21 January 2015

Suven Life Sciences

Niche business model at an inflexion; initiating with a Buy

Rating: **Buy**
Target Price: ₹336
Share Price: ₹220

We initiate coverage on Suven Life Sciences, with a Buy rating and a target price of ₹336. We are positive about the company considering its well-established niche business model with upward potential, sustainable revenue growth momentum, very high margins with no working-capital issues, a strong balance sheet and a 37% adjusted PAT CAGR over FY15-17e. In addition, successful monetisation of SUVN 502 (an innovative molecule) could offer further upside.

High-margin NCE-based CRAMS set to take off. Suven has a distinct niche business model of NCE-based CRAMS, which ensures long-term business stickiness with global pharma innovators. It has 99 CRAMS projects in the pipeline, and three molecules have reached the commercial stage. This could provide a sustainable revenue stream from FY16 (US$18m in FY17e). Further, capacity addition in specialty chemicals could improve revenue, from US$20m in FY14 to US$35m in FY16. We expect a 20% revenue CAGR in its base CRAMS business over FY15-17.

Good progress on innovative R&D. The company has built a strong NCE (new chemical entity) pipeline on its own, with 14 molecules mainly in the most lucrative CNS segment, where successful monetisation to drive further upside. SUVN 502 is the lead molecule and is in phase-II trials, which if successful could be monetised by FY17-end through out-licensing.

Sound financials. We expect Suven to register 23.1% revenue and 37.2% PAT CAGRs over FY15-17 along with EBITDA margin improvement of 400bps to 35.7%. Excluding innovative R&D, the margin could be 43.7% in FY17. The RoE and RoCE could, after factoring in the recent dilution, improve to, respectively, 28.8% and 26.2% by FY17.

Valuation. Our target price of ₹336 is based on 16x FY17e base business EPS (excluding R&D expenses), ₹167 for SUVN 502 based on probability-adjusted DCF valuations and reducing ₹114 for R&D expenses. **Risks:** Currency fluctuations and failure of SUVN 502.

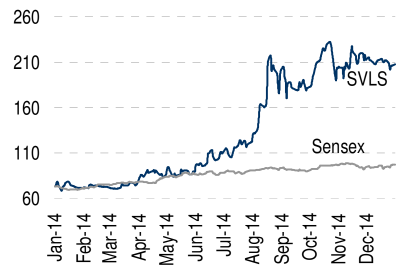
Key financials (YE Mar)	FY13	FY14	FY15e	FY16e	FY17e
Sales (₹m)	2,579	5,103	4,972	6,177	7,530
Net profit (₹m)	308	1,442	999	1,424	1,880
EPS (₹)	2.6	12.3	7.9	11.2	14.8
Growth (%)	114.7	367.4	-36.4	42.5	32.1
PE (x)	83.3	17.8	28.0	19.7	14.9
EV/EBITDA (x)	49.6	11.7	16.6	12.7	9.6
P/B (x)	16.6	9.7	5.2	4.6	4.0
RoE (%)	21.9	68.8	25.0	25.0	28.8
RoCE (%)	20.0	50.1	21.6	22.5	26.2
Dividend yield (%)	1.3	3.5	0.9	0.9	1.3
Net gearing (%)	50.6	(1.1)	(31.5)	(29.0)	(30.2)

Source: Company

Key data	SVLS IN / SUVP.BO
52-week high / low	₹236 / ₹67.5
Sensex / Nifty	28785 /8696
3-m average volume	US$ 3.1m
Market cap	₹28bn / US$0.45bn
Shares outstanding	127.3m

Shareholding pattern (%)	Dec '14	Sep'14	Jun '14
Promoters	59.4	64.8	64.8
- of which, Pledged	-	-	-
Free Float	40.6	35.2	35.2
- Foreign Institutions	2.8	1.4	0.8
- Domestic Institutions	6.5	0.6	0.6
- Public	31.3	33.3	33.8

Relative price performance



Source: Bloomberg

Sriram Rathi
+9122 6626 6737
sriramrathi@rathi.com

Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY13	FY14	FY15e	FY16e	FY17e
Net revenues	2,579	5,103	4,972	6,177	7,530
Revenue growth (%)	26.3	97.9	(2.6)	24.2	21.9
- Oper. expenses	2,047	2,913	3,396	4,111	4,844
EBIDTA	**532**	**2,191**	**1,576**	**2,066**	**2,686**
EBITDA margin (%)	20.6	42.9	31.7	33.5	35.7
- Interest expenses	135	105	50	50	50
- Depreciation	79	88	227	258	284
+ Other income	10	30	70	192	224
- Tax	20	586	370	351	520
Effective tax rate (%)	6	29	27	27	27
Reported PAT	308	1,442	999	949	1,406
+/- Extraordinary items	0	0	0	(650)	(650)
+/- Minority interest	0	0	0	0	0
Adjusted PAT	308	1,442	999	1,424	1,880
Adj. FDEPS (₹/sh)	2.6	12.3	7.9	11.2	14.8
Adj. FDEPS growth (%)	114.7	367.4	-36.4	42.5	32.1

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY13	FY14	FY15e	FY16e	FY17e
Share capital	117	117	127	127	127
Reserves & surplus	1,428	2,528	5,224	5,896	6,890
Net worth	1,545	2,644	5,351	6,023	7,018
Minority interest	0	0	0	0	0
Total debt	920	663	663	663	663
Def. tax liab. (net)	(157)	276	276	276	276
Capital employed	**2,308**	**3,583**	**6,291**	**6,962**	**7,956**
Net fixed assets	1,657	1,921	2,843	3,185	3,500
Investments	1	0	0	0	0
- of which, Liquid	1	0	0	0	0
Net working capital	433	968	1,013	1,286	1,588
Cash and bank balance	218	694	2,434	2,490	2,867
Capital deployed	**2,308**	**3,583**	**6,291**	**6,962**	**7,956**
Net debt	702	(32)	(1772)	(1828)	(2205)
WC days	69.5	66.6	91.2	84.4	83.9
Book value (₹/sh)	13.2	22.6	42.0	47.3	55.1

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY13	FY14	FY15e	FY16e	FY17e
PAT	328	1,442	999	949	1,406
+Non-cash items	98	88	227	258	284
Cash profit	425	1,530	1,227	1,208	1,690
- Incr./(Decr.) in WC	192	536	45	273	302
Operating cash flow	233	994	1,182	935	1,388
-Capex	199	378	1,150	600	600
Free-cash-flow	34	616	32	335	788
-Dividend	41	342	292	278	411
+ Equity raised	0	(0)	2,000	0	0
+ Debt raised	141	(257)	0	0	0
-Investments	(45)	(0)	0	0	0
-Misc. items	(8)	(458)	0	0	0
Net cash-flow	187	476	1,740	56	377
+Opening cash	32	218	694	2,434	2,490
Closing cash	218	694	2,434	2,490	2,867

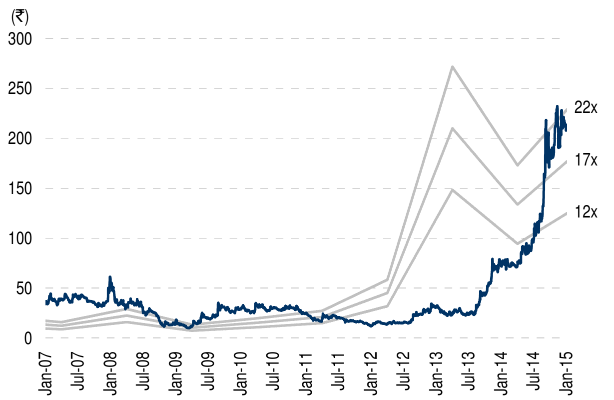
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @ ₹220

Year-end: Mar	FY13	FY14	FY15e	FY16e	FY17e
P/E (x)	83.3	17.8	28.0	19.7	14.9
P/B (x)	16.6	9.7	5.2	4.6	4.0
EV/EBITDA (x)	49.6	11.7	16.6	12.7	9.6
RoE (%)	21.9	68.8	25.0	25.0	28.8
RoCE (%)	20.0	50.1	21.6	22.5	26.2
Dividend yield (%)	1.3	3.5	0.9	0.8	1.3
Dividend payout (%)	11.4	20.3	25.0	25.0	25.0
Asset turnover (x)	0.9	1.3	0.8	0.8	0.8
Net Debt/Equity (x)	0.5	(0.0)	(0.3)	(0.3)	(0.3)
Net debt/EBITDA (x)	1.3	0.0	-1.1	-0.9	-0.8
Net debt/Op. CF (x)	3.0	0.0	-1.5	-2.0	-1.6
Interest coverage (x)	3.4	20.0	27.1	36.4	48.3
P/CEPS (x)	66.4	16.8	22.8	16.6	12.9
EV/ sales (x)	10.2	5.0	5.3	4.2	3.4
M-cap/sales (x)	10.0	5.0	5.6	4.5	3.7

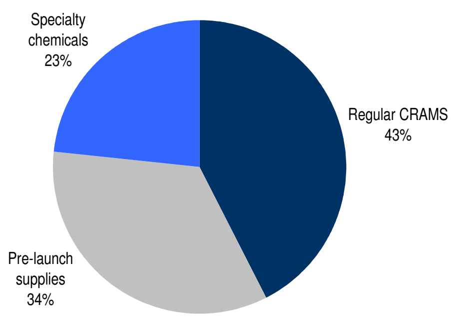
Source: Company, Anand Rathi Research

Fig 5 – PE band



Source: Bloomberg, Anand Rathi Research

Fig 6 – Segment-wise revenue break-up (FY14)



Source: Company

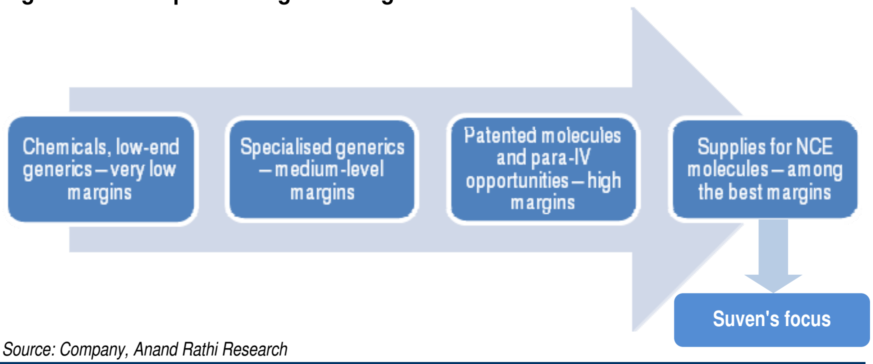
NCE-based CRAMS to take off

- Within CRAMS, Suven supplies intermediates for products being developed, commercialised products and specialty chemicals.
- Ninety-nine active CRAMS projects-under-development at different stages of trials contribute 43% to revenue and we expect a 21.7% revenue CAGR over FY14-17e.
- Commercial supplies for three products under patent would commence from FY16 and we expect Suven's commercial supplies revenue to increase to US$18m in FY17.
- We expect revenue from supplies for specialty chemicals to increase from US$20m in FY14 to US$38m in FY17.

Suven focuses on the highest value chain of CRAMS by supplying intermediates for NCE molecules. This affords it business stickiness and very high margins

Suven offers contract research and manufacturing services (CRAMS) across the value chain to its customers. It is a niche operator focused on providing CRAMS for drug discovery and development of molecules (new chemical entities, NCEs) for innovators, with 22 global pharmaceutical companies as its customers. It has already executed more than 700 NCE-based CRAMS projects since inception and is currently working on 99 such projects. The projects include process research, custom synthesis and NCEs based on APIs and intermediates. Its focus is on the highest value chain of CRAMS, which involves supplies of products for innovative molecules of the large pharma innovators, thereby providing it best-in-class margins (>35%) and a sustainable revenue stream on the success of the molecules.

Fig 7 – Suven's positioning in the highest value chain of CRAMS



Source: Company, Anand Rathi Research

Its present pipeline of 99 projects includes 52 molecules in phase I, 46 in phase II and one in phase III of the innovators to whom Suven is supplying the intermediates. The greater number of projects in phase II is encouraging as successful migration to phase III would lead to increased volume and value growth; also, supplies for phase II are substantially higher than those for phase I.

More molecules moving from phase I to phase II and III would improve revenue growth and profitability

Fig 8 – CRAMS pipeline

	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14
Number of products	250	274	313	358	408	471	515	551	590	645	696
Additions during the year	34	24	39	45	50	63	44	36	39	55	51
Dropped during the year	29	22	32	40	41	51	37	41	35	49	42
Currently active products	43	45	52	57	66	78	85	80	84	90	99
Products in phase I	17	15	26	30	32	39	48	47	51	46	52
Products in phase II	17	22	21	23	30	34	33	30	32	41	46
Products in phase III	9	8	5	4	4	5	4	3	1	3	1

Source: Company

The company has seen a consistent and healthy increase in phase II CRAMS projects, from 30 in FY11 to 46 in FY14, indicating a higher success rate in phase-I trials. This throws up potential for greater growth in future with better margins. It also increases the probability of more products moving to phase III, where volumes supplied are almost 10 times those in phase II.

Within CRAMS, it has three types of revenue streams, namely base CRAMS for products in development, CRAMS for commercial products and supplies for specialty chemicals.

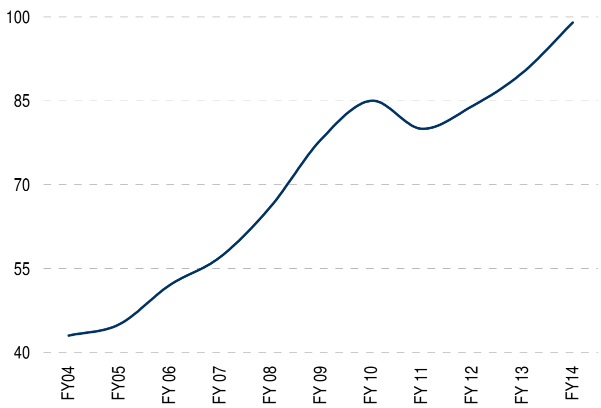
Consistent rise in the number of molecules in phase II, for which supplies are almost 10x those in phase I

Base CRAMS for products in development

Suven works with global innovator companies, supplying intermediates for their NCEs during the clinical phase of drug development; this, if successful, can potentially translate into long-term supply agreements. It is currently working on 99 such products and its customers are large global pharma companies focused on innovation, specialty pharmaceutical companies, biotech companies, etc. At present, Suven is working with 61 such companies for the 99 products and is supplying them with intermediates.

Generally, Suven gets a new product at phase I, which gradually moves further based on the innovator's success; the volume of intermediates supplied increases 10 times if the product moves to phase II and, similarly, if it moves to phase III. The profit margins in supplies for phase I are very low due to low volumes and involvement in R&D; margins improve substantially in phase II and phase III, however.

Fig 9 – Consistent increase in active products under CRAMS

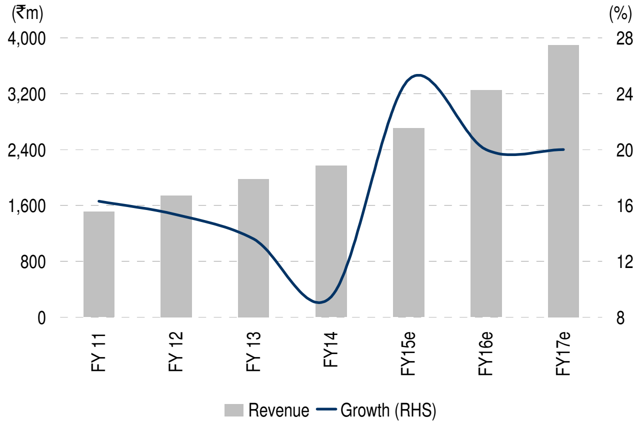


Source: Company

Expect a 21.6% revenue CAGR from CRAMS for NCE molecules in development

Over the years the company has experienced a consistent rise in the number of active products under CRAMS, for which intermediates are still being supplied, except in FY11. The drop in FY11 to 80 products (from 85 in FY10) was due to R&D portfolio restructuring by large pharma companies consequent on the 2009 global economic meltdown. However, management believes that this was positive as huge pharma companies have turned more focused on molecules which they are pursuing, than their earlier strategy of pursuing a number of molecules at one time and keeping several on hold despite success. This has also resulted in a significant rise in phase II molecules (from 30 in FY11 to 46 in FY14), for which Suven is supplying intermediates. We expect revenue from the base CRAMS business to register a 21.6% CAGR over FY14-17 driven by the consistent rise in number of active molecules and more molecules in phase II trials for the innovators.

Fig 10 – Growth to pick up in the base CRAMS business



Source: Company, Anand Rathi Research

Sustainable revenue stream from commercialised products

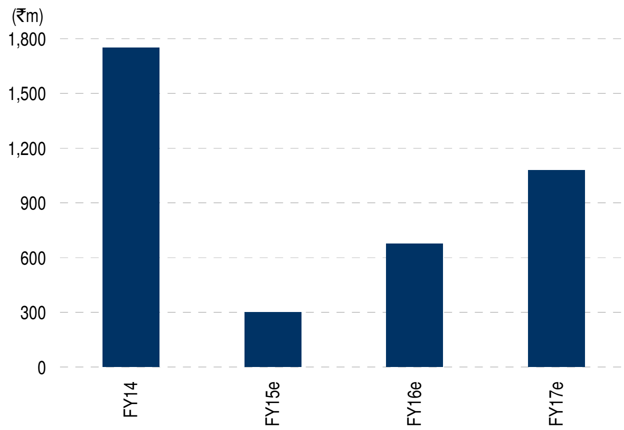
Repeat business from three commercialised molecules would start from FY16 and would become an annuity business for the company

In FY14 three products of its partner innovators successfully cleared phase III trials. (Suven had been supplying intermediates.) This resulted in huge orders for Suven, of US$30m in FY14 and an additional US$5m in 1QFY15, as pre-launch supplies from its partners. Since this was R&D pricing, Suven made a ~70% EBITDA margin and a ~50% net-profit margin on these supplies. The products have been commercialised on successful FDA approvals in FY15. The repeat business for these products is expected to commence from 1HFY16. (It takes 15-18 months for the innovators to develop formulations, obtain regulatory approvals and launch the products.)

The three products pertain to three therapeutic indications, namely rheumatoid arthritis for a US innovator, anti-depressant for a European innovator and anti-diabetes for a European innovator. We expect base annualised revenue from supplies for these three products to be ~US$15m considering 30% volume reduction (as pre-launch supplies are generally for 15-18 months' requirement) and an additional 30% price erosion (due to commercial pricing). Revenue would increase gradually based on a ramp-up in sales for the innovator in its home area and a launch of such products in new territories and countries.

We expect US$11m in revenue in FY16 and US$18m in FY17 from those products which have been commercialised

Fig 11 – Revenue from CRAMS for commercial products



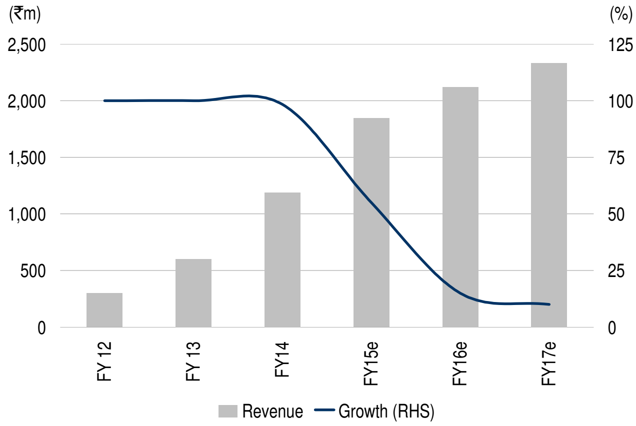
Source: Company, Anand Rathi Research

Capacity addition to boost revenue from specialty chemicals

The company is setting up a greenfield site in Visakhapatnam to increase capacity for specialty chemicals based on increased order sizes from customers

Suven is also supplying intermediates for one specialty chemical product to a large global conglomerate operating in pharmaceuticals and agro-chemicals. Supplies of this specialty chemical pertain to an agro-chemical product which has already been commercialised by the innovator and is under patent. Suven started supplying this product in FY12 with revenue of US$5m, which rose to US$20m in FY14. It is adding capacity at a greenfield plant in Visakhapatnam based on greater order size from the innovator, which would increase revenue for Suven, from US$20m now to US$35m by FY16. We expect revenue from specialty chemicals to register a 25.2% CAGR over FY14-17 to ₹2.3bn.

Fig 12 – Revenue from specialty chemicals



Source: Company, Anand Rathi Research

ANDA filings – An exercise in leverage

As a exercise in leverage, Suven is filing ANDAs, which would add to profitability

The company has a US FDA-approved formulations unit at its Pashamylaram, Andhra Pradesh, plant which has been built for Suven's own NCE pipeline for innovative R&D. However, utilisation at this unit is minimal as formulations are developed merely for trials. In order to leverage the formulations unit, Suven has started filing ANDAs for under-the-radar products with lower sales and where large pharmaceuticals are not in competition.

It has filed six ANDAs till now in partnership with marketing companies and, according to agreements, Suven would supply such products to partners at cost-plus-margins along with royalty on sales from the partners. One such product is Malathion lotion, developed and filed by Suven and which went into litigation with Taro Pharmaceuticals for patent infringement.

Later, Suven was granted an exclusive marketing license for its malathion lotion to Taro for the USA, Canada and Mexico. This product is used to treat scalp infection and is marketed as a brand-named product by Taro. Suven will manufacture and supply it to Taro at cost-plus-margins. In addition, Suven would receive royalty of US$2m-2.5m, which may increase depending upon rising sales of Taro.

Good progress on innovative R&D

- The company has successfully developed an NCE pipeline of 14 molecules largely aimed at the CNS segment, which is one of the fastest-growing categories.
- SUVN 502 is in the most advanced stage and is in phase II clinical trials. Successful completion of trials would lead to monetisation of this molecule, which would provide further upside to valuations.

Suven has also demonstrated its skill in innovation by developing 14 molecules, which are now at different stages of development

In addition to establishing itself in the NCE-based CRAMS business, Suven has also made good progress on its own innovative R&D in building its NCE pipeline. It began working on innovative R&D in FY04 and has built a strong NCE research pipeline of 14 molecules at different stages of development.

The focus of innovative R&D for Suven lies in the CNS category, which is the second-largest and fastest-growing therapeutic category, with huge un-met medical needs. Suven became the first collaborating Indian partner of an MNC in the innovative R&D field by partnering with Eli Lily in 2006 to develop NCEs together. After the 2008-09 global economic meltdown, however, Eli Lily restructured its portfolio and the partnership came to an end. Suven, though, continued to pursue its molecules and, as a result, now has a promising NCE pipeline of CNS molecules.

Promising NCE pipeline

Its promising NCE pipeline consists of 14 molecules, mainly in the CNS therapeutic category. The pipeline includes one molecule in phase-II trials and one in phase-I trials. Another two are expected to enter phase-I clinical trials in the next six months. Within CNS, Suven is developing molecules for cognition, Alzheimer's, schizophrenia, pain and major depressive disorders. CNS, though, is its prime focus. Suven's major thrust is into drug discoveries related to CNS, which have a market potential of more than US$120bn with cognitive disorders accounting for over US$30bn. It has received 678 product patents for 18 inventions and 35 process patents.

Fig 13 – NCE pipeline

	Design	Discovery	Pre Clinical	IND	Phase - I	Phase - II	Phase - III	Expected Launch
Neurodegenerative Diseases (MCI / Cognition / Alzheimer's / Schizophrenia)								
SUVN-501 (5-HT6 Antagonist)								
SUVN-502 (5-HT6 Antagonist)				2008	2009	2015		
SUVN-507 (5-HT6 Antagonist)								
SUVN-512 (5-HT6 Antagonist)				2016				
SUVN-976 (5-HT6 Antagonist)								
SUVN-D4010 (5-HT4 Partial Agonist)				2015	2015			
M1-PAM				2016				
SUVN-G3031 (Histamine-3)				2014	2014			
Pain / Major Depressive Disorder (MDD)								
nAChR Alpha-4 Beta-2 Antagonist (Pain)								
SUVN-911 (nAChR Alpha-4 Beta-2) (MDD)				2015	2015			
CB2 Agonist (Pain)				2016				
Obesity / Metabolic Disorders								
SUVN-504 (5-HT6 Antagonist)								
Histamine-3								
nAChR Alpha-4 Beta-2								

Source: Company

SUVN 502 – Earliest monetisation opportunity

SUVN 502 is a 5-HT6 antagonist and has entered phase-II clinical trials, indicated for treatment of patients with Alzheimer's. This molecule can also be tested to treat cognition problems and schizophrenia. Suven will conduct phase-II trials on 600 patients and test dosages up to 200mg. It will conduct phase-II trials in the US and expects to complete them by end-CY16. If successful, Suven will seek to license them out and monetise them.

Successful monetisation of SUVN 502 would provide upside potential

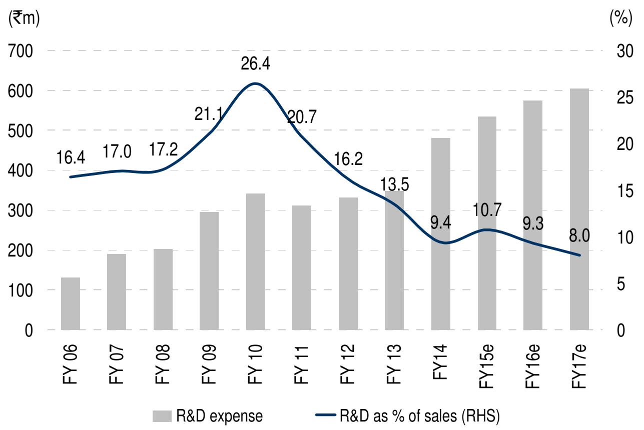
One similar molecule Lu AE58054 of Lundbeck, which is indicated for the same problems, was licensed to Otsuka Pharma in July'13 for an upfront US$150m, milestone payments of over US$600m and royalty on sales if launched successfully.

We believe that there would be good demand for such molecules from MNCs on successful completion of phase-II trials, considering the huge un-met medical requirement for these diseases in the US and non-availability of many drugs for them.

Expensing off R&D expenses

Suven has been expensing off the R&D expenses pertaining to its NCE pipeline through its income statement every year instead of capitalising them, as down by some of its peers. Non-capitalisation of innovative R&D expenses is considered to be the best accounting practice and, hence, indicates strong corporate governance. This is despite its revenue size being very small and R&D expenses more than its EBITDA until FY12. This resulted in depressed EBITDA margins over the years, though, excluding R&D expenses, the EBITDA margin had been healthy.

Fig 14 – R&D expenses being expensed off



Source: Company, Anand Rathi Research

Financials

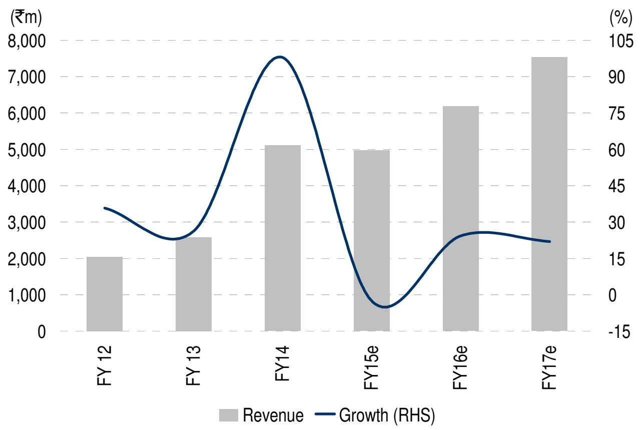
- We expect revenue to grow at a 23.1% CAGR over FY15-17, fueled by steady growth in its base CRAMS business for products being developed and a pickup in sales for supplies already for commercialised products.
- We estimate adjusted PAT to grow at a strong 37.2% CAGR, driven by strong revenue and a 400-bp margin expansion over FY15-17.
- Its balance sheet is strong with a net cash position and improving RoE and RoCE.

23.1% revenue CAGR over FY15-17

Strong traction in CRAMS for products being developed, increased capacity for specialty chemicals and repeat business from commercialised products would drive strong revenue growth

We expect a 23.1% revenue CAGR over FY15-17 to ₹7.5bn, driven by good traction in its base CRAMS business for NCEs under development, commercial supplies for three successful products to innovators and capacity addition in specialty chemicals based on greater order sizes from customers. The growth would be fuelled by a 20% revenue CAGR in the base CRAMS segment, a 12.5% CAGR in specialty chemicals and revenue from commercial supplies for three innovative drugs touching US$18m with yet upward potential.

Fig 15 – Revenue growth trend



Source: Company, Anand Rathi Research

Growth momentum strong across business segments

Fig 16 – Revenue break-up

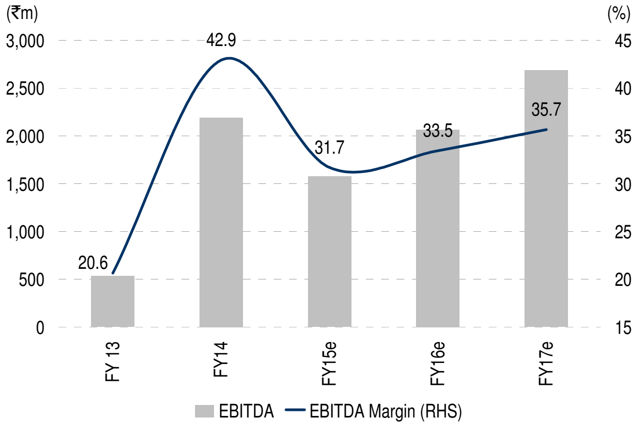
(₹m)	FY 13	FY14	FY15e	FY16e	FY17e
Base CRAMS	1,979	2,166	2,708	3,249	3,899
% growth	13.6	9.5	25.0	20.0	20.0
% of sales	76.7	42.4	54.5	52.6	51.8
Commercial supplies for 3 products	-	1,750	300	675	1,080
% growth		NA	(82.5)	125.0	60.0
% of sales	-	34.3	6.0	10.9	14.3
Specialty Chemicals	600	1,190	1,845	2,121	2,333
% growth	100.0	98.3	55.0	15.0	10.0
% of sales	23.3	23.3	37.1	34.3	31.0
Royalty from ANDAs	-	-	120	132	218
% growth	NA	NA	NA	10.0	65.0
% of sales	-	-	2.4	2.1	2.9
Total Revenue	**2,579**	**5,106**	**4,972**	**6,177**	**7,530**

Source: Company, Anand Rathi Research

EBITDA margin to be strong and register steady improvement

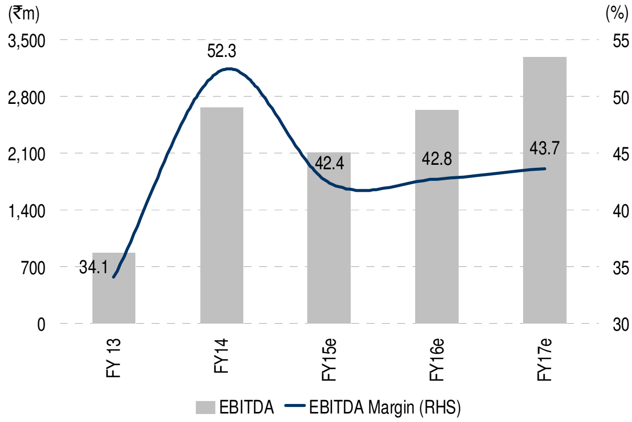
We expect a 400-bp improvement in the EBITDA margin over FY15-17, from 31.7% to 35.7%, driven by strong growth in its high-margin NCE-based CRAMS, added automated capacity for specialty chemicals, commencement of commercial supplies for three products from FY16 and a decrease in R&D costs (as percent of sales) due to the larger revenue base. In absolute terms, we expect EBITDA to register a 30.5% CAGR over FY15-17, led by strong revenue growth and improving margins. However, excl. innovative R&D, the FY17e margin would be 43.7%.

Fig 17 – EBITDA and margin trend (post-R&D)



Source: Company, Anand Rathi Research

Fig 18 – EBITDA and margin trend (pre-R&D)



Source: Company, Anand Rathi Research

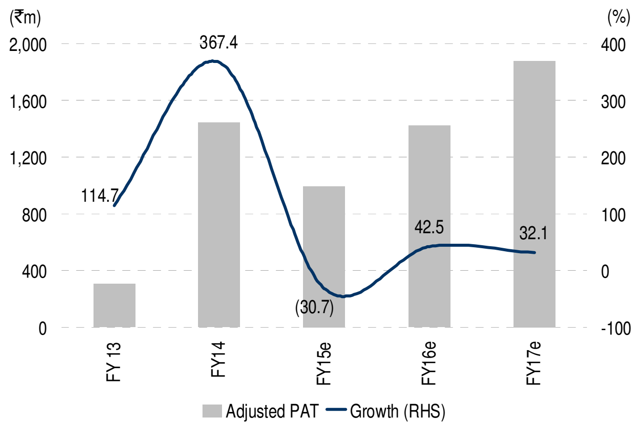
37.2% adjusted-net-profit CAGR

Margin improvement and decent revenue growth to result in strong PAT growth

We expect the company to register a 37.2% CAGR over FY15-17 in adjusted net profit to ₹1.88bn, boosted by strong revenue growth and EBITDA margin expansion. The growth in net profit, we estimate, would be considerably more than that in revenue, largely because of the EBITDA-margin expansion and no major increase in depreciation charge or interest cost.

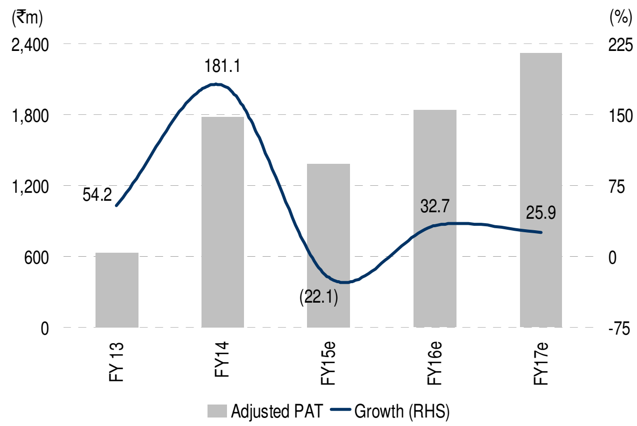
The net profit margin, too, would improve, from 20.1% in FY15 to 25% in FY17, driven by the strong PAT growth. The expected decline in FY15 adjusted PAT would be because of the very high base from FY14, which saw pre-launch supplies of US$30m with a 70% EBITDA margin and a ~30% PAT margin. Excluding that, PAT growth would be healthy.

Fig 19 – Growth in adjusted PAT (post-R&D)



Source: Company, Anand Rathi Research

Fig 20 – Growth in adjusted PAT (pre-R&D)



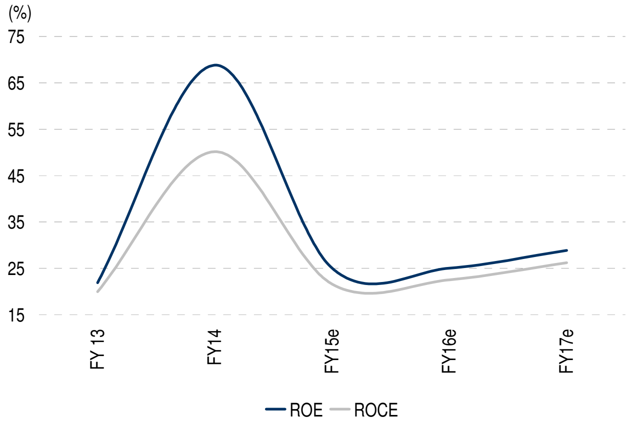
Source: Company, Anand Rathi Research

Better return ratios

RoE and RoCE to be affected in FY15 due to the recent equity dilution. We expect them to improve, however, from FY16

Considering the strong net-profit growth and better margins in the next three years, we expect substantial improvement in return ratios. We estimate the RoE and RoCE to improve from 25% and 21.6% in FY15, respectively, to 28.8% and 26.2% in FY17 after factoring in the recent equity dilution of ₹2bn, which is expected to generate returns from FY17. The decline from FY14 levels is due to the huge pre-launch supplies of the three molecules in FY14.

Fig 21 – Improving return ratios



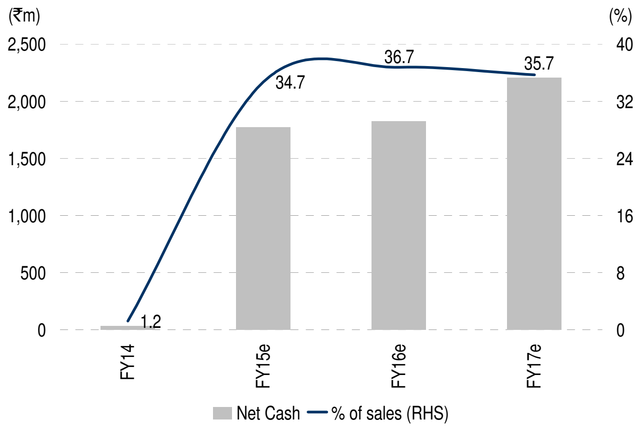
Source: Company, Anand Rathi Research

Strong balance sheet

Strong profitability to improve cash position, leading to a strong balance sheet

Suven has a very healthy balance sheet and became a zero-debt company at end-FY14. Most of the planned capex would also be managed through internal accruals. Further, the company recently raised ₹2bn through equity dilution by way of a QIP (qualified institutional placement), which would help fund the capex program for its CRAMS business and take care of ~US$25m investment in phase-II trials of the SUVN 502 NCE molecule.

Fig 22 – Net cash position



Source: Company, Anand Rathi Research

Fig 23 – Income statement (₹ m)

Y/E March	FY13	FY14	FY15e	FY16e	FY17e
Revenues	**2,579**	**5,103**	**4,972**	**6,177**	**7,530**
Growth in revenues (%)	*26.3*	*97.9*	*(2.6)*	*24.2*	*21.9*
Raw materials	813	1,365	1,601	1,995	2,413
% of Sales	*31.5*	*26.8*	*32.2*	*32.3*	*32.0*
Personnel expenses	234	314	388	453	548
% of Sales	*9.1*	*6.2*	*7.8*	*7.3*	*7.3*
Selling and other expenses	653	753	873	1,088	1,280
% of Sales	*25.3*	*14.8*	*17.6*	*17.6*	*17.0*
R&D expenses	347	479	534	574	603
% of Sales	*13.5*	*9.4*	*10.7*	*9.3*	*8.0*
EBITDA	**532**	**2,191**	**1,576**	**2,066**	**2,686**
EBITDA Margin (%)	*20.6*	*42.9*	*31.7*	*33.5*	*35.7*
Depreciation	79	88	227	258	284
PBIT	**453**	**2,102**	**1,348**	**1,808**	**2,401**
Interest expenses	135	105	50	50	50
PBIT from operations	**318**	**1,997**	**1,298**	**1,758**	**2,352**
Other non operating income	10	30	70	192	224
PBT before extra-ordinary items	329	2,027	1,369	1,950	2,576
Extraordinary income/ (expenses)	-	-	-	(650)	(650)
PBT	329	2,027	1,369	1,300	1,926
Provision for tax	20	586	370	351	520
Effective tax rate	*6.1*	*28.9*	*27.0*	*27.0*	*27.0*
PAT	**308**	**1,442**	**999**	**949**	**1,406**
Minority Interest	-	-	-	-	-
PAT after minority interest	**308**	**1,442**	**999**	**949**	**1,406**
Adjusted PAT	**308**	**1,442**	**999**	**1,424**	**1,880**
Growth in PAT (%)	*114.7*	*367.4*	*(30.7)*	*42.5*	*32.1*
PAT margin (%)	*12.0*	*28.2*	*20.1*	*23.0*	*25.0*

Source: Company, Anand Rathi research

Fig 24 – Balance sheet (₹ m)

Y/E March	FY13	FY14	FY15e	FY16e	FY17e
Equity Share Capital	117	117	127	127	127
Reserves	1,428	2,528	5,224	5,896	6,890
Shareholders' fund	1,545	2,644	5,351	6,023	7,018
Minority Interest	-	-	-	-	-
Debt	920	663	663	663	663
Deferred Tax Liability	(157)	276	276	276	276
Total Capital Employed	**2,308**	**3,583**	**6,290**	**6,962**	**7,956**
Gross Block	2,383	2,674	3,824	4,124	4,624
Accumulated depreciation	768	882	1,109	1,367	1,652
Net Block	1,615	1,792	2,715	2,757	2,972
Capital WIP	41	128	128	428	528
Total Fixed Assets	1,657	1,921	2,843	3,185	3,500
Investments	1	0	0	0	0
Inventories	538	786	917	1,110	1,308
Debtors	238	655	638	792	966
Cash and bank balances	218	694	2,434	2,490	2,867
Loans and Advances	333	807	786	947	1,127
Other current / non current assets	200	4	3	4	5
Total current assets	1,527	2,945	4,778	5,343	6,273
Current liabilities and provisions	877	1,283	1,331	1,567	1,818
Net current assets	650	1,662	3,447	3,776	4,455
Misc. Expenditure	-	-	-	-	-
Total Assets	**2,308**	**3,583**	**6,290**	**6,962**	**7,956**

Source: Company, Anand Rathi research

Fig 25 – Cash flow statement (₹ m)

Y/E March	FY13	FY14	FY15e	FY16e	FY17e
Cash flow from operating activities					
Profit before tax	329	2,027	1,369	1,300	1,926
Depreciation	79	88	227	258	284
Interest expenses	135	105	50	50	50
Operating profit before working capital change	**542**	**2,221**	**1,646**	**1,608**	**2,260**
Working capital adjustment	147	535	44	273	302
Gross cash generated from operations	**395**	**1,686**	**1,602**	**1,336**	**1,958**
Direct taxes paid	1	586	370	351	520
Cash generated from operations	**394**	**1,100**	**1,232**	**985**	**1,438**
Cash flow from investing activities					
Capex	(174)	(352)	(1,150)	(600)	(600)
Investment	45	0	(0)	(0)	(0)
Cash generated from investment activities	**(130)**	**(352)**	**(1,150)**	**(600)**	**(600)**
Cash flow from financing activities					
Proceeds from share capital and premium	0	(0)	2,000	-	-
Borrowings/ (Repayments)	141	(257)	-	-	-
Interest paid	(135)	(105)	(50)	(50)	(50)
Dividend paid	(41)	(342)	(292)	(278)	(411)
Cash generated from financing activities	**(35)**	**(704)**	**1,658**	**(327)**	**(461)**
Others	(43)	432	-	(1)	-
Net cash increase/ (decrease)	**187**	**476**	**1,740**	**56**	**377**

Source: Company, Anand Rathi research

Fig 26 – Ratios

Y/E March	FY13	FY14	FY15e	FY16e	FY17e
Margin Ratios (%)					
EBITDA margin	20.6	42.9	31.7	33.5	35.7
PBIT margin	17.6	41.2	27.1	29.3	31.9
PBT margin	12.7	39.7	27.5	21.1	25.6
PAT margin	12.0	28.2	20.1	23.0	25.0
Growth Ratios (%)					
Revenues	26.3	97.9	(2.6)	24.2	21.9
EBITDA	129.8	311.9	(28.1)	31.2	30.0
Net Profit	114.7	367.4	(30.7)	42.5	32.1
Return Ratios (%)					
RoCE	20.0	50.1	21.6	22.5	26.2
RoIC	19.4	52.5	26.9	32.7	37.7
RoE	21.9	68.8	25.0	25.0	28.8
Turnover Ratios (x)					
Asset turnover ratio (x)	0.9	1.3	0.8	0.8	0.8
Working capital cycle (days)	70	67	91	84	84
Average collection period (days)	35	32	47	42	43
Average payment period (days)	55	48	48	48	50
Inventory holding (days)	89	83	92	90	91
Per share (₹)					
EPS	2.6	12.3	7.9	11.2	14.8
CEPS	3.3	13.1	9.6	13.2	17.0
Book Value	13.2	22.6	42.0	47.3	55.1
Solvency ratios (x)					
Net Debt/ Equity	0.5	0.0	(0.3)	(0.3)	(0.3)
Interest coverage	3.4	20.0	27.1	36.4	48.3
Net Debt/ EBITDA	1.3	(0.0)	(1.1)	(0.9)	(0.8)
Valuation parameters (x)					
P/E	83.3	17.8	28.0	19.7	14.9
P/BV	16.6	9.7	5.2	4.6	4.0
EV/ EBITDA	49.6	11.7	16.6	12.7	9.6
EV/ Sales	10.2	5.0	5.3	4.2	3.4
M-Cap/ Sales	10.0	5.0	5.6	4.5	3.7

Source: Company, Anand Rathi research

Valuation

Considering the expected strong, 37.2%, adjusted PAT CAGR over FY15-17 with upward potential, the strong balance sheet, improving return ratios and good corporate governance practices, we are sanguine about the long-term outlook for the company. The stock has experienced a strong valuation re-rating in the past 18 months as the company reported substantial improvement in revenue growth, margins and profitability from 1QFY14, fueled by the commencement of pre-launch supplies for three NCE-based CRAMS molecules, which have successfully cleared phase-III trials. Further, visibility about a sustainable revenue stream from FY16 has improved following commercial supplies for those three molecules and larger order sizes for specialty chemicals.

We initiate coverage on the stock, with a Buy rating and a target price of ₹336, implying 53% upside

At present, the stock trades at 19.7x FY16e and 14.9x FY17e earnings. Excluding R&D expenses pertaining to innovative R&D, however, it quotes at 15.2x FY16e and 12.1x FY17e earnings. We initiate coverage on Suven Life Sciences with a Buy recommendation and a target price of ₹336 a share. Our target price is based on 16x FY17e base business EPS (excl. NCE-related R&D expenses), ₹167 a share for SUVN 502 based on probability-adjusted DCF valuations and reducing ₹114 a share for R&D expenses pertaining to innovative R&D including the US$25m to be incurred for phase-II trials of SUVN 502. We have assumed a 10% constant increase in annually recurring R&D and WACC (weighted average cost of capital) of 15%.

Fig 27 – Valuation methodology

	₹ m
PAT (FY17e)	1,880
Add: NCE R&D cost, post-tax	374
Base business PAT, pre-R&D	2,255
Diluted no. of equity shares (m)	127
Base business EPS (₹)	17.7
Target P/E (x)	16
Base business value per share (₹)	283
Add: probability-adjusted DCF value per share of SUVN 502 (₹)	167
Less: R&D expenses per share (₹)	114
Target price per share (₹)	**336**

Source: Anand Rathi research

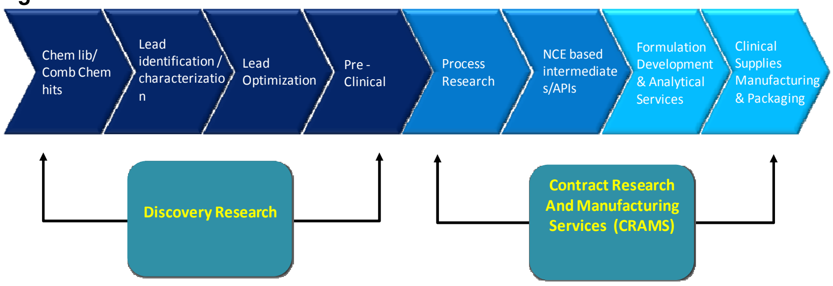
Company Background & Management

Company overview

Gradual and successful emergence of business – from NCE-based CRAMS to innovation

Promoted by Venkateswarlu Jasti, Suven Life Sciences started off as just a bulk- drug manufacturing company in 1989, then gradually established itself as a full-fledged bio-pharmaceuticals one. It has successfully emerged from general CRAMS to drug discovery and development and further to collaborative long-term research partnerships. It is also a leader in CNS-based internal discovery in India. Suven has more than 50% of its employees in its R&D department across analytical development, discovery, process R&D and formulations development.

Fig 28 – Business model

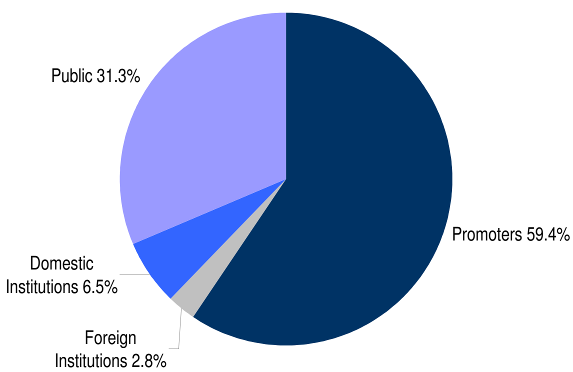


Source: Company

Suven's drug-discovery portfolio has a promising NCE research pipeline of thirteen molecules covering several therapies such as major depressive disorders (MDD), obesity and pain through neuronal nicotinic receptor modulators. It has 678 product patents for 18 inventions, and 35 process patents. It has a strong research set-up with a team of 386 scientists, of which 30 are PhDs.

Suven has been following prudent governance practices over the years. It has generally written off research and development expenses every year through its income statement, including expenses pertaining to innovative research and development. Hence, there are no intangible assets in the balance sheet pertaining to R&D. The company has five independent directors and two executive directors including one woman director. This indicates a fairly independent board. Further, it has been consistently paying dividends each year.

Fig 29 – Shareholding pattern



Source: BSE

Fig 30 – Management and Board of Directors

Name	Position	Profile
Board of Directors		
Venkateswarlu Jasti	Chairman & CEO	The promoter holds a master's degree in pharmacy from Andhra University along with master's in science from St. John University, New York. He was president of the Essex County Pharmaceutical Society of New Jersey in 1988, He was president of the Indian Pharmaceutical Association in 2000-2002, President of the Bulk Drug Manufacturers Association of India in 2002-04 and Chairman of the Pharmaceutical Export Promotion Council for 2006-09.
Sudha Rani Jasti	Whole Time Director	Holds a bachelor's degree in science and handles administrative matters and operations
Maripuri Rangaswamy Naidu	Independent Director	Has a doctorate from Nagarjuna University and was chairman of Hindustan Machine Tools
KV Raghvan	Independent Director	A doctorate from IIT, Chennai, and a fellow of the National Academy of Engineering, Indian Institute of Chemical Engineers, Andhra Pradesh, Academy of Sciences and the University of Grants Commission
Govinda Prasad Dasu	Independent Director	A member of ICAI and associated with Canara Cank and Exim Bank. Has experience in trade finance, international finance, corporate strategies, loan syndications and co-financing with multilateral agencies
Seyed Ehtesham Hasnain	Independent Director	A doctorate from the Jawaharlal Nehru University and a post-doctoral Fellowship from the University of Alberta, Canada, and Texas A&M University. A recipient of the Padmashri Award. Was a member of the Scientific Advisory Council to the Prime Minister during 2004-2014. Was honoured by the president of Germany with Bundesverdienstkreuz, Class 1 (Federal Cross of the Order of Merit)
Gopalakrishna Muddusetty	Independent Director	Was an Indian Administrative Services officer. Has, in the past, worked for the government of India, governments of Assam and Andhra Pradesh. Retired in 1997 as chairman of the Rural Electrification Corporation
Key Management personnel		
Dr N V S Ramakrishna	VP - Drug Discovery	Holds a master's degree in science from Andhra University and a doctor of philosophy in skeleton re-arrangements, interactions in phenyl-acetylenes and azathi-benzanilides on electron impact from IIT, Madras. Also holds a post-graduate diploma in patent laws and practice.
Dr C. Rajendiran	VP - R&D	Master's in science and doctor of philosophy in natural product chemistry from the University of Madras; experience of over two decades in organic & chemical products and process development
M Mohan Rao	VP - Business Dvpt & Regulatory Affairs	Technical consultant and responsible for developing and monitoring marketing strategies

Source: Company

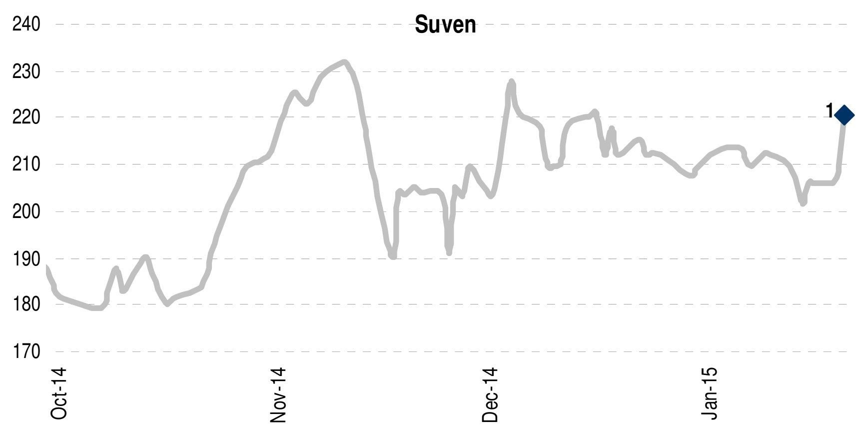
Appendix

Analyst Certification

The views expressed in this Research Report accurately reflect the personal views of the analyst(s) about the subject securities or issuers and no part of the compensation of the research analyst(s) was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report. The research analysts are bound by stringent internal regulations and also legal and statutory requirements of the Securities and Exchange Board of India (hereinafter "SEBI") and the analysts' compensation are completely delinked from all the other companies and/or entities of Anand Rathi, and have no bearing whatsoever on any recommendation that they have given in the Research Report.

Important Disclosures on subject companies

Rating and Target Price History (as of 21 January 2014)



	Date	Rating	TP (₹)	Share Price (₹)
1	21-Jan-15	Buy	336	220

Anand Rathi Ratings Definitions

Analysts' ratings and the corresponding expected returns take into account our definitions of Large Caps (>US$1bn) and Mid/Small Caps (<US$1bn) as described in the Ratings Table below:

Ratings Guide

	Buy	Hold	Sell
Large Caps (>US$1bn)	>15%	5-15%	<5%
Mid/Small Caps (<US$1bn)	>25%	5-25%	<5%

Anand Rathi Research Ratings Distribution (as of 20 January 2015)

	Buy	Hold	Sell
Anand Rathi Research stock coverage (196)	60%	27%	13%
% who are investment banking clients	4%	0%	0%

Research Disclaimer and Disclosure inter-alia as required under Securities and Exchange Board of India (Research Analysts) Regulations, 2014

Anand Rathi Share and Stock Brokers Ltd. (hereinafter refer as ARSSBL) (Research Entity) is a subsidiary of Anand Rathi Financial Services Ltd. ARSSBL is a corporate trading and clearing member of Bombay Stock Exchange Ltd, National Stock Exchange of India Ltd. (NSEIL), Multi Stock Exchange of India Ltd (MCX-SX), United Stock Exchange and also depository participant with National Securities Depository Ltd (NSDL) and Central Depository Services Ltd. ARSSBL is engaged in the business of Stock Broking, Depository Participant and Mutual Fund distributor.

The research analysts, strategists, or research associates principally responsible for the preparation of Anand Rathi research have received compensation based upon various factors, including quality of research, investor client feedback, stock picking, competitive factors and firm revenues.

General Disclaimer: This Research Report (hereinafter called "Report") is meant solely for use by the recipient and is not for circulation. This Report does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. The recommendations, if any, made herein are expression of views and/or opinions and should not be deemed or construed to be neither advice for the purpose of purchase or sale of any security, derivatives or any other security through ARSSBL nor any solicitation or offering of any investment /trading opportunity on behalf of the issuer(s) of the respective security (ies) referred to herein. These information / opinions / views are not meant to serve as a professional investment guide for the readers. No action is solicited based upon the information provided herein. Recipients of this Report should rely on information/data arising out of their own investigations. Readers are advised to seek independent professional advice and arrive at an informed trading/investment decision before executing any trades or making any investments. This Report has been prepared on the basis of publicly available information, internally developed data and other sources believed by ARSSBL to be reliable. ARSSBL or its directors, employees, affiliates or representatives do not assume any responsibility for, or warrant the accuracy, completeness, adequacy and reliability of such information / opinions / views. While due care has been taken to ensure that the disclosures and opinions given are fair and reasonable, none of the directors, employees, affiliates or representatives of ARSSBL shall be liable for any direct, indirect, special, incidental, consequential, punitive or exemplary damages, including lost profits arising in any way whatsoever from the information / opinions / views contained in this Report. The price and value of the investments referred to in this Report and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance. ARSSBL does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding taxation aspects of any potential investment.

Opinions expressed are our current opinions as of the date appearing on this Research only. We do not undertake to advise you as to any change of our views expressed in this Report. Research Report may differ between ARSSBL's RAs and/ or ARSSBL's associate companies on account of differences in research methodology, personal judgment and difference in time horizons for which recommendations are made. User should keep this risk in mind and not hold ARSSBL, its employees and associates responsible for any losses, damages of any type whatsoever.

ARSSBL and its associates or employees may; (a) from time to time, have long or short positions in, and buy or sell the investments in/ security of company (ies) mentioned herein or (b) be engaged in any other transaction involving such investments/ securities of company (ies) discussed herein or act as advisor or lender / borrower to such company (ies) these and other activities of ARSSBL and its associates or employees may not be construed as potential conflict of interest with respect to any recommendation and related information and opinions. Without limiting any of the foregoing, in no event shall ARSSBL and its associates or employees or any third party involved in, or related to computing or compiling the information have any liability for any damages of any kind.

Details of Associates of ARSSBL and Brief History of Disciplinary action by regulatory authorities & its associates are available on our website i. e. www.rathi.com

Disclaimers in respect of jurisdiction: This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would subject ARSSBL to any registration or licensing requirement within such jurisdiction(s). No action has been or will be taken by ARSSBL in any jurisdiction (other than India), where any action for such purpose(s) is required. Accordingly, this Report shall not be possessed, circulated and/or distributed in any such country or jurisdiction unless such action is in compliance with all applicable laws and regulations of such country or jurisdiction. ARSSBL requires such recipient to inform himself about and to observe any restrictions at his own expense, without any liability to ARSSBL. Any dispute arising out of this Report shall be subject to the exclusive jurisdiction of the Courts in India.

Statements on ownership and material conflicts of interest, compensation - ARSSBL and Associates

Answers to the Best of the knowledge and belief of ARSSBL/ its Associates/ Research Analyst who is preparing this report

ARSSBL/its Associates/ Research Analyst/ his Relative have any financial interest in the subject company? Nature of Interest (if applicable)	No
ARSSBL/its Associates/ Research Analyst/ his Relative have actual/beneficial ownership of one per cent or more securities of the subject company	No
ARSSBL/its Associates/ Research Analyst/ his Relative have any other material conflict of interest at the time of publication of the research report or at the time of public appearance?	No
ARSSBL/its Associates/ Research Analyst/ his Relative have received any compensation from the subject company in the past twelve months	Yes
ARSSBL/its Associates/ Research Analyst/ his Relative have managed or co-managed public offering of securities for the subject company in the past twelve months	Yes
ARSSBL/its Associates/ Research Analyst/ his Relative have received any compensation for investment banking or merchant banking or brokerage services from the subject company in the past twelve months	Yes
ARSSBL/its Associates/ Research Analyst/ his Relative have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past twelve months	No
ARSSBL/its Associates/ Research Analyst/ his Relative have received any compensation or other benefits from the subject company or third party in connection with the research report	No

Other Disclosures pertaining to distribution of research in the United States of America

This material was produced by ARSSBL, solely for information purposes and for the use of the recipient. It is not to be reproduced under any circumstances and is not to be copied or made available to any person other than the recipient. It is distributed in the United States of America by Enclave Capital LLC (19 West 44th Street, Suite 1700, New York, NY 10036) and elsewhere in the world by ARSSBL or an authorized affiliate of ARSSBL (such entities and any other entity, directly or indirectly, controlled by ARSSBL, the "Affiliates"). This document does not constitute an offer of, or an invitation by or on behalf of ARSSBL or its Affiliates or any other company to any person, to buy or sell any security. The information contained herein has been obtained from published information and other sources, which ARSSBL or its Affiliates consider to be reliable. None of ARSSBL or its Affiliates accepts any liability or responsibility whatsoever for the accuracy or completeness of any such information. All estimates, expressions of opinion and other subjective judgments contained herein are made as of the date of this document. Emerging securities markets may be subject to risks significantly higher than more established markets. In particular, the political and economic environment, company practices and market prices and volumes may be subject to significant variations. The ability to assess such risks may also be limited due to significantly lower information quantity and quality. By accepting this document, you agree to be bound by all the foregoing provisions.

1. ARSSBL or its Affiliates may or may not have been beneficial owners of the securities mentioned in this report.

2. ARSSBL or its affiliates may have or not managed or co-managed a public offering of the securities mentioned in the report in the past 12 months.

3. ARSSBL or its affiliates may have or not received compensation for investment banking services from the issuer of these securities in the past 12 months and do not expect to receive compensation for investment banking services from the issuer of these securities within the next three months.

4. However, one or more of ARSSBL or its Affiliates may, from time to time, have a long or short position in any of the securities mentioned herein and may buy or sell those securities or options thereon, either on their own account or on behalf of their clients.

5. As of the publication of this report, ARSSBL does not make a market in the subject securities.

6. ARSSBL or its Affiliates may or may not, to the extent permitted by law, act upon or use the above material or the conclusions stated above, or the research or analysis on which they are based before the material is published to recipients and from time to time, provide investment banking, investment management or other services for or solicit to seek to obtain investment banking, or other securities business from, any entity referred to in this report.

Enclave Capital LLC is distributing this document in the United States of America. ARSSBL accepts responsibility for its contents. Any US customer wishing to effect transactions in any securities referred to herein or options thereon should do so only by contacting a representative of Enclave Capital LLC.

Additional information on recommended securities/instruments is available on request.

ARSSBL registered address: 4th Floor, Silver Metropolis, Jaicoach Compound, Opposite Bimbisar Nagar, Goregaon (East), Mumbai - 400 063.
Tel No: +91 22 4001 3700 | Fax No: +91 22 4001 3770 | CIN: U67120MH1991PLC064106.