

Pharmaceutical Sector

5 April 2019

US Business To Aid Performance

The pharmaceutical sector is in a recovery mode and the positive trajectory in earnings growth witnessed in 3QFY19 should also be visible in 4QFY19. Pricing pressure in the US has moderated and new products launched are contributing to growth. Incrementally, rationalisation of R&D spending has also begun which is also supporting earnings growth. As regards the domestic market, the reported growth of major companies has not been encouraging in the first nine months of FY19 because of channel inventory correction and an overall slowdown in Indian Pharmaceutical Market (IPM) growth. We expect the channel inventory to stabilise from here on and expect the companies in our coverage universe to post double-digit growth, in line with IPM growth (10%-11%). Growth in rest of the world has been impacted by the decline in tender business following a deteriorating funding environment. We will continue to see the impact in 4QFY19. A fair bit of selective earnings performance volatility could emerge from price hike of APIs and shortages in the US. For the companies in our coverage, we expect positive earnings momentum.

Biocon should report strong QoQ and YoY growth led by increased traction in biosimilar Neulasta where it continues to strengthen the market share. Currently, there are two competitors and a third one (Apotex / Intas) may enter any time, depending on successful manufacturing compliance. Sandoz has also refilled its application post completer response letter from the USFDA last year and it may also enter the market in CY19.

Natco Pharma should report positive momentum on QoQ basis led by increase in volume of its limited-competition assets (Copaxone and Tamiflu suspension generics). The flu season has worsened at the fag end of the quarter, which led to a sharp increase in Tamiflu sales volume.

Dr. Reddy's Laboratories (DRL) will benefit from new product launches (Welchol, Suboxone and Diprivan generics), which will be partially offset by the ongoing erosion in ToprolXL generic. DRL is also anticipating the strong momentum in emerging markets to sustain. On YoY basis, DRL's earnings should grow 25%, while on QoQ basis they may decline 22% as we factor in significantly higher R&D expenses on QoQ basis, in line with the company's guidance.

Cipla has witnessed the adverse impact of a poor funding environment impacting its tender business, which is now largely in the base. In 4Q FY19, it may strengthen the upward momentum as the US and domestic business should also help, after it gave guidance of low-teen growth.

Aurobindo Pharma benefited from new business opportunities in the US in the previous quarter, and if these opportunities sustain then the company may deliver flattish earnings performance (QoQ). During the quarter, the company will also acquire European assets of Apotex.

Sun Pharmaceutical Industries could witness QoQ earnings decline as we anticipate a significant increase in promotional investment in its specialty portfolio and also as the company prepares for the launch of its dry eye drug (Cequa) in 1QFY20. Lialda generic launch during the quarter is yet to show up its impact on market share.

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Company (Rsmn)	TP (Rs)	CMP (Rs)	Rating	Sales			EBITDA			EBITDA margin (%)			PAT		
				4QFY19E	YoY(%)	QoQ(%)	4QFY19E	YoY(%)	QoQ(%)	4QFY19E	3QFY19	4QFY18	4QFY19E	YoY(%)	QoQ(%)
Aurobindo	867	782	Acc.	49,938	23	(5)	11,231	40	3	22	21	20	6,926	31	(3)
Biocon	505	613	Sell	15,891	36	3	4,301	85	13	27	25	20	1,883	45	(13)
Cipla	695	522	Buy	40,334	9	1	8,035	44	14	20	18	15	4,019	162	24
Dishman Carbogen	446	226	Buy	5,181	15	8	1,511	25	14	29	28	27	621	22	21
Dr. Reddy's Labs	3,348	2,772	Buy	38,420	9	-	8,182	42	(6)	21	23	16	3,787	25	(22)
Indoco Remedies	289	208	Buy	2,687	-	2	297	(40)	20	11	9	18	69	(66)	-
Jubilant Life	1,037	718	Buy	24,403	8	3	5,293	16	7	22	21	20	2,819	85	5
Natco Pharma	779	556	Buy	6,051	(21)	9	2,763	(28)	33	46	37	50	2,098	(30)	32
Pfizer	2,963	3,251	Acc.	5,719	10	11	1,773	28	15	31	30	27	1,296	24	(2)
Sanofi India**	7,049	5,869	Buy	6,969	13	(4)	1,802	34	31	26	19	22	1,149	39	45
Sequent Scientific	131	70	Buy	2,881	24	7	450	49	26	13	11	8	238	621	83
Sun Pharma	581	462	Buy	73,388	9	(4)	18,365	9	(15)	25	28	25	10,209	(22)	(18)
Our coverage universe				271,863	12	(1)	64,003	24	-	24	23	21	35,114	12	(5)

**1QCY19 - Sanofi India follows Calendar year; Source: Respective companies, Nirmal Bang Institutional Equities Research

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Jubilant Life Sciences' earnings are on a positive momentum as its pharmaceutical business is being led by rising volume in contract manufacturing, market penetration of Ruby Fill, tailwind on its API business and favourable competitive dynamics in the allergy immunotherapy business. In addition, the LSI business is on an upward trajectory led by recovery in Vitamin B3 prices.

Indoco Remedies' earnings will remain under pressure because of negative operating leverage (manufacturing facilities coming under USFDA warning letter). The warning for the sterile facility has been lifted recently, but the oral solid facility is still under it.

Sanofi India and Pfizer are expected to deliver low-teen revenue growth, in line with the IPM. Earnings growth should outpace revenue growth.

We expect strong double-digit earnings growth for Dishman Carbogen Amcis driven by its CRAMS business - commercialisation of new custom synthesis facility and uptake in commercial manufacturing products.

Sequent Scientific should continue to deliver strong QoQ growth led by some recovery in Turkey and the ongoing growth in API exports driven by a rising share of regulated markets and improved pricing environment

We rollover the target prices of companies in our coverage universe to Mar 2021 estimated EPS (From September 2020 estimated EPS)

Exhibit 2: Valuation Rollover

Company	FY21 EPS (Rs/share)	Multiple (PE) (x)	New Target Price (Rs)	Previous Target Price (Rs)
Aurobindo	54.2	16	867	866
Biocon	23	22	506	468
Cipla	31.6	22	695	657
Dr. Reddy's Labs	186	18	3348	3,122
Jubilant Life	80	13	1037	1,012
Natco Pharma	38.95	20	779	776
Pfizer	114	26	2963	2,963
Sanofi India	248.4	28.4	7049	7,049
Sun Pharma	29	20	581	581

Source: Nirmal Bang Institutional Equities Research

Exhibit 3: Rollover Valuation

Company	FY21 EBITDA (Rsmn)	Multiple (EV/EBITDA) (x)	New Target Price (Rs)	Previous Target Price (Rs)
Dishman Carbogen	6512	11	446	429
Indoco Remedies	2363	12	289	273
Sequent Scientific	2173	13.8	131	123

Source: Nirmal Bang Institutional Equities Research

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