



## INDIA

STR IN Outperform

Price (at 12:20, 23 May 2014 GMT) Rs536.55

Valuation Rs 800.00

- Sum of Parts

12-month target Rs 800.00

Upside/Downside % +49.1

12-month TSR % +49.6

Volatility Index Medium

## GICS sector

Pharmaceuticals, Biotechnology &amp; Life Sciences

Market cap Rsm 31,960

Market cap US\$m 546

Free float % 64

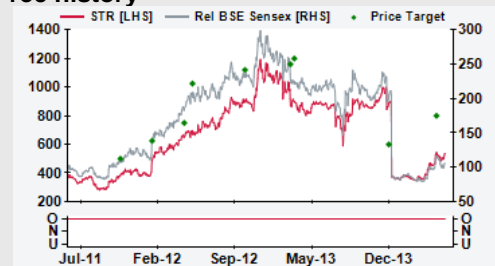
30-day avg turnover US\$m 6.9

Number shares on issue m 59.57

## Investment fundamentals

Year end 31 Mar		2013A	2014E	2015E	2016E
Revenue	m	23,073	13,750	13,258	16,276
EBITDA	m	5,353	2,839	2,983	3,744
EBITDA growth	%	3.4	-47.0	5.1	25.5
Adjusted profit	m	1,875	1,229	2,097	2,697
EPS adj	Rs	31.29	20.50	35.00	45.01
EPS adj growth	%	2.1	-34.5	70.7	28.6
PER adj	x	17.1	26.2	15.3	11.9
Total DPS	Rs	2.00	505.00	5.00	5.00
Total div yield	%	0.4	94.1	0.9	0.9
ROA	%	8.3	6.6	11.9	13.7
ROE	%	11.0	8.1	19.1	20.6
EV/EBITDA	x	6.3	12.2	11.6	9.3
Net debt/equity	%	68.1	-10.6	-14.1	-18.2
P/BV	x	1.5	3.2	2.7	2.2

## STR IN rel BSE Sensex performance, &amp; rec history



Note: Recommendation timeline - if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.

Source: FactSet, Macquarie Research, May 2014

(all figures in INR unless noted)

## Analyst(s)

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23 May 2014

Macquarie Capital Securities India (Pvt) Ltd

## Strides Arcolab

## Guidance beat - multiple triggers ahead

## Event

- STR reported Mar-14 results, with consolidated pharma revenues of Rs3.4bn (up 44% YoY, 4.3% QoQ) and EBITDA of Rs640m, ahead of company guidance of Rs2.8b sales & Rs580m EBITDA. Strides expects niche product approvals in US near-term, which could drive significant upside in the US market. STR remains our top small-cap pick with TP of Rs800.
- STR reiterated that they intend to pay out the remaining US\$290m (from Agila deal) in the form of a dividend upon release of contingent hold-backs (US\$250m) and regulatory escrow (US\$40m) by end 1HFY15.

## Impact

- Generic business (regulated markets) – US at inflection point:** Generic business (regulated markets) accounted for ~27% of sales for the quarter. Approval of the Bangalore facility by US FDA last month is a positive step forward, as it paves the way for eventual approval of some of the key products in the US (like Combivir, methoxasamine, Calcitriol & Prograf), which are awaited by this facility (likely 1HFY15). STR has ~17 ANDAs pending approval with the US FDA, plans to file another 20 ANDAs with US FDA in FY15 and expects 5-7 approvals this year. Soft gelatine (Rx) market is worth ~US\$4b and STR expects to be a major player in the space globally.
- Institutional business – Anti-malaria business a key growth driver:** This segment accounted for ~53% of revenue in Mar-14; however, the contribution from the anti-malaria portfolio still remains low (Macq estimate Rs150m for the quarter). Strides highlighted that the anti-malarial business is undergoing a change in procurement mechanism with tenders getting centralized and this could have a significant impact on the future of this business. Strides launched the anti-malarial product Artemether + Lumefantrine (AL) in Dec-14 and we expect this to be a key growth contributor in FY15 (we estimate sales of Rs1b).
- Branded generic business:** Almost one-fourth of the revenue for the quarter comes from branded generic business in Africa & India, which continues to grow strongly driven by strong expansion in the African business (5 new countries and over 100 new field staff added last year).
- Con call takeaways:** (a) Biotech plant in Johor, Malaysia will be ready for commissioning by Jun-16; (b) Expect resolution of Agila FDA issues by Sept; (c) FY15E: Capex and R&D expense of ~ Rs500m each, Tax rate ~15-20%.

## Earnings and target price revision

- Updated for FY14 P&L actuals; fine-tune 15E and 16E EPS by <1%.

## Price catalyst

- 12-month price target: Rs800.00 based on a Sum of Parts methodology.
- Catalyst: 1) Niche US FDA approvals 2) contingent & escrow cash release

## Action and recommendation

- In arriving at our target price we have been conservative and valued the remaining contingent and escrow cash at a 50% discount. Assuming no discount to cash could mean potential ~90-100% upside to current price. We continue to highlight current levels as an attractive opportunity to add.

**Fig 1 Strides – beats guidance comfortably during Mar-14 quarter**

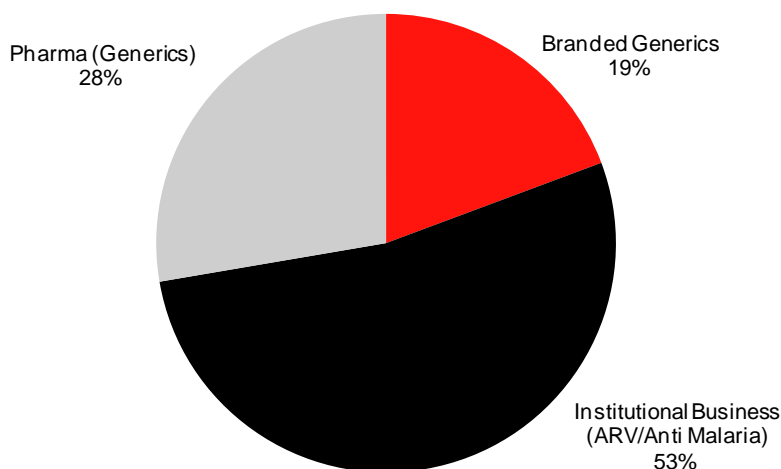
Rs m	Mar-14	Mar-13	YoY(%)	Dec-13	QoQ(%)	Comments
Pharma sales	3400	2360	44.1%	3260	4.3%	Vs guidance of ~Rs3bn
Pharma EBITDA	640	600	6.7%	600	6.7%	Beats guidance of Rs580m of EBITDA

Source: Company data, Macquarie Research, May 2014

**Fig 2 Strides – SOTP of Rs800/share**

<b>Realized EV for Agila</b>		<b>US\$m</b>	<b>1,750</b>
Contingent Payment	Due in 2014		(250)
Money Realized upfront from Mylan		US\$m	1,500
Net Debt (US\$m)			(295)
Other transaction closure cost (US\$m)	Minority Interest \$58m , US\$ 38m distributed to employees, US\$ 30m capex		(125)
Remediation cost + Pfizer portfolio cost			(150)
Tax on Transaction (US\$m)			(180)
Growth capital held for Agila biotech (US\$ m)			(75)
Escrow Cash	To be released later....(50m restricted for 1 yr and 100m restricted for 4 yrs)		(150)
<b>Money distributed immediately post closing (US\$ m)</b>	<b>Post retiring debt, meeting all obligation and paying gain tax</b>	<b>US\$m</b>	<b>525</b>
Tax for this distribution if any			(45)
<b>Cash already distributed as Dividend [Dec-13]</b>	<b>INR per share</b>		<b>500</b>
Pharma business 1 yr fwd EPS (Sep-15E)	1yr Forward EPS		40
Target PER multiple			15.0 x
<b>Remaining Operating business value</b>	<b>INR per share</b>		<b>600</b>
Contingent Payment post warning letter closure	Mylan contingent Payment	US\$m	250
Restricted cash	Restricted Cash....(50m restricted for 1 yr and 100m restricted for 4 yrs)	US\$m	150
<b>Total Net Cash</b>		<b>US\$m</b>	<b>400</b>
	Value of net cash (INR /Share) @50% discount		200
<b>Target Price</b>	<b>INR per share</b>		<b>800</b>

Source: Macquarie Research, May 2014

**Fig 3 Strides – sales breakup (Mar-14 quarter)**

Source: Company data, Macquarie Research, May 2014

**Strides Arcolab (STR IN, Outperform, Target Price: Rs800.00)**

Quarterly Results					Profit & Loss						
		3Q/14A	4Q/14E	1Q/15E	2Q/15E		2013A	2014E	2015E	2016E	
<b>Revenue</b>	m	<b>3,438</b>	<b>3,438</b>	<b>3,315</b>	<b>3,315</b>	<b>Revenue</b>	m	<b>23,073</b>	<b>13,750</b>	<b>13,258</b>	<b>16,276</b>
<b>Gross Profit</b>	m	<b>1,651</b>	<b>1,651</b>	<b>1,657</b>	<b>1,657</b>	<b>Gross Profit</b>	m	<b>13,093</b>	<b>6,603</b>	<b>6,629</b>	<b>8,301</b>
Cost of Goods Sold	m	1,787	1,787	1,657	1,657	Cost of Goods Sold	m	9,980	7,147	6,629	7,975
<b>EBITDA</b>	m	<b>710</b>	<b>710</b>	<b>746</b>	<b>746</b>	<b>EBITDA</b>	m	<b>5,353</b>	<b>2,839</b>	<b>2,983</b>	<b>3,744</b>
Depreciation	m	141	141	113	113	Depreciation	m	1,095	565	450	470
Amortisation of Goodwill	m	0	0	0	0	Amortisation of Goodwill	m	0	0	0	0
Other Amortisation	m	0	0	0	0	Other Amortisation	m	0	0	0	0
<b>EBIT</b>	m	<b>569</b>	<b>569</b>	<b>633</b>	<b>633</b>	<b>EBIT</b>	m	<b>4,258</b>	<b>2,274</b>	<b>2,533</b>	<b>3,274</b>
Net Interest Income	m	-272	-272	0	0	Net Interest Income	m	-1,934	-1,089	0	0
Associates	m	0	0	0	0	Associates	m	0	0	0	0
Exceptionals	m	-66	-66	0	0	Exceptionals	m	6,587	-266	0	0
Forex Gains / Losses	m	0	0	0	0	Forex Gains / Losses	m	0	0	0	0
Other Pre-Tax Income	m	65	65	0	0	Other Pre-Tax Income	m	583	260	0	0
<b>Pre-Tax Profit</b>	m	<b>295</b>	<b>295</b>	<b>633</b>	<b>633</b>	<b>Pre-Tax Profit</b>	m	<b>9,495</b>	<b>1,180</b>	<b>2,533</b>	<b>3,274</b>
Tax Expense	m	-54	-54	-109	-109	Tax Expense	m	-1,021	-217	-436	-576
<b>Net Profit</b>	m	<b>241</b>	<b>241</b>	<b>524</b>	<b>524</b>	<b>Net Profit</b>	m	<b>8,473</b>	<b>963</b>	<b>2,097</b>	<b>2,697</b>
Minority Interests	m	0	0	0	0	Minority Interests	m	-11	0	0	0
<b>Reported Earnings</b>	m	<b>-584</b>	<b>-584</b>	<b>524</b>	<b>524</b>	<b>Reported Earnings</b>	m	<b>8,462</b>	<b>-2,335</b>	<b>2,097</b>	<b>2,697</b>
<b>Adjusted Earnings</b>	m	<b>307</b>	<b>307</b>	<b>524</b>	<b>524</b>	<b>Adjusted Earnings</b>	m	<b>1,875</b>	<b>1,229</b>	<b>2,097</b>	<b>2,697</b>
EPS (rep)		-9.74	-9.74	8.75	8.75	EPS (rep)		141.22	-38.97	35.00	45.01
EPS (adj)		5.13	5.13	8.75	8.75	EPS (adj)		31.29	20.50	35.00	45.01
EPS Growth yoy (adj)	%	-34.5	-34.5	70.7	70.7	EPS Growth (adj)	%	2.1	-34.5	70.7	28.6
						PE (rep)	x	6.2	nmf	15.3	11.9
						PE (adj)	x	27.9	18.9	15.3	11.9
EBITDA Margin	%	20.6	20.6	22.5	22.5	Total DPS		2.00	505.00	5.00	5.00
EBIT Margin	%	16.5	16.5	19.1	19.1	Total Div Yield	%	0.2	130.4	0.9	0.9
Earnings Split	%	25.0	25.0	25.0	25.0	Weighted Average Shares	m	60	60	60	60
Revenue Growth	%	-40.4	-40.4	-3.6	-3.6	Period End Shares	m	58	60	60	60
EBIT Growth	%	-46.6	-46.6	11.4	11.4						
<b>Profit and Loss Ratios</b>		<b>2013A</b>	<b>2014E</b>	<b>2015E</b>	<b>2016E</b>	<b>Cashflow Analysis</b>		<b>2013A</b>	<b>2014E</b>	<b>2015E</b>	<b>2016E</b>
Revenue Growth	%	-10.5	-40.4	-3.6	22.8	<b>EBITDA</b>	m	<b>5,353</b>	<b>2,839</b>	<b>2,983</b>	<b>3,744</b>
EBITDA Growth	%	3.4	-47.0	5.1	25.5	Tax Paid	m	-887	-3,245	-436	-576
EBIT Growth	%	3.0	-46.6	11.4	29.2	Chgs in Working Cap	m	-3,105	805	-555	-604
Gross Profit Margin	%	56.7	48.0	50.0	51.0	Net Interest Paid	m	-1,976	-1,089	0	0
EBITDA Margin	%	23.2	20.6	22.5	23.0	Other	m	1,958	0	0	0
EBIT Margin	%	18.5	16.5	19.1	20.1	<b>Operating Cashflow</b>	m	<b>1,344</b>	<b>-690</b>	<b>1,992</b>	<b>2,564</b>
Net Profit Margin	%	8.1	8.9	15.8	16.6	Acquisitions	m	11,241	48,050	0	0
Payout Ratio	%	6.4	2,463.0	14.3	11.1	Capex	m	-3,377	-688	-1,061	-1,302
EV/EBITDA	x	10.0	9.1	11.6	9.3	Asset Sales	m	0	0	0	0
EV/EBIT	x	12.5	11.3	13.7	10.6	Other	m	201	260	0	0
<b>Balance Sheet Ratios</b>						<b>Investing Cashflow</b>	m	<b>8,065</b>	<b>47,623</b>	<b>-1,061</b>	<b>-1,302</b>
ROE	%	11.0	8.1	19.1	20.6	Dividend (Ordinary)	m	-136	-32,550	-298	-298
ROA	%	8.3	6.6	11.9	13.7	Equity Raised	m	89	0	0	0
ROIC	%	10.2	5.3	21.7	24.9	Debt Movements	m	-8,578	0	0	0
Net Debt/Equity	%	68.1	-10.6	-14.1	-18.2	Other	m	-1,275	0	0	0
Interest Cover	x	2.2	2.1	nmf	nmf	<b>Financing Cashflow</b>	m	<b>-9,900</b>	<b>-32,550</b>	<b>-298</b>	<b>-298</b>
Price/Book	x	2.5	2.3	2.7	2.2	<b>Net Chg in Cash/Debt</b>	m	<b>-491</b>	<b>14,383</b>	<b>634</b>	<b>964</b>
Book Value per Share		349.2	169.0	199.2	239.5	<b>Free Cashflow</b>	m	<b>-2,033</b>	<b>-1,377</b>	<b>932</b>	<b>1,262</b>
						<b>Balance Sheet</b>		<b>2013A</b>	<b>2014E</b>	<b>2015E</b>	<b>2016E</b>
						Cash	m	1,657	6,324	1,776	2,740
						Receivables	m	4,832	3,648	4,415	5,421
						Inventories	m	4,423	1,760	4,042	4,962
						Investments	m	0	418	418	418
						Fixed Assets	m	13,182	3,009	3,620	4,452
						Intangibles	m	19,400	3,531	3,531	3,531
						Other Assets	m	4,607	2,281	3,964	4,658
						<b>Total Assets</b>	m	<b>48,102</b>	<b>20,970</b>	<b>21,766</b>	<b>26,181</b>
						Payables	m	4,631	2,679	4,231	5,195
						Short Term Debt	m	8,633	4,746	0	0
						Long Term Debt	m	7,311	436	0	0
						Provisions	m	0	0	0	0
						Other Liabilities	m	6,545	2,285	4,910	5,963
						<b>Total Liabilities</b>	m	<b>27,121</b>	<b>10,145</b>	<b>9,141</b>	<b>11,157</b>
						Shareholders' Funds	m	20,262	10,068	11,868	14,267
						Minority Interests	m	719	757	757	757
						Other	m	0	0	0	0
						<b>Total S/H Equity</b>	m	<b>20,981</b>	<b>10,825</b>	<b>12,625</b>	<b>15,024</b>
						<b>Total Liab &amp; S/H Funds</b>	m	<b>48,102</b>	<b>20,970</b>	<b>21,766</b>	<b>26,181</b>

All figures in INR unless noted.

Source: Company data, Macquarie Research, May 2014

## Important disclosures:

## Recommendation definitions

## Macquarie - Australia/New Zealand

Outperform – return >3% in excess of benchmark return  
Neutral – return within 3% of benchmark return  
Underperform – return >3% below benchmark return

Benchmark return is determined by long term nominal GDP growth plus 12 month forward market dividend yield

## Macquarie – Asia/Europe

Outperform – expected return >+10%  
Neutral – expected return from -10% to +10%  
Underperform – expected return <-10%

## Macquarie First South - South Africa

Outperform – expected return >+10%  
Neutral – expected return from -10% to +10%  
Underperform – expected return <-10%

## Macquarie - Canada

Outperform – return >5% in excess of benchmark return  
Neutral – return within 5% of benchmark return  
Underperform – return >5% below benchmark return

## Macquarie - USA

Outperform (Buy) – return >5% in excess of Russell 3000 index return  
Neutral (Hold) – return within 5% of Russell 3000 index return  
Underperform (Sell) – return >5% below Russell 3000 index return

## Volatility index definition\*

This is calculated from the volatility of historical price movements.

**Very high-highest risk** – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

**High** – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

**Medium** – stock should be expected to move up or down at least 30–40% in a year.

**Low-medium** – stock should be expected to move up or down at least 25–30% in a year.

**Low** – stock should be expected to move up or down at least 15–25% in a year.

\* Applicable to Asia/Australian/NZ/Canada stocks only

**Recommendations** – 12 months

**Note:** Quant recommendations may differ from Fundamental Analyst recommendations

## Financial definitions

All "Adjusted" data items have had the following adjustments made:

Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense  
Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

**EPS** = adjusted net profit / epowa\*

**ROA** = adjusted ebit / average total assets

**ROA Banks/Insurance** = adjusted net profit / average total assets

**ROE** = adjusted net profit / average shareholders funds

**Gross cashflow** = adjusted net profit + depreciation

\*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

## Recommendation proportions – For quarter ending 31 March 2014

	AU/NZ	Asia	RSA	USA	CA	EUR	
Outperform	51.32%	60.23%	41.25%	40.21%	58.52%	48.74%	(for US coverage by MCUSA, 8.21% of stocks followed are investment banking clients)
Neutral	34.54%	24.97%	40.00%	53.19%	35.56%	32.77%	(for US coverage by MCUSA, 6.67% of stocks followed are investment banking clients)
Underperform	14.14%	14.80%	18.75%	6.60%	5.92%	18.49%	(for US coverage by MCUSA, 0.00% of stocks followed are investment banking clients)

## STR IN vs BSE Sensex, &amp; rec history



(all figures in INR currency unless noted)

Note: Recommendation timeline – if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.

Source: FactSet, Macquarie Research, May 2014

## 12-month target price methodology

STR IN: Rs800.00 based on a Sum of Parts methodology

## Company-specific disclosures:

**STR IN:** Macquarie Group Limited together with its affiliates beneficially owns 1% or more of the equity securities of Strides Arcolab Ltd. Important disclosure information regarding the subject companies covered in this report is available at [www.macquarie.com/disclosures](http://www.macquarie.com/disclosures).

Date	Stock Code (BVG code)	Recommendation	Target Price
28-Apr-2014	STR IN	Outperform	Rs800.00
11-Dec-2013	STR IN	Outperform	Rs600.00
12-Mar-2013	STR IN	Outperform	Rs1200.00
01-Mar-2013	STR IN	Outperform	Rs1160.00
20-Oct-2012	STR IN	Outperform	Rs1120.00
21-May-2012	STR IN	Outperform	Rs1025.00
27-Apr-2012	STR IN	Outperform	Rs750.00
25-Jan-2012	STR IN	Outperform	Rs625.00
25-Oct-2011	STR IN	Outperform	Rs500.00

## Target price risk disclosures:

**STR IN:** Any inability to compete successfully in their markets may harm the business. This could be a result of many factors which may include geographic mix and introduction of improved products or service offerings by competitors. The results of operations may be materially affected by global economic conditions generally, including conditions in financial markets. The company is exposed to market risks, such as changes in interest rates, foreign exchange rates and input prices. From time to time, the company will enter into transactions, including transactions in derivative instruments, to manage certain of these exposures.

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