Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Dr. Reddy's Laboratories Ltd

Continues to expand inorganically in the regulated markets

Pharmaceuticals	Sharekhan code: DRREDDY

Reco/View: Buy	↔	CMP: Rs. 5,780	Price Target: Rs. 6,373	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Dr Reddy's Laboratories has entered into an agreement for the development and commercialisation of COYA 302, an investigational combination therapy for the treatment of Amyotrophic Lateral Sclerosis (ALS).
- Dr. Reddy's will make a USD 7.5 million upfront payment to Coya. Coya is also eligible to receive sales-based milestone payments of up to USD 677.25 million linked to tiers of cumulative net sales achieved over several years (over the term of the agreement subject to product commercial exclusivity).
- Under the Agreement, Dr. Reddy's will obtain commercialization rights for COYA 302 in the United States, Canada, the European Union and the United Kingdom for patients with ALS.
- Management retains its strong guidance of over 25% EBITDA margin in the near term, driven by settled product agreements like gRevlimid and double-digit growth in the India business. The stock trades at an attractive valuation of 17.3x and 15.4x its FY2025E and FY2026E estimates vs. peers' 26x and 22.1x, indicating attractive valuations. Hence we maintain BUY with PT of Rs. 6,373.

Dr.Reddy's has entered into an agreement for the development and commercialisation of COYA 302, an investigational combination therapy for the treatment of Amyotrophic Lateral Sclerosis (ALS). COYA 302 is an investigational combination biologic for subcutaneous administration, comprised of low-dose IL-2 and CTLA4-Ig (abatacept). COYA 302 has a dual mechanism of action intended to suppress the chronic and sustained inflammation underlying certain neurodegenerative diseases. COYA will be responsible for development, including conducting the Phase 2 clinical trial and obtaining regulatory approval in the United States. In early 2023, Coya entered into an in-licensing agreement with Dr. Reddy's to license its proposed biosimilar abatacept for the development and commercialization of COYA 302.

- **US sales Ex of Revlimid expected to report healthy growth:** Dr.Reddy's has recently acquired Mayne portfolio, which led to strong 13% YoY growth in INR terms to Rs 3,170 crs while revenues were up 9% to US$ 384 mn in 2Q (1H sales at US$ 774 mn) followed by favourable forex movement. Dr. Reddy guided 25-30 launches in FY24 (10 launches in 1HFY24). During 2QFY24, Revlimid was not the key contributor, but expects Revlimid to remain a key contributor and will keep on increasing each year. The base business is experiencing moderate Price erosion in the US of mid-single digit, but generally it ranges from high single-digit to low double-digit, and it also depends on the competition and product portfolio. Recently Dr.Reddy's have also signed a deal with Coya Therapeutic for the development and Commercialization of COYA 302, an Investigational Combination Therapy for the Treatment of Amyotrophic Lateral Sclerosis (ALS) to be sold in regulated markets like North America, EU and the United Kingdom.
- **India will grow in double digits from 2HFY24:** India business was flat at 3% growth to Rs 1190 crs in 2QFY24 as growth was dragged by NLEM impact and weak acute season. India's market has guided for double-digit growth in the upcoming quarters of 3Q and 4Q. Chronic share in India is 35% of sales, while the management expects more launches on the chronic side going forward. The focus is on bringing innovation to the Indian market through licencing deals and collaboration with global innovators targeting areas like cardiac, diabetes, CNS, and oncology. Currently, the company has signed about 10 licencing deals with opportunity sizes in the range of Rs 1 bn but it takes 12-18 months for the deal to fructify as some products require clinical trials for approvals/launch in India. The current MR count stands at around 6,000+, although they see no need to increase it further as it depends on innovation portfolio launches. The management guided that the EBITDA margin profile of the India business is better than US generic business.
- **Biosimilar vertical to scale up slowly:** Biosimilars will be the main driver of earnings from FY27 onwards as its contribution will increase by then. Biosimilar for Rituximab has been submitted in April 2023. PAI has happened and management expects to provide further updates to FDA queries by November 2023, with expected launch in the beginning of FY25E. Rituximab will be launched by its US partner Fresenius, while Dr. Reddy's own launches with their own sales force will start to take place from FY25 onwards. For Pegfilgrastim in the US – Dr. Reddy's gets only royalty from the product, which is not a big amount. Main biosimilar activity is primarily seen in EM, India, and Russia. Dr. Reddy's is in the process of ramping up that activity in RoW markets. It expects 5 phase III biosimilar's to launch globally in the next three years. Teriparatide – Dr. Reddy's is ready for launch in the first wave, that will depend on patent expiry.

Our Call

View – Maintain BUY with revised PT of Rs.6373: The company reported a strong 21% beat on the net profit front from our consensus estimates in Q2FY2024, led by a stronger-than-anticipated rise in sales in the U.S. and Europe. This led to strong operating leverage and a favourable product mix, which in turn led to a strong earnings beat in Q2FY2024. As the company believes that if limited quantity and settled products like gRevlimid continue to be a part of the U.S. segment, the company can register an EBITDA margin of over 25% in the near to medium term. The company expects 25-30 new meaningful launches by FY2027; hence, we have introduced FY2026 earnings. We believe the company is on track to sustain its superior performance both organically and inorganically; hence, we maintain our Buy rating on the stock. The stock is currently trading at an attractive valuation of 16x and 14x its FY2025E and FY2026E EPS of Rs. 333.8 and Rs. 375.2 per share, respectively. Due to sustained growth prospects in regulated markets like the U.S. and Europe and higher margin trajectory, we ascribe a P/E of 17x on FY2026E to arrive at a price target (PT) of Rs. 6,373

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY2021	FY2022	FY2023	FY2024E	FY2025E	FY2026E
Net sales	18972.2	21439.1	24587.9	28136.5	31046.0	34016.5
EBITDA	4566.4	4886.2	7047.9	7892.3	8894.7	10017.8
EBITDA (%)	24.1	22.8	28.7	28.1	28.7	29.5
Adj PAT	1723.8	2356.8	4506.7	5075.8	5540.6	6228.8
Adj. EPS (Rs)	137.4	171.0	243.3	305.8	333.8	375.2
PER (x)	32.9	24.8	23.8	18.9	17.3	15.4
EV/Ebidta (x)	16.4	14.2	12.9	11.3	9.7	8.3
RoNW (%)	13.8	15.5	19.2	20.1	18.5	17.7
RoCE (%)	18.5	18.8	26.3	26.0	24.9	24.1

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	26.60
Updated Jun 08, 2023	

Medium Risk

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

Source: Morningstar

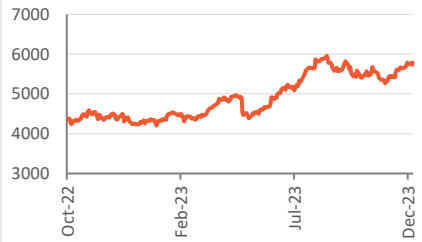
Company details

Market cap:	Rs. 96,218 cr
52-week high/low:	Rs. 5,986 / 4,176
NSE volume: (No of shares)	4.5 lakh
BSE code:	500124
NSE code:	DRREDDY
Free float: (No of shares)	12.2 cr

Shareholding (%)

Promoters	26.7
FII	41.5
DII	18.8
Others	13.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.6	11.5	22.9	32.2
Relative to Sensex	-3.5	5.8	12.8	20.8

Sharekhan Research, Bloomberg

Stock Update

Company Update

Outlook and Valuation

■ Sector View – Input cost easing with companies focusing on complex product launches

Over the years, Indian pharmaceutical companies have established themselves as a dependable source for global pharma companies. The confluence of other factors, including a focus on speciality/complex products and emerging opportunities in the API space, would be key growth drivers over the long term. The sector is witnessing an easing of input costs like raw-material costs, freight, and power, which would aid the sector in expanding margins. The sector is also witnessing an easing of price erosion, followed by increasing contributions from new product launches. We believe the sector is in a sweet spot, where it is experiencing a healthy product mix and cost rationalisation, which increases the operational profit of companies. The sector is mainly a low-debt sector and increasing operational profit followed by experiencing the advantage of low tax rate due to its operations in the SEZ sector hence overall, we have a positive view of the sector.

■ Company Outlook – Inorganic growth opportunity drives growth

DRL has a global presence, especially in the formulations segment. Globally, the company is present in most markets, with the U.S. and India accounting for ~41% and ~20%, respectively, of overall sales. In addition, 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 strong geographical diversification, performance is expected to gather pace, backed by geographical expansion. A strong product pipeline in the U.S. generics and speciality business would fuel U.S. sales. On the other hand, a likely traction in acute therapies and acquired portfolio and efforts to expand geographically and leverage the digital platform to grow brands would be key drivers for the Indian business.

■ Valuation – Maintain Buy with a revised PT of Rs. 6,373

The company reported a strong 21% beat on the net profit front from our consensus estimates in Q2FY2024, led by a stronger-than-anticipated rise in sales in the U.S. and Europe. This led to strong operating leverage and a favourable product mix, which in turn led to a strong earnings beat in Q2FY2024. The company believes that if limited quantity and settled products like gRevlimid continue to be a part of the U.S. segment, the company can register an EBITDA margin of over 25% in the near to medium term. The company expects 25-30 new meaningful launches by FY2027; hence, we have introduced FY2026 earnings. We believe the company is on track to sustain its superior performance both organically and inorganically; hence, we maintain our Buy rating on the stock. The stock is currently trading at an attractive valuation of 16x and 14x its FY2025E and FY2026E EPS of Rs. 333.8 and Rs. 375.2 per share, respectively. Due to sustained growth prospects in regulated markets like the U.S. and Europe and higher margin trajectory, we ascribe a P/E of 17x on FY2026E to arrive at a PT of Rs. 6,373.

About company

DRL is one of the leading pharmaceutical companies present across most markets globally. Concerning 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 over 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, paediatrics, 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 the 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 segment, accounting 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 treating 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-size pharmaceutical companies.

Investment theme

DRL is one of the leading pharmaceutical companies globally, with a higher presence in the formulation segments and backward integration for select APIs. Globally, the company is present in most markets with the U.S. 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, 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 U.S. generic business would fuel U.S. sales. On the other hand, a likely revival in acute therapies and expected traction in the acquired portfolio would be key drivers for the India business. Moreover, COVID-related opportunities, including the COVID-19 vaccine Sputnik V, offer a sizeable growth opportunity as the company looks to tap export markets for Sputnik V. However, loss of exclusivity on gRevlimid's 2.5 and 20 mg strengths, besides competitive intensity in the U.S. and India business, will lead to a decline in earnings over the short to medium term at high single digits.

Key Risks

- Adverse regulatory changes can impact earnings prospects.
- 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: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	APS Trust	20.59
2	Life Insurance Corporation	5.59
3	First State Investments ICVC	2.70
4	Vanguard Group Inc	2.40
5	Blackrock Inc	2.41
6	HDFC AMC	1.81
7	SBI Funds Management	1.71
8	Republic of Singapore	1.21
9	Norges Bank	1.06
10	HDFC Life Insurance Co.	1.04

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

DISCLAIMER

This information/document has been prepared by Sharekhan Ltd. (SHAREKHAN) and is intended for use only by the person or entity to which it is addressed to. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This information/ document is subject to changes without prior notice.

Recommendation in reports based on technical and derivatives analysis is based on studying charts of a stock's price movement, trading volume, outstanding positions, as opposed to focusing on a company's fundamentals and as such, may not match with a report on a company's fundamentals. However, this would only apply for information/document focused on technical and derivatives research and shall not apply to reports/documents/ information focused on fundamental research.

This information/document does not constitute an offer to sell or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Though disseminated to all customers who are due to receive the same, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this information/report.

The information contained herein is obtained from publicly available data or other sources believed to be reliable and SHAREKHAN has not independently verified the accuracy and completeness of the said data and hence it should not be relied upon as such. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Recipients of this report should also be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved) and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other recommendations/ reports that are inconsistent with and reach different conclusions from the information presented in this recommendations/report.

This information/recommendation/report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

The analyst certifies that the analyst might have dealt or traded directly or indirectly in securities of the company and that all the views expressed in this document accurately reflect his or her personal views about the subject company or companies and its or their securities and do not necessarily reflect those of SHAREKHAN. The analyst and SHAREKHAN further certifies that either he or his relatives or Sharekhan associates might have direct or indirect financial interest or might have actual or beneficial ownership of 1% or more in the securities of the company at the end of the month immediately preceding the date of publication of the research report. The analyst and SHAREKHAN encourages independence in research report/ material preparation and strives to minimize conflict in preparation of research report. The analyst and SHAREKHAN does not have any material conflict of interest or has not served as officer, director or employee or engaged in market making activity of the company. The analyst and SHAREKHAN has not been a part of the team which has managed or co-managed the public offerings of the company, and no part of the analyst's compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document. Sharekhan Ltd or its associates or analysts have not received any compensation for investment banking, merchant banking, brokerage services or any compensation or other benefits from the subject company or from third party in the past twelve months in connection with the research report.

Either SHAREKHAN or its affiliates or its directors or employees / representatives / clients or their relatives may have position(s), make market, act as principal or engage in transactions of purchase or sell of securities, from time to time or may be materially interested in any of the securities or related securities referred to in this report and they may have used the information set forth herein before publication. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

Forward-looking statements (if any) are provided to allow potential investors the opportunity to understand management's beliefs and opinions in respect of the future so that they may use such beliefs and opinions as one factor in evaluating an investment. These statements are not a guarantee of future performance and undue reliance should not be placed on them. Such forward-looking statements necessarily involve known and unknown risks and uncertainties, which may cause actual performance and financial results in future periods to differ materially from any projections of future performance or result expressed or implied by such forward-looking statements. Sharekhan/its affiliates undertakes no obligation to update forward-looking statements if circumstances or management's estimates or opinions should change except as required by applicable securities laws. The reader/investors are cautioned not to place undue reliance on forward-looking statements and use their independent judgement before taking any investment decision.

Investment in securities market are subject to market risks, read all the related documents carefully before investing. The securities quoted are for illustration only and are not recommendatory. Registration granted by SEBI, and certification from NISM in no way guarantee performance of the intermediary or provide any assurance of returns to investors.

Client should read the Risk Disclosure Document issued by SEBI & relevant exchanges and the T&C on www.sharekhan.com

---

Registration and Contact Details: Name of Research Analyst - Sharekhan Limited, Research Analyst Regn No.: INH000006183. CIN): - U99999MH1995PLC087498. Registered Office: The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA. Tel: 022-6115000.

Correspondence/Administrative Office: Gigaplex IT Park, Unit No 1001, 10th Floor, Building No.9, TTC Industrial Area, Digha, Airoli-West, Navi Mumbai – 400 708. Tel: 022 61169000 / 61150000, Fax No. 61169699.

Other registrations of 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.

Compliance Officer: Ms. Binkle Oza; Tel: 022-62263303; email id: complianceofficer@sharekhan.com

For any complaints/grievance, email us at igc@sharekhan.com or you may even call Customer Service desk on - 022-41523200 / 022-69920600.