

**HOLD**

TP: Rs 4,450 | ▲ 5%

**DR REDDY'S LABS**

| Pharmaceuticals

| 20 May 2022

## Operating performance in line; impairment weighs down profit

- India, Russia, US and one-off opportunities drove 15% YoY sales growth in Q4; non-core brands divested in Russia and India
- Price erosion in core US/Europe portfolio offset by new launches; prudent cost management remains vital to sustain margins
- We cut FY23-FY24 EBITDA estimates by 5-9%, leading to a lower TP of Rs 4,450 (vs. Rs 4,700); maintain HOLD

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**One-off opportunities helped maintain growth in EMs:** DRRD delivered a 6% topline beat over consensus in Q4FY22, posting 15% YoY consolidated revenue growth to Rs 54.4bn. QoQ growth was flattish due to a decline in India formulations (-6%) and proprietary products (-51%). Russia sales grew 47% QoQ following the divestment of non-core brands for Rs 1.8bn. Ex-divestments in India & Russia, sales growth stood at Rs 52.2bn, up 10% YoY. Reported PAT declined 76% YoY due to impairment of ~7.5bn in Q4 while OPM remained stable with 100bps decline.

**New launches offset higher price erosion:** The US business grew 6% QoQ CC to US\$ 264mn backed by new product launches and volume traction in some products, which countered higher price erosion. Per the management, price erosion in the US is in double digits (high-teens) as compared to normal single-digit levels. DRRD launched 17 new products in NA in FY22 and expects to launch a 20-25 in FY23.

**Traction in volume growth and new products aid Europe and EM sales:** Europe growth of 12% YoY and 10% QoQ was due to new products, partly set off by price erosion. EMs grew 36% YoY with volume traction from launches in Russia and CIS regions despite the war.

**gRevlimid revenues could disappoint:** We find consensus expectations of the gRevlimid opportunity overstated and expect revenue of US\$ 100mn in FY23 and US\$ 170mn in FY24 vs. US\$ 200m p.a. for consensus. Note that execution has fallen short of market expectations on several fronts in the recent past – viz. gVascepa, Sputnik vaccine, gSuboxone, gNuvaring and gCopaxone.

**TP revised to Rs 4,450, retain HOLD:** We cut our FY23-FY24 EBITDA estimates by 5-9% considering lower visibility on non-gRevlimid products in the US, uncertainties in Eastern EU, Russia and CIS due to the ongoing war, and delayed approvals. While our target FY24E EV/EBITDA multiple remains at 12.5x (unchanged), revised EBITDA estimates translate to a reduced TP of Rs 4,450 (from Rs 4,700). Current valuations offer 5% upside and hence we retain HOLD.

## Key changes

Target	Rating
▼	◀ ▶

Ticker/Price	DRRD IN/Rs 4,249
Market cap	US\$ 9.1bn
Free float	73%
3M ADV	US\$ 31.1mn
52wk high/low	Rs 5,615/Rs 3,654
Promoter/FPI/DII	27%/29%/16%

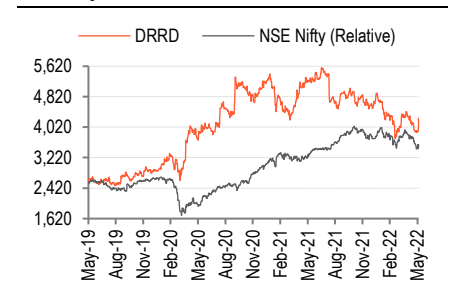
Source: NSE | Price as of 20 May 2022

## 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)	24.0	22.3	19.6
EV/EBITDA (x)	15.6	13.3	11.8
Adj. EPS growth (%)	11.2	7.7	13.6

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

## Stock performance



Source: NSE



**Fig 1 – Quarterly performance**

(Rs mn)	Q4FY22	Q4FY21	YoY (%)	Q3FY22	QoQ (%)	FY22	FY21	YoY (%)
<b>Net Sales</b>	<b>54,368</b>	<b>47,284</b>	<b>15.0</b>	<b>53,197</b>	<b>2.2</b>	<b>2,14,391</b>	<b>1,89,722</b>	<b>13.0</b>
<b>EBITDA</b>	<b>11,702</b>	<b>10,080</b>	<b>16.1</b>	<b>12,018</b>	<b>(2.6)</b>	<b>46,102</b>	<b>44,684</b>	<b>3.2</b>
Depreciation	2,959	3,169	-	2,976	-	11,825	12,798	-
EBIT	8,743	6,911	26.5	9,042	(3.3)	34,277	31,886	7.5
Interest	(859)	(318)	-	(289)	-	(2,119)	(1,654)	-
Other Income	291	587	-	240	-	2,761	982	-
<b>PBT</b>	<b>9,893</b>	<b>7,816</b>	<b>26.6</b>	<b>9,571</b>	<b>3.4</b>	<b>39,157</b>	<b>34,522</b>	<b>13.4</b>
Less: Taxation	1,608	2,536	-	2,644	-	8,730	9,175	-
Less: Minority Interest	(105)	(179)	-	(185)	-	(703)	(480)	-
<b>Recurring PAT</b>	<b>8,390</b>	<b>5,459</b>	<b>53.7</b>	<b>7,112</b>	<b>18.0</b>	<b>31,130</b>	<b>25,827</b>	<b>20.5</b>
Exceptional items	(7,515)	(1,835)	-	(47)	-	(7,562)	(8,588)	-
<b>Reported PAT</b>	<b>875</b>	<b>3,624</b>	<b>(76)</b>	<b>7,065</b>	<b>(87.6)</b>	<b>23,568</b>	<b>17,239</b>	<b>36.7</b>
<b>Key Ratios (%)</b>			<b>(bps)</b>		<b>(bps)</b>			<b>(bps)</b>
Gross Margin	52.9	53.7	(80)	53.8	(92)	53.1	54.3	(123)
EBITDA Margin	21.5	21.3	21	22.6	(107)	21.5	23.6	(205)
Tax / PBT	16.3	32.4	-	27.6	-	22.3	26.6	-
NPM	15.4	11.5	-	13.4	-	14.5	13.6	-
Adj. EPS (Rs)	50.4	32.8	53.7	42.7	18.0	187.1	155.2	-

Source: Company, BOBCAPS Research

**Fig 2 – Segmental mix**

(Rs mn)	Q4FY22	Q4FY21	YoY (%)	Q3FY22	QoQ (%)	FY22	FY21	YoY (%)
Global generics	46,117	38,737	19.1	44,508	3.6	1,79,169	1,54,404	16.0
North America	19,971	17,491	14.2	18,645	7.1	74,915	70,495	6.3
Europe	4,444	3,956	12.3	4,058	9.5	16,631	15,404	8.0
India	9,689	8,445	14.7	10,266	(5.6)	41,957	33,419	25.5
ROW	12,013	8,845	35.8	11,539	4.1	45,666	35,086	30.2
PSAI	7,557	7,915	(4.5)	7,271	3.9	30,740	31,982	(3.9)
Proprietary Products	693	632	9.7	1,418	(51.1)	4,481	3,336	34.3
<b>Net Sales</b>	<b>54,367</b>	<b>47,284</b>	<b>15.0</b>	<b>53,197</b>	<b>2.2</b>	<b>2,14,390</b>	<b>1,89,722</b>	<b>13.0</b>
USDINR	76	73	4.0	75	1.1	75	74	1.2
US revenue (US\$ mn)	264	240	9.8	249	6.0	1,004	956	5.0

Source: Company, BOBCAPS Research

## Earnings call takeaways

- **India business:** India growth in Q4FY22 was primarily driven by volume traction, price increases in the non-DPCO portfolio, product launches and non-core brand divestment to Mankind Pharma.
- **Covid contribution:** The company's Covid portfolio revenue contribution was less than 4% in Q4. India and EMs, however, saw double-digit growth without Covid sales contribution.
- **US business:** DRRD reported 6% QoQ CC growth in North America revenue to US\$ 264mn. The company continues to see double-digit price erosion in its US generics business, partially offset by the sales from 17 products launched in FY22. It expects to launch a further 20-25 new products in FY23 in North America. In Q4FY22, DRRD launched 6 ANDAs – Vigabatrin tablets (CGT status granted), Febuxostat tablets, Capecitabine tablets, Fluphenazine Hydrochloride tablets, Lansoprazole OD tablets and Abiraterone Acetate in Canada.
- **Pending ANDAs:** The company has 95 ANDAs pending for approval by the USFDA (92 ANDAs and 3 NDAs). Of these, 47 are Para IVs which include 23 that have 'First to File' status.
- **China business:** DRRD filed 11 products and received 3 approvals in FY22. It expects to launch 7 products in China in FY23.
- **Divestment of non-core brands:** DRRD divested brands that contributed Rs 500mn-600mn annually in Russia.
- **Capex:** Capex is planned at Rs 15bn-17bn in FY23.
- **R&D:** R&D expense for FY23 is guided at 8% of sales.
- **ETR:** The effective tax rate stood at 16.3% in Q4FY22. Normalised ETR is guided at 24-26% for FY23.

## Valuation methodology

We find consensus expectations of the gRevlimid opportunity overstated and expect revenue of US\$ 100mn in FY23 and US\$ 170mn in FY24 vs. US\$ 200m p.a. for consensus. Note that execution has fallen short of market expectations on several fronts in the recent past – viz. gVascepa, Sputnik vaccine, gSuboxone, gNuvaring and gCopaxone.

We cut our FY23/FY24 EBITDA estimates by 9%/5% considering lower visibility on non-gRevlimid products in the US, uncertainties in Eastern EU, Russia and CIS due to the ongoing war, and delayed approvals. While our target FY24E EV/EBITDA remains at 12.5x (unchanged), our revised EBITDA estimates translate to a reduced TP of Rs 4,450 (from Rs 4,700). Current valuations offer 5% upside and hence we retain HOLD.

**Fig 3 – Revised estimates**

(Rs bn)	New		Old		Change (%)	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Revenue	241.4	260.4	246.4	261.2	(2.0)	(0.3)
EBITDA	52.6	58.6	58.1	61.5	(9.3)	(4.8)
EBITDA Margin (%)	21.8	22.5	23.6	23.6	(176bps)	(106bps)
EPS (Rs)	190.7	216.7	207.7	217.0	(8.2)	(0.2)

Source: BOBCAPS Research

**Fig 4 – Key assumptions**

Revenue (Rs bn)	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 FY21-24E (%)	EV/EBITDA (Rs)		ROE (%)		Target EV/EBITDA (x)
					FY23E	FY24E	FY23E	FY24E	
Dr. Reddy's	DRRD IN	BUY	4,450	9.0	12.2	11.0	16.5	16.3	12.5
Cipla	CIPLA IN	BUY	1,100	8.8	14.9	13.2	12.9	13.6	16.0
Lupin	LPC IN	HOLD	800	4.4	10.9	9.7	9.7	10.8	11.0
Sun Pharma	SUNP IN	BUY	1,100	16.9	15.8	14.2	16.9	16.8	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	1.9	1,735	2,050	BUY
Alembic Pharma	ALPM IN	1.9	754	770	HOLD
Alkem Labs	ALKEM IN	4.6	3,003	3,400	BUY
Aurobindo Pharma	ARBP IN	4.2	558	850	BUY
Cipla	CIPLA IN	10.2	978	1,100	BUY
Divi's Labs	DIVI IN	14.7	4,305	5,250	BUY
Dr Reddy's Labs	DRRD IN	9.1	4,249	4,450	HOLD
Eris Lifesciences	ERIS IN	1.3	716	970	BUY
Laurus Labs	LAURUS IN	4.0	575	645	HOLD
Lupin	LPC IN	3.7	638	800	HOLD
Sun Pharma	SUNP IN	28.3	916	1,100	BUY

Source: BOBCAPS Research, NSE | Price as of 20 May 2022

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
<b>Total revenue</b>	<b>1,74,601</b>	<b>1,89,722</b>	<b>2,14,391</b>	<b>2,41,446</b>	<b>2,60,353</b>
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
<b>Reported net profit</b>	<b>19,509</b>	<b>19,516</b>	<b>21,825</b>	<b>31,650</b>	<b>35,969</b>
Adjustments	(12,739)	(6,903)	(7,562)	0	0
<b>Adjusted net profit</b>	<b>32,248</b>	<b>26,419</b>	<b>29,387</b>	<b>31,650</b>	<b>35,969</b>

### 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
<b>Total liab. and equities</b>	<b>2,17,717</b>	<b>2,54,501</b>	<b>2,83,873</b>	<b>3,08,198</b>	<b>3,45,415</b>
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
<b>Total assets</b>	<b>2,17,717</b>	<b>2,54,501</b>	<b>2,83,873</b>	<b>3,08,198</b>	<b>3,45,415</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
<b>Cash flow from operations</b>	<b>25,282</b>	<b>29,884</b>	<b>24,058</b>	<b>31,871</b>	<b>52,683</b>
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
<b>Cash flow from investing</b>	<b>(12,824)</b>	<b>(10,939)</b>	<b>(24,482)</b>	<b>(17,250)</b>	<b>(12,000)</b>
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
<b>Cash flow from financing</b>	<b>(12,633)</b>	<b>(6,169)</b>	<b>447</b>	<b>(7,853)</b>	<b>(4,205)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>(175)</b>	<b>12,776</b>	<b>23</b>	<b>6,769</b>	<b>36,478</b>
<b>Closing cash &amp; cash eq.</b>	<b>2,053</b>	<b>14,829</b>	<b>14,852</b>	<b>21,621</b>	<b>58,099</b>

### 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	3.7	3.3	2.9	2.7
EV/EBITDA	17.8	15.7	15.6	13.3	11.8
Adjusted P/E	21.9	26.7	24.0	22.3	19.6
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
<b>Adjusted ROAE</b>	<b>23.1</b>	<b>17.2</b>	<b>17.2</b>	<b>16.5</b>	<b>16.3</b>

### Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22P	FY23E	FY24E
<b>YoY growth (%)</b>					
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
<b>Profitability &amp; Return ratios (%)</b>					
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
<b>Working capital days (days)</b>					
Receivables	105	96	114	100	100
Inventory	73	87	87	87	75
Payables	35	42	44	35	35
<b>Ratios (x)</b>					
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
<b>Adjusted debt/equity</b>	<b>0.0</b>	<b>0.1</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

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

## Disclaimer

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

**BUY** – Expected return >+15%

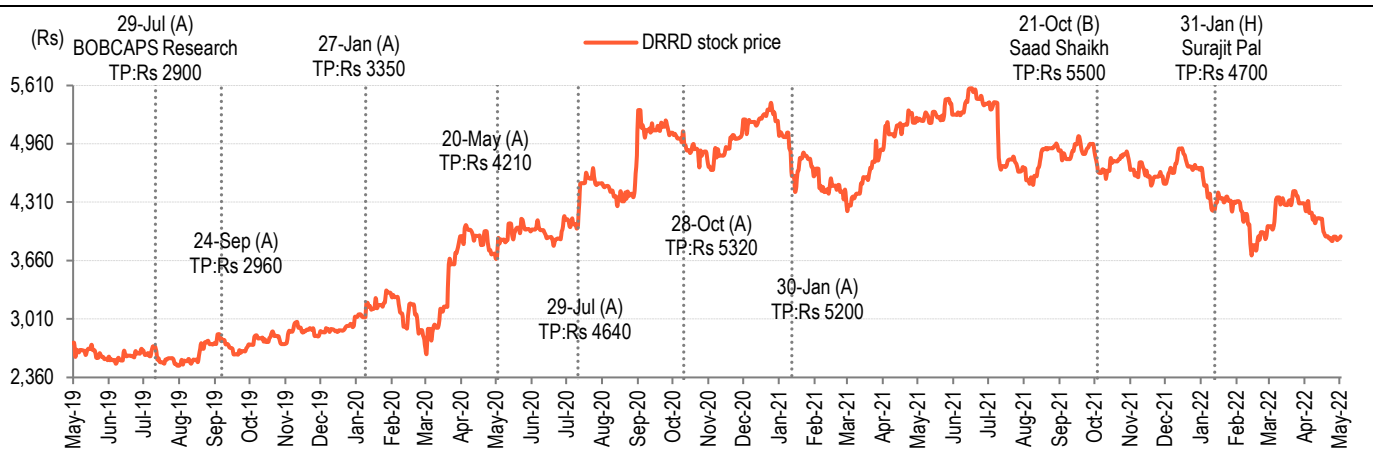
**HOLD** – Expected return from -6% to +15%

**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

### Rating distribution

As of 30 April 2022, out of 116 rated stocks in the BOB Capital Markets Limited (BOBCAPS) coverage universe, 66 have BUY ratings, 30 have HOLD ratings, 5 are rated ADD\*, 1 is rated REDUCE\* and 14 are rated SELL. One company rated ADD has been an investment banking client in the last 12 months. (\*Our ADD and REDUCE ratings are in the process of being migrated to the new recommendation structure.)

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