



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	✓	↔	✓

Company details

Market cap:	Rs. 104,042 cr
52-week high/low:	Rs. 5,986/4,288
NSE volume: (No of shares)	8.6 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	0.7	5.4	14.3	34.0
Relative to Sensex	0.4	2.4	1.3	8.8

Sharekhan Research, Bloomberg

Dr Reddy's Laboratories Ltd

Transition from generic to niche company

Pharmaceuticals

Sharekhan code: DRREDDY

Reco/View: Buy



Upgrade



Maintain



Downgrade

CMP: Rs. 6,250

Price Target: Rs. 6,537

Summary

- We reiterate our Buy rating on Dr. Reddy's after interacting with the management of the company in our recent visit to Hyderabad where they are positive on growth momentum led by Horizon 1 and Horizon 2 strategy.
- North America to clock a 7% CAGR from FY24-26E driven by 25 new product launches in the generics segment (either FTFs or in the 1st wave), gRevlimid and biosimilar launches.
- India sales to grow in double digits led by internal restructuring of MRs leading to higher productivity, expanding into digital therapeutic and OTC/nutraceutical products.
- Stock trades at attractive valuation of 18x and 16x its FY2025E and FY2026E estimates. The company is focusing on shifting its focus to pure generics company to Biosimilars, digital therapeutics, nutraceuticals, CDMO segment hence we maintain a Buy with a PT of Rs. 6,537.

We reiterate our BUY call on the stock post our interaction with the company management in our recent visit to Hyderabad. The company is focused to maintain the growth momentum. The company has identified 25 new generics with double-digit market size to be launched in the North America region in FY25E, which would enjoy either FTF or to be launch in the 1st wave. In the India region, the company has 5800 medical representatives (MRs) and current restructuring to lead to higher productivity. The company has higher acute portfolio with 65% of the sales driven by acute therapies. The company currently caters to 700-800 million patients in India and going forward intends to cater to a 1.5 billion population in the domestic region. The company is shifting its strategy from pure generic company to bringing innovation to country by focusing on value added products like digital therapeutics, over-the-counter (OTC) drugs, Nutraceuticals, and wellness products in India. Hence we maintain our Buy recommendation on the stock.

Biosimilars to drive next leg of growth in North America region

Dr.Reddy's US sales growth was largely driven by gRevlimid in FY24E. In FY25E too we expect gRevlimid to remain a meaningful contributor. Apart from gRevlimid, the company has a healthy pipeline of 20+ products in the complex generics space, where it does not have competitors. The company has identified ~25 products with either FTF or to be filed in the 1st wave especially in the injectables space. The company is also focusing on Biosimilar launches where it has 6 assets to be launch by FY32. The company has launched **Pegfilgrastim** with its partner Fresenius Kabi. Another Biosimilar **Rituximab** has completed its clinical trials, filed with US and Europe and is awaiting USFDA approval. **Tocilizumab** – completed phase 1 studies and initiated phase-3 studies while **Bevacizumab** – received UK MHRA approval. Due to a slew of bisosimilar launches, FTFs in complex generics and meaningful gRevlimid sales till January 2026, we believe North America would continue to clock a 7%CAGR by FY24-26E.

Dr. Reddy's India market growth to surpass IPM in FY25E

The India market grew in single digit due to divestment of non-core products and Cidmus (Sucubritil + Valsartan) going off-patent but going forward the company expects to surpass the IPM's growth and grow in double digit by bringing a science-based innovation technique to India. India growth to be driven by digital therapeutic where the company has partnered with an Israeli company to manufacture a device called Nerivio (preamp migraine attack). In the generic portfolio, the company has 15 brands in the top 300 brands and 10 brands with size of Rs 100 crore each. The company currently caters to 700- 800 million population and intends to attend 1.5 billion patients by FY30. The company also plans to diversify into biosimilars and intends to launch 6 biosimilars in India. Biosimilars currently contributes ~2% of the domestic sales, which is expected to increase significantly due to lower base. The company also plans to diversify into vaccine portfolio where it has entered into agreement with Sanofi Healthcare India. The company has entered exclusive distribution partnership to distribute vaccines in India which clocked sales of Rs 426 crore in FY23 as per IQVIA. We believe all these measures to aid company in surpassing IPM growth rate in the near term. All these parameters to aid EBITDA margin profile of the India business to be better than the US generic business.

Healthy margins to retain post gRevlimid

Dr. Reddy's expects to retain healthy margins. Currently gRevlimid is the major contributor for margin increment to 29%. gRevlimid to continue to contribute higher in FY25E, hence margins are expected to sustain at current levels. Currently, the Red Sea crisis led the company to take longer route resulting in increased freight/logistic cost but this would be offset by financial muscle and other value-added products like 1) Nerivio – digital therapeutics, 2) Biosimilar launches in the US region, 3) stabilizing of price erosion in the base portfolio, and 4) FTF or 1st wave launches in the identified 20 new complex generic products in the US region. Hence, we expect Dr.Reddy's margins to report 25% plus by FY26E.

Our Call

View – Maintain a Buy with a PT of Rs. 6,537: We believe the company is on track to sustain its superior performance both organically and inorganically. The company has strategized its growth vision into Horizon 1 and Horizon 2. The Horizon1 which includes core portfolio growth of generics, branded generics, APIs, OTCs could not boost growth hence have strategized Horizon 2 which have value added products such as CDMOs, Biologics, NCEs/NBEs, Digital Therapeutics and wellness/ OTC products which would aid growth. The company has cash of ~US\$ 700 mn which to be utilised for inorganic growth aiding in maintaining a 25% ROCE. The stock is currently trading at an attractive valuation of 16x and 14x its FY2025mE and FY2026E EPS of Rs. 348.5 and Rs. 391.5 per share, respectively. Due to sustained growth prospects in regulated markets such as the US & Europe, the India market is expected to surpass IPM growth and higher margin trajectory, we ascribe a P/E of 17x on FY2026E EPS of Rs 391.5 per share to arrive at price target (PT) of Rs. 6,537.

Key Risks

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

Valuation (consolidated)

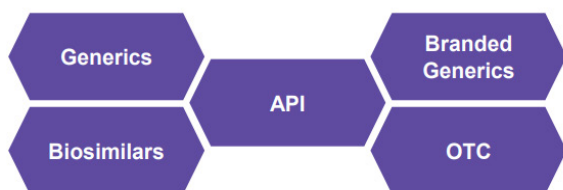
Particulars	FY2022	FY2023	FY2024E	FY2025E	FY2026E
Net sales	21439.1	24587.9	28238.3	31161.9	34146.3
EBITDA	4886.2	7047.9	8203.2	9239.5	10397.5
EBITDA (%)	22.8	28.7	29.1	29.7	30.5
Adj PAT	2356.8	4506.7	5302.4	5785.2	6498.1
Adj. EPS (Rs)	171.0	243.3	319.4	348.5	391.5
PER (x)	24.8	25.7	19.5	17.9	15.9
EV/Ebitda (x)	14.2	14.0	11.8	10.2	8.6
RoNW (%)	15.5	19.2	20.9	19.1	18.2
RoCE (%)	18.8	26.3	27.0	25.7	24.7

Source: Company; Sharekhan estimates

Strategizing growth through Horizons

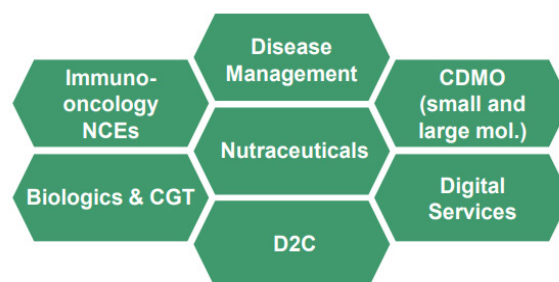
We continue to progress on our journey in two horizons...

Horizon 1 – Growing the core



(drivers in short to medium-term)

Horizon 2 – Building the future



(drivers in short to long-term)

Source: Company

The company has strategised its growth through Horizon, where the cash flow generated through Horizon 1 is ploughed back as capex for Horizon 2. Though Horizon 1's success is largely driven by gSuboxone and gRevlimid, Horizon 2's success would be driven by the launch of niche products with lesser competition.

The following products are to be launched in Horizon 2-

1- Biosimilars in the US market where out of 6, only two products to be launched through partner Fresenius Kabi. The remaining 4 biosimilars to be launched by the company on its own over FY30E-32E. The company has 5-6 assets in the biosimilars space with the following status

- Tocilizumab** – completed phase 1 study and initiated phase 3 studies.
- Rituximab** – full set of clinical studies completed – filing in USA and Europe- awaiting USFDA inspection.
- Pegfilgrastim** – partner launched in USA and Europe
- Bevacizumab** – received UK MHRA approval.

2. Disease Management –

a- **Nerivio** – The company has collaborated with an Israeli company and launched this product in the Indian market. This is the first science-based innovation product company has launched in the Indian market. This product is also one of its kind to treat migraine which cost around Rs 14,000-15,000 per unit. The company intends to focus on creating brands in such products through collaboration as it is less R&D intensive.

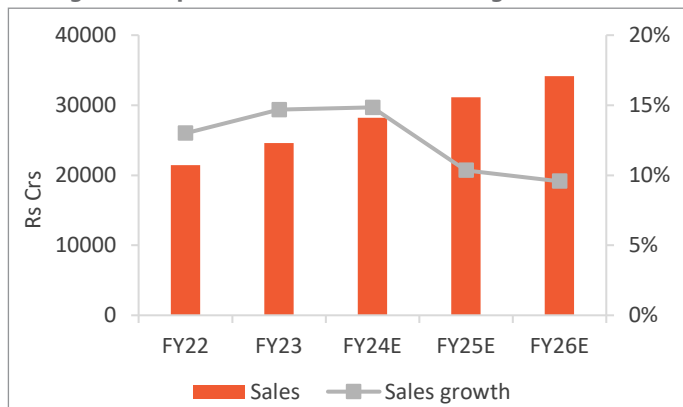
3. **NBE/ NCE molecules** – The company intends to enter NBE segment through larger molecules and NCE segment through smaller molecules through innovation and have lesser competition.

4. **CDMO** – The company is currently focusing on CDMO segment through small molecules. Currently as the CDMO size is small, they have clubbed CDMO with APIs. Going forward, the company intends to report its CDMO business separately as it widens in scale.

The above drivers would result in company-level sales growing in double digits, sustained margin increment and a steady 25% plus ROCE post gRevlimid.

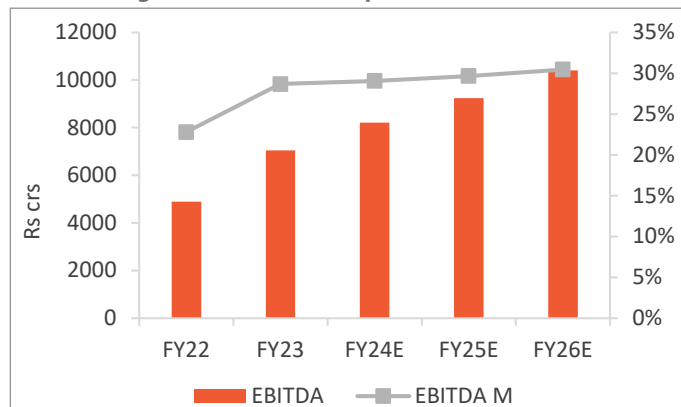
Financials in charts

Sales growth expected to remain in double digits



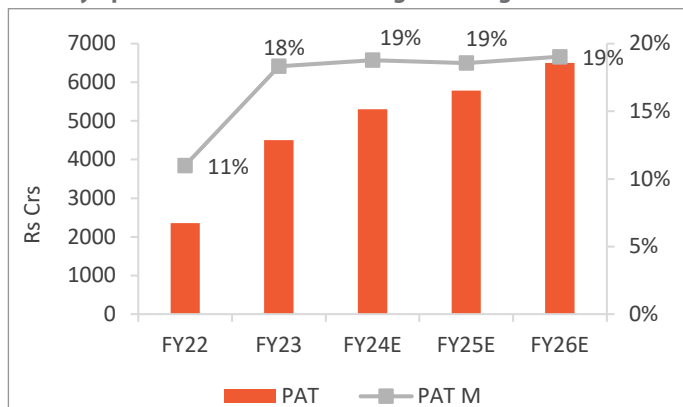
Source: Company, Sharekhan Research

EBITDA Margin to sustain at 25% plus



Source: Company, Sharekhan Research

Healthy operations resulted in strong PAT Margins



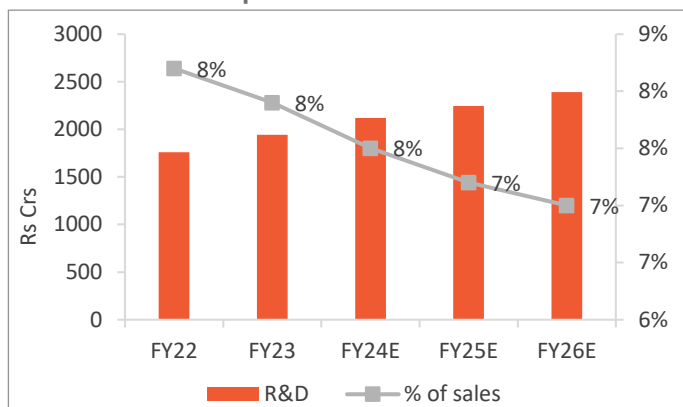
Source: Company, Sharekhan Research

EPS growth expected to be highest ever



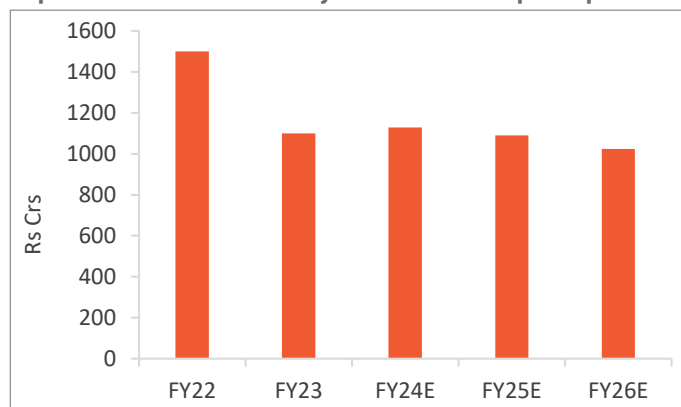
Source: Company, Sharekhan Research

R&D as a % to sales expected to decline



Source: Company, Sharekhan Research

Capex to slow down as no major incremental Capex expected



Source: Company, Sharekhan Research

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 seeing an easing of input costs such as 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 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 US 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 US generics and speciality business would fuel US 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 a Buy with a PT of Rs. 6,537

We believe the company is on track to sustain its superior performance both organically and inorganically. The company has strategized its growth vision into Horizon 1 and Horizon 2. The Horizon1 which includes core portfolio growth of generics, branded generics, APIs, OTCs could not boost growth hence have strategized Horizon 2 which have value added products such as CDMOs, Biologics, NCEs/NBEs, Digital Therapeutics and wellness/ OTC products which would aid growth. The company has cash of ~US\$ 700 mn which to be utilised for inorganic growth aiding in maintaining a 25% ROCE. The stock is currently trading at an attractive valuation of 16x and 14x its FY2025mE and FY2026E EPS of Rs. 348.5 and Rs. 391.5 per share, respectively. Due to sustained growth prospects in regulated markets such as the US & Europe, the India market is expected to surpass IPM growth and higher margin trajectory, we ascribe a P/E of 17x on FY2026E EPS of Rs 391.5 per share to arrive at a price target (PT) of Rs. 6,537.

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

- 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: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	APS Trust	20.59
2	Life Insurance Corporation	5.16
3	Blackrock Inc	2.83
4	First State Investments ICVC	2.70
5	Vanguard Group Inc	2.44
6	HDFC AMC	1.60
7	SBI Funds Management	1.43
8	Republic of Singapore	1.07
9	Norges Bank	1.06
10	ICICI Prudential AMC	0.86

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 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

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