

Dr Reddy's Labs

Estimate change	↔
TP change	↔
Rating change	↔

CMP: INR4,259 TP: INR5,000 (+17%) Buy

Multiple one-offs hurt 1QFY23 profitability... ...but outlook remains intact in key segments

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Bloomberg	DRRD IN
Equity Shares (m)	166
M.Cap.(INRb)/(USDb)	708.9 / 8.9
52-Week Range (INR)	5079 / 3655
1, 6, 12 Rel. Per (%)	-10/2/-18
12M Avg Val (INR M)	2302

- Dr. Reddy's Labs (DRRD) delivered in-line operational performance in 1QFY23, adjusting for the multiple non-recurring factors. Muted performances in North America (NAM), Pharmaceutical services & ingredient (PSAI) and Russia segment was offset by domestic formulation (DF) segment. Niche launches are likely to revive sales prospects for NAM from 2HFY23 onwards.
- We maintain our FY23/FY24 EPS estimates and expect 16% earnings CAGR over FY22-24, backed by: a) limited competition product launches (such as g-Revlimid in 2HFY23), b) steady industry outperformance in DF/Russia segment, c) revival in PSAI segment (through new launches/catering newer markets) and d) better outlook in Russia business. We value DRRD at 24x 12M forward P/E multiple for its base business and add NPV of INR210 for g-Revlimid to arrive at our TP of INR5,000. **Maintain BUY.**

Lower opex on adjusted basis drives profitability for the quarter

Financials & Valuations (INR b)

Y/E MARCH	FY22	FY23E	FY24E
Sales	212.2	229.1	250.2
EBITDA	44.9	51.6	59.5
Adj. PAT	29.3	36.6	39.1
EBITDA Margin (%)	21.2	22.5	23.8
Cons. Adj. EPS (INR)	175.9	219.9	234.7
EPS Gr. (%)	22.8	25.0	6.7
BV/Sh. (INR)	1,145	1,363	1,573

Ratios

Net D:E	-0.2	-0.4	-0.6
RoE (%)	16.0	17.5	16.0
RoCE (%)	12.3	14.5	13.4
Payout (%)	16.9	9.9	10.7

Valuations

P/E (x)	24.2	19.4	18.1
EV/EBITDA (x)	15.3	12.7	10.6
Div. Yield (%)	0.5	0.5	0.5
FCF Yield (%)	3.1	3.1	3.8
EV/Sales (x)	3.2	2.9	2.5

Shareholding pattern (%)

As On	Jun-22	Mar-22	Jun-21
Promoter	26.7	26.7	26.7
DII	25.2	24.8	15.7
FII	26.2	25.4	29.4
Others	22.0	23.1	28.2

FII Includes depository receipts

- DRRD received INR2.3b income from sale of brands to JB Chemicals and Torrent Pharma. Adjusting for the same, DRRD's 1QFY23 revenue was stable YoY at INR50b (v/s est. of INR52.3b).
- DF sales rose 4% YoY to INR11b (22% of sales); Europe sales grew 4% YoY to INR4.1b (8% of sales); NAM sales were up 2% YoY to INR17.8b (~USD230m; 36% of sales); and Emerging Market sales declined slightly YoY to INR9b (17% of sales). PSAI revenue decreased 6% YoY to INR7.1b.
- Multiple non-recurring factors (currency headwinds, elevated commodity prices, inventory-led disruption and reduced business further dragging operating leverage) adversely affected margins. Even outsourcing of 'Cidmus' (product acquired from Novartis) impacted margins negatively in 1QFY23.
- Adjusting for the same, Gross margin (GM) contracted 130bp YoY to 51% due to change in product mix.
- EBITDA margin expanded 240bp YoY to 20.7% (our est: 19.6%) on account of reduced SGA (down 310bp YoY) and lower R&D spend (down 50bp YoY).
- EBITDA grew 14.5% YoY to INR10.3b (v/s est. of INR10.2b).
- During the quarter, DRRD also recognized present value of receivables from Indivior on settlement for Suboxone to the tune of INR5.6b.
- Adjusting for the same, PAT grew 43% YoY to INR8.2b (our est: INR7b), due to higher other income and lower tax rate.

Highlights from the management commentary

- G-Revlimid (Lenalidomide) launch with limited volume is expected in Sep'22.
- The 13% QoQ decline in NAM sales to USD230m was largely because of the increased competition in g-Suboxone and g-Vasopressin injection.
- Russia on a constant currency (CC) basis declined 14% YoY, primarily due to political turmoil and post-stocking inventory normalization in 4QFY22.
- Recent sale of brands was at an Avg. EV/sales multiples 3.5x/4.0x.

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Investors are advised to refer through important disclosures made at the last page of the Research Report.

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Quarterly Performance - IFRS

(INR b)

Y/E March	FY22				FY23E				FY22	FY23E	Estimates	
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE			1QE	% Var
Sales	49.2	57.6	53.2	52.2	49.9	53.2	58.9	67.2	212.2	229.1	52.3	-4.7
YoY Change (%)	11.4	17.7	9.9	10.4	1.3	-7.7	10.6	28.8	11.9	8.0	6.3	
Total Expenditure	40.2	44.3	41.2	41.7	39.5	42.3	44.8	51.0	167.3	177.6	42.0	
EBITDA	9.0	13.4	12.0	10.5	10.3	10.9	14.1	16.2	44.9	51.6	10.2	0.9
YoY Change (%)	-18.9	9.3	15.9	4.4	14.5	-18.4	17.1	54.4	0.5	14.8	13.6	
Margins (%)	18.3	23.2	22.6	20.2	20.7	20.5	23.9	24.2	21.2	22.5	19.6	5.8
Amortization	2.9	3.0	3.0	3.0	3.1	2.8	3.1	3.3	11.8	12.1	2.7	
EBIT	6.1	10.4	9.0	7.6	7.3	8.1	11.0	13.0	33.1	39.4	7.5	
YoY Change (%)	-23.4	16.0	26.4	9.4	19.1	-21.5	21.7	71.7	3.8	19.1	23.0	
Margins (%)	12.4	18.0	17.0	14.5	14.6	15.3	18.7	19.3	15.6	17.2	14.4	
Other Income	1.3	2.3	0.7	1.3	2.8	1.6	1.6	1.9	5.6	7.9	1.7	
PBT before EO expenses	7.4	12.7	9.8	8.8	10.1	9.7	12.6	14.9	38.7	47.3	9.3	9.3
One-off income/(expense)	0.0	0.0	0.0	-6.3	4.5	0.0	0.0	0.0	-6.4	4.5	4.5	
Profit before Tax	7.4	12.7	9.7	2.5	14.7	9.7	12.6	14.9	32.3	51.9	13.8	6.5
PBT after EO Expenses	7.4	12.7	9.7	2.5	14.6	9.7	12.6	14.8	32.3	51.8	13.8	
Tax	1.7	2.8	2.6	1.6	2.8	2.2	3.0	3.6	8.7	11.6	3.4	
Rate (%)	23.1	21.8	27.2	64.8	19.0	23.0	23.5	24.3	27.0	22.4	24.5	
Reported Profit	5.7	9.9	7.1	0.9	11.9	7.5	9.7	11.2	23.6	40.3	10.4	14.3
Adjusted PAT	5.7	9.9	7.1	6.5	8.2	7.5	9.7	11.2	29.3	36.6	7.0	17.3
YoY Change (%)	-1.5	34.2	19.6	38.7	43.6	-24.6	35.8	72.3	22.8	25.0	82.0	
Margins (%)	11.6	17.2	13.4	12.5	16.4	14.1	16.4	16.7	13.8	16.0	19.9	

Key performance Indicators (Consolidated)

Y/E March	FY22				FY23E				FY22	FY23E	FY23E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE			
INR b											
North America	17.4	18.9	18.6	20.0	17.8	17.5	22.0	27.6	74.9	85.0	19.9
YoY Change (%)	0.6	3.2	7.2	14.2	2.4	-7.2	12.0	38.0	6.3	13.4	14.5
Europe	4.0	4.1	4.1	4.4	4.1	4.3	4.5	4.8	16.6	17.7	4.6
YoY Change (%)	12.5	10.1	-2.1	12.3	3.7	3.0	12.0	7.1	8.0	6.5	15.0
India	10.6	11.4	10.3	9.3	11.0	11.7	11.0	10.3	41.6	44.1	9.5
YoY Change (%)	69.3	25.0	7.0	10.1	4.2	3.0	7.0	10.6	24.4	6.0	-10.0
Russia & Others CIS	4.9	7.9	7.1	7.4	5.1	6.2	7.3	8.4	27.4	27.0	5.6
YoY Change (%)	4.3	31.5	7.6	25.9	3.5	-21.4	3.1	12.7	18.2	-1.7	14.3
Others	4.2	5.1	4.4	2.8	4.0	4.6	4.5	4.9	16.5	17.9	3.6
YoY Change (%)	28.9	93.3	46.8	-4.5	-6.5	-10.0	2.0	72.4	38.8	8.6	-15.0
PSAI	7.5	8.4	7.3	7.6	7.1	8.0	8.4	10.2	30.7	33.6	8.3
YoY Change (%)	-11.8	-1.6	3.7	-4.5	10.0	-5.0	15.0	34.7	-3.9	9.3	10.0
Cost Break-up											
COGS (% of Sales)	47.8	46.6	46.2	49.1	49.0	48.5	45.5	43.9	47.4	46.5	49.4
SG&A (% of Sales)	24.7	22.5	23.4	22.5	21.5	23.0	22.5	30.7	23.2	22.8	22.5
R&D Expenses(% of Sales)	9.2	7.7	7.8	8.3	8.7	8.0	8.1	10.4	8.2	8.2	8.5
Gross Margins (%)	52.2	53.4	53.8	50.9	51.0	51.5	54.5	56.1	52.6	53.5	50.6
EBITDA Margins (%)	18.3	23.2	22.6	20.2	20.7	20.5	23.9	24.2	21.2	22.5	19.6
EBIT Margins (%)	12.4	18.0	17.0	14.5	14.6	15.3	18.7	19.3	15.6	17.2	14.4

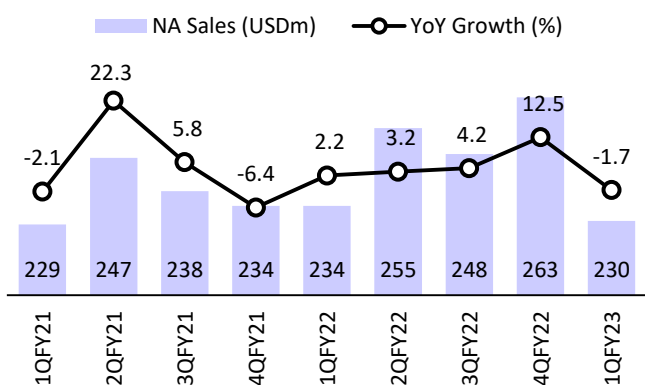


Management call highlights

- The limited quantity supply agreement for g-Revlimid will be until 31st Jan'26.
- DRRD has not hedged for Russia and has worked by reducing working capital to minimize the currency-related impact.
- Adjusting for the Covid impact/divestment of brands and acquisition, India business had single-digit growth YoY for the quarter.
- DRRD launched five new products during the quarter.
- PSAI business' sequential decline was primarily due to lower volumes of base business, partly offset by new product launches and favorable forex rate.
- R&D expense stood at INR4.3b (8.3% of sales).

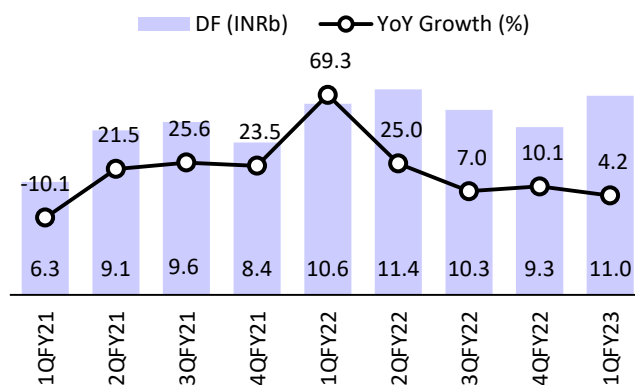
Key exhibits

Exhibit 1: In CC terms, NA sales down 1.7% YoY



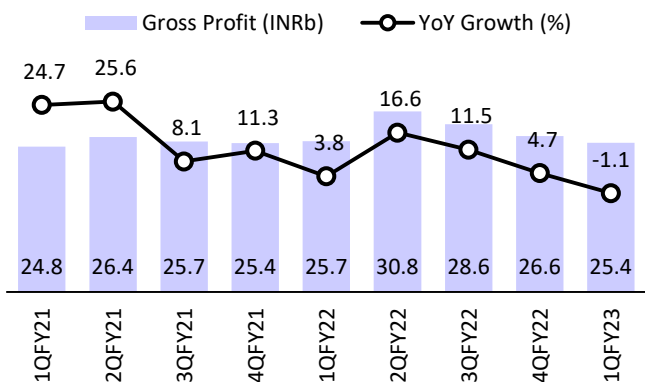
Source: MOFSL, Company

Exhibit 2: DF sales up ~4.2% YoY in 1QFY23



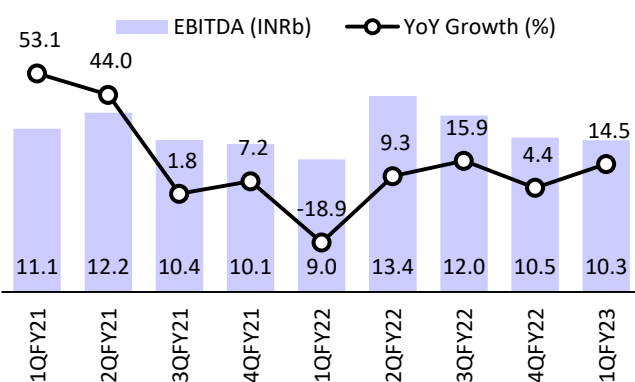
Source: MOFSL, Company

Exhibit 3: Gross profit stable YoY in 1QFY23



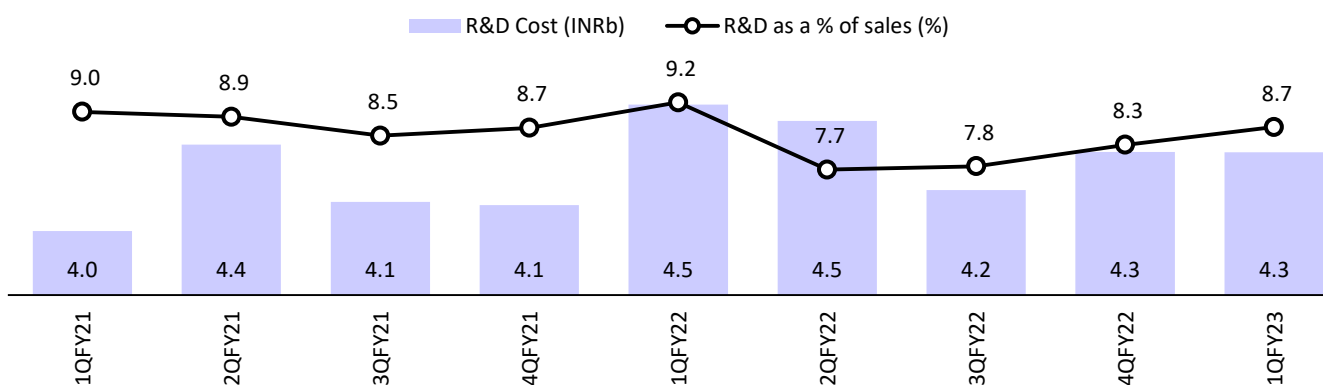
Source: Company, MOFSL

Exhibit 4: EBITDA grows 14.5% in 1QFY23



Source: Company, MOFSL

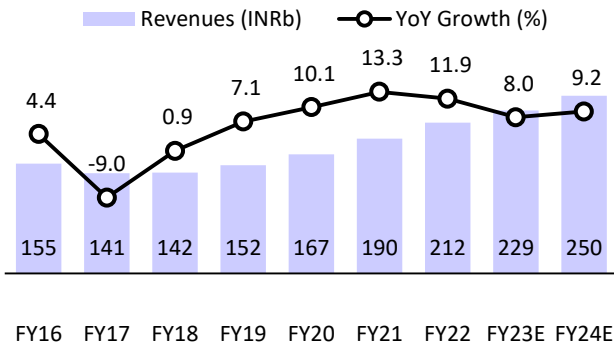
Exhibit 5: R&D expense as % of sales slightly on uptrend 8.7% in 1QFY23



Source: MOFSL, Company

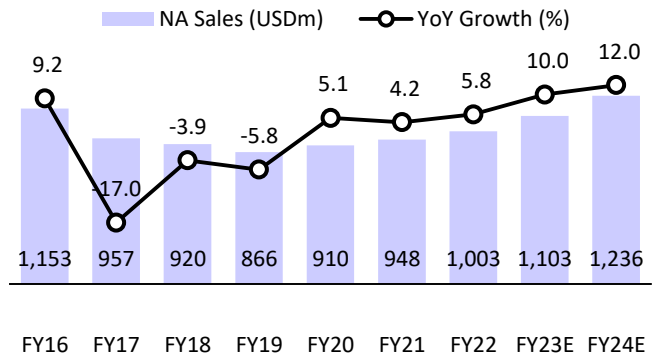
Story in charts

Exhibit 6: Expect sales CAGR of ~9% over FY22-24



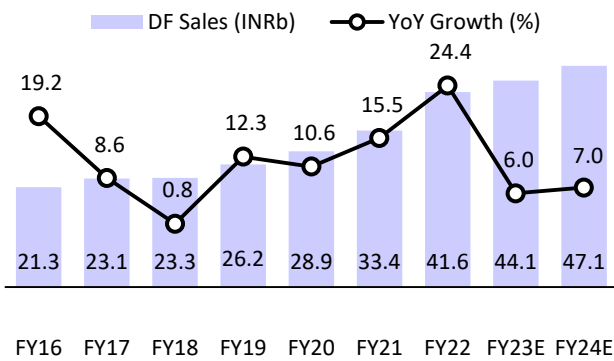
Source: Company, MOFSL

Exhibit 7: NA sales to see ~11% CAGR over FY22-24



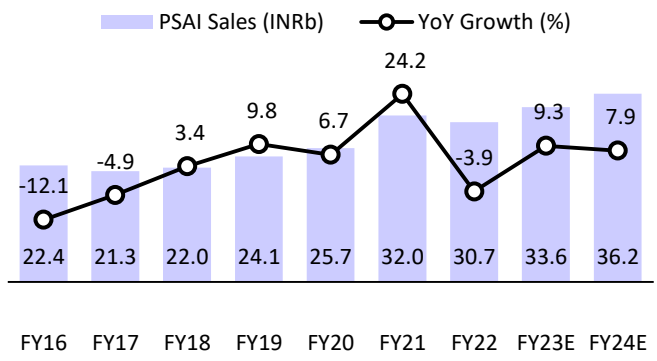
Source: Company, MOFSL

Exhibit 8: Expect DF sales to exhibit 6% CAGR over FY22-24



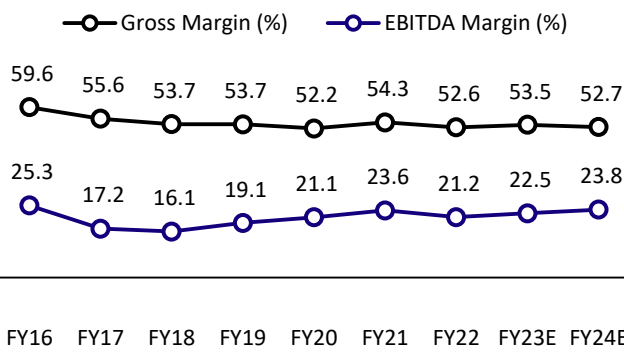
Source: Company, MOFSL

Exhibit 9: PSAI to see ~9% sales CAGR over FY22-24



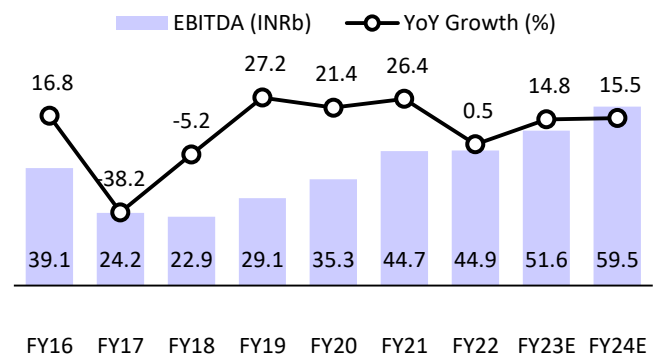
Source: Company, MOFSL

Exhibit 10: Margins to remain stable over FY22-24



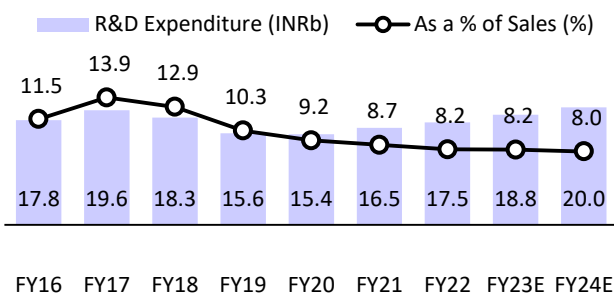
Source: Company, MOFSL

Exhibit 11: Expect EBITDA CAGR of ~15% over FY22-24



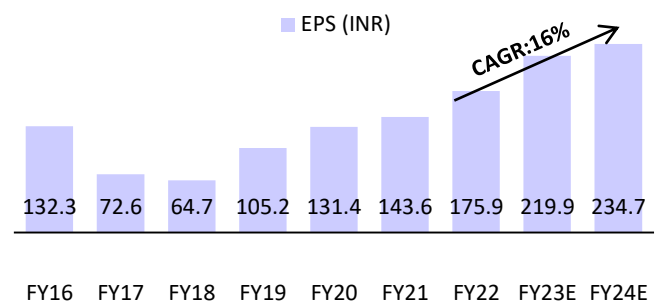
Source: Company, MOFSL

Exhibit 12: R&D expense to settle at ~8% of sales by FY24



Source: Company, MOFSL

Exhibit 13: Expect EPS CAGR of ~16% over FY22-24



Source: Company, MOFSL

Strong execution across segments to drive earnings

Niche launches to drive medium-term growth

- DRRD's sales on constant currency basis declined 2% YoY (USD230m) largely on account of the increased competition in g-Suboxone and g-Vasopressin, partially offset by the 7 launches during the quarter.
- DRRD will be launching limited quantities of gLenalidomide (Revlimid) till 31st Jan'26 and given the size (~USD8b annual sales) represents sizeable opportunity.
- DRRD has a robust pipeline of 86 ANDAs and NDAs pending approval, which would support its long-term aspirations in the US. While the ongoing price erosion in the US may hinder growth slightly over the near term, potential launches to aid 11% sales CAGR over FY22-24 to reach ~INR93b.

Optimizing portfolio in DF segment through divestment/acquisition of brands

- DRRD launched five new products during the quarter.
- DRRD will continue to divest non-core brands and focus on select therapies to be among the top 5 companies in India. Its Digital health initiatives are also expected to yield better margins. The focus on the Over-the-Counter (OTC) segment will also strengthen its brand recall. Smaller cities and rural markets, where it currently has a limited presence, would provide additional opportunities.
- However, considering COVID led high base in FY22, we expect sales CAGR of 6% over FY22-24.

PSAI segment on gradual revival mode

- The PSAI segment posted ~6% decline in revenues YoY in 1QFY23, with margins trending down to 13.6% during the quarter. The PSAI segment decline was largely on account of high base of covid sales last year.
- We expect the PSAI business to post moderate sales CAGR of 4% over FY22-24 on the back of gradual recovery in the business.

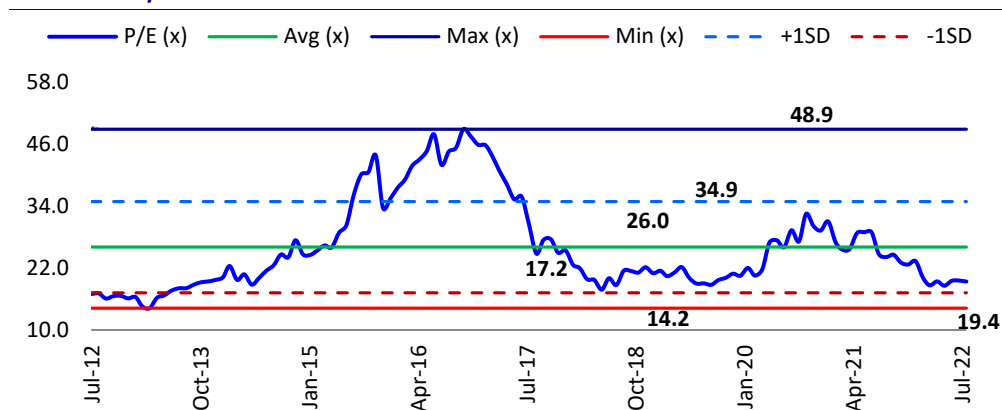
Political issues creates temporary setback in Russia; expect recovery over near term

- DRRD's Russia business declined 9% YoY to INR3.2b in 1QFY23. The decline in Russia business was largely on account of the channel inventory normalization post stocking up in Q4 FY22.
- DRRD will continue to build biosimilars portfolio as well in Russia as it remains a very important market for DRRD.
- The political turmoil had impacted business in Russia in 1QFY23, which is expected to normalize in coming quarters. Further, DRRD has pipeline of new launches in this segment.
- Accordingly, we expect a ~6% sales CAGR in Russia over FY22-24.

Expect 16% earnings CAGR over FY22-24

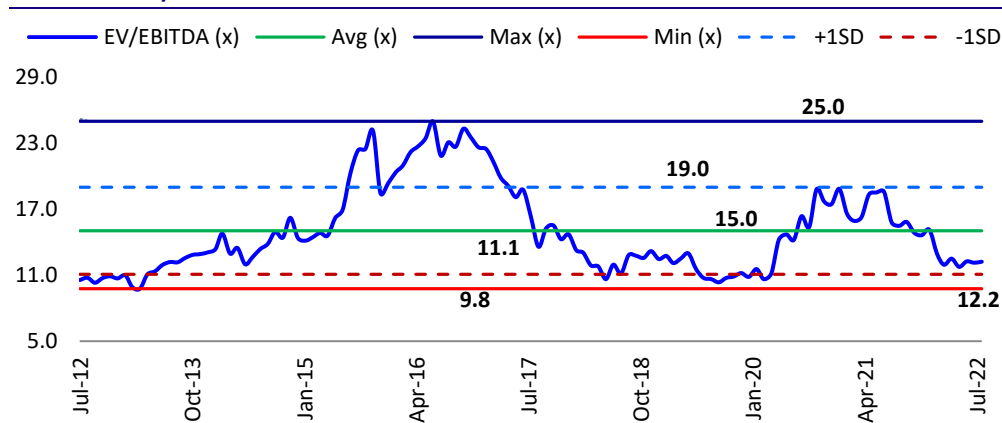
- We maintain our EPS estimate for FY23/FY24 and expect 16% earnings CAGR over FY22-24, backed by a) limited competition products launches (like g-Revlimid in 2HFY23), b) steady industry outperformance in DF segment, revival in PSAI segment (through new launches/catering newer markets) and better outlook in Russia business.
- We value DRRD at 24x 12M forward PE multiple for its base business and add NPV of INR210 for g-Revlimid to arrive at price target of INR5,000.
- We remain positive on DRRD on the back of healthy ANDA pipeline in US market, portfolio optimization in DF segment and building levers to drive better business prospects in China market. Maintain BUY.

Exhibit 14: P/E chart



Source: MOFSL, Company, Bloomberg

Exhibit 15: EV/EBITDA chart



Source: MOFSL, Company, Bloomberg

Financials and valuations

Income Statement							(INR m)	
Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Net Sales	1,40,809	1,42,028	1,52,051	1,67,400	1,89,722	2,12,227	2,29,147	2,50,201
Change (%)	-9.0	0.9	7.1	10.1	13.3	11.9	8.0	9.2
Total Expenditure	1,16,654	1,19,137	1,22,938	1,32,058	1,45,038	1,67,306	1,77,589	1,90,653
EBITDA	24,155	22,891	29,113	35,342	44,684	44,921	51,558	59,548
Change (%)	-38.2	-5.2	27.2	21.4	26.4	0.5	14.8	15.5
Margin (%)	17.2	16.1	19.1	21.1	23.6	21.2	22.5	23.8
Depreciation & Amort.	11,722	11,762	11,980	12,472	12,798	11,825	12,145	12,510
Net Interest Exp	0	817	1,163	983	-1,653	-2,119	-2,303	-2,447
One-off (Gains)/Losses	0	0	-1,800	7,718	7,700	6,381	-4,537	0
PBT before EO Expense	14,653	14,341	22,443	25,749	35,001	38,679	47,316	51,385
Change (%)	-46.0	-2.1	56.5	14.7	35.9	10.5	22.3	8.6
PBT after EO Expense	14,653	14,341	22,443	18,033	27,298	32,298	51,853	51,385
Tax	2,614	4,535	3,648	-1,466	9,175	8,730	11,592	12,333
Tax Rate (%)	17.8	31.6	16.3	-8.1	33.6	27.0	22.4	24.0
Reported PAT	12,039	9,806	18,795	19,499	18,123	23,568	40,260	39,053
Adjusted Net Profit	12,039	10,736	17,459	21,807	23,834	29,265	36,584	39,053
Change (%)	-46.7	-10.8	62.6	24.9	9.3	22.8	25.0	6.7
Margin (%)	8.5	7.6	11.5	13.0	12.6	13.8	16.0	15.6

Balance Sheet							(INR m)	
Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Equity Share Capital	829	830	830	830	830	832	832	832
Reserves	1,21,792	1,24,886	1,39,406	1,55,158	1,75,587	1,89,695	2,25,906	2,60,979
Net Worth	1,22,621	1,25,716	1,40,236	1,55,988	1,76,417	1,90,527	2,26,738	2,61,811
Loans	49,075	50,651	34,125	17,836	29,444	33,845	32,845	31,845
Deferred Liabilities/Tax	-5,164	-3,455	-3,844	-12,179	-10,397	-12,721	-12,721	-12,721
Capital Employed	1,66,532	1,72,912	1,70,517	1,61,645	1,95,464	2,11,651	2,46,862	2,80,935
Gross Block	92,605	99,286	1,15,385	1,26,148	1,43,664	1,60,797	1,57,300	1,64,663
Less: Accum. Deprn.	42,324	49,553	61,533	74,005	86,803	98,628	1,10,773	1,23,283
Net Fixed Assets	56,376	57,411	53,852	52,143	56,861	62,169	46,527	41,380
Investments	26,317	28,935	30,769	33,264	33,115	38,393	38,393	38,393
Goodwill/Intangibles	46,176	46,974	47,393	31,711	40,847	31,664	31,664	31,664
Curr. Assets	82,512	86,718	88,325	1,02,936	1,24,659	1,51,647	1,74,615	2,21,723
Inventory	28,528	29,089	33,579	35,067	45,412	50,884	51,678	60,686
Account Receivables	38,196	40,696	39,982	52,015	49,759	66,818	58,725	69,125
Cash and Bank Balance	3,865	2,638	2,228	2,053	14,829	14,852	45,880	69,394
Others	11,923	14,295	12,536	13,801	14,659	19,093	18,332	22,518
Curr. Liability & Prov.	44,849	47,126	49,822	58,409	60,018	72,222	45,198	53,085
Account Payables	10,569	13,345	13,671	15,248	18,109	25,572	16,090	18,610
Other Current Liabilities	34,280	33,781	36,151	43,161	41,909	46,650	29,109	34,474
Net Current Assets	37,663	39,592	38,503	44,527	64,641	79,425	1,29,417	1,68,638
Appl. of Funds	1,66,532	1,72,912	1,70,517	1,61,645	1,95,464	2,11,651	2,46,001	2,80,075

Financials and valuations

Ratios

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
EPS	72.6	64.7	105.2	131.4	143.6	175.9	219.9	234.7
Cash EPS	143.3	135.5	177.3	206.5	220.7	246.9	292.8	309.9
BV/Share	739.6	757.3	844.8	939.7	1,062.8	1,145.0	1,362.6	1,573.4
DPS	20.0	20.0	20.0	23.6	25.0	20.4	20.4	21.5
Payout (%)	33.1	40.7	21.3	23.5	26.8	16.9	9.9	10.7
Valuation (x)								
P/E	58.7	65.9	40.5	32.4	29.7	24.2	19.4	18.1
PEG (x)	NA	-6	1	1	3	1.1	0.8	2.7
P/BV	5.8	5.6	5.0	4.5	4.0	3.7	3.1	2.7
EV/Sales	5.2	5.1	4.7	4.1	3.6	3.2	2.9	2.5
EV/EBITDA	30.1	31.7	24.3	19.5	15.4	15.3	12.7	10.6
Dividend Yield (%)	0.5	0.5	0.5	0.6	0.6	0.5	0.5	0.5
Return Ratios (%)								
ROIC	8.9	5.8	10.8	21.9	17.0	18.0	22.1	22.8
RoE	9.7	8.6	13.1	14.7	14.3	16.0	17.5	16.0
RoCE	6.4	4.8	8.9	17.4	11.8	12.3	14.5	13.4
Working Capital Ratios								
Fixed Asset Turnover (x)	1.6	1.5	1.4	1.4	1.4	1.4	1.4	1.6
Debtor (Days)	103	101	97	100	98	100	100	93
Inventory (Days)	70	74	75	75	77	83	82	82
Leverage Ratio								
Net Debt/Equity (x)	0.1	0.1	0.0	-0.1	-0.2	-0.2	-0.4	-0.6

Cash Flow Statement

(INR m)

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Op. Profit/(Loss) before Tax	14,653	14,341	22,443	25,749	35,001	38,679	47,316	51,385
Depreciation	11,722	11,762	11,980	12,472	12,798	11,825	12,145	12,510
Interest/Dividends Recd.	-2,220	-4,029	-6,473	4,839	6,238	2,917	-10,137	-1,901
Direct Taxes Paid	-2,614	-4,535	-3,648	1,466	-9,175	-8,730	-11,592	-12,333
(Inc)/Dec in WC	-192	-3,156	679	-6,199	-7,338	-14,761	-18,965	-15,707
CF from Operations	21,444	18,030	28,704	38,542	43,629	34,489	18,767	33,955
(inc)/dec in FA	-40,922	-13,595	-8,840	4,919	-26,652	-7,950	3,497	-7,363
Free Cash Flow	-19,573	788	16,141	43,246	10,872	21,980	22,264	26,592
(Pur)/Sale of Investments	17,757	1,411	2,839	-2,495	149	-5,278	0	0
CF from Investments	-18,404	-14,883	-7,727	-4,923	-26,503	-26,387	3,497	-7,363
Change in net worth	-11,130	-2,719	-273	835	1,653	-5,479	-70	199
(Inc)/Dec in Debt	15,672	1,576	-16,526	-16,289	11,608	4,401	-1,000	-1,000
Dividend Paid	-3,986	-3,992	-4,002	-4,582	-4,852	-3,979	-3,877	-4,076
CF from Fin. Activity	-3,692	-4,440	-21,326	-25,159	-4,545	3,959	-3,849	-3,779
Inc/Dec of Cash	-652	-1,293	-349	8,460	12,581	12,061	18,415	22,813
Add: Beginning Balance	4,921	3,865	2,638	2,228	2,053	14,829	14,852	45,880
Closing Balance	4,269	2,572	2,289	10,688	14,634	26,890	33,267	68,693
FX Impact	-492	57	35	-25	195	0	0	0
Closing Balance	3,865	2,638	2,228	2,053	14,829	14,852	45,880	69,394

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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