

HOLD

TP: Rs 1,427 | ▲ 12%

DR REDDY'S LABS

Pharmaceuticals

06 November 2024

Healthy Q2; margins post gRevlimid LOE to remain wary

- Revenue/EBITDA earnings above our and street estimates. APAT ~46% above estimates. Estimates adjusted for JV and impairment cost
- Second consecutive quarter of high teens growth in the domestic business, driven by base business and Sanofi's vaccine business
- Post gRevlimid going off patent core margins to fall, hence maintain HOLD and ascribe 21x PE on Sep'26 rollover to arrive at Rs 1,427 TP

Foram Parekh

research@bobcaps.in

Healthy numbers on an adjusted basis: DRRD delivered above our and consensus estimates on revenue/EBITDA, while sales grew by 16.5% (5% above our estimates) and EBITDA by 8% YoY (5% above our estimates) driven by the performance of the India and North America businesses. However, there was a one-time expense of Rs 924mn towards the impairment of gNuvaring and Rs 7.3bn towards additional investments on the nutraceutical business, adjusting against them PAT grew by 34% YoY to Rs 19.8bn (46% above our estimate).

Restructuring of domestic business is yielding results: DRRD's India sales grew by 18% YoY to Rs 13.9bn. This was primarily driven by the newly-acquired vaccine portfolio from Sanofi. Apart from the vaccine portfolio, DRRD's base business grew almost double digits. We expect the India business's healthy momentum to continue in the base business and vaccine portfolio.

North America sales driven by gRevlimid: DRRD's North America sales grew by 18% YoY to Rs 37.2bn primarily driven from gRevlimid. We expect gRevlimid's sales to contribute significantly even in H2FY25. DRRD increased its R&D spend to 9% of sales for Q2 through which management expects meaningful new products to be launched from FY26.

End-to-end provider of GLP-1 products: DRRD aims to participate in GLP-1 products by manufacturing both API and formulations in-house. Management aims to be one of the initial players in all markets and to participate in 14-15 products over a decade through in-house capabilities.

Retain HOLD: We remain wary of fluctuating core margins, slowdown in North America business post gRevlimid going off patent in CY26 and the lack of new product launches in the US region. Also, the current investments in the nutraceutical business and JV in Nestle are at a nascent stage and would take many years to scale up, hence we maintain our HOLD rating. However, we ascribe a P/E of 21x, and roll forward our valuations to Sep'26, with new TP of Rs 1,427 (from Rs 1,180).

Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	DRRD IN/Rs 1,272
Market cap	US\$ 12.6bn
Free float	73%
3M ADV	US\$ 7.4mn
52wk high/low	Rs 1,421/Rs 1,057
Promoter/FPI/DII	27%/27%/23%

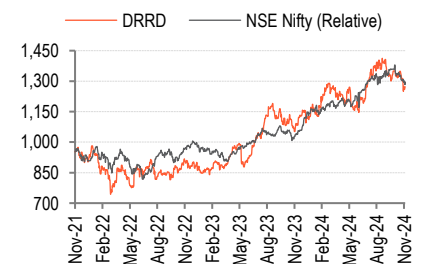
Source: NSE | Price as of 5 Nov 2024

Key financials

Y/E 31 Mar	FY24A	FY25E	FY26E
Total revenue (Rs mn)	279,164	305,052	333,165
EBITDA (Rs mn)	78,377	89,990	90,788
Adj. net profit (Rs mn)	55,684	56,885	58,702
Adj. EPS (Rs)	66.8	68.2	70.4
Consensus EPS (Rs)	66.8	68.3	70.6
Adj. ROAE (%)	22.5	19.2	16.7
Adj. P/E (x)	19.1	18.7	18.1
EV/EBITDA (x)	13.1	11.2	10.7
Adj. EPS growth (%)	21.5	2.2	3.2

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Earnings call highlights

Current quarter update

DRRD recently entered into a voluntary licence agreement with Gilead Science to manufacture and commercialise the HIV treatment drug Lenacapavir in more than 120 countries.

Subsidiary Aurigene Oncology announced promising results in its Phase 1 study of India's first trial for novel autologous CAR-T cell therapy for multiple myeloma. The USFDA approved the Investigational New Drug (IND) for AUR-112, an asset developed by Aurigene Oncology for the treatment of lymphoid malignancies.

The US business

In 2Q, sequential growth was lowered due to supply chain issues from distributors on the inventory side. However, the North America region would continue to grow in both base products and new product launches.

gRevlimid: H2 sales will be as significant as H1 sales.

ANDA update: DRRD filed two new ANDAs with the USFDA, with the YTD ANDA filing count at three. As of 30 September 2024, 80 generic filings were pending approval from the USFDA, of which 75 are ANDAs and five are New Drug Applications (NDAs). Of the 75 ANDAs, 44 are Paragraph IV applications, and 22 of these have First to File status.

New launches: Management expects meaningful new launches to start from FY26.

R&D spend allocation: Of the total R&D spend, 36% went towards biologics and Aurigene (innovator arm), 14% towards API, and the balance 50% towards Generics.

Denosumab biosimilar: DRRD is on track to file Denosumab biosimilar in the US market by CY24.

India segment

Base business: During the quarter, ex of Sanofi's vaccines, DRRD's base business grew ~10% and management expects the momentum in the base business to continue.

DRRD will spend more on SG&A in India and the Emerging Market region as both markets are very profitable.

Nestle JV: The Nestle JV for nutraceutical products in India was operationalised in August. Nestle products are not yet registered and brought to India. So the main intent of this franchise is to bring in Nestle brands that are very successful in other countries. The size of the business is merely ~Rs 100mn, hence it is a sticky business and it would take DRRD a long time to grow this business.

GLP-1 opportunity: The company is focusing on end-to-end manufacturing of both API and Formulations. Management expects to participate in 14 to 15 GLP-1 products that are coming up, mostly with patent dates in the next decade. DRRD plans to be in all the

markets once they open up, and be ready to launch its products from the IP standpoint. It plans to launch its products based on its capabilities in API and formulations.

Outlook

DRRD expects to maintain SG&A spend contribution at 27.5-28% in FY25, and the effective tax rate to normalise to 25% in FY25.

Valuation methodology

DRRD reported a strong set of numbers on an adjusted basis where sales/EBITDA were 5% each above our and Street expectations. Revenue growth was driven by India sales, which was driven by both the base business and Sanofi's vaccine business, and North America sales growth on a yearly basis was driven by gRevlimid.

We remain wary of fluctuating core margins, slowdown in the North America business post gRevlimid going off patent in CY26, and the lack of new product launches in the US region. The current investments in the nutraceutical business and JV in Nestle are still at a nascent stage and would take many years to scale up, hence we raise our sales estimates for FY25/FY26 by 3.5%/6.2%, and raise EBITDA estimates for FY25/FY26 by 13%/9%, but cut it by 6% for FY27. We maintain our HOLD rating. However, we ascribe a P/E of 21x, and roll forward our valuations to Sep'26, with a new TP of Rs 1,427 (Rs 1,180 earlier).

Fig 1 – Revised estimates

(Rs mn)	Revised				Old			Change (%)		
	FY24	FY25E	FY26E	FY27E	FY25E	FY26E	FY27E	FY25E	FY26E	FY27E
Sales	279,164	305,052	333,165	334,941	294,842	313,800	334,369	3.5	6.2	0.2
EBITDA	78,377	89,990	90,788	83,735	79,607	83,157	88,608	13.0	9.2	(5.5)
EBITDA margin (%)	28.1	29.5	27.3	25.0	27.0	26.5	26.5	250bps	75bps	(150bps)
EPS (Rs)	67	68	70	65	60	63	70	12.9	11.0	(5.9)

Source: Company, BOBCAPS Research

Fig 2 – Key Assumptions

(Rs mn)	FY24	FY25E	FY26E	FY27E
Revenue	279,164	305,052	333,165	334,941
EBITDA	78,377	89,990	90,788	83,735
PAT	55,684	56,885	58,702	54,624
EBITDA margin (%)	28.1	29.5	27.3	25.0
EPS (Rs)	67	68	70	65

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 new product launches in the North America region.

Downside risks: (a) Irregular flow of USFDA product approvals may lead to a bunching up of key launches for limited competition products. (b) Adverse USFDA observations on manufacturing plants. (c) Increasing pricing pressure.

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY23A	FY24A	FY25E	FY26E	FY27E
Total revenue	245,879	279,164	305,052	333,165	334,941
EBITDA	64,129	78,377	89,990	90,788	83,735
Depreciation	11,824	14,700	15,451	16,426	17,401
EBIT	52,305	63,677	74,539	74,362	66,334
Net interest inc./(exp.)	(1,428)	(1,711)	(1,952)	(2,967)	(2,819)
Other inc./(exp.)	10,188	9,904	3,259	6,875	9,317
Exceptional items	0	0	0	0	0
EBT	61,065	71,870	75,846	78,270	72,832
Income taxes	15,300	16,186	18,962	19,567	18,208
Extraordinary items	(699)	(3)	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	45,066	55,681	56,885	58,702	54,624
Adjustments	(699)	(3)	0	0	0
Adjusted net profit	45,765	55,684	56,885	58,702	54,624

Balance Sheet

Y/E 31 Mar (Rs mn)	FY23A	FY24A	FY25E	FY26E	FY27E
Accounts payables	26,444	30,919	33,430	36,511	36,706
Other current liabilities	44,601	49,676	54,909	59,970	60,289
Provisions	5,513	5,444	5,949	6,497	6,532
Debt funds	13,472	20,020	19,019	18,068	17,165
Other liabilities	0	0	0	0	0
Equity capital	833	834	834	834	834
Reserves & surplus	223,795	269,851	322,566	377,098	427,552
Shareholders' fund	224,628	270,685	323,400	377,932	428,386
Total liab. and equities	314,658	376,744	436,707	498,978	549,078
Cash and cash eq.	5,779	7,107	63,138	111,970	165,843
Accounts receivables	72,485	80,298	83,576	91,278	91,765
Inventories	48,670	63,552	62,682	68,459	68,823
Other current assets	24,788	28,079	30,505	33,317	33,494
Investments	61,380	79,618	79,618	79,618	79,618
Net fixed assets	66,462	76,886	76,435	75,009	72,608
CWIP	0	0	0	0	0
Intangible assets	35,094	41,204	40,753	39,327	36,926
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	314,658	376,744	436,707	498,978	549,078

Cash Flows

Y/E 31 Mar (Rs mn)	FY23A	FY24A	FY25E	FY26E	FY27E
Cash flow from operations	54,400	55,587	77,703	70,494	74,364
Capital expenditures	(22,618)	(15,200)	(15,000)	(15,000)	(15,000)
Change in investments	(23,881)	(18,238)	0	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(46,499)	(33,438)	(15,000)	(15,000)	(15,000)
Equities issued/Others	1	1	0	0	0
Debt raised/repaid	(20,373)	6,548	(1,001)	(951)	(903)
Interest expenses	(1,428)	(1,711)	(1,952)	(2,967)	(2,819)
Dividends paid	(4,165)	(4,170)	(4,170)	(4,170)	(4,170)
Other financing cash flows	8,991	(21,489)	451	1,426	2,401
Cash flow from financing	(16,974)	(20,821)	(6,672)	(6,662)	(5,491)
Chg in cash & cash eq.	(9,073)	1,328	56,031	48,832	53,873
Closing cash & cash eq.	5,779	7,107	63,138	111,970	165,843

Per Share

Y/E 31 Mar (Rs)	FY23A	FY24A	FY25E	FY26E	FY27E
Reported EPS	54.1	66.8	68.2	70.4	65.5
Adjusted EPS	54.9	66.8	68.2	70.4	65.5
Dividend per share	5.0	5.0	5.0	5.0	5.0
Book value per share	270.6	326.1	389.6	455.3	516.1

Valuations Ratios

Y/E 31 Mar (x)	FY23A	FY24A	FY25E	FY26E	FY27E
EV/Sales	4.3	3.7	3.3	2.9	2.7
EV/EBITDA	16.4	13.1	11.2	10.7	10.9
Adjusted P/E	23.2	19.1	18.7	18.1	19.4
P/BV	4.7	3.9	3.3	2.8	2.5

DuPont Analysis

Y/E 31 Mar (%)	FY23A	FY24A	FY25E	FY26E	FY27E
Tax burden (Net profit/PBT)	74.9	77.5	75.0	75.0	75.0
Interest burden (PBT/EBIT)	116.7	112.9	101.8	105.3	109.8
EBIT margin (EBIT/Revenue)	21.3	22.8	24.4	22.3	19.8
Asset turnover (Rev./Avg TA)	27.3	26.4	24.1	22.6	19.9
Leverage (Avg TA/Avg Equity)	1.1	1.1	1.1	1.1	1.0
Adjusted ROAE	22.7	22.5	19.2	16.7	13.5

Ratio Analysis

Y/E 31 Mar	FY23A	FY24A	FY25E	FY26E	FY27E
YoY growth (%)					
Revenue	14.7	13.5	9.3	9.2	0.5
EBITDA	37.5	22.2	14.8	0.9	(7.8)
Adjusted EPS	46.8	21.5	2.2	3.2	(6.9)
Profitability & Return ratios (%)					
EBITDA margin	26.1	28.1	29.5	27.3	25.0
EBIT margin	21.3	22.8	24.4	22.3	19.8
Adjusted profit margin	18.6	19.9	18.6	17.6	16.3
Adjusted ROAE	22.7	22.5	19.2	16.7	13.5
ROCE	27.8	27.8	24.6	22.0	18.0
Working capital days (days)					
Receivables	108	105	100	100	100
Inventory	72	83	75	75	75
Payables	39	40	40	40	40
Ratios (x)					
Gross asset turnover	1.1	1.2	1.2	1.3	1.2
Current ratio	2.0	2.1	2.5	3.0	3.5
Net interest coverage ratio	36.6	37.2	38.2	25.1	23.5
Adjusted debt/equity	(0.2)	(0.2)	(0.2)	(0.1)	(0.1)

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

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Registered office Address: **1704, B Wing, Parinee Crescenzo, G Block, BKC, Bandra East, Mumbai 400051**

SEBI Research Analyst Registration No: **INH000000040 valid till 03 February 2025**

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BUY – Expected return >+15%

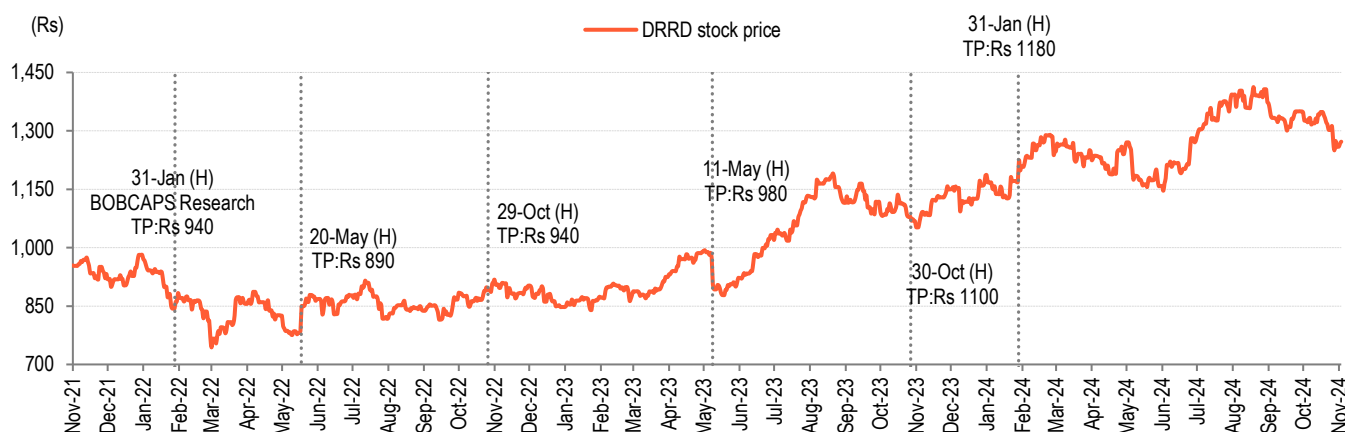
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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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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