

ADD

TP: Rs 5,200 | ▲ 13%

DR REDDY'S LABS

Pharmaceuticals

30 January 2021

## US sales weak; gVascepa and margin recovery near-term triggers

Dr Reddy's (DRRD) reported a Q3 operational miss after a strong H1. EBITDA was a 13% miss (18% ex-onetime income) and margins were lower at 23% partly on one-off spends. An unexpected fall in US sales (-5% QoQ) was a key negative as was a drop in PSAI (-18% QoQ). India sales rose by 26% YoY (8% ex-Wockhardt), Russia/CIS by 11% QoQ and EM 16% QoQ. PAT missed the mark on an added impairment charge of Rs 6bn. DRRD is confident of retaining ~25% margins. We cut FY22/FY23 EPS ~4% and roll to a new Mar'22 TP of Rs 5,200 (vs. Rs 5,320).

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**US and PSAI sales a drag:** DRRD's Q3 sales missed estimates by 5% as: (1) US sales declined 5% QoQ to US\$ 237mn due to price erosion in some key molecules and slowdown in hospital-based products due to Covid, and (2) PSAI sales moderated after higher stocking in H1. The company launched four ANDAs in Q3 (19 in 9M), including several niche products. A potential Q1FY22 launch for gVascepa (~US\$ 50mn sales opportunity) should aid growth in coming quarters. DRRD retains its +30-launch target for FY21. Russia/CIS grew 11% QoQ and EM was up 16% on volume recovery. We expect US sales of US\$ 1.4bn by FY23 (20% CAGR over FY21, 5% ex-Copaxone, Vascepa).

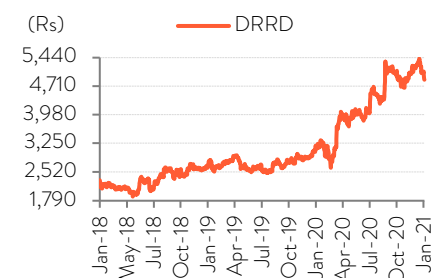
**Weak Q3 margins likely to recover:** EBITDA margin of 23% (H1: 25%) shrank 200bps QoQ due to higher SG&A spends (+14% QoQ on one-offs incurred to build digital capabilities across plants besides higher freight) and a 1ppt impact from export incentive withdrawal. We expect margin recovery as the SG&A base moderates, US sales recover and new incentive schemes come in.

**Earnings call takeaways:** (1) DRRD remains positive on PSAI opportunities. (2) Target of 125mn dose capacity in Sputnik-V vaccine over time; phase-3 trial completion by May'21. (3) Proprietary product sales grew 147% QoQ (incl. milestone income of Rs 500mn). (4) Nuvaring impairment charge: Rs 3.2bn.

Ticker/Price	DRRD IN/Rs 4,603
Market cap	US\$ 10.5bn
Shares o/s	166mn
3M ADV	US\$ 82.8mn
52wk high/low	Rs 5,513/Rs 2,495
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	192,164	215,621	250,231
EBITDA (Rs mn)	31,333	40,942	46,655	51,230	63,361
Adj. net profit (Rs mn)	17,895	32,248	27,196	31,353	41,295
Adj. EPS (Rs)	107.8	194.3	163.8	188.9	248.8
Adj. EPS growth (%)	90.3	80.2	(15.7)	15.3	31.7
Adj. ROAE (%)	13.8	23.1	18.0	18.1	20.1
Adj. P/E (x)	42.7	23.7	28.1	24.4	18.5
EV/EBITDA (x)	25.3	19.2	16.5	14.5	11.3

Source: Company, BOBCAPS Research

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**FIG 1 – QUARTERLY PERFORMANCE**

(Rs mn)	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)	Q3FY21E	Var (%)	9MFY21	9MFY20	YoY (%)
<b>Net Sales</b>	<b>49,296</b>	<b>43,838</b>	<b>12.5</b>	<b>48,967</b>	<b>0.7</b>	<b>51,869</b>	<b>(5.0)</b>	<b>142,438</b>	<b>130,282</b>	<b>13.5</b>
<b>EBITDA</b>	<b>11,260</b>	<b>10,188</b>	<b>10.5</b>	<b>12,215</b>	<b>(7.8)</b>	<b>12,952</b>	<b>(13.1)</b>	<b>34,604</b>	<b>31,535</b>	<b>30.7</b>
Depreciation	3,217	3,085	-	3,272	-	3,403	-	9,629	9,506	-
<b>EBIT</b>	<b>8,043</b>	<b>7,103</b>	<b>13.2</b>	<b>8,943</b>	<b>(10.1)</b>	<b>9,549</b>	<b>-</b>	<b>24,975</b>	<b>22,029</b>	<b>50.4</b>
Interest	(493)	(419)	-	(237)	-	(237)	-	(1,336)	(1,043)	-
Other Income	128	228	-	149	-	149	-	395	4,122	-
<b>PBT</b>	<b>8,664</b>	<b>7,750</b>	<b>11.8</b>	<b>9,329</b>	<b>(7.1)</b>	<b>9,935</b>	<b>(12.8)</b>	<b>26,706</b>	<b>27,194</b>	<b>55.6</b>
Less: Taxation	2,645	423	-	998	-	2,186	-	6,639	(966)	-
Less: Minority Interest	(151)	(176)	-	(73)	-	(73)	-	(301)	(456)	-
<b>Recurring PAT</b>	<b>6,170</b>	<b>7,503</b>	<b>(17.8)</b>	<b>8,404</b>	<b>(26.6)</b>	<b>7,822</b>	<b>(21.1)</b>	<b>20,368</b>	<b>28,616</b>	<b>93.0</b>
Exceptional items	(5,972)	(13,200)	-	(781)	-	0	-	(6,753)	(16,760)	-
<b>Reported PAT</b>	<b>198</b>	<b>(5,697)</b>	<b>(103.5)</b>	<b>7,623</b>	<b>(97.4)</b>	<b>7,822</b>	<b>(97.5)</b>	<b>13,615</b>	<b>11,856</b>	<b>3.7</b>
<b>Key Ratios (%)</b>										
Gross Margin	53.8	54.1	-	53.9	-	54.0	-	54.6	54.7	-
EBITDA Margin	22.8	23.2	-	24.9	-	25.0	-	24.3	24.2	-
Tax / PBT	30.5	5.5	-	10.7	-	22.0	-	24.9	(3.6)	-
NPM	12.5	17.1	-	17.2	-	15.1	-	14.3	22.0	-
<b>EPS (Rs)</b>	<b>36.2</b>	<b>44.0</b>	<b>-</b>	<b>49.3</b>	<b>-</b>	<b>45.9</b>	<b>-</b>	<b>119.5</b>	<b>168.0</b>	<b>-</b>

Source: Company, BOBCAPS Research

**FIG 2 – REVENUE MIX**

(Rs mn)	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)	Q3FY21E	Var (%)	9MFY21	9MFY20	YoY (%)
Global Generics	40,751	35,927	13.4	39,841	2.3	42,163	(3.3)	115,667	101,725	12.4
North America	17,394	15,999	8.7	18,328	(5.1)	19,875	(12.5)	53,004	46,586	7.8
Europe	4,143	3,093	33.9	3,754	10.4	4,129	0.3	11,448	8,261	48.7
India	9,591	7,636	25.6	9,123	5.1	9,123	5.1	24,974	22,107	10.5
ROW	9,623	9,199	4.6	8,636	11.4	9,036	6.5	26,241	24,771	13.6
PSAI	7,009	6,906	1.5	8,505	(17.6)	8,505	(17.6)	24,067	18,552	6.7
Proprietary Products	1,536	1,005	52.8	621	147.3	1,201	27.9	2,704	10,005	(117.8)
<b>Net Sales</b>	<b>49,296</b>	<b>43,838</b>	<b>12.5</b>	<b>48,967</b>	<b>0.7</b>	<b>51,869</b>	<b>(5.0)</b>	<b>142,438</b>	<b>130,282</b>	<b>10.0</b>
INR/US\$	74	71	3	74	0.0	73.5		71	71	2
US in \$ terms (mn)	237	225	5	249	(5.1)	270	(12)	744	656	5

Source: Company, BOBCAPS Research

## Valuation methodology

DRRD has demonstrated (1) strong execution in its US portfolio including potential monetisation of several high-value assets (Vascepa, Copaxone, Revlimid), and (2) strong SGA cost control (mere 3% increase in the last three years). This along with emerging growth opportunities from China and the PSAI segment augurs well for the stock over the long term. But after the recent stock rally has taken valuations to 24x/18x FY22E/FY23E EPS, we believe risk-reward is balanced – at least from a medium-term perspective.

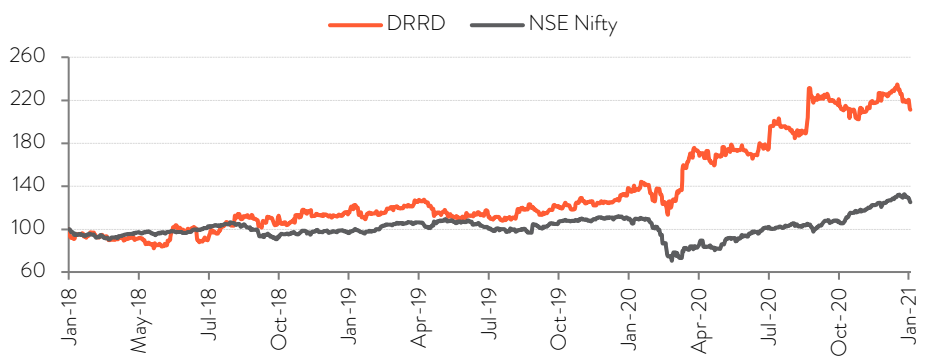
We cut FY22/FY23 EPS estimates by ~4% each to factor in slight margin moderation. We estimate core EPS at Rs 170/Rs 198 (ex-Copaxone, Vascepa, Revlimid). On rolling valuations forward, we have a revised Mar'22 target price of Rs 5,200 (from Rs 5,320), based on an unchanged EV/EBITDA multiple of 14x on Mar'23E (21x implied P/E). Our valuation includes Revlimid upside of Rs 350/sh on NPV basis. Maintain ADD.

**FIG 3 – REVISED ESTIMATES**

(Rs bn)	New			Old			Change (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Sales	192.2	215.6	250.2	195.6	218.9	255.1	(1.8)	(1.5)	(1.9)
EBITDA	46.7	51.2	63.4	47.5	52.0	64.9	(1.8)	(1.4)	(2.3)
EBITDA margin (%)	24.3	23.8	25.3	24.3	23.7	25.4	(1bps)	1bps	(10bps)
EPS (Rs)	164	189	249	173	195	258	(5.5)	(3.0)	(3.7)

Source: Company, BOBCAPS Research

**FIG 4 – RELATIVE STOCK PERFORMANCE**



Source: NSE

## Key risks

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

## FINANCIALS

### Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Total revenue</b>	<b>153,852</b>	<b>174,601</b>	<b>192,164</b>	<b>215,621</b>	<b>250,231</b>
EBITDA	31,333	40,942	46,655	51,230	63,361
Depreciation	12,399	12,471	13,209	13,664	14,444
EBIT	18,934	28,471	33,446	37,566	48,917
Net interest income/(expenses)	(889)	(983)	(550)	(550)	(550)
Other income/(expenses)	3,498	3,294	2,889	4,788	6,694
Exceptional items	0	0	0	0	0
EBT	21,543	30,782	35,784	41,804	55,061
Income taxes	3,648	(1,466)	8,588	10,451	13,765
Extraordinary items	901	(12,739)	(6,753)	0	0
Min. int./Inc. from associates	0	0	0	0	0
<b>Reported net profit</b>	<b>18,796</b>	<b>19,509</b>	<b>20,443</b>	<b>31,353</b>	<b>41,295</b>
Adjustments	901	(12,739)	(6,753)	0	0
<b>Adjusted net profit</b>	<b>17,895</b>	<b>32,248</b>	<b>27,196</b>	<b>31,353</b>	<b>41,295</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	14,553	16,659	18,427	20,676	23,995
Other current liabilities	27,219	32,188	34,590	38,812	45,042
Provisions	4,218	3,854	4,242	4,759	5,523
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	158,462	185,660	222,800
Shareholders' fund	136,594	143,005	159,293	186,491	223,631
<b>Total liabilities and equities</b>	<b>220,965</b>	<b>217,717</b>	<b>238,562</b>	<b>272,749</b>	<b>320,202</b>
Cash and cash eq.	2,228	2,053	33,102	56,322	87,570
Accounts receivables	39,869	50,278	52,648	59,074	68,556
Inventories	33,579	35,066	39,486	44,306	51,417
Other current assets	17,061	19,557	24,981	28,031	32,530
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
<b>Total assets</b>	<b>220,965</b>	<b>217,717</b>	<b>238,562</b>	<b>272,749</b>	<b>320,202</b>

Source: Company, BOBCAPS Research

**Cash Flows**

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	31,195	31,980	33,652	45,017	55,740
Interest expenses	889	983	550	550	550
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(2,530)	(7,681)	(7,657)	(7,307)	(10,780)
Other operating cash flows	0	0	0	0	0
<b>Cash flow from operations</b>	<b>29,554</b>	<b>25,282</b>	<b>26,546</b>	<b>38,261</b>	<b>45,510</b>
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
<b>Cash flow from investing</b>	<b>(7,462)</b>	<b>(12,824)</b>	<b>(2,000)</b>	<b>(12,000)</b>	<b>(12,000)</b>
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
<b>Cash flow from financing</b>	<b>(22,502)</b>	<b>(12,633)</b>	<b>6,504</b>	<b>(3,041)</b>	<b>(2,261)</b>
<b>Changes in cash and cash eq.</b>	<b>(410)</b>	<b>(175)</b>	<b>31,049</b>	<b>23,220</b>	<b>31,248</b>
<b>Closing cash and cash eq.</b>	<b>2,228</b>	<b>2,053</b>	<b>33,102</b>	<b>56,322</b>	<b>87,570</b>

**Per Share**

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	113.2	117.5	123.2	188.9	248.8
Adjusted EPS	107.8	194.3	163.8	188.9	248.8
Dividend per share	25.0	25.0	25.0	25.0	25.0
Book value per share	822.9	861.5	959.6	1,123.4	1,347.2

**Valuations Ratios**

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	5.2	4.5	4.0	3.5	2.9
EV/EBITDA	25.3	19.2	16.5	14.5	11.3
Adjusted P/E	42.7	23.7	28.1	24.4	18.5
P/BV	5.6	5.3	4.8	4.1	3.4

**DuPont Analysis**

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	83.1	104.8	76.0	75.0	75.0
Interest burden (PBT/EBIT)	113.8	108.1	107.0	111.3	112.6
EBIT margin (EBIT/Revenue)	12.3	16.3	17.4	17.4	19.5
Asset turnover (Revenue/Avg TA)	22.0	25.7	27.7	27.7	27.5
Leverage (Avg TA/Avg Equity)	1.3	1.2	1.1	1.1	1.1
Adjusted ROAE	13.8	23.1	18.0	18.1	20.1

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

**Ratio Analysis**

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
<b>YoY growth (%)</b>					
Revenue	8.3	13.5	10.1	12.2	16.1
EBITDA	37.0	30.7	14.0	9.8	23.7
Adjusted EPS	90.3	80.2	(15.7)	15.3	31.7
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	20.4	23.4	24.3	23.8	25.3
EBIT margin	12.3	16.3	17.4	17.4	19.5
Adjusted profit margin	11.6	18.5	14.2	14.5	16.5
Adjusted ROAE	13.8	23.1	18.0	18.1	20.1
ROCE	12.9	18.7	21.0	21.7	24.5
<b>Working capital days (days)</b>					
Receivables	95	105	100	100	100
Inventory	80	73	75	75	75
Payables	35	35	35	35	35
<b>Ratios (x)</b>					
Gross asset turnover	0.8	0.9	0.9	1.0	1.1
Current ratio	2.0	2.0	2.6	2.9	3.2
Net interest coverage ratio	21.3	29.0	60.8	68.3	88.9
Adjusted debt/equity	0.1	0.0	0.0	0.0	0.0

Source: Company, BOBCAPS Research

## Disclaimer

### Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

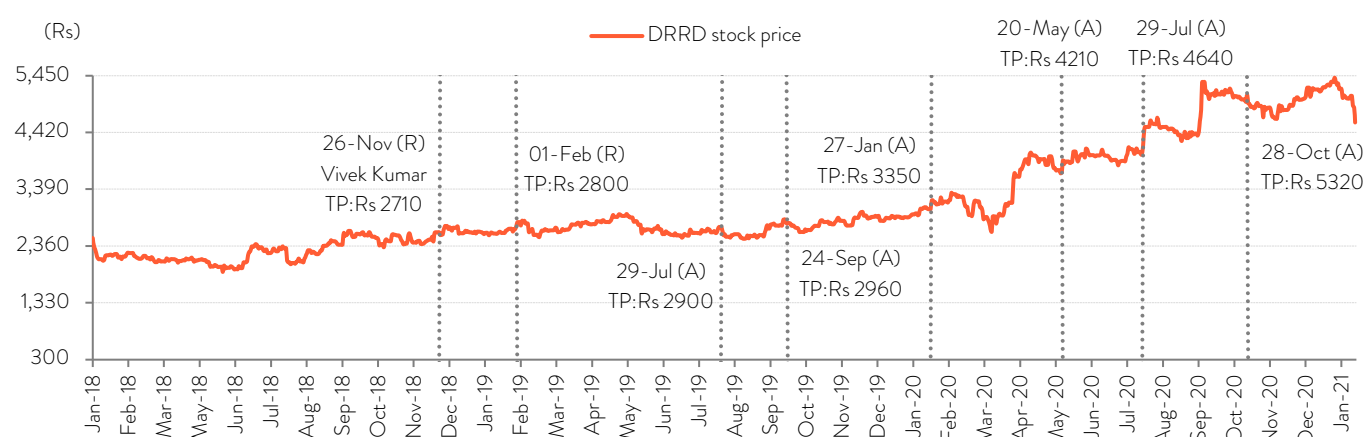
**ADD** – Expected return from >+5% to +15%

**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)

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

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