DTL 2024 EQUITY RESEARCH CHALLENGE ROUND 1: REPORT

BY

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EXECUTIVE SUMMARY

FY24 Performance

₹ 27,916 Cr
Revenues
14%YoY

₹ 8,301 Cr | ~30%
EBITDA | EBITDA %
14%YoY

₹ 7,187 Cr | ~26%
PBT | PBT %
19%YoY

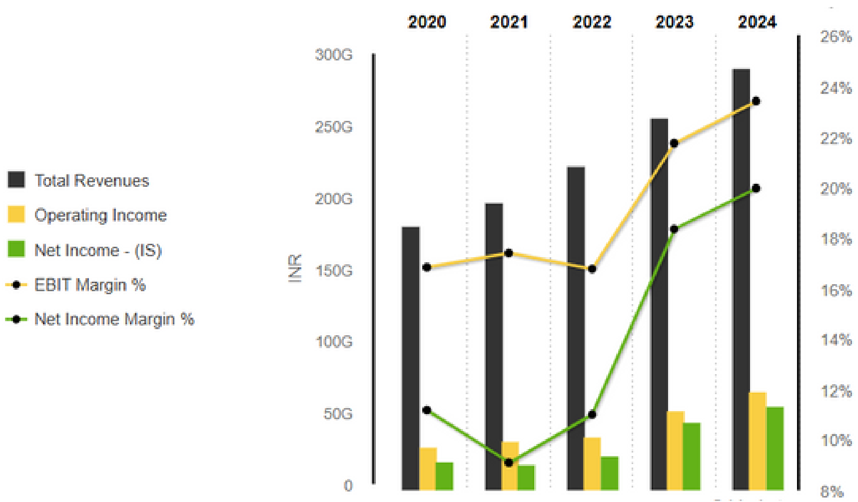
₹ 5,569 Cr | ~20%
PAT | PAT %
24%YoY

Dr. Reddy's Laboratories Limited was incorporated in 1984 and is headquartered in Hyderabad, India. Since its inception, the company has grown to become a leading integrated pharmaceutical company with a global footprint. Key milestones include entering the US generics market in 1997, launching its first biosimilar in 2007, and expanding its presence in emerging markets.

We first analyzed the business aspects of Dr. Reddy's Laboratories Limited, focusing on its three primary segments: Global Generics, Pharmaceutical Services and Active Ingredients (PSAI), and Others. We examined how each segment contributes to the company's revenue and growth. Next, we reviewed the company's key milestones.

We then went into the company's financial performance, particularly the trends in R&D spending. Dr. Reddy's consistent investment in research and development, averaging around 9-10% of annual revenues, supports its market expansion. This analysis was followed by an exploration of strategic initiatives, including partnerships with Nestlé India and the launch of digital therapeutics like Nerivio®. These initiatives are poised to drive significant future revenue growth which is yet to happen.

We also identified the key risks and challenges faced by Dr. Reddy's, such as market competition, and the management of R&D costs. We then conducted a valuation analysis, projecting that Dr. Reddy's will continue to experience steady revenue growth. Therefore, we conclude with a "Buy or Hold" recommendation for Dr. Reddy's Laboratories stock, based on its growth potential and strategic initiatives that offer significant upside for investors.



Discounted Cash Flow (DCF) Analysis

Year	Revenue @ 10%	Revenue @ 6%
2024	270,466.9	295,913.84
2025	297,513.6	313,668.67
2026	327,265.0	332,488.79
2027	359,991.5	352,438.12
2028	395,990.6	373,584.41

R&D Spending Trends

Dr. Reddy's Laboratories has consistently invested in research and development (R&D), with spending typically around 9-10% of annual revenues. This investment supports the development of new generics, biosimilars, and innovative therapies. The company's R&D expenditure has grown from INR 15.5 billion in 2021 to INR 19.1 billion in 2023, reflecting its commitment to innovation and market expansion. R&D expenses for FY2024 were INR 22.87 billion, or 8.2% of revenue, versus 7.9% in FY2023. The YoY increase by 18% is primarily on account of increase in number of filings and developmental efforts of complex products across our markets for both small molecules and biosimilars.

Business Segments and Revenue Drivers

Dr. Reddy's operates through three primary segments:

- Global Generics: This segment manufactures and markets prescription and over-the-counter finished pharmaceutical products. These products are marketed either under a brand name or as generic finished dosages with therapeutic equivalence to branded formulations. The segment also includes the company's biologics business.
- Pharmaceutical Services and Active Ingredients (PSAI): The PSAI segment manufactures and markets active pharmaceutical ingredients (APIs) and intermediates, which are essential components for finished pharmaceutical products. Additionally, this segment offers contract research services and manufactures APIs and steroids tailored to specific customer requirements.
- Others: This segment is involved in developing therapies in the fields of oncology and inflammation, conducting research and development of differentiated formulations, and providing digital healthcare and information technology-enabled business support services.

Particulars	FY2024		
	(US$)	(₹)	%
Global Generics	**2,945**	**245,453**	**87.9**
North America		129,895	
Europe*		20,511	
India		46,407	
Emerging Markets#		48,640	
PSAI	**358**	**29,801**	**10.7**
Others	**47**	**3,910**	**1.4**
Total	**3,350**	**279,164**	**100**

There is consistent growth in the Global Generics segment, which has shown a steady increase in gross margins, reaching 63% in 2024 from 57% in 2020. This segment continues to be a strong driver of the company's profitability and overall financial health. In contrast, the PSAI segment has exhibited fluctuating performance, with gross margins varying significantly, dropping to a low of 16% in 2023 before recovering to 23% in 2024. This inconsistency highlights challenges within the PSAI segment, indicating the need for strategic adjustments to stabilize and enhance its contribution.

ALL VALUES IN (MILLION)

Particulars	FY2023 ($)	FY2023 (₹)	FY2023 %	FY2022 ($)	FY2022 (₹)	FY2021 (US$)	FY2021 (₹)	FY2021 %	FY2020 (US$)	FY2020 (₹)	FY2020 %
Global Generics	2,601	2,13,768	86.9	2,180	1,79,170	2,111	1,54,404	81.4	1,888	1,38,123	79.1
North America		1,01,704			74,915		70,494			64,659	
Europe*		17,603			16,631		15,404			11,707	
India		48,932			41,957		33,419			28,946	
Emerging Markets#		45,529			45,666		35,087			32,811	
Pharmaceutical Services and Active Ingredients (PSAI)	354	29,069	11.8	374	30,740	437	31,982	16.8	352	25,747	14.8
Others	37	3,042	1.2	55	4,481	46	3,336	1.8	147	10,730	6.1
Total	**2,992**	**2,45,879**	**100**	**2,608**	**2,14,391**	2,594	1,89,722	100	2,387	1,74,600	100

Year ending March 31	2024	2023	2022	2021
Profitability Ratios				
EBITDA Margin %	30%	30%	24%	25%
Gross Margin %	59%	57%	53%	54%
- Global Generics	63%	62%	58%	59%
- PSAI	23%	16%	22%	29%
Net Profit Margin (%)	19.9%	18.3%	11.0%	9.1%
Return on Net Worth (%)	20%	20%	12%	10%
Asset Productivity Ratios				
Fixed Asset Turnover	3.9	3.8	3.6	3.5
Total Assets Turnover	0.8	0.8	0.8	0.8

Additionally, the "Others" segment, encompassing new drug discovery and digital healthcare initiatives, has not yet demonstrated substantial impact on overall profitability. Therefore, while the Global Generics segment remains a cornerstone of growth, focused efforts are required to address the volatility in the PSAI segment and to unlock potential in the "Others" segment.

Key Milestones

Dr. Reddy's Laboratories Limited, founded by Dr. Anji Reddy in 1984, is headquartered in Hyderabad, India. The company quickly expanded its footprint, launching its first API factory in Bollaram, Hyderabad, in 1985 and opening an international branch in Russia by 1992. Notably, it became the first Asian pharma company outside Japan to list on the New York Stock Exchange in 1996 and achieved 180-day marketing exclusivity from the USFDA for Fluoxetine capsules in 2001. Dr. Reddy's has been a pioneer in sustainability, releasing its first Safety, Health, and Environment (SHE) report in 2003 and building a Zero Liquid Discharge (ZLD) plant in 2004.

The company launched its first mega-brand, Omez (Omeprazole), in 1993 and continued to innovate with products like the monoclonal antibody biosimilar Reditux and generic darbepoetin alfa (Cresp) in 2007. In 2010, it was listed on the Dow Jones Sustainability Index for Emerging Markets. By 2016, Dr. Reddy's had launched Authorized Generics (AG) in the U.S. and became the first foreign generics company to supply Olanzapine to China's public hospitals in 2019. During the COVID-19 pandemic, Dr. Reddy's combined in-house efforts with partnerships to provide vaccines and therapeutics, reaching over 5 million patients.

The company also entered into a joint venture with Nestlé India for nutraceutical products and was recognized by the World Economic Forum for its use of Industry 4.0 technologies in 2021. In 2022, Dr. Reddy's debuted on the Dow Jones Sustainability World Index and launched the digital therapeutic Nerivio® in India. The company has been included in the Bloomberg Gender-Equality Index for six consecutive years and continues to innovate with strategic collaborations for novel molecules. Dr. Reddy's CSR efforts are extensive, focusing on health, education, livelihood, and environmental sustainability through the Dr. Reddy’s Foundation

Debt

Year ending March 31	2024	2023	2022	2021	2020
Gearing Ratios					
Net Debt/Equity	(0.23)	(0.21)	(0.08)	(0.04)	(0.03)
Interest Coverage	39.7	40.3	31.5	25.5	16.8
Current Ratio	2.6	2.4	1.9	1.8	1.8
Valuation Ratios					
Earnings per share (₹)	334.0	270.9	141.7	103.6	117.4
Book Value per share (₹)^	1,683	1,388	1,145	1,041	933
Dividend Payout	12%	15%	21%	24%	21%
Trailing Price/Earnings Ratio	18.4	17.1	30.3	43.6	26.6

The gearing ratios of Dr. Reddy's Laboratories Ltd. reflect a strong and improving financial position with respect to debt. The Net Debt/Equity ratio has significantly improved from -0.03 in 2020 to -0.23 in 2024, indicating that the company has reduced its net debt over the years and, in recent years, even accumulated more cash than debt. This negative ratio is a positive indicator, showing that the company is less leveraged and has a strong balance sheet.
The Interest Coverage ratio has also shown substantial improvement, rising from 16.8 in 2020 to 39.7 in 2024. This ratio measures the company's ability to pay interest on its outstanding debt, and the higher values indicate that Dr. Reddy's Laboratories is generating ample earnings to comfortably cover its interest obligations. This improvement suggests enhanced profitability and operational efficiency.
Lastly, the Current Ratio has increased from 1.8 in 2020 to 2.6 in 2024, reflecting improved liquidity. A current ratio above 1 indicates that the company has more current assets than current liabilities, which implies good short-term financial health and the ability to cover its short-term obligations without difficulty.

Strategic Initiatives and Potential Catalysts

Dr. Reddy's Laboratories Ltd. has embarked on several strategic initiatives aimed at driving future growth and enhancing its market position. One of the key initiatives is the joint venture with Nestlé India to introduce health science nutraceutical products. This collaboration leverages Nestlé's expertise in nutrition and Dr. Reddy's extensive pharmaceutical capabilities to tap into the growing nutraceutical market, which addresses the rising consumer demand for health and wellness products.

Another significant initiative is the launch of the digital therapeutic device Nerivio® in India, marking Dr. Reddy's entry into the digital therapeutics space. Nerivio®, a wearable device for migraine management, represents a move towards innovative, patient-centric solutions that complement traditional pharmaceutical products. This aligns with the global trend towards integrating technology with healthcare to provide more personalized and effective treatments.

The company's strategic focus also includes expanding its product portfolio and geographical reach. Dr. Reddy's has entered into strategic collaborations for novel molecules, such as partnerships with Coya Therapeutics for a novel combination biologic for ALS, Junshi Biosciences for Toripalimab, and Jiangsu Hengrui for Pyrotinib. These collaborations are expected to enhance the company's pipeline with innovative therapies that address unmet medical needs.

In terms of potential catalysts, new product launches and regulatory approvals are critical. The company has a robust pipeline of generic and biosimilar products awaiting approval in key markets, which could significantly impact revenue growth upon successful launch. Regulatory milestones, such as obtaining 180-day marketing exclusivity from the USFDA, can provide a competitive edge and boost market share in the highly lucrative US market.

Advancements in digital therapeutics and the successful commercialization of new products in this domain could also serve as catalysts. As the healthcare industry increasingly adopts digital health solutions, Dr. Reddy's initiatives in this area could position it as a leader in the field, opening up new revenue streams and enhancing its value proposition to patients and healthcare providers.

Sum-of-the-Parts (SOTP) Valuation

The SOTP valuation method involves valuing each of the company's business segments individually and summing these values to get the total enterprise value. For Dr. Reddy's Laboratories, we can break down the valuation into its major business segments:

1. Global Generics
2. Pharmaceutical Services and Active Ingredients (PSAI)
3. Proprietary Products

Segment-wise Revenue and EBITDA Contribution

Segment	Revenue (2024)	% of Total Revenue	EBITDA Margin (%)	EBITDA (2024)
Global Generics	195,414	70%	30%	58,624.2
PSAI	55,833	20%	23%	12,841.6
Proprietary Products	27,917	10%	35%	9,771.0
Total	279,164	100%	-	81,236.8

Apply Valuation Multiples

Segment	EBITDA (2024)	EV/EBITDA Multiple	Enterprise Value
Global Generics	58,624.2	10	586,242
PSAI	12,841.6	8	102,733
Proprietary Products	9,771.0	12	117,252
Total	81,236.8	-	806,227

Net Debt=Total Long-term Debt−Cash and Cash Equivalents=5,990−7,107=−1,117
Equity Value=Enterprise Value−Net Debt=806,227+1,117=807,344

Discounted Cash Flow (DCF) Analysis

Year	Revenue	Revenue Growth	EBIT Margin	EBIT
2024	270,466.9	10%	24.3%	65,823.6
2025	297,513.6	10%	24.3%	72,300.8
2026	327,265.0	10%	24.3%	79,522.5
2027	359,991.5	10%	24.3%	87,474.0
2028	395,990.6	10%	24.3%	96,221.3

Assumptions:

Revenue Growth Rate: 10%
Operating Margin: 24.3%
Tax Rate: 25%
WACC: 10%
Terminal Growth Rate: 2%

Year	EBIT	Tax (25%)	Depreciation (5%)	Change in Working Capital (10%)	Capital Expenditures (10%)	FCF
2024	65,823.6	16,455.9	13,523.3	27,046.7	27,046.7	8,797.6
2025	72,300.8	18,075.2	14,875.7	29,751.4	29,751.4	9,598.6
2026	79,522.5	19,880.6	16,363.3	32,726.5	32,726.5	10,278.2
2027	87,474.0	21,868.5	17,999.6	35,999.1	35,999.1	10,606.9
2028	96,221.3	24,055.3	19,799.5	39,599.1	39,599.1	10,366.3

Calculate Terminal Value:

$$\text{Terminal Value} = \frac{\text{FCF 2028} \times (1 + \text{Terminal Growth Rate})}{\text{WACC} - \text{Terminal Growth Rate}} = \frac{10,366.3 \times 1.02}{0.10 - 0.02} = 13$$

Discount FCFs and Terminal Value to Present Value:

Year	FCF	PV of FCF (10%)
2024	8,797.60	7,998.7
2025	9,598.60	7,930.1
2026	10,278.20	7,712.3
2027	10,606.90	7,251.3
2028	10,366.30	6,444.1
	Terminal Value	82,442.4

ENTERPRISE VALUE:

Enterprise Value=∑PV(FCF)+PV(Terminal Value)
=7,998.7+7,930.1+7,712.3+7,251.3+6,444.1+82,442.4=119,778.9

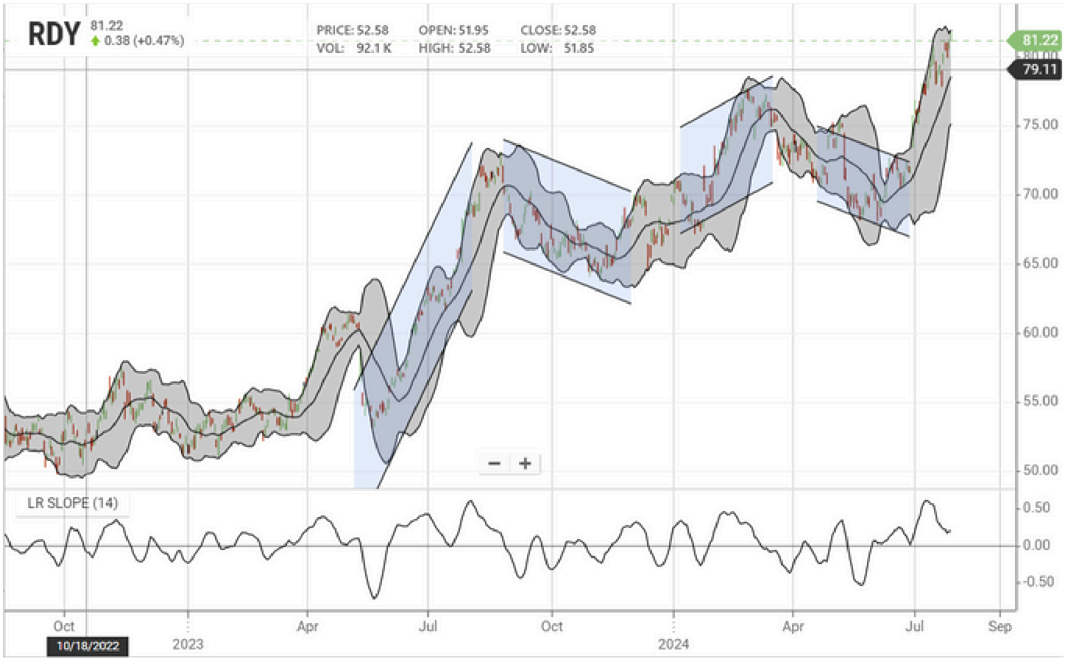
EQUITY VALUE:

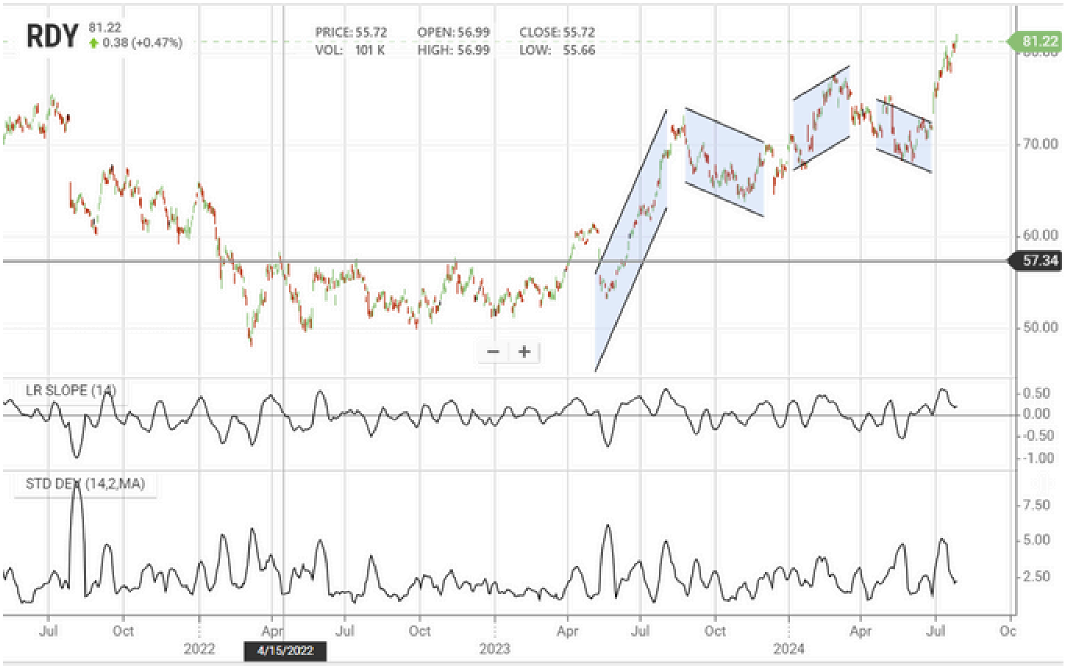
Equity Value=Enterprise Value−Net Debt=119,778.9+1,117=120,895.9

DCF VALUATION

Calculation	Value
Total Present Value of FCFs	37,336.5
Present Value of Terminal Value	82,442.4
Enterprise Value	119,778.9
Net Debt	-1,117
Equity Value	120,895.9

Stock strength Analysis





The chart shows Dr. Reddy's Laboratories stock performance, highlighting price movements, the Linear Regression (LR) Slope, and Standard Deviation (Std Dev). The LR Slope measures the direction and strength of the stock's trend over 14 periods. A positive slope indicates an upward trend, while a negative slope indicates a downward trend. The higher the slope, the stronger the trend. The Std Dev measures the stock's volatility, showing how much the price deviates from its average. High Std Dev means high volatility with larger price swings, while low Std Dev indicates stability with smaller price changes.

The chart highlights several periods of consistent upward or downward trends, shown as ascending and descending channels. Currently, the stock price is 81.22, near a recent high, indicating strong performance. When the LR Slope is high and positive, it shows strong upward trends, and high Std Dev during these times means the stock is very volatile. Periods with low LR Slope and Std Dev show stable and less active price movements. Right now, Dr. Reddy's stock is in an upward trend with high volatility, suggesting it will go through many price movements.