

Sector: Pharmaceuticals
Result Update

	Change
Reco: Hold	↔
CMP: Rs. 1,681	
Price Target: Rs. 1,720	↔

↑ Upgrade ↔ No change ↓ Downgrade

Company details

Market cap:	Rs. 28,441 cr
52-week high/low:	Rs. 1964/1453
NSE volume: (No of shares)	3.2 lakh
BSE code:	500420
NSE code:	TORNTPHARM
Sharekhan code:	TORNTPHARM
Free float: (No of shares)	4.9 cr

Shareholding (%)

Promoters	71.3
FII	7.8
DII	13.1
Others	7.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-3.3	11.3	-7.6	5.4
Relative to Sensex	-5.7	8.3	-9.1	-8.8

Sharekhan Research, Bloomberg

Torrent Pharmaceuticals
USFDA woes to remain an overhang

Torrent Pharmaceuticals Limited (Torrent Pharma) reported a strong set of numbers for Q2FY2020. Sales at Rs. 2,005 crore grew by 6% y-o-y and are marginally below estimates. Operating profit at Rs. 541 crore grew by 14% y-o-y and is broadly in line with estimates. Operating margin expanded by 200 BPS to 27%. PAT at Rs. 244 crore beat our estimates of Rs. 209.5 crore because of lower than expected tax. During the quarter, performance across geographies was subdued. Recently, Torrent's Indrad plant has received a warning letter and the company's Dahej plant was classified as Official Action Indicated (OAI) by the USFDA. OAI status does not impact the existing operations of the company; however, new product approvals would be withheld and could get delayed. We feel this event is likely to remain as an overhang (until successfully closed/resolved).

Key positives

- Strong gross margin of 73.2% (a 210 BPS y-o-y improvement) was reported during the quarter because of better product mix.
- Operating profit margin (OPM) also improved by 200 BPS to 27% during the quarter.

Key negatives

- Warning Letter to Indrad facility and USFDA's OAI status at Dahej facility to delay product approvals. Management expects the overhang to stay over the near to medium term.

Our Call

Valuation - Maintain Hold with unchanged PT of Rs. 1,720: Torrent is trading at 18x its FY2021E earnings. We expect the company to report sales and adjusted profit CAGR of 17% and 43%, respectively, over FY2019-FY2021E. We feel, in the near term, USFDA woes will continue to remain an overhang on the stock price. We have maintained our estimates for FY2020E and FY2021E currently. Due to uncertainty related to USFDA outcome, we maintain our Hold recommendation on the stock with an unchanged price target (PT) of Rs. 1,720.

Key Risk:

Delays in resolution for the US FDA issues at Dahej and Indrad facility

Valuation (Consolidated)

Particulars	Rs cr			
	FY18	FY19	FY20E	FY21E
Net sales	5825.0	7462.0	8450.4	10255.9
OPM (%)	21.0	23.8	24.8	26.2
Adjusted net profit	676.0	793.0	1014.4	1622.8
EPS (Rs.)	39.8	46.6	59.7	95.5
PER (x)	42.3	36.0	28.2	17.6
EV/EBITDA (x)	28.2	19.3	14.9	11.0
Debt: Equity	1.47	1.35	0.95	0.61
ROCE (%)	13.2	12.6	15.8	20.7
RONW (%)	15.1	17.0	19.5	25.3

Source: Company; Sharekhan estimates

Strong operating performance, low tax leads to PAT beat: For Q2FY2020, Torrent Pharma reported 6% y-o-y sales growth, mainly driven by strong growth in domestic business and in rest of world geographies. U.S. revenue declined because of USFDA issues. India business for the quarter reported 10% y-o-y growth at Rs. 1,022 crore (adjusted for base impact of discontinued products, growth was 13% y-o-y). U.S. business reported a drop of 3.6% y-o-y growth to Rs. 380 crore for the quarter. Gross margin for the quarter improved by 210 BPS to 73.2% due to better product mix and savings in raw-material costs. Operating profit grew by 14% to Rs. 541 crore, resulting in OPM of 27% (200 BPS y-o-y improvement). Profit growth for the quarter was robust at 36% y-o-y to Rs. 244 crore, attributable to low tax rate. The company plans to file 15 ANDAs in FY2020.

USFDA regulatory issue at Indrad and Dahej to be an overhang on the stock in the near term: Torrent's plant at Dahej, which was inspected by the USFDA between March 11-19, 2019, has received Form 483 with five observations with none of them relating to data integrity. USFDA classified this inspection under OAI, indicating unsatisfactory response submitted by the company (for Form 483). The OAI status could result in with holding of new product approvals. Secondly, the company's Indrad facility (inspected between April 8-16, 2019) has received a warning letter and is red flagged by the USFDA. If the above issues are not resolved satisfactorily within a stipulated timeframe, then it could result in escalation to a Import Ban Alert. Hence, we feel this event is likely to remain an overhang in the near term (until successfully closed/resolved). Although Dahej plant is relatively new, it is strategically important for the company as several new filings come from this unit.

Q2FY2020 Conference call highlights:

Geographical Revenue Mix: Torrent's domestic revenue (51% of total sales) grew by 10% y-o-y for the quarter, attributable to a steep 8.4% price hike taken by the company. Volumes declined by 3.4% y-o-y. Adjusted for discontinued products, India growth stood at 13%. Revenue from the U.S. (19% of sales) dropped by 3.6% y-o-y, attributable to USFDA issues. Revenue from Brazil grew by 6%, while those from the rest of the world (10% of sales) increased by 15%. Germany revenue remained flat.

ANDA approvals: Torrent has 42 ANDAs pending approvals; and of this, six are with tentative approvals. The company plans to file 15 ANDAs in FY2020. The company launched one product in Q1FY2020 and plans to launch one in 2HFY2020.

R&D Cost: Torrent has incurred R&D cost of Rs. 130 crore in Q2FY2020, which is around 7% of sales. Management has indicated that it aims to maintain R&D cost at 7-8% of sales going ahead.

Debt Repayment: In 1HFY2020, Torrent repaid debt amounting to Rs. 443 crore and has plans to repay debt in excess of Rs. 440 crore in 2HFY2020.

Management confident of USFDA issue resolution: Management stated that since no observations in Form 483 issued by the USFDA (for Dahej plant) relate to data integrity, resolution with USFDA is possible. Management has stated that it would take 12-15 months (from the date of receipt of warning letter/observations) for the issues to be resolved at both the plants. Consequently, U.S. business is expected to be impacted by this.

Results (Consolidated)					Rs cr	
Particulars	Q2FY20	Q2FY19	YoY %	Q1FY20	QoQ %	
Total Sales	2,005.0	1,894.0	5.9	2,022.0	-0.8	
Expenditure	1,464.0	1,421.0	3.0	1,481.0	-1.1	
Operating profit	541.0	473.0	14.4	541.0	0.0	
Other income	34.0	10.0	240.0	20.0	70.0	
EBITDA	575.0	483.0	19.0	561.0	2.5	
Interest	116.0	126.0	-7.9	122.0	-4.9	
Depreciation	163.0	152.0	7.2	160.0	1.9	
PBT	296.0	205.0	44.4	279.0	6.1	
Taxes	52.0	26.0	100.0	63.0	-17.5	
Adjusted PAT	244.0	179.0	36.3	216.0	13.0	
Reported Profit	244.0	179.0	36.3	216.0	13.0	
EPS (Rs.)	14.4	10.5	36.3	12.7	13.0	
Margins			BPS		BPS	
OPM %	27.0	25.0	201	26.8	23	
Adj. PATM %	12.2	9.5	272	10.7	149	

Source: Company; Sharekhan Research

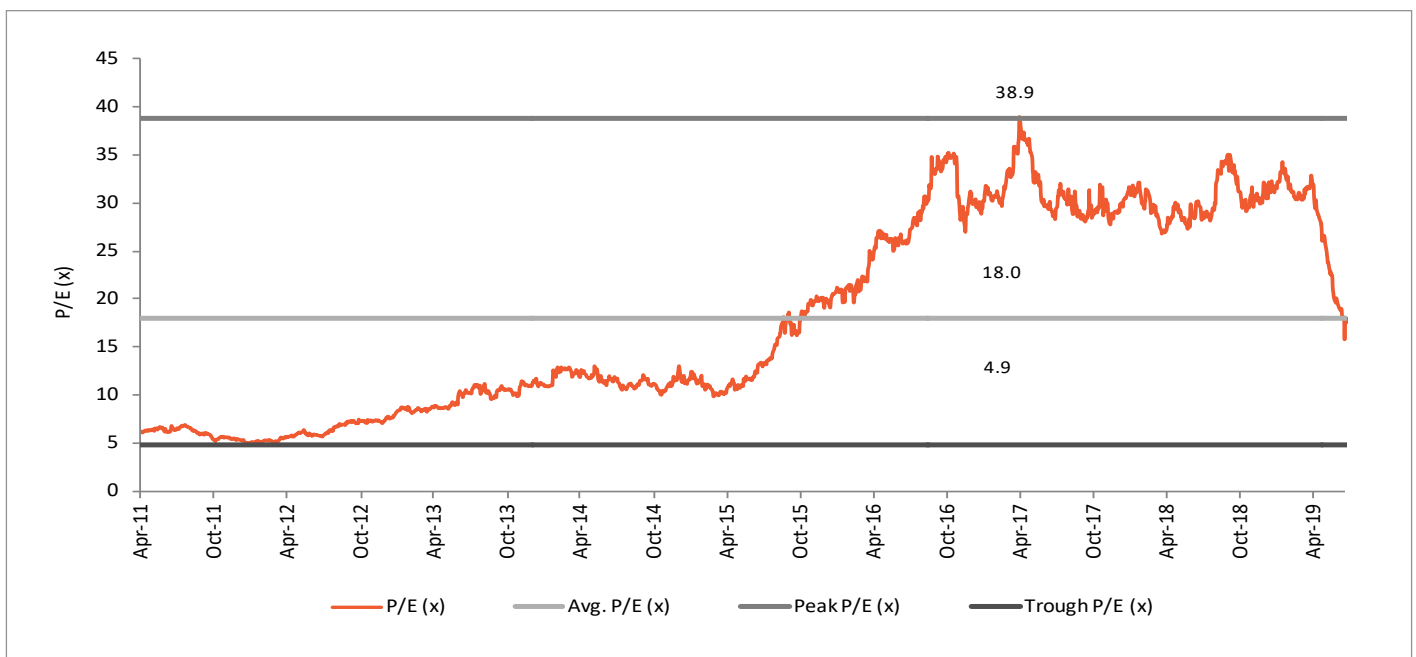
Outlook

Torrent Pharma's operating performance remains strong despite a challenging environment in the U.S. and some slowdown in domestic business. Management stated that since no observations in Form 483 issued by the USFDA relate to data integrity, resolution with USFDA is possible in the near to medium term. We expect the company to report sales and adjusted profit CAGR of 17% and 43%, respectively, over FY2019-FY2021E. USFDA woes will continue to remain an overhang on the stock price, until successfully resolved.

Valuation

Torrent Pharma is currently trading at 18x its FY2021E earnings, which is close to its long-term historical average multiple. However, we feel uncertainty related to USFDA outcome of OAI for Dahej and warning letter issued to Indrad facility are likely to remain an overhang in the near term. Hence, we maintain our Hold recommendation on the stock with an unchanged PT of Rs. 1,720.

One-year forward P/E (x) Band



Source: Sharekhan Research

About company

Torrent Pharma, the flagship company of Torrent Group, was incorporated in 1972. Torrent Pharma has a strong international presence across 40 countries with operations in regulated and emerging markets such as the U.S., Europe, Brazil and Rest of the World. The company operates through its wholly owned subsidiaries spread across 12 nations with major setups in Brazil, Germany and the U.S. The company is also one of the leading pharmaceutical companies present in India as a dominant player in the therapeutic areas of cardiovascular (CV) and central nervous system (CNS). The company also has significant presence in gastro-intestinal, diabetology, anti-infective and pain management segments.

Investment theme

Torrent Pharma continues to focus on branded business mix from India and Brazil, which balances well for sustainable growth in a challenging global environment for the pharma sector. U.S. business is also stable. Operating leverage from acquired domestic business is likely to be visible from FY2020.

Key Risks

- ◆ Slowdown in ANDA approvals and USFDA-related regulatory risks could hurt business prospects.
- ◆ Delay in product launches in Brazil, Germany and the U.S. could restrict growth in these key geographies.
- ◆ Currency fluctuation poses risk to export businesses.

Additional Data

Key management personnel

Mr. Sudhir Mehta	Chairman (Emeritus)
Mr. Samir Mehta	Chairman
Mr. Sudhir Menon	CFO
Dr. Chaitanya Dutt	Director (R&D)
Mr. Mahesh Agrawal	VP (Legal) & Company Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Torrent Pvt Ltd	71.3
2	HDFC Asset Management Co Ltd	2.5
3	UTI Asset Management Co Ltd	1.6
4	MIRAE ASSET FOCUSED	1.5
5	Mirae Asset Global Investments Co	1.5
6	HDFC Life Insurance Co Ltd	1.3
7	SBI Funds Management Pvt Ltd	0.9
8	Reliance Capital Trustee Co Ltd	0.9
9	Vanguard Group Inc/The	0.8
10	T Rowe Price Group Inc	0.8

Source: Bloomberg

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