

May 13, 2015

Dr Reddy's Laboratories (DRREDD) ₹ 3485

Higher R&D, adverse product mix hit margins

- Revenues grew 11.2% YoY to ₹ 3870.4 crore (I-direct estimate: ₹ 3993 crore) mainly on account of 15% growth in US formulation sales to ₹ 1715.4 crore
- EBITDA margins declined 111 bps YoY to 21.3% vs. I-direct estimate of 26%. The delta was mainly due to higher R&D spend, change in product mix and currency fluctuation. EBITDA in absolute terms increased 5.7% to ₹ 825.6 crore vs. I-direct estimate of ₹ 1038.2 crore
- Net profit increased 7.7% to ₹ 518.8 crore vs. I-direct estimate of ₹ 755.9 crore. The miss was on account of lower operational income and higher finance expenses

Global generics to piggyback on strong, sustainable US traction

The global generics (GG) segment is expected to grow at a CAGR of 17% in FY15-17E driven by strong US traction, which is likely to grow at a CAGR of ~19% during the same period. DRL has developed a knack for exclusivity/FTF launches on a fairly continuous basis in the US. We expect this trend to continue further. However, the focus has now shifted to more unique launches like OTC, complex generics, controlled releases, etc. The US traction is also likely to nullify European slowdown. The US pipeline includes 220 filed ANDAs including 68 pending approvals.

Russia CIS becomes volatile; India to provide more stability

Global generics (ex US, Europe) are likely to grow at a steady CAGR of ~17% in FY15-17E driven by growth in India as the Russian performance remains volatile. These two markets are more or less identical in nature (branded generics and OTC) with similar growth potential and similar kinds of risks. DRL is well versed with the dynamics in Russia by virtue of being an early mover. However, the recent currency volatility and political unrest have caused disturbances in an otherwise safe market for the company. For India, growth is expected to be largely from launches in the oncology and biosimilars space besides an improvement in productivity of the enhanced field force.

Portfolio realignment eminent

We envisage a fall in share of low margin/high risk segments such as PSAI and European generics (especially Betapharm), going ahead. Thus, growth in FY15-17E is likely to emanate from more productive and sustainable segments such as US and India. Similarly, in terms of product offering, we envisage more launches in the fields of injectables, OTC, complex/limited competition products & biosimilars, besides legacy generics.

US franchisee looks promising; India growth likely to sustain

US and India together hold the key for global generics growth as well as DRL's overall growth. Among them, the US is the main catalyst with a pending product portfolio of 68 ANDAs, which includes 43 Para IVs and 13 FTFs. The company is investing heavily in R&D to bring more and complex generics and limited competition products, mainly from the non-oral category, which is likely to take care of sustained US growth for the next two or three years. India is showing promising growth as well with a recalibrated approach and the recent acquisition (UCB's India business) bodes well for the future. Russia, Europe and PSAI segments, however, continue to pose challenges for being lumpy and volatile. We have ascribed a target of ₹ 3949 based on 22x FY17E EPS of ₹ 179.5.

Rating matrix

Rating	:	Buy
Target	:	₹ 3949
Target Period	:	12-15 months
Potential Upside	:	13%

What's Changed?

Target	Changed from ₹ 3332 to ₹ 3949
EPS FY16E	Changed from ₹ 151 to 150.9
EPS FY17E	Changing from ₹ 185.1 to ₹ 179.5
Rating	Changed from Hold to Buy

Quarterly Performance

	Q4FY15	Q4FY14	YoY (%)	Q3FY15	QoQ (%)
Revenue	3,870.4	3,480.9	11.2	3,843.1	0.7
EBITDA	825.6	781.3	5.7	980.2	-15.8
EBITDA (%)	21.3	22.4	-111 bps	25.5	-417 bps
Net Profit	518.8	481.7	7.7	574.6	-9.7

Key Financials

(₹crore)	FY14	FY15	FY16E	FY17E
Revenues	13217.0	14818.9	17291.5	19438.4
EBITDA	3312.7	3482.7	4065.1	4667.0
Net Profit	2151.3	2099.0	2562.6	3048.2
EPS (₹)	126.7	123.6	150.9	179.5

Valuation summary

	FY14	FY15	FY16E	FY17E
PE (x)	27.5	28.2	23.1	19.4
Target PE (x)	31.2	31.9	26.2	22.0
EV to EBITDA (x)	14.8	13.9	11.7	9.8
Price to book (x)	5.3	4.4	3.7	3.0
RoNW (%)	23.7	19.3	19.6	19.4
RoCE (%)	19.2	18.1	20.2	21.3

Stock data

Particular	Amount
Market Capitalisation	₹ 59280 crore
Debt (FY15)	₹ 3635 crore
Cash & cash equivalents (FY15)	₹ 3114 crore
EV	₹ 59800 crore
52 week H/L	3808/2250
Equity capital	₹ 85.0 crore
Face value	₹ 5

Price performance (%)

	1M	3M	6M	1Y
Dr Reddy's Labs	-8.7	4.1	0.8	27.4
Sun Pharma	-15.2	2.8	4.8	54.8
Lupin	-11.0	8.1	22.9	82.3

Research Analyst

Siddhant Khandekar
siddhant.khandekar@icicisecurities.com
Mitesh Shah
mitesh.shah@icicisecurities.com
Nandan Kamat
nandan.kamat@icicisecurities.com

Variance analysis

	Q4FY15	Q4FY15E	Q4FY14	Q3FY15	YoY (%)	QoQ (%)	Comments
Revenue	3,870.4	3,993.0	3,480.9	3,843.1	11.2	0.7	The growth was mainly driven by 14.6% growth in the US and 15.7% growth in India.
Raw Material	1,089.6	958.3	927.7	961.7	17.4	13.3	Raw material cost increase was mainly due to adverse product mix, inventory write-off in the US and currency fluctuation
Other manufacturing expenses	658.8	678.8	561.0	646.2	17.4	1.9	
SGNA	794.5	878.5	835.1	857.5	-4.9	-7.3	
R & D cost	514.4	447.2	398.5	431.6	29.1	19.2	R&D cost as percentage of sales increased 184 bps to 13.3% on account of planned scale up in overall R&D spend and filing of three NDAs
Write down of Intangible assets	0.0	0.0	0.0	0.0	0.0	0.0	
Write down of goodwill	0.0	0.0	0.0	0.0	0.0	0.0	
Other (income)/expenses	-12.5	-8.0	-22.6	-34.1	NA	NA	
Total Expenditure	1,296.4	1,317.7	1,211.0	1,255.1	7.1	3.3	
EBITDA	825.6	1,038.2	781.3	980.2	5.7	-15.8	
EBITDA (%)	21.3	26	22.4	25.5	-111 bps	-417 bps	Fall in margins was mainly on account of increase in R&D spend, change in product mix and currency volatility in the emerging markets
Depreciation	213.7	195.9	195.6	257.4	9.3	-17.0	
Finance (income)/ expenses	23.3	-42.0	-16.4	-101.3	LP	LP	
Share of pr/(loss) to equity investee	4.4	5.0	4.8	4.7	-9.7	-6.2	
Tax	74.2	133.4	125.2	254.1	-40.8	-70.8	
Net Profit	518.8	755.9	481.7	574.6	7.7	-9.7	Increase in profit was mainly in line with lower operational performance
Key Metrics							
North America formulations	1715.4	1945.3	1496.4	1681.9	14.6	2.0	Growth was on account of acquiring of Habitrol brand and increased market shares in key products. Delta vis-à-vis estimates was on account of lower-than-expected injectable sales
Europe formulations	234.1	147.2	177.4	194.7	32.0	20.2	Growth was mainly due to new CNS products launches in UK and Germany's non tender business
India formulations	474.4	459.3	410.1	432.8	15.7	9.6	The growth was mainly on the back of volume expansion in focused brands and new launches (three products)
Russia & Other CIS formulations	328.9	341.6	451.9	476.6	-27.2	-31.0	The decline was mainly on account of depreciation of Rouble and higher base. On a constant currency basis, Russia grew 3% YoY
RoW markets formulations	346.5	382.2	196	383.2	76.8	-9.6	Growth was mainly due to robust growth in Venezuela on continuous volume uptick
PSAI segment	741.5	630.5	664.1	611.2	11.7	21.3	Strong growth on the back of lower base
Proprietary products & Others	29.6	86.8	85.1	89.76	-65.2	-67.0	

Source: Company, ICICIdirect.com Research

Change in estimates

(₹ Crore)	FY16E			FY17E		
	Old	New	% Change	Old	New	% Change
Revenue	17,036.9	17,291.5	1.5	19,538.3	19,438.4	-0.5
EBITDA	4,091.1	4,065.1	-0.6	4,789.3	4,667.0	-2.6
EBITDA Margin (%)	24.0	23.5	-50 bps	24.5	24.0	-50 bps
PAT	2,582.8	2,562.6	-0.8	3,143.6	3,048.2	-3.0
EPS (₹)	152.1	150.9	-0.8	185.1	179.5	-3.0

Source: Company, ICICIdirect.com Research

Assumptions

Growth (%)			Current		Earlier		Comments
	FY14	FY15	FY16E	FY17E	FY16E	FY17E	
North America formulations	73.4	17.1	23.9	15.0	20.0	22.0	We have reduced our US growth assumption due to higher base on account of Habitrol acquisition and slow product approvals
Europe formulations	-15.6	3.0	-0.7	-0.9	-0.5	-1.0	
India formulations	21.5	13.7	21.3	16.7	15.0	15.0	
Russia & Other CIS formulations	49.5	-10.6	0.9	5.0	0.9	5.0	
RoW markets formulations	88.5	77.4	35.3	25.0	30.0	25.0	
PSAI segment	0.7	6.2	1.7	2.0	1.7	2.0	
Proprietary products & Other	13.1	-19.4	2.0	2.0	2.0	2.0	

Source: Company, ICICIdirect.com Research

Company Analysis

Established in 1984, Dr Reddy's Laboratories (DRL) is one of India's pedigreed players with a firm footing in the US and other export markets. DRL has deep rooted product and market knowledge across therapies. Like Cipla, DRL also recognised the importance of having good manufacturing practices (GMP) accreditation in the eighties and eventually got USFDA approval (first of its kind approval for a formulation facility in India) in 1987. The company owns 22 manufacturing facilities and four developing centres across the globe. The facilities have been approved by various agencies like the USFDA, WHO-Geneva, UKMHRA, TGA-Australia, MCC-South Africa, DMA Denmark, Brail ANVISA, among others. Over the years, along with generics, the company also established itself in the field of discovery of new chemical entities (NCEs) but with little success.

DRL's business can be classified into three broad segments- 1) global generics (GG), 2) pharmaceutical services and active ingredients (PSAI) and 3) proprietary products (PP). GG (81% of revenues) includes branded and unbranded prescription and over-the-counter (OTC) products business. It also includes the operations of the biologics business. This segment comprises formulation sales to regulated markets of the US, Europe and emerging markets such as Russia/CIS, India and RoW.

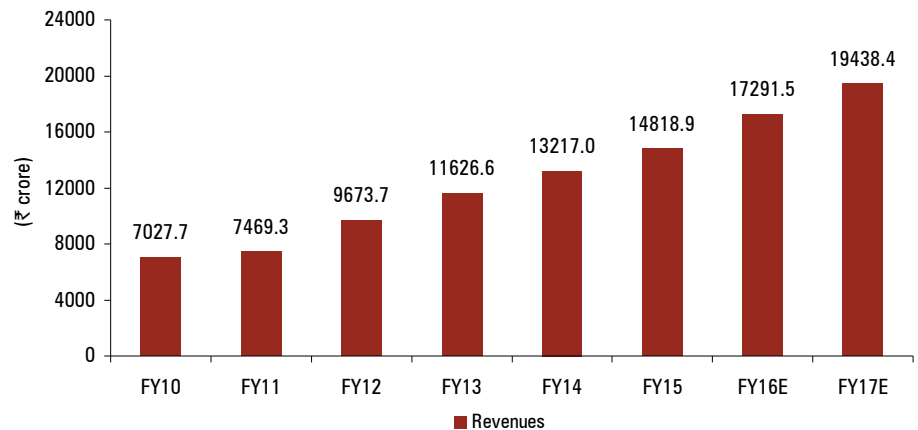
PSAI (17% of revenues) consists of the active pharmaceutical ingredients (API) business and custom pharmaceutical services (CPS) business. PP (2% of revenues) consists of NCEs, differentiated formulations and dermatology focused specialty business operated through Promius Pharma.

DRL is one of the few Indian companies to foray into new drug discovery & development (NDDS) and new chemical entity (NCE) research. The company started research operations in 1992 through a non profit organisation, Dr Reddy's Research Foundation, which was later merged into the company. Despite being an early entrant, the company is yet to taste success in it. DRL is also the first Indian company to out-license molecules to big pharma companies.

DRL has spent around 8-9% of the turnover on R&D in the last four years but this figure is likely to touch 10-11%, going ahead. Beside ANDAs, it has also filed 10 new drug applications (NDAs) in the 505 b (2) route that are awaiting approval.

We expect revenues to grow at 15% CAGR to ₹ 19438 crore in FY15-17E, on the back of growth in the GG segment. This, in turn, will be driven by the US. The GG is likely to grow at a CAGR of 17% to ₹ 16544 crore during the same period. On the other hand, the PSAI segment is likely to slow down, mainly on the back of 1) higher internal consumption and 2) pricing pressure/order uncertainty in the API and CPS segments, respectively. The PSAI segment is likely to register 2% CAGR to ₹ 2640 crore in FY15-17E.

Exhibit 1: Revenues to grow at CAGR of 15% in FY15-17E



Source: Company, ICICIdirect.com Research

Exhibit 2: Geography wise revenue break-up

(₹ crore)	FY10	FY11	FY12	FY13	FY14	FY15	FY16E	FY17E
North America	1681.7	1899.6	3188.9	3784.6	5530.3	6473.4	8018.7	9221.5
Europe	963.8	843.1	825.9	771.6	697.0	718.1	713.1	706.8
India	1015.8	1169.0	1293.1	1456.0	1571.3	1787.0	2167.6	2530.2
Russia & Other CIS	911.9	1085.8	1326.0	1690.8	1981.9	1771.4	1787.5	1876.9
RoW	287.3	336.5	390.4	553.3	735.9	1305.7	1766.9	2208.6
Global Generics	4860.5	5334.0	7024.3	8256.3	10516.4	12055.7	14453.8	16544.0
North America	367.3	317.0	427.2	574.4	435.4	460.5	469.7	479.1
Europe	665.2	702.0	842.4	1200.7	877.0	945.2	955.8	974.9
India	264.6	261.9	358.6	463.8	378.7	441.1	450.0	459.0
RoW	743.3	683.8	753.1	831.3	706.3	698.8	712.8	727.0
PSAI	2040.4	1964.7	2381.3	3070.2	2397.4	2545.7	2588.3	2640.0
Prop. Products & Others	126.8	170.5	268.2	300.1	303.3	244.6	249.5	254.4
Total	7027.7	7469.2	9673.8	11626.6	13217.1	14845.9	17291.5	19438.4

Source: Company, ICICIdirect.com Research

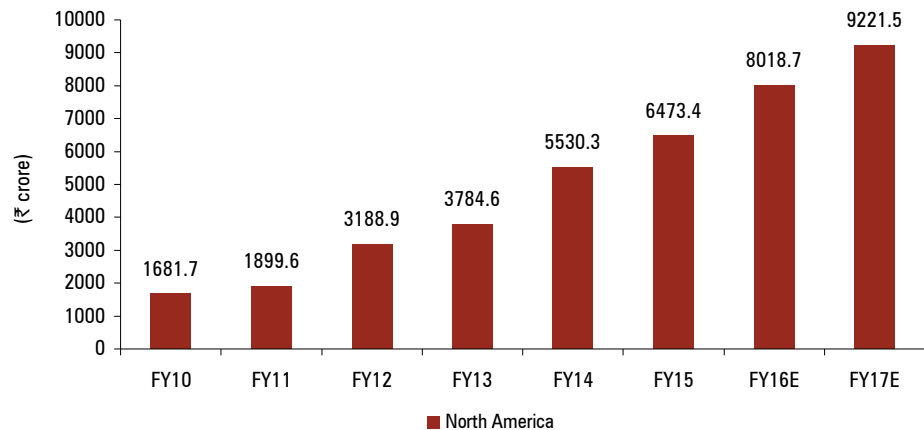
US remains in sweet spot; banking on capabilities and capacity

The US contributes more than 98% of North American sales while the remaining sales are from Canada. DRL has four USFDA approved formulations facilities including two in the US. The company operates in the prescriptions (Rx) and OTC segments in the US market. The sales are channelled through drug stores, drug wholesalers, health maintenance organisations and pharmacy chains. DRL is also an authorised supplier to the US government. After establishing itself in the US generics space, the focus was shifted to the first to file (FTFs) and AG space.

From FY08 onwards, DRL started filing limited competition/niche products like injections, controlled releases and complex generics in the US market in order to reduce the dependence on plain generics. DRL also owns one of the largest over the counter (OTC) product portfolios in the US.

DRL has a strong product pipeline of 220 ANDAs with 68 pending approvals. Of these, 43 are Para IVs while 13 have first to file (FTF) status. Beside ANDAs, DRL has also filed seven NDAs through the 505 b (2) route, which are awaiting approval. We expect the company to file 18-20 ANDAs every year, going ahead. Going by the future pipeline, (we expect DRL to launch eight to 10 products per annum, which includes at least two or three complex products every year besides plain vanilla generic and FTF opportunities. We expect sales from North America to grow at a CAGR of 19% in FY15-17E.

Exhibit 3: North America sales to be driven by robust pipeline

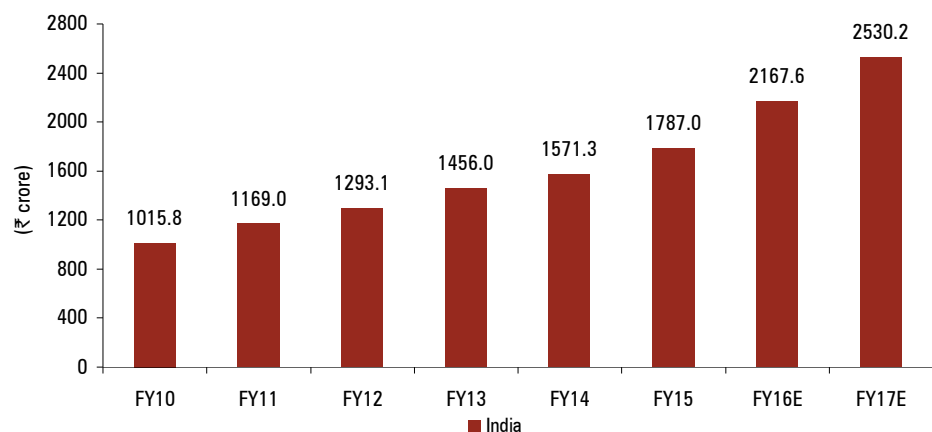


Source: Company, ICICIdirect.com Research

India: Field force expansion, niche forays to drive growth

DRL ranks seventeenth (in terms of market share, AIOCD, April, 2015) with a market share of 2.16%. The acute-chronic ratio currently stands at 70:30. Gastrointestinal (GI) is the largest therapeutic group and the company ranks fifth in this therapeutic group. In many other therapies, however, it remains a marginal player. The only therapeutic category, where it holds No. 1 position is anti-neoplastics (oncology), which as a therapy remains an important but untapped opportunity. To bolster the domestic franchise, DRL has almost doubled the MR strength from 2250 in FY09 to ~4300 as of today. In order to push domestic growth, DRL has forayed into the complex biosimilars space, which till date has not witnessed much crowding. At the same time, these products have not witnessed the expected traction either. It launched the first biosimilar oncology product Filgrastim under the brand name Grafeel in 2001. Again in 2007, it launched another oncology product Rituximab, a biosimilar of Roche's blockbuster Mabthera under the brand name Reditux. Overall, it has launched four biosimilars till date including these two.

Exhibit 4: New launches, improved MR productivity to drive domestic growth



Source: Company, ICICIdirect.com Research

Another interesting high growth/low penetration space for DRL is oncology. It owns the branded portfolio of products such as Capibine (Capecitabine), Docetere (Docetaxel) and Cytogem (Gemcitabine). We expect Indian formulations to grow at a CAGR of 19% in 2015-17E. As per the management, the NLEM 2011 impact is confined to just ~3-5% of domestic sales.

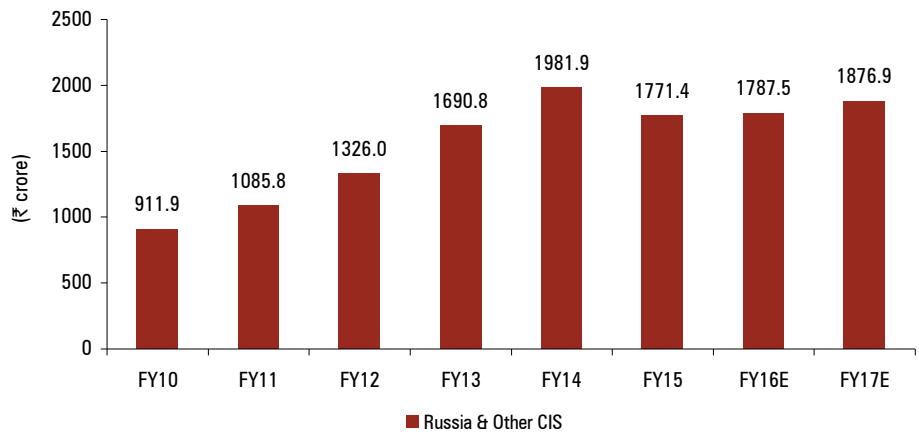
Russia & CIS - banking on experience; region of late has become volatile

DRL was the first Indian entrant in Russia and the CIS, dating back to 1992. Early entry into these markets has helped the company to get hold of the changing dynamics of these high potential but notoriously volatile territories. The CIS segment includes countries such as Ukraine, Belarus, Kazakhstan and Uzbekistan. Russia comprises ~83% of the overall Russia & CIS (RCIS) segment.

DRL has consolidated its position in the Russian market by focusing on select therapies such as pain management, anti-infectives, gastro-intestinal, respiratory, oncology and cardiovascular encompassing prescription, OTC and hospital sales. The top four brands: Nise, Omez, Ketorol and Cetrine constituted ~60% of overall Russian sales.

DRL has also struck in-licensing deals with other Indian companies such as Cipla and Torrent. However, due to the political unrest and sanctions due to Ukrainian invasion, the region has lost its safe haven status for DRL besides Rouble volatility. We expect sales from Russia CIS to grow at a CAGR of 3% in FY15-17E.

Exhibit 5: Russia & CIS to witness tempered growth due to regional issues



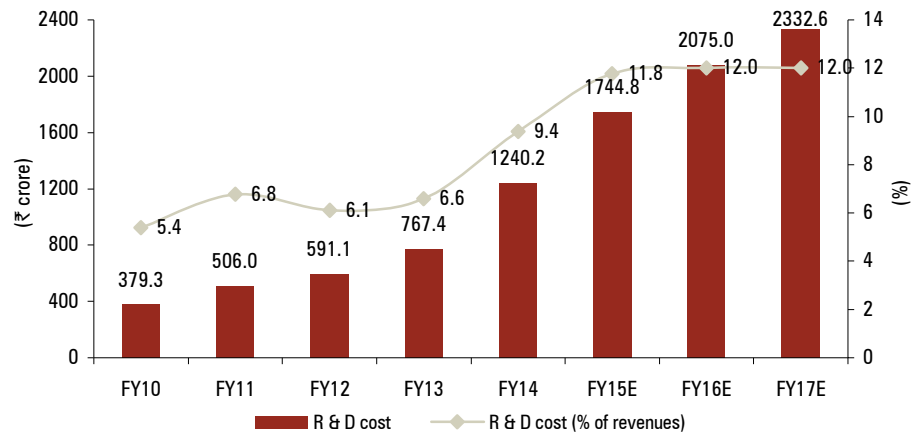
Source: Company, ICICIdirect.com Research

R&D cost to increase further

Dr Reddy's is one of the few Indian companies to foray into new drug discovery & development (NDDS) and new chemical entity (NCE) research with a focus on therapies like dermatology, anti-inflammatory and anti-infectives from CVS and diabetics. DRL is also the first Indian company to launch biosimilars in the domestic market.

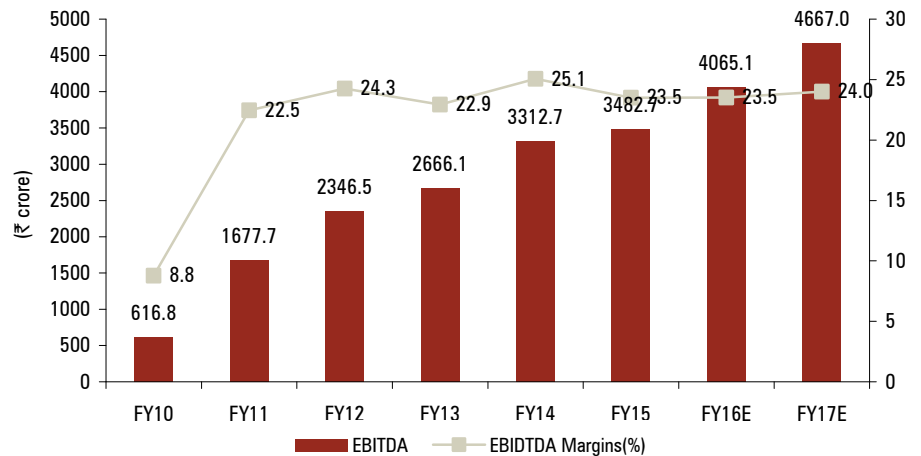
The R&D cost is expected to be ~12% of turnover in FY16 mainly due to higher spend in (i) complex generic including injectables and (ii) biosimilars and novel drug discovery.

Exhibit 6: R&D cost to go up due to complex generics and biosimilars



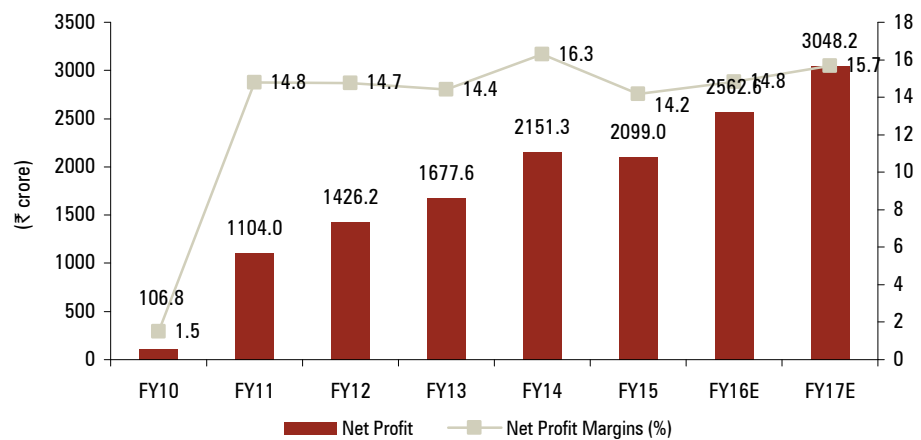
Source: Company, ICICIdirect.com Research

Exhibit 7: Higher R&D cost likely to restrict improvement in EBITDA margins



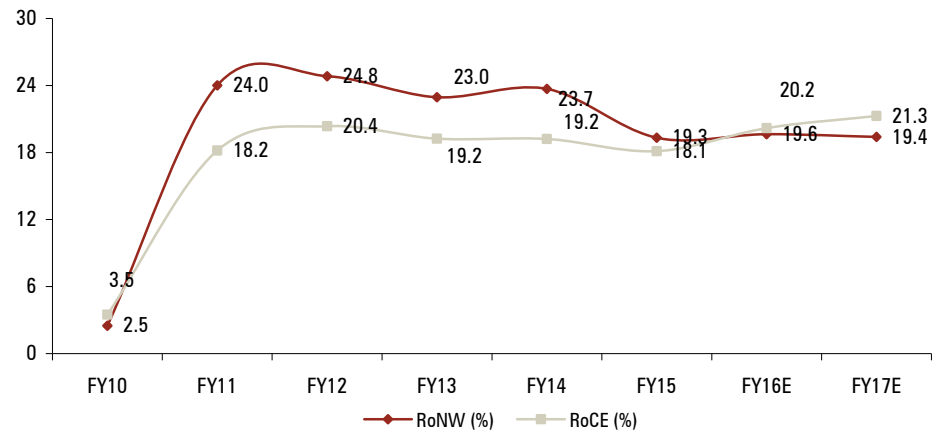
Source: Company, ICICIdirect.com Research

Exhibit 8: Net profit to grow at CAGR of 21% in FY14-17E on high base



Source: Company, ICICIdirect.com Research

Exhibit 9: Trends in return ratios



Source: Company, ICICIdirect.com Research

Exhibit 10: Trend in quarterly financials

₹ Crore	Q4FY12	Q1FY13	Q2FY13	Q3FY13	Q4FY13	Q1FY14	Q2FY14	Q3FY14	Q4FY14	Q1FY15	Q2FY15	Q3FY15	Q4FY15	YoY (%)	QoQ (%)
Revenues	2658.4	2540.6	2880.9	2865.2	3340.0	2844.9	3357.5	3533.8	3480.9	3517.5	3587.8	3843.1	3870.4	11.2	0.7
(inc)/dec in SIT & WIP	13.7	-123.4	-75.1	-45.4	107.8	-118.8	-100.8	-33.6	-77.8	-69.3	-123.8	-127.0	264.5		
Raw Material	844.0	902.8	959.9	943.7	1030.0	943.9	986.7	890.7	1005.5	853.6	968.8	1088.6	825.1	-17.9	-24.2
Other manufacturing exp.	403.6	407.2	465.6	478.1	517.6	517.8	524.7	537.5	561.0	648.8	644.2	646.2	658.8	17.4	1.9
Cost of Revenues	1261.4	1186.5	1350.4	1376.3	1655.5	1343.0	1410.6	1394.7	1488.7	1433.2	1489.2	1607.9	1748.4	17.4	8.7
% of Revenues	47.4	46.7	46.9	48.0	49.6	47.2	42.0	39.5	42.8	40.7	41.5	41.8	45.2	241 bps	333 bps
Gross Profit	1397.0	1354.1	1530.5	1488.8	1684.6	1501.9	1946.9	2139.1	1992.2	2084.4	2098.6	2235.2	2122.1	6.5	-5.1
Gross Profit Margins (%)	52.6	53.3	53.1	52.0	50.4	52.8	58.0	60.5	57.2	59.3	58.5	58.2	54.8	-241 bps	-333 bps
SGNA	581.1	698.0	663.7	718.9	722.9	718.1	800.4	815.3	835.1	880.7	871.6	857.5	794.5	-4.9	-7.3
% of Revenues	21.9	27.5	23.0	25.1	21.6	25.2	23.8	23.1	24.0	25.0	24.3	22.3	20.5	-346 bps	-179 bps
R & D cost	174.1	156.4	175.8	202.5	232.6	243.0	300.9	297.9	398.5	387.5	411.3	431.6	514.4	29.1	19.2
% of Revenues	6.6	6.2	6.1	7.1	7.0	8.5	9.0	8.4	11.4	11.0	11.5	11.2	13.3	184 bps	206 bps
Other (income)/expense	-19.9	-21.8	-39.6	-23.3	-163.2	-37.6	-63.7	-17.7	-22.6	-18.5	-26.6	-34.1	-12.5	-44.6	-63.3
% of Revenues	-0.7	-0.9	-1.4	-0.8	-4.9	-1.3	-1.9	-0.5	-0.7	-0.5	-0.7	-0.9	-0.3	33 bps	56 bps
Total Expenditure	2100.8	2019.1	2219.0	2274.5	2447.9	2266.5	2448.1	2490.1	2699.7	2682.9	2745.6	2862.9	3044.8	12.8	6.4
% of Revenues	79.0	79.5	77.0	79.4	73.3	79.7	72.9	70.5	77.6	76.3	76.5	74.5	78.7	111 bps	417 bps
EBITDA	557.6	521.5	661.8	590.7	892.1	578.5	909.3	1043.7	781.3	834.7	842.2	980.2	825.7	5.7	-15.8
EBITDA Margins (%)	21.0	20.5	23.0	20.6	26.7	20.3	27.1	29.5	22.4	23.7	23.5	25.5	21.3	-111 bps	-417 bps
Depreciation	140.5	129.7	137.6	138.2	149.4	161.3	173.3	179.3	195.6	187.2	195.7	257.5	213.7	9.3	-17.0
EBITA	417.1	391.8	524.2	452.5	742.7	417.2	736.0	864.4	585.7	647.5	646.5	722.7	612.0	4.5	-15.3
Finace (income)/exp.	-8.2	21.2	-37.1	9.7	-39.8	7.0	-29.1	-1.5	-16.4	-48.1	-42.1	-101.3	23.3	-242.2	-123.0
Share of pr./(loss)	1.1	1.9	2.8	3.1	2.5	3.6	4.4	4.7	4.8	5.3	5.1	4.7	4.4	-9.7	-6.2
EBT	426.4	372.5	564.2	446.0	785.0	413.7	769.5	870.6	606.9	700.9	693.7	828.6	593.0	-2.3	-28.4
Tax	83.7	36.5	156.7	82.7	214.1	52.8	79.3	252.1	125.2	150.5	119.6	254.1	74.2	-40.8	-70.8
Tax %	19.6	9.8	27.8	18.5	27.3	12.8	10.3	29.0	20.6	21.5	17.2	30.7	12.5		
Net Profit	342.7	336.0	407.4	363.3	570.9	360.9	690.2	618.5	481.7	550.4	574.1	574.5	518.8	7.7	-9.7
% of Revenues	12.9	13.2	14.1	12.7	17.1	12.7	20.6	17.5	13.8	15.6	16.0	14.9	13.4		

Source: Company, ICICIdirect.com Research

SWOT Analysis

Strengths – A seasoned player in the US generic space with a proven track record. A strong US pipeline with many FTF/limited competition products. The largest Indian player in Russia/CIS.

Weakness – The PSAI and European businesses remain a drag on margins and growth. Higher R&D spends in future are expected to put pressure on current margins. The Russian region has also become volatile and unpredictable due to political unrest.

Opportunities - The US generics space has scope for complex/limited competition products. The biosimilars space across the globe. Indian franchise is still pretty small for a player of DRL's calibre.

Threats - Increased USFDA scrutiny across the globe regarding cGMP issues and consolidation in the US pharmacy space. Its Srikakulam API plant has recently received Form 483 from the USFDA with nine observations.

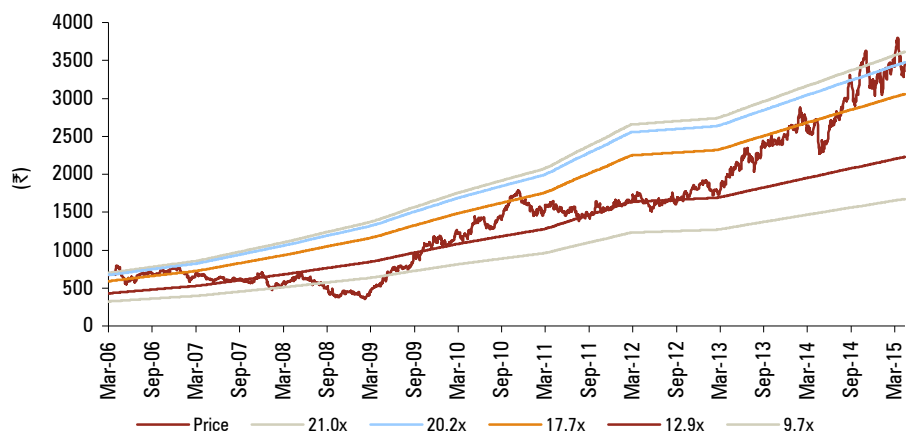
Conference call highlights

- DRL expects four or five meaningful USFDA approvals in FY16
- The company expects to complete the acquisition of UCB's domestic portfolio by Q1FY16
- The company has completed the site transfer and updated the USFDA for gNexium API from Srikakulam facility (that received Form 483 observations) to other API plant
- The company has registered balance sheet translation loss in Venezuela to the tune of US\$14 million in FY15 due to the prevalence of three-tier currency system in Venezuela. DRL has applied SIMADI rate of VEF193/US\$ to translate its net monetary assets, other than those which qualify for the CENCOEX rate of VEF6.3/US\$. This has been included in the financial income (net)
- The company expects its R&D cost at ~12% in FY16E. DRL spends 60% of its R&D on generics & APIs and the remaining on proprietary and biosimilar products
- The company has hedged US\$440 million of cash flow (40-60% of US forecasted cash flow) for the next 18 months and US\$291 million of balance sheet in the range of ₹ 60-64.5/US\$. It has also hedged Russian cash flows of RUB 1760 million (~30% of forecasted cash flow) at the rate of ₹ 1.16/RUB for FY16
- In Q4FY15, it filed and launched one product each in the US. Till date, the company is awaiting 68 ANDA approvals, which includes 43 Para IV filings comprising 13 products with FTF status. Total ANDA filings stood at 220
- The company filed eight DMFs in Europe in Q4FY15. Global cumulative DMF filings have reached 735
- The injectable business contribution was ~US\$280 million (~27% of total US sales) in FY15
- The OTC business contributed 36% in FY15 in Russia's total sales

Valuation

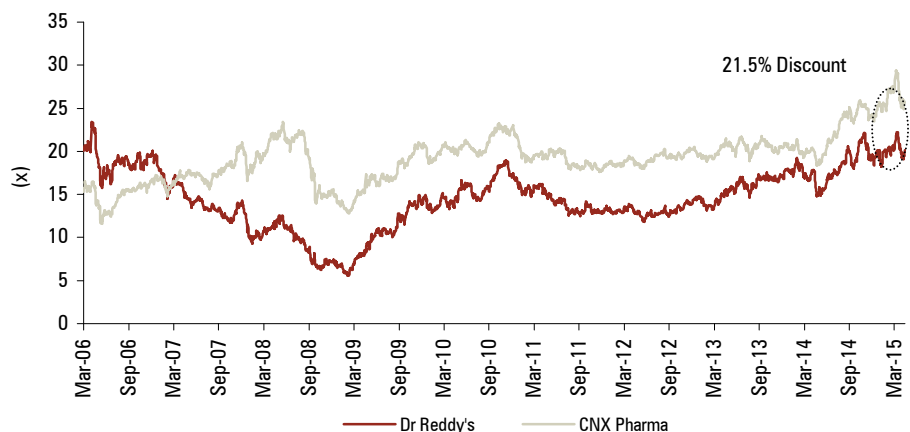
The miss was on the back of slower US growth and negative Russian growth. With Russia now struggling, the US and India together hold the key for global generics growth as well as DRL's overall growth. Among them, the US is the main catalyst with a pending product portfolio of 68 ANDAs, which include 43 Para IVs and 13 FTFs. The company is investing heavily in R&D to bring more and complex generics and limited competition products mainly from non-oral category, which is likely to take care of sustained US growth for the next two or three years. India is showing promising growth as well with a recalibrated approach. On the flip side, Russia has become a new matter of concern besides Europe and the PSAI segment. We have ascribed a target price of ₹ 3949 based on 22x FY17E EPS of ₹ 179.5.

Exhibit 11: One year forward PE



Source: Company, ICICIdirect.com Research

Exhibit 12: One year forward PE of company vs. BSE Healthcare Index



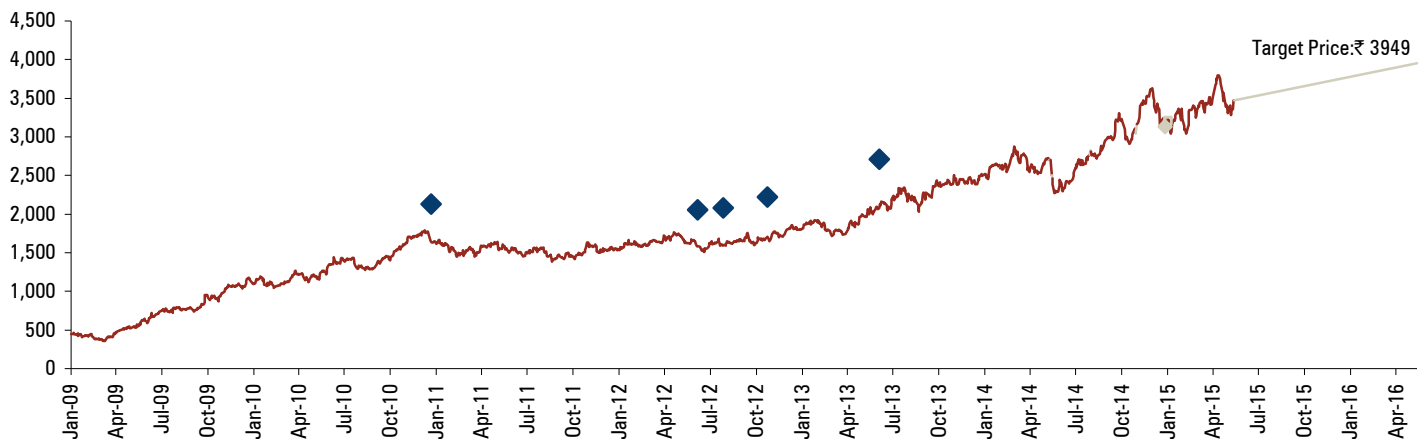
Source: Company, ICICIdirect.com Research

Exhibit 13: Valuation

	Revenues (₹ crore)	Growth (%)	EPS (₹)	Growth (%)	P/E (x)	EV/EBITDA (X)	RoNW (%)	RoCE (%)
FY14	13217	13.7	126.7	28.1	22.3	14.8	23.7	19.2
FY15	14819	12.1	123.6	3.2	22.8	13.9	19.3	18.1
FY16E	17291	16.7	150.9	16.6	18.7	11.7	19.6	20.2
FY17E	19438	12.4	179.5	14.9	15.7	9.8	19.4	21.3

Source: Company, ICICIdirect.com Research

Company snapshot



Source: Bloomberg, Company, ICICIdirect.com Research

Key events

Date	Event
Jun-09	Announces a partnership with GSK to develop and market select products across emerging markets outside India. Under the tie-up, GSK will have access to more than 100 branded products of DRL
Nov-10	Acquires GSK's US oral penicillin facility and product portfolio. Under the agreement, GSK will transfer rights for Augmentin and Amoxil brands in the US market
Dec-10	Enters into licensing of technology transfer, manufacturing and marketing agreement with R-Pharm of Russia. The collaboration is in the area of high-technology and will work on a profit sharing model
Jun-12	Dr Reddy's and Merck Serono sign an agreement to co-develop and commercialise a portfolio of biosimilars compounds in oncology
Jul-12	USFDA lifts import alert for chemical manufacturing facility at Cuernavaca, Mexico
Oct-12	Acquires Netherland based specialty injectable company OctoPlus NV
Jun-13	Dr Reddy's and Fujifilm Corporation call off their joint venture. The JV was started in July 2011 for developing and launching generic drugs in the Japanese market
Dec-14	Dr. Reddy's Labs closed the acquisition of Habitrol brand, an over-the-counter nicotine replacement therapy transdermal patch, from Novartis for a consideration of US\$ 80 million
Apr-15	Enters a €118 million (₹ 800 crore) definitive agreement to acquire a select portfolio of established products from UCB in India

Source: Company, ICICIdirect.com Research

Top 10 Shareholders

Rank	Name	Latest Filing Date	% O/S	Position (m)	Change (m)
1	Dr Reddys Holdings Pvt. Ltd.	31-Mar-15	23.32	39.7	0.0
2	Commonwealth Bank of Australia	31-Dec-13	8.54	14.6	14.6
3	First State Investment Management (UK) Limited	31-Mar-15	8.45	14.4	0.0
4	OppenheimerFunds, Inc.	31-Mar-15	4.27	7.3	0.8
5	BlackRock Institutional Trust Company, N.A.	31-Mar-15	3.08	5.3	0.7
6	Abu Dhabi Investment Authority	31-Mar-15	2.09	3.6	-0.1
7	Capital World Investors	31-Mar-15	1.68	2.9	2.9
8	Life Insurance Corporation of India	31-Mar-15	1.65	2.8	-0.5
9	Franklin Templeton Asset Management (India) Pvt. Ltd.	31-Mar-15	1.59	2.7	0.6
10	Capital Research Global Investors	31-Dec-14	1.40	2.4	0.0

Source: Reuters, ICICIdirect.com Research

Shareholding Pattern

(in %)	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
Promoter	25.5	25.5	25.5	25.5	25.5
FII	34.3	35.3	38.4	38.5	38.9
DII	6.3	5.4	5.4	5.7	5.4
Others	33.9	33.8	30.7	30.3	30.2

Recent Activity

Buys			Sells		
Investor name	Value	Shares	Investor name	Value	Shares
Commonwealth Bank of Australia	596.68m	14.55m	Investec Asset Management Ltd.	-56.00m	-1.28m
Capital World Investors	160.46m	2.86m	Norges Bank Investment Management (NBIM)	-34.58m	-0.67m
OppenheimerFunds, Inc.	46.83m	0.84m	Life Insurance Corporation of India	-28.24m	-0.50m
BlackRock Institutional Trust Company, N.A.	38.47m	0.69m	J.P. Morgan Asset Management (Hong Kong) Ltd.	-23.45m	-0.45m
Franklin Templeton Asset Management (India) Pvt. Ltd.	34.91m	0.62m	Schroder Investment Management (Hong Kong) Ltd.	-16.08m	-0.30m

Source: Reuters, ICICIdirect.com Research

Financial summary

Profit and loss statement ₹ Crore				
(Year-end March)	FY14	FY15E	FY16E	FY17E
Revenues	13217.0	14818.9	17291.5	19438.4
Growth (%)	36.6	12.1	16.7	12.4
Cost of Revenues	5636.9	6278.7	7217.6	8016.6
Gross Profit	7580.2	8540.2	10073.9	11421.9
Gross Profit Margins (%)	57.4	57.6	58.3	58.8
SGNA	3168.8	3404.4	3977.0	4470.8
R & D cost	1240.2	1744.8	2075.0	2332.6
Intangible write down	0.0	0.0	0.0	0.0
Goodwill write down	0.0	0.0	0.0	0.0
Other (income)/expense	-141.6	-91.7	-43.2	-48.6
Total Expenditure	9904.4	11336.2	13226.4	14771.4
EBITDA	3312.7	3482.7	4065.1	4667.0
Growth (%)	41.2	5.1	16.7	14.8
EBITDA Margins (%)	25.1	23.5	23.5	24.0
Depreciation	709.5	854.0	880.8	908.9
PBIT	2603.2	2628.7	3184.3	3758.1
Finance Income	167.4	79.6	163.0	188.1
Finance Expenses	127.4	30.4	82.0	58.2
Net Finance (income)/expenses	-40.0	-49.2	-81.0	-129.9
Profit/(loss) of ERI*	17.4	19.5	20.0	20.0
EBT	2660.6	2697.4	3285.4	3908.0
Tax	509.4	598.4	722.8	859.8
Net Profit	2151.3	2099.0	2562.6	3048.2
Growth (%)	50.8	-2.4	22.1	19.0
EPS (₹)	126.7	123.6	150.9	179.5

Source: Company, ICICIdirect.com Research

Balance sheet ₹ Crore				
(Year-end March)	FY14	FY15E	FY16E	FY17E
Equity Capital	85.1	85.1	85.1	85.1
Net Networth	8995.0	10780.8	12965.3	15635.3
Total share holder funds	9080.1	10865.9	13050.3	15720.4
Total Debt	4474.2	3634.7	2733.6	1941.6
Minority Interest	0.0	0.0	0.0	0.0
Deferred tax liabilities	274.4	314.4	354.4	394.4
Non current Liabilities & other	187.5	138.1	160.3	179.6
Total Liabilities	14016.2	14953.0	16298.6	18236.0
Gross Block	10335.4	11335.4	12635.4	13935.4
Acc. Depreciation	5433.6	6217.4	7098.2	8007.1
Net Block	4901.8	5118.0	5537.2	5928.3
CWIP	667.5	567.5	467.5	367.5
Total Fixed Assets	5569.3	5685.5	6004.7	6295.8
inves in eq. acc. investees	80.6	80.6	80.6	80.6
Other investments-non current	0.0	0.0	0.0	0.0
Liquid Investments	2508.3	2508.3	2508.3	2508.3
Goodwill	342.8	342.8	342.8	342.8
Deferred tax assets	605.4	625.4	645.4	665.4
other non current assets	49.5	66.7	77.8	87.5
Inventories	2399.2	2842.0	3316.2	3727.9
Trade Receivables	3303.7	4060.0	4737.4	5325.6
Derivative financial instruments	55.4	55.4	55.4	55.4
Other current assets	1263.0	1325.3	1533.1	1714.9
Cash & Cash Equivalents	845.1	605.9	680.1	1561.3
Total Current Assets	7866.4	8888.6	10322.2	12385.0
Trade Payables	1050.3	1218.0	1421.2	1597.7
Derivative financial instruments	30.5	30.5	30.5	30.5
Bank overdraft	0.0	0.0	0.0	0.0
provision	281.9	311.2	363.1	408.2
other current liabilities	1643.4	1685.2	1868.3	2093.0
Total Current Liabilities	3006.1	3244.9	3683.2	4129.4
Net Current Assets	4860.3	5643.7	6639.0	8255.6
Total Assets	14016.2	14953.0	16298.6	18236.0

Source: Company, ICICIdirect.com Research

Cash flow statement ₹ Crore				
(Year-end March)	FY14	FY15E	FY16E	FY17E
Net Profit/(Loss)	2151.3	2099.0	2562.6	3048.2
Add: Depreciation	709.5	854.0	880.8	908.9
(Inc)/Dec in current assets	-659.8	-1261.3	-1359.5	-1181.7
Inc/ (Dec) in Current Liabilities	46.8	238.8	438.3	446.2
CF from Operating activities	2247.7	1930.4	2522.3	3221.7
(Inc)/Dec in Goodwill	-23.5	0.0	0.0	0.0
(Purchase)/Sale of Liq. Inves.	-812.0	0.0	0.0	0.0
Fixed Assets	-1414.6	-970.2	-1200.0	-1200.0
Deferred Tax	-164.1	20.0	20.0	20.0
Inc/(Dec) in MI	-2.0	0.0	0.0	0.0
(Inc)/Dec in Other Investments	20.9	0.0	0.0	0.0
Others	52.3	-66.6	11.1	9.7
CF from Investing activities	-2343.0	-1016.8	-1168.9	-1170.3
Equity Shares	0.2	0.0	0.0	0.0
Inc/(Dec) in Share Premium	33.9	0.0	0.0	0.0
Dividend and Dividend Tax	-298.5	-338.3	-378.2	-378.2
Debt	806.4	-839.5	-901.1	-792.0
Other components of equity	-124.7	25.2	0.0	0.0
Inc/(Dec) in Debenture Reserve	-171.1	0.0	0.0	0.0
Adjustment Retained earnings	170.6	0.0	0.0	0.0
Others	10.0	0.0	0.0	0.0
CF from Financial activities	426.7	-1152.7	-1279.3	-1170.2
Net Cash flow	331.5	-239.1	74.1	881.2
Cash at the beginning	513.6	845.1	605.9	680.1
Cash	845.1	605.9	680.1	1561.3

Source: Company, ICICIdirect.com Research

Key ratios				
	FY14	FY15E	FY16E	FY17E
Per Share Data (₹)				
EPS	126.7	123.6	150.9	179.5
Cash EPS	168.4	173.9	202.7	233.0
BV	534.6	639.8	768.4	925.6
Cash per Share	197.4	183.4	187.7	239.6
DPS	15.0	17.0	19.0	19.0
Operating Ratios				
Gross Profit Margins	57.4	57.6	58.3	58.8
EBITDA margins	25.1	23.5	23.5	24.0
PBT margins	19.7	17.7	18.4	19.3
Net Profit margins	16.3	14.2	14.8	15.7
Return Ratios				
RoE	23.7	19.3	19.6	19.4
RoCE	19.2	18.1	20.2	21.3
RoIC	26.0	23.3	25.2	27.2
Valuation Ratios				
P/E	22.3	22.8	18.7	15.7
EV / EBITDA	14.8	13.9	11.7	9.8
EV / Revenues	3.7	3.3	2.7	2.4
Market Cap / Revenues	3.6	3.2	2.8	2.5
Revenues / Equity	1.5	1.4	1.3	1.2
Price to Book Value	5.3	4.4	3.7	3.0
Dividend yield	11.8	13.8	12.6	10.6
Turnover Ratios				
Inventory Days	66	70	70	70
Debtor days	91	100	100	100
Creditor days	29	30	30	30
Asset turnover ratio (x times)	2.2	2.5	2.7	2.9
Solvency Ratios				
Debt / Equity	0.5	0.3	0.2	0.1
Debt/EBITDA	1.4	1.0	0.7	0.4
Current Ratio	2.6	2.7	2.8	3.0
Quick Ratio	1.8	1.9	1.9	2.1

Source: Company, ICICIdirect.com Research

ICICIdirect.com coverage universe (Healthcare)

ICICIdirect Healthcare coverage Universe																				
Company	I-Direct Code	CMP (₹)	TP (₹)	Rating	M Cap (₹ Cr)	EPS (₹)			PE(x)			EV/EBITDA (x)			RoCE (%)			RoNW (%)		
						FY14	FY15E	FY16E	FY14	FY15E	FY16E	FY14	FY15E	FY16E	FY14	FY15E	FY16E	FY14	FY15E	FY16E
Ajanta Pharma	AJAPHA	1247	1488	BUY	11001.3	26.5	38.3	45.6	47.1	32.6	27.4	29.9	21.6	18.2	44.9	40.6	38.1	39.4	32.8	28.9
Apollo Hospitals	APOHOS	1239	1455	BUY	17274.6	22.8	26.8	36.8	54.4	46.3	33.7	27.1	24.0	17.0	11.6	12.0	15.5	10.6	11.5	14.2
Aurobindo Pharma	AURPHA	1322	1303	BUY	38690.2	47.3	57.4	70.5	28.0	23.1	18.7	19.8	16.4	13.3	24.1	23.4	24.4	31.3	31.6	28.6
Biocon	BIOCON	431.8	447	HOLD	8654.9	20.7	20.1	22.5	35.1	29.2	32.4	21.2	21.1	18.0	12.2	10.7	11.7	13.7	15.2	12.4
Cadila Healthcare	CADHEA	1650	1634	HOLD	33850.1	39.2	51.1	66.2	42.0	32.3	24.9	29.9	22.4	17.4	15.9	19.0	21.7	23.4	24.6	25.4
Cipla	CIPLA	664.1	648	HOLD	53441.1	17.3	15.9	21.7	38.4	41.7	30.5	25.4	23.0	18.5	15.5	14.2	17.6	13.8	11.3	14.2
Dr Reddy's Labs	DRREDD	3469	3949	BUY	59232.6	126.7	123.6	150.9	27.4	28.1	23.0	17.9	17.0	14.6	19.2	18.1	20.2	23.7	19.3	19.6
Glenmark Pharma	GLEPHA	869.1	824	HOLD	23629.7	20.0	21.5	34.0	43.4	40.4	25.6	19.9	21.5	14.2	16.0	17.1	23.5	18.3	17.4	22.8
Indoco Remedies	INDREM	325	375	BUY	2998.7	6.3	9.5	13.3	51.7	34.2	24.4	25.4	17.3	13.3	16.6	21.8	28.1	12.6	16.4	19.4
Ipca Laboratories	IPCLAB	653.1	622	HOLD	8260.1	37.9	25.6	31.8	17.2	25.5	20.5	10.8	14.3	13.7	27.6	16.1	17.8	24.4	14.7	16.0
Jubilant Life Sciences	VAMORG	170	138	SELL	2716.1	6.8	-6.5	20.0	24.9	-26.3	8.5	6.6	11.9	5.8	10.1	4.5	7.6	4.2	-3.5	7.6
Lupin	LUPIN	1748	1866	BUY	78804.8	41.0	53.6	60.4	42.7	32.6	29.0	27.1	21.4	18.8	34.5	33.4	31.9	26.5	27.1	24.5
Natco Pharma	NATPHA	2077	1354	HOLD	6918.5	30.3	32.5	44.9	58.5	54.6	39.5	39.9	33.1	26.7	15.3	16.7	18.7	14.1	13.5	16.1
Sun Pharma	SUNPHA	949.7	1036	BUY	229025.2	29.0	34.8	39.9	32.7	27.3	23.8	23.6	22.9	19.6	32.4	31.2	28.8	27.0	25.3	23.1
Torrent Pharma	TORPHA	1179	1165	HOLD	20001.7	39.2	47.2	50.4	30.1	25.0	23.4	21.2	18.9	15.1	28.5	21.4	26.7	34.9	32.4	28.0
Unichem Laboratories	UNILAB	199.8	214	HOLD	1817.9	18.7	7.2	14.1	10.7	27.6	14.1	10.1	17.2	10.3	15.7	7.2	13.5	20.7	7.5	13.9

Source: Company, ICICIdirect.com Research

RATING RATIONALE

ICICIdirect.com endeavours to provide objective opinions and recommendations. ICICIdirect.com assigns ratings to its stocks according to their notional target price vs. current market price and then categorises them as Strong Buy, Buy, Hold and Sell. The performance horizon is two years unless specified and the notional target price is defined as the analysts' valuation for a stock.

Strong Buy: > 15%/20% for large caps/midcaps, respectively, with high conviction;

Buy: > 10%/15% for large caps/midcaps, respectively;

Hold: Up to +/-10%;

Sell: -10% or more;



Pankaj Pandey

Head – Research

pankaj.pandey@icicisecurities.com

**ICICIdirect.com Research Desk,
ICICI Securities Limited,
1st Floor, Akruti Trade Centre,
Road No 7, MIDC,
Andheri (East)
Mumbai – 400 093
research@icicidirect.com**

ANALYST CERTIFICATION

We /I, Siddhant Khandekar, CA INTER and Mitesh Shah, MS (finance), Nandan Kamat MBA Research Analysts, 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.

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 is a wholly-owned 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.

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.

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 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 have any material conflict of interest at the time of publication of this report.

It is confirmed that Siddhant Khandekar, CA INTER and Mitesh Shah, MS (finance), Nandan Kamat MBA, Research Analysts of this report have not received any compensation from the companies mentioned in the report in the preceding twelve months.

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 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.

It is confirmed that Siddhant Khandekar, CA INTER and Mitesh Shah, MS (finance), Nandan Kamat MBA, Research Analysts do not serve as an officer, director or employee of the companies mentioned in the 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.