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Syngene International: Discover the chemistry.

Higher contribution from end-to-end fee-based services should boost the company's profitability.

The stock of Biocon's contract research and manufacturing (CRAMS) subsidiary, Syngene International, has more than doubled since its initial public offer last July. Since its incorporation in 1994, the company's business has undergone a gradual transformation.

From a pure play research services company, catering to the research needs of innovative pharma companies, Syngene is now repositioning itself as a fully integrated contract research and manufacturing company. This should help improve its profitability.

The stock now trades at over 26 times its estimated 2017-18 earnings. This implies an almost 12 per cent premium to the market leader Divis Laboratories, which trades at about 22 times its anticipated 2017-18 earnings.

Given the sharp rally over the past year, gains over the near term may be capped. Shareholders can hold on to their investment while those seeking to invest afresh can wait for a price correction.

Research model

Syngene started off as a plain vanilla research service provider, working with multinationals on a long-term basis as full time equivalent (FTE) partners.

Under this model, Syngene would have a dedicated team working with companies on their molecules. In an FTE model, the company's costs are covered and margins protected. While it helps as a de-risking strategy, the margins are limited. So, the real upside comes only from an integrated end-to-end contract research model. In the latter, the contract research firm works with the innovator company across the product development life cycle, from discovery to development and, finally, commercialisation. Once the drug is approved and commercialised, Syngene could be the manufacturing partner for the drug.

FTE business accounts for about 60 per cent of Syngene's revenue and fee for service segment constitutes the balance 40 per cent. The company's strategy of having long-term service agreements with multinationals in addition to the end-to-end comprehensive fee-based services has improved revenue visibility. Besides, higher contribution from integrated end-to-end services should also boost Syngene's profitability in the medium term.

Innovative initiatives

Under the FTE model, the company currently is believed to have long-term agreements with innovators such as BMS (Bristol Myers Squibb), Baxter and Abbott to provide dedicated research infrastructure.

Recently, Syngene's contract with BMS, its largest FTE segment client accounting for almost a third of the company's revenue, was extended up to 2020.

Though the revenue contribution from BMS is significant, it has gradually reduced over the last five years. From 44 per cent in 2011-12, BMS' share in Syngene's revenue has fallen to 32 per cent in 2014-15. This was thanks to higher contribution from other clients and ramp up in Syngene's fee-based services segment. Syngene's clientele has doubled in the last four years — from 115 in 2011-12 to 256 in 2015-16. The top 10 clients account for 70 per cent of the company's revenue. The company also recently sealed a strategic collaboration agreement with Amgen Inc for setting up a dedicated research and development centre. These initiatives should help reduce revenue concentration further in the medium term.

As part of the tie-up, Syngene's scientists will work closely with Amgen's global scientific team on cutting edge small and large molecule research. Syngene's recent acquisition of the bioinformatics assets of Strand Life Sciences along with its team of data scientists should further strengthen the company's data analytics capabilities.

Also, the improving investment climate, particularly for novel research, is a positive. Increase in research spend by global pharma majors after the slowdown witnessed between 2008 and 2013 should bode well for contract research and manufacturing players.

Expanding facility

While the increase in investment in the biopharma space is a positive and can be attributed to the capital influx, innovators are also under pressure to keep tight control over development cost. This should particularly benefit integrated, end-to-end research and manufacturing service providers such as Syngene, which are well placed to offer quality research and manufacturing services at competitive prices.

The penetration of contract research services globally is a little over 50 per cent. Given the cost and time constraints for global pharma, this can increase to about three fourth of the total market. This should augur well for CRAMS players.

Given the strong pipeline of innovative molecules across various development phases for Syngene's clients, the company plans to expand its manufacturing capabilities.

It has outlined $200 million as capex to expand its contract research and manufacturing facilities between 2015-16 and 2018-19. This should drive Syngene's growth in the medium to long term. For the first half of the fiscal, the company grew its revenue by 22 per cent year-on-year to ₹610 crore.

Better revenue mix, coupled with control over other costs, has helped Syngene improve its operating profit margin by almost 4 percentage points to 33 per cent. Thanks to the strong operating performance, the company's net profit grew 41 per cent year-on-year during the April-September 2016 period to ₹135 crore.

Source:

http://www.thehindubusinessline.com/portfolio/firm-calls/syngene-international-discover-the-chemistry/article9285713.ece?homepage=true