

## Margin under pressure; downgrade to Hold

We downgrade Marksans Pharma (MPL) to Hold from Buy rating with a TP of Rs31 (earlier Rs55) based on 18x March'20E EPS of Rs1.7. MPL's Q4FY18 results were lower than our expectations. The drug maker's Q4FY18 revenue grew 8% YoY, EBITDA margin declined by 200bps to 2.1% and net profit declined to Rs(65)mn YoY from Rs(33)mn. The Goa facility was approved by UK MHRA and TGA-Australia. We expect MPL's performance to improve led by the recent launch of four new products in the US and expected approvals for softgel capsules from US FDA. Key positive trigger to our assumption includes stupendous growth in the US market and key negative risk includes regulatory issues for the Goa facility from US FDA.

- **Revenue grew by 8%YoY:** MPL's revenues grew 8%YoY to Rs1.99bn from Rs1.85bn due to strong growth in the UK and Europe. MPL's US and N. America business (45% of revenues) declined marginally by 0.3% YoY to Rs898mn from Rs901mn. The company did not witness any piecing pressure in the US market. MPL's UK & Europe business (45% of revenues) grew by 40%YoY to Rs872mn from Rs625mn due to clearance of Goa facility by UK MHRA and TGA-Australia. The drug manufacturer's Australia and New Zealand business (12% of revenues) declined by 7% YoY due to lower off-take. We expect sales to grow, driven by US, UK and Europe businesses.
- **Margin declined by 200bps YoY:** MPL's EBITDA margin declined by 200bps YoY to 2.1% from 4.1% due to the increase in other expenses. Material cost declined by 1,100bps to 53.2% from 64.2% due to the profitable product mix. Personnel cost declined by 160bps YoY to 19.1% from 20.7%. Other expenses grew by 1,460bps YoY to 25.6% from 11.0%. We expect margins to improve from strong growth in its products in the US, UK and Europe and additional ANDA approvals from US FDA.
- **Net profit set to grow:** MPL's net profit for the quarter declined to Rs(65)mn from Rs(33)mn YoY due to sharp decline in margin and rise in interest cost. MPL's interest cost grew 122%YoY to Rs35mn from Rs16mn due to the rise in working capital. We expect the company to report sustainable growth, driven by the US, UK and EU businesses and commencement of the domestic formulation business.
- **Recommendation and key risks:** We have revised our FY19E and FY20E EPS downwards by 41% and 43% respectively. We downgrade MPL to Hold from Buy rating, with a TP of Rs31 based on 18x March'20E EPS of Rs1.7, and a 10.2% upside from CMP. Key positive upsides would be additional ANDA approvals from US FDA and key negative would be regulatory issue with US FDA for its Goa facility.

Particulars (Rs mn)	Q4FY18	Q4FY17	YoY Gr%	Q3FY18	QoQ Gr %	Q4FY18E	% Var.
<b>Total Revenues</b>	<b>1,994</b>	<b>1,848</b>	<b>7.9</b>	<b>2,184</b>	<b>(8.7)</b>	<b>2,393</b>	<b>(16.7)</b>
Raw material cost	1,061	1,187	(10.6)	1,144	(7.3)	1,280	(17.1)
Employee cost	381	383	(0.6)	362	5.2	400	(4.8)
Other expenses	510	202	152.0	390	30.8	410	24.4
<b>EBIDTA</b>	<b>42</b>	<b>75</b>	<b>(44.2)</b>	<b>288</b>	<b>(85.4)</b>	<b>303</b>	<b>(86.1)</b>
EBIDTA margin (%)	2.1	4.1		13.2		12.7	
Depreciation	62	76	(18.1)	62	0.0	75	(17.3)
Interest	35	16	121.5	18	94.4	25	40.0
Other income	0	2	NA	4	NA	4	NA
PBT	(55)	(14)	NA	212	NA	207	NA
Prov. For tax	10	19	(47.6)	37	(73.0)	55	(81.8)
Net profit before minority	(65)	(33)	NA	175	NA	152	NA
Minority interest	4	0	NA	7	NA	8	(50.0)
<b>Net profit after minority</b>	<b>(69)</b>	<b>(33)</b>	<b>NA</b>	<b>168</b>	<b>NA</b>	<b>144</b>	<b>NA</b>

Source: Company, Centrum Research Estimates

Y/E Mar (Rsmn)	Revenue	YoY (%)	EBITDA	EBITDA (%)	Adjust. PAT	YoY (%)	DEPS Rs.	RoE (%)	RoCE (%)	P/E (x)	EV/EBITDA (x)
FY16	8,933	12.1	1,363	15.3	784	(28.3)	1.9	19.4	17.7	40.9	24.0
FY17	7,673	(14.1)	448	5.8	88	(88.8)	0.2	2.0	3.0	212.2	43.6
FY18	9,127	19.0	866	9.5	330	274.9	0.8	7.3	7.5	53.0	21.1
FY19E	10,893	19.3	1,144	10.5	480	45.3	1.2	9.7	9.3	23.9	10.7
FY20E	13,155	20.8	1,514	11.5	701	46.0	1.7	12.7	11.8	16.3	8.0

Source: Company, Centrum Research Estimate

In the interest of timeliness, this document is not edited

Centrum Equity Research is available on Bloomberg, Thomson Reuters and FactSet

Target Price	Rs31	Key Data	
CMP*	Rs28	Bloomberg Code	MRKS IN
Upside	10.2%	Curr Shares O/S (mn)	409.3
Previous Target	Rs55	Diluted Shares O/S(mn)	409.3
Previous Rating	Buy	Mkt Cap (Rsbn/USDmn)	11.4/169.8
<b>Price Performance (%)*</b>		52 Wk H / L (Rs)	52.3/23.6
		5 Year H / L (Rs)	115/5.2
MRKS IN	(3.1)	(24.4)	(36.0)
Daily Vol. (3M NSE Avg.)			2303824
Nifty	0.2	4.9	12.0

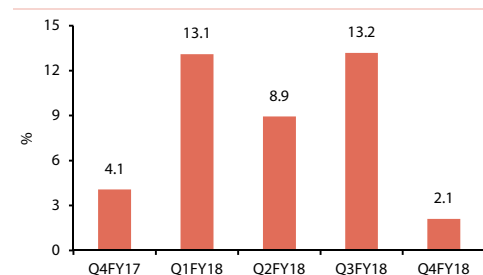
Source: Bloomberg, Centrum Research, \*as on 8<sup>th</sup> June 2018

### Shareholding pattern\* (%)

	March-18	Dec-17	Sept-17	Jun-17
Promoter	48.3	48.3	48.3	48.3
Fils	3.2	2.3	7.7	8.5
DIs	1.8	2.8	0.4	0.3
Others	46.7	46.6	43.6	42.9

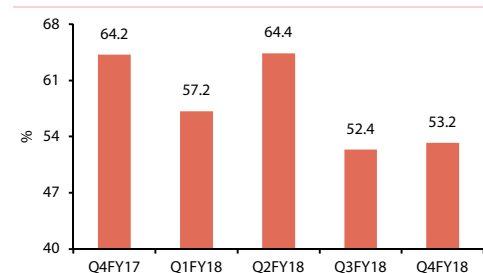
Source: BSE, \*as on 8<sup>th</sup> June 2018

### Trend in EBITDA margin (%)



Source: Company, Centrum Research

### Trend in Material cost (%)



Source: Company, Centrum Research

### Earning Revision

Particulars (Rs mn)	FY19E			FY20E		
	New	Old	Chg (%)	New	Old	Chg (%)
Revenue	10,893	11,033	(1.3)	13,155	13,131	0.2
EBITDA	1,144	1,474	(22.4)	1,514	2,000	(24.3)
EBITDA Margin (%)	10.5	13.4	(290)bps	11.5	15.2	(370)bps
PAT	480	815	(41.1)	702	1,232	(43.0)

Source: Centrum Research Estimates

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## Sales composition

MPL's Q4FY18 sales composition was as follows:

MPL's revenue grew by 8% YoY to Rs1.99bn from Rs1.85bn due to the absence of new launches in UK and US markets. The company's UK, Europe revenues (44% of sales) grew by 40% YoY to Rs872mn from Rs625mn. The US business (45% of sales) declined marginally by 0.3% YoY to Rs898mn from Rs901mn due to the absence of new launches. The company's Australia & New Zealand business (12% of revenues) declined by 7% YoY to Rs241mn from Rs258mn due to lower off-take. We expect the US and UK, Europe businesses to drive future growth.

### Exhibit 1: Geography-wise revenues (consolidated)

Particulars (Rs mn)	Q4FY18	Q4FY17	YoY Gr%	Q3FY18	QoQ Gr %	Q4FY18E	% Var.
Europe, UK-formulations	872	625	39.5	906	(3.8)	980	(11.0)
US, N.America-formulations	898	901	(0.3)	921	(2.5)	1020	(12.0)
Australia, NZ-formulations	241	258	(6.6)	235	2.6	255	(5.5)
RoW formulations	(13)	67	NA	122	(110.7)	138	(109.4)
Other op. income	0	0	NA	0	NA		NA
Total Revenues	1998	1851	8.0	2184	(8.5)	2393	(16.5)

Source: Company

## Other developments

### US business-likely to improve

- MPL's US business (45% of revenues) declined marginally by 0.3%YoY to Rs898mn from Rs901mn.
- MPL has commenced marketing of the following products in the US after receiving approvals from US FDA: Metformin HCl ER tablets 500 and 750mg, Paricalcitol softgel capsules 1, 2 and 4 mcg , Loratidine softgel capsules 10mg and Dutasteride softgel capsules 0.5mg . Paricalcitol softgel capsules and Dutasteride softgel capsules have limited competition whereas Loratidine softgel has no competition from other generic players.
- The company is currently marketing 13 approved products in the US and awaiting further approval from the eight pending ANDAs with US FDA.
- The company did not witness any price erosion for its products in the US generic market.

### UK, Europe business-Goa facility cleared by UK MHRA

- The company's UK & Europe business (44% of revenues) grew by 40% YoY to Rs872mn from Rs625mn due to commencement of despatches after clearance of Goa facility by UK MHRA.
- During FY17, sales to UK and Europe were impacted by restrictive import of critical products in the UK by UK MHRA.

### Australia, NZ-business declined by 7% YoY

- MPL's Australia, NZ business (12% of revenues) declined by 7%YoY due to lower off take of its products.
- The Goa facility was inspected by TGA-Australia in FY17 and cleared without any observations.

### IT initiatives and automation

- MPL has incorporated state-of-the-art IT applications in Quality, Manufacturing and R&D functions with laboratory automation, instrument integration, manufacturing execution and expecting to reap the benefits from the same.
- The company has established a new R&D centre in Nerul for formulation development and NDDS for regulated markets and has recruited 15 scientists. The major work would involve the preparation of dossiers for the regulated markets. The R&D centre is functional and is expected to have 60 scientists by end of FY19.
- MPL has plans to generate a pipeline of over 30 products for the regulated markets by FY20.

- The company generates over 95% of its revenues from the regulated markets of the US, EU, Australia/NZ and Canada.
- MPL has entered into the branded generic business in the domestic market with over 50 brands in dermatology, respiratory and CNS segments. The revenues are likely to accrue from FY19 onwards.
- The company has received EIR for its Goa facility from UK MHRA and has commenced supplies to UK and EU markets.

## Earnings revision

Based on Q4FY18 results, we have revised our FY19E and FY20E EPS downwards by 42% and 44% respectively in view of sharp drop in EBITDA margin to 2.1% from 4.1%. MPL received EIR for its Goa facility from UK MHRA in Sept'17. We expect MPL's performance to improve, with good growth expected in the US market from the recent launch of Metformin ER tablets in the US and six pending ANDA approvals for softgel capsules. The UK and EU business has normalised after EIR from UK MHRA for its Goa facility. We downgrade MPL to Hold from Buy rating, with a TP of Rs31 based on 18x March'20E EPS of Rs1.7, and a 10.2% upside from CMP. Key positive upsides for MPL would be pending ANDA approvals from US FDA and key negative would be regulatory issue with US FDA for its Goa facility.

### Exhibit 2: Earnings revision

Particulars (Rs mn)	FY19E			FY20E		
	New	Old	Chg (%)	New	Old	Chg (%)
Revenue	10,893	11,033	(1.3)	13,155	13,131	0.2
EBITDA	1,144	1,474	(22.4)	1,514	2,000	(24.3)
EBITDA Margin (%)	10.5	13.4	(290)bps	11.5	15.2	(370)bps
PAT	480	815	(41.1)	702	1,232	(43.0)

Source: Centrum Research Estimates

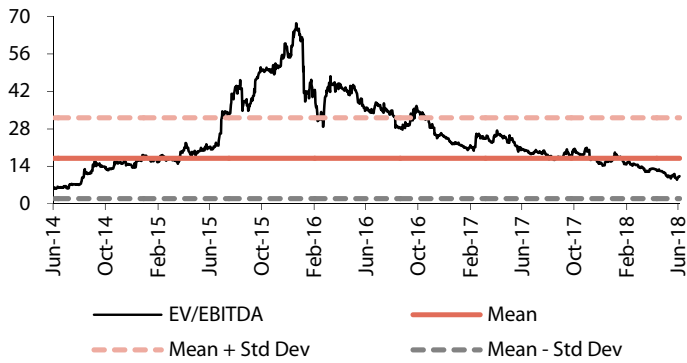
## Valuation and recommendation

### Exhibit 3: Sensitivity Analysis

Sensitivity to key variables – FY19E	% change	% impact on EBITDA	% impact on EPS
Sales	1	9.5	22.7
Material cost	1	(5.4)	(12.9)

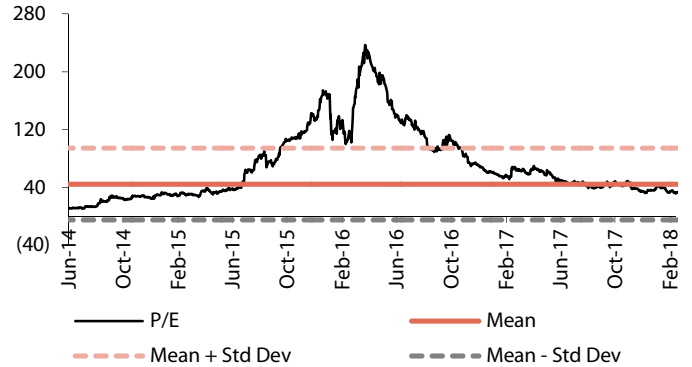
Source: Company, Centrum Research Estimates

### Exhibit 4: 1 year forward EV/EBITDA chart



Source: Bloomberg, Company, Centrum Research Estimates

### Exhibit 5: 1 year forward P/E chart



Source: Bloomberg, Company, Centrum Research Estimates

### Exhibit 6: Comparative Valuations

Company	Mkt Cap (Rs mn)	CAGR FY17-FY19E (%)			EBITDA Margin (%)			PE (x)			EV/EBITDA (x)			RoE (%)			Div Yield (%)		
		Rev.	EBITDA	PAT	FY17	FY18	FY19E	FY17	FY18	FY19E	FY17	FY18	FY19E	FY17	FY18	FY19E	FY17	FY18	FY19E
Marksans Pharma	11,461	19.1	59.8	133.5	5.8	9.5	10.5	212.2	53.0	23.9	43.6	21.1	10.7	2.0	7.3	9.7	0.3	0.1	0.4
Granules India	20,066	19.2	13.0	12.7	20.8	16.5	18.7	19.5	25.1	9.6	11.0	14.4	7.3	21.0	12.0	15.0	0.9	0.9	2.1
Strides Shasun*	32,018	(6.6)	(13.6)	(37.0)	18.8	14.5	16.1	21.2	18.6	18.0	17.1	10.2	10.9	16.6	4.9	6.7	0.4	1.6	1.0
Unichem Labs*	17,524	NA	NA	NA	11.8	NA	NA	22.4	NA	NA	14.1	NA	NA	10.8	NA	NA	0.7	NA	NA

Source: Company, Centrum Research Estimates, \*Bloomberg Estimates Prices as on 8<sup>th</sup> June 2018

## Quarterly financials, Operating Metrics and Key Performance Indicators

### Exhibit 7: Quarterly Financials

Particulars (Rs mn)	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18
<b>Total Sales</b>	<b>1,868</b>	<b>1,804</b>	<b>2,152</b>	<b>1,848</b>	<b>2,211</b>	<b>2,738</b>	<b>2,184</b>	<b>1,994</b>
Materials Cost	1,098	1,100	1,202	1,187	1,264	1,763	1,144	1,061
Personnel expenses	383	352	383	383	374	360	362	381
Other expenses	252	349	299	202	283	370	390	510
Total Expenditure	1,733	1,801	1,884	1,772	1,921	2,493	1,896	1,952
<b>EBIDTA</b>	<b>135</b>	<b>3</b>	<b>268</b>	<b>75</b>	<b>290</b>	<b>245</b>	<b>288</b>	<b>42</b>
Other income	0	67	0	2	0	0	4	0
<b>PBDIT</b>	<b>135</b>	<b>70</b>	<b>268</b>	<b>77</b>	<b>290</b>	<b>245</b>	<b>292</b>	<b>42</b>
Depreciation	48	59	118	76	74	70	62	62
Interest	13	11	18	16	19	30	18	35
<b>PBT</b>	<b>74</b>	<b>0</b>	<b>132</b>	<b>(14)</b>	<b>197</b>	<b>145</b>	<b>212</b>	<b>(55)</b>
Tax	21	(9)	16	19	52	41	37	10
<b>PAT before minority</b>	<b>53</b>	<b>9</b>	<b>116</b>	<b>(33)</b>	<b>145</b>	<b>104</b>	<b>175</b>	<b>(65)</b>
Minority interest	9	1	16	(0)	8	10	7	4
<b>PAT after minority</b>	<b>44</b>	<b>8</b>	<b>100</b>	<b>(33)</b>	<b>137</b>	<b>94</b>	<b>168</b>	<b>(69)</b>
<b>Growth Rates %</b>								
Sales	(11.1)	(29.4)	(1.0)	(12.1)	18.4	51.8	1.5	7.9
EBIDTA	(73.1)	(99.4)	(12.1)	74.7	115.1	NM	7.5	(44.2)
Net profit	(85.9)	(97.7)	(44.3)	(42.4)	208.6	NM	68.0	NA
<b>Margin %</b>								
EBIDTA margin	7.2	0.2	12.5	4.1	13.1	8.9	13.2	2.1
PBT margin	4.0	0.0	6.1	(0.8)	8.9	5.3	9.7	(2.8)
Net margin	2.4	0.4	4.6	(1.8)	6.2	3.4	7.7	(3.5)

Source: Company, Centrum Research

### Exhibit 8: Key performance indicators

Key performance indicator	FY16	FY17	FY18	FY19E	FY20E
Sales gr. Rate%	12.1	(14.1)	19.0	19.3	20.8
Material cost %	57.1	59.8	57.3	56.7	56.3

Source: Company, Centrum Research Estimates

## Financials -consolidated

### Exhibit 9: Income Statement

Y/E March	FY16	FY17	FY18	FY19E	FY20E
<b>Revenues</b>	<b>8,933</b>	<b>7,673</b>	<b>9,127</b>	<b>10,893</b>	<b>13,155</b>
Material cost	5,097	4,588	5,231	6,180	7,410
% of revenues	57.1	59.8	57.3	56.7	56.3
Employee cost	1,224	1,497	1,477	1,745	2,070
% of revenues	13.7	19.5	16.2	16.0	15.7
Other Expenses	1,249	1,140	1,553	1,824	2,161
% of revenues	14.0	14.9	17.0	16.7	16.4
<b>EBIDTA</b>	<b>1,363</b>	<b>448</b>	<b>866</b>	<b>1,144</b>	<b>1,514</b>
EBIDTA margin (%)	15.3	5.8	9.5	10.5	11.5
Depreciation & Amortisation	281	301	268	304	348
EBIT	1,082	147	598	840	1,167
Interest Expenses	102	68	102	110	120
PBT from operations	980	79	496	730	1,047
Other income	89	70	4	10	15
PBT	1,068	149	499	740	1,062
Tax provision	242	36	140	225	320
Effective tax rate (%)	22.7	24.1	28.0	30.4	30.1
Net profit	826	113	359	515	742
Minority interest	42	25	29	35	40
Reported net profit	784	88	330	480	701
<b>Adj. Net profit</b>	<b>784</b>	<b>88</b>	<b>330</b>	<b>480</b>	<b>701</b>

Source: Company, Centrum Research Estimates

### Exhibit 10: Key Ratios

Y/E March	FY16	FY17	FY18	FY19E	FY20E
<b>Growth Ratios (%)</b>					
Revenues	12.1	(14.1)	19.0	19.3	20.8
EBIDTA	(26.2)	(67.1)	93.3	32.1	32.4
Adj. Net Profit	(28.3)	(88.8)	274.9	45.3	46.0
<b>Margin Ratios (%)</b>					
EBIDTA margin	15.3	5.8	9.5	10.5	11.5
PBT from operations margin	11.0	1.0	5.4	6.7	8.0
Adj. PAT margin	8.8	1.1	3.6	4.4	5.3
<b>Return Ratios (%)</b>					
RoCE	17.7	3.0	7.5	9.3	11.8
RoE	19.4	2.0	7.3	9.7	12.7
RoIC	20.9	2.1	7.9	10.0	12.8
<b>Turnover ratios (days)</b>					
Gross Block Turnover (x)	2.5	1.8	2.0	2.2	2.6
Debtors	89	118	71	111	78
Creditors	49	77	27	74	39
Inventory	69	90	87	90	89
Cash Conversion Cycle	109	131	131	127	128
<b>Solvency Ratio</b>					
Debt-Equity	0.2	0.3	0.2	0.3	0.2
Net Debt-Equity	0.1	0.2	0.2	0.1	0.1
Current Ratio	2.6	2.3	3.4	2.3	3.0
Interest Coverage Ratio	0.1	0.5	0.2	0.1	0.1
Gross Debt/EBIDTA	0.7	2.4	1.4	1.1	0.9
<b>Per Share (Rs)</b>					
FDEPS (adjusted)	1.9	0.2	0.8	1.2	1.7
CEPS	2.6	1.0	1.5	1.9	2.6
Book Value	11.1	10.6	11.5	12.7	14.2
Dividend	0.12	0.12	0.05	0.1	0.15
Dividend Payout (%)	8.6	66.3	7.4	10.1	10.4
<b>Valuations (x) (Avg Mkt Cap)</b>					
PER	40.9	212.2	53.0	23.9	16.3
P/BV	7.1	4.3	3.7	2.2	2.0
EV/EBIDTA	24.0	43.6	21.1	10.7	8.0
Dividend Yield (%)	0.2	0.3	0.1	0.4	0.6
5-yr Avg AOCF/EV yield(%)	1.1	2.8	3.0	4.0	2.1

Source: Company, Centrum Research Estimates

### Exhibit 11: Balance Sheet

Y/E March	FY16	FY17	FY18	FY19E	FY20E
Share capital	409	409	409	409	409
Reserves & surplus	4,009	3,925	4,299	4,789	5,418
Total shareholders Funds	4,418	4,334	4,708	5,198	5,827
Total Debt(incl. Pref.cap)	1,004	1,097	1,174	1,300	1,400
Minority interest	84	62	96	106	115
Deferred tax Liab.	(19)	41	46	35	30
<b>Total Liabilities</b>	<b>5,487</b>	<b>5,534</b>	<b>6,024</b>	<b>6,639</b>	<b>7,372</b>
Gross Block	4,241	4,450	4,793	5,051	5,241
Less: Acc. Depreciation	1,544	1,780	1,998	2,242	2,520
Net Block	2,697	2,670	2,795	2,809	2,721
Capital WIP	-	4	-	5	7
<b>Net Fixed Assets</b>	<b>2,697</b>	<b>2,674</b>	<b>2,795</b>	<b>2,814</b>	<b>2,728</b>
Investments	-	-	-	-	-
Inventories	1,678	1,901	2,181	2,700	3,200
Debtors	2,173	2,476	1,769	3,300	2,800
Loans & Advances	303	6	9	20	25
Cash & Bank Balance	352	250	398	544	717
Other assets	-	210	140	160	180
<b>Total Current Assets</b>	<b>4,506</b>	<b>4,843</b>	<b>4,497</b>	<b>6,724</b>	<b>6,922</b>
Trade payable	1,190	1,618	675	2,200	1,400
Other current Liabilities	7	127	124	15	20
Provisions	519	238	469	684	858
<b>Net Current Assets</b>	<b>2,790</b>	<b>2,860</b>	<b>3,229</b>	<b>3,826</b>	<b>4,644</b>
<b>Total Assets</b>	<b>5,487</b>	<b>5,534</b>	<b>6,024</b>	<b>6,639</b>	<b>7,372</b>

Source: Company, Centrum Research Estimates

### Exhibit 12: Cash Flow

Y/E March	FY16	FY17	FY18	FY19E	FY20E
CF before WC changes	1,189	370	636	797	1,061
Working Capital Changes	(881)	(172)	(221)	(450)	(646)
<b>CF from Operations</b>	<b>308</b>	<b>198</b>	<b>415</b>	<b>347</b>	<b>416</b>
Adj OCF (OCF-Interest)	270	130	313	237	296
Change in fixed assets	(1,319)	(278)	(389)	(323)	(262)
Adj. FCF (AOCF-Capex)	(1,049)	(147)	(76)	(86)	34
<b>CF from Investing</b>	<b>(1,230)</b>	<b>(278)</b>	<b>(389)</b>	<b>(323)</b>	<b>(262)</b>
<b>CF from Financing</b>	<b>(578)</b>	<b>160</b>	<b>53</b>	<b>77</b>	<b>27</b>
<b>Net change in Cash</b>	<b>(1,500)</b>	<b>80</b>	<b>78</b>	<b>101</b>	<b>181</b>

Source: Company, Centrum Research Estimates

## Appendix A

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## Marksans Pharma price chart



Source: Bloomberg, Centrum Research



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