Syngene International

Setting the stage for capacity driven growth

Syngene is a Bengaluru based Custom Research Organisation. Company is in the Contract Research Outsourcing (CRO) business and has capacity to perform discovery, pre-clinical and clinical research on potential drug candidates.

Unique investment opportunity in drug research business: While almost all Indian pharma companies are in generic drugs business, Syngene supports its clients to invent new drugs. It has 8 of the top 10 global pharma companies as its clients and also has long term contracts with some big pharma companies. In our view Syngene provides a unique investing opportunity in drug research business.

CRO is an attractive business: Syngene operates in an attractive business with several growth drivers. The rising cost of drug research is a tailwind for the sector, as this has prompted innovative pharma companies to outsource their R&D to low cost alternatives. Global R&D spends by pharma companies is set to grow from $150bn in 2015 to $172bn in FY2020. The CRO industry is estimated to grow from $31.4bn in 2015 to $56.4bn by 2020, indicating a rising pie of outsourcing in the innovative R&D segment.

Syngene has constantly evolved to capture opportunities: Syngene has acquired a critical mass to become a sizable player in the industry. It is already witnessing a rise in the dedicated R&D centers. Moreover, with opening of new facilities, long term contracts should increase going ahead. Company has capacity in both chemical and biologics drugs, and it is also forward integrating in API manufacturing, which we believe is a scalable opportunity.

Earnings expected to grow in FY2019E: Syngene reported weak performance in FY2017 due to ~10% loss of facility in a fire incident in 3QFY2017. While this would impact 1HFY2018E revenues, recovery is expected from 2HFY2018E. We expect FY2019E revenue/PAT/ROE at `1,829cr/ `418cr/21.6% respectively.

Outlook & Valuation: At the CMP of `478, Syngene trades at 23.0x its FY2019E EPS. We compare Syngene with its Chinese peer WuXi PharmaTech, which before delisting, traded at ~24x. While WuXi's growth was fueled by acquisitions, Syngene's is mostly an organic growth story and has headroom for both organic (capacity utilization) and inorganic growth. We rate Syngene 'Buy' with Price Target of `564 (27.0x of FY2019E EPS).

Key Financials

Y/E March (` cr)	FY2016	FY2017	FY2018E	FY2019E
Net Sales	**1,107**	**1,201**	**1,411**	**1,829**
% chg	*28.7*	*8.5*	*17.5*	*29.7*
Net Profit	**241**	**287**	**301**	**418**
% chg	*37.6*	*19.3*	*4.8*	*38.7*
OPM (%)	34.4	33.9	32.3	36.4
EPS (Rs)	**12.1**	**14.4**	**15.1**	**20.9**
P/E (x)	39.5	33.2	31.7	22.9
P/BV (x)	9.3	7.4	6.1	4.9
RoE (%)	23.5	22.2	19.2	21.6
RoCE (%)	14.8	13.9	12.9	17.3
EV/Sales (x)	8.8	8.0	7.1	5.5
EV/EBITDA (x)	25.6	23.6	21.9	15.1

Source: Company, Angel Research; Note: CMP as of July 5, 2017

BUY

CMP	`478
Target Price	`564
Investment Period	12 Months

Stock Info	
Sector	Pharmaceuticals
Market Cap (` cr)	9,551
Net Debt (` cr)	85
Beta	1.0
52 Week High / Low	663/402
Avg. Daily Volume	83,062
Face Value (`)	10
BSE Sensex	31,246
Nifty	9,638
Reuters Code	SYNN NS
Bloomberg Code	SYNG IN

Shareholding Pattern (%)	
Promoters	74.5
MF / Banks / Indian FIs	16.7
FII / NRIs / OCBs	0.1
Indian Public / Others	8.6

Abs. (%)	3m	1yr	*2yr
Sensex	4.2	15.0	12.1
Syngene	(13.2)	10.0	53.8

** Since listing*

Price Chart

Source: Company, Angel Research

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Company background

Company overview

Established in 1994, Syngene International Limited is one of India's largest and Asia's second largest Contract Research Organizations (CRO). It is a full service CRO and provides the entire services basket for drug development, from discovery to development stage and also has small scale manufacturing facility to support clinical trial level supplies. Syngene has established a robust track record across the discovery and development chain and has established itself as a leading CRO.

The company offers its services for novel molecular entities (NMEs) across industrial sectors like pharmaceutical, biopharmaceutical, biotechnology, etc. Along with small molecule development, Syngene offers biologics discovery and development platforms, which contribute significantly to the R&D efforts of biotechnology focused partners.

Company offers these services through flexible business models ranging from a Full-Time-Equivalent (FTE) to a Fee-For-Service (FFS) model or a suitable model customized for client's requirement. Company has been able to grow its customer base from 104 in 2011 to over 300 in March 2017, which includes major global biopharma companies and a number of mid-sized biotech and pharma firms and several small and virtual enterprises.

It has facilities audited by US FDA, EMA, AAALAC and major life sciences partners. Company employs more than 3,300 employees of whom ~85% are scientists with Doctorate or Masters Degree.

Services overview

Dedicated R&D centers: Involves long-term strategic collaborations, usually five years or longer and involves setting up dedicated customized infrastructure with a dedicated team of scientists.

Exhibit 1: Syngene's five dedicates research centres

Bristol-Myers Squibb	Baxter International	Abbott Laboratories	Amgen	Herblife
>400 scientists	~150 scientists	~30 scientists	>100 scientists	~3,000sqft facility
Operational since 2009	Operational since 2013	Operational since 2012	Started in 2016	Started in 2017
Developed 9 drug candidates	Parenteral nutrition and renal therapy research	Focus on maternal, pediatric, neo-natal nutrition and diabetes	4 year contract	Nutrition research centre

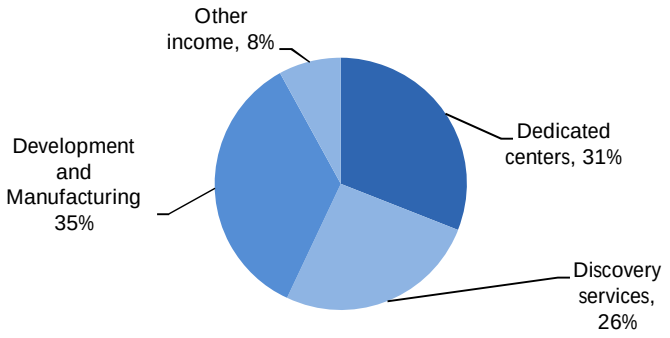
Source: Company

Discovery research services: This includes multiple client engagements across discovery chemistry and discovery biology segments. This vertical has shown promising growth in the discovery biology mirroring global trend.

Product development and manufacturing services: This vertical offers services when molecules move to pre-clinical and clinical studies and includes manufacturing of molecules for studies. This segment has seen growth due to the chemical development, as large number of client projects have moved in the later stages of research.

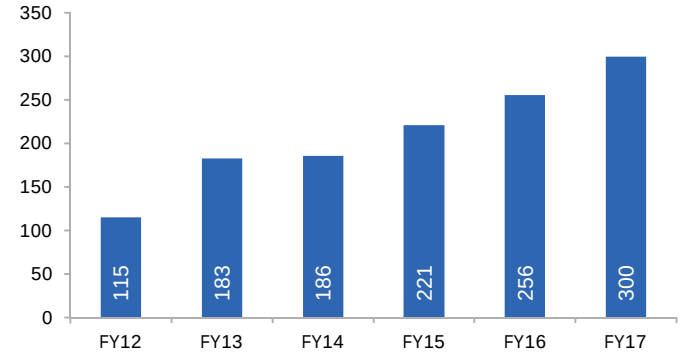
Syngene story in tables and charts

Exhibit 2: Business mix (1QFY2017)



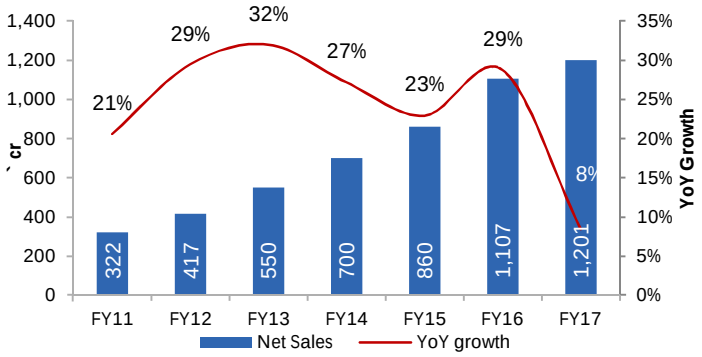
Source: Data as per 1QFY17 transcript, Angel Research

Exhibit 3: Addition in new clients



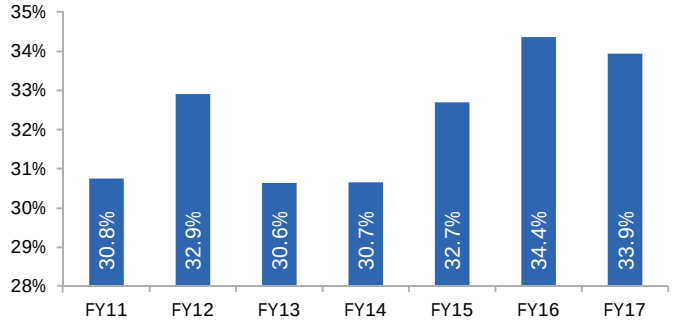
Source: Company, Angel Research

Exhibit 4: 25% CAGR in net sales (FY2011-17)



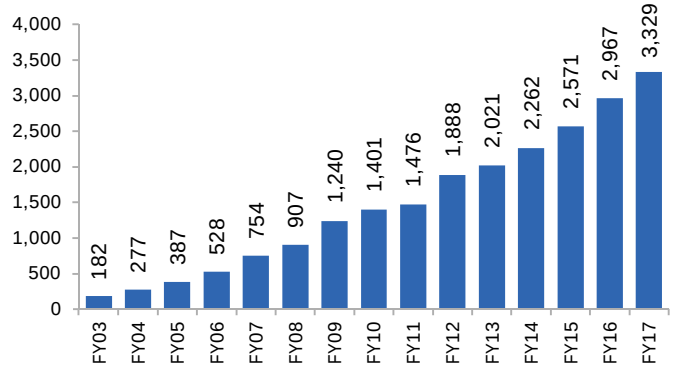
Source: Company, Angel Research

Exhibit 5: EBITDA margin improvement from 31% to 34%



Source: Company, Angel Research

Exhibit 6: Increasing employee strength



Source: Company, Angel Research

Exhibit 7: Evolution of Syngene International

Year	Milestone
1994	Syngene starts operations
1999	Expansion of R&D lab
2000	Foray in clinical research
2001	Dedicated chemical development facility
2003	Moves in 63K sqft facility
2007	Expansion to 148k sqft facility, BMS contract
2009	Initiated large molecules development services
2010	Operations in formulation development
2011	Contract with Endo Pharmaceuticals
2012	Contract with Abbott, Acquisition of Clinigene
2013	Contract with Baxter
2014	Contract with Bristol-Myers Squibb
2015	IPO and listing, $200 Mn capex announced
2016	Amgen research centre, fire in one of the facility
2017	Herblife research centre

Source: Company, Angel Research

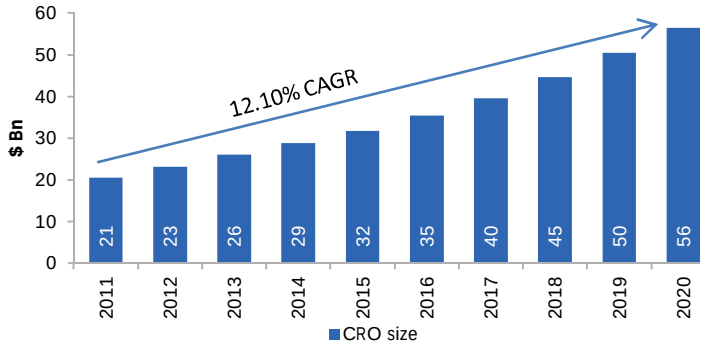
Investment Rationale

CRO Industry – Dynamic with secular growth drivers

CROs (Custom Research Organizations) offer outsourced research services to companies in various sectors, especially those in the pharma and biotech industries. CROs depend upon the R&D spending by the innovator companies. The innovator companies are consistently spending on research to discover and develop new drugs, however the rising cost of research puts pressure on their profitability. Custom research industry emerged out of this need to reduce the research costs of innovators.

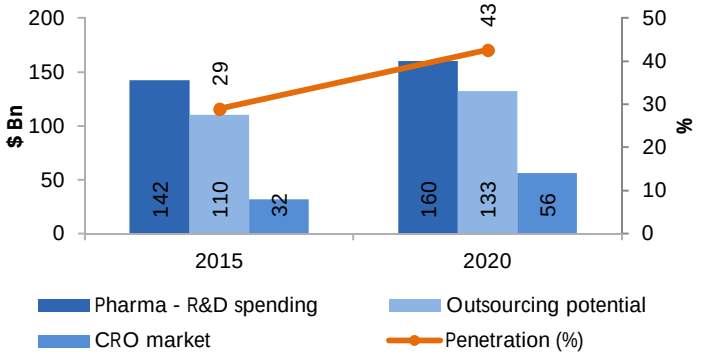
This is a very fragmented industry with thousands of CROs globally. However, top 10 companies hold the maximum market share (in 2014, top 10 CROs held 53% market share). According to Frost & Sullivan, the CRO market size was ~$20.6bn in 2011, which is estimated to grow at a CAGR of 11.8% to reach at ~$56.4bn by 2020P. Out of the total $150bn spending on R&D by the global innovator companies in 2015, $31.8bn was outsourced to the CROs, however, the potential to outsource the R&D was $110bn. This penetration of ~21% is expected to rise to ~33% by 2020, when global pharma R&D expenses would rise to $172bn.

Exhibit 8: CRO market to grow at 11.8%



Source: Angel Research

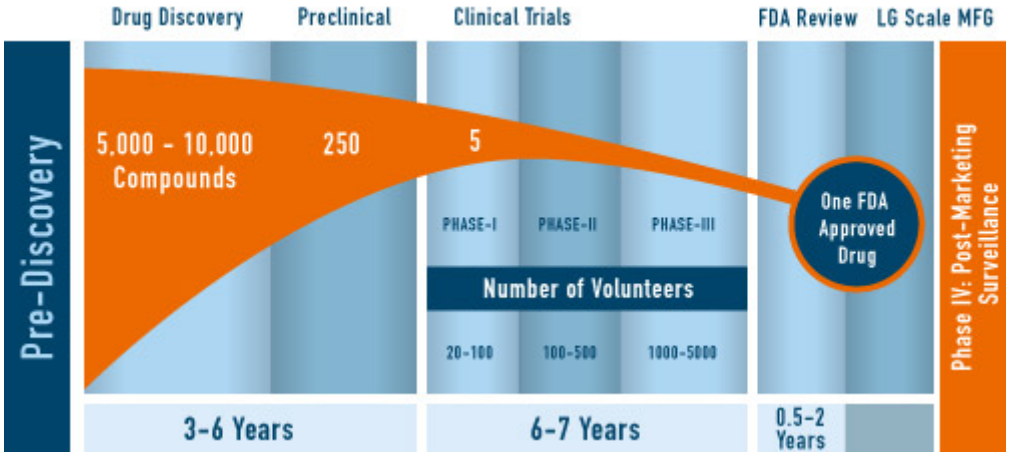
Exhibit 9: Penetration of CRO services to rise to 46%



Source: Angel Research

R&D – Pharma's key growth driver: The success of a Pharma Company lies in its ability to discover new drugs that can treat diseases better than the existing drugs. New drugs can be potential blockbusters (>$1bn annual sales) and hold a key to superior profitability. The future R&D budgets also depend upon the success of the drugs that are already in the pipeline; therefore, the success of R&D is paramount in the pharma business.

Exhibit 10: Drug discovery to approval – process and timeline



Source: Pharmaexams.com, Angel Research

Drug discovery and development is a prolonged process, which on an average, takes more than a decade to get a drug from discovery to commercial manufacturing stage. It also requires several thousand of potential compounds to be studied in the beginning of the discovery phase. From these thousands of compounds, very few compounds enter in the clinical trials stage, of which only one or two can get to the final stage, i.e. drug approval from the regulator. The clinical studies require manufacturing of a drug at the highest quality in adequate quantity to support the trials, hence, companies are also required to have pilot level manufacturing capability during the clinical trial stages.

Exhibit 11: Drug development stages

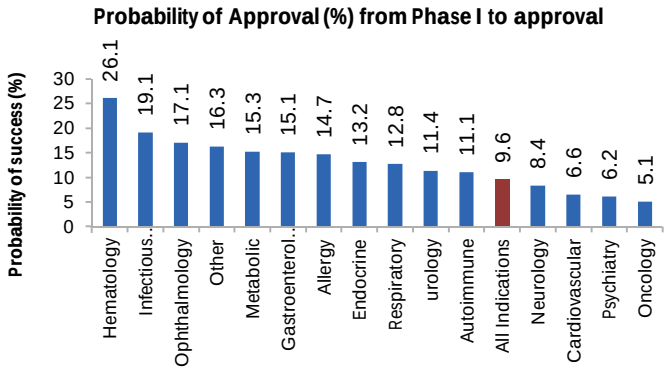
Discovery Services	Preclinical Services	Clinical Trials	Drug approval
Narrow down from thousands of compounds to a few hundred and identify promising possibilities.	Laboratory and animal experimentation of the preclinical drug candidates and get data on safety and efficacy on animal models.	Studies in humans to determine the safety, efficacy and suitable drug dosage of INDs, trials happen in several stages.	INDs are filed with regulator for new drug application (NDA) or Biologic License Application (BLA). Post approval, company start manufacturing and selling the drug in the market.

Source: Company

To get these studies, innovator drug companies employ teams of doctors and researchers. Companies are also required to perform the clinical studies of varying sizes and sometimes in different countries. Companies typically spend more than $1bn on new drug development; however, this does not guarantee success of the R&D, as company can be forced to abandon the studies due to reasons like results not meeting endpoints, safety and efficacy issues, approval of a better product by competitors, etc. Over the years, the drug development costs have seen a huge inflation with the total cost to develop a drug increasing from $140mn in mid 1970s to nearly ~$1.2bn in early 2000.

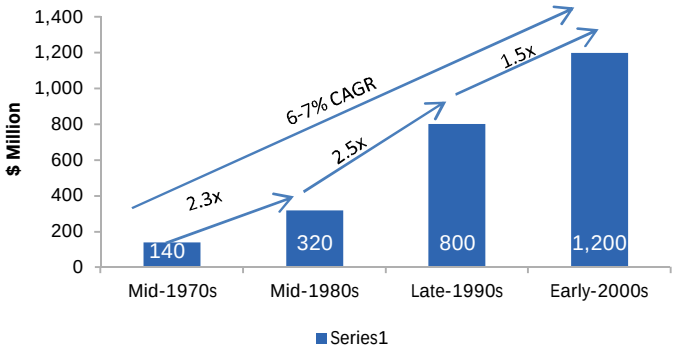
While the drug development costs continue to soar, the probability of moving the drug from Phase 1 Clinical trial to approval stage remains another challenging factor for the drug companies. More complex the disease, less is the probability of getting a drug approval.

Exhibit 12: Complex diseases = low approval probability



Source: Bio.org, Angel Research

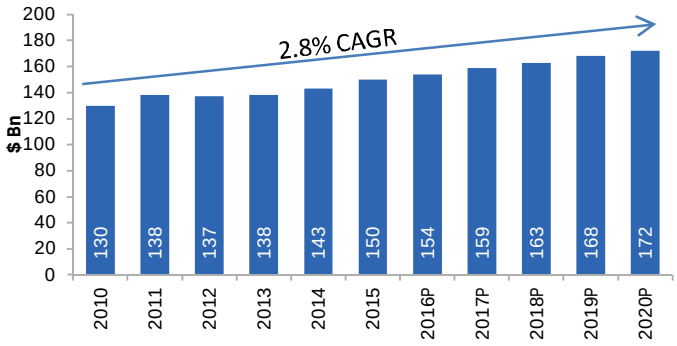
Exhibit 13: Soaring drug development costs



Source: Company

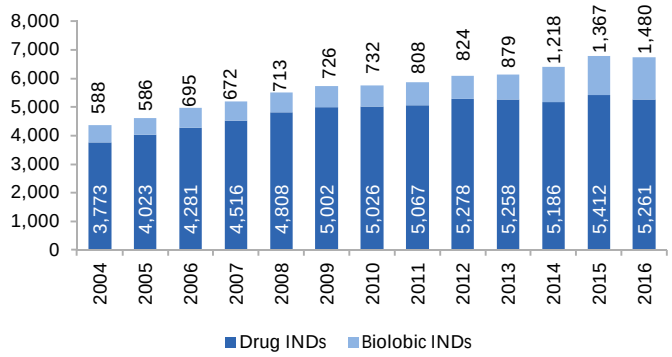
R&D spending continues to grow: Owing to the pharma company's focus on inventing new drugs, the pharma companies spend a huge amount on their R&D. Some companies spend as high as 8-9% of their sales on R&D. From 2010 to 2015, total R&D spends by pharma companies grew from $130bn to $150bn, at a CAGR of ~2.9%. Going ahead, this spending is expected to grow at a CAGR of 2.8% to reach ~$172bn by 2020E.

Exhibit 14: Growing R&D spending



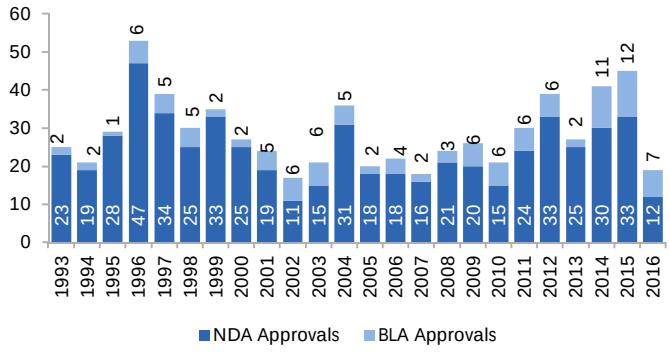
Source: *Statista.com, Angel Research*

Exhibit 15: Healthy Investigational New Drug Pipeline



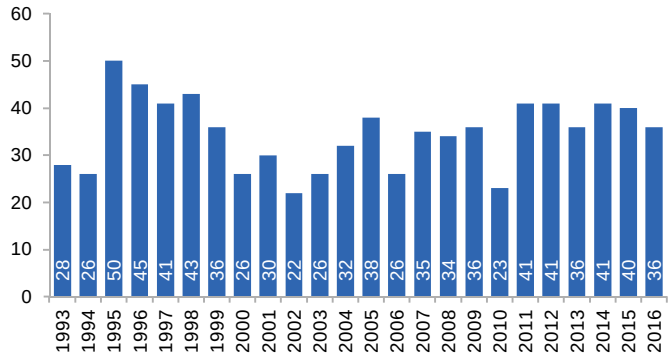
Source: *USFDA, Angel Research*

Exhibit 16: NDA and BLA approvals



Source: USFDA, ***NDA:*** *New Drug Approval,* ***BLA:*** *Biologic License Approval)*

Exhibit 17: Total new drug Filings (NDA+BLA)



Source: USFDA

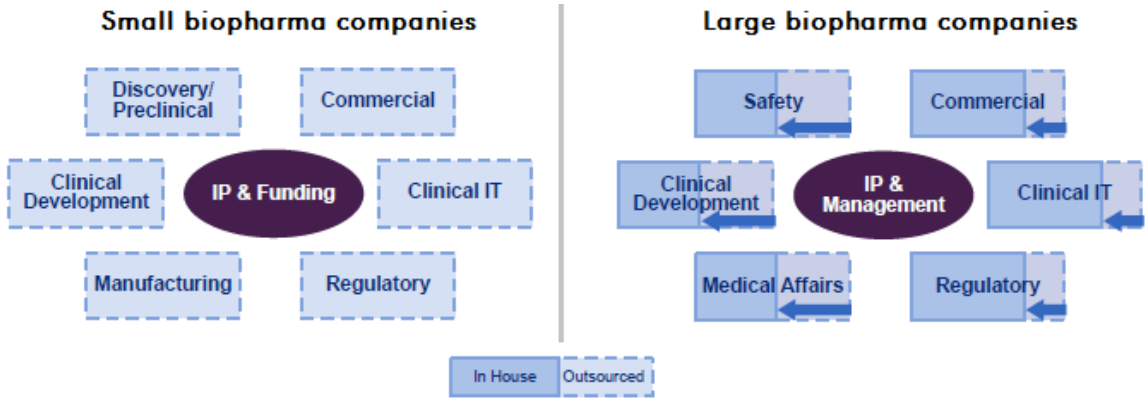
The steady rate of drug approvals by the USFDA (NDA and BLAs) and higher biologic drugs sales are the main drivers for R&D spending.

R&D outsourcing – A transformation gradually picking up in life sciences: The life sciences industry has been under pressure due to the increasing generic drugs penetration, declining profitability, poor shareholder returns and lower efficiency of the in-house R&D. Life sciences companies have been realizing the need to alter their operating methods and responding accordingly. As a part of this, life sciences companies first started to outsource their manufacturing process and have been successful in their strategy. The next thing they can outsource is R&D, which they have been extremely reluctant to do.

For the life science companies, R&D is the critical part, as it involves the sensitive information of their intellectual properties. However, there are not many ways with which life sciences companies can cut costs on sustained basis and R&D outsourcing is gaining popularity. The rising penetration of the CRO industry is a testimony of this changing mindset of the life science companies towards R&D outsourcing.

The clinical trials saw the first wave of outsourcing and saw companies like Quintiles, Covance, Parexel, Charles River, InVentive Health, etc. getting the big revenue pie. The clinical trial outsourcing has become so successful that about 3/4th of the total clinical trials are carried out by the professional CROs.

Exhibit 18: Dependence of Bio-pharma Companies on outsourcing services



Source: PAREXEL presentation, Angel Research

The R&D outsourcing, especially in the biopharma space has seen huge strides with the small biopharma companies being almost fully reliant on the outsourced services, while the large biopharma companies increasing their exposure to the outsourcing services.

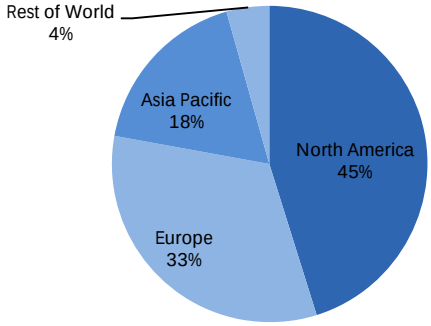
We believe that similar wave of outsourcing is currently taking place in the early stage R&D; and going by the experience in clinical trials outsourcing, in few years, most of the discovery stage research could be carried by the CROs. Within that, companies with capability from drug discovery to development stage including clinical trials would be most preferred. Cost arbitration would be an added advantage for the life sciences companies, and this is where the market is likely to move going ahead.

CRO business models: CRO services typically range from preclinical stage until approval stage including ability to pilot level manufacturing capability to support clinical trials. CROs with all the above capabilities are called as full service CROs and not all CROs are full service CROs. Contrary to this, there are specialty CROs

who have limited capability, however, are flexible in services. Full service CROs are the 'One Stop Shop' which handle end to end services, have the experience in diverse services and scale-up capability. Most CRO service providers specialize on the needs of their clients and the market in which they operate i.e. 1) discovery 2) development, and 3) manufacturing.

Full service CROs are mostly preferred by the large companies, while the specialty CROs are best suited for the small companies. The CRO's in Asia Pacific are also seeing a growth traction with a total 18% of market share in 2014.

Exhibit 19: CRO industry revenue share by geography



Source: Syngene RHP

What is the growth potential of CRO industry? The CRO industry has been growing at a healthy rate of 10-11% over the last five years. With the secular growth drivers, the industry is expected to continue growing by 11-12%. With the increasing number of companies looking to outsource their R&D, penetration of R&D outsourcing is expected to increase. It is expected that the R&D outsourcing penetration will increase by about 100-200bps each year with the CRO services penetration moving towards ~60% in the long term. The Discovery services, Clinical trials and Clinical services are expected to grow by 11.5%, 11.9% and 13.5% respectively. Within the industry, the bigger CROs are expected to grow faster either due to inorganic avenues or due to the gaining market share. There is also growing demand for the services from the Asia Pacific countries, due to the cost arbitrage over the local players.

Exhibit 20: CRO Industry Growth

	CRO Industry size ($bn)			
Year	**Discovery Services**	**Preclinical Services**	**Clinical Trials**	**#Clinical services**
2014	14.7	3.8	15.5	9.2
2018	22.7	4.6	24.7	15.2
CAGR (%	11.5	5.2	11.9	13.5

Source: Syngene RHP - Combined estimates by IQ4I and Frost & Sullivan, #Includes Bioanalytics, Biostatistics, Pharmacovigilance, Data management, etc.

In a nutshell, CRO is an exciting and attractive space to be in. The entire space is undergoing a strong growth and due to the secular growth drivers, the growth is in the range of 11-12%, and is expected to be maintained going ahead due to with the continued spending of pharma companies on R&D, and higher penetration of CRO services.

Syngene – Poised for capex driven growth

One-Stop-Shop, an attractive business model: Over the years, Syngene has evolved as a full service CRO having both chemical and biologics capabilities. Company operates a flexible business model called as plug and play. This model has several entry points for the clients to initiate their work at any stage of the drug development cycle at Syngene.

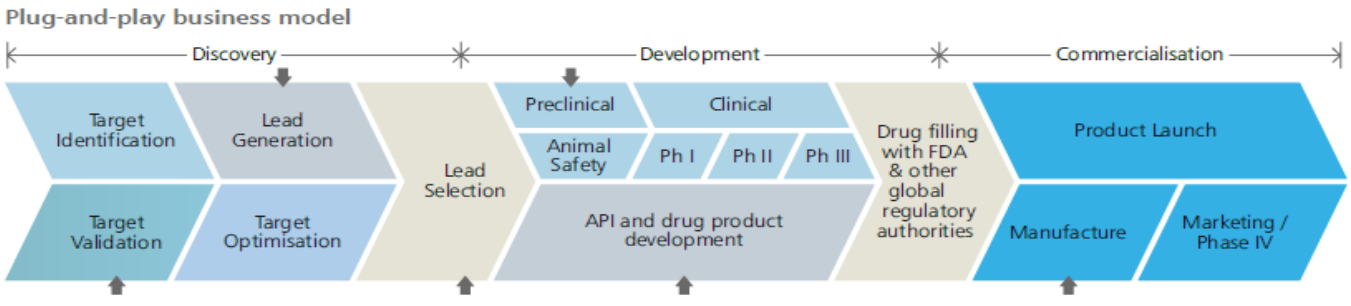
It offers a complete set up of client's R&D through dedicated centers and can also work on standalone contracts. Company offers two types of contracts i.e. 1) Fee-For-Service (FFS), and 2) Full-Time-Equivalent (FTE). These contracts are customized as per the client's requirement.

We believe that this flexible model has been attractive for its clients, which has translated in the superior growth for the company. Client additions have been strong with total clients going up from 104 in FY2011 to over 300 in FY2017. Company now has 8 of the top 10 global pharmaceutical companies as its clients.

With the biologic drugs seeing increased indications and a strong growth traction globally, biologics make an important business segment for Syngene. In the last few years, company has been investing more on the biologics side and has completed acquisition of Strand Life Sciences in the bioinformatics space widening its services basket. Recently, it has also commissioned viral testing capacity, which also further enhances its offerings.

Syngene is gradually becoming a one stop shop for its clients with capabilities ranging from discovery to development. Within the next three years, company will foray in commercial manufacturing with completion of its Mangalore API manufacturing facility in FY2020. With the commercial research and manufacturing capability, Syngene appears to be even more attractive proposition for its clients, as due to its know-how of the manufacturing process of the molecules, which get researched at Syngene's research facilities.

Exhibit 21: Plug and play business model



Source: Company, Angel Research

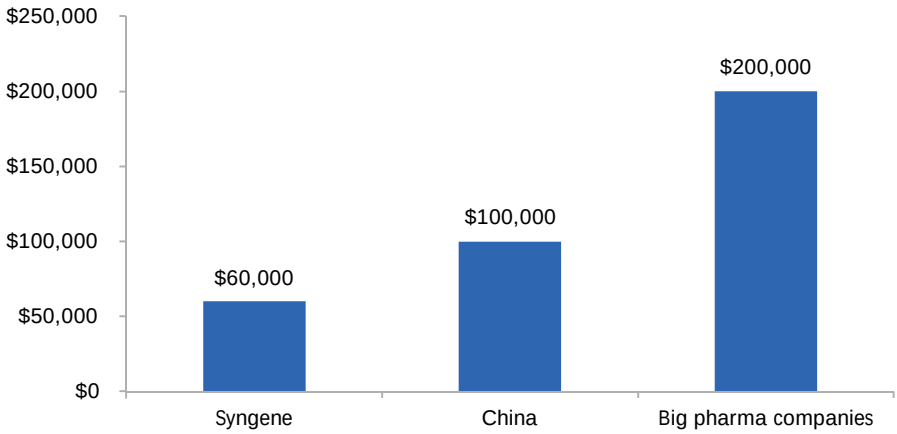
Attractive cost arbitrage for innovators- Syngene's business model gives a lot of cost arbitration to its clients. The big pharma companies spend about $200k-$240K per annum, per scientist. The average salary of scientists in China is ~90K-$100K per year. The average annual salary of $60,000 offered in India gives a lot

of cost arbitrage opportunity for the innovators. Syngene's pricing per scientist is 30-40% below its Chinese counterparts and ~70% lower than big pharma companies.

With the pharma companies relooking at their cost structure, outsourcing at the low cost but with the equivalent quality will be a key differentiator. Syngene derives a huge cost arbitrage over its US and Chinese counterparts, and this has benefitted the company in attracting more clients. This benefit is expected to continue, as there is a lot of headroom left, which will continue to be an attractive proposition for its clients.

Company also has pricing power to the tune of 3-4% price hikes every very, and hence, we believe that Syngene is likely be derive benefits (getting more dedicated R&D centers, long term relationships, more R&D outsourcing contracts, etc.) going ahead.

Exhibit 22: Average annual salary per scientist



Source: Company, Angel Research

Dedicated centers – strong operating leverage play for future: Syngene currently has 5 dedicated R&D centers for the global pharma companies. Dedicated centers are the long term contracts, which offer flexibility and cost reduction to the innovators.

Exhibit 23: Syngene's five dedicates research centres

Bristol-Myers Squibb	Baxter International	Abbott Laboratories	Amgen	Herblife
>400 scientists	~150 scientists	~30 scientists	>100 scientists	~3,000sqft facility
Operational since 2009	Operational since 2013	Set-up since 2012	Started in 2016	Started in 2017
Developed 9 drug candidates	Parenteral nutrition and renal therapy research	Focus on maternal, pediatric, neo-natal nutrition and diabetes	4 year contract	Nutrition research centre

Source: Company

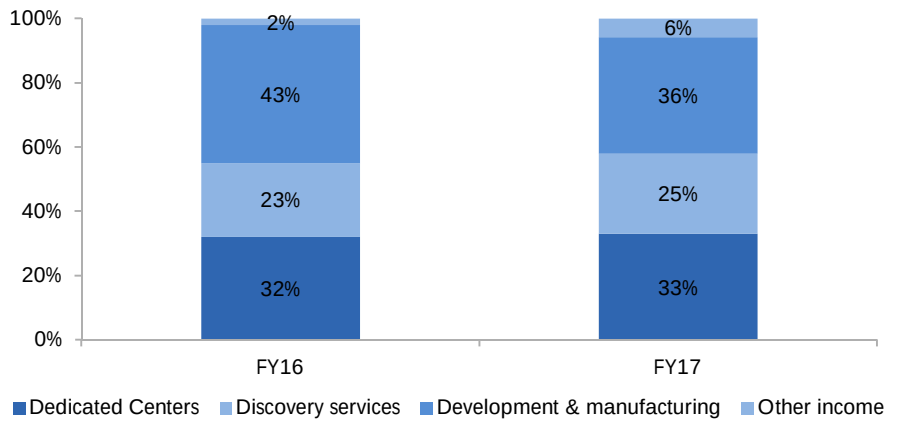
Dedicated centers are the second largest revenue contributors for Syngene, however, we believe that this business is set to become the largest business segment in the next few years. The dedicated centers at the end of FY2017 contributed 33-35% of revenues v/s. ~32% in FY2016. In FY2017, company has seen addition of two new clients in dedicated centers, which will see a meaningful contribution in the revenues from the dedicated centers in FY2018E onwards.

Dedicated centers help Syngene to build its repute in the fragmented CRO market. A strong brand name will be a key to attract more clients and long term contracts in our opinion. Company already has 8 of the top 10 pharma companies as its clients and growing brand equity is likely to add more dedicated centers going ahead.

Discovery research – The shining spot: While the separate revenue split is not available for biology and chemical discovery services, we believe that the company is seeing a strong traction in the discovery biologics business. We estimate 17-18% growth in this business in FY2017 v/s. 9% growth in Syngene's net sales in FY2017. Within this segment, we believe that biologics is seeing a strong traction, in-line with the current trend in the global healthcare sector. Company has indicated that ~50% of the clients' research pipeline is in the biologics drugs, which gives a glimpse that the biologics is where the future of Syngene lies.

Discovery services business is likely a feeder segment for the other services (development and manufacturing) hence, the growth of this segment is extremely important for Syngene. Increasing traction in the discovery services indicate a sustained momentum for other businesses, as molecules that get cleared in the discovery stage, would pass to the development/clinical trials stage. While this is not guaranteed, probability is that a few molecules would proceed to the next level i.e. development. The company has indicated that margin profile goes up once molecules move from discovery stage to development and manufacturing stage. Hence, we believe that the growing discovery business is an indication of a sound future business opportunity and better margins.

Exhibit 24: Discovery services: 200bps jump in Syngene's revenue mix



Source: Company, Angel Research, #Dedicated centers ~33-35% of revenue in FY17

API manufacturing - forward integration and scalable opportunity: Syngene's development and manufacturing business is the largest segment and contributed ~36% to its FY2017 revenues. The work in this segment is drug development like clinical trials and commercial manufacturing in low volumes. This segment is expected to see strong growth with company moving in the forward integration through its API facility in Mangalore.

Globally, most contract research organizations focus on research related work, Syngene however, is looking beyond CRO business to become a meaningful Contract Manufacturing Organization. This forward integration capability will have

rich rewards for the company, as API manufacturing is a scalable opportunity. The company will focus on the molecules of its partners, which means that company already knows the manufacturing process and technical knowhow, which we believe is additional lever for margin boost.

Company has indicated that the late stage molecules have high potential to enter in commercial manufacturing. It has also said that contracts for two chemical molecules are already in place and company is currently supplying these molecules in small volumes. The NDA approval for these two molecules will be a very important trigger for the manufacturing segment.

This API manufacturing facility is a part of $200mn capex plan and will be operational by 1HFY2020E. The facility was earlier expected to be operational by end of FY2019E however, has been delayed due to the environment clearances and company is sure to get this in-line by FY20E.

Investing in new capacities: CROs are required to expand their capacities and also invest in the new capabilities/technologies. In this sense, CROs are constantly in the capacity expansion mode and failure in doing so means stagnant growth.

Syngene has also been constantly investing in capacities, this has helped it to maintain the growth momentum and richly outperform the CRO industry growth. Company in FY2016 announced a $200mn capex plan, which is biggest so far, to be executed between FY2017-19. This includes expansion of its research capabilities as well as investing in new API manufacturing capacity. While the earlier capex plans focused on augmenting the capacities, this time, company is investing 50% of the capex on building the commercial manufacturing capacity.

Exhibit 25: Break-up of $200mn capex plan

Capacity	Location	Capex Amount	Description	Capacity opening
Biologics Manufacturing			5x increase in its biologics manufacturing facility	Operational
Formulation Centre	Bangalore	$100mn	Clinical and commercial supplies in small volumes	Operational
Research Centre			0.2mn sqft facility to support the discovery programs	50K sqft. operational
Commercial Manufacturing	Mangalore	$100Mn	Manufacturing of of API and intermediaries of novel molecules	Operational in FY20

Source: Company, Angel Research

Despite this, the current capex plan is its biggest plan if we consider that $100mn is allocated towards adding new capabilities, which will strengthen its integrated platform. In this capex plan, company is also increasing its offerings in oligonucleotide manufacturing, viral testing and antibody-drug conjugates. Besides, company has also recently acquired the Bioiformatics capability from Strand Life Sciences. The global Bioinformatics market was ~$10bn in 2013, which is growing at a CAGR of 15%. The acquisition of Bioinformatics capability opens up another area of growth for the company.

Exhibit 26: New technologies/capabilities to increase service offerings

Technology	Description	Application
Viral testing	Test the viral contamination	Biologic drugs
Oligonucleotide manufacturing	Manufacturing of Synthetic DNA/RNA materials	Drug development
Antibody-drug conjugates	Create efficient monoclonal antibody by attaching cell-killing agents	Cancer treatment
Bioinformatics	Analysis of data generated in drug development	Biologic drugs

Source: Company, Angel Research

While the revenue potential of these new technologies cannot be estimated, these services increase the service offerings of Syngene.

Syngene is best placed amongst its peers: A comparative study of Syngene v/s. its peers indicates that Syngene is best placed among other CROs in the industry. While the cost advantage and access to the huge pool of science graduates is a strong advantage, Syngene also has a broad range of offerings and has superior financial performance than peers.

Exhibit 27: Syngene, best placed amongst its competitors

Peer	Discovery	Dev./Clinical stage	API manufacturing	Revenue CAGR 5yr	EBITDA margin (5 yr avg.)	Average ROE (5 yr)
Syngene International	**Yes**	**Yes**	**By FY20E**	**28%**	**33%**	**21%**
# WuXi	Yes	Yes	Yes	13.1%	23.8%	18.7%
Covance + Lab Corp. of America	No	Yes	No	11.2%	15.1%	17.0%
Icon Plc	No	Yes	No	12.0%	17.1%	19.5%
Charles River	Yes	Yes	No	8.0%	21.1%	18.4%
Parexel International	No	Yes	No	11.6%	13.4%	19.4%
$Quintile	No	Yes	No	7.6%	16.2%	NA
*INC Research	No	Yes	No	19.7%	12.7%	NA

*Source:# Bloomberg estimates, Individual annual fillings of companies, Angel Research, * INC research has recently turned profitable, $Quintiles data for 2011-2015*

Due to the attractiveness of the industry, M&A activity has been very active. The CRO sector has seen consolidation in the last few years with bigger players like Covance, WuXi, Quintiles, etc. getting acquired. Parexel is also in advanced stages to get acquired by Pamplona Capital for $5 billion (deal to be completed by 4Q2017).

We believe that Syngene has capabilities at par with its peers and has also outperformed bigger competitors on growth and returns front. We also believe that this strong performance is expected to continue with increased service offerings, new capex and foray in the API manufacturing.

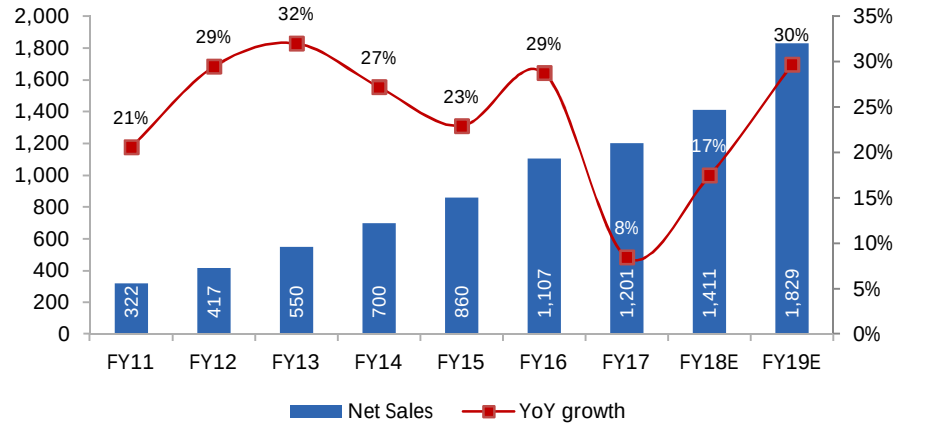
Financial performance

Fire incident impacted FY2017 Financial performance: For most of the period since existence, Syngene has maintained a strong yoy growth of more than 20%. Between FY2011-16, company reported a strong growth CAGR of 28%; during this period company also spent ~`700cr in capex, which helped it to achieve this superior growth. The growth however, slowed down in FY2017 due to the fire incident at one of its Chemical and analytical facility (S2 block) in December 2017. The fire impacted ~10% of its capacity and also led to a loss of one client with annual revenue potential of ~`40cr (~3% of FY2017 annual revenue). The company has indicated that the `80cr damage to its facility is fully recoverable through the insurance claim and the claim settlement would happen in 2HFY18E.

Though company moved projects from the damaged facility to other facilities or newly created facilities, the impact was enough to pull down its full year yoy growth to 8%. Despite efforts to minimize the fire impact, company expects the impact to last until 3QFY2018E. On this basis, FY2018E is expected to be a slow growth year. In our opinion, addition of two dedicated centers and Canadian biotech client, addition of new capacities and foray in newer technology, would enable the company to observe lower impact of fire incident in FY2018E.

Syngene expected to return to high growth path in FY2019E: Syngene reported a poor revenue growth in FY2017 due to the fire incident. In the first three quarters, company reported a double digit growth but the fourth quarter revenue growth was negative, as this quarter fully absorbed the impact of the fire incident. The company has indicated that the fire incident will impact the near term growth outlook, however expects ~20% revenue growth in FY2018E on the back of capacity additions that took place in FY2017, addition of new dedicated centers and a Canadian client in biotech space and overall growth momentum in the biologics. We expect Syngene's FY18E revenue to grow by 17% to `1,411cr.

Exhibit 28: Syngene's revenue to rebound in FY2018E



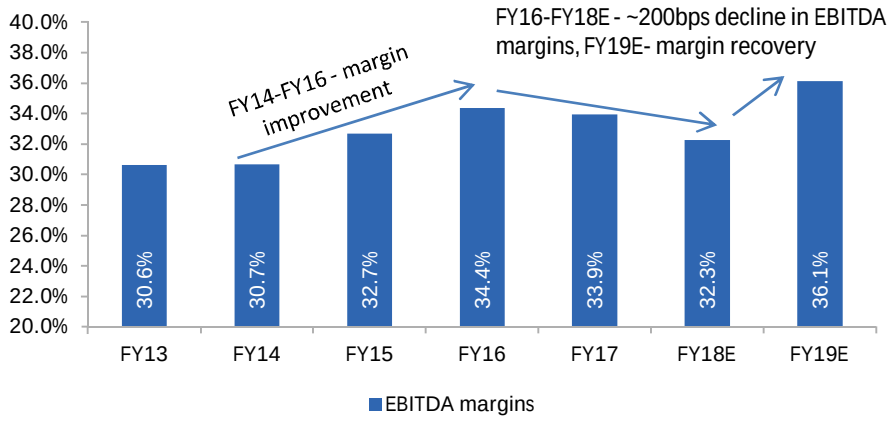
Source: Company, Angel Research

FY2019E is expected to see a strong rebound in revenues. We observe that new facilities take 2-3 years to achieve a 1.0x asset turnover indicating that company is likely to see a very significant growth over the next 3 years (FY2018-21) owing to capacities added in the last year. On the back of this strong operating leverage,

we expect ~30% growth in FY2019E revenues. We also believe that the growth momentum is sustainable beyond FY2021E with the addition of new API facility and supply agreement with partners for late stage molecules.

Margins to remain under pressure in FY2018E: Syngene has indicated of higher spends on safety, compliance and business development, which will decline its operating margins by 200-300bps in FY2018E. In FY2016, company reported EBITDA margins of 34.4%, which dropped to 33.9% in FY2017. We expect FY2018E margins at 32.3%, ~200bps below FY2016 margins. FY2019E margins however, should make a strong recovery to ~36.1%. We observe that company saw a strong improvement in the EBITDA margins over FY2014-16 owing to the strong business momentum and addition of two dedicated centers. The momentum is continued and the company added new clients in FY2017, hence we remain optimistic of recovery.

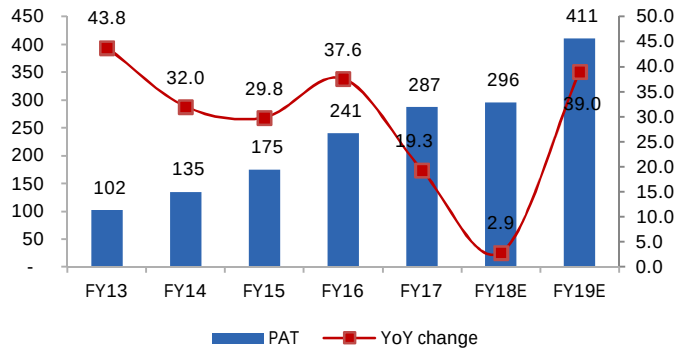
Exhibit 29: EBIDTA Margin to recover in FY2019E



Source: Company, Angel Research

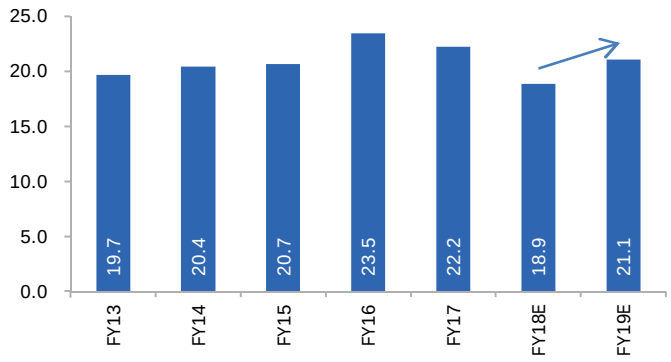
Healthy ROE profile to be maintained: We expect company to maintain a healthy ROE profile going ahead. FY2018E is expected to see decline in the ROE and ROIC ratios, however the same is expected to rebound in FY2019E. We expect FY2018E and FY2019E ROE to be at ~18.9% and 21.1% respectively. Company has a healthy balance sheet with total cash and investments of more than `1,000cr and debt of ~`800cr and debt-to-equity ratio of 0.6x.

Exhibit 30: 1.5x of FY2017 PAT by FY2019E



Source: Company, Angel Research

Exhibit 31: ROE recovery in FY2019E



Source: Company, Angel Research

Outlook & Valuation

Since the fire incident at the Bangalore facility, Syngene's shares have fallen by 25%, underperforming the broader market, which was up ~18% during the same period. At the CMP of `478, Syngene trades at 22.9x of its FY2019E earnings. While this valuation is in-line with its peers, there is no exact comparable listed peer. Chinese company WuXi PharmaTech (which was a public company until 2015) has similar business model to Syngene (API manufacturing + formulations +discovery chemical and discovery biology business). WuXi was acquired for $3.3 billion by a consortium led by its promoters who have taken the company private. At this price ($46 per American depository Share), WuXi's PE multiple works out to be between 23-24x. We also note that WuXi's growth was fueled by inorganic means of growth.

We also look at the Parexel International acquisition by private-equity firm Pamplona Capital Management. According to our estimates, at $88.10 per share, Pamplona Capital has valued Parexel International at ~25-26x of its forward earnings.

While Syngene appears to be currently trading in its peer's range, we believe that Syngene deserves a premium. While saying so, we consider following factors 1) foray in the API manufacturing, which will be scalable and long term sustainable opportunity; 2) wide array of services, especially in biologic research; 3) high exposure to the growing biologics segment; 4) $200mn capex plan, which creates operating leverage; and 5) promoters strong background and consistency in delivering results. We also consider that the Syngene's growth so far is mostly organic and any material acquisition will lead to faster growth. The CRO sector is seeing an influx of M&A activity, which also indicates that there is a lot of growth potential in this sector.

During the last two years, Syngene has traded at an average PE multiple of ~29x and current valuation seems to offer a good margin of safety. We value Syngene at 27.0x of its FY2019E EPS of ` 21 to arrive at a price target of `564. This valuation is ~13% premium to WuXi's transaction multiple and at par with the Parexel's transaction multiple.

Risks to Our Estimates

- **High client concentration** - Syngene derives 3/4th of its revenue from the top 10 clients. This is also true with some bigger CROs as well, hence we believe this is an industry standard. Despite this, loss of any big client may lead to significant decline in its revenue.
- **Regulatory approvals** – Syngene is in the pharmaceutical drug research and clinical trials business. Company is also planning to add commercial manufacturing facility. Failure to get timely regulatory approvals for its facilities may result in loss of clients/revenue, which can significantly impact its share price.
- **Failure of client's drug candidates to get a regulatory approval**: Syngene is dependent upon its clients for business. Client's failure to get an approval for their drugs at various stages of clinical trials may lead to reduced business opportunities, and hence, lower revenues to Syngene.

Exhibit 32: Income Statement

Y/E March (`cr)	FY15	FY16	FY17	FY18E	FY19E
Total operating income	**860**	**1,107**	**1,201**	**1,411**	**1,829**
% chg	*22.9*	*28.7*	*8.5*	*17.5*	*29.7*
Total Expenditure	**579**	**727**	**793**	**956**	**1,163**
Cost of Materials	239	310	322	392	488
Personnel	202	249	309	348	412
Others Expenses	138	167	163	216	263
EBITDA	**281**	**380**	**408**	**455**	**666**
% chg	*31.1*	*35.3*	*7.2*	*11.6*	*46.3*
(% of Net Sales)	*32.7*	*34.4*	*33.9*	*32.3*	*36.4*
Depreciation& Amortisation	81	97	114	149	193
EBIT	**200**	**283**	**293**	**306**	**473**
% chg	*34.2*	*41.8*	*3.6*	*4.3*	*54.5*
(% of Net Sales)	*23.2*	*25.6*	*24.4*	*21.7*	*25.8*
Interest & other Charges	8	8	18	20	20
Other Income	12	6	71	73	51
(% of PBT)	*5.7*	*2.2*	*20.4*	*20.3*	*10.1*
Recurring PBT	**204**	**281**	**347**	**359**	**503**
% chg	*29.9*	*38.1*	*23.3*	*3.5*	*40.4*
Prior Period & Extra. Exp./(Inc.)	-	-	-	-	-
PBT (reported)	**204**	**281**	**347**	**359**	**503**
Tax	29	40	59	57	86
(% of PBT)	*14.0*	*14.3*	*17.1*	*16.0*	*17.0*
PAT (reported)	**175**	**241**	**287**	**301**	**418**
Add: Share of earnings of asso.	-	-	-	-	-
Less: Minority interest (MI)	-	-	-	-	-
PAT after MI (reported)	**175**	**241**	**287**	**301**	**418**
ADJ. PAT	**175**	**241**	**287**	**301**	**418**
% chg	*29.8*	*37.6*	*19.3*	*4.8*	*38.7*
(% of Net Sales)	*20.4*	*21.8*	*23.9*	*21.3*	*22.8*
Basic EPS (`)	**9.0**	**12.4**	**14.8**	**15.5**	**21.5**
Fully Diluted EPS (`)	**8.8**	**12.1**	**14.4**	**15.1**	**20.9**
% chg	*29.8*	*37.6*	*18.8*	*4.8*	*38.7*

Balance Sheet Statement

Y/E March (` cr)	FY15	FY16	FY2017P	FY18E	FY19E
SOURCES OF FUNDS					
Equity Share Capital	199.1	200.0	200.0	200.0	200.0
Reserves& Surplus	645.8	824.7	1,092.6	1,364.7	1,733.9
Shareholders' Funds	**845**	**1,025**	**1,293**	**1,565**	**1,934**
Minority Interest	-	-	-	-	-
Total Loans	155.0	891.0	821.8	802.3	802.3
Other long-term liabilities	64.7	53.5	51.7	67.7	87.8
Long-term provisions	13.2	18.1	19.9	22.6	29.3
Total Liabilities	**1,078**	**1,987**	**2,186**	**2,457**	**2,853**
APPLICATION OF FUNDS					
Gross Block	938.0	1,111.4	1,439.9	1,863.1	2,411.9
Less: Acc. Depreciation	434.7	531.2	645.5	794.6	987.5
Net Block	**503**	**580**	**794**	**1,069**	**1,424**
Capital Work-in-Progress	105.1	236.8	174.9	400.0	350.0
Investments	146.0	276.6	300.2	352.7	457.3
Other noncurrent assets	227.3	134.1	170.5	200.3	259.7
Current Assets	440	1,058	1,097	845	914
Inventories	38.4	37.7	32.2	46.4	60.1
Sundry Debtors	179.9	185.2	198.7	255.1	340.8
Cash	115.7	719.9	736.8	391.2	315.4
Loans & Advances	33.8	31.9	36.0	42.3	54.9
Other Assets	72.0	83.4	93.7	110.0	142.7
Current liabilities	338.8	370.2	423.1	481.0	623.7
Net Current Assets	**101**	**688**	**674**	**364**	**290**
Deferred Tax Asset	**-**	**71.7**	**71.7**	**71.7**	**71.7**
Deferred Tax Liability	4.9	-	-	-	-
Total Assets	**1,078**	**1,987**	**2,186**	**2,457**	**2,853**

Cash Flow Statement

Y/E March (Rs cr)	FY15	FY16	FY17E	FY18E	FY19E
Profit before tax	204	258	347	359	503
Depreciation	81	97	114	149	193
Change in Working Capital	-216	-6	31	-35	-2
Interest / Dividend (Net)	-2	2	18	20	20
Direct taxes paid	-42	-40	-59	-57	-86
Others	-6	1	0	0	0
Cash Flow from Operations	**19**	**312**	**450**	**435**	**629**
(Inc.)/ Dec. in Fixed Assets	-197	-290	-267	-648	-499
(Inc.)/ Dec. in Investments	209	-126	-60	-82	-164
Cash Flow from Investing	**12**	**-416**	**-327**	**-731**	**-663**
Issue of Equity	133	0	0	0	0
Inc./(Dec.) in loans	-3	742	-69	-1	27
Dividend Paid (Incl. Tax)	-133	-24	-19	-29	-49
Interest paid	-8	-8	-18	-20	-20
Cash Flow from Financing	**-10**	**709**	**-106**	**-50**	**-42**
Inc./(Dec.) in Cash	20	606	17	-346	-76
Opening Cash balances	**95**	**114**	**720**	**737**	**391**
Closing Cash balances	**116**	**720**	**737**	**391**	**315**

Key ratios

Y/E March	FY15	FY16	FY17	FY18E	FY19E
Valuation Ratio (x)					
P/E (on FDEPS)	54.3	39.5	33.2	31.7	22.9
P/CEPS	37.1	28.1	23.8	21.2	15.6
P/BV	11.3	9.3	7.4	6.1	4.9
Dividend yield (%)	4.4	0.2	0.2	0.3	0.5
EV/Sales	11.2	8.8	8.0	7.1	5.5
EV/EBITDA	34.1	25.6	23.6	21.9	15.1
EV / Total Assets	8.9	4.9	4.4	4.1	3.5
Per Share Data (`)					
EPS (Basic)	9.0	12.4	14.8	15.5	21.5
EPS (fully diluted)	8.8	12.1	14.4	15.1	20.9
Cash EPS	12.9	17.0	20.1	22.5	30.5
DPS	21.0	1.0	1.0	1.5	2.5
Book Value	42.2	51.2	64.6	78.2	96.7
Returns (%)					
ROCE	20.0	14.8	13.9	12.9	17.3
Angel ROIC (Pre-tax)	31.5	41.5	32.5	25.0	29.3
ROE	20.7	23.5	22.2	19.2	21.6
Turnover ratios (x)					
Asset Turnover (Gross Block)	0.9	1.0	0.8	0.8	0.8
Inventory / Sales (days)	16	12	10	12	12
Receivables (days)	76	61	60	66	68
Payables (days)	29	25	31	27	27
Working capital cycle (ex-cash) (days)	63	49	39	51	53

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1. Financial interest of research analyst or Angel or his Associate or his relative	No
2. Ownership of 1% or more of the stock by research analyst or Angel or associates or relatives	No
3. Served as an officer, director or employee of the company covered under Research	No
4. Broking relationship with company covered under Research	No

Ratings (Based on expected returns over 12 months investment period):	*Buy (> 15%)*	*Accumulate (5% to 15%)* *Reduce (-5% to -15%)*	*Neutral (-5 to 5%)* *Sell (< -15)*