Dr. Reddy's

08 May 2024

Drop in EBITDA due to increase in R&D spends

RESULT UPDATE

Sector: Pharmaceuticals	**Rating: HOLD**
CMP: Rs 6,259	**Target Price: Rs 5,518**

Stock Info

Sensex/Nifty	73,512/22,303
Bloomberg	DRRD IN
Equity shares	167mn
52-wk High/Low	Rs 6,506/4,383
Face value	Rs 5
M-Cap	Rs 1,044bn/ USD 12.5bn

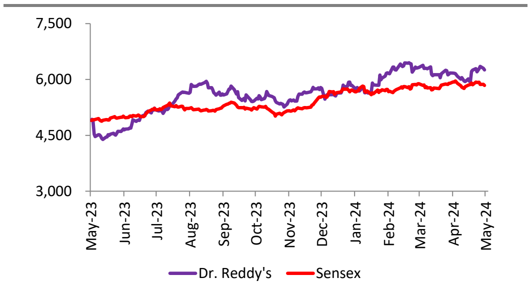
Financial Snapshot (Rs mn)

Y/E March	FY24	FY25E	FY26E
Sales	279,164	295,172	296,930
Gross profit	163,607	173,060	171,213
Gross Margin %	58.6	58.6	57.7
EBITDA	82,731	86,908	81,133
Margin %	29.6	29.4	27.3
PAT	55,684	60,704	57,529
EPS	333.8	363.9	344.9
DPS(Rs)	39.9	43.4	41.2
ROE(%)	19.8	18.2	15.0
P/E(x)	18.8	17.2	18.1
EV/EBITDA (x)	11.1	10.8	11.1

Shareholding pattern (%)

	Sept-23	Dec-23	Mar-23
Promoter	26.66	26.65	26.65
–Pledged	-	-	-
FII	28.18	28.62	29.13
DII	21.04	18.65	18.31
Others	24.12	26.08	25.91

Stock Performance (1-year)



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Dr. Reddy's (DRRD IN) Q4FY24 Revenue were broadly in line with expectations, but EBITDA came in lower than expectations owing to significant surge in R&D investments (9.7% of sales vs 7.7% in 3QFY24). R&D investment are being driven by biosimilar pipeline and novel oncology assets. About 20% of the R&D spend is towards clinical trials on Biosimilars. In the near term the small molecule launches should continue to support growth in the US. About 20 plus launches are expected in FY2025, but there is no visibility around how many of these would be limited competition. Over the last several years, we haven't seen many limited competition launch (complex generic) from DRL internal R&D pipeline and hence we remain cautious and do not build any meaningful upside to our US forecasts. While company continues to file new products aggressively in China, we prefer to be cautious on the growth opportunity considering the geopolitical risks. We retain our estimates on DRL and maintain our Hold rating with PT of Rs. 5,518 Based on 16x FY26E EPS. Strong Ramp up in China and meaningful contribution from limited competition launches in the US are upside risks to our estimates.

4QFY24 earnings highlights

DRRD's 4QFY24 revenue at Rs 70,830mn, was up 12.5% YoY but down 1.8% QoQ. EBITDA at Rs 18,720mn rose 14.8% YoY but was down 11.3% QoQ. EBITDA margin stood at 26.4% was up 52 bps YoY but down 283 bps QoQ basis. PAT at Rs 13,070mn up 36.3% YoY but down 5.2% QoQ. PAT margin stood at 18.5% was up 332 bps YoY but down 66 bps QoQ. R&D expenses stood at Rs 6,877mn (9.7% of sales).

North America business revenue at Rs 32,626mn, was up 28.8% YoY and 4.8% QoQ. The YoY growth was largely on account of increase in volumes in base business, contribution from new launches, this was partly offset by price erosion. Sequential decline was due to decrease in base business volumes and price erosion in select brands.

Europe business revenue at Rs 5,208mn, rose ~5% both YoY and QoQ. The growth was primarily on account of improvement in base business volumes, new product launches, partly offset by price erosion.

India business revenue at Rs 11,265mn, was down by 12.2% YoY and 4.5% QoQ. YoY decline was mainly due to brand divestment income in same quarter pervious year. QoQ decline was on account of lower volumes from base business.

Rest of World (RoW) business revenue at Rs 12,091mn, was up 8.5% YoY but down 5.8% QoQ. The revenue from Russia has shown degrowth of 4% YoY and 15% sequentially. Sharp QoQ decline was on account of unfavourable forex.

PSAI revenue at Rs 8,219mn, was up 5.5% YoY and 4.8% QoQ. YoY growth YoY growth was mainly driven by revenues from new products, favourable forex, partially offset by price decline. QoQ growth was driven by improved volumes in base business partially offset by price decline.

Proprietary Products & Others business segment reported strong revenue at Rs 1,420mn, was up 53.7% YoY and 17% QoQ.

Investors are advised to refer disclosures made at the end of the research report.

4QFY24 earnings call highlights

- **North America Business**
  - ✓ The **North America generic business** recorded revenue of USD 392mn for the quarter with YoY growth of ~26% but slight decline by 3% sequentially. The YoY increase was mainly due to expansion in key products, integration of acquired portfolios and some forex gains.
  - ✓ Received VAI status from USFDA for both their formulation facility in Bachupally, Hyderabad.
  - ✓ About 20+ launches are expected in FY25.
  - ✓ The company has acquired Menolabs with the aim to create a franchise in women healthcare and dietary supplement.
- **India Business-**
  - ✓ excluding impact of divestment income, the India sales reported ~11% growth. According to IQVIA, the company's IPM rank was at 10 for the quarter.
  - ✓ Recently formed JV with Nestle to bring nutraceuticals to consumers in India. The JV is expected to leverage trusted global brands of Nestle healthcare science and well-established commercial capabilities of Dr. Reddy's in India. This will take longer to contribute to revenue (Probably post FY26).
- **Biosimilars**
  - ✓ Commercial rollout of Biosimilar portfolio is expected from FY27 onwards.
  - ✓ On Biosimilar Rituximab, the CRL has questions on Chemistry, Manufacturing and Control (CMC) of the product. The company will file a response shortly and TAD should be 6 months henceforth.
  - ✓ Expect to launch Rituximab in UK shortly.
- Will continue to file 15 products per year in **China**.
- The **SG&A expenses** have inched up YoY on account of investment in Sales & marketing activities, new business initiatives including scaling up of consumer health and OTC business and digitalization initiatives. These investments are likely to have results in coming years. These expenses are expected to be in the same range (as a % of sales) for coming quarters.
- There is an **increase in inventory** owing to geopolitical risk as companies try to proactively build inventory ensuring no loss in sales due to these tensions.
- The effective tax rate for FY25 to be in the range of 24-25%.
- The **R&D spent** for the quarter was Rs 6.8bn, which is 9.7% of the sales R&D spent were higher due to a higher number of filings and efforts to build a pipeline of complex products.

Exhibit 1: Quarterly performance.

Particulars (Rs mn)	4QFY23	3QFY24	4QFY24	YoY (%)	QoQ (%)	FY23	FY24	YoY (%)
Revenues	**62,968**	**72,148**	**70,830**	***12.5***	***(1.8)***	**245,879**	**279,164**	***13.5***
Cost of Revenues	26,971	29,945	29,347	*8.8*	*(2.0)*	106,536	115,557	*8.5*
% of revenue	*42.8*	*41.5*	*41.4*	*(140) bps*	*(7) bps*	43.3	41.4	*(193) bps*
SG&A Expenses	17,992	20,228	20,476	*13.8*	*1.2*	68,026	77,201	*13.5*
% of revenue	*28.6*	*28.0*	*28.9*	*34 bps*	*87 bps*	27.7	27.7	*(1) bps*
R&D Expenses	5,366	5,565	6,877	*28.2*	*23.6*	19,381	22,873	*18.0*
% of revenue	*8.5*	*7.7*	*9.7*	*119 bps*	*200 bps*	7.9	8.2	*31 bps*
Impairment of Non-Current Assets	540	110	(173)	*(132.0)*	*(257.3)*	699	3	*(99.6)*
Other Operating (income)/expense	(281)	(967)	(656)	*133.5*	*(32.2)*	(5,907)	(4,199)	*(28.9)*
Results from operating activities	**12,380**	**17,267**	**14,959**	***20.8***	***(13.4)***	**57,144**	**67,729**	***18.5***
Net finance expense/(income)	(799)	(963)	(1,022)	*27.9*	*6.1*	(2,853)	(3,994)	*40.0*
Share of (profit) / loss of equity accounted investee	(76)	(27)	(35)	*(53.9)*	*29.6*	(370)	(147)	*(60.3)*
Profit before income tax	13,255	18,257	16,016	*20.8*	*(12.3)*	60,367	71,870	*19.1*
Income tax expense	3,663	4,468	2,946	*(19.6)*	*(34.1)*	15,300	16,186	*5.8*
Profit for the period	**9,592**	**13,789**	**13,070**	***36.3***	***(5.2)***	**45,067**	**55,684**	***23.6***
Profit Margin	***15.2***	***19.1***	***18.5***	***322 bps***	***(66) bps***	**18.3**	**19.9**	***162 bps***

Source: Company, Systematix Institutional Research

Exhibit 2: Revenue break up

Particulars (Rs mn)	4QFY22	1QFY23	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24	3QFY24	4QFY24	YoY	QoQ
Global Generics	**46,117**	**44,323**	**55,946**	**59,241**	**54,257**	**60,083**	**61,009**	**63,095**	**61,190**	**12.8**	**(3.0)**
North America	19,971	17,815	28,001	30,567	25,321	31,978	31,700	33,492	32,626	28.8	(2.6)
Europe	4,444	4,141	4,199	4,303	4,960	5,071	5,286	4,970	5,208	5.0	4.8
India	9,689	13,339	11,500	11,274	12,834	11,482	11,860	11,800	11,265	(12.2)	(4.5)
RoW	12,013	9,028	12,246	13,097	11,142	11,552	12,163	12,833	12,091	8.5	(5.8)
PSAI	**7,557**	**7,090**	**6,434**	**7,758**	**7,787**	**6,709**	**7,034**	**7,839**	**8,219**	**5.5**	**4.8**
Proprietary Products & Others	**693**	**740**	**677**	**701**	**924**	**592**	**684**	**1,214**	**1,420**	**53.7**	**17.0**
Total Revenue	**54,367**	**52,153**	**63,057**	**67,700**	**62,968**	**67,384**	**68,727**	**72,148**	**70,829**	**12.5**	**(1.8)**

Source: Company, Systematix Institutional Research

Exhibit 3: Revenue mix (%)

Particulars (%)	4QFY22	1QFY23	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24	3QFY24	4QFY24
Global Generics	**84.8**	**85.0**	**88.7**	**87.5**	**86.2**	**89.2**	**88.8**	**87.5**	**86.4**
North America	36.7	34.2	44.4	45.2	40.2	47.5	46.1	46.4	46.1
Europe	8.2	7.9	6.7	6.4	7.9	7.5	7.7	6.9	7.4
India	17.8	25.6	18.2	16.7	20.4	17.0	17.3	16.4	15.9
RoW	22.1	17.3	19.4	19.3	17.7	17.1	17.7	17.8	17.1
PSAI	**13.9**	**13.6**	**10.2**	**11.5**	**12.4**	**10.0**	**10.2**	**10.9**	**11.6**
Proprietary Products & Others	**1.3**	**1.4**	**1.1**	**1.0**	**1.5**	**0.9**	**1.0**	**1.7**	**2.0**

Source: Company, Systematix Institutional Research

Exhibit 4: QoQ growth (%)

Particulars (%)	4QFY22	1QFY23	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24	3QFY24	4QFY24
Global Generics	**3.6**	**(3.9)**	**26.2**	**5.9**	**(8.4)**	**10.7**	**1.5**	**3.4**	**(3.0)**
North America	7.1	(10.8)	57.2	9.2	(17.2)	26.3	(0.9)	5.7	(2.6)
Europe	9.5	(6.8)	1.4	2.5	15.3	2.2	4.2	(6.0)	4.8
India	(5.6)	37.7	(13.8)	(2.0)	13.8	(10.5)	3.3	(0.5)	(4.5)
RoW	4.1	(24.8)	35.6	6.9	(14.9)	3.7	5.3	5.5	(5.8)
PSAI	**3.9**	**(6.2)**	**(9.3)**	**20.6**	**0.4**	**(13.8)**	**4.8**	**11.4**	**4.8**
Proprietary Products & Others	**(51.1)**	**6.8**	**(8.5)**	**3.5**	**31.8**	**(35.9)**	**15.5**	**77.5**	**17.0**
Total Revenue	**2.2**	**(4.1)**	**20.9**	**7.4**	**(7.0)**	**7.0**	**2.0**	**5.0**	**(1.8)**

Source: Company, Systematix Institutional Research

Exhibit 5: YoY growth (%)

Particulars (%)	4QFY22	1QFY23	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24	3QFY24	4QFY24
Global Generics	**19.1**	**7.8**	**18.0**	**33.1**	**17.7**	**35.6**	**9.0**	**6.5**	**12.8**
North America	14.2	2.4	48.1	63.9	26.8	79.5	13.2	9.6	28.8
Europe	12.3	3.7	1.5	6.0	11.6	22.5	25.9	15.5	5.0
India	14.7	25.8	0.9	9.8	32.5	(13.9)	3.1	4.7	(12.2)
RoW	35.8	(1.1)	(5.7)	13.5	(7.3)	28.0	(0.7)	(2.0)	8.5
PSAI	**(4.5)**	**(6.0)**	**(23.1)**	**6.7**	**3.0**	**(5.4)**	**9.3**	**1.0**	**5.5**
Proprietary Products & Others	**9.7**	**36.8**	**(63.0)**	**(50.6)**	**33.3**	**(20.0)**	**1.0**	**73.2**	**53.7**
Total Revenue	**15.0**	**6.0**	**9.4**	**27.3**	**15.8**	**29.2**	**9.0**	**6.6**	**12.5**

Source: Company, Systematix Institutional Research

Exhibit 6: Margin summary

Particulars (%)	4QFY22	1QFY23	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24	3QFY24	4QFY24
Gross Margin	52.9	49.9	59.1	59.2	57.2	58.7	58.7	58.5	58.6
EBITDA Margin	23.9	34.1	30.6	29.0	25.9	31.7	31.7	29.3	26.4
EBIT Margin	18.4	28.3	25.7	24.2	20.8	26.4	26.2	24.0	21.2
PAT Margin	1.6	22.8	17.6	18.4	15.2	20.8	21.5	19.1	18.5

Source: Company, Systematix Institutional Research

Exhibit 7: Change in estimates

Particulars (Rs mn)	New estimates		Old estimates		Change (%)	
	FY25E	FY26E	FY25E	FY26E	FY25E	FY26E
Net sales	295,172	296,930	279,790	295,172	3.7	0.0
EBITDA	86,908	81,133	85,006	89,451	0.6	(2.8)
Margin (%)	*29.4*	*27.3*	*30.4*	*30.3*	*(89) bps*	*(86) bps*
PAT	60,704	57,529	56,758	62,498	1.8	(2.9)
Margin (%)	*20.6*	*19.4*	*20.3*	*21.2*	*(37) bps*	*(61) bps*
EPS	365.7	346.6	342.0	376.5	1.8	(2.9)

Source: Systematix Institutional Research

Exhibit 8: Actuals vs estimates

Particulars (Rs mn)	Actuals	Systematix	Var(%)	Cons.	Variance (%)
Net sales	70,830	68,784	*3.0*	69,818	*1.4*
EBITDA	18,720	21,060	*(11.1)*	19,838	*(5.6)*
Margin (%)	26.4	30.6	*(419) bps*	28.4	*(198) bps*
PAT	13,070	13,786	*(5.2)*	13,132	*(0.5)*
Margin (%)	18.5	20.0	(159) bps	18.8	***(36) bps***

Source: Company, Systematix Institutional Research

FINANCIALS

Profit & Loss Statement

YE: Mar (Rs mn)	FY22	FY23	FY24	FY25E	FY26E
Net Revenues	**2,14,391**	**2,45,879**	**2,79,164**	**2,95,172**	**2,96,930**
YoY gr. (%)	13%	15%	14%	6%	1%
Cost of Goods Sold	1,00,551	1,06,536	1,15,557	1,22,112	1,25,718
Gross Profit	1,13,840	1,39,343	1,63,607	1,73,060	1,71,213
Margin (%)	53%	56.7%	58.6%	58.6%	57.7%
SG&A Expenses	62,081	68,026	77,201	81,061	85,114
R&D Expenses	17,482	19,381	22,873	23,559	24,266
Impairment Loss	7,562	699	3	-	-
Other (Income) / Expense	-2,761	-5,907	-4,199	-3,000	-3,000
Operating Profit	**29,476**	**57,144**	**67,729**	**71,440**	**64,833**
YoY gr. (%)	21%	94%	19%	5%	-9%
Margin (%)	14%	23%	24%	24%	22%
Finance (Expense) / Income	2,119	2,853	3,994	7,197	9,612
Share of Profit in Eq. Invt.	703	370	147	198	268
Extraordinary Income	-	-	-	-	-
Profit Before Tax	32,298	60,367	71,870	78,836	74,713
Tax	8,730	15,300	16,186	18,132	17,184
Effective tax rate (%)	27%	25%	23%	23%	23%
Profit After Tax	23,568	45,067	55,684	60,704	57,529
EPS	142.0	271.5	333.8	363.9	344.9
YoY gr. (%)	36.7%	91.2%	22.9%	9.0%	-5.2%

Source: Company, Systematix Institutional Research
*Note: *IFRS Format*

Balance Sheet

YE: Mar (Rs mn)	FY22	FY23	FY24	FY25E	FY26E
Equity Share Capital	832	833	834	834	834
Reserves & Surplus	1,89,695	2,30,158	2,79,716	3,33,172	3,83,833
Net Worth	**1,90,527**	**2,30,991**	**2,80,550**	**3,34,006**	**3,84,667**
Short term debt	28,099	12,194	14,030	15,250	14,791
Long term debt	5,746	1,278	5,990	4,193	2,935
Trade payables	25,572	26,444	30,919	32,692	32,887
Other Provisions	4,258	5,454	5,383	5,692	5,726
Other liabilities	42,452	45,493	50,646	55,297	55,330
Total Liabilities	**2,96,654**	**3,21,854**	**3,87,518**	**4,47,129**	**4,96,335**
Net block	93,833	1,01,556	1,18,090	1,24,913	1,32,499
Other Non-current asset	21,715	13,358	17,661	17,859	18,127
Investments	29,513	56,018	74,363	74,363	74,363
Cash and Cash Equivalents	14,852	5,779	7,107	49,707	90,229
Debtors	66,764	72,485	80,298	84,902	85,408
Inventories	50,884	48,670	63,552	67,196	67,597
Other current asset	19,093	23,988	26,447	28,188	28,112
Total Assets	**2,96,654**	**3,21,854**	**3,87,518**	**4,47,129**	**4,96,335**

Source: Company, Systematix Institutional Research

Cash Flow

YE: Mar (Rs mn)	FY22	FY23	FY24	FY25E	FY26E
PBT	32,298	60,367	71,870	78,836	74,713
Depreciation	11,824	12,636	14,841	15,269	16,032
Interest	-7	248	-567	-	-
Others	5,344	4,193	-482	-198	-268
Working capital	-13,914	-7,855	-20,182	-3,257	-569
Direct tax	-7,437	-10,714	-20,047	-18,132	-17,184
Net cash from Op. activities	**28,108**	**58,875**	**45,433**	**72,517**	**72,724**
Net Capital expenditures	-14,660	-11,323	-16,403	-19,721	-20,975
Others	-11,727	-30,050	-23,880	-2,372	-2,643
Net Cash from Invt. activities	**-26,387**	**-41,373**	**-40,283**	**-22,093**	**-23,618**
Issue of share cap./premium	334	157	805	-	-
Debt changes	3,520	-19,382	5,493	1,220	-459
Dividend paid	-4,146	-4,979	-6,648	-7,247	-6,868
Others	-2,130	-2,657	-3,413	-8,994	-10,870
Net cash from Fin. activities	**-2,422**	**-26,861**	**-3,763**	**-15,022**	**-18,197**
Net change in cash	**-701**	**-9,359**	**1,387**	**35,402**	**30,909**

Source: Company, Systematix Institutional Research

Key Financial Metrics

YE: Mar (Rs mn)	FY22	FY23	FY24	FY25E	FY26E
Per Share(Rs)					
EPS	142.0	271.5	333.8	363.9	344.9
CEPS	258.8	376.1	454.5	455.4	441.0
BVPS	1,147.9	1,391.7	1,690.3	2,012.3	2,317.6
DPS	25.0	30.0	39.9	43.4	41.2
Return Ratio(%)					
RoCE	15.2	25.4	25.0	23.0	19.1
RoE	12.4	19.5	19.8	18.2	15.0
Balance Sheet					
Net Debt : Equity (x)	-0.1	-0.2	-0.2	-0.3	-0.4
Net Working Capital (Days)	187.7	184.8	186.5	202.5	205.2
Valuation(x)					
PER	44.1	23.1	18.8	17.2	18.1
EV/EBITDA	20.0	12.8	11.1	10.8	11.1
EV/Sales	4.8	4.0	3.5	3.2	3.0

Source: Company, Systematix Institutional Research

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