

Suven Life Sciences Ltd.

Market Cap.

Rs. 2,075 Cr

52 Week H/L

Rs.275/144

CMP

Rs. 163

Target Price

Rs. 220

STOCK DATA

Recommendation	BUY	
Reuters Code	SUVP.BO	
Bloomberg Code	SLVS IN	
BSE Code	530239	
NSE Symbol	SUVEN	
Face Value	Rs. 1	
Shares Outstanding*	12.7 Cr	
Avg. Daily Volume (6m)	70,641 shares	
Price Performance (%)		
1M	3M	6M
(2)	(13)	(16)
200 Days EMA Rs. 198		

* On fully diluted equity Shares

SHARE HOLDING (%)

Promoters	60.0
FII	1.9
FI/Bank	5.4
Body Corporate	3.4
Public & Others	29.2

Strong pipeline of CRAMS projects provides long term visibility: The company at the end of Q2FY17, has 115 active CRAMS projects of which 71 projects are in Phase-1, 42 projects are in Phase-2, 2 projects are in Phase-3, and another 3 projects have reached the commercial phase. The Management expects this segment to grow at 10-15% for FY17 and FY18 without considering any positive surprises of success with the customers' molecule. Since, the company caters to NCE based CRAMS, the Management expects margins to sustain broadly in the long-run.

Strong financials provides cushion for further investments and expenditure: The company spends usually more than 10% of the revenue towards research and development which takes away a chunk of their profits. The good part is that the R&D expenditure is expensed out on a run-time basis leaving no stress on the balance sheet. Further, the borrowings remain at quite low level of Rs.66 crore including the short-term working capital requirement – and the debt-equity ratio stands at 0.1x leaving a wide window, in case, if the company needs to spend on any of their verticals. Furthermore, the company has nearly Rs.250 cr cash which the company had raised to fund its research expenses to be incurred on SUVN-502.

SUVN-502 – A bet for a bonanza: The current market size of Alzheimer's disease which stands at \$10 bn is likely to triple by 2022 in USA. Molecules similar to SUVN-502 like Lu AE58054 (Lundbeck, Otsuka) July, 2013 which is currently ongoing Phase-3 had received \$150 mn upfront for phase-2 program. Another, RVT-101 (GSK, Axovant) December, 2014 was bought post PoC from GSK for \$5 mn plus future milestone payments and sales royalties. Raised \$362 Mn in June, 2015. It is also currently ongoing Phase-3.

OUTLOOK & VALUATION

Suven Life Sciences has a fundamentally strong business model targeting the niche at the top of the pyramid – the CRAMS division which engages contract research rather than contract manufacturing and thus commands better margins unlike other CRAMS players. The long established relationships with over a score of global pharma giants and a robust pipeline of projects provides a good long-term business visibility. Additionally, the proprietary NCEs which includes promising molecules – SUVN-502, SUVN-G3031, SUVN-D4010 presents huge opportunity value. Furthermore, the strong financial position - low debt-equity ratio, of 0.1x, cash worth Rs.241 crore on balance sheet, visibility of stable revenue for the next couple of years with healthy profitability followed by substantial price correction presents an opportunity to re-enter the stock with long-term horizon. We value the stock at 28x FY19 EPS of Rs.7.90 arriving at a target price of Rs.220 representing 35% potential upside.

Y/E Mar (Consol.)	Net Sales (Rs. Cr)	EBITDA (Rs. Cr)	RPAT (Rs. Cr)	NPM (%)	REPS (Rs.)	P/E (x)	P/S (x)	P/BV (x)
FY16	499.5	95.0	66.7	13.4	5.2	31.1	4.2	3.5
FY17E	549.5	107.1	75.6	13.8	5.9	27.4	3.8	3.2
FY18E	598.9	125.8	87.8	14.7	6.9	23.6	3.5	2.9
FY19E	646.8	145.5	100.1	15.5	7.9	20.7	3.2	2.6

Company Overview



Founded by Dr. Venkat Jasti in 1989, the company commenced its operations as a manufacturer of pharmaceutical ingredients and soon expanded into manufacturing and export of fine chemical intermediates. By 1994, the company had initiated working on contract research and manufacturing services – CRAMS. Over the next few years, the company obtained recognition as an export house, acquired a couple of assets in India and US, set up in-house research and development unit which got recognized by Department of Scientific & Industrial Research and finally got US FDA approvals. Following its vision statement of ‘Graduating from Contract Research to Collaborative Research’, the company during these two decades, has evolved from a bulk drug manufacturer to complete biopharmaceuticals company. Today, the company has world class manufacturing facilities in the business of pharmaceuticals and fine chemical intermediates for global life-science companies for New Chemical Entities (NCEs) as the thrust area and it also leads the country in Central Nervous System (CNS) based internal discovery.

The company has long term relationships with 22 global pharmaceutical companies including Lilly, AstraZeneca, Pfizer, GlaxoSmithKline, Abbott, Bayer, Johnson & Johnson, Merck, etc. The company caters to these companies through its manufacturing facilities based at Vizag, Pashamylaram, Suryapet and its R&D plant at Jeedimetla in Andhra Pradesh. The company is headquartered at Hyderabad and has business office in New Jersey, US.

The company has created a wholly owned subsidiary in US, Suven, Inc., - a clinical-stage biopharmaceutical company focused on the acquisition, development and commercialization of novel therapeutics for the treatment of neuro-degenerative disorders with the short-term focus to develop SUVN-502 for the treatment of Alzheimer's disease and other forms of dementia.

The company has two business divisions – Contract Research And Manufacturing Services (CRAMS), and Drug Discovery and Development Support Services (DDDSS). During the year ended March 31, 2016, the company's top-line stood at Rs.500 cr (Rs.468 cr contributed by the CRAMS division and the balance Rs.32 crore from DDDSS segment) with an EBITDA margin of 25.7% (post-R&D) and 38.3% (pre-R&D). The bottom-line stood at Rs.100 cr resulting into an EPS of Rs.7.86. The total borrowings stood at Rs.66.0 cr, nearly a tenth of company's networth as on March 31, 2016.

Business Overview

The company has two business segments which derives the revenue

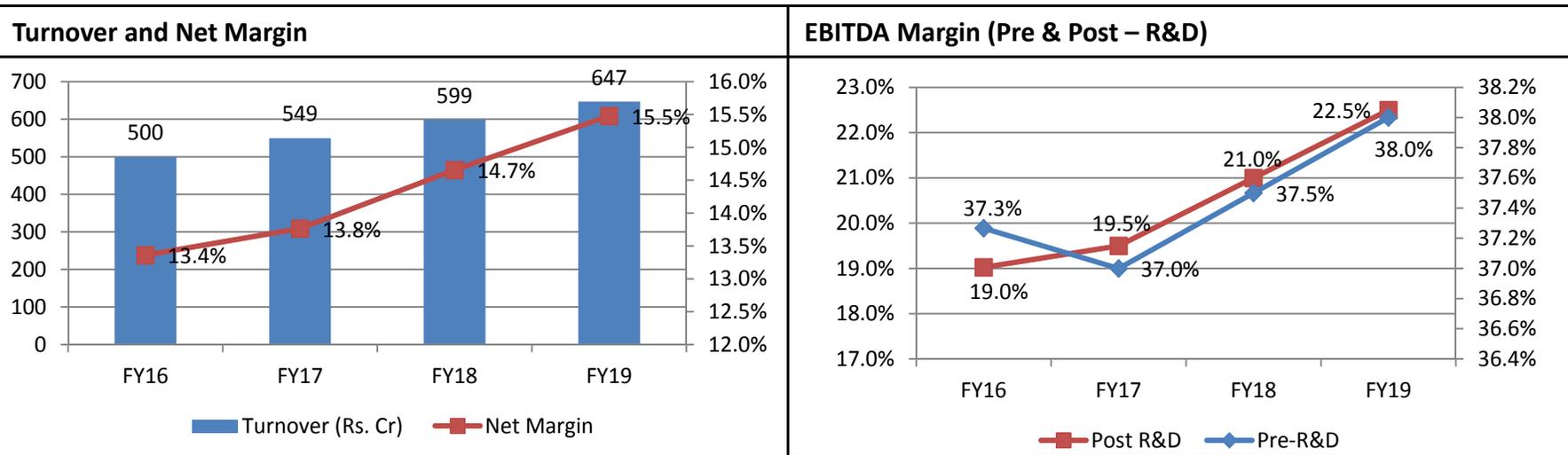
- (1) **CRAMS:** The company has been a pioneer in CRAMS and has undertaken over 750 projects since 1991 serving global life science and fine chemical companies by developing and supplying cost-effective pharmaceutical and agro-chemical intermediates for NCEs meeting world standards of quality and speed. The range of services includes process research; NCE-based intermediates; formulation, development & analytical services, and clinical supplies, manufacturing & packaging – virtually, present across the value chain. With a qualified research team of over 386 scientists of which 30 are PHDs, the company has been able to leverage on its research capabilities to deliver NCE research. The company has managed to carve its niche in this space thereby, ensuring long-term relationships with global innovators. Currently, the company has 118 live projects, of which, 3 molecules have reached the commercial stage – 71 are in Phase-1, 42 in Ph-2, and 2 in Ph-3 which make a strong pipeline and showcases long-term commercial supply opportunities.
- (2) **DDSS:** The company got into ‘Drug Discovery and Development Support Services’ in 2005 which involves lead identification, lead optimization and pre-clinical trials – primarily the support services for global pharmaceutical players working on drug discovery programs. This segment is small and contributes less than 10% of the total revenue.

Proprietary NCE:

As mentioned earlier, the company leads India’s internal discovery in CNS segment and is one of the few players in the world in this high value segment research which happens to be the second largest therapeutic and fastest growing segment. The company has built strong intellectual capabilities in this segment and has promising NCE research pipeline of 13 molecules.

Of these 13 molecules, SUVN-502 is currently ongoing Phase 2a (Proof Of Concept) clinical trial in USA. SUVN-G3031 for Cognition in Alzheimer completed Phase1 Clinical Trial in USA under US-IND and undergoing long-term toxicology studies prior to entering Phase-2 trial; SUVN-D4010 for Cognition in Alzheimer; has also completed Phase-1 Clinical Trial in USA under US-IND but the preparation for long term toxicology studies are going on. SUVN-911 undergoing IND enabling long-term toxicology studies prior to entering Phase-1 study. The company has 770 product patents across the world for 27 inventions and 37 process patents for 7 inventions.

To achieve success in this stream of the business is the ultimate dream of the promoters as mentioned in the company’s tag-line ‘In search of new CNS therapies for better living’ while the CRAMS remains the source to support the operations. Nevertheless, the targeted space in the NCE based CRAMS itself is a niche and commands good margins thereby provides good long-term visibility.



Pipeline of Proprietary NCEs							Pipeline of CRAMS						
Molecule	Segment	D	PC	IND	Ph-1	Ph-2	Ph-3	Expected Launch	Phase - 1	Phase - 2	Phase - 3	Total	
SUVN-501	5-HT6 Antagonist								FY12	51	32	1	84
SUVN-502	5-HT6 Antagonist						2015	2020	FY13	46	41	3	90
SUVN-507	5-HT6 Antagonist								FY14	52	46	1	99
SUVN-512	5-HT6 Antagonist								FY15	57	52	1	110
Muscraic M1	PAM			2017					FY16	64	48	1	113
SUVN-D4010	5-HT4 Partial Agonist				2015	2017			FY17	71	42	2	115
SUVN-G3031	Histamine-3 Antagonist				2014	2017							
nAChR Alpha-4 Beta2	Pain												
SUVN-911	MDD			2016	2016								
CB2	Pain												
Multi Modal	Psychiatric Disorders			2017									

Source: Company Data, Sushil Finance (D-Discovery, PC-Pre-Clinical)

Investment Rationale

Strong pipeline of CRAMS projects provides long term visibility: As mentioned earlier, the company at the end of Q2FY17, has 115 active CRAMS projects of which 71 projects are in Phase-1, 42 projects are in Phase-2, 2 projects are in Phase-3 while 3 molecules have hit the commercial stage. The company supplies intermediates for products being developed, commercialized products and specialty chemicals. The 42 projects in the second phase (which usually has higher volumes than the first phase) provides long-term optimism as successful migration to the third phase would lead to further increase in volumes as the trial batch size increases. The Management expects this segment to grow at 10-15% for FY17 and FY18 without considering any positive surprises of success with the customers' molecule. Since, the company caters to NCE based CRAMS, the Management expects margins to sustain broadly in the long-run. During FY14 and FY15, three of the company's projects pertaining to three therapeutic indications got commercialized, (for rheumatoid arthritis for a US innovator, anti-depressant for a European innovator and anti-diabetes for a European innovator) resulting into one-off revenues to the tune of nearly Rs.150 crore. The company expects repeat orders for the same in the upcoming quarters – although value and margins would be lower but would provide long-term sticky revenue to the company. The company is currently executing the Rs.30 crore order for one of those commercialized molecules of which Rs.19 crore has been supplied and the balance needs to be supplied.

Strong financials provides cushion for further investments and expenditure: The company spends usually more than 10% of the revenue towards research and development which takes away a chunk of their profits. During the last fiscal, the R&D expenses, as a percentage of revenue increased to 18.2% as the company's molecule SUVN-502 prepares to enter Phase-2 (B). The good part is that the R&D expenditure is expensed out on a run-time basis leaving no stress on the balance sheet. Moreover, the company is still able to maintain healthy profit margins. The three molecules which got commercialized a couple of years ago, led to a steep jump in FY14 top-line and super-normal return ratios but the non-recurrence of repeat orders led the top-line and return ratios to cool-off again. It usually takes 15-18 months to get the repeat orders for the commercialized molecules – the Management expects these orders to flow in the coming quarters. Further, the borrowings remain at quite low level of Rs.66 crore including the short-term working capital requirement – and the debt-equity ratio stands at 0.1x leaving a wide window, in case, if the company needs to spend on any of their verticals. On the CRAMS side, the company doesn't have much of capex to be done following the new facility set up at Vizag a couple of years ago with an investment of over Rs.100 crore. For the current fiscal, the Management expects the capital expenditure to be nearly Rs.50 crore – which is towards upgradation and modernization at Unit-III in Pashamylaram, including the routine capex. Furthermore, the company has nearly Rs.250 cr cash and cash equivalents (transferred to current investments during the last quarter) which the company had raised via QIP to fund its research expenses to be incurred on SUVN-502. We expect EBITDA margins to sustain around the current levels for the coming years.

SUVN-502: A Bet for a Bonanza

The company is working on 13 molecules of which a few have engrossed significance over the last few years as they have progressed into the advanced stages of clinical developments. SUVN-502 is now closest to their objective while SUVN-G3031, SUVN-D4010 and SUVN-911 make good pipeline for the future. Prior to the initiation of Phase 2A study which began in October, 2015, SUVN-502 has successfully undergone two Ph-1 studies in Switzerland and USA on 122 healthy young and elderly male populations with no major adverse events and no serious adverse events. The molecule is undergoing clinical trials in US with 537 patients target to be enrolled in about another one to one and half year. Currently, the company has enrolled about close to 140 patients for the trial which is progressing well. The enrolment is likely to be completed by end of 2017 or during the first quarter of 2018. The results are expected towards the end of Q4 FY18 or beginning of Q1 FY19.

The company will be incurring R&D expense of \$20-22 mn, of which, they have already spent up to \$7.4 mn including \$2.5 mn during the current year. For this molecule's progress, the company has enough cash on its balance sheet. Any success towards the end of this phase would provide the company opportunities to monetize the molecule.

Looking at the recent history, the similar molecules had reached the following milestones:

- (a) Lu AE58054 (Lundbeck, Otsuka) July, 2013 – Received \$150 mn upfront for phase-2 program. Ongoing phase-3.
- (b) RVT-101 (GSK, Axovant) December, 2014 -- Bought post POC compound in December, 2014 from GSK for \$5 mn + future milestones and sales royalties. Raised \$362 Mn in June, 2015. Ongoing Phase-3 program

The Management is of the view that SUVN-502 is placed better as compared to the above molecules on account of its non-modified compounds which present better margins of safety and negligible side effects. However, the chances of success at this stage are always miniscule and any positive outcome would be bonanza for the company and the shareholders.

According to the Alzheimer's Association, Alzheimer's disease is the sixth leading cause of death in the United States and is the only cause of death in the top ten in America that cannot be prevented, cured or slowed. One in every three older people dies of Alzheimer's or another dementia in US. The current market size of Alzheimer's disease which stands at \$10 bn is likely to triple by 2022 in USA. Globally, 26 mn people were affected with Alzheimer in 2015.

PROFIT & LOSS STATEMENT				(Rs.Cr)
Y/E Mar.	FY16	FY17E	FY18E	FY19E
Net Sales	499.5	549.5	598.9	646.8
Material cost	166.4	181.3	194.7	207.0
Employee cost	41.6	50.6	56.3	61.4
Manufacturing	74.5	81.3	88.0	95.1
R&D	91.1	96.2	98.8	100.3
Others	30.9	33.0	35.3	37.5
EBITDA (Post R&D)	95.0	107.1	125.8	145.5
Depreciation	16.7	17.8	19.9	22.2
Finance cost	5.4	5.3	5.1	5.5
Other Income	19.4	20.3	20.3	20.3
PBT	92.2	104.3	121.1	138.1
Tax expense	25.5	28.7	33.3	38.0
PAT	66.7	75.6	87.8	100.1
EPS	5.2	5.9	6.9	7.9
CEPS	6.6	7.3	8.5	9.6

BALANCE SHEET STATEMENT				(Rs.Cr)
As on 31 st Mar.	FY16	FY17E	FY18E	FY19E
Share Capital	12.7	12.7	12.7	12.7
Reserves & Surplus	582.7	639.3	708.0	782.6
Net Worth	595.5	652.0	720.7	795.4
LT Borrowings	43.2	42.4	46.8	51.7
LT Provisions	2.4	2.4	2.4	2.4
Def Tax Liabilities (Net)	34.4	34.4	34.4	34.4
ST Borrowings	24.2	22.8	25.2	27.8
Trade Payables	35.3	35.3	37.2	38.9
Other Current Liabilities	47.9	46.8	50.3	53.8
ST Provisions	2.7	2.7	2.7	2.7
Fixed Assets	312.6	349.7	389.6	432.1
Other Non-current Assets	5.7	5.7	5.7	5.7
Inventories	83.5	91.8	101.7	111.6
Receivables	53.6	63.2	68.9	74.4
Cash & Cash Equivalents	241.3	237.7	255.0	276.6
ST Loans & Adv; Other CAs	89.0	90.6	98.8	106.7
Total Assets	785.6	838.8	919.8	1007.1

Source: Company, Sushil Finance Research Estimates

CASH FLOW STATEMENT

(Rs.Cr)

Y/E Mar.	FY16	FY17E	FY18E	FY19E
PBT	92.2	104.3	121.1	138.1
Depreciation & Amortization	16.7	17.8	19.9	22.2
Finance Cost	5.4	5.3	5.1	5.5
Chg. in Inventories	(1.7)	(8.4)	(9.9)	(9.9)
Chg. In Receivables	(13.4)	(9.7)	(5.7)	(5.5)
Chg. In Payables	(8.6)	(0.1)	1.9	1.7
Other Changes in WK	5.8	(1.1)	3.6	3.5
Taxes Paid	25.5	28.7	33.3	38.0
Net Operating Cash Flow	71.1	79.6	102.6	117.6
Capex	(45.6)	(54.9)	(59.9)	(64.7)
Cash Flow from Investing	(45.6)	(54.9)	(59.9)	(64.7)
Change in L&A, Provisions	(17.2)	(1.7)	(8.1)	(7.9)
Change in Borrowings	(22.3)	(2.2)	6.9	7.5
Finance Cost	(5.4)	(5.3)	(5.1)	(5.5)
Dividends	(12.7)	(19.1)	(19.1)	(25.5)
Cash Flow from Financing	(63.5)	(41.2)	(26.0)	(21.0)
Opening Cash	279.7	241.3	237.7	255.0
Cashflow during the year	(32.3)	(3.7)	17.4	21.5
Cash at the End of the Year	241.3	237.7	255.0	276.6

Source: Company, Sushil Finance Research Estimates

FINANCIAL RATIO STATEMENT

Y/E Mar.	FY16	FY17E	FY18E	FY19E
Growth (%)				
Net Sales	(4.1)	10.0	9.0	8.0
EBITDA	(40.4)	12.8	17.4	15.7
Reported Net Profit	(38.6)	13.3	16.1	14.1
Profitability (%)				
EBIDTA Margin (%)	19.0	19.5	21.0	22.5
Net Profit Margin (%)	13.4	13.8	14.7	15.5
ROCE (%)	11.2	11.6	12.2	12.6
ROE (%)	11.8	12.5	13.4	14.1
Per Share Data (Rs.)				
EPS (Rs.)	5.2	5.9	6.9	7.9
CEPS (Rs.)	6.6	7.3	8.5	9.6
BVPS (Rs)	46.8	51.2	56.6	62.5
Valuation				
PER (x)	31.1	27.4	23.6	20.7
P/BV (x)	3.5	3.2	2.9	2.6
EV/EBITDA (x)	19.8	17.6	15.0	12.9
P/ Sales (x)	4.2	3.8	3.5	3.2
Turnover				
Inventory Days	61	61	62	63
Debtor Days	39	42	42	42
Creditors Days	54	49	48	47
Gearing Ratio				
D/E	0.1	0.1	0.1	0.1

Outlook & Valuation

Suven Life Sciences has a fundamentally strong business model targeting the niche at the top of the pyramid – the CRAMS division which actually does the contract research rather than contract manufacturing commands good profitability unlike other CRAMS players. The long established relationships with over a score of global pharmaceutical giants and a robust pipeline of projects provides a good long-term business visibility. Additionally, the proprietary NCEs which includes promising molecules – SUVN-502, SUVN-G3031, SUVN-D4010 presents huge opportunity value. Furthermore, the strong financial position - low debt-equity ratio, of 0.1x, cash worth Rs.241 crore on Balance Sheet, visibility of stable revenue for the next couple of years with healthy profitability followed by substantial price correction presents an opportunity to re-enter the stock with long-term horizon. The stock currently trades at 31x FY16 earnings and 20x FY19 earnings estimate. We value the stock at 28x FY19 EPS of Rs.7.9 arriving at a target price of Rs.220.

H1 FY17

For the half year ended September 30, 2016, the top-line stood at Rs.249 cr, representing a growth of 14.1% YoY and an EBITDA margin of 32.3% (post-R&D) and 44.1% (pre-R&D). The company has reported a net profit of Rs.59 cr in H1 FY17 as compared to Rs.46 cr in H1 FY16, a jump of 29.1% YoY. The EPS stands at Rs.4.65 on standalone basis as against Rs.3.60 in the first half of previous fiscal.

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Analyst Stock Ownership	No
Stock Recommended to Clients	Yes
Remuneration/Benefits received from company in 12 months	No
Merchant Banking Market Making activities / projects	No
Sushil Financial Services Pvt. Ltd and Group Companies Holding	Yes
Sushil Financial Services Pvt. Ltd and Group Directors Holding	Yes
Broking Relationship with the company covered	No