Strides Shasun

BUY

INDUSTRY	PHARMA
CMP *(as on 16 Oct 2017)*	**Rs 881**
Target Price	**Rs 1,200**
Nifty	10,231
Sensex	32,634
KEY STOCK DATA	
Bloomberg	STR IN
No. of Shares (mn)	89
MCap (Rs bn) / ($ mn)	79/1,218
6m avg traded value (Rs mn)	368

STOCK PERFORMANCE (%)			
52 Week high / low			**Rs 1,275/832**
	3M	**6M**	**12M**
Absolute (%)	(17.1)	(21.5)	(11.2)
Relative (%)	(18.3)	(31.6)	(28.4)

SHAREHOLDING PATTERN (%)	
Promoters	31.1
FIs & Local MFs	14.6
FPIs	34.5
Public & Others	19.8

Source : BSE

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Specialist in wealth creation

Over the last decade, Strides Shasun (STR) has given its shareholders a phenomenal ~30% compounded annual return. Capital invested in Oct-07 would have grown ~10x today. While STR's aggressive M&A activity can be viewed negatively in-terms of capital allocation, its track record of value creation cannot be questioned. The company's philosophy on this remains unchanged and its focus remains firmly on enhancing shareholder wealth.

Post the sale of the Agila Specialties division in 2013, STR's top-line has grown at 47% CAGR, driven by both organic and inorganic expansion. STR has now rebuilt its businesses in Australia and the US and the majority of investments are now complete. These businesses are hence likely to grow at a fast clip, resulting in top-line/earnings CAGR of 18%/34% over FY17-20E (adj. for API hive-off). We believe that STR possesses the potent combination of a diversified business mix, strong regulatory record, high growth potential and comfortable valuation. Initiate coverage with BUY rating and a TP of Rs 1,200 (18x Sep-19E + Rs 100/sh for Solara + Rs 30/sh for the biopharma investments).

- **The US is gaining mass again:** Post the Agila sale in 2013, STR has since re-built its US business and filed 40 ANDAs. Focus has been on launching products in differentiated categories like softgels, modified releases and topicals. At present, there are 26 ANDAs pending with the US FDA, most being post-GDUFA. With 20+ launches expected over the next two years, we believe that the US business will scale up from US$ 95mn in FY17 to US$ 230mn by FY20. Launches like potassium citrate, gLovaza, gGilenya and gRenvela/gRenagel would be key growth drivers.
- **Australian investments to pay off:** At present, STR is the third largest company in the region. Tie-ups with organizations like Sigma and Pharmacy Alliance have given STR priority access to 20% of Australian pharmacies. Going ahead, the focus is on launching more products from its pipeline and start manufacturing in India and Singapore, which will more than offset the impact of PBS price erosion and facilitate top-line CAGR of 13-14% over FY17-20E.
- **Improving fundamentals:** Return ratios currently look unimpressive, owing to the recent investments that are yet to play out. However, with no major capex planned, and operating leverage to aid margins in both the US and Australia, we expect return ratios to reach high-teens by FY20E. This will be driven by both a better product mix and higher asset turnover.
- **Valuation and view:** At CMP, the stock is trading at 17x FY19E and 13x FY20E, a discount to mid-cap peers. We believe that this discount is likely to contract once the US approvals run-rate picks up.

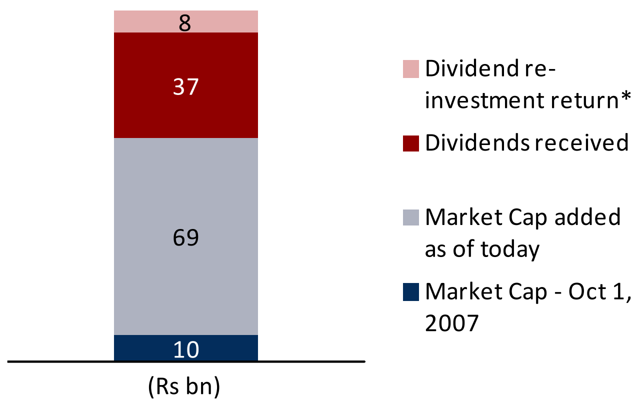
Financial Summary

YE Mar (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Net Sales	28,044	34,131	35,360	39,888	46,810
EBITDA	4,140	6,428	6,471	7,658	9,596
APAT	1,085	3,997	3,578	4,592	6,040
Adj. EPS (Rs/sh)	20.8	34.0	40.0	51.3	67.5
P/E (x)	48.8	15.8	22.0	17.2	13.1
RoE (%)	8.4	13.1	13.7	15.7	18.0

Source: Company, HDFC sec Inst Research

Strong track record of value creation

Shareholder Wealth Added By STR Since Oct-07

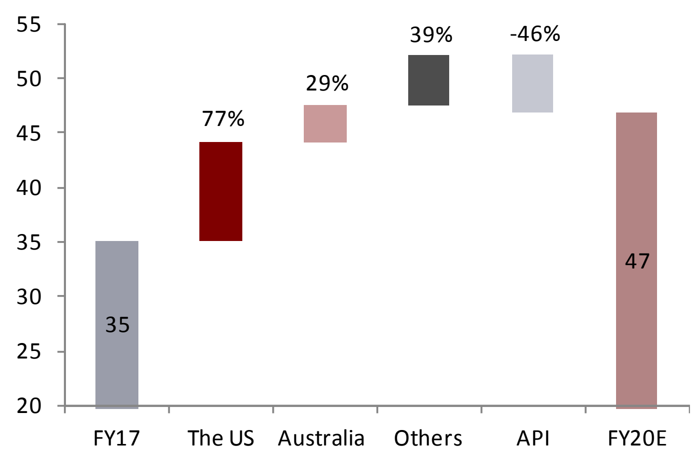


Source: Company, HDFC sec Inst Research
*We have assumed a dividend re-investment return of 7%, compounded annually.

- STR has a strong history of value creation. Since October 1, 2007, the company has compounded shareholder wealth at an outstanding ~30% annually.
- In FY14 and FY15, STR distributed an aggregate special dividend of Rs 605/sh (Rs 500 in FY14, Rs 105 in FY15), aggregating US$ 650mn (pre-tax), a corporate record in India.
- Over the same period, only 2 pharma companies (>Rs70bn Mcap) have delivered >30% returns.
- We believe that with 30+% earnings CAGR, STR is likely to continue enhancing shareholder wealth over the next three years, this time largely driven by organic growth.

Australia and the US lead the way

Revenue Waterfall Over FY17-20E (Rs bn)



Source: Company, HDFC sec Inst Research

- The US and Australian businesses are crucial going forward, and will contribute 55% of revenues and 60% of profits in FY20E.
- With STR striving to become the number one player in Australia, it is likely to cross US$ 200mn sales by FY21E and will be launching 65-70 products over the next two years. This will be driven by past investments in R&D, product acquisitions, in-licensing, and distribution tie-ups.
- With 20+ ANDA filings done in GDUFA cohorts 4-5, STR would be launching close to 20 products over FY18-19E in the US. These launches include topicals, softgels, hard-gels and modified releases and STR could easily cross US$ 200mn sales in FY20E.

STR's formulations business is expected to post ~16% CAGR over FY17-20E

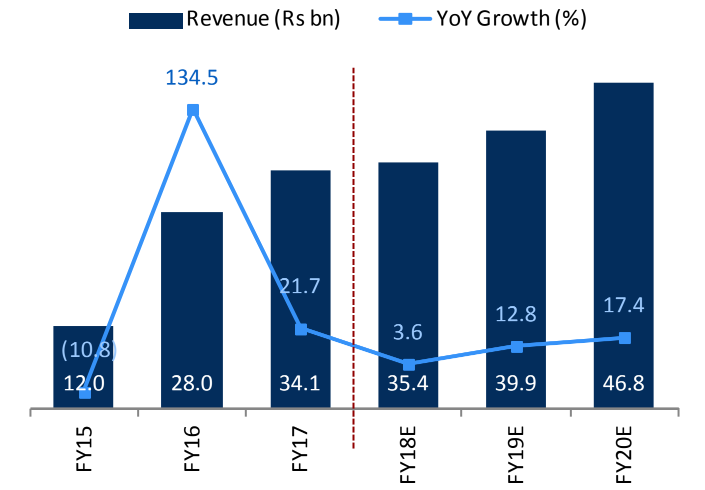
Operating leverage in Australia and the US businesses will be the key driver for the EBITDA margin

Paring of debt to aid bottom-line growth

Return ratios to show strong upward trend

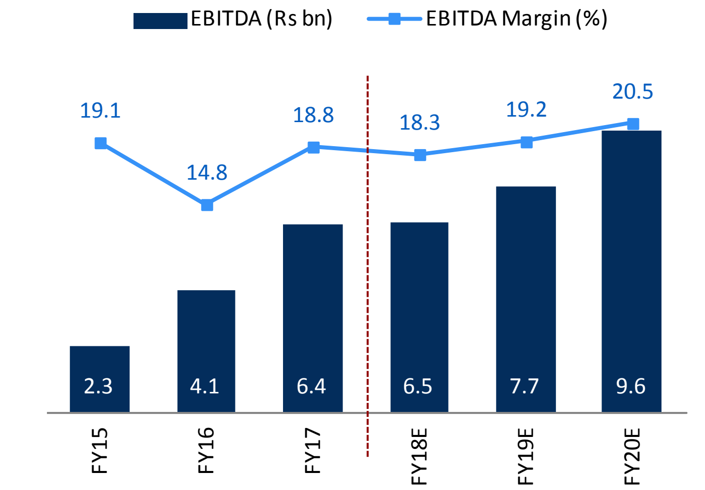
Snapshot

API Biz Hive-off = Optically Poor Top-line Growth



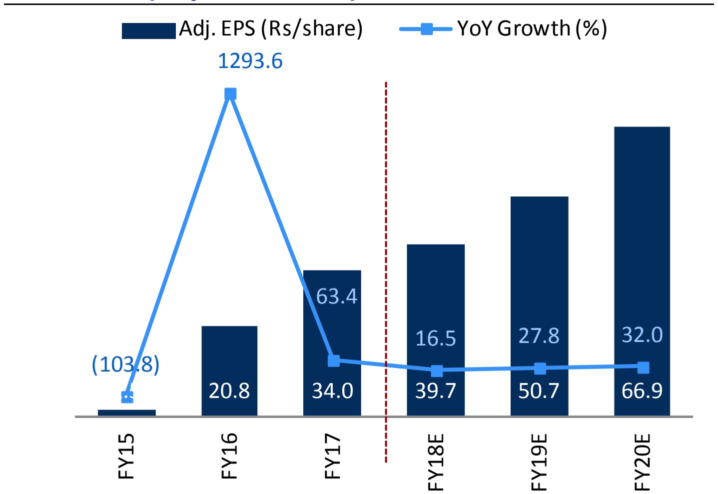
Source: Company, HDFC sec Inst Research

EBITDA Margin: Oplev. To Drive Improvement



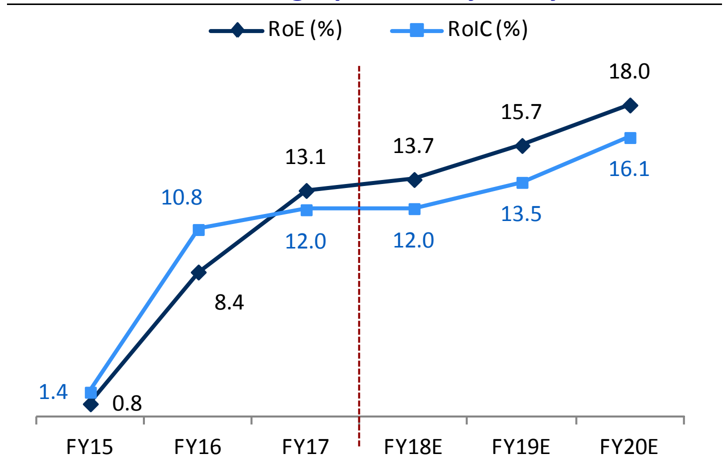
Source: Company, HDFC sec Inst Research

EPS: 34% (Adj. For Solara) CAGR Over FY17-20E



Source: Company, HDFC sec Inst Research

Return Ratios: Strong Upward Trajectory



Source: Company, HDFC sec Inst Research

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STR is a backward integrated pharmaceutical company, having a significant presence in Australia, Africa and the US

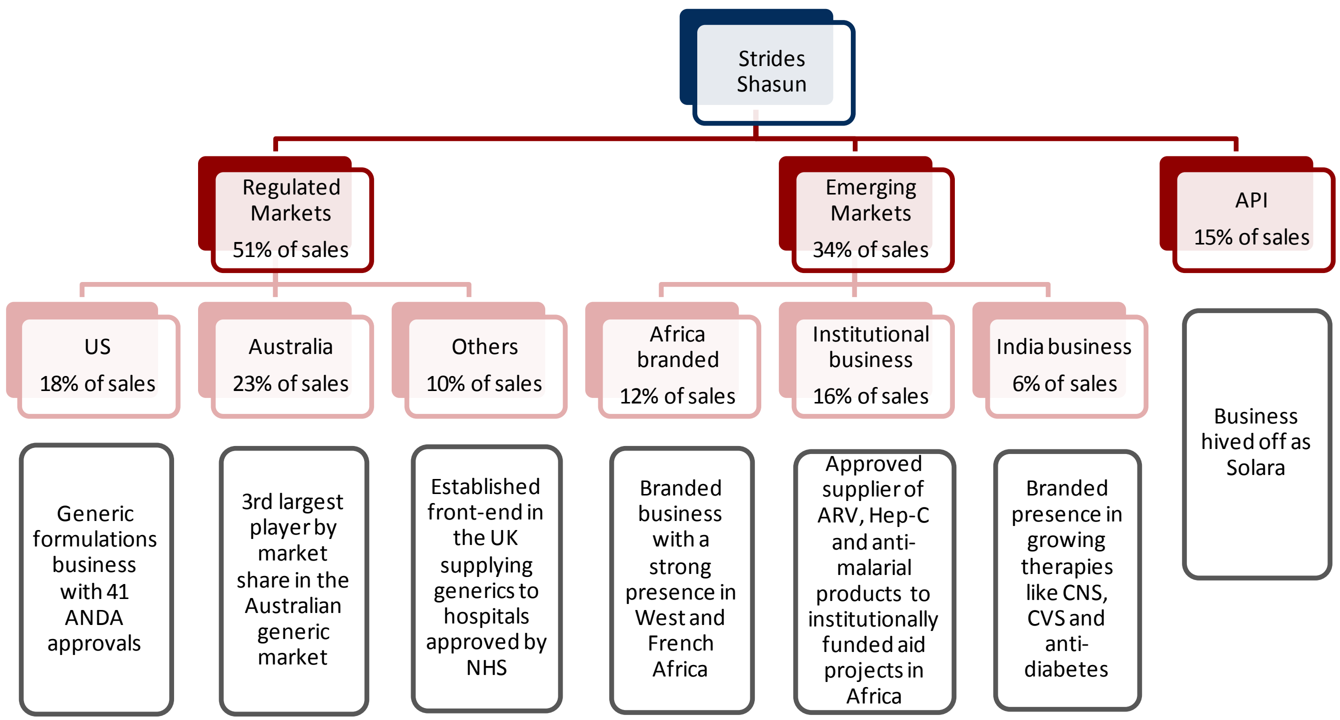
The regulated market pie will be the key growth driver for the company going forward

STR is hiving-off its commodity API business w.e.f October 1, 2017

Business summary

- STR is a backward integrated pharmaceutical company, having a significant presence in Australia, Africa and the US.
- **Regulated markets:** Within regulated markets, Australia and the US are the key geographies with ~40% contribution to total revenue.
- **Australia:** STR is the 3rd largest generic player in the Australian market, having access to 20% of the pharmacies in the region. With a significant number of launches planned over the next two years, it is aiming to become the largest generic player.
- **The US:** STR has a front end presence in the US market with a 41 ANDA portfolio. STR specializes in niche product categories such as softgels, topicals and modified releases.
- **Emerging markets:** STR' emerging markets (EM) business consists of three major parts; Africa, India and the institutional business. The Africa and India businesses are branded while the institutional business is by and large a B2B model. Except from India, the two other businesses are growing and highly profitable for the company, contributing 34% on topline in FY17.
- **API de-merger:** To focus on its formulation segments, STR is de-merging its commodity API business and merging it with SeQuent's human API business to form a new entity called Solara. This de-merger will lead to improved EBITDA margin, return ratios, and a higher asset turnover. Solara will likely get listed on the bourses post regulatory approvals in 4QFY18 and is valued at ~Rs 100/sh of STR.

Business Snapshot



Approximately 23% of Strides' overall top-line comes from the Australian Pharma market

The size of the APM was estimated to be ~A$ 14bn in 2016

Products are sold in the Australian market via two routes, through or outside the PBS

The PBS is a national scheme to provide affordable medicines to all Australians. It is essentially a list of medicines that are subsidized by the government

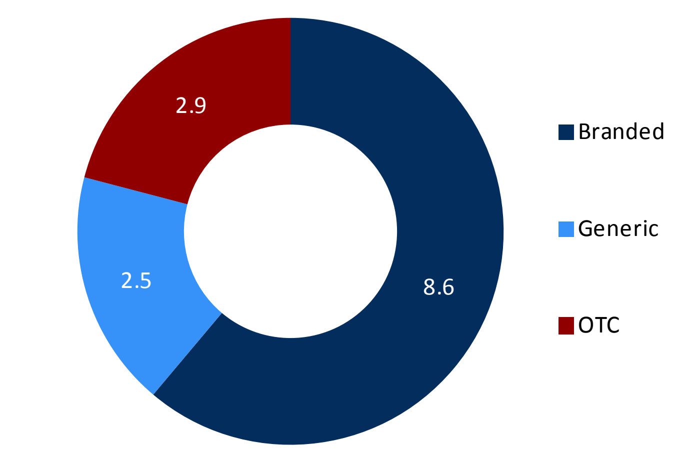
Australia: Aiming to become no. 1

Approximately 23% of Strides' overall top-line comes from the Australian Pharma market. After initially selling its business in the year 2012, STR re-entered the market in FY16 with the acquisition of ~130 products from Aspen, re-branding it Arrow (same as original Aus business).

Australian Pharma Market

- **Market Structure:** The size of the APM was estimated to be ~A$ 14bn in 2016. Products are sold in the Australian market via two routes, through or outside the PBS. The Pharmaceutical Benefits Scheme (PBS), which is a part of Australia's universal healthcare system and most drugs are sold via this route. Total PBS share of the market was ~A$ 11bn. The balance market flows via the non-PBS route comprises various pharmacy OTC products. However, in order to market goods on any platform, companies have to go through the process of registering a drug with the Therapeutic Goods Association (TGA), which functions similarly to the US FDA.

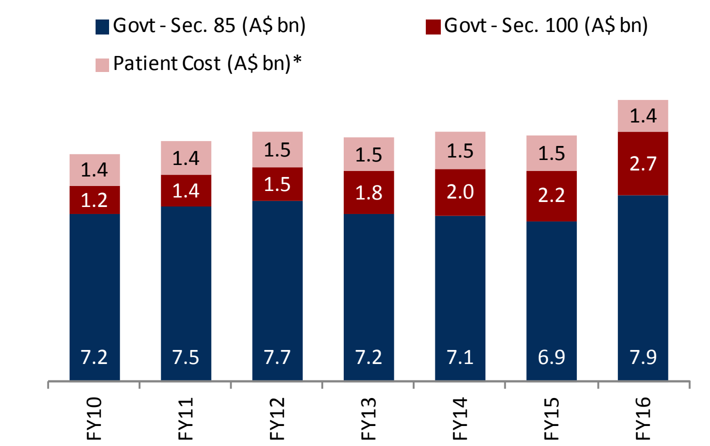
Australian Market Break-up (IMS MAT Jun-14)



Source: HDFC Sec Inst Research

- **What is PBS?:** The PBS is a national scheme to provide affordable medicines to all Australians. It is essentially a list of medicines that are subsidized by the government. The Pharmaceutical Benefit Advisory Committee (PBAC) advises the Minister for Health on whether or not a drug should be listed on the PBS. It typically takes 2-3 years from product filing to listing on the PBS list. PBS medicines have been split-up under two sections, Section 85, containing the majority of the drugs which are used commonly and Section 100 for highly specialized medicines (eg. chemotherapy).

Govt. and Patient Expenditure Under PBS



Source: HDFC Sec Inst Research
*Section 100 portion of public cost is not included.
**The table is as per Australian FY, which is July 1 to June 30.

- **PBS Prices and Safety Net:** When purchasing medicine under PBS, the maximum price a patient pays is the patient contribution (also called a co-payment or out-of-pocket cost). Patients are divided into two categories, general and concessional (low-income earners, welfare recipients etc.). The general patients pay a maximum total charge of A$ 38.30, while concessional patients pay A$ 6.3 per medicine. The safety net provision of PBS caps patient spending

There are various mechanisms by which prices are adjusted under PBS

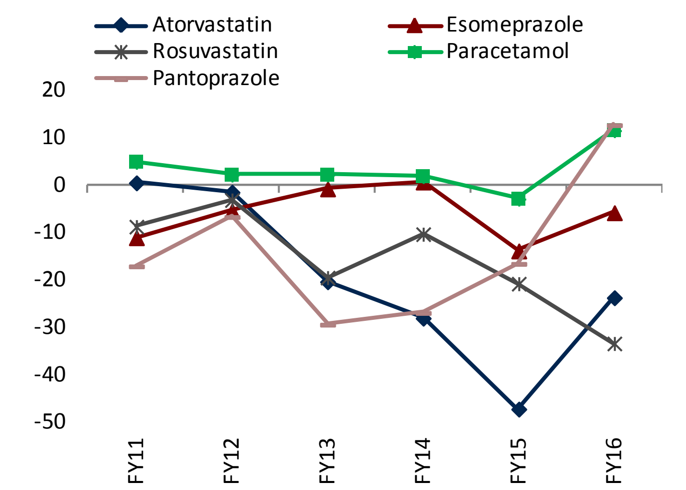
Outside of the PBS structure, various OTC products are sold by pharmacies. These account for ~20% of the APM. Prices in this segment are un-regulated

Market structure is concentrated in terms of wholesale distribution Symbian, API and Sigma together have 90% of the wholesale market share

at a certain amount per calendar year, A$ 1494.9 for general and A$ 378 for concessional. Beyond this, general patients pay for medicines at the concessional rate and concessional patients are not charged any further for that calendar year.

- **PBS Price Changes:** There are a few mechanisms by which prices are adjusted under PBS. Drugs are listed under two lists, F1 and F2. F1 are those drugs that do not have a bioequivalent in the market and are generally on-patent drugs. F2 drugs are generally off-patent drugs. In PBS pricing, the concept of AEMP (average ex-manufacturers price) is crucial, with the AEMP being the determined PBS price for all brands of a pharmaceutical item.

PBS Price Change (%) In Top 5 Vol Products (2016)



Source: HDFC Sec Inst Research

- Drugs under the F1 list have a compulsory 5% AEMP reduction after being listed on the PBS for 5 years.

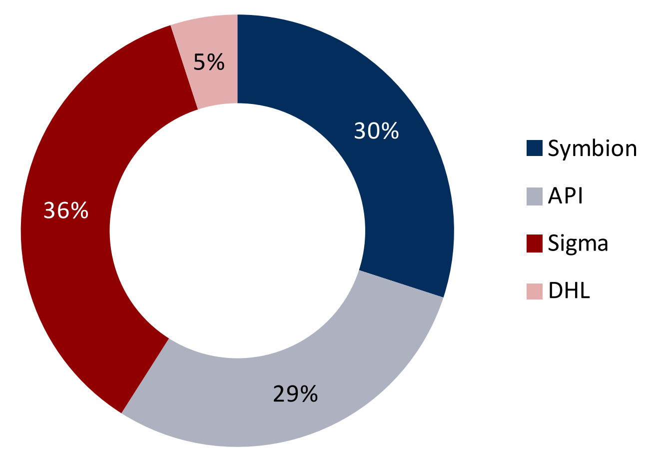
- Drugs under the F2 list have prices adjusted twice in a year, on April 1 and October 1. A weighted average price deduction is calculated based on the adjusted volumes and revenues for the relevant period of all brands in a pharmaceutical item. In order for the price to be reduced, the WAPD needs to be 10% minimum, i.e. the AEMP is not adjusted unless there is a 10% or more reduction as per the calculation.

- Besides these, a statutory price reduction of 16% is applied to existing PBS-listed products when the first new brand or item that is bioequivalent or biosimilar and has the same manner of administration as an existing brand or item lists on the PBS.

- **Non-PBS Sales:** Outside of the PBS structure, various OTC products are sold by pharmacies, such as medicines for self-treatment, nutraceuticals etc. These account for ~20% of the APM. Prices in this segment are un-regulated, and hence present an opportunity for companies to earn higher margins.

- **Wholesale distribution:** Market structure is concentrated in terms of wholesale distribution. The top three generic companies holding 75% market share (Apotex, Mylan and Arrow) have each tied-up with a wholesaler - Symbian, API and Sigma, who together hold 90% of the wholesale market share. This has been stable over the last few years.

Wholesale Market Share In The APM



Source: HDFC Sec Inst Research

The APM is an extremely pharmacy-centric market, with the key customers being pharmacies

In the APM, pharmacies typically identify one principal generic supplier and purchase all their requirements from said supplier

Only four generic players (STR being one) supply 90% of all generic drugs sold in Australia

The Aspen deal gave STR access to ~130 commercialised products and made STR the 3rd largest generic manufacturer by market share, and 2nd largest in terms of drug product range

- **Pharmacy-centric:** It is worth noting that the APM is an extremely pharmacy-centric market, with the key customers being pharmacies. The Australian Government reimburses the pharmacist for the cost of the medicine, as well as paying a nominal mark-up and dispensing fee. The pharmacist in turn pays the wholesaler who distributes the medicine.

- It is also significant that pharmacies typically have one principal generic supplier and give preference to said supplier for all their requirements. Only four generic players (incl STR) supply 90% of the generic drugs sold in the APM. Even if the supplier is late to launch a generic, the pharmacy will continue to purchase the brand until the principal supplier launches a generic version (assuming visibility on launch). Hence, it becomes crucial for generic players to have as wide a range of products as possible.

- By law, pharmacy ownership in Australia must be independent from manufacturing, hence preventing vertical integration across the supply chain.

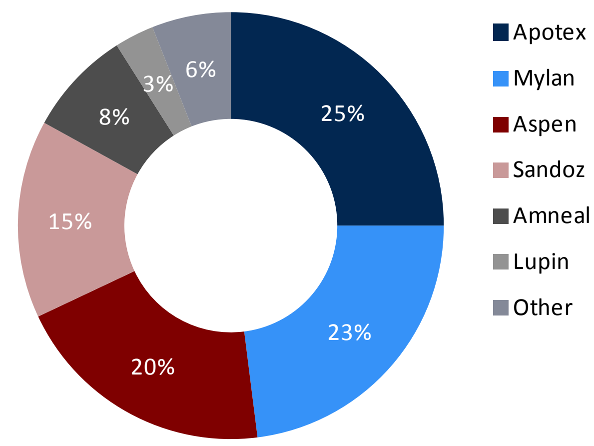
- **Gaining market share:** There are ~5500 pharmacies in Australia, with ~3500 pharmacy owners. This has led to the development of major pharmacy brands, which follow a membership / franchisee model and help smaller pharmacy owners streamline their operations and improve profitability. Hence, as opposed to a traditional MR to doctor marketing dynamic, market share gains in the APM are driven at a senior level by capturing additional pharmacies as customers. Another key driver of market share is the major pharmacy groups bringing more pharmacies under their brand leading to new customers for the supplier. Unlike other markets, there is no price differentiation between players.

Strides in Australia

The nature of the Australian market has led STR to adopt an acquisitive approach in this market. STR's non-compete for the APM expired in Jan-15, post which the company re-entered the market in FY16, via the acquisition of Aspen's generic business.

- **Re-entry with Aspen deal:** The Aspen deal gave STR access to ~130 commercialised products and made STR the 3rd largest generic manufacturer by market share, and 2nd largest in terms of drug product range. STR also gained access to "Chemists' Own", an OTC product range. It is the preferred OTC range in 20% of pharmacies in Australia.

Generic Market Share (Pre-Aspen Deal)



Source: HDFC Sec Inst Research

- **Investment in GP:** A controlling stake in a generic supplier, Generic Partners (GP), gave STR access to 47 commercialsed products, 22 products pending TGA registration and a pipeline of 32 molecules. GP currently develops and out-licenses products to customers in Australia. Manufacturing requirements are out-sourced. GP's customer base included the top 5 generic pharmaceutical companies including Aspen/Arrow. GP had revenues of A$ 39mn and

Acquisitions like Generic Partners (GP) and Amneal's Australian operations further boosted STR's capabilities and product range

Margins have contracted sharply since re-entry (almost ~700-800bps), largely owing to investments for increasing the scale of the business

Increasing market share via the deployment of a larger product basket is a primary goal

Currently, STR is the front-line supplier for 700-800 pharmacies. STR is targeting 1,100 by FY18 end and 2,000 by FY20

operating loss. However, adjusted EBITDA is ~18% (ex-R&D). STR's R&D initiatives for the APM will be consolidated under GP, leveraging its product development and registration capabilities. GP will continue to supply to other generic players as the need for product exclusivity is nullified by the pharmacy tie-ups.

- **Amneal acquisition:** The recent acquisition of Amneal's Australian operations further boosted STR's market share and product range. Post integration, the acquisition is expected to add revenues of A$ 25mn and improve Arrow's generic market share to 22%.
- **Distribution tie-ups:** A 10-year supply partnership with Pharmacy Alliance, a major pharmacy brand strengthened STR's supply relationships. Pharmacy Alliance currently has ~600 pharmacies i.e.10% of the market under its network, and plans to double this to 20%. STR is also the preferred generic partner, and has signed an exclusive distribution agreement with Sigma, the largest pharmacy wholesaler by market share in Australia. Sigma also has the largest retail pharmacy footprint in Australia.
- While the top-line has been flat since re-entry, margins have contracted sharply (almost ~700-800bps). Our conversation with the CEO of Arrow Pharma, Mr. Dennis Bastas, revealed that the margins have been under pressure largely owing to investments for increasing the scale of the business.

Strides in Australia: Sequence Of Events

When	Event	Deal Value (A$ mn)	Deal Value (Rs cr)
Feb-08	Entered APM in by acquiring a controlling stake in Ascent PharmaHealth	65	260
Dec-10	Stake in Ascent increased to 94% from 58%	36	162
Jan-12	Sold the Australian business (full 94% stake) to Watson	375	1,968
May-15	Re-entered the APM with purchase of a generic business from Aspen (re-named Arrow)	380	1,900
Feb-16	Purchased 51% stake in Generic Partners, a generic player in the APM	15	75
Aug-17	Acquired Australian operations of Amneal	17	85

Source: HDFC Sec Inst Research

- **What next?:** The strategy for STR going forward would be to leverage the recent investments and achieve a large scale of business in the APM. Increasing market share via the deployment of a larger product basket is a primary goal. The acquisition of Amneal's Australian business has supplemented its portfolio, provided new customers and also eliminated competition.
- STR plans to launch 70 products in the coming two years, the market value of which would be A$ 4-5bn. We expect STR to at least maintain its current run-rate of an average of ~A$ 1mn per product.
- In-licensing opportunities are also being sought, such as the recent launch of Cipla's inhalers in the APM.
- Expanding distribution reach is a primary driver of growth in the APM, and STR has made significant moves in this direction with the agreements with Sigma and Pharmacy Alliance. Currently, STR is the front-line supplier for 700-800 pharmacies. STR is targeting 1,100 by FY18 end and 2,000 by FY20.
- **Margin levers:** (1) STR's planned 70 launches over the next two years would have a higher margin than the current average margin of the company, (2) Significant operating leverage is available for the

There are various margin levers in Australia such as higher margin average from new launches, operating leverage and cost saving from shifting of manufacturing base to India/Singapore

Overall, we foresee 12-13% revenue CAGR in Australia over FY17-20E

company considering the extent of investments made recently, and (3) Shifting of a large part of the manufacturing base to India and Singapore, which will provide significant cost advantages, especially considering that currently 85-90% of the production requirements are out-sourced.

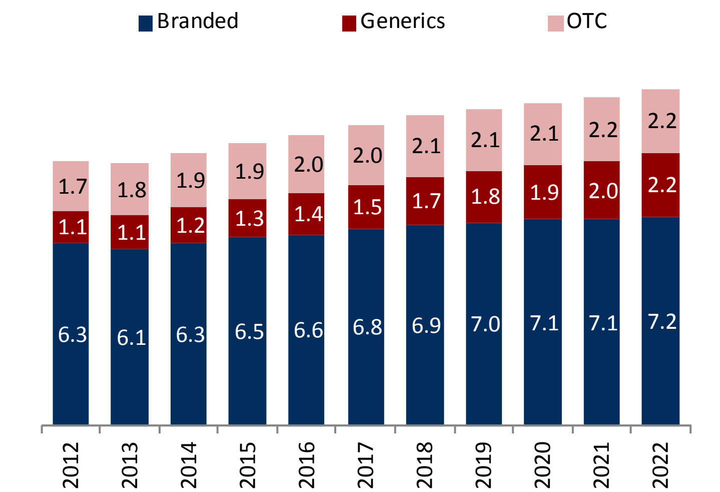
- As a part of the Aspen deal, STR also acquired an established OTC brand – Chemists' Own. Sales from this business have come off significantly over the past 2-3 years and were ~A$ 25mn at their peak. STR's initial target is to return to historical levels and the business is now growing in high double-digits.

- **Market opportunity and growth:** Generic penetration in the APM is low compared to the US (60% vs 90-95%). This gap is expected to narrow over the coming years. The generic market is ~A$ 2bn and STR's mgt pegs its covered market opportunity at A$ 1.5bn.

- The APM is expected to grow at a modest 0-3% CAGR over 2018-2022. However, within this, generics are predicted to grow at 7.2% CAGR.

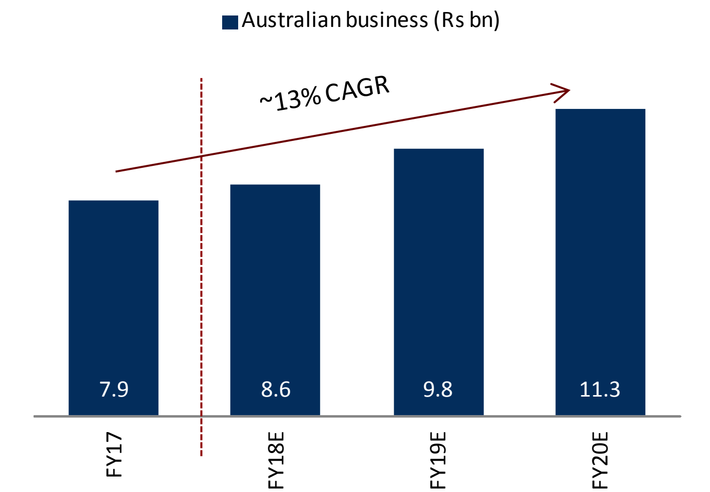
- Overall, we foresee 12-13% revenue CAGR in Australia over FY17-20E. Operating leverage from business scale and the launch of higher margin products would be the keys to expanding margins in Australia. We expect ~200bps expansion by FY20E.

Australian Market Forecast Until 2022



Source: Company, HDFC sec Inst Research

Australia Business: Growth To Pick Up



Source: Company, HDFC sec Inst Research

With 20+ launches expected over next two years, we believe US business will scale up from US$ 95mn sales in FY17 to US$ 230mn by FY20E

Launches like gLovaza, potassium citrate, gGilenya, gRenvela would be key growth drivers for the US market

US business: Regaining mass

- **The US is gaining mass again:** Post the sale of Agila in 2013, STR had a minimal presence in the US. It has re-built its business there and has since filed 40 ANDAs. Focus remained on launching niche products in categories like softgels, modified release and topicals. At present, there are 26 ANDAs pending with the US FDA. Most of these filings are post GDUFA. With 20+ launches expected over the next two years, we believe that the US business will scale up from US$ 95mn sales in FY17 to US$ 230mn by FY20E. Launches like gLovaza, potassium citrate, gGilenya and gRenvela would be key growth drivers for the US market.
- **Cetrizine:** Strides recently received final approval for Cetirizine 10mg. These are soft gel capsules and will be sold over-the-counter. It is used to reduce the symptoms of respiratory allergies. At present, the market size is US$ 60mn and there is only one other generic player with approval. We have modeled US$ 15mn in sales from this product by FY20, as the scale up through the OTC channel is gradual due to required branding.
- **Potassium citrate:** It is the first modified release product for STR. Potassium citrate is a urinary alkalinizing agent and used for preventing certain types of kidney stones. At present, there are two other players who have received approvals along with Stides – Cadila and Impax. However, Impax has not launched this product yet. Overall, post Cadila launch in FY15 market size is reduced to US$ 110mn. We believe Strides can generate US$ 10-15mn sales from this product annually.
- **Lovaza**: A key launch for STR in FY18 will be the Lovaza capsules (Omega-3-acid ethyl esters). As per the management, <u>the opportunity size is estimated to be ~US$ 300mn.</u> There are currently four generic players selling this product. Teva was the first to launch in April-14, at which point the US market size alone was US$ 1.1bn. STR has partnered with Par Pharma for this product, with STR doing the manufacturing. Par is an existing player in gLovaza and has 30% market share, thus ensuring that STR will generate ~US$30mn annually from this opportunity.
- **Gilenya:** Strides has settled this para IV opportunity to launch it in Feb-19. Although there are several players who would be launching this product on approval, it is a sizable market with annual sales of US$ 3bn. We believe Strides can generate ~US$ 8-10mn in its first year of launch.
- **Daliresp:** Daliresp is another para IV opportunity in STR's pipeline. Daliresp is AstraZeneca product with market sales of US$ 200mn. The product is protected by 6 patents and one exclusivity. Earliest patent will expire in Jan-20 while labeling exclusivity will protect the product till Aug-20. We expect generic product to get launched between Jan 2020 to 2024. STR is among the first three filers and also received tentative approval early this year. It could become a significant opportunity for the company if not more than three players enters the market.
- **Soft Gel capabilities:** With over two decades of experience, STR is among the world's largest manufacturers of specialty soft gelatin capsules. The global soft gel capsules market was estimated to be ~US$ 200bn in 2016. STR's 1mn sq ft. soft gel facility at Bangalore is one of the largest of its kind in the world with an annual capacity of 2.5 bn soft gel capsules.

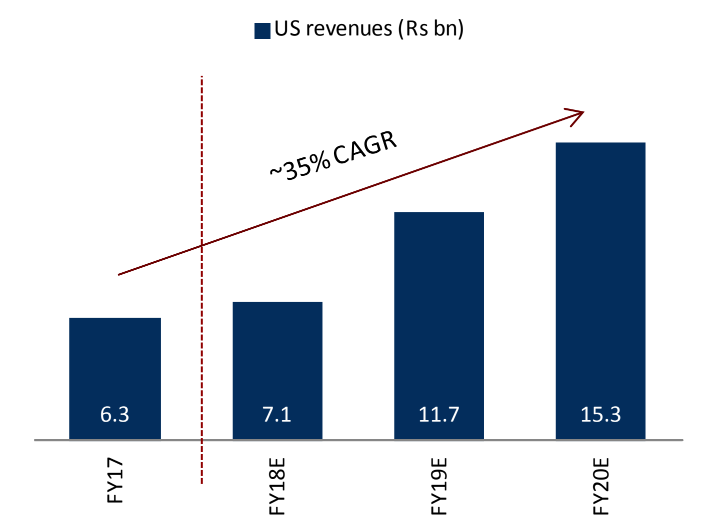
As most of the filings are post GDUFA filings, STR expects to receive at least 20 approvals over next 15-18 months

Of 26 pending ANDAs, 7 products are topicals, 5-6 are soft/hard gelatin capsules and 2 are modified release. Among these, 6 are para IVs (2 settled, 4 pending approval

With more than 20 launches over the next two years, we believe STR' US business is likely to grow at +30% CAGR over FY17-20E

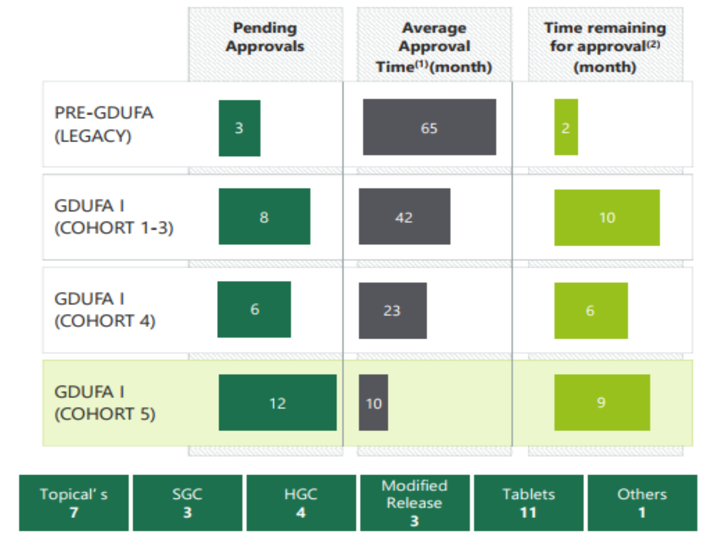
- **Filing/approval momentum expected to pick-up over the next 15-18 months:** STR has filed 67 ANDAs in the US market till now. It has received 41 ANDA approvals till date and 26 ANDA fillings are still pending with the US FDA. As most of the filings are post GDUFA filings, the company expects to receive at least 20 approvals over next 15-18 months. Of 26 pending ANDAs, 7 products are topicals, 5-6 are soft/hard gelatin capsules and 2 are modified release. Among these, 6 are para IVs (2 settled, 4 pending approval). The company is also working on a few 505b(2) products for the US market. These are likely to get filed over the next 2 years.
- Filing momentum too has picked up strongly, with 5 ANDAs filed in 1QFY18. The mgt expects to file 15-20 ANDAs in FY18 including softgels, topicals and modified release platforms. Historically, STR's annual filing rate has been in the single-digits.
- **Vivimed JVs:** STR has signed definitive agreements with Vivimed Labs to form a 50:50 JV which will own Vivimed's US FDA approved formulations facility in Chennai. Another JV in Singapore will be formed through STR's Singapore arm which will own certain approved ANDAs and product pipeline. STR will pay Rs 750 mn towards these JVs. As a part of these JVs, STR will get access to the 1.5bn tablet capacity to manufacture some of its own ANDAs, as well as marketing rights to the ANDAs being developed by Vivimed. On the manufacturing front, this will be STR's 4th facility in addition to Bengaluru, Puducherry and Singapore (upcoming). This will secure STR's capacity requirements for atleast 3-4 years.
- **Looking ahead:** With more than 20 launches over the next two years, which include key product launches like Lovaza, potassium citrate, gGilenya, gRenvela, we believe Strides' US business is likely to grow at +30% CAGR over FY17-20E (from US$ 95mn to US$ 220m by FY20E.)

US Revenues To Grow At A Fast Clip



Source: Company, HDFC sec Inst Research

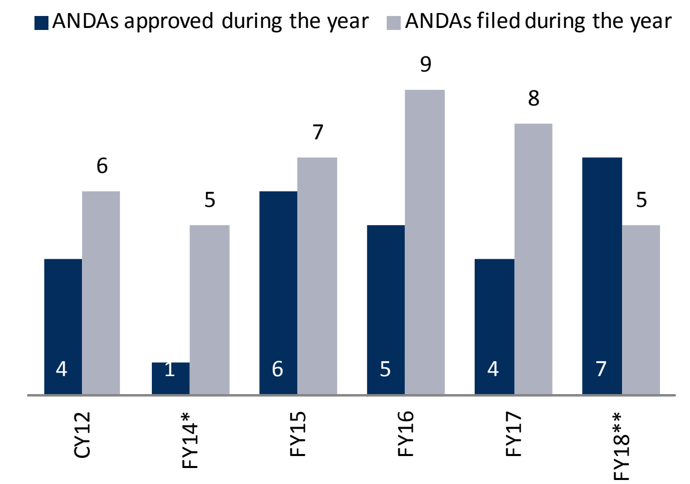
High Number Of Approvals Pending From Cohort 5



Source: Company, HDFC sec Inst Research

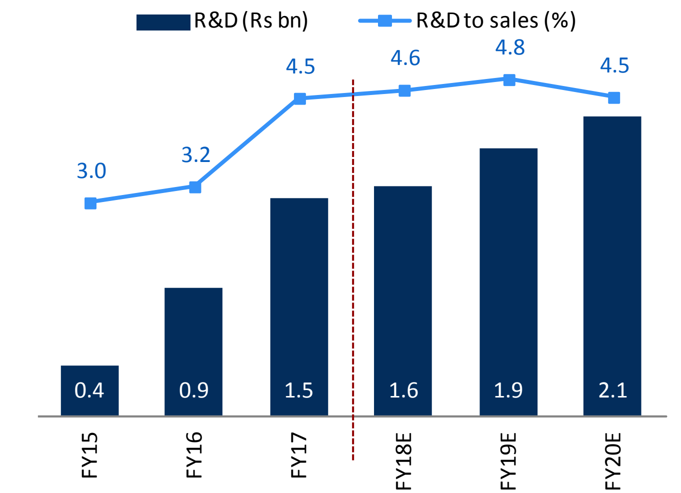
ANDA approval pace is clearly picking up

ANDA Approval Pace Picking Up



*FY14 represents a 15 month period
**Denotes ANDA approvals as of today
Source: Company, HDFC sec Inst Research

R&D Expense: Below Peer Levels



Source: Company, HDFC sec Inst Research

STR has managed to achieve good market share in a number of competitive products

Market Share In Key Products

Brand	Molecule	Form	Market Size (at launch, US$ mn)	Launch Date	Players	Aug-17	Aug-16	Aug-15
Precose	Acarbose	Tablet	21	Jul-11	8	19%	13%	2%
Tessalon	Benzonatate	Capsule - Softgel	41	Jul-15	11	20%	19%	0%
Rocaltrol	Calcitriol	Capsule - Softgel	50	Dec-14	5	17%	15%	5%
Avodart	Dutasteride	Capsule - Softgel	470	Nov-15	16	28%	16%	N/A
Vitamin D	Ergocalciferol	Capsule - Softgel	63	Aug-10	4	47%	41%	25%
Oxsoralen-Ultra	Methoxsalen	Capsule - Softgel	14	Jul-14	2	36%	48%	49%
Zantac	Ranitidine HCL	Tablet	125	Aug-16	10	26%	N/A	N/A
Soma	Carisoprodol	Tablet	38	Nov-15	10+	96%	N/A	N/A
Vancocin	Vancomycin HCL	Capsule	332	Apr-12	5	55%	N/A	N/A

Source: Bloomberg, HDFC Sec Inst Research

Opportunities like gRenvela, gRenagel, gLovaza, gGilenya and gDaliresp will be important growth drivers for STR

Potential ANDA Opportunities:

Molecule	Brand Name	Form	Generic?	Therapy	Market Size (US$ mn)	No. of Players	Potential Launch
Based on tentative approvals / settlements / on-going litigation							
Tenofovir Disoproxil Fumarate	Viread	Tablet	No	HIV/ARV	591	8	4QFY18
Efavirenz	Sustiva	Tablet	No	HIV/ARV	901	10	FY19
Efavirenz	Sustiva	Capsule	No	HIV/ARV		3	FY19
Fingolimod	Gilenya	Capsule	No	CNS	3109	10	2HFY19
Roflumilast	Daliresp	Tablet	No	Respiratory	134	10	2HFY20
Emtricitabine; Tenofovir Disoproxil Fumarate	Truvada	Tablet	No	HIV/ARV	2400	5	FY21-22
Diclofenac Potassium	Zipsor	Capsule	No	Pain/Analgesics	30	6-7	FY23
Rilpivirine	Edurant	Tablet	No	HIV/ARV	600	1	FY23-24
Based on DMF filings							
Pregabalin	Lyrica	Capsule/ Solution	No	CNS	3139	10	2HFY19
Lurasidone Hydrochloride	Latuda	Tablet	No	CNS	1254	15+	FY19-20
Sevelamer Carbonate	Renvela	Suspension, Tablet	Yes	Nephrology	~1000	3-4	Upon approval
Sevelamer Hydrochloride	Renagel	Tablet	No	Nephrology	~200	5-6	Upon approval
Colesevelam Hydrochloride	Welchol	Suspension, Tablet	No	CVS	~750	4-5	FY23
Celecoxib	Celebrex	Capsule	Yes	Others	976	9	Upon approval
Dextromethorphan Polistirex	Delsym	Suspension ER Oral	Yes	Anti-infective	100	2	Upon approval
Aprepitant	Emend	Capsule; Suspension	Yes	Others	62	3	N/A
Posaconazole	Noxafil	Suspension	No	Others	595	1	N/A
Posaconazole	Noxafil	Tablet DR	No	Others		1	N/A
Posaconazole	Noxafil	Solution; IV	No	Others		1	N/A

Source: HDFC Sec Inst Research

Strides' emerging markets (EM) business consists of three major parts; Africa, India and the institutional business

Africa accounted for ~13% of FY17 revenues, and STR follows an 'in Africa, for Africa' strategy here, with and a special focus on the Sub-Saharan region (presence in over 40 countries)

STR's focus in this region is firmly on creating a strong branded presence backed by local manufacturing

We expect STR to post a double-digit growth in the region on the back of the expanding geographical footprint and new product launches

Emerging markets

Strides' emerging markets (EM) business consists of three major parts; Africa, India and the institutional business (grouped here from FY18). The Africa and India businesses are branded while the institutional business is by and large a B2B model.

Africa: On auto-pilot

Africa accounted for ~13% of FY17 revenues, and STR follows an 'in Africa, for Africa' strategy here, with and a special focus on the Sub-Saharan region (presence in over 40 countries). STR has over 750 products registered in Africa and a further 500 in the pipeline. STR currently operates with a sales force of 250 MRs in the region and plans to significantly ramp up this number to 1,000 over the next five years.

STR In Africa

Source: Company, HDFC Sec Inst Research

- **Re-structuring:** STR announced this year, its plans to exit its African generics business for a cash consideration was ~US$ 16mn. This was a low-margin business and contributed ~US$ 21mn (~4% of total revenue) and an EBITDA of ~US$ 1.6mn. The exit was hence margin accretive.

- **Universal Corporation acquisition:** In Feb-16, STR acquired Universal Corporation (UC), a Nairobi based pharma manufacturing and marketing company with a strong presence in East Africa, for a consideration of US$ 11mn (with performance-related payout capped at US$ 3mn). This acquisition complimented STR's strong foothold in West and French Africa. UC's facility is one of only two WHO Pre-qualified sites in Sub-Saharan Africa, other than in South Africa. This is in-line with the 'in Africa, for Africa' strategy, and STR will leverage this facility's multiple dosage capabilities and rising preference for local procurement in the region. STR also plans to transfer several strategic institutional products to this facility as donor agencies prefer 'Made in Africa' products.

- **Looking ahead:** STR's focus in this region is firmly on creating a strong branded presence backed by local manufacturing. Boosted by growth in the African market, we expect STR to post a double-digit growth in the region on the back of the expanding geographical footprint and new product launches. Margins are expected to expand gradually with higher MR productivity and improving business mix.

STR had sales of Rs 5.7bn in this segment in FY17, ~16% of total revenue

Currently, STR is an approved supplier to institutionally funded aid projects and global procurement agencies like UNITAID, PFSCM, PEPFAR, CHAI and Global Fund

STR is present in ARV, Hep-C and anti-malarials

Institutional Business: Focus on vertical integration

STR had sales of Rs 5.7bn in this segment in FY17, ~16% of total revenue. Currently, STR is an approved supplier to institutionally funded aid projects and global procurement agencies like UNITAID, PFSCM, PEPFAR, CHAI and Global Fund. STR believes while the market is concentrated between 5-6 key players, there is an opportunity of ~US$ 2.5bn in terms of procurement.

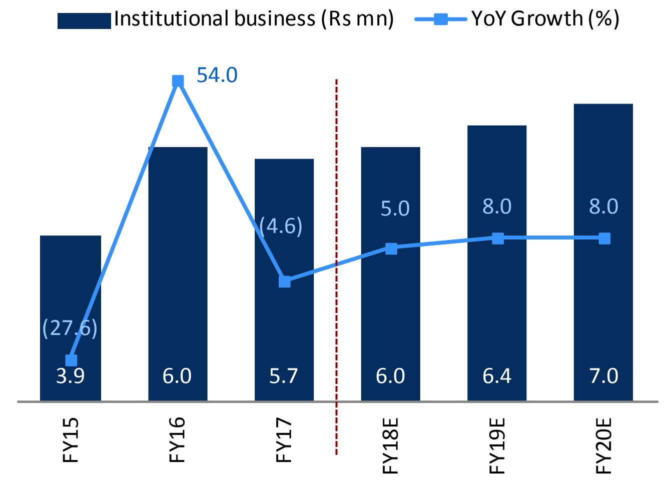
- **ARV and Hep-C franchise:** STR has entered into a licensing agreement with Gilead Sciences to produce and distribute (1) sofosbuvir (gSovaldi), and (2) an investigational single tablet regimen of ledipasvir/sofosbovir (gHarvoni) for treatment of chronic Hepatitis C. The agreement is for distribution to 101 developing countries including high burden countries like India, Eqypt and Indonesia. STR is one of 11 companies with whom Gilead has signed licensing agreements. STR is focused on selling the two in-licensed drugs (branded 'Virso' and 'Virpas' respectively) in lower competition markets like CIS and South East Asia, where margins and realizations would be higher.
- In Dec-15, STR became the third company to get the DCGI's (Drug Controller General of India) approval to manufacture Sofosbuvir 400mg, after Natco Pharma and Hetero.
- There is also a licensing agreement with Gilead for the rights to manufacture and distribute Tenofovir Alafenamide (TAF), both as a single agent product and in combination with other drugs. The license being granted to Strides extends to 112 countries, which together account for more than 30 million people living with HIV.
- STR has also signed a sub-licensing agreement with the Medicines Patent Pool (MPP) to develop Dolutegravir (DTG) for treatment of HIV in developing countries. Other companies with this license include Cipla, Desano, Emcure, Hetero Labs, Laurus Labs, Lupin, Micro Labs and Mylan.
- **Anti-malarials:** STR started receiving orders from Global Fund to supply anti-malaria products from 2HFY15. Strong execution and problems for key competitor IPCA led to quick business growth. As compared to ARV, this has been a much higher margin business for the company. STR is also collaborating with MMV for the development of rectal artesunate for pre-referral treatment of children with severe malaria (Cipla is the only other company partnering MMV for this drug).
- This business is now however seeing a slowdown, with a decline in donor funding (down 20-25% in FY17). While STR was able to maintain its market share, there was a significantly lower contribution from the malarial portfolio during FY17, which led to a decline in the overall institutional business. IPCA's re-entry in this business would be a key monitorable.
- **Merger benefits:** Prior to the merger with Shasun, STR was a fringe player in the business, with limited formulation capacities. STR was also the only non-backward integrated player in the business other than Aspen. The merger added this crucial element of vertical integration to STR's institutional business, as well as additional formulations capacities. Shasun had a portfolio of 23 DMFs under development, including DMF filings for Tenofovir (anti-retroviral) and commercialised Cycloserine (anti-TB), which complemented STR's institutional business. Following the de-merger of the API business, STR plans to support its institutional business through the recently acquired Perrigo API facility.
- **UC plant:** STR plans to transfer large parts of its institutional business to the Universal Corporation

With lower funding in the anti-malarials business combined with increasing competitve intensity in the ARV segment, we believe that the growth in this segment will be in single digits going forward. Foresee 7% rev. CAGR over FY18-20E

facility in Kenya. This will enable to gain access to local business funded by local agencies and also deploy a more robust supply chain for the emerging market and institutional business. The tech transfer of the institutional products has been initiated, with supplies expected to commence from 2HFY18.

- **Outlook:** While the success rates for these medicines are high, the penetration is low. STR plans to leverage its quickly expanding footprint and strong supply chain to access a wider range of markets, and also derive cost and reach synergies from the UC plant in Kenya. There is also a focus on developing the next generation of products in line with evolving treatment regimens. However, with lower funding in the anti-malarials business combined with increasing competitve intensity in the ARV segment, we believe that the growth in this segment will be in single digits going forward. Foresee 7% rev. CAGR over FY18-20E.

Growth To Be Muted Going Forward



Source: Company, HDFC Sec Inst Research

STR is a branded generics player in the domestic market with established brands such as Renerve, Raricap, Solus, Otogesic, Ehnorub, and Stugil

We believe that the India business is a non-performing segment for the company as the organic growth in the existing porfolio is poor and there is no sign of a pick-up

We have assumed only 7-8% growth in this business over the next two years

India: Underperforming business

STR entered the Indian Pharmaceuticals Market (IPM) market in 2007 with the acquisition of Grandix and has since followed a largely inorganic growth strategy. It has now positioned itself as a branded generics player, with established brands such as Renerve, Raricap, Solus, Otogesic, Ehnorub, and Stugil. At present, it is contributing ~Rs 2.2bn in sales to STR's top-line and margins are likely to be in the mid-teens.

- **Inorganic fuel:** STR has made various acquisitions over the years which have boosted the India business: (1) Global rights of Raricap (women's health), in FY15, (2) Two CNS divisions 'Solus' and 'Solus Care' from Sun Pharma in FY16, and (3) Seven brands from Johnson & Johnson (J&J) in FY16 in the dermatology, anti-emetic and pain management therapy categories that include Otogesic eardrops, Ehnorub ointment and Stugil tablets.

Recent Acquisitions

	Therapy	When	Consideration (Rs mn)	Annual sales (Rs mn)
Raricap	Vitamins	FY15	481	200
Solus, Solus Care	CNS	FY16	1,650	920
7 JnJ Brands	Various	FY16	619	320

Source: Company, HDFC Sec Inst Research

- **Largely chronic but not lucrative:** STR has product offerings in growing therapies such as CNS, CVS, anti-diabetes, gastro intestinal, women's health and pain management. The portfolio is largely skewed towards specialty segment with close 65% of sales. STR has built marketing field force of 750 MRs covering 3,500 stockists and 80,000 doctors. However, the MR/productivity is significanlty low despite having large specialty portfolio.

Top 10 Brands: Mixed Growth

Brand	Therapy	MAT Aug-17 (Rs mn)	4 yr CAGR
Renerve Plus	Vit/Min/Nutr	464	9%
Lactovit	Gastro	169	43%
Raricap	Gynaecological	160	-3%
Lactogut	Gastro	157	77%
Desval Er	Neuro / CNS	153	-1%
Serlift	Neuro / CNS	147	15%
Domped	Gastro	103	65%
Selzic	Neuro / CNS	89	-2%
Levroxa	Neuro / CNS	86	-4%
Livliv	Gastro	80	85%

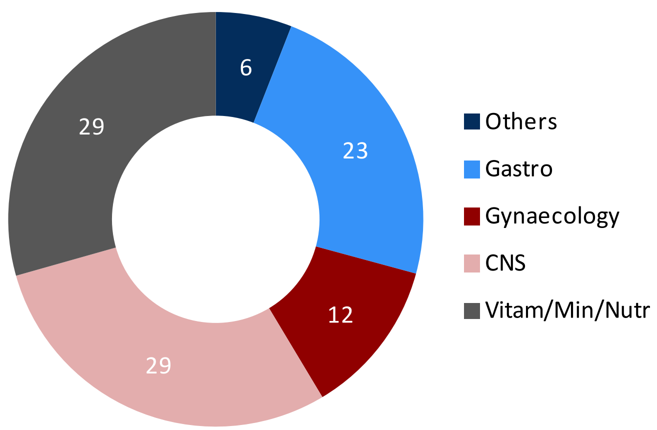
Source: AIOCD, HDFC Sec Inst Research

- **Underperfoming business:** Despite achieving Rs 2.2bn in sales, we believe that the India business is a non-performing segment for the company as the organic growth in the existing porfolio is poor and there is no sign of a pick-up. The branded generic business in India, especially in chronic therapies, has a long gestation period with several hurdles to break the association between incumbents and speciality doctors. Pricing or quality is not the only critieria as brand loyalty is strong among doctors. We have assumed only 7-8% growth in this business over the next two years.

Acute-chronic mix has been deteriorating

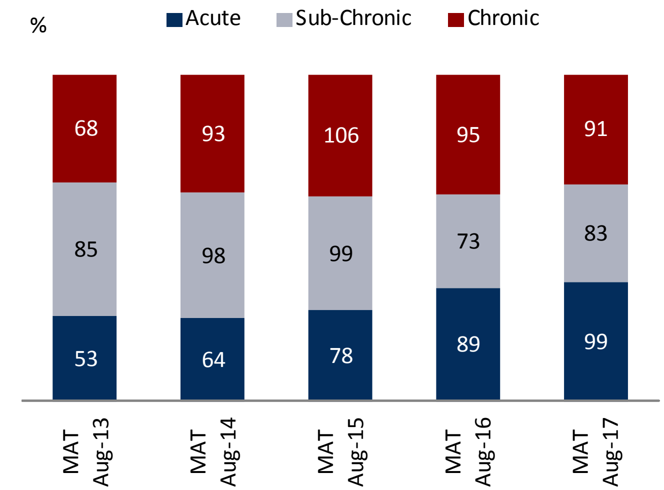
MR productivity is extremely low at ~Rs 3mn/MR

Therapy Mix % (MAT Aug-17)



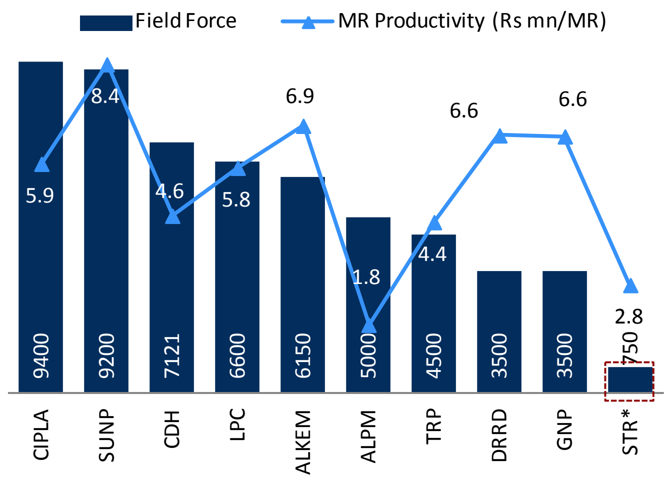
Source: AIOCD, HDFC Sec Inst Research

Acute-Chronic Mix: Deteriorating



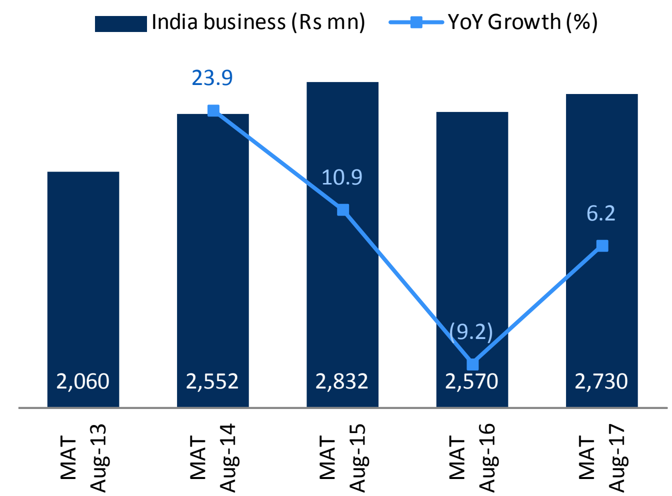
Source: AIOCD, HDFC Sec Inst Research

Productivity: Significant Scope For Improvement



Source: Company, HDFC sec Inst Research
*STR's India revenues have been estimated at 6% of total FY17 revenues.

India Business: Underperforming



*We have included historical sales of acquired products
Source: AIOCD, HDFC sec Inst Research

STR has consistently missed deadlines and targets in this business, and we do not expect any revenues from biopharma for the next 1-1.5 years. However, the opportunity is significant and the outlook is promising

If Stelis becomes successful in the CDMO business and Oncobiologics is able to launch a couple of biosimilars by FY20E, there would be significant jump in the valuations of these investments

At present, both businesses are valued at a combined Rs 30/sh

Biologics: Preparing for the future

Strides entered into the biologics business in 2010, through the acquisition of a 70% stake in Bangalore based biotech startup, Inbiopro Solutions. At the time, Inbiopro had a pipeline of eight oncology candidates, estimated to have global sales of over US$ 28bn and the start of commercialization was targeted in 2013.

- **Evolution since entry:** STR went on to acquire the remaining shares of Inbiopro in 2012, and consolidated its biologics business under Stelis Biopharma, a fully owned subsidiary in 2013. The company develops both 'biosimilars' and 'novel biotherapeutics' for regulated global markets and its business spans the full value chain from development to production and commercialisation.
- Stelis had begun the construction of a biopharma manufacturing facility in Malaysia in 2014. Due to operational issues, this project was shifted to Bangalore, and a 22,000 sq ft facility is being constructed. It will house 60 scientists.
- Although there is no visibility on the out-licensing of existing molecules, Stelis can also de-risk its investments by venturing into the CDMO business in the biopharma space. This would lead to higher utilization of its developing capacities both in R&D and manufacturing.
- **Oncobiologics investment:** In Jul-2014, STR made a strategic investment in Oncobiologics Inc., a privately held New Jersey biopharmaceutical firm developing a pipeline of biosimilars and next generation biotherapeutics, for an undisclosed sum.
- Oncobiologics has biosimilars for four drugs (Humira, Avastin, Herceptin and Prolia/Xgeva) in the pipeline. A Phase 3 trial for ONS-3010 was initiated in Jul-16, after the Phase I trial met primary and secondary end points. A Phase III trial is to be initiated for ONS-1045 in the near-term. Oncobiologics has out-licensed the rights to ONS-3010 and 1045 to GMS Tenshi for emerging markets except India, China and Mexico for an upfront payment of US$ 2.5mn, US$ 5mn in milestones and also a net profit share.
- **Other developments:** (1) GMS Holdings, a Jordan-based privately-owned investment fund, acquired a 25.1% strategic stake in Stelis Biopharma via GMS Pharma (Singapore) Private Limited in Dec-15 for US$ 10mn, thereby valuing the company at US$ 40mn (2) Oncobiologics was listed in the US at a price of US$ 4.8/share. STR holds ~6 mn shares in the company, at a cost of US$ 1.83/sh.
- **Hidden value?:** STR has consistently missed deadlines and targets in this business, and we do not expect any revenues from biopharma for the next 1-1.5 years. However, the opportunity is significant and the outlook is promising. The Stelis and Oncobiologics investments could lead to strong value unlocking for STR. Even if Stelis becomes successful in the CDMO business and not in its own filings, and Oncobiologics is able to launch a couple of biosimilars by FY20E, there would be significant jump in the valuations of these investments. At present, both businesses are valued at a combined Rs 30/sh.

At present, 15% of total revenues comes from APIs sold to third parties

STR has decided to hive-off its commodity third-party API business. This will be combined with SeQuent Scientific's human API business in one entity called Solara Active Pharma Sciences

As per the scheme of arrangement, STR's shareholders will have 60% holding in Solara, leading to a ~Rs 100/sh value on their per share holding in STR

STR's Biopharma Pipeline

Product	From	Nature	Brand	Global sales (US$ bn)	Therapy	Current Status	Potential Launch	No. of Approvals
SBL001	Stelis	Biosim	-	-	Pain	-	2019	-
SBL005	Stelis	Biosim	-	-	Pain	-	2018	-
SBL011	Stelis	NBE	-	-	Ophthalmology	-	N/A	-
SBL012	Stelis	Biosim	-	-	Anti-diabetes	-	2019	-
ONS-3010	Oncobio.	Biosim	Humira	16.1	Oncology	Phase III		2
ONS-1045	Oncobio.	Biosim	Avastin	6.9	Oncology	Phase III ready		1
ONS-1050	Oncobio.	Biosim	Herceptin	6.9	Oncology	Phase I ready		-
ONS-4010	Oncobio.	Biosim	Prolia/Xgeva	3.2	Oncology	Phase I ready		-

Source: Company, HDFC Sec Inst Research

API biz: Hive-off value accretive

- **Current API busines:** At present, 15% of total revenues comes from APIs sold to third parties. It has two key US FDA approved facilities in India, with a large customer base for high volume commodity products like ibuprofen, naproxen, gabapentin, ranitidine and olanzapine. STR is one of the five API suppliers of ibuprofen for the US market. The margin of this business is close to 15-16% due to economies of scale achieved in key products. Interestingly, it will also be supplying sevelamer/colesevelam API to several Indian players who have filed gRenvela, gRenagel and gWelchol in the US. Put together, these 3 products represent a US$ 3bn+ ANDA opportunity, which could translate into a ~US$ 300mn sustainable generic market for the suppliers.

- **Hive-off:** As the focus & skillset required for an API B2B business is significantly different than STR's current goal of building a B2C franchise, the management has decided to hive-off its commodity third-party API business. This will be combined with SeQuent Scientific's human API business in one entity called Solara Active Pharma Sciences. The effective date of this transaction is October 1, 2017.

- We believe STR's commodity API business (being transferred to Solara) will achieve a Rs 8.5bn top-line over the next three years by gaining higher market share in key products like gabapentin and new product launches like sevelamer and colesevelam.

- **Solara listing and value:** Solara is likely to be listed once the required regulatory approvals are in place and we expect this to happen in 4QFY18. As per the scheme of arrangement, STR's shareholders will have 60% holding in Solara, leading to a ~Rs 100/sh value on their per share holding in STR.

Solara: Valuation

	FY17	FY18E	FY19E	FY20E
Solara	5,336	6,200	7,130	8,200
SeQuent	3,000	3,360	3,763	4,215
Total sales (Rs mn)	8,336	9,560	10,893	12,414
EBITDA (%)	16%	16%	16%	17%
EBITDA (Rs mn)	1,334	1,530	1,743	2,110
EV/EBITDA (x)				10
EV (Rs mn)				19,267
Expected mkt cap (Rs mn)				14,767
60% (STR's SHs share)				8,860
Value for STR's shareholders (Rs/share)				100

Source: Company, HDFC Sec Inst Research

Gross margin triggers include improving business mix, shift to in-house manufacturing for the Australia biz and divestment of the lower margin API and African generic businesses

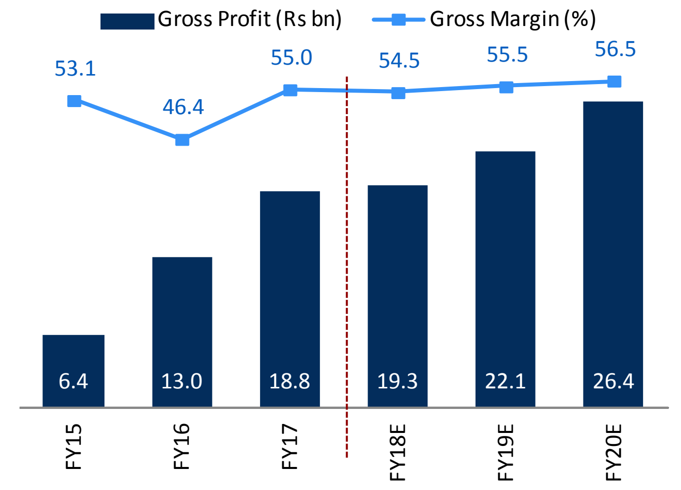
Overall, we foresee 20% EBITDA CAGR (adjusted for API hive-off) and ~200 bps margin expansion over FY17-20E

Financial analysis

- **Gross margin:** STR's gross margin is restricted by a high contribution from the Australian business, where margin expansion is constrained by the PBS price cuts. The gross margin in the institutional business too is not increasing. However, (1) Improving business mix (higher contribution from the US and Australia), (2) Shift to in-house manufacturing for the Australia business, and (3) Divestment of the lower margin API and African generic businesses should see a pick-up in the gross margin going ahead. On a conservative basis, we foresee ~150bps expansion over FY17-20E.

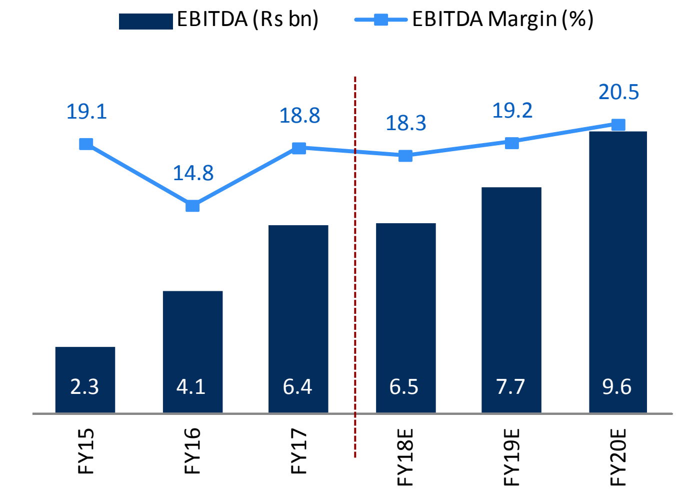
- **EBITDA margin:** There are several EBITDA margin drivers for STR in the foreseeable future; (1) Operating leverage in the US and Australia led by numerous product launches every year, and (2) Expanding presence and higher capacity utilization in the high margin African branded generics business will be margin accretive. Overall, we foresee 20% EBITDA CAGR (adjusted for API hive-off) and ~200 bps margin expansion over FY17-20E.

Gross Margin: Multiple Drivers



Source: Company, HDFC sec Inst Research

Op Lev. To Boost EBITDA Margin



Source: Company, HDFC sec Inst Research

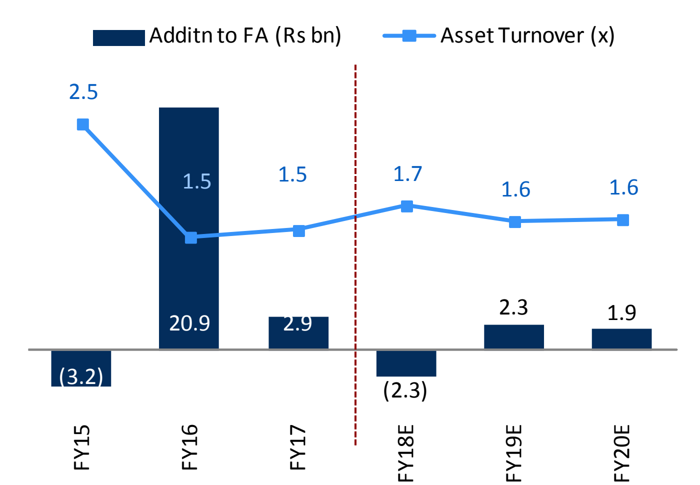
Aggressive M&A activity and high investments in the Australian and US businesses have hampered FCF generation over the last 2-3 years

Modest capex plans, important launches like gLovaza and potassium citrate in the US market and operating leverage from the investments in Australia will be the primary drivers behind FCF generation

Higher FCF generation will also enable debt reduction, and we expect the net debt to equity to fall to 0.2x by FY20E

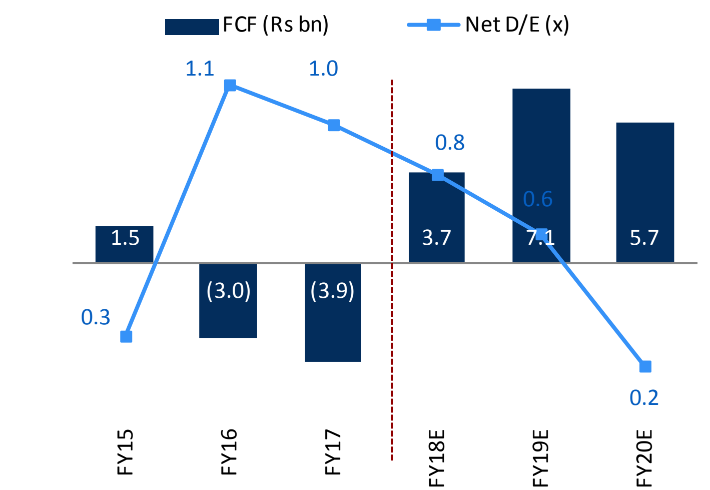
- **Strong FCF generation:** Aggressive M&A activity and high investments in the Australian and US businesses have hampered FCF generation over the last 2-3 years. Debt too was taken on in order to fuel the re-entry into the Australian market and the net debt to equity ratio rose from 0.3x in FY15 to 1x in FY17. FCF generation is of particular importance to STR due to its aggressive inorganic pursuits. A higher degree of internal funding for expansion plans could provide a significant boost to STR's bottom line. We expect the FCF generation momentum to pick-up over the next three years, with upto US$ 80-100 mn generated annually. This will also enable debt reduction, and we expect the net debt to equity to fall to 0.2x by FY20E. Modest capex plans, important launches like gLovaza and potassium citrate in the US market and operating leverage from the investments in Australia will be the primary drivers behind FCF generation.

Asset Turnover: Stable At 1.6-1.7x



Source: Company, HDFC sec Inst Research

FCF Generation To Pick Up From FY18E



Source: Company, HDFC sec Inst Research

Valuation discount to narrow owing to strong EPS outlook, improving return ratios and strong FCF generation

Valuation

At CMP, STR is trading at 17x FY19E and 13x FY20E EPS, a 15-20% discount to mid-cap peers.

We believe this discount is unjustified owing to:

- A strong EPS outlook; 33% CAGR over FY17-20E backed by 18% revenue CAGR
- Improvement in RoIC from 12% currently to 16-17% by FY20E
- Strong free cash flow generation of US$ 250mn over FY18-20E

<u>We value STR's base business at 18x Sep-19E, Solara at Rs 100/sh and the biopharma investments at Rs 30/sh, arriving at a TP of Rs 1,200/sh, implying ~36% upside.</u>

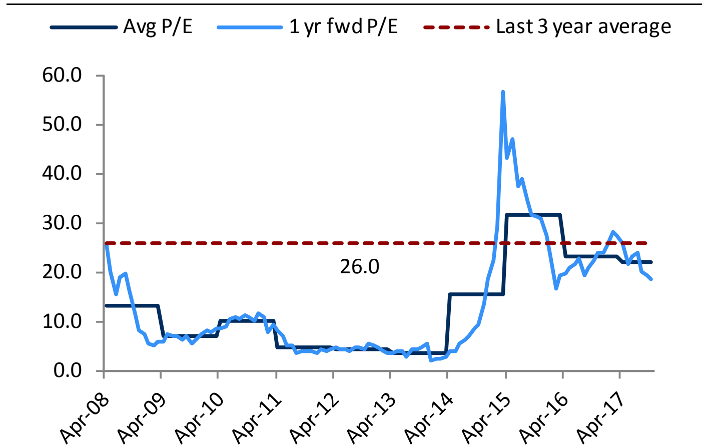
Key catalysts

- Pick up in the US and Australia businesses (from 2HFY18)
- Divestment of non-performing businesses at lucrative valuations

Risks to our investment thesis:

- Unfavourable foreign currency fluctuations
- Business decline in Australia due to PBS price-cuts

STR P/E Band



Source: HDFC Sec Inst Research

Peer Valuations

	Mcap (Rs bn)	CMP (Rs/sh)	Reco	TP	Adj EPS (Rs/sh)				P/E (x)				RoE (%)			
					FY17	FY18E	FY19E	FY20E	FY17	FY18E	FY19E	FY20E	FY17	FY18E	FY19E	FY20E
Sun Pharma	1,286	548	NEU	525	26.0	15.8	23.0	30.8	21.1	34.7	23.9	17.8	17.9	10.1	13.6	16.1
Cadila Healthcare	514	501	BUY	570	14.5	14.4	19.1	26.5	34.4	34.8	26.1	18.9	23.5	19.0	20.8	23.6
Lupin	477	607	BUY	1,605	57.0	48.2	67.9	85.2	48.5	33.0	24.5	19.2	20.9	15.2	18.7	19.8
Cipla	476	1,070	NEU	565	12.5	18.4	24.7	31.7	18.8	22.2	15.7	12.6	8.4	11.2	13.5	15.2
Aurobindo Pharma	436	758	BUY	820	39.3	40.1	48.0	54.2	19.3	18.9	15.8	14.0	27.6	22.5	21.8	20.2
Dr Reddy's	400	2,404	SELL	2,300	72.7	77.2	123.4	165.2	33.1	31.1	19.5	14.5	9.5	10.0	14.5	17.0
Alkem Laboratories	219	1,843	BUY	2,060	74.6	64.9	87.9	108.2	24.7	28.4	21.0	17.0	21.9	16.3	19.2	20.3
Torrent Pharma	215	1,287	BUY	1,400	51.2	46.9	60.7	79.0	25.1	27.4	21.2	16.3	22.1	17.8	20.6	22.7
Glenmark	170	612	BUY	1,035	29.6	27.2	43.7	55.1	20.7	22.5	14.0	11.1	18.1	14.1	19.0	19.9
Alembic Pharma	93	496	BUY	650	21.4	21.0	27.7	37.2	23.2	23.6	17.9	13.3	23.0	19.4	21.8	24.2
Strides Shasun	**78**	**881**	**BUY**	**1,200**	**34.0**	**40.0**	**51.3**	**67.5**	**25.9**	**22.0**	**17.2**	**13.1**	**13.1**	**13.7**	**15.7**	**18.0**
Granules India	31	141	BUY	190	7.2	8.4	10.6	13.3	19.6	16.7	13.3	10.6	21.0	19.6	20.7	22.2

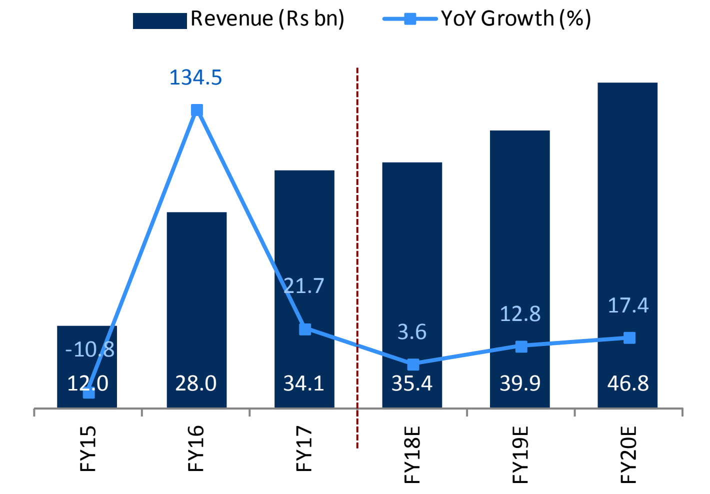
Source: HDFC sec Inst Research

Management profile

Who	Designation	Education	Other Details
Arun Kumar	Founder and Chairman of the Board	Degree in Commerce	Has moved to a Non-Exec position effective May 18, 2017. He has been on the Board since inception of the Company in 1990. He was earlier the General Manager of British Pharmaceuticals Limited.
Shashank Sinha	Managing Director	Bachelor's Degree in Engineering, MBA (IIM, Lucknow)	Appointed to the Board on May 18, 2017. He was the Group CEO and associated with the Strides since March 2016. Prior to Strides, led the US$ 1 billion global flexibles business of Huhtamaki Oyj, a leading consumer packaging company headquartered in Finland. He has also held senior leadership positions at Godrej Consumer Products, Sara Lee Corporation, Reckitt Benckiser plc and Navis Capital Partners.
Badree Komandur	Executive Director	CA, CS, CWA, Degree in Commerce from Univ of Madras	Appointed to the Board on May 18, 2017. He was the Group CFO and is associated with Strides since February 2010. Prior to joining Strides, had 15 years of industrial experience in Information Technology and Engineering Sectors.
Ramaraju P. V. S	Chief Operations Officer	N/A	Has been with Strides for the last 10 years and has over 23 years of experience in the pharmaceutical industry. Has a successful track record of handling inspections, regulatory audits and documentation. Has led many international regulatory audits like USFDA, UK-MHRA, WHO, SA-MCC, Brazil-Anvisa, TGA Australia etc.
Umesh Kale	Chief Quality Officer	M.Pharm (gold medalist) from SGS Institute of Technology and Science, Indore	Has over 24 years of experience in the Pharma industry and is currently responsible for the quality governance of the entire organization, including subsidiaries. Prior to joining Strides, he worked with organizations like Nicholas Piramal, FDC, Lupin, Dr. Reddy's and Ranbaxy. Has handled various regulatory and customer inspections and has successfully led many international regulatory audits like USFDA, UK-MHRA, WHO, SA-MCC, Brazil-Anvisa, TGA Australia, EU etc.

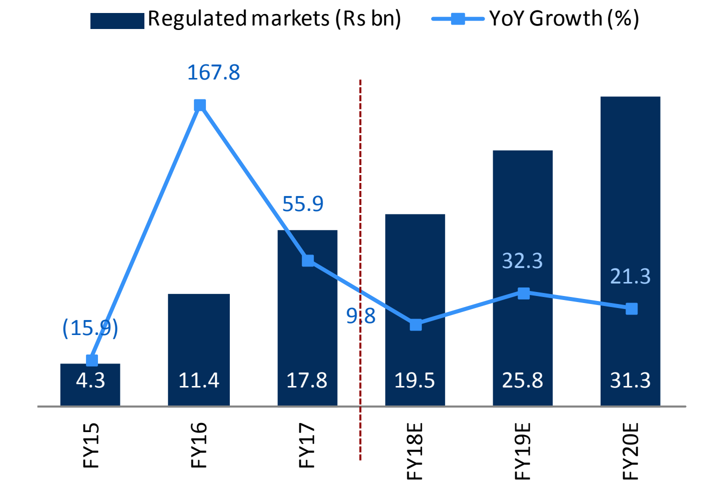
Strides Shasun in charts

Revenue: 18% CAGR Over FY17-20E (Ex-API sales)



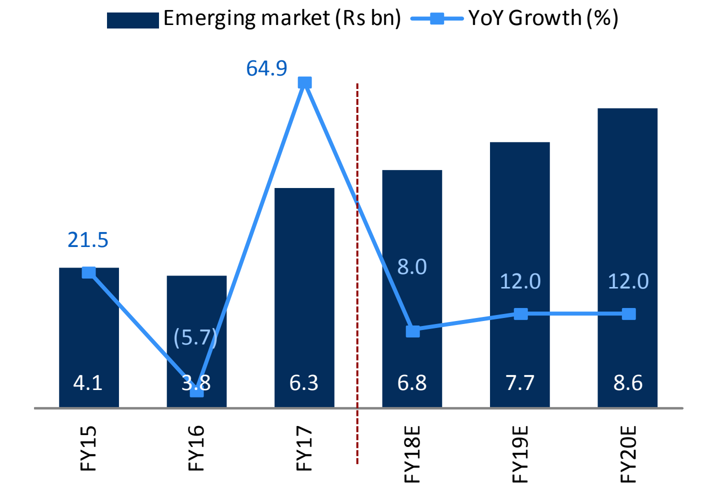
Source: Company, HDFC sec Inst Research

Regulated Markets Business: Key Growth Driver



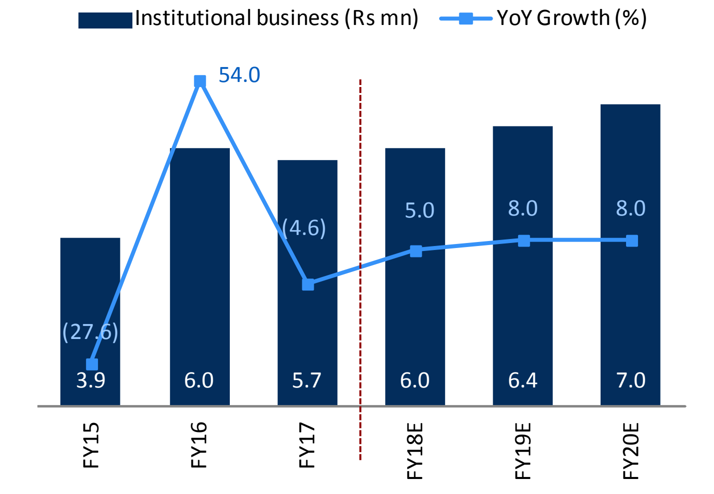
Source: Company, HDFC sec Inst Research

Emerging Markets Business: Modest Growth



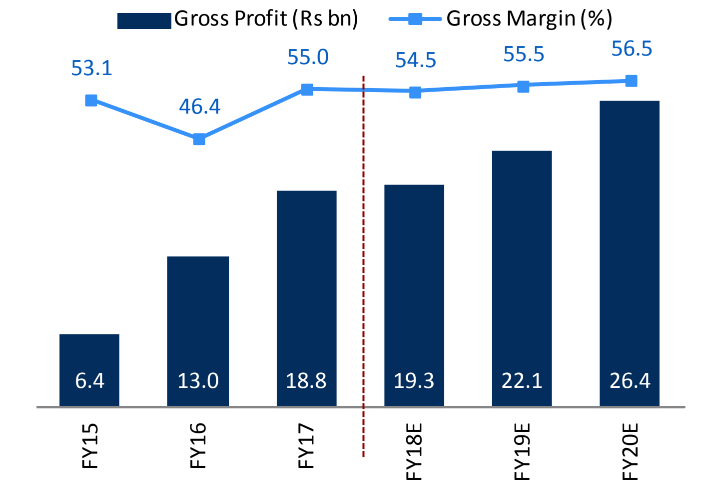
Source: Company, HDFC sec Inst Research

Institutional Business: Muted Growth



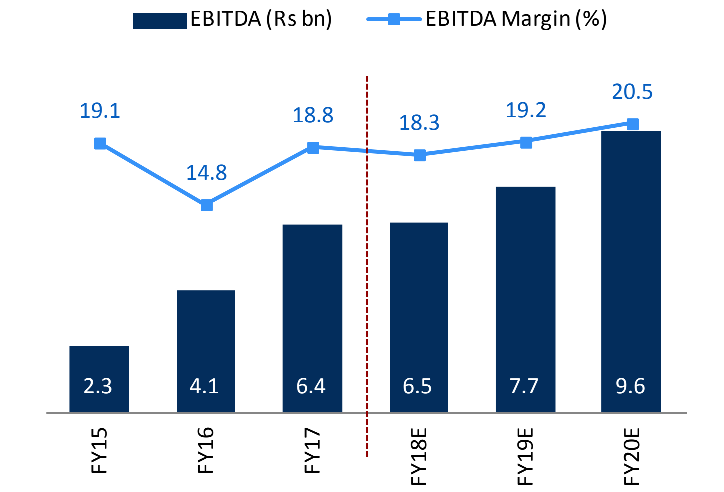
Source: Company, HDFC sec Inst Research

Gross Margin To Expand By ~150bps By FY20E



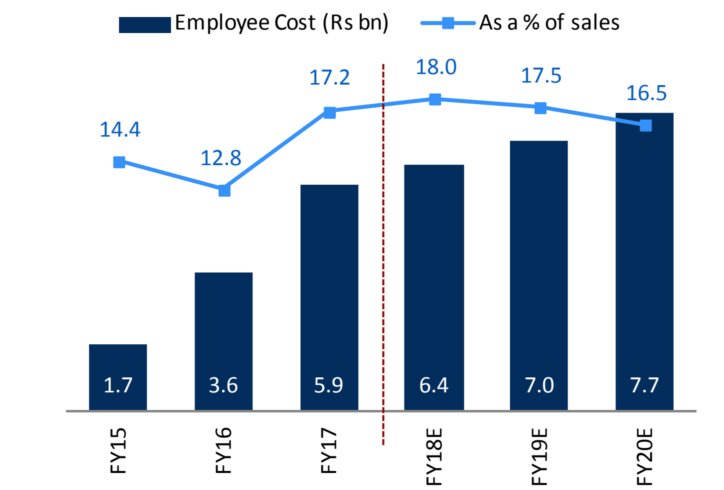
Source: Company, HDFC sec Inst Research

EBITDA Margin: ~200bps Expansion By FY20E



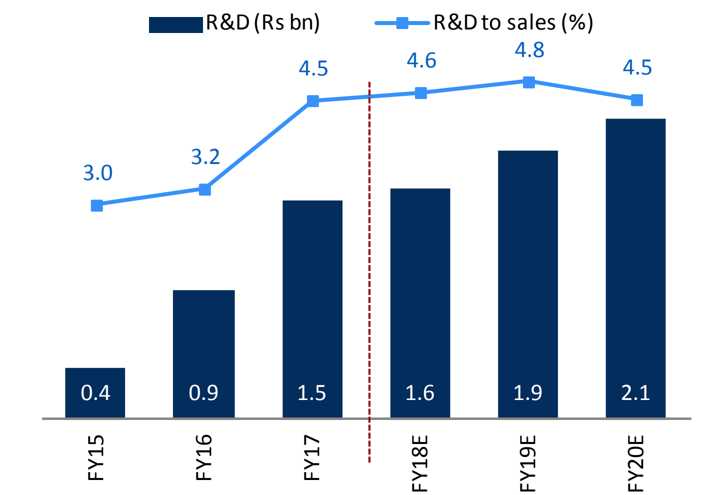
Source: Company, HDFC sec Inst Research

Employee (Fixed) Costs Significant



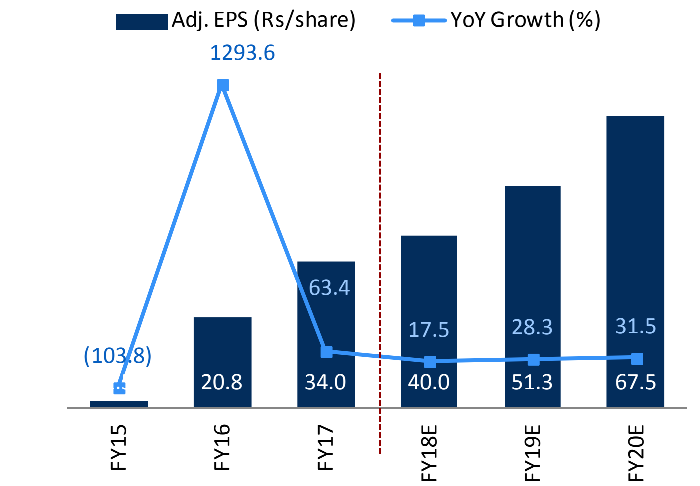
Source: Company, HDFC sec Inst Research

R&D Costs: Capped At US$ 30mn



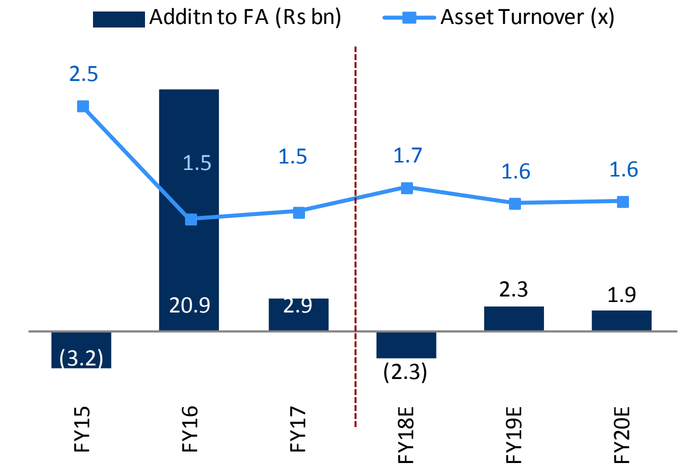
Source: Company, HDFC sec Inst Research

EPS CAGR Of 33% Over FY17-20E (Ex-API biz)



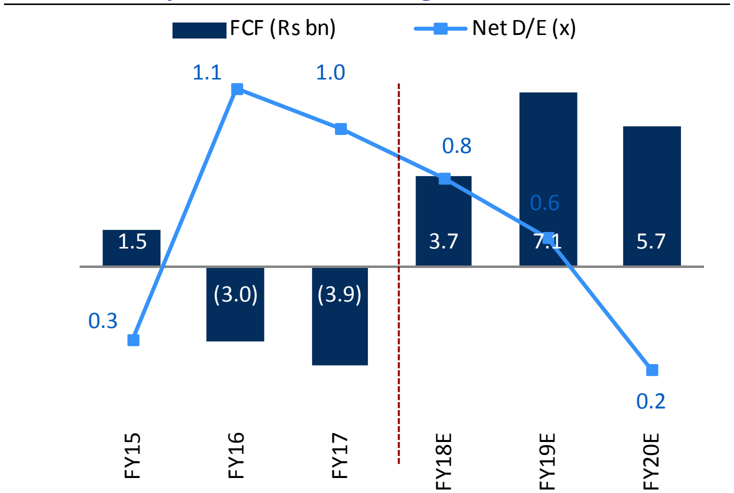
Source: Company, HDFC sec Inst Research

Asset Turnover: Stable At 1.6-1.7x



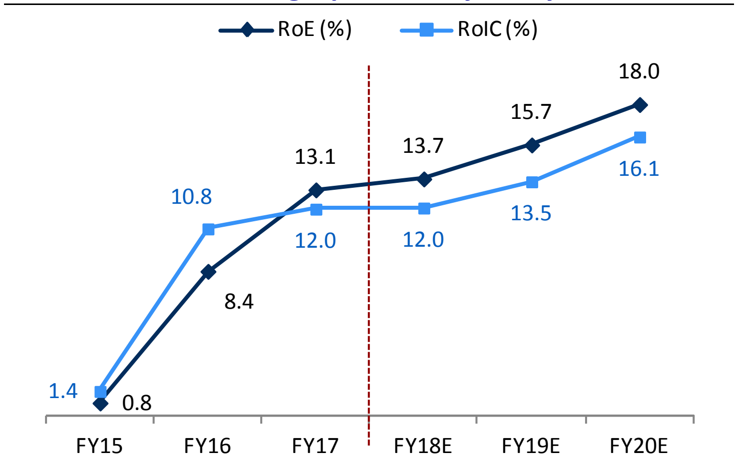
Source: Company, HDFC sec Inst Research

Prudent Capex Will Lead To Higher FCF Generation



Source: Company, HDFC sec Inst Research

Return Ratios: Strong Upward Trajectory



Source: Company, HDFC sec Inst Research

Income Statement (Consolidated)

Year ending March (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Net Revenues	**28,044**	**34,131**	**35,360**	**39,888**	**46,810**
Growth (%)	***134.5***	***21.7***	***3.6***	***12.8***	***17.4***
Material Expenses	15,023	15,362	16,089	17,750	20,362
Employee Expenses	3,577	5,881	6,365	6,980	7,724
Other Operating Expenses	5,304	6,459	6,436	7,499	9,128
EBITDA	**4,140**	**6,428**	**6,471**	**7,658**	**9,596**
EBITDA Margin (%)	***14.8***	***18.8***	***18.3***	***19.2***	***20.5***
EBITDA Growth (%)	***80.9***	***55.3***	***0.7***	***18.4***	***25.3***
Depreciation	1,313	1,872	1,662	1,774	1,929
EBIT	**2,827**	**4,556**	**4,809**	**5,884**	**7,667**
Other Income (Including EO Items)	921	1,686	1,750	1,850	1,950
Interest	1,682	2,269	1,965	1,696	1,581
Exceptional Items	(414)	(1,006)	-	-	-
PBT	**1,653**	**2,967**	**4,594**	**6,038**	**8,036**
Tax (Incl Deferred)	425	470	666	996	1,446
Profit/(loss) from discontinuing operations	(232)	1,959	-	-	-
Profit/(loss) of associate company	(47)	4	-	-	-
Minority Interest	135	(462)	(350)	(450)	(550)
RPAT	**1,085**	**3,997**	**3,578**	**4,592**	**6,040**
EO (Loss) / Profit (Net Of Tax)	(645)	953	-	-	-
APAT	**1,730**	**3,045**	**3,578**	**4,592**	**6,040**
APAT Growth (%)	***1836.0***	***75.9***	***17.5***	***28.3***	***31.5***
Adjusted EPS (Rs)	**20.8**	**34.0**	**40.0**	**51.3**	**67.5**

Source: Company, HDFC sec Inst Research

Balance Sheet (Consolidated)

Year ending March (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
SOURCES OF FUNDS					
Share Capital - Equity	893	894	894	894	894
Reserves	25,685	26,210	29,359	33,262	38,214
Total Shareholders' Funds	**26,579**	**27,104**	**30,253**	**34,156**	**39,109**
Minority Interest	502	1,640	1,990	2,440	2,990
Long Term Debt	26,270	16,377	11,877	10,877	9,877
Short Term Debt	7,005	13,940	13,940	13,940	13,940
Total Debt	**33,275**	**30,317**	**25,817**	**24,817**	**23,817**
Net Deferred Taxes	(502)	88	230	150	100
Other Non-current Liabilities & Provns	1,833	4,855	5,120	5,500	5,650
TOTAL SOURCES OF FUNDS	**61,686**	**64,004**	**63,409**	**67,063**	**71,665**
APPLICATION OF FUNDS					
Net Block	17,520	19,462	15,533	18,259	20,329
CWIP	8,149	7,802	7,500	5,250	3,150
Goodwill	9,267	9,670	9,670	9,670	9,670
Investments	1,272	3,157	3,906	4,226	4,578
Other Non-current Assets	2,245	2,212	2,900	3,100	3,400
Total Non-current Assets	**38,452**	**42,302**	**39,508**	**40,504**	**41,127**
Cash & Equivalents	**15,253**	**16,090**	**12,367**	**15,722**	**17,414**
Inventories	6,131	7,380	6,781	8,196	9,618
Debtors	10,330	9,971	10,656	10,928	12,825
Other Current Assets	3,434	4,734	5,311	5,547	6,280
Total Current Assets	**19,896**	**22,084**	**22,749**	**24,672**	**28,723**
Creditors	7,754	7,465	6,612	8,754	9,763
Other Current Liabilities & Provns	4,161	9,006	4,602	5,082	5,835
Total Current Liabilities	**11,915**	**16,471**	**11,213**	**13,835**	**15,598**
Net Current Assets	**7,981**	**5,613**	**11,535**	**10,836**	**13,125**
TOTAL APPLICATION OF FUNDS	**61,686**	**64,005**	**63,410**	**67,063**	**71,665**

Source: Company, HDFC sec Inst Research

Cash Flow

Year ending March (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Reported PBT	1,464	4,971	4,594	6,038	8,036
Non-operating & EO items	941	(1,599)	142	(80)	(50)
Interest expenses	995	1,521	1,965	1,696	1,581
Depreciation	1,520	1,987	1,662	1,774	1,929
Working Capital Change	(3,417)	(3,413)	(6,346)	879	(2,438)
Tax Paid	(770)	(586)	(666)	(996)	(1,446)
OPERATING CASH FLOW (a)	**732**	**2,881**	**1,351**	**9,311**	**7,611**
Capex	(3,691)	(6,823)	2,302	(2,250)	(1,900)
Free cash flow (FCF)	*(2,959)*	*(3,942)*	*3,653*	*7,061*	*5,711*
Investments	(18,506)	(647)	530	(896)	(957)
Non-operating Income	471	846	-	-	-
Others	(521)	(427)	-	-	-
INVESTING CASH FLOW (b)	**(22,248)**	**(7,051)**	**2,832**	**(3,146)**	**(2,857)**
Debt Issuance/(Repaid)	19,115	6,037	(4,500)	(1,000)	(1,000)
Interest Expenses	(1,347)	(2,370)	(1,965)	(1,696)	(1,581)
FCFE	*(3,748)*	*(502)*	*(2,282)*	*3,469*	*2,174*
Share Capital Issuance	12,264	165	-	-	-
Dividend	(265)	(451)	(429)	(689)	(1,087)
Others	(327)	-	267	-	-
FINANCING CASH FLOW (c)	**29,439**	**3,382**	**(6,627)**	**(3,385)**	**(3,668)**
NET CASH FLOW (a+b+c)	**7,924**	**(788)**	**(2,444)**	**2,780**	**1,087**
EO Items, Others	195	(5,169)	-	-	-
Closing Cash & Equivalents	**11,107**	**5,151**	**851**	**3,631**	**4,718**

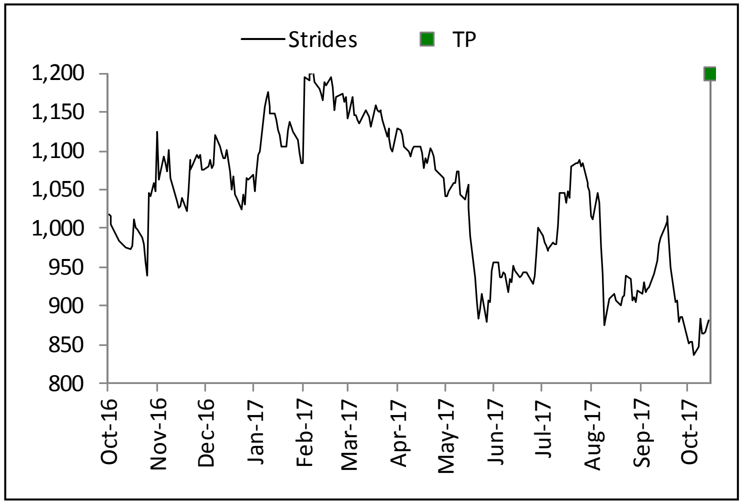
Source: Company, HDFC sec Inst Research

Key Ratios

Year ending March	FY16	FY17	FY18E	FY19E	FY20E
PROFITABILITY (%)					
GPM	46.4	55.0	54.5	55.5	56.5
EBITDA Margin	14.8	18.8	18.3	19.2	20.5
APAT Margin	5.7	10.3	11.1	12.6	14.1
RoE	8.4	13.1	13.7	15.7	18.0
RoIC (or Core RoCE)	10.8	12.0	12.0	13.5	16.1
RoCE	1.2	4.8	8.5	8.5	9.2
EFFICIENCY					
Tax Rate (%)	20.5	11.8	14.5	16.5	18.0
Fixed Asset Turnover (x)	1.5	1.5	1.7	1.6	1.6
Inventory (days)	*79.8*	*78.9*	*70.0*	*75.0*	*75.0*
Debtors (days)	*134.4*	*106.6*	*110.0*	*100.0*	*100.0*
Other Current Assets (days)	*40.7*	*36.4*	*43.9*	*41.6*	*40.9*
Payables (days)	*100.9*	*79.8*	*68.3*	*80.1*	*76.1*
Other Current Liab & Provns days)	*52.2*	*94.3*	*45.5*	*44.5*	*43.5*
Cash Conversion Cycle (days)	*101.8*	*47.8*	*110.1*	*92.0*	*96.3*
Debt/EBITDA (x)	8.0	4.7	4.0	3.2	2.5
Net D/E (x)	1.1	1.0	0.8	0.6	0.2
Interest Coverage (x)	2.2	2.8	3.3	4.6	6.1
PER SHARE DATA (Rs)					
EPS	18.0	55.9	40.0	51.3	67.5
Dividend	4.0	4.5	4.0	6.4	10.1
Book Value	297.1	302.9	338.1	381.7	437.1
VALUATION					
P/E (x)	48.8	15.8	22.0	17.2	13.1
P/BV (x)	3.0	2.9	2.6	2.3	2.0
EV/EBITDA (x)	26.3	16.5	16.0	13.1	10.2
EV/Revenues (x)	3.9	3.1	2.9	2.5	2.1
OCF/EV (%)	0.7	2.7	1.3	9.3	7.8
FCF/EV (%)	(2.7)	(3.7)	3.5	7.1	5.8
FCFE/Mkt Cap (%)	(4.8)	(0.6)	(2.9)	4.4	2.8
Dividend Yield (%)	0.5	0.5	0.5	0.7	1.1

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
16-Oct-17	881	BUY	1,200

Rating Definitions

BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period
NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

Disclosure:

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Any holding in stock –No

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Strides Shasun

BUY

INDUSTRY	PHARMA
CMP *(as on 20 Nov 2017)*	Rs 818
Target Price	Rs 1,200
Nifty	10,299
Sensex	33,360
KEY STOCK DATA	
Bloomberg	STR IN
No. of Shares (mn)	89
MCap (Rs bn) / ($ mn)	73/1,125
6m avg traded value (Rs mn)	426

STOCK PERFORMANCE (%)			
52 Week high / low	Rs 1,275/752		
	3M	6M	12M
Absolute (%)	(9.8)	(17.4)	(21.3)
Relative (%)	(15.6)	(26.9)	(48.8)

SHAREHOLDING PATTERN (%)	
Promoters	31.1
FIs & Local MFs	15.9
FPIs	34.2
Public & Others	18.8

Source : BSE

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Another good deal

In another business restructuring, Strides Shasun (STR) has sold its India-branded business to Eris Life Sciences, for a consideration of Rs 5bn. The business contributed only ~5% to the total topline in FY17, and would have required significant investment to scale it up further. This is the second such business rationalisation by STR in FY18, along with the hive-off of the commodity API business. We believe that these divestments would help narrow STR's focus on the high potential business segments, i.e. the US and Australia, where investments are now complete, and strong growth is expected to kick-in over FY18-20E.

At ~16x/12x FY19E/FY20E EPS, STR is available at attractive valuations. With debt expected to drop by ~Rs 8bn in FY19E (32% of Sep-17 net debt) owing to these divestments, we find more comfort with our FY19/20E earnings estimates. On the back of the launches of gLovaza and potassium citrate in the US, and an expected string of approvals over the next 12 months (new GDUFA guidelines), mgt has guided for a ~US$ 50mn/qtr rev run-rate for the US business from 4QFY18 (v/s our est. of US$ ~38mn). We believe that this is an opportune time to invest in STR, with strong sequential improvement likely from 2HFY18. Re-iterate BUY with a TP of Rs 1,200 (18x Sep19E + Rs 100/sh for Solara + Rs 30/sh for Biopharma).

- **Deal closed at reasonable valuations:** At 2.7x sales and 25-30x Price/EBITDA, we believe that STR has closed this deal at a good valuation, considering that growth was a struggle and margins were in mid single-digits. With a large part of the business coming from three recent acquisitions that added Rs 1.5bn to sales (~80% of total) at Rs 2.75bn acquisition cost, the Rs 5bn cash transaction appears to be a significant ROI for the company, which validates our thesis of STR's focus on wealth creation in our IC note dated October 16, 2017 (Specialist in wealth creation).
- **Deal to be earnings accretive:** Of the Rs 5bn cash, STR would use ~Rs 4bn to repay debt. Consequently, the lower interest cost and removal of the amortisation cost of the acquired India brands make this deal earnings accretive for STR. Moreover, net debt worth Rs 20bn post the India business sell-off is likely to go down further with the proposed divestment of the Solara API business (by Rs 4bn) in 4QFY18, reducing interest cost by 35-40% in FY19 (v/s FY17).
- **View:** Over the last 12-18 months, STR has exited several non-core and low margin businesses (commodity APIs, India branded generic, Africa generic). With the re-structuring exercise appearing to be largely complete, we believe that STR is now poised to deliver strong and margin accretive growth in its focus businesses. Re-iterate BUY.

Financial Summary

(Rs mn)	FY17	FY18E	FY19E	FY20E
Net Sales	34,131	37,119	38,284	45,191
EBITDA	6,428	6,162	7,350	9,264
APAT	3,045	3,127	4,614	6,040
EPS (Rs/sh)	34.0	35.0	51.6	67.5
P/E (x)	14.6	24.7	15.9	12.1
RoE (%)	13.1	11.7	16.0	18.2

Source: Company, HDFC sec Inst Research # Consolidated

Business and deal details

- **About the business:** STR's India branded business had sales of Rs 1.81bn in FY17, contributing ~5% of the total top-line. The business was built largely through a series of acquisitions over the last two to three years. As highlighted in our IC note, the India business was underperforming, with STR struggling to bring growth in the business. A significant investment in marketing would have been required to boost the business, and as such, we believe that STR's resources and focus are better placed elsewhere.

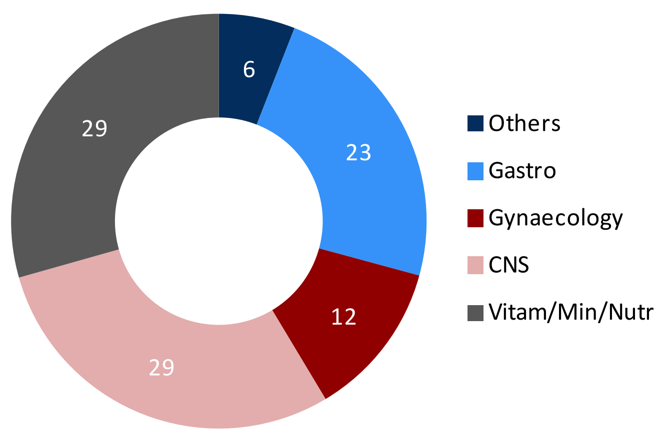
Recent Acquisitions

	Therapy	When	Consideration (Rs mn)	Sales (Rs mn)
Raricap	Vitamins	FY15	481	200
Solus, Solus Care	CNS	FY16	1,650	920
7 JnJ Brands	Various	FY16	619	320

Source: Company, HDFC Sec Inst Research

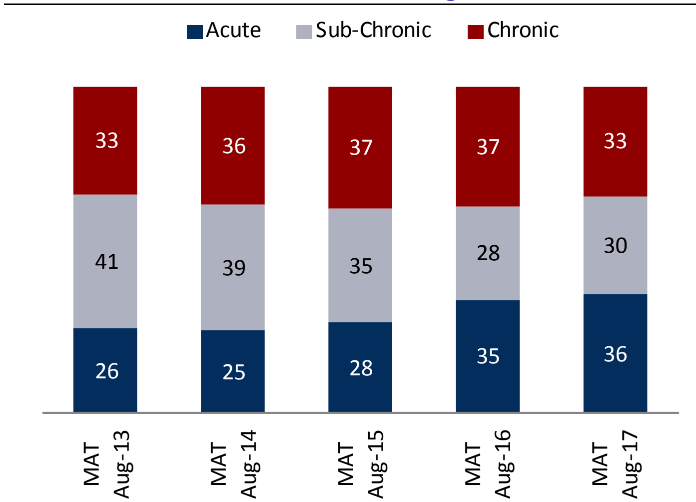
- **Deal details**: The entire business, comprising of ~130 brands, ~800 sales personnel, intellectual properties, intangible assets and contracts is being sold on a slump sales basis for an all cash consideration of Rs 5bn. STR will retain global rights for the divested product portfolio (expected to be largely for Africa). The deal is expected to be competed by November 30th, 2017. <u>We believe that this deal was the best outcome for STR, especially considering the current state of the India busniess and the ROI STR has been able to generate on this transaction (another example of STR's corporate savvy).</u>

Therapy Mix % (MAT Aug-17)



Source: AIOCD, HDFC Sec Inst Research

Acute-Chronic Mix: Deteriorating



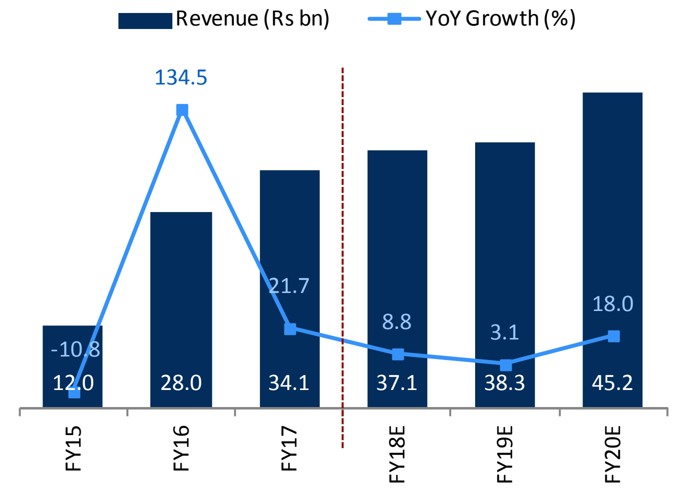
Source: AIOCD, HDFC Sec Inst Research

Revenue will be driven by growth in the US and Australia businesses, which are both expected to grow strongly over FY18-20E

Emerging markets business is expected to grow ~15% CAGR over FY18-20E (ex-India)

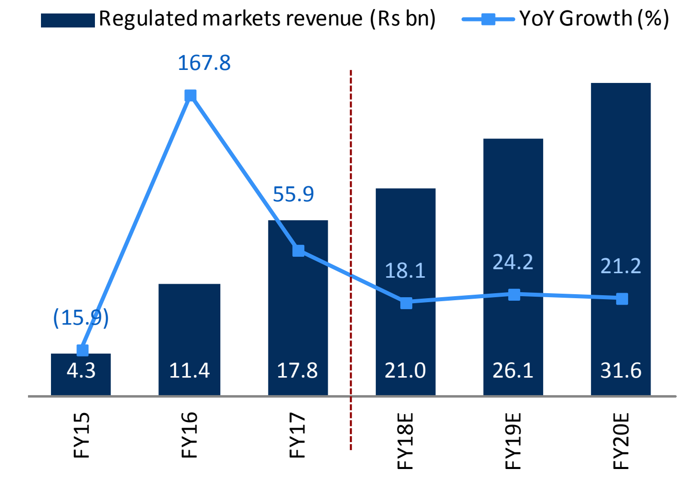
Strides Shasun In Charts

Revenue: 15% CAGR Over FY17-20E (Ex-API sales)



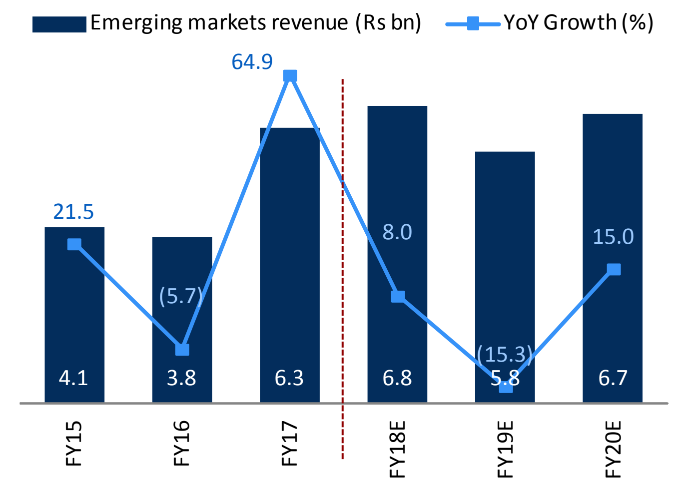
Source: Company, HDFC sec Inst Research

Regulated Markets Business: Key Growth Driver



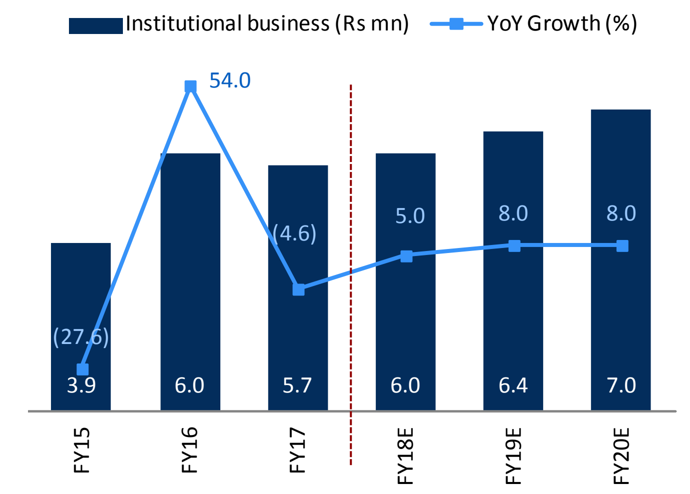
Source: Company, HDFC sec Inst Research

Emerging Markets: India Divestment Impacts Optically



Source: Company, HDFC sec Inst Research

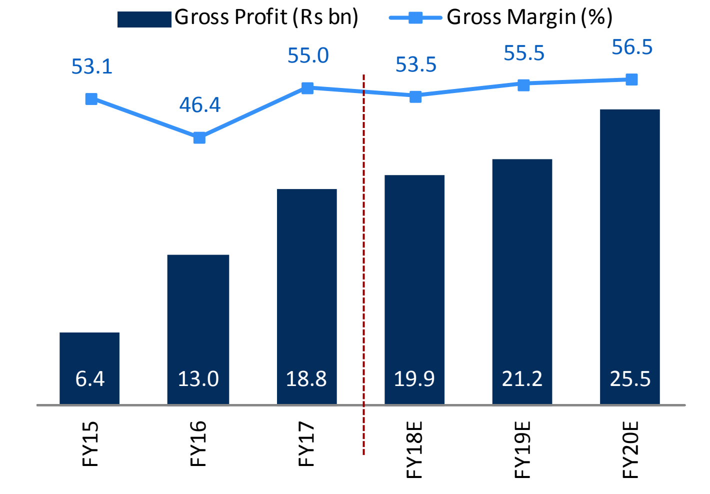
Institutional Business: Muted Growth



Source: Company, HDFC sec Inst Research

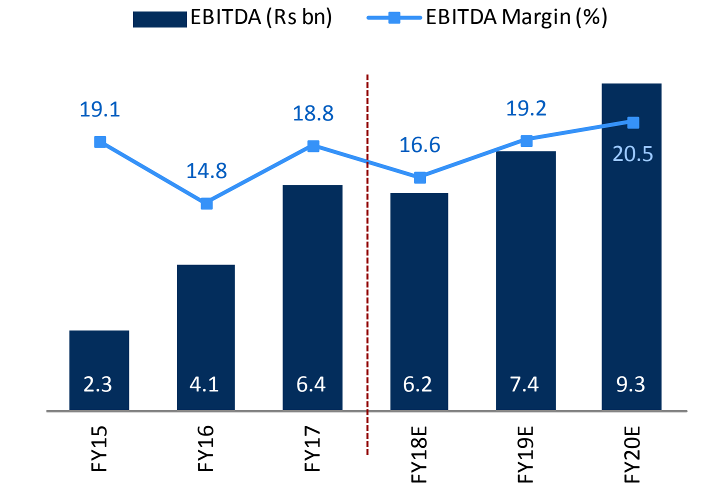
We have modeled a conservative margin expansion over FY17-20E

Gross Margin To Expand By ~150bps By FY20E



Source: Company, HDFC sec Inst Research

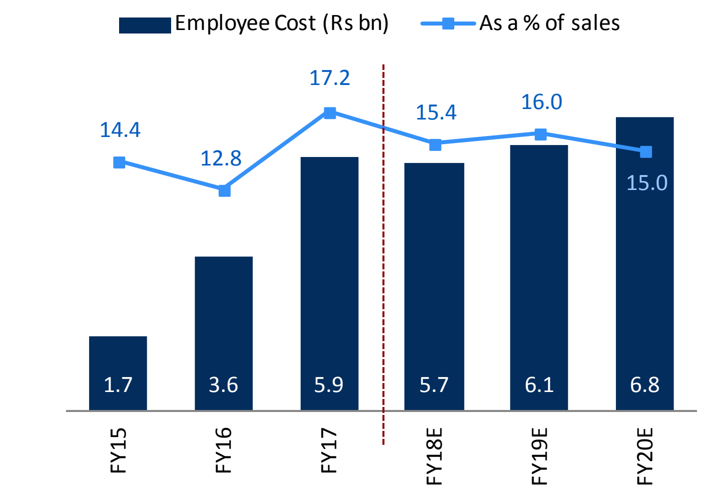
EBITDA Margin: ~200bps Expansion By FY20E



Source: Company, HDFC sec Inst Research

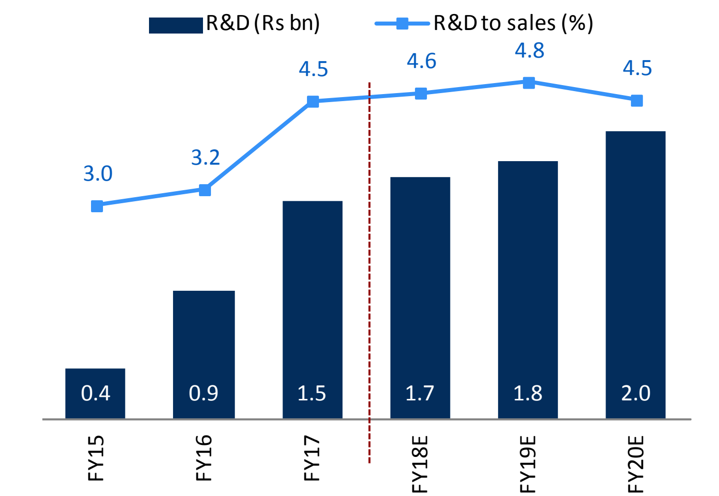
STR has investmented heavily in Australia and the US, and the expected top-line growth will lead to signficant operating leverage

Employee (Fixed) Costs Significant



Source: Company, HDFC sec Inst Research

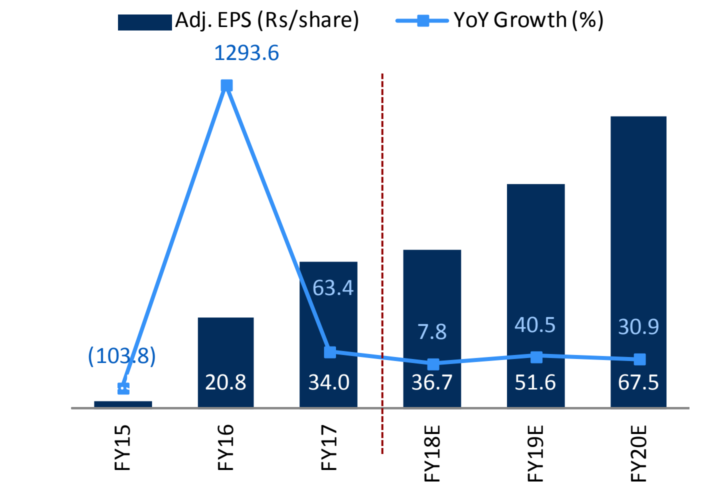
R&D Costs: Capped At US$ 30mn



Source: Company, HDFC sec Inst Research

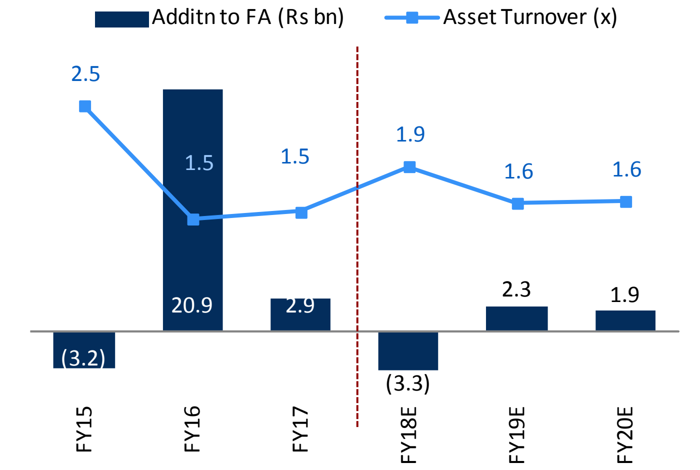
Asset turnover is expected to remain stable at 1.6-1.7x going forward

EPS CAGR Of 33% Over FY17-20E (Ex-API Biz)



Source: Company, HDFC sec Inst Research

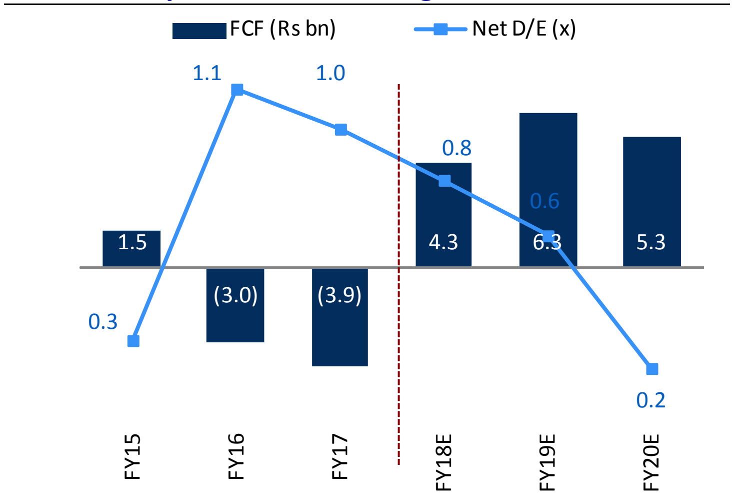
Asset Turnover: Stable At 1.6-1.7x



Source: Company, HDFC sec Inst Research

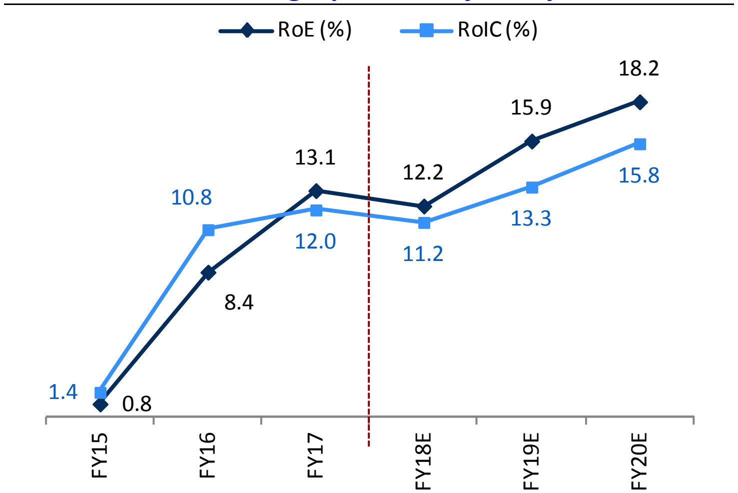
The divestment of the India business is earnings accretive, which is help the return ratios

Prudent Capex Will Lead To Higher FCF Generation



Source: Company, HDFC sec Inst Research

Return Ratios: Strong Upward Trajectory



Source: Company, HDFC sec Inst Research

Peer Valuations

	Mcap (Rs bn)	CMP (Rs/sh)	Reco	TP	Adj EPS (Rs/sh)				P/E (x)				RoE (%)			
					FY17	FY18E	FY19E	FY20E	FY17	FY18E	FY19E	FY20E	FY17	FY18E	FY19E	FY20E
Sun Pharma	1,244	517	NEU	485	26.0	14.6	20.9	28.5	19.9	35.3	24.7	18.1	17.9	9.4	12.5	15.2
Cipla	485	604	NEU	630	12.5	21.2	27.6	35.2	48.3	28.5	21.9	17.2	8.4	12.8	14.7	16.3
Cadila Healthcare	457	446	BUY	540	14.5	12.6	19.2	25.9	30.7	35.3	23.2	17.2	23.5	16.9	21.6	24.0
Aurobindo	413	706	NEU	800	39.3	37.7	46.7	53.7	18.0	18.7	15.1	13.2	27.6	21.3	21.5	20.3
Dr Reddy's	386	2,274	SELL	2,220	72.7	71.0	118.8	158.9	31.3	32.0	19.1	14.3	9.5	9.2	14.1	16.6
Lupin	371	826	BUY	1,125	56.9	36.7	46.6	66.0	14.5	22.5	17.7	12.5	20.9	11.8	13.6	17.0
Divis Labs	278	1,048	NEU	1,100	39.9	35.9	46.5	53.1	26.2	29.2	22.5	19.7	22.0	16.8	19.4	19.8
Alkem Laboratories	236	1,978	BUY	2,100	74.6	63.6	85.5	104.8	26.5	31.1	23.1	18.9	21.9	16.0	18.8	19.8
Torrent Pharma	211	1,250	BUY	1,480	51.2	46.9	60.7	79.0	24.4	26.7	20.6	15.8	22.1	17.8	20.6	22.7
Glenmark	167	593	BUY	1,000	29.6	25.1	41.9	54.6	20.0	23.6	14.1	10.8	18.1	13.1	18.4	20.0
Jubilant Life Sciences	105	660	BUY	850	37.0	41.9	55.1	70.1	5.3	4.7	3.5	2.8	18.0	17.9	19.7	20.9
Alembic Pharma	97	515	NEU	555	21.4	21.1	24.7	31.1	24.1	24.4	20.9	16.6	23.0	19.5	19.6	21.0
Strides Shasun	**73**	**818**	**BUY**	**1,200**	**34.0**	**35.0**	**51.6**	**67.5**	**24.0**	**23.4**	**15.9**	**12.1**	**13.1**	**11.7**	**16.0**	**18.2**
Dishman Carbogen Amcis	46	283	BUY	410	9.0	11.8	16.7	22.9	31.4	24.0	17.0	12.4	3.0	3.9	5.3	6.9
Granules India	32	126	BUY	170	7.5	6.9	9.0	12.2	16.7	18.3	13.9	10.2	21.0	15.5	16.0	19.1

Source: HDFC sec Inst Research

STR trades at attractive valuations compared to peers

Income Statement (Consolidated)

Year ending March (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Net Revenues	**28,044**	**34,131**	**37,119**	**38,284**	**45,191**
Growth (%)	***134.5***	***21.7***	***8.8***	***3.1***	***18.0***
Material Expenses	15,023	15,362	17,260	17,036	19,658
Employee Expenses	3,577	5,881	5,716	6,125	6,779
Other Operating Expenses	5,304	6,459	7,981	7,772	9,490
EBITDA	**4,140**	**6,428**	**6,162**	**7,350**	**9,264**
EBITDA Margin (%)	***14.8***	***18.8***	***16.6***	***19.2***	***20.5***
EBITDA Growth (%)	***80.9***	***55.3***	***(4.1)***	***19.3***	***26.0***
Depreciation	1,313	1,872	1,837	1,708	1,896
EBIT	**2,827**	**4,556**	**4,324**	**5,643**	**7,368**
Other Income (Including EO Items)	921	1,686	1,750	1,850	1,950
Interest	1,682	2,269	2,007	1,428	1,321
Exceptional Items	(414)	(1,006)	(166)	-	-
PBT	**1,653**	**2,967**	**3,901**	**6,064**	**7,997**
Tax (Incl Deferred)	425	470	590	1,001	1,408
Profit/(loss) from discontinuing operations	(232)	1,959	-	-	-
Profit/(loss) of associate company	(47)	4	-	-	-
Minority Interest	135	(462)	(350)	(450)	(550)
RPAT	**1,085**	**3,997**	**2,961**	**4,614**	**6,040**
EO (Loss) / Profit (Net Of Tax)	(645)	953	(166)	-	-
APAT	**1,730**	**3,045**	**3,127**	**4,614**	**6,040**
APAT Growth (%)	***1836.0***	***75.9***	***2.7***	***47.5***	***30.9***
Adjusted EPS (Rs)	**20.8**	**34.0**	**35.0**	**51.6**	**67.5**

Source: Company, HDFC sec Inst Research

Balance Sheet (Consolidated)

Year ending March (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
SOURCES OF FUNDS					
Share Capital - Equity	893	894	894	894	894
Reserves	25,685	26,210	28,816	32,738	37,691
Total Shareholders Funds	**26,579**	**27,104**	**29,710**	**33,632**	**38,585**
Minority Interest	502	1,640	1,990	2,440	2,990
Long Term Debt	26,270	16,377	7,877	6,877	5,877
Short Term Debt	7,005	13,940	13,940	13,940	13,940
Total Debt	**33,275**	**30,317**	**21,817**	**20,817**	**19,817**
Net Deferred Taxes	(502)	88	230	150	100
Other Non-current Liabilities & Provns	1,833	4,855	5,120	5,500	5,650
TOTAL SOURCES OF FUNDS	**61,686**	**64,004**	**58,867**	**62,539**	**67,141**
APPLICATION OF FUNDS					
Net Block	17,520	19,462	14,566	17,358	19,462
CWIP	8,149	7,802	7,500	5,250	3,150
Goodwill	9,267	9,670	9,670	9,670	9,670
Investments	1,272	3,157	3,906	4,226	4,578
Other Non-current Assets	2,245	2,212	2,900	3,100	3,400
Total Non-current Assets	**38,452**	**42,302**	**38,541**	**39,603**	**40,259**
Cash & Equivalents	**15,253**	**16,090**	**8,682**	**11,512**	**13,039**
Inventories	6,131	7,380	7,119	8,181	9,657
Debtors	10,330	9,971	11,186	11,013	13,000
Other Current Assets	3,434	4,734	5,364	5,507	6,244
Total Current Assets	**19,896**	**22,084**	**23,669**	**24,701**	**28,901**
Creditors	7,754	7,465	7,093	8,401	9,425
Other Current Liabilities & Provns	4,161	9,006	4,932	4,877	5,633
Total Current Liabilities	**11,915**	**16,471**	**12,025**	**13,279**	**15,058**
Net Current Assets	**7,981**	**5,613**	**11,643**	**11,423**	**13,843**
TOTAL APPLICATION OF FUNDS	**61,686**	**64,005**	**58,867**	**62,538**	**67,141**

Source: Company, HDFC sec Inst Research

Cash Flow

Year ending March (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Reported PBT	1,464	4,971	4,067	6,064	7,997
Non-operating & EO items	941	(1,599)	142	(80)	(50)
Interest net	995	1,521	2,007	1,428	1,321
Depreciation	1,520	1,987	1,837	1,708	1,896
Working Capital Change	(3,417)	(3,413)	(6,454)	401	(2,570)
Tax Paid	(770)	(586)	(590)	(1,001)	(1,408)
OPERATING CASH FLOW (a)	**732**	**2,881**	**1,010**	**8,520**	**7,186**
Capex	(3,691)	(6,823)	3,302	(2,250)	(1,900)
Free cash flow (FCF)	*(2,959)*	*(3,942)*	*4,312*	*6,270*	*5,286*
Investments	(18,506)	(647)	4,369	(704)	(755)
Non-operating Income	471	846	-	-	-
Others	(521)	(427)	-	-	-
INVESTING CASH FLOW (b)	**(22,248)**	**(7,051)**	**7,671**	**(2,954)**	**(2,655)**
Debt Issuance/(Repaid)	19,115	6,037	(8,500)	(1,000)	(1,000)
Interest Expenses	(1,347)	(2,370)	(2,007)	(1,428)	(1,321)
FCFE	*(3,748)*	*(502)*	*(1,826)*	*3,138*	*2,211*
Share Capital Issuance	12,264	165	-	-	-
Dividend	(265)	(451)	(355)	(692)	(1,087)
Others	(327)	-	(108)	-	-
FINANCING CASH FLOW (c)	**29,439**	**3,382**	**(10,970)**	**(3,120)**	**(3,408)**
NET CASH FLOW (a+b+c)	**7,924**	**(788)**	**(2,290)**	**2,446**	**1,123**
EO Items, Others	195	(5,169)	-	-	-
Closing Cash & Equivalents	**11,107**	**5,151**	**1,005**	**3,451**	**4,575**

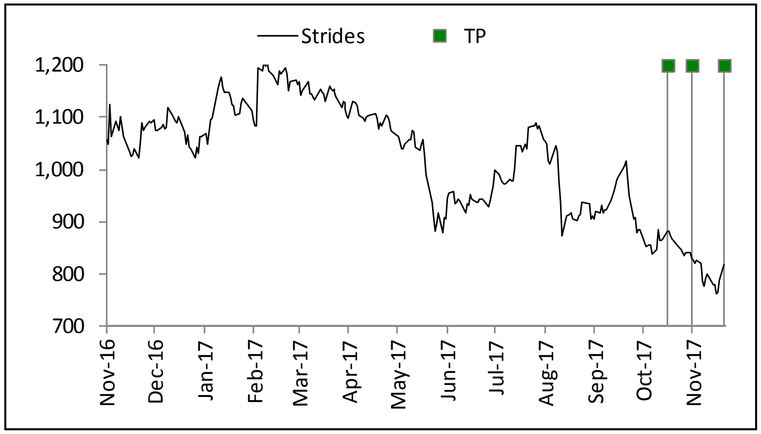
Source: Company, HDFC sec Inst Research

Key Ratios

	FY16	FY17	FY18E	FY19E	FY20E
PROFITABILITY (%)					
GPM	46.4	55.0	53.5	55.5	56.5
EBITDA Margin	14.8	18.8	16.6	19.2	20.5
APAT Margin	5.7	10.3	8.9	13.2	14.6
RoE	8.4	13.1	11.7	16.0	18.2
RoIC (or Core RoCE)	10.8	12.0	11.2	13.3	15.8
RoCE	1.2	4.8	8.8	8.1	9.5
EFFICIENCY					
Tax Rate (%)	20.5	11.8	14.5	16.5	17.6
Fixed Asset Turnover (x)	1.5	1.5	1.9	1.6	1.6
Inventory (days)	*79.8*	*78.9*	*70.0*	*78.0*	*78.0*
Debtors (days)	*134.4*	*106.6*	*110.0*	*105.0*	*105.0*
Other Current Assets (days)	*40.7*	*36.4*	*41.8*	*43.4*	*42.4*
Payables (days)	*100.9*	*79.8*	*69.8*	*80.1*	*76.1*
Other Current Liab & Provns (days)	*52.2*	*94.3*	*46.5*	*44.5*	*43.5*
Cash Conversion Cycle (days)	*101.8*	*47.8*	*105.5*	*101.8*	*105.8*
Debt/EBITDA (x)	8.0	4.7	3.5	2.8	2.1
Net D/E (x)	1.1	1.0	0.7	0.5	0.2
Interest Coverage (x)	2.2	2.8	3.0	5.2	7.1
PER SHARE DATA (Rs)					
EPS	18.0	55.9	33.1	51.6	67.5
Dividend	4.0	4.5	3.3	6.4	10.1
Book Value	297.1	302.9	332.1	375.9	431.2
VALUATION					
P/E (x)	45.3	14.6	24.7	15.9	12.1
P/BV (x)	2.8	2.7	2.5	2.2	1.9
EV/EBITDA (x)	25.0	15.6	15.3	12.3	9.5
EV/Revenues (x)	3.7	2.9	2.5	2.4	2.0
OCF/EV (%)	0.7	2.9	1.1	9.4	8.1
FCF/EV (%)	(2.9)	(3.9)	4.6	6.9	6.0
FCFE/Mkt Cap (%)	(5.1)	(0.7)	(2.5)	4.3	3.0
Dividend Yield (%)	0.5	0.6	0.4	0.8	1.2

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
16-Oct-17	881	BUY	1,200
1-Nov-17	827	BUY	1,200
21-Nov-17	818	BUY	1,200

Rating Definitions

BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period
NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

Disclosure:
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20 November 2017

Update | Sector: Healthcare

Strides Shasun

BSE SENSEX	S&P CNX
33,343	10,284

CMP: INR787 TP: INR1,214(+54%) Buy

Divestment to focus on profitable businesses

We believe that sale of domestic formulation business at 2.7x EV/FY17 sales is not only at good multiple but would also enable Strides Shasun (STR) to focus on US and Australia's regulated market and Africa business in emerging market. The deal also enables STR to reduce financial leverage, thereby improving profitability.

- **Transaction details:** Strides Shasun (STR) has entered into definitive agreement with Eris Lifesciences for sale of domestic branded formulation business for cash consideration of INR5b. In this transaction, STR would divest portfolio of 130+ brands along-with employees forming part of the domestic branded business. STR would retain global rights of these products. The transaction is subject to customary closing conditions and both companies intend to close the transaction by 30 November 2017.
- **Deal to improve operating margin and reduce financial leverage:** STR, over past two years had spent ~INR2.5b to acquire brands from J&J, Sun Pharma and Medispan. The sale of these brands was INR1.8b in FY17, implying EV/sales of 2.7x, which is decent as this business has been EBITDA neutral for STR. Thus, sale of this business would reduce revenue for STR and improve EBITDA margin. Repayment of debt of INR4b would reduce annual interest outgo to the tune of INR350m, thereby improving profitability as well.
- **Change in estimates and view:** We tweak our estimates to incorporate sales of business and use of proceeds to repay debt. Accordingly, we marginally raise our EPS estimate to INR47.4/INR74.8/INR92.1 for FY18E/FY19E/FY20E and raise our price target to INR1,214 (SOTP basis). We continue to like STR on the back of robust ANDA pipeline, consistent compliance, outperforming industry in Australia market and lower net debt to equity ratio. Re-ieterate Buy

Stock Info

Bloomberg	STR IN
Equity Shares (m)	89.5
52-Week Range (INR)	1,259/754
1, 6, 12 Rel. Per (%)	-13/-30/-50
M.Cap. (INR b)	70.4
M.Cap. (USD b)	1.1
Avg Val (INRm)/Vol m	423.2 / 0.4
Free float (%)	68.9

Financials Snapshot (INR b)

Y/E Mar	2017	2018E	2019E
Net Sales	34.8	40.4	49.4
EBITDA	6.4	7.8	10.4
PAT	2.9	3.7	6.2
EPS (INR)	32.3	41.8	69.2
Gr. (%)	77.6	29.5	65.5
BV/Sh (INR)	303.1	342.5	411.6
RoE (%)	10.8	12.9	18.3
RoCE (%)	8.3	9.3	12.0
P/E (x)	24.4	18.8	11.4
P/BV (x)	2.6	2.3	1.9

Shareholding pattern (%)

As On	Sep-17	Jun-17	Sep-16
Promoter	31.1	31.1	31.1
DII	16.5	15.5	12.6
FII	33.6	33.9	35.3
Others	18.8	19.5	21.0

FII Includes depository receipts

Stock Performance (1-year)

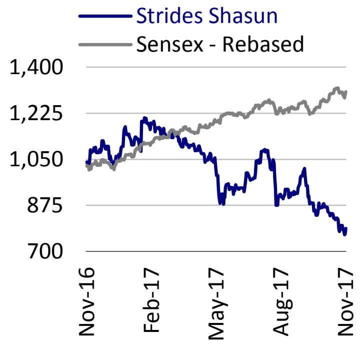

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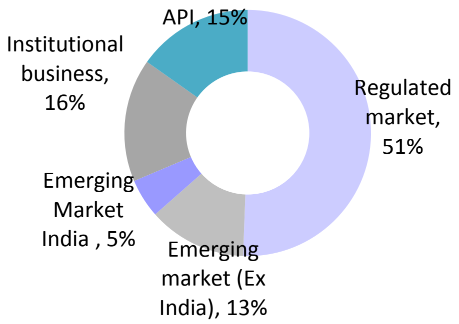
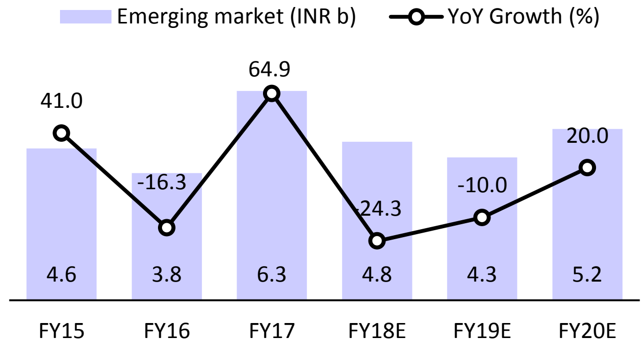
Exhibit 1: India branded business formed 5% of sales (FY17)



Source: MOSL, Company

Exhibit 2: Organic and inorganic route led growth in EMs



Source: MOSL, Company

Exhibit 3: Key changes in estimates

INR b	Old estimates			New estimates			Change (%)		
	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E
Sales	41,455	51,927	59,855	40,372	49,415	56,966	(2.6)	(4.8)	(4.8)
EBITDA	7,752	10,333	12,151	7,751	10,377	12,191	(0.0)	0.4	0.3
EBITDA Margin (%)	18.7	19.9	20.3	19.2	21.0	21.4			
PAT	3,729	6,103	7,490	3,737	6,186	7,623	0.2	1.3	1.8
EPS (INR)	41.7	68.3	83.8	41.8	69.2	85.3	0.2	1.3	1.8
TP		**1,201**			**1,214**			**1.0**	

Source:

Exhibit 4: SOTP based target price of INR1,214

Particulars	FY19
Valuation of Strides Pharma	
Strides Pharma PAT (INR m)	5,003
PE multiple (x)	18
Target Mkt Cap (INR m)	90,050
Valuation of Solara	
API business EBITDA (INR m)	2,671
EV/EBITDA multiple	13
EV of API business	34,724
Net Debt of API business (INR m)	4500
Stake of Strides Pharma (%)	60
Target Mkt Cap (INR m)	18,135
Total target Mkt Cap (INR m)	**108,184**
No. of shares	89.4
Target Price (INR)	**1,214**
% Upside	54.2

Source: MOSL

Financials and Valuations

Consolidated - Income Statement								(INR m)
Y/E March	CY12	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Total Income from Operations	**9,618**	**13,410**	**11,959**	**28,622**	**34,834**	**40,372**	**49,415**	**56,966**
Change (%)	-62.3	39.4	-10.8	139.3	21.7	15.9	22.4	15.3
Raw Materials	4,918	7,147	5,605	15,023	15,362	17,521	21,001	24,097
Employees Cost	1,203	1,572	1,721	3,577	5,881	6,702	8,055	9,228
Other Expenses	2,490	2,457	2,345	5,882	7,163	8,397	9,982	11,450
Total Expenditure	**8,612**	**11,175**	**9,670**	**24,482**	**28,406**	**32,620**	**39,038**	**44,775**
% of Sales	89.5	83.3	80.9	85.5	81.5	80.8	79.0	78.6
EBITDA	**1,006**	**2,235**	**2,288**	**4,140**	**6,428**	**7,751**	**10,377**	**12,191**
Margin (%)	10.5	16.7	19.1	14.5	18.5	19.2	21.0	21.4
Depreciation	309	565	640	1,313	1,872	2,099	2,465	2,613
EBIT	**697**	**1,670**	**1,648**	**2,827**	**4,557**	**5,653**	**7,912**	**9,578**
Int. and Finance Charges	795	1,089	474	1,682	2,269	2,065	1,456	1,326
Other Income	342	602	386	921	1,686	1,413	1,482	1,424
PBT bef. EO Exp.	**245**	**1,183**	**1,560**	**2,067**	**3,973**	**5,001**	**7,939**	**9,676**
EO Items	7,001	-266	-74	-414	-1,006	-197	0	0
PBT after EO Exp.	**7,246**	**918**	**1,486**	**1,653**	**2,967**	**4,804**	**7,939**	**9,676**
Total Tax	112	409	532	425	470	761	1,257	1,533
Tax Rate (%)	1.5	44.5	35.8	25.7	15.8	15.8	15.8	15.8
Minority Interest	11	6	-6	-88	458	472	496	521
Tax on dividend received from subsidiries	0	2,837	944	0	0	0	0	0
Reported PAT from Continuing Ops.	**7,123**	**-2,333**	**16**	**1,317**	**2,039**	**3,571**	**6,186**	**7,623**
Adj. PAT from Continuing Ops.	**230**	**651**	**1,007**	**1,624**	**2,886**	**3,737**	**6,186**	**7,623**
Change (%)	-87.4	182.9	54.7	61.3	77.6	29.5	65.5	23.2
Margin (%)	2.4	4.9	8.4	5.7	8.3	9.3	12.5	13.4

Consolidated - Balance Sheet								(INR m)
Y/E March	CY12	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Equity Share Capital	588	596	596	894	894	894	894	894
Total Reserves	19,675	9,473	10,853	25,685	26,210	29,728	35,914	43,537
Net Worth	**20,263**	**10,068**	**11,449**	**26,579**	**27,104**	**30,622**	**36,808**	**44,431**
Minority Interest	719	757	187	502	1,640	1,640	1,640	1,640
Total Loans	15,945	5,466	8,917	35,418	36,997	32,997	31,722	29,947
Deferred Tax Liabilities	272	17	-54	-502	89	89	89	89
Capital Employed	**37,198**	**16,308**	**20,500**	**61,997**	**65,829**	**65,347**	**70,258**	**76,106**
Gross Block	18,240	8,039	9,437	18,987	22,233	28,954	31,163	32,558
Less: Accum. Deprn.	4,976	3,528	3,792	1,468	2,771	4,870	7,334	9,947
Net Fixed Assets	**13,264**	**4,511**	**5,645**	**17,520**	**19,462**	**24,085**	**23,828**	**22,611**
Goodwill on Consolidation	16,903	1,034	1,368	9,267	9,670	9,670	9,670	9,670
Capital WIP	2,415	995	1,712	8,149	7,802	2,040	984	805
Total Investments	**1**	**4,430**	**6,300**	**13,409**	**15,952**	**15,952**	**15,052**	**15,052**
Curr. Assets, Loans&Adv.	**15,378**	**9,993**	**9,668**	**25,256**	**27,582**	**30,486**	**41,156**	**51,462**
Inventory	4,423	1,760	2,077	6,131	7,380	8,475	10,142	11,633
Account Receivables	4,832	3,640	3,900	10,330	9,971	11,555	14,144	16,305
Cash and Bank Balance	1,658	2,312	1,469	3,116	3,295	2,416	7,030	12,181
Loans and Advances	4,465	2,281	2,223	5,679	6,936	8,039	9,840	11,343
Curr. Liability & Prov.	**10,762**	**4,655**	**4,194**	**11,605**	**14,638**	**16,885**	**20,432**	**23,493**
Account Payables	4,631	2,679	2,065	7,836	7,521	8,636	10,335	11,854
Other Current Liabilities	4,733	879	1,268	2,943	5,986	6,938	8,492	9,790
Provisions	1,399	1,098	861	826	1,131	1,311	1,604	1,849
Net Current Assets	**4,616**	**5,338**	**5,474**	**13,652**	**12,944**	**13,601**	**20,724**	**27,969**
Appl. of Funds	**37,198**	**16,308**	**20,500**	**61,997**	**65,829**	**65,347**	**70,258**	**76,106**

Financials and Valuations

Ratios

Y/E March	CY12	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Basic (INR)								
EPS	**2.6**	**7.3**	**11.3**	**18.2**	**32.3**	**41.8**	**69.2**	**85.3**
Cash EPS	6.0	13.6	18.4	32.8	53.2	65.3	96.7	114.5
BV/Share	226.6	112.6	128.0	297.2	303.1	342.5	411.6	496.9
DPS	1.3	336.5	71.9	0.8	0.0	0.0	0.0	0.0
Payout (%)	1.9	-1,410.0	43,880.3	6.2	0.0	0.0	0.0	0.0
Valuation (x)								
P/E			69.9	43.3	24.4	18.8	11.4	9.2
Cash P/E			42.7	24.0	14.8	12.1	8.1	6.9
P/BV			6.1	2.6	2.6	2.3	1.9	1.6
EV/Sales			6.5	3.6	3.0	2.5	1.9	1.5
EV/EBITDA			34.0	24.8	16.2	13.0	9.2	7.2
Dividend Yield (%)	0.2	42.8	9.1	0.1	0.0	0.0	0.0	0.0
FCF per share	-21.7	-82.3	-17.6	-32.7	-43.2	47.5	61.0	82.2
Return Ratios (%)								
RoE	1.4	4.3	9.4	8.5	10.8	12.9	18.3	18.8
RoCE	2.7	4.9	7.3	6.8	8.3	9.3	12.0	13.0
RoIC	2.0	4.4	10.8	8.7	10.1	11.4	14.5	16.9
Working Capital Ratios								
Fixed Asset Turnover (x)	0.5	1.7	1.3	1.5	1.6	1.4	1.6	1.7
Asset Turnover (x)	0.3	0.8	0.6	0.5	0.5	0.6	0.7	0.7
Inventory (Days)	168	48	63	78	77	77	75	75
Debtor (Days)	183	99	119	132	104	104	104	104
Creditor (Days)	176	73	63	100	79	78	76	76
Leverage Ratio (x)								
Current Ratio	1.4	2.1	2.3	2.2	1.9	1.8	2.0	2.2
Interest Cover Ratio	0.9	1.5	3.5	1.7	2.0	2.7	5.4	7.2
Net Debt/Equity	0.7	-0.1	0.1	0.7	0.7	0.5	0.3	0.1

Consolidated - Cash Flow Statement (INR m)

Y/E March	CY12	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
OP/(Loss) before Tax	9,495	28,899	9,920	1,464	4,971	4,751	7,939	9,676
Depreciation	1,095	1,539	640	1,520	1,987	2,099	2,465	2,613
Interest & Finance Charges	1,523	1,835	163	998	1,521	652	-26	-98
Direct Taxes Paid	-888	-1,259	-560	-770	-586	-761	-1,257	-1,533
(Inc)/Dec in WC	-3,105	-2,607	-959	-3,417	-3,413	-1,535	-2,510	-2,094
CF from Operations	**8,121**	**28,407**	**9,205**	**-206**	**4,480**	**5,205**	**6,610**	**8,564**
Others	-6,732	-31,124	-8,371	938	-1,599	0	0	0
CF from Operating incl EO	**1,389**	**-2,717**	**834**	**732**	**2,881**	**5,205**	**6,610**	**8,564**
(Inc)/Dec in FA	-3,331	-4,639	-2,406	-3,658	-6,746	-960	-1,152	-1,216
Free Cash Flow	**-1,942**	**-7,356**	**-1,572**	**-2,925**	**-3,865**	**4,245**	**5,458**	**7,348**
(Pur)/Sale of Investments	11,054	47,935	4,515	286	1,269	0	900	0
Others	-151	-6,739	427	-25,153	-607	1,413	1,482	1,424
CF from Investments	**7,572**	**36,556**	**2,536**	**-28,525**	**-6,084**	**453**	**1,230**	**208**
Issue of Shares	89	259	31	12,264	165	0	0	0
Inc/(Dec) in Debt	-7,877	1,430	3,208	18,789	5,962	-4,000	-1,275	-1,775
Interest Paid	-1,976	-2,192	-381	-1,347	-2,370	-2,065	-1,456	-1,326
Dividend Paid	-137	-32,683	-7,070	-251	-376	0	0	0
Others	0	0	0	-15	0	-472	-496	-521
CF from Fin. Activity	**-9,900**	**-33,185**	**-4,213**	**29,439**	**3,382**	**-6,537**	**-3,227**	**-3,621**
Inc/Dec of Cash	**-940**	**654**	**-843**	**1,647**	**179**	**-879**	**4,614**	**5,151**
Opening Balance	2,597	1,657	2,312	1,469	3,116	3,295	2,416	7,030
Closing Balance	**1,657**	**2,312**	**1,469**	**3,116**	**3,295**	**2,416**	**7,030**	**12,181**

NOTES

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AXIS DIRECT

7 NOV 2017 | Quarterly Update

STRIDES SHASUN

PHARMACEUTICALS

BUY

Target Price: Rs 940

Q2 margin miss; to improve from H2'18

Q2 revenue growth (18% YoY) was in line, but EBITDA declined 15% YoY (12% below our expectations) on lower gross margin of 51.4% (down 570 bps YoY) and higher other expenses. Gross margin declined due to lower contribution of higher margin anti-malaria tender sales, and higher sales of lower margin API. Higher depreciation coupled with lower interest income led to 65% YoY decline in PBT (~50% below our estimates). Company expects margins to pick up from H2FY18 via (1) increasing traction of its key products (gLovaza, Potassium Citarte) and monetization of its US pipeline (50% differentiated), (2) synergy benefits from acquisitions in Australia & (3) steady performance in India & Africa

We cut FY18/19E EPS by 38%/22% and revise SoTP to Rs 940 (16x Sep'19 EPS + Rs 31 for 40% stake in Stelis R&D + Rs 77 for 60% stake in API co.) vs. Rs 1,030 earlier. Maintain **BUY**

CMP	: Rs 827
Potential Upside	: 14%

MARKET DATA

No. of Shares	: 89 mn
Free Float	: 69%
Market Cap	: Rs 74 bn
52-week High / Low	: Rs 1,259 / Rs 803
Avg. Daily vol. (6mth)	: 421,496 shares
Bloomberg Code	: STR IB Equity
Promoters Holding	: 31%
FII / DII	: 35% / 16%

- **While growth rebounds led by regulated markets..:** Regulated market revenues (US and Australia, ~50% of sales) grew 13% YoY/ 21% QoQ, driven by new product launches in the US (gLovaza, Potassium Citrate ER capsules) along with organic growth in its key products. Australia business posted strong mid-teens YoY growth (double digit volume growth) driven by launch of 7 new products, expansion of distribution footprint by 50 stores. EM revenue (31% of sales) was flat YoY/grew 17% QoQ led by healthy double digit growth in the Africa brand business. India business witnessed a strong sequential rebound with pickup in channel stocking. However, Institutional business was soft in Q2FY18, with weakness in procurement by global donor agencies and postponement of Anti-malarial tender. API business (19% of sales) grew 119% YoY on a low Q2FY17 base
- **...margins remain weak:** Gross margin declined 570 bps YoY/ up 120 bps QoQ to 51.4% led by lower contribution from higher margin Anti-malarial products in the institutional business and adverse PSAI product mix. Additionally, Rs 161 mn investment towards building its consumer healthcare business in the US and India pulled EBITDA margin down 450 bps YoY (up 280 bps QoQ) to 13.2%

Financial summary (Consolidated)

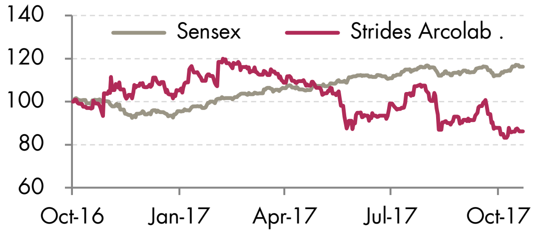
Y/E March	FY17	FY18E	FY19E	FY20E
Sales (Rs mn)	34,834	35,925	37,952	43,401
Adj PAT (Rs mn)	3,045	2,371	4,044	5,274
Con. EPS* (Rs)	-	39.8	58.5	58.5
EPS (Rs)	34.0	26.6	45.3	59.1
Change YOY (%)	53.3	(22.0)	70.5	30.4
P/E (x)	20.1	31.1	18.3	14.0
RoE (%)	11.3	8.5	13.3	15.4
RoCE (%)	9.8	8.3	11.5	13.5
EV/E (x)	13.7	15.5	11.6	9.5
DPS (Rs)	4.5	7.0	7.0	7.0

Source: *Consensus broker estimates, Company, Axis Capital

Key drivers

(%)	FY17	FY18E	FY19E
Revenue growth	22	3	6
Gross margin	55.9	53.3	55.0
EBITDA margin	18.5	15.5	19.3

Price performance



(...Continued from page 1)

- **Outlook on business segments:** (1) **Regulated markets**: **US** – Growth will be driven by gLovaza, Potassium Citrate ER capsules (~1-1.5 months sales in Q2FY18), new launches (28 ANDA filings pending approval from USFDA - almost all under the time bound GDUFA regime - ~50% differentiated generics). Expects quarterly exit run rate of USD 45-50 mn in Q4FY18. **Australia:** Expansion of store coverage, accelerated manufacturing out of India operations and new launches to drive margin improvement. Australian operations of Amneal pharma acquired in Aug'17, to also aid growth **(2) Emerging markets: Africa** – Sales footprint is now being expanded into East Africa, pivoting around the Kenyan (UCL) platform **India –** Continues to focus on initiatives to improve sales force productivity and improve operating leverage in the business; **(3) Institutional business:** Anti-malarial tender likely to be finalized in Q3FY18 – Strides currently has 20% share and expects to maintain/improve its market share. Also witnessing pick up in local government tenders; **(4) API:** Partner has now received approval for gRenvela which will drive stronger growth for the business. The appointed date for the scheme of demerger of API business continues to be 1st October 2017; **(5) R&D (3.8% of Q2 revenue):** 1 filing in Q2 FY18 (5 in Q2FY18). On track to file 15-20 products in FY18.

Exhibit 1: Strong growth led by regulated markets

(Rs mn)	% of Q2FY18 sales	Q2FY17	Q1FY18	Q2FY18	% YoY growth	% QoQ growth
Regulated markets	50	4,453	4,147	5,025	13%	21%
Emerging markets*	31	3,167	2,697	3,152	0%	17%
PSAI	18	835	1,514	1,830	119%	21%
Total revenues		8,455	8,358	10,007	18%	20%

Source: Company, Note: PSAI: Pharma Services and Active Ingredient.

** Institutional business now combined in emerging markets segment

Exhibit 2: Lower gross margin & higher SG&A weighed down EBITDA margin

(Rs mn)	Q2'17	Q1'18	Q2'18	YoY (%)	QoQ (%)
Total Revenue	**8,720**	**8,418**	**9,956**	**14**	**18**
Gross profit	4,980	4,225	5,119	3	21
Gross margin (%)	57.1	50.2	51.4	-570 bps	123 bps
Staff expenses	1,556	1,465	1,577	1	8
% to sales	18	17	16	-200 bps	-156 bps
SG&A	1,885	1,887	2,230	18	18
% to sales	22	22	22	78 bps	-2 bps
EBITDA	**1,540**	**873**	**1,312**	**(15)**	**50**
EBITDA margin (%)	**17.7**	**10.4**	**13.2**	**-448 bps**	**280 bps**
Depreciation	444	511	543	22	6
Interest	580	640	619	7	(3)
Other Income	546	361	223	(59)	(38)
PBT (before exceptional items)	**1,062**	**82**	**373**	**(65)**	**354**
Exceptional Items from integartion	(77)	(27)	(171)	-	-
Tax	129	(33)	42	(68)	(225)
Minority Interest	114	83	84		
Reported PAT	**741**	**6**	**76**	**(90)**	**1,255**

Source: Company

Exhibit 3: Q2 PBT further impacted by M&A costs, discontinued business

(Rs mn)	Q2'17	Q1'18	Q218	YoY (%)	QoQ (%)
EBITDA	1,540	873	1,312	(15)	50
PBT (before exceptional Items)	1,062	82	373	(65)	354
Exceptional Items	(77)	(27)	(171)		
Exchange fluctuation (loss) / gain	(11)	44	20		
Merger and acquisition costs	(54)	(27)	(58)		
Fair valuation of derivative instruments	-	(44)	(70)		
Net gain / (loss) on discontinued businesses	45	-	(32)		
Write off/ Provision of assets (net)	(27)	-	(11)		
Interest Income		-	-		
Unwinding of discounts on gross obligations over written put options	(31)	-	(21)		
PBT (post exceptional Items)	984	55	202	(79)	267
PAT (before minorities)	855	88	160	(81)	81
Minority Interest	114	83	84		
Reported PAT	741	6	76	(90)	1,255

Source: Company, Axis Capital

Exhibit 4: Restructuring activities – Key data points

Demerger of API facility	
Turnover	Rs. 7,122 mn (23% of consolidated turnover)
Change in Shareholding pattern	None
Exchange/Share Ratio	Strides shareholder will 1 equity share of Rs 10 each of Solara Active Pharma sciences (resultant entity); for every 6 equity shares of Strides. Sequent Scientific shareholder - 1 share of Rs 10 each of Solara; for every 25 shares of Sequent. The appointed date for the scheme of the merger continues to be 1st October 2017
Listing will be sought for resulting Entity	Yes
Exiting Africa Generics	
Turnover	Rs. 1,377 mn (4% of consolidated turnover)
Date of completion	4th May 2017
Cash Consideration	Rs 1,087 mn
Details of Buyer	Sold to current management led by Mr Sinhue Noronha (CEO - Emerging Markets)
Related Party Transaction	No
Additional Information	Divestment of business through a combination of share sale and slump sale
Exiting Probiotic Business	
Turnover	Rs. 15 mn (0.005% of consolidated turnover)
Date of completion	4th May 2017
Cash Consideration	Rs 1,02.4 mn
Details of Buyer	Promoter group entity
Related Party Transaction	Yes - At arms length

Source: Company

Exhibit 5: Sustaining market share in key brands, gained market share in gZantac

Approval date	Brand	Generic	IMS Revenue (USD mn)	Existing competition	Market share						
					Sep'16	Dec'16	Mar'17	Jun'17	Jul'17	Aug'17	Sep'17
11-Apr-14	Vancocin	Vancomycin	332	5	50%	49%	49%	47%	46%	47%	47%
6-Jun-14	Oxsoralen	Methoxsalen	14	2	42%	31%	33%	36%	32%	41%	31%
16-Dec-14	Rocaltrol	Calcitriol	50	4	13%	13%	15%	11%	14%	17%	18%
15-May-15	Combivir	Lamivudine and Zidovudine Tablets	120	8	23%	23%	19%	20%	20%	20%	19%
30-Jul-15	Tessalon	Benzonatate	41	8	17%	19%	18%	18%	18%	17%	18%
21-Nov-15	Avodart	Dutasteride	470	12	14%	13%	18%	26%	27%	27%	28%
16-Nov-15	Soma (250 mg)	Carisoprodol tablets	250	4	70%	79%	84%	87%	87%	84%	83%
24-Aug-16	Zantac	Ranitidine Tablets	125	8	-	3%	14%	14%	19%	22%	24%

Source: Bloomberg

Conference call highlights and our view

Guidance

- **US:** Expects quarterly exit run rate of USD 45-50 mn in Q4FY18
- Expects **margin improvement** in H2FY18, with higher anti-malaria tender sales, regulated market sales
- Debt reduction of Rs 4.5 bn with demerger of commodity API business

Regulated markets (50% of Q2 sales, +13% YoY/+21% QoQ):

- **Australia – strong quarter**: Witnessed early teens growth in Q2FY18. Witnessed double digit growth in value and volume terms in Q2FY18
  - Launched 7 new products during Q2FY18
  - Increased its distribution footprint by 50 stores, now covering >1,000 stores (~20% of market of total 5,200 stores)
  - Acquired Australian operations of Amneal Pharmaceuticals with annual revenues of ~AUD 25 mn (USD 20 mn), for a total consideration of AUD 17 mn (USD 13.4 mn). Acquisition to improve Arrow's generics market share to ~22% (vs. 20% currently), and adds ~200 new first-line stores expanding its first-line pharmacies to more than 1,200 stores (vs. 1,000 stores currently). Acquisition further bolsters its product portfolio with the addition of 13 molecules to the Arrow range (current product portfolio of ~170 molecules). Complete integration is expected to happen over the next 12 months. Acquired Amneal pharma operations/financial were not consolidated in reported Q2FY18 financials.
  - 10 of the 12 site transfer applications approved by TGA, for backward integration of Australian product portfolio. Expects backward integration program to accelerate and start contributing cost savings through supply chain efficiency
- **North America:**
  - Growth was driven by launch of gLovaza (partnership with Par – higher revenue/profit share for Strides), Potassium Citrate ER capsules along with organic growth with sustained market share in its key products. Booked 1-1.5 month of sales for gLovaza, Potassium Citrate ER capsulesin Q2FY18
  - **Pricing erosion:** Witnessing average mid-single digit price erosion in overall North America business
  - **Direct portfolio (50% of business):** Sustained market share in key products, Ranitidine – first fully integrated product - increased market share by 600 bps to 27% in Q2 vs. 21% in Q1
- Strides has received 8 approvals in FY18 YTD (6 in Q1, 2 in Q2) – Potassium Citrate ER tablets (USD 110 mn market), Omega–3–Acid Ethyl Esters softgel capsules (USD 250 mn market, Cetirizine Softgel Capsules (USD 60 mn market), Promethazine Hydrochloride Tablets (USD 17 mn market), Amantadine Hydrochloride Tablets (USD 22 mn market), Amantadine Hydrochloride Capsules (USD 25 mn market), Ibuprofen Tablets (USD 520 mn market) and Memantine hydrochloride Tablets (USD 60 mn market)

Emerging Markets (incl. institutional business): 31% of Q2 sales, +17% QoQ

- **India:**
  - Witnessed strong rebound in performance QoQ with pick up in channel stocking
  - Continue to focus on initiatives to improve sales force productivity and improve operating leverage in the business
- **Africa:**
  - Witnessed mid-teens growth in the Africa Brand business
  - Favorable product mix and improved sales force productivity helped in significant margin expansion
  - Sales footprint is now being expanded into East Africa, pivoting around the Kenyan (UCL) platform
- **Institutional sales**:
  - Institutional business was soft in Q2FY18, with weakness in the procurement by global donor agencies and postponement of Anti-malarial tender (likely to be finalized in Q3FY18 – Strides currently has 20-22% share and expects to maintain/improve its market share)
  - Anti – Retroviral (ARV) portfolio continued to grow. Also witnessed pick up in local government tenders
  - However, the product mix continued to be unfavorable in Q2 with lower contribution from higher-margin institutional anti-Malarial tender business
  - Kenyan facility (UCL) received GMP status from WHO. Site transfer of institutional products is on track with first set of filings done and supplies are expected to commence from H2FY18.

PSAI: Partner has now received approval for gRenvela which will drive stronger growth for the business.

R&D spend: for the quarter increased 9% YoY to Rs 380 mn against Rs 348 mn in Q2FY17. The Company made 1 filing in Q2FY18 (5 in Q2FY18), and targets 15 - 20 filings in FY18. Cumulatively filed 68 ANDA's till date, of which 28 ANDA filings pending approval from USFDA (almost all pending ANDA under the time bound GDUFA regime – ~50% differentiated generics). Received 8 product approvals – FY18 YTD.

USFDA inspection

- Received EIR for Bangalore facility (had received form 483 with 3 observations in May'17)

Financials

- Gross margin decline led by adverse product mix of lower contribution from Anti-malarial products in the institutional business, adverse PSAI product mix
- Additionally, Strides is investing in building a consumer healthcare business in the US and India (requiring upfront investment in marketing and media support in advance of sales) which impacted EBITDA by Rs 161 mn in Q2FY18. Expects the impact to taper off as brand sales gather momentum

Strides restructuring activities

Demerger of API business to Solara Active Pharma Sciences

- Received key approvals from the Competition Commission of India, stock exchanges and SEBI for demerger of the API business
- Clearance from National Company Law Tribunal is pending as of date. Upon NCLT approval, shareholder and creditor approval will be obtained. The appointed date for the scheme of the merger continues to be 1st October 2017

Exhibit 6: Key M&A -Acquired Australian operations of Amneal Pharma in Aug'17

Date	Region	Company	Acq value (USD mn)	Acq value (Rs mn)	Rev (Rs mn)
21-May-15	Australia	Arrow	380	17,821	5,628
08-Feb-16	Australia	Generic Partners* (51% stake acquired)	25	1,204	1,873
29-Feb-16	Australia	Pharmacy Alliance	13.99	681	739
31-Aug-17	Australia	Amneal Pharma	13.4	858	1,280
	Australia	Total		20,563	9,520
21-Jul-14	India	Bafna Pharma's - India branded (74% stake)		481	200
19-Sep-15	India	Ranbaxy - CNS divisions (Solus & Solus care)		1,650	920
23-Oct-15	India	Brands from J&J / Medispan (51% stake acquired)		-	320
	India	Total		2,131	1,440
08-Feb-16	Africa (Kenya)	Universal corporation* (51% stake acquired)	14	951	1,522
07-Mar-16	USA, Australia, Middle East	Moberg Pharma* (Sweden) - 3 OTC brands	10	670	409
25-Nov-16	USA, Australia, Middle East	Moberg Pharma* (Sweden) - PediaCare (Pediatric brand)	5	343	402
09-Dec-16	India	Perrigo API (USFDA approved)		1000	738
		TOTAL		24,316	12,891

Source: Company, Axis Capital

Financial summary (Consolidated)

Profit & loss (Rs mn)

Y/E March	FY17	FY18E	FY19E	FY20E
Net sales	34,834	35,925	37,952	43,401
Other operating income	-	-	-	-
Total operating income	34,834	35,925	37,952	43,401
Cost of goods sold	(15,362)	(16,795)	(17,079)	(19,313)
Gross profit	19,472	19,130	20,874	24,087
Gross margin (%)	56	53	55	56
Total operating expenses	(13,044)	(13,562)	(13,568)	(15,299)
EBITDA	6,428	5,568	7,306	8,789
EBITDA margin (%)	18	16	19	20
Depreciation	(1,872)	(1,597)	(1,637)	(1,765)
EBIT	4,557	3,971	5,669	7,024
Net interest	(2,269)	(2,055)	(1,744)	(1,564)
Other income	1,686	1,250	1,260	1,260
Profit before tax	3,973	3,166	5,185	6,720
Total taxation	(470)	(475)	(881)	(1,226)
Tax rate (%)	12	15	17	18
Profit after tax	3,503	2,691	4,304	5,494
Minorities	(462)	(160)	(160)	(160)
Profit/ Loss associate co(s)	4	(160)	(100)	(60)
Adjusted net profit	3,045	2,371	4,044	5,274
Adj. PAT margin (%)	9	7	11	12
Net non-recurring items	(1,018)	-	-	-
Reported net profit	2,027	2,371	4,044	5,274

Balance sheet (Rs mn)

Y/E March	FY17	FY18E	FY19E	FY20E
Paid-up capital	894	894	894	894
Reserves & surplus	26,210	27,854	31,170	35,716
Net worth	28,744	30,388	33,704	38,251
Borrowing	30,317	24,981	18,981	18,981
Other non-current liabilities	5,644	5,984	6,348	6,737
Total liabilities	81,168	78,191	76,761	83,312
Gross fixed assets	32,687	33,087	36,587	40,087
Less: Depreciation	(2,850)	(4,447)	(6,084)	(7,849)
Net fixed assets	29,837	28,640	30,503	32,238
Add: Capital WIP	7,802	7,514	7,241	6,981
Total fixed assets	37,639	36,154	37,743	39,219
Total Investment	15,246	12,451	7,451	7,451
Inventory	7,380	7,874	8,318	9,513
Debtors	9,971	10,827	11,438	13,080
Cash & bank	3,295	2,613	2,811	4,220
Loans & advances	1,330	1,338	1,347	1,355
Current liabilities	16,462	16,838	17,727	19,343
Net current assets	8,907	9,718	10,676	13,987
Other non-current assets	2,913	3,031	3,163	3,313
Total assets	81,168	78,191	76,761	83,312

Source: Company, Axis Capital

Cash flow (Rs mn)

Y/E March	FY17	FY18E	FY19E	FY20E
Profit before tax	3,973	3,166	5,185	6,720
Depreciation & Amortisation	(1,872)	(1,597)	(1,637)	(1,765)
Chg in working capital	(3,413)	(1,492)	(760)	(1,902)
CF from operations	2,330	3,601	5,664	5,660
Capital expenditure	(8,566)	(4,000)	(3,500)	(3,500)
CF from investing	(7,051)	(1,205)	1,500	(3,500)
Equity raised/ (repaid)	34	-	-	-
Debt raised/ (repaid)	5,680	(5,335)	(6,000)	-
Dividend paid	769	-	-	-
CF from financing	3,382	(6,068)	(6,732)	(732)
Net chg in cash	(1,339)	(3,671)	432	1,428

Key ratios

Y/E March	FY17	FY18E	FY19E	FY20E
OPERATIONAL				
FDEPS (Rs)	34.0	26.6	45.3	59.1
CEPS (Rs)	43.6	44.5	63.6	78.8
DPS (Rs)	4.5	7.0	7.0	7.0
Dividend payout ratio (%)	19.9	26.4	15.5	11.9
GROWTH				
Net sales (%)	21.7	3.1	5.6	14.4
EBITDA (%)	55.3	(13.4)	31.2	20.3
Adj net profit (%)	71.3	(22.1)	70.5	30.4
FDEPS (%)	53.3	(22.0)	70.5	30.4
PERFORMANCE				
RoE (%)	11.3	8.5	13.3	15.4
RoCE (%)	9.8	8.3	11.5	13.5
EFFICIENCY				
Asset turnover (x)	0.8	0.8	0.9	0.9
Sales/ total assets (x)	0.4	0.5	0.5	0.5
Working capital/ sales (x)	0.2	0.2	0.2	0.2
Receivable days	104.5	110.0	110.0	110.0
Inventory days	94.8	94.7	99.1	100.3
Payable days	95.8	88.8	92.9	94.0
FINANCIAL STABILITY				
Total debt/ equity (x)	1.1	0.8	0.6	0.5
Net debt/ equity (x)	0.5	0.4	0.3	0.3
Current ratio (x)	1.5	1.6	1.6	1.7
Interest cover (x)	2.0	1.9	3.3	4.5
VALUATION				
PE (x)	20.1	31.1	18.3	14.0
EV/ EBITDA (x)	13.7	15.5	11.6	9.5
EV/ Net sales (x)	2.5	2.4	2.2	1.9
PB (x)	2.7	2.6	2.3	2.0
Dividend yield (%)	0.5	0.8	0.8	0.8
Free cash flow yield (%)	(8.4)	(0.5)	2.9	2.9

Source: Company, Axis Capital

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