

HOLD

TP: Rs 4,700 | ▲ 11%

DR REDDY'S LABS

| Pharmaceuticals

| 31 January 2022

Stable quarter, US price erosion continues; cut to HOLD

- Growth in Q3 driven by product launches and higher volumes, partly offset by US price erosion
- Prudent cost management and better product-mix helped to limit reduction in EBITDA margin by 60bps to 22.6% despite headwinds
- We pare FY23/FY24 EBITDA by 4-10% and roll forward to a new TP of Rs 4,700 (vs. Rs 5,500). Downgrade from BUY to HOLD

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US price erosion continues: DRRD reported revenue/adj. PAT growth of 8%/15% YoY in Q3FY22, 3%/5% below consensus estimates. US revenue dipped 2% QoQ (in CC) to US\$ 248mn due to double-digit price erosion, partially offset by Rx share gains in key drugs such as gVascepa, gCiprodex and gSuboxone as well as four launches. gVascepa garnered 11-12% Rx prescription share for DRRD while gRevlimid in Canada is yet to reach its full potential. Management guided further headroom in growth for both the limited competition generics. The company submitted additional data to the USFDA on gCopaxone and is awaiting a response. We expect no US launch of gCopaxone and gNuvaring in H1FY23 launch date.

Lower Covid contribution slows India growth: Domestic sales declined by 10% QoQ as DRRD's Covid-19 portfolio underperformed the market, growing at a modest 7% YoY. Core portfolio volumes declined as well but derived some benefits from price increases and new brand launches.

Modest EM performance but outlook muted: Revenue grew 5% YoY in Russia on the back of price hikes for existing products, new product launches and a favorable forex rate. Revenue traction also revived in RoW markets (+20% YoY) due to launches and higher base business volumes. Management expects geopolitical turmoil between Russia and Ukraine (two largest markets in CIS) may have a negative impact on DRRD's business from Q4FY22E.

Downgrade to HOLD; TP cut to Rs 4,700: Given modest India growth, a slowing Covid portfolio with a vanishing Sputnik opportunity, potential risk in the CIS-Russia region as well as regulatory uncertainty, we cut our EV/EBITDA multiple to 12.5x (21x implied P/E) from 14x. We also reduce our FY23E/FY24E EBITDA estimates by 4-10%. On rolling valuations over to FY24E, we have a revised TP of Rs 4,700 (from Rs 5,500) and downgrade the stock from BUY to HOLD.

Key changes

Target	Rating
▼	▼

Ticker/Price	DRRD IN/Rs 4,219
Market cap	US\$ 9.3bn
Free float	73%
3M ADV	US\$ 25.4mn
52wk high/low	Rs 5,615/Rs 4,135
Promoter/FPI/DII	27%/29%/16%

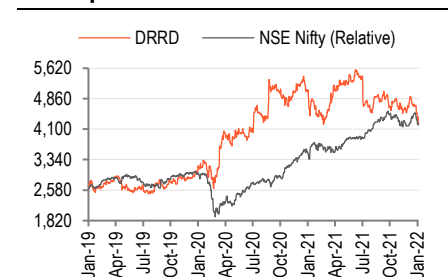
Source: NSE | Price as of 28 Jan 2022

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	1,89,722	2,14,352	2,49,847
EBITDA (Rs mn)	46,052	48,860	58,781
Adj. net profit (Rs mn)	26,716	28,712	35,161
Adj. EPS (Rs)	160.9	173.0	211.8
Consensus EPS (Rs)	160.9	175.2	217.4
Adj. ROAE (%)	17.4	16.2	17.2
Adj. P/E (x)	26.2	24.4	19.9
EV/EBITDA (x)	15.3	14.3	11.8
Adj. EPS growth (%)	(17.4)	7.5	22.5

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	9MFY22	9MFY21	YoY (%)
Net Sales	53,197	49,296	7.9	57,632	(7.7)	1,60,023	1,42,438	12.3
EBITDA	12,018	11,260	6.7	13,357	(10.0)	34,400	34,604	(0.6)
Depreciation	2,976	3,217	-	2,985	-	8,866	9,629	-
EBIT	9,042	8,043	12.4	10,372	(12.8)	25,534	24,975	2.2
Interest	(289)	(493)	-	(319)	-	(1,260)	(1,336)	-
Other Income	240	128	-	1,743	-	2,470	395	-
PBT	9,571	8,664	10.5	12,434	(23.0)	29,264	26,706	9.6
Less: Taxation	2,644	2,645	-	2,761	-	7,122	6,639	-
Less: Minority Interest	(185)	(151)	-	(247)	-	(598)	(301)	-
Recurring PAT	7,112	6,170	15.3	9,920	(28.3)	22,740	20,368	11.6
Exceptional items	(47)	(5,972)	-	0	-	(47)	(6,753)	-
Reported PAT	7,065	198	3,468	9,920	(28.8)	22,693	13,615	67
Key Ratios (%)			(bps)		(bps)			(bps)
Gross Margin	53.8	53.8	(5)	53.4	37	53.2	54.6	(137)
EBITDA Margin	22.6	22.8	(25)	23.2	(58)	21.5	24.3	(280)
Tax / PBT	27.6	30.5	-	22.2	-	24.3	24.9	-
NPM	13.4	12.5	-	17.2	-	14.2	14.3	-
EPS (Rs)	42.7	37.1	15.3	59.6	(28.3)	136.7	122.4	11.6

Source: Company, BOBCAPS Research

Fig 2 – Revenue mix

(Rs mn)	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	9MFY22	9MFY21	YoY (%)
Global Generics	44,508	40,751	9.2	47,431	(6.2)	1,33,052	1,15,667	15.0
North America	18,645	17,394	7.2	18,909	(1.4)	54,944	53,004	3.7
Europe	4,058	4,143	(2.1)	4,135	(1.9)	12,187	11,448	6.5
India	10,266	9,591	7.0	11,402	(10.0)	32,268	24,974	29.2
ROW	11,539	9,623	19.9	12,985	(11.1)	33,653	26,241	28.2
PSAI	7,271	7,009	3.7	8,372	(13.2)	23,183	24,067	(3.7)
Proprietary Products	1,418	1,536	(7.7)	1,829	(22.5)	3,788	2,704	40.1
Net Sales	53,197	49,296	7.9	57,632	(7.7)	1,60,023	1,42,438	12.3
USDINR	75	74	2.0	74	1.2	74	74	0.4
US revenue (US\$ mn)	249	237	5.1	255	(2.5)	740	716	3.3

Source: Company, BOBCAPS Research

Earnings call highlights

- **India formulations business affected by lower Covid portfolio sales:** DRRD's Covid-19 portfolio grew just 7% YoY in Q3FY22, lower than the Indian pharma market, contributing to a 10% QoQ decline in its India revenue. The core portfolio saw price hikes and new brand launches, albeit partly offset by lower volume growth.

The company saw no meaningful benefits from the sale of Sputnik vaccines during the third Covid wave. It currently has five major Covid-19 products: Sputnik vaccine, Remdesivir, Favipiravir (Avigan), 2-DG (2-deoxy-D-Glucose) and Molnupiravir. Management has not guided for any robust pickup in Sputnik while its single-dose vaccine is currently undergoing limited-period trials in India.

- **US generics witness double-digit price erosion:** US sales for Q3 declined 2% (in CC) QoQ to US\$ 249mn due to double-digit price erosion in US generics. Management has guided that (a) the erosion is product-specific, (b) it has no plans to launch gNuvaring in the near term, (c) gCopaxone approval is pending with the USFDA though DRRD has replied with the required data, and (d) partner Fresenius Kabi will launch biosimilar Pegfilgrastim in CY22.
- **Russia and CIS business:** While management has not given any specific guidance, it does anticipate some impact on Russia and CIS sales in Q4 and FY23 due to the political tensions with Ukraine.
- **Regulatory issues:** Management has replied to the USFDA observations on its Duvaada plant and is awaiting a response. The company has filed a few complex drugs in the US in 9MFY22, including 1-2 ANDAs from the Duvaada plant.
- **ETR:** The tax rate in 3QFY22 was 27.2%. Normalised ETR guided to be 25-26%.
- **R&D:** R&D spend for the quarter stood at 7.8% of sales.

Valuation methodology

Given modest India growth, a slowing Covid portfolio with a vanishing Sputnik opportunity, potential risk in the CIS-Russia region as well as regulatory uncertainty, we cut our EV/EBITDA multiple to 12.5x (21x implied P/E) from 14x. We also reduce our FY23/FY24 EBITDA estimates by 4-10%. On rolling valuations over to FY24, we have a revised TP of Rs 4,700 (from Rs 5,500) and downgrade the stock from BUY to HOLD.

Fig 3 – Revised estimates

(Rs bn)	New			Old			Change (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Sales	214.4	249.8	264.8	215.5	251.4	266.9	(0.5)	(0.6)	(0.8)
EBITDA	48.9	58.8	62.3	49.6	61.1	69.3	(1.5)	(3.8)	(10.0)
EBITDA margin (%)	22.8	23.5	23.5	23.0	24.3	26.0	(22bps)	(78bps)	(242bps)
EPS (Rs)	173.0	211.8	221.4	168.9	218.1	255.5	2.4	(2.9)	(13.4)

Source: BOBCAPS Research

Fig 4 – Key assumptions

(Rs bn)	FY21	FY22E	FY23E	FY24E
North America	70.5	76.6	97.8	97.6
Europe	15.4	16.3	17.3	18.3
India	33.4	40.1	44.1	48.5
EM (Russia, CIS, Romania, ROW)	35.1	41.5	47.1	53.5
PSAI	32.0	34.9	38.0	40.7
PP and Others	3.3	5.0	5.5	6.1

Source: Company, BOBCAPS Research

Fig 5 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	Revenue CAGR FY21-24E (%)	EPS (Rs)		ROE (%)		Target P/E (x)
					FY23E	FY24E	FY23E	FY24E	
Cipla	CIPLA IN	BUY	1,160	11.0	13.2	11.7	13.6	14.5	16.0
Dr. Reddy's	DRRD IN	HOLD	4,700	10.6	12.6	11.9	17.2	15.5	12.5
Lupin	LPC IN	HOLD	1,045	19.0	11.4	9.6	12.9	15.1	11.6
Sun Pharma	SUNP IN	BUY	955	13.5	15.7	14.1	15.4	15.4	18.4
Aggregate		-	-	-	13.2	11.8	14.7	15.1	-

Source: BOBCAPS Research

Key risks

Key upside 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;
- favourable forex in EM currencies;
- faster resolution of political turmoil in Russia/CIS region; 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	2.5	2,178	2,800	BUY
Alembic Pharma	ALPM IN	2.0	746	980	BUY
Alkem Labs	ALKEM IN	5.4	3,417	4,250	HOLD
Aurobindo Pharma	ARBP IN	4.9	624	886	BUY
Cipla	CIPLA IN	10.0	932	1,160	BUY
Divi's Labs	DIVI IN	13.9	3,941	5,540	HOLD
Dr Reddy's Labs	DRRD IN	9.3	4,219	4,700	HOLD
Eris Lifesciences	ERIS IN	1.3	696	890	BUY
Laurus Labs	LAURUS IN	3.6	500	570	HOLD
Lupin	LPC IN	5.4	900	1,045	HOLD
Sun Pharma	SUNP IN	26.4	827	955	BUY

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

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Total revenue	1,74,601	1,89,722	2,14,352	2,49,847	2,64,760
EBITDA	40,942	46,052	48,860	58,781	62,310
Depreciation	12,471	12,796	12,029	12,744	14,653
EBIT	28,471	33,256	36,831	46,037	47,657
Net interest inc./(exp.)	(983)	(970)	(1,818)	(1,909)	(1,969)
Other inc./(exp.)	3,294	3,605	2,766	2,754	3,313
Exceptional items	0	0	0	0	0
EBT	30,782	35,891	37,779	46,882	49,001
Income taxes	(1,466)	9,175	9,067	11,720	12,250
Extraordinary items	(12,739)	(6,903)	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	19,509	19,813	28,712	35,161	36,751
Adjustments	(12,739)	(6,903)	0	0	0
Adjusted net profit	32,248	26,716	28,712	35,161	36,751

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	16,659	21,916	20,554	23,958	25,388
Other current liabilities	32,188	32,740	38,583	42,474	45,009
Provisions	3,854	3,493	3,946	4,600	4,875
Debt funds	22,011	30,299	30,299	30,299	30,299
Other liabilities	0	0	0	0	0
Equity capital	831	832	832	832	832
Reserves & surplus	1,42,174	1,63,832	1,88,384	2,19,385	2,51,976
Shareholders' fund	1,43,005	1,64,664	1,89,216	2,20,217	2,52,808
Total liab. and equities	2,17,717	2,53,112	2,82,599	3,21,548	3,58,378
Cash and cash eq.	2,053	14,829	18,410	25,145	71,404
Accounts receivables	50,278	49,759	58,726	68,451	72,537
Inventories	35,066	45,412	51,092	59,553	54,403
Other current assets	19,557	18,068	25,722	37,477	34,419
Investments	26,778	27,717	29,380	31,143	31,143
Net fixed assets	52,332	57,111	58,082	58,337	55,684
CWIP	0	0	0	0	0
Intangible assets	31,653	40,216	41,187	41,442	38,789
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	2,17,717	2,53,112	2,82,599	3,21,548	3,58,378

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash flow from operations	25,282	30,689	25,192	27,822	61,735
Capital expenditures	(11,917)	(10,000)	(13,000)	(13,000)	(12,000)
Change in investments	(907)	(939)	(1,663)	(1,763)	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(12,824)	(10,939)	(14,663)	(14,763)	(12,000)
Equities issued/Others	1	1	0	0	0
Debt raised/repaid	(16,370)	8,288	0	0	0
Interest expenses	(983)	(970)	(1,818)	(1,909)	(1,969)
Dividends paid	(4,155)	(4,160)	(4,160)	(4,160)	(4,160)
Other financing cash flows	8,874	(10,133)	(971)	(256)	2,653
Cash flow from financing	(12,633)	(6,974)	(6,948)	(6,324)	(3,476)
Chg in cash & cash eq.	(175)	12,776	3,581	6,735	46,259
Closing cash & cash eq.	2,053	14,829	18,410	25,145	71,404

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	117.5	119.4	173.0	211.8	221.4
Adjusted EPS	194.3	160.9	173.0	211.8	221.4
Dividend per share	25.0	25.0	25.0	25.0	25.0
Book value per share	861.5	992.0	1,139.9	1,326.6	1,522.9

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	4.1	3.7	3.2	2.8	2.6
EV/EBITDA	17.6	15.3	14.3	11.8	11.0
Adjusted P/E	21.7	26.2	24.4	19.9	19.1
P/BV	4.9	4.3	3.7	3.2	2.8

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	104.8	74.4	76.0	75.0	75.0
Interest burden (PBT/EBIT)	108.1	107.9	102.6	101.8	102.8
EBIT margin (EBIT/Revenue)	16.3	17.5	17.2	18.4	18.0
Asset turnover (Rev./Avg TA)	25.7	26.4	25.9	26.6	24.8
Leverage (Avg TA/Avg Equity)	1.2	1.2	1.2	1.1	1.1
Adjusted ROAE	23.1	17.4	16.2	17.2	15.5

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	13.5	8.7	13.0	16.6	6.0
EBITDA	30.7	12.5	6.1	20.3	6.0
Adjusted EPS	80.2	(17.4)	7.5	22.5	4.5
Profitability & Return ratios (%)					
EBITDA margin	23.4	24.3	22.8	23.5	23.5
EBIT margin	16.3	17.5	17.2	18.4	18.0
Adjusted profit margin	18.5	14.1	13.4	14.1	13.9
Adjusted ROAE	23.1	17.4	16.2	17.2	15.5
ROCE	18.7	20.5	19.1	20.8	19.1
Working capital days (days)					
Receivables	105	96	100	100	100
Inventory	73	87	87	87	75
Payables	35	42	35	35	35
Ratios (x)					
Gross asset turnover	0.9	0.9	1.0	1.0	1.1
Current ratio	2.0	2.2	2.4	2.7	3.1
Net interest coverage ratio	29.0	34.3	20.3	24.1	24.2
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%

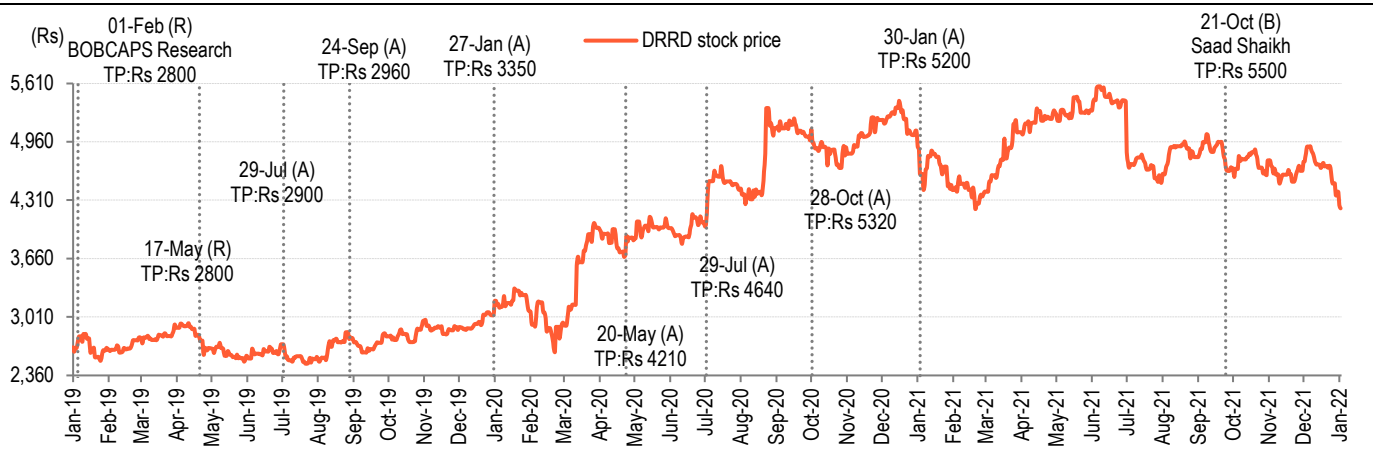
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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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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