

August 19, 2024

Company Report | Sector: Pharmaceuticals

Syngene

Reality check on recovery? Stay positive for now

We parsed the commentary of Charles River (CRL), a global CDMO player that offers preclinical and post-trial services along with manufacturing capabilities. While we are cognizant there is not a perfect overlap, a certain commonality exists across discovery services and pre-IND work as well as target customers. We highlight sobering commentary put out by CRL in its Q2 earnings call which is a change from the positive narrative of recovery in biotech funding. CRL believes there is an urgency amongst clients to prioritize trial work with an eye on commercial marketing. This implies less of a focus on early-stage research and discovery – areas which are important for Syngene. CRL believes the soft demand and cutback in large biopharma would continue in 2025, a scenario which is certainly not factored in ours as well as consensus growth expectation for Syngene. Reckon what such a commentary from a global peer does is put the spotlight back on Syngene H2 growth. For now, our ADD rating stays even as the purpose of this update is to highlight the developing backdrop amidst which Syngene has to deliver a strong performance to meet FY25 guidance.

Key global CDMO peer gives sobering outlook

We parse the Q2 commentary of key global player Charles River (CRL) which has given a sobering outlook for key verticals like early-stage research and discovery services. According to the company, recent emerging trends indicate a softening demand outlook which has resulted in a much more negative outlook for rest of CY24. CRL alluded to major restructuring programs undertaken by global biopharma companies likely triggered by IRA in US and/or patent expiration leading to tighter budgets and additional pipeline reprioritization activities in current year. CRL has pointed out to a slower recovery in biotech which is likely to persist in 2025.

Disproportionate focus on clinic vs IND work says CRL

CRL believes there is an urgency to push drugs through trials and into commercial production; what this has meant is pre-IND work and early-stage discovery has taken a kind of back seat. While company is not willing to wager how long this (disproportionate focus on clinic) would continue, it is hopeful that successful attempts to get drugs to market would fund more work on IND phase and then ultimately more discovery requirements.

Where does this outlook leave Syngene?

We recollect Syngene's majority of revenues today still accrue from research services even as it creates capacity to cater to small molecule and biologics manufacturing. Syngene management has indicated a sharp 50% recovery in RFPs across discovery and manufacturing verticals; albeit a potential slowdown in research and pre-IND work demand would make Syngene vulnerable as ex-manufacturing business comprises of short gestation projects. We note that CRL had downgraded their CY24 guidance and now expect a revenue decline vs growth earlier as it does not expect overall demand from biopharma clients to improve in H2 CY24.

Subdued peer commentary puts H2 Syngene guidance under spotlight

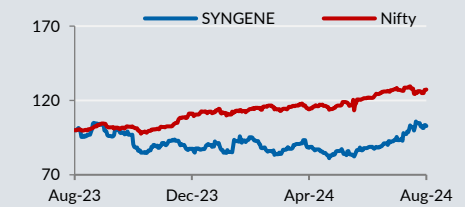
Syngene had maintained its outlook for a growth rebound in H2 though subdued commentary by a global peer would likely create a situation where pace of growth delivery might be put under the spotlight. We do not change our estimates (continue to expect a strong second half recovery necessary to achieve full year guidance) though we would tend to give increased weightage to a possibility that any miss on growth is not completely ruled out. Retain ADD rating with unchanged multiple and TP based on 45x FY26 EPS.

Reco	: ADD
CMP	: Rs 824
Target Price	: Rs 900
Potential Return	: +9%

Stock data (as on August 19, 2024)

Nifty	24,573
52 Week h/l (Rs)	875 / 608
Market cap (Rs/USD mn)	333052 / 3972
Outstanding Shares (mn)	401
6m Avg t/o (Rs mn):	696
Div yield (%):	0.2
Bloomberg code:	SYNG IN
NSE code:	SYNGENE

Stock performance



	1M	3M	1Y
Absolute return	10.0%	19.4%	2.7%

Shareholding pattern (As of Jun'24 end)

Promoter	54.7%
FII+DII	37.4%
Others	7.4%

Δ in stance

(1-Yr)	New	Old
Rating	ADD	ADD
Target Price	900	900

Δ in earnings estimates

	FY25e	FY26e
EPS (New)	15.1	18.9
EPS (Old)	15.1	18.9
% change	-	-

Financial Summary

(Rs mn)	FY24	FY25E	FY26E
Net Revenue	34,886	37,997	46,185
YoY Growth	9.3	8.9	21.5
EBIDTA	10,702	11,525	15,368
YoY Growth	9.6	7.7	33.3
PAT	5,094	6,056	7,952
YoY Growth	9.7	18.9	31.3
ROE	14.6	13.4	15.3
EPS	12.7	15.1	19.9
P/E	64.7	54.4	41.4
BV	105.9	119.7	138.3
EV/EBITDA	30.6	28.1	20.6

BHAVESH GANDHI

Lead Analyst

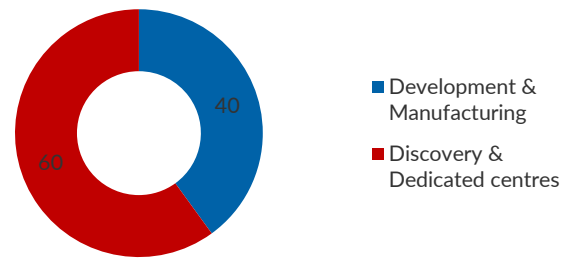
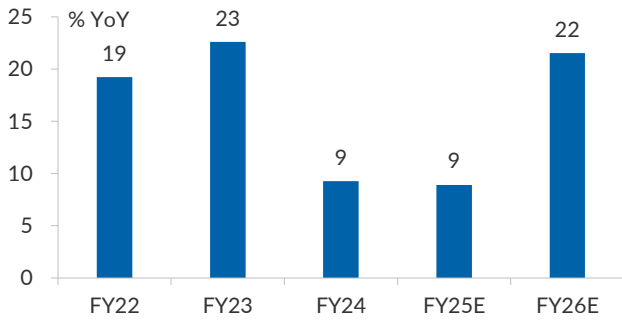
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STORY IN CHARTS

Exhibit 1: Revenue - build in solid acceleration next year

Exhibit 2: FY24 revenue break-up (%)

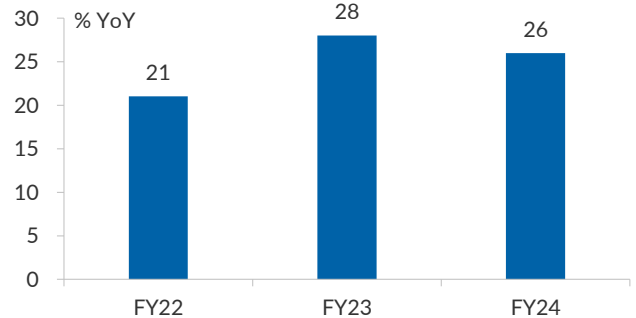
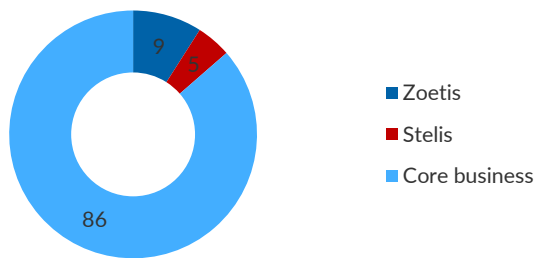


Source: Company, YES Sec

Source: Company, YES Sec

Exhibit 3: FY26 revenue break-up across segments (%)

Exhibit 4: Development & manufacturing revenue trend

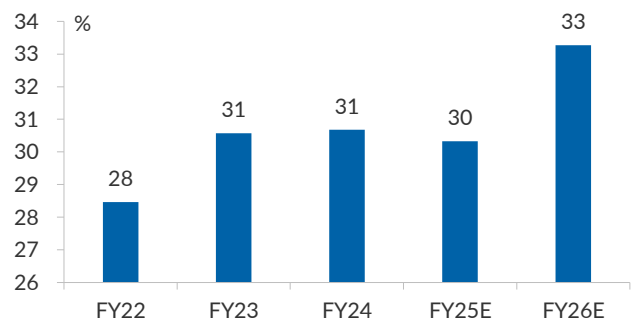
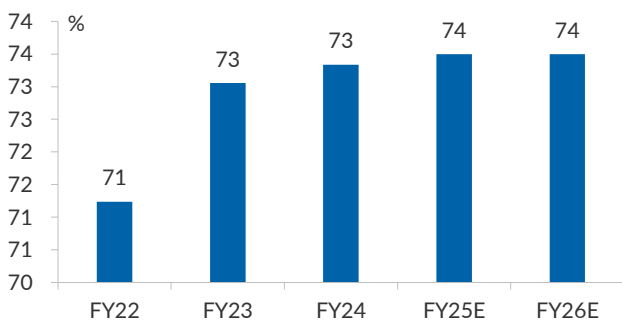


Source: Company, YES Sec

Source: Company, YES Sec

Exhibit 5: Gross margin seen at around historic range

Exhibit 6: Margin to rebound on strong growth in FY26



Source: Company, YES Sec

Source: Company, YES Sec

Highlights of Charles River Q2 call – relevant takeaways for Syngene

- Lack of a recovery in demand from biotechnology clients as well as recently emerging and softening demand trends in global biopharmaceutical client base have caused us to take a much more negative view of growth prospects for H2 CY24
- Most global biopharma companies have announced major restructuring programs likely precipitated by the IRA or pending patent expirations or both. And this has undoubtedly led to tighter budgets and additional pipeline reprioritization activities this year.
- But it's clear that their (biopharma cos) emphasis is on the clinic, to get drugs into the clinic, to do -- to pay for their clinical trials and obviously to get drugs into the market.
- Proposal activity and bookings began to notably decline and diverge from biotech clients during the second quarter. Now expect demand for global biopharmaceutical clients to further deteriorate over the remainder of the year. In contrast to large pharma, demand KPIs for small and mid-sized biotech clients have stabilized and trended somewhat more favorably through the first half, reflecting the solid funding environment and favorable sentiment around interest rates.
- Have seen a slower recovery in biotech, although it's been recovering, and have seen this very soft demand and cutbacks in pharma. It feels like that's likely to persist into 2025.
- Biotech funding particularly strong in the first quarter. Second quarter was okay. July wasn't great. So, looks like it's cooling off a bit again.
- It's difficult to know how long a disproportionate focus on the clinic will be. But it can't be forever or there is no pharmaceutical industry. They have to use, hopefully, drugs that successfully get to market to fund more work on the IND phase, and then ultimately, more discovery to start
- Company hasn't seen this level of pullback this severe in a long time but saw it years ago when there was another patent cliff. Hence, the emphasis on the clinic.
- It's hard to believe that the BIOSECURE ACT won't have a positive benefit to the demand curve for biologics, CDMO, safety, discovery.
- There's a lot of Chinese competitors in that space who compete principally on price but have very good scale and CRL clients have been quite happy with them.
- Want to be careful not to overstate the potential, although think there is a potential over time.
- Had meetings with a couple of very big VC firms with whom we (CRL) work who said they had, "Instructed their portfolio of companies not to do work in China."
- These are VCs that are creating new companies from scratch and the fact that they don't even want to start with China, is quite interesting.

FINANCIALS

Exhibit 7: Balance sheet

Y/e 31 Mar (Rs mn)	FY22	FY23	FY24	FY25E	FY26E
Equity capital	4,008	4,014	4,020	4,020	4,020
Reserves	28,968	32,166	38,557	44,110	51,559
Net worth	32,976	36,180	42,577	48,130	55,579
Debt	10,373	10,248	7,496	7,496	7,496
Total liabilities	43,349	46,428	50,073	55,626	63,075
Fixed Asset	27,392	28,438	36,881	37,543	37,538
Investments	5,531	4,923	4,638	4,638	4,638
Net Working Capital	9,770	12,371	8,147	13,038	20,493
Inventories	1,794	3,328	2,385	2,598	3,157
Sundry debtors	5,077	5,293	4,416	4,810	5,846
Cash	12,817	13,561	10,767	15,190	22,915
Other current assets	2,371	2,071	2,022	2,660	3,233
Sundry creditors	(2,328)	(2,580)	(2,555)	(2,783)	(3,383)
Other CL	(9,961)	(9,302)	(8,888)	(9,437)	(11,276)
Def tax assets	656	696	407	407	407
Total Assets	43,349	46,428	50,073	55,626	63,075

Exhibit 8: Income statement

Y/e 31 Mar (Rs mn)	FY22	FY23	FY24	FY25E	FY26E
Revenue	26,042	31,929	34,886	37,997	46,185
Operating profit	7,413	9,762	10,702	11,525	15,368
Depreciation	(3,097)	(3,665)	(4,259)	(4,335)	(5,016)
Interest expense	(241)	(452)	(472)	(525)	(750)
Other income	528	709	900	1,000	1,000
Profit before tax	4,603	6,354	6,871	7,665	10,602
Taxes	(886)	(1,292)	(1,108)	(1,610)	(2,651)
Adj. profit	3,717	5,062	5,763	6,056	7,952
Exceptional items	241	(418)	(669)	0	0
Net profit	3,958	4,644	5,094	6,056	7,952

Exhibit 9: Cash flow statement

Y/e 31 Mar (Rs mn)	FY22	FY23	FY24	FY25E	FY26E
Profit before tax	4,603	6,354	6,871	7,665	10,602
Depreciation	3,097	3,665	4,259	4,335	5,016
Def tax assets (net)	231	(40)	289	-	-
Tax paid	(886)	(1,292)	(1,108)	(1,610)	(2,651)
Working capital Δ	(875)	(1,857)	1,430	(467)	270
Other operating items	241	(418)	(669)	-	-
Operating cashflow	6,411	6,412	11,072	9,923	13,237
Capital expenditure	(6,107)	(4,711)	(12,702)	(4,997)	(5,010)
Free cash flow	304	1,701	(1,630)	4,926	8,227
Equity raised	1,205	(938)	1,806	-	0
Investments	(39)	608	285	-	-
Debt financing/disposal	1,085	(125)	(2,752)	-	-
Dividends paid	(401)	(502)	(503)	(503)	(503)
Net Δ in cash	2,154	744	(2,794)	4,423	7,725

Exhibit 10: Du Pont Analysis

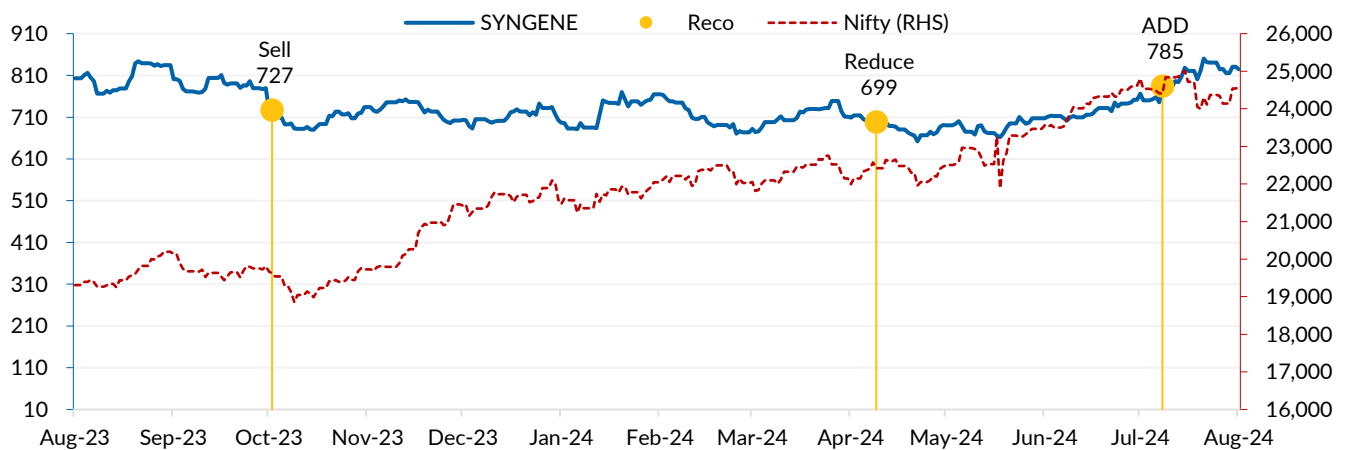
Y/e 31 Mar (Rs mn)	FY22	FY23	FY24	FY25E	FY26E
Tax burden (x)	0.81	0.80	0.84	0.79	0.75
Interest burden (x)	0.95	0.93	0.94	0.94	0.93
EBIT margin (x)	0.19	0.21	0.21	0.22	0.25
Asset turnover (x)	0.51	0.57	0.59	0.59	0.64
Financial leverage (x)	1.68	1.63	1.51	1.42	1.40
RoE (%)	12.1	14.6	14.6	13.4	15.3

Exhibit 11: Ratio analysis

Y/e 31 Mar	FY22	FY23	FY24	FY25E	FY26E
Growth matrix (%)					
Revenue growth	19.2	22.6	9.3	8.9	21.5
Op profit growth	13.2	31.7	9.6	7.7	33.3
EBIT growth	8.9	40.5	7.9	11.5	38.6
Net profit growth	(2.2)	17.3	9.7	18.9	31.3
Profitability ratios (%)					
OPM	28.5	30.6	30.7	30.3	33.3
EBIT margin	18.6	21.3	21.0	21.6	24.6
Net profit margin	14.3	15.9	16.5	15.9	17.2
RoCE	12.0	15.2	15.2	15.5	19.1
RoNW	12.1	14.6	14.6	13.4	15.3
RoA	7.2	9.0	9.7	9.4	11.0

Y/e 31 Mar	FY22	FY23	FY24	FY25E	FY26E
Per share ratios					
EPS	9.3	12.6	14.4	15.1	19.8
Dividend per share	1.0	1.3	1.3	1.3	1.3
Cash EPS	17.0	21.7	25.0	25.9	32.3
Book value per share	82.2	90.1	106.1	119.9	138.5
Valuation ratios (x)					
P/E	83.3	71.0	64.7	54.4	41.4
P/BV	10.0	9.1	7.8	6.9	6.0
M Cap/Sales	12.7	10.4	9.5	8.7	7.2
EV/EBIDTA	44.2	33.5	30.6	28.1	20.6
Payout (%)					
Tax payout	19.2	20.3	16.1	21.0	25.0
Dividend payout	10.1	10.8	9.9	8.3	6.3
Liquidity ratios					
Debtor days	71	61	46	46	46
Inventory days	25	38	25	25	25
Creditor days	33	29	27	27	27

Recommendation Tracker



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Analyst signature

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YES Securities (India) Limited ("YSIL") is a wholly owned subsidiary of YES BANK LIMITED. YSIL is a Securities and Exchange Board of India (SEBI) registered Stock broker holding membership of National Stock Exchange (NSE), Bombay Stock Exchange (BSE), Multi Commodity Exchange (MCX) & National Commodity & Derivatives Exchange (NCDEX). YSIL is also a SEBI-registered Category I Merchant Banker, Investment Adviser and Research Analyst. YSIL is also a Sponsor and Investment Manager of Alternate Investment Fund - Category III (YSIL Alternates) and AMFI registered Mutual Fund Distributor. The Company is also a registered Depository Participant with CDSL and NSDL. YSIL offers, inter alia, trading/investment in equity and other financial products along with various value added services. We hereby declare that there are no disciplinary actions taken against YSIL by SEBI/Stock Exchanges.