Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 7,973**	
Price Target: **Rs. 9,249**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

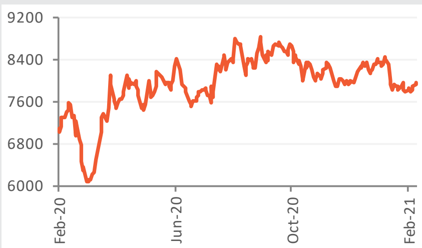
Company details

Market cap:	Rs. 18,361 cr
52-week high/low:	Rs. 8,999 / 5,900
NSE volume: (No of shares)	0.3 lakh
BSE code:	540065
NSE code:	SANOFI
Free float: (No of shares)	91.2 cr

Shareholding (%)

Promoters	60.4
FII	13.6
DII	16.2
Others	9.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-5.2	-3.1	-9.4	12.6
Relative to Sensex	-7.0	-16.0	-38.9	-8.3

Sharekhan Research, Bloomberg

Sanofi India

Better growth prospects ahead

Pharmaceuticals	Sharekhan code: SANOFI	Result Update

Summary

- Sanofi India (Sanofi) reported a weak performance for the quarter with results missing estimates, though numbers are not comparable with previous quarters.
- Strong performance of top 10 brands which have dominant share in their respective segments augurs well and provides visibility on growth ahead.
- Sanofi has recommended dividend per share of Rs. 365 for CY2020, which translates into healthy dividend yield of ~4.5%.
- Better growth prospects, strong balance sheet with no debt, minimal capex, and healthy cash position are the key positives. We retain Buy with an unchanged PT of Rs. 9,249.

Sanofi India (Sanofi) reported a weak performance for the quarter with results missing estimates, though numbers are not comparable with the previous quarters as the company had hived off its Ankleshwar facility. Revenue for the quarter declined by 12.8% y-o-y to Rs. 720 crore and is below estimates. During the quarter, COVID-led challenges had an adverse impact on the topline, which resulted in the decline in sales. Operating profit margin (OPM) for the quarter expanded by 160 bps y-o-y to 23.2%, primarily led by lower operating expenses. Moreover, during the quarter, the company reported a one-time exceptional income of Rs. 7.8 crore, while tax rate was lower. Consequently, adjusted PAT at Rs. 115 crore was down 1.7% y-o-y, missing estimates. Sanofi's Q4CY2020 topline performance was impacted by transient challenges on account of COVID-19; and the same could normalise going ahead. Sanofi is a player with a chronic-intensive focus. The company is present in various therapy areas such as diabetology, cardiology, dermatology, and neurology. Of these, diabetology and cardiology collectively account for more than half of the company's domestic sales and have been growing in double digits. Sanofi has a sizeable presence in cardiology therapy, which has been one of the fastest growing segments for the industry in the quarter ending December 2020. A higher share of chronics augurs well as chronic medicines tend to have sticky demand and provide growth visibility even in uncertain times. Further, strong performance of the top 10 brands (constituting ~ 85% of overall sales) with a dominant share in their respective categories augurs well and provides visibility on growth ahead. Focus on high-growth branded formulations business and favourable mix would help OPM to expand. Consequently, Sanofi's PAT is expected to report double-digit 10% CAGR over CY2020-CY2022E.

Key positives

- Higher share of the chronic segment augurs well, as chronics are the fastest growing segment in the Indian Pharmaceutical Market (IPM).
- OPM expanded by 162 bps y-o-y to 23.2%, backed by savings in operating expenses.
- Management has recommended a dividend of Rs. 365 per share for CY2020, which translates into a strong dividend yield of ~4.5%.

Key negatives

- Sales declined by 12.8% y-o-y, impacted by COVID-led challenges.

Our Call

Valuation: Retain Buy recommendation with an unchanged PT of Rs. 9,249: Sanofi reported a weak performance for the quarter, though numbers are not comparable due to the completion of the slump sale transaction of the Ankleshwar plant. The topline decline for Q4CY2020 could be looked up on as an aberration, attributable to COVID-led challenges, and is expected to normalise going ahead. Moreover, a chronic-heavy portfolio and strong performance of the top brands coupled with a dominant share in their respective categories (due to strong brand positioning) provides comfort on growth ahead. Given the divesture of Ankleshwar plant and increasing focus on the high-growth branded formulations segment, OPM is expected to expand. Therefore, healthy topline growth coupled with margin expansion would result in a double-digit earnings CAGR for CY2020-CY2022. Based on Q4CY2020 performance, we have fine-tuned our earnings estimates for CY2021 and CY2022. At the CMP, the stock is trading at 31.1x/29.1x its CY2021E/CY2022E earnings. Considering high growth visibility from chronics, low exposure to highly regulated markets, strong balance sheet with no debt, minimal capex, and healthy cash position, premium valuations are expected to sustain. Moreover, management has recommended dividend per share of Rs. 365 for CY2020, which translates into healthy dividend yield of ~4.5%. We retain our Buy recommendation on the stock with an unchanged PT of Rs. 9,249.

Key Risks

Inclusion of the company's products in the National List of Essential Medicines could have an adverse impact on earnings performance.

Valuation Rs cr

Particulars	CY2018	CY2019	CY2020	CY2021E	CY2022E
Total Sales	2770.8	3070.6	2901.9	3191.9	3417.2
EBIDTA	713.2	759.4	802.9	896.8	956.9
OPM (%)	22.5	21.7	24.6	25.0	25.4
Reported PAT	380.6	473.5	519.3	590.5	631.0
EPS (Rs.)	165.5	205.9	225.8	256.7	274.4
PER (x)	48.2	38.7	35.3	31.1	29.1
EV/EBITDA (x)	23.8	22.1	20.8	18.5	17.0
P/BV (x)	8.3	7.5	8.7	7.6	6.8
ROCE (%)	25.9	26.0	32.2	32.9	31.4
RONW (%)	17.2	17.0	22.5	24.6	23.4

Source: Company; Sharekhan estimates

Investment Rationale

Weak quarter: Sanofi reported weak performance for Q4CY2020. However, the performance is not comparable to the performance of the previous quarters due to completion of slump sale transaction dated May 29, 2020, which resulted in transfer of Ankleshwar manufacturing facility and few products to the acquirer. Revenue for the quarter declined by 12.8 y-o-y to Rs. 720 crore and was below estimates. Overall sales for the quarter were impacted by COVID-led uncertainties. OPM for the quarter expanded by 160 bps y-o-y, primarily led by lower operating expenses (other expenses/sales declined by 290 bps y-o-y). OPM for the quarter stood at 23.2% as compared to 21.6% in Q4CY2019. Operating profit for the quarter at Rs. 167 crore was down 6.3% y-o-y. Moreover, during the quarter, the company reported one-time exceptional income of Rs. 7.8 crore, while tax rate stood at 27.7% as compared to 39.7% in the corresponding quarter of the previous year. Consequently, adjusted PAT at Rs. 115 crore was down by 1.7% y-o-y, missing our estimates.

Indian pharmaceutical markets growth revives in Q4CY2020: Sanofi is an India focused MNC company. The company derives its revenue from India markets, hence fortunes are linked to that of the IPM. After a decline of 2.5% y-o-y for 1HFY2021, IPM growth has shown signs of revival, reporting 6.4% y-o-y growth for Q3FY2021. A larger chunk of growth can be attributed to price increases (up around 5% y-o-y), followed by share of new product introductions, which contributed to around 3% to overall growth. Overall volumes declined by 1.90% for the quarter, which is an improvement as compared to a 6.6% decline in the quarter ending September 2020. Further, for January 2021, IPM grew by 4.5% y-o-y with select therapy areas such as gastro and vitamins exhibiting strong revival, staging 14.3% and 12.2% growth, respectively, on a y-o-y basis. The pickup in IPM is largely driven by sustained traction in chronic and sub-chronic therapies, while acute therapies are showing signs of pickup. Going ahead, industry reports point that the strong pricing growth and share of new products is expected to sustain, which is likely to be complimented by pick-up in volume growth. Collectively, IPM is expected to report double-digit growth in FY2022, which in turn would have a positive rub-off effect on companies such as Sanofi with a chronic-heavy presence.

Sturdy performance of top brands; Chronic-heavy presence to drive topline growth: Sanofi is a chronics-focused company, with the segment constituting a lion's share of the company's revenue. Within chronics, diabetology and cardiology account for around half of Sanofi's domestic sales. The company has a wide portfolio of anti-diabetic medicines, with larger portion of insulins followed by oral solids. In India, Sanofi is among the leading players in the anti-diabetic category. Going ahead, the company is expected to fortify its presence further, backed by healthy growth in key brands such as Lantus and Amaryl. In addition to anti-diabetics, Sanofi has a major presence in cardiology as well. The therapy segment has been one of the leading growth drivers for the industry recently. Being chronic in nature, cardiology medicines tend to have sticky demand. Cardiology is one of the fastest growing segments in IPM and, hence, has a robust growth outlook. The respiratory portfolio is also likely to grow at a healthy pace going ahead, backed by healthy performance of its key brands - Allegra. The acute segment is also expected to pick up once the lockdown relaxes gradually and OPDs commence, which would drive up prescriptions. Overall Sanofi's top 10 products constitute around 85% of the overall revenue and command a dominating share in the respective categories.

OPM expansion to fuel earnings growth: Sanofi's Q4CY2020 OPM surprised positively, expanding by 160 bps y-o-y to 23.2%. OPM expansion can be attributed to lower operating expense for the quarter. Post the divesture of its Ankleshwar plant, Sanofi's focus has shifted to the high-growth branded formulations segment in domestic markets. The branded formulations segment is lucrative and yields higher margins. Thus, a favourable product mix due to increasing share of branded formulations segment and new launches would help OPM expand. We expect OPM to expand to 25.4% from 24.6% over CY2020-CY2022E. This is expected to lead to a 10% earnings CAGR over the same period.

Results Rs cr

Particulars	Q4CY2020	Q4CY2019	Y-o-Y %	Q3CY2020	Q-o-Q %
Total Sales	720.3	826.3	-12.8	686.6	4.9
Expenditure	553.3	648.1	-14.6	494.4	11.9
Operating Profits	167.0	178.2	-6.3	192.2	-13.1
Other income	16.2	24.8	-34.7	14.9	8.7
Interest	0.4	0.3	33.3	0.4	0.0
Depreciation	20.4	21.5	-5.1	20.6	-1.0
PBT	170.2	161.3	5.5	185.9	-8.4
Taxes	47.2	64.0	-26.3	-53.0	-189.1
Adjusted PAT	115.2	117.2	-1.7	133.1	-13.4
Margins			**BPS**		**BPS**
OPM %	23.2	21.6	162	28.0	-481

Source: Company; Sharekhan Research

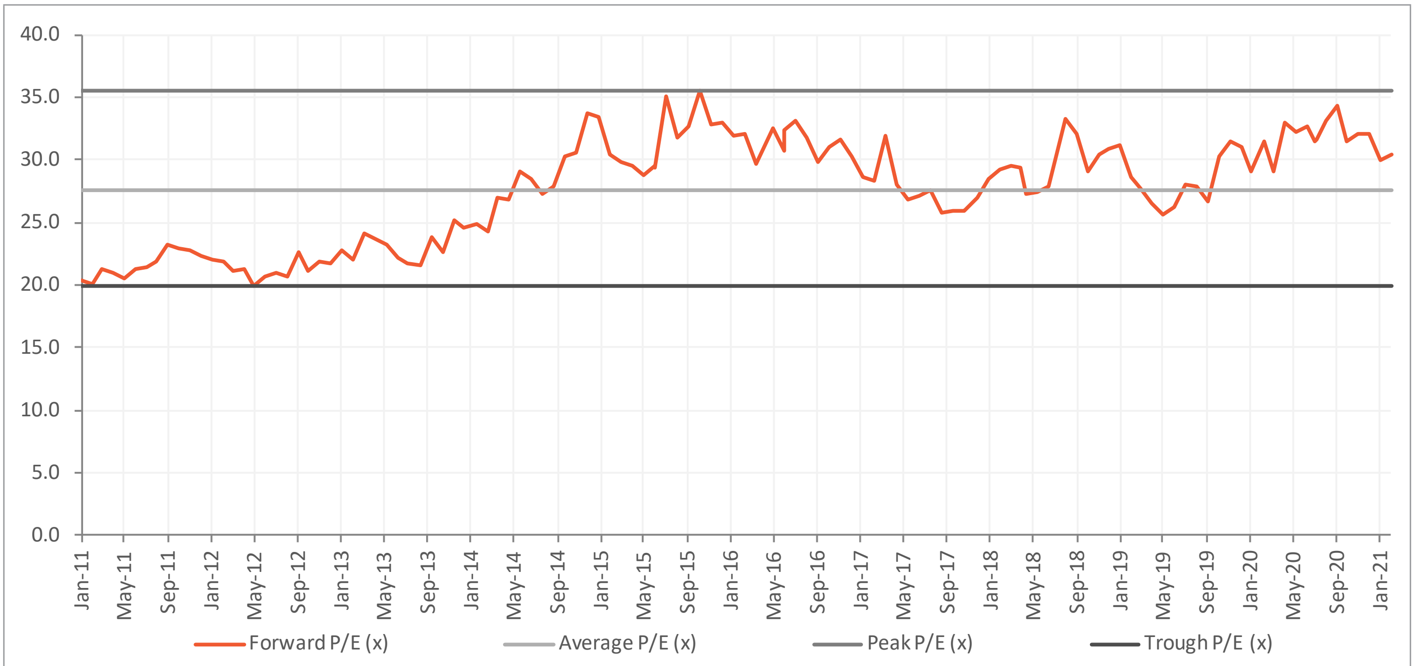
Outlook and Valuation

■ **Sector View: Growth prospects look better:** Indian pharmaceutical companies are better placed to harness opportunities and report healthy growth going ahead. Indian companies are among the most competitive ones globally and hold a sizeable market share in most developed as well as other markets. Moreover, other factors such as easing of pricing pressures (especially in the US generics market), rise in product approvals, and plant resolutions by the USFDA coupled with strong growth prospects in domestic markets and emerging opportunities in the API space would be key growth drivers. This would be complemented by strong capabilities developed by Indian companies (leading to a shift towards complex molecules and biosimilars) and commissioning of expanded capacities by select players over the medium term. Collectively, this indicates a strong growth potential going ahead for pharma companies.

■ **Company outlook - Healthy earnings visibility -** Sanofi is one of the leading MNC pharma companies focused on the Indian market. Diabetology is the company's forte and it is among the fastest-growing companies in India in this space. New launches in the space coupled with the strong parentage offer a healthy growth for the therapy. In addition to anti-diabetics, cardiology is also one of the key segments for the company and is among the fastest growing segments in the IPM. A higher share of chronics (more than half of the revenue) points at stable revenue growth going ahead due to sticky demand for products. Moreover, in the overall industry, the chronic segment is a leading growth driver and this bodes well for Sanofi. Strong growth in the top five brands coupled with OPM expansion (due to a favourable mix) points at sturdy earnings growth.

■ **Valuation - Retain Buy recommendation with an unchanged PT of Rs. 9,249:** Sanofi reported a weak performance for the quarter, though numbers are not comparable due to the completion of the slump sale transaction of the Ankleshwar plant. Topline performance for the quarter could be looked up on as an aberration attributable to COVID-led challenges. We expect this to normalise going ahead. Moreover, strong performance of the top brands coupled with a dominant share in their respective categories (due to strong brand positioning) provides comfort on the growth ahead. Given the divesture of Ankleshwar plant and increasing focus on the high-growth branded formulations segment, OPM is expected to expand. Therefore, healthy topline growth coupled with margin expansion would result in a double-digit earnings CAGR for CY2020-CY2022. Based on Q4CY2020 performance, we have fine tuned our earnings estimates for CY2021/CY2022. At the CMP, the stock is trading at 31.1x/29.1x its CY2021E/CY2022E earnings. Considering high-growth visibility from chronics, low exposure to highly regulated markets, strong balance sheet with no debt, minimal capex, and healthy cash position, premium valuations are expected to sustain. Moreover, management has recommended a dividend per share of Rs. 356 for CY2020, which translates into a healthy dividend yield of ~4%. We retain Buy on the stock with an unchanged PT of Rs. 9,249.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)			EV/EBIDTA (x)			RoE (%)		
				CY20	CY21E	CY22E	CY20	CY21E	CY22E	CY20	CY21E	CY22E
Sanofi India	7,973.0	2.3	18,361.0	35.3	31.1	29.1	20.8	18.5	17.0	22.5	24.6	23.4
Abbott India*	14,475.0	2.1	30,758.0	51.9	41.8	37.5	32.8	27.0	24.0	24.4	26.3	25.3

*Source: * Nos for FY20/FY21E/FY22E*

About company

Sanofi was incorporated in 1956 with the name of Hoechst Fedco Pharma Pvt. Ltd. Sanofi is a subsidiary company of MNC pharma giant, Sanofi SA, based in France. In India, the group operates through three main companies – Sanofi India, Shantha Biotechnics through Sanofi Pasteur (the R&D and vaccine business unit), and Sanofi Genzyme, which provides diagnostics and testing services. Of all the three group companies, Sanofi is the largest subsidiary of Sanofi SA and is one of the leading pharma companies in India present in multiple therapies. The company offers a wide array of medicines across therapies such as diabetology and cardiology, vaccines, respiratory, pain, CNS, gastrointestinal, anti-infectives, and dermatology. Sanofi has a manufacturing facility located in Goa. Sanofi primarily derives a chunk of its revenue from domestic markets (~70% as of CY2018), while the balance is generated from exports markets. However, post the recent divesture of the Ankleshwar plant to Zentiva, revenue share from exports is expected to fall drastically as Ankleshwar plant contributed to around 40% to total exports. The company's top five brands, including Lantus, Combiflam, Allegra, Ameryl, and Hexaxim, constitute 38%-40% of the company's revenue.

Investment theme

Sanofi is one the leading MNC pharma companies focused on Indian markets. Diabetology is the company's forte; and the company is among the fastest-growing companies in India in this space. Sanofi has a strong parentage from Sanofi SA, which is an MNC pharma major. Higher share of chronics points at stable revenue growth going ahead due to the sticky/inelastic demand for products. Strong growth in the top five brands coupled with OPM expansion points at sturdy earnings growth. High-growth visibility from chronics, low exposure to highly regulated US markets, strong balance sheet with no debt, minimal capex, healthy cash position, and sturdy cash conversion cycle are key drivers that would enable to sustain premium valuations.

Key Risks

- The National List of Essential Medicines is expected to be revised in CY2020; and if in case, any of Sanofi's products are included under this, it would adversely impact growth.
- Any negative impact on the top five brands/high-growth products would impact earnings.

Additional Data

Key management personnel

Mr Aditya Narayan	Chairman
Mr Rajaram Narayan	Managing Director
Mr Charles Billard	Whole Time Director & CFO
Usha Thorat	Independant Director

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Standard Life Aberdeen PLC	3.38
2	Aditya Birla Sunlife Trustee Co	2.97
3	PineBridge Investments	2.79
4	UTI Asset Management Co	2.12
5	Reliance Capital Trustee Co	2.01
6	SBI Funds Management	1.63
7	L&T Mutual Fund trustee Ltd / India	1.13
8	Bajaj Allianz Life Insurance Co	1.1
9	HDFC Life Insurance Co	1.05
10	Vangaurd Group PLC	0.81

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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