

September 01, 2017

Dr. Reddy's Laboratories Limited

Summary of rated instruments

Instrument*	Rated Amount (in Rs. crore)	Rating Action
Short-term, fund-based / non-fund based limits	400.0	[ICRA]A1+; re-affirmed

*Instrument details are provided in Annexure-1

Rating action

ICRA has re-affirmed the short-term rating of [ICRA]A1+ (pronounced ICRA A one plus)¹ assigned to the Rs. 400.0 crore² short-term, fund-based / non-fund based bank facilities of Dr. Reddy's Laboratories Limited ('DRL' or 'the company').

Rationale

The rating re-affirmation takes into account the company's diversified revenue mix, integrated presence across the value chain, healthy product pipeline and strong financial profile. Although the pace of revenue and profit growth of DRL witnessed moderation during FY2017 and Q1 FY2018, ICRA believes the company's increasing focus on limited competition niche products, injectables and biosimilars would provide fillip to its revenues in the medium term given its strong research & development (R&D) capabilities. As on June 30, 2017, DRL has 99 abbreviated new drug applications (ANDAs) pending approvals from the US Food and Drug Administration (USFDA). The ratings also take into consideration the strong financial profile of the company, as evinced by its healthy profitability levels, robust return indicators and strong liquidity position, supported by sizeable cash balances.

ICRA notes that the price erosions from competitive pressure on key products such as valganciclovir, decitabine and azacitidine, decline in sale to Mc Neil Consumer Healthcare following conclusion of supply arrangements, channel consolidation and supply constraints following regulatory issues at its manufacturing sites in light of the Warning Letter issued by USFDA for the two API manufacturing facilities at Srikakulam and Miryalaguda (Telengana) and the formulation manufacturing facility at Duvvada (Andhra Pradesh) have impacted DRL's financial performance in FY2017. The company thus reported YoY de-growth of ~9% and a muted YoY growth of ~2.7% in operating income in FY2017 and Q1 FY2018, respectively, due to lack of limited competition product launches during the year and the quarter. The domestic formulations business also shown de-growth of ~10% in Q1 FY2018 due to supplier channel de-stocking following goods & services tax (GST) GST rollout. The above resulted in a decline in operating profit margin to 17.5% during FY2017 and 10.8% during Q1 FY2018. The operating profit margin in FY2017 was also impacted due to higher level of repairs and maintenance charges incurred at some of the manufacturing facilities. Furthermore, the regulatory issues at some of the facilities have resulted in incremental provision of inventory built-up in anticipation of new product launch that failed to materialize (Aloxi and Gleevec) and failure to supply penalties incurred due to supply disruption also impacted the profitability of DRL. ICRA, however, takes note of the receipt of the establishment inspection report for the Miryalguda facility in July 2017 providing. The timely resolution of the warning letters at the other three facilities is critical for the company's revenue growth.

¹ For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications

² 100 lakh = 1 crore = 10 million

Aided by strong cash flow generation, DRL's credit metrics remain strong. However, large inorganic investments by the company would remain an event risk and impact of such investments on the company's business and credit profile would be monitored on a case by case basis.

ICRA also take note of the recent class action lawsuit filed by a law firm on behalf of shareholders alleging that the company misled investors in connection with a warning letter from the USFDA dated November 6, 2015 and a letter from Regierung von Oberbayern in Germany, dated August 10, 2017 causing them to lose money on their investments. ICRA will continue to monitor developments in this regards.

Key rating drivers

Credit strengths

- **Strong and well-diversified business model supported by branded formulations business (in India and regulated markets), generic business (with leadership position in certain segments) and backward integration in active pharmaceutical ingredients (APIs)**
- **Well diversified geographic mix, with a strong presence in key generic markets globally** – DRL has a presence in both emerging and developed generics markets, with North America and Europe together contributing ~50% of the total generic sales in FY2017.
- **Pipeline of limited competition products or complex generics for the US generic market indicates good opportunity if the issues related to warning letters are timely resolved** - The company has launched six and four limited competition products in the US in FY2017 and Q1 FY2018, respectively, and has several niche opportunities in pipeline including those acquired from Teva Pharmaceuticals. Near-term US revenue build up hinges on a number of approvals, including among others gLovenox, gPentasa, gDiprivan, gDoxil, gCopaxone and gNuvaring. It is critical for DRL to timely resolve the warning letters and receives USFDA approvals on time.
- **Domestic formulations business growth supported by integration of brands acquired from UCB SA**– DRL's domestic formulations business witnessed YoY growth of 9% in FY2017, supported by xxx. The same, however, reported YoY de-growth of ~10% in Q1 FY2018 following supplier channel de-stocking resulting from transition to GST regime. The revenue from domestic market is, however, expected to improve on the back of field force expansion and improvement in productivity, new product launches (including biosimilars) and focus on brand building.
- **Diversified product portfolio with a large number of product filings across the globe** - DRL filed 26 ANDAs in FY2017 and 2 in Q1 FY2018. As on June 30, 2017, DRL has 258 cumulative filings (255 ANDAs, 3 NDAs), of which 99 (97 ANDAs, 2 NDAs) are pending for approval - 59 are para IV filings with 26 having first to file status.
- **Strong R&D capabilities supporting development of a strong generic product pipeline (including FTFs, complex technology products as well as biosimilars) in developed markets**
- **Moderate debt levels resulting in comfortable capital structure and healthy coverage indicators** – Total consolidated debt of DRL as on March 31, 2017 is Rs. 4,918.0 crore, resulting in comfortable gearing of 0.40 times. The increase in debt has been due to incremental working capital requirements. The coverage indicators, though, moderated in FY2017 stands comfortable as reflected by OPBITDA/Interest of 39.1 times and NCA/Total Debt of 40%.

Credit weaknesses

- **Moderation in profitability in FY2017 and Q1 FY2018 in the backdrop of continuing increased competition and a challenging pricing environment in the US** - The operating profit margin of DRL has declined to 17.46% in FY2017 and further to 10.84% Q1 FY2018 following pricing pressures in the US arising from intense competition among manufacturers, new entrants to the market and supply channel consolidations.

- **Delays in resolution of warning letters issued to the Srikakulam API facility and Duvvada and Bachupally formulations facilities; if rectifications are not undertaken in a speedy manner, this may aggravate the supply issues** - The pace of ANDA filings of the company has continued to be weak, attributed to a) warning letters issued to Srikakulam, Duvvada and Bachupally facilities and b) increasing focus on complex products
- **Management strategy of R&D focus on limited competition, proprietary products and biosimilars to result in higher R&D cost**
- **Increased focus on cost containment by Governments in various regulated markets may continue to limit profitability of generic players**

Analytical approach: For arriving at the rating, ICRA has taken a consolidated view of DRL.

Links to applicable criteria:

[Rating Methodology for Pharmaceutical Industry](#)

[Corporate Credit Rating Methodology](#)

About the company:

Dr. Reddy's Laboratories Limited was incorporated by its promoter and founder Chairman, Late Dr. K. Anji Reddy, as a private limited company on February 24, 1984. The company was subsequently converted to a public limited company on December 6, 1985 and listed on the Bombay Stock Exchange and the National Stock Exchange in August 1986 and on the New York Stock Exchange on April 11, 2001. As on June 30, 2017, the promoters and promoter group hold 26.78% stake in the company.

The company has manufacturing facilities located at India, UK, US, China and Mexico, and R&D centre located in Andhra Pradesh (India). DRL has a nine member Board, comprising two promoter directors and seven independent directors, each an eminent personality in the field of finance, strategic consulting, science and economics.

For the 12-month period ended March 31, 2017, DRL (consolidated) reported a profit after tax (PAT) of Rs. 1,257.2 crore on an operating income (OI) of Rs. 14,196.1 crore, as against a PAT of Rs. 2,107.7 crore on an OI of Rs. 15,568.3 crore for the 12-month period ended March 31, 2016.

For the three-month period ended June 30, 2017, DRL (consolidated) reported a PAT of Rs. 94.80 crore on an OI of Rs. 3333.20 crore.

Key Financial Indicators (Audited)

	FY2016	FY2017
Operating Income (Rs. crore)	15,568.3	14,196.1
PAT (Rs. crore)*	2,107.7	1,257.2
OPBDIT/ OI (%)	25.75%	17.46%
RoCE (%)	20.48%	10.21%
Total Debt/ TNW (times)	0.27	0.40
Total Debt/ OPBDIT (times)	0.84	1.98
Interest coverage (times)	48.54	39.11
NWC/ OI (%)	25%	29%

*Before minority interest

OI: Operating Income; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net-Worth + Deferred Tax Liability - Capital Work - in Progress); NWC: Net Working Capital

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for last three years:

Table:

S. No.	Instrument	Current Rating (FY2018)			Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Date & Rating	Date & Rating in FY2017	Date & Rating in FY2016	Date & Rating in FY2015
				Sept 2017	-	March 2016	January 2015
1	Fund-based / non-fund based bank facilities	Short-term	400.00	[ICRA]A1+	-	[ICRA]A1+	[ICRA]A1+

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in



Annexure-1
Instrument Details

Instrument	Date of Issuance / Sanction	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating
Fund-based / non-fund based bank facilities	-	-	-	400.00	[ICRA]A1+

Source: Dr. Reddy's Laboratories Limited

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

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