Solara Active Pharma Sciences

Stellar quarter; Robust outlook

Stock Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Pharmaceuticals	Sharekhan code: SOLARA	Result Update

3R MATRIX

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

\+ Positive = Neutral - Negative

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 1,138**	
Price Target: **Rs. 1,371**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 4,076 cr
52-week high/low:	Rs. 1,310 / 367
NSE volume: (No of shares)	1.7 lakh
BSE code:	541540
NSE code:	SOLARA
Free float: (No of shares)	2.0 cr

Shareholding (%)

Promoters	44.2
FII	28.2
DII	4.7
Others	22.9

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	5.7	73.4	94.0	167.1
Relative to Sensex	1.6	68.4	76.5	168.2

Sharekhan Research, Bloomberg

Summary

- We retain our Buy recommendation on Solara Active Pharma Sciences (Solara) with a revised PT of Rs. 1,371.
- Solara has delivered its best-ever quarterly performance, with the sales and PAT staging a sturdy growth of 13% and 96% yoy respectively
- The company is witnessing improved demand traction across its segment and geographies and has revised upwards its FY2021 Revenue and EBITDA growth guidance to 30%+ and 40%+ respectively. It also expects 2HFY2021 to be stronger than 1HFY21.
- Strong growth prospects, better earnings visibility, healthy balance sheet, and improving return ratios would support multiple expansion.

Solara Active Pharma Sciences (Solara) has delivered its best-ever quarterly performance. Results are ahead of estimates. Sales at Rs. 397.6 crore grew by 13% y-o-y, backed by 17% y-o-y growth in regulated markets. Other markets reported 3% growth. Operating profit margin (OPM) stood at 24.5%, expanding impressively by 518 bps y-o-y, aided by 450 bps expansion in gross margin due to favourable product mix. Operating profit at Rs. 97.6 crore was up 43.5% y-o-y. PAT for the quarter stood at Rs. 56.7 crore, up 96.2% y-o-y and was ahead of estimates. Solara has proven capabilities to manufacture complex/combination active pharmaceutical ingredients (APIs). There are immense opportunities that have opened up for API players such as Solara. The company is witnessing improved demand tractions across its customers and geographies. The base business is expected to grow because of robust demand environment, market share gains, and higher wallet share of existing customers. New product launches are expected to gain traction. Further, the company has strong product pipeline, which would unfold going ahead and would add to topline growth. Cost-control measures, operating leverage, and favourable mix would drive OPM expansion. Solara has commissioned the phase I of Vizag Greenfield plant with commercial production likely in 2HFY2021. Phase II of the facility is expected to be ready by the end of FY2021. Incremental capacities would support growth. Further, based on impressive Q2FY2021 performance, Solara has revised upwards its FY2021 revenue and EBITDA growth guidance to 30%+ and 40%+, respectively. Moreover, the company expects 2HFY2021 performance to be stronger than that of 1HFY2021.

Key positives

- Solara delivered its best-ever quarterly performance. Revenue and earnings grew impressively by 13% and 96% y-o-y, respectively.
- Management has revised its FY2021 revenue and EBITDA growth guidance upwards to 30%+ and 40%+, respectively
- OPM expanded sharply by 518 bps y-o-y to 24.5% y-o-y, which is ahead of estimates.

Key negatives

- Revenue from other markets grew at a slower pace of 3% y-o-y.
- Withdrawal of export incentives would have an impact on performance, but the company is working towards de-risking from the same.

Our Call

Valuation: Retain Buy with a revised PT of Rs. 1,371: Solara has posted a record performance for the quarter, with best-ever quarterly topline and PAT. The company is witnessing a strong demand environment for its business going ahead. The API space is witnessing strong and widespread growth opportunities. This coupled with the company's strong customer relationship and capabilities provide ample visibility for growth going ahead. Given strong demand traction and commissioning of Vizag plant, the company sees 2HFY2021 to be stronger than 1HFY2021. Further, Solara has revised FY2021 revenue and EBITDA growth guidance upwards to 30%+ and 40%+, respectively. The company's emphasis on growing the CRAMS business bodes well, and CRAMS business would sustain the double-digit growth trajectory. Given the strong quarterly performance, we have revised upwards our earnings estimates for FY2021/FY2022/FY2023. At the CMP, the stock is trading at an attractive valuation of 15.9x/12.5x its FY2022/FY2023E EPS. The company's strong growth prospects, better earnings visibility, healthy balance sheet, and improving return ratios would support multiple expansion. We retain our Buy recommendation on the stock with a revised PT of Rs. 1,371.

Key risk

1) Any adverse change in the regulatory landscape can impact earnings prospects; 2) adverse foreign exchange movement.

Valuation Rs cr

Particulars	FY2019	FY2020	FY2021E	FY2022E	FY2023E
Total Sales	1386.7	1321.8	1705.1	2007.4	2400.2
EBIDTA	220.8	259.4	405.8	471.7	571.3
OPM (%)	15.9	19.6	23.8	23.5	23.8
Reported PAT	67.1	114.5	215.4	253.5	324.1
EPS (Rs.)	18.9	32.3	60.7	71.5	91.4
PER (x)	60.2	35.2	18.7	15.9	12.5
EV/EBITDA (x)	19.9	17.6	11.2	9.5	7.4
P/BV (x)	4.2	3.7	3.1	2.6	2.2
ROCE (%)	9.9	10.8	16.3	16.7	18.1
RONW (%)	7.0	10.5	16.6	16.4	17.5

Source: Company; Sharekhan estimates

Note: We now convert Solara Active Pharma Sciences into a Stock update; it was earlier a 'Viewpoint' under our coverage.

Strong performance in Q2FY2021: Solara has reported its best-ever quarterly performance with results coming in ahead of estimates. Sales at Rs. 397.6 crore grew by 13% y-o-y (largely because of strong volume growth) and were marginally ahead of estimates. Segment wise, growth was driven by 17% growth in regulated markets, which constitute around 77% of the quarterly revenue. Other markets reported 3% growth. OPM stood at impressive 24.5%, an expansion of 518 bps y-o-y, and was ahead of estimates. OPM expansion can largely be attributed to gross margin expansion of 450 bps due to favourable product mix. Operating profit at Rs. 97.6 crore was up 43.5% y-o-y. Tracking the strong operating performance, PAT for the quarter stood at Rs. 56.7 crore, up by 96.2% y-o-y, and was substantially ahead of estimates.

Management revises growth guidance upwards for FY2021: Solara reported a stellar performance for Q2FY2021. The topline recorded strong growth of 13% y-o-y, primarily aided by 17% growth in regulated markets. Solara has managed to gain wallet share from existing customers. Moreover, the company has gained market share in select pockets, while demand for base products was strong. These were the key revenue drivers for Q2FY2021. Management expects strong growth momentum to sustain going ahead as well and expects performance in 2HFY2021 to be stronger than that of 1HFY2021. Solara is witnessing a strong demand outlook across geographies for its products. The base business has performed well and strong growth momentum is expected to sustain going ahead as well. The company has a portfolio of 40+ products, which is well diversified. Moreover, the company has strong relationship with its customers, which would enable it garner a higher wallet share. These would drive growth in the base business. Moreover, new products/recent launches are fast gaining traction, which in turn would support topline growth. In addition to this, Solara has a strong product pipeline, which would enable it to maintain the growth momentum. Secondly, Solara has commissioned the phase 1 of its Vizag capacity expansion in the current quarter and expects production to ramp to full capacity over the next four quarters. Along with this, to consistently support growth momentum, Solara is also setting up phase 2 at Vizag, which is likely to be ready by the end of Q4FY2021 and would commence from Q1FY2022. Cumulatively, a strong demand outlook, market share gains, higher wallet share from existing customers, new product launches lined up, and incremental capacities going on stream provide ample growth visibility. Consequently, management had revised upwards the revenue guidance for FY2021 to 30%+ from the earlier guidance of 25%-30%.

Backed by benefits of operating leverage, favourable mix, EBITDA growth guidance has been revised upwards for FY2021 substantially: Solara has reported its best-ever OPM for the quarter. OPM expanded by 518 bps y-o-y to 24.5%. The strong performance is supported by stellar 450 bps expansion in gross margin, attributable to a favourable mix coupled with cost-control measures implemented by the company. Management expects cost-control measures to result in higher cost efficiencies, which would be sustainable going ahead as well. Further, given the buoyant demand scenario, the topline is also likely to grow at a sturdy pace, thereby bringing in benefits of operating leverage. Based on these, management has revised its EBITDA growth guidance for FY2021 to 40% as against the earlier growth guidance of 25%-30% for the same period. This bodes well for the company from a growth perspective.

Q2FY2021 Concall highlights

- **Record performance:** Solara reported a record performance for the quarter, reporting the best-ever quarterly revenue, EBITDA, and PAT. Revenue increased by 13% y-o-y; EBITDA and PAT grew impressively by 43.5% and 96.3%, respectively, on a y-o-y basis. The company's core strategy led by strong customer partnerships, diverse product mix, engaged and committed employees, and a world-class compliance framework is playing out well and has led to the impressive performance.
- **Buoyant demand outlook for both API and CRAMS business:** Solara is witnessing a strong demand traction across its segments. The top 10 products of the company constitute around 77% of sales and are well placed to grow. Solara is looking for higher wallet shares from clients and market share gains to grow its base products while new product launches are expected to gain traction. In the CRAMS business too, the company has added multiple new clients, which would drive growth. CRAMS business is expected to outpace the overall topline growth going ahead.

- **New product launches/fillings:** Solara has filed for two new DMFs in Q2FY2021 for the US market. While it has filed for 10 product extensions for existing products during the quarter. The company has commercialised two new products in 1HFY2021. Collectively, this points towards a strong product pipeline being created by the company, which would fuel growth in the times to come.
- **Vizag capacity expansion:** Solara is in the midst of setting up a new facility at Vizag. This would be done in two phases. The first phase of the Vizag facility has gone on stream and commercial activity is expected to start in 2HFY2021. Phase I is an Ibuprofen facility with 3,600 kilo litre capacity. Solara expects the facility to ramp up fully over the next four quarters. Phase II would be a multi-purpose facility and is likely to be ready by the end of FY2021. Incremental capacities going on stream would support topline growth for the company.
- **Cuddalore plant updates:** Solara's Cuddalore plant is under USFDA scanner. The regulator had classified the plant at Official Action Indicated (OAI). Management has since then completed its CAPAs and has submitted its responses to USFDA. A revert on the same is awaited.
- **Exploring inorganic growth opportunities:** Post the conversion of warrants into equity shares, Solara has a strong cash position. Leveraging this, management is exploring inorganic growth avenues; although time lines and other exact details are awaited.

Results Rs cr

Particulars	Q2FY2021	Q2FY20	YoY %	Q3FY20	QoQ %
Total Income	397.6	351.1	13.2	348.4	14.1
Operating profit	97.6	68.0	43.5	83.8	16.5
Other income	6.1	5.0	23.6	4.6	33.6
EBIDTA	103.7	73.0	42.2	88.4	17.4
Interest	19.4	20.3	-4.5	19.8	-2.3
Depreciation	27.6	23.5	17.4	26.2	5.2
PBT	56.8	29.2	94.6	42.3	34.1
Tax	0.1	0.3	-73.3	0.0	60.0
Reported PAT	56.7	28.9	96.3	42.3	34.1
Margins			**BPS**		**BPS**
OPM (%)	24.5	19.4	518.3	24.1	50.3

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.

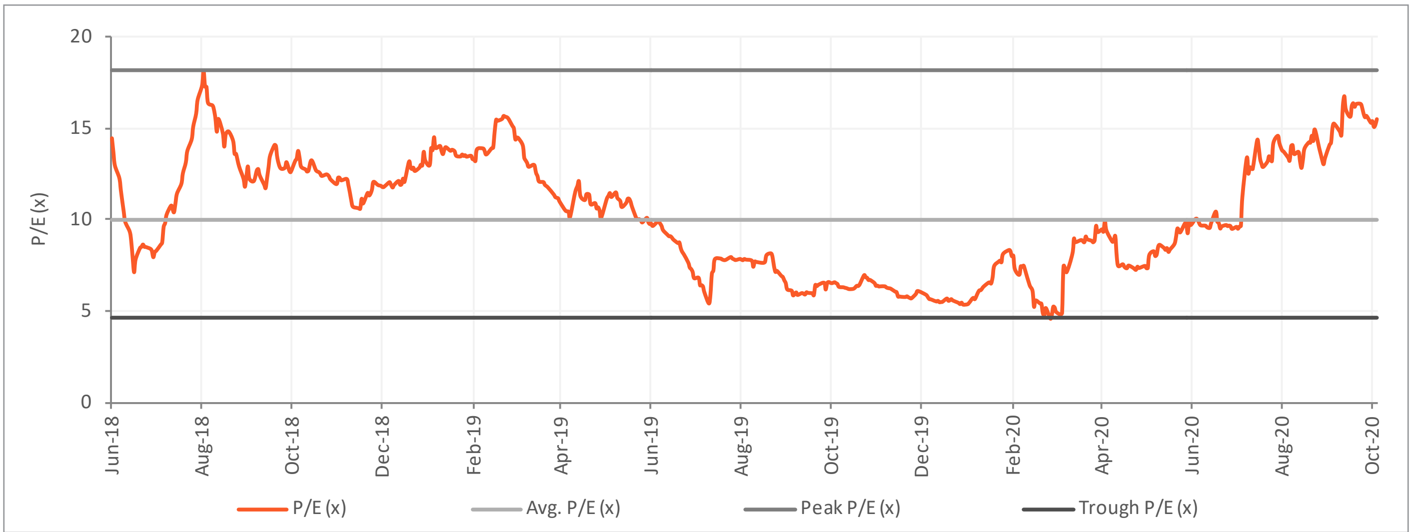
Company Outlook – Strong growth prospects

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, while stocking of essential medicines has led to increased demand in the short to medium term. Solara has initiated efforts to backward integrate KSMs (Key Starting Materials) 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 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 to grow the CRAMS business bodes well, as it yields better margins as compared to the API business.

Valuation – Retain Buy with a revised PT of Rs. 1,371

Solara has posted a record performance for the quarter with best-ever quarterly topline and PAT. The company is witnessing a strong demand environment for its business going ahead. The API space is witnessing strong and widespread growth opportunities. This coupled with the company's strong customer relationship and capabilities provide ample growth visibility going ahead. Given the strong demand traction and commissioning of Vizag plant, the company sees 2HFY2021 to be stronger than 1HFY2021. Further, the company has revised FY2021 revenue and EBITDA growth guidance upwards to 30%+ and 40%+, respectively. The company's emphasis on growing the CRAMS business bodes well, and CRAMS business would sustain the double-digit growth trajectory. Given the strong quarterly performance, we have revised upwards our earnings estimates for FY2021/FY2022/FY2023. At the CMP, the stock is trading at an attractive valuation of 15.9x/12.5x its FY2022/FY2023E EPS. The company's strong growth prospects, better earnings visibility, healthy balance sheet, and improving return ratios would support multiple expansion. We retain our Buy recommendation on the stock with a revised PT of Rs. 1,371.

One year forward PE chart



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
Solara	1138	3.5	4076	18.7	15.9	12.5	11.2	9.5	7.4	16.6	16.4	17.5
Divis Laboratories	3,140.0	26.5	83,366	48.8	68.3	89.1	43.2	31.0	24.0	17.7	20.7	22.0

Source: Company, Sharekhan estimates

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 life cycle 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 kilo litre.

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 the 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.

Key Risks

1) Any adverse change in the regulatory landscape can impact earnings prospects; 2) adverse foreign exchange movement.

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 Website

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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