

India seasonality, stable US good for Alkem, DRRD; Cipla weak

We expect Alkem and DRRD to report a good quarter with largely stable US sales QoQ. Cipla will see weakness both in India & the US but commentary is unlikely to be incrementally negative. LPC and SUNP could see a down quarter for the US due to a high Q1 base and lack of impactful launches. Pick-up in specialty assets has been weak (Ilumya, Solosec). India growth for our coverage ex-Cipla is forecast to improve to 14% YoY (vs. 11% in Q1). Expect strong EBITDA in Laurus and stable results from DIVI. EM fx/US\$ is stable QoQ while JPY/INR is up 4%.

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Key to watch: **(1) Alkem Labs:** Commentary on potential regulatory action on margin capping, FDA update for Daman unit. **(2) Aurobindo (ARBP):** Business impact due to Form 483 at formulation unit 7, Sandoz deal, CAPAs progress at three API units. **(3) Cipla:** Incremental risk to India & US base run-rate, gProventil launch, readthrough on Goa 483s (12 observations in Sep'19). **(4) Dr Reddy's (DRRD):** Inventory write-off risk in the US post Nuvaring CRL (complete response letter), Srikakulam/CTO6 reinspection, cost control. **(5) Divi's (DIVI):** Gross margin QoQ. **(6) Lupin (LPC):** Levo capacity addition, Solosec uptick, remediation progress (Goa, Indore-2, Somerset). **(7) Sun Pharma (SUNP):** Rapid pickup in Skyrizi Rx which is now 10x of Ilumya.

RECOMMENDATION SNAPSHOT

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

FIG 1 – Q2FY20: US REVENUE EXPECTATIONS

(US\$ mn)	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20E	QoQ (%)	YoY (%)
ALKEM	63	69	74	69	69	73	6.1	5.1
ARBP	283	318	338	352	384	380	(1.1)	19.5
CIPLA	101	108	118	162	160	130	(18.7)	20.1
DRRD	237	210	209	212	233	237	1.6	13.0
LPC	177	178	197	247	220	193	(12.3)	8.2
SUNP (ex-Taro)	225	183	186	264	260	210	(19.2)	14.7
TARO	155	159	176	180	161	161	0.0	1.4

Source: Company, BOBCAPS Research

FIG 2 – Q2FY20 PREVIEW: GOOD FOR ALKEM & DRRD, BEST-EVER EBITDA FOR LAURUS, WEAK FOR CIPLA

Companies	Sales (Rs mn)			EBITDA (Rs mn)			PAT (Rs mn)			EBITDA Margin (%)		
	Q2FY20E	YoY (%)	QoQ (%)	Q2FY20E	YoY (%)	QoQ (%)	Q2FY20E	YoY (%)	QoQ (%)	Q2FY20E	Q2FY19	Q1FY20
ALKEM	21,368	11.4	15.5	4,083	12.1	54.3	2,899	13.9	56.1	19.1	19.0	14.3
ARBP	54,409	14.5	(0.1)	11,434	11.4	(0.3)	6,464	(4.7)	1.1	21.0	21.6	21.1
CIPLA	39,099	(2.5)	(2.0)	6,924	(1.3)	(23.5)	3,128	(16.9)	(34.6)	17.7	17.5	22.7
DRRD	43,216	13.8	12.4	8,488	14.7	16.8	4,548	(9.7)	(31.4)	19.6	19.5	18.9
LPC	44,867	13.6	1.5	7,647	39.1	(11.1)	2,948	9.0	(2.7)	17.0	13.9	19.5
SUNP	76,097	11.1	(7.9)	14,584	1.3	(19.6)	9,715	(2.6)	(26.4)	19.2	21.0	22.0
DIVI	12,425	(3.3)	9.0	4,280	(16.8)	11.3	2,990	(13.1)	9.4	34.4	40.0	33.7
LAURUS	6,438	9.5	16.9	1,192	57.3	43.1	390	139.0	157.7	18.5	12.9	15.1
Sector Agg.	297,918	9.7	1.0	58,631	8.3	(5.2)	33,081	(3.9)	(14.7)	19.7	19.9	21.0

Source: Company, BOBCAPS Research

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Company-wise expectations

ALKEM: Strong India business seasonality & stable US should drive Q2

Better acute seasonality should drive India sales growth at 14% YoY (secondary growth was 19.8%/20.8%/14.5% for July/Aug/Sep). US sales should remain steady at US\$ 73mn (+6% QoQ), led by a stable base portfolio and ramp-up in gVesicare (Alkem tracking 16% market share at Sep-end vs. 6% in June). Contribution from gAmpyra is stable (19-20% market share) and Mycophenolate suspension is yet to see incremental competition. Overall, we forecast EBITDA growth at 12-13% YoY with 20bps margin expansion.

Key to watch: Margin guidance; commentary on Oct'19 domestic season; clarity over regulatory action on margin capping; FDA update on the Daman unit (USFDA issued two observations during Aug'19 inspection)

ARBP: Good quarter with stable US sales; update on Sandoz & US ramp-up post Unit 7 Form-483 is key

We expect ARBP's US sales to be flattish at US\$ 380mn due to (1) Eugia unit ramp-up which would compensate for the Ertapenem decline (where ARBP currently has 64% share, Apotex has gained 23% share vs. 12% in Jun'19, ACS Dobfar's launch is yet to hit the market); and (2) volume increase in baseline products such as Rosuvastatin, Aripiprazole and Pantoprazole. EBITDA and margins are projected to remain largely flat QoQ. Sandoz FTC approval timeline has moved from Sep'19 to Dec'19, as per Novartis commentary.

Key to watch: CAPA progress/reinspection for three API units; assessment of business impact due to Form 483 at formulation unit 7 (FDA issued seven observations in Sep'19)

CIPLA: Weak quarter both in India & US; generic impact in key assets to bottom only by Q4

We anticipate a weak quarter for Cipla with India sales dropping 9% YoY (trade generic sales loss) and US sales down to US\$ 130mn (vs. a Q1 base of US\$ 160mn, gSensipar-led). Cipla had three launches in Q2 – these were not very impactful plus pricing pressure in some high-value base products such as gSensipar, Pulmicort and gVoltaren are a key drag for the US business. For gSensipar, three players have launched since Jul'19 (ARBP, Strides, SUNP). Cipla's market share in gPulmicort has fallen to 18% as at Sep-end from 26% in Jul'19 as LPC is ramping up. The full generic impact in these assets should normalise by Q4. EM business could see QoQ recovery due to recognition of deferred supplies worth US\$ 15mn from Q1.

Key to watch: Incremental risk to India base and US base business run-rate; launch timeline on gAlbuterol (Proventil) slated for Q4FY20; better readthrough on Goa unit Form 483 (USFDA issued 12 observations in Sep'19)

DRRD: Sequentially higher EBITDA but H2 to be more launch heavy

New launches (Vigabatrin, Carboprost, Pregaba), ramp-up in Suboxone and Isotretinoin should help offset base price erosion. In Suboxone, we note that DRRD has gained 14% share from 10% in Q1 and market dynamics are stable with four players. We expect US sales to grow 2% QoQ to US\$ 237mn. DRRD is planning 16+ launches in H2 (vs. 13 in H1). PSAI sales/margin normalisation after a weak Q1 overall should drive EBITDA margins QoQ. India growth is likely to be strong at 17% YoY in Q2, in line with secondary trends.

Key to watch: Inventory write-off risk in the US post Nuvaring CRL; Srikakulam/CTO6 reinspection; cost control

DIVI: Q2 a non-event; stronger margin visibility from Q3

DIVI is likely to report only a slight improvement in gross margins despite 9% QoQ growth in sales. This is due to liquidation of high-cost inventory procured from China in Q1. Management reiterated that operational efficiency should return to normal from Q3 onwards as the benefits from backward integration initiatives and a better CS mix fructify.

LAURUS: Best-ever EBITDA led by formulations

We expect a strong quarter YoY and QoQ both on sales and EBITDA for Laurus backed by higher sales (US\$ 17mn) and operating leverage in the formulations business. ARV sales should see some sequentially recovery – we expect 18% growth. Gross margins are estimated to remain healthy at ~48% with EBITDA of Rs 1.2bn (+57% YoY, +43% QoQ) and net profits at Rs 390mn. The synthesis business is forecast to report 20% YoY growth.

LPC: Core EBITDA to improve 6% QoQ; weak Solosec ramp-up

Reported EBITDA will be boosted by one-time licensing income from Boehringer Ingelheim (Rs 1.4bn). Adjusted for this, core EBITDA should improve 6-7% QoQ. We expect US sales to decline 12% QoQ to US\$ 193mn mainly due to Ranexa exclusivity loss (Teva, SUNP, Ajanta launched) otherwise existing base run-rate should remain steady. Scale-up in Levo (+25% MoM; 3.5% share vs. Mar'20 target of 20%), Fosaprepitant injection and approval of one depo injectable (expected in Q3) should drive H2. India business is forecast to grow ~14% YoY in Q2. LPC also

benefits from INR depreciation against the Yen. Solosec has not seen any material pick-up in weekly prescription plus volume & value growth QoQ is ~6-7%.

Key to watch: Levo capacity addition; Solosec uptick post launch of direct promotion strategy; remediation progress/inspection timelines (Goa, Indore-2 and Somerset)

SUNP: High R&D, weak Ilumya growth and down quarter for the US

US had one-off sales of US\$ 60mn in Q1 plus Q2 did not see any meaningful launches; hence, we expect US sales ex-Taro to decline 19% QoQ to US\$ 210mn. Taro should largely remain flat QoQ. SUNP has yet to launch Pantoprazole Injection (US\$ 15mn-20mn annual opportunity). Ilumya ramp-up is tapering – we note that Skyrizi prescription as on Sep’19 is 10x higher than Ilumya and on MoM basis, Skyrizi volumes are up 44% vs. Ilumya which is down 25%. We expect EBITDA to drop sequentially with a step-up in R&D spends despite higher India sales. India sales growth is forecast at 13% YoY (vs. 11% secondary trend).

Key to watch: Commentary on Ilumya (sales and R&D expense for new indication)

Avg. USDINR rate at Rs 70.3 in Q2 (vs. Rs 69.6 QoQ); EM currencies largely stable; JPY has appreciated ~4% vs. INR

FIG 3 – CROSS-CURRENCY MOVEMENT

Quarter End	Closing rate					Average rate				
	USDINR	EURINR	JPYINR	RUBINR	ZARINR	USDINR	EURINR	JPYINR	RUBINR	ZARINR
Sep 2017	65.3	77.1	0.6	1.1	4.8	64.3	75.5	0.6	1.1	4.9
Dec 2017	63.9	76.5	0.6	1.1	5.2	64.7	76.2	0.6	1.1	4.8
Mar 2018	65.2	80.8	0.6	1.1	5.5	64.3	79.0	0.6	1.1	5.4
Jun 2018	68.5	79.8	0.6	1.1	5.0	67.1	79.9	0.6	1.1	5.3
Sep 2018	72.5	84.0	0.6	1.1	5.1	70.1	81.5	0.6	1.1	5.0
Dec 2018	69.8	80.0	0.6	1.0	4.8	72.1	82.3	0.6	1.1	5.0
Mar 2019	69.2	77.7	0.6	1.1	4.8	70.5	80.1	0.6	1.1	5.0
Jun 2019	69.0	78.5	0.6	1.1	4.9	69.6	78.2	0.6	1.1	4.8
Sep 2019	70.8	77.3	0.6	1.1	4.7	70.3	78.2	0.7	1.1	4.8

Source: Bloomberg, BOBCAPS Research

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BUY – Expected return >+15%

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

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