

Industry **Pharmaceuticals**
 Bloomberg **DRRD IN**
 BSE CODE **500124**

One-off gains led to better performance this quarter

RATING	NEUTRAL
CMP	2838
Price Target	2819
Potential Upside	-1%

Rating Change	
Estimate Change	
Target Change	

STOCK INFO	
52wk Range H/L	2965/2065
Mkt Capital (Rs Cr)	47131
Free float (%)	73%
Avg. Vol 1M (,000)	601
No. of Shares (Crs)	17
Promoters Pledged %	0%

2QFY20 Result update

- Overall revenue grew by 26% YoY to Rs.4801 crs majorly on account of license fee of Rs.723 crs received for selling US and select territory rights for Neurology brands ZEMBRACE, SYMTOUCH 3 mg and TOSYMRATM 10 mg, to Upsher-Smith Laboratories, LLC.
- The sales from North America declined by 13% YoY to Rs.1427 crs on account of price erosion and lower volumes. Further impact on account of voluntary recall of ranitidine and temporary disruption in supplies due to logistics issues faced during this quarter.
- Revenue from Europe grew by 44% YoY primarily on account of new products and volume traction in base business partly offset by lower realizations.
- PSAI revenue grew by 18% YoY on account of increase in volumes from existing products. PP sales were 809 crs on account of license fees received by Upsher-Smith Laboratories, LLC.
- Gross margin for the quarter grew by 156 bps YoY to 70.9% and EBITDA margin expanded by 221 bps YoY to 22.1%.
- PAT grew by 114% to Rs. 1107 crs due to recognition of deferred tax assets of Rs. 520 crs, primarily related to the MAT credit.

View and Valuation

The overall revenue this quarter grew by 26% YoY to Rs. 4801 crs (vs our estimate of Rs. 4159 crs) majorly on account of license fee of Rs.723 crs received for selling US and select territory rights for Neurology brands to Upsher-Smith Laboratories, LLC. The US business declined by 13% YoY on account of voluntary recall of Ranitidine and temporary disruption in supplies due to logistics issues faced during this quarter. Other markets like Europe, India and ROW has improved on account of new products and volume traction

Going forward, Drreddy is progressing well on the biosimilars front and based on the management commentary of normalized US sales from Q3FY20 onwards and total expected launch of 30 products in FY20 makes us positive about the US sales in the next 2 quarters to be better than Q2FY20. However, factoring in the impact of the product recall and delay in the launch of gNuvaring & gCopaxone; we maintain our NEUTRAL stance with the target price of Rs. 2819.

Key Risks to our rating and target

- Re-inspection at Srikakulam facility .
- gNuvaring & gCopaxone launch.

Fig in Rs Cr

KEY FINANCIAL/VALUATIONS	FY17	FY18	FY19	FY20E	FY21E
Net Sales	14196	14281	15448	17079	18414
EBITDA	2221	2351	3178	3650	3656
EBIT	1194	1274	2043	2439	2375
PAT	1041	947	1950	2641	2034
EPS (Rs)	63	57	118	159	123
EPS growth (%)	-50%	-9%	106%	35%	-23%
ROE (%)	8.5%	7.5%	13.9%	16.2%	11.4%
ROCE (%)	9.3%	8.4%	12.6%	13.2%	11.8%
BV	740	758	845	980	1079
P/B (X)	3.5	2.7	3.3	2.9	2.6
P/E (x)	40.9	36.5	23.6	17.8	23.2

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2QFY20 Results

Fig in Rs Cr

FINANCIALS	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	YoY %	QoQ%	FY18	FY19	YoY %
Net Sales	3,818	3,865	4,030	3,858	4,813	26.1%	24.7%	14,281	15,448	8.2%
Other Income	128	102	83	430	54	-57.9%	-87.4%	155	338	117.5%
COGS	1,052	1,176	1,262	1,207	1,401	33.2%	16.1%	4,040	4,495	11.3%
Gross Margin	72.5%	69.6%	68.7%	68.7%	70.9%	-1.6%	2.2%	71.7%	70.9%	-0.8%
Employee Cost	872	805	842	862	826	-5.4%	-4.2%	3,215	3,356	4.4%
Other Expen.	1,134	1,079	1,107	1,048	1,522	34.2%	45.3%	4,675	4,419	-5.5%
EBITDA	759	805	819	742	1,064	40.1%	43.4%	2,351	3,178	35.2%
EBITDA Mar.	19.9%	20.8%	20.3%	19.2%	22.1%	2.2%	2.9%	16.5%	20.6%	4.1%
Depreciation	279	290	287	289	313	12.4%	8.3%	1,077	1,135	5.3%
EBIT	481	514	532	453	751	56%	65.8%	79	89	12.8%
Interest	21	24	25	30	30	46%	1.7%	79	89	12.8%
PBT	588	593	591	853	774	31.7%	-9.2%	912	1,906	109%
Exceptional Item										
Tax	81	101	151	193	(321)	-497%	-266%	438	386	-12%
PAT	507	500	455	677	1,107	118.1%	63.6%	947	1,950	106%
PAT Margin	13.6%	12.9%	12.9%	12.9%	12.9%	-0.6%	0.0%	6.6%	12.6%	6%

Concall Highlights

- The sales from North America declined by 13% YoY to Rs.1427 crs on account of price erosion and lower volumes. Further impact on account of voluntary recall of ranitidine and temporary disruption in supplies due to logistics issues faced during this quarter.
- DRRD is on track to launch more than 30 plus products in FY20. The company launched eight products in Q2FY20.
- gSuboxone: The Potential exit of AG is positive and the company has the capacity to take up the opportunity. Currently, the market share is higher than 15%.
- Launched five products in India, leading to 9% YoY growth.
- Revenue from Europe grew by 44% YoY primarily on account of new products and volume traction in base business partly offset by lower realizations.
- PSAI revenue grew by 18% YoY on account of increase in volumes from existing products. PP sales were 809 crs on account of license fees received by Upsher-Smith Laboratories, LLC.
- Gross profit margin for GG and PSAI business segments were at 55.5% and 24.6% respectively.
- Impairment charges of Rs. 355 crs recognised in SG&A head relating to 3 product related intangibles i.e., ramelteon, tobramycin and imiquimod, there is an additional Rs 100 crs one-off in the SG&A. Normalized for the one-offs, the SG&A spend this quarter was lower sequentially.
- R&D expenses for quarter were at 370 crs, 7.6% of sales in Q2FY20 in comparison to 10.8% of sales in Q2FY19. For the full year, management has guided for R&D spend to be in the range of US\$ 200-240 mn.
- As a result of reduction of MAT rate from 21.5% to 17.5% (including surcharge and cess), the Company recognized an amount of Rs. 499 crs as deferred tax asset during this quarter. Therefore, the ETR for FY20 as guided by the management is expected to be less than 10%.
- The free cash flow this quarter was 874 crs, Capex for the quarter were at Rs. 110 crs.
- On the regulatory front, the company expects inspection by the USFDA for the API plant in Srikakulam in the near future.
- For Nuvaring and Copaxone, the company has received CRL from USFDA; the company is in the process to address it.
- **Biosimilars**
 - Rituximab trial is progressing well.
 - Pegfilgrastim: Phase III was completed and Fresenius Kabi is preparing to file.
 - Xenoport: Completed IIb studies.

Exhibit: Sales and Sales Growth

The overall revenue this quarter grew by 26% YoY to Rs. 4801 crs (vs our estimate of Rs. 4159 crs)

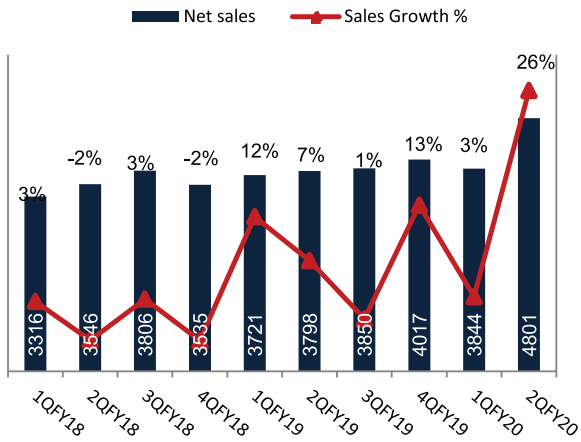


Exhibit: Gross and EBITDA margin

Gross margin grew by 156 bps YoY to 70.9% and EBITDA margin expanded by 221 bps YoY to 22.1%.

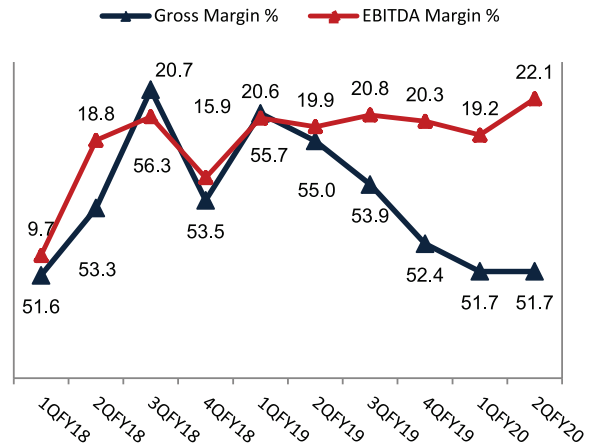


Exhibit: PAT and PAT margin

PAT grew by 114% to Rs. 1107 crs due to recognition of deferred tax assets of Rs. 520 crs.

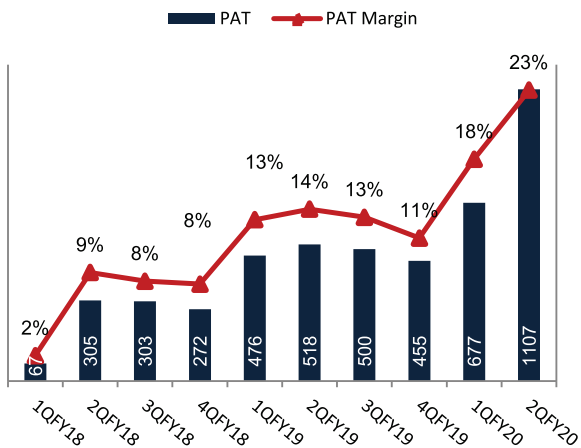


Exhibit: R&D cost and R&D as a % of sales

R&D expenses for quarter were at 370 crs, 7.6% of sales in Q2FY20 in comparison to 10.8% of sales in Q2FY19.

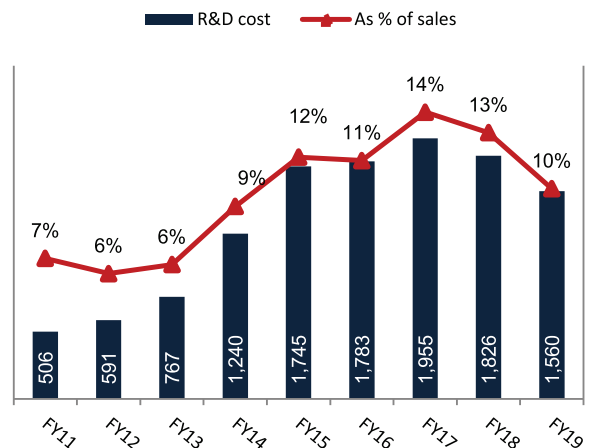
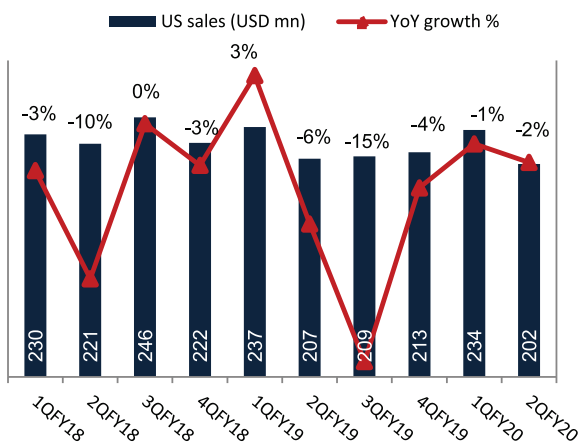


Exhibit: US sales and YoY growth

The US sales declined by 13% YoY to Rs.1427 crs on account of product recall & supplies issues.



Operational Details

Fig in Rs Cr

GEOGRAPHY	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20
North America	1432	1607	1449	1590	1427	1483	1496	1632	1427
Europe	242	201	171	202	192	203	191	240	276
India	637	613	614	607	686	674	651	696	751
Emerging Markets	551	590	550	664	749	774	701	730	828
PSAI	565	544	625	541	603	594	677	454	711
Proprietary products and others	119	252	126	116	141	122	302	91	0

REVENUE GR. %	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20
North America	-11%	-3%	-6%	6%	0%	-8%	3%	3%	0%
Europe	36%	-7%	-17%	-3%	-21%	1%	12%	19%	44%
India	2%	3%	7%	30%	8%	10%	6%	15%	9%
Emerging Markets	14%	-1%	-9%	16%	36%	31%	27%	10%	10%
PSAI	-2%	1%	16%	16%	7%	9%	8%	-16%	18%
Proprietary products and others	10%	145%	26%	10%	19%	-52%	139%	-21%	-100%

REVENUE MIX%	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20
North America	40%	42%	41%	43%	38%	39%	37%	42%	36%
Europe	7%	5%	5%	5%	5%	5%	5%	6%	7%
India	18%	16%	17%	16%	18%	18%	16%	18%	19%
Emerging Markets	16%	16%	16%	18%	20%	20%	17%	19%	21%
PSAI	16%	14%	18%	15%	16%	15%	17%	12%	18%
Proprietary products and others	3%	7%	4%	3%	4%	3%	8%	2%	0%

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	16,182	17,816
Networth	7,865	9,853	12,570	12,262	12,572	14,024	16,265	17,899
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	315	339
Total Capital Employed	12,001	13,470	15,910	17,170	17,637	17,436	19,678	21,312
Net Fixed Assets (incl CWIP)	5,280	5,906	7,335	10,255	10,439	10,125	9,999	11,205
Non Current Investments	0	146	330	683	465	334	314	314
Other Non Current Assets	424	670	925	1,195	1,142	897	1,402	1,412
Non Current Assets	5,704	6,721	8,590	12,133	12,046	11,356	11,715	12,930
Inventory	2,419	2,570	2,558	2,853	2,909	3,358	3,961	4,269
Debtors	3,325	4,101	4,125	3,799	4,053	3,987	4,567	4,772
Cash & Bank	2,301	1,872	492	387	264	223	936	1,155
Other Current Assets	2,281	3,333	4,619	2,646	3,273	3,543	3,976	4,084
Current Assets	10,326	11,877	11,794	9,684	10,498	11,110	13,440	14,280
Creditors	893	867	907	1,057	1,335	1,367	1,511	1,629
Provisions	816	1,144	529	513	439	479	487	525
Other Current Liabilities	2,021	2,624	2,640	2,488	2,564	2,839	3,163	3,406
Curr Liabilities	3,730	4,636	4,075	4,057	4,338	4,685	5,162	5,560
Net Current Assets	6,596	7,241	7,719	5,626	6,161	6,425	8,277	8,720
Total Assets	16,030	18,598	20,384	21,817	22,544	22,466	25,155	27,211

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	17,079	18,414
Change (%)	13%	12%	4%	-9%	1%	8%	11%	8%
EBITDA	3251	3494	3585	2221	2351	3178	3650	3656
Change (%)	20%	7%	3%	-38%	6%	35%	15%	0%
Margin (%)	24%	23%	23%	16%	16%	21%	21%	20%
Depr & Amor.	648	760	939	1027	1077	1135	1212	1281
EBIT	2603	2734	2646	1194	1274	2043	2439	2375
Int. & other fin. Cost	127	108	83	63	79	89	119	119
Other Income	170	274	295	172	155	338	567	232
EBT	2,646	2,900	2,859	1,302	1,350	2,292	2,886	2,487
Exp Item	-	-	-	-	-	-	-	-
Tax	683	563	751	297	438	386	289	497
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	2,598	1,990
Adjusted PAT	1,963	2,336	2,131	1,041	947	1,950	2,641	2,034
Change (%)	29%	19%	-9%	-51%	-9%	106%	35%	-23%
Margin(%)	15%	16%	14%	7%	7%	13%	15%	11%

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%	16.2%	11.4%
ROCE	26.2%	24.2%	19.4%	9.3%	8.4%	12.6%	13.2%	11.8%
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	20
P/E	21.2	24.4	23.4	40.9	36.5	23.6	17.8	23.2
Price / Book Value	5.3	5.8	4.0	3.5	2.7	3.3	2.9	2.6
EV/EBITDA	13	16	14	19	16	15	13	13
FCF per Share	52	58	156	56	53	131	96	45
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	2,930	2,531
(inc)/Dec in Working Capital	(1,005)	(1,484)	(18)	(525)	(897)	(577)	(1,373)	(209)
Non Cash Op Exp	648	760	971	1,027	1,077	1,135	1,212	1,281
Int Paid (+)	127	108	82	63	79	89	119	119
Tax Paid	(714)	(546)	(710)	(577)	(276)	(484)	(289)	(497)
others	269	786	1,047	603	469	(345)	-	-
CF from Op. Activities	1,970	2,524	4,048	2,144	1,803	2,870	2,600	3,224
(inc)/Dec in FA & CWIP	(1,083)	(1,532)	(1,388)	(1,223)	(929)	(696)	(1,002)	(2,486)
Free Cashflow	887	992	2,660	922	874	2,175	1,598	739
(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	(366)	-
CF from Inv. Activities	(1,694)	(2,265)	(1,942)	(1,840)	(1,488)	(773)	(1,368)	(2,486)
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)	713	219
Add: Opening Balance	611	757	154	443	384	258	223	936
Closing Balance	862	583	559	378	254	223	936	1,155

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