

Strides Arcolab

Inline 4Q, recent acquisitions to deepen asset growth

Strides reported in-line 4QFY15 adjusting for one-time expenses. We remain optimistic on company's business prospects in India, Africa and the US. Besides, its merger with Shasun and integration of Arrow Pharma will help create significant value over medium term as operational synergies play out. We factor in the recent acquisition and increase EPS by 15%/24% for FY16/17E, respectively as the deal is accretive from 1st year. We maintain BUY with a revised Target Price of Rs1,565 (Rs1,306 earlier).

Result snapshot

According to disclosures, Strides' reported consolidated revenues of Rs3.4bn (flat yoy, adjusted for one-time sales-growth of 18%, in-line with our estimates), EBITDA margins at 21.8% (expanded 420bps yoy and 170bps qoq) was aided by better product mix. PAT of Rs345mn (we saw Rs494mn) was lower than our expectations impacted by change in accounting policies (impact of Rs87mn) and merger related expense of Rs16mn.

Geography-wise performance

Institutional business remains lumpy in nature, declining by 23.4% qoq led by lower order inflows for Arthemether Lumefantrine in Africa. Regulated markets pepped up the growth momentum (up 20% qoq) on the back of 5 new launches in FY15 under Strides' own label. Emerging markets also performed in-line (up 24.8% qoq) boosted by branded business in Africa, increasing contribution of Raricap in India and improved productivity levels (increased sales force in Africa to 230, up 60%). Sovaldi contribution will be meaningful once the company receives final approval from DCGI.

Aspen assets acquisition

Strides acquired Australian assets (both generic and branded) of Aspen Pharma for A\$380mn. The target entity will operate under the brand of Arrow Pharma with 50 people on board. It had sales of A\$120mn with margins at ~31% as of June'14. The deal values Arrow Pharma at ~10x EV/EBITDA and is expected to close by 2QFY16E. Management expects this to be its most profitable business once integrated. Australian Pharma market is limited in size and scale and Strides expects to optimize the opportunity leveraging its relationships (from Ascent earlier). Strides will sell 149 generic prescription drugs and certain OTC products in Australia. Mandated PBS price cuts have pressured near-term growth in the Australian generic market. However, management emphasized that such price cuts will not impact Arrow Pharma margins as majority of price erosion will have to be borne at the pharmacist level. We believe a strong pipeline coupled with the transfer of product manufacturing to the TGA-approved facility in India will help deliver growth & significant cost synergies for pharmacy products in the Australian market. We build in the EPS at Rs8/10 for FY16/17E, respectively (see details inside).

BUY

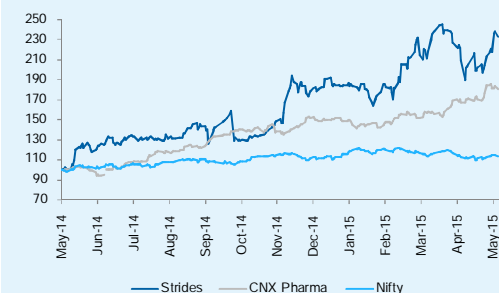
CMP* (Rs)	1,170
Target Price (Rs)	1,565
Upside/ (Downside) (%)	34
Bloomberg Ticker	STRP:IN
Market Cap. (Rs mn)	69,750
Free Float (%)	72
Shares O/S (mn)	60

Shareholding Pattern (%)	Dec'14	Mar'15
Promoter	27.7	27.7
FII	37.7	34.8
DII	8.7	11.2
Others	25.9	26.4

(Rs mn)	FY15	FY16E	FY17E
Sales	11,958	36,579	43,158
EBITDA	2,289	6,727	9,175
APAT	1,033	4,272	6,006
EPS (Rs)	17.3	52.7	74.2
DPS (Rs)	3.0	2.2	2.2

	FY15	FY16E	FY17E
P/E (x)	69.0	22.7	16.1
P/B (x)	6.2	5.9	4.4
EV/EBITDA	32.6	16.2	11.5
RoE (%)	0.1	26.1	27.1
Divi. Yield (%)	0.3	0.2	0.2

1 Year Stock Price Performance



Note: * CMP as on May 25, 2015

Research Analyst: Sapna Jhavar

Contact: 022-3320 1601

Email: sapna.jhavar@relianceada.com

Outlook and Valuation

We remain positive on Strides' ability to turnaround Shasun's low performing business segments and create a value enhancing business model from the combined entity. With expansion in margins, we expect RoE/RoCE to improve significantly. We project the combined entity to report revenue/PAT CAGR of 90%/141% for FY15-17E largely driven by mergers, ramp up in US sales (base business) as additional ANDAs are commercialized. **We maintain BUY with a revised Target Price of Rs1,565 (Rs1,306 earlier).**

Risks to the view

- Delay in ramp up of Shasun and Arrow Pharma merger
- Strides garner 90% of revenues from exports (large part from emerging markets). Any adverse impact on currency could pose potential downside risks to our estimates

Exhibit 1: Quarterly performance (standalone numbers)

(Rs mn)	4QFY15	5QFY14	% yoy	3QFY15	% qoq	FY15	FY14	% yoy
Net Sales	2,401.8	2,423.6	(0.9)	2,324.3	3.3	11,958.5	13,409.6	(10.8)
Material cost	1,440.4	1,530.4	(5.9)	1,475.4	(2.4)	5,604.8	7,146.7	(21.6)
% of net sales	60.0	63.1		63.5		46.9	53.3	
Staff costs	332.0	353.9	(6.2)	299.6	10.8	1,720.6	1,571.8	9.5
% of net sales	13.8	14.6		12.9		14.4	11.7	
Other expenses	500.4	383.9	30.3	374.0	33.8	2,344.5	2,457.0	(4.6)
% of net sales	20.8	15.8		16.1		19.6	18.3	
Total operating exp.	2,272.8	2,268.2	0.2	2,149.0	5.8	9,670.0	11,175.4	(13.5)
Operating profit	129.1	155.3	(16.9)	175.3	(26.4)	2,288.5	2,234.2	2.4
OPM (%)	5.4	6.4		7.5		19.1	16.7	
Interest	92.4	116.1	(20.4)	69.2	33.5	474.3	1,088.8	(56.4)
Depreciation	134.9	101.9	32.4	123.1	9.6	640.3	564.8	13.4
EBIT	(98.2)	(62.6)	56.9	(16.9)	479.9	1,173.9	580.6	102.2
Other Income	499.3	496.6	0.6	367.2	36.0	385.7	602.4	(36.0)
PBT	401.1	434.0	(7.6)	350.3	14.5	1,559.5	1,183.0	31.8
Total tax	175.1	(183.8)	(195.3)	253.0	(30.8)	532.3	408.6	30.3
Tax Rate (%)	43.7	(42.3)		72.2		34.1	34.5	
Minority Interest	0.0	0.0	-	0.0	-	(5.9)	(0.1)	-
Adjusted PAT	226.0	617.8	(63.4)	97.3	132.3	1,033.1	774.5	33.4
Net profit margin (%)	9.4	25.5		4.2		8.6	5.8	
Extra-ordinary Items	470.6	(1,100.4)	(142.8)	876.7		(1,017.4)	(3,102.3)	-
Forex (loss)/gain	44.9	26.8		(5.8)		(132.1)	(265.5)	-
Others	(425.8)	1,127.2		(882.5)	-	885.3	2,836.8	-
Reported Net profit	696.6	(482.7)	244.3	974.0	(28.5)	15.6	(2,327.8)	(100.7)
Reported EPS (Rs)	11.7	(8.1)		16.4		0.3	(39.1)	
Adjusted EPS (Rs)	3.8	10.4		1.6		17.3	13.0	

Source: Company, RSec Research

Analyst meet takeaways: 1) Company has launched 5 new products in US and filed 6 ANDAs (includes 2 FTFs) in FY15. 2) Strides have 33 filings of which 16 are awaiting approval (all in non-PEPFAR category). 3) Company intends to increase its R&D expense focusing on niche and complex products. It plans to file ~25 ANDAs in FY16E. 4) Commercialization of Gilead agreement is expected towards end of FY16-17E. 5) Portfolio rationalization with Shasun will be completed by June 2017. Company has received NOC from the exchanges and CCI approval for the same. 6) Strides will be scouting for value added acquisitions/mergers specifically in Africa.

Exhibit 3: Consolidated quarter numbers

Particulars	4QFY15	5QFY14	% yoy	3QFY15	% qoq	FY15	FY14	% yoy
Net sales	3,405	3,400	0.1	3,261	4.4	11,958	13,410	(10.8)
Ebitda	741	597	24.1	654	13.3	2,289	2,234	2.4
Ebitda Margins (%)	22	18		20		19	17	14.9
Adj PAT	345	597	(42.2)	415	(16.9)	1,033	774	33.4

Source: Company, RSec Research

Key Highlights

Regulated markets: Regulated markets grew phenomenally well with 20.1% qoq growth led by newer launches under Strides' own label.

US: Strides launched 5 products and filed 6 ANDAs (includes 2 FTFs) in FY15, namely, Calcitrol Softgel (market size US\$50mn, 5 players), Imiquimod (market size US\$200mn, 7 players), Methoxsalen (market size US\$15mn, no competition, market share 50%), Tacrolimus (market size US\$675mn, multiple players) and Vancomycin (market share increased to 53%). This takes the cumulative filings to 33 with 16 ANDAs pending for approvals. Besides, we expect Combivir (US\$250mn), Avodart (US\$500mn) and Lovaza (US\$850mn) approvals to pep up the momentum in FY16E.

R&D spends to increase: R&D for the year stood at Rs329mn (Rs203mn in FY15). Management is committed towards niche and complex filings and has guided for higher R&D expense going ahead as it seeks to file ~25 ANDAs in FY16E.

EU: Management remains confident of European market and is actively exploring various options for product launches.

Institutional Malaria business: Malaria segment is lumpy in nature and suffered from low order inflows in 4Q declining by 23.4% qoq and 27.6% yoy in 4Q and FY15, respectively. The segment now comprises 29% of the total sales as against 39% in 3Q. The recent agreement with Gilead Life sciences for Hepatitis-C drug Sovaldi (generic Sofosbuvir) is expected to ramp up over FY16-17E. We expect this to become a US\$100-120mn target opportunity over the next 2-3 years (assuming Strides is able to target 10% market share). We build in Rs146 per share for Solvadi in our forecasts.

Emerging markets: Strides reported healthy 24.8% qoq growth in 4Q and 21.5% yoy in FY15. The growth was led by strong branded performance in Africa and improved productivity levels. Strides has successfully integrated Raricap business (acquired from Bafna Pharma) enabling pan India presence. Africa business remains key growth driver with improving margin scenario vis-à-vis single-digit margins earlier.

Shasun merger: The progress with Shasun merger is smooth. Portfolio rationalization with Shasun will be completed by June 2017. Company has received NOC from the exchanges and CCI clearance. We remain positive on Strides' ability to turnaround Shasun's low performing business segments and create a value enhancing business model from the combined entity. We believe that this merger will create value over the medium term as operational synergy plays out.

Exhibit 3: Segmental break-up

Particulars	4QFY15	3QFY15	% qoq	FY15	FY14	% yoy
Regulated markets	1,160	966	20.1	4,255	5,060	(15.9)
Emerging market	1,262	1,011	24.8	4,070	3,350	21.5
Institutional market	983	1,284	(23.4)	3,865	5,336	(27.6)
Total Sales	3,405	3,261	4.4	12,190	13,746	(11.3)

Source: Company, RSec Research

Overview of Australian generic market

The Australian generic market is valued at US\$700mn and is highly concentrated with only 5 major players holding 90% of all generic drugs and 3 wholesalers (Sigma, Symbion, API) catering to all the pharmacies. Top 3 players have market share of 70% with Aspen being the 3rd.

With over 5,240 pharmacies catering to 23mn population, the average dispensing price for generic drugs is 2.5x higher than UK market. Australian market operates in a completely different manner than the US and EU markets wherein the top players are aligned to the top wholesalers. The business is more of relationship-driven in Australian generic market (Arrow Pharma is a preferred supplier to Sigma).

Deal details

- Strides will acquire Chemists' Own brand with 51 products and 95 SKU's (OTC range) and 6 more brands for US\$92mn (9x EV/EBITDA).
- Arrow will provide Strides with IP ownership over products that account for 70% of revenues.
- The acquisition at 10x EV/EBITDA is reasonable in our view, given the prevalent multiples are much higher for such assets.
- The deal will be funded through mix of internal accruals and debt. The debt will also be a combination of Indian as well as foreign debt with cost of capital at 5.5%.
- Strides will take some time to backward integrate the product range for Arrow.

Our assumptions: We assume average growth of 14-15% for Arrow Pharma. Besides, the margins in FY16E will be subdued with certain one-time costs associated with the merger and time line to site transfer manufacturing to India (~6 months). This should subsequently aid margins in FY17E. We expect margin expansion of 50/70bps in FY16/17E at 31.5%/32.7%. Assuming 5.5% cost of capital on a debt of US\$250mn (to fund the acquisition) we expect the EPS to be in the range Rs8 and Rs10 for FY16/17E, respectively.

Profit & Loss Statement				
Y/E March (Rs mn)	FY14	FY15	FY16E	FY17E
Net Sales	13,410	11,958	36,579	43,158
Total Expenditure	11,175	9,670	29,852	33,983
Cost of Materials	7,147	5,605	17,009	19,551
Personnel	1,572	1,721	5,048	5,611
Others	2,457	2,345	7,795	8,821
EBITDA	2,234	2,289	6,727	9,175
<i>% chg</i>	<i>122.1</i>	<i>2.4</i>	<i>193.9</i>	<i>36.4</i>
<i>(% of Net Sales)</i>	<i>16.7</i>	<i>19.1</i>	<i>18.4</i>	<i>21.3</i>
Depreciation & Amortization	565	640	1,939	2,093
EBIT	1,669	1,648	4,788	7,082
<i>% chg</i>	<i>139.4</i>	<i>(1.3)</i>	<i>190.5</i>	<i>47.9</i>
<i>(% of Net Sales)</i>	<i>12.4</i>	<i>13.8</i>	<i>13.1</i>	<i>16.4</i>
Interest & other Charges	1,089	474	600	575
Other Income	602	386	1,361	1,294
<i>(% of PBT)</i>	<i>50.9</i>	<i>24.7</i>	<i>24.5</i>	<i>16.6</i>
Recurring PBT	1,183	1,560	5,548	7,801
<i>% chg</i>	<i>383.3</i>	<i>31.8</i>	<i>255.8</i>	<i>40.6</i>
PBT (reported)	1,183	1,560	5,548	7,801
Tax	409	532	1,276	1,794
<i>(% of PBT)</i>	<i>34.5</i>	<i>34.1</i>	<i>23.0</i>	<i>23.0</i>
Minority Interest	(0)	(6)	-	-
Adjusted PAT	774	1,033	4,272	6,006
Less: Extraordinary item(EI)	(3,102)	(1,017)	-	-
Reported PAT	(2,328)	16	4,272	6,006
<i>% chg</i>	<i>(132.7)</i>	<i>(100.7)</i>	<i>27,206.4</i>	<i>40.6</i>
<i>(% of Net Sales)</i>	<i>(17.4)</i>	<i>0.1</i>	<i>11.7</i>	<i>13.9</i>
Adjusted EPS (Rs)	13.0	17.3	52.7	74.2
<i>% chg</i>	<i>522.9</i>	<i>33.3</i>	<i>204.4</i>	<i>40.6</i>

Balance Sheet

Y/E March (Rs mn)	FY14	FY15	FY16E	FY17E
SOURCES OF FUNDS				
Equity Share Capital	596	596	810	810
Reserves & Surplus	9,473	10,853	15,558	21,386
Shareholders' Funds	10,068	11,449	16,368	22,196
Minority Interest	757	187	187	187
Total Loans	2,666	4,723	22,523	21,223
Total Liabilities	13,491	16,359	39,078	43,606
Gross Block	8,039	8,725	23,725	28,725
Less: Acc. Depreciation	3,528	4,168	6,107	8,201
Net Block	4,511	4,557	17,618	20,525
Capital Work-in-Progress	995	2,800	6,000	6,000
Goodwill on consolidation	1,034	1,368	1,368	1,368
Investments	4,430	6,313	6,313	6,313
Current Assets	9,992	9,784	33,753	39,289
Inventory	1,760	2,077	5,211	5,912
Sundry Debtors	3,640	3,900	11,224	13,007
Cash	2,311	1,469	10,335	12,079
Loans and Advances	2,145	2,229	6,817	8,043
Others	136	111	166	249
Current Liabilities	7,456	8,517	26,028	29,943
Net Current Assets	2,537	1,267	7,725	9,346
Net Deferred Tax	(17)	54	54	54
Total Assets	13,491	16,359	39,078	43,606

Cash Flow Statement

Y/E March (Rs mn)	FY14	FY15	FY16E	FY17E
Profit before tax	1,183	1,560	5,548	7,801
Depreciation	565	640	1,939	2,093
Interest Provided	1,089	474	600	575
Change in Working Capital	87	427	2,408	123
Tax Paid	(409)	(532)	(1,276)	(1,794)
Others	19,399	-	-	-
Cash Flow from Operations	21,913	2,569	9,220	8,798
(Inc.)/ Dec. in Fixed Assets	27,489	(2,826)	(18,200)	(5,000)
(Inc.)/ Dec. in Investments	(4,418)	(1,883)	-	-
Cash Flow from Investing	23,071	(4,708)	(18,200)	(5,000)
Issue of Equity	305	505	214	-
Inc./Dec. in loans	(10,645)	2,057	17,800	(1,300)
Dividend Paid (Incl. Tax)	(32,902)	(179)	(179)	(179)
Interest Provided	(1,089)	(474)	(600)	(575)
Cash Flow from Financing	(44,330)	1,909	17,234	(2,054)
Inc./Dec. in Cash	654	(230)	8,254	1,744
Opening Cash balances	1,657	2,311	2,081	10,335
Closing Cash balances	2,311	2,081	10,335	12,079

Key Ratios

Y/E March	FY14	FY15	FY16E	FY17E
Valuation Ratio (x)				
P/E (on FDEPS)	91.9	69.0	22.7	16.1
P/CEPS	(40.4)	108.6	15.6	11.9
P/BV	7.1	6.2	5.9	4.4
Dividend yield (%)	0.3	0.4	1.4	1.0
EV/Sales	46.2	0.3	0.2	0.2
EV/EBITDA	5.3	6.2	3.0	2.5
EV / Total Assets	32.0	32.6	16.2	11.5
Per Share Data (Rs)				
EPS (Basic)	5.3	4.6	2.8	2.4
EPS (fully diluted)	13.0	17.3	52.7	74.2
Cash EPS	(29.6)	11.0	76.7	100.0
DPS	551.5	3.0	2.2	2.2
Book Value	169.0	192.1	202.1	274.0
Returns (%)				
RoCE	16.8	12.4	15.7	19.2
RoIC	18.2	15.4	22.4	29.3
RoE	(23.1)	0.1	26.1	27.1
Turnover ratios (x)				
Asset Turnover (Gross Block)	1.0	0.7	0.9	1.0
Inventory / Sales (days)	117	52	52	50
Receivables (days)	115	115	112	110
Payables (days)	300	262	250	245

General Disclaimers: This Research Report (hereinafter called 'Report') is prepared and distributed by Reliance Securities Limited (RSL) for information purposes only. The recommendations, if any, made herein are expression of views and/or opinions and should not be deemed or construed to be neither advice for the purposes of purchase or sale of any security, derivatives or any other security through RSL nor any solicitation or offering of any investment /trading opportunity on behalf of the issuer(s) of the respective security(ies) referred to herein. These information / opinions / views are not meant to serve as a professional investment guide for the readers. No action is solicited based upon the information provided herein. Recipients of this Report should rely on information/data arising out of their own investigations. Readers are advised to seek independent professional advice and arrive at an informed trading/investment decision before executing any trades or making any investments. This Report has been prepared on the basis of publicly available information, internally developed data and other sources believed by RSL to be reliable. RSL or its directors, employees, affiliates or representatives do not assume any responsibility for, or warrant the accuracy, completeness, adequacy and reliability of such information / opinions / views. While due care has been taken to ensure that the disclosures and opinions given are fair and reasonable, none of the directors, employees, affiliates or representatives of RSL shall be liable for any direct, indirect, special, incidental, consequential, punitive or exemplary damages, including lost profits arising in any way whatsoever from the information / opinions / views contained in this Report.

Risks: Trading and investment in securities are subject market risks. There are no assurances or guarantees that the objectives of any of trading / investment in securities will be achieved. The trades/ investments referred to herein may not be suitable to all categories of traders/investors. The names of securities mentioned herein do not in any manner indicate their prospects or returns. The value securities referred to herein may be adversely affected by the performance or otherwise of the respective issuer companies, changes in the market conditions, micro and macro factors and forces affecting capital markets like interest rate risk, credit risk, liquidity risk and reinvestment risk. Derivative products may also be affected by various risks including but not limited to counter party risk, market risk, valuation risk, liquidity risk and other risks. Besides the price of the underlying asset, volatility, tenor and interest rates may affect the pricing of derivatives.

Disclaimers in respect of jurisdiction: The possession, circulation and/or distribution of this Report may be restricted or regulated in certain jurisdictions by appropriate laws. No action has been or will be taken by RSL in any jurisdiction (other than India), where any action for such purpose(s) is required. Accordingly, this Report shall not be possessed, circulated and/or distributed in any such country or jurisdiction unless such action is in compliance with all applicable laws and regulations of such country or jurisdiction. RSL requires such recipient to inform himself about and to observe any restrictions at his own expense, without any liability to RSL. Any dispute arising out of this Report shall be subject to the exclusive jurisdiction of the Courts in India.

Disclosure of Interest: The research analysts who have prepared this Report hereby certify that the views /opinions expressed in this Report are their personal independent views/opinions in respect of the securities and their respective issuers. Neither RSL nor the research analysts had any known direct /indirect conflict of interest including any long/short position(s) in any specific security on which views/opinions have been made, during the preparation of this Report.

Copyright: The copyright in this Report belongs exclusively to RSL. This Report shall only be read by those persons to whom it has been delivered. No reprinting, reproduction, copying, distribution of this Report in any manner whatsoever, in whole or in part, is permitted without the prior express written consent of RSL.

Important These disclaimers, risks and other disclosures must be read in conjunction with the information / opinions / views of which they form part of.

Reliance Securities Limited is a Stock Broker with BSE Limited (SEBI Registration Nos. INB011234839, INF011234839 and INE011234839); with National Stock Exchange of India Limited (SEBI Registration Nos. INB231234833, INF231234833, and INF231234833).