

ADD

TP: Rs 5,320 | ▲ 7%

DR REDDY'S LABS

Pharmaceuticals

28 October 2020

All-round beat; H2 catalysts tracking well

Dr Reddy's (DRRD) reported a Q2 EBITDA beat of 13% led by better operating leverage across markets. EBITDA margin was stable QoQ at 25% despite a 2ppt fall in gross margin and higher integration cost on Wockhardt. India sales (+21.5% YoY, 5% ex-Wockhardt), Russia/CIS (+28% QoQ), and the US (8% QoQ) were strong; PSAI was in line. DRRD is confident of containing SGA at ~20%. Key H2 catalysts are Q2 launch traction, gVascepa & Russia/CIS recovery. We raise FY22/ FY23 EPS by ~7%; retain ADD with a new Sep'21 TP of Rs 5,320 (vs. Rs 4,640).

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All-round sales beat; H2 catalysts tracking well: DRRD reported 11% QoQ sales growth led by strong volume traction in the base (ex-PSAI), offsetting the price erosion impact. India sales grew 21.5% YoY (strong growth in acquired Wockhardt brands) and the US grew 8% QoQ to US\$ 249mn (stable base, Ciprodex launch). DRRD launched nine ANDAs in Q2 (incl. two injectables – Faslodex, Precedex – two OTC drugs and Tecfidera) and gVascepa (~US\$ 50mn sales opportunity), which should aid H2 sales. Russia/CIS grew 28% QoQ on volume recovery. Higher stocking continued to drive PSAI sales. We expect US sales of US\$ 1.15bn by FY22 (12% CAGR over FY20, 5% ex-Copaxone, Vascepa).

| | |
|------------------|-------------------|
| Ticker/Price | DRRD IN/Rs 4,951 |
| Market cap | US\$ 11.1bn |
| Shares o/s | 166mn |
| 3M ADV | US\$ 171.1mn |
| 52wk high/low | Rs 5,513/Rs 2,495 |
| Promoter/FPI/DII | 27%/27%/18% |

Source: NSE

EBITDA margins surprise: Gross margin fell 200bps QoQ to 54% on adverse forex and export incentive withdrawal (Sep month impact only). DRRD retains gross margin guidance of 53-56%. EBITDA margin was healthy at 25% despite full Wockhardt integration cost and higher promotional spends. Led by digital initiatives, DRRD expects to contain SGA at ~20%, supporting healthy margins.

STOCK PERFORMANCE



Source: NSE

Earnings call takeaways: (1) Customer stocking boosted H1 PSAI; expected to normalise. (2) Sputnik-V vaccine: targeting 100mn dose capacity over time; phase-3 trial completion by May'21. (3) Expects +30 ANDA launches in FY21 vs. 25 earlier. (4) Remdesivir traction picking up, capacity expansion underway.

KEY FINANCIALS

| Y/E 31 Mar | FY19A | FY20A | FY21E | FY22E | FY23E |
|-------------------------|---------|---------|---------|---------|---------|
| Total revenue (Rs mn) | 153,852 | 174,601 | 195,637 | 218,858 | 255,147 |
| EBITDA (Rs mn) | 31,333 | 40,942 | 47,520 | 51,976 | 64,873 |
| Adj. net profit (Rs mn) | 17,895 | 32,248 | 28,784 | 32,321 | 42,893 |
| Adj. EPS (Rs) | 107.8 | 194.3 | 173.4 | 194.7 | 258.4 |
| Adj. EPS growth (%) | 90.3 | 80.2 | (10.7) | 12.3 | 32.7 |
| Adj. ROAE (%) | 13.8 | 23.1 | 18.5 | 17.8 | 19.9 |
| Adj. P/E (x) | 45.9 | 25.5 | 28.6 | 25.4 | 19.2 |
| EV/EBITDA (x) | 27.2 | 20.6 | 17.4 | 15.4 | 11.8 |

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

| (Rs mn) | Q2FY21 | Q2FY20 | YoY (%) | Q1FY21 | QoQ (%) | Q2FY21E | Var (%) | H1FY21 | H1FY20 | YoY (%) |
|-------------------------|---------------|---------------|---------------|---------------|-------------|---------------|-------------|---------------|---------------|-------------|
| Net Sales | 48,967 | 48,009 | 2.0 | 44,175 | 10.8 | 46,051 | 6.3 | 93,142 | 86,444 | 13.5 |
| EBITDA | 12,215 | 14,080 | (13.2) | 11,129 | 9.8 | 10,783 | 13.3 | 23,344 | 21,347 | 30.7 |
| Depreciation | 3,272 | 3,339 | - | 3,140 | - | 3,266 | - | 6,412 | 6,421 | - |
| EBIT | 8,943 | 10,741 | (16.7) | 7,989 | 11.9 | 7,518 | - | 16,932 | 14,926 | 50.4 |
| Interest | (237) | (231) | - | (606) | - | (606) | - | (843) | (624) | - |
| Other Income | 149 | 135 | - | 118 | - | 118 | - | 267 | 3,894 | - |
| PBT | 9,329 | 11,107 | (16.0) | 8,713 | 7.1 | 8,242 | 13.2 | 18,042 | 19,444 | 55.6 |
| Less: Taxation | 998 | (3,261) | - | 2,996 | - | 1,978 | - | 3,994 | (1,389) | - |
| Less: Minority Interest | (73) | (117) | - | (77) | - | (77) | - | (150) | (280) | - |
| Recurring PAT | 8,404 | 14,485 | (42.0) | 5,794 | 45.0 | 6,341 | 32.5 | 14,198 | 21,113 | 93.0 |
| Exceptional items | (781) | (3,560) | - | 0 | - | 0 | - | (781) | (3,560) | - |
| Reported PAT | 7,623 | 10,925 | (30.2) | 5,794 | 31.6 | 6,341 | 20.2 | 13,417 | 17,553 | 3.7 |
| Key Ratios (%) | | | | | | | | | | |
| Gross Margin | 53.9 | 57.5 | - | 56.0 | - | 54.5 | - | 54.9 | 54.9 | - |
| EBITDA Margin | 24.9 | 29.3 | - | 25.2 | - | 23.4 | - | 25.1 | 24.7 | - |
| Tax / PBT | 10.7 | (29.4) | - | 34.4 | - | 24.0 | - | 22.1 | (7.1) | - |
| NPM | 17.2 | 30.2 | - | 13.1 | - | 13.8 | - | 15.2 | 24.4 | - |
| EPS (Rs) | 49.3 | 85.0 | - | 34.0 | - | 37.2 | - | 83.3 | 123.9 | - |

Source: Company, BOBCAPS Research

FIG 2 – REVENUE MIX

| (Rs mn) | Q2FY21 | Q2FY20 | YoY (%) | Q1FY21 | QoQ (%) | Q2FY21E | Var (%) | H1FY21 | H1FY20 | YoY (%) |
|----------------------|---------------|---------------|------------|---------------|-------------|---------------|------------|---------------|---------------|-------------|
| Global Generics | 39,841 | 32,816 | 21.4 | 35,075 | 13.6 | 37,204 | 7.1 | 74,916 | 65,798 | 12.4 |
| North America | 18,328 | 14,265 | 28.5 | 17,282 | 6.1 | 17,760 | 3.2 | 35,610 | 30,587 | 7.8 |
| Europe | 3,754 | 2,764 | 35.8 | 3,551 | 5.7 | 3,658 | 2.6 | 7,305 | 5,168 | 48.7 |
| India | 9,123 | 7,511 | 21.5 | 6,260 | 45.7 | 7,761 | 17.6 | 15,383 | 14,471 | 10.5 |
| ROW | 8,636 | 8,276 | 4.3 | 7,982 | 8.2 | 8,026 | 7.6 | 16,618 | 15,572 | 13.6 |
| PSAI | 8,505 | 7,107 | 19.7 | 8,553 | (0.6) | 8,300 | 2.5 | 17,058 | 11,646 | 6.7 |
| Proprietary Products | 621 | 8,086 | (92.3) | 547 | 13.5 | (384) | (261.7) | 1,168 | 9,000 | (117.8) |
| Net Sales | 48,967 | 48,009 | 2.0 | 44,175 | 10.8 | 46,051 | 6.3 | 93,142 | 86,444 | 13.5 |
| INR/US\$ | 74 | 70 | 5.0 | 75 | (2.0) | 73.5 | - | 71 | 71 | 2.4 |
| US in \$ terms (mn) | 249 | 204 | 22.4 | 230 | 8.2 | 242 | 3.2 | 500 | 431 | 5.3 |

Source: Company, BOBCAPS Research

Valuation methodology

DRRD is trading at reasonable valuations of 24x/18x FY22E/FY23E EPS. The company 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 PSAl segment augurs well for the stock over the long term. But we believe risk-reward is balanced, at least from a medium-term perspective, after the recent stock rally.

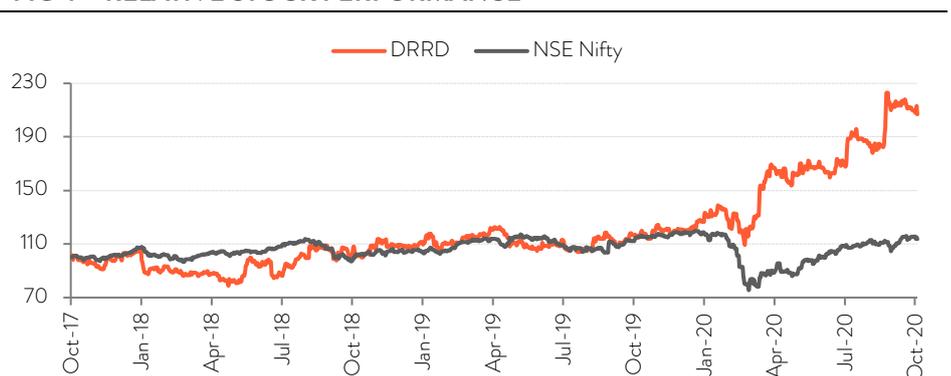
We raise FY22/FY23 EPS estimates by ~7% to factor in improved growth in India, Russia and CIS sales led by volume recovery and in US sales as we incorporate Vascepa upsides. We estimate core EPS at Rs 176/Rs 204 (ex-Copaxone, Vascepa, Revlimid). Our target price stands revised to Rs 5,320 (from Rs 4,640), based on an unchanged EV/EBITDA multiple of 14x Sep'22E (23x implied P/E). Our valuation includes Revlimid upside (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 | 195.6 | 218.9 | 255.1 | 185.8 | 202.8 | 236.8 | 5.3 | 7.9 | 7.8 |
| EBITDA | 47.5 | 52.0 | 64.9 | 42.5 | 47.5 | 59.6 | 11.9 | 9.4 | 8.9 |
| EBITDA margin (%) | 24.3 | 23.7 | 25.4 | 22.9 | 23.4 | 25.2 | 143bps | 33bps | 26bps |
| EPS (Rs) | 173 | 195 | 258 | 158 | 182 | 244 | 9.6 | 7.2 | 6.5 |

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 | 195,637 | 218,858 | 255,147 |
| EBITDA | 31,333 | 40,942 | 47,520 | 51,976 | 64,873 |
| Depreciation | 12,399 | 12,471 | 13,209 | 13,664 | 14,444 |
| EBIT | 18,934 | 28,471 | 34,311 | 38,312 | 50,428 |
| Net interest income/(expenses) | (889) | (983) | (550) | (550) | (550) |
| Other income/(expenses) | 3,498 | 3,294 | 3,143 | 5,333 | 7,313 |
| Exceptional items | 0 | 0 | 0 | 0 | 0 |
| EBT | 21,543 | 30,782 | 36,903 | 43,094 | 57,191 |
| Income taxes | 3,648 | (1,466) | 8,119 | 10,774 | 14,298 |
| 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 | 28,784 | 32,321 | 42,893 |
| Adjustments | 901 | (12,739) | 0 | 0 | 0 |
| Adjusted net profit | 17,895 | 32,248 | 28,784 | 32,321 | 42,893 |

Balance Sheet

| Y/E 31 Mar (Rs mn) | FY19A | FY20A | FY21E | FY22E | FY23E |
|---------------------------------------|----------------|----------------|----------------|----------------|----------------|
| Accounts payables | 14,553 | 16,659 | 18,760 | 20,986 | 24,466 |
| Other current liabilities | 27,219 | 32,188 | 35,215 | 39,394 | 45,927 |
| Provisions | 4,218 | 3,854 | 4,318 | 4,831 | 5,632 |
| 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 | 166,803 | 194,969 | 233,707 |
| Shareholders' fund | 136,594 | 143,005 | 167,634 | 195,800 | 234,538 |
| Total liabilities and equities | 220,965 | 217,717 | 247,938 | 283,022 | 332,574 |
| Cash and cash eq. | 2,228 | 2,053 | 40,362 | 64,623 | 96,946 |
| Accounts receivables | 39,869 | 50,278 | 53,599 | 59,961 | 69,903 |
| Inventories | 33,579 | 35,066 | 40,199 | 44,971 | 52,428 |
| Other current assets | 17,061 | 19,557 | 25,433 | 28,451 | 33,169 |
| 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 | 247,938 | 283,022 | 332,574 |

Source: Company, BOBCAPS Research

Cash Flows

| Y/E 31 Mar (Rs mn) | FY19A | FY20A | FY21E | FY22E | FY23E |
|-------------------------------------|-----------------|-----------------|----------------|-----------------|-----------------|
| Net income + Depreciation | 31,195 | 31,980 | 41,993 | 45,985 | 57,338 |
| Interest expenses | 889 | 983 | 550 | 550 | 550 |
| Non-cash adjustments | 0 | 0 | 0 | 0 | 0 |
| Changes in working capital | (2,530) | (7,681) | (8,739) | (7,233) | (11,304) |
| Other operating cash flows | 0 | 0 | 0 | 0 | 0 |
| Cash flow from operations | 29,554 | 25,282 | 33,805 | 39,302 | 46,584 |
| 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) | 38,309 | 24,261 | 32,323 |
| Closing cash and cash eq. | 2,228 | 2,053 | 40,362 | 64,623 | 96,946 |

Per Share

| Y/E 31 Mar (Rs) | FY19A | FY20A | FY21E | FY22E | FY23E |
|----------------------|-------|-------|---------|---------|---------|
| Reported EPS | 113.2 | 117.5 | 173.4 | 194.7 | 258.4 |
| Adjusted EPS | 107.8 | 194.3 | 173.4 | 194.7 | 258.4 |
| Dividend per share | 25.0 | 25.0 | 25.0 | 25.0 | 25.0 |
| Book value per share | 822.9 | 861.5 | 1,009.8 | 1,179.5 | 1,412.9 |

Valuations Ratios

| Y/E 31 Mar (x) | FY19A | FY20A | FY21E | FY22E | FY23E |
|----------------|-------|-------|-------|-------|-------|
| EV/Sales | 5.5 | 4.8 | 4.2 | 3.7 | 3.0 |
| EV/EBITDA | 27.2 | 20.6 | 17.4 | 15.4 | 11.8 |
| Adjusted P/E | 45.9 | 25.5 | 28.6 | 25.4 | 19.2 |
| P/BV | 6.0 | 5.7 | 4.9 | 4.2 | 3.5 |

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 | 107.6 | 112.5 | 113.4 |
| EBIT margin (EBIT/Revenue) | 12.3 | 16.3 | 17.5 | 17.5 | 19.8 |
| Asset turnover (Revenue/Avg TA) | 22.0 | 25.7 | 27.6 | 26.9 | 26.9 |
| Leverage (Avg TA/Avg Equity) | 1.3 | 1.2 | 1.1 | 1.1 | 1.1 |
| Adjusted ROAE | 13.8 | 23.1 | 18.5 | 17.8 | 19.9 |

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 | 12.0 | 11.9 | 16.6 |
| EBITDA | 37.0 | 30.7 | 16.1 | 9.4 | 24.8 |
| Adjusted EPS | 90.3 | 80.2 | (10.7) | 12.3 | 32.7 |
| Profitability & Return ratios (%) | | | | | |
| EBITDA margin | 20.4 | 23.4 | 24.3 | 23.7 | 25.4 |
| EBIT margin | 12.3 | 16.3 | 17.5 | 17.5 | 19.8 |
| Adjusted profit margin | 11.6 | 18.5 | 14.7 | 14.8 | 16.8 |
| Adjusted ROAE | 13.8 | 23.1 | 18.5 | 17.8 | 19.9 |
| ROCE | 12.9 | 18.7 | 21.1 | 21.4 | 24.3 |
| 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 | 1.0 | 1.0 | 1.1 |
| Current ratio | 2.0 | 2.0 | 2.7 | 3.0 | 3.3 |
| Net interest coverage ratio | 21.3 | 29.0 | 62.4 | 69.6 | 91.6 |
| 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%

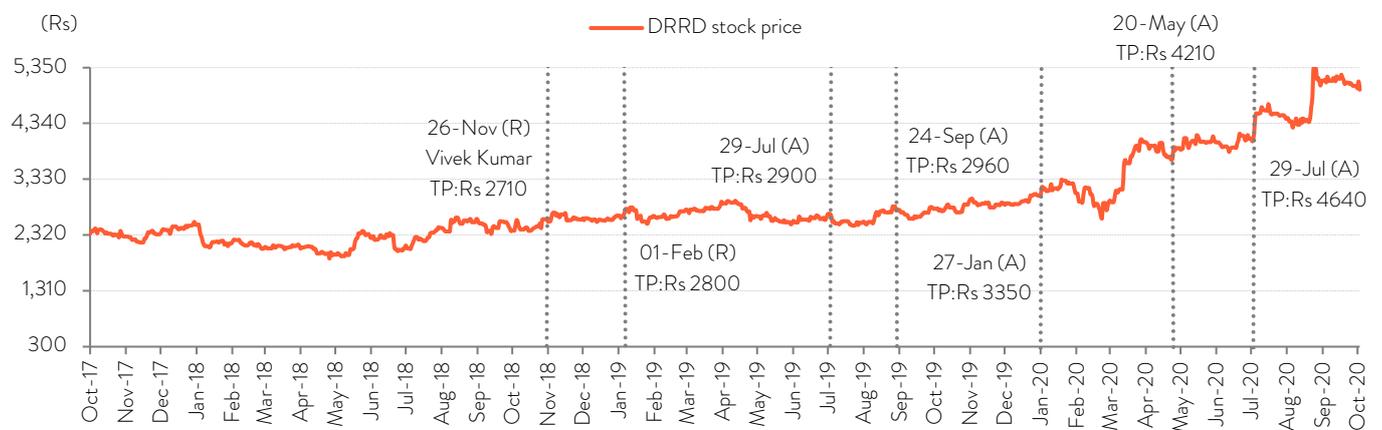
ADD – Expected return from >+5% to +15%

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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