

Torrent Pharma

BSE SENSEX 16,937 S&P CNX 5,092

CMP: INR581

TP: INR800

Buy

Bloomberg TRP IN
Equity Shares (m) 84.6
52-Week Range (INR) 687/497
1,6,12 Rel. Perf. (%) -1/13/19
M.Cap. (INR b) 49.2
M.Cap. (USD b) 1.0

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EY/	EY/
END	(INR M)	(INR M)	(INR)	GR. (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
03/10A	19,040	2,680	31.7	9.9	-	-	36.2	28.7	-	-
03/11A	22,265	2,702	31.9	0.8	18.2	4.8	29.2	24.1	2.2	12.2
03/12E	25,877	3,403	40.2	26.0	14.4	3.8	29.2	24.5	1.9	9.4
03/13E	30,278	4,239	50.1	24.6	11.6	3.0	28.7	25.6	1.6	7.6

- 2QFY12 performance was in line with estimates, led by the international formulations segment. Its revenues grew by 17.5% YoY to INR6.83b (v/s our estimate of 14.3% YoY growth to INR6.64b), EBITDA grew by 19.6% YoY to INR1.41b (v/s our estimate of INR1.34b) and adjusted PAT reported growth of 11.3% YoY to INR848m (v/s our estimate of 15%YoY growth to INR878m).
- Revenue growth was led by a robust 36.7% YoY growth in the international formulations business to INR3.8b (v/s our estimate of INR3.2b). However, the domestic formulations business reported muted growth of 8.4% YoY to INR2.4b (v/s our estimate of 13% YoY growth to INR2.5b).
- EBITDA grew by a healthy 19.6% YoY to INR1.41b (v/s our estimate of INR1.34b) and EBITDA margins expanded by 40bp YoY to 20.6% (v/s our estimate of 20.2%). EBITDA growth was led mainly by the benefit of operating leverage in the international formulations business.
- Adjusted PAT grew by 11.3% YoY to INR848m (v/s our estimate of 15.2% YoY growth to INR878m) despite healthy growth in EBITDA due to forex losses of INR 189.3m in 2QFY12.

Over the past five years, TRP posted earnings CAGR of 34%. However, the CAGR of capital employed in the business was just 17%. TRP has consistently improved its profitability, with RoCE increasing from 14.5% in FY05 to 24.1% in FY11. TRP is likely to post earnings CAGR of 22% over FY11-13, in line with its strong operating performance. TRP is likely to sustain its high return ratios despite its large capex and growing cash on the books. We believe current valuations do not reflect the improvement in TRP's profitability, its turnaround of international operations and strong positioning in the domestic formulations business. We believe TRP should trade at a premium to most mid-cap pharmaceutical companies and its valuation gap vis-à-vis frontline pharmaceutical companies should decline, going forward. At the current market price, the stock trades at 14.4x FY12E and 11.6x FY13E earnings. We believe the superior financial performance will drive a re-rating in the stock. We maintain a **Buy** rating and a target price of INR800 (16x FY13E EPS), an upside of 38%.

Quarterly Performance

Y/E March	(INR Million)									
	FY11				FY12				FY11	FY12E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Net Revenues (Core)	5,410	5,815	5,775	5,264	6,475	6,833	6,437	6,131	22,265	25,877
YoY Change (%)	12.5	21.2	20.3	10.8	19.7	17.5	11.5	16.5	16.2	16.2
EBITDA	1,121	1,175	1,150	646	1,531	1,406	1,198	1,079	4,092	5,214
Margins (%)	20.7	20.2	19.9	12.3	23.6	20.6	18.6	17.6	18.4	20.2
Depreciation	142	155	161	167	202	201	243	306	626	952
Interest	24	34	35	28	41	28	25	20	121	114
Other Income	22	25	18	16	-2	-147	40	110	81	2
PBT before EO Expense	977	1,012	972	466	1,287	1,030	971	862	3,427	4,150
Extra-Ord Expense	0	0	0	0	-21	-152	0	0	0	-173
PBT after EO Expense	977	1,012	972	466	1,308	1,182	971	862	3,427	4,323
Tax	235	250	203	37	282	174	165	126	725	747
Rate (%)	24.0	24.7	20.9	8.0	21.9	16.9	17.0	14.6	21.2	18.0
Reported PAT	742	762	769	428	1,026	1,000	806	736	2,702	3,576
Adj PAT	742	762	769	428	873	848	806	736	2,702	3,403
YoY Change (%)	9.2	3.0	-7.3	-27.6	17.6	11.3	4.8	71.9	-4.9	26.0
Margins (%)	13.7	13.1	13.3	8.1	13.5	12.4	12.5	12.0	12.1	13.2

E: MOSL Estimates

International formulations business leads TRP's top-line growth

Torrent Pharma's (TRP) 2QFY12 performance was in line with our estimate, led by the international formulations segment. Its revenue grew by 17.5% YoY to INR6.83b (v/s our estimate of 14.3% YoY growth to INR6.64b), EBITDA grew by 19.6% YoY to INR1.41b (v/s our estimate of INR1.34b) and adjusted PAT reported growth of 11.3% YoY to INR848m (v/s our estimate of 15% YoY growth to INR878m).

Overall revenue grew by 17.5% YoY to INR6.83b led by a robust 36.7% YoY growth in the international formulations business to INR3.8b (v/s our estimate of INR3.2b) led by (a) 34% YoY growth in Brazil due to channel restocking by one of TRP's large distributors, (b) 28% YoY growth in Germany due to favorable currency movements and new tenders along with new product launches and (c) 57% YoY growth in the US albeit on a low base. CRAMS revenues declined by 1% YoY to INR 551m (v/s our estimate of INR656m) mainly due to channel de-stocking.

The domestic formulations business reported muted growth of 8.4% YoY to INR2.4b (v/s our estimate of 13% YoY growth to INR2.5b) due to lower sales growth in acute therapies (impacted mainly by competitive pressure and an overall industry slowdown).

Geographical sales mix (INR m)

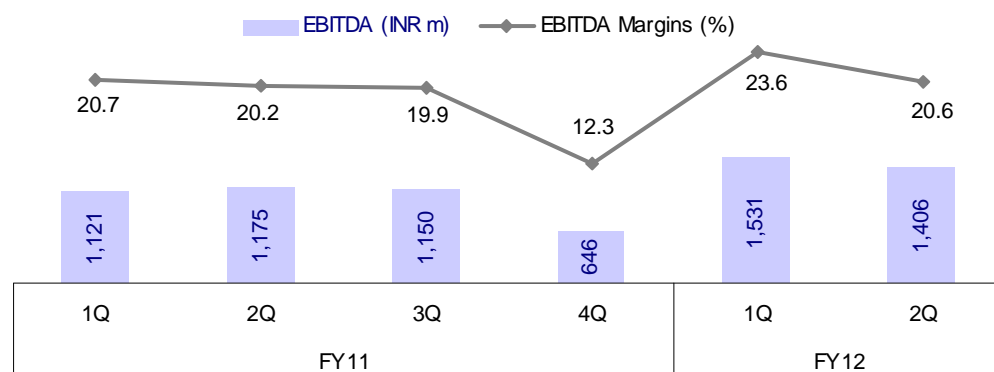
	2QFY12	2QFY11	% YoY	1QFY12	% QoQ
Domestic Formulations	2,385	2,199	8.4	2,460	-3.1
International	3,762	2,752	36.7	3,061	22.9
Latam	1,240	916	35.4	1,082	14.6
Germany	938	724	29.6	825	13.7
USA	515	313	64.5	422	22.0
Europe (ex-Germany)	507	316	60.4	332	52.7
Russia & CIS	165	114	44.7	108	52.8
RoW	408	369	10.6	292	39.7
Contract Mfg	551	558	-1.2	610	-9.6
Others	17	10	65.0	3	450.0
Total	6,715	5,519	21.7	6,134	9.5

Source: Company/MOSL

EBITDA in line with estimates

TRP's 2QFY12 EBITDA grew by a healthy 19.6% YoY to INR1.41b (v/s our estimate of INR1.34b) and EBITDA margins expanded by 40bp YoY to 20.6% (v/s our estimate of 20.2%). EBITDA growth was led mainly by the benefit of operating leverage in the international formulations business and a favorable revenue mix in the international business with higher revenue coming from one of the most profitable geographies, Brazil. Adjusted PAT grew by 11.3% YoY to INR848m (v/s our estimate of 15.2% YoY growth to INR878m) despite healthy growth in EBITDA, due to forex losses of INR189.3m in 2QFY12.

EBITDA margins



Source: Company/MOSL

Key takeaways from the concall

- India formulations:** Growth was only 8.4% YoY, which was lower than the average industry growth. The management indicated that increased competition in the gastro-intestinal segment (19% of domestic sales) and overall slowdown in the acute therapeutic segments impacted revenue growth in 2QFY12. However, the management mentioned that TRP had taken corrective action and would improve its performance in 2HFY12. It also indicated that growth in the chronic therapies segment continued in line with or above industry growth in the covered market. TRP's 2HFY12 guidance is for 15% YoY growth in the business segment. We have projected 12% YoY growth in this segment for the company in FY12.
- Brazil:** Business in Brazil grew by a robust 34% in rupee terms. The growth came mainly due to restocking by one of TRP's large distributors in 2QFY12. The management said that such high growth was unlikely to be sustained in future. The management guidance is for 15% growth in local currency terms in future. We are forecasting 20% overall growth for TRP's Latam operations in FY12 given the high growth it reported in 1HFY12.
- Germany:** TRP's business in Germany grew by 28% in 2QFY12, led by favorable currency movement and revenue from recently awarded tenders. TRP was awarded about nine products in recently floated tenders. TRP also launched three new products in the branded market during 2QFY12. The management indicated that such high growth was not sustainable, going forward. Normalized growth for this business will be 5-10%.
- US Generics:** The business grew by 57% on a low base and led partly by new launches. The management guidance is for strong growth going forward as it scales up US operations, which will be led mainly by new launches. It has ~32 ANDAs pending approval with the US FDA. TRP does not have a very strong patent challenge strategy and hence the launch of these products will be mainly linked to relevant patent expiries.
- CRAMS:** The business reported 1% decline in revenue mainly due to inventory destocking. The management indicated that the revenue run-rate for this business was sustainable through forthcoming quarters.
- Capex will be ~INR2b and the tax rate will be ~18% in FY12.

Play on highly profitable, fast growing lifestyle segments in the domestic market; Growth concerns persist in the acute segment

Although ranked seventeenth in terms of revenue in the domestic formulations segment, TRP derives its strength from being the leader in some of the most lucrative and fastest growing chronic therapy segments. It enjoys market leadership in niche therapy segments of CVS and CNS, which are highly profitable and are likely to sustain high growth. It has consistently maintained leadership in these therapeutic classes, with strong brands and new product launches. TRP has six brands in the industry's top 300 brands, and has 37 brands in leadership positions in their respective molecule segments. Despite strong chronic business, TRP has seen muted growth in this business over the past three quarters due to overall slowdown in acute therapy segments like anti-infective and gastro-intestinal segments and increased competitive intensity in these therapeutic segments. We expect the business to post 15% revenue CAGR over FY11-13, led by strong chronic therapy franchise, recent additions in the field force, geographic expansion and entry into new therapy segments. Growth in FY12 will be lower at 12% due to slower growth in the acute therapeutic segments. TRP witnessed lower margins in this business due to higher manpower and marketing costs coupled with higher operational costs related to its Sikkim facility.

International business: Regulated markets lead growth; Emerging markets lead to improved profitability

TRP's investments in international operations have begun to pay off and we expect profit margins to expand as operations scale up. This, combined with healthy revenue growth expected in markets like the US, Europe and Brazil, and entry into some of the largest branded generics markets like Mexico, will drive revenue growth and increase profits from international operations. TRP has established itself in large international markets like Brazil and Germany and we believe the next phase of growth will be driven by regulated markets like the US and Europe (ex-Germany). We expect revenue from regulated markets (ex-Germany) to post CAGR of 21% over FY11-13, led by the US market. Other emerging markets, such as Brazil, are likely to improve profitability, led by critical size and operational leverage.

Valuation and outlook

Over the past five years TRP posted earnings CAGR of 34% and capital employed in the business, CAGR of just 17%. TRP has consistently improved profitability, with RoCE increasing from 14.5% in FY05 to 24.1% in FY11 and it is likely to post earnings CAGR of 22% over FY11-13, in line with its strong operating performance. It is likely to sustain its high return ratios despite its large capex and growing cash on the books. We believe current valuations do not reflect TRP's improved profitability, turnaround of international operations and strong positioning in the domestic formulations business. We believe TRP should trade at a premium to most mid-cap pharmaceutical companies and its valuation gap vis-à-vis frontline pharmaceutical companies should narrow, going forward. At the current market price, the stock trades at 14.4x FY12E and 11.6x FY13E earnings. We believe the superior financial performance will drive a re-rating in the stock. We maintain a **Buy** rating and a target price of INR800 (16x FY13E EPS), an upside of 38%.

Torrent Pharma: an investment profile

Company description

Torrent Pharma (TRP) is a second tier pharmaceutical companies that is actively targeting regulated generics and semi-regulated markets. TRP has a strong presence in the domestic market with focus and leadership in the CVS and CNS segments. The company has a large presence in some key global markets like Brazil and Germany and it is expanding in key markets like the US, Europe and RoW.

Key investment arguments

- TRP derives its strength from being the leader in some of the most lucrative and fast growing chronic therapy segments such as CVS and CNS.
- In the international formulations business, TRP will grow profitable due to its presence in the generic and branded markets.
- TRP has consistently delivered improved financial performance with an increase in RoCE and RoE. TRP's net debt-equity ratio has fallen from 0.7x in FY07 to nil in FY11.

Key investment risks

- There are regulatory risks, related to product approvals, manufacturing costs and laws across business segments.
- There is a foreign exchange risk as about half TRP's revenue comes from export markets.

Recent developments

- TRP signed a manufacturing contract with a Europe-based company to make its novel products.

Valuation and view

- Valuations at 14.4x FY12E and 11.6x FY13E EPS with sustainable RoE of over 30%.
- Maintain **Buy** with a target price of INR800 (16x FY13E EPS).

Sector view

- Regulated markets will remain key sales and profit drivers in the medium term. Japan is expected to emerge as the next growth driver, particularly for companies with a direct marketing presence.
- We are overweight on companies that are nearing the end of the investment phase, with benefits expected to accrue from the next fiscal.

Comparative valuations

		Torrent Pharma	Glenmark	Cadila Healthcare
P/E (x)	FY12E	14.4	17.5	26.9
	FY13E	11.6	13.9	18.4
P/BV (x)	FY12E	3.8	3.1	5.7
	FY13E	3.0	2.5	4.6
EV/Sales (x)	FY12E	1.9	2.6	3.2
	FY13E	1.6	2.3	2.7
EV/EBITDA (x)	FY12E	9.4	9.6	15.9
	FY13E	7.6	9.9	12.8

Shareholding pattern (%)

	Sep-11	Jun-11	Sep-10
Promoter	71.5	71.5	71.5
Domestic Inst	12.3	12.7	11.6
Foreign	4.9	4.3	3.8
Others	11.3	11.5	13.1

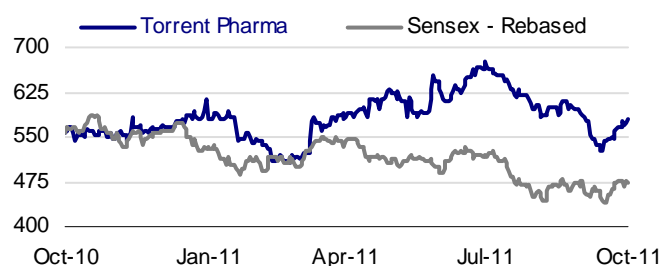
EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY12	40.2	39.4	2.1
FY13	50.1	47.6	5.2

Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
581	800	37.7	Buy

Stock performance (1 year)



Financials and Valuation

Income Statement		(INR Million)			
Y/E March	2010	2011	2012E	2013E	
Net Revenues	19,040	22,265	25,877	30,278	
Change (%)	16.8	16.9	16.2	17.0	
Total Expenditure	14,944	18,173	20,663	24,025	
% of Sales	78.5	81.6	79.8	79.3	
EBITDA	4,096	4,092	5,214	6,252	
Margin (%)	18.5	14.4	16.4	17.0	
Depreciation	661	626	952	1,137	
EBIT	3,435	3,466	4,263	5,115	
Int. and Finance Charges	251	121	114	86	
Other Income - Rec.	127	81	2	140	
PBT before EO Expense	3,312	3,427	4,150	5,169	
EO Expense/(Income)	368	0	-173	0	
PBT after EO Expense	2,944	3,427	4,323	5,169	
Current Tax	705	720	747	930	
Deferred Tax	-74	5	0	0	
Tax	632	725	747	930	
Tax Rate (%)	19.1	21.2	18.0	18.0	
Reported PAT	2,312	2,702	3,576	4,239	
Net Profit	2,312	2,702	3,576	4,239	
Adj PAT	2,680	2,702	3,403	4,239	

Balance Sheet		(INR Million)			
Y/E March	2010	2011	2012E	2013E	
Equity Share Capital	423	423	423	423	
Total Reserves	7,887	9,801	12,662	16,053	
Net Worth	8,310	10,224	13,085	16,476	
Deferred liabilities	499	480	480	480	
Total Loans	5,224	5,721	5,721	5,721	
Capital Employed	14,033	16,441	19,285	22,676	
Gross Block	8,129	10,385	12,685	14,885	
Less: Accum. Deprn.	2,718	3,343	4,295	5,432	
Net Fixed Assets	5,411	7,041	8,390	9,452	
Capital WMP	1,098	1,500	1,200	1,500	
Investments	1,412	1,460	1,460	1,460	
Curr. Assets	11,607	15,346	18,221	21,956	
Inventory	3,236	5,048	5,509	6,531	
Account Receivables	2,982	3,404	4,476	5,322	
Cash and Bank Balance	3,883	4,788	5,963	7,361	
Loans & Advances	1,506	2,106	2,272	2,741	
Curr. Liability & Prov.	5,496	8,907	9,985	11,692	
Account Payables	4,216	7,479	7,919	9,273	
Provisions	1,280	1,427	2,066	2,419	
Net Current Assets	6,111	6,440	8,236	10,264	
Appl. of Funds	14,033	16,441	19,285	22,676	

E: MOSL Estimates

Ratios					
Y/E March	2010	2011	2012E	2013E	
Basic EPS (INR)					
EPS	31.7	31.9	40.2	50.1	
Cash EPS	35.1	39.3	53.5	63.5	
BV/Share	98.2	120.8	154.6	194.7	
DPS	7.0	9.3	8.5	10.0	
Payout (%)	25.6	29.1	20.0	20.0	
Valuation (x)					
P/E		18.2	14.4	11.6	
Cash P/E		14.8	10.9	9.1	
P/BV		4.8	3.8	3.0	
EV/Sales		2.2	1.9	1.6	
EV/EBITDA		12.2	9.4	7.6	
Dividend Yield (%)		1.6	1.5	1.7	
FCF per Share		0.0	0.0	0.0	
Return Ratios (%)					
EBITDA Margins (%)	18.5	14.4	16.4	17.0	
Net Profit Margins (%)	14.1	12.1	13.2	14.0	
RoE	36.2	29.2	29.2	28.7	
RoCE	28.7	24.1	24.5	25.6	
Working Capital Ratios					
Asset Turnover (x)	1.4	1.4	1.3	1.3	
Fixed Asset Turnover (x)	3.6	3.6	3.4	3.4	
Debtor (Days)	56	55	62	63	
Inventory (Days)	62	83	78	79	
Working Capital Turnover (x)	43	27	32	35	
Leverage Ratio (x)					
Current Ratio	2.1	1.7	1.8	1.9	
Interest Cover Ratio	13.7	28.7	37.3	59.6	
Debt/Equity	0.6	0.6	0.4	0.3	

Cash Flow Statement		(INR Million)			
Y/E March	2010	2011	2012E	2013E	
Oper. Profit/(Loss) before Tax	4,096	4,092	5,214	6,252	
Interest/Dividends Recd.	127	81	2	140	
Direct Taxes Paid	-717	-744	-747	-930	
(Inc)/Dec in WVC	349	577	-621	-630	
CF from Operations	3,856	4,005	3,848	4,832	
EO Expense / (Income)	368	0	-173	0	
CF from Operating incl EO	3,488	4,005	4,021	4,832	
(inc)/dec in FA	-1,487	-2,657	-2,000	-2,500	
(Pur)/Sale of Investments	-17	-48	0	0	
CF from Investments	-1,504	-2,705	-2,000	-2,500	
(Inc)/Dec in Debt	398	513	-16	0	
Interest Paid	-251	-121	-114	-86	
Dividend Paid	-592	-787	-715	-848	
Others	44	-1	0	0	
CF from Fin. Activity	-401	-395	-846	-934	
Inc/Dec of Cash	1,583	905	1,175	1,398	
Add: Beginning Balance	2,300	3,883	4,788	5,963	
Closing Balance	3,883	4,788	5,963	7,361	

N O T E S

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Torrent Pharma

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Motilal Oswal Securities Ltd

3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021

Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: reports@motilaloswal.com