

## PHARMACEUTICALS

10 March 2021

### Multiyear earnings upcycle in sight; prefer Cipla, Aurobindo, Laurus

Pharma valuations have course corrected in last 6M/3M with BSE healthcare index underperforming Nifty by 20%/11% due to sector rotation amid receding Covid headwinds and reemergence of FDA risk while earnings were resilient. Q3FY21 was better than expected for our universe with revenue/EBITDA rising 12%/34% YoY, partly from cost savings. We expect multiyear earnings upcycle in the sector (US/India growth, increased CDMO upside) and believe ROIC would surpass FY15 levels of 29%, supporting a re-rating.

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**Earnings momentum strong; FY22 to be tepid:** Optically, the sector's FY22 EBITDA margin could be muted at 25% (26% in FY21) as 80% of A&P and R&D spending cuts are likely to be reversed. On the whole, we believe a rising specialty mix in the US (for Cipla, Sun – SUNP, Aurobindo – ARBP and Dr Reddy's – DRRD) and operating leverage in India can add ~400bps to margins over FY20-FY23, aiding a 17% CAGR in EPS for our universe.

**Physical FDA inspection a key monitorable:** Restoration of full-blown FDA inspections will be crucial to stock performance in CY21. In Feb'21 the FDA inspected units of Shilpa Medicare (import alert) and Alembic Pharma F3 (ALPM; five observations). It is still early to call this a big setback for the sector. We expect a benign regulatory environment with announcement from FDA's India head that the regulator may grant approval without inspection if a drug belongs to an already approved profile or if manufacturer has a solid cGMP record – firms with completed CAPA and pending inspections (Cipla, ARBP, SUNP) could benefit.

**Biosimilars, API/KSM import substitution to propel India pharma to US\$ 130bn by 2030:** Indian pharma has clocked a ~13% CAGR in the last two decades (~11% in the domestic market, ~16% in export markets), aided by leadership in generics supply. FICCI estimates that the Indian pharma industry could log a ~12% CAGR over 2020-30, rising from US\$ 41.7bn to US\$ 130bn.

**Stocks to BUY:** With the course correction in stocks in the last six months (BSE HC underperforming Nifty by 20%), several companies are trading close to historical EV/EBITDA (of 13x, i.e. 15% below the 8Y mean). Over three years, we are more positive on Cipla (TP: Rs 1,000), ARBP (TP: Rs 1,100) and Laurus (TP: Rs 480) on improving fundamentals, mix change and valuation merit. We also prefer Alkem, Ajanta Pharma (AJP), ALPM and Eris. ADD Divi's (DIVI), SUNP, DRRD, Lupin (LPC).

#### RECOMMENDATION SNAPSHOT

Ticker	Price	Target	Rating
AJP IN	1,782	2,100	BUY
ALPM IN	938	1,230	BUY
ALKEM IN	2,772	3,750	BUY
ARBP IN	853	1,100	BUY
CIPLA IN	797	1,000	BUY
DIVI IN	3,503	3,700	ADD
DRRD IN	4,448	5,200	ADD
ERIS IN	585	730	BUY
LAURUS IN	347	480	BUY
LPC IN	1,032	1,070	ADD
SUNP IN	613	630	ADD

Price & Target in Rupees

#### SECTOR VS BROADER INDICES

Index (%)	1Y	6M	3M	1M
Nifty Pharma	56	7	(2)	(5)
BSE Healthcare	58	14	1	(2)
Nifty 50	44	34	12	0
Sensex	43	34	11	(1)

Source: NSE, BSE



**FIG 1 – BOBCAPS PHARMA UNIVERSE: VALUATION SNAPSHOT**

Companies	Price (09-Mar-21)	Mcap (US\$ mn)	Rating	EBITDA CAGR (%) (FY20-23E)	P/E (x)		EV/EBITDA (x)		ROE (%)	ROIC (%)
					FY22E	FY23E	FY22E	FY23E	FY21E	FY21E
<b>Coverage universe</b>										
Aurobindo Pharma	853	6,891	BUY	5.8	14.9	13.9	9.1	8.6	16.2	21.1
Cipla	797	8,897	BUY	13.9	25.7	23.7	13.8	13.1	13.8	19.9
Dr Reddy's Labs	4,448	10,184	ADD	11.2	23.8	18.1	13.9	11.2	18.0	29.2
Lupin	1,032	6,496	ADD	16.2	36.8	30.0	15.3	13.1	6.6	12.0
Sun Pharma	613	20,109	ADD	14.1	23.4	20.0	14.9	13.1	15.1	18.8
Divi's Labs	3,503	12,694	ADD	28.3	41.8	34.3	29.0	24.0	25.5	32.0
Laurus Labs	347	2,508	BUY	51.1	17.3	14.6	12.1	10.2	42.5	36.8
Alkem Labs	2,772	4,541	BUY	18.9	20.0	17.3	14.9	13.0	27.4	36.4
Alembic Pharma	938	2,485	BUY	18.2	18.9	15.4	12.4	10.4	28.0	28.3
Ajanta Pharma	1,782	2,084	BUY	16.7	23.3	18.9	15.9	13.5	19.9	29.5
Eris Life	585	1,065	BUY	16.4	19.0	15.9	14.4	12.2	25.7	26.2
<b>Aggregate</b>					<b>24.1</b>	<b>20.2</b>	<b>15.1</b>	<b>13.0</b>	<b>21.7</b>	<b>26.4</b>
<b>Indian MNCs*</b>										
Sanofi	8,298	2,605		6	29.2	27.7	20.7	20.8	26.6	-
Glaxo Pharma	1,521	3,509		14	41.3	35.6	29.6	26.0	28.2	-
Abbott India	14,760	4,271		13	39.6	34.4	29.0	25.2	27.2	-
Pfizer	4,653	2,899		7	36.7	33.4	26.3	24.0	17.9	-
<b>Aggregate</b>					<b>36.7</b>	<b>32.8</b>	<b>26.4</b>	<b>24.0</b>	<b>25.0</b>	
<b>Global peers*</b>										
Endo	8	1,768		(2)	3.7	3.8	7.3	7.5	(71.7)	-
Viartis (Mylan)	14	16,694		3	3.8	3.6	6.4	6.1	179.6	-
Perrigo	42	5,566		7	14.4	12.7	11.4	10.2	8.6	-
Teva	11	11,655		3	3.9	3.7	7.1	6.9	24.4	-
<b>Aggregate</b>					<b>6.4</b>	<b>5.9</b>	<b>8.1</b>	<b>7.7</b>	<b>35.2</b>	

Source: BOBCAPS Research, \*Bloomberg

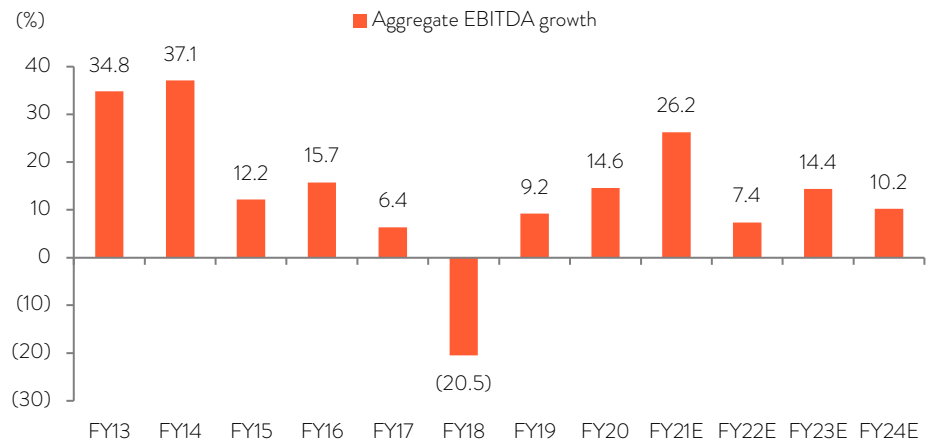
**FIG 2 – MULTIYEAR ROIC TO SUPPORT RERATING BEYOND 8Y MEAN**

Company	8 Year Historical Range		FY23E ROIC (%)	Target EV/EBITDA (x)
	EV/EBITDA band (1Y fwd) (x)	ROIC band (%)		
Aurobindo	4-16	10-26	22	11.10
Cipla	12-22	10-20	21	16.21
Dr. Reddy's	10-18	10-28	41	12.00
Lupin	10-22	11-40	17	13.78
Sun Pharma	11-27	13-45	22	13.43
Divi's Lab	12-26	27-36	37	26.37
Laurus Lab	7-17	8-24	38	14.14
Alkem	14-25	18-35	38	18.35
Alembic Pharma*	5-17	22-35	29	14.02
Ajanta Pharma	5-24	23-50	35	16.06
Eris Life	12-30	35-120	53	20.03
<b>Aggregate</b>	<b>9-22</b>			<b>16.00</b>

Source: Company, BOBCAPS Research | \*DRRD's ROIC is 35% ex-Revlimid. ^Assuming core earnings will drive EV/EBITDA band and ROIC

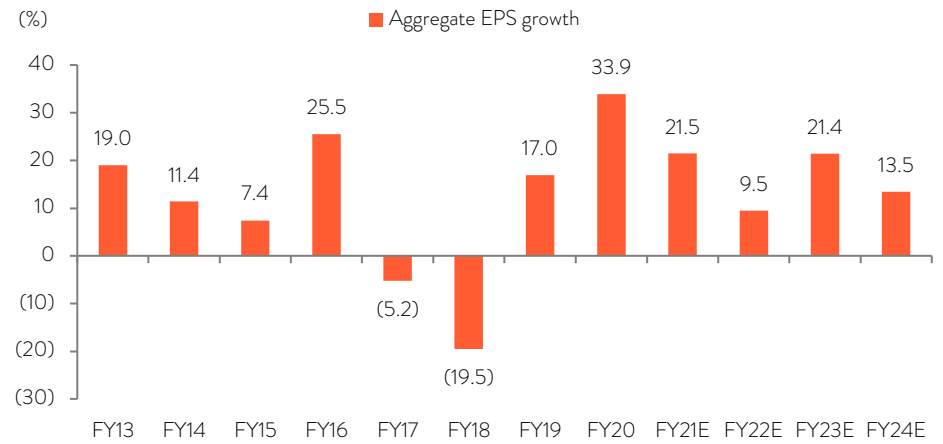
**We see 16% EBITDA CAGR for FY20-FY23 (abnormally high growth in FY21 due to Covid-led temporary cost reduction)**

**FIG 3 – BOBCAPS PHARMA UNIVERSE: STRONG EBITDA GROWTH...**



Source: Company, BOBCAPS Research

**FIG 4 – ...AND 17% EPS CAGR OVER FY20E-FY23E**

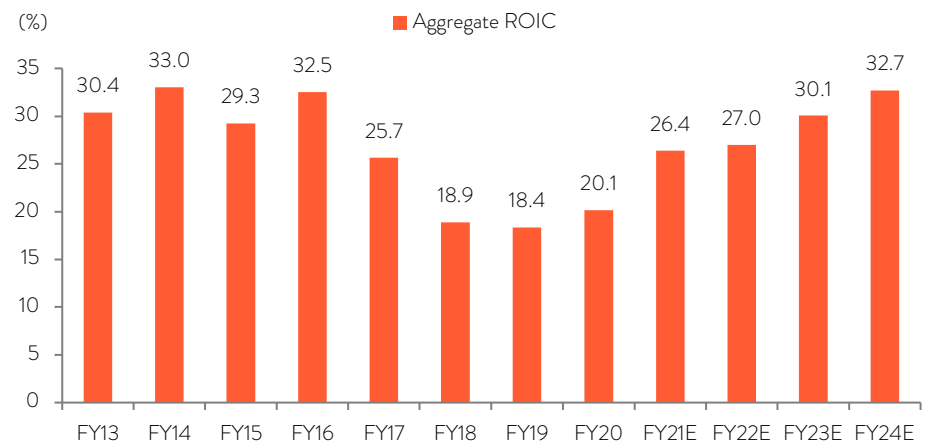


Source: Company, BOBCAPS Research

**DRRD, Cipla, Alkem and Laurus to hit new ROIC peaks over next three years**

**SUNP and LPC to remain meaningfully (at least 30%) below 8Y average**

**FIG 5 – ROIC TO SURPASS FY15 LEVELS OF 29% – SUPPORTING A RERATING**



Source: Company, BOBCAPS Research

**New launches, domestic recovery and US momentum fueling sales growth**

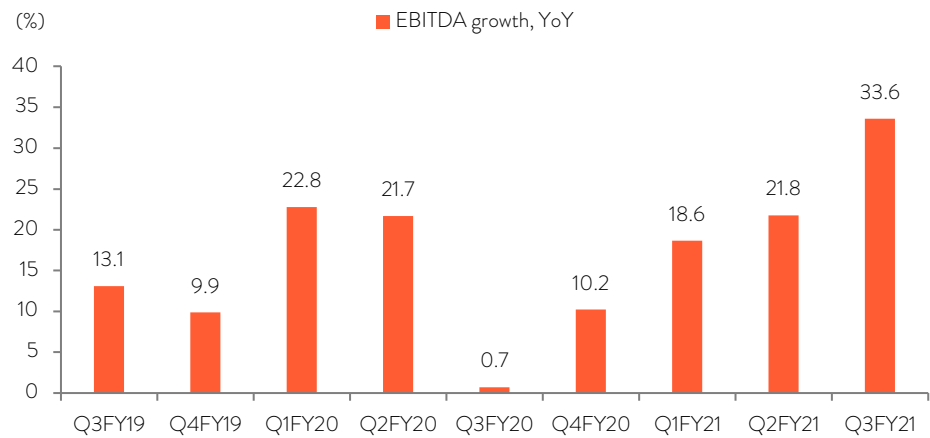
**FIG 6 – PHARMA UNIVERSE: SALES GROWTH BACK TO DOUBLE DIGIT YOY**



Source: Company, BOBCAPS Research

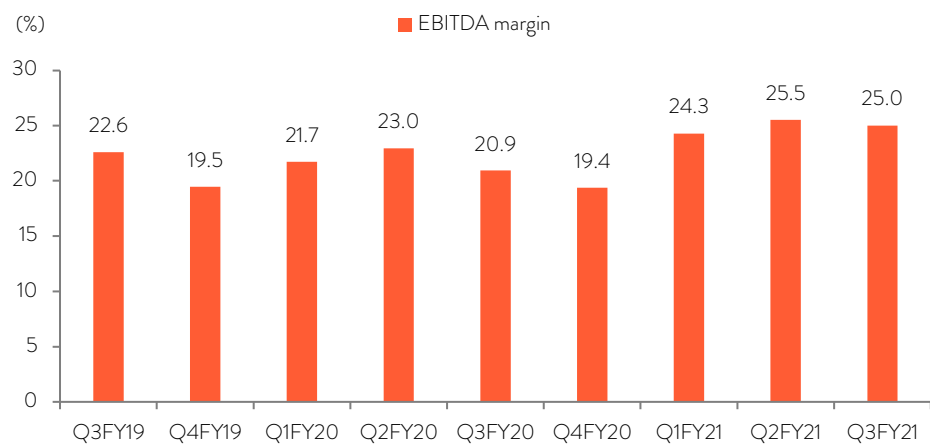
**Low base of CIPLA, SUNP & LPC supported 34% YoY EBITDA growth in Q3FY21**

**FIG 7 – COST SAVINGS & LOW BASE RESULTED IN EBITDA JUMP IN Q3FY21**



Source: Company, BOBCAPS Research

**FIG 8 – EXPECT FY21 MARGIN TO BE IN LINE WITH 9MFY21**



Source: Company, BOBCAPS Research

## BOBCAPS view on coverage stocks and key catalyst

**AJP** | TP: Rs 2,100 | BUY

**View:** AJP's branded generic franchise (India and EM) is robust and likely to remain resilient – this alongside operating leverage in the US business should drive an accelerated 25%+ EPS CAGR over FY21-FY23 (vs. flat growth for FY18-FY20). Completion of the capex cycle is likely to fuel a doubling of current sales. We expect improved FCF momentum over the next 2-3 years based on healthy earnings growth and a normalised capex run-rate of Rs 1bn-1.25bn annually. ROIC levels are projected to expand from 26% in FY20 to 36% by FY23.

**Key catalyst:** Commercialisation of the ophthalmology block (Guwahati), contribution from Divalproex DR (launched in mid-Dec) and capex moderation.

**Valuation:** We retain BUY with an unchanged Mar'22 TP of Rs 2,100, based on a 16x one-year forward EV/EBITDA multiple (23x implied P/E).

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	20,553	25,878	27,803	31,723	36,072
EBITDA (Rs mn)	5,653	6,944	8,671	9,413	11,046
Adj. net profit (Rs mn)	3,869	4,082	5,751	6,593	8,128
Adj. EPS (Rs)	44.1	46.6	65.6	75.2	92.7
Adj. EPS growth (%)	(17.4)	5.5	40.9	14.6	23.3
Adj. ROAE (%)	17.8	16.6	19.9	19.5	20.5
Adj. P/E (x)	40.4	38.3	27.2	23.7	19.2
EV/EBITDA (x)	27.5	22.4	17.9	16.3	13.7

Source: Company, BOBCAPS Research

**ALPM** | TP: Rs 1,230 | BUY

**View:** ALPM has strong earnings growth prospects (+20% over next two years), high FCF generation and a stable 25-30% ROIC profile vs. an 18% average for large and mid-sized generic-focused companies. In the US business, it enjoys a deep pipeline coupled with best-in-class margins (ex-R&D) of ~60% vs. Indian peers. This together with a nimble supply chain should aid a stock re-rating in coming years. Improving profitability of Rhizen also supports prospective earnings upside.

**Key catalyst:** Stock catalysts include monetisation of US investments, commercialisation of new plants and remediation of FDA 483 observations at the F3 injectable plant (five observations).

**Valuation:** We maintain BUY with an unchanged Mar'22 TP of Rs 1,230, based on a 14x EV/EBITDA multiple on Mar'23E (implied P/E of 21x).

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	39,350	46,050	53,845	57,311	64,511
EBITDA (Rs mn)	8,737	12,223	15,782	14,546	17,305
Adj. net profit (Rs mn)	5,938	8,718	11,376	9,514	11,709
Adj. EPS (Rs)	29.7	44.4	57.9	48.4	59.6
Adj. EPS growth (%)	32.6	49.2	30.5	(16.4)	23.1
Adj. ROAE (%)	23.4	29.4	28.0	17.8	18.8
Adj. P/E (x)	31.6	21.2	16.2	19.4	15.7
EV/EBITDA (x)	21.4	15.7	12.5	13.3	10.5

Source: Company, BOBCAPS Research

### ALKEM | TP: Rs 3,750 | BUY

**View:** Alkem has a strong India acute franchise with a deep focus on raising the high-margin acute mix and increasing MR efficiency. We also see strong operating leverage in the US from new launches (expect 2x jump in margins from current single digits) and improving pipeline quality. Over the next three years, we project sustained ROIC of >35% (vs. ~23% over FY18-FY20) and strong FCF of Rs 40bn (vs. Rs 10bn in the last five years).

**Key Catalyst:** Gross margin recovery and structural cost savings in the India business while NLEM coverage expansion is a key risk.

**Valuation:** We expect 21% EBITDA growth over the next two years. Strong FCF should support expansion in one-year forward EV/EBITDA multiples closer to the three-year mean of 19x from ~15x currently. We reiterate BUY and keep our Mar'22 TP at Rs 3,750, based on a target EV/EBITDA multiple of 19x (implied P/E of 24x).

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	73,558	82,983	91,288	1,01,943	1,13,526
EBITDA (Rs mn)	11,135	14,730	20,767	21,621	24,768
Adj. net profit (Rs mn)	7,298	11,270	15,960	16,662	19,276
Adj. EPS (Rs)	61.0	94.3	133.5	139.4	161.2
Adj. EPS growth (%)	15.7	54.4	41.6	4.4	15.7
Adj. ROAE (%)	16.3	22.7	27.4	23.6	22.8
Adj. P/E (x)	45.4	29.4	20.8	19.9	17.2
EV/EBITDA (x)	29.8	22.6	16.1	15.2	12.8

Source: Company, BOBCAPS Research

### ARBP | TP: Rs 1,100 | BUY

**View:** ARBP has key competitive moats in the form of superior execution, limited portfolio concentration, rising complexity of filings and balance sheet flexibility. We expect high-margin US injectable sales alone to account for 28% of its FY24 US sales, clocking a ~20% CAGR to US\$ 550mn. Management expects to double injectable sales to US\$ 700mn by FY24 by improving the complex launch

pipeline and building on its diversified product portfolio (of inhalers, nasal drugs, oncology/hormone therapy, depo-injections, biosimilars and vaccines).

Current valuations do not reflect PLI scheme potential considering that the PLI awarded in Feb'21 could add an estimated 10-13% to EPS from FY24 onwards. We model for a ~10% EPS CAGR for ARBP over next two years and see further upside potential to our earnings estimates.

**Key catalyst:** Injectable unit commissioning and biosimilar/depo-injection filings are key near-term events in FY21. Covid vaccine optionality (unit to be ready for 450mn doses by Apr'21) is another potential stock trigger.

**Valuation:** The stock is trading at 8x FY23E EBITDA (eight-year historical band of 5-15x), which is ~25% higher than global peers Teva, Endo, Mylan and Perrigo. Growing balance sheet comfort could fuel multiple expansion over the next 12 months, with net-debt/EBITDA (0.5x in FY20) moving into net cash (1x EBITDA in FY22E) and FCF yield estimated at 5-6% after providing for US\$ 250mn+ in annual capex.

Maintain BUY as we roll over to a revised Mar'22 TP of Rs 1,100 (earlier Rs 1,050), based on an unchanged 11x FY23E EV/EBITDA target multiple (16x implied P/E).

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	1,95,634	2,30,986	2,49,002	2,54,638	2,69,765
EBITDA (Rs mn)	39,519	48,640	52,910	54,250	57,539
Adj. net profit (Rs mn)	24,126	28,911	31,980	33,867	36,309
Adj. EPS (Rs)	41.2	49.3	54.6	57.8	62.0
Adj. EPS growth (%)	(0.4)	19.8	10.6	5.9	7.2
Adj. ROAE (%)	18.8	18.7	16.2	14.1	13.3
Adj. P/E (x)	20.7	17.3	15.6	14.8	13.8
EV/EBITDA (x)	13.5	11.1	10.2	9.4	8.2

Source: Company, BOBCAPS Research

### CIPLA | TP: Rs 1,000 | BUY

**View:** Cipla has a robust India franchise, rich US pipeline and low price erosion risk (top 3 products form 25% of US sales). Its growing respiratory pipeline has bigger optionality value, with US quarterly sales targeted to reach US\$ 250mn in the next five years, including for Revlimid, Abraxane and Advair. Cipla's market share in Albuterol continues to trend up (~12% currently). Further, management expects meaningful launches in the next 12-18 months.

Branded generic markets such as India, South Africa and ROW are steady cash generators, which account for 75% of EBITDA. We expect 24% sustained operating margins aided by cost optimisation and operating leverage in India and

the US. Over FY20-FY23, we estimate an >18% core EPS CAGR for Cipla, with Advair approval representing an upside risk to our estimates.

**Key catalyst:** Upside catalysts include strong growth in India OTC products (~5% of India sales), Albuterol ramp-up, Advair approval (TAD Jun'22) and cost savings in the India business.

**Valuation:** The stock is trading at 13x FY23E EBITDA (historical 8-year band of 12-22x). With multiple stock catalysts and ROIC forecast to close in on peak levels of 20% in the next two years, valuations can expand. Cipla remains our top pick in the pharma sector – our Mar'22 TP remains at Rs 1,000 based on 16x EV/EBITDA (implied P/E of 29x). Delay in US approvals and Goa OAI escalation are key risks to our estimates.

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	1,63,621	1,71,243	1,92,962	2,06,712	2,23,685
EBITDA (Rs mn)	30,973	32,574	44,032	45,820	48,135
Adj. net profit (Rs mn)	13,426	15,858	24,463	25,286	27,381
Adj. EPS (Rs)	16.7	19.7	30.4	31.4	34.0
Adj. EPS growth (%)	8.8	18.1	54.3	3.4	8.3
Adj. ROAE (%)	9.0	10.0	13.8	12.7	12.3
Adj. P/E (x)	47.8	40.5	26.2	25.4	23.5
EV/EBITDA (x)	21.5	20.3	14.7	13.8	12.8

Source: Company, BOBCAPS Research

## DIVI | TP: Rs 3,700 | ADD

**View:** We expect DIVI to post strong growth from FY22 with the commercialisation of planned fast-track capex (Rs 37bn across existing and new capacity), benefits of backward integration, and an improving mix in favour of the high-margin synthesis business. Long-term, DIVI is likely to maintain 50% sales share from custom synthesis, up from the current 40%.

The company's order book and operating leverage have improved sharply in Q3FY21 and management expects further improvement ahead. China supply derisking and a solid execution track record (chemistry capability, cost edge, strong balance sheet) bode well. We build in earnings growth of 30% over FY20-FY23.

**Key catalyst:** Commercial benefits of the new Rs 4bn capex in custom synthesis would start in Jul/Aug'21. Sustainability of recent gross margin gains (9MFY21: 66%) and operating leverage from new capex represent potential stock triggers.

**Valuation:** DIVI has the best execution record in the CDMO space. With Big Pharma outsourcing gaining momentum and a strong cost edge, its valuation premium looks sustainable. The stock is at 22x FY23E EBITDA vs. the historical



8-year band of 12-26x. We maintain ADD and raise our TP to Rs 3,700 (vs. Rs 3,520) as we roll over to Mar'23 earnings – our target multiple remains at 26x EV/EBITDA.

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	49,462	54,088	67,089	79,175	92,122
EBITDA (Rs mn)	18,719	18,150	26,901	31,747	38,321
Adj. net profit (Rs mn)	13,219	12,903	18,697	22,269	27,187
Adj. EPS (Rs)	49.8	48.6	70.4	83.9	102.4
Adj. EPS growth (%)	55.8	(2.4)	44.9	19.1	22.1
Adj. ROAE (%)	20.6	18.2	23.6	23.9	25.0
Adj. P/E (x)	70.4	72.1	49.7	41.8	34.2
EV/EBITDA (x)	48.7	50.2	34.0	29.0	23.9

Source: Company, BOBCAPS Research

### DRRD | TP: Rs 5,200 | ADD

**View:** DRRD has demonstrated robust execution capabilities in the US portfolio besides enjoying potential monetisation opportunities in several high-value assets (Vascepa, Copaxone, Revlimid). Revlimid NPV should remain largely protected at Rs 300/sh even in our worst-case scenario due to fixed volume share. The company also has lower concentration risk with its top 3 products accounting for just 15% of US sales. Further, it has successfully controlled cost, R&D spend and capex while maintaining high-margin launches in the US and scaling up EM business.

US pipeline depth, India (Wockhardt portfolio integration benefits) and EM opportunities (China) along with a broader API basket augur well for the stock's long-term prospects. The PSAI segment would also benefit from supply chain diversification. Management has guided for EBITDA margin and ROCE of 25% in FY22, which looks achievable in our view. We model for ROIC of >40% by FY23 vs. 28% in FY21.

**Key catalyst:** Launch of gVascepa in the US (expected in Q1FY22) and approval for the Sputnik-V vaccine in India are near-term catalysts for the company. Rituximab biosimilar approval would be another potential stock trigger.

**Valuation:** We estimate core FY22/FY23 EPS at Rs 170/Rs 198 (ex-Copaxone, Vascepa, Revlimid) and retain our ADD rating. Our Mar'22 TP remains at Rs 5,200, which includes Revlimid upside of Rs 350/sh on NPV basis, and is set at 14x EV/EBITDA on Mar'23E (21x implied P/E).

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	1,53,852	1,74,601	1,92,164	2,15,621	2,50,231
EBITDA (Rs mn)	31,333	40,942	46,655	51,230	63,361
Adj. net profit (Rs mn)	17,895	32,248	27,196	31,353	41,295
Adj. EPS (Rs)	107.8	194.3	163.8	188.9	248.8
Adj. EPS growth (%)	90.3	80.2	(15.7)	15.3	31.7
Adj. ROAE (%)	13.8	23.1	18.0	18.1	20.1
Adj. P/E (x)	41.3	22.9	27.2	23.6	17.9
EV/EBITDA (x)	24.5	18.6	15.9	14.0	10.9

Source: Company, BOBCAPS Research

## ERIS | TP: Rs 730 | BUY

**View:** We reiterate our strong FY22 outlook of >15% sales growth, >37% EBITDA margins and stronger cash generation for ERIS. New launches in cardio-diabetics, doctor reach expansion and productivity improvements/technological initiatives are key priorities that will underpin operating leverage in coming years.

We expect the stock to witness a rerating over the next 12 months led by (a) an underappreciated chronic franchise (~75% of EBITDA), (b) expected rebound in earnings growth to 18% CAGR over FY21-FY24, and (c) accompanying ROIC expansion to +55% by FY24E – better than our pharma coverage and higher than the average for MNCs ex-Abbott – with the optionality of better capital allocation between M&A and payouts than in the past.

**Key catalyst:** Traction in new products such as Zomelis, Gluxit and Zayo, the launch of three more products in FY21 and recovery in acute therapies represent near-term stock catalysts.

**Valuation:** We reiterate BUY with an unchanged Mar'22 TP of Rs 730, based on 20x FY23E EBITDA (implied P/E of 20x). The stock is currently trading at compelling valuations of 17x P/E and 14x EV/EBITDA on FY23E, which is ~30% below the three-year mean and at ~40% discount to Indian branded generic players.

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	9,822	10,741	11,903	13,566	15,355
EBITDA (Rs mn)	3,449	3,684	4,174	4,971	5,806
Adj. net profit (Rs mn)	2,908	2,965	3,346	4,113	4,910
Adj. EPS (Rs)	21.4	21.8	24.6	30.3	36.2
Adj. EPS growth (%)	(1.1)	2.0	12.9	22.9	19.4
Adj. ROAE (%)	31.1	26.5	25.7	26.0	25.5
Adj. P/E (x)	27.2	26.7	23.6	19.2	16.1
EV/EBITDA (x)	22.9	21.6	18.6	15.4	12.7

Source: Company, BOBCAPS Research

**LAURUS | TP: Rs 480 | BUY**

**View:** Laurus has solid R&D and process capabilities with a dominant position in select APIs and therapies. We highlight the consistent increase in EBITDA share from high-margin businesses (synthesis, formulations, other APIs ex-ARV) and sharp turnaround in return ratios (visible in the 9MFY21 beat). Over the next two years, these high-margin segments are expected to drive >90% of incremental EBITDA, supported by recalibration in the procurement strategies of global companies, in turn aiding sustained ROIC of >35% from ~14% in FY20. We model for >25% EPS growth over the next two years.

**Key catalyst:** Upside risks include a sustainable rise in operating leverage, commercial benefits from the Rs 12bn planned capex (starting FY23), and an uptrend in ARV treatment dispensing.

**Valuation:** The share price has more than tripled in the last one year, but current valuations of 10x FY23E EBITDA are still below the three-year historical mean of 12x one-year forward (7-17x band). We retain BUY and our Mar'22 TP of Rs 480 set at a one-year forward EV/EBITDA multiple of 14x. Key downside risks to our estimates are price pressure in ARVs, delays in formulation ramp-up and unfavourable regulations.

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	22,919	28,317	45,300	51,103	58,292
EBITDA (Rs mn)	3,560	5,645	14,442	16,463	19,071
Adj. net profit (Rs mn)	937	2,553	9,270	10,864	12,892
Adj. EPS (Rs)	1.8	4.8	17.3	20.3	24.1
Adj. EPS growth (%)	(36.8)	172.3	263.2	17.2	18.7
Adj. ROAE (%)	6.2	15.3	42.5	35.2	30.9
Adj. P/E (x)	197.7	72.6	20.0	17.1	14.4
EV/EBITDA (x)	54.8	34.7	13.6	12.0	10.3

Source: Company, BOBCAPS Research

**LPC | TP: Rs 1,070 | ADD**

**View:** LPC's EMEA sales momentum looks sustainable backed by NaMuscla ramp-up and gEnbrel launch in new markets (France, Belgium). Management expects costs to hold at current levels and targets operating margins of 20-22% in the medium term, led by operating leverage and full benefits from gProAir, Glumetza and stable India profits. A deepening US product pipeline, drug shortage opportunity in the US market and a high share of branded generics are added long-term positives.

**Key catalyst:** Potential stock triggers include ramp-up in gProAir, expected approval of Fostair in Q4FY21, Somerset/Goa unit clearance, market share gains in gEnbrel, and the Spiriva US launch opportunity in FY23 (trial scheduled for Sep'21).

**Valuation:** We restate ADD and maintain our Mar'22 TP at Rs 1,070, based on an EV/EBITDA multiple of 14x on Mar'23E EPS (implied P/E of 31x). Our target multiple is in line with the earlier discount of 10% accorded to LPC vis-à-vis other frontline stocks (Cipla, DRRD) and the 10% premium vis-à-vis SUNP.

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	1,67,010	1,53,528	1,59,884	1,80,636	1,96,620
EBITDA (Rs mn)	27,020	23,330	25,408	31,309	36,586
Adj. net profit (Rs mn)	9,464	3,541	8,761	12,691	15,599
Adj. EPS (Rs)	20.9	7.8	19.4	28.0	34.5
Adj. EPS growth (%)	(44.8)	(62.6)	147.4	44.9	22.9
Adj. ROAE (%)	6.9	2.6	6.6	9.3	10.8
Adj. P/E (x)	49.3	131.9	53.3	36.8	29.9
EV/EBITDA (x)	19.2	22.2	19.6	15.3	13.0

Source: Company, BOBCAPS Research

### SUNP | TP: Rs 630 | ADD

**View:** While we expect 17% growth in SUNP's core EPS over FY20-FY22, we remain cautious about ramp-up in specialty drugs such as Ilumya over the next 2-3 years given significant competition in the psoriasis market from two drugs coming in next year – Bimekizumab and Mirikizumab. Solid India/EM business and management focus on yield improvement are key positives. However, valuation constraints could emerge in the medium term from generic competition risk in Absorica and Cequa, as well as an anti-trust liability/adverse US Department of Justice ruling on generic price fixing for multiple Ranbaxy products.

**Key catalyst:** Stock catalysts include continued recovery in global specialty sales, Halol facility clearance and Ilumya label expansion. We note that SUNP has launched several products in 9MFY21 which should reflect in Q4 and full-year financials.

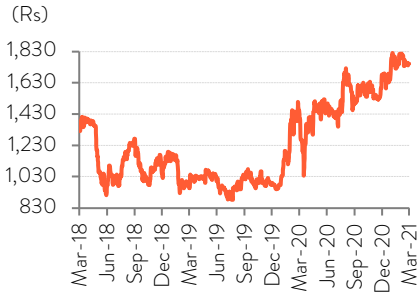
**Valuation:** The stock is trading at reasonable valuations of 12x FY23E EBITDA. We maintain ADD and our Mar'22 TP of Rs 630 which is set at a one-year forward EV/EBITDA multiple of 13x (20x implied P/E) to factor in better-than-expected operating leverage in global specialty sales. Our target multiple is at 20% discount to frontline stocks Cipla and DRRD.

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	2,86,906	3,23,880	3,35,599	3,82,176	4,28,675
EBITDA (Rs mn)	60,746	69,823	87,404	91,181	1,03,795
Adj. net profit (Rs mn)	36,484	40,453	68,834	62,760	73,414
Adj. EPS (Rs)	15.2	16.9	28.7	26.2	30.6
Adj. EPS growth (%)	8.4	10.9	70.2	(8.8)	17.0
Adj. ROAE (%)	8.4	8.7	14.0	11.9	12.6
Adj. P/E (x)	40.3	36.3	21.4	23.4	20.0
EV/EBITDA (x)	22.9	20.1	16.0	15.0	12.9

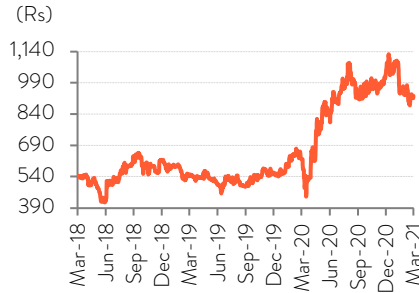
Source: Company, BOBCAPS Research

Stock performance

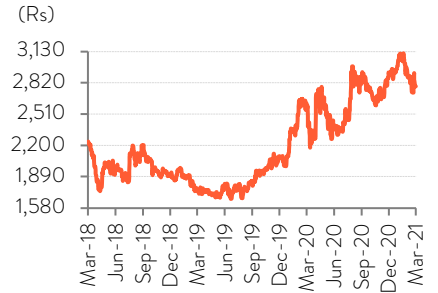
**FIG 9 – AJANTA PHARMA**



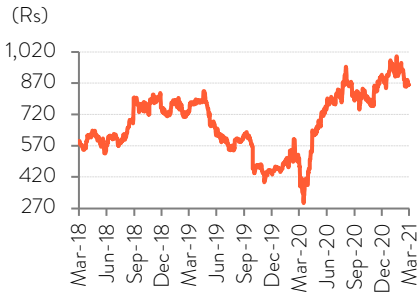
**FIG 10 – ALEMBIC PHARMA**



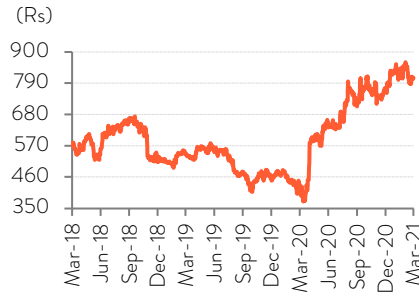
**FIG 11 – ALKEM LABS**



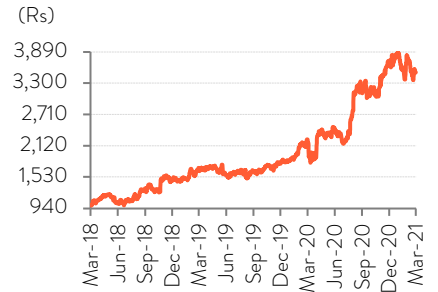
**FIG 12 – AUROBINDO PHARMA**



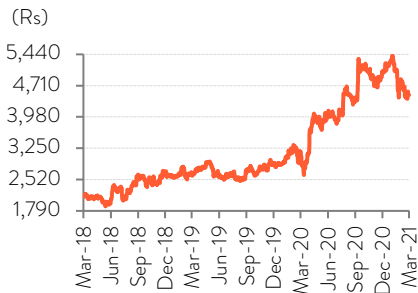
**FIG 13 – CIPLA**



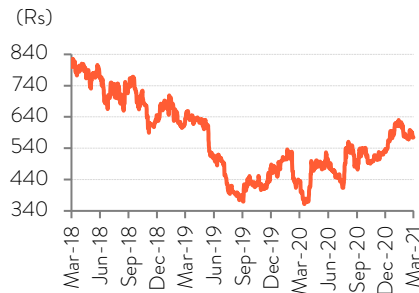
**FIG 14 – DIVI'S LABS**



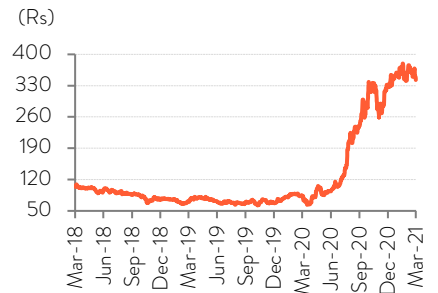
**FIG 15 – DR REDDY'S LABS**



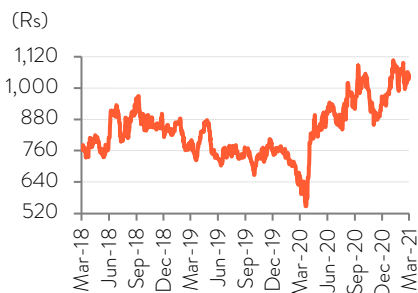
**FIG 16 – ERIS LIFESCIENCES**



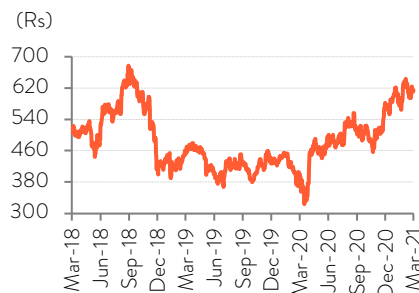
**FIG 17 – LAURUS LABS**



**FIG 18 – LUPIN**



**FIG 19 – SUN PHARMA**



Source: NSE

## Disclaimer

### Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

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

**REDUCE** – Expected return from -5% to +5%

**SELL** – Expected return <-5%

**Note:** Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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