

Dr Reddy's Labs

Estimate change 

TP change 

Rating change 

CMP: INR5,841

TP: INR5,540 (-5%)

Neutral

NA/PSAI drive earnings

Higher working capital needs reduce free cash flow for the quarter

- Dr. Reddy's Labs (DRRD) delivered a marginally better-than-expected performance for the quarter, led by healthy traction in the North America (NA) and Pharmaceutical Services & Active Ingredients (PSAI) segments. The India business has been witnessing moderation in YoY growth for three quarters now. DRRD continues to invest on its product pipeline, and marketing initiatives across key markets. The benefits are expected from FY25 onwards.
- We raise our earnings estimates by 7%/5%/4% for FY24/FY25/FY26 factoring in: 1) market share expansion in key products, 2) new launches, and 3) better operating leverage. We value DRRD on an SOTP basis (22x 12M forward P/E for the base business and adding NPV of INR90 for g-Revlimid) to arrive at our TP of INR5,540.
- Even after raising our earnings estimates, we expect a modest 3% earnings CAGR over FY24-26. Further, the product-specific concentration of earnings remains elevated for DRRD. **Reiterate Neutral.**

Higher SG&A expenses hurt margins for the quarter

- DRRD's 3QFY24 revenue grew 7% YoY to INR72b (vs. est. of INR69b).
- The US sales rose 9% YoY to INR33.5b (~USD401m; 46% of sales), led by market share expansion in existing key products and revenue from new product launches, partly offset by price erosion. The EU sales grew 15% YoY to INR5b (7% of sales). India sales rose 5% YoY to INR12b (16% of sales). This was led by new launches. However, the EM sales declined 2% YoY to INR13b (17% of sales). The business was hit by unfavorable forex movements. PSAI segment's revenue was flat YoY to INR7b (11% of sales).
- Gross margin (GM) contracted 70bp YoY to 58.5%, as the GG segment witnessed lower GM (down 260bp YoY as a % of sales) for the quarter.
- However, EBITDA margin contracted at a higher rate of 220bp YoY to 28% (our est: 27.8%) due to higher SG&A (+90bp YoY as a % of sales) and R&D (+60bp YoY as % of sales) expenses. EBITDA grew marginally by 2% YoY to INR20b (our est: INR19b).
- R&D expenses stood at INR5.6b (7.7% of sales).
- DRRD reported a PAT of INR13.8b (our est: INR12b), up 5% YoY.
- In 9MFY24, revenue/EBITDA/PAT grew 15%/24%/25% YoY to INR208b/INR61b/INR41b.

Highlights from the management commentary

- DRRD expects to launch 26 products in the US over the next two years. Of these, about two products are from FTO-3.
- It aims for biosimilar product launches in the US/EU starting in CY27.
- Management expects the base business in India to grow in double digits YoY in the coming quarters.
- DRRD has strong capabilities in developing and manufacturing peptides, and the company is well-positioned to monetize GLP-1 opportunities, considering relevant patent situations.

Bloomberg	DRRD IN
Equity Shares (m)	167
M.Cap.(INRb)/(USDb)	974.3 / 11.7
52-Week Range (INR)	5990 / 4281
1, 6, 12 Rel. Per (%)	2/-5/13
12M Avg Val (INR M)	2288

Financials & Valuations (INR b)

Y/E MARCH	FY24E	FY25E	FY26E
Sales	278.9	306.1	340.5
EBITDA	80.0	83.6	89.9
Adj. PAT	53.0	53.8	56.4
EBITDA Margin (%)	28.7	27.3	26.4
Cons. Adj. EPS (INR)	317.8	322.9	338.8
EPS Gr. (%)	29.9	1.6	4.9
BV/Sh. (INR)	1,680	1,978	2,291

Ratios

Net D:E	-0.3	-0.6	-0.6
RoE (%)	20.7	17.7	15.9
RoCE (%)	19.6	16.8	15.7
Payout (%)	7.9	7.8	7.4

Valuations

P/E (x)	18.4	18.1	17.2
EV/EBITDA (x)	11.3	10.1	9.1
Div. Yield (%)	0.4	0.4	0.4
FCF Yield (%)	2.1	5.7	4.2
EV/Sales (x)	3.2	2.8	2.4

Shareholding pattern (%)

As On	Dec-23	Sep-23	Dec-22
Promoter	26.7	26.7	26.7
DII	18.7	21.0	23.4
FII	44.1	42.4	38.1
Others	10.6	11.6	11.8

FII Includes depository receipts

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Investors are advised to refer through important disclosures made at the last page of the Research Report.

Motilal Oswal research is available on www.motilaloswal.com/Institutional-Equities, Bloomberg, Thomson Reuters, Factset and S&P Capital.

Quarterly Performance - IFRS

(INR b)

Y/E March	FY23				FY24E				FY23	FY24E	Estimates	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE			3QE	% Var
Sales	49.9	63.1	67.7	60.3	67.4	68.8	72.1	70.5	240.9	278.9	68.7	5.0
YoY Change (%)	1.3	9.4	27.3	15.6	35.2	9.1	6.6	16.9	13.5	15.8	1.5	
Total Expenditure	39.5	45.0	47.1	47.1	46.9	48.8	51.9	51.2	178.8	198.8	49.6	
EBITDA	10.3	18.0	20.6	13.2	20.5	20.0	20.3	19.3	62.1	80.0	19.1	6.2
YoY Change (%)	14.5	35.0	71.1	25.4	97.8	10.7	-1.3	46.6	38.3	28.8	-7.1	
Margins (%)	20.7	28.6	30.4	21.9	30.3	29.0	28.1	27.4	25.8	28.7	27.8	
Amortization	3.1	3.2	3.3	3.2	3.6	3.8	3.9	3.9	12.7	15.2	3.9	
EBIT	7.3	14.9	17.3	10.0	16.9	16.1	16.4	15.4	49.5	64.8	15.3	
YoY Change (%)	19.1	43.5	91.2	32.2	131.5	8.3	-5.1	54.4	49.4	31.1	-11.8	
Margins (%)	14.6	23.6	25.5	16.6	25.0	23.4	22.7	21.9	20.5	23.3	22.2	
Other Income	2.8	0.3	0.2	1.2	1.1	1.6	2.0	1.3	4.5	5.9	1.0	
PBT before EO expenses	10.1	15.2	17.5	11.2	18.0	17.7	18.4	16.7	53.9	70.7	16.2	13.3
One-off income/(expense)	4.5	0.9	-1.1	2.1	0.5	1.4	-0.1	0.0	6.4	1.8	0.0	
Profit before Tax	14.7	16.1	16.3	13.3	18.5	19.1	18.3	16.7	60.4	72.5	16.2	12.6
PBT after EO Expenses	14.6	16.1	16.3	13.3	18.5	19.1	18.3	16.7	60.4	72.5	16.2	
Tax	2.8	5.0	3.9	3.7	4.4	4.3	4.5	4.4	15.3	17.7	4.1	
Rate (%)	19.0	30.9	23.7	27.6	24.0	22.7	24.5	26.6	25.3	24.4	25.3	
Reported Profit	11.9	11.1	12.5	9.6	14.0	14.8	13.8	12.2	45.1	54.9	12.1	13.8
Adjusted PAT	8.2	11.4	13.1	8.1	13.7	13.3	13.8	12.2	40.8	53.0	12.1	13.7
YoY Change (%)	43.6	14.9	84.2	23.7	66.6	16.5	5.1	51.7	39.3	29.9	-7.6	
Margins (%)	16.4	18.1	19.4	13.4	20.3	19.3	19.1	17.4	16.9	19.0	17.6	

E: MOFSL Estimates

Key performance Indicators (Consolidated)

Y/E March	FY23				FY24E				FY23	FY24E	FY24E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE			
INRm											
North America	17.8	28.0	30.6	25.3	32.0	31.7	33.5	33.1	101.7	130.2	31.5
YoY Change (%)	2.4	48.1	63.9	26.8	79.5	13.2	9.6	30.6	35.8	28.1	12.0
Europe	4.1	4.2	4.3	5.0	5.1	5.3	5.0	5.0	17.6	20.3	4.9
YoY Change (%)	3.7	1.5	6.0	11.6	22.5	25.9	15.5	1.1	5.8	15.6	15.0
India	11.0	11.5	11.3	10.2	11.5	11.9	11.8	11.1	44.0	46.2	12.0
YoY Change (%)	4.2	0.9	9.8	9.6	3.9	3.1	4.7	8.6	5.9	5.0	6.0
Russia & Others CIS	5.1	8.1	9.1	7.5	7.6	8.0	8.2	8.3	29.8	32.1	8.2
YoY Change (%)	3.5	2.7	28.2	1.0	49.8	-1.2	-9.9	11.2	8.6	7.9	-10.3
Others	4.0	4.1	4.0	3.6	4.0	4.2	4.6	4.5	15.7	17.3	4.4
YoY Change (%)	-6.5	-18.6	-10.0	29.5	-0.1	2.2	15.9	22.9	-4.7	10.0	9.0
PSAI	7.1	6.4	7.8	7.8	6.7	7.0	7.8	7.6	29.1	29.1	7.1
YoY Change (%)	-6.0	-23.1	6.7	3.0	-5.4	9.3	1.0	-2.8	-5.4	0.3	-8.0
Cost Break-up											
COGS (% of Sales)	49.0	42.4	40.8	44.7	41.3	41.3	41.5	42.2	43.9	41.6	42.0
SG&A (% of Sales)	21.5	21.3	21.7	24.5	21.0	21.7	22.7	22.6	22.3	22.0	22.0
R&D Expenses(% of Sales)	8.7	7.7	7.1	8.9	7.4	7.9	7.7	7.8	8.0	7.7	8.2
Gross Margins(%)	51.0	57.6	59.2	55.3	58.7	58.7	58.5	57.8	56.1	58.4	58.0
EBITDA Margins(%)	20.7	28.6	30.4	21.9	30.3	29.0	28.1	27.4	25.8	28.7	27.8
EBIT Margins(%)	14.6	23.6	25.5	16.6	25.0	23.4	22.7	21.9	20.5	23.3	22.2

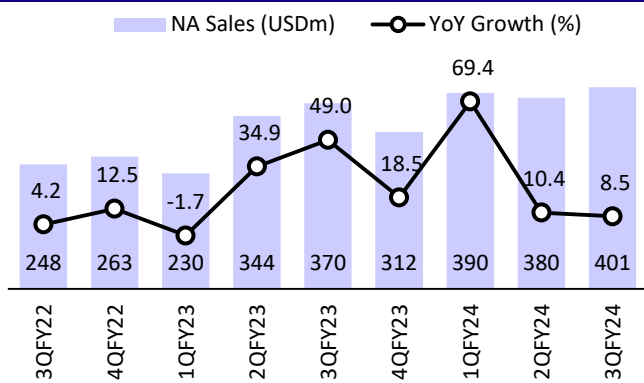


Management call highlights

- SGA expenses were up 12% YoY due to investments in sales/marketing/ digitization and other new initiatives. The benefits of the same are expected from FY25 onwards.
- It received three product approvals in China during the quarter, taking the cumulative approvals to nine for FY24YTD.
- DRRD has 12/8 launches/filings in NA for FY24YD.
- DRRD posted double-digit YoY growth in the PSAI segment on ex-Covid basis.
- The OTC contribution was 10% of the overall revenue.
- It expects ETR to be at 24-25% for FY24.

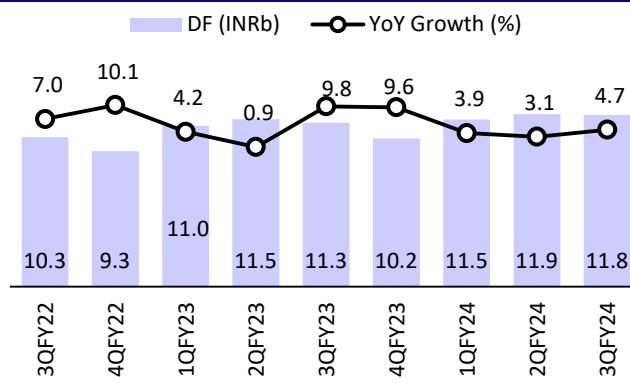
Key exhibits

Exhibit 1: In CC terms, NA sales grew ~9% YoY in 3QFY24



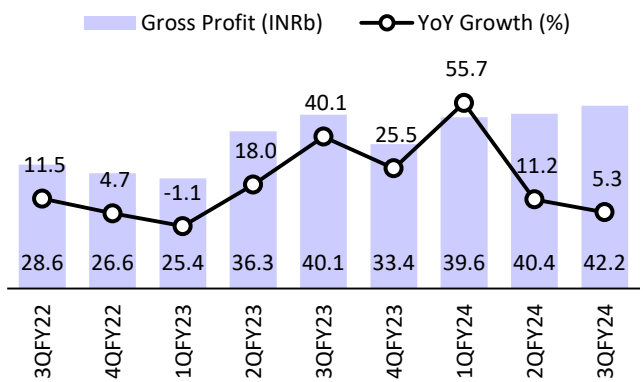
Source: MOFSL, Company

Exhibit 2: DF sales grew 5% YoY in 3QFY24



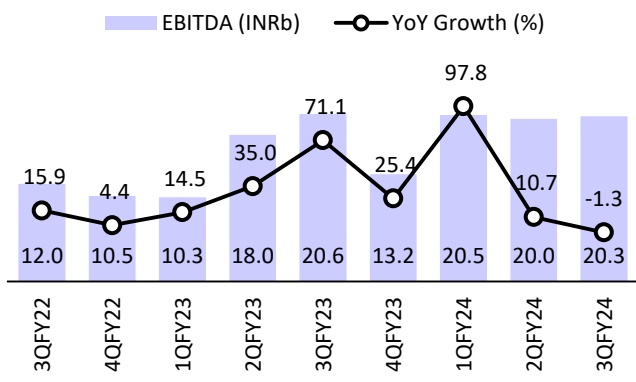
Source: MOFSL, Company

Exhibit 3: Gross profit increased 5% YoY in 3QFY24

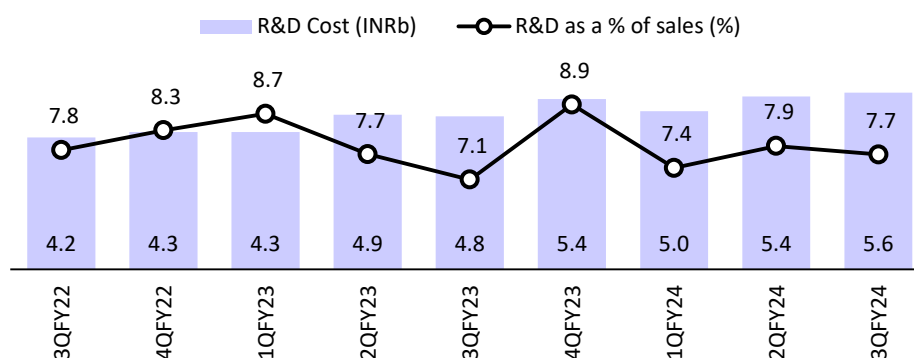


Source: Company, MOFSL

Exhibit 4: EBITDA was stable YoY in 3QFY24



Source: Company, MOFSL

Exhibit 5: R&D expenses as a proportion of sales were stable QoQ

Source: MOFSL, Company

Region-specific strategy to improve outlook over the medium term**Building complex product pipeline to support growth prospects in NA**

- In 9MFY24, DRRD's NA sales posted a robust 24% YoY growth to USD1.2b. This was driven by increased market share in the base portfolio and higher volume off-take of differentiated products. Moreover, the reduced intensity of price erosion also aided growth.
- Having launched 14 new products in the US during 9MFY24, DRRD remains on track to sustain the launch momentum.
- There are 75 ANDAs and four NDAs under the 505(b)(2) route awaiting approval. Of these ANDAs, 41 are Para IVs, and 21 have the potential to secure the 'First to File' status.
- Over FY24-26, we expect the US segment to report a 12% sales CAGR to ~INR161b (USD2b).

Focused approach on select brands to drive growth in India

- In 9MFY24, India sales witnessed a modest growth rate of 4% YoY to INR35b. There has been underperformance in cardiac therapy (down 14% YoY). This was offset partly by healthy growth in the therapy areas of gastro, derma, pain, etc.
- Major growth drivers have been price hikes and new product launches.
- We expect a sales CAGR of 11% to reach INR57b over FY24-26.

The EM segment to witness a gradual recovery

- In 9MFY24, the EM sales grew 7% YoY to INR36.6b. The EM segment is witnessing reducing growth since the past two quarters, leading to a moderation in overall YoY sales growth for 9MFY24.
- The Russia business has witnessed lower growth due to the high base of the last year in addition to the adverse currency impact. However, this was partly offset by robust performance in other markets, led by price increase, new launches, and favorable currency movement.
- We expect a sales CAGR of 9% to reach INR38b over FY24-26.

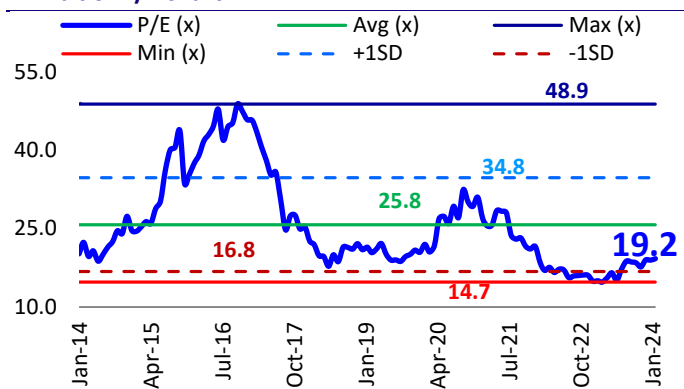
PSAI segment: Volume/new launches to aid growth

- In 9MFY24, the PSAI segment’s revenue grew at a meager 1% YoY to INR21.6b. This was due to the base portfolio witnessing price erosion.
- However, the PSAI segment witnessed a gross margin expansion of 520bp YoY to 15.6%. This was led by an improvement in product mix and increased traction.
- We expect the PSAI business to post a 9% sales CAGR to INR34.7b over FY24-26. This will be led by the volume uptick in the base business and new launches.

Maintain Neutral

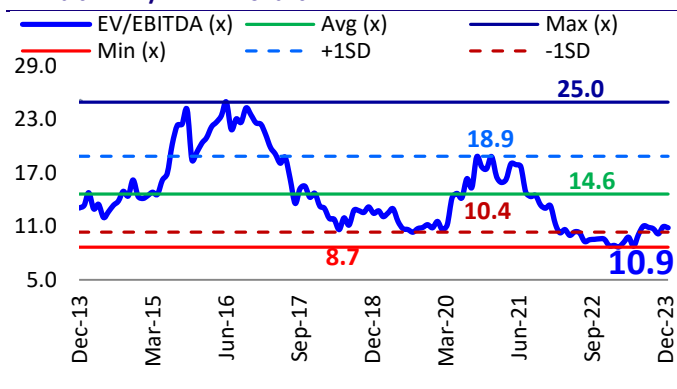
- We raise our earnings estimates by 7%/5%/4% for FY24/FY25/FY26 factoring in: 1) market share expansion in key products, 2) new launches, and 3) better operating leverage. We value DRRD on an SOTP basis (22x 12M forward P/E for the base business and adding NPV of INR90 for g-Revlimid) to arrive at our TP of INR5,540.
- Even after raising our earnings estimates, we expect a modest 3% earnings CAGR over FY24-26. Further, the product-specific concentration of earnings remains elevated for DRRD. **Reiterate Neutral.**

Exhibit 6: P/E chart



Source: MOFSL, Company, Bloomberg

Exhibit 7: EV/EBITDA chart



Source: MOFSL, Company, Bloomberg

Story in charts

Exhibit 8: Expect sales CAGR of ~11% over FY24–26

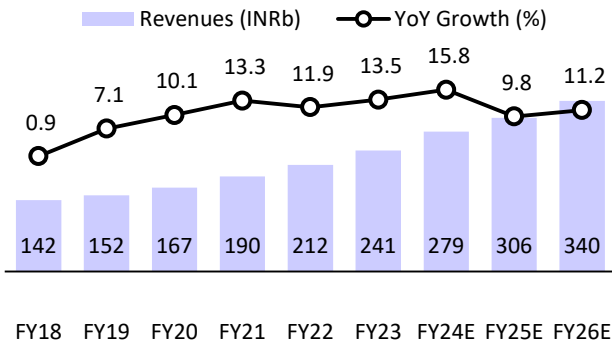


Exhibit 9: NA sales to report ~12% CAGR over FY24–26

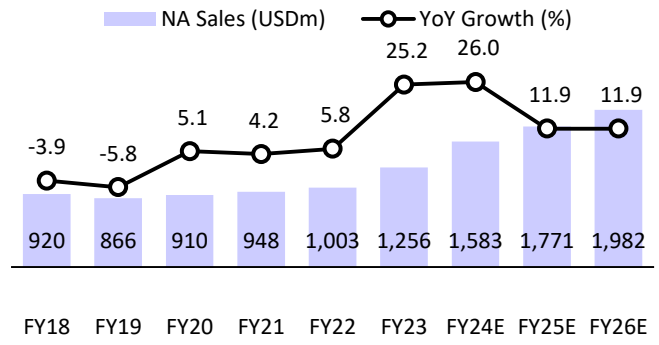


Exhibit 10: DF sales to exhibit 11% CAGR over FY24–26

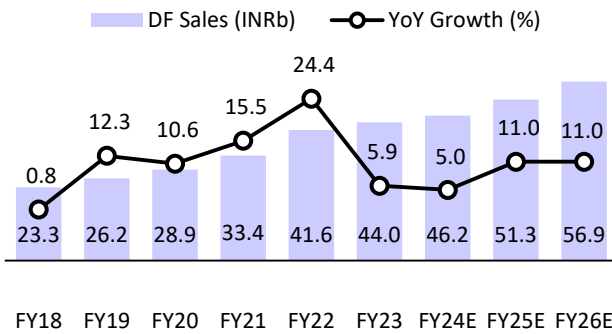


Exhibit 11: PSAI to post 9% sales CAGR over FY24–26

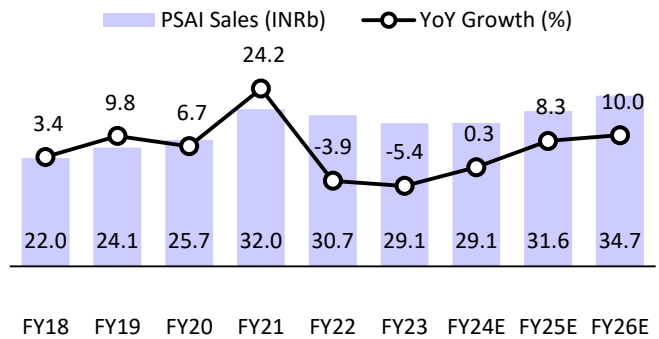


Exhibit 12: EBITDA margin to contract 230bp over FY24–26

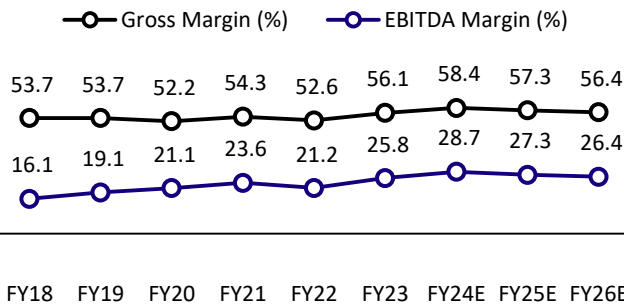


Exhibit 13: Expect EBITDA CAGR of ~6% over FY24–26

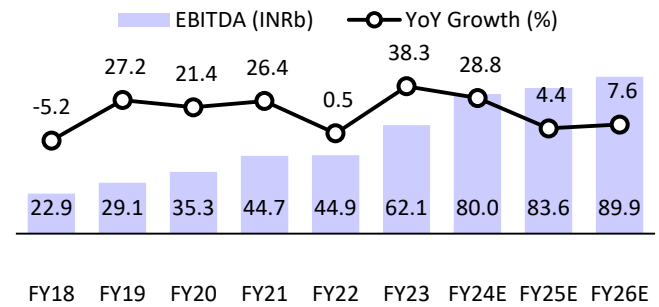


Exhibit 14: R&D expense to settle at ~8% of sales by FY25

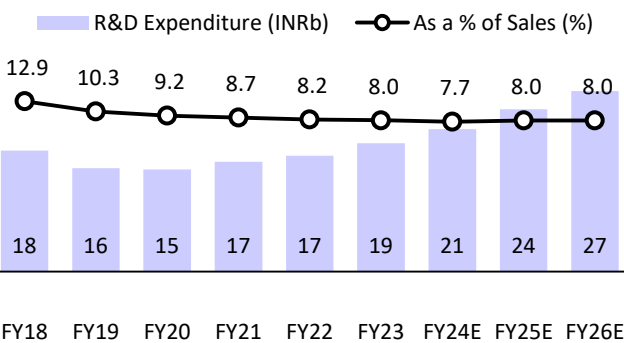
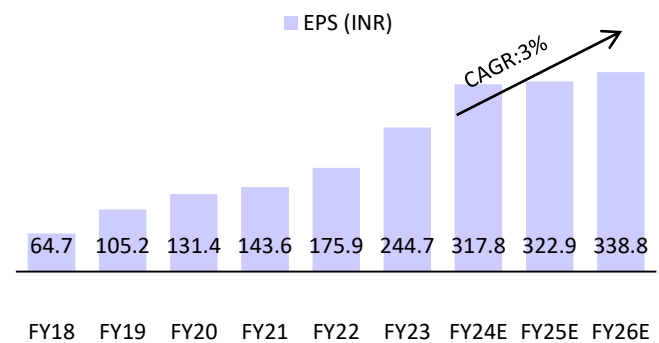


Exhibit 15: Expect EPS CAGR of 3% over FY24–26



Source: Company, MOFSL

Source: Company, MOFSL

Financials and valuations

Income Statement										(INR b)
Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Net Sales	141	142	152	167	190	212	241	279	306	340
Change (%)	-9.0	0.9	7.1	10.1	13.3	11.9	13.5	15.8	9.8	11.2
Total Expenditure	117	119	123	132	145	167	179	199	223	251
EBITDA	24	23	29	35	45	45	62	80	84	90
Change (%)	-38.2	-5.2	27.2	21.4	26.4	0.5	38.3	28.8	4.4	7.6
Margin (%)	17.2	16.1	19.1	21.1	23.6	21.2	25.8	28.7	27.3	26.4
Depreciation & Amort.	12	12	12	12	13	12	13	15	16	18
EBIT	12	11	17	23	32	33	49	65	68	72
Net Interest Exp	0	1	1	1	-2	-2	-3	-1	-1	0
One-off (Gains)/Losses	0	0	-2	8	8	6	-5	0	0	0
PBT before EO Expense	12	10	18	14	26	29	58	66	69	72
Change (%)	-46.0	-2.1	56.5	14.7	35.9	10.5	39.5	31.1	-0.2	4.9
PBT after EO Expense	12	10	18	14	26	29	58	66	69	72
Tax	3	5	4	-1	9	9	15	18	17	18
Tax Rate (%)	21.0	44.0	20.5	-10.3	35.5	30.3	26.5	26.8	24.5	24.4
Reported PAT	12	10	19	19	18	24	44	53	54	56
Adjusted Net Profit	12	11	17	22	24	29	41	53	54	56
Change (%)	-46.7	-10.8	62.6	24.9	9.3	22.8	39.3	29.9	1.6	4.9
Margin (%)	8.5	7.6	11.5	13.0	12.6	13.8	16.9	19.0	17.6	16.6

Balance Sheet										(INR b)
Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Equity Share Capital	1	1	1	1	1	1	1	1	1	1
Reserves	122	125	139	155	176	190	230	279	329	381
Net Worth	123	126	140	156	176	191	231	280	329	382
Loans	49	51	34	18	29	34	13	12	11	10
Deferred Liabilities/Tax	-5	-3	-4	-12	-10	-13	-6	-6	-6	-6
Capital Employed	167	173	171	162	195	212	238	286	335	386
Gross Block	93	99	115	126	144	161	178	191	200	209
Less: Accum. Deprn.	42	50	62	74	87	99	111	126	142	142
Net Fixed Assets	56	57	54	52	57	62	66	64	57	66
Investments	26	29	31	33	33	38	62	62	62	62
Goodwill/Intangibles	46	47	47	32	41	32	35	35	35	35
Curr. Assets	83	87	88	103	125	152	151	193	250	304
Inventory	29	29	34	35	45	51	49	61	59	71
Account Receivables	38	41	40	52	50	67	72	88	94	104
Cash and Bank Balance	4	3	2	2	15	15	6	18	70	98
Others	12	14	13	14	15	19	24	25	28	31
Curr. Liability & Prov.	45	47	50	58	60	72	77	76	78	81
Account Payables	11	13	14	15	18	26	26	23	26	31
Other Current Liabilities	34	34	36	43	42	47	50	52	51	50
Net Current Assets	38	40	39	45	65	79	74	124	180	222
Appl. of Funds	167	173	171	162	195	212	238	286	335	386

Financials and valuations

Ratios

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Basic (INR)										
EPS	72.6	64.7	105.2	131.4	143.6	175.9	244.7	317.8	322.9	338.8
Cash EPS	143.3	135.5	177.3	206.5	220.7	246.9	320.8	409.1	418.4	445.1
BV/Share	739.6	757.3	844.8	939.7	1,062.8	1,145.0	1,386.5	1,679.9	1,977.7	2,291.4
DPS	20.0	20.0	20.0	23.6	25.0	20.4	20.4	21.4	21.4	21.4
Payout (%)	33.1	40.7	21.3	23.5	26.8	16.9	9.0	7.9	7.8	7.4
Valuation (x)										
P/E	80.4	90.2	55.5	44.4	40.6	33.2	23.8	18.4	18.1	17.2
PEG (x)	NA	-8.3	0.9	1.8	4.4	1.5	0.6	0.6	11.4	3.5
Cash P/E	40.7	43.1	32.9	28.3	26.4	23.6	18.2	14.3	13.9	13.1
P/BV	7.9	7.7	6.9	6.2	5.5	5.1	4.2	3.5	3.0	2.5
EV/Sales	7.0	7.0	6.4	5.7	5.0	4.5	3.8	3.2	2.8	2.4
EV/EBITDA	40.9	43.1	33.3	26.9	21.3	21.1	14.7	11.3	10.1	9.1
Dividend Yield (%)	0.3	0.3	0.3	0.4	0.4	0.4	0.3	0.4	0.4	0.4
Return Ratios (%)										
ROIC	8.9	5.8	10.8	21.9	17.0	18.0	23.1	28.1	26.6	27.0
RoE	9.7	8.6	13.1	14.7	14.3	16.0	19.3	20.7	17.7	15.9
RoCE	6.4	4.8	8.9	17.4	11.8	12.3	15.9	19.6	16.8	15.7
Working Capital Ratios										
Fixed Asset Turnover (x)	1.6	1.5	1.4	1.4	1.4	1.4	1.4	1.5	1.6	1.7
Debtor (Days)	103	101	97	100	98	100	106	105	108	106
Inventory (Days)	70	74	75	75	77	83	75	72	72	70
Payable (Days)	25	31	32	32	32	38	39	33	30	31
Leverage Ratio										
Current Ratio (x)	1.8	1.8	1.8	1.8	2.1	2.1	2.0	2.5	3.2	3.7
Net Debt/Equity (x)	0.1	0.1	0.0	-0.1	-0.2	-0.2	-0.3	-0.3	-0.6	-0.6

Cash Flow Statement

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
(INR b)										
Op. Profit/(Loss) before Tax	15	14	22	26	35	39	54	71	71	74
Depreciation	12	12	12	12	13	12	13	15	16	18
Interest/Dividends Recd.	-2	-4	-6	5	6	3	-7	-5	-2	-2
Direct Taxes Paid	-3	-5	-4	1	-9	-9	-15	-18	-17	-18
(Inc)/Dec in WC	0	-3	1	-6	-7	-15	-4	-30	-3	-22
CF from Operations	21	14	25	38	38	30	40	33	64	50
EO Expense	0	0	0	0	-6	-5	0	0	0	0
CF from Operations	21	18	29	39	44	34	40	33	64	50
(inc)/dec in FA	-41	-14	-9	5	-27	-8	-20	-13	-9	-9
Free Cash Flow	-20	1	16	43	11	22	20	20	56	41
(Pur)/Sale of Investments	18	1	3	-2	0	-5	-24	0	0	0
Others	5	-3	-2	-7	0	-13	0	0	0	0
CF from Investments	-18	-15	-8	-5	-27	-26	-44	-13	-9	-9
Change in net worth	-11	-3	0	1	2	-5	0	0	0	0
(Inc)/Dec in Debt	16	2	-17	-16	12	4	-20	-1	-1	-1
Other Items	-4	1	-1	-5	-13	9	1	2	2	-9
Dividend Paid	-4	-4	-4	-5	-5	-4	-4	-4	-4	-4
CF from Fin. Activity	-4	-4	-21	-25	-5	4	-23	-3	-3	-14
Inc/Dec of Cash	-1	-1	0	8	13	12	-27	17	52	27
Add: Beginning Balance	5	4	3	2	2	15	15	6	18	70
Closing Balance	4	3	2	11	15	27	-12	22	70	98
FX Impact	0	0	0	0	0	0	0	0	0	0
FX impact net of bank balances	0	0	0	-9	0	-12	18	-4	0	0
Closing Balance	4	3	2	2	15	15	6	18	70	98

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