1,245.7
FCF	157.7	75.7	80.5	61.9
DPS	-	-	-	-
Return Ratio(%)				
RoCE	11.7	15.0	11.5	11.9
ROIC	10.2	13.5	10.8	11.3
RoE	14.7	18.3	11.8	11.7
Balance Sheet				
Net Debt : Equity (x)	0.1	(0.1)	(0.1)	(0.1)
Net Working Capital (Days)	141	140	141	145
Valuation(x)				
PER	23.5	16.3	22.1	19.9
P/B	3.3	2.7	2.5	2.2
P/CEPS	14.8	11.3	13.5	12.3
EV/EBITDA	14.7	11.2	12.1	10.9
EV/Sales	3.0	2.6	2.5	2.3
Dividend Yield (%)	-	-	-	-

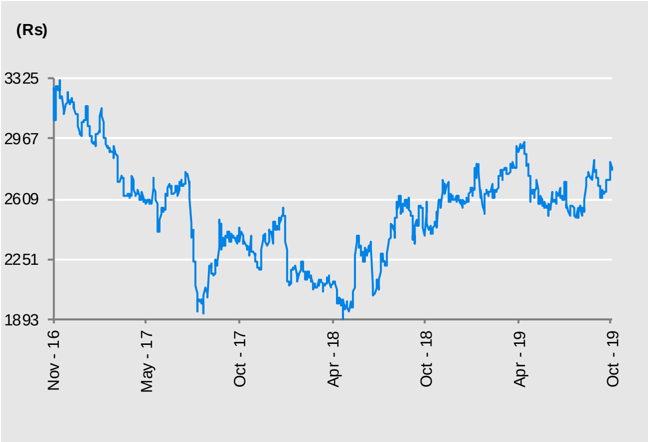
Source: Company Data, PL Research

Key Operating Metrics

Y/e Mar	FY19	FY20E	FY21E	FY22E
India Formulations	26,179	29,059	32,255	35,481
US formulations	59,957	63,530	66,389	69,376
Russia	20,500	22,709	25,221	27,881
PSAI	24,140	25,588	27,635	29,294

Source: Company Data, PL Research

Price Chart



Recommendation History

No.	Date	Rating	TP (Rs.)	Share Price (Rs.)
1	22-Oct-19	Accumulate	2,997	2,820
2	3-Oct-19	Accumulate	2,997	2,677
3	29-Jul-19	Accumulate	2,997	2,648
4	4-Jul-19	Hold	2,997	2,602
5	19-May-19	Hold	2,997	2,725
6	5-Apr-19	Reduce	2,558	2,754
7	6-Feb-19	Reduce	2,558	2,821
8	4-Feb-19	Reduce	2,558	2,791
9	7-Jan-19	Reduce	2,170	2,559

Analyst Coverage Universe

Sr. No.	Company Name	Rating	TP (Rs)	Share Price (Rs)
1	Aurobindo Pharma	Hold	511	452
2	Cadila Healthcare	Accumulate	266	234
3	Cipla	Reduce	439	441
4	Dr. Lal PathLabs	Accumulate	1,120	1,390
5	Dr. Reddy's Laboratories	Accumulate	2,997	2,820
6	Eris Lifesciences	Accumulate	459	431
7	Glenmark Pharmaceuticals	Reduce	385	320
8	Indoco Remedies	Hold	157	159
9	Ipca Laboratories	Accumulate	1,008	905
10	Jubilant Life Sciences	Reduce	433	562
11	Lupin	Reduce	730	701
12	Lupin	Reduce	730	701
13	Lupin	Reduce	730	701
14	Sun Pharmaceutical Industries	Reduce	396	388
15	Thyrocare Technologies	BUY	500	595

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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Prabhudas Lilladher Pvt. Ltd.
3rd Floor, Sadhana House, 570, P. B. Marg, Worli, Mumbai-400 018, India | Tel: (91 22) 6632 2222 Fax: (91 22) 6632 2209
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