

Pharmaceuticals

Target price: Rs336

Earnings revision

(%)	FY21E	FY22E	FY23E
Sales	(4.2)	(9.1)	(13.5)
EPS	(11.8)	(10.5)	(16.8)

Target price revision

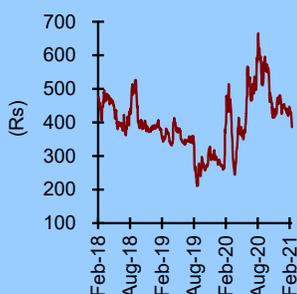
Rs336 from Rs448

Shareholding pattern

	Jun '20	Sep '20	Dec '20
Promoters	53.8	53.3	53.3
Institutional investors	26.8	19.5	19.5
MFs and others	0.0	2.8	2.3
FIs/Banks	0.5	0.0	0.0
FII	26.5	16.7	17.2
Others	19.4	27.2	27.2

Source: BSE India

Price chart



INDIA

Shilpa Medicare

REDUCE

Downgrade from *Hold*

Rs386

USFDA import alert at Jadcherla unit

Shilpa Medicare (Shilpa) announced that USFDA has imposed an import alert on its Jadcherla unit, its only oncology formulation manufacturing facility. This facility was inspected by the USFDA in Feb'20 with fifteen observations, of which, four were repeat observations and was later issued a warning letter in Oct'20. The revenue contribution from this facility was ~23% of total sales in 9MFY21. Three large products (*Azacitidine*, *Erlotinib* and *Cyclophosphamide*) have been exempted and company can continue to be sell them considering potential shortage in US market, however, USFDA has the option to reconsider its stance as the demand and supply for these product normalises. We view this development to negatively impact the company, since oncology formulation was key growth driver. **Downgrade to Reduce from Hold.**

► **Import Alert on Jadcherla unit:** Jadcherla is a formulation manufacturing facility for sterile as well as non-sterile oncology products. This facility was inspected in Feb'20, post which it received fifteen observations. These observations included four repeat observations from their prior inspection. Later this facility was issued a warning letter in Oct'20 with two citations – 1) inadequate handling of OOS and 2) inadequate handling of market complaints, including failure to file FAR within stipulated time. Now an import alert has been imposed which means, existing approved products from this facility can no longer be marketed in US until USFDA provides clearance to the plant. However, three large products namely, *Azacitidine*, *Erlotinib* and *Cyclophosphamide* have been exempted and can be supplied to US however, USFDA has the option to reconsider its stance.

► **Impact on financials:** Total formulations revenue for the company in FY20 was ~21% of total sales and ~23% in 9MFY21, that are being sold in the US and EU. The contribution of the three exempted products was ~69% in FY20 ~86% in 9MFY21 of the formulations sales. If USFDA observes that the demand and supply for these three products has normalised, it can rescind the exemption on these three products. Formulations business was expected to be key growth driver and anecdotally, we believe resolution may take over two years. Hence, we reduce revenue and earnings estimates by 9-14% and 10-17%, respectively, to factor in delay of new product approvals due to import alert.

► **Outlook:** We are now negative on stock considering import alert may take few years to resolve and we estimate flattish earnings over FY20-FY23E. We believe the company's strategy of building high value oncology pipeline for regulated markets would get delayed and success in biosimilars/biologics would also take time.

► **Valuations and risks:** Downgrade to **REDUCE** from *Hold* with a revised target price of Rs336/share based on 18x FY23E (earlier: Rs448/share based on 20x FY23E). We have cut target P/E(x) from 20x to 18x due to import alert which would impact growth over medium term. Key up risks: Early resolution of import alert, scale-up in EU sales and earlier than estimated success in biosimilars or transdermals.

Market Cap	Rs31.5bn/US\$433mn
Reuters/Bloomberg	SHME.BO/SLPA IN
Shares Outstanding (mn)	81.5
52-week Range (Rs)	692/240
Free Float (%)	46.7
FII (%)	17.2
Daily Volume (USD/'000)	4,547
Absolute Return 3m (%)	(9.0)
Absolute Return 12m (%)	(12.1)
Sensex Return 3m (%)	16.2
Sensex Return 12m (%)	25.5

Year to Mar	FY20	FY21E	FY22E	FY23E
Revenue (Rs mn)	9,079	9,075	9,211	9,751
Net Income (Rs mn)	1,562	1,245	1,374	1,520
EPS (Rs)	19.2	15.3	16.9	18.6
% Chg YoY	62.3	(20.2)	10.4	10.6
P/E (x)	20.2	25.3	22.9	20.7
CEPS (Rs)	24.5	21.7	23.8	26.5
EV/E (x)	15.9	17.9	16.8	15.1
Dividend Yield (%)	0.5	0.3	0.2	0.2
RoCE (%)	10.0	7.2	7.2	7.4
RoE (%)	12.4	8.8	8.8	9.0

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Revising sales and earnings estimates

For FY20-FY23E, we forecast a modest revenue CAGR of 2.4% with PAT remaining flattish over the period. We reduce revenue and earnings estimates by 9-14% and 10-17%, respectively, to factor in delay of new product approvals due to import alert.

Table 1: Earnings revision

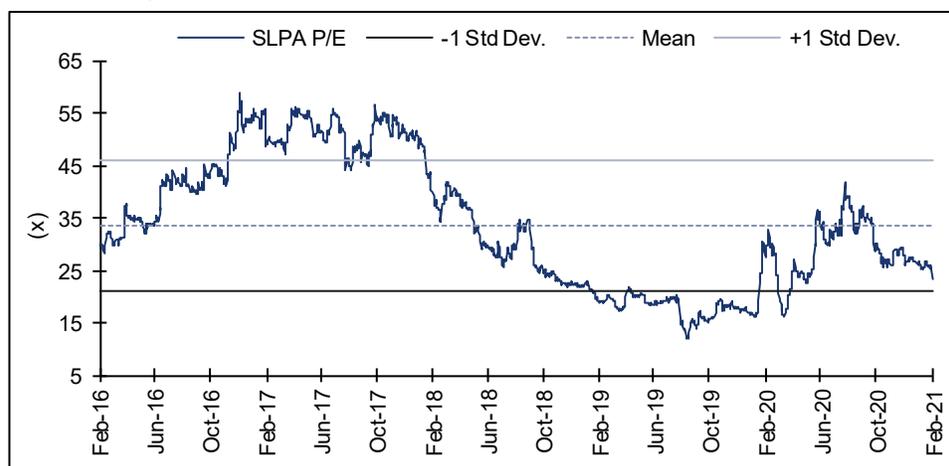
	FY21E	FY22E	FY23E
Total sales (Rs mn)			
Sales – new	9,075	9,211	9,751
Sales – old	9,471	10,137	11,279
Change (%)	(4.2)	(9.1)	(13.5)
EPS (Rs)			
EPS – new	15.3	16.9	18.6
EPS – old	17.3	18.8	22.4
Change (%)	(11.8)	(10.5)	(16.8)

Source: I-Sec research

Valuations

We expect Shilpa's earnings to remain flattish over FY20-FY23E with a modest revenue growth of 2.4% and stable EBITDA margins over the period. The announced import alert would remain a hurdle for the key growth segment of oncology formulations over the medium term as anecdotal evidence suggests it would take more than two years for the company to clear the regulatory issues. Hence, we have cut target P/E(x) from 20x to 18x and downgraded our rating to **REDUCE** from *Hold* with a revised target price of Rs336/share based on 18x FY23E (earlier: Rs448/share based on 20x FY23E). The stock currently trades at 22.9x FY22E and 20.7x FY23E earnings and EV/EBITDA of 16.8x FY22E and 15.1x FY23E. The company has traded at an average PE of 33.7x one-year forward earnings over the past five years.

Chart 1: 1-year forward P/E



Source: Company data, I-Sec research

Financial summary (consolidated)

Table 2: Profit & loss statement

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
Total Net Revenue	9,079	9,075	9,211	9,751
yoy Growth%	23.8	(0.0)	1.5	5.9
Total Op. Exp.	6,881	7,117	7,060	7,354
EBITDA	2,198	1,958	2,151	2,397
Margins %	24.2	21.6	23.4	24.6
yoy Growth%	41.0	(10.9)	9.8	11.4
Depreciation	438	521	566	639
EBIT	1,760	1,437	1,585	1,758
Other Income	166	311	311	311
Interest	46	171	198	189
EO Items	-	608	-	-
PBT	1,881	2,185	1,698	1,880
Tax	335	481	340	376
Tax Rate (%)	17.8	22.0	20.0	20.0
Minority Interest	(16)	(16)	(16)	(16)
Reported PAT	1,562	1,720	1,374	1,520
Adj. PAT	1,562	1,245	1,374	1,520
Net Margins (%)	17.2	13.7	14.9	15.6

Source: Company data, I-Sec research

Table 3: Balance sheet

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
Paid-up Capital	82	82	82	82
Reserves & Surplus	13,212	14,829	16,121	17,549
Total Equity	13,294	14,910	16,202	17,631
Minority Interest	(79)	(95)	(111)	(127)
Total Debt	3,899	5,899	5,399	5,399
Deferred Liabilities	420	420	420	420
Capital Employed	17,533	21,134	21,910	23,323
Current Liabilities	2,328	2,412	2,483	2,650
Total Liabilities	19,861	23,546	24,393	25,973
Net Fixed Assets	13,167	14,646	17,080	18,442
Investments	105	105	105	105
Inventory	2,264	2,342	2,323	2,420
Debtors	2,437	2,648	2,688	2,845
Other Current Assets	1,445	1,445	1,461	1,524
Cash and Equivalents	443	2,361	737	637
Total Cur. Assets	6,590	8,796	7,208	7,426
Total Assets	19,861	23,546	24,393	25,973

Source: Company data, I-Sec research

Table 4: Cashflow statement

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
PBT (Adj. for Extraordinary)	1,881	2,185	1,698	1,880
Depreciation	438	521	566	639
Net Chg in WC	(683)	(204)	23	(194)
Taxes	(422)	(481)	(340)	(376)
Others	(21)	(0)	11	43
CFO	1,192	2,021	1,958	1,992
Capex	(3,445)	(2,000)	(3,000)	(2,000)
Net Investments made	511	-	-	-
Others	46	-	-	-
CFI	(2,888)	(2,000)	(3,000)	(2,000)
Change in Share capital	-	-	-	-
Change in Debts	1,935	2,000	(500)	-
Div. & Div Tax	(206)	(103)	(82)	(91)
Others	(531)	-	-	-
CFF	1,197	1,897	(582)	(91)
Total Cash Generated	(500)	1,918	(1,624)	(99)
Cash Opening Balance	945	446	2,363	739
Cash Closing Balance	446	2,363	739	640

Source: Company data, I-Sec research

Table 5: Key ratios

(Year ending March 31)

	FY20	FY21E	FY22E	FY23E
Adj EPS	19.2	15.3	16.9	18.6
YoY Growth%	62.3	(20.2)	10.4	10.6
Cash EPS	24.5	21.7	23.8	26.5
EBITDA - Core (%)	24.2	21.6	23.4	24.6
NPM (%)	17.2	13.7	14.9	15.6
Net Debt to Equity (x)	0.3	0.2	0.3	0.3
P/E (x)	20.2	25.3	22.9	20.7
EV/EBITDA Core (x)	15.9	17.9	16.8	15.1
P/BV (x)	2.4	2.1	1.9	1.8
EV/Sales (x)	3.8	3.9	3.9	3.7
RoCE (%)	10.0	7.2	7.2	7.4
RoE (%)	12.4	8.8	8.8	9.0
RoIC (%)	10.4	7.7	7.7	7.7
Book Value (Rs)	163	183	199	216
DPS (Rs)	2.1	1.1	0.8	0.9
Dividend Payout (%)	11.0	5.0	5.0	5.0
Div Yield (%)	0.5	0.3	0.2	0.2
Asset Turnover Ratio	0.5	0.4	0.4	0.4
Avg Collection days	90	102	106	104
Avg Inventory days	110	118	121	118

Source: Company data, I-Sec research

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