Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

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. 887**	
Price Target: **Rs. 1,020**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

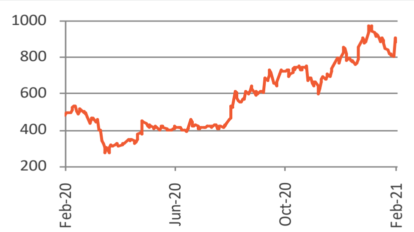
Company details

Market cap:	Rs. 7,949 cr
52-week high/low:	Rs. 1000 / 271
NSE volume: (No of shares)	13.4 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	-5.5	37.5	89.5	83.5
Relative to Sensex	-10.5	12.9	55.2	59.4

Sharekhan Research, Bloomberg

Strides Pharma Sciences

Weak quarter; Long-term growth levers intact

Pharmaceuticals	Sharekhan code: STAR	Result Update

Summary

- We retain Buy recommendation on Strides Pharma Sciences (Strides) with a revised PT of Rs 1,020
- Q3FY2021 was a weak quarter for Strides on the back of weak flu season, & price erosion in US markets and one off expenses. The results missed estimates.
- Healthy growth in the base business and strong product launch pipeline provides ample visibility for growth of the US business. Growth prospects in other regulated markets are also likely to get better, led by new product launches, increased market share, and portfolio optimization efforts.
- Strong growth prospects and earnings visibility, improving balance sheet strength, and healthy return ratios would support multiple re-ratings.

Q3FY2021 was a weak quarter for Strides Pharma Sciences (Strides) with results missing estimates. Performance for the quarter reflected the impact of a weak flu season in the US and one-time exceptional loss on account of Ranitidine withdrawal from US markets, which was partly offset by forex gains. Revenue from operations stood at Rs. 832 crore, up 13.6% y-o-y, slightly below estimates. Operating profit margin contracted by 550 bps y-o-y to 19.2% because a 650 bps decline in gross margin, attributable to unfavorable mix and withdrawal of export incentives. During the quarter, the company reported net exceptional expenses of Rs. 13 crore; adjusting for this, PAT stood at Rs. 47.7 crore versus Rs. 75 crore in Q3FY2020. However, weak performance for the quarter is being construed by the management as a short-lived one. Going ahead, the company's growth levers over the long term are intact. Moreover, Strides has strengthened its top management team by inducting candidates with rich and varied experiences, at key positions to drive performance of the US as well as other markets. Growth is expected to be driven by market share gains in existing base products, expected traction in new products, and a sturdy new product pipeline in the US business. Growth prospects in other regulated markets are also healthy with strong volume traction, new product launches, increased market share, and portfolio optimisation. The emerging markets segment is also expected to gain traction, backed by likely revival in the institutional business. Based on the above triggers, Strides' earnings are expected to record impressive CAGR of 57% over FY2020-FY2023.

Key positives

- Revenue of the other regulated markets grew by 37% y-o-y (in USD terms), backed by healthy volume growth.
- Successful commercialization of TLD in emerging markets during Q3FY2021.
- Strong product pipeline with cumulative 127 ANDAs filled and 30 awaiting approval.

Key negatives

- US sales were weaker, declining 4% sequentially due to weaker-than-anticipated flu season and price erosion for some of its products.
- Gross margin declined due to unfavourable business mix and withdrawal of export incentives.

Our Call

Retain Buy with a revised PT of Rs. 1,020: After a weak performance in Q3FY2021, management seems confident of strong growth for Strides going ahead. Performance is expected to be driven by sturdy growth across segments of regulated and emerging markets. A strong product pipeline, growth in the base business, and expected traction in new product launches would result in strong growth in the US business. The portfolio maximisation strategy adopted by the company in other regulated markets has played out well and has yielded good results. Strides sees the benefit from the same to accrue going ahead as well. Further, Strides had strengthened its top management team by inducting candidates with rich and varied experiences at key positions to drive the performance of the US as well as other markets. Moreover, the board has approved the demerger of the biotech business under Stellis and is evaluating listing the business on a standalone basis. This points at potential value-unlocking opportunities going ahead. Overall, the weak performance in Q3FY2021 is a short-lived phenomenon and long-term growth levers for Strides are intact and could play out well going ahead. At the CMP, the stock trades at valuation of 19.9x/14.7x its FY2022E/FY2023E EPS. Strong growth prospects and earnings visibility, improving balance sheet strength, and healthy return ratios would support multiple re-ratings. Possible de-merger of Stellis business provides a significant value-unlocking opportunity. We retain Buy on the stock with a revised PT of Rs. 1,020.

Key Risks

Any change in the regulatory landscape and adverse forex movements can impact earnings prospects.

Valuation Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Total Sales	2178.4	2752.0	3320.1	3795.2	4348.5
EBIDTA	296.6	587.8	707.5	870.1	1024.3
OPM (%)	11.7	19.4	19.5	21.2	21.9
Adj. PAT	81.1	139.9	261.8	399.7	541.8
EPS (Rs.)	9.1	15.6	29.2	44.6	60.5
PER (x)	98.0	56.8	30.3	19.9	14.7
EV/EBIDTA (x)	34.5	15.1	12.4	9.8	7.9
P/BV (x)	3.0	3.1	2.9	2.5	2.2
ROCE (%)	2.7	8.5	10.3	12.8	14.6
RONW (%)	3.4	1.7	11.1	12.8	15.0

Source: Company; Sharekhan estimates

Weak quarter: Q3FY2021 was a weak quarter for Strides with results missing estimates. Performance for the quarter reflected the impact of a weak flu season in the US and one-time exceptional loss on account of Ranitidine withdrawal from US markets, which was partly offset by forex gains. Revenue from operations stood at Rs. 832 crore, up 13.6% y-o-y because of healthy growth in emerging markets as well as regulated markets. OPM contracted by 550 bps y-o-y to 19.2% because of a 650 bps decline in gross margin, which was partially offset by savings in other operational expenses. Operating profit for the quarter stood at Rs. 159.4 crore, which is a decline of 11.9% y-o-y. During the quarter, the company reported net exceptional expenses of Rs. 13 crore, which includes Rs. 47.57 crore sales return and write-down of inventory towards withdrawal of Ranitidine from US markets. This was largely offset by foreign exchange gain of Rs. 36 crore on long-term foreign currency loans. Moreover, tax rate for the quarter was high at 14.8% versus 9% in Q3FY2020. Adjusting for exceptional expenses, PAT stood at Rs. 47.7 crore as compared to Rs. 75 crore in the corresponding quarter of the previous year and missed estimates.

Robust outlook for US markets; strengthening of top management team augurs well: US markets are key markets for Strides and constitute around 56% of FY2020 sales. For Q3FY2021, US performance was muted (US revenue grew by 10% y-o-y in USD terms), impacted by weaker-than-expected flu season, which affected few of the company's products. Moreover, price erosion in a few select products added to the pressure. Given the headwinds in Q3FY2021, Strides has revised its growth guidance for the US business for FY2021 to around $220 million as against earlier revenue guidance of $230 million-250 million (In 9MFY2021, the company reported sales of $157 million). Going ahead, Strides expects a marked improvement in the US business, as the company has strengthened its executive top management team, with a CEO coming on board for the US business. In addition to this, growth would be driven largely by market share gains in base products and expected traction in new/recent product launches, leading to widening of the product basket. Strides has a strong product pipeline. The company has received 12 ANDA approvals in FY2021, including the gTruvada, which is a high-value launch. Moreover, the company has filed for six ANDAs. Cumulatively, the company has total of 127 ANDA fillings with USFDA, with 30 pending approvals. Overall, with the current portfolio build being well diversified with a basket of market-leading products to deliver sustainable growth, new product launches are also expected to gain traction, thus adding to topline growth. Further, the front end of the US business, which constitutes around 85% of the company's US sales, is going strong and is likely to sustain the strong growth momentum. We expect US business revenue to grow strongly in double digits over FY2020-FY2023.

Other regulated markets to sustain the growth momentum backed by portfolio maximization strategy: Other regulated markets cover countries such as the UK, Germany, Australia, the Nordic nations, including the Netherlands. Revenue from the segment for the quarter in USD terms stood at $40 million, up 37% y-o-y, attributable to broad-based healthy volume traction. Further, plants commencing operations (which were shut in Q2 due to lower order fulfillment for the few products) have supported volumes growth. With plants attaining normalcy, management expects growth momentum to improve in other regulated markets as well. This would be led by a strategy based on portfolio maximisation across multiple markets. The company has received 13 new product approvals in FY2021, while it has filed for 12 products during the quarter. Going ahead, in Q4FY2021 and beyond, the company expects to sustain the strong filling momentum. Thus, revenue from other regulated markets are expected to grow in sturdy double digits over FY2020-FY2023.

Q3FY2021 Conference call highlights:

- **Stellis Biopharma Demerger:** The board of Strides approved in principle the demerger of its biotech business under Stelis Biopharma. The demerger is expected to unlock significant value for Strides' shareholders. A committee of the directors has been formed to explore various options of discovering value, which includes likely listing of the business on a standalone basis. Further clarity in this regard is expected over the next 4-6 weeks. The demerger is also subject to shareholder approvals and other necessary approvals.

- **Stellis to break even in FY2022:** Stellis is expected to break even in FY2022 as the business completes its incubation phase and enters the growth phase. Consequent to this, the fund requirement for Stellis is expected to be around $100 million to fund its programmes over the next three years.

- **Operational Highlights:** Strides witnessed headwinds due to weaker-than-anticipated flu season in the US markets, leading to weaker demand for few of the company's products. Further, Strides is witnessing price erosion for few of its products.

- **Institutional business offers healthy growth opportunities:** Under the institutional business, Strides manufactures drugs in the ARV, anti-malarial, anti-tuberculosis, Hepatitis, and other infectious disease segments. During the quarter, the company has commercialised TLD and now looks to target African markets with this. Strides is looking to participate in the tender business as well and looks to corner a fair share of this market.

- **Regulatory Updates:** Strides' Puducherry plant in under USFDA scanner. The company is working closely with USFDA to resolve the issues and is awaiting a re-inspection of the site.

Results Rs cr

Particulars	Q3FY21	Q3FY20	y-o-y (%)	Q2FY21	q-o-q (%)
Total Income	832.0	732.4	13.6	793.6	4.8
Expenditure	672.6	551.6	21.9	636.3	5.7
Operating profit	159.4	180.8	-11.9	157.2	1.4
Other income	13.2	12.2	8.0	12.9	2.6
EBIDTA	172.6	193.1	-10.6	170.1	1.5
Interest	34.7	39.6	-12.5	36.9	-5.9
Depreciation	52.5	43.5	20.8	52.8	-0.5
PBT	85.4	110.0	-22.3	80.4	6.2
Tax	10.8	11.3	-4.7	6.1	76.4
Adjusted PAT	47.7	75.3	-36.6	44.2	8.0
			BPS		**BPS**
OPM (%)	19.2	24.7	-553.1	19.8	-65.2

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view - Growth momentum to improve

Indian pharmaceutical companies are better placed to harness opportunities and register 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.

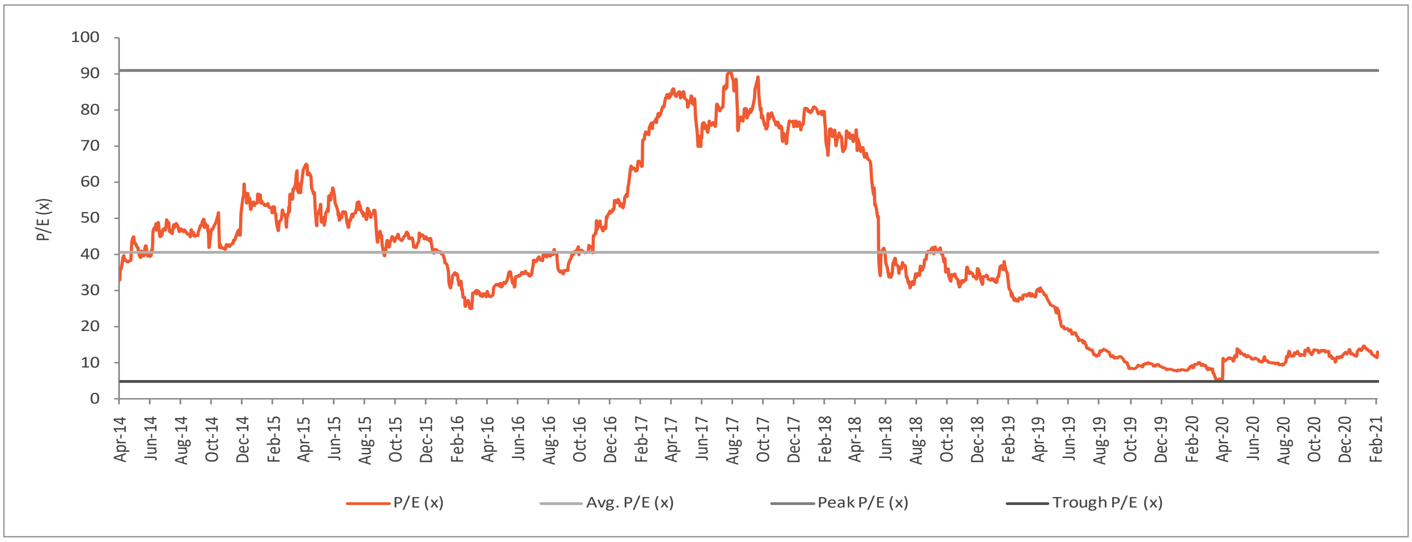
■ Company outlook - Strong earnings growth

Strides is well positioned to benefit from opportunities in the global pharmaceutical market. The company derives a higher share of revenue 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 are yet to be commercialised and offer sizeable market opportunities. Growth prospects in other regulated markets are also likely to be better, led by product launches, increased market share, and portfolio optimisation/maximisation. The emerging markets segment is expected to gain traction backed by a likely revival in the institutional business and strong growth in 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. The board's approval of the demerger of Stelis Biopharma points at potential value-unlocking opportunities for Strides' shareholders.

■ Valuation - Retain Buy with a revised PT of Rs. 1,020

After a weak performance in Q3FY2021, management seems confident of strong growth for Strides going ahead. Performance is expected to be driven by sturdy growth across segments of regulated and emerging markets. A strong product pipeline, growth in the base business, and expected traction in new product launches would result in strong growth in the US business. The portfolio maximisation strategy adopted by the company in the other regulated markets has played out well and has yielded good results. Strides sees the benefit from the same to accrue going ahead as well. Further, Strides had strengthened its top management team by inducting candidates with rich and varied experiences at key positions to drive performance of the US as well as other markets. Moreover, the board has approved the demerger of the biotech business under Stellis and is evaluating listing the business on a standalone basis. This points at potential value-unlocking opportunities going ahead. Overall, the weak performance in Q3FY2021 is a short-lived phenomenon and long-term growth levers for Strides are intact and could play going ahead. At the CMP, the stock trades at valuation of 19.9x/14.7x its FY2022E/FY2023E EPS. Strong growth prospects and earnings visibility, improving balance sheet strength, and healthy return ratios would support multiple re-ratings. Possible de-merger of the Stellis business provides significant value-unlocking opportunity. We retain our Buy recommendation on the stock with a revised PT of Rs. 1,020.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP (Rs / Share)	O/S Shares (Crs)	Mcap (Rs Cr)	P/E (x)			EV/EBIDTA (x)			RoE (%)		
				FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Aurobindo Pharma	927	24.7	54,287	18.6	17.3	15.1	11.7	10.4	8.6	19.0	17.2	16.8
Laurus Labs	347	53.2	18,609	72.3	20.1	16.9	34.4	13.7	11.5	14.4	34.2	28.8
Strides Pharma Sciences	887	9.0	7949	56.8	30.3	19.9	15.1	12.4	9.8	1.7	11.1	12.8

Source: Company, Sharekhan estimates

About company

Strides is a global pharmaceutical company and operates two business verticals, viz - regulated markets and emerging markets. Regulated markets include the US and other regulated markets. The balance is constituted by emerging markets verticals, which include 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 healthcare facility. In addition to the Africa business, the emerging markets vertical 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 revenue 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 are yet to be commercialised 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 optimisation. The emerging markets segment is also expected to gain traction backed by likely revival in the institutional business and strong growth in Africa business. The board's approval of the demerger of Stelis Biopharma points at potential value-unlocking opportunities for Strides' shareholders.

Key Risks

Any change in the regulatory landscape and adverse forex movements can impact earnings prospects.

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

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
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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