

May 12, 2016

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Rating	Accumulate
Price	Rs2,971
Target Price	Rs2,993
Implied Upside	.7%
Sensex	25,790
Nifty	7,900

(Prices as on May 12, 2016)

Trading data

Market Cap. (Rs bn)	503.8
Shares o/s (m)	169.6
3M Avg. Daily value (Rs m)	1284

Major shareholders

Promoters	25.57%
Foreign	35.54%
Domestic Inst.	5.69%
Public & Other	33.20%

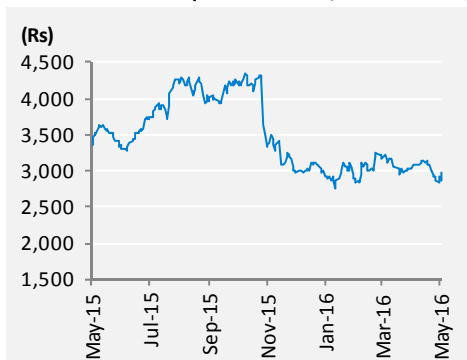
Stock Performance

(%)	1M	6M	12M
Absolute	(3.6)	(11.6)	(14.3)
Relative	(6.2)	(11.3)	(10.3)

How we differ from Consensus

EPS (Rs)	PL	Cons.	% Diff.
2017	128.4	149.8	-14.3
2018	133.4	175.7	-24.1

Price Performance (RIC: REDY.BO, BB: DRRD IN)



Source: Bloomberg

Dr Reddy's (DRL) sales, core EBITDA and core PAT were at Rs 37.5bn (-3%), Rs 9bn (+24%) and Rs 5.1bn (-3%) in Q4FY16. Overall result was below our estimates of Rs39.5bn in sales, Rs10bn in EBITDA and Rs5.7bn in PAT. Higher market share and revenues in Imitrex auto-injector and Valcyte were the major drivers of US generics in Q4FY16. With growing competitive landscape impact with price erosion in older generics, management expects launches of US generics such as gGleevec and gPalonesetron and volume growth to help maintain US sales growth in US. Prevalence of oncology injectables among the top-5 products (contributes 35% of US sales), will also help in lower price erosion in comparison to other generics in US. Dr Reddy's draws major US revenues from limited-contention injectables such as Imitrex, Reclast, Dacogen, Vidaza. We expect entry of new generics in Valcyte to impact US sales in FY17E, though management expect to compensate loss of sales with increase in volume in overall core US generics.

With marginal changes in overall sales estimates (+1% in FY17E, -2% in FY18E) and higher estimates of promotion and R&D costs, we reduce our earnings estimates by 1% in FY17E and FY18E. The management guided better visibility of new generics in US (gXeloda, gPropofolin near term) and lower remediation costs to achieve better gross and EBITDA margin in H2FY17E. With strong focus in power brands in India formulations and expansion of portfolio in Russia including launch of biosimilars, DRL will be able to maintain 6-7% consolidated sales growth, 23% EBITDA margin and 13% PAT growth in FY17E and FY18E. We maintain 'Accumulate' and retain TP at Rs2,993.

■ **Imitrex, Valcyte drive US growth by 2% in Q4FY16:** DRL's core US sales were US\$285m, increased by 2% (US\$ growth) YoY in Q4FY16 due to major sales on Valcyte and Imitrex auto-injector. DRL has also recaptured 10% market share from Sun Pharma in gImitrex post their manufacturing issues in Halol. US sales in Q4FY16 also benefitted from Nexium re-launch and branded sales of Habitrol brand. Management however cautioned that increase in number of approvals in its limited competition drugs could change scenario in near term.

Key financials (Y/e March)	2015	2016	2017E	2018E
Revenues (Rs m)	148,189	154,708	163,535	174,685
Growth (%)	12.1	4.4	5.7	6.8
EBITDA (Rs m)	34,101	39,088	37,777	39,828
PAT (Rs m)	22,823	20,013	21,913	22,750
EPS (Rs)	134.0	117.3	128.4	133.4
Growth (%)	5.9	(12.4)	9.5	3.8
Net DPS (Rs)	15.0	14.9	14.9	—

Profitability & Valuation	2015	2016	2017E	2018E
EBITDA margin (%)	23.0	25.3	23.1	22.8
RoE (%)	22.6	16.7	15.9	14.4
RoCE (%)	14.7	13.5	12.0	11.6
EV / sales (x)	3.7	3.5	3.3	3.0
EV / EBITDA (x)	16.1	13.8	14.2	13.2
PE (x)	22.2	25.3	23.1	22.3
P / BV (x)	4.5	4.0	3.4	3.0
Net dividend yield (%)	0.5	0.5	0.5	—

Source: Company Data; PL Research

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Exhibit 1: Change in Estimates

(Rs m)	Old		New		Difference	
	FY17E	FY18E	FY17E	FY18E	FY17E	FY18E
Sales	161,916	178,250	163,535	174,685	1%	-2%
EBITDA	38,547	40,641	37,777	39,828	-2%	-2%
<i>EBITDA margin</i>	<i>23.8%</i>	<i>22.8%</i>	<i>23.1%</i>	<i>22.8%</i>		
PAT	22,246	22,980	21,913	22,750	-1%	-1%
EPS (Rs)	130.4	134.7	128.4	133.4		

Source: PL Research

Exhibit 2: Q4Y16 Result Overview (Rs m)

Y/e March	Q4FY16	Q4FY15	YoY gr. (%)	Q3FY16	FY16	FY15	YoY gr. (%)
Net Sales	37,562	38,704	(3.0)	39,679	154,708	148,189	4.4
Raw Material	8,377	10,190	(17.8)	8,196	31,253	33,819	(7.6)
<i>% of Net Sales</i>	<i>22.3</i>	<i>26.3</i>		<i>20.7</i>	<i>20.2</i>	<i>22.8</i>	
Personnel Cost	7,909	7,294	8.4	7,893	31,174	28,967	7.6
<i>% of Net Sales</i>	<i>21.1</i>	<i>18.8</i>		<i>19.9</i>	<i>20.2</i>	<i>19.5</i>	
Others	13,479	12,994	3.7	13,557	53,193	51,302	3.7
<i>% of Net Sales</i>	<i>35.9</i>	<i>33.6</i>		<i>34.2</i>	<i>34.4</i>	<i>34.6</i>	
Total Expenditure	29,765	30,478	(2.3)	29,646	115,620	114,088	1.3
EBITDA	7,797	8,227	(5.2)	10,033	39,088	34,101	14.6
<i>Margin (%)</i>	<i>20.8</i>	<i>21.3</i>		<i>25.3</i>	<i>25.3</i>	<i>23.0</i>	
Depreciation	3,032	2,232	35.8	2,577	10,343	8,732	18.4
EBIT	4,765	5,995	(20.5)	7,456	28,745	25,369	13.3
Other Income	307	125	145.0	122	874	917	(4.7)
Interest	2,646	233	1,035.1	62	2,708	(1,682)	
PBT	2,426	5,887	(58.8)	7,516	26,911	27,968	(3.8)
Extra-Ord. Inc./Exps.	(59)	(44)		(64)	(229)	(195)	
Total Taxes	1,739	742	134.4	1,788	7,127	5,984	19.1
<i>ETR (%)</i>	<i>71.7</i>	<i>12.6</i>		<i>23.8</i>	<i>26.5</i>	<i>21.4</i>	
Reported PAT	746	5,189	(85.6)	5,792	20,013	22,179	(9.8)

Source: Company Data, PL Research

**Exhibit 3: Major Sources of Revenues (Rs m)**

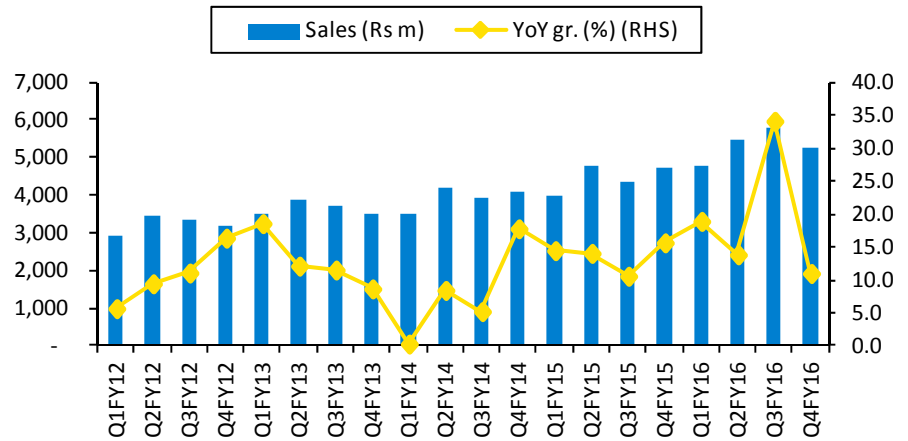
Y/e March	Q4FY16	Q4FY15	YoY gr. (%)	Q3FY16	FY16	FY15	YoY gr. (%)
PSAI (CPS & API)	5,765	7,414	(22.2)	5,082	22,379	25,456	(12.1)
<i>% of Net Sales</i>	15.3	19.2		12.8	14.5	17.2	
India	603	668	(9.7)	622	2,618	3,288	(20.4)
<i>% of Net Sales</i>	1.6	1.7		1.6	1.7	2.2	
International	5,162	6,746	(23.5)	4,460	19,761	22,168	(10.9)
<i>% of Net Sales</i>	13.7	17.4		11.2	12.8	15.0	
North America	742	1,400	(47.0)	1,037	3,052	4,605	(33.7)
<i>% of Net Sales</i>	2.0	3.6		2.6	2.0	3.1	
Europe	2,585	3,223	(19.8)	1,951	9,313	10,507	(11.4)
<i>% of Net Sales</i>	6.9	8.3		4.9	6.0	7.1	
ROW	1,835	2,123	(13.6)	1,472	7,396	7,056	4.8
<i>% of Net Sales</i>	4.9	5.5		3.7	4.8	4.8	
Branded Formulation	30,775	30,993	(0.7)	33,558	128,062	120,556	6.2
India	5,267	4,744	11.0	5,805	21,293	17,870	19.2
<i>% of Net Sales</i>	14.0	12.3		14.6	13.8	12.1	
International	25,508	26,249	(2.8)	27,753	106,769	102,686	4.0
<i>% of Net Sales</i>	67.9	67.8		69.9	69.0	69.3	
Russia & CIS	3,100	3,289	(5.7)	4,000	14,100	17,713	(20.4)
<i>% of Net Sales</i>	8.3	8.5		10.1	9.1	12.0	
Europe	1,759	2,341	(24.9)	1,937	7,732	7,193	7.5
<i>% of Net Sales</i>	4.7	6.0		4.9	5.0	4.9	
North America Generics	18,950	17,154	10.5	19,417	75,445	64,723	16.6
<i>% of Net Sales</i>	50.4	44.3		48.9	48.8	43.7	
Emerging Mkt Generics	1,699	3,465	(51.0)	2,399	9,492	13,057	(27.3)
<i>% of Net Sales</i>	4.5	9.0		6.0	6.1	8.8	
Innovative Prod. (Proprietary Prod.)	1,022	296	245.3	1,039	4,267	2,177	96.0
<i>% of Net Sales</i>	2.7	0.8		2.6	2.8	1.5	
Net Sales	37,562	38,703	(2.9)	39,679	154,708	148,189	4.4

Source: Company Data, PL Research

Key takeaways from conference call

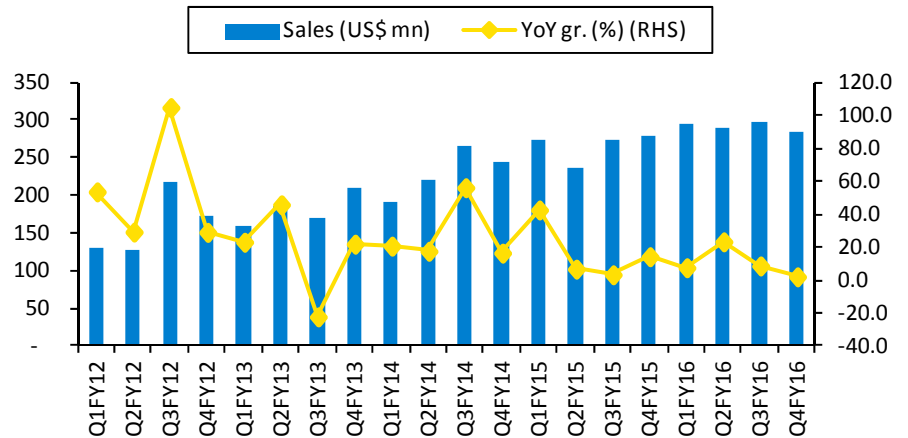
- Management highlighted that growing completion in US generics, absence of new launches due manufacturing issues in three Indian plants, lower PSAI sales and lower institutional oncology business in India were the reasons for 3% decline in consolidated sales in Q4FY16
- PSAI sales growth remains uncertain on delay in dispatch of drugs due to remediation measures in Srikakulam plant in Q4FY16. Its 22% decline in PSAI sales was also caused by competition of a partner's products (with profit sharing) which was crowded with new entry of generics
- Domestic formulations growth is driven by strong traction of core portfolio and benefits of UCB portfolio in Q4FY16. The contribution of NLEM drugs in domestic portfolio is lower for DRL than its peers. Management expect strong momentum to continue in coming quarters. We estimates sustainable growth of 15% in FY17E and FY18E
- With expectation of lower number of approvals, DRL expects US launch of 4-6 which are not dependent on Srikakulam API plant. Management guided that completion of site-transfer for 4-6 key products from Srikakulam plants will help to launch key drugs such as Gleevec (in August), Propofol (H2FY17) and Xeloda (H2FY17) in near term
- DRL's application of three NDA received approval in Jan-Feb 2016 though it is not expected for sizeable contribution in first year of launch. With current sales force of 50 reps, DRL launched Zembrace in April 2016 and plans to launch Cornio in June 2016. The company does not require additional reps for derma products, while it requires new sales team for its CNS drugs.
- DRL submitted data and communicated with USFDA at regular intervals and completed its response on CAPA on all the three plants (for which Warning Letter issued) in January 2016. Next quality update in its plants to be completed in May 2016 and USFDA is expected to be invited for plant visit in September 2016
- Management guided capex of Rs12bn each in FY17E and FY18E and effective tax rate to be 21-22% in next 24 months

Exhibit 4: India Formulations: Sales and Growth



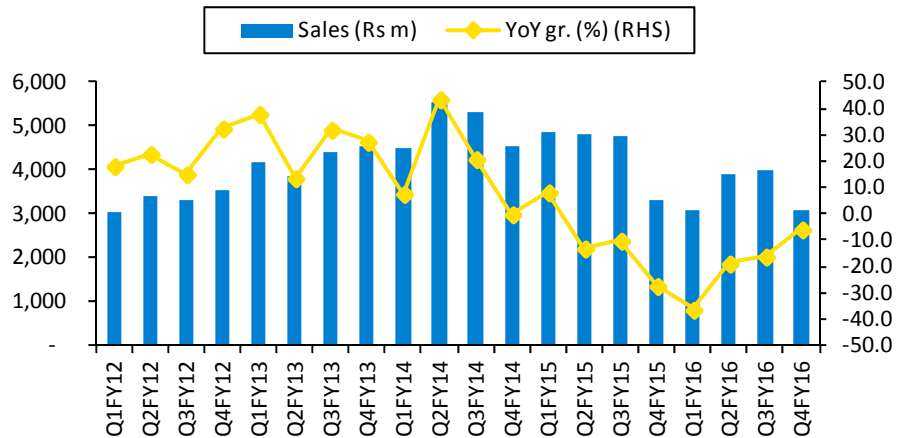
Source: Company Data, PL Research

Exhibit 5: US Generics (US\$ m): sales and growth



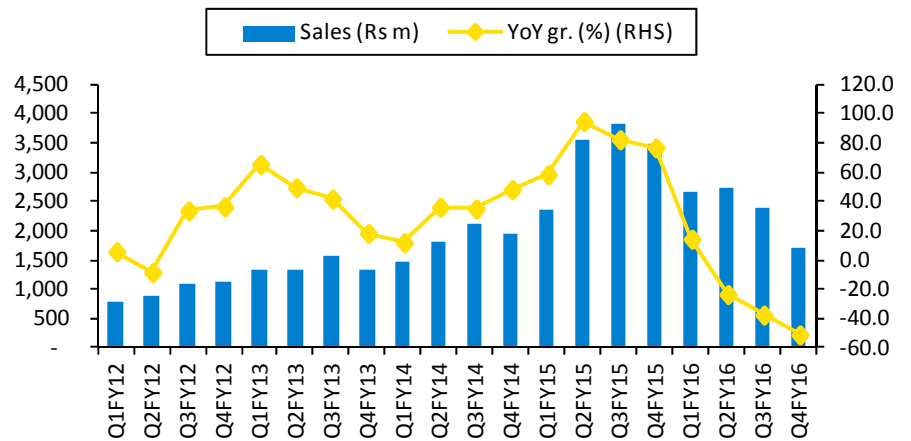
Source: Company Data, PL Research

Exhibit 6: Russia and CIS Sales and growth



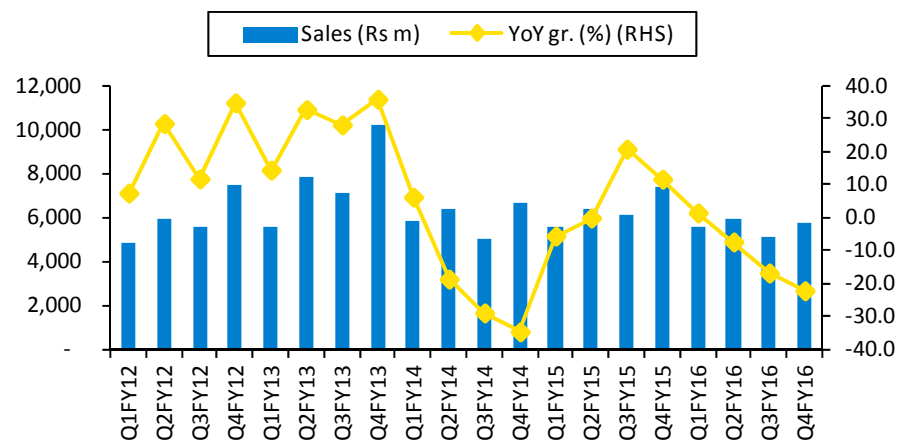
Source: Company Data, PL Research

Exhibit 7: Emerging mkt: Sales and growth



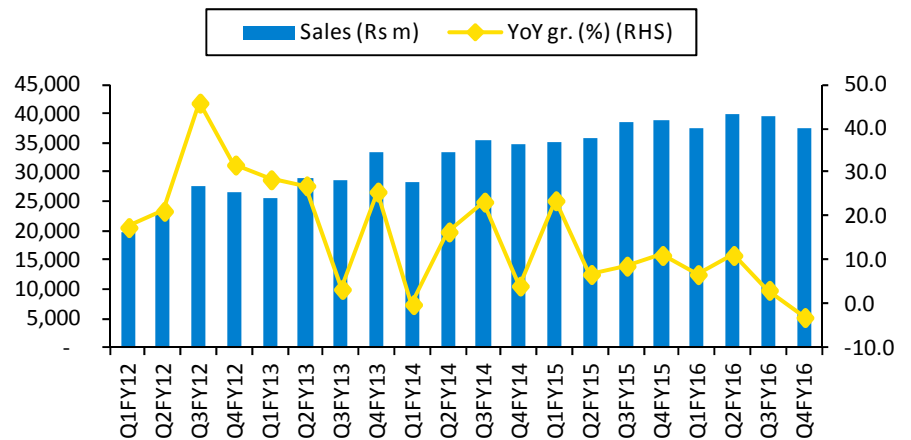
Source: Company Data, PL Research

Exhibit 8: PSAI: Sales and growth (Rs m)



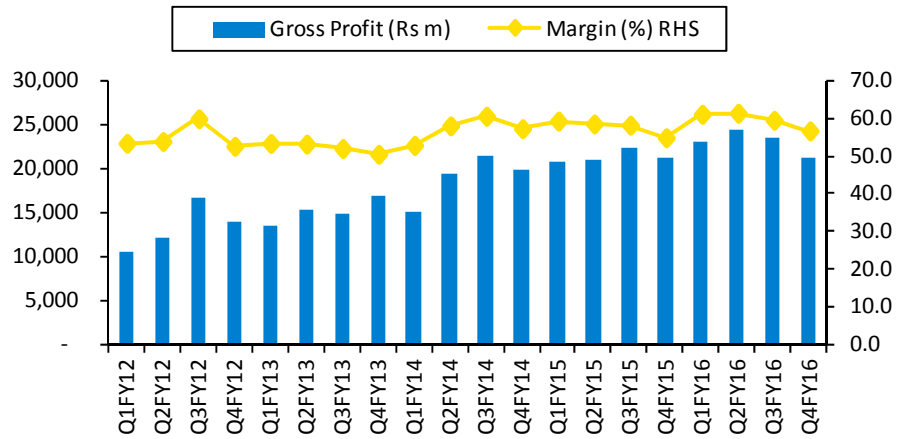
Source: Company Data, PL Research

Exhibit 9: Overall Sales and Growth



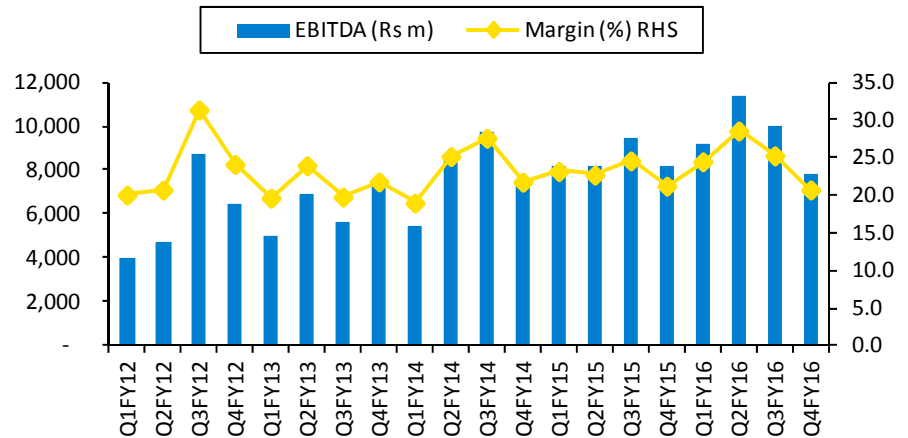
Source: Company Data, PL Research

Exhibit 10: Gross profit and Margin



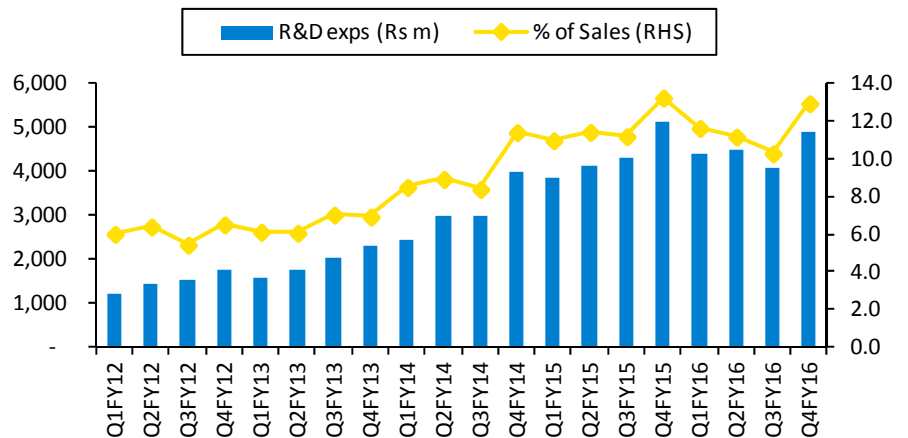
Source: Company Data, PL Research

Exhibit 11: EBITDA and margin



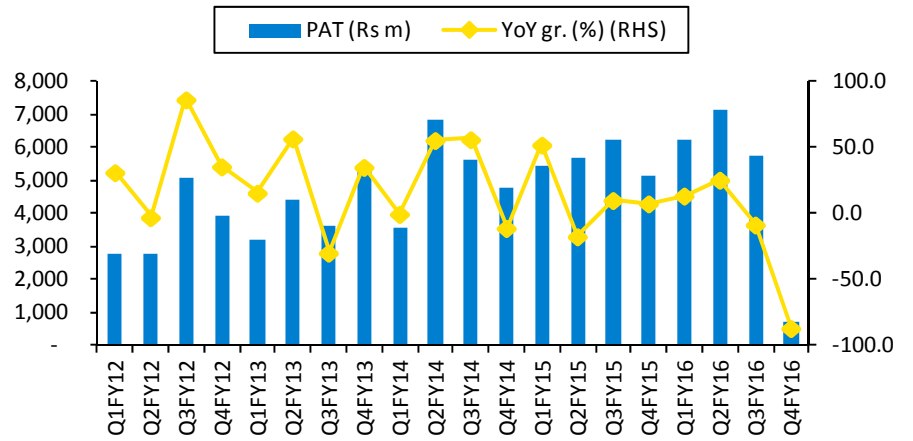
Source: Company Data, PL Research

Exhibit 12: R&D exps and % of sales



Source: Company Data, PL Research

Exhibit 13: PAT and growth



Source: Company Data, PL Research

Income Statement (Rs m)

Y/e March	2015	2016	2017E	2018E
Net Revenue	148,189	154,708	163,535	174,685
Raw Material Expenses	33,819	31,253	32,707	35,286
Gross Profit	114,370	123,455	130,828	139,398
Employee Cost	28,967	31,174	34,342	36,684
Other Expenses	51,302	53,193	58,709	62,887
EBITDA	34,101	39,088	37,777	39,828
Depr. & Amortization	5,722	6,874	7,472	8,326
Net Interest	(1,682)	2,708	(1,514)	(1,211)
Other Income	3,927	4,343	5,687	5,933
Profit before Tax	33,988	33,849	37,505	38,646
Total Tax	5,340	7,127	6,002	5,866
Profit after Tax	28,648	26,722	31,503	32,780
Ex-Od items / Min. Int.	195	229	—	—
Adj. PAT	22,823	20,013	21,913	22,750
Avg. Shares O/S (m)	170.4	170.6	170.6	170.6
EPS (Rs.)	134.0	117.3	128.4	133.4

Cash Flow Abstract (Rs m)

Y/e March	2015	2016	2017E	2018E
C/F from Operations	25,033	46,948	22,658	41,507
C/F from Investing	(22,904)	(21,120)	(19,716)	(22,011)
C/F from Financing	(4,118)	(9,056)	(4,551)	(10,776)
Inc. / Dec. in Cash	(1,989)	16,771	(1,610)	8,719
Opening Cash	8,451	5,394	22,165	20,555
Closing Cash	5,394	22,165	20,555	29,275
FCFF	18,290	19,895	6,461	20,232
FCFE	18,177	10,119	5,531	12,498

Key Financial Metrics

Y/e March	2015	2016	2017E	2018E
Growth				
Revenue (%)	12.1	4.4	5.7	6.8
EBITDA (%)	9.2	14.6	(3.4)	5.4
PAT (%)	6.1	(12.3)	9.5	3.8
EPS (%)	5.9	(12.4)	9.5	3.8
Profitability				
EBITDA Margin (%)	23.0	25.3	23.1	22.8
PAT Margin (%)	15.4	12.9	13.4	13.0
RoCE (%)	14.7	13.5	12.0	11.6
RoE (%)	22.6	16.7	15.9	14.4
Balance Sheet				
Net Debt : Equity	0.4	0.2	0.2	0.1
Net Wrkng Cap. (days)	229	221	255	253
Valuation				
PER (x)	22.2	25.3	23.1	22.3
P / B (x)	4.5	4.0	3.4	3.0
EV / EBITDA (x)	16.1	13.8	14.2	13.2
EV / Sales (x)	3.7	3.5	3.3	3.0
Earnings Quality				
Eff. Tax Rate	19.1	26.5	21.5	20.5
Other Inc / PBT	3.3	3.2	3.2	3.2
Eff. Depr. Rate (%)	8.9	8.7	8.3	8.2
FCFE / PAT	79.6	50.6	25.2	54.9

Source: Company Data, PL Research.

Balance Sheet Abstract (Rs m)

Y/e March	2015	2016	2017E	2018E
Shareholder's Funds	111,302	128,336	147,671	168,070
Total Debt	46,505	36,729	35,799	28,065
Other Liabilities	(4,013)	(4,230)	(955)	(838)
Total Liabilities	153,794	160,835	182,514	195,297
Net Fixed Assets	65,282	79,668	90,602	101,918
Goodwill	—	—	—	—
Investments	38,110	38,331	36,050	36,336
Net Current Assets	50,402	42,836	55,862	57,042
<i>Cash & Equivalents</i>	5,394	4,921	6,446	8,291
<i>Other Current Assets</i>	80,184	79,733	86,099	89,191
<i>Current Liabilities</i>	35,177	41,818	36,683	40,440
Other Assets	—	—	—	—
Total Assets	153,794	160,835	182,514	195,297

Quarterly Financials (Rs m)

Y/e March	Q1FY16	Q2FY16	Q3FY16	Q4FY16
Net Revenue	37,578	39,890	39,679	37,562
EBITDA	9,206	11,404	10,033	7,797
<i>% of revenue</i>	24.5	28.6	25.3	20.8
Depr. & Amortization	1,619	2,466	2,577	3,032
Net Interest	(216)	216	62	2,646
Other Income	125	320	122	307
Profit before Tax	7,928	9,041	7,516	2,426
Total Tax	1,721	1,879	1,788	1,739
Profit after Tax	6,257	7,219	5,792	746
Adj. PAT	6,257	7,219	5,792	746

Key Operating Metrics (Rs m)

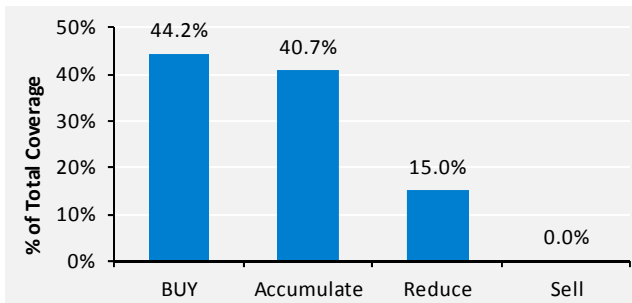
Y/e March	2015	2016	2017E	2018E
India Formulations	17,870	21,293	24,487	27,915
US Formulations	64,723	75,445	78,630	82,561
Russia	17,713	14,100	14,943	15,972
PSAI	25,456	22,379	21,747	21,105

Source: Company Data, PL Research.

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Reduce	:	Underperformance to Sensex over 12-months
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Trading Sell	:	Over 10% absolute decline in 1-month
Not Rated (NR)	:	No specific call on the stock
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