

## STRIDES SHASUN

**PHARMACEUTICALS** 

22 JUN 2017

Visit Note

# BUY

Target Price: Rs 1,200

# Investor meeting highlights

Strides' management, represented by Founder/Chairman#Arun Kumar and MDShashankSinha, reiterated the company has now attained critical mass with organic and inorganic strategies (USD 560mn sales in FY17 from USD 190 mn in FY14) under Strides version 2.0.With its diversified market positioning, it is currently strongly positioned (in terms of infrastructure, compliance, R&D pipeline)— this will result in better return ratios.

We expect revenue growth/margin to improve from H2'18 on (a)15-20 approvals in US in FY18, (b) new products and expanding pharmacy coverage in Australia and (c) exit from lower-margin API business. We maintain **BUY** with SOTP ofRs 1,200 (17x FY19 EPS + Rs 31 for 40% stake in Stelis R&D + Rs 72 for 60% stake in API co.), on diversified business model and attractive valuations.

MARKET DATA

Potential Upside

CMP

No. of Shares : 89mn Free Float : 69% Market Cap : Rs84bn

52-week High / Low : Rs1,259 / Rs849 Avg. Daily vol. (6mth) : 357,716 shares Bloomberg Code : STR IB Equity

: Rs 936

: 28%

Promoters Holding : 31% | FII / DII : 35% / 14%

## Drivers inplace; growth momentum from H2FY18

◆ US: Ramp up in business to be led by improved product pipeline (28 pending ANDAs; USD 9.5bn addressable opportunity, expects significant portion of the pending pipeline to get approved in 12 months – received 4 approvals in May-June'17 MTD). Strides has gained and maintained healthy market share in it's recently launches – Carisoprodol: >90% market share, Vancomycin:>50%, Ergocalciferol: >40%, Ranitidine: >20%, and Methoxsalen:~30%. It plans to file 15-20 ANDAs per annum from FY18 (8 filings in H2FY17) and expects to cap its R&D investment at USD 30mn peryear. It expectsgrowth to accelerate from H2FY18 when it starts getting approvals at much faster pace (GDUFA approval timeline of 8-10 months – Oct '17 onwards) leading to annualized revenue run-rate of USD 200mn by end FY18 (vs ~USD100mn in FY17). This is backed by its compliant manufacturing base;4 of last 5 USFDA audits at its facilities were successful in last 12 months with no observations.

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Financial summary (Consolidated)

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Y/E March	FY16	FY17	FY18E	FY19E		
Sales (Rs mn)	28,622	34,834	36,645	40,074		
Adj PAT (Rs mn)	1,595	3,507	4,376	5,759		
Con. EPS* (Rs)	-	-	48.0	66.1		
EPS (Rs)	19.9	39.2	49.0	64.5		
Change YOY (%)	15.1	96.7	25.0	31.6		
P/E (x)	39.3	20.2	19.1	14.5		
RoE (%)	8.4	13.1	15.1	17.3		
RoCE (%)	8.9	9.8	11.0	13.2		
EV/E (x)	24.7	15.5	13.5	11.2		
DPS (Rs)	3.9	4.5	7.0	7.0		

Source: \*Consensus broker estimates, Company, Axis Capital

# Non Executive

### **Key drivers**

(%)	FY17	FY18E	FY19E
Revenue growth	22	5	9
Gross margin	55.9	57.0	58.5
EBITDA margin	18.5	19.5	21.0

## Price performance





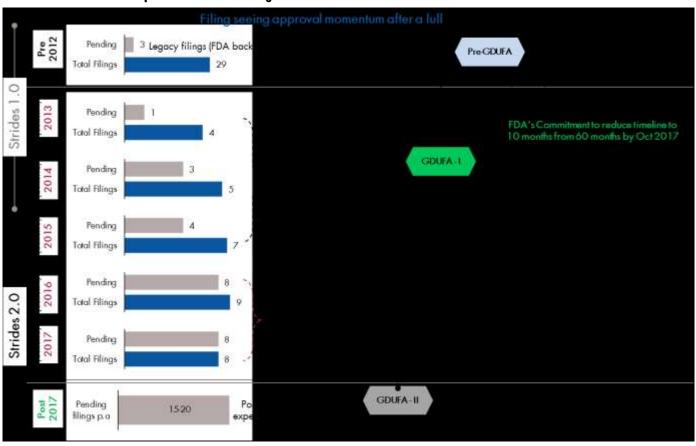


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- Australia: Scaled up with full value chain in Australia markets through various acquisitions to grow at a pace faster than the market over the next few years. It is currently ranked #2 by volume and #3 by revenue in Australia, and targets to become the market leader in 3 years. While some pricing headwinds could constrain revenue growth, it would be offset by strong pipeline (incl. new products from Generic Partners) and expanding coverage of over 1,100pharmacies. This coupled with site transfer of products to lower cost base in India would lead to healthy margin.
- Demerged its API unit into a pure play API unit (Solara Active Pharma Sciences

   SAPS): along with human API business of Sequent Scientific where Strides shareholders would own 60% in the entity. Given the changing industry dynamics, it expects SAPS' large scale compliant capacities to have an edge.

Exhibit 1: US: In a sweet spot under new GDUFA guidelines

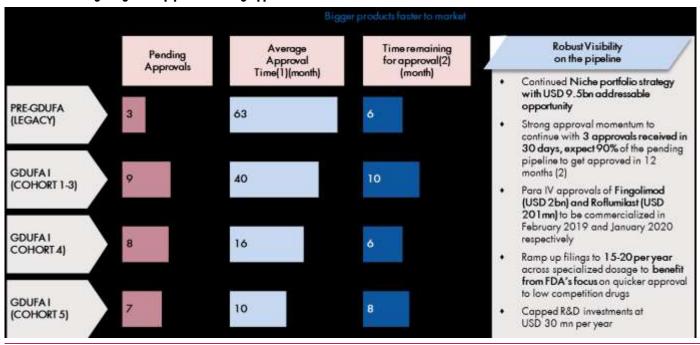




### **STRIDES SHASUN**

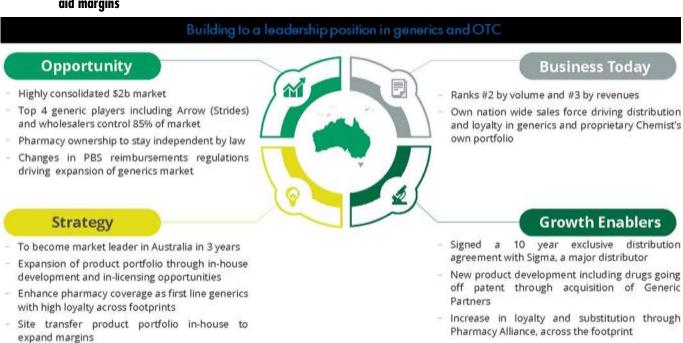
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### Exhibit 2: Exciting US growth pipeline nearing approval



Source: Company

Exhibit 3: Australia — Targets to become market leader in 3 years; product site transfer to aid margins



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### Exhibit 4: United States - Targets 15-20 filings every year

### Opportunity

- \$380b+ market for generics with patent expiry of brands worth \$87b in the next 5 years
- Indian generics have 40% of volumes in US market
- Regulatory overhang paving way for fully compliant and integrated players
- New GDUFA guidelines accelerating entry of new players and products

### Strategy

- Focus on niche, low competition, high technology barrier products built around modified release, soft gel capsules, topicals and integrated products
- Focused OTC franchise
- Target of 15-20 filings every year, to benefit from new GDUFA regulations

Source: Company

# **Business Today**

- Portfolio of 62 filed ANDAs (18 commercialized and 28 pending approval)
- Key products have captured leadership position: Carisoprodol: >90%, #1 in market, Vancomycin: >50%, #1 in market, Ergocalciferol: >40%, #1 in market , Ranitidine: >20%, #3 in market and Methoxsalen:~30%, #3 in market
- Achieved \$100m+ sales within a short period

### **Growth Enablers**

- Strong R&D capability leveraging API and FDF to develop integrated products
- Future ready mirrored facilities with Integrated capabilities across dosage forms
- Leveraging front end capabilities to go direct to market with reduced reliance on marketing partners

## Exhibit 5: European Union – Expanding front-end presence in UK

### Driving momentum on UK Front end and partnership in EU

## Opportunity

- The European pharmaceutical market is likely to grow to \$230b by 2022
- Growth expected on innovations in medicinal drugs across therapy areas including multiple sclerosis, chronic heart failure, rheumatoid arthritis and Alzheimer's.

### **Business Today**

- Diversified portfolio including Rx soft gelatin capsules, sachets and oral solids in wide ranging therapies
- Established UK Front end supplying generics to hospitals approved by NHS
- Registration Capability for regulatory markets of Europe including UK

### Strategy

- Focus on portfolio maximization through global regulated market portfolio
- Increasing coverage by expanding front end presence in UK
- Strategic partnerships to carry own IP generics to rest of Europe

### **Growth Enablers**

- Leveraging existing product portfolio of US and Australia
- Manufacturing facilities with key EU approvals including MHRA
- Developing niche formulations in soft-gel capsules and oral liquids



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### Exhibit 6: Africa — Focus on lifestyle chronic therapies

### "In Africa for Africa" theme with focus on Branded Generics

### Opportunity

- Strong macro tailwinds with increased urbanization, improving purchasing power and healthcare infrastructure
- Increasing incidences of chronic lifestyle diseases
- Market expected to reach \$44b by 2020
- Regulatory trend towards global standards such as WHO pre-qualification for manufacturing

## **Business Today**

- Footprint in 40+ countries across Sub-Saharan Africa
- 250 local medical field force with coverage of 30,000 doctors
- 750 product registrations with a pipeline of 500 product registrations
- Strong brand equity being a local player with the doctors and community

### **Growth Enablers**

- Manufacturing consolidation under the WHO approved facility in Kenya and dedicated EM plant in India
- Well established player in West Africa
- Expanding footprint in East Africa to strengthen the branded generic platform
- Increase MR head count for penetration

### Strategy

- To become a Sub-Saharan Africa branded generic player with leadership position in key markets and therapies
- Focus on lifestyle chronic therapies- driven by brands

Source: Company

### Exhibit 7: India — Focus on specialty therapies; foraying into high growth OTC segment

### Gaining Traction with Focus on Select Therapies

### Opportunity

- Indian Pharma market is estimated at \$17.3b and growing @10%
- Market primarily dominated by anti-infective, Cardiac sciences, gastro-intestinal, anti-diabetic and respiratory drugs
- Life style drugs demonstrating the highest growth in the market

## **Business Today**

- Pan India branded generics player
- Field force of 750 medical representatives covering 3,500 stocklest and 80,000 doctors
- Well Established brands such as Renerve, Raricap, Solus, Otogesic, Ehnorub, and Stugil

## Strategy

- Focused on high growth areas of CNS, Diabetes, Cardiovascular, Women health and pain management
- Building a portfolio of strong brands
- Foray into high growth OTC segment including Rx to OTC switch

### **Growth Enablers**

- Leveraging Pan India footprint for cross selling opportunities
- Improving sales force efficiency with focus on productivity
- Bolt on inorganic strategy in focused areas







### Exhibit 8: Institutional Business —Capitalizing on Kenya facility for global donor agencies and local government tenders

### Focus on Backward integration

## Opportunity

- Market opportunity of \$2.5b in terms of procurement
- Concentrated market with 5-6 key players holding majority of the business
- New treatment regimen attracting donor funding



# **Business Today**

- Approved supplier to institutionally funded aid projects and global procurement agencies like UNITAID, PEPFAR, CHAI and Global Fund
- Strong Portfolio of products in HIV, anti-malaria, and Hep-C
- Filed dossiers with product registrations across **Emerging markets**

### **Growth Enablers**

- Capitalizing on WHO Approved manufacturing facility in Kenya for global donor agencies and local government tenders
- Increased collaboration for voluntary licensing
- Robust delivery track record with superior supply chain execution

## Strategy

- R&D focus on developing next generation products as per donor agency guidelines
- Leverage strong visibility with innovator organization to be amongst the first wave of launches in select emerging markets

Source: Company

### Exhibit 9: Restructuring activities — Key data points

Demerger of API facility	
Turnover	Rs. 7,122 mn (23% of consolidated turnover)
Change in Shareholding pattern	None
Exchange/Share Ratio	Strides shareholder will 1 equity share of Rs 10 each of Solara Active Pharma sciences (resultant entity) for every 6 equity shares of Strides. Sequent Scientific shareholder - 1 share of Rs 10 each of Solara; fo every 25 shares of Sequent.
Listing will be sought for resulting Entity	Yes
Exiting Africa Generics	
Turnover	Rs. 1,377 mn (4% of consolidated turnover)
Date of completion	4th May 2017
Cash Consideration	Rs 1,087 mn
Details of Buyer	Sold to current management led by Mr Sinhue Noronha (CEO - Emerging Markets)
Related Party Transaction	No
Additional Information	Divestment of business through a combination of share sale and slump sale
Exiting Probiotic Business	
Turnover	Rs. 15 mn (0.005% of consolidated turnover)
Date of completion	4th May 2017
Cash Consideration	Rs 1,02.4 mn
Details of Buyer	Promoter group entity
Related Party Transaction	Yes - At arms length





### Exhibit 10: Demerged API entity -Solara well poised to bridge industry gaps

### Sharper Focus for the B2B oriented API business through a blended strategy



### Supply Chain

- Expanding size and scope to become one of the largest standalone API company in India
- 5 Manufacturing facilities with key regulatory approvals including USFDA



### Compliance

- Diversified manufacturing base to mitigate regulatory risks
- Leverage on pharma experience of SeQuent and Strides
- Staying ahead of the curve on GMP and EHS



### Technology

- Focus on automated procedures around processes, quality systems and packaging
- Step-up automation levels ahead of industry



### Advanced APIs

- R&D Focus on moving up the value chain and strengthening presence in high entry barrier markets
- Foray into advanced next generation APIs



### **Partnerships**

Work on supply chain security with innovator and generic companies and evaluate profit sharing alternatives

Source: Company

## Exhibit 11: Building pure-play API base to capitalize on changing industry dynamics

### Changing industry dynamics necessitate large scale highly compliant capacities

~\$50B API INDUSTRY IS FRAGMENTED AND MOST OF EXISTING PLAYERS HAVE FORWARD INTEGRATED





Compliance



Technology



Advanced APIs



- Fragmented supply chain leading to loss of control
- Most companies do not have the scale and capacities to meet global API demand
- Increased FDA oversight leading to compliance issues for API companies in China and India
- Need for strong EHS framework along with GMP
- Low level of automation and worker culture identified as one of the key concerns for the issues in the API industry
- Most players either go for generics or partner innovators, not many players working on new generations APIs
- Due to forward integration of few of API players, the industry lacks standalone players who can work on partnership model for integrated solutions





Exhibit 12: Strides continues to gain/maintain its high market share in its key products

Approval date	Brand	Generic	IMS revenue	Existing						
Approval date	Didiid	Generic	(USD mn)	competition	Mar'16	Jun'16	Sep'16	Dec'16	Mar'1 <i>7</i>	Apr'17
11-Apr-14	Vancocin	Vancomycin	332	5	50%	50%	50%	49%	49%	48%
6-Jun-14	Oxsoralen	Methoxsalen	14	2	37%	44%	42%	31%	33%	33%
16-Dec-14	Rocaltrol	Calcitriol	50	4	10%	10%	13%	13%	15%	14%
15-May-15	Combivir	Lamivudine and Zidovudine Tablets	120	8	7%	23%	24%	22%	18%	19%
30-Jul-15	Tessalon	Benzonatate	41	8	9%	13%	17%	19%	18%	19%
21-Nov-15	Avodart	Dutasteride	470	12	14%	14%	14%	13%	18%	19%
16-Nov-15	Soma (250 mg)	Carisoprodol tablets	250	1	6%	50%	70%	79%	84%	85%
24-Aug-16	-	Ranitidine Tablets	125	8	-	-	-	3%	14%	15%

Source: Bloomberg

Exhibit 13: Key M&A events in the recent past

Date	Region	Company	Acq value	Acq value (Rsmn)	Rev (Rsmn)
21-May-15	Australia	Arrow	380	17,821	5,628
08-Feb-16	Australia	Generic Partners* (51% stake acquired)	25	1,204	1,873
29-Feb-16	Australia	Pharmacy Alliance	13.99	681	739
	Australia	Total		19, <i>7</i> 06	8,240
21-Jul-14	India	BafnaPharma's - India branded (74% stake)		481	200
19-Sep-15	India	Ranbaxy - CNS divisions (Solus&Solus care)		1,650	920
23-Oct-15	India	Brands from J&J / Medispan (51% stake acquired)		-	320
	India	Total		2,131	1,440
			USD mn		
08-Feb-16	Africa (Kenya)	Universal corporation* (51% stake acquired)	14	951	1,522
07-Mar-16	USA, Australia, Middle East	MobergPharma* (Sweden) - 3 OTC brands	10	670	409
25-Nov-16	USA, Australia, Middle East	MobergPharma* (Sweden) - PediaCare (Pediatric brand)	5	343	402
09-Dec-16	India	Perrigo API (USFDA approved)		1000	<i>7</i> 38
		Total		23,458	11,611

Source: Company, Axis Capital







# Financial summary (Consolidated)

# Profit &loss (Rsmn)

V/E 14 1	E)/1./	EV41-7	EV/1.0E	EV/10E
Y/E March	FY16	FY1 <i>7</i>	FY18E	FY19E
Net sales	28,622	34,834	36,645	40,074
Other operating income	-	-	-	-
Total operating income	28,622	34,834	36,645	40,074
Cost of goods sold	(15,023)	(15,362)	(15,758)	(16,631)
Gross profit	13,599	19,472	20,888	23,443
Gross margin (%)	47.5	55.9	57.0	58.5
Total operating expenses	(9,459)	(13,044)	(13,742)	(15,028)
EBITDA	4,140	6,428	<i>7</i> ,146	8,416
EBITDA margin (%)	14.5	18.5	19.5	21.0
Depreciation	(1,313)	(1,872)	(1,628)	(1,676)
EBIT	2,827	4,557	5,518	6,739
Net interest	(1,682)	(2,269)	(1,924)	(1,564)
Other income	921	1,686	1,550	1,595
Profit before tax	2,067	3,973	5,144	6, <i>77</i> 1
Total taxation	(425)	(470)	(772)	(1,016)
Tax rate (%)	20.5	11.8	15.0	15.0
Profit after tax	1,642	3,503	4,373	5,755
Minorities	(47)	4	4	4
Profit/ Loss associate co(s)	-	-	-	-
Adjusted net profit	1,595	3,507	4,376	5,759
Adj. PAT margin (%)	5.6	10.1	11.9	14.4
Net non-recurring items	(645)	1,020	-	-
Reported net profit	950	4,527	4,376	5,759

# Balance sheet (Rsmn)

Y/E March	FY16	FY1 <i>7</i>	FY18E	FY19E
Paid-up capital	893	894	894	894
Reserves & surplus	25,685	26,210	29,859	34,891
Net worth	26,579	27,104	30,753	35,786
Borrowing	33,475	30,545	24,981	18,981
Other non-current liabilities	2,306	5,612	5,951	6,315
Total liabilities	62,861	64,901	63,326	62,722
Gross fixed assets	36,508	41,270	41,575	45,075
Less: Depreciation	(9,876)	(12,135)	(13,763)	(15,439)
Net fixed assets	26,632	29,135	27,812	29,636
Add: Capital WIP	8,303	<i>7,7</i> 98	<i>7,</i> 511	7,237
Total fixed assets	34,936	36,933	35,323	36,873
Total Investment	12,663	15,246	12,451	7,451
Inventory	6,131	7,380	8,032	8,783
Debtors	10,330	9,971	11,044	12,077
Cash & bank	3,116	3,295	3,826	4,816
Loans & advances	309	513	516	519
Current liabilities	11,715	16,171	16,671	17,833
Net current assets	11,313	9,120	11,500	13,830
Other non-current assets	3,951	3,601	4,052	4,568
Total assets	62,861	64,901	63,326	62,722

Source: Company, Axis Capital

## Cash flow (Rsmn)

Y/E March	FY16	FY17	FY18E	FY19E
Profit before tax	2,067	3,973	5,144	6, <i>77</i> 1
Depreciation & Amortisation	1,313	1,872	1,628	1,676
Chg in working capital	(3,424)	2,371	(1,849)	(1,340)
Cash flow from operations	<i>7</i> 1 <i>7</i>	9,282	4,526	6,060
Capital expenditure	(22,950)	(3,330)	(4,000)	(3,500)
Cash flow from investing	(22,284)	(5,914)	(1,205)	1,500
Equity raised/ (repaid)	11,316	1	-	-
Debt raised/ (repaid)	18,917	(2,930)	(5,564)	(6,000)
Dividend paid	436	-	-	-
Cash flow from financing	29,487	(3,414)	(6,296)	(6,732)
Net chg in cash	7,920	(45)	(2,975)	828

Key ratios				
Y/E March	FY16	FY1 <i>7</i>	FY18E	FY19E
OPERATIONAL				
FDEPS (Rs)	19.9	39.2	49.0	64.5
CEPS (Rs)	28.3	71.5	67.3	83.3
DPS (Rs)	3.9	4.5	7.0	7.0
Dividend payout ratio (%)	32.9	8.9	14.3	10.9
GROWTH				
Net sales (%)	139.3	21.7	5.2	9.4
EBITDA (%)	80.9	55.3	11.2	17.8
Adj net profit (%)	54.4	119.8	24.8	31.6
FDEPS (%)	15.1	96.7	25.0	31.6
PERFORMANCE				
RoE (%)	8.4	13.1	15.1	17.3
RoCE (%)	8.9	9.8	11.0	13.2
EFFICIENCY				
Asset turnover (x)	1.0	0.8	0.8	0.9
Sales/ total assets (x)	0.6	0.4	0.5	0.5
Working capital/sales (x)	0.2	0.2	0.2	0.2
Receivable days	131.7	104.5	110.0	110.0
Inventory days	91.4	94.8	99.4	101.3
Payable days	115.6	95.9	93.2	94.9
FINANCIAL STABILITY				
Total debt/ equity (x)	1.7	1.1	0.8	0.5
Net debt/ equity (x)	0.9	0.5	0.4	0.3
Current ratio (x)	2.0	1.6	1.7	1.8
Interest cover (x)	1.7	2.0	2.9	4.3
VALUATION				
PE (x)	39.3	20.2	19.1	14.5
EV/ EBITDA (x)	24.7	15.5	13.5	11.2
EV/ Net sales (x)	3.6	2.9	2.6	2.4
PB (x)	2.8	3.1	2.7	2.3
Dividend yield (%)	0.4	0.5	0.7	0.7
Free cash flow yield (%)	(0.3)	0.1	-	-
Source: Company, Axis Capital				





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### Research Team

Sr. No	Name	Designation	E-mail
1	Hiren Trivedi	Research Associate	hiren.trivedi@axissecurities.in
2	Kiran Gawle	Associate	kiran.gawle@axissecurities.in

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22 JUN 2017

DEFINITION OF RATINGS				
Ratings Expected absolute returns over 12-18 months				
BUY	More than 10%			
HOLD	Between 10% and -10%			
SELL	Less than -10%			

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