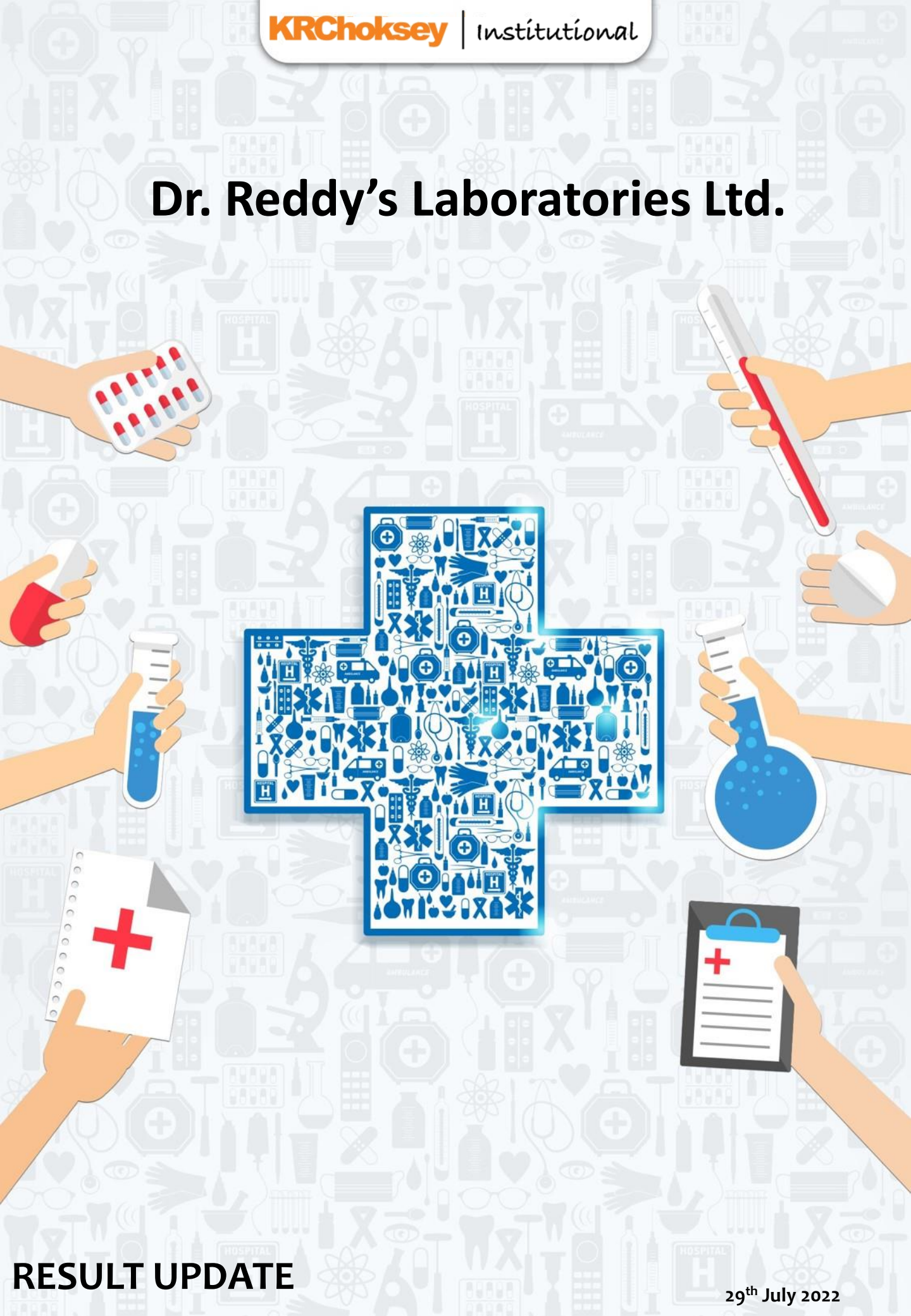


# Dr. Reddy's Laboratories Ltd.



# Dr. Reddy's Laboratories Ltd.

**Major underperformance due to price erosions in the US and Europe**

CMP <b>INR 4,090</b>	Target <b>INR 4,869</b>	Potential Upside <b>19.0%</b>	Market Cap (INR mn) <b>INR 680,800</b>	Recommendation <b>BUY</b>	Sector <b>Pharmaceuticals</b>
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## Result Highlights of Q1FY23

- Dr. Reddy's Laboratories reported adjusted Revenue growth at 1.2% YoY (-4.9% QoQ) to INR 50.03 bn due to muted growth in the global generics (GG) segment revenue and a decline in the PSAI revenue in Q1FY23.
- GG was affected by slower revenue growth or decline in it, in the US, Europe and Emerging markets in Q1FY23.
- PSAI witnessed a decline due to a higher base in Q1FY22 due to higher sales of COVID 19 products then.
- The company has underperformed our expectations by 43.0% on EBITDA and 45.0% on net profits in Q1FY23.
- The company earned a set of unusual gains, such as income from sale of brands in India of INR 2.30 bn and recognition of settlement receivables of INR 5.64 bn in Q1FY23.
- Adjusting for these gains, adjusted PAT declined 30.0% YoY (-45.2% QoQ) to INR 3.95 bn in Q1FY23.

### MARKET DATA

Shares outs (Mn)	166
Equity Cap (INR Mn)	192,124
Mkt Cap (INR Mn)	680,800
52 Wk H/L (INR)	5,077/3,654
Volume Avg (3m K)	462
Face Value (INR)	5
Bloomberg Code	DRRD IN EQUITY

### KEY FINANCIALS

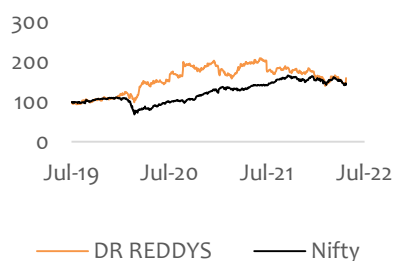
INR Mn	FY19	FY20	FY21	FY22	FY23E	FY24E
Revenue	1,54,482	1,75,170	1,90,475	2,15,452	2,24,082	2,34,223
EBITDA	31,898	41,471	45,467	46,981	42,289	54,808
Adjusted PAT	19,500	38,313	24,060	28,395	24,000	32,411
Adj. EPS (INR)	117.5	230.5	144.6	170.6	144.2	194.8
EBITDA Margin	20.6%	23.7%	23.9%	21.8%	18.9%	23.4%
Adjusted NPM	12.6%	21.9%	12.6%	13.2%	10.7%	13.8%

Source: Company, KRChoksey Research

**Adjusted revenue growth muted, due to subdued performance in the US, Europe, Emerging Markets and PSAI segments:** Dr. Reddy's Laboratories reported adjusted Revenue growth at 1.2% YoY (-4.9% QoQ) to INR 50.03 bn due to muted growth in GG segment revenue and a decline in the PSAI revenue in Q1FY23. The GG segment (85.0% of total revenue) revenue grew at 7.8% YoY (+0.8% QoQ) while the PSAI segment (13.6% of revenue) revenue declined at 6.0% YoY (-6.2% QoQ) and PP and other segments' revenue (1.4% of revenue) increased 36.8% YoY (+6.8% QoQ) in Q1FY23. The company had set of unusual gains in Q1FY23 such as income from sale of brands in India of INR 2.30 bn after selling Z&D, Pedicloryl, Pecef and Ezinapi to JB Chemicals and Pharma Ltd. and Styptovit E, Finast, Finast T, and Dynapres to Torrent Pharma in Q1FY22 (this was a part of India's revenue) and settlement receivables recognized in other income of INR 5.64 bn in Q1FY23. Excluding this unusual income from revenue and other income respectively, the company's adjusted or normalized EBITDA has rather declined 22.6% YoY (-33.8% QoQ) to INR 7.11 bn while EBITDA margins declined 436 bps YoY (-623 bps QoQ) to 14.2% in Q1FY23. The US (40.2% of the GG segment) revenue rose by a muted rate of 2.4% YoY (-10.8% QoQ) to INR 17.82 bn, against our growth estimate of 10.0% YoY (-4.0% QoQ) growth in it in Q1FY23. This was due to price erosions the company witnessed in its key products in the US, notwithstanding promising product launches and favorable forex rates. This is worrisome, as the company had earlier stated that although the GG segment is witnessing price erosions, it has been able to mitigate it with the help of gaining volume share in the existing products and launch of new and complex products such as gVascepa, and gVascostrict, etc. recently.

**Adjusted Net income declined at a heavy-duty pace:** The company's adjusted net income declined 30.0% YoY (-45.2% QoQ) to INR 3.95 bn in Q1FY23 due to muted sales growth, and large erosion in gross profits and EBITDA margins, both YoY and QoQ, due to pricing weakness and higher operating expenses, both YoY and QoQ. This was despite a 168.9% YoY (138.0% QoQ) rise in normalized other income to INR 2.90 bn in Q1FY23, which was offset by a 79.8% YoY (+10.2% QoQ) rise in interest expenses to INR 347 mn in Q1FY23. Without adjusting for the unusual gains, the company has reported a better 2.5% YoY (-12.4% QoQ) rise in EBITDA while EBITDA margin contracted only marginally by 58 bps YoY (-245 bps QoQ) to 18.0% in Q1FY23 and a 212.6% YoY (+1,125.8% QoQ) rise in PAT to INR 11.89 bn in Q1FY23.

### SHARE PRICE PERFORMANCE



### MARKET INFO

SENSEX	56,858
NIFTY	16,930

### SHARE HOLDING PATTERN (%)

Particulars	Jun-22 (%)	Mar-22 (%)	Dec-21 (%)
Promoters	26.7	26.7	26.7
FIIIs	25.9	25.2	27.4
DIIIs	25.2	24.8	22.3
Others	22.2	23.3	23.6
Total	100	100	100

# 4.3%

Revenue CAGR between FY22 and FY24E

# 6.8%

PAT CAGR between FY22 and FY24E

## Dr. Reddy's Laboratories Ltd.

**Key Concall Highlights:** (i) The company's aspirational EBITDA margin is 25.0% however it is likely to fluctuate over the medium term (ii) Revlimid's launch even at limited quantity will be a significant driver of gross margin expansion, secondly, the company intends to increase the share of its in-house manufacturing for several brands to enhance margins and thirdly it is launching productivity improvement plans to drive margins. (iii) Revlimid will be a limited launch in Sep 2022 and the company is geared up for it. Also, the company will have nearly 25 additional launches in the US in FY23.

**Valuation and view:** As per the quarterly results, price erosion in the US and Europe markets has more than offset any benefits which accrue from new complex product launches as broad-based geographic growth becomes uncertain and volumes share of the existing products also takes a toll, due to competition. The company has underperformed our expectations by 43.0% on EBITDA and 45.0% on net profits in Q1FY23. **We, therefore, reduce our revenue and adj. net income growth projections down to 4.3% and 6.8% (vs. earlier 9.9% and 16.1% CAGR, respectively) respectively over FY22-FY24E. Since our last update on the stock in May 22, the stock has been stable. The stock is trading at 29.5x/21.9x on its FY23E/FY24E EPS estimates. We apply a higher multiple of 25.0x (earlier: 22.9x) on the reduced FY24E EPS of INR 194.78 (vs. earlier INR 230.05). As such we reduce the target price to INR 4,869 (from the earlier target of INR 5,261) on the shares of Dr. Reddy's. As the new target price gives an upside potential of 19.0% from its CMP of INR 4,090/ share, we maintain our "BUY" rating on the shares of Dr. Reddy's. We enhance the valuation multiples only because of the quality of its products pipeline, which are complex products, largely. The company had launched limited competition gVasostrict in Q4FY22. Also, it is slated to launch the blockbuster drug gRevlimid, in limited quantity, in Q2FY23. We lower the CAGR growth expectations on revenue and net income, only to reflect the volatility to which it is subject to, due to price competition, slower demand due to base effect or recessionary trends and increased operating expenses.**

Segments Result (INR Mn)	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23
<b>Total Sales</b>	<b>49,194</b>	<b>57,632</b>	<b>53,198</b>	<b>52,203</b>	<b>52,153</b>
<b>Global Generics</b>	<b>41,113</b>	<b>47,431</b>	<b>44,508</b>	<b>43,953</b>	<b>44,323</b>
North America	17,390	18,909	18,645	19,971	17,815
Europe	3,994	4,135	4,058	4,444	4,141
India	10,600	11,402	10,266	9,299	13,339
Emerging Markets	9,129	12,985	11,539	10,239	9,028
<b>PSAI</b>	<b>7,540</b>	<b>8,372</b>	<b>7,271</b>	<b>7,557</b>	<b>7,090</b>
<b>PP &amp; Others</b>	<b>541</b>	<b>1,829</b>	<b>1,419</b>	<b>693</b>	<b>740</b>

Segments Result (% YoY)	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23
<b>Total Sales</b>	<b>11.4%</b>	<b>17.7%</b>	<b>7.9%</b>	<b>10.4%</b>	<b>6.0%</b>
<b>Global Generics</b>	<b>17.2%</b>	<b>19.1%</b>	<b>9.2%</b>	<b>13.5%</b>	<b>7.8%</b>
North America	0.6%	3.2%	7.2%	14.2%	2.4%
Europe	12.5%	10.1%	-2.1%	12.3%	3.7%
India	69.3%	25.0%	7.0%	10.1%	25.8%
Emerging Markets	14.4%	50.4%	19.9%	15.8%	-1.1%
<b>PSAI</b>	<b>-11.8%</b>	<b>-1.6%</b>	<b>3.7%</b>	<b>-4.5%</b>	<b>-6.0%</b>
<b>PP &amp; Others</b>	<b>-1.1%</b>	<b>194.5%</b>	<b>-7.6%</b>	<b>9.7%</b>	<b>36.8%</b>

Revenue Mix (%)	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23
<b>Total Sales</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>
<b>Global Generics</b>	<b>83.6%</b>	<b>82.3%</b>	<b>83.7%</b>	<b>84.2%</b>	<b>85.0%</b>
North America	35.3%	32.8%	35.0%	38.3%	34.2%
Europe	8.1%	7.2%	7.6%	8.5%	7.9%
India	21.5%	19.8%	19.3%	17.8%	25.6%
Emerging Markets	18.6%	22.5%	21.7%	19.6%	17.3%
<b>PSAI</b>	<b>15.3%</b>	<b>14.5%</b>	<b>13.7%</b>	<b>14.5%</b>	<b>13.6%</b>
<b>PP &amp; Others</b>	<b>1.1%</b>	<b>3.2%</b>	<b>2.7%</b>	<b>1.3%</b>	<b>1.4%</b>

Source: Company, KRChoksey Research

# Dr. Reddy's Laboratories Ltd.

## KEY FINANCIALS

### Exhibit 1: Profit & Loss Statement

INR Mn	FY 19	FY 20	FY 21	FY 22	FY 23E	FY 24E
<b>Revenues</b>	<b>1,54,482</b>	<b>1,75,170</b>	<b>1,90,475</b>	<b>2,15,452</b>	<b>2,24,082</b>	<b>2,34,223</b>
COGS	44,948	55,544	60,789	74,422	82,077	78,699
<b>Gross profit</b>	<b>1,09,534</b>	<b>1,19,626</b>	<b>1,29,686</b>	<b>1,41,030</b>	<b>1,42,005</b>	<b>1,55,524</b>
Employee cost	33,562	33,802	36,299	38,858	41,455	42,160
Other expenses	44,074	44,353	47,920	55,191	58,261	58,556
<b>EBITDA</b>	<b>31,898</b>	<b>41,471</b>	<b>45,467</b>	<b>46,981</b>	<b>42,289</b>	<b>54,808</b>
<b>EBITDA Margin</b>	<b>20.65%</b>	<b>23.67%</b>	<b>23.87%</b>	<b>21.81%</b>	<b>18.87%</b>	<b>23.40%</b>
Depreciation & amortization	11,348	11,631	12,288	11,652	13,582	15,064
<b>EBIT</b>	<b>20,550</b>	<b>29,840</b>	<b>33,179</b>	<b>35,329</b>	<b>28,706</b>	<b>39,744</b>
Interest expense	889	983	970	958	1,305	1,301
Other income	3,375	6,206	2,914	4,844	3,445	5,305
<b>PBT</b>	<b>22,920</b>	<b>18,296</b>	<b>28,355</b>	<b>29,911</b>	<b>30,845</b>	<b>43,748</b>
Tax	3,858	-1,403	9,319	8,789	7,546	12,037
Share of Profit/(Loss) of Associates	438	561	480	703	700	700
<b>PAT</b>	<b>19,500</b>	<b>20,260</b>	<b>19,516</b>	<b>21,825</b>	<b>24,000</b>	<b>32,411</b>
EPS (INR)	117.5	122.0	117.7	131.2	144.2	194.8
<b>Adj. PAT</b>	<b>19,500</b>	<b>38,313</b>	<b>24,060</b>	<b>28,395</b>	<b>24,000</b>	<b>32,411</b>
Adj EPS (INR)	117.5	230.5	144.6	170.6	144.2	194.8

Source: Company, KRChoksey Research

### Exhibit 2: Cash Flow Statement

INR Mn	FY19	FY20	FY21	FY22	FY23E	FY24E
Net Cash Generated From Operations	28,704	29,841	35,703	28,108	27,913	44,262
Net Cash Flow from/(used in) Investing Activities	(7,727)	(4,923)	(22,660)	(26,387)	(15,247)	(16,467)
Net Cash Flow from Financing Activities	(21,326)	(25,159)	(298)	(2,422)	(100)	(100)
Net Inc/Dec in cash equivalents	(349)	(241)	12,745	(701)	12,566	27,695
Opening Balance	2,638	2,228	2,053	14,820	14,852	27,224
Adjustment	(61)	66	31	733	(194)	0
Closing Balance Cash and Cash Equivalents	2,228	2,053	14,829	14,852	27,224	54,920

Source: Company, KRChoksey Research

### Exhibit 3: Key Ratios

Key Ratio	FY19	FY20	FY21	FY22	FY23E	FY24E
EBITDA Margin (%)	20.6%	23.7%	23.9%	21.8%	18.9%	23.4%
Tax rate (%)	16.8%	-7.7%	32.9%	29.4%	24.5%	27.5%
Adj. Net Profit Margin (%)	12.6%	21.9%	12.6%	13.2%	10.7%	13.8%
RoE (%)	13.9%	24.6%	13.6%	14.8%	11.2%	12.9%
RoCE (%)	11.8%	17.2%	16.1%	15.8%	11.6%	14.1%
Current Ratio (x)	1.88	1.75	1.80	1.82	1.98	2.27
Adj. EPS (INR)	117.5	230.5	144.6	170.6	144.2	194.8

Source: Company, KRChoksey Research

# Dr. Reddy's Laboratories Ltd.

## Exhibit 4: Balance Sheet

INR Mn	FY19	FY20	FY21	FY22	FY23E	FY24E
<b>EQUITY AND LIABILITIES</b>						
<b>Equity</b>						
Equity share capital	830	831	832	832	832	832
Other equity	1,39,406	1,55,157	1,75,585	1,91,292	2,14,272	2,50,192
<b>Shareholders Fund</b>	<b>1,40,236</b>	<b>1,55,988</b>	<b>1,76,417</b>	<b>1,92,124</b>	<b>2,15,104</b>	<b>2,51,024</b>
<b>Total Debt</b>	<b>34,125</b>	<b>17,836</b>	<b>29,444</b>	<b>30,882</b>	<b>31,799</b>	<b>31,699</b>
<b>Other NCL &amp; Provisions</b>	<b>2,974</b>	<b>2,800</b>	<b>2,125</b>	<b>3,873</b>	<b>6,027</b>	<b>6,231</b>
Trade payables	13,671	15,248	18,109	22,662	24,993	23,177
OCL & Provisions	33,177	40,361	39,784	47,914	49,242	51,704
<b>Total equity and liabilities</b>	<b>2,24,656</b>	<b>2,32,253</b>	<b>2,66,168</b>	<b>2,97,469</b>	<b>3,27,165</b>	<b>3,63,834</b>
<b>ASSETS</b>						
Property, plant and equipment	49,127	47,779	47,322	48,869	50,534	51,936
Capital work-in-progress	4,725	4,364	9,539	12,796	13,436	14,108
Goodwill	4,659	4,913	5,599	5,473	34,108	35,814
Investment in joint ventures	2,529	2,763	3,375	4,318	4,534	4,761
Other non-current asset	8,968	19,317	14,624	19,511	22,238	23,350
<b>Total No-current assets</b>	<b>1,13,555</b>	<b>1,06,262</b>	<b>1,20,665</b>	<b>1,19,646</b>	<b>1,24,850</b>	<b>1,29,968</b>
Inventories	33,579	35,067	45,412	50,884	56,118	52,039
Trade receivables	39,869	50,278	49,641	66,764	69,438	74,993
Other Current Assets	12,896	14,906	15,877	25,150	49,535	51,915
Cash and cash equivalents	2,228	2,053	14,829	14,852	27,224	54,920
<b>Total Current Assets</b>	<b>1,11,101</b>	<b>1,25,991</b>	<b>1,45,503</b>	<b>1,77,823</b>	<b>2,02,315</b>	<b>2,33,867</b>
<b>Total Assets</b>	<b>2,24,656</b>	<b>2,32,253</b>	<b>2,66,168</b>	<b>2,97,469</b>	<b>3,27,165</b>	<b>3,63,834</b>

Source: Company, KRChoksey Research

# Dr. Reddy's Laboratories Ltd.

Dr. Reddy's Laboratories Ltd.				Rating Legend (Expected over a 12-month period)	
Date	CMP (INR)	TP (INR)	Recommendation	Our Rating	Upside
29-07-22	4,090	4,869	BUY	Buy	More than 15%
24-05-22	4,275	5,261	BUY		
31-01-22	4,303	5,261	BUY	Accumulate	5% – 15%
02-11-21	4,746	5,261	Accumulate	Hold	0 – 5%
05-09-21	4,899	5,261	Accumulate	Reduce	-5% – 0
29-07-21	4,673	4,790	HOLD		
17-05-21	5,203	5,497	Accumulate	Sell	Less than – 5%

**ANALYST CERTIFICATION:**

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**KRChoksey Shares and Securities Pvt. Ltd**

**Registered Office:**

1102, Stock Exchange Tower, Dalal Street, Fort, Mumbai – 400 001.  
Phone: +91-22-6633 5000; Fax: +91-22-6633 8060.

**Corporate Office:**

ABHISHEK, 5th Floor, Link Road, Andheri (W), Mumbai – 400 053.  
Phone: +91-22-6696 5555; Fax: +91-22-6691 9576.