



Torrent Pharmaceuticals Ltd

Curatio a strategic fit; earnings dilutive in near term

Pharmaceuticals

Sharekhan code: TORNTPHARM

Reco/View: Buy



Upgrade



Maintain



Downgrade

CMP: Rs. 1,493

Price Target: Rs. 1,730

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	■	↔	■

ESG Disclosure Score

NEW

ESG RISK RATING

Updated July 08, 2022

37.61

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 50,530 cr
52-week high/low:	Rs. 1,652 / 1,243
NSE volume: (No of shares)	2.3 lakh
BSE code:	500420
NSE code:	TORNTPHARM
Free float: (No of shares)	9.7 cr

Shareholding (%)

Promoters	71.3
FII	11.0
DII	10.1
Others	7.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-3.1	4.4	5.6	-3.9
Relative to Sensex	-0.8	-2.3	9.1	1.2

Sharekhan Research, Bloomberg

Summary

- Torrent Pharma (Torrent) has acquired 100% stake in Curatio Health Care (Curatio) for Rs. 2,000 crore (EV of Rs. 1,885 crore; valuation at 6.9x FY23E EV/sales); Curatio has strong focus on cosmetic dermatology (with 50+ brands).
- Curatio's revenues are expected to grow by 18% in FY23 to Rs. 275 crore (with top 5 brands expected to grow by 22%) from Rs. 224 crore in FY22. EBITDA margins are lower at 26% compared with Torrent at ~30%. However, the same is expected to improve in line with Torrent's margins through efficiencies.
- Acquisition will be funded by a mix of debt:internal accruals (80:20). Acquisition will be earnings dilutive by 4-6% in FY2023/24 due to lower margins and high debt funding.
- Curatio acquisition will place Torrent among top 10 players in dermatology market in India. Thus, acquisition is long-term strategic fit but earnings dilutive in the near term. We maintain Buy with revised PT of Rs. 1,730.

Torrent has entered into definitive agreements to acquire 100% stake in Curatio Health Care (I) Private Limited (Curatio), a dermatology company with a strong focus on India. It has a strong presence in the cosmetic dermatology segment (84% contribution to revenues) with a portfolio of over 50 brands, marketed in India. Derma is a high-growth therapy area in India and Curatio acquisition will bring Torrent into Top 10 players list in the domestic dermatology market. The acquisition has potential to add 1.5%-3% to the Torrent's total revenues in FY2023/24. Torrent has acquired Curatio for Rs. 2,000 crore (EV of Rs. 1,885 crore). With expected revenues of Rs. 275 crore in FY2023, the deal is valued at 6.9x its EV/sales, which is expensive considering some of the deals in the pharma space. The acquisition is strategic fit for Torrent from a long-term growth perspective. However same is earnings dilutive in the near term.

- **Event – Acquisition of Curatio:** Torrent Pharma has entered into definitive agreements to acquire 100% stake in Curatio Health Care (I) Private Limited (Curatio), a company with strong focus in the domestic dermatology space (accounting for 84% of revenues). The purchase consideration for the deal is Rs. 2,000 crore including Rs. 115 crore of cash and cash equivalents in the acquired business indicating an Enterprise Value of Rs. 1,885 crore. Curatio has a strong presence in the cosmetic dermatology segment with a portfolio of over 50 brands, marketed in India. With this acquisition, Torrent will add field force 600 MRs and distribution network of 900 stockists.
- **Strong portfolio of brands brings** Torrent in top 10 in Derma space: Curatio has built a strong portfolio of high market share brands in cosmetic and paediatric dermatology. Curatio's portfolio consists of leading brands such as Tedibar, Atogla, Spoo, B4 Nappi, and Permite are ranked amongst top 5 brands in their covered market. Top 10 brands contribute 75% to the portfolio while top 3 brands contribute more than 50% of the total sales. Top 10 brands have potential to grow in high double digits. Curatio's reported revenue for FY2022 was Rs 224 Crores. With YTD August sales up by 25%, Curatio is expected to cross Rs. 275 crore of revenue in FY2023. EBITDA margins stood at 26% in FY2022 (lower than Torrent's margins of 29-30%). However, scale-up in revenues, synergies in procurement and production and reduction in fixed cost will help EBITDA margins to improve in the coming years (likely to be at par with Torrents margins in FY2023).
- **Deal valuation expensive; acquisition will be funded through debt and internal accruals:** Purchase value for the acquisitions stood at Rs. 2,000 crore (enterprise value of Rs. 1,885 crore). At expected of revenues of Rs. 275 crore in FY2023, the deal is valued at 6.9x its FY2023E EV/sales (and ~24x its FY2023E EV/EBITDA at premium to Torrent's expected valuation of 19x EV/EBITDA). The company will be funding the acquisition through debt and internal accruals in an 80:20 ratio. Average cost of debt is expected to be 7-7.5%. Assuming debt of Rs. 1,500 crore and lower margin profile, the acquisition is expected to be earning dilutive by 4-6% in FY2023/24.

Our Call

View: Retain Buy with a revised price target of Rs. 1,730: The acquisition of Curatio is a long term strategic fit for Torrent, as its portfolio of strong brands provides immense scope for the company to build a strong position in the domestic dermatology space. We believe it will take another 2-3 years for acquisition to be earnings neutral for Torrent. Curatio's strong growth prospects and Torrent's strong business outlook for existing India business will help to mitigate some of the pressure in the international market such as US. At the current market price, the stock is trading at 32.8x/26.7x its FY2023E and FY2024E earnings. We maintain a Buy on the stock with a revised target of Rs. 1,730 (lowering it by 5% in view of earning dilution led by the Curatio acquisition).

Key Risks

Delays in the resolution of USFDA issues at its plants and heightened competitive pressures in the US.

Valuation (Consolidated)

Particulars	FY2021	FY2022	FY2023E	FY2024E
Net sales	8005.0	8508.0	9427.0	10736.0
Operating Profit	2485.0	2431.0	2875.2	3435.5
OPM (%)	31.0	28.6	30.5	32.0
Adjusted net profit	1252.0	1262.0	1548.2	1898.2
EPS (Rs)	36.8	37.1	45.5	55.8
PER (x)	40.5	40.2	32.8	26.7
EV/Ebitda (x)	22.3	22.4	19.0	15.5
P/BV (x)	8.6	8.4	7.3	6.1
ROCE (%)	16.9	18.4	22.8	26.1
RONW (%)	23.1	21.1	23.8	24.8

Source: Company; Sharekhan estimates

Torrent Pharma acquires 100% stake in Curatio

Torrent Pharma has entered into definitive agreements to acquire 100% stake in Curatio Health Care (I) Private Limited (Curatio), a dermatology company with a strong focus on cosmetic dermatology. The purchase consideration for the deal is Rs. 2,000 crore including Rs. 115 crores of cash and cash equivalents in the acquired business (on the date of signing) indicating an Enterprise Value of Rs. 1,885 crore. As of FY2022-end Torrent had cash and cash equivalent of Rs. 400 crore on its books. The acquisition will be funded through mix of debt and internal accruals. The deal is valued at 6.9x its FY2023E EV/Sales.

Curatio: Leader in cosmetic dermatology

In over 17 years of operations, Curatio has built a strong presence in the cosmetic dermatology segment with a portfolio of over 50 brands, having operations in India, Nepal, Srilanka & Philippines. Curatio's portfolio consists of leading brands such as Tedibar, Atogla, Spoo, B4 Nappi, and Permite, which are ranked amongst top 5 brands in their covered market. Top 10 brands contribute 75% to the portfolio while top three brands contribute more than 50% of the total sales. Curatio's reported revenue for FY2022 was Rs 224 crore. With YTD August sales up by 25%, Curatio is expected to cross Rs. 275 crores revenue in FY2023. Dermatology is a key therapy for Curatio contributing 95% in its overall sales. Within dermatology, 84% of derma therapy sales contributed by high growth cosmetic dermatology. With this acquisition, Torrent will add a field force of 600 medical representatives and a distribution network of 900 stockists.

Curatio acquisition enables Torrent to enter the top league in Dermatology

RANK	CORPORATE
	DERMA
1	GSK
2	GLENMARK
3	SUN*
4	HEGDE & HEGDE
5	ABBOTT*
6	DR. REDDYS
7	MANKIND
8	ZYDUS*
9	WIN-MEDICARE
10	TORRENT+CURATIO
11	MACLEODS
12	INTAS
13	CIPLA
14	USV
15	GALDERMA
18	CURATIO
21	TORRENT

Source: Company, Sharekhan Research

Good opportunity through high growth therapy area of Dermatology

Over the last decade, dermatology as a therapy has delivered 13% CAGR which is 1.3x of the UPM CAGR, while cosmetic dermatology has delivered an 16% CAGR which is 1.6x of the IPM CAGR. With this deal, Torrent Pharma will enter the league of top 10 players in the dermatology segment and will be the leader in the cosmetic dermatology space.

Portfolio clocks strong annualised growth

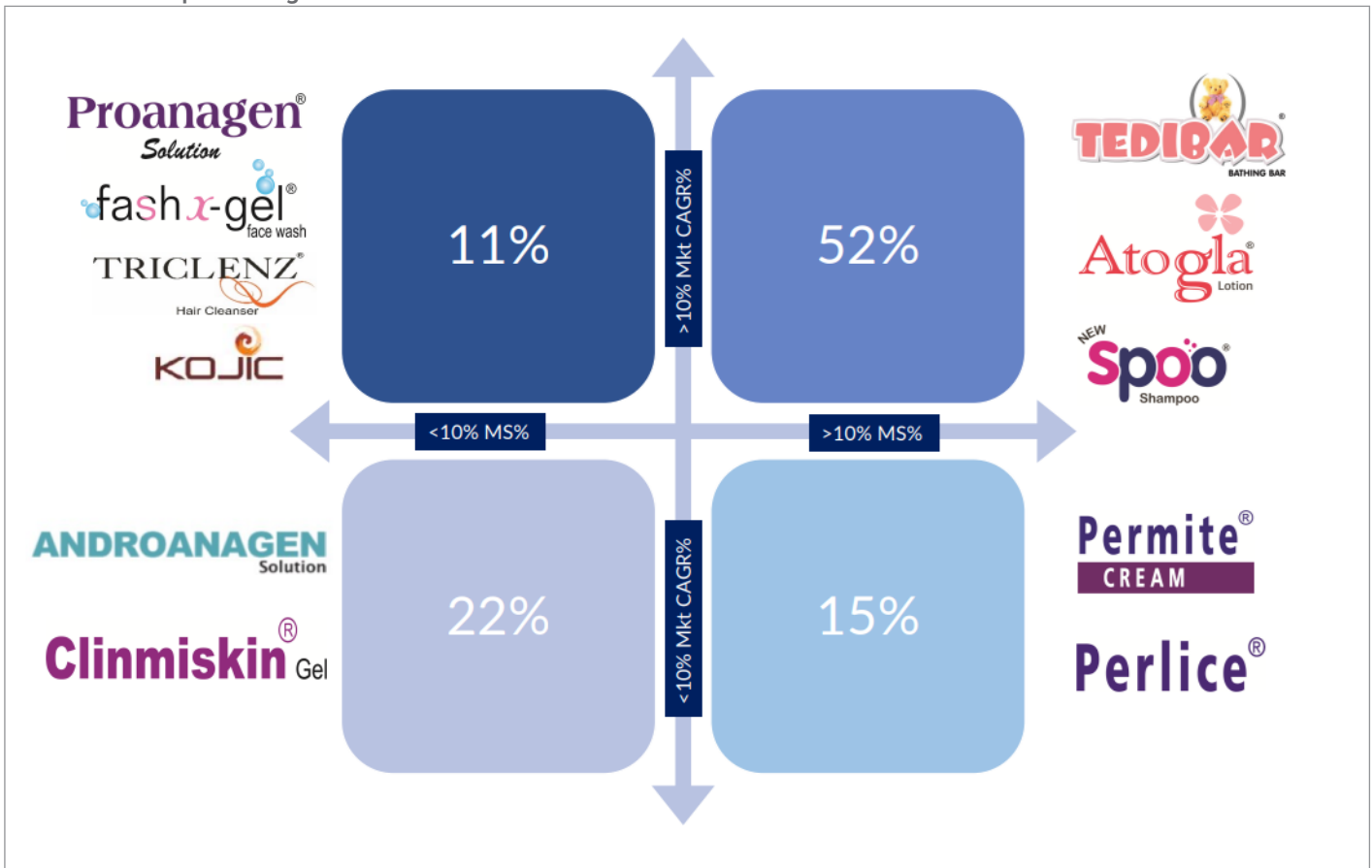
Portfolio	FY2022 sales contribution	Key products	Three-year CAGR
Pedia Products	~60%	Tedibar, Atogla Lotion & Cream, Spoo	17%
Acne/Face care	~20%	Tracnil, Acnemoist, Clinmiskin, Fash	15%
Hair/Scalp care	~12%	Perlice, Proanagen, Noskurf	9%

Source: Company, Sharekhan Research

Strong brands to support growth

- ♦ **Tedibar:** Tedibar is Curatio's major revenue contributing product with a market size of Rs. 1,477 crore. It is India's leading low pH cleansing bar which is made from synthetic detergent to maintain pH. The brand ranks second in its category and registered a 2-year CAGR of 11%. Individuals typically start using the product as a toddler and may continue its use later as well. It is a high gross contribution product with significant headroom for increase. As per the company, 80% potential market is not yet served which provides significant opportunity for growth. In FY2022, the brand reported a revenue of Rs. 76 crore and YTD August, the growth is expected at 15%. For FY2023, the expected to grow by 25% y-o-y to Rs. 95 crore.
- ♦ **Atgola:** Atgola has a market size of Rs. 1,300 crore with 2-year CAGR at 11%. The brand ranks 5th in its category. In FY2022, the brand reported a revenue of Rs. 27 crore and is expected to grow by 20% y-o-y in FY2023 to Rs. 32 crore.
- ♦ **Spoo:** Spoo has a market size of Rs. 174 crore with 2-year CAGR at 10%. The brand ranks 1st in its category. In FY2022, the brand reported a revenue of Rs. 13 crore and is expected to grow by 11% y-o-y in FY2023 to Rs. 14 crore.
- ♦ **Other key brands:** B4 Nappi has a market size of Rs. 1,466 crore with 2-year CAGR at 11%. The brand ranks third in its category. In FY2022, the Permite/Perlice brand reported a revenue of Rs. 14 crore and is expected to grow by 21% y-o-y in FY2023 to Rs. 17 crore. In FY2022, the Clinmiskin brand reported a revenue of Rs. 8 crore and is expected to grow by 19% y-o-y in FY2023 to Rs. 10 crore. The Top 5 brands – Tedibar, Atgola, Permite/Perlice, Spoo and Clinmiskin – contribute ~60% to the portfolio. Also, key brands of Curatio are a part of high growth market with high market share.

Curatio's brand positioning



Source: Company, Sharekhan Research

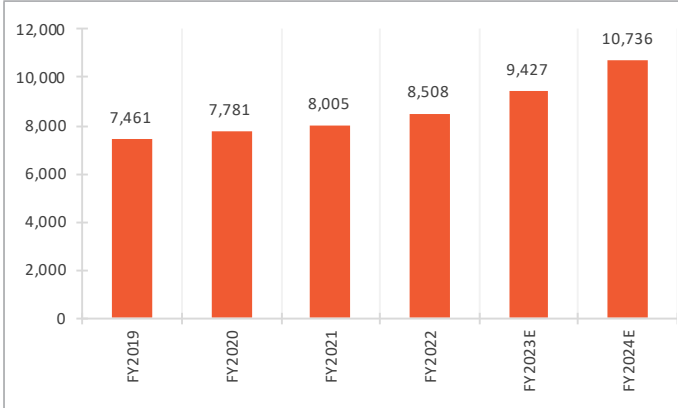
Key conference call highlights

- ◆ **Acquisition in line with Torrent's strategy:** The acquisition is in-line with the company's strategy to focus on India market and fill the gaps in the therapy areas. Long term macro factors which are favorable for the acquisition are growth in dermatology/cosmetics with increase in disposable income.
- ◆ **Pediatric coverage:** Curatio covers many pediatricians which Torrent does not currently cover. Curatio covers 6,000-7,000 dermatologists and 16,000 pediatricians (out of a total coverage universe of 25,000 pediatricians).
- ◆ **Tedibar to scale up:** Tedibar reported Rs. 76 crore revenue in FY22 and grew by 15% in YTD FY23. The brand is expected to grow in high-double digit going ahead due to expansion in reach especially in North & East coupled with growth in the dermatology cases in West & South.
- ◆ **Acquisition margin dilutive in short term, expected to be margin accretive in long term:** Curatio's gross margins are similar to Torrent's India business. However, Curatio reported EBITDA margin of 26.8% in FY2022 (reported revenue of Rs. 224 crore and an EBITDA of Rs 60 crore in FY2022) which is lower than Torrent's overall FY2022 EBITDA margins of 28.6%. In FY2023, the company expects Curatio's margins to be similar to Torrent's overall EBITDA margins. However, in the next few quarters, Curatio's EBITDA margins are expected to be at par with TRP's domestic EBITDA margins aided by higher revenues, synergies in procurement, productivity improvement as well as lower fixed costs.

- ◆ **Deal to be financed through mix of debt and internal accruals:** The acquisition would be done by a mix of internal accruals and debt funding. Around 75-80% of acquisition cost will be funded through debt with cost of debt expected to be around 7-7.5%. Torrent's interest cost will increase by Rs. 100-110 crore.
- ◆ **Net debt expected at Rs. 1,000-1,100 crore by FY2025-end:** In FY2022-end, Torrent's net debt stood at ~Rs. 3,440 crore. By FY2024-end, the company expects net debt to be at Rs. 3,100 crore. The company expects to repay a substantial part (Rs. 2,000 crore) of its overall debt in FY2025, and hence expects net debt to reduce to Rs. 1,000-1,100 crore by FY2025-end.
- ◆ **OTC platform to scale up in medium term:** Currently 15-20% of Curatio's sales are from the online channel. The company plans to increase the OTC marketing next year given the high potential of the key brands. Torrent also plans to launch brand extensions in the medium term.
- ◆ **Pricing strategy to be evaluated:** Pricing of Curatio's products is lower as compared to peers. The pricing for Tedibar (Curatio's major product) is significantly lower than competition (Rs. 165 versus Rs. 200-250 for peers). The company is evaluating the pricing strategy going forward. Curatio recently undertook a 10% price hike (one-off price hike), but price hikes have been generally 4-5% y-o-y for the Curatio portfolio. As the entire portfolio needs either a cosmetic or a food license and not a drug license, there is no cap on taking price hikes.
- ◆ **15-year amortisation:** Torrent will follow an amortization period of 15 years for this deal, which is in-line with its policy. Most of Curatio's assets are intangibles.
- ◆ **Cost synergies likely in medium term:** Torrent expects COGS improvement going ahead as Torrent has better negotiating power as compared to Curatio. Also, certain fixed expenses structures are better at Torrent so cost synergies are likely in the medium term. The management has indicated that no significant investments will be undertaken in the next 1-2 years.
- ◆ **Key Curatio management to stay:** Almost entire team of Curatio will continue at Torrent except a few key management personnel who have opted out.

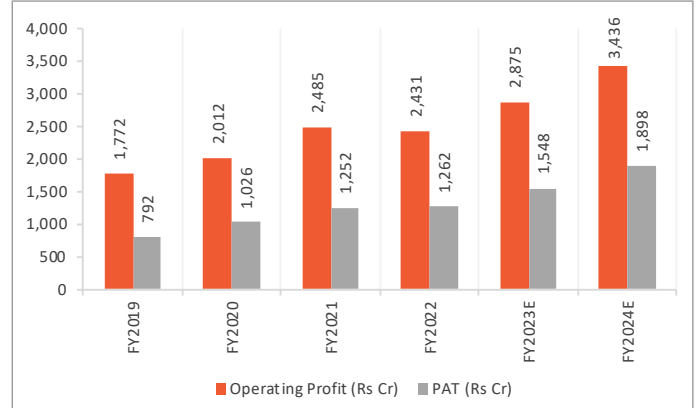
Financials in charts

Sales Trends (Rs Cr)



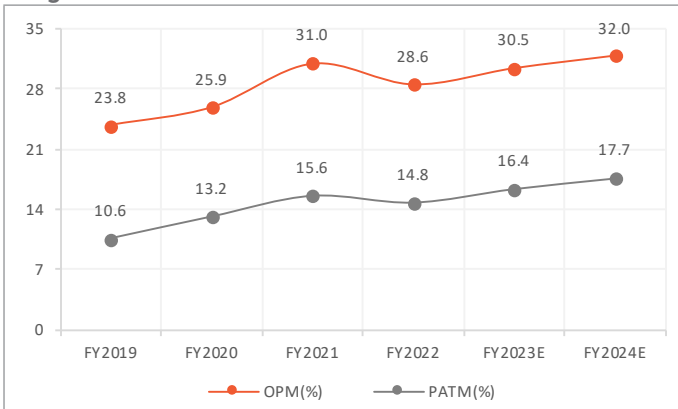
Source: Sharekhan Research

Operating Profit - PAT Trend



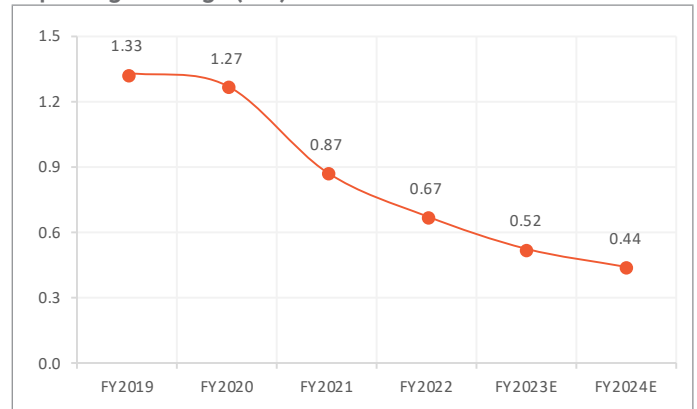
Source: Sharekhan Research

Margin Trend



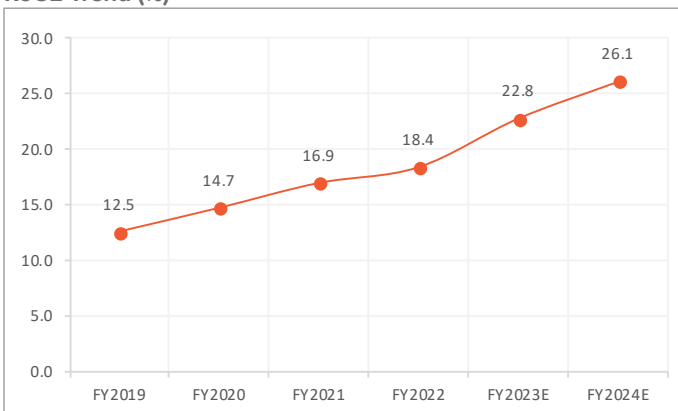
Source: Sharekhan Research

Improving Leverage (D:E)



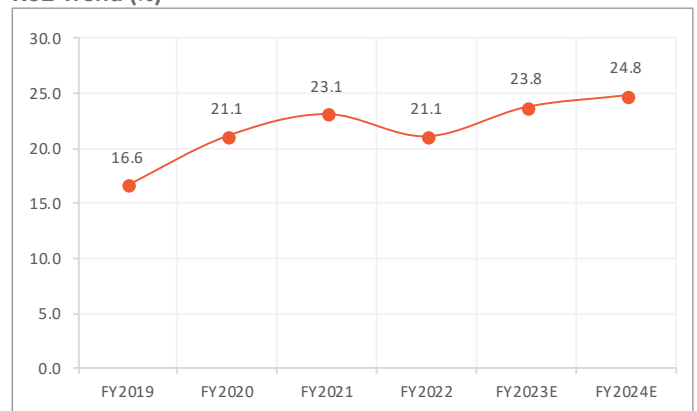
Source: Sharekhan Research

RoCE Trend (%)



Source: Sharekhan Research

RoE Trend (%)



Source: 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 the easing of pricing pressures (especially in the US generics market), a rise in product approvals, plant resolutions by the USFDA, 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 the commissioning of expanded capacities by select players over the medium term. Collectively, this indicates a strong growth potential going ahead for pharmaceutical companies.

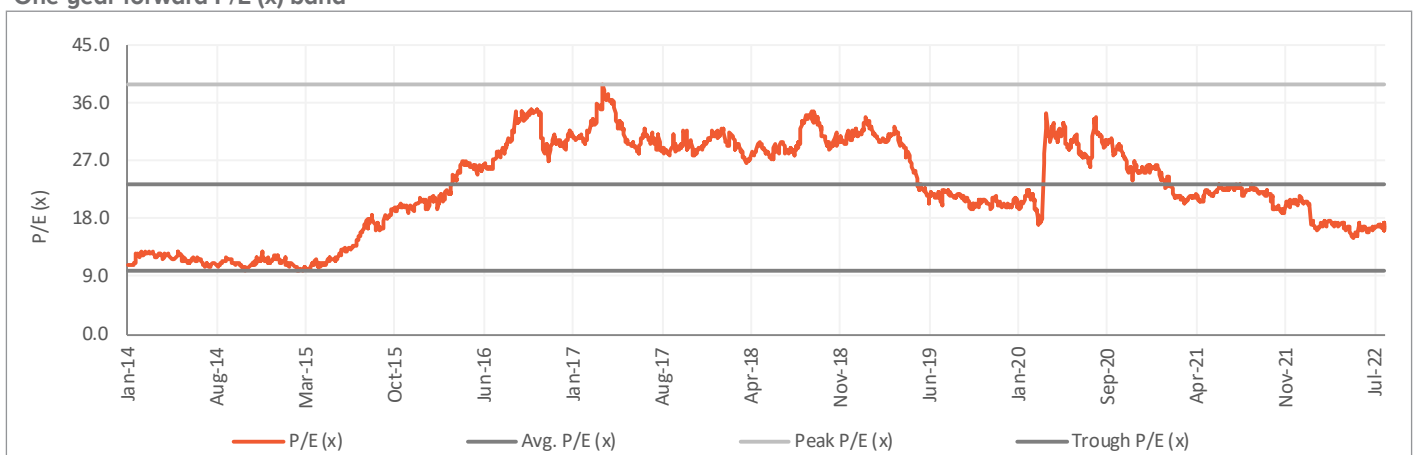
■ Company Outlook – Indian and Brazilian businesses to stage strong growth

Torrent is a leading pharmaceutical company present in emerging as well as developed markets. The company has a higher exposure to chronic therapies. Moreover, the company derives a substantial portion of its sales from India, followed by the US, Germany, and Brazil, which collectively form the core markets. The company has been outperforming in the Indian as well as Brazilian markets and management expects to sustain traction going ahead as well and sees these geographies as key growth drivers. Moreover, the German business is expected to gain traction and stage strong growth ahead, backed by growth in the base business and new product launches. The company's US business has been under pressure as two of its plants, which cater to US markets – Dahej and Indrad – are under the USFDA's scanner with OAI/WL classifications. However, the Levittown plant has commenced operations and the company expects to launch a new product in the US market from the plant, which could help it mitigate pricing pressures. Timely and successful resolution of these USFDA observations at its two plants is critical and could result in earnings upgrades upon resolution.

■ Valuation – Retain Buy with Revised PT of Rs. 1,730

The acquisition of Curatio is a long term strategic fit for Torrent, as its portfolio of strong brands provides immense scope for the company to built a strong position in the domestic dermatology space. We believe it will take another 2-3 years for acquisition to be earnings neutral for Torrent. Curatio's strong growth prospects and Torrent's strong business outlook for existing India business will help to mitigate some of the pressure in the international market such as US. At the current market price, the stock is trading at 32.8x/26.7x its FY2023E and FY2024E earnings. We maintain a Buy on the stock with a revised target of Rs. 1,730 (lowering it by 5% in view of earning dilution led by the Curatio acquisition).

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 (%)		
				FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Torrent Pharma	1493	33.8	50529.9	40.2	32.8	26.7	22.4	19.0	15.5	21.1	23.8	24.8
Cipla	1097	80.7	88516.9	32.3	28.5	22.4	19.2	17.3	13.9	14.6	13.9	15.4

Source: Company, Sharekhan estimates

About company

Torrent, the flagship company of Torrent Group, was incorporated in 1972. Torrent has a strong international presence across 40 countries with operations in regulated and emerging markets such as the US, Europe, Brazil, and RoW. The company operates through its wholly owned subsidiaries spread across 12 nations with major setups in Brazil, Germany, and the US. The company is also one of the leading pharmaceutical companies present in India as a dominant player in the therapeutic areas of cardiovascular (CV) and central nervous system (CNS). The company also has a significant presence in gastro-intestinal, diabetology, anti-infectives, and pain management segments.

Investment theme

Torrent continues to focus on a branded business mix from India and Brazil, which balances well for sustainable growth in a challenging global environment for the pharma sector. US business is also stable. Operating leverage from the acquired domestic business is likely to be visible from FY2020. Three manufacturing plants of Torrent are reeling under regulatory issues with a warning letter being issued by the USFDA. Management expects at least 12-15 months for the issues to be resolved; and till such time, approvals from these plants would be withheld. Torrent has submitted its responses to the regulator and is awaiting a revert on this. Timely and successful resolution of USFDA issues is critical from a growth perspective. Acquisition of Curatio is a long term strategic fit but will be earnings dilutive in the near term.

Key Risks

- ◆ Slowdown in ANDA approvals and USFDA-related regulatory risks could hurt business prospects.
- ◆ Delay in product launches in Brazil, Germany, and the US could restrict growth in these key geographies.
- ◆ Currency fluctuation poses a risk to export businesses.

Additional Data

Key management personnel

Mr. Sudhir Mehta	Chairman (Emeritus)
Mr. Samir Mehta	Executive Chairman
Mr. Sudhir Menon	CFO

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Mirae Asset Global investment Company	2.14
2	UTI Asset Management Co Ltd	1.37
3	FMR LLC	1.31
4	Blackrock Inc	0.88
5	Vanguard Group Inc	0.87
6	Pictet Funds SA	0.76
7	T Rowe Price Group Inc	0.72
8	Kotak Mahindra Asset Management Co	0.62
9	Norges Bank	0.5
10	ICICI Prudential Life Insurance Co	0.48

Source: Bloomberg (old data)

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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 deteriorating 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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