

Shasun Chemicals

STOCK INFO.	BLOOMBERG
BSE SENSEX: 12,367	SSCD IN
	REUTERS CODE
S&P CNX: 3,579	SHAS.BO

27 September 2006

Buy

Previous Recommendation: Buy

Rs86

Equity Shares (m)	48.1
52-Week Range	111/60
1,6,12 Rel. Perf. (%)	-2/-19/-54
M.Cap. (Rs b)	4.1
M.Cap. (US\$ b)	0.1

YEAR	NET SALES*	PAT*	EPS*	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
03/06A	3,578	365	7.6	11.7	11.3	2.3	23.0	19.7	1.4	7.0
03/07E	7,181	5	0.1	N.A.	-	2.0	19.5	17.4	1.3	6.6
03/08E	8,428	448	9.2	N.A.	9.3	1.7	23.2	20.6	1.0	4.9

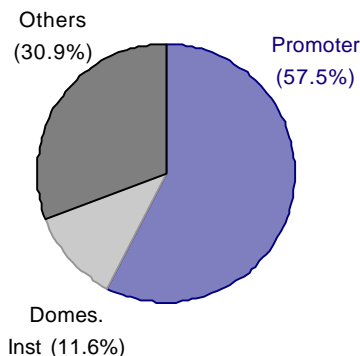
*Consolidated

We visited Shasun's UK facilities (now known as SPSL) which were recently acquired from Rhodia. Following are our key observations:

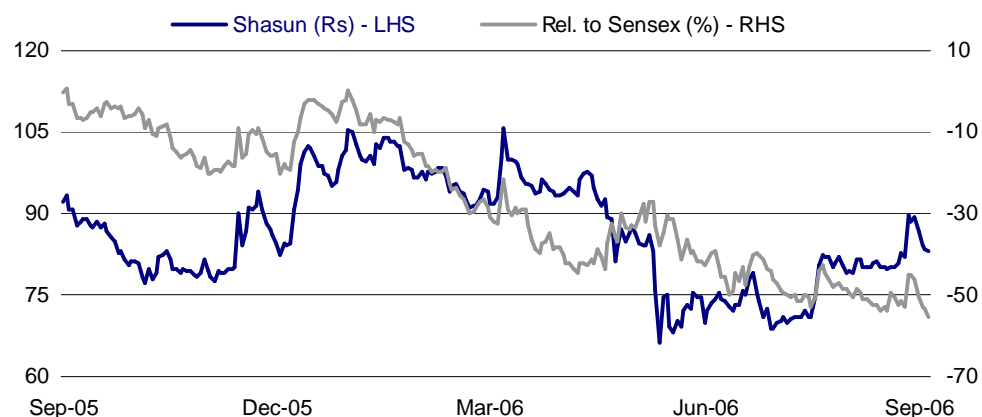
- SPSL has presence across the entire value-chain of the CRAMS segment starting from custom chemical synthesis (CCS) to commercial manufacturing of APIs.
- It also owns certain IPRs related to critical technologies like Hydrolytic Kinetic Resolution, Aromatic Bond Formation and Fluorination which generate revenues for the company in the form of technology licensing income.
- SPSL expects to break-even in FY07 (or even generate a minor profit) led by higher traction in existing CRAMS projects as well as increased contribution from products which progress in the clinical trials.
- We have estimated a loss of EUR6.8m for SPSL in FY07. While the consolidated performance for Shasun will be adversely impacted in FY07, we believe that the acquisition will bring-in long term benefits through increased customer access, presence across the entire value-chain of the CRAMS segment, presence in both Europe (proximity to the customer) as well as in India and the overall increase in pharmaceutical outsourcing in the coming years.

This acquisition would aid transformation of Shasun's operations in favor of CRAMS business. This, along with commercialization of the company's generic's pipeline would result in gradual improvement in EBITDA margins in medium term. However, the consolidated performance for FY07E will be significantly impacted due to the losses of the acquired company. At 9.3x FY08E consolidated EPS, we believe valuations are attractive. Maintain **Buy**.

SHAREHOLDING PATTERN (JUN-06)



STOCK PERFORMANCE (1 YEAR)



Rhodia acquisition - Short-term negative but will bring in long-term benefits

Shasun has recently acquired the pharmaceutical customs synthesis business of Rhodia Pharma Solutions (SPSL), UK.

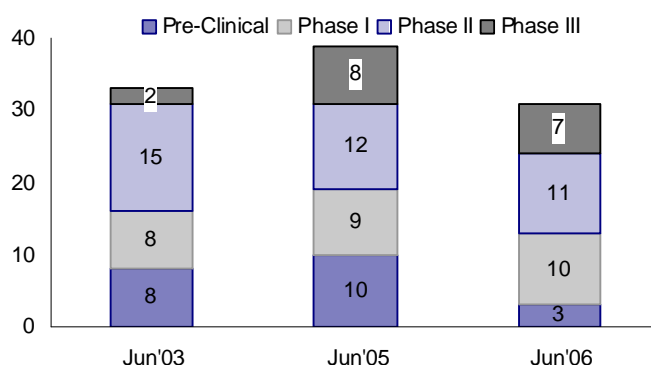
Key highlights of the acquisition are:

- ✎ Shasun acquires the assets of Rhodia's development and custom manufacturing services, catering to innovator MNCs and other pharmaceutical clients in US, Europe and Asia. This was a part of Rhodia's pharmaceutical business.
- ✎ The acquisition includes manufacturing sites at Dudley and Annan located in the UK. The transaction excludes transfer of debt or any other liabilities, including any pension liabilities, for event prior to the completion date. SPSL had revenues of Eur 60m in CY05 and had operating loss of Eur 9m. Shasun would retain existing management along with 349 employees.
- ✎ Shasun would be investing around US\$35m in SPSL, including purchase consideration, working capital requirement and enhancing capabilities. Also, Shasun is currently setting up an API facility at Vizag at capex of Rs1b. Of investment of US\$35m for SPSL, Shasun would be making equity investment of around US\$10m in SPS and balance US\$25m would be in form of debt.
- ✎ Shasun would fund the acquisition as well as the capex through debt and equity (if required). Hence, we do not rule out a minor equity dilution.
- ✎ SPSL has a pipeline of 14 products in Phase II(B) and Phase III, with around 10 products already commercialized. This acquisition gives Shasun access to critical patented technologies like Hydrolytic Kinetic Resolution (HKR), Aromatic Bond Formation (ABF) and Radical Trifluoromethylation. Shasun's CCS pipeline gets strengthened because of this acquisition.
- ✎ Also, this acquisition brings in customer base which primarily consists of emerging pharma companies.
- ✎ SPSL has been making loss at operating level as it had only around 10 products commercialized and was operating at around 50% capacity utilization. Shasun is hopeful of turning around SPSL in next 24 months by improving capacity utilization as 14 products are in late stage of development. The company is hopeful of achieving 10-15% growth in revenues of SPSL and

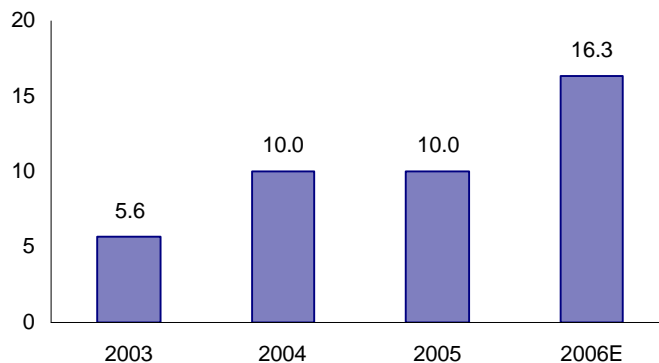
marginal savings in cost arising out of sourcing some raw material from India. We believe that top-line growth is critical to SPSL turnaround.

SPSL has presence across the CRAMS segment (CCS to commercial manufacturing).

CCS PIPELINE



TREND IN CCS REVENUES (GBP M)



Source: Company/ Motilal Oswal Securities

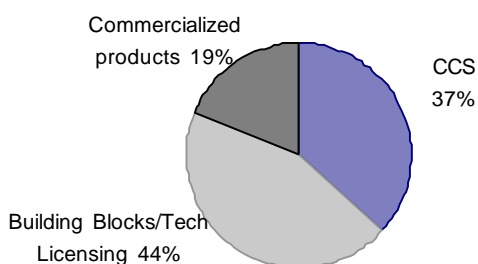
Commercialized pipeline

The company is a preferred supplier for 4 of the top 5 pharmaceutical companies and supplies to 18 of the top 20 companies globally. SPSL has indicated significant traction in this segment with revenues expected to touch GBP14m in 2006E as compared to GBP7m in 2005. This growth will be driven by progression of some products through the clinical development pipeline.

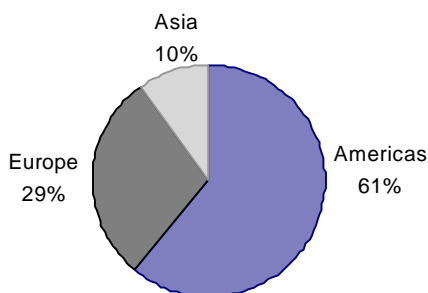
SPSL owns certain IPRs (53 patents) related to Chiral Synthesis, Fluorination and Aromatic Bond Formation.

These IPRs earned GBP3.8m in revenues for the company in 2005 which is expected to touch about GBP5m in 2006E. The company has tied up with a lead optimization company to provide libraries related to SPSL's IPRs to the latter's clients. SPSL 2005 sales (GBP36.7m) breakup is as under:

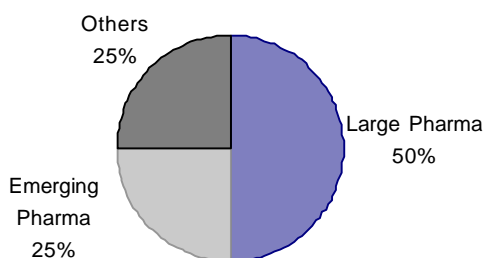
SEGMENT MIX (CY05)



MARKET MIX (CY05)



CLIENT PROFILE (CY05)



Source: Company/ Motilal Oswal Securities

SPSL is looking at a small-sized acquisition in the US to gain proximity to its US clients and is also evaluating opportunities in the clinical trials and formulations outsourcing.

The management has indicated that while it does not expect to dilute equity capital for its current capex and the UK acquisition, it may dilute equity over a period of time to fund its other future initiatives.

Short-term adverse impact; positive in long-term

We believe that Shasun may not be able to immediately transfer the SPSL manufacturing to India, given some of the critical technologies involved and hence the acquired business would drag down the consolidated earnings in the short-term. On consolidation with SPSL (and factoring in the increased funding requirements), we expect EPS in FY07E to decline to just Re0.1 as against stand-alone EPS of Rs7.8.

For FY08E EPS is expected to decline to Rs9.2 on consolidation from stand-alone EPS of Rs10.9. However, this acquisition would aid transformation of Shasun's operations in favor of CRAMS business. Through the SPSL acquisition, it gets access to new MNC clients and strengthens its CCS pipeline. This, along with commercialization of the company's generics pipeline would result in gradual improvement in EBITDA margins in medium term. At 9.3x FY08E consolidated EPS, we believe valuations are reasonable. **Maintain Buy.**

Shasun Chemicals: an investment profile

Company description

Shasun has been focusing on the partnership model for all the segments of its operations. It has existing relationships with innovator pharmaceutical companies like GSK, Eli Lilly and Reliant Pharma, which augur well for future outsourcing opportunities. Shasun has leveraged its strength in manufacturing and relationships with global majors to position itself as a 'partner of choice' for innovator companies across the product life cycle and value chain.

Key investment arguments

- Business to undergo a gradual transformation led by higher revenues from CRAMS and generics resulting in EBITDA margin expansion over the next 2-3 years
- Likely beneficiary of the increased pharmaceutical outsourcing from India
- Existing relationships with MNCs and a partnership approach to augur well for the company

Key investment risks

- Execution risks in CRAMS business
- Delay in turn-around of Rhodia's custom manufacturing business may stretch the company's financials
- Funding of acquisitions and future capex may lead to equity dilution

Valuation and view

- Has existing relationships with innovators like GSK and Eli Lilly which can be leveraged for more outsourcing contracts in the future
- Partnerships with Actavis and Glenmark in the generics space to start contributing incrementally from FY07E onwards
- At 9.3x FY08E consolidated EPS, we believe valuations are reasonable. Maintain **Buy**.

Sector view

- Very few players from India are adequately prepared for exploiting the huge outsourcing opportunity
- Expect a time-lag of about 18-24 months between signing of contracts and actual commencement of revenues
- We are overweight on companies that are towards the end of the investment phase

COMPARATIVE VALUATIONS

		SHASUN	DIVI'S LABS	JUBILANT
P/E (x)	FY07E	-	26.5	17.8
	FY08E	9.3	21.9	13.2
P/BV (x)	FY07E	2.0	6.5	2.6
	FY08E	1.7	5.2	2.1
EV/Sales (x)	FY07E	1.3	4.5	1.8
	FY08E	1.0	4.1	1.4
EV/EBITDA (x)	FY07E	6.6	17.1	9.9
	FY08E	4.9	14.7	7.1

SHAREHOLDING PATTERN (%)

	JUN.06	MAR.06	JUN.05
Promoter	57.5	42.3	40.9
Domestic Inst	11.6	14.1	15.4
Foreign	0.0	13.8	16.9
Others	30.9	29.8	26.8

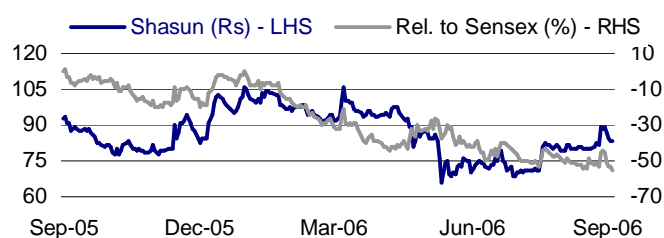
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	0.1	6.7	-
FY08	9.2	9.7	-5.2

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
86	100	17.0	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Net Sales	2,676	3,271	3,578	4,044	4,820
Net Sales (incl RPS)	2,676	3,271	3,578	7,181	8,428
Change (%)	12.7	22.2	9.4	13.0	19.2
Total Expenditure	2,154	2,587	2,880	3,248	3,817
% of Sales	80.5	79.1	80.5	80.3	79.2
EBITDA	522	684	698	796	1,003
Margin (%)	19.5	20.9	19.5	19.7	20.8
Depreciation	169	216	231	287	315
Int. and Finance Charges	51	34	49	64	70
Other Income - Rec.	14	8	13	12	15
PBT	316	443	431	457	633
Current Tax	56	70	63	59	70
Deferred Tax	22	62	3	23	41
Tax Rate (%)	24.6	29.9	15.2	13.0	17.5
PAT Adj for EO Items	238	310	365	375	522
Change (%)	47.7	30.2	17.7	2.6	39.3
Margin (%)	8.9	9.5	10.2	9.3	10.8
Add: Share of RPS profits	0	0	0	-370	-80
Net Profit (incl RPS)	238	310	365	5	441

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Equity Share Capital	91	91	96	96	96
Total Reserves	1,047	1,296	1,703	1,957	2,342
Net Worth	1,139	1,387	1,799	2,053	2,438
Deferred Liabilities	143	205	208	231	272
Total Loans	557	893	795	1,345	995
Capital Employed	1,838	2,485	2,802	3,630	3,706
Gross Block	2,085	2,517	2,914	3,464	3,864
Less: Accum. Deprn.	762	952	1,166	1,453	1,768
Net Fixed Assets	1,323	1,565	1,747	2,010	2,095
Capital WIP	39	170	22	300	150
Total Investments	2	2	59	445	445
Curr. Assets, Loans an	1,159	1,496	1,706	1,719	2,010
Inventory	459	471	450	555	652
Account Receivables	537	652	918	752	893
Cash and Bank Balance	27	150	50	204	218
Loans and Advances	135	222	288	208	247
Curr. Liability & Prov.	693	749	733	845	995
Account Payables	464	470	421	476	567
Other Current Liabilities	156	174	204	218	257
Provisions	73	104	108	151	171
Net Current Assets	466	747	973	874	1,015
Misc Expenditure	10	3	1	1	1
Appl. of Funds	1,838	2,486	2,802	3,630	3,706

E: M OSt Estimates; SPS=Shasun Pharma SolutionsUK

RATIOS					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Basic (Rs)					
EPS	5.2	6.8	7.6	0.1	9.2
Cash EPS	8.9	11.5	12.4	6.1	15.7
BV/Share	24.7	30.3	37.4	42.7	50.7
DPS	1.2	1.5	1.7	2.2	2.5
Payout (%)	24.4	25.3	25.5	32.2	26.3
Valuation (x)					
P/E		12.6	11.3	-	9.3
Cash P/E		7.4	6.9	14.1	5.4
P/BV		2.8	2.3	2.0	1.7
EV/Sales		1.5	1.4	1.3	1.0
EV/EBITDA		7.1	7.0	6.6	4.9
Dividend Yield (%)		18	2.0	2.6	2.9
Return Ratios (%)					
RoE	25.7	24.7	23.0	19.5	23.2
RoCE	24.0	24.0	19.7	17.4	20.6
Working Capital Ratios					
Debtor (Days)	71	71	91	66	66
Creditor (Days)	122	103	87	87	89
Inventory (Days)	63	53	46	50	49
Working Capital Turnover (L	60	67	94	61	60
Leverage Ratio (x)					
Debt/Equity	0.5	0.6	0.4	0.7	0.4

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Oper. Profit/(Loss) before T	522	684	698	796	1,003
Interest/Dividends Recd.	14	8	13	12	15
Direct Taxes Paid	-56	-70	-63	-59	-70
(Inc)/Dec in WC	-40	-159	-326	253	-127
CF from Operations	441	464	323	1,002	822
(Inc)/Dec in FA	-447	-589	-266	-828	-250
CF from Investments	-447	-589	-323	-1,214	-250
Issue of Shares	225	23	142	0	0
(Inc)/Dec in Debt	-101	336	-98	551	-350
Interest Paid	-51	-34	-49	-64	-70
Dividend Paid	-58	-78	-93	-121	-137
CF from Fin. Activity	15	247	-99	366	-557
Inc/Dec of Cash	9	122	-99	154	14
Add: Beginning Balance	18	27	150	50	204
Closing Balance	27	149	50	204	218



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Disclosure of Interest Statement	Shasun Chemicals
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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