Stock Update

Result Update

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 47.06

Updated Oct 08, 2022

Severe Risk

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

Source: Morningstar

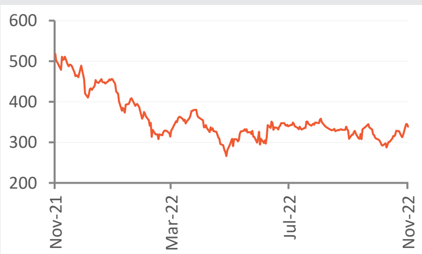
Company details

Market cap:	Rs. 3,061 cr
52-week high/low:	Rs. 533 / 263
NSE volume: (No of shares)	6.4 lakh
BSE code:	532531
NSE code:	STAR
Free float: (No of shares)	6.3 cr

Shareholding (%)

Promoters	31.1
FII	24.1
DII	15.5
Others	29.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	10.5	-5.3	9.9	-34.6
Relative to Sensex	4.4	-8.1	-4.5	-37.4

Sharekhan Research, Bloomberg

Strides Pharma Sciences

Strong Q2; Growth visibility improves

Pharmaceuticals	Sharekhan code: STAR

Reco/View: Buy	↔	CMP: **Rs. 339**	Price Target: **Rs. 450**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Strides Pharma Sciences (Strides) posted strong performance in Q2FY2023 with the fourth consecutive quarter of sequential improvement in OPM to 9.4%. Revenue grew by 24.3% y-o-y to Rs. 897.1 crore; adjusted PAT stood at Rs. 16.7 crore.
- US business registered one of the best quarterly performances, with revenue at $60mn. Management has guided for $250 mn revenue from the US for FY2023, which translates into strong growth.
- A strategic review of the other regulated market business has led to exit from low-margin businesses. The business is expected to return to historical levels with superior margins from Q3.
- The stock price has corrected sharply by ~35% from its 52-week highs and is trading at reasonable valuations of 17.3x its FY2024E earnings. We retain our Buy recommendation on the stock with an unchanged PT of Rs. 450.

Strides Pharma Sciences (Strides') posted the fourth consecutive quarter of strong operating performance with sequential improvement in OPM to 9.4%. Revenue at Rs. 897.1 crore grew by 24.3% y-o-y, driven by 34% y-o-y growth in regulated markets, while emerging markets declined by 8.8% y-o-y. Within regulated markets, US grew by 88.9% y-o-y, while other regulated markets declined by 14.5% y-o-y. Operating profit margin (OPM) stood at 9.4% against a loss in Q2FY2022. It consistently improved from 0.3% in Q3FY2022. Going ahead, the US business's performance is expected to stage a marked improvement with green shoots visible. Management has guided for $250 million in revenue from the US for FY2023 on account of contribution from the acquired portfolio, likely reduction in price erosion, and easing out of inventory levels, which translates into strong growth. On the other hand, revenue of other regulated markets is expected to recover to historical levels with strong margin improvement.

Key positives

- Revenue from the US increased by 89% y-o-y to Rs. 472.6 crore, driven by improved market share and volume traction across key molecules in its portfolio.
- Strides' OPM improved to 9.4% in Q2FY2023 from 5.5% in Q1FY2023 and the compenay witnessed marginal loss in Q2FY2022 on account of better operating leverage coupled with lower freight cost.

Key negatives

- Revenue of other regulated market decreased by 15% due to strategic review of the business and change in the operating model.
- Institutional and Africa business revenue declined by 7% and 11%, respectively, on a y-o-y basis.

Management Commentary

- Management has guided for $250 million in sales in the US, backed by new launches from the acquired portfolio and easing of price erosion. Strides looks to launch 20 new products in the US in FYFY23E. The new launch momentum is expected to pick up in the coming quarters, as it leverages a vast portfolio of over 100 approved products undergoing cost improvements and manufacturing site changes in the near term.
- The company has completed the strategic review of other regulated markets' (ORM) business and decided to exit several low-margin product lines, resulting in a lower topline in Q2. The long-term outlook of ORM business continues to be robust and it expects revenue to comeback to historical levels by Q3 with expanded gross margins.
- The company is targeting net debt to EBIDTA to stay below 3x in the coming quarters with strong improvement in the profitability, higher free cash generation, and reduction in debt. Between Strides and Stelis, around Rs. 1,300 crore to Rs. 1,500 crore of debt will be reduced in the group.
- Significant actions around manufacturing network optimisation, operating cost reduction, and aggressive right sizing across P&Ls have been completed, and the same has started contributing to OPM. Further, softening in the freight cost will add to margins in the quarters ahead. Overall, the company is targeting consistent margin improvement in the coming quarters.

Revision in estimates – Strides' Q2FY2023 operating performance improved sequentially as the company reported operating profit for the fourth consecutive quarter. Going ahead the strong outlook provides visibility for growth. We have fine-tuned our earnings estimates for FY2023 and FY2024 and introduced FY2025 earnings estimates through this note.

Our Call

Valuation: Retain Buy with an unchanged PT of Rs. 450: Strides' US business was impacted by multiple headwinds such as high price erosion, which has stabilised and is likely to improve going ahead. Moreover, the acquired portfolio has been integrated and has added to the company's performance. Based on this, Strides has guided for $250 million in revenue in the US for FY2023. ORM business is expected to post a strong recovery in the coming quarters with higher margins. Moreover, the company has implemented a cost-control plan, which is expected to yield benefits in the subsequent quarters. At the CMP, the stock trades at 17.3x its FY2024E estimates. Further, the stock price has corrected sharply by ~35% from its 52-week highs with the valuations now appearing reasonable at 17.3x its FY2024E earnings. On account of reasonable valuations and encouraging outlook for the US business, we retain our Buy recommendation on the stock with an unchanged price target (PT) of Rs. 450.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY2021	FY2022	FY2023E	FY2024E	FY2025E
Total Sales	3315.9	3070.3	4044.2	4475.5	4913.6
EBIDTA	626.8	-10.3	441.7	536.6	634.1
OPM (%)	18.9	-0.3	10.9	12.0	12.9
Adj PAT	192.4	-220.6	67.3	175.4	267.1
EPS (Rs)	21.5	-24.6	7.5	19.6	29.8
PER (x)	15.8	-	45.1	17.3	11.4
EV/Ebidta (x)	6.1	-	10.2	8.2	6.6
ROCE (%)	8.8	-	7.0	9.1	11.0
RONW (%)	8.8	-	2.8	7.1	10.0

Source: Company; Sharekhan estimates

Strong performance in Q2 with consistent OPM improvement

Strides reported strong performance in Q2FY2023, registering double-digit revenue growth, while losses declined on a y-o-y basis. Revenue growth was driven by high double-digit growth in the US (contributing 53% to sales). Sales at Rs. 897.1 crore grew by 24.3% y-o-y, driven by 34% y-o-y growth in regulated markets, while emerging markets declined by 8.8% y-o-y. Within regulated markets, US grew by 88.9% y-o-y, while other regulated markets declined by 14.5% y-o-y. In emerging markets, Africa declined by 10.9%, while institutional business declined by 7% y-o-y. Revenue was marginally lower than our estimate of Rs. 916 crore. EBITDA margin stood at 9.4% against a loss in Q2FY2022. EBITDA margin came in higher than our estimate of 5.4%. EBITDA for Q2FY2023 was at Rs. 84.2 crore against a loss of Rs. 1 crore in Q2FY2022. The company reported adjusted loss of Rs. 28.2 crore against a loss of Rs. 95.6 crore in Q2FY2022. We had anticipated loss of Rs. 46 crore for Q2FY2023. Strides reported an exceptional income in the quarter amounting to Rs. 14.5 crore. Adjusting for the one-time income and including the share of profit from associates/JV, the company's reported PAT came in at Rs. 0.3 crore.

Q2FYFY2023 conference call highlights

- The company witnessed its best-ever quarter since inception of the U.S. business, which led to margin expansion. The company also improved market shares of the existing niche portfolio, getting back to the market shares that were lost over the last several quarters. Management is confident of achieving an excess run rate of $250-odd million with regards to the US business. Management strongly believes EBITDA-to-debt ratio to be under 3 due to a strong order book for H2FY2023.
- The other regulated markets saw a one-time dip in revenue, which is a one-off situation, and the numbers will return to their historical values as soon as Q3 of this financial year with improved gross margins. During the quarter, gross margin was driven by a combination of cost reduction, improved gross margin expansion, a reduction in logistics costs, and the 57% can be sustainable according to management. Management's guidance for EBITDA in Q4 is more than $150 million.
- The company will see a slight elevation of around Rs. 100 crore in the debt book due to exchange rate reset, which does not signify the increase in debt. The guidance for debt reduction of Rs. 1,000 crore stays the same with most of it occurring in H2FY2023.
- The institutional business will be muted as no new contracts have been awarded to any companies; and despite having a strong Q1, Q2 is usually softer for this business. For the coming quarter, no significant change will be seen in this business. Q4 will be a turning point, until then the rest of the business will make up for that.
- Stelis Business – The company holds some stock of the Sputnik vaccine. The promoters have committed to infuse along with the lead partners, TPG, additional Rs. 500 crore into Stelis to ensure the company meets its obligations. Between Strides and Stelis, around Rs. 1,300 crore to Rs. 1,500 crore of debt will be reduced in the group. The Stelis business would hit breakeven in the next 18 odd months and the current focus remains on reducing operating losses, improve the debt book, and acquire more and more customers.
- The company will be launching 20 new products per year in an idealistic scenario. These new products meet the criteria of gross margin and EBITDA that the company is known for pre-Covid, where gross margin is about 60% and EBITDA is at 22-23%. The company's new filings for the US will be less than 10.
- AmbiVax a new product waiting for approval is the world's only thermostable vaccine. It is designed for frontier markets where supply/cold chain is a challenge. The company will target frontier markets such as Africa and parts of Latin America as well as work with global NGOs, large organizations and partner with large governments.

Results (Consolidated) Rs cr

Total Income	**897.1**	**721.5**	**24.3**	**940.7**	**-4.6**
Expenditure	812.9	722.6	12.5	888.9	-8.5
Operating profit	84.2	-1.1	-	51.9	62.3
Other income	23.5	22.2	5.6	13.5	73.2
EBIDTA	107.6	21.1	-	65.4	64.6
Interest	67.6	43.6	55.3	54.5	24.0
Depreciation	61.7	56.6	9.1	60.4	2.1
PBT	-21.7	-79.0	-72.5	-49.6	-56.2
Tax	-38.4	-6.8	-	-28.1	36.8
Adjusted PAT (Bfr. Excp. Item)	16.7	-72.2	-	-21.5	-
EO	-44.8	-23.4	91.8	-56.4	-20.5
Adjusted PAT	-28.2	-95.6	-70.5	-77.9	-63.9
Margins			**BPS**		**BPS**
OPM (%)	9.4	-0.1	953	5.5	387.0
EBIDTA margin (%)	12.0	2.9	907	7.0	505
Net profit margin (%)	1.9	-10.0	-	-2.3	415
Tax Rates (%)	-	8.6	-	56.6	-

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 strong growth prospects in domestic markets and emerging opportunities in the active pharmaceutical ingredients (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 pharmaceutical companies.

Company Outlook – Green shoots of revival visible

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 product pipeline, which is approved but yet to be commercialised and offers sizeable market opportunities. Moreover, the recent acquisition of the product portfolio from Endo Pharmaceuticals, including commercialised products, would also add to the company's product basket as well as diversify its portfolio across therapies and dosage forms. 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 likely revival in the institutional business and growth in the African business. Further, management expects challenges in the US business in the form of price erosion, and elevated inventory levels to normalise soon and has guided for $250 mn of revenue by FYFY23, translating into a strong growth momentum. As markets open up, the performance of other regulated markets is also expected to improve going ahead. Further, Stelis Biopharma, the CDMO arm of the company, is progressing well and has added six new customers in the first year of operations.

Valuation – Retain Buy with unchanged PT of Rs 450

Strides' US business was impacted by multiple headwinds such as high price erosion, which has stabilised and is likely to improve going ahead. Moreover, the acquired portfolio has been integrated and has added to the company's performance. Based on this, Strides has guided for $250 million in revenue in the US for FY2023. ORM business is expected to post a strong recovery in the coming quarters with higher margins. Moreover, the company has implemented a cost-control plan, which is expected to yield benefits in the subsequent quarters. At the CMP, the stock trades at 17.3x its FY2024E estimates. Further, the stock price has corrected sharply by ~35% from its 52-week highs with the valuations now appearing reasonable at 17.3x its FY2024E earnings. On account of reasonable valuations and encouraging outlook for the US business, we retain our Buy recommendation on the stock with an unchanged price target (PT) of Rs. 450.

Peer valuation

Companies	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
Cipla	1122	80.7	90,578	33.0	28.5	22.8	19.7	17.4	14.1	14.6	14.2	15.5
Strides Pharma Science	339	9.0	3,061	-	45.1	17.3	-	10.2	8.2	-	2.8	7.1

Source: Company, Sharekhan estimates

About company

Strides is a global pharmaceutical company operating in two business verticals, viz – regulated markets and emerging markets. Regulated markets include the US and other regulated markets. The balance is constituted by emerging market verticals, which include Africa and the institutional business. With respect to segments, Strides operates in the pharma generics, branded generics, and institutional businesses. 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 trajectory, driven by increasing urbanisation and rapid expansion of primary healthcare facilities. 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. Strides has a strong product pipeline, which is approved but yet to be commercialised and offers sizeable market opportunities. Moreover, the recent acquisition of the portfolio from Endo Pharmaceuticals, including commercialised products, would also add to the product basket as well as diversify the portfolio across therapies and dosage forms. Growth prospects in other regulated markets are also likely to be better, led by product launches, increased market share, and portfolio optimisation. However, given the steep price erosion in US markets, overall gross margins are expected to be under pressure, though this could partially offset in H2FY2022 with the completion of the product portfolio. As markets open up, the performance of other regulated markets is also expected to improve from Q2FY2022. Further, the board's approval of the demerger of Stellis Biopharma points to potential value-unlocking opportunities for Strides' shareholders.

Key Risks

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

Additional Data

Key management personnel

Arun Kumar	Chairman
Badree Komundur	Executive Director and Group CFO
Ms. Manjula Ramamurthy	Company Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Aditya Birla Sun Life AMC	5.78
2	Life Insurance Corp India	4.94
3	Route One Investment Co Lp	2.79
4	Norges Bank	2.29
5	Vanguard Group Inc	2.25
6	SBI Funds Management	2.24
7	Capri Global Advisory Services	2.07
8	BNP Paribas SA	1.34
9	Dimensional Fund Advisors LP	1.29
10	BlackRock Inc	1.16

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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