

# Sequent Scientific

14 November 2019

Reuters: SEQU.BO; Bloomberg: SEQ IN

## API business delivers strong performance, Injectable filings begin

Sequent Scientific or SSL's 2QFY20 revenue at Rs2,842mn was in line with our estimate. Revenue grew by 14.5% YoY (cc) and was primarily led by growth in API sales. API sales grew by 30% YoY and now contribute 33% to total sales. The growth in API sales should sustain at least until the end of FY21 as the company expects to monetize its niche VMF (Veterinary master files) filings with low competitive intensity. About 5 of the 17 VMF filings of Sequent Formulations are niche, where SSL is the only filer.

Formulation sales grew slower at 8% during the quarter as the company's largest geography – Europe underperformed and declined 2.5% YoY. The decline in Europe is transient and was on account of a supply chain challenge. One of its injectable suppliers had plant issues, which led to disruption but the same is now restored. Adjusting for these challenges, the company believes it can execute mid teens growth on its formulation business. During the quarter, the company has commercialized a nutritional plant in Spain, which should contribute to sales in 2HFY20. New launches on the formulation front are also expected in second half. In the near term, the formulation business growth should gain intensity and scale once the injectable portfolio under development is commercialized. During the quarter, the company filed for the first injectable product in Europe that has global brand sales of US\$300mn. It would look to file this product for the US market in 4QFY20. We can look forward to commercialization of these injectable filings beginning FY22 and these would be very meaningful opportunities. The injectable filings will continue to happen and increase in number and we can see a major pick up in formulation revenues from FY22 onwards.

EBITDA for the quarter stood at Rs372mn, 10.5% below our estimate. EBITDA margin stood at 13.1%, which declined 75bps QoQ and was up 206bps YoY. The decline in EBITDA was a consequence of lower gross margin and reflected business mix during the quarter. Net profit post minority interest stood at Rs213mn, which was 55.8% above our estimate. The net profit was favorably impacted by higher than usual other income (Rs58mn) on account of special dividend by Strides, which was partially offset by Rs18mn one time OpEx.

**Outlook and valuation:** With the API business gaining significant proportion over the last one year, SSL gets a strong earnings base over which the formulations business growth will continue to be built. The API business has further steam left and can deliver similar growth rates until FY21. On the formulations front, the company is expecting growth, driven by approval of new registrations. The larger part of growth in formulations segment will be driven by monetization of the injectable pipeline in the US and other regulated markets, which should begin FY22 onwards. We change our valuation methodology from EV/EBITDA to P/E based and assign an 18x multiple to its September FY22E earnings and arrive at a target price of Rs97.

## BUY

**Sector:** Pharmaceuticals

**CMP:** Rs68

**Target Price:** Rs97

**Upside:** 43%

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### Key Data

Current Shares O/S (mn)	246.9
Mkt Cap (Rsbn/US\$mn)	16.8/232.8
52 Wk H / L (Rs)	89/62
Daily Vol. (3M NSE Avg.)	417,799

### Price Performance (%)

	1 M	6 M	1 Yr
Sequent Scientific	(11.4)	(1.6)	0.3
Nifty Index	4.7	5.0	13.0

Source: Bloomberg

Y/E March (Rsmn)	2QFY19	1QFY20	2QFY20	YoY (%)	QoQ (%)	1HFY19	1HFY20	YoY (%)
<b>Net revenues</b>	<b>2,517</b>	<b>2,780</b>	<b>2,842</b>	<b>12.9</b>	<b>2.2</b>	<b>4,869</b>	<b>5,622</b>	<b>15.5</b>
Total material costs	1,311	1,431	1,508	15.0	5.3	2,576	2,939	14.1
% of revenues	52.1	51.5	53.0	98 bps	157 bps	52.9	52.3	(64) bps
Staff costs	345	397	408	18.4	2.7	696	805	15.7
% of revenues	13.7	14.3	14.4	66 bps	7 bps	14.3	14.3	3 bps
Other expenses	585	567	555	(5.1)	(2.2)	1,095	1,123	2.6
% of revenues	23.2	20.4	19.5	(370) bps	(88) bps	22.5	20.0	(252) bps
<b>EBITDA</b>	<b>277</b>	<b>384</b>	<b>372</b>	<b>34.0</b>	<b>(3.3)</b>	<b>503</b>	<b>756</b>	<b>50.4</b>
<b>EBITDA margin (%)</b>	<b>11.0</b>	<b>13.8</b>	<b>13.1</b>	<b>206 bps</b>	<b>(75) bps</b>	<b>10.3</b>	<b>13.4</b>	<b>312 bps</b>
Other income	24	13	60	144.4	355.0	43	73	71.1
Interest costs	78	89	78	0.8	(12.4)	156	168	7.9
Depreciation	102	120	125	22.2	3.8	198	245	23.4
Exceptional Items	0	0	0	0.0	0.0	0	0	0.0
<b>PBT</b>	<b>122</b>	<b>188</b>	<b>228</b>	<b>87.1</b>	<b>21.4</b>	<b>191</b>	<b>416</b>	<b>117.7</b>
Tax	(33)	35	(16)	-	-	(9)	19	-
Tax rate (%)	(27.0)	18.6	(7.2)	-	-	(4.5)	4.5	-
<b>PAT continuing operation</b>	<b>155</b>	<b>153</b>	<b>245</b>	<b>57.9</b>	<b>60.0</b>	<b>200</b>	<b>398</b>	<b>99.0</b>
MI	3	38	32	1,085.8	(17.2)	15	70	378.0
<b>PAT post MI</b>	<b>152</b>	<b>115</b>	<b>213</b>	<b>39.8</b>	<b>85.8</b>	<b>185</b>	<b>327</b>	<b>76.8</b>

Source: Company, Nirmal Bang Institutional Equities Research

## Conference call highlights

**US business:** Alivira has filed for VMF of Robenfoxib with USFDA, making it the sole filer. The company has in total filed 17 DMFs and in 5 of them it is the sole filer. The company will be filling the first product in the US in 4Q and according to historic timelines approval is expected in the first quarter of FY22. Management has further targeted 10 filings in the next three years.

**Europe business:** The company has experienced slowdown in Europe on account of BREXIT concerns, Supplier disruption in the UK and slowdown in Spain. The company however has better prospects as it has filed the world's largest animal health injectable product from German facility with an addressable market of US\$300mn.

**Turkey market:** The Turkey business has de-grown sequentially however the business has grown 63.5% on constant currency basis (YoY).

**API Business:** The Company is expanding in developed markets and continues to focus on high margin products. There are now 12 APIs where the company has less than 3 competitors and the potential revenue contribution from these could allow it 25% growth on the base over FY21.

**Italy:** The Company commercialized operations in Italy in the quarter under review and filed 4 oral formulations in September. The company is filling 3 injectibles in this quarter. However, it continues to incur losses in Italy and breakeven is expected in 4QFY20.

**Tax rate:** The Company has guided for tax rate of slightly less than 15% for the full year FY20. However, the tax rate will be 15% in the second half. The tax rate for FY21 is 15% as per the company's guidance.

**Exhibit 1: Financial summary**

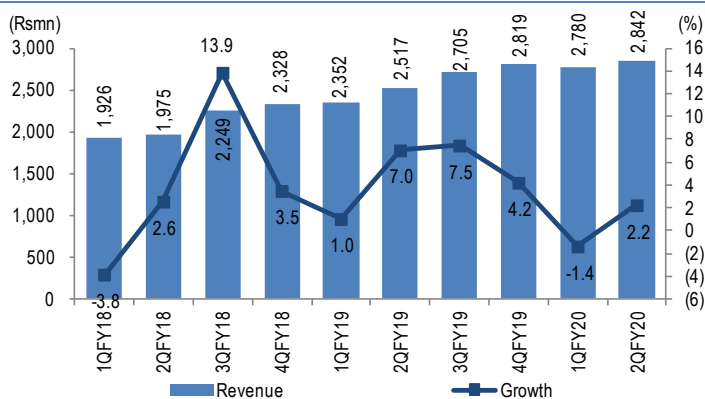
Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Net sales	8,479	10,393	12,538	14,542	16,553
EBITDA	830	1,249	1,630	2,322	2,783
*Adjusted net profit	10	487	704	1,163	1,470
Adjusted EPS (Rs)	0.0	2.0	2.9	4.8	6.0
Adjusted EPS growth (%)	0.0	4,991.6	44.7	65.2	26.4
EBITDA margin (%)	9.8	12.0	13.0	16.0	16.8
P/E (x)	0.0	34.1	23.5	14.3	11.3
P/BV (x)	2.4	2.2	1.9	1.6	1.3
EV/EBITDA (x)	22.1	14.5	9.9	6.0	4.0
RoCE (%)	3.6	8.5	10.8	14.1	14.5
RoE (%)	0.1	6.8	8.7	12.0	12.3

Source: Company, Nirmal Bang Institutional Equities Research

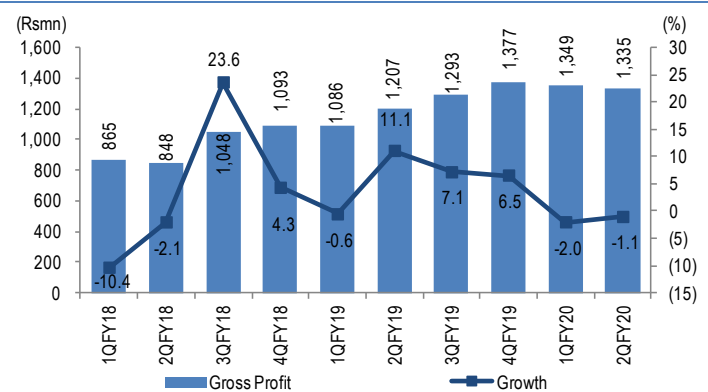
**Exhibit 2: Actual performance versus our estimates**

Particulars (Rsmn)	Actual	NBIE est.	Var. (%)
Revenues	2,842	2,844	(0.0)
EBITDA	372	415	(10.5)
EBITDA margin (%)	13.1	14.6	(153) bps
PAT	213	137	55.8
PAT margin (%)	7.5	4.8	269 bps

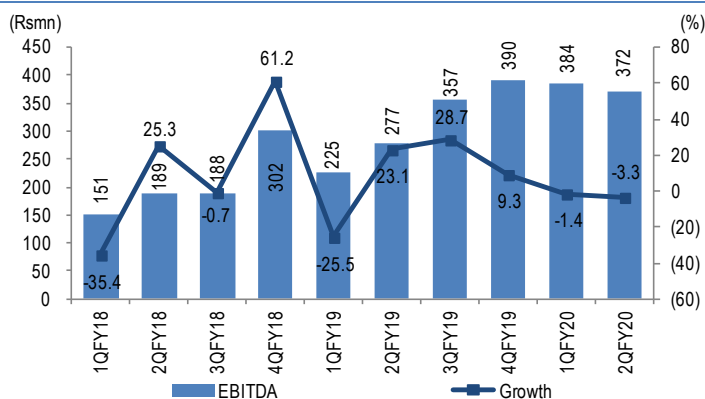
Source: Company, Bloomberg, Nirmal Bang Institutional Equities Research

**Exhibit 3: Revenue and growth trend**


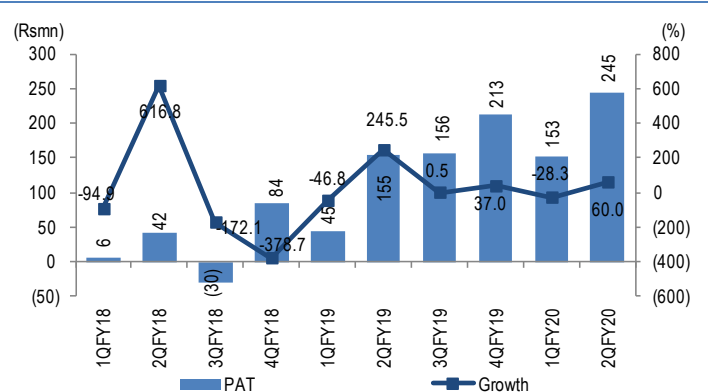
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 4: Gross profit and growth trend**


Source: Company, Nirmal Bang Institutional Equities Research

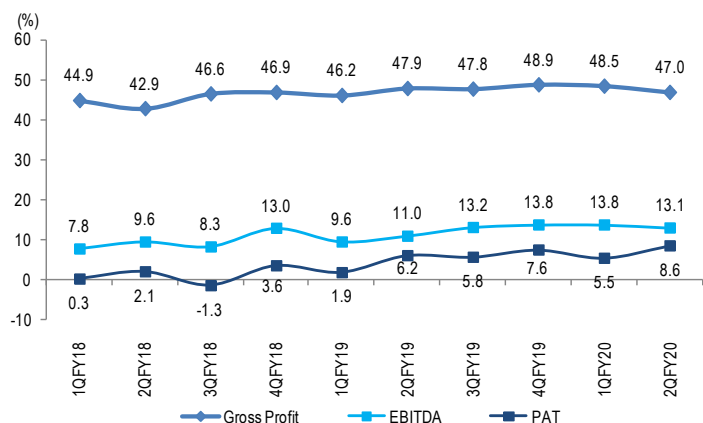
**Exhibit 5: EBITDA and growth trend**


Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 6: PAT and growth trend**


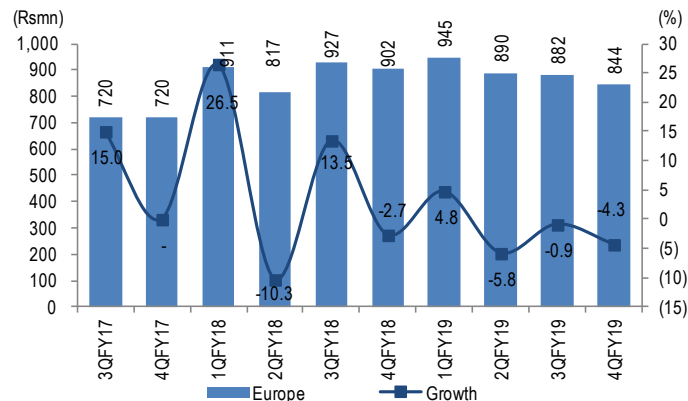
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 7: Margin trend**



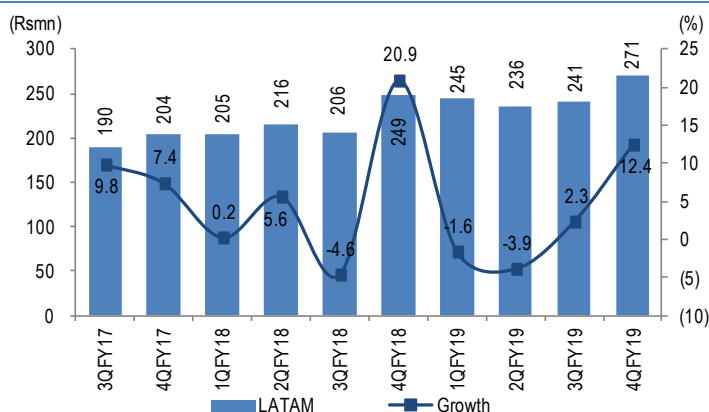
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 8: Europe revenue and growth trend**



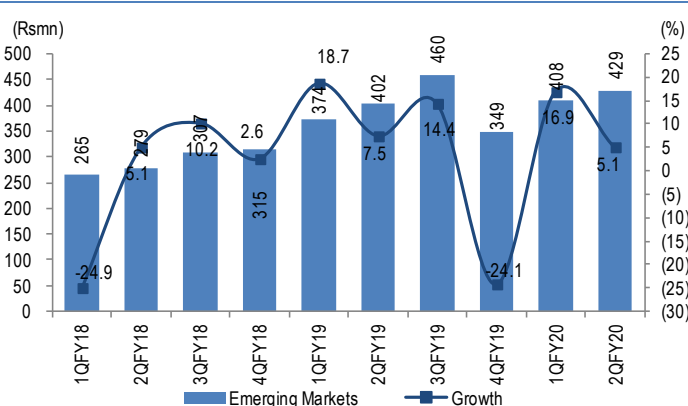
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 9: LATAM revenue and growth trend**



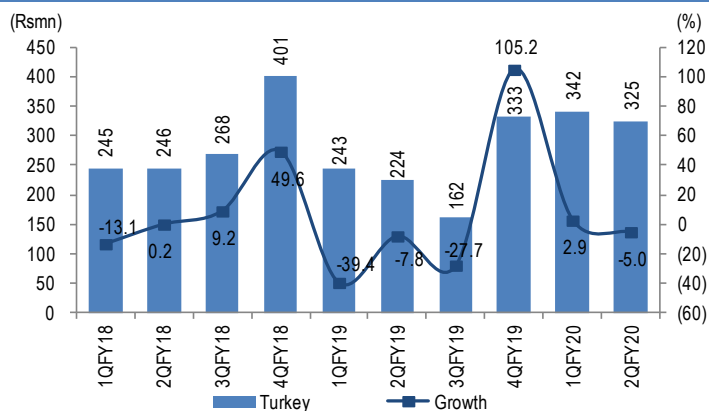
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 10: Emerging Markets revenue and growth trend**



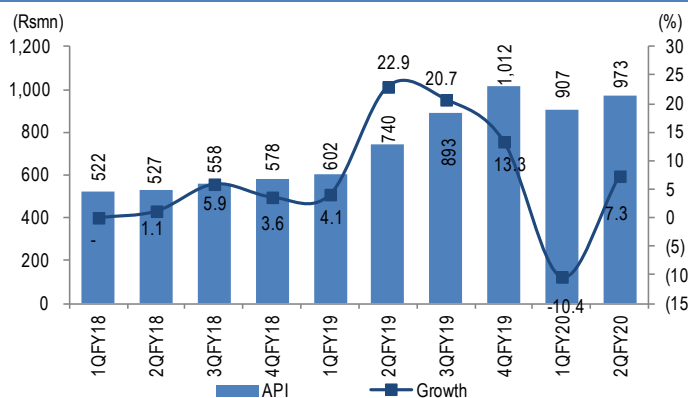
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 11: Turkey revenue and growth trend**



Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 12: API revenue and growth trend**



Source: Company, Nirmal Bang Institutional Equities Research

## Financial statements

### Exhibit 13: Income statement

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
<b>Net sales</b>	<b>8,479</b>	<b>10,393</b>	<b>12,538</b>	<b>14,542</b>	<b>16,553</b>
Growth (%)	24.0	22.6	20.6	16.0	13.8
COGS	4,625	5,430	6,750	7,562	8,607
Employee expenses	1,138	1,459	1,678	1,930	2,162
Other expenses	1,885	2,254	2,480	2,727	3,000
Total expenditure	7,649	9,144	10,908	12,219	13,769
<b>EBITDA</b>	<b>830</b>	<b>1,249</b>	<b>1,630</b>	<b>2,322</b>	<b>2,783</b>
Growth (%)	93.3	50.5	30.5	42.5	19.8
<b>EBITDA margin (%)</b>	<b>9.8</b>	<b>12.0</b>	<b>13.0</b>	<b>16.0</b>	<b>16.8</b>
Other income	166	87	245	284	323
Interest costs	331	328	360	360	360
Depreciation	413	419	442	473	505
Exceptional items	0	0	0	0	0
<b>PBT</b>	<b>237</b>	<b>589</b>	<b>1,073</b>	<b>1,773</b>	<b>2,241</b>
Tax	135	20	215	355	448
Effective tax rate (%)	56.8	3.4	20.0	20.0	20.0
<b>PAT</b>	<b>10</b>	<b>487</b>	<b>704</b>	<b>1,163</b>	<b>1,470</b>
Growth (%)	0.0	4,991.6	44.7	65.2	26.4
<b>Adjusted EPS (Rs)</b>	<b>0</b>	<b>2</b>	<b>3</b>	<b>5</b>	<b>6</b>
<b>EPS growth</b>	<b>0.0</b>	<b>4,991.6</b>	<b>44.7</b>	<b>65.2</b>	<b>26.4</b>

Source: Company, Nirmal Bang Institutional Equities Research

### Exhibit 15: Balance sheet

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Equity	487	494	494	494	494
Reserves	5,988	6,573	7,432	8,850	10,643
Net worth	6,476	7,067	7,925	9,344	11,137
Minority interest	370	403	746	1,313	2,030
Short-term loans	1,524	1,188	2,243	2,567	2,923
Long-term loans	1,035	1,478	1,035	1,035	1,035
Total loans	2,560	2,667	3,278	3,603	3,958
Deferred tax liabilities	108	103	103	103	103
Other non-current liabilities	1,129	494	1,650	1,899	2,149
Liabilities directly associated with assets classified as held for sale	0	0	0	0	0
<b>Total liabilities</b>	<b>10,642</b>	<b>10,734</b>	<b>13,703</b>	<b>16,262</b>	<b>19,378</b>
Fixed assets including CWIP	2,269	2,442	2,616	2,772	2,898
Intangible assets	2,671	2,765	2,265	2,085	1,905
Noncurrent investments	2,217	1,797	1,797	1,797	1,797
Other non-current assets	890	875	1,316	1,526	1,738
Current investments	173	5	5	5	5
Inventories	1,586	2,001	2,314	2,593	2,951
Debtors	2,583	2,783	3,820	4,431	5,044
Cash and cash equivalents	395	678	2,857	4,778	7,285
Other current assets	642	534	784	901	1,019
Total Current Assets	5,380	6,000	9,781	12,708	16,304
Creditors	1,605	2,094	2,342	2,624	2,987
Other current liabilities/provisions	1,180	1,051	1,728	2,001	2,275
Total current liabilities	2,785	3,145	4,071	4,625	5,262
Net current assets	2,595	2,855	5,710	8,083	11,042
Assets classified as held for sale	0	0	0	0	0
<b>Total assets</b>	<b>10,642</b>	<b>10,734</b>	<b>13,703</b>	<b>16,262</b>	<b>19,379</b>

Source: Company, Nirmal Bang Institutional Equities Research

### Exhibit 14: Cash flow

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
PBT	237	589	1,073	1,773	2,241
(Inc.)/dec. in working capital	(207)	36	(676)	(451)	(452)
Cash flow from operations	30	624	398	1,321	1,789
Other income	(166)	(87)	(245)	(284)	(323)
Other expenses	365	323	360	360	360
Depreciation	413	419	442	473	505
Tax paid	(135)	(20)	(215)	(355)	(448)
<b>Net cash from operations</b>	<b>508</b>	<b>1,260</b>	<b>740</b>	<b>1,516</b>	<b>1,883</b>
Capital expenditure	1,815	(687)	(114)	(450)	(451)
<b>Net cash after capex</b>	<b>2,323</b>	<b>573</b>	<b>626</b>	<b>1,066</b>	<b>1,432</b>
Other investment activities	2,987	523	(197)	74	112
Cash from financial activities	(5,356)	(814)	1,750	781	963
Opening cash balance	441	395	678	2,857	4,778
Closing cash balance	395	678	2,857	4,778	7,285
Change in cash balance	(45)	283	2,179	1,921	2,507

Source: Company, Nirmal Bang Institutional Equities Research

### Exhibit 16: Key ratios

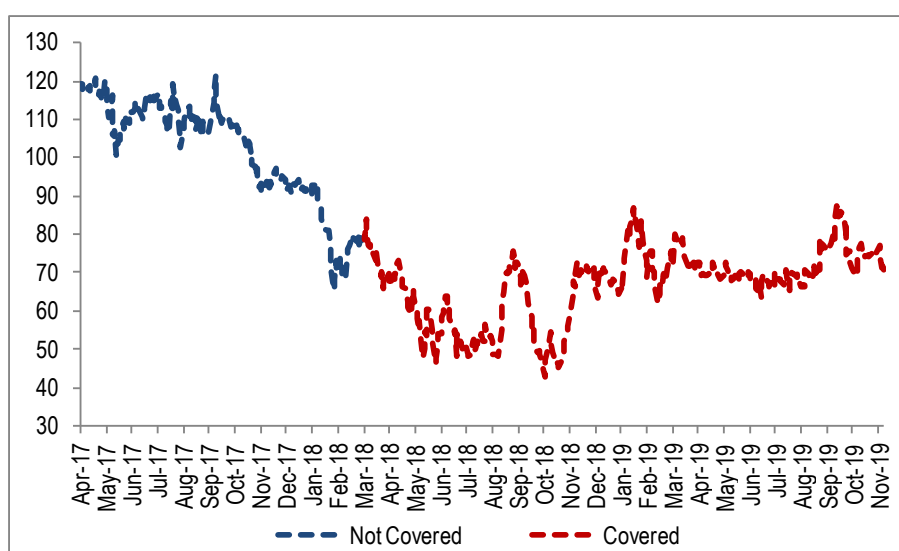
Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
<b>Per share (Rs)</b>					
EPS	0.0	2.0	2.9	4.8	6.0
BPS	28.1	30.6	35.6	43.7	53.8
<b>Profitability &amp; return ratios (%)</b>					
EBITDA margin	9.8	12.0	13.0	16.0	16.8
EBIT margin	4.9	8.0	9.5	12.7	13.8
PAT margin	2.8	5.7	8.6	12.2	13.5
RoCE	3.6	8.5	10.8	14.1	14.5
RoE	0.1	6.8	8.7	12.0	12.3
<b>Working capital &amp; liquidity ratios</b>					
Receivables (days)	110	94	96	104	104
Inventory (days)	126	121	117	118	118
Payables (days)	143	124	120	120	119
Current ratio(x)	1.1	1.2	1.4	1.5	1.8
Quick ratio(x)	0.8	0.9	0.9	1.2	1.4
<b>Valuation ratios (x)</b>					
P/E	-	34.1	23.5	14.3	11.3
P/BV	2.4	2.2	1.9	1.6	1.3
EV/EBITDA	22.1	14.5	9.9	6.0	4.0
EV/sales	2.2	1.7	1.3	1.0	0.7

Source: Company, Nirmal Bang Institutional Equities Research

## Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
13 March 2018	Buy	84	121
19 April 2018	Buy	69	85
28 May 2018	Buy	61	85
5 November 2018	Buy	52	123
4 February 2019	Buy	78	123
5 April 2019	Buy	70	131
15 May 2019	Buy	68	116
1 August 2019	Buy	69	116
23 September 2019	Buy	86	129
14 November 2019	Buy	68	97

## Rating track graph



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### Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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