

August 13, 2010

Piramal Healthcare (NICPIR)

Rs 480

WHAT'S CHANGED...

PRICE TARGET Changed from Rs 530 to Rs 526
 EPS (FY11E) Changed from Rs 26.0 to Rs 23.9
 EPS (FY12E) Changed from 30.9 to Rs 29.8
 RATING..... Changed from Buy to Add

CRAMS still a major drag...

Piramal Healthcare's (PHIL) Q1FY11 results were very much off the line mainly on account of dismal pharma solutions (CRAMS) performance and subdued growth in the outgoing healthcare solutions business. Net sales grew by just 2.5% against our expectation of ~13% growth YoY. EBITDA declined by ~14% while the margin also dropped by 310 bps YoY on account of structural cost changes. Except for Piramal Critical Care, which grew by 49% YoY, all segments registered slow to negative growth. The management has altered its guidance for the CRAMS business from ~15% (given at the end of Q4FY10) to flat growth YoY. With further downsizing of business segments after the sale of the diagnostics business, the company will have its task cut out to improve the prospects of the CRAMS business.

■ Highlights for the quarter

During the quarter, PHIL signed a definitive agreement to sell its diagnostic business to Super Ranbaxy Laboratories (SRL) for Rs 600 crore. SRL is promoted by Malvinder and Shivinder Singh. Piramal will receive Rs 300 crore on closure of the deal and a final payment of Rs 300 crore after three years. The deal is valued at 3x the revenue of the diagnostics business and is expected to close by end of Q3FY11. The diagnostics business contributed ~5.6% to the FY10 topline. The deal includes transfer of 107 laboratories, ~300 collection centres and ~450 employees to SRL.

Valuation

With two of its segments, namely healthcare solutions and diagnostics, on their way out, we have changed our valuation matrix to incorporate certain but futuristic cash flows and growth from the remaining businesses (~40% of FY10 sales). We have not factored the possible one-off dividend in our valuation. We have arrived at a value of Rs 526, revising our rating from BUY to ADD.

Exhibit 1: Performance Highlights

(Rs Crore)	Q1FY11A	Q1FY11E	Q1FY10	Q4FY10	YoY Gr.(%)	QoQ Gr.(%)	FY10
Net Sales	842.4	925.8	821.5	941.8	2.5	-10.6	2729.2
EBITDA	137.9	180.3	160.2	221.2	-13.9	-37.7	519.8
EBITDA Margin (%)	16.4	19.5	19.5	23.5	310 bps	710 bps	19.0
Depreciation	38.1	34.8	38.5	23.3	-1.1	63.5	119.4
Interest	14.5	19.7	25.4	19.2	-42.9	-24.5	72.4
Reported PAT	80.7	109.4	85.1	154.3	-5.1	-47.7	327.5
EPS (Rs)	3.9	5.2	4.1	7.4			15.7

Source: Company, ICICIdirect.com Research

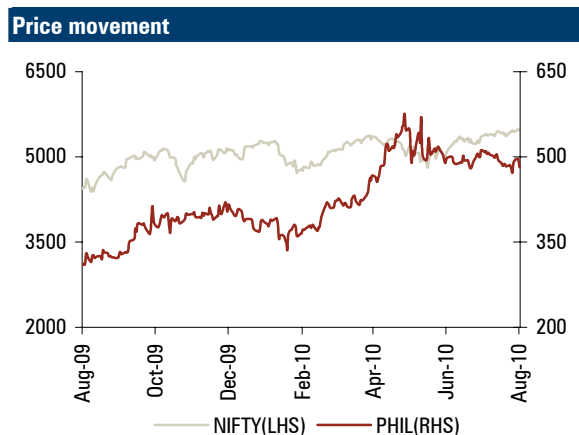
Rating matrix	
Rating	: Add
Target	: Rs 526
Target Period	: 12-15 months
Potential Upside	: 10%

Key Financials		(Rs Cr)			
(Rs Crore)	FY09	FY10	FY11E*	FY12E*	
Net Sales	3281.1	3671.1	4019.5	4542.8	
EBITDA	581.3	740.9	792.2	958.7	
Net Profit	316.2	481.8	499.9	623.1	

Valuation Summary		FY09	FY10	FY11E*	FY12E*
EPS (Rs)		15.1	23.1	23.9	29.8
PE (x)		33.3	21.9	20.1	16.1
Target PE (x)		34.7	22.8	22.0	17.6
EV to EBITDA (x)		19.4	15.2	14.0	11.4
Price to book (x)		8.0	6.2	4.9	4.0
RoNW (%)		24.0	28.3	24.4	25.2
RoCE (%)		17.7	18.8	19.6	22.5

* subject to changes post deals.

Stock Data	
Market Capitalisation (Rs Crore)	10032.0
Debt (FY10), (Rs Crore)	1418.1
Cash (FY10), (Rs Crore)	138.2
EV (Rs Cr)	11311.9
52 week H/L	599/300
Equity capital (Rs Crore)	41.8
Face value (Rs)	2.0
MF Holding (%)	1.0
FII Holding (%)	23.9



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Result Analysis

■ Sales growth of 2.5% YoY below our expectation

PHIL's consolidated revenues grew by a tepid 2.5% YoY to Rs 842 crore on account of the subdued performance from the flagship healthcare solutions business and de-growth registered by the pharma solutions (CRAMS) business. Sales of healthcare solutions, which mainly comprise domestic branded formulations, were hit by transitional procedures as this business has been sold to Abbott in May. With more than 4% share in the domestic branded formulations market, which itself is growing at ~13-15%, there cannot be any other reason for slower growth than for transitional procedure, for such tepid growth. Sales from this segment grew by ~5% YoY to Rs 461 crore. Even the sales of the OTC business (not included in Abbott Deal) got hit and de-grew by ~15% to Rs 22 crore YoY. It seems that the company has already surrendered the faith of this division to Abbott. This scenario may continue in Q2 as well.

The company continues to bleed on the CRAMS front. The overall pharma solutions business de-grew by ~17% to Rs 175 crore. Sales from assets in India de-grew by ~18% and from assets outside India de-grew by ~16% YoY. PHIL sees recovery coming in the second and third quarter of the current fiscal mainly from assets outside India. This buoyancy is based upon clear visibility from orders in hand. Performance of CRAMS was mainly affected by currency movement, especially the rupee appreciation vis-à-vis GBP. The management has altered its guidance for the segment from 15% growth (given at the end of Q4FY10) to flat growth YoY for FY11.

Piramal's critical care segment grew by ~49% YoY to Rs 108 crore mainly on account of robust growth registered by its Minrad facility in the US. Minrad sales grew by ~103% to \$19.5 million YoY.

The diagnostics business, which was sold to SRL, grew by ~11% YoY to Rs 54 crore during the quarter.

Exhibit 2: Business highlights

Business Mix (Rs Crore)	Q1FY11	Q1FY10	YoY (%)	Q4FY10	QoQ (%)	FY10
Healthcare Solutions (A)	461.3	439.7	4.9	539.4	-14.5	2000.2
% of Net Sales	54.8	53.5		57.3		54.5
Pharma Solutions (B)	174.8	210.4	-16.9	216.0	-19.1	885.0
% of Net Sales	20.7	25.6		22.9		24.1
From Assets In India	66.0	80.7	-18.3	81.8	-19.3	375.9
From Assets Outside India	108.8	129.7	-16.1	134.2	-18.9	509.1
Piramal Critical Care ©	108.2	72.9	48.5	88.4	22.4	327.7
% of Net Sales	12.8	8.9		9.4		8.9
Diagnostics (D)	53.6	48.5	10.6	52.9	1.3	206.4
% of Net Sales	6.4	5.9		5.6		5.6
Others (E)	44.5	50.1	-11.1	45.1	-1.4	251.7
% of Net Sales	5.3	6.1		4.8		6.9
Net Sales (A+B+C+D+E)	842.4	821.5	2.5	941.8	-10.6	3671.1

Source: Company, ICICIdirect.com Research

Consolidated revenues grew by ~2.5% YoY on account of dismal performances from the main segments

Sales from healthcare solutions grew by just ~5% due to transitional procedures

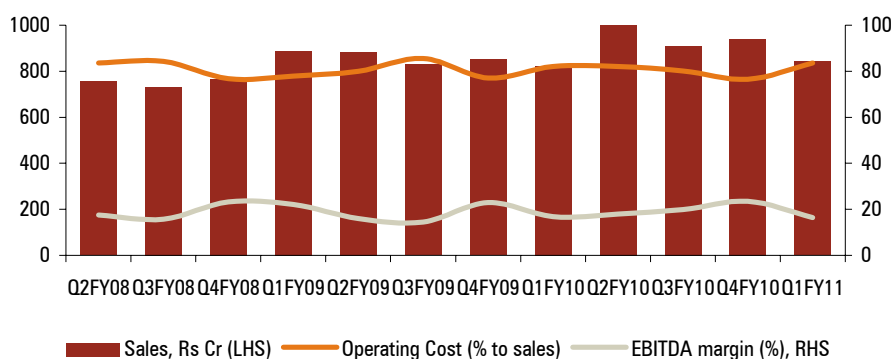
CRAMS continues to bleed. Full year guidance has been altered

Good growth in critical care, mainly on account of Minrad

EBITDA margin down due to structural changes

PHIL reported a decline in the EBITDA margin in Q1FY11 by 310 bps YoY to 16.4% due to: i) ~5% growth in materials cost on account of a change in the product mix and ii) ~16% growth in the employees cost on account of increments and bonuses paid during the quarter, which normally come in Q2. In value terms, the EBITDA was down by ~14% to Rs 138 crore due to weak sales growth and cost pressure. Since the high margin businesses are on their way out, it needs to be seen how the company will be able to maintain the threshold 20% margin range.

Exhibit 3: EBITDA margin trend



Source: Company, ICICIdirect.com Research

Net profit below expectation

Net profit for Q1FY11 was down by 5% YoY to Rs 81crore (we estimated Rs 109 crore). This was due to the cascading effect of weaker sales and higher costs. Lower interest outgo and lesser tax provision arrested a further downfall.

Exhibit 4: Common size profit and loss account (Rs crore)

	Q1FY10	Q2FY10	Q3FY10	Q4FY10	Q1FY11
Net Sales	100	100	100	100	100
Depreciation	4.7	3.8	4.8	2.5	4.5
Interest	3.1	2.5	2.4	2.0	1.7
PBT	11.7	11.6	12.7	12.7	10.1
Tax (% of PBT)	11.7	8.1	-17.7	10.3	3.2
Net Profit	10.4	10.6	15.0	16.4	9.6

Source: Company, ICICIdirect.com Research

Valuation

On account of sale of almost 60% of the FY10 business, we have revised our valuation methodology, which was applicable till the previous quarter (Q4FY10). Hence, our estimates for FY11 and FY12 are up for a complete overhaul although we will keep them in our notes till the actual closure of the two deals. We have arrived at a value of Rs 526, which is based on cash valuation from the two deals — Abbott and SRL, at Rs 447 and Rs 22, respectively, and Rs 57 from the continuing businesses based on 10x FY12E EPS of Rs 5.7. We have not estimated the likely amount of dividend to be declared by the company (which may be substantial) on account of uncertainty in timing. Also, we have assumed Abbott's cash flow at 10% discount as a safety cushion against utilisation of cash for non-core business lines. The management has not yet chalked out a clear cut strategy for the utilisation of cash. Clearly, it has multiple options available with such huge cash. We believe CRAMS will regain growth momentum by the end of FY11 while the critical care business will maintain the tempo through FY11 and FY12.

Exhibit 5: Valuation Matrix

Piramal - Abbott Deal					
	Upfront	Annuity payment (US\$ 400 mn from FY11)			
Payment from Abbott (US\$ 2.12 bn)	9540	1800	1800	1800	1800
NPV, discounted at 15%	14679				
Adjusted for BV	13979				
Less Capital gains tax at 21.5%	3005				
Less Debt Repayment	1300				
Total Cash	10373				
Cash Per Share (90%)	447				

Piramal - SRL Deal		
	Upfront	To be received after 3 years
Payment from SRL	300	300
NPV, discounted at 15%	497	
Adjusted for BV	202	
Less Capital gains tax at 21.5%	43	
Total Cash	454	
Cash Per Share	22	

Residual business valuation	
FY12 estimated PAT	118
FY12E EPS	5.7
Target price at 10x FY12E EPS	57
Target Price per share (post deal)	526

Source: Company, ICICIdirect.com Research

Exhibit 6: Valuation Table

	Sales (Rs Cr)	Sales Gr (%)	EPS (Rs)	EPS Gr (%)	PE (x)	EV/EBIDTA (x)	RoNW (%)	RoCE (%)
FY09E	3281.1	15.2	15.1	-5.3	34.0	19.4	24.0	17.7
FY10E	3671.1	11.9	23.1	52.4	22.3	15.2	28.3	18.8
FY11E*	4019.5	9.5	23.9	3.7	20.1	14.0	24.4	19.6
FY12E*	4542.8	13.0	29.8	24.7	16.1	11.4	25.2	22.5

* subject to changes post deals.

Source: Company, ICICIdirect.com Research

ICICIdirect.com Coverage Universe

Alembic					Sales (Rs Cr)	EPS (Rs)	PE(x)	EV/E (x)	RoNW (%)	RoCE (%)
Idirect Code	ALECHE	CMP	46	FY08	1003.2	8.0	5.7	7.1	32.6	19.1
		Target	46	FY09	1116.1	3.4*	14.6	8.7	14.0*	11.3
MCap	634.8	Upside (%)	1	FY10E	1141.7	3.6	12.8	7.3	8.1	8.8
				FY11E	1222.9	4.6	9.9	5.6	12.2	11.4
Biocon					Sales (Rs Cr)	EPS (Rs)	PE(x)	EV/E (x)	RoNW (%)	RoCE (%)
Idirect Code	BIOCON	CMP	321	FY09	1608.7	12.0	18.2*	19.8	11.4	13.2
		Target	335	FY10E	2367.8	14.7	21.9	13.3	12.4	15.6
MCap	6420.0	Upside (%)	4	FY11E	2701.9	17.1	18.7	12.2	13.2	16.7
				FY12E	3085.7	20.2	15.9	10.3	13.9	17.5
Dishman					Sales (Rs Cr)	EPS (Rs)	PE(x)	EV/E (x)	RoNW (%)	RoCE (%)
Idirect Code	DISHPHA	CMP	204	FY09	1062.4	18.2	11.2	8.9	20.9	13.6
		Target	218	FY10	915.4	14.6	14.0	11.6	15.0	9.1
MCap	1645.4	Upside (%)	7	FY11E	1012.6	14.6	14.0	10.6	13.3	8.9
				FY12E	1210.3	18.2	11.2	8.4	14.8	10.8
IPCA Labs					Sales (Rs Cr)	EPS (Rs)	PE(x)	EV/E (x)	RoNW (%)	RoCE (%)
Idirect Code	IPCLAB	CMP	280	FY09	1283.8	8.1	34.7	15.4	16.0	19.6
		Target	302	FY10	1559.6	16.4	17.0	12.2	23.7	20.5
MCap	3500.0	Upside (%)	8	FY11E	1812.5	17.7	15.8	10.7	21.1	20.9
				FY12E	2165.9	23.2	12.1	8.3	22.3	23.9
Piramal Health					Sales (Rs Cr)	EPS (Rs)	PE(x)	EV/E (x)	RoNW (%)	RoCE (%)
Idirect Code	NICPIR	CMP	480	FY09	3281.1	15.1	31.7	19.4	24.0	17.7
		Target	526	FY10E	3671.1	23.1	20.8	15.2	28.3	18.8
MCap	10032.0	Upside (%)	10	FY11E	4019.5	23.9	20.1	14.0	24.4	19.6
				FY12E	4542.8	29.8	16.1	11.4	25.2	22.5
Sun Pharma					Sales (Rs Cr)	EPS (Rs)	PE(x)	EV/E (x)	RoNW (%)	RoCE (%)
Idirect Code	SUNPHA	CMP	1807	FY09	4271.4	88.1	20.5	19.3	25.9	28.5
		Target	1739	FY10	4019.8	65.2	27.7	26.2	17.8	19.6
MCap	37426.2	Upside (%)	-4	FY11E	4906.5	83.9	21.5	19.3	19.2	21.2
				FY12E	5324.2	86.9	20.8	18.1	17.1	19.1
Glenmark					Sales (Rs Cr)	EPS (Rs)	PE(x)	EV/E (x)	RoNW (%)	RoCE (%)
Idirect Code	GLEPHA	CMP	285	FY09	2093.0	7.7	35.5	20.6	19.4	16.4
		Target	325	FY10	2484.9	12.2	22.3	14.6	13.9	14.6
MCap	7678.2	Upside (%)	14	FY11E	2876.5	15.4	18.6	12.1	18.0	17.2
				FY12E	3345.2	20.7	13.8	9.7	20.3	19.7
Lupin					Sales (Rs Cr)	EPS (Rs)	PE(x)	EV/E (x)	RoNW (%)	RoCE (%)
Idirect Code	LUPIN	CMP	1951	FY08	2706.4	49.8	39.2	38.9	31.9	22.2
		Target	2101	FY09	3775.9	61.3	31.8	26.7	35.6	23.6
MCap	17350.4	Upside (%)	8	FY10E	4740.5	78.7	24.8	21.4	27.3	22.4
				FY11E	5883.6	94.6	20.6	16.2	27.5	25.7
				FY12E	6943.2	117.0	16.7	13.1	24.9	23.8
Unichem Labs					Sales (Rs Cr)	EPS (Rs)	PE(x)	EV/E (x)	RoNW (%)	RoCE (%)
Idirect Code	UNILAB	CMP	455	FY09	735.2	30.0	13.3	10.2	22.3	23.2
		Target	486	FY10E	765.5	36.9	10.9	9.4	23.3	25.7
MCap	1640.5	Upside (%)	7	FY11E	895.2	41.6	10.9	7.1	22.1	25.9
				FY12E	1044.4	49.8	9.1	5.9	22.4	26.2
Indoco Remedies					Sales (Rs Cr)	EPS (Rs)	PE(x)	EV/E (x)	RoNW (%)	RoCE (%)
Idirect Code	INDREM	CMP	440	FY09	350.6	25.6	15.9	11.4	11.3	10.9
		Target	432	FY10E	398.3	34.2	11.9	9.6	13.3	11.1
MCap	540.8	Upside (%)	-2	FY11E	461.4	43.3	10.2	7.9	14.5	13.3
				FY12E	530.9	49.1	9.0	6.6	14.3	13.8

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