Valuations turning attractive for Dr Reddy's as company outperforms sector

US price erosion, India growth trends would be keenly tracked

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The Dr Reddy's Laboratories stock is down 17 per cent since the start of CY22. The decline over this period was led by pricing headwinds in key markets, regulatory issues across multiple plant locations and its ability to sustain growth trajectory in focus markets. Near-term pressure on the stock is also due to the unfolding geopolitical situation and the impact on its sales to the affected regions.

Russia and Ukraine account for 10 per cent ($300 million) of the company's overall revenues and near term growth may be hit due to the war. While receivables are $100 million, most of it, according to the company, is hedged. On the Sputnik deal, Kotak Institutional Equities citing the company in a report says that there are no further imports required from Russia and there is no impact on the deal with RDIF for Sputnik V vaccine as of now.

For the US market perspective, the EIR or Establishment Inspection Report for its Duvvada facility in Andhra Pradesh is positive and removes an overhang. The company had indicated last month that its formulation manufacturing facilities including an oncology injectable unit received the EIR from the US Food and Drug Administration (US FDA) indicating a closure of the inspection. The US FDA had inspected the site in October last year which resulted in a Form 483 with eight observations. With the go ahead, the company will be launching multiple products from this site in FY23.

While the price erosion (high single digit-low double digit) trends in the US are expected to remain in the near term, the company is hoping to offset this with the launch of 25-30 products annually including complex products. This comes on the back of 80 products the company launched over the last three years. While there is no clarity on the launch of contraceptive Nuvaring, near-term opportunities include the generic version of Copaxone for multiple sclerosis and cancer drug Revlimid.

In addition to the US, its biggest market, the street will keep an eye on the growth trajectory in India and the emerging markets. The company, according to IIFL Research, is eyeing a top 5 position in the Indian pharma market from its current 12th position over the next five years led by organic and inorganic growth. The company has been outperforming the sector (23 per cent 27 per cent growth respectively in Q3 and January vs 18 per cent and 21 per cent of the pharma market) and the trend is expected to continue in the near term.

While there are near term challenges, at the current price, the stock is trading at attractive levels of under 18 times its FY23 earnings estimates.

Read our full coverage on Dr Reddy's Laboratories

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