



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 **37.61**
Updated Oct 08, 2022

High Risk

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

Source: Morningstar

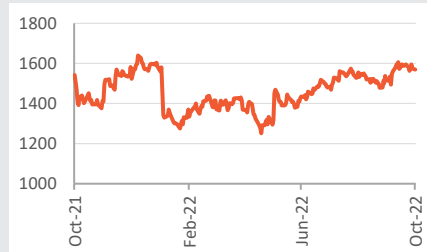
Company details

| | |
|-------------------------------|-----------------|
| Market cap: | Rs. 53,305 cr |
| 52-week high/low: | Rs. 1,652/1,243 |
| NSE volume: (No of shares) | 2.6 lakh |
| BSE code: | 500420 |
| NSE code: | TORNTPHARM |
| Free float: (No of shares) | 9.7 cr |

Shareholding (%)

| | |
|-----------|------|
| Promoters | 71.3 |
| FII | 11.5 |
| DII | 9.5 |
| Others | 7.7 |

Price chart



Price performance

| (%) | 1m | 3m | 6m | 12m |
|--------------------|-----|------|------|-----|
| Absolute | 4.1 | 5.4 | 15.2 | 2.2 |
| Relative to Sensex | 0.3 | -0.9 | 11.8 | 4.9 |

Sharekhan Research, Bloomberg

Torrent Pharmaceuticals Ltd
Soft quarter, improved outlook for H2

| | | | |
|------------------------|-----------------------------------|-----------------------|--------------------------------|
| Pharmaceuticals | Sharekhan code: TORNTPHARM | | |
| Reco/View: Buy | ↔ | CMP: Rs. 1,575 | Price Target: Rs. 1,820 |
| ↑ Upgrade | ↔ Maintain | ↓ Downgrade | |

Summary

- Torrent Pharmaceuticals Limited (Torrent) reported soft performance in Q2FY2023 but medium-term outlook is improving with healthy outlook from India and Brazil business, while Germany business is expected to recover in H2FY2023.
- Revenue grew by 7% y-o-y, driven by 13% and 19% y-o-y growth in India and Brazil business, respectively; OPM fell 125 bps y-o-y to 29.6%; PAT stood flat at Rs. 312 crore.
- India business likely to grow by 13-14%, Brazil business to grow by 19-20%, and Germany to see sequential recovery in the quarters ahead. OPM is likely to remain at ~30%.
- Given better growth prospects across India and Brazil businesses, we retain Buy with an unchanged PT of Rs. 1,820.

Torrent Pharmaceuticals Limited (Torrent) delivered soft performance in Q2FY2023. The company's revenue grew by 7% y-o-y to Rs. 2,291 crore, while OPM declined by 125 bps y-o-y. PAT for the quarter stood flat at Rs. 312 crore. Double-digit growth in Brazil and India businesses provides some support to overall growth, while Germany sales saw sequential improvement. Going ahead, India and Brazil businesses could be the company's key growth drivers, while US business is likely to be under stress due to prolonged delays for plant re-inspection by USFDA, leading to lack of new launches and high competitive pressures. Germany business is expected to see good recovery in H2FY2023. OPM is expected to remain at 29-30% in H2FY2023. However, cost savings due to discontinuation of the liquids business and other cost-control measures implemented could result in OPM expansion for FY2024/FY2025.

Key positives

- Domestic business revenue grew by 13% y-o-y, led by outperformance across therapy areas and new launches.
- Brazil's revenue grew by 19% y-o-y, led by new launches; as per secondary data, Torrent's growth of 14% was ahead of BGx market growth of 10% for the quarter ended August 2022.

Key negatives

- Delay in the resolution of OAI/WL at Indrad and Dahej plants and high pricing pressures in the US led to muted performance in the region.

Management Commentary

- India business is on a steady footing and focus on growing the trade generics business, strong growth in branded generics, expanded field force, and strong product pipeline could be key growth drivers for India business. Management expects mid-teens growth to sustain in the coming quarters.
- Acquisition of Curatio Healthcare was completed in mid-October and it will be integrated by Q3. It will start adding materially to the company's revenue from Q4, based on the integration.
- Brazil to maintain its growth momentum, backed by performance of the top brands, new launches, field force expansion as well as good performance in the generics division. Germany should continue on a modest positive trend, led by field force expansion and good performance from the acquired portfolio.
- US will take time to see recovery in the performance. Torrent has responded to USFDA's Form 483 with three observations received for its Gujarat Facility. The company is expected to hear from USFDA in the next 90 days. The company expects approvals and launch of new products post the FDA clearance.
- Management has indicated that raw-material prices are expected to be stable in the near term. Moreover, the logistics cost has come down to Q3FY2022 levels. So, margins are expected to remain at the current level in the near term.

Revision in estimates – Torrent reported soft performance in Q2. We have reduced our earnings estimates for FY2023 and FY2024 to factor in below-par performance in Q2 and lower-than-earlier estimated other income. We have introduced FY2025 earnings estimates through this note.

Our Call

View: Retain Buy with an unchanged PT of Rs. 1,820 – Torrent's Q2 performance was soft. However, it sees a healthy outlook for India business, backed by expanding reach, market share gains, and likely traction in the new trade generics division. Expected growth in the existing portfolio, and plans to fortify presence in the covered markets would drive Brazilian sales growth, while elevated cost pressures, price erosion, and delays in re-inspection for plants by USFDA could slow down US growth momentum. Germany is expected to see a good recovery from H2. At the CMP, the stock trades at 38.1x/31.5x its FY2023E and FY2024E. Given better growth prospects across Indian and Brazilian businesses, we retain our Buy recommendation on the stock with an unchanged price target (PT) of Rs. 1,820.

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 | FY2025E |
|---------------------|--------|--------|---------|---------|---------|
| Net sales | 8005.0 | 8508.0 | 9338.2 | 10657.3 | 12042.9 |
| OPM (%) | 31.0 | 28.6 | 30.0 | 31.0 | 31.5 |
| Adjusted net profit | 1252.0 | 1262.0 | 1405.7 | 1698.8 | 2027.6 |
| EPS (Rs) | 36.8 | 37.1 | 41.3 | 50.0 | 59.6 |
| PER (x) | 42.8 | 42.4 | 38.1 | 31.5 | 26.4 |
| EV/Ebitda (x) | 23.4 | 23.5 | 20.5 | 17.1 | 14.4 |
| P/BV (x) | 9.0 | 8.9 | 7.8 | 6.7 | 5.7 |
| ROCE (%) | 16.9 | 18.4 | 21.0 | 24.1 | 25.4 |
| RONW (%) | 23.1 | 21.1 | 21.8 | 22.9 | 23.4 |

Source: Company; Sharekhan estimates

Muted Q2 - Revenue growth at 7% y-o-y; OPM down by 125 bps y-o-y

Torrent reported revenue growth of 7% y-o-y to Rs. 2,291 crore, backed by 19%, 13%, and 10% y-o-y growth in Brazil, India, and RoW, respectively, while Europe (Germany) sales declined by 12% y-o-y. Gross margin marginally declined by ~15 bps y-o-y to 72% and OPM at 29.6% contracted by 125 bps y-o-y. Operating profit stood at Rs. 679 crore, up 2.9% y-o-y. The y-o-y increase can be attributed to the benefits of operating leverage playing out. Adjusted PAT for the quarter declined by 1.3% y-o-y to Rs. 312 crore, owing to muted revenue growth coupled with lower other income (down by 69% y-o-y). For H1FY2023, revenue grew by 7.8% y-o-y to Rs. 4,553 crore, while PAT increased by 3.1% y-o-y to Rs. 666 crore. OPM declined by 111 bps y-o-y to 30.6% in H1FY2023.

Torrent Pharma acquired a 100% stake in Curatio in Q2FY2023

Torrent entered into a definitive agreement 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 was fixed at Rs. 2,000 crore, including Rs. 115 crore of cash and cash equivalents in the acquired business (on the date of signing), indicating an enterprise value of Rs. 1,885 crore. The acquisition will be funded through a mix of debt and internal accruals. The acquisition is in line with the company's strategy to focus on India market and fill the gaps in therapy areas. Long-term macro factors, which are favourable for the acquisition, are growth in dermatology/cosmetics with increased disposable income. The acquisition of Curatio is a long-term strategic fit for Torrent, as its strong brand portfolio provides immense scope for the company to build a strong position in the domestic dermatology space.

Q2FY2023 Concall Highlights

- ♦ **India business growth ahead of the industry:** Torrent's India business grew by 13% y-o-y to Rs. 1,224 crore in Q2FY2023. For H1FY2023, revenue was Rs. 2,468 crore, up 13%. Strong performance can be attributed to new launches, robust performance of the top brands, and market outperformance in focused therapies. As per AIOCD, the company reported growth of 19% (6% volume, 9% price, and 4% new products) versus IPM growth of 13%. For the trade generic business, the current contribution is 2.5-3% and management has indicated that it is steady and sustainable in the near term. The company expects the launch momentum to continue. Management is positive on maintaining its leadership position in India. Overall, the growing trade generics business, strong growth in branded generics, increased field force numbers, and a robust product pipeline could be key growth drivers for the domestic business. Therefore, based on the above drivers, Torrent expects to outpace IPM growth in FY2023. In the medium term, the company aims to grow by 3% to 4% above market growth in the domestic business.
- ♦ **Brazil market expected to continue its growth momentum:** Revenue from Brazil grew by 19% y-o-y (10% in CC terms) to Rs. 185 crore. For H1FY2023, revenue was Rs. 369 crore, up by 20%. The company experienced enhanced competition on one of its key launches, Rivaroxaban, and another cardio product, which led to price reduction. Adjusted for these price reductions, growth for Q2 would have been close to 20%. As per the secondary data from IQVIA, Torrent's branded generic business is currently growing at 14.4% as compared to the branded generic market growth of 12.1%. The company expects Brazil to continue its growth momentum, backed by performance of the top brands, new launches, field force expansion as well as generics division, and growth in double digits in FY2023. In the medium term, the company aims to grow its Brazil business by 3% to 4% above market growth.
- ♦ **Muted quarter for the US business:** US sales for the quarter stood at Rs. 292 crore, which is growth of 3% y-o-y. For H1FY2023, revenue stood at Rs. 591 crore, up by 7%. Capacity utilisation in Q2 stood at 54% and the company expects it to grow in the medium term. As on September 30, 2022, 48 ANDAs were pending approval with the USFDA and three tentative approvals were received. USFDA inspected the company's manufacturing facility at Indrad, Gujarat. At the end of the inspections, the company got Form 43 with three observations. The company has already responded to the USFDA within the stipulated time and expects to hear back from the FDA in the next 90 days. As per management, there is no new capex being done for US market. Moreover, the goal of the company is no longer to file a high double-digit number

of ANDAs but rather rebalance the R&D investment more in favour of markets like Brazil and Germany. Having said that, there are no plans of the company to become non-competitive or to reduce presence in the US. Going ahead, management sees US business to be under stress in the near-to-medium term as competitive intensity is on the higher side and there is sustained price erosion, which could also impact margins.

- ◆ **Another weak quarter for Europe (Germany):** Revenue declined by 12% y-o-y to Rs. 220 crore. For H1FY2023, revenue increased to Rs. 434 crore, down 15% y-o-y. Growth in Germany was impacted by tender losses in the previous quarters. Torrent has already initiated measures to improve price competitiveness. The company expects sales in Germany to pick up pace towards the end of the year. In the medium term, Germany business is expected to deliver high single-digit growth and in the mid-to-high single digits if there are more tenders (as it will lead to increased competition).
- ◆ **Margins to remain stable:** Torrent's OPM declined by 125 bps y-o-y to 29.6%. Management has indicated that raw-material prices are expected to be stable in the near term. Moreover, the logistics cost has come down to Q3FY2022 level. So, margins are expected to remain at the current level in the near term.

Results (Consolidated)

| Particulars | Rs cr | | | | |
|-------------------------|--------------|--------------|------------|--------------|-------------|
| | Q2FY2023 | Q2FY2022 | Y-o-Y % | Q1FY2023 | Q-o-Q % |
| Total Sales | 2,291.0 | 2,137.0 | 7.2 | 2,347.0 | -2.4 |
| Expenditure | 1,612.0 | 1,477.0 | 9.1 | 1,635.0 | -1.4 |
| Operating profit | 679.0 | 660.0 | 2.9 | 712.0 | -4.6 |
| Other income | 16.0 | 51.0 | -68.6 | 30.0 | -46.7 |
| EBITDA | 695.0 | 711.0 | -2.3 | 742.0 | -6.3 |
| Interest | 69.0 | 71.0 | -2.8 | 55.0 | 25.5 |
| Depreciation | 163.0 | 168.0 | -3.0 | 155.0 | 5.2 |
| PBT | 463.0 | 472.0 | -1.9 | 532.0 | -13.0 |
| Taxes | 151.0 | 156.0 | -3.2 | 178.0 | -15.2 |
| Adjusted PAT | 312.0 | 316.0 | -1.3 | 354.0 | -11.9 |
| EPS (Rs.) | 18.4 | 18.6 | -1.3 | 20.8 | -11.9 |
| Margins | | | BPS | | BPS |
| OPM % | 29.6 | 30.9 | -125 | 30.3 | -70 |
| EBITDA % | 30.3 | 33.3 | -293 | 31.6 | -128 |
| Adj. PATM % | 13.6 | 14.8 | -117 | 15.1 | -146 |
| Tax % | 32.6 | 33.1 | -44 | 33.5 | -85 |

Source: Company; Sharekhan Research

Region-wise revenue performance

| Particulars | Q2FY2023 | Q2FY2022 | Y-o-Y % |
|-----------------------|--------------|--------------|----------|
| India | 1,224 | 1,087 | 13 |
| US | 292 | 284 | 3 |
| Germany | 220 | 251 | -12 |
| Brazil | 185 | 156 | 19 |
| Other countries (RoW) | 239 | 219 | 10 |
| Others | 131 | 140 | -7 |
| Total | 2,291 | 2,137 | 7 |

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, 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 for pharmaceutical companies going ahead.

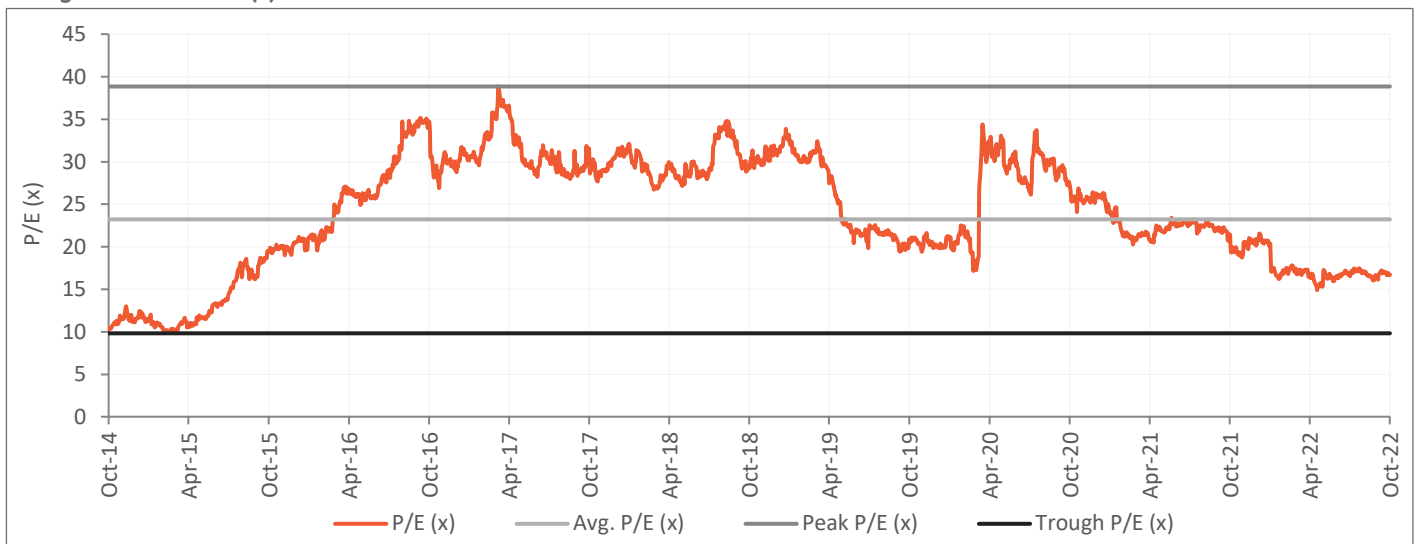
■ Company Outlook – Indian and Brazilian businesses to stage strong growth

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 classification. 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. A 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 an unchanged PT of Rs1,820

Torrent's Q2 performance was soft. However, it sees a healthy outlook for India business, backed by expanding reach, market share gains, and likely traction in the new trade generics division. Expected growth in the existing portfolio, and plans to fortify presence in the covered markets would drive Brazilian sales growth, while elevated cost pressures, price erosion, and delays in re-inspection for plants by USFDA could slow down US growth momentum. Germany is expected to see a good recovery from H2. At the CMP, the stock trades at 38.1x/31.5x its FY2023E and FY2024E. Given better growth prospects across Indian and Brazilian businesses, we retain our Buy recommendation on the stock with an unchanged PT of Rs. 1,820.

One-year forward P/E (x) band



Source: Company, Sharekhan Research

Peer valuation

| Particulars | CMP (Rs / Share) | O/S Shares (Cr) | MCAP (Rs Cr) | P/E (x) | | | EV/EBITDA (x) | | | RoE (%) | | |
|----------------|------------------------|-----------------------|-----------------|---------|-------|-------|---------------|-------|-------|---------|-------|-------|
| | | | | FY22 | FY23E | FY24E | FY22 | FY23E | FY24E | FY22 | FY23E | FY24E |
| Torrent Pharma | 1575 | 33.8 | 53305.2 | 42.4 | 38.1 | 31.5 | 23.5 | 20.5 | 17.1 | 21.1 | 21.8 | 22.9 |
| Cipla | 1155.0 | 80.7 | 93197.0 | 34.0 | 30.0 | 23.6 | 20.3 | 18.3 | 14.7 | 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 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.

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 Investments | 1.84 |
| 2 | ICICI Prudential Life Insurance | 1.40 |
| 3 | Kotak Mahindra AMC | 1.07 |
| 4 | Nippon Life India AMC | 1.02 |
| 5 | Vanguard Group Inc. | 0.96 |
| 6 | BlackRock Inc. | 0.91 |
| 7 | UTI AMC | 0.90 |
| 8 | FMR LLC | 0.83 |
| 9 | T Rowe Price Group Inc. | 0.79 |
| 10 | Norges Bank | 0.71 |

Source: Bloomberg

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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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