MOTILAL OSWAL

3QFY05 Results Update
SECTOR: PHARMACEUTICALS

Pfizer

STOCK INFO.	BLOOMBERG
BSE Sensex: 8,526	PFIZ IN
	REUTERS CODE
S&P CNX: 2,575	PFIZ BO

Equity Shares (m)	29.8
52-Week Range	891/485
1,6,12 Rel. Perf. (%)	-11/-12/-4
M.Cap. (Rs b)	24.0
M.Cap. (US$ b)	0.5

27 September 2005

Neutral

Previous Recommendation: Neutral Rs804

YEAR END	NET SALES (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES	EV/ EBITDA
11/04A	5,829	572	19.2	47.5	42.0	7.0	16.7	27.2	3.9	24.7
11/05E	6,238	954	32.0	66.7	25.2	6.2	24.5	39.4	3.5	14.6
11/06E	7,017	1,276	42.7	33.8	18.8	5.3	28.1	44.9	3.0	10.8

Pfizer's 3QFY05 results were ahead of our estimates at the operating level, with EBITDA margins of 27.2% (as against our estimate of 22.9%). Although revenue is lower than our estimates, this was compensated by better cost management resulting in significant margin expansion. Key highlights of the quarter include:

- Net revenues grew 15.3% YoY to Rs1695m and adjusted net profit grew 89.8% YoY to Rs291m
- EBIDTA margins expanded 11.3ppt YoY to 27.2% (highest ever EBITDA margin), driven primarily by efficiency improvement measures under the LEAP programme.
- We have upgraded our FY05E EPS by 5.8% to Rs32/share, to factor in better-than-anticipated cost efficiency.

Achieving earnings growth is not an issue for Pfizer over the next two years, as it is coming off a low base. Restructuring benefits, along with steady topline growth, would drive a healthy 49% CAGR in adjusted PAT over FY04-06E. However, at valuations of 25.2x FY05E and 18.8x FY06E, further re-rating would be driven by clear signals on the parent's intent to drive growth in the listed subsidiary. Re-iterate **Neutral**.

QUARTERLY PERFORMANCE (INCLUDING PHARMACIA) (Rs Million)

Y/E NOVEMBER	FY04				FY05				FY04	FY05E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Net Revenues	**1,416**	**1,403**	**1,470**	**1,540**	**1,383**	**1,421**	**1,695**	**1,739**	**5,830**	**6,238**
YoY Change (%)	*33.4*	*19.9*	*4.0*	*10.3*	*-2.4*	*1.2*	*15.3*	*12.9*	*15.6*	*7.0*
Total Expenditure	1,199	1,220	1,236	1,264	1,101	1,104	1,235	1,286	4,919	4,725
EBITDA	**218**	**183**	**234**	**276**	**282**	**317**	**461**	**453**	**911**	**1,512**
Margins (%)	*15.4*	*13.1*	*15.9*	*17.9*	*20.4*	*22.3*	*27.2*	*26.1*	*15.6*	*24.2*
Depreciation	19	28	25	31	29	37	32	40	103	139
Interest	2	3	2	3	2	0	0	0	8	2
Other Income	35	46	31	30	34	31	34	39	141	137
PBT before EO Items	**231**	**199**	**238**	**273**	**285**	**311**	**462**	**451**	**941**	**1,509**
EO Expense/(Income)	52	70	32	39	58	58	115	59	192	291
PBT after EO items	**179**	**130**	**207**	**234**	**226**	**252**	**347**	**392**	**748**	**1,218**
Tax	76	52	72	93	92	98	129	130	293	448
Rate (%)	*42.3*	*40.2*	*34.9*	*39.9*	*40.5*	*38.7*	*37.2*	*33.2*	*39.2*	*36.8*
Reported PAT	**103**	**77**	**134**	**141**	**135**	**155**	**218**	**262**	**455**	**770**
PAT adj. for Excep Items	**133**	**119**	**155**	**164**	**169**	**191**	**291**	**302**	**572**	**954**
YoY Change (%)	*34.7*	*445.7*	*4.9*	*70.9*	*27.0*	*60.0*	*87.4*	*84.1*	*52.8*	*66.7*
Margins (%)	*9.4*	*8.5*	*10.5*	*10.6*	*12.2*	*13.4*	*17.1*	*17.3*	*9.8*	*15.3*

E: MOSt Estimates

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Revenue growth back on track

Pfizer's revenue in 3QFY05 at Rs1.7b grew by 15.3% YoY, after two sluggish quarters. Revenue growth was primarily driven by 15.9% growth in the pharmaceutical business and 57% growth in service income (income derived from clinical data management). However, revenues from the animal healthcare business declined marginally by 0.5%.

SEGMENT MIX: PHARMA DRIVING REVENUE GROWTH (RS M)

PARTICULARS	3QFY05	3QFY04	YOY (%)	2QFY05	QOQ (%)
Pharmaceuticals	1,489	1,285	15.9	1,202	23.8
% of sales	*87.8*	*87.4*	-	*84.6*	-
Animal Health	146	147	-0.5	152	-4.1
% of sales	*8.6*	*10.0*	-	*10.7*	-
Services-Clinical dev.	61	39	57.0	66	-8.3
% of sales	*3.6*	*2.6*	*4.7*	-	-
Total	**1,695**	**1,470**	**15.3**	**1,421**	**19.3**

Source: Company/Motilal Oswal Securities

The growth in pharma sales was primarily driven by high growth in *Gelusil* (due to low base last year on account of quality issues with the previous loan licensee vendor) and improvement in *Corex* sales (despite cautious approach taken by the company due to regulatory issues involved). All major brands witnessed good momentum resulting in across-the-board sales growth with volume growth of 10% and value growth of 5%. The management indicated that it is contemplating launching two to three new products in late 4QFY05 or early 1QFY06.

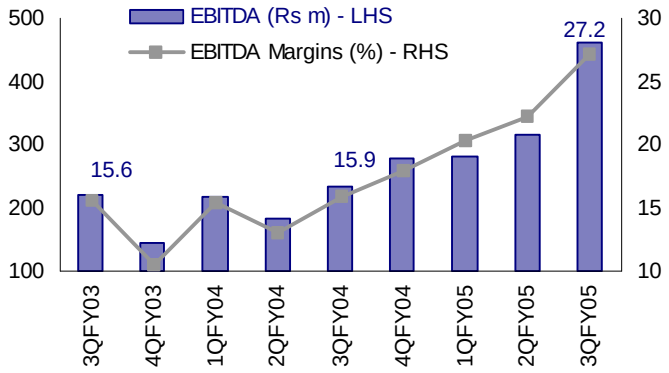
While the animal health business de-grew marginally by 0.5% to Rs146m (on account of substantial price decline in products of the poultry segment), services income grew by 57% as the company commenced new clinical studies for the parent.

With growth momentum expected to continue, we expect net revenues for FY05 to grow by 7%.

Margin expansion continues for 7th quarter in a row

EBIDTA margins continued to improve for the 7th quarter in a row, moving up to 27.2% in 3QFY05 from 15.9% in 3QFY04. Margin improvements were driven primarily by lower raw material cost (32.5% of sales v/s 35.5% in 3QFY04) due to improving product mix and lower other expenditure - on account of efficiency improvement measures undertaken by the company under the LEAP programme.

EBITDA MARGINS: HIGHEST EVER



Source: Company/Motilal Oswal Securities

The pharma business has seen PBIT margins improving to 30.9% from 23.9% in 3QFY04. Improved product mix (with the commencement of *Gelusil* sales and improvement in *Corex* sales) and savings in procurement cost were the main factors driving the sharp improvement in pharma PBIT margins. Also, PBIT margins of animal health business improved by 14.2ppt YoY to 27.8%, as the company went slow on sale of a poultry segment product, where prices have fallen substantially.

PBIT MARGIN IMPROVEMENT: PHARMA THE KEY DRIVER (RS M)

PARTICULARS	3QFY05	3QFY04	GR. (%)	2QFY05	GR. (%)
Pharmaceuticals	460	307	50.1	334	37.7
% of sales	*30.9*	*23.9*	-	*27.8*	-
Animal Health	41	20	102.5	-10	-505.0
% of sales	*27.8*	*13.6*	-	*-6.6*	-
Services-Clinical dev.	7	4	82.1	6	10.9
% of sales	*11.7*	*10.1*	-	*9.6*	-
Total	**508**	**331**	**53.6**	**331**	**53.6**

Source: Company/Motilal Oswal Securities

Pfizer is now firmly on the path of margin improvement, with improved efficiencies and control on costs expected to drive rapid improvement in margins. The company has gone through a couple of value dilutive mergers (with Parke

Davis and Pharmacia), which took a severe toll on margins in the past. However, things are back on track and the LEAP programme alone is expected to lead to a 12.4ppt improvement in EBIDTA margins over FY04-06E. With revenues expected to grow around 9.7% CAGR, we expect EBIDTA margins to trend upwards to 24.2% and 28% in FY05E and FY06E, respectively.

Adjusted net profit up 90%

Adjusted net profit (excluding net extraordinary expenses of Rs115m) grew 90% to Rs291m. Higher depreciation (up 30% to Rs32m), following the capitalization of the Thane plant in FY04 and higher tax provision (37.2% v/s 34.9% of PBT in 3QFY04).

Revising earnings estimate

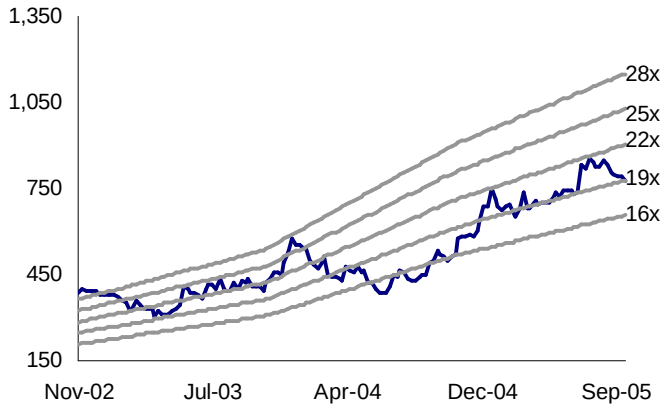
We have revised our earnings estimate for Pfizer based on higher-than-anticipated efficiency gains. We have raised our EPS estimate for FY05E by 5.8% to Rs32/share (from Rs30.2/share). However, we maintain our FY06E earnings estimate of Rs42.7/share.

Valuations reflect positives; Re-iterate Neutral

In our opinion, achieving high growth is not an issue for Pfizer over the next couple of years, as it is coming off a very low base. A steady 9.7% CAGR in revenues along with significant improvement in margins on the back of the LEAP programme would lead to a 49% CAGR in net profit over FY04-06E.

However, at valuations of 25.2xFY05E and 18.8xFY06E, further re-rating would be driven by clear signals on the parent's intent to drive growth in the listed subsidiary. We would like to wait for some more positive signals on the business before taking a re-look at our recommendation. We re-iterate our **Neutral** rating on the stock with a price target of Rs745 (~17.5x FY06E).

PER BAND



Pfizer: an investment profile

Company description

Pfizer India, a 40% subsidiary of Pfizer Inc, has interests in pharmaceuticals (~86% of sales), animal health (~10% of sales) and services (~4% of sales). Pfizer India's profile is completely different from its parent and many other emerging market subsidiaries. Pfizer has a strong field force, skewed towards mature categories owing to the nature of its product portfolio.

Key investment arguments

- With merger integration related issues out of the way, Pfizer has started focusing on gearing up for the product patent era
- Focus on revamping the sales force in line with the parent's focus therapeutic areas
- Over the longer term, Pfizer with its parent's robust pipeline and strong brand equity in India could emerge as a key gainer from product patent introduction

Key investment risks

- Has been conservative with respect to new product launches – leading to an aging product portfolio and low growth
- Ineffective implementation of product patents in India could suppress growth potential

Recent developments

- Mr Kewal Handa has been appointed as Managing Director of Pfizer India

Valuation and view

- Valuations of 25.2x FY05E and 18.8x FY06E earnings are reasonable given the rapid growth prospects and rich pipeline of the parent
- We would, however, like to wait for some more positive signs on the business in India, before turning more bullish
- Re-iterate **Neutral**, with a target price of Rs745.

Sector view

- Indian Pharma market expected to witness steady growth, on the back of gradual increase in low penetration levels – companies with strong brands and marketing muscle to benefit the most
- IPR regime unlikely to lead to any major change in the near term; MNCs and large Indian players to benefit over the longer term
- Among MNCs, we are bullish on companies whose domestic portfolio is well aligned with its parent and where risk of conflict with 100% subsidiaries is limited

COMPARATIVE VALUATIONS

		PFIZER	AVENTIS	GLAXO
P/E(x)	FY06	25.2	19.3	24.8
	FY07	18.8	16.6	20.7
P/BV(x)	FY06	6.2	6.4	7.2
	FY07	5.3	5.0	6.0
EV/Sales(x)	FY06	3.5	3.7	4.6
	FY07	3.0	3.2	4.0
EV/EBITDA(x)	FY06	14.6	12.1	16.2
	FY07	10.8	10.0	13.2

EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY05	32.3	28.7	11.5
FY06	42.0	38.0	12.4

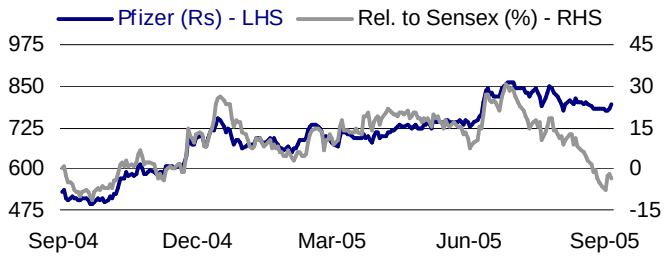
TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
804	745	-7.3	Neutral

SHAREHOLDING PATTERN (%)

	JUN.05	MAR.05	JUN.04
Promoters	41.2	40.0	40.0
Domestic Institutions	25.5	28.0	25.8
FIIs/FDIs	6.0	5.3	3.8
Others	27.3	26.8	30.4

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT (Rs Million)

Y/E NOVEMBER	2002	2003	2004^	2005E^	2006E^
Net Income	**5,861**	**5,041**	**5,829**	**6,238**	**7,017**
Change (%)	*72.1*	*-14.0*	*15.6*	*7.0*	*12.5*
Total Expenditure	4,794	4,409	4,919	4,725	5,052
EBITDA	**1,066**	**632**	**911**	**1,512**	**1,965**
Change (%)	*49.7*	*-40.7*	*44.1*	*66.1*	*29.9*
Margin (%)	*18.2*	*12.5*	*15.6*	*24.2*	*28.0*
Depreciation	106	108	103	139	145
Int. and Finance Charges	8	4	8	2	0
Other Income - Rec.	164	111	141	137	189
PBT & EO Items	**1,116**	**630**	**941**	**1,509**	**2,009**
Change (%)	*44.9*	*-43.5*	*49.2*	*60.4*	*33.1*
Extra Ordinary Items	152	-167	-192	-291	-149
PBT after EO Items	**1268**	**463**	**748**	**1218**	**1860**
Tax	509	188	293	448	679
Tax Rate (%)	*40.1*	*40.6*	*39.2*	*36.8*	*36.5*
Reported PAT	**759**	**275**	**455**	**770**	**1,181**
PAT Adj for EO Items	**669**	**374**	**572**	**954**	**1,276**
Change (%)	*40.8*	*-44.0*	*52.8*	*66.7*	*33.8*
Margin (%)	11.4	7.4	9.8	15.3	18.2

^2004, 2005E and 2006E include the merger effect of Pharmacia

BALANCE SHEET (Rs Million)

Y/E NOVEMBER	2002	2003	2004^	2005E^	2006E^
Equity Share Capital	288	288	298	298	298
Reserves	2,792	2,796	3,129	3,598	4,242
Net Worth	**3,080**	**3,084**	**3,428**	**3,897**	**4,540**
Loans	0	0	120	0	0
Deferred Tax Liabilities	-79	-99	-64	-64	-64
Capital Employed	**3,001**	**2,985**	**3,484**	**3,833**	**4,477**
Gross Block	1,369	1,368	1,588	1,548	1,598
Less: Accum. Deprn.	853	802	871	1,169	1,314
Net Fixed Assets	**516**	**566**	**717**	**379**	**284**
Capital WIP	54	45	39	30	40
Investments	53	32	32	32	32
Curr. Assets	**3,493**	**3,182**	**3,765**	**4,997**	**6,098**
Inventory	848	866	739	1,088	1,158
Account Receivables	1,234	588	717	967	1,123
Cash and Bank Balance	684	891	1,611	1,989	2,835
Others	726	837	698	953	982
Curr. Liability & Prov.	**1,636**	**1,381**	**1,670**	**1,903**	**2,105**
Account Payables	1,111	962	1,128	1,293	1,333
Provisions	524	419	542	610	772
Net Current Assets	**1,857**	**1,801**	**2,094**	**3,095**	**3,993**
Deferred Revenue Exp (VRS)	522	540	601	297	128
Appl. of Funds	**3,001**	**2,985**	**3,484**	**3,833**	**4,477**

E: MOSt Estimates

RATIOS

Y/E NOVEMBER	2002	2003	2004	2005E	2006E
Basic (Rs)					
EPS	**23.2**	**13.0**	**19.2**	**32.0**	**42.7**
Cash EPS	26.9	16.8	22.6	36.6	47.6
BV/Share	107.0	107.1	114.9	130.6	152.2
DPS	7.5	7.5	10.0	13.0	16.0
Payout (%)	28.4	88.6	73.8	56.7	45.5
Valuation (x)					
P/E	-	61.9	42.0	25.2	18.8
Cash P/E	-	48.0	35.6	22.0	16.9
P/BV	-	7.5	7.0	6.2	5.3
EV/Sales	-	4.6	3.9	3.5	3.0
EV/EBITDA	-	36.6	24.7	14.6	10.8
Dividend Yield (%)	-	0.9	1.2	1.6	2.0
Return Ratios (%)					
RoE	21.7	12.1	16.7	24.5	28.1
RoCE	37.5	21.3	27.2	39.4	44.9
Working Capital Ratios					
Asset Turnover (x)	2.0	1.7	1.7	1.6	1.6
Debtor (Days)	77	43	45	57	58
Inventory (Days)		63	46	64	60
Working Capital (Days)		66	30	65	60
Leverage Ratio					
Current ratio		2.3	2.3	2.6	2.9
Debt/Equity	0.0	0.0	0.0	0.0	0.0

CASH FLOW STATEMENT (Rs Million)

Y/E NOVEMBER	2002	2003	2004^	2005E	2006E
Oper. Profit/(Loss) before Tax	1,066	632	911	1,512	1,965
Interest/Dividends Recd.	164	111	141	137	189
Direct Taxes Paid	-538	-188	-293	-448	-679
(Inc)/Dec in WC	-641	235	258	-723	-153
CF from Operations	**52**	**789**	**1,016**	**478**	**1,322**
EO Items	152	-167	-192	-291	-149
CF from Opr.incl EO Items	**204**	**622**	**823**	**187**	**1,173**
(Inc)/Dec in FA	-255	-150	-19	209	-60
(Pur)/Sale of Investments	-20	20	0	0	0
CF from Investments	**-275**	**-129**	**-19**	**209**	**-60**
Issue of Shares	54	0	0	0	0
(Inc)/Dec in Debt	0	0	-40	-120	0
Dividend Paid	-129	-216	-244	-336	-436
Others	160	1	220	60	19
CF from Fin. Activity	**84**	**-215**	**-64**	**-396**	**-417**
Inc/Dec of Cash	**13**	**278**	**741**	**291**	**845**
Add: Beginning Balance	576	618	896	1,611	1,989
Closing Balance	**589**	**896**	**1,637**	**1,902**	**2,834**

^ 2004 and 2003 balance sheet items are not comparable due to Pharmacia merger

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1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	Yes
3. Broking relationship with company covered	No

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