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Q4 RESULTS PREVIEW PHARMACEUTICALS

Maintaining the momentum

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Pharma universe is likely to report steady year-on-year growth and profit margins

WE EXPECT Dr Reddy's (DRL) and Cadila Healthcare, among large caps, to report strong numbers, while in mid-caps, Aurobindo Pharma and Ipca Laboratories will have strong traction. Ranbaxy, Lupin and Sun Pharmaceuticals, among large caps, will have weak operating performance in the quarter, while in mid-caps, Unichem is likely to report lower numbers.

We expect the pharma universe to report a steady revenue growth of 10% YoY (flat QoQ) during Q4FY11, with a positive impact from the consolidation of Taro (36% YoY in Sun.) Cadila will outperform peers in the large-cap space, with a strong growth of 27% YoY. In mid-caps, growth will remain robust (20-22%) for most peers like Torrent, Ipca, and Aurobindo, led by strong performance in branded generics and ramp-up from new capacities.

Among large caps, growth in Ranbaxy and Lupin could be impacted from higher exclusivity sales in US generics in Q4FY10. Ranbaxy is likely to report degrowth of 16% YoY, from $180m of sales from Valtrex in Q1CY10, while Lupin could see impact from Lotrel price erosion and lower Suprax sales. Excluding Ranbaxy and Sun, revenue growth is 16% YoY during the quarter.

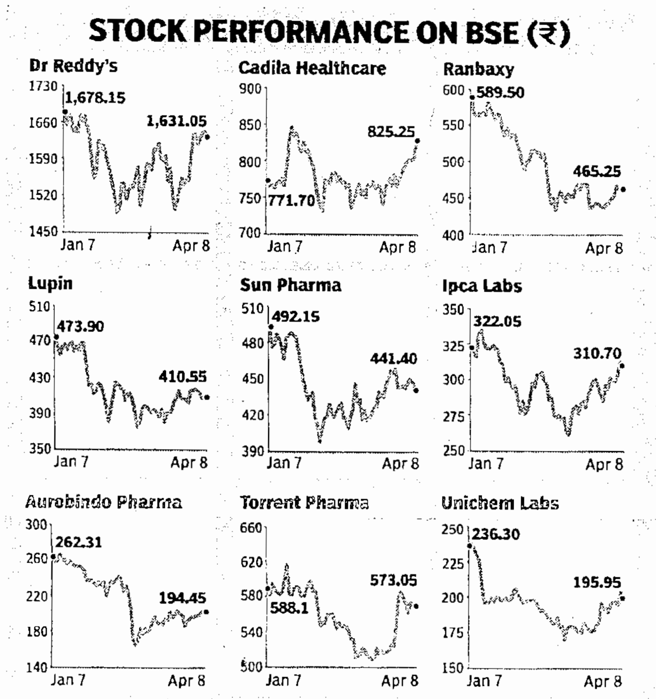
Ebitda (adjusted for Sun & Ranbaxy) could grow 18% YoY (40 bps expansion in Ebitda margins), driven by higher contribution from branded generics business (Cipla, Cadila) and niche product approvals in the US (41% YoY growth in DRL). Ramp-up in SEZ revenues will positively impact operating margins of Aurobindo (150bps YoY). Including Sun and Ranbaxy, Ebitda growth for the quarter is likely to decline 11% YoY (520 bps contraction in Ebitda margins, led by of one-off impact from higher margins from Valtrex (Ranbaxy) and full integration of Taro (Sun) that has lower Ebitda margins). Excluding Taro, Sun's margin is expected to decline due to higher fixed costs in Caraco.

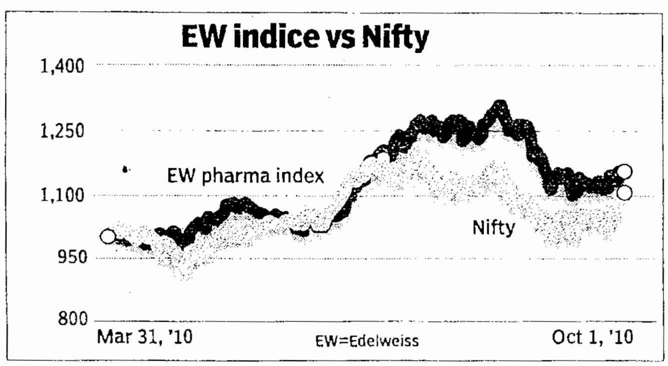
We expect relatively higher growth in earnings during the quarter. Excluding Ranbaxy and Sun, adjusted PAT (profit after tax) is likely to grow 17% YoY for the quarter, led by strong earnings growth in DRL (49% YoY), Aurobindo (43% YoY), and Cadila (23% YoY). However, lower growth and higher fixed cost will lead to a decline in earnings for Ranbaxy (-61% YoY), Unichem (-25% YoY) and Sun (-21% YoY), resulting in 15% YoY decline in the PAT of the pharma universe.

We expect strong revenue visibility for FY12, with a double-digit growth in domestic formulations and ROW (rest of world) markets and upsides in US generics from $35 bn patent expires in FY12. Further, investments in field force and capacities during FY11 are likely to consolidate and will result in higher growth over H2FY12; however, performance could vary across companies.

The pharma universe is currently trading at 17x (times) FY12e earnings, at a relative premium of 11% to the Sensex, which likely expands during market consolidation. Hence, we remain focused on specific stock performance. DRL and Lupin are our top picks in large caps, and Torrent our preferred pick in mid-caps.

—Edelweiss





Industry