

Pharmaceuticals

Refer to important disclosures at the end of this report

Q2FY20 Preview: Weak US business to drag earnings down

- Weak US growth will once again be the dominating theme for earnings in Q2 and will overshadow the revival in domestic business. We expect revenues/EBITDA to grow 12%/8% yoy for our coverage universe – the lowest in the last four quarters.
- Margins should decline 140bps qoq for our coverage companies as they ramp up their R&D and specialty related spends. Further, the competition in high-margin products – gRanexa, gSensipar, gLialda, gLevorphanol – will also cause margins to fall.
- Sequentially, we expect Divi's to report strong operating performance followed by Ipca Lab, Granules and Dr. Reddy's, while Sun Pharma and Lupin will post a sharp decline in EBITDA. Cipla, Aurobindo and Cadila are likely to register flat growth.
- Although earnings have been reset to a large extent, we believe the trend (of EPS cuts) will continue in Q2 with possible disappointments in the US business amid compliance-related issues and a lack of meaningful approvals/launches. We remain selective and prefer Divi's/Ipca as absolute Buys and Cipla/Aurobindo as relative bets.

This report is solely produced by Emkay Global. The following person(s) are responsible for the production of the recommendation:

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Recovery still elusive; Q2 likely to be another weak quarter: Earnings expectations have been reset to a large extent for the pharma sector, but we believe the trend of EPS cuts will continue in Q2. US growth is likely to be weak for nearly all companies (a sharp decline in approvals in Q2, lack of meaningful launches, and competition in base portfolios) even as domestic growth may see a revival, benefitting from the late onset of monsoons. Most companies underprovided for R&D in Q1. Hence, a ramp-up in R&D spends coupled with competition in high-margin products should impact margins. We expect margins to decline by 140bps qoq for our coverage universe.

Winners and Losers: Divi's, in line with management guidance, should see the highest sequential improvement in its operating performance followed by Ipca Labs (strong India/institutional business), Granules (benefitting from new capacities) and Dr. Reddy's (cost rationalization and strong India growth). On the other hand, SUNP (weak US, increase in DTC and R&D spends), Lupin (competition in gRanexa, slower ramp-up in Levo/Solosec and weak Japan in anticipation of price cuts in the country) are likely to underperform. Cipla, Aurobindo and Cadila should record flat growth.

Remain selective: The US continues to remain a key earnings driver for Indian companies. Although the generic segment is hit by compliance-related issues, competition in base portfolios and a lack of meaningful approvals/launches, the ramp-up in specialty portfolios has also been slower than anticipated, squeezing margins in the interim due to huge upfront costs. A meaningful recovery in overall earnings thus remains still elusive. We remain selective and prefer Divi's/Ipca as absolute Buys and Cipla/Aurobindo on a relative basis.

Please see our sector EAP (page 9): [Pharmaceuticals](#)

Financial Snapshot (Consolidated)

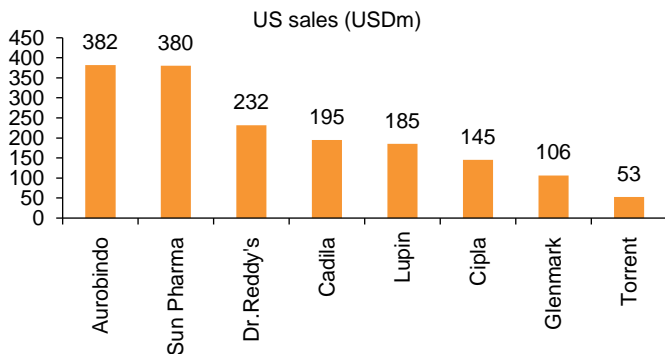
(Rs mn)	EPS		EV/EBITDA		P/E	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Cipla	22.3	27.0	9.1	7.8	18.5	15.2
Cadila Healthcare	17.0	17.8	9.4	8.7	13.8	13.1
Aurobindo Pharma	45.5	50.6	10.4	8.7	12.7	11.4
Divi's Lab	57.6	70.1	19.4	16.0	28.2	23.2
Dr. Reddy's Lab	136.3	140.3	12.5	11.2	19.7	19.2
Glenmark Pharma	26.4	34.6	6.8	5.8	12.1	9.2
Granules India	13.5	14.7	7.1	5.6	7.8	7.1
Ipca Lab	50.3	60.0	12.1	9.7	17.7	14.9
Lupin	23.1	36.1	11.3	9.0	30.4	19.5
Sun Pharma	21.1	23.4	11.1	9.3	18.3	16.5
Torrent Pharma	53.7	62.0	13.9	12.4	30.1	26.1

Source: Company, Emkay Research

Story in Charts

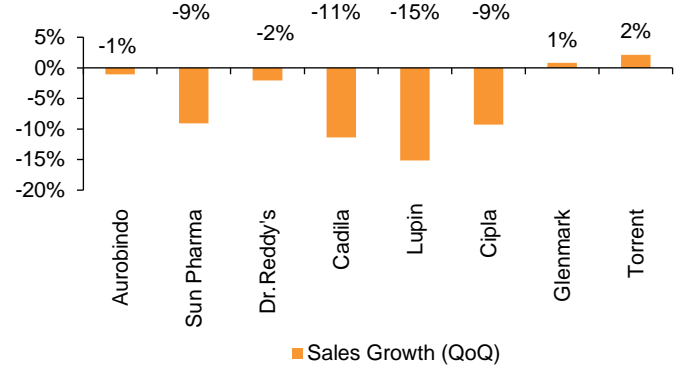
US business should be weak for almost all companies with a sharp dip in approvals in Q2, compliance issues, lack of meaningful launches and competition in base portfolios

Exhibit 1: Absolute US sales



Source: Emkay Research, Company

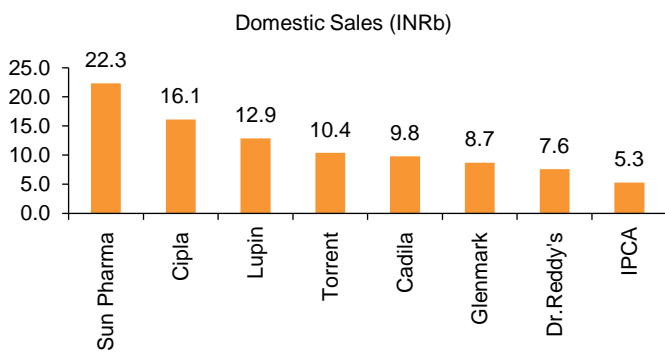
Exhibit 2: Movement in US sales qoq



Source: Emkay Research, Company

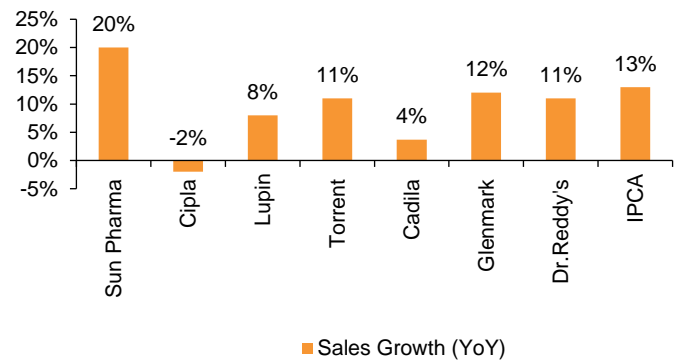
Domestic businesses see some revival with the late onset of monsoons and a low base

Exhibit 3: Absolute India business



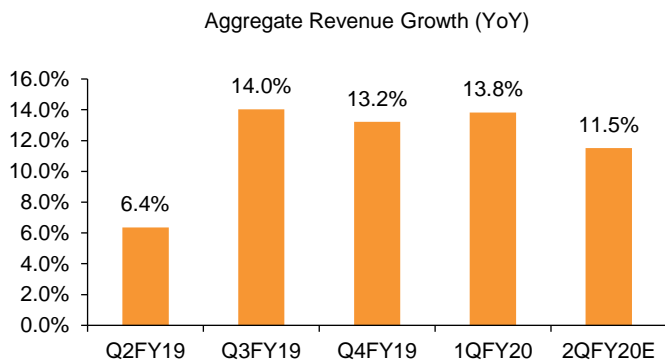
Source: Emkay Research, Company

Exhibit 4: Movement in India sales yoy



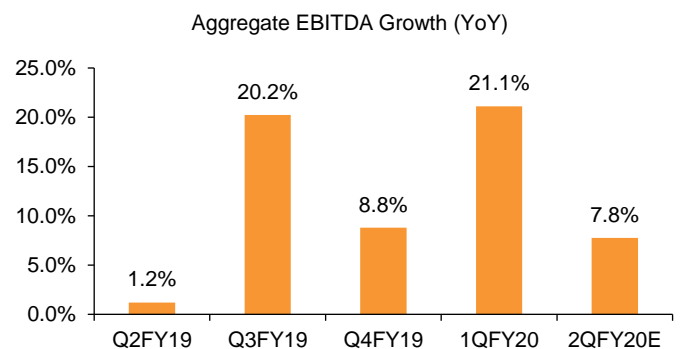
Source: Emkay Research, Company

Exhibit 5: Aggregate revenue should grow the lowest in the last four quarters

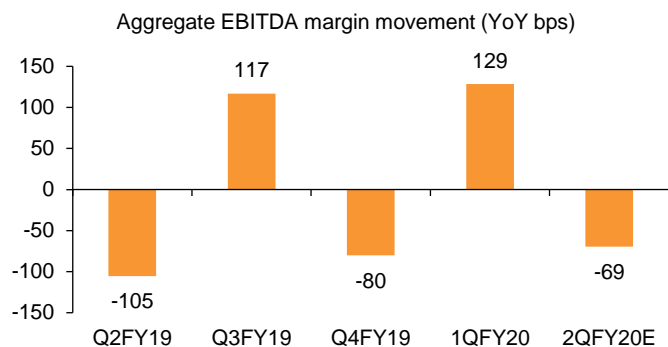


Source: Emkay Research, Company

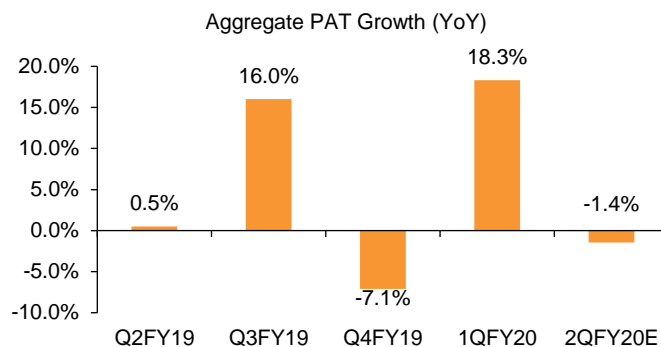
Exhibit 6: ..which should reflect in EBITDA growth as well...



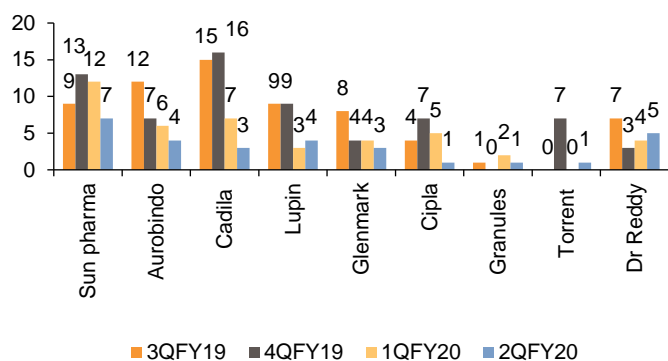
Source: Emkay Research, Company

Exhibit 7: Ramp up in R&D spends, specialty-related investments and competition in high-margin products should lead to lower margins

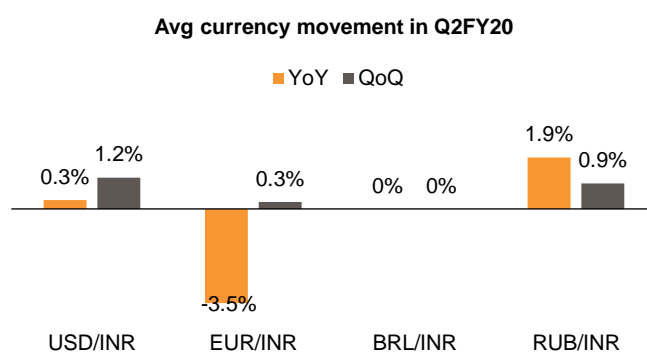
Source: Emkay Research, Company

Exhibit 8: PAT growth continues to remain weak

Source: Emkay Research, Company

Exhibit 9: Abbreviated New Drug Application (ANDA) approvals have seen a sharp decline in Q2

Source: Emkay Research, Company

Exhibit 10: Currency chart

Source: Emkay Research, Company

Exhibit 11: Financial Summary

	Revenue (INR mn)			EBITDA (INR mn)			EBITDA Margin (%)			Adjusted PAT (INR mn)		
	Q2FY20E	YoY	QoQ	Q2FY20E	YoY	QoQ	Q2FY20E	YoY	QoQ	Q2FY20E	YoY	QoQ
Sun Pharma	79,889	15.2%	-4.6%	15,578	2%	-22%	19.5%	-257 bps	-433 bps	11,148	12%	-20%
Lupin	41,952	6.2%	-5.1%	6,677	21%	-22%	15.9%	201 bps	-355 bps	2,065	-22%	-32%
Cipla	43,088	7.4%	8.0%	8,795	17%	-3%	20.4%	165 bps	-227 bps	4,428	17%	-7%
Dr. Reddy	41,671	9.7%	8.4%	8,052	9%	11%	19.3%	-17 bps	42 bps	4,559	-10%	-31%
Aurobindo	56,457	18.8%	3.7%	11,574	17%	1%	20.5%	-26 bps	-56 bps	6,751	6%	4%
Cadila Healthcare	34,752	17.4%	-0.6%	6,556	-5%	4%	18.9%	-436 bps	79 bps	3,215	-23%	6%
Torrent Pharma	20,730	9.4%	2.5%	5,493	10%	2%	26.5%	21 bps	-26 bps	2,203	8%	2%
Glenmark	26,427	2.4%	13.8%	3,717	-16%	9%	14.1%	-298 bps	-65 bps	1,328	-46%	22%
Divis	13,547	5.4%	16.5%	5,080	-1%	31%	37.5%	-251 bps	421 bps	3,637	-9%	33%
IPCA	11,254	12.8%	11.3%	2,307	34%	18%	20.5%	318 bps	121 bps	1,602	34%	21%
Granules	6,564	13.0%	10.3%	1,313	31%	11%	20.0%	269 bps	7 bps	720	19%	-14%
Total	3,76,330	11.5%	2.6%	75,143	7.8%	-4.3%	20.0%	-69bp	-140bps	41,655	-1.4%	-9.5%

Source: Company, Emkay Research

Exhibit 12: Earnings reset has been sharper in select large caps and continuing...

FY20E	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20
Sun Pharma	23.5	24.0	22.0	21.2	20.0	19.3
Aurobindo	49.2	51.6	54.0	53.9	51.1	48.9
Lupin	43.9	39.2	37.8	34.7	30.7	26.5
Glenmark	38.3	38.3	37.7	35.7	33.6	27.0
Cadila	21.9	21.1	20.1	19.1	17.6	15.1
Cipla	28.8	28.7	24.6	23.4	23.4	21.7
Torrent Pharma	66.3	66.3	65.6	63.9	54.2	51.9
Ipca Labs	38.5	38.3	40.4	43.2	44.6	44.4
Granules	8.8	9.4	10.2	10.2	10.7	11.3
Divi's	49.6	50.4	57.2	60.2	58.5	55.1
Dr. Reddy's	126.2	125.6	129.7	131.2	129.5	137.7
FY21E	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20
Sun Pharma	28.1	28.4	26.5	25.0	23.9	23.1
Aurobindo	53.1	58.1	59.4	59.4	58.0	56.8
Lupin	52.3	46.7	44.8	43.7	41.0	37.2
Glenmark	52.1	46.5	44.0	43.0	40.5	32.9
Cadila	23.7	22.5	21.9	20.7	19.3	17.1
Cipla	34.7	33.6	29.2	28.2	28.0	25.6
Torrent Pharma	81.1	83.3	82.9	82.7	72.1	68.5
Ipca Labs	45.7	46.7	49.7	52.5	54.4	55.4
Granules	11.6	13.0	13.2	12.5	12.9	13.6
Divi's	56.2	58.1	64.0	68.1	67.5	65.8
Dr. Reddy's	159.6	146.4	151.0	152.9	152.8	151.4

Source: Bloomberg

Pharmaceuticals

Name			Sep'19E	Jun'19	Sep'18	% Chg YoY	% Chg QoQ	Comments
Aurobindo Pharma								
CMP (Rs)	577	Net Sales (Rs mn)	56,457	54,446	47,514	19%	4%	The impact of higher competition in gErtapenem and no valsartan sales in the US will be negated by the commissioning of Eugia facility (launched four products) and new launches. We expect US business to be flat qoq.
Mkt Cap (Rs bn)	337.9	EBITDA (Rs mn)	11,574	11,464	9,863	17%	1%	
		EBITDA Margin (%)	20.5%	21.1%	20.8%	-26 bps	-56 bps	
		PAT (Rs mn)	6,751	6,485	6,383	6%	4%	
		EPS (Rs)	11.5	11.1	10.9	6%	4%	
Cadila Healthcare								
CMP(Rs)	234	Net Sales (Rs mn)	34,752	34,963	29,612	17%	-1%	Competition in key products - gAndrogel, gLevorphanol, gLialda - in the US coupled with weak growth in its wellness business should keep earnings muted. Q1FY20 base includes one-time costs of Rs700mn, excluding which, margins should decline 110bps qoq.
Mkt Cap (Rs bn)	239.7	EBITDA (Rs mn)	6,556	6,320	6,878	-5%	4%	
		EBITDA Margin (%)	18.9%	18.1%	23.2%	-436 bps	79 bps	
		PAT (Rs mn)	3,215	3,036	4,175	-23%	6%	
		EPS (Rs)	3.1	3.0	4.1	-23%	6%	
Cipla								
CMP(Rs)	412	Net Sales (Rs mn)	43,088	39,890	40,119	7%	8%	Seasonality in India and deferred sales of USD14mn in EMs should drive revenue growth qoq. Cipla has held on to its market share in gSensipar/gVoltaren despite increased competition and hence, the US business fall should be contained to <10% qoq. Higher R&D spends, however, should impact margins qoq.
Mkt Cap (Rs bn)	332.4	EBITDA (Rs mn)	8,795	9,046	7,528	17%	-3%	
		EBITDA Margin (%)	20.4%	22.7%	18.8%	165 bps	-227 bps	
		PAT (Rs mn)	4,428	4,782	3,771	17%	-7%	
		EPS (Rs)	5.5	5.9	4.7	18%	-7%	

Pharmaceuticals

Name		Sep'19E	Jun'19	Sep'18	% Chg YoY	% Chg QoQ	Comments	
Divi's								
CMP(Rs)	1622	Net Sales (Rs mn)	13,547	11,629	12,850	5%	16%	Growth in Q2 is likely to be affected by a high base, but sequential growth should be strong. Management guidance of 10% for FY20 implies an average quarterly run-rate of Rs14bn in balance three quarters - at those level of sales, Divi's sees strong operating leverage. In addition, the currency tailwinds should benefit as around 30% of sales benefit from USD-INR movement on a net basis.
Mkt Cap (Rs bn)	430.7	EBITDA (Rs mn)	5,080	3,871	5,141	-1%	31%	
		EBITDA Margin (%)	37.5%	33.3%	40.0%	-251 bps	421 bps	
		PAT (Rs mn)	3,637	2,724	3,977	-9%	33%	
		EPS (Rs)	13.7	10.3	15.0	-9%	33%	
Dr. Reddy's								
CMP(Rs)	2690	Net Sales (Rs mn)	41,671	38,435	37,978	10%	8%	Margins should positively benefit from: a) a pickup in PSAI gross margins, and b) lower marketing spends in the proprietary business. This will be negated to an extent by: a) increase in R&D spends (Q1 spend was only 18-20% of guided FY20 spends) and amortization of new launches. DRRD is likely to book one-time income of USD70mn from sales of proprietary products.
Mkt Cap (Rs bn)	446.7	EBITDA (Rs mn)	8,052	7,267	7,403	9%	11%	
		EBITDA Margin (%)	19.3%	18.9%	19.5%	-17 bps	42 bps	
		PAT (Rs mn)	4,559	6,628	5,038	-10%	-31%	
		EPS (Rs)	27.5	39.9	30.3	-10%	-31%	
Glenmark								
CMP(Rs)	319	Net Sales (Rs mn)	26,427	23,229	25,813	2%	14%	Q2FY19 base included around Rs400mn in sales from ortho products, which were subsequently divested. India growth should thus be around 12%. The benefit from key launches - a day-1 launch and CGT product guided in Q1FY20 - is unlikely to be material and we expect flat US sales qoq. Annual payouts happen in Q2 for GNP and hence, margins should decline qoq.
Mkt Cap (Rs bn)	90	EBITDA (Rs mn)	3,717	3,419	4,401	-16%	9%	
		EBITDA Margin (%)	14.1%	14.7%	17.0%	-298 bps	-65 bps	
		PAT (Rs mn)	1,328	1,093	2,468	-46%	22%	
		EPS (Rs)	4.7	3.9	8.7	-46%	22%	

Pharmaceuticals

Name			Sep'19E	Jun'19	Sep'18	% Chg YoY	% Chg QoQ	Comments
Granules								
CMP(Rs)	105	Net Sales (Rs mn)	6,564	5,953	5,809	13%	10%	Granules should continue to benefit from the recently added capacities, while the impact of lower Ibuprofen prices should not be visible until Nov-Dec 2019.
Mkt Cap (Rs bn)	26.7	EBITDA (Rs mn)	1,313	1,186	1,005	31%	11%	
		EBITDA Margin (%)	20.0%	19.9%	17.3%	269 bps	7 bps	
		PAT (Rs mn)	720	833	603	19%	-14%	
		EPS (Rs)	2.8	3.3	2.4	19%	-14%	
Ipca Labs								
CMP(Rs)	892	Net Sales (Rs mn)	11,254	10,110	9,978	13%	11%	Q2 is seasonally strong for India, while institutional sales should pick up qoq with the commencement of global fund orders. Margins are likely to improve sequentially, driven by normalization of gross margins, break-even in Bayshore Pharma and lower remediation costs.
Mkt Cap (Rs bn)	112.7	EBITDA (Rs mn)	2,307	1,950	1,728	34%	18%	
		EBITDA Margin (%)	20.5%	19.3%	17.3%	318 bps	121 bps	
		PAT (Rs mn)	1,602	1,321	1,198	34%	21%	
		EPS (Rs)	12.7	10.5	9.5	34%	21%	
Lupin								
CMP(Rs)	703	Net Sales (Rs mn)	41,952	44,184	39,511	6%	-5%	Muted US (decline in gRanexa sales, and slower ramp-up of Levothyroxine/Solosec), sequential decline in India and weak Japan (in anticipation of price cuts in Oct 2019) should keep revenue growth muted with a commensurate impact on margins.
Mkt Cap (Rs bn)	318.3	EBITDA (Rs mn)	6,677	8,602	5,496	21%	-22%	
		EBITDA Margin (%)	15.9%	19.5%	13.9%	201 bps	-355 bps	
		PAT (Rs mn)	2,065	3,031	2,660	-22%	-32%	
		EPS (Rs)	4.6	6.7	5.9	-22%	-32%	

Pharmaceuticals

Name			Sep'19E	Jun'19	Sep'18	% Chg YoY	% Chg QoQ	Comments
Sun Pharma								
CMP(Rs)	386	Net Sales (Rs mn)	79,889	83,744	69,376	15%	-5%	Q1 benefitted from lower R&D spends and seasonality in direct-to-consumer advertising costs, which will scale up in Q2 and thus, lead to a decline in margins. Further, the US business should see a sharp fall qoq as the one-time generic supply order in the US has ceded.
Mkt Cap (Rs bn)	927.4	EBITDA (Rs mn)	15,578	19,956	15,312	2%	-22%	
		EBITDA Margin (%)	19.5%	23.8%	22.1%	-257 bps	-433 bps	
		PAT (Rs mn)	11,148	13,922	9,956	12%	-20%	
		EPS (Rs)	4.7	5.8	4.1	13%	-19%	
Torrent Pharma								
CMP(Rs)	1618	Net Sales (Rs mn)	20,730	20,220	18,940	9%	3%	With Losartan sales resuming and subsequent market share ramping up to 15%+, we expect US sales to be flat qoq. India growth should be around 11%, while Brazil would be seasonally weak.
Mkt Cap (Rs bn)	273.8	EBITDA (Rs mn)	5,493	5,410	4,980	10%	2%	
		EBITDA Margin (%)	26.5%	26.8%	26.3%	21 bps	-26 bps	
		PAT (Rs mn)	2,203	2,160	2,040	8%	2%	
		EPS (Rs)	13.0	12.8	12.1	8%	2%	

Emkay Alpha Portfolio – Pharmaceuticals



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Sector

Pharmaceuticals

Analyst bio

Praful Bohra holds an MBA in Finance and has more than 11 years of experience in equity research. His team currently covers 12 stocks in the Pharmaceuticals space.

EAP sector portfolio

Company Name	BSE200 Weight	EAP Weight	OW/UW (%)	OW/UW (bps)	EAP Weight (Normalised)
Pharmaceuticals	2.87	2.87	0%	0	100.00
Aurobindo Pharma	0.28	0.35	27%	7	12.27
Cadila Healthcare	0.10	0.00	-100%	-10	0.00
Cipla	0.37	0.40	9%	3	14.00
Divi's Lab	0.35	0.47	33%	12	16.23
Dr. Reddy's Lab	0.55	0.43	-21%	-12	15.00
Glenmark Pharma	0.08	0.00	-100%	-8	0.00
Granules India	0.00	0.11	NA	11	4.00
Ipca Lab	0.00	0.14	NA	14	5.00
Lupin	0.28	0.14	-49%	-14	5.00
Sun Pharma	0.72	0.82	14%	10	28.50
Suven Life Sciences	0.00	0.00	NA	0	0.00
Torrent Pharma	0.14	0.00	-100%	-14	0.00
Cash	0.00	0.00	NA	0	0.00

Source: Emkay Research

* Not under coverage: Equal Weight

■ High Conviction/Strong Over Weight ■ High Conviction/Strong Under Weight

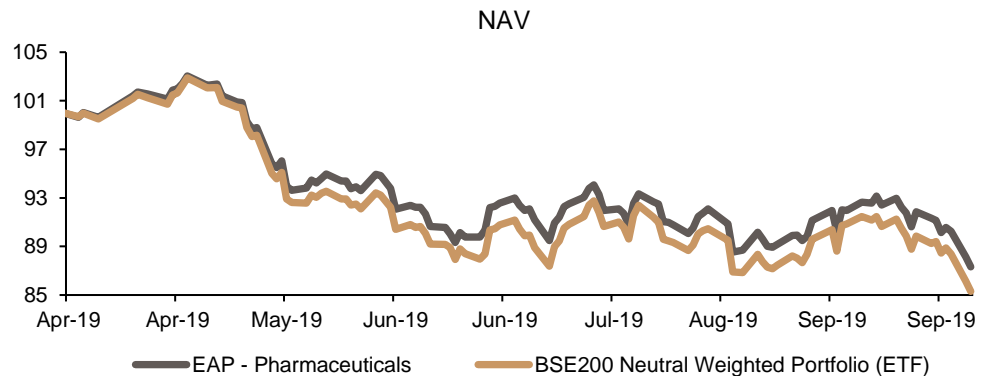
Sector portfolio NAV

	Base			Latest
	01-Apr-19	02-Jul-19	30-Aug-19	01-Oct-19
EAP - Pharmaceuticals	100.0	92.4	91.1	87.3
BSE200 Neutral Weighted Portfolio (ETF)	100.0	90.4	89.6	85.3

*Performance measurement base date 1st April 2019

Source: Emkay Research

NAV chart



Source: Emkay Research

Please see our sector EAP: [SMID](#)

Please see our India EAP: [Nifty](#)

Emkay Rating Distribution

Ratings	Expected Return within the next 12-18 months.
BUY	Over 15%
HOLD	Between -5% to 15%
SELL	Below -5%

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Sources for all charts and tables are Emkay Research unless otherwise specified.

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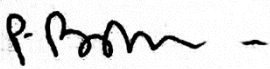
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