

Good Q4 for DRRD, LPC, DIVI, Laurus; FY21 guidance key to watch

We expect DRRD, LPC (Levo ramp-up + Losartan/HCTZ), and DIVI (leverage post FDA audit) to report a good quarter, with higher margins QoQ for LPC/DIVI (decline for DRRD on R&D cost increase). US sales QoQ should rise 7-13% for DRRD/LPC, stay stable for ARBP/SUNP, and fall 7% for Cipla. Q4 is seasonally soft for India sales; expect 10% YoY growth. The Covid-19 impact across markets could reflect from Q1FY21. Laurus should see its best-ever quarter. On forex (avg. basis), the USD is favourable (+3% QoQ); EMs are weak (RUB -3%, ZAR -8%).

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Key to watch: FY21 guidance is key amidst Covid-19 disruptions. **(1) Alembic:** EU recovery, update on Sartans shortage. **(2) Aurobindo (ARBP):** Unit IV remediation, reinspection timelines for Unit 10/Eugia. **(3) Cipla:** Progress on Goa warning letter, update on key respiratory assets (gAdvair filing). **(4) Dr Reddy's (DRRD):** Cost control, China business, Srikulam/CTO6 remediation. **(5) Divi's (DIVI):** Covid-19 supply disruption, progress on capex, and CS ramp-up. **(6) Lupin (LPC):** Sequential EBITDA increase, update on Solosec, bEnbrel and gFostair in the EU (H1FY21), on gProAir (H1FY21), and FDA reinspection for Somerset/Goa sites. **(7) Laurus:** Hydroxychloroquine supply potential. **(8) Sun Pharma (SUNP):** Halol OAI update, specialty products, cost control.

RECOMMENDATION SNAPSHOT

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

FIG 1 – Q4FY20: US REVENUE EXPECTATIONS

| (US\$ mn) | Q4FY18 | Q1FY19 | Q2FY19 | Q3FY19 | Q4FY19 | Q1FY20 | Q2FY20 | Q3FY20 | Q4FY20E | QoQ (%) | YoY (%) |
|----------------|--------|--------|--------|--------|--------|--------|--------|--------|---------|---------|---------|
| ALPM | 45 | 34 | 60 | 43 | 44 | 49 | 77 | 72 | 66 | (8.9) | 49.5 |
| ALKEM | 63 | 63 | 69 | 74 | 69 | 69 | 76 | 82 | 78 | (5.1) | 12.9 |
| ARBP | 272 | 283 | 318 | 338 | 352 | 384 | 405 | 418 | 415 | (0.8) | 17.8 |
| CIPLA | 104 | 101 | 108 | 118 | 162 | 160 | 136 | 133 | 123 | (7.4) | (24.1) |
| DRRD | 223 | 237 | 210 | 209 | 212 | 233 | 204 | 225 | 240 | 6.8 | 13.0 |
| LPC | 233 | 177 | 178 | 197 | 247 | 220 | 189 | 193 | 218 | 12.8 | (11.8) |
| SUNP (ex-Taro) | 200 | 225 | 183 | 186 | 264 | 259 | 179 | 203 | 210 | 3.0 | (20.5) |
| TARO | 175 | 155 | 159 | 176 | 180 | 161 | 161 | 148 | 155 | 5.0 | (13.8) |

Source: Company, BOBCAPS Research

FIG 2 – Q4FY20 PREVIEW: STRONG FOR DRRD, LPC, DIVI, LAURUS; IN-LINE FOR OTHERS

| Companies | Sales (Rs mn) | | | EBITDA (Rs mn) | | | PAT (Rs mn) | | | EBITDA margin (%) | | |
|--------------------|----------------|------------|------------|----------------|-------------|--------------|---------------|-------------|---------------|-------------------|-------------|-------------|
| | Q4FY20E | YoY (%) | QoQ (%) | Q4FY20E | YoY (%) | QoQ (%) | Q4FY20E | YoY (%) | QoQ (%) | Q4FY20E | Q4FY19 | Q3FY20 |
| ALPM | 11,198 | 20.8 | (7.4) | 2,501 | 40.4 | (23.1) | 1,603 | 29.4 | (31.7) | 22.3 | 19.2 | 26.9 |
| ALKEM | 19,985 | 7.8 | (8.4) | 3,074 | 30.7 | (32.2) | 2,121 | 26.6 | (44.5) | 15.4 | 12.7 | 20.8 |
| ARBP | 60,619 | 14.5 | 2.8 | 12,366 | 16.6 | 2.4 | 7,264 | 16.2 | 2.3 | 20.4 | 20.0 | 20.5 |
| CIPLA | 43,159 | (2.0) | (1.3) | 7,385 | (23.2) | (8.7) | 3,389 | (7.8) | (15.5) | 17.1 | 21.8 | 18.5 |
| DRRD | 43,999 | 9.5 | 0.4 | 9,927 | 21.1 | (2.6) | 4,993 | 14.9 | (33.5) | 22.6 | 20.4 | 23.2 |
| LPC | 39,314 | (10.8) | 4.3 | 5,279 | (39.5) | 23.0 | 1,620 | (43.6) | 42.8 | 13.4 | 19.8 | 11.4 |
| SUNP | 81,774 | 16.1 | 1.7 | 14,930 | 56.8 | (9.2) | 9,096 | 31.2 | 9.3 | 18.3 | 13.5 | 20.4 |
| DIVI | 14,599 | 16.2 | 5.0 | 5,515 | 31.9 | 11.0 | 3,792 | 28.0 | 10.6 | 37.8 | 33.3 | 35.7 |
| LAURUS | 7,750 | 22.0 | 6.2 | 1,600 | 43.0 | 7.9 | 668 | 54.9 | (9.2) | 20.6 | 17.6 | 20.3 |
| Sector Agg. | 322,397 | 8.1 | 0.8 | 62,577 | 11.6 | (4.2) | 34,544 | 13.7 | (10.0) | 19.4 | 18.8 | 20.4 |

Source: Company, BOBCAPS Research

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Company-wise expectations

ALPM: Healthy quarter led by Sartans

We expect ALPM to report healthy growth YoY driven by recovery in the India business and stable US business of US\$ 66mn (-9% QoQ). EBITDA margins are forecast to expand 250-300bps YoY led by stable sartan franchise sales and INR depreciation given that the company is a net exporter. While ALPM continues to have enough inventory to meet supplies for international markets, there are some supply disruptions for EU markets.

Key to watch: India/EU commentary, update on sartan opportunity, sequential gross margins

ALKEM: Good Q4 led by gross margin expansion; cautious on Q1FY21

ALKEM anticipates a possible hit on India sales in Q1FY21 if the Covid-19 lockdown is extended to May'20, but could see recovery in H2 as underlying demand drivers are intact. For Q4, we expect overall sales/PAT growth at 8%/31% YoY. EBITDA margins are projected to expand 250bps YoY, led by gross margin expansion and controlled R&D cost. We forecast 6% QoQ growth for the India business (vs. 8% growth on secondary trends). US sales are likely to remain largely steady at US\$ 78mn (-5% QoQ), backed by a stable base portfolio.

ARBP: EBITDA to expand QoQ; FDA inspection of Unit 10/Eugia key

We expect stable US sales for the quarter at US\$ 415mn, supported by volume gains in baseline products such as Rosuvastatin, Aripiprazole and Pantoprazole. However, Auromedics injectable sales could be affected due to the decline in footfalls at hospitals. EBITDA is projected to expand marginally QoQ due to INR depreciation. ARBP has roughly three months of inventory plus all its plants are operating at normalised levels (only a few are 5-10% below-normal), which should suffice to drive growth in near-/mid-term quarters.

Key to watch: FDA update on Unit IV remediation, reinspection timelines for Unit 10/Eugia

CIPLA: Sequentially soft EBITDA margins

US sales are forecast to decline 7% QoQ to US\$ 123mn in the absence of meaningful launches and with pressure on gVoltaren gel (after the USFDA mandated a prescription to OTC switch from Feb'20). Q4 for India is seasonally softer but YoY momentum should continue with 10% growth. EM sales could increase with recognition of deferred sales. We expect EBITDA margins to decline 140bps QoQ to 17%.

Key to watch: Goa warning letter remediation, progress on respiratory filings (including Advair), US specialty

DRRD: Strong US sales but margins can decline QoQ

We expect US sales to increase 7% QoQ to US\$ 240mn mainly due to (1) ramp-up in products such as Suboxone (post AG exit, market share increased to 20% from 17% in Dec'19), Toprol XL (market share up 6ppt to 30% from Jan'20), Carboprost, Isotretinoin and Doxercalciferol injectables, and (2) contribution from new launches such as gVimovo. India sales are likely to grow at a strong 15% YoY but Q1FY21 can be impacted if the lockdown is extended. We expect EBITDA margins to decline 70bps QoQ to ~22% on higher R&D and RM cost. On a closing basis, the RUB/INR has weakened by 17% QoQ and should offset INR/USD depreciation positives in Q4.

Key to watch: Cost control, China business, Srikakulam/CTO6 remediation progress

DIVI: Improved plant utilisation to drive sales and margins

Q3 operating results were adversely affected by lower utilisation due to multiple plant inspections, but we expect recovery in Q4. We estimate sales/EBITDA growth of 16%/32% YoY led by operating leverage. This along with currency benefits should take EBITDA margins to 37.8% (+450bps YoY, +200bps QoQ). Gross margin improvement from backward integration should be visible in this quarter as well.

Key to watch: Covid-19 supply disruptions, progress on capex, ramp-up in CS business

LAURUS: Best-ever quarter expected

We expect strong results from Laurus with sales/EBITDA growth of 22%/43% YoY. Operating margins should further improve both YoY and QoQ to 20.6%. A stable formulation mix, higher synthesis sales and integration benefits in oncology API are key drivers. The synthesis business is likely to report 20% YoY growth. We estimate EBITDA of Rs 1.6bn (+43% YoY).

Key to watch: Update on Hydroxychloroquine (HCQ) supply potential, formulation capex

LPC: Strong US to drive margins; watch for EBITDA increase QoQ

US sales are projected to increase 13% QoQ to US\$ 218mn, led by (1) Levo ramp-up (market share up from 5% in Jan'20 to ~8%), (2) Losartan/HCTZ shortage opportunity (LPC's share up from 6% to 14% in Losartan and from 5% to 25% in Losartan+HCTZ), (3) gVimovo AG launch and favorable flu season. This along with reduction in R&D spends could lead to 200bps sequential EBITDA margin expansion. In India, we expect QoQ growth of 12%. On forex, the USD is favourable (+3%) while ZAR and BRL weakened (-8%).

Key to watch: Sequential EBITDA growth & stability (after Q3 negative surprise on cost), update on key products: Solosec, bEnbrel and gFostair in the EU (H1FY21), update on gProAir (H1FY21), FDA reinspection of Somerset/Goa sites

SUNP: Sequential drop in EBITDA but US sales stable

SUNP is likely to report a sequentially flat quarter of sales and a 9% drop in EBITDA. Margins are expected to decline QoQ on higher R&D cost. US ex-Taro sales could see 2-3% QoQ growth given better ramp-up in the seasonal specialty portfolio and increased share in recent product launches (such as Pantoprazole and Deferasirox injectables). Taro sales are estimated to rise 5% QoQ. The India business secondary growth trend is tracking at 10-12% (Jan-Mar'20) and should be in line with estimates.

Key to watch: Guidance for FY21, Halol OAI update, commentary on specialty products, cost control

Avg. USDINR rate at Rs 72.4 in Q4 (vs. Rs 71.2 QoQ)

EM currencies (ZAR, BRL) have weakened ~8% while RUB is -3% on average basis

FIG 3 – CROSS-CURRENCY MOVEMENT

| Quarter End | Closing rate | | | | | Average rate | | | | |
|-------------|--------------|--------|--------|--------|--------|--------------|--------|--------|--------|--------|
| | USDINR | EURINR | JPYINR | RUBINR | ZARINR | USDINR | EURINR | JPYINR | RUBINR | ZARINR |
| 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 | 5.1 | 71.2 | 78.9 | 0.7 | 1.1 | 4.8 |
| Mar 2020 | 75.5 | 82.3 | 0.7 | 0.9 | 4.2 | 72.4 | 79.8 | 0.7 | 1.1 | 4.4 |

Source: Bloomberg, BOBCAPS Research

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BUY – Expected return >+15%

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

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