

Initiating Coverage

Opto Circuits India (OPTCIR)

A growth monitor ...

Opto Circuits India Ltd (OCIL), a leading player in the non-invasive (non-surgical) sensor segment, plans to grow through the organic and inorganic route, and enhance its presence in the international market. It forayed into the invasive segment (surgical) through the acquisition of EuroCor GmbH, Germany, in 2006. We believe the growth momentum would continue on the back of its strong global distribution network, expanded product portfolio and outsourcing opportunities. We expect a 30.6% CAGR in revenues to Rs 449.7 crore over FY07-010E, and a 26.6% CAGR in bottom-line to Rs 146.4 crore. EPS on an expanded post-bonus equity would grow from Rs 7.7 in FY07 to Rs 15.5 in FY10E. We rate the stock a **PERFORMER** with a target price of Rs 489 over a 12-month timeframe.

▪ **Core business provides immense growth opportunities**

OCIL's core business of SpO2 (sensor oxy probe) and patient-monitoring systems would be the key drivers for future growth. The US FDA has given its approval for SpO2 sensors. Further, the expiry of the patent for pulse oximetry technology offered by Nellcor, the leading manufacturer of SpO2 in the US, has opened the huge US market for OCIL. The US accounts for 70% of the over \$540 million market for SpO2 sensors, and OCIL is targeting a 10% market share in the coming years from the existing 4-5%.

▪ **Acquisitions: A growth ladder**

The company's acquisition strategy has helped it widen its product portfolio and also enhance its presence in various geographies. The recently acquired EuroCOR posted revenues of Rs 48.6 crore in last financial year, and is likely to double in the current year. OCIL also recently acquired two more companies manufacturing catheters, stone graspers and dilator sets used in urology, gastroenterology and gynaecology, which would expand its product portfolio and boost revenue.

Valuation

Opto Circuit is on acquisition spree and set to grow at a robust growth rate. We have valued the company on sum of part basis, giving 30 PE multiple to its core business, at Rs 464. AMDL is a listed entity and discounting the same by 20%, we arrive at value per share of Rs 2.8. EuroCor is rapidly growing business and we have valued its business on 1.5x sales to arrive at value of Rs 22. We initiate coverage on the company with a **PERFORMER** rating and target price of Rs 489.

Exhibit 1: Key Financials

Year to March 31	FY06	FY07	FY08E	FY09E	FY10E
Net Profit (Rs crore)	35.0	72.7	94.5	119.0	146.4
Shares in issue (crore)	2.7	6.2	9.5	9.5	9.5
Adj. EPS (Rs)	3.7	7.7	10.0	12.6	15.5
Growth (%)	82.8	107.7	29.9	26.0	23.0
P/E (x)	120.0	57.8	44.5	35.3	28.7
Price/Book (x)	16.3	13.0	12.1	9.8	7.8
EV/EBIDTA (x)	110.1	54.1	41.1	32.8	26.7
EBITDA Margin (%)	32.9	38.5	36.7	35.8	35.0
RoNW (%)	37.7	40.0	30.6	28.2	28.2
RoCE (%)	55.5	51.2	33.8	30.6	30.3

Current price Rs 444	Target price Rs 489
Potential upside 10%	Time Frame 12 months

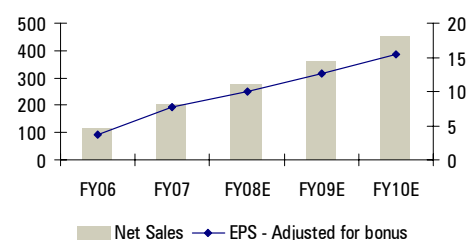
PERFORMER

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Sales & EPS trend



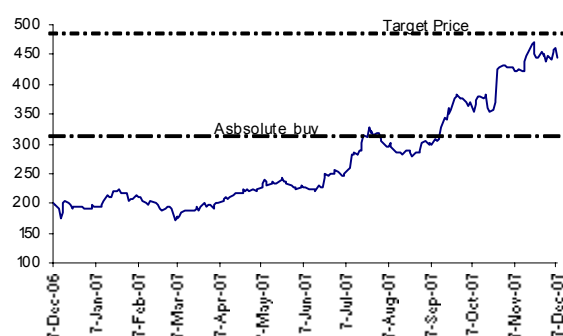
Stock metrics

Promoters Holding	30.4(%)
Market Cap	4,170 crore
52 Week H/L	480 / 167
Sensex	19,147
Average Volume	59,593

Comparative return metrics

	3M	6M	12M
Opto Circuit	13.7	80	108.2

Price Trend



Company Background

Opto Circuit is engaged in the design, development and manufacturing of devices that are employing light to sense and detect, medical monitoring products and the distribution thereof.

It has emerged as a leading player in non-invasive sensor segment. Its product portfolio includes digital thermometers, sensors, probes, pulse oxymeters, and patient-monitoring systems. The company derives 95% of its revenues from the overseas market. Out of this 70% comes from OEMs (original equipment manufacturers).

The company acquired the patient-monitoring division of Palco Labs, US, in 2003, and renamed it Mediaid Inc. Mediaid is a 100% subsidiary and OCIL's uses its (Mediaid) strong distribution network spread across the US, Latin America and Europe to market its brands.

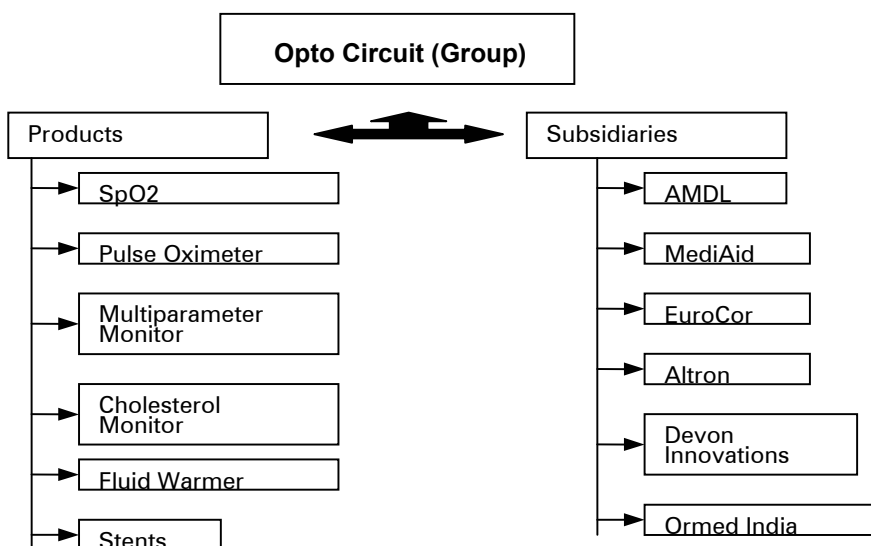
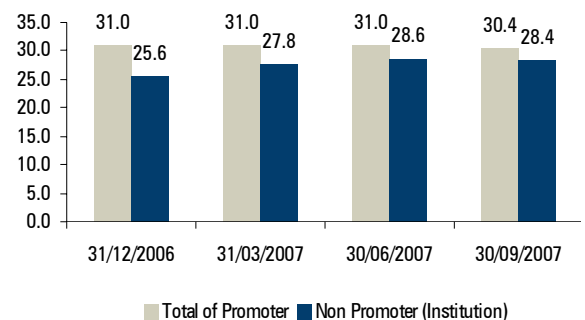
In India, OCIL's products are marketed by Bangalore-based Advanced Micronic Devices Ltd (AMD L), a listed company. OCIL acquired a 59.7% stake AMDL in 2001. Including AMDL's distribution network, OCIL currently has nationwide network of 15 sales offices and more than 260 stockists and distributors. OCIL plans to leverage AMDL's strong distribution network to boost domestic revenues.

Opto Circuit acquired a German based stents manufacturing company EuroCor making a foray into invasive segment in 2006. It recently acquired two more new companies – Ormed Midical Technology and Devon Innovations Pvt Ltd, enhancing its product portfolio to catheters, stone graspers and dilator

Share holding pattern (30/09/2007)

	Shareholding (%)
Promoters	30.4%
Institutional Investors	28.4%
Other Investors	20.3%
General Public	21.1%

Promoter & Institutional holding trend



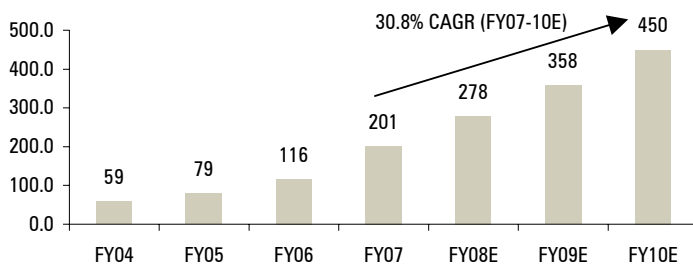
INVESTMENT RATIONALE

Core business provides immense growth opportunities

OCIL's core business of SpO₂ (sensor oxy probe) sensors and monitoring systems would be the key driver for its future growth. The US FDA has approved SpO₂ sensors manufactured by OCIL. Further, the patent for pulse oximetry technology offered by Nellcor, the leading manufacturer of SpO₂ in the US, has expired. This will open up the huge US market for OCIL. The US accounts for 70% of the over \$540 million global market, and OCIL is targeting a 10% market share in coming years from the existing 4-5%.

For OCIL as a group, non-invasive equipment account for around 75% of its total product portfolio. We expect revenues from this segment to witness a robust 30% CAGR over FY07-10E. New product launches, and strong network from its subsidiaries, AMDL (domestic arm) and MediAid (US), would help distribute the products under various segments.

Exhibit 2: Robust sales growth from core business (Rs crore)



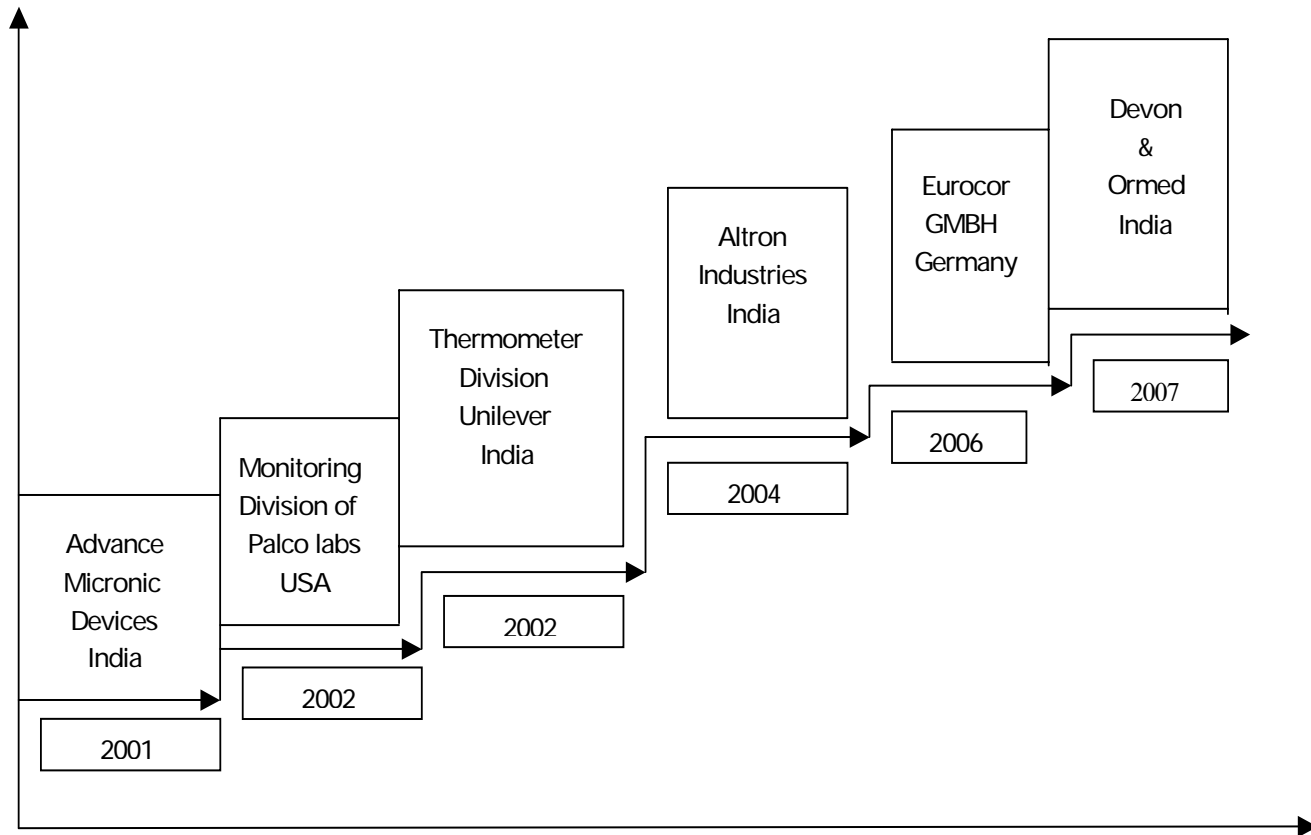
Patient monitoring business growing at robust growth rate

Source: ICICIdirect Research

Acquisitions: A growth ladder

ICIL's growth strategy has been to acquire companies to widen its product portfolio and enhance its presence in different geographies. This has been complemented by the launch of innovative products, and focus on R&D (research and development) in its core business segment.

Exhibit: 3: Timeline of acquisitions



Source: Company

AMDL: The acquisition of AMDL brought the digital thermometer into OCIL's product kitty. It also gave OCIL access to AMDL's domestic distribution network. OCIL currently has nationwide network of 15 sales offices and more than 260 stockiest and distributors (including AMDL's distribution network).

Palco Labs: In 2002, OCIL acquired the monitoring division of Palco Labs, US. Palco was converted into a 100% subsidiary and renamed MediAid Inc. Mediaid Inc has a worldwide distribution network having presence in the US, Latin America and Europe. OCIL's FDA approved products are sold through Mediaid in the US.

Recent acquisitions

EuroCor GmbH: In 2006, OCIL acquired EuroCor GmbH, a Germany-based stent-manufacturing, which gave it an entry into the invasive segment. The total current global market size of stents is the US\$12 billion (Rs 468 billion). The US is largest market for stents accounting for 50%, followed by Europe with a size of US \$ 3 billion. This acquisition is expected to help OCIL tap these markets and boost revenues.

Acquisition a key strategy to expand product portfolio

a. Widening product portfolio to invasive segment

EuroCor specialises in the research, development and manufacture of interventional cardiology products, mainly stents. Stents are of two types – bare metal stents (BMS) and drug eluting stents (DES). DES significantly reduces the risks of recurring blockages in arteries of diabetic patients as compared to BMS, which has made them more preferable. **EuroCor** has 8 products offerings, which would be key growth drivers going forward.

b. Leveraging on EuroCor’s presence in European markets

EuroCor has CE Mark approval for stent, which enables it market DES in 25 countries in the European Union (EU) as well as in the Middle East, Latin America and Asia. EuroCor has a presence in 32 countries. The CE Mark approval would not only help EuroCor sell stents, but also its products in these countries. (Though the US is the single largest market for stents, OCIL cannot sell stents in the US, as it does not have US FDA approval. The process for receiving approval is likely to take another 2-3 years.)

c. Pricing strategy to garner market share

The major players in the stents market are Johnson & Johnson, Boston Scientific, Guidant, and Medtronic. These companies sell their products in the price range of \$2,200-\$3,500 per stent. EuroCor currently has a miniscule market share. By pricing its products comparatively cheaper than its competitors, OCIL hopes to garner a larger market share in the coming years. Its strategy would be volume growth. Further, EuroCor is focusing on continuous innovations to introduce new coronary stent technology. OCIL is planning to invest 20 million Euros in EuroCor’s R&D efforts, which would enable the latter introduce new innovative cardiac products, and enhance OCIL’s product portfolio.

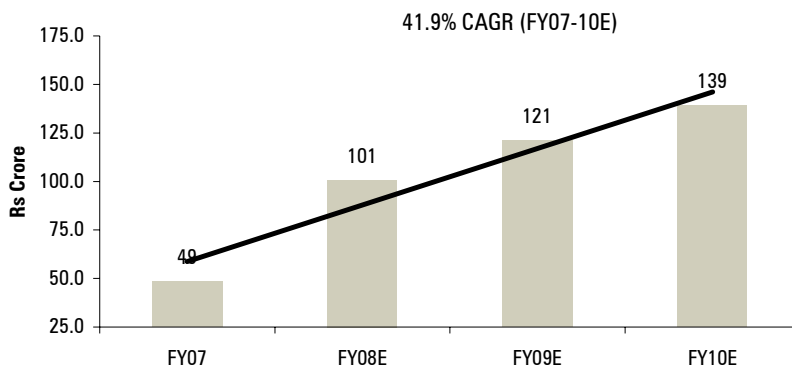
d. Revenues to grow exponentially

The world figure for stent implants stand at approximately 4 million currently (70% are DES, and 30% BMS). The restenosis rates are 10% and 30% on drug eluting and bare metal stents, respectively. EuroCor expects 856,000 balloon catheters to be used on these patients, which approximately translates into a revenue stream worth US\$1.20 billion. With the only CE accreditation in place, EuroCor is well poised for a massive market share in this product category.

With the only CE accreditation in place, EuroCOR is well poised for a massive market share

We project revenues from stent business to rise at a CAGR of 41.9% over FY07-10E to Rs 139.1 crore from Rs 48.6 crore. EurCOR is however working on very low net profit margin and likely to earn profit of Rs 3 crore from Rs 0.7 crore, though rising at exponential rate of 62.5%. For the initial few years, EurCOR should be considered only from product portfolio enhancement perspective and not from profit-booster perspective. Once its products are well placed and garner a comfortable market share, we believe its bottom-line should start improving.

Exhibit 4: Stents’ sales to rise at excellent rate



Source: ICICIdirect Research

Devon Innovations Pvt Ltd (acquired in 2007) manufactures catheters and allied products for various medical segments. **Ormed Medical Technology Ltd** (also acquired in 2007) deals in orthopedic prosthesis and surgical disposables. These acquisitions would add products like catheters, stone graspers, and stone baskets, dilator sets for different specialized applications mainly in the areas of urology, gastroenterology and gynecology. This would help penetrate domestic as well as international market.

OCIL has used acquisitions as a growth strategy and it is currently mulling the takeover of two more companies in the US. These would result in expanding its product portfolio and increasing its foothold in the US market.

Strong distribution channel – a positive

OCIL has strong distribution network through its subsidiaries. AMDL takes care of domestic marketing. Mediaid Inc has worldwide distribution network, even though its major presence is in the US. EuroCor is present in 35 countries through dedicated distributors. These would help company to sell its products worldwide and currently it receives around 90% of its revenues from exports.

The market potential stated by company to garner higher market share in various categories is given below.

Exhibit 5: Market potential of various products

<u>Products</u>	<u>Market size</u>
Patient monitors	\$ 520 million
Sensors	\$ 540 million
Cardiac and peripheral	\$ 4 billion

Source: Company

Other developments

The company has decided to develop a specialized facility for health care industry and has received a formal approval from the Central government to set up a SEZ (special economic zone).

FINANCIALS

OCIL reported a steady performance in the past. The company reported net sales of Rs 201.6 crore and net profit of Rs 72.2 crore in FY07, registering robust growth of 73.8% and 107.7% respectively.

Going forward, we expect standalone revenues to increase at a CAGR of 30.6% to Rs 449.7 crore over FY-07-10E, and net profit at a CAGR of 26.2% to Rs 146.4 crore.

We expect EBITDA margins to be at around 35%. They will decline from 38.5% due to the increasing kitty of various products, which are sold at different EBITDA margins.

In the recent past, the company has continuously rewarded shareholders with bonus issues and currently its equity is diluted to Rs 94.7 crore. The return ratios continue to remain robust. We expect, RoCE to be at 28.1% and RoE at 30.2% in FY10.

We are not including the consolidated financial statements for the company. MediAid Inc, is basically a US-based marketing arm of the OCIL with sales revenues of Rs 45.8 crore and net profit of Rs 0.10 crore. Altron Industries is also small company with net sales of Rs 0.14 crore. We have projected revenue growth for core business, AMDL and EuroCor, which has been tabulated in the table given below.

Exhibit 6: Performance highlights (Opto as a group)

	FY06	FY07	FY08E	FY09E	FY10E
Net sales					
Stand alone	116.0	201.6	278.2	358.3	449.7
Consolidated	168.5	299.8	429.0	534.3	648.8
EBITDA					
Stand alone	38.2	77.6	102.2	128.4	157.2
Consolidated	44.3	136.0	213.6	262.5	311.2
EBITDA Margins (%)					
Stand alone	32.9	38.5	36.7	35.8	35.0
Consolidated	26.3	45.4	49.8	49.1	48.0
Net Profit					
Stand alone	35.0	72.7	94.5	119.0	146.4
Consolidated	37.2	102.1	177.6	224.2	271.2
Equity	26.8	61.6	94.7	94.7	94.7
EPS					
Standalone basis	3.7	7.7	10.0	12.6	15.5
Consolidated basis	3.9	10.8	18.8	23.7	28.6

EBITDA margins to remain robust

Source: ICICIdirect Research

VALUATION

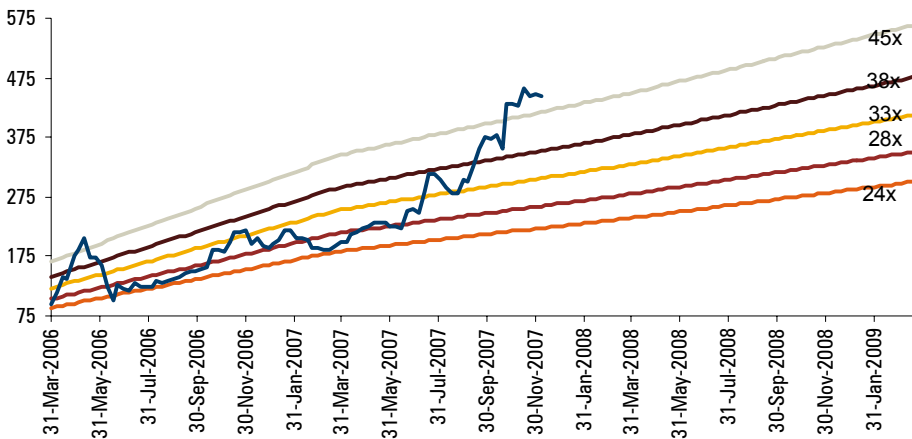
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Exhibit 7: Sum of parts valuations

	Parameter	Basis	% Stake	Multiple	Value
Opto Circuit	FY10E EPS	15.5	-	30	463.7
AMDL	Market price	44.9	59.7%	20% discount to market price	2.8
EuroCor	Market cap. to sales	208.7	100%	1.5x	22.0
Total value per share (Rs)					488.5
CMP (Rs)					444.0
Potential upside (Rs)					44.5
Potential upside (%)					10.0

Source: ICICIdirect Research

Exhibit 8 : PE band



Source: ICICIdirect Research

FINANCIAL SUMMARY

Profit & Loss statement

(Rs Crore)

Rs Crore	FY06	FY07	FY08E	FY09E	FY10E
Net Sales	116.0	201.6	278.2	358.3	449.7
% Growth	46.6	73.8	37.9	28.8	25.5
Raw Material	67.2	107.0	153.0	201.7	258.3
Staff	2.9	4.2	5.6	7.2	9.0
Operational exp	2.4	2.7	4.0	5.0	6.1
Selling & Admin	5.4	10.1	13.4	16.1	19.1
Total Expenditure	77.9	124.0	176.0	230.0	292.5
EBITDA	38.2	77.6	102.2	128.4	157.2
% Growth	71.4	103.4	31.6	25.6	22.5
EBITDA margin (%)	32.9	38.5	36.7	35.8	35.0
Other income	1.2	2.7	0.4	0.4	0.4
Interest	3.0	5.0	4.9	6.2	6.7
Gross Profit	36.4	75.3	97.6	122.6	150.9
% Growth	75.4	107.0	29.6	25.5	23.1
Depreciation	1.2	1.6	1.9	2.0	2.5
Profit Before Tax	35.2	73.7	95.7	120.6	148.4
% Growth	80.7	109.6	29.8	26.0	23.1
Tax	0.1	1.0	1.2	1.6	2.1
Net Profit	35.0	72.7	94.5	119.0	146.4
% Growth	82.8	107.7	29.9	26.0	23.0

Sales to rise at a CAGR of 30.6%

Net profit to rise at a CAGR of

Balance sheet

(Rs crore)

	FY06	FY07	FY08E	FY09E	FY10E
Equity	26.8	61.6	94.7	94.7	94.7
Reserves	47.5	149.6	254.3	335.5	443.8
Net worth	72.9	211.0	349.0	430.2	538.5
Short-term Loans	1.5	0.2	0.2	0.2	0.2
Long-term Loans	58.0	49.0	49.0	74.0	59.0
Total Loans	59.4	49.3	49.3	74.3	59.3
Total liabilities	132.3	260.3	398.3	504.5	597.8
Gross Block	26.0	38.5	39.3	39.3	59.3
Depreciation	6.0	7.5	9.4	11.4	13.9
Net Block	20.1	31.0	29.9	27.9	45.4
Capital work-in-progress	0.0	0.3	0.0	0.0	0.0
Long-term Investments	34.4	37.6	99.6	149.6	149.6
Inventories	22.5	48.1	68.8	84.9	112.3
Debtors	74.1	128.9	171.5	216.0	264.9
Cash	2.2	30.6	14.1	13.1	15.9
Liquid Investments	5.2	5.2	5.2	5.2	5.2
Loans & Advances	4.5	38.6	38.1	44.2	49.3
Total Current assets	108.5	251.5	297.7	363.5	447.6
Creditors	15.8	21.2	28.9	36.5	44.9
Other current liabilities	14.9	38.9	0.0	0.0	0.0
Total current liabilities	30.6	60.1	28.9	36.5	44.9
Net current assets	77.8	191.3	268.8	326.9	402.7
Total assets	132.3	260.3	398.3	504.5	597.8

Cashflow statement
(Rs crore)

	FY06	FY07	FY08E	FY09E	FY10E
EBIT	38.1	76.0	61.5	126.4	154.7
(Inc.)/Dec in working capital	-40.5	-109.2	-55.1	-59.1	-73.0
Cash flow from operations	-2.4	-33.2	6.5	67.3	81.7
Other income	0.4	2.7	0.4	0.4	0.4
Depreciation	1.2	1.6	1.9	2.0	2.5
Interest paid (-)	-3.0	-5.0	-4.9	-6.2	-6.7
Tax paid (-)	-0.1	-1.6	-1.2	-1.6	-2.1
Dividends paid (-)	-6.2	-12.2	-38.2	-37.8	-38.1
Net cash from operations	-10.1	-47.7	-35.5	24.1	37.8
Capital Expenditure (-)	-1.6	-12.8	-0.5	0.0	-20.0
Net cash after capex	-11.7	-60.4	-36.0	24.1	17.8
Inc./(Dec.) in short-term borrowing	19.5	16.5	0.0	0.0	0.0
Inc./(dec.) in long-term borrowing	24.0	-26.7	0.0	25.0	-15.0
Inc./(dec.) in borrowings	43.5	-10.2	0.0	25.0	-15.0
Inc./(Dec.) in Investments	-29.9	-3.2	-62.0	-50.0	0.0
Inc./(Dec.) in Preference Capital	0.0	0.0	0.0	0.0	0.0
Equity issue/(Buyback)	-1.4	102.2	81.5	0.0	0.0
Cash from Financial Activities	12.3	88.8	19.5	-25.0	-15.0
Opening cash	2.3	2.2	30.6	14.1	13.1
Closing cash	2.2	30.6	14.1	13.1	15.9
Change in Cash	-0.06	28.3	-16.5	-0.9	2.8

Ratios

Year to March 31	FY06	FY07	FY08E	FY09E	FY10E
EPS (Rs)	3.7	7.7	10.0	12.6	15.5
Growth (%)	82.8	107.7	29.9	26.0	23.0
P/E (x)	120.0	57.8	44.5	35.3	28.7
Price/Book (x)	16.3	13.0	12.1	9.8	7.8
EV/EBIDTA (x)	110.1	54.1	41.1	32.8	26.7
EBITDA Margin (%)	32.9	38.5	36.7	35.8	35.0
RoNW (%)	37.7	40.0	30.6	28.2	28.2
RoCE (%)	55.5	51.2	33.8	30.6	30.3

Robust return ratios

ANNEXURE

FDA approval: Any product, which enjoys FDA approval, signifies that it is safe to use and fit to be exported to the US market. FDA approval involves two steps: approval to market and approval to sell. Some of the SpO2 sensors under OCI's subsidiaries have FDA clearance. The company is geared up to obtain FDA for its products as and when required.

CE approval: The European Commission refers to the CE Marking of products as a "passport" which can allow a manufacturer to freely circulate their products within the European marketplace. The marking applies only to products regulated by the European Commissions health, safety and environmental protection legislation (product directives). Since a very important part of OCIL's business is in the European Union (EU) member states - Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxemburg, the Netherlands, Portugal, Spain, Sweden and United Kingdom, CE marking is helpful in exporting goods there.

Product portfolio of Opto Circuit as a group

1. **SpO2 (reusable and disposable):** A customized interface circuitry to link overall patient monitoring system for checking the percentage of saturated oxygen in the blood and pulse rate
2. **Pulse Oximeter:** A pulse oximeter is a patient monitoring system, which provides continuous confirmation that the delivery of oxygen to the tissues is adequate. It is used to measure the level of oxygen saturation in the blood, the pulse rate. These are used in operation theatres as well as intensive care units.
3. **Multiparameter Monitor:** These systems are used for monitoring the patient's vital signs such as ECG, blood pressure, temperature and oxygen level saturations. Multi Parameter Monitors are used in intensive care units and specialty clinics. These are now enhanced with added features like connectivity to the network & battery back up, which puts it in the league of international brands.
4. **Digital Thermometer:** It is a microprocessor chip and thermistor for enabling quick and accurate measurement of body temperature.
5. **Cholesterol Monitor:** It is a portable battery operated instrument, which uses an invasive method of measuring the total cholesterol in the blood. It displays the cholesterol level through an LCD panel. The unit also undertakes health risk analysis based on the cholesterol value to indicate heart attack and cardiac arrest risk for various ages.
6. **Fluid Warmer:** These are used during surgeries and blood transfusions as it helps in maintaining the temperature of the blood at 37 degree centigrade for smooth flow. It is particularly necessary in cold climates, where blood becomes thicker with much lower temperature compared to the body resulting in thermal shocks.
7. **Genius MegaFlex coronary stent:** It is a low restenosis coronary stent technology, which provides long-term patient result. As per the multi study results, the restenosis rate is only 11% -13%.
8. **TaxCor coronary stent:** It is clinically advanced drug eluting coronary stenting technology. TaxCor provides the clinically safest and most efficient release of Paclitaxel to the stented lesion and into the injured coronary artery. Paclitaxel is a clinically proven anti-restenosis agent.
9. **Supercross:** This modern coronary dilatation catheter is a PTCA balloon. Its outstanding lesion cross and re-cross and superior trackability tortuous coronary arteries which is helpful to cardiologist in most demanding clinical situations.

RATING RATIONALE

ICICIDirect endeavours to provide objective opinions and recommendations. ICICIdirect assigns ratings to its stocks according to their notional target price vs current market price and then categorises them as Outperformer, Performer, Hold, and Underperformer. The performance horizon is 2 years unless specified and the notional target price is defined as the analysts' valuation for a stock.

Outperformer: 20% or more;

Performer: Between 10% and 20%;

Hold: \pm 10% return;

Underperformer: -10% or more.

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