

Dr Reddy's Laboratories (DRRD)

Pharmaceuticals | NBIE conference Update

ACCUMULATE

CMP: Rs6,376 | Target Price (TP): Rs6,553 | Upside: 2.8%

February 21, 2024

US and Europe to drive growth

Key Points

- We hosted the management of Dr. Reddy's Laboratories to gain insights into the current business outlook. New launches in the US and the EU are expected to drive growth.
- Growth in the US is being led by both base business as well as limited volume products, with a mix of complex and non-complex filings. Emerging Markets (EM) strategy focuses on brand building and leveraging products developed for the US and Europe.
- In India, emphasis is on core business and innovation in three areas: innovative assets, consumer health and digital. Strong growth is expected in the Gx segment in the near term on the back of Revlimid, stable base business performance and key launches in the Developed Markets (DM). The company is actively spending on complex products, Biosimilars and Horizon II.
- We maintain ACCUMULATE on DRL with a revised target price (TP) of Rs6,553, valuing it at 24x PE on Dec'25E base EPS of Rs264 and NPV of Rs212 for the Revlimid opportunity.

US & EU: The US market has demonstrated growth in both base business as well as limited volume launches such as Lenalidomide (Revlimid). Europe continues to perform well. The company aims to launch 20-25 new products annually, comprising a mix of complex and non-complex filings. Biosimilars and Consumer Health initiatives are expected to contribute to US growth. Regarding the Coxa Therapeutics deal, the Coxa product is currently in phase 2, awaiting trial data and FDA discussions for commercialization. In Europe, the company focuses on generic growth with additional layers of innovation in Consumer Health and Biosimilars segments.

India business: In India, the focus is on the core business and innovation in three key areas: innovative assets, consumer health and digital. The India business grew by 5% YoY, but a 1% decline QoQ was attributed to a decrease in plant seed prices and divestment. Strategies for growth include innovative assets, consumer health initiatives and digital therapeutics. The company management anticipates pay-offs from these initiatives in the coming quarters. As part of the Digital Therapeutic initiative, the company has launched Nerivio for the treatment of Migraines.

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Est Change	Upward
TP Change	Maintain
Rating Change	Maintain

Company Data and Valuation Summary

Reuters:	REDY.BO
Bloomberg:	DRRD IN Equity
Mkt Cap (Rsbn/US\$bn):	1,059.1 / 12.7
52 Wk H / L (Rs):	6,465 / 4,297
ADTV-3M (mn) (Rs/US\$):	2,738.3 / 32.9
Stock performance (%) 1M/6M/1yr:	12.7 / 7.4 / 41.5
Nifty 50 performance (%) 1M/6M/1yr:	2.8 / 11.4 / 25.6

Shareholding	1QFY24	2QFY24	3QFY24
Promoters	26.7	26.7	26.7
DII's	22.0	21.0	18.7
FII's	27.0	28.2	28.6
Others	11.8	10.1	10.8
Pro pledge	0.0	0.0	0.0

Financial and Valuation Summary

Particulars (Rsmn)	FY23	FY24E	FY25E	FY26E
Net sales	245,879	276,941	294,203	310,237
EBITDA	63,873	73,850	71,741	70,277
Net profit	45,067	50,553	49,054	47,720
EPS (Rs)	271.5	304.5	295.5	287.5
EPS growth (%)	58.3	12.2	-3.0	-2.7
EBITDA margin (%)	26.0	26.7	24.4	22.7
PER (x)	23.5	20.9	21.6	22.2
EV/Sales (x)	4.1	3.6	3.3	3.0
EV/EBITDA (x)	15.8	13.4	13.4	13.2
RoCE (%)	19.0	19.1	16.3	14.1
RoE (%)	21.4	20.1	16.9	14.5
ROIC(%)	24.4	25.6	23.1	21.9

Source: Bloomberg, Company, Nirmal Bang Institutional Equities Research

Please refer to the disclaimer towards the end of the document.

Other Highlights

EMs

- The EM strategy involves building brands and leveraging products developed for the US and Europe markets.
- Positive trends are expected in China due to the improved regulatory environment.

Other Points

- The company boasts of a healthy cash flow and a robust balance sheet and therefore it is actively seeking inorganic growth opportunities.
- India remains a priority for inorganic growth, primarily in the branded segment.
- The overall inorganic focus is on branded opportunities, encompassing both innovative as well as consumer health segments.

Employee productivity and up-skilling

- The focus is on improving productivity in manufacturing and sales & marketing.
- The 3-pronged approach for innovation involves buying talent, building capabilities and borrowing from companies with relevant expertise.

Valuation and Outlook

Excluding Revlimid, DRL's revenue is expected to clock a CAGR of 8.4% over FY23-FY25E with EBITDA margin likely remaining at ~24%. Revenue is expected to be mainly driven by strong growth in Branded Generics, including in India, Russia and other EMs. The US business (ex-Revlimid and Mayne acquisition) is likely to clock 6% CAGR over FY23-FY25E, driven by new product launches, partially offset by continuous price erosion in the base business. On the margin front, under Horizon 2, resumption of investments in the Speciality pipeline and persistent spending on complex generics & biosimilars are likely to affect margins. Net profit (ex-Revlimid) is expected to clock ~11% CAGR over FY23-FY25E, mainly led by a subdued operational performance.

The company is currently trading at 19.2x/19.7x PE on FY24E/FY25E and 12.2x/12.1x on FY24E/FY25E EV/EBITDA. ROE/ROCE is expected to be at 16%/15.4% in FY25E. We like DRL management's strategic decision-making ability and focus on OTC products in the US along with enhanced focus on the Branded business. However, restructuring and shift in focus from Gx to BRx markets are likely to weigh on near to medium term growth. Also, capital allocation is still high towards DM acquisition, complex products and the innovative pipeline. Spending on Horizon 2 opportunity (mainly due to innovation) and Biosimilars is likely to drag DRL's overall financials. We maintain ACCUMULATE on DRL with a revised TP of Rs6,553, valuing it at 24x PE on Dec'25E base EPS of Rs264 and NPV of Rs212 for the Revlimid opportunity.

Exhibit 1: One-year Rolling Forward P/E Chart



Source: BSE, Bloomberg, Company, Nirmal Bang Institutional Equities Research

Financial statements

Exhibit 2: Income statement

Y/E March (Rsmn)	FY22	FY23	FY24E	FY25E	FY26E
Net sales	212,617	245,879	276,941	294,203	310,237
% growth	12.1	15.6	12.6	6.2	5.4
Cost of Sales	100,551	106,536	118,677	130,442	140,493
Gross profit	112,066	139,343	158,264	163,762	169,744
% growth	8.7	24.3	13.6	3.5	3.7
R&D Expenditure	17,482	19,381	22,155	23,536	24,819
SG&A Expenditure	49,273	56,089	62,259	68,485	74,648
Total expenditure	167,306	182,006	203,091	222,463	239,960
Operating Profit	45,311	63,873	73,850	71,741	70,277
% growth	1.6	41.0	15.6	(2.9)	(2.0)
Operating Profit margin (%)	21.3	26.0	26.7	24.4	22.7
Extraordinary Items	(6,724)	-	-	-	-
Other Income	2,761	5,907	3,727	3,914	4,109
Finance (Expense) / Income	2,119	2,853	3,462	3,530	3,723
Depreciation & Amortisation	11,872	12,636	13,968	14,129	14,849
Share of Profit in Equity Investments	703	370	333	350	367
Profit before tax	32,298	60,367	67,405	65,405	63,627
% growth	22.3	86.9	11.7	(3.0)	(2.7)
Tax	8,730	15,300	16,851	16,351	15,907
Effective tax rate (%)	27.0	25.3	25.0	25.0	25.0
Reported PAT	23,568	45,067	50,553	49,054	47,720
Adjusted PAT	28,475	45,067	50,553	49,054	47,720
% growth	10.3	58.3	12.2	(3.0)	(2.7)
EPS (Rs)	172	271	305	296	287
% growth	10.3	58.3	12.2	(3.0)	(2.7)

*In IFRS format

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Balance sheet

Y/E March (Rsmn)	FY22	FY23	FY24E	FY25E	FY26E
Equity	832	833	833	833	833
Reserves	189,695	230,158	270,029	308,718	346,355
Net worth	190,527	230,991	270,862	309,551	347,188
Net deferred tax liabilities	-12,721	-6,363	-6,363	-6,363	-6,363
Short-term loans	28,099	12,194	7,194	7,194	7,194
Long-term loans	5,746	1,278	278	178	78
Other non-current liabilities	2,479	2,907	2,907	2,907	2,907
Liabilities	214,130	241,007	274,878	313,467	351,004
Intangible assets & goodwill	31,664	35,094	35,094	35,094	35,094
Net block	62,169	66,462	67,494	68,365	68,516
Other non-current assets	8,934	6,162	6,263	6,319	6,371
Inventories	50,884	48,670	60,699	64,483	67,997
Debtors	66,764	72,485	72,081	76,574	80,747
Cash	14,852	5,779	6,844	29,192	51,498
Loans and advances	31,419	57,250	67,250	77,250	87,250
Other current assets	17,187	22,756	25,291	26,700	28,009
Total current assets	181,106	206,940	232,165	274,199	315,501
Creditors	25,572	26,444	13,006	14,295	15,396
Other current liabilities	44,171	47,207	53,132	56,216	59,082
Total current liabilities	69,743	73,651	66,138	70,511	74,478
Net current assets	111,363	133,289	166,027	203,689	241,022
Total assets	214,130	241,007	274,878	313,467	351,004

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Cash flow

Y/E March (Rsmn)	FY22	FY23	FY24E	FY25E	FY26E
PBT	32,298	45,067	67,405	65,405	63,627
Depreciation	11,872	12,636	13,968	14,129	14,849
Net Chg in WC	(17,929)	(7,855)	(25,063)	(6,987)	(6,586)
Taxes	7,437	(10,714)	(16,851)	(16,351)	(15,907)
Others	(5,570)	20,027	3,289	1,618	1,506
CFO	28,108	59,161	42,747	57,814	57,489
Capex	(16,059)	(18,784)	(15,000)	(15,000)	(15,000)
Net Investments made	(11,201)	(23,366)	(10,000)	(10,000)	(10,000)
Others	873	777	-	-	-
CFI	(26,387)	(41,373)	(25,000)	(25,000)	(25,000)
Change in Share capital	334	368	-	-	-
Change in Debts	2,735	(20,397)	(6,000)	(100)	(100)
Div. & Div Tax	-4,146	-4,979	-10,682	-10,365	-10,083
Others	(621)	(1,853)	-	-	-
CFF	(1,698)	(26,861)	(16,682)	(10,465)	(10,183)
Total Cash Generated	23	(9,073)	1,065	22,349	22,306
Cash Opening Balance	14,829	14,852	5,779	6,844	29,192
Cash Closing Balance	14,852	5,779	6,844	29,192	51,498

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Key ratios

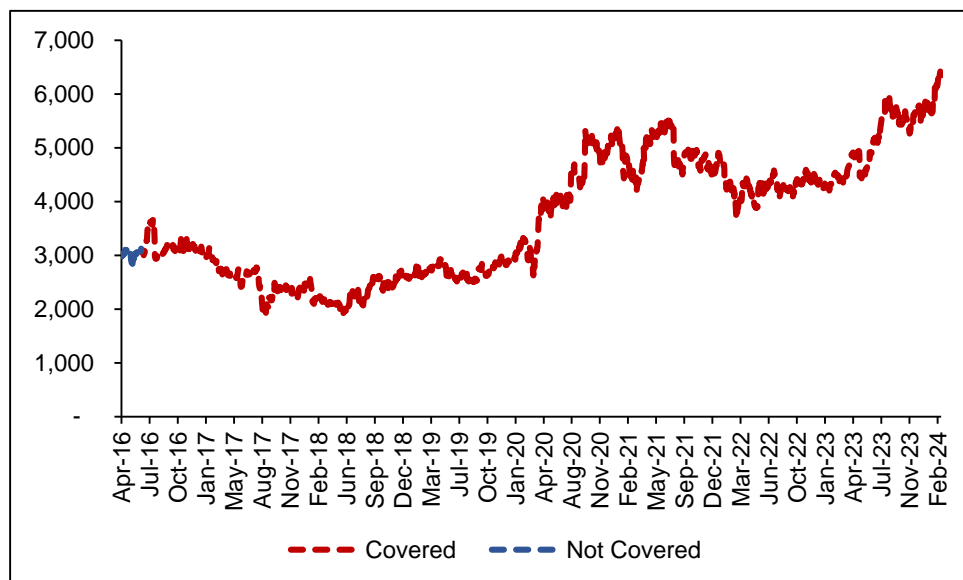
Y/E March	FY22	FY23	FY24E	FY25E	FY26E
Profitability & return ratios					
EBITDA margin (%)	21.3	26.0	26.7	24.4	22.7
Net profit margin (%)	13.4	18.3	18.3	16.7	15.4
RoE (%)	15.7	21.4	20.1	16.9	14.5
RoCE (%)	13.2	19.0	19.1	16.3	14.1
Working capital & liquidity ratios					
Receivables (days)	100	95	95	95	95
Inventory (days)	83	80	80	80	80
Payables (days)	42	40	40	40	40
Current ratio (x)	2.6	2.8	3.5	3.9	4.2
Quick ratio (x)	1.9	2.1	2.6	3.0	3.3
Leverage ratios					
Net Debt/Equity (x)	0.0	0.0	-0.2	-0.2	-0.3
Net Debt/EBITDA (x)	-0.2	-0.8	-0.9	-1.4	-1.9
Valuation ratios					
EV/sales (x)	4.9	4.1	3.6	3.3	3.0
EV/EBITDA (x)	23.1	15.8	13.4	13.4	13.2
P/E (x)	37.2	23.5	20.9	21.6	22.2
P/BV (x)	5.6	4.6	3.9	3.4	3.0

Source: Company, Nirmal Bang Institutional Equities Research

Rating Track

Date	Rating	Market price	Target price (Rs)
10 June 2016	Buy	3,160	3,950
27 July 2016	Buy	3,300	3,950
6 February 2017	Buy	3,142	3,950
15 May 2017	Buy	2,584	3,366
28 July 2017	Buy	2,620	3,020
1 November 2017	Buy	2,428	3,216
29 January 2018	Buy	2,508	3,077
23 May 2018	Buy	2,004	2,898
23 July 2018	Buy	2,059	2,898
27 July 2018	Buy	2,110	2,898
29 October 2018	Buy	2,405	3,122
4 February 2019	Accumulate	2,791	3,122
5 April 2019	Buy	2,772	3,348
20 May 2019	Buy	2,748	3,281
30 July 2019	Buy	2,653	3,281
23 September 2019	Accumulate	2,829	3,138
4 November 2019	Buy	2,755	3,138
28 January 2020	Accumulate	3,189	3,188
27 March 2020	Accumulate	2,945	3,333
23 April 2020	Sell	4,056	3,647
20 May 2020	Sell	3,911	3,647
30 July 2020	Sell	4,300	3,998
18 September 2020	Buy	4,827	5,656
23 September 2020	Accumulate	5,168	5,656
29 October 2020	Buy	4,950	5,737
27 November 2020	Buy	4,899	5,648
7 January 2021	Buy	5,292	6,231
1 February 2021	Buy	4,603	5,594
10 March 2021	Buy	4,448	5,594
5 April 2021	Buy	4,588	5,594
17 May 2021	Accumulate	5,197	5,782
28 July 2021	Accumulate	4,844	5,240
26 September 2021	Buy	4,777	5,515
31 October 2021	Buy	4,670	5,644
30 January 2022	Buy	4,218	5,689
21 February 2022	Buy	4,321	5,710
31 March 2022	Buy	4,351	5,349
20 May 2022	Buy	3,928	5,424
29 July 27, 2022	Buy	4,259	5,587
29 September 2022	Accumulate	4,267	4,468
29 October 2022	Accumulate	4,461	4,640
27 January 2023	Accumulate	4,200	4,745
16 March 2023	Accumulate	4,384	4,482
11 May 2023	Accumulate	4,868	4,762
19 July 2023	Accumulate	5,187	5,180
27 July 2023	Accumulate	5,437	5,788
29 October 2023	Accumulate	5,420	5,997
31 January 2024	Accumulate	5,835	6,553
21 February 2024	Accumulate	6,376	6,553

Rating Track Graph



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SELL < -5%

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