HDFC securities

INSTITUTIONAL RESEARCH

COMPANY UPDATE | 10 MAY 2018

Strides Shasun

BUY

INDUSTRY	PHARMA
CMP *(as on 09 May 2018)*	**Rs 573**
Target Price	**Rs 980**
Nifty	10,742
Sensex	35,319
KEY STOCK DATA	
Bloomberg	STR IN
No. of Shares (mn)	90
MCap (Rs bn) / ($ mn)	51/763
6m avg traded value (Rs mn)	382

STOCK PERFORMANCE (%)

52 Week high / low **Rs 1,069/536**

	3M	6M	12M
Absolute (%)	(20.2)	(25.3)	(44.2)
Relative (%)	(24.0)	(31.5)	(62.2)

SHAREHOLDING PATTERN (%)

Promoters	31.1
FIs & Local MFs	14.6
FPIs	34.5
Public & Others	19.8

Source : BSE

Amey Chalke
amey.chalke@hdfcsec.com
+91-22-6171-7321

Numéro une in Australia

After the proposed merger of Apotex's Australia business, with almost 50% market share, STR will become the largest generic player in the region. It will also gain the priority access to 58% of Australian pharmacies. Till now, three large generic players have controlled more than 78% generic market and pharmacy reach had become the major barrier for any new entrant. With this merger, the market is likely to become more opaque. STR, after becoming the largest player in the market, will be able to leverage its strong pharmacy reach to launch new products with 50% assured market share and can also become a preferred partner for marketing niche generic opportunities in areas like bio-similars/inhalers and Insulins. Hence, we believe this business segment is likely to become a sustainable cash generating unit for STR.

With improving traction in both Australia and US geographies and fresh institutional orders for Anti-malarial products, we believe the operating performance of the overall business is likely to show sharp improvement over next few quarters. Maintain BUY rating with a TP of Rs 980 (16x FY20E + Rs 30/sh for biopharma).

- **Small market with limited incumbents:** In comparison to any other regulatory market in the world, the Australia pharma market is small with a 24mn population and A$ 15bn in value. However, the top three pharma players have captured 78% of the generic market and STR (Arrow) is one of them. It remains a key business for STR as it contributes 26% on top line and ~30% on EBITDA in FY18E.
- **Numero une in Australia:** Post this merger, STR will become the number one generic player in the market with ~50% market share, followed by Mylan with 24%. STR will also gain access to 3200 pharmacies (~1400 now). Together, they will have more than 300 products in their portfolio, but with large overlap. As told by the management, the merger is yet to be approved by competition commission. However, regardless of any divestment which could be needed for this merger to go through, STR is likely to get majority stake in the merged entity. This is largely because the profitability of Apotex business is significantly lower than STR. STR has not disclosed the share swap ratio for this merger yet.
- **Earnings accretive from first year:** The merged entity is likely to derive synergies from (1) complementary IPs, (2) lower requirement of outsourcing and (3) steep reduction in corporate costs. The management believes this merger is likely to be earnings accretive from the first year itself. We have not included this merger in our estimates as we expect more clarity from the management after the competition commission approval.

Financial Summary

YE Mar (Rs bn)	FY16	FY17	FY18E	FY19E	FY20E
Net Sales	28.0	34.1	33.6	35.4	42.1
EBITDA	4.1	6.4	4.7	6.7	8.8
APAT	1.7	3.0	2.5	3.5	5.3
Adj. EPS (Rs/sh)	20.8	34.0	27.7	39.0	59.4
P/E (x)	31.7	10.2	22.7	14.6	9.6
RoE (%)	8.4	13.1	4.6	12.9	17.1

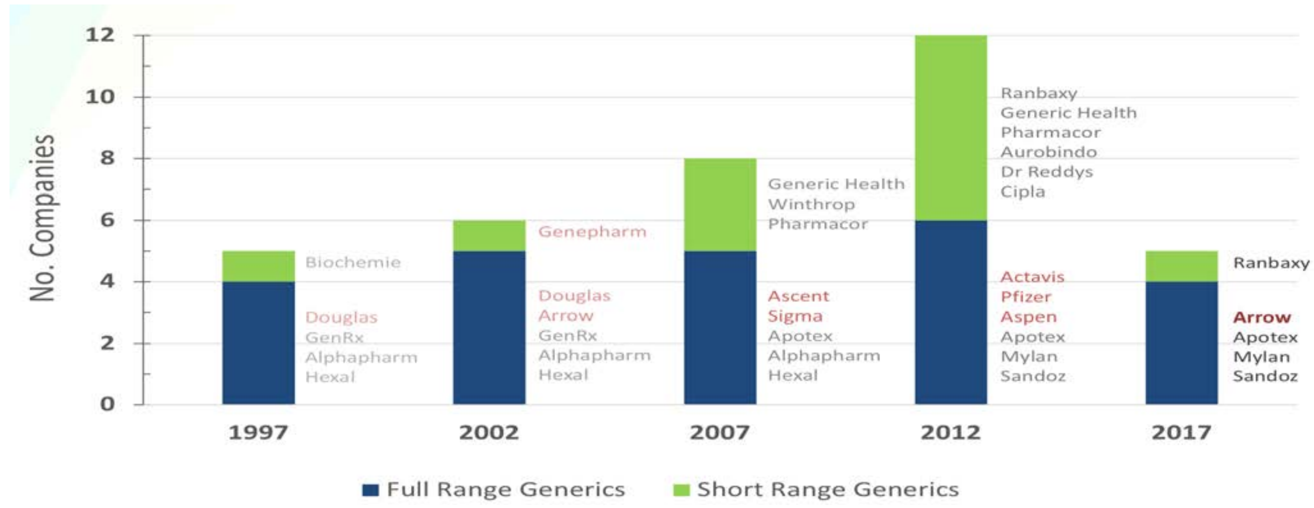
Source: Company, HDFC sec Inst Research

In 2012, there were 6 major players in the Australian market providing a full range of generics and 6 players with a shorter range (including Indian players like Aurobindo, Cipla, Dr. Reddy's).

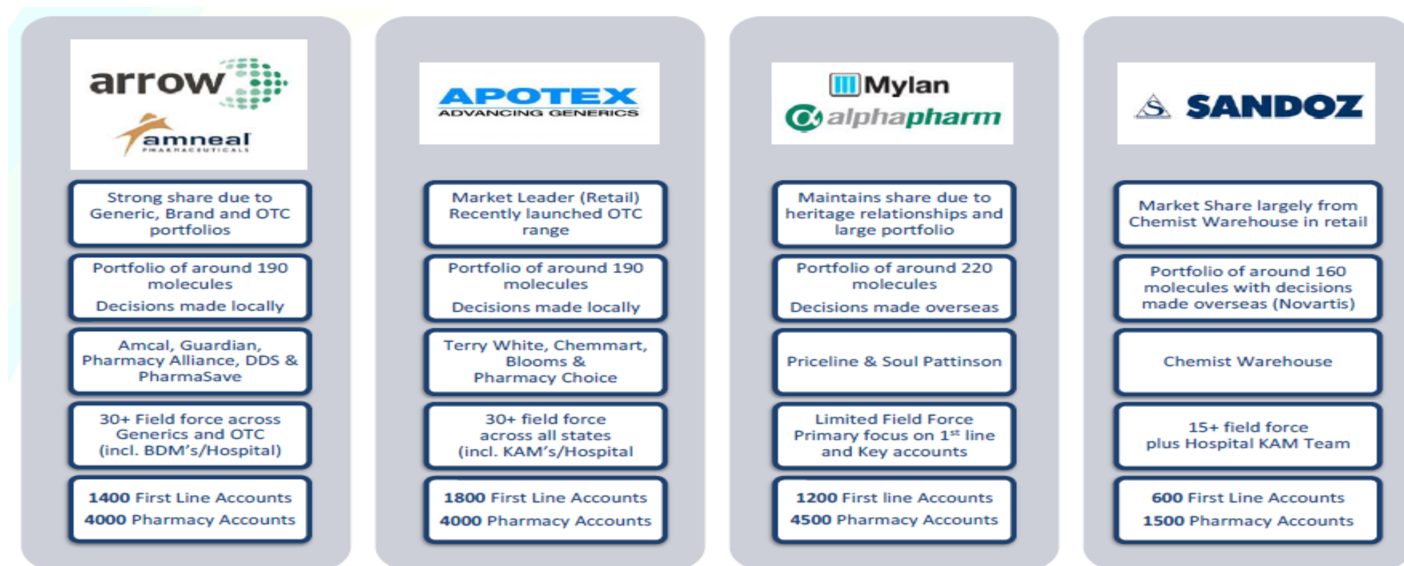
The distribution focused nature of the market combined with a high cost of operations has led to significant consolidation. Today, there are only 4 major players with a full range of generics

Australia Pharma market (APM)

Market consolidation due to high cost of operation and competitive barriers



Generic Companies – A Comparison



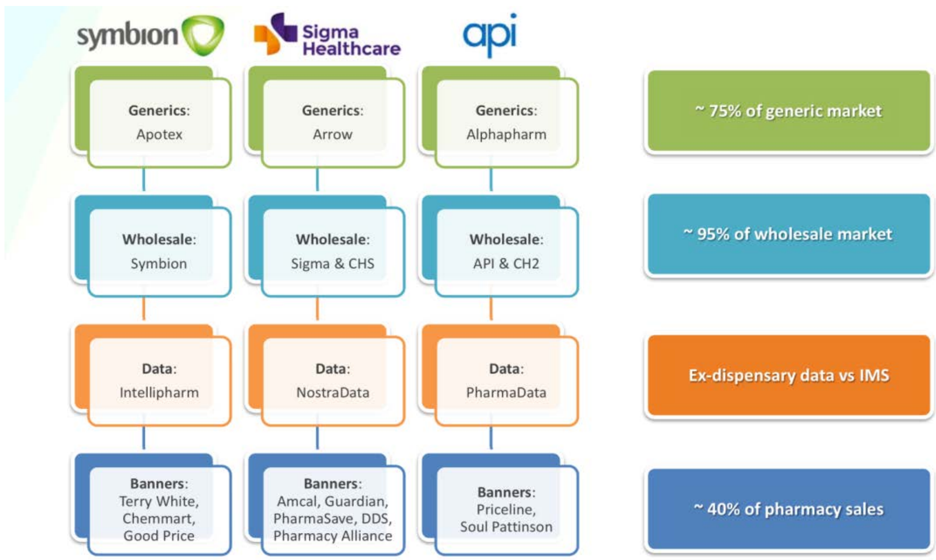
Source: Company, HDFC Sec Inst Research

Each of these leading four players have aligned themselves with various banner and buyer groups. Higher the pharmacies under these groups more reliable is business for these players

Vertical integration exhibit explains how each of the wholesalers has aligned themselves with various stakeholders in the value chain

Generic Alignment: Banner And Buying Groups

Vertical integration (from wholesaler's perspective)



Source: Company, HDFC Sec Inst Research

Income Statement (Consolidated)

Year ending March (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Net Revenues	**28,044**	**34,131**	**33,589**	**35,364**	**42,069**
Growth (%)	***134.5***	***21.7***	***(1.6)***	***5.3***	***19.0***
Material Expenses	15,023	15,362	16,123	15,737	18,300
Employee Expenses	3,577	5,881	5,374	5,658	6,310
Other Operating Expenses	5,304	6,459	7,390	7,250	8,624
EBITDA	**4,140**	**6,428**	**4,703**	**6,719**	**8,834**
EBITDA Margin (%)	***14.8***	***18.8***	***14.0***	***19.0***	***21.0***
EBITDA Growth (%)	***80.9***	***55.3***	***(26.8)***	***42.9***	***31.5***
Depreciation	1,313	1,872	1,837	1,708	1,896
EBIT	**2,827**	**4,556**	**2,865**	**5,011**	**6,938**
Other Income (Including EO Items)	921	1,686	1,000	1,200	1,500
Interest	1,682	2,269	2,150	1,492	1,321
Exceptional Items	(414)	(1,006)	(225)	-	-
PBT	**1,653**	**2,967**	**1,490**	**4,719**	**7,118**
Tax (Incl Deferred)	425	470	206	779	1,253
Profit/(loss) from discontinuing operations	(232)	1,959	820	-	-
Profit/(loss) of associate company	(47)	4	-	-	-
Minority Interest	135	(462)	150	(450)	(550)
RPAT	**1,085**	**3,997**	**2,254**	**3,490**	**5,315**
EO (Loss) / Profit (Net Of Tax)	(645)	953	(225)	-	-
APAT	**1,730**	**3,045**	**2,479**	**3,490**	**5,315**
APAT Growth (%)	***1836.0***	***75.9***	***(18.6)***	***40.8***	***52.3***
Adjusted EPS (Rs)	**20.8**	**34.0**	**27.7**	**39.0**	**59.4**

Source: Company, HDFC sec Inst Research

Balance Sheet (Consolidated)

Year ending March (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
SOURCES OF FUNDS					
Share Capital - Equity	893	894	894	894	894
Reserves	25,685	26,210	28,194	31,160	35,519
Total Shareholders Funds	**26,579**	**27,104**	**29,088**	**32,055**	**36,413**
Minority Interest	502	1,640	1,490	1,940	2,490
Long Term Debt	26,270	16,377	7,877	6,877	5,877
Short Term Debt	7,005	13,940	13,940	13,940	13,940
Total Debt	**33,275**	**30,317**	**21,817**	**20,817**	**19,817**
Net Deferred Taxes	(502)	88	230	150	100
Other Non-current Liabilities & Provns	1,833	4,855	5,120	5,500	5,650
TOTAL SOURCES OF FUNDS	**61,686**	**64,004**	**57,744**	**60,461**	**64,469**
APPLICATION OF FUNDS					
Net Block	17,520	19,462	14,566	17,358	19,462
CWIP	8,149	7,802	7,500	5,250	3,150
Goodwill	9,267	9,670	9,670	9,670	9,670
Investments	1,272	3,157	3,906	4,226	4,578
Other Non-current Assets	2,245	2,212	2,900	3,100	3,400
Total Non-current Assets	**38,452**	**42,302**	**38,541**	**39,603**	**40,259**
Cash & Equivalents	**15,253**	**16,090**	**8,608**	**9,959**	**10,961**
Inventories	6,131	7,380	6,442	7,557	8,990
Debtors	10,330	9,971	10,123	10,173	12,102
Other Current Assets	3,434	4,734	5,258	5,434	6,176
Total Current Assets	**19,896**	**22,084**	**21,822**	**23,164**	**27,267**
Creditors	7,754	7,465	6,626	7,761	8,774
Other Current Liabilities & Provns	4,161	9,006	4,601	4,505	5,244
Total Current Liabilities	**11,915**	**16,471**	**11,227**	**12,266**	**14,018**
Net Current Assets	**7,981**	**5,613**	**10,595**	**10,899**	**13,249**
TOTAL APPLICATION OF FUNDS	**61,686**	**64,005**	**57,744**	**60,461**	**64,469**

Source: Company, HDFC sec Inst Research

Cash Flow

Year ending March (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Reported PBT	1,464	4,971	1,715	4,719	7,118
Non-operating & EO items	941	(1,599)	142	(80)	(50)
Interest expenses	995	1,521	2,150	1,492	1,321
Depreciation	1,520	1,987	1,837	1,708	1,896
Working Capital Change	(3,417)	(3,413)	(5,406)	(123)	(2,501)
Tax Paid	(770)	(586)	(206)	(779)	(1,253)
OPERATING CASH FLOW (a)	**732**	**2,881**	**233**	**6,937**	**6,531**
Capex	(3,691)	(6,823)	3,302	(2,250)	(1,900)
Free cash flow (FCF)	*(2,959)*	*(3,942)*	*3,535*	*4,687*	*4,631*
Investments	(18,506)	(647)	4,369	(704)	(755)
Non-operating Income	471	846	-	-	-
Others	(521)	(427)	-	-	-
INVESTING CASH FLOW (b)	**(22,248)**	**(7,051)**	**7,671**	**(2,954)**	**(2,655)**
Debt Issuance/(Repaid)	19,115	6,037	(8,500)	(1,000)	(1,000)
Interest Expenses	(1,347)	(2,370)	(2,150)	(1,492)	(1,321)
FCFE	*(3,748)*	*(502)*	*(2,747)*	*1,491*	*1,555*
Share Capital Issuance	12,264	165	(0)	-	0
Dividend	(265)	(451)	(270)	(524)	(957)
Others	(327)	-	653	-	-
FINANCING CASH FLOW (c)	**29,439**	**3,382**	**(10,268)**	**(3,016)**	**(3,277)**
NET CASH FLOW (a+b+c)	**7,924**	**(788)**	**(2,364)**	**968**	**599**
EO Items, Others	195	(5,169)	-	-	-
Closing Cash & Equivalents	**11,107**	**5,151**	**930**	**1,898**	**2,496**

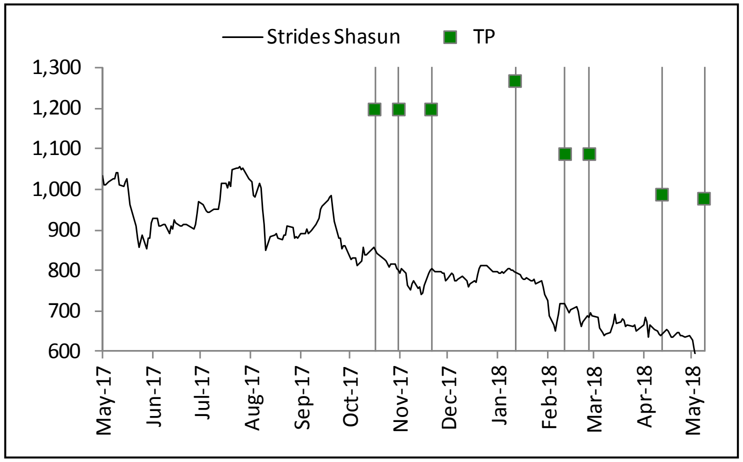
Source: Company, HDFC sec Inst Research

Key Ratios

Year ending March	FY16	FY17	FY18E	FY19E	FY20E
PROFITABILITY (%)					
GPM	46.4	55.0	52.0	55.5	56.5
EBITDA Margin	14.8	18.8	14.0	19.0	21.0
APAT Margin	5.7	10.3	3.8	11.1	13.9
RoE	8.4	13.1	4.6	12.9	17.1
RoIC (or Core RoCE)	10.8	12.0	7.4	11.2	14.4
RoCE	7.4	8.6	5.2	8.7	11.0
EFFICIENCY					
Tax Rate (%)	20.5	11.8	12.0	16.5	17.6
Fixed Asset Turnover (x)	1.5	1.5	1.7	1.5	1.5
Inventory (days)	*79.8*	*78.9*	*70.0*	*78.0*	*78.0*
Debtors (days)	*134.4*	*106.6*	*110.0*	*105.0*	*105.0*
Other Current Assets (days)	*40.7*	*36.4*	*46.2*	*47.0*	*45.6*
Payables (days)	*100.9*	*79.8*	*72.0*	*80.1*	*76.1*
Other Current Liab & Provns days)	*52.2*	*94.3*	*48.0*	*44.5*	*43.5*
Cash Conversion Cycle (days)	*101.8*	*47.8*	*106.2*	*105.4*	*108.9*
Debt/EBITDA (x)	8.0	4.7	4.6	3.1	2.2
Net D/E (x)	1.1	1.0	0.7	0.6	0.2
Interest Coverage (x)	2.2	2.8	1.8	4.2	6.4
PER SHARE DATA (Rs)					
EPS	18.0	55.9	25.2	39.0	59.4
Dividend	4.0	4.5	2.5	4.9	8.9
Book Value	297.0	302.8	325.0	358.2	406.9
VALUATION					
P/E (x)	31.7	10.2	22.7	14.6	9.6
P/BV (x)	1.9	1.9	1.8	1.6	1.4
EV/EBITDA (x)	19.6	12.2	15.3	10.4	7.7
EV/Revenues (x)	2.9	2.3	2.1	2.0	1.6
OCF/EV (%)	0.9	3.7	0.3	9.9	9.5
FCF/EV (%)	(3.6)	(5.0)	4.9	6.7	6.8
FCFE/Mkt Cap (%)	(7.3)	(1.0)	(5.4)	2.9	3.0
Dividend Yield (%)	0.7	0.8	0.4	0.9	1.6

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
16-Oct-17	881	BUY	1,200
1-Nov-17	827	BUY	1,200
20-Nov-17	818	BUY	1,200
11-Jan-18	827	BUY	1,270
11-Feb-18	740	BUY	1,090
27-Feb-18	710	BUY	1,090
13-Apr-18	639	BUY	990
10-May-18	573	BUY	980

Rating Definitions

BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period

NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period

SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

Disclosure:
I, **Amey Chalke, MBA**, author and the name subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. HSL has no material adverse disciplinary history as on the date of publication of this report. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.
Research Analyst or his/her relative or HDFC Securities Ltd. **does not have** any financial interest in the subject company. Also Research Analyst or his relative or HDFC Securities Ltd. or its Associate may have beneficial ownership of 1% or more in the subject company at the end of the month immediately preceding the date of publication of the Research Report. Further Research Analyst or his relative or HDFC Securities Ltd. or its associate **does not have** any material conflict of interest.
Any holding in stock –No
HDFC Securities Limited (HSL) is a SEBI Registered Research Analyst having registration no. INH000002475.

Disclaimer:
This report has been prepared by HDFC Securities Ltd and is meant for sole use by the recipient and not for circulation. The information and opinions contained herein have been compiled or arrived at, based upon information obtained in good faith from sources believed to be reliable. Such information has not been independently verified and no guaranty, representation of warranty, express or implied, is made as to its accuracy, completeness or correctness. All such information and opinions are subject to change without notice. This document is for information purposes only. Descriptions of any company or companies or their securities mentioned herein are not intended to be complete and this document is not, and should not be construed as an offer or solicitation of an offer, to buy or sell any securities or other financial instruments.
This report is not directed to, or intended for display, downloading, printing, reproducing or for distribution to or use by, any person or entity who is a citizen or resident or located in any locality, state, country or other jurisdiction where such distribution, publication, reproduction, availability or use would be contrary to law or regulation or what would subject HSL or its affiliates to any registration or licensing requirement within such jurisdiction.
If this report is inadvertently send or has reached any individual in such country, especially, USA, the same may be ignored and brought to the attention of the sender. This document may not be reproduced, distributed or published for any purposes without prior written approval of HSL.
Foreign currencies denominated securities, wherever mentioned, are subject to exchange rate fluctuations, which could have an adverse effect on their value or price, or the income derived from them. In addition, investors in securities such as ADRs, the values of which are influenced by foreign currencies effectively assume currency risk.
It should not be considered to be taken as an offer to sell or a solicitation to buy any security. HSL may from time to time solicit from, or perform broking, or other services for, any company mentioned in this mail and/or its attachments.
HSL and its affiliated company(ies), their directors and employees may; (a) from time to time, have a long or short position in, and buy or sell the securities of the company(ies) mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as a market maker in the financial instruments of the company(ies) discussed herein or act as an advisor or lender/borrower to such company(ies) or may have any other potential conflict of interests with respect to any recommendation and other related information and opinions.
HSL, its directors, analysts or employees do not take any responsibility, financial or otherwise, of the losses or the damages sustained due to the investments made or any action taken on basis of this report, including but not restricted to, fluctuation in the prices of shares and bonds, changes in the currency rates, diminution in the NAVs, reduction in the dividend or income, etc.
HSL and other group companies, its directors, associates, employees may have various positions in any of the stocks, securities and financial instruments dealt in the report, or may make sell or purchase or other deals in these securities from time to time or may deal in other securities of the companies / organizations described in this report.

HSL or its associates might have managed or co-managed public offering of securities for the subject company or might have been mandated by the subject company for any other assignment in the past twelve months.
HSL or its associates might have received any compensation from the companies mentioned in the report during the period preceding twelve months from t date of this report for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory service in a merger or specific transaction in the normal course of business.
HSL or its analysts did not receive any compensation or other benefits from the companies mentioned in the report or third party in connection with preparation of the research report. Accordingly, neither HSL nor Research Analysts have any material conflict of interest at the time of publication of this report. Compensation of our Research Analysts is not based on any specific merchant banking, investment banking or brokerage service transactions. HSL may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report.
Research entity has not been engaged in market making activity for the subject company. Research analyst has not served as an officer, director or employee of the subject company. We have not received any compensation/benefits from the subject company or third party in connection with the Research Report.

HDFC securities Limited, I Think Techno Campus, Building - B, "Alpha", Office Floor 8, Near Kanjurmarg Station, Opp. Crompton Greaves, Kanjurmarg (East), Mumbai 400 042 Phone: (022) 3075 3400 Fax: (022) 2496 5066
Compliance Officer: Binkle R. Oza Email: complianceofficer@hdfcsec.com Phone: (022) 3045 3600

HDFC Securities Limited, SEBI Reg. No.: NSE-INB/F/E 231109431, BSE-INB/F 011109437, AMFI Reg. No. ARN: 13549, PFRDA Reg. No. POP: 04102015, IRDA Corporate Agent License No.: HDF 2806925/HDF C000222657, SEBI Research Analyst Reg. No.: INH000002475, CIN - U67120MH2000PLC152193

HDFC securities
Institutional Equities
Unit No. 1602, 16th Floor, Tower A, Peninsula Business Park,
Senapati Bapat Marg, Lower Parel, Mumbai - 400 013
Board : +91-22-6171 7330 www.hdfcsec.com