

## 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 of Rs 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.

CMP : Rs 936  
Potential Upside : 28%

#### MARKET DATA

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  
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 its 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 expects growth 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.

(Continued on page 2...)

#### Financial summary (Consolidated)

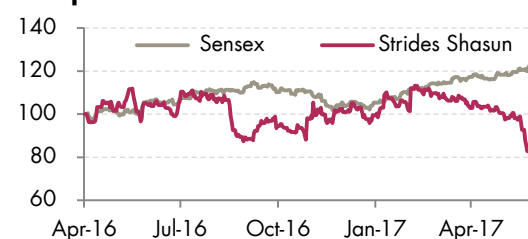
Y/E March	FY16	FY17	FY18E	FY19E
Sales (Rs mn)	28,622	34,834	36,645	40,074
Adj PAT (Rs mn)	1,595	3,507	4,376	5,759
Con. EPS* (Rs)	-	-	48.0	66.1
EPS (Rs)	19.9	39.2	49.0	64.5
Change YOY (%)	15.1	96.7	25.0	31.6
P/E (x)	39.3	20.2	19.1	14.5
RoE (%)	8.4	13.1	15.1	17.3
RoCE (%)	8.9	9.8	11.0	13.2
EV/E (x)	24.7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

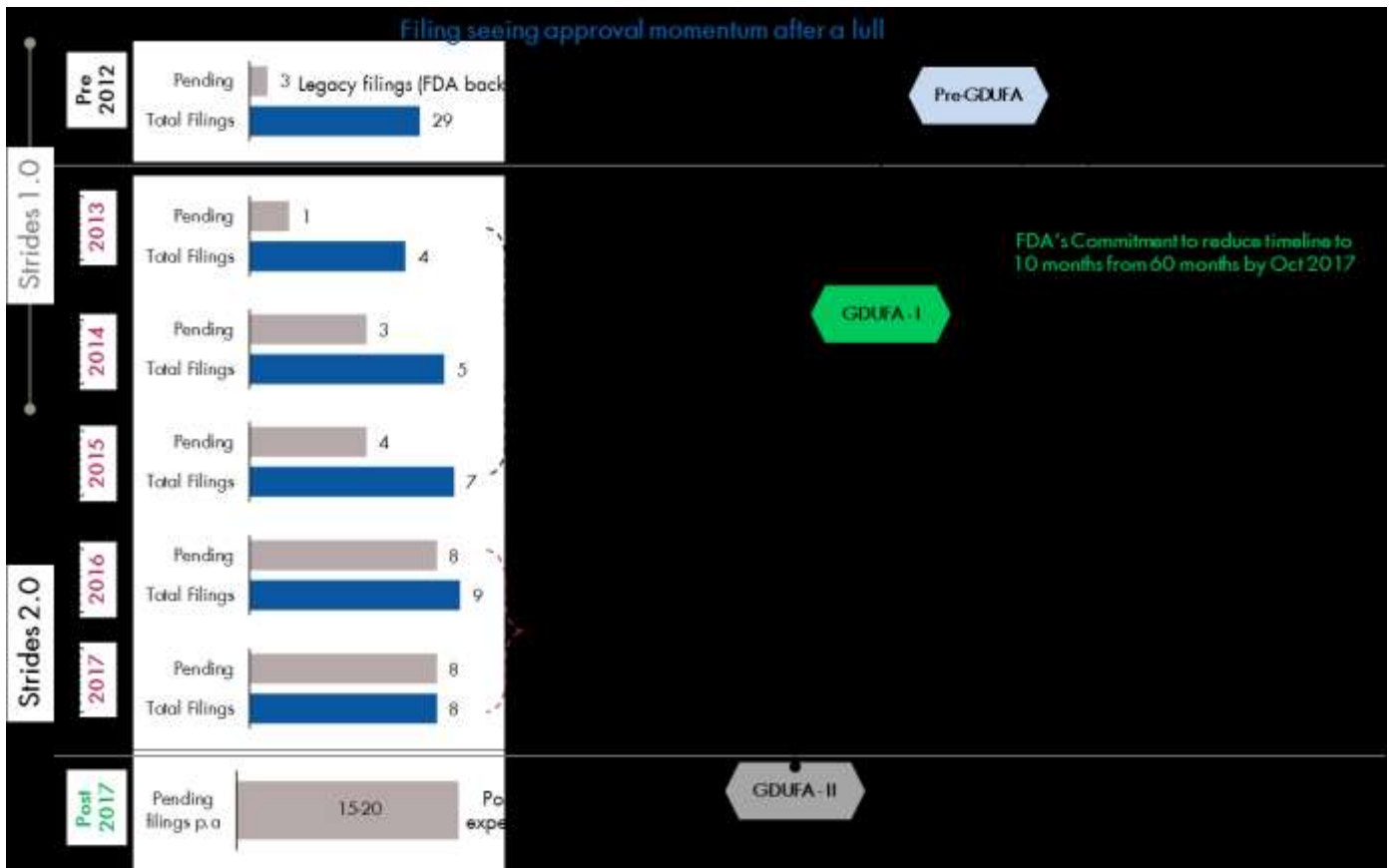
#### Price performance



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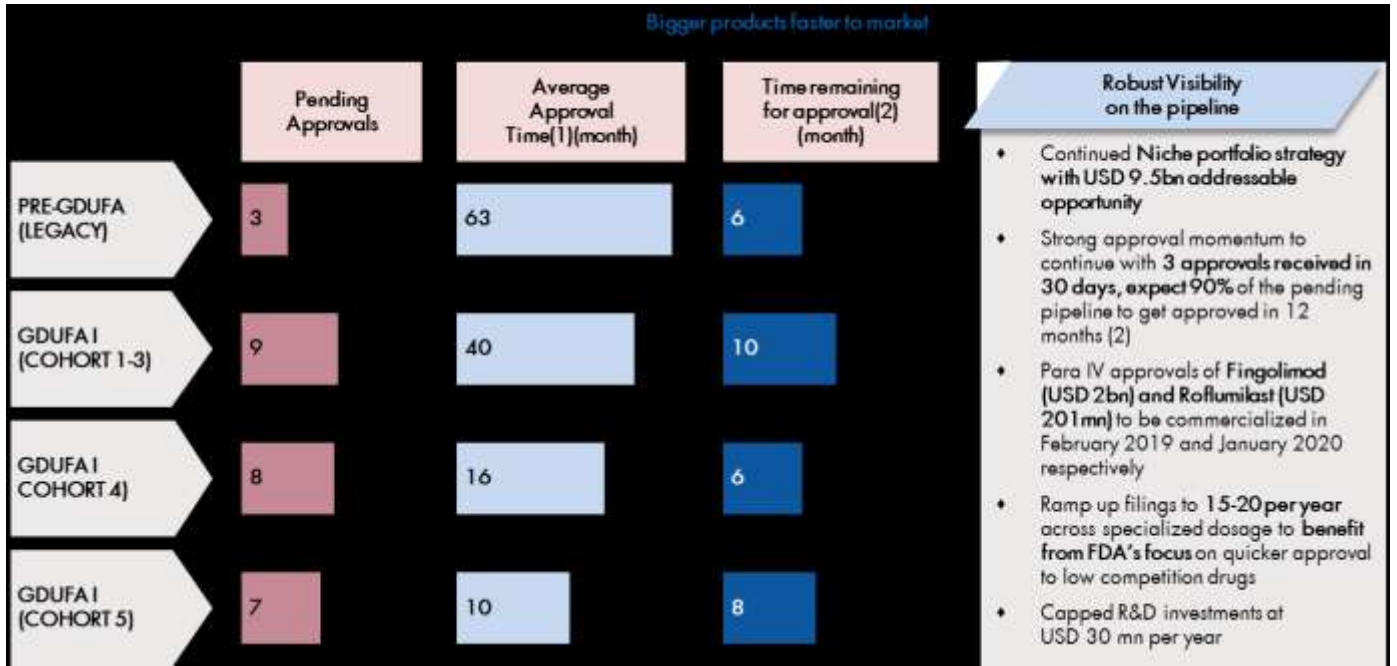
- ◆ **Australia:** Scaled up with full value chain in Australia markets through various acquisitions to grow at a pace faster than the market over the next few years. It is currently ranked #2 by volume and #3 by revenue in Australia, and targets to become the market leader in 3 years. While some pricing headwinds could constrain revenue growth, it would be offset by strong pipeline (incl. new products from Generic Partners) and expanding coverage of over 1,100 pharmacies. 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**



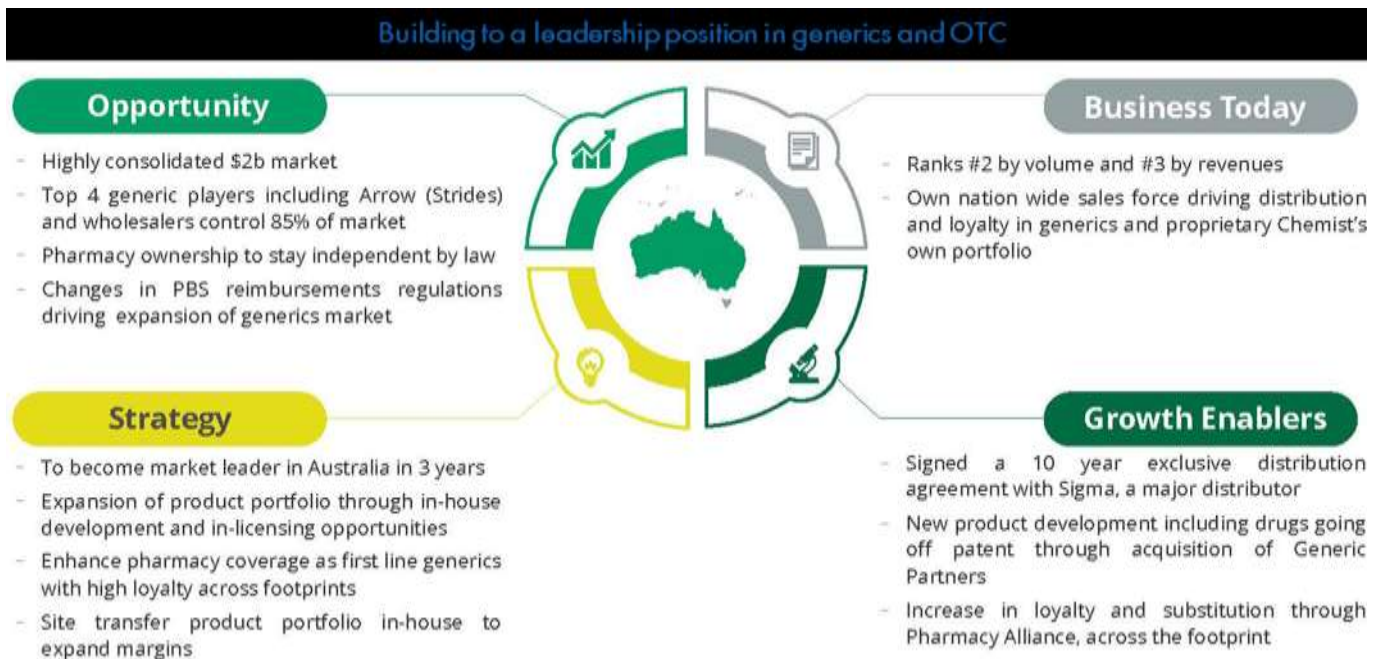
Source: Company

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



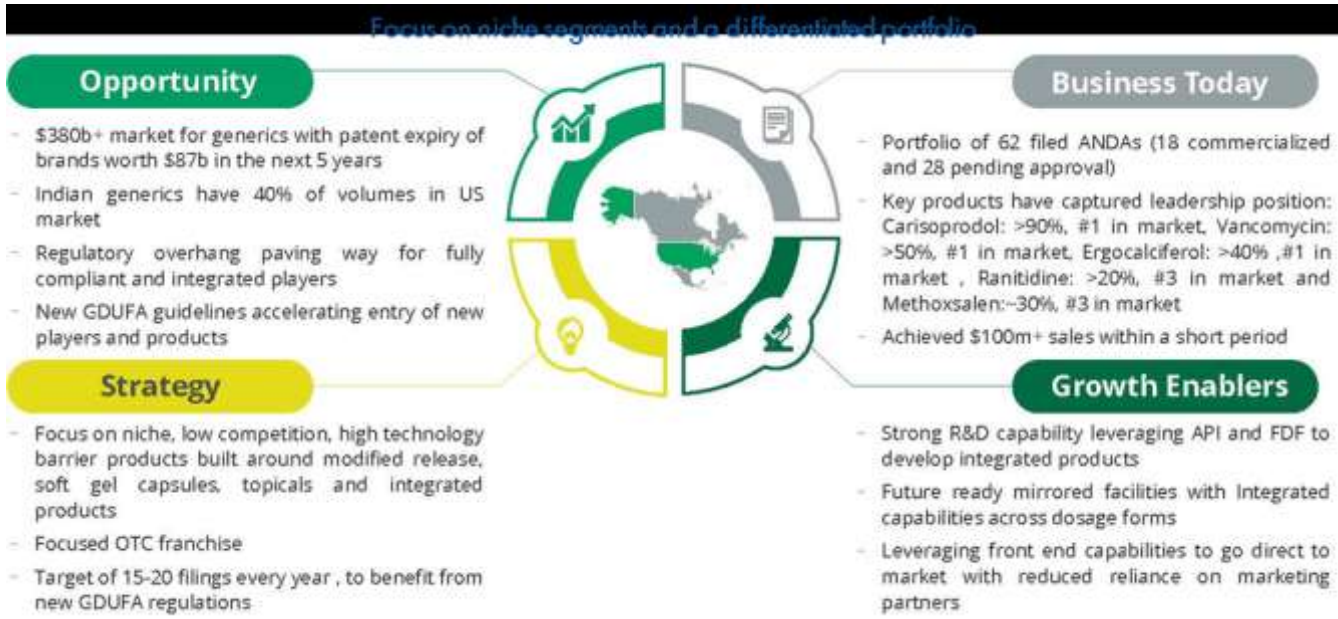
Source: Company

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



Source: Company

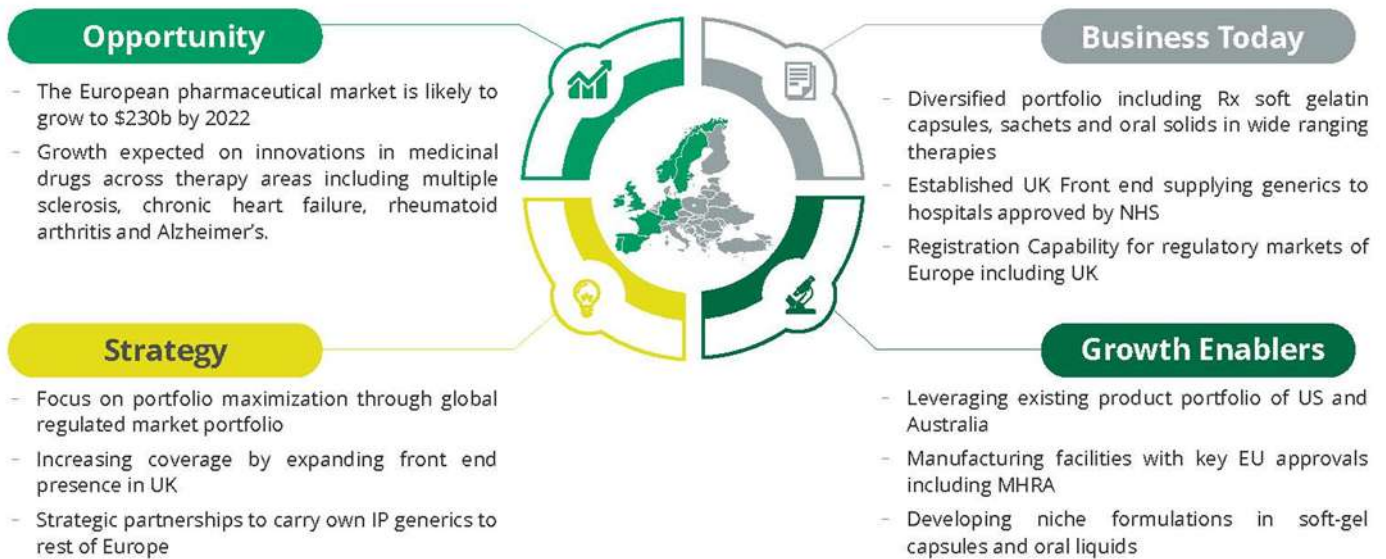
**Exhibit 4: United States – Targets 15-20 filings every year**



Source: Company

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

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

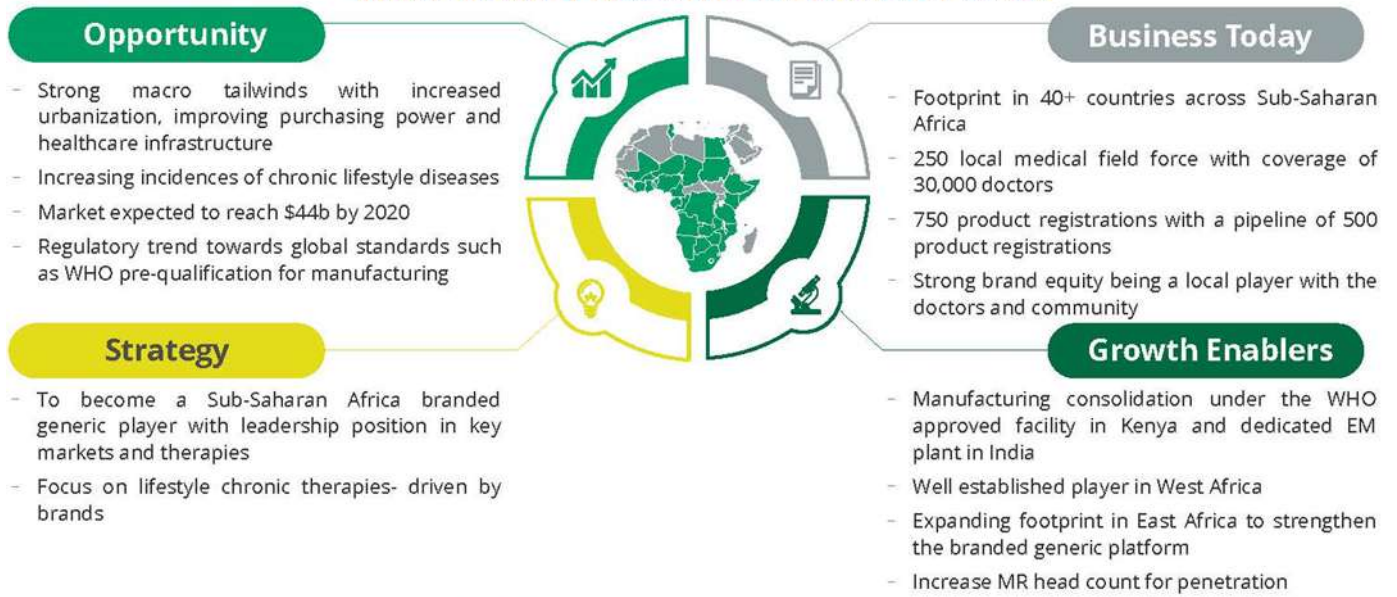


Source: Company



**Exhibit 6: Africa – Focus on lifestyle chronic therapies**

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



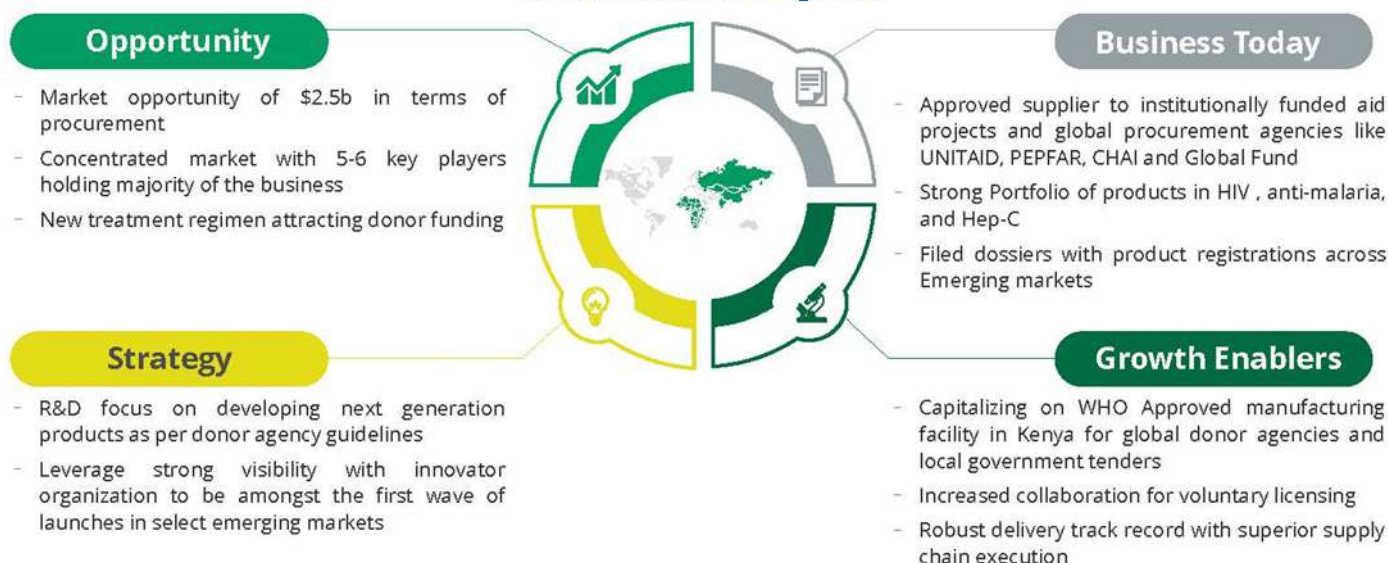
Source: Company

**Exhibit 7: India – Focus on specialty therapies;foraying into high growth OTC segment**

**Gaining Traction with Focus on Select Therapies**



Source: Company

**Exhibit 8: Institutional Business –Capitalizing on Kenya facility for global donor agencies and local government tenders**
**Focus on Backward integration**


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; for 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

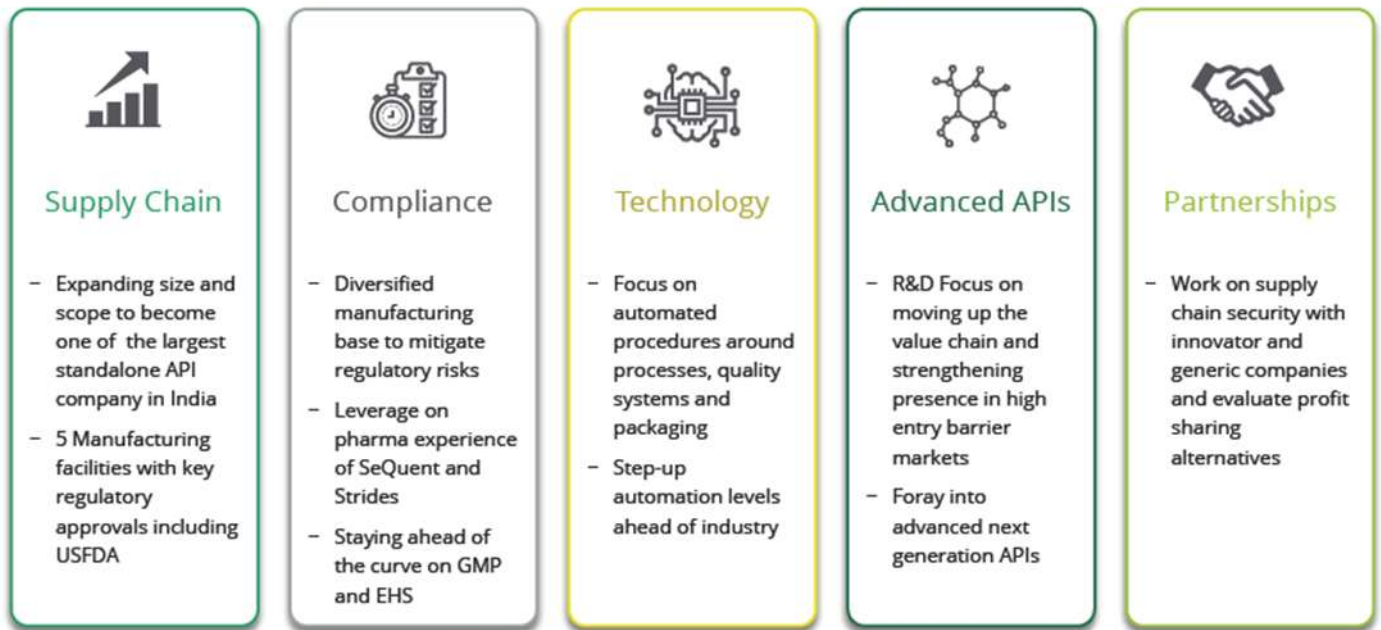
**Exiting Probiotic Business**

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

Source: Company

**Exhibit 10: Demerged API entity –Solara well poised to bridge industry gaps**

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

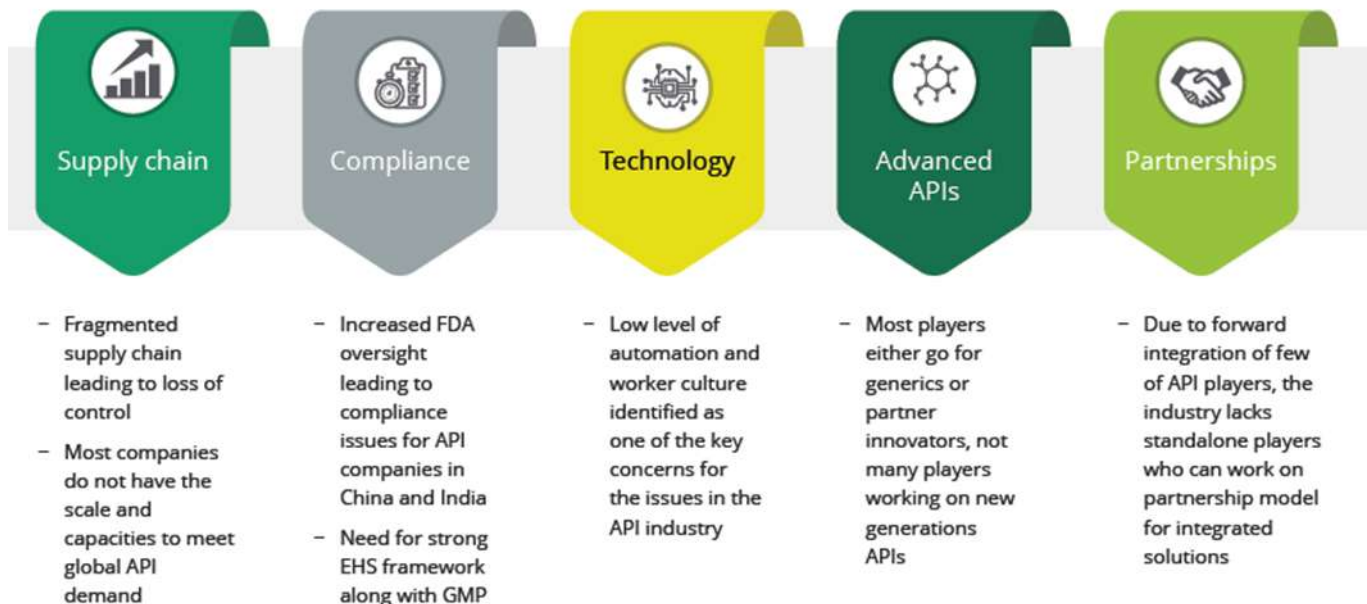


Source: Company

**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



Source: Company

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

Approval date	Brand	Generic	IMS revenue (USD mn)	Existing competition	Mar'16	Jun'16	Sep'16	Dec'16	Mar'17	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
	<b>Australia</b>	<b>Total</b>		<b>19,706</b>	<b>8,240</b>
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
	<b>India</b>	<b>Total</b>		<b>2,131</b>	<b>1,440</b>
			<b>USD mn</b>		
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	738
		<b>Total</b>		<b>23,458</b>	<b>11,611</b>

Source: Company, Axis Capital



**Financial summary (Consolidated)**
**Profit & loss (Rsmn)**

Y/E March	FY16	FY17	FY18E	FY19E
Net sales	28,622	34,834	36,645	40,074
Other operating income	-	-	-	-
<b>Total operating income</b>	<b>28,622</b>	<b>34,834</b>	<b>36,645</b>	<b>40,074</b>
Cost of goods sold	(15,023)	(15,362)	(15,758)	(16,631)
Gross profit	13,599	19,472	20,888	23,443
<i>Gross margin (%)</i>	<i>47.5</i>	<i>55.9</i>	<i>57.0</i>	<i>58.5</i>
Total operating expenses	(9,459)	(13,044)	(13,742)	(15,028)
<b>EBITDA</b>	<b>4,140</b>	<b>6,428</b>	<b>7,146</b>	<b>8,416</b>
<i>EBITDA margin (%)</i>	<i>14.5</i>	<i>18.5</i>	<i>19.5</i>	<i>21.0</i>
Depreciation	(1,313)	(1,872)	(1,628)	(1,676)
<b>EBIT</b>	<b>2,827</b>	<b>4,557</b>	<b>5,518</b>	<b>6,739</b>
Net interest	(1,682)	(2,269)	(1,924)	(1,564)
Other income	921	1,686	1,550	1,595
<b>Profit before tax</b>	<b>2,067</b>	<b>3,973</b>	<b>5,144</b>	<b>6,771</b>
Total taxation	(425)	(470)	(772)	(1,016)
<i>Tax rate (%)</i>	<i>20.5</i>	<i>11.8</i>	<i>15.0</i>	<i>15.0</i>
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
<i>Adj. PAT margin (%)</i>	<i>5.6</i>	<i>10.1</i>	<i>11.9</i>	<i>14.4</i>
Net non-recurring items	(645)	1,020	-	-
Reported net profit	950	4,527	4,376	5,759

**Balance sheet (Rsmn)**

Y/E March	FY16	FY17	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
<b>Total liabilities</b>	<b>62,861</b>	<b>64,901</b>	<b>63,326</b>	<b>62,722</b>
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	7,798	7,511	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
<b>Total assets</b>	<b>62,861</b>	<b>64,901</b>	<b>63,326</b>	<b>62,722</b>

Source: Company, Axis Capital

**Cash flow (Rsmn)**

Y/E March	FY16	FY17	FY18E	FY19E
Profit before tax	2,067	3,973	5,144	6,771
Depreciation & Amortisation	1,313	1,872	1,628	1,676
<i>Chg in working capital</i>	<i>(3,424)</i>	<i>2,371</i>	<i>(1,849)</i>	<i>(1,340)</i>
<b>Cash flow from operations</b>	<b>717</b>	<b>9,282</b>	<b>4,526</b>	<b>6,060</b>
<i>Capital expenditure</i>	<i>(22,950)</i>	<i>(3,330)</i>	<i>(4,000)</i>	<i>(3,500)</i>
<b>Cash flow from investing</b>	<b>(22,284)</b>	<b>(5,914)</b>	<b>(1,205)</b>	<b>1,500</b>
<i>Equity raised/ (repaid)</i>	<i>11,316</i>	<i>1</i>	<i>-</i>	<i>-</i>
<i>Debt raised/ (repaid)</i>	<i>18,917</i>	<i>(2,930)</i>	<i>(5,564)</i>	<i>(6,000)</i>
<i>Dividend paid</i>	<i>436</i>	<i>-</i>	<i>-</i>	<i>-</i>
<b>Cash flow from financing</b>	<b>29,487</b>	<b>(3,414)</b>	<b>(6,296)</b>	<b>(6,732)</b>
Net chg in cash	7,920	(45)	(2,975)	828

**Key ratios**

Y/E March	FY16	FY17	FY18E	FY19E
<b>OPERATIONAL</b>				
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
<b>GROWTH</b>				
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
<b>PERFORMANCE</b>				
RoE (%)	8.4	13.1	15.1	17.3
RoCE (%)	8.9	9.8	11.0	13.2
<b>EFFICIENCY</b>				
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
<b>FINANCIAL STABILITY</b>				
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
<b>VALUATION</b>				
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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