

## RESEARCH

### BOB Economics Research | Monthly Chartbook

Recovery holding ground

### BOB Economics Research | Inflation and IIP

Inflation ebbs, industrial activity slips

### Pharmaceuticals | Q3FY21 Preview

Lupin, Sun, Dr Reddy's to report strong Q3

## SUMMARY

### India Economics: Monthly Chartbook

India's economic recovery continues to gain momentum. Consumption is showing signs of improvement—higher non-oil-non-gold imports and auto sales. Centre's capex is picking up as its tax receipts are improving. Food inflation is also tapering-off though higher commodity prices and sticky core inflation implies CPI inflation will average 4.5% in FY22 implying no more rate cuts. RBI has started its liquidity normalisation operations by announcing a Rs 2tn reverse repo after a span of 10 months leading to a flatter yield curve. Yield trajectory also depends upon FY22 fiscal deficit. Our estimate is 5.2% with gross borrowing of Rs 11.2tn. Broader direction will be towards higher yields—both domestic and global.

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### India Economics: Inflation and IIP

India's recovery in industrial output hit a snag in Nov'20 as it fell by 1.9% following a 4.2% increase in Oct'20. Capital goods and intermediate goods fell the most. CPI inflation too eased significantly to 4.6% in Dec'20 from 6.9% in Nov'20. This was driven by (-) 10% vegetable inflation. Other food items too moderated as did core inflation. While the dip in CPI inflation is positive, some of it may not sustain with reversal in vegetable prices. Thus RBI will remain on hold and maintain accommodative stance. Focus shifts to Budget.

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## TOP PICKS

### LARGE-CAP IDEAS

Company	Rating	Target
<a href="#">Cipla</a>	Buy	900
<a href="#">GAIL</a>	Buy	155
<a href="#">Petronet LNG</a>	Buy	330
<a href="#">TCS</a>	Buy	3,710
<a href="#">Tech Mahindra</a>	Buy	1,040

### MID-CAP IDEAS

Company	Rating	Target
<a href="#">Alkem Labs</a>	Buy	3,600
<a href="#">Greenply Industries</a>	Buy	150
<a href="#">Laurus Labs</a>	Buy	410
<a href="#">Transport Corp</a>	Buy	300
<a href="#">Mahanagar Gas</a>	Sell	750

Source: BOBCAPS Research

## DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.15	3bps	25bps	(70bps)
India 10Y yield (%)	5.92	4bps	2bps	(68bps)
USD/INR	73.39	(0.2)	0.4	(3.6)
Brent Crude (US\$/bbl)	55.66	(0.6)	11.4	(13.3)
Dow	31,009	(0.3)	3.2	7.3
Shanghai	3,531	(1.1)	5.5	13.3
Sensex	49,269	1.0	6.9	17.7
India FII (US\$ mn)	8 Jan	MTD	CYTD	FYTD
FII-D	22.4	28.8	28.8	(4,064.8)
FII-E	819.7	1,395.3	1,395.3	31,371.0

Source: Bank of Baroda Economics Research

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## Pharmaceuticals: Q3FY21 Preview

We expect a strong Q3 for LPC (flu, India recovery), SUNP (specialty) and DRRD (US launches) with QoQ growth in EBITDA and margins, partly aided by cost savings. US sales growth is forecast at 4-9% QoQ. Results for Cipla (ex-onetime trade generic gains) and ARBP (ex-Natrol) should be healthy. We expect a stable quarter from Alkem, ERIS and ALPM while cost reversal may weigh on AJP. India growth overall can surprise YoY. DIVI could see lumpy sales; Laurus's strong margins should sustain. EM currencies have recovered as at end-Q3.

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## Recovery holding ground

**India's economic recovery continues to gain momentum. Consumption is showing signs of improvement—higher non-oil-non-gold imports and auto sales. Centre's capex is picking up as its tax receipts are improving. Food inflation is also tapering-off though higher commodity prices and sticky core inflation implies CPI inflation will average 4.5% in FY22 implying no more rate cuts. RBI has started its liquidity normalisation operations by announcing a Rs 2tn reverse repo after a span of 10 months leading to a flatter yield curve. Yield trajectory also depends upon FY22 fiscal deficit. Our estimate is 5.2% with gross borrowing of Rs 11.2tn. Broader direction will be towards higher yields—both domestic and global.**

**Recovery gathering momentum:** India's economic recovery is gaining momentum led by consumption. Non-oil-non-gold imports increased by 7.9% in Dec'20 (highest in 26 months). Electronic imports increased by 20%. In addition, automobile sales, e-way bills and GST collections point out to sustained recovery. So do digital transactions. Rabi sowing too is progressing well, up by 4.3%. However, higher MNREGA jobs demanded in Dec'20 shows that labour market rigidities are continuing.

**Revival in government spending:** General government fiscal deficit (12M sum basis) in Nov'20 remained unchanged at 10.2% with centre's fiscal deficit expanding and that of states' consolidating. During Q3FY21 (Oct-Nov'20), centre's total expenditure increased by 28.9% compared with 11.9% drop in Q2. State spending has also improved but at a slower pace (decline of 7.9% in Q3 versus drop of 11.5% in Q2). However, an underlying trend is pick-up in capex. The improvement in economic

activity is visible in a 12.4% increase in Centre's net tax revenues compared with a drop of 18.2% in Q2. States' tax revenue is up by only 0.3% versus a decline of 12% in Q2. We see fiscal tailwind to growth in H2FY21.

**Inflationary pressure is expected to ebb:** In Dec'20, vegetable prices have seen a sharp fall. Even a favourable statistical base would lend support to bring down headline CPI print in Dec'20. However, international commodity prices are rising (3.6% MoM in Dec'20). So are domestic petrol and diesel prices (7.9% and 11.4% MoM resp.). While food inflation is coming-off, we expect core to remain sticky.

**Eyes on Budget for trajectory of yield :** India's 10Y yield (5.85GS2030) has fallen by 4bps in Dec'20 supported by RBI's OMO purchase and likely softening of CPI print. However, RBI after a span of 10 months is now conducting variable rate reverse repo auction of Rs 2tn. This will result in flattening of 10Y yield curve. However, all eyes will be on the Union Budget and upcoming borrowing calendar. We expect gross borrowing of Rs 11.2tn.

**INR to trade with an appreciating bias:** Led by FII inflows of US\$ 8bn and a weaker US\$, INR appreciated by 1.3% in Dec'20. Oil prices and imports rose in Dec'20 and are likely to climb further as global and domestic economic recovery gains traction. Trade deficit is however likely to be lower than FY20. Steady foreign inflows will support INR at current levels.



## INFLATION AND IIP

12 January 2021

### Inflation ebbs, industrial activity slips

India's recovery in industrial output hit a snag in Nov'20 as it fell by 1.9% following a 4.2% increase in Oct'20. Capital goods and intermediate goods fell the most. CPI inflation too eased significantly to 4.6% in Dec'20 from 6.9% in Nov'20. This was driven by (-) 10% vegetable inflation. Other food items too moderated as did core inflation. While the dip in CPI inflation is positive, some of it may not sustain with reversal in vegetable prices. Thus RBI will remain on hold and maintain accommodative stance. Focus shifts to Budget.

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**IIP slips:** Industrial output contracted by 1.9% in Nov'20 compared with an increase of 4.2% in Oct'20. Mining output declined at a 3-month low of (-) 7.3% in Nov'20. Manufacturing output too declined. Electricity output moderated to 3.5% in Nov'20 from 11.2% in Oct'20. Base effect and Diwali falling in month of November explain some of the variation. Decline in manufacturing sector is led by capital goods at (-) 7.1%. Intermediate goods output fell by 3%. High frequency indicators show revival holding up in Dec'20.

**CPI falls, driven by food:** CPI inflation slipped to 15-month low of 4.6% in Dec'20. Food inflation edged lower from 9.5% in Nov'20 to 3.4% in Dec'20 led by sharp contraction in vegetables (decline of 10.4% in Dec'20 versus an increase of 15.5% in Nov'20). Moderation was also seen in other food categories such as pulses (16% versus 18.1% in Nov'20), eggs (16.1% versus 20.4%), and meat and fish (15.2% versus 17% in Nov'20). Cereal inflation fell to 1% versus 2.5% in Nov'20. While a part of decline can be explained by a favourable base, the decline is relatively broad-based and thus encouraging.

**Core inflation eases:** Core inflation too eased by 30bps to 5.7% in Dec'20 from 6% in Nov'20. This was driven by moderation in transport and communication inflation to 9.3% from 11.1% in Nov'20 despite rising domestic and international oil prices. A favourable base explains the above. Some moderation was also seen in personal care and education. However, health inflation rose by 40bps MoM to 6%. The underlying economic recovery and mean reversion implies core inflation is likely to remain elevated next year. Food inflation is likely to trend lower than FY21 as supply conditions turn favourable. The current CPI print does not change our hypothesis that RBI will remain on an extended pause and continue to absorb excess domestic liquidity in a calibrated manner through reverse repo auctions as the economy normalises.

#### KEY HIGHLIGHTS

- CPI inflation moderated to 4.6% in Dec'20 from 6.9% in Nov'20 led by food inflation.
- Core inflation edged down by 30bps to 5.7% in Dec'20.
- IIP growth contracted by 1.9% following a rise of 4.2% in Oct'20.



## Lupin, Sun, Dr Reddy's to report strong Q3

We expect a strong Q3 for LPC (flu, India recovery), SUNP (specialty) and DRRD (US launches) with QoQ growth in EBITDA and margins, partly aided by cost savings. US sales growth is forecast at 4-9% QoQ. Results for Cipla (ex-onetime trade generic gains) and ARBP (ex-Natrol) should be healthy. We expect a stable quarter from Alkem, ERIS and ALPM while cost reversal may weigh on AJP. India growth overall can surprise YoY. DIVI could see lumpy sales; Laurus's strong margins should sustain. EM currencies have recovered as at end-Q3.

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**Key to watch:** (1) Ajanta Pharma (AJP): India/EM commentary. (2) Alembic (ALPM): India growth recovery. (3) Alkem: Cost control sustainability, API prices. (4) Aurobindo (ARBP): US injectable recovery. (5) Cipla: India outlook, Goa warning letter remediation, respiratory filings. (6) Dr Reddy's (DRRD): Copaxone CRL, Vascepa launch timeline. (7) Divi's (DIVI): QoQ sales and margins, progress on ongoing capex. (8) Lupin (LPC): US recovery QoQ, EU approval timeline on gFostair (Q3FY21), FDA reinspection for Goa site. (9) Laurus: TLE400 scale-up timeline, margin sustainability. (10) Sun Pharma (SUNP): Ramp-up in specialty products, cost control, update on Halol OAI.

### RECOMMENDATION SNAPSHOT

Ticker	Rating
AJP IN	BUY
ALPM IN	BUY
ALKEM IN	BUY
ARBP IN	BUY
CIPLA IN	BUY
DIVI IN	ADD
DRRD IN	ADD
ERIS IN	BUY
LAURUS IN	BUY
LPC IN	ADD
SUNP IN	ADD

### FIG 1 – Q3FY21: US REVENUE EXPECTATIONS

(US\$ mn)	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21E	QoQ (%)	YoY (%)
AJP	11	15	16	22	20	20	21	20	(5.2)	(11.9)
ALPM	44	49	77	72	81	79	79	80	0.4	10.0
ALKEM	69	69	76	82	84	89	85	88	2.9	6.8
ARBP	352	384	405	418	415	414	434	418	(3.7)	(0.1)
CIPLA	162	160	136	133	119	136	143	141	(1.2)	6.1
DRRD	212	233	204	225	251	230	249	270	8.4	20.3
LPC	247	220	189	193	219	162	190	208	9.3	7.6
SUNP (ex-Taro)	264	259	179	203	202	167	196	205	4.2	0.5
TARO	180	161	161	148	175	118	143	143	0.0	(3.3)

Source: Company, BOBCAPS Research

### FIG 2 – Q3FY21 PREVIEW: EXPECT GOOD QUARTER FOR LPC, SUNP, DRRD

Companies	Sales (Rs mn)			EBITDA (Rs mn)			PAT (Rs mn)			EBITDA margin (%)		
	Q3FY21E	YoY (%)	QoQ (%)	Q3FY21E	YoY (%)	QoQ (%)	Q3FY21E	YoY (%)	QoQ (%)	Q3FY21E	Q3FY20	Q2FY21
AJP	6,778	4.1	(5.3)	2,117	13.7	(22.9)	1,376	27.3	(19.3)	31.2	28.6	38.3
ALPM	14,112	16.7	(3.1)	4,143	27.4	(6.6)	2,826	20.4	(15.3)	29.4	26.9	30.4
ALKEM	23,486	7.6	(0.6)	5,281	16.5	(12.0)	4,062	6.3	(14.0)	22.5	20.8	25.4
ARBP	62,607	6.2	(3.4)	12,970	7.4	(9.5)	7,980	12.4	(0.1)	20.7	20.5	22.1
CIPLA	47,879	9.5	(5.0)	10,846	34.2	(7.8)	6,752	68.3	1.5	22.7	18.5	23.4
DRRD	51,869	18.3	5.9	12,952	27.1	6.0	7,822	4.3	(6.9)	25.0	23.2	24.9
ERIS	3,004	12.8	(9.0)	1,088	41.7	(12.8)	924	45.3	(14.2)	36.2	28.8	37.8
LPC	40,032	6.2	4.4	6,742	57.1	16.0	2,769	133.1	31.4	16.8	11.4	15.2
SUNP	87,847	9.3	3.9	22,514	37.0	1.6	15,443	85.6	(20.0)	25.6	20.4	26.2
DIVI	16,638	19.7	(2.9)	6,600	32.8	(11.4)	4,572	33.4	(13.0)	39.7	35.7	43.5
LAURUS	11,344	55.5	(0.4)	3,744	152.5	0.1	2,455	233.8	1.3	33.0	20.3	32.8

Source: Company, BOBCAPS Research



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

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