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Strides Shasun Ltd.

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Shasun and Arrow acquisition to drive the growth

Strides Shasun Limited (Strides) is a fully integrated global pharmaceutical company with business interests in developing niche and complex pharmaceutical products. With its presence in more than 85 countries, Strides is engaged in the manufacture of pharmaceutical dosage forms in branded as well generic categories. The company manufactures capsules, soft gelatin capsules, parenterals and semi–solids.

Investment Rationale

Regulated markets business to witness traction: In FY16, the growth in North American markets was driven by front-end operations while base portfolio delivered a strong performance with healthy market share for key products such as Vancomycin, Ergocalciferol, Methoxsalen, Calcitriol. Importantly, Strides has more than 120 products in the pipeline with a focus on Softgels, derma and extended release. The company expects to get 7-8 ANDA approvals in FY17E with an addressable market size of USD1bn (including Lovaza). Interestingly, approval for Lovaza (market size at USD 700 mn) is expected in FY17E, which will contribute significantly to the overall revenues due to limited competition in this space. Hence, we expect regulated markets to grow at a CAGR of 46% over FY16-18E primarily driven by Shasun's consolidation.

Africa to bolster Emerging markets revenue: Strides witnessed improvement in African revenues on account of two factors: 1) higher growth in branded formulations during FY16 and 2) disciplined approach followed to counter the credit risks in a volatile operating environment. Branded business continues to post healthy growth while demand for generic products got impacted as few countries in Africa faced volatile currency environment. Going forward, African business is expected to grow consistently, driven by new product launches, enhanced sales force & local manufacturing base. Besides, it has comprehensive portfolio of product registrations across these markets and a robust pipeline of ~300 products that will be launched over next few years.

Shasun acquisition to aid growth ahead: Shasun merger provides vertical integration benefits with better cost synergies and scale to strengthen institutional and US business. Before acquiring Shasun, Strides used to outsource API from third parties. However, consolidation of Shasun would help in de-risking the US product pipeline & also provide backward integration benefits for its regulated and institutional businesses. Moreover, Shasun and Arrow's acquisitions will diversify company's revenue mix with US and Africa being the key growth drivers.

Valuation: We expect Strides revenue and PAT to grow at a CAGR of 26% & 59% respectively over FY16-18E. Further, EBITDA margins are expected to improve by 570bps on account of Shasun's backward integration, key launches in FY17 coupled with incremental growth from recent acquisitions. Hence, we initiate Strides with BUY rating with a TP of Rs. 1,255 at 18x FY18E earnings.

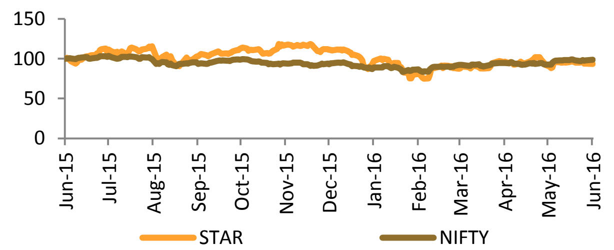
Market Data

Rating	**BUY**
CMP (Rs.)	1,093
Target (Rs.)	1,255
Potential Upside	15%
Duration	Long Term
Face Value (Rs.)	10
52 week H/L (Rs.)	1,412/848
Adj. all time High (Rs.)	1412
Decline from 52WH (%)	22.6
Rise from 52WL (%)	28.9
Beta	1.1
Mkt. Cap (Rs.Cr)	9,769

Fiscal Year Ended

Y/E	FY15	FY16	FY17E	FY18E
Net sales (Rs.Cr)	1,196	3,156	4,345	4,996
Net profit (Rs.Cr)	9	246	435	623
EPS (Rs.)	1.5	27.5	48.7	69.7
P/E (x)	728.8	39.7	22.4	15.7
P/BV (x)	5.7	3.4	3.0	2.5
ROE (%)	0.8	12.3	14.2	17.6

One year Price Chart



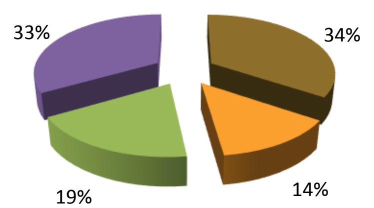
Shareholding Pattern	Mar-16	Dec-15	Chg.
Promoters (%)	31.1	31.0	0.1
Public (%)	68.9	69.0	0.1

Strides is a fully integrated global pharmaceutical company with business interests in developing niche and complex pharmaceutical products

Company overview

Strides Shasun Limited (Strides) is a fully integrated global pharmaceutical company with business interests in developing niche and complex pharmaceutical products. With its presence in more than 85 countries, Strides is engaged in the manufacture of pharmaceutical dosage forms in branded as well generic categories. The company manufactures capsules, soft gelatin capsules, parenterals and semi–solids. The Company also has a strong commercial platform to market its pharmaceutical products globally through front-end presence. The pharma generics business focuses on the key regulated markets of US, UK, Euro and Australia. Branded generics business caters to the emerging markets of India and Africa. Institutional business represents Company's business with global funding agencies for Anti-retroviral and Anti-malaria medicines.

Revenue break-up



Source: Company, In-house research

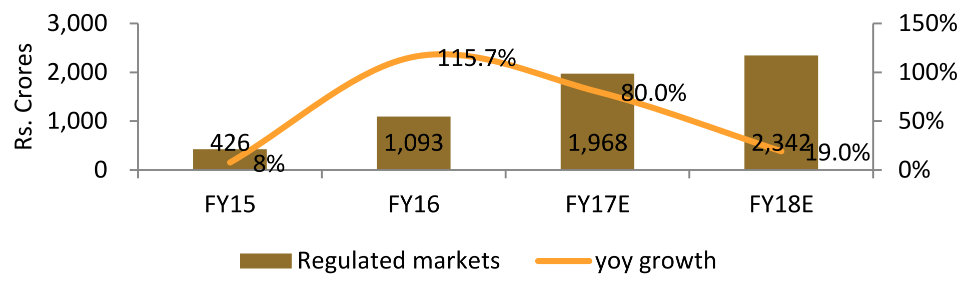
The company expects to get 7-8 ANDA approvals in FY17E with an addressable market size of USD1bn (including Lovaza).

US to drive the regulated markets growth at CAGR of 46% over FY16-18E

Post divestment of Agila's business in 2013 (injectable segment), Strides became a small player in US with FY15 sales of just USD 19 mn. However, it has started its own front-end in the US and built a new R&D centre in Bangalore. In addition, the Shasun acquisition has provided Strides with a large complementary product pipeline. Strides is focusing on small off-patent products and derma in the complex generics.

Importantly, regulated markets contributed 34% to total revenues in FY16. In FY16, the growth in North American markets was driven by front-end operations while base portfolio delivered a strong performance with healthy market share for key products such as Vancomycin, Ergocalciferol, Methoxsalen, Calcitriol. Further, Strides has more than 120 products in the pipeline with a focus on Softgels, derma and extended release. The company expects to get 7-8 ANDA approvals in FY17E with an addressable market size of USD1 bn (including Lovaza). Interestingly, approval for Lovaza (market size at USD 700 mn) is expected in FY17E, which will contribute significantly to the overall revenues due to limited competition in this space. With the merger of Shasun, Strides revenue streams got geographically diversified across regulated markets in Europe and US. Strides is expected to file 20-25 ANDAs in FY17 & currently it has 29 ANDAs pending for approval. Hence, we expect regulated markets to grow at a CAGR of 46% over FY16-18E primarily driven by Shasun's consolidation.

Regulated markets to grow at a CAGR of 46%% during FY16-18E



Source: Company, In-house research

Africa to drive emerging markets growth at 19% CAGR over FY16-18E

African business is expected to grow consistently, driven by new product launches, enhanced sales force & local manufacturing base.

Strides has been one of the few Indian companies which has focused on African markets. While it has generic presence in 27 countries, it has branded presence in just 12 of these countries. Entered Africa in 1990 via the generic market, Strides started by supplying to partners and expanded the branded business to Nigeria, Ghana and other new geographies. It has six own manufacturing plants in Africa and is planning to set up more plants going ahead.

Strides witnessed improvement in African revenues on account of two factors: 1) higher growth in branded formulations during FY16 and 2) disciplined approach followed to counter the credit risks in a volatile operating environment. Branded business continues to post healthy growth while demand for generic products got impacted as few countries in Africa faced volatile currency environment. Going forward, African business is expected to grow consistently, driven by new product launches, enhanced sales force & local manufacturing base. Besides, it has comprehensive portfolio of product registrations across these markets and a robust pipeline of ~300 products that will be launched over next few years. Growth from generics will be faster than the branded space over FY16-20, driven by new product launches & increasing MR head-count (increasing field force from 220 to 1,000).

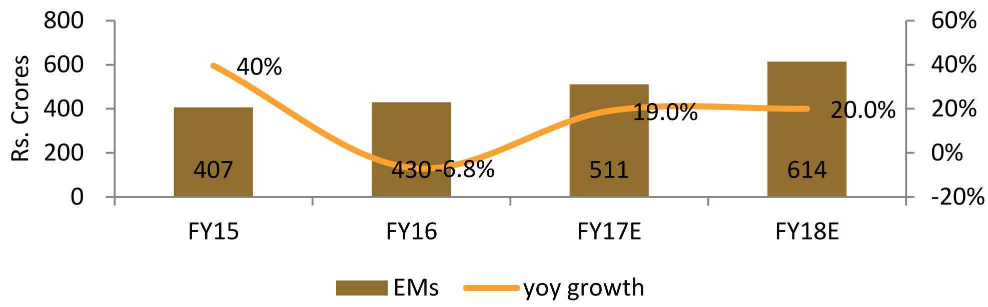
India: Inorganic growth to provide incremental revenues

The recent acquisitions of two CNS divisions (Rs92cr sales) of Sun Pharma and the J&J portfolio will provide incremental growth to the Indian business of Strides.

Strides entered the Indian market through the Grandix acquisition in 2007, which provided Strides with the ReNerve brand. In 2014, Strides acquired brand Raricap (women's health portfolio) and the Indian Branded Generic Business of Bafna Pharmaceuticals to strengthen domestic brands business, which now has a pan-India reach. The recent acquisitions of two CNS divisions (Rs92cr sales) of Sun Pharma and the J&J portfolio will provide incremental growth to the Indian business of Strides. EMs business now has a strong product portfolio and a well-integrated field force which will provide levers to India's growth story. The company collaborated with Gilead Sciences Inc to produce generic sofosbuvir for chronic Hepatitis C. The collaboration enabled it to distribute medicines to 91 developing countries and it is one among the seven pharmaceutical companies in India (launched a generic drug Sofosbuvir in India, under the brand name Virso), who are licensed by Gilead Sciences Inc.

The company's investment in new markets of Russia, CIS and South East Asia is going to build a strong branded generics platform in the growing pharmaceuticals markets globally. We expect Strides EMs business to grow at a CAGR of 19% over FY16-18E on account of scale up in revenues from acquisitions coupled with the continuous traction in branded generics in Africa.

Emerging Markets revenue growth FY16-18E



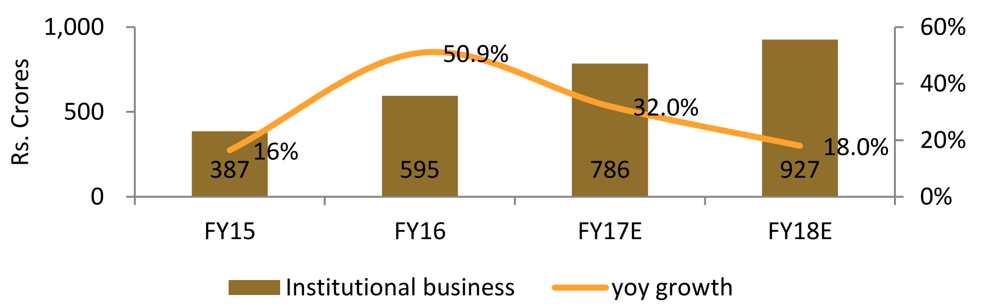
Institutional business: Shasun acquisition to provide backward integration

The company develops and manufactures antiretroviral and antimalarial medicines to institutionally-funded projects.

Institutional business contributed 19% to overall revenue in FY16. The company develops and manufactures antiretroviral and antimalarial medicines to institutionally-funded projects and Global Procurement Agencies, such as UNITAID, Global Drug Facility, PEPFAR and Clinton Foundation. It has multiple qualified WHO and USFDA sites for manufacturing ARV and antimalarial drugs. Currently it is working in collaboration with Medicines for Malaria Venture (MMV) for the development of rectal artesunate for pre-referral treatment of children with severe malaria. It has already signed a sub-licensing agreement with the Medicines Patent Pool (MPP) to develop Dolutegravir (DTG) for treatment of HIV in developing countries. Further, it has tied up with Gilead Sciences for development and distribution of Tenofovir Alafenamide (TAF) in developing economies.

Increased off take in ARV segment and strong supply chain execution for higher volumes in Anti-Malarial's helped to deliver paramount performance in FY16. Moreover, Strides gets access to Shasun's USFDA/WHO-approved finished dosage and API plant (one finished dosage, two API, one CRAMS) which would help it to scale operations and would see better EBITDA margin.

Institutional business to grow at CAGR of 25% during FY16-18E



Source: Company, In-house research

PSAI: APIs captive consumption to increase due to front end expansion

APIs to grow at CAGR of 3% as complex natures of products are increasing towards captive consumption for formulations.

PSAI (Pharmaceutical Services and Active Ingredients) business contributed 33% to overall revenue in FY16 due to Shasun's acquisition. The company intends to use this division for backward integration and defocus on external sales. It has strong API manufacturing capability with 3 USFDA manufacturing facilities in India and UK. The company has aligned R&D function for API and formulations to ensure smooth finishing of backward integration plan for its key products across markets. In FY16, it has filed 5 new DMF's including 3 filed for captive use in line with formulations strategy and rationalized API portfolio for commodity products with focus on delivering higher margins. We expect APIs to grow at CAGR of 3% as complex natures of products are increasing towards captive consumption for formulations.

Key Risks:

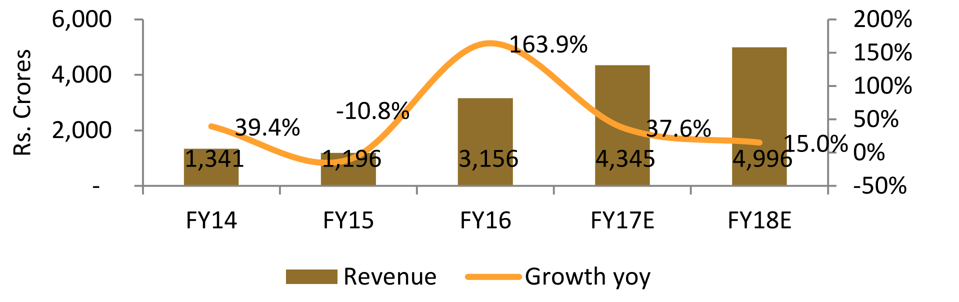
- Delay in key ANDA approvals from USFDA.
- Any adverse movement of global currencies vs INR
- USFDA scrutiny against the company's manufacturing plants regarding cGMP practices.

Financials

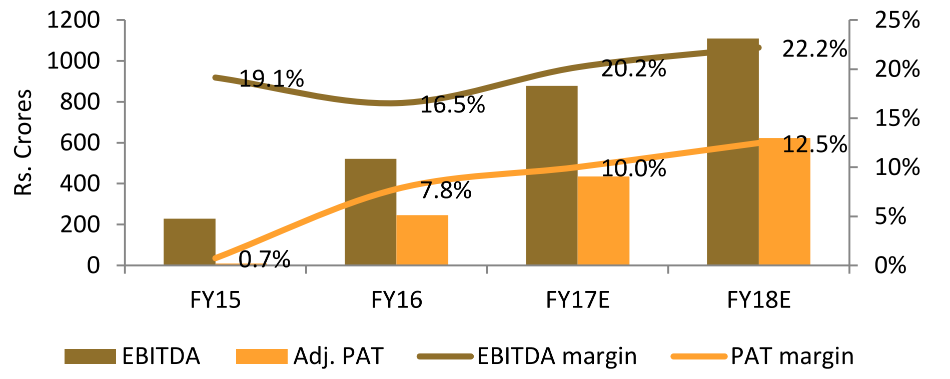
Revenue to grow at CAGR of 26% with EBITDA margin expansion of 570bps

We expect Strides' revenue to grow at a CAGR of 26%, driven by scale up of revenues due to multiple acquisitions (Shasun, Aspen's drug portfolio i.e. Arrow) coupled with new launches and. Hence, we expect 570bps improvements in EBITDA margin over FY16-18E led by API's integration & shift in mix of product portfolio.

Revenue to grow at a CAGR of 26% FY16-18E



EBITDA & PAT margin to improve by 570bps and 470bps respectively

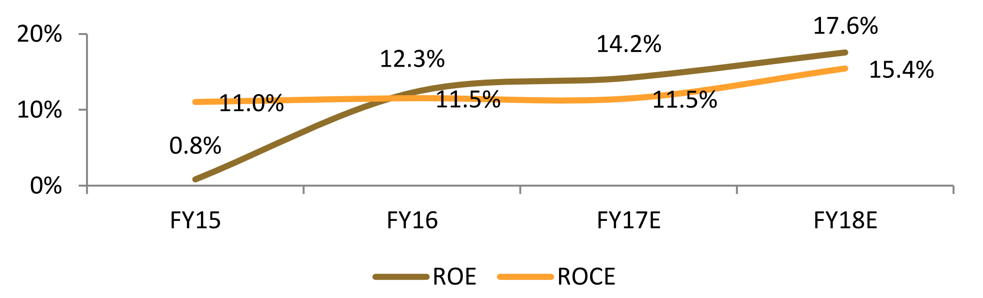


Source: Company, In-house research

Return ratios to improve significantly

We expect Strides' return ratios to improve further on account of healthy profitability coupled with strong revenue growth. While ROE is likely to improve from 12.3% in FY16 to 17.6% in FY18E, ROCE is projected to increase from 11.5% in FY16 to 15.4% in FY18E.

Return ratios on an uptrend



Source: Company, In-house research

Profit & Loss Account (Consolidated)

Y/E (Rs. Cr)	FY15	FY16	FY17E	FY18E
Total operating Income	**1,196**	**3,156**	**4,345**	**4,996**
Raw Material cost	560	1,529	2,129	2,348
Employee cost	172	499	687	790
Other operating expenses	234	607	652	749
EBITDA	**229**	**521**	**877**	**1,109**
Depreciation	64	157	207	217
EBIT	**165**	**364**	**671**	**892**
Other Income	39	121	25	25
Interest cost	47	180	171	157
Profit before tax	**156**	**305**	**524**	**760**
Tax	148	72	89	137
Profit after tax	**8**	**233**	**435**	**623**
Minority Interests	(1)	(13)	-	-
P/L from Associates	-	-	-	-
Adjusted PAT	**9**	**246**	**435**	**623**
E/o income / (Expense)	836	(37)	-	-
Reported PAT	**845**	**209**	**435**	**623**

Balance Sheet (Consolidated)

Y/E (Rs. Cr)	FY15	FY16	FY17E	FY18E
Paid up capital	60	89	89	89
Reserves and Surplus	1,085	2,774	3,167	3,749
Net worth	1,145	2,863	3,257	3,838
Minority interest	19	43	43	43
Total Debt	892	3,447	2,447	2,247
Other non-current liabilities	35	31	35	38
Total Liabilities	**2,090**	**6,384**	**5,781**	**6,166**
Total fixed assets	590	3,273	3,391	3,374
Capital WIP	146	175	50	50
Goodwill	137	177	177	177
Investments	630	1,304	104	104
Net Current assets	473	1,149	1,720	2,086
Deferred tax assets (net)	5	(15)	(15)	(15)
Other non-current assets	110	322	354	390
Total Assets	**2,090**	**6,384**	**5,781**	**6,166**

Cash Flow Statement (Consolidated)

Y/E (Rs. Cr)	FY15	FY16	FY17E	FY18E
Pretax profit	992	268	524	760
Depreciation	64	157	207	217
Chg. in Working Capital	(96)	(708)	(278)	(224)
Others	(821)	59	146	132
Tax paid	(56)	(72)	(89)	(137)
Cash flow from operating activities	**83**	**(295)**	**510**	**748**
Capital expenditure	(242)	(2,869)	(200)	(200)
Chg. in investments	400	(674)	1,200	-
Other investing cashflow	(106)	121	25	25
Cash flow from investing activities	**52**	**(3,422)**	**1,025**	**(175)**
Equity raised/(repaid)	3	1,515	-	-
Debt raised/(repaid)	321	2,555	(1,000)	(200)
Dividend paid	(707)	(42)	(42)	(42)
Other financing activities	(38)	(180)	(171)	(157)
Cash flow from financing activities	**(421)**	**3,848**	**(1,213)**	**(399)**
Net chg in cash	(286)	131	322	174

Key Ratios (Consolidated)

Y/E	FY15	FY16	FY17E	FY18E
Growth (%)				
Net Sales	(10.8)	163.9	37.6	15.0
EBITDA	2.4	127.8	68.3	26.4
Net profit	(104.3)	2,648.9	77.1	43.2
Margin (%)				
EBITDA	19.1	16.5	20.2	22.2
EBIT	13.8	11.5	15.4	17.9
NPM	0.7	7.8	10.0	12.5
Return Ratios (%)				
RoE	0.8	12.3	14.2	17.6
RoCE	11.0	11.5	11.5	15.4
Per share data (Rs.)				
EPS	1.5	27.5	48.7	69.7
DPS	107.9	4.0	4.0	4.0
Valuation(x)				
P/E	728.8	39.7	22.4	15.7
EV/EBITDA	31.8	24.8	13.2	10.1
EV/Net Sales	6.1	4.1	2.7	2.3
P/B	5.7	3.4	3.0	2.5
Turnover Ratios (x)				
Net Sales/GFA	1.3	1.3	1.1	1.2
Sales/Total Assets	0.5	0.6	0.6	0.7

Rating Criteria

Large Cap.	Return	Mid/Small Cap.	Return
Buy	More than equal to 10%	**Buy**	More than equal to 15%
Hold	Upside or downside is less than 10%	**Accumulate***	Upside between 10% & 15%
Reduce	Less than equal to -10%	**Hold**	Between 0% & 10%
		Reduce/sell	Less than 0%

***** To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.

***** Strides Shasun is a mid-cap company

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