

## Robust India drives Q3

Q3 results reaffirms stable base business outlook for the US (for last 6 quarters) and strong trends for domestic formulations business (double digit growth at 11% for covered companies vs 9.5% for IPM). R&D spends remain calibrated at 7.8% of sales (vs 9%+ in FY17/18) and EBIDTA margins improved 30bps QoQ. We forecast revenue/EPS CAGR of 9%/15% over FY20-22e for our covered universe. Torrent and Cipla are preferred Buys.

**Key visible trends:** a) aggressive push towards India business via acquisition/in-licensing/field force expansion, b) calibration of R&D spend – targeted towards specialty/key pipeline assets, c) increased compliance cost for US FDA plants.

**Covid-19 outbreak – Immediate risk is limited but prolonged shutdown will have implications:** Indian Pharma Industry's dependence on China for key starting material (KSM)/intermediates/ API is very high. Share of China in bulk drug and intermediates imports was ~67% at USD2.4bn in FY19 (source:DGCIS). In the event of extended shutdown, the industry faces risk of supply disruption and increased input cost. Most companies have inventory of 3-4 months and are closely monitoring the situation. It is difficult to ascertain specific impact at

### Valuation Summary

Company	MCAp (Rs. bn)	CMP (Rs./ Sh)	RECO	TP	EPS CAGR FY20-22E	PER(X)			EV/ EBITDA (X)			ROCE		
						FY20E	FY 21E	FY22E	FY 20E	FY 21E	FY 22E	FY 20E	FY 21E	FY 22E
Cipla	351	436	BUY	495	8.5%	20.8	20.7	17.7	11.5	10.8	9.3	12.4	12.0	13.0
Dr. Reddy's	541	3,255	NEU	3,440	14.5%	24.8	23.0	18.9	16.9	13.5	11.4	12.5	15.5	17.0
Lupin	317	699	NEU	705	23.8%	30.2	25.0	19.7	14.5	12.6	10.5	7.1	8.4	10.2
Sun	972	405	BUY	500	13.7%	23.2	21.9	17.9	13.1	11.8	9.6	10.3	10.6	11.5
Torrent	378	2,235	BUY	2,405	20.3%	40.8	34.7	28.2	19.2	17.1	15.0	16.5	18.9	20.8

Source: Company, HDFC sec Inst Research

this stage but a prolonged shutdown will impact the entire supply chain which could have knock on effect on the cost of goods produced globally.

We believe over a longer term the Indian API industry would stand to benefit as regulators encourage investments and incentivise the API industry to reduce dependence on China. Also, the cost arbitrage has narrowed between Indian and Chinese manufacturers given stricter environmental and compliance regulations in addition to increased labour cost in China.

### Q3FY20 Review

- Domestic biz of large cap pharma outperformed IPM and posted revenue growth of 11% YoY in Q3 (vs 9.5% for IPM).
- US revenues largely reflected stable base business performance (+6% YoY and +4% QoQ).
- Gross margins were flat YoY and QoQ at 66%.
- EBIDTA growth was at -2.4% YoY and +1% QoQ and margins declined by 160bps YoY and improved 30bps QoQ for covered companies.
- R&D expense were flat YoY and increased 30bps QoQ at 7.8% of sales.

Company	RECO	TP
Cipla	BUY	495
Dr. Reddy's	NEU	3,440
Lupin	NEU	705
Sun	BUY	500
Torrent	BUY	2,405

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**Q3 revenues grew by 5% YoY led by strong growth in India and stable performance in US**

**IPM growth break up of 9.5% for the Q3 - price (5.4%), volume (1.4%) and new products (2.7%)**

**IPM growth was 9.5% for 9MFY20 driven by acute (10.1%), chronic (9.2%) and sub-chronic (8.2%)**

**US base business reported stable revenues whereas Specialty portfolio saw slower traction**

### Q3FY20 result snapshot

Rs mn	Revenue	YoY	QoQ	EBIDTA	YoY	QoQ	Adj. PAT	YoY	QoQ	Comments
Cipla	43,710	9%	-1%	7,583	7%	-20%	3,510	6%	-34%	India growth bounced back, margins were in line
Dr. Reddy's	43,838	14%	7%	10,416	24%	36%	7,503	69%	7%	Strong performance across markets, gNuvaring impairment led to reported loss
Lupin	37,693	-5%	-11%	4,291	-37%	-37%	1,197	-34%	-130%	Trough quarter in terms of margins, one offs led to reported loss
Sun Pharma	81,549	5%	0%	17,596	-7%	-2%	9,135	-26%	-16%	Strong growth in India at 13% YoY, US base improved despite decline in Taro
Torrent	19,650	-1%	-2%	5,390	2%	0%	2,510	19%	3%	India biz growth disappointed (+8.5% YoY, adjusted), lower R&d aided margins

Source: Company, HDFC sec Inst Research

### India business reported strong growth, guides for outperforming the IPM

India (Rs mn)	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Comments
Cipla	15%	13%	21%	0%	-1%	11%	-12%	6%	12%	Realignment in trade gx biz impacted growth in 1HFY20. Reported growth for 9MFY20 at 2%
Dr. Reddy's	3%	7%	30%	8%	10%	6%	15%	9%	13%	Improved growth trajectory (+12% YoY) in 9MFY20
Lupin	8%	10%	28%	4%	11%	9%	10%	12%	9%	Consistent performance (+10% YoY) in 9MFY20
Sun Pharma	6%	2%	22%	-16%	7%	-44%	8%	35%	13%	Higher growth (+18% YoY) in 9MFY20 on low base
Torrent*	17%	48%	79%	34%	42%	9%	9%	10%	4%	Reported growth of 8% YoY (adjusted 11.5%) for 9MFY20
<b>IPM</b>	<b>6%</b>	<b>8%</b>	<b>9%</b>	<b>10%</b>	<b>10%</b>	<b>10%</b>	<b>8%</b>	<b>12%</b>	<b>9%</b>	IPM growth for 9MFY20 was at 9.5% led by higher growth in acute segment

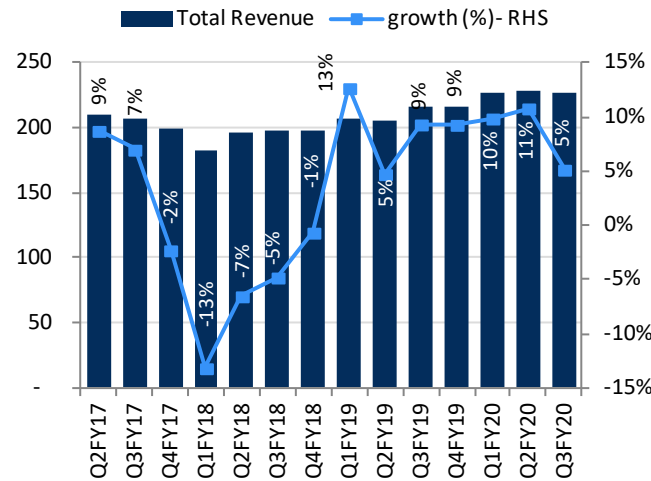
Source: AIOCD AWACS, Company data, HDFC Sec Inst research, \*includes Unichem from Q3FY18

### US business reported revenues in line with expectations

US sales (USD mn)	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Comments
Cipla	100	116	100	108	118	163	161	135	133	Stable base business. gSensipar contribution has normalized
Dr. Reddy's	241	228	247	207	213	216	234	202	224	Recovered from Q2 lows as 5 new launches offset price erosion in base. Q2 was impacted on account of ranitidine recall and supply issues
Lupin	223	224	168	171	194	245	218	184	186	gTamiflu contribution was similar to Q2 and Levo/Solosec ramp up is muted
Sun Pharma	328	368	380	342	362	443	424	339	350	Sun's base business and specialty improved despite Taro's decline of 8% QoQ
Torrent	40	44	49	55	58	53	51	52	52	Stable base, Valsartan ramp up remains calibrated

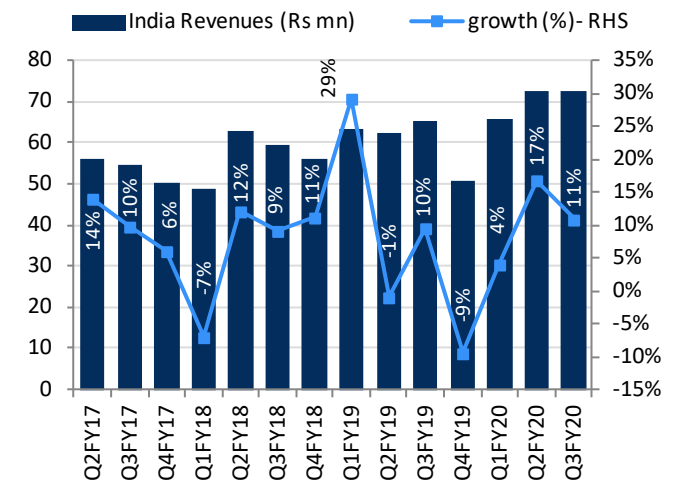
Source: Company, HDFC sec Inst Research

**Revenues grew by 5% YoY in Q3**



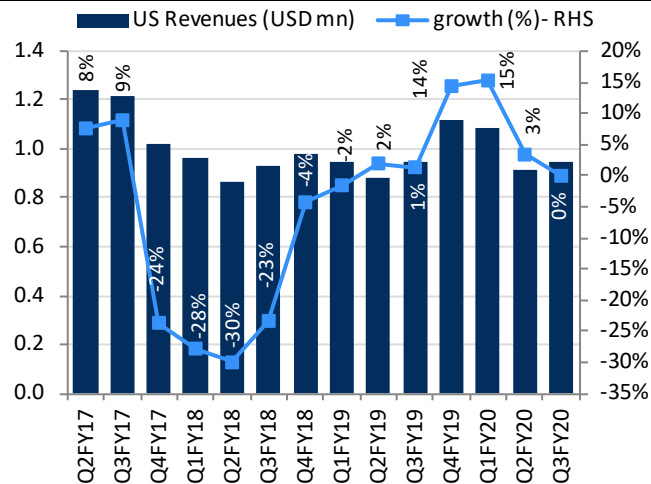
Source: Company, HDFC sec Inst Research

**India biz posted double digit growth at 11% YoY**



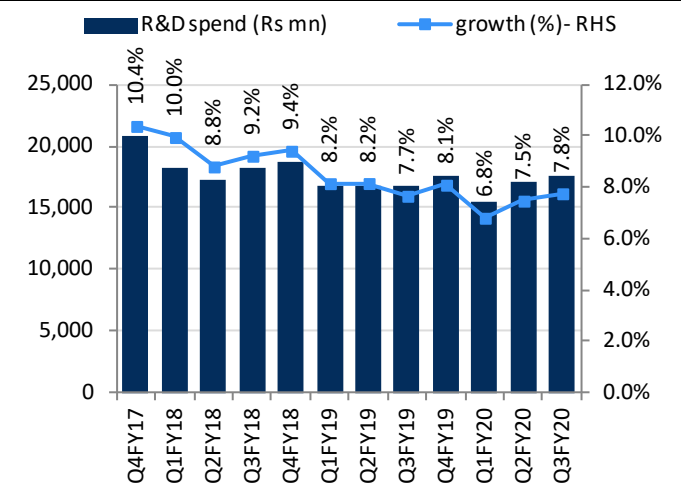
Source: Company, HDFC sec Inst Research, Q4FY19 was impacted as Sun transferred biz from AML to wholly owned subsidiary

**US base was flat YoY and grew 4% QoQ**



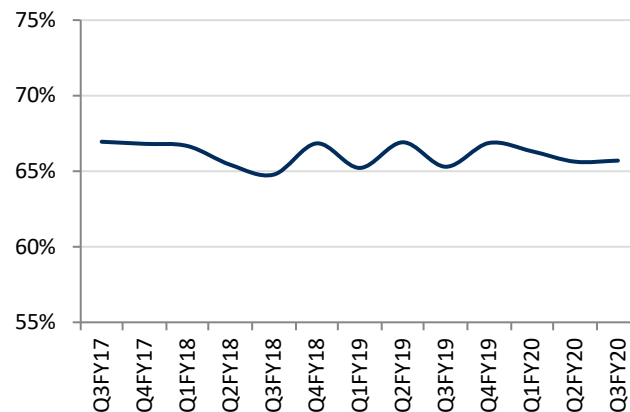
Source: Company, HDFC sec Inst Research

**R&D spend remains moderated at 7.8% of sales**



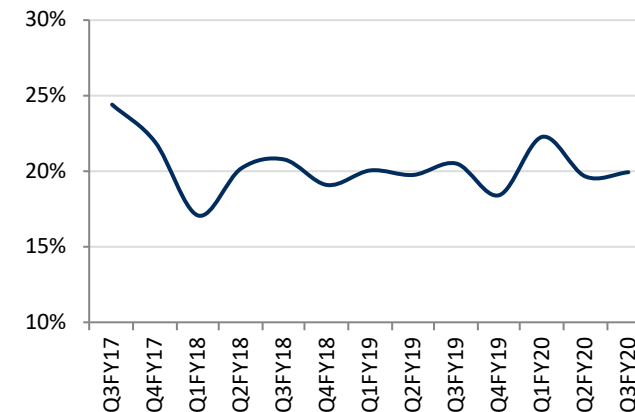
Source: Company, HDFC sec Inst Research

**Gross margins were largely stable at 66%**



Source: Company, HDFC sec Inst Research

**EBIDTA margins declined 140bps YoY to 20%**



Source: Company, HDFC sec Inst Research

**Change in estimates and TP**

- We cut earnings for Cipla by 2% for FY21/22 to account for gVoltaren switch to OTC from prescription and revise our TP down to Rs495 from Rs510. Our Buy rating remains unchanged.
- We increase our target multiple for Torrent from 15x to 16x (10% premium to domestic peers) and revise our TP to Rs2,405 from Rs2,250. Our Buy rating remains unchanged.

**Peerset comparison**

Company	Market Cap (Rs. bn)	CMP (Rs./ Sh)	RECO	TP	EPS CAGR FY20-22E	PER(X)			EV/ EBITDA (X)			ROE		
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Alkem	318	2,658	NA	NA	16.5%	30.6	26.1	22.5	20.7	17.5	15.3	17.9	18.0	18.1
Cadila	286	279	NA	NA	12.4%	19.8	17.3	15.7	12.9	11.6	10.8	12.7	13.4	13.7
Glenmark	91	322	NA	NA	16.6%	12.6	10.4	9.2	7.0	6.1	5.5	12.0	12.6	12.8
Ipca Labs	184	1,455	NA	NA	19.7%	30.6	24.9	21.3	17.3	14.7	12.7	17.5	18.2	18.0
Eris Lifesciences	59	433	NA	NA	16.8%	16.9	14.6	12.4	17.0	15.0	13.0	26.8	25.2	22.5

Source: Bloomberg, HDFC sec Inst Research

**Rating Definitions**

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