

**ADD**

TP: Rs 4,210 | ▲ 8%

**DR REDDY'S LABS**

Pharmaceuticals

20 May 2020

## EBITDA miss; risk-reward fair – TP raised to Rs 4,210

**Q4 EBITDA of Rs 9.4bn (-8% QoQ) was a miss despite a strong beat in the US and Europe, cost control, and net forex benefits. India (+5% YoY) and Russia/ROW (+6-8%) were weak. Gross margins shed 260bps QoQ on a softer product mix and inventory provisions. Core FY20 EPS totals Rs 130; we expect Rs 154/Rs 170 for FY21/FY22. Reported profit of Rs 7.6bn was boosted by MAT credits and DTA. Management continues to target 25% margins and ROCE in coming years. We raise our TP to Rs 4,210 (vs. Rs 3,350) set at 14x FY22E EV/EBITDA (12x earlier).**

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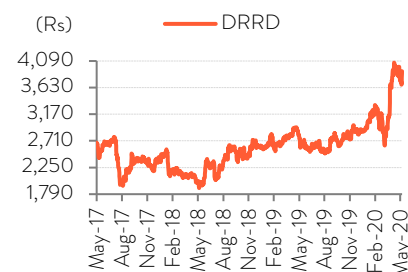
**India miss offset by US and EU:** US sales rose 12% QoQ to US\$ 251mn led by Covid-related stock refills and scale-up in base products. Dr Reddy's (DRRD) has been witnessing a normalised primary sales trend in the US post Covid-19 vs. a decline reported by IQVIA for Apr-May'20. It launched 27 products in FY20 and expects 25 more in FY21. Strong sales growth in Europe at 80% YoY was led by Germany and injectable launches in Spain, France and Italy. Management expects to build further on the FY20 base. The US and EU offset weakness in India and PSAI sales (logistics issues). We expect US sales of US\$ 1.1bn by FY22 (10% CAGR over FY20, 5% ex-Copaxone, Nuvaring).

Ticker/Price	DRRD IN/Rs 3,910
Market cap	US\$ 8.6bn
Shares o/s	166mn
3M ADV	US\$ 59.8mn
52wk high/low	Rs 4,132/Rs 2,351
Promoter/FPI/DII	27%/27%/18%

Source: NSE

**Margins disappoint:** EBITDA margin stood at 21.2% (vs. 22.6% est.), as gross margins declined while SG&A control was strong (flat YoY, +4% QoQ). Gross margins weakened partly due to a high share of Europe sales and decline in the branded business (India, EM), apart from inventory write-offs. Global generics margin dropped 230bps QoQ to 55.9% and PSAI margin fell 160bps to 28.4%.

### STOCK PERFORMANCE



Source: NSE

**Earnings call takeaways:** (1) gNuvaring/Copaxone Complete Response letter (CRL) likely in the near term. (2) FY21 outlook: Capex of >Rs 10bn vs. Rs 4.8bn in FY20 (towards product development and injectable capacities), ETR of 22%, R&D spends to sales of 9-10%. (3) Focus on China to continue.

### KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
Total revenue (Rs mn)	142,028	153,852	174,802	186,243	203,625
EBITDA (Rs mn)	22,869	31,333	40,934	40,792	46,249
Adj. net profit (Rs mn)	9,404	17,895	35,774	25,627	30,416
Adj. EPS (Rs)	56.7	107.8	215.5	154.4	183.2
Adj. EPS growth (%)	(20.1)	90.3	99.9	(28.4)	18.7
Adj. ROAE (%)	7.7	13.8	24.8	15.8	16.3
Adj. P/E (x)	69.0	36.3	18.1	25.3	21.3
EV/EBITDA (x)	28.9	21.7	16.4	15.9	13.4

Source: Company, BOBCAPS Research

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**FIG 1 – QUARTERLY PERFORMANCE**

(Rs mn)	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	Q4FY20E	Var (%)	FY20	FY19	YoY (%)
<b>Net Sales</b>	<b>44,318</b>	<b>40,166</b>	<b>10.3</b>	<b>43,838</b>	<b>1.1</b>	<b>43,999</b>	<b>0.7</b>	<b>174,600</b>	<b>153,851</b>	<b>13.5</b>
<b>EBITDA</b>	<b>9,406</b>	<b>8,198</b>	<b>14.7</b>	<b>10,188</b>	<b>(7.7)</b>	<b>9,927</b>	<b>(5.2)</b>	<b>40,941</b>	<b>31,332</b>	<b>30.7</b>
Depreciation	2,965	3,183	-	3,085	-	3,085	-	12,471	12,399	-
<b>EBIT</b>	<b>6,441</b>	<b>5,015</b>	<b>28.4</b>	<b>7,103</b>	<b>(9.3)</b>	<b>6,842</b>	<b>-</b>	<b>28,470</b>	<b>18,933</b>	<b>50.4</b>
Interest	(435)	(349)	-	(419)	-	(100)	-	(1,478)	(1,117)	-
Other Income	168	330	-	228	-	400	-	4,290	1,955	-
<b>PBT</b>	<b>7,044</b>	<b>5,694</b>	<b>23.7</b>	<b>7,750</b>	<b>(9.1)</b>	<b>7,342</b>	<b>(4.1)</b>	<b>34,238</b>	<b>22,005</b>	<b>55.6</b>
Less: Taxation	(500)	1,507	-	423	-	2,349	-	(1,466)	3,648	-
Less: Minority Interest	(105)	(157)	-	(176)	-	0	-	(561)	(438)	-
<b>Recurring PAT</b>	<b>7,649</b>	<b>4,344</b>	<b>76.1</b>	<b>7,503</b>	<b>1.9</b>	<b>4,993</b>	<b>53.2</b>	<b>36,265</b>	<b>18,795</b>	<b>93.0</b>
Exceptional items	(7)	0	-	(13,200)	-	0	-	(16,767)	0	-
<b>Reported PAT</b>	<b>7,642</b>	<b>4,344</b>	<b>75.9</b>	<b>(5,697)</b>	<b>(234.1)</b>	<b>4,993</b>	<b>53.1</b>	<b>19,498</b>	<b>18,795</b>	<b>3.7</b>
<b>Key Ratios (%)</b>										
Gross Margin	51.5	52.4	-	54.1	-	54.0	-	53.8	54.2	-
EBITDA Margin	21.2	20.4	-	23.2	-	22.6	-	23.4	20.4	-
Tax / PBT	(7.1)	26.5	-	5.5	-	32.0	-	(4.3)	16.6	-
NPM	17.3	10.8	-	17.1	-	11.3	-	20.8	12.2	-
<b>EPS (Rs)</b>	<b>44.9</b>	<b>25.5</b>	<b>-</b>	<b>44.0</b>	<b>-</b>	<b>29.3</b>	<b>-</b>	<b>212.8</b>	<b>110.3</b>	<b>-</b>

Source: Company, BOBCAPS Research

**FIG 2 – REVENUE MIX**

(Rs mn)	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	Q4FY20E	Var (%)	FY20	FY19	YoY (%)
Global Generics	36,399	30,384	19.8	35,927	1.3	34,970	4.1	138,124	122,910	12.4
North America	18,072	14,957	20.8	15,999	13.0	17,280	4.6	64,658	59,957	7.8
Europe	3,446	1,912	80.2	3,093	11.4	2,294	50.2	11,707	7,873	48.7
India	6,839	6,505	5.1	7,636	(10.4)	7,486	(8.6)	28,946	26,184	10.5
ROW	8,042	7,010	14.7	9,199	(12.6)	7,909	1.7	32,813	28,896	13.6
PSAI	7,195	6,765	6.4	6,906	4.2	7,442	(3.3)	25,747	24,140	6.7
Proprietary Products	(232)	323	(171.8)	(226)	2.7	388	(159.9)	(296)	1,663	(117.8)
Others	957	2,694	(64.5)	1,231	(22.3)	1,200	(20.3)	11,026	5,145	114.3
<b>Net Sales</b>	<b>44,319</b>	<b>40,166</b>	<b>10.3</b>	<b>43,838</b>	<b>1.1</b>	<b>43,999</b>	<b>0.7</b>	<b>174,601</b>	<b>153,858</b>	<b>13.5</b>

Source: Company, BOBCAPS Research

## Valuation methodology

DRRD is trading at reasonable valuations of 21x 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.

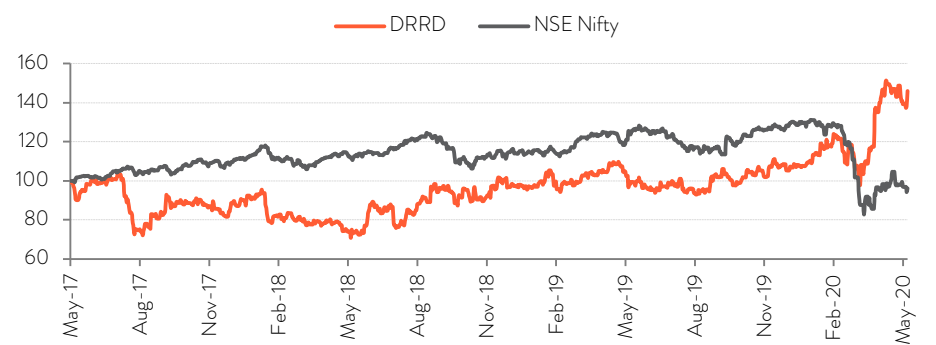
We marginally tweak FY21/FY22 EPS estimates and forecast core EPS at Rs 154/Rs 170 (ex-Copaxone). We also raise our Mar'21 target price to Rs 4,210 (from Rs 3,350) as we increase our target FY22E EV/EBITDA multiple to 14x (23x implied P/E) from 12x. Our valuation includes Revlimid upside (Rs 200/sh on NPV basis). Maintain ADD.

**FIG 3 – REVISED ESTIMATES**

(Rs bn)	New			Old			Change (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Sales	174.8	186.2	203.6	173.7	184.4	204.2	0.6	1.0	(0.3)
EBITDA	40.9	40.8	46.2	41.6	41.3	47.2	(1.7)	(1.1)	(2.1)
EBITDA margin (%)	23.4	21.9	22.7	24.0	22.4	23.1	(55bps)	(47bps)	(42bps)
EPS (Rs)	216	154	183	168	157	186	28.2	(1.5)	(1.4)

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)	FY18A	FY19A	FY20P	FY21E	FY22E
<b>Total revenue</b>	<b>142,028</b>	<b>153,852</b>	<b>174,802</b>	<b>186,243</b>	<b>203,625</b>
EBITDA	22,869	31,333	40,934	40,792	46,249
Depreciation	11,740	12,399	12,470	13,215	13,670
EBIT	11,129	18,934	28,464	27,577	32,580
Net interest income/(expenses)	(788)	(889)	(756)	(553)	(553)
Other income/(expenses)	3,598	3,498	6,600	5,831	7,474
Exceptional items	0	0	0	0	0
EBT	13,939	21,543	34,308	32,855	39,501
Income taxes	4,535	3,648	(1,466)	7,228	9,085
Extraordinary items	402	901	(16,700)	0	0
Min. int./Inc. from associates	0	0	0	0	0
<b>Reported net profit</b>	<b>9,806</b>	<b>18,796</b>	<b>19,074</b>	<b>25,627</b>	<b>30,416</b>
Adjustments	402	901	(16,700)	0	0
<b>Adjusted net profit</b>	<b>9,404</b>	<b>17,895</b>	<b>35,774</b>	<b>25,627</b>	<b>30,416</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Accounts payables	16,052	14,553	16,762	17,859	19,526
Other current liabilities	26,248	27,219	31,464	33,524	36,653
Provisions	3,785	4,218	4,792	5,106	5,583
Debt funds	50,555	38,381	22,102	22,102	22,102
Other liabilities	0	0	0	0	0
Equity capital	830	830	830	830	830
Reserves & surplus	122,704	135,764	150,688	172,165	198,431
Shareholders' fund	123,534	136,594	151,518	172,995	199,261
<b>Total liabilities and equities</b>	<b>220,174</b>	<b>220,965</b>	<b>226,639</b>	<b>251,586</b>	<b>283,124</b>
Cash and cash eq.	2,638	2,228	12,583	48,370	72,653
Accounts receivables	40,617	39,869	52,015	51,025	55,788
Inventories	29,089	33,579	35,918	38,269	41,841
Other current assets	18,368	17,061	13,984	24,212	26,471
Investments	22,983	25,871	25,871	25,871	25,871
Net fixed assets	49,941	49,363	48,893	37,678	36,009
CWIP	7,928	4,725	4,725	4,725	4,725
Intangible assets	48,610	48,269	32,650	21,435	19,766
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>220,174</b>	<b>220,965</b>	<b>226,639</b>	<b>251,586</b>	<b>283,124</b>

Source: Company, BOBCAPS Research

**Cash Flows**

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Net income + Depreciation	21,546	31,195	31,544	38,841	44,085
Interest expenses	788	889	756	553	553
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(4,407)	(2,530)	(4,380)	(8,119)	(5,322)
Other operating cash flows	0	0	0	0	0
<b>Cash flow from operations</b>	<b>17,927</b>	<b>29,554</b>	<b>27,921</b>	<b>31,275</b>	<b>39,316</b>
Capital expenditures	(13,167)	(4,574)	(12,000)	(2,000)	(12,000)
Change in investments	(1,873)	(2,888)	0	0	0
Other investing cash flows	0	0	0	0	0
<b>Cash flow from investing</b>	<b>(15,040)</b>	<b>(7,462)</b>	<b>(12,000)</b>	<b>(2,000)</b>	<b>(12,000)</b>
Equities issued/Others	1	0	0	0	0
Debt raised/repaid	1,567	(12,174)	(16,279)	0	0
Interest expenses	(788)	(889)	(756)	(553)	(553)
Dividends paid	(3,992)	(4,150)	(4,150)	(4,150)	(4,150)
Other financing cash flows	(903)	(5,289)	15,619	11,215	1,670
<b>Cash flow from financing</b>	<b>(4,115)</b>	<b>(22,502)</b>	<b>(5,566)</b>	<b>6,512</b>	<b>(3,033)</b>
<b>Changes in cash and cash eq.</b>	<b>(1,228)</b>	<b>(410)</b>	<b>10,355</b>	<b>35,787</b>	<b>24,283</b>
<b>Closing cash and cash eq.</b>	<b>2,638</b>	<b>2,228</b>	<b>12,583</b>	<b>48,370</b>	<b>72,653</b>

**Per Share**

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20P	FY21E	FY22E
Reported EPS	59.1	113.2	114.9	154.4	183.2
Adjusted EPS	56.7	107.8	215.5	154.4	183.2
Dividend per share	20.0	25.0	25.0	25.0	25.0
Book value per share	744.2	822.9	912.8	1,042.1	1,200.4

**Valuations Ratios**

Y/E 31 Mar (x)	FY18A	FY19A	FY20P	FY21E	FY22E
EV/Sales	4.7	4.4	3.8	3.5	3.0
EV/EBITDA	28.9	21.7	16.4	15.9	13.4
Adjusted P/E	69.0	36.3	18.1	25.3	21.3
P/BV	5.3	4.8	4.3	3.8	3.3

**DuPont Analysis**

Y/E 31 Mar (%)	FY18A	FY19A	FY20P	FY21E	FY22E
Tax burden (Net profit/PBT)	67.5	83.1	104.3	78.0	77.0
Interest burden (PBT/EBIT)	125.2	113.8	120.5	119.1	121.2
EBIT margin (EBIT/Revenue)	7.8	12.3	16.3	14.8	16.0
Asset turnover (Revenue/Avg TA)	20.7	22.0	25.1	25.3	24.4
Leverage (Avg TA/Avg Equity)	1.4	1.3	1.2	1.1	1.1
Adjusted ROAE	7.7	13.8	24.8	15.8	16.3

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

**Ratio Analysis**

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
<b>YoY growth (%)</b>					
Revenue	0.9	8.3	13.6	6.5	9.3
EBITDA	(5.3)	37.0	30.6	(0.3)	13.4
Adjusted EPS	(20.1)	90.3	99.9	(28.4)	18.7
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	16.1	20.4	23.4	21.9	22.7
EBIT margin	7.8	12.3	16.3	14.8	16.0
Adjusted profit margin	6.6	11.6	20.5	13.8	14.9
Adjusted ROAE	7.7	13.8	24.8	15.8	16.3
ROCE	8.6	12.9	20.1	18.1	19.2
<b>Working capital days (days)</b>					
Receivables	104	95	109	100	100
Inventory	75	80	75	75	75
Payables	41	35	35	35	35
<b>Ratios (x)</b>					
Gross asset turnover	0.8	0.8	0.9	0.9	0.9
Current ratio	2.0	2.0	2.2	2.9	3.2
Net interest coverage ratio	14.1	21.3	37.6	49.9	59.0
Adjusted debt/equity	0.3	0.1	0.0	0.0	0.0

Source: Company, BOBCAPS Research

## Disclaimer

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

**BUY** – Expected return >+15%

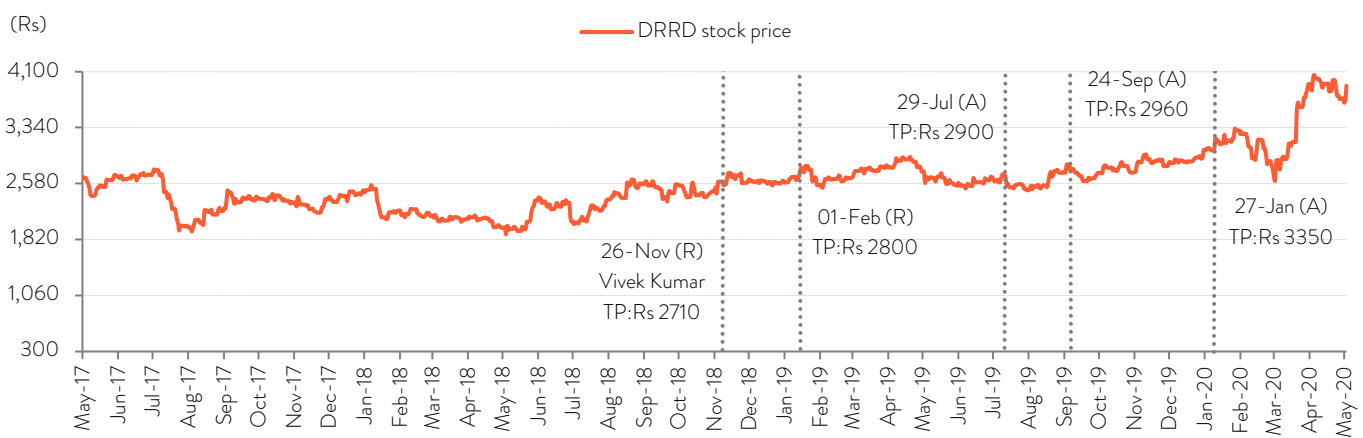
**ADD** – Expected return from >+5% to +15%

**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)

### HISTORICAL RATINGS AND TARGET PRICE: DR REDDY'S LABS (DRRD IN)



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

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