

HOLD

TP: Rs 4,900 | ▲ 8%

DR REDDY'S LABS

| Pharmaceuticals

| 11 May 2023

Core business remains sluggish

- Q4 broadly in line as revenue/EBITDA grew 16%/35% YoY (-7%/-23% QoQ), albeit aided by one-offs
- Excluding one-time divestment proceeds, EBITDA margin would have been 21-22%, well below 25% guidance
- We raise FY24/FY25 EBITDA 2-4% and roll to a new TP of Rs 4,900 (vs. Rs 4,700), set at a lower 11x FY25E EBITDA; retain HOLD

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gRevlimid and divestment income save the day: DRRD reported a 7%/23% QoQ decline in Q4FY23 revenue/EBITDA to Rs 62.9bn/Rs 15.8bn owing to lower sequential contribution from gRevlimid. On a YoY basis, growth was at 16%/35% primarily driven by gRevlimid sales (which began from Q2FY23) and the one-off divestment of non-core brands in the India business. US revenue grew 27% YoY but declined 17% QoQ (-18% QoQ CC to US\$ 308mn). The end of exclusivities in key strengths for DRRD and rising competition in gRevlimid further undermine the growth outlook in the US.

India business grew 32% YoY (+14% QoQ), but stripped of divestment income of Rs 2.6bn, growth drops to just 5%. Management aims to beat market growth via a focus on core therapies/brands and is open to partnerships and M&A to spur growth.

Guidance of 25%+ EBITDA margin and ROCE reiterated: Gross/EBITDA margins expanded 430bps/360bps YoY to 57%/25% due to the absence of gRevlimid and divestiture income in the base quarter, but contracted sequentially by 205bps/520bps on lower gRevlimid contribution. Adjusted net income grew 21% YoY (-20% QoQ), missing consensus estimates by 7% due to a higher tax outgo. Management expects a better gross margin going forward on the back of double-digit growth across geographies and a slew of launches.

Maintain HOLD; TP revised to Rs 4,900: We expect DRRD's core business to remain under pressure amid continued deep price erosion and a lack of meaningful near-term launches (ex-Revlimid) in the US. Thus, while we raise our FY24-FY25 EBITDA estimates by 2-4% to bake in the full-year print, we lower our target EV/EBITDA multiple to from 12.5x to 11x. Upon rolling valuations forward to FY25E, we arrive at a revised TP of Rs 4,900 (Rs 4,700 earlier). Our target multiple is at a 15% discount to the stock's 5Y average. Given weak upside potential from the current market price, we maintain HOLD.

Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	DRRD IN/Rs 4,532
Market cap	US\$ 9.2bn
Free float	73%
3M ADV	US\$ 20.6mn
52wk high/low	Rs 4,989/Rs 3,790
Promoter/FPI/DII	27%/27%/23%

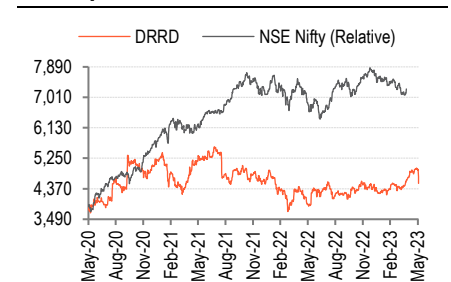
Source: NSE | Price as of 11 May 2023

Key financials

Y/E 31 Mar	FY23P	FY24E	FY25E
Total revenue (Rs mn)	2,45,880	2,60,858	2,79,192
EBITDA (Rs mn)	64,130	63,910	69,798
Adj. net profit (Rs mn)	45,766	41,037	46,467
Adj. EPS (Rs)	274.7	246.3	278.9
Consensus EPS (Rs)	274.7	257.6	283.0
Adj. ROAE (%)	22.7	16.9	16.4
Adj. P/E (x)	16.5	18.4	16.2
EV/EBITDA (x)	11.7	11.4	9.9
Adj. EPS growth (%)	46.8	(10.3)	13.2

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ (%)	FY23	FY22	YoY (%)
Net Sales	62,968	54,368	15.8	67,700	(7.0)	2,45,879	2,14,391	14.7
EBITDA	15,829	11,702	35.3	20,562	(23.0)	64,572	46,102	40.1
Depreciation	3,190	2,959	7.8	3,271	-	12,636	11,825	-
EBIT	12,639	8,743	44.6	17,291	(26.9)	51,936	34,277	51.5
Interest	(799)	(859)	(7.0)	139	-	(2,853)	(2,119)	-
Other Income	281	291	-	(732)	-	269	2,761	-
PBT	13,719	9,893	38.7	16,420	(16.4)	55,058	39,157	40.6
Less: Taxation	3,663	1,608	-	3,875	-	15,300	8,730	-
Less: Minority Interest	(76)	(105)	-	(60)	-	(370)	(703)	-
Recurring PAT	10,132	8,390	20.8	12,605	(19.6)	40,128	31,130	28.9
Exceptional items	(540)	(7,515)	-	(134)	-	4,939	(7,562)	-
Reported PAT	9,592	875	996.2	12,471	(23.1)	45,067	23,568	91.2
Key Ratios (%)			(bps)		(bps)			(bps)
Gross Margin	57.2	52.9	430	59.2	(205)	56.7	53.1	357
EBITDA Margin	25.1	21.5	361	30.4	(523)	26.3	21.5	476
Tax / PBT	26.7	16.3	-	23.6	-	27.8	22.3	-
NPM	16.1	15.4	-	18.6	-	16.3	14.5	-
Adj. EPS (Rs)	60.9	50.4	20.8	75.8	(19.6)	241.2	187.1	-

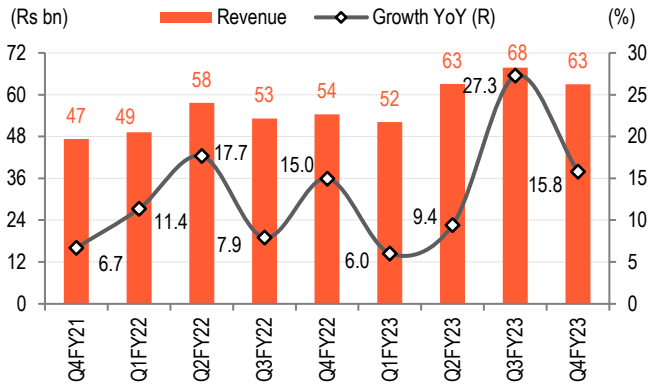
Source: Company, BOBCAPS Research

Fig 2 – Revenue mix

(Rs mn)	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ (%)	FY23	FY22	YoY (%)
Global generics	54,257	46,117	17.7	59,241	(8.4)	2,13,767	1,79,169	19.3
North America	25,321	19,971	26.8	30,567	(17.2)	1,01,704	74,915	35.8
Europe	4,960	4,444	11.6	4,303	15.3	17,603	16,631	5.8
India	12,834	9,689	32.5	11,274	13.8	48,947	41,957	16.7
ROW	11,142	12,013	(7.3)	13,097	(14.9)	45,513	45,666	(0.3)
PSAI	7,787	7,557	3.0	7,758	0.4	29,069	30,740	(5.4)
Others	924	693	33.3	701	31.8	3,042	4,481	(32.1)
Net Sales	62,968	54,368	15.8	67,700	(7.0)	2,45,879	2,14,391	14.7
INR/US\$	82.2	76	8.5	81.5	0.8	81	75	8.2
US revenue (USD mn)	308	264	16.9	375	(17.9)	1260	1004	25.5

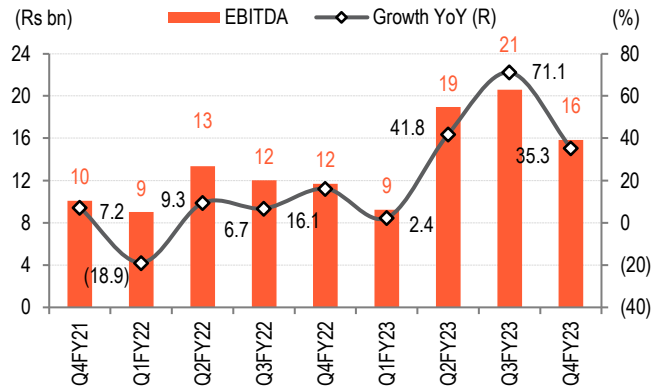
Source: Company, BOBCAPS Research

Fig 3 – Revenue



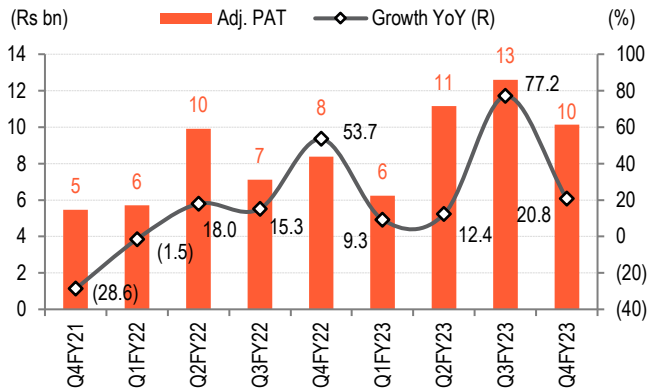
Source: Company, BOBCAPS Research

Fig 4 – EBITDA



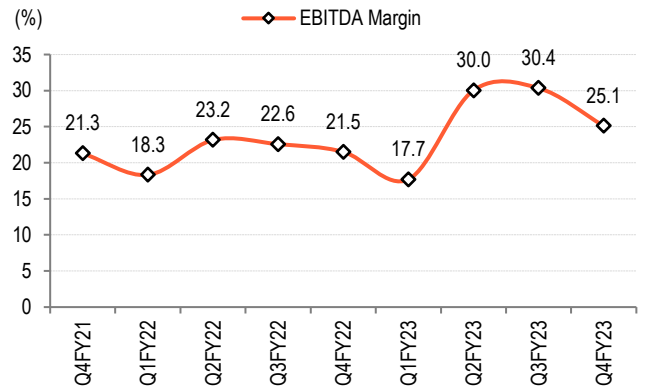
Source: Company, BOBCAPS Research

Fig 5 – Adj. PAT



Source: Company, BOBCAPS Research

Fig 6 – EBITDA margin



Source: Company, BOBCAPS Research

Earnings call highlights

- **India:** Excluding divestment income of Rs 2.6bn, Q4FY23 revenue growth drops to just 5% YoY for the domestic business. DRRD expects to outperform the Indian pharma market in FY24 led by key therapeutic areas and brands, innovation-led partnerships, and mergers & acquisitions (M&A).
- **US:** US market price erosion was lower in Q4 than the previous quarters. Management has guided for double-digit growth in the US business during FY24, to be backed by existing and new products (25-30 new launches planned), including gRevlimid and the women's health portfolio recently acquired from Mayne Pharma. DRRD is open to more inorganic opportunities in the US.
- **Europe:** Europe revenue grew +12% YoY (+15% QoQ) bolstered by new launches and increased volumes, though partly offset by price erosion.
- **Emerging markets:** EM sales declined 7% YoY (-15% QoQ) on a high base as a few brands were divested in Russia.
- **Guidance:** Management reiterated its guidance of (1) double-digit revenue growth across geographies in FY24, (2) sustainable EBITDA margin and ROCE of 25%+, (3) incremental capital allocation towards Horizon-2 business (both capex and R&D), and (4) product-specific inorganic growth using cash flow obtained from Revlimid.
- **R&D:** DRRD expects to maintain R&D spend at 8-9% of sales, to be tilted more toward biosimilars and complex injectables.
- **M&A:** Per management, the M&A focus will be on in-licensing, product acquisitions and partnerships.
- **Capex:** Capex was at Rs 2.6bn in Q4 and Rs 11.3bn in FY23.
- **Tax rate:** The tax rate is guided to be in the range of 24-25% going forward.

Valuation methodology

We expect DRRD's core business to remain under pressure amid continued price erosion and a lack of meaningful near-term launches (ex-Revlimid) in the US. Thus, while we raise our FY24-FY25 EBITDA estimates by 2-4% to bake in the full-year print, we lower our target EV/EBITDA multiple to from 12.5x to 11x. Upon rolling valuations forward to FY25E, we arrive at a revised TP of Rs 4,900 (Rs 4,700 earlier). Our target multiple is at a 15% discount to the stock's five-year average. Given weak upside potential from the current market price, we maintain HOLD.

Fig 7 – Revised estimates

(Rs bn)	New		Old		Change (%)	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Sales	260.9	279.2	261.1	279.1	(0.1)	0.0
EBITDA	63.9	69.8	62.7	67.0	2.0	4.2
EBITDA margin (%)	24.5	25.0	24.0	24.0	50bps	100bps
EPS (Rs)	246.3	278.9	238.1	267.2	3.5	4.4

Source: BOBCAPS Research

Fig 8 – Key assumptions

Parameter	FY23A	FY24E	FY25E
Global generics	213.8	226.1	241.6
North America	101.7	103.8	106.0
Europe	17.6	19.0	20.2
India	48.9	53.8	59.2
Emerging Markets	45.5	49.5	56.3
PSAI	29.1	31.4	33.9
Others	3.0	3.3	3.7

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	2.0	1,268	1,520	BUY
Alembic Pharma	ALPM IN	1.4	569	615	HOLD
Alkem Labs	ALKEM IN	5.1	3,498	3,000	SELL
Aurobindo Pharma	ARBP IN	4.3	606	635	BUY
Cipla	CIPLA IN	9.3	944	1,250	BUY
Divi's Labs	DIVI IN	10.8	3,329	3,200	HOLD
Dr Reddy's Labs	DRRD IN	9.2	4,532	4,900	HOLD
Eris Lifesciences	ERIS IN	1.1	639	810	BUY
Glenmark Life Sciences	GLS IN	0.8	541	600	BUY
Laurus Labs	LAURUS IN	2.1	321	340	HOLD
Lupin	LPC IN	4.2	765	700	HOLD
Sun Pharma	SUNP IN	28.1	961	1,100	HOLD

Source: BOBCAPS Research, NSE | Price as of 11 May 2023

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
Total revenue	1,89,722	2,14,392	2,45,880	2,60,858	2,79,192
EBITDA	45,247	46,632	64,130	63,910	69,798
Depreciation	12,288	11,652	11,824	13,432	14,092
EBIT	32,959	34,980	52,306	50,478	55,706
Net interest inc./(exp.)	(970)	(958)	(1,428)	(808)	(808)
Other inc./(exp.)	3,605	5,838	10,188	4,326	6,648
Exceptional items	0	0	0	0	0
EBT	35,594	39,860	61,066	53,996	61,546
Income taxes	9,175	8,730	15,300	12,959	15,079
Extraordinary items	(6,903)	(7,562)	(699)	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	19,516	23,568	45,067	41,037	46,467
Adjustments	(6,903)	(7,562)	(699)	0	0
Adjusted net profit	26,419	31,130	45,766	41,037	46,467

Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
Accounts payables	21,916	25,572	26,444	25,014	26,772
Other current liabilities	34,129	42,335	44,601	44,346	50,255
Provisions	3,493	4,315	5,513	5,849	6,260
Debt funds	30,299	33,845	13,472	13,472	13,472
Other liabilities	0	0	0	0	0
Equity capital	832	832	833	833	833
Reserves & surplus	1,63,832	1,76,974	2,23,795	2,60,667	3,02,969
Shareholders' fund	1,64,664	1,77,806	2,24,628	2,61,500	3,03,802
Total liab. and equities	2,54,501	2,83,873	3,14,658	3,50,180	4,00,560
Cash and cash eq.	14,829	14,852	5,779	38,953	82,894
Accounts receivables	49,759	66,818	72,485	71,468	76,491
Inventories	45,412	50,884	48,670	53,601	57,368
Other current assets	19,457	19,987	24,788	26,086	27,919
Investments	27,717	37,499	61,380	61,380	61,380
Net fixed assets	57,111	62,169	66,462	65,030	62,938
CWIP	0	0	0	0	0
Intangible assets	40,216	31,664	35,094	33,662	31,570
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	2,54,501	2,83,873	3,14,658	3,50,180	4,00,560

Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
Cash flow from operations	29,884	25,801	54,401	48,716	58,822
Capital expenditures	(10,000)	(14,700)	(11,300)	(12,000)	(12,000)
Change in investments	(939)	(9,782)	(23,881)	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(10,939)	(24,482)	(35,181)	(12,000)	(12,000)
Equities issued/Others	1	0	1	0	0
Debt raised/repaid	8,288	3,546	(20,373)	0	0
Interest expenses	(970)	(958)	(1,428)	(808)	(808)
Dividends paid	(4,160)	(4,160)	(4,165)	(4,165)	(4,165)
Other financing cash flows	(9,328)	276	(2,328)	1,432	2,092
Cash flow from financing	(6,169)	(1,296)	(28,293)	(3,541)	(2,881)
Chg in cash & cash eq.	12,776	23	(9,073)	33,174	43,940
Closing cash & cash eq.	14,829	14,852	5,779	38,953	82,894

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23P	FY24E	FY25E
Reported EPS	117.3	141.6	270.5	246.3	278.9
Adjusted EPS	158.8	187.1	274.7	246.3	278.9
Dividend per share	25.0	25.0	25.0	25.0	25.0
Book value per share	992.0	1,071.1	1,353.2	1,575.3	1,830.1

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23P	FY24E	FY25E
EV/Sales	4.0	3.5	3.0	2.8	2.5
EV/EBITDA	16.8	16.1	11.7	11.4	9.9
Adjusted P/E	28.5	24.2	16.5	18.4	16.2
P/BV	4.6	4.2	3.3	2.9	2.5

DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23P	FY24E	FY25E
Tax burden (Net profit/PBT)	74.2	78.1	74.9	76.0	75.5
Interest burden (PBT/EBIT)	108.0	114.0	116.7	107.0	110.5
EBIT margin (EBIT/Revenue)	17.4	16.3	21.3	19.4	20.0
Asset turnover (Rev./Avg TA)	26.4	26.4	27.3	25.4	23.6
Leverage (Avg TA/Avg Equity)	1.2	1.2	1.1	1.1	1.0
Adjusted ROAE	17.2	18.2	22.7	16.9	16.4

Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23P	FY24E	FY25E
YoY growth (%)					
Revenue	8.7	13.0	14.7	6.1	7.0
EBITDA	10.5	3.1	37.5	(0.3)	9.2
Adjusted EPS	(18.2)	17.8	46.8	(10.3)	13.2
Profitability & Return ratios (%)					
EBITDA margin	23.8	21.8	26.1	24.5	25.0
EBIT margin	17.4	16.3	21.3	19.4	20.0
Adjusted profit margin	13.9	14.5	18.6	15.7	16.6
Adjusted ROAE	17.2	18.2	22.7	16.9	16.4
ROCE	20.3	20.1	27.8	21.4	21.1
Working capital days (days)					
Receivables	96	114	108	100	100
Inventory	87	87	72	75	75
Payables	42	44	39	35	35
Ratios (x)					
Gross asset turnover	0.9	0.9	1.0	1.0	1.1
Current ratio	2.2	2.1	2.0	2.5	2.9
Net interest coverage ratio	34.0	36.5	36.6	62.4	68.9
Adjusted debt/equity	0.1	0.0	(0.2)	(0.2)	(0.1)

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

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BUY – Expected return >+15%

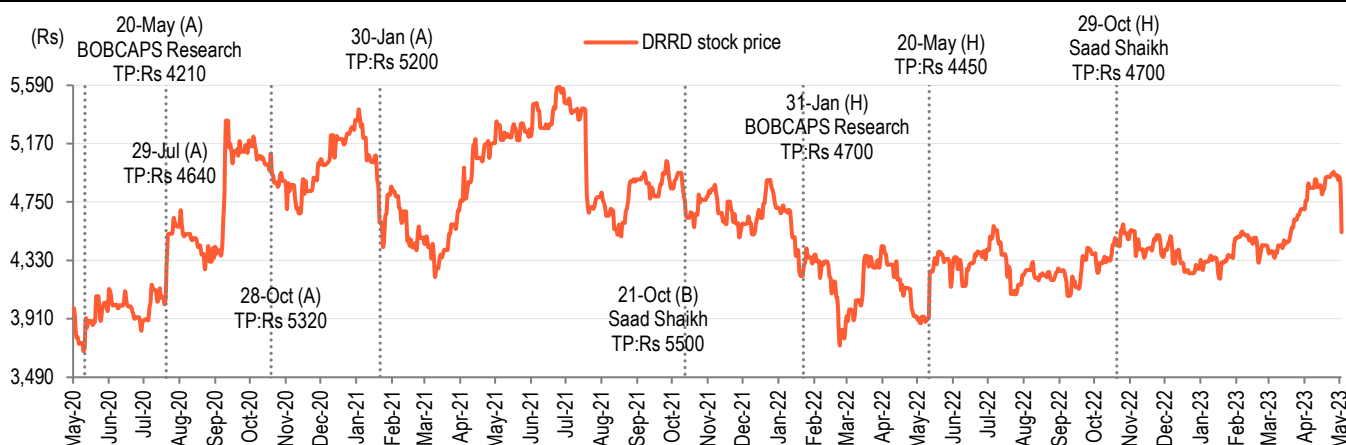
HOLD – Expected return from -6% to +15%

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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