kotak Institutional Equities

Pharmaceuticals
India

Sector View: **Neutral** NIFTY-50: **21,457** **December 15, 2023**

Jan Aushadhi—in the fast lane

In another instance exemplifying the Indian government's intent to push generics, it has set an imposing timeline to achieve its objective of reaching 25,000 Jan Aushadhi stores. The government targets to increase the store count by 2.5X to 25,000 in less than 2.5 years (end-FY2026). Apart from store additions, there is also an effort to improve the geospatial coverage of stores (skewed toward South India currently). On the other hand, the ongoing clamp down on non-compliant manufacturers augurs well for our coverage. Nevertheless, we maintain that current implied domestic valuations of pharma companies do not adequately factor in threats from any acceleration in the pace of adoption of unbranded and trade generics in India.

Jan Aushadhi store count—target of 2.5X growth in less than 2.5 years

In August 2023, without providing a timeline, the government had announced its intent to open 25,000 Jan Aushadhi stores across India. As of November 30, 2023, 10,006 stores have been opened across 753 out of the total of 785 districts in the country. Recently, the government announced that it aims to reach a store count of 25,000 from 10,006 currently by March 2026. We note the government achieved the milestone of 10,000 stores earlier than its aim of end-FY2024. Apart from opening more stores, the endeavor is to improve the geospatial coverage of the stores. Currently, ~33% of the stores are located in South India, with a high skew toward Karnataka and Kerala. Among states, Uttar Pradesh has the highest number of Jan Aushadhi stores at 1,481 currently. The government is targeting sales of Rs14 bn for the PMBJP program in FY2024E. Our channel checks suggest that despite the slight improvement over the past few years, supply chain challenges remain and it will be particularly important to ensure continuity of supplies, amid the rapid store addition.

Ongoing crack down on non-compliant suppliers augurs well for listed cos

One of the key concerns with enforcing genericization in India is the lack of assurance on the quality of unbranded generic drugs. Amid the government's drive to push affordable unbranded generics, we highlight that the central drug regulator CDSCO has also been increasingly upping the ante on compliance. This bodes well for our coverage, as it is likely to drive further gradual consolidation in the market. However, we believe these are still early days and it will take quite a few years for the quality conundrum to be addressed.

Risk of further acceleration in generics adoption not being adequately baked in

Factoring in the impact of lower prices in the trade generics and Jan Aushadhi (unbranded generics) channels, we estimate a 70-110 bps annual dent on branded growth at least until FY2028E. With Jan Aushadhi's rapid expansion, there is a risk of this hit on IPM swelling further. Currently, most domestic businesses are trading at an implied valuation of 30-35X FY2025E EPS for acute-heavy companies and 35-40X FY2025E EPS for chronic-heavy companies. We note that current valuations imply the ongoing steady decline in the share of branded generics will continue and do not factor in any further growth deceleration over the next few years. SUNP, Mankind and Cipla are our preferred picks in the pharma sector.

Company data and valuation summary

Company	Rating	Fair Value (Rs)	P/E (X) 2024E	P/E (X) 2025E
Aurobindo Pharma	SELL	840	20.1	17.3
Biocon	REDUCE	235	56.9	27.1
Cipla	ADD	1,320	24.7	21.7
Concord Biotech	REDUCE	1,300	45.1	35.2
Divis Laboratories	SELL	2,775	57.2	44.4
Dr Reddy's Laboratories	REDUCE	5,375	17.3	16.5
Gland Pharma	SELL	1,365	33.7	28.3
Glenmark Life Sciences	NR	—	NA	NA
Laurus Labs	SELL	270	54.8	31.7
Lupin	SELL	1,005	32.5	28.0
Mankind Pharma	ADD	2,000	42.0	33.7
Sun Pharmaceuticals	ADD	1,280	32.2	26.8
Torrent Pharmaceuticals	REDUCE	1,950	43.3	34.8
Pharmaceuticals	**Neutral**		**30.6**	**25.7**

Source: Bloomberg, Company data, Kotak Institutional Equities estimates

Prices in this report are based on the market close of December 15, 2023

Quick Numbers

The Indian government intends to increase the Jan Aushadhi store count by 2.5X to 25,000 in less than 2.5 years.

Currently, Jan Aushadhi and trade generics combined constitute ~20-22% of total drug volumes in India.

We estimate a 70-110 bps annual dent from trade generics and Jan Aushadhi on the branded segment's (IPM) growth at least until FY2028E.

Related Research

→ IPM pulse - back and forth

→ Mankind Pharma: Not the ideal mix

→ IPM: Genericization threat is for real

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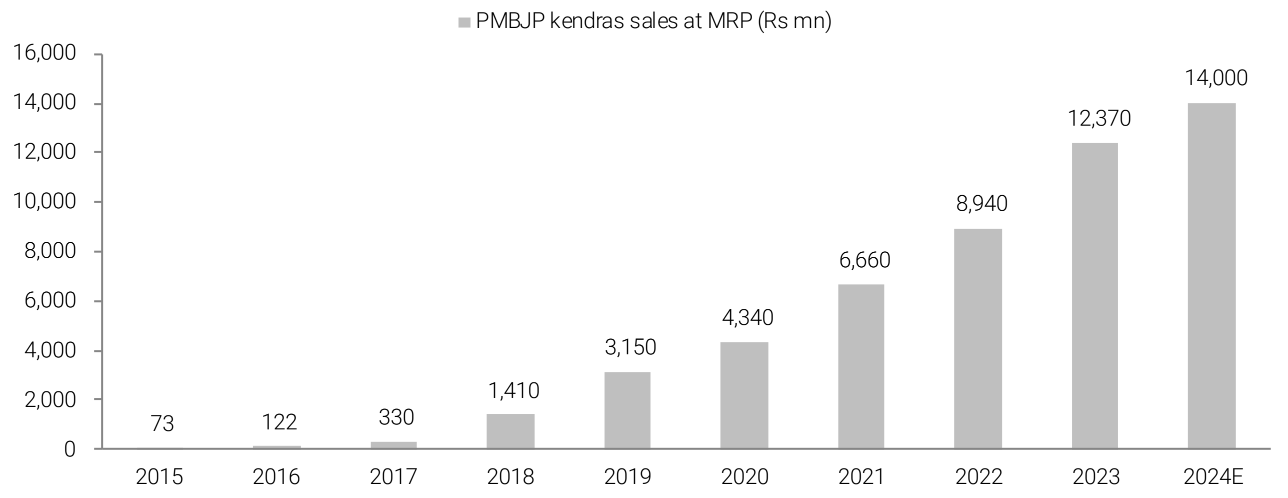
Jan Aushadhi store count has increased 3X in the past 5 years to reach 10,006

The government has been focusing on improving access to affordable drugs through an aggressive roll-out of Jan Aushadhi stores. The number of stores has grown by more than 100X in the past 9 years from only 80 in CY2014. As of November 30, 2023, 10,006 stores have been opened across 753 out of the total of 785 districts in the country. In August 2023, without providing a timeline, the government had announced its intent to open 25,000 Jan Aushadhi stores across India. Recently, the government announced an imposing timeline of achieving this target of 25,000 Jan Aushadhi stores by March 2026. We note the Jan Aushadhi program (PMBJP) reported sales of Rs12.4 bn in FY2023 and ~Rs7 bn in 1HFY24. The government is targeting sales of Rs14 bn for the PMBJP program in FY2024E. According to the government, the PMBJP program resulted in savings of ~Rs74.2 bn (6X PMBJP's sales) to Indian citizens in FY2023. Over the past nine years, the government estimates the combined savings from this program to be Rs230+ bn. As part of PMBJP, a margin of 20% on the retail price and an incentive of 15% of monthly purchases, subject to a ceiling of Rs15,000 per month is given to store owners.

Government is targeting sales of Rs14 bn for the PMBJP program in FY2024E

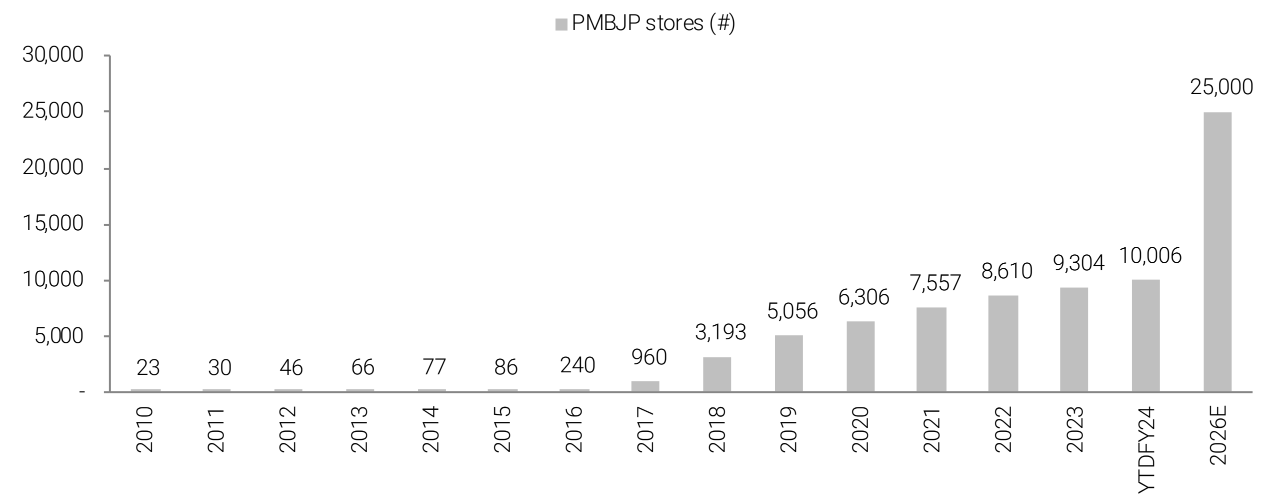
Exhibit 1: Jan Aushadhi sales, March fiscal year-end, 2015-24E (Rs mn)



Source: Department of Pharmaceuticals, Kotak Institutional Equities

Pace of expansion of Jan Aushadhi stores picked up meaningfully since CY2016; government plans to add ~15,000 stores by FY2026

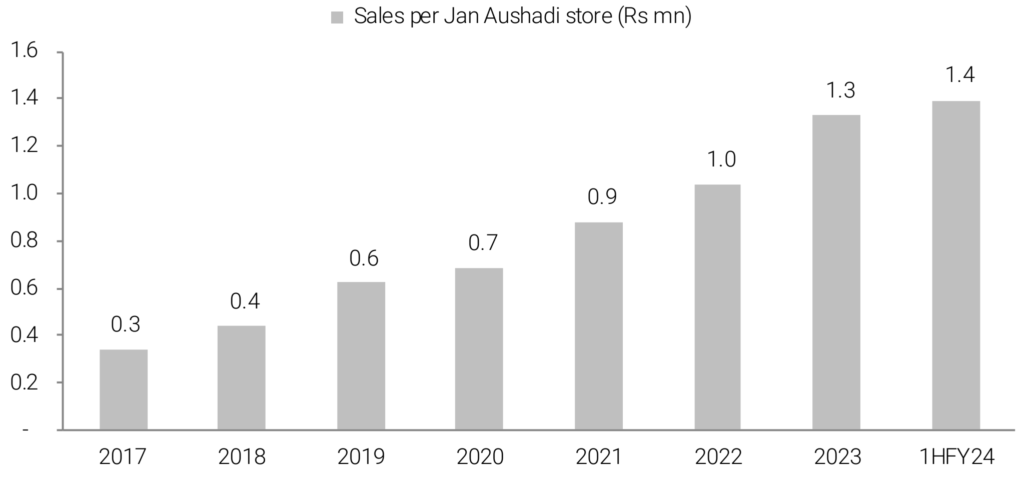
Exhibit 2: Number of Jan Aushadhi stores, March fiscal year-end, 2009-26E (#)



Source: Department of Pharmaceuticals, Kotak Institutional Equities

Notwithstanding rapid store expansion, sales per Jan Aushadhi store have been inching up after Covid

Exhibit 3: Sales per Jan Aushadhi store, March fiscal year-end, 2017-23 (Rs mn)



Notes:

(a) 1HFY24 sales are annualized for yearly calculation comparison

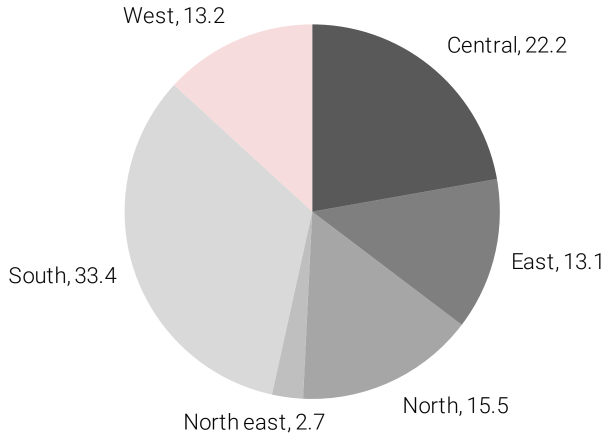
Source: Department of Pharmaceuticals, Kotak Institutional Equities

Improving geographical coverage of Jan Aushadhi stores is an important focus area

Apart from opening more stores, the Indian government's endeavor is to improve the geospatial coverage of the stores. An analysis of the implementation of the PMBJP scheme based on the availability of stores and density of the population across districts has suggested that 651 districts of the country have a deficient number of Jan Aushadhi stores. Currently, ~33% of the stores are located in South India, with a high skew toward Karnataka and Kerala. Among states, Uttar Pradesh has the highest number of Jan Aushadhi stores at 1,481 currently. The government has recently invited online applications from different districts of the country where the coverage is low. There remains a provision for government hospitals, municipal bodies and state/UT governments to send their proposal to set up Jan Aushadhi stores. Earlier this year, the government decided to allow Primary Agricultural Credit Societies (PACS) to open 2,000 stores by end-CY2023.

South India has the highest proportion of Jan Aushadhi stores

Exhibit 4: Zone-wise division of Jan Aushadhi centers, as of 30 Nov 2023 (%)



Source: Department of Pharmaceuticals, Kotak Institutional Equities

Uttar Pradesh has the highest number of Jan Aushadhi stores

Exhibit 5: State-wise stores count as on 30 November, 2023 (#)

Name of the state/UT	Number of Jan Aushadhi stores opened
Uttar Pradesh	1,481
Karnataka	1,119
Kerala	970
Tamil Nadu	861
Maharashtra	655
Gujarat	617
Bihar	470
Odisha	448
Delhi	411
Punjab	335
Madhya Pradesh	305
West Bengal	302
Haryana	276
Jammu and Kashmir	234
Uttarakhand	223
Chhattisgarh	213
Rajasthan	211
Telangana	186
Andhra Pradesh	173
Assam	120
Jharkhand	93
Himachal Pradesh	66
Manipur	38
DNH & D&D	35
Arunachal Pradesh	29
Tripura	25
Puducherry	21
Nagaland	20
Meghalaya	18
Goa	12
Mizoram	12
Chandigarh	11
Andaman & Nicobar	9
Sikkim	5
Ladakh	2
Lakshadweep	—
Total	**10,006**

Notes:

(a) Medicines are directly supplied to the administration of UT of Lakshadweep.

Source: Department of Pharmaceuticals, Kotak Institutional Equities

Government has been making a pitch to attract more entrepreneurs to the PMBJP program

Exhibit 6: Pradhan Mantri Bhartiya Jan Aushadhi application placard for pharmacists, December 2023

Source: Department of Pharmaceuticals, Kotak Institutional Equities

Chronic drugs constitute 6 out of the 10 top-selling drugs in Jan Aushadhi stores

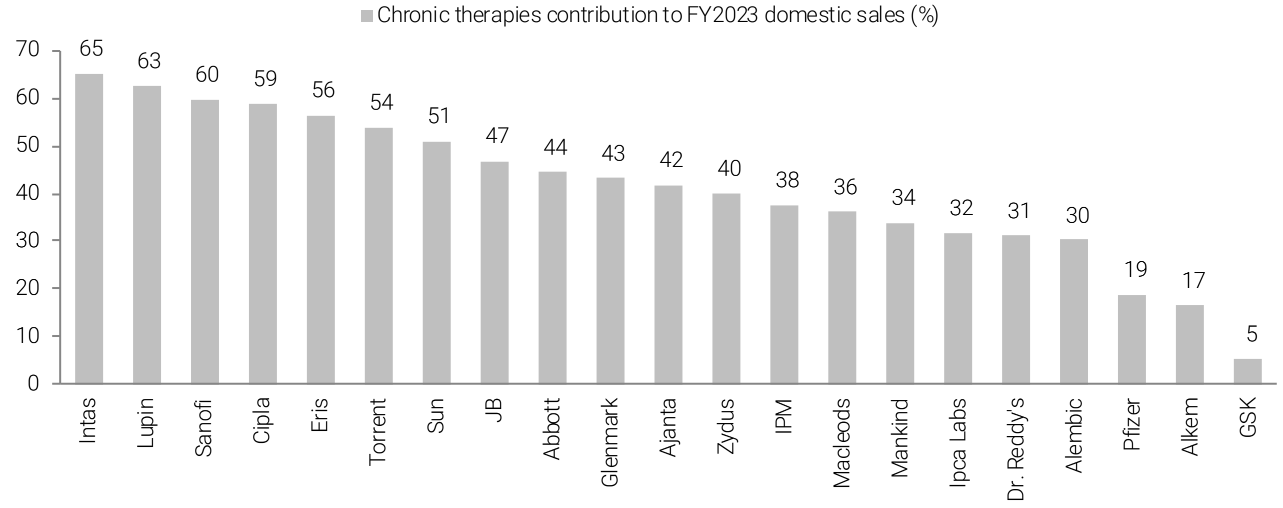
Exhibit 7: Top-selling drugs and their average sales in Jan Aushadhi stores

Top selling drugs under PMBJP	Indication	Average sales (units/month)
Pantoprazole (40 mg) and Domperidone (30 mg) capsules	Acidity, heartburn and acid reflux	1,086,446
Telmisartan tablets (40 mg)	High blood pressure	932,580
Amlodipine tablets (5 mg)	High BP and heart-related chest pain	855,565
Metformin hydrochloride (500 mg) and Glimepiride (1 mg) tablets	Blood glucose levels	803,578
Pantoprazole gastroresistant tablets (40 mg)	Heartburn and acid reflux	790,200
Metformin hydrochloride prolonged release (500 mg) and Glimepiride (2 mg) tablets	Blood glucose levels	714,250
Atorvastatin (10 mg) tablets	Lower lipids like cholestrol and triglycerides in blood	530,498
Metformin hydrochloride prolonged release (500 mg) tablets	High blood sugar	524,881
Montelukast Sodium (10 mg) and Sodium Levocetrizine (5 mg) tablets	Allergic symptoms	498,054
Diclofenac 1.16% w/w, Linceed oil 3% w/w, Methyl Salicyclate 10% w/w, and Menthol 5% w/w gel	Joint pain from arthiritis and pain associated with muscl	456,444

Source: Department of Pharmaceuticals, Kotak Institutional Equities

Just as in India, adoption of unbranded generics has been higher in chronic segment in most emerging markets

Exhibit 8: Chronic contribution to sales across leading companies, March fiscal year-end, 2023 (%)



Source: IQVIA, Kotak Institutional Equities

Jan Aushadhi commands 4.0-4.5% of total volumes in domestic pharma market

Jan Aushadhi now has a 4.0-4.5% share of total volumes in the domestic pharma market. Notwithstanding rapid store additions, revenues per Jan Aushadhi store have improved post-Covid, suggesting increasing traction. Presently, Jan Aushadhi stores have a higher presence in the urban and semi-urban markets, whereas coverage in rural areas remains low. Within Jan Aushadhi, the chronic segment (CVS, diabetes) is growing rapidly. The government recently mentioned that it expects to continue to grow Jan Aushadhi sales at a fast clip. The focus remains on expanding Jan Aushadhi's presence, thereby making affordable medicines available to the people across the country. According to norms, these medicines can be priced at a maximum of 50% of the average price of the top-three branded drugs. However, despite the thrust on adding Jan Aushadhi stores, the government is yet to sort out the supply chain issues, leading to a lower fill rate at these stores.

Improving the supply chain further will be important, especially given the steep expansion target

Currently, the product basket of PMBJP includes more than 1,965 drugs and 293 medical consumables and equipment. More than 1 mn people visit Jan Aushadhi stores daily. The government has set up a network of four warehouses at Gurugram, Bengaluru, Guwahati and Surat, along with 36 distributors across the country. This includes an IT-enabled end-to-end supply chain system and SAP-based inventory management system. Our channel checks suggest that despite the slight improvement in supply chain issues over the past few years, it will be particularly important to ensure the continuity of supplies, amid the rapid store addition. The drugs are procured only from WHO GMP-certified suppliers. According to the government, each batch at the warehouses is tested at NABL-accredited labs before their dispatch to the stores.

Quality conundrum is yet to be solved

One of the key concerns with enforcing genericization is the lack of assurance on the quality of generic drugs. This results from the absence of standardization of manufacturing processes and inadequate testing, potentially leading to lower efficacy, thereby impacting trustworthiness. In our view, robust GMP regulations across facilities with stringent testing requirements are required before generic prescriptions are made mandatory. Presently, quality standards vary significantly across manufacturers, with the existing regulatory framework not providing egalitarian opportunities for all companies. On the other hand, renowned brands come with a certain stamp of quality and track record, thereby lending comfort to doctors for prescribing these brands. One of the key impediments toward providing a level playing field is lack of common standards for drug regulators at the Center and the states. According to the Drugs and Cosmetics Act, it is the responsibility of state regulators to control the manufacturing, sale and distribution of drugs, while the Center is responsible for approving new drugs, conducting clinical trials, setting drug standards and more. Currently, there are 38 drug regulators in the country, each having its own database. If a particular state drug regulator finds violations, it is likely that this information is not passed onto other regulators or even with the Central Drugs Standard Control Organization (CDSCO).

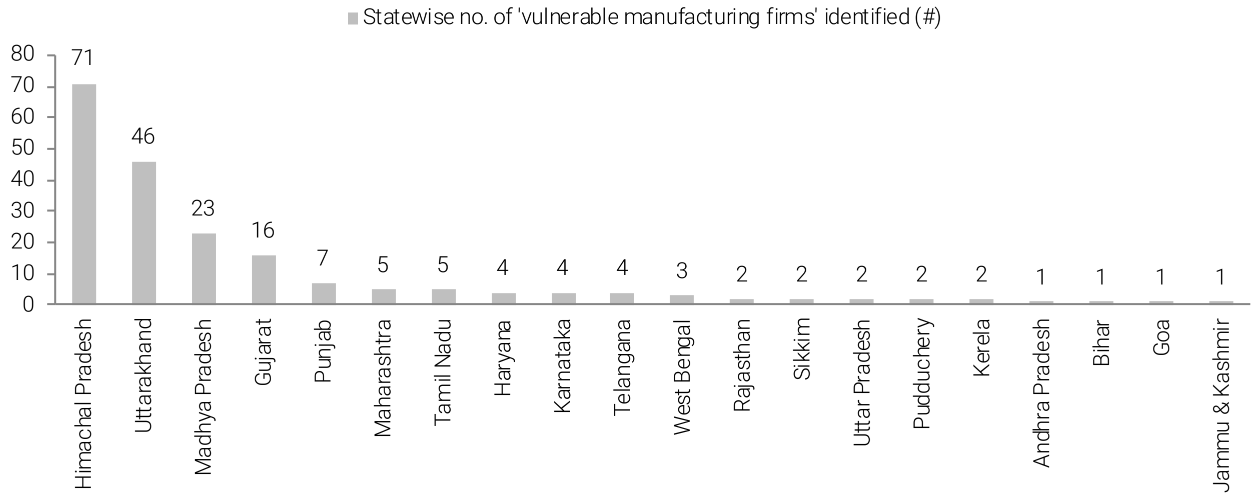
According to the Indian Medical Association (IMA), less than 1% of the generic drugs manufactured in India are tested for quality. Although 300,000 batches of 70,000 drug formulations are produced in India, the quality assurance mechanism in the country can ascertain quality control of only 15,753 drugs annually, according to the IMA. For instance, in FY2023, only ~12,000 tests were conducted by the CDSCO and State Drug Control Departments. If one sample from each batch had been tested, the minimum required number of tests would have been ~300,000. As BE studies are not mandated for generic drugs in India, there are concerns on their quality. Particularly so, as most generic drugs are manufactured by smaller companies, some of which may not be adhering to the requisite quality control standards. Hence, the absence of information on manufacturers and lack of any track record around outcomes and source that help build trust, make it difficult for doctors to prescribe generics, given the inherent risk to a patient's health.

Nevertheless, the drug regulator has been increasingly upping the ante on compliance

Amid the government's drive to push affordable unbranded generics, we highlight the central drug regulator CDSCO has also been increasingly upping the ante on compliance. According to media reports, the CDSCO has recently ordered 76 out of 237 pharma manufacturing facilities it has inspected over the past one year to stop manufacturing for poor standards. Out of the 237 facilities inspected, 179 have been issued show cause notices, with licenses of 15 firms being cancelled.

Himachal Pradesh had highest number of vulnerable manufacturing firms identified

Exhibit 9: State-wise bifurcation of vulnerable manufacturing firms identified by regulator, 2023 (#)

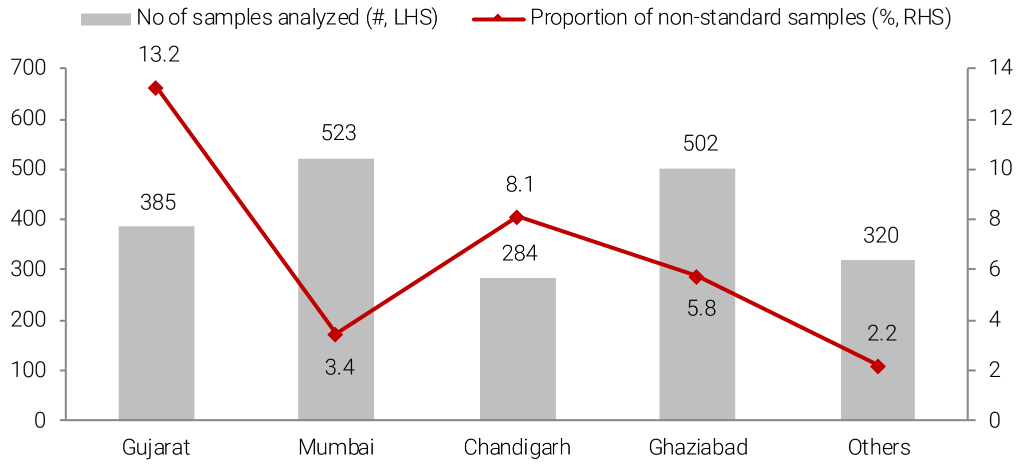


Source: Moneycontrol, Kotak Institutional Equities

This comes in the aftermath of some cough syrups manufactured in India being linked to deaths in other countries. The DCGI has also embarked on a nationwide campaign to ensure that cough syrups manufactured within the country meet global quality standards. It has ordered a robust testing protocol to be carried out across several cough syrup manufacturing firms and test impurity levels of the toxic components. In Exhibit 10, we have summarized the results from the sample testing across key locations. Altogether, 2,014 samples were tested, of which ~6% (128 samples) were found to not meet global quality standards.

Gujarat had the highest proportion of non-standard samples

Exhibit 10: Samples tested at different locations by DCGI, 2023 (#, %)



Source: Central Drugs Standard Control Organization (CDSCO), Kotak Institutional Equities

Recently, CDSCO found large-scale data manipulation and non-compliance with good laboratory practices (GLP) by public testing laboratories. According to a government report, since July 2023, 72 public testing labs have been audited. Out of these, 39 were sent show-cause notices, nine were issued orders to stop testing, five were sent warning letters and six were issued suspension of testing orders.

Rising generics penetration continues to eat into IPM growth

With ~70% of the out-of-pocket expenditure on healthcare in India being on medicines, the government has been working on enhancing the affordability of medicines, with the aggressive roll-out of the PMBJP program and ongoing expansion of the national list of essential medicines (NLEM). On one hand, Jan Aushadhi stores continue to gain volumes in the urban and semi-urban markets; on the other hand, the trade generics segment has been witnessing strong growth in the semi-urban and rural markets. Together, both channels constitute ~20-22% of total drug volumes in India. Apart from Cipla (~Rs20 bn annual trade generics sales) and Alkem (~Rs13 bn annual trade generics sales), historically, pharma companies have been rather non-committal about expanding their presence in the ~Rs205 bn trade generics market. However, owing to a continued gradual volume shift toward generics, pharma companies have been increasingly focusing on the trade generics segment. Over the recent past, companies such as Mankind, Torrent and DRRD have started their trade generics divisions. Factoring in the impact of lower prices in both the trade generics and Jan Aushadhi (unbranded generics) channels, we estimate a 70-110 bps annual dent from trade generics and Jan Aushadhi on the branded segment's (IPM) growth at least until FY2028E. Although there surely remains a possibility, we have not assumed a significant acceleration in the pace of generics adoption in this calculation.

Without factoring in meaningful acceleration in generics adoption, we estimate 70-110 bps annual hit on IPM growth

Exhibit 11: Impact of generics on IPM sales, March fiscal year-end, 2015-28E (Rs bn, %, bps)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024E	2025E	2026E	2027E	2028E
Sales (Rs bn)														
IPM branded market (excluding trade generics and Jan Aushadhi)	915	1,048	1,143	1,225	1,356	1,503	1,569	1,855	2,005	2,206	2,448	2,705	2,989	3,288
Trade generics market				105	120	137	156	186	205	234	266	304	346	395
Jan Aushadi sales	0	0	0	1	3	4	7	9	12	15	19	25	33	41
Yoy growth (%)														
IPM branded market (excluding trade generics and Jan Aushadhi)		*14.5*	*9.1*	*7.2*	*10.7*	*10.9*	*4.3*	*18.2*	*8.1*	*10.0*	*11.0*	*10.5*	*10.5*	*10.0*
Trade generics market					*14.3*	*14.0*	*14.0*	*19.5*	*10.0*	*14.0*	*14.0*	*14.0*	*14.0*	*14.0*
Jan Aushadi sales					*123.4*	*37.8*	*53.5*	*34.2*	*38.4*	*21.1*	*30.0*	*30.0*	*30.0*	*25.0*
Impact on growth (bps)														
Impact on IPM growth of trade generics and Jan Aushadi						***(58)***	***(164)***	***(39)***	***(74)***	***(75)***	***(84)***	***(100)***	***(109)***	***(111)***

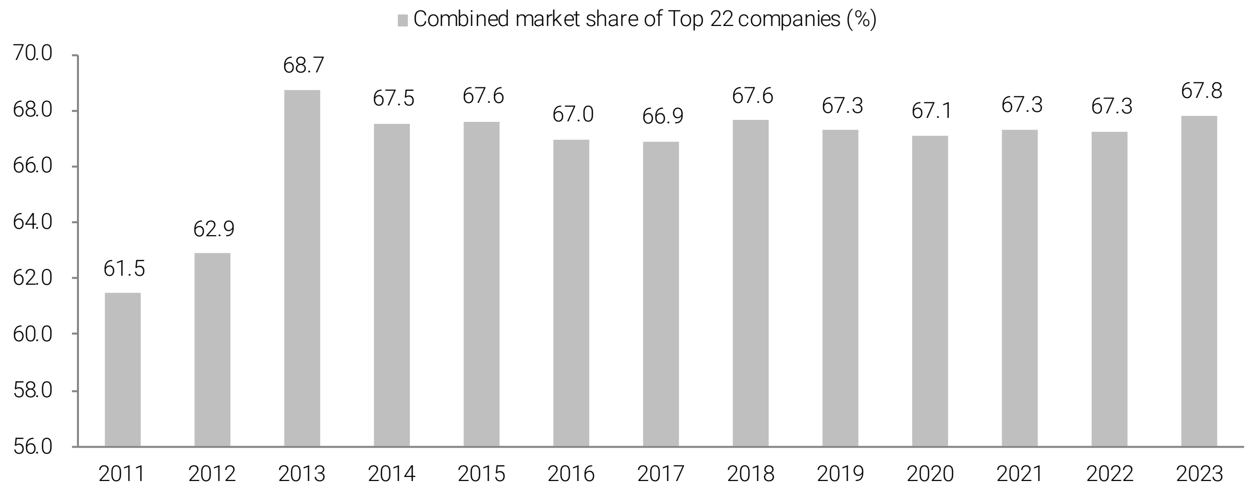
Source: IQVIA, Department of Pharmaceuticals, Kotak Institutional Equities

High concentration of leading pharma companies also delays generics push

There are more than 2,500 pharma companies supplying drugs in the IPM, but leading companies continue to garner a lion's share of the market. We highlight the share of the top-22 companies in the IPM has been broadly stable at an elevated level of 67-68% over the past decade. On the other hand, the distribution and retail space in the IPM is extremely fragmented, thereby lending higher bargaining power (in terms of margins, working capital and clout) to the larger pharma companies. This, in turn, also acts as a stumbling block for any major genericization thrust, as the larger pharma companies remain focused on ensuring that their trade generics segments do not cannibalize their branded generics sales. With an increasing regulatory push and channel consolidation along with the onset of health-tech platforms and consolidation of retailers/distributors, there remains a long-term possibility of reduced dominance of pharma companies. Over the foreseeable future, though, we expect branded generics to continue to dominate the domestic pharma landscape.

Combined market share for top-22 companies remained broadly constant over past decade

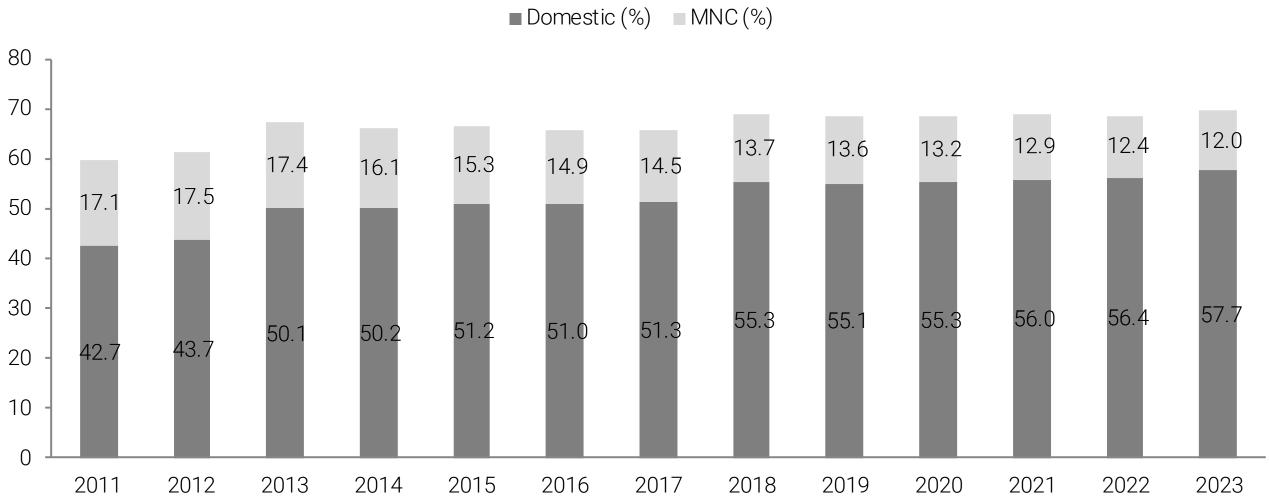
Exhibit 12: Top-22 companies' combined IPM market share, March fiscal year-end 2011-23 (%)



Source: IQVIA, Kotak Institutional Equities

Domestic pharma companies have been consistently gaining market share

Exhibit 13: Top-22 companies' combined IPM domestic versus MNC market share mix, March fiscal year-end, 2011-23 (%)



Source: IQVIA, Kotak Institutional Equities

Current valuations leave limited scope for deceleration in branded growth

In our view, the current implied domestic valuations of pharma companies do not adequately factor in the threat from an accelerated pace of penetration of unbranded and trade generics in India. Currently, domestic businesses are trading at an implied valuation of 30-35X FY2025E EPS for acute-heavy companies and 35-40X FY2025E EPS for chronic-heavy companies. These valuations factor in a 10-11% IPM CAGR over the next few years, thereby implying a 70-130 bps annual dent from trade generics and Jan Aushadhi on IPM growth, followed by a steady deceleration. If the share of branded slips faster, there is scope for a derating. For instance, our FV of Rs2,000 for Mankind is underpinned by a DCF model, which implies 10-year sales/adjusted EBITDA CAGRs of 14/17%.

In our view, current valuations factor in a 10-11% IPM CAGR over the next few years, thereby implying a 70-110 bps annual dent from trade generics and Jan Aushadhi on branded (IPM) growth, followed by steady growth deceleration. If the share of branded slips faster, there is scope for derating. As seen earlier and more recently with the NMC regulations, which were rolled back, the government is keen on pushing generics. Yet, in our view, a forced change might be ineffective, unless the quality conundrum is addressed.

Our FV is underpinned by DCF model, which implies 10-year sales and adjusted EBITDA CAGRs of 14% and 17%, respectively

Exhibit 14: Reverse DCF valuation, March fiscal year-ends, 2020-44E (Rs mn)

	2020	2021	2022	2023	2024E	2025E	2026E	2027E	2028E	2029E	2030E	2031E
Reverse DCF model												
Net sales	**58,652**	**62,144**	**77,816**	**87,494**	**101,221**	**115,828**	**132,847**	**152,070**	**173,542**	**197,439**	**223,936**	**253,205**
%yoy growth	*16.7*	*6.0*	*25.2*	*12.4*	*15.7*	*14.4*	*14.7*	*14.5*	*14.1*	*13.8*	*13.4*	*13.1*
Pre-Ind AS-116 EBITDA	**15,257**	**16,621**	**19,870**	**18,976**	**24,545**	**29,805**	**35,962**	**41,819**	**48,592**	**56,270**	**64,829**	**74,442**
Pre-Ind AS-116 EBITDA margin (%)	*26.0*	*26.7*	*25.5*	*21.7*	*24.2*	*25.7*	*27.1*	*27.5*	*28.0*	*28.5*	*29.0*	*29.4*
Gross block	19,710	21,399	42,577	52,661	61,693	68,393	73,093	79,176	87,072	96,944	108,141	120,801
Depreciation & amortisation	(991)	(1,190)	(1,666)	(3,259)	(3,702)	(4,104)	(4,386)	(5,146)	(5,660)	(6,301)	(7,029)	(7,852)
%gross block	*(5.0)*	*(5.6)*	*(3.9)*	*(6.2)*	*(6.0)*	*(6.0)*	*(6.0)*	*(6.5)*	*(6.5)*	*(6.5)*	*(6.5)*	*(6.5)*
EBIT	14,266	15,431	18,204	15,717	20,843	25,701	31,576	36,673	42,932	49,969	57,800	66,590
EBIT margin (%)	*24.3*	*24.8*	*23.4*	*18.0*	*20.6*	*22.2*	*23.8*	*24.1*	*24.7*	*25.3*	*25.8*	*26.3*
NOPAT	**10,480**	**11,795**	**13,395**	**12,317**	**16,270**	**20,078**	**24,659**	**28,055**	**32,628**	**37,976**	**43,928**	**49,809**
Tax rate (%)	*(26.5)*	*(23.6)*	*(26.4)*	*(21.6)*	*(21.9)*	*(21.9)*	*(21.9)*	*(23.5)*	*(24.0)*	*(24.0)*	*(24.0)*	*(25.2)*
Capex	(2,028)	(3,054)	(4,649)	(7,890)	(6,500)	(5,100)	(4,600)	(6,083)	(7,896)	(9,872)	(11,197)	(12,660)
%sales	*(3.5)*	*(4.9)*	*(6.0)*	*(9.0)*	*(6.4)*	*(4.4)*	*(3.5)*	*(4.0)*	*(4.6)*	*(5.0)*	*(5.0)*	*(5.0)*
Change in working capital	(908)	(1,139)	(6,030)	2,146	(919)	(1,755)	(2,045)	(2,285)	(2,577)	(2,868)	(3,180)	(3,512)
Free cash flow to firm	**8,534**	**8,792**	**4,383**	**9,831**	**12,553**	**17,327**	**22,400**	**24,833**	**27,815**	**31,538**	**36,581**	**41,489**
Discount factor						0.50	1.50	2.50	3.50	4.50	5.50	6.50
Discounted free cash flow to firm						**16,390**	**18,961**	**18,810**	**18,853**	**19,128**	**19,854**	**20,150**

	2032E	2033E	2034E	2035E	2036E	2037E	2038E	2039E	2040E	2041E	2042E	2043E	2044E
Reverse DCF model													
Net sales	**285,413**	**320,719**	**359,270**	**401,197**	**446,614**	**494,938**	**546,017**	**599,636**	**655,523**	**712,358**	**769,491**	**826,204**	**881,726**
%yoy growth	*12.7*	*12.4*	*12.0*	*11.7*	*11.3*	*10.8*	*10.3*	*9.8*	*9.3*	*8.7*	*8.0*	*7.4*	*6.7*
Pre-Ind AS-116 EBITDA	**85,196**	**97,178**	**110,476**	**125,174**	**141,353**	**158,875**	**177,182**	**196,681**	**217,306**	**238,640**	**260,473**	**282,562**	**304,636**
Pre-Ind AS-116 EBITDA margin (%)	*29.9*	*30.3*	*30.8*	*31.2*	*31.7*	*32.1*	*32.5*	*32.8*	*33.2*	*33.5*	*33.9*	*34.2*	*34.6*
Gross block	135,072	151,108	169,071	189,131	211,462	236,209	263,509	293,491	326,267	360,104	394,732	429,845	465,114
Depreciation & amortisation	(8,645)	(9,520)	(10,482)	(11,537)	(12,688)	(13,936)	(15,284)	(16,729)	(18,271)	(19,806)	(21,316)	(22,782)	(24,186)
%gross block	*(6.4)*	*(6.3)*	*(6.2)*	*(6.1)*	*(6.0)*	*(5.9)*	*(5.8)*	*(5.7)*	*(5.6)*	*(5.5)*	*(5.4)*	*(5.3)*	*(5.2)*
EBIT	76,551	87,658	99,993	113,637	128,666	144,939	161,899	179,952	199,035	218,834	239,157	259,780	280,450
EBIT margin (%)	*26.8*	*27.3*	*27.8*	*28.3*	*28.8*	*29.3*	*29.7*	*30.0*	*30.4*	*30.7*	*31.1*	*31.4*	*31.8*
NOPAT	**57,260**	**65,568**	**74,795**	**85,000**	**96,242**	**108,414**	**121,100**	**134,604**	**148,878**	**163,688**	**178,890**	**194,315**	**209,777**
Tax rate (%)	*(25.2)*	*(25.2)*	*(25.2)*	*(25.2)*	*(25.2)*	*(25.2)*	*(25.2)*	*(25.2)*	*(25.2)*	*(25.2)*	*(25.2)*	*(25.2)*	*(25.2)*
Capex	(14,271)	(16,036)	(17,964)	(20,060)	(22,331)	(24,747)	(27,301)	(29,982)	(32,776)	(33,837)	(34,627)	(35,114)	(35,269)
%sales	*(5.0)*	*(5.0)*	*(5.0)*	*(5.0)*	*(5.0)*	*(5.0)*	*(5.0)*	*(5.0)*	*(5.0)*	*(4.8)*	*(4.5)*	*(4.3)*	*(4.0)*
Change in working capital	(3,865)	(4,237)	(4,626)	(5,031)	(5,450)	(5,799)	(6,129)	(6,434)	(6,706)	(6,820)	(6,856)	(6,806)	(6,663)
Free cash flow to firm	**47,769**	**54,815**	**62,688**	**71,446**	**81,149**	**91,805**	**102,954**	**114,917**	**127,667**	**142,837**	**158,722**	**175,178**	**192,031**
Discount factor	7.50	8.50	9.50	10.50	11.50	12.50	13.50	14.50	15.50	16.50	17.50	18.50	19.50
Discounted free cash flow to firm	**20,760**	**21,317**	**21,814**	**22,248**	**22,612**	**22,891**	**22,971**	**22,944**	**22,809**	**22,835**	**22,706**	**22,425**	**21,997**

Asset valuation	
WACC (%)	**11.8**
Sum of discounted free cash flows	**422,475**
Terminal growth rate (%)	*5.5*
Terminal value	**371,177**
Enterprise value	**793,651**
Net debt	(27,303)
Equity value	**820,954**
Minority interest	19,779
Equity value attributable to parent	**801,176**
Number of shares (mn)	401
Fair value per share (Rs)	**2,000**

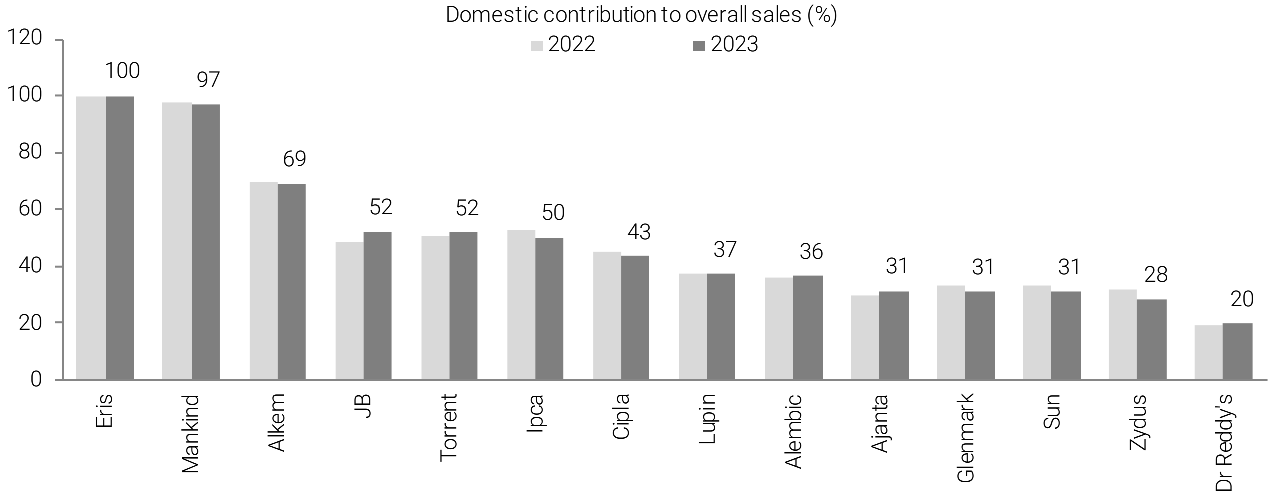
Source: Company, Kotak Institutional Equities estimates

In our estimates, we have factored in a steady increase in the pace of adoption for trade generics and Jan Aushadhi, in line with recent trends. However, if there is significant acceleration in adoption of generics, there is a downside risk to our fair values. As we have seen over the past few years and more recently with the NMC regulations, the government remains keen on pushing generic drugs, even as the approach remains ad hoc. One constant has been the sustained push on increasing penetration of Jan Aushadhi stores. The major roadblock in pushing genericization in India remains lax manufacturing practices amid the absence of stringent enforcement regulations. Hence, assuming no major shift in the regulatory regime, we expect branded generics to continue to dominate the domestic formulations landscape, led by the competitive dynamics, importance of brands and higher availability. As a result, currently, we hold on to our implied domestic valuation multiples for our coverage. Nevertheless, we remain cognizant of the risks from increasing penetration of trade and unbranded generics.

In terms of absolute sales, among domestic companies, though Sun is the largest player in the domestic formulations market, Eris, Mankind, Alkem, JB and Torrent have a higher sales contribution from the domestic segment.

Within our coverage, Mankind and Torrent have highest domestic sales mix

Exhibit 15: Domestic contribution to overall sales, March fiscal year-ends,

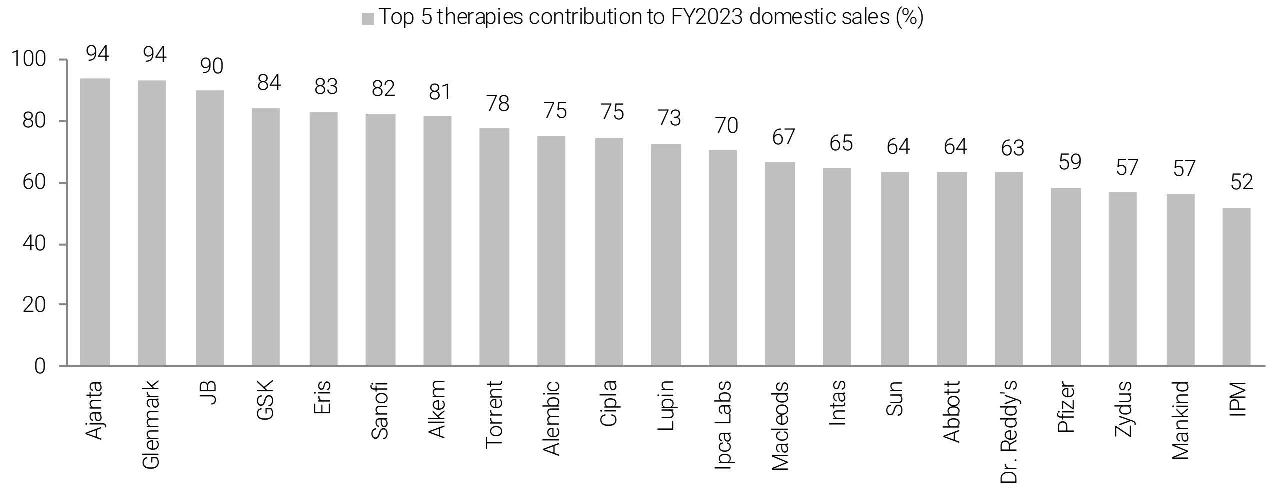


Source: Companies, Kotak Institutional Equities

In our view, companies with a broad-based portfolio and strong presence across multiple therapies will be better placed to tackle any regulatory pressures. Within our coverage, Mankind, DRRD and Sun have the lowest therapy concentration.

Mankind has a broad-based portfolio, with much lesser therapy concentration than peers

Exhibit 16: Contribution of top-5 therapies to domestic sales, March fiscal year-end, 2011-23 (%)



Source: IQVIA, Kotak Institutional Equities

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REDUCE. We expect this stock to deliver -5-+5% returns over the next 12 months.

SELL. We expect this stock to deliver <-5% returns over the next 12 months.

Our Fair Value estimates are also on a 12-month horizon basis.

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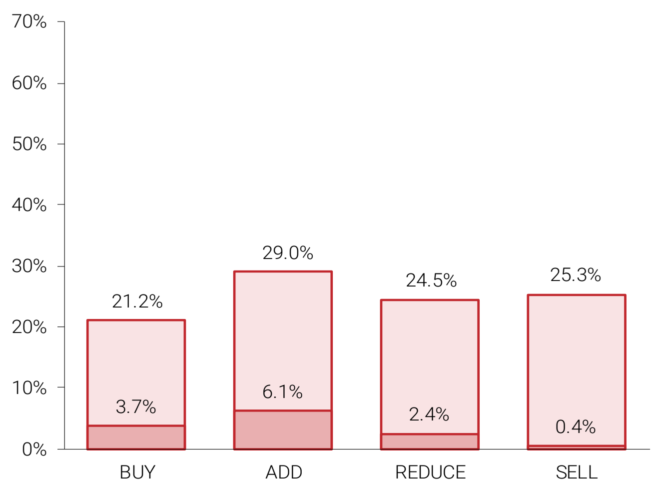
Kotak Institutional Equities Research coverage universe



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Source: Kotak Institutional Equities

As of September 30, 2023

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