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Sanofi India

Mixed quarter; Promising outlook

Pharmaceuticals	Sharekhan code: SANOFI	Result Update

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

\+ Positive = Neutral - Negative

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 8,384**	
Price Target: **Rs. 9,249**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

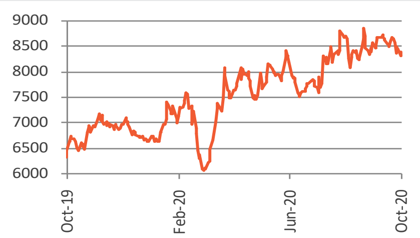
Company details

Market cap:	Rs. 19,308 cr
52-week high/low:	Rs. 8,999/5,900
NSE volume: (No of shares)	26,922
BSE code:	500674
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	-2.0	8.9	9.8	29.8
Relative to Sensex	-10.4	2.1	-17.9	26.6

Sharekhan Research, Bloomberg

Summary

- We retain a Buy recommendation for Sanofi India (Sanofi) with an PT of Rs 9249.
- Sanofi reported a mixed performance for Q3CY2020, though numbers are not comparable with the previous quarters. Revenues declined 11.9% YoY to Rs 687 crore, Adjusted PAT declined 19.8% to Rs 133 crore
- Higher Share of Chronic, which provides a stable stream of revenues coupled with sustained traction from the top brands and margin expansion, due to favorable mix, to lead to double digit earnings growth over CY2019-CY2022E.
- Better growth prospects, low exposure to regulated markets, strong balance sheet, healthy cashflows, would continue to support premium valuations.

Sanofi India (Sanofi), reported mixed performance for the quarter. Though the numbers are not comparable with the previous quarters as the company had hived off its Ankleshwar facility. The revenues for the quarter declined 11.9% y-o-y to Rs 687 crore and were below estimates. Low IPM (Indian Pharmaceutical Markets) growth coupled with weak performance by few therapy areas due to COVID related restrictions impacted the performance for the quarter. The operating margins surprised positively expanding by 547 bps y-o-y to 28% and were above the expectations. The operating profits at Rs 192 crore grew 9.5% y-o-y. Adjusting for exceptional expenses in corresponding quarter and low tax therein, adjusted PAT declined by 19.8% y-o-y to Rs 133 crore. We believe Q3CY2020 performance has some amount of aberration, attributable to low IPM growth, impact of COVID-related uncertainties and expect this to normalise going ahead. Sanofi is a player with a chronic-intensive focus. It has presence in therapies 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 for the quarter ending September 2020. Strong growth momentum is expected to sustain. A higher share of chronics augurs well as chronic medicines tend to have sticky demand and provide growth visibility even in uncertain times. Focus on high-growth branded formulations business and a favourable mix would help OPM expand. Consequently, Sanofi's PAT is expected to report double-digit 11% CAGR over CY2019-CY2022E.

Key Positives:

- Higher share of chronic segment augurs well as chronics are the fastest growing segment in IPM
- OPM expanded 547 bps y-o-y to 28%, which is a positive surprise.

Key Negatives:

- Employee cost / sales up by 100 bps y-o-y for the Q3CY2020.

Our Call

Valuation: Retain Buy Recommendation with a PT of Rs 9249: Sanofi reported a mixed performance for the quarter, though the numbers are not comparable due to the completion of the slump sale transaction. The performance for the quarter could be looked at as an aberration due to the COVID impact and low growth of the IPM. We believe this will normalize going ahead. Pharma MNC companies such as Sanofi with a high degree of India exposure are comparatively well positioned to grow. Sanofi focuses on chronic therapies and a higher share of this segment augurs well as it provides a stable revenue stream. This coupled with expected traction in top brands and rising OPM is likely to drive earnings growth. Basis the Q3CY2020 performance we have fine tuned our earnings estimates for CY2021/CY2022. At CMP, the stock is trading at 31.9x/29.9x its CY2021E/CY2022E earnings. Considering high growth visibility from chronics, low exposure to highly regulated markets, strong balance sheet with no debt, minimal capex, healthy cash positions, premium valuations are expected to sustain. We retain Buy recommendation on the stock with an PT of Rs 9249.

Key Risks

The National List of Essential medicines is expected to be revised every year. If any of Sanofi's products are included under this, it would adversely impact the earnings prospects.

Valuation Rs cr

Particulars	CY2018	CY2019	CY2020E	CY2021E	CY2022E
Total Sales	2770.8	3070.6	2990.8	3328.7	3584.6
EBIDTA	713.2	759.4	840.5	940.9	1001.1
OPM (%)	22.5	21.7	24.8	25.0	25.2
Reported PAT	380.6	473.5	552.0	604.8	644.3
EPS (Rs)	165.5	205.9	240.0	263.0	280.1
PER (x)	50.7	40.7	34.9	31.9	29.9
EV/Ebidta (x)	25.1	23.3	20.5	17.9	16.5
P/BV (x)	8.7	7.9	7.0	6.2	5.6
ROCE (%)	25.9	26.0	26.7	26.8	25.8
RONW (%)	17.2	17.0	19.9	19.4	18.6

Source: Company; Sharekhan estimates

Note: We now convert Sanofi India into a Stock update; it was earlier a 'Viewpoint' under our coverage.

Investment Rationale

Mixed performance: Sanofi reported a mixed performance for Q3CY2020. The performance though is not comparable to the performance of the previous quarters due to due to completion of slump sale transaction dated 29 May 2020, which resulted in transfer of Ankleshwar manufacturing facility and a few products to the acquirer. The revenues for the quarter declined 11.9%y-o-y to Rs 687 crore and were below estimates. Few of the therapy areas were effected due to COVID-19 restrictions which impacted the performance for the quarter. The operating margins surprised positively expanding by 547 bps y-o-y to 28% and were above the expectations. The operating profits at Rs 192 crore also grew 9.5% y-o-y. The corresponding quarter had a low tax base with the tax rate of 4.6% as against a 28.5% tax rate for Q3CY2020. Consequently the adjusted PAT stood at Rs 133 crore down 19.8% y-o-y (Q3CY2019 reflected exceptional expenses of Rs 39.4 crore pertaining to slump sale of Ankaleshwar plant, which is adjusted in the PAT) and missed estimates.

Indian Pharmaceutical markets report a muted performance in September quarter; Chronics amongst the fast growing segments: Sanofi is a MNC pharma company deriving a higher share of revenues from the Indian markets and hence the fortunes are linked to that of the IPM (Indian Pharmaceutical Markets),that bounced back in September after a decline in August and an almost flat growth in July 2020. For the month of September, the industry recorded a six-month high growth of 4.5% as compared to a 2.2% decline in the month of August, while growing by a meager 0.2% y-o-y in July 2020. The growth for the quarter ended September stood muted in low single digits ~1% y-o-y on the back of 6.5% decline in volumes. The price growth and new products growth 4.6% y-o-y and 2.9% y-o-y respectively. Among therapies, chronics grew the most lead by cardio which recorded a growth of 11.5%/13% and 17% y-o-y in the months of July / August / September respectively. While the antidiabetic therapies grew by almost mid single digits in the quarter. The IPM is expected to grow in mid single digits for FY21, with a chunk of the growth being contributed by chronic segment. Better growth visibility amidst uncertain times augurs well. Sanofi is a chronic heavy company with presence in the diabetology and cardiology segments. Chronics account for more than half of the company's revenue and this augurs well as it provides a stable revenue stream.

Higher share of chronics, strong performance of top brands to aid revenue growth: Sanofi is a chronics-focused company with the segment constituting a lion's share of the revenues. 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 India is amongst the leading in the anti-diabetic category. The revenues from the diabetic segment grew at an impressive 17% CAGR over the past 4 years (between CY2015-CY2019). Going ahead the strong growth traction is expected to sustain backed by a healthy growth in the key brands such as Lantus, Toujeo, Amaryl and Apidra. In addition to anti-diabetics, Sanofi has a major presence in the cardiology as well. The therapy segment has been one of the leading growth drivers for the industry recently. Being chronic in nature, the cardiology medicines tend to have a sticky demand. The cardiology is one of the fastest growing segments in the IPM and hence also has robust growth outlook. The respiratory portfolio too is likely to grow at a healthy pace going ahead, backed by healthy performance of its key brands - Allegra and Avil. The acute segment is also expected to pick up once the lockdown relaxes gradually and OPDs commence, which would drive up prescriptions.

OPM expansion to fuel earnings growth: Sanofi india's Q3CY2020 operating margins surprised positively, expanding by 547 BPS y-o-y to 28%. The operating margins expansion could be attributable to the 250 bps y-o-y expansion in the gross margins while saving in other expenses also added to the OPM expansion. Post the divesture of its Ankleshwar plant; Sanofi's focus has shifted to high-growth branded formulations segment in domestic markets. The branded formulations segment is lucrative one and yields relatively higher margins. Thus, a favorable product mix due to increasing share of branded formulations segment and new launches would help OPM expand. We expect OPM to expand by 350 bps to 25.2% over CY2019-CY2022E. This is expected to lead to 11% earnings CAGR over the same period.

Results Rs cr

Particulars	Q3CY2020	Q3CY2019	YoY %	Q2CY2020	QoQ %
Total Sales	686.6	779.1	-11.9	710.5	-3.4
Operating Profits	192.2	175.5	9.5	177.2	8.5
Other income	14.9	22.9	-34.9	29.2	-49.0
Interest	0.4	0.0	-	0.5	-20.0
Depreciation	20.6	26.3	-21.7	20.5	0.5
PBT	185.9	132.7	40.1	186.5	-0.3
Taxes	53.0	6.1	768.9	-50.2	-205.6
Adjusted PAT	133.1	166.0	-19.8	135.2	-1.6
Margins			BPS		BPS
OPM %	28.0	22.5	547	24.9	305

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view - Improved growth prospects:

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

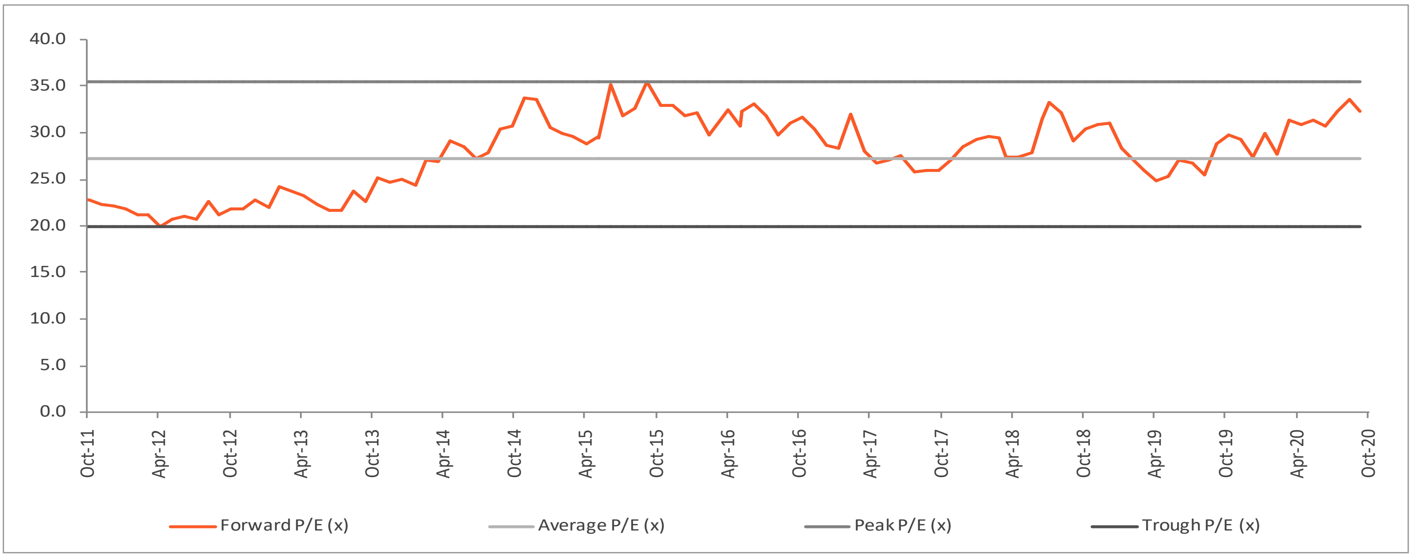
■ Company outlook - Better earnings visibility

Sanofi India is one of the leading MNC pharma companies focused on Indian market. Diabetology is the company's forte and it is amongst the fastest-growing companies in India in this space. New launches in the space coupled with the strong parentage offers a healthy growth for the therapy. In addition to anti-diabetics, cardiology is also one of the key segments for the company and is amongst 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 the sticky demand for products. Also 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 a PT of Rs 9249

Sanofi reported a mixed performance for the quarter, though the numbers are not comparable due to the completion of the slump sale transaction. The performance for the quarter could be looked at as an aberration due to the COVID impact and low growth of the IPM. We believe this will normalize going ahead. Pharma MNC companies such as Sanofi with a high degree of India exposure are comparatively well positioned to grow. Sanofi focuses on chronic therapies and a higher share of this segment augurs well as it provides a stable revenue stream. This coupled with expected traction in top brands and rising OPM is likely to drive earnings growth. Basis the Q3CY2020 performance we have fine tuned our earnings estimates for CY2021/CY2022. At CMP, the stock is trading at 31.9x/29.9x its CY2021E/CY2022E earnings. Considering high growth visibility from chronics, low exposure to highly regulated markets, strong balance sheet with no debt, minimal capex, healthy cash positions, premium valuations are expected to sustain. We retain Buy recommendation on the stock with an PT of Rs 9249.

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 (%)	
				CY20E	CY21E	CY20E	CY21E	CY20E	CY21E
Sanofi India	8,384.0	2.3	19,308.0	34.9	31.9	20.5	17.9	19.9	19.4
Abbott India*	15,565.0	2.1	33,074.0	46.0	36.9	29.8	23.8	25.9	27.1

Source: Company, Sharekhan Research
** Nos for FY21E/FY22E*

About company

Sanofi India Limited (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. Off all the three group companies, Sanofi India 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. It 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

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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