

ADD

TP: Rs 4,640 | ▲ 8%

DR REDDY'S LABS

Pharmaceuticals

29 July 2020

Good beat but ETR increase caps earnings upgrade – ADD

Dr Reddy's (DRRD) reported a Q1 EBITDA beat of 21% despite a marginal surprise on sales. 2/3rd of the beat was led by product mix and productivity and rest came from currency benefits. PSAI sales (+19% QoQ), ROW ex-Russia/CIS (+40%) saw strong growth while India was weak and the US in line. Gross margin at 56% is on higher side and may fluctuate in the 53-56% range in coming quarters. PAT was a lower 9% beat due to higher ETR. Management is confident of growth despite Covid. We roll to a new Sep'21 TP of Rs 4,640 (vs. Rs 4,210).

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PSAI, ROW (ex-Russia/CIS) and Europe more than offset weak India and US

sales: DRRD saw strong volume traction (ex-India/US), largely offsetting the price erosion impact. US sales declined 7% QoQ to US\$ 234mn as pre-buying normalised. DRRD launched six products in Q1 (incl. gZytiga, gColcrys) which should scale up in coming quarters. India sales (with 20 days of Wockhardt integration) were weak, declining 10% YoY. Offsetting this, was strong growth for ROW (led by China), PSAI (deferred sales from Q4) and Europe (led by Germany, Spain). We retain our US sales estimate of US\$ 1.1bn by FY22 (10% CAGR over FY20, 5% ex-Copaxone, Nuvaring).

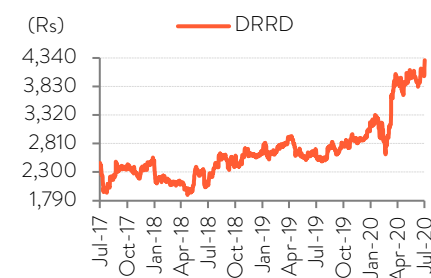
Adj. EBITDA beat at 16%: Gross margin rose 460bps QoQ to 56% despite flat sales. About 70% of the gains were driven by product mix and productivity improvement within PSAI, Europe and China; the rest was forex benefits. Our interaction with DRRD suggests that ~100bps of mix-related margin tailwinds could be non-recurring. Adj. EBITDA was a 16% beat (21% on reported EBITDA).

Earnings call takeaways: (1) CRL for Copaxone submitted while that for gNuvaring is pending. (2) ETR revised upward to 25-27% for FY21 (from 22%). (3) PSAI saw order book improvement across markets. (4) Wockhardt portfolio to focus on full brand recognition via higher promotional spends.

Ticker/Price	DRRD IN/Rs 4,302
Market cap	US\$ 9.6bn
Shares o/s	166mn
3M ADV	US\$ 57.8mn
52wk high/low	Rs 4,336/Rs 2,351
Promoter/FPI/DII	27%/27%/18%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	153,852	174,601	185,782	202,826	236,766
EBITDA (Rs mn)	31,333	40,942	42,473	47,502	59,572
Adj. net profit (Rs mn)	17,895	32,248	26,272	30,137	40,447
Adj. EPS (Rs)	107.8	194.3	158.3	181.5	243.7
Adj. EPS growth (%)	90.3	80.2	(18.5)	14.7	34.2
Adj. ROAE (%)	13.8	23.1	17.1	16.9	19.3
Adj. P/E (x)	39.9	22.1	27.2	23.7	17.7
EV/EBITDA (x)	23.8	18.0	16.9	14.5	11.1

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)	Q1FY20E	Var (%)	FY20	FY19	YoY (%)
Net Sales	44,175	38,435	14.9	44,318	(0.3)	43,237	2.2	174,600	153,851	13.5
EBITDA	11,129	7,267	53.1	9,406	18.3	9,176	21.3	40,941	31,332	30.7
Depreciation	3,140	3,082	-	2,965	-	3,100	-	12,471	12,399	-
EBIT	7,989	4,185	90.9	6,441	24.0	6,076	-	28,470	18,933	50.4
Interest	(606)	(393)	-	(435)	-	(400)	-	(983)	(1,117)	-
Other Income	118	3,759	-	168	-	150	-	3,294	1,955	-
PBT	8,713	8,337	4.5	7,044	23.7	6,626	31.5	30,782	22,005	55.6
Less: Taxation	2,996	1,872	-	(500)	-	1,458	-	(1,466)	3,648	-
Less: Minority Interest	(77)	(163)	-	(105)	-	(170)	-	(561)	(438)	-
Recurring PAT	5,794	6,628	(12.6)	7,649	(24.3)	5,338	8.5	32,809	18,795	93.0
Exceptional items	0	0	-	(7)	-	0	-	(12,739)	0	-
Reported PAT	5,794	6,628	(12.6)	7,642	(24.2)	5,338	8.5	20,070	18,795	3.7
Key Ratios (%)										
Gross Margin	56.0	51.7	-	51.5	-	52.0	-	53.8	54.2	-
EBITDA Margin	25.2	18.9	-	21.2	-	21.2	-	23.4	20.4	-
Tax / PBT	34.4	22.5	-	(7.1)	-	22.0	-	(4.3)	16.6	-
NPM	13.1	17.2	-	17.3	-	12.3	-	20.8	12.2	-
EPS (Rs)	34.0	38.9	-	44.9	-	31.3	-	194.3	110.3	-

Source: Company, BOBCAPS Research

FIG 2 – REVENUE MIX

(Rs mn)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)	Q1FY20E	Var (%)	FY20	FY19	YoY (%)
Global Generics	35,075	32,982	6.3	36,399	(3.6)	35,387	(0.9)	138,124	122,910	12.4
North America	17,282	16,322	5.9	18,072	(4.4)	17,908	(3.5)	64,658	59,957	7.8
Europe	3,551	2,404	47.7	3,446	3.0	3,191	11.3	11,707	7,873	48.7
India	6,260	6,960	(10.1)	6,839	(8.5)	6,859	(8.7)	28,946	26,184	10.5
ROW	7,982	7,296	9.4	8,042	(0.7)	7,429	7.4	32,813	28,896	13.6
PSAI	8,553	4,539	88.4	7,195	18.9	6,800	25.8	25,747	24,140	6.7
Proprietary Products	(384)	102	(476.5)	(232)	65.5	50	(868.0)	(296)	1,663	(117.8)
Others	931	812	14.7	957	(2.7)	1,000	(6.9)	11,026	5,145	114.3
Net Sales	44,175	38,435	14.9	44,319	(0.3)	43,237	2.2	174,601	153,858	13.5

Source: Company, BOBCAPS Research

Valuation methodology

DRRD is trading at reasonable valuations of 24x FY22E EPS. With the nearing monetisation of key assets (Copaxone, Revlimid) and strong SG&A cost control (mere 3% increase in the last three years), we think the stock should hold strong even though upsides could be capped following the recent rally.

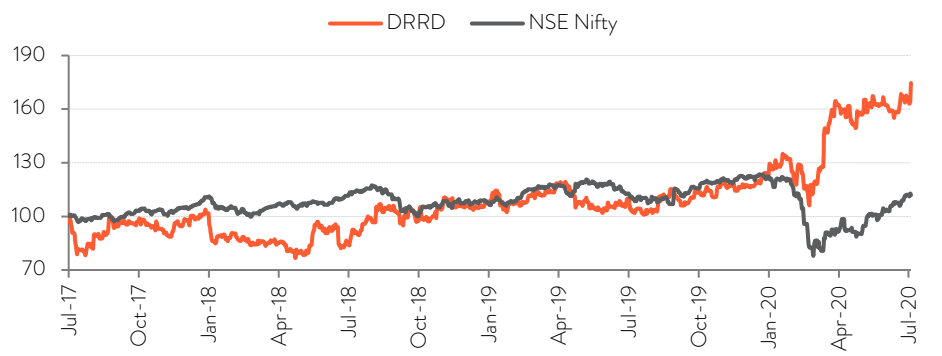
We marginally tweak FY21/FY22 EPS estimates to factor in higher tax guidance due to discontinuation of weighted deduction on R&D, and forecast core EPS at Rs 158/Rs 170 (ex-Copaxone). We also raise our target price to Rs 4,640 (from Rs 4,210) as we roll over to Sep'22E EPS. Our target EV/EBITDA multiple remains unchanged at 14x (22x implied P/E). Our valuation includes Revlimid upside (Rs 200/sh on NPV basis). Maintain ADD.

FIG 3 – REVISED ESTIMATES

(Rs bn)	New			Old			Change (%)		
	FY20A	FY21E	FY22E	FY20P	FY21E	FY22E	FY20E	FY21E	FY22E
Sales	174.6	185.8	202.8	174.8	186.2	203.6	(0.1)	(0.2)	(0.4)
EBITDA	40.9	42.5	47.5	40.9	40.8	46.2	0.0	4.1	2.7
EBITDA margin (%)	23.4	22.9	23.4	23.4	21.9	22.7	3bps	96bps	71bps
EPS (Rs)	194	158	182	216	154	183	(9.9)	2.5	(0.9)

Source: Company, BOBCAPS Research

FIG 4 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- US approval delays for niche products (gCopaxone, gNuvaring, gRevlimid)
- Weakness in EM currencies
- Regulatory risk at manufacturing units

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	153,852	174,601	185,782	202,826	236,766
EBITDA	31,333	40,942	42,473	47,502	59,572
Depreciation	12,399	12,471	13,209	13,664	14,444
EBIT	18,934	28,471	29,264	33,838	45,128
Net interest income/(expenses)	(889)	(983)	(550)	(550)	(550)
Other income/(expenses)	3,498	3,294	4,969	6,895	9,352
Exceptional items	0	0	0	0	0
EBT	21,543	30,782	33,683	40,182	53,930
Income taxes	3,648	(1,466)	7,410	10,046	13,482
Extraordinary items	901	(12,739)	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	18,796	19,509	26,272	30,137	40,447
Adjustments	901	(12,739)	0	0	0
Adjusted net profit	17,895	32,248	26,272	30,137	40,447

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	14,553	16,659	17,815	19,449	22,704
Other current liabilities	27,219	32,188	33,441	36,509	42,618
Provisions	4,218	3,854	4,101	4,477	5,226
Debt funds	38,381	22,011	22,011	22,011	22,011
Other liabilities	0	0	0	0	0
Equity capital	830	831	831	831	831
Reserves & surplus	135,764	142,174	164,291	190,273	226,565
Shareholders' fund	136,594	143,005	165,122	191,104	227,396
Total liabilities and equities	220,965	217,717	242,490	273,550	319,955
Cash and cash eq.	2,228	2,053	40,920	64,921	95,529
Accounts receivables	39,869	50,278	50,899	55,569	64,867
Inventories	33,579	35,066	38,174	41,677	48,651
Other current assets	17,061	19,557	24,152	26,367	30,780
Investments	25,871	26,778	26,778	26,778	26,778
Net fixed assets	49,363	52,332	41,123	39,459	37,014
CWIP	4,725	0	0	0	0
Intangible assets	48,269	31,653	20,444	18,780	16,335
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	220,965	217,717	242,490	273,550	319,955

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	31,195	31,980	39,482	43,801	54,892
Interest expenses	889	983	550	550	550
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(2,530)	(7,681)	(5,669)	(5,309)	(10,572)
Other operating cash flows	0	0	0	0	0
Cash flow from operations	29,554	25,282	34,363	39,042	44,870
Capital expenditures	(4,574)	(11,917)	(2,000)	(12,000)	(12,000)
Change in investments	(2,888)	(907)	0	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(7,462)	(12,824)	(2,000)	(12,000)	(12,000)
Equities issued/Others	0	1	0	0	0
Debt raised/repaid	(12,174)	(16,370)	0	0	0
Interest expenses	(889)	(983)	(550)	(550)	(550)
Dividends paid	(4,150)	(4,155)	(4,155)	(4,155)	(4,155)
Other financing cash flows	(5,289)	8,874	11,209	1,664	2,444
Cash flow from financing	(22,502)	(12,633)	6,504	(3,041)	(2,261)
Changes in cash and cash eq.	(410)	(175)	38,867	24,001	30,609
Closing cash and cash eq.	2,228	2,053	40,920	64,921	95,529

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	113.2	117.5	158.3	181.5	243.7
Adjusted EPS	107.8	194.3	158.3	181.5	243.7
Dividend per share	25.0	25.0	25.0	25.0	25.0
Book value per share	822.9	861.5	994.7	1,151.2	1,369.9

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	4.8	4.2	3.9	3.4	2.8
EV/EBITDA	23.8	18.0	16.9	14.5	11.1
Adjusted P/E	39.9	22.1	27.2	23.7	17.7
P/BV	5.2	5.0	4.3	3.7	3.1

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	83.1	104.8	78.0	75.0	75.0
Interest burden (PBT/EBIT)	113.8	108.1	115.1	118.7	119.5
EBIT margin (EBIT/Revenue)	12.3	16.3	15.8	16.7	19.1
Asset turnover (Revenue/Avg TA)	22.0	25.7	26.4	25.3	25.6
Leverage (Avg TA/Avg Equity)	1.3	1.2	1.1	1.1	1.1
Adjusted ROAE	13.8	23.1	17.1	16.9	19.3

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	8.3	13.5	6.4	9.2	16.7
EBITDA	37.0	30.7	3.7	11.8	25.4
Adjusted EPS	90.3	80.2	(18.5)	14.7	34.2
Profitability & Return ratios (%)					
EBITDA margin	20.4	23.4	22.9	23.4	25.2
EBIT margin	12.3	16.3	15.8	16.7	19.1
Adjusted profit margin	11.6	18.5	14.1	14.9	17.1
Adjusted ROAE	13.8	23.1	17.1	16.9	19.3
ROCE	12.9	18.7	19.4	20.4	23.6
Working capital days (days)					
Receivables	95	105	100	100	100
Inventory	80	73	75	75	75
Payables	35	35	35	35	35
Ratios (x)					
Gross asset turnover	0.8	0.9	0.9	0.9	1.0
Current ratio	2.0	2.0	2.8	3.1	3.4
Net interest coverage ratio	21.3	29.0	53.2	61.5	82.0
Adjusted debt/equity	0.1	0.0	0.0	0.0	0.0

Source: Company, BOBCAPS Research

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

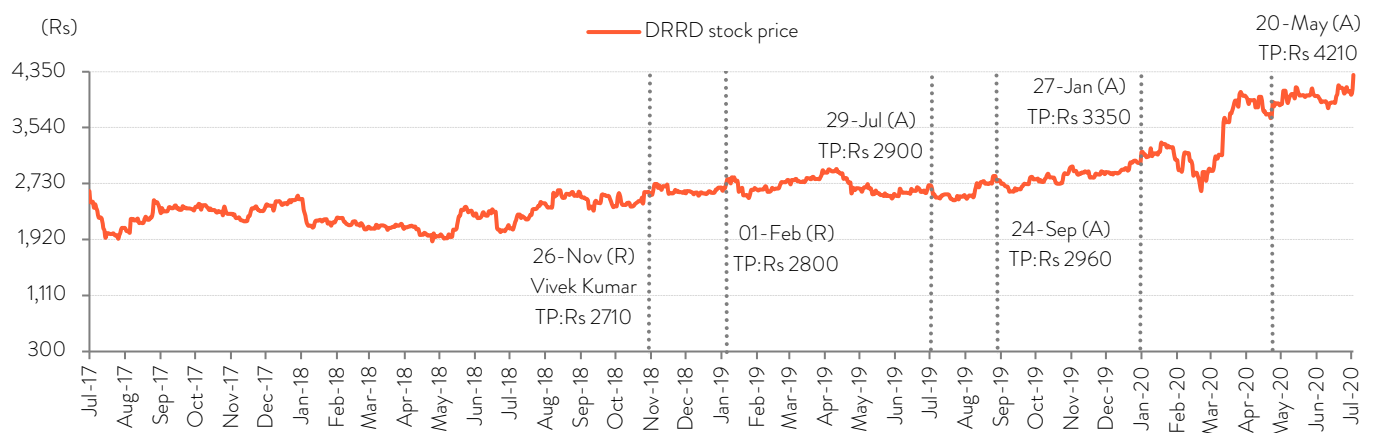
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

RATINGS AND TARGET PRICE (3-YEAR HISTORY): DR REDDY'S LABS (DRRD IN)



B – Buy, A – Add, R – Reduce, S – Sell

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