

# Dr Reddys

ADD

CMP Rs4,600

Target Rs5,370

Upside 16.5%

## US growth key to margin

**Our view:** With cost levers having played out over FY19-21 coupled with no significant rise in dollar R&D budget, reckon margin support would have to come from revenue boost; which is what we assume with estimated ~10% sales growth in FY22 and FY23 each (ex-Revlimid). Dr Reddys' has a diversified US portfolio compared to Lupin and also less risky growth pathway in comparison to Sun Pharma. Hence, DRRD is a better proposition when compared to such peers and is our preferred bet in large cap pharma. Q3 proved to be a disappointing quarter as US revenues came in much weaker than our expectation on top a large impairment write off in Nuvaring, Metformin and other acquired products. Accordingly, we cut FY21 estimates to factor in the write off and also moderate FY22 margin estimate to around 25%. Also roll over to FY23 EPS (ex-Revlimid) and retain target PE of 24x to arrive at revised TP Rs5,350 (from Rs5,270 earlier, including unchanged Rs300/share Revlimid NPV).

### Q3 call highlights

- ✓ In the neighborhood of aspirational 25% margin and in the next few quarters should be in the range
- ✓ Nuvaring, Metformin and other acquired products from Teva have been impaired
- ✓ North American sales driven by new products launches, increase in volumes in the base business and a favorable forex, which was partially offset by price erosion
- ✓ Received another CRL on Copaxone and preparing response
- ✓ Price erosion is there in both oral solids and injectables
- ✓ Increase in inventory is in line with planned increase for certain products
- ✓ Witnessed COVID related slowdown towards end of quarter
- ✓ India - base business grew 8% excluding Wockhardt in Q3 and in single digits for 9m
- ✓ Revenue in Russia and other countries still not reach pre-covid level; expects it to reach the pre-covid level in next few quarters.
- ✓ Ambitious digitization program lined up; investments behind brands and partly freight mix (more Air than sea) led to higher SG&A
- ✓ One off litigation cost which is included in the quarter and is non-recurring in nature
- ✓ Recognized milestone income received for the compound AUR102.
- ✓ Large part of SG&A is getting normalized to pre COVID level
- ✓ Sourcing of Sputnik vaccine has increased to 125mn doses and more countries
- ✓ ETR of 25% not including impairment charges

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## Exhibit 1: Financial summary

Y/e 31 Mar (Rs m)	FY19	FY20	FY21E	FY22E	FY23E
Revenues	154,482	175,170	191,019	208,476	228,566
yoy growth (%)	8.2	13.4	9.0	9.1	9.6
Operating profit	31,782	41,471	42,091	54,652	60,531
OPM (%)	20.6	23.7	22.0	26.2	26.5
Reported PAT	19,500	20,267	21,608	31,356	34,958
yoy growth (%)	106.0	3.9	6.6	45.1	11.5
EPS (Rs)	117.5	122.1	130.2	188.9	210.6
P/E (x)	39.2	37.7	35.3	24.4	21.8
P/BV (x)	5.4	4.9	4.4	3.8	3.3
EV/EBITDA (x)	24.0	17.7	17.1	12.9	11.3
Debt/Equity (x)	0.2	0.0	0.0	0.0	0.0
ROE (%)	14.3	24.6	12.8	16.5	16.0
ROCE (%)	14.4	22.5	17.5	20.9	20.3

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