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Strides Pharma Sciences

Soft Quarter; robust growth outlook

Pharmaceuticals	Sharekhan code: STAR	Result Update

Stock Update

Summary

- We retain Buy recommendation on Strides Pharma Science (Strides) with a PT of Rs 864.
- Q2FY2021 was a soft quarter for Strides. The results missed estimates. Revenues grew 11% YoY to Rs 793 crore while the adjusted PAT at Rs 44 crore declined by 9%.
- Srtrides expects a marked improvement in its performance in 2HFY2021 as compared to 1HFY2021, driven by a sturdy growth across segments of regulated and emerging markets.
- Despite of a soft 1HFY21, Strides had retained its US revenue guidance of $230mn -$250 mn for FY21. Strong growth prospects and earnings visibility, sturdy balance sheet and healthy return ratios would support multiple re-ratings.

Q2FY2021 was a soft quarter for Strides Pharma Sciences (Strides). The results missed estimates. The quarter witnessed supply disruptions due to COVID-19, lower patient footfalls and reduced elective surgeries leading to lower prescriptions, which collectively slowed the growth for the quarter. The revenues at Rs 793 crore grew 11% y-o-y backed by a 7.5% growth in the regulated markets. The emerging markets grew at a higher pace of 56.9% y-o-y. Operating margins at 19.8% declined by 70 bps y-o-y. Adjusting for exceptional items, the PAT stood at Rs 44.2 crore, down by 8.9% y-o-y and missed estimates. Going ahead, the management expects the performance of 2HFY2021 to be better than 1HFY2021 and also has retained its US revenue growth guidance of $230-250 mn. (In 1HFY2021, the company has achieved a turnover of $104 mn) The growth is expected to be driven by market share gains in the existing base products, expected traction in the new product launches. Growth prospects in other regulated markets are also healthy led by product launches, increased market share, and portfolio optimisation. Emerging markets segment is also expected to gain traction backed by a likely revival in the institutional business and a strong growth in the Africa business. Considering the strong topline growth and margin expansion (due to a favourable mix, operating leverage), Strides' earnings are expected to record phenomenal CAGR growth of 55% over FY2020-FY2023.

Key positives

- Double digit revenue growth of 11% despite challenging situation.
- Emerging markets revenues grew by 56.9% y-o-y for the quarter.
- Management retains its US business growth guidance of $230-250 mn for FY2021, despite a slower growth in 1HFY2021.

Key negatives

- The US revenues growth at 7.5% YoY, missed estimates on the back of lower patient footfalls at hospitals, lower prescriptions, price erosion in select products and supply constraints for select products. H2FY2021 is expected to see a revival backed by market share gains in the existing base products, expected traction in the new product launches.

Our Call

Valuation: retain Buy with a PT of Rs 864: After a soft performance in Q2FY2021, the management expects 2HFY2021 performance to be strong one. Performance is expected to be driven by a sturdy growth across segments of regulated and emerging markets. The re-entry in the high-value sterile injectables space would offer new growth opportunities, though over the medium term. A strong product pipeline, growth in the base business and expected traction in new product launches would result in a strong growth in the US business. Strides had a strong balance sheet position pointing towards a sturdy financial muscle. Moreover, given strong earnings performance, return ratios too are set to improve sharply and touch ~14.5% as of FY2023. At CMP, the stock trades at an attractive valuation of 14.9x /11.5x its FY2022 / FY2023E EPS. Strong growth prospects and earnings visibility, sturdy balance sheet and healthy return ratios would support multiple re-ratings. Further, recently, the stock prices have corrected by around 12% from its highs and this provides a good entry point for investors. We retain Buy recommendation on the stock with a PT of Rs 864.

Key Risks

Any change in regulatory landscape can impact earning prospects; adverse forex movements.

Valuations Rs cr

Particulars	FY2019	FY2020	FY2021E	FY2022E	FY2023E
Total Sales	2178.4	2752.0	3341.4	3819.3	4356.6
EBIDTA	296.6	587.8	729.6	876.7	1023.8
OPM (%)	11.7	19.4	20.1	21.3	21.9
Adj PAT	81.1	139.9	281.2	405.5	524.0
EPS (Rs)	9.1	15.6	31.4	45.3	58.5
PER (x)	74.4	43.1	21.4	14.9	11.5
EV/Ebidta (x)	28.1	11.8	9.4	7.6	6.0
P/BV (x)	2.3	2.4	2.1	1.9	1.7
ROCE (%)	2.7	8.5	10.7	12.8	14.6
RONW (%)	3.4	1.7	11.7	12.9	14.5

Source: Company; Sharekhan estimates

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

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. 673**	
Price Target: **Rs. 864**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

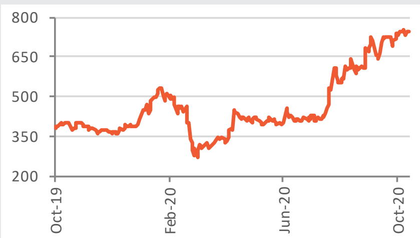
Company details

Market cap:	Rs. 6027 cr
52-week high/low:	Rs. 765 / 271
NSE volume: (No of shares)	14.4 lakh
BSE code:	532531
NSE code:	STAR
Free float: (No of shares)	6.3 cr

Shareholding (%)

Promoters	29.7
FII	29.5
DII	15.3
Others	25.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-7.4	56.3	49.7	76.6
Relative to Sensex	-12.1	51.9	28.2	76.8

Sharekhan Research, Bloomberg

Soft quarter: Q2FY2021 was a soft quarter for Strides with results missing estimates. The performance for the quarter reflect the impact of the COVID-19 related turbulences. These further impacted manufacturing and supply of products from due to intermittent shutdowns. Further, demand side challenges including reduced patient footfalls, reduced elective surgeries leading to lower prescriptions also impacted the performance. The revenues for the quarter at Rs 793 crore grew 11% y-o-y backed by a 7.5% growth in the regulated markets. The emerging markets grew at a higher pace of 56.9% y-o-y, due to a low base. The revenues were below estimates. Operating margins at 19.8% declined by 70 bps y-o-y and are in line with the estimates of 20.1%. The gross margins expanded by 290 bps y-o-y to 61.1%. However, the higher staff cost (due to wage hikes and some COVIDrelated expenses) and other expenses offset the benefits of gross margin expansion. The operating profits stood at Rs 157.2 crore, up by 7.2% y-o-y. Strides reported an exceptional gain amounting to Rs 13.1 crore of this Rs 17.4 cr is towards forex gain. This offset a onetime loss amounting to Rs 4.28 crore towards restructuring expenses and unwinding/ cancellation of obligations. Adjusting for the above the PAT stands at Rs 44.2 crore, which is decline of 8.9% y-o-y and missed estimates.

Robust outlook for the US business; Strong performance likely in 2HFY2021: US markets are a key markets for Strides and constitute around 22% of the FY2020 sales. For Q2FY21, the US performance was muted (US revenues grew by 7.5% y-o-y) impacted by COVID-19 related disturbances, which impacted supplies translating into shortages for a select products. Further price erosion in a few select products and low prescriptions also added to the pressures. Consequently, the growth in US revenues was lower than expected. For 1HFY2021 the US business has recorded a growth of 8% y-o-y to Rs 778.5 crore. However, Strides has retained its US business revenue guidance of $230-250 mn for FY2021. (In 1HFY21 the company reported sales of $104 mn). Going ahead, Strides expects a marked improvement in the US business in 2HFY2021. Growth would be driven largely by market share gains in the base products and expected traction in the new / recent product launches. In addition to this, the company has a strong product pipeline. It has received 8 ANDA approvals in FY2021 and has launched 2 products as well. Further It has files for 3 ANDA in H1 FY21 and expects to file another 8+ ANDA filings in H2FY21. Overall with the current portfolio build being well diversified with a basket of market leading products to deliver sustainable growth, the new product launches are also expected to gain traction, thus adding to the topline growth. Further in Q2CY2021, the front end of the US business which constitutes around 85% of the US sales has grown by 25% y-o-y for the quarter, thus pointing at possible improvements. We expect the US business revenues to grow strongly in double digits over FY2020-FY2023.

Other regulated markets to stage a strong growth backed by a strong order book position: Other regulated markets cover countries such as the UK, Germany, Australia, the Nordic nations including the Netherlands. The revenues from the segment for the quarter grew by 7.5% y-o-y to Rs 238.6 crore. The performance from the geography was soft as business was impacted by low prescriptions generations, reduced footfalls in the pharmacies attributable to a second wave of COVID-19 in the select European countries. Further plant shutdowns in India resulted to lower order fulfillment for the few products as well. However, the operations at plants have attained normalcy and would support the growth. The management expects growth momentum to improve in the other regulated markets as well. This would be led by a strategy based on portfolio maximisation across multiple markets. The company has received 9 new product approvals in 1HFY2021 while it has filed for 8 products during the quarter. Going ahead in 2HFY2021, the company expects to file 10 plus products, which point at a strong filling momentum. Thus, revenues from other regulated markets are also expected to grow in sturdy double digits over FY20-FY23.

Key result highlights from Concall

- **Operational Highlights:** Strides witnessed headwinds from COVD-19 during Q2FY2021. This impacted manufacturing and supply of products from India plants due to intermittent shutdowns. This led to inventory depletions for a few SKU's.
    - Further, challenges in the form of reduced foot-falls in the market, lower elective surgeries and lower prescription rates were also witnessed.
    - The front end operations in the US and Europe also were soft during the quarter
    - Strides witnessed price erosion across markets, but managed to offset the impact of the same through improved portfolio mix.

- **Institutional Business offers healthy growth opportunities:** Under the institutional business, Strides manufacture drugs in the ARV, anti-malarial, anti-tuberculosis, Hepatitis and other infectious disease segments. Strides has multiple approvals from various authorities – WHO PQ and PEPFAR for TLD and accordingly, the company has filed it in specific countries. The size of opportunity for TLD under WHO PQ and PEPFAR is around $200 – 300 mn each and the company expects to corner a fair share of this.
- **Stellis Biopharma operations to break even in FY2022:** Through Stellis, Strides is looking to further expand as well as strengthen its presence in the bio pharmaceuticals space. The company expects to break even in the segment by FY2022. In the past, Strides has committed to invest a $40 mn in to Stellis for a majority stake in the Biotech business, off this the company has already invested $ 31 mn.
- **Biosimilar Products:** Strides has filed for one product - PTH (Teriparatide) in Q2FY2021 in the EU and the product is under review. With respect to the US, the product development is on track and Strides looks to manage the front end of the product in the US. Also the development for Insulin Glargine is on track. The company is looking to start dosing of Glargine in emerging markets in Q3FY202.
- **Regulatory Updates:** Strides's Puducherry plant in under the USFDA scanner. The re-inspection of the site has not occurred as the USFDA is yet to resume offshore audits. Strides had just 1 key product attached to the Site.
- **Outlook for 2HFY2021:** The management expects the performance of 2HFY2021 to be better than that of 1HFY2021. With the operations re-gaining normalcy post the COVID disruption, provides ample visibility on supply capabilities going ahead. The other regulated markets are witnessing a strong order book position which also includes resumption of Supplies to Australia. Also inventory replenishment to historic levels across markets would fuel the growth in 2HFY2021.

Results — Rs cr

Particulars	Q2FY21	Q2FY20	YoY %	Q1FY21	QoQ %
Total Income	793.6	715.1	11.0	781.8	1.5
Operating profit	157.2	146.6	7.2	151.0	4.1
Other income	12.9	13.0	-0.9	12.3	4.6
EBIDTA	170.1	159.6	6.6	163.3	4.1
Interest	36.9	40.4	-8.8	36.9	-0.1
Depreciation	52.8	42.0	25.7	49.1	7.4
PBT	80.4	77.2	4.2	77.3	4.1
Tax	6.1	7.4	-17.3	3.3	86.0
Adjusted PAT	44.2	48.5	-8.9	53.0	-16.7
Margins			**BPS**		**BPS**
OPM (%)	19.8	20.5	-68.9	19.3	49.5

Source: Company; Sharekhan Research

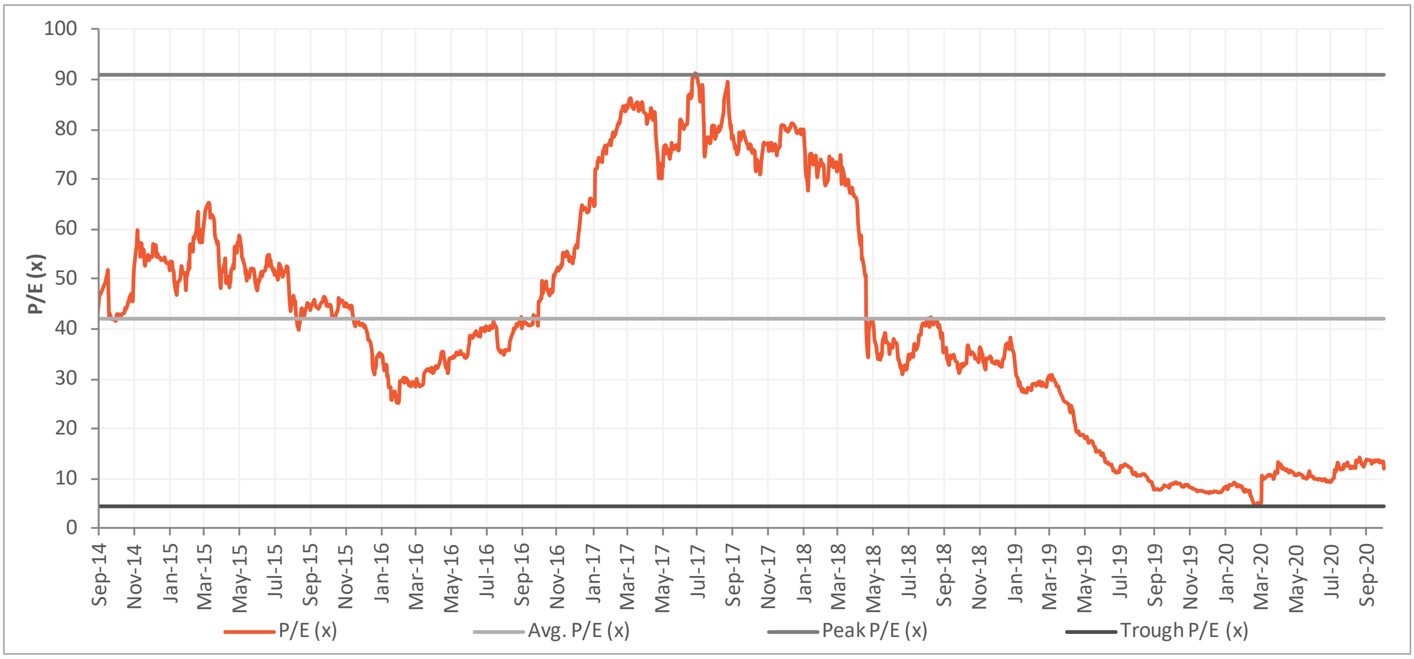
Outlook and Valuation

- **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 - Strong earnings growth:** Strides is well-positioned to benefit from the opportunities in the global pharmaceutical market. The company derives a higher share of revenues from regulated markets, especially the US. Healthy growth in the base business in the US and a strong product launch pipeline are expected to fuel growth for the segment. Strides has a strong pipeline of products, which are approved but yet to be commercialised and offer sizeable market opportunities. Growth prospects in other regulated markets too are likely to be better led by product launches, increased market share, and portfolio optimization / maximisation. Emerging markets segment are expected to gain traction backed by a likely revival in institutional business and a strong growth in the Africa business. The company's re-entry in the sterile injectables business offers new growth opportunities, which are likely to unfold over the medium term.

- **Valuation - Retain Buy with a PT of Rs 864:** After a soft performance in Q2FY2021, the management expects 2HFY2021 performance to be strong one. Performance is expected to be driven by sturdy growth across segments of regulated and emerging markets. The re-entry in the high-value sterile injectables space would offer new growth opportunities, though over the medium term. A strong product pipeline, growth in the base business and expected traction in new product launches would result in a strong growth in the US business. Strides had strong balance sheet position pointing towards a sturdy financial muscle. Moreover, given strong earnings performance, return ratios too are set to improve sharply and touch ~14.5% as of FY2023. At CMP, the stock trades at an attractive valuation of 14.9x /11.5x its FY2022 / FY2023E EPS. Given the strong growth prospects and earnings visibility, improving balance sheet strength and healthy return ratios would support multiple re-ratings. Further recently, the stock prices have corrected by around 12% from its highs and this provides a good entry point for investors. We retain Buy recommendation on the stock with a PT of Rs 864.

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/EBIDTA (x)			RoE (%)		
				FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Granules India	383.0	24.7	9,482.0	28.7	23.2	18.6	18.4	13.5	10.8	17.9	18.5	19.2
Laurus Labs	330.4	53.2	17,707.0	68.8	34.7	27.9	32.9	19.8	16.2	14.4	22.3	21.7
Strides Pharma Sciences	673	9.0	6027.3	43.1	21.4	14.9	11.8	9.4	7.6	1.7	11.7	12.9

Source: Company, Sharekhan estimates

About company

Strides Pharma Sciences (Strides) is a global pharmaceutical company and operates two business verticals, viz - regulated markets and emerging markets. The regulated markets include the US and other regulated markets. The balance is constituted by emerging markets verticals, which includes Africa and the institutional business. With respect to segments, Strides operates in the pharma generics, branded generics and Institutional business. The Pharma generics business largely comprises the regulated markets business and is led by IP-driven product licensing and marketing and distribution partnerships across the globe. Strides is among the leading players worldwide in soft gel capsules. The branded generic segment comprises the Africa business. Africa poses a significant opportunity for pharmaceutical companies' all over the world. While it is a very complex market to do business, it demonstrates an industry-leading growth driven by increasing urbanisation and rapid expansion of primary health care facility. In addition to the Africa business, the emerging markets vertical also includes the institutional business. Under this, Strides manufactures drugs in the anti-retroviral, anti-malarial, anti-tuberculosis, Hepatitis and other infectious disease drug segments. Customers for this business segment include institutionally-funded aid projects and global procurement agencies.

Investment theme

The company derives a higher share of revenues from the regulated markets, especially the US. Healthy growth in the base business in the US and a strong product launch pipeline are expected to fuel growth for the segment. Strides has a strong pipeline of products which are approved but to be commercialized and offer sizeable market opportunities. Benefits from these products are expected to unfold gradually over the medium to long term. Growth prospects in other regulated markets are also likely to be better led by product launches, increased market share and portfolio optimization. The emerging markets segment too is expected to gain traction backed by a likely revival in the institutional business and a strong growth in the Africa business. Further Stelis' CDMO division is ready and is likely to commence operations by end of FY2021. The full benefits of the Stelis stable are likely to accrue over the long term. Considering the strong topline growth and margin expansion (due to a favourable mix, operating leverage), earnings are expected to record a phenomenal growth over FY2020-FY2022.

Key Risks

Any change in regulatory landscape can impact earning prospects; adverse forex movements.

Additional Data

Key management personnel

Arun Kumar	Chairman of the Board
Dr A Ananthanarayanan	Managing Director & CEO
Badree Komundur	Executive Director & Group CFO

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Pronomz Ventures LLP	17.83
2	Aditya Birla Sunlife trustee Co	8.21
3	Route one investments Co LP	7.46
4	SBI Funds Management	7.31
5	Life Insurance Corp of India	3.63
6	Government Pension Fund global	3.45
7	Norges Bank	3.44
8	Dimensional Fund Advisors LP	2.00
9	Vangaurd Group PLC	1.73
10	Lifecell International Pvt Limited	1.56

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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