

**PHARMACEUTICALS**

| Q1FY21 Preview

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**India sales firm despite Covid hit; good Q1 for Cipla, LPC, Laurus**

We expect a good Q1 for Cipla (led by OTC switch, gProventil), Alkem (deferred India sales) and LPC (Levo ramp-up) – cost savings can further aid higher margins QoQ. SUNP, ARBP and DRRD could see a soft Q1 with US sales declining 4-6% QoQ led by destocking and tepid inj. sales; India sales can surprise positively QoQ despite the Covid impact. ALPM should be stable while AJP/DIVI can see weak margin expansion QoQ. Laurus can continue to outperform. On forex (avg. basis), the USD is favourable (+5% QoQ); EMs are weak.

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**Key to watch:** Covid impact on India sales and cost-cutting measures will be closely watched. **(1) Ajanta (AJP):** Clarity on FY21 guidance. **(2) Alembic (ALPM):** Update on Sartans shortage, fund raising plans. **(3) Aurobindo (ARBP):** US injectable sales recovery. **(4) Cipla:** Goa warning letter remediation, respiratory filings. **(5) Dr Reddy's (DRRD):** Update on Nuvaring/Copaxone CRL. **(6) Divi's (DIVI):** QoQ margin pick-up, CS ramp-up. **(7) Lupin (LPC):** QoQ margin increase, Solosec recovery, gProAir approval (H1FY21), FDA reinspection for Somerset/Goa sites. **(8) Laurus:** TLE400 scale-up timeline, ARV demand outlook. **(9) Sun Pharma (SUNP):** FY21 guidance, update on specialty products, US antitrust litigation.

**RECOMMENDATION SNAPSHOT**

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

**FIG 1 – Q1FY21: US REVENUE EXPECTATIONS**

(US\$ mn)	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21E	QoQ (%)	YoY (%)
AJP	11	9	11	15	16	22	20	18	(10.6)	23.5
ALPM	60	43	44	49	77	72	81	72	(11.4)	46.1
ALKEM	69	74	69	69	76	82	84	88	4.4	27.9
ARBP	318	338	352	384	405	418	415	395	(4.9)	2.8
CIPLA	108	118	162	160	136	133	119	125	5.1	(21.8)
DRRD	210	209	212	233	204	225	251	242	(3.6)	3.8
LPC	178	197	247	220	189	193	219	213	(2.9)	(3.3)
SUNP (ex-Taro)	183	186	264	259	179	203	202	190	(5.8)	(26.5)
TARO	159	176	180	161	161	148	175	165	(5.7)	2.4

Source: Company, BOBCAPS Research

**FIG 2 – Q1FY21 PREVIEW: EXPECT GOOD QUARTER FOR CIPLA, LPC, LAURUS AND ALKEM**

Companies	Sales (Rs mn)			EBITDA (Rs mn)			PAT (Rs mn)			EBITDA margin (%)		
	Q1FY21E	YoY (%)	QoQ (%)	Q1FY21E	YoY (%)	QoQ (%)	Q1FY21E	YoY (%)	QoQ (%)	Q1FY21E	Q1FY20	Q4FY20
AJP	6,100	(0.3)	(10.6)	1,511	(10.3)	(9.2)	963	(16.1)	(5.1)	24.8	27.5	24.4
ALPM	11,609	22.3	(3.7)	2,994	33.1	(8.4)	1,835	24.1	(21.9)	25.8	23.7	27.1
ALKEM	20,656	11.7	0.8	3,204	21.1	5.7	2,395	29.0	26.8	15.5	14.3	14.8
ARBP	59,659	9.6	(3.1)	12,682	10.6	(5.5)	7,389	15.6	(14.4)	21.3	21.1	21.8
CIPLA	41,953	5.2	(4.1)	7,402	(18.2)	16.8	3,137	(34.4)	27.6	17.6	22.7	14.5
DRRD	43,237	12.5	(2.4)	9,176	26.3	(2.4)	5,338	(19.5)	(30.2)	21.2	18.9	21.2
LPC	39,878	(9.7)	3.7	5,675	(34.0)	8.0	2,464	(18.7)	(19.4)	14.2	19.5	13.7
SUNP	81,486	(1.3)	0.9	14,785	(18.5)	5.6	9,186	(30.4)	14.0	18.1	22.0	17.3
DIVI	14,400	26.3	4.6	5,029	30.8	12.1	3,506	28.3	4.7	34.9	33.7	32.6
LAURUS	8,264	50.1	(1.5)	1,752	110.3	(8.6)	789	421.5	(28.3)	21.2	15.1	22.8

Source: Company, BOBCAPS Research

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## Company-wise expectations

### AJP: Weak quarter but lower SG&A spends to support QoQ margins

We expect a subdued Q1FY21 for AJP with EBITDA declining ~10% YoY/QoQ, primarily due to an 11% YoY decrease in India sales (Covid-19 impact on the acute portfolio, especially dermatology and ophthalmology segments) and an 18% drop in Africa sales. Discontinuation of Ranitidine would hurt US sales (-11% QoQ). However, temporary reduction in SG&A spends (lower travel/promotional costs under lockdown) could support EBITDA margins.

**Key to watch:** Clarity on FY21 guidance, progress on ophthalmology block

### ALPM: Steady quarter – Sartans pricing stable

We expect a sequential decline in operating results (but a strong print YoY) due to normalisation of Covid-led inventory stocking in the US and weak India sales. US sales are estimated at US\$ 72mn (-11% QoQ). The company confirmed that sartan franchise volumes have dropped 12-14% from Mar'20 levels but the unit price is mostly stable. Also, ALPM has seen good 22%+ volume gains on Famotidine QoQ, as per Symphony data, which should support the base business. EU supply challenges have begun to abate. EBITDA margins are forecast to expand 250-300bps YoY to 26% factoring in USDINR depreciation benefit.

**Key to watch:** India/EU commentary, update on sartans and fund raising

### ALKEM: Deferred India sales, cost control to aid margin expansion

Q1 performance will be mainly driven by deferred sales of Rs 1.3bn in the India business and cost control. We expect overall sales/EBITDA growth of 12%/21% YoY. EBITDA margins are projected to expand 100bps YoY led by gross margin expansion and rationalisation of staff incentives and promotional expense. We forecast 5% YoY growth for the India business (incl. deferred sales). ALKEM has exhibited healthy growth recovery in June compared to April/March (which were affected by the extended Covid lockdown). US sales are likely to remain largely steady at US\$ 88mn (+4% QoQ), backed by a stable base portfolio.

**Key to watch:** Covid impact on India business, cost control sustainability

### **ARBP: Sequential EBITDA drop but market share intact; injectables recovery key to watch**

We expect reduced US sales of US\$ 395mn (-5% QoQ) mainly as lower footfalls in hospitals and delayed surgeries erode injectable sales. However, market share in base products such as Rosuvastatin, Aripiprazole and Pantoprazole remains stable even as overall category volumes have dropped from Mar'20 levels. EBITDA is likely to decline ~5% QoQ as the INR depreciation benefit is offset by normalisation in EU sales and a decline in US sales. EBITDA margins are expected to remain stable at ~21%. YoY, we estimate healthy sales and EBITDA growth of 10-11% each.

**Key to watch:** Unit VII remediation/reinspection update, US injectables recovery

### **Cipla: Q1 to benefit from US Proventil sales and India OTC switch**

US sales to increase to US\$ 125mn (+5% QoQ), partly led by gProventil HFA sales (~US\$ 7mn) even as the Covid-led stocking normalises. We expect improved contribution from Proventil, the recently launched gMigranal (under CGT) and Esomeprazole OS to reflect from Q2. Our interaction with Cipla suggests that the current market share of ~3% on Proventil does not reflect the true picture as a large part of inventory is still in the channel. Underlying market share in base products (incl. Gabapentin, Wellbutrin XL) is stable.

The pandemic impact on QoQ India sales has been limited due to portfolio synergies under the 'One India' strategy (switching of trade generics to OTC brands). We expect operating margins to improve ~300bps QoQ to 17.6%. EM sales should recover in Q1 while South Africa & Global Access (SAGA) will be subdued.

**Key to watch:** India formulations QoQ, Goa facility remediation, respiratory filings

### **DRRD: US destocking and cost control to drive modest quarter**

We expect US sales to decline 4% QoQ owing to destocking. DRRD's market share in the base business is broadly stable (Suboxone ~19%, Toprol XL ~28%) and contribution from Q4 limited-competition launches has increased (gVimovo AG, Narcan CGT launch, Daraprim). The company has launched six products in Q1 (incl. gZytiga, gColcrys) which will scale up in coming quarters.

India sales growth is expected to be flat YoY (incl. 20 days of Wockhardt), PSAI (deferred sales booking) and the EU should be strong, while EM sales are likely to be soft due to currency devaluation. The ruble has weakened 4% QoQ and should offset INR/US\$ depreciation positive. R&D cost can rise but controlled SGA spends should aid stable EBITDA margins of 21%.

**Key to watch:** Nuvaring/Copaxone CRL updates, gross margin pickup QoQ, Covid-19 impact

### DIVI: Weak operating leverage; QoQ margin improvement key

DIVI is likely to post subdued sequential improvement in operational results due to (1) lower operating leverage stemming from logistical disruptions, and (2) higher costs incurred on new capacities. We estimate sales/EBITDA growth of 5%/12% QoQ (and 26%/31% YoY off a low base). We expect EBITDA margins of 35% (+100bps YoY, +230bps QoQ), factoring in positive forex benefits and some improvement in the custom synthesis business mix.

**Key to watch:** Extent of QoQ margin expansion, sales impact from Covid-19 supply disruptions, progress on capex

### LAURUS: Another strong quarter

Core operating results should be strong for Laurus driven by (1) steady momentum in formulations – partly supported by Hydroxychloroquine (HCQS) supplies, (2) improving growth in Other APIs (cardio-diabetic), and (3) demand tailwinds within the ARV portfolio (TLD, EFA). We also expect the synthesis business to grow 20% YoY. Operating margins are forecast to improve 600bps YoY to 21%, with EBITDA at Rs 1.75bn (+110% YoY, on a low formulation base).

**Key to watch:** Progress on formulations capex, TLE400 scale-up timeline, ARV business demand outlook

### LPC: Positive quarter with marginal QoQ decline in US sales

We expect a marginal 3% QoQ decline in the US despite Covid destocking and seasonal weakness in cephalosporins. Growth will be supported by (1) a 2ppt increase in Levo market share to 12% in June'20 with volume gains of >30% QoQ, (2) stable pricing in Losartan/HCTZ, (3) >50% volume gains in Famotidine suspension which benefitted from the Ranitidine recall, and (4) contribution from a few good launches such as Apriso AG and Myfortic DR. India growth could surprise positively (+2% YoY, +11% QoQ) while cost rationalisation in the specialty US business can drive sequential margin expansion. The USD is favourable (+5% QoQ vs. the INR) while the ZAR and BRL are not (-10% and -13% respectively).

**Key to watch:** QoQ margin recovery, Solosec revival, approval timelines on gFostair in the EU (Q3FY21) and gProAir (H1FY21), FDA reinspection for Somerset/Goa sites

### SUNP: Muted quarter; US sales to decline 6% QoQ

Overall Q1 sales should be flattish QoQ. The India and US businesses are both headed for sequential declines off a high base, due to Covid de-stocking. US ex-Taro sales could fall 6% QoQ given continued pricing pressure in generics and softness in specialty products such as Cequa, BromSite and Yonsa. Part of this should be offset by steady Ilumya sales (TRx is flat QoQ) and share increase in Pantoprazole and Deferasirox injectables. We expect Taro sales to also drop 6% QoQ but note that the impact of a few good launches in Q1 will be visible from Q2. Sequential EBITDA recovery appears muted but margins could expand on cost control.

**Key to watch:** FY21 guidance, cost control efficacy, updates on specialty products, Halol OAI and DOJ penalty/antitrust litigation

**FIG 3 – CROSS-CURRENCY MOVEMENT**

Quarter End	Closing rate					Average rate				
	USDINR	EURINR	BRLINR	RUBINR	ZARINR	USDINR	EURINR	BRLINR	RUBINR	ZARINR
Jun 2018	68.5	79.8	17.66	1.09	4.99	67.1	79.9	18.59	1.08	5.30
Sep 2018	72.5	84.0	17.90	1.11	5.13	70.1	81.5	17.76	1.07	4.99
Dec 2018	69.8	80.0	17.92	1.01	4.84	72.1	82.3	18.93	1.08	5.04
Mar 2019	69.2	77.7	17.68	1.06	4.78	70.5	80.1	18.71	1.07	5.03
Jun 2019	69.0	78.5	17.91	1.09	4.89	69.6	78.2	17.74	1.08	4.84
Sep 2019	70.8	77.3	17.00	1.09	4.67	70.3	78.2	17.74	1.09	4.80
Dec 2019	71.4	80.0	17.72	1.15	5.08	71.2	78.9	17.31	1.12	4.85
Mar 2020	75.5	82.3	14.47	0.96	4.22	72.5	79.8	16.31	1.09	4.73
Jun 2020	75.5	84.8	13.81	1.06	4.35	75.8	83.6	14.15	1.05	4.23

Source: Bloomberg, BOBCAPS Research

Avg. USDINR rate at Rs 75.8 in Q1 (vs. Rs 72.5 QoQ)

EM currencies (RUB, ZAR, BRL) have weakened 4%, 10% and 13% resp. on average

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**BUY** – Expected return >+15%

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

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