

**HOLD**
**DR.REDDY'S LABORATORIES LTD**

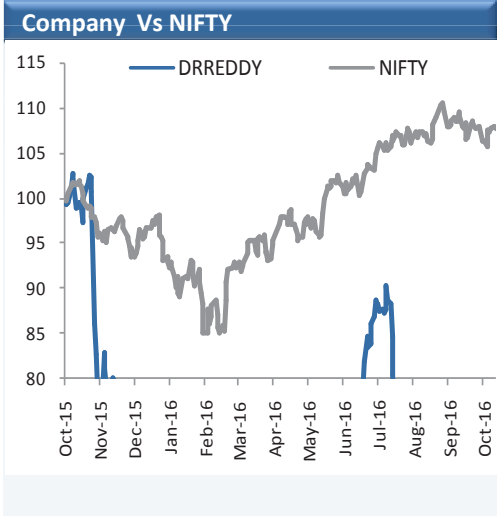
27th Oct 2016

Company Update	
CMP	3182
Target Price	3815
Previous Target Price	3815
Upside	20%
Change from Previous	0%

Market Data	
BSE Code	500124
NSE Symbol	DRREDDY
52wk Range H/L	4379/2750
Mkt Capital (Rs Cr)	52671
Av. Volume(,000)	30450
Nifty	30.45

Stock Performance			
	1M	3M	12M
Absolute	0.3	-26.2	6.4
Rel.to Nifty	0.6	-31.2	-11.0

Share Holding Pattern-%			
	2QFY17	1QFY17	4QFY16
Promoters	26.7	26.4	25.6
Public	73.3	73.6	74.4
Others			
Total	100.0	100.0	100.0



Dr Reddy has reported Revenue of Rs. 3616 Cr (up by 10.9% QoQ basis) led by the growth in the domestic and emerging markets. PSAI (Pharmaceuticals services & Active Ingredients) business grew 23.3%QoQ to 753 Cr. Increased pricing pressure and competition has impacted the revenue by a large extent; but the management has indicated that the second half of FY17 will be better than the first half. Four new launches in 2QFY17 and further more expected launches in second half , gives the visibility of revenue improvement in coming few months. On the contrary, ongoing concerns with the USFDA may pose challenge for the company in next couple of months. Considering near term uncertainties we recommend "HOLD" rating in this stock with a target price of Rs 3815.

**Business Highlights**

- EBITDA margin has increased to 17.3% from 12.1% in the 2QFY17. Gross Profit margin at 56% ,lower by ~530 bps verses the same quarter in FY16
- Research & Development expenses at Rs. 520 Cr ,i.e 14.5% of Revenue
- Revenue from the Global generics business at Rs. 2900 Cr YoY decline of 12% .This is led primarily on account of lower contribution from North America and loss of sales of Venezuela
- Revenue from India business at Rs. 630 Cr billion , YoY growth of 14%
- Revenue from Europe at Rs. 180 Cr , YoY decline of 16%
- During 2QFY17 , 15 DMF's were filed globally of which 3 were in the US. The cumulative number of DMF filings as on 30th September 2016, was 797
- In Aug 2016, Dr Reddy's Laboratories has successfully completed the previously announced acquisition of eight ANDAs in the US from Teva Pharmaceuticals Industries and an affiliate of Allergan Plc
- In September 2016 , Dr. Reddy's Expands Strategic Collaboration with Amgen in India. Under collaboration Dr. Reddy will commercialize XGEVA,Vectibix,Prolia in India

in(Rs Cr)	2012	2013	2014	2015	2016
Sales	9815	11896	13415	15023	15698
EBITDA	2431	2720	3251	3494	3921
Net Profit	1301	1527	1963	2336	2151
EPS	77	90	115	137	126
ROE	26%	24%	25%	24%	18%

(Source: Company/Eastwind)

## Earnings Call Highlights of 2QFY17

- Management has indicated that 2HFY17 will be better than 1HFY17. New Lauches for the second half of FY17 are in the pipeline
- Company is still waiting for the USFDA to set a face-to-face meeting
- Site transfer for Gleevac has started , approval from USFDA is expected in 4QFY17
- R&D expenses will be around Rs. 520 Cr in FY17 , 14.5% of sales
- Tax guidance for FY17 is 20-22%
- Capex Guidance for FY17 is Rs. ~ 3000 Cr
- Effective tax rate to be ~20-22% in FY17

## Business Overview

The Company is organized into the following businesses which are reportable segments:

**Pharmaceutical Services and Active Ingredients:** This segment includes active pharmaceutical ingredients and intermediates, also known as active pharmaceutical products or bulk drugs, which are the principal ingredients for finished pharmaceutical products. Active pharmaceutical ingredients and intermediates become finished pharmaceutical products when the dosages are fixed in a form ready for human consumption such as a tablet, capsule or liquid using additional inactive ingredients. This segment also includes contract research services and the manufacture and sale of active pharmaceutical ingredients and steroids in accordance with the specific customer requirements.

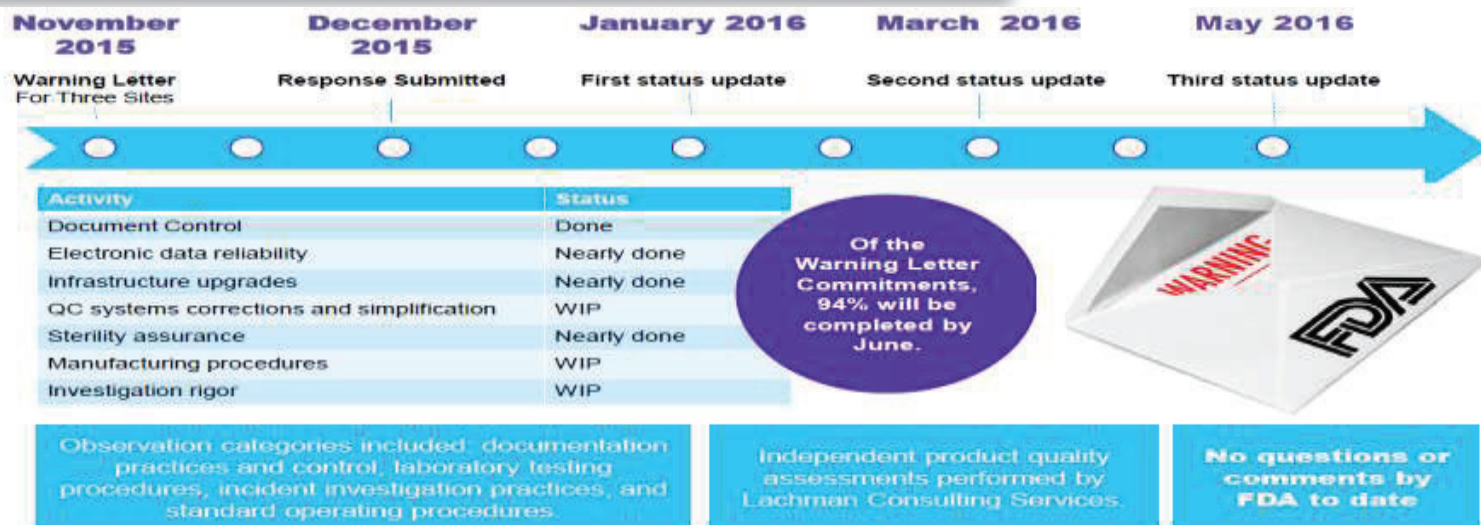
**Global Generics:** This segment consists of finished pharmaceutical products ready for consumption/ use by the patient, marketed under a brand name (Branded formulations) or as generic finished dosages with therapeutic equivalence to branded formulations (generics). This segment includes the operations of the Company's biologics business.

**Proprietary Products:** This segment consists of the Company's differentiated formulations business, New Chemical Entities ("NCEs") business, and the dermatology focused specialty business operated through Promius™ Pharma.

**Others:** This includes the operations of the Company's wholly-owned subsidiary, Aurigene Discovery Technologies Limited, a discovery stage biotechnology company developing novel and best-in-class therapies in the fields of oncology and inflammation and which works with established pharmaceutical and biotechnology companies in early-stage collaborations, bringing drug candidates from hit generation through Investigational New Drug ("IND") filing.



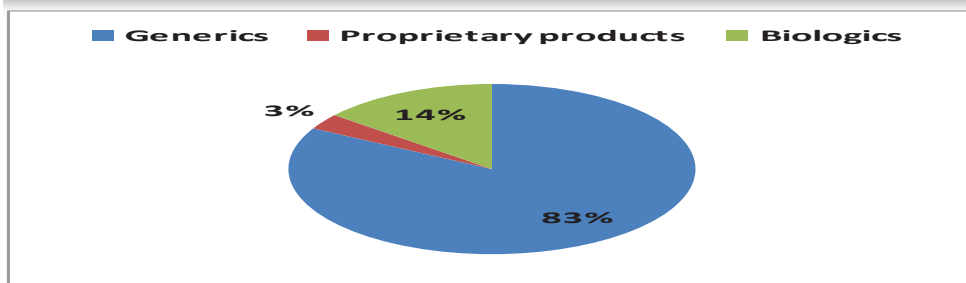
## Update on ongoing US FDA matters



## Key Risk to Target Price

Key Momentum For Stock	Upside Risk	Downside Risk
Clearance of Form 483 issues at Srikakulam API facility	Margin improvement despite increase in R&D	Regulatory delays affecting key US launches
Launch of key products like gCopaxone, gNexium, etc	Stabilisation of emerging market economies/currency, mainly Russia/CIS (12% of sales)	Adverse foreign exchange fluctuation

## R&D investment breakup (FY16)



### R&D costs increasing.

DRReddy remains committed to investing aggressively in R&D, to help build a robust pipeline of complex generics and products with significant entry barriers lending competitive advantage over the long run.

R&D guidance is around 12% of sales as per planned scale up in development activities

## About the Company

Dr. Reddy's is one of the largest Indian generic companies in the world with presence in more than 40 countries. USA is its largest market and contributes more than 40% of its revenues. It has one of the largest portfolios among Indian generic players and has enabled it to become a prominent generic player in the US. Russia and India are the two other key geographies, where it has significant presence. Apart from strengths in developing niche generic products, vertical integration into APIs has enabled it to become a global generic powerhouse. It operates 16 manufacturing bases (10 USFDA approved) and is actively supported by an extensive R&D programme. It also has one of the deepest pipelines of biosimilars amongst leading global generic companies, addressing global brand sales of USD30bn. The key therapeutic focus is on gastro-intestinal, cardiovascular, diabetology, oncology, pain management, anti-infective and paediatrics.

### Financials Snap Shot

INCOME STATEMENT				
	FY13	FY14	FY15	FY16
Revenue	11896	13415	15023	15698
Other Income	150	170	274	269
Total Revenue	12046	13585	15297	15967
COGS	3454	3261	3712	3541
GPM	29%	24%	25%	23%
Other Expenses	2751	2944	2995	4805
EBITDA	2720	3251	3494	3921
EBITDA Margin (%)	23%	24%	23%	25%
Depreciation	550	648	760	971
EBIT	2169	2603	2734	2950
Interest	100	127	108	82
PBT	2219	2646	2900	3137
Tax	638	683	563	524
Tax Rate (%)	29%	26%	19%	17%
Reported PAT	1527	1963	2336	2151
Dividend Paid	272	298	359	399
No. of Shares	17	17	17	17

Source: Eastwind/Company

RATIOS				
	FY13	FY14	FY15	FY16
EPS	90	115	137	126
Book Value	375	462	578	687
DPS	16.0	17.5	21.1	23.4
Payout (incl. Div. Tax.)	18%	15%	15%	19%
<b>Payout</b>				
P/E	19.6	22.2	25.4	24.0
Price / Book Value	4.7	5.5	6.0	4.4
Dividend Yield (%)	1%	1%	1%	1%
<b>Profitability Ratios</b>				
RoE	24%	25%	24%	18%
RoCE	28%	26%	24%	23%
<b>Turnover Ratios</b>				
Asset Turnover (x)	0.88	0.84	0.81	0.78
Debtors (No. of Days)	98.0	90.0	100.0	97.0
Inventory (No. of Days)	67.0	66.0	62.4	60.0
Creditors (No. of Days)	29.6	24.3	21.1	22.0
Net Debt/Equity (x)	0.2	0.3	0.1	0.1

Source: Eastwind/Company

BALANCE SHEET				
	FY13	FY14	FY15	FY16
Share Capital	85	85	85	85
Reserves and surplus	6284	7780	9768	11616
Shareholders' funds	6369	7865	9853	11701
Long term Debt	1266	2076	1432	1069
Total Borrowings	3165	4136	3617	3341
Non Current liabilities	193	299	492	404
Long term provisions	51	56	78	95
Short term Provisions	674	816	1144	1195
Current liabilities	3760	3730	4636	4565
Total liabilities	13487	16030	18598	20010
Net Fixed Assets	4616	5280	5906	7227
Non Current Investments	0.40	0.40	145.60	146.00
Long term Loans & Advan	149	232	418	519
Current assets	8527	10326	11877	11820
Total Assets	13487	16030	18598	20010

Source: Eastwind/Company

CASH FLOW STATEMENT				
	FY13	FY14	FY15	FY16
OP/(Loss) before Tax	2165	2646	2900	2675
Depreciation	550	648	760	971
Direct Taxes Paid	-555	-714	-546	-710
Operating profit before v	3228	3689	4554	4775
CF from Op. Activity	1378	1970	2524	4048
Purchase of Non Current	-1156	-2509	-3701	-5516
Capital expenditure on fi	-756	-1083	-1532	-1388
CF from Inv. Activity	-1446	-1694	-2265	-1942
Repayment of Long Term	0	1010	0	0
Interest Paid	-126	-116	-109	-92
Divd Paid (incl Tax)	-272	-298	-359	-411
CF from Fin. Activity	-157	-24	-433	-1701
Inc/(Dec) in Cash	-225	251	-174	405
Add: Opening Balance	746	611	757	154
Closing Balance	520	862	583	559

Source: Eastwind/Company