September 28, 2023

# Dr. Reddy's Laboratories Limited: Ratings reaffirmed

## Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|---|---|---|---|
| Long-term, fund-based/ non-fund based limits | 500.00 | 500.00 | [ICRA]AA+ (Stable); reaffirmed |
| **Total** | **500.00** | **500.00** | |

**Instrument details are provided in Annexure-I*

## Rationale

The rating reaffirmation for Dr. Reddy's Laboratories Limited (DRL) factors in its established position as one of leading Indian pharmaceutical companies and a healthy financial profile, as marked by its strong cash accrual generation and liquidity position, as well as comfortable capital structure with robust debt protection metrics. DRL's operating income grew to Rs. 24,669.7 crore in FY2023 (14.5% YoY) and Rs. 6,757.9 crore in Q1 FY2024 (29.1% YoY) while operating margins have also expanded by ~470 basis points in FY2023 over FY2022. This was supported by improvement in the performance of its generics business in North America owing to increased revenue contribution from new product launches, including the volume limited launch of Lenalidomide[1] capsules, as well as a steady performance across other key markets. Margins are expected to largely sustain over the near to medium term, despite some volatility on account of change in product mix, which shall depend on new product launches and competition in key existing products. Additionally, strong accrual generation coupled with low reliance on debt has continued to result in a comfortable capital structure, with net cash position for the company.

DRL's business remains well diversified across geographies like North America, India, Europe and other emerging markets, and has an integrated presence across the value chain with backward integration into active pharmaceutical ingredients (APIs). Moreover, it has a strong pipeline of generic products in developed markets across the globe, supported by strong R&D capabilities with an increasing focus towards biosimilars and injectables that are expected to drive its growth over the medium to long term.

The operations, however, remain exposed to regulatory risks including scrutiny by regulatory agencies like the US FDA[2], US SEC[3] and US DoJ[4]. While regulatory issues with the US FDA can have an impact on DRL's ability to maintain a healthy portfolio, especially in the US, comfort can be drawn from the successful outcomes of the US FDA inspections of its manufacturing facilities over the past year as DRL has no outstanding issues with the US FDA. Moreover, there have been no material adverse developments across the key issues including the ongoing industry-wide investigation by the anti-trust division of the US DoJ on price fixing and price collusion allegations as well as the ongoing litigations and investigations. DRL's profitability also remains vulnerable to foreign exchange (forex) fluctuations on account of its foreign operations and foreign currency borrowings, though the company has a defined hedging policy in place.

The Stable outlook on the rating reflects s ICRA's opinion that the company will maintain its healthy credit profile and strong liquidity position, supported by healthy cash accrual generation, with an established market position, diverse product mix and geographic presence in key markets.

[1] *Generic version of Revlimid (used in oncology therapy)*

[2] *United States Food and Drug Administration*

[3] *United States Securities and Exchange Commission*

[4] *United States Department of Justice*

## Key rating drivers and their description

### Credit strengths

**Well diversified geographic mix; strong presence in key generic markets globally –** DRL has an established presence across the globe in the branded formulations business across India and emerging markets as well as in the generics business across developed markets in North America and Europe. Its key markets include North America (41% of DRL's revenues in FY2023), India (20%), Europe (7%), Russia (9%), the Commonwealth of Independent States (CIS nations; 3%) and rest of the world (RoW; 6%). The North American business has witnessed a healthy revenue growth over FY2023 and Q1 FY2024 supported by new product launches; and DRL continues to focus on limited competition drugs with a particular focus on injectables and biosimilars, which are expected to support its performance in the region. It is also expected to continue a heathy growth momentum across some other key geographies supported by a robust pipeline of new launches and focus on developing its core business. While there have been some challenges with respect to supply chain in Russia and Ukraine owing to the ongoing conflict, overall the business has remained largely unimpacted and DRL's revenue grew YoY in Russia and the CIS nations by 2% and 4%, respectively, in FY2023 and 75% and 2%, respectively, in Q1 FY2024.

**Integrated presence across value chain with backward integration into APIs –** The pharmaceutical services and active ingredients (PSAI) business of DRL generated 12% of its FY2023 revenues. The API business, in addition to external partners, also supplies APIs to DRL's own generic business. This backward integration presents a significant cost advantage to DRL and supports its overall margin profile. Moreover, DRL aims to backward-integrate more than 70% of its core molecules over the next 4-5 years, which will continue to support its margin profile.

**Strong R&D capabilities supporting development of strong generic product pipeline in developed markets –** DRL has a robust R&D set up focused on complex and differentiated formulations/injectables, first-to-file (FTF) products and biosimilar compounds. Its R&D spend was 7.9% and 8.1% of its sales in FY2023 and FY2022, respectively. Aurigene Oncology Limited, a subsidiary of DRL, is involved in discovery and clinical development of novel and best-in-class therapies to treat cancer and inflammatory diseases. As of June 30, 2023, DRL had 85 filings pending approval with the US FDA, which includes 82 ANDAs and three NDAs filed under section 505(b)(2). Of these filings, 43 are Paragraph IV filings and 17 of these filings are expected to have FTF status.

**Healthy financial profile characterised by robust credit metrics and strong liquidity –** DRL has continued to maintain a healthy financial profile supported by strong cash accruals, which coupled with limited reliance on debt have continued to result in a net cash position and strong liquidity position. Its total debt was reduced to Rs. 1,347.2 crore as on March 31, 2023, against Rs. 3,384.5 crore as on March 31, 2022. Accordingly, its leverage and coverage indicators continued to remain robust in FY2023 with an interest coverage of 45.8 times (49.0 times in FY2022), total debt/OPBDIT of 0.2 time (0.7 time in FY2022) and total outside liabilities/tangible net worth of 0.4 time (0.5 time in FY2022). While DRL has continued to make some small and mid-sized investments/ acquisitions, these have largely been funded through internal accruals. Moreover, its leverage and coverage indicators are expected to continue to remain low in the absence of any major debt-funded investments as normal capex and any small to medium sized investments are expected to be funded primarily through internal accruals. DRL's return indicators have strengthened in FY2023 supported by operating margin expansion and are likely to remain healthy, going forward.

### Credit challenges

**Ongoing investigations, pending resolution of product litigations as well as exposure to regulatory risks –** Similar to its peers, DRL's operations continue to remain exposed to risks of scrutiny by various regulatory agencies including the US FDA, US SEC and US DoJ. While DRL has successfully resolved all its past regulatory non-compliances from the USFDA, its ability to continue to maintain a healthy launch momentum in the US and other key geographies remains dependent on successful closure of any future inspections by such regulatory agencies. Moreover, DRL is yet to resolve the ongoing industry-wide investigation by the anti-trust division of the US DoJ on price fixing and price collusion allegations. Further, there are ongoing investigations with respect to allegation of violation of anti-corruption laws in the US and other product and patent related matters, whose outcomes are unascertainable at the moment and would require to be monitored on a case-by-case basis.

**Vulnerability of profitability to forex fluctuations –** DRL's profitability remains vulnerable to forex fluctuations on account of its foreign operations as well as foreign currency borrowings, though it hedges the same through both derivative and non-derivative financial instruments, such as foreign exchange forward contracts, option contracts and currency swap contracts.

## Environmental and Social Risks

**Environmental concerns –** DRL does not face any major physical climate risk. However, it remains exposed to tightening environmental regulations with regard to breach of the waste and pollution norms, which can lead to an increase in operating costs and new capacity instalment costs. This can also require capital investments to upgrade its effluent treatment infrastructure to reduce the carbon footprint and waste generation. However, DRL has constantly been making efforts to minimise the impact of environmental risks on its operations. It has set various targets to be achieved by 2030 as a part of its ESG framework including transition to 100% renewable power (42% in FY2023), carbon neutrality in scope 1 and 2 emissions (30% in FY2023), reduce scope 3 emissions by 12.5%. DRL has also achieved water positivity.

**Social considerations –** DRL faces high industry-wide social risks related to product safety and its associated litigation risks, access to qualified personnel for R&D and process engineering, and maintenance of high manufacturing compliance standards.

## Liquidity position: Strong

DRL's liquidity position remains strong, supported by a healthy generation of cash flow from operations, consolidated unencumbered cash, cash equivalents and liquid investments of Rs. 6,057.7 crore and undrawn working capital limits (standalone) of ~Rs. 5,000 crore as on March 31, 2023. The cash flow generation of the company is also expected to continue to remain strong over the medium term supported by revenue growth across major geographies. DRL is expected to incur an annual capex of around Rs. 1,200–1,500 crore (excluding that towards any inorganic expansion), which is expected to be funded through internal accruals. Moreover, it is likely to continue to invest in inorganic expansion through acquisitions for further strengthening its core businesses.

## Rating sensitivities

**Positive factors –** The rating may be upgraded if there is substantial growth in DRL's revenues and profitability, leading to sustained improvement in return indicators and further strengthening of its financial risk profile.

**Negative factors –** The rating may be downgraded if there is a weakening in the company's revenues and profitability due to lower than anticipated performance in key markets; and/or increase in debt levels on account of inorganic investments, leading to an increase in net debt/ OPBDIT to above 1.0x on a sustained basis. Any adverse outcome of the ongoing litigations/ lawsuits/ investigations would remain an event risk, and their impact on the company's business, credit profile and liquidity position would be monitored on a case-by-case basis.

## Analytical approach

| Analytical Approach | Comments |
|---|---|
| **Applicable rating methodologies** | Corporate Credit Rating Methodology<br>Rating Methodology for Entities in the Pharmaceutical Industry |
| **Parent/Group support** | Not applicable |
| **Consolidation/Standalone** | For arriving at the ratings, ICRA has considered the consolidated financials of DRL. As on March 31, 2023, the company had 48 subsidiaries and step-down subsidiaries, two joint ventures and three other consolidating entities (where the company does not have any equity interests but has significant influence or control over them) that are enlisted in Annexure-II. |

## About the company

DRL was incorporated by its promoter and Founder Chairman, the Late Dr. K. Anji Reddy, as a private limited company on February 24, 1984. The company was subsequently converted to a public limited one on December 6, 1985, and listed on the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE) in August 1986, as well as on the New York Stock Exchange (NYSE) on April 11, 2001. As on March 31, 2023, the promoters and the promoter Group held 26.69% stake in the company.

DRL offers a portfolio of pharmaceutical products and services, including generics, APIs, custom pharmaceutical services, biosimilars and differentiated formulations. It has three divisions—global generics (87% of revenues in FY2023), PSAI (12%) and others (1%). The major therapeutic areas of focus for the company include the central nervous system, gastro-intestinal, oncology, cardiovascular and pain management, with the US, India, West Europe, Russia and the CIS nations being its major markets.

DRL, currently, has nine API-manufacturing facilities, of which six are in India, one in Mexico, one in the US and one in the UK. It also has 13 formulations manufacturing facilities in India, and one each in the US and China. In addition, the company has one biologics facility in India and eight technology development and R&D centres in India and across the globe.

### Key financial indicators (audited)

| DRL - Consolidated | FY2022 | FY2023 |
|---|---|---|
| Operating income | 21,545.2 | 24,669.7 |
| PAT | 2,112.2 | 4,470.3 |
| OPBDIT/OI | 21.8% | 26.5% |
| PAT/OI | 9.8% | 18.1% |
| Total outside liabilities/Tangible net worth (times) | 0.5 | 0.4 |
| Total debt/OPBDIT (times) | 0.7 | 0.2 |
| Interest coverage (times) | 49.0 | 45.8 |

*PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore; All ratios as per ICRA calculation*

### Status of non-cooperation with previous CRA: Not applicable

### Any other information: None

## Rating history for past three years

| | Instrument | Current rating (FY2024) | | | | Chronology of rating history for the past 3 years | | |
|---|---|---|---|---|---|---|---|---|
| | | Type | Amount rated (Rs. crore) | Amount outstanding as of (Rs. crore) | Date & rating in FY2024 | Date & rating in FY2023 | Date & rating in FY2022 | Date & rating in FY2021 |
| | | | | | Sep 28, 2023 | Jul 28, 2022 | Jul 29, 2021 | Jun 25, 2020 |
| 1 | Fund-based / non-fund based Limits | Long term | 500.00 | -- | [ICRA]AA+ (Stable) | [ICRA]AA+ (Stable) | [ICRA]AA+ (Stable) | [ICRA]AA+ (Stable) |

## Complexity level of the rated instruments

| Instrument | Complexity Indicator |
|---|---|
| Long-term, fund-based / non fund based limits | Simple |

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: Click Here

## Annexure I: Instrument details

| ISIN | Instrument Name | Date of Issuance | Coupon Rate | Maturity | Amount Rated (Rs. crore) | Current Rating and Outlook |
|---|---|---|---|---|---|---|
| NA | Proposed fund-based/ non-fund based limits | NA | NA | NA | 500.00 | [ICRA]AA+ (Stable) |

*Source: Company*

## Annexure II: List of entities considered for consolidated analysis

| Company Name | DRL's Ownership | Consolidation Approach |
|---|---|---|
| **Subsidiaries** | | |
| Aurigene Discovery Technologies (Malaysia) Sdn. Bhd, Malaysia | 100.0% | Full Consolidation |
| Aurigene Oncology Limited (formerly, Aurigene Discovery Technologies Limited) | 100.0% | Full Consolidation |
| Aurigene Pharmaceutical Services Limited, India | 100.0% | Full Consolidation |
| Beta Institut gemeinnützige GmbH, Germany | 100.0% | Full Consolidation |
| Betapharm Arzneimittel GmbH, Germany | 100.0% | Full Consolidation |
| Cheminor Investments Limited, India | 100.0% | Full Consolidation |
| Chirotech Technology Limited, UK (under liquidation) | 100.0% | Full Consolidation |
| Dr Reddy's Laboratories LLP, Kazakhstan | 100.0% | Full Consolidation |
| Dr. Reddy's (Thailand) Limited, Thailand | 100.0% | Full Consolidation |
| Dr. Reddy's (Beijing) Pharmaceutical Co. Limited | 100.0% | Full Consolidation |
| Dr. Reddy's Bio-sciences Limited, India | 100.0% | Full Consolidation |
| Dr. Reddy's Formulations Limited, India | 100.0% | Full Consolidation |
| Dr. Reddy's Farmaceutica Do Brasil Ltda., Brazil | 100.0% | Full Consolidation |
| Dr. Reddy's Laboratories (Australia) Pty. Limited, Australia | 100.0% | Full Consolidation |
| Dr. Reddy's Laboratories (EU) Limited, UK | 100.0% | Full Consolidation |
| Dr. Reddy's Laboratories (Proprietary) Limited, South Africa | 100.0% | Full Consolidation |
| Dr. Reddy's Laboratories (UK) Limited, UK | 100.0% | Full Consolidation |
| Dr. Reddy's Laboratories Canada, Inc., Canada | 100.0% | Full Consolidation |
| Dr. Reddy's Laboratories Inc., USA | 100.0% | Full Consolidation |
| Dr. Reddy's Laboratories LLC, Ukraine | 100.0% | Full Consolidation |
| Dr. Reddy's Laboratories Malaysia Sdn. Bhd., Malaysia | 100.0% | Full Consolidation |
| Dr. Reddy's Laboratories New York, LLC | 100.0% | Full Consolidation |
| Dr. Reddy's New Zealand Limited, New Zealand | 100.0% | Full Consolidation |
| Dr. Reddy's Philippines Inc., Philippines | 100.0% | Full Consolidation |
| Dr. Reddy's Research and Development B.V. | 100.0% | Full Consolidation |
| Dr. Reddy's SRL, Italy | 100.0% | Full Consolidation |
| Dr. Reddy's Laboratories Chile SPA., Chile | 100.0% | Full Consolidation |
| Dr. Reddy's Laboratories Japan KK, Japan | 100.0% | Full Consolidation |
| Dr. Reddy's Laboratories Louisiana LLC, USA | 100.0% | Full Consolidation |
| Dr. Reddy's Laboratories Romania S.R.L., Romania | 100.0% | Full Consolidation |
| Dr. Reddy's Laboratories SA, Switzerland | 100.0% | Full Consolidation |
| Dr. Reddy's Laboratories SAS, Colombia | 100.0% | Full Consolidation |
| Dr. Reddy's Laboratories Taiwan Limited, Taiwan | 100.0% | Full Consolidation |
| Dr. Reddy's Venezuela, C.A., Venezuela | 100.0% | Full Consolidation |
| Dr. Reddy's Laboratories LLC, Russia | 100.0% | Full Consolidation |
| DRL Impex Limited, India | 100.0% | Full Consolidation |
| Idea2Enterprises (India) Private Limited, India | 100.0% | Full Consolidation |

| Company Name | DRL's Ownership | Consolidation Approach |
|---|---|---|
| **Imperial Credit Private Limited, India** | 100.0% | Full Consolidation |
| **Industrias Quimicas Falcon de Mexico, S.A.de C.V, Mexico** | 100.0% | Full Consolidation |
| **Lacock Holdings Limited, Cyprus** | 100.0% | Full Consolidation |
| **Promius Pharma LLC, USA** | 100.0% | Full Consolidation |
| **Reddy Holding GmbH, Germany** | 100.0% | Full Consolidation |
| **Reddy Netherlands B.V., Netherlands** | 100.0% | Full Consolidation |
| **Reddy Pharma Iberia SAU, Spain** | 100.0% | Full Consolidation |
| **Reddy Pharma Italia S.R.L, Italy** | 100.0% | Full Consolidation |
| **Reddy Pharma SAS, France** | 100.0% | Full Consolidation |
| **Svaas Wellness Limited** | 100.0% | Full Consolidation |
| **Nimbus Health GmbH (from 24 February 2022)** | 100.0% | Full Consolidation |
| | | |
| **Joint Ventures** | | |
| **DRES Energy Private Limited** | 26.0% | Equity Method |
| **Kunshan Rotam Reddy Pharmaceutical Company Limited** | 51.3% | Equity Method |
| | | |
| **Other Consolidating Entities*** | | |
| **Cheminor Employees Welfare Trust** | - | Full Consolidation |
| **Dr. Reddy's Employees ESOS Trust** | - | Full Consolidation |
| **Dr. Reddy's Research Foundation** | - | Full Consolidation |

**The company does not have any equity interests in these entities, but has significant influence or control over it*

***Source:*** *DRL FY2023 annual report*

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## About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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## Branches