Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Strides Pharma Sciences

Strong Q4; margins on an upswing

Pharmaceuticals	Sharekhan code: STAR

Reco/View: Buy	↔	CMP: Rs. 360	Price Target: Rs. 450	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX

	+	=	-
Right Sector (RS)		✓	
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS	Positive	↓	Neutral
RQ	Positive	↔	Positive
RV	Positive	↔	Positive

ESG Disclosure Score NEW

ESG RISK RATING 36.8

Updated Dec 16, 2022

High Risk

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

Source: Morningstar

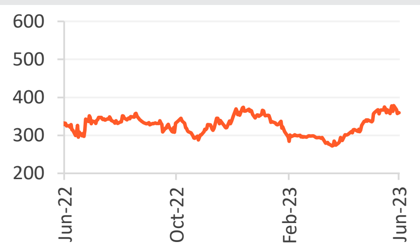
Company details

Market cap:	Rs. 3,203 cr
52-week high/low:	Rs. 392 / 268
NSE volume: (No of shares)	1.6 lakh
BSE code:	532531
NSE code:	STAR
Free float: (No of shares)	6.3 cr

Shareholding (%)

Promoters	29.5
FII	18.5
DII	18.0
Others	34.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	5.7	20.7	1.3	6.7
Relative to Sensex	3.6	14.4	1.7	-5.5

Sharekhan Research, Bloomberg

Summary

- Strides continued to post strong numbers in Q4FY2023 with the 6th. consecutive quarter of a sequential improvement in EBITDA margins to ~15.8% from ~0.6% in Q3FY2022
- Revenues grew by ~13.9% y-o-y to Rs. 986.4 crore; adjusted PAT stood at Rs. 34.2 crore versus Rs. 148.9 crore in Q4FY22 and Rs. 0.23 crore in Q3FY23.
- The regulated Markets of US, Europe, UK, and South Africa continued to grow at a strong rate in Q4FY2023, since Q1FY2023. They grew at an average ~35.2% rate each quarter of FY23 (y-o-y) vs. an average decline of -14.4% seen in the 4 quarters of FY22, y-o-y.
- Management is hopeful of reaching historical margins of ~20%-21% in the short – medium term vs. ~11.7% EBITDA margins recorded in FY23.
- Stock trades at reasonable valuations of ~17.4x/10.0x its FY2024E/FY2025E earnings vs peers trading at ~20.0x/16.0x its FY24E/FY25E EPS. We retain a Buy on the stock with an unchanged PT of Rs. 450.

Strides Pharma Ltd. (Strides) posted a strong ~13.9% y-o-y rise in revenue to Rs. 986.4 crore (vs. our estimate of Rs. 866 crore) This was largely driven by stronger-than-expected growth in regulated markets, which increased at ~39.9% y-o-y to Rs. 900.1 crore (~91.3% of revenue). The regulated market's growth was driven by a ~54.4% y-o-y rise in the US sales to Rs. 509.7 crore (~51.7% of revenue) and other regulated markets (ORM) growing at ~24.6% y-o-y to Rs. 390.4 crore (~39.6% of revenue). It was partially offset by a ~60.1% y-o-y decline in emerging market revenue to Rs. 90.3 crore (~9.2% of revenue). The company posted ~274.8% y-o-y rise in EBITDA or operating income to ~Rs. 155.6 crore. in Q4FY23 as gross margins improved by ~874 bps y-o-y to 59.4% indicating healthy products mix and flat growth in operating expenses y-o-y in Q4FY23. As a result, despite a ~68.5% y-o-y decline in other income to Rs. 27.1 crore while interest costs increased by ~62.7% y-o-y to Rs. 80.5 crore and depreciation being flat y-o-y, adjusted PBT before exceptional items including profits / losses from JVs increased ~ 136.9% y-o-y to Rs. 41.2 crore while PAT, without tax benefits and excluding exceptional items, declined ~77.1% y-o-y to Rs. 34.15 crore (versus our estimate of PAT of Rs. 91.5 crore). Reported loss was at Rs. 13.8 crore in Q4FY23 vs. net income of Rs. 29.0 crore in Q4FY22 and net loss of Rs. 82.1 crore in Q3FY23.

Key positives

- US sales reached an all-time high of $232.0 million in FY23.
- Other regulated markets (ORMs) of UK, Europe, South Africa, and Australia also recorded highest quarterly sales of $48.0 million in Q4FY23.
- Gross margins of ~59% attained in Q4FY23 reaching to historical peak of ~60.0%.
- EBITDA margins of around ~15.8% in Q4FY23, up 11 percentage points y-o-y, trending upwards to the company's historical margins of ~20-21%.
- Gross Debt has been reduced by ~Rs. 250 crore. The net debt to EBITDA as per Q4FY23's annualized EBITDA stands at ~3.4x, which is closer to the targeted ratio of <3.0x.
- Stelis saw a Rs. 470 crore reduction in debt which brings the total amount of debt paid by the group to ~Rs. 720 crore in FY23.
- The company received EIR for its Puducherry facility in May 2023.

Key negatives

- Continued and rising losses at its associate company, Stelis Biopharma; however, Strides guides for a positive EBITDA for Stelis by FY2024 and PAT positive status by FY2025.
- Emerging market revenue has declined due to loss of Institutional business over the last 2 quarters as of Q4FY23; However, there has been a q-o-q rise in its sales Q4FY23. Also, the company has been awarded the institutional contract again for 3 years, which is to start contributing from Q1FY24.

Management Commentary

- Company is confident of reaching EBITDA of Rs. 700 crore – Rs. 750 crore in FY24 vs. EBITDA of Rs. 446 crore in FY23.
- It hopes to grow at ~15.0% y-o-y with faster growth likely to come from emerging markets and new geographies than from the regulated markets.
- The company targets debt reduction of ~ Rs. 500 crore in FY24 as its overall net debt to EBITDA is around 3.0x.

Revision in estimates: We expect it to record a ~15.3% and ~104.2% CAGR rise in sales and earnings (due to low base) over FY23-FY25E.

Our Call

Valuation: Retain Buy with an unchanged PT of Rs. 450: Strides Pharma has witnessed strong earnings growth driven by strong growth witnessed by the regulated markets such as the US and other regulated markets (ORMs) such as Australia, Canada, and Europe. The company expects to sustain the momentum in regulated markets driven by new products in the front ends and forming new partnerships in the B2B business. The company plans to launch from its pool of approved ANDAs. The company also plans to increase the branded portfolio of products in South Africa and focus on productivity enhancements of its field force to drive growth and margins in the segment. It also intends to concentrate on maximizing the US and UK approved portfolio, accelerating market penetration in Africa and new regions. The stock trades at reasonable valuations of ~17.4x/10.0x its FY2024E/FY2025E earnings vs peers trading at ~20.0x/16.0x its FY24E/FY25E EPS. We retain our Buy recommendation on the stock with an unchanged 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	FY22	FY23	FY24E	FY25E
Total Sales	3070.3	3688.4	4260.6	4905.9
EBIDTA	(10.3)	430.2	611.4	738.7
OPM (%)	(0.3)	11.7	14.3	15.1
Adj PAT*	(95.8)	81.1	193.8	338.2
EPS (Rs)	(10.4)	8.6	20.6	36.0
PER (x)	NM	41.7	17.4	10.0
EV/Ebidta (x)	NM	14.0	9.3	7.5
ROCE (%)	NM	5.2	9.3	11.3
RONW (%)	NM	-9.2	8.3	13.1

Source: Company Data; Sharekhan estimates Excluding exceptional items and Losses from JVs*

Strong Q4: Driven by strong growth in Regulated Markets:

Strides Pharma Ltd. (Strides) posted a strong ~13.9% y-o-y rise in revenue to Rs. 986.4 crore (vs. our estimate of Rs. 866 crore) This was largely driven by stronger than expected growth in regulated markets, which increased at ~39.9% y-o-y to Rs. 900.1 crore (~91.3% of revenue). The regulated markets' growth was driven by a ~54.4% y-o-y rise in US sales to Rs. 509.7 crore (~51.7% of revenue) and other regulated markets (ORM) of the UK, Europe, South Africa and Australia, growing at ~24.6% y-o-y to Rs. 390.4 crore (~39.6% of revenue). It was partially offset by a ~60.1% y-o-y decline in emerging market revenue to Rs. 90.3 crore (~9.2% of revenue). The US market clocked in the strongest revenue at $232 million. It was driven by continued growth in the base business as the leading products maintained a solid market share without witnessing significant price erosion. Sales in the US was also benefited by integration of Endo also helped in solid growth on an annual basis. Growth in the ORM business was led by the recovery in the UK and other front-end markets to their previous levels of growth and profitability and continuing portfolio expansion in the new regions with improved volumes growth and the addition of customers. The company's newly launched B2B platform, SynergICE, has seen growth and is likely to deliver on its goals in ORM region. Emerging markets growth was driven by new launches and improved operating efficiencies. Additionally, the return of new tender off-take for retrovirals has added to growth in emerging markets revenue. The company intends to grow at 15.0% y-o-y driven by higher growth from emerging markets and new geographies, we believe through B2B partnerships.

The company posted a ~274.8% y-o-y rise in EBITDA or operating income to ~Rs. 155.6 crore. in Q4FY23 as gross margins improved by ~874 bps y-o-y to 59.4% indicating a healthy products mix and flat growth in operating expenses y-o-y in Q4FY23. As a result, despite a ~68.5% y-o-y decline in other income to Rs. 27.1 crore while interest cost increased by ~62.7% y-o-y to Rs. 80.5 crore and depreciation being flat y-o-y, adjusted PBT before exceptional items including profits / losses from JVs increased ~ 136.9% y-o-y to Rs. 41.2 crore, while PAT, without tax benefits and excluding exceptional items, declined ~77.1% y-o-y to Rs. 34.15 crore. (versus our estimate of Rs. Reported loss was at Rs. 13.8 crore in Q4FY23 vs. net income of Rs. 29.0 crore and net loss of Rs. 82.1 crore in Q3FY23.

Q4FY2023 conference call highlights:

- **Guidance:** Strides is confident of reaching EBITDA of Rs. 700 crore – Rs. 750 crore in FY24 vs. EBITDA of Rs. 446 crore in FY23. The company hopes to grow at ~15% y-o-y with faster growth likely to come from emerging markets and new geographies than from the regulated markets. The company targets debt reduction of ~ Rs. 500 crore in FY24 as its overall net debt to EBITDA is around 3.0x. The company intends to focus on reaching historical gross margins of ~60%. The company intends to reach EBITDA margins of ~20%-21% in the short – medium term. Emerging markets continue to be the focus area as they grow. The company has been witnessing players exiting the smaller size therapies where Stride specializes in and hence can continue the growth momentum further in the US. The focus will continue to be on niche portfolio and margin expansion. The company intends to reduce debt by Rs. 500 crore in FY24. The same will be achieved through network optimization, product launches, market expansion, branded business increases in Africa and improved cash generation for FY24. Long-term loans have repayment of $15-16 million p.a.
- **Highest sales reported:** The company has returned to growth in a big way as it has reported its highest annual sales in FY23 and Q4FY23. This has been driven by the performance and calibrated reset the company carried out for the US market. The US business has grown to $232.0 million (which is in the middle of $220-$240 million guidance) in FY23 vs. $157.0 million in FY22 as it has surpassed pre-COVID period sales. Even other regulated markets have recorded the highest ever quarterly sales of $48.0 million led by UK operations.
- **Gross Debt:** The company has reduced its gross debt by Rs 250 crore in FY23, which is a significant improvement in its net debt to EBITDA ratio. In Q1FY23, the company started at 8.3x and has reached to an annualized exit rate of 3.4x as at the end of Q4FY23. The company believes that as the US is a working capital-intensive business, the net debt to EBITDA could not be brought down around ~3x. It will be the focus in FY24. At Stelis the company reduced the peak debt from Rs. 1,200 crore to Rs. 650 crore at the end of March 23.
- **Stelis Biopharma:** The segment has taken impairment for Sputnik. The focus is on the CDMO business. Its first product approval for PTH has been secured and the company has partnered in over 19 countries covering almost 80.0% of the market opportunity and soon will be closing out a partner in Europe and

expect to launch the product in FY24. About 3 out of 5 new partners are amongst the top 10 companies globally and the company currently has a total of 20 partners. Stelis will be EBITDA positive. Its first multimillion contract for an MSA for biologics has been secured. The first commercial sales is expected in June 23 and one of its partners has now received 2 product approvals from this site for inspection.

- **Compliance:** Company has got the EIR for all its sites that were inspected during FY23 i.e., Chestnut, Ridge, New York, Bengaluru facility, Singapore and the Puducherry facility, which was given the warning letter in 2019.
- **Strong products pipeline:** Company has 280+ products filed (out of which nearly 100 came from Endo) and approved and only 60 have been commercialized in the US which is to allow it the headroom to let go of products or revenue when the pricing is not in favor. This helps it to maintain profitability and price discipline.
- **Emerging markets:** Emerging markets, especially for Latin America and Asia, are witnessing a regulatory filing and partnering phase.
- **B2B model:** The company has launched a division called SynergICE which allows it to do B2B partnerships with companies worldwide where it does not intend to front end except for Africa. Strategic alliances and partnerships which the company does not intend to front end at, will be a key strategic growth driver in the future.
- **US market:** The company has the top market share (nearly 40%-50% market share in each of the products as more than 70% if its rank 1 portfolio has no Indian competitors) in 19 out of the 60 commercialized products as it specializes in niche and small size products and take market leadership in it to avoid any price pressure that is common for chronic and large size therapy products. The company also has 60 products going through improvements before they can be launched. The company has attained market share, price discipline and consecutively has been able to have $60 million quarterly sales. The company intends to increase its focus on expanding the market and use the free cash generated from the US business to add to growth. The US has closer to ~65-67% gross margins.
- **R&D Spend:** As the company has a large basket of group products the company has redirected its R&D spend towards emerging markets and Europe. As a result, the R&D spend is likely to drop from $20-25 million to $12-13 million.
- **Share pledge:** The company has pledged shares to invest Rs. 500 crore. in Stelis Biopharma The company intends to reduce the pledge on shares to ~33% from ~40% levels currently.

Results Rs cr

Particulars	Q4FY23	Q4FY22	YoY %	Q3FY23	QoQ %
Total Income	986.4	866.0	13.9	864.8	14.1
Expenditure	830.8	824.5	0.8	748.5	11.0
Operating profit	155.6	41.5	274.8	116.3	33.7
Other income	27.1	86.1	-68.5	6.6	308.0
Interest	80.5	49.5	62.7	58.4	37.8
Depreciation	60.9	60.7	0.4	60.2	1.2
PBT	41.2	17.4	136.9	4.3	853.6
Tax	7.1	-131.5	NM	4.1	73.3
Adjusted PAT	34.15	148.92	-77.1	0.23	144.9
Exceptional items	-7.3	-76.3	NM	61.1	NM
Profits from associates	-40.6	-43.6	NM	-143.5	NM
Reported PAT	-13.8	29.0	NM	-82.1	NM
Margins			**BPS**		**BPS**
Gross Margins (%)	59.4	50.6	873.8	57.5	186.9
EBIDTA margin (%)	15.8	4.8	1097.8	13.5	231.8
Adjusted Net profit margin (%)	3.5	17.2	-1373.4	0.0	343.5
Tax Rate (%)	17.2	-755.8	NM	94.6	-7740.0

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Regulatory concerns and pricing erosion prove a hurdle over the short-medium term

Over the years, Indian pharmaceutical companies have established themselves as a dependable source for global pharma companies. The confluence of other factors, including a focus on specialty/complex products in addition to emerging opportunities in the API space, would be key growth drivers in the long term. However, ongoing USFDA plant inspections and a few companies being issued Form-483 with observations point at apparent regulatory concerns. We believe in the near term, based on the headwinds that may drag the performance, especially in the API and CDMO space and for large pharma players seeing USFDA OAI or a WL status on their facilities, we have a Neutral view of the sector.

■ 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 revenues 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 the segment's growth. 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, the management expects challenges in the US business in the form of price erosion, and elevated inventory levels to normalise soon and has guided for $220-240 million of revenues by FYFY23, translating into 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 an unchanged PT of Rs. 450

Strides Pharma has witnessed strong earnings growth driven by strong growth witnessed by the regulated markets such as the US and other regulated markets (ORMs) such as Australia, Canada, and Europe. The company expects to sustain the momentum in regulated markets driven by new products in the front ends and forming new partnerships in the B2B business. The company plans to launch from its pool of approved ANDAs. The company also plans to increase the branded portfolio of products in South Africa and focus on productivity enhancements of its field force to drive growth and margins in the segment. It also intends to concentrate on maximizing the US and UK approved portfolio, accelerating market penetration in Africa and new regions. The stock trades at reasonable valuations of ~17.4x/10.0x its FY2024E/FY2025E earnings vs peers trading at ~20.0x/16.0x its FY24E/FY25E EPS. We retain our Buy recommendation on the stock with an unchanged PT of Rs. 450.

Peer Comparison

Companies	CMP (Rs / Share)	O/S Shares (Crs)	Mcap (Rs Cr)	P/E (x)			EV / EBITDA (x)			RoE (%)		
				FY23	FY24E	FY25E	FY23	FY24E	FY25E	FY23	FY24E	FY25E
Cipla	965	80.7	77,855	26.1	22.8	19.6	15.3	13.9	12.4	12.6	12.8	13.2
Strides Pharma Science	360	9.0	3,246	41.7	17.4	10.0	14.0	9.3	7.5	NM	8.3	13.1

Source: Company; Sharekhan Research

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 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, with the steep price erosion in US markets, overall gross margins were under pressure during FY2022. As markets opened up, the performance of regulated markets improved, profitability is expected to reach historical peak levels over short-medium term.

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

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Aditya Birla Sun Life AMC	5.99
2	Life Insurance Corp India	4.94
3	Quant Money Managers Ltd.	3.12
4	Route One Fund ILP	2.79
5	Vanguard Group Inc	2.55
6	Norges Bank	2.29
7	SBI Funds Management	2.24
8	Capri Global Advisory Services	2.07
9	Karuna Business Solutions	1.86
10	Dimensional Fund Advisors	1.37

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

Sharekhan

by BNP PARIBAS

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Other registrations of Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669.

Compliance Officer: Ms. Binkle Oza; Tel: 022-61169602; email id: complianceofficer@sharekhan.com

For any complaints/grievance, email us at igc@sharekhan.com or you may even call Customer Service desk on - 022- 41523200/022- 33054600