Stock Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Sanofi India Ltd

Weak quarter; focus on core biz to drive growth

Pharmaceuticals	Sharekhan code: SANOFI
Reco/View: Buy ↔	CMP: Rs. 7,277 / Price Target: Rs. 9,250 ↓

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 37.92

Updated Oct 08, 2021

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

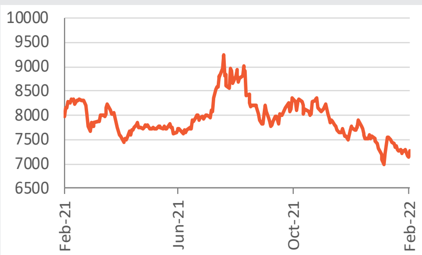
Company details

Market cap:	Rs. 16,760 cr
52-week high/low:	Rs. 9,300 / 6,946
NSE volume: (No of shares)	17,890
BSE code:	500674
NSE code:	SANOFI
Free float: (No of shares)	91.2 cr

Shareholding (%)

Promoters	60.4
FII	10.3
DII	19.1
Others	10.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-0.7	-10.1	-17.5	-8.7
Relative to Sensex	2.4	-7.7	-20.5	-23.8

Sharekhan Research, Bloomberg

Summary

- We retain Buy recommendation on Sanofi India Limited (Sanofi) with a revised PT of RS 9250.
- Sanofi reported weak performance for quarter and results missed estimates. Although numbers are not comparable on a y-o-y basis due to the hiving off of the neutraceuticals business. Revenues and adjusted PAT declined by 4.5% and 26.5% yoy respectively.
- Divesture of Nutraceuticals business as well as slow moving brands, to remove a drag on the company's growth and would facilitate enhanced focus on key growth areas – anti diabetes, cardiac.
- High-growth visibility from chronics, strong, debt-free balance sheet, sturdy dividends and healthy cash position are the key positives.

Sanofi India Limited (Sanofi) reported a weak performance for the quarter and results missed estimates. However, numbers are not comparable on a y-o-y basis due to the hiving off of the neutraceuticals business. Revenue at Rs. 688 crore declined by 4.5% y-o-y, while operating profit margin (OPM) contracted steeply by 469 bps y-o-y, reflecting cost pressures and operating de-leverage. Consequently, adjusted PAT at Rs. 90.4 crore declined by 26.5% y-o-y and was below estimates. With divestment of the slow-moving business – Nutraceuticals and Soframycin and Sofradex recently and Ankaleshwar plant in the previous year, the company is eyeing a linear cost structure and has created a bandwidth to enhance focus on growing its core therapies of diabetes cardiac, which bodes well from a growth perspective.

Key positives

- Management has declared a sturdy dividend per share of Rs. 490 for CY2021 as against Rs. 365 in CY2020.
- Divesture of the slow-moving business (Nutraceuticals) and brands (Soframycin and Sofradex) removes a drag on the company's overall growth.

Key negatives

- Revenue declined by 4.5% y-o-y to Rs. 688 crores.
- Gross margin and OPM contracted by 100 bps and 469 bps y-o-y, respectively, pointing at high cost pressures.

Revision in estimates – Given the weak performance for Q4CY2021 with results missing estimates, we have revised downwards our earnings estimates by 8% and 9% for CY2022E and CY2023E, respectively.

Our Call

Valuation – Retain Buy with a revised PT of Rs. 9,250: Sanofi has divested its slow-moving business and has laid its focus on the anti-diabetic's segment for growth and is looking to enhance its geographical penetration. Moreover, a chronic-heavy portfolio, strong performance of top brands, and a dominant share in their respective categories provide comfort on growth ahead. At the CMP, the stock trades at 27x and 24.3x, respectively, its CY2022E and CY2023E estimates. Considering its high-growth visibility from chronics, strong and debt-free balance sheet, sturdy dividends, and healthy cash position, premium valuations are expected to sustain. We retain our Buy recommendation on the stock with a revised price target (PT) of Rs. 9,250.

Key Risks

1) Inclusion of the company's products in the National List of Essential Medicines could have an adverse impact on earnings performance; and 2) Slow growth in top brands.

Valuation Rs cr

Particulars	CY2020	CY2021	CY2022E	CY2023E
Total Sales	2901.9	2956.6	3079.7	3295.1
EBIDTA	802.9	836.9	905.9	1000.8
OPM (%)	24.6	25.8	27.0	28.0
Adjusted PAT	519.3	568.2	620.3	687.8
EPS (Rs.)	225.8	247.0	269.7	299.1
PER (x)	32.2	29.5	27.0	24.3
EV/EBITDA (x)	18.8	17.6	16.0	14.2
ROCE (%)	32.2	33.2	32.4	32.3
RONW (%)	22.5	42.5	25.0	24.8

Source: Company; Sharekhan estimates

Weak quarter: Sanofi reported a weak performance for the quarter and results missed estimates. Although numbers are not comparable on a y-o-y basis due to the hiving off of the neutraceuticals business. Revenue at Rs. 688 crore declined by 4.5% y-o-y and missed estimates. OPM at 18.5% contracted steeply by 469 bps y-o-y and missed estimates. Margin contraction can be attributed to the 100 bps gross margin drop coupled with higher employee costs and other expenses due to operating de-leverage. Consequently, EBITDA for the quarter stood at Rs. 27.2 crore, down 23.8% y-o-y. Reflecting the weak operating performance, adjusted PAT at Rs. 90.4 crore declined by 26.5% y-o-y and was below estimates.

Healthy outlook for IPM: Sanofi is an India focused pharmaceutical company. Hence, growth is reflective of IPM growth. After modest 1.6% y-o-y growth for FY2021, IPM growth has bounced back; and for 9MFY22, IPM grew by 19% y-o-y, largely backed by a low base in the corresponding period of the previous year. YTD growth is supported by a 9.6% growth in volumes, while the share of pricing and new products stand at ~4.4% and 5.4%, respectively. Adjusted for the high growth months of April and May 2021, IPM growth stood at 10.7% y-o-y, which is encouraging. Going ahead, industry reports point that pricing growth and the share of products are expected to sustain and would be well supported by volume growth. Overall, industry reports indicate that IPM is expected to report double-digit growth in FY2022 and is likely to sustain the momentum in FY2023 as well. While in the near term, acute therapies have increasingly contributed to IPM's growth (due to a significantly low base as demand was impacted in the pandemic times). Going ahead, chronic is also expected to catch up. Emerging lifestyle diseases are likely to drive demand for chronic medicines upwards. This bodes well for chronic-heavy companies such as Sanofi.

Top brands to sustain healthy growth momentum: Sanofi is a chronic-focused company. Within chronic, diabetology, and cardiology account for around half of Sanofi's domestic sales. Sanofi 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. The company looks to fortify its presence further, backed by likely faster growth in key brands such as Lantus and Amaryl. In addition to anti-diabetics, Sanofi has a sizeable presence in cardiology as well. Being chronic in nature, cardiology medicines tend to have sticky demand. Cardiac therapy drugs have staged healthy growth of ~9% y-o-y for April-December 2021, while anti-diabetes products have reported ~7% y-o-y growth. Both cardiology and anti-diabetes segments have been among the consistently growing therapy areas in IPM and have a healthy growth outlook. Sanofi is also present in the respiratory segment and this has been one of the leading growing segments in IPM, registering strong 35% y-o-y growth over April–December 2021. Going ahead, expected traction in key brands – Allegra are expected to support the respiratory segment's growth. Overall, Sanofi's top 10 products constitute around 80% plus of overall revenue and command a dominating share in their respective categories.

Soframycin and Sofradex divestment bodes well: Sanofi has recently announced a divestment of its two brands – Soframycin and Sofradex for a consideration of Rs. 125 crore. Post the divestment, the acquiring company would have the right to exclusively sell and distribute these products in the territories of India and Sri Lanka. As both these products divested were slow moving products and were a drag on the company. However, the divesture of these products bodes well as it would enable the company to focus on its key therapies/products, which are comparatively fast-moving products and have a good growth potential.

OPM expansion to drive earnings growth: In Q4CY2021, OPM contracted by 469 bps y-o-y to 18.5%, attributable to 100 bps contraction in gross margin and overall increase costs. Moreover, operating de-leverage added to margin contraction. However, the margin outlook stays strong, backed by a slew of factors. Sanofi is looking to enhance its geographical presence by leveraging the digital platform partly to engage with physicians and is accordingly investing to build the same. We expect the shift to a hybrid model to expand reach, which could result in operational efficiencies. Moreover, the company has divested its slowgrowing nutraceuticals business as well as two brands (Soframycin and Sofradex), which were a drag on overall growth and this bodes well. Therefore, we expect OPM to expand by 220 bps to 28%, leading to a strong 10% earnings CAGR over CY2021-CY2023E.

Results (Standalone) **Rs cr**

Particulars	Q4CY2021	Q4CY2020	YoY %	Q3CY2021	QoQ %
Revenue	687.9	720.3	-4.5	754.5	-8.8
Operating Profit	127.2	167.0	-23.8	198.8	-36.0
Other income	16.3	16.2	0.6	14.7	10.9
Interest	0.4	0.4	0.0	0.5	-20.0
Depreciation	10.9	20.4	-46.6	14.3	-23.8
PBT	132.2	170.2	-22.3	198.7	-33.5
Taxes	41.8	47.2	-11.4	-45.7	-191.5
Adjusted PAT	90.4	123.0	-26.5	153.0	-40.9
Adj. EPS (Rs.)	39.3	53.5	-26.5	66.5	-40.9
Margins			**BPS**		**BPS**
OPM %	18.5	23.2	-469	26.3	-786
Adj PAT Margins (%)	13.1	17.1	-393	20.3	-714
Tax Rate (%)	31.6	27.7	389	-23.0	5,462

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector outlook – 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 and 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 pharmaceutical companies.

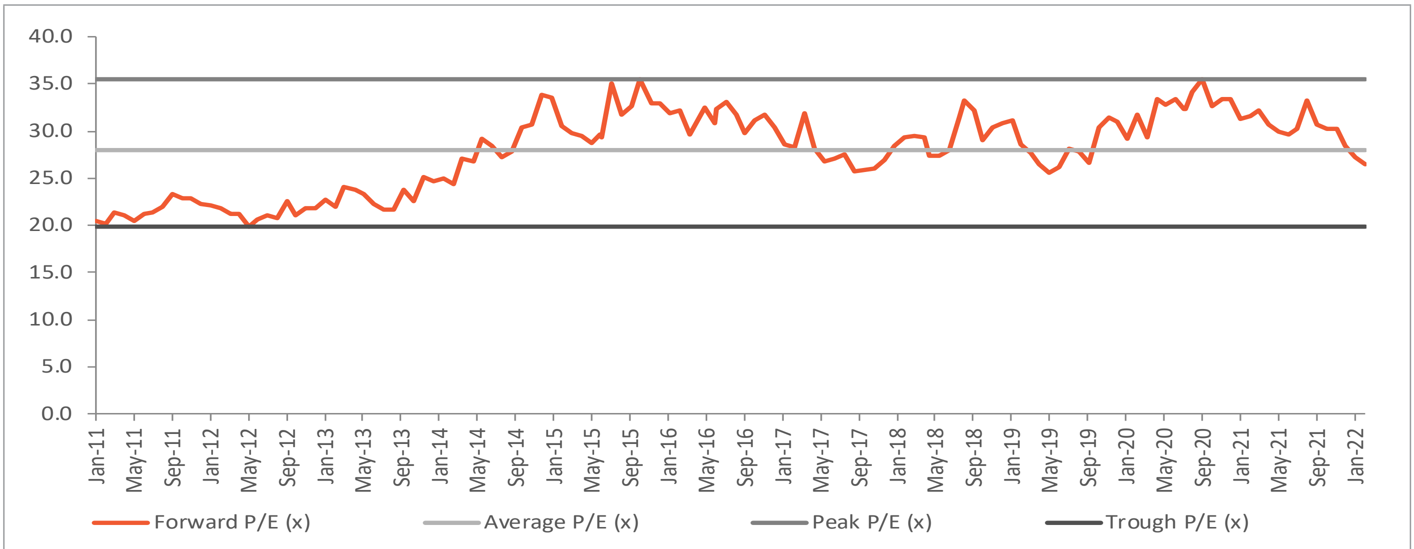
■ Company outlook – Healthy earnings growth

Sanofi is an MNC pharmaceutical companies focused on the Indian market. Diabetology is the company's forte and it is among India's fastest-growing companies in this space. New launches in diabetology and a strong parentage point at healthy growth prospects. In addition to anti-diabetics, cardiology is one of the key segments for the company. Sanofi is also present in the respiratory space, which is also a fast-growing segment in the IPM. A higher share of chronic (that fetch more than half of the revenues) 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 brands and OPM expansion point at sturdy earnings growth. Further, post the divesture of the Ankaleshwar unit, the company as a part of strategic review has also divested nutraceuticals business along with its slow-moving brands (Soframycin and Sofradex) and this would help Sanofi set a higher focus on its key growth pillars.

■ Valuation – Retain Buy with Revised PT of Rs. 9250

Sanofi has divested its slow-moving business and has laid its focus on the anti-diabetics segment for growth and is looking to enhance its geographical penetration. Moreover, a chronic-heavy portfolio, strong performance of top brands, and a dominant share in their respective categories provide comfort on growth ahead. At the CMP, the stock trades at 27x and 24.3x, respectively, its CY2022E and CY2023E estimates. Considering its high-growth visibility from chronics, strong and debt-free balance sheet, sturdy dividends, and healthy cash position, premium valuations are expected to sustain. We retain our Buy recommendation on the stock with a revised PT of Rs. 9,250.

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 (%)		
				CY21	CY22E	CY23E	CY21	CY22E	CY23E	CY21	CY22E	CY23E
Sanofi India	7,277.0	2.3	16,760.0	29.5	27.0	24.3	17.6	16.0	14.2	42.5	25.0	24.8
Abbott India*	17,010.0	2.1	36,145.0	52.3	44.7	39.4	33.8	28.8	25.1	26.5	26.6	25.6

Source: Company, Sharekhan estimates (Nos for FY21/FY22E/FY23E)*

About the 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 Ankaleshwar plant to Zentiva, revenue share from exports is expected to fall drastically as Ankaleshwar 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 pharma MNCs focused on the Indian market. 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 brands/high-growth products would impact earnings.

Additional Data

Key management personnel

Mr Aditya Narayan	Chairman
Mr Rajaram Narayan	Managing Director
Mr Vaibhav Karandikar	Whole Time Director & CFO

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Standard Life Aberdeen PLC	3.4
2	Aditya Birla Sunlife Trustee Co	3.0
3	PineBridge Investments	2.8
4	UTI Asset Management Co	2.1
5	Reliance Capital Trustee Co	2.0
6	SBI Funds Management	1.6
7	L&T Mutual Fund trustee Ltd / India	1.1
8	Bajaj Allianz Life Insurance Co	1.1
9	HDFC Life Insurance Co	1.1
10	Vangaurd Group PLC	0.8

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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