

Dr Reddy's Laboratories

Performance Highlights

Y/E March (₹ cr)	4QFY2016	3QFY2016	% chg (qoq)	4QFY2015	% chg (yoy)
Net sales	3,756	3,968	(5.3)	3,870	(3.0)
Gross profit	2,431	2,636	(7.8)	2,309	5.3
Operating profit	844	1,023	(17.4)	787	7.3
Adj. net profit	376	579	(35.0)	519	(27.5)

Source: Company, Angel Research

For 4QFY2016, Dr Reddy's Laboratories (DRL) posted results much lower than our estimates. The company posted a 3.0% yoy de-growth in sales to ₹3,756cr V/s ₹4,500cr expected and V/s ₹3,870cr in 4QFY2015. The sales dip mainly happened on account of flat global generics and a 22% dip in the PSAI segment. On the operating front, the EBIT margin came in at 12.7% V/s 22.2% expected and V/s 11.4% in 4QFY2015, mainly owing to lower sales and a 15.4% yoy rise in SG&A expenditure. Thus, the Adj. net profit came in at ₹376cr V/s ₹729cr expected and V/s ₹519cr in 4QFY2015, a yoy de-growth of 27.5%. **We recommend a Buy rating on the stock.**

Sales lower than expected: The company posted a 3.0% yoy de-growth in sales to ₹3,756cr V/s ₹4,500cr expected and V/s ₹3,870cr in 4QFY2015. The sales dip mainly happened owing to flat global generics and a 22% dip in the PSAI segment. In generics, its key market USA posted a 12% yoy growth, Europe posted an 18% yoy dip, while Emerging markets posted a dip of 31% during the quarter. On the operating front, the EBIT margin came in at 12.7% V/s 22.2% expected and V/s 11.4% in 4QFY2015, mainly owing to lower sales and a 15.4% rise in SG&A expenditure. Thus, the Adj. net profit came in at ₹376cr V/s ₹729cr expected and V/s ₹519cr in 4QFY2015, a yoy de-growth of 27.5%. However, on back of the Venezuela related write offs of ₹430cr, the reported net profit came in at ₹75cr v/s ₹519cr in 4QFY2015, a de-growth of 85.6% yoy.

Outlook and valuation: We expect net sales to grow at a CAGR of 13.8% to ₹20,021cr and adjusted EPS to record a 12.2% CAGR to ₹173.8 over FY2016-18E. **On back of valuations, we recommend a Buy rating on the stock.**

Key financials (IFRS Consolidated)

Y/E March (₹ cr)	FY2015	FY2016	FY2017E	FY2018E
Net sales	14,819	15,471	17,479	20,021
% chg	12.1	4.4	13.0	14.5
Net profit	2,218	2,001	2,600	2,965
% chg	3.1	(9.8)	29.9	14.0
Adj net profit	2,218	2,357	2,600	2,965
% chg	3.1	6.3	10.3	14.0
Adj. EPS (₹)	130.2	138.2	152.4	173.8
EBITDA margin (%)	22.2	24.6	24.6	24.2
P/E (x)	23.2	21.8	19.8	17.3
RoE (%)	21.9	19.7	18.7	18.2
RoCE (%)	18.1	18.7	19.2	19.3
P/BV (x)	4.6	4.0	3.4	2.9
EV/Sales (x)	3.4	3.3	2.9	2.5
EV/EBITDA (x)	15.5	13.4	11.8	10.3

Source: Company, Angel Research; Note: CMP as of May 17, 2016

BUY

CMP	₹3,015
Target Price	₹3,476

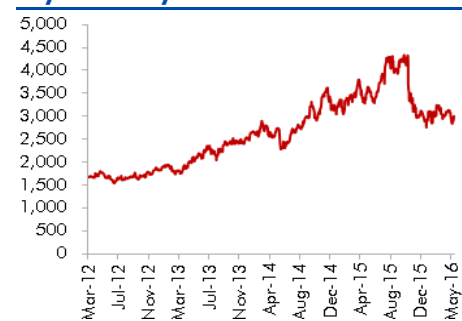
Investment Period 12 Months

Stock Info	
Sector	Pharmaceutical
Market Cap (₹ cr)	51,436
Net Debt (₹ cr)	(663)
Beta	0.7
52 Week High / Low	4,383/2,750
Avg. Daily Volume	38,816
Face Value (₹)	5
BSE Sensex	25,774
Nifty	7,891
Reuters Code	REDY.BO
Bloomberg Code	DRRD@IN

Shareholding Pattern (%)	
Promoters	25.6
MF / Banks / Indian Fls	9.5
FII / NRIs / OCBs	56.7
Indian Public / Others	8.2

Abs. (%)	3m	1yr	3yr
Sensex	10.2	(5.7)	27.1
Dr Reddy	1.8	(13.7)	45.1

3-year Daily Price Chart



Source: Company, Angel Research

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Exhibit 1: 4QFY2016 performance (IFRS, consolidated)

Y/E March (₹ cr)	4QFY2016	3QFY2016	% chg (QoQ)	4QFY2015	% chg (yoy)	FY2016	FY2015	% chg
Net sales	3,756	3,968	(5.3)	3,870	(3.0)	15,471	14,819	4.4
Other income	(234)	6	-	(11)	-	(183)	260	-
Total income	3,522	3,792	(7.1)	3,860	(8.7)	15,287	15,079	1.4
Gross profit	2,431	2,636	(7.8)	2,309	5.3	10,262	9,288	10.5
Gross margin (%)	64.7	66.4		59.7		66.3	62.7	
SG&A expenses	1,163	1,204	(3.4)	1,008	15.4	4,570	4,259	7.3
R&D expenses	488	410	19.1	514	(5.2)	1,783	1,745	2.2
EBDITA	844	1,023	(17.4)	787	7.3	3,909	3,284	19.0
EBDITA (%)	22.5	25.8	-	20.3		25.3	22.2	-
Depreciation	303	277	9.4	187.2	62.0	1,034.3	747.4	(75.0)
Interest	-	-	-	-	-	-	-	-
PBT	307	752	(59.1)	589	(47.8)	2,691	2,797	(78.9)
Tax	174	179	(2.7)	74	134.4	713	598	19.2
Net Profit	133	573	(76.7)	515	(74.1)	1,978	2,199	(10.0)
Share of profit/ (loss) in associates	5.9	6.4	(7.8)	4.3		22.9	19.5	
Reported net profit before exceptional	75	579	(87.1)	519	(85.6)	2,001	2,218	(9.8)
Exceptional items (loss) /profit	(431)	-		-		(509)	-	
Reported PAT	75	579	(87.1)	519	(85.6)	2,001	2,218	(9.8)
Adj. Net Profit	376	579	(35.0)	519	(27.5)	2,357	2,218	6.3
EPS (₹)	22.2	34.1		30.6		138.8	130.6	

Source: Company, Angel Research

Exhibit 2: Actual vs Estimates

(₹ cr)	Actual	Estimates	Variation (%)
Net sales	3,756	4,500	(16.5)
Other income	(234)	20	-
Operating profit	844	1,002	(15.7)
Tax	174	296	(41.3)
Adj. Net profit	376	729	(48.4)

Source: Company, Angel Research

Revenue lower than expectation: The company posted a 3.0% yoy de-growth in sales to ₹3,756cr V/s ₹4,500cr expected and V/s ₹3,870cr in 4QFY2015. The sales dip mainly happened owing to flat global generics and a 22% dip in the PSAI segment.

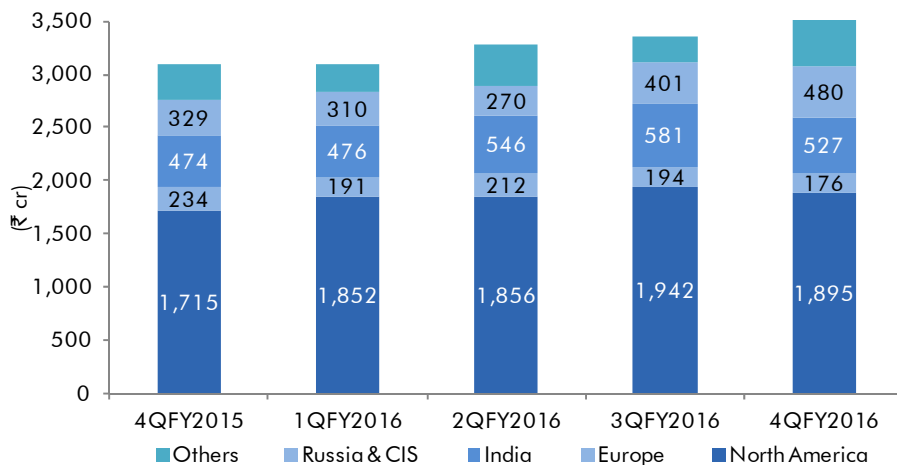
In the generic segment (accounting for 82% of sales), the US (₹1,890cr) grew by 12% yoy, Europe (₹176cr) de-grew by 18.0% yoy, India (₹527cr) grew by 11.0% yoy, while Emerging Markets (including Russia & CIS; ₹479cr) de-grew by 31% yoy.

The India business delivered double digit growth for the eight consecutive quarter on account of sustained improvement in the performance of the top brands. According to AIOCD, Dr Reddy's growth in domestic market was at 22% (secondary market data) for the Jan-Mar'2016 quarter, much ahead of industry yoy growth of 9.3%.

In the PSAI segment (15% of sales) - US de-grew by 60% yoy and ROW grew by 18% yoy. Europe de-grew by 2% yoy while India dipped by 10% yoy, during the quarter. Proprietary Products & Others (₹102cr) posted a yoy growth of 79%.

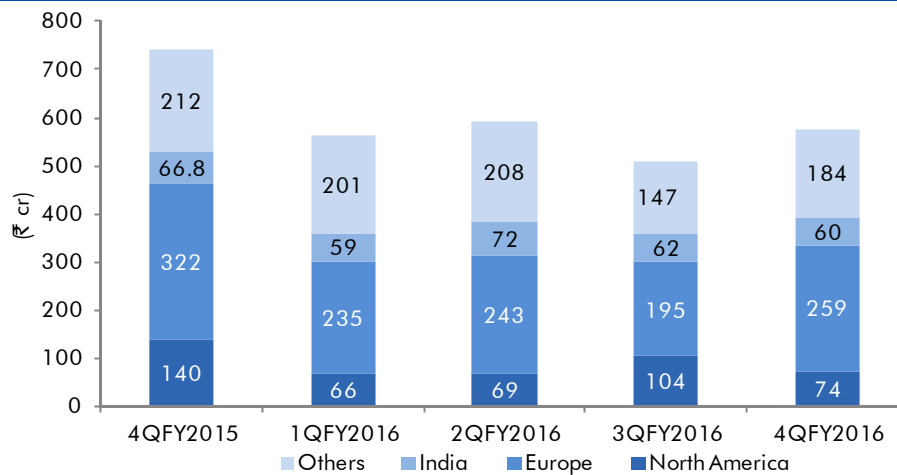
During FY2016, DRL filed for 14 new products in the US, taking the cumulative ANDA filings to 230. Pending ANDAs stands at 82 including 52 Para IVs of which 18 are FTFs.

Exhibit 3: Trend in Global generics



Source: Company, Angel Research

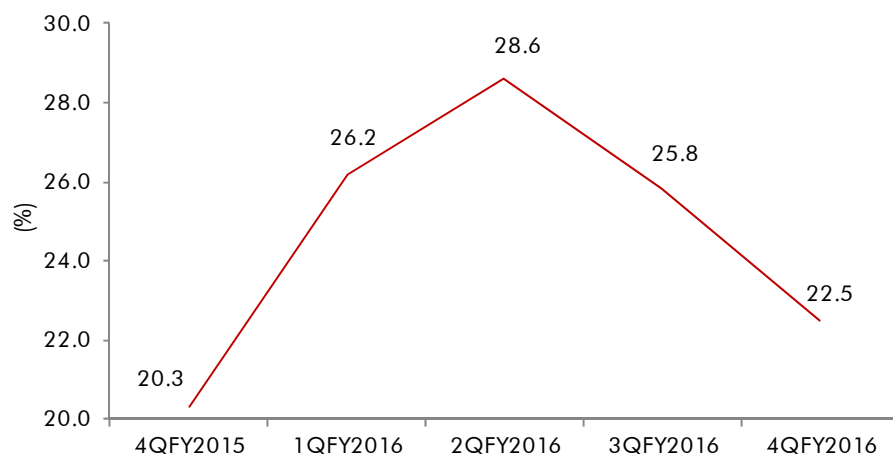
Exhibit 4: PSAI trend



Source: Company, Angel Research

EBITDA dips yoy: On the operating front, the EBITDA margin came in at 22.5% V/s 28.9% expected and V/s 20.3% in 4QFY2015, weighed down by lower than expected sales and 15.4% yoy growth in SG&A expenditure. R&D expenditure for the quarter was 13.0% of sales V/s 13.3% in 4QFY2015.

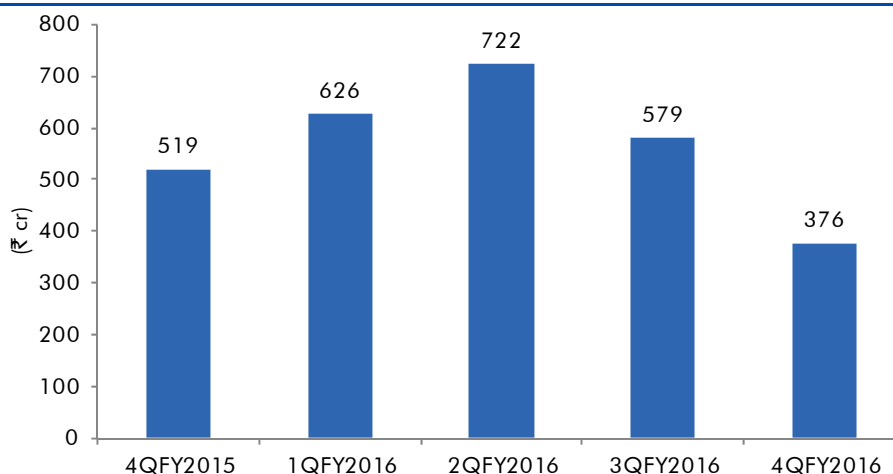
Exhibit 5: EBITDA margin trend (%)



Source: Company, Angel Research

Net profit lower than expected: Consequently, the net profit came in at ₹376cr V/s ₹729cr expected and V/s ₹519cr in 4QFY2015, a yoy de-growth of 27.5%. This was owing to Venezuela related write offs of ₹430cr; the reported net profit came in at ₹75cr v/s ₹519cr in 4QFY2015, a de-growth of 85.6% yoy.

Exhibit 6: Adjusted net profit trend



Source: Company, Angel Research

Concall takeaways

- DRL provided 1st and 2nd update to USFDA on 28th Jan and 30th Mar 2016. The company intends to finish the remediation procedure by 1QFY2017 end.
- Russia business is to see revival in 2HFY2016.
- Capex for FY2017 & FY2018 expected to be ~₹1,200cr and should come down thereafter.

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 (82 ANDAs are pending approval, of which, 52 are Para IVs and 18 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. On back of the import alert on the three facilities of the company, on worst case scenario, we expect the ex-exclusivity US sales to post a CAGR of ~16.4% during FY2016-18E.

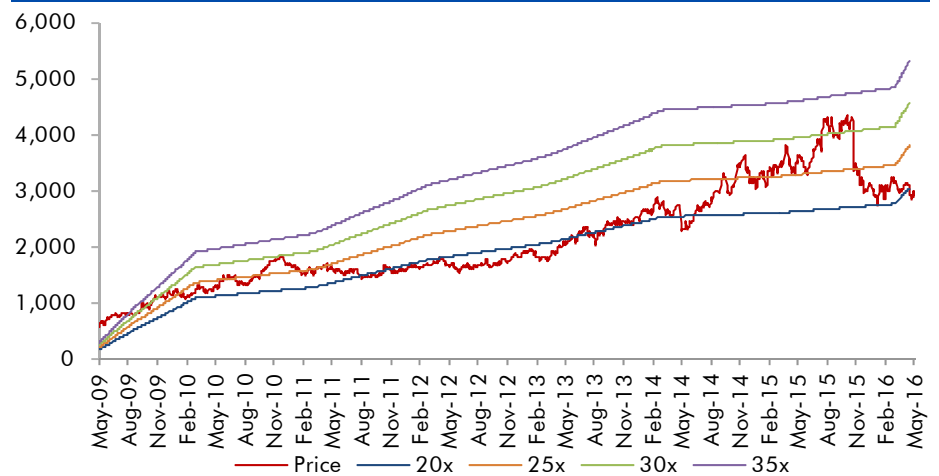
Domestic back in focus: DRL reported a 19.0% yoy growth in FY2016. The Management expects the company's performance to rebound and targets to achieve an above industry growth rate going ahead, driven by a) field force expansion and improvement in productivity, b) new product launches (including biosimilars) 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 ~16.0% over FY2016-18E.

Valuation: We expect net sales to grow at a CAGR of 12.8% to ₹20,021cr and adjusted EPS to record an 12.2% CAGR to ₹173.8 over FY2016-18E. The stock has seen severe beating post the import alert from the USFDA. Considering the valuations, we **recommend a Buy with a reduced price target of ₹3,476.**

Exhibit 7: Key assumptions

	FY2017E	FY2018E
PSAI segment growth (%)	0.3	1.2
Generics segment growth (%)	15.0	16.4
Operating margin (%)	24.6	24.2
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 (%)	FY2017E			FY15-17E	FY2017E	
					PE (x)	EV/Sales (x)	EV/EBITDA (x)	CAGR in EPS (%)	RoCE (%)	RoE (%)
Alembic Pharma	Neutral	573	-	-	20.0	2.7	14.1	11.4	23.5	21.3
Aurobindo Pharma	Accumulate	776	856	10.3	18.1	2.9	12.7	15.6	23.5	30.2
Cadila Healthcare	Accumulate	321	352	9.5	18.3	2.7	12.5	24.6	25.2	29.0
Cipla	Buy	525	605	15.3	19.1	2.5	13.4	18.3	16.7	16.1
Dr Reddy's	Buy	3,015	3,476	15.3	19.8	2.9	11.8	6.8	19.2	18.7
Dishman Pharma	Neutral	158	-	-	15.8	1.7	7.9	15.9	9.4	11.0
GSK Pharma*	Neutral	3,429	-	-	50.2	8.8	39.8	6.6	33.7	34.3
Indoco Remedies	Neutral	265	-	-	19.4	2.1	11.6	23.0	19.7	19.7
Ipca labs	Buy	452	750	66.1	16.1	1.7	9.1	17.9	11.8	14.9
Lupin	Neutral	1,613	-	-	23.6	4.0	15.0	13.1	29.6	24.7
Sanofi India	Accumulate	4,305	4,738	10.1	28.0	3.9	22.3	34.2	21.0	25.6
Sun Pharma	Buy	800	950	18.8	29.7	5.2	17.0	8.4	15.8	16.6

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 key therapeutic focus is on gastro-intestinal, cardiovascular, diabetology, oncology, pain management, anti-infective and paediatrics. The key markets for DRL include India, USA, Russia & CIS, and Germany.

Profit & loss statement (IFRS Consolidated)

Y/E March	FY2013	FY2014	FY2015	FY2016E	FY2017E	FY2018E
Net sales	11,627	13,217	14,819	15,471	17,479	20,021
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	17,567	20,108
% chg	21.8	12.5	11.6	4.3	12.9	14.5
Total expenditure	8,951	10,096	11,535	11,669	13,186	15,184
Cost of revenues	4,825	4,977	5,531	5,315	6,071.51	7,035.66
SG&A expenses	3,358	3,878	4,259	4,570	5,017	5,746
R&D expenses	767.3	1,240.2	1,744.9	1,783.4	2,097.5	2,402.5
EBITDA	2,676	3,121	3,284	3,802	4,294	4,837
% chg	3.0	16.6	5.2	15.8	12.9	12.6
(% of Net Sales)	23.0	23.6	22.2	24.6	24.6	24.2
Depreciation & amortisation	743.7	659.8	747.4	927.4	990.1	1,052.8
EBIT	1,932	2,462	2,537	2,875	3,304	3,784
% chg	4.3	27.4	3.1	13.3	14.9	14.5
(% of Net Sales)	16.6	18.6	17.1	18.6	18.9	18.9
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	3,414	3,894
% chg	14.7	19.0	5.9	-3.6	25.8	14.1
Extraordinary expense/(Inc.)	68.8	-	-	508.5	-	-
PBT (reported)	2,167.7	2,660.6	2,816.3	2,714.0	3,413.9	3,894.3
Tax	490.0	509.4	598.4	712.7	813.8	929.1
(% of PBT)	22.6	19.1	21.2	26.3	23.8	23.9
PAT (reported)	1,677.7	2,151.2	2,217.9	2,001.3	2,600.1	2,965.1
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	2,600.1	2,965.1
ADJ. PAT	1,750.0	2,151.2	2,217.9	2,357.0	2,600.1	2,965.1
% chg	17.0	22.9	3.1	6.3	10.3	14.0
(% of Net Sales)	14.4	16.3	15.0	12.9	14.9	14.8
Basic EPS (₹)	103.1	126.7	130.2	138.2	152.4	173.8
Fully Diluted EPS (₹)	103.1	126.7	130.2	138.2	152.4	173.8
% chg	16.8	22.9	2.7	6.1	10.3	14.0

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	14,949	17,515
Shareholders funds	7,309	9,080	11,130	12,834	15,034	17,600
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	18,273	20,839
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	10,087	12,149
Cash	513.6	845	539	492	660	1,358
Loans & Advances	697.6	793.0	889.1	928.2	1,048.8	1,201.3
Other	5,664	6,228	7,129	7,045	8,378	9,590
Current liabilities	3,252	3,006	4,214	4,193	4,813	5,510
Net Current Assets	3,623	4,860	4,344	4,273	5,273	6,639
Other Assets	-	-	76	106	106	106
Total Assets	11,068	13,361	14,683	16,073	18,273	20,839

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	3,414	3,894
Depreciation	744	660	747	927	990	1,053
(Inc)/Dec in Working Capital	535	(906)	211	24	(833)	(668)
Less: Other income	46	40	168	(271)	-	-
Direct taxes paid	490	509	598	713	814	929
Cash Flow from Operations	2,980	1,865	3,008	3,224	2,758	3,350
(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)	168	698
Opening Cash balances	738	514	845	539	492	660
Closing Cash balances	514	845	539	492	660	1,358

Key ratios

Y/E March	FY2013	FY2014	FY2015	FY2016	FY2017E	FY2018E
Valuation Ratio (x)						
P/E (on FDEPS)	29.3	23.8	23.2	21.8	19.8	17.3
P/CEPS	21.1	18.2	17.3	17.6	14.3	12.8
P/BV	7.0	5.6	4.6	4.0	3.4	2.9
Dividend yield (%)	0.5	0.5	0.5	0.5	0.5	0.5
EV/Sales	4.5	4.0	3.4	3.3	2.9	2.5
EV/EBITDA	19.7	16.7	15.5	13.4	11.8	10.3
EV / Total Assets	4.8	3.9	3.5	3.2	2.8	2.4
Per Share Data (₹)						
EPS (Basic)	103.1	126.7	130.2	138.2	152.4	173.8
EPS (fully diluted)	103.1	126.7	130.2	138.2	152.4	173.8
Cash EPS	142.6	165.5	174.0	171.7	210.4	235.5
DPS	15.0	15.0	15.0	15.0	15.0	15.0
Book Value	430.4	534.7	653.3	752.3	881.3	1,031.7
Dupont Analysis						
EBIT margin	16.6	18.6	17.1	18.6	18.9	18.9
Tax retention ratio	77.4	80.9	78.8	73.7	76.2	76.1
Asset turnover (x)	1.2	1.2	1.1	1.0	1.1	1.1
ROIC (Post-tax)	14.9	17.4	15.1	14.3	15.2	15.6
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	18.6	18.2
Returns (%)						
ROCE (Pre-tax)	17.8	20.2	18.1	18.7	19.2	19.3
Angel ROIC (Pre-tax)	23.1	25.6	22.5	22.9	23.4	23.5
ROE	26.8	26.3	21.9	19.7	18.7	18.2
Turnover ratios (x)						
Asset Turnover (Gross Block)	3.3	3.5	3.6	3.2	2.9	2.8
Inventory / Sales (days)	63	62	61	60	61	64
Receivables (days)	88	89	90	96	88	93
Payables (days)	44	40	43	59	43	42
WC cycle (ex-cash) (days)	104	97	96	89	87	90
Solvency ratios (x)						
Net debt to equity	0.4	0.4	0.3	0.2	0.2	0.1
Net debt to EBITDA	1.2	1.2	1.0	0.8	0.7	0.5
Interest Coverage (EBIT / Int.)	-	-	-	-	-	-

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Disclosure of Interest Statement

Dr. Reddy's Laboratories

1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹1 lakh for Angel, its Group companies and Directors

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%)