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After a weak quarter, Dr Reddy's stares at a gradual recovery

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Dr Reddy's Laboratories Ltd's stock emerged as the top loser among the Nifty 50 companies on Thursday, dropping nearly 7% following the release of disappointing March quarter (Q4 FY23) earnings. Its revenue took a hit due to lower sales from gRevlimid and the US generics portfolio, which resulted in a sequential decline of 530 basis point in its calculated Ebitda margin to 25.1% for the March quarter.

Some analysts reckoned that the valuations were factoring in most of the positives initially. So far this calendar year, the stock gained 15% before its Q4 result announcement. "Adjusting for various divestments, the core Ebitda margins as per our estimates came in at about 21.9%," said Antique Stock Broking analysts. Note, the company had launched gRevlimid in US in Q2FY23 with sales exclusivity of 180 days for 2.5 mg and 20 mg strengths. Its lower sales in Q4 weighed on the last quarter's profitability.

The path ahead seems tough with profit growth expected to moderate in FY24 after a strong performance in FY23. Analysts worry that the high base of FY23 and limited visibility of potential products over the next two years may drag Dr Reddy's earnings.

Under pressure

Dr Reddy's saw a sharp sequential drop in its operating margin in Q4FY23.

Note: Ebitda is earnings before interest, taxes, depreciation and amortization

Source: Company, Antique Stock Broking

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In FY23, it launched 25 new products in the US. Further, it has a robust pipeline of 81 abbreviated new drug applications, or ANDAs. While gRevlimid offers significant opportunity, its sales may fluctuate as the exclusivity period is over. Moreover, substantial growth, excluding gRevlimid, could be challenging.

Among positives, JM Financial Institutional Securities' analysts expect the Mayne Pharma acquisition to be earning accretive in FY24 itself. The brokerage has factored the acquisition into their estimates. Dr Reddy's aspires to be one of the top five pharma companies in India. Its domestic business may beat industry growth, as it explores inorganic growth on the back of strong cash -flows. However, price erosion remains a concern. "Competition is high in India with everyone wanting a share of the chronic segment. It may eventually reduce market share for Dr Reddy's," Unnati Jadhav, research analyst at Sharekhan by BNP Paribas, said.

The company's management expects all key markets to grow in double digits in FY24. Thus, all eyes will be on new launches, which can fetch revenues, sales of existing products and maintaining quality at its facilities.

Margin performance is monitorable, though. "We continue to believe the competitive intensity remains high in the US business and lack of niche limited competition products is likely to cap its core Ebitda margins at 22-23%," said Antique's analysts.