Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Torrent Pharmaceuticals Limited

Mixed quarter; concerns yet to abate

Pharmaceuticals	Sharekhan code: TORNTPHARM	Result Update

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

+ Positive = Neutral - Negative

Reco/View	Change
Reco: **Hold**	↔
CMP: **Rs. 2,654**	
Price Target: **2,871**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

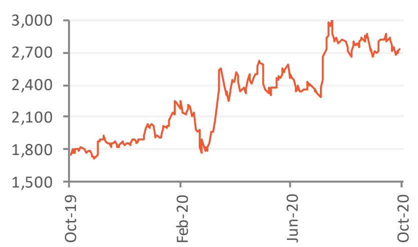
Company details

Market cap:	Rs. 44,919 cr
52-week high/low:	Rs. 3,040/1,619
NSE volume: (No of shares)	5.96 lakh
BSE code:	500420
NSE code:	TORNTPHARM
Free float: (No of shares)	4.9 cr

Shareholding (%)

Promoters	71.3
FII	8.7
DII	12.3
Others	7.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-2.5	14.0	9.1	52.1
Relative to Sensex	-9.9	8.7	-19.0	49.3

Sharekhan Research, Bloomberg

Summary

- We retain Hold recommendation on the stock of Torrent Pharma (Torrent) with a revised PT of Rs 2871.
- Torrent reported a mixed performance for the quarter with results missing estimates. Revenues were flat YoY, while PAT grew 27% backed by OPM expansion.
- Outlook for the India business is healthy and Torrent looks to outperform the industry growth. Other markets such as US are under stress, while Europe performance is likely to improve, though over medium term.
- USFDA response on resolution for Dahej & Indrad is awaited. Rich valuation and recent run up in stock prices leaves limited upside.

Torrent Pharmaceuticals Limited (Torrent) reported a mixed performance for Q2FY2021. Revenues at Rs. 2,017 crore were flat on a y-o-y basis but were below estimates. The domestic business grew by 7.5% which offset the 6.4% decline in the international business. Operating profit margin (OPM) at 31.5% expanded 450 bps y-o-y, backed by savings in other expenses , due to lower marketing spends. OPM's were in line with estimates. Tracking the operating performance, the PAT for the quarter stood at Rs 310 crore, up 27% y-o-y,but missed our estimates. Torrent has higher dependence on chronic therapies, which bodes well for the company. The company derives 55-60% of its sales collectively from India and Brazil markets. Torrent has outperformed the industry growth in both these markets and looks to sustain momentum backed by new launches, albeit over the medium to -long term. In its commentary, management mentioned that the patient footfalls are on an improving trend and now stand around 75-80% of pre COVID levels. However the adverse currency situation for Brazil, is expected to over weigh the healthy performance. The Europe (Germany) performance though is improving after a decline for 4 consecutive quarters, a meaningful revival is expected in FY2022 and onwards. Growth in the US is expected to be constrained due to price erosion and absence of new launches. Torrent has submitted responses to the USFDA for all its plants and is awaiting a response from the regulator. The management expects the Levittown plant to commence operations possibly by end of FY2021, while a revert from the USFDA on Dahej and Indrad is awaited. Timely and successful resolution of USFDA issues is critical from growth perspective as new product approvals could be expected once the plants get clearances.

Key positives

- The India formulations business grew by 7% for the quarter, outperforming the growth in the Indian pharmaceutical markets.
- Torrent has repaid Rs. 440 crore of debt in H1FY2021 and has guided to repay a higher amount in 2HFY2021.

Key negatives

- The gross margins contracted by 63 BPS y-o-y to 72.5%.
- Brazil revenues declined by 18% y-o-y impacted by the adverse currency situation.
- US revenue declined by 14% due to continued price erosion and absence of new launches.

Our Call

Maintain Hold with a Revised PT of 2871: Torrent has reported a mixed performance for the quarter, largely backed by a growth in the domestic business, while the international business declined. Going ahead the outlook for the India business is healthy and the company expects to outperform the industry growth. The international business is expected to be under stress, attributable to a weak performance of US business. The Brazil region is also witnessing pressures on account of a adverse currency situation. The Europe (Germany) business is witnessing gradual improvement, though a meaningful revival is expected FY2022 onwards. A successful resolution of the USFDA WL /OAI status for Dahej, Indrad, and Levittown plants are critical from a growth perspective. The management has submitted its response to the USFDA and is awaiting a revert from the regulator. Torrent's sales and PAT are expected to grow by 11% / 18% CAGR over FY2020-FY2023. On the basis of the Q2FY2021 results we have tweaked our FY21/FY22 estimates and have introduced FY2023 estimates. At the CMP the stock is trading at 30.8x / 26.5x its FY2022 / FY2023 E EPS, which has been trending towards the higher end of the long term average multiple, thus leaving limited scope for multiple expansion. Also Torrent's stock price has run up substantially and has risen by ~40% in the past seven months. Consequently, we retain Hold recommendation on the stock with a revised PT of Rs 2871.

Key risk

Delays in resolution of USFDA issues at its plants.

Valuation (Consolidated) Rs cr

Particulars	FY2019	FY2020	FY2021E	FY2022E	FY2023E
Net sales	7461.0	7780.0	8442.3	9349.1	10584.9
Operating Profit	1772.0	2011.0	2330.1	2608.4	2984.9
OPM (%)	23.8	25.8	27.6	27.9	28.2
Adjusted net profit	792.0	1025.0	1247.0	1466.6	1700.7
EPS (Rs)	46.6	60.3	73.4	86.3	100.0
PER (x)	57.0	44.0	36.2	30.8	26.5
EV/Ebidta (x)	28.6	25.2	21.1	18.3	15.5
P/BV (x)	9.6	9.4	7.7	6.4	5.3
ROCE (%)	12.6	14.8	17.3	18.6	19.8
RONW (%)	16.9	21.5	23.3	22.7	22.0

Source: Company; Sharekhan estimates

Mixed performance for Q2FY2021: Torrent reported a mixed set of results for Q2FY2021. The results missed estimates. Revenues for the quarter were almost flat on a y-o-y basis to Rs 2017 crore and were below our estimated Rs 2142 crore. The India revenues grew 7.5% while the revenues from the international operations declined by 6.4% y-o-y. The operating margins for the quarter stood at 31.5%, an expansion of 450 bps y-o-y and were in line with the estimates. The expansion in operating margins can be largely attributable to the savings in the other expenses due to lower SGA (the MR visits were lower during the quarter). The operating profits for the quarter stood at Rs 635 crore a growth of 17% YoY, but were below the estimates of Rs 671 crores. The tax rate for the quarter stood at 19.3% as compared to 17.6% in Q2FY2020. Tracking the operating performance, the PAT for the quarter stood at Rs 310 crore, up 27% y-o-y, but missed our estimates.

India business to outperform the industry growth; US and Brazil to be under stress; Europe on the improvement path: Torrent's India business largely comprises the domestic formulations business, which has staged a healthy growth of 7% y-o-y to Rs 963 crore. The chronic therapies constitute around 77% of the formulations pie and this has been growing at a healthy pace (as the demand for these medicines tends to be sticky) and is expected to sustain the strong growth. The management expects the domestic market growth to outperform the industry growth. With the doctors returning to the OPDs, the Medical representatives (MR) visits are also expected to increase. Also the company expects the field force productivity to improve to Rs 10 lakhs over a period of time as compared to Rs 8 lakh for the quarter. This would also be supported by growth from new products, whose contribution is expected to improve. The outlook for the German (Europe) business is also improving and the management expects a pick up over the next few quarters, though a meaningful growth is expected in FY2022. Brazil is also an important market for Torrent and the volumes in the market have posted a strong growth, which the management believes to sustain going ahead. However an adverse currency movement (depreciation of the Brazillian real) is expected to over weigh on the growth in the near to medium term at-least. Torrent's US business too is under stress on the back of lack of new launches, adverse impact of price erosion in US generics and temporary withdrawal from the Sartans. Also the USFDA clearance for Dahej and Indrad plant is awaited, which also slows down the growth of the US business.

CAPA at Indrad and Dahej plants done; USFDA response awaited: Torrent's Dahej plant, inspected by the USFDA (between March 11-19, 2019) was classified as OAI, indicating an unsatisfactory response submitted by the company (for Form 483). Indrad facility (inspected between April 8-16, 2019) has received a warning letter and is red flagged by the USFDA. The management has mentioned that it has completed its corrective and preventive actions (CAPA) around the areas highlighted by the USFDA and has submitted its responses. A reply from the USFDA is awaited on this. Moreover, the US manufacturing plant located at Levittown (Pennsylvania) was also issued a warning letter for cGMP violations relating to finished pharmaceutical products. Currently, production at Levitt town plant is completely stalled and management expects to start production of at the plant towards the end of FY2021. Torrent's sizeable fillings for the US markets are linked to Dahej and Indrad plants. Moreover, as these are yet to be cleared by the USFDA, new product approvals are on hold. The company has submitted its responses to the regulator and is awaiting a revert.

Q2FY2021 Conference call highlights:

Geographical revenue mix

- Torrent's domestic revenue grew by 7% y-o-y for the quarter to Rs 963 crore. The company has outperformed the industry's growth because of its chronic heavy portfolio. As per AIOCD, Q2FY2021 growth was 7% versus India Pharmaceutical Market (IPM) growth of 1%. As of Q2FY2021, the company had an MR strength of 4,000 and productivity stood at Rs.8 lakhs. The company looks to improve the productivity to Rs 10 lakhs.
- Revenue from the US declined by 13.9% y-o-y to Rs 327 crore, impacted by price erosion in the base business and absence of new product launches.

- Revenue from Brazil at Rs. 129 crore declined in double digits by 18% y-o-y for the quarter. However, constant currency sales increased by 5% y-o-y. Torrent has outperformed the industry, clocking a growth of 7.8% as compared to a 6% growth of the industry. The outperformance was driven by its Chronic portfolio and market share gains. The company expects the Brazil market to clock a healthy growth (3-6% in the branded generics space) and Torrent is expected to outperform the market growth in the local currency terms.
- Europe (Germany) sales grew 4% yoy to Rs 261 crore, after a decline in 4 consecutive quarters. The company has largely completed the upgradation of its quality management systems. The revenue traction is expected to improve going ahead.

ANDA approvals (US markets): As of Q2FY2021, the company has 47 ANDAs pending for approvals and the company received six tentative approvals. Torrent filed for 1 ANDA during the quarter.

Debt repayment: In 1HFY2021, the company has repaid around Rs. 440 crore debt and management expects to repay a higher amount as compared to 1HFY2021 backed by improving cashflows. As of September, total debt on books stood at ~Rs. 3952 crore.

Results (Consolidated) Rs cr

Particulars	Q2FY2021	Q2FY2020	YoY %	Q1FY2021	QoQ %
Total Sales	2,017.0	2,005.0	0.6	2,056.0	-1.9
Operating profit	**635.0**	**541.0**	**17.4**	**661.0**	**-3.9**
Other income	6.0	34.0	-82.4	4.0	50.0
EBITDA	641.0	575.0	11.5	665.0	-3.6
Interest	92.0	116.0	-20.7	102.0	-9.8
Depreciation	165.0	163.0	1.2	161.0	2.5
PBT	384.0	296.0	29.7	402.0	-4.5
Taxes	74.0	52.0	42.3	81.0	-8.6
Adjusted PAT	310.0	244.0	27.0	321.0	-3.4
Margins			**BPS**		**BPS**
OPM %	31.5	27.0	450	32.1	-67

Source: Company; Sharekhan Research

Outlook and Valuation

Sector View – Growth momentum to improve

Indian pharmaceutical companies are better placed to harness opportunities and clock 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 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 the key growth drivers. This would be complemented by the strong capabilities developed by Indian companies (leading to a shift towards complex molecules, 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.

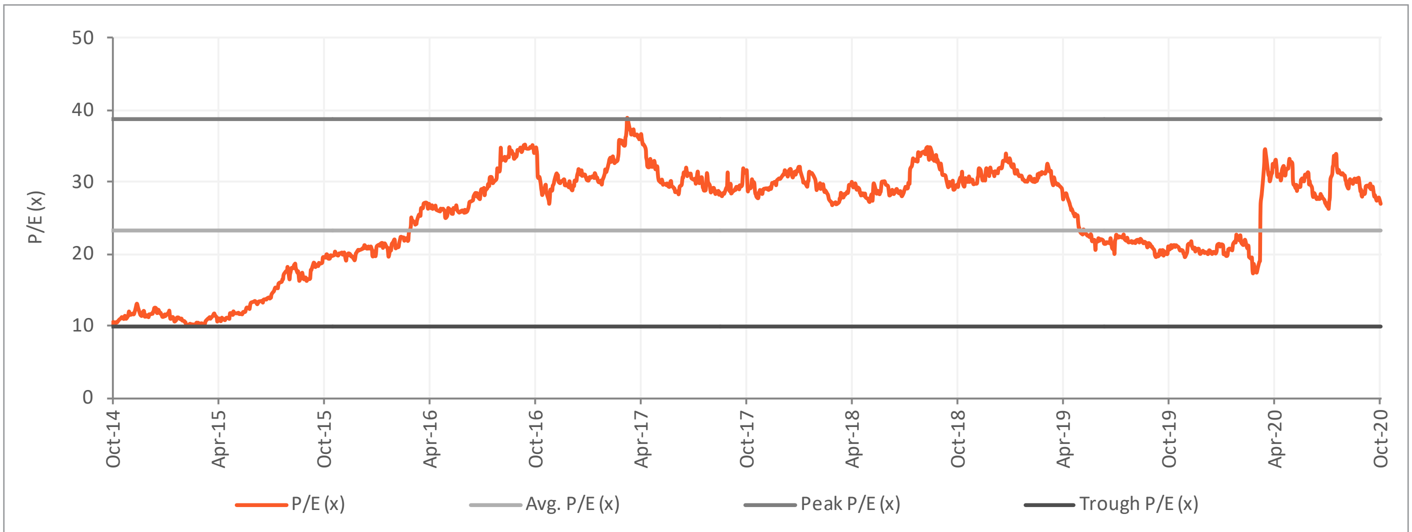
Company Outlook – Concerns yet to abate

Torrent is a leading pharma company present in emerging as well as developed markets. The company has a higher exposure to chronic therapies. Moreover, the company derives a substantial portion of its sales from India followed by US, Germany, and Brazil. The company has been outperforming in the Indian as well as Brazilian markets and management expects to sustain the traction going ahead as well. However the adverse currency situation in Brazil is expected to over-weigh on the performance of the company. The performance in the Europe is also getting on the improvement path albeit a meaningful revival is likely in FY2022.The US business of the company has been under pressure as three of its plants, which cater to US markets – Dahej, Indrad, and Levit town (US) are under the USFDA scanner with OAI/WL classification. Torrent has submitted its responses to the regulator and is awaiting a response from USFDA on this. Torrent expects the Levittown plant to commence operations by the end of FY2021. A timely and successful resolution of these issues is critical from the company's growth perspective as new product approvals are held up, while price erosion is impacting the base business.

Valuation – Maintain Hold with a Revised PT of 2871

Torrent has reported a mixed performance for the quarter, largely backed by a growth in the domestic business, which offset decline in the international business. Going ahead the outlook for the India business is healthy and the company expects to outperform the industry growth. The international business is expected to be under stress, attributable to a weak performance of US business. The Brazil region is also witnessing pressures on account of a adverse currency situation. The Europe (Germany) business is witnessing gradual improvement, though a meaningful revival is expected FY2022 onwards. Torrent's three plants – Dahej, Indrad, and Levittown are under USFDA scanner. Management sees the Levittown plant to commence operations by end of FY2021, a revert on Dahej and Indrad plants is awaited from the USFDA. A timely and successful resolution of both these plants is critical from the growth perspective. Torrent's sales and PAT are expected to grow by 11% / 18% CAGR over FY2020-FY2023. Basis the Q2FY2021 results we have tweaked our FY21/FY22 estimates and have introduced FY2023 estimates. At the CMP the stock is trading at 30.8x / 26.5x its FY2022 / FY2023 E EPS, which has been trending towards the higher end of the long term average multiple, thus leaving limited scope for multiple expansion. Also Torrent's stock price has run up substantially and has risen by ~40% in the past seven months. Consequently, we retain Hold recommendation on the stock with a revised PT of Rs 2871.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)			EV/EBIDTA (x)			RoE (%)		
				FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Torrent Pharma	2654	16.99	44919	44.0	36.2	30.8	25.2	20.7	17.9	21.5	23.1	22.0
Lupin	963	45.3	43,658	123.7	34.3	26.7	20.8	14.9	11.7	2.8	9.2	10.6

Source: Company, Sharekhan estimates

About company

Torrent, the flagship company of Torrent Group, was incorporated in 1972. Torrent has a strong international presence across 40 countries with operations in regulated and emerging markets such as the US, Europe, Brazil, and the Rest of the World. The company operates through its wholly owned subsidiaries spread across 12 nations with major setups in Brazil, Germany, and US. 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 a significant presence in gastro-intestinal, diabetology, anti-infective, and pain management segments.

Investment theme

Torrent continues to focus on a branded business mix from India and Brazil, which balances well for sustainable growth in a challenging global environment for the pharma sector. US business is also stable. Operating leverage from the acquired domestic business is likely to be visible from FY2020. Three manufacturing plants of Torrent are reeling under regulatory issues with a warning letter being issued by the USFDA. Management expects at least 12-15 months for the issues to be resolved; and till such time, approvals from these plants would be withheld. Torrent has submitted its responses to the regulator and is awating a revert on this. Timely and successful resolution of the USFDA issues is critical from the growth perspective.

Key Risks

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

Additional Data

Key management personnel

Mr. Sudhir Mehta	Chairman (Emeritus)
Mr. Samir Mehta	Executive 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	FMR LLC	1.53
2	UTI Asset Management Co Ltd	1.27
3	HDFC Asset Management	1.05
4	HDFC Life Insurance Co Ltd	1.00
5	Axis Asset Management Co Ltd/India	0.99
6	Mirae Asset Global investment Company	0.93
7	Vangaurd Group Inc	0.89
8	T Rowe Price Group Inc	0.8
9	Blackrock Inc	0.75
10	Reliance Capital Trustee Co Ltd	0.6

Source: Bloomberg

Sharekhan Limited, its analyst or dependant(s) of the analyst might be holding or having a position in the companies mentioned in the article.

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

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Disclaimer: This document has been prepared by Sharekhan Ltd. (SHAREKHAN) and is intended for use only by the person or entity to which it is addressed to. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This Document is subject to changes without prior notice. This document does not constitute an offer to sell or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Though disseminated to all customers who are due to receive the same, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this report.

The information contained herein is obtained from publicly available data or other sources believed to be reliable and SHAREKHAN has not independently verified the accuracy and completeness of the said data and hence it should not be relied upon as such. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Recipients of this report should also be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other reports that are inconsistent with and reach different conclusions from the information presented in this report.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

The analyst certifies that the analyst has not dealt or traded directly or indirectly in securities of the company and that all of the views expressed in this document accurately reflect his or her personal views about the subject company or companies and its or their securities and do not necessarily reflect those of SHAREKHAN. The analyst further certifies that neither he or its associates or his relatives has any direct or indirect financial interest nor have actual or beneficial ownership of 1% or more in the securities of the company at the end of the month immediately preceding the date of publication of the research report nor have any material conflict of interest nor has served as officer, director or employee or engaged in market making activity of the company. Further, the analyst has also not been a part of the team which has managed or co-managed the public offerings of the company and no part of the analyst's compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document. Sharekhan Limited or its associates or analysts have not received any compensation for investment banking, merchant banking, brokerage services or any compensation or other benefits from the subject company or from third party in the past twelve months in connection with the research report.

Either SHAREKHAN or its affiliates or its directors or employees / representatives / clients or their relatives may have position(s), make market, act as principal or engage in transactions of purchase or sell of securities, from time to time or may be materially interested in any of the securities or related securities referred to in this report and they may have used the information set forth herein before publication. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;

Disclaimer: Client should read the Risk Disclosure Document issued by SEBI & relevant exchanges and the T&C on www.sharekhan.com; Investment in securities market are subject to market risks, read all the related documents carefully before investing.