

BSE SENSEX
 26,052

 S&P CNX
 8,033

CMP: INR701 TP: INR925 (+32%)
Buy

Stock Info

Bloomberg	SUNP IN
Equity Shares (m)	2,406.7
52-Week Range (INR)	898/572
1, 6, 12 Rel. Per (%)	1/-9/-3
M.Cap. (INR b)/ (USD b)	1,604.8/23.4
Avg Val, (INR m)	2,973
Free float (%)	45.0

Financials Snapshot (INR b)

Y/E Mar	2016	2017E	2018E
Sales	277.4	313.2	338.3
EBITDA	79.6	97.5	114.8
Rep. PAT	47.1	76.2	94.8
Rep.EPS (INR)	19.6	31.7	39.4
Adj. PAT	47.1	69.4	94.8
Core EPS (INR)	19.6	28.8	39.4
EPS Gr. (%)	-0.7	61.8	24.5
BV/Sh. (INR)	130.5	144.6	177.0
RoE (%)	16.5	21.0	24.5
RoCE (%)	18.7	22.9	25.3
Payout (%)	0.0	19.4	16.0

Valuations

P/E (x)	35.8	24.3	17.8
P/BV (x)	5.4	4.8	4.0
EV/EBITDA (x)	20.3	15.5	12.5
Div. Yield (%)	0.0	0.9	0.9

Estimate change

TP change

Rating change

Russian company acquisition to provide local manufacturing footprint

- Sun Pharma (SUNP)** today announced the acquisition of 85.1% equity stake in JSC Biosintez – a Russian pharmaceutical company with operations in Russia and the CIS region – for a consideration of USD24m. SUNP would also assume debt of ~USD36m as part of this transaction. The transaction, which was executed at trailing EV/sales of 1.2x (revenue of USD52m in 2015), is expected to be completed by end-CY16.
- Local manufacturing presence could be key reason for acquisition:** Through this transaction, SUNP will have a manufacturing facility in Russia (in Penza Region). Russia & CIS region (contributed ~USD200m to sales in FY16) is an important market for SUNP. Notably, as per the import substitution program initiated by Russia, it is mandatory to have a manufacturing facility in the country to participate in the government's pharma tenders (government business accounts for ~30% of total market). Currently, SUNP supplies products to the Russian market through its manufacturing plant in Romania. Russia remains one of the largest markets in Eastern Europe with secondary sales of ~USD10b (MAT Sep-16).
- Biosintez: Loss-making company, but its manufacturing plant could be put to good use:** Biosintez is a Russian pharmaceutical company focusing on the hospital segment with annual revenues of ~USD52m in CY2015. More than 80% of Biosintez's revenues come from Russia and ~17% from the CIS regions. The company produces a wide variety of dosage forms, including powders for injections, blood substitutes, blood preservatives, ampoules, tablets, ointment, creams, gels, suppositories and APIs. Biosintez is a loss-making company with PAT loss of RUB41m in 9MCY16. We believe the primary reason to acquire Biosintez would be to have a local manufacturing presence in Russia.
- Russia's 'Pharma 2020' plan favors local players:** In 2009, a three-stage program 'Pharma 2020' was launched in Russia to increase availability of domestically manufactured medicines for the Russian population. The government targets to increase the share of locally produced products to ~50% (from ~20% in 2010) and ensure that 90% of vital and essential medicines are produced domestically. To achieve these targets, the government implemented a host of reforms, including preference to local manufacturers in government tenders. Since 2009, companies such as Sanofi, Teva, Astra Zeneca and Novo Nordisk have invested in the Russian market.
- Valuation remains attractive:** We believe the current stock price does not reflect key positives like RBXY integration benefits, Halol and Mohali plant resolution, and investments in the specialty business. We see the current weakness in stock price as an opportunity to add. SUNP remains an attractive Indian play on specialty business in the US. We maintain **Buy** rating with a target price of INR925, based on 22x 1HFY19E.

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Investors are advised to refer through important disclosures made at the last page of the Research Report.

 Motilal Oswal research is available on www.motilaloswal.com/Institutional-Equities, Bloomberg, Thomson Reuters, Factset and S&P Capital.

Biosintez

Exhibit 1: Biosintez Financials – RUB m

RUB m	CY2012	CY2013	CY2014	CY2015	9M CY16
Revenues	2,502.0	2,893.6	2,591.8	3,208.3	2,062.1
YoY Growth (%)		16%	-10%	24%	
Gross Profit	690.9	918.3	612.2	917.4	559.7
Gross margin (%)	28%	32%	24%	29%	27%
Adjusted PAT	59.9	95.3	0.0	0.0	(41.2)
PAT margin (%)	2%	3%	0%	0%	-2%
YoY Growth (%)		59%	-100%	11%	

The company has been undertaking cost rationalization measures.

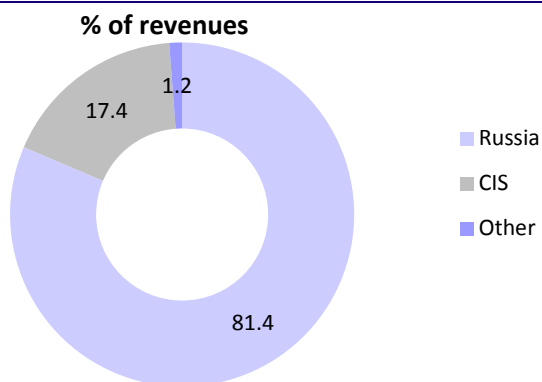
Source: MOSL, Bloomberg, Company reports

Exhibit 2: Biosintez Financials – USD m

USD m	CY2012	CY2013	CY2014	CY2015	9M CY16
Revenues	80.7	90.9	68.6	52.9	30.2
YoY Growth (%)		13%	-24%	-23%	
Gross Profit	22.3	28.8	16.2	15.1	8.2
Gross margin (%)	28%	32%	24%	29%	27%
EBITDA					
EBITDA margin (%)					
Adjusted PAT	1.9	3.0	0.0	0.0	(0.6)
PAT margin (%)	2%	3%	0%	0%	-2%
YoY Growth (%)		55%	-100%	-31%	

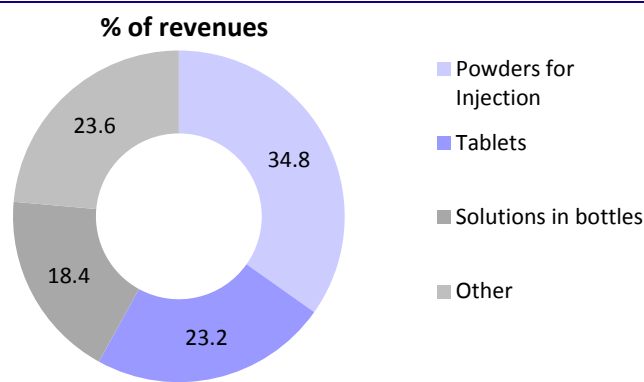
Source: MOSL, Bloomberg, Company reports

Exhibit 3: Biosintez revenue split – Geographical



Source: MOSL, Company reports

Exhibit 4: Biosintez revenue Split – Dosage form



Source: MOSL, Company reports

SUNP does not have a manufacturing base in Russia currently. We believe SUNP's facility in Romania supplies to the Russia market.

Exhibit 5: SUNP Russia-Romania revenues

INR m	FY15	FY16
Russia		
Revenues	3684.9	4384.9
PAT	-49.9	18.6
Romania		
Revenues	8064.4	9124.7
PAT	1221.8	1939.9
Total		
Revenues	11749.3	13509.6
% of SUNP revenues	4%	5%

Source: MOSL, Company

Core goal of Pharma 2020 is self-sufficiency for Russia in terms of pharmaceutical drugs.

To achieve the goals of Pharma 2020, the strategy has been split into three phases.

Russia – Pharma 2020

As a priority move, the Russian government launched the “Pharma 2020” program in 2009. It asserted the development of a strong domestic pharmaceutical industry. The core goal of Pharma 2020 is to raise the market share of domestically produced drugs from 22% of sales in 2010 to 50% by 2020. Furthermore, drugs manufactured in Russia should account for at least 90% of drugs on the List of Vital and Essential Medicines (ZHNVLV). The initiative also aims to launch an import substitution policy that would see Russia producing highly innovative drugs that currently have no Russian-made equivalents.

The utter need for such a strategy was highlighted in recent years, as the oil crisis devalued the Russian ruble. The economic crisis saw some foreign manufacturers cut production of certain medications, as the ruble devaluation and strict state pricing dampened profit margins.

Exhibit 6: Phased approach to Pharma 2020

Phase	Period	Objectives
I	2009-12	Construction of new manufacturing facilities and investment in R&D
II	2013-17	Focus on domestic production of generics, implementation of an import substitution policy and progress toward pharmaceutical self-sufficiency
III	2018-20	Focus on exports growth

Source: MOSL

Current Progress

Russia was on pace to localize 90% of medicines currently in use in Russia by 2018. The 2012 ZHNVLV list contained 567 drugs, with only 93 manufactured in Russia and 267 by joint ventures between Russian and foreign companies. The December 2014 list includes 608 drugs, 413 of which were locally manufactured.

The second phase of Pharma2020 is also progressing well. A flurry of legislations has been introduced in recent years. Legislations range from pricing benefits to domestic producers (extended to foreign manufacturers that bid in government tenders but had established plants in Russia) to legislation obstructing the participation of foreign companies in government tenders.

Exhibit 7: Legislations introduced to promote domestic manufacturing

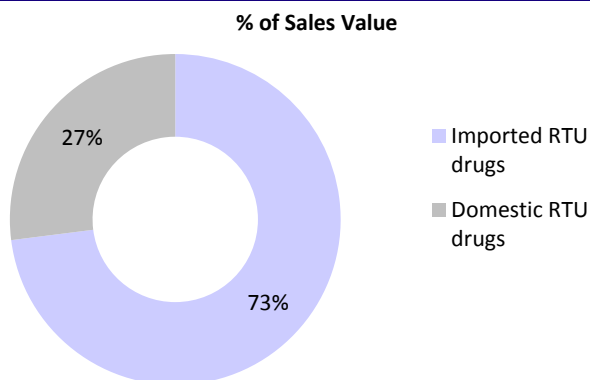
Sr. No.	Legislation
1	15% preferential contract price granted to domestic producers bidding in government tenders
2	Foreign companies not allowed to participate in public tenders, where the same product is produced by at least 2 manufacturers from the Eurasian Customs Union (an EU-type economic alliance formed in 2010 consisting of Russia, Belarus and Kazakhstan).

Source: MOSL

By 2017, the government aims to substitute 50% of all generic drugs with domestic alternatives; by 2020, it aims to achieve 50% manufacturing of all innovative drugs in Russia

If import substitution is one of Russia’s priorities, it is also important to assess where Russia currently stands on this front. In terms of sales value, ~73% of all prescription drugs sold in Russia was imported in 2015. However, in terms of sales volume, ~39% of all prescription drugs sold in Russia were imported in 2015.

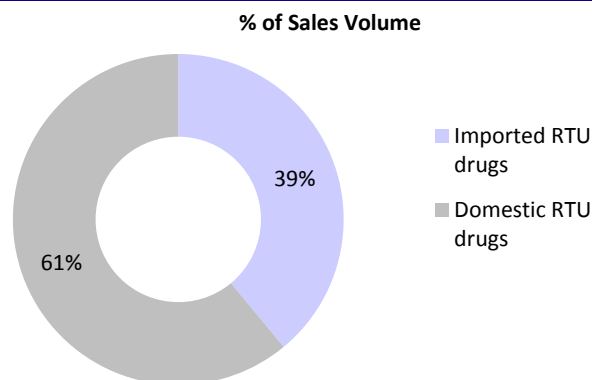
Exhibit 8: Russia pharma market -- Proportion of sales of imported and domestic RTU drugs in terms of sales value



*RTU- Ready to Use

Source: DSM

Exhibit 9: Russia pharma market -- Proportion of sales of imported and domestic RTU drugs in terms of sales volume



Source: DSM

Local production base – the need of the hour

By introducing such legal provisions, Russian authorities aim to support domestic manufacturers while also pressuring foreign pharmaceutical producers to invest in Russia. The strategy has proved successful as foreign pharmaceutical companies have started to localize their production in Russia by building plants of their own, buying existing facilities or arranging production of certain drugs using the local production base (pharmaceutical outsourcing)

Exhibit 10: Some foreign companies that have localized manufacturing in Russia

Company	Region	Commencement of production	Gross investment (USD m)
Sanofi	Orel	2009	60
Servier	Moscow	2009	109
Takeda (Nycomed)	Yaroslavi	2012	80
Astra Zeneca	Kaluga	2014	187
Teva	Yaroslavl	2014	350
Novo Nordisk	Kaluga	2014	100
Novartis Baxter	Lningrad	2014	140
Sun Pharma	Penza	2016	60
Baxter	-	2020	25

Source: MOSL

Russia’s strategy with Pharma 2020 has been to make it more challenging for manufacturers without local presence to compete in the Russian market.

Valuation and view

SUNP has historically commanded 20-25% premium to Indian pharma peers, typically at 25-27x one-year forward P/E multiples. The stock is trading at 24x FY17E and 18x FY18E, which does not fully value its rich US pipeline and stable, cash-generating domestic business. Consistent outperformance in the domestic market with market share gains and high profitability reflect management's execution capability (and product selection skills). Identification of value-accretive assets and integrating them successfully has been one of the cornerstones of SUNP's success.

We believe that valuation premium is likely to be maintained on the back of:

- High earnings visibility on a favorable base (forecast EPS CAGR of 30% over FY16-19E).
- Sustained improvement in RoE, implying high capital efficiency. We expect RoE to expand from 16.5% in FY16 to 22.6% by FY19E.
- Strong cash generation and healthy balance sheet. We expect SUNP to generate INR350b free cash flows over FY16-19E

Our target price implies 30%+ upside

We assign target P/E of 22x to SUNP's base business EPS for 1HFY19E and arrive at a target price of INR925, implying 32% upside from current levels. Our target multiple is:

- At lower end of its historical average P/E band (1-year forward).
- At 10% premium to sector average P/E of 20x.

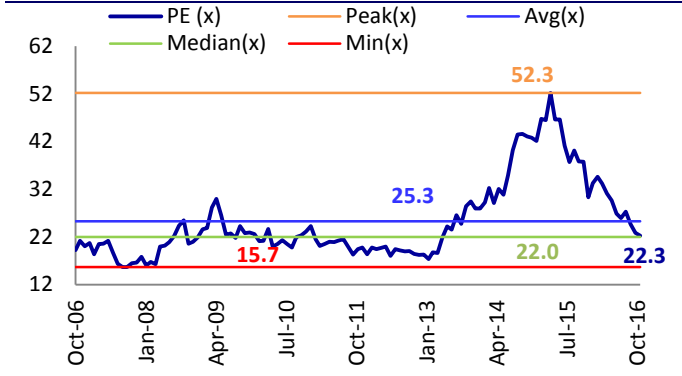
Key catalysts going forward are:

- We have not factored in any potential acquisition that SUNP can execute (net cash surplus) as well as positive development of its novel molecule (tildrakizumab, in-licensed from Merck).
- Execution of RBXY integration would be a key catalyst to watch out in future.

Risks to our thesis are:

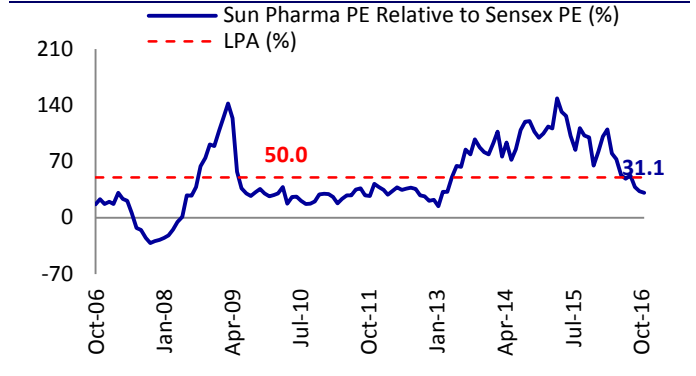
- **Currency volatility:** SUNP derives more than 70% of its revenues (and profits) from overseas business (largely the US), and is thus affected by currency fluctuations on operational level. As a prudent measure though, the company has hedged ~50% of its net exposure to the USD through forward covers (<12mths duration) in the past. A reversal in current trend (i.e., rupee appreciation) thus poses downside risk to forecasts.
- **Increased competition in US derma market:** Taro accounts for 20% of SUNP's business and is currently witnessing pricing pressure owing to increased competition in the US derma market. Additionally, if some of the approved players (2-3) re-enter the market, there could be accelerated risk to pricing in the US derma market, hurting SUNP (Taro) adversely.

Exhibit 11: P/E band (x)



Source: Company, MOSL

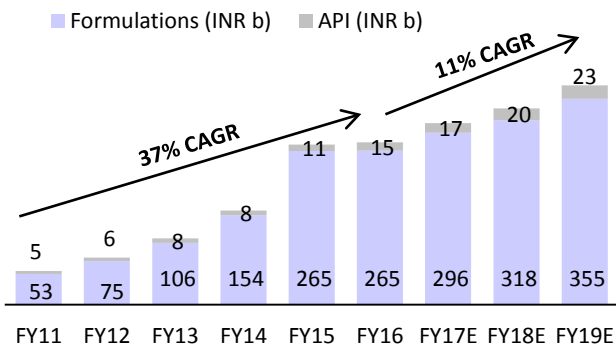
Exhibit 12: P/E relative to Sensex



Source: Company, MOSL

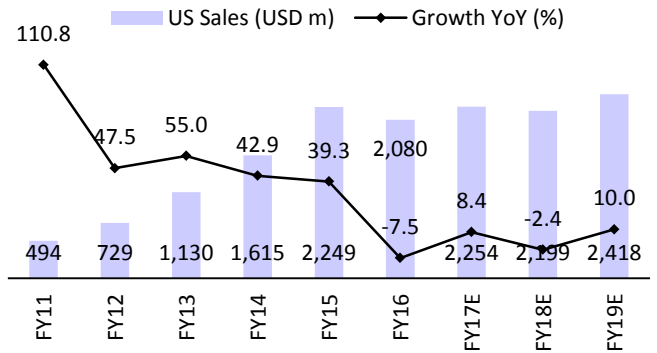
Story in charts

Exhibit 13: Revenues to exhibit 11% CAGR over FY16-19E



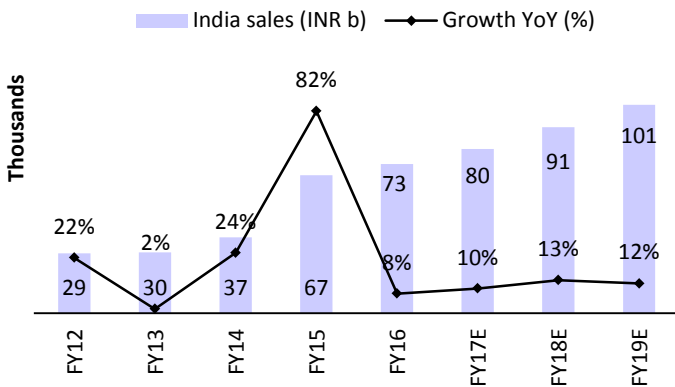
Source: Company, MOSL

Exhibit 14: US generic sales to be driven by new launches



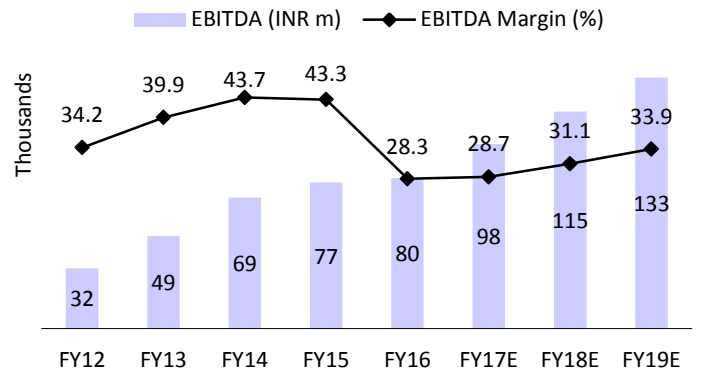
Source: Company, MOSL

Exhibit 15: Domestic business to exhibit robust growth



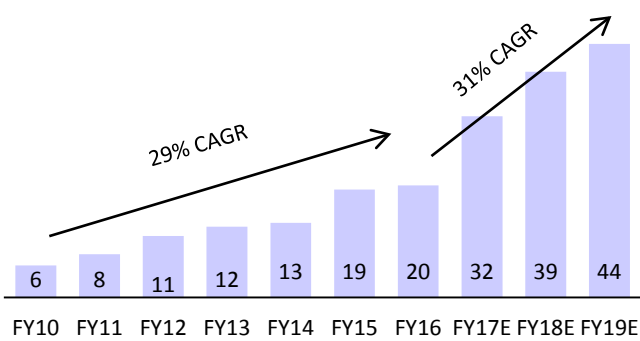
Source: Company, MOSL

Exhibit 16: RBXY synergy benefits to drive margin expansion



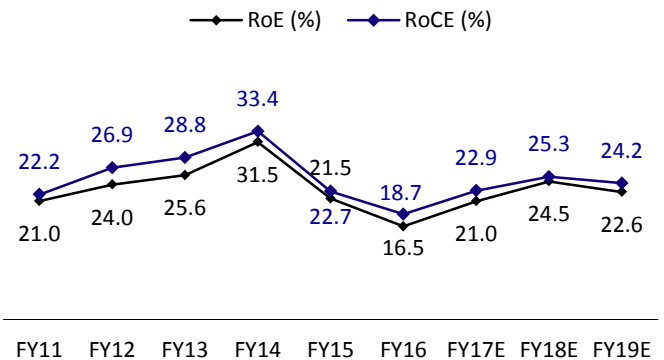
Source: Company, MOSL

Exhibit 17: Earnings to exhibit 31% CAGR (on fav. base)



Source: Company, MOSL

Exhibit 18: Margin expansion to yield superior return ratios



Source: Company, MOSL

Financials and Valuation

Income Statement

(INR Million)

Y/E March	2014	2015	2016	2017E	2018E	2019E
Net Sales	160,044	272,865	277,442	313,159	338,326	378,256
Change (%)	42.4	70.5	1.7	12.9	8.0	11.8
EBITDA (INR b)	69,257	77,198	79,561	97,542	114,785	132,730
Margin (%)	43.3	28.3	28.7	31.1	33.9	35.1
Depreciation	4,092	11,947	10,135	12,400	13,000	14,000
EBIT	65,165	65,250	69,426	85,142	101,785	118,730
Int. and Finance Charges	442	5,790	4,769	4,000	3,000	2,000
Other Income - Rec.	6,282	6,946	9,848	21,400	25,000	26,500
Extra-ordinary Exp	25,174	2,378	6,852	0	0	0
PBT	45,831	64,029	67,653	102,542	123,785	143,230
Tax	7,022	9,147	9,349	15,381	17,949	23,633
Tax Rate (%)	15.3	14.3	13.8	15.0	14.5	16.5
Profit after Tax	38,809	54,882	58,304	87,161	105,836	119,597
Change (%)	11.9	41.4	6.2	49.5	21.4	13.0
Margin (%)	24	20	21	28	31	32
Less: Minority Interest	7375	9488	11145	11000	11000	13000
Reported PAT	31,434	45,394	47,159	76,161	94,836	106,597
Adjusted PAT (excl. Ex. Items)	52,813	47,415	47,069	69,407	94,836	106,597

Balance Sheet

(INR Million)

Y/E March	2014	2015	2016	2017E	2018E	2019E
Equity Share Capital	2,071	2,406	2,406	2,406	2,406	2,406
Total Reserves	183,178	253,826	311,636	345,431	423,377	513,084
Net Worth	185,249	256,232	314,042	347,837	425,783	515,490
Minority Interest	19,212	28,661	40,859	51,859	62,859	75,859
Deferred Liabilities	-9110	-17516	-21259	-21259	-21259	-21259
Total Loans	24,982	77,827	83,381	47,308	34,795	25,700
Capital Employed	220,333	345,203	417,023	425,745	502,178	595,790
Gross Block	63,886	130,369	165,221	154,369	166,369	191,369
Less: Accum. Deprn.	28,904	60,617	69,301	79,335	90,149	102,588
Net Fixed Assets	34,982	69,752	95,920	75,034	76,220	88,781
Capital WIP	8,415	20,386	22,425	24,667	27,134	29,847
Goodwill	33,191	57,073	57,073	57,073	57,073	57,073
Investments	27,860	27,163	13,086	27,163	27,163	27,163
Curr. Assets	177,393	297,403	331,817	395,558	480,955	578,882
Inventory	31,230	56,680	64,236	60,220	59,522	63,452
Account Receivables	22,004	53,123	67,959	55,912	60,272	67,139
Cash and Bank Balance	75,902	109,980	139,893	190,167	264,172	340,786
L & A and Others	48,257	77,619	59,730	89,259	96,989	107,504
Curr. Liability & Prov.	61,509	126,574	103,297	153,750	166,367	185,956
Account Payables	15,887	59,198	48,325	64,645	63,896	68,115
Provisions	45,622	67,376	54,972	89,105	102,471	117,841
Net Current Assets	115,884	170,828	228,520	241,808	314,588	392,926
Appl. of Funds	220,333	345,203	417,024	425,745	502,178	595,790

E: MOSL Estimates

Financials and Valuation

Ratios

Y/E March	2014	2015	2016	2017E	2018E	2019E
Reported EPS	13.1	18.9	19.6	31.7	39.4	44.3
Cash EPS	14.8	23.8	23.8	36.8	44.8	50.1
BV/Share	77.0	106.5	130.5	144.6	177.0	214.3
DPS	2.6	4.3	0.0	6.0	6.0	6.0
Payout (%)	18.7	21.8	0.0	19.4	16.0	14.1
Valuation (x)						
P/E		35.6	35.8	24.3	17.8	15.8
P/BV		6.6	5.4	4.8	4.0	3.3
EV/Sales		6.0	5.8	4.8	4.2	3.6
EV/EBITDA		21.1	20.3	15.5	12.5	10.1
Dividend Yield (%)		0.6	0.0	0.9	0.9	0.9
Return Ratios (%)						
RoE	31.5	21.5	16.5	21.0	24.5	22.6
RoCE	33.4	22.7	18.7	22.9	25.3	24.2
RoIC	55.5	37.8	27.9	34.0	47.4	51.9
Working Capital Ratios						
Fixed Asset Turnover (x)	4.8	5.2	3.3	3.7	4.5	4.6
Debtor (Days)	50	71	89	65	65	65
Creditor (Days)	209	321	272	321	321	321
Inventory (Days)	71	76	85	70	64	61
Leverage Ratio						
Debt/Equity (x)	0.2	0.3	0.3	0.2	0.1	0.1

Cash Flow Statement

(INR Million)

Y/E March	2014	2015	2016	2017E	2018E	2019E
OP/(Loss) bef. Tax	44,083	74,820	72,709	97,542	114,785	132,730
Int./Dividends Recd.	6,282	6,946	9,848	21,400	25,000	26,500
Direct Taxes Paid	-9,010	-17,553	-13,092	-15,381	-17,949	-23,633
(Inc)/Dec in WC	-5,589	-20,865	-27,780	36,986	1,225	-1,724
CF from Operations	35,767	43,348	41,685	140,547	123,061	133,873
(inc)/dec in FA	-18,580	-82,570	-38,341	6,244	-16,653	-29,274
Free Cash Flow	17,187	-39,223	3,344	146,791	106,408	104,599
(Pur)/Sale of Invest.	-3,745	698	14,077	-14,077	0	0
CF from investments	-22,324	-81,872	-24,264	-7,833	-16,653	-29,274
Change in networth	6,674	37,513	11,705	-25,476	0	0
(Inc)/Dec in Debt	22,910	52,845	5,554	-36,073	-12,513	-9,095
Interest Paid	-442	-5,790	-4,769	-4,000	-3,000	-2,000
Dividend Paid	-7,270	-11,964	0	-16,890	-16,890	-16,890
CF from Fin. Activity	21,872	72,605	12,490	-82,439	-32,403	-27,985
Inc/Dec of Cash	35,315	34,080	29,911	50,275	74,005	76,614
Add: Beginning Balance	40,587	75,902	109,980	139,893	190,167	264,172
Closing Balance	75,902	109,982	139,892	190,167	264,172	340,786

E: MOSL Estimates; Note: Cash flows do not tally due to acquisition

Corporate profile

Company description

Sun Pharma is among the largest players in the domestic formulations market and the most profitable one. It makes and markets specialty medicines and APIs for chronic therapy areas such as cardiology, psychiatry, neurology, etc. Sun has forayed into regulated markets by acquiring majority stake in CaracoPharma and has strengthened its presence in US by recent acquisition of Taro.

Exhibit 1: Sensex rebased



Source: MOSL/Bloomberg

Exhibit 2: Shareholding pattern (%)

	Sep-16	Jun-16	Sep-15
Promoter	55.0	55.0	54.7
DII	10.9	10.2	8.1
FII	22.4	24.8	27.6
Others	11.7	10.1	9.7

Note: FII Includes depository receipts Source: Capitaline

Exhibit 3: Top holders

Holder Name	% Holding
Life Insurance Corporation Of India	3.4
Government Of Singapore	1.5
Lakshdeep Investments & Finance (P) Ltd.	1.1

Source: Capitaline

Exhibit 4: Top management

Name	Designation
Israel Makov	Chairman
Dilip S Shanghvi	Managing Director
Sunil R Ajmera	Company Secretary

Source: Capitaline

Exhibit 5: Directors

Name	Name
Israel Makov	S Mohanchand Dadha*
Dilip S Shanghvi	Sudhir V Valia
Ashwin Dani*	Sailesh T Desai
Keki M Mistry*	Rekha Sethi*
Hasmukh S Shah*	

*Independent

Exhibit 6: Auditors

Name	Type
Deloitte Haskins & Sells LLP	Statutory
Kailash Sankhlecha & Associates	Cost Auditor

Source: Capitaline

Exhibit 7: MOSL forecast v/s consensus

EPS (INR)	MOSL forecast	Consensus forecast	Variation (%)
FY17	31.7	29.5	7.4
FY18	39.4	35.3	11.7

Source: Bloomberg

SUN PHARMA GALLERY

SUN PHARMA

Sun Pharma Buy

Halal facility receives warning letter

Early resolution is critical: given that Halal remains one of the key facilities for SUNP with high level of contribution to total sales and 12% to EBITDA sales.

Key Risks: Warning letter conversion into import alert (low probability) is our main risk.

Revenue Growth

2019	2020	2021	2022	2023
16.5%	18.8%	18.8%	18.8%	18.8%
16.5%	18.8%	18.8%	18.8%	18.8%
16.5%	18.8%	18.8%	18.8%	18.8%
16.5%	18.8%	18.8%	18.8%	18.8%

Key Risks

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Sun Pharma Buy

Key Risks

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Revenue Growth

2019	2020	2021	2022	2023
16.5%	18.8%	18.8%	18.8%	18.8%
16.5%	18.8%	18.8%	18.8%	18.8%
16.5%	18.8%	18.8%	18.8%	18.8%
16.5%	18.8%	18.8%	18.8%	18.8%

SUN PHARMACEUTICAL Buy

Key Risks

- Warning letter conversion into import alert (low probability) is our main risk.
- Key Risks: Warning letter conversion into import alert (low probability) is our main risk.

Revenue Growth

2019	2020	2021	2022	2023
16.5%	18.8%	18.8%	18.8%	18.8%
16.5%	18.8%	18.8%	18.8%	18.8%
16.5%	18.8%	18.8%	18.8%	18.8%
16.5%	18.8%	18.8%	18.8%	18.8%

OTHER COMPANIES

Alembic Pharmaceuticals Buy

Key Risks

- Warning letter conversion into import alert (low probability) is our main risk.
- Key Risks: Warning letter conversion into import alert (low probability) is our main risk.

Revenue Growth

2019	2020	2021	2022	2023
16.5%	18.8%	18.8%	18.8%	18.8%
16.5%	18.8%	18.8%	18.8%	18.8%
16.5%	18.8%	18.8%	18.8%	18.8%
16.5%	18.8%	18.8%	18.8%	18.8%

GLENNMARK Buy

Key Risks

- Warning letter conversion into import alert (low probability) is our main risk.
- Key Risks: Warning letter conversion into import alert (low probability) is our main risk.

Revenue Growth

2019	2020	2021	2022	2023
16.5%	18.8%	18.8%	18.8%	18.8%
16.5%	18.8%	18.8%	18.8%	18.8%
16.5%	18.8%	18.8%	18.8%	18.8%
16.5%	18.8%	18.8%	18.8%	18.8%

Aurobindo Pharma Buy

Key Risks

- Warning letter conversion into import alert (low probability) is our main risk.
- Key Risks: Warning letter conversion into import alert (low probability) is our main risk.

Revenue Growth

2019	2020	2021	2022	2023
16.5%	18.8%	18.8%	18.8%	18.8%
16.5%	18.8%	18.8%	18.8%	18.8%
16.5%	18.8%	18.8%	18.8%	18.8%
16.5%	18.8%	18.8%	18.8%	18.8%

SECTOR UPDATES

Healthcare

Channel consolidation

Fortified capabilities, sustained growth

Regulatory hurdles

Price controls

Revenue growth

Healthcare

Euro depreciation: Who gets impacted?

Companies with high exposure to EU may witness margin pressure

Revenue growth

Healthcare

Only the fittest thrive!

Revenue growth

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