

ICICI Securities Limited  
is the author and  
distributor of this report

Company update and  
earnings revision

## Pharmaceuticals

Target price Rs2,338

### Earnings revision

(%)	FY20E	FY21E	FY22E
Sales	(1.1)	(1.2)	(0.0)
EPS	0.5	0.4	0.6

### Target price revision

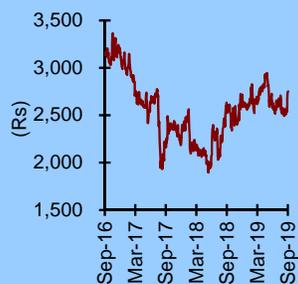
Rs2,338 from Rs2,328

### Shareholding pattern

	Dec '18	Mar '19	Jun '19
Promoters	26.8	26.8	26.8
Institutional investors	45.6	45.4	44.7
MFs and others	10.6	9.1	8.6
Insurance Cos.	5.3	5.1	4.9
FII	29.7	31.2	30.8
Others	27.6	27.6	28.5

Source: BSE India

### Price chart



# Dr. Reddy's Laboratories

**REDUCE**

Maintained

**Rs2,749**

Overpricing the opportunities, concerns remain

Dr. Reddy's Laboratories (DRL) stock price has appreciated ~10% over last few days without any positive development and fundamental change. We believe the valuation is now overpricing the key product opportunities (*Nuvaring*, *Copaxone* etc) and cost control benefits. The company has demonstrated very effective cost control with 250bps margin expansion in FY19 and our estimates assume additional benefit of ~100bps base business margin expansion from the ongoing efforts. However, the key concerns pertaining to 1) the recent CRLs for *Nuvaring* and *Copaxone* could delay the launch, 2) the pending issues at Srikakkulam API facility remain an overhang for *Copaxone* launch and 3) the recent 483 observations at Duvvada facility would restrict growth. Maintain REDUCE.

- **Prolonged delay in key product opportunities:** Generic *Copaxone*, *Nuvaring* and *Suboxone* are the key high value product opportunities for DRL. However, there has been constant delay in their launches due to additional queries pertaining to the filings and litigation. They were initially expected to be launched in early FY19 but only generic *Suboxone* was launched in Q4FY19, with slow ramp-up in market share. We now expect launch of *Nuvaring* and *Copaxone* in H2FY21 and these three products together would contribute 10.5/11.0/15.6% of total EPS in FY20E/FY21E/FY22E. We believe delay in approvals of the two products would reduce the opportunity size for the company with increasing competition and earnings begin to drop.
- **US sales growth and cost control benefits already priced in:** Excluding the key product opportunities, we expect 5.1% CAGR in base US sales to US\$1bn over FY19-FY22E. Slower growth is due to a continuous price erosion of ~5% in base portfolio and increasing competition in other key products like generic *Dacogen*, *Toprol XL* etc. New launches of 10-15 products per year and recent acquisition of 42 ANDAs in US including 30 injectables would support growth. The company has successfully demonstrated efficient cost control exercises which helped in 250bps EBITDA margin improvement in FY19 and we estimate additional improvement of ~100bps over FY19-FY22E.
- **Outlook:** We largely maintain our estimates. Overall, we expect revenues and earnings to grow at 9.3% and 14.2% CAGRs respectively over FY19-FY22E with 210bps EBITDA margin expansion including large product opportunities. Strong PAT growth would be driven by revenues from generic *Suboxone*, *Nuvaring* and *Copaxone*, which together would contribute ~15.6% to EPS in FY22E. Gross margin had been weak over past two quarters with change in revenue mix.
- **Valuations and risks:** We maintain REDUCE rating on the stock with a revised target price of Rs2,338/share (earlier: Rs2,328). Key upside risks are: early launch of *Nuvaring* and/or *Copaxone* and early resolution of warning letter at Srikakulam facility.

Market Cap	Rs457bn/US\$6.4bn
Reuters/Bloomberg	REBY.BO/DRRD IN
Shares Outstanding (mn)	166.1
52-week Range (Rs)	2942/2340
Free Float (%)	73.2
FII (%)	30.8
Daily Volume (US\$/'000)	26,317
Absolute Return 3m (%)	7.3
Absolute Return 12m (%)	5.2
Sensex Return 3m (%)	(5.6)
Sensex Return 12m (%)	(2.0)

Year to Mar	FY19	FY20E	FY21E	FY22E
Revenue (Rs mn)	152,044	166,156	181,230	198,785
Net Income (Rs mn)	18,795	17,515	20,503	24,993
EPS (Rs)	101.3	105.6	123.7	150.7
% Chg YoY	47.9	4.3	17.1	21.9
P/E (x)	27.1	26.0	22.2	18.2
CEPS (Rs)	176.1	181.5	200.2	227.5
EV/E (x)	15.9	13.7	11.7	9.7
Dividend Yield (%)	0.7	0.7	0.8	1.0
RoCE (%)	9.2	9.5	10.6	12.1
RoE (%)	12.6	11.9	12.7	13.9

### Research Analysts:

**Sriraam Rathi**

sriraam.rathi@icicisecurities.com  
+91 22 6637 7574

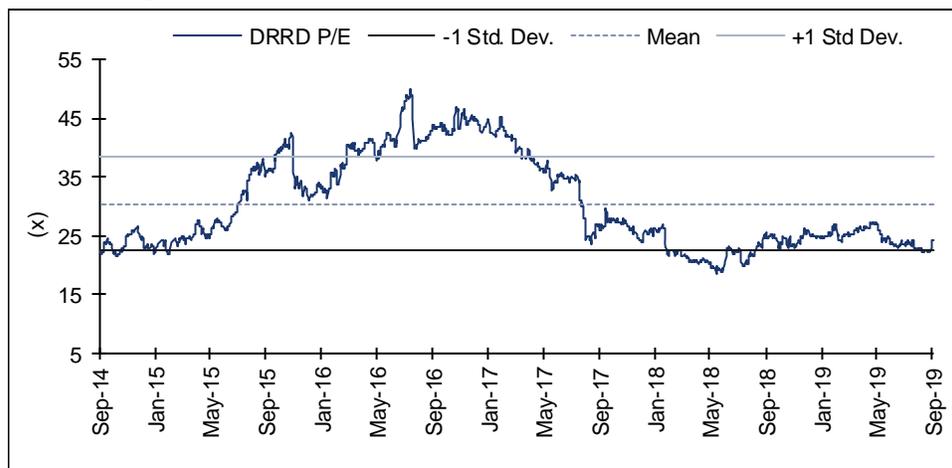
**Vinay Bafna**

vinay.bafna@icicisecurities.com  
+91 22 6637 7339

## Valuations

We expect revenue and PAT CAGRs of 9.3% and 14.2% over FY19-FY22E with margin expansion to 21.5%. The stock currently trades at 22.2x FY21E and 18.2x FY22E earnings and EV/EBITDA multiple of 11.7x FY21E and 9.7x FY22E. Considering potential increase in concentration risk for earnings (~20% EPS from *Suboxone*, *Nuvaring* & *Copaxone*) and delay in approvals for generic *Nuvaring* and generic *Copaxone*, weakening gross margin profile and expensive valuations, we maintain our **REDUCE** rating a revised target price of Rs2,338 (base business at 20x FY21E EPS and three product opportunities at 10x FY21E EPS) (earlier: Rs2,328).

**Chart 1: 1-year forward P/E**



Source: Company data, I-Sec research

## Financial summary

Table 1: Profit and Loss Statement

(Rs mn, year ending March 31)

	FY19	FY20E	FY21E	FY22E
Global Generics	122,903	135,660	148,293	164,037
PSAI	24,140	25,660	26,943	28,290
Proprietary Products	2,943	2,675	3,725	4,075
Others	2,058	2,161	2,269	2,382
<b>Net Sales</b>	<b>152,044</b>	<b>166,156</b>	<b>181,230</b>	<b>198,785</b>
<b>Total Revenue</b>	<b>152,044</b>	<b>166,156</b>	<b>181,230</b>	<b>198,785</b>
yoy Growth%	7.1	9.3	9.1	9.7
<b>Total Op. Exp.</b>	<b>122,518</b>	<b>133,166</b>	<b>144,038</b>	<b>155,949</b>
<b>EBITDA</b>	<b>29,526</b>	<b>32,990</b>	<b>37,192</b>	<b>42,836</b>
Margins %	19.4	19.9	20.5	21.5
yoy Growth%	27.2	11.7	12.7	15.2
Deprn. & Amortisation	12,400	12,580	12,691	12,721
<b>EBIT</b>	<b>17,126</b>	<b>20,410</b>	<b>24,501</b>	<b>30,114</b>
Other Inc/Interest (net)	2,464	2,045	1,784	1,929
Extraordinary Items	2,853	0	0	0
<b>PBT</b>	<b>22,443</b>	<b>22,455</b>	<b>26,286</b>	<b>32,043</b>
Tax	3,648	4,940	5,783	7,049
Tax Rate (%)	16.3	22.0	22.0	22.0
Minority Interest	-	-	-	-
<b>Reported PAT</b>	<b>18,795</b>	<b>17,515</b>	<b>20,503</b>	<b>24,993</b>
<b>Adjusted PAT</b>	<b>16,406</b>	<b>17,515</b>	<b>20,503</b>	<b>24,993</b>
Net Margins (%)	10.8	10.5	11.3	12.6

Source: Company data, I-Sec research

Table 2: Balance Sheet

(Rs mn, year ending March 31)

	FY19	FY20E	FY21E	FY22E
Paid-up Capital	830	830	830	830
Reserves & Surplus	139,367	153,156	169,297	188,974
<b>Total Equity</b>	<b>140,197</b>	<b>153,986</b>	<b>170,127</b>	<b>189,804</b>
<b>Total Debt</b>	<b>38,381</b>	<b>30,381</b>	<b>25,381</b>	<b>20,381</b>
Other non-current liab.	2,920	2,920	2,920	2,920
<b>Capital Employed</b>	<b>181,498</b>	<b>187,287</b>	<b>198,428</b>	<b>213,105</b>
Total Cur. Lia. & Prov.	43,319	48,260	52,538	57,516
<b>Total Liabilities</b>	<b>224,817</b>	<b>235,547</b>	<b>250,966</b>	<b>270,622</b>
<b>Net Fixed Assets</b>	<b>102,357</b>	<b>96,777</b>	<b>92,086</b>	<b>87,365</b>
Deferred tax asset	3,558	3,558	3,558	3,558
Investments	3,342	3,342	3,342	3,342
Inventory	33,579	34,242	37,349	40,967
Debtors	39,869	43,978	47,968	52,614
Other Current Assets	17,355	18,617	19,965	21,534
Cash and Equivalents	24,757	35,033	46,698	61,242
<b>Total Cur. Assets</b>	<b>115,560</b>	<b>131,871</b>	<b>151,980</b>	<b>176,357</b>
<b>Total Assets</b>	<b>224,817</b>	<b>235,547</b>	<b>250,966</b>	<b>270,622</b>

Source: Company data, I-Sec research

Table 3: Cashflow Statement

(Rs mn, year ending March 31)

	FY19	FY20E	FY21E	FY22E
PBT (Adj. for EO items)	22,443	22,455	26,286	32,043
Depreciation	12,400	12,580	12,691	12,721
Net Chg in WC	(6,301)	(2,505)	(5,682)	(6,631)
Taxes	(4,841)	(4,940)	(5,783)	(7,049)
Others	5,003	1,411	1,515	1,776
<b>CFO</b>	<b>28,704</b>	<b>29,002</b>	<b>29,027</b>	<b>32,860</b>
Capex	(6,226)	(7,000)	(8,000)	(8,000)
Net Investments made	(2,282)	-	-	-
Others	781	-	-	-
<b>CFI</b>	<b>(7,727)</b>	<b>(7,000)</b>	<b>(8,000)</b>	<b>(8,000)</b>
Change in Share capital	-	-	-	-
Change in Debts	(15,182)	(8,000)	(5,000)	(5,000)
Div. & Div Tax	(4,002)	(3,726)	(4,361)	(5,317)
Others	(2,203)	-	-	-
<b>CFF</b>	<b>(21,387)</b>	<b>(11,726)</b>	<b>(9,361)</b>	<b>(10,317)</b>
<b>Total Cash Generated</b>	<b>(410)</b>	<b>10,276</b>	<b>11,665</b>	<b>14,543</b>
<b>Cash Opening Balance</b>	<b>2,638</b>	<b>2,228</b>	<b>12,504</b>	<b>24,169</b>
<b>Cash Closing Balance</b>	<b>2,228</b>	<b>12,504</b>	<b>24,169</b>	<b>38,713</b>

Source: Company data, I-Sec research

Table 4: Key Ratios

(Year ending March 31)

	FY19	FY20E	FY21E	FY22E
Adj EPS (Rs)	101.3	105.6	123.7	150.7
yoy Growth%	47.9	4.3	17.1	21.9
Cash EPS (Rs)	176.1	181.5	200.2	227.5
EBITDA - Core (%)	19.4	19.9	20.5	21.5
NPM (%)	10.8	10.5	11.3	12.6
Net Debt to Equity (x)	0.1	(0.0)	(0.1)	(0.2)
P/E (x)	27.1	26.0	22.2	18.2
EV/EBITDA Core (x)	15.9	13.7	11.7	9.7
P/BV (x)	3.3	3.0	2.7	2.4
EV/Sales (x)	3.1	2.7	2.4	2.1
ROCE (%)	9.2	9.5	10.6	12.1
ROE (%)	12.6	11.9	12.7	13.9
ROIC (%)	10.6	11.3	13.4	16.4
Book Value (Rs)	845.6	928.7	1,026.1	1,144.8
DPS (Rs)	20.0	18.6	21.8	26.6
Dividend Payout (%)	17.6	17.6	17.6	17.6
Div Yield (%)	0.7	0.7	0.8	1.0
Asset Turnover Ratio	0.7	0.7	0.7	0.8
Avg Collection days	97	97	97	97
Avg Inventory days	75	75	75	75

Source: Company data, I-Sec research

*This report may be distributed in Singapore by ICICI Securities, Inc. (Singapore branch). Any recipients of this report in Singapore should contact ICICI Securities, Inc. (Singapore branch) in respect of any matters arising from, or in connection with, this report. The contact details of ICICI Securities, Inc. (Singapore branch) are as follows: Address: 10 Collyer Quay, #40-92 Ocean Financial Tower, Singapore - 049315, Tel: +65 6232 2451 and email: navneet\_babbar@icicisecuritiesinc.com, Rishi\_agrawal@icicisecuritiesinc.com.*

*"In case of eligible investors based in Japan, charges for brokerage services on execution of transactions do not in substance constitute charge for research reports and no charges are levied for providing research reports to such investors."*

*New I-Sec investment ratings (all ratings based on absolute return; All ratings and target price refers to 12-month performance horizon, unless mentioned otherwise)  
BUY: >15% return; ADD: 5% to 15% return; HOLD: Negative 5% to Positive 5% return; REDUCE: Negative 5% to Negative 15% return; SELL: < negative 15% return*

#### ANALYST CERTIFICATION

1/We, *Sriram Rathi, CA; Vinay Bafna, MBA*; authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report. Analysts are not registered as research analysts by FINRA and are not associated persons of the ICICI Securities Inc. It is also confirmed that above mentioned Analysts of this report have not received any compensation from the companies mentioned in the report in the preceding twelve months and do not serve as an officer, director or employee of the companies mentioned in the report.

#### Terms & conditions and other disclosures:

ICICI Securities Limited (ICICI Securities) is a full-service, integrated investment banking and is, inter alia, engaged in the business of stock brokering and distribution of financial products. ICICI Securities Limited is a SEBI registered Research Analyst with SEBI Registration Number – INH000000990. ICICI Securities Limited SEBI Registration is INZ000183631 for stock broker. ICICI Securities is a subsidiary of ICICI Bank which is India's largest private sector bank and has its various subsidiaries engaged in businesses of housing finance, asset management, life insurance, general insurance, venture capital fund management, etc. ("associates"), the details in respect of which are available on [www.icicibank.com](http://www.icicibank.com).

ICICI Securities is one of the leading merchant bankers/ underwriters of securities and participate in virtually all securities trading markets in India. We and our associates might have investment banking and other business relationship with a significant percentage of companies covered by our Investment Research Department. ICICI Securities generally prohibits its analysts, persons reporting to analysts and their relatives from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover.

Recommendation in reports based on technical and derivative analysis centre on studying charts of a stock's price movement, outstanding positions, trading volume etc as opposed to focusing on a company's fundamentals and, as such, may not match with the recommendation in fundamental reports. Investors may visit [icicidirect.com](http://icicidirect.com) to view the Fundamental and Technical Research Reports.

Our proprietary trading and investment businesses may make investment decisions that are inconsistent with the recommendations expressed herein.

ICICI Securities Limited has two independent equity research groups: Institutional Research and Retail Research. This report has been prepared by the Institutional Research. The views and opinions expressed in this document may or may not match or may be contrary with the views, estimates, rating, target price of the Retail Research.

The information and opinions in this report have been prepared by ICICI Securities and are subject to change without any notice. The report and information contained herein is strictly confidential and meant solely for the selected recipient and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ICICI Securities. While we would endeavour to update the information herein on a reasonable basis, ICICI Securities is under no obligation to update or keep the information current. Also, there may be regulatory, compliance or other reasons that may prevent ICICI Securities from doing so. Non-rated securities indicate that rating on a particular security has been suspended temporarily and such suspension is in compliance with applicable regulations and/or ICICI Securities policies, in circumstances where ICICI Securities might be acting in an advisory capacity to this company, or in certain other circumstances.

This report is based on information obtained from public sources and sources believed to be reliable, but no independent verification has been made nor is its accuracy or completeness guaranteed. This report and information herein is solely for informational purpose and shall not be used or considered as an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. ICICI Securities will not treat recipients as customers by virtue of their receiving this report. Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to your specific circumstances. The securities discussed and opinions expressed in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient. This may not be taken in substitution for the exercise of independent judgment by any recipient. The recipient should independently evaluate the investment risks. The value and return on investment may vary because of changes in interest rates, foreign exchange rates or any other reason. ICICI Securities accepts no liabilities whatsoever for any loss or damage of any kind arising out of the use of this report. Past performance is not necessarily a guide to future performance. Investors are advised to see Risk Disclosure Document to understand the risks associated before investing in the securities markets. Actual results may differ materially from those set forth in projections. Forward-looking statements are not predictions and may be subject to change without notice.

ICICI Securities or its associates might have managed or co-managed public offering of securities for the subject company or might have been mandated by the subject company for any other assignment in the past twelve months.

ICICI Securities or its associates might have received any compensation from the companies mentioned in the report during the period preceding twelve months from the date of this report for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory service in a merger or specific transaction.

ICICI Securities or its associates might have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the companies mentioned in the report in the past twelve months.

ICICI Securities encourages independence in research report preparation and strives to minimize conflict in preparation of research report. ICICI Securities or its associates or its analysts did not receive any compensation or other benefits from the companies mentioned in the report or third party in connection with preparation of the research report. Accordingly, neither ICICI Securities nor Research Analysts and their relatives have any material conflict of interest at the time of publication of this report.

Compensation of our Research Analysts is not based on any specific merchant banking, investment banking or brokerage service transactions.

ICICI Securities or its subsidiaries collectively or Research Analysts or their relatives do not own 1% or more of the equity securities of the Company mentioned in the report as of the last day of the month preceding the publication of the research report.

Since associates of ICICI Securities are engaged in various financial service businesses, they might have financial interests or beneficial ownership in various companies including the subject company/companies mentioned in this report.

ICICI Securities may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report.

Neither the Research Analysts nor ICICI Securities have been engaged in market making activity for the companies mentioned in the report.

We submit that no material disciplinary action has been taken on ICICI Securities by any Regulatory Authority impacting Equity Research Analysis activities.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject ICICI Securities and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

This report has not been prepared by ICICI Securities, Inc. However, ICICI Securities, Inc. has reviewed the report and, in so far as it includes current or historical information, it is believed to be reliable, although its accuracy and completeness cannot be guaranteed.