

Dr Reddys Laboratories | BUY

A lucrative acquisition

In line with its strategic intent, DRRD acquired Haleon's global Nicotine Replacement Therapy ('NRT') OTC brands for GBP 500mn (2.3x sales) of which GBP 42mn is contingent consideration payable in CY25/26. This acquisition will help leverage customer relationships and give an opportunity to cross-sell. The management guided for better growth by reinvesting excess margins (beyond 25%). While the current growth trajectory is modest (mid-to-high single digit), it adds 8% to FY26 revenue and is EPS accretive (+4% to FY26e) for DRRD, in our view. The acquisition alleviates concerns around managing gRevlimid cliff. Recent initiatives like Nestle JV, biosimilars, innovation, licensing deals, etc. pinpoint towards DRRD's focus on growing its new businesses. With domestic growth catching up with market growth and Haleon brand acquisitions enhancing ex-Revlimid EPS, we believe there is an opportunity to unlock value here. We maintain BUY with a revised Jun'25 TP of INR 7390.

- What is DRRD acquiring?** DRRD signed a definitive agreement to acquire Haleon's global non-US portfolio of Nicotine Replacement Therapy ('NRT') brands. The portfolio consists of Nicotinell (a global leader in NRT category) and local market-leading brands – Nicabate (Australia), Thrive (Canada) and Habitrol (New Zealand and Canada). It includes all dosage forms such as lozenges, sprays, patch, gum, etc. DRRD will also acquire a pipeline of assets. Nicotinell is the 2nd largest brand globally and is 4x the size of next player. DRRD's will also acquire field force (after due consultation) but no manufacturing assets as it is made by CMOs.
- Deal Rationale:** DRRD's acquisition is in line with its strategic intent – OTC brands contribute ~10% to global revenues (US revenues: USD 140mn). There have been multiple acquisitions in this space over the last few quarters with Nestle JV being the most recent and prominent one. The key rationale for DRRD's is (1) leverage customer relationships for better pharmacy access; (2) cross-sell products and build a bigger OTC portfolio. **DRRD aims to grow this portfolio faster than its current single digit rate and believes it is margin accretive.** The current concentration is in Europe (40%), other developed countries (20-24%) and bal. from others (like Brazil, etc.). As this was a non-focus brand, DRRD's can improve the growth by more aggressive promotion, penetration in Asian countries and new additions to portfolio. Since its an established consumer brand, it has a lot of pricing power. Recent initiatives include, JV with Nestle, acquisition of Habitrol, Doan's, Premama and MenoLabs.
- Consideration and financial implications:** DRRD will acquire the global consumer healthcare OTC portfolio for GBP 500mn (2.3x sales) of which GBP 42mn is contingent consideration payable in CY25/26. The deal is margin accretive and EPS accretive, in our view. This will add 8%/4% to Revenue/EPS in FY26. We expect the portfolio to grow in mid-to-high single digits. It is a cash generating asset acquired at a reasonable value and enhances ex-Revlimid EPS alleviating some of the concerns around post-Revlimid scenario.



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Recommendation and Price Target

Current Reco.	BUY
Previous Reco.	BUY
Current Price Target (12M)	7,390
Upside/(Downside)	18.5%
Previous Price Target	6,935
Change	6.6%

Key Data – DRRD IN

Current Market Price	INR6,236
Market cap (bn)	INR1,040.3/US\$12.5
Free Float	67%
Shares in issue (mn)	165.9
Diluted share (mn)	165.9
3-mon avg daily val (mn)	INR2,845.0/US\$34.1
52-week range	6,506/5,004
Sensex/Nifty	79,243/24,045
INR/US\$	83.5

Price Performance

%	1M	6M	12M
Absolute	6.2	9.1	24.1
Relative*	0.7	-0.3	0.1

* To the BSE Sensex

Financial Summary					(INR mn)
Y/E March	FY23A	FY24A	FY25E	FY26E	FY27E
Net Sales	2,45,879	2,79,164	3,13,723	3,53,309	3,40,984
Sales Growth (%)	14.7	13.5	12.4	12.6	-3.5
EBITDA	64,572	78,388	85,539	97,288	80,519
EBITDA Margin (%)	26.3	28.1	27.3	27.5	23.6
Adjusted Net Profit	39,510	55,684	56,420	62,717	50,099
Diluted EPS (INR)	238.2	335.6	340.1	378.0	302.0
Diluted EPS Growth (%)	36.9	40.9	1.3	11.2	-20.1
ROIC (%)	22.3	25.2	21.5	21.4	16.3
ROE (%)	18.7	21.8	18.4	17.4	12.2
P/E (x)	26.2	18.6	18.3	16.5	20.7
P/B (x)	4.5	3.7	3.1	2.7	2.4
EV/EBITDA (x)	15.3	12.4	11.4	9.6	11.0
Dividend Yield (%)	0.5	0.6	0.3	0.6	0.6

Source: Company data, JM Financial. Note: Valuations as of 27/Jun/2024

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Please see Appendix I at the end of this report for Important Disclosures and Disclaimers and Research Analyst Certification.

Key Details:

- Dr Reddy's signed a definitive agreement for purchase of Northstar Switzerland, a Haleon group company (Haleon was formed by merging Pfizer and GSK's consumer business) to acquire Haleon's global portfolio of consumer healthcare brands in Nicotine Replacement Therapy (NRT). This is for brands outside of the United States.
- NRT is recommended by the 'World Health Organization Model List of Essential Medicines' for nicotine use disorders.
- The portfolio to be acquired consists of Nicotinell, a global leader in the NRT category with an extensive footprint in over 30 countries spanning Europe, Asia including Japan, and Latin America, and local market-leading brand names of the product – Nicabate in Australia, Thrive in Canada, and Habitrol in New Zealand and Canada. The proposed acquisition will be inclusive of all formats such as lozenge, patch, gum as well as pipeline products, in all applicable global markets outside of the United States.
- Nicotinell is the 2nd largest NRT brand globally. It holds the first or second position in 14 of the top 17 global markets, with the lozenge/mini lozenge format holding top position globally. Nicotinell ranks among the top 15 biggest brands among all OTC brands in Europe (excluding Russia, Italy), and ranks 32 among all OTC global brands (excluding the U.S.)
- The top 12 brands account for ~80% of CY23 revenues.
- Revenue: The proposed portfolio reported Revenues of GBP 217mn in CY23 (vs. ~GBP 200mn in CY22 and CY21).
- Consideration: Dr Reddy's will pay GBP 500mn (2.3x sales) an upfront consideration of GBP 458mn and additional contingent consideration of GBP 42mn over CY25-26.
- The transaction is expected to close by early Q4 of CY24.
- With increasing presence in consumer health and OTC in global markets, the company has been strengthening its capabilities in brand-building, marketing, digital and analytics, including exploring e-commerce partnerships. The latest proposed acquisition of Nicotinell and related portfolio gives Dr. Reddy's a strong footprint in Europe as well as other global markets, complementing and building on its existing global presence and capabilities.
- The company had a net cash surplus of INR 64.6bn as on Mar'24 which is sufficient to pay the entire consideration.

Concall KTAs:

- The acquisition of consumer healthcare portfolio includes established NRT brands in the developed markets (ex-US) – nicotinell+3 brands+ non-US pipeline assets
- DRRD aims to grow faster than the current rate. It has healthy profitability and is margin accretive. The management alluded to using some of the excess profits for reinvesting in ad-spends, new launches and entry into newer geographies and hence guided for 25%+ margin.
- No manufacturing assets are being taken over. Dr Reddy's will acquire sales teams which remains after a consultation process. Will disclose details post the closure.
- The transaction will be funded through internal accruals (Dr Reddy's has INR 64.6bn net cash surplus as on Mar'24)
- The operations will be moved in a phased manner. It is currently manufactured by CMOs with whom they have 20+ years of relationship. The manufacturing is complicated and capital intensive.

- Dr Reddy's continues to evaluate value accreting opportunities.
- DRRD's ~10% of global sales is OTC and USD 140mn is from US.
- The idea is to add more assets to this asset pool by leveraging customer relationships (gain more space at pharmacies for Dr Reddy's portfolio). This is possible as these assets are very valued assets as it promotes health and is also priced very high
- The company believes it has a sizeable opportunity and Haleon didn't invest much here. In developed countries, cigarette smoking population is declining with vaping (authorities are trying to take some action here) whereas in developing countries, this continues to grow.
- The current position of this is No 2 and it is 4x the size of next player.
- The company has sizeable presence in the 12 countries that account for 80% of sales – Europe contributes 60% of this.
- DRRD will require 4 approvals (from Brazil, Saudi, UAE and a few others) and believes they are manageable.
- The business by nature is complex for consumers as well as there is a psychological factor involved. A person attempts repeatedly in his lifetime to quit smoking as there are relapses. Consumers use it for 6 months to 1 year also. This business is a long-term play.
- The products are primarily classified as 'OTC' in most countries.
- In consumer space, stronger the brands, the more the pricing power.

Exhibit 1. Changes in estimates

(Figures in INR mn)	FY25E				FY26E				FY27E	
	Old	New	growth	chg %	Old	New	growth	chg %	New	growth
Total revenue	303565	313723	12%	3%	327339	353309	13%	8%	340984	-3%
Gross profit	176068	181959	11%	3%	184947	204919	13%	11%	189246	-8%
% margin	58%	58%			57%	58%			56%	
Adj.EBITDA	83098	85539	9%	3%	86006	97288	14%	13%	80519	-17%
% margin	27.4%	27.3%			26.3%	27.5%			23.6%	
Adj.PAT	56176	56420	1%	0%	58279	62717	11%	8%	50099	-20%
Adj.EPS	339	340	1%	0%	351	378	11%	8%	302	-20%
Ex-Revlimid EPS	247	248	5%	1%	273	284	14%	4%	302	6%

Source: JM Financial

Exhibit 2. Recent initiatives

Date	Notable events in Specialty/Specialty generics
Jan-24	Launched inhouse PRIMCYV (Breast Cancer Drug taken from Pfizer) in India
Feb-24	Acquired Mayne Pharma US generic portfolio
Jun-24	Completed Phase 1 studies of Tocilizumab Biosimilar
Jul-24	Submitted Trastuzumab dossier in US, UK and Europe
Nov-24	Launched Nerivio (US FDA approved Path breaking Migraine treatment) in India
Dec-24	Enters into exclusive agreement for Coya 302 (ALS product)
Jan-24	Announces the acquisition of MenoLabs in US (women healthcare & Nutra)
Jan-24	Forayed into the consumer health market of UK with the launch of allergy medication, Histallay
Mar-24	Launches Versavo (Bevacizumab biosimilar) in UK
Mar-24	In licensed first in class Cethaquine for Hypovolemic shock in India
Mar-24	Exclusive distribution partnership for Sanofi's Vaccines brands in India
Apr-24	Partnered with Bayer to distribute Vericiguat, a heart failure management drug, in India
Apr-24	Launched migraine management wearable device, Nerivio®, in Germany and South Africa
Apr-24	Launched 'DailyBloom IBS' digital integrated care plan to manage Irritable Bowel Syndrome
Apr-24	Announced JV with Nestle for health science nutraceutical portfolio
May-24	Acquired Haleon's global consumer OTC brands for NRT

Source: Company

Financial Tables (Consolidated)

Income Statement		(INR mn)				
Y/E March	FY23A	FY24A	FY25E	FY26E	FY27E	
Net Sales	2,45,879	2,79,164	3,13,723	3,53,309	3,40,984	
Sales Growth	14.7%	13.5%	12.4%	12.6%	-3.5%	
Other Operating Income	0	0	0	0	0	
Total Revenue	2,45,879	2,79,164	3,13,723	3,53,309	3,40,984	
Cost of Goods Sold/Op. Exp	1,06,536	1,15,557	1,31,764	1,48,390	1,51,738	
Personnel Cost	0	0	0	0	0	
Other Expenses	74,771	85,219	96,420	1,07,632	1,08,727	
EBITDA	64,572	78,388	85,539	97,288	80,519	
EBITDA Margin	26.3%	28.1%	27.3%	27.5%	23.6%	
EBITDA Growth	40.1%	21.4%	9.1%	13.7%	-17.2%	
Depn. & Amort.	12,636	14,855	17,254	19,510	20,551	
EBIT	51,936	63,533	68,286	77,778	59,968	
Other Income	8,760	8,193	5,761	4,535	5,721	
Finance Cost	0	0	0	0	0	
PBT before Excep. & Forex	60,696	71,726	74,046	82,312	65,689	
Excep. & Forex Inc./Loss(-)	0	0	0	0	0	
PBT	60,696	71,726	74,046	82,312	65,689	
Taxes	15,300	16,186	17,817	19,805	15,821	
Extraordinary Inc./Loss(-)	-699	-3	0	0	0	
Assoc. Profit/Min. Int.(-)	370	147	191	210	231	
Reported Net Profit	45,067	55,684	56,420	62,717	50,099	
Adjusted Net Profit	39,510	55,684	56,420	62,717	50,099	
Net Margin	16.1%	19.9%	18.0%	17.8%	14.7%	
Diluted Share Cap. (mn)	165.9	165.9	165.9	165.9	165.9	
Diluted EPS (INR)	238.2	335.6	340.1	378.0	302.0	
Diluted EPS Growth	36.9%	40.9%	1.3%	11.2%	-20.1%	
Total Dividend + Tax	6,441	7,612	3,904	7,612	7,612	
Dividend Per Share (INR)	33.0	39.0	20.0	39.0	39.0	

Source: Company, JM Financial

Cash Flow Statement		(INR mn)				
Y/E March	FY23A	FY24A	FY25E	FY26E	FY27E	
Profit before Tax	61,066	71,873	74,237	82,523	65,920	
Depn. & Amort.	12,636	14,841	17,254	19,510	20,551	
Net Interest Exp. / Inc. (-)	248	-567	-630	-2,495	-2,081	
Inc (-) / Dec in WCap.	-7,855	-20,182	-7,219	-12,347	3,844	
Others	3,494	-485	0	0	0	
Taxes Paid	-10,714	-20,047	-17,817	-19,805	-15,821	
Operating Cash Flow	58,875	45,433	65,825	67,386	72,413	
Capex	-18,866	-27,435	-64,862	-22,117	-17,049	
Free Cash Flow	40,009	17,998	964	45,268	55,364	
Inc (-) / Dec in Investments	-23,284	-14,640	0	0	0	
Others	777	1,792	3,195	3,515	3,901	
Investing Cash Flow	-41,373	-40,283	-61,666	-18,603	-13,148	
Inc / Dec (-) in Capital	157	805	0	0	0	
Dividend + Tax thereon	-4,979	-6,648	-3,904	-7,612	-7,612	
Inc / Dec (-) in Loans	-20,397	4,346	0	-3,000	-3,000	
Others	-1,356	-2,325	-2,565	-1,020	-1,820	
Financing Cash Flow	-26,575	-3,822	-6,469	-11,632	-12,432	
Inc / Dec (-) in Cash	-9,073	1,328	-2,310	37,151	46,834	
Opening Cash Balance	14,852	5,779	7,107	4,797	41,948	
Closing Cash Balance	5,779	7,107	4,797	41,948	88,781	

Source: Company, JM Financial

Balance Sheet		(INR mn)				
Y/E March	FY23A	FY24A	FY25E	FY26E	FY27E	
Shareholders' Fund	2,30,991	2,80,550	3,33,067	3,88,172	4,30,659	
Share Capital	833	834	834	834	834	
Reserves & Surplus	2,30,991	2,80,550	3,33,067	3,88,172	4,30,659	
Preference Share Capital	0	0	0	0	0	
Minority Interest	0	0	0	0	0	
Total Loans	13,472	20,020	20,020	17,020	14,020	
Def. Tax Liab. / Assets (-)	-6,363	-9,865	-9,865	-9,865	-9,865	
Total - Equity & Liab.	2,38,100	2,90,705	3,43,222	3,95,327	4,34,814	
Net Fixed Assets	1,01,556	1,18,090	1,65,698	1,68,305	1,64,803	
Gross Fixed Assets	1,42,313	1,58,405	1,71,581	1,85,714	1,99,353	
Intangible Assets	1,22,997	1,32,776	1,84,461	1,92,446	1,95,856	
Less: Depn. & Amort.	-1,73,710	-1,84,810	-2,02,064	-2,21,574	-2,42,125	
Capital WIP	9,956	11,719	11,719	11,719	11,719	
Investments	61,380	79,618	79,618	79,618	79,618	
Current Assets	1,51,722	1,79,036	1,89,144	2,49,350	2,89,005	
Inventories	48,670	63,552	62,745	70,662	68,197	
Sundry Debtors	72,485	80,298	90,249	1,01,637	98,091	
Cash & Bank Balances	5,779	7,107	4,797	41,948	88,781	
Loans & Advances	0	0	0	0	0	
Other Current Assets	24,788	28,079	31,353	35,103	33,936	
Current Liab. & Prov.	76,558	86,039	91,238	1,01,946	98,612	
Current Liabilities	29,292	34,888	34,052	37,848	36,666	
Provisions & Others	47,266	51,151	57,186	64,098	61,946	
Net Current Assets	75,164	92,997	97,906	1,47,403	1,90,393	
Total - Assets	2,38,100	2,90,705	3,43,222	3,95,327	4,34,814	

Source: Company, JM Financial

Dupont Analysis						
Y/E March	FY23A	FY24A	FY25E	FY26E	FY27E	
Net Margin	16.1%	19.9%	18.0%	17.8%	14.7%	
Asset Turnover (x)	1.0	1.0	0.9	0.9	0.8	
Leverage Factor (x)	1.1	1.1	1.1	1.1	1.0	
RoE	18.7%	21.8%	18.4%	17.4%	12.2%	

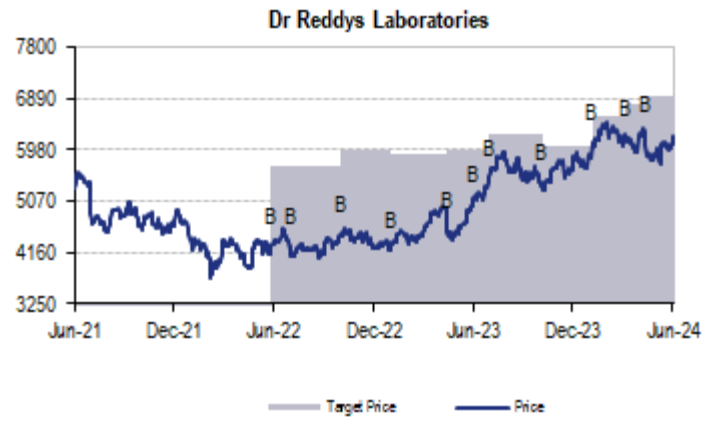
Key Ratios						
Y/E March	FY23A	FY24A	FY25E	FY26E	FY27E	
BV/Share (INR)	1,392.4	1,691.1	2,007.6	2,339.8	2,595.9	
ROIC	22.3%	25.2%	21.5%	21.4%	16.3%	
ROE	18.7%	21.8%	18.4%	17.4%	12.2%	
Net Debt/Equity (x)	-0.2	-0.2	-0.2	-0.3	-0.3	
P/E (x)	26.2	18.6	18.3	16.5	20.7	
P/B (x)	4.5	3.7	3.1	2.7	2.4	
EV/EBITDA (x)	15.3	12.4	11.4	9.6	11.0	
EV/Sales (x)	4.0	3.5	3.1	2.6	2.6	
Debtor days	108	105	105	105	105	
Inventory days	72	83	73	73	73	
Creditor days	53	56	48	48	46	

Source: Company, JM Financial

History of Recommendation and Target Price

Date	Recommendation	Target Price	% Chg.
22-Jun-22	Buy	5,685	
28-Jul-22	Buy	5,685	0.0
29-Oct-22	Buy	5,960	4.8
26-Jan-23	Buy	5,890	-1.2
11-May-23	Buy	5,980	1.5
25-Jun-23	Buy	5,980	0.0
26-Jul-23	Buy	6,260	4.7
29-Oct-23	Buy	6,055	-3.3
31-Jan-24	Buy	6,585	8.8
31-Mar-24	Buy	6,780	3.0
7-May-24	Buy	6,935	2.3

Recommendation History



APPENDIX I

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Corporate Identity Number: U67100MH2017PLC296081

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Hold	Price expected to move in the range of 10% downside to 10% upside from the current market price for stocks with market capitalisation in excess of INR 200 billion and REITs* and in the range of 10% downside to 15% upside from the current market price for all other stocks, over the next twelve months.
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