

Product mix to drive growth

3rd September 2018

CMP: Rs. 280
Target Rs 325
Recommendation Accumulate

Stock Info

BSE Group	A
BSE Code	530239
NSE Symbol	SUVEN
Bloomberg	SVLS.IN
Reuters	SUVP.BO
BSE Sensex	38645
NSE Nifty	11680

Market Info

Market Capital	Rs. 3,559 cr
Equity Capital	Rs. 12.72 cr
6M Avg. Trading Vol.	786,250
52 Wk High/ Low	300/157
Face Value	Rs.1

Shareholding Pattern (%) (Jun 2018)

Promoters	60.00
Domestic Institutions	2.28
Foreign Institutions	4.41
Public & Others	33.31

Price Vs Sensex Chart



Suven Life Sciences (SLS) is a compelling play on the recovery being witnessed in global R&D spending, as reflected in strong fund raising by biotech start-ups as well as a fast-growing research pipeline across multiple stages of clinical trials. SLS has witnessed strong growth in revenue of 22.6% CAGR, whereas operating profit has shown growth of 42.4% CAGR over FY11 to FY18. With improved operating efficiency, we expect the EBITDA margin to expand at a higher rate than the gross margin due to lower than average R&D expense of 10% in FY19-20E compared to average 17% during FY16-18. R&D spending on consolidated level is expected to stand at ~Rs100-120 crore annually for FY19-20E. SLS enjoys a strong margin profile with EBITDA margin of 32%+ in CRAMS segment. We expect return ratios to remain in the range of 15-17%, as growth normalizes.

Valuations:

Considering the 16% adjusted PAT CAGR over FY18-20E with upward potential, strong balance sheet, improving return ratios and good corporate governance practices, we are optimistic about the long-term growth prospect of the company. At the CMP of Rs 280, the stock is trading at 25x its FY19E EPS of Rs 11 and 21x its FY20E EPS of Rs 13. We initiate coverage on the stock & recommend 'Accumulate' rating with target price of Rs 325 per share. Our target price is based on 25x FY20E EPS which gives a potential upside of 16%.

Financial Snapshot:

Particulars (Rs. In Crore)	FY16	FY17	FY18	FY19E	FY20E
Sales	500	544	625	665	766
EBITDA	130	165	233	215	261
EBITDA Margins	26%	30%	37%	32%	34%
PAT	100	123	158	140	170
EPS (Rs.)	8	10	12	11	13
PE(X)	36	29	22	25	21
ROE	17%	18%	18%	15%	16%

Investment Rationale:

Suven Life Sciences (SLS) is a compelling play on the recovery being witnessed in global R&D spending, as reflected in strong fund raising by biotech start-ups as well as a fast-growing research pipeline across multiple stages of clinical trials.

Also, the global Clinical Development & Manufacturing Organizations (CDMO) industry has undergone significant consolidation, both at the Clinical Research Organizations (CRO) level as well as at the API manufacturing level. As a result, fewer and only niche players are left in both clinical services and API manufacturing.

Core CRAMS:

SLS enjoys a strong margin profile with EBITDA margin of 32%+. With ~90% contribution to total revenue from CRAMS remains the primary business for SLS. The company has vast experience due to successful delivery 800+ projects and has 400+ scientists working on CRAMS projects. In Base CRAMS (~55- 60% of revenue), SLS supplies intermediates to innovator companies for NCE development. Generally, SLS gets a new product at phase I, which gradually moves further based on the innovator's success; the volume of intermediates supplied increases 10 times if the product moves to phase II and, similarly, if it moves to phase III. The profit margins in supplies for phase I are very low due to low volumes and involvement in R&D; margins improve substantially in phase II and phase III, however. The Pharma segment, which saw 10% contraction in revenue growth over FY15-17, has shown signs of traction in growth /during FY18. Overall Pharma revenue growth is expected to be 10-15% going ahead. SLS remains a preferred supplier for most of its clients. We expect revenue from base CRAMS business to register a 16% CAGR over FY18-20E driven by the consistent rise in number of active molecules and more molecules in Phase II trial for the innovators.

It has traditionally enjoyed one of the highest EBITDA margins in the CRAMS business, which has been diluted by NCE related R&D spending. However, the pace of R&D spending is expected to level off in FY19. The company also has one of the healthiest ROICs (28-30%) in the CRAMS space, which is set to continue.

SLS has been working on its proprietary NCE pipeline with at least 2 molecules now in mid stage trials i.e. SUVN 502 slated to complete Phase 2 trials in mid-2019 and SUVN 3031 to enter Phase 2 trials in 2019. SLS also has at least 10 more molecules in early stage trials.

CRAMS Projects	2012	2013	2014	2015	2016	2017	2018
Phase I	51	46	52	57	64	70	72
Phase II	32	41	46	52	48	41	36
Phase III	1	3	1	1	1	2	1
Pre-Approval	0	0	0	0	0	0	1
Commercial	0	0	0	0	0	0	3
Total	84	90	99	110	113	113	113

Commercial CRAMS: Flattish revenue for FY19/20E

Although the company has been in CRAMS from FY06, it has reached the commercialization threshold with three molecules during FY15. The Commercial CRAMS is a high value, high margin business involving supply of intermediates for NCE's that are already launched by innovator companies. The four molecules addressing Rheumatoid Arthritis, Diabetes, Depression and Women's Health for US and EU based clients have generated major part of revenues of Rs.120 crores in FY18 at 38.7% CAGR over FY15-18.

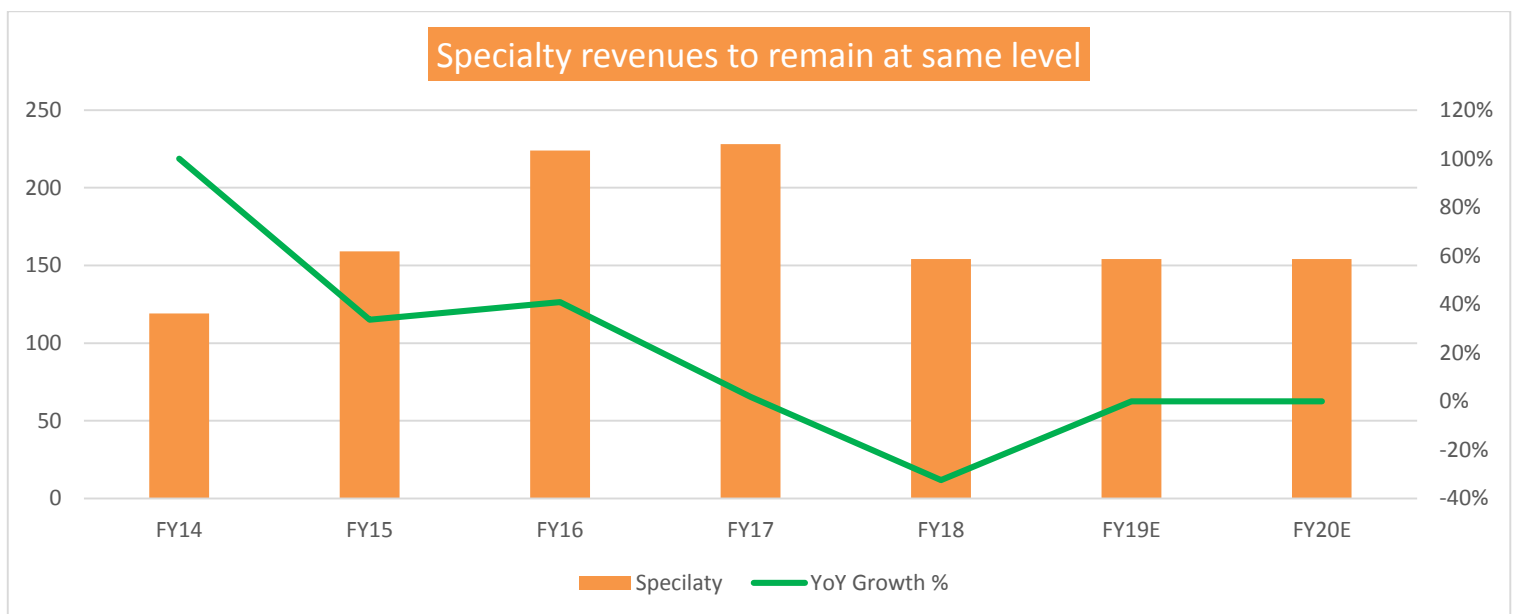
Historically volatile revenue trajectory in this segment is largely due to bunching up of intermediate supplies in FY14 and early FY15. These intermediates were consumed by clients in the following year. This early stocking and subsequently lower-than-expected product takeoff meant that Commercial CRAM supplies declined to NIL in FY16. Since then, supplies have improved, both in FY17 and FY18.

During FY18, SLS has also received its first order for the supply of intermediates for a women's health product for an NDA filing. Revenue is expected to remain in the range of Rs 100 Crore. Commercial supply depends on the innovator's requirements. The company is among the 2-3 suppliers for the intermediary and the exclusivity is expected to last up to FY21. We project overall commercial CRAMS revenue to cap at Rs 100 crore over FY19/20E, however, one more addition to commercial phase further enhances overall revenue for the segment. However, we haven't factored any molecule commercialization in our estimates.

Specialty chemical –Generic competition to cap growth

SLS is also supplying intermediates for one specialty chemical product to a large global conglomerate operating in pharmaceuticals and agrochemicals. Supplies of this specialty chemical pertain to an agro -chemical product which has already been commercialized by the innovator and is under patent. During FY13-18 Specialty chemical CRAMS delivered strong revenue growth of 40% CAGR. However due to generic competition post the patent expiry, revenue in some of the territories have reduced during FY18. Management expects specialty chemical business to deliver flat revenue growth till FY20E. We expect specialty chemical business revenue to remain at same level in FY19 and FY20 at Rs 154 crore. Since opportunity size is unknown, we have not factored in additional revenue from new launches in our estimates.

Specialty revenues to remain at same level



Drug Discovery Services:

SUVN 502 is the advance molecule of Suven, which is a class of selective 5-HT6 receptor compound for the treatment of Alzheimer's disease. SUVN 502 entered phase 2 clinical trials in September 2015. The spending specific to this drug stands reflected only in consolidated numbers, as this spending is done through a US-based 100% subsidiary. Successful completion of phase 2 would result in partnership (in licensing) offers from global pharma companies which will help in monetizing the molecule.

Management is confident about the success of SUVN-502 against its competitors due to no side effects. Currently, SUVN 502 is undergoing phase 2 clinical trials in the US, with the total number of enrolled participants ~500 patients. Another 37 patients are expected to be enrolled by Oct-18 and with last patient out in April-19, final study results expected by July-19. Successful completion of phase 2 trials will provide SLS an opportunity to give out its marketing rights for further study. We believe that there would be good demand for such molecules from MNCs, considering the huge unmet medical requirement for these diseases in the US and non-availability of many drugs for them.

SUVN G3031: Next NCE to enter Phase 2 trials

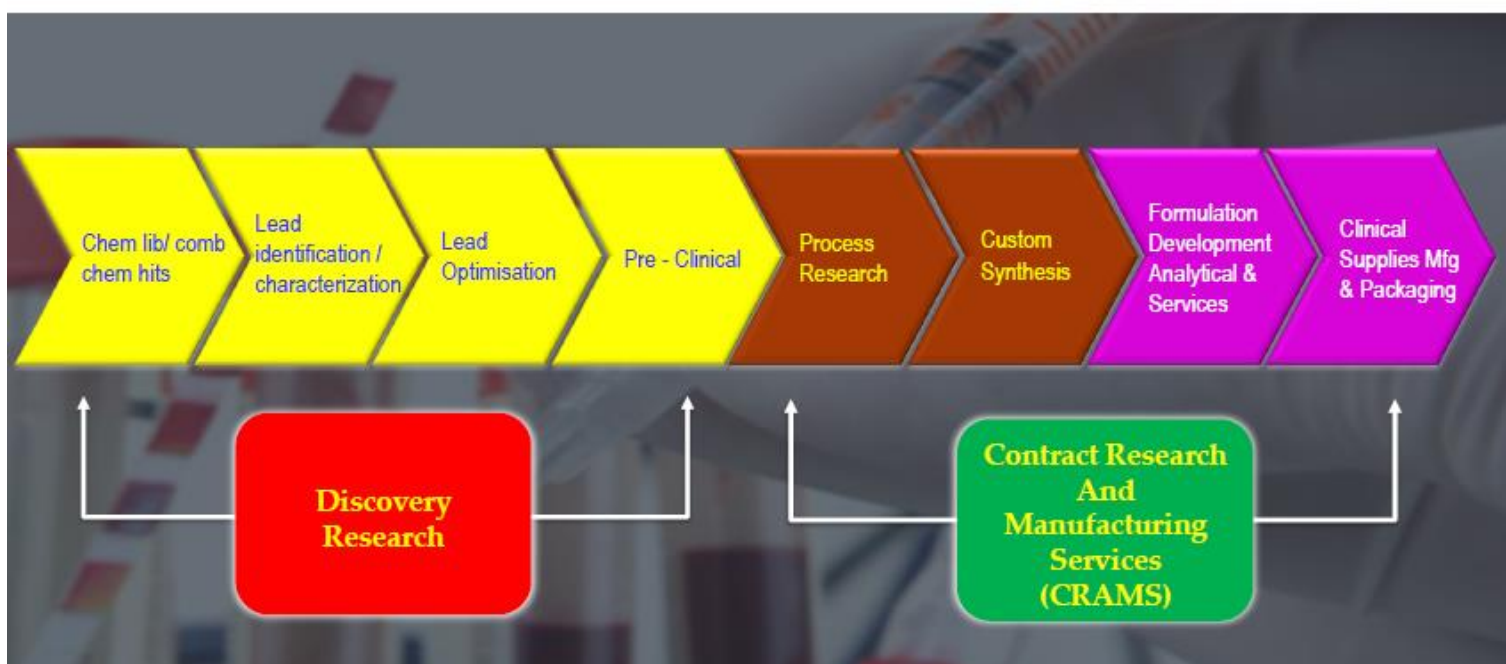
SUVN G3031 is a selective H3 inverse agonist class of drug, which is used to treat cognitive dysfunction associated with AD/Schizophrenia. Currently, SUVN G3031 is set to enter Phase 2 clinical trials in the US and SLS is expected to spend ~US\$15mn over the next two years starting FY19.

ANDA fillings in progress:

The company is working on high value, low volume, niche molecules with lower market size and limited competition due to complex chemistry. The company has US FDA-approved formulations unit at Pashamylaram, Andhra Pradesh, plant which has been built for SLS's own NCE pipeline for innovative R&D. Utilizing its research strength, the company plans to file 6- 8 ANDAs in the next two years with average 3-4 ANDA fillings. The company is already out licensing its Malathion ANDA to Taro Pharmaceuticals which will last till 2026, with an exclusive right to distribute and market in USA, Canada and Mexico. The company earned about Rs10.8 crore as Royalty payment from Taro during a year.

Company Background:

SVLS (Suven Life Sciences) is a clinical-stage Biopharmaceuticals company, which manufactures and supplies drug intermediates and speciality chemicals to global innovator companies. It provides Contract Research & Manufacturing Services (CRAMS), including development and supply of pharmaceuticals for New Chemical Entities (NCEs). In addition, it also undertakes proprietary research on NCEs for CNS disorders. SLS' expertise lies in Process Research, Custom Synthesis and NCE Development Support Services. Currently, in the NCE space, 13 molecules are at various stages of development.



CRAMS: The primary business segment for SLS is CRAMS, which drives overall company revenues. **It contributes ~91% to the total revenue. The CRAMS segment is divided into three sub segments - Core CRAMS, Commercial CRAMS and Speciality Chemicals.** Core CRAMS and Commercial CRAMS make up the Pharma segment while the Speciality Chemicals business caters to Agrochemicals.

Core CRAMS:

It is part of the Pharma CRAMS business and accounts for ~47% of total revenue (FY18). This segment caters to supplying intermediates to NCE projects of global innovators.

Commercial CRAMS:

It is a high-value and high-margin business segment, which involves supply of intermediates to NCEs that are already launched by innovator companies. The historically volatile revenue trajectory in this segment is largely due to bunching up of intermediate supplies in FY14 and early FY15. These intermediates were consumed by clients in the following year. This early stocking and subsequently lower-than-expected product takeoff meant that Commercial CRAM supplies declined to NIL in FY16. Since then, supplies have improved, both in FY17 and FY18.

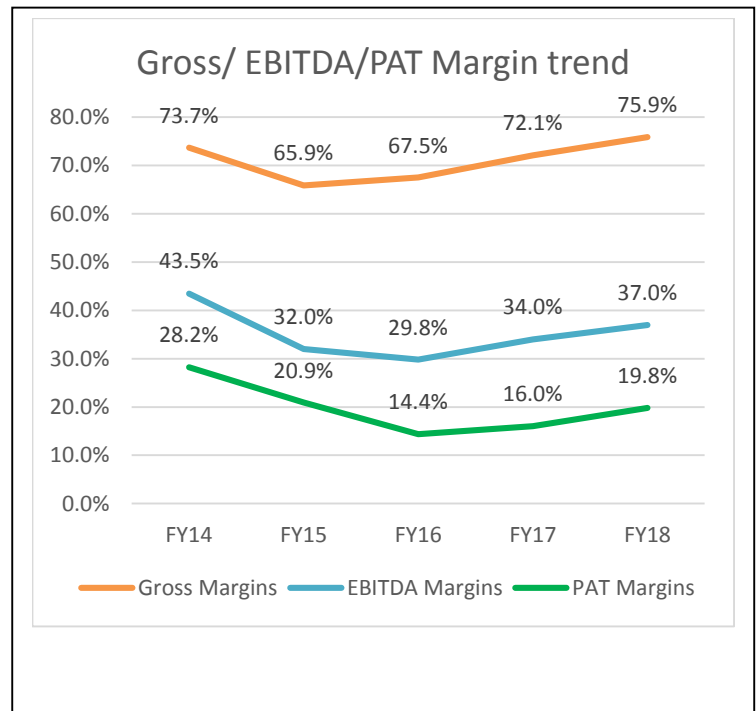
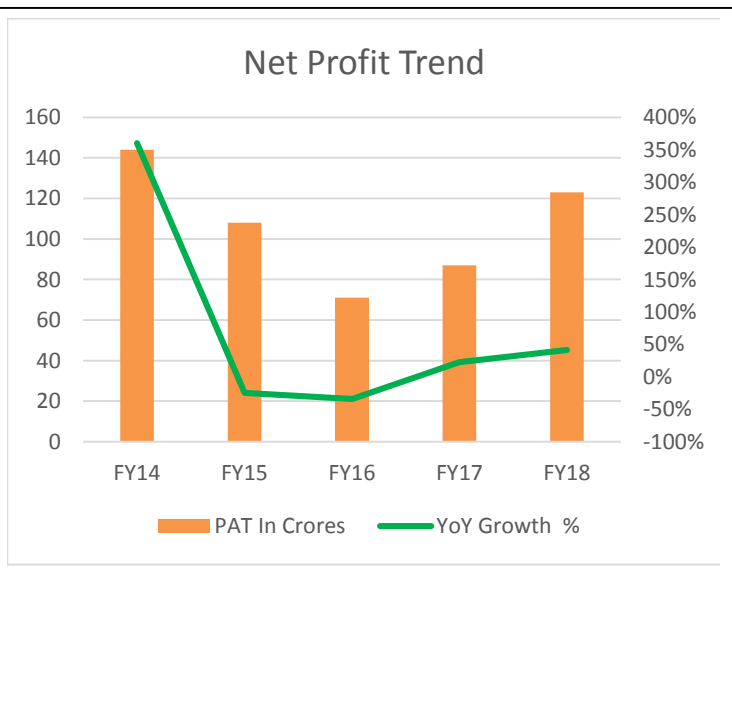
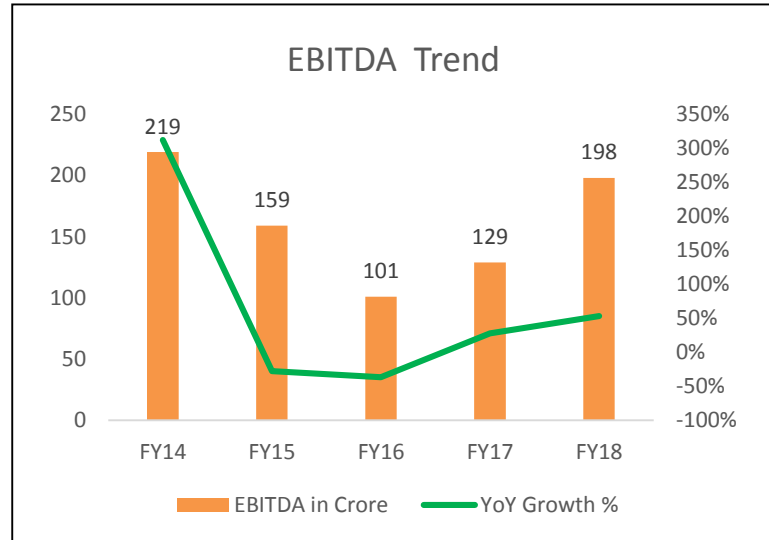
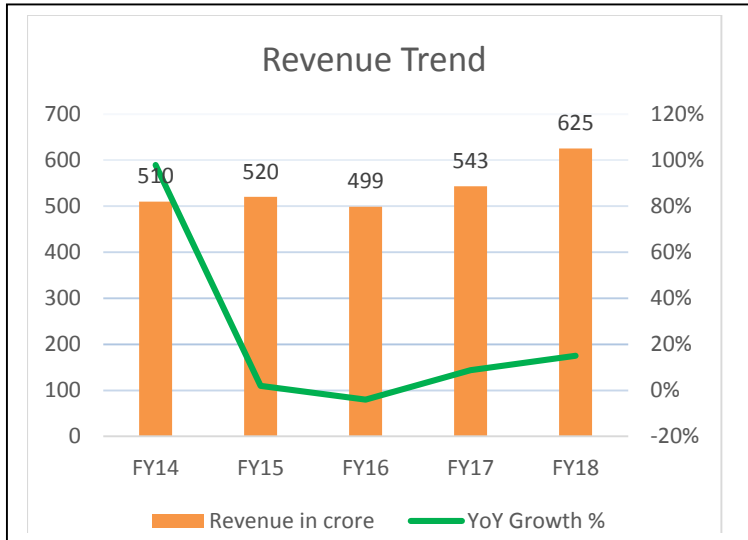
Speciality Chemicals:

Speciality Chemicals CRAMS has historically enjoyed strong growth with revenue CAGR of 40% over FY13-FY17. This was primarily driven by one key Agrochemical molecule, supplied to a global innovator. However, in FY18, the business had a hit due to patents expiry for the product in certain geographies.

Key Risks and concerns:

- **Foreign currency fluctuations:** SLS earns close to 92% of revenues from exports exposing it to significant currency fluctuation risk.
- **Risk of NCE failure:** Company has developed a well-diversified portfolio of 13 molecules. Any set back in the long drawn process of the NCE development will have an impact in the short term. It has to be noted that the company does not have any downside financial risk in any event of failure or set back of approvals as the financing is by equity sources and balance sheet does not carry any of the assets under development.
- **Regulatory slowdown in approvals:** Even as the company is not involved in the approvals of client products, it supplies intermediates to the clients and significant increase in rejections could significantly impact the revenues of the company across streams.

Financial Highlights:



Key Milestone

1989	Suven Pharmaceuticals Pvt. Ltd. is incorporated.
1991	Expands into Fine Chemical Intermediates.
1994	Initiates CRAMS business model (Contract Research And Manufacturing Services).
1995	Goes public (IPO).
2002	Commissions cGMP Lab at Suven Research Center at Hyderabad.
2006	Suven and Lilly establish Drug Discovery Collaboration.
2007	Suven Unit III cGMP facility is accepted by USFDA for manufacture of API's.
2009	Unit 1 receives US FDA acceptance.
2014	Receives US FDA acceptance for Pashamylaram's unit.
2015	SUVN 502 – Completes phase 1b clinical trial under US-IND.
2015	Suven facility at JNPC, Vishakapatnam, Andhra Pradesh commences commercial operation.
2016	SUVN-D4010 Phase 1 clinical trial completed successfully in the US.
2016	Successful USFDA inspection of Pashamylaram unit.
2017	Announces initiation of Phase 1 Clinical Trial and First Dosing of SUVN-911.

Management Details

Name	Age	Designation	Qualification
Venkateswarlu Jasti	69 Years	Chairman & CEO	M Pharma
Sudharani Jasti	64 Years	Whole-time Director	B.Sc

Peers:

Company	CMP	Market Cap in Cr	EPS (Rs/share)			P/E(x)			Revenue in Cr	EBITDA Margins	ROE	D/E
			FY18	FY19E	FY20E	FY18	FY19E	FY20E				
Suven	280	3551	12	11	13	22	25	21	625	36.4	17.9	0.03
Dishman*	296	4778	10	14	18	31	21	16	1695	26.9	12.7	0.2
Divis*	1306	34606	33	42	49	40	31	27	3816	33.5	15.3	0.01

*Bloomberg estimates

Quarterly Update:

Particulars in Crore	Q1FY19	Q1FY18	Q4FY18	YoY	QoQ
Sales	185	137	208	35%	-11%
Other operating income	7	4	5	90%	25%
Total Revenue	192	141	214	36%	-10%
Other Income	8	6	9	45%	-12%
Total Income	200	147	223	36%	-10%
Expenses					
Cost Of Material	39	37	45	5%	-14%
Employee Benefit	17	16	16	9%	10%
R&D expenses	16	16	17	0%	-5%
Total	133	96	122	39%	9%
EBITDA	58	45	91	29%	-36%
EBITDA Margins	30%	32%	43%	-5%	-29%
Depreciation	6	5	5	6%	3%
EBIT	53	40	86	31%	-39%
EBIT Margins	29%	29%	41%	-2%	-31%
Finance Costs	1	1	1	-16%	-15%
PBT	60	44	94	35%	-36%
Total Tax	21	15	31	41%	-33%
Effective Tax Rate	35%	33%	33%		
PAT	39	30	63	31%	-38%
EPS	3.05	2.32	4.91	31%	-38%

Income Statement:

Income Statement Rs in Crore	FY16	FY17	FY18	FY19E	FY20E
Revenue	500	544	625	665	766
Cost of materials	163	147	175	189	219
Gross Margins	33%	27%	28%	28%	29%
Operation and other expenses	207	231	217	261	287
Total Operating Expenses	370	378	392	451	505
EBIDTA	130	165	233	215	261
EBIDTA Margin	26%	30%	37%	32%	34%
Depreciation	17	21	21	27	29
EBIT	112	144	212	187	232
Interest	6	6	5	5	5
Other Income	20	21	23	27	27
PBT	126	159	230	209	254
Tax	26	36	72	69	84
PAT	100	123	158	140	170
Growth (%)	-8%	23%	28%	-12%	21%
EPS	8	10	12	11	13

Balance Sheet:

Balance Sheet Rs Crore	FY16	FY17	FY18	FY19E	FY20E
Shareholder's funds					
Share Capital	13	13	13	13	13
Reserves & Surplus	611	719	854	957	1089
Net Worth	623	732	867	969	1102
Total Non Current Liabilities	45	30	29	29	29
Total Current Liabilities	104	114	113	102	109
Total Liabilities	772	876	1009	1100	1239
Net Block	305	304	305	320	316
Capital Work-in-Progress	7	9	25	26	25
Total Non Current Assets	346	389	454	864	971
Cash and bank balance	239	4	13	3	13
Total Current Assets	427	487	555	236	269
Total Assets	772	876	1009	1100	1239

Cash Flow:

Cash Flow Rs Crore	FY16	FY17	FY18	FY19E	FY20E
Profit Before taxes	126	159	230	209	254
Add:- Depreciation	24	28	25	27	29
Change in Working Capital	-20	10	-92	41	29
Cash generated from operations	117	182	148	282	317
Taxes paid	-27	-35	44	69	84
Net cash flow from operating activities	90	147	105	213	233
Purchase of fixed assets	-58	-31	-40	-200	-200
Others	-4	-322	2	0	0
Net cash flow from investing activities	-62	-353	-38	-200	-200
Dividend paid, including dividend tax	-40	-15	-23	-23	-23
Other	-22	-9	-35	0	0
Net cash used in financing activities	-62	-25	-58	-23	-23
Net Cash Flow	-34	-230	9	-10	10
Opening Cash balance	280	240	4	13	3
Closing Cash balance	240	4	13	3	13

Key Ratios:

Key Ratios	FY16	FY17	FY18	FY19E	FY20E
Particulars					
EPS	7.86	9.70	12.45	11.01	13.38
Book Value Per Share	48.98	57.47	68.09	76.15	86.54
P/E	35.61	28.86	22.50	25.43	20.93
EBIDTA Margin	26%	30%	37.3%	32%	34%
PBT Margin	25%	29%	36.8%	31%	33%
PAT Margin	20%	23%	25%	21%	22%
Debt/Equity	0.13	0.10	0.03	0.03	0.03
Current Ratio	2.57	2.83	4.92	2.33	2.48
ROE	17%	18%	18%	15%	16%
DPS	2.00	1.00	1.50	1.50	1.50

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Stock Rating Scale

	Absolute Return
BUY	>20%
ACCUMULATE	12% to 20%
HOLD	5% to 12%
NEUTRAL	-5% to 5%
REDUCE	<-5%

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