



Dr Reddy's Laboratories Limited

Growth Levers intact

Pharmaceuticals

Sharekhan code: DRREDDY

Company Update

3R MATRIX

	+	=	-
Right Sector (RS)	✓	✗	✗
Right Quality (RQ)	✓	✗	✗
Right Valuation (RV)	✓	✗	✗

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS	✓	↔	✓
RQ	✓	↔	✓
RV	✓	↔	✓

Reco/View	Change
Reco: Buy	↔
CMP: Rs. 4,574	
Price Target: Rs. 6,500	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

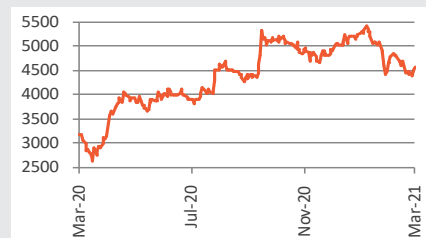
Company details

Market cap:	Rs. 76065 cr
52-week high/low:	Rs. 5,515/2,498
NSE volume: (No of shares)	18.1 lakh
BSE code:	500124
NSE code:	DRREDDY
Free float: (No of shares)	12.2 cr

Shareholding (%)

Promoters	26.7
FII	43.2
DII	14.7
Others	15.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-2.0	-6.8	5.8	44.2
Relative to Sensex	-2.4	-19.6	-26.8	11.8

Sharekhan Research, Bloomberg

Summary

- We re-iterate Buy recommendation on Dr Reddy's Laboratories Limited (DRL) with an unchanged PT of Rs 6500
- Improving growth prospects, sturdy new product pipeline, growth in the base business would be the key drivers for US business, which is expected to clock a double digit growth over the next two years.
- India business expected to stage a double digit growth backed by improvement in the IPM, pick up in the acquired portfolio and an expected growth in the acute therapy..
- The Sputnik-V Vaccine, if approved, could unlock sizeable growth potential and could result in earnings upgrades.

Dr Reddy's Laboratories Limited (DRL), is witnessing improved growth prospects across most of its geographies. The US accounts for around 37% of FY2020 sales and is expected to grow in double digits over the next two years. Substantial product launches in the recent past have led to widening of the base business and expected traction therein coupled with a sturdy pipeline of new product launches (DRL has guided for 30+ products launches in FY2021), which would unfold going ahead, would boost the US revenue. Over the past two months, DRL has launched around 5 products in the US market, offering a healthy growth potential. With respect to Sputnik V vaccine, Russia has initiated a study on the effectiveness of the Sputnik V vaccine against the new mutations of Corona virus including the UK and South Africa strains and initial results show positive efficacy levels. Further, pursuant to DRL's application for Sputnik V to DCGI, the regulator has asked for immunogenicity data of the vaccine, which could be expected post the completion of the Phase III studies of the vaccine (which are currently underway). Also, Europe has initiated a rolling review process for Sputnik V after select countries in the EU already approving Sputnik V. This could possibly have a positive rub off effect on the approval process in India also. DRL's India business largely consists of legacy products (Base business), which is an acute focused portfolio. The base business constitutes around 60% of the overall India business. With the performance of the IPM (Indian Pharmaceutical Markets) on an improving trend, industry reports suggests a mid-single digit growth for IPM in FY2021 and a likely double-digit growth in FY2022. This bodes well for the growth of India business. Further, the confluence of cost-control as well as productivity improvement measures, synergies through partnerships, strong execution, and product-specific opportunities would be the key growth drivers for the company. We expect DRL's sales and PAT to report 14.4% and 25.8% CAGR over FY2020-FY2023.

Our Call

Valuation: Re-iterate Buy with an unchanged PT of Rs. 6,500: Sturdy new product pipeline, growth in base business would drive the growth in the US business. Backed by a likely improvement in acquired portfolio, expected pick up in acute therapies and sustained traction in chronics could drive the India sales. Further, initial observations of the recent study by Russia depicts that Sputnik V vaccine is effective against new mutations of the virus. The DCGI, pursuant to DRL's application seeking emergency authorization for Sputnik V has asked for immunogenicity data which could be expected post the completion of the Phase III studies, that are currently underway. With Europe commencing a rolling review of the Sputnik V vaccine and few member countries in the EU approving the vaccine, it could also have a positive rub off effect on the approval process in India. At CMP, the stock is trading at a P/E multiple of 24.4x/18.8x its FY2022E/FY2023E EPS. Over the past 3 months the stock has underperformed the healthcare index & Sensex by ~9% and 19% respectively, with the stock price declining by ~7-8% providing a good entry point for investors. We re-iterate Buy recommendation with an unchanged PT of Rs 6500

Key Risks

1) Adverse development on the regulatory front can impact earnings prospects; 2) Currency risks.

Valuation (Consolidated)

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Net sales	14870.6	16357.4	19240.4	21563.9	24485.8
EBITDA	3189.8	4147.1	4390.7	5047.7	6390.5
EBITDA (%)	21.5	25.4	22.8	23.4	26.1
PAT	1950.0	2026.0	2711.7	3112.1	4033.3
EPS (Rs)	117.5	122.0	163.4	187.5	243.0
PER (x)	38.9	37.5	28.0	24.4	18.8
EV/Ebitda (x)	21.7	15.7	14.9	13.2	10.0
P/BV (x)	5.4	4.9	4.4	3.9	3.5
RoCE (%)	11.5	7.4	16.0	17.1	20.7
RoNW (%)	13.9	13.0	15.8	16.1	18.4

Source: Company; Sharekhan estimates

Investment Rationales:

Sputnik V, if approved would provide substantial growth opportunities:

COVID-19 has also opened up substantial growth opportunities for select players such as DRL. The company has entered in to an agreement with the Russian Direct Investment Fund (RDIF) for manufacturing and distribution of its COVID-19 Vaccine – Sputnik V. The vaccine is developed by Gamaleya Institute, Russian Defense Ministry and Sovereign RDIF and is already approved by the Russian regulator for public use based on Phase I/II trial data. However, recent interim studies published for the vaccine indicate a ~91.6% efficacy levels at protecting people from COVID-19, which is a key advantage. Based on the agreement entered with RDIF, DRL would lead the registration process for the vaccine in India. Consequently, the company had applied for the emergency use authorization with the regulatory authorities. However, the regulator has not approved the company's request and has sought immunogenicity data. Simultaneously Russia has initiated a study on the effective ness of the vaccine against the new mutations including the UK and South Africa strains. The initial data from the trial shows efficacy levels, however the results from the trial are expected to be out soon. An initial level of efficacy of the vaccine against the new strains augurs well and could points at a possible favorable rub off effect. Given the huge size of population in India, we believe there would be ample demand for Sputnik V to consummate the minimum 125mn doses as committed by DRL.

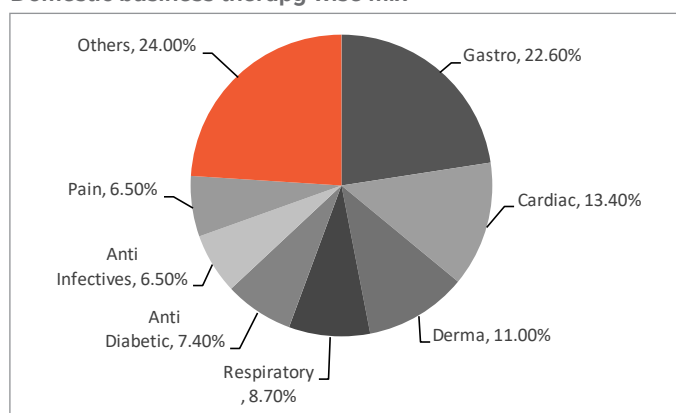
Strong new product pipeline, growth in base business to boost North America revenues:

DRL's US business accounts for ~37% of overall FY2020 sales. Going ahead, the outlook for DRL's US business is robust driven by a sturdy new product pipeline, including partner products, and strong growth momentum expected in the base business. Over the past two months the company has launched five new products in the US markets across therapies. Some of the ley new product launches include Vigabatrin (Market size \$ 141 mn), Fluphenazine Hydrochloride Tablets (market size \$134 mn), Capecitabine Tablets (market size \$90 mn) and Lensoprazole DR (market size \$ 87 mn). Also the company has recently launched Linagliptin tablets which are indicated to treat type II diabetes patients. Further during the quarter ending September 2021 the company has launched four new products in the US markets which include Cinacalcet Tablets, Sapropterin Dihydrochloride Tablets and Succinylcholine Chloride Injection. In addition to this, it has also launched Daptomycin Injection in Canada. Further, the base business in the US is gaining traction and is picking up as gSubexone, which is one of DRL's largest products,(Market share ~ 17%) is growing at a healthy pace. Overall, the new product launch intensity has been strong over the past two years with over 60 products launched since FY2019 and average sales per product at \$5-7 million. Going ahead, DRL has lined up a sturdy product pipeline where it has guided for over 30 + launches in FY2021 (in H1FY2021, it has already done around 15). Therefore, growth in the base business and a sturdy new launch pipeline are expected to result in double-digit sales growth for the US business

Improved growth prospects for the IPM, pick up in acquired portfolio coupled with likely recovery in acute therapies to aid the growth in the India business :

DRL's India business is expected to constitute around 17% of overall FY2020 revenue of the company. Performance of the India business has improved remarkably for the quarter ending December 2020. DRL's India sales were up 26% yoy comfortably outpacing the industry growth, largely attributable to the growth in the acquired portfolio and base business. DRL's India business can be broadly classified in to the base business or the legacy business, the recently acquired portfolio and Covid products. The base business is around 60% of the overall India business and largely comprises the acute therapies.

Domestic business therapy wise mix

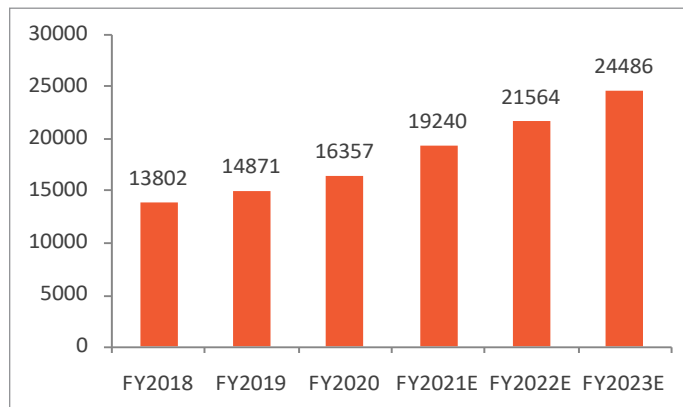


Source: Industry reports, Sharekhan

The performance of the Indian Pharmaceutical Market's (IPM) has been improving with the industry reporting a ~6.4% y-o-y growth for the quarter ending December 2020. This is followed by a 4.5% growth in the January 2021. The growth was largely led by the outperformance of the chronics as well as the sub-chronics segment, while the acute therapies were weak, which could revive going ahead. Overall, IPM is expected to post a mid-single digit growth in FY2021. This bodes well for DRL's India business as well. Cumulatively, we expect India business revenue to report double-digit growth over FY2020-FY2023.

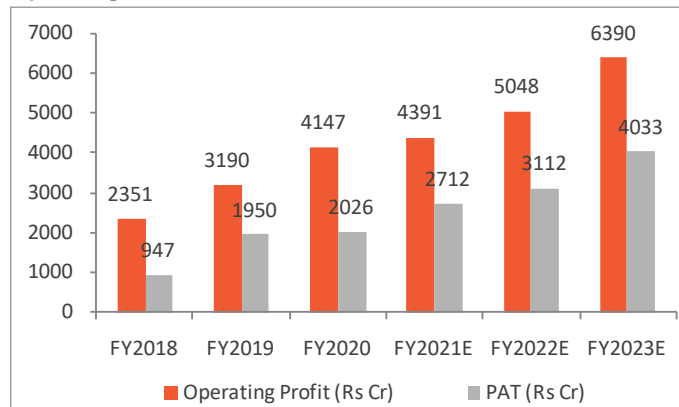
Financials in charts

Sales Trends Rs Cr



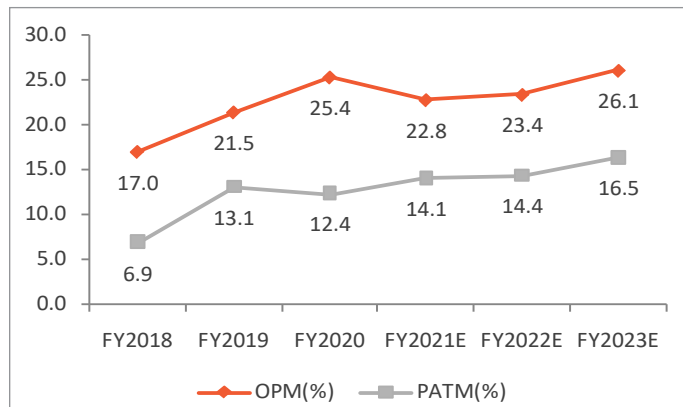
Source: Company, Sharekhan Research

Operating Profit - PAT Trends



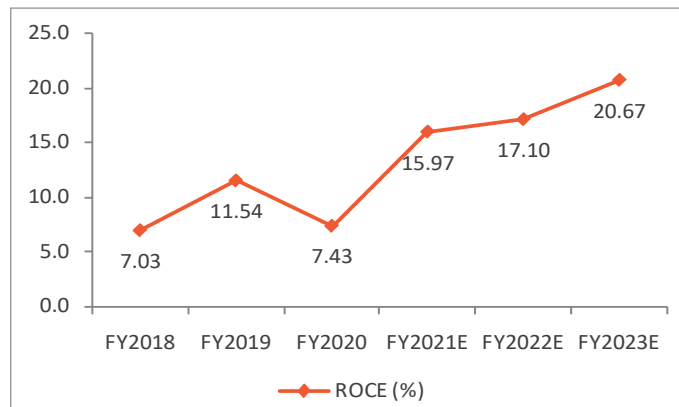
Source: Company, Sharekhan Research

OPM's to improve



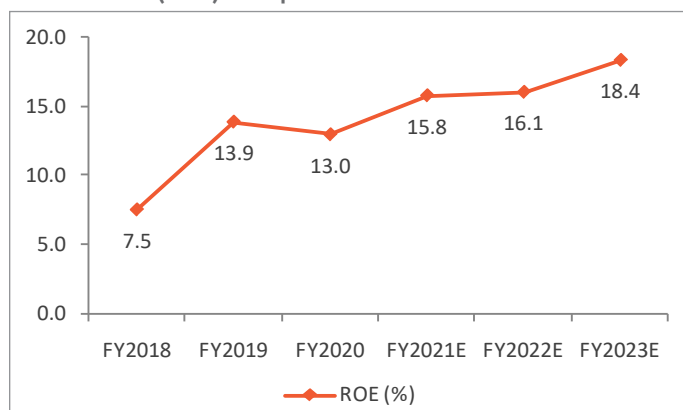
Source: Company, Sharekhan Research

ROCE (%)



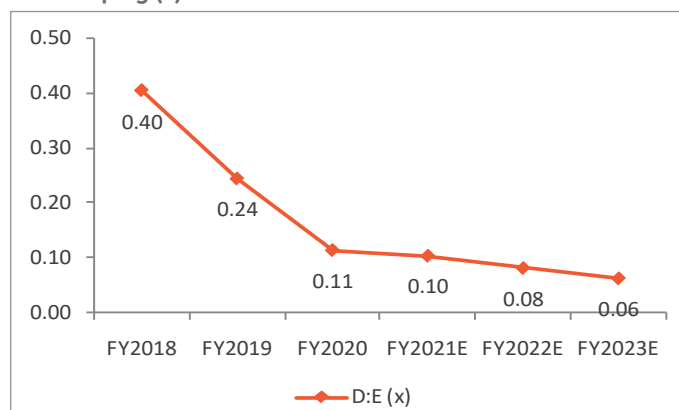
Source: Company, Sharekhan Research

Return ratios (ROE) to improve



Source: Company, Sharekhan Research

Debt : Equity (x)



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Growth momentum to improve

The Indian pharmaceutical companies are better placed to harness opportunities and report healthy growth going ahead. Indian companies are among the most competitive ones globally and hold a sizeable market share in most developed as well as other markets. Moreover, other factors such as the easing of pricing pressures (especially in US generics market), rise in product approvals, and plant resolutions by the USFDA coupled with strong growth prospects in domestic markets and emerging opportunities in the API space would be key growth drivers. This would be complemented by strong capabilities developed by Indian companies (leading to a shift towards complex molecules and biosimilars) and commissioning of expanded capacities by select players over the medium term. Collectively, this indicates a strong growth potential going ahead for pharma companies.

■ Company outlook - Gaining traction

DRL is one of the leading pharmaceutical companies globally with higher presence in the formulations segments and a backward integration for select APIs. Globally, the company is present in most markets with US and India accounting for ~37% and 17%, respectively, of overall sales. The company has a healthy compliance track record, which augurs well for it. DRL is on the verge on an inflection point, wherein the performance is expected to improve remarkably. A confluence of cost-control as well as productivity improvement measures, synergies through partnerships, strong execution and product-specific opportunities would be key growth drivers for the company. Moreover, with the base business diversifying, the performance is expected to gather pace, backed by geographical expansion. A strong product pipeline and easing pricing pressures in the US generic business which would fuel US sales. On the other hand, a likely revival in the acute therapies and expected traction in the acquired portfolio would be key drivers for India business. The Sputnik-V Vaccine, if approved, could unlock sizeable growth potential and could result in earnings upgrades.

■ Valuation - Re-iterate Buy with an unchanged PT of Rs. 6,500

Sturdy new product pipeline, growth in base business would drive the growth in the US business. Backed by a likely improvement in acquired portfolio, expected pick up in acute therapies and sustained traction in chronics could drive the India sales. Further, initial observations of the recent study by Russia depicts that Sputnik V vaccine is effective against new mutations of the virus. The DCGI, pursuant to DRL's application seeking emergency authorization for Sputnik V has asked for immunogenicity data which could be expected post the completion of the Phase III studies, that are currently underway. With Europe commencing a rolling review of the Sputnik V vaccine and few member countries in the EU approving the vaccine, it could also have a positive rub off effect on the approval process in India. At CMP, the stock is trading at a P/E multiple of 24.4x/18.8x its FY2022E/FY2023E EPS. Over the past 3 months the stock has underperformed the healthcare index & Sensex by ~9% and 19% respectively, with the stock price declining by ~7-8% providing a good entry point for investors. We re-iterate Buy recommendation with an unchanged PT of Rs 6500.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)			EV / EBITDA (x)			RoE (%)		
				FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Dr Reddy's	4,574.0	16.6	76,065.0	37.5	28.0	24.4	15.7	14.9	13.2	13.0	15.8	16.1
Aurobindo	875	58.6	51240	17.6	15.7	13.5	11.1	8.9	7.2	19.0	16.3	15.1
Sun Pharma	619.0	239.9	148,431.0	36.9	25.8	22.4	21.6	16.7	14.7	8.9	12.3	12.5

Source: Company, Sharekhan Research

About company

DRL is one of the leading pharmaceutical company with a presence across most of the markets globally. With respect to segments, global generics (generic formulations) is one of the key segments accounting for around 79% of the overall revenue. Under global generics, the company offers more than 400 high-quality generic drugs, keeping costs reasonable by leveraging its integrated operations. Generic formulations include tablets, capsules, injectables, and topical creams across major therapeutic areas of gastrointestinal ailments, cardiovascular disease, pain management, oncology, anti-infective, pediatrics and dermatology. DRL is also present in Active Pharmaceuticals Ingredients (APIs). It is one of the leading manufacturers of API and partners several leading generic formulator companies world over. DRL, through the API business, focuses on innovation-led affordability, which offers customers access to the most complex active ingredients, while maintaining a consistent global quality standard. The proprietary business is the third business segment and accounts for around 6% of the overall sales of the company. The proprietary products business focuses on developing differentiated formulations which significantly enhance benefits in terms of efficacy, ease of use, and the resolution of unmet patient needs. DRL, is a wholly owned subsidiary of - Aurigene Discovery, that is a clinical stage biotech company committed to bringing novel therapeutics for the treatment of cancer and inflammation. The company has fully integrated drug discovery and development infrastructure from hit generation to clinical development. Aurigene Discovery has pioneered customised models of drug discovery and development collaborations with large and mid-sized pharmaceutical companies.

Investment theme

DRL is one of the leading pharmaceutical companies globally with higher presence in the formulations segments and a backward integration for select APIs. Globally, the company is present in most of the markets with US and India accounting for ~37% and 17%, respectively, of overall sales. The company has a healthy compliance track record, which augurs well. DRL is on a verge on an inflection point, wherein the performance is expected to improve remarkably. A confluence of cost control as well as productivity improvement measures, synergies through partnerships, strong execution, and product-specific opportunities would be the key growth drivers for the company. Moreover, with the base business getting more diversified, the performance is expected to gather pace, backed by geographical expansion. A strong product pipeline coupled with easing pricing pressures in the US generic business would fuel US sales, while a likely revival in acute therapies coupled with expected traction in the acquired portfolio would be key drivers for India business. In addition to this, Covid-related opportunities – as Favipiravir/Remdesivir would also add to growth. The Sputnik V Vaccine, if approved, could unlock sizeable growth potential and could result in earnings upgrades.

Key Risks

- 1) Adverse regulatory changes can impact earnings prospects
- 2) Currency risk

Additional Data

Key management personnel

Mr. K Satish Reddy	Chairman
Mr. G V Prasad	Co Chairman and Managing Director
Mr. Erez Israeli	Chief Executive Officer
Mr. Saumen Chakraborty	President and Chief Financial Officer

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	BlackRock Inc	4.34
2	Life Insurance Corp of India	4.22
3	First State Investments ICVC	3.65
4	First Sentier Global Umbrella Fund	3.05
5	SBI Funds Management Pvt Ltd	2.38
6	Axis Asset Management Co Ltd/India	1.79
7	ICICI Prudential Life Insurance Co	1.57
8	Aditya Birla Sun Life Asset Manage	1.42
9	Vanguard Group Inc/The	1.36
10	DSP Investment Managers Pvt Ltd	1.19

Source: Bloomberg

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Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and deteriorating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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