

Dr. Reddy's Labs

gRevlimid - A key opportunity settled

- Meaningful addition:** Dr. Reddy's settles patent litigation with Celgene (Bristol Myers Squibb) in the US for gRevlimid (USD7.6bn). The drug is indicated for multiple myeloma (cancer). As per the settlement terms, Dr. Reddy's is licensed to sell volume-limited quantity after Mar 2022 and without volume-restriction after Jan 31, 2026 subject to product approval from the US FDA. While the details pertaining to launch date and market share are not disclosed, the opportunity can add an NPV of Rs384/share to our target price in a base case scenario (assuming 5-20% market share, 30-45% price erosion between FY23-26). We increase our target price to Rs5,054 to factor gRevlimid launch in FY23 and maintain our ADD rating. Key catalysts are launch of gVascepa, approval for gCopaxone and gNuvaring.
- Competitive landscape:** Natco and Alvogen have settled for a volume-limited launch until Jan 31, 2026. However, Natco's terms are favorable compared to Alvogen with launch starting from Mar 2022 (first to market) and volumes increasing every year upto Mar 2025 but capped at one-third volume share in the final year. Alvogen will enter after Mar 2022 and their volumes can increase each period to no more than a single-digit percentage in the final year. Other known filers are Cipla, Aurobindo, Sun, Hetero, ANDA Inc, Cadila, Mylan, Lupin.
- Bull-Bear spread of Rs205-Rs540:** Our base case scenario assumes 30-45% price erosion and 5-20% market share between FY23-26 which results in an NPV of Rs384/share. Our bear case scenario assumes higher competition, higher price erosion and lower market share resulting in an NPV of Rs205/share and bull case scenario assumes three player market with lower price erosion and higher market share resulting in an NPV of Rs540/share.
- Strong pipeline in US will drive higher growth:** The growth visibility in the US has improved with limited competition products such as gCiprodex, gVoltaren OTC (launched), gKuvan (settled for Oct-20 launch), gVascepa (launch likely towards end FY21). We expect these assets, combined with gNuvaring and gCopaxone (uncertain timelines), to generate incremental revenues of ~USD300mn and drive 17% CAGR over FY20-FY22.
- Valuation and risks:** We maintain ADD rating and increase our SOTP based target price to Rs5,054 to factor gRevlimid settlement. Our target price is based on 22x FY22 EPS and NPV of Rs384/share for gRevlimid. Key risks: delay in key approvals; higher price erosion in the US; adverse outcome on drug price fixing lawsuit in US; and delay in turnaround of Wockhardt portfolio.

Financial Summary

(Rs bn)	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Net Sales	1,40,809	1,40,728	1,53,851	1,67,371	1,95,367	2,26,633	2,51,115
EBITDA	25,154	22,696	30,672	34,546	49,846	58,900	65,391
Rep. PAT	12,039	9,806	18,794	19,497	28,637	35,343	40,221
EPS (Rs)	72.4	58.9	112.9	117.1	172.0	212.3	241.6
P/E (x)	63.0	91.0	42.8	31.4	28.1	22.8	20.0
RoCE (%)	8.9	5.7	11.3	16.0	15.6	16.6	16.2

Source: Company, HSIE Research

ADD

CMP(as on 17 Sept 2020)	Rs 4,827
Target Price	Rs 5,054
NIFTY	11,516

KEY CHANGES	OLD	NEW
Rating	ADD	ADD
Price Target	Rs 4,670	Rs 5,054
EPS %	FY21E	FY22E
	-	-

KEY STOCK DATA

Bloomberg code	DRRD IN
No. of Shares (mn)	166
MCap (Rs bn) / (\$ mn)	802/10,903
6m avg traded value (Rs mn)	5,005
52 Week high / low	Rs 4,850/2,495

STOCK PERFORMANCE (%)

	3M	6M	12M
Absolute (%)	21.1	73.6	76.3
Relative (%)	4.8	46.1	69.5

SHAREHOLDING PATTERN (%)

	Mar-20	Jun-20
Promoters	26.75	26.74
FIs & Local MFs	14.35	16.21
FPIs	30.15	29.33
Public & Others	28.75	27.72
Pledged Shares	0.00	0.00

Source : BSE

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Financials

Consolidated Income Statement

Year to March (INR mn)	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Revenues	1,40,809	1,40,728	1,53,851	1,67,371	1,95,367	2,26,633	2,51,115
Cost of revenues	62,453	65,724	70,421	80,591	85,866	99,264	1,10,518
Gross profits	78,356	75,004	83,430	86,780	1,09,502	1,27,369	1,40,597
<i>Gross Margin (%)</i>	55.6	53.3	54.2	51.8	56.0	56.2	56.0
SGA expenses	42,647	43,115	44,946	46,297	51,076	57,791	62,779
R&D expenses	19,551	18,265	15,607	15,410	18,052	20,850	22,600
Amortization expenses	3,725	3,476	3,944	3,832	4,581	4,624	4,624
Other operating Income/ (expense)	1,065	788	1,955	833	472	1,000	1,000
Total operating expenses	64,858	64,068	62,542	64,706	73,237	82,265	89,003
Operating income	13,498	10,936	20,888	22,074	36,265	45,103	51,594
<i>Operating Margin (%)</i>	9.6	7.8	13.6	13.2	18.6	19.9	20.5
Equity in profit / (loss) of affiliates	349	344	438	561	308	640	640
Other (expense)/income	806	766	1,117	1,478	1,921	2,017	2,118
Tax	-2,614	-3,231	-3,648	1,466	-9,857	-12,418	-14,132
<i>Effective tax rate (%)</i>	17.8	26.8	16.3	-6.1	25.6	26.0	26.0
One time income/charges	684	-991	-2,697	6,082	-	-	-
Reported Net Income	12,039	9,806	18,795	19,497	28,637	35,343	40,221

Source: Company, HSIE Research

Consolidated Balance Sheet

Year to March (INR mn)	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Current Assets	41,931	43,255	42,097	52,331	55,583	66,756	90,145
Cash And Equivalents	3,866	2,638	2,228	2,053	4,734	7,770	24,786
Accounts Receivable, Net Of Allowances	38,065	40,617	39,869	50,278	50,849	58,987	65,359
Inventories	28,529	29,089	33,579	35,067	40,144	46,568	51,599
Deferred Income Tax	3,413	4,567	3,400	4,379	4,379	4,379	4,379
Investment Securities	14,270	18,330	22,529	23,687	23,687	23,687	23,687
Other Current Assets	12,232	14,404	12,896	14,906	17,663	20,490	22,704
Total Current Assets	85,000	69,692	59,700	72,814	83,096	79,180	80,595
Property, Plant And Equipment	57,160	57,869	54,088	52,332	62,332	68,332	74,332
Investment In Affiliates	1,603	2,104	2,529	2,763	2,763	2,763	2,763
Intangible Assets	48,677	48,610	48,269	31,653	44,483	44,483	44,483
Deferred Tax Asset	5,580	3,628	4,168	12,214	12,214	12,214	12,214
Other Assets	1,189	1,199	1,059	2,581	2,581	2,581	2,581
Total Assets	2,19,821	2,25,604	2,25,427	2,32,241	2,66,158	2,92,582	3,29,215
Current Liabilities	57,066	41,581	30,934	37,457	47,482	43,566	44,981
Borrowing From Banks	43,539	25,466	12,125	16,532	23,947	16,947	15,947
Trade Accounts Payables	13,417	16,052	14,553	16,659	19,269	22,353	24,768
Other Current Liabilities	21,932	22,764	24,351	29,382	29,382	29,382	29,382
Total Current Liabilities	85,000	69,692	59,700	72,814	83,096	79,180	80,595
Long Term Debt, Excl Current Portion	5,449	25,089	22,000	1,304	1,304	1,304	1,304
Liabilities	95,777	99,144	85,230	77,253	87,535	83,619	85,034
Total Stockholders Equity	1,24,044	1,26,460	1,40,197	1,54,988	1,78,623	2,08,963	2,44,181
Total Liabilities	2,19,821	2,25,604	2,25,427	2,32,241	2,66,158	2,92,582	3,29,215

Source: Company, HSIE Research

Consolidated Cash Flow

Year to March (INR mn)	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Net income	12,039	9,806	18,795	19,497	28,637	35,343	40,221
Adjustments	20,594	19,948	20,521	11,493	13,754	13,797	13,797
Depreciation & Amortization	11,277	11,710	12,190	12,472	13,754	13,797	13,797
Taxes Payable	-5,770	-2,761	-4,841	392	-573	-	-
Change in working capital	-11,120	-11,725	-10,612	-3,002	1,877	-21,305	-12,202
Cash flow from operations	21,513	18,029	28,704	27,988	44,268	27,835	41,816
Capex	-12,278	-9,291	-6,955	-10,716	-23,754	-19,797	-19,797
Net Investment In Securities	21,858	-4,391	-2,282	-	-	-	-
Others	15,665	-9,983	-3,054	17,101	-12,830	-	-
Cash flow from investing activities	3,387	-19,274	-10,009	6,385	-36,584	-19,797	-19,797
Shares Issued	-15,693	1	-	285	-	-	-
Change in debt	16,316	882	-15,182	-20,696	-	-	-
Dividend	-3,390	-3,992	-4,002	-5,003	-5,003	-5,003	-5,003
Interest	-925	-1,331	-1,607	-	-	-	-
Others	-4,315	-5,323	-6,144	-5,003	-5,003	-5,003	-5,003
Cash flows from financing activities	-3,692	-4,440	-21,326	-25,414	-5,003	-5,003	-5,003
Effects of exchange rate changes on cash	-492	57	35	-	-	-	-
Net Change in Cash	-1,142	-1,237	-349	8,959	2,681	3,035	17,017
Opening cash balance	4,921	3,866	2,542	2,228	2,053	4,734	7,770
Closing cash balance	3,779	2,629	2,228	11,187	4,734	7,770	24,786
Free Cash Flow	9,235	8,738	21,749	17,272	20,514	8,038	22,019

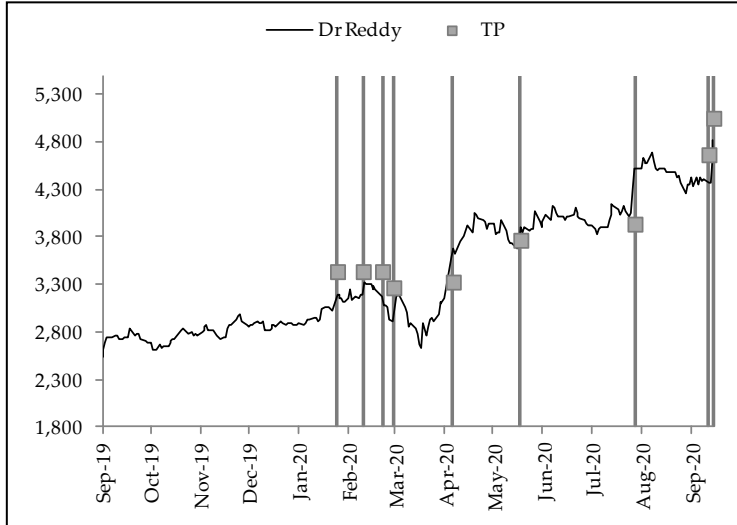
Source: Company, HSIE Research

Key Ratios

Year to March (INR mn)	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
PROFITABILITY (%)							
GPM	55.6	53.3	54.2	51.8	56.0	56.2	56.0
EBITDA Margin	17.9	16.1	19.9	20.6	25.5	26.0	26.0
APAT Margin	8.5	7.0	14.0	11.6	14.7	15.6	16.0
RoE	10.3	7.0	13.4	16.5	16.0	16.9	16.5
RoIC (or Core RoCE)	8.5	5.3	9.4	15.1	15.3	16.4	17.3
RoCE	8.9	5.7	11.3	16.0	15.6	16.6	16.2
EFFICIENCY							
Tax Rate (%)	17.8	26.8	16.3	-6.1	25.6	26.0	26.0
Fixed Asset Turnover (x)	1	1	1	2	2	2	2
Inventory (days)	74	75	80	76	75	75	75
Debtors (days)	99	105	95	110	95	95	95
Other Current Assets (days)	32	37	31	33	33	33	33
Payables (days)	35	42	35	36	36	36	36
Other Current Liab & Provns (days)	69	69	68	72	62	53	48
Cash Conversion Cycle (days)	138	139	140	150	134	134	134
Debt/EBITDA (x)	1.2	1.3	0.4	-0.1	0.0	-0.2	-0.4
Net D/E (x)	0.2	0.2	0.1	-0.0	0.0	-0.0	-0.1
PER SHARE DATA (Rs)							
EPS	72.4	58.9	112.9	117.1	172.0	212.3	241.6
Dividend	20.0	20.0	20.0	25.0	25.0	25.0	25.0
Book Value	746	760	842	931	1,073	1,255	1,467
VALUATION							
P/E (x)	66.7	82.0	37.4	41.3	28.1	22.8	20.0
P/BV (x)	6.5	6.4	5.7	5.2	4.5	3.8	3.3
EV/EBITDA (x)	62.7	77.7	40.1	37.3	22.8	18.1	15.5
EV/Revenues (x)	5.7	5.9	5.4	4.8	4.1	3.5	3.1
OCF/EV (%)	2.7	2.2	3.5	3.5	5.5	3.5	5.4
FCF/EV (%)	1.1	1.1	2.6	2.1	2.6	1.0	2.8
Dividend Yield (%)	0.4	0.4	0.4	0.5	0.5	0.5	0.5

Source: Company, HSIE Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
28-Jan-20	3,188	NEU	3,440
13-Feb-20	3,196	NEU	3,440
24-Feb-20	3,255	NEU	3,440
2-Mar-20	2,926	ADD	3,270
8-Apr-20	3,583	REDUCE	3,330
21-May-20	3,910	REDUCE	3,770
30-Jul-20	4,302	REDUCE	3,940
15-Sep-20	4,364	ADD	4,670
18-Sep-20	4,827	ADD	5,054

From 2nd March 2020, we have moved to new rating system

Rating Criteria

- BUY: >+15% return potential
- ADD: +5% to +15% return potential
- REDUCE: -10% to +5% return potential
- SELL: > 10% Downside return potential

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