

## RESEARCH

### Top picks

- **Large-cap ideas** – Tata Motors replaced by **Cipla**  
 (see [Robust growth, attractive valuations – initiate with BUY, 26Nov18](#))
- **Mid-cap ideas** – Supreme Industries replaced by **Laurus Labs**  
 (see [Earnings at inflection point, risk-reward favourable – initiate with BUY, 26Nov18](#))

### Pharmaceuticals

Structural challenges persist – Prefer Cipla, Sun, Aurobindo, Laurus;  
 REDUCE Dr Reddy's

### BOB Economics Research | Weekly Wrap

Oil drop positive for India

## SUMMARY

### Pharmaceuticals

Optimism around receding industry headwinds (cGMP, price erosion) and currency tailwinds has brought the pharma sector back in favour. In our view, structural challenges will persist even though the one-time downward reset in US base business is over for now. We are selective on stocks given protracted ROCE recovery and likely consensus earnings cuts (we are ~10% below consensus). Players with broad-based recovery, low pricing risk, strong specialty slates and high earning visibility can outperform. Prefer Cipla, Sun Pharma, Aurobindo and Laurus from our coverage.

[Click here for the full report.](#)

## TOP PICKS

### LARGE-CAP IDEAS

Company	Rating	Target
<a href="#">Axis Bank</a>	Buy	750
<a href="#">Cipla</a>	Buy	615
<a href="#">GAIL</a>	Buy	525
<a href="#">Reliance Industries</a>	Buy	1,340
<a href="#">TCS</a>	Buy	2,360

### MID-CAP IDEAS

Company	Rating	Target
<a href="#">Greenply Industries</a>	Buy	250
<a href="#">L&amp;T Infotech</a>	Buy	2,070
<a href="#">Laurus Labs</a>	Buy	495
<a href="#">Mayur Uniquoters</a>	Buy	565
<a href="#">Mphasis</a>	Buy	1,360

Source: BOBCAPS Research

### DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	3.04	(2bps)	(6bps)	72bps
India 10Y yield (%)	7.71	(8bps)	(16bps)	72bps
USD/INR	70.70	1.1	3.4	(9.5)
Brent Crude (US\$/bbl)	58.80	(6.1)	(22.8)	(7.5)
Dow	24,286	(0.7)	(1.2)	3.2
Shanghai	2,579	(2.5)	(0.9)	(23.0)
Sensex	34,981	(0.6)	2.8	(7.5)
India FII (US\$ mn)	20 Nov	MTD	CYTD	FYTD
FII-D	(5.1)	875.2	(7,586.0)	(7,832.0)
FII-E	(679.6)	43.7	(5,714.4)	(7,839.9)

Source: Bank of Baroda Economics Research

### BOBCAPS Research

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## India Economics: Weekly Wrap

Global yields fell as oil prices slumped by 12% and concerns over slowing global growth emerged. Flash manufacturing PMIs fell across countries corroborating narrative of slowing global growth. US home sales data showed some recovery. Lower yields will help US housing market. Lower oil prices and global yields drove Indian yields lower as well. INR too has appreciated by 1.7% in the week as CAD will be in much better shape. G-20 summit and Fed speak will decide the trajectory of markets this week. India is insulated as lower oil prices bode well for Indian markets.

[Click here](#) for the full report.

## PHARMACEUTICALS

26 November 2018

### Structural challenges persist – prefer Cipla, Sun, Aurobindo, Laurus

Optimism around receding industry headwinds (cGMP, price erosion) and currency tailwinds has brought the pharma sector back in favour. In our view, structural challenges will persist even though the one-time downward reset in US base business is over for now. We are selective on stocks given protracted ROCE recovery and likely consensus earnings cuts (we are ~10% below consensus). Players with broad-based recovery, low pricing risk, strong specialty slates and high earning visibility can outperform. Prefer Cipla, Sun Pharma, Aurobindo and Laurus from our coverage.

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**US business – innovative pipeline, higher approvals to drive 6% CAGR:** Key pipeline catalysts, broader portfolios with low concentration and progress on US specialty (high-visibility) business are key to stock picks. Investors must be watchful of recovery based on a few large generic opportunities. We expect the US base to stabilise and deliver 6% sales growth (incl. three large assets for Dr Reddy's – DRRD) over FY19-FY21. In the long-term, innovative pipelines (Ilumya, Solosec, etc.) should see meaningful scale benefits, contributing 35%+ of US growth.

#### KEY RECOMMENDATIONS

Ticker	Price	Target	Rating
ARBP IN	790	920	BUY
CIPLA IN	518	615	BUY
DIVI IN	1,529	1,630	ADD
DRRD IN	2,609	2,710	REDUCE
LAURUS IN	389	495	BUY
LPC IN	851	930	ADD
SUNP IN	526	615	BUY

Price & Target in Rupees

**Earnings at inflection point – expect 20% CAGR:** We believe 2018 was an inflection year, with operating profit/EPS growth now reversing to a 17%/20% CAGR over FY19-FY21 for our coverage universe, with 50%+ share coming from the US. Key drivers include: (1) resolution of plant issues, (2) revival in approval cycle including for several high-value launches, (3) decline in US price erosion from 10%+ to 8% in the near term, and (4) steady volume-led EM sales.

**Structural headwinds not worsening but ROCE to settle at lower levels:** Despite the earnings pick-up, ROCE is likely to remain depressed at an FY19-FY21 average of 14% vs. the last nine-year average of 19%. While consolidation risk in the sector has reduced considerably, faster approvals and frequent FDA inspections are here to stay. US generic opportunities are estimated to halve in the next three years to US\$ 30bn and aggressive M&A can dampen the industry margin profile.

**Valuation course correction – stay selective:** We believe easy money in the sector has already been made in the last five months. Sector optimism is widespread, as reflected in higher consensus estimates and steep valuations (which have now begun to correct). We remain cautious and selective, initiating coverage on the sector with BUY on Cipla, Sun Pharma (SUNP), Aurobindo Pharma (ARBP) & Laurus Labs; ADD on Divi's Labs (DIVI) post the recent rally & Lupin (LPC); and REDUCE on DRRD as earnings recovery hinges on a few high-value launches.



**WEEKLY WRAP**

26 November 2018

**Oil drop positive for India**

Global yields fell as oil prices slumped by 12% and concerns over slowing global growth emerged. Flash manufacturing PMIs fell across countries corroborating narrative of slowing global growth. US home sales data showed some recovery. Lower yields will help US housing market. Lower oil prices and global yields drove Indian yields lower as well. INR too has appreciated by 1.7% in the week as CAD will be in much better shape. G-20 summit and Fed speak will decide the trajectory of markets this week. India is insulated as lower oil prices bode well for Indian markets.

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**Markets**

- **Bonds:** Global yields closed lower led by 12% slump in oil prices which closed at more than 1-year low of US\$ 59/bbl. Prospects of a weak global economy also drove yields lower. Indian 10Y yield dipped by 11bps (7.71%) in response to falling crude prices. Liquidity deficit in the system swelled to Rs 1.2tn as on 22 Nov 2018 versus Rs 669bn in the previous week.
- **Currency:** Except INR, all major currencies depreciated as dollar strengthened (DXY rose by 0.5%). Concerns over weak global growth supported the dollar. EUR depreciated by 0.7% in the week on the back of weak consumer confidence and PMI data. INR appreciated by 1.7% supported by declining oil prices which fell by 12% in the week to end below US\$ 60/bbl.
- **Equity:** Global indices closed lower led by escalated concerns of trade war and worries over slowdown in global growth. Dow was the worst performer amongst other indices as it posted a sharp weekly loss of (-) 4.4%. This was followed by Shanghai Comp (-3.7%) and Dax (-1.3%). Sensex too ended the week in red.
- **Upcoming key events:** Markets will closely watch various macro prints such as US GDP (2<sup>nd</sup> est.) for Q3CY18, new home sales and consumer confidence data. FOMC minutes and members' speeches along with G-20 meeting will drive markets in the week. On domestic front, GDP data will be released this week.



## 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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