

India

**Neutral** (no change)**Highlighted Companies****Ajanta Pharma Ltd**

ADD, TP Rs2400, Rs2152 close

A play on branded generics.

**Aurobindo Pharma**

ADD, TP Rs1178, Rs1034 close

Top-notch generics player.

**Sun Pharmaceutical Industries**

ADD, TP Rs1665, Rs1510 close

Specialty segment is ramping up well.

**Summary Valuation Metrics**

P/E (x)	Mar24-F	Mar25-F	Mar26-F
Ajanta Pharma Ltd	33.97	28.78	25.26
Aurobindo Pharma	19.38	15.4	12.82
Sun Pharmaceutical Industries	37.66	31.67	27.53
P/BV (x)	Mar24-F	Mar25-F	Mar26-F
Ajanta Pharma Ltd	7.4	6.84	6.15
Aurobindo Pharma	2.05	1.83	1.62
Sun Pharmaceutical Industries	5.77	5.08	4.44
Dividend Yield	Mar24-F	Mar25-F	Mar26-F
Ajanta Pharma Ltd	2.37%	2.32%	2.32%
Aurobindo Pharma	0.58%	0.68%	0.77%
Sun Pharmaceutical Industries	0.76%	0.76%	0.76%

# Pharmaceuticals

## 3QFY24 results review

- The 3QFY24 report card was mixed – we upgraded Zydus Lifesciences' rating to ADD while downgrading Cipla to HOLD and Gland Pharma to REDUCE.
- Sector drivers remain strong, led by the US market, recovery in India as well as margins holding up. The non-US international market can be a dark horse.
- Upgrade Sun Pharma to ADD. Aurobindo, Zydus, Ajanta, and Torrent Pharma are the other ADD-rated stocks. REDUCE ratings: Divi's Labs & Laurus Labs.

### Mixed performance – two upgrades and two downgrades

The 3QFY24 earnings report card was mixed for our coverage universe, with two downgrades and two upgrades. However, our broader thesis remains intact, with the US business largely holding up its strong momentum, margins sustaining and, in some cases, even improving & the domestic business recovering in 2H. Surprisingly, we observed a very strong momentum across the EU and RoW markets over the past two quarters, and most companies expect the momentum to sustain. Logistics costs were cited as a key near-term worry, with some companies highlighting almost a 30% jump in freight costs as well as a likely surge in the inventory level to manage supply chains, although none of them called out for any meaningful dent on their margins in the near term.

### US momentum remains strong

In 3QFY24, the US business was up 6% QoQ for our coverage universe and has sustained strong momentum since 1QFY24. Commentary on US price erosion has been largely benign, with most companies highlighting low single-digit erosion in the base. In addition to segments like injectables benefitting from shortages, Aurobindo Pharma witnessed a strong momentum in the oral solids business as well. Other companies which posted strong growth in the US market include Dr. Reddy's Laboratories (strong growth in the base portfolio) and Sun Pharmaceutical Industries (strong growth in the specialty segment).

### India business saw sharp recovery after a weak 1HFY24 performance

India business was up 11% YoY for our coverage universe, witnessing a sharp recovery, after a weak 1HFY24 performance. After a weak acute therapy season in 1H, India business growth recovered strongly and is likely to close FY24F with around 8-9% growth. On the positive side, we have seen strong growth in the ex-US international market over the past two quarters (average growth of ~11%) and this is likely to sustain, as per the commentaries of most companies.

### Hits and misses

Post 3QFY24, we have upgraded Zydus Lifesciences' rating to ADD (from HOLD) as we expect the company to largely sustain its growth momentum (despite assuming competition in gAsacol HD), with a robust recovery in India/RoW markets and a strong rebound in the US/Zydus wellness businesses likely from 4QFY24F. We have also upgraded Sun Pharma's rating to ADD (from HOLD earlier), with the strong momentum in specialty sales likely to continue. Conversely, we have downgraded Cipla's rating to HOLD (ADD earlier) on stock price run-up + delay in key launches, and Gland Pharma to REDUCE (HOLD earlier) due to the delay in Cenexi synergies. CDMO/API companies like Divi's Laboratories and Laurus Labs continued to disappoint (both REDUCE-rated), with both companies missing expectations on the margins front. While we do expect a recovery (aptly baked in our as well as consensus numbers), we believe a full-fledged margin recovery is still some quarters away and the earnings' cut cycle is not yet over.

### Sector outlook

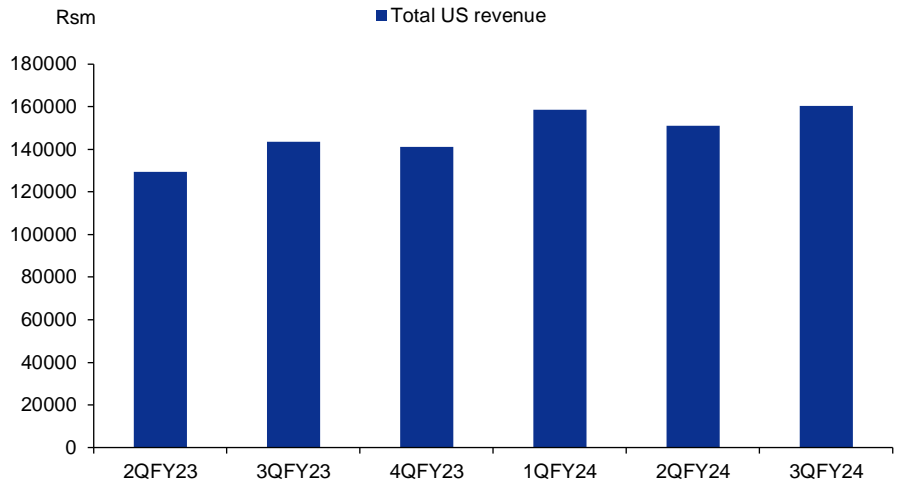
While we are broadly positive on the sector and expect the outperformance to largely continue, with the momentum sustaining in India/US markets as well as on the margins front, we prefer stocks where the earnings momentum is likely to remain strong in the medium term. We remain bullish on Aurobindo Pharma (the worst factored in on Eugia-III plant 483, business momentum very strong), Ajanta Pharma/Torrent Pharmaceuticals (branded business plays), Sun Pharma (specialty segment ramping up well) and Zydus Lifesciences (can surprise positively on the US business).

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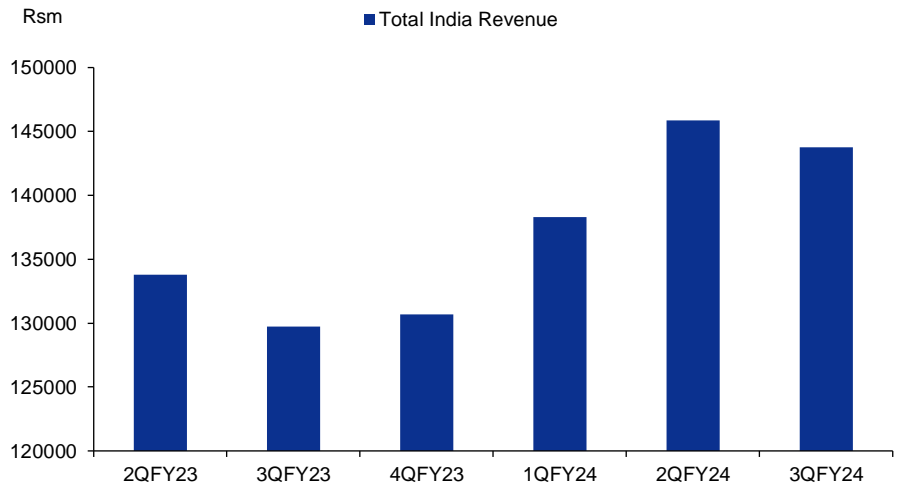
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**Figure 1: US business has seen a strong traction over the past couple of quarters**



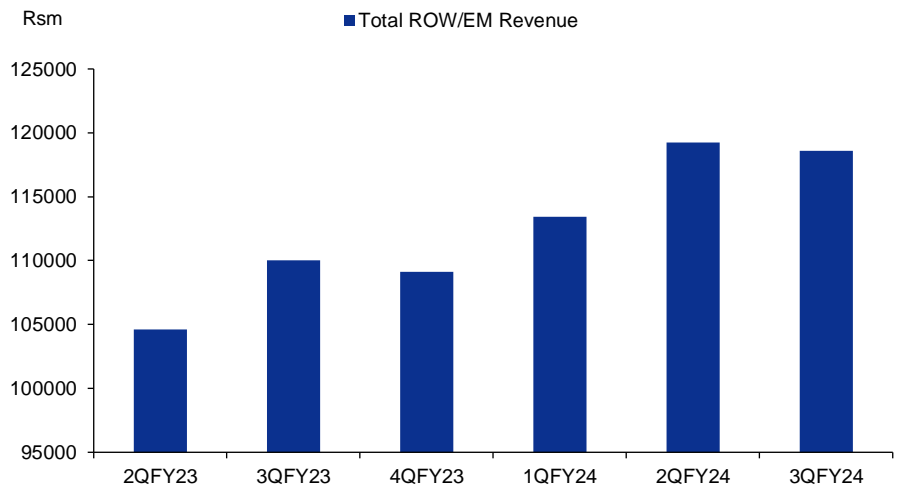
SOURCE: INCRED RESEARCH, COMPANY REPORTS

**Figure 2: India business recovers smartly in the past two quarters**



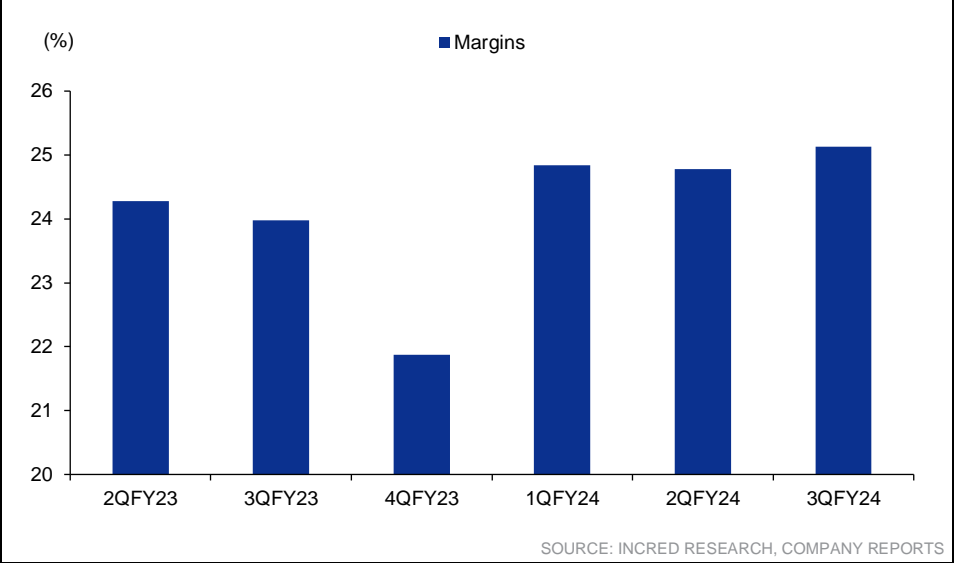
SOURCE: INCRED RESEARCH, COMPANY REPORTS

**Figure 3: Sharp upturn in the ex-US international market in the past two quarters**



SOURCE: INCRED RESEARCH, COMPANY REPORTS

**Figure 4: Sustains margins**



**Figure 5: Rating changes post 3QFY24 results**

	Current Rating	Previous rating	Earnings	Commentary
Ajanta Pharma	ADD	ADD	Positive	
Alkem Labs	HOLD	HOLD	Neutral	
Cipla	HOLD	ADD	Neutral	
Dr. Reddy's Labs	HOLD	HOLD	Neutral	
Divi's Labs	REDUCE	REDUCE	Weak	
Gland Pharma	REDUCE	HOLD	Weak	
Laurus Labs	REDUCE	REDUCE	Weak	
Torrent Pharma	ADD	ADD	Positive	
Ipca Labs	HOLD	HOLD	Neutral	
Aurobindo Pharma	ADD	ADD	Positive	
Zydus Lifesciences	ADD	HOLD	Positive	
Sun Pharma	ADD	HOLD	Positive	
			Positive	
			Neutral	
			Weak	

SOURCE: INCRED RESEARCH, COMPANY REPORTS

**Figure 6: Earnings revision summary post 3QFY24 results**

	FY24F	FY25F
Ajanta Pharma	-	-
Alkem Labs	15%	15%
Cipla	5%	-6%
Divi's Labs	-7%	-14%
Dr. Reddy's Labs	-1%	-8%
Gland Pharma	-18%	-18%
Laurus Labs	-47%	-35%
Torrent Pharma	-5%	-3%
Ipca Labs	-14%	-14%
Aurobindo Pharma	2%	3%
Zydus Lifesciences	6%	9%
Sun Pharma	6%	9%

SOURCE: INCRED RESEARCH, COMPANY REPORTS

### Upgrade Sun Pharma's rating to ADD

Sun Pharmaceutical Industries or Sun Pharma's 3Q earnings underpins strong momentum in US specialty sales (US\$296m, +23% QoQ and +15% QoQ excluding milestone income). Key products – Ilumya, Winlevi, Cequa and Levulan continue to grow while there are further drivers in place – Nidlegly filing and approval in the EU - which should complement Odomzo sales, continued ramp-up in Ilumya (no impact of bHumira so far) with more markets like China ramping up, the US Food and Drug Administration's ruling on 180-day marketing exclusivity for Sezaby and the approval for deuruxolitinib should drive specialty sales over the next two-to-three years, in our view. This drives our FY24F/25F EPS upgrade by 6%/9%, respectively. We increase our target price to Rs1,665 (Rs1,154 earlier), as we roll over our target price to FY26F EPS. We upgrade the stock's rating to ADD (from HOLD earlier).

**Profit & Loss**

(Rs mn)	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
<b>Total Net Revenues</b>	<b>386,545</b>	<b>438,857</b>	<b>485,399</b>	<b>531,557</b>	<b>583,176</b>
<b>Gross Profit</b>	<b>283,030</b>	<b>332,235</b>	<b>375,624</b>	<b>415,906</b>	<b>457,790</b>
<b>Operating EBITDA</b>	<b>102,438</b>	<b>117,729</b>	<b>130,681</b>	<b>150,505</b>	<b>170,566</b>
Depreciation And Amortisation	(21,437)	(25,294)	(25,563)	(26,500)	(28,000)
<b>Operating EBIT</b>	<b>81,000</b>	<b>92,435</b>	<b>105,118</b>	<b>124,005</b>	<b>142,566</b>
Financial Income/(Expense)	(1,274)	(1,720)	(2,049)	(2,000)	(2,000)
Pretax Income/(Loss) from Assoc.					
Non-Operating Income/(Expense)	10,755	5,084	10,708	12,000	13,500
<b>Profit Before Tax (pre-EI)</b>	<b>90,481</b>	<b>95,799</b>	<b>113,776</b>	<b>134,005</b>	<b>154,066</b>
Exceptional Items					
<b>Pre-tax Profit</b>	<b>90,481</b>	<b>95,799</b>	<b>113,776</b>	<b>134,005</b>	<b>154,066</b>
Taxation	(11,519)	(8,476)	(16,703)	(18,761)	(21,569)
Exceptional Income - post-tax	(44,904)	(1,715)			
<b>Profit After Tax</b>	<b>34,058</b>	<b>85,608</b>	<b>97,074</b>	<b>115,244</b>	<b>132,496</b>
Minority Interests	(1,331)	(873)	(883)	(867)	(923)
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
<b>Net Profit</b>	<b>32,727</b>	<b>84,736</b>	<b>96,191</b>	<b>114,377</b>	<b>131,574</b>
Recurring Net Profit	77,631	86,450	96,191	114,377	131,574
<b>Fully Diluted Recurring Net Profit</b>	<b>77,631</b>	<b>86,450</b>	<b>96,191</b>	<b>114,377</b>	<b>131,574</b>

**Cash Flow**

(Rs mn)	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
<b>EBITDA</b>	<b>102,438</b>	<b>117,729</b>	<b>130,681</b>	<b>150,505</b>	<b>170,566</b>
Cash Flow from Invt. & Assoc.					
Change In Working Capital	15,591	(56,618)	(20,273)	(16,516)	(25,398)
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense					
Other Operating Cashflow	83,115	64,480	121,115	145,989	158,668
Net Interest (Paid)/Received	(1,274)	(1,720)	(2,049)	(2,000)	(2,000)
Tax Paid	8,004	(13,167)	(26,244)	(29,628)	(33,992)
<b>Cashflow From Operations</b>	<b>89,845</b>	<b>49,593</b>	<b>92,822</b>	<b>114,361</b>	<b>122,676</b>
Capex	(14,344)	(20,646)	(14,000)	(15,000)	(16,000)
Disposals Of FAs/subsidiaries					
Acq. Of Subsidiaries/investments	(41,643)	(46,858)			
Other Investing Cashflow					
<b>Cash Flow From Investing</b>	<b>33,858</b>	<b>(17,911)</b>	<b>78,822</b>	<b>99,361</b>	<b>106,676</b>
Debt Raised/(repaid)	(28,718)	52,602	(48,744)	(2,007)	1,560
Proceeds From Issue Of Shares					
Shares Repurchased					
Dividends Paid	(21,692)	(25,197)	(27,592)	(27,592)	(27,592)
Preferred Dividends					
Other Financing Cashflow	80,469	13,976	8,659	10,000	11,500
<b>Cash Flow From Financing</b>	<b>30,059</b>	<b>41,380</b>	<b>(67,677)</b>	<b>(19,599)</b>	<b>(14,533)</b>
Total Cash Generated	63,918	23,470	11,144	79,762	92,143
<b>Free Cashflow To Equity</b>	<b>94,986</b>	<b>84,284</b>	<b>122,899</b>	<b>211,716</b>	<b>230,912</b>
<b>Free Cashflow To Firm</b>	<b>124,977</b>	<b>33,403</b>	<b>173,692</b>	<b>215,723</b>	<b>231,352</b>

**Balance Sheet**

(Rs mn)	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Total Cash And Equivalents	128,373	151,842	162,986	242,748	334,892
Total Debtors	105,929	114,385	131,058	143,520	157,457
Inventories	89,968	105,131	116,496	127,574	145,794
Total Other Current Assets	25,880	27,476	31,551	34,551	40,822
<b>Total Current Assets</b>	<b>350,150</b>	<b>398,833</b>	<b>442,091</b>	<b>548,394</b>	<b>678,965</b>
Fixed Assets	111,689	113,537	101,975	90,475	78,475
Total Investments	52,147	3,894	3,894	3,894	3,894
Intangible Assets	125,777	180,396	180,396	180,396	180,396
Total Other Non-Current Assets	58,237	110,776	110,776	110,776	110,776
<b>Total Non-current Assets</b>	<b>347,849</b>	<b>408,603</b>	<b>397,040</b>	<b>385,540</b>	<b>373,540</b>
Short-term Debt	8,086	61,979	61,979	61,979	61,979
Current Portion of Long-Term Debt					
Total Creditors	44,793	56,815	57,281	61,137	66,149
Other Current Liabilities	119,126	80,276	91,650	97,819	105,838
<b>Total Current Liabilities</b>	<b>172,006</b>	<b>199,070</b>	<b>210,910</b>	<b>220,935</b>	<b>233,965</b>
Total Long-term Debt	4,817		(48,744)	(50,751)	(49,191)
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities	10,515	15,211	15,211	15,211	15,211
<b>Total Non-current Liabilities</b>	<b>15,332</b>	<b>15,211</b>	<b>(33,533)</b>	<b>(35,540)</b>	<b>(33,980)</b>
Total Provisions					
<b>Total Liabilities</b>	<b>187,338</b>	<b>214,281</b>	<b>177,377</b>	<b>185,396</b>	<b>199,986</b>
Shareholders Equity	480,112	559,954	627,669	713,586	816,645
Minority Interests	30,549	33,201	34,084	34,951	35,874
<b>Total Equity</b>	<b>510,661</b>	<b>593,155</b>	<b>661,753</b>	<b>748,538</b>	<b>852,519</b>

**Key Ratios**

	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Revenue Growth	15.4%	13.5%	10.6%	9.5%	9.7%
Operating EBITDA Growth	21.0%	14.9%	11.0%	15.2%	13.3%
Operating EBITDA Margin	26.5%	26.8%	26.9%	28.3%	29.2%
Net Cash Per Share (Rs)	48.13	37.45	62.41	96.49	134.25
BVPS (Rs)	200.10	233.38	261.60	297.41	340.36
Gross Interest Cover	63.60	53.74	51.30	62.00	71.28
Effective Tax Rate	12.7%	8.8%	14.7%	14.0%	14.0%
Net Dividend Payout Ratio					
Accounts Receivables Days	92.79	91.62	92.28	94.27	94.19
Inventory Days	317.24	333.94	368.45	385.15	397.89
Accounts Payables Days	149.03	173.92	189.68	186.87	185.27
ROIC (%)	17.1%	13.4%	15.0%	17.6%	19.7%
ROCE (%)	15.4%	15.7%	15.8%	17.3%	17.5%
Return On Average Assets	11.6%	11.8%	12.0%	13.2%	13.5%

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