

HOLD

TP: Rs 5,900 | ▼ 3%

DR REDDY'S LABS

| Pharmaceuticals

| 09 May 2024

Driven by North America; India continues to underperform

- DRRD reported largely in-line revenue/EBITDA, but higher tax aided in PAT beat
- Growth driven almost entirely by North America business; slowdown in India remains a concern; partnerships & JVs should help
- We maintain our estimates for FY25/26, TP and rating. Our TP on DRRD remains Rs 5,900 based on an unchanged 11x FY26E EV/EBITDA. **HOLD**

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In-line headline numbers; ex-North America a concern: DRRD delivered in-line revenue/EBITDA compared to Bloomberg consensus estimates entirely driven by the performance of the North America business, while India disappointed with a decline of 12% YoY. Overall revenue was up by 12% YoY to Rs 70.8bn. EBITDA/PAT grew +13%/+36% YoY to Rs 17.8bn/13.0bn.

Lacklustre ex-North America performance; India disappoints: Most of the incremental revenue in Q4FY24 compared to last year was on account of the North America business (~90%), while other regions reported modest growth and accounted for the remaining 10% of incremental revenue. India was a concern with a decline of 12% YoY (-5% QoQ). Underperformance in the India business was on account of lower base business volumes while the company launched 3 new brands in Q4FY24. Adjusting for brand sales in the base quarter, adjusted India growth stood at ~11% YoY. The company expects to grow its domestic sales in double digits for the next year to be supported by new launches and JVs. The company is guiding for +25 material launches in the US in the next 3-4 years including peptides and, hence, increased its R&D guidance.

Margins maintained despite surge in R&D expenditure: Gross margin improved YoY by 140bps to 58.5% and remained stable sequentially. EBITDA margin at 25.2% remained the same as last year but contracted 280bps QoQ. This was due to the surge in SG&A expenses which increased by 14% due to higher sales and marketing expenditure while R&D expenses stood at Rs 6.9bn (9.7% vs. 7.7%/8.5% in Q3FY24/Q4FY23) due to an increase in complex filings. PAT was 15% ahead of Bloomberg consensus due to a lower tax rate of 18.6% (vs. 24.4% in Q3FY24 and 26.7% in Q4FY23) due to a one-time tax benefit.

Retain HOLD: We maintain our estimates, TP and rating on DRRD. Our Rs 5,900 TP is based on an unchanged EV/EBITDA of 11x. We remain wary of fluctuating core margins, profit support from one-offs such as Production Linked Incentive (PLI) benefits, slowdown in India business and regulatory overhang, prompting us to retain our HOLD rating. Recently forged partnerships & JVs will help India business.

Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	DRRD IN/Rs 6,056
Market cap	US\$ 12.3bn
Free float	73%
3M ADV	US\$ 27.9mn
52wk high/low	Rs 6,506/Rs 4,384
Promoter/FPI/DII	27%/27%/23%

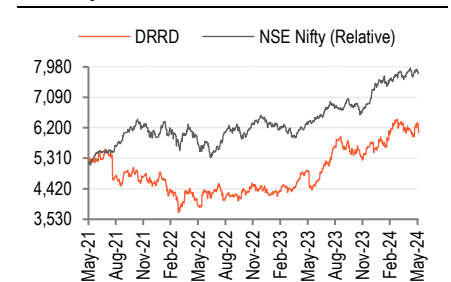
Source: NSE | Price as of 8 May 2024

Key financials

Y/E 31 Mar	FY24P	FY25E	FY26E
Total revenue (Rs mn)	279,164	294,842	313,800
EBITDA (Rs mn)	78,377	79,607	83,157
Adj. net profit (Rs mn)	55,684	50,371	52,839
Adj. EPS (Rs)	333.8	302.0	316.8
Consensus EPS (Rs)	333.8	332.9	337.0
Adj. ROAE (%)	22.5	17.1	15.5
Adj. P/E (x)	18.1	20.1	19.1
EV/EBITDA (x)	12.5	12.0	11.1
Adj. EPS growth (%)	21.5	(9.5)	4.9

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

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q4FY24	Q4FY23	YoY (%)	Q3FY24	QoQ (%)	FY24	FY23	YoY (%)
Net Sales	70,830	62,968	12.5	72,148	(1.8)	279,164	245,879	13.5
EBITDA	17,842	15,829	12.7	20,180	(11.6)	78,388	64,572	21.4
Depreciation	3,712	3,190	16.4	3,770	-	14,855	12,636	-
EBIT	14,130	12,639	11.8	16,410	(13.9)	63,533	51,936	22.3
Interest	(1,022)	(799)	27.9	(963)	-	(3,994)	(2,853)	-
Other Income	656	281	-	967	-	4,199	269	-
PBT	15,808	13,719	15.2	18,340	(13.8)	71,726	55,058	30.3
Less: Taxation	2,946	3,663	-	4,468	-	16,186	15,300	-
Less: Minority Interest	(35)	(76)	-	(27)	-	(147)	(370)	-
Recurring PAT	12,897	10,132	27.3	13,899	(7.2)	55,687	40,128	38.8
Exceptional items	173	(540)	-	(110)	-	(3)	4,939	-
Reported PAT	13,070	9,592	36.3	13,789	(5.2)	55,684	45,067	23.6
Key Ratios (%)			(bps)		(bps)			(bps)
Gross Margin	58.6	57.2	140	58.5	7	58.6	56.7	193
EBITDA Margin	25.2	25.1	5	28.0	(278)	28.1	26.3	182
Tax / PBT	18.6	26.7	-	24.4	-	22.6	27.8	-
NPM	18.2	16.1	-	19.3	-	19.9	16.3	-
Adj. EPS (Rs)	77.5	60.9	27.3	83.5	(7.2)	334.7	241.2	-

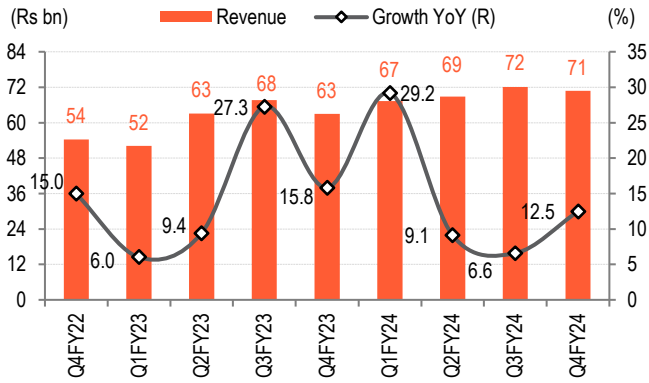
Source: Company, BOBCAPS Research

Fig 2 – Revenue mix

(Rs mn)	Q4FY24	Q4FY23	YoY (%)	Q3FY24	QoQ (%)	FY24	FY23	YoY (%)
Global generics	61,190	54,257	12.8	63,095	(3.0)	245,377	213,767	14.8
North America	32,626	25,321	28.8	33,492	(2.6)	129,796	101,704	27.6
Europe	5,208	4,960	5.0	4,970	4.8	20,535	17,603	16.7
India	11,265	12,834	(12.2)	11,800	(4.5)	46,407	48,947	(5.2)
ROW	12,091	11,142	8.5	12,833	(5.8)	48,639	45,513	6.9
PSAI	8,219	7,787	5.5	7,839	4.8	29,801	29,069	2.5
Others	1,420	924	53.7	1,214	17.0	3,910	3,042	28.5
Net Sales	70,830	62,968	12.5	72,148	(1.8)	279,164	245,878	13.5
INR/US\$	83	82	1.4	83.2	0.2	82.9	80.7	2.7
US in \$ terms (mn)	391	308	27.1	403	(2.8)	1,565	1,260	24.3

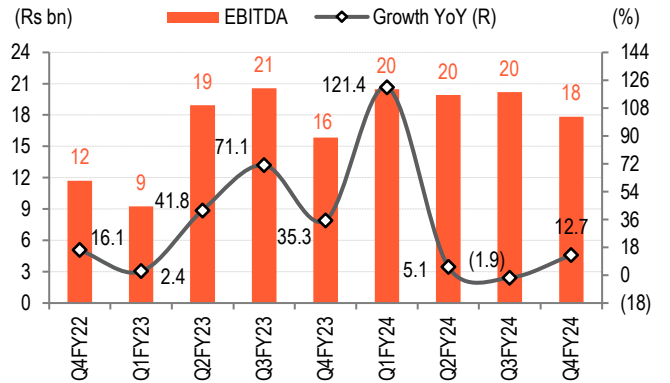
Source: Company, BOBCAPS Research

Fig 3 – Revenue



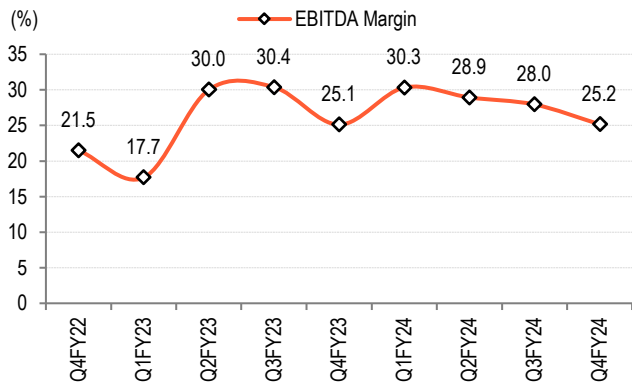
Source: Company, BOBCAPS Research

Fig 4 – EBITDA



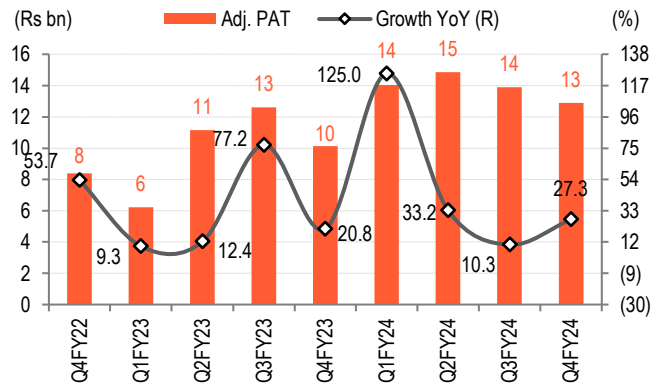
Source: Company, BOBCAPS Research

Fig 5 – EBITDA margin



Source: Company, BOBCAPS Research

Fig 6 – Adj. PAT



Source: Company, BOBCAPS Research

Earnings call highlights

- Revenue growth attributed to strong generic business in the US.
- SG&A expenses increased by 14% due to higher sales and marketing expenditure.
- R&D expenses stood at Rs 6.9bn (9.7% of sales increase).
- Lower effective tax rate due to one-time tax benefits.
- Net cash: Rs 64.6bn; free cash flow: Rs 5.3bn (Q4FY24) and Rs 19.1bn (FY24).
- Capex: Rs 5bn (Q4FY24) and Rs 15.2bn (FY24), mostly for expansion.
- Exclusive partnerships with Sanofi and Bayer for vaccine and heart failure management drugs.
- Licensing agreement with Pharmazz for Centhaquine in India.
- JV revenue with Nestle to start flowing from FY26.
- R&D allocation: 60% small molecules, 20% biosimilars, 20% active pharmaceutical ingredient (APIs).

The US

- Growth from base business volumes and new launches, offset by price erosion.
- Launched 5 new products in Q4FY24; filed 9 abbreviated new drug applications (ANDA).
- Small molecule growth from FY25; biosimilar revenue from FY27.
- gRevlimid sales; base business performance impacted overall US business.
- Stable price erosion; gLumify approval for Q1FY25.

India

- Decline due to lower base business volumes.
- Launched 3 new brands in Q4FY24.

Europe

- Growth from base business volumes and new launches.
- Planning Ritiximab launch in Ukraine.
- Launched 6 new products in the region.

Emerging Markets

- YoY growth from new product launches; QoQ decline due to forex.
- Launched 17 new products across various countries.

Biosimilars

- Significant product launch in the US during FY27; breakeven expected post launch.

Guidance

- Anticipated effective tax rate for FY25: 24-25%.
- Branded generic business to grow in double digits.
- Aiming for top 5 position in the domestic market (Rs 1,200bn revenue).
- Emerging markets to experience double-digit growth.
- R&D expenditure: 8.5-9% for FY25.
- Expect Chinese market product introductions.

Valuation methodology

We maintain our estimates, TP and rating on DRRD. Our TP of Rs 5,900 is based on an unchanged EV/EBITDA of 11x. 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 (%)	
	FY25E	FY26E	FY25E	FY26E	FY25E	FY26E
Sales	294.8	313.8	297.5	316.7	(0.9)	(0.9)
EBITDA	79.6	83.2	80.3	83.9	(0.9)	(0.9)
EBITDA margin (%)	27.0	26.5	27.0	26.5	(0bps)	(0bps)
EPS (Rs)	302	317	313.1	328.4	(3.5)	(3.5)

Source: BOBCAPS Research

Fig 8 – Key assumptions

Revenue (Rs bn)	FY24E	FY25E	FY26E
Global Generics	245.5	258.4	274.3
North America	129.9	132.0	135.5
Europe	20.5	23.0	25.7
India	46.4	51.0	56.2
Emerging Markets	48.6	52.3	56.9
PSAI	29.8	32.2	34.8
Others	3.9	4.3	4.7

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 US Food and Drug Administration (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.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	3.6	2,368	2,585	BUY
Alembic Pharma	ALPM IN	2.4	1,004	970	HOLD
Alkem Labs	ALKEM IN	7.5	5,164	4,800	SELL
Aurobindo Pharma	ARBP IN	8.1	1,136	1,100	HOLD
Cipla	CIPLA IN	13.6	1,385	1,576	BUY
Divi's Labs	DIVI IN	12.7	3,927	3,000	SELL
Dr Reddy's Labs	DRRD IN	12.3	6,056	5,900	HOLD
Eris Lifesciences	ERIS IN	1.4	873	955	BUY
Glenmark Life Sciences	GLS IN	1.3	840	790	HOLD
Laurus Labs	LAURUS IN	2.8	434	305	SELL
Lupin	LPC IN	8.9	1,616	1,600	HOLD
Sun Pharma	SUNP IN	44.4	1,522	1,550	HOLD

Source: BOBCAPS Research, NSE | Price as of 8 May 2024

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24P	FY25E	FY26E
Total revenue	214,391	245,879	279,164	294,842	313,800
EBITDA	46,631	64,129	78,377	79,607	83,157
Depreciation	11,652	11,824	14,700	15,451	16,426
EBIT	34,979	52,305	63,677	64,157	66,731
Net interest inc./(exp.)	(958)	(1,428)	(1,711)	(1,952)	(2,967)
Other inc./(exp.)	5,838	10,188	9,904	4,074	6,687
Exceptional items	0	0	0	0	0
EBT	39,859	61,065	71,870	66,278	70,452
Income taxes	8,730	15,300	16,186	15,907	17,613
Extraordinary items	(7,562)	(699)	(3)	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	23,567	45,066	55,681	50,371	52,839
Adjustments	(7,562)	(699)	(3)	0	0
Adjusted net profit	31,129	45,765	55,684	50,371	52,839

Balance Sheet

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24P	FY25E	FY26E
Accounts payables	25,572	26,444	30,919	32,311	34,389
Other current liabilities	42,335	44,601	49,676	53,072	56,484
Provisions	4,315	5,513	5,444	5,750	6,119
Debt funds	33,845	13,472	20,020	19,019	18,068
Other liabilities	0	0	0	0	0
Equity capital	832	833	834	834	834
Reserves & surplus	176,974	223,795	269,851	316,052	364,721
Shareholders' fund	177,806	224,628	270,685	316,886	365,555
Total liab. and equities	283,873	314,658	376,744	427,038	480,616
Cash and cash eq.	14,852	5,779	7,107	59,385	104,829
Accounts receivables	66,818	72,485	80,298	80,779	85,973
Inventories	50,884	48,670	63,552	60,584	64,480
Other current assets	19,987	24,788	28,079	29,484	31,380
Investments	37,499	61,380	79,618	79,618	79,618
Net fixed assets	62,169	66,462	76,886	76,435	75,009
CWIP	0	0	0	0	0
Intangible assets	31,664	35,094	41,204	40,753	39,327
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	283,873	314,658	376,744	427,038	480,616

Cash Flows

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24P	FY25E	FY26E
Cash flow from operations	25,800	54,400	55,587	73,950	67,106
Capital expenditures	(12,430)	(22,618)	(15,200)	(15,000)	(15,000)
Change in investments	(9,782)	(23,881)	(18,238)	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(22,212)	(46,499)	(33,438)	(15,000)	(15,000)
Equities issued/Others	0	1	1	0	0
Debt raised/repaid	3,546	(20,373)	6,548	(1,001)	(951)
Interest expenses	(958)	(1,428)	(1,711)	(1,952)	(2,967)
Dividends paid	(4,160)	(4,165)	(4,170)	(4,170)	(4,170)
Other financing cash flows	(1,993)	8,991	(21,489)	451	1,426
Cash flow from financing	(3,565)	(16,974)	(20,821)	(6,672)	(6,662)
Chg in cash & cash eq.	23	(9,073)	1,328	52,278	45,444
Closing cash & cash eq.	14,852	5,779	7,107	59,385	104,829

Per Share

Y/E 31 Mar (Rs)	FY22A	FY23A	FY24P	FY25E	FY26E
Reported EPS	141.6	270.5	333.8	302.0	316.8
Adjusted EPS	187.1	274.7	333.8	302.0	316.8
Dividend per share	25.0	25.0	25.0	25.0	25.0
Book value per share	1,071.1	1,353.2	1,630.6	1,909.0	2,202.1

Valuations Ratios

Y/E 31 Mar (x)	FY22A	FY23A	FY24P	FY25E	FY26E
EV/Sales	4.7	4.1	3.5	3.2	2.9
EV/EBITDA	21.6	15.6	12.5	12.0	11.1
Adjusted P/E	32.4	22.0	18.1	20.1	19.1
P/BV	5.7	4.5	3.7	3.2	2.8

DuPont Analysis

Y/E 31 Mar (%)	FY22A	FY23A	FY24P	FY25E	FY26E
Tax burden (Net profit/PBT)	78.1	74.9	77.5	76.0	75.0
Interest burden (PBT/EBIT)	114.0	116.7	112.9	103.3	105.6
EBIT margin (EBIT/Revenue)	16.3	21.3	22.8	21.8	21.3
Asset turnover (Rev./Avg TA)	26.4	27.3	26.4	23.5	21.8
Leverage (Avg TA/Avg Equity)	1.2	1.1	1.1	1.1	1.1
Adjusted ROAE	18.2	22.7	22.5	17.1	15.5

Ratio Analysis

Y/E 31 Mar	FY22A	FY23A	FY24P	FY25E	FY26E
YoY growth (%)					
Revenue	13.0	14.7	13.5	5.6	6.4
EBITDA	3.1	37.5	22.2	1.6	4.5
Adjusted EPS	17.8	46.8	21.5	(9.5)	4.9
Profitability & Return ratios (%)					
EBITDA margin	21.8	26.1	28.1	27.0	26.5
EBIT margin	16.3	21.3	22.8	21.8	21.3
Adjusted profit margin	14.5	18.6	19.9	17.1	16.8
Adjusted ROAE	18.2	22.7	22.5	17.1	15.5
ROCE	20.1	27.8	27.8	21.8	20.4
Working capital days (days)					
Receivables	114	108	105	100	100
Inventory	87	72	83	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	2.1	2.5	3.0
Net interest coverage ratio	36.5	36.6	37.2	32.9	22.5
Adjusted debt/equity	0.0	(0.2)	(0.2)	(0.2)	(0.2)

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

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BUY – Expected return >+15%

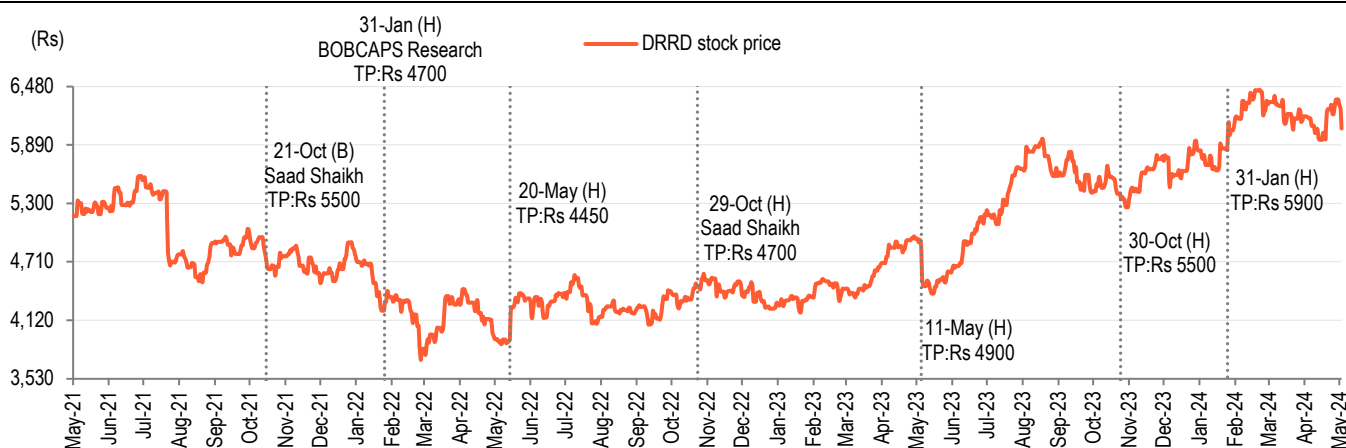
HOLD – Expected return from -6% to +15%

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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