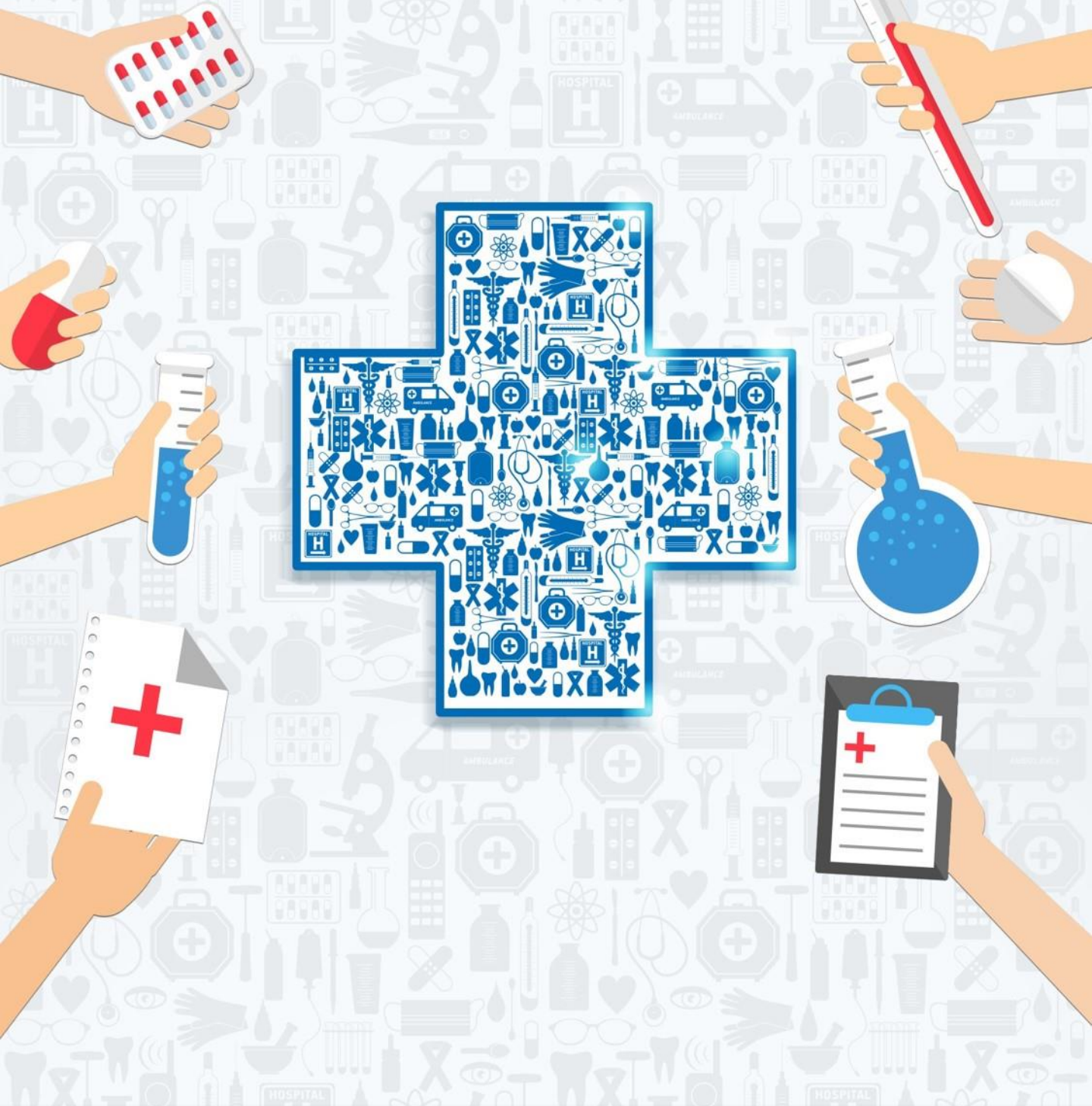


Dr. Reddy's Laboratories Ltd



Dr. Reddy's Laboratories Ltd

Lack of near term key product launches to affect growth momentum

| | | | | | |
|------------------|---------------------|--------------------------|--------------------------------------|------------------------|---------------------------|
| CMP INR 6,121 | Target INR 6,460 | Potential Upside 5.5% | Market Cap (INR Mn) INR 10,18,730 | Recommendation HOLD | Sector Pharmaceuticals |
|------------------|---------------------|--------------------------|--------------------------------------|------------------------|---------------------------|

Result Highlights of Q3FY24:

- We anticipate ~7.0% and ~9.9% CAGR rise in revenue and net income over FY23-FY26E. Currently, the stock is trading at 18.3x/16.3x/17.1x based on our FY24E/FY25E/FY26E EPS estimates, respectively. We introduce FY26E EPS estimates and roll forward our valuation basis to FY26 EPS while increase our target price to INR 6,460/share (earlier Rs. 5,826), applying an unchanged ~18.0x multiple on FY26 EPS and downgrade our rating to HOLD (upside: 5.5%) from ACCUMULATE.
- In Q3FY24, Dr. Reddy's posted a 6.6% Y-o-Y (+4.8% Q-o-Q) rise in revenue to Rs. 72,368 Mn (vs. our estimate of Rs. 71,872 Mn). The overall slower sales growth (Y-o-Y) for Q3FY24 was largely driven by improved market share for its existing products in the US, continued momentum in Europe, and contribution from new products; partially offset by price erosion in certain existing products.
- Including higher income from sale of non – core brands, the company posted an 11.9% Y-o-Y (-6.4% Q-o-Q) rise in adjusted PAT to Rs. 13,919 Mn and an 11.0% Y-o-Y (-6.8% Q-o-Q) rise in reported PAT to Rs. 13,809 Mn in Q3FY24 (vs. our estimate of Rs. 13,846 Mn)

MARKET DATA

| | |
|---------------------|-------------|
| Shares outs (Mn) | 167 |
| Equity Cap (INR Mn) | 2,54,968 |
| Mkt Cap (INR Mn) | 10,18,730 |
| 52 Wk H/L (INR) | 6,149/4,285 |
| Volume Avg (3m K) | 43,625 |
| Face Value (INR) | 5 |
| Bloomberg Code | DRRD IN |

KEY FINANCIALS

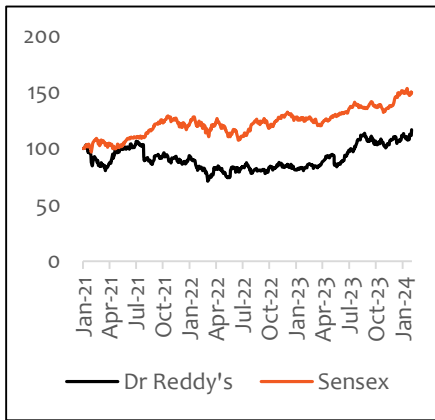
| INR Millions | FY 22 | FY 23 | FY 24E | FY 25E | FY 26E |
|----------------|---------|---------|---------|---------|---------|
| Revenue | 215,452 | 246,697 | 275,058 | 287,671 | 301,970 |
| EBITDA | 46,981 | 63,825 | 78,943 | 82,788 | 87,272 |
| Adj PAT | 28,395 | 45,073 | 55,768 | 62,572 | 59,863 |
| Adj. EPS (INR) | 170.6 | 271.5 | 334.3 | 375.1 | 358.9 |
| EBITDA Margin | 21.8% | 25.9% | 28.7% | 28.8% | 28.9% |
| Adjusted NPM | 13.2% | 18.3% | 20.3% | 21.8% | 19.8% |
| P/E | 46.7x | 22.6x | 18.3x | 16.3x | 17.1x |

Source: Company, KRChoksey Research

Revenue growth was driven by market share rise in existing products in the US, continuing growth trend in Europe and new product launches: In Q3FY24, Dr. Reddy's posted a 6.6% Y-o-Y (+4.8% Q-o-Q) rise in revenue to Rs. 72,368 Mn (vs. our estimate of Rs. 71,872 Mn). The growth was driven by US sales (53.1% of revenue) growing at 9.6% Y-o-Y (+5.7% Q-o-Q) to Rs. 33,492 Mn (vs. our estimate of Rs. 32,707 Mn), 4.7% Y-o-Y (-0.5% Q-o-Q) growth in India revenue (18.7% of revenue) to Rs. 11,800 Mn (vs. our estimate of Rs. 11,950 Mn), 15.5% Y-o-Y (-6.0% Q-o-Q) rise in Europe revenue (7.9% of revenue) to Rs. 4,970 Mn (vs. our estimate of Rs. 5,207 Mn) while PSAL revenue (10.9% of revenue) increased 1.0% Y-o-Y (+11.4% Q-o-Q) to Rs. 7,839 Mn (vs. our estimate of Rs. 7,913 Mn); partially offset by Emerging Market revenue declining at 2.0% Y-o-Y (+5.5% Q-o-Q) to Rs. 12,833 Mn (vs. our estimate of Rs. 13,359 Mn). The overall sales growth was largely driven by improved market share for its existing products in the US, continued momentum in Europe, and contribution from new products; partially offset by price erosion in certain existing products.

Price erosion affected the gross profitability while increased marketing and R&D expenses affected operating profitability: The company's gross profits margins (GPMs) reduced 59 bps Y-o-Y (-105 bps Q-o-Q) to 69.9% (vs. our estimate of 70.9%) in Q3FY24 due to price erosion on certain of its products; partially offset by improved products mix and productivity. Similarly, due to increased investments in sales and marketing activities, digitization, new business and innovation initiatives, and R&D spend, the company's EBITDA margins came in at 28.1% (vs. our estimate of 28.0%). The gross profits increased at 5.7% Y-o-Y (+3.3% Q-o-Q) to Rs. 50,608 Mn while EBITDA increased at 4.2% Y-o-Y (+1.0% Q-o-Q) to Rs. 20,341 Mn in Q3FY24. Consequently, including higher income from sale of non – core brands, the company posted an 11.9% Y-o-Y (-6.4% Q-o-Q) rise in adjusted PAT to Rs. 13,919 Mn and an 11.0% Y-o-Y (-6.8% Q-o-Q) rise in reported PAT to Rs. 13,809 Mn in Q3FY24 (vs. our estimate of Rs. 13,846 Mn) Reported EPS was at Rs. 82.8 vs. Rs. 74.8 in Q3FY23 and Rs. 88.9 in Q2FY24.

SHARE PRICE PERFORMANCE

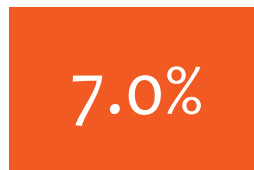


MARKET INFO

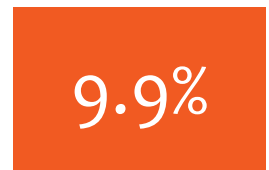
| | |
|--------|--------|
| SENSEX | 71,752 |
| NIFTY | 21,726 |

SHARE HOLDING PATTERN (%)

| Particulars | Dec-23 (%) | Sep-23 (%) | Jun-23 (%) |
|-------------|------------|------------|------------|
| Promoters | 26.7 | 26.7 | 26.7 |
| FIIIs | 28.6 | 28.2 | 27 |
| DIIIs | 18.7 | 21.0 | 22.0 |
| Others | 26 | 24.1 | 24.3 |
| Total | 100 | 100 | 100 |



Revenue CAGR between FY23 and FY26E



Adj. PAT CAGR between FY23 and FY26E

Dr. Reddy's Laboratories Ltd

Key Concall Highlights:

- Guidance:** The company expects normalized ETRs to be in the range of 24%-25% for FY24. The company is tracking to clock in double digit growth in Emerging Markets and India markets in the coming quarters. India remains a priority market with focus on growing generics as well. India market growth for the company is expected to be at 1.5x the IPM growth. The company expects the PSAI segment revenue to improve on the back of collaboration with regional and global players. R&D spend is towards bringing in value accretive products including several generic injectable and biosimilar, which is pivotal for the growth ahead. For the US market, Lenalidomide will continue to be meaningful. Also, price environment and existing products will continue to be conducive for growth. Investments in brands will start showing up in FY25's growth in India as the company is intending to create demand for those brands. The company plans to launch 26 products in the US over the next 2 years. Out of these 2 products are from FTO-3. Some of the investments in products will be contributing only from FY26 onwards up-till FY27 to offset the impact of loss of exclusivity with respect to limited quantity sales of Lenalidomide from Jan 26. CDMO business may not have huge capital allocation and in the overall scheme of things it will be relatively a smaller segment.
- Financial highlights:** Dr. Reddy's growth in revenue was driven by contribution from both base business and new product launches GPM was lower both Y-o-Y and Q-o-Q due to price erosions partially offset by improved products mix and productivity. Operating margins were lower due to increased sales and marketing, digitization capabilities, and new business and innovation initiatives. R&D spend was at Rs. 5,570 Mn (USD 67 Mn), up 15.0% Y-o-Y (+2.0% Q-o-Q, 7.7% of sales) in Q3FY24. The increased investments in R&D is a result of ongoing clinical trials on differentiated assets and developmental efforts that can build healthy pipeline of new products for both small molecule as well as biosimilar. The other income was higher due to sale of non current assets. ETR was at 24.5% in Q3FY24, marginally higher Y-o-Y, due to increase in the proportion of the company's profits coming from higher tax jurisdiction; partly offset by adoption of corporate tax rate under section 115BAA of the Income Tax Act of India. Operating working capital increased Q-o-Q due to increased inventory and receivables. FCF before acquisition related payout was at Rs. 220 Mn (USD 2.6 Mn). As a result, the company has a cash surplus of Rs. 59,070 Mn (USD 710 Mn) as of Q3FY24
- North America business:** The company's US generic business recorded sales of USD 401 Mn in Q3FY24, up 7.0% Y-o-Y (+4.0% Q-o-Q). The company launched 4 new products in Q3FY24. The company has bought MenoLabs portfolio, a women health and dietary supplement brands in the US in Q4FY24 that can complement well with the US healthcare and wellness business portfolio. The base business is expected to continue to grow driven by the inventory it has built in the US in the backdrop supply challenges and kind of service offerings and the relationship it has with the customers besides the recent acquisitions and 3-4 in-licensing agreements the company has entered into.
- Europe business:** The segment recorded revenue of EUR 55 Mn, up 8% Y-o-Y (-6.0% Q-o-Q) in Q3FY24, which was driven by new product launches and improvement in the base business volumes, which partially offset the price erosion. The company launched 6 new products in the segment in Q3FY24. Also, in Q4FY24, the company entered into UK OTC consumer health market by launching an allergy medication Histallay.
- Emerging market business:** The segment recorded revenue of Rs 1,2830 Mn, down 2% Y-o-Y (+6.0% Q-o-Q) in Q3FY24, which was driven by new product launches and price increases taken in certain markets; partially offset by unfavorable forex. The company launched 30 new products in Q3FY24 across various countries of the emerging markets. Russia grew at 3.0% Y-o-Y (+7.0% Q-o-Q) on a constant currency basis.
- India business:** The segment recorded sales of Rs. 11,800 Mn, up 5.0% Y-o-Y with a marginal Q-o-Q decline in Q3FY24. The company has forayed into Digital Therapeutics in India as a part of the company intension to bring innovation.
- Biosimilar and Biologics development:** The company has entered into a collaboration with US based Coya Therapeutics Inc. in Q3FY24 for development and commercialization of Coya 302 which is an investigational combination biologics for treatment of neurodegenerative disease called Amyotrophic Lateral Sclerosis (ALS). The company has received approval from UK-MHRA for proposed rituximab biosimilar. The company is planning to launch 6 products from H2FY27-FY30 subject to gaining approvals for it and winning patent cases for the same. Some more products are likely during FY31-FY35 as well. These are expected to be first biosimilar or the first way launch.
- Inorganic growth updates:** The company has acquired a leading women's health and dietary supplement portfolio of brands called MenoLabs in the US in Q3FY24. This should aid in the company's ambition to grow its OTC segment revenue in the US which stands at ~10% of revenue on an annualized basis. In addition, the company has entered in the UK consumer health space with the launch of an anti-hay fever medicine Histallay as an OTC offering. The company has been taking measures to strengthen its OTC business globally. Mayne Pharma's acquisition is also contributing to growth as expected (acquired in the US in Feb 23)
- Regulatory updates on plants and filings:** The company has completed a routine USFDA cGMP inspection of its formulation manufacturing FTO-3 in Oct 23 and GMP and pre-approval inspection (PAI) at its R&D facility in Dec 23 with 10 and 3 observations, respectively. The company has submitted a response within the stipulated time. The company has 9 global generic filings done including 2 ANDAs in the US in Q3FY24. The company has bagged 9 approvals in China since the beginning of FY24 and 3 in Q3FY24 indicating strong momentum for China. For 9MFY24, the company has launched 12 products in the US. The company has carried out 8 new filings and its pending ANDAs have reduced from 90 in Q4FY22 to 79 as of Q3FY24 because the company intends to do product filings which are meaningful. However, 79 ANDAs are also healthy. The company plans to launch 20 products in FY24. Remediation measures at FTO -3 is underway.
- ESG Update:** The company's efforts in ESG has been gaining pace. The company becomes the first Indian Pharma company to be featured in the Dow Jones Sustainability World Index for 2023 and retain its place in the Emerging Market Index for the 8th time in a row. Additionally, it was given Gold Medal status by EcoVadis. The company witnessed its MSCI ESG Rating improve to BBB from BB. Also, the company was awarded with Golden Peacock for corporate social responsibility 2023.

Valuation and view:

The company has been seeing deceleration in the revenue growth owing to lack of any near term key product launches that can propel the growth higher in the short term. The company is underway with building the product pipeline, which can offset the impending impact of likely reduction in sales from Lenalidomide from H2FY26. Investments in product pipeline and marketing continues to weigh on the results; partially offset by improved products mix and productivity. **We anticipate ~7.0% and ~9.9% CAGR rise in revenue and net income over FY23-FY26E. Currently, the stock is trading at 18.3x/16.3x/17.1x based on our FY24E/FY25E/FY26E EPS estimates, respectively. We introduce FY26E EPS estimates and roll forward our valuation basis to FY26 EPS while increase our target price to INR 6,460/share (earlier Rs. 5,826), applying an unchanged ~18.0x multiple on FY26 EPS and downgrade our rating to HOLD (upside: 5.5%) from ACCUMULATE.**

Dr. Reddy's Laboratories Ltd

KEY FINANCIALS

Exhibit 1: Revenue Segments

| Segment-wise Revenue (INR Mn) | Q3FY23 | Q4FY23 | Q1FY24 | Q2FY24 | Q3FY24 |
|-------------------------------|---------------|---------------|---------------|---------------|---------------|
| Total Sales | 67,700 | 62,968 | 67,384 | 68,802 | 72,148 |
| Global Generics | 59,241 | 54,257 | 60,083 | 61,084 | 63,095 |
| North America | 30,567 | 25,321 | 31,978 | 31,700 | 33,492 |
| Europe | 4,303 | 4,960 | 5,071 | 5,286 | 4,970 |
| India | 11,274 | 12,834 | 11,482 | 11,860 | 11,800 |
| Emerging Markets | 13,097 | 11,142 | 11,552 | 12,163 | 12,833 |
| PSAI | 7,758 | 7,787 | 6,709 | 7,034 | 7,839 |
| PP & Others | 701 | 924 | 592 | 684 | 1,214 |

| Segment-wise Growth YoY (%) | Q3FY23 | Q4FY23 | Q1FY24 | Q2FY24 | Q3FY24 |
|-----------------------------|---------------|--------------|---------------|-------------|--------------|
| Total Sales | 27.3% | 20.6% | 29.2% | 9.1% | 6.6% |
| Global Generics | 33.1% | 23.4% | 35.6% | 9.2% | 6.5% |
| North America | 63.9% | 26.8% | 79.5% | 13.2% | 9.6% |
| Europe | 6.0% | 11.6% | 22.5% | 25.9% | 15.5% |
| India | 9.8% | 38.0% | -13.9% | 3.1% | 4.7% |
| Emerging Markets | 13.5% | 8.8% | 28.0% | -0.7% | -2.0% |
| PSAI | 6.7% | 3.0% | -5.4% | 9.3% | 1.0% |
| PP & Others | -50.6% | 33.3% | -20.0% | 1.0% | 73.2% |

| Segment-wise Contribution (%) | Q3FY23 | Q4FY23 | Q1FY24 | Q2FY24 | Q3FY24 |
|-------------------------------|---------------|---------------|---------------|---------------|---------------|
| Total Sales | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |
| Global Generics | 87.5% | 86.2% | 89.2% | 88.8% | 87.5% |
| North America | 45.2% | 40.2% | 47.5% | 46.1% | 46.4% |
| Europe | 6.4% | 7.9% | 7.5% | 7.7% | 6.9% |
| India | 16.7% | 20.4% | 17.0% | 17.2% | 16.4% |
| Emerging Markets | 19.3% | 17.7% | 17.1% | 17.7% | 17.8% |
| PSAI | 11.5% | 12.4% | 10.0% | 10.2% | 10.9% |
| PP & Others | 1.0% | 1.5% | 0.9% | 1.0% | 1.7% |

Source: Company, KRChoksey Research

Exhibit 2: Profit & Loss Statement

| INR Millions | FY 22 | FY 23 | FY 24E | FY 25E | FY 26E |
|--------------------------------------|----------------|----------------|----------------|----------------|----------------|
| Revenues | 215,452 | 246,697 | 275,058 | 287,671 | 301,970 |
| COGS | 74,422 | 76,577 | 81,406 | 87,162 | 91,494 |
| Gross profit | 141,030 | 170,120 | 193,653 | 200,509 | 210,476 |
| Employee cost | 38,858 | 46,466 | 49,246 | 47,818 | 49,825 |
| Other expenses | 55,191 | 59,829 | 65,464 | 69,904 | 73,379 |
| EBITDA | 46,981 | 63,825 | 78,943 | 82,788 | 87,272 |
| EBITDA Margin | 21.81% | 25.87% | 28.70% | 28.78% | 28.90% |
| Depreciation & amortization | 11,652 | 13,176 | 14,471 | 14,847 | 15,585 |
| EBIT | 35,329 | 50,649 | 64,472 | 67,940 | 71,687 |
| Interest expense | 958 | 1,428 | 1,482 | 1,566 | 1,644 |
| Other income | 4,844 | 10,919 | 9,048 | 8,594 | 9,021 |
| PBT | 29,911 | 60,115 | 72,038 | 74,968 | 79,064 |
| Tax | 8,789 | 15,412 | 17,382 | 18,396 | 19,401 |
| Share of Profit/(Loss) of Associates | 703 | 370 | 1,112 | 6,000 | 200 |
| PAT | 21,825 | 45,073 | 55,768 | 62,572 | 59,863 |
| EPS (INR) | 131.2 | 271.5 | 334.3 | 375.1 | 358.9 |
| Adj. PAT | 28,395 | 45,073 | 55,768 | 62,572 | 59,863 |
| Adj EPS (INR) | 170.6 | 271.5 | 334.3 | 375.1 | 358.9 |

Source: Company, KRChoksey Research

Dr. Reddy's Laboratories Ltd

Exhibit 3: Cash Flow Statement

| INR Millions | FY 22 | FY 23 | FY 24E | FY 25E | FY 26E |
|---|----------|----------|----------|----------|----------|
| Net Cash Generated From Operations | 28,108 | 58,875 | 64,127 | 68,878 | 72,980 |
| Net Cash Flow from/(used in) Investing Activities | (26,387) | (41,373) | (22,544) | (23,584) | (24,756) |
| Net Cash Flow from Financing Activities | (2,422) | (26,861) | (1,482) | (1,566) | (1,644) |
| Net Inc/Dec in cash equivalents | (701) | (9,359) | 40,102 | 43,729 | 46,580 |
| Opening Balance | 14,820 | 14,852 | 5,779 | 45,881 | 89,609 |
| Adjustment | 733 | 286 | 0 | 0 | 0 |
| Closing Balance Cash and Cash Equivalents | 14,852 | 5,779 | 45,881 | 89,609 | 136,189 |

Source: Company, KRChoksey Research

Exhibit 4: Key Ratios

| Key Ratio | FY 22 | FY 23 | FY 24E | FY 25E | FY 26E |
|----------------------------|-------|-------|--------|--------|--------|
| EBITDA Margin (%) | 21.8% | 25.9% | 28.7% | 28.8% | 28.9% |
| Tax rate (%) | 29.4% | 25.6% | 24.1% | 24.5% | 24.5% |
| Adj. Net Profit Margin (%) | 13.2% | 18.3% | 20.3% | 21.8% | 19.8% |
| RoE (%) | 14.8% | 19.4% | 19.3% | 17.8% | 14.6% |
| RoCE (%) | 15.8% | 20.8% | 21.5% | 18.7% | 17.0% |
| Current Ratio (x) | 1.82 | 2.38 | 2.77 | 3.18 | 3.59 |
| Adj. EPS (INR) | 170.6 | 271.5 | 334.3 | 375.1 | 358.9 |

Source: Company, KRChoksey Research

Exhibit 5: Balance Sheet

| INR Millions | FY 22 | FY 23 | FY 24E | FY 25E | FY 26E |
|--------------------------------------|----------------|----------------|----------------|----------------|----------------|
| EQUITY AND LIABILITIES | | | | | |
| Equity | | | | | |
| Equity share capital | 832 | 833 | 833 | 833 | 833 |
| Other equity | 191,292 | 232,028 | 287,796 | 350,368 | 410,231 |
| Shareholders Fund | 192,124 | 232,861 | 288,629 | 351,201 | 411,064 |
| Total Debt | 30,882 | 11,190 | 11,190 | 11,190 | 11,190 |
| Other NCL & Provisions | 3,873 | 3,509 | 3,912 | 4,092 | 4,295 |
| Trade payables | 22,662 | 22,684 | 24,114 | 25,820 | 27,103 |
| OCL & Provisions | 47,914 | 51,847 | 57,808 | 60,458 | 63,463 |
| Total equity and liabilities | 297,469 | 322,851 | 386,413 | 453,521 | 517,875 |
| ASSETS | | | | | |
| Property, plant and equipment | 48,869 | 56,542 | 63,106 | 70,259 | 77,767 |
| Capital work-in-progress | 12,796 | 9,752 | 9,752 | 9,752 | 9,752 |
| Goodwill | 5,473 | 5,474 | 5,474 | 5,474 | 5,474 |
| Investment in joint ventures | 4,318 | 4,702 | 5,814 | 11,814 | 12,014 |
| Other non-current asset | 19,511 | 10,742 | 11,166 | 11,355 | 11,569 |
| Total No-current assets | 119,646 | 118,596 | 128,205 | 143,131 | 152,716 |
| Inventories | 50,884 | 48,670 | 51,739 | 55,397 | 58,151 |
| Trade receivables | 66,764 | 72,485 | 80,818 | 84,524 | 88,725 |
| Other Current Assets | 25,150 | 21,302 | 23,751 | 24,840 | 26,075 |
| Cash and cash equivalents | 14,852 | 5,779 | 45,881 | 89,609 | 136,189 |
| Bank balances other than (iii) above | 0 | 11,523 | 11,523 | 11,523 | 11,523 |
| Total Current Assets | 177,823 | 204,255 | 258,208 | 310,390 | 365,159 |
| Total Assets | 297,469 | 322,851 | 386,413 | 453,521 | 517,875 |

Source: Company, KRChoksey Research

Dr. Reddy's Laboratories Ltd

| Dr. Reddy's Laboratories | | | |
|--------------------------|-----------|----------|----------------|
| Date | CMP (INR) | TP (INR) | Recommendation |
| 01-Feb-24 | 6,121 | 6,460 | HOLD |
| 13-Nov-23 | 5,458 | 5,826 | ACCUMULATE |
| 28-July-23 | 5,552 | 6,560 | BUY |
| 12-May-23 | 4,464 | 5,155 | BUY |
| 31-Oct-22 | 4,427 | 5,200 | BUY |
| 29-July-22 | 4,090 | 4,869 | BUY |
| 24-May-22 | 4,275 | 5,261 | BUY |

| Rating Legend (Expected over a 12-month period) | |
|---|----------------|
| Our Rating | Upside |
| Buy | More than 15% |
| Accumulate | 5% – 15% |
| Hold | 0 – 5% |
| Reduce | -5% – 0 |
| Sell | Less than – 5% |

ANALYST CERTIFICATION:

I, Unnati Jadhav (MMS, Finance), Research Analyst, author and the name subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect my views about the subject issuer(s) or securities. I also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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