

## PHARMACEUTICALS

24 September 2019

### Corporate tax cut – bonanza for healthcare services

The corporate tax cut from 30% to 22% (including surcharge from 34.9% to 25.2%) effective FY20 could spur an 8-15% earnings upgrade for pharma MNCs (Not Rated) and Diagnostic players/hospitals (Not Rated), as well as a marginal 3-4% benefit for Divi's Labs among our Indian pharma coverage. The impact on other pharma companies within our coverage is largely limited as current rates including exemptions are close to the new tax rates. The MAT rate cut from 18.5% to 15% should boost the cash flow for players overall.

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#### Our interactions with companies suggest Divi's could see 3-4% EPS benefit:

We see limited benefits from the new tax regime for stocks under our coverage, as most of them avail tax benefits on SEZ profits and R&D spends (150% weighted tax deducted u/s 35 2AB; benefit expires Mar'20). Our interactions with various managements suggest limited implications for FY20 guided tax rates.

The effective tax rate for pharma companies under our coverage ranges from 16-30% for FY19 and 15-40% for FY20E, with Lupin at the top end (due to losses in international subsidiaries; else cash tax is 27-28%). Factoring in exemptions, the existing blended tax rate remains at par or below the new rate of 25.2% (incl. surcharge) for all players, barring DIVI which could see a 3-4% earnings upgrade.

**8-15% EPS upside for pharma MNCs, diagnostic players/hospitals:** As per Bloomberg estimates, most pharma MNCs (Abbott, Sanofi, Pfizer) and diagnostic players (Dr Lal Pathlabs, Metropolis, Thyrocare and Apollo Hospital) have effective tax rates in the range of 32-37%. These companies stand to gain the most as their effective rates could come down by 5-9ppt, boosting FY20 EPS by 8-15% (see Fig 1 for lag in stock movement relative to upgrades).

**Alkem remains our top pick; DIVI upgraded to ADD:** We retain our tax rate and earnings forecasts for most of our coverage stocks. In our view, the government tax stimulus could cause some near-term capital churn out of defensives into cyclicals given the positive change in earnings outlook. Alkem Labs remains our top pick followed by Cipla (TP cut to Rs 555 from Rs 595 led by 4% EPS cut to factor in US\$ 520mn exit rate for US sales in FY20 vs. US\$ 540mn earlier led from incremental competition in Volteron) and Laurus. We raise DIVI from REDUCE to ADD and downgrade Aurobindo from BUY to ADD post the recent stock price movements. Retain REDUCE on Sun Pharma.

#### KEY RECOMMENDATIONS

Ticker	Price	Target	Rating
ARBP IN	614	700	ADD
CIPLA IN	449	555	BUY
DIVI IN	1,612	1,750	ADD
DRRD IN	2,782	2,960	ADD
LAURUS IN	351	480	BUY
LPC IN	732	840	ADD
SUNP IN	408	430	REDUCE
ALKEM IN	1,925	2,230	BUY

Price &amp; Target in Rupees



**FIG 1 – EPS BENEFIT FROM TAX CUTS**

Company (Rs mn)	FY19			FY19	FY19	FY20E	Benefit from new tax structure (25.2% incl. surcharge)		Stock price chg (20-23 Sep)*
	Deferred tax	Current tax	Reported PBT	Current tax rate (%)	Effective tax rate (%)	Assumed	Reduction in ETR (ppt)	EPS benefit %	
<b>Coverage</b>									
Sun Pharma	(2,030)	8,040	38,102	21.1	15.8	15.0	-	-	0.0
Lupin	85	7,950	26,824	29.6	30.0	40.0	-	-	(1.0)
Dr Reddy's	(849)	4,707	22,920	20.5	16.8	23.0	-	-	1.9
Cipla	(1,781)	7,477	20,791	36.0	27.4	26.0	-	-	0.0
Aurobindo	657	7,120	30,913	23.0	25.2	25.0	-	-	1.0
Divi's Labs	268	4,755	18,550	25.6	27.1	27.5	2.3	3.2	1.9
Laurus Labs	12	248	1,197	20.7	21.7	27.0	-	-	2.0
Alkem Labs	(481)	2,292	9,546	24.0	19.0	20.0	-	-	3.0
<b>MNC Pharma</b>									
Abbott	26	2,458	6,988	35.2	35.5	35.6	10.0	15.5	8.7
Sanofi	(117)	2,409	6,098	39.5	37.6	36.5	7.3	11.5	5.8
Pfizer	(129)	2,437	6,599	36.9	35.0	33.3	9.3	14.0	4.3
<b>Healthcare Services</b>									
Dr. Lal Pathlabs	(35)	1,035	3,005	34.4	33.3	33.7	9.4	14.3	12.3
Metropolis	0	630	1,865	33.8	33.8	32.7	9.2	13.7	8.7
Thyrocare	0	529	1,380	38.3	38.3	33.5	9.4	14.2	5.6
Apollo	475	1,258	3,735	33.7	46.4	31.8	5.4	7.9	4.0

Source: Company, BOBCAPS Research | \*Price change between close of 20 Sep (date of tax cut announcement) and yesterday's close

**FIG 2 – SECTOR VALUATION AND RATINGS**

Company	Price	Mcap (US\$ mn)	Rating	Target price (Rs)	Upside / Downside (%)	EBITDA CAGR % (FY19-FY21E)	EPS (Rs)		P/E (x)		EV/EBITDA (x)	
							FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
<b>Coverage</b>												
Aurobindo	614	5,084	ADD	700	14	18.2	48.0	50.9	12.8	12.1	8.3	7.4
Cipla	449	5,157	BUY	555	24	4.3	18.0	20.4	24.9	22.1	12.1	11.2
Dr. Reddy's	2,782	6,597	ADD	2,960	6	16.6	126.6	151.6	22.0	18.3	12.6	11.2
Lupin	732	4,758	ADD	840	15	14.3	22.8	32.7	32.1	22.4	12.6	10.8
Sun Pharma	408	14,123	REDUCE	430	5	16.8	19.8	23.1	20.6	17.6	12.6	11.2
Divi's Labs	1,612	6,057	ADD	1,750	9	14.7	54.0	64.7	29.9	24.9	20.0	16.6
Laurus Labs	351	523	BUY	480	37	29.3	11.6	21.9	30.3	16.0	11.1	8.1
Alkem Labs	1,925	1,697	BUY	2,230	16	18.7	75.0	93.1	25.7	20.7	17.6	14.7
<b>Indian companies outside coverage</b>												
Cadila	251	3,627		-	-	2.6	15.2	17.1	16.6	14.6	11.7	10.7
Glenmark	352	1,401		-	-	7.9	27.1	32.9	13.0	10.7	7.8	6.8
Granules	106	380		-	-	21.7	11.2	13.3	9.4	7.9	7.4	6.2
Strides Pharma	362	457		-	-	21.3	24.9	37.2	14.5	9.7	10.5	8.7
Torrent	1,701	4,063		-	-	8.3	52.4	68.5	32.5	24.8	15.7	13.7
<b>Global peers</b>												
Endo	3	738		-	-	2.6	2.7	2.9	1.2	1.1	7.4	7.1
Mylan	21	10,761		-	-	7.8	5.2	5.6	4.0	3.7	7.8	7.4
Perrigo	55	7,439		-	-	2.4	4.8	5.0	11.4	10.9	11.0	10.7
Teva	7	8,305		-	-	(0.9)	2.8	2.9	2.6	2.5	10.2	10.0

Source: Company, BOBCAPS Research

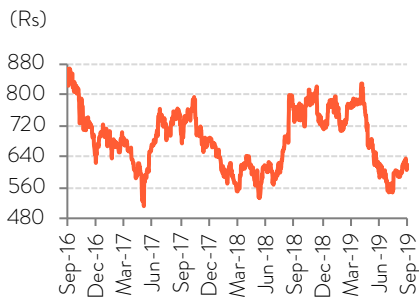
**FIG 3 – RATING & TARGET PRICE CHANGE**

Company	Rating		Target Price			Reason for Change in Rating/Target
	Old	New	Old	New	% Change	
Aurobindo	BUY	ADD	700	700	0	Retained US business multiple at 8x EV/EBITDA & step-up in stock price
Cipla	BUY	BUY	595	555	(7)	EPS cut by 4-5%, India business multiple marginally lowered to 14x EV/EBITDA
Dr Reddy's	ADD	ADD	2,900	2,960	2	Marginal change in India business EV/EBITDA multiple
Lupin	ADD	ADD	870	840	(3)	Marginal change in India business EV/EBITDA multiple
Sun Pharma	REDUCE	REDUCE	455	430	(5)	Marginal change in India business EV/EBITDA multiple
Divi's Labs	REDUCE	ADD	1,750	1,750	0	Stock price movement and FY21 earnings upgrade possibility
Laurus Labs	BUY	BUY	480	480	0	NA
Alkem Labs	BUY	BUY	2,100	2,230	6	Marginal increase in India business EV/EBITDA multiple

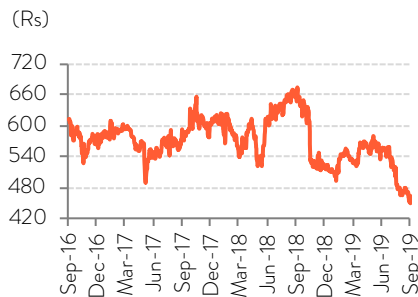
Source: BOBCAPS Research

## Stock performance

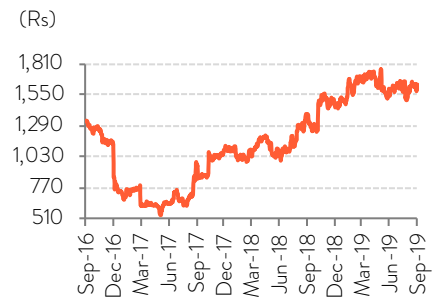
**FIG 4 – AUROBINDO PHARMA**



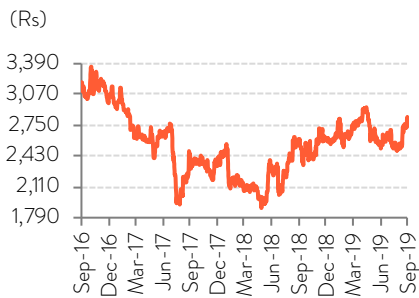
**FIG 5 – CIPLA**



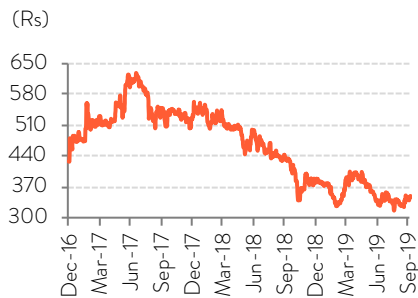
**FIG 6 – DIVI'S LABS**



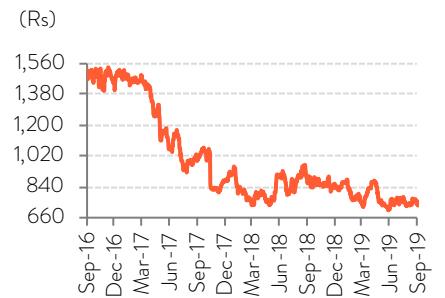
**FIG 7 – DR REDDY'S LABS**



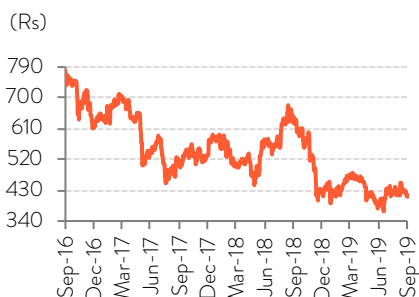
**FIG 8 – LAURUS LABS**



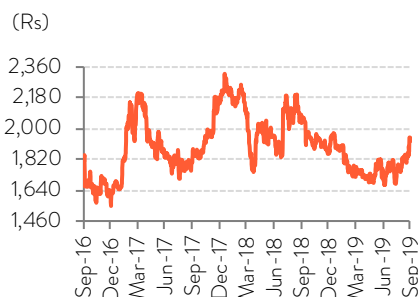
**FIG 9 – LUPIN**



**FIG 10 – SUN PHARMA**



**FIG 11 – ALKEM LABS**



Source: NSE

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### 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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