

# Strides Arcolabs


 DOLAT CAPITAL

CMP: ₹ 645

TP: ₹ 715

Accumulate

## Topline marginally ahead of estimates; an operationally strong quarter

Strides Arcolab's Q1CY12 revenue (including 24 days of Ascent Pharma sales) grew 7.3% YoY to ₹ 5.34bn. However, the topline on a like-to-like basis grew 40% YoY to ₹ 4.95bn. Licensing income for the quarter stood at ₹ 640mn.

Highlight of this growth was healthy performance in the specialty division driven by new product launches and benefit of operating leverage. Core revenue from the division (ex licensing income) more than doubled to ₹ 2.74bn with operating margins at 26%.

The company has acquired an FDA approved sterile formulations facility to effectively capitalize on the US drug shortage opportunity. Its existing capacities (including non-oncology) are already tied up.

The Pharma division's revenue on a like-to-like basis grew 37% YoY to ₹ 1.58bn with its core operating margin (ex licensing income) at 19% for the quarter.

Operating margin increased by 450bps YoY to 24.9% mainly due to lower other expenses (down 270bps YoY) and raw material costs (down 110bps YoY).

The exceptional items for the quarter include (a) forex loss of ₹ 250mn, (b) loss of ₹ 15mn related to fair value of options and (c) profit on sale of investments of ₹ 6.32bn (mainly pertaining to Ascent sale).

Recurring PAT (adjusted for tax impact and excl. exceptional items) grew 126% YoY to ₹ 608mn (₹ 269mn in Q1CY11).

At the same time, the management indicated of high growth potential in sterile business, to be aided by launch of 31 products this year and higher contribution from Penem exports from Brazilian facility. To reflect the benefit of operating leverage on commercialisation of these products, we have revised our earnings estimate upward by 4.7%/4.2% for CY12E/CY13E.

## High Points

- Higher contribution from Specialty biz aids topline growth
- Operating leverage backed by new launches
- Specialty revenues to surge with 31 product launches in CY12E
- Acquires sterile plant ₹ 1.25bn
- View: Maintain Accumulate with a revised target price of ₹ 715 (13x CY13E EPS)

## Scrip Details

Equity	₹ 585mn
Face Value	₹ 10/-
Market Cap	₹ 37.8bn
	USD 755mn
52 week High / Low	₹ 681 / 276
Avg. Volume (no)	115,334
BSE Sensex	17,151
NSE Nifty	5,202
Bloomberg Code	STR IN
Reuters Code	STAR.BO

## Q1CY12 Result (₹ mn)

Particulars	Q1CY12	Q1CY11	YoY%	Q4CY11	QoQ%
<b>Income from Operations</b>	<b>5338</b>	<b>4973</b>	<b>7.3</b>	<b>6982</b>	<b>-23.5</b>
Other Income	58	0	-	0	-
<b>Total Income</b>	<b>5396</b>	<b>4973</b>	<b>8.5</b>	<b>6982</b>	<b>-22.7</b>
<b>Total Expenditure</b>	<b>4007</b>	<b>3958</b>	<b>1.2</b>	<b>5893</b>	<b>-32.0</b>
<b>PBIDT</b>	<b>1389</b>	<b>1015</b>	<b>36.8</b>	<b>1089</b>	<b>27.5</b>
<b>OPM%</b>	<b>24.9%</b>	<b>20.4%</b>	<b>-</b>	<b>15.6%</b>	<b>-</b>
Interest	390	430	-9.2	507	-23.0
<b>PBDT</b>	<b>998</b>	<b>585</b>	<b>70.6</b>	<b>583</b>	<b>71.4</b>
Depreciation	237	183	29.1	298	-20.5
<b>PBT</b>	<b>761</b>	<b>402</b>	<b>89.6</b>	<b>285</b>	<b>167.5</b>
Tax	392	89	340.0	141	176.9
<b>PAT before Min.Int &amp; EOI</b>	<b>370</b>	<b>313</b>	<b>18.3</b>	<b>143</b>	<b>158.2</b>
Minority Interest	1	44	-	42	-
EOI - Fx (Gains)/Losses	<b>-6052</b>	<b>-138</b>	<b>-</b>	<b>-582</b>	<b>-</b>
- Exchange fluctuation - Loss/(Gain)	250	-8	-	-598	-
- Profit/Loss on sale Plant/investments - Loss/(Gain)	-6316	0	-	20	-
- Fair value of options	15	-131	-	-4	-
<b>PAT</b>	<b>6421</b>	<b>407</b>	<b>-</b>	<b>684</b>	<b>-</b>
<b>Adj. PAT (before fx gains)</b>	<b>608</b>	<b>269</b>	<b>126</b>	<b>102</b>	<b>-</b>

## Financials (Consolidated)

Years	Net Sales#	% growth	EBIDTA	OPM %	Adj. PAT	% growth	EPS(₹)	% growth	PER(x)	ROANW %	ROACE %
CY10	17,611	32.6	3,918	22.2	1,218	133.6	20.9	133.6	30.9	11.6	10.9
CY11	25,769	46.3	5,176	20.1	1,750	43.6	30.0	43.6	21.5	16.9	11.0
CY12E*	23,342	-9.4	5,240	22.5	2,752	57.3	47.0	56.8	13.7	18.6	12.3
CY13E	27,575	18.1	5,953	21.6	3,221	17.0	55.0	17.0	11.7	18.4	15.1

Figures in ₹ Mn, #Includes other operating income; \* Divestment of Ascent Pharma biz.

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### Q1CY12 Result

- Strides Arcolab's Q1CY12 revenue (including 24 days of Ascent Pharma sales) grew 7.3% YoY to ₹ 5.34bn. However, the topline on a like-to-like basis grew 40% YoY to ₹ 4.95bn. Licensing income for the quarter stood at ₹ 640mn (₹ 1.1bn in Q1CY11).
- The specialty division's revenue grew 42% YoY to ₹ 3.37bn. However, core sales (ex licensing income) more than doubled to ₹ 2.74bn (₹ 1.35bn in Q1CY11). Core operating margins stood at 26%.
- The Pharma division's revenue on a like-to-like basis grew 37% YoY to ₹ 1.58bn with its core operating margin (ex licensing income) at 19% for the quarter.
- Operating margin increased by 450bps YoY to 24.9% mainly due to lower other expenses (down 270bps YoY) at 16.7% of sales and raw material costs (down 110bps YoY) at 46% of sales. Employee cost also stood lower by 70bps YoY at 12.4% of sales. Operating margin on a like-to-like basis (excl. Ascent business) reflects a similar trend of 420bps YoY increase to 27.7% from 23.5% in Q1CY11.
- Interest cost declined 9.2% YoY to ₹ 390mn (post debt repayment - net debt/equity has reduced from 1.67x to 0.63x).
- PBT (excl. extra ordinary items) stood at ₹ 761mn, up 89.6% YoY. The exceptional items for the quarter include (a) forex loss of ₹ 250mn, (b) loss of ₹ 15mn related to fair value of options and (c) profit on sale of investments of ₹ 6.32bn (mainly pertaining to Ascent sale).
- Recurring PAT (adjusted for tax impact and excl. exceptional items) grew 126% YoY to ₹ 608mn (₹ 269mn in Q1CY11).

### Earnings concall – Key takeaways:

- The prevailing of drug shortages in regulated markets continues to present a favourable opportunity for Strides Arcolab. The management has actively participated in resolving 9-10 shortages which has earned them long-term contracts from GPOs.
- Due to the long-term nature of these contracts, its existing capacities (including the non-oncology facility) are currently booked and expected to be tied-up till CY14E.
- In order to effectively capitalize on the opportunity from drug shortages, the company has acquired an FDA approved sterile formulations facility for a cash consideration of ₹ 1.25bn. Two blocks with a capacity of 97 mn units (non-penicillin, non-cephalosporins injectables) will be commercialized by Q3CY12 and the company will incur capex of USD 7mn to increase this capacity to 200mn units by CY13E. The acquisition is EPS accretive.
- Its Polish facility, which is intended to cater to the US market, will be inspected by the FDA during this quarter. The facility is already being utilized to meet the drug shortages in Canada - this upside is expected in coming quarters.
- The company obtains approximately 33% of its specialties sales from US, of which the Pfizer supply deal constitutes a major proportion.
- The management indicated of the GSK tie-up being on track; shipment of seven-eight products (of total 10) has commenced as per the deal.
- Healthy operational performance in Brazilian unit was attributed to the enoxaparin shortage opportunity which may not be sustainable once the innovator resolves manufacturing issues.

- Brazilian unit is exposed to foreign currency risk as it imports its APIs. The management aims to mitigate this risk by commencing exports of Penems which have received necessary approvals in Europe.
- During the quarter, nine drugs were launched in from the specialty segment taking the total to 35. Additionally, there are 31 approved products that will be commercialized in CY12. The company launched two products during the quarter from the Pharma division.
- The company also expects to file 50 ANDAs this year; 45 in specialty segment and five in pharma.

### Financials

- Gross debt as of Mar-12 stands at ₹ 21.5bn (Dec-11: ₹ 25.6bn) and the net-debt/equity ratio pulled down to 0.63x. Borrowings include forex loan of USD 100mn and working capital of ₹ 5.4bn.
- Cash in books stands at ₹ 9.75bn as of Mar-12 (Dec-11: ₹ 2.6bn). The company received ₹ 1.2bn cash proceeds (net of taxes) from the Ascent Pharma sale. Of this, ₹ 3bn was used to retire long term debt and ₹ 1.25 to acquire the sterile formulations facility. The balance is maintained as cash in books and is sufficient to redeem FCCBs worth approx. ₹ 6bn.
- Capex guidance for CY12 stands at USD 25mn.

### Revised estimates

Particulars (₹ mn)	Revised*		Earlier		Change%	
	CY12E	CY13E	CY12E	CY13E	CY12E	CY13E
Income from Operations	23,342	27,575	23,226	27,322	0.5	0.9
EBITDA	5,240	5,953	4,994	5,738	4.9	3.8
OPM%	22.5	21.6	21.5	21.0		
Profit After Tax	2,752	3,221	2,628	3,092	4.7	4.2

\* Adjusted for higher licensing income and operating leverage in speciality & Pharma segment.

### Valuation

STAR stands to benefit from the current drug shortages in the US as global players like Hospira experience manufacturing compliance issues. A total of 31 products have been approved by the FDA and will be launched in CY12E which shall consequently accrue benefit of operating leverage.

We expect 36% earnings growth over CY11-13E. Increased contribution from steriles, uptick in profitability from the pharma division and low debt gearing aids earnings growth.

Further, with the capex cycle nearing the end, return ratios will observe an uptick. At CMP of ₹ 645, the stock trades at 13.7xCY12E and 11.7xCY13E earnings. We recommend **Accumulate** on the stock with a revised target price of ₹ 715 (13x CY13E earnings).

INCOME STATEMENT					CASH FLOW				
Particulars	Dec'10	Dec'11	Dec'12E	Dec'13E	Particulars	Dec'10	Dec'11	Dec'12E	Dec'13E
<b>Net Sales</b>	<b>16,958</b>	<b>25,245</b>	<b>22,742</b>	<b>26,975</b>	<b>Profit before tax</b>	<b>1,858</b>	<b>2,232</b>	<b>3,480</b>	<b>4,063</b>
Operating Income	652	524	600	600	Depreciation & w.o.	639	1,043	910	980
<b>Income from Operations</b>	<b>17,611</b>	<b>25,769</b>	<b>23,342</b>	<b>27,575</b>	Net Interest Exp	1,466	1,903	850	910
Other income	45	2	0	0	Direct taxes paid	(452)	(387)	(696)	(813)
Total Income	17,655	25,772	23,342	27,575	Chg in Working Capital	(5,224)	5,354	1,246	(1,955)
Total Expenditure	13,693	20,594	18,101	21,621	<b>(A) CF from Opt. Activities</b>	<b>(1,713)</b>	<b>10,145</b>	<b>5,790</b>	<b>3,186</b>
<b>EBIDTA (Excl. Other Income)</b>	<b>3,918</b>	<b>5,176</b>	<b>5,240</b>	<b>5,953</b>	Capex	(1,865)	(6,200)	4,250	(1,800)
<b>EBIDTA (Incl. Other Income)</b>	<b>3,963</b>	<b>5,178</b>	<b>5,240</b>	<b>5,953</b>	<b>Free Cash Flow</b>	<b>(3,578)</b>	<b>3,945</b>	<b>10,040</b>	<b>1,386</b>
Interest	1,466	1,903	850	910	Inc./ (Dec.) in Investments	3,396	18	0	0
<b>Gross Profit</b>	<b>2,496</b>	<b>3,275</b>	<b>4,390</b>	<b>5,043</b>	Other (Bal fig.)	(5,498)	(6,982)	2,840	14
Depreciation	639	1,043	910	980	<b>(B) CF from Invt. Activities</b>	<b>(3,968)</b>	<b>(13,164)</b>	<b>7,090</b>	<b>(1,786)</b>
Profit Before Tax & EO Items	1,858	2,232	3,480	4,063	Issue of Equity/ Preference	4,206	(1,229)	(383)	0
Extra Ordinary Exps/(Income)	(6)	(495)	0	0	Inc./ (Dec.) in Debt	5,530	5,567	(11,415)	1,500
Profit Before Tax	1,864	2,727	3,480	4,063	Interest exp net	(1,466)	(1,903)	(850)	(910)
Tax	452	387	696	813	Dividend Paid (Incl. Tax)	(107)	(136)	(136)	(136)
<b>Net Profit</b>	<b>1,412</b>	<b>2,340</b>	<b>2,784</b>	<b>3,251</b>	<b>(C) CF from Financing</b>	<b>8,163</b>	<b>2,299</b>	<b>(12,785)</b>	<b>454</b>
Minority Interest	187	95	32	30	Net Change in Cash	2,482	(719)	95	1,853
<b>Net Profit</b>	<b>1,224</b>	<b>2,245</b>	<b>2,752</b>	<b>3,221</b>	<b>Opening Cash balances</b>	<b>912</b>	<b>3,395</b>	<b>2,675</b>	<b>2,770</b>
<b>Adj. Net Profit</b>	<b>1,218</b>	<b>1,750</b>	<b>2,752</b>	<b>3,221</b>	<b>Closing Cash balances</b>	<b>3,395</b>	<b>2,675</b>	<b>2,770</b>	<b>4,624</b>

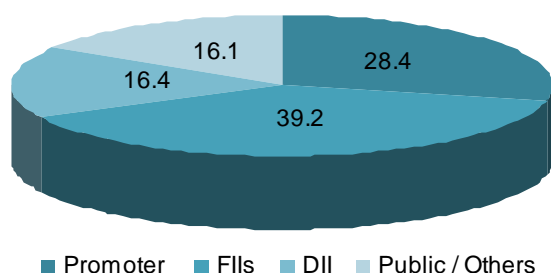
E-estimates

BALANCE SHEET				
Particulars	Dec'10	Dec'11	Dec'12E	Dec'13E
<b>Sources of Funds</b>				
Equity Capital	577	584	585	585
ESOP outstanding account	21	28	31	34
Share Premium	6,661	5,426	5,041	5,041
Other Reserves	5,568	7,677	10,293	13,378
<b>Net Worth</b>	<b>12,828</b>	<b>13,715</b>	<b>15,951</b>	<b>19,038</b>
Secured Loans	13,874	18,000	12,000	13,500
Unsecured Loans	6,224	7,665	2,250	2,250
<b>Loan Funds</b>	<b>20,098</b>	<b>25,665</b>	<b>14,250</b>	<b>15,750</b>
Deferred Tax Liability	31	(127)	(116)	(106)
Minority Interest	2,725	465	497	527
<b>Total Capital Employed</b>	<b>35,681</b>	<b>39,718</b>	<b>30,581</b>	<b>35,209</b>

<b>Applications of Funds</b>				
Gross Block	11,511	15,075	14,375	16,175
Less: Accumulated Depreciation	2,984	4,027	4,937	5,917
<b>Net Block</b>	<b>8,526</b>	<b>11,048</b>	<b>9,438</b>	<b>10,258</b>
Capital Work in Progress	1,915	4,550	1,000	1,000
<b>Goodwill</b>	<b>14,756</b>	<b>19,826</b>	<b>17,000</b>	<b>17,000</b>
<b>Investments</b>	<b>18</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Current Assets, Loans &amp; Advances</b>				
Inventories	3,120	4,799	4,984	6,060
Sundry Debtors	3,838	5,384	4,984	5,912
Cash and Bank Balance	3,395	2,675	2,770	4,624
Loans and Advances	8,840	4,543	2,000	3,000
Other Current Assets	412	1,597	1,246	1,478
<i>sub total</i>	19,604	18,999	15,985	21,074
<b>Current Liabilities &amp; Provisions</b>				
Current Liabilities	7,249	11,996	9,969	10,346
Provisions	1,988	2,709	2,873	3,776
<i>sub total</i>	9,236	14,705	12,842	14,122
Net Current Assets	10,367	4,294	3,143	6,951
<b>Total Assets</b>	<b>35,681</b>	<b>39,718</b>	<b>30,581</b>	<b>35,209</b>

E-estimates

#### Shareholding Pattern as on Mar'12 (%)



#### IMPORTANT RATIOS

Particulars	Dec'10	Dec'11	Dec'12E	Dec'13E
<b>(A) Measures of Performance (%)</b>				
EBIDTA Margin (excl. O.I.)	22.2	20.1	22.5	21.6
EBIDTA Margin (incl. O.I.)	22.5	20.1	22.5	21.6
Interest / Sales	8.6	7.5	3.7	3.4
Gross Profit Margin	14.2	12.7	18.8	18.3
Tax/PBT	24.2	14.2	20.0	20.0
Net Profit Margin	7.0	8.7	11.8	11.7

#### (B) As Percentage of Net Sales

Raw Material	45.7	49.0	48.0	48.9
Employee Expenses	12.8	11.7	11.6	11.5
Other Expenses	19.2	19.1	18.0	18.0

#### (C) Measures of Financial Status

Debt / Equity (x)	1.6	1.9	0.9	0.8
Interest Coverage (x)	2.7	2.7	6.2	6.5
Average Cost Of Debt (%)	8.5	8.3	4.3	6.1
Debtors Period (days)	83	78	80	80
Closing stock (days)	67	69	80	82
Inventory Turnover Ratio (x)	5.4	5.3	4.6	4.5
Fixed Assets Turnover (x)	1.5	1.7	1.6	1.7
Working Capital Turnover (x)	1.6	5.9	7.2	3.9
Non Cash Working Capital (₹ Mn)	6,973	1,619	373	2,328

#### (D) Measures of Investment

EPS (₹) (excl EO)	20.9	30.0	47.0	55.0
EPS (₹)	21.0	38.5	47.0	55.0
CEPS (₹)	32.3	56.3	62.6	71.8
DPS (₹)	1.6	2.0	2.0	2.0
Dividend Payout (%)	7.6	5.2	4.3	3.6
Profit Ploughback (%)	92.4	94.8	95.7	96.4
Book Value (₹)	222.1	234.9	272.5	325.2
RoANW (%)	11.6	16.9	18.6	18.4
RoACE (%)	10.9	11.0	12.3	15.1
RoAIC (%) (Excl Cash & Invest.)	11.7	11.9	13.4	17.0

#### (E) Valuation Ratios

CMP (₹)	645	645	645	645
P/E (x)	30.9	21.5	13.7	11.7
Market Cap. (₹ Mn.)	37,245	37,655	37,758	37,758
MCap/ Sales (x)	2.2	1.5	1.7	1.4
EV (₹ Mn.)	53,949	60,645	49,238	48,885
EV/Sales (x)	3.2	2.4	2.2	1.8
EV/EBDITA (x)	13.8	11.7	9.4	8.2
P/BV (x)	2.9	2.7	2.4	2.0
Dividend Yield (%)	0.2	0.3	0.3	0.3

E-estimates



*Intentionally Left Blank*

BUY	Upside above 20%
ACCUMULATE	Upside above 5% and up to 20%
REDUCE	Upside up to 5%
SELL	Negative Returns

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