Strides margin to improve on Ascent sale

Deal proceeds will help deleverage balance sheet and invest in fast growing specialty injectibles business

UJJVAL JAUHARI

It is not surprising that Strides Arcolab's stock has risen sharply after the company announced stake sale in its low-margin subsidiary, Ascent Pharma. After this news, in just five trading sessions, the stock has risen 29 per cent to ₹526 — its all-time high. The all-cash deal involves Strides selling its 94 per cent stake in the subsidiary to Watson Pharma at an enterprise value of $393 million.

Strides, which will get $370 million for its stake, will be able to drastically cut its gross debt of close to ₹2,625 crore and save on interest costs. And, will still have cash to fund expansion in its fast growing core specialty business, comprising sterile products (around 44 per cent of its portfolio at present). Absence of the low-margin generics business will also mean overall margins will improve by around 500 basis points, say analysts (one percentage point is 100 bps).

Against this backdrop, and even after the recent rise, most analysts remain positive on the stock. Even as the consensus target price for the stock earlier stood at ₹522.71, analysts are raising it after announcement of the deal. For instance, Macquarie analysts have raised their target price to ₹625.

Sale at attractive valuations

Strides was on a lookout for some time to unlock value out of Ascent Pharma, which markets products in Australia and Southeast Asia. Its portfolio comprised close to 400 products, including the generics, over-the-counter (OTC) and skincare range. In Australia, Ascent focused on promoting its dermatology product range, through a specialist sales force, to dermatologists, doctors and pharmacists, for treating mild to severe skin conditions. It had a total sales workforce of 300 people promoting various products in around eight countries. This entire sales force, along with Ascent's manufacturing facility at Singapore, will now go to Watson. While 2011 calendar year results are yet to be declared, ICICI Direct analysts estimate Ascent to clock sales of close to $154 million, with Ebitda of around $19 million. On the basis of these, it translates into a deal valuation of around 2.5 times sales and around 20 times EV/Ebitda — a lucrative price and good bargain for Strides.

Boost to profitability

Based on these estimates, the Ebitda margins work out to 12.33 per cent. These low margins have been a drag on the overall margins, given that the company had clocked Ebitda margins of nearly 19 per cent in 2010 calendar year. Even for 2011, the consensus estimates stand at 20.8 per cent. So, though the sale of Ascent may lead to a decline in overall revenues in the immediate term, it will push overall margins up. According to analysts' revised estimates, Strides' Ebitda margins may touch 26 per cent in 2012.

Besides these, Strides will also benefit from lower interest costs, as it plans to utilise $250 million of the sale proceeds to reduce debt. Total debt (including FCCBs) on its books stands at $525 million, translating into a debt-equity ratio of 1.6 times, according to Reliance Securities analysts. After the loan repayment, its debt will come down to $275 million and the debt-equity ratio to a reasonable level of 1.0.

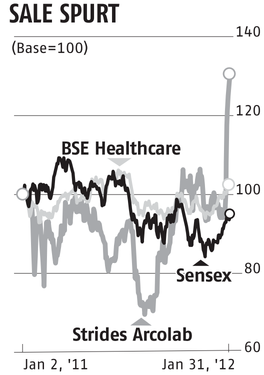
BOOST TO PROFITABILITY

In ₹ crore	CY2010	CY2011E	CY2012E
Net sales	**1,695.8**	**2,461.7**	**1,940.0**
Y-o-Y change (%)	30.0	45.2	-21.2
Ebitda	**320.9**	**511.9**	**502.0**
Ebitda (%)	18.9	20.8	25.9
Net profit	**122.5**	**203.0**	**284.0**
Y-o-Y change (%)	11.6	65.8	39.9
EPS (₹)	**26.1**	**34.5**	**47.4**
PE (x)	**20.2**	**15.2**	**11.1**

E: Estimates Source: CapitaLine Plus, Bloomberg, Analyst reports

SALE SPURT

(Base=100)



Data compiled by BS Research Bureau

Arun Kumar, executive vice chairman & group CEO

Other growth drivers

Even after stake sale in Ascent, Strides will continue to market Pfizer's established off-patent medicines and branded generics in Australia, through its direct distribution channel, observe Reliance Securities analysts in their report.

Besides, Strides has two major licensing agreements, with GlaxoSmithKline and Pfizer, which continue to contribute to its growth. Glaxo sources products from Strides for emerging markets, while Pfizer is commercialising off-patent products, primarily injectibles licensed/supplied by Strides for regulated markets like the US. Backed by Pfizer's strong marketing, distribution and low competition, analysts at Motilal Oswal Securities observe that Strides targets 15-25 per cent market share in the US. Analysts at Macquarie, in their report, observed that contracts are structured using a pick-or-pay mechanism, guaranteeing minimum revenues to Strides and a share in end-profits.

More important, Strides will continue to focus on the branded generics business in India and Africa, as well as institutional sales related to anti-malarial and anti-TB segments. However, the key focus area would still remain the speciality segment business (recently renamed Agila), which mainly comprise sterile products and is estimated to account for 60 per cent of Strides' revenues after the Ascent deal.

Strides has an impressive product pipeline to aid future growth in the speciality segment. It has commercialised its first oncology approval in the US, that is, gemcitabine, which, too, has a significant market ($700 million). MSFL analysts estimate sales of close to $10.5 million for Strides from this product in 2012 calendar year.