Sharekhan by BNP PARIBAS

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Stock Update

Solara Active Pharma Sciences

Synergetic Merger, Earnings accretive

Pharmaceuticals	Sharekhan code: SOLARA	Company Update

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. 1,441**	
Price Target: **Rs. 1,730**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

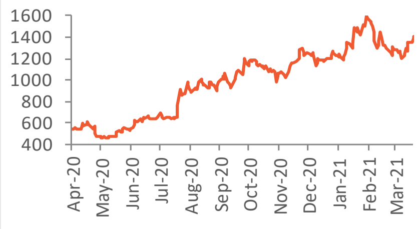
Company details

Market cap:	Rs. 5,174 cr
52-week high/low:	Rs. 1,625 / 439
NSE volume: (No of shares)	0.9 lakh
BSE code:	541540
NSE code:	SOLARA
Free float: (No of shares)	2.0 cr

Shareholding (%)

Promoters	44.1
FII	28.8
DII	4.6
Others	22.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	12.6	17.7	27.7	164.6
Relative to Sensex	18.3	21.0	9.8	108.6

Sharekhan Research, Bloomberg

Summary

- The Board of Solara has approved the amalgamation of Aurore Life Sciences, Empyrean Life Sciences, and Hydra Active Pharma Sciences with Solara.
- The merger opens up substantial growth opportunities for Solara going ahead.
- The combined entity would be a pure play API company of scale, with a strong presence in regulated markets and emerging markets, having a broad product portfolio, robust operations infrastructure, and excellent R&D capabilities; and it would strengthen the CRAMS business of Solara with clear synergies to further accelerate growth.
- We retain our Buy recommendation on the stock with a revised PT of Rs. 1,730.

The Board of Solara Active Pharma Sciences (Solara) has approved the amalgamation of Aurore Life Sciences (Aurore), Empyrean Life Sciences, and Hydra Active Pharma Sciences with Solara. Post the merger, Solara would also hold a 67% stake in Aurore Pharmaceuticals Private Limited. The merger is in line with Solara's strategy of accelerating growth through inorganic route. Post merger, the combined entity would be a pure play API company of scale, with a strong presence in regulated markets and emerging markets, having a broad product portfolio, robust operations infrastructure, and excellent R&D capabilities; and it would strengthen Solara's CRAMS business with clear synergies to further accelerate growth. Aurore's well-diversified product portfolio (non-overlapping with that of Solara), a healthy filling pipeline of 20+ DMFs in regulated markets of the US, and a strong presence in the Asia Pacific region of Japan and Korea (which have been the focus markets for Solara) offer substantial synergies and provide ample growth visibility. Moreover, strong and established R&D capabilities at Aurore are expected to increase the product filling to 25 per annum under the merged entity as compared to 8-10 fillings from Solara's end now. Aurore's revenue from CRAMS business is almost double that of Solara and, thus, would yield scale benefits. In addition, non-overlapping customer and high value and niche product portfolios are the key positives that would drive growth ahead for CRAMS. Other benefits including synergies from integration are expected to accrue, which in turn could enhance the competitive advantage for Solara going ahead. On the financial front, Aurore has better OPM of ~32% as compared to around 24% for Solara, which is a key positive. The merger is expected to be completed by Q4FY2022 post requisite approvals in place. Solara's existing business is also well placed to grow and is expected to comfortably achieve management's growth guidance of 40% y-o-y for FY2021 EBITDA.

Our Call

Valuation – Retain Buy with a revised PT of Rs. 1,730: Aurore's merger with Solara opens up substantial growth opportunities for Solara going ahead, especially in areas of product portfolio (non-over-lapping), strong customer relationships, integration benefits, enhancing geographical reach, and augmenting manufacturing capacities. Solara's CRAMS business is also expected to benefit from Aurore's high-value and niche portfolio and also bring in benefits of scale. Solara's existing capex plans would well support Aurore's need for capacities going ahead, which would enable a faster ramp up in market share for few products. R&D synergies would enable the merged entity to almost triple the product filling rate per year to around 25 products. Overall, the combined entity would be a pure play API company of scale and would provide a compelling value proposition for both generic API and CRAMS customers, which provide ample growth visibility. Our quick estimates suggest that the merger could be EPS accretive and could drive the earnings higher by 2%-4% for FY2022E/FY2023E, though we would await further clarity on financials. At the CMP, the stock is trading at an attractive valuation of 19.6x/15.3x its FY2022/FY2023E EPS. The company's strong growth prospects, better earnings visibility, healthy balance sheet, and improving return ratios would support multiple expansions. We retain our Buy recommendation on the stock with a revised price target (PT) of Rs. 1,730.

Key Risks

1) Any adverse change in the regulatory landscape can impact earnings prospects; 2) delay to complete the merger with Aurore beyond Q4FY2022.

Valuation Rs cr

Particulars	FY2019	FY2020	FY2021E	FY2022E	FY2023E
Total Sales	1386.7	1321.8	1705.1	2033.9	2442.1
EBIDTA	220.8	259.4	409.2	480.0	581.2
OPM (%)	15.9	19.6	24.0	23.6	23.8
Reported PAT	67.1	114.5	218.4	260.8	334.6
EPS (Rs.)	18.9	32.3	61.6	73.5	94.4
PER (x)	76.2	44.6	23.4	19.6	15.3
EV/EBIDTA (x)	24.7	21.7	13.7	11.5	9.1
P/BV (x)	5.3	4.7	3.9	3.3	2.7
ROCE (%)	9.9	10.8	16.4	17.0	18.3
RONW (%)	7.0	10.5	16.8	16.8	17.9

Source: Company; Sharekhan estimates

Solara to merge Aurore Life Sciences with itself, merger to be EPS accretive from FY2022: Solara's board has approved a scheme of merger of Aurore with itself in an all-stock transaction. Along with this, Empyrean Lifesciences Private Limited and Hydra Active Pharma Sciences Private Limited (both Aurore's group companies) shall also be merged into Solara. Post the merger, Solara would also hold 67% stake in Aurore. The appointed date for the merger is April 1, 2021, and the merger is expected to be complete by Q4FY2022 post the receipt of requisite approvals. Since the merger is an all-stock transaction, Solara shall be issuing around 1.32 crore equity shares to the promoters of Aurore, which represent around 27% stake in the merged entity. As of FY2021, Aurore has reported revenue of Rs. 545 crore, OPM of around 32% (Solara's OPM are around 24% levels), and PAT of Rs. 95 crore. Going ahead, with strong growth outlook for Aurore by the management, we believe earnings could grow strongly and, in the process, add to Solara's earnings growth.

Aurore's strong product pipeline, R&D capabilities, and presence in Solara's focus markets point at significant synergies for growth ahead: Established in 2017, Aurore is a pure play API company. Since inception, Aurore has developed strong capabilities in the areas of API and CRAMS. The company has two manufacturing plants in India with a capacity of 800 KL and one of the flagship plants is compliant with major regulators world over. Further, based on strong R&D capacities, the company is emerging as the reliable supplier in the API and key intermediates space. The combined entity post the merger would be a pure play API company of scale, with a strong presence in regulated markets, emerging markets, a broad product portfolio, robust operations infrastructure, and excellent R&D capabilities; and it will strengthen the CRAMS business of Solara with clear synergies to further accelerate growth.

Synergies between Solara and Aurore

Parameter	Solara	Aurore	Merged Entity
Manufacturing Sites (nos)	6	2	8
R&D Center (nos)	2	1	3
Commercial Products (nos)	60	40	100
DMF's (nos)	90	20	110
Employees (nos)	2500	700	3200
Scientist (nos)	200	110	310

Source: Company, Sharekhan Research

Aurore has a very well-diversified product portfolio spread across key therapy areas as well as key markets. The top 10 products constitute around 29% of the overall revenue, including CRAMS business, which management expects to reach to 50% to 60% levels going ahead with more approvals flowing in. Of the top 10 products, eight products hold a position in the top three in their respective segments, which points at a strong position. Aurore also has a strong presence in the high-value ARV segment, in which Solara does not have a presence, thus facilitating entry in new therapy areas as well. With respect to the filling pipeline, Aurore has a strong 20+ DMF's filed in the US with none overlapping with that of Solara. Further, Aurore has dedicated established capabilities in R&D, which complement that of Solara. Post the merger, management expects the filling rate to touch around 25 per year as compared to 8 to 10 per year for Solara. Further, Solara has identified Asia Pacific region for growth going ahead; and Aurore has a strong presence in this region, thus synergizing on the geographical front as well. Moreover, Aurore has around seven fillings in Chinese markets, taking the total submissions to 14 under Solara, thus strongly complementing growth in Chinese markets. Collectively, a well-diversified product portfolio, strong filling pipeline, R&D capabilities, foray into new areas of ARV for Solara, and strong presence in Asia Pacific region are key synergy areas arising from the merger and are key focus area from a growth perspective.

Key Concall Highlights:

Merger to generate significant synergies for the CRAMS business: Solara's CRAMS business is still at a nascent stage with revenue of around Rs. 75 crore. This compares with Rs. 150 crore revenue from Aurore's CRAMS segment, which is double that of Solara, thus pointing at possible scale benefits. Further, the customer profile of CRAMS business is significantly diversified and Aurore's strong customer relations can be leveraged for opportunities in high-value molecules. Further, in CRAMS, Aurore has a well-balanced product portfolio with a good mix of high volume (Amlodipine, Valacyclovir) and niche products (Nafamostat Camostat, Levothyroxine), which complement Solara's strategy at a different scale. In the CRAMS space, Aurore has completed sizeable investments in the ARV space, which provides Solara an entry in the new space, generating a new growth avenue.

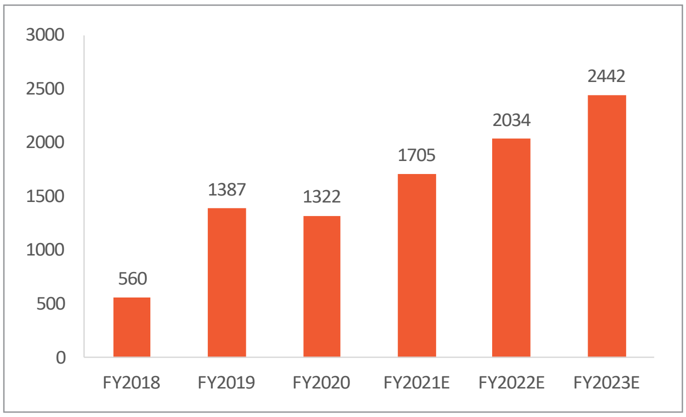
Aurore's strong demand traction and Solara's capex plan highly complementary: Aurore currently has a capacity of 800 KL spread across two plants, which is likely to be consummated. Therefore, Solara's capex plans at Vizag will cater to Aurore's need for capacities and enable faster ramp up.

Benefits of backward integration to accrue: The merger of Solara and Aurore is expected to benefit Solara in terms of improving integration levels. Aurore's presence in key intermediates will enable supply chain de-risking by providing backward integration for key starting materials (KSMs), while Aurore's scale would provide supply chain efficiencies and, in a way, boost competitive advantage.

Other benefits expected from the merger: The merger between both the companies would provide cross-selling opportunities as well as provide an opportunity for partnering with customers for specific product/ products. Further, Aurore's well-diversified product portfolio would be leveraged properly by Solara's strategic customer-focused approach, leading to further strengthening of customer relations.

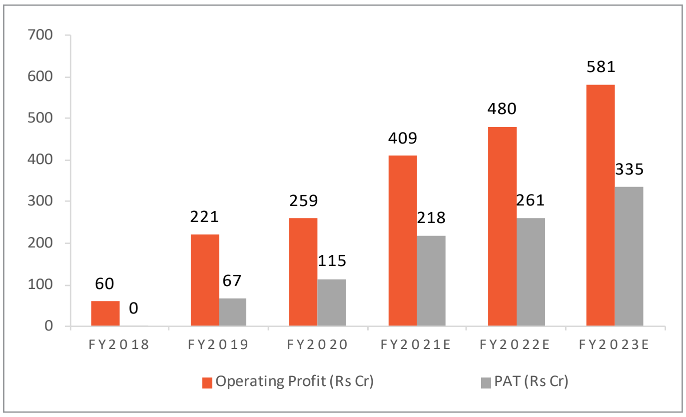
Financials in charts

Sales Trends Rs Cr



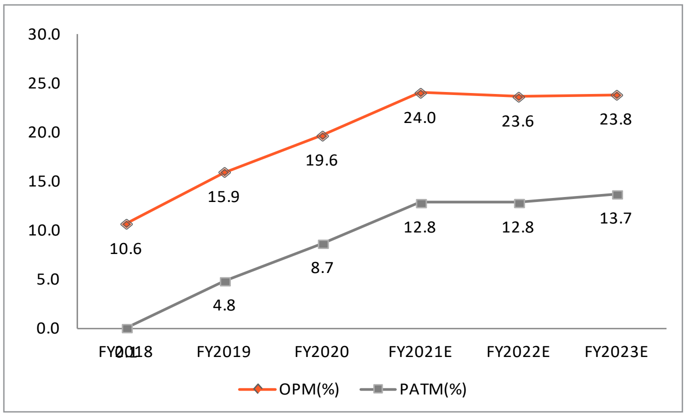
Source: Company, Sharekhan Research

Operating Profit - PAT Trends



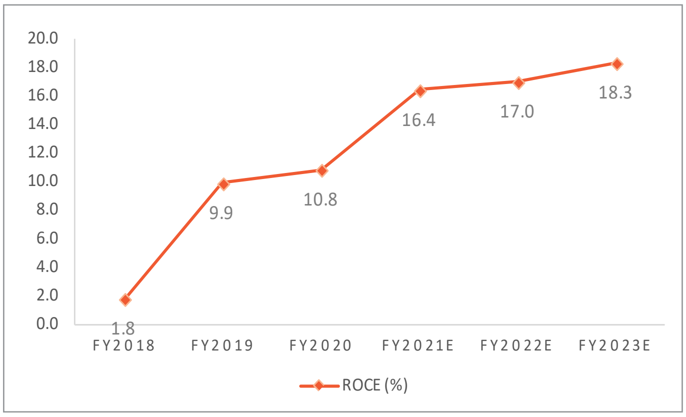
Source: Company, Sharekhan Research

Margins on an improving trend



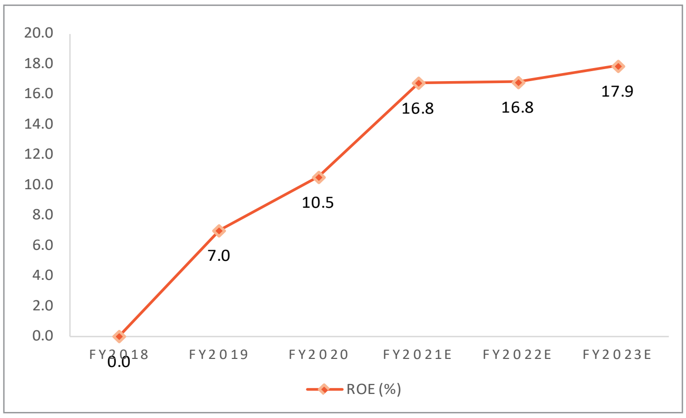
Source: Company, Sharekhan Research

ROCE (%)



Source: Company, Sharekhan Research

Return ratios improving (RoE %)



Source: Company, Sharekhan Research

Debt : Equity (x)

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Growth momentum to improve:

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.

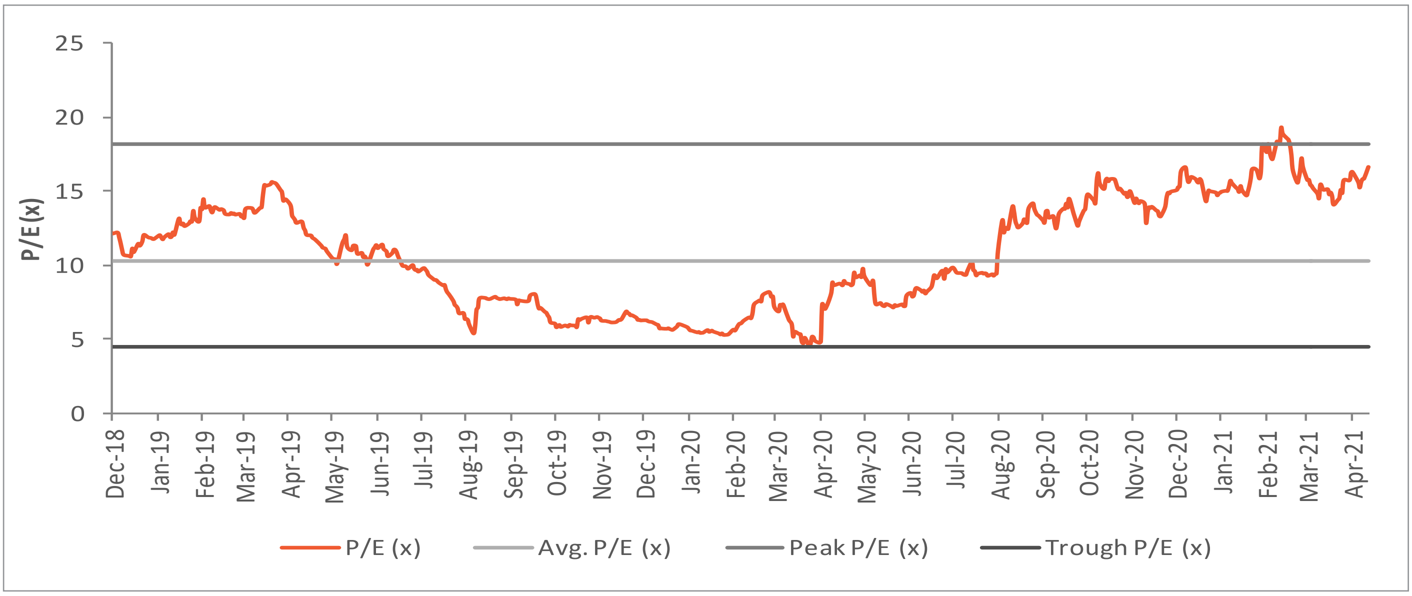
■ Company outlook - Strong growth prospects:

There are immense opportunities ahead for pure play API companies such as Solara to grow going ahead. Excess dependence on China has led to dual source qualification, which augurs well for API companies such as Solara. Solara has initiated efforts to backward integrate KSMs of its key APIs as well as collaborate with local manufacturers to reduce its dependence on China. While there are cost differences between India and China, the deciding factor in a post-COVID-19 world would be supply chain reliability along with quality, as it has taken precedence over pricing. Solara's overarching objective remains to bridge the industry gap by delivering value-based products that cater to customer requirements. The company is well poised to grow as a leading 'global pure-play API company' focusing on highly compliant business operations. In addition to this, management's emphasis on the CRAMS business bodes well, as it yields better margins as compared to the API business. The fruits of this are likely to accrue over the long term. The recent merger of Aurore is highly synergistic to Solara's business and is expected to open up substantial growth opportunities going ahead.

■ Valuation - Retain Buy with a revised PT of Rs. 1,730:

Aurore's merger with Solara opens up substantial growth opportunities for Solara going ahead, especially in areas of product portfolio (non-over-lapping), strong customer relationships, integration benefits, enhancing geographical reach, and augmenting manufacturing capacities. Solara's CRAMS business is also expected to benefit from Aurore's high-value and niche portfolio and also bring in benefits of scale. Solara's existing capex plans would well support Aurore's need for capacities going ahead, which would enable a faster ramp up in market share for few products. R&D synergies would enable the merged entity to almost triple the product filling rate per year to around 25 products. Overall, the combined entity would be a pure play API company of scale and would provide a compelling value proposition for both generic API and CRAMS customers, which provide ample growth visibility. Our quick estimates suggest that the merger could be EPS accretive and could drive the earnings higher by 2%-4% for FY2022E/FY2023E, though we would await further clarity on financials. At the CMP, the stock is trading at an attractive valuation of 19.6x/15.3x its FY2022/FY2023E EPS. The company's strong growth prospects, better earnings visibility, healthy balance sheet, and improving return ratios would support multiple expansions. We retain our Buy recommendation on the stock with a revised price target (PT) of Rs. 1,730.

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/EBITDA (x)			RoE (%)		
				FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Solara Active Pharma Sciences	1441	3.5	5174	44.6	23.4	19.6	21.7	13.7	11.5	10.5	16.8	16.8
Divis Laboratories	3,783.0	26.5	1,00,437.0	77.6	51.1	39.0	52.0	34.8	26.9	17.7	22.1	23.2
IPCA Laboratories	2154	12.6	27315	45.0	23.5	22.2	30.4	16.8	15.3	18.1	27.7	22.8

Source: Company, Sharekhan Research

About company

Solara is a customer-oriented API manufacturer. The company has legacy of over three decades and has its origins traced from the API expertise of Strides Shasun Limited and the technical know-how of human API business of one of the leading pharma companies. Solara has 200+ scientists, six API manufacturing facilities armed with global approvals, and two dedicated R&D facilities. Solara offers a basket of diversified, high-value commercial APIs, and contract manufacturing services in over 75 countries, covering the entire lifecycle of a new chemical entity, from pre-clinical and clinical phases to validation and commercial supply, while fully complying with domestic and international guidance. The company is focusing on highly compliant business operations and customer support. The company's six API manufacturing facilities are located in Ambernath (near Mumbai), Cuddalore, Mangalore, Mysore, Puducherry, and Visakhapatnam with a capacity of over 2,000 KL.

Investment theme

The pandemic has opened up immense opportunities for the Indian pharmaceutical sector. Excess dependence on China has led to dual source qualification, while stocking of essential medicines has led to increased demand in the short to medium term. Solara has initiated efforts to backward integrate KSMs of its key APIs as well as collaborate with local manufacturers to reduce its dependence on China. While there are cost differences between India and China, the deciding factor in a post COVID-19 world will be supply chain reliability, as it has taken precedence over pricing. Solara's overarching objective remains to bridge the industry gap by delivering value-based products that cater to customer requirements. In addition to this, management's emphasis to grow the CRAMS business bodes well, as it yields better margins as compared to the API business. The fruits of this are likely to accrue over the long term. The recent merger of Aurore is highly synergistic to Solara's business and is expected to open up substantial growth opportunities going ahead.

Key Risks

1) Any adverse change in the regulatory landscape can impact earnings prospects; 2) delay to complete the merger with Aurore beyond Q4FY2022.

Additional Data

Key management personnel

Mr Deepak Vaidya	Chairman & Non Executive Director
Mr Bharat Sesha	Managing Director & Chief Executive Officer
Mr. Subash Anand	Chief Financal officer

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	TPG GROWTH IV SF PTE. LTD.	4.09
2	SBI MAGNUM MIDCAP FUND	3.57
3	IMF Holdings	3.01
4	Chayadeep ventures	2.81
5	HBM Halthcare investments	1.58
6	Kotak Mahindra Asset Management Co	0.61
7	Devicam Capital LLP	0.42
8	Dimensional Fund Advisors	0.27
9	Agnus Holdings Pvt Ltd	0.2
10	State Street Corp	0.19

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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