

HOLD

TP: Rs 5,500 | ▲ 3%

DR REDDY'S LABS

| Pharmaceuticals

| 30 October 2023

One-offs fuel PAT beat; India business still soft

- Q2 revenue in line but PAT outdid consensus by 22% on account of PLI benefits, litigation settlement and interest income
- US revenue grew 9% YoY to US\$ 382mn backed by momentum in base business, Mayne integration and contribution from gRevlimid
- TP revised to Rs 5,500 (vs. Rs 4,900) as we raise FY24/FY25 revenue 6%/5% and hike margin assumptions; retain HOLD

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US and Europe lead growth: DRRD reported largely in-line Q2FY24 revenue at Rs 68.8bn, growing 9% YoY (+2% QoQ), as US sales increased 9% YoY (-2% QoQ) to US\$ 382mn and Europe business was up 26%. In the US market, growth momentum was led by gRevlimid sales and Mayne consolidation as well traction in core business. The company launched four products in the US during Q2, and management hopes these rollouts coupled with market share gains in key products will enable it to sustain the current quarterly run rate. Sales in Russia declined 2% YoY and PSAI sales increased 9% for the quarter.

India subdued due to weak acute season and NLEM impact: Domestic business grew a mere 3% on YoY as well as QoQ basis amid weak seasonality for acute therapies. Per management, excluding divestments and the NLEM-related price impact, the India business registered mid-single-digit growth. Management expects double-digit growth in domestic revenue by the year-end and highlighted that the company is focusing on big brands for revival.

One-offs buoy PAT: Gross margin at 58.7% was flat YoY and QoQ while EBITDA margin contracted 110bps YoY (-140bps QoQ) to 28.9%, resulting in EBITDA growth of 5% YoY (-3% QoQ). Management expects improvement in India and Russia business ahead coupled with PLI support to aid margins. Other operating income was higher at Rs 1.8bn (vs. Rs 0.3bn in Q2FY23) due to a Rs 980mn one-off benefit from the settlement of product-related litigation. Net finance income swelled to Rs 1.2bn (vs. Rs 0.2bn in Q2FY23) owing to profit on sale of mutual funds and other investments. This led to 33% YoY PAT growth to Rs 14.8bn, surpassing consensus estimates by 22%.

Maintain HOLD: We raise our FY24/FY25 EBITDA estimates by 22%/13% following a 6%/5% increase in our revenue forecasts and a 350bps/200bps hike in operating margin assumptions to factor in a higher contribution from gRevlimid than earlier anticipated. Our TP thus rises to Rs 5,500 (Rs 4,900), set at an unchanged 11x FY25E EV/EBITDA – 10% discount to the 5Y average multiple. We remain wary of fluctuating core margins in addition to the slowdown in India business and hence retain our HOLD rating.

Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	DRRD IN/Rs 5,345
Market cap	US\$ 10.8bn
Free float	73%
3M ADV	US\$ 32.3mn
52wk high/low	Rs 5,990/Rs 4,175
Promoter/FPI/DII	27%/27%/23%

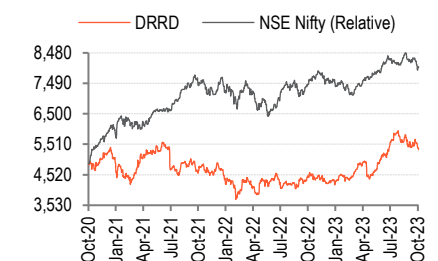
Source: NSE | Price as of 30 Oct 2023

Key financials

Y/E 31 Mar	FY23A	FY24E	FY25E
Total revenue (Rs mn)	245,879	277,246	292,640
EBITDA (Rs mn)	64,129	77,629	79,013
Adj. net profit (Rs mn)	45,765	50,679	51,150
Adj. EPS (Rs)	274.7	304.2	307.0
Consensus EPS (Rs)	274.7	296.8	310.7
Adj. ROAE (%)	22.7	20.4	17.4
Adj. P/E (x)	19.5	17.6	17.4
EV/EBITDA (x)	13.8	11.1	10.4
Adj. EPS growth (%)	46.8	10.7	0.9

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q2FY24	Q2FY23	YoY (%)	Q1FY24	QoQ (%)	H1FY24	H1FY23	YoY (%)
Net Sales	68,802	63,057	9.1	67,384	2.1	136,186	115,211	18.2
EBITDA	19,916	18,943	5.1	20,450	(2.6)	40,366	28,181	43.2
Depreciation	3,790	3,125	21.3	3,583	-	7,373	6,175	-
EBIT	16,126	15,818	1.9	16,867	(4.4)	32,993	22,006	49.9
Interest	(1,225)	156	(885.3)	(784)	-	(2,009)	(2,193)	-
Other Income	1,796	334	-	780	-	2,576	720	-
PBT	19,147	15,996	19.7	18,431	3.9	37,578	24,919	50.8
Less: Taxation	4,334	4,983	-	4,438	-	8,772	7,762	-
Less: Minority Interest	(42)	(140)	-	(43)	-	(85)	(234)	-
Recurring PAT	14,855	11,153	33.2	14,036	5.8	28,891	17,391	66.1
Exceptional items	(55)	(25)	-	(11)	-	(66)	5,613	-
Reported PAT	14,800	11,128	33.0	14,025	5.5	28,825	23,004	25.3
Key Ratios (%)			(bps)		(bps)			(bps)
Gross Margin	58.7	59.1	(40)	58.7	(3)	58.7	54.9	378
EBITDA Margin	28.9	30.0	(109)	30.3	(140)	29.6	24.5	518
Tax / PBT	22.6	31.2	-	24.1	-	23.3	31.1	-
NPM	21.6	17.7	-	20.8	-	21.2	15.1	-
Adj. EPS (Rs)	89.3	67.0	33.2	84.4	5.8	173.6	104.5	-

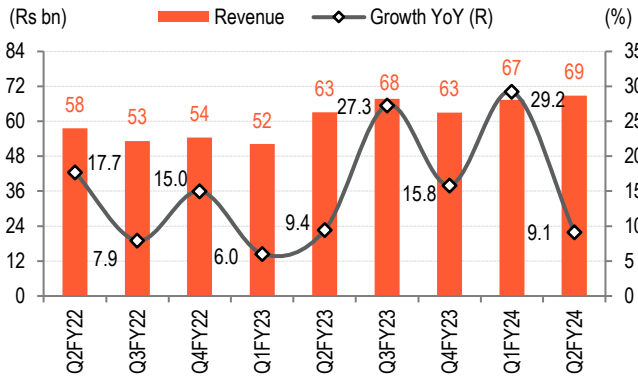
Source: Company, BOBCAPS Research

Fig 2 – Revenue mix

(Rs mn)	Q2FY24	Q2FY23	YoY (%)	Q1FY24	QoQ (%)	H1FY24	H1FY23	YoY (%)
Global Generics	61,084	55,946	9.2	60,083	1.7	121,167	100,270	20.8
North America	31,700	28,001	13.2	31,978	(0.9)	63,678	45,816	39.0
Europe	5,286	4,199	25.9	5,071	4.2	10,357	8,340	24.2
India	11,860	11,500	3.1	11,482	3.3	23,342	24,839	(6.0)
ROW	12,163	12,246	(0.7)	11,552	5.3	23,715	21,274	11.5
PSAI	7,034	6,434	9.3	6,709	4.8	13,743	13,524	1.6
Others	684	677	1.0	592	15.5	1,276	1,417	(10.0)
Net Sales	68,802	63,057	9.1	67,384	2.1	136,186	115,211	18.2
USDINR	83	80	3.6	82.1	1.2	82	79	3.8
US revenue (US\$ mn)	382	349	9.3	390	(2.1)	776	580	33.8

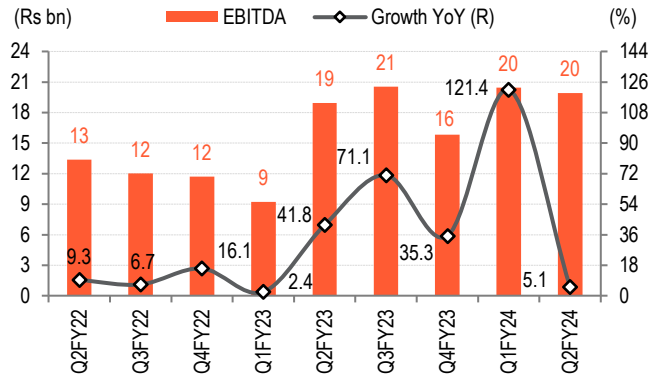
Source: Company, BOBCAPS Research

Fig 3 – Revenue



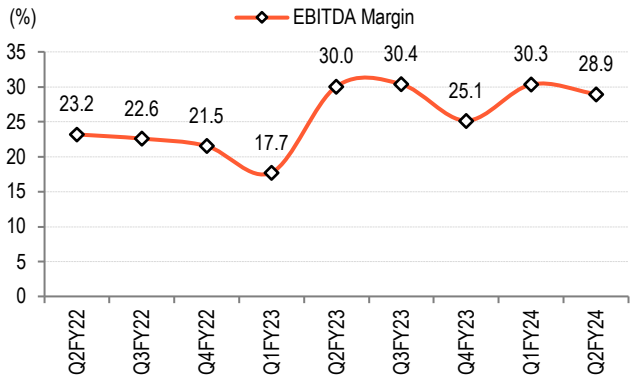
Source: Company, BOBCAPS Research

Fig 4 – EBITDA



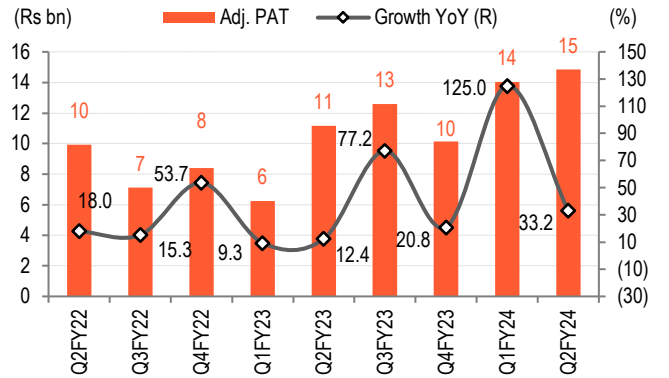
Source: Company, BOBCAPS Research

Fig 5 – EBITDA margin



Source: Company, BOBCAPS Research

Fig 6 – Adj. PAT



Source: Company, BOBCAPS Research

Valuation methodology

We raise our FY24/FY25 revenue estimates for DRRD by 6%/5% given healthy gRevlimid contribution and management's optimistic outlook on US sales. Moreover, to factor in the higher EBITDA margins of 28.9%/29.6% in Q2/H1FY24 than we assumed earlier (albeit aided by PLI benefits and gRevlimid) and management's positive margin commentary, we raise our margin assumptions by 350bps/200bps, leading to a 22%/13% hike in EBTDA forecasts. We also introduce FY26 projections for DRRD.

We continue to apply an FY25E EV/EBITDA multiple of 11x to the stock, which is a 10% discount to the five-year average, and arrive at a revised TP of Rs 5,500 (vs. Rs 4,900). We remain wary of fluctuating core margins, profit support from one-offs such as PLI benefits, and the slowdown in India business, and hence retain our HOLD rating.

Fig 7 – Revised estimates

(Rs bn)	New			Old			Change (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Sales	277.2	292.6	310.3	260.9	279.2	NA	6.3	4.8	NA
EBITDA	77.6	79.0	82.2	63.9	69.8	NA	21.5	13.2	NA
EBITDA margin (%)	28.0	27.0	26.5	24.5	25.0	NA	350bps	200bps	NA
EPS (Rs)	304	307	326	246.3	278.9	NA	23.5	10.1	NA

Source: BOBCAPS Research

Fig 8 – Key assumptions

Revenue (Rs bn)	FY23A	FY24E	FY25E	FY26E
Global generics	213.8	242.5	255.1	269.7
North America	101.7	126.2	128.2	131.5
Europe	17.6	19.4	20.5	21.8
India	48.9	49.9	54.9	60.4
Emerging Markets	45.5	47.1	51.5	56.0
PSAI	29.1	31.4	33.9	36.6
Others	3.0	3.3	3.7	4.0

Source: Company, BOBCAPS Research

Key risks

Key risks to our estimates are:

- **Upside risks:** (1) Speedy resolution of regulatory issues in key manufacturing units. (2) Above-expected contribution from gRevlimid.
- **Downside risks:** (1) Irregular flow of USFDA product approvals, which may lead to a bunching up of key launches for limited-competition products. (2) Adverse USFDA observations on manufacturing plants. (3) Increasing pricing pressure.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	2.7	1,754	1,860	BUY
Alkem Labs	ALKEM IN	5.4	3,692	3,300	SELL
Aurobindo Pharma	ARBP IN	6.1	861	880	HOLD
Cipla	CIPLA IN	11.7	1,193	1,360	BUY
Divi's Labs	DIVI IN	11.0	3,403	3,200	HOLD
Dr Reddy's Labs	DRRD IN	10.8	5,345	5,500	HOLD
Eris Lifesciences	ERIS IN	1.4	860	955	BUY
Glenmark Life Sciences	GLS IN	0.9	620	620	HOLD
Laurus Labs	LAURUS IN	2.4	361	340	HOLD
Lupin	LPC IN	6.3	1,140	800	SELL
Sun Pharma	SUNP IN	32.6	1,115	1,160	HOLD

Source: BOBCAPS Research, NSE | Price as of 30 Oct 2023

Glossary

Glossary of Abbreviations			
ANDA	Abbreviated New Drug Application	MR	Marketing Representatives
API	Active Pharmaceutical Ingredient	NLEM	National List of Essential Medicines
CAPA	Corrective and Preventive Actions	OTC	Over the Counter
CDMO	Contract Development and Manufacturing Operations	PLI	Production-Linked Incentives
CMO	Contract Manufacturing Organisations	PSAI	Pharmaceutical Services and Active Ingredients

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Total revenue	214,391	245,879	277,246	292,640	310,326
EBITDA	46,631	64,129	77,629	79,013	82,236
Depreciation	11,652	11,824	14,463	15,438	16,413
EBIT	34,979	52,305	63,166	63,575	65,824
Net interest inc./(exp.)	(958)	(1,428)	(808)	(808)	(808)
Other inc./(exp.)	5,838	10,188	4,326	4,982	7,308
Exceptional items	0	0	0	0	0
EBT	39,859	61,065	66,683	67,748	72,323
Income taxes	8,730	15,300	16,004	16,598	18,081
Extraordinary items	(7,562)	(699)	(66)	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	23,567	45,066	50,613	51,150	54,242
Adjustments	(7,562)	(699)	(66)	0	0
Adjusted net profit	31,129	45,765	50,679	51,150	54,242

Balance Sheet

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Accounts payables	25,572	26,444	30,383	32,070	34,008
Other current liabilities	42,335	44,601	47,132	52,675	55,859
Provisions	4,315	5,513	6,216	6,561	6,958
Debt funds	33,845	13,472	13,472	13,472	13,472
Other liabilities	0	0	0	0	0
Equity capital	832	833	833	833	833
Reserves & surplus	176,974	223,795	270,243	317,228	367,306
Shareholders' fund	177,806	224,628	271,076	318,061	368,139
Total liab. and equities	283,873	314,658	368,280	422,840	478,436
Cash and cash eq.	14,852	5,779	43,619	90,135	138,308
Accounts receivables	66,818	72,485	75,958	80,175	85,021
Inventories	50,884	48,670	56,968	60,131	63,766
Other current assets	19,987	24,788	27,725	29,264	31,033
Investments	37,499	61,380	61,380	61,380	61,380
Net fixed assets	62,169	66,462	66,999	66,561	65,148
CWIP	0	0	0	0	0
Intangible assets	31,664	35,094	35,631	35,193	33,780
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	283,873	314,658	368,280	422,840	478,436

Cash Flows

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Cash flow from operations	25,800	54,400	58,350	66,052	66,733
Capital expenditures	(12,430)	(22,618)	(15,000)	(15,000)	(15,000)
Change in investments	(9,782)	(23,881)	0	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(22,212)	(46,499)	(15,000)	(15,000)	(15,000)
Equities issued/Others	0	1	0	0	0
Debt raised/repaid	3,546	(20,373)	0	0	0
Interest expenses	(958)	(1,428)	(808)	(808)	(808)
Dividends paid	(4,160)	(4,165)	(4,165)	(4,165)	(4,165)
Other financing cash flows	(1,993)	8,991	(537)	438	1,413
Cash flow from financing	(3,565)	(16,974)	(5,510)	(4,535)	(3,560)
Chg in cash & cash eq.	23	(9,073)	37,840	46,516	48,173
Closing cash & cash eq.	14,852	5,779	43,619	90,135	138,308

Per Share

Y/E 31 Mar (Rs)	FY22A	FY23A	FY24E	FY25E	FY26E
Reported EPS	141.6	270.5	303.8	307.0	325.6
Adjusted EPS	187.1	274.7	304.2	307.0	325.6
Dividend per share	25.0	25.0	25.0	25.0	25.0
Book value per share	1,071.1	1,353.2	1,633.0	1,916.0	2,217.7

Valuations Ratios

Y/E 31 Mar (x)	FY22A	FY23A	FY24E	FY25E	FY26E
EV/Sales	4.1	3.6	3.1	2.8	2.5
EV/EBITDA	19.0	13.8	11.1	10.4	9.5
Adjusted P/E	28.6	19.5	17.6	17.4	16.4
P/BV	5.0	4.0	3.3	2.8	2.4

DuPont Analysis

Y/E 31 Mar (%)	FY22A	FY23A	FY24E	FY25E	FY26E
Tax burden (Net profit/PBT)	78.1	74.9	76.0	75.5	75.0
Interest burden (PBT/EBIT)	114.0	116.7	105.6	106.6	109.9
EBIT margin (EBIT/Revenue)	16.3	21.3	22.8	21.7	21.2
Asset turnover (Rev./Avg TA)	26.4	27.3	26.5	23.8	21.8
Leverage (Avg TA/Avg Equity)	1.2	1.1	1.1	1.0	1.0
Adjusted ROAE	18.2	22.7	20.4	17.4	15.8

Ratio Analysis

Y/E 31 Mar	FY22A	FY23A	FY24E	FY25E	FY26E
YoY growth (%)					
Revenue	13.0	14.7	12.8	5.6	6.0
EBITDA	3.1	37.5	21.1	1.8	4.1
Adjusted EPS	17.8	46.8	10.7	0.9	6.0
Profitability & Return ratios (%)					
EBITDA margin	21.8	26.1	28.0	27.0	26.5
EBIT margin	16.3	21.3	22.8	21.7	21.2
Adjusted profit margin	14.5	18.6	18.3	17.5	17.5
Adjusted ROAE	18.2	22.7	20.4	17.4	15.8
ROCE	20.1	27.8	25.8	22.3	20.5
Working capital days (days)					
Receivables	114	108	100	100	100
Inventory	87	72	75	75	75
Payables	44	39	40	40	40
Ratios (x)					
Gross asset turnover	1.1	1.1	1.2	1.2	1.2
Current ratio	2.1	2.0	2.4	2.8	3.3
Net interest coverage ratio	36.5	36.6	78.1	78.7	81.4
Adjusted debt/equity	0.0	(0.2)	(0.2)	(0.1)	(0.1)

Source: Company, BOBCAPS Research | Note: TA = Total Assets

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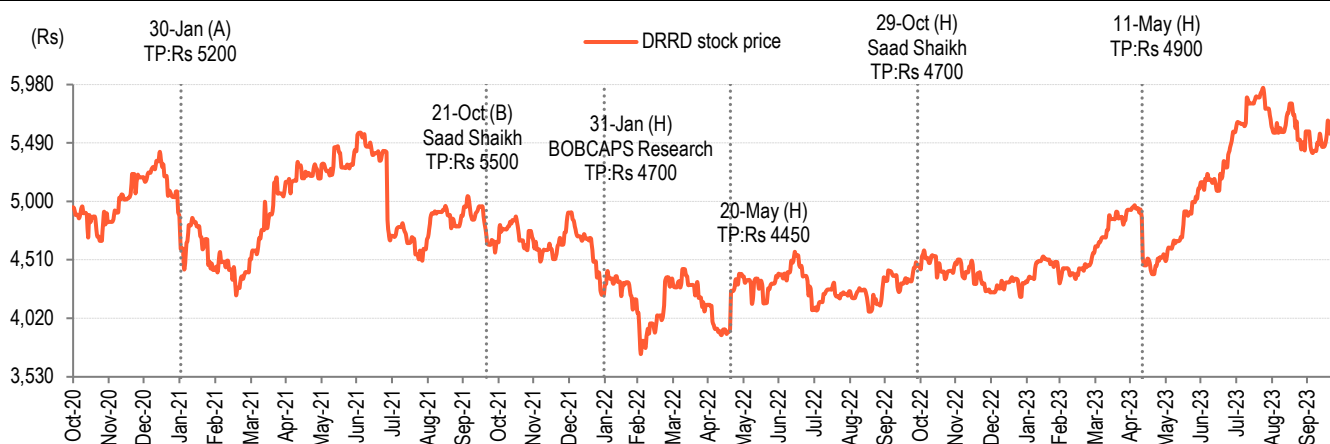
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): DR REDDY'S LABS (DRRD IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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