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Q1FY21 result review  
and estimates revision

## Pharmaceuticals

Target price: Rs4,406

### Earnings revision

(%)	FY21E	FY22E
Sales	2.4	3.2
EPS	7.1	8.1

### Target price revision

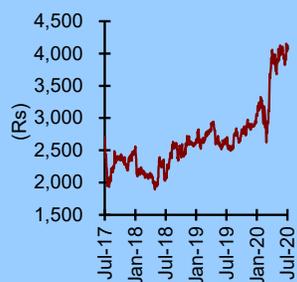
Rs4,406 from Rs4,076

### Shareholding pattern

	Dec '19	Mar '20	Jun '20
Promoters	26.8	26.8	26.7
Institutional investors	45.1	44.5	44.0
MFs and others	9.5	8.8	10.0
Insurance Cos.	5.5	5.5	4.5
FII	30.1	30.3	29.5
Others	28.1	28.7	29.3

Source: BSE India

### Price chart



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INDIA

**ICICI Securities**

## Dr. Reddy's Laboratories

**HOLD**

**Maintained**

**Rs4,300**

### Strong margin beat

Dr. Reddy's Laboratories' (DRL) has reported Q1FY21 performance substantially above our estimates at the gross margin level, supported by better product mix and favorable forex movement. Total revenue grew 14.9% YoY, gross margin was up 430/450bps YoY/QoQ to 56.0% (I-Sec: 52.0%) and reported EBITDA margin at 25.2% was higher than estimated 21.0%. Adjusted PAT grew 47.4% to Rs5.8bn (I-Sec: Rs5.2bn). However, India revenue declined 10.1% YoY impacted by lockdown on account of COVID-19. We expect the growth momentum in branded generics business (India & EMs) to recover in coming quarters as would the steady pick-up in US. Acquisition of Wockhardt's was completed in Jun'20 which would be an additional contribution to branded generics. Current valuations seem fair, hence, we maintain HOLD with a revised target price of Rs4,406/share.

- ▶ **Strong growth in PSAI and EU generics:** PSAI business segmented reported stellar growth of 88.4% driven by strong traction in API supplies, albeit on a low base. We expect current revenue trend to continue with customers focusing on diversifying API supply sources. EU generics also reported strong 47.7% growth led by new launches and high traction in volumes across markets. India sales declined 10.1% despite consolidation of Wockhardt products for ~20days in Q1FY21. The drop in sales was due to implementation of nationwide lockdown due to COVID-19. US revenue declined 8.4% QoQ to US\$229mn vs estimated US\$240mn. EM revenues grew 9.0% led by CIS and ROW with new launches and strong traction in volumes. Russia declined 17% with decline of patient footfalls.
- ▶ **Margins surprise positively:** Gross margin stood at 56.0%, up 430/450bps YoY/QoQ on back of favorable currency and better product mix. This led to 630/400bps YoY/QoQ improvement in EBITDA margin vs estimated 21%. Gross margin in global generics rose to 61.4% and that in PSAI improved to 33.4%. Gross margin has been quite volatile on quarterly basis and we expect it to remain ~54% vs 52.2% in FY20.
- ▶ **Outlook:** We raise our revenue/EPS estimates by 2-3/7-8% for FY21E-FY22E to factor-in higher growth in PSAI business and better gross margin. Overall, we expect revenues and earnings to grow at 13.4% and 26.3% CAGRs, respectively, over FY20-FY22E with 270bps EBITDA margin expansion. Margin expansion would be largely driven by improving revenue mix leading to higher gross margin and controlled S,G&A expenses.
- ▶ **Valuations and risks:** Considering fair valuation, we maintain **HOLD** on the stock with a revised target price of Rs4,406/share based on 24x FY22E EPS and an additional Rs115/share for *Revlimid* (earlier: Rs4,076/share). Key upside risks: Earlier than expected launch of *Nuvaring* and *Copaxone* and material gross margin improvement with better revenue mix. Key downside risks: regulatory hurdles and currency volatility.

Market Cap	Rs715bn/US\$9.6bn
Reuters/Bloomberg	REBY.BO/DRRD IN
Shares Outstanding (mn)	166.2
52-week Range (Rs)	4302/2493
Free Float (%)	73.3
FII (%)	29.5
Daily Volume (US\$/'000)	53,827
Absolute Return 3m (%)	11.6
Absolute Return 12m (%)	63.1
Sensex Return 3m (%)	17.0
Sensex Return 12m (%)	2.2

Year to Mar	FY19	FY20	FY21E	FY22E
Revenue (Rs mn)	152,044	167,371	196,474	215,140
Net Income (Rs mn)	18,795	19,497	25,965	29,679
EPS (Rs)	102.1	112.0	156.4	178.8
% Chg YoY	49.2	9.7	39.7	14.3
P/E (x)	42.1	38.4	27.5	24.1
CEPS (Rs)	175.5	187.1	236.4	260.7
EV/E (x)	24.6	20.1	15.4	13.4
Dividend Yield (%)	0.5	0.5	0.6	0.7
RoCE (%)	9.3	10.3	13.6	13.9
RoE (%)	12.7	12.6	15.7	15.8

Please refer to important disclosures at the end of this report

## Highlights of Q1FY21 result and earnings call

- **Net sales** grew 14.9% YoY to Rs44.2bn drive by its PSAI segment, Europe and Emerging markets.
  - **Global generics'** revenue grew 6.3% YoY with growth across regions except India.
 

**North America** sales grew 5.9% YoY (-4.4% QoQ) to Rs17.3bn. In constant currency, it declined 8.0% QoQ to US\$230mn was due to lower sales in key molecules. Company launched six new products during the quarter and filed for five new products. The company continues to do well in *Suboxone*. Pricing in the generics has been stable while injectable have seen an uptick. Cumulatively, the company has 99 ANDAs {including two NDAs under 505(b)(2)} pending for approval, of which 54 are Para IV, and 28 are believed to have First to File (FTF) status.

The company will be responding to CRLs for generic *NuvaRing* in coming months. It has already submitted the CRL response for *Copaxone*.
  - **India sales** declined 10.1% YoY (-8.5% QoQ) to Rs6.3bn. The decline was due to lower volume due to the lockdown caused by COVID-19. Company launched four new brands during the quarter and completed the transaction with Wockhardt.
  - **Europe sales** grew 47.7% YoY (3.0% QoQ) to Rs3.6bn with new launches and volume traction across markets as well as favourable forex movement.
  - **Emerging markets (Russia, CIS and RoW)** sales grew 9.4% YoY.
    - **Russia and CIS sales:** Russia sales declined 17.5% YoY on account of lower volume impacted by COVID-19. CIS and Romania sales grew 16.7% to Rs1.4bn with new launches and higher volume.
    - **RoW sales** grew 56.6% YoY to Rs3.3bn led by new launches and volume traction in new markets as well as in base business.
  - **PSAI segment** grew 88.4% YoY (+18.9% QoQ) to Rs8.6bn with increase in volume in certain products, growth in recently launched products and forex movement. Growth from the segment is expected to continue with high demand and strong order book. The company filed one DMF in the US during the quarter.
  - **PP segment** declined 40.2% YoY and 24.6% QoQ.
- **Gross margin** grew 430/450bps YoY/QoQ on account of change in business mix, and favourable forex movement. Gross margins for global generics and PSAI in Q1FY21 stood at 61.4% (+550bps QoQ) and 33.4% (+500bps QoQ), respectively.
- **R&D expenses** stood at 9.0% of net sales, a drop of 400bps YoY (-500bps QoQ).
- **Adjusted PAT** grew 47.4% YoY to Rs5.8bn.
- **Capex** during the quarter stood at Rs1.5bn.

**Table 1: Q1FY21 result review***(Rs mn, year ending March 31)*

	Q1FY21	Q1FY20	YoY % Chg	Q4FY20	QoQ % Chg
<b>Net Sales</b>	<b>44,175</b>	<b>38,435</b>	<b>14.9</b>	<b>44,318</b>	<b>(0.3)</b>
Gross Profit	24,755	19,859	24.7	22,808	8.5
<b>EBITDA</b>	<b>11,129</b>	<b>7,267</b>	<b>53.1</b>	<b>9,406</b>	<b>18.3</b>
Other income	195	462	(57.8)	273	(28.6)
<b>PBIDT</b>	<b>11,324</b>	<b>7,729</b>	<b>46.5</b>	<b>9,679</b>	<b>17.0</b>
Depreciation	3,140	3,082	1.9	2,965	5.9
Interest	(605)	(393)	53.9	(435)	39.1
<b>PBT</b>	<b>8,789</b>	<b>8,500</b>	<b>3.4</b>	<b>8,406</b>	<b>4.6</b>
Tax	2,996	1,872	60.0	764	292.1
<b>Adjusted PAT</b>	<b>5,793</b>	<b>3,930</b>	<b>47.4</b>	<b>6,384</b>	<b>(9.3)</b>
Extra ordinary income/ (exp.)	-	3,460		1,257	
<b>Reported PAT</b>	<b>5,793</b>	<b>6,628</b>	<b>(12.6)</b>	<b>7,642</b>	<b>(24.2)</b>
EBITDA margins (%)	25.2	18.9	630bps	21.2	400bps

Source: Company data, I-Sec research

**Table 2: Revenue mix***(Rs mn, year ending March 31)*

	Q1FY21	Q1FY20	YoY % Chg	Q4FY20	QoQ % Chg
Global Generics	<b>35,075</b>	<b>32,983</b>	<b>6.3</b>	<b>36,399</b>	<b>(3.6)</b>
North America	17,282	16,323	5.9	18,072	(4.4)
Europe	3,551	2,404	47.7	3,446	3.0
India	6,260	6,960	(10.1)	6,839	(8.5)
Russia & Other CIS	4,700	5,200	(9.6)	5,700	(17.5)
ROW	3,282	2,096	56.6	2,342	40.1
PSAI	<b>8,553</b>	<b>4,539</b>	<b>88.4</b>	<b>7,195</b>	<b>18.9</b>
Proprietary Products & others	547	914	(40.2)	725	(24.6)
<b>Total</b>	<b>44,175</b>	<b>38,435</b>	<b>14.9</b>	<b>44,318</b>	<b>(0.3)</b>

Source: Company data, I-Sec research

**Table 3: Segment gross margin***(%, year ending March 31)*

Segment Gross Margin	Q1FY21	Q1FY20	YoY % Chg	Q4FY20	QoQ % Chg
Global Generics	61.4	57.6	380bps	55.9	550bps
PSAI	33.4	7.2	2620bps	28.4	500bps

Source: Company data, I-Sec research

## Revising sales and earnings estimates

Overall, we expect revenues and earnings to grow at 13.4% and 26.3% CAGRs, respectively, over FY20-FY22E with 270bps EBITDA margin expansion. We raise our revenue/EPS estimates by 2-3/7-8% for FY21E-FY22E to factor-in higher growth in PSAI business and better gross margin.

**Table 4: Earnings revision**

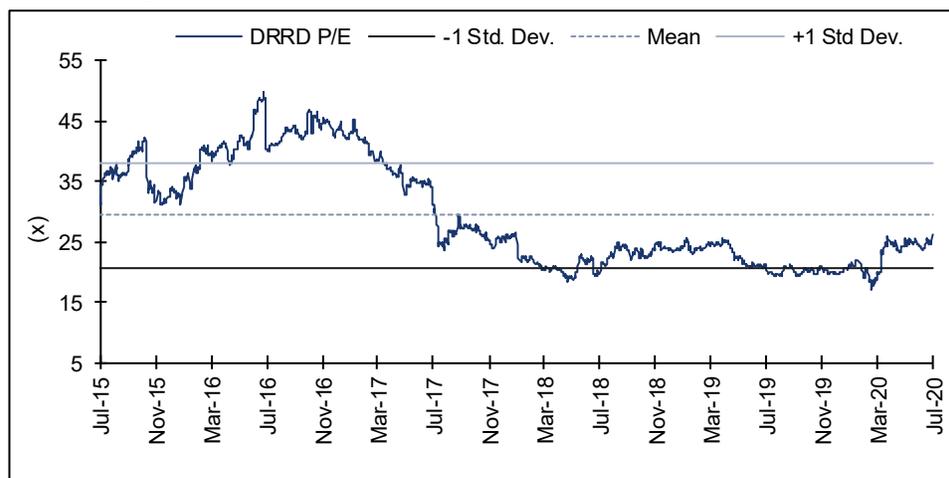
	FY21E	FY22E
<b>Total sales (Rs mn)</b>		
Sales – new	196,474	215,140
Sales – old	191,801	208,465
Change (%)	2.4	3.2
<b>EPS (Rs)</b>		
EPS – new	156.4	178.8
EPS – old	146.1	165.3
Change (%)	7.1	8.1

Source: I-Sec research

## Valuations

Overall, we expect revenues and earnings to grow at 13.4% and 26.3% CAGRs, respectively, over FY20-FY22E with 270bps EBITDA margin expansion. The stock currently trades at 27.5x FY21E and 24.1x FY22E earnings and EV/EBITDA multiple of 15.4x FY21E and 13.4x FY22E. We maintain our **HOLD** rating with a revised target price of Rs4,406/share based on 24x FY22E earnings and an additional Rs115/share for *Revlimid* (earlier: Rs4,076/share).

**Chart 1: 1-year forward P/E**



Source: Company data, I-Sec research

## Financial summary

Table 5: Profit and loss statement

(Rs mn, year ending March 31)

	FY19	FY20	FY21E	FY22E
Global Generics	122,903	138,123	161,032	176,295
PSAI	24,140	25,747	32,612	35,874
Proprietary Products	2,943	671	0	0
Others	2,058	2,830	2,830	2,972
<b>Net Sales</b>	<b>152,044</b>	<b>167,371</b>	<b>196,474</b>	<b>215,140</b>
<b>Total Revenue</b>	<b>152,044</b>	<b>167,371</b>	<b>196,474</b>	<b>215,140</b>
yoy Growth%	7.1	10.1	17.4	9.5
<b>Total Op. Exp.</b>	<b>122,518</b>	<b>132,047</b>	<b>150,503</b>	<b>163,832</b>
<b>EBITDA</b>	<b>29,526</b>	<b>35,324</b>	<b>45,971</b>	<b>51,309</b>
Margins %	19.4	21.1	23.4	23.8
yoy Growth%	27.2	19.6	30.1	11.6
Deprn. & Amortisation	12,190	12,472	13,272	13,591
<b>EBIT</b>	<b>17,336</b>	<b>22,852</b>	<b>32,699</b>	<b>37,718</b>
Other Inc/Interest (net)	2,464	2,869	2,869	2,939
Extraordinary Items	2,643	(7,690)	0	0
<b>PBT</b>	<b>22,443</b>	<b>18,031</b>	<b>35,568</b>	<b>40,656</b>
Tax	3,648	4,998	9,603	10,977
Tax Rate (%)	16.3	27.7	27.0	27.0
Minority Interest	-	(6,464)	-	-
<b>Reported PAT</b>	<b>18,795</b>	<b>19,497</b>	<b>25,965</b>	<b>29,679</b>
<b>Adjusted PAT</b>	<b>16,582</b>	<b>25,055</b>	<b>25,965</b>	<b>29,679</b>
Net Margins (%)	10.9	15.0	13.2	13.8

Source: Company data, I-Sec research

Table 6: Balance sheet

(Rs mn, year ending March 31)

	FY19	FY20	FY21E	FY22E
Paid-up Capital	830	831	831	831
Reserves & Surplus	139,367	154,157	175,119	198,479
<b>Total Equity</b>	<b>140,197</b>	<b>154,988</b>	<b>175,950</b>	<b>199,310</b>
<b>Total Debt</b>	<b>38,381</b>	<b>22,102</b>	<b>22,102</b>	<b>22,102</b>
Other non-current liab.	2,920	2,860	2,860	2,860
<b>Capital Employed</b>	<b>181,498</b>	<b>179,950</b>	<b>200,912</b>	<b>224,272</b>
Total Cur. Lia. & Prov.	43,319	52,016	61,070	66,739
<b>Total Liabilities</b>	<b>224,817</b>	<b>231,966</b>	<b>261,982</b>	<b>291,011</b>
<b>Net Fixed Assets</b>	<b>102,357</b>	<b>83,985</b>	<b>101,213</b>	<b>99,622</b>
Deferred tax asset	3,558	11,939	11,939	11,939
Investments	3,342	3,091	3,091	3,091
Inventory	33,579	35,066	40,490	44,337
Debtors	39,869	50,278	52,003	56,943
Other Current Assets	17,355	21,867	24,716	26,543
Cash and Equivalents	24,757	25,740	28,530	48,535
<b>Total Cur. Assets</b>	<b>115,560</b>	<b>132,951</b>	<b>145,739</b>	<b>176,359</b>
<b>Total Assets</b>	<b>224,817</b>	<b>231,966</b>	<b>261,982</b>	<b>291,011</b>

Source: Company data, I-Sec research

Table 7: Cashflow statement

(Rs mn, year ending March 31)

	FY19	FY20	FY21E	FY22E
PBT (Adj. for EO items)	22,443	18,031	35,568	40,656
Depreciation	12,190	12,472	13,272	13,591
Net Chg in WC	(6,301)	(12,357)	(4,085)	(6,932)
Taxes	(4,841)	(7,105)	(9,603)	(10,977)
Others	5,213	18,800	3,140	1,987
<b>CFO</b>	<b>28,704</b>	<b>29,841</b>	<b>38,293</b>	<b>38,325</b>
Capex	(6,226)	(5,725)	(30,500)	(12,000)
Net Investments made	(2,282)	(214)	-	-
Others	781	1,016	-	-
<b>CFI</b>	<b>(7,727)</b>	<b>(4,923)</b>	<b>(30,500)</b>	<b>(12,000)</b>
Change in Share capital	-	4	-	-
Change in Debts	(15,182)	(19,165)	-	-
Div. & Div Tax	(4,002)	(3,916)	(5,003)	(6,320)
Others	(2,203)	(2,016)	-	-
<b>CFF</b>	<b>(21,387)</b>	<b>(25,093)</b>	<b>(5,003)</b>	<b>(6,320)</b>
<b>Total Cash Generated</b>	<b>(410)</b>	<b>(175)</b>	<b>2,790</b>	<b>20,005</b>
<b>Cash Opening Balance</b>	<b>2,638</b>	<b>2,228</b>	<b>2,053</b>	<b>4,843</b>
<b>Cash Closing Balance</b>	<b>2,228</b>	<b>2,053</b>	<b>4,843</b>	<b>24,848</b>

Source: Company data, I-Sec research

Table 8: Key ratios

(Year ending March 31)

	FY19	FY20	FY21E	FY22E
Adj EPS (Rs)	102.1	112.0	156.4	178.8
yoy Growth%	49.2	9.7	39.7	14.3
Cash EPS (Rs)	175.5	187.1	236.4	260.7
EBITDA - Core (%)	19.4	21.1	23.4	23.8
NPM (%)	10.9	15.0	13.2	13.8
Net Debt to Equity (x)	0.1	(0.0)	(0.0)	(0.1)
P/E (x)	42.1	38.4	27.5	24.1
EV/EBITDA Core (x)	24.6	20.1	15.4	13.4
P/BV (x)	5.1	4.6	4.1	3.6
EV/Sales (x)	4.8	4.2	3.6	3.2
ROCE (%)	9.3	10.3	13.6	13.9
ROE (%)	12.7	12.6	15.7	15.8
ROIC (%)	10.7	11.9	15.9	17.0
Book Value (Rs)	844.6	933.7	1,059.9	1,200.7
DPS (Rs)	20.0	20.7	25.0	31.6
Dividend Payout (%)	17.7	17.7	16.0	17.7
Div Yield (%)	0.5	0.5	0.6	0.7
Asset Turnover Ratio	0.7	0.7	0.8	0.8
Avg Collection days	97	97	97	97
Avg Inventory days	75	75	75	75

Source: Company data, I-Sec research

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