June 27, 2022

# Narrative favours CRAMS, branded domestic; calculated approach for US…

After a buoyant FY21 (Covid induced), the pharmaceutical sector witnessed a mixed FY22 amid three overarching themes- 1) contraction of Covid led opportunities, 2) industry specific structural issues such as, a) US price erosion, b) significant inventory de-stocking, and 3) adverse global macro deflators like, a) higher input, freight and power cost and b) supply chain challenges due to Covid and geo-political issues from H2FY22. Structural stories in pharmaceutical space like CRAMS and branded domestic formulations continue to deliver on their earning potential. We also draw comfort from companies with a diversified geographical presence in the branded space and select players in the US with portfolios of complex nature (specialty, biosimilars, injectable and complex generics with limited competition).

The pharma CRAMs story continued to unfold on capex-driven opportunities in FY22 while the pandemic driven windfall gains further added to the already strong prints of most CRAMs players. Aggressive capex drives based on "China-plus One" theme is now coming to the fore as the post-Covid scenario further strengthens the argument in favour of outsourcing with incremental order wins and client additions. Aggregated financial performances of the I-direct pharma CRAMs universe reflect the improved trajectory, which is likely to persist as companies prepare for the next capex cycle.

US oral solid dosages (OSD) Generics witnessed intense price erosion in FY22, affecting both revenues and margins of pharma companies with higher mix for US generics. Nonetheless, we expect better prospects for the US as a whole from H2FY23 onwards due to 1) moderation in OSD pricing pressure on back of exits due to product unviability 2) optical focus on more complex products (injectables, oncology, respiratory, biosimilars), which may shift bargaining power towards manufacturers and 3) decongestion of pending approvals pipeline as the USFDA and product inspection momentum which can go back to pre-pandemic level.

Domestic formulations business continues to remain main lever for growth during both tough as well as normal times. During lockdowns and limited MR activities/patients footfalls in clinics, most companies shifted focus to Covid related opportunities. As the situation started to normalise, the focus was back on normal activities via digital drives, new products introduction, etc. Many companies, including market leader Sun, have augmented MR recruitment drive to focus on untapped therapy areas.

Considering structural advantage for CRAMS, steady growth rate of domestic branded generics besides calibrated US approach, we have earmarked top picks – **Divi's Lab (BUY rating; target price: ₹ 4,655), Laurus Labs (BUY rating; target price: ₹ 690), Sun Pharma (BUY rating; target price: ₹ 1,070)** and **Cipla (BUY rating; target price: ₹ 1,095).**

**Sector View: Positive**

### Top Picks

| Company | CMP (₹/share) | Target (₹/share) | Upside (%) | Rating |
|---|---|---|---|---|
| Cipla | 940 | 1095 | 16% | BUY |
| Divi's Lab | 3670 | 4655 | 27% | BUY |
| Laurus Labs | 470 | 690 | 47% | BUY |
| Sun Pharma | 845 | 1070 | 27% | BUY |

### Key risks to our call

- Higher-than-expected competition and continued US high price erosion
- High input cost for APIs and slower demand revival for generic APIs
- Negative outcomes from USFDA increased visits for plant inspection
- Supply chain issues limiting execution capabilities amid robust order-book for CRAMS

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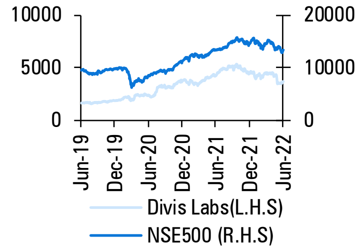
# Top bets in Pharmaceutical Coverage Universe

## Divi's Lab

Divi's is engaged in manufacturing generic APIs and intermediates, custom synthesis of active ingredients and advanced intermediates. The company has been building capacities in a few more niche APIs as per the evolving demand scenario in the backdrop of 'China plus one' opportunities and upcoming opportunity size of ~US$20 billion in molecules going off-patent over FY23-25. Divi's has identified execution strategy for growth areas of 1) Established generics, 2) Existing generics, 3) New generics, 4) Sartan APIs, 5) Contrast Media and 6) CS. We take comfort from the company's plant level fungibility, which offers flexibility to the company to capture opportunities emerging in either of generics or custom synthesis segment. We retain **BUY** rating and value Divi's at ₹ 4655 i.e. 38x on FY24E EPS of ₹ 122.5.

**Price Chart**




**Particulars**

| Particular | Amount |
|---|---|
| Market Capitalisation | ₹ 97427 crore |
| Debt (FY22) | ₹ 4 crore |
| Cash & equivalents (FY22) | ₹ 2891 crore |
| EV | ₹ 94540 crore |
| 52 week H/L | 5425/3790 |
| Equity capital | ₹ 53.1 crore |
| Face value | ₹ 2 |

Exhibit 1: Financial Summary

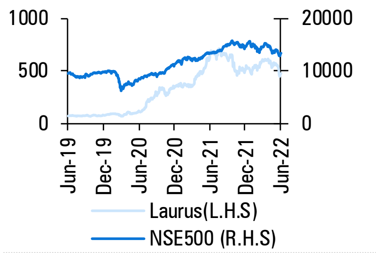
| Key Financials (₹ crore) | FY20 | FY21 | FY22 | 5 year CAGR (FY17-22) | FY23E | FY24E | 2 year CAGR (FY22-24E) |
|---|---|---|---|---|---|---|---|
| Revenues | 5394.4 | 6969.4 | 8959.8 | 17.1 | 9031.4 | 10348.8 | 7.5 |
| EBITDA | 1816.1 | 2859.9 | 3881.9 | 21.8 | 3938.1 | 4554.1 | 8.3 |
| EBITDA margins (%) | 33.7 | 41.0 | 43.3 | | 43.6 | 44.0 | |
| Adj. Net Profit | 1376.5 | 1984.3 | 2960.5 | 22.8 | 2805.3 | 3252.4 | 4.8 |
| Adjusted EPS (₹) | 51.9 | 74.7 | 111.5 | | 105.7 | 122.5 | |
| PE (x) | 70.8 | 49.1 | 32.9 | | 34.7 | 30.0 | |
| RoNW (%) | 18.8 | 21.3 | 25.2 | | 20.3 | 20.0 | |
| RoCE (%) | 23.9 | 27.6 | 30.2 | | 25.8 | 25.5 | |

*Source: Company, ICICI Direct Research*

## Laurus Labs

Laurus Labs operates in the segment of generic APIs & FDFs (formulations), custom synthesis and biotechnology. In the near to medium term, Laurus plans to 1) diversify into Non-ARV APIs and formulations, 2) scale up synthesis business and 3) leverage Richore acquisition to tap into new area of biologics. Laurus has multiple planned capacity expansions in portfolio based on complexity and scale and has set an aspirational target of US$1 billion revenues in FY23. We retain **BUY** rating and value Laurus at ₹ 690 i.e. 26x P/E on FY24E EPS of ₹ 26.5.

**Price Chart**




**Particulars**

| Particular | Amount |
|---|---|
| Market Capitalisation | ₹ 25256 crore |
| Debt (FY22) | ₹ 1915 crore |
| Cash & Equivalents (FY22) | ₹ 76 crore |
| EV (₹ Cr) | ₹ 27095 crore |
| 52 week H/L (₹) | 724/433 |
| Equity capital | ₹ 107.5 crore |
| Face value | ₹ 2 |

Exhibit 2: Financial Summary

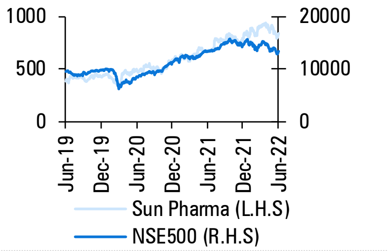
| Key Financials (₹ Crore) | FY20 | FY21 | FY22 | 5 year CAGR (FY17-22) | FY23E | FY24E | 3 year CAGR (FY22-24E) |
|---|---|---|---|---|---|---|---|
| Net Sales | 2831.7 | 4813.5 | 4935.7 | 21.0 | 6439.4 | 7750.4 | 25.3 |
| EBITDA | 561.0 | 1550.7 | 1422.4 | 30.7 | 1846.2 | 2327.4 | 27.9 |
| EBITDA Margins (%) | 19.8 | 32.2 | 28.8 | | 28.7 | 30.0 | |
| Adj. Profit | 255.3 | 983.6 | 827.5 | 39.7 | 1107.7 | 1426.0 | 31.3 |
| Adj. EPS (₹) | 4.8 | 18.3 | 15.4 | | 20.6 | 26.5 | |
| PE (x) | 98.9 | 25.7 | 30.5 | | 22.8 | 17.7 | |
| RoE (%) | 14.4 | 37.9 | 24.7 | | 25.5 | 25.3 | |
| RoCE (%) | 13.0 | 31.7 | 21.3 | | 22.6 | 24.7 | |

*Source: Company, ICICI Direct Research*

## Sun Pharma

Sun Pharma's portfolio mix is changing with increased higher contribution from global specialty and strong branded franchise for more remunerative businesses. In the US, Sun is diversifying into specialty products like Ilumya, Levulan, BromSite, Cequa, Xelpros, Odomzo, Yonsa, Winlevi, etc. Global specialty business contribution has inched up from 7% in FY18 to 13% in FY22 and sales grew 39% in FY22 to US$674 million. Sun Pharma continues to maintain launch momentum in India and plans for field expansion in FY23. We retain **BUY** rating and value Sun Pharma at ₹ 1070 i.e. 28x P/E on FY24E EPS of ₹ 38.3.

**Price Chart**




**Particulars**

| Particular | Amount |
|---|---|
| Market Capitalisation | ₹ 202744 crore |
| Debt (FY22) | ₹ 1290 crore |
| Cash & Equivalents (FY22) | ₹ 5033 crore |
| EV (₹ Cr) | ₹ 199001 crore |
| 52 week H/L (₹) | 967/653 |
| Equity capital | ₹ 239.9 crore |
| Face value | ₹ 1 |

Exhibit 3: Financial Summary

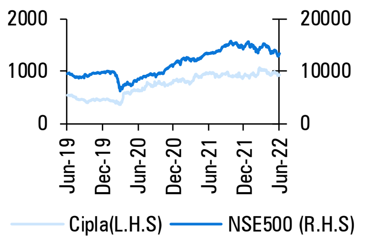
| Key Financials (₹ Crore) | FY20 | FY21 | FY22 | 5 year CAGR (FY17-22) | FY23E | FY24E | 2 year CAGR (FY22-24E) |
|---|---|---|---|---|---|---|---|
| Net Sales | 32837.5 | 33498.1 | 38654.5 | 4.1 | 42606.9 | 46710.0 | 9.9 |
| EBITDA | 6989.8 | 8491.4 | 10397.7 | 0.6 | 11500.2 | 13195.6 | 12.7 |
| EBITDA Margins (%) | 21.3 | 25.3 | 26.9 | | 27.0 | 28.3 | |
| Adj. Profit | 4025.6 | 7210.0 | 7667.1 | 1.9 | 7822.9 | 9189.1 | 9.5 |
| Adj. EPS (₹) | 16.8 | 30.0 | 32.0 | | 32.6 | 38.3 | |
| PE (x) | 53.9 | 69.8 | 61.9 | | 25.9 | 22.1 | |
| RoE (%) | 8.9 | 15.5 | 16.0 | | 14.3 | 14.7 | |
| RoCE (%) | 10.0 | 14.2 | 18.2 | | 17.7 | 18.2 | |

*Source: Company, ICICI Direct Research*

## Cipla

Cipla has a long-drawn strategy of targeting four verticals viz. One India, South Africa & EMs, US generics & specialty and lung leadership. In the US, significant momentum is likely from H2FY23 onwards on the back of peptide portfolio unlocking and possible approvals, launches of gRevlimid, gAdvair and gAbraxane besides gains from Albuterol portfolio. In branded prescription portfolio therapy mix reflects strong fundamentals across chronic and acute segments while company is focussed on board transformation from tenderised model to private model in exports market. We retain **BUY** rating and value Cipla at ₹ 1095 i.e. 25x P/E on FY24E EPS of ₹ 42.5 + ₹ 32 NPV for gRevlimid.

**Price Chart**




**Particulars**

| Particular | Amount |
|---|---|
| Market Capitalisation | ₹ 75841 crore |
| Debt (FY22) | ₹ 824 crore |
| Cash (FY22) | ₹ 1928 crore |
| EV | ₹ 74736 crore |
| 52 week H/L (₹) | 1083/850 |
| Equity capital | ₹ 161.4 crore |
| Face value | ₹ 2 |

Exhibit 4: Financial Summary

| Key Financials (₹ crore) | FY20 | FY21 | FY22 | 5 year CAGR (FY17-22) | FY23E | FY24E | 2 year CAGR (FY22-24E) |
|---|---|---|---|---|---|---|---|
| Revenues | 17132.0 | 19159.6 | 21763.3 | 8.3 | 23507.7 | 25798.7 | 8.9 |
| EBITDA | 3206.0 | 4252.4 | 4552.8 | 13.0 | 4967.9 | 5675.7 | 11.7 |
| EBITDA margins (%) | 18.7 | 22.2 | 20.9 | | 21.1 | 22.0 | |
| Adjusted PAT | 1546.5 | 2404.9 | 2650.2 | 21.4 | 2915.5 | 3422.8 | 13.6 |
| Adj. EPS (₹) | 19.2 | 29.9 | 32.9 | | 36.2 | 42.5 | |
| PE (x) | 48.9 | 31.5 | 30.1 | | 26.0 | 22.1 | |
| RoNW (%) | 9.8 | 13.1 | 12.7 | | 12.6 | 13.3 | |
| RoCE (%) | 12.0 | 16.3 | 16.7 | | 16.7 | 17.7 | |

*Source: Company, ICICI Direct Research*

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Sell: <-15%

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