Sectoral View on Pharmaceutical

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WAY2WEALTH
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Nifty Pharma : 9205

Fundamental Perspective on Pharma Sector

The Nifty Pharma index has underperformed Nifty50 in the last three years, falling ~21 % in comparison to the Nifty50 that has gained ~51 % during the same period. The underperformance of the sector has been primarily due pricing pressure in the US market, regulatory hurdles, soaring R&D expense, rise in API prices, and investments towards inorganic growth.

- **Change in business mix –** Indian pharmaceutical companies have been changing their priorities from generic to specialty. Most of the companies have made large investments in building specialty business through licensing, partnerships or developing in-house through the 505(b) (2) pathway. Sun Pharma is the largest player in specialty play followed by Dr. Reddy, Lupin, Cadila and Cipla. We believe Indian players can sustain strong growth in the long term as huge opportunities exist with almost two-thirds of the overall medicines spends are on specialty molecules and they command higher margin because of limited competition.

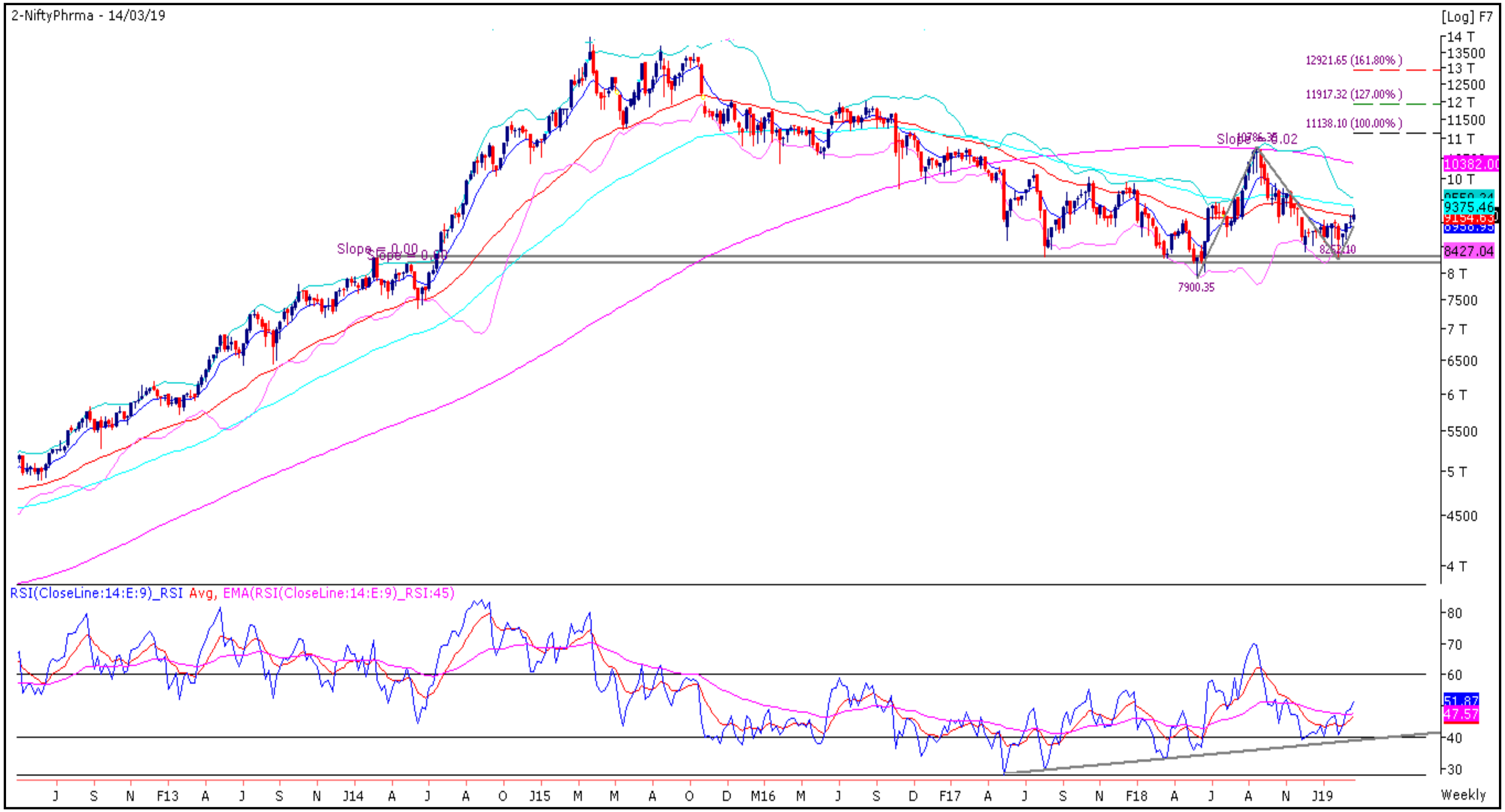
- **Pricing getting stabilized in the US market –** Rise in USFDA's approval rate since FY15 and consolidation at the buyer's level had directly impacted prices of generic drugs in the US market. This environment caught Indian players off-guard and led to declining sales and profitability for several quarters. Most of the companies during this phase witnessed price erosion on their base business in the range of higher single-digit to lower double-digit. We expect price erosion to subside and settle at the long term average of the lower single-digit for most of the pharmaceutical companies. Furthermore, Indian generics exporter and global majors (Teva, Mylan) has also indicated in their recent comments that pricing concerns have bottomed.

Fundamental Perspective on Pharma Sector

- **Focus on complex generics –** Most of the Indian companies have benefitted by launching Mee too drugs in the US market because of the minimal cost and limited complexity in development. This product usually witnesses price erosion up to ~ 95% once 7-8 players enter the market leading to a decline in growth rates and pressure on margins. We believe success from hereon will depend on the launch of niche and limited competition molecules such as injectables, respiratory, oncology, dermatology, and biosimilars products. The competition in this niche molecules is usually restricted to limited players and price erosion is not at the same extent as of plain vanilla generics. Indian companies have been already working on the right path as most of them have invested in complex products. Players like Biocon has been the early entrant in the biosimilar space at the global level, Cipla and Lupin gearing up to launch their generic version of inhalers in the US market, Natco and Dr. Reddy dominating domestic oncology space while Aurobindo, Sun Pharma, Dr. Reddy and Cipla building an injectable portfolio. We believe these areas are still not commoditized and long term opportunity still exist if companies are able to successfully launch the product.
- **Outlook on the Sector –** We believe valuations are close to the bottom for most of the domestic pharmaceutical companies and the majority of the headwinds have eased for the sector. At the current valuation, Nifty Pharma Index trades at 26.70x 1- year forward P/E versus a peak of ~37x(Nov-2015) and the 5-year average of ~26x. We see initial offshoots of a recovery as pricing concerns in the US market have begun to subside with some high-value drugs already getting approved in the past few months. We believe the Indian Pharmaceutical sector is likely to witness a recovery because of the changing business mix, pricing getting stabilized in the US market and companies shift focus to limited competition drugs. Based on above mentioned thesis, we advise investors to take/hike exposure in pharma stocks/mutual funds.

Nifty Pharma : 9205

Technical Perspective on Nifty Pharma Index



Nifty Pharma Index Weekly Chart

Source: Falcon 7

Technical Perspective on Nifty Pharma Index

- After confirming its breakdown from 'Double Top' pattern during the beginning of calendar year 2016, Nifty Pharma Index ended its dream run around 14000 and eventually entered into a corrective phase. On weekly charts, index made lower top and lower bottom pattern which is a bearish pattern and as a result, index corrected by more than 42% in last 2 years and made low of almost 7900 levels in May 2018.
- Subsequently, Index found support near 7900 – 8200 zone which coincided with the previous resistance zone (marked as a horizontal trend line). The said zone reversed its role post breakout and probably acted as an immediate support (change of polarity rule). Along with that, the index formed a 'Bullish Divergence' pattern precisely near the said support zone.
- The impact of such development was seen during the last year of June, 2018 as index rebound sharply and precisely tested its 200-Week Moving Average (SMA). Failure to cross such zone triggered fresh sell-off and index resumed its southward journey. However, during the rally from 7900.35 (weekly candle low of May 25, 2018) to 10786.35 (weekly candle high of September 14, 2018), the weekly RSI (14) broke and entered well inside the 60 level for the first time since April, 2015.
- During the course of correction from 10786.35, index managed to hold its swing low of 7900.35 (candle low of May 25, 2018) and registered a higher bottom of 8252.10. Whereas, the weekly RSI (14) precisely found support near the 40 level which is a bullish sign.
- On a monthly chart, February month candle resembles a formation of 'Bullish Hammer' pattern. The said pattern needs confirmation in terms of monthly closing above 9088.55. Also, the said candle precisely occurred near the lower band of Bollinger Band.

Technical Perspective on Nifty Pharma Index

- If we apply the Eliot Wave theory than the rally from the bottom of 7900.35 to 10786.35 can be marked as Wave 1 and correction from 10786.35 to 8252.10 as Wave 2. As per that rule, index has entered into Wave 3 which is usually dynamic in nature and generally extend 161.8% of Wave 1. Thus, the possible target of Wave 3 comes around 12922.
- On daily charts, Nifty Pharma Index recently confirmed its breakout from 'Double Bottom' pattern.
- Considering the above evidences, we maintain our bullish view on Nifty Pharma index over the next 18 months with a potential upside target of nearly 40 percent from current level. On the flip side, if index breaches and starts sustaining below 7900 in that case our bullish view will be negated.

Recommended Pharma Mutual Funds

SBI Healthcare Opportunities Fund

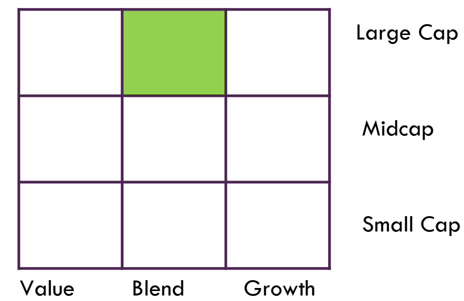
Fund Attributes	
Launch Date	05th July 1999
Fund Manager	Tanmay Desai
Benchmark	S&P BSE HC
AUM (Rs crore)	1002.13
Total No of Holdings	20
Expense Ratio(%)	2.24
PE Ratio	29.95
PB Value	3.97
Standard Deviation	13.73
Beta	1.24
Sharpe	0.69
Jensons Alpha	-3.26
Exit Load (Holding period less than)	0.5% (15 Days)

Data for February 2019

Top 5 Investments

Company/ Security	% Net Assets
Aurobindo Pharma Ltd	10.6
Divis Laboratories Ltd	10.5
Dr Reddys Laboratories Ltd	10.0
Strides Pharma Science Ltd	8.4
Lupin Ltd	8.4

Investment Style



Performance (15th March 2019)

3 months	1 year	2 year	5 year
0.21	-2.48	-6.87	8.26

Return for <1 year absolute & >1 year CAGR

- SBI Healthcare Opportunities Fund adopts a bottom-up approach to pick pharma companies which have positioned themselves to capture this potential and have the capability to do so.
- SBI Healthcare Opportunities Fund tops the list of pharma funds across time periods. The outperformance has also been quite consistent with a 5 & 10year outperforming the benchmark- S&P BSE Healthcare by 150- 400bps.
- The scheme has a higher standard deviation of 13.89 as compared to its peers ,hence we expect that the scheme should outperform the category peers with the upsides in the Pharma Sector.
- With the undervaluation's in the pharma companies and prolonged underperformance of the SBI Healthcare Opportunities Fund in the past three years has left significant potential on the upsides. Therefore we do recommend the investors to invest in SBI Healthcare Opportunities Fund.

[Factsheet]

Mirae Asset HealthCare Fund

Fund Attributes	
Launch Date	02nd July 2018
Fund Manager	Vrijesh Kasera
Benchmark	S&P Healthcare TRI
AUM (Rs crore)	326.41
Total No of Holdings	24
Expense Ratio(%)	2.67
PE Ratio	34.85
PB Value	4.72
Standard Deviation	-
Beta	-
Sharpe	-
Jensons Alpha	-
Exit Load (Holding period less than)	1% (12 Months)

Data for February 2019

Top 5 Investments

Company/ Security	% Net Assets
Sun Pharmaceuticals Industries Ltd.	11.4
Divis Laboratories Ltd	10.2
Cipla Ltd	9.5
Dr Reddys Laboratories Ltd	8.1
Aurobindo Pharma Ltd	6.8

Investment Style

	Value	Blend	Growth
Large Cap			■
Midcap			
Small Cap			

Performance (15th March 2019)

3 months	1 year	2 year	5 year
2.80	-	-	-

Return for <1 year absolute & >1 year CAGR

- Mirae Asset as a fund house has been quite successful in identifying the sustainable competitiveness of the companies such, as a commanding market share, comparative advantages to competitors, a differentiated business model and high levels of transparency and corporate governance. Mirae Assets has a long term approach of investing in companies which are intrinsically competitive and generate stable cash flows.
- The investment strategy of the Mirae Assets Fund house has been quite successful which can be observed in the success of Mirae Asset Emerging Bluechip and Mirae Asset India Equity Fund.
- Mirae Asset Healthcare Fund seeks to adopt a fundamental & bottom up approach that aims to identify growth companies which have high return ratio's (ROE) and have sustainable advantage. It endeavour's to maintain a concentrated portfolio of 30-40 stocks in Pharma, Healthcare and Allied sectors.
- We believe Mirae Asset's Healthcare Fund with a successful investment management team should reap the benefits of current undervaluation in the pharma sector

Factsheet

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