

# Pharmaceuticals

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## *4QFY18 Results Preview*

13 Apr 2018

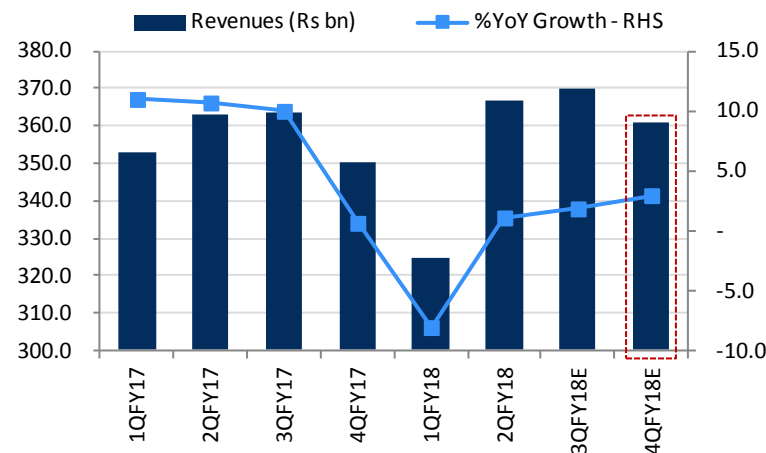
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# Still not out of the woods

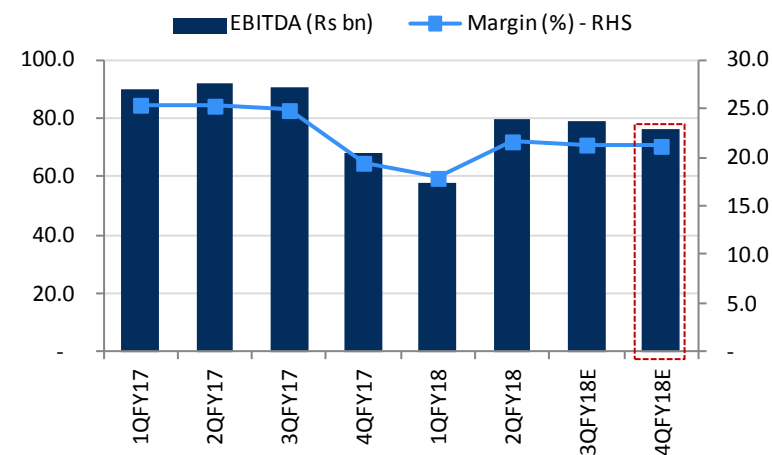
- After reporting two better quarters, we expect the top line for our pharmaceutical coverage universe to decline 2-3% QoQ while EBITDA margin is likely to remain steady at 21% in 4QFY18. Within the sector, considering the seasonality in the business, only CRAMS companies are likely to report sequential improvement. Most of the US focused formulation companies will report single digit decline in the top line and earnings are likely to be better sequentially due to low base of 3QFY18 (hit by US tax adjustments). Although YoY performance appears much better (Revenues – Up 3%YoY and EBITDA Margin up 170bps YoY), structural issues like unfavorable US pricing environment, pending plant clearances and low visibility on the lucrative approvals are still dominating. We continue to believe that the US generic businesses are not completely out of the woods and will need more time to recover.
- Strong revenue growth elusive for many US focused companies:** With increased competition in niche products like gRenvela and gLialda, DRRD, CDH, ARBP and CIPLA to see their US business revenues normalizing and profitability to come down sequentially. While SUNP and LPC will deliver improved EBITDA over QoQ. The performance of both these players will be plagued by lingering regulatory issues, vulnerable US product portfolio and increased cost structures for specialty/complex generic molecules. ALPM's performance is likely to be hit by the negative operating leverage due to underutilized new capacities. On YoY, all of these companies will fare better as 4QFY17 was hit by severe price erosion in the US.
- Continue to prefer domestic/CRAMS/diversified model:** We believe that pharma companies having differentiated business models like CRAMs (DIVI and DCAL) or highly diversified business mixes (GRAN, JUBILANT and STR) are likely to report good numbers in 4QFY18 as well. We expect (1) improved traction in JUBILANT's pharma business, (2) better profitability in STR due to absence of one off cost and improved regulatory businesses, (3) benefits of capacity expansion and better pricing in select molecules for GRAN and (4) seasonally good quarters for DIVI, DCAL and NLL.

- Top picks: CDH, ALKEM, DCAL, NLL**

## Expect ~3% YoY Rev Increase For Our Coverage Universe



## Overall EBITDA Margin To Remain Steady



Source: Company, HDFC sec Inst Research

# Still not out of the woods

COMPANY	4QFY18E OUTLOOK	WHAT'S LIKELY	KEY MONITORABLES
Sun Pharma	AVG	<ul style="list-style-type: none"> <li>The top-line is likely to decline 5%YoY and flat QoQ with no big ticket launches in the US market over last one year. Domestic business will grow at market rate.</li> <li>Sequential improvement of EBITDA margin to continue as spend on the specialty part of the US business is stabilizing.</li> </ul>	<ul style="list-style-type: none"> <li>FY19E generic launch guidance</li> <li>Updates on Halol facility</li> <li>Specialty pipeline progress</li> </ul>
Cipla	AVG	<ul style="list-style-type: none"> <li>With higher competition in gRenvela and lack of traction in recently launched Pulmicort respules, CIPLA's revenues will be up only 8%YoY and down 1.3% QoQ in 4QFY18. This too is largely aided by domestic and RoW market growth.</li> <li>EBITDA margin will contract to ~20% (down 60bps QoQ) owing to the increase price erosion in key products like gRenvela.</li> </ul>	<ul style="list-style-type: none"> <li>Commentary on the launch of further limited competition opportunities in the US</li> <li>Clarity on recent US FDA inspections in Goa and Indore facilities</li> </ul>
Cadila Healthcare	GOOD	<ul style="list-style-type: none"> <li>CDH to post another bumper quarter with limited competition product like gLialda and gTamiflu in the US. However, top line will decline sequentially as higher channel filling is likely to have happen in 3QFY18. Ex-US, all other businesses are likely maintain their growth trajectory.</li> <li>EBITDA margin at 23.7% will be up 388bps YoY and down 215bps QoQ</li> </ul>	<ul style="list-style-type: none"> <li>Guidance on other significant approvals such as transdermals and Asacol HD</li> </ul>
Lupin	AVG	<ul style="list-style-type: none"> <li>With no incremental competition in gFortamet and gGlumetza, and absence of one off costs, LPC to report improved operational performance in 4QFY18.</li> <li>Top line may decline 11%YoY and 4%QoQ but EBITDA margin will be up~100bps YoY and 200bps QoQ to 19.3%.</li> </ul>	<ul style="list-style-type: none"> <li>Visibility on significant product launches in the US market in FY19</li> <li>Commentary on price erosion in gGlumetza and gFortamet</li> </ul>

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COMPANY	4QFY18E OUTLOOK	WHAT'S LIKELY	KEY MONITORABLES
Dr Reddy's Labs	BAD	<ul style="list-style-type: none"> <li>With gRenvela and gToprol XL revenues to go down in 4QFY18 due to new entrants, top line is likely to decline 6%QoQ. We expect US\$ 240mn sales from the US market v/s US\$ 247mn in 3QFY18.</li> <li>EBITDA margin is likely to be at ~19.6% for the quarter, up ~320bps YoY but down ~60bps QoQ</li> </ul>	<ul style="list-style-type: none"> <li>Update on regulatory matters (Duuveda, Medak)</li> <li>Base business erosion.</li> <li>Visibility on key product launches like gSuboxone, gCopaxone, gNuvaring.</li> </ul>
Aurobindo Pharma	AVG	<ul style="list-style-type: none"> <li>Similar to DRRD and CIPLA, ABRP is also likely to witness drop in the US top line due to lower sales from gRenvela. Expect overall revenues to decline 5%QoQ and grow 14%YoY.</li> <li>With low gRenvela sales and higher R&amp;D spend, expect margins to decline 100bps.</li> </ul>	<ul style="list-style-type: none"> <li>Guidance on complex product approvals in FY19</li> <li>Base business growth in the US market</li> <li>Capex and debt reduction plan</li> </ul>
Divi's Labs	GOOD	<ul style="list-style-type: none"> <li>With the import alert being lifted in Nov-17 and 4Q traditionally stronger for DIVI, we foresee ~10% QoQ growth in the top-line and a pick-up in margins to ~34.7%, up ~180bps QoQ.</li> <li>Comparisons on YoY basis would not be appropriate due to the regulatory disruptions to the business in FY18.</li> </ul>	<ul style="list-style-type: none"> <li>Recovery in the business post import alert lifting</li> <li>Pending Unit 1 inspection</li> <li>Commentary on capacity expansion</li> </ul>
Alkem Labs	BAD	<ul style="list-style-type: none"> <li>4Q has always been seasonally weak quarter for ALKEM in the past, largely due to lower acute product sales and early book closure. Expect top line to decline 19% QoQ and grow ~13%YoY in 4QFY18. EBITDA margin to post 70bps YoY contraction at 11.2%.</li> <li>We have cut our target PE multiple from 25x to 20x after it received thirteen 483 observations for Daman formulation facility. We believe these observations are serious in nature and could delay ANDA approvals over next 6-8 months.</li> <li><b>Revise TP: Rs 2,124, Rating: BUY</b></li> </ul>	<ul style="list-style-type: none"> <li>Commentary on US business ramp-up from 2HFY18</li> <li>Clarity on recent US FDA inspections at Daman plant</li> </ul>

# Still not out of the woods

COMPANY	4QFY18E OUTLOOK	WHAT'S LIKELY	KEY MONITORABLES
<b>Torrent Pharma</b>	<b>GOOD</b>	<ul style="list-style-type: none"> <li>Integration of Unichem's India brands (from mid Dec-17) will provide an optical boost to top-line growth for TRP, It is likely to grow at 20%YoY and 16%QoQ in 4QFY18.</li> <li>Expect EBITDA margin to be at ~24% (up 344bps YoY, down 26bps QoQ) in 4QFY18E as the business mix normalizes.</li> </ul>	<ul style="list-style-type: none"> <li>Pick-up in filings for the US market</li> <li>Timeline for launches of in-hand products in the US market</li> </ul>
<b>Glenmark</b>	<b>AVG</b>	<ul style="list-style-type: none"> <li>With the base of gZetia launch under 180-days exclusivity in 4QFY17, GNP is likely to post a ~15% YoY top-line decline in 4QFY18.</li> <li>EBITDA margin is likely to contract ~427bps YoY, but improve ~280bps sequentially (due to better business mix)</li> </ul>	<ul style="list-style-type: none"> <li>Progress on debt reduction</li> <li>Guidance on pick-up in US launches</li> <li>Progress of novel pipeline products and any out-licensing arrangements</li> </ul>
<b>Jubilant Life Sciences</b>	<b>GOOD</b>	<ul style="list-style-type: none"> <li>Integration of Triad and continued traction in the specialty chemicals business should see the top-line growing 22.5% YoY.</li> <li>Although we expect pricing tailwinds in the specialty chemicals business to settle down in 4QFY18, improved traction in speciality business could lead to better EBITDA margin sequentially (20-25bps)</li> </ul>	<ul style="list-style-type: none"> <li>Progress in radio pharma business, especially Ruby-Fill</li> <li>Long-term outlook on specialty chemicals business</li> </ul>
<b>Alembic Pharma</b>	<b>BAD</b>	<ul style="list-style-type: none"> <li>With the absence of new product approvals for the US market and steady growth in other segments we expect ALPM top line to grow at 6%YoY and decline 6%QoQ.</li> <li>EBITDA margin to decline 180bps sequentially with more capacities being commissioned in 4QFY18 and production activities are yet to start. (230bps YoY improvement is largely on account of a low base)</li> </ul>	<ul style="list-style-type: none"> <li>Guidance on growth revival in the US business</li> </ul>

# Still not out of the woods

COMPANY	4QFY18E OUTLOOK	WHAT'S LIKELY	KEY MONITORABLES
Strides Shasun	GOOD	<ul style="list-style-type: none"> <li>Expect STR to continue the sequential improvement in its operational performance aided by better traction in the US and Australia and absence of one off promotional cost for the consumer business.</li> <li>Top line to grow 3% and EBITDA margins to improve 30bps QoQ in 4QFY18. YoY performance is not comparable due to divestment of India and API businesses.</li> </ul>	<ul style="list-style-type: none"> <li>Visibility on further niche product filings / launches in the US</li> <li>Progress in the Australia business and launch guidance</li> </ul>
Dishman Carbogen	GOOD	<ul style="list-style-type: none"> <li>Foresee ~10%YoY decline in top line on a high base of 4QFY17. Sequentially we would see 5% jump as 4Q is seasonally strong quarter for the CRAMS companies.</li> <li>Higher contribution from Carbogen entity is likely to keep EBITDA margin flat sequentially.</li> </ul>	<ul style="list-style-type: none"> <li>Guidance/visibility on further commercial launches</li> <li>Growth outlook on Vitamin D business</li> </ul>
Granules India	GOOD	<ul style="list-style-type: none"> <li>Revenue to grow at 17% YoY, with fresh API and PFI capacities getting commissioned.</li> <li>EBITDA margin will be impacted by higher raw material cost. Expect 350bps YoY margin erosion .</li> </ul>	<ul style="list-style-type: none"> <li>Update on ANDA filings.</li> <li>Commentary on US formulations launches</li> </ul>
Neuland Labs	AVG	<ul style="list-style-type: none"> <li>Revenue to grow 19%QoQ and decline 4% YoY in 4QFY18. Higher Cipro sales are likely to help NLL to deliver sequential growth.</li> <li>EBITDA margin is likely to remain subdued due to negative operating leverage (low capacity utilization).</li> </ul>	<ul style="list-style-type: none"> <li>FY19 guidance</li> <li>Progress in various CMS projects</li> </ul>

# Financial Summary

Company	NET SALES (Rs bn)			EBITDA (Rs bn)			EBITDA Margin (%)			APAT (Rs bn)			Adj. EPS (Rs/sh)		
	4Q FY18E	QoQ (%)	YoY (%)	4Q FY18E	QoQ (%)	YoY (%)	4Q FY18E	QoQ (bps)	YoY (bps)	4Q FY18E	QoQ (%)	YoY (%)	4Q FY18E	3Q FY18	4Q FY17
Sun Pharma	67.8	1.8	(5.1)	15.4	6.1	(0.3)	22.8	92	108	10.0	14.1	(18.1)	4.2	3.8	6.1
Cipla	38.6	(1.3)	7.9	7.8	(4.2)	54.9	20.3	(62)	617	3.3	(16.5)	(640.9)	4.2	5.3	4.7
Cadila Healthcare	30.7	(5.7)	24.0	7.3	(13.6)	48.3	23.7	(215)	388	5.3	(3.1)	36.5	5.1	4.9	3.2
Lupin	38.0	(4.4)	(10.6)	7.3	6.7	(6.0)	19.3	200	95	3.8	70.6	(0.5)	8.4	10.1	14.0
Dr. Reddy's Labs	35.9	(5.7)	1.0	7.0	(8.4)	20.7	19.6	(58)	320	3.0	(11.0)	(4.8)	17.9	17.2	28.3
Aurobindo Pharma	41.0	(5.5)	13.8	9.3	(9.4)	28.8	22.7	(99)	264	5.7	(3.3)	10.7	9.8	13.3	9.9
Divi's Labs	11.4	9.6	6.7	4.0	15.5	1.1	34.7	178	(192)	2.8	16.7	(2.6)	10.6	7.4	10.1
Alkem Labs	14.1	(19.0)	12.7	1.6	(56.0)	5.9	11.2	(946)	(71)	1.3	(21.4)	(1.5)	11.3	26.8	19.5
Torrent Pharma	17.2	16.2	19.7	4.1	14.8	39.7	24.0	(29)	344	2.1	259.9	1.3	12.3	12.1	13.5
Glenmark Pharma	20.6	(5.1)	(15.0)	3.3	14.8	(32.8)	16.2	281	(427)	1.7	83.2	711.4	10.6	7.4	10.1
Jubilant Life Sciences	19.6	(5.3)	22.5	4.0	(4.3)	30.8	20.4	21	129	2.0	(5.4)	34.1	12.6	8.2	7.7
Alembic Pharma	7.8	(6.6)	6.3	1.6	(14.1)	19.6	20.5	(180)	228	0.9	(23.4)	0.3	5.0	6.4	4.6
Strides Shasun	7.7	3.1	(13.0)	1.3	4.9	(17.9)	16.7	28	(98)	1.0	11.7	(11.8)	11.2	1.9	27.2
Dishman Carbogen	4.8	4.8	(9.8)	1.3	10.0	(9.1)	27.7	130	20	0.6	33.7	31.2	3.5	3.0	2.0
Granules India	4.1	0.7	16.5	0.8	2.2	(2.2)	18.3	25	(350)	0.4	13.1	(13.3)	1.6	1.8	1.5
Neuland Labs	1.4	19.1	(3.6)	0.1	40.3	(38.2)	10.0	151	(561)	0.0	52.2	(78.4)	2.1	1.4	9.6
<b>Aggregate</b>	<b>360.7</b>	<b>(2.5)</b>	<b>2.9</b>	<b>76.3</b>	<b>(3.2)</b>	<b>12.2</b>	<b>21.2</b>	<b>(13.3)</b>	<b>173.7</b>	<b>44.0</b>	<b>9.0</b>	<b>13.9</b>			

Source: Company, HDFC sec Inst Research

# Peer Valuation

Company	Mcap (Rs bn)	CMP (Rs/sh)	Reco	TP	EPS (Rs/sh)				P/E (x)				RoE (%)			
					FY17	FY18E	FY19E	FY20E	FY17	FY18E	FY19E	FY20E	FY17	FY18E	FY19E	FY20E
Sun Pharma	1,241	516	NEU	544	26.0	14.0	20.1	27.2	19.9	36.9	25.6	19.0	17.9	9.1	12.3	14.8
Cipla	447	556	NEU	631	12.5	18.4	25.7	33.2	44.5	30.2	21.6	16.7	8.4	11.2	14.0	15.8
Cadila Healthcare	400	390	BUY	523	14.5	11.3	16.4	22.7	26.8	34.4	23.8	17.2	23.5	15.4	19.0	22.3
Lupin	348	773	BUY	1,219	33.4	18.5	43.9	64.2	23.2	41.7	17.6	12.1	12.2	6.1	13.3	17.2
Dr Reddy's Labs	350	2,061	NEU	2,320	72.7	64.7	116.0	161.0	28.4	31.8	17.8	12.8	9.5	8.4	13.9	17.0
Aurobindo Pharma	357	610	BUY	835	39.3	35.2	46.0	52.2	15.5	17.3	13.3	11.7	27.6	20.0	21.4	20.0
Divis Labs	298	1,121	NEU	1,100	39.9	33.4	44.9	51.7	28.1	33.5	25.0	21.7	22.0	15.7	18.8	19.0
Alkem Labs	210	1,758	BUY	2,124	74.6	62.6	85.0	106.2	23.6	28.1	20.7	16.6	21.9	15.8	18.8	20.2
Torrent Pharma	223	1,315	BUY	1,748	51.2	38.9	62.0	79.5	25.7	33.8	21.2	16.5	22.1	14.9	21.5	23.2
Glenmark Pharma	158	558	BUY	781	29.6	18.5	30.0	43.8	18.9	30.2	18.6	12.7	18.1	9.8	14.0	17.5
Jubilant Life Sciences	130	813	BUY	1,020	37.0	41.3	62.2	77.2	22.0	19.7	13.1	10.5	18.0	17.6	22.1	22.4
Alembic Pharma	94	500	NEU	575	21.4	23.1	25.2	31.9	23.4	21.6	19.8	15.6	23.0	21.1	19.7	21.1
Strides Shasun	57	639	BUY	990	34.0	27.7	39.0	59.4	18.8	23.1	16.4	10.8	13.1	4.6	12.9	17.1
Dishman Carbogen	54	333	BUY	480	9.0	9.9	15.2	22.4	37.0	33.7	21.9	14.9	16.3	14.9	17.6	20.2
Granules India	27	107	BUY	177	7.5	6.0	8.5	11.8	14.3	18.0	12.7	9.1	21.0	13.7	15.3	18.9

Source: Company, HDFC sec Inst Research



**INSTITUTIONAL RESEARCH**
**Rating Definitions**

BUY	: Where the stock is expected to deliver more than 10% returns over the next 12 month period
NEUTRAL	: Where the stock is expected to deliver (-) 10% to 10% returns over the next 12 month period
SELL	: Where the stock is expected to deliver less than (-) 10% returns over the next 12 month period

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