

Q3 strong for DRRD, LPC, SUN, Alkem & Laurus

DRRD, LPC, Sun & Alkem to report strong quarters both for US and India. DRRD benefits from deferred sales in US and SG&A normalization from Q2 while Sun benefits from Cequa launch, Dusa/Absorica seasonality, LPC from Levo/better flu season. Cipla, ARBP, ALPM should be stabilising quarters. Sequential pick-up in the Ilumya, Solosec is weak. India growth is healthy ~10% YoY and Alkem's EBITDA is forecast to grow 17% YoY. Laurus will have another strong quarter while DIVI is non-event. EM fx/US\$ is stable QoQ.

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Key to watch: (1) **Alembic:** EU sales recovery, India commentary. (2) **Aurobindo (ARBP):** update on Sandoz FTC approval (guided for Jan'20), FDA update on Unit IV & VII inspection. (3) **Cipla:** Progress on Goa 483s, update on key respiratory assets (gAdvair filing & gProventil launch). (4) **Dr Reddy's (DRRD):** inventory write off risk post generics entry in Nuvaring, Srikakulam/CTO6 re-inspection, Duvvada EIR update. (5) **Divi's (DIVI):** Gross margin QoQ, capex progress. (6) **Lupin (LPC):** Incremental generics in Levo, Solosec update, Remediation progress (Goa, Indore-2, Somerset). (7) **Laurus:** Formulation offtake, gross margin QoQ, ARV commentary. (8) **Sun Pharma (SUNP):** higher R&D spends in 2H (vs 1H of 5.5% of Sales), update on Halol 483s, Ilumya, and Cequa.

KEY RECOMMENDATIONS

Ticker	Rating
ALPM IN	BUY
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 – Q3FY20: US REVENUE EXPECTATIONS

(US\$ mn)	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20E	QoQ (%)	YoY (%)
ALPM	60	43	44	49	77	66	(14.5)	54.0
ALKEM	69	74	69	69	76	79	4.0	6.2
ARBP	318	338	352	384	405	400	(1.3)	18.4
CIPLA	108	118	162	160	136	128	(6.2)	8.2
DRRD	210	209	212	233	204	238	16.8	13.9
LPC	178	197	247	220	189	213	12.6	8.2
SUNP (ex-Taro)	183	186	264	259	179	210	17.5	13.1
TARO	159	176	180	161	161	165	2.6	(6.4)

Source: Company, BOBCAPS Research

FIG 2 – Q3FY20 PREVIEW: GOOD FOR DRRD, LPC, SUNP, ALKEM, LAURUS; STABILISING FOR OTHERS

Companies	Sales (Rs mn)			EBITDA (Rs mn)			PAT (Rs mn)			EBITDA margin (%)		
	Q3FY20E	YoY (%)	QoQ (%)	Q3FY20E	YoY (%)	QoQ (%)	Q3FY20E	YoY (%)	QoQ (%)	Q3FY20E	Q3FY19	Q2FY20
ALPM	11,576	13.7	(6.7)	2,821	16.5	(18.4)	1,865	9.9	(24.3)	24.4	23.8	27.9
ALKEM	21,219	10.2	(6.3)	3,650	17.1	(19.3)	2,435	20.2	(34.3)	17.2	16.2	20.0
ARBP	59,410	12.7	6.1	12,302	13.2	5.4	7,107	3.4	4.6	20.7	20.6	20.8
CIPLA	43,835	9.4	(0.3)	8,360	18.1	(8.1)	4,055	21.7	(14.0)	19.1	17.7	20.7
DRRD	43,228	12.3	(10.0)	9,684	18.7	(31.2)	4,654	(4.1)	(67.9)	22.4	21.2	29.3
LPC	41,211	(8.5)	(5.5)	7,166	(4.8)	(2.0)	2,494	31.5	(41.0)	17.4	16.7	16.8
SUNP	82,565	7.8	3.9	17,459	(5.0)	8.6	11,877	17.8	12.5	21.1	24.0	20.2
DIVI	15,162	12.9	8.0	5,503	(2.5)	13.4	3,883	(7.7)	14.2	36.3	42.0	34.6
LAURUS	6,803	28.5	(4.5)	1,352	54.2	(1.9)	485	171.7	(14.5)	19.9	16.6	19.4
Sector Agg.	325,010	8.0	(0.7)	68,298	6.6	(5.7)	38,854	10.6	(23.7)	21.0	21.3	22.1

Source: Company, BOBCAPS Research

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Company-wise expectations

ALEMBIC PHARMA: Good YoY led by stable Sartans opportunity in US; Q3 to see Derma unit opex hit

We expect Alembic to report good quarter YoY, with 50-60bps EBITDA margin expansion. This is driven by stable contribution from sartan franchise in US (not seen any fresh generics entrants over Q2). However, we assume US sales US\$ 66mn (down 14% QoQ), reflecting price erosion in base business. Q3 should also see additional cost on account of Derma unit commercialisation hence expect QoQ EBITDA to dip.

Key to watch: EU sales recovery, India commentary and sequential gross margins.

ALKEM: Better gross margins and low tax key drivers

Overall Sales/EBITDA growth expected to be 10%/17% and profits could be boosted from lower tax. EBITDA margins should expand 100bps YoY, led by softening RM prices. We expect 12% growth for India business (in line with secondary trend). US sales to remain steady at US\$ 79mn (up 4% QoQ), led by stable base portfolio. Mycophenolate Suspension is yet to see incremental competition.

ARBP: Sequentially flat quarter; update on Sandoz & remediation of Unit IV/VII is key

We expect stable US sales for the quarter at US\$ 400mn, led by a) Ramp up at Eugia unit, and b) volume gains in baseline products like Omeprazole, Rosuvastatin, Aripiprazole, Pantoprazole. Auromedics injectable sales should stay at US\$ 75mn for Q3 (flat QoQ). We expect EBITDA and margins to largely remain stable QoQ.

Key to watch: update on Sandoz FTC approval timeline (guided for Jan'20), FDA update on formulation units (Unit IV and VII inspection)

CIPLA: Stable Q3 with core EBITDA uptick – FDA update on Goa unit key watch

Overall Cipla should report stable quarter, led by positive surprise on India business growth (we factor 8-9% growth). Management believes the trade generics business is steady and do not see any material disruption risk here on. US sales to drop 6% QoQ to US\$ 128mn due to 7-8% base price erosion, no big launches & pricing drop in gVolteron (Cipla vol share vs Q3 is stable at 28%). US exit rate for FY20 retained at US\$ 120-125mn levels. EM recovery from deferred

sales could be mild. Core margins (ex gSensipar in Q2) could increase both YoY and QoQ to 19%.

Key to watch: Remediation progress on Goa 483s, update on key respiratory assets (gAdvair filing & gProventil launch timelines), US specialty.

DRRD: Expect sequential increase in EBITDA & US sales

EBITDA/margins should improve QoQ as one-offs in RM & SG&A cost normalize. Sequentially, US sales expected to increase 17% to US\$ 238mn, following resumption of logistic issues, Suboxone (DRL share steady at 15%, Alvogen – supply constraint looks sorted out & share is up at 9% from 6-7% till Nov). Contribution from 1H launches (Carboprost, Vigabatrin, Isotretinoin etc) is gaining momentum. PSAI margins should be stable. India growth sec. trend is tracking strong at 15-18% YoY.

Key to watch: inventory write off risk in US post generics entry in Nuvaring, Srikakulam/CTO6 re-inspection, Duvada EIR update, cost control.

DIVI: Non-event quarter; QoQ gross margin uptick key to watch

Divi's Q3 results likely to remain subdued even though Sales growth might look strong YoY. This is primarily due to suppressed gross margins from high cost Chinese inventory procured to meet additional demand. Our discussion with company suggests that the benefits of the ongoing integration on the several APIs would be visible from Q4.

Key to watch: Progress on capex, CS mix uptick and improvement in gross margins QoQ.

LAURUS: Another strong quarter, led by positive surprise in formulations

We expect strong quarter from Laurus (in line with Q2), with 54% YoY growth in EBITDA and stable margins. Further, gross margin should improve sequentially led by higher formulation business (Global Fund supplies) and lower ARV revenue mix (lack of supplementary tenders). We note that, the revenue contribution mix in Q3 from ARV is expected to drop to 40% (vs 49%/42% in Q1/Q2). Formulation business in Q3 can positively surprise growing double digit QoQ while Synthesis business likely to report 30% YoY growth. We estimate EBITDA of Rs 1.4bn (+54% YoY) and PAT at Rs 485mn.

LPC: Operationally better; Tamiflu season better than expected

Q3 results should be ex-Kyowa, Japan (divesture completed in Dec'19). US sales expected to increase 13% QoQ to US\$ 213mn due to higher Tamiflu sales, Levo ramp up – tracking 5% share (up 35% MoM). Lupin has 5-6 US launches in Q3 which should contribute in coming quarters plus generic supply is looking robust for 4QFY20 with 3 injectable products in the US, per Lupin. Solosec growth on Scripts/value is moderate up 9-10% QoQ. Tamiflu season is turning out to be better than expected. Overall EBITDA margins to expand to 17.4% on higher US sales.

Key to watch: Levo incremental generic competition, direct promotion strategy on Solosec, Remediation progress/inspection timelines (Goa, Indore-2, Somerset).

SUNP: Q3 driven by Cequa stocking & India growth

Sun should report an improving quarter with margin expanding to 21.1% sequentially. This is mainly driven by Cequa inventory stocking in US (launched on 15th Oct) & better Absorica seasonality. We expect ex-Taro sales increase of 18% QoQ. Sun has launched Pantoprazole Injection (US\$15-20mn annual opp. size) in Oct 19 and ramp up should reflect in Q4. Taro should largely remain flat QoQ. Ilumya quarterly TRx ramp up remain subdued at US\$ 15mn (incl rebates). We expect India growth to remain healthy at 9-10% (vs. 11% secondary trend).

Key to watch: higher R&D spends in 2H (vs 1H which was at 5.5% of Sales, lower than 7-8% guidance), update on Halol 483s, Commentary on specialty products Ilumya, Cequa.

Avg. USDINR rate at Rs 71.2 in Q3 (vs. Rs 70.3 QoQ); EM currencies largely stable.

FIG 3 – CROSS-CURRENCY MOVEMENT

Quarter End	Closing rate					Average rate				
	USDINR	EURINR	JPYINR	RUBINR	ZARINR	USDINR	EURINR	JPYINR	RUBINR	ZARINR
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
Dec 2019	71.4	80.0	0.6	1.1	4.7	71.2	78.9	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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