

# Sector Update

## Moderate quarter; continue to remain Neutral

### Pharma

#### Q3FY2019 results preview

**Moderate performance:** We expect moderate performance in Q3FY2019 quarter due to 1) easing pricing pressure in US for large pharma companies; 2) single digit domestic business growth and, 3) an 11% depreciation in the Indian rupee. We expect our coverage universe to report sales growth of 7.5% (growth led by favourable movement in the rupee. Operating profit margin is likely to decline by 162 bps to 23.3% due to raw material cost escalation. We expect adjusted profit to grow by 7.9%.

**US, domestic businesses to stabilise:** We feel that the US generic business will see pricing pressures ease due to lower market share erosion and 11% y-o-y depreciation in the Indian rupee. Also, the domestic business is expected to see single-digit growth on back of new launches. Hence we expect that both these will see single-digit growth in Q3 aided by limited launches by competitors and a weak rupee, which will also help some recovery in ROW/EM businesses.

**Outlook – Challenges persist but see improving trend:** The sector continues to grapple with challenges given the pricing pressure in the US business due to faster approvals; stringent USFDA regulations and increased raw material costs due to supply disruption from China for key active pharmaceutical ingredients (APIs). However, there are signs of easing out of pricing pressure in US and currency movement would help somewhat mitigate margin pressures. Thus, we maintain our neutral stance on the sector and see opportunity in select, quality companies.

**Valuation:** Though, most stocks in our coverage our trading at a reasonable valuation, the risk of earnings downgrade persists given the near-term challenges. We see opportunity to invest in select, quality companies and within our coverage universe, we prefer Biocon and Divis.

**Preferred Picks:** Divis, Biocon

**Earnings outperformers in Q3FY2019:** Divis, Glenmark, Biocon and Dr Reddy's.

**Earnings laggards in Q3FY2019:** Cadila, Cipla & Lupin

#### Q3FY2019 results estimates

Rs cr

Companies	Net sales				OPM (%)		BPS	BPS	Adjusted PAT <sup>1</sup>			
	Q3FY19E	Q3FY18	YoY %	QoQ%	Q3FY19E	Q3FY18	(YoY)	(QoQ)	Q3FY19E	Q3FY18	YoY %	QoQ%
<b>Under coverage</b>												
Aurobindo	4888.0	4336.0	12.7	2.9	22.2	23.7	-144.5	62.2	729.0	654.0	11.5	7.5
Cadila	3043.0	3260.0	-6.7	2.8	22.3	25.8	-345.1	-88.9	382.0	543.0	-29.7	-8.6
Cipla	4185.8	3913.8	6.9	4.3	18.9	20.9	-205.3	137.5	405.0	471.0	-14.0	10.4
Divis	1297.4	1037.9	25.0	1.0	41.1	33.0	816.8	105.1	370.0	241.0	53.5	7.2
Glenmark	2494.0	2204.0	13.2	-3.4	17.4	14.7	278.7	39.4	206.5	105.0	96.7	-16.4
Lupin	3970.0	3976.0	-0.2	0.5	14.0	19.4	-537.6	9.0	286.4	341.0	-16.0	6.8
Sun Pharma	7052.0	6653.0	6.0	1.6	22.6	21.8	76.1	53.7	1027.4	878	17.0	3.2
Torrent Pharma	1973.0	1477.0	33.6	4.2	28.6	24.3	424.9	41.4	199.0	243.0	-18.1	11.2
<b>Total - A</b>	<b>28903.2</b>	<b>26857.7</b>	<b>7.6</b>	<b>1.9</b>	<b>21.6</b>	<b>22.1</b>	<b>-51.1</b>	<b>48.9</b>	<b>3605.3</b>	<b>3476.0</b>	<b>3.7</b>	<b>3.1</b>
<b>Under soft coverage</b>												
Biocon	1400.7	1057.9	32.4	6.0	26.0	21.0	504.5	29.3	190.0	92.0	106.5	2.2
Dr Reddy's Lab	3905.0	3834.0	1.9	2.3	20.7	20.7	-1.7	77.1	472.4	294.2	60.6	-6.9
Laurus Labs	550.0	479.0	14.8	-6.5	15.2	18.1	-297.8	235.8	17.8	34.4	-48.3	13.4
Natco	534.0	562.0	-5.0	-1.8	38.0	51.0	-1296.4	-251.8	165.0	217.0	-24.0	-8.8
Suven	126.0	164.0	-23.2	40.8	35.9	33.3	255.5	126.0	27.2	34.6	-21.4	51.0
<b>Total - B</b>	<b>6515.7</b>	<b>6096.9</b>	<b>6.9</b>	<b>2.6</b>	<b>25.0</b>	<b>27.7</b>	<b>-272.9</b>	<b>73.1</b>	<b>872.4</b>	<b>672.2</b>	<b>29.8</b>	<b>-4.5</b>
<b>Grand Total (A+B)</b>	<b>35418.9</b>	<b>32954.6</b>	<b>7.5</b>	<b>2.0</b>	<b>23.3</b>	<b>24.9</b>	<b>-162.0</b>	<b>53.8</b>	<b>4477.7</b>	<b>4148.2</b>	<b>7.9</b>	<b>1.4</b>

## Valuation

Companies	CMP (Rs)	Reco	EPS (Rs)			P/E (X)			Price target (Rs)
			FY18	FY19E	FY20E	FY18	FY19E	FY20E	
Aurobindo	724	Buy	41.6	54.4	74.5	17.4	13.3	9.7	895
Cadila	348	Hold	16.9	16.3	21.4	20.6	21.3	16.3	410
Cipla	514	Hold	17.6	19.7	29.1	29.2	26.1	17.6	635
Divis	1490	Buy	33.0	47.1	60.2	45.1	31.6	24.8	1750
Glenmark	655	Hold	26.2	33.1	44.2	25.0	19.8	14.8	780
Lupin	821	Reduce	32.5	32.7	40.1	25.3	25.1	20.5	UR
Sun Pharma	430	Hold	13.0	17.4	25.9	33.2	24.7	16.6	525
Torrent Pharma	1820	Buy	42.8	51.6	77.9	42.5	35.2	23.4	1900

## Key expectations in Q3FY2019 results

Companies	Expectation
<b>Aurobindo</b>	We expect depreciation of the Indian rupee to help company grow in double digit coupled with limited competition launches.
<b>Cadila</b>	Weak yoy performance is mainly due to high base; However we shall see qoq improvement led by new launches like own Asacol HD, gToprol and favourable currency.
<b>Cipla</b>	Moderate quarter despite limited competition launches.
<b>Divis</b>	Recovery in overall profitability led by reduction in remediation expenses after clearance of Vizag Unit-2; business as usual along with new opportunities due to API supply shortage in China.
<b>Glenmark</b>	Profit shows robust growth due to low base of US business in Q3FY2018.
<b>Lupin</b>	Competition in its exclusive products (gGlumetza and gFortamet) and lack of new launches will affect the US business; domestic business will be muted due to high base; increased raw material costs to impact operating margins and in turn profitability.
<b>Sun Pharma</b>	Stable performance in the US and currency movement to support earnings growth; Operating performance to improve due to improving US sales and no remediation costs;
<b>Torrent Pharma</b>	Unichem acquisition to aid sales growth, however high interest cost due to acquisition related debt and high depreciation cost to dent profitability.
<b>Biocon</b>	Strong quarter performance on the back of Neulasta biosimilar launch.
<b>Dishman</b>	Better sale of key API products and new facility commercialisation to help improve quarter performance.
<b>Dr Reddy's Lab</b>	Flat sales due to increased competition in existing products; new launches to reflect from Q4FY2019.
<b>Laurus Labs</b>	Though favourable currency will aid sales growth; increased RM cost will affect operating performance.
<b>Natco</b>	Support from favourable market share gain in Copaxone generic during the quarter; Tamiflu suspension may not be meaningful.
<b>Suven</b>	Sequential improvement led by core business growth coupled with repeat order for commercial supplies.

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