

Topline grows with volumes and new launches across markets



Sequential price erosion in US, gNUVARING impairment impact profitability

- Adj. Sales +13% yoy/+0.7% qoq Rs 49.3 bn, in line with our estimate of 49.2 bn, growth driven by India (+26%), US (+29%), EU (+34%) and ROW.
- EBITDA +10% yoy to Rs 11.9 bn, due to +13% material costs, +14% SG&A spend and +4% R&D spend.
- EBITDA margins at 24%, +50 bps yoy/-190 bps qoq
- PBT excluding one offs Rs 2692 mn -65% yoy.
- The company took an impairment of Rs 5972 mn during the quarter for gNUVARING and few more products, in view of competition and price erosion in the product. In Q3FY20, the impairment for gNUVARING was at Rs 11.1 bn.
- Adjusted PAT -64% yoy/-70% Rs 2251 mn, with an EPS of Rs 13.5.

Key Highlights

- Of the 26% India business growth, sales (ex Wockhardt) have grown 8%, implying 10% growth for the Wockhardt brands.
- The company has successfully integrated the Wockhardt salesforce and is working on productivity improvement.
- Sequential 5% degrowth in US due to demand slowdown in view of lower patient footfalls in hospitals.
- The company has submitted its response to the USFDA for gNUVARING, gCopaxone & gREVLIMID.
- Dr. Reddy's is progressing well in its Phase III trials in India on 1600 subjects for Sputnik vaccine for Covid19. The phase III trial on 33760 subjects in Russia has been closed. Interim efficacy on 22000 subjects show 91.4% efficacy meeting safety & efficacy norms for the same.
- Sputnik vaccine has received Emergency use authorization in 12 countries in Europe, Asia, LATAM and Africa.
- In view of the impairment for gNUVARING we have revised our PAT estimates for FY21E/FY22E and FY23E downwards by 25%/10%/10%.

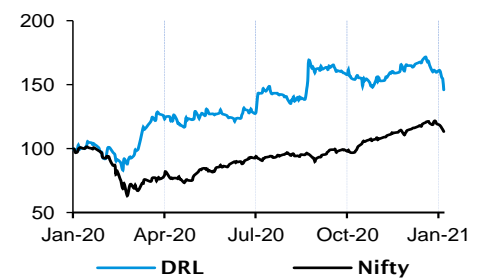
Rating	TP (Rs)	Up/Dn (%)
BUY	5613	22

Market data

Current price	Rs	4,599
Market Cap (Rs.Bn)	(Rs Bn)	765
Market Cap (US\$ Mn)	(US\$ Mn)	10498
Face Value	Rs	5
52 Weeks High/Low	Rs	5515/2498
Average Daily Volume	('000)	1090
BSE Code		500124
Bloomberg		DRRD:IN

Source: Bloomberg

One Year Performance



Source: Bloomberg

% Shareholding	Dec-20	Sep-20
Promoters	26.73	26.74
Public	73.05	73.03
Others	0.22	0.23
Total	100	100

Source: BSE

Y/E Mar (Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
Net sales	1,54,482	1,75,170	1,94,528	2,14,858	2,40,059
Adjusted net prof	19,500	20,340	28,791	35,764	43,450
Vs Consensus			5%	10%	10%
Free cash flow	23,797	31,830	19,908	24,299	35,490
EPS (Rs)	117.5	122.4	173.2	215.2	261.4
growth (%)	106.0	4.3	41.5	24.2	21.5
P/E (x)	39.7	38.1	26.9	21.7	17.8
P/B (x)	5.5	5.0	4.4	3.8	3.1
EV/EBITDA (x)	25.3	18.7	15.3	12.7	10.5
D/E	0.2	0.1	0.1	0.1	0.1
RoIC (%)	13.6	14.5	18.9	21.4	24.3
RoE (%)	13.9	13.0	16.4	17.6	17.6
Dividend yield (%)	0.6	1.0	1.0	1.0	1.0

Source: Company

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Conference Call Key Takeaways

Operational Highlights

- Revenue by geographies
- **India:** Rs 9.6 bn (+26% yoy/+5% qoq) due to Wockhardt acquisition and new launches in the Indian market. Excluding Wockhardt, sales growth is at 8%. Sequential 5% growth was driven by higher volumes.
- **US:** Rs 17.4 bn (+9% yoy/-5% qoq), due to volume growth in base business, 4 new product launches, currency benefit, partially **offset by price erosion**.
- The company has 89 ANDAs pending approval, of which 48 are Para IVs and 28 FTFs.
- The company has submitted its response to the USFDA for gNUVARING and continues to work on gCopaxone & gREVLIMID.
- **Russia & CIS:** Rs 6.6 bn (-1.5% yoy/+10% qoq). Degrowth (-8%) in Russia from weaker Ruble, despite better volumes and sequential recovery. CIS grew 18% yoy/+8% qoq due to higher volumes and new launches.
- **ROW:** Rs 3 bn (+21% yoy/+10% qoq), due to new launches and better volumes.
- **Europe** Rs 4.1 bn (+34% yoy/+10% qoq), due to new launches and favourable forex, and higher volumes.
- **PSAI** Rs 7 bn (+2% yoy), due to new products and currency benefit, new launches offset by lower volumes in some products.
- **Proprietary Products** Rs 1536 mn, +53% yoy due to milestone income on AUR102
- Gross margins: 53.8% (-30 bps yoy/-10 bps qoq) due to price erosion and lower export incentives.
- SG & A +14% due to a larger share of airlifting, one time litigation expenses and higher freight.
- R & D spend: Rs 4.1 bn – 8.3% of sales.
- Capex Rs 2.9 bn.
- Net Cash Rs 839 mn.
- Free Cash Flow – net outflow of Rs 580 mn to Glenmark for acquisition of 5 anti-allergy brands for Russia & CIS.

Better volumes in India drive 5% sequential growth.

Sequential degrowth in US due to price erosion & demand slowdown due to lower footfalls at the hospitals.

Muted PSAI growth due to lower volumes in some products.

Quarterly Performance Analysis

Exhibit 1

Particulars	Q3FY21	Q2FY21	Q3FY20	% yoy	% qoq	9MFY21	9MFY20	% Change
Net Income from Sales & Services	49296	48967	43838	12%	1%	142438	130283	9%
Gross Profit	26538	26409	23722	12%	0%	77702	71202	
GPM (%)	53.8%	53.9%	54.1%			54.6%	54.7%	
SG&A expenses	-14387	-13107	-12670	14%	10%	-40280	-38012	
R&D Expenses	-4108	-4359	-3949			-12447	-11220	
EBIDTA excl one offs	11852	12673	-2463		-6%	36148	26676	36%
EBIDTA (%)	24.0%	25.9%	-6.7%			25.4%	20.5%	
Other Income	128	149	228			395	4122	-90%
Impairment	-5972	-781	-13200			-6753	-16700	
EBIT	2199	8311	-5869			18617	9392	98%
Interest	493	237	419			1335	1043	
PBT excl. one offs	2692	8548	-2654		-69%	19952	29755	
Profit before tax	2692	8548	-5450			19952	10435	91%
Tax	-2645	-998	-423			-6639	966	
Profit After tax before MI	47	7550	-5873			13313	11401	17%
Share of Profit	151	73	176			301	456	
Profit After Tax	198	7623	-5697		-97%	13614	11857	15%
NPM (%)	0.40%	15.57%	-13.00%			9.56%	9.10%	
Equity	830.6	830.6	830.6			830.6	830.6	
Number of shares	166.12	166.12	166.12			166.12	166.12	
EPS excl exceptional	13.55	45.89	37.45			94.3	106	
EPS -(Rs)	1.19	45.89	-34.29			82.0	71	

Source: Dalal & Broacha Research, Company

Robust revenue growth across markets

Impact on profitability due to higher SG &A and R & D.

Valuation & Outlook

The impairment of gNUVARING and sequential degrowth in the US came in as a major negative for Dr. Reddy's. The management is confident of sustaining profitability at 24%-25% going forward. With promising results for the Sputnik vaccine in Russia and ongoing trials in India, there is possibility of the vaccine being a success. Further with high value assets like gREVLIMID, gCOPAXONE, gNUVARING and some more, we believe the lower bottomline will reverse in a few quarters.

We have revised our estimates in view of the impairment.

At Rs 4600, Dr. Reddy's trades at 20x FY23E EPS of Rs 236. We have valued Dr. Reddy's as weighted average of 15xEV/EBITDA (50%) and 22x P/E (50%) and arrived at a target price of Rs 5613.

The stock has significantly corrected after the results. We maintain BUY rating on the stock.

Financial

P&L (Rs mn)	FY19	FY20	FY21E	FY22E	FY23E	Cash Flow St. (Rs. mn)	FY19	FY20E	FY21E	FY22E	FY23E
Net Sales	1,54,482	1,75,170	1,94,528	2,14,858	2,40,059	Net Profit	19,500	20,340	28,791	35,764	43,450
Other operating income						Add: Dep. & Amort.	11,348	11,631	12,287	13,272	13,929
Raw materials	(44,948)	(55,070)	(63,687)	(70,476)	(78,916)	Cash profits	30,848	31,971	41,078	49,036	57,379
Employee costs	(33,562)	(33,802)	(34,478)	(35,512)	(36,578)	(Inc)/Dec in					
Other Expenses	(44,190)	(44,353)	(45,684)	(47,968)	(52,765)	-Sundry debtors	714	(12,033)	(7,549)	(6,350)	(7,893)
Cost of sales	(1,22,700)	(1,33,225)	(1,43,848)	(1,53,957)	(1,68,258)	-Inventories	(4,490)	(1,488)	(4,237)	(4,190)	(5,208)
Operating Profit	31,782	41,945	50,680	60,902	71,801	-Loans/advances	(834)	(2,010)	(224)	(235)	(247)
Depreciation	(11,348)	(11,631)	(12,287)	(13,272)	(13,929)	-Sundry creditors	326	1,577	1,474	1,783	2,216
Impairment	-	(17,160)	-	-	-	-Others	3,636	2,409	40	30	19
PBIT	20,434	13,154	38,392	47,630	57,872	Change in working capita	(648)	(11,545)	(10,497)	(8,963)	(11,114)
Other income	3,375	6,206	496	546	601	CF from Oper. activities	30,200	20,426	30,581	40,074	46,265
Interest	(889)	(983)	(892)	(892)	(803)	CF from Inv. activities	(10,954)	4,989	(6,220)	(29,346)	(26,488)
Profit before tax	22,920	18,377	37,997	47,284	57,670	CF from Fin. activities	(22,647)	(46,498)	(10,983)	(11,451)	(3,262)
Provision for tax	(3,858)	1,402	(9,879)	(12,294)	(14,994)	Cash generated/(utilise	(3,401)	(21,083)	13,378	(723)	16,515
PAT Bfr Excp Items	19,062	19,779	28,118	34,990	42,676	Cash at start of the year	7,205	5,628	6,432	19,810	19,087
Share of Profit	438	561	673	774	774	Cash at end of the year	5,628	6,432	19,810	19,087	35,602
Net Profit	19,500	20,340	28,791	35,764	43,450						

Balance Sheet	FY19	FY20	FY21E	FY22E	FY23E	Ratios	FY19	FY20	FY21E	FY22E	FY23E
Equity capital	830	831	831	831	831	OPM	20.6	23.9	26.1	28.3	29.9
Reserves	1,39,406	1,55,157	1,75,197	2,02,210	2,45,660	NPM	12.4	11.2	14.8	16.6	18.1
Net worth	1,40,236	1,55,988	1,76,028	2,03,041	2,46,491	Tax rate	(16.8)	7.6	(26.0)	(26.0)	(26.0)
Def. Tax Liab.+Minority Ir	473	20	22	24	27	Growth Ratios (%)					
Secured loans	22,000	1,304	1,304	1,304	1,304	Net Sales	8.2	13.4	11.1	10.5	11.7
Unsecured loans	12,125	16,532	16,532	16,532	16,532	Operating Profit	35.2	32.0	20.8	20.2	17.9
Total debt	34,125	17,836	17,836	17,836	17,836	PAT	106.0	4.3	41.5	24.2	21.5
Other Liabilities	2,181	2,055	2,261	2,487	2,735	Per Share (Rs.)					
CAPITAL EMPLOYED	1,77,015	1,75,899	1,96,146	2,23,388	2,67,089	Net Earnings (EPS)	117.5	122.38	173.2	215.2	261.4
Gross block	1,66,901	1,77,184	1,87,184	2,02,184	2,12,185	Cash Earnings (CPS)	185.8	192.4	247.2	295.0	345.2
Accumulated depreciation	(1,17,774)	(1,29,405)	(1,41,692)	(1,54,965)	(1,68,893)	Dividend	30.0	45.0	45.0	45.0	46.0
Net block	49,127	47,779	45,492	47,219	43,292	Book Value	844.8	938.6	1,059.1	1,221.7	1,483.1
Capital WIP	4,725	4,364	4,364	4,364	4,364	Free Cash Flow	115.9	152.9	146.6	64.5	119.0
Total fixed assets	53,852	52,143	49,856	51,583	47,656	Valuation Ratios					
Intangible assets	42,734	26,798	27,897	29,105	30,435	P/E(x)	40	38	27	22	18
Goodwill	4,659	4,913	4,913	4,913	4,913	P/B(x)	6	5	4	4	3
Investments	25,871	26,778	21,778	34,778	49,779	EV/EBIDTA(x)	25	19	15	13	11
Other non current assets	1,138	1,002	1,123	1,260	1,417	EV/SALES(x)	5	4	4	4	3
Inventories	33,579	35,067	39,304	43,495	48,703	Div. Yield(%)	1	1	1	1	1
Sundry debtors	39,982	52,015	59,564	65,914	73,807	FCF Yield(%)	2	3	3	1	3
Cash & bank	5,628	6,432	19,810	19,087	35,602	Return Ratios (%)					
Loans & advances	2,472	4,482	4,706	4,941	5,188	ROE	13.9	13.0	16.4	17.6	17.6
Other current assets	10,424	10,424	11,466	12,613	13,874	ROCE	11.5	7.5	19.6	21.3	21.7
Sundry creditors	(13,671)	(15,248)	(16,722)	(18,505)	(20,721)	ROA	11.8	11.3	14.5	16.0	16.4
Acceptances	(5,537)	(8,114)	(8,925)	(9,818)	(10,800)	ROIC	13.6	14.5	18.9	21.4	24.3
Provisions	(5,582)	(5,414)	(5,685)	(5,969)	(6,267)						
Working capital	44,444	52,066	75,941	84,181	1,11,810						
Deferred tax assets	4,317	12,199	14,639	17,567	21,080						
CAPITAL DEPLOYED	1,77,015	1,75,899	1,96,146	2,23,388	2,67,089						

Source: Dalal & Broacha Research, Company

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