

## RESEARCH

### Pharmaceuticals

Corporate tax cut – bonanza for healthcare services

## SUMMARY

### Pharmaceuticals

The corporate tax cut from 30% to 22% (including surcharge from 34.9% to 25.2%) effective FY20 could spur an 8-15% earnings upgrade for pharma MNCs (Not Rated) and Diagnostic players/hospitals (Not Rated), as well as a marginal 3-4% benefit for Divi's Labs among our Indian pharma coverage. The impact on other pharma companies within our coverage is largely limited as current rates including exemptions are close to the new tax rates. The MAT rate cut from 18.5% to 15% should boost the cash flow for players overall.

[Click here for the full report.](#)

## TOP PICKS

### LARGE-CAP IDEAS

Company	Rating	Target
<a href="#">Cipla</a>	Buy	555
<a href="#">GAIL</a>	Buy	175
<a href="#">ONGC</a>	Buy	175
<a href="#">TCS</a>	Add	2,360
<a href="#">HPCL</a>	Sell	200

### MID-CAP IDEAS

Company	Rating	Target
<a href="#">Balkrishna Ind</a>	Buy	1,290
<a href="#">Future Supply</a>	Buy	715
<a href="#">Greenply Industries</a>	Buy	195
<a href="#">Laurus Labs</a>	Buy	480
<a href="#">PNC Infratech</a>	Buy	250

Source: BOBCAPS Research

## DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.73	1bps	19bps	(136bps)
India 10Y yield (%)	6.75	(4bps)	18bps	(137bps)
USD/INR	70.94	0	1.0	2.3
Brent Crude (US\$/bbl)	64.77	0.8	9.2	(20.2)
Dow	26,950	0.1	5.2	1.5
Shanghai	2,977	(1.0)	2.7	7.0
Sensex	39,090	2.8	6.5	7.7
India FII (US\$ mn)	20 Sep	MTD	CYTD	FYTD
FII-D	68.4	176.4	4,423.6	3,878.9
FII-E	83.5	(770.6)	6,435.5	(409.8)

Source: Bank of Baroda Economics Research

## BOBCAPS Research

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## PHARMACEUTICALS

24 September 2019

### Corporate tax cut – bonanza for healthcare services

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#### Our interactions with companies suggest Divi's could see 3-4% EPS benefit:

We see limited benefits from the new tax regime for stocks under our coverage, as most of them avail tax benefits on SEZ profits and R&D spends (150% weighted tax deducted u/s 35 2AB; benefit expires Mar'20). Our interactions with various managements suggest limited implications for FY20 guided tax rates.

The effective tax rate for pharma companies under our coverage ranges from 16-30% for FY19 and 15-40% for FY20E, with Lupin at the top end (due to losses in international subsidiaries; else cash tax is 27-28%). Factoring in exemptions, the existing blended tax rate remains at par or below the new rate of 25.2% (incl. surcharge) for all players, barring DIVI which could see a 3-4% earnings upgrade.

**8-15% EPS upside for pharma MNCs, diagnostic players/hospitals:** As per Bloomberg estimates, most pharma MNCs (Abbott, Sanofi, Pfizer) and diagnostic players (Dr Lal Pathlabs, Metropolis, Thyrocare and Apollo Hospital) have effective tax rates in the range of 32-37%. These companies stand to gain the most as their effective rates could come down by 5-9ppt, boosting FY20 EPS by 8-15% (see Fig 1 for lag in stock movement relative to upgrades).

**Alkem remains our top pick; DIVI upgraded to ADD:** We retain our tax rate and earnings forecasts for most of our coverage stocks. In our view, the government tax stimulus could cause some near-term capital churn out of defensives into cyclicals given the positive change in earnings outlook. Alkem Labs remains our top pick followed by Cipla (TP cut to Rs 555 from Rs 595 led by 4% EPS cut to factor in US\$ 520mn exit rate for US sales in FY20 vs. US\$ 540mn earlier led from incremental competition in Volteron) and Laurus. We raise DIVI from REDUCE to ADD and downgrade Aurobindo from BUY to ADD post the recent stock price movements. Retain REDUCE on Sun Pharma.

#### KEY RECOMMENDATIONS

Ticker	Price	Target	Rating
ARBP IN	614	700	ADD
CIPLA IN	449	555	BUY
DIVI IN	1,612	1,750	ADD
DRRD IN	2,782	2,960	ADD
LAURUS IN	351	480	BUY
LPC IN	732	840	ADD
SUNP IN	408	430	REDUCE
ALKEM IN	1,925	2,230	BUY

Price &amp; Target in Rupees



## Disclaimer

### Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

**ADD** – Expected return from >+5% to +15%

**REDUCE** – Expected return from -5% to +5%

**SELL** – Expected return <-5%

**Note:** Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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