

Investment Memo - Tarsons

Mcap (Rs bn)	30	Price (Rs)	560
Promoter shareholding	47.31%	Trailing P/E (TTM)	34
5Y average pre-tax ROCE	32%	Date	14th March 2023

Company Background

- Tarsons was established in 1983 and has since evolved into a leading Indian company in the plastic labware market, which is dominated by global companies. The company was started by Mr. Sanjive Sehgal and as of now being run by him and his son. Mr. Rohan Sehgal. The promoters own ~47% stake in the company; Clear Vision Partners owns ~23% with rest being owned by retail and institutional investors.
- The company IPO-ed in Nov-21 at a price of Rs662. It listed on 26th Nov-21 at Rs-830. IPO comprised mostly offer for sale component which was Rs8.7 bn; fresh issue was only Rs1.5 bn. Clear Vision Partners sold 50% of its pre-IPO shareholding for Rs8.3 bn, comprising bulk of the offer for sale. Average cost of acquisition (2018) of Clear Vision was Rs52 per share; it invested Rs1.3 bn in total into the company for 49% stake. Clear Vision also subscribed (in 2018) to CCDs worth Rs22 Cr which were bought back by the company in May-21.
- Tarsons manufactures plastic labware which accounted for ~96% of sales in FY22 with the remaining coming from lab equipment like Vortex Shakers, Centrifuges etc. In the plastic labware, company segments its sales into: a) consumables like pipettes, petri dish, PCR consumables (tubes, plates and strips), cryogenic and centrifuge ware (tubes and accessories), and, b) reusables like bottles, beakers, measuring cylinders etc. In FY22 consumables and reusables were 63% and 33% of sales.

Revenue break up by segments (Rs mn)	2019	2020	2021
Domestic	1,307	1,263	1,523
Consumables	849	841	1,061
Reusables	323	302	355
Other	135	120	107
Export	508	445	755
Consumables	138	156	342
Reusables	369	288	412
Others	1	1	1
Total	1815	1708	2278

- The company has 9-12% share of the Indian plastic labware market (Rs12.2 bn in FY20) and is amongst the top 3 companies in this space. If one excludes markets which are not being addressed by the company (like PCR and cell culture related products) which account for almost 50% of the market; market share of the company in segments which it addresses is ~25% and is close to 50% in some of the specific products being manufactured by the company. Domestic sales contributed to ~67% of overall sales in FY22. The company has been growing its exports at a much faster pace from a lower base; export sales increased from Rs250 mn in FY15 to Rs990 mn in FY22. 60% of exports in FY21 were to developed markets of US and Europe and the remaining to emerging markets like Latam and Asia. The company exports under its own brand to emerging markets while it mostly follows ODM model in developed markets where it designs and manufactures plastic labware for global companies as per their specifications. ODM sales were Rs560 mn in FY22

accounting for large part of export sales. Branded sales have increased to 43% of exports from zero, 10 years back.

(Rs mn)	2015	2016	2017	2018	2019	2020	2021	2022	9MFY23	CAGR 2015-22(%)
Domestic	809	951	1,052	1,100	1,307	1,263	1,533	2015	1,330	14%
Exports	256	305	325	382	508	445	756	993	680	21%
Total	1,065	1,256	1,377	1,483	1,815	1,708	2,289	3,008	2,010	16%

- The company supplies its products through distributors in the domestic and export markets. It has 140 distributors in India who give it pan India presence. In export markets, it has 45 distributors which sell its products in 40 countries. The only difference between GTM in India and export markets is: In India the company also has ~60 sales employees on its rolls who help the distributor in servicing existing clients and targeting new ones. In export markets, the company does not have any feet-on-street on its rolls. Hence, sales effort is entirely led by distributors outside India.
- Out of total domestic sales of Rs1.5 bn in FY21, 32%, 17% and 24% were to research institutes and academia, pharma companies and diagnostic companies, respectively.

Revenue breakup by Customer			
Type (Rs mn)	2019	2020	2021
Domestic	1,307	1,263	1,523
Research institutes & Academia	532	580	492
Pharma	245	232	259
CRO	176	170	179
Diagnostics	197	158	373
Others	157	123	219
Exports	508	445	756
Branded	170	170	287
White label	338	275	469
Total	1,815	1,708	2,279

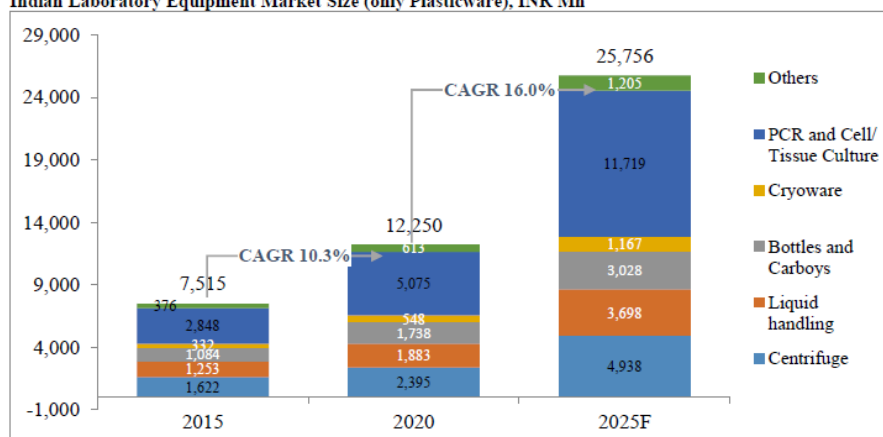
Revenue breakup by Product			
(Rs mn)	2019	2020	2021
Liquid handling	264	279	461
Centrifuge ware	258	283	343
Petri Dish	158	155	129
Cryoware	40	33	58
Equipment	137	122	108
PCR	17	23	94
Bottles / Carboys / Beakers	352	299	429
Others (Racks, stands, boxes)	589	513	656
Total	1,815	1,708	2,278

- The company follows a consistent pricing strategy of selling its products at ~15-20% discount (both in domestic and export markets) to global companies while maintaining similar quality.
- The company has grown its sales, EBITDA and PAT at a CAGR of 17%, 25% and 40%, respectively, in FY17-22. FY22 was a blockbuster year for the company led by higher demand from covid related products.

Industry structure

- Indian laboratory equipment market (only plastic ware) has grown at a CAGR of ~10% in FY15-20 to Rs12.25 bn in FY20. Overall lab equipment market (including glassware) has grown at a much slower CAGR of 5% in the same duration (market size Rs23.5 bn in FY20). Plastic ware has grown faster on account of it replacing glassware on account of: a) it is cheaper, b) unbreakable and hence safer to use for lab personnel, c) better reusability, d) there is issue of leaching of inorganic ions into aqueous solutions kept in glass. Plasticware products which used to account for 41% of the overall industry in 2015 are already at 52% of the industry. Our channel checks indicate that this transition from glass to plastic is almost complete now and wherever glass is being used, it mostly can't be avoided. Within the overall industry, cryoware and PCR/cell culture related products (accounting for almost 50% of the industry) are the faster growing segments.
- Cell culture related products are the most challenging to manufacture; entry barriers are very high. As per our understanding cell culture related products need to be manufactured in a sort of customized fashion where companies make claims like, "for a particular cell culture production process using a specific cell culture media, our products offer the maximum yield with a minimal (levels need to be defined) level of leachables". Hence, cell culture products market in India is 100% preserve of global companies. Tarsons would be the first Indian company attempting to break into this market with its new greenfield facility commissioning in 2HFY24. In India almost 90% market of cell culture related products is with 2 large vaccine manufacturers; Serum and Bharat Biotech.

Indian Laboratory Equipment Market Size (only Plasticware), INR Mn

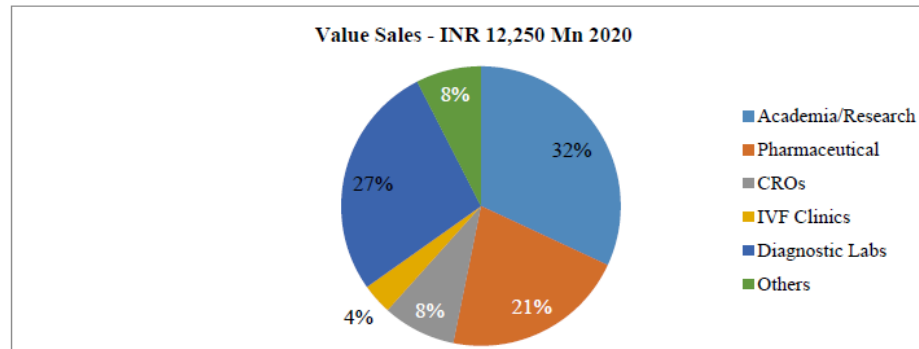


Others mainly constitutes to General Labware, Reagents, Disposables, New Products and other Equipment

	Centrifuge	Liquid handling	Bottles and Carboys	Cryoware	PCR & Cell Culture
2015-20 CAGR	8.1%	8.5%	9.9%	10.5%	12.3%
2020-25 CAGR	15.6%	14.5%	11.8%	16.4%	18.2%

Source: Frost & Sullivan

Indian Laboratory Equipment Market by End Use (only Plasticware), INR Mn, 2020

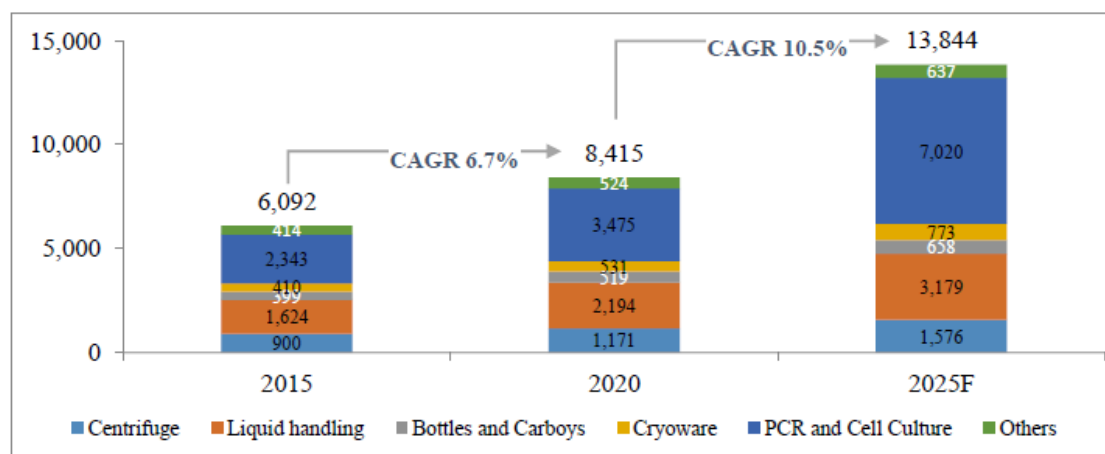


	Academia/Research	Pharmaceutical	CROs	IVF Clinics	Diagnostic Labs
2015-20 CAGR	10.1%	10.6%	12.2%	12.1%	9.8%
2020-25 CAGR	13.2%	17.1%	15.4%	17.8%	17.6%

Source: Frost & Sullivan

- Driver of labware market are: a) increasing research activities in the chemicals and biologics space whether in academia or in companies, b) rising penetration of healthcare, c) improving diagnostic facilities, d) increasing pharmaceutical research and manufacturing outsourcing to India.
- Global lab equipment market (only plastic ware) has grown at 7% CAGR in 2015-20. The trends driving global market are more or less the same as Indian market.

Global Laboratory Equipment Market Size (only Plasticware), USD Mn

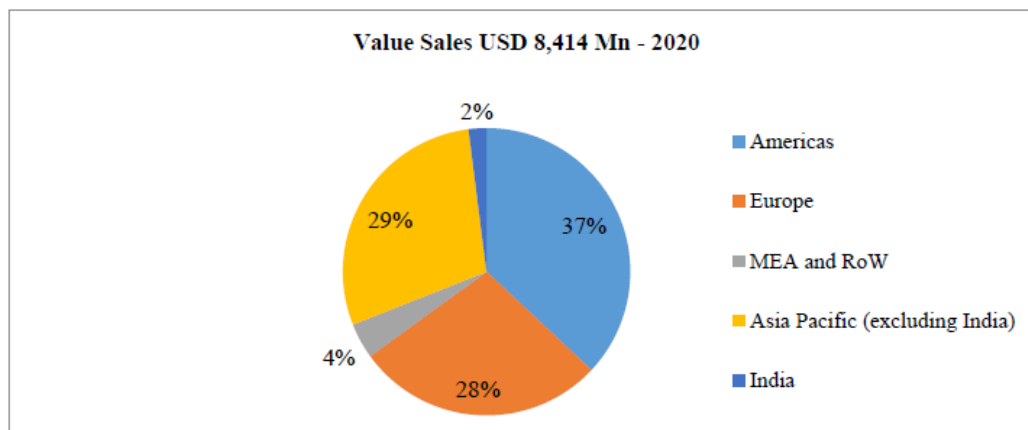


Others mainly constitutes to General Labware, Reagents, Disposables, New Products and other Equipment

	Centrifuge	Liquid handling	Bottles and Carboys	Cryoware	PCR & Cell Culture
2015-20 CAGR	5.4%	6.2%	5.4%	5.3%	8.2%
2020-25 CAGR	6.1%	7.7%	4.9%	7.8%	15.1%

Source: Frost & Sullivan

Global Laboratory Equipment Market Size (only Plasticware) by Geography, USD Mn, 2020



	Americas	Europe	MEA and ROW	Asia Pacific	India
2015-20 CAGR	4.7%	6.1%	8.3%	9.7%	10.3%
2020-25 CAGR	8.2%	9.4%	11.7%	13.5%	16.0%

Source: Frost & Sullivan

- As per the DRHP (shown on the market charts above as well) both the global and Indian market for lab plastic ware should accelerate meaningfully in 2020-25 versus the growth witnessed in the last 5 years. The reasons given for acceleration don't seem convincing and seem to be continuation of trends witnessed in the prior 5 years; in our view, this opinion is colored by the extraordinary growth (due to covid) witnessed from 1HFY21 to 1HFY22 and hence in my view, industry growth trends might not be as strong as projected in the above exhibit.
- As per the DRHP, MNC companies have 30-40% market share in the Indian lab plastic ware market. Top 7-8 players make up 50-55% of the market with Tarsons accounting for ~10-12% of the overall lab plastic ware market and ~25% of the market in addressable segments. Rest of the market is serviced by a large number of small and medium sized domestic players.
- As per Thermofisher's presentation, global labware industry is fragmented with Thermofisher and 2 other players having close to 40% market share and rest of the industry being comprised of 100s of small companies. Hence, as per Thermofisher, there is ample opportunity for driving growth through M&A. I would guess that a similar opportunity would be there for Tarsons' as well.
- Indian lab plasticware industry is heavily reliant on imports (mostly from US and Europe) with imports contributing to almost 50% of the industry. Most of the imports are done by global companies who are primarily supplying the Indian market with imports from their global plants. Imports have been coming down; in 2010-15 they used to account for 70% of the market. Global players which have been serving the Indian market through imports have been ceding market share to companies (mostly domestic) which have created a quality manufacturing set up in India. This trend should continue in future as well.
- China does not seem to be a credible player in Indian imports; Chinese imports would be low single digit % of the plastic labware market in India. These imports cater to the lowest priced end of the market which is unorganized diagnostic labs and small blood banks in tier 2/3 cities.
- Amongst the Indian companies, based on historical numbers, it seems that Tarsons is the most dominant and is significantly ahead in terms of its scale. As per Tarson's mgmt., it is primarily competing with global companies. The only other company which they think has a credible

offering is Accumax which is primarily into exports; As per our understanding, Accumax sales are Rs4.5 bn (FY22; including its European companies) and it is mostly into exports or B to B business.

Financial details of major players in the Indian industry (Rs mn)

Tarsons	2015	2016	2017	2018	2019	2020	2021	2022	CAGR (%)
Sales	1,065	1,256	1,377	1,483	1,787	1,759	2,289	3,008	23%
Gross margin (%)	64.2	69.5	68.0	72.3	71.5	72.3	73.1	79.1	
EBITDA	323	470	506	520	717	693	1,034	1,527	36%
EBITDA (%)	30.3	37.4	36.7	35.1	40.1	39.4	45.2	50.8	
PAT	102	93	187	189	390	405	689	1,007	58%
Thermofischer	2015	2016	2017	2018	2019	2020	2021	2022	CAGR (%)
Sales	5,653	6,583	7,248	7,915	9,802	10,241	12,165	15,889	23%
Gross margin (%)	44.2	42.7	44.1	45.9	43.3	45.2	39.7	37.7	
EBITDA	145	-39	366	478	791	1,116	980	1,529	
EBITDA (%)	2.6	-0.6	5.0	6.0	8.1	10.9	8.1	9.6	
PAT	619	3	150	317	635	628	673	1,007	
Eppendorf	2015	2016	2017	2018	2019	2020	2021	2022	CAGR (%)
Sales	733	815	932	963	1,169	1,254	1,942	2,073	16%
Gross margin (%)	-	-	43.6	43.8	38.4	38.6	29.2	29.3	
EBITDA	44.8	8.9	50.4	42.7	53.1	39.2	78.6	65.4	
EBITDA (%)	6.1	1.1	5.4	4.4	4.5	3.1	4.0	3.2	
PAT	67.5	8.3	82.1	24.8	44.8	18.0	61.4	56.9	
Genaxxy	2015	2016	2017	2018	2019	2020	2021	2022	CAGR (%)
Sales	236	247	276	209	199	215	668	749	18%
Gross margin (%)	29.8	32.0	27.4	33.1	31.4	33.2	35.6	33.0	
EBITDA	13	19.6	11.4	4.5	-2.8	1.8	121	118	
EBITDA (%)	5.5	8.0	4.1	2.2	-1.4	0.8	18.1	15.7	
PAT	9.6	13.2	8.8	7.4	3.7	5.1	94.1	95.0	
Abdos	2015	2016	2017	2018	2019	2020	2021	2022	CAGR (%)
Sales	132	166	197	245	353	331	520	813	30%
Gross margin (%)	-	-	51.3	48.4	47.5	50.7	58.0	60.0	
EBITDA	7.3	10.4	13.2	13.2	33	40.8	151.8	307.6	
EBITDA (%)	5.6	6.3	6.7	5.4	9.3	12.3	29.2	37.8	
PAT	-2.94	-2.14	-2.47	-2.76	-0.13	0.38	99.2	177.7	

Nature of the business

- From top-down perspective the business seems very attractive from growth point of view as:
 - The business seems like in its infancy in India given that India is only 2% of the global lab plastic ware market and hence it appears that high growth in the region of 10-12% for the overall market can be sustained for the next 5-10 years.
 - There seems to be no IP related barriers in labware products except in cell culture related products. It seems like barriers from manufacturing point of view are related to: a) process, b) quality of manufacturing facility, c) rigorous quality control, d) auditability of the manufacturing process, etc. Hence, a well-run Indian company can manufacture similar quality products as global companies and hence over time can gain market share based on better value proposition (lower prices and more agile supply chain), thereby growing ahead of market.
- Entry barriers in the business are high as:
 - Client base is fragmented. Even single large domestic pharma company has multiple labs in India each of which needs to be targeted separately.
 - Clients are loath to change a vendor for labware given that most of the users are very

quality sensitive since bad quality products could have adverse implications on quality of the final product/service, which usually gets known after a lag of couple of months by which time financial cost of the error becomes quite high.

- Client would want one vendor to take care of all its labware requirements. Hence, a new player can't just start with a one-off SKU. For a new vendor to build a decent portfolio of products (there are 1700 SKUs across 300 products) would require significant effort and capital on the manufacturing side.
- A new player building this business would require a long time as one would have to build it client by client; approaching each client for a small volume of business and then converting it over a period of time based on trials and meeting technical specifications. All this while one would have to incur costs of maintaining a high-quality sales force and expensive manufacturing facilities.
- The business is capital intensive with asset turns of 1x and high working capital requirement (130-150 days). Working capital requirements are high as one has to maintain inventory at multiple locations to take care of client delivery timeline requirements. My sense is that none of the clients would be maintaining a significant inventory and given the sensitivity of the work, delivery timeline requirements would be short.

Capital efficiency parameters of the Tarson's business

(Rs mn)	2019	2020	2021	2022
Gross block	2,292	2,496	2,875	3,948
Gross block excl CWIP	2,226	2,303	2,660	3,626
Working capital	879	831	980	1,361
Debtors	446	382	470	652
Inventory	464	487	467	824
Other current assets	51	67	159	112
Payables	82	104	116	226
Sales	1,787	1,759	2,289	3,008
Asset turns (X)	0.8	0.8	0.9	0.8
WC (no of days of sales)	180	173	156	165

Return ratios (%)	2015	2016	2017	2018	2019	2020	2021	2022	2023E
ROE	20	16	24	22	34	24	31	27	18
RoCE (pre-tax)	15	10	24	27	37	27	37	35	23

- Though the business is B to B, but, given: 1) fragmented client base, 2) low competition, 3) quality sensitivity of client, and 4) requirement of approval from the users (scientists etc) also apart from the supply chain manager, it should be possible to charge a premium, which would enable a better RoCE versus a typical B to B manufacturing business. This is evident with Tarsons reporting post-tax ROCE at ~25% in the last few years.
- The manufacturing process looks simple from outside. The company buys raw materials like Polystyrene, Polypropylene, HDPE, LDPE etc, mostly from foreign suppliers (75% RM is imported) even though the same materials are available from domestic suppliers as the company uses specialized medical grades of these polymers which have minimal additives which could potentially leach. These resins are DMF registered and comply with various regulatory specifications. These raw materials are fed into injection molding machines which contain specific molds for specific SKUs. Asset turns for Tarsons are low at ~0.7-1X versus a generic injection molding business (~1.2) on account of very high number of SKUs which would

necessitate frequent changeovers. Difference between generic injection molding based B to B business and Tarsons, on the manufacturing side is that for Tarsons: 1) It is precision manufacturing, 2) It requires clean room facilities, 3) higher automation is required so as to reduce human contact to make the manufacturing environment as aseptic as possible, 4) quality of molds is very important; 33% of total net block (Rs1.8 bn in FY22) of Tarsons is molds. As per my understanding investment into molds is not much of an entry barrier (except the capital intensity) as Tarsons also procures them from third party vendors only. The mgmt. claims that mold makers manufacture molds as per drawings which Tarsons gives them and hence that allows the company to build its manufacturing edge versus competition in terms of efficiency.

Investment rationale

- **Strong growth with sales projected to grow in the region of 12-15% CAGR in the next 5 years.**
This would be led by:
 - a. Strong growth of the underlying market at ~10-12% CAGR. Tarson's sales have grown at a CAGR of 13% in FY17-23. We expect the same to sustain in future as well; pace of scale up in PCR/Cell Culture products would determine if this growth rate could be lower or higher by couple of % points. While scaling up sales in PCR related products is not that difficult from manufacturing point of view; as explained earlier, entry barrier in cell culture products is very high in manufacturing.
 - b. Tarsons is a recent entrant in both PCR and cell culture related products. PCR related products were launched in 2019 and cell culture related products were launched (through trading) one or two years back. Both these market segments account for almost 50% of the Indian plastic labware market and also growing the fastest amongst all categories and hence if Tarsons is able to establish itself in these markets, it can become a major growth driver for the company in the coming years.
 - i. In our view, PCR market is relatively easier to crack from technology point of view. PCR consumables market is poised for significant growth in the coming years despite COVID related demand going away. COVID has led to proliferation of RT-PCR machines in India and trained human resource to work on these machines; today any decent lab (even unorganized ones) would have an RT-PCR machine. PCR is essentially a technique which amplifies or replicates a particular DNA sequence (of a pathogen), so that the machine is able to detect it and hence application of PCR based testing can be much wider, in more accurate detection of various other infections, in the coming years and hence we expect a strong growth in this market going forward.
 - ii. Tarsons (PCR related sales at ~\$3 mn in FY23), Abdos and Accumax are the only 3 companies manufacturing PCR related plastic consumables in India. These companies are catering to only maybe 20% of the market with rest of the market serviced through imports by global brands. Capacity as of now in India is much greater than demand. In our view, Tarsons can keep on gaining share from imports as: a) its products are priced at 15-20% discount versus global brands, while giving similar quality, b) it can provide more agile supply chain to its customers given that it manufactures in India.
 - iii. In our view, for Tarsons to establish itself in cell culture related consumables is going to be a tall ask as: a) ~90% of India's market is with two companies, Serum and Bharat Biotech and b) technical know how required is much higher. However, in our view, there exists an opportunity as well as: a) Global majors source 70% (total global market size is \$4bn) of cell culture products from China; and hence if Chinese companies can crack the technology, so can Tarsons. Given strategic imperative of global brands to diversify away from China, Tarsons could scale up export revenues by becoming a manufacturing partner to some of the global

brands, b) Serum/Bharat Biotech and other users can give Tarsons a break into the market by using Tarson's products for research/production for unregulated markets. Hence, in our view, there is a possibility that Tarsons would be able to scale up its market share in these products, gradually.

- c. Export revenues can be scaled up significantly as: 1) product is standardized, 2) competition in global markets is the same as in India as all the global majors have a presence in India. Hence, business model which works in India should produce similar results outside India as well over time and if execution is good. Tarsons has scaled up its export revenues from a low base of Rs250 mn in FY15 to Rs990 mn FY22 (total exports out of India are Rs4 bn). It started exporting only in 2010 and reached export sales similar to Accumax (if one takes into account exports from its India plants only and excludes sales from plants in Europe) which has been exporting since 2000. Branded exports have increased to 35% of overall exports from almost zero levels 10 years back. The company is following 2-tier strategy to grow exports: 1) it is targeting developed markets (US and Europe) to grow ODM sales, 2) it will grow branded business in emerging markets.
 - i. Chinese players are very dominant in export markets. China exports US\$ 1bn of plastic labware products while India is at Rs4 bn. Almost 70% (of global consumption) of cell culture related plastic labware products are manufactured in China (all global brands source from China). As per our understanding, Chinese players have built significant edge versus others led by development of the whole ecosystem for manufacturing labware products right from the local manufacturing of machines used; as a result, a manufacturing plant in China costs less than half the amount (also it comes up much faster) it would take to make the same plant in India (mostly machinery is imported from Europe), giving Chinese producers a significant edge in global markets. Also, the ecosystem of manufacturing is so well developed, that all repair maintenance and re-tooling of existing factories happens with lightning speed.
- **Tarsons can compete effectively with global majors in India.** Tarsons has the following advantages: a) it has economies of scale given its high volumes in most of the 1700 SKUs that it manufactures; hence its cost (manufacturing only) positioning is comparable to the best or atleast in the first quartile, globally. Its overheads also are much lower and b) For clients in India, it offers a much more agile supply chain versus the global majors as none of them have manufacturing presence in India and hence they are not able to react to sudden changes in demand patterns as quickly as Tarsons. Given these advantages, we think that Tarsons can hold its fort versus global companies.
- **Good quality 'franchise' business to hold for the long term.** As per my understanding the business is:
 - 1) Stable with high entry barriers. The company has been consistently improving its ROCE over the years and in FY19-23, post-tax ROCE has averaged ~25%, which is very good.
 - 2) Can grow consistently at ~12-15% CAGR in the long term.
 - 3) It has a brand play.
 - 4) Growth can be financed entirely from internal accruals and hence the company can deliver steady compounding over the long term. Despite strong growth projected over the next 5 years, the company is expected to remain debt free, despite very capital-intensive nature of the business. The company would complete its Rs5.5 bn of capex (done over 2 years) in the middle of FY24 which would effectively double its capacity. In our view, post this expansion capex is going to be much lower.
 - 5) We got really strong feedback on quality of top management and strength of the brand (in

India) during our channel checks with competing companies, both local and global.

Potential returns

The stock is priced attractively at ~34X trailing (TTM) earnings, given potential to grow sales and earnings at ~15% CAGR for the next 3-5 years with attractive ROCE (~25% post-tax) and debt free balance sheet. In our view, the stock would give return in line with growth in sales in the long term; there could be a bit of case for increase in multiples from current levels as performance of the company improves in the coming quarters which could add (2-5%) to the returns CAGR in the next 3-5 years.

Risks / Concerns

- Entry barriers in the business are high as clients are very sensitive to quality and are loath to change vendors given significant financial (losses) implications. Given that Thermofisher has ~20% market share of \$9bn global plastic labware market is a reflection of this fact. Hence, to scale up in the business is tough. As per our channel checks, top tier Indian pharma companies or research labs use Tarsons' products in research/production related to unregulated markets and avoid it for regulated (US/Europe) markets. Reason: The production facilities and labs of these companies keep on getting audited by either regulatory agencies like USFDA or their clients (global pharma companies). Hence, even if Tarsons were to manufacture products which are same quality as Thermofisher and also offer discounts, still clients will prefer to buy from Thermofisher or other well-known global brands as they want auditors to see familiar brands (to create a good impression) when they are doing audit work at their facilities. During one of our interactions with one of the other labware manufacturer, a senior person commented, "Even if I buy cell culture products from Eppendorf (leading German company) and sell it at a 50% discount, people won't buy it still".

Hence, for Tarsons to keep on growing in the long term, it is critical to scale up the brand over time led by R&D, so as its clients start using it even for work related to regulated markets. If Tarsons is not able to do that, growth will be sub-par versus expectations.

- Due to significant scale up in sales/profits for all the plastic labware companies, in FY21 and FY22, due to covid related demand, almost all players are in the process of expanding their capacity 2X. Hence, there could be pressure on margins incase some of these companies start aggressive discounting in order to fill their capacities. In our view, this is more of a risk in case of export markets as in domestic market brand and distribution are an entry barrier and any company with weak or no distribution/brand can't push products using discounting as a strategy. In export markets, there could be pressure on realizations, however, our channel checks suggest that: a) channel margins in these products are very high (~30%) and hence distributors also don't shift suppliers (supplying white labelled products) for 3-5% discounts; they are also bothered more about maintaining quality, b) whenever a distributor/OE changes the supplier there is a quality control process involved which creates friction which people want to avoid. Labware products can lead to adverse implications on quality of the final product and hence generally proper due-diligence needs to be done before changing vendors, and c) as per Tarsons mgmt. given weak demand conditions on the ground in the last few quarters and also realization of the fact that covid related demand is not going to be there, some of the companies might shelf part of their expansion plans and hence actual capacity addition might be lower than expected.
- In our view, gross margins of the company are defensible. There could be an impact on EBITDA margins due to negative impact of operating leverage which could depress margins below the levels seen in last 2 years. The company is commissioning large capacities (capacity increasing almost 2X) in the coming 2-3 quarters and hence depending on the pace of utilization of these new facilities, EBITDA margins could vary by a significant margin versus past.

- The company is taking a big bet on cell culture related products. Out of Rs5.5 bn Cr of capex which is underway (Rs2.5 bn on land and utilities), major capex in plant and machinery (total Rs3 bn) is devoted towards cell culture products (Rs1.5 bn). As mentioned above, entry barriers from point of view of technology are very high in these products. In our view, company could target low hanging fruit first, as mentioned above. However, there is a risk that scale up gets delayed in this product segment which could have negative implications on future growth and margins.
- Long term growth in the business depends on the mgmt. creating a good R&D set up to get into newer and higher value-added products/services. Failure to do that would compromise the long-term growth story to a significant extent. As per our understanding, till a few years back, Tarsons R&D was more or less a one-man (Mr. Sanjive Sehgal) show. The company has started building its R&D team in the last couple of years. Its early days for R&D at Tarsons; however, scaling up of R&D would be a critical for sustaining growth of the company in the long term.

Financials

Profit and loss account

Rs mn	2016	2017	2018	2019	2020	2021	2022	2016-22	
								2023E	CAGR (%)
Sales	1,256	1,377	1,483	1,787	1,759	2,289	3,008	3,017	13%
RM cost	383	440	410	510	487	615	629	679	
Employee cost	72	85	109	161	201	244	314	339	
Other expenses	332	346	444	400	379	395	538	581	
EBITDA	470	506	520	717	693	1,034	1,527	1,418	17%
Interest	93	81	81	72	61	27	42	20	
Depreciation	146	138	132	146	142	137	220	256	
Other income	2	-2	11	60	42	54	85	136	
PBT	232	285	318	558	531	924	1,350	1,278	
PAT	93	187	189	390	405	689	1,007	958	40%
Margins (%)									
Gross margin	70	68	72	71	72	73	79	78	
EBITDA	37.4	36.7	35.1	40.1	39.4	45.2	50.8	47.0	
Emp cost	5.7	6.2	7.3	9.0	11.4	10.7	10.4	11.2	
Other expenses	26.4	25.1	29.9	22.4	21.5	17.3	17.9	19.3	

Balance sheet

Rs mn	2016	2017	2018	2019	2020	2021	2022	2023E
Equity	597	783	972	1,353	1,976	2,443	4,898	5,857
Debt	730	765	437	645	359	335	216	216
Non Current liabilities	62	52	40	39	48	65	101	101
Payables	32	50	47	20	59	60	130	130
Other current liabilities	183	130	351	62	45	56	97	97
Total sources of funds	1,603	1,781	1,848	2,120	2,487	2,960	5,442	6,401
Net fixed assets	746	744	790	911	1069	1357	2143	3087
Other non current assets	84	151	150	238	219	474	854	854
Inventories	327	390	385	464	487	467	824	826
Debtors	342	405	455	446	382	470	652	654
Cash	17	18	16	9	263	31	858	860
Other current assets	87	73	50	51	67	159	112	120
Total uses of funds	1604	1781	1848	2120	2487	2960	5442	6401

Cash flow statement

Rs mn	2016	2017	2018	2019	2020	2021	2022	2023E
Operating profit before WC	475	500	602	771	731	1,082	1,587	1,554
WC changes	-235	-212	125	-88	64	-160	-418	-13
Tax	-94	-108	-140	-170	-153	-241	-334	-319
Others								
Cash flow from operations	146	181	586	513	642	682	835	1,222
Capex	-198	-136	-179	-337	-260	-642	-1,320	-1,200
Other investment income/ca.	10	2	2	1	6	3	-60	-
Cash flow from investments	-189	-135	-178	-336	-254	-639	-1,379	-1,200
Proceeds from equity	-	-	-	-	-	-	1,457	-
Proceeds from debt	145	35	-328	-121	-90	-223	-118	-
Interest	-93	-81	-81	-62	-48	-50	-43	-20
Cash from finance	53	-46	-409	-182	-138	-272	1,296	-20
FCF	-145	-37	326	115	334	-10	-528	2

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(Type of Registration- Non-Individual, Validity of Registration- 20.12.2022 to Perpetual)

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