Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Solara Active Pharma Sciences

Growth Levers Intact

Pharmaceuticals	Sharekhan code: SOLARA	Company Update

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. 1,260**	
Price Target: **Rs. 1,450**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 4,525 cr
52-week high/low:	Rs. 1,325 / 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	15.1	36.0	130.8	189.8
Relative to Sensex	6.2	17.1	98.1	177.1

Sharekhan Research, Bloomberg

Summary

- We retain our Buy recommendation on Solara Active Pharma Sciences (Solara) with a revised PT of Rs. 1,450.
- Solara is witnessing strong demand traction across its business segments. It is well poised to grow as a leading 'global pure-play API company' given the strong customer relationships, expanding capacities and compliant business operations.
- Solara's emphasis on growing the CRAMS business bodes well, and would support the double-digit growth trajectory over the medium term.
- Solara's strong growth prospects, better earnings visibility, healthy balance sheet, and improving return ratios would support multiple expansion.

Solara Active Pharma Sciences (Solara) is witnessing strong demand traction across its business as immense opportunities lie ahead for pure play API companies. While there are cost differences between India and China, the deciding factor in the post-pandemic era would be supply chain reliability along with quality, as quality takes precedence over pricing factor. Consequently, established companies such as Solara, which are well placed will benefit from the situation, given the strong customer relations and compliant operations. Solara is targeting higher wallet share from existing clients and market share gains to grow its base business while new product launches which would unfold gradually, are expected to gain traction and support topline growth. Solara's overarching objective remains to bridge the industry gap by delivering value-based products that cater to customer requirements. In addition to API's, management's emphasis to grow the CRAMS business (through new client additions) bodes well, as it yields better margins as compared to the API business. The fruits of this are likely to accrue over the medium to long term. Solara has recently commissioned the Phase I (Ibuprofen plant with a capacity of 3600 kilo liters) of its Vizag facility which is likely to ramp up over the next four quarters, while the Phase II (multi product facility) is expected to be ready by end of FY2021. In order to reap the benefits of the backward integration, Solara shall be participating in the Government of India's PLI scheme, though in a small way. Further there could be some logistics issues in the ongoing quarter, due to the pandemic, however it is unlikely to have any material impact on the performance of the company. Overall, a strong demand outlook coupled with capacity expansion plans provides ample visibility on growth and would also help achieve the management's topline and EBITDA growth guidance of 30% and 40% respectively for FY2021.

Our Call

Retain Buy with a revised PT of Rs. 1,450: Solara is witnessing a strong demand environment for its business with the API business likely to benefit from the "China +1" strategy being adopted by global pharma companies. This coupled with the company's strong customer relationship and capabilities, new product launches, commissioning of Vizag plant (Phase I) would support growth and provides ample confidence on achieving the management's guidance of 30% topline growth and 40% EBITDA growth for FY2021. The company's emphasis on growing the CRAMS business bodes well, though it would bear fruits over the medium term and would support the double-digit growth trajectory. At CMP, the stock is trading at a valuation of 17.5x/13.5x 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. 1,450.

Key risk

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

Valuation Rs cr

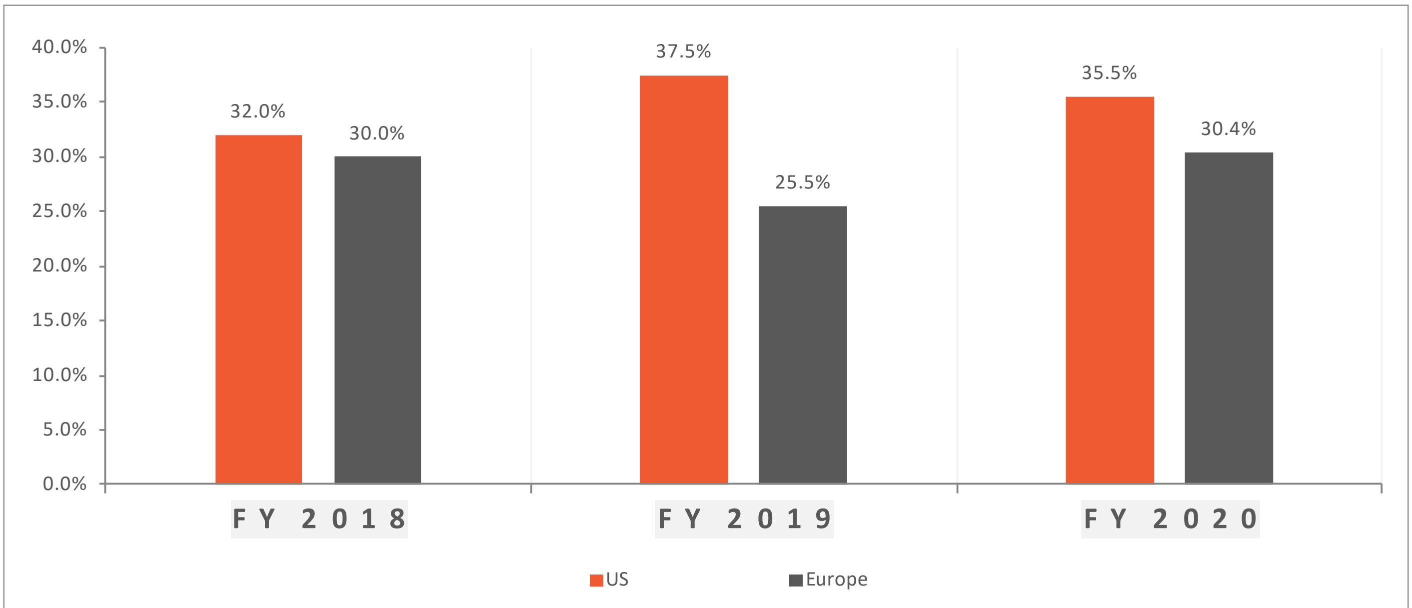
Particulars	FY2019	FY2020	FY2021E	FY2022E	FY2023E
Total Sales	1386.7	1321.8	1705.1	2015.3	2420.1
EBIDTA	220.8	259.4	405.8	473.6	576.0
OPM (%)	15.9	19.6	23.8	23.5	23.8
Reported PAT	67.1	114.5	215.4	255.1	330.1
EPS (Rs)	18.9	32.3	60.7	71.9	93.1
PER (x)	66.6	39.0	20.7	17.5	13.5
EV/Ebidta (x)	21.8	19.3	12.3	10.3	8.1
P/BV (x)	4.7	4.1	3.4	2.9	2.4
ROCE (%)	9.9	10.8	16.3	16.8	18.2
RONW (%)	7.0	10.5	16.6	16.5	17.8

Source: Company; Sharekhan estimates

Huge potential lies ahead in the API space; Solara witnesses strong demand traction

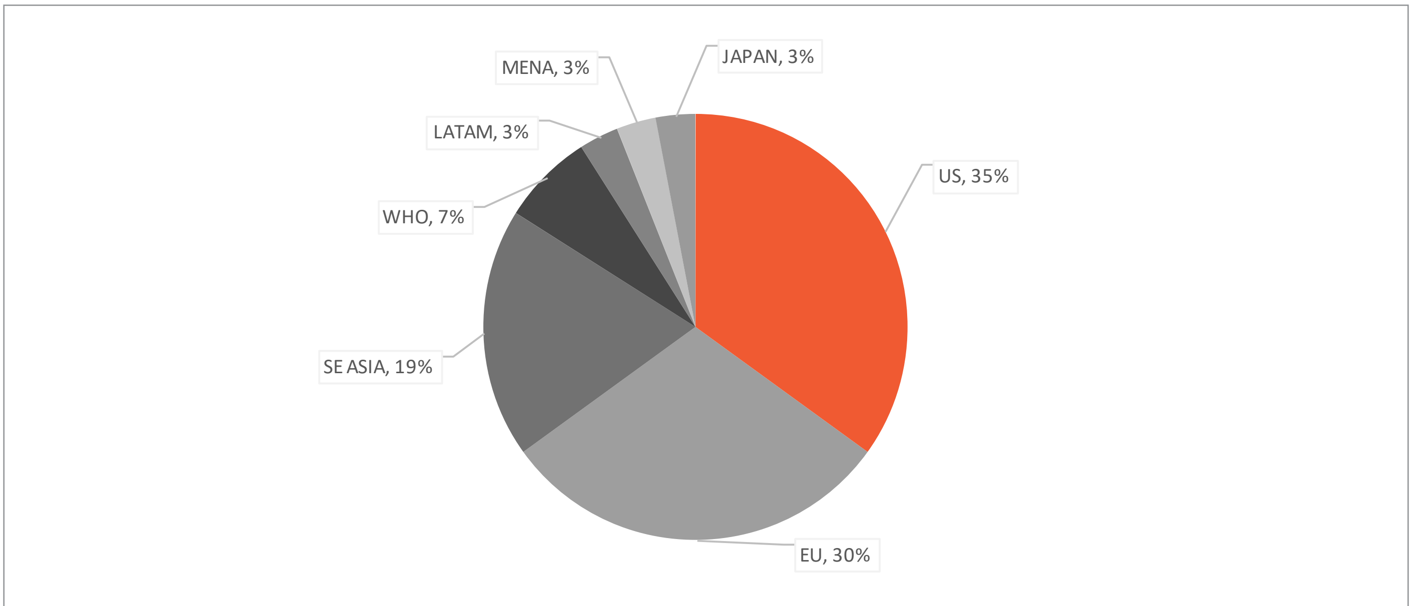
The API space offers immense growth potential for companies as substantial opportunities have emerged amidst uncertain times of the pandemic. In these testing and challenging times, pharmaceutical companies globally have confronted challenges with respect to supply disruption as dependence on China was far higher. In the post pandemic era, supply reliability and quality are factors that have taken precedence over pricing, and pharma companies the world over are looking for these points while selecting their partners.

Revenue share trends - US and Europe (% of sales)



Source: Company; Sharekhan Estimates

Revenue Mix - Geographywise (% of FY2020 sales)



Source: Company; Sharekhan Estimates

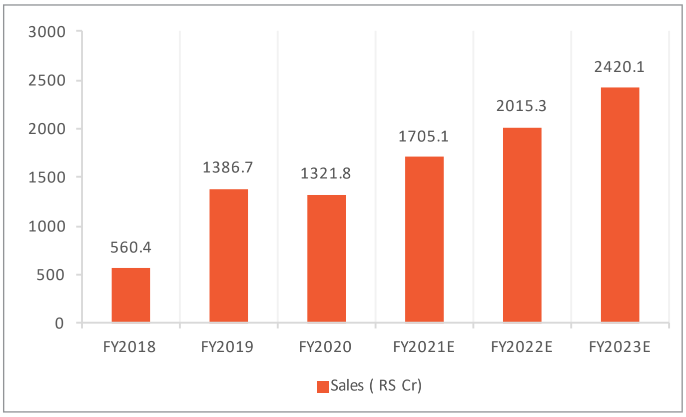
Established players such as Solara are likely to benefit from the situation as its "China +1" strategy gains momentum. Also the Indian companies such as Solara have the required capabilities and bandwith to cater to the requirements of global companies. Further, for the quarter ending September 2020, Solara has managed to gain wallet share from its existing customers. Also the company has gained market share in select pockets, while demand for base products was strong. Solara is witnessing 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 to 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 Overall we expect the company to benefit from a structural shift in global supply chains, which are likely to favour Indian API companies, with a significant potential for market share gains. This coupled with strong growth in the base business and new product launches would be the key growth drivers for the API segment. The API segment revenues are expected to clock a strong double digit 22% CAGR over FY2020 to Fy2023.

Capacity Expansion plans provides visibility on topline growth:

Solara is in the midst of a capacity expansion plan where in it has commissioned the phase 1 of its Vizag capacity expansion in the quarter ending September 2020 and expects production to ramp up fully and achieve the optimum levels over the next four quarters. Phase I is an Ibuprofen facility with 3,600 kilo litre capacity. To consistently support growth momentum, Solara is also setting up phase 2 at Vizag, which is likely to be ready by FY2021. Phase II would be a multi product facility. Incremental capacities going on stream would support topline growth for the company. The incremental capacities going on stream coupled with a buoyant demand environment would support the topline growth. In the quarter ending September 2020, the company had guided for a 30% topline growth for FY2021 and basis the above positives, the management seems quite confident of achieving the target growth.

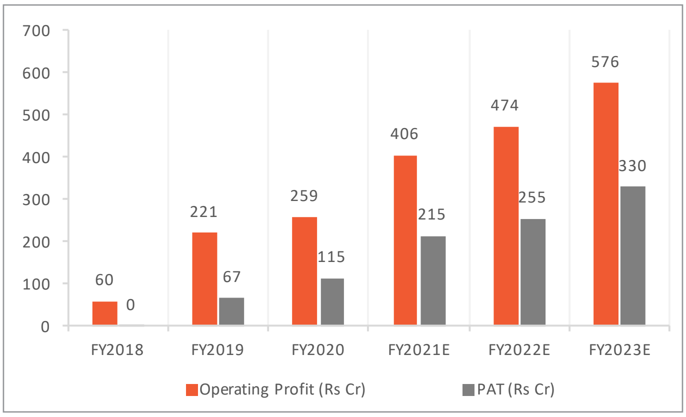
Financials in charts

Sales Trends (Rs Cr)



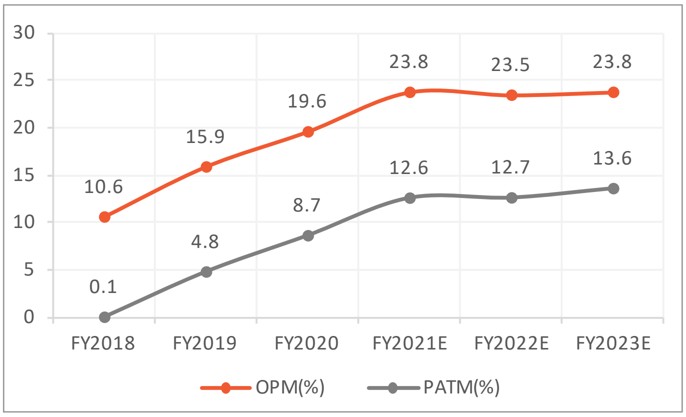
Source: Company, Sharekhan Research

Operating Profit - PAT Trends



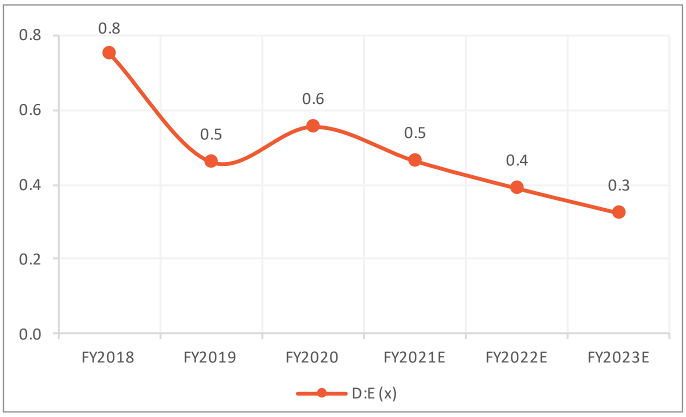
Source: Company, Sharekhan Research

Margins on an improving trend



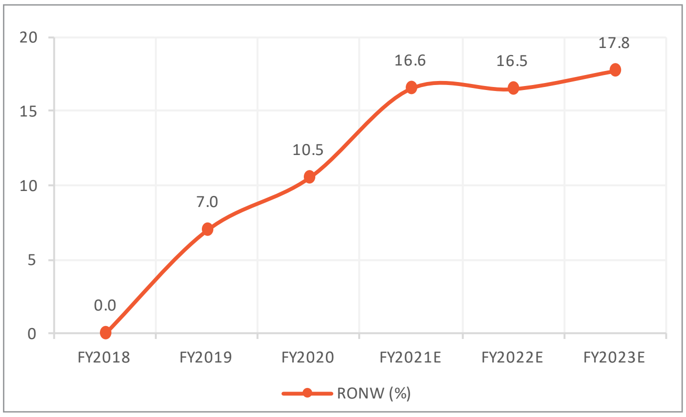
Source: Company, Sharekhan Research

Debt : Equity (x)



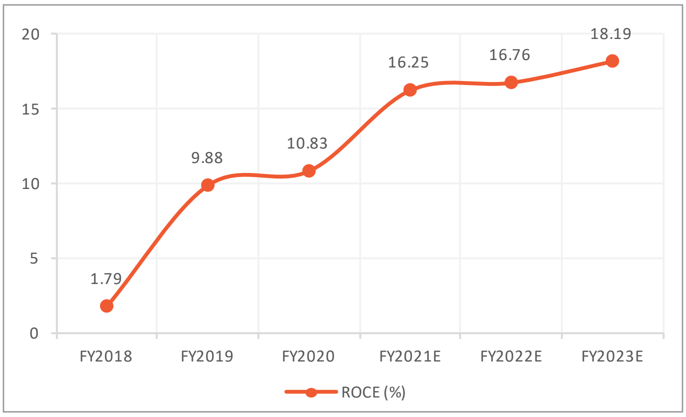
Source: Company, Sharekhan Research

Return ratio to improve



Source: Company, Sharekhan Research

ROCE (%)



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.

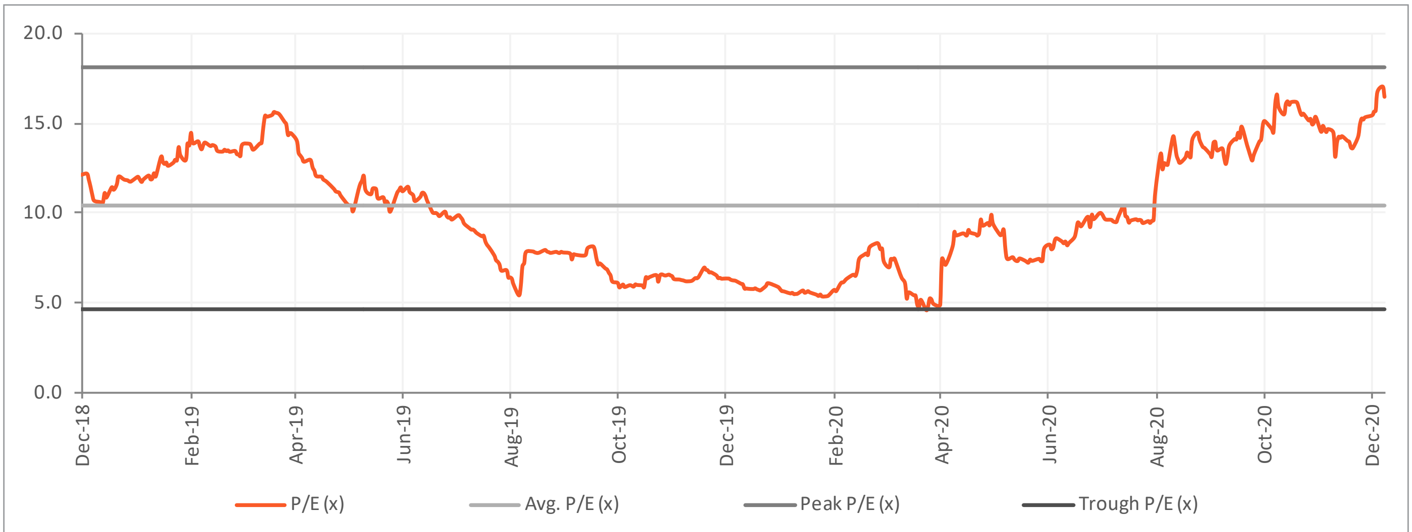
■ Company Outlook – Strong growth prospects

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. 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-pandemic era 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, the 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.

■ Valuation – Retain Buy with a revised PT of Rs. 1,450

Solara 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, new product launches, provide ample growth visibility going ahead. Further, the commissioning of Vizag plant would support the growth and provides ample confidence on achieving the managements target of 30% topline growth and 40% EBITDA growth for FY2021. The company's emphasis on growing the CRAMS business bodes well, though it would bear fruits over the medium term and would support the double-digit growth trajectory. At CMP, the stock is trading at a valuation of 17.5x/13.5x 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. 1,450.

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	1260	3.5	4525	39.0	20.7	17.5	19.3	12.3	10.3	10.5	16.6	16.5
Divis Laboratories	3,689	26.5	97,929	75.6	51.0	39.1	50.8	34.6	26.9	17.7	21.7	22.8

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

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 Hariharan S	Executive Director - Finance
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 *as on Sep 13, 2020*

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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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