

Dr. Reddy's Laboratories

Performance Highlights

Y/E March (₹ cr)	2QFY2017	1QFY2017	% chg (qoq)	2QFY2016	% chg (yoy)
Net sales	3,586	3,235	10.9	3,989	(10.1)
Gross profit	2,294	2,121	8.2	2,694	(14.8)
Operating profit	596	477	24.9bp	1,140	(47.8)bp
Adj. net profit	295	126	134.1	722	(59.2)

Source: Company, Angel Research

Dr. Reddy's Laboratories (DRL) posted results lower than expected on net profit front. While the sales were marginally higher than expected, operating profit was much lower than expected. In INR terms, the consolidated revenues came in at ₹3,586cr (vs. ₹3,500cr expected vs. ₹3,989cr in 2QFY2016), down by 10.1% yoy, mainly driven by pressure on the generic market. The global generic market with sales (₹2,899.5cr, down by 12.0% yoy), mainly lead by the Europe (₹177.6cr, 16% dip yoy) and Emerging market (₹483.4cr, a yoy dip of 27%). The PSAI segment posted sales of ₹578.4cr, down by 2.0%. On the operating front, the EBIT margin came in at 8.7% (vs. 12.1% expected vs. 22.4% in 2QFY2016). Consequently, the PAT came in at ₹295cr (vs. ₹325cr expected vs. ₹722cr in 2QFY2016), a yoy de-growth of 59.2%. **We maintain our Neutral rating on the stock.**

A subdued quarter: DRL posted results lower than expected on net profit front. While the sales were marginally higher than expected, operating profit was much lower than expected. In INR terms, the consolidated revenues came in at ₹3,586cr (vs. ₹3,500cr expected vs. ₹3,989cr in 2QFY2016), down by 10.1% yoy, mainly driven by pressure on the generic market. The global generic market with sales (₹2,899.5cr, down by 12.0% yoy), mainly lead by the Europe (₹177.6cr, 16% dip yoy) and Emerging market (₹483.4cr, a yoy dip of 27%). The PSAI segment posted sales of ₹578.4cr, down by 2.0%. On the operating front, the EBIT margin came in at 8.7% (vs. 12.1% expected vs. 22.4% in 2QFY2016). Consequently, the PAT came in at ₹295cr (vs. ₹325cr expected vs. ₹722cr in 2QFY2016), a yoy de-growth of 59.2%.

Outlook and valuation: We expect net sales to grow at a CAGR of 8.2% to ₹18,119cr and adjusted EPS to record a CAGR of 1.7% to ₹142.9 over FY2016-18E. **We recommend a Neutral rating on the stock given the valuations.**

Key financials (IFRS Consolidated)

Y/E March (₹ cr)	FY2015	FY2016	FY2017E	FY2018E
Net sales	14,819	15,471	16,043	18,119
% chg	12.1	4.4	3.7	12.9
Net profit	2,218	2,001	1,918	2,437
% chg	3.1	(9.8)	(4.2)	27.1
Adj net profit	2,218	2,357	1,918	2,437
% chg	3.1	6.3	(18.6)	27.1
Adj. EPS (₹)	130.2	138.2	112.4	142.9
EBITDA margin (%)	22.2	24.6	20.8	22.4
P/E (x)	25.1	22.3	27.4	21.5
RoE (%)	21.9	19.7	14.1	15.9
RoCE (%)	18.1	18.7	13.9	16.2
P/BV (x)	5.0	4.3	3.9	3.4
EV/Sales (x)	3.7	3.6	3.4	3.0
EV/EBITDA (x)	16.8	14.5	16.5	13.5

Source: Company, Angel Research; Note: CMP as of November 4, 2016

NEUTRAL

CMP	₹3,077
Target Price	-

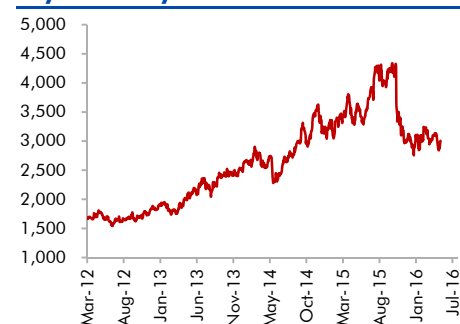
Investment Period	-
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Stock Info	
Sector	Pharmaceutical
Market Cap (₹ cr)	51,310
Net Debt (₹ cr)	(663)
Beta	0.8
52 Week High / Low	4,326/2,750
Avg. Daily Volume	45,624
Face Value (₹)	5
BSE Sensex	27,274
Nifty	8,434
Reuters Code	REDY.BO
Bloomberg Code	DRRD@IN

Shareholding Pattern (%)	
Promoters	26.7
MF / Banks / Indian Fls	9.2
FII / NRIs / OCBs	55.4
Indian Public / Others	8.7

Abs. (%)	3m	1yr	3yr
Sensex	(1.0)	3.2	29.1
Dr Reddy	10.9	(24.6)	31.5

3-year Daily Price Chart



Source: Company, Angel Research

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Exhibit 1: 2QFY2017 performance (IFRS, consolidated)

Y/E March (₹ cr)	2QFY2017	1QFY2017	% chg (qoq)	2QFY2016	% chg (yoy)	1HFY2017	1HFY2016	% chg
Net sales	3,586	3,235	10.9	3,989	(10.1)	6,714	7,642	(12.1)
Other income/(loss)	64	61	-	10	-	246	243	-
Total income	3,650	3,296	10.7	3,999	(8.7)	6,960	7,885	(11.8)
Gross profit	2,294	2,121	8.2	2,694	(14.8)	5,091	5,829	(12.7)
Gross margin (%)	64.0	65.6		67.5		75.8	76.3	
SG&A expenses	1,177	1,228	(4.2)	1,106	6.5	2,303	2,150	7.1
R&D expenses	521	480	8.6	447	16.6	1,917	1,711	12.1
EBDITA	596	477	24.9	1,140	(47.8)	871	1,969	(55.8)
EBDITA (%)	16.6	14.7	-	28.6		13.0	26.1	-
Depreciation	285	303	(6.1)	246.6	15.5	505.8	426.8	18.5
Interest	-	-	-	-	-	-	-	-
PBT	375	235	59.6	904	(58.5)	611	1,784	(65.8)
Tax	89	44	99.3	188	(52.9)	148	380	(61.0)
Net Profit	287	191	50.3	716	(60.0)	462	1,405	(67.1)
Share of profit/ (loss) in associates	(8.4)	-		(6.0)		-	-	
Reported net profit before exceptional	295	126	134.1	722	(59.2)	462	1,405	(67.1)
Exceptional items (loss) /profit	-	-		-		-	-	
Reported PAT	295	126	134.1	722	(59.2)	462	1,405	(67.1)
Adj. Net Profit	295	126	134.1	722	(59.2)	575	1,405	(59.1)
EPS (₹)	17.4	7.4		42.5		35.0	82.7	

Source: Company, Angel Research

Exhibit 2: Actual Vs Estimates

(₹ cr)	Actual	Estimates	Variation (%)
Net sales	3,586	3,500	2.4
Other income	64	10	542.0
Operating profit	596	708	(15.8)
Tax	89	108	(18.2)
Adj. Net profit	295	325	(9.1)

Source: Company, Angel Research

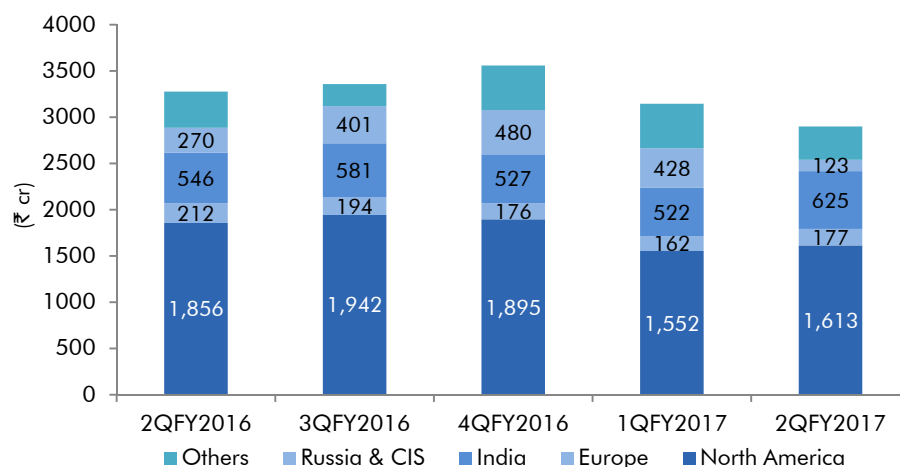
Revenue just in line with expectation: In INR terms, the consolidated revenues came in at ₹3,586cr (vs. ₹3,500cr expected vs. ₹3,989cr in 2QFY2016), down by 10.1% yoy, mainly driven by pressure on the generic market.

The global generic market with sales (₹2,899.5cr, down by 12.0% yoy), mainly lead by the Europe (₹177.6cr, 16% dip yoy) and Emerging market (₹483.4cr, a yoy dip of 27%). Other key markets like US dipped by 13% yoy to ₹1613.4cr and India grew by 14% yoy to ₹625.1cr.

The PSAL segment posted sales of ₹578.4cr, down by 2.0%. The growth came in on back of US (₹113.5cr, a yoy growth of 64%), Europe (₹209.5cr, a yoy dip of 14.0%), India (₹57.5cr, a yoy dip of 21%) and ROW (₹197.9cr, a yoy dip of 5%).

As of September 30, 2016, 85 generic filings are pending approval with the USFDA, including 56 Para IVs (of which 19 are FTFs).

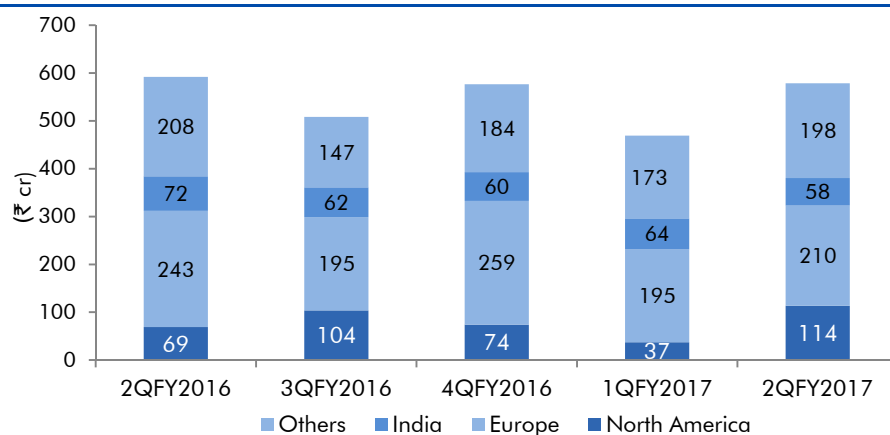
Exhibit 3: Trend in Global generics



Source: Company, Angel Research

In the PSAI segment (16% of sales), the US grew by 64% yoy; while ROW, Europe, and India de-grew by 5%, 14% and 21% yoy, respectively, during the quarter. Proprietary Products & Others (₹578.4cr) posted a yoy de-growth of 2%.

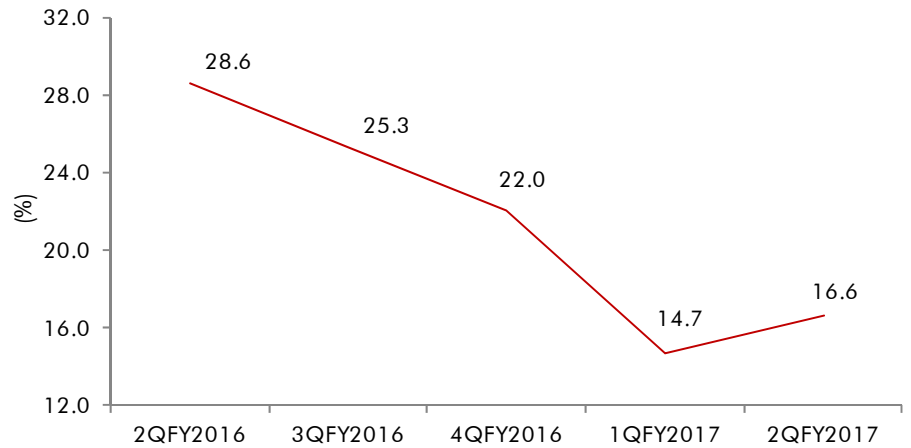
Exhibit 4: PSAI trend



Source: Company, Angel Research

EBITDA margin dips yoy: On the operating front, lower sales led the EBIT of come in soft at 8.7% (vs. 12.1% expected vs. 22.4% in 2QFY2016). The EBITDA margin came in at 16.6% (vs. 17.2% expected vs. 28.6% in 2QFY2016), hurt by lower sales and 6.5% yoy growth in SG&A expenses. R&D expenditure for the quarter amounted to 16.6% of sales (vs. 28.6% in 2QFY2016).

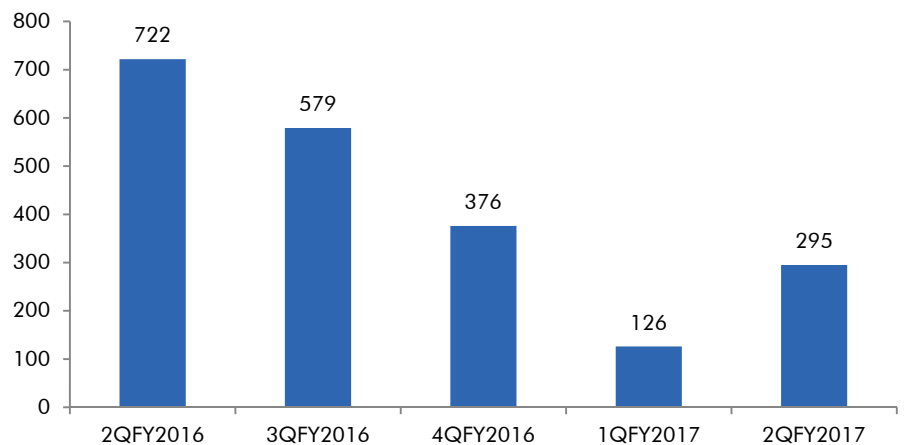
Exhibit 5: EBITDA margin trend (%)



Source: Company, Angel Research

Net profit lower than expected: Other income for the quarter came in at ~₹64cr (vs. ₹10cr in 2QFY2016). The net profit stood at ₹295cr (vs. ₹325cr expected vs. ₹722cr in 2QFY2016), a yoy de-growth of 59.2%.

Exhibit 6: Adjusted net profit trend



Source: Company, Angel Research

Concall takeaways

- Remediation plan largely over; DRRD is planning to set a face-to-face meeting with USFDA.
- Effective Tax rate to be 20-22% of PBT in FY2017.
- The company incurs 12-15% of its total R&D spends on bio-similar research.

Investment arguments

Robust growth in the US going ahead: After attaining a critical mass (US\$1,139mn in FY2016), DRL aims to scale up its business to the next orbit in the US market on the back of a strong product pipeline (85 ANDAs are pending approval, of which, 56 are Para IVs and 19 are FTFs). The Management has guided for a robust growth in the US over the medium term, driven by introduction of new products, some of which are also Para IV opportunities. Owing to the import alert on the three facilities of the company, in a worst case scenario, we expect the ex-exclusivity US sales to post a CAGR of ~7.0% during FY2016-18E.

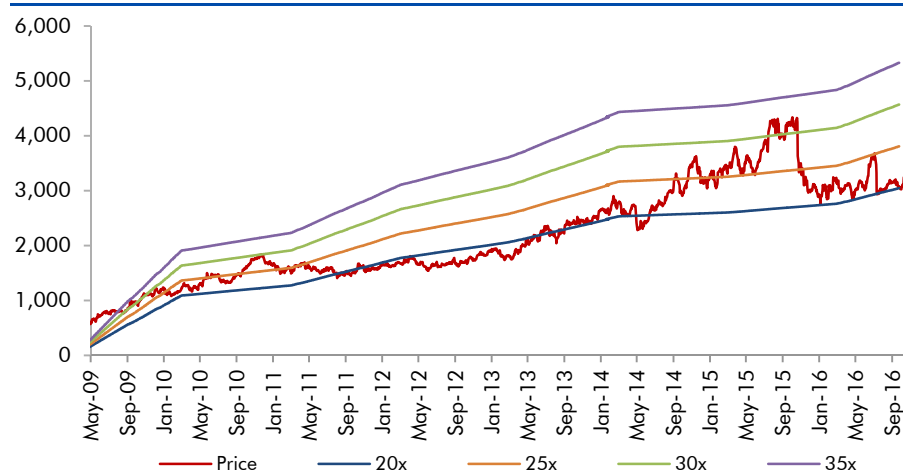
Domestic back in focus: DRL reported a 19.0% yoy growth in FY2016. The management expects the company's performance to rebound and targets to achieve an above industry growth rate going ahead, driven by a) field force expansion and improvement in productivity, b) new product launches (including biosimilars) and c) focus on brand building. In 4QFY2015, DRL had acquired UCB's India portfolio and has completed the integration process of these brands in 1QFY2016. UCB's India business had registered ~₹150cr sales in CY2014 and has a branded portfolio of 21 products focusing on Allergy, Respiratory, Dermatology and Pediatric space. The acquisition has been successfully integrated by 2QFY2016. Thus, we expect sales in India to post a CAGR of ~12.0% over FY2016-18E.

Valuation: We expect net sales to grow at a CAGR of 8.2% to ₹18,119cr and adjusted EPS to record a CAGR of 1.7% to ₹142.9 over FY2016-18E. The stock has been severely beaten down post the import alert from the USFDA. Still, considering the valuations, **we recommend a Neutral rating on the stock.**

Exhibit 7: Key assumptions

	FY2017E	FY2018E
PSAI segment growth (%)	(0.9)	(0.1)
Generics segment growth (%)	3.9	14.8
Operating margin (%)	20.8	22.4
Capex (₹ cr)	1200	1200

Source: Company, Angel Research

Exhibit 8: PE chart


Source: Company, Angel Research

Exhibit 9: Recommendation summary

Company	Reco.	CMP (₹)	Tgt Price (₹)	Upside (%)	FY2018E			FY16-18E	FY2018E	
					PE (x)	EV/Sales (x)	EV/EBITDA (x)	CAGR in EPS (%)	RoCE (%)	RoE (%)
Alembic Pharma	Neutral	656	-	-	21.6	2.9	13.4	(10.8)	27.5	25.3
Aurobindo Pharma	Accumulate	727	877	20.7	15.4	2.5	10.7	18.1	22.5	26.1
Cadila Healthcare	Neutral	390	-	-	18.4	3.1	14.3	13.4	22.7	25.7
Cipla	Neutral	545	-	-	20.0	2.5	13.8	20.4	13.5	15.2
Dr Reddy's	Neutral	3,077	-	-	21.5	2.8	12.4	1.7	16.2	15.9
Dishman Pharma	Neutral	227	-	-	20.1	2.3	9.9	3.1	10.3	10.9
GSK Pharma	Neutral	2,775	-	-	46.7	6.0	42.1	15.9	33.7	30.6
Indoco Remedies	Neutral	276	-	-	17.7	2.1	11.3	31.5	19.1	19.2
Ipca labs	Accumulate	583	613	5.1	29.6	2.0	13.4	36.5	8.8	9.4
Lupin	Buy	1,421	1,809	27.3	20.5	3.9	12.6	17.2	24.4	20.9
Sanofi India*	Neutral	4,276	-	-	25.3	3.4	18.2	21.2	24.9	28.4
Sun Pharma	Buy	653	944	44.6	19.9	3.9	12.6	22.0	33.1	18.9

Source: Company, Angel Research; Note: *December year ending

Company Background

Established in 1984, Dr. Reddy's Laboratories is an integrated global pharmaceutical company, through its three businesses - Pharmaceutical Services and Active Ingredients, Global Generics and Proprietary Products. The company's key therapeutic focus is on gastro-intestinal, cardiovascular, diabetology, oncology, pain management, anti-infective and paediatrics. The company's key markets include India, USA, Russia & CIS, and Germany.

Profit & loss statement (IFRS Consolidated)

Y/E March	FY2013	FY2014	FY2015	FY2016	FY2017E	FY2018E
Net sales	11,627	13,217	14,819	15,471	16,043	18,119
Other operating income	247.9	141.6	91.7	87.4	87.4	87.4
Total operating income	11,875	13,359	14,911	15,558	16,130	18,207
% chg	21.8	12.5	11.6	4.3	3.7	12.9
Total expenditure	8,951	10,096	11,535	11,669	12,710	14,059
Cost of revenues	4,825	4,977	5,531	5,315	5,812.02	6,267.44
SG&A expenses	3,358	3,878	4,259	4,570	4,492	5,073
R&D expenses	767.3	1,240.2	1,744.9	1,783.4	2,406.4	2,717.9
EBITDA	2,676	3,121	3,284	3,802	3,332	4,061
% chg	3.0	16.6	5.2	15.8	(12.4)	21.9
(% of Net Sales)	23.0	23.6	22.2	24.6	20.8	22.4
Depreciation & amortisation	743.7	659.8	747.4	927.4	990.1	1,052.8
EBIT	1,932	2,462	2,537	2,875	2,342	3,008
% chg	4.3	27.4	3.1	13.3	-18.5	28.4
(% of Net Sales)	16.6	18.6	17.1	18.6	14.6	16.6
Interest & other charges	-	-	-	-	-	-
Other Income	46.0	40.0	168.2	(270.8)	-	-
(% of PBT)	2.1	1.5	6.0	(10.0)	-	-
Share in profit of associates	10.4	17.4	19.5	22.9	22.9	22.9
Recurring PBT	2,237	2,661	2,816	2,714	2,453	3,118
% chg	14.7	19.0	5.9	-3.6	-9.6	27.1
Extraordinary expense/(Inc.)	68.8	-	-	508.5	-	-
PBT (reported)	2,167.7	2,660.6	2,816.3	2,714.0	2,452.5	3,118.1
Tax	490.0	509.4	598.4	712.7	534.5	680.9
(% of PBT)	22.6	19.1	21.2	26.3	21.8	21.8
PAT (reported)	1,677.7	2,151.2	2,217.9	2,001.3	1,918.0	2,437.2
Add: Share of earnings of asso.	-	-	-	-	-	-
Less: Minority interest (MI)	-	-	-	-	-	-
Exceptional items	-	-	-	-	-	-
PAT after MI (reported)	1,677.7	2,151.2	2,217.9	2,001.3	1,918.0	2,437.2
ADJ. PAT	1,750.0	2,151.2	2,217.9	2,357.0	1,918.0	2,437.2
% chg	17.0	22.9	3.1	6.3	(18.6)	27.1
(% of Net Sales)	14.4	16.3	15.0	12.9	12.0	13.5
Basic EPS (₹)	103.1	126.7	130.2	138.2	112.4	142.9
Fully Diluted EPS (₹)	103.1	126.7	130.2	138.2	112.4	142.9
% chg	16.8	22.9	2.7	6.1	(18.6)	27.1

Balance sheet (IFRS Consolidated)

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016	FY2017E	FY2018E
SOURCES OF FUNDS						
Equity share capital	84.9	84.9	85.2	85.3	85.3	85.3
Preference Capital	-	-	-	-	-	-
Reserves & surplus	7,224	8,995	11,045	12,748	14,267	16,305
Shareholders funds	7,309	9,080	11,130	12,834	14,352	16,390
Minority Interest						
Total loans	3,676.0	4,474.2	3,954.3	3,661.9	3,661.9	3,661.9
Deferred tax liability	83.3	(192.9)	(401.3)	(423.0)	(423.0)	(423.0)
Total liabilities	11,068	13,361	14,683	16,073	17,591	19,629
APPLICATION OF FUNDS						
Net fixed assets	3,781	3,945	4,314	5,396	6,596	7,796
Goodwill /other intangibles	1,402	1,470	1,643	1,969	1,969	1,969
Capital Work-in-Progress	495.2	495.2	495.2	495.2	495.2	495.2
Investments	1,764	2,589	3,811	3,833	3,833	3,833
Current Assets	6,875	7,866	8,558	8,465	9,011	10,418
Cash	513.6	845	539	492	356	648
Loans & Advances	697.6	793.0	889.1	928.2	962.6	1,087.2
Other	5,664	6,228	7,129	7,045	7,692	8,683
Current liabilities	3,252	3,006	4,214	4,193	4,420	4,989
Net Current Assets	3,623	4,860	4,344	4,273	4,591	5,429
Other Assets	-		76	106	106	106
Total Assets	11,068	13,361	14,683	16,073	17,591	19,629

Cash flow statement (IFRS Consolidated)

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016	FY2017E	FY2018E
Profit before tax	2,237	2,661	2,816	2,714	2,453	3,118
Depreciation	744	660	747	927	990	1,053
(Inc)/Dec in Working Capital	535	(906)	211	24	(455)	(546)
Less: Other income	46	40	168	(271)	-	-
Direct taxes paid	490	509	598	713	535	681
Cash Flow from Operations	2,980	1,865	3,008	3,224	2,453	2,944
(Inc.)/Dec.in Fixed Assets	(431)	(164)	(369)	(1,082)	(1,200)	(1,200)
(Inc.)/Dec. in Investments	687	824	1,222	22	-	-
Other income	46	40	168	(271)	-	-
Cash Flow from Investing	302	701	1,021	(1,331)	(1,200)	(1,200)
Issue of Equity	0	-	0	0	-	-
Inc./(Dec.) in loans	(1,155)	798	(520)	(292)	-	-
Dividend Paid (Incl. Tax)	298	358	399	399	399	399
Others	(2,649)	(3,390)	(4,214)	(2,047)	(1,789)	(1,851)
Cash Flow from Financing	(3,506)	(2,234)	(4,335)	(1,940)	(1,389)	(1,452)
Inc./(Dec.) in Cash	(224)	331	(306)	(47)	(136)	292
Opening Cash balances	738	514	845	539	492	356
Closing Cash balances	514	845	539	492	356	648

Key ratios

Y/E March	FY2013	FY2014	FY2015	FY2016	FY2017E	FY2018E
Valuation Ratio (x)						
P/E (on FDEPS)	29.9	24.3	23.6	22.3	27.4	21.5
P/CEPS	21.6	18.6	17.7	17.9	18.1	15.0
P/BV	7.6	6.1	5.0	4.3	3.9	3.4
Dividend yield (%)	0.5	0.5	0.5	0.5	0.5	0.5
EV/Sales	4.9	4.3	3.7	3.6	3.4	3.0
EV/EBITDA	20.0	17.1	15.8	13.6	15.6	12.7
EV / Total Assets	4.8	4.0	3.5	3.2	3.0	2.6
Per Share Data (₹)						
EPS (Basic)	103.1	126.7	130.2	138.2	112.4	142.9
EPS (fully diluted)	103.1	126.7	130.2	138.2	112.4	142.9
Cash EPS	142.6	165.5	174.0	171.7	170.5	204.6
DPS	15.0	15.0	15.0	15.0	15.0	15.0
Book Value	430.4	534.7	653.3	752.3	841.3	960.8
Dupont Analysis						
EBIT margin	16.6	18.6	17.1	18.6	14.6	16.6
Tax retention ratio	77.4	80.9	78.8	73.7	78.2	78.2
Asset turnover (x)	1.2	1.2	1.1	1.0	1.0	1.0
ROIC (Post-tax)	14.9	17.4	15.1	14.3	11.2	13.0
Cost of Debt (Post Tax)	0.0	0.0	0.0	0.0	0.0	0.0
Leverage (x)	0.6	0.4	0.4	0.3	0.2	0.2
Operating ROE	23.5	24.7	20.4	18.3	13.9	15.7
Returns (%)						
ROCE (Pre-tax)	17.8	20.2	18.1	18.7	13.9	16.2
Angel ROIC (Pre-tax)	23.1	25.6	22.5	22.9	16.8	19.2
ROE	26.8	26.3	21.9	19.7	14.1	15.9
Turnover ratios (x)						
Asset Turnover (Gross Block)	3.3	3.5	3.6	3.2	2.7	2.5
Inventory / Sales (days)	63	62	61	60	59	61
Receivables (days)	88	89	90	96	86	88
Payables (days)	44	40	43	59	41	41
WC cycle (ex-cash) (days)	104	97	96	89	91	90
Solvency ratios (x)						
Net debt to equity	0.4	0.4	0.3	0.2	0.2	0.2
Net debt to EBITDA	1.2	1.2	1.0	0.8	1.0	0.7
Interest Coverage (EBIT / Int.)	-	-	-	-	-	-

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Dr. Reddy's Laboratories

1. Financial interest of research analyst or Angel or his Associate or his relative	No
2. Ownership of 1% or more of the stock by research analyst or Angel or associates or relatives	No
3. Served as an officer, director or employee of the company covered under Research	No
4. Broking relationship with company covered under Research	No

Ratings (Based on expected returns over 12 months investment period):

Buy (> 15%)

Accumulate (5% to 15%)
Reduce (-5% to -15%)

Neutral (-5 to 5%)
Sell (< -15)