

HOLD

TP: Rs 4,450 | ▲ 4%

DR REDDY'S LABS

| Pharmaceuticals

| 22 June 2022

Investor Day: Peek into the future

- DRRD unveiled a framework to make its business future ready
- Company is redefining prospects till FY30E in two horizons; DRRD expect advanced product portfolio to contribute 50% of sales by FY27E
- We maintain HOLD rating and reiterate TP of Rs. 4,450, based on FY24 EV/EBITDA of 12.5x (unchanged)

Surajit Pal | Saad Shaikh
research@bobcaps.in

We attended investor day held by DRRD, below are key takeaway from the meet.

Key takeaways:

Management emphasized its long-term guidance of double-digit revenue growth with aspirational 25% EBITDA margin and 25% ROCE.

Company intends to expand its patient reach to 1.5bn+ by 2030 and would be focusing on 3 Innovative products to improve standard of treatment every year.

Company aims to make 25% of its new launches to be first generics in the respective markets by FY27E.

Management highlighted that the company is focusing on (i) capital reallocation, (ii) leveraging portfolio across markets, and (iii) continuous focus on raising productivity.

Company acknowledged the challenges faced by the industry in terms of Intense competition in traditional generics, shift in demand towards more complex products, injectables and biologics, patients looking for holistic solutions, entry of new players in the health ecosystem, disruption through digital means, geopolitical issues and macroeconomic challenges.

Company chartered its future growth strategies in two parts for each of its key markets into two horizons, Horizon 1 (growing the core) to focus on short to medium term growth drivers involving core business of the company including Generics, Branded Generics, OTC, API, and Biosimilars.

Horizon 2 (building the future) would focus on short to long term growth drivers involving future business opportunities. This will include building Immuno-oncology NCEs, Biologics & Cell and Gene Therapies (CGT), CDMO (small and large molecules), Nutraceuticals, Disease management, D2C, Digitization.

Key changes

Target	Rating
◀▶	◀▶

Ticker/Price	DRRD IN/Rs 4,261
Market cap	US\$ 9.0bn
Free float	73%
3M ADV	US\$ 26.4mn
52wk high/low	Rs 5,615/Rs 3,654
Promoter/FPI/DII	27%/29%/16%

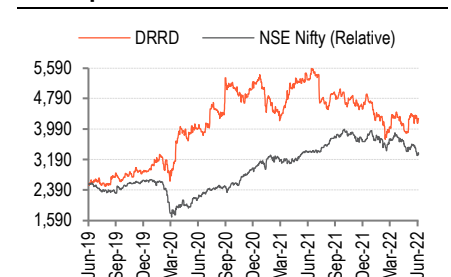
Source: NSE | Price as of 22 Jun 2022

Key financials

Y/E 31 Mar	FY22P	FY23E	FY24E
Total revenue (Rs mn)	2,14,391	2,41,446	2,60,353
EBITDA (Rs mn)	44,889	52,635	58,579
Adj. net profit (Rs mn)	29,387	31,650	35,969
Adj. EPS (Rs)	177.0	190.7	216.7
Consensus EPS (Rs)	175.2	217.4	261.2
Adj. ROAE (%)	17.2	16.5	16.3
Adj. P/E (x)	24.1	22.3	19.7
EV/EBITDA (x)	15.7	13.3	11.8
Adj. EPS growth (%)	11.2	7.7	13.6

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

Stock performance



Source: NSE



Given the investment required to implement these initiatives, company expect R&D expenses to inch up to 10-11% of sales from existing 8-9%.

Biologics Business:

DRRD plans to scale-up its global biosimilar business in Horizon 1 with focus on regulated market approvals, and would be focusing on innovative technologies like cell & gene therapy (CGT) apart from growing its CDMO business in Horizon 2.

Horizon 1: Scaling-up current Biosimilars business

Company's focus areas in biosimilar space would on Oncology and Auto-immune diseases. Currently it has a portfolio of 6 commercial products in India and more than 25 EMs.

- **PEG-GCSF (Out-licensed):** already approved in Europe and in advanced stages of review with US FDA
- **Rituximab:** Advanced stages of completing global safety efficacy trials; expected filing for regulated markets by early 2023

Company has a pipeline of 12 products, of which one has been filed. The peak innovator sales of company's pipeline products approximate to USD 50bn.

Company expects that 2 assets will enter clinical phase while 2 other assets would be scaled-up by FY23.

Horizon 2: Building Biologics

Given the limited access to innovator therapies like CGT and their high cost, company would be working towards bringing CGT therapies at affordable range. In horizon 2 of biologics, company would also be focusing on building its CDMO Biologics business.

API business:

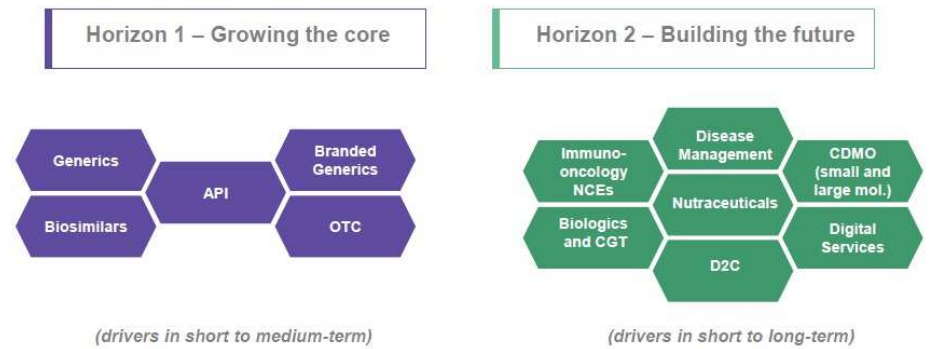
- DRRD plans to scale up core API business globally and would be focusing on backward-integration of more than 70% of core molecules which could result in +500 bps gross margin improvement in next 5 years. Company currently has 225+ active DMFs and 55+ products in its pipeline.
- In API+, Currently DRRD is present in 25+ countries; aims to be in 60+ countries in next 5 years.
- Discovery + CDMO (APSL): DRRD is currently serving 3 of the top 5 innovators and 120 biotech companies globally where it provides discovery and CDMO services.

Productivity improvement:

DRRD emphasized that it will continue to focus on improving overall productivity through continuous improvements, digitization and automation in addition to field force productivity improvement.

Company aims to achieve this through integrated product offerings, first to market launches, low-cost manufacturing, life cycle management and through implementation of new age industry 4.0 technologies.

Fig 1 – Horizon 1 (core business) & Horizon 2 (future business)



Source: Company

Fig 2 – Key focus areas across markets and pipeline

	Current Status	Key Focus Areas		Pipeline
		Horizon 1	Horizon 2	
North America	<ul style="list-style-type: none"> 5% revenue CAGR over FY19-22 despite price erosion 335+ products of which 160+ commercial and rest in various stages of the pipeline 60% retail products ranked 1-3 55% institutional products ranked 1-3 Ranked 2 in Rx- OTC segment 	<ul style="list-style-type: none"> Injectables Business Agile business model and productivity in Retail generics OTC – Private label and brands Direct to patient channels 	<ul style="list-style-type: none"> Biosimilars Digital-led selfcare & wellness solutions Drug-device combinations Immuno - Oncology 	<ul style="list-style-type: none"> Complex Gx (Semaglutide, Teriparatide, Octreotide, Liraglutide, Regadenoson, Dasatinib) Biosimilars (Pegfilgrastim, Rituximab, Tocilizumab, Abatacept)
Europe	<ul style="list-style-type: none"> Became 2X in the last 3 years 160 commercial products Expansion into 5 new countries in the last year 	<ul style="list-style-type: none"> Build scale in EU5 – Germany, UK, Spain, France and Italy Selective geographic expansion to other markets More first-to-market launches leveraging current portfolio 	<ul style="list-style-type: none"> Branded businesses - differentiated branded and OTC play Pioneering in new spaces, e.g Pharmaceutical Cannabis Biosimilars 	<ul style="list-style-type: none"> Biosimilars: Pegfilgrastim#, Rituximab, Tocilizumab, Abatacept Complex Generics: Liraglutide, Doxorubicin liposomal Other Generics: Apixaban, Rivaroxaban, DMF, Sacubitril
India	<ul style="list-style-type: none"> Became 2X in last 4 years, continues to outperform IPM 16 Brands in IPM Top 300 15 Brands with >100Cr+ 10 MQT Rank in the IPM 	<ul style="list-style-type: none"> Building big brands through strong product management Processes Winning in chosen therapy/ disease areas through differentiated portfolio & inorganic play Productivity through sales & marketing excellence using Digital & Analytics 	<ul style="list-style-type: none"> Nutraceuticals OTC Biologics and CAR-T NCE / NBE Condition & disease management Digital ecosystem play Other inorganic moves 	
Emerging Markets	<ul style="list-style-type: none"> Became 2X in last 4 years 13 new markets in last 5 years Serving patients in 33 countries 11 brands with >100 Cr+ 564 filings in last 4 years 	<ul style="list-style-type: none"> Grow Megabrands in Rx and OTC Leverage global portfolio into EM Geography Reach Productivity Growth through S&M excellence 	<ul style="list-style-type: none"> Differentiated formulations, Nutrition portfolio Biologics NCE / NBE Disease management Direct-to-Customer 	

Source: Company, #Partnered product

Fig 3 – Future goals and ambitions

Markets	Future ambitions
North America	<ul style="list-style-type: none"> ~40% Injectables/ Sterile products 25+ complex products across Drug-device combos, peptides, long-acting Injectables & RTUs At advanced stages on multiple platform technologies: Particulate Systems, Microsphere & Liposomal, Peptides platform, Emulsions and Suspensions
India	<ul style="list-style-type: none"> Aim to be among Top 5 in India
Emerging Markets	<ul style="list-style-type: none"> Russia: China: Aim to be 2-3X in next 5 years, Double-digit filings annually Brazil: Aim to be 4-5X in next 5 years, Oncology & Institutional

Source: Company

Valuation methodology

While the redefinition of its framework will likely improve visibility of growth in short to long term, we expect there will be higher probability of increase in overhead cost, mainly R&D expenses during its investment phase on biosimilars till FY27E. Once its biosimilars begins to receive approvals from key regulators, it will also increase sales and marketing costs including building dedicated sales team and high promotional expenses for at least 6 months during the launch of each of its biosimilars. We believe that the benefits of the new business framework will be back-ended, and would need strong and sustainable investment focus for at least 4-6 years before realizing net profit from Horizon-2 product portfolio. Hence, we believe the impact from the new framework will be too early to consider both in sales and operating costs of DRRD. We plan to incorporate and discount the new business model in our earnings once there is better clarity on the execution of the business plan in short to medium term.

We maintain our TP at Rs. 4,450 based on FY24 EV/EBITDA of 12.5x (unchanged) and reiterate HOLD as company has failed to meet market expectations in terms of execution track record on several fronts in recent past – viz. gVascepa, Sputnik vaccine, gSuboxone, gNuvaring and gCopaxone.

Fig 4 – Key assumptions

Parameter	FY22A	FY23E	FY24E
North America	74.92	90.28	92.57
Europe	16.63	17.63	18.69
India	41.96	47.41	53.57
EM (Russia, CIS, Romania, ROW)	45.67	47.69	54.25
PSAI	30.74	33.51	35.85
PP and Others	4.48	4.93	5.42

Source: Company, BOBCAPS Research

Fig 5 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	EBITDA CAGR FY22-24E (%)	EV/EBITDA (x)		ROIC (%)		Target EV/EBITDA (x)
					FY22E	FY23E	FY22E	FY23E	
Dr. Reddy's	DRRD IN	HOLD	4,450	14.2	13.3	11.9	23.3	27.1	12.5
Cipla	CIPLA IN	BUY	1,100	9.6	15.0	13.3	21.0	25.3	16.0
Lupin	LPC IN	SELL	600	17.1	12.8	10.6	11.4	14.2	10.0
Sun Pharma	SUNP IN	BUY	1,100	13.6	15.2	13.6	30.2	34.2	18.5

Source: BOBCAPS Research

Key risks

Key risks to our estimates are:

- irregular flow of USFDA product approvals, which may lead to a bunching up of key launches for limited-competition products currently not discounted in valuations;
- faster resolution of political turmoil in Russia/CIS region;
- adverse USFDA inspection on manufacturing plants; and
- speedy resolution of regulatory issues in key manufacturing units.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	1.3	1,215	2,050	BUY
Alembic Pharma	ALPM IN	1.8	719	770	HOLD
Alkem Labs	ALKEM IN	4.5	2,980	3,400	BUY
Aurobindo Pharma	ARBP IN	3.9	519	680	BUY
Cipla	CIPLA IN	9.4	917	1,100	BUY
Divi's Labs	DIVI IN	12.2	3,600	4,250	HOLD
Dr Reddy's Labs	DRRD IN	9.0	4,261	4,450	HOLD
Eris Lifesciences	ERIS IN	1.1	639	970	BUY
Glenmark Life Sciences	GLS IN	0.7	439	620	BUY
Laurus Labs	LAURUS IN	3.1	452	645	BUY
Lupin	LPC IN	3.6	613	600	SELL
Sun Pharma	SUNP IN	24.8	809	1,100	BUY

Source: BOBCAPS Research, NSE | Price as of 22 Jun 2022

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
Total revenue	1,74,601	1,89,722	2,14,391	2,41,446	2,60,353
EBITDA	40,942	45,247	44,889	52,635	58,579
Depreciation	12,471	12,288	11,652	12,424	13,140
EBIT	28,471	32,959	33,237	40,211	45,440
Net interest inc./(exp.)	(983)	(970)	(958)	(1,117)	(1,185)
Other inc./(exp.)	3,294	3,605	5,838	3,106	3,703
Exceptional items	0	0	0	0	0
EBT	30,782	35,594	38,117	42,200	47,958
Income taxes	(1,466)	9,175	8,730	10,550	11,990
Extraordinary items	(12,739)	(6,903)	(7,562)	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	19,509	19,516	21,825	31,650	35,969
Adjustments	(12,739)	(6,903)	(7,562)	0	0
Adjusted net profit	32,248	26,419	29,387	31,650	35,969

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
Accounts payables	16,659	21,916	25,572	23,152	24,965
Other current liabilities	32,188	34,129	42,335	41,046	44,260
Provisions	3,854	3,493	4,315	4,860	5,240
Debt funds	22,011	30,299	33,845	33,845	33,845
Other liabilities	0	0	0	0	0
Equity capital	831	832	832	832	832
Reserves & surplus	1,42,174	1,63,832	1,76,974	2,04,464	2,36,273
Shareholders' fund	1,43,005	1,64,664	1,77,806	2,05,296	2,37,105
Total liab. and equities	2,17,717	2,54,501	2,83,873	3,08,198	3,45,415
Cash and cash eq.	2,053	14,829	14,852	21,621	58,099
Accounts receivables	50,278	49,759	66,818	66,150	71,329
Inventories	35,066	45,412	50,884	57,550	53,497
Other current assets	19,557	19,457	19,987	24,145	26,035
Investments	26,778	27,717	37,499	39,749	39,749
Net fixed assets	52,332	57,111	62,169	64,745	63,605
CWIP	0	0	0	0	0
Intangible assets	31,653	40,216	31,664	34,240	33,100
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	2,17,717	2,54,501	2,83,873	3,08,198	3,45,415

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
Cash flow from operations	25,282	29,884	24,058	31,871	52,683
Capital expenditures	(11,917)	(10,000)	(14,700)	(15,000)	(12,000)
Change in investments	(907)	(939)	(9,782)	(2,250)	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(12,824)	(10,939)	(24,482)	(17,250)	(12,000)
Equities issued/Others	1	1	0	0	0
Debt raised/repaid	(16,370)	8,288	3,546	0	0
Interest expenses	(983)	(970)	(958)	(1,117)	(1,185)
Dividends paid	(4,155)	(4,160)	(4,160)	(4,160)	(4,160)
Other financing cash flows	8,874	(9,328)	2,019	(2,576)	1,140
Cash flow from financing	(12,633)	(6,169)	447	(7,853)	(4,205)
Chg in cash & cash eq.	(175)	12,776	23	6,769	36,478
Closing cash & cash eq.	2,053	14,829	14,852	21,621	58,099

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22P	FY23E	FY24E
Reported EPS	117.5	117.6	131.5	190.7	216.7
Adjusted EPS	194.3	159.1	177.0	190.7	216.7
Dividend per share	25.0	25.0	25.0	25.0	25.0
Book value per share	861.5	992.0	1,071.1	1,236.7	1,428.3

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22P	FY23E	FY24E
EV/Sales	4.2	3.8	3.3	2.9	2.7
EV/EBITDA	17.8	15.7	15.7	13.3	11.8
Adjusted P/E	21.9	26.8	24.1	22.3	19.7
P/BV	4.9	4.3	4.0	3.4	3.0

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22P	FY23E	FY24E
Tax burden (Net profit/PBT)	104.8	74.2	77.1	75.0	75.0
Interest burden (PBT/EBIT)	108.1	108.0	114.7	104.9	105.5
EBIT margin (EBIT/Revenue)	16.3	17.4	15.5	16.7	17.5
Asset turnover (Rev./Avg TA)	25.7	26.4	26.4	26.8	25.5
Leverage (Avg TA/Avg Equity)	1.2	1.2	1.2	1.2	1.2
Adjusted ROAE	23.1	17.2	17.2	16.5	16.3

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22P	FY23E	FY24E
YoY growth (%)					
Revenue	13.5	8.7	13.0	12.6	7.8
EBITDA	30.7	10.5	(0.8)	17.3	11.3
Adjusted EPS	80.2	(18.3)	11.2	7.7	13.6
Profitability & Return ratios (%)					
EBITDA margin	23.4	23.8	20.9	21.8	22.5
EBIT margin	16.3	17.4	15.5	16.7	17.5
Adjusted profit margin	18.5	13.9	13.7	13.1	13.8
Adjusted ROAE	23.1	17.2	17.2	16.5	16.3
ROCE	18.7	20.3	19.2	19.2	19.3
Working capital days (days)					
Receivables	105	96	114	100	100
Inventory	73	87	87	87	75
Payables	35	42	44	35	35
Ratios (x)					
Gross asset turnover	0.9	0.9	0.9	1.0	1.0
Current ratio	2.0	2.2	2.1	2.5	2.8
Net interest coverage ratio	29.0	34.0	34.7	36.0	38.4
Adjusted debt/equity	0.0	0.1	0.0	0.0	0.0

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

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

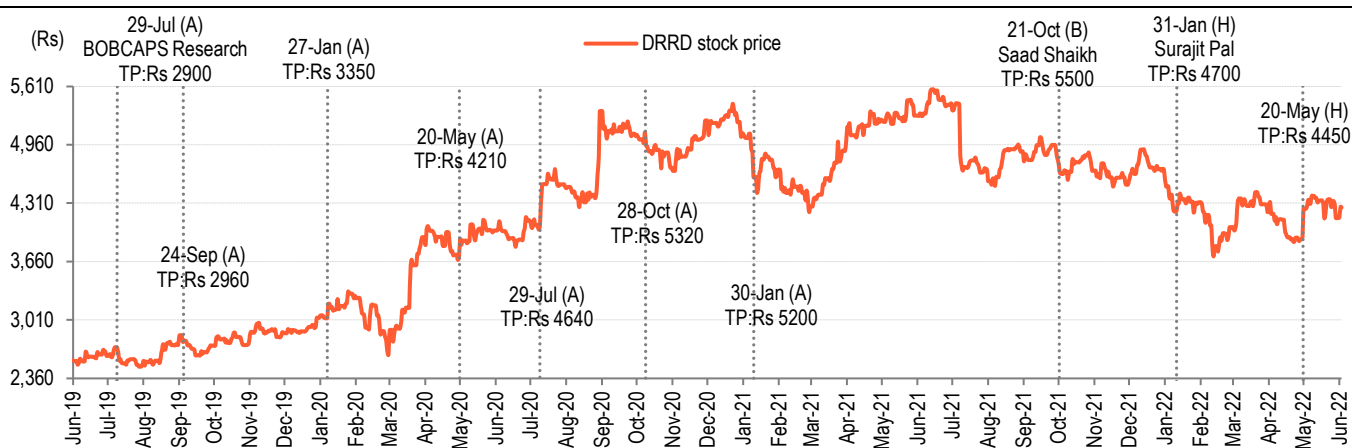
HOLD – Expected return from -6% to +15%

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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