

HOLD

TP: Rs 4,700 | ▲ 5%

DR REDDY'S LABS

| Pharmaceuticals

| 29 October 2022

US launch of gRevlimid buoys quarter

- Q2 revenue up 9% YoY on sales of gRevlimid in the US; gross margin expansion aids EBITDA growth of 42% YoY
- Gross margin up 565bps YoY to 59% backed by a better product mix and PLI benefits, but higher tax limits PAT growth to 12%
- We raise FY23-FY24 EBITDA by 5% each and revise our TP to Rs 4,700 (vs. Rs 4,450); retain HOLD on limited upside triggers

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US launch of gRevlimid drives topline: DRRD's Q2FY23 revenue grew 9% YoY (+21% QoQ) to Rs 63bn led solely by the US market which posted sales of US\$ 344mn (+35% QoQ) following the launch of gRevlimid. PSAI (pharmaceutical services and active ingredients) declined 23% YoY (-9% QoQ) due to lower volumes as the base quarter had Covid product sales, which was partly offset by new product sales and favourable forex rates.

India business muted: India business grew just 1% YoY on a high Covid-led base (adjusted growth in double digits) and declined sequentially by 14% on account of divestment of a few brands in Q1FY23. Others segment declined 63% YoY due to licensing fee in the base quarter.

Better product mix and PLI benefit lift margins: Gross margin at 59.1% soared 565bps YoY in Q2 led by a better product mix (aided by launches) and accrued benefits from the government's production-linked incentive scheme, which more than compensated for price erosion and Covid inventory provisions (~Rs 1bn). Global generics/PSAI margins stood at 65.4%/3.6%. Excluding Covid-related provisions, PSAI gross margin would be in the high single digits. EBITDA margin rose to 30% (+685bps YoY, +1,230bps QoQ), and management retained its FY23 margin guidance at 25%.

Higher tax curbs PAT growth: The effective tax rate for the quarter stood at 31.2% vs. 19.1%/22.2% in Q1FY23/Q2FY22, which limited PAT growth to 12% YoY at Rs 11bn (vs. PBT growth of 29% YoY). The higher tax outgo was on account of a change in jurisdiction mix. Management expects an FY23 tax rate of 25-26%.

Retain HOLD: We raise our FY23-FY24 EBITDA estimates by 5% each to bake in the H1FY23 results. Our TP stands revised to Rs 4,700 (vs. Rs 4,450) based on an unchanged 12.5x FY24E EV/EBITDA multiple – a 15% discount to the stock's 5Y average. With upsides from gRevlimid already in the price, a slowdown in meaningful launches in the US and subdued growth in other regions off a high base, we see limited upside triggers for the stock and hence maintain HOLD.

Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	DRRD IN/Rs 4,460
Market cap	US\$ 9.0bn
Free float	73%
3M ADV	US\$ 20.5mn
52wk high/low	Rs 4,931/Rs 3,654
Promoter/FPI/DII	27%/29%/16%

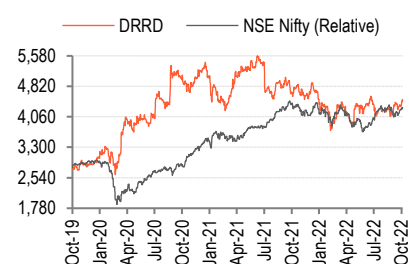
Source: NSE | Price as of 28 Oct 2022

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	2,14,392	2,40,459	2,60,578
EBITDA (Rs mn)	46,632	55,306	61,236
Adj. net profit (Rs mn)	31,130	35,262	38,462
Adj. EPS (Rs)	187.1	211.9	231.1
Consensus EPS (Rs)	187.1	200.0	238.0
Adj. ROAE (%)	18.2	18.0	16.6
Adj. P/E (x)	23.8	21.0	19.3
EV/EBITDA (x)	15.8	13.3	11.8
Adj. EPS growth (%)	17.8	13.3	9.1

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	H1FY23	H1FY22	YoY (%)
Net Sales	63,057	57,632	9.4	52,154	20.9	1,15,211	1,06,826	7.8
EBITDA	18,943	13,357	41.8	9,238	105.1	28,181	22,382	25.9
Depreciation	3,125	2,985	-	3,050	-	6,175	5,890	-
EBIT	15,818	10,372	52.5	6,188	155.6	22,006	16,492	33.4
Interest	156	(319)	-	(2,349)	-	(2,193)	(971)	-
Other Income	334	1,743	-	386	-	720	2,230	-
PBT	15,996	12,434	28.6	8,923	79.3	24,919	19,693	26.5
Less: Taxation	4,983	2,761	-	2,779	-	7,762	4,478	-
Less: Minority Interest	(140)	(247)	-	(94)	-	(234)	(413)	-
Recurring PAT	11,153	9,920	12.4	6,238	78.8	17,391	15,628	11.3
Exceptional items	(25)	0	-	5,638	-	5,613	0	-
Reported PAT	11,128	9,920	12.2	11,876	(6.3)	23,004	15,628	47.2
Key Ratios (%)			(bps)		(bps)			(bps)
Gross Margin	59.1	53.4	565	49.9	920	54.9	52.9	203
EBITDA Margin	30.0	23.2	686	17.7	1,233	24.5	21.0	351
Tax / PBT	31.2	22.2	-	31.1	-	31.1	22.7	-
NPM	17.7	17.2	-	12.0	-	15.1	14.6	-
Adj. EPS (Rs)	67.0	59.6	12.4	37.5	78.8	104.5	93.9	-

Source: Company, BOBCAPS Research

Fig 2 – Segmental performance

(Rs mn)	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	H1FY23	H1FY22	YoY (%)
Global Generics	55,946	47,431	18.0	44,323	26.2	1,00,269	88,544	13.2
North America	28,001	18,909	48.1	17,815	57.2	45,816	36,299	26.2
Europe	4,199	4,135	1.5	4,141	1.4	8,340	8,129	2.6
India	11,500	11,402	0.9	13,339	(13.8)	24,839	22,002	12.9
EM	12,246	12,985	(5.7)	9,028	35.6	21,274	22,114	(3.8)
PSAI	6,434	8,372	(23.1)	7,090	(9.3)	13,524	15,912	(15.0)
Others	677	1,829	(63.0)	740	(8.5)	1,417	2,370	(40.2)
Net Sales	63,057	57,632	9.4	52,153	20.9	1,15,210	1,06,826	7.8
USDINR	81	74	9.8	79	3.0	79	74	7.2
US revenue in US\$ (mn)	344	255	34.8	225	52.6	580	492	17.8

Source: Company, BOBCAPS Research

Earnings call highlights

- **North America:** DRRD's US business grew 48% YoY (+57% QoQ) to Rs 28bn in Q2FY23 spurred by the launch and scale up of new products (including gRevlimid) and favourable forex movement, which was partly offset by price erosion in some key molecules. DRRD expects gRevlimid to continue to contribute meaningfully in coming quarters. Overall, the company launched seven new molecules during the quarter – Lenalidomide, Fesoterodine Fumarate, Bortezomib, Neostigmine, Potassium Chloride, Fexofenadine HCl + Pseudoephedrine HCl ER tablets, and Oxaliplatin injectable in Canada. ANDA filings are guided to pick up in H2, in line with filing trends seen each year.
- **India:** Adjusted for a high Covid-driven quarter last year, India business grew in double digits. The sequential decline of 14% was on account of brand divestments in Q1FY23.
- **Emerging markets:** Softer base business volumes, higher Covid-led sales in Q2FY22 and volatile currencies caused emerging market business to fall 6% YoY despite launches in Russia/RoW. **(1) Russia:** Revenue from Russia grew 4% YoY on account of product launches, increased prices and a favourable forex rate, partly offset by reduction in base business volumes. **(2) CIS countries and Romania:** Sales to these markets declined 1% YoY due to a reduction in base volumes and adverse forex movement, partly countered by an increase in sale prices and launches.
(3) Rest of World (ROW): ROW revenue declined 18% YoY despite product launches due to a reduction in Covid product sales and lower pricing.
- **Europe:** DRRD's Europe business grew 2% YoY on account of volume traction in the base business. This along with new launches helped offset price erosion and an adverse forex impact. Overall, the company launched 10 new products in the EU in Q2.
- **PSAI:** DRRD's PSAI sales declined 23% YoY primarily on account of a higher base in Q2FY22 which had Covid product sales.

Valuation methodology

We raise our FY23-FY24 EBITDA estimates by 5% each to bake in the H1FY23 results and expect EBITDA margin in the vicinity of 23% for these years. Our TP stands revised to Rs 4,700 (vs. Rs 4,450) based on an unchanged 12.5x FY24E EV/EBITDA multiple – a 15% discount to the stock's five-year average. With upsides from gRevlimid already in the price, a slowdown in meaningful launches in the US, subdued growth in other regions off a high base and currency volatility, we see limited upside triggers for the stock and hence maintain our HOLD rating.

Fig 3 – Revised estimates

(Rs bn)	New		Old		Change (%)	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Revenue	240.5	260.6	241.4	260.4	(0.4)	0.1
EBITDA	55.3	61.2	52.6	58.6	5.1	4.5
EBITDA Margin (%)	23.0	23.5	21.8	22.5	120bps	100bps
EPS (Rs.)	211.9	231.1	190.7	216.7	11.1	6.7

Source: BOBCAPS Research

Fig 4 – Key assumptions

Parameter (Rs bn)	FY22A	FY23E	FY24E
North America	74.9	96.2	100.3
Europe	16.6	17.6	18.7
India	42.0	46.6	52.6
EM (Russia, CIS & Romania, ROW)	45.7	47.7	54.2
PSAI	30.7	29.2	31.2
Others	4.5	3.1	3.5

Source: Company, BOBCAPS Research

Fig 5 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	Revenue CAGR FY21-23E (%)	EV/EBITDA (x)		ROCE (%)		Target P/E (x)
					FY22E	FY23E	FY22E	FY23E	
Dr. Reddy's Labs	DRRD IN	HOLD	4,700	14.6	13.2	11.9	19.7	18.6	12.5
Cipla	CIPLA IN	BUY	1,100	9.6	18.6	16.5	16.0	17.0	16.0
Lupin	LPC IN	SELL	600	15.9	13.8	10.5	9.3	13.0	10.0
Sun Pharma	SUNP IN	BUY	1,100	13.6	18.7	16.7	17.8	18.0	18.5

Source: BOBCAPS Research

Key risks

Key risks to our estimates are:

- **Upside risks:** Speedy resolution of regulatory issues in key manufacturing units
- **Downside risks:** Irregular flow of USFDA product approvals, which may lead to a bunching up of key launches for limited-competition products, and adverse USFDA observations on manufacturing plants

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	2.0	1,311	1,500	BUY
Alembic Pharma	ALPM IN	1.3	550	770	HOLD
Alkem Labs	ALKEM IN	4.5	3,113	3,220	HOLD
Aurobindo Pharma	ARBP IN	3.7	522	695	BUY
Divi's Labs	DIVI IN	11.4	3,548	4,250	HOLD
Dr Reddy's Labs	DRRD IN	9.0	4,460	4,700	HOLD
Eris Lifesciences	ERIS IN	1.2	726	970	BUY
Glenmark Life Sciences	GLS IN	0.6	419	535	BUY
Laurus Labs	LAURUS IN	2.9	445	540	HOLD
Lupin	LPC IN	3.8	696	600	SELL
Sun Pharma	SUNP IN	28.8	990	1,100	BUY

Source: BOBCAPS Research, NSE | Price as of 28 Oct 2022

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Total revenue	1,74,602	1,89,722	2,14,392	2,40,459	2,60,578
EBITDA	40,943	45,247	46,632	55,306	61,236
Depreciation	12,471	12,288	11,652	12,424	13,140
EBIT	28,472	32,959	34,980	42,882	48,096
Net interest inc./(exp.)	(983)	(970)	(958)	(1,185)	(1,185)
Other inc./(exp.)	3,294	3,605	5,838	5,955	4,372
Exceptional items	0	0	0	0	0
EBT	30,783	35,594	39,860	47,651	51,283
Income taxes	(1,466)	9,175	8,730	12,389	12,821
Extraordinary items	(12,739)	(6,903)	(7,562)	5,613	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	19,510	19,516	23,568	40,875	38,462
Adjustments	(12,739)	(6,903)	(7,562)	5,613	0
Adjusted net profit	32,249	26,419	31,130	35,262	38,462

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Accounts payables	16,659	21,916	25,572	23,058	24,987
Other current liabilities	32,188	34,129	42,335	40,878	44,298
Provisions	3,854	3,493	4,315	4,840	5,245
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	2,13,689	2,47,991
Shareholders' fund	1,43,005	1,64,664	1,77,806	2,14,521	2,48,823
Total liab. and equities	2,17,717	2,54,501	2,83,873	3,17,142	3,57,198
Cash and cash eq.	2,053	14,829	14,852	31,168	69,752
Accounts receivables	50,278	49,759	66,818	65,879	71,391
Inventories	35,066	45,412	50,884	57,315	53,543
Other current assets	19,557	19,457	19,987	24,046	26,058
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	3,17,142	3,57,198

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Cash flow from operations	25,283	29,884	25,801	41,486	54,789
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)	(1,185)	(1,185)
Dividends paid	(4,155)	(4,160)	(4,160)	(4,160)	(4,160)
Other financing cash flows	8,873	(9,328)	276	(2,576)	1,140
Cash flow from financing	(12,634)	(6,169)	(1,296)	(7,920)	(4,205)
Chg in cash & cash eq.	(175)	12,776	23	16,316	38,584
Closing cash & cash eq.	2,053	14,829	14,852	31,168	69,752

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22A	FY23E	FY24E
Reported EPS	117.5	117.6	142.0	246.2	231.7
Adjusted EPS	194.0	158.8	187.1	211.9	231.1
Dividend per share	25.0	25.0	25.0	25.0	25.0
Book value per share	861.5	992.0	1,071.1	1,292.3	1,498.9

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22A	FY23E	FY24E
EV/Sales	4.4	3.9	3.4	3.0	2.8
EV/EBITDA	18.6	16.5	15.8	13.3	11.8
Adjusted P/E	23.0	28.1	23.8	21.0	19.3
P/BV	5.2	4.5	4.2	3.5	3.0

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22A	FY23E	FY24E
Tax burden (Net profit/PBT)	104.8	74.2	78.1	74.0	75.0
Interest burden (PBT/EBIT)	108.1	108.0	114.0	111.1	106.6
EBIT margin (EBIT/Revenue)	16.3	17.4	16.3	17.8	18.5
Asset turnover (Rev./Avg TA)	25.7	26.4	26.4	26.1	24.5
Leverage (Avg TA/Avg Equity)	1.2	1.2	1.2	1.2	1.1
Adjusted ROAE	23.1	17.2	18.2	18.0	16.6

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22A	FY23E	FY24E
YoY growth (%)					
Revenue	13.5	8.7	13.0	12.2	8.4
EBITDA	30.7	10.5	3.1	18.6	10.7
Adjusted EPS	80.0	(18.2)	17.8	13.3	9.1
Profitability & Return ratios (%)					
EBITDA margin	23.4	23.8	21.8	23.0	23.5
EBIT margin	16.3	17.4	16.3	17.8	18.5
Adjusted profit margin	18.5	13.9	14.5	14.7	14.8
Adjusted ROAE	23.1	17.2	18.2	18.0	16.6
ROCE	18.7	20.3	20.1	21.2	19.8
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	2.6	3.0
Net interest coverage ratio	29.0	34.0	36.5	36.2	40.6
Adjusted debt/equity	0.0	0.1	0.0	0.0	0.0

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

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BUY – Expected return >+15%

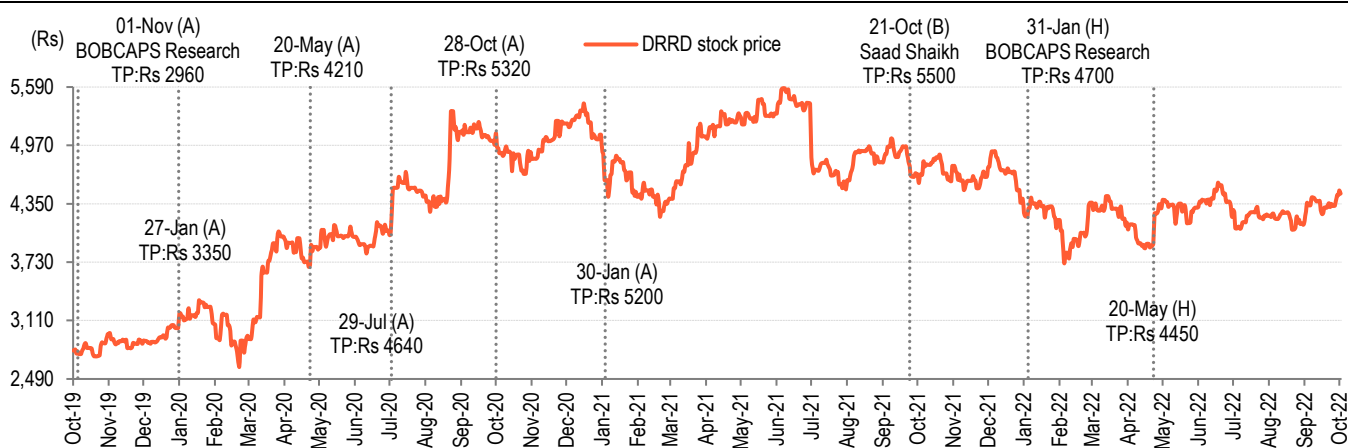
HOLD – Expected return from -6% to +15%

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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