

Torrent Pharmaceuticals Limited

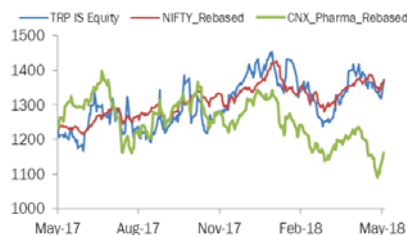
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Revenues exceed expectations but margins disappoint

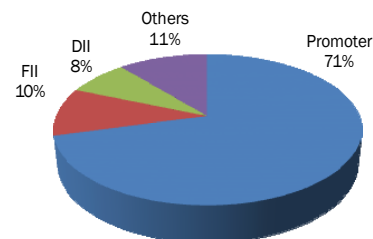
Strong Buy

Sector	: Pharmaceuticals
Target Price	: Rs 1,485
Current Market Price	: Rs 1,411
Market Cap	: Rs 236.9 bn
52-week High/Low	: Rs 1,475/1,147
Daily Avg. Volume	: 1,85,539
Face Value	: Rs 5
Beta	: 0.85
Pledged Shares	: 0%
Year End	: March
BSE Scrip Code	: 500420
NSE Scrip Code	: TORNTPHARMA
Bloomberg Code	: TRP IN
Reuters Code	: TORP.BO
Nifty	: 10,736
BSE Sensex	: 33,322
Analyst	: Fathima Khan

Price Performance



Shareholding Pattern



Result Update – 4Q FY18 & FY 2018

Financial Performance

- Torrent Pharma’s total income increased 16.6% q-o-q and 20.1% y-o-y to Rs 17,220 mn in 4Q FY18 exceeding our expectations. Domestic sales increased 48.4% y-o-y during the quarter as it benefited from inclusion of branded business of Unichem Laboratories Ltd acquired in December 2017. US business also clocked growth of 9.3% y-o-y during 4Q FY18 benefiting from inclusion of revenues from liquid & suppository manufacturing facilities acquired during the quarter. Meanwhile, base business continued to be pressurised by pricing pressure. Total income remained flat y-o-y at Rs 60,020 mn in FY 2018.
- EBITDA remained flat q-o-q but increased 23.4% y-o-y to Rs 3,640 mn in 4Q FY18. EBITDA margin decreased 317 bps q-o-q but increased 57 bps y-o-y to 21.1% falling short of our expectation for the quarter. EBITDA remained flat at Rs 13,490 mn while EBITDA margin decreased 105 bps to 22.5% in FY 2018.
- Net profit increased 293.1% q-o-q and 10.7% y-o-y at Rs 2,280 mn in 4Q FY18. Net margin increased 931 bps q-o-q but decreased 112 bps y-o-y to 13.2% falling short of our expectation for the quarter mainly due to poor performance at operating level.
- Diluted EPS was Rs 13.6 in 4Q FY18 compared to Rs 3.4 in 3Q FY18 and Rs 12.2 in 4Q FY17.

Outlook

Though base business suffered from price erosion during the quarter, volume increase and business from newly acquired liquid & suppository manufacturing plant offset the price erosion and clocked a high single digit growth. The company plans to file 15-20 ANDAs during the year. The new filing targets high margin chronic segments such as dermatology, oncology and ophthalmology. The company plans to launch more limited competition products in FY 2019 which would not only drive top-line but also ensure margin expansion. The company has transferred 16 products to its Dahej plant. Capex is expected to close to Rs 2 bn mainly in-lieu of maintenance. Domestic business continues to benefit from integration of Unichem products and this trend is expected to continue. However, high interest cost is expected to result in deal being accretive to EPS only after 3 years as expected during deal finalisation. In the Indian market, Torrent does not seem to have new growth drivers apart from integration of Unichem in the medium term. Brazil business is expected to post high single digit growth in FY 2019 driven by new product launches.

We have revised upward our FY 2019E revenue and operating margin expectation considering amalgamation of new portfolio acquired from Unichem and business from liquid and suppository manufacturing plant to the existing business. However, we have revised downwards our net margin expectation due to change in tax rate in-line with current trend.

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Valuation

Considering the strong revenue growth expectations and margin expansion we value the business at 22x FY 2020E EPS of Rs 65.4 i.e Rs 1,440 per share. Torrent Pharma valuation through DCF is Rs 1,530 per share. Consequently, using a weighted average methodology we arrive at a share price of Rs 1,485, generating 5.5% potential upside from current levels. Hence, we reiterate our 'Market-perform' rating for Torrent Pharma common stock.

Exhibit 1: 4Q FY18 Result

Rs mn	4Q FY17A	3Q FY18A	4Q FY18A	Q-o-Q change	Y-o-Y change	KSL estimates	Variation in KSL estimates
Total income	14,340	14,770	17,220	16.6%	20.1%	16,119	6.8%
EBITDA	2,950	3,590	3,640	1.4%	23.4%	3,796	(4.1%)
EBITDA margin	20.6%	24.3%	21.1%	(317)bps	57bps	23.6%	(241)bps
Net profit	2,060	580	2,280	293.1%	10.7%	2,307	(1.2%)
Net margin	14.4%	3.9%	13.2%	931bps	(112)bps	14.3%	(108)bps
Diluted EPS(Rs)	12.2	3.4	13.6	302.1%	11.3%	13.4	1.1%

Source: Company data, Khambatta Research

Exhibit 2: FY 2018 Result

Rs mn	FY 2017A	FY 2018A	Y-o-Y change	KSL estimates	Variation in KSL estimates
Total income	58,570	60,020	2.5%	58,919	1.9%
EBITDA	13,780	13,490	(2.1%)	13,646	(1.1%)
EBITDA margin	23.5%	22.5%	(105)bps	23.2%	(68)bps
Net profit	9,340	6,780	(27.4%)	6,807	(0.4%)
Net margin	15.9%	11.3%	(465)bps	11.6%	(26)bps
Diluted EPS(Rs)	55.2	40.1	(27.3%)	40.0	0.4%

Source: Company data, Khambatta Research

Exhibit 3: Revision in estimates

Rs mn	Previous FY 2019A	Revised FY 2019E	FY 2020E
Total income	68,883	73,551	84,547
EBITDA	16,807	18,967	23,081
EBITDA margin	24.4%	25.8%	27.3%
Net profit	11,029	8,207	11,011
Net margin	16.0%	11.2%	13.0%
Diluted EPS (Rs)	65.1	48.8	65.4

Source: Company data, Khambatta Research

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Guide to Khambatta's research approach

Valuation methodologies

We apply the following absolute/relative valuation methodologies to derive the 'fair value' of the stock as a part of our fundamental research:

DCF: The Discounted Cash Flow (DCF) method values an estimated stream of future free cash flows discounted to the present day, using a company's WACC or cost of equity. This method is used to estimate the attractiveness of an investment opportunity and as such provides a good measure of the company's value in absolute terms. There are several approaches to discounted cash flow analysis, including Free Cash Flow to Firm (FCFF), Free Cash Flow to Equity (FCFE) and the Dividend Discount Model (DDM). The selection of a particular approach depends on the particular company being researched and valued.

ERE: The Excess Return to Equity (ERE) method takes into consideration the absolute value of a company's return to equity in excess of its cost of equity discounted to the present day using the cost of equity. This methodology is more appropriate for valuing banking stocks than FCFF or FCFE methodologies.

Relative valuation: In relative valuation, various comparative multiples or ratios including Price/Earnings, Price/Sales, EV/Sales, EV/EBITDA, Price/Book Value are used to assess the relative worth of companies which operate in the same industry/industries and are thereby in the same peer group. Generally our approach involves the use of two multiples to estimate the relative valuation of a stock.

Other methodologies such as DuPont Analysis, CFROI, NAV and Sum-of-the-Parts (SOTP) are applied where appropriate.

Stock ratings

Strong Buy recommendations are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) by at least 15%.

Market-perform recommendations are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) between 5% and 15%.

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