

HOLD
 TP: Rs 5,900 | ▲ 1%

DR REDDY'S LABS

| Pharmaceuticals

| 31 January 2024

Buoyant US sales drive performance

- **Healthy quarter with revenue/PAT coming in 3%/4% ahead of consensus; US sales a positive surprise, rising 6% QoQ**
- **Higher opex and lower gross margin led to 240bps YoY drop in EBITDA margin to 28%**
- **TP raised to Rs 5,900 (vs. Rs 5,500) on rollover; retain HOLD**

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Buoyant US business aids revenue growth: DRRD reported 7% YoY revenue growth to Rs 72.1bn in Q3FY24, coming in 3% ahead of Bloomberg consensus estimates. North America business led the way, rising 6% QoQ to US\$ 403mn on the back of increased volumes in the base business and a lower impact of price erosion due to market share gain in other products. gRevlimid and Myne Pharma integration also aided growth in the US. Revenue from the EU increased 16% YoY while emerging market sales declined 2% YoY due to unfavourable forex movements. PSAI segment revenue was flat YoY.

India growth remains modest: India formulation business grew at a modest 5% YoY in Q3 and dipped 3% YoY in 9MFY24. To revive growth, the company is focusing on new launches and looking to organic and inorganic means, with a focus on brands that can grow 1.5 times faster than the market. Management expects double-digit growth in India business from FY25 onwards.

Margins contract: Gross/EBITDA margins contracted 75bps/240bps YoY to 58.5%/28% owing to price erosion and higher operating expenses. R&D expenses remained elevated at 7.7% of sales on account of clinical trials for differentiated assets and biosimilar developments. PAT grew 11% YoY (-7% QoQ) to Rs 13.8bn.

Maintain HOLD, TP revised to Rs 5,900: We raise our FY24/FY25/FY26 EPS estimates for DRRD by 4%/2%/1% given the 9MFY24 print and double-digit growth outlook for the India business. On rolling valuations over to FY26E, we arrive at a revised TP of Rs 5,900 (vs. Rs 5,500), which is based on an unchanged EV/EBITDA multiple of 11x, a 10% discount to the stock's 5Y average. We remain wary of fluctuating core margins, profit support from one-offs such as production-linked incentive (PLI) benefits, the slowdown in India business and regulatory overhang, prompting us to retain our HOLD rating.

Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	DRRD IN/Rs 5,841
Market cap	US\$ 11.8bn
Free float	73%
3M ADV	US\$ 29.3mn
52wk high/low	Rs 5,990/Rs 4,285
Promoter/FPI/DII	27%/27%/23%

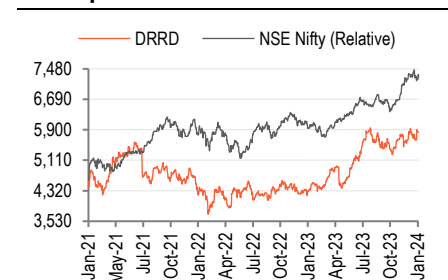
Source: NSE | Price as of 30 Jan 2024

Key financials

Y/E 31 Mar	FY23A	FY24E	FY25E
Total revenue (Rs mn)	245,879	280,755	297,481
EBITDA (Rs mn)	64,129	80,858	80,320
Adj. net profit (Rs mn)	45,765	52,749	52,160
Adj. EPS (Rs)	274.7	316.6	313.1
Consensus EPS (Rs)	274.7	317.1	321.0
Adj. ROAE (%)	22.7	21.2	17.6
Adj. P/E (x)	21.3	18.4	18.7
EV/EBITDA (x)	15.1	11.7	11.3
Adj. EPS growth (%)	46.8	15.3	(1.1)

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Quarterly performance

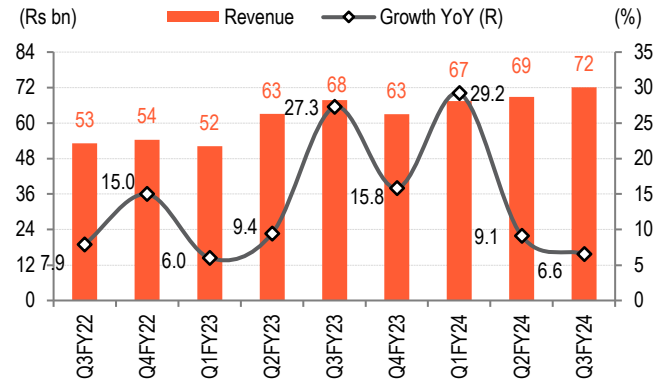
(Rs mn)	Q3FY24	Q3FY23	YoY (%)	Q2FY24	QoQ (%)	9MFY24	9MFY23	YoY (%)
Net Sales	72,148	67,700	6.6	68,802	4.9	208,334	182,911	13.9
EBITDA	20,180	20,562	(1.9)	19,916	1.3	60,546	48,743	24.2
Depreciation	3,770	3,271	15.3	3,790	-	11,143	9,446	-
EBIT	16,410	17,291	(5.1)	16,126	1.8	49,403	39,297	25.7
Interest	(963)	139	(792.8)	(1,225)	-	(2,972)	(2,054)	-
Other Income	967	(732)	-	1,796	-	3,543	(12)	-
PBT	18,340	16,420	11.7	19,147	(4.2)	55,918	41,339	35.3
Less: Taxation	4,468	3,875	-	4,334	-	13,240	11,637	-
Less: Minority Interest	(27)	(60)	-	(42)	-	(112)	(294)	-
Recurring PAT	13,899	12,605	10.3	14,855	(6.4)	42,790	29,996	42.7
Exceptional items	(110)	(134)	-	(55)	-	(176)	5,479	-
Reported PAT	13,789	12,471	10.6	14,800	(6.8)	42,614	35,475	20.1
Key Ratios (%)								
Gross Margin	58.5	59.2	(73bps)	58.7	(18bps)	58.6	56.5	212bps
EBITDA Margin	28.0	30.4	(240bps)	28.9	(98bps)	29.1	26.6	241bps
Tax / PBT	24.4	23.6	-	22.6	-	23.7	28.2	-
Net Profit Margin	19.3	18.6	-	21.6	-	20.5	16.4	-
Adj. EPS (Rs)	83.5	75.8		89.3	(6.4)	257.2		

Fig 2 – Revenue mix

(Rs mn)	Q3FY24	Q3FY23	YoY (%)	Q2FY24	QoQ (%)	9MFY24	9MFY23	YoY (%)
Global generics	63,095	59,241	6.5	61,009	3.4	184,187	159,510	15.5
North America	33,492	30,567	9.6	31,700	5.7	97,170	76,383	27.2
Europe	4,970	4,303	15.5	5,286	(6.0)	15,327	12,643	21.2
India	11,800	11,274	4.7	11,860	(0.5)	35,142	36,113	(2.7)
Emerging Market	12,833	13,097	(2.0)	12,163	5.5	36,548	34,371	6.3
PSAI	7,839	7,758	1.0	7,034	11.4	21,582	21,282	1.4
Other	1,214	701	73.2	684	77.5	2,490	2,118	17.6
Net Sales	72,148	67,700	6.6	68,802	5.0	208,234	182,911	13.9
USDINR	83	82	2.1	83.1	0.1	82.8	80.2	3.2
US revenue (US\$ mn)	403	375	7.3	382	5.5	1174	952	23.3

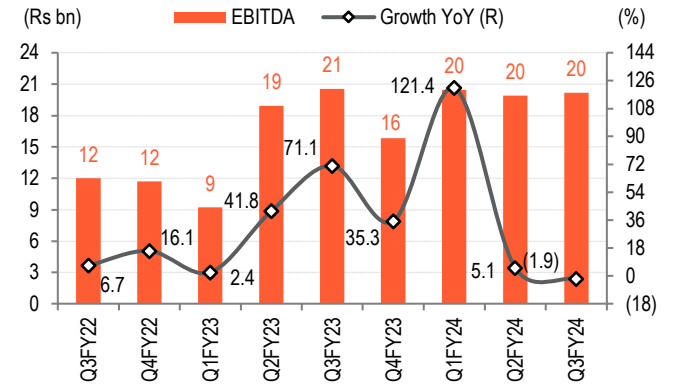
Source: Company, BOBCAPS Research

Fig 3 – Revenue



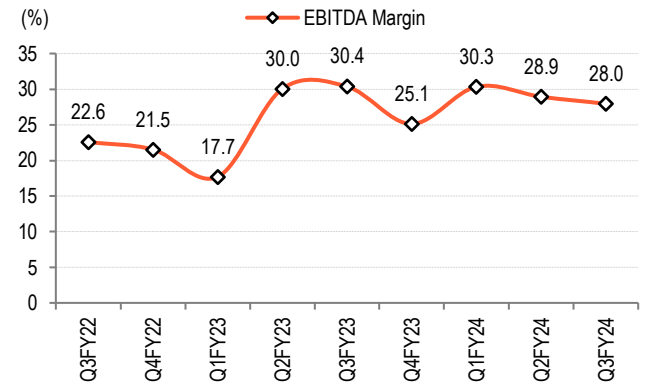
Source: Company, BOBCAPS Research

Fig 4 – EBITDA



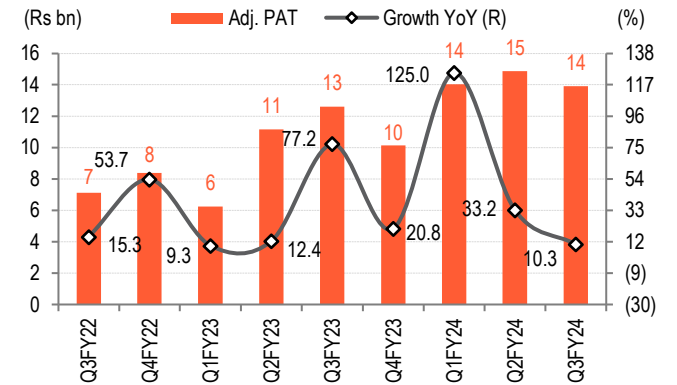
Source: Company, BOBCAPS Research

Fig 5 – EBITDA margin



Source: Company, BOBCAPS Research

Fig 6 – Adj. PAT



Source: Company, BOBCAPS Research

Valuation methodology

We raise our FY24/FY25/FY26 EPS estimates for DRRD by 4%/2%/1% given the 9MFY24 print and double-digit growth outlook for the India business. On rolling valuations over to FY26E, we arrive at a revised TP of Rs 5,900 (vs. Rs 5,500), which is based on an unchanged EV/EBITDA multiple of 11x, a 10% discount to the stock's five-year average. We remain wary of fluctuating core margins, profit support from one-offs such as PLI benefits, the slowdown in India business and regulatory overhang, prompting us to retain our HOLD rating.

Fig 7 – Revised estimates

(Rs bn)	New			Old			Change (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Sales	280.8	297.5	316.7	277.2	292.6	310.3	1.3	1.7	2.1
EBITDA	80.9	80.3	83.9	77.6	79.0	82.2	4.2	1.7	2.1
EBITDA margin (%)	28.8	27.0	26.5	28.0	27.0	26.5	80bps	0bps	(0bps)
EPS (Rs)	317	313	328	304.2	307.0	325.6	4.1	2.0	0.9

Source: BOBCAPS Research

Fig 8 – Key assumptions

Parameter (Rs bn)	FY23	FY24E	FY25E	FY26E
Global Generics	213.8	246.6	260.5	276.7
North America	101.7	129.9	132.0	135.5
Europe	17.6	20.2	22.7	25.4
India	48.9	49.4	54.4	59.8
EM	45.5	47.1	51.5	56.0
PSAI	29.1	30.8	33.3	35.9
Others	3.0	3.3	3.7	4.0

Source: Company, BOBCAPS Research

Key risks

Key risks to our estimates are:

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

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	280,755	297,481	316,709
EBITDA	46,631	64,129	80,858	80,320	83,928
Depreciation	11,652	11,824	14,463	15,438	16,413
EBIT	34,979	52,305	66,395	64,882	67,515
Net interest inc./(exp.)	(958)	(1,428)	(1,314)	(1,248)	(1,897)
Other inc./(exp.)	5,838	10,188	4,326	4,997	7,326
Exceptional items	0	0	0	0	0
EBT	39,859	61,065	69,407	68,632	72,944
Income taxes	8,730	15,300	16,658	16,472	18,236
Extraordinary items	(7,562)	(699)	(176)	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	23,567	45,066	52,573	52,160	54,708
Adjustments	(7,562)	(699)	(176)	0	0
Adjusted net profit	31,129	45,765	52,749	52,160	54,708

Balance Sheet

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Accounts payables	25,572	26,444	30,768	32,601	34,708
Other current liabilities	42,335	44,601	47,728	53,547	57,008
Provisions	4,315	5,513	6,295	6,670	7,101
Debt funds	33,845	13,472	12,798	12,158	11,551
Other liabilities	0	0	0	0	0
Equity capital	832	833	833	833	833
Reserves & surplus	176,974	223,795	272,203	320,198	370,741
Shareholders' fund	177,806	224,628	273,036	321,031	371,574
Total liab. and equities	283,873	314,658	370,626	426,007	481,942
Cash and cash eq.	14,852	5,779	43,931	90,497	138,115
Accounts receivables	66,818	72,485	76,919	81,502	86,770
Inventories	50,884	48,670	57,689	61,126	65,077
Other current assets	19,987	24,788	28,076	29,748	31,671
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	370,626	426,007	481,942

Cash Flows

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Cash flow from operations	25,800	54,400	59,842	67,180	67,875
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)	(674)	(640)	(608)
Interest expenses	(958)	(1,428)	(1,314)	(1,248)	(1,897)
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)	(6,689)	(5,615)	(5,257)
Chg in cash & cash eq.	23	(9,073)	38,152	46,565	47,619
Closing cash & cash eq.	14,852	5,779	43,931	90,497	138,115

Per Share

Y/E 31 Mar (Rs)	FY22A	FY23A	FY24E	FY25E	FY26E
Reported EPS	141.6	270.5	315.6	313.1	328.4
Adjusted EPS	187.1	274.7	316.6	313.1	328.4
Dividend per share	25.0	25.0	25.0	25.0	25.0
Book value per share	1,071.1	1,353.2	1,644.8	1,933.9	2,238.4

Valuations Ratios

Y/E 31 Mar (x)	FY22A	FY23A	FY24E	FY25E	FY26E
EV/Sales	4.5	3.9	3.4	3.0	2.7
EV/EBITDA	20.8	15.1	11.7	11.3	10.3
Adjusted P/E	31.2	21.3	18.4	18.7	17.8
P/BV	5.5	4.3	3.6	3.0	2.6

DuPont Analysis

Y/E 31 Mar (%)	FY22A	FY23A	FY24E	FY25E	FY26E
Tax burden (Net profit/PBT)	78.1	74.9	76.0	76.0	75.0
Interest burden (PBT/EBIT)	114.0	116.7	104.5	105.8	108.0
EBIT margin (EBIT/Revenue)	16.3	21.3	23.6	21.8	21.3
Asset turnover (Rev./Avg TA)	26.4	27.3	26.8	24.0	22.1
Leverage (Avg TA/Avg Equity)	1.2	1.1	1.1	1.0	1.0
Adjusted ROAE	18.2	22.7	21.2	17.6	15.8

Ratio Analysis

Y/E 31 Mar	FY22A	FY23A	FY24E	FY25E	FY26E
YoY growth (%)					
Revenue	13.0	14.7	14.2	6.0	6.5
EBITDA	3.1	37.5	26.1	(0.7)	4.5
Adjusted EPS	17.8	46.8	15.3	(1.1)	4.9
Profitability & Return ratios (%)					
EBITDA margin	21.8	26.1	28.8	27.0	26.5
EBIT margin	16.3	21.3	23.6	21.8	21.3
Adjusted profit margin	14.5	18.6	18.8	17.5	17.3
Adjusted ROAE	18.2	22.7	21.2	17.6	15.8
ROCE	20.1	27.8	27.0	22.6	20.9
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	50.5	52.0	35.6
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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BUY – Expected return >+15%

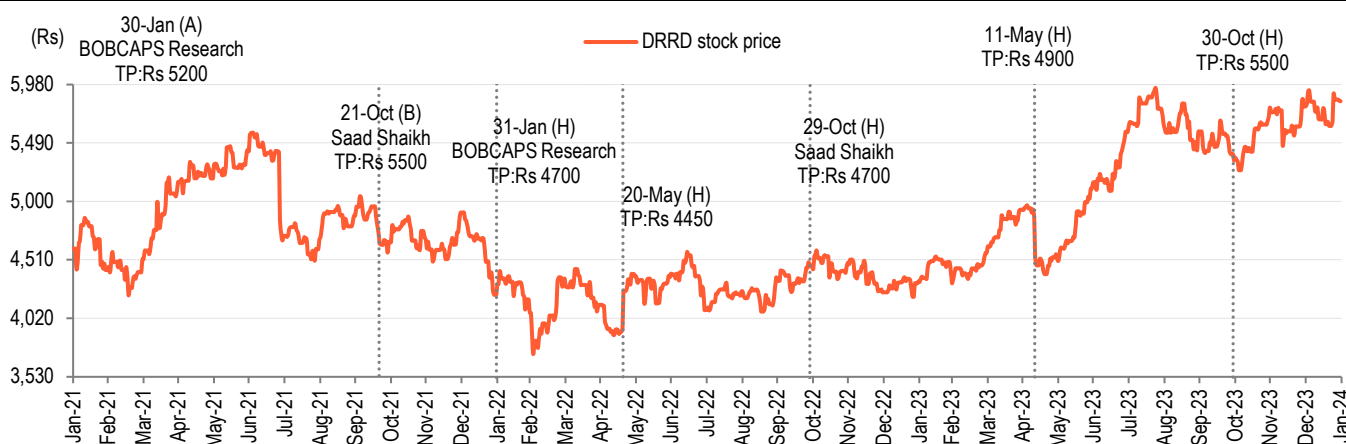
HOLD – Expected return from -6% to +15%

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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