

BSE SENSEX	S&P CNX
28,241	8,741
Bloomberg	DRRD IN
Equity Shares (m)	170.4
M.Cap.(INR b)/(USD b)	535.4 / 8.0
52-Week Range (INR)	3,689/ 2,815
1, 6, 12 Rel. Per (%)	-4/4/-12
Avg Val, INR m	1,204

Financials & Valuations (INR b)

Y/E Mar	2016	2017E	2018E
Sales	154.7	143.6	168.6
EBITDA	39.1	26.6	38.8
Net Profit	22.6	13.3	22.1
Adj. EPS (INR)	132.3	77.7	129.4
EPS Gr. (%)	1.7	-41.3	66.4
BV/Sh. (INR)	752	809	925
RoE (%)	18.8	10.0	14.9
RoCE (%)	13.9	7.4	11.8
Payout (%)	17.6	17.6	17.6
Valuation			
P/E (x)	23.4	39.8	23.9
P/BV (x)	4.1	3.8	3.3
EV/EBITDA (x)	13.2	19.6	13.3
Div. Yield (%)	0.6	0.4	0.6

Estimate change	↔↔
TP change	↔↔
Rating change	↔

CMP: INR3,142 TP: INR3,050 (-3%)
Neutral
Recovery in site; US FDA resolution is key

- **Operating performance in-line:** DRRD's 3QFY17 net revenue increased ~3% QoQ to INR 37bn (in-line with estimate) whereas EBITDA margins improved from lower base of 16.8% in 2Q FY17 to 23% in 3Q. Reported EBITDA during the quarter improved on the back of enhanced emphasis on operational efficiencies, currency benefits in EM, change in product mix, controlling of SG&A costs across businesses and significant reduction in remediation cost.
- **Pricing pressure impact largely built-in; US business to remain muted in 4Q:** US sales for DRRD stood at USD248m in 3Q (v/s ~USD241m in 2Q). Limited meaningful launches in 9M FY17 coupled with pricing pressure in 1H in key products has led to muted growth in US business in YTD FY17. The company sees a risk of deferral of Gleevec launch (was earlier expected in 4Q FY17) due to issues at partner site.
- **India delivered muted growth; EM starts to benefit from stable currency :** India business grew at muted pace of ~2.4% YoY due to price control and demonetization impact. EM sales declined ~7% YoY in INR terms (Ex- Venezuela growth of ~7% YoY). Russia (accounts for >50% of EM) declined ~5% YoY in constant currency. The RoW business declined 23% YoY primarily on account of sales decline in Venezuela.
- **Key call takeaways:** (1) Remediation process over; Inspection at all three facilities are expected in Feb/ Mar-17. (2) Copaxone 20mg response to US FDA was submitted in Dec-16. (3) DRRD expects 15 ANDA launches in FY18 (including 4-5 meaningful launches. (4) 9 ANDAs were filled in 3Q; DRRD plans to file 25 ANDAs in FY17.
- **US FDA remediation key; maintain Neutral:** Although long-term fundamentals remain intact, the stock will remain range bound in the near term due to regulatory concerns. We have valued the company at 21x 1H FY19E PER (in-line with sector average) on the back of robust balance sheet, expectation of US FDA resolution over the next 6 months and rich product pipeline. We maintain **Neutral** with a TP of INR3,050 @ 21x 1H FY19E PER. We have cut our FY18/ 19E EPS estimate by ~10% as we build slower US sales.

Quarterly Performance - IFRS (INR m)

Y/E March	(INR M)											
	FY16				FY17E				FY16	FY17E	Estimates	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		3QE	% Var	
Sales	37,578	39,890	39,679	37,562	32,345	35,857	37,065	38,888	154,708	143,587	37,242	-0.5
YoY Change (%)	6.8	11.2	3.2	-3.0	-13.9	-10.1	-6.6	3.5	4.4	-7.2	-6.1	
Total Expenditure	27,723	28,486	29,646	29,313	28,572	29,834	28,539	30,078	115,620	117,023	29,421	
EBITDA	9,855	11,404	10,033	8,249	3,773	6,023	8,526	8,810	39,088	26,564	7,821	9.0
Margins (%)	26.2	28.6	25.3	22.0	11.7	16.8	23.0	22.7	25.3	18.5	21.0	
Amortization	2,268	2,466	2,577	3,032	2,681	2,914	2,924	2,968	10,343	11,487	2,500	
Other Income	390	160	124	-2,732	615	726	320	275	-1,605	1,926	515	
Profit before Tax	7,977	9,098	7,580	2,484	1,707	3,835	5,922	6,117	27,139	17,002	5,836	1.5
Tax	1,721	1,879	1,788	1,739	444	885	1,221	1,191	7,127	3,741	1,342	
Rate (%)	21.6	20.7	23.6	70.0	26.0	23.1	20.6	19.5	26.3	22.0	23.0	
Reported PAT	6,256	7,219	5,792	745	1,263	2,950	4,701	4,926	20,012	13,261	4,494	
Adjusted PAT	6,256	7,219	5,792	3,762	1,263	3,244	4,701	4,926	20,012	13,261	4,494	4.6
YoY Change (%)	13.7	25.7	0.8	-27.5	-79.8	-55.1	-18.8	31.0	-9.8	-33.7	-22.4	
Margins (%)	16.6	18.1	14.6	10.0	3.9	9.0	12.7	12.7	12.9	9.2	12.1	

E - MOSL Estimates

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Investors are advised to refer through important disclosures made at the last page of the Research Report.

 Motilal Oswal research is available on www.motilaloswal.com/Institutional-Equities, Bloomberg, Thomson Reuters, Factset and S&P Capital.

Business highlights

3Q Revenues declined ~7%YoY to INR37b due to increased competition, price erosion in US market and loss of business in Venezuela. PSAI business grew 6%YoY to INR5.4b and Innovator product segment declined 1%YoY in 3Q.

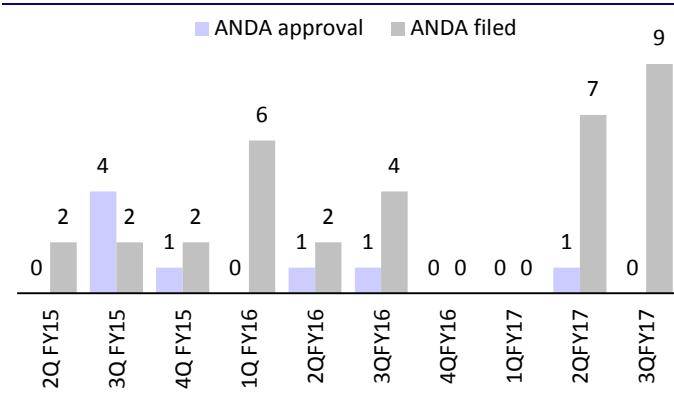
- **North America (44.8% of sales):** In 3Q, on constant currency basis, DRRD declined to USD248m (~USD241m in 2Q) due to increased competition, price erosion and delay in launches. New competitor's entry in some of key molecules in 3Q should put additional pressure in coming quarters.

Exhibit 1: Resilient US biz fell 16%YoY (in dollar terms)



Source: Company, MOSL

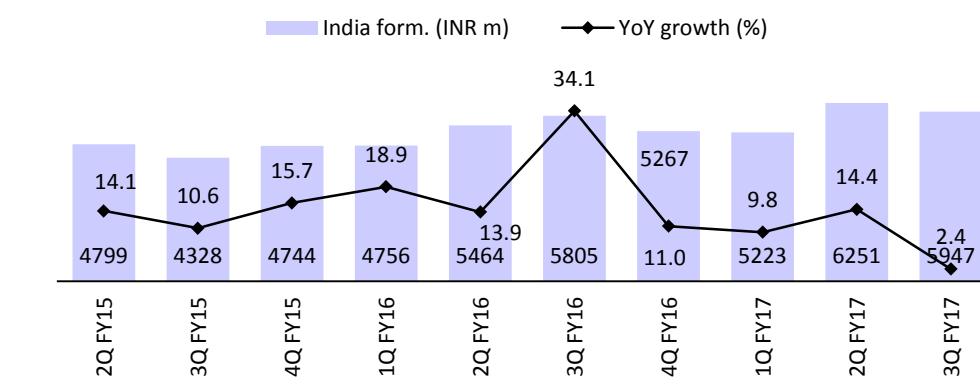
Exhibit 2: ANDA filings - quarterly trend



Source: Company, MOSL

- **India (16% of sales):** Revenue from India was Rs5.9b with growth YoY2%. India business delivered weakest QoQ growth in the last 8 quarters on account of NPPA pricing notifications and WPI based annual price decline. The company has successfully integrated UCB brands.

Exhibit 3: India formulation sales ...



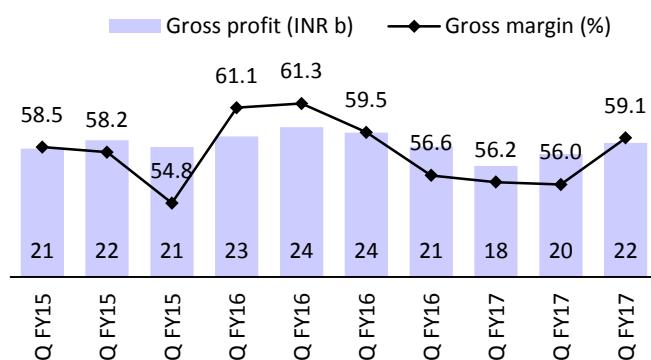
Source: Company, MOSL

RoW sales including Russia/CIS (11% of sales): Revenue in Russia were at INR3.1bYoY (decline of 2% YoY in INR terms). Moderate growth witnessed on account of depreciation of Ruble. In constant currency revenues declined by 5%YoY. Decline in RoW sales is also contributed by Venezuela.

Europe (6% of sales): DRRD registered 11%YoY growth in Europe sales at INR2.1b. The company is expected to launch more products in coming quarters.

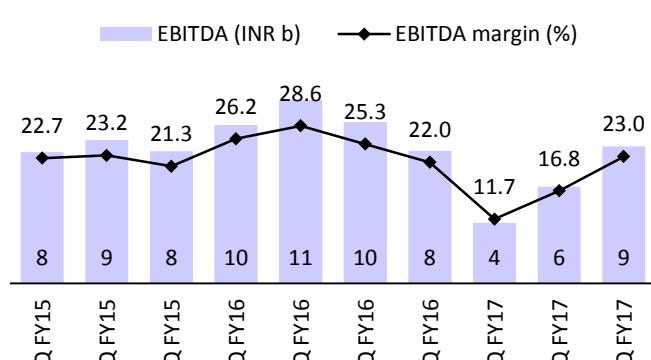
- **Margins growth due to operational efficiencies:** 3Q EBITDA margins at 23% were 2% above our expectations (21%) due to increased operational efficiencies and controlled SG&A costs.

Exhibit 4: Gross Margin (%) declined YoY due to price erosion in US



Source: Company, MOSL

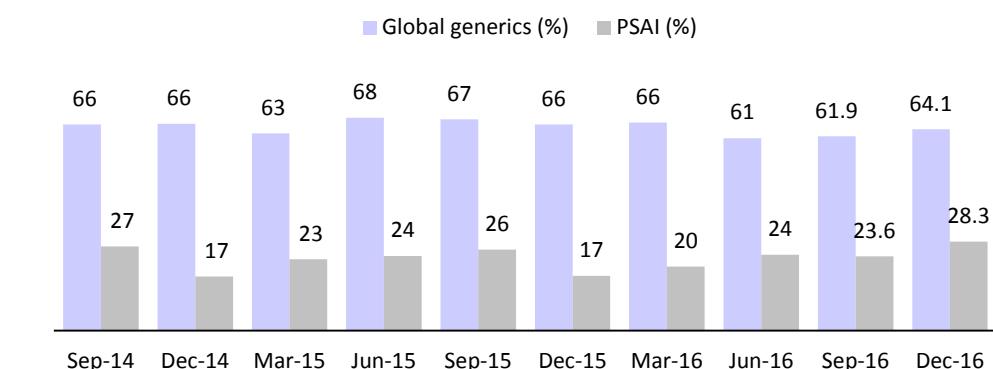
Exhibit 5: EBITDA Margin (%) improved due to operational efficiencies



Source: Company, MOSL

- **Improved gross margins:** Overall gross margins at 59.1% (declined ~40bps YoY) were driven by price erosion in US and loss of business in Venezuela. Gross margins for Global generics and PSAI segment stood at 64.1% and 28.3%, respectively in 3QFY17.

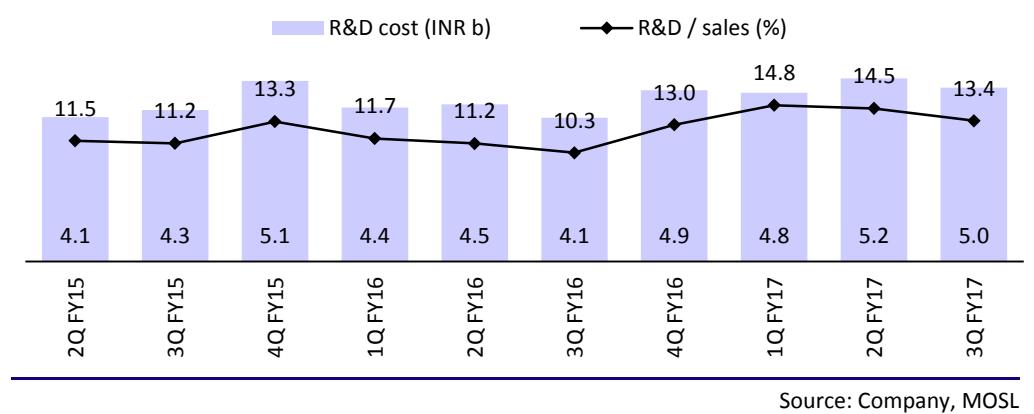
Exhibit 6: Gross margin quarterly trend (Segment wise)



Source: Company, MOSL

- **R&D spends has remained at higher levels:** R&D expense was at 13.4% of sales at INR 5b v/s 14.5% of sales in 2QFY17. R&D expense is expected to remain at higher level due to strong product pipeline of complex generics, Biosimilars and differentiated products.

Exhibit 7: R&D spend remained more or less static



- **Derivative hedges** stand at USD135m at INR67.6-70.4/USD, while balance sheet hedges are at USD251m. Cash flow hedges in other currencies stood at – RUB300m at INR1.08/RUB and EURO1.5m at 75-82.05/EUR (maturing over next 3 months).

Operating metrics

Exhibit 8: Key operating metrics

	FY14				FY15				FY16				FY17		3Q	
	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	1Q	2Q		
Revenue Mix (%)																
US	45.9	43.0	46.8	39.8	42.8	44.3	49.3	46.5	48.9	50.4	48.0	45.0	44.8			
India	11.1	11.8	11.4	13.4	11.3	12.3	12.7	13.7	14.6	14.0	16.1	17.4	16.0			
Europe	5.3	5.1	4.1	4.0	4.4	6.0	5.1	5.3	4.9	4.7	5.0	5.0	5.8			
Russia	15.0	13.0	13.8	13.4	12.4	8.5	8.2	9.8	9.2	6.1	9.2	9.9	11.1			
Others	5.9	5.6	6.3	9.9	10.6	9.0	7.2	6.8	7.0	6.7	4.0	3.6	5.0			
PSAI	14.3	19.1	15.7	17.8	15.9	19.2	14.9	14.8	12.8	15.3	14.5	16.1	14.6			
Innovative products	2.5	2.4	1.8	1.7	2.6	0.8	2.7	3.0	2.6	2.7	3.1	3.0	2.8			
Revenue Gr. (%)	23.3	4.2	23.6	6.9	8.8	11.2	6.8	11.2	3.2	-3.0	-13.9	-10.1	-6.6			
US	75.5	31.1	51.5	7.9	1.5	14.6	12.4	29.9	18.0	10.5	-16.2	-13.1	-14.5			
India	5.2	17.8	14.5	14.1	10.6	15.7	18.9	13.9	34.1	11.0	9.8	14.4	2.4			
Europe	-3.6	-3.1	-7.2	-18.6	-8.6	32.0	31.0	48.1	13.8	-24.9	-15.5	-16.4	10.9			
Russia	20.9	0.0	8.3	-13.0	-10.0	-27.2	-36.7	-18.4	-23.8	-30.7	-3.3	-9.8	-2.0			
Others	35.1	48.3	50.0	94.8	94.0	76.8	21.9	-23.8	-32.1	-27.3	-51.9	-51.9	-23.0			
PSAI	-29.0	-34.7	-5.6	-0.2	20.7	11.7	1.4	-7.4	-16.9	-22.3	-16.4	-2.3	6.3			
Innovative products	26.4	28.5	-6.6	-1.0	11.8	-65.2	58.2	94.8	5.6	245.3	1.2	-10.5	-1.2			
Cost on sales (%)	71.0	78.2	76.8	77.3	76.8	78.7	73.8	71.4	74.7	78.0	88.3	83.2	77.0			
Raw material	39.5	42.8	40.7	41.5	41.8	45.2	38.9	38.7	40.5	43.4	43.8	44.0	40.9			
SG&A	23.1	24.0	25.0	24.3	23.7	20.3	23.2	21.5	23.8	21.7	29.7	24.7	22.7			
R&D cost	8.4	11.4	11.0	11.5	11.2	13.3	11.7	11.2	10.3	13.0	14.8	14.5	13.4			
Tax Rate	29.0	20.6	21.5	17.2	30.7	12.5	21.6	20.7	23.6	70.0	26.0	23.1	20.6			
Margins (%)																
Gross Margins	60.5	57.2	59.3	58.5	58.2	54.8	61.1	61.3	59.5	56.6	56.2	56.0	59.1			
EBITDA Margins	29.0	21.8	23.2	22.7	23.2	21.3	26.2	28.6	25.3	22.0	11.7	16.8	23.0			
EBIT Margins	24.0	16.2	17.9	17.3	17.9	15.5	20.2	22.4	18.8	13.9	3.4	8.7	15.1			
PAT margins	16.1	13.9	15.6	16.0	16.3	13.7	16.6	18.1	14.6	10.0	3.9	9.0	12.7			

Source: Company; MOSL

Valuation and view

We value DRRD at 18x FY18E EPS, at 10% discount to sector average (one-year forward P/E) and at 20-25% discount to large peers due to:

- With weak earnings growth of 10% CAGR (>20% for larger peers)
- Weak return ratios (RoE at 15-16%)
- Low visibility on launches due to recent warning letters to three plants.

Key catalysts to drive stock's performance over the medium term are:

- Stabilisation of emerging market economies/currency, mainly Russia/CIS (12% of sales).
- Clearance of warning letters for three facilities
- Launch of key products like gCopaxone, gGleevec, etc

Key risks to our investment thesis

- Regulatory delays affecting key US launches,
- Adverse outcome of pending FDA issues (API facility)
- Further depreciation of Russian currency. Every 10% depreciation of Rouble hereon (vs USD) leads to 2% downgrade in EPS estimate (annualized).

Exhibit 9: DRRD trades at 22% premium to 10 year avg. PE

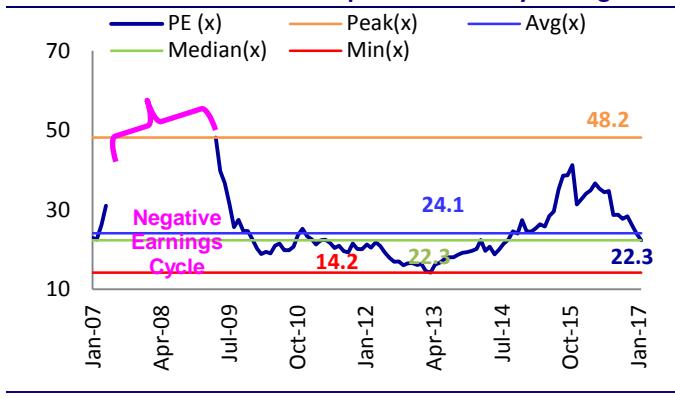
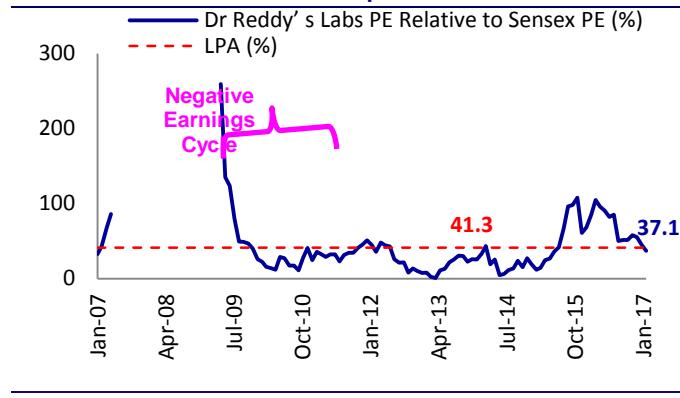


Exhibit 10: DRRD trades at 37% premium to Sensex PE



Financials and Valuations

Income Statement (INR Million)					
Y/E March	2014	2015	2016	2017E	2018E
Net Sales	132,171	148,189	154,708	143,587	168,560
Change (%)	13.7	12.1	4.4	-7.2	17.4
Other Income	1,753	2,871	1,103	2,260	2,480
EBITDA	31,699	33,472	39,088	26,564	38,769
Change (%)	28.0	5.6	16.8	-32.0	45.9
Margin (%)	24.0	22.6	25.3	18.5	23.0
Depreciation & Amort.	7,085	8,103	10,343	11,487	12,642
EBIT	24,614	25,369	28,745	15,077	26,127
Int. and Finance Charges	0	0	0	0	0
Net Interest Exp	79	77	334	334	309
Forex (Gains)/Losses	-329	0	2,374	0	0
PBT & EO Expense	26,616	28,163	27,140	17,003	28,298
Change (%)	22.8	5.8	-3.6	-37.4	66.4
PBT after EO Expense	26,616	28,163	27,140	17,003	28,298
Tax	5,093	5,984	7,127	3,741	6,226
Tax Rate (%)	19.1	21.2	26.3	22.0	22.0
Reported PAT	21,524	22,179	20,013	13,262	22,072
Adjusted Net Profit	21,188	22,179	22,577	13,262	22,072
Change (%)	54.9	4.7	1.8	-41.3	66.4
Margin (%)	16.0	15.0	14.6	9.2	13.1
Balance Sheet (INR Million)					
Y/E March	2014	2015	2016	2017E	2018E
Equity Share Capital	851	852	853	853	853
Reserves	89,950	110,450	127,483	137,233	156,977
Net Worth	90,801	111,302	128,336	138,086	157,830
Loans	44,742	43,126	33,513	33,403	28,403
Deferred Liabilities/Tax	-3,310	-4,013	-4,230	-4,230	-4,230
Capital Employed	132,233	150,414	157,619	167,259	182,003
Gross Block	63,444	72,011	83,198	94,257	105,317
Less: Accum. Deprn.	25,695	30,040	35,356	41,246	47,653
Net Fixed Assets	44,424	48,090	53,961	59,130	63,783
Investments	26,384	38,871	39,394	32,409	32,409
Goodwill/Intangibles	14,697	16,430	24,644	24,644	24,645
Curr. Assets	78,664	85,580	84,654	84,664	99,329
Inventory	23,992	25,529	25,578	28,710	32,920
Account Receivables	33,037	40,755	41,306	35,362	41,513
Cash and Bank Balance	8,451	5,394	4,921	6,233	6,355
Others	13,184	13,901	12,849	14,359	18,542
Curr. Liability & Prov.	31,936	38,556	45,034	33,590	38,163
Account Payables	10,503	10,660	12,300	11,797	13,527
Other Current Liabilities	21,433	27,896	32,734	21,793	24,637
Net Current Assets	46,728	47,024	39,620	51,074	61,166
Appl. of Funds	132,233	150,415	157,618	167,257	182,002
					200,457

* IFRS reporting from FY09 onwards. Financials prior to FY09 are as per US GAAP

Financials and Valuations

Ratios

Y/E March	2014	2015	2016	2017E	2018E	2019E
Basic (INR)						
EPS	124.6	130.2	132.3	77.7	129.4	160.2
Cash EPS	166.2	177.7	193.0	145.1	203.5	240.7
BV/Share	533.8	653.2	752.3	809.4	925.1	1,062.6
DPS	18.0	20.0	17.6	11.7	19.4	24.0
Payout (%)	16.6	17.9	17.6	17.6	17.6	17.6
Valuation (x)						
P/E	25.2	24.1	23.7	39.8	23.9	19.3
PEG (x)	0.5	5.2	13	NA	0.4	0.8
P/BV	5.9	4.8	4.2	3.8	3.3	2.9
EV/Sales	4.1	3.6	3.4	3.6	3.1	2.6
EV/EBITDA	17.2	16.0	13.4	19.6	13.3	10.6
Dividend Yield (%)	0.6	0.6	0.6	0.4	0.6	0.8
Return Ratios (%)						
ROIC	23.5	20.9	20.5	10.2	15.7	17.9
RoE	25.9	21.9	18.8	10.0	14.9	16.1
RoCE	16.6	14.2	13.9	7.4	11.8	13.6
Working Capital Ratios						
Fixed Asset Turnover (x)	2.3	2.2	2.0	1.6	1.7	1.8
Debtor (Days)	91	100	97	90	90	90
Inventory (Days)	66	63	60	73	71	70
Leverage Ratio						
Debt/Equity (x)	0.5	0.4	0.3	0.2	0.2	0.1

Cash Flow Statement

Y/E March	2014	2015	2016	2017E	2018E	2019E	(INR Million)
Op. Profit/(Loss) before Tax	31,699	33,472	39,088	26,564	38,769	47,698	
Interest/Dividends Recd.	2,003	2,793	-1,605	1,926	2,171	2,001	
Direct Taxes Paid	-5,093	-5,984	-7,127	-3,741	-6,226	-8,630	
(Inc)/Dec in WC	-5,265	-3,353	6,931	-10,142	-9,970	-9,475	
CF from Operations	23,344	26,929	37,287	14,607	24,745	31,594	
(inc)/dec in FA	-14,371	-13,502	-24,428	-16,656	-17,295	-17,927	
Free Cash Flow	8,973	13,427	12,859	-2,049	7,449	13,666	
(Pur)/Sale of Investments	-8,253	-12,487	-523	6,985	0	0	
CF from Investments	-22,624	-25,989	-24,950	-9,671	-17,295	-17,927	
Change in net worth	-247	2,302	534	-1,185	1,546	922	
(Inc)/Dec in Debt	8,064	-1,617	-9,613	-110	-5,000	-5,000	
Other Items	-1,640	-704	-219	0	0	0	
Dividend Paid	-3,581	-3,979	-3,512	-2,327	-3,874	-4,796	
CF from Fin. Activity	2,596	-3,998	-12,810	-3,622	-7,327	-8,874	
Inc/Dec of Cash	3,315	-3,058	-474	1,313	122	4,793	
Add: Beginning Balance	5,136	8,451	5,394	4,921	6,233	6,355	
Closing Balance	8,451	5,393	4,921	6,234	6,355	11,148	

Corporate profile

Company description

Dr. Reddy's is a vertically integrated company, with presence across the pharmaceutical value chain through its core businesses of Global Generics, Pharmaceutical Services and Active Ingredients (PSAI) and Proprietary Products. Company is currently developing bio-generics and NCEs. Key focus markets include India, the US, Europe and Russia.

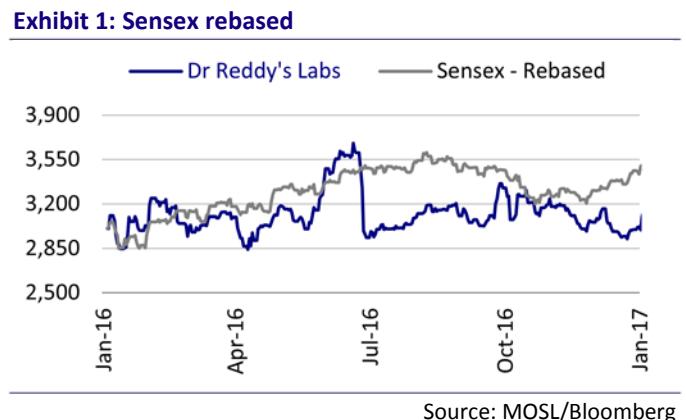


Exhibit 2: Shareholding pattern (%)

	Sep-16	Jun-16	Sep-15
Promoter	26.7	26.4	25.5
DII	6.5	5.8	5.2
FII	37.2	52.3	55.0
Others	29.7	15.6	14.4

Note: FII Includes depository receipts

Source: Capitaline

Exhibit 3: Top holders

Holder Name	% Holding
Jp Morgan Chase Bank Na	16.6
Oppenheimer Developing Markets Fund	4.2
Life Insurance Corporation Of India	3.5
Natl.Westmin.Bank Plc As Depos.Of 1st	
Sta.Asia Pac.Lesders Fund A Sub Fund Of 1st	3.3
Sta.Invsts.lcvc	
Government Of Singapore	1.3

Source: Capitaline

Exhibit 4: Top management

Name	Designation
Satish Reddy	Chairman
G V Prasad	Vice Chairman & MD & CEO
Sandeep Poddar	Company Secretary

Source: Capitaline

Exhibit 5: Directors

Name	Name
Satish Reddy	Hans Peter Hasler*
G V Prasad	Kalpana Morparia*
Anupam Puri*	Omkar Goswami*
Ashok Sekhar Ganguly*	Ravi Bhoothalingam*
Bharat Doshi*	Sridar Iyengar*
Bruce L A Carter*	

*Independent

Exhibit 6: Auditors

Name	Type
BSR & Co LLP	Statutory

Source: Capitaline

Exhibit 7: MOSL forecast v/s consensus

EXHIBIT 11: MOSL vs. Consensus			
EPS (INR)	MOSL forecast	Consensus forecast	Variation (%)
FY17	77.7	92.3	-15.8
FY18	129.4	139.8	-7.4
FY19	160.2	174.1	-8.0

Source: Bloomberg

Disclosures

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