

Industry	Pharmaceuticals
Bloomberg	DRRD IN
BSE CODE	500124

Growth across geographies offset by lower uptake in Proprietary products and PSAI segment.

RATING	BUY
CMP	2562
Price Target	3025
Potential Upside	18%

Rating Change	↔
Estimate Change	↑
Target Change	↔

Stock Info

52wk Range H/L	2965/2065
Mkt Capital (Rs Cr)	42792
Free float (%)	73%
Avg. Vol 1M (,000)	618
No. of Shares (Crs)	17
Promoters Pledged %	0%

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1QFY20 Result update

- ❑ US sales grew by 10% YoY to US\$ 234 mn on account of new product launches such as Daptomycin, Testosterone gel, Tobramycin, Vitamin K & OTC calcium carbonate and re-launched Isotretinoin during the quarter.
- ❑ Revenues from India grew by 15% YoY to Rs. 696 crs-driven by volume traction and improved realizations in base business and new product launches.
- ❑ Revenues from Europe grew by 19% YoY to Rs 240 crs primarily on account of new products and volume traction on account of improvement in supplies.
- ❑ Gross profit margin declined by 400 bps to 51.7% due to price erosion, lower sales from PSAI business and also due to provisions related to product supplies in the US.
- ❑ Other income includes Rs. 350 crs received from Celgene on account of settlement of gRevlimid in Canada.

View and Valuation

Overall revenue for the quarter grew by 3% YoY to Rs. 3844 crs (vs our estimate of 4483 crs) The revenue growth in Q1FY20 was driven by growth in key geographies like US, India and ROW offset by lower uptake in PASI and Proprietary products segment. The margins for the quarter was mainly impacted due to decline in the PSAI margins from 22% in the previous quarter to 7.2% this quarter and also due to provisions related to product supplies in the US.

Going forward, we expect US sales to improve on the back of new launches and traction in the sales of Suboxone. Other Emerging markets are expected to grow on account of new products, volume traction and improved realizations in base business. PSAI segment will stabilize from Q2FY20 onwards based on the healthy order book as mentioned by the management. We believe the expected launch of gNuvaring and gCopaxone in FY20/FY21 and cost optimization and productivity improvement initiatives undertaken by the company will add positively to the revenues and margins in the medium term. Therefore, recommend BUY with the target price of Rs. 3025.

Key Risks to our rating and target

- ❑ R&D expenditure.
- ❑ Delay in approval for gNuvaring and gCopaxone.
- ❑ Re-inspection at Srikakulam facility (CTO-6).

Fig in Rs Cr

KEY FINANCIAL/VALUATIONS	FY17	FY18	FY19	FY20E	FY21E
Net Sales	14196	14281	15448	16666	18525
EBITDA	2221	2351	3178	3132	3603
EBIT	1194	1274	2043	1984	2412
PAT	1041	947	1950	1917	2000
EPS (Rs)	63	57	118	116	121
EPS growth (%)	-50%	-9%	106%	-2%	4%
ROE (%)	8%	8%	14%	12%	12%
ROCE (%)	9%	8%	13%	11%	12%
BV	740	758	845	937	1033
P/B (X)	3.5	2.7	3.3	2.7	2.5
P/E (x)	40.9	36.5	23.6	22.2	21.2

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1QFY20 Results

Financials	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	YoY %	QoQ%	Fig in Rs Cr		
								FY18	FY19	YoY %
Net Sales	3,737	3,818	3,865	4,030	3,858	3.3%	-4.3%	14,281	15,448	8.2%
Other Income	50	128	102	83	430	753.4%	416.3%	155	338	117.5%
COGS	1,005	1,052	1,176	1,262	1,207	20.1%	-4.4%	4,040	4,495	11.3%
Gross Margin	73.1%	72.5%	69.6%	68.7%	68.7%	-4.4%	0.0%	71.7%	70.9%	-0.8%
Employee Cost	837	872	805	842	862	2.9%	2.4%	3,215	3,356	4.4%
Other Expen.	1,126	1,134	1,079	1,107	1,048	-6.9%	-5.3%	4,675	4,419	-5.5%
EBITDA	769	759	805	819	742	-3.5%	-9.4%	2,351	3,178	35.2%
EBITDA Mar.	20.6%	19.9%	20.8%	20.3%	19.2%	-1.4%	-1.1%	16.5%	20.6%	4.1%
Depreciation	279	279	290	287	289	3.7%	0.6%	1,077	1,135	5.3%
EBIT	490	481	514	532	453	-8%	-14.9%	79	89	12.8%
Interest	20	21	24	25	30	53%	21.6%	79	89	12.8%
PBT	521	588	593	591	853	63.7%	44.5%	912	1,906	109%
Exceptional										
Tax	53	81	101	151	193	262.4%	27.9%	438	386	-12%
PAT	468	507	500	455	677	44.6%	48.6%	947	1,950	106%
PAT Margin	12.7%	13.6%	12.9%	12.9%	12.9%	0.2%	0.0%	6.6%	12.6%	6%

Growth across geographies offset by lower uptake in Proprietary products and PSAI segment

The overall revenue for the quarter grew by 3% YoY to Rs. 3844 crs. US sales was flat YoY but grew sequentially 10% to US\$ 234 mn on account of new launches. India sales grew by 15% YoY to Rs. 696 crs on account of volume traction and improved realization in base business and new product launches. Europe grew by 19% YoY on account of improvement in supplies. The growths in these geographies were offset by weak PSAI segment, which de-grew by 16% on account of decline in sales volume of certain products due to manufacturing issues.

Gross margin contracted due to one-off though EBITDA margin maintained at 19%-20% from the 5 consecutive quarters.

Gross margin this quarter declined by 400 bps to 51.7% on account of provision made for inventories and lower PASI sales on account of manufacturing issues.

Though the EBITDA margin has been impacted due lower gross margin but the fall is not steep and is maintained at 19.2% for the quarter based on cost optimization and productivity improvement initiatives undertaken by the company.

Concall Highlights

- Europe - the company has launched 6 products in Germany, 4 products in UK, 1 product in Spain, and 3 products in France.
- PASI sales declined by 16% to Rs 454 crs due to decline in the sales volume of certain products due to manufacturing issues.
- Gross profit margin for GG and PSAI business segments are at 57.6% and 7.2% respectively.
- R&D expenses for the quarter are at Rs 361 crs (9.4% of sales). For the full year, management guided the R&D spend to be in the range of US\$ 250-300 mn.
- PASI sales- The Company expects strong revival in Q2FY20 on account of healthy order book.
- The management expects the gross margins to be in the range of 53%- 56%.
- Free cash flow generated for the quarter was at 850 crs.
- DRREDDY is on track to launch more than 30 products in FY20.
- **gSuboxone**: The shift from innovator to generics was slow. Now generic penetration is at 50%, DRREDDY has 20% of the generic market.
- **gNuvaring**- The company has responded to the USFDA, the company is expecting further queries from the USFDA.
- **gRevlimid**: In legal proceedings. No date announced.
- Srikakulam facility (CTO-6): The company had an interaction with the USFDA and is expects a re-inspection.

Exhibit: Sales and Sales Growth

Sales for the quarter grew by 3% YoY to Rs.3844 crores (vs our estimate of Rs. 4483 crs)

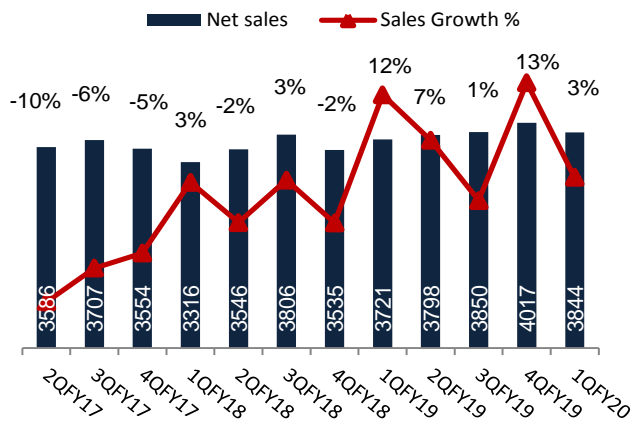


Exhibit: Gross and EBITDA margin

Gross margin this quarter declined by 400 bps to 51.7% on account of lower PASI sales.

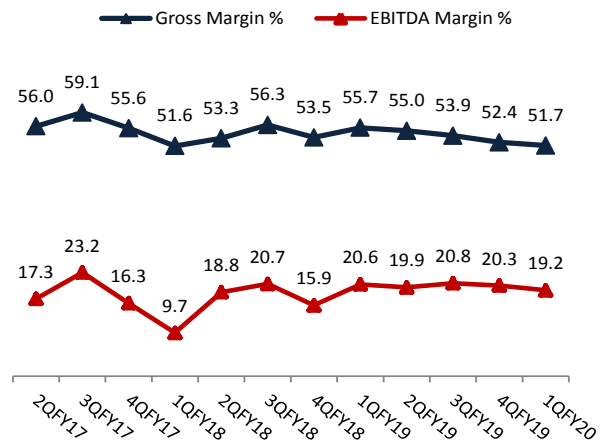


Exhibit: PAT and PAT margin

PAT for the quarter grew by 18% to Rs.677 crs on account of settlement of gRevlimid in Canada.

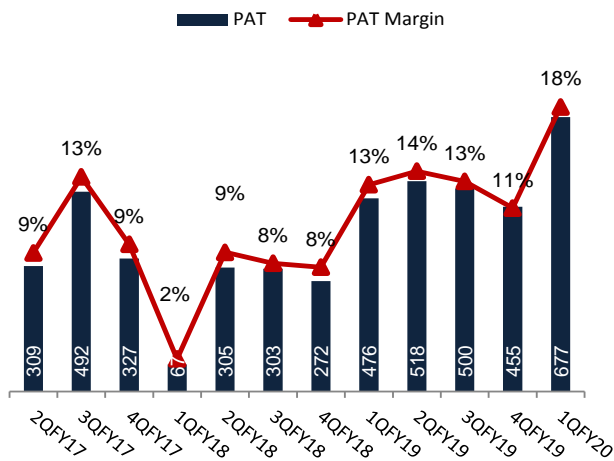


Exhibit: R&D cost and R&D as a % of sales

R&D expenses for Q1FY20 were at Rs 361 crs (9.4% of sales). R&D expenses would increase in the rest of the yr.

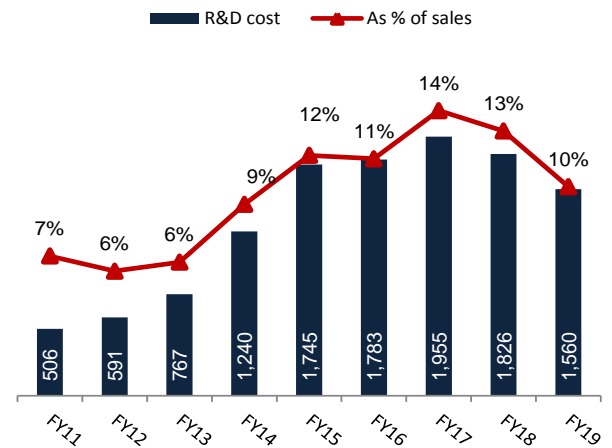


Exhibit: Domestic sales and YoY growth

India sales grew by 15% YoY to Rs. 696 crs on account of growth in base business and new product

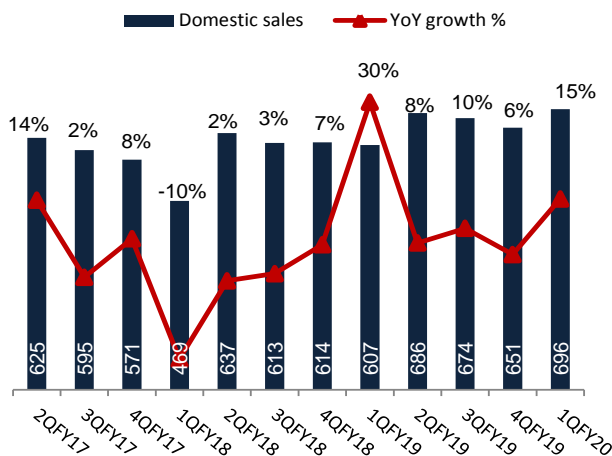
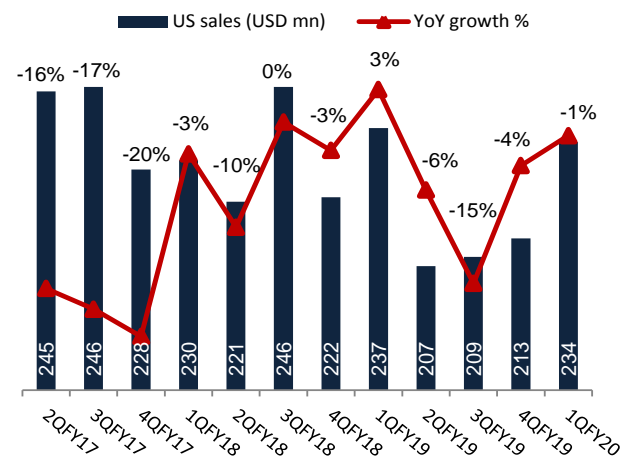


Exhibit: US sales and YoY growth

US sales were flat YoY to USD 234 million though sequentially has improved by 9%.



Operational Details

Fig in Rs Cr

Geography	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20
<i>North America</i>	1495	1432	1607	1449	1590	1427	1483	1496	1632
<i>Europe</i>	208	242	201	171	202	192	203	191	240
<i>India</i>	469	637	613	614	607	686	674	651	696
<i>Emerging Markets</i>	575	551	590	550	664	749	774	701	730
<i>PSAI</i>	465	565	544	625	541	603	594	677	454
<i>Proprietary products and</i>	105	119	252	126	116	141	122	302	91

Revenue gr. %	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20
<i>North America</i>	-4%	-11%	-3%	-6%	6%	0%	-8%	3%	3%
<i>Europe</i>	28%	36%	-7%	-17%	-3%	-21%	1%	12%	19%
<i>India</i>	-10%	2%	3%	7%	30%	8%	10%	6%	15%
<i>Emerging Markets</i>	34%	14%	-1%	-9%	16%	36%	31%	27%	10%
<i>PSAI</i>	-1%	-2%	1%	16%	16%	7%	9%	8%	-16%
<i>Proprietary products and</i>	4%	10%	145%	26%	10%	19%	-52%	139%	-21%

Revenue mix%	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20
<i>North America</i>	45%	40%	42%	41%	43%	38%	39%	37%	42%
<i>Europe</i>	6%	7%	5%	5%	5%	5%	5%	5%	6%
<i>India</i>	14%	18%	16%	17%	16%	18%	18%	16%	18%
<i>Emerging Markets</i>	17%	16%	16%	16%	18%	20%	20%	17%	19%
<i>PSAI</i>	14%	16%	14%	18%	15%	16%	15%	17%	12%
<i>Proprietary products and</i>	3%	3%	7%	4%	3%	4%	3%	8%	2%

Financial Details

Balance Sheet

Fig in Rs Cr

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
Share Capital	85	85	85	83	83	83	83	83
Reserves	7,780	9,768	12,485	12,179	12,489	13,941	15,458	17,059
Networth	7,865	9,853	12,570	12,262	12,572	14,024	15,541	17,142
Debt	4,136	3,617	3,340	4,908	5,065	3,413	3,413	3,413
Other Non Current Liab	299	492	399	590	570	345	360	391
Total Capital Employed	12,001	13,470	15,910	17,170	17,637	17,436	18,954	20,555
Net Fixed Assets (incl CWIP)	5,280	5,906	7,335	10,255	10,439	10,125	11,147	11,956
Non Current Investments	0	146	330	683	465	334	314	314
Other Non Current Assets	424	670	925	1,195	1,142	897	906	988
Non Current Assets	5,704	6,721	8,590	12,133	12,046	11,356	12,367	13,258
Inventory	2,419	2,570	2,558	2,853	2,909	3,358	3,865	4,295
Debtors	3,325	4,101	4,125	3,799	4,053	3,987	4,456	4,801
Cash & Bank	2,301	1,872	492	387	264	223	254	623
Other Current Assets	2,281	3,333	4,619	2,646	3,273	3,543	3,388	3,539
Current Assets	10,326	11,877	11,794	9,684	10,498	11,110	11,963	13,258
Creditors	893	867	907	1,057	1,335	1,367	1,475	1,639
Provisions	816	1,144	529	513	439	479	481	532
Other Current Liabilities	2,021	2,624	2,640	2,488	2,564	2,839	3,060	3,398
Curr Liabilities	3,730	4,636	4,075	4,057	4,338	4,685	5,016	5,570
Net Current Assets	6,596	7,241	7,719	5,626	6,161	6,425	6,947	7,688
Total Assets	16,030	18,598	20,384	21,817	22,544	22,466	24,330	26,516

Income Statement

Fig in Rs Cr

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
Revenue from Operation	13,415	15,023	15,568	14,196	14,281	15,448	16,666	18,525
Change (%)	13%	12%	4%	-9%	1%	8%	8%	11%
EBITDA	3251	3494	3585	2221	2351	3178	3132	3603
Change (%)	20%	7%	3%	-38%	6%	35%	-1%	15%
Margin (%)	24.2%	23.3%	23.0%	15.6%	16.5%	20.6%	18.8%	19.5%
Depr & Amor.	648	760	939	1027	1077	1135	1149	1191
EBIT	2603	2734	2646	1194	1274	2043	1984	2412
Int. & other fin. Cost	127	108	83	63	79	89	119	119
Other Income	170	274	295	172	155	338	555	232
EBT	2,646	2,900	2,859	1,302	1,350	2,292	2,419	2,525
Exp Item	-	-	-	-	-	-	-	-
Tax	683	563	751	297	438	386	545	568
Minority Int & P/L share of Ass.	-	-	23	35	34	44	44	44
Reported PAT	1,963	2,336	2,108	1,006	912	1,906	1,874	1,957
Adjusted PAT	1,963	2,336	2,131	1,041	947	1,950	1,917	2,000
Change (%)	29%	19%	-9%	-51%	-9%	106%	-2%	4%
Margin(%)	14.6%	15.6%	13.7%	7.3%	6.6%	12.6%	11.5%	10.8%

Financial Details

Key Ratios

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
ROE	25.0%	23.7%	17.0%	8.5%	7.5%	13.9%	12.3%	11.7%
ROCE	26.2%	24.2%	19.4%	9.3%	8.4%	12.6%	11.2%	12.5%
Asset Turnover	3	3	2	1	1	2	2	2
Debtor Days	91	100	97	98	104	95	98	95
Inv Days	66	63	60	74	75	80	85	85
Payable Days	25	21	21	27	34	32	32	32
Int Coverage	22	21	25	32	19	16	23	17
P/E	21.2	24.4	23.4	40.9	36.5	23.6	22.2	21.2
Price / Book Value	5.3	5.8	4.0	3.5	2.7	3.3	2.7	2.5
EV/EBITDA	13	16	14	19	16	15	14	12
FCF per Share	52	58	156	56	53	131	22	54
Div Yield	1%	1%	1%	1%	1%	1%	1%	1%

Cash Flow Statement

Fig in Rs Cr

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
PBT	2,646	2,900	2,675	1,554	1,350	2,292	2,463	2,569
(inc)/Dec in Working Capital	(1,005)	(1,484)	(18)	(525)	(897)	(577)	(737)	(423)
Non Cash Op Exp	648	760	971	1,027	1,077	1,135	1,149	1,191
Int Paid (+)	127	108	82	63	79	89	119	119
Tax Paid	(714)	(546)	(710)	(577)	(276)	(484)	(545)	(568)
others	269	786	1,047	603	469	(345)	-	-
CF from Op. Activities	1,970	2,524	4,048	2,144	1,803	2,870	2,449	2,888
(inc)/Dec in FA & CWIP	(1,083)	(1,532)	(1,388)	(1,223)	(929)	(696)	(2,086)	(2,000)
Free Cashflow	887	992	2,660	922	874	2,175	363	888
(Pur)/Sale of Inv	(2,509)	(3,701)	(5,516)	(4,972)	(6,829)	7,629	-	-
others	1,898	2,967	4,962	4,354	6,270	7,692	188	-
CF from Inv. Activities	(1,694)	(2,265)	(1,942)	(1,840)	(1,488)	(773)	(1,898)	(2,000)
inc/(dec) in NW				(1,569)				
inc/(dec) in Debt	390	34	(1,199)	1,631	88	(1,518)	-	-
Int. Paid	(116)	(109)	(92)	(92)	(133)	(161)	(119)	(119)
Div Paid (inc tax)	(298)	(359)	(411)	(339)	(399)	(400)	(400)	(400)
others	0	1	0	-	-	-	-	-
CF from Fin. Activities	(24)	(433)	(1,701)	(369)	(444)	(2,133)	(519)	(519)
Inc(Dec) in Cash	251	(174)	405	(65)	(129)	(35)	31	369
Add: Opening Balance	611	757	154	443	384	258	223	254
Closing Balance	862	583	559	378	254	223	254	623

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