FIRST LIGHT

07 February 2022

RESEARCH

Lupin | Target: Rs 815 | –7% | SELL

Major benefits remain back ended, 3Q disappoints

BOB Economics Research | RBI: Pre-Policy View

Time to Hike: Reverse Repo

Alkem Labs | Target: Rs 4,000 | +14% | HOLD

Strong domestic growth; weak margins

Astral | Target: Rs 2,465 | +13% | HOLD

Decent quarter; FY24 outlook bright

Daily macro indicators

Indicator	03-Feb	02-Jan	Chg (%)
US 10Y yield (%)	1.83	1.78	6
India 10Y yield (%)	6.89	6.88	1
USD/INR	74.86	74.84	0.0
Brent Crude (US$/bbl)	91.1	89.5	1.8
Dow	35,111	35,629	(1.5)
Hang Seng	23,802	23,550	1.1
Sensex	58,788	59,558	(1.3)
India FII (US$ mn)	**02-Feb**	**01-Jan**	**Chg ($ mn)**
FII-D	(10.6)	(90.1)	79.5
FII-E	80.6	(12.9)	93.4

Source: Bank of Baroda Economics Research

SUMMARY

Lupin

- Q3 revenue growth modest at 4% YoY (+2% QoQ) despite strong US and India formulation business, as API revenue declined 25%
- Higher RM cost and pricing pressure impacted gross margin; adding on a one-off expense, EBITDA margin shrank 1,050bps YoY
- Downgrade from HOLD to SELL as we roll forward to a lower TP of Rs 815 (vs. Rs 1,045) based on 11x FY24E EV/EBITDA (vs. 12x)

Click here for the full report.

India Economics: RBI: Pre-Policy View

Elevated crude oil and commodity prices continue to add to India's inflation concerns. It may be expected that the RBI will reprioritise and focus back on inflation. Excess liquidity in the system is another issue to contend. We expect RBI will hike reverse repo rate by 25bps and thus reduce the gap in policy corridor. Short term rates have also been inching towards Repo rate. We anticipate no change in repo rate, while GDP forecast is likely to revised lower for FY22.

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Alkem Labs

- Robust traction in India formulations (+20% YoY) during Q3, partly offset by a 7% decline in US generic revenue
- Reversal of SG&A savings hit EBITDA margin; management expects continued headwinds to impact Q4 gross margin by ~3%
- Reiterate HOLD with a lower TP of Rs 4,000 (vs. Rs 4,250) as we roll valuations over and pare our EV/EBITDA multiple to 17x (vs. 19x)

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Astral

- Consolidated Q3 revenue grew ~23% YoY with pipe/adhesive segments up 25%/16%; pipe volumes dipped 4% due to dealer destocking
- Operating margin declined 340bps YoY to 18% as pipe/adhesive margins contracted by 305bps/455bps
- We maintain our TP of Rs 2,465, valuing ASTRA at 65x FY24E P/E; retain HOLD as upside potential looks limited

Click here for the full report.

SELL
TP: Rs 815 | ⩔ 7%

LUPIN | Pharmaceuticals | 05 February 2022

Major benefits remain back ended, 3Q disappoints

- **Q3 revenue growth modest at 4% YoY (+2% QoQ) despite strong US and India formulation business, as API revenue declined 25%**
- **Higher RM cost and pricing pressure impacted gross margin; adding on a one-off expense, EBITDA margin shrank 1,050bps YoY**
- **Downgrade from HOLD to SELL as we roll forward to a lower TP of Rs 815 (vs. Rs 1,045) based on 11x FY24E EV/EBITDA (vs. 12x)**

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US and India witnessed decline in key portfolio: LPC reported modest 4% YoY revenue growth in Q3FY22 as with 7% YoY growth in the formulations business (US +9% and India +8%) was countered by a 25% YoY drop in API revenue (-4% QoQ). In formulations, the APAC/EMEA geographies posted positive growth of 14%/5% YoY but LATAM/ROW declined by 11%/6%. The US growth was driven gAlbuterol while its core US portfolio witnessed strong price erosion in key products such as Famotidine, gGlumetza and Levothyroxin. India formulations underperformed to the peers due to lower sales of Covid portfolio.

US reports growth with higher Rx share of gAlbuterol: US sales rose 10% QoQ to US$ 213mn on account 20% Rx share in gAlbuterol, and better traction in new launch of inhalation product. Management however guided to expect the continuation of strong price erosion in US generics as supplies from the peers are gradually normalizing. LPC guided only limited number of products to drive growth in FY23 and FY24 and also depended on faster approval from Goa and Indore plants.

Steep rise in RM cost and one-off expense impact margin: Raw material cost rose 23% YoY to 41% of revenue (vs. 34% of revenue in 3QFY21), depleting gross margin by 650bps YoY to 59.3% (-100bps QoQ). EBITDA margin contracted 1,050bps YoY (-100bps QoQ) to 8.9% due to the lower gross margin and a Rs 1.9bn one-off expense from returns of products in Metformin and bad flu season impacted sales of Oseltamivir. EBITDA margin sans one-off was 13.5% (-585 YoY, -85bps QoQ).

Downgrade to SELL: We cut our FY22-FY24 EBITDA estimates by 23% each with tepid 3QFY22 and soft near-term outlook. On rollover to FY24 valuations, we have a new TP of Rs 815 (vs. Rs 1,045) based on a lower EV/EBITDA multiple of 11x (implied P/E of 21x) from 12x earlier. Our target multiple factors in near-term operational and industry challenges and is at a 30% discount to the aggregate of frontline players such as SUNP, DRRD and CIPLA – downgrade from HOLD to SELL. Lupins EV/EBITDA multiple of 11x is 30% discount to the average multiple of frontline stocks like SUNP, DRRD, CIPLA.

Key changes

Target	Rating
▼	▼

Ticker/Price	LPC IN/Rs 872
Market cap	US$ 5.3bn
Free float	53%
3M ADV	US$ 16.3mn
52wk high/low	Rs 1,268/Rs 854
Promoter/FPI/DII	47%/16%/24%

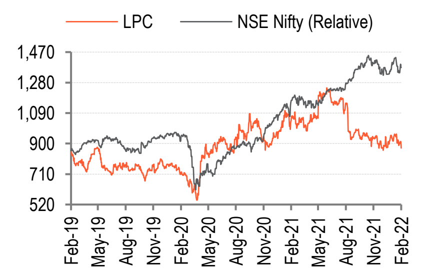
Source: NSE | Price as of 4 Feb 2022

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	1,51,630	1,60,118	1,72,749
EBITDA (Rs mn)	25,669	24,037	28,133
Adj. net profit (Rs mn)	12,166	11,433	14,062
Adj. EPS (Rs)	26.9	25.3	31.1
Consensus EPS (Rs)	26.9	33.6	43.9
Adj. ROAE (%)	9.2	8.9	11.3
Adj. P/E (x)	32.4	34.5	28.1
EV/EBITDA (x)	16.2	16.1	13.8
Adj. EPS growth (%)	235.1	(6.0)	23.0

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

RBI: PRE-POLICY VIEW

05 February 2022

Time to Hike: Reverse Repo

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Elevated crude oil and commodity prices continue to add to India's inflation concerns. It may be expected that the RBI will reprioritise and focus back on inflation. Excess liquidity in the system is another issue to contend. We expect RBI will hike reverse repo rate by 25bps and thus reduce the gap in policy corridor. Short term rates have also been inching towards Repo rate. We anticipate no change in repo rate, while GDP forecast is likely to revised lower for FY22.

Ongoing Challenges for economy: In the last 2 months, countries across the globe once again fought the new variant of Covid-19. India too was caught in the winds once again as it bravely battled the third wave of covid-19. States re-imposed restrictions in order to curtail the spread of Covid-19. With service sector challenges, the economy is again expected to witness some slowdown. However, the impact is expected to be mild as things have improved for the better with Covid-19 cases ebbing lower and states slowly and gradually reopening up.

GDP remains in the target range: Given recent headwinds to growth, India's economy is expected to grow by 8.8% in FY22 and 7.75% to 8% in FY23. This is on the back of revival in demand including credit.

Can RBI be behind the curve? : Global central banks have sprung in to action by tightening the monetary policy with BoE hiking rates consecutively in its last two meetings. There has also been anticipation of rate hike from US Fed. With this, there is an expectation of rate hike from RBI too as it returns to its mandate of price stability.

Inflation remains worrisome: An uptick in CPI inflation has been observed lately as it climbed up to 5.6% in Dec'21 from 4.9% in Nov'21. Given the spike in crude oil prices, along with increase in global commodity prices, these factors are likely to impinge on inflation. Further, once the state elections are over, inflation is expected to increase further as fuel prices are changed.

Expectations from RBI: Given the revision in FY21 estimates by NSO, we expect RBI too revise its growth forecast for FY22 downwards. However, no change in inflation forecast is expected at this juncture. Overall, we expect a reverse repo rate hike by 25bps and reduce the asymmetric gap in the policy corridor. Apart from this, we expect RBI to retain Repo rate at 4%. We also do not expect any changes in the CRR in this policy meet.

RESULT REVIEW

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TRUST | INNOVATION | EXCELLENCE

HOLD

TP: Rs 4,000 | 14%

ALKEM LABS | Pharmaceuticals | 05 February 2022

Strong domestic growth; weak margins

- **Robust traction in India formulations (+20% YoY) during Q3, partly offset by a 7% decline in US generic revenue**
- **Reversal of SG&A savings hit EBITDA margin; management expects continued headwinds to impact Q4 gross margin by ~3%**
- **Reiterate HOLD with a lower TP of Rs 4,000 (vs. Rs 4,250) as we roll valuations over and pare our EV/EBITDA multiple to 17x (vs. 19x)**

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India-led growth recovery helped by acute portfolio: Alkem reported 13% YoY growth in Q3FY22 revenue led by better traction in India formulations (+20% YoY, ~70% of sales), partially offset by a decline in US generics (-7% YoY, 22% of sales). The ROW market contributed 8% of revenue and grew 25% YoY. India formulations growth was aided by recovery in acute therapy segments such as anti-infectives, vitamins, minerals & nutrients, gastrointestinal and pain management, together with Covid-19 tailwinds. The trade generics business witnessed traction in 9MFY22 despite the disadvantage of a high base effect.

US pricing pressure affects growth: The US generics business declined 6% QoQ to US$ 77mn in Q3 on account of significant pricing pressure on the base business. This was mitigated to some extent by product launches.

Steep rise in SG&A expense dampens EBITDA margin: Gross margin for the quarter was stable at 61.9% (+25bps YoY, -30bps QoQ), but a steep rise in overhead costs caused EBITDA margin to shrink 380bps YoY (-330bps QoQ) to 19%. SG&A expense ex-R&D increased by 42% YoY to 19% of revenue vs. 15% YoY. Management has guided for a ~3% negative impact on the Q4 gross margin due to continued headwinds. Margin contraction as well as lower non-operating income resulted in a Q3 PBT decline of 15% YoY (-20% QoQ). Deferred tax benefits due to restructuring of the US business stood at Rs 1.6bn, aiding a 17% YoY rise in PAT.

Retain HOLD: We reduce our FY22-FY24 EBITDA margin estimates by 100bps in light of management's gross margin guidance and a weaker overall outlook for Q4FY22. We also roll valuations over to FY24 and pare our target EV/EBITDA multiple to 17x (implied P/E of 21x) from 19x earlier given margin weakness, the rise in cost of goods sold and a lack of growth drivers in the US generics business over the near-to-medium term. Our TP thus declines to Rs 4,000 (from Rs 4,250); maintain HOLD.

Key changes

Target	Rating
▼	◄►

Ticker/Price	ALKEM IN/Rs 3,514
Market cap	US$ 5.6bn
Free float	39%
3M ADV	US$ 6.5mn
52wk high/low	Rs 4,070/Rs 2,540
Promoter/FPI/DII	59%/5%/14%

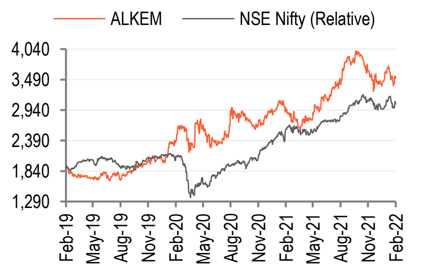
Source: NSE | Price as of 4 Feb 2022

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	92,336	1,06,093	1,19,218
EBITDA (Rs mn)	23,110	20,898	24,380
Adj. net profit (Rs mn)	19,536	17,988	19,622
Adj. EPS (Rs)	163.4	150.5	164.1
Consensus EPS (Rs)	163.4	144.3	161.7
Adj. ROAE (%)	34.0	25.9	23.4
Adj. P/E (x)	21.5	23.4	21.4
EV/EBITDA (x)	18.3	20.1	16.7
Adj. EPS growth (%)	73.3	(7.9)	9.1

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

HOLD
TP: Rs 2,465 | ⮝ 13%

ASTRAL

| Plastic Products | 05 February 2022

Decent quarter; FY24 outlook bright

- **Consolidated Q3 revenue grew ~23% YoY with pipe/adhesive segments up 25%/16%; pipe volumes dipped 4% due to dealer destocking**
- **Operating margin declined 340bps YoY to 18% as pipe/adhesive margins contracted by 305bps/455bps**
- **We maintain our TP of Rs2,465, valuing ASTRA at 65x FY24E P/E; retain HOLD as upside potential looks limited**

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Steady revenue growth but volumes decline: ASTRA's consolidated Q3FY22 revenue grew ~23% YoY to Rs 11bn as better realisations (at Rs 243/kg vs. Rs 189/kg YoY) countered a contraction in volumes due to extended rainfall, construction bans in some geographies, the third Covid-19 wave and destocking by dealers due to PVC price fluctuations. Standalone revenue increased ~24% YoY in PVC pipes (volumes down 4%) and 16% YoY in adhesives. Management expects demand to improve backed by an increase in housing uptake, absorption of real estate inventory and PVC price normalisation.

Margin declines as RM costs climb: Consolidated EBITDA margin declined 340bps YoY to 18% as both of ASTRA's business segments saw cost inflation. EBITDA margin in pipes fell 305bps YoY to 19.8% due to higher raw material cost (+320bps) and lower volumes (-4%). Adhesive margins contracted 455bps to 11.7% owing to high chemical costs and price hikes coming into effect with a lag. In addition, UK performance was subdued due to the non-availability of key input silicon, which further affected margins.

Full expansion benefits to kick in from FY24: ASTRA has completed the following expansion projects: (a) Hosur plastic water tank, (b) Bhubaneshwar machine installation (trials to start in February and commercial production by March), (c) valve project at Dholka (a few sizes launched and a few under trials), (d) pipe manufacturing at Aurangabad, and (e) blow molding water tanks at Santej and Ghiloth. The company has finalised the design and vendors for sanitaryware and faucetware and plans to launch products in these segments in May'22. Its adhesive plant in the Dahej (Gujarat) Chemical Zone will be ready by FY23-end.

Maintain HOLD: We like ASTRA for its strong growth prospects, market leadership, above-industry volume growth (9% in 9MFY22), net-debt free balance sheet, wide distribution network and healthy return ratios. The stock is trading at 58x FY24E P/E vs. its five-year median of ~70x. While we believe ASTRA merits a premium to peers and hence value the stock at 65x FY24E EPS, we see limited upside potential from current levels and hence retain HOLD. Our TP remains at Rs 2,465.

Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	ASTRA IN/Rs 2,181
Market cap	US$ 5.9bn
Free float	44%
3M ADV	US$ 11.5mn
52wk high/low	Rs 2,525/Rs 1,411
Promoter/FPI/DII	56%/20%/24%

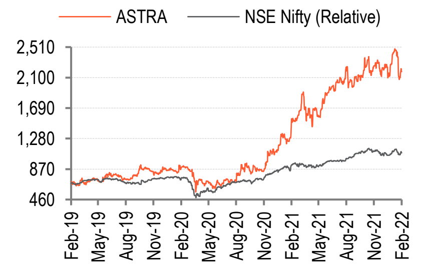
Source: NSE | Price as of 4 Feb 2022

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	31,763	39,324	47,535
EBITDA (Rs mn)	6,445	7,136	9,064
Adj. net profit (Rs mn)	4,059	4,526	5,935
Adj. EPS (Rs)	20.2	22.5	29.5
Consensus EPS (Rs)	20.2	25.9	31.6
Adj. ROAE (%)	23.9	22.5	26.0
Adj. P/E (x)	107.9	96.8	73.8
EV/EBITDA (x)	68.1	61.1	47.9
Adj. EPS growth (%)	62.5	11.5	31.1

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

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Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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