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20 YEARS

Initiating Coverage

Suven Pharmaceuticals Ltd.

17-May-2021

RETAIL RESEARCH

Suven Pharmaceuticals Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Pharmaceuticals	Rs. 517.4	Buy on dips to Rs 490 & add more on dips to Rs 435	Rs. 544	Rs. 595	2 quarters

HDFC Scrip Code	SUVPHAEQNR
BSE Code	543064
NSE Code	SUVENPHAR
Bloomberg	SUVENPHA IN
CMP May 14, 2021	517.4
Equity Capital (Rs cr)	25.5
Face Value (Re)	1
Equity Share O/S (cr)	25.5
Market Cap (Rs cr)	13170
Book Value (Rs)	45
Avg. 52 Wk Volumes	521961
52 Week High	565
52 Week Low	153

Share holding Pattern % (Mar, 2021)	
Promoters	60
Institutions	12.5
Non Institutions	27.5
Total	100.0

Fundamental Research Analyst
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Our Take:

Suven Pharmaceuticals is focused on the business of Contract Development and Manufacturing Operations (CDMO) in Pharmaceuticals and CRAMS Specialty Chemicals and Formulation business. In the last year, Suven Life Sciences Limited, a 30 years old entity got demerged and the CRAMS business undertaking, is now integrated to company and the Group Company (Suven Lifesciences) retained discovery research and clinical development of new molecules focused on Central Nervous System (CNS) disorders. The demerger was done to create two focused entities and moreover due to the fact that the market wasn't realizing the value of highly profitable CRAMS business.

Suven Pharma is associated with more than 70 global companies. The company has an established market position in the CRAMS segment and is among the top five players in India who supply high-end intermediaries to innovators. It has multi-location manufacturing facilities and has presence across the entire CDMO value chain, intermediates & APIs. The company is in the process of moving up the value chain and establishing itself as a full-fledged pharmaceutical solutions provider with profitable growth across all the three categories 1) Pharma-CDMO 2) Non-Pharma CDMO and 3) Formulations. Suven commands the best-in-class operating performance (45%+ EBITDA margins) when compared to its peer group India CDMO players. This is mainly on the back of its focus on NCE in pharma and specialty chemical segment. The company has around 120 active projects under CRAMS as on Mar-2020. Suven gets repeat business owing to long standing relationships with MNC companies, which augurs well for the long term growth of the company. NCE-based CDMO has high entry barriers, needs deep technical expertise and is a sticky business. Clients focus more on strategic partnership than cost arbitrage. More than 90% of revenue comes from regulated markets such as US, Europe etc. Suven has long term commercial supply opportunity in the launch of products by the global sponsors. Company generates strong operating cash flow and enjoys robust return ratios, which support premium valuations. It works with innovator companies in developed markets having stringent regulations, which reflects its overall research skills.

Company is expanding into ANDA based formulations with backward integration of APIs. In 9MFY21, the company derived ~8% of revenue from formulations. In next 2 years, it aims to make this space profitable and an important growth driver for the company. While CRAMS specialty chemicals segment continues to grow led by product offering, CRAMS Pharma and formulations businesses will be the key value drivers. Within the next three years, Suven expects the formulations vertical to emerge as an important business and profitability driver for the company.

Valuation & Recommendation:

In 9MFY21, Suven has registered ~16% growth in total revenue on the back of robust growth from CRAMS Pharma business. Operating margin remained strong at 46.4% and net profit grew 15% YoY at Rs 280cr. We estimate 18% CAGR in revenue led by strong 22% growth from CRAMS Pharma segment and steady 9% CAGR in CRAMS Specialty Chemical business. On a low base, formulation revenue may see 23% CAGR in FY20-23E. We believe margin should remain in 45-47% range in the same period. Strong revenue and steady margin would lead to 17% CAGR in net profit over FY20-23E. With strong margin profile (> 40%) without R&D burden of innovative pipeline, free cash flow is likely to remain strong. Despite pandemic and high base, the company has guided 15-20% growth based on strong order book position. China+1 strategy could be a strong tailwind for Indian CDMO pegged at US$ 5bn, a third of China. Private equity players have been buying stake in CDMO companies across the globe and valuations in M&A deals over last three years have been between 15-28x EV/EBITDA depending on the size.

We are positive on the company due to its strong execution capability and focused approach without burden of success/failure of the innovative pipeline, strong B/S and robust return ratios. After steep rise in the past two months, the stock trades at 26x FY23E EPS. We recommend buy on the stock on dips to Rs 490 and add further on declines to Rs 435 for base case fair value of Rs 544 (27.5x FY23E EPS) and bull case fair value of Rs 595 (30x FY23E EPS) over the next two quarters.

Financial Summary

Particulars (Rs cr)	Q3 FY21	Q3 FY20	YoY (%)	Q2 FY21	QoQ (%)	FY19	FY20	FY21E	FY22E	FY23E
Total Revenues	275	179	53.9	237.4	15.8	664	834	997	1,171	1,385
EBITDA	138	80	73.1	99	40.1	160	385	462	536	643
Depreciation	9	6	57.1	7.5	17.3	22	24	34	40	49
Other Income	21	11	82.5	9.3	123.7	24	18	19	23	28
Interest Cost	3	8	-64.5	3.3	-18.2	4	23	12	10	8
Tax	34	20	71.7	22.8	49.1	72	88	119	143	172
RPAT	114	58	95.9	74.1	53.3	87	317	365	419	504
EPS (Rs)						3.4	12.4	14.3	16.4	19.8
RoE (%)						10.9	37.8	36.7	31.6	29.2
P/E (x)						151.7	41.6	36.1	31.5	26.1
EV/EBITDA (x)						81	33.7	28.1	24.2	20.2

(Source: Company, HDFC sec)

Q3FY21 result highlights

Company reported robust growth of 54%/96% in revenue/PAT in Q3 FY21 leading to full recovery for 9MFY21, otherwise hit by the Covid-19 pandemic. Operating margin expanded 570bps YoY at ~50% due to more supplies for clinical stage molecules. In Q3FY21, CDMO pharma division reported robust 175% YoY growth to Rs 217cr. Management has maintained its FY21 overall 15-20% profit growth guidance.

Specialty CRAMS sales fell 49.5% to Rs 35cr. Management is confident of initiating commercial supplies for one specialty chemical molecule each in Q1 FY22/FY23 and one in pharma in FY22. Formulation sales stood at Rs 23cr in the quarter, 9MFY21 revenue stood at Rs 68cr.

Key takeaways from conference call

- Company guides for 15-20% growth in revenue for FY21, hopes to achieve same in FY22; EBITDA margins sustainable above 40%.
- Pharma CRAMS to grow 20%+ YoY; Specialty chemical CRAMS to stay flattish; formulations growth to be around 20%. Formulation business for 9MFY21 stood at Rs. 68cr.
- Capex for 9MFY21 stood at Rs 94 crore; Rs 600 crore capex is planned in the next three years to 1) increase Pashamylaram facility capacity, 2) relocate R&D facilities, 3) replace/modernise some existing facilities. Around 80% of investments will be for modernization and ~20% in building new facility at Pashamylaram, Medak.
- 80% of planned capex is for technology upgradation and maintenance and the balance for new facility. It will be mostly through internal accruals. It is for upgradation, so it will not give incremental capacity, but it will give additional capabilities.
- Profit share from Rising Pharma stood at Rs 35 crore vs. Rs 27 crore in 9MFY20; In FY20, it was at Rs 48 crore
- Two contracts ongoing in specialty chemical, another in Q1FY22 and one more in development for FY22
- Working capital + term loans stood at Rs 104 crore as on Dec-2020; Suven Pharma will pay Rs 66cr to Suven Life over the next 12 months. As on Mar-2020, Suven Pharma had to repay Rs 115cr to Suven Lifesciences.
- Company guides for > 40% operating margin on sustainable basis in the coming years.
- In the Pharma CRAMS segment, there is one product that will move into commercialization, so that will give additional revenue in FY22. Similarly, One molecule will move into Phase-3, additional molecules that also will give some revenue in the next few quarters.
- In agrochemical segment, two products are under development. One will be commercialized in CY21 and the other one will be sometime in FY23.

- Company has added 1 new customer in the past 6 months. Currently, Suven supplies 4 commercialized molecules. From the current pipeline, management indicated that 1 molecule has moved in phase III.
- The company supplies intermediates for two molecules and is on track to commercialize one more molecule in H2FY21. Company has sufficient capacity to meet additional demand in specialty CRAMS and can add additional blocks if required.
- Company has filed 11 ANDAs and 6 pending for approval with the US FDA. Out of 5 approvals, the company has commercialized 4 ANDAs as on Dec-2020. Management guided for 1/2 new launches along with 3-4 filings in H2 FY21. In FY22, it plans to file 7-8 ANDA and launch 3-4 products.
- Company is looking to hire a professional CEO to run the day to day affairs.

Key Business Segments

Suven Pharmaceuticals mainly caters into three business segments 1) CRAMS Pharma (CDMO), 2) CRAMS Specialty Chemicals and 3) Formulations. Company derived ~65% of revenue from CRAMS Pharma, which is the most profitable business vertical. Around 27% of revenue comes from CRAMS Specialty Chemical business and 8% from formulations.

As per the management, customer concentration keeps changing because today’s number one customer maybe tomorrow’s number 5 or 10 customer because of the product mix as the volume of the business that takes off. So, about ten customers gives 80-90% of the business, which will keep changing between them.

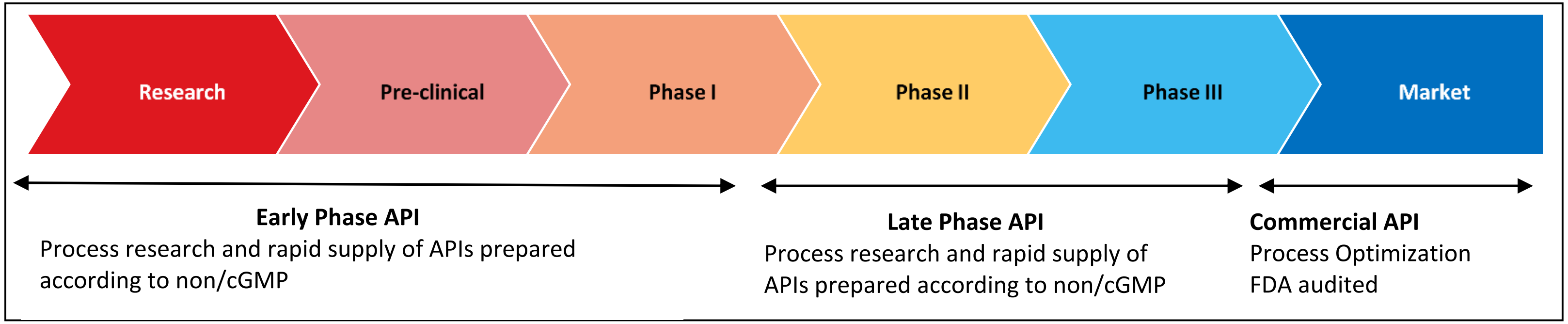
CRAMS Pharma (CDMO)

Suven Pharma partners with innovators for NCE molecule development and supply of intermediates. This commercial supply piece is a high-value, high-margin business, involving the supply of intermediates for New Chemical Entity (NCEs) that are already launched by innovators companies. Suven supplies intermediates for four molecules addressing rheumatoid arthritis, anti-diabetes, CNS and women’s health for clients based in the US and Europe. Revenue increases gradually based on a ramp-up in sales for the innovator and launch in new territories and countries.

CDMO business registered a revenue of Rs 468 crore in FY20 as against Rs 380 crore, an increase of 24%. This was owing to an increase in the number of development projects received and delivered by the company. Also, the number of return-accretive projects have increased, which led to strong growth. In addition, the increased supplies of intermediates for the commercial molecules also contributed to the business growth. In 9MFY21, CRAMS Pharma revenue witnessed robust 29% YoY growth at Rs 486cr. We expect the segment revenue to grow at 22% CAGR over FY20-23E.

NCE-based CDMO has high entry barriers, high switching costs, needs deep technical expertise and is a sticky business. Clients focus more on strategic partnership than cost arbitrage.

Value Chain



Specialty Chemicals CRAMS

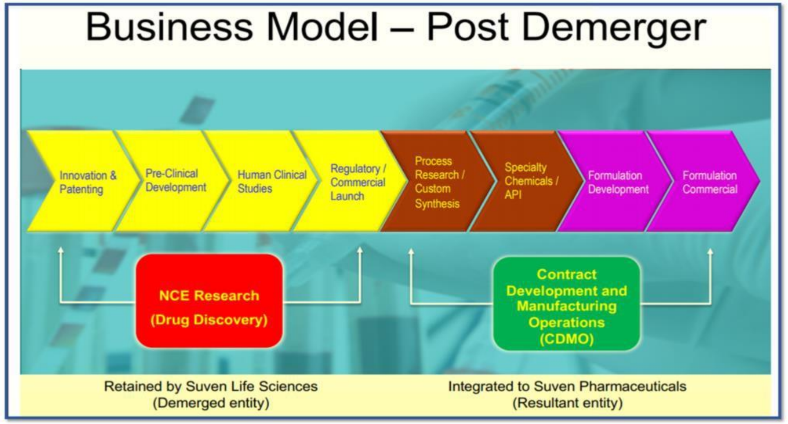
Suven Pharma is developing two molecules which are likely to commercialised in FY21. These molecules have the potential to generate an annual revenue of about US$ 7mn (~Rs 52 crore) each at optimum volumes. But the scale-up to this level will take time. It will depend on the traction which clients' products attract globally. Further, the company is working on some interesting molecules which are at an early stage in their respective developmental cycles.

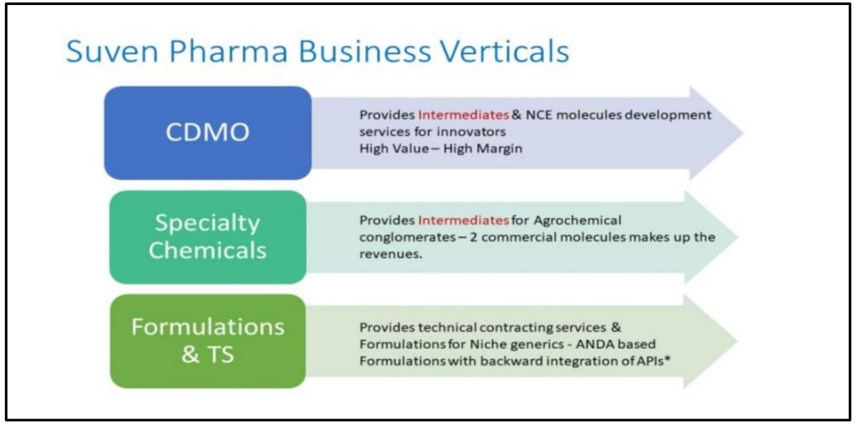
Suven is supplying intermediates – derived out of its CDMO competence – for two specialty chemical products (agrochemical) to large global conglomerates, the approval for one was received towards the end of FY19. As a result, FY20 was a great year from a specialty chemicals perspective.

Revenue increased to Rs 304cr as compared to Rs 216 crore in FY19, a rise of in excess of 40%. About 90% of specialty chemical molecules are for agro chemicals. In 9MFY21, the segment revenue declined 12% YoY at Rs 197cr. Company has guided for almost flat revenue growth YoY in FY21. We expect the segment revenue to grow at 22% CAGR over FY20-23E.

Formulations business

The segment comprises fees for technical services provided by the company to global pharmaceutical companies. It also includes royalty from its exclusive marketing licence for its Malathion lotion (a formulated product) to Taro Pharmaceuticals for the North American markets. Revenue grew to Rs 70cr in FY20 as compared to Rs 50cr in FY19. Although this is the smallest vertical at present, it promises to emerge as one of the key growth and profitability drivers for Suven over the next 3-4 years as company launches new formulation products into this segment. Company has filed 11 ANDAs and 6 pending for approval with the US FDA. Out of 5 approvals, the company has commercialized 4 ANDAs as on Dec-2020. In FY22, it plans to file 7-8 ANDA and launch 3-4 products.





Suven Pharma holds 25% stake in Rising Pharma Holdings Inc., USA

During the last year, the company invested US$ 35mn in Rising Pharma Holdings, Inc., USA through its wholly owned subsidiary, Suven Pharma, Inc., USA. Company holds 25% stake in Rising Pharma Holdings Inc. as on Mar-2020.

Rising Pharma Holdings, Inc., will assist in expanding formulation venture. Rising is a development and distribution company in the formulations space. It has many ANDAs in development every year with its partners and some of those may fit into key metrics for Suven. The additional advantage with Rising is its strong forte in distribution.

Suven and Rising have interesting synergies, which help to explore ways of combining its capabilities for strengthening individual businesses and relations. To cater to these opportunities, Suven had announced Rs 320cr capex plan which included creating a multi-vertical capacity. Out of this, Rs 210cr was pumped into the business in FY20, while the rest will be invested In FY21.

Out of the 11 ANDAs filed, two are those of Rising Pharma. Suven will also utilize their expertise in distribution of formulations. One commercialised product is being distributed by them. Rising Pharma had reported net profit in CY19. Suven gets a share of profits only when the company declares dividend. It will need funds to build stability in the marketplace.

Since acquisition, Rising has managed to turn around its operations (it was in bankruptcy when Suven invested in it) and has yielded Suven a proportional profit share of Rs 48.2cr from Rising's total profits in FY20.

De-merger of businesses

Suven's board had approved a scheme of demerger in 2019. Contract Research and Manufacturing Services business (along with its respective assets and liabilities) was transferred to Suven Pharmaceutical Limited (SPL). SPL will be a wholly owned subsidiary of Suven Life Sciences Limited (SLSL), which will be listed on exchanges. SPL issued one equity share of Rs 1 each equity share of Rs 1 held by shareholder of SLSL. In accordance with Suven Life Sciences management's endeavour to split its innovation and CRAMS businesses, demerger of its CRAMS business got effective in Jan, 2020 to be held by the demerged entity, Suven Pharmaceuticals (SPL), while Suven Life will continue to hold the discovery research segment and IPs. Subsequently, Suven Pharma got listed on exchanges in Mar, 2020.

Planned capex outlay of ~Rs 600cr over the next 3 years

Company has planned for a capex of Rs 600cr, a large part of which will be utilized in facility upgradation, technology enhancement and relocation spread over 3 years. Management is yet to furnish details of the plan. This will be over and above the current ongoing capex of Rs 320cr spent over FY19-21.

As part of the upgradation plan, Suven plans to refurbish about 3-decade old block at Suryapet. The new block shall be ~2-3x vs. existing block (huge maintenance expense incurred currently). Further, as per the new policy of Telangana government, its Jeedimetla plant will have to relocate outside the city. An additional block will be created at Pashamylaram (Medak), Telangana in order to cater to higher demand. Suven has spent Rs 110cr on creating a multi-purpose facility at Vizag which shall largely be utilized for specialty chemicals. Its Vizag facility is expected to be commercialized by CY21.

Indian CRAMS industry outlook

India has become the preferred destination for outsourcing of research as well as manufacturing activities as it is able to offer high end research services, biologics, and complex technology services, at a low cost. There are large number of US FDA approved manufacturing facilities along with high skilled labour possessing expertise in pharmaceuticals manufacturing which have been the key drivers of growth. Indian CRAMS companies continue to enjoy competitive edge in being the preferred partners for drug development and manufacturing. Various factors driving the Contract Research Organisation services market growth are 1) increasing prevalence of diseases such as cardiovascular, diabetes & cancer 2) A robust pipeline of pharmaceutical & biopharmaceutical products 3) An increasing complexity of clinical trials and fast-paced changing regulatory framework associated with commercialisation.

Moreover, the Indian government policies to encourage exports and support growing R&D through several tax benefits also leads to better growth in contract research and manufacturing services. CRAMS landscape is witnessing increased activity with many pharma players increasingly outsourcing early drug development activities covering pre-clinical and early phase research to some of the leading Contract Research Organization (CRO) players in the market as a strategy to stay competitive, flexible and profitable.

Suven Pharmaceuticals Ltd.

Key Risks

- Substantial decline in operating margin would lead to lower profitability (operating margin was at ~46% for 9MFY21). Company has maintained its guidance of operating margin of > 40%.
- Large acquisition and/or debt-funded capital expenditure.
- Delay in orders in CRAMS business from key clients
- Pharmaceutical industry is highly regulated and requires various approvals, licenses, registrations and permissions. Regulatory compliance risk, especially pertaining to the US FDA and EDQM continue to remain a key overhang on the sector.
- Inability to scale-up the formulation business which is still at a very nascent stage
- There was a fire accident on April 26, 2020 at one of the company's buildings having research facilities in Jeedimetla, Hyderabad and the insurance claim is under process.
- A spike in raw material costs owing to shortage in supply of raw materials, especially from China.
- In CDMO business there can lumpiness in revenue and profitability on quarterly basis due to nature of its business. The commercial supplies are generally uneven as once if the customer buys one batch the next order usually comes after 12-18 months.
- Company earns profit share from Rising Pharma, which is dependent upon performance of Rising Pharma Inc.
- Company has incurred large capital expenditure over the past three years and has aggressive capex plans over the next few years. Delay in monetisation of current/future round of capex/lower traction from new units remain a concern.

Suven Pharmaceuticals Ltd.

Company Background

Erstwhile Suven Life Sciences, was a research based service provider to global innovator companies by supplying intermediates for New Chemical Entities (NCE) development, which could potentially translate into long-term supplies if the drug is approved. The company had a strong balance sheet with the support of best management team. It has followed a unique path with development of new drug development (via using cash generated from its base CRAMS business) with its own efforts and focus on Alzheimer and central nervous system (CNS) diseases, an investment opportunity with focused return. Company has interests mainly in CRAMS Pharma (CDMO), CRAMS Specialty Chemicals and Formulations.

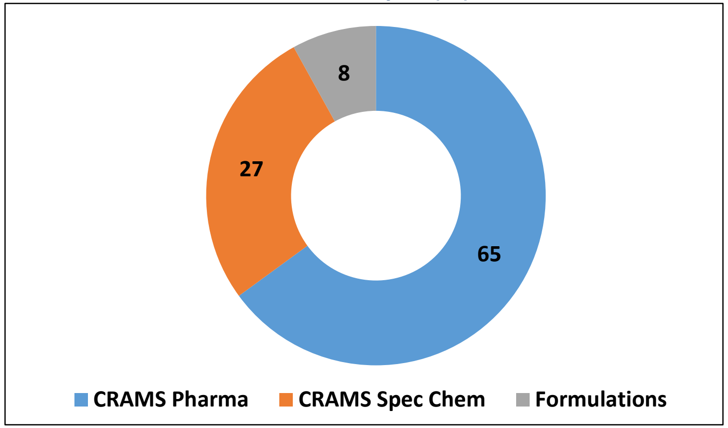
In accordance with Suven Life Sciences management's endeavour to split its innovation and CRAMS businesses, the company had announced a demerger of its CRAMS business in Jan, 2020 to be held by the demerged entity, Suven Pharmaceuticals (SPL), while Suven Life will continue to hold the discovery research segment and IPs. Subsequently, Suven Pharma got listed on exchanges on Mar 9, 2020. Mr. Venkateshwarlu Jasti is the Chairman and Managing Director of the company. He holds a dual postgraduate degree in pharmacy and specialized in industrial pharmacy. He has an experience of over three decades in contract research industry which helped the company to associate with 70+ global companies. Suven group has established market position in the CRAMS segment and is among the top five players in India who supply high-end intermediates to innovators.

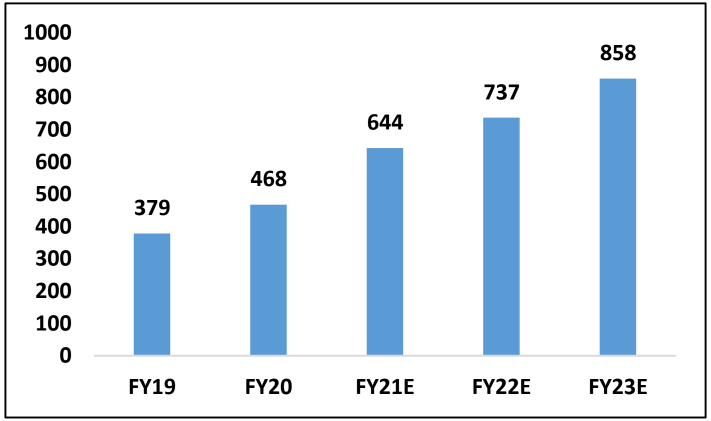
Peer Comparison

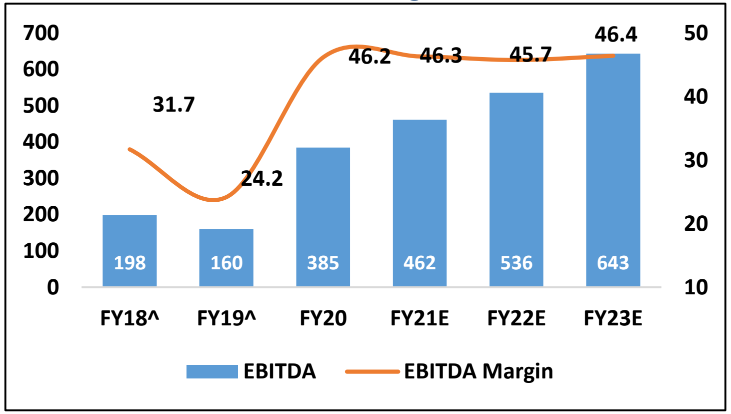
Company	Mcap (Rs cr)	Revenue				EBITDA Margin				PAT				RoE			
		FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E
Suven Pharma	13170	834	997	1171	1385	46.2	46.3	45.7	46.4	317	365	419	504	37.8	36.7	31.6	29.4
Syngene International	22658	2012	2184	2537	3068	30.7	30.7	30.5	32.3	412	405	427	564	14.8	16.2	14.1	16.6
Neuland Laboratories	2662	763	937	1057	1225	13.4	15.7	17.3	18.0	16	80.6	98	125	2.5	11	11.7	13.3

Company	EV/EBITDA				P/E			
	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E
Suven Pharma	33.7	28.1	24.2	20.2	41.6	36.1	31.5	26.1
Syngene International	36.4	35.3	29.2	23.0	55.0	55.9	53.1	40.2
Neuland Laboratories	27.2	19.7	15.5	13.0	166.4	33.0	27.2	21.3

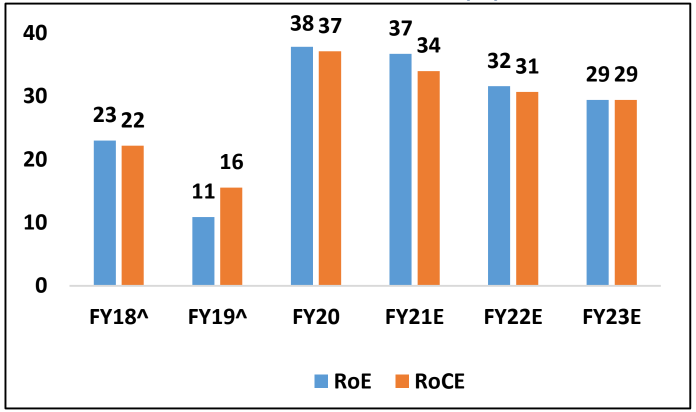
Suven Pharmaceuticals Ltd.







Source: Company, HDFC sec Research, ^pre demerger



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RETAIL RESEARCH

Suven Pharmaceuticals Ltd.

Financials

Income Statement

(Rs Cr)	FY20	FY21E	FY22E	FY23E
Total Income	**834**	**997**	**1171**	**1385**
Growth (%)	25.7	19.5	17.5	18.3
Operating Expenses	449	535	635	742
EBITDA	**385**	**462**	**536**	**643**
Growth (%)	140	19.9	16.1	20
EBITDA Margin (%)	**46.2**	**46.3**	**45.7**	**46.4**
Depreciation	24	34	40	49
EBIT	361	428	496	594
Other Income	18	19	23	28
Interest expenses	23	12	10	8
Profit share from Associates	48	49	54	62
PBT	404	484	562	676
Tax	88	119	143	172
RPAT	**317**	**365**	**419**	**504**
Growth (%)	264.4	15.3	14.7	20.4
EPS	12.4	14.3	16.4	19.8

Balance Sheet

As at March	FY20	FY21E	FY22E	FY23E
SOURCE OF FUNDS				
Share Capital	**12.7**	**25.5**	**25.5**	**25.5**
Reserves	832	1121	1481	1896
Shareholders' Funds	**845**	**1146**	**1506**	**1921**
Long Term Debt	92	74	68	51
Net Deferred Taxes	28	28	27	26
Long Term Provisions & Others	8	12	15	20
Total Source of Funds	**973**	**1260**	**1616**	**2019**
APPLICATION OF FUNDS				
Net Block	456	557	767	938
Intangible Assets	3	3	3	3
Non-current Investments	323	341	359	395
Total Non-Current Assets	**781**	**901**	**1129**	**1335**
Current Investments	31	34	40	49
Inventories	175	210	241	283
Trade Receivables	117	145	171	198
Cash & Equivalents	14	118	190	303
Other Current Assets	55	57	61	69
Total Current Assets	**392**	**564**	**703**	**903**
Short-Term Borrowings	94	77	67	48
Trade Payables	71	89	105	122
Other Current Liabilities	32	36	41	45
Short-Term Provisions	3	3	3	4
Total Current Liabilities	**200**	**206**	**216**	**219**
Net Current Assets	191	359	487	684
Total Application of Funds	**973**	**1260**	**1616**	**2019**

Suven Pharmaceuticals Ltd.

Cash Flow Statement

(Rs Cr)	FY20	FY21E	FY22E	FY23E
Reported PBT	404	484	562	676
Non-operating & EO items	-12	-19	-23	-28
Interest Expenses	23	12	10	8
Depreciation	24	34	40	49
Working Capital Change	63	-64	-56	-84
Tax Paid	-86	-119	-143	-172
OPERATING CASH FLOW (a)	**416**	**329**	**390**	**449**
Capex	-99	-135	-250	-220
Free Cash Flow	568	194	140	229
Investments	-334	-18	-18	-36
Non-operating income	12	19	23	28
INVESTING CASH FLOW (b)	**-422**	**-134**	**-245**	**-227**
Debt Issuance / (Repaid)	106	-14	-4	-12
Interest Expenses	-23	-12	-10	-8
FCFE	614	167	126	209
Share Capital Issuance	0	13	0	0
Dividend	-77	-77	-59	-89
FINANCING CASH FLOW (c)	**6**	**-90**	**-73**	**-109**
NET CASH FLOW (a+b+c)	**1**	**104**	**72**	**113**

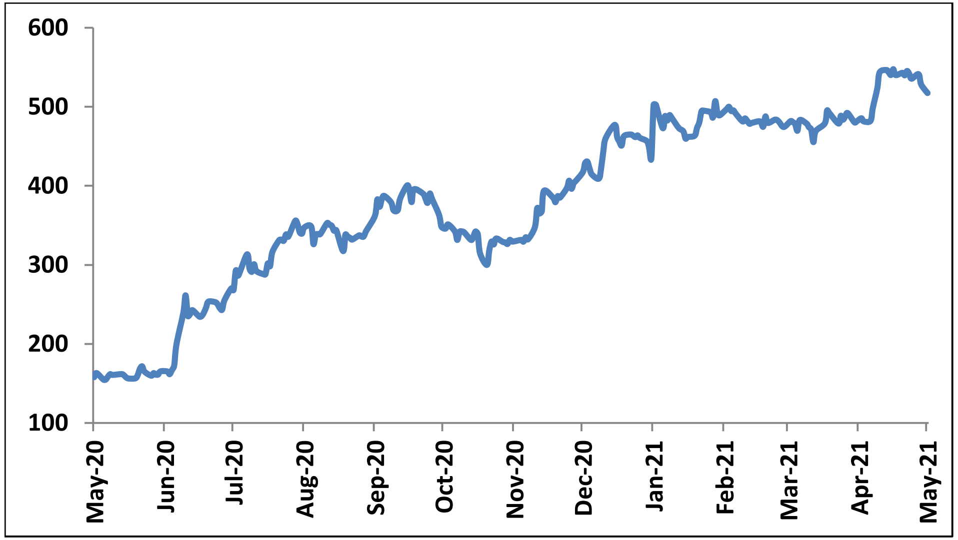
Key Ratios

	FY20	FY21E	FY22E	FY23E
Profitability (%)				
EBITDA Margin	46.2	46.3	45.7	46.4
EBIT Margin	43.3	42.9	42.3	42.9
APAT Margin	38	36.6	35.8	36.4
RoE	37.8	36.7	31.6	29.4
RoCE	37.1	34	30.7	29.4
Solvency Ratio				
Net Debt/EBITDA (x)	0.4	0	-0.2	-0.4
D/E	0.2	0.1	0.1	0.1
Net D/E	0.2	0	-0.1	-0.1
Per Share Data				
EPS	12.4	14.3	16.4	19.8
CEPS	26.8	15.6	18	21.7
BV	33	45	59	75
Dividend	5	2	2.3	3.5
Turnover Ratios (days)				
Debtor days	51	53	53	52
Inventory days	73	77	75	75
Creditors days	89	95	93	92
VALUATION (x)				
P/E	41.6	36.1	31.5	26.1
P/BV	15.6	11.5	8.8	6.9
EV/EBITDA	33.7	28.1	24.2	20.2
EV / Revenues	16.4	13.7	11.7	9.9
Dividend Payout (%)	40.3	14	14	17.7

Source: Company, HDFC sec Research

Suven Pharmaceuticals Ltd.

Stock Price Chart



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