

CMP – Rs.300.30, Buy in the 305-275 band, 6M Target Price – Rs. 358
Pharmaceuticals – Multinational
Value Buy
Price Chart

Stock Details

BSE Code	500126
NSE Code	MERCK
Bloomberg	EMER IN
Price as on 05/11/2008	300.30
Equity Capital (Rs Cr)	16.86
Face Value (Rs)	10.00
Eq. Shares O/s (Cr)	1.67
Market Cap (Rs Cr)	506.31
Book Value (Rs)	250.83
Avg Dly Vol (3 Mths)	2624
52 wk H/L	460.00/260.00

Shareholding Pattern

	In %
(as on 30 Sep 2008)	
Foreign Promoters	51.00
Non Promoter – Institutional	19.38
Public & Others	29.62
Total	100.00

Company with value embedded – awaiting acceleration in growth!!!
Background

E-Merck (India) (51% subsidiary of Merck KGaA, Germany) started operations in 1966 as a manufacturer of pharmaceutical specialities and over the years, it has diversified its product range to include basic drugs, fine and industrial chemicals, and diagnostics. It is gradually increasing its presence in the cardiovascular, anti-infectives and anti-malarial segments to widen its therapeutic reach. With the acquisition of Serono by the parent company, the number of pharma products will increase gradually.

Triggers

- ML is one of the **old, established and largest players in the vitamin formulations segment**. Although the ethical business is a slow growing segment, with the launch of new products and new variants to its existing products in CY07 viz. **Olmighty, Evion Forte Tablets, Livogen CZ, Nasivion Care**, etc., ML is planning to gradually expand its ethical business.
- ML could improve possibilities of **higher revenue growth on the back of Consumer Health Care (CHC) business** due to launch of a variant of Electrobin called Electrobin SIP, a flavoured Oral Rehydration Salt (ORS) and likely foray in Women healthcare. ML has **created a separate dedicated field force and has also ramped up its field force** in CHC business that would be targeting the doctors and pharmacists, thereby improving the revenues in CHC business.
- **Capacity expansion of Oxynex** manufacturing facility (due in Dec 08) could help boost the revenues in the chemical segment. ML also enjoys tax benefit due to its **EOU status to the units manufacturing Oxynex and Guaiazulene**, which could improve its net margins.
- A huge advantage enjoyed by ML is being a Cash rich company with a huge cash reserve of about Rs. 350 crs in CY07 and the status of being a Debt Free company. This cash has been lying in the balance sheet for a while and has been kept aside to fund some brand acquisitions locally, which could boost shareholder value. The **Cash per share being Rs. 208 is quite attractive** from valuation perspective. Its **book value per share too is healthy at Rs. 250.83** per share in CY07.
- The Parent Company with the **acquisition of Serono, Italy** has become one of the leading players in the biopharmaceuticals segment. While Serono has a tie up with Serum Institute of Pune for some products, a few other products are sold through Merck KGaA's 100% subsidiary in India i.e. Merck Specialities Ltd. **Introduction of the cancer drug "Erbix"** in India through **Merck Specialities Ltd shows the intention of the parent about its strategy going forward**, we still think that older Pharma brands & non pharma products could still be launched through ML. Apart from this, restructuring Indian operations in future remains a distinct possibility that could benefit the listed ML.
- ML has been a **consistent dividend paying company for the past 17 years** and ML has been distributing dividend **yielding between 3-6%**. The performance of ML over the years and the liberal distribution policy speaks about strength of ML. It maintains a payout ratio of 25-30% year after year.
- During the group Chairman's recent visit to India, he mentioned that **Merck KGaA is planning to invest 20% of the revenues from Indian operations towards expansion**, as it foresees India to be one of its prime focus areas. The planned investments could go towards expanding production, infrastructure and R&D Infrastructure. He also mentioned that it plans to acquire technologies and brands to expand its presence in India. Finally to reassure the minority shareholders of the listed company ML, he mentioned that it would launch global products in India through the listed entity as well as the 100% subsidiary depending on the nature of the product.

Standalone Financials at a Glance

Rs. In Cr	CY05	CY06	CY07	CY08E	CY09E
Revenues	396.46	329.49	314.83	390.26	437.09
% growth y-o-y		-16.89	-4.45	23.96	12.00
EBITDA	125.03	110.65	106.46	103.55	116.86
% growth y-o-y		-11.50	-3.79	-2.74	12.86
PAT	60.03	133.35	68.82	66.59	75.49
% growth y-o-y		122.14	-48.39	-3.24	13.36
EPS	35.60	79.09	40.82	39.50	44.77
% growth y-o-y		122.14	-48.39	-3.24	13.36
PE	8.43	3.80	7.36	7.60	6.71

Valuations & Recommendation:

ML has been a large player in the vitamin formulations business and has been slowly improving on the chemicals and bulk drugs segment as well. The capacity expansion in Oxynex facility would help it in enhancing its chemical business portfolio. Moreover, being the only producer of Guaiazulene among the Merck group companies, this could further strengthen ML's position in chemicals division. With the introduction of a new variant in the form of ElectroBion SIP, ML seems to be concentrating more on the Healthcare platform. However, ML is also trying to maintain its growth in Ethicals business via launch of new products like Olmighty tablets in Cardiologics segment.

Adequate support and assistance from the parent company is a sufficient reason for ML to improve the Ethicals and CHC business. A distinct advantage in the form of a rich cash balance and a debt free status makes ML a long-term value buy stock. ML plans to utilise this cash for making brand acquisitions locally, which could enhance shareholder value. ML is a clear value buy due to various parameters of being a good and consistent dividend yield stock, strong presence in the vitamins and chemicals segment and trading at a reasonable P/E of 6.7 times its CY09 (E) earnings.

ML has Cash per share of Rs. 208 on its Balance Sheet of CY07. While ML is struggling to grow its revenue at a faster pace, we think the current situation of large cash balances and absence of new large products/business may not continue for long. One could see growth in other income due to higher interest rates, which could partially offset the fall in margins due to rise in raw material cost and staff expenses. However, in the absence of new product launches, revenue growth is muted. But ML has inherent triggers waiting to unlock in the form of possible restructuring by Parent company of various group companies, delisting of shares from the market, brand / company acquisitions locally and high dividend payout ratio. All such events could lead to value unlocking for shareholders of ML. One could accumulate the stock in the 305-275 band for a price target of Rs. 358 over 6 months, which is 8 times P/E its CY09 (E) EPS.

Investment Rationale

Seasoned player in the ethical Pharmaceuticals segment

ML is one of the established players in the ethical pharmaceuticals business segment. The ethical division comprises of therapeutics segments like Vitamins, Cardiologics, Cough & Cold preparations, Dermatological, Haematinics, Anti Mararials, etc. In CY07, the pharmaceuticals business accounted for Rs. 250 crs of revenues out of total revenues of Rs.319 cr. The ethicals business grew by roughly 4-5% y-o-y. Due to high coverage in the Vitamin formulations business, the Drug Price Control Order (DPCO) affects ML as nearly 58% of its products falls under the DPCO.

As the sales growth is short of industry standards, ML has decided to improve its presence in the rural and semi-urban areas. For this purpose, it has increased its marketing staff and has also introduced some new products and newer versions of the existing products. Some of the products introduced in CY07 in the therapeutic segments are as follows:

Name of new products/Line Extensions	Therapeutic segment
Olmighty Tablets - New	Cardiologicals
Evion Forte Tablets in food category	Vitamins
Polybion Complete Syrup	Vitamins
Met Neurobion Injection	Vitamins
Livogen CZ Tablets	Haematinics
Nasivion Care Drops	Cough & Cold

(Source: Annual Report)

All the products mentioned above are newer versions of the existing products except for Olmighty tablet, which has been introduced in CY07. As this product has been recently launched, the success of this product can be gauged only over the next 1-2 years. Hesitation of introducing new drugs from the parent's stable due to patents laws has resulted in muted growth in ethical pharma segment. Vitamins constitute a lion's share in the Pharmaceutical sales with Cardiologicals and cold and cough following way behind.

[Strength in marketing base to support Consumer Health Care \(CHC\) business](#)

The CHC business, which consists Nasal Drops, Oral Rehydration Salts, Health Supplement, Joint Care, etc., is the growth segment for ML. The CHC business accounts for roughly 7-9% of revenues in CY07 and it has been growing at a much faster pace than the Ethicals business. So as to improve the CHC business, ML has ramped up its field force substantially over the last 6 months and they have created a separate and dedicated force for CHC to boost revenues in the CHC business. These steps taken by ML for penetration into the wider market network should start yielding results in the coming years.

Some variants of the existing products have been launched in the last few quarters in the CHC division, which could help in improving revenues. Moreover, with the dedicated field force for CHC business, ML could focus more on enhancing its revenues in CHC business. Electrobion sip, an Oral Rehydration Salt (ORS) comes in different flavours and it may also be considered as an energizer. This product has been launched at a competitive price and good brand visibility has also been provided among the chemist shops. ML is adopting a 2-pronged strategy, wherein it is targeting doctors and super markets in the next phase. All this could help in the CHC business to improve its revenues and CHC is expected to achieve a growth in the range of 20-25% in the next 1-2 years.

[Expansion in Chemicals Division to guide revenue growth](#)

The Chemicals division, which contributes more than 10% to the total turnover, manufactures Bulk Drugs such as Vitamin E, OxyneX, Thiamine Disulfide (TDS) and Guaiazulene at the manufacturing facility in Goa. All the chemicals are manufactured in the Goa unit itself, with only OxyneX and Guaiazulene units (part of Goa premises) having EOU status. The major product manufactured is Vitamin E, wherein apart from meeting its captive requirements, it also caters to its other formulators in India and abroad.

Chemicals business includes pigments and other bulk chemicals that are imported and distributed in India. Vitamins, TDS, Guaiazulene and OxyneX form the balance.

Although, the vitamin prices have been rising internationally which may help in improving realisations, this has been negated by increase in raw material prices (vitamin bulks), which is used for ML's formulations, thereby offsetting the benefit from rise in vitamin prices. Over the past few years, ML has also been exporting to the Merck group companies on a cost plus basis.

In the other segments of Chemical division, ML has a production capacity of 20 tons p.a for OxyneX (used in Hair care). To meet with the growing demand for OxyneX, ML has initiated steps for setting up a new project for expansion of the capacity in Goa. This facility will be a 100% EOU unit and is expected to be completed by September 2008. This expansion would cost about Rs. 25-30 crs, and funded through internal accruals. With this expansion, the OxyneX production will increase from 22 tons p.a. to 150 tons p.a and the production will start by Dec 08. This expansion will improve the revenue growth in the chemical segment by 15-20% once the expanded facilities stabilize.

Chemicals	Used for	Markets	Customers
Bulk Drugs			
Vitamin E	Captive & non- associated formulators	Local and Exports	Merck Group
Oxynex	Hair Care	Exports	Merck Group
Thiamine Disulfide (TDS)	Used in Formulators	European continent some parts of Asia	
Guaiazulene	Cosmetics	Some parts of Europe and Asia	
Pigments	Dyes & Paints	Local	

(Source: Company)

The other products that are manufactured are Thiamine Disulphide (TDS) and Guaiazulene. TDS is exported to Europe and Asia. Guaiazulene, which is a 100% EOU is also exported mainly to Europe and Asia. These products are low in volume, but generate good margins. ML feels that the Chemicals business will be guided by an intense marketing driven campaign supported by good distribution, quality and speed of delivery.

[A Cash Rich, Debt Free Status ensures smooth future expansion](#)

ML enjoys a very strong balance sheet in the form of a heavy cash surplus and also enjoys the status of being a debt free company. ML has been a debt free company for the past 7 years. As on 31st Dec 2007, ML boasts of a Cash & Bank balance of Rs. 116.91 crs and Investments worth Rs. 233.97 crs, summing up to a total cash value of Rs. 350.88 crs. This translates to a Balance Sheet value per share of Rs. 208. ML has been maintaining such huge cash balances for acquiring brands in India and abroad.

ML is in the lookout for some brand acquisitions and thereby deploy its excess cash. ML has set up a Mergers & Acquisition division recently with a strategy to grow aggressively through the inorganic route. With the formation of its in house M&A team, ML is optimistic about acquiring business to supplement its growth initiatives. ML also has been liberal in distributing its cash to the shareholders in the form of dividends.

With such strong cash balances and a debt free status, ML is positioned to come up with a delisting open offer, if its efforts to make acquisitions do not end up.

[Serono Acquisition by Parent company may increase the pharma product base of Merck group in India](#)

The Parent company's acquisition of Serono in January 2007 has made Merck KGaA one of the world's leading biopharmaceutical companies. Merck Serono is the largest division of the Merck Group. It generated revenues worth Euros 4,458 m accounting for 70% of total Merck's revenues. This led to a revenues growth of 7.4% largely due to higher sales in the targeted cancer therapy Erbitux and Rebif for the treatment of relapsing forms of multiple sclerosis (MS). Global sales of Rebif increased in 2007 to Euros 1218 mn, a growth of 5.3% over previous year. The revenues of Erbitux also grew steadily by 40% to Euros 470 mn.

While Serono has a tie up with Serum Institute of Pune for some products, a few other products are sold through the 100% subsidiary of Merck KGaA i.e. Merck Specialities Ltd. Introduction of the new cancer drug "Erbitux" in India through Merck Specialities Ltd shows the intention of the parent about its strategy going forward, we still think that older Pharma brands & non pharma products could still be launched through ML. Apart from this, restructuring Indian operations in future remains a distinct possibility that could benefit the listed ML.

[Consistent in dividend payout with good dividend yield](#)

ML has had a consistent record of paying good dividends to its shareholders over the past 8-10 years. ML has also maintained a good dividend yield over the years. It has been consistently maintaining a good dividend yield in the range of 3-6% as well. This indicates that it has the habit of paying out profits quite regularly to its shareholders. The

performance and stability of ML speaks volumes with the way it has been declaring dividend for past few years, which is evident from the table given below:

Year of Dividend	% of dividend	Dividend Amt paid (in Crs)	Reported PAT (in Crs)	Dividend Payout Ratio - %	Dividend yield
2004	100	16.86	70.99	23.75	3.33
2005	150	25.29	78.79	32.10	5.00
2006	200	33.72	133.35	25.29	6.66
2007	200	33.72	68.82	49.00	6.66

(Source: Annual report)

Plans of Expansion in India by Parent Company (Merck KGaA)

During the group Chairman's recent visit to India, he mentioned that Merck KGaA is planning to invest 20% of the revenues from Indian operations towards expansion, as it foresees India to be one of its prime focus areas. The planned investments could go towards expanding production, infrastructure and R&D Infrastructure. He also mentioned that it plans to acquire technologies and brands to expand its presence in India.

It considers India to be a key focus area like in case with Japan and China. The Parent company's investment in India is in line with its new three-pronged strategy to drive global growth: continued innovation, a focus on biotechnology and an emphasis on speciality product research in selected therapeutic areas for both the pharmaceuticals and CHC business. Finally to reassure the minority shareholders of the listed company ML, he mentioned that it would launch global products in India through the listed entity as well as the 100% subsidiary depending on the nature of the product.

Company Background

Erstwhile E Merck (India) was incorporated in Apr.'67, to take over the business of the Indian branch of Emeda Exports. ML a 51% subsidiary of German firm Merck KGaA is a leading player in vitamin formulations. It has a manufacturing facility located in Goa and also an injectable plant in Goa. It also has 15 toll centres across the country to whom raw materials are supplied and finished products outsourced under strict supervision. In 2002, the name of the company was been changed during 2002, from E Merck India Ltd to Merck Ltd. In 2004, ML sold its Taloja Plant to Biochem Pharmaceuticals Industries Ltd by signing the Deed of Assignment. During 2004, its collaborator Merck KGaA divested its holding in VWR International Ltd., UK. ML also sold its Life science & Analytic business unit to the Merck Specialities Pvt Ltd., a wholly owned subsidiary of company's Parent Company Merck KGaA, Germany in 2006. This unit was sold for Rs. 81.66 crs wef 01/04/2006. Sales of Chemicals division fell to Rs. 60.37 crs in CY07 from Rs. 88.21 crs in CY06.

Presently, it has five divisions - pharma, bulk drugs and pigments. ML started operations as a manufacturer of pharmaceutical specialities and over the years, it has diversified its product range to include basic drugs, fine and industrial chemicals, and diagnostics. It is gradually increasing its presence in the cardiovascular, anti-infectives and anti-malarial segments to widen its therapeutic reach. ML is the only manufacturer of Guaiazulene within the Merck group globally.

Parent Company Background

The Merck Group is a global pharmaceutical and chemical company with 185 companies in 60 countries, Merck has a presence on every continent and activities ranging from research and development, production, sales and marketing as well as an extensive range of services. Merck has focused its research and development activities in Darmstadt; however, it also has important research locations in France, Spain, Great Britain, the United States and Japan. It operates its production facilities at 50 locations in 23 countries; thus guaranteeing proximity to local markets. Around 32,000 committed employees around the world are helping to continue the company's successful tradition of more than 300 years.

Latest Updates on Merck KGaA

Merck KGaA reported a sharp rise in its third-quarter 2008 posting, from €200.1m (\$ 252.81m) compared with € 36.2m (\$ 45.6m) a year earlier, when the company booked a charge of € 183m (\$230.6m) related to the purchase of Swiss-based pharmaceuticals company Serono. Total revenue, including royalty payments made to Merck KGaA, grew 8.7% to €1.89bn (\$ 2.38bn) from €1.74bn (\$ 2.19bn). Sales of Rebif, its multiple-sclerosis treatment, rose 10% to €338m (almost \$426m), while sales of its cancer treatment Erbitux increased 13% to €134m (about \$169m). Revenue for the liquid-crystals division grew 12%, but remained unchanged from a year earlier due to the negative currency effects. Merck KGaA expects 2008 revenue to grow between 6 and 8%, and OPM to increase between 23-25%.

In Oct 08, Lpath, Inc and Merck Serono, a division of Merck KGaA, Darmstadt, Germany, have entered into a world wide alliance to develop and commercialize ASONEP, Lpath's Phase 1 monoclonal antibody that is being evaluated for the treatment of cancer. Under the terms of the agreement, Merck Serono will provide Lpath upto \$23m of upfront payments and R&D funding to support Lpath's completion of the Phase 1 clinical trial. If Merck Serono accepts the responsibility to develop ASONEP beyond Phase 1, it will pay Lpath an additional \$28m and will fund all continuing development activities. Further payments will be made on achievement of development, regulatory, and sales milestones that could total up to \$422m should ASONEP be approved in multiple indications.

Merck KGaA had started a mid-stage trial to evaluate the safety and efficacy of atacicept in patients with relapsing multiple sclerosis in April 08. Atacicept has the potential to complement existing multiple-sclerosis drugs by offering a novel mode of action and convenient administration. The trial will last over 36 weeks, with the main objective of reducing central nervous system inflammation in patients with relapsing multiple sclerosis.

Merck bought Serono SA for 10.3bn euros in 2007, adding Rebif and reducing Merck's reliance on liquid crystals for flat-panel televisions. Merck has used its 70% share of the liquid crystals market to prop up earnings as it expanded sales of Erbitux and close the gap on Roche Holding AG's Avastin.

Business & Product Portfolio

ML's products are divided into 2 segments, Pharmaceuticals and Pigments & Life Science Products. The products manufactured are specialities in the group of neurotropics, dermatology, antibiotics, nasal decongestants, basic vitamins, imaging agents, laboratory and fine chemicals, etc. Its products suite is as follows:

Pharmaceuticals: ML's products cover various therapeutic segments, spread as they are across anti-biotics, anti-malarials, cardiologicals, cough & cold formulations, dermatologicals, haematinics, neurologicals, ORS, and non-steroidal anti-inflammatory drugs. The various products with the description is as follows:

Product	Form	Description
Anemidox	Capsules	Haematinic containing iron and calcium, for anaemia during pregnancy
Beta Sclerebion		Offers 9 anti-oxidants for comprehensive management of health
Electrobion	Powder	Oral Rehydration Therapy, to prevent dehydration during diarrhoea and vomiting.
Emflam Plus	Tablets	Reduces inflammation and pain
Emquin range	Tablets, Syrup, and Injection	For effective malaria management
Evion	Capsules	Offers Vitamin E, a vitamin with proven anti-oxidant properties
Evion	Cream	Keeps skin soft and healthy with topical Vitamin E
Exflam	Gel	Topical anti-inflammatory-analgesic for sprains and strains
Livogen range	Cap tabs, Syrup	Oral haem atinic with iron, folic acid and zinc for

		nutritional deficiency anaemia, especially associated with pregnancy.
Nasivion (Adult/Pediatric/Mini) range and Nasivion-S	Nasal drops	Clears nasal congestion
Neurobion Forte	Tablets and Injection	Contains five neurotropic vitamins
Polybion Range	Tablets, Capsules, Syrup, and Injection	Provides B – complex factors.
Polyzee	Capsules	Offers zinc, in addition to B–complex vitamins

(Source: Company Website)

Pigments, Cosmetic Ingredients & Life Sciences: Pigments and Life Science Products offer cosmetic active ingredients like Allantoin, Sun Screen agents and Rona Cosmetic Pigments.

1. **Pigments:** Sourced from Merck Operations Worldwide, Iridin Pearl Lustre Pigments are promoted and sold to varied customers. Industrial grades find application in plastics, textiles, printing inks, and paper. Iridin weather-resistant grades find application in automotive paints for cars, scooters, and bicycles. Antidumping duties of 10% are levied on some pigments but this segment of trading business continues to record steady business.
2. **Life Science Products:** This division supplies chemicals that are used in the cosmetics, health, and nutrition industries.

Risks and Concerns

- ML is prone to the risk of currency fluctuations, which is having an impact on the export realisations. However ML is a net importer as expenditure in foreign currency at Rs. 52 crs exceeded earnings in foreign currency of Rs. 21 crs. ML is now more affected in case the Rupee depreciates.
- ML is severely affected by the uncertainties relating to the drug prices under DPCO. About 58% of the total value of ML's business falls under the price control. However, ML is trying to dilute this impact by having a proper mix of production facilities backed by necessary sourcing with cost reduction. It also is looking to dilute this risk by increasing sales of CHC pharma and chemicals business that do not fall under DPCO.
- ML faces heavy competition from its peers and local players in the pharma as well as the chemical segment. The low priced generic products of other local companies have affected the revenues of the large players. Products of ML like Evion, Polybion and Electrobin have many substitutes in the generics categories, which are sold at much cheaper rates.
- ML needs to contain the growing attrition in the marketing division. ML has been increasing its marketing and sales staff in order to improve its revenue book, but if ML is not able to retain talent, it may have to incur huge employee costs or its marketing thrust may not gain momentum.
- ML faces the risk of heavy competition in Vitamin products from Chinese and European manufacturers.
- ML is a cash rich company and these funds are being invested in low yielding bonds and deposits. ML needs to speed up its process of looking out for brand buyouts, in order to utilise this cash effectively.
- ML is prone to huge volatility in the raw material prices, as the bulk drug prices have increased in the range of 20-100% over the past few months due to depreciation of the Rupee and supply issues pre and post Olympics in China. If raw material prices don't fall back in a hurry, this could affect the operating margins as ML has limited ability to pass on price increase due to DPCO coverage of most of its products.

- Conflict of interest due to presence of a 100% subsidiary of the group in India could a lingering concern for shareholders of the listed company.

Conclusion

ML has been a large player in the vitamin formulations business and has been slowly improving on the chemicals and bulk drugs segment as well. The capacity expansion in OxyneX facility would help it in enhancing its chemical business portfolio. Moreover, being the only producer of Guaiazulene among the Merck group companies, this could further strengthen ML's position in chemicals division. With the introduction of a new variant in the form of ElectroBion SIP, ML seems to be concentrating more on the Healthcare platform. However, ML is also trying to maintain its growth in Ethicals business via launch of new products like Olmighty tablets in Cardiologics segment.

Adequate support and assistance from the parent company is a sufficient reason for MI to improve the Ethicals and CHC business. A distinct advantage in the form of a rich cash balance and a debt free status makes ML a long-term value buy stock. MI plans to utilise this cash for making brand acquisitions locally, which could enhance shareholder value. ML is a clear value buy due to various parameters of being a good and consistent dividend yield stock, strong presence in the vitamins and chemicals segment and trading at a reasonable P/E of 6.7 times its CY09 (E) earnings.

ML has Cash per share of Rs. 208 on its Balance Sheet of CY07. While ML is struggling to grow its revenue at a faster pace, we think the current situation of large cash balances and absence of new large products/business may not continue for long. One could see growth in other income due to higher interest rates, which could partially offset the fall in margins due to rise in raw material cost and staff expenses. However, in the absence of new product launches, revenue growth is muted. But ML has inherent triggers waiting to unlock in the form of possible restructuring by Parent company of various group companies, delisting of shares from the market, brand / company acquisitions locally and high dividend payout ratio. All such events could lead to value unlocking for shareholders of ML. One could accumulate the stock in the 305-275 band for a price target of Rs. 358 over 6 months, which is 8 times P/E its CY09 (E) EPS.

Financial Performance over the last 4 quarters

Particulars (In Crs)	Q3CY08	Q3CY07	%Chg	Q2CY07	Q2CY06	%Chg	Q1CY08	Q1CY07	%Chg	Q4CY07	Q4CY06	%Chg
Net Sales	107.92	81.62	32.22	105.06	83.05	26.50	83.36	70.41	18.39	79.55	69.89	13.82
Other Income	10.76	11.09	-2.98	11.06	8.14	35.87	10.84	9.37	15.69	10.89	9.79	0.00
Total Income	118.68	92.71	28.01	116.12	91.19	27.34	94.20	79.78	18.07	90.44	79.68	13.50
Total Expenditure	91.81	63.63	44.29	88.60	64.95	36.41	69.09	55.15	25.28	64.03	60.14	6.47
PBIDT	26.87	29.08	-7.60	27.52	26.24	4.88	25.11	24.63	1.95	26.41	19.54	35.16
Interest	0.00	0.00	0.00	0.00	0.00	0.00	0.01	0.00	0.00	0.01	0.00	0.00
Depreciation	1.28	1.63	-21.47	1.37	1.63	-15.95	1.43	1.71	-16.37	1.62	1.67	-2.99
PBT	25.59	27.45	-6.78	26.15	24.61	6.26	23.67	22.92	3.27	24.78	17.87	38.67
Total Tax	7.94	8.39	-5.36	8.15	8.29	-1.69	7.48	6.99	0.00	7.36	6.27	0.00
PAT	17.65	19.06	-7.40	18.00	16.32	10.29	16.19	15.93	1.63	17.42	11.60	50.17
EPS	10.47	11.30	-7.40	10.68	9.68	10.29	9.60	9.45	1.63	10.33	6.88	50.17
Equity	16.86	16.86		16.86	16.86		16.86	16.86	0.00	16.86	16.86	0.00
Face Value	10.00	10.00		10.00	10.00		10.00	10.00		10.00	10.00	
PBIDTM (%)	24.90	35.63		26.19	31.60		30.12	34.98		33.20	27.96	
PATM (%)	16.35	23.35		17.13	19.65		19.42	22.62		21.90	16.60	

Note: Standalone Financials

(Source: Capital Line Plus)

Segmental Annual Results Review

On a full year basis, the revenues fell from Rs. 338.02 crs in CY06 to Rs. 320.71 crs in CY07, a fall of 5.12% mainly due to fall in the Chemicals segment, which fell by 31.53%. This fall in turnover was on account of sale of the Life Science and Analytics (excluding Bulk Drugs) Business in April 2006. The Pharmaceuticals division registered a growth of 5.47% y-o-y. This growth was not in line with the industry growth due to over dependence on Vitamins therapeutic segment. There was a fall in the PBIT margins due to fall in performance in the Chemicals division and due to the sale of the life sciences division. The PBIT margins fell from 25.17% in CY06 to 23.42% in CY07. Due to high coverage of vitamin formulations, ML's operations were negatively affected as about 58% of its Pharma products fall under the purview of price control under DPCO.

Particulars	CY05	CY06	% Chg	CY07	% Chg	9M CY08
Revenue from Ops						
Pharmaceuticals	225.82	241.28	6.85	254.47	5.47	240.04
Chemicals	179.96	96.74	-46.24	66.24	-31.53	66.91
Total Revenues	405.78	338.02	-16.70	320.71	-5.12	306.95
PBIT						
Pharmaceuticals	68.25	66.66	-2.33	63.08	-5.37	45.66
Chemicals	38.83	18.43	-52.54	12.03	-34.73	10.08
PBIT	107.08	85.09	-20.54	75.11	-11.73	55.74
%PBIT	26.39	25.17		23.42		18.16

(Source: Capital Line Plus)

Third Quarter Results Update

ML recorded relatively good Q3 CY08 numbers reporting a revenue growth of 32% y-o-y and a sequential growth of 3%. This growth in sales was mainly on the back of higher revenues in Chemicals, which grew at 62% y-o-y and 13% q-o-q growth in revenues and this was well complimented by the Pharma division, which reported a growth of 30% y-o-y and 2.4% sequentially. The Chemicals division did well on account of good growth in the Pigments division and support by the export oriented products like Thiamine Disulfide and Guaiazulene, as the demand increased for these products from abroad. Even exports of Vitamin E intermediate jumped. Rupee depreciation helped in boosting rupee value of realisations. Exports accounted for about 10% of the total revenues of ML. Q3 is generally a good quarter due to monsoon period, but the sales are expected to drop in the last quarter of CY08 due to seasonality factors.

The fall in the other income was mainly because a part of the cash was utilised for capacity expansion of the Oxyne facility. ML was affected by the rise in raw material prices (Vitamin E bulk drug prices increased manifold, other raw material increased in the range of 10-20%) and the Rupee depreciation led to rise in the raw material consumption in rupee terms. However, raw material as a % of Sales reduced. ML has not been able to increase the prices of its products compared to rise in raw materials as most of its products are covered under the DPCO. Addition of staff strength (permanent and contract) over the last few quarters has led to higher sales growth over the past 1-2 quarters.

Margins witnessed severe pressure, due to rupee depreciation and raw material price rise and ML may find it difficult to sustain the operating margins recorded in its previous quarters. The OPMs fell significantly from 35.63% in Q3 CY07 and 26.19% in Q2 CY08 to 24.90% in Q3 CY08. ML recorded a fall in its net profit by 7.4% from Rs. 19.06 crs in Q3 CY07 to Rs. 17.65 crs in Q3 CY08. However expected fall in the raw material prices could cushion a fall in OPM going forward.

Standalone Financials & Projections

Profit & Loss A/c

YE March (Rs. Cr.)	CY05	CY06	CY07	CY08E	CY09E
Net Sales	396.46	329.49	314.83	390.26	437.09
Other Income	18.37	31.22	39.50	43.06	46.93
Total Income	414.83	360.71	354.33	433.32	484.02
Raw Materials	179.71	139.32	126.49	163.91	181.39
Personnel Expenses	31.00	33.93	33.20	50.73	56.82
Other Expenses	79.09	76.81	88.18	115.13	128.94
Total Operating Expenses	289.80	250.06	247.87	329.77	367.16
EBITDA	125.03	110.65	106.46	103.55	116.86
Interest	0.02	0.01	0.01	0.01	0.01
Depreciation	7.75	6.44	6.59	7.03	7.45
Profit Before Tax	117.26	104.20	99.86	96.51	109.40
Total Tax	28.23	36.35	31.04	29.92	33.91
Net Profit After Tax	60.03	133.35	68.82	66.59	75.49

(Source: Capital Line Plus, HDFC Sec Estimates)

Balance Sheet

YE March (Rs. Cr.)	CY05	CY06	CY07	CY08E	CY09E
Share Capital	16.86	16.86	16.86	16.86	16.86
Reserves & Surplus	281.27	376.17	406.04	432.80	468.06
Shareholders Funds	298.13	393.03	422.90	449.66	484.92
Loan Funds	0.00	0.00	0.00	0.00	0.00
Deferred Tax Liability	2.54	4.59	4.80	4.80	4.80
Source of Funds	300.67	397.62	427.70	454.46	489.72
Gross Block	115.22	115.39	116.82	137.85	146.12
Less: Depreciation	72.18	75.43	78.78	85.81	93.26
Net Block	43.04	39.96	38.04	52.04	52.86
Inventories	41.90	35.94	36.29	48.16	56.33
Sundry Debtors	57.29	28.03	31.12	38.49	49.10
Cash & Bank	83.82	106.01	116.91	111.28	124.54
Loans & Advances	14.47	19.28	30.74	29.62	33.61
Total Current Assets	197.48	189.26	215.06	227.54	263.59
Current Liabilities & Provisions	82.22	80.02	61.83	71.72	80.43
Working Capital	115.26	109.24	153.23	155.82	183.16
Application of Funds	300.67	397.62	427.70	454.46	489.72

(Source: Capital Line Plus, HDFC Sec Estimates)

Ratio Analysis

YE March	CY05	CY06	CY07	CY08E	CY09E
EPS (Rs.)	35.60	79.09	40.82	39.50	44.77
PE (x)	8.43	3.80	7.36	7.60	6.71
Book Value (Rs.)	176.83	233.11	250.83	266.70	287.62
P/BV (x)	1.70	1.29	1.20	1.13	1.04
EBIDTA (%)	26.90	24.11	21.27	15.50	16.00
PBT (%)	29.58	31.62	31.72	24.73	25.03
NPM (%)	15.14	40.47	21.86	17.06	17.27
ROCE (%)	39.34	26.51	23.62	21.46	22.56
RONW (%)	20.14	33.93	16.27	14.81	15.57
Debt-Equity	0.00	0.00	0.00	0.00	0.00
Current Ratio	2.40	2.37	3.48	3.17	3.28
Mcap/Sales (x)	1.28	1.54	1.61	1.30	1.16
EV/EBITDA	3.38	3.62	3.66	3.82	3.27

(Source: Capital Line Plus, HDFC Sec Estimates)

Cash Flow Statement

Ye March	CY05	CY06	CY07	CY08E	CY09E
Profit Before Tax	117	104	100	97	109
Net Opt Cash Flow	68	66	38	62	65
Net Cash from Investing Activity	-11	-15	30	-28	-12
Net Cash from Financing Activity	-19	-29	-58	-39	-40
Cash & Cash Equivalents	84	106	117	111	125
Net Inc/(Dec) in Cash	0	22	11	-5	14

(Source: Capital Line Plus, HDFC Sec Estimates)

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