Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Dr. Reddy's Laboratories Ltd

Strong Q3; strong beat across revenue and profits

Pharmaceuticals	Sharekhan code: DRREDDY

Reco/View: Buy	↔	CMP: Rs. 4,201	Price Target: Rs. 5,460	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Dr. Reddy's Laboratories (DRL) continued to register strong numbers in Q3FY2023 also, led by even stronger growth in the US and recovery in the other markets.
- US revenue growth was driven by new product launches, increase in volumes, and favorable forex movement; partly offset by price erosion.
- Consolidated revenues grew by 27.2% y-o-y to Rs. 6,789.8 crore; gross margins improved by 452 bps y-o-y to 70.5% and OPM improved by 589 bps y-o-y to 28.7%; PAT grew by a strong 75.4% y-o-y to Rs. 1,243.9 crore aided by strong growth in operating profits with improved new product launches and favorable products mix, despite increase in interest cost and taxes y-o-y.
- The stock is currently trading at an attractive valuation of 14.5x/12.4x its FY2024E/25E. We maintain our Buy recommendation on the stock with unchanged PT of Rs. 5,460.

Dr. Reddy's Laboratories (DRL) recorded highest ever sales and profits, leading to strong FCF generation. FCF was Rs. 1,975 crore as of Q3FY2023. Growth in FCF was driven by strong revenue growth at 27.2% y-o-y to Rs. 6,789.8 crore, which in turn, was driven by stronger revenue growth in the US markets due to new product launches, increase in volumes of the base business, and favorable products mix; partly offset by price erosion. It was also aided by strong recovery in other markets, especially in India and emerging markets. India grew at 9.8% y-o-y to Rs. 1,127.4 crore, while emerging markets grew at 13.5% y-o-y to Rs. 1,309.7 crore. Due to new product launches and favorable products mix, the company's gross profits increased 35.9% y-o-y to Rs. 4,788.4 crore and gross margins expanded by a strong 452 bps y-o-y to 70.5% while EBITDA grew at 59.9% y-o-y to Rs. 1,951.9 crore and EBITDA margins expanding by 589 bps y-o-y to 28.7%. As a result, despite increase in finance costs and taxes y-o-y, the company posted a strong net income growth of 75.4% y-o-y to Rs. 1,243.9 crore on a reported basis and 81.1% y-o-y to Rs. 1,251.3 crore, on a adjusted basis. We believe the company's strong line up of exclusive and complex products pipeline with traction in biosimilar products should support its growth momentum in the quarters ahead.

Key positives

- Recorded highest ever sales and profits, leading to strong FCF generation in the quarter. FCF was Rs. 1,975 crore as of Q3FY2023.
- Launched five new products in Q3 and has 78 ANDAs pending for approval including 3 NDAs under 505(b)(2) route. In addition, out of these 78 filings, nearly 41 ANDA filings are Para IV filings and 21 have FTF status indicating strong complex line up of products.
- Significant progress made for biosimilars as completed clinical trials for Rituximab.

Management Commentary

- Company recorded highest-ever sales and profits, leading to strong FCF generation in the quarter. FCF was Rs. 1,975 crore as of Q3FY2023.
- Healthy sales growth was driven by strong growth in base business and also came from new products launches.
- Gross margins stood at 59.2% in the quarter, an increase of 545 bps y-o-y and 15 bps QoQ. It was aided by contribution from new products and favorable product mix.
- R&D spend was at Rs. 482 crore. which is 7.1% of revenue in Q3FY2023. The company continues to invest in strengthening the product pipeline, productivity improvements, marketing initiatives and for Horizon II vision.

Revision in estimates – With strong recovery in other market's sales coupled with even stronger growth in the US revenue and strong margin expansion due to new product launches, higher volume from the base products and improved products mix, we revise our sales and earnings growth estimate from 14.4% and 33.0% CAGR, respectively to 17.1% and 37.1% CAGR, respectively over FY22-FY25E.

Our Call

View: Retain Buy with an unchanged PT of Rs. 5,460: DRL posted even more strong performance in Q3FY2023 driven by strong growth in the US and recovery in other markets. The company is focusing on building a robust pipeline of products including biosimilars, improving its productivity and investing into horizon II vision. At CMP, the stock trades at an attractive P/E multiple of 14.5x/12.4x it's FY24E/FY25E EPS. We retain our Buy recommendation on the stock with an unchanged PT of Rs. 5,460.

Key Risks

1) Adverse regulatory developments including outcome of inspections can impact earnings prospects; 2) Currency fluctuation risks.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E	FY25E
Net sales	18420.2	20514.4	25278.3	29019.5	32927.2
EBITDA (%)	24.7	22.9	26.1	26.2	26.4
Adj. PAT	1951.6	2182.5	4152.4	4821.7	5618.2
Adj. EPS (Rs)	117.6	131.5	250.1	290.5	338.4
PER (x)	35.7	32.0	16.8	14.5	12.4
EV/Ebidta (x)	14.1	13.1	9.7	8.4	6.6
RoCE (%)	12.7	11.4	22.0	22.6	22.9
RoNW (%)	11.1	11.4	19.9	19.7	19.6

Source: Company; Sharekhan estimates

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 31.33

Updated Dec 08, 2022

High Risk

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

Source: Morningstar

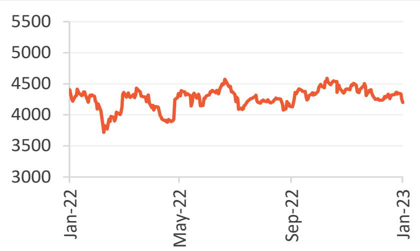
Company details

Market cap:	Rs. 69,932 cr
52-week high/low:	Rs. 4,645/3,654
NSE volume: (No of shares)	2.9 lakh
BSE code:	500124
NSE code:	DRREDDY
Free float: (No of shares)	12.2 cr

Shareholding (%)

Promoters	26.7
FII	37.8
DII	23.4
Others	12.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	4.9	0.0	9.0	4.8
Relative to Sensex	5.0	-2.7	-7.2	-3.6

Sharekhan Research, Bloomberg

Q3FY2023 concall highlights

- **Highest-ever sales:** Recorded highest ever sales and profits, leading to strong FCF generation in the quarter. FCF was Rs. 1,975 crore as of Q3FY2023.
- **Sales growth:** Healthy sales growth was driven by strong growth in base business and also came from new products launches.
- **Gross profit margins (GPM):** Stood at 59.2% in the quarter, an increase of 545 bps y-o-y and 15 bps q-o-q. It was aided by contribution from new products and favorable products mix.
- **R&D spend** stood at Rs. 482 crore. which is 7.1% of revenue in Q3FY2023. The company continues to invest in strengthening the product pipeline, productivity improvements, marketing initiatives and for horizon II vision.
- **ETR:** The effective tax rate stood at 23.7% in Q3FY2023 and normalized levels are expected to be 25-26% levels.
- **Operating working capital fell** by Rs. 490 crore QoQ due to higher collection of receivables and some increase in sales.
- **Capex stood** at Rs. 292 crore.
- **Business highlights:**
  - o Strong traction in revenue due to the US and other markets
  - o High cash generation leading to net cash generation standing at Rs. 3,400 crore. as of Q3FY2023.
  - o Significant progress made for biosimilars as completed clinical trials for Rituximab.
  - o Launched five new products in the US.
  - o The total ANDAs pending approval stood at 78 including 3 NDAs under 505(b)(2) route.

Results Rs cr

Particulars	Q3FY23	Q3FY22	y-o-y %	Q2FY23	QoQ %
Revenues	6,789.8	5,338.3	27.2	6,331.8	7.2
Expenditure	4,837.9	4,117.9	17.5	4,430.4	9.2
EBITDA	1,951.9	1,220.4	59.9	1,901.4	2.7
Depreciation	323.7	298.9	8.3	311.7	3.8
Operating Profit	1,628.2	921.5	76.7	1,589.7	2.4
Interest	41.8	21.6	93.5	30.9	35.3
Other income	58.7	55.8	5.2	40.8	43.9
PBT	1,645.1	955.7	72.1	1,599.6	2.8
Tax	393.8	264.9	48.7	499.4	-21.1
Adjusted PAT	1,251.3	690.8	81.1	1,100.2	13.7
Reported PAT	1,243.9	709.3	75.4	1,114.2	11.6
Margins			**BPS**		**BPS**
GPM (%)	70.5	66.0	452	70.8	-31
EBITDA (%)	28.7	22.9	589	30.0	-128
Adj PAT (%)	18.4	12.9	549	17.4	105
Tax Rate (%)	23.9	27.7	-378	31.2	-728

Source: Company, Sharekhan Research

Segment/region wise performance Rs cr

Particulars	Q3FY23	Q3FY22	y-o-y %	Q2FY23	q-o-q %
Global Generics	**5,924.1**	**4,450.8**	**33.1**	**5,594.6**	**5.9**
- North America	3,056.7	1,864.5	63.9	2,800.1	9.2
- Europe	430.3	405.8	6.0	419.9	2.5
- India	1,127.4	1,026.6	9.8	1,150.0	-2.0
- Emerging Markets	1,309.7	1,153.9	13.5	1,224.6	6.9
API	**775.8**	**727.1**	**6.7**	**643.4**	**20.6**
Others	70.1	141.8	-50.6	67.7	3.5
Total	**6,770.0**	**5,319.7**	**27.3**	**6,305.7**	**7.4**
Other operating income	19.9	18.6	7.0	26.1	-23.8
Revenue from operations	**6,789.9**	**5,338.3**	**27.2**	**6,331.8**	**7.2**

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Multiple growth engines ahead

The Indian Pharma market (IPM) is growing with increased consumer spend and awareness. Additionally, Indian pharmaceutical players with large market share in IPM and a strong pipeline of speciality products will help them gain market share in the US and thereby partially offset any impact of competitive pricing pressure in the US. Moreover, other factors such as faster product approvals and resolutions by the USFDA regards to plant observations and 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, biosimilars and injectables) and commissioning of expanded capacities by select players over the medium term. Collectively, this indicates a strong growth potential going ahead for Indian pharma companies.

■ Company outlook - Strong FCF generation driven by strong profitability improvement.

DRL has a global presence, especially in the formulations segment. Globally, the company is present in most markets with US and India accounting for ~35% and 20%, respectively, of overall sales. In addition, the management has charted out key focus areas for growth over the near term (under Horizon 1) and over the long term (under Horizon 2) which would propel growth. A confluence of cost control and productivity improvement measures, synergies through partnerships, market and product portfolio expansion, 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, a 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 the Indian 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. 5,460

DRL posted a strong performance in Q3FY2023 driven by strong growth in the US and recovery in other markets. The company is focusing on building a robust pipeline of products including biosimilars, improving its productivity and investing into horizon II vision. At CMP, the stock is trading at an attractive P/E multiple of 14.5x/12.4x it's FY24E/FY25E EPS. We retain our Buy recommendation on the stock with an unchanged PT of Rs. 5,460.

Peer valuation

Companies	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)			EV/EBIDTA (x)			RoE (%)		
				FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Dr Reddy's	4,201.0	16.6	69,931.8	16.8	14.5	12.4	9.7	8.4	6.6	19.9	19.7	19.6
Sun Pharma	1,040.1	239.9	2,49,542.8	28.9	24.4	20.5	18.7	15.4	12.4	15.5	15.7	15.9
Biocon	235.2	120.1	28,238.1	27.2	17.9	15.1	13.5	9.3	7.7	11.0	14.5	14.7

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

1) Adverse regulatory changes can impact earnings prospects.

2) Currency risk.

Additional Data

Key management personnel

K Satish Reddy	Chairman
Erez Israeli	Chief Executive Officer
Parag Agarwal	Chief Financial Officer
K Randhir Singh	Company Secretary & Compliance Officer

Source: BSE; Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp India	15.16
2	JP Morgan Chase	10.62
3	BlackRock Inc	2.65
4	First State Investments ICVC	2.51
5	Vanguard Group Inc.	2.28
6	ICICI Prudential Life Insurance	2.22
7	Republic of Singapore	1.86
8	NPS Trust UTI	1.80
9	Kuwait Investment Authority	1.66
10	Aditya Birla Sun Life AMC	1.47

Source: Bloomberg

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 detoriating 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

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Compliance Officer: Ms. Binkle Oza; Tel: 022-61150000; email id: complianceofficer@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com.

Registered Office: Sharekhan Limited, The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA, Tel: 022 - 67502000/ Fax: 022 - 24327343. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O/ CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183.