MOTILAL OSWAL

4 August 2021

1QFY22 Results Update | Sector: Healthcare

Solara Active Pharma

Estimate change	↑
TP change	↑
Rating change	↔

Motilal Oswal values your support in the Asiamoney Brokers Poll 2021 for India Research, Sales, Corporate Access and Trading team. We request your ballot.

Bloomberg	SOLARA IN
Equity Shares (m)	36
M.Cap.(INRb)/(USDb)	62.1 / 0.8
52-Week Range (INR)	1859 / 830
1, 6, 12 Rel. Per (%)	-3/14/59
12M Avg Val (INR m)	215
Free float (%)	58.9

Financials & Valuations (INR b)

Y/E MARCH	2021	2022E	2023E
Sales	16.2	26.0	30.7
EBITDA	3.9	6.4	7.8
Adj. PAT	2.2	4.1	5.1
EBIT Margin (%)	17.1	19.4	20.5
Cons. Adj. EPS (INR)	45.0	82.4	103.4
EPS Gr. (%)	93.2	83.1	25.4
BV/Sh. (INR)	442.2	534.7	647.3
Ratios			
Net D:E	0.2	0.3	0.13
RoE (%)	16.6	23.1	24.0
RoCE (%)	15.7	21.2	21.6
Payout (%)	13.3	21.4	20.5
Valuations			
P/E (x)	38.0	20.8	16.5
EV/EBITDA (x)	16.7	14.1	11.2
Div. Yield (%)	0.4	0.9	1.1
FCF Yield (%)	(0.3)	(2.9)	9.1
EV/Sales (x)	4.0	3.5	2.85

Shareholding pattern (%)

As On	Jun-21	Mar-21	Jun-20
Promoter	41.1	44.1	41.9
DII	6.4	4.0	6.7
FII	16.6	13.7	16.7
Others	35.9	38.3	34.7

FII Includes depository receipts

CMP: INR1,728 TP: INR2,050 (+20%) Buy

Comprehensive approach in API/CRAMS to drive growth

Customer additions/differentiated technology aids better visibility in the CRAMS business

- SOLARA delivered an in line 1QFY22 earnings, led by increased contribution from new products, ramp in other markets like Asia-Pacific, and healthy growth in the Contract Research and Manufacturing Services (CRAMS) business. SOLARA has delivered a robust performance, with EBITDA margin/PAT growing to 24%/INR2.2b in FY21 from 14%/INR380m in FY18. SOLARA further aims to achieve 25% revenue CAGR over FY21-25 through enhanced portfolio offering in generic API, strong scale-up in the CRAMS segment, and the inorganic route.
- We raise our FY22E/FY23E EPS estimate by 5%/7% to factor in: a) benefits from successful backward integration for Ibuprofen manufacturing, b) extended tax benefits, and c) increased growth prospects in the CRAMS segment. We continue to value SOLARA at 13x its 12-month forward EV/EBITDA to arrive at our TP of INR2,050.
- We remain positive on SOLARA as it is well-placed in the API space (product offering supported by manufacturing capacity/capability) to take advantage of the favorable demand scenario and building its presence across the CRAMS value chain. We reiterate our **BUY** rating.

line 1QFY22; lower regulated market sales impacts profitability

- Revenue grew 16.4% YoY to INR4.1b (est. INR4.2b) in 1QFY22.
- Gross margin contracted by 100bp YoY to 56% due to the reduced share of the regulated market business.
- EBITDA margin contracted by 160bp YoY to 22.5%.
- EBITDA margin contracted at a higher rate due to lower realizations in the portfolio and increased opex (other expense up 110bp YoY, but partially offset by a 50bp YoY decline in employee cost as a percentage of sales).
- EBITDA grew 9% YoY to INR914m (est. INR953m).
- PAT grew 20% YoY to INR507m (est. INR504m).

Highlights from the management commentary

- The management expressed its long-term aspiration of 25% revenue CAGR, EBITDA margin of 23-25%, and ~30% revenue from the CRAMS segment over FY21-25. This would be largely driven by the organic route.
- Specifically for FY22, it guided at sales/EBITDA margin of INR28b/23-25% (including the AURORE merger).
- SOLARA expects INR1.5-2.2b in synergy benefits in the first year of operations post the merger of SOLARA and AURORE.
- It has been successful in backward integration in the Ibuprofen manufacturing process. This would enhance the profitability of this product considerably. SOLARA is one of the only two Ibuprofen manufacturers globally to have complete backward integration.
- The management does not expect any goodwill creation on the AURORE acquisition.
- Net debt is up INR1b to INR5.3b on higher working capital requirements.

Tushar Manudhane - Research Analyst (Tushar.Manudhane@MotilalOswal.com)

Bharat Hegde, CFA (Bharat.Hegde@motilaloswal.com);

Valuation and view

- We raise our FY22E/FY23E EPS estimate by 5%/7% to factor in: a) better profitability from complete integration in the Ibuprofen manufacturing process, b) addition of customers/better traction from existing customers in the CRAMS segment and c) extended tax benefits.
- We expect 38% revenue CAGR over FY21-23E, driven by 31%/112% CAGR in API/CRAMS revenue in SOLARA and addition of the AURORE business. With operating leverage and synergy benefits, we expect EBITDA to grow at 42% CAGR over FY21-23E.
- We value SOLARA at 13x EV/EBITDA on a 12-month forward EBITDA, arriving at our TP of INR2,050. We reiterate our **BUY** rating.

Consolidated quarterly earnings model (INR m)

Y/E March	FY21				FY22				FY21	FY22E	FY22E	Var. (%)
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE			1QE	
Gross Sales	**3,484**	**3,976**	**4,267**	**4,442**	**4,056**	**4,572**	**4,992**	**6,138**	**16,169**	**26,022**	**4,200**	**-3.4**
YoY Change (%)	5.5	13.2	24.2	49.7	16.4	15.0	17.0	38.2	22.3	60.9	20.5	
Total Expenditure	2,646	2,999	3,214	3,451	3,142	3,525	3,819	4,824	12,310	19,595	3,247	
EBITDA	**838**	**976**	**1,053**	**991**	**914**	**1,047**	**1,173**	**1,314**	**3,859**	**6,427**	**953**	**-4.1**
YoY Change (%)	31.6	43.5	35.6	97.9	9.1	7.2	11.4	32.6	48.7	66.6	13.8	
Margin (%)	24.1	24.6	24.7	22.3	22.5	22.9	23.5	21.4	23.9	24.7	22.7	
Depreciation	262	276	274	274	277	280	282	311	1,087	1,383	270	
Interest	198	194	205	248	190	198	215	217	845	1,089	200	
Other Income	46	61	83	98	59	56	61	52	288	312	20	
PBT before EO expense	**423**	**568**	**658**	**566**	**507**	**626**	**737**	**838**	**2,215**	**4,268**	**503**	**0.7**
Extra-Ord. expense	0	0	0	0	6	0	0	0	0	0	0	
PBT	**423**	**568**	**658**	**566**	**501**	**626**	**737**	**838**	**2,215**	**4,268**	**503**	**-0.5**
Tax	1	1	0	0	0	5	5	10	2	213	0	
Rate (%)	0.1	0.1	0.0	0.0	0.0	0.8	0.7	1.2	0.1	5.0	0.0	
Reported PAT	**423**	**567**	**658**	**566**	**501**	**621**	**732**	**828**	**2,214**	**4,055**	**504**	**-0.5**
Adj. PAT	**423**	**567**	**658**	**566**	**507**	**621**	**732**	**828**	**2,214**	**4,055**	**504**	**0.7**
YoY Change (%)	59.4	96.4	59.1	217.8	19.9	9.5	11.3	46.2	93.3	83.1	19.1	
Margin (%)	12.1	14.3	15.4	12.8	12.5	13.6	14.7	13.5	13.7	15.6	12.0	

Note: FY22 numbers are not comparable to the sum of the four quarters as only the fiscal numbers include business from the Aurore Life Science merger. The merger process is awaiting regulatory approvals.

Key performance indicators (consolidated)

Y/E March	FY21				FY22				FY21	FY22E	FY22E
	1Q	2Q	3Q	4QE	1Q	2QE	3QE	4QE			1QE
RM Cost (% of Sales)	43.0	43.8	44.0	47.9	44.0	43.9	43.5	47.9	44.0	43.9	43.1
Staff Cost (% of Sales)	15.6	14.6	14.0	12.8	15.1	15.4	16.0	12.8	14.5	14.6	17.0
Other Cost (% of Sales)	17.3	17.0	17.3	16.9	18.4	17.8	17.0	16.9	16.8	16.2	18.0
Gross Margin (%)	57.0	56.2	56.0	52.1	56.0	56.1	56.5	52.1	56.0	56.1	56.9
EBITDA Margin (%)	24.1	24.6	24.7	22.3	22.5	22.9	23.5	21.4	23.9	24.7	22.7
EBIT Margin (%)	16.5	17.6	18.3	16.1	15.7	16.8	17.9	16.3	17.1	19.4	16.3

Highlights from the management interaction

CONFERENCE CALL

- CRAMS contribution to revenue was in the high single-digits in 1QFY22.
- Most of the CRAMS projects are in contract manufacturing and a few are in contract development.
- The management said regulated market sales will remain muted in 2QFY22 due to the COVID-19 outbreak. This is expected to normalize in 3-6 months.
- Demand for Ibuprofen softened in regulated markets due to the pandemic. This is expected to normalize in 3-6 months.
- SOLARA has addressed the issues in Cuddalore and awaits USFDA inspection. OAI from USFDA for Cuddalore was due to NDMA issue in Ranitidine.
- It will continue to be a MAT paying company for 1-2 years after FY22.

- New product sales stood at INR800m (~20% of sales), including some contribution from Favipiravir.
- The company is on track to file 25 products globally in FY22.

Well laid out plans in API/CRAMS space to better return ratios going forward

Solara 2.0 unveiled

SOLARA unveiled its goal of being among the top 10 global pure-play API players. It is targeting 25% sales CAGR over FY21-25, 23-25% EBITDA margin, and a 30% revenue contribution from CRAMS by FY25. This includes the recent (AURORE) and future inorganic expansion opportunities. It has also strengthened its organizational structure by appointing Mr. Aditya Puri as Chairman of the board and Mr. Arun Kumar, founder of SOLARA, to the board as a Non-Executive Director.

Generic APIs – healthy traction in 'other markets'

- SOLARA reported ~INR3.7b revenue in API in 1QFY22, aided by INR800m in revenue contribution from new launches, which included Favipiravir API sales.
- It has been successful in backward integration in the Ibuprofen manufacturing process. It will start accruing commercial benefits in coming quarters, making it one of the only two fully backward integrated Ibuprofen manufacturers in the world. This will help it gain market share, improve margin, and navigate price volatility in Ibuprofen.
- It is on track to file 10-12 DMFs in the US in FY22. The acquired portfolio of AURORE is expected to increase the breadth of SOLARA's offerings as there is minimum overlap. The acquisition also adds the Anti-Viral product portfolio to its offerings. The management expects to launch 25 products in FY22, leveraging its ALS' filing capabilities. We expect 31% CAGR in API sales to INR27b over FY21-23E.

CRAMS adds differentiated capabilities to fast-track growth

SOLARA added four new customers in the CRAMS segment in 1QFY22. It also grew the opportunity pipeline by 40% QoQ. The management is now focusing on increasing projects in the R&D stage. It intends to build its CRAMS business through strong expertise in chemistry, and adds science-based differentiation and technological capabilities. We expect CRAMS sales to expand 4.5x to INR3.6b over FY21-23E.

Synergy benefits from the ALS acquisition to support margin expansion

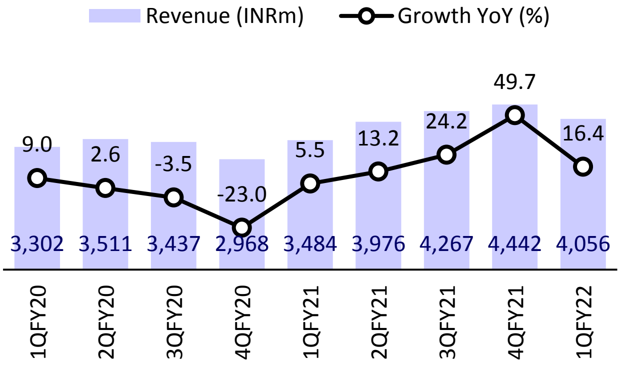
SOLARA expects INR1.5-2.2b in synergy benefits in the first year of operations post the merger. Savings of INR500-750m are expected to accrue in overhead costs, INR250-350m from R&D cost rationalization, INR250-300m in procurement, and INR500-750m in additional gross profit from cross-selling opportunities.

Earnings growth momentum to sustain over the next 3-4 years

- We raise our FY22E/FY23E EPS estimate by 5%/7% to factor in: a) benefits from successful backward integration for Ibuprofen manufacturing, b) extended tax benefits, and c) increased growth prospects in the CRAMS segment.
- We continue to value SOLARA at 13x its 12-month forward EV/EBITDA to arrive at our TP of INR2,050.
- We expect 38% revenue CAGR over FY21-23E, driven by 31%/112% CAGR in API/CRAMS revenue. With operating leverage and synergy benefits, we expect EBITDA to grow at 42% CAGR over FY21-23E.

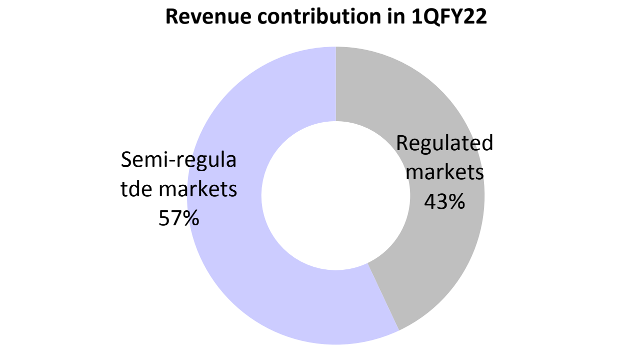
Story in charts

Exhibit 1: Revenue grew by ~16% in 1QFY22



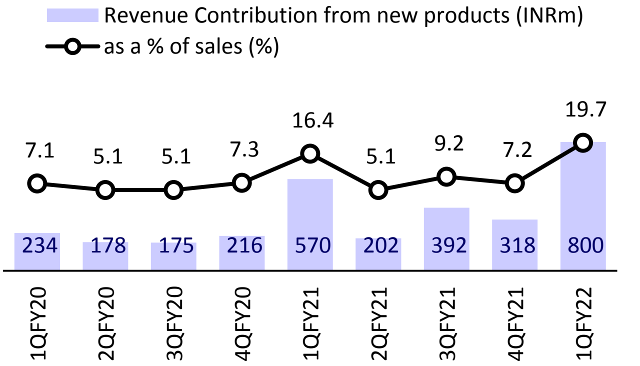
Source: MOFSL, Company

Exhibit 2: Revenue contribution from regulated markets stood at 43%



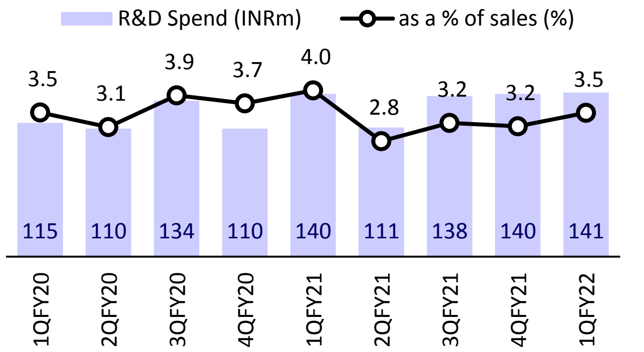
Source: MOFSL, Company

Exhibit 3: New products contribute 20% to revenue



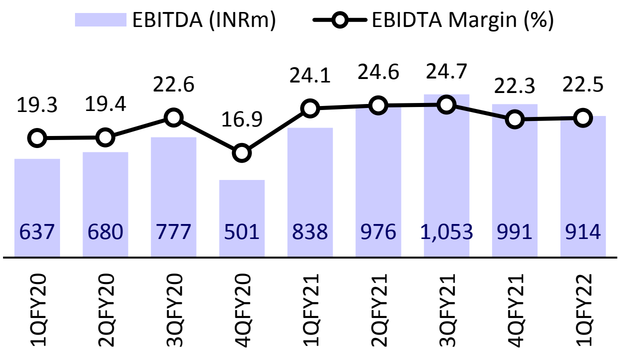
Source: MOFSL, Company

Exhibit 4: R&D spends at 3.5% of sales in 1QFY22



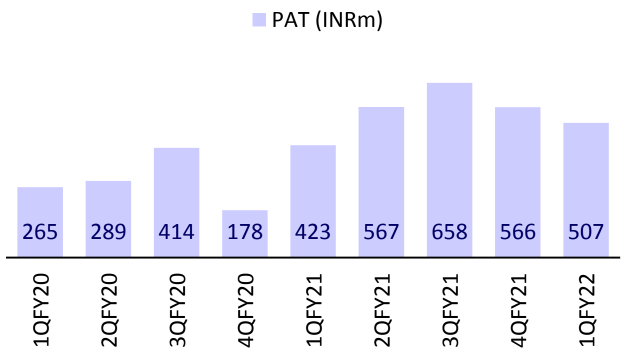
Source: MOFSL, Company

Exhibit 5: EBITDA margin contracts by 160bp YoY in 1QFY22



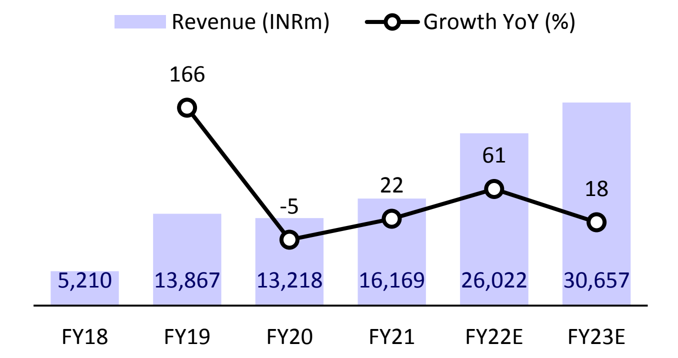
Source: MOFSL, Company

Exhibit 6: PAT grew by 20% YoY in 1QFY22



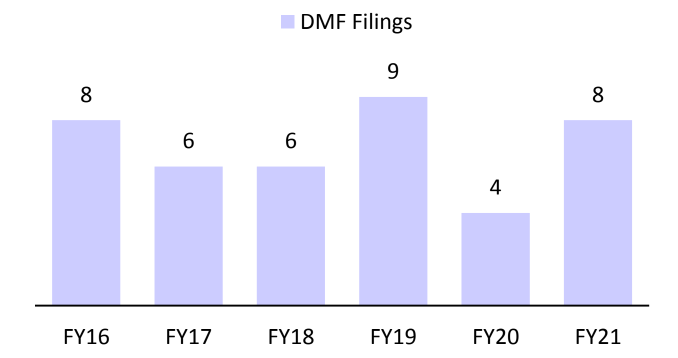
Source: MOFSL, Company

Exhibit 7: Expect revenue to exhibit ~38% CAGR over FY21-23E



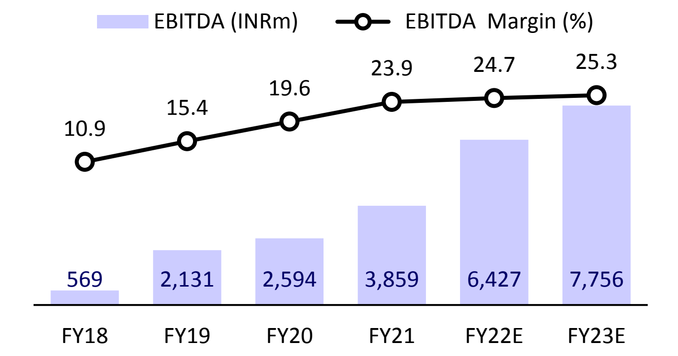
Source: MOFSL, Company

Exhibit 8: DMF filings to improve with the ALS acquisition



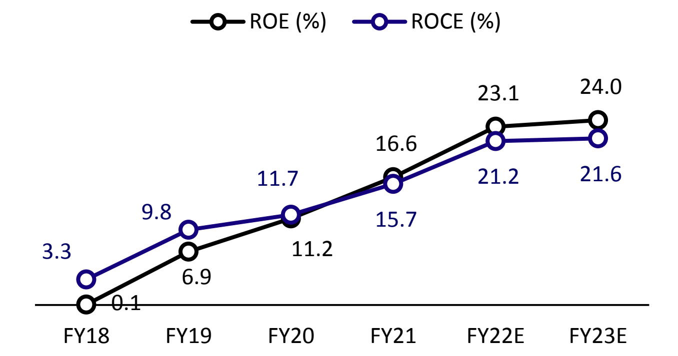
Source: MOFSL, Company

Exhibit 9: Expect 150bp margin expansion over FY21-23E



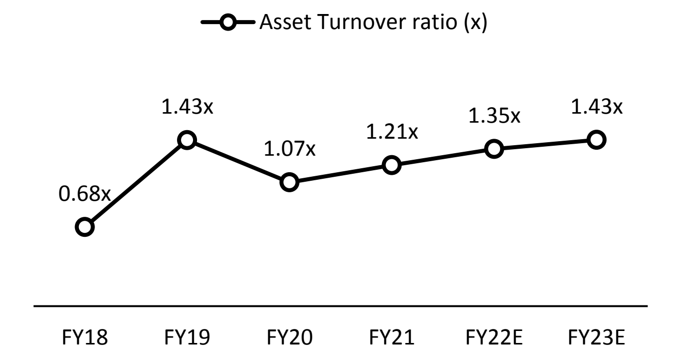
Source: MOFSL, Company

Exhibit 10: Return ratios to improve over the next two years



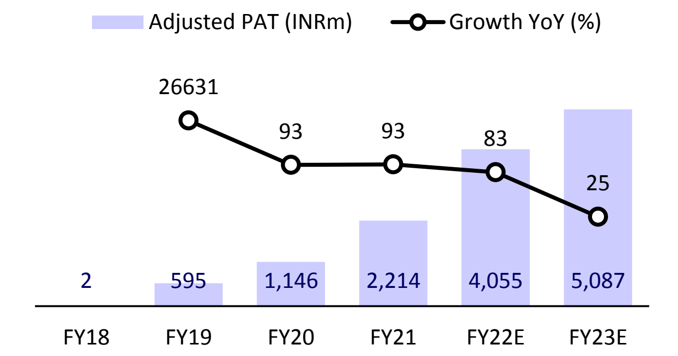
Source: MOFSL, Company

Exhibit 11: Asset turnover ratio on an uptrend



Source: MOFSL, Company

Exhibit 12: Expect 52% earnings CAGR over FY21-23E



Source: MOFSL, Company

Financials and valuations

Consolidated Income Statement						(INR m)
Y/E March	**FY18**	**FY19**	**FY20**	**FY21**	**FY22E**	**FY23E**
Total Income from Operations	**5,210**	**13,867**	**13,218**	**16,169**	**26,022**	**30,657**
Change (%)	NA	166.2	-4.7	22.3	60.9	17.8
Total Expenditure	**4,641**	**11,736**	**10,623**	**12,310**	**19,595**	**22,901**
% of Sales	89.1	84.6	80.4	76.1	75.3	74.7
EBITDA	**569**	**2,131**	**2,594**	**3,859**	**6,427**	**7,756**
Margin (%)	10.9	15.4	19.6	23.9	24.7	25.3
Depreciation	340	831	942	1,087	1,383	1,462
EBIT	**229**	**1,300**	**1,653**	**2,772**	**5,045**	**6,294**
Int. and Finance Charges	251	824	779	845	1,089	1,193
Other Income	25	124	275	288	312	368
PBT bef. EO Exp.	**2**	**600**	**1,149**	**2,215**	**4,268**	**5,469**
EO Items	-18	-6	3	0	0	0
PBT after EO Exp.	**-16**	**594**	**1,152**	**2,215**	**4,268**	**5,469**
Total Tax	-1	6	4	2	213	383
Tax Rate (%)	8.7	1.0	0.3	0.1	5.0	7.0
Minority Interest	0	-1	-1	-1	-1	-1
Reported PAT	**-14**	**589**	**1,149**	**2,214**	**4,055**	**5,087**
Adjusted PAT	**2**	**595**	**1,146**	**2,214**	**4,055**	**5,087**
Change (%)	NA	NA	92.6	93.2	83.1	25.4
Margin (%)	0.0	4.3	8.7	13.7	15.6	16.6

Consolidated Balance Sheet						(INR m)
Y/E March	**FY18**	**FY19**	**FY20**	**FY21**	**FY22E**	**FY23E**
Equity Share Capital	247	258	269	359	492	492
Total Reserves	7,393	8,261	9,631	15,526	18,714	22,760
Net Worth	**7,640**	**9,559**	**10,859**	**15,885**	**19,206**	**23,252**
Minority Interest	45	44	43	42	42	42
Total Loans	6,329	5,381	7,068	5,157	7,657	7,257
Deferred Tax Liabilities	484	328	118	-256	-256	-256
Capital Employed	**14,497**	**15,311**	**18,088**	**20,829**	**26,649**	**30,295**
Gross Block	7,641	9,697	12,384	13,317	19,221	21,402
Less: Accum. Deprn.	367	1,170	2,066	3,152	4,535	5,997
Net Fixed Assets	**7,274**	**8,527**	**10,319**	**10,165**	**14,686**	**15,404**
Goodwill on Consolidation	3,586	3,651	3,651	3,651	3,651	3,651
Capital WIP	715	404	405	880	1,476	1,295
Total Investments	**8**	**4**	**3**	**4**	**4**	**4**
Curr. Assets, Loans and Adv.	**6,633**	**7,014**	**7,157**	**11,180**	**14,547**	**18,673**
Inventory	1,877	2,139	2,797	2,950	4,724	5,333
Account Receivables	2,625	2,888	2,265	4,839	6,416	6,719
Cash and Bank Balance	470	765	568	1,985	1,324	4,168
Loans and Advances	1,661	1,222	1,527	1,406	2,082	2,453
Curr. Liability and Prov.	**3,718**	**4,289**	**3,447**	**5,051**	**7,714**	**8,732**
Account Payables	3,207	2,532	2,262	3,093	4,563	5,019
Other Current Liabilities	390	1,624	1,053	1,826	2,939	3,463
Provisions	121	133	132	132	212	250
Net Current Assets	**2,915**	**2,725**	**3,711**	**6,129**	**6,832**	**9,941**
Appl. of Funds	**14,497**	**15,311**	**18,088**	**20,829**	**26,649**	**30,295**

Financials and valuations

Ratios						
Y/E March	**FY18**	**FY19**	**FY20**	**FY21**	**FY22E**	**FY23E**
Basic (INR)						
EPS	**0.1**	**12.1**	**23.3**	**45.0**	**82.4**	**103.4**
Cash EPS	9.5	39.7	58.1	91.9	151.4	182.3
BV/Share	212.7	266.1	302.3	442.2	534.7	647.3
DPS	NA	NA	0.0	7.0	15.0	18.0
Payout (%)	0.0	0.0	0.0	13.3	21.4	20.5
Valuation (x)						
P/E	27,592.5	141.4	73.4	38.0	20.8	16.5
Cash P/E	179.6	43.1	29.4	18.6	11.3	9.4
P/BV	8.0	6.4	5.7	3.9	3.2	2.6
EV/Sales	1.1	0.3	4.0	4.0	3.5	2.8
EV/EBITDA	10.3	2.2	20.2	16.7	14.1	11.2
Dividend Yield (%)	NA	NA	0.0	0.4	0.9	1.1
FCF per share	NA	NA	-8.7	-4.4	-33.5	103.8
Return Ratios (%)						
RoE	0.1	6.9	11.2	16.6	23.1	24.0
RoCE	3.3	9.8	11.7	15.7	21.2	21.6
RoIC	3.1	9.4	10.5	15.8	22.9	24.1
Working Capital Ratios						
Fixed Asset Turnover (x)	0.7	1.4	1.1	1.2	1.4	1.4
Asset Turnover (x)	0.4	0.9	0.7	0.8	1.0	1.0
Inventory (Days)	131	56	77	67	66	63
Debtor (Days)	184	76	63	109	90	80
Creditor (Days)	225	67	62	70	64	60
Leverage Ratio (x)						
Current Ratio	1.8	1.6	2.1	2.2	1.9	2.1
Interest Coverage Ratio	0.9	1.6	2.1	3.3	4.6	5.3
Net Debt/Equity	0.8	0.5	0.6	0.2	0.3	0.1

Consolidated Cash Flow Statement						(INR m)
Y/E March	**FY18**	**FY19**	**FY20**	**FY21**	**FY22E**	**FY23E**
OP/(Loss) before Tax	2	578	1,149	2,215	4,268	5,469
Depreciation	367	837	942	1,087	1,383	1,462
Interest and Finance Charges	226	749	723	703	777	825
Direct Taxes Paid	-29	-144	-243	-334	-213	-383
(Inc.)/Dec. in WC	-108	-253	-165	-2,057	-1,364	-265
CF from Operations	**458**	**1,767**	**2,406**	**1,613**	**4,850**	**7,108**
Others	35	-103	36	-58	0	0
CF from Operations incl. EO	**492**	**1,663**	**2,442**	**1,556**	**4,850**	**7,108**
(Inc.)/Dec. in FA	-347	-582	-2,676	-1,715	-6,500	-2,000
Free Cash Flow	**145**	**1,081**	**-234**	**-160**	**-1,650**	**5,108**
Others	-497	-546	-906	653	312	368
CF from Investments	**-844**	**-1,124**	**-3,581**	**-1,063**	**-6,188**	**-1,632**
Issue of Shares	0	440	298	2,982	133	0
Inc./(Dec.) in Debt	528	-881	1,618	-1,002	2,500	-400
Interest Paid	-220	-775	-810	-832	-1,089	-1,193
Dividend Paid	0	0	-129	-197	-867	-1,041
Others	369	982	-27	-26	1	1
CF from Fin. Activity	**677**	**-234**	**949**	**925**	**677**	**-2,633**
Inc./Dec. in Cash	**326**	**305**	**-189**	**1,417**	**-661**	**2,843**
Opening Balance	145	460	757	568	1,985	1,324
Closing Balance	**470**	**765**	**568**	**1,985**	**1,324**	**4,168**

NOTES

Explanation of Investment Rating	
Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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