MOTILAL OSWAL

26 July 2012

2QCY12 Results Update | Sector: Healthcare

# Sanofi India

| BSE SENSEX | S&P CNX |
|---|---|
| 16,846 | 5,110 |
| Bloomberg | SANL IN |
| Equity Shares (m) | 23.0 |
| 52-Week Range (INR) | 2,430/1,980 |
| 1,6,12 Rel. Perf. (%) | 3/-3/15 |
| M.Cap. (INR b) | 50.7 |
| M.Cap. (USD b) | 0.9 |

**CMP: INR2,200** **TP: INR1,848** **Neutral**

| Year End | Net Sales (INR m) | PAT (INR m) | EPS (INR) | EPS Gr. (%) | P/E (X) | P/BV (X) | RoE (%) | RoCE (%) | EV/ Sales | EV/ EBITDA |
|---|---|---|---|---|---|---|---|---|---|---|
| 12/10A | 10,850 | 1,550 | 67.3 | -1.5 | - | - | 15.5 | 23.6 | - | - |
| 12/11A | 12,297 | 1,912 | 83.0 | 23.3 | 26.5 | 4.6 | 17.3 | 25.3 | 3.9 | 27.4 |
| 12/12E | 14,864 | 1,693 | 73.5 | -11.4 | 29.9 | 4.2 | 13.9 | 20.6 | 3.2 | 22.3 |
| 12/13E | 17,144 | 2,128 | 92.4 | 25.7 | 23.8 | 3.7 | 15.6 | 23.1 | 2.7 | 17.8 |

Sanofi India's (SANL) 2QCY12 operational performance was in line with our expectations. Key highlights:

- Net sales grew 23.5% YoY to INR3.74b v/s our estimate of INR3.7b. We believe topline growth has been led by strong growth in domestic revenue on consolidation of Universal Medicare acquisition. Exports are also likely to have grown during the quarter.
- EBITDA grew 22% YoY to INR522m v/s our estimate of INR537m. EBITDA margin contracted 10bp to 14% v/s our estimate of 14.5%.
- Adjusted PAT declined 18.5% YoY to INR405m and was lower than our estimate of INR442m due to higher amortization cost relating to the brands and technical knowhow acquired from Universal Medicare in 2011.
- SANL has, in the past, indicated that for the domestic business, the rural and OTC segments will be the key growth drivers, and that it is likely to incur extra expenditure to establish its presence in these segments. This is likely to pressurize short-term profitability.

We believe SANL will be one of the key beneficiaries of the patent regime in the long-term. The parent has a strong R&D pipeline with a total of 61 products undergoing clinical trials, of which 18 are in Phase-III or pending approvals. Some of these are likely to be launched in India. However, SANL's profitability has declined significantly in the last five years, with EBITDA margin declining from 25% in CY06 to 14.3% in CY11, mainly impacted by discontinuation of Rabipur sales in the domestic market, lower export growth and higher staff & promotional expenses. RoE has declined from 28.6% to 17.3% during the period. The stock trades at 29.9x CY12E and 23.8x CY13E EPS. We believe that the stock performance will remain muted in the short term until clarity emerges on future growth drivers. Maintain **Neutral**.

**Quarterly Performance** (INR Million)

| Y/E December | CY11 | | | | CY12 | | | | CY11 | CY12E | Est. | Var. |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1Q | 2Q | 3Q | 4Q | 1Q | 2Q | 3QE | 4QE | | | 2QCY12 | vs Est |
| Net Sales | 2,763 | 3,028 | 3,127 | 3,379 | 3,225 | 3,741 | 3,901 | 4,008 | 12,297 | 14,864 | 3,705 | 1.0% |
| YoY Change (%) | 9.9 | 11.5 | 13.5 | 17.9 | 16.7 | 23.5 | 24.8 | 18.6 | 13.3 | 20.9 | 22.3 | |
| Total Expenditure | 2,328 | 2,600 | 2,624 | 2,985 | 2,733 | 3,219 | 3,266 | 3,525 | 10,537 | 12,743 | 3,167 | |
| EBITDA | 435 | 428 | 503 | 394 | 492 | 522 | 636 | 483 | 1,760 | 2,122 | 537 | -2.9% |
| Margins (%) | 15.7 | 14.1 | 16.1 | 11.7 | 15.3 | 14.0 | 16.3 | 12.1 | 14.3 | 14.3 | 14.5 | -50bp |
| Depreciation | 54 | 54 | 61 | 142 | 183 | 186 | 195 | 200 | 311 | 764 | 159 | |
| Interest | 2 | 0 | 0 | 2 | 4 | 4 | 0 | 2 | 4 | 10 | 0 | |
| Other Income | 379 | 361 | 369 | 286 | 289 | 267 | 309 | 323 | 1,395 | 1,188 | 285 | |
| PBT before EO Items | 758 | 735 | 811 | 535 | 594 | 599 | 750 | 604 | 2,839 | 2,535 | 663 | |
| Extra-Ord Expense | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | |
| PBT after EO Items | 758 | 735 | 811 | 535 | 594 | 599 | 750 | 604 | 2,839 | 2,535 | 663 | -9.7% |
| Tax | 252 | 238 | 263 | -10 | 193 | 194 | 250 | 205 | 743 | 842 | 221 | |
| Effective tax Rate (%) | 33.2 | 32.4 | 32.4 | -1.8 | 32.5 | 32.4 | 33.4 | 33.8 | 26.2 | 33.2 | 33.4 | |
| Reported PAT | 506 | 497 | 548 | 545 | 401 | 405 | 499 | 400 | 2,096 | 1,693 | 442 | -8.3% |
| Adj PAT | 506 | 497 | 548 | 545 | 401 | 405 | 499 | 400 | 2,096 | 1,693 | 442 | -8.3% |
| YoY Change (%) | 40.2 | 17.2 | 15.9 | | -20.8 | -18.5 | -8.9 | -26.7 | 31.2 | -19.2 | -11.1 | |
| Margins (%) | 18.3 | 16.4 | 17.5 | 16.1 | 12.4 | 10.8 | 12.8 | 10.0 | 17.0 | 11.4 | 11.9 | |

E: MOSL Estimates

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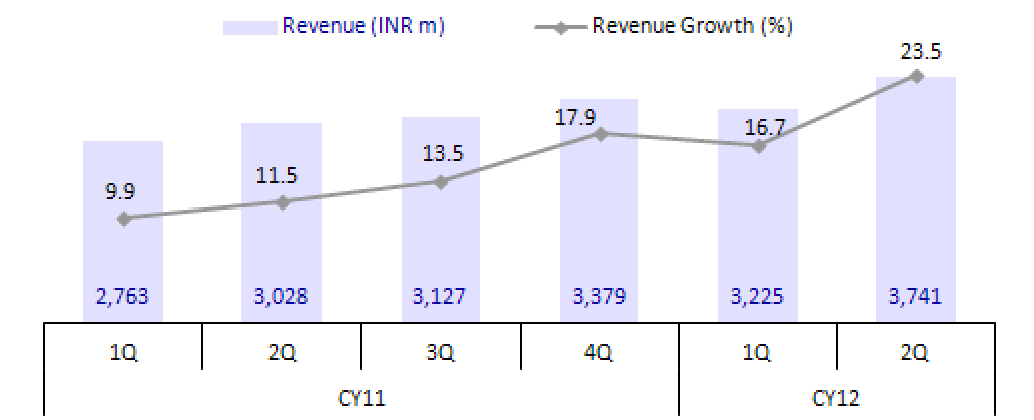
## Revenue growth is likely to have led by domestic business

SANL's 2QCY12 operational performance was in line with our estimates with 23.5% YoY growth in net sales to INR3.74b (v/s est INR3.7b) and 22% YoY growth in EBITDA to INR522m (v/s est INR537m). EBITDA margins contracted 10bp to 14% (v/s est 14.5%). Adj PAT declined 18.5% YoY to INR405m and was lower than our estimate of INR442m

The company has stopped giving revenue break-up between domestic formulation and export revenues. We believe topline growth is led by strong growth in domestic formulation revenues on the back of consolidation of Universal Medicare acquisition. Export revenues have likely grown this quarter.

**Revenue trend**

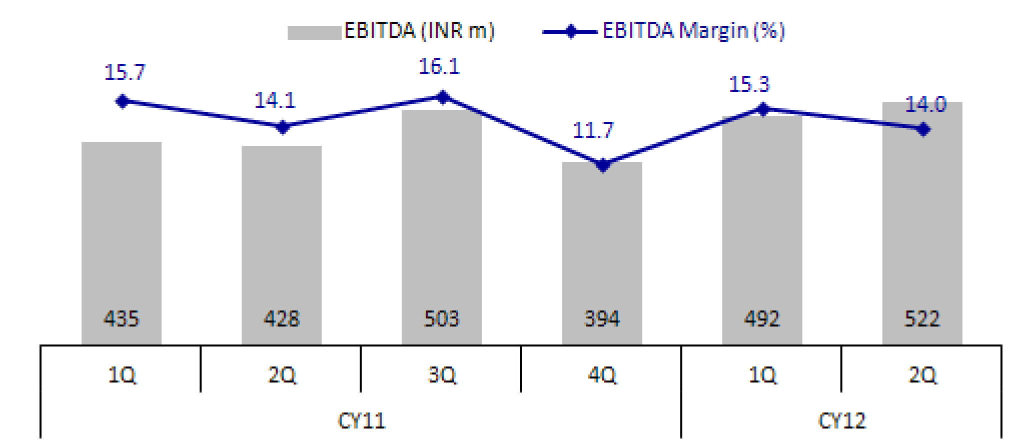



Source: Company, MOSL

## EBITDA was in-line with estimates

EBITDA grew 22% YoY to INR522m (v/s est INR537m). EBITDA margins contracted 10bp to 14% (v/s est 14.5%). Adj PAT declined 18.5% YoY to INR405m and was lower than our estimate of INR442m, due to higher amortization cost related to the brands and technical know-how acquired from Universal Medicare in 2011.

**EBITDA and margin trend**




Source: Company, MOSL

The company has, in the past, indicated that for the domestic business, rural and OTC segment will be key growth drivers in the future, and that the company is likely to incur some extra expenditure for establishing its presence in these segments. This is likely to pressurize short-term profitability.

## Domestic formulations - new product introductions hold the key

In the past few quarters, SANL's domestic formulation revenue growth has lagged the average industry growth. Taking a longer term view, we believe SANL is well placed to benefit from the introduction of product patents, given its strengths in marketing, a supportive parent and a healthy product pipeline (of NCEs). SANL's history of launching patented products in India, a well mapped portfolio vis-à-vis the parent, and ability to build them into big brands make it one of the potential beneficiaries of the product patent regime in India. Further, the company is planning to strengthen its portfolio in diabetes segment. The parent (Sanofi-Aventis) currently has 61 projects in research and development, including about 36 in late stage (Phase II & III) development and registration. About 20% of the product development pipeline consists of vaccines. The table below gives details on the parent's R&D pipeline.

**SANL - Parent's NCE Pipeline**

| Therapeutic area | No of projects | | | | |
|---|---|---|---|---|---|
| | Phase I | Phase II | Phase III | Registration | Total |
| Metabolic Disorders | 2 | 1 | 0 | 2 | 5 |
| Oncology | 6 | 4 | 3 | 2 | 15 |
| Genetic Diseases | 1 | 0 | 1 | 0 | 2 |
| Thrombosis | 1 | 0 | 1 | 0 | 2 |
| Central Nervous System | 2 | 0 | 1 | 1 | 4 |
| Internal Medicine | 3 | 5 | 1 | 0 | 9 |
| Ophthalmology | 3 | 2 | 0 | 0 | 5 |
| Aging | 3 | 3 | 0 | 0 | 6 |
| Vaccines | 4 | 3 | 5 | 1 | 13 |
| **Total** | **25** | **18** | **12** | **6** | **61** |

Source: Company, MOSL

## Rural initiatives and entry into OTC segment- long term positive but may pressurize profitability in short-term

AVEN is one of the few MNCs which is focusing on rural India. Given the increasing disposable income, various government initiatives to improve rural healthcare infrastructure, and low competition, AVEN may benefit from its early entry into this segment. Management feels that it has made strong progress with project Prayas and will continue to invest resources on the project. Prayas is present in 14 states of India. The project has engaged more than 10,000 doctors and conducted over 2,000 workshops. However, we believe that this will not contribute significantly to revenues in the short-to-medium term. Rather it is a long-term positive. In fact, in the short-term, this initiative is likely to pressurize AVEN's profitability given the investments. required in establishing a presence in this segment as well as the relatively lower profitability of this market. Rural division generated revenues of INR185mn in CY10. The management expects the rural division to break even in the next 3 years. On the back of the success in project 'Prayas', Aventis has launched other initiatives like 'I am a Champ', 'Saath 7' and 'Together for More'. Further, company's entry into OTC segment is also likely to keep margins under pressure as it requires higher advertising spend.

## Cutting earnings estimates by 5%

Based on 2QCY12 results and taking into account the full impact of amortization of brands acquired from Universal Medicare, we are downgrading our EPS estimates for CY12 and CY13 by 5.2% each to INR73.5 (down 11.4% YoY) and INR92.4 (up 25.7%).

**Revised Forecast (INR m)**

| | CY12 | | | CY13 | | |
|---|---|---|---|---|---|---|
| | Rev | Old | Chg (%) | Rev | Old | Chg (%) |
| Net Sales | 14,864 | 14,774 | 0.6 | 17,144 | 17,038 | 0.6 |
| Net Profit | 1,693 | 1,786 | -5.2 | 2,128 | 2,245 | -5.2 |
| EPS (INR) | 73.5 | 77.6 | -5.2 | 92.4 | 97.5 | -5.2 |

Source: CMOSL

## Valuation and view

We believe SANL will be one of the key beneficiaries of the patent regime in the long-term. The parent has a strong R&D pipeline with a total of 61 products undergoing clinical trials, of which 18 are in Phase-III or pending approvals, some of which are likely to be launched in India. However, SANL's profitability has declined significantly in last 5 years with EBITDA margins declining from 25% for CY06 to 14.3% for CY11, mainly impacted by discontinuation of Rabipur sales in the domestic market, lower export growth and higher staff & promotional expenses. RoE has declined from 28.6% to 17.3% in the same period. Based on our revised estimates, the stock trades at 29.9x CY12E and 23.8x CY13E EPS. We believe the stock performance will remain muted in the short term until clarity emerges on future growth drivers. Maintain **Neutral**.

# Sanofi India (SANL): an investment profile

## Company description

SANL (60% subsidiary of Sanofi Aventis, France) is the fifth largest MNC and among the top 15 formulations players in India. The company has built a very strong franchise in chronic therapy areas like anti-diabetes, oncology and CVS, in the process realigning its domestic portfolio with that of its parent.

## Key investment arguments

- SANL is well placed to benefit from the introduction of product patents, given its strengths in marketing, a supportive parent and a healthy NCE product pipeline of parent company
- SANL's history of launching patented products in India, a well mapped portfolio vis-à-vis the parent and ability to build them into big brands make it one of the potential beneficiaries of the product patent regime in India

## Key investment risks

- Biggest risk to SANL could be the implementation of the new pharmaceutical policy in the current form. The new policy proposes to significantly increase the span of control by bringing in total 348 drugs under price control.
- Possible pre-grant and post-grant patent challenges by domestic generic companies could hamper the plans and prospects of launch of patented product.

## Recent developments

- In November 2011, the company acquired Universal Medicare Pvt. Ltd in India for the total consideration of INR5.6b

## Valuation and view

- SANL will be one of the key beneficiaries of the patent regime in the long-term. In the long-term, focus on growing strategic brands and strong support from the parent will augur well for the company. We believe that it is very well positioned to take advantage of the patent regime in the long-term.
- The stock is currently valued at 29.9x CY12E and 23.8x CY13E earnings. We maintain Neutral.

## Sector view

- The domestic market is expected to witness 14-15% growth, with gradual increase in the low penetration levels - companies with strong brands and marketing muscle to benefit.
- IPR regime unlikely to lead to any major change in the near term; MNCs and large Indian players to gain over the longer term.
- Among MNCs, we are bullish on companies whose domestic portfolio is well aligned with its parent and where risk of conflict with 100% subsidiaries is limited.

### Comparative valuations

| | | Aventis | GSK |
|---|---|---|---|
| P/E (x) | CY12E | 29.9 | 26.7 |
| | CY13E | 23.8 | 22.8 |
| P/BV (x) | CY12E | 4.2 | 8.9 |
| | CY13E | 3.7 | 7.9 |
| EV/Sales (x) | CY12E | 3.2 | 6.2 |
| | CY13E | 2.7 | 5.3 |
| EV/EBITDA (x) | CY12E | 22.3 | 19.5 |
| | CY13E | 17.8 | 16.1 |

### Shareholding pattern (%)

| | Mar-12 | Dec-11 | Mar-11 |
|---|---|---|---|
| Promoter | 60.4 | 60.4 | 60.4 |
| Domestic Inst | 15.8 | 17.8 | 18.3 |
| Foreign | 12.4 | 10.5 | 10.0 |
| Others | 11.5 | 11.3 | 11.3 |

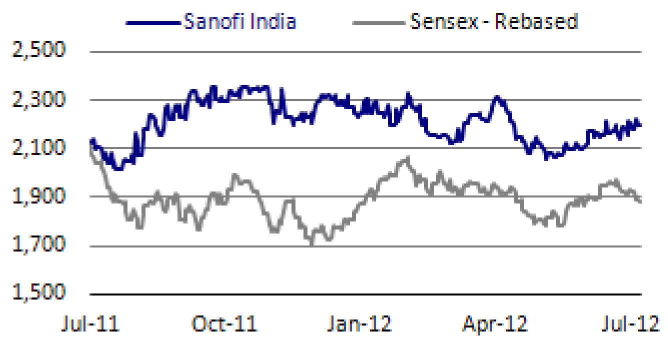
### EPS: MOSL forecast v/s consensus (INR)

| | MOSL Forecast | Consensus Forecast | Variation (%) |
|---|---|---|---|
| CY12 | 73.5 | 99.7 | -26.3 |
| CY13 | 92.4 | 100.5 | -8.1 |

### Target Price and Recommendation

| Current Price (INR) | Target Price (INR) | Upside (%) | Reco. |
|---|---|---|---|
| 2,200 | 1,848 | -16 | Neutral |

### Stock performance (1 year)



## Financials and Valuation

| Income Statement | | | | | (INR Million) |
|---|---|---|---|---|---|
| Y/E December | 2009 | 2010 | 2011 | 2012E | 2013E |
| Exports | 2,290 | 2,141 | 2,273 | 2,500 | 2,925 |
| Net Domestic Sales | 7,454 | 8,709 | 10,024 | 12,364 | 14,218 |
| **Net Sales** | **9,744** | **10,850** | **12,297** | **14,864** | **17,144** |
| Change (%) | -0.9 | 11.3 | 13.3 | 20.9 | 15.3 |
| Materials Consumed | 4,820 | 5,390 | 6,194 | 7,313 | 8,400 |
| Personnel Expenses | 1,440 | 1,633 | 1,764 | 1,941 | 2,135 |
| Other Expenses | 2,007 | 2,396 | 2,579 | 3,489 | 4,056 |
| Total Expenditure | 8,267 | 9,418 | 10,537 | 12,743 | 14,591 |
| **EBITDA** | **1,478** | **1,431** | **1,761** | **2,122** | **2,552** |
| Change (%) | -20.4 | -3.1 | 23.0 | 20.5 | 20.3 |
| Margin (%) | 15.2 | 13.2 | 14.3 | 14.3 | 14.9 |
| Depreciation | 173 | 197 | 311 | 764 | 800 |
| **EBIT** | **1,304** | **1,234** | **1,449** | **1,357** | **1,752** |
| Int. and Finance Charge | 1 | 29 | 4 | 10 | 0 |
| Other Income - Rec. | 1,111 | 1,135 | 1,395 | 1,188 | 1,435 |
| **PBT & EO Items** | **2,415** | **2,340** | **2,840** | **2,535** | **3,186** |
| Change (%) | -7.0 | -3.1 | 21.4 | -10.7 | 25.7 |
| Extra Ordinary Income/( | 0 | 757 | 0 | 0 | 0 |
| **PBT after EO Items** | **2,415** | **3,097** | **2,840** | **2,535** | **3,186** |
| Tax | 840 | 790 | 928 | 842 | 1,058 |
| Tax Rate (%) | 34.8 | 25.5 | 32.7 | 33.2 | 33.2 |
| **Reported PAT** | **1,574** | **2,308** | **1,912** | **1,693** | **2,128** |
| **PAT Adj for EO Items** | **1,574** | **1,550** | **1,912** | **1,693** | **2,128** |
| Change (%) | -5.3 | -1.5 | 23.3 | -11.4 | 25.7 |
| Margin (%) | 16.2 | 14.3 | 15.5 | 11.4 | 12.4 |

| Balance Sheet | | | | | (INR Million) |
|---|---|---|---|---|---|
| Y/E December | 2009 | 2010 | 2011 | 2012E | 2013E |
| Equity Share Capital | 230 | 230 | 230 | 230 | 230 |
| Reserves | 8,951 | 9,783 | 10,816 | 11,934 | 13,371 |
| Revaluation Reserves | 136 | 128 | 120 | 111 | 103 |
| **Net Worth** | **9,318** | **10,142** | **11,166** | **12,275** | **13,704** |
| Deferred Tax Liabilities | -146 | -99 | 85 | 85 | 85 |
| **Capital Employed** | **9,172** | **10,043** | **11,251** | **12,360** | **13,789** |
| Gross Block | 3,346 | 3,755 | 4,355 | 4,555 | 4,755 |
| Less: Accum. Deprn. | 1,897 | 2,044 | 2,309 | 3,074 | 3,874 |
| **Net Fixed Assets** | **1,449** | **1,710** | **2,046** | **1,481** | **881** |
| Capital WIP | 271 | 133 | 302 | 302 | 302 |
| Investments | 52 | 4 | 4 | 4 | 4 |
| Goodwill | | | 5,324 | 5,324 | 5,324 |
| **Curr. Assets** | **10,135** | **12,138** | **7,350** | **9,728** | **12,413** |
| Inventory | 2,311 | 2,413 | 2,543 | 3,014 | 3,476 |
| Account Receivables | 527 | 604 | 730 | 1,018 | 1,174 |
| Cash and Bank Balance | 5,860 | 6,554 | 2,342 | 3,457 | 5,180 |
| Others | 1,437 | 2,567 | 1,735 | 2,240 | 2,583 |
| **Curr. Liability & Prov.** | **2,735** | **3,943** | **3,775** | **4,480** | **5,167** |
| Account Payables | 1,582 | 1,737 | 2,195 | 2,443 | 2,818 |
| Other Liabilities | | | | | |
| Provisions | 1,154 | 2,206 | 1,579 | 2,036 | 2,348 |
| **Net Current Assets** | **7,400** | **8,196** | **3,575** | **5,249** | **7,247** |
| **Appl. of Funds** | **9,172** | **10,043** | **11,251** | **12,360** | **13,789** |

E: MOSL Estimates

| Ratios | | | | | |
|---|---|---|---|---|---|
| Y/E December | 2009 | 2010 | 2011 | 2012E | 2013E |
| **Basic (INR)** | | | | | |
| **EPS** | **68.4** | **67.3** | **83.0** | **73.5** | **92.4** |
| Cash EPS | 75.9 | 75.9 | 96.5 | 106.7 | 127.2 |
| BV/Share | 398.7 | 434.8 | 479.7 | 528.2 | 590.6 |
| DPS | 20.0 | 55.0 | 33.0 | 25.0 | 30.0 |
| Payout (%) | 34.2 | 63.9 | 46.0 | 34.0 | 32.5 |
| **Valuation (x)** | | | | | |
| P/E | | | 26.5 | 29.9 | 23.8 |
| Cash P/E | | | 22.8 | 20.6 | 17.3 |
| P/BV | | | 4.6 | 4.2 | 3.7 |
| EV/Sales | | | 3.9 | 3.2 | 2.7 |
| EV/EBITDA | | | 27.4 | 22.3 | 17.8 |
| Dividend Yield (%) | | | 1.5 | 1.1 | 1.4 |
| **Return Ratios (%)** | | | | | |
| RoE | 17.1 | 15.5 | 17.3 | 13.9 | 15.6 |
| RoCE | 26.3 | 23.6 | 25.3 | 20.6 | 23.1 |
| **Working Capital Ratios** | | | | | |
| Fixed Asset Turnover (x) | 6.8 | 6.9 | 6.5 | 8.4 | 14.5 |
| Debtor (Days) | 20 | 20 | 22 | 25 | 25 |
| Inventory (Days) | 87 | 81 | 75 | 74 | 74 |
| Working Capital (Days) | 58 | 55 | 37 | 44 | 44 |
| **Leverage Ratio (x)** | | | | | |
| Debt/Equity | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

| Cash Flow Statement | | | | | (INR Million) |
|---|---|---|---|---|---|
| Y/E December | 2009 | 2010 | 2011 | 2012E | 2013E |
| OP/(Loss) before Tax | 1,478 | 1,431 | 1,761 | 2,122 | 2,552 |
| Interest/Dividends Recd | 1,111 | 1,135 | 1,395 | 1,188 | 1,435 |
| Direct Taxes Paid | -833 | -743 | -745 | -842 | -1,058 |
| (Inc)/Dec in WC | 81 | -102 | 410 | -559 | -275 |
| **CF from Operations** | **1,837** | **1,722** | **2,820** | **1,909** | **2,654** |
| EO Items | 0 | 757 | 0 | 0 | 0 |
| **CF from Ope (EO items)** | **1,837** | **2,479** | **2,820** | **1,909** | **2,654** |
| (Inc)/Dec in FA | -411 | -329 | -6,148 | -208 | -208 |
| (Pur)/Sale of Investmen | 0 | 48 | 0 | 0 | 0 |
| **CF from Investments** | **-411** | **-281** | **-6,148** | **-208** | **-208** |
| Interest Paid | -1 | -29 | -4 | -10 | 0 |
| Dividend Paid | -539 | -1,476 | -879 | -576 | -691 |
| **CF from Fin. Activity** | **-540** | **-1,504** | **-883** | **-586** | **-691** |
| **Inc/Dec of Cash** | **886** | **694** | **-4,211** | **1,115** | **1,755** |
| Add: Beginning Balance | 4,974 | 5,860 | 6,554 | 2,342 | 3,457 |
| **Closing Balance** | **5,860** | **6,554** | **2,342** | **3,457** | **5,179** |

# N O T E S

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