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DALAL STREET INVESTMENT JOURNAL
DEMOCRATIZING WEALTH CREATION

Syngene International

BSE Code	:	**539268**
Time Duration	:	**18 months**
CMP	:	**₹308.00 (as on 25 July, 2019)**
Target Price	:	**₹370**

Large Rhino
Swiftest Performers Among Heavy Weights

Our Large Rhino pick for the month of July is Syngene International, the largest contact research organisation (CRO) in India and the second largest in Asia. It provides integrated services for small and large molecules, antibody-drug conjugates, and oligonucleotides. It has three key business verticals, namely, dedicated R&D centres, discovery services, development and manufacturing services. In the dedicated R&D centre division (30 per cent of sales), the company sets up customised R&D centres with dedicated infrastructure and scientific teams for a specific client. These are largely FTE (full-time equivalent) base long-term contracts. In discovery services (25 per cent of sales) segment, there is multi-client infrastructure to provide services on discovery chemistry, discovery biology, in-vivo services, peptide synthesis, etc. These are largely FTE-based short-term contracts. The development and manufacturing services includes (45 per cent of sales) pre-clinical studies, stability, formulation, biologics, CMC and clinical supplies, clinical development etc.

Well-poised to capitalise on rising R&D outsourcing

The global players in the pharma space are going through structural issues like looming patent overhang, increasing research and development costs, a dwindling product pipeline and growing competition. To overcome these issues, the global pharma players are looking for an option like outsourcing their research and development work, which would help them to sustain their global positioning and revive financial performance. We believe being the largest CRO in India and second largest in Asia with 3,996 qualified scientists and 1.4 million sq.ft area of R&D and manufacturing infrastructure, Syngene International is well-poised to reap the benefit from these opportunities and continue to maintain its growth trajectory going forward. Notably, Syngene has cost advantage over its Chinese peers as the billing rates from Chinese players are much higher than (approx. 300 per cent) Synegne's. Also, the ongoing trade war tension between the US and China is likely to provide huge opportunity for Asian companies due to the shift in outscoring from China to other countries.

Well-positioned to rollover business from existing clients

As of FY19, the company's list of clients includes around 331 clients from across the world. Around 19 per cent of the clients have entered into long term contracts extending over 5 years or more. During the year, the company added 15 new clients. Over the years, with diversification the company has reduced its dependence on top 10 clients, which account for 66 per cent of the revenue as against 71 per cent in FY15. Syngene has also increased the scope of its relationship with existing clients like BMS, Baxter, GSK Global, Merck etc. The company has built and maintained strong relations with its clients, which underpins the company's rollover business from its existing clients.

Investing in capacity expansion to meet rising demand

The company is focusing on capitalising on the opportunity from rising demand, for which it is investing in expansion of production facility. During last fiscal, Syngene invested around Rs. 590 crore towards capex programmes, which resulted in total investment in fixed assets of around Rs. 2444.7 crore. The company is eyeing to continue its capex over the next two years and expects to take its total asset base to Rs. 3850 crore by the end of FY21. The construction activities at Syngene's upcoming commercial scale API manufacturing facility in Mangalore are in full swing and the facility is expected to become operational by the end of FY20. This strategic investment in large scale API will enable is the company to strengthen its position in the drug discovery to manufacturing value chain. The ongoing capex will also include an investment of around Rs. 525 crore towards upcoming API manufacturing facility in Mangalore. Apart from capacity expansion, this capex will also be towards new centres for new services like virology, biologic plant, etc.

Enormous opportunity for biologics business to grow

The company is eyeing to grab a share from the pie of growing biologics space for contract research and manufacturing organisations. The global demand for biologics is strengthened by their ability to treat major chronic diseases. The development and manufacturing of these drugs can be complex and expensive. As a specialised CRO, Syngene is well-poised to capitalise on the opportunity arising from the increasingly outsourced biologics drug development market. Also, many biotech companies are initiating new projects, but they lack the infrastructure to support R&D activities, thus providing opportunity for players like Syngene to grow. The company has already built a reputation for providing world-class end-to-end solutions and has a prestigious client portfolio. Even though there are existing players in this division, as the market opportunity is large, there is headroom for Syngene to grow its biologics business. Hence, to capitalise on this opportunity, the company is looking to double the biologics reactors.

Financials

In FY2018-19, the company's revenue grew by nearly 28.3 per cent to Rs. 1825.60 crore from Rs. 1,423 crore in FY18. This strong performance was led by a broad-based growth across all business units, with improved traction in discovery services and dedicated R&D centres. The company's EBITDA in FY19 grew 16.2 per cent yoy to Rs. 611.9 crore. Profit after tax for the year increased by 8.5 per cent to Rs. 331.6 crore.

In the first quarter of FY20, the company's revenue increased marginally by 3.7 per cent yoy to Rs. 420.9 crore. EBITDA for the period grew 20.83 per cent yoy to Rs. 119.5 crore with corresponding margin expansion of around 403 bps. EBITDA margin stood at 28.40 per cent. Profit after tax in Q1FY20 grew 8.8 per cent yoy to Rs. 72 crore.

Most of the Synegene's clients are located outside India and nearly 94 per cent of its sales are denominated in foreign currency, predominantly in the USD. Thus, fluctuation in currency remains a key concern for the company. The company tries to mitigate this risk by hedging between 50 per cent and 100 per cent of its exposure over the coming 24 months and up to 100 per cent of the exposure for long-term fixed price contracts.

Outlook & valuations

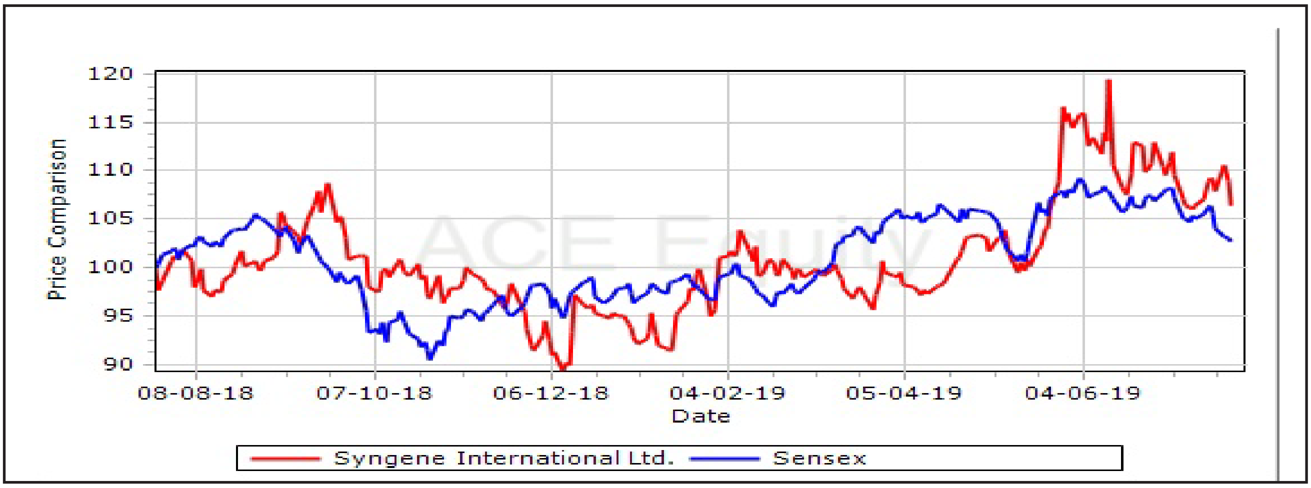
The company's management expects to maintain the growth level and margins at FY19 levels. Besides, the capacity addition, rising outsourcing activities by global pharma companies, coupled with new client acquisition would help Syngene to continue its growth trajectory in the coming years. The company's ROE and ROCE stands healthy at 18.26 per cent and 16.93 per cent respectively. In terms of valuation, the stock of Syngene is currently available at P/E multiple of 38.82x which is near to its one-year median P/E of 37.56x. Considering all the factors, we recommend a **BUY** on the stock with potential target of Rs. 370, representing 20 per cent upside.

Inc/Exp Statement(Consolidated) (Rs in Crore)

Description	201903	201803
Net Sales	1825.60	1423.10
Total Income	1901.80	1559.20
Total Expenditure	1289.90	1032.60
PBIDT	611.90	526.60
PAT	331.60	305.40
Dividend %	5.00	10.00
Adj. EPS(Rs)	8.29	7.64

Quarter On Quarter (Consolidated) (Rs in Crore)

Particulars	201906	201903	Q on Q Var%	201806	Y on Y Var%
Net Sales	420.90	533.90	-21.17	406.00	3.67
Total Expenditure	301.40	373.90	-19.39	307.10	-1.86
PBIDT (Excl OI)	119.50	160.00	-25.31	98.90	20.83
PAT	72.00	100.10	-28.07	66.20	8.76
PBIDTM% (Excl OI)	28.39	29.97	-5.27	24.36	16.54
PBIDTM%	33.64	33.86	-0.65	31.60	6.46
PATM%	17.11	18.75	-8.75	16.31	4.90
Adj. EPS(Rs)	1.80	2.50	-28.00	1.66	8.43



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