

Dr. Reddys(RDY)

\$41.16 (As of 03/10/20)

Price Target (6-12 Months): **\$44.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 03/11/20)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: B

Growth: B

Momentum: D

Summary

In third-quarter fiscal 2020, Dr. Reddy's top and bottom lines recorded year-over-year growth. This was supported by strength in Europe, emerging markets and India, and new product launches. However, Price erosion in the North America generics market will impact sales from that region. Moreover, the European market is also witnessing high price erosion in some of the key molecules. As of Dec 31, the company had 101 generic filings (99 abbreviated New Drug Applications and two new drug applications) pending FDA approval. Approval of new generics should further bolster the portfolio. The company is divesting non-core assets to channelize its sources to increase profitability. Shares of the company have outperformed the industry in the past year.

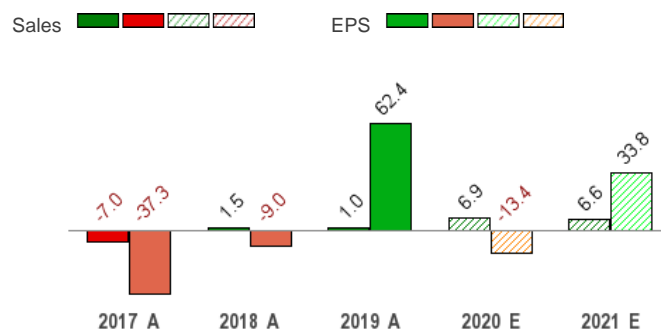
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$46.19 - \$34.67
20 Day Average Volume (sh)	167,502
Market Cap	\$6.8 B
YTD Price Change	1.4%
Beta	0.23
Dividend / Div Yld	\$0.26 / 0.6%
Industry	Medical - Generic Drugs
Zacks Industry Rank	Top 45% (115 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	NA
Last Sales Surprise	NA
EPS F1 Est- 4 week change	0.0%
Expected Report Date	05/15/2020
Earnings ESP	0.0%
P/E TTM	18.0
P/E F1	29.0
PEG F1	NA
P/S TTM	2.8

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					2,535 E
2020	558 A	680 A	614 A		2,378 E
2019	543 A	524 A	535 A	581 A	2,225 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021					\$1.90 E
2020	\$0.58 A	\$0.93 A	\$0.40 A		\$1.42 E
2019	\$0.40 A	\$0.42 A	\$0.41 A	\$0.38 A	\$1.64 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 03/10/2020. The reports text is as of 03/11/2020.

Overview

India-based Dr. Reddy's Laboratories Ltd. is an integrated global pharmaceutical company engaged in providing affordable and innovative medicines since 1984.

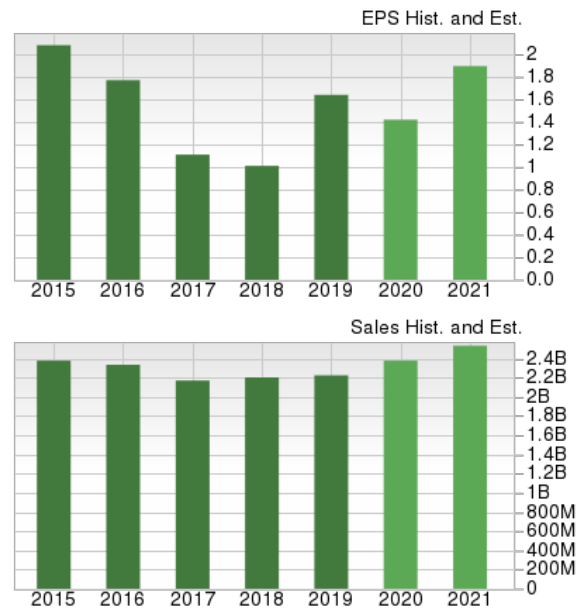
The company markets its products in countries like the U.S., the UK, Germany, India, Russia, Venezuela, Romania and South Africa. Dr. Reddy's operates through three segments:

- **Global Generics** – This segment consists of branded and unbranded prescription drugs along with over-the-counter (OTC) drugs. It includes the operations of the company's biologics business.
- **Pharmaceutical Services & Active Ingredients (PSAI)** – This segment is composed of active pharmaceutical ingredients (API) and custom pharmaceutical services.
- **Proprietary Products and Others** – This segment involves the new chemical entities, the differentiated formulations business and a dermatology specialty business.

Global Generics contributed 79.9%, PSAI contributed 15.7% and Proprietary Products and Others contributed 4.4% to total revenues in fiscal 2019.

The company has a strategic partnership with Glaxo to market selected products across emerging markets outside India.

Dr. Reddy's reported fiscal 2019 (ending Mar 31, 2019) revenues of \$2.2 billion (up 8% year over year).



Reasons To Buy:

▲ **Strong Generic Pipeline:** Dr. Reddy's enjoys a strong position in the generics market. As of Dec 31, 2019, the company had 101 generic filings (99 abbreviated New Drug Applications [ANDAs] and two new drug applications) pending FDA approval. Of these 99 ANDAs, 53 were Para IV filings and 32 have first-to-file status. New product launches, especially complex generics, should help drive the generics business over regular intervals. In the third quarter of fiscal 2020, the company launched five products (bortezomib injection, doxercalciferol, deferasirox dispersible tabs, deferasirox film coated tabs, sodium nitroprusside injection).

Dr. Reddy's enjoys a strong position in the generics market. Efforts on strengthening its presence in the biosimilars market have been commendable too.

In April 2019, Dr. Reddy's entered a definitive agreement to acquire the yet-to-be-marketed portfolio of 42 non-marketed ANDAs in the United States. The portfolio includes more than 30 generic injectable products. These products will be technology transferred and ready for launch within the next one to two years. The deal is in sync with the company's strategy to strengthen its portfolio in its chosen growth markets. This transaction will help the company expand its injectable products portfolio in the U.S. market and globally.

▲ **Biosimilars Market to Boost Revenues:** Dr. Reddy's is working with Merck Serono to develop and commercialize a portfolio of biosimilar compounds in oncology, primarily focused on MABs. Dr. Reddy's has already expanded its biosimilars facility in India to meet growing demand in emerging markets. Dr. Reddy's in July 2018 launched Hervycta (Trastuzumab), a biosimilar of Roche's Herceptin in India, indicated for the treatment of HER2-positive cancers (early breast cancer, metastatic breast cancer and metastatic gastric cancer).

▲ **Strategic Initiatives:** The company is undertaking some strategic measures to combat the ongoing challenges. It plans to modernize some of its infrastructure, systematically implement its new quality management system and automate some of the critical manufacturing and quality related processes.

In order to revitalize growth, Dr. Reddy's remains focused on accelerating the development of its complex generics portfolio and also making efforts to ensure that the approvals come in time through appropriate risk management and proactive measures to deal with possible deficiencies.

Reasons To Sell:

- ▼ **Pricing pressure on North America business:** The company's North America base business is witnessing pricing pressures since the last few quarters due to enhanced channel consolidation and increased competitive pressure on sales of some of its key generic products.

In-fact, the United States' generics industry is facing significant competitive and pricing pressure. The ongoing consolidation of customers in the industry has led to increasing price erosion and decreasing volume. The consolidation in the industry has increased the ability to negotiate lower prices for generic drugs. A sharp decline in generic drug prices is proving to be a major challenge for generic drugmakers as well as drug distributors. Moreover, the FDA is speeding up the approval of generic drugs, which means more competition, increasing price cuts and decreasing volume. The pricing and competitive pressures are expected to continue.

The implementation of general sales tax (GST) in India is also hurting its topline to an extent.

- ▼ **Warning Letter for Manufacturing Facilities:** In November 2015, Dr. Reddy's received a warning letter from the FDA regarding a couple of API manufacturing facilities in India as well as its Oncology Formulation manufacturing facility in India. In December 2015, the company submitted a comprehensive, corrective and preventive action plan, to address all the issues raised, which includes manufacturing network and quality/compliance issues. The company has completed its remedial measures and submitted the same as of Mar 2017. The FDA conducted reinspection of the aforementioned manufacturing facilities in March and April 2017. During the re-inspections, the FDA issued three observations with respect to the company's API facility at Miryalaguda, two observations with respect to its API facility at Srikakulam and thirteen observations with respect to its oncology formulation manufacturing facility. With respect to API manufacturing facility at Srikakulam, the company was asked to carry out certain detailed investigations and analyses. The company has completed a portion of this investigation.

In June 2018, the company requested the FDA to schedule a re-inspection of the oncology formulation manufacturing facility at Duvvada. In October 2018, the re-inspection for the injectable plant in Duvvada was completed and the FDA issued eight observations. The company comprehensively responded to this observation and received certain specific questions from the agency, seeking further clarification on some of the company's responses. With respect to the API manufacturing facility in Srikakulam, the company submitted the results of the investigation, and responded to all the queries asked by the FDA. The company is awaiting re-inspection of the facility.

Consequent to this warning letter, the company has been facing a number of challenges that includes price erosion and delay in product launches. These challenges are adversely affecting the company's top-line growth.

- ▼ **Competition in Generics Segment:** The generic market is highly crowded and Dr. Reddy's faces competition from players like Mylan, Teva, Endo and Sandoz among others. Competition is fierce as generic companies strive to be the first to launch a generic version once a brand product loses exclusivity so that they can capture significant market share. Once additional generic companies enter the market, market share, revenues and gross profit typically decline. Therefore, it is very important for generic companies to develop and introduce new products in a timely and cost-effective manner to maintain revenues and gross profit. In addition to competition from other generic players, brand name companies also provide competition by marketing their own generic version (authorized generics) of their brand products.

In December 2019, there was a generic launch and an authorized generic launch for the product, NuvaRing, which has led to a considerable reduction in the valuation of this product for the company.

Persisting macroeconomic issues in some territories in emerging markets and negative impact of a depreciating ruble remain a concern. The FDA warning letter for some manufacturing facilities is also a concern.

Last Earnings Report

Dr. Reddy's (RDY) Q3 Earnings and Revenues Increase Y/Y

Dr. Reddy's reported third-quarter fiscal 2020 loss of 48 cents per share, per American Depositary Share (ADS). However, the loss includes an impairment charge of \$156.5 million related to the generic launch and an authorized generic launch of the product-Nuvaring, which led to considerable erosion in the value of this product for the company. Excluding the impairment charge, earnings were 63 cents per ADS compared with 41 cents in the year-ago quarter.

Moreover, revenues grew 14% year over year to \$614 million. In the second quarter of fiscal 2020, the company out-licensed two neuro products from the proprietary products business and recognized revenues of \$7.2 billion. Adjusting for this, the sequential growth in the quarter was 7% — the highest-ever quarterly sales from operations, without any one-off item.

Quarter in Detail

Dr. Reddy's reported revenues under three segments — Global Generics, Pharmaceutical Services & Active Ingredients ("PSAI"), and Proprietary Products and Others.

Global Generics revenues were INR35.9 billion (\$503.5 million), up 15% year over year in the fiscal third quarter. Growth was led by contributions from Europe, emerging markets and India, primarily owing to volume gains and product launches.

PSAI revenues were INR6.9 billion (\$96.8 million), up 16% from the year-ago quarter.

Revenues at the Proprietary Products segment came in at INR0.2 billion (\$0.11 million) compared with INR0.7 billion in the year-ago quarter. The company had out-licensed its commercialized derma products in the fourth quarter of fiscal 2019 and commercialized neuro products in the second quarter of fiscal 2020. This, mainly, led to the decline.

Research and development expenses were up 8% year over year to \$55 million.

Selling, general and administrative expenses were \$178 million, up 5% year over year.

As of Dec 31, 2019, Dr. Reddy's had 101 generic filings (99 abbreviated New Drug Applications [ANDAs] and two new drug applications) pending FDA approval. Of these 99 ANDAs, 53 were Para IV filings and 32 have first-to-file status.

Quarter Ending **12/2019**

Report Date	Jan 27, 2020
Sales Surprise	NA
EPS Surprise	NA
Quarterly EPS	0.40
Annual EPS (TTM)	2.29

Recent News

Launch of Naproxen and Esomeprazole Magnesium Delayed-Release Tablets in the U.S. Market – Feb 27

Dr. Reddy's announced the first-to-market launch of Naproxen and Esomeprazole Magnesium delayed-release tablets, the therapeutic generic equivalent of Vimovo delayed-release tablets, approved by the FDA. Vimovo is a trademark of Horizon PharmaMedicines LLC.

Agrees to Acquire Select Business Divisions of Wockhardt in India – Feb 12

Dr. Reddy's announced that it has entered into an agreement with India-based Wockhardt Limited. Per the agreement, Dr. Reddy's will acquire select divisions of branded generics business of Wockhardt in India and a few other international territories. Selected business divisions include a portfolio of 62 brands spanning across multiple therapy areas such as Respiratory, Neurology, VMS, Dermatology, Gastroenterology, Pain and Vaccines. The transaction is expected to close during the second quarter of 2020.

Amendment of Collaboration Agreement with Curis – Feb 7

Dr. Reddy's announced that its collaboration partner, Curis, has entered into amendment of an existing collaboration, license and option agreement with its subsidiary, Aurigene Discovery Technologies. Per the amended terms, Curis will fund and conduct a phase IIb/III study to evaluate CA-170 in patients with non-squamous non-small cell lung cancer. Aurigene will receive rights to develop and commercialize CA-170 in Asia, in addition to its existing rights in India and Russia.

Launch of Trientine Hydrochloride Capsules in the U.S. Market – Feb 7

Dr. Reddy's announced the launch of Trientine Hydrochloride Capsules USP, 250 mg, a therapeutically equivalent generic version of Syprine capsules, approved by the FDA. Syprine is a trademark of Alton Pharma.

Valuation

Dr. Reddy's shares are up 1.4% in the year-to-date period and up 7.3% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Medical sector are down 8.9% and 7.0%, respectively, in the year-to-date period. Over the past year, the Zacks sub-industry and sector are down 10.7% and 6.5%, respectively.

The S&P 500 index is down 10.6% in the year-to-date period but up 2.1% in the past year.

The stock is currently trading at 22.02X forward 12-month earnings per share, which compares to 8.28X for the Zacks sub-industry, 19.33X for the Zacks sector and 16.58X for the S&P 500 index.

Over the past five years, the stock has traded as high as 32.35X and as low as 16.25X, with a 5-year median of 21.56X. Our Neutral recommendation indicates that the stock will in line with the market. Our \$44.00 price target reflects 23.54X forward 12-month earnings per share.

The table below shows summary valuation data for RDY

Valuation Multiples - RDY					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	22.02	8.28	19.33	16.58
	5-Year High	32.35	16.2	21.08	19.34
	5-Year Low	16.25	6.54	15.82	15.18
	5-Year Median	21.56	9.42	18.86	17.42
P/S F12M	Current	2.7	1.46	2.62	3.05
	5-Year High	4.26	4.35	3.84	3.44
	5-Year Low	1.83	1.19	2.46	2.54
	5-Year Median	2.7	1.97	2.96	3.01
P/B TTM	Current	3.28	1.21	4.27	3.88
	5-Year High	6.13	3.72	5.04	4.55
	5-Year Low	2.48	0.87	3.49	2.9
	5-Year Median	3.48	1.32	4.33	3.64

As of 03/10/2020

Industry Analysis Zacks Industry Rank: Top 45% (115 out of 253)



Top Peers

Bausch Health Cos Inc. (BHC)	Neutral
Endo International plc (ENDP)	Neutral
GlaxoSmithKline plc (GSK)	Neutral
Mallinckrodt public limited company (MNK)	Neutral
Mylan N.V. (MYL)	Neutral
Novartis AG (NVS)	Neutral
Sanofi (SNY)	Neutral
Teva Pharmaceutical Industries Ltd. (TEVA)	Neutral

Industry Comparison Industry: Medical - Generic Drugs				Industry Peers		
	RDY Neutral	X Industry	S&P 500	MYL Neutral	NVS Neutral	TEVA Neutral
VGM Score	B	-	-	B	B	B
Market Cap	6.82 B	275.74 M	20.21 B	7.78 B	194.69 B	10.23 B
# of Analysts	2	4	13	9	5	13
Dividend Yield	0.64%	0.00%	2.18%	0.00%	2.36%	0.00%
Value Score	B	-	-	A	B	A
Cash/Price	0.04	0.30	0.05	0.06	0.06	0.18
EV/EBITDA	12.65	-1.02	12.36	6.88	13.18	71.82
PEG Ratio	NA	0.80	1.78	1.27	1.74	0.80
Price/Book (P/B)	3.27	1.79	2.77	0.65	3.50	0.68
Price/Cash Flow (P/CF)	15.26	3.78	11.04	1.81	10.88	2.41
P/E (F1)	28.55	7.20	16.09	3.38	14.80	3.82
Price/Sales (P/S)	2.80	2.24	2.17	0.68	4.10	0.59
Earnings Yield	3.45%	-13.84%	6.20%	29.58%	6.76%	26.25%
Debt/Equity	0.01	0.04	0.70	0.94	0.40	1.63
Cash Flow (\$/share)	2.70	-0.17	7.01	8.33	7.80	3.89
Growth Score	B	-	-	C	C	D
Hist. EPS Growth (3-5 yrs)	-0.76%	2.46%	10.85%	2.42%	0.76%	-18.67%
Proj. EPS Growth (F1/F0)	-13.41%	2.58%	6.14%	0.81%	9.54%	2.31%
Curr. Cash Flow Growth	29.21%	-3.68%	6.09%	-3.91%	4.27%	-9.67%
Hist. Cash Flow Growth (3-5 yrs)	-0.91%	6.89%	8.52%	16.74%	7.11%	-6.21%
Current Ratio	1.81	2.95	1.24	1.21	1.04	0.98
Debt/Capital	0.81%	8.59%	42.57%	48.55%	28.42%	61.99%
Net Margin	9.62%	-33.23%	11.69%	0.15%	24.73%	-5.75%
Return on Equity	18.08%	-41.42%	16.74%	19.35%	23.39%	16.57%
Sales/Assets	0.75	0.30	0.54	0.37	0.39	0.30
Proj. Sales Growth (F1/F0)	8.93%	2.37%	3.71%	4.01%	6.74%	-3.45%
Momentum Score	D	-	-	D	B	C
Daily Price Chg	2.64%	0.00%	4.87%	4.87%	4.28%	5.52%
1 Week Price Chg	5.90%	0.00%	-0.67%	-10.41%	2.10%	-10.67%
4 Week Price Chg	-7.57%	-18.49%	-15.65%	-32.53%	-13.52%	-24.01%
12 Week Price Chg	1.68%	-13.30%	-13.60%	-19.92%	-9.25%	-3.40%
52 Week Price Chg	7.36%	-30.73%	-2.27%	-44.90%	-5.68%	-40.24%
20 Day Average Volume	167,502	292,593	2,778,843	7,885,702	3,252,712	24,260,698
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	-0.16%	-1.16%	0.77%	-1.90%
(F1) EPS Est 12 week change	-5.96%	-0.14%	-0.57%	-0.38%	1.13%	-2.19%
(Q1) EPS Est Mthly Chg	NA%	-0.47%	-0.49%	-2.13%	1.23%	-2.79%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	B
Growth Score	B
Momentum Score	D
VGM Score	B

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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