26 February 2013

4QCY12 Results Update | Sector: Healthcare

Sanofi India

BSE Sensex 19,332	S&P CNX 5,855
Bloomberg	SANL IN
Equity Shares (m)	23.0
M.Cap. (INR b)/(USD b)	53.1/1.0
52-Week Range (INR)	2,450/2,002
1,6,12 Rel. Perf. (%)	9/-1/-4

CMP: INR2,307 **TP: INR2,015** **Neutral**

Financials & Valuation (INR b)

Y/E Dec	2012	2013E	2014E
Sales	14.9	17.2	19.7
EBITDA	2.3	2.7	3.0
Net Profit	1.8	2.0	2.3
Adj. EPS (INR)	76.7	86.4	100.7
EPS Gr. (%)	-7.6	12.6	16.6
BV/Sh. (INR)	518.0	558.0	606.5
RoE (%)	14.8	15.5	16.6
RoCE (%)	21.5	22.5	24.1
Payout (%)	49.9	53.7	51.8
Valuations			
P/E (x)	30.1	26.7	22.9
P/BV (x)	4.5	4.1	3.8
EV/EBITDA (x)	21.0	18.4	15.6
Div. Yield (%)	1.4	1.7	2.0

- Sanofi India's (SANL) 4QCY12 operational performance was above estimates, with 18.6% YoY growth in net sales to INR4b (v/s est INR3.93b) and 28.6% YoY growth in EBITDA to INR507m (v/s est INR477m).
- EBITDA margin expanded by 100bp YoY to 12.7%, higher than estimate of 12%, mainly due to lower other expenses.
- Adj PAT grew 24.3% YoY to INR448m and was higher than our estimate of INR377m, boosted by higher other income (INR382m v/s est of INR279m).
- PAT growth is lower than the EBITDA growth due to change in accounting policy (since 3QCY12), which has increased depreciation & amortization cost.
- The company, as in the past, indicated that for the domestic business, rural and OTC segment will be key growth drivers in the future, and it is likely to incur some extra expenditure for establishing a presence in these segments. This is likely to pressurize short term profitability.

We believe SANL will be one of the key beneficiaries of the patent regime in the long term. The parent has a strong R&D pipeline with a total of 64 products (including vaccines) undergoing clinical trials, of which 17 are in Phase-III or pending approvals, some of which are likely to be launched in India. However, SANL's profitability has declined significantly in the last 6 years, with EBITDA margin declining from 25% for CY06 to 15.6% for CY12, mainly impacted by discontinuation of Rabipur sales in the domestic market, lower export growth and higher staff & promotional expenses. RoE declined from 28.6% to 14.8% over the same period. Post 4QCY12 performance, we have retained our EPS estimates for CY13E/CY14E as the outperformance during the quarter was mainly driven by higher other income, which we conservatively expect to normalize over the next two years. Based on our estimates, the stock is valued at 26.7x CY13E and 22.9x CY14E EPS. We believe the stock performance is likely to remain muted in the short term, until clarity emerges on future growth drivers. Maintain **Neutral** with a target price of INR2,015 (20x CY14E EPS).

Quarterly Performance (INR Million)

Y/E December	CY11				CY12				CY11	CY12	Est.	Var.
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q			4QE	vs Est
Net Sales	2,763	3,028	3,127	3,379	3,225	3,741	3,966	4,007	12,297	14,939	3,932	1.9%
YoY Change (%)	9.9	11.5	13.5	17.9	16.7	23.5	26.8	18.6	13.3	21.5		
Total Expenditure	2,328	2,600	2,624	2,985	2,733	3,219	3,161	3,500	10,537	12,613		
EBITDA	435	428	503	394	492	522	805	507	1,760	2,326	472	7.5%
Margins (%)	15.7	14.1	16.1	11.7	15.3	14.0	20.3	12.7	14.3	15.6	12.0	65
Depreciation	54	54	61	142	183	186	307	223	311	899		
Interest	2	0	0	2	4	4	3	3	4	14		
Other Income	379	361	369	286	289	267	266	382	1,395	1,204		
PBT before EO Items	758	735	811	535	594	599	761	663	2,839	2,617	558	18.8%
PBT after EO Items	758	735	811	535	594	599	761	663	2,839	2,617	558	18.8%
Tax	252	238	263	175	193	194	248	215	928	850		
Effective tax Rate (%)	33.2	32.4	32.4	32.7	32.5	32.4	32.6	32.4	32.7	32.5		
Reported PAT	506	497	548	360	401	405	513	448	1,911	1,767	377	18.9%
Adj PAT	506	497	548	360	401	405	513	448	1,911	1,767	377	18.9%
YoY Change (%)	40.2	17.2	15.9		-20.8	-18.5	-6.4	24.3	19.6	-7.5		
Margins (%)	18.3	16.4	17.5	10.7	12.4	10.8	12.9	11.2	15.5	11.8		

E: MOSL Estimates

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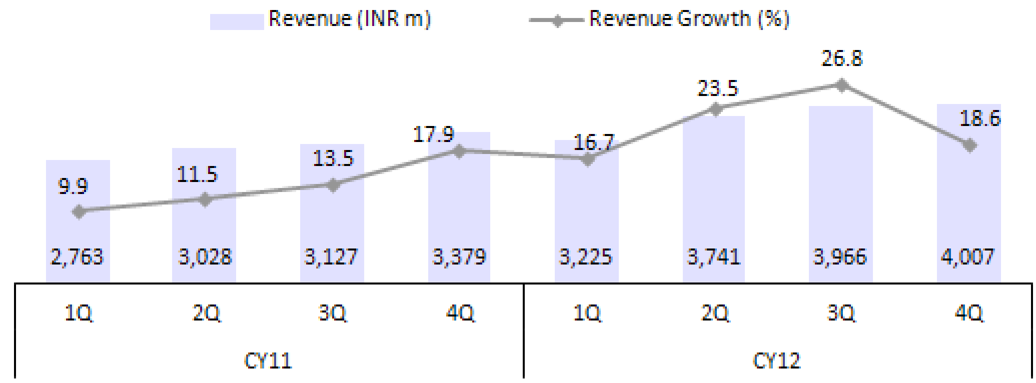
Revenue growth likely to have been led by domestic business

SANL's 4QCY12 operational performance was above estimates, with 18.6% YoY growth in net sales to INR4b (v/s est INR3.93b) and 28.6% YoY growth in EBITDA to INR507m (v/s est INR477m).

Company has stopped giving revenue break-up between domestic formulation and export revenues. We believe top line growth is led by strong growth in domestic formulation revenues on the back of consolidation of Universal Medicare acquisition. Export revenues are likely to have grown this quarter.

Revenue trend



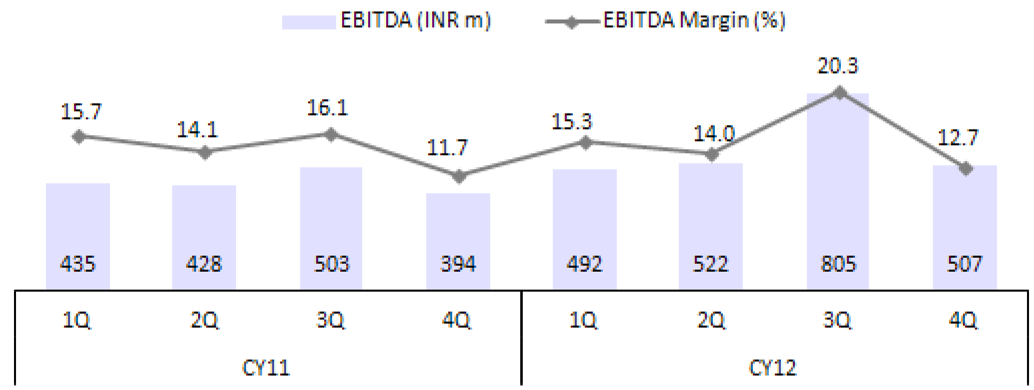
Source: Company, MOSL

EBITDA was above estimate

EBITDA grew 28.6% YoY to INR507m (v/s est INR477m). EBITDA margin expanded by 100bp YoY to 12.7%, higher than our estimate of 12%, mainly due to lower other expenses. Adj PAT grew 24.3% YoY to INR448m and was higher than our estimate of INR377m, boosted by higher other income (INR382m v/s est of INR279m).

PAT growth is lower than the EBITDA growth on account of a change in company's accounting policy (since 3QCY12), which led to an increase in depreciation & amortization cost. The change resulted in a fixed amortization schedule chalked out to write off goodwill from the Universal acquisition (INR1.252b). Also, amortization of brands and technical knowhow acquired from Universal (not present in CY12) have impacted profits (amount not disclosed).

EBITDA and margin trend



Source: Company, MOSL

The company, as in the past, indicated that for the domestic business, rural and OTC segment will be key growth drivers in the future, and it is likely to incur some extra expenditure for establishing a presence in these segments. This is likely to pressurize short term profitability.

Domestic formulations - new product introductions hold the key

We believe SANL is well-placed to benefit from the introduction of product patents, given its strengths in marketing, a supportive parent and a healthy product pipeline (of NCEs). SANL's history of launching patented products in India, a well-mapped portfolio vis-à-vis the parent and ability to build them into big brands make it one of the potential beneficiaries of the product patent regime in India. Further, it is planning to strengthen the portfolio in diabetes segment. We believe that the patent regime will bring significant benefits to SANL, albeit in the long term. Company is yet to give any long term visibility on launch of patented products in India. It is not planning to launch any product from the parent's pipeline in CY11. The parent (Sanofi-Aventis) currently has 64 projects in research and development, including ~35 in late stage (Phase II & III) development and registration. Around 20% of the product development pipeline consists of vaccines. The table below shows parent's R&D pipeline:

SANL - Parent's NCE Pipeline

	No of projects				
	Phase I	Phase II	Phase III	Registration	Total
Therapeutic area					
Metabolic Disorders	1	0	1	2	4
Oncology	8	4	2	0	14
Genetic Diseases	2	0	1	0	3
Thrombosis	1	0	1	0	2
Central Nervous System	2	0	0	2	4
Internal Medicine	3	7	1	0	11
Ophthalmology	4	1	0	0	5
Aging	4	3	0	0	7
Vaccines	4	3	5	2	14
Total	**29**	**18**	**11**	**6**	**64**

Source: Company, MOSL

Rural initiatives and entry into OTC segment - long term positive but may pressurize profitability in short term

SANL is among the few MNCs which are focusing on rural India. Given increasing disposable income, various government initiatives to improve rural healthcare infrastructure and low competition, SANL may benefit from its early entry into this segment. Management believes that it has made strong progress with project 'Prayas' and will continue to invest resources on the project. 'Prayas' is present in 14 states of India and has engaged more than 10,000 doctors and conducted over 2,000 workshops. However, we believe that this will not contribute significantly to revenues in the short-to-medium term. Rather, it is a long term positive. In the short term, this initiative is likely to pressurize SANL's profitability, given investments required in establishing a presence in this segment and the relatively lower profitability of this market. Rural division generated revenues of INR185m in CY10. However, according to the management, rural division is expected to break even in the next 3 years. On the back of success in 'Prayas', SANL has launched other initiatives like 'I am a Champ', 'Saath 7' and 'Together for More'. Further, company's entry into OTC segment is likely to keep margins under pressure as it requires higher advertising spend.

Valuation and view

We believe SANL will be one of the key beneficiaries of the patent regime in the long term. The parent has a strong R&D pipeline with a total of 64 products (including vaccines) undergoing clinical trials, of which 17 are in Phase-III or pending approvals, some of which are likely to be launched in India. However, SANL's profitability has declined significantly in the last 6 years, with EBITDA margin declining from 25% for CY06 to 15.6% for CY12, mainly impacted by discontinuation of Rabipur sales in the domestic market, lower export growth and higher staff & promotional expenses. RoE declined from 28.6% to 14.8% over the same period.

Post 4QCY12 performance, we have retained our EPS estimates for CY13E/CY14E as the outperformance during the quarter was mainly driven by higher other income, which we conservatively expect to normalize over the next two years. Our estimates exclude potential adverse impact of the proposed New Pharma Pricing Policy and its pending implementation. However, we believe the policy will adversely impact MNCs like GLXO and SANL and hence expect a downgrade in our estimates, post implementation of the policy. Based on our estimates, the stock is valued at 26.7x CY13E and 22.9x CY14E EPS. We believe the stock performance is likely to remain muted in the short term, until clarity emerges on future growth drivers. Maintain **Neutral** with a target price of INR2,015 (20x CY14E EPS).

Sanofi India (SANL): an investment profile

Company description

Sanofi India (60% subsidiary of Sanofi Aventis, France) is the fifth largest MNC and among top 15 formulation players in India. Company has built a robust franchise in chronic therapies like anti-diabetes, oncology and CVS, thus realigning its domestic portfolio with the parent.

Key investment arguments

- SANL is well-placed to benefit from the introduction of product patents, given its strengths in marketing, a supportive parent and a healthy NCE product pipeline of parent company.
- Its history of launching patented products in India, a well-mapped portfolio vis-à-vis the parent and ability to build them into big brands make it one of the potential beneficiaries of the product patent regime in India.
- SANL is among the few companies which are focusing on rural India. Given the increasing disposable income, various government initiatives to improve rural healthcare infrastructure and low competition, it may benefit from an early entry into this segment.

Key investment risks

- Biggest risk to SANL could be the implementation of new pharmaceutical policy in the current form. The new policy proposes to significantly increase the span of control by bringing a total of 348 drugs under price control. This could severely impact the profitability of its business.
- Possible pre-grant and post-grant patent challenges by domestic generic companies could hamper the plans and prospects to launch patented product.

Recent developments

- Launched Combiflam ® Plus line extension in February 2013

Valuation and view

- SANL will be one of the key beneficiaries of the patent regime in the long term. In the long term, focus on growing strategic brands and strong support from the parent will augur well for the company.
- The stock is valued at 26.7x CY13E and 22.9x CY14E earnings. We maintain **Neutral**.

Sector view

- The domestic market is expected to witness 14-15% growth, with gradual increase in the low penetration levels - companies with strong brands and marketing muscle to benefit.
- IPR regime unlikely to lead to any major change in the near term; MNCs and large Indian players to gain over the longer term.
- We are bullish on MNCs whose domestic portfolio is well-aligned with its parent and where risk of conflict with 100% subsidiaries is limited.

Comparative valuations

		Sanofi India	GSK
PP/E (x)	CY13E	26.7	23.2
	CY14E	22.9	20.9
P/BV (x)	CY13E	4.1	8.2
	CY14E	3.8	7.6
EV/Sales (x)	CY13E	2.8	5.5
	CY14E	2.4	4.8
EV/EBITDA (x)	CY13E	18.4	17.3
	CY14E	15.6	15.1

Shareholding pattern (%)

	Dec-12	Sep-12	Dec-11
Promoter	60.4	60.4	60.4
Domestic Inst	14.9	15.3	17.8
Foreign	13.4	13.3	10.5
Others	11.4	11.0	11.3

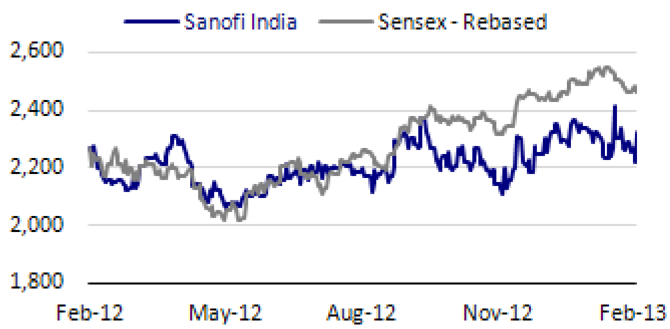
EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
CY13	86.4	89.1	-3.0
CY14	100.7	104.5	-3.7

Target Price and Recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
2,307	2,015	-12.7	Neutral

Stock performance (1 year)



Financials and Valuation

Income Statement				(INR Million)
Y/E December	2011	2012	2013E	2014E
Net Sales	12,297	14,939	17,231	19,704
Change (%)	13.3	21.5	15.3	14.3
Materials Consumed	6,194	7,355	8,443	9,655
Personnel Expenses	1,764	2,136	2,456	2,825
Other Expenses	2,579	3,122	3,668	4,181
Total Expenditure	10,537	12,613	14,568	16,661
EBITDA	1,761	2,326	2,663	3,043
Change (%)	23.0	32.1	14.5	14.3
Margin (%)	14.3	15.6	15.5	15.4
Depreciation	311	899	933	965
EBIT	1,449	1,427	1,730	2,079
Int. and Finance Charges	4	14	10	10
Other Income - Rec.	1,395	1,204	1,226	1,367
PBT & EO Items	2,840	2,617	2,947	3,435
Change (%)	21.4	-7.8	12.6	16.6
Extra Ordinary Income/(Exp	0	0	0	0
PBT after EO Items	2,840	2,617	2,947	3,435
Tax	928	850	958	1,117
Tax Rate (%)	32.7	32.5	32.5	32.5
Reported PAT	1,912	1,767	1,989	2,319
PAT Adj for EO Items	1,912	1,767	1,989	2,319
Change (%)	23.3	-7.6	12.6	16.6
Margin (%)	15.5	11.8	11.5	11.8

Ratios				
Y/E December	2011	2012	2013E	2014E
Basic (INR)				
EPS	83.0	76.7	86.4	100.7
Cash EPS	96.5	115.8	126.9	142.6
BV/Share	479.7	518.0	558.0	606.5
DPS	33.0	33.0	40.0	45.0
Payout (%)	46.0	49.9	53.7	51.8
Valuation (x)				
P/E	27.8	30.1	26.7	22.9
Cash P/E	23.9	19.9	18.2	16.2
P/BV	4.8	4.5	4.1	3.8
EV/Sales	4.1	3.3	2.8	2.4
EV/EBITDA	28.8	21.0	18.4	15.6
Dividend Yield (%)	1.4	1.4	1.7	2.0
Return Ratios (%)				
RoE	17.3	14.8	15.5	16.6
RoCE	25.3	21.5	22.5	24.1
Working Capital Ratios				
Fixed Asset Turnover (x)	6.5	6.9	7.5	8.8
Debtor (Days)	22	24	25	25
Inventory (Days)	75	67	74	74
Working Capital (Days)	37	13	44	44
Leverage Ratio (x)				
Debt/Equity	0.0	0.0	0.0	0.0

Balance Sheet				(INR Million)
Y/E December	2011	2012	2013E	2014E
Equity Share Capital	230	230	230	230
Reserves	10,816	11,700	12,620	13,737
Revaluation Reserves	120	111	103	103
Net Worth	11,166	12,041	12,953	14,070
Deferred Tax Liabilities	85	213	213	213
Capital Employed	11,251	12,254	13,166	14,283
Gross Block	4,355	5,010	5,410	5,810
Less: Accum. Deprn.	2,309	2,708	3,141	3,606
Net Fixed Assets	2,046	2,302	2,269	2,204
Capital WIP	302	302	302	302
Investments	4	4	4	4
Goodwill	5,324	4,824	4,324	3,824
Curr. Assets	7,350	8,882	11,460	13,887
Inventory	2,543	2,725	3,493	3,995
Account Receivables	730	986	1,180	1,350
Cash and Bank Balance	2,342	4,289	4,190	5,573
Others	1,735	882	2,597	2,969
Curr. Liability & Prov.	3,775	4,060	5,193	5,938
Account Payables	2,195	2,392	2,833	3,239
Provisions	1,579	1,668	2,360	2,699
Net Current Assets	3,575	4,822	6,267	7,949
Appl. of Funds	11,251	12,254	13,166	14,283

E: MOSL Estimates

Cash Flow Statement				(INR Million)
Y/E December	2011	2012	2013E	2014E
OP/(Loss) before Tax	1,761	2,326	2,663	3,043
Interest/Dividends Recd.	1,395	1,204	1,226	1,367
Direct Taxes Paid	-745	-722	-958	-1,117
(Inc)/Dec in WC	410	700	-1,544	-298
CF from Operations	2,820	3,508	1,388	2,996
EO Items	0	0	0	0
CF from Ope (EO items)	2,820	3,508	1,388	2,996
(Inc)/Dec in FA	-6,148	-663	-408	-400
(Pur)/Sale of Investments	0	0	0	0
CF from Investments	-6,148	-664	-408	-400
Interest Paid	-4	-14	-10	-10
Dividend Paid	-879	-882	-1,069	-1,202
CF from Fin. Activity	-883	-898	-1,079	-1,212
Inc/Dec of Cash	-4,211	1,947	-99	1,383
Add: Beginning Balance	6,554	2,342	4,289	4,190
Closing Balance	2,342	4,289	4,190	5,573

N O T E S

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