July 28, 2022(Revised)

Dr. Reddy's Laboratories Limited: Rating 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	500.0	500.0	[ICRA]AA+ (Stable) reaffirmed
Total	**500.0**	**500.0**	

**Instrument details are provided in Annexure-I*

Rationale

The rating reaffirmation for Dr. Reddy's Laboratories Limited (DRL) factors in its healthy credit profile, which is expected to be sustained in the near to medium term led by favourable growth prospects across key geographies. DRL's operating income (OI) grew by 13.1% YoY in FY2022 supported by substantial double-digit growth in emerging markets (30.2% YoY) and India (25.5% YoY). North America and Europe also witnessed YoY growth of 6.3% and 8.0%, respectively, in revenues. The growth was aided by increase in sales volume of existing products (formulations and APIs[1]), Covid-19 related drugs and new product launches across key markets, even though Sputnik vaccine sales were significantly lower than the anticipated levels. The rating continues to derive comfort from DRL's geographically diversified revenue mix, coupled with increasing penetration in emerging markets and an integrated presence across the value chain and healthy product pipeline. The rating factors in the company's increasing focus on limited competition among its niche products, injectables and biosimilars, which are expected to boost its revenues in the medium term, given its strong research and development (R&D) capabilities.

DRL's operating profit margin (OPM) declined to 21.8% in FY2022 from 23.9% in FY2021. The decline was primarily attributable to pricing pressure in North America and Europe, combined with the effect of increase in commodity prices. The company also had higher provisioning for inventory, including for Covid-related products. In FY2022, DRL recognised an impairment of Rs. 930.4 crore towards product related intangibles and Shreveport subsidiary related assets, which moderated the net margin to an extent. The company remains vulnerable to further deterioration in the market potential for various molecules, and this is a key monitorable. The coverage indicators remain robust, aided by improvement in OPBDITA[2] and strong cash flows. DRL also has a strong liquidity profile. It remained cash surplus as of March 31, 2022, with healthy free cash and bank balance and liquid investments of Rs. 4,416.5 crore, against total debt of Rs. 3,384.5 crore. The liquidity profile is further supported by sizeable undrawn working capital lines.

DRL's ability to maintain a healthy product portfolio in the US market, secure timely approval for key launches and capability to continue to grow in other key geographies are critical for sustaining its profitability and strong credit metrics. The operations of the company also remain exposed to regulatory risks arising out of the scrutiny of regulatory agencies, including the US SEC[3], US DoJ[4] and USFDA[5]. DRL's formulations manufacturing plant at Srikakulam, Andhra Pradesh, was issued a Form 483 with two observations on July 7, 2022, which the management expects to address within the stipulated time.

[1] *Active pharmaceutical ingredients*

[2] *Operating Profit Before Depreciation, Interest, Tax and Amortisation*

[3] *Securities and Exchange Commission*

[4] *Department of Justice*

[5] *United States Food and Drug Administration*

The profitability of the company 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. Further, DRL is facing certain ongoing litigations/ lawsuits/ investigations, including product and patent related litigations and investigations, by the US SEC and DoJ. While DRL has made provisions for some of these litigations, for many of the cases, the liability that might arise remains unascertainable. Any adverse outcome of the ongoing litigations/ lawsuits/ investigations remains an event risk, and the impact of such events on the company's business and credit profile and liquidity position will be monitored on a case-by-case basis. Further, large inorganic investments by the company would remain an event risk, and the impact of such investments on the company's business and credit profile would be monitored on a case-by-case basis.

ICRA will also continue to monitor the developments around the ongoing geo-political issues between Russia and Ukraine and its impact on DRL's business. While the company has very limited presence in Ukraine, Russia is a key market accounting for 8-10% of its revenues in recent years. There has not been any material adverse impact on the company's performance over recent quarters in this market, as evidenced by 70% YoY growth in Q4 FY2022[6] and 32% YoY growth in FY2022.

The Stable outlook reflects ICRA expectation that DRL will maintain its current healthy credit profile, aided by its strong market position, diverse product mix and geographic presence, as well as strong liquidity profile with healthy growth across major geographies.

Key rating drivers and their description

Credit strengths

Well diversified geographic mix with a sustainable steady growth across key geographies; strong presence in key generic markets globally – DRL has an established presence in emerging and developed markets for branded formulations and generic businesses, respectively. The key markets for global generics and formulations are the North America Generics (34.9% of DRL's FY2022 revenues), Europe (7.8%), India (19.6%), Russia (9.7%), CIS (3.9%) and Rest of the World (RoW; 7.7%). DRL has continued its efforts to improve its market share in emerging markets and has seen healthy revenue growth in many of the key emerging markets in a wide range of therapeutic areas, including the central nervous system, oncology, cardiovascular and pain management.

Integrated presence across value chain with backward integration into APIs – DRL's global generics segment is backward integrated into APIs to the extent of around 50%. It derived 14.3% of its FY2022 revenues from the pharmaceutical services and active ingredients (PSAI) segment.

Strong R&D capabilities supporting development of strong generic product pipeline in developed markets – The company has been investing significantly in R&D (8.1% in FY2022), in line with its strategy to expand its focus on complex and differentiated formulations/ injectables, first-to-file products and biosimilar compounds. DRL is one of the few Indian companies to have forayed into new drug discovery and development (NDDD) and new chemical entity (NCE) research, with a focus on therapies like oncology and biosimilars. The company launched 17 products in North America in FY2022 and is focussed on continuing its momentum to launch about 20-25 new products in FY2023. In FY2022, DRL had 87 ANDAs[7] and three new drug applications (NDAs) filed under the 505(b)(2) route pending approval from the USFDA. Of the 87 pending ANDAs, 44 are Paragraph IV applications, of which 24 are expected to have first-to-file status.

Healthy financial profile characterised by robust credit metrics and strong liquidity – DRL's OI grew by 13.1% on a YoY basis in FY2022 supported by growth across all key geographies led by increase in sales volume of existing products and new product launches, partially offset by price erosion in generic business across regulated and certain emerging markets. The industry, including DRL, witnessed increased pricing pressure in the US market, which coupled with volatility in raw material prices, led to moderation in the company's OPM to 21.8% in FY2022 from 23.9% in FY2021. However, DRL remains focussed on growing

[6] *Also supported by the sale of territorial rights relating to 2 of the company's anti-bacterial brands in Russia and CIS region*

[7] *Abbreviated new drug applications*

its presence in non-US markets, especially India, which coupled with regular product launches is expected to support the revenue growth, improvement in OPM and return indicators over the medium term.

The company's leverage and coverage indicators remain healthy as demonstrated by interest cover of 49.0 times (46.9 times in FY2021), Total debt/OPBDITA of 0.7 time (0.7 time in FY2021) and total outside liabilities/total net worth of 0.5 time (0.4 time in 2021) in FY2022. The company's leverage is expected to remain low going forward in the absence of any debt-funded capex, further strengthening its financial flexibility. DRL has continued to make small to medium sized investments/ acquisitions over the past year to widen its product portfolio/ market presence. However, the same have been funded through internal accruals, thereby not impacting the company's leverage levels. Moreover, DRL's liquidity position remains strong supported by healthy cash flow generation and free cash and bank balance and liquid investments of Rs. 4,416.5 crore, against total debt of Rs. 3,384.5 crore as on March 31, 2022.

Credit challenges

Ongoing investigations, pending resolution of product litigations as well as exposure to regulatory risks – 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 as well as the ongoing product litigations. DRL had also received a subpoena from the US SEC for the production of documents pertaining to certain CIS markets. While the company has submitted reports for several countries during the last few quarters, there has not been any further material development in this matter as per the company's disclosures. These ongoing investigations remain key rating monitorables. DRL's operations also remain exposed to regulatory risks of greater scrutiny by regulatory agencies, including the USFDA. DRL's formulations manufacturing plant at Srikakulam was issued a Form 483 with two observations on July 7, 2022, which the management expects to address within the stipulated time. ICRA notes that DRL has successfully resolved all its past regulatory non-compliances from the USFDA.

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.

Liquidity position: Strong

DRL's liquidity position remains strong, marked by consolidated unencumbered cash and bank balances and liquid investments of Rs. 4,416.5 crore and undrawn working capital limits (standalone) of Rs. 2,548.9 crore as on March 31, 2022. The cash flow generation of the company is also expected to remain strong over the medium term supported by revenue growth across major geographies. The annual capex of ~Rs. 1,200-1,500 crore is expected to be financed by internal accruals. DRL has no long-term debt repayments in FY2023.

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/ OPBDITA 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 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, 2022, the company had 52 subsidiaries and step-down subsidiaries, three joint ventures and three other consolidating entities (where the company does not have any equity interests but has significant influence or control over it) that are enlisted in Annexure-2.

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, 2022, the promoters and the promoter Group held 26.72% stake in the company.

DRL offers a portfolio of products and services, including pharmaceutical generics, APIs, custom pharmaceutical services, biosimilars and differentiated formulations. It has three divisions—global generics (accounted for 83.6% of its revenues in FY2022), PSAI (14.3%) and proprietary products and others (PP and Aurigene Discovery Technologies Limited; 2.1%). The major therapeutic areas for the company include central nervous system, gastro-intestinal, oncology, cardiovascular and pain management with the US, India, Western Europe, Russia and the CIS countries being its major markets.

DRL has nine API-manufacturing facilities, of which six are in India, one in Mexico, one in the US and one in the UK, coupled with 10 formulations manufacturing facilities in India, and one each in the UK and US. In addition, the company has one biologics facility in India and nine technology development and R&D centres in India and across the globe.

Key financial indicators (audited)

DRL Consolidated	FY2021	FY2022
Operating Income (Rs. crore)	19,047.5	21,545.2
PAT (Rs. crore)	1,903.6	2,112.2
OPBDIT/OI (%)	23.9%	21.8%
PAT/OI (%)	10.0%	9.8%
Total Outside Liabilities/Tangible Net Worth (times)	0.4	0.5
Total Debt/OPBDIT (times)	0.7	0.7
Interest Coverage (times)	46.9	49.0

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020
					July 28, 2022	July 29, 2021	Jun 25, 2020	Nov 8, 2019
1	Fund-based / Non-fund Based Limits	Long-term	500.0	-	**[ICRA]AA+ (Stable)**	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)
2	Fund-based / Non-fund Based Limits	Short-term	-	-	-	-	-	[ICRA]A1+; withdrawn

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: www.icra.in

Annexure I: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Fund-based / Non-fund Based Limits	NA	NA	NA	500.0	[ICRA]AA+ (Stable)

Source: *Company*

Annexure II: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Subsidiaries	100.0%	Full Consolidation
Aurigene Discovery Technologies Limited	100.0%	Full Consolidation
Cheminor Investments Limited	100.0%	Full Consolidation
Dr. Reddy's Bio-Sciences Limited	100.0%	Full Consolidation
Dr. Reddy's Formulations Limited (incorporated effective 11 March 2021)	100.0%	Full Consolidation
Dr. Reddy's Farmaceutica Do Brasil Ltda.	100.0%	Full Consolidation
Dr. Reddy's Laboratories SA	100.0%	Full Consolidation
Idea2Enterprises (India) Private Limited	100.0%	Full Consolidation
Imperial Credit Private Limited	100.0%	Full Consolidation
Industrias Quimicas Falcon de Mexico, S.A.de C.V.	100.0%	Full Consolidation
Svaas Wellness Limited (Formerly known as Regkinetics Services Limited)	100.0%	Full Consolidation
	100.0%	
Step-down Subsidiaries	100.0%	
Aurigene Discovery Technologies (Malaysia) SDN BHD	100.0%	Full Consolidation
Aurigene Discovery Technologies Inc.	100.0%	Full Consolidation
Aurigene Pharmaceutical Services Limited, India (from 16 September 2019)	100.0%	Full Consolidation
Beta Institut gemeinnützige GmbH	100.0%	Full Consolidation
Betapharm Arzneimittel GmbH	100.0%	Full Consolidation
Chirotech Technology Limited	100.0%	Full Consolidation
DRL Impex Limited	100.0%	Full Consolidation
Dr. Reddy's Laboratories (Australia) Pty. Limited	100.0%	Full Consolidation
Dr. Reddy's (Beijing) Pharmaceutical Co. Limited (incorporated effective 19 August 2020)	100.0%	Full Consolidation
Dr. Reddy's Laboratories B.V. (Formerly Eurobridge Consulting B.V.)	100.0%	Full Consolidation
Dr. Reddy's Laboratories Canada, Inc.	100.0%	Full Consolidation
Dr. Reddy's Laboratories Chile SPA.	100.0%	Full Consolidation
Dr. Reddy's Laboratories (EU) Limited	100.0%	Full Consolidation
Dr. Reddy's Laboratories Inc.	100.0%	Full Consolidation
Dr. Reddy's Laboratories Japan KK	100.0%	Full Consolidation
Dr. Reddy's Laboratories Kazakhstan LLP	100.0%	Full Consolidation
Dr. Reddy's Laboratories LLC	100.0%	Full Consolidation
Dr. Reddy's Laboratories Louisiana LLC	100.0%	Full Consolidation
Dr. Reddy's Laboratories Malaysia Sdn. Bhd.	100.0%	Full Consolidation
Dr. Reddy's Laboratories New York, Inc. (transfer of ownership from DRL Swiss to DRL Inc. effective 29 October 2020 and conversion from Inc. to LLC effective 30 October 2020	100.0%	Full Consolidation
Dr. Reddy's Laboratories Philippines Inc.	100.0%	Full Consolidation
Dr. Reddy's Laboratories (Proprietary) Limited	100.0%	Full Consolidation
Dr. Reddy's Laboratories Romania S.R.L.	100.0%	Full Consolidation
Dr. Reddy's Laboratories SAS	100.0%	Full Consolidation
Dr. Reddy's Laboratories Taiwan Limited	100.0%	Full Consolidation
Dr. Reddy's Laboratories (Thailand) Limited	100.0%	Full Consolidation
Dr. Reddy's Laboratories (UK) Limited	100.0%	Full Consolidation
Dr. Reddy's New Zealand Limited	100.0%	Full Consolidation
Dr. Reddy's Research and Development B.V.	100.0%	Full Consolidation
Dr. Reddy's Srl	100.0%	Full Consolidation
Dr. Reddy's (WUXI) Pharmaceutical Co. Limited	100.0%	Full Consolidation
Dr. Reddy's Venezuela, C.A.	100.0%	Full Consolidation
Lacock Holdings Limited	100.0%	Full Consolidation
OOO Dr. Reddy's Laboratories Limited	100.0%	Full Consolidation
OOO DRS LLC	100.0%	Full Consolidation

Company Name	Ownership	Consolidation Approach
Promius Pharma LLC	100.0%	Full Consolidation
Reddy Holding GmbH	100.0%	Full Consolidation
Reddy Netherlands B.V.	100.0%	Full Consolidation
Reddy Pharma Iberia SA	100.0%	Full Consolidation
Reddy Pharma Italia S.R.L	100.0%	Full Consolidation
Reddy Pharma SAS	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
DRANU LLC	50.0%	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 FY2022 annual report*

Corrigendum

Document dated July 28, 2022 has been corrected with revisions as detailed below:

Revisions: - Page 1 - free cash and bank balance and liquid investments has been revised

Page 3- free cash and bank balance and liquid investments, and undrawn working capital limits (standalone) has been revised

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