

Claris Lifesciences (CLAR IN – INR 315 - BSE)

CLAR_DVD2_

Year		EPS	P/E		PMV		
2017E	INR	17.6	17.8	x	INR 612	Dividend:	INR 2.0
2016E		-10.6	NA		603	Shares O/S:	54.6 Million
2015E		27.4	11.5		642	52 week range:	INR 430.1 – INR 129.2
2013A		13.2	23.8		586		

UPDATE: MAJOR DEAL MILESTONE CROSSED

In April 2016, the Indian Government reversed an earlier ban on (foreign investment) FDI in brownfield Pharma companies by allowing FDI, though only after obtaining an 'FIPB' approval. In July 2016, Fosun China announced a deal to acquire Gland Pharma (a privately held injectable's manufacturer). FIPB approval for this deal was continuously deferred until it was finally approved on March 29, 2017. Obtaining an FIPB approval for Gland Pharma took longer than expected, as this was the first deal seeking an FIPB approval in the pharmaceutical sector after the relaxed FDI norms were announced. We believe any uncertainty about whether CLAR and BAX will be able to obtain an FIPB approval has been significantly dispelled. (Also see Timeline and Risk sections).

SALE OF INJECTABLES SEGMENT: On December 15, 2016, CLAR announced that they will sell their injectable's segment for USD 625 million (~INR 42.4 billion; INR/USD: 67.82) to Baxter International Inc. (BAX US). The deal implied a forward EV/EBITDA multiple of 19.8x.

Recommendation

We recommend buying CLAR at the 03/29/2017 share price of INR 315 as it trades at 49% discount to our FY17 PMV of INR 612. The estimated annualised return from the position will vary from 56% to 95% depending on how cash received from BAX is distributed to shareholders (Table 2). The deal is likely to be completed in 12 months.

Background

CLAR, based in Ahmedabad, India, is a specialty pharmaceuticals company that manufactures injectable formulations for therapeutic areas such as anaesthesia, anti-infectives, renal & transplant, oncology, etc.

Required approvals & timeline: Approvals by CLAR shareholders, Foreign Investment Promotion Board of India (FIPB) and Federal Trade Commission, US are required for the deal to get consummated. On December 16, 2016, CLAR in a conference call with analysts announced a timeline of 4 to 6 months to get required approvals and complete the deal. A further 6 to 8 months will be required to distribute the proceeds to shareholders (Table 1).

Table 1: Timeline

Steps	Earliest by	Latest by	Day 1	12/16	01/17	02/17	03/17	04/17	05/17	06/17	07/17	08/17	09/17	10/17	11/17	12/17	01/18	02/18	03/18
Deal announcement	12/15/2016																		
FIPB approval: Gland Pharma #	12/28/2016	03/29/2017																	
FIPB approval	04/15/2017	06/15/2017																	
FTC, US	04/15/2017	06/15/2017																	
Distribution to shareholders	12/15/2017	03/15/2018																	

In July 2016, Fosun bought Gland Pharma and on March 29, 2017, FIPB approved the deal.

Put option embedded in the left out business: After the sale of the injectable business, CLAR will be left with a 20% stake in Claris Otsuka. Claris Otsuka represents CLAR's infusion business in which CLAR had sold 80% to Otsuka Pharmaceutical Factor and Mitsui & Co for an EV of INR 10.5 billion in December 2012. CLAR has a put option, which expires on September 2017, to sell their remaining 20% stake in the Infusion business (Table 2).

Distribution to shareholders: After the sale of injectable business there would be no other operating business left except a 20% stake in Claris Otsuka. Management of CLAR has said that they will distribute most of the proceeds from sale of injectable business.

Table 2: PMV calculation and return to shareholder

	Total value (INR Mn)	Value per share (INR)	Remarks
EV of injectable business	42,388	777	EV paid by BAX to CLAR
Less tax liability	6,878	126	20% long term capital gains tax on the difference between EV paid by Baxter and book value of ~INR 8 billion of the injectables segment ~USD 15 million
Less legal fee/transaction charges	1,017	19	
Less Debt	6,029	110	
Add cash	3,632	67	
Add 20% stake in Claris Otsuka	1,300	24	In a call with analysts on 12/16/2016, CLAR mentioned that their 20% stake in infusion business would worth ~INR 1.3 to 1.5 billion.
Total equity value	33,396		
Shares outstanding (million)	54.6		
PMV		612	
Stock price (02/29/2017)		315	
Current Market - Discount to PMV		49%	
Return to shareholders if distribution takes place			
+ Through share buyback		95%	
+ By way of dividend		56%	Will attract 20% distribution tax

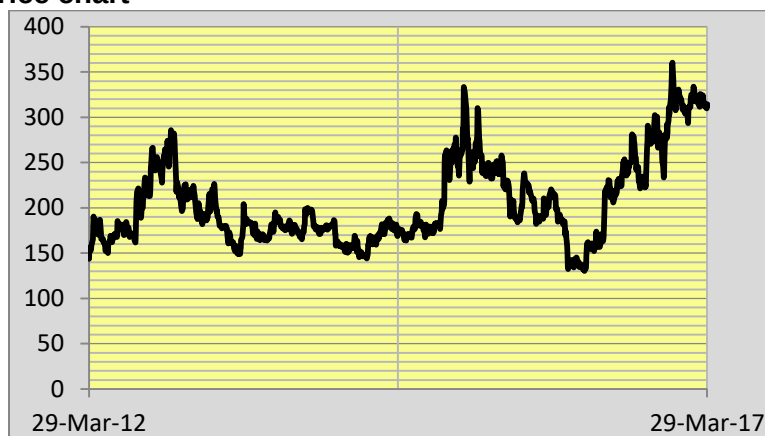
Risk: After opening up 20% from INR 358 to INR 430 on December 16, 2016 (a day after the announcement), CLAR stock price has been declining (Figure 1). Possible reasons for the stock to trade lower after the announcement is:

1. US FDA inspections: On August 26, 2016, CLAR announced that US FDA carried their inspection and issued five 483's¹. However, this issue is known to BAX as the deal has been announced subsequent to the issuance of the 483's
2. CLAR's past history with the US FDA: In November 2010, the US FDA had issued a warning letter to CLAR after the US FDA found that CLAR was producing contaminated drugs. CLAR was barred from selling their products in the US. Though, in August 2012, CLAR addressed all the complaints and was allowed to resume sales in the US.
3. No clear distribution policy announced: Though CLAR intends to distribute most of the cash received from BAX (as confirmed in the analyst call), it has not announced as how and when they will distribute. Distribution by means of dividend will attract a 20% distribution tax and as a result our PMV will decline by the same amount.
4. **Delay in FIPB approval:** In April 2016, the Indian Government reversed an earlier ban on (foreign investment) FDI in brownfield Pharma companies by allowing FDI, though only after obtaining an 'FIPB' approval. In July 2016, Fosun China announced a deal to acquire Gland Pharma (a privately held injectable's manufacturer). FIPB approval for this deal was continuously deferred until it was finally approved on March 29, 2017. Obtaining an FIPB approval for Gland Pharma took longer than expected, as this was the first deal seeking an FIPB approval in the pharmaceutical sector after the relaxed FDI norms were announced. We

believe any uncertainty about whether CLAR and BAX will be able to obtain an FIPB approval has been significantly dispelled.

5. Since Fosun has been successful in obtaining an FIPB approval, we see no reason why BAX would be denied one. However, given the fact that BAX has already done their due diligence, CLAR received ANDA approval Flumazenil injection after US FDA issued 483s and CLAR's expectation of no US FDA inspection over the next 5-6 months, decline in share price post announcement of the deal is unwarranted.

Figure 1: CLAR – Price chart



Source: Horizon Research, BSE

ⁱAt the conclusion of an inspection, the FDA Form 483 is presented and discussed with the company's senior management. Companies are encouraged to respond to the FDA Form 483 in writing with their corrective action plan and then implement that corrective action plan expeditiously.