CREDIT SUISSE

Strides Shasun Limited

(STAR.BO / STR IN)

INITIATION

Building blocks in place; returns to improve

- **Initiate coverage with OUTPERFORM and Rs1,720 TP (25% potential upside).** After exiting its injectable business, Strides has rebuilt itself into a geographically diversified generic company with presence across the US (15% of revenues), Africa (24%), and Australia (18%).
- **Acquisitive, but low-risk approach.** The transition phase and geographical expansion are largely over through inexpensive, low-risk acquisitions over the past two years. Focus now is on increasing scale and profitability in existing markets, and we do not expect a large acquisition, but bolt-ons to fill the gaps.
- **Strong Africa franchise; US the key growth driver.** The US and Africa are the key growth drivers—we expect a 30%-plus CAGR over the next three years. In the US, Strides transitioned from a partnership model to having its own front-end, has a few niche products, and strengthened its pipeline through the Shasun acquisition. The company has organically built an enviable Africa business over the past decade and could command a premium valuation.
- **Catalysts: Lovaza approval and margin improvement.** Lovaza approval is expected in FY17, and a potential market share ramp-up in existing products should drive its US business. Margin improvement could be visible over the next few quarters, driven by revenue mix and backward-integration benefits.
- **Balance sheet to strengthen; returns to expand.** Strides offers a strong organic EPS CAGR of 35%-plus, but trades at a 10% discount to peers owing to lower RoCEs (due to acquisitions). Reduction in leverage (net/debt to EBITDA of 2x by FY18) and RoCE expansion due to improving asset utilisations (8% to 15% by FY18) are likely to further rerate the stock. Our TP is based on 20x LTM Sep-17E EPS (in line with peers). Its proposed fund-raising should fast-track the leverage reduction. **Key risks:** (1) PBS impact; and (2) integration issues.

Rating	OUTPERFORM*
Price (09 Dec 15, Rs)	1,381.60
Target price (Rs)	1,720.00[1]
Upside/downside (%)	24.5
Mkt cap (Rs mn)	111,416 (US$ 1,670)
Enterprise value (Rs mn)	137,945
Number of shares (mn)	80.64
Free float (%)	65.6
52-week price range	1,381.6 - 826.1
ADTO - 6M (US$ mn)	9.4

**Stock ratings are relative to the coverage universe in each analyst's or each team's respective sector.*
[1]Target price is for 12 months.

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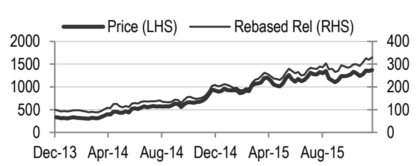
Share price performance



The price relative chart measures performance against the S&P BSE SENSEX IDX which closed at 25036.05 on 09/12/15
On 09/12/15 the spot exchange rate was Rs66.72/US$1

Performance over	1M	3M	12M	
Absolute (%)	10.3	26.1	54.5	—
Relative (%)	14.5	28.4	64.4	—

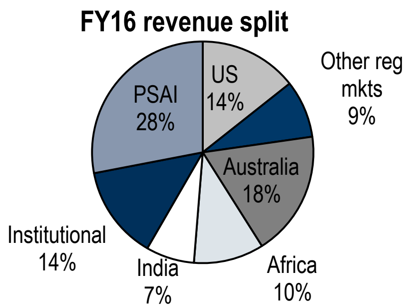
Financial and valuation metrics

Year	3/15A	3/16E	3/17E	3/18E
Revenue (Rs mn)	11,958.5	32,541.7	44,982.9	52,702.7
EBITDA (Rs mn)	2,288.5	5,801.4	9,177.3	11,181.6
EBIT (Rs mn)	1,648.2	4,402.3	7,660.9	9,565.3
Net profit (Rs mn)	1,033.1	3,430.9	5,882.1	7,518.5
EPS (CS adj.) (Rs)	17.34	42.55	72.89	93.17
Change from previous EPS (%)	n.a.			
Consensus EPS (Rs)	n.a.	43.8	72.5	87.4
EPS growth (%)	33.5	145.3	71.3	27.8
P/E (x)	79.7	32.5	19.0	14.8
Dividend yield (%)	0	0.7	1.2	1.6
EV/EBITDA (x)	49.5	23.8	14.9	11.9
P/B (x)	7.2	4.2	3.6	3.0
ROE (%)	9.6	18.0	20.3	22.0
Net debt/equity (%)	15.8	98.5	80.7	57.9

Source: Company data, Thomson Reuters, Credit Suisse estimates

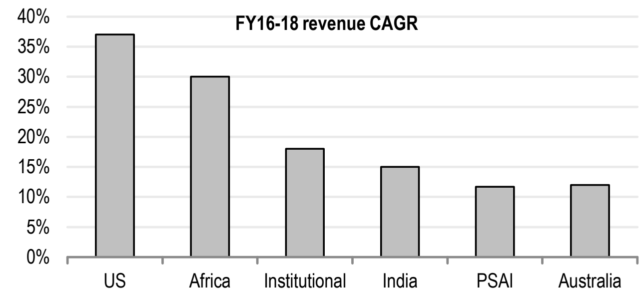
Focus charts

Figure 1: Strides is now diversified with global front-end presence post Shasun and Arrow acquisitions



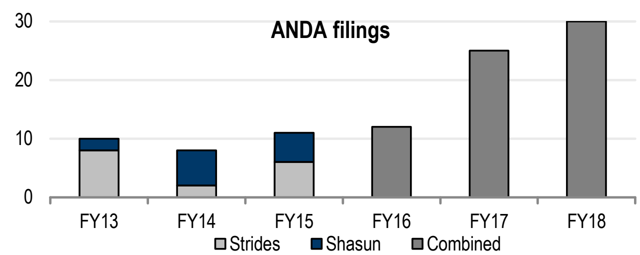
Source: Company data, Credit Suisse estimates

Figure 2: US and Africa are the key growth drivers



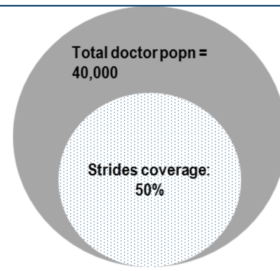
Note: Normalised revenue CAGR. Source: Company data, Credit Suisse estimates

Figure 3: US filings and R&D expected to increase



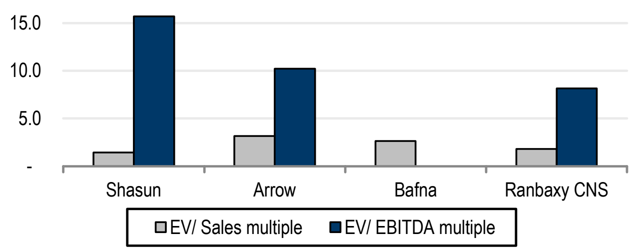
Source: Company data, Credit Suisse estimates

Figure 4: Africa growth to be driven by enhancing doctor coverage as MR count increases from 225 to 600



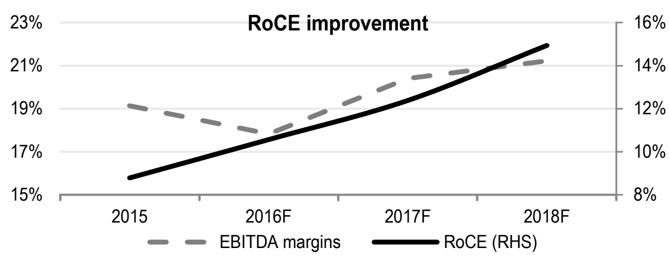
Source: Company data, Credit Suisse estimates

Figure 5: Acquisitions over the past two years have been low risk, inexpensive, and in known areas



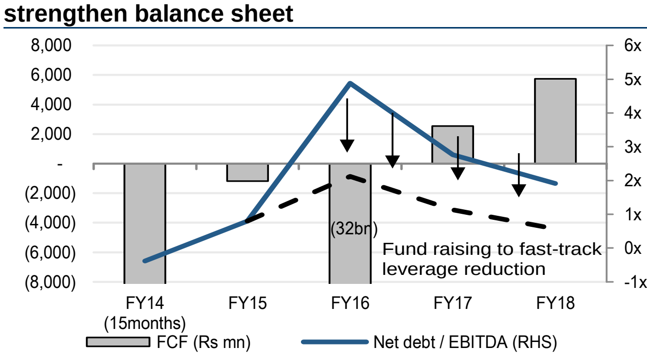
Source: Company data, Credit Suisse estimates

Figure 6: Margin expansion and lower capex to lead to ROCE expansion



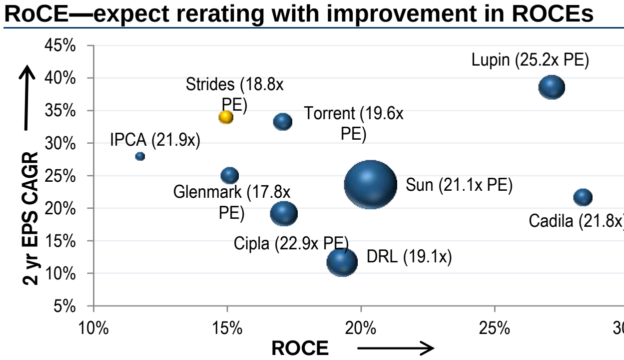
Source: Company data, Credit Suisse estimates

Figure 7: FCF generation and fund-raising to help strengthen balance sheet



Source: Company data, Credit Suisse estimates

Figure 8: Strides trades at a discount due to lower RoCE—expect rerating with improvement in ROCEs



Note: Size of the bubble represent the revenues; P/E ratio is on FY17 earnings. Source: Company data, Credit Suisse estimates

Building blocks in place; returns to improve

Acquisitive, but low-risk approach provides comfort

Post divestments, Strides has rebuilt its business through acquisitions. The company has transformed itself from being an Africa-dominated player to a global diversified one. Strides' management has exhibited strong track record of M&As in the past as well. The current round of acquisitions provides comfort as they have been low-risk, cheap (with the exception of Shasun), and in known areas/territories where Strides has proven expertise.

The current round of acquisitions provides comfort as they have been low-risk, cheap and in known areas/territories

We do not expect any large acquisition in the near term, as (1) its balance sheet is stretched with net debt/EBITDA at ~5x, (2) management's focus will likely be on integration, (3) promoter's (Mr Arun Kumar) holding is now at <24%, and (4) its proposed fund-raising (~US$225 mn) should help reduce leverage, but would provide room for a big acquisition. Geographical expansion is largely done and further acquisitions are likely to towards building scale in existing geographies.

US and Africa: The growth engines

The US and Africa are the key growth drivers for Strides—we expect them to post a 30%-plus CAGR. Post Agila's exit, Strides became a small player in the US with FY15 top line of just US$19 mn. However, the company has set up its own front-end, a new R&D centre, and acquired a sizeable complementary pipeline from Shasun. R&D and filings are slated to pick up materially from 2H FY16, but R&D still remains lower than peers. Given the slim product basket, Strides has to go through the tough phase of building a product portfolio, but it has shown capability to garner high market share on low-competition products.

US and Africa are the key growth drivers for Strides

Africa is a difficult market to operate in, given (1) the diversity and fragmented markets there, with individual markets being small, and (2) each country has its own regulator and approval process. Strides has done the initial hard work of setting up operations successfully, and is ready to reap the rewards of its investments, in our view. The company targets to reach US$200 mn in revenue by 2020 (from US$50 mn in FY15), and has identified the branded business growth from increasing MR strength and product launches, and the generic business growth from its local manufacturing "in-Africa, for-Africa" strategy.

Execution is key for acquisitions to deliver

Acquisitions form over 50% of FY17E revenue, and execution should be key for Strides, as (1) the Australian business faces regulatory and margin headwinds, (2) the Shasun acquisition requires integration of R&D, increase in filing rate, and backward integration, (3) the India business is sub-scale and needs growth revival, and (4) Sovaldi opportunity is lower than peers in India, because Strides lacks focus in the GI segment.

We derive comfort from the fact that Strides has roped in former CEO of Ascent, Mr Dennis Bastas, to run the Australian business and will transfer production to India to counter the PBS impact. On Sovaldi, Strides has already started selling in a couple of EMs and begun the approval process for other key markets. A strong Africa presence should help Strides, once donor funding is assigned.

Initiate with OUTPERFORM, and TP Rs1,720

Strides has built a strong business model, which provides it medium-term growth visibility with 15-16% revenue and 18-20% EBITDA growth. With potential free cash flow generation (~US$125 mn over the next two years), we expect Strides to strengthen balance sheet and reduce net debt/EBITDA to <2x. Its proposed fund-raising should fast-track the reduction.

Strides' strong business model provides it medium-term growth visibility with 15-16% revenue and 18-20% EBITDA growth

While acquisitions have been accretive to earnings and have enhanced growth profile, they have been a drag on the returns. With improvement in EBITDA margins, and improving asset utilisations, we expect RoCEs to improve to 15% (from 8%) by FY18. The market has rewarded its acquisition-led growth and the company has re-rated over the past year, but its stock trades at a discount to other small/mid-cap peers, despite similar/better growth profile, due to the lower returns. Our target price of Rs1,720 is based on 20x Sep-17E EPS(in line with peers), as we believe the stock should rerate further with improving returns.

Strides Shasun Limited STAR.BO / STR IN

Price (09 Dec 15): **Rs1,381.60**, Rating**: OUTPERFORM**, Target Price: **Rs1,720.00**, Analyst: **Chunky Shah**

Target price scenario			
Scenario	**TP**	**%Up/Dwn**	**Assumptions**
Upside	1,850	33.86	Valued at 22x Sep-17 earnings, assumed EBITDA margins to improve to 22.5% by FY18.
Central case	1,720	24.49	Valued at 20x Sep-17 earnings, assumed EBITDA margins to improve to 21.4% by FY18.
Downside	1,250	-9.55	Valued at 18x Sep-17 earnings, assumed EBITDA margins to stay flat.

Income statement (Rs mn)	3/15A	3/16E	3/17E	3/18E
Sales revenue	**11,958**	**32,542**	**44,983**	**52,703**
Cost of goods sold	5,605	15,612	21,508	25,199
SG&A	—	—	—	—
Other operating exp./(inc.)	4,065	11,129	14,298	16,322
EBITDA	**2,289**	**5,801**	**9,177**	**11,182**
Depreciation & amortisation	640	1,399	1,516	1,616
EBIT	**1,648**	**4,402**	**7,661**	**9,565**
Net interest expense/(inc.)	395	1,523	1,852	1,852
Non-operating inc./(exp.)	306	1,380	1,394	1,501
Associates/JV	—	—	—	—
Recurring PBT	**1,560**	**4,260**	**7,203**	**9,214**
Exceptionals/extraordinaries	—	—	—	—
Taxes	532	835	1,329	1,707
Profit after tax	**1,027**	**3,425**	**5,874**	**7,507**
Other after tax income	—	—	—	—
Minority interests	(5.9)	(6.4)	(8.0)	(12.0)
Preferred dividends	—	—	—	—
Reported net profit	**1,033**	**3,431**	**5,882**	**7,519**
Analyst adjustments	—	—	—	—
Net profit (Credit Suisse)	**1,033**	**3,431**	**5,882**	**7,519**

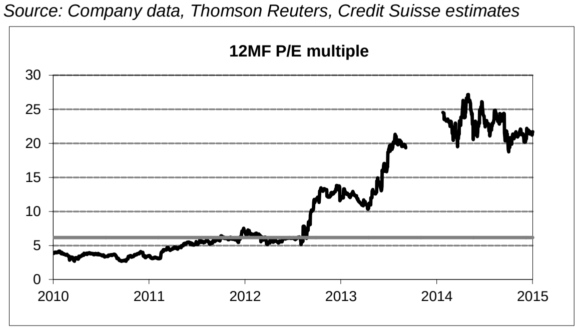
Cash flow (Rs mn)	3/15A	3/16E	3/17E	3/18E
EBIT	**1,648**	**4,402**	**7,661**	**9,565**
Net interest	—	—	—	—
Tax paid	—	—	—	—
Working capital	(857)	(2,871)	(3,843)	(2,537)
Other cash & non-cash items	7,442	428	(262)	(430)
Operating cash flow	**8,234**	**1,959**	**3,555**	**6,598**
Capex	(2,069)	(8,076)	(1,000)	(1,000)
Free cash flow to the firm	**6,165**	**(6,117)**	**2,555**	**5,598**
Disposals of fixed assets	—	—	—	—
Acquisitions	—	—	—	—
Divestments	—	—	—	—
Associate investments	—	—	—	—
Other investment/(outflows)	(1,234)	(25,678)	—	—
Investing cash flow	**(3,303)**	**(33,754)**	**(1,000)**	**(1,000)**
Equity raised	(6,890)	12,676	—	—
Dividends paid	(179)	(803)	(1,376)	(1,759)
Net borrowings	3,466	26,234	(5,000)	(5,000)
Other financing cash flow	(569.6)	(6.3)	(8.0)	(12.0)
Financing cash flow	**(4,172)**	**38,100**	**(6,384)**	**(6,771)**
Total cash flow	**758**	**6,305**	**(3,829)**	**(1,173)**
Adjustments	—	—	—	—
Net change in cash	**758**	**6,305**	**(3,829)**	**(1,173)**

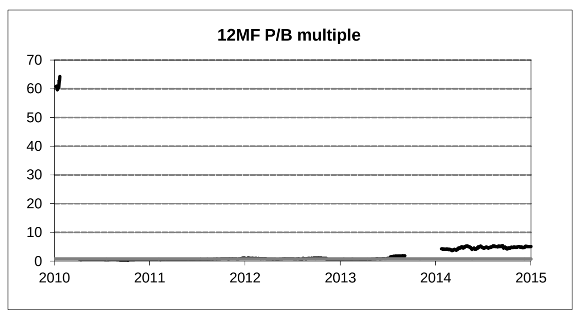
Balance sheet (Rs mn)	3/15A	3/16E	3/17E	3/18E
Cash & cash equivalents	7,082	8,578	4,749	3,576
Current receivables	3,900	9,714	14,173	16,605
Inventories	2,077	6,793	9,859	11,551
Other current assets	1,236	4,335	4,998	5,856
Current assets	**14,294**	**29,419**	**33,779**	**37,588**
Property, plant & equip.	5,812	12,489	11,972	11,356
Investments	687.6	952.0	952.0	952.0
Intangibles	2,914	28,170	28,170	28,170
Other non-current assets	1,154	1,311	1,311	1,311
Total assets	**24,861**	**72,340**	**76,183**	**79,376**
Accounts payable	2,344	6,534	8,627	10,107
Short-term debt	6,243	24,579	21,079	17,578
Current provisions	—	—	—	—
Other current liabilities	1,612	3,369	5,623	6,588
Current liabilities	**10,199**	**34,483**	**35,328**	**34,273**
Long-term debt	2,674	10,527	9,028	7,528
Non-current provisions	—	—	—	—
Other non-current liab.	351.9	396.4	396.4	396.4
Total liabilities	**13,225**	**45,406**	**44,752**	**42,198**
Shareholders' equity	**11,449**	**26,753**	**31,258**	**37,018**
Minority interests	187.1	180.7	172.7	160.7
Total liabilities & equity	**24,861**	**72,340**	**76,183**	**79,376**

Per share data	3/15A	3/16E	3/17E	3/18E
Shares (wtd avg.) (mn)	59.6	80.6	80.7	80.7
EPS (Credit Suisse) (Rs)	**17.3**	**42.5**	**72.9**	**93.2**
DPS (Rs)	—	10.0	17.1	21.8
BVPS (Rs)	192	332	387	459
Operating CFPS (Rs)	138	24	44	82

Key ratios and valuation	3/15A	3/16E	3/17E	3/18E
Growth(%)				
Sales revenue	(11)	172	38	17
EBIT	(1)	167	74	25
Net profit	34	232	71	28
EPS	34	145	71	28
Margins (%)				
EBITDA	19.1	17.8	20.4	21.2
EBIT	13.8	13.5	17.0	18.1
Pre-tax profit	13.0	13.1	16.0	17.5
Net profit	8.6	10.5	13.1	14.3
Valuation metrics (x)				
P/E	79.7	32.5	19.0	14.8
P/B	7.19	4.16	3.57	3.01
Dividend yield (%)	—	0.72	1.23	1.58
P/CF	10.0	56.9	31.4	16.9
EV/sales	9.5	4.2	3.0	2.5
EV/EBITDA	49.5	23.8	14.9	11.9
EV/EBIT	68.7	31.3	17.9	13.9
ROE analysis (%)				
ROE	9.6	18.0	20.3	22.0
ROIC	9.3	10.6	11.3	13.5
Asset turnover (x)	0.48	0.45	0.59	0.66
Interest burden (x)	0.95	0.97	0.94	0.96
Tax burden (x)	0.66	0.80	0.82	0.81
Financial leverage (x)	2.14	2.69	2.42	2.14
Credit ratios				
Net debt/equity (%)	15.8	98.5	80.7	57.9
Net debt/EBITDA (x)	0.80	4.57	2.76	1.93
Interest cover (x)	4.17	2.89	4.14	5.16

Source: Company data, Thomson Reuters, Credit Suisse estimates





Source: IBES

Acquisitive, but low-risk approach; track record provides comfort

Post divestments, Strides has rebuilt its business through acquisitions. The company has (1) grown its top line from US$185 mn to over US$700 mn, (2) transformed itself from being Africa-dominated to a global and diversified player, and (3) shifted from B2B to largely a B2C model with front-ends spread globally. Strides' management has exhibited a strong track record of M&As in the past (this is not the first time that Strides is gaining scale via M&As)—the last round ended with Agila and Ascent divestments and sharing significant wealth with the shareholders. The current round of acquisitions provides comfort as they have been low-risk, inexpensive (with the exception of Shasun), and in known areas/geographies where Strides has already proved its expertise.

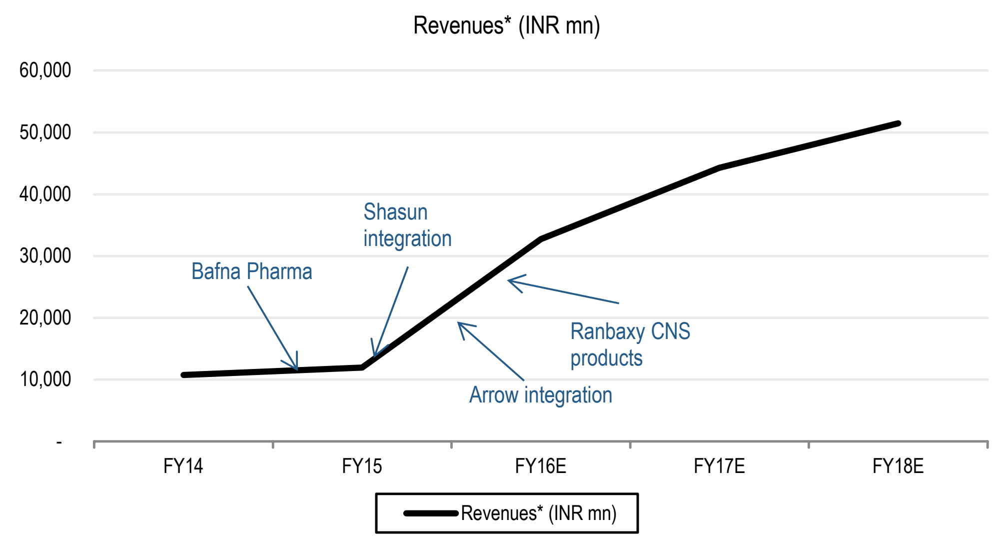
We do not expect any large acquisition in the near term, as (1) its balance sheet is stretched with net debt/EBITDA at ~5x, (2) management's focus will likely be on integration, (3) promoter's (Arun Kumar) holding is now at <24%, and (4) the proposed fund-raising (~US$225 mn) should help reduce leverage, but would not allow a big acquisition. Geographical expansion is largely done and further acquisitions are likely to towards building scale in existing geographies.

Acquisitive, but has a low-risk approach; track record provides comfort

Restart post divestments: Acquisitions have provided a base for take-off

Agila and Ascent divestments resulted in a small business with the key geography being Africa and a small presence in the UK and the US. Strides has again rebuilt the business with a host of acquisitions over the past couple of years. It acquired Shasun to bolster the US pipeline, Arrow from Aspen to re-enter the tried and tested territory of Australia, and a couple of assets in India to kickstart a branded business in the country. We note that except for Shasun, Strides has managed to acquire assets at cheap valuations—this has been a key highlight of its past M&A strategy as well.

Figure 9: **Acquisitions have provided a base to kick-start growth**



Revenues are adjusted to 12 months where reporting periods were higher than 12 months.

Source: Company data, Credit Suisse estimates

Figure 10: **Acquisitions post Agila exit**

Date	Acquisition	Value (US$ mn)	Details
Jul-14	Bafna Pharma	8	India branded business - key product Raricap; gives Strides presence outside South India
Jul-14	Oncobiologics	n.a.	Undisclosed stake - biosimilars pipeline
Sep-14	Shasun	~200 mn	All stock deal; provides US pipeline and backward integration
May-15	Arrow	300	Aspen's Australia arm, re-entry into Australia
Sep-15	Ranbaxy CNS products	25	Two CNS divisions of Ranbaxy
Oct-15	J&J brands	n.a.	7 J&J brands
Oct-15	Medispan	n.a.	Probiotics segment

Source: Company data, Credit Suisse

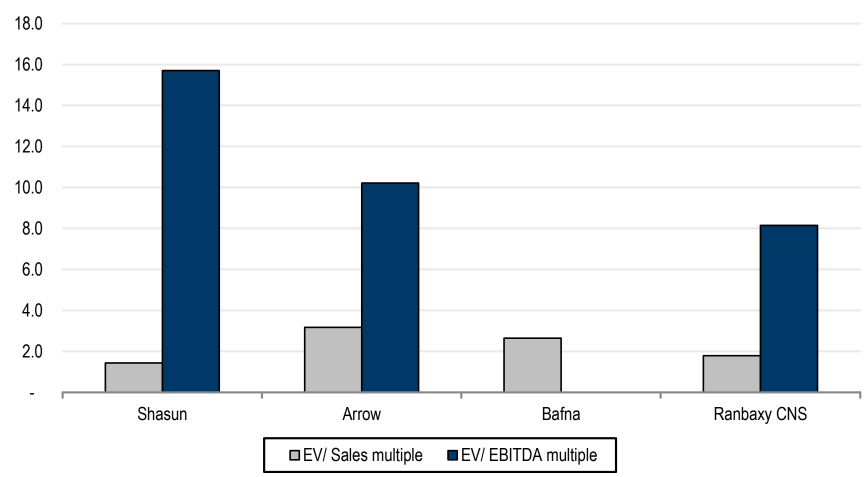
Acquisitions have been low-risk

Strides has a sound track record of creating value through M&As

Strides has a sound track record of creating value through M&As—the previous round ended with sharing substantial wealth with the shareholders (details in the following section). The current round of acquisitions has been low-risk and in known geographies/areas where Strides already has capabilities.

- **Low-risk acquisitions:** Strides has refrained from making big acquisitions in unknown territories, and has made acquisitions in largely known areas where it already has expertise. The Australian acquisition is a prime example of this strategy. The company was earlier present in the Australian market through Ascent. The current business will be run by ex-Ascent CEO Mr Dennis Bastas. Re-entering a known territory with the same team insures Strides from the unknowns of the market. While Strides has also expressed interest in entering a few other geographies, management has taken a cautious approach and started with a small inorganic move to test the waters, rather than going for a big bang acquisition. Even in the case of smaller acquisitions, it has acquired portfolios (mainly in India) that have been well established brands (Raricap), or in its area of choice (lifestyle diseases in India—CNS Ranbaxy) and have been largely complementary.
- **Multiple bolt-on acquisitions to build scale:** Along with the two large acquisitions, Strides has gone for a few smaller acquisitions that are complementary and help build scale for the company.
- **Acquisitions that require lower integration:** Apart from Shasun's US overlap (where Strides was a much smaller player), the integration process for other acquisitions is less.

Figure 11: **Strides has made acquisitions at cheap valuations (except for Shasun)**



Source: Company data, Credit Suisse estimates

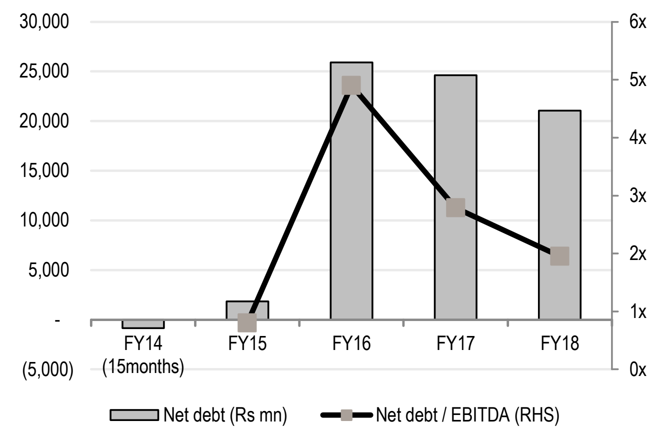
Acquisitions have left the balance sheet stretched; FCF generation over next two years and fund-raising plan likely to set its balance sheet in order

Post the Arrow (funded through debt) and Shasun (brought in debt of ~US$110 mn) acquisitions, Strides' balance sheet has become stretched with net debt of close to US$500 mn, and a net debt/EBITDA ratio of ~5x. While the company is expected to generate strong cash flows over the next couple of years of ~US$125 mn, balance sheet would still be under some stress, in our view.

Strides' balance sheet has become stretched with net debt of close to US$500 mn, and net debt/EBITDA ratio of ~5x

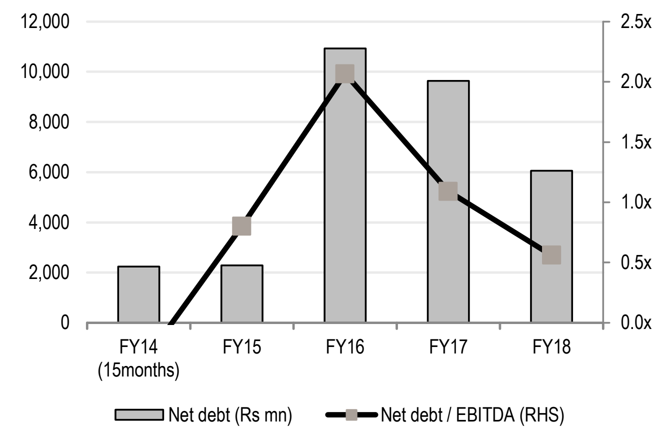
Strides has announced a fund-raising plan for ~US$230 mn (Rs1.5 bn) by way of issue of GDR/ADR/FCCBs/QIP or any other equity-linked instruments. Management has highlighted that close to half of these funds will be used to repay debt. It intends to use half of the funds raised for working capital needs and additional acquisitions.

Figure 12: **Net debt/EBITDA expected to reduce to 2x by FY18…**



Source: Company data, Credit Suisse estimates

Figure 13: **…fund-raising can fast-track the reduction**



Note: Net debt/EBITDA to be below 2x in absence of any acquisition
Source: Company data, Credit Suisse estimates

Do not expect a large acquisition—only bolt-ons

We do not expect further large acquisitions from Strides as:

1. The leverage level has gone up to ~5x net debt/EBITDA. Cash flow generation will help in gradual improvement in balance sheet, leading to net debt/EBITDA reduction to 2x only by FY18.
2. On the other hand, the two large acquisitions have just received approvals and the company is in the process of integration. We expect Strides to consolidate for a period of at least 12-18 months before it can look at another big acquisition.
3. With a leveraged balance sheet, large acquisitions would have been possible through equity dilution. Post the Shasun merger, Strides original promoter's (Arun Kumar) shareholding has reduced to <25%. Post the proposed fund-raising, this can potentially reduce to 20% levels. Hence, we believe further equity dilution to be difficult as it leads to reduction in shareholding below 20%.

However, we expect Strides to continue with small acquisitions in existing geographies, such as India (branded products), Africa, and the US (product portfolio). In new geographies, Strides is keen on CIS, and Southeast Asian markets. The company has already made a headstart in Russia, while Southeast Asia was part of Ascent which Strides sold to Watson.

We expect Strides to continue with small acquisitions in existing geographies

Figure 14: Possible geographies for acquisition; expect small multiple acquisitions

Geography	Comments
India	Focus is to create big brands; therapies of interest are CVS, women health, pain management and diabetes
Africa	Has been largely organic so far; acquisitions could be get pan-African presence or brands. MENA / Turkey is also area of interest for Strides
US	Shasun acquisition has got pipeline, but front-end is still weak—could look to acquire product portfolio
New geographies	Russia / CIS and Southeast Asia on top of management's plan

Source: Company data, Credit Suisse estimates

Biologics demerger could unlock marginal value

Strides also has a biotech business under its subsidiary Stelis Biopharma, which was renamed from Inbiopro. In Sep-14, GMS Holdings invested US$22 mn in Stelis for a 25.1% stake, valuing the company at ~US$90 mn. Currently, the company spends ~US$2-3 mn on R&D.

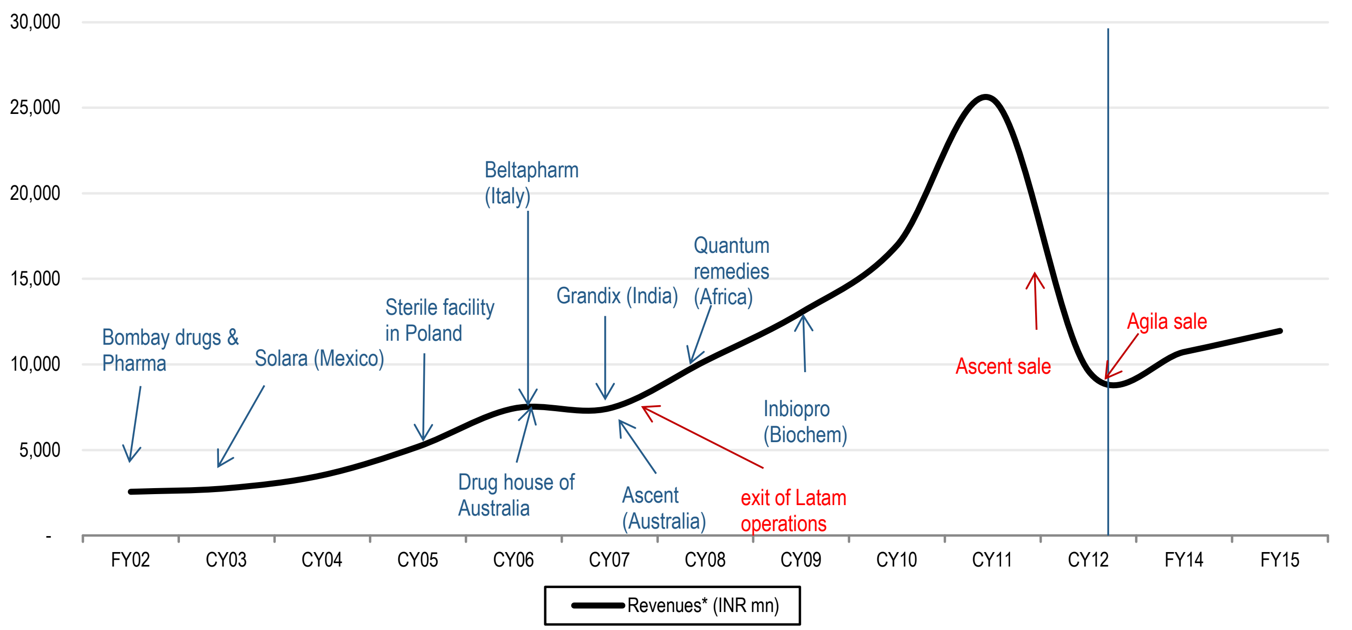
Strides intends to spin-off the Biotech business into a separate listed entity, and retain up to a 20% stake in the demerged entity and make it self-sufficient for running the business. Stelis incurs a loss of ~US$2-3 mn annually and ends up being value-dilutive for the company. A separate listing could lead to value unlocking for the biologics business.

A separate listing could lead to value-unlocking for the biologics business

Not the first round of acquisitions

Strides has a history of buying assets at cheap valuations or acquiring small assets and turning them into an efficient valuable business; it has also made a couple of value-accretive divestments.

Figure 15: Strides has grown through acquisitions in the past as well



Note: Revenues are adjusted to 12 months where reporting periods were higher than 12 months.

Source: Company data, Credit Suisse estimates

Profitable exits in the past: Agila and Ascent divestments—special dividends

Strides sold Agila and Ascent (~70% of revenues in CY11) for US$$1.6 bn and US$395 mn in Feb-13 and Jan-12, respectively.

- **Agila:** Agila was the global injectable arm for Strides. It had 122 ANDAs pending in the US and presence in 70 countries. Strides sold Agila for US$1.6 bn (with an additional US$250 mn in potential payments, subject to the satisfaction of certain conditions by Strides) to Mylan in Feb-13. Agila had revenues of US$255 mn in CY12 with EBITDA of US$86 mn. The deal was valued at 19x EBITDA.

- **Ascent:** Ascent was Strides' Australia and Southeast Asia business. Strides had a 94% stake in Ascent (the remainder 6% was held by Ascent CEO Mr Dennis Bastas), which was sold to Watson for an enterprise value of US$395 mn. Strides had invested US$113 mn through 2008-10 in Ascent and exited with a sum of US$371 mn. The deal was valued at 20x EBITDA and 2.5x revenue.

Post the Agila deal, Strides paid out special dividends to the tune of US$660 mn (Rs605 per share), in two tranches.

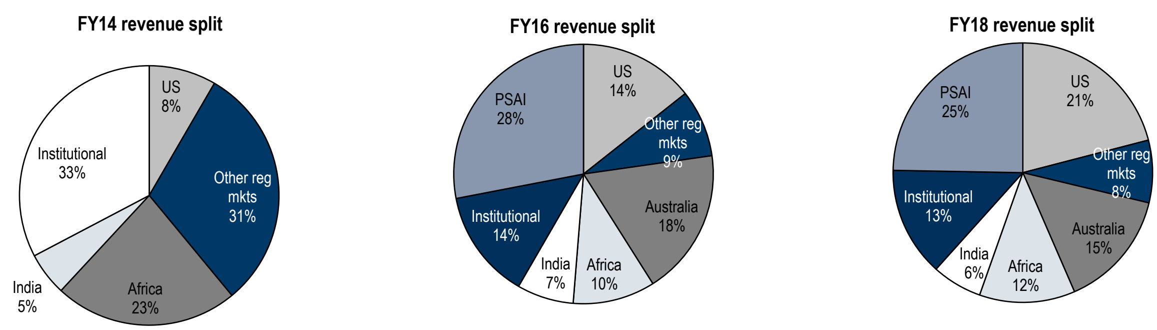
More geographically diverse, backward integrated

Post Agila exit, Strides was largely an Africa-focussed business (branded generic, generic generic, and institutional), with a small presence in the US and the UK. The company has focused on building the key geographies of the US and Africa, and re-entering Australia. The Shasun acquisition helps in getting the US pipeline, and backward integration benefits for its institutional and US businesses.

The sales mix for Strides is now more diversified with the US and Africa being the key growth drivers

With the acquisitions, the sales mix for Strides is now more diversified with the US and Africa being the key growth drivers.

Figure 16: **Strides revenue more diversified post the acquisitions of Shasun and Arrow**



Note: FY16 revenues are adjusted for annual sales for Australian acquisition.
Source: Company data, Credit Suisse estimates

US and Africa: The growth engines

The US and Africa will be the key growth drivers for Strides and are expected to grow at a 30%-plus CAGR over the next couple of years, driven by the pipeline from Shasun, increasing market share and the low base in the US, growth in branded products, and the local manufacturing “in-Africa for-Africa” strategy in Africa.

Post Agila exit, Strides became a small player in the US with FY15 top line of just US$19 mn and a few pending products. However, over the past 12 months, it has started its own front-end in the US and built a new R&D centre in Bangalore. In addition, the Shasun acquisition has provided Strides with a large complementary product pipeline, with expertise in Extended Release (ER) products. Both R&D and filings are slated to pick up materially after the Shasun integration. Overall, Strides is focused on low-competition, small off-patent products and soft-gels and derma in the complex generics. Its strategy is different from other smaller Indian firms which focus on product expiries. Given the slim product basket currently, Strides has to go through the tough phase of building a product portfolio—until then it will have lower than fair market share, but Strides has shown capability to garner high market share on low-competition products.

In the US, Strides is focused on low-competition, small off-patent products, and soft-gels and derma in the complex generics

Strides has been one of the few Indian companies that has focused on Sub-Saharan Africa. Africa is a difficult continent to operate in, given (1) the diversity and fragmented markets with individual markets being small, and (2) each country has its own regulator and approval process. Strides has done the initial hard work of setting up successfully, and is ready to reap the rewards of its investments. The company targets to reach US$200 mn in revenue by 2020, and has identified the branded business growth from increasing MR strength and product launches, and the generic business growth from the local manufacturing “in-Africa, for-Africa” strategy.

Restart post Agila; execution is the key challenge

Strides is a late entrant and a very small player in the US with regard to the oral portfolio. US sales for Strides were just US$19 mn in FY15. In its earlier avatar, Strides had largely focussed on the injectable space, which it sold to Mylan. It had a small portfolio, which was partnered with various players. Out of the partnered portfolio, Vancomycin is the key contributor and accounts for over 70% of FY15 Strides sales.

Post Agila exit, Strides has started with its own front-end in the US and bought back most of its partnered products. Execution remains a challenge as a smaller product portfolio restricts its ability to gain fair market share. Of the 11 products launched so far, Strides has gained fair market share in only a couple of products (Figure 17). But the recent trends suggest that Strides has done well/showed improvement in a few products (Figure 18 and Figure 19).

Of the 11 products launched so far, Strides has gained fair market share in only a couple of products

While its new front-end has resulted in lower market shares in the initial phase for its recent launches, it should help Strides retain a higher portion of the profits in the future.

US portfolio has a few niche products with low competition, and Strides has done well in those

Strides has adopted a different approach from other smaller Indian players and focuses on smaller, already genericised products, which are outside the focus of other players. The sweet spot for Strides is product revenues of US$5 mn and EBITDA of US$2-3 mn. In our view, a couple of products from the ones already launched easily fit this criteria. Despite having a top line of US$19 mn in FY15 (Strides alone), the company was EBITDA positive due to high contribution from Vancomycin and the above-mentioned strategy.

While its new front-end has resulted in lower market shares in the initial phase for its recent launches, it should help Strides retain a higher portion of the profits in the future

In the niche segment, the key focus area for Strides is Soft Gelatins where the company has already filed or is working on all relevant products. In Soft-gels (SGC) there is limited competition as there are not many approved facilities. Strides has a total of eight SGC products, of which five are already approved (Ergocalciferol, Calcitriol, Methoxsalen, Dutasteride and Benzonatate), two are pending approvals, and one is in the development pipeline. In SGCs, Strides has managed to garner decent market share and competition has been among 2-5 players. Additionally, Strides also has capabilities for Cream and Suspension products. The Shasun acquisition brought in capabilities in the extended release space.

In Dutasteride (Avodart), competition is higher, given the large size of the product (US$500 mn). An analysis of the launches in Dutasteride confirms that the larger players do not have SGC facilities—and most of the products are manufactured by third-party firms (Figure 21). Due to this we do not expect competition to increase materially in the smaller SGCs. But among the Indian firms, Dr. Reddys has filed in Soft gels and has five products pending approval.

In SGCs, Strides has managed to garner decent market share and competition has been among 2-5 players

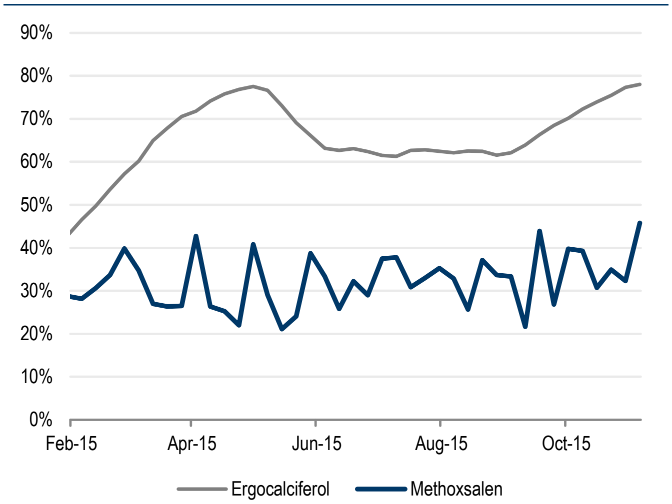
Figure 17: **Strides launches under own front-end, has a few niche launches**

Product	Launch date	Brand	Size (US$mn)	No. of players	Strides mkt share	Fair mkt share	Strides mkt share below fair mkt share
Acarbose	Mar-14	Precose	12	8	3%	13%	-10%
Mycophenolate	Mar-14	Cellcept	220	10	3%	10%	-7%
Hydralazine	Jun-14	Apresoline	43	6	1%	17%	-16%
Imiquimod	Jun-14	Aldara	80	8	1%	13%	-11%
Methoxsalen	Jun-14	8-Mop	13	2	38%	50%	-12%
Ergocalciferol	Oct-14	Drisdol	8	4	78%	25%	53%
Tacrolimus	Nov-14	Prograf	500	8	1%	13%	-12%
Calcitriol	Dec-14	Rocaltrol	56	5	7%	20%	-13%
Buspirone	Jan-15	Buspar	78	6	1%	17%	-16%
Lamivudine; Zidovudine	May-15	Combivir	120	7	2%	14%	-13%
Benzonatate	Jul-15	Tessalon	55	4	9%	25%	-16%
Median					**2.9%**	**16.7%**	**0.2x**

Note: Highlighted rows are Softgels.

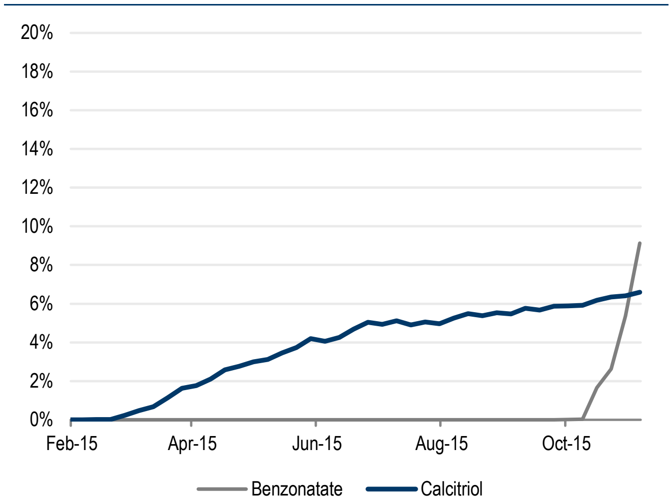
Source: IMS health, Credit Suisse

Figure 18: **Strides has done well where competition is low…**



Source: IMS health, Credit Suisse research

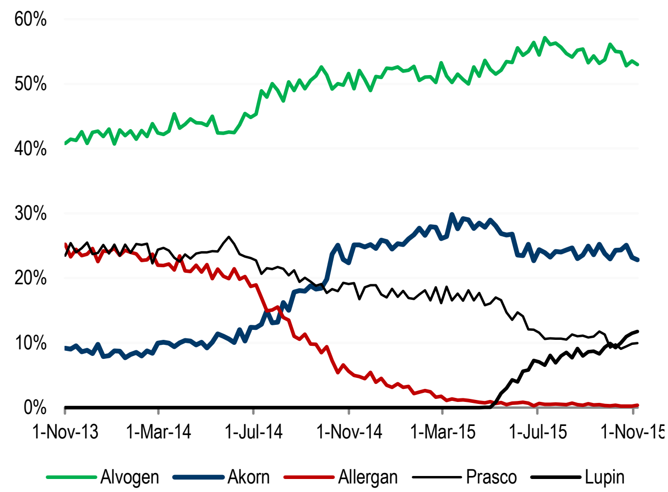
Figure 19: **…and is gaining traction in a couple of recent launches as well**



Source: IMS health, Credit Suisse research

Vancomycin continues to do well for Strides despite Lupin's entry. In fact, post Lupin's entry, Alvogen's (Strides partner) market share has actually increased from 40% range to 50%+ at the expense of Allergan (Figure 20)

Figure 20: **Alvogen has gained market share in Vancomycin despite Lupin's entry**



Source: IMS health, Credit Suisse estimates

Figure 21: **All players in Avodart soft-gels get product manufactured from third parties, indicating low competition for smaller Soft-gels**

Seller in US	Manufacturer
Roxane	Cipla
Teva	Pharmaceutics International Inc
Actavis	Pharmaceutics International Inc
Rising	Catalent Pharma
Breckenridge	Douglas, New Zealand
Apotex	Accucaps Industries
Strides	Strides

Source: US FDA, Company data, Credit Suisse estimates

Strides' average share as a percentage of fair share is low at 0.2x

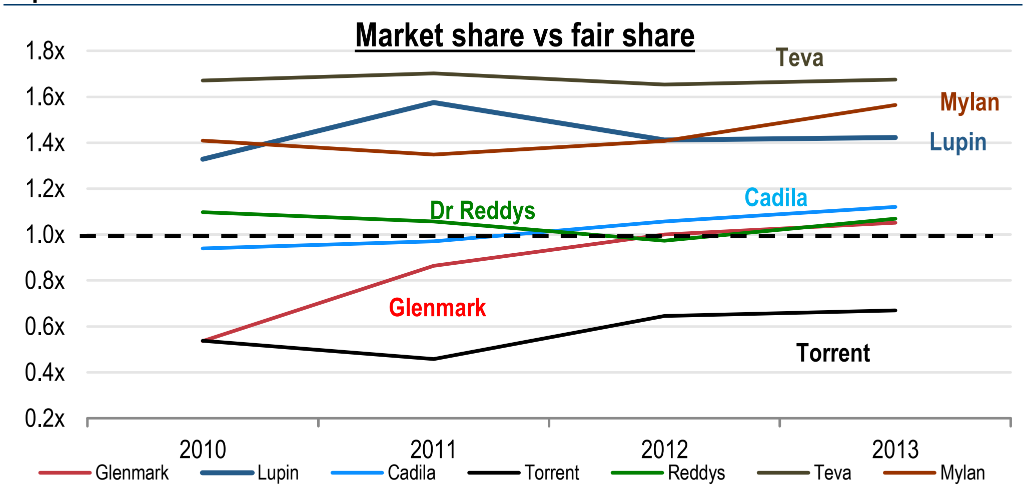
Overall, Strides' average share as a percentage of fair share (fair share is calculated by 1 divided by the number of players) is low at 0.2x. We expect this share to move up gradually (Figure 23), as it reaches critical size both in number of products and in terms of revenues. We acknowledge that Strides has been a late entrant and most of these products have well entrenched competition. Hence, with a shallow product basket, Strides will continue to lag larger peers on market share. In our assumptions for Strides future launches, we continue to build lower than fair share.

Figure 22: **Strides' execution has been slow due to small basket of products**

Product market share	Number of pdts	Remarks
<5%	7	
5-10%	2	Benzonatate, Calcitriol
10-20%	0	
20%+	2	Ergocalciferol (78%), Methoxsalen (38%)

Source: Company data, Credit Suisse estimates

Figure 23: **Market share above fair share is possible with a large product basket and superior execution**



Source: Company data, Credit Suisse estimates

What does Shasun bring to the table?

Shasun acquisition helps in augmenting the product pipeline and streamlining R&D

Strides has 16 pending ANDAs in the US. While Shasun brought a few pending products (ten), the Shasun acquisition brought (1) a large complementary product pipeline with expertise in “extended release” products, and (2) a R&D centre.

Shasun also followed a partnership model in the US which was in the nature of contract manufacturing, where ANDAs were filed in the name of the partner and Shasun only manufactured the products. Before the acquisition, Shasun had also announced intentions of starting its own front end in the US.

Strides has 16 pending ANDAs in the US. Shasun acquisition brought (1) a large complementary product pipeline with expertise in “extended release” products, and (2) a R&D centre

Figure 24: **Existing products for Shasun**

Revenues (USD mn)	Partner	CY11	CY12	CY13	CY14	CY15*
Ibuprofen	Ascend	1	1	6	16	17
Ranitidine	Glenmark	5	3	6	13	13
Dozazosin	Pfizer / Greenstone	6	5	4	5	9
Carvedilol	Solco Healthcare	1	1	1	5	6
Gabapentin tablet	Solco Healthcare				0	3
Nystatin	Heritage	-	1	1	1	2
Nizatidine	Glenmark	0	1	2	1	1

**CY15 = Annualized Sep-15 sales Source: IMS health, Credit Suisse estimates*

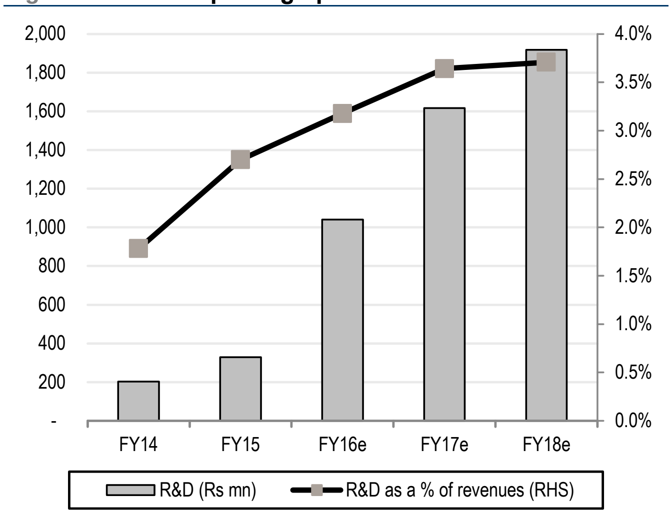
R&D (and filings) to pick up, but remain lower than peers

Post the Agila transaction, Strides did not have an R&D centre. As a result R&D spend for Strides was much lower than peers, which impacted filings. Strides commissioned a R&D centre at Bangalore in FY15. In addition, Shasun also brings in an R&D centre. The combined entity will have 400-plus scientists, and the R&D spend is expected to rise to 8% of developed market sales. But R&D is expected to remain low at <4% of overall sales.

While we acknowledge that the R&D spend is lower than peers, this is reflective of the focus of the company. The cost of development per ANDA is expected to be lower for Strides vs peers as focus is on already genericised products where (1) the development-to-success ratio is high, (2) there are no legal costs—in Para IV filings, litigation costs are substantial, and (3) the complexity of products is lower, and within complex generics, Strides is restricted to Soft gelatin (a large part of the filings is already done) and creams.

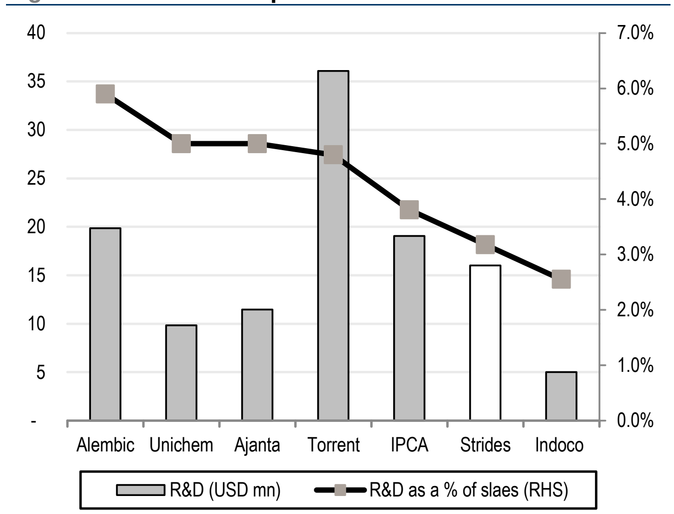
The combined entity will have 400-plus scientists, and the R&D spend is expected to rise to 8% of developed market sales. But R&D is expected to remain low at <4% of overall sales.

Figure 25: **R&D is picking up…**



Source: Company data, Credit Suisse estimates

Figure 26: **…but below peers**



Note: Numbers for FY15, except Strides which is FY16 (incl Shasun).
Source: Company data, Credit Suisse estimates

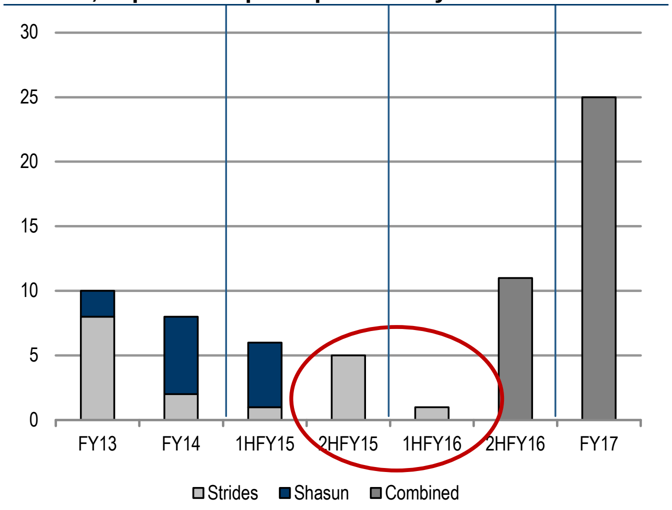
Filings: Slow start post merger announcement; expect to pick up speed now

Post the merger announcement in Sep-14, filings have been slow—both at Strides as well as at Shasun. We believe the reason for the slow filings is calibration of the strategies of both the companies and delay in regulatory nod for the Strides-Shasun merger approval. The filings are now expected to pick up and the company has guided for 10-12 filings in 2H FY16 and 25 filings in FY17 The company has shortlisted 80-100 products, which it intends to work in the next few years, and has already firmed up 40-50 products for the next two years.

US filings are expected to pick up with 10-12 filings in 2H FY16 and 25 filings in FY17

Post Shasun, Strides has more than 110 products in the pipeline with a focus on Softgels, derma (Strides) and extended release (Shasun). A few products from Shasun are still tied-up with existing partners.

Figure 27: **Product filings have been slow over the past 12 months; expected to pick up materially**



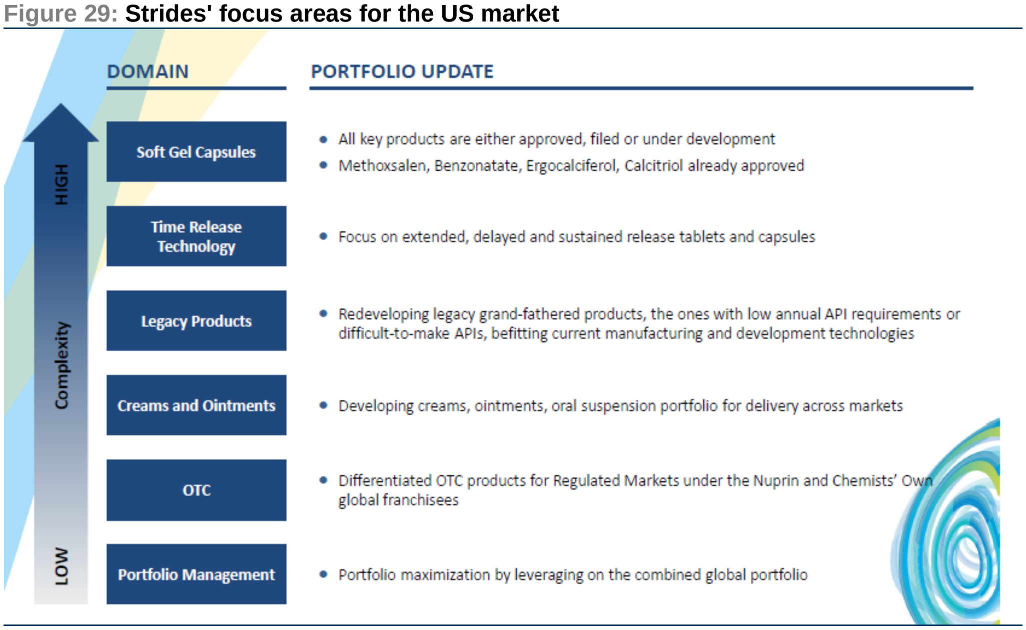
Source: Company data, Credit Suisse estimates

Figure 28: **Strides + Shasun pipeline in the US**

USFDA filings	Approved	Filed	Pipeline	Total
SGC	5	2	1	**8**
Extended Release	0	1	32	**33**
Creams and Ointments	1	1	8	**10**
Suspension	0	0	6	**6**
OTC	3	3	7	**13**
505 (b(2))	0	1	0	**1**
FTF	0	2	0	**2**
Other	12	16	58	**80**
Total	**21**	**26**	**112**	**153**

Source: Company data, Credit Suisse estimates

Figure 29: **Strides' focus areas for the US market**



Source: Company data

GDUFA to help in newer filings

The FDA started Generic User Fees programme in Oct-12 to reduce the approval timeline. As shown in Figure 30, for filings made after Oct-15, FDA response timelines are reduced to 15 months and for filings post Oct-16, 90% of the applications will be processed within ten months. As most of Strides' filings will happen from 2H FY16, the company will benefit from the lower timelines and can be faster to the market.

Figure 30: GDUFA timelines

		Filing date	Timeline-commitments
		Before Oct 2012	90% of all ANDAs by end of FY17 (Sep-17)
Year 1 cohort	FY2013	Oct-12 to Sep-13	no commitments
Year 2 cohort	FY2014	Oct-13 to Sep-14	no commitments
Year 3 cohort	FY2015	Oct-14 to Sep-15	60% of applications within 15 months
Year 4 cohort	FY2016	Oct-15 to Sep-16	75% of applications within 15 months
Year 5 cohort	FY2017	Oct-16 to Sep-17	90% of applications within 10 months

Source: Company data, Credit Suisse

Low base, increasing market share, and Shasun help to deliver 35%-plus CAGR over the next three years

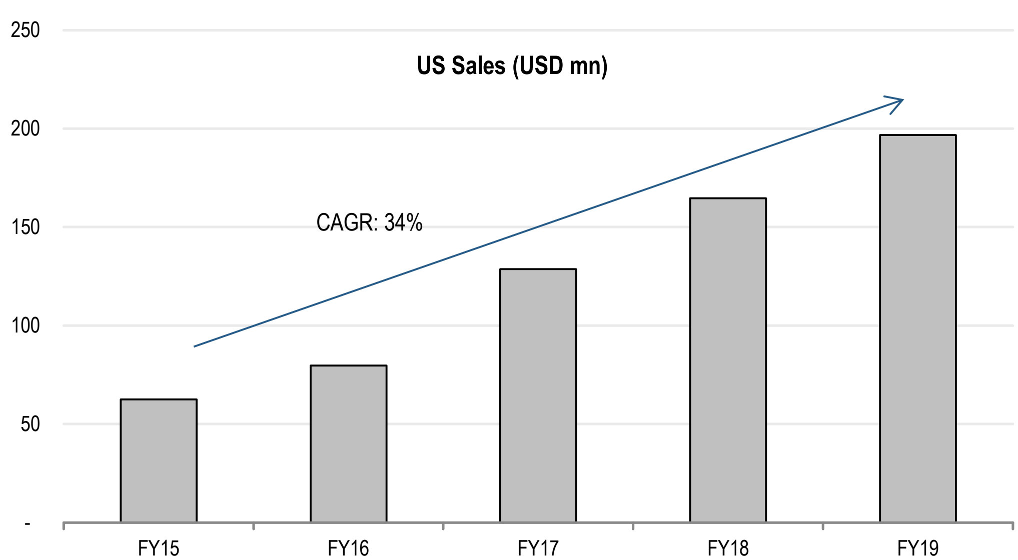
Strides + Shasun FY15 revenues in the US were small at US$65 mn. Strides has received a spate of approvals over the past 12 months, where the market share response has been significantly lower than fair share due to the small basket. We expect Strides to benefit from market share gains as its product portfolio expands.

The combined entity had 26 pending approvals with ~12-14 products, where filings have been made two years back. We expect the combined entity to launch mid-single-digit products in the US over the next couple of years, before upside from increased filings starts delivering.

The next key product for Strides is Lovaza, which is already genericised and has four generics in the market, but the market size is large at US$700 mn

The next key product for Strides is Lovaza, which is already genericised and has four generics in the market, but the market size is large at US$700 mn. We expect Lovaza's approval to come through in FY17.

Figure 31: US sales to post a 34%-plus CAGR



Source: Company data, Credit Suisse estimates

Figure 32: **US pipeline—assume low market share for future launches, but small market share gains in launched PDTs**

Product	Brand	Size (US$ mn)	No of players	Strides revenue FY15	FY16	FY17	FY18
Already launched							
Vancomycin Hydrochloride	Vancocin	160	5	13	10	10	10
Meloxicam	Mobic	33	8+	1	1	1	1
Nevirapine	Viramune	10	8+	1	1	1	1
Mycophenolate Mofetil	Cellcept	220	10	1	2	3	3
Ergocalciferol	Drisdol	8	4	1	2	4	3
Acarbose	Precose	12	8	0.2	0.2	0.6	0.6
Hydralazine Hydrochloride	Apresoline	43	6	0.1	0.1	0.1	0.9
Diphenhydramine Hydrochloride; Ibuprofen	Advil PM	4	2		0.4	0.4	0.4
Methoxsalen	8-Mop	13	2	1	2	4	4
Imiquimod	Aldara	80	8	0.4	0.8	0.8	0.8
Tacrolimus	Prograf	250	8	0.1	0.3	0.6	0.9
Buspirone Hcl	Buspar	78	6	0.2	0.5	0.5	0.5
Polyethylene Glycol 3350		20			0.3	0.4	0.7
Benzonatate	Tessalon	55			2	4	4
Lamivudine And Zidovudine	Combivir	120	7		1	3	3
Dutasteride	Avodart	500	9-10		1	2	2
Calcitrol	Rocaltrol	56	4		1	2	3
Strides				**19**	**25**	**37**	**38**
Shasun Base sales				44	52	52	52
Carisoprodol					2	3	3
Shasun				**44**	**54**	**58**	**58**
Upcoming launches							
Omega-3	Lovaza	700	4			11	22
Other launches					2	26	50
	Total			**63**	**80**	**129**	**165**
	YoY growth				28%	61%	28%

Source: Company data, Credit Suisse estimates

Facility updates

Post the Shasun merger, Strides has three formulation facilities and two API facilities. Shasun has contributed to one formulation and two API facilities. Most of Strides and Shasun's facilities have been inspected in the past 12 months and the next inspection is due at Shasun's Cuddalore facility.

Most of Strides and Shasun's facilities have been inspected in the past 12 months

Figure 33: **FDA inspections on Strides facilities**

Period	Facility	Inspection Result
May-15	Italy	483 issued
Jun-13	Italy	483 issued
May-15	Bangalore	No 483
Aug-14	Bangalore	483 issued
Jul-11	Bangalore	No 483
Mar-08	Bangalore	483 issued
Mar-05	Bangalore	No 483

Source: Company data, Credit Suisse

Figure 34: **FDA inspections on Shasun's facilities**

Period	Facility	Inspection Result
Formulations		
Jun-14	Cuddalore	483 issued
Apr-11	Cuddalore	483 issued
Mar-07	Cuddalore	483 issued
Formulations / API		
Feb-15	Puducherry	483 issued
Feb-09	Puducherry	483 issued
Apr-05	Puducherry	483 issued
Nov-00	Puducherry	483 issued

Source: Company data, Credit Suisse

Africa: Difficult business to build; commands premium valuation

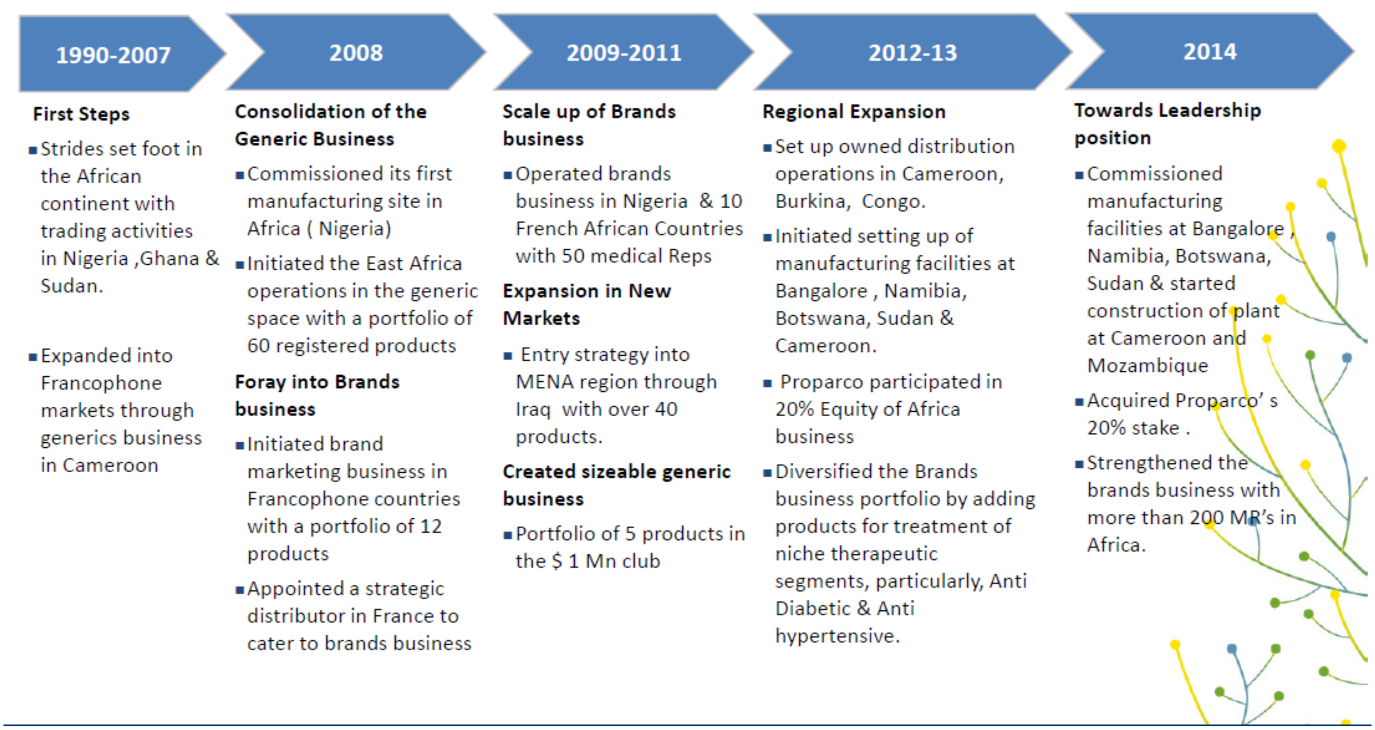
Africa accounts for 10% of Strides' FY16 normalised revenue. The company has been one of the few Indian companies that has focused on Sub-Saharan Africa (SSA). Strides is present in 27 countries in the SSA (excluding South Africa). It has generic presence in all 27 countries, and in addition branded presence in 12 of these countries, viz, ten countries of French-Africa, Nigeria and Ghana. Unlike other Indian players, Strides does not have presence in South Africa and North Africa (MENA, except Iraq).

Strides is one of the few Indian companies that has focused on Sub-Saharan Africa (SSA).

Built organically

Strides entered Africa as early as in the 1990s via the generic market. It started by supplying to partners in Nigeria, Ghana and Sudan and expanded into Francophone markets over the next decade. In 2008, Strides entered the branded market, initiating with Francophone countries with 12 products. Over the next few years, Strides expanded the branded business to Nigeria and Ghana and entered new geographies, Iraq and Angola.

Figure 35: **Strides' African journey**



Source: Company data

Complexity of Africa business underappreciated

Africa's pharma industry has witnessed a CAGR of ~15% over the past decade and the industry size was ~US$21 bn. According to a McKinsey report, the Africa market is expected to reach between US$45 bn (conservative) and US$67 bn (optimistic), at a CAGR of 10-14% (Figure 36). It is well established that Africa would be the fastest growing continent for the pharma industry, but the complexity of the markets is underappreciated, in our view.

Africa market is expected to reach between US$45 bn (conservative) and US$67 bn (optimistic), at a CAGR of 10-14%

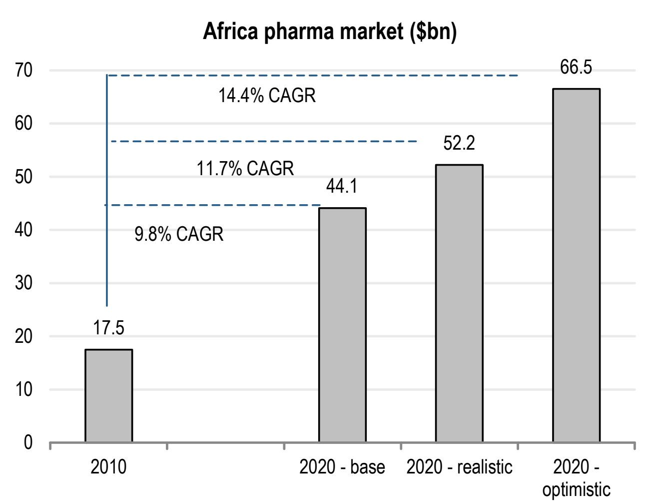
Broadly, Africa can be divided into four regions: (1) Anglo Africa, (2) Franco Africa, (3) Portuguese Africa, and (4) Arab speaking Africa. The characteristics among the four regions are completely different and this has led to fragmentation of the markets. While the countries in the regions have similar characteristics, each is governed by an independent regulatory authority. We believe the points listed below make Africa a difficult continent to operate in and build a business.

1. **No concept of 'One Africa':** Unlike Europe, where there is only one regulator for all countries, every country within Africa has its own regulator and set of rules and regulations. The facility and every product need to be approved by the specific countries. Approval time for a facility is 9-12 months, while product approvals take atleast a year and can easily go upto 2-3 years. The longer registration timelines impact negatively on the ability to launch products in certain markets.

Every country within Africa has its own regulator and set of rules and regulations

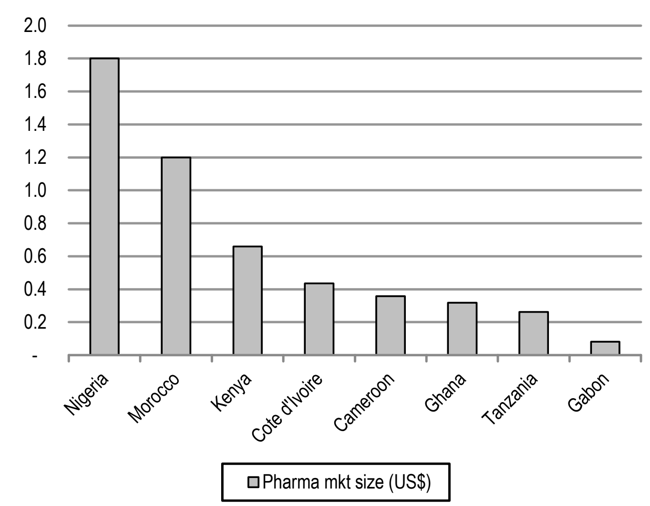
2. **Small individual markets:** On the other hand, size of each market individually is small, ranging from US$300 mn-2 bn (Figure 36). The largest market in Strides' covered countries is Nigeria at ~US$2 bn (in sub-Saharan Africa, the largest pharma market is South Africa). The smaller scale makes it difficult to justify the investments required for investing in having own distribution and branded business in the country. This is specifically the reason that despite having presence in 27 countries, Strides has own distribution in only three countries and branded business in 12-13 countries.

Figure 36: **Africa pharma market expected to deliver strong growth…**



Source: McKinsey – Africa a continent of opportunity for pharma and patients; WHO; World Bank; IMF; African Development Bank; BMI Research

Figure 37: **…but individually countries are complex, diversified and small**



Source: BMI, African development bank, Credit Suisse estimates

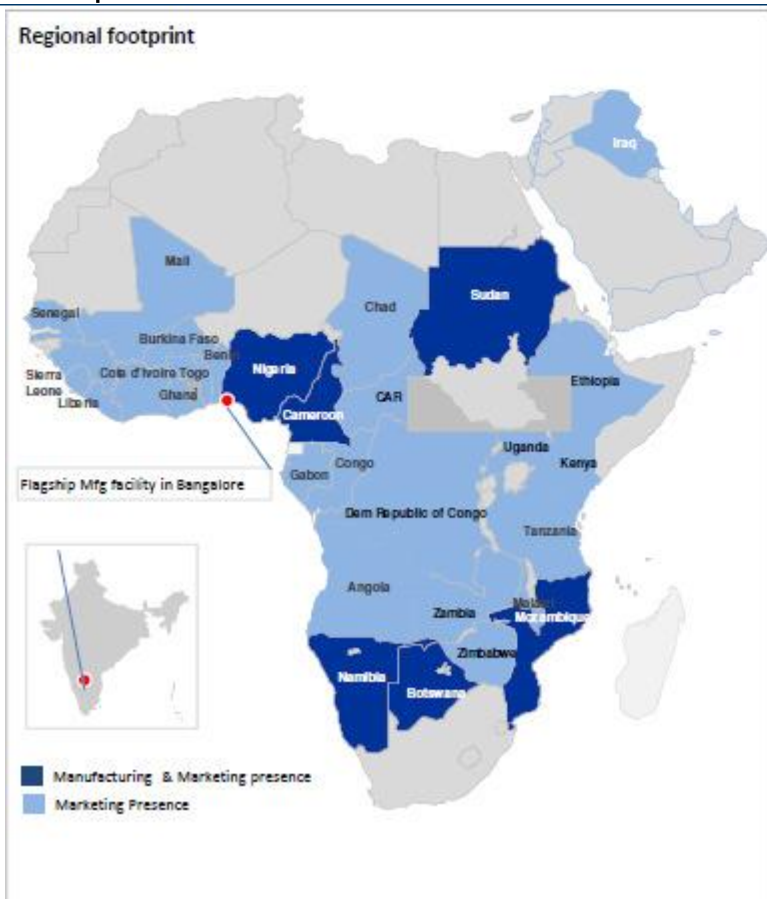
3. **Large generic (OTC) market:** About 70% of the market in Africa is self-prescription or the generic (OTC) market. In the generic market, players compete on pricing and retailers are the key decision maker. The company willing to sell the goods at a lower rates sets a benchmark for other companies to follow, unless the company has created a 'brand equity' which is possible by PoS advertising, repeat satisfied

customers and attractive packaging. Also, a "Local Technical Distributor" (LTR) is required for importing the goods into the country—a company can set up its own local distribution as well and act as the LTR, provided the scale of operations.

4. **Peculiar characteristics of population:** In the generic market, particularly, medicines are known by their colour. And the same medicine is known by a different color in different regions.

Strides has done the business building part successfully, and is ready to reap the rewards of the investments made in the continent. The complexity also makes this business a key target for a large company in the future and could demand premium valuation.

Figure 38: **Strides' presence in Africa**



Source: Company data

Strides has identified two growth drivers for Africa

Strides has achieved revenues of ~US$50 mn in FY15. ~35% of the revenues come from the branded business (increased to 40% in FY16) and the remaining 65% is from the generic segment. Strides' management expects to grow the Africa business into a US$200 mn business over the next five years. Strides has identified two growth drivers for Africa:

~35% of the revenues come from the branded business (increased to 40% in FY16) and the remaining 65% is from the generic segment

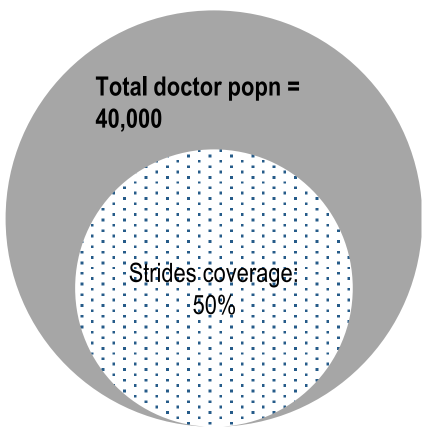
1. **Branded business: Growth from increasing MR headcount and product launches; geographically well-spread**

In the branded business, Strides is focused on the lifestyle diseases. Strides currently has 45 products registered in every market, of which 38-40 are actively promoted. Strides endeavours to increase the product per market to 80-100 over the next five years.

Geographically, Strides has covered most of the countries that it aspires to be in—remaining expansions will be small in Angola and East African markets (growth in East African branded markets is slow).

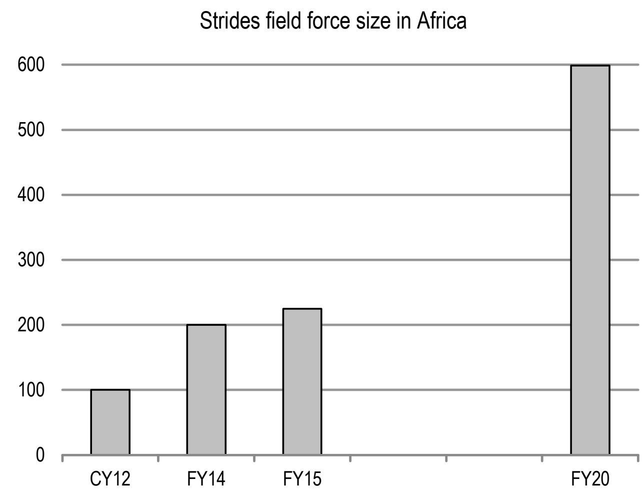
Strides has ~225 representatives in Africa currently, and is aiming to increase the field force size to 600 by FY20 (Aspen has a field force of ~700 people in Africa). The ramp-up in MRs will satisfy three objectives: (1) There are ~40,000 doctors in Strides' covered markets and with its current field force, it is addressing half of these. The initial ramp-up of the field force will be to complete the doctor coverage. (2) In addition, once the doctor cliff is achieved, the objective will be to divide Medical Reps into teams, so that more than one rep addresses the same doctor with a different product range. This will help generate more traction for Strides' products with the doctors. (3) Paramedics in Africa can also write prescriptions for basic medicines. There are an equal number of paramedics in the covered geographies. Strides does not cater to any of these currently and increased MR strength will help Strides cover the relevant population of paramedics.

Figure 39: Strides covers 50% of doctors currently in its covered regions



Source: Company data, Credit Suisse estimates

Figure 40: Strides aims to increase the field force to 600 over next three years



Source: Company data, Credit Suisse estimates

2. Generic business growth to come from local manufacturing—"For Africa, In Africa"

Strides achieved revenue of US$31-32 mn in FY15 from the generic segment. It has set up its own distribution subsidiaries in three countries: Cameroon (US$7 mn revenue), Nigeria (US$3 mn revenue), and Burkina Faso. In other countries, Strides operates through local distributors.

Growth from generics should be faster than the branded space over FY16-20, driven by setting up of local plants. Strides has already set up six plants in Africa and could set up further plants. It sets up plants on invitation from the local government and infuses a partner for being the face of the company and regulatory clearances. While opex in African plants is higher than that in India, but the benefits of local manufacturing more than offset the higher opex. Hence, growth driven by local manufacturing will also lead to margin expansion for Strides.

Setting up local plant has the following advantages:

- **Invitation from government:** Strides sets up own facility on invitation from the local government. Setting up a plant on invitation from the government helps in getting higher volumes, and the choice of products to be supplied.

- **15% lower pricing for local government tenders:** Strides does not participate in these tenders currently, but with new local plants, Strides can supply to these tenders at attractive margins
- **Import duty + clearing charges:** API import has lower duty and in certain cases high duties are levied on finished products (for e.g., Nigeria had levied 35% duty + clearing charges).
- **Products reserved for domestic production:** There are certain government ban on the import of a few products, reserving them for domestic production—e.g., Namibia, Sudan, and Ghana
- **Low payback:** The payback period for local sites is low at 2-3 years and in certain cases can be as low as one year.

Strides has already tasted success in Namibia with the local manufacturing. Based on its Annual Report, Strides achieved revenue of US$5 mn in FY15 itself (first year of facility). The company is looking to build a couple of more plants over the next 12 months as well.

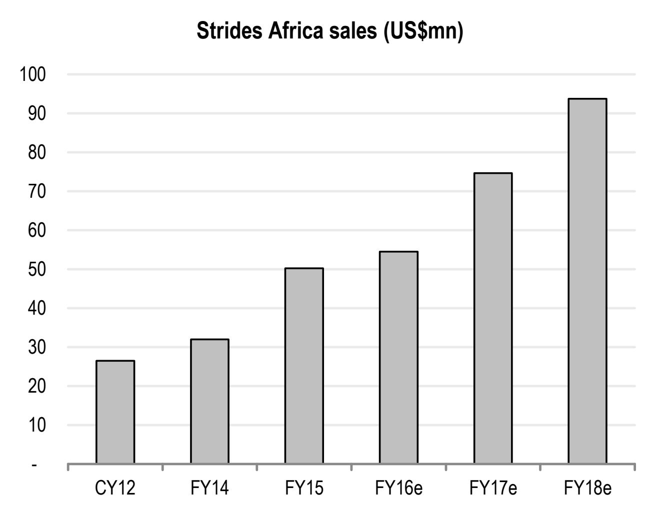
Strides has already tasted success in Namibia with the local manufacturing. Based on its Annual Report, Strides achieved revenue of US$5 mn in FY15 itself

Figure 41: **List of Strides' plants in Africa**

Country	Type
Botswana	Packaging
Cameroon	Manufacturing
Mozambique	Manufacturing
Namibia	Packaging
Nigeria	Manufacturing
Sudan	Manufacturing

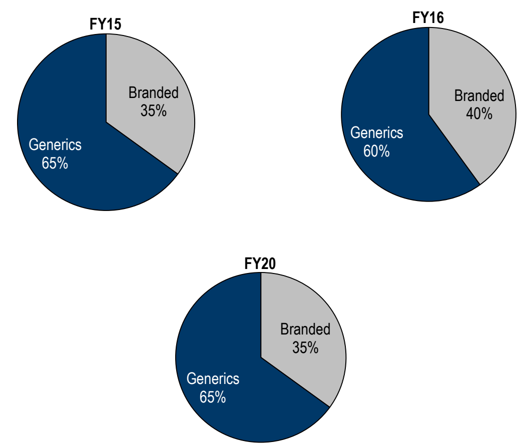
Source: Company data, Credit Suisse estimates

Figure 42: **Strides Africa revenue expected to grow at 30%-plus CAGR**



Source: Company data, Credit Suisse estimates

Figure 43: **Generic sales to remain at 65% levels, driven by local manufacturing led growth**



Source: Company data, Credit Suisse estimates

Inorganic activity will be required to reach US$200 mn

In order to reach the level of US$200 mn by FY20, Strides might need to go for the inorganic route as well. Strides' management has highlighted the following areas for acquisition in Africa.

In order to reach the level of US$200 mn by FY20, Strides might need to go for the inorganic route as well.

1. **Facilities:** Acquisitions of companies firmly entrenched in the business having manufacturing facilities

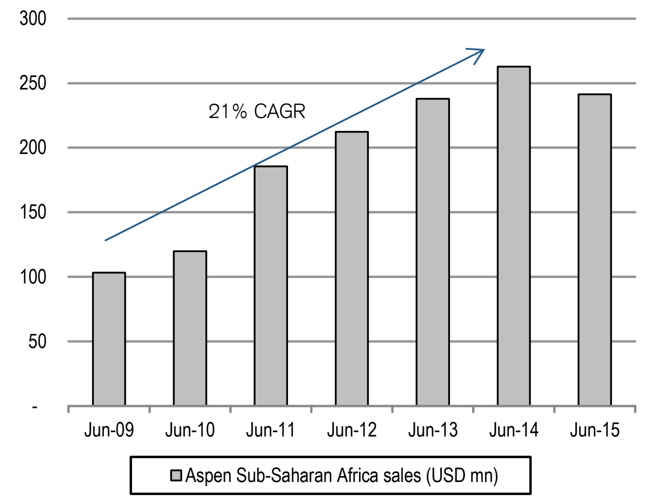
2. **Local/MNC brands**: Strides can buy the brands and manufacture from their own facilities

Aspens case shows that US$200 mn target is achievable

Strides intends to reach US$200 mn in Africa over the next five years. We map Aspen's journey to being a US$200 mn company in Sub-Saharan Africa (ex-South Africa). Aspen is present in 48 countries in the Sub-Saharan Africa region (SSA) with more than 200 distributors and a sales force of more than 700 people. Strides intends to increase the field force to 600 over the next five years and will be similar to Aspen's field force size in Africa.

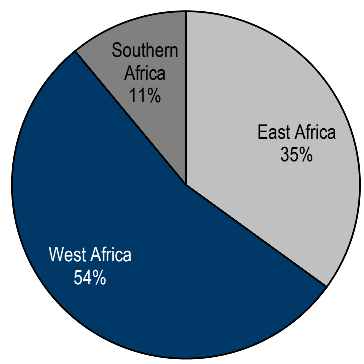
Aspen began its (SSA) journey with acquisition of Shelys (Tanzania, Kenya and Uganda) and "Collaboration" with GSK to sell GSK's and Aspen's products in 2009. From revenues of US$100 mn in FY06/09, Aspen reached revenues of US$200 mn in FY06/12. A large part of the growth was led through the GSK Collaboration which is the highest contributor. Aspen is present through Shelys in East Africa, has a subsidiary in Nigeria and exports directly from South Africa to other SSA countries.

Figure 44: **Aspen's Sub-Saharan revenues have witnessed a CAGR of 21% over 2009-14**



Source: Company data

Figure 45: **Aspen's sales split in sub-Saharan Africa**



Source: Company data

Execution is key for acquisitions to deliver

Acquisitions are going to form 50%-plus of revenues, and execution will be key for Strides

Acquisitions are going to form 50%-plus of revenues, and execution will be key for Strides as (1) its Australian business faces regulatory and margin headwinds, (2) the Shasun acquisition requires integration of R&D, an increase in the filing rate, and backward integration, (3) the India business is still sub-scale and Strides also needs to revive the growth in the India business, (4) the Sovaldi opportunity is lower than peers, given Strides lacks focus on Gastroenterologists in India.

For Australia, Strides has taken steps to ensure streamlined execution such as getting the ex-Ascent head Mr Dennis Bastas to run the Australian operations and transfer products to India to counter the PBS impact. On Sovaldi, Strides has already started selling in a couple of EMs and started the process for other key markets. A strong Africa presence should also help Strides, once the donor funding for Sovaldi is assigned.

Australia: Regulatory headwinds + margin pressures

Strides acquired the Australian generics business of Aspen (Arrow Pharma) in May-15, post the expiry of three years of non-compete clause which got over in Jan-15. Arrow Pharma had revenues of US$95 mn with EBITDA margins of 31%. The total consideration for the acquisition is ~US$300 mn. The acquisition is a re-entry into the familiar territory of Australia, where Strides had earlier built and sold Ascent business (see details in section 1).

The acquisition comprises two parts:

1. A generic portfolio of 130-plus products, and a pipeline of 51 products—this portfolio had revenues of US$84 with PBT margins of 25%.
2. Six branded products having revenues of US$12 mn, with high PBT margins of 80%-plus

The valuation for the both the segments is similar at 10x EV/EBITDA. The headline margins of 31% are actually driven by the branded segment (where growth will be lower) and the generic margins are in the ~25% range. Since these margins are for the carved-out portfolio, they do not include corporate overheads, which could be in the 3-4% range. Hence, the headline margin for Strides is in the 27-28% range and faces headwinds from (1) PBS reforms, and (2) the erosion in the branded prescription segment.

Figure 46: **Aspen's Australia acquisition consisted of generics and six branded products**

Portfolio	No of products	Revenues (US$ mn)	PBT (US$ mn)	PBT margins	Consideration (US$ mn)
Generics + OTC (Chemist's Own range)	130; pipeline of 51 products	84	21	25%	208
Branded prescription products	6	12	10	83%	92
Total		**95**	**31**	**32%**	**300**

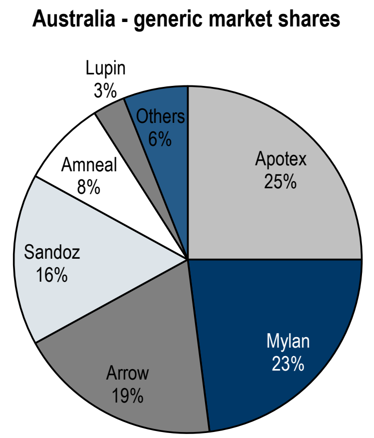
Source: Company data, Credit Suisse

Arrow is well positioned…

Arrow is the second-largest player in the Australian market with more than 130 products in the market and a pipeline of another 51 products pending approval. In terms of market share, Arrow is the third-largest player. In addition, Arrow also has an OTC product range under the brand Chemist's Own. Arrow is the preferred generic drug partner to Sigma, the largest pharmacy wholesaler in Australia. The market is well-entrenched.

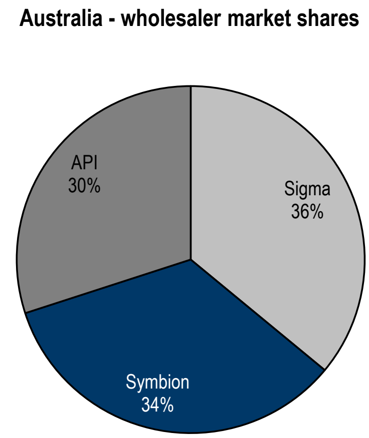
Strides has roped in the management team of erstwhile Ascent—Mr Dennis Bastas to run the business.

Figure 47: **Arrow is the third-largest generic player in Australia….**



Source: Company data

Figure 48: **…and is the preferred drug partner with Sigma, the largest pharmacy wholesaler**



Source: Company data

Figure 49: **Arrow's Chemists' Own brand (1)**

Source: Company data

Figure 50: **Arrow's Chemists' Own brand (2)**

Source: Company data

…but faces regulatory headwinds

The Australian healthcare market is largely government funded. The Australian government has undertaken a lot of its cost-cutting initiatives in the past few years with cuts in PBS (Pharmaceutical Benefits Scheme) spending. The key change in the PBS, which is slated to be implemented from 1 October 2016, is that for generic drugs; the originator brand's price will be excluded from the calculation of weighted average price. This will push the weighted average price down and lead to greater price percentage reductions for generic medicines in Australia. This could lead to 26-39% decrease in prices in few products. (Figure 51)

The Australian government has undertaken a lot of its cost-cutting initiatives in the past few years with cuts in PBS

Figure 51: **Change in PBS pricing could lead to 26-39% decline in prices**

Product	Old price (AUD)	New price (AUD)	Price decline
Atorvastatin	14.6	10.7	-27%
Clopidogrel	14.0	10.4	-26%
Rosuvastatin	29.7	18.3	-39%
Venlafaxine	16.5	11.7	-29%

Source: Australian government, Department of Health

The government also tried to introduce a co-payment fee for a doctor's visit—currently the doctor's cost is completely reimbursed by the government. Due to backlash, the government was not able to pass this co-payment fee, but can potentially be introduced in the future. The potential impact of this proposal could be a reduction of doctors' visits. This, in turn, may have an adverse impact on the number of scripts prescribed by doctors and dispensed, resulting in additional challenges for all industry participants.

Transferring products to India to help offset PBS pricing impact

According to management, the impact of PBS cuts could in the 3-4% range and the larger impact will be borne by pharmacies. Strides plans to mitigate the PBS impact by shifting production to India. Most of the production is currently outsourced and Strides supplies a certain portion (<15% in our view). Site-transfer requests are processed in six months by the Australian regulator and management expects to site-transfer most of the products within the next 12 months.

Strides plans to mitigate the PBS impact by shifting production to India

India: Yet to achieve scale; portfolio needs a growth booster

Strides has a small presence in India with Rs1 bn sales in FY15 (6% of FY17 sales accounting for all acquisitions). Strides did not have an Indian business until 2007 and entered the Indian market through the Grandix acquisition, which provided Strides with the ReNerve brand and presence largely in South India. In 2014, Strides acquired Raricap from Bafna (revenues of Rs200 mn). With Bafna, Strides' presence extended beyond South India to the whole of India.

Strides has a small presence in India with Rs1 bn sales in FY15

Recent acquisitions: Cheap but need growth revival

1. Strides acquired two CNS divisions of Ranbaxy (Solus + Solus care) for a consideration of Rs1.65 bn. The deal also involves transfer of employees. Revenue of these two divisions as per IMS is Rs920 mn as of twelve months ending July 2015. Headline multiple at 2x EV/sales looks cheap, given that most of the transactions recently in Indian Pharma have been done at 4-5x sales. In our view, the deal is done at a lower EV/sales multiple as the portfolio was growing slowly. This portfolio has not grown over last four year (as per IMS sales) as sales of two of the largest brands in the portfolio Diazepam (brand name: Calmpose) and Alprazolam (brand name: Anxinil) declined by more than 50%. The reasons were a combination of decline in molecule sales overall (old molecules), and Ranbaxy's lost market share.
2. Strides acquired seven brands from Johnson & Johnson in the dermatology, antiemetic and pain management therapies. The key products in the acquired portfolio include Otogesic eardrops, Ehnorub ointment and Stugil tablets. These three products have been flat over the last three years.
3. Strides has acquired a 51% stake in Medispan, a part of the Shriram Group, with a presence in probiotic, nutritional, anti-infective and gastrointestinal drugs. The brands that Strides will gain from Medispan include Lactovit and Lactogut. Revenue from this portfolio is ~Rs150-160 mn. Medispan's portfolio has posted at a CAGR of 23% over FY13-15.

With the recent acquisitions, Strides has completed its pan-India presence. Post the Ranbaxy integration, CNS will be the largest therapy for Strides. The key challenge for Strides is to revive growth in the Ranbaxy portfolio and the J&J legacy brands.

The key challenge for Strides is to revive growth in the Ranbaxy portfolio and the J&J legacy brands

Figure 52: **Strides will require to revive growth in the recent acquisitions**

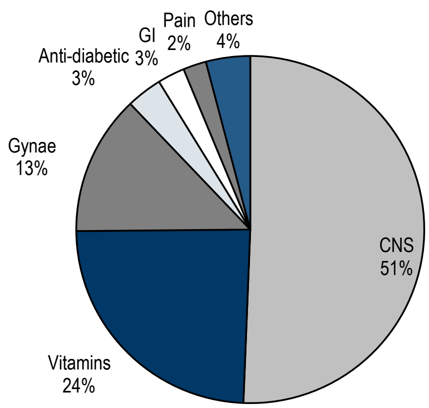
Brands	Revenues (Rs mn)	Acquisition date	Company	Y/Y growth FY13	FY14	FY15
Renerve	550	2007	Grandix	22%	24%	14%
Raricap	332	Sep-14	Bafna	21%	215%	17%
Recent acquisitions						
Solus + Solus Care	920	Sep-15	Ranbaxy CNS	-1%	-4%	0%
J&J brands	**170-180**	**Oct-15**				
Otogesic	60			10%	0%	-11%
Stugil	99			5%	1%	2%
Medispan	150-160	Oct-15	Sriram group	-3%	16%	30%

Source: Company data, Credit Suisse estimates

Expect more acquisitions in India

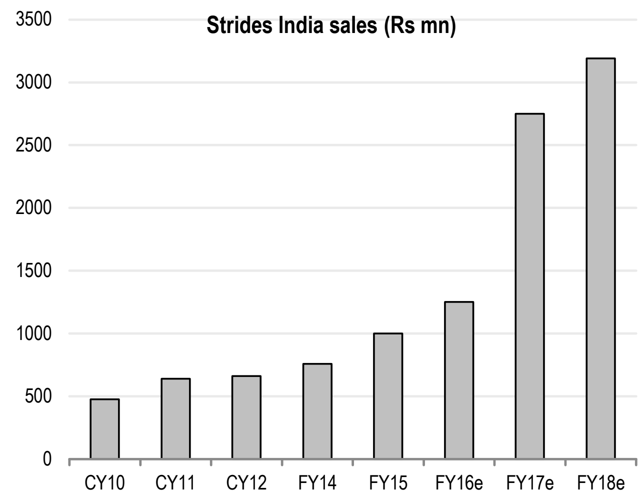
With the recently announced transactions, Strides can achieve scale of Rs2.5-3 bn by FY17. Strides has a target of achieving Rs5-6 bn scale over the next three-four years. We expect Strides to do more, albeit small acquisitions in the India space as it aims to achieve scale.

Figure 53: **CNS is the major therapy area post Ranbaxy portfolio acquisition**



Source: IMS ORG, Credit Suisse

Figure 54: **Strides will require to turn around the Ranbaxy portfolio to achieve 15-16% revenue growth**



Source: Company data, Credit Suisse estimates

Institutional: Backward integration to help

The Institutional business accounted for 32% of revenues (US$60 mn-plus) for Strides in FY15. The company's focus was primarily on the anti-retroviral space, where Strides has 17 approved PEPFAR filings. Strides entered the anti-malaria business last year after the WHO approval and is ramping up. Anti-malarial accounted for a third of the revenues in FY15. The margins for this segment are lower than the corporate margins, in our view, due to higher competition, lower scale and absence of backward integration.

Shasun's acquisition provides a kicker to this business and provides scale as it has US FDA plants and backward integration (API facility). Shasun already has a DMF filing for Tenofovir (anti-retroviral) and has commercialised Cycloserine drug (anti-TB) which complements Strides' institutional business. Shasun is expected to file DMFs for remaining products over the period of next 12-15 months. Growth in this segment will be driven by anti-malarial ramp-up, while profitability will be driven by backward integration, in our view.

Sovaldi: Expect slow ramp-up; potentially contingent on donor funding

Gilead out-licensed its Hepatitis-C drug Sovaldi (g. Sofosbuvir) to seven companies—Strides, Natco, Hetero, Mylan, Cadila, Cipla and Ranbaxy—in 2014 for manufacture and distribution in 91 emerging market countries including India. According to Gilead, there are over 100 mn people with Hep-C in these markets, but the detection rate is low.

Strides has launched the drug in India under the brand name Virso in Mar-15, which is supplied by Natco. Hep-C is treated by Gastroenterologists and Hepatologists, where Strides coverage is negligible. Hence, Strides has not been able to garner a high market share in India. In the EMs, Strides has started selling Sofosbuvir in a couple of markets in the Sep-15 quarter. Strides expects Africa and CIS markets the key for Virso. In Africa, Hep-C market is expected to be donor funded, and currently there is a very small market in absence of donor funding.

In Africa, the Hep-C market is expected to be donor funded, and currently there is a very small market in absence of donor funding.

We build in a slow ramp-up for Sofosbuvir for Strides and has the potential to become a significant opportunity when (1) diagnosis and awareness of the disease increases, and (2) donor funding is available in African markets.

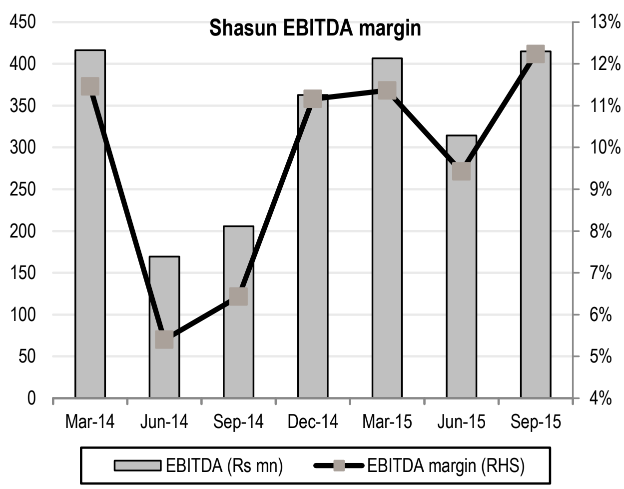
PSAI business: Backbone for backward integration; CRAMS business can throw up surprises

About 79% of Shasun's revenues was from API and CRAMs businesses. The company has a portfolio of 43 commercialised DMFs and another 23 under development. Strides intends to use this division for backward integration and defocus on external sales. Shasun does have some interesting DMFs like Sevelemar Hydrochloride and Sevelemar Carbonate (combined brand size of US$1 bn-plus), Welchol and Lyrica. In addition to API revenues, there could be possible upside if Shasun is the formulation supplier for any of these products. We have not built-in any formulation revenues from these opportunities.

In UK CRAMS, Strides expects a couple of products to be commercialised in the next 9-12 months, which could drive profitability.

The UK CRAMS business was loss-making in the past 24 months, due to black box warning for one of the key products and this impacted Shasun's margins significantly. The company has turned around the business with a few order wins, and a margin recovery is visible at Shasun. Strides expects a couple of products to be commercialised in the next 9-12 months, which could drive profitability.

Figure 55: Shasun EBITDA margins have started showing signs of recovery



Source: Company data, Credit Suisse estimates

Initiate with OUTPERFORM and TP of Rs1,720

Strides is trading at 18.9x FY17E P/E, a 10% discount to the mid-cap peers and the sector average. We value the company at 20x Sep-17E earnings (in line with peers) and expect Strides to re-rate with improving RoCE. We initiate coverage on Strides with an OUTPERFORM rating and a Rs1,720 target price.

The company has built a strong business model, which provides it medium-term growth visibility with 15-16% revenue and 18-20% EBITDA growth. With potential free cash flow generation (~US$125 mn over the next two years), we expect Strides to strengthen its balance sheet and reduce net debt/EBITDA to under 2x. The proposed fund-raising could fast-track the reduction.

The company has built a strong business model which provides medium-term growth visibility with 15-16% revenue and 18-20% EBITDA growth.

While acquisitions have been accretive to earnings and have enhanced growth profile, they have been a drag on the returns. With improvement in EBITDA margins, and improving asset utilisations, we expect RoCEs to improve to 15% (from 8%) by FY18. The market has rewarded the acquisition-led-growth and the company has re-rated over the past year, but the stock trades at a discount to other small/mid-cap peers, despite similar/better growth profile due to the lower returns.

Business model can deliver 15-16% organic growth over the medium term…

In our view, Strides' revenues are expected to grow ~25% over the next two years, driven by higher US and Africa growth and the base effect of Arrow and India acquisitions. Over the medium term, its business model has sales growth potential of 15-16% beyond FY18. PSAI and Australia businesses could be drags on its revenue growth, whereas the US, Africa and India are likely to be the key growth drivers. Growth for the Institutional business will likely be driven by Sovaldi and Anti-Malaria (aided by backward integration from Shasun). The PSAI , in the next year, will be driven by launches in Shasun's CRAMs portfolio.

Figure 56: **Strides can deliver 18% growth in the medium term**

	FY16 sales split	FY16-18 growth CAGR	FY18 sales split	Normalised growth CAGR
US	16%	44%	21%	28-30%
Other reg mkts	10%	15%	8%	10-12%
Australia	11%	45%	15%	8%
Africa	12%	30%	12%	20%
India	4%	60%	7%	14-15%
Institutional	15%	17%	13%	13-14%
PSAI	30%	12%	25%	10%
		26%		**15-16%**

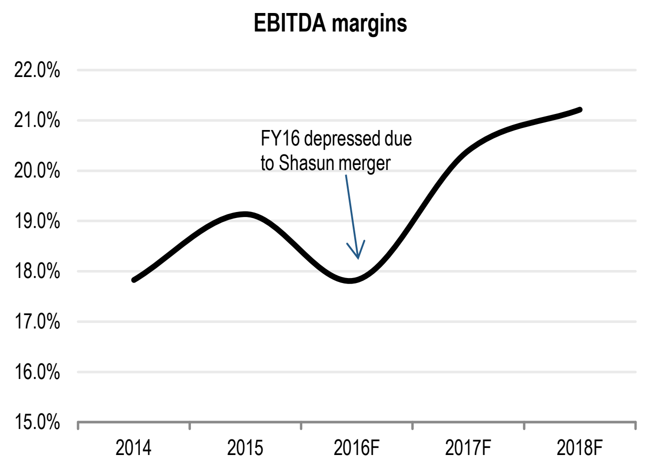
Source: Company data, Credit Suisse estimates

…margins to improve with improving mix

We expect margins for Strides to improve from 17.8% in FY16 to 21.4% in FY18, driven by full-year integration of Australia—the Australia portfolio has margins of 27-28%. On an organic basis, we expect margins to improve 100-150 bps annually, driven by the US business, the operational leverage in Africa and India businesses, and the backward integration benefit from Shasun. The Shasun portfolio has already started margin improvement on a quarter on quarter basis and Strides expects to improve margins further as a couple of products are expected to be commercialised from Shasun's CRAMS portfolio.

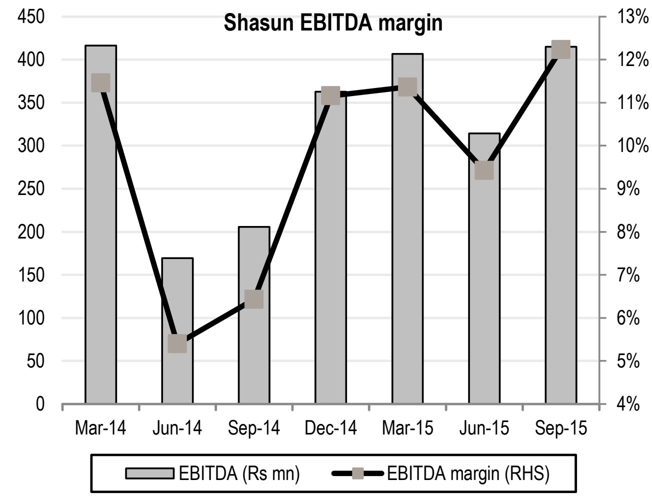
We expect margins for Strides to improve from 17.8% in FY16 to 21.4% in FY18

Figure 57: **Consolidated EBITDA margins expected to improve**



Source: Company data, Credit Suisse estimates

Figure 58: **Shasun EBITDA margin has started showing signs of recovery**



Source: Company data, Credit Suisse estimates

RoCE improvement, driven by margin expansion and asset utilisations

Strides' RoCE for FY14 and FY15 was impacted due to lower margin post exit from Agila and high capex to re-build the business. FY16 ROCE was impacted due to multiple acquisitions. However, with acquisitions getting integrated, pick-up in sales growth, low capex and improvement in margins, we expect ROCE to improve to ~15% by FY18. Excluding the Shasun acquisition GW, ROCE is expected to increase to 17% by FY18.

Figure 59: **ROCE is expected to expand to 15% (17% excluding Shasun GW)**

Dupont (RoCE)	2015	2016F	2017F	2018F
EBIT margin	14%	12%	17%	18%
Asset turns (Sales/ Gross Block) (incl. intangibles)	1.3x	0.9x	1.0x	1.2x
Gross Block/ Capital Employed	0.5x	0.6x	0.7x	0.7x
ROCE	8%	6%	12%	15%

Source: Company data, Credit Suisse estimates

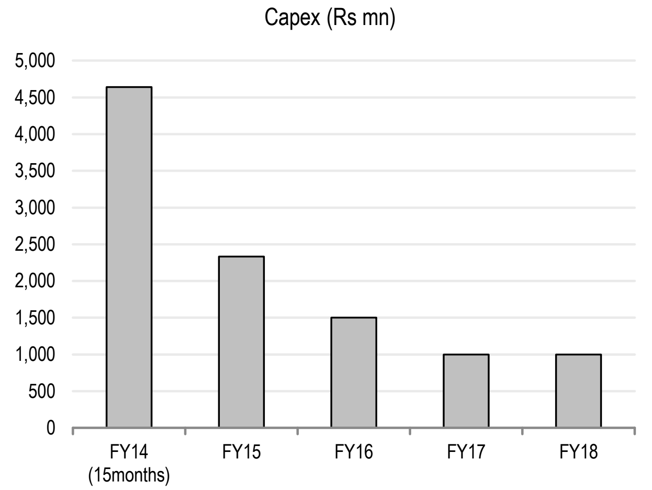
Strong cash generation and fund-raising help strengthen balance sheet

Post the Arrow (funded through debt) and Shasun (brought in debt of ~US$110 mn) acquisitions, Strides' balance sheet has become stretched with a net debt of close to US$400 mn, and net debt/EBITDA of ~5x. We expect Strides to generate strong cash flows over the next couple of years of ~US$125 mn, which should lead to net debt/EBITDA ratio to improve to ~2x by FY18.

We expect Strides to generate strong cash flows over the next couple of years of ~US$125 mn,

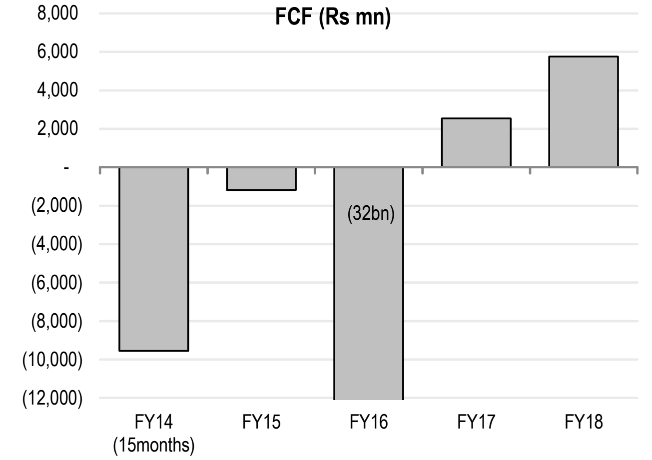
Strides has announced a fund-raising plan for ~US$230 mn (Rs1.5 bn) by way of issue of GDR/ADR/FCCBs/QIP or any other equity linked instruments. Management has highlighted that close to half of these funds will be used to repay debt. Strides intends to use the other half for working capital needs and additional acquisitions. In the absence of any acquisitions, with the capital infusion, Strides net debt/EBITDA will be under 2x for FY16 itself.

Figure 60: Large part of capex is complete



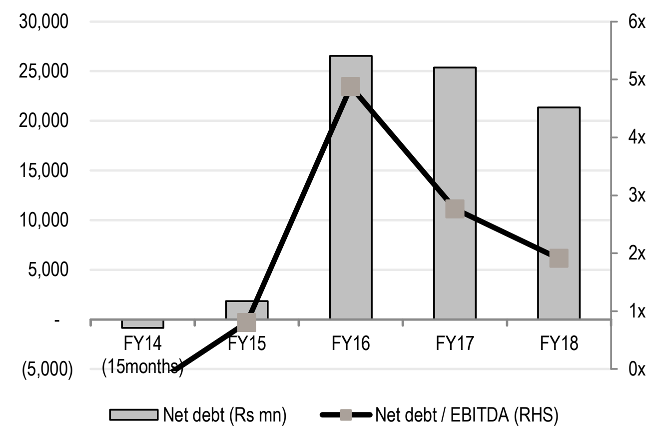
Source: Company data, Credit Suisse estimates

Figure 61: FCF generation is expected to be strong



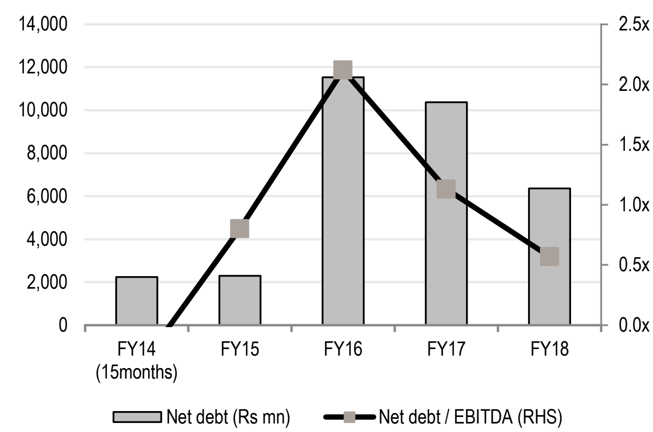
Source: Company data, Credit Suisse estimates

Figure 62: Net debt/EBITDA expected to reduce to 2x by FY18…



Source: Company data, Credit Suisse estimates

Figure 63: …fund raising can fast track the reduction (in absence of any new acquisition)

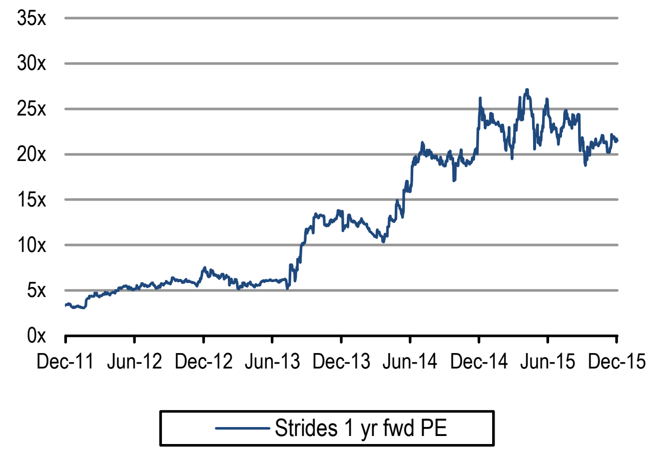


Source: Company data, Credit Suisse estimates

Strides has re-rated with the acquisitions

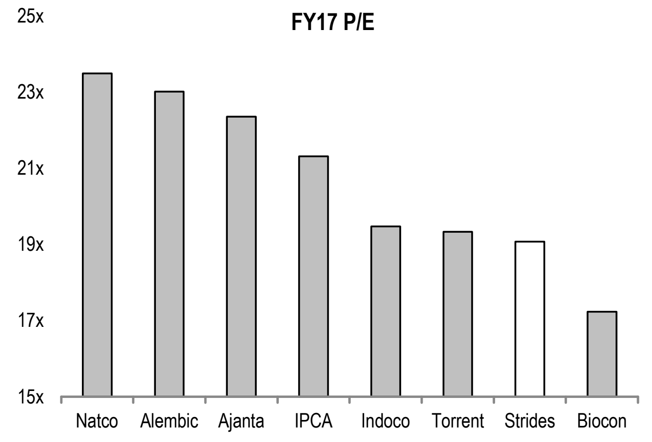
Strides has re-rated over the past 18 months along with the acquisitions and trades at 20x one-year forward P/E and 19x FY17E earnings. But compared to peers, Strides trades at lower multiple despite having a higher earnings CAGR, given its lower RoCE profile due to acquisitions.

Figure 64: Strides has re-rated post the acquisitions…



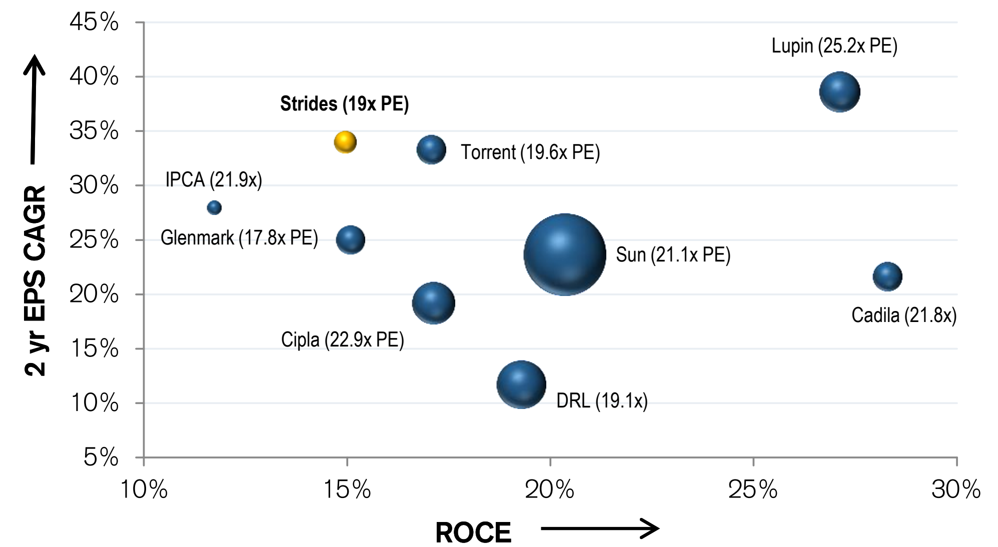
Source: IBES, Credit Suisse estimates

Figure 65: …but trades cheaper than other mid-cap peers



Source: Company data, Credit Suisse estimates

Figure 66: Strides could see higher earnings CAGR over next two years, but lower RoCE than peers due to acquisitions—hence trades at a discount



Size of the bubble represent the revenues; PE ratio is on FY17 earnings.
Source: Company data, Credit Suisse estimates

Valuation comparison

Figure 67: **Valuation comparison of Indian pharma companies**

9-Dec-2015	Mcap (US$ mn)	CMP	Rating	TP	Upside/ (down-side) (%)	Sales ($mn) FY16	Sales ($mn) FY17	EBITDA margin (%) FY16	EBITDA margin (%) FY17	EPS growth (%) FY16	EPS growth (%) FY17	PE (x) FY16	PE (x) FY17	PB (x) FY16	PB (x) FY17	RoE (%) FY16	RoE (%) FY17	EV/EBITDA (x) FY16	EV/EBITDA (x) FY17
India																			
Sun	27,780	771	N	775	1%	4,318	4,975	32.6	37.7	34	35	30.5	22.6	5.8	4.8	19	21	19.0	13.8
Lupin	12,054	1,803	O	2,150	19%	2,124	2,792	24.1	29.6	-14	70	39.2	23.1	7.6	5.9	19	26	23.0	15.1
Dr. Reddy's	7,778	3,071	N	3,600	17%	2,571	2,736	26.0	24.2	26	0	18.6	18.6	3.9	3.3	21	18	11.9	11.5
IPCA	1,411	750	O	800	7%	719	818	14.4	18.7	6	77	37.9	21.4	3.9	3.4	10	16	21.0	13.7
Glenmark	3,760	929	U	805	-13%	1,182	1,392	22.6	23.6	18	31	27.8	21.3	5.5	4.4	20	21	16.2	12.8
Cipla	7,730	642	O	750	17%	2,219	2,641	23.1	21.7	66	20	26.4	22.0	4.1	3.5	15	16	15.3	14.6
Cadila	6,048	394	U	360	-9%	1,520	1,809	20.9	20.6	33	20	26.5	22.0	7.6	6.2	29	28	19.9	16.7
Strides	**1,670**	**1,382**	**O**	**1,720**	**25%**	**500**	**673**	**16.7**	**20.4**	**48**	**25**	**32.4**	**18.8**	**4.3**	**3.4**	**18**	**20**	**18.4**	**12.3**
India – not covered																			
Aurobindo	6,982	798				2,139	2,462	23	24	28	24	22.9	18.4	6.7	5.0	33	30	15.2	12.5
Alembic	1,961	694				463	501	27	23	107	-3	22.8	23.0	8.8	6.8	50	35	15.9	16.9
Ajanta	1,663	1,261				263	318	34	34	25	26	28.1	22.4	9.6	7.0	36	33	18.8	15.3
Indoco	1,670	1,382				500	673	19	21	68	65	31.5	19.1	6.1	4.7	24	28	18.4	12.3
Natco	438	317				152	188	19	21	25	49	28.7	19.5	4.9	4.1	18	22	15.1	11.1
Unichem	1,338	511				116	170	28	29	46	34	43.6	23.5	8.2	6.3	20	28	43.0	28.2

Source: Company data, Credit Suisse estimates

Strides on CS HOLT®

To overlay an objective and independent valuation framework to our forecasts, we link our expectations to the HOLT framework.

Figure 68: CS HOLT valuation implies 41% potential upside

HOLT - Credit Suisse Analyst Scenario Data

STRIDES ARCOLAB LIMITED. (STAR)

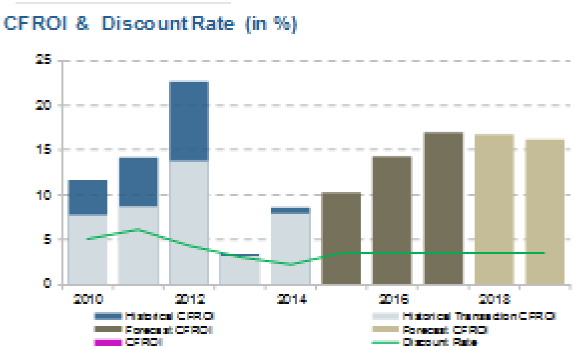
Current Price : INR 1373.30 Warranted Price : INR 1947.60 Valuation date: 09-Dec-15

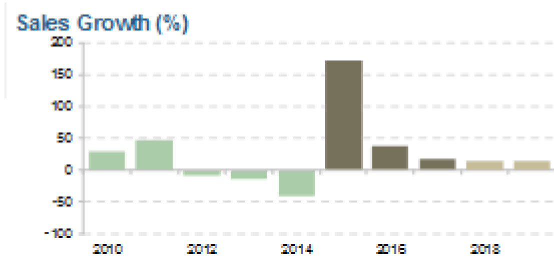
EBITDA Margin (parallel % point change to forecasts) vs. Sales Growth (parallel %point change to forecasts)

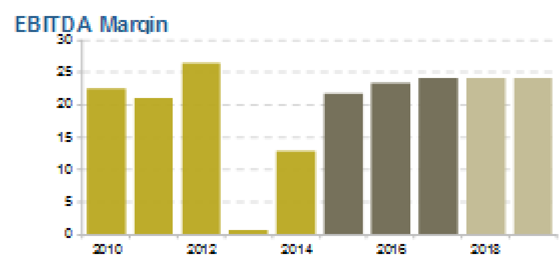
INR	-2.0%	-1.0%	0.0%	1.0%	2.0%
-2.0%	7%	16%	26%	36%	48%
-1.0%	14%	23%	34%	45%	57%
0.0%	21%	31%	42%	54%	66%
1.0%	28%	39%	50%	62%	75%
2.0%	35%	46%	58%	71%	85%

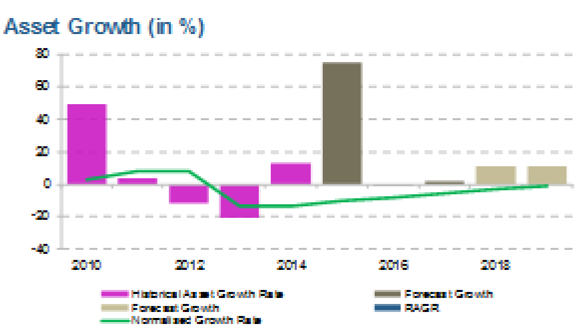
More than 10% downside | Within 10% | More than 10% upside

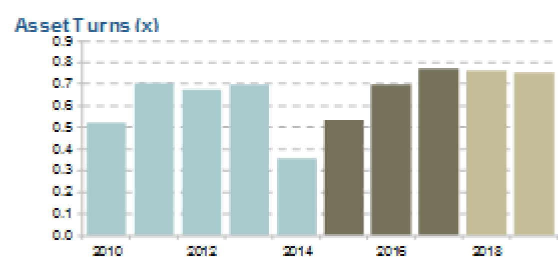
	Mar 14A	Mar 15A	Mar 16E	Mar 17E	Mar 18E
Sales Growth, %	-13.0	-40.4	172.1	37.4	17.9
EBITDA Mgn, %	0.6	12.9	21.6	23.3	24.2
Asset Turns, x	0.70	0.4	0.5	0.7	0.8
CFROIS, %	3.5	8.6	10.3	14.3	17.0
Disc Rate, %	3.1	2.3	3.5	3.5	3.5
Asset Grth, %	-21.0	13.1	74.6	-0.5	2.0
Value/Cost, x	1.3	2.7	2.5	2.4	2.2
Economic PE, x	37.0	30.8	24.2	16.4	12.7
Leverage, %	12.1	19.4	26.0	23.5	20.8











Source: Credit Suisse HOLT®. CFROI and HOLT are trademarks or registered trademarks of Credit Suisse Group AG or its affiliates in the United States and other countries.

Source: Credit Suisse HOLT®

The charts reflect our forecasts for sales, margins, and returns. Based on our assumptions, HOLT calculates CFROI® of 10.33% to 16.97% from 3/2016 to 3/2018. Thereafter, we normalise sales growth and EBITDA margins to a medium-term average of 15% and 24%, respectively, leading to a CFROI average of 16.2%—reflecting the monetisation potential of the new business model coupled with the Shasun integration.

Beyond the explicit forecast window of five years, HOLT assumes the CFROI and discount rate fade to 6%, while asset growth fades to 2.5%—incorporating the economic reality of competition which causes the CFROI and growth rate to regress to the mean. We also review the HOLT default discount rate of 2.4%, particularly generous level for Strides given the huge build up in leverage post acquisition from Aspen and the Shasun amalgamation. We apply a 3.5% rate to account for the higher risk owing to this leverage increase.

The above assumptions suggest a HOLT-warranted price of Rs1,947.50 per share as compared to our target price of Rs1,720, suggesting 42% upside to Strides' current share price of Rs1,381.

Investment risks

Higher-than-expected PBS impact

The Australian government can change the pricing mechanism for generics in the future as well. Any adverse pricing could lead to loss of sales and margin pressures. Also the government has unsuccessfully tried to implement other cost-cutting measures as well like introducing a co-payment fee for a doctor's visit—currently the doctor's cost is completely reimbursed by the government. Due to backlash, the government was not able to pass this co-payment fee, but it can potentially be introduced in the future. The potential impact of this proposal could be a reduction of doctors' visits. This, in turn, may have an adverse impact on the number of scripts prescribed by doctors and dispensed, resulting in additional challenges for all industry participants.

Execution risks: Failure to integrate the acquired business

Acquisitions will account for more than 50% of revenues in FY17. A large part of the growth and margin expansion is expected to be driven by successful integration of the acquired businesses. High integration costs or delay in achieving synergies could be a drag on earnings and stock.

Delay in US filings / approvals

Filings are expected to pick up materially for Strides from 2H FY16 and further in FY17/18. Any delay in filings would mean delay in approvals and de-rail the US growth story. Also, any adverse FDA inspection could mean delay in approvals—Strides does not have any pending 483s from the FDA.

Adverse business environment in Africa

The African economy is driven by commodities, and commodity prices have fallen over the past 12-15 months. Any further deterioration in prices could lead to weakness in the economy thereby impacting growth prospects. Also, currency fluctuation is a risk, especially in Nigeria.

Also, there has been political instability in a few countries (including Nigeria). Strides is banking on local manufacturing to drive growth in its generic segment. Any adverse change in government policy could lead to loss of business for Strides.

Financials

Figure 69: **Financials**

Year-end 31 Mar (Rs mn)	2014	2015	2016F	2017F	2018F
Income statement					
Revenues	**13,410**	**11,958**	**32,542**	**44,983**	**52,703**
Expenses	11,175	9,670	26,740	35,806	41,521
EBITDA	**2,234**	**2,289**	**5,801**	**9,177**	**11,182**
Depreciation and amortisation	565	640	1,399	1,516	1,616
EBIT	**1,669**	**1,648**	**4,402**	7,661	9,565
Non-operating income/(expense)	(486)	(89)	(143)	(458)	(351)
Profit before Tax	**1,183**	**1,560**	**4,260**	7,203	9,214
Income Tax	409	532	835	1,329	1,707
Net profit (after exceptional items)	**768**	**1,033**	**3,431**	5,882	7,519
EPS (Rs)	**58**	**17**	**43**	**73**	**93**
Balance sheet					
Cash and cash equivalents	6,324	7,082	8,578	4,749	3,576
Receivables	3,640	3,900	9,714	14,173	16,605
Inventory	1,760	2,077	6,793	9,859	11,551
Other current assets	1,363	1,236	4,335	4,998	5,856
Total current assets	**13,086**	**14,294**	**29,419**	**33,779**	**37,588**
Net fixed assets	4,383	5,812	12,489	11,972	11,356
Intangibles	2,157	2,914	28,170	28,170	28,170
LT investments	418	688	952	952	952
Other assets	946	1,154	1,311	1,311	1,311
Total other assets	**7,904**	**10,567**	**42,921**	**42,405**	**41,789**
Total assets	**20,990**	**24,861**	**72,340**	**76,183**	**79,376**
Short-term debt	2,711	6,243	24,579	21,079	17,578
Payables	2,623	2,344	6,534	8,627	10,107
Other current liabilities	1,740	1,612	3,369	5,623	6,588
Total current liabilities	**7,074**	**10,199**	**34,483**	**35,328**	**34,273**
Long-term debt	2,755	2,674	10,527	9,028	7,528
Total other liabilities	3,092	3,026	10,923	9,424	7,925
Total liabilities	**10,166**	**13,225**	**45,406**	**44,752**	**42,198**
Total equity	**10,825**	**11,636**	**26,934**	**31,431**	**37,178**
Cash Flow Statement					
Net profit	**17,667**	**8,450**	**3,431**	**5,882**	**7,519**
Depreciation and amortisation	565	640	1,399	1,516	1,616
Change in working capital	712	(857)	(2,871)	(3,843)	(2,537)
Operating cash flow	**18,944**	**8,234**	**1,959**	**3,555**	**6,598**
Change in fixed assets	5,615	(2,069)	(8,076)	(1,000)	(1,000)
Change in other assets	20,201	(965)	(25,413)	0	0
Total investment cash flow	**25,397**	**(3,303)**	**(33,754)**	**(1,000)**	**(1,000)**
Change in gross debt	(11,852)	3,466	26,234	(5,000)	(5,000)
Change in equity	(27,514)	(6,890)	12,676	0	0
Dividend paid	(348)	(179)	(803)	(1,376)	(1,759)
Total financing cash flow	**(39,676)**	**(4,173)**	**38,100**	**(6,384)**	**(6,771)**
Total cash flow	**4,666**	**758**	**6,305**	**(3,829)**	**(1,173)**

Note: 2014 is taken as a 15-month period.

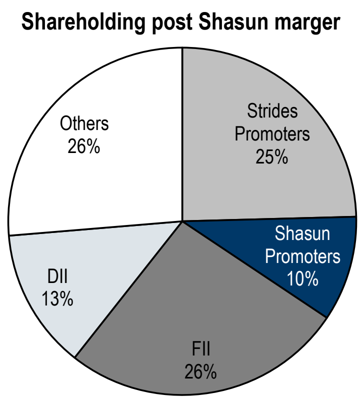
Source: Company data, Credit Suisse estimates

Appendix

Shareholding

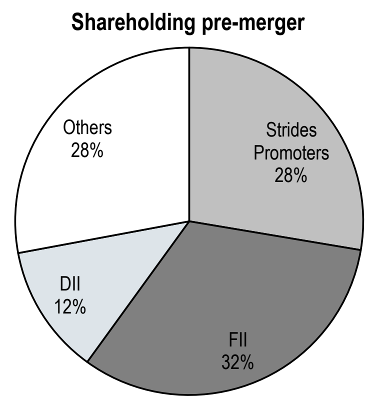
Post the Shasun merger, the promoter holding base has widened for Strides as promoters for Shasun have been included as promoters for the new Strides Shasun Limited. Shareholding of the erstwhile promoters of Strides has reduced to 25% (effective holding is lower at 23% since 4% is held by SeQuent where promoters have a 57% share). Shasun's promoter family holds 10%, while FII holding is 26%

Figure 70: **Strides shareholding post the merger**



Source: Company data, BSE

Figure 71: **Strides shareholding pre merger**



Source: BSE

Management team

Figure 72: **Key management profile**

Arun Kumar	Founder and Promoter Director	Mr. Arun Kumar is the Founder and Promoter Director of the Company and has been on the Board as Managing Director since its inception in 1990.
S Abhaya Kumar	Shasun promoter, Executive Director	Mr. S. Abhaya Kumar was the Managing Director of Shasun. He is a chemical engineer and as such has been instrumental in honing the technical aspects of the Shasun offering.
Badree Komandur	CFO and Company Secretary	Mr. Badree Komandur joined Strides in March 2010. As the Chief Financial Officer of the Company, Mr. Badree is responsible for Finance, Taxation, Treasury, Information Technology and Investor Relations
Mohan Kumar	CEO - Pharma	Mr. Mohan Kumar has over 35 years of Operational and Commercial experience in the Pharmaceutical Industry both in India and overseas. He has been with Strides since its inception in 1990. Mohan has served in various key roles for the company throughout his career with Strides.
Sinhue B. Noronha	CEO - Africa	Mr. Noronha has over 28 years of in-depth experience in the pharmaceutical industry, 20 years of which have been in international marketing and largely in Africa.

Source: Company data

Companies Mentioned *(Price as of 09-Dec-2015)*

Ajanta Pharma (AJPH.NS, Rs1260.9)
Alembic Pharma (ALEM.BO, Rs668.6)
Allergan (AGN.N, $310.47)
Aspen Pharmacare Holdings Ltd (APNJ.J, R301.94)
Aurobindo Pharm (ARBN.BO, Rs786.65)
Biocon (BION.BO, Rs462.55)
Cadila Healthcare (CADI.BO, Rs385.0)
Cipla Limited (CIPL.BO, Rs623.4)
Divi's (DIVI.BO, Rs1121.45)
Dr. Reddy's Laboratories Limited (REDY.BO, Rs2997.3)
Glenmark Pharmaceuticals (GLEN.BO, Rs882.25)
IPCA Laboratories Limited (IPCA.BO, Rs759.15)
Indoco Remedies (INRM.NS, Rs317.3)
Lupin Ltd (LUPN.BO, Rs1761.05)
Natco Pharma (NATP.NS, Rs511.4)
Strides Shasun (STAR.NS, Rs1381.85)
Strides Shasun Limited (STAR.BO, Rs1381.6, OUTPERFORM, TP Rs1720.0)
Sun Pharmaceuticals Industries Limited (SUN.BO, Rs758.8)
Torrent Pharma (TORP.BO, Rs1442.45)
Unichem (UNLB.NS, Rs270.2)

Disclosure Appendix

Important Global Disclosures

Chunky Shah and Anubhav Aggarwal each certify, with respect to the companies or securities that the individual analyzes, that (1) the views expressed in this report accurately reflect his or her personal views about all of the subject companies and securities and (2) no part of his or her compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

The analyst(s) responsible for preparing this research report received Compensation that is based upon various factors including Credit Suisse's total revenues, a portion of which are generated by Credit Suisse's investment banking activities

As of December 10, 2012 Analysts' stock rating are defined as follows:

Outperform (O) : The stock's total return is expected to outperform the relevant benchmark*over the next 12 months.

Neutral (N) : The stock's total return is expected to be in line with the relevant benchmark* over the next 12 months.

Underperform (U) : The stock's total return is expected to underperform the relevant benchmark* over the next 12 months.

**Relevant benchmark by region: As of 10th December 2012, Japanese ratings are based on a stock's total return relative to the analyst's coverage universe which consists of all companies covered by the analyst within the relevant sector, with Outperforms representing the most attractive, Neutrals the less attractive, and Underperforms the least attractive investment opportunities. As of 2nd October 2012, U.S. and Canadian as well as European ratings are based on a stock's total return relative to the analyst's coverage universe which consists of all companies covered by the analyst within the relevant sector, with Outperforms representing the most attractive, Neutrals the less attractive, and Underperforms the least attractive investment opportunities. For Latin American and non-Japan Asia stocks, ratings are based on a stock's total return relative to the average total return of the relevant country or regional benchmark; prior to 2nd October 2012 U.S. and Canadian ratings were based on (1) a stock's absolute total return potential to its current share price and (2) the relative attractiveness of a stock's total return potential within an analyst's coverage universe. For Australian and New Zealand stocks, the expected total return (ETR) calculation includes 12-month rolling dividend yield. An Outperform rating is assigned where an ETR is greater than or equal to 7.5%; Underperform where an ETR less than or equal to 5%. A Neutral may be assigned where the ETR is between -5% and 15%. The overlapping rating range allows analysts to assign a rating that puts ETR in the context of associated risks. Prior to 18 May 2015, ETR ranges for Outperform and Underperform ratings did not overlap with Neutral thresholds between 15% and 7.5%, which was in operation from 7 July 2011.*

Restricted (R) : In certain circumstances, Credit Suisse policy and/or applicable law and regulations preclude certain types of communications, including an investment recommendation, during the course of Credit Suisse's engagement in an investment banking transaction and in certain other circumstances.

Volatility Indicator [V] : A stock is defined as volatile if the stock price has moved up or down by 20% or more in a month in at least 8 of the past 24 months or the analyst expects significant volatility going forward.

Analysts' sector weightings are distinct from analysts' stock ratings and are based on the analyst's expectations for the fundamentals and/or valuation of the sector* relative to the group's historic fundamentals and/or valuation:

Overweight : The analyst's expectation for the sector's fundamentals and/or valuation is favorable over the next 12 months.

Market Weight : The analyst's expectation for the sector's fundamentals and/or valuation is neutral over the next 12 months.

Underweight : The analyst's expectation for the sector's fundamentals and/or valuation is cautious over the next 12 months.

**An analyst's coverage sector consists of all companies covered by the analyst within the relevant sector. An analyst may cover multiple sectors.*

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Global Ratings Distribution

Rating	Versus universe (%)	Of which banking clients (%)
Outperform/Buy*	58%	(33% banking clients)
Neutral/Hold*	29%	(34% banking clients)
Underperform/Sell*	12%	(25% banking clients)
Restricted	1%	

**For purposes of the NYSE and NASD ratings distribution disclosure requirements, our stock ratings of Outperform, Neutral, and Underperform most closely correspond to Buy, Hold, and Sell, respectively; however, the meanings are not the same, as our stock ratings are determined on a relative basis. (Please refer to definitions above.) An investor's decision to buy or sell a security should be based on investment objectives, current holdings, and other individual factors.*

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Price Target: (12 months) for Strides Shasun Limited (STAR.BO)

Method: Our target price of Rs1,720 for Strides is based on 20x Sep-17E earnings per share (in-line with peers). Strides has re-rated since Jun-14 along with acquisitions, but trades lower than peers due to lower RoCE (return on capital employed). We expect the discount to reduce as RoCE improves.

Risk: Risks that could impede achievement of our target price of Rs1,720 for Strides Shasun Limited include: (1) Higher than expected impact of PBS cuts, (2) Integration issues w.r.t acquisition, (3) adverse currency movements.

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