Suven Pharmaceuticals| BUY | TP: Rs 580

Crème de la crème

MONARCH NETWORTH CAPITAL

Initiating Coverage

We initiate coverage on Suven Pharmaceuticals (SPL), a pure-play new chemical entity (NCE)-based contract development & manufacturing organisation (CDMO) and a highly under-researched stock, with BUY and TP of Rs580 (40% upside). India being at the cusp of a multi decadal opportunity in Innovator pharma outsourcing, with rising R&D spends and outsourcing penetration, further supplemented by China+1 strategy, is a bazooka for CDMO players. SPL's eminently successful execution track record of NCE-based projects, best-in-class EBITDA margins and robust return ratios are a testimony to the quality of business, coupled with added momentum from formulations and its robust launch pipeline. Investment in Rising Holdings brings significant synergies for SPL's formulations business for joint development and distribution.

- **Innovator Pharma outsourcing - The IT moment for Indian Pharma:** The $90bn CDMO sector remains a high growth area due to increasing Innovator R&D spends and higher outsourcing penetration with small & midsized players. CDMO remains a multi-decadal opportunity for the Indian players on account of its inherent strengths i.e. stellar track record (>50% of new DMFs filed annually), manufacturing prowess (highest number of USFDA approved API facilities) and low-cost technical labour. Further, China+1 strategy to remain a strong tailwind for Indian CDMO pegged at $5bn, a third of China.
- **Crème de la crème of CDMO value chain:** SPL has carved a niche for itself by leveraging its innovative capabilities to undertake NCE-based CDMO projects (850+) to discover and develop intermediates for innovator companies. NCE-based CDMO has high entry barriers, high switching costs, needs deep technical expertise and is a sticky business, where clients focus more on strategic partnership than cost arbitrage. Further, best-in-class EBITDA margins (46% FY20) and robust return ratios (40%+ RoE/RoCE FY20) are testimony to the quality of business.
- **Formulations driving bottom-line growth:** Pharma CDMO will be driven by four commercial molecules and project migration in the core business and the Spec Chem CDMO by commercialisation of two new agrochem molecules. Growth will be led by formulations, where SPL is targeting niche, low-competition molecules with $2-4mn PAT opportunity. SPL is looking to launch 3-4 molecules p.a. and its 25% investment in Rising Holdings would create significant synergies for distribution and joint development. Capex of Rs6bn, in addition to the ongoing Rs3.2bn capex, will be a long-term positive despite being initially FCF-dilutive.
- **Structural tailwind + best-in-class return ratios + valuation comfort => Re-rating**
  SPL remains one of the most attractive plays on NCE-based CDMO and is best placed to capture the tailwind for Indian APIs on account of China+1 strategy. SPL has the best margin profile amongst the listed players (India & globally) and its strong cash flow generation allows it to pursue further growth related projects. After detailed analysis of recent M&A transactions and global peer multiples, we arrive at a TP of Rs 580, implying 40% upside over CMP, for SPL using SOTP based valuation and initiate coverage with BUY. Our Bear Case TP is Rs 447 which implies 8% upside from the CMP, while our Bull case TP is Rs 695 which implies ~68% upside from the CMP. Execution of API based CDMO project and better performance in the US generics formulations remain our key upside triggers.

Target Price	Rs 580	Key Data	
		Bloomberg Code	SUVENPHA IN
CMP*	Rs415	Curr Shares O/S (mn)	254.5
		Diluted Shares O/S(mn)	254.5
Upside	40%	Mkt Cap (Rsbn/$bn)	105/1.4
Price Performance (%)*		52 Wk H / L (Rs)	440/87
	1M 3M 6M	Daily Vol. (3M Avg.)	483,988

	1M	3M	6M
SUVENPHA IN	26.0	6.9	140.3
NIFTY	6.3	20.9	43.3

*as on December 18th 2020; Source: Bloomberg, MNCL Research

Shareholding pattern (%)

Particulars	Mar -20	Jun-20	Sep-20
Promoter	60.00	60.00	60.00
FIIs	4.24	3.55	4.15
DIIs	3.95	4.61	4.99
Others	31.81	31.84	30.86

Source: BSE

Valuations scenarios using SOTP

Particulars (Rs mn)	Bear Case	Base Case	Bull Case
Formulations EV	20,985	28,756	39,695
CDMO EV	80,105	1,06,506	1,24,539
Rising Stake	9,564	9,564	9,564
Total Enterprise Value	1,10,654	1,44,827	1,73,798
Implied Value per share	**447**	**580**	**695**
Upside on CMP	**8%**	**40%**	**68%**

Source: MNCL Research

Key sections to read in the report
Tailwinds in outsourcing Pharma
SOTP based valuations scenarios

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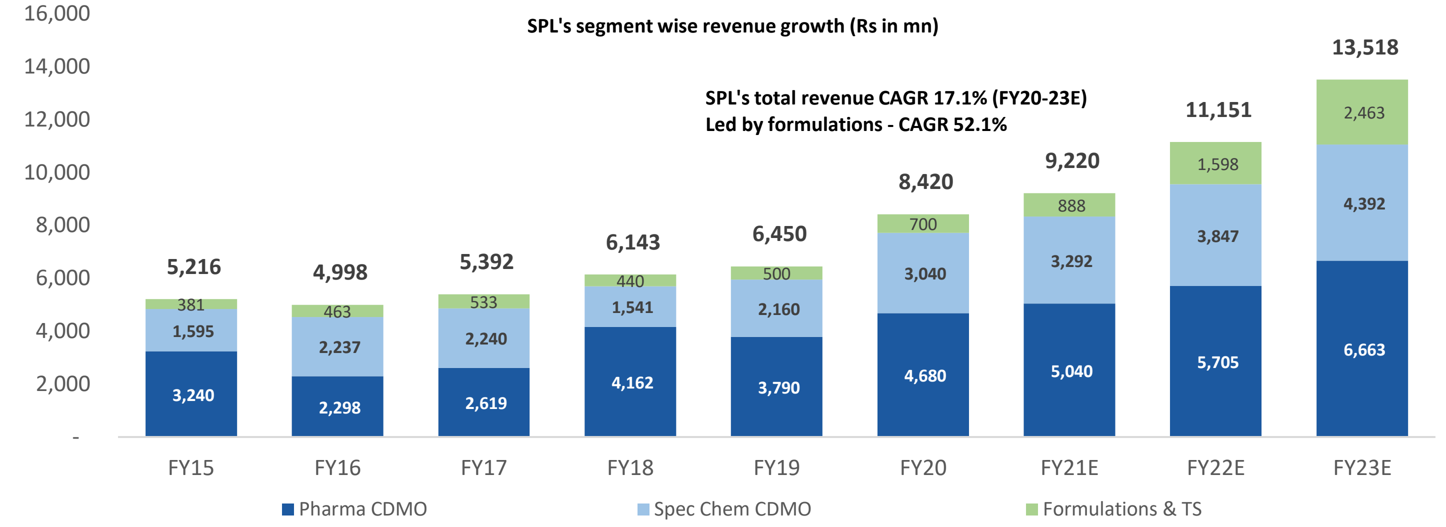
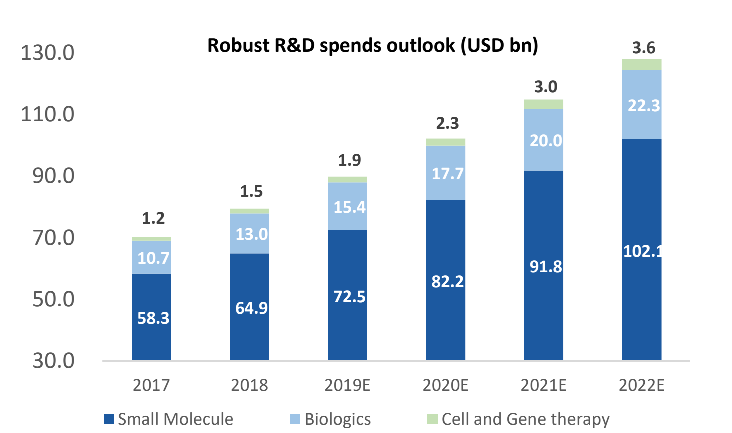
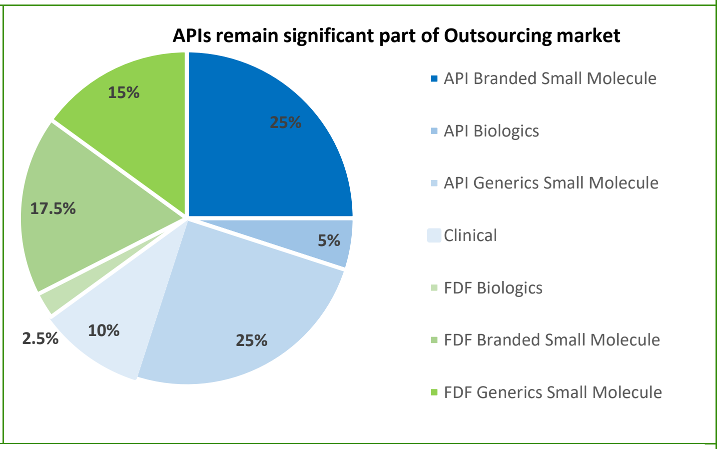
Y/E Mar (Rsmn)	Revenue	YoY (%)	EBITDA	EBITDA (%)	Adj PAT	YoY (%)	Adj EPS	RoE (%)	RoCE (%)	P/E (x)	EV/EBITDA (x)
FY20	8,338		3,849	46.2	3,170		12.5	44.2	42.8	26.7	22.5
FY21E	9,220	10.6	4,241	46.0	3,686	16.3	14.5	37.3	35.8	23.0	20.0
FY22E	11,151	20.9	5,319	47.7	4,519	22.6	17.8	34.5	35.9	18.8	15.7
FY23E	13,518	21.2	6,651	49.2	5,581	23.5	21.9	32.8	35.9	15.2	12.3

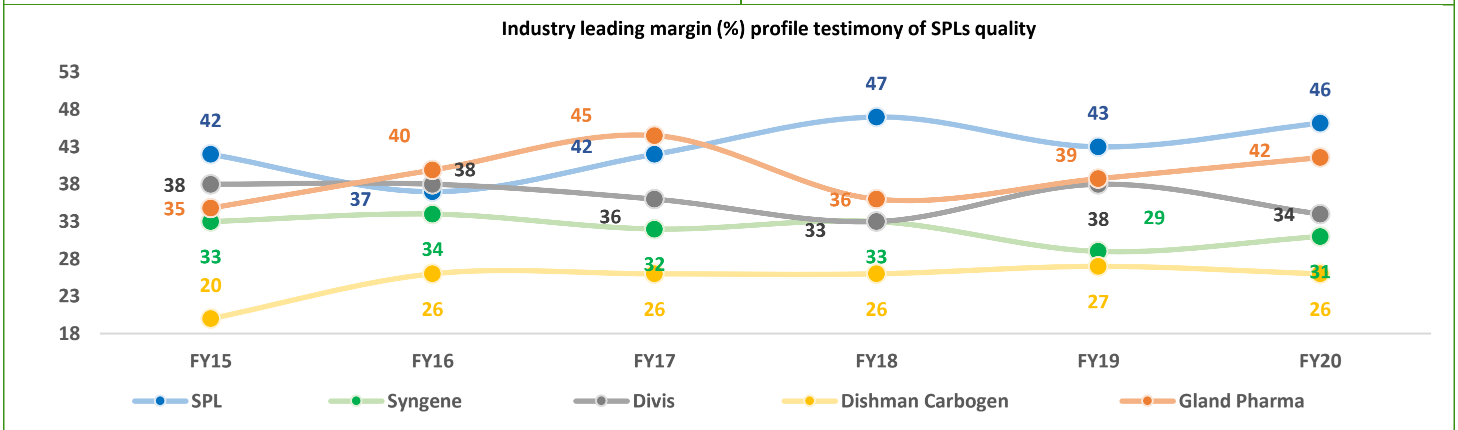
Source: Company, MNCL Research Estimates

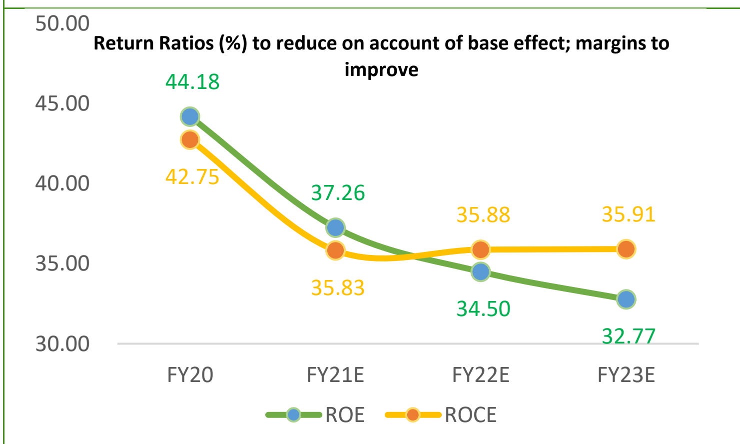
Investment Thesis in Charts

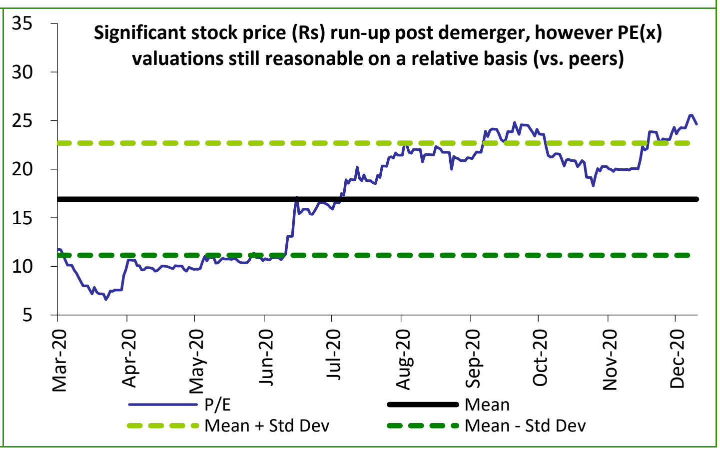






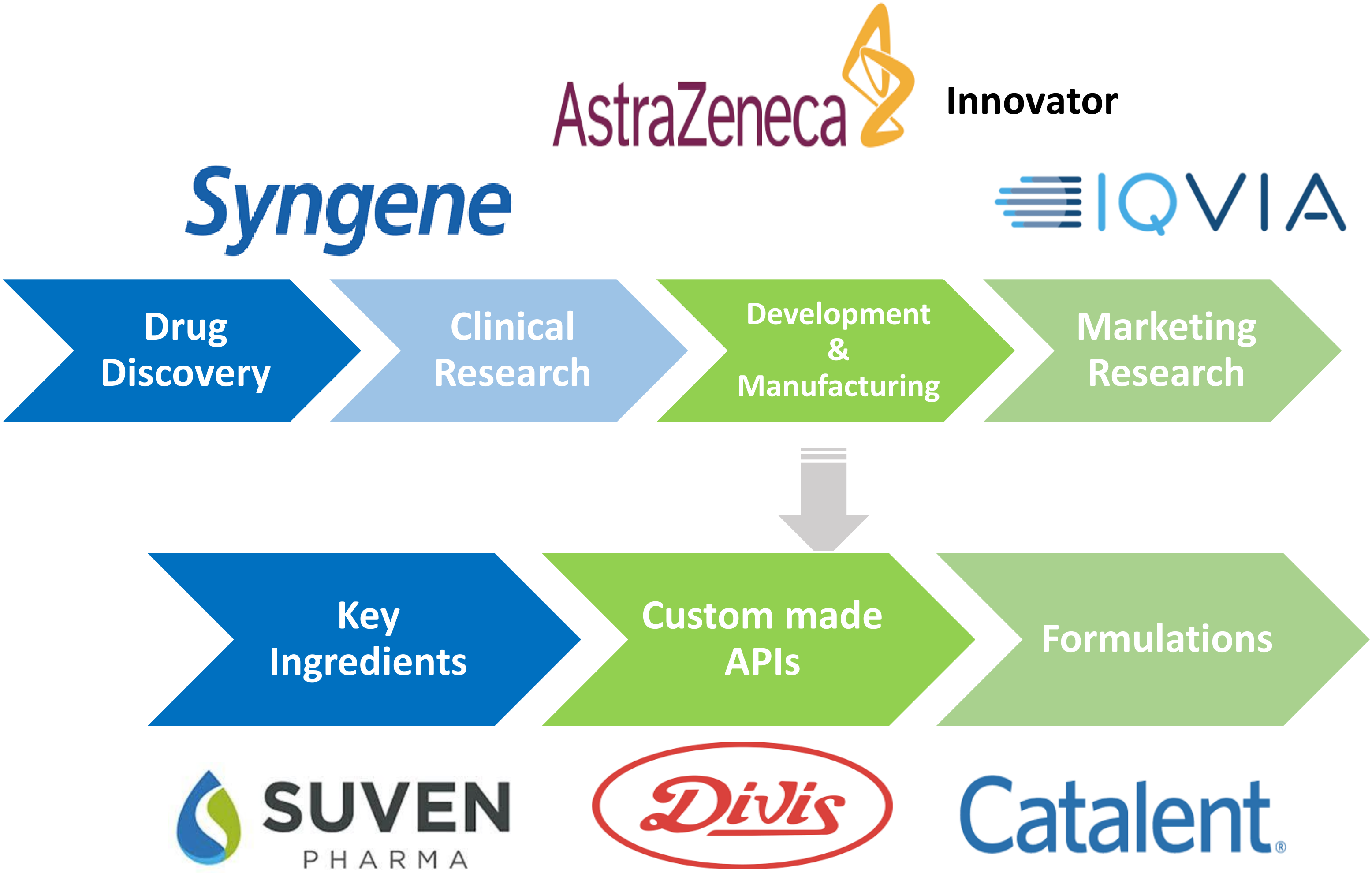






Source: Company, MNCL Research Estimates

Innovator Pharma Outsourcing Value-chain



(Just for the purpose of illustration)

Generic Pharma Outsourcing Value-chain

(Just for the purpose of illustration)

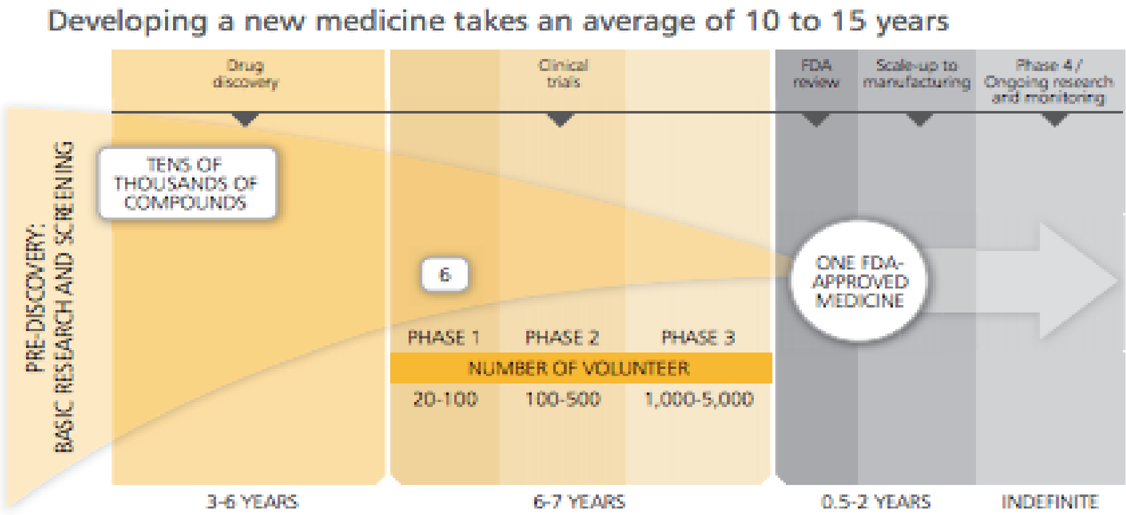
Lengthy and costly drug development process drives outsourcing demand

Average R&D on new molecule: $ 1bn

Success Rate: 5000:1

Drug development process includes early stage R&D, pre-clinical, clinical research, commercialized manufacturing, etc.; on an average, development process of a new molecule takes more than 10 years and requires over US$1bn costs while the success rate for developing a new molecule from drug discovery to approval could be lower than 0.01%.

Exhibit 1: Overview of CDMO value chain and brief description of services offered

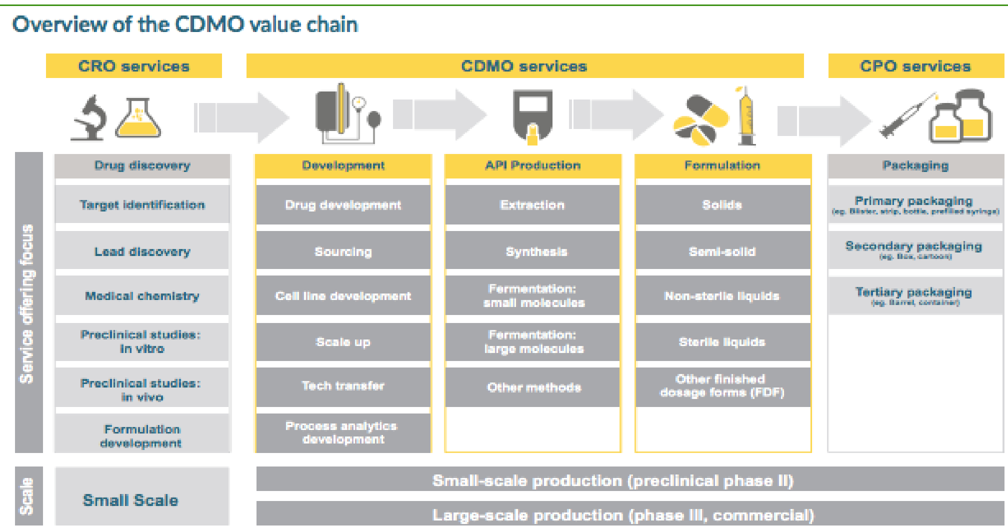


Source: Company, MNCL Research Estimates

Given the patent protection period is usually 20 years for a certain innovative molecule, shortened R&D cycle will directly lead to longer remaining patent protection period after launch and higher return for pharmaceutical companies. Thus, we expect pharmaceutical companies to be more reliant on outsourcing companies in order to save time and money for drug R&D.

Pharmaceutical R&D outsourcing services mainly contain two types:
1) Contract Research Organisations (CROs)
2) Contract Development & Manufacturing Organisations (CDMOs)

Exhibit 2: Overview of CDMO value chain and brief description of services offered



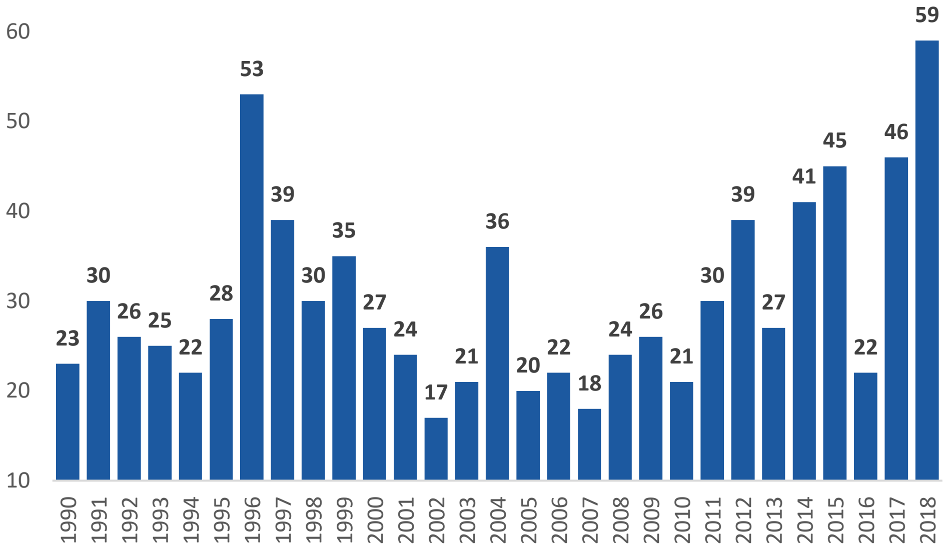
Source: Company, MNCL Research Estimates

Increasing global R&D spend; Strong tailwind for the Pharma Outsourcing Industry

The number of New Drug approvals by the USFDA is at a record high over the last 5 years. This is largely led by sustained increase in the overall R&D investments towards break through therapies (increase in First-in-class drug approvals – *Exhibit 4*) and regulatory support by the USFDA (increase in Orphan drug approvals – *Exhibit 5*).

Exhibit 3: Encouraging global R&D spends outlook, a significant tailwind for the CDMOs (USD bn)

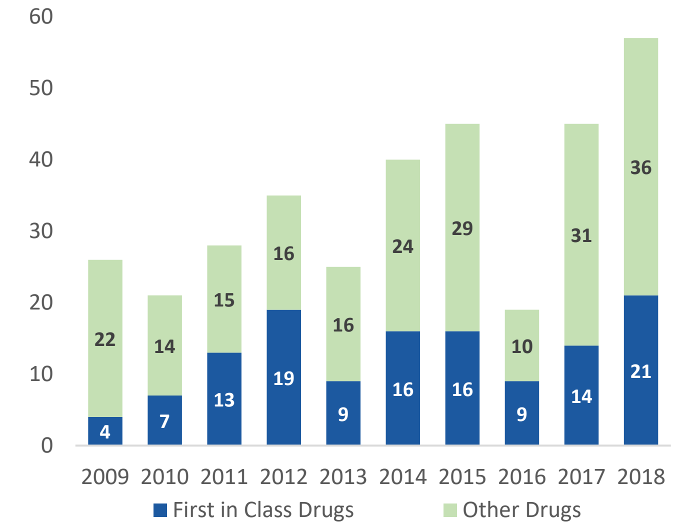
New Orphan Drug approval is an indicator for increased NCE based R&D over medium term



Source: Company, MNCL Research Estimates

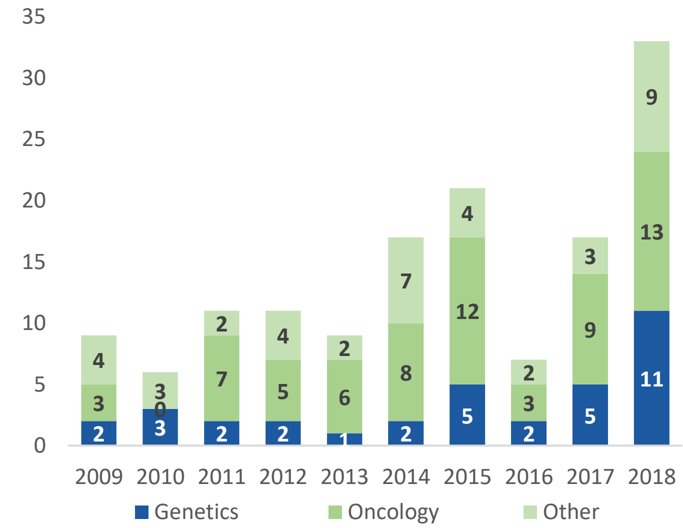
First-in-class drugs, as per the USFDA are "drugs which use a new and unique mechanism of action for treating a medical condition". The number of new first-in-class drugs approved is often used as an indicator of true innovation in pharma. Further, Orphan drug approvals by the USFDA have considerably increased in the recent years, thus improving the additional revenue potential by expanding into larger indications.

it 4: First-in-class New drug approvals (nos)



Source: Company, MNCL Research

Exhibit 5: New orphan drug approvals (nos)



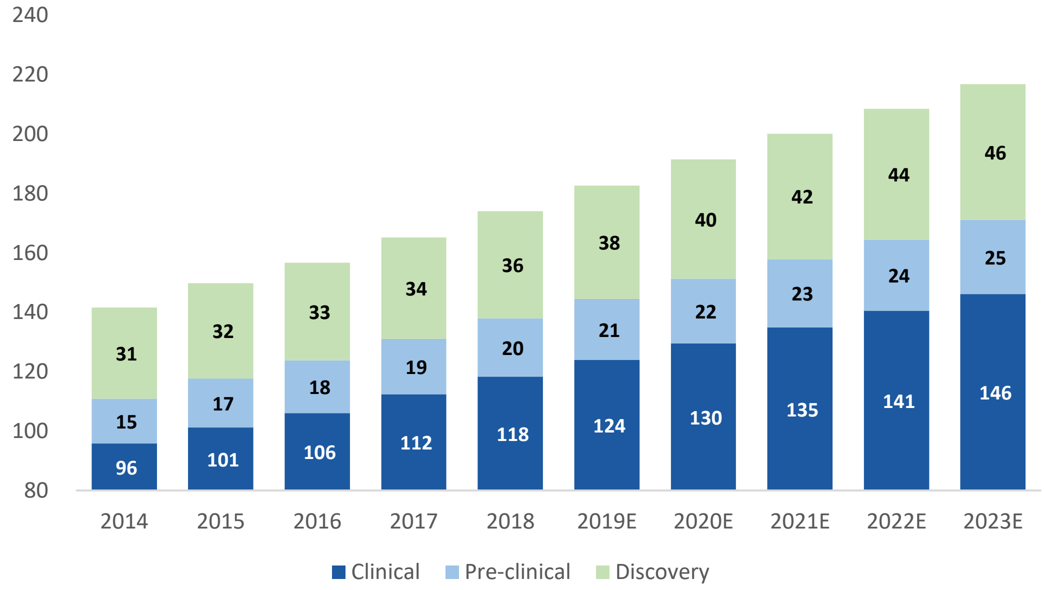
Source: Company, MNCL Research

The global R&D spending by the innovators is slated to increase from US$174.0bn in 2018 to US$216.8bn in 2023E, representing a 4.5% CAGR. The Clinical R&D spends remain the biggest segment with ~67% contribution to the total R&D spends followed by Drug Discovery R&D spends of ~21%. The overall increase in R&D expenditures and higher Pharma outsourcing trend both in small & mid-sized innovators as well as Big Pharma remains one of the strongest tailwinds for CDMOs

Clinical R&D spends: 67% of total R&D

Drug discovery R&D: ~21%

Exhibit 6: Encouraging global R&D spends outlook a significant tailwind for the CDMOs

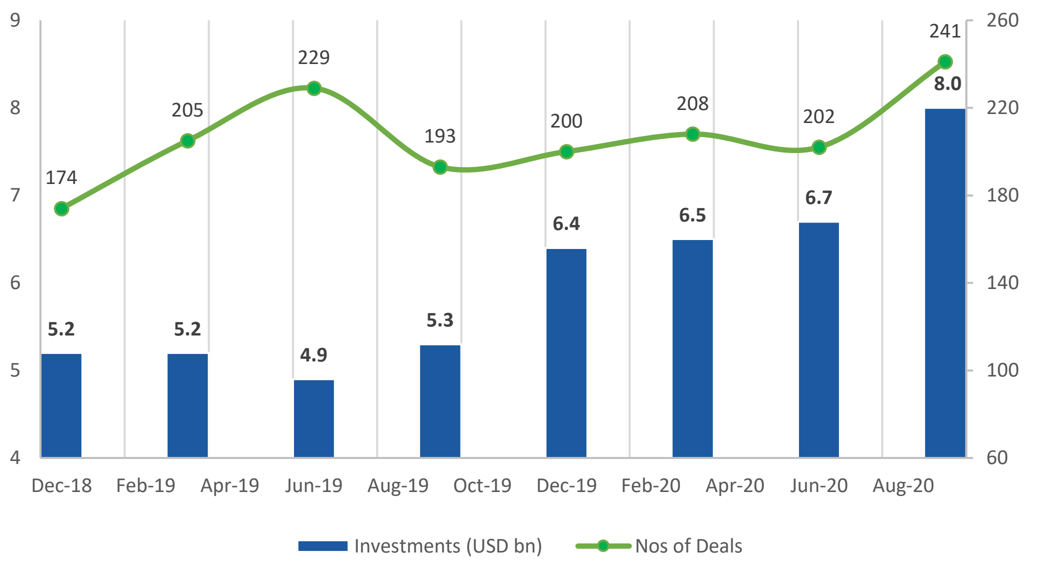


Source: Company, MNCL Research Estimates

We expect robust Innovator R&D spending momentum led by robust PE / Venture Capital (VC) funding environment for small & mid-sized innovators (~50% of overall R&D spends) and shift by pharmaceutical companies towards externalized R&D models. According to the report published by PwC and CB Insights, "Healthcare MoneyTree Report Q3 2018", a total of US$8bn was invested in healthcare industry by venture capitals in 2Q19 while deal numbers reached 241 during the same period. Compared to the same quarter in FY19, investments increased 50%, and the number of deals also increased by 25% in Q3FY20.

Post Covid-19 has seen record deal activity in small biotech space

Exhibit 7: VC Funding activity in early stage healthcare



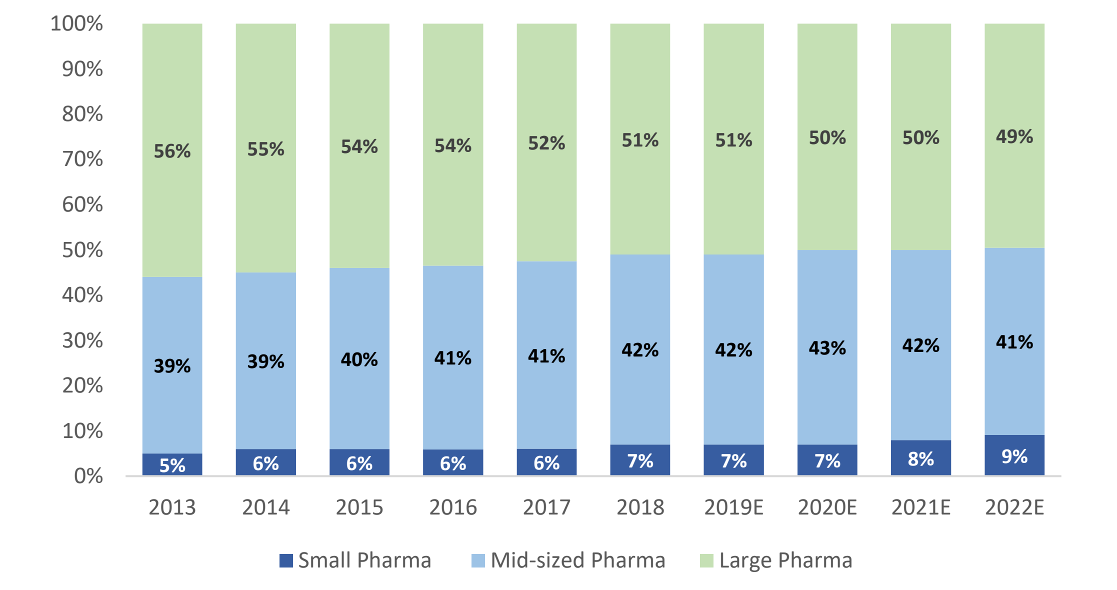
Source: Company, MNCL Research Estimates

Outsourcing dependent small & mid-sized innovators continue to drive the R&D

Small and mid-sized innovators are usually characterized by high drug discovery capabilities with significant new drug approvals originating from these companies. These setups however lack the ability to develop and manufacture the molecules for the pre-clinical, clinical and the commercial phase, thus they heavily depend on the CDMOs as developing and manufacturing partners over the course of their development.

Small & Mid-sized entities contribute ~50% of overall R&D spends

Exhibit 8: R&D spends by large, mid-sized and small pharma companies

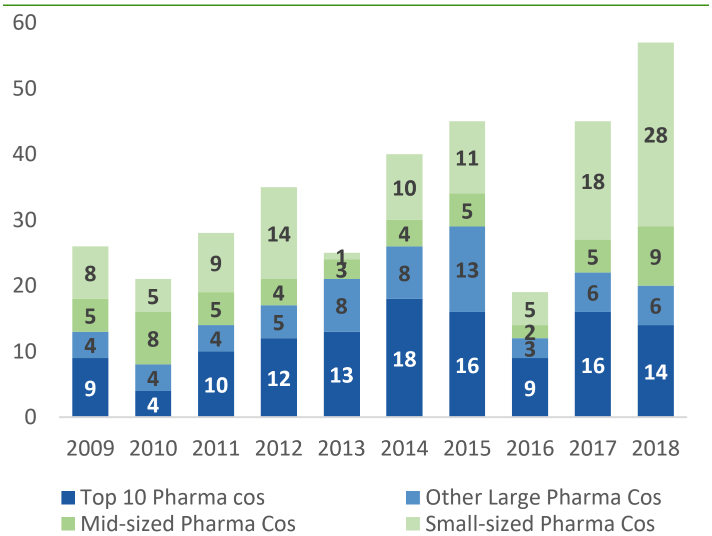


Source: Company, MNCL Research Estimates

More than 70% drugs originate from small & mid-sized players

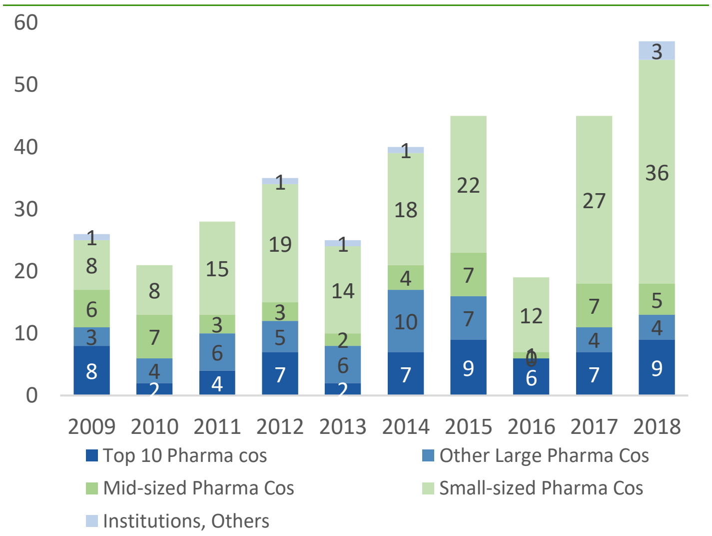
Further, recent trends of increased venture capital & private equity investments in the Bio-tech companies in the US have reduced the need for these small and mid-sized innovators to out license their molecule to Big pharma companies, thus keeping bulk of the profit pool with themselves.

it 9: Drug approvals by type of Owner/Sponsors (nos)



Source: Company, MNCL Research

Exhibit 10: Drug approvals by Size of Drug Originator (nos)



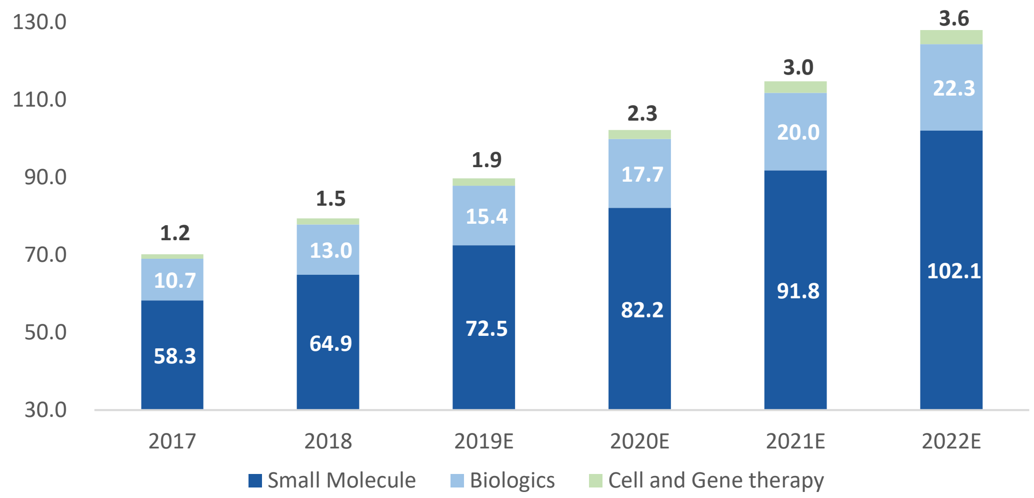
Source: Company, MNCL Research

CDMO Market dynamics

Emergence of small & midsized innovators and the increasing complexities of developing and manufacturing new generations of pharma solutions have increased the need to outsource manufacturing operations and reduce operating expenditure. These emerging trends have led to increasing penetration of CDMOs in the Innovator Pharmaceuticals outsourcing market, leading to the overall market size for CDMO to increase from $90bn in 2019 to $117bn in 2023E.

NCE-based CDMO likely to be $117bn market by FY23E

Exhibit 11: CDMO Market Outlook: Encouraging R&D spends outlook a significant tailwind (USD bn)

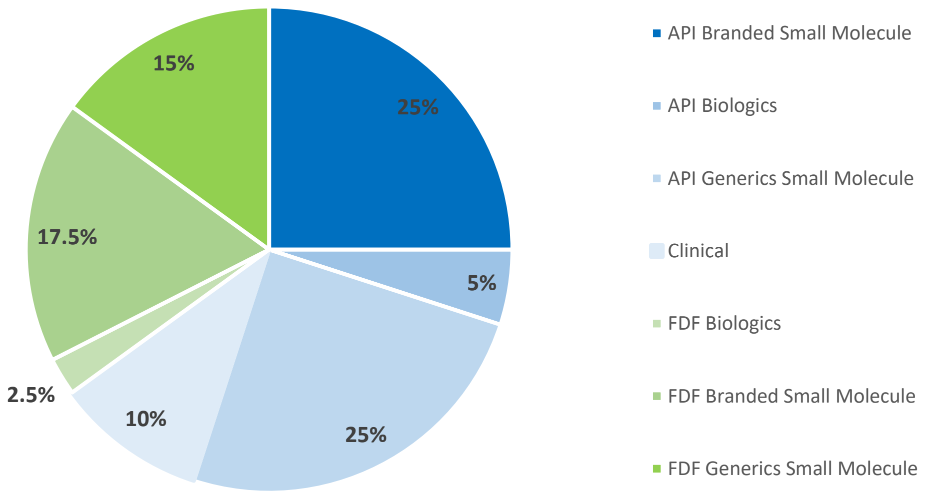


Source: Industry, MNCL Research Estimates

CDMO activities can broadly be divided into three fields i.e. product development, manufacture of active pharmaceutical ingredients (API), and manufacture of finished dosage forms (FDF), all of which are required from the production of small-scale clinical batches to largescale commercial production. As such, once a dedicated manufacturing line is established and validated at a CDMO, it is often difficult, time consuming and costly to switch CDMOs, meaning partnerships between pharma companies and their CDMOs are often long-lasting.

APIs continue to be the largest component of the overall CDMO market

Exhibit 12: Break-up of CDMO industry



Source: Industry, MNCL Research Estimates

Increasing outsourcing penetration, a key driver for CDMO growth

Given the overall total addressable market for CDMO services is about $341bn in 2019 (Total Pharma manufacturing), CDMOs have penetrated about ~26% of the total addressable market. Further, market penetration of CDMOs in small & mid-sized innovators is significantly higher, estimated to be at ~80%, while that for Big Pharma companies would stand at ~20%. The potential for CDMOs to expand their business is therefore significant, and the current outsourcing levels leave substantial scope for CDMOs to increase market penetration.

Penetration with small Pharma: ~80%

Penetration with big Pharma: ~20%

In addition to increasing outsourcing levels, pharma companies are looking more towards strategic partnerships with CDMOs and using fewer vendors which should benefit the CDMOs with global operations (particularly in Europe and the United States) that can offer multiple services and minimize the number of touchpoints required for biopharma procurement/supply chain personnel.

Fragmented market structure

CDMO market remains extremely fragmented with Top 5 players having ~15% of the global market share. There are approximately 20 CDMO businesses generating in excess of $500mn revenue and companies generating less than $50m in annual revenue represent over two thirds of all CDMOs. Fragmentation, which is generally associated with higher entry barrier in a market, is not particularly the case as far as CDMOs are concerned, as major entry barriers include relationships with innovators, which takes years to develop specialized service offering w.r.t therapies / drug delivery systems and multi-site offerings.

Long term client relationship

CDMOs cannot be easily replaced after they sign a contract with Innovators, because it usually takes 1-2 years to produce a commercial product after entering such an agreement on account of the product development activity. The CDMO transfers technology to the client in order to produce its product, undergoes safety checks during the engineering run, and then produces trial products before applying for manufacturing approval. During this period, pharmaceutical companies have to pay for the cost of raw materials, including milestone fees to the CDMOs.

The cost of producing trial products and the time spent becomes a sunk cost that hinders the ability of clients to replace a CDMO. A timely launch of a new product is important if sales are to be maximised, i.e., by utilising exclusive rights within the patent period. Thus, the selection of a CDMO requires a lot of consideration from pharmaceutical companies.

Can this be the IT moment for Indian Pharma?

Indian NCE-based CDMO est. market size: $5bn

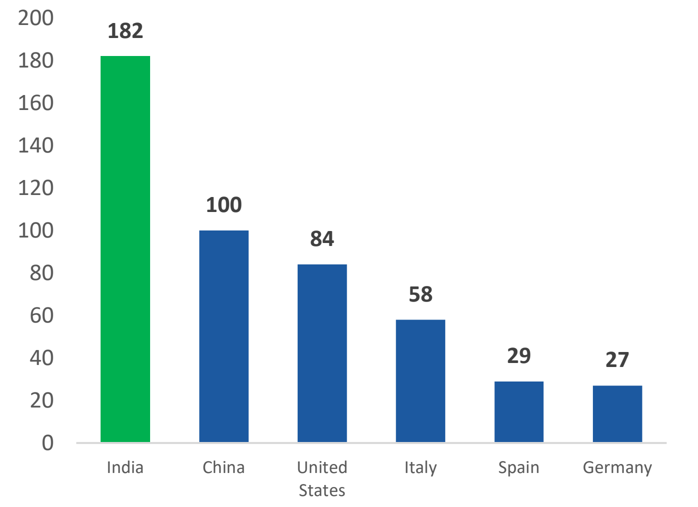
Chinese market size: $20bn

Proven developmental capability and lower technical labour cost remain key ingredients for making India a key pharmaceutical outsourcing destination similar to IT services industry during early 2000s. Indian CDMO market is estimated to be $5bn vs. total Asia-pacific market expected to be $44bn in 2018, large part of which remains with China. Given the anti-China sentiments and improving profile of the Indian players, we believe India has the potential to be amongst the top outsourcing destinations globally.

India remains the best in API developmental

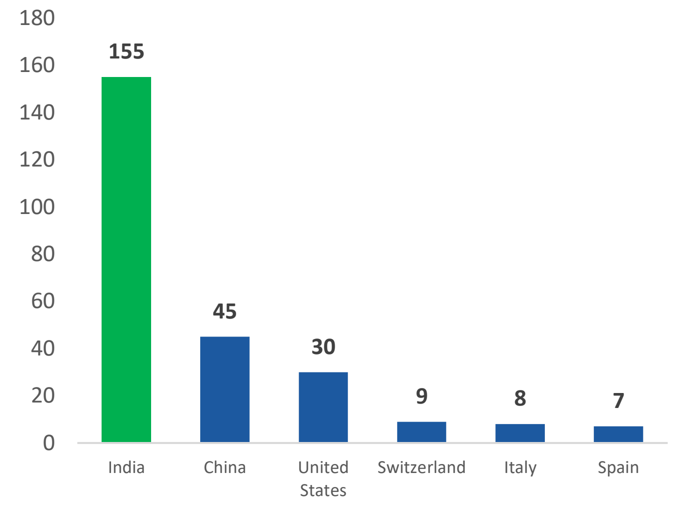
Though China commands massive share in APIs as per volumes, India remains a leader as far as new API development is concerned. India continues to remain amongst highest filers of DMFs in the US and also has the highest number of USFDA approved facilities in the world as at FY2020.

Exhibit 13: India has the highest number of USFDA approved API facilities



Source: Company, MNCL Research

Exhibit 14: India leads in number of new DMF fillings with the USFDA as on first half of calendar year 2020



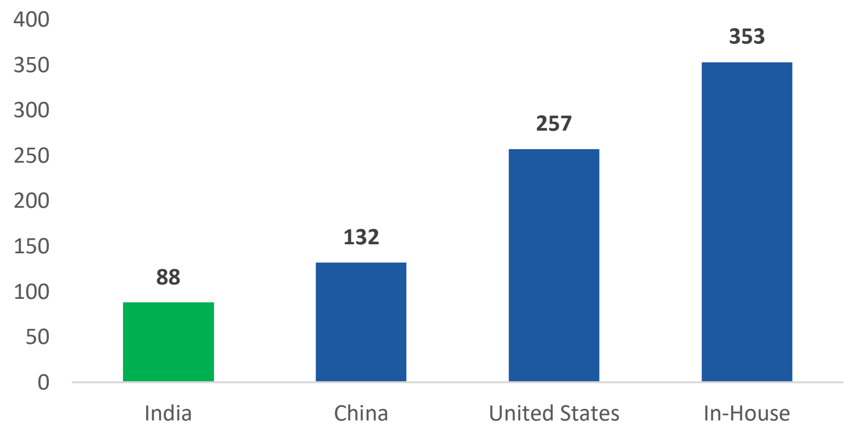
Source: Company, MNCL Research

Large pool of low cost technical labor

India boasts of a large pool of English speaking pharma scientists, which gives a significant advantage to the Indian CDMOs versus their global competitors. Below is the comparison of average salary cost per scientist in India and other geographies, as mentioned by Syngene International Ltd. in its presentation.

India adds 4 lakh English speaking Pharma graduates every year

Exhibit 15: Average cost of Research Scientist Is lowest in India ($ in thousands)



Source: Syngene International limited Investor Presentation, MNCL Research Estimates

Pure play NCE-based CDMO

SPL has created a niche for itself by leveraging its innovative capabilities to undertake New Chemical Entity (NCE)-based CDMO projects (850+) to discover and develop intermediates for innovator companies. It has built its reputation among global pharmaceutical giants given its expertise in process research, custom synthesis and development. SPL remains the only listed player which does only NCE-based CDMO both, in Pharma and Specialty Chemicals.

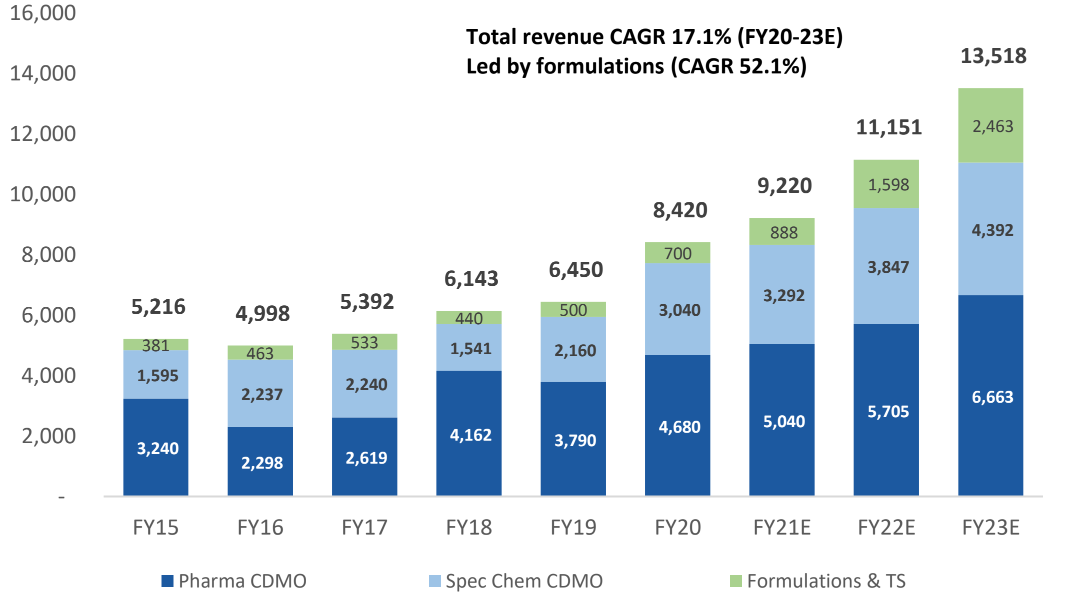
SPL has a track record of executing 850+ NCE-based CDMO projects

Under CDMO, SPL undertakes innovative process research and development, supplies intermediates to clinical trials, rapid response pilot scale manufacture and dedicated commercial manufacturing on an exclusive basis. Under the specialty chemicals segment, SPL supplies a complex specialty intermediary derived from its CDMO competence, especially to its agrochemical customers. Beyond pre-clinical molecules, it has also been supplying for four commercial molecules. These four intermediates for commercial molecules consist of Arthritis, Diabetes, Depression, and Women's Health. Out of these four, three molecules were commercialized in 2014 and their patent is set to expire in 2025, while the fourth molecule is for women's health and the supply for its intermediate was started in 2018.

Under the specialty chemicals CDMO business, SPL has a strategy of going after patented molecules largely in the agrochemicals industry. Currently, the company has two molecules that are commercialized with Agrochemical innovators with another two more in pipeline.

A large part of the incremental growth over next couple of years is expected to come from generic formulations business, which has been a relatively newer business segment for SPL. The company would target niche ANDAs with lower competition, which would be developed and distributed on a profit share basis along with partners.

Exhibit 16: SPL's sales break-up; Formulations to be largest contributor to top-line growth

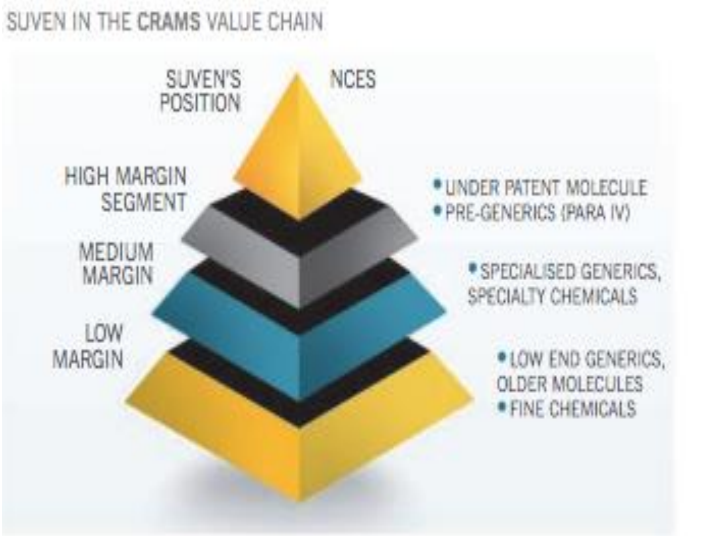


Source: Company, MNCL Research Estimates

Crème de la crème of CDMO value chain

SPL works exclusively for NCEs as far as the CDMO value chain is concerned, both in Pharmaceuticals and Specialty Chemical business. While NCE-based CDMO focuses on developmental chemistry, the generic based CDMOs would focus more on cost optimisation. NCE-based CDMO is characterised by extremely high entry barriers with respect to getting on boarded as a vendor with the innovators, long duration of product pipeline and extremely high developmental capabilities. On account of this NCE-based CDMO company generally maintains significantly higher margins as compared to other API / generic focused CDMO businesses.

it 17: SPL's value chain



Source: Company, MNCL Research

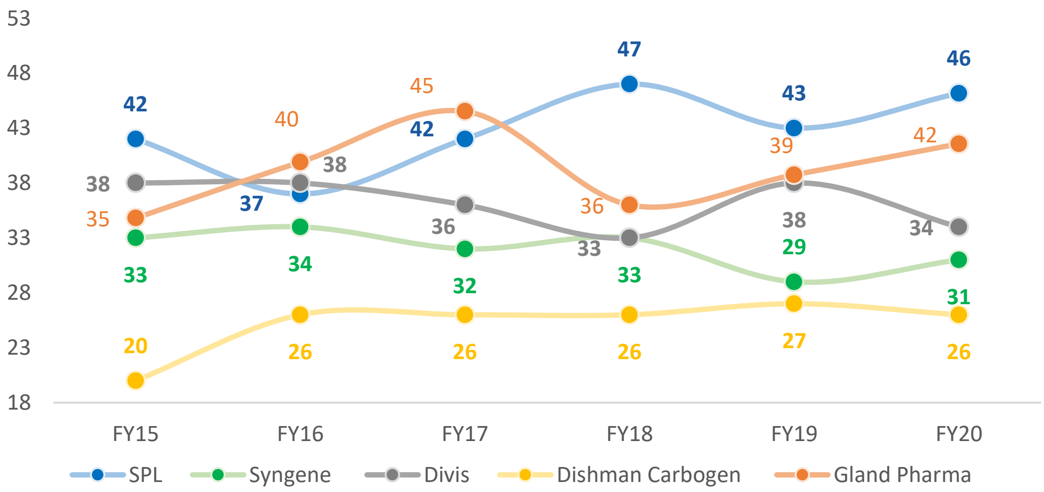
Exhibit 18: Listed CDMOs along with their core focus

Source: Company, MNCL Research

SPL remains the only listed company with entire CDMO practice coming from NCE-based clients. On account of this, SPL's overall margin profile remains superior when compared to other comparable listed companies. In the analysis below, SPL's margins before demerger are computed on a pre-R&D EBITDA basis.

SPL has maintained best–in-class EBITDA margins & ROCEs

Exhibit 19: SPL's business model focusing on NCEs leads to consistently higher margins (%)



Source: Company, MNCL Research Estimates

Best-in-class execution track record with global clientele

Vendor on boarding is one of the biggest entry barriers as far as NCE-based CDMOs are concerned on account of the criticality of the vendors in the product development / clinical trial phase with respect to developmental capabilities, compliance track record and IP related issues.

Given this, SPL's track record of executing marquee projects for leading R&D spenders is a testament of its execution capabilities.

Exhibit 20: SPL works with all the leading R&D spenders globally

Source: Company, MNCL Research Estimates

As per the latest annual report, most of the customers are based out of Europe contributing ~79% to the revenues as at FY20 vs. 67.2% as at FY19. Further, there is a significant customer concentration risk with Top 10 customers contributing ~90% to revenues and the Top customer contributing ~40% of the total revenues.

4 Commercial molecules and new molecules progressing to late stage to add to Pharma CDMO growth

SPL's Pharma CDMO division has done more than 850+ projects and has a healthy pipeline for the same. The projects under development are first introduced in "Base CRAMS" business, which on commercialisation, SPL would be amongst approved suppliers forming part of the "Commercial CRAMS" business.

Exhibit 21: Project track record in NCE based CDMO

Particulars	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	Q2FY19
Phase I	51	46	52	57	64	70	72	82	78
Phase II	32	41	46	52	48	38	36	33	34
Phase III	1	3	1	1	1	2	1	1	3
Commercial			3	3	3	3	4	4	4
Total Projects	84	90	102	113	117	113	113	120	119

Source: Company, MNCL Research Estimates

New capex to add capabilities; FCF generation to be impacted

SPL's last major expansion project involved setting up a Greenfield facility in Vishakhapatnam to cater to its base CRAMS business and was completed during FY16. Further, post this the ongoing Greenfield expansion was announced for about Rs3.2bn, break-up of the same is as follows:

- Rs1.1bn for Vizag Plant, which is meant for CRAMS and specialty chemicals
- Rs0.9bn for the formulation facility at Pashamylaram
- Rs1.2bn for OEL level 4 facility at Pashamylaram

Of the above, SPL would incur Rs0.9-1bn in FY21 and the above Capex is expected to start contributing FY22E onwards.

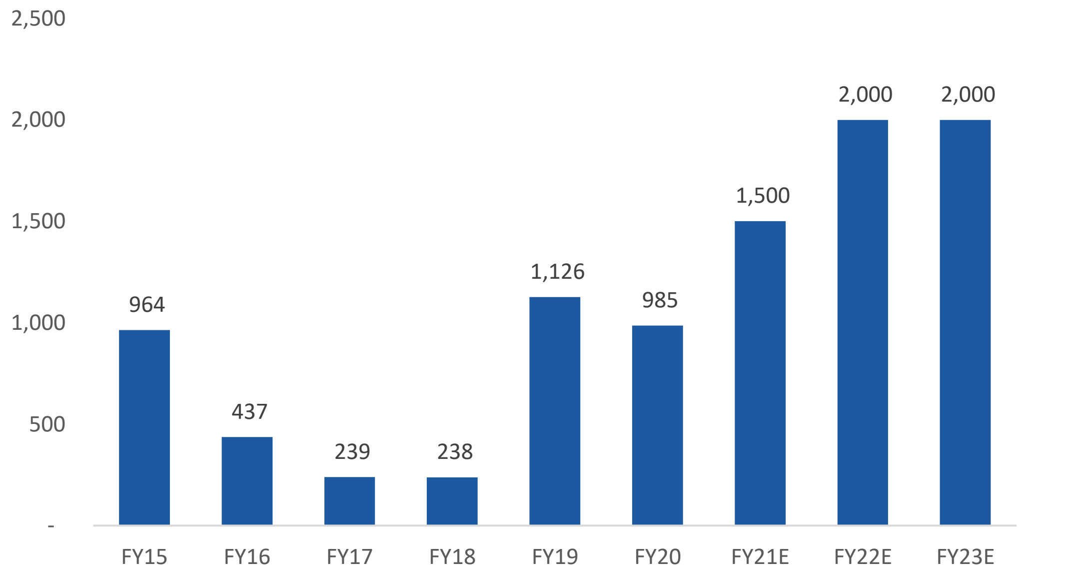
Exhibit 22: Plant locations along with their reactor capacities

Plants	Purpose	Capacity
Vizag, Andhra Pradesh	API's/Advanced Intermediate's/CMO	307 KL reactor volume. 3KL to 12KL Reactors GL/SS (45No's)
Pashamylaram, Telangana	API & Formulation R&D	120 kL reaction volume. 50L – 6000 L GL/SS (45)
Suryapet, Telangana	GMP Intermediates	300 CM reactors (93). 500L to 10 KL GL/SS
Jeedimetla, Telangana	R&D–Pilot Plant	Killo lab, 30L CM Reactors (32). 50L – 4000 L GL/SS

Source: Company, MNCL Research Estimates

Even as the current round of Capex is about to be completed in FY21E, the company in its recent concall has intended to spend Rs6bn on modernization and upgradation of its older capacities over a period of 3 years. The modalities of the capex are yet to be finalised as per the company. However, for the purpose of projections, we have assumed Rs0.5bn in FY21, and Rs2bn in FY22E & FY23E for the purpose of new capex.

Exhibit 23: Overall capex to be elevated for the medium term (Rs bn)



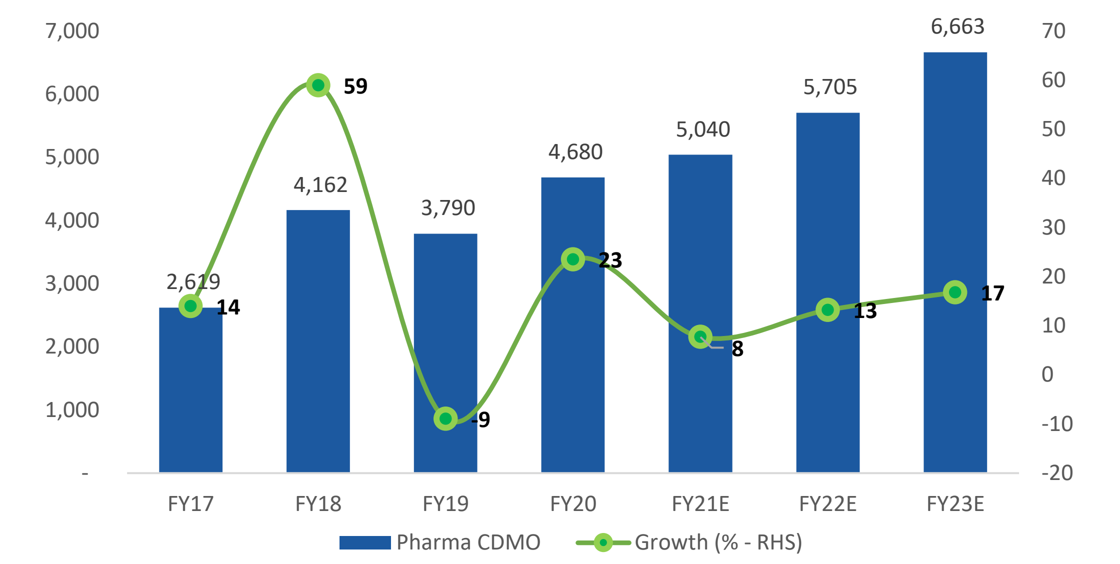
Source: Company, MNCL Research Estimates

New capex of Rs6bn to impact FCF generation in the medium term

Commercial molecules to lead Pharma CDMO growth

Under Pharmaceutical CDMO, the company undertakes innovative process research and development, supplies to clinical trials, rapid response pilot scale manufacture and dedicated commercial manufacturing on an exclusive basis for innovators.

Exhibit 24: Pharma CDMO business likely to grow at 12.5% CAGR over FY20–23E (Rs mn)



Source: Company, MNCL Research Estimates

Maturing pipeline would support margin expansion and volume growth

Under Pharma CDMO, SPL supplies intermediates to both clinical stage molecules and commercial molecules. Clients generally have multiple sources for procurement of intermediates and orders are generally divided amongst the listed vendors. For the clinical stage molecules, also known as Base CRAMS business, the volumes and the margins keep on increasing as the products migrate to the next phase of trials given the upfront developmental expenditure by the vendors and the increase in the participant pool for the clinical trials. Hence, the profit margins and the revenue contribution remain lowest for the Phase 1 projects versus the commercial projects.

Exhibit 25: Volume and margin built-up over the course of drug development

Particulars	Pre-Clinical	Phase I	Phase II	Phase III	Commercial	Post Patent Expiry
Probability of Success	33%	63%	44%	70%		
Volume Increase form previous phase	Low	5x of Clinical quantities	7x-10x of Phase I Quantities	10x of Phase II quantities	10x of Phase III (based on the market size)	Reduces
EBITDA Margins	<20%	20-30%		50-60%		Reduces

Source: MNCL Research Estimates

Maturing pipeline would support margin expansion and volume growth

Beyond pre-clinical molecules, it has also been supplying for four commercial molecules. These four intermediates for commercial molecules consist of Arthritis, Diabetes, Depression, and Women's Health. Out of these, three molecules were commercialized in 2014 and their patent is set to expire in 2025, while the fourth molecule is for women's health and the supply for its intermediate was started in 2018.

Overall the volumes in the commercial part of the business remain extremely lumpy as customers place a single large order in 18 months, which contributes to the quarterly variances. From an EBITDA margin prospective, commercial molecules contribute upwards of 70% and continue to remain so over period of patent protection.

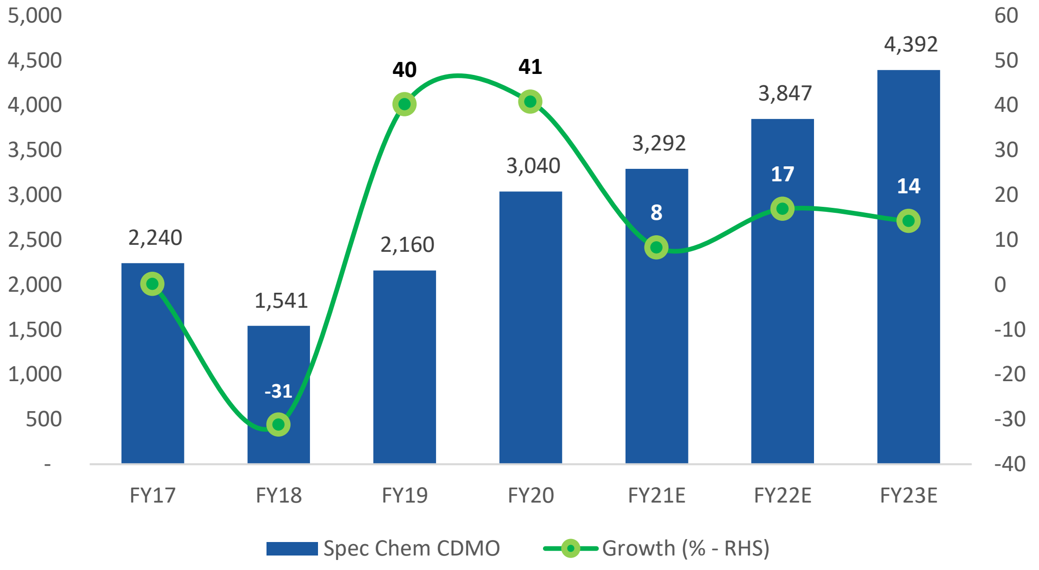
Specialty Chemicals CDMO to be driven by new commercialisations

Under the specialty chemicals CDMO business, SPL has a strategy of going after patented molecules, largely in the agrochemicals industry. Currently, the company has two molecules that are commercialized with Agrochemical innovators with another two in pipeline. Of the two commercialised molecules, one has gone off patent while other agrochemical molecule has been commercialised in FY19. Incremental growth is expected to come from two new commercial molecules with sale potential of Rs500mn each.

Pertinent to note that, Spec Chemical CDMO business is very similar to the Pharma CDMO business with respect to the time to commercialisation, the validation process and other commercial arrangements with respect to offtake.

Specialty Chemicals CDMO growth to be led by 2 new commercial launches

Exhibit 26: Spec CDMO business is expected to grow at 13.05% CAGR over FY20-23E



Source: Company, MNCL Research Estimates

For the Spec Chemicals business, growth significantly depends upon the scale up of new molecules and performance in the base business. In our base case, we estimate at least one of the two molecules to start contributing in H2FY21; while of the current two molecules, the new molecule to lead the overall growth in the current base.

Exhibit 27: Scenario analysis for the Spec Chem business

Spec Chem CDMO		Bear Case			Base Case			Bull Case		
Particulars	**FY20**	**FY21**	**FY22**	**FY23**	**FY21**	**FY22**	**FY23**	**FY21**	**FY22**	**FY23**
Current Base	3,040	3,192	3,447	3,723	3,192	3,447	3,792	3,283	3,612	3,973
New Molecules	-	-	200	400	100	400	600	150	500	700
Total	3,040	3,192	3,647	4,123	3,292	3,847	4,392	3,433	4,112	4,673

Source: Company, MNCL Research Estimates

Key differentiators in CDMO business

Emergence of developing and manufacturing more recent generations of pharma (including biologics) have led to the need for an outsourcing partner with niche capabilities. Further, as many CDMOs today are multi-disciplinary, there are very few true one-stop-shops and pharma companies will typically use a range of CDMOs across their product portfolios selected on parameters like development/manufacturing technologies or expertise, manufacturing capacity or geographical location, etc. Each CDMO tries to differentiate in order to gain more client interest, which have been articulated below.

Exhibit 28: Key differentiators in CDMO business

Positioning	Summary	Example	SPL's Positioning
Platform expansion or "One Stop Shop"	The desire of innovators to deal with fewer and larger CDMOs, with broad development and manufacturing capabilities, has driven business traction as companies look to expand services offered across the value chain.	**Syngene International**: Post commercialisation of its units will have capabilities in both CRO + CMO thus will be able to service customers across lifecycle of drug development along with clinical trials. **Samsung Biologics**: Now has capabilities across CRO + CDO + CMO in Bio Pharma	**Weak** SPL's niche remains intermediates for NCE based molecules which is a relatively small part of entire CDMO value chain. Gaining traction from smaller entities, who are looking to outsource on a "One Stop Shop" basis would be difficult.
Multisite offering	Clients are preferring vendors having multiple sites across geographies in order to reduce supply disruption and de-risk from any compliance related risk from regulators.	**Piramal Pharma Solutions**: Has API facilities in US, Canada & India while formulations facility in US, UK and India. **Dishman Carbogen**: Facilities across France, Switzerland, UK, India, Netherland and China serving early phase and late phase molecules.	**Medium / Weak** SPL has its facilities only in India and thus remains at risk of any compliance action. However, given its current focus on intermediates, and thus, exposed to relatively lower regulators' scrutiny, we believe this shortcoming will not have a huge impact on SPL's positioning.
Complex and niche capabilities	CDMOs with niche and complex manufacturing capabilities in high growth and high margin end markets have commanded the highest M&A multiples.	**Catalent**'s acquisition of Paragon Bioservices for $ 0.85bn (7x revenue) Key trigger was high-growth gene and cell therapy markets	**Strong** SPL remains a strong player given its track record with drug development (Suvn-502).

Source: MNCL Research

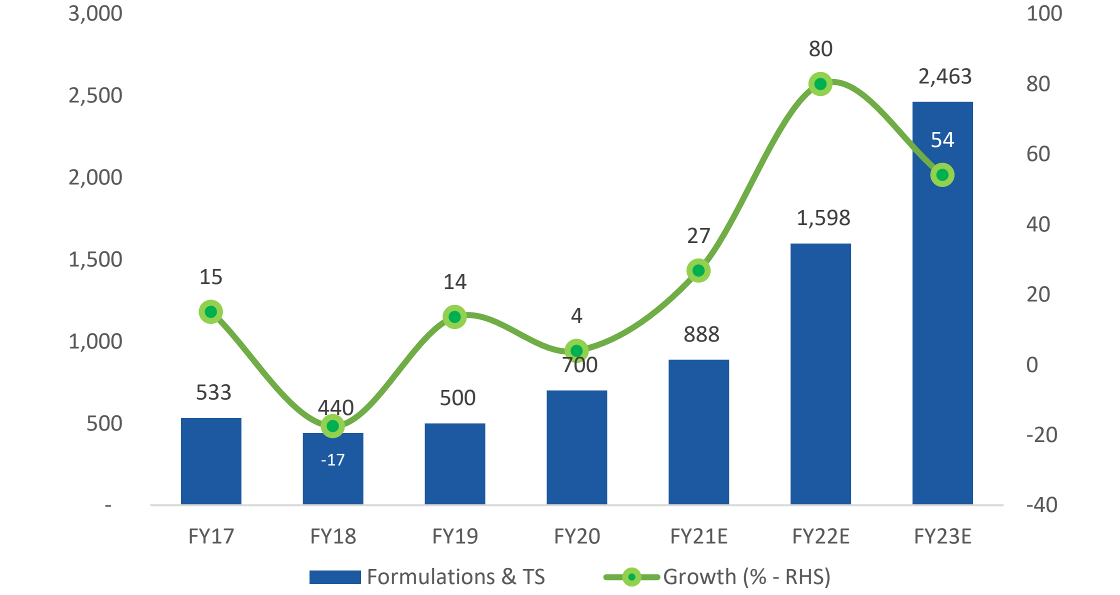
Formulations: Largest contributor to the profit growth

Growth to be led by 3 launches with a guided PAT contribution of $2-4mmn

A large part of the incremental growth over the next couple of years is expected to come from generic formulations business, which has been a relatively newer business segment for SPL. The company would target niche ANDAs with lower competition which would be developed and distributed on a profit share basis along with partners.

Beyond generic ANDAs, this segment comprises fees for technical services provided to global pharmaceutical giants and fee from its exclusive marketing license for its Malathion lotion to Taro Pharmaceuticals for the US and Canada. Revenue recorded a decline since FY18 owing to general reduction in royalty and reduction in product mix in services.

Exhibit 29: Formulations to be the largest contributor to growth – CAGR 52% over FY20-23E (Rs mn)



Source: Company, MNCL Research Estimates

SPL has 11 ANDAs in the pipeline of which three belong to SPL, six are in collaboration with other customers (of which two are with Rising Pharma Holdings) and two are ANADA (Abbreviated New Animal Drug Applications) along with customers. Each ANDA has the potential of $2-4mn PAT on account of profit share potential on each molecule. Most of the molecules which are being targeted are small market size molecules wherein larger players may not be interested. SPL expects to file 5-6 ANDAs each year.

We tried to analyse the overall economics of the formulations business from the context of the profit share and the overall PAT contribution guidance as given by the management ($2-4mn PAT per molecule).

Exhibit 30: Scenario analysis for ANDA Profitability

Particulars (in $ mn)	Lower estimate	Base estimate	Bull estimate	Analysis
Profit Share component	2.47	3.80	5.13	
Sale Price	1.00	1.00	1.00	Assumed to be same irrespective of the complexity / potential
Total Revenues	3.47	4.80	6.13	
Direct Expenses	0.80	0.80	0.80	Assuming products are transferred on 20% gross margin basis (over and above the profit share component)
PBT	2.67	4.00	5.33	
PBT %	77%	83%	87%	Effective margins on formulation products based on the chemistry. Overall formulations to be EBITDA accretive.
Tax	0.67	1.00	1.33	Tax rate assumed is 25%
PAT	2.00	3.00	4.00	Based on Management estimates

Source: MNCL Research Estimates

Formulation to be margin accretive on account of the profit share component

Significant synergies with Rising Investment

Background

Suven Pharma Inc. is a wholly owned subsidiary of SPL. It is an SPV created to invest in Rising Pharma Holdings Inc (‘Rising’). Suven Pharma Inc. has 25% holding in Rising Pharma Holdings Inc. Further, Rising Pharma Holdings Inc. is a New Jersey, USA based development & distribution company, predominantly in the US generic formulations space. In April 2019, an investment of $35mn for 25% stake in Rising was made through Suven USA. The investment was made after Rising Pharma filed for bankruptcy. Since then, Rising has managed to turn around its operations and has yielded SPL a proportional share of Rs482mn profit from Rising’s total profits in FY20.

Rationale for Investing

Distribution partner for Formulations business: SPL would use Rising’s distribution capability in the US generic market instead of partnering with another distributor. Out of the total 11 ANDAs that SPL has filed, two are in partnership with Rising. Further, Rising also distributes one of the commercialized ANDAs for SPL.

SPL to remain preferred partner for ANDA development: Rising has more than 100 ANDAs with multiple customers. It plans to develop 10-15 ANDAs every year for which SPL would have the first right of refusal. This will aid both the CRAMS and the formulations business for SPL.

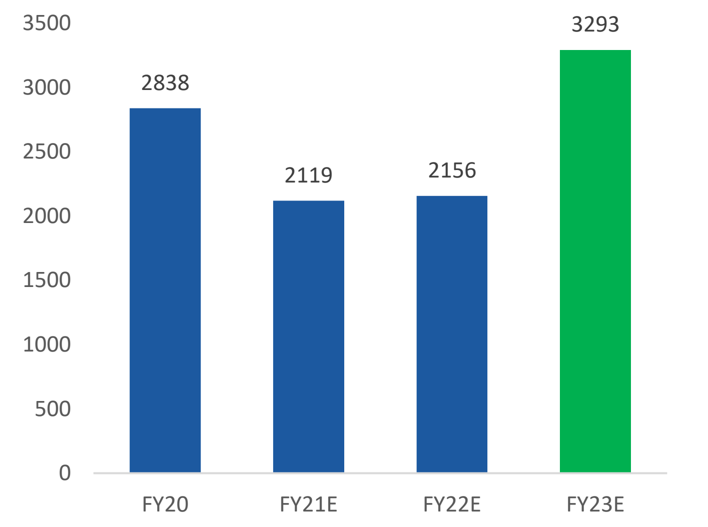
Financial investment: SPL invested $35mn for 25% stake in Rising as a financial investment. Rising is expected to contribute Rs500-600mn as profit share in in FY21E. SPL expects Rising to start giving out dividends to the US subsidiary and multi fold value to be created out of the investment over next 3-4 years.

Financial Analysis

New capex announcements to impact FCF generation

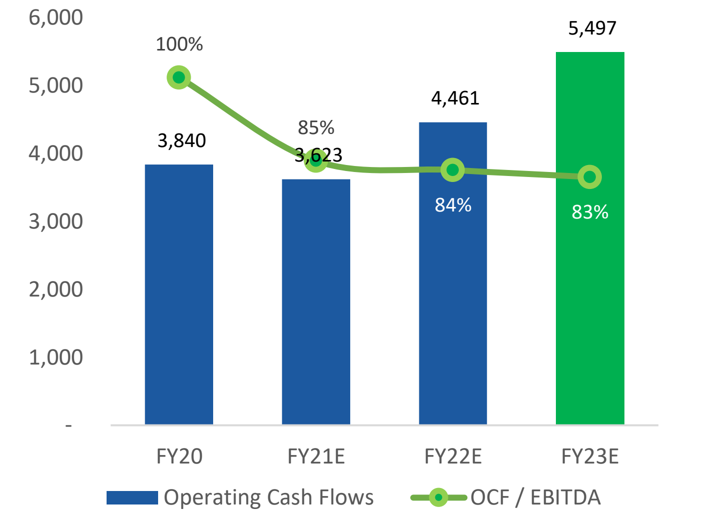
SPL's cash flows are likely to be impacted on account of new capex announcement of Rs6bn over next 3 years, over and above the ongoing capex round of Rs3.2bn, which will start yielding results FY22E onwards. SPL is expected to maintain strong OCF generation on the back of Spec Chem CDMO and Formulations. OCF/EBITDA is showing a declining trend, however this cannot be benchmarked to FY20 numbers and remains in lines with historical base and OCF/EBITDA conversion of other listed peers.

t 31: FCF generation to be impacted with new capex (Rs mn)



Source: Company, MNCL Research

Exhibit 32: OCF generation remains superior (Rs in mn)

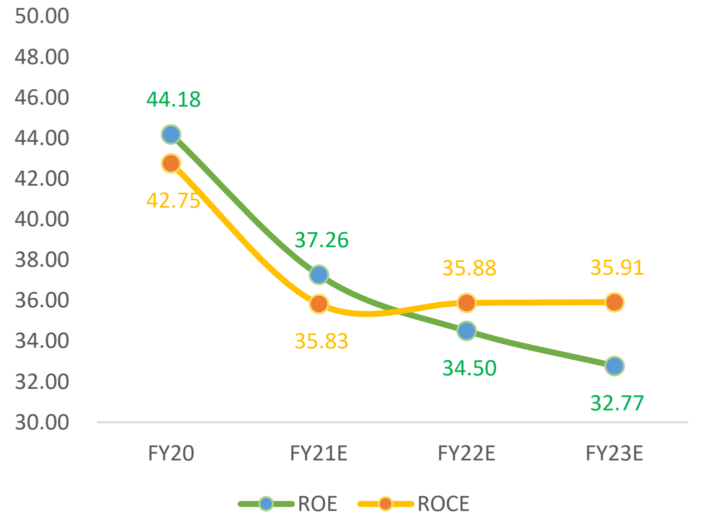


Source: Company, MNCL Research

Problem of plenty: Strong FCF & limited re-investment opportunity

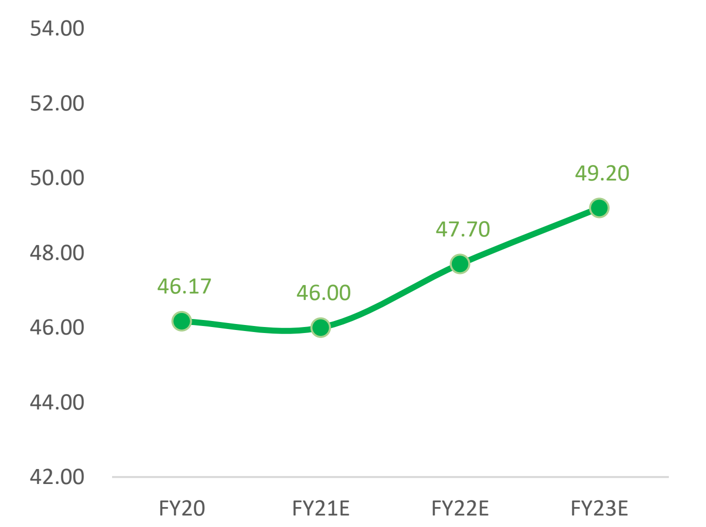
Even as we expect EBITDA margins to expand on the back of formulations business, SPL's return ratios are expected to reduce on account of robust cash flow generation and a relatively smaller capital base of Rs11.3bn shareholders fund (FY21E). As the base normalises, return ratios to stabilise post FY23E.

33: Return ratios to reduce on account of base effect (%)



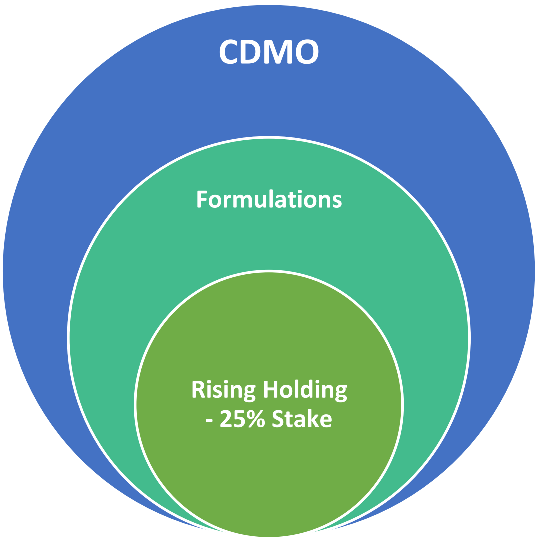
Source: Company, MNCL Research

Exhibit 34: Improvement result of formulations profit share (%)



Source: Company, MNCL Research

SOTP based valuations for businesses with different economics



CDMO as a business has extremely high entry barriers, long term contracts with the customers and rich margin profile which remains largely constant. Formulation business on the other end remains exposed to competitive pressure of the US generic market, need for continuous re-investment in R&D for future growth and relatively lower entry barriers into products. Given the different economics of the formulations and CDMO business, we believe both the businesses should be valued separately. Further, we have valued SPL's stake in Rising on the basis of multiples based valuation based on our PAT estimates.

Generic formulations business to be valuation dilutive, attracts a lower multiple than CDMO business

On comparing various listed peers based on profitability, we believe SPL's formulations business would score much higher on account of the limited competition nature of most of the products, which allows SPL to earn much higher profit share. However, as this strategy remains untested and not scalable to larger molecules, we believe formulation business should be valued at EV/EBITDA of 15x on FY23E EBITDA on the formulation business.

Exhibit 35: Analysis of listed peers in the US generics space

Particulars	Market Cap (Rs bn)	ROE % (3year Average)	ROCE % (3year Average)	PE (1 year forward)	EV/EBITDA (1 year forward)
Sun Pharmaceuticals	1365	9.8	10.7	27.4	17.1
Dr Reddy's Lab	834	11.8	10.6	46.3	25.3
Cipla	610	9.5	10.8	28.7	15.7
Aurobindo	525	19.9	19.7	15.7	9.8
Cadila	477	18.3	14.7	24.7	14.8
Torrent Pharma	227	16.0	13.7	33.6	17.5
Alembic Pharmaceuticals	213	24.3	23.2	18.0	13.5
Average		**15.7**	**14.8**	**27.8**	**16.2**

Source: Company, MNCL Research Estimates

Key weakness of the formulation business

- - Focus on smaller molecules, and thus, not scalable
- - Extremely critical to the thesis is assumption of market share retention along with continuous launch pipeline

- Exposed to competiition of cyclicality of generic pharma market

Key strenghts of the formulation business

- - Rising Investment gives SPL oppurtunity to take up lucrative formulations oppurtunity with low competition

- Profit share with partners helps them to have better profit pool versus other generic manufacturers

Our projections are based on number of launches (three launches for FY21 & FY22E, four launches for FY23E) and retention of market share by the commercial products. We have also assumed R&D expenses based on the pace of filings assumed. Moreover, EBITDA margins remain elevated on account of a component of profit share included in the revenues, which would depend on the quality of molecules and competition.

On EV/EBITDA multiple of 15x on FY23E formulations EBITDA, we arrive at an Enterprise Value of Rs21bn in the Bear case, Rs28.8bn in the Base case and Rs39.7bn in the Bull case.

Exhibit 36: Scenario analysis for ANDA Profitability

Particulars	Bear Case			Base Case			Best Case		
Y/E March (Rs. mn)	**FY21E**	**FY22E**	**FY23E**	**FY21E**	**FY22E**	**FY23E**	**FY21E**	**FY22E**	**FY23E**
Total Formulations Revenue	780	1326	1968	888	1598	2463	1058	2257	3216
R&D Expenses	88	101	115	92	112	135	96	123	150
EBITDA	512	919	1399	648	1220	1917	824	1840	2646
EV/EBITDA Multiple x			**15**			**15**			**15**
Enterprise Value			**20985**			**28756**			**39695**

Source: Company, MNCL Research Estimates

Valuations rich for CDMO segment given the inherent quality

Our analysis of the recent M&A transaction and valuations of globally listed peers suggest that SPL scores much higher in terms of margin profile, cash flow generation and growth ratios. However, most of the global companies are placed in high growth areas such as biologics and gene therapy. Further, the deal valuations in the exhibit below are influenced by factors including expansion of platform / capability and high growth areas such as biologics and gene therapy.

Exhibit 37: Analysis of the recent M&A Deals in the CDMO space

Date	Buyer	Target	Size ($mn)	EV/EBITDA	Comments
07/08/19	Permira	Cambrex	1,882	19.5x	PE deal for a Leading global CDMO
15/04/19	Catalent	Paragon Bioservices	881	21.4x	Increased exposure to high-growth gene and cell therapy markets
25/03/19	Thermo Fisher	Brammer Bio	1,247	28.3x	Increased exposure to high-growth gene and cell therapy markets
23/07/18	Cambrex	Halo Pharma	301	15.7x	Adds small molecule FDF capabilities
05/10/17	Fosun	Gland Pharma	948	17.6x	Adds sterile injectable capabilities
19/09/17	Catalent	Cook Pharmica	659	17.3x	Increased exposure to biologics market
06/06/17	Carlyle/GTCR	AMRI	1,174	22.2x	Adds early stage small molecule development
15/05/17	Thermo Fisher	Patheon	5,447	21.6x	Entry into CDMO market

Source: Company, MNCL Research Estimates

We note that most of the companies in the CDMO listed space trade at a significantly higher multiple (both Indian and global peers) versus pharmaceutical companies in Generics and Branded segments. This is on account of the overall secular growth trends for CDMO versus the cyclicality and competition in the other segments. Further, CDMO companies continue to enjoy much richer return ratios and superior growth owing to the robust R&D spends pipeline.

Exhibit 38: Peer analysis of Indian and Global listed companies in the CDMO space

Company	Brief Summary	Mcap	EBITDA %	ROE %	PER - FY21	PER - FY22	PER - FY23	EV/EBITDA - FY21	EV/EBITDA - FY22	EV/EBITDA - FY23
Samsung Biologics	CRO + CDMO	48.5	27	6	215	139	98	113	94	85
Lonza	CRO + CDMO	46.7	27	13	44	38	34	29	26	22
Wuxi Apptec	CRO + CDMO	38.5	26	14	84	69	51	53	46	35
Wuxi Biologics	CDMO	37.9	34	12	167	135	85	121	93	76
Catelent	CDMO	16.3	22	8	43	36	31	23	19	17
Divis Labs	APIs + CDMO	13.3	34	19	46	37	33	36	24	21
Charles River	CRO + CDMO	12.5	23	17	36	31	28	24	21	17
Asymchem Lab	CDMO	8.3	26	21	93	75	49	73	57	46
Gland Pharma	CMO	4.9	36	23	38	29	24	28	21	17
Syngene	CR0 + CDMO	3.5	20	20	63	47	38	35	28	24
Suven	CDMO	1.4	46	30	NA	NA	NA	NA	NA	NA

Source: Bloomberg, MNCL Research

Key weakness of the CDMO business

- Focused only on Intermediates which capture a small part of the entire value chain
- Difficult to service small & mid-sized clients who are looking for "One Stop Shop" vendors. Small & mid-sized clients control ~50% of R&D spends and ~40% of drug originations

Key strenghts of the CDMO business

- \- Strong execution capability demonstrated by long execution track record, acts as a significant entry barrier for other competitors

\- Focus only on NCE-based molecules makes SPL amongst the best quality CDMO plays in the listed universe

We use the EV/EBITDA valuation methodology to value SPL, as the significant recent capex intensity (recently concluded round of Rs3.2bn and new capex announcement of Rs6bn) and the resultant impact on the free cash flow generation for the company will lead to an inaccurate base from a DCF prospective.

We assign a 20x EV/EBITDA multiple to SPL on its FY23E CDMO EBITDA, which is still a significant discount to most of its listed peers (both in India & Globally) mentioned earlier exhibits. Our multiple incorporates factors like lack of presence in the overall CDMO value chain and its high concentration risk. On EV/EBITDA multiple of 20x on FY23E formulations EBITDA, we arrive at an Enterprise Value of Rs80.1bn in the Bear case, Rs94.7bn in the Base case and Rs99.6bn in the Bull case.

Exhibit 39: Scenario analysis for ANDA Profitability

Particulars	Bear Case			Base Case			Bull Case		
Y/E March (Rs mn)	**FY21E**	**FY22E**	**FY23E**	**FY21E**	**FY22E**	**FY23E**	**FY21E**	**FY22E**	**FY23E**
CDMO Pharma	4788	5087	5407	5040	5705	6663	5112	5921	7156
CDMO Specialty Chem	3192	3647	4123	3292	3847	4392	3433	4112	4673
Total Revenue	7980	8735	9530	8332	9553	11055	8545	10032	11829
EBITDA	3403	3729	4005	3593	4099	4734	3709	4145	4982
EV/EBITDA Multiple x			20			22.5			25
Enterprise Value			**80105**			**1,06,506**			**1,24,539**

Source: Company, MNCL Research Estimates

Rising Holdings valuations on the basis of PER

SPL invested $35mn for 25% stake in Rising as a financial investment. Rising is expected to contribute Rs500-600mn as profit share in FY21E. SPL expects Rising to start giving out dividends to the US subsidiary and multi fold value to be created out of the investment over next 3-4 years.

Based on our profit share assumption of Rs637mn in FY23E and giving a multiple of 15x PER on the same, we arrive at a valuation of Rs9.5bn for SPL's stake in Rising Holdings.

Exhibit 40: SOTP valuation in Bear Case, Bull Case and Base Case (Rs mn)

Particulars	Bear Case			Base Case			Bull Case		
Y/E March (Rs mn)	**FY21E**	**FY22E**	**FY23E**	**FY21E**	**FY22E**	**FY23E**	**FY21E**	**FY22E**	**FY23E**
Formulations									
EBITDA	512	919	1399	648	1220	1917	824	1840	2646
EV/EBITDA Multiple			15			15			15
Enterprise Value			**20,985**			**28,756**			**39,695**
CDMO									
EBITDA	3403	3729	4005	3593	4099	4734	3709	4145	4982
EV/EBITDA Multiple			20			23			25
Enterprise Value			**80,105**			**1,06,506**			**1,24,539**
Rising Stake									
PAT Contribution	482	554	638	482	554	638	482	554	638
PER			15			15			15
Rising Valuation			**9564**			**9564**			**9564**
Total Enterprise Value			110654			144827			173798
Net Debt (FY23E)			-3221			-3221			-3221
Market Cap			113876			148048			177019
Target Price			**447**			**580**			**695**
Upside on CMP			**8%**			**40%**			**68%**

Source: Company, MNCL Research Estimates

Key Downside Triggers

- Competition in generic formulations / slower launch rate to impact the overall profitability
- Slower pick-up in new Spec Chem molecule and lower contribution from current molecules
- Delay in monetisation of current round of Capex / Lower traction from new units
- Delay in Increasing the management bandwidth over next 2-3 years

Key Upside Triggers

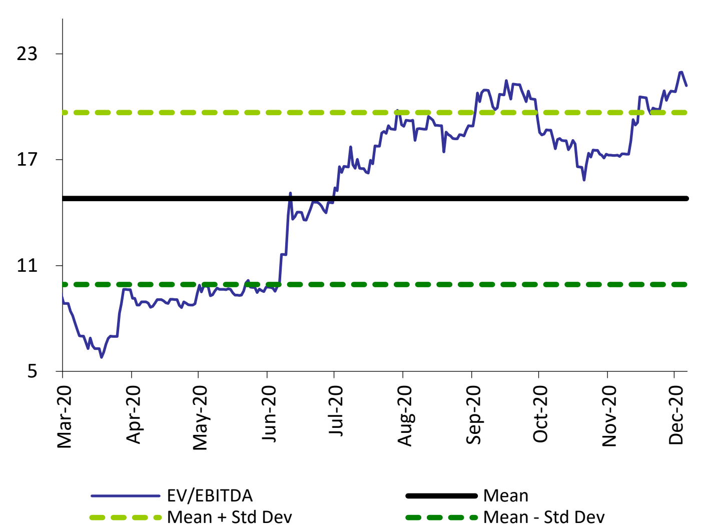
- Execution on API based CDMO project, likely to remain a significant re-rating trigger
- Higher launch rate in the formulation segment to aid profitability
- Dividends from Rising Investments / repayment of Suven Lifesciences debt
- Migration of Pharma based projects towards late stage / commercialisation

Structural tailwind + Best-in-class return ratios + Valuation comfort => Re-rating Candidate

SPL remains one of the most attractive plays on NCE-based CDMO, being best placed to capture the tailwind for Indian APIs on account of China+1 strategy. SPL has the best margin profile amongst the listed players (India & globally) and its strong cash flow generation allows it to pursue further growth related projects. Additionally, given its strong balance sheet, we note that underlying business fundamentals for SPL remain robust. Accordingly, we assign a Dec - 2021 TP of Rs 580 (Base Case) for SPL and initiate coverage with a BUY rating on the stock. On our FY23E estimates, the stock is trading at 12.3x EV/EBITDA on the CMP.

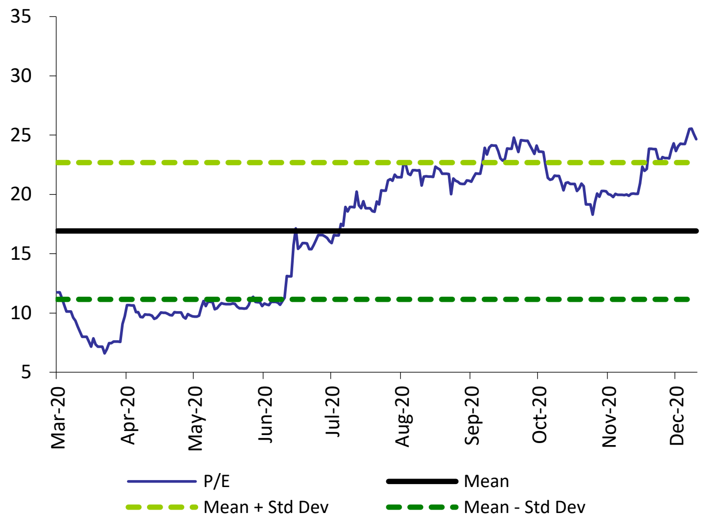
Our Bear Case TP is Rs 447 which implies 8% upside form the CMP, while our Bull case TP is Rs 695 which implies ~68% upside from the CMP.

Exhibit 41: 1 Year forward EV / EBITDA chart



Source: Company, MNCL Research

Exhibit 42: 1 Year forward PER chart



Source: Company, MNCL Research

MONARCH NETWORTH CAPITAL

Exhibit 43: Segment wise Scenario analysis

Particulars	Historical		Bear Case			Base Case			Bull Case		
Y/E March (Rs mn)	**H2FY19**	**FY20**	**FY21E**	**FY22E**	**FY23E**	**FY21E**	**FY22E**	**FY23E**	**FY21E**	**FY22E**	**FY23E**
CDMO Pharma	1988	4680	4788	5087	5407	5040	5705	6663	5112	5921	7156
CDMO Specialty Chem	1450	3040	3192	3647	4123	3292	3847	4392	3433	4112	4673
Formulations and other services	299	700	780	1326	1968	888	1598	2463	1058	2257	3216
Net Sales	3737	8420	8760	10061	11498	9220	11151	13518	9603	12290	15045

Source: Company, MNCL Research Estimates

Exhibit 44: Analysis of Profit and Loss / Operating matrix

Particulars	Historical		Bear Case			Base Case			Bull Case		
Y/E March (Rs mn)	**H2FY19**	**FY20**	**FY21E**	**FY22E**	**FY23E**	**FY21E**	**FY22E**	**FY23E**	**FY21E**	**FY22E**	**FY23E**
Net Sales	3778	8338	8760	10061	11498	9220	11151	13518	9603	12290	15045
Raw Materials	1032	2292	2497	2767	3105	2536	2955	3447	2593	3195	3761
Employee Costs	296	694	701	785	862	738	870	1014	720	922	1053
R&D Expenses	0	60	88	101	115	92	112	135	96	123	150
Other Expenditure	735	1443	1559	1761	2012	1614	1896	2271	1661	2065	2452
EBITDA	1716	3849	3916	4648	5404	4241	5319	6651	4533	5985	7628
RM / Sales %	27%	27%	29%	28%	27%	28%	27%	26%	27%	26%	25%
Employee Cost / Sales %	8%	8%	8%	8%	8%	8%	8%	8%	8%	8%	7%
R&D Expenses / Sales %	0%	1%	1%	1%	1%	1%	1%	1%	1%	1%	1%
Other Expenditure / Sales %	19%	17%	18%	18%	18%	18%	17%	17%	17%	17%	16%
EBITDA Margins %	45%	46%	45%	46%	47%	46%	48%	49%	47%	49%	51%
Gross Margins %	73%	73%	72%	73%	73%	73%	74%	75%	73%	74%	75%

Source: Company, MNCL Research Estimates

Quarterly Results & Analysis

Exhibit 45: Quarterly results

Y/E March (Rs mn)	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20	Q4FY20	Q1FY21	Q2FY21
Net Sales	**1,269**	**2,509**	**1,974**	**2,729**	**1,787**	**1,848**	**2,382**	**2,374**
Raw Materials	278	754	413	911	438	530	707	736
Employee Costs	134	163	170	174	176	174	174	209
R&D Expenses	-	-	27	-	-	32	31	38
Other Expenditure	362	373	338	389	377	339	349	405
EBITDA	**495**	**1,220**	**1,025**	**1,256**	**796**	**773**	**1,121**	**985**
Depreciation	55	60	55	56	56	70	71	75
Interest	10	17	38	44	76	72	32	33
Other Income	2	4	24	54	49	53	57	4
PBT (Before EI / Share of Associates)	**431**	**1,147**	**956**	**1,210**	**713**	**684**	**1,076**	**881**
Share of Profit / (Loss) from Associates	-	-	174	35	64	210	103	88
Exceptional Item (EI)	-	-	-	-	-	-	-	
PBT	**431**	**1,147**	**1,130**	**1,245**	**777**	**894**	**1,179**	**968**
Tax	87	399	211	315	198	152	263	228
Tax rate (%)	0	0	0	0	0	0	0	0
Reported PAT	**345**	**748**	**919**	**930**	**579**	**742**	**915**	**741**
Y-o-Y Growth (%)								
Revenue					41	(26)	21	(13)
EBITDA					61	(37)	9	(22)
PAT					68	(1)	(0)	(20)
Q-o-Q Growth (%)								
Revenue		98	(21)	38	(35)	3	29	(0)
EBITDA		146	(16)	23	(37)	(3)	45	(12)
PAT		117	23	1	(38)	28	23	(19)
Margin (%)								
Gross Margins	78	70	79	67	75	71	70	69
EBITDA	39	49	52	46	45	42	47	41
PAT	27	30	47	34	32	40	38	31

Source: Company, MNCL Research Estimates

Exhibit 46: Segment wise quarterly performance

Y/E March (Rs mn)	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20	Q4FY20	Q1FY21	Q2FY21
CDMO Pharma	850	1,138	918	2,060	792	910	1,276	1,442
CDMO Specialty Chem	270	1,180	1,005	540	695	800	970	682
Formulations and other services	140	159	67	130	365	138	136	250
Net Sales	**1,260**	**2,477**	**1,990**	**2,730**	**1,852**	**1,848**	**2,382**	**2,374**

Source: Company, MNCL Research Estimates

Management Call Highlights on Q2FY21

On Guidance for H2FY21

- Management sticks to its growth guidance of 15-20%, expecting H2FY21E to be much stronger
- Margins have declined on account of higher operational expenses and change in product mix
- Profit share component from formulations will reflect in H2FY21E

On New Capex Announcement

- Additional capex announced of Rs600cr, to be used for technology upgradation and adding capabilities across R&D unit and existing capacities
- Break-up of the exact spends will be worked out and shared later
- Capex would be completed over a period of 36 months; to be funded using internal accruals

On Current Capex

- On capex of Rs320cr, expects full utilization and impact to be seen in next 24 months
- Rs110 crores for Vizag Plant, which is meant for CRAMS and specialty chemicals
- Rs90cr for the formulation facility at Pashamylaram
- Rs120cr for OEL-4 facility at Pashamylaram

On Projects Pipeline

- Enquiries have been strong post Covid-19 related disruptions in Q1FY21
- **On Pharma:** One project has migrated to Phase III (making it 2); will start supplying in H2FY21
- Pitching for assignments on the API side from current customers for other products, will take time to onboard
- **On Spec Chem:** 2 new commercial launches, 1 Product to launch in H2FY21 while another next year

On Formulations

- Have done a total of 11 fillings, of which five are approved and three are commercial
- Expecting to launch two more before the end of this year
- Share of profits from Rising Pharmaceuticals at Rs19cr in H1FY21; total FY21 guidance stands at Rs48cr.

Others

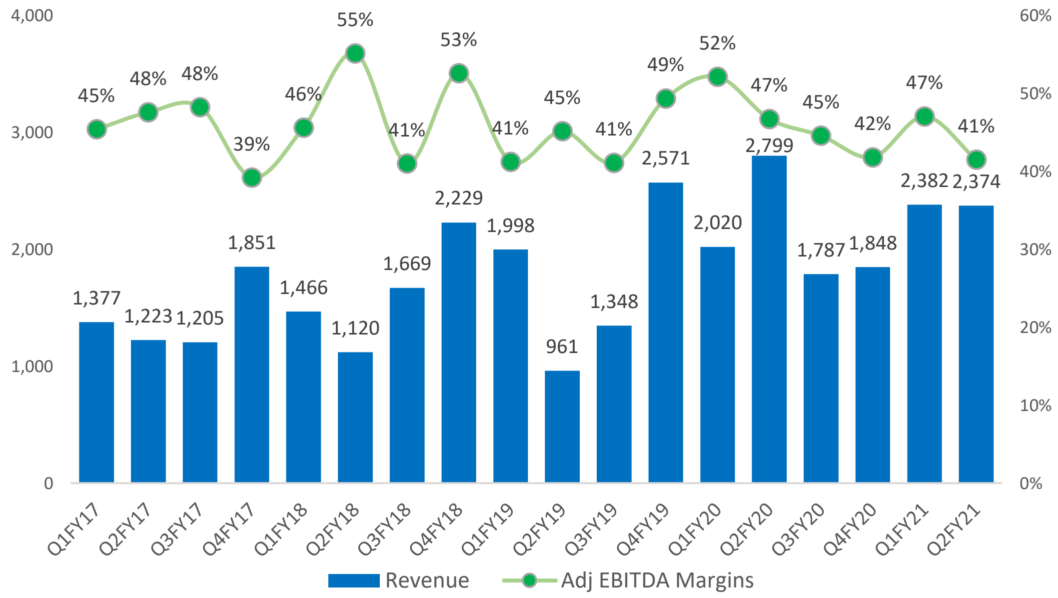
- Not looking for any stake-sale in Suven Pharmaceuticals
- Keen on leadership level hiring, delayed on account of Covid; will take time

Our analysis of the results

Annual Performance more important than Quarterly Performance

Given the nature of SPL's business, we strongly believe quarterly variances shouldn't be extrapolated both on the growth and margin fronts. This is on account of the inherent nature of the business in which it operates.

Exhibit 47: Quarterly variation in performances both top-line and margins



Source: Company, MNCL Research Estimates

H2FY21 likely to be much better than H1FY21

Latest results (Q2FY21) when compared to same quarter last year and Q1FY21 would suggest subdued performance. However, we continue to remain bullish given management sticking to its FY21 growth guidance. Pertinent to note that, most of the profit share from formulations would hit the P&L only in H2FY21, thus, supporting the overall EBITDA margins. Further, both on the Pharma and Spec Chem side new products are likely to support the top-line in H2FY21.

Key Risks

Compliance risk: Any unexpected issues from USFDA inspections or other international bodies could directly impact the company's sales revenue. Further, any negative compliance track record can have a potential to not only impact the contracts on hand but also on new contract wins.

Contract risk: Inability to secure contract research projects could jeopardise the company's growth. Further, as per our assessment, bulk of the growth would come from generic formulations and not CDMO, which potentially alters the profile of the company.

Growth risk: Maintaining the historical growth momentum could appear a challenge unless SPL is able to generate it from other verticals. We would be keen to see SPL's ability to move from Intermediate based CDMO to API based CDMO. Further, commercial products going off patents post FY24 have a potential to impact overall growth.

People risk: SPL's management has communicated the intentions of initiating leadership level hiring, which on account of Covid related disruptions have now been delayed. Further, delay on account of this may negatively impact the company. Also, SPL focusses on quality research and lack of personal or unexpected attrition can be detrimental.

Brief background

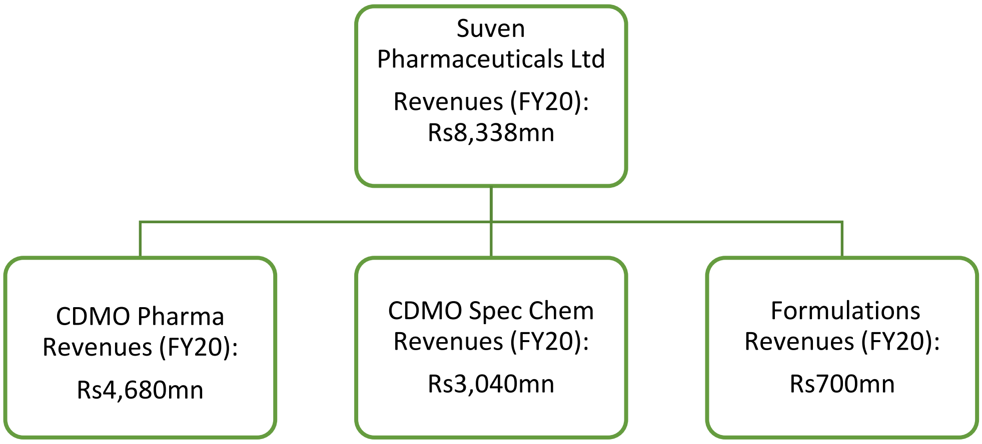
Suven Pharmaceuticals Ltd (SPL) demerged from Suven Life Sciences in 2018. SPL is a biopharmaceutical company specialized in New Chemical Entity (NCE)-based Contract Research and Manufacturing Services (CRAMS) for global life science companies, while Suven Life Sciences retained discovery research and clinical development of new molecules focused on Central Nervous System (CNS) disorders. It is promoted by Mr. Venkateshwarlu Jasti and is based out of Hyderabad, Telangana. SPL is among the top five players in India that supplies high-end intermediaries to innovators. SPL got listed on Bombay Stock Exchange and National Stock Exchange on March 09, 2020.

Suven Pharma Inc. is a wholly owned subsidiary of SPL. It is an SPV created to invest in Rising Pharma Holdings Inc. Suven Pharma Inc. has 25% holding in Rising Pharma Holdings Inc. Rising Pharma Holdings Inc. is a New Jersey, USA based pharmaceutical company focused on developing generic pharmaceuticals products in various therapeutic segments.

Under CRAMS, SPL undertakes innovative process research and development, supplies to clinical trials, rapid response pilot scale manufacture and dedicated commercial manufacturing on an exclusive basis. Under the specialty chemicals segment, SPL supplies a complex specialty intermediary derived from its CRAMS competence, especially to its agrochemical customers.

Under formulations, it has two commercialised ANDAs for which it follows a profit share driven partnership model.

Exhibit 48: Bird's eye view



Source: Company, MNCL Research

Shareholding Analysis

Exhibit 49: Promoter holding

Particulars	Mar-20	Jun-20	Sep-20
Jasti Property & Equity Holdings Private Limited	60.00	60.00	60.00
Total	**60.00**	**60.00**	**60.00**

Source: Company, MNCL Research

Exhibit 50: Non promoter holding >1%

Particulars	Mar-20	Jun-20	Sep-2
L&T Midcap Fund	-	2.47	3.25
Aditya Birla Sun Life Pure Value Fund	1.48	-	-
Taiyo Greater India Fund	1.23	1.30	-
Rambabu Chirumamilla	2.52	2.24	2.31

Source: Company, MNCL Research

Corporate governance

We believe that sound corporate governance is necessary for enhancing the trust of shareholders and other stakeholders. We have undertaken a detailed corporate governance study covering broad aspects such as the composition of the board of directors, independent directors, compensation paid to the promoter directors and independent directors, details of auditors, nature and amount of contingent liabilities, related party transactions and CSR expenditure.

Board of Directors

MNCL Recommendation: There needs to be better representation of non-promoter executive directors' / business heads in the Board of the company. Currently none of the non-promoters directors have any executive role in the business.

Exhibit 51: Board composition

Particulars	FY20
- Total Strength	6
- Promoter group Directors	1
- Non-Promoter Executive Directors	0
- Independent Directors	3
- % share of promoters	**16.67%**
- % share of Non-Promoter Executive Directors	**0.00%**
- % share of independent	**50.00%**

Source: Company, MNCL Research

Promoter compensation

During the period under review, Mr Venkateshwarlu Jasti was paid total remuneration of Rs 60.8mn. As per us, the % of compensation to PBT do not raise any governance issue.

MNCL Recommendations: The Annual report makes mention of Remunerations paid to the directors of the company, however remunerations paid to KMP must also be disclosed along with the earlier disclosures rather than related party transactions.

Exhibit 52: Promoter compensation

Name (Rs mn)	FY20
Chairman	**60.8**
- % share of PBT	1.5%
Other Promoters	**27.1**
- % share of PBT	0.7%
Total	**87.9**
- % share of PBT	**2.2%**

Source: Company, MNCL Research

Contingent liabilities

Overall contingent liabilities are relatively immaterial to the net worth of the company.

Exhibit 53: Contingent liability

Particulars (Rs mn)	FY20
Restoration Fee / Delay condonation fee	60.7
Letter of Credits for imports	32.8
Bank Guarantee	1.6
Total	**95.3**
Net Worth (September – 20)	**10090**
As a % of Networth, adjusted for safe items	**0.9%**

Source: Company, MNCL Research

Related party transactions

SPL's related party transactions mainly involve loans given to Suven Lifesciences. This inter-corporate loan transaction was a part of the discussion before the de-merger took place and hence it doesn't raise any corporate governance issues for us. The details are as follows:

Exhibit 54: Related party transactions

Particulars (Rs mn)	FY19	FY20
Loans given		
Suven Lifescience	474.9	1332.5

Source: Company, MNCL Research

Auditors

SPL has appointed M/s Karvy & Co, Chartered Accountants as a statutory auditors for period of 5 years upto FY24. The details of the auditors remuneration is as follows:

Exhibit 55: Auditors Remuneration (Rs mn)

Particulars	FY20
Audit Fees	1.6
Other Fees	0.6

Source: Company, MNCL Research

CSR activities

SPL has been actively involved in CSR activities by contributing to education, healthcare, and sustainable livelihood. CSR Activity spend details:

Exhibit 56: Auditors Remuneration (Rs mn)

Year	Prescribed Expenditure (Rs mn)	Total Spend (Rs mn)	Total spend as % of prescribed limit
FY20	10.5	10.5	100

Source: Company, MNCL Research

Exhibit 57: Key Management Personnel

Name	Designation	Profile
Mr Venkateswarlu Jasti	Chairman & Managing Director	Mr. Venkateswarlu Jasti, Chairman & Managing Director, is a Post Graduate in Pharmacy from Andhra University, Visakhapatnam, and also a Post Graduate in Pharmacy from St. John University, New York, specializing in Industrial Pharmacy. Having registered himself as a Registered Pharmacist, he successfully owned and operated a chain six of community pharmacies in the state of New York and New Jersey in USA from 1977 till 1989. He was the president elect of Essex County Pharmaceutical Society of New Jersey in 1988. Under his leadership, Suven Life Sciences Limited developed innovative business models like CRAMS (Contract Research and Manufacturing Services) and DDDSS (Drug Discovery & Development Support Services). He is the Chief architect for the formation of A.P. Chief Minister's task force for Pharma during 2001 and responsible for the creation of Pharma City at Vishakhapatnam by Government of Andhra Pradesh and PHARMEXCIL (Pharmaceutical Export Promotion Council), head quartered at Hyderabad. He was Chairman for PHARMEXCIL till 2009.

Source: Company, Bloomberg, MNCL Research

Financials

Exhibit 58: Income Statement

Y/E March (Rs mn)	FY20	FY21E	FY22E	FY23E
Net Sales	**8,338**	**9,220**	**11,151**	**13,518**
% growth		10.6	20.9	21.2
Raw Materials	2,292	2,536	2,955	3,447
% of sales	27.5	27.5	26.5	25.5
Personnel	694	738	870	1,014
% of sales	8.3	8.0	7.8	7.5
Manufact. & Other Exp.	1,503	1,706	2,007	2,406
% of sales	18.0	18.5	18.0	17.8
EBITDA	**3,849**	**4,241**	**5,319**	**6,651**
EBITDA Margin (%)	46.2	46.0	47.7	49.2
Depreciation	237	286	356	444
EBIT	**3,613**	**3,956**	**4,963**	**6,207**
Interest Expenses	231	128	71	7
PBT From Operations	**3,382**	**3,827**	**4,892**	**6,200**
Other Income	181	280	224	179
PBT	**3,563**	**4,107**	**5,116**	**6,379**
Share of Profit from Associate / JV	482	482	554	638
PBT after Exceptional	4,045.2	4,589.4	5,670.4	7,016.6
Tax-Total	875	904	1,151	1,435
Effective Tax Rate (%)	21.6	19.7	20.3	20.5
Reported PAT	**3,170**	**3,686**	**4,519**	**5,581**
Extraord. items -Adj.	-	-	-	-
Adjusted PAT	**3,170**	**3,686**	**4,519**	**5,581**
PAT Margin	38.0	40.0	40.5	41.3
% Growth		16.3	22.6	23.5

Exhibit 59: Balance Sheet

Y/E March (Rs mn)	FY20	FY21E	FY22E	FY23E
SOURCES OF FUNDS				
Capital	127	127	127	127
Reserves & Surplus	8,320	11,211	14,736	19,074
Shareholders' Funds	**8,448**	**11,338**	**14,863**	**19,201**
Minority Interest				
Total Loan Funds	**1,853**	**1,283**	**713**	**70**
Deferred Tax Liabilities-Net	276	276	276	276
Total Liabilities	**10,665**	**12,980**	**15,935**	**19,631**
APPLICATION OF FUNDS				
Gross Block	4,520	5,870	7,070	9,070
Accumulated Dep.	989	1,275	1,631	2,075
Capital WIP	1,017	1,167	2,267	2,467
Net Fixed Assets	**4,584**	**5,802**	**7,751**	**9,511**
Investments	3,122	3,122	3,122	3,122
Other non-current assets	105	105	105	105
Goodwill				
Inventories	1,749	1,900	2,225	2,618
Sundry Debtors	1,172	1,409	1,704	2,065
Other Current Assets	853	853	703	553
Cash & Cash Equivalent	141	1,022	1,741	3,292
Loans and Advances	2	2	2	2
Total Current Assets	**3,916**	**5,186**	**6,374**	**8,530**
Trade Payables	**711**	**807**	**943**	**1,112**
Other Current Liabilities	328	404	449	500
Provisions	25	25	25	25
Total Current Liab. & Prov.	**1,063**	**1,236**	**1,417**	**1,637**
Net Current Assets	**2,853**	**3,950**	**4,957**	**6,892**
Total Assets	**10,665**	**12,980**	**15,935**	**19,631**

Exhibit 60: Key Ratios

Y/E March	FY20	FY21E	FY22E	FY23E
Growth ratios (%)				
Net sales	-	10.6	20.9	21.2
EBITDA	124.4	10.2	25.4	25.0
Adjusted Net Profit	190.1	16.3	22.6	23.5
Margin Ratio (%)				
EBITDA Margin	46.2	46.0	47.7	49.2
EBIT Margin	43.3	42.9	44.5	45.9
PBT Margins	48.5	49.8	50.9	51.9
PAT Margin	38.0	40.0	40.5	41.3
Return Ratio (%)				
ROE	44.2	37.3	34.5	32.8
ROCE	42.8	35.8	35.9	35.9
ROIC	38.8	36.4	36.1	37.7
Turnover Ratio days (days)				
Net Fixed Asset Turnover Ratio	2.0	1.8	1.6	1.6
Inventory Period	142	140	140	140
Debtors Period	51	55	55	55
Creditors Period	68	70	70	70
Cash Conversion Cycle	124	125	125	125
Solvency Ratio (%)				
Debt-equity (x)	0.2	0.1	0.0	0.0
Net Debt-equity (x)	0.2	0.0	(0.1)	(0.2)
Current ratio (x)	0.2	0.3	0.3	0.3
Interest coverage ratio	16.7	33.1	74.6	945.0
Gross Debt/EBITDA	0.5	0.3	0.1	0.0
O/s Shares	255	255	255	255
Fully Diluted Shares	255	255	255	255
Dividend	636	796	994	1,243
Dividend per share	2.5	3.1	3.9	4.9
Dividend Payout (%)	20.1	21.6	22.0	22.3
Dividend Yield (%)				
Per share (Rs)				
Basic EPS (reported)	12.5	14.5	17.8	21.9
CEPS	13.4	15.6	19.2	23.7
Book value	33.2	44.5	58.4	75.4
Valuation				
P/E	26.7	23.0	18.8	15.2
P/BV	10.0	7.5	5.7	4.4
EV/EBITDA	22.5	20.0	15.7	12.3
EV/Sales	10.4	9.2	7.5	6.0

Exhibit 61: Cash Flows

Y/E March (Rs mn)	FY20	FY21E	FY22E	FY23E
Pre-tax profit	4,045.2	4,589.4	5,670.4	7,016.6
Net chg in working capital	220.1	(237.0)	(311.5)	(410.5)
Cash flow from operating activities (a)	3,839.6	3,622.6	4,460.5	5,497.2
Capital expenditure	(1,001.7)	(1,503.7)	(2,304.0)	(2,204.5)
Adjusted FCF	2,837.9	2,119.0	2,156.5	3,292.8
Cash flow from investing activities (b)	(4,009.4)	(1,247.5)	(2,106.2)	(2,053.9)
Debt raised/(repaid)	1,025.0	(570.0)	(570.0)	(642.5)
Dividend (incl. tax)	(636.4)	(795.5)	(994.4)	(1,243.0)
Cash flow from financing activities (c)	181.6	(1,493.8)	(1,635.7)	(1,892.5)
Net chg in cash (a+b+c)	11.8	881.4	718.7	1,550.8

Source: Company, MNCL Research Estimates

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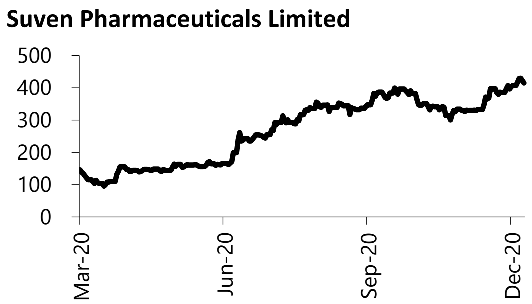

Source: Bloomberg, ACE Equity, MNCL Research

Analyst holding in stock: **NO**

Key to MNCL Investment Rankings

Buy: Upside by >15%, Accumulate: Upside by 5% to 15%, Hold: Downside/Upside by -5% to +5%, Reduce: Downside by 5% to 15%, Sell: Downside by >15%

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