

## Dr. Reddy's Labs

### Hits pause, pipeline execution is key

Dr. Reddy's Q3 EBITDA margin disappointed (22.3%, down 300bps QoQ, higher SG&A), after achieving ~25% levels in the past couple of quarters. Reported PAT was further impacted by impairment charge (Rs6bn, including gNuvaring). While there are multiple triggers that could play out over the next few years such as (a) complex launches of gVascepa, gCopaxone, gRevlimid, gNuvaring in the US (factored in estimates) and (b) Covid upsides (Sputnik V vaccine, Favipiravir trial in US), we reckon they come with high degree of uncertainty with respect to timelines and extent of upsides. With recovery in India, tailwinds in PSAI, strong pipeline in the US and cost optimisation efforts, the core business performance is expected to improve and drive 11% revenue and 19% earnings CAGR over FY21e-23e. We cut FY21-23e estimates by 8-10% to factor in the Q3 miss and delay in key launches. Our revised TP is Rs 5,300/sh. Maintain ADD.

- Muted performance in US, PSAI offset by strong growth in India, EU:** Revenue grew by 11% YoY (flat QoQ) as strong growth in India (+26% YoY, 8% YoY ex-Wockhardt), EU (+34% YoY, new launches, currency gains offset price erosion) and RoW markets (+21% YoY, volumes, new launches) offset muted performance in Russia (-8% YoY, weakening of ruble), PSAI (+1% YoY, -18% QoQ, lower volumes) and US (-5% QoQ, price erosion offset new launches gains).
- Margins disappoint:** EBITDA margin declined by ~300bps QoQ to 22.3% due to lower gross margins (down 57bps) and higher SG&A cost (+270bps QoQ, investment in brands, one-time litigation cost). Dr. Reddy's aims to achieve ~25% EBITDA margin over the next few quarters, driven by revenue growth and cost optimisation efforts. Adjusted PAT (impairment charge: Rs6bn, milestone income: Rs500mn) at Rs5.7bn was ~20% below our estimate.
- Key call highlights:** a) gVascepa – high value launch, gCopaxone – received another CRL, response few months away, gNuvaring – submitted response in Dec'20, the product is completely written off, gRemodulin – launch is some time away; b) Sputnik V – rights to distribute 125mn doses (vs 100mn earlier) – expect phase 3 trial data by Mar'21; c) Wockhardt business – progressing well.
- Valuation and risks:** We maintain ADD rating and reduce our SOTP-based target price to Rs 5,300 (vs. Rs 5,745 earlier). Our target price is based on 22x FY23e EPS and NPV of Rs384/share for gRevlimid. Key risks: delay in key approvals, higher price erosion in the US, and lower growth in India.

#### Financial Summary

	Q3 FY21	Q3 FY20	YoY (%)	Q2 FY21	QoQ (%)	FY20	FY21E	FY22E	FY23E
Net Sales	48,796	43,838	11.3	48,967	-0.3	1,67,371	1,90,991	2,14,878	2,36,441
EBITDA	10,888	10,416	4.5	12,364	-11.9	34,546	45,753	53,614	59,966
EBITDA Margin	22.3	23.8	-145 bps	25.2	-294 bps	20.6	24.0	25.0	25.4
Rep. PAT	198	-5,697	NA	7,623	-97.4	19,497	19,697	32,281	37,185
EPS (Rs)	1.2	-34.2	NA	45.8	-97.4	117.1	118.3	193.9	223.4
P/E* (x)						36.0	35.6	21.7	18.9
EV/ EBITDA* (x)						31.6	21.5	16.9	13.9
RoACE* (%)						14.4	13.8	15.4	15.8

Source: Company, HSIE Research; \*Adjusted for gRevlimid

### ADD

CMP(as on 29 Jan 2021)	Rs 4,603
Target Price	Rs 5,300
NIFTY	13,635

KEY CHANGES	OLD	NEW
Rating	ADD	ADD
Price Target	Rs 5,745	Rs 5,300
EPS %	FY22E	FY23E
	-8%	-8%

#### KEY STOCK DATA

Bloomberg code	DRRD IN
No. of Shares (mn)	166
MCap (Rs bn) / (\$ mn)	765/10,493
6m avg traded value (Rs mn)	9,616
52 Week high / low	Rs 5,607/2,495

#### STOCK PERFORMANCE (%)

	3M	6M	12M
Absolute (%)	(6.9)	7.0	46.2
Relative (%)	(23.3)	(14.6)	33.9

#### SHAREHOLDING PATTERN (%)

	Dec -20	Sep -20
Promoters	26.73	26.74
FIs & Local MFs	16.30	15.59
FPIs	29.13	29.58
Public & Others	27.62	28.09
Pledged Shares	0.00	0.00

Source : BSE

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