



Powered by the Sharekhan 3R Research Philosophy

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	■	↔	■

ESG Disclosure Score

NEW

ESG RISK RATING

Updated Feb 08, 2022

31.35

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

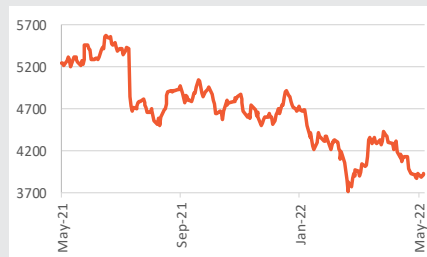
Company details

Market cap:	Rs. 65,369 cr
52-week high/low:	Rs. 5614 / 3655
NSE volume: (No of shares)	4.7 lakh
BSE code:	500124
NSE code:	DRREDDY
Free float: (No of shares)	12.2 cr

Shareholding (%)

Promoters	26.7
FII	28.4
DII	22.3
Others	22.6

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-6.7	-9.1	-15.9	-25.0
Relative to Sensex	-0.2	-0.6	-6.2	-30.8

Sharekhan Research, Bloomberg

Dr. Reddy's Laboratories Ltd

Strong Q4; getting on a sustainable growth path

Pharmaceuticals

Sharekhan code: DRREDDY

Reco/View: Buy

CMP: Rs. 3,928

Price Target: Rs. 5,550

Upgrade ↔ Maintain ↓ Downgrade

Summary

- Q4FY22 was a strong quarter, adjusting for one off impairment charges. The revenues as well as adjusted PAT staged a double digit growth.
- Strong product pipeline, growth in base business to enable DRL tide over pricing pressures in the US and drive up sales in the region. Healthy growth prospects exist for India business backed by growth in the existing portfolio, new product launches and price hikes
- Management commentary too remains optimistic over the long term, though high -cost pressures could be near-term concerns. DRL has retained its EBITDA margins guidance of 25% by 2025.
- We retain our Buy recommendation on Dr Reddys Laboratories (DRL) with an unchanged price target (PT) of Rs. 5,550.

Dr. Reddy's Laboratories (DRL) DRL reported strong performance for the quarter, adjusting for one-off impairment charges. Performance for the quarter was driven by a double-digit growth across the India, US and Emerging markets, while operating margins contracted marginally y-o-y. The revenues as well as the adjusted PAT staged a double-digit growth and are ahead of estimates.. Overall, higher costs and elevated competitive pressures in the US are near term challenges for DRL, but a strong new product pipeline and growth in the base business could enable it tide over the pricing pressures. Expected double-digit growth in India business, gradual pick up in PSAl segment and strong product pipeline in the US including limited competition / FTF products, point towards better prospects and are key positives.

Key positives

- Backed by product launches, a pick-up in the base business, the US revenues grew by 14% y-o-y, which is a positive, given the double-digit price erosion in the US markets.
- India Sales too were up 15% y-o-y due to price increases and new product launches.
- Revenue from emerging markets grew strongly by 36% y-o-y, led by strong growth of 70% in Russia, while CIS markets grew by 20%.

Key negatives

- DRL witnessed a double digit price erosion in its US business, which could stay going ahead.
- Gross margins declined by 230 bps y-o-y due to inflationary pressures.

Management Commentary

- DRL is witnessing heightened competitive pressures in the US, leading to price erosion. Substantial product launch pipeline and growth in the base business would enable DRL to mitigate the risk. DRL has a strong product pipeline for the US including limited competition products / FTF's.
- DRL's India business is expected to stage a double digit growth for FY23 backed by product portfolio expansion and price increases and expanding geographical reach.
- DRL's Russia business has staged a strong 70% y-o-y growth for the quarter and management sees good growth potential from the geography.

Revision in estimates – DRL reported strong performance for the quarter, adjusting for the one off impairment charges. The management commentary too was optimistic over the long term, though high -cost pressures and price erosion in US could be near term concerns and DRL has levers to tide over the pressures. Basis the commentary, we have fine-tuned our estimates for FY23E/FY24E.

Our Call

Valuation – Retain Buy with unchanged PT of Rs. 5,550: Strong growth prospects across business, opportunities from vaccines exports, a sturdy product pipeline, and expected growth in the existing portfolio in the US would likely enable DRL to tide over pricing pressures in the US and provide ample growth visibility. Also, an expected gradual recovery in PSAl segment bodes well. At the CMP, the stock is trading at a P/E multiple of 18.5x/16.3x its FY23E/FY24E EPS. While near-term cost pressures could affect the performance, DRL's long-term growth levers are intact. We retain our Buy recommendation on the stock with unchanged PT of Rs. 5,550.

Key Risks

- Adverse development on the regulatory front including outcome of inspections can impact earnings prospects;
- currency fluctuation risk

Valuation (Consolidated)

Particulars	Rs cr			
	FY2021	FY2022	FY2023E	FY2024E
Net sales	18420.2	20514.4	23566.4	25738.0
EBITDA	4546.7	4698.1	5843.3	6531.3
EBITDA (%)	24.7	22.9	24.8	25.4
Adj PAT	1951.6	2182.5	3518.9	3996.8
EPS (Rs)	117.6	131.5	212.0	240.8
PER (x)	33.4	29.9	18.5	16.3
EV/Ebitda (x)	13.2	12.2	9.9	8.2
P/BV (x)	3.7	3.4	3.1	2.7
RoCE (%)	12.7	11.4	17.5	17.9
RoNW (%)	11.1	11.4	16.9	16.8

Source: Company; Sharekhan estimates

Strong Q4; adjusting for one offs results ahead of estimates: DRL reported strong performance for the quarter, adjusting for the one off impairment charges. Performance for the quarter was driven by a double-digit growth across India, the US and emerging markets, while operating margins contracted marginally y-o-y. The adjusted results are ahead of estimates. Revenues at Rs 5475 crore, grew by 14.8% y-o-y driven by 19% y-o-y growth in the global generic segment while the API business grew by 5% y-o-y. A 36% y-o-y growth in the emerging markets and a 15% and 14% y-o-y growth in the India and US markets drove the global generics revenues. The revenue were ahead of estimates. Operating margins at 21.8% contracted marginally by 33 bps y-o-y and were ahead of estimates. The gross margins contracted by 230 bps y-o-y and savings in the employee cost and the other expenses offset the impact of the same. The operating profit for the quarter stood at Rs 1193 crore, up 13% y-o-y. The company has reported a one-time impairment charges amounting to Rs 741.9 crore towards the impairment of non-current assets. In addition, adjusting for this the Pat stood at Rs 838.9 cr up by 50% y-o-y and was ahead of estimates. In addition, a lower tax outgo aided the PAT growth on a y-o-y basis.

Q4FY2022 Concall Highlights

- ◆ **PSAI segment revenues grow modest 4%, management expects gradual improvement:** The PSAI segment's revenue stood at Rs. 755 crore, decline of 5% y-o-y. The decline is due to lower volumes and price erosion while q-o-q growth was driven by new product sales. Going ahead, the management expects an uptick in the PSAI segment backed by new product launches lined up by the customers as well as an expected uptick in the base business. During Q4FY22 the company filed for 3 DMF's in the US markets.
- ◆ **DRL to offset pricing pressures in the US backed by new product pipeline:** US revenue for the quarter stood at Rs. 1997 crore, translating into 14% y-o-y / 7% QoQ growth, driven by growth in the existing portfolio and new product launches, which enabled to offset the impact of price erosion. However, going ahead, management expects growth in the US business to be driven by new product launches largely which would be complemented by the pick-up in the base business. During Q4FY2022, the company launched three new products, including – Vessopressin injection, Nicotin Lozenges and Clobetaol Shampoo in Canada. For FY22 the company has launched 17 new products in the US markets. In the recent launches including g Vascepa, DRL has garnered a-double-digit market share in the US. In addition to this, the pipeline is healthy with 90 generic filings pending for approval with USFDA, which include 87 ANDAs and 3 NDAs under the 505(b)(2) route. Out of the pending ANDAs, 44 are Para IVs and 24 have 'First to File' status. Also the DRL has plans for complex injectable products in the US markets. Further, the base business in the US is gaining traction and is expected to pick up with the full impact of recent launches expected to be reflected in the coming quarters. Overall, new product launch intensity has been strong; and going ahead, the product launch intensity is likely to be healthy with DRL planning to launch 20-25 new products in the US markets in FY23, which could enable the company to tide over the double digit pricing pressures in the US and provide ample growth visibility going ahead.
- ◆ **India business to stage double-digit growth:** DRL's India business has reported a healthy 16% y-o-y growth of Q4 to Rs 968.9 crore but declined by 6% q-o-q. A reduction in the share of covid products resulted in the 10% decline sequentially. The y-o-y growth can be attributable to volume traction in the base business, favorable price increases, new product launches and divestment of non core brands. DRL expects India business to grow at a healthy pace due to investments towards expansion in rural areas, growing the OTC portfolio, price increases and new launches. In addition, the company plans to leverage the digital Tech platform for growing its brands, which is expected to improve profitability as well. Overall the management expects the India business to stage a double digit growth for FY23
- ◆ **Europe:** DRL's revenue from Europe stood at Rs. 444 crore, growing 12% YoY and 10% QoQ. The growth on a y-o-y business could be attributable to new product launches, which were partly offset by the price erosion in the base business

- ◆ **Emerging Markets:** Revenue from the segment stood at Rs. 1,201.3 crore and was sharply up by 36% y-o-y. Revenue from Russia increased by 70% y-o-y due to traction in the volumes of the base business and income from divestment of few non-core brands. DRL looks towards Russia as potential market and over the medium term expects the revenues from the Russia markets to grow. Revenues from other CIS countries and Romania grew 20% y-o-y, due to launch of new products and price benefits in some of markets.
- ◆ **EBITDA margin outlook:** DRL has retained its target of 25% EBITDA margin and expects this to be driven by a favourable mix, leveraging digital platform, and possible market share gains in branded products.

Results (Consolidated)

Particulars	Rs cr				
	Q4FY22	Q4FY21	Y-o-Y %	Q3FY22	Q-o-Q %
Revenues	5474.9	4768.2	14.8	5338.3	2.6
Operating profit	1192.9	1054.7	13.1	1220.4	-2.3
Other income	121.9	82.6	47.6	55.8	118.5
EBIDTA	1314.8	1137.3	15.6	1276.2	3.0
Interest	31.5	29.7	6.1	21.6	45.8
Depreciation	293.0	310.3	-5.6	298.9	-2.0
PBT	990.3	797.3	24.2	955.7	3.6
Tax	161.9	257.9	-37.2	264.9	-38.9
Adjusted PAT	97.0	557.3	-82.6	709.3	-86.3
Margins			BPS		BPS
OPM (%)	21.8	22.1	-33.1	22.9	-107.3
Adj PAT Margins (%)	-1.8	-11.7	991.6	-13.3	1151.5
Tax Rate (%)	16.3	32.3	-1599.8	27.7	-1136.9

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Growth momentum to improve

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 easing of pricing pressures (especially in the 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 pharmaceutical companies.

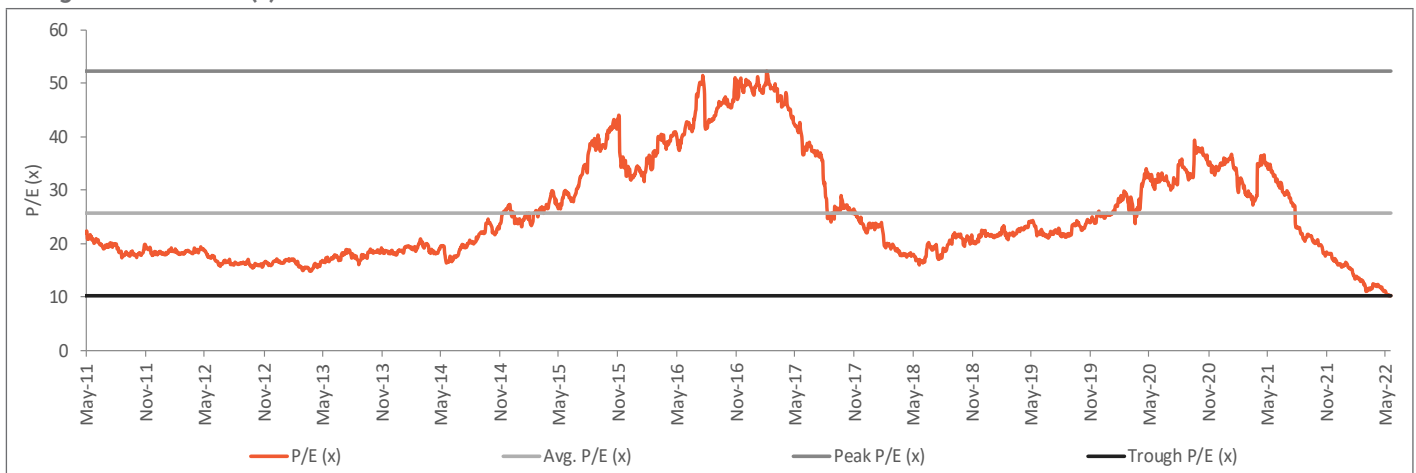
■ Company outlook – On the growth path

DRL has a global presence, especially in the formulations segment. Globally, the company is present in most markets with US and India accounting for ~37% and 17%, respectively, of overall sales. 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. Moreover, with the base business diversifying, performance is expected to gather pace, backed by geographical expansion. A strong product pipeline in the US generics business and improvement in the existing business would fuel US sales. On the other hand, likely traction in acute therapies and acquired portfolio coupled with efforts to expand geographically and leverage the digital platform to grow brands would be key drivers for India business. However, the PSAI segment's performance is expected to be soft in the near term with a likely gradual improvement.

■ Valuation – Retain Buy with an unchanged PT of Rs. 5,550

DRL is witnessing headwinds in the form of pricing pressures in the US business, which are expected to continue. However, given the ramp-up in new products, a strong product pipeline, and growth in the base business, the impact of price erosion is likely to be reduced. Further, growth in acquired products, focus on the OTC portfolio, and rural areas for growth coupled with leveraging the digital platform would fuel India business growth. DRL's PSAI segments performance too is expected to improve gradually. DRL reported strong performance for the quarter, adjusting for the one-off impairment charges and basis the commentary we have fine-tuned our estimates for FY23E/FY24E. At CMP, the stock is trading at a P/E multiple of 18.5x/16.3x its FY23E/FY24E EPS. While near-term cost pressures could affect the performance, DRL's long-term growth levers are intact. We retain our Buy recommendation on the stock with unchanged PT of Rs. 5,550.

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/EBIDTA (x)			RoE (%)		
				FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Dr Reddy's	3,928.0	16.6	65,369.0	29.9	18.5	16.3	12.2	9.9	8.2	11.4	16.9	16.8
Cipla	938.0	80.6	75,683.0	27.6	24.6	19.4	16.4	14.8	11.9	14.6	13.8	15.3
Caplin Point Labs	792.0	7.6	6,000.0	19.4	16.1	13.9	12.6	10.2	8.2	23.1	22.5	21.5

Source: Company, Sharekhan estimates

About company

DRL is one of the leading pharmaceutical companies present across most markets globally. With respect to segments, global generics (generic formulations) is one of the key segments accounting for around 79% of the company's 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 APIs. The company is one of the leading manufacturers of API and partners with 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 company's overall sales. 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's wholly owned subsidiary – Aurigene Discovery 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 customized models of drug discovery and development collaborations with large and mid-size pharmaceutical companies.

Investment theme

DRL is one of the leading pharmaceutical companies globally with higher presence in the formulations segments and backward integration for select APIs. Globally, the company is present in most markets with the 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 at an inflection point, wherein 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 diversification of its base business, performance is expected to gather pace, backed by geographical expansion. A strong product pipeline in the US generic business would fuel US sales. On the other hand, a likely revival in acute therapies and expected traction in the acquired portfolio would be key drivers for India business. Moreover, COVID-related opportunities, including COVID-19 vaccine Sputnik V, offer a sizeable growth opportunity going ahead as the company looks to tap export markets for Sputnik V.

Key Risks

- ◆ Adverse regulatory changes can impact earnings prospects.
- ◆ 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

Source: Company Website

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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