Volume No. 1 Issue No. 24

Torrent Pharmaceuticals Ltd.

June 17, 2015

BSE Code:	500420	NSE Code:	TORNTPHARM	Reuters Code:	TORP.NS	Bloomberg Code:	TRP:IN

Established in 1959, Torrent Pharmaceuticals Ltd (Torrent Pharama), with an annual turnover of over ₹4,700 crore is the flagship company of the Torrent Group. Torrent Pharma ranked 15th (by turnover) in the domestic formulations market with six of its brands among the top 300 brands in India. The company is a leading player in the key chronic segments such as cardiovascular (CVS) and central nervous systems (CNS) in India. The company's international presence spanning over 40 countries with over 1,200 product registrations. The company has three manufacturing facilities at Indrad (Gujarat), Baddi (Himachal Pradesh) and Sikkim. The company's new facility is taking shape at Dahej SEZ in Western India, which will cater to the international markets.

Investment Rationale

Elder's branded formulation portfolio acquisition to boost margin growth

Torrent Pharma's Indian branded formulation business is likely to gain from the favorable environment in the domestic market place. We believe that the acquisition of Elder Pharma's branded portfolio is likely to add new therapies such as neutraceuticals and gynecology and will help Torrent Pharma in filling up gap in product portfolio. We believe the full impact of price hike undertaken in Elder portfolio (in mid-Nov'14) would fully reflect from next quarter, improving revenue as well as profitability growth visibility.

Opportunities from international business to higher upside

The company's international business has been showing phenomenal growth in the recent past. The international operations of the company, which accounts ~55% of sales, have grown at CAGR of 35% YoY during FY09-15, driven by strong growth from US and ROW markets. With strong growth in US market, we expect international generics business continues to be a significant growth driver for the company. While, we expect Brazil to lead the company's expansion in the developed markets as Brazil continues to remain the largest market for the company outside India in branded formulations business. We believe Torrent Pharma's robust product pipeline in existing markets will drive revenue from overseas business, going forward.

Acquisition to fuel its future growth

With focus on acquisition, Torrent Pharma aims to expand its business aggressively both in domestic or international space. After acquiring Elder's branded formulation business, the company has recently inked an agreement to take-over 100% stake in Zyg Pharma, a company engaged in manufacturing various dermatological formulations like creams, ointments, gels, lotions, and solutions.

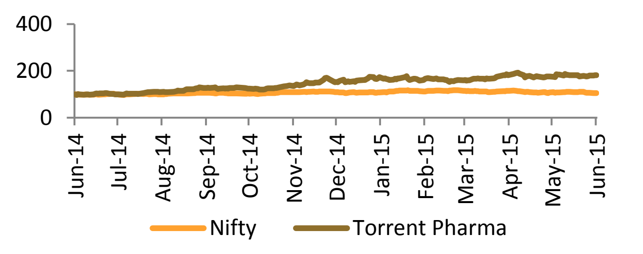
Market Data

Rating	BUY
CMP (₹)	1,297
Target (₹)	1,504
Potential Upside	~16%
Duration	Long Term
Face Value (₹)	5.0
52 week H/L (₹)	1,333.7/659.5
Adj. all time High (₹)	1,333.7
Decline from 52WH (%)	2.7
Rise from 52WL (%)	96.7
Beta	0.4
Mkt. Cap (₹cr)	22,049.0
EV (₹cr)	23,667.0

Fiscal Year Ended

Y/E	FY14A	FY15A	FY16E	FY17E
Revenue (₹cr)	4,184	4,653	5,651	6,668
EBITDA (₹cr)	952	1,020	1,311	1,607
Net Profit (₹cr)	664	751	879	1,157
EPS (₹)	39.1	44.2	51.7	68.1
P/E (x)	33.2	29.4	25.1	19.1
P/BV (x)	11.6	8.9	7.2	5.8
EV/EBITDA (x)	23.1	23.2	18.0	14.4
ROCE (%)	32.9	20.1	23.9	27.5
ROE (%)	34.9	30.1	28.7	30.3

One year Price Chart



Shareholding Pattern	Mar 15	Dec14	Diff.
Promoters	71.2	71.5	(0.3)
FII	12.3	12.0	(0.6)
DII	6.8	6.5	0.2
Others	9.7	9.1	0.6

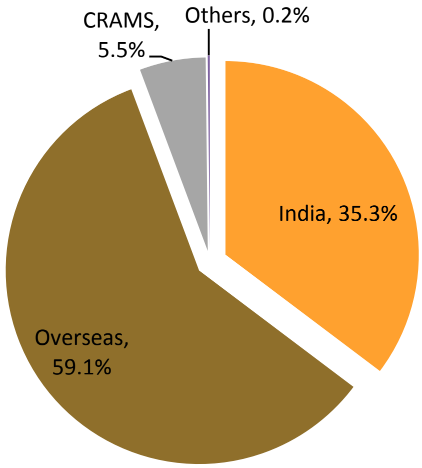
Torrent Pharma: a leading pharmaceutical company

Torrent Pharma has strong presence in domestic market with focus and leadership in CVS and CNS segments. Recent acquisition of Elder's brand in India strengthens its positioning further.

Established in 1959, Torrent Pharma, with an annual turnover of over ₹4,700 crore is the flagship company of the Torrent Group. Torrent Pharma ranked 15th (by turnover) in the domestic formulations market with six of its brands among the top 300 brands in India. Torrent Pharma's competitive advantage stems from its world-class manufacturing facilities, advanced R&D capabilities, extensive domestic network and a widespread global presence. The company is a leading player in the key chronic segments such as cardiovascular (CVS) and central nervous systems (CNS) in India. With strong international presence spanning over 40 countries with over 1200 product registrations, the company has healthy presence in US, UK, Germany, Brazil, Russia, Mexico, Philippines and other major markets.

The company has three world-class manufacturing facilities at Indrad (Gujarat), Baddi (Himachal Pradesh) and Sikkim. The company's new facility is taking shape at Dahej SEZ in Western India, which will cater to the international markets. Thus, presently, Torrent Pharma, with its state of the art manufacturing and research facilities and a global presence, is all poised to carve a niche for itself in the international pharma arena.

Revenue segmentation in FY15



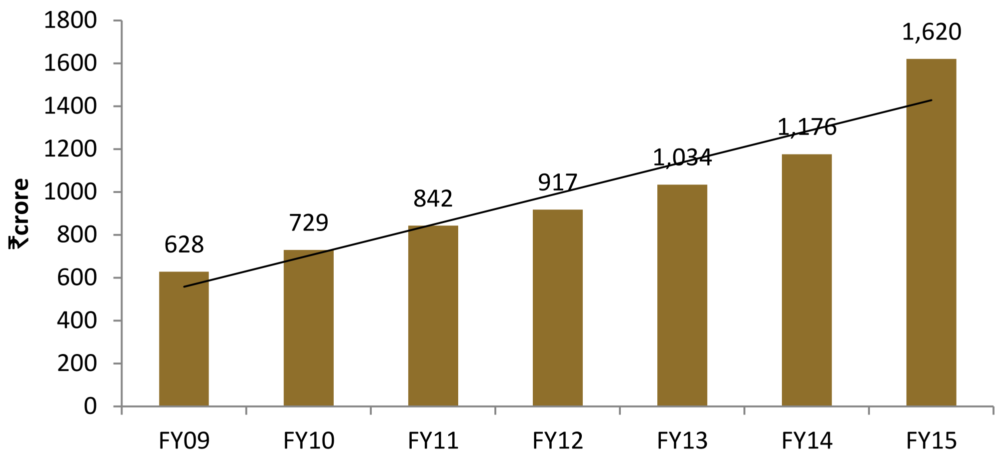
Capitalizing on its market-leading presence in domestic formulation business

The company is to focus on its strategic priorities on driving productivity through brand building in major therapies, expanding portfolio in newly entered segments and accelerating performance in the acute segment.

The Indian formulations segment, which accounts for 35% of the company's total sales, grew at a CAGR of ~17% over FY10-15. According to All India Organisation of Chemists and Druggists (AIOCD), Torrent Pharma outperformed the market, with 27% growth in domestic formulation business as compared to covered market growth of 16% during Q4FY15. While, in FY15, the company's domestic formulation business growth came at 16% as against the covered market growth of 13%. (AIOCD Dataset March 2015). We believe that the company's continued efforts and strategic initiatives post the acquisition of Elder Pharma' branded formulation portfolio will further improve its market share through re-alignment of business units to bring in higher focus on key customer segments.

Torrent is also maintaining leadership position in some of the key chronic therapies of Cardiovascular and Neuro-psychiatry. The company is ranked fourth in both cardiovascular and Neuro-psychiatry therapies in Indian Pharmaceuticals market (IPM). With a market share of 2.34%, the company ranked 15th by turnover in the domestic market as per AIOCD (MAT April 2015). The company has strong presence in chronic segment as 64% of revenue of the company is from chronic segment as compared to 27% of IPM, which shows that the company is well poised to grab the shifting chronic market. The company is to focus on its strategic priorities on driving productivity through brand building in major therapies, expanding portfolio in newly entered segments and accelerating performance in the acute segment.

Domestic formulation revenue grew at a CAGR of ~17% during FY09-15



Garnered significant strength in the Brazilian and US market

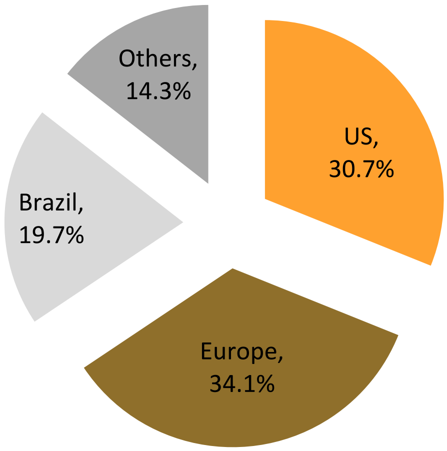
International generic opportunity continues to be growth engine for the company. On the back of strong product pipeline, low R&D, and manufacturing and good market reach, the company is well positioned to capitalize on these growth opportunities. The company's overseas business, which accounts 59% of the total sales, is seeing strong growth traction, especially from US, the largest pharmaceutical market with a market size of ~$310 billion.

With the launch of 8-10 low competition products in FY16E and 15-18 product fillings in next two years, we expect strong traction in US sales at a CAGR of 33% over FY15-17E.

Torrent Pharma's Brazilian pharmaceutical market started showing signs of recovery with 14% YoY growth in revenue from the company's Brazil operation. The company expects volumes to increase going forward. We expect Brazilian business to post ~15% revenue growth, on the back of new product launches and re-alignment of the existing field-force. The company plans generic products for the Brazilian market and expects to launch 4-5 products in the near term.

In US, the company has healthy product pipeline, with 48 ANDA approvals in FY15 and its pipeline consists of 19 pending approvals and 40 products under development. Other export markets like Europe and ROW are growing at a steady pace. The pipeline for the US market also includes the generic launches of blockbuster drug Abilify (an anti-psychotic medication having brand sales of $6.5 billion), which is currently being litigated by four players including Torrent Pharma. We believe that the launch of gAbilify and awaiting approval for gNexium and gDetrol to enhance revenue visibility from US business. Further, with the launch of 8-10 low competition products in FY16E and 15-18 product fillings in next two years, we expect strong traction in US sales to grow at a CAGR of 33% over FY15-17E.

Export revenue mix in FY15



Elder's branded formulation portfolio acquisition to boost margin growth

In Q1FY15, Torrent Pharma acquired branded formulation business of Elder Pharmaceuticals in India and Nepal. The branded domestic formulation business of Elder comprises a portfolio of over 30 brands. We believe that the acquisition of Elder Pharma's branded portfolio is likely to add new therapies such as neutraceuticals and gynecology and will help Torrent Pharma in filling up gap in product portfolio. We believe the full impact of price hike undertaken in Elder portfolio (in mid-Nov'14) would fully reflect from next quarter, improving revenue as well as profitability growth visibility.

Acquisition to cash accretive from FY16E onwards

With the above mentioned acquisition, Torrent's market share in IPM will improve from 2.3% to 2.7% in FY16E and so will the ranking from 15 to 12. We perceive strong scale up potential with leveraging of key brands of Elder's specialty portfolio such as Shelcal, Chymoral, Carnisure to Torrent's existing portfolio. It also renders deeper access to tier II-IV markets with 1,100 market representatives and adds distribution network of 2,900 stockiest to its existing base of ~1,700, thereby enabling better penetration in North and West India.

The management of the company expects that Torrent-Elder deal to add value to company's EPS from third year onwards and cash earnings-accretive in the second year from the closure of the deal onwards.

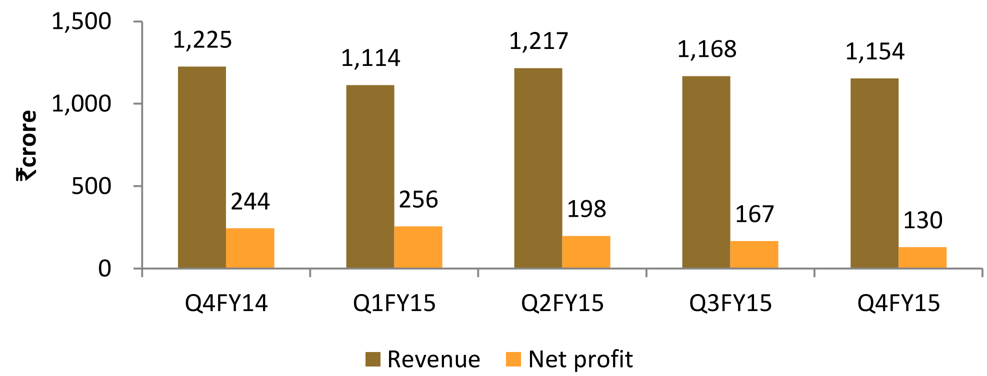
The company funded this ₹2,000 crore acquisition with cash and internal accruals and borrowings. Post-acquisition, we expect the company's debt to equity to increase 1.2 times. Moreover, this would also constraint its ability to pursue aggressive capital expansion. As a result, interest costs will increase. The acquired asset has a strong profit margin of 35%, which will lift Torrent's operating profit. The incremental gains, however, may not be sufficient to service the debt and amortization of the acquired assets' goodwill. But the management expects that the Torrent-Elder deal to add value to the company's EPS from the third year onwards and cash earnings-accretive in the second year from the closure of the deal onwards. To achieve the target, sales and profits at the acquired brands need to be scaled up immensely.

Subdued Q4FY15 performance, however, FY15 performance continued to remain firm

The company's EBITDA showed de-growth of 54% YoY to ₹160 crore in Q4FY15 as compared to ₹350 crore in Q4FY14 due to higher employee costs and other expenses.

Torrent Pharma reported muted performance in Q4FY15, with revenue declining by 6% YoY to ₹1,154 crore as compared to ₹1,225 crore, in the corresponding quarter a year-ago as 37% YoY growth in revenue from India was offset by 23% YoY decline in revenue from export market. In terms of regional performance, Brazil reported strong growth of 33% YoY in constant currency (cc) and revenue from Europe & ROW grew by 5% YoY and 3% YoY, respectively. While revenue from US business declined by 44% YoY. The company's EBITDA showed de-growth of 54% YoY to ₹160 crore in Q4FY15 as compared to ₹350 crore in Q4FY14 due to higher employee costs and other expenses. Consequently, EBITDA margin of the company contracted to 14.3% in Q4FY15 from 29.0% in Q4FY14. The sharp rise in other income to ₹100 crore as compared to ₹10 crore on account of forex gains was offset by higher finance cost. As a result, the net profit of the company plunged by 46.7% YoY to ₹130 crore in Q4FY15 from ₹244 crore in Q4FY14.

Quarterly performance trend



We believe that improved domestic business post Elder's acquisitions, robust product pipeline from US business and recovery in business from Brazil is expected to drive profitability in the coming years.

In FY15, the company's net sales rose by 11% YoY to ₹4,653 crore from ₹4,184 crore in previous year, on account of 28.7% YoY revenue growth from domestic business. The company's domestic business grew strongly during the year mainly on account of 37.8% YoY revenue growth from branded formulation segment. In line with this, EBITDA rose 7.1% to ₹1,020 crore in FY15 from ₹952 crore in previous year. However, EBITDA margin declined by 83 bps to 21.9% in FY15, due to higher operating expenses. Despite of higher depreciation & finance charges, the company managed to post 13.1% YoY growth in its consolidated net profit to ₹751 crore in FY15. We believe that improved domestic business post Elder's acquisitions, robust product pipeline from US business and recovery in business from Brazil is expected to drive profitability in the coming years.

More acquisitions & new alliance to expand business

In line with the strategy to expand its business, Torrent Pharma remained focus on acquisitions to fuel its future growth. Recently, Torrent Pharma inked a deal to acquire a 100% stake in Zyg Pharma Pvt Ltd, a part of the Mumbai-based Encore Group. Zyg Pharma engaged in manufacturing dermatological formulations. This acquisition will help Torrent Pharma to strengthen its position in the niche dermatological segment, especially in the developed markets like US and Europe. Torrent Pharma has also entered into an exclusive licensing agreement with Reliance Life Sciences for marketing three biosimilars in India – Rituximab, Adalimumab and Cetuximab.

Balance Sheet (Consolidated)

Y/E (₹cr)	FY14A	FY15A	FY16E	FY17E
Share Capital	85	85	85	85
Reserve and surplus	1,818	2,406	2,983	3,729
Net Worth	**1,903**	**2,491**	**3,068**	**3,814**
Long-term borrowings	745	2,185	1,985	1,588
Deferred tax liabilities	47	189	189	189
Other long term liabilities	10	8	9	10
Long-term provisions	190	207	228	250
Current Liabilities	2,174	2,831	3,256	3,744
Total equity & liabilities	**5,069.0**	**7,911.0**	**8,734.2**	**9,595.1**
Fixed assets	1,409	3,495	3,665	3,774
Deferred tax assets	66	84	84	84
Non-current investments	0	16	16	16
Long-term loans & advances	129	207	248	298
Other assets	61	50	53	55
Current Assets	3,404	4,059	4,668	5,368
Total Assets	**5,069.0**	**7,911.0**	**8,734.2**	**9,595.1**

Profit & Loss Account (Consolidated)

Y/E (₹cr)	FY14A	FY15A	FY16E	FY17E
Revenue	**4,184**	**4,653**	**5,651**	**6,668**
Expenses	3,232	3,633	4,340	5,062
EBITDA	**952**	**1,020**	**1,311**	**1,607**
Other Income	38	286	194	210
Depreciation	87	191	220	253
EBIT	**903**	**1,115**	**1,286**	**1,564**
Interest	59	175	159	79
Profit Before Tax	**844**	**940**	**1,127**	**1,485**
Tax	180	189	248	327
Minority interest	0	0	0	0
Net Profit	664	751	879	1,157

Key Ratios (Consolidated)

Y/E	FY14A	FY15A	FY16E	FY17E
EBITDA Margin (%)	22.8	21.9	23.2	24.1
EBIT Margin (%)	21.6	24.0	22.8	23.5
NPM (%)	15.9	16.1	15.6	17.4
ROCE (%)	32.9	20.1	23.9	27.5
ROE (%)	34.9	30.1	28.7	30.3
EPS (₹)	39.1	44.2	51.7	68.1
P/E (x)	33.2	29.4	25.1	19.1
BVPS (₹)	111.9	146.5	180.5	224.4
P/BVPS (x)	11.6	8.9	7.2	5.8
EV/Operating Income (x)	5.3	5.1	4.2	3.5
EV/EBITDA (x)	23.1	23.2	18.0	14.4

Valuation and view

With new product launches and improved productivity, better growth traction in Brazil coupled with recovery in domestic formulations business beginning H1FY16E, the company sees increase in volume. We believe that strong product pipeline and growing domestic as well as international business make the company an attractive investment opportunity for the long-term investors. Further, the company's acquisition of Elder's domestic formulation business to add more brands to its existing portfolio, which is turn, would further enhance its growth visibility.

At a current market price (CMP) of ₹1,297, the stock trades at an EV/EBITDA of 18x FY16E and 14.4x FY17E. We recommend 'BUY' with a target price of ₹1,504, which implies potential upside of ~16% to the CMP from long term perspective.

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Contact Us:

Funds India
H.M Center, Second Floor, 29,
Nungambakkam High Road, Nungambakkam,
Chennai - 600 034.
T: +91 7667 166 166
Email: contact@fundsindia.com