Opto Circuits (India) Ltd.

A consi'Stent' performer...

BUY **CMP: INR184** **Target Price: INR295**

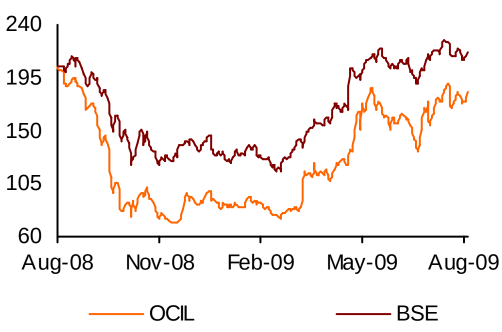
August 24, 2009 Strictly confidential

Market Data		
Sector	:	Medical Devices
Market Cap (INRbn)	:	29
Market Cap (USDm)	:	616
O/S shares (m)	:	161
Free Float (m)	:	95
52-wk HI/LO (INR)	:	209/68
Avg 12m Vol ('000)	:	1,691
Face Value (INR)	:	10
Bloomberg	:	OPTC IN
Reuters	:	OPTO.BO

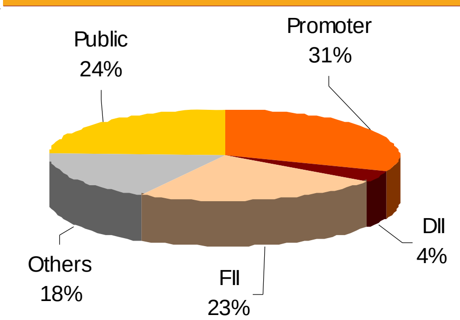
Price Performance

	1m	3m	6m	12m
Absolute	17.6	9.1	111.7	(9.7)
Relative	18.6	(0.6)	22.5	(14.7)

Price Performance vs NIFTY



Shareholding Pattern



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Investment Rationale

Opto Circuits (I) Ltd. (OCIL) is manufacturer of invasive and non-invasive medical devices, with strong brand equity and proven track record of pioneering products, rooted in proprietary technology.

The consistent ramp up in revenues and profits over the years (3 year CAGR of 80% and 70% respectively), brought about by organic and inorganic growth, underscores the management bandwidth, technology assimilation and implementation skills.

OCIL is focussing on improving the monetisation of its base of proprietary technology in the patient monitoring (*Criticare*) and invasive cardiac (*Eurocor*) segments, with a marked thrust on increasing profitabililty of operations.

Its marquee products (viz. patient monitors and stents) are making significant inroads at home and abroad, as is apparent from the sales volumes and geographical distribution of revenues.

At the CMP of INR184, OCIL is trading at a PER of 7.7x and EV/EBIDTA of 6.9x, discounting its FY11e numbers.

Valuation

OCIL is currently maintaining focussing on developing cost-effective and technologically superior products, while simultaneously expanding its reach in domestic and international markets through appropriate products at suitable price points. In the backdrop of increasing non-discretionary healthcare spend and greater product acceptance, the company is interestingly poised, in terms of revenue and profit growth. Hence we inititate coverage with a 'BUY' recommendation and a price target of INR295, which represents an upside of 60% from current levels.

Key financials

INRm	2009a	2010e	2011e	2012e
Revenues	8,185	11,060	14,408	18,663
EBITDA	2,591	3,518	4,721	6,268
EBITDA Margin	31.6	31.8	32.8	33.6
EBITDA growth	88.8	35.8	34.2	32.8
PAT	2,087	2,815	3,970	5,347
PAT growth	59.7	34.9	41.1	34.7
EPS (INR)	12.5	16.8	23.7	31.9
EPS growth	59.7	34.9	41.1	34.7
P/E	14.2	10.9	7.7	5.7
P/BV	5.7	3.7	2.7	2.0
EV/EBITDA	11.8	9.3	6.9	5.2
RoE (%)	49.2	42.0	40.8	40.5

Source: Antique

Introduction

Opto Circuits (I) Ltd. (OCIL) was started in 1992 by a first generation entrepreneur, Mr. Vinod Ramnani, along with two technocrats, Mr. Thomas Dietiker and Mr. Jayesh Patel. It commenced operations by manufacturing sensors for Original Equipment Manufacturers (OEM). Starting with one product, namely *Pulse Oximetry Sensors*, it has consistently scaled up its product range and has emerged as a player to reckon with in the medical equipment space.

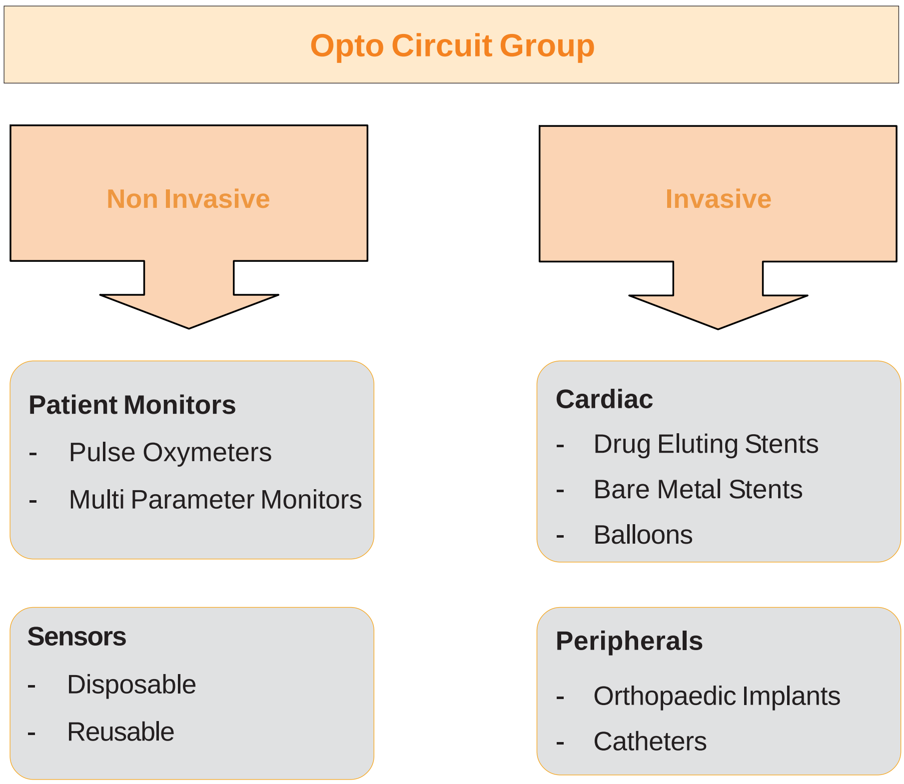
Over the years, it has built up vibrant relationships with global medical equipments majors as a reliable OEM supplier. After building up strong domain expertise and skill sets, OCIL ramped up its scale of operations and expanded its product profile, both organically as well as through a series of acquisitions. This has enabled it garner a larger share of the spend of the healthcare providers it has been targeting in developed as well as developing countries.

It has emerged as the largest player in the domestic medical equipments space and has also managed to carve out a formidable reputation globally on account of its product range, technological innovation and IPRs, and currently has rights over 35 product patents, with 28 applications pending.

Its product profile consists of ~ 90 products spread across the non-invasive and invasive segments of medical devices and it also provides ancillary and complementary services for its patient monitoring devices. With manufacturing operations located in India, Germany and U.S., and marketing presence in ~56 countries, it has emerged as a player to reckon with on the global arena.

It went public towards the end of FY01, with an issue of 2.7m share of F.V. INR10 at a rate of INR 40per share. After a series of bonus issues, its equity base currently stands at INR1.6bn, consisting of ~162m shares of F.V. INR10 each. It has recently issued 0.6m warrants of F.V. INR10 at a rate of INR210 per share to promoters, employees and others.

Business verticals of the group



Source: Company, Antique

Manufacturing Locations

The manufacturing facilities of the company are located in India and the US, with a design and development centre located in Germany.

The main manufacturing facilities in India are located in Bengaluru (Karnataka) in Electronic City and the same has US FDA registration and CE certification for vital signs monitor, SpO2 sensors (disposable as well as reusable) and thermometers. It is a registered 100% EOU (Export Oriented Unit) and is thus eligible for tax concessions from export sales till Mar'11. [*U.S. FDA and C.E. approvals are required to sell medical equipment in the U.S. and Europe respectively*.]

Its other facilities in India are at : Parwanoo (Himachal Pradesh), for manufacturing catheters and stents for urology, gastroenterology, gynecology and radiology uses; Chennai (Tamil Nadu), for manufacturing surgical implants and at Vishakapatnam (Andhra Pradesh) which is an SEZ facility.

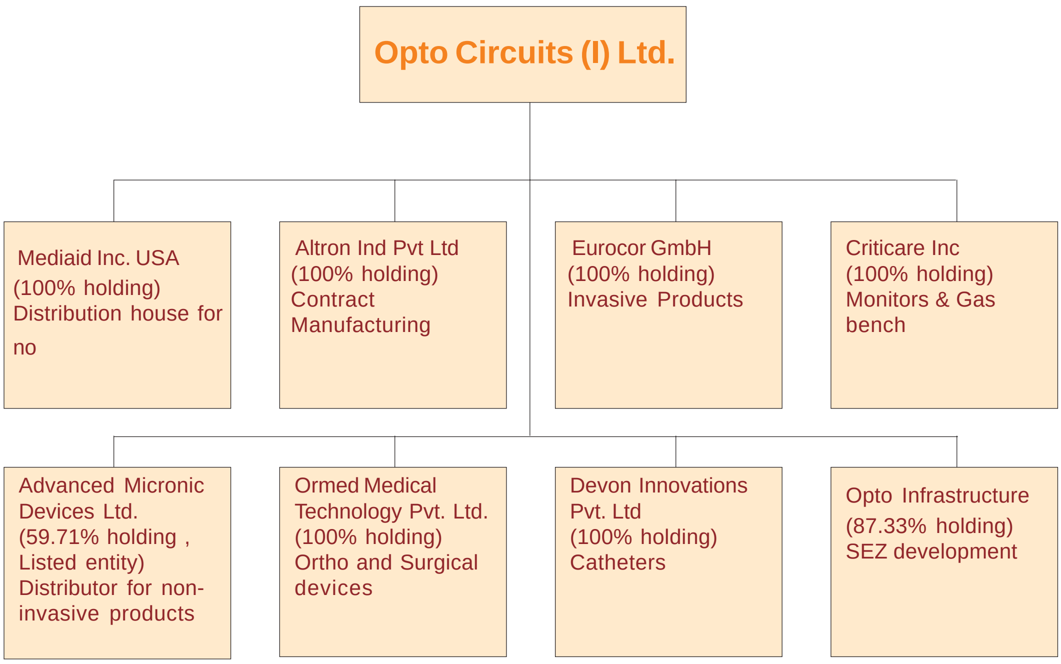
The SEZ facility was set up by OCIL to ensure that it will have the advantage of a tax shelter, in case the concessions available at its Bengaluru facilities are not extended beyond Mar'11.

The company has also set up a subsidiary, *Opto Infrastructure* (87.33% holding) through which it intends to set up an SEZ in Hassan, Karnataka, so that it retains its costing advantage on the manufacturing front on account of tax concession, in the years to come.

The facility in US at Wisconsin manufactures US FDA approved patient monitoring systems. It came into OCIL's fold post its acquisition of Criticare in Apr'08. The headcount at this facility is 25.

The *Eurocor* facility in Bonn, Germany designs and develops Coronary stents, Balloons, Catheters and allied devices, which are later CE certified. This came into the company's fold in Jan'06, post its acquisition of Eurocor. The head count at this facility is 29 and the same would a key differentiating factor in the company's thrust in the Invasive segment as design and product innovation is a key separator.

Holding structure of Opto Circuits group



Source: Antique

Marketing Setup

In order to obtain critical customer reach, OCIL has continuously scaled up its operations and managed to build a strong marketing network at home as well as abroad.

Its distributor strength in India is ~380 and the same is being serviced by a 100 member strong sales team. The overseas marketing structure of over 800 distributors spans almost 56 countries and is serviced by a team of 30 sales personnel.

Despite being an OEM supplier to many global majors for sensors, OCIL has taken considerable efforts to tap the demand from the replacement and after sales market where public domain design sensors / compatible sensors are used.

The company also participates in the tender business, but not to a large extent, as the dynamics of that business are distinctly different from the distribution model. However, this is largely to sovereign entities in India and large scale procurement organisations in developed countries viz. GPO etc. As a derisking measure, the company limits its exposure to institutional buyers to ~10% of its sales. The average ticket size of sales for the company is ~USD5,000 -10,000 and in case of institutional sales it ranges around USD150,000-200,000.

As part of a brand building and market penetration exercise, the company regularly sponsors trade shows, seminars etc. where not only its products are show cased, but also case papers on its usage presented. Its efforts to carve out a distinctive brand equity for its products and safeguard the same have yielded 29 trademarks registerations, with 8 applications pending.

The company has managed to set up a strong marketing, distribution and receivable collection system. This, along with the fact that no distributor accounts for over 5% of its net sales, has ensured that its receivables have never exceeded 180 days and delinquencies have been negligible.

After Sales Service Setup

In the critical care medical equipment market, a strong after sales service backup is just as important as brand equity and marketing reach. A well crafted after sales service strategy, along with a point of presence in places usually overlooked by large competitors which usually chase big ticket sales, can ensure that companies like OCIL make strong inroads into markets which are usually not serviced by global majors.

In India, OCIL has an after sales service team of ~100 and supports installations directly as well as through distributors and the network is adequately stocked with spares. While this could strain the working capital of the company on account of inventory carrying costs, the assurance of minimal downtime is probably the best brand equity builder in this segment.

In international markets, the after sales service is provided directly in some areas, and through distributors in majority of the locations. Its personnel strength in the same is ~30 and OCIL has points of presence in locations across Europe and the US.

Product Profile

Non-invasive Devices

Patient Monitors: A non-invasive patient monitor is a medical device that displays two or more vital signs or parameters which indicate the patient's condition, thereby enabling treatment options. The company develops, manufactures and distributes ~30 variants of proprietary technology based single-parameter, multi-parameter and vital signs monitors on both, singular and modular platforms. These are used in doctors' clinics, surgery centres, ICUs, operating rooms and emergency rooms.

Sensors: Sensors are the crucial interface between the patient and the monitoring systems. The company has a comprehensive range of , which are classified as reusable or disposable sensors.

Reusable sensors can be reused a number of times before being replaced. Currently reusable sensors are widely used, especially in developing markets. However, due to hygiene reasons and growing healthcare awareness, the market is shifting towards disposable sensors.

Disposable sensors are one time use sensors and have wide acceptance, especially in developed markets. Since a disposable sensor is used on one patient and only once, the risk of cross-contamination is eliminated. Developed markets such as the United States have gradually transitioned to disposable sensors as compared to developing countries that use reusable sensors due to cost considerations. Reusable sensors usually cost around USD110-150 while the disposable one cost around USD4-10.

In FY09, ~40% and 35% of OCIL's revenues accrued from patient monitors and sensors respectively. These products are manufactured through the company's proprietary technology and are CE and US FDA certified. They are sold under the brand names of *Mediaid* and *Criticare* and are distributed in most of the developed markets of the world.

Invasive Products

Cardiac implants: This vertical comprises of products like Drug eluting stents, Bare Metal stents and Balloons. Coronary stents are implanted in heart vessels when they get blocked due to arteriosclerosis. A coronary artery stent is a small, metal mesh tube that expands inside a coronary artery and keeps the arteries open, even after surgical treatment.

Stents can broadly be divided into two types:

Bare Metal Stents (BMS): These are the earliest developed form of stents of early 1990s vintage. BMS have a plain metal body mesh and are usually made of stainless steel, cobalt-chromium etc.

Drug Eluting Stents (DES): These are an evolved form of BMS and are used to release drugs in the artery gradually over a period of two to three months. This is done to prevent the recurrence of blockage and are currently preferred by cardiologists over BMS.

Drug Eluting Balloons (DEB): These deliver the drug during the surgery in a more effective manner, thus preventing blockage of the artery. OCIL has pioneered the use of this product and is currently aggressively marketing the same amongst cardiologists.

The cardiac implants manufactured are CE certified. The company is awaiting FDA certification for its BMS product line, which is marketed under the *Eurocor* brand and distributed in most of the developed markets of the world, except US, Canada and Japan.

Orthopedic Implants: Orthopedic implants are used to surgically replace damaged or troubled joints. These are constructed from titanium alloys for strength and lined with plastic to act as artificial cartilage.

The invasive products contributed ~22% to the company's revenues in FY09 and we estimate this proportion to ramp up significantly in the coming years with increased marketing efforts of the company and increasing acceptance of the product range.

Industry Overview

Medical devices form a crucial healthcare part of the present health and healthcare sector. The sector covers ~ 8,000 types of products, covering a wide spectrum, from bandages and spectacles, implantable devices, screening and diagnostic equipment etc. (Source: European Commission).

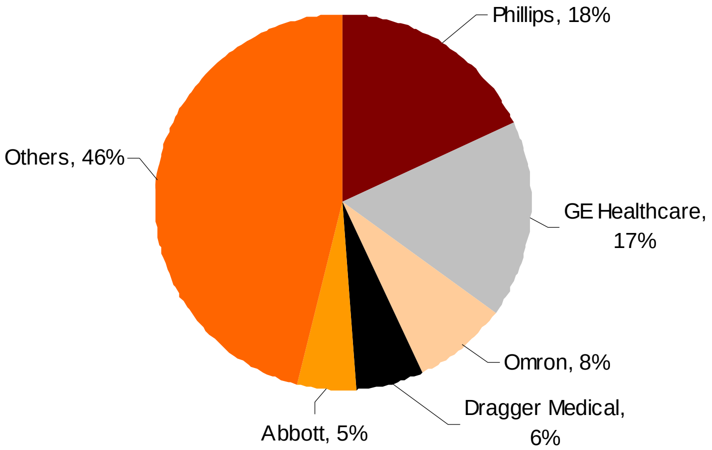
The medical devices industry can be broadly classified into non-invasive (including patient monitors and sensors) and invasive devices (including implants and stent systems).

Non-invasive Devices

OCIL's non-invasive devices viz. patient monitoring devices, sensors, etc. form a part of the non-invasive healthcare devices market. Globally, this market is estimated to grow to USD5.7bn by 2011, with multi-parameter patient monitors accounting for over 40% of the market.

Furthermore, the North American market is expected to grow at a CAGR of over 8% and account for 56% of the worldwide market for patient monitors by 2011. Interestingly, remote patient monitoring is expected to grow the fastest at a CAGR of over 10%. This augurs well for OCIL as it has just commercialised a state-of-the-art 'Remote Patient Monitoring Module' through its *Criticare* brand, which it is marketing aggressively.

Competitive Scenario: Global Market Scenario: Patient Monitoring Devices



Source: Industry Estimates

Growth Drivers for Non-Invasive Devices

Increasing outlay on healthcare by governments: The GoI has budgeted significant amounts for mobile health care delivery service through programs such as the National Rural Health Mission (NRHM). This includes coverage of upto INR30,000 for diseases that require hospitalization. (*Source: www.rsby.in*). The US Government is also planning healthcare reforms to introduce significant budgetary and legislative initiatives in order to expand healthcare coverage and increase expenditure on healthcare institutes while controlling rising health care costs. (*Source: www.healthreform.gov*)

Improvements in technology: The trend in patient monitoring devices is steadily veering towards modularisation and compatibility, with emphasis on miniaturisation and making them more suitable for ambulatory purposes. OCIL is well poised to tap this demand on back of recently developed products like its miniature gas bench and modular patient monitor.

Compatibility of equipment and technology: Currently, most sensors used are patient monitor specific and incompatible with monitors of other OEMs, resulting in a bundling of sensors with the patient monitors and limiting the end users' choice, thereby reducing cost effectiveness. The emerging trend in the industry is the development of sensors that are compatible with a range of patient monitors, which may lead to the market for sensors opening up further.

There is also a distinct shift in medical treatment patterns and with costing being a prime driver and institutional insurance coverage becoming scarce, individual are now opting for cost effective treatments in centres which can emerge as value for money options. A brief table on costing of medical treatment and surgeries across geographies is given in the table overleaf

While one of the key differentiators for cheaper medical treatments is manpower i.e. doctor and nursing costs, there has been a concerted efforts on part of medical/hospital service providers to keep their capital costs as well as operational cost low, thus spawning up demand for technologically innovative players like OCIL who are carving a niche for themselves.

Procedure costs in US, UK, India, Thailand, Singapore, (USD), 2008

Procedure Costs	US	UK	India	Thailand	Singapore
Heart bypass surgery	24,000	20,000	6,500	8,000	10,500
Hear valve replacement surgery	200,000	90,000	8,500	10,000	12,500
Spinal fusion	20,000	10,000	2,000	3,500	4,500
Cosmetic surgery	**62,000**	**50,000**	**5,500**	**7,000**	**9,000**

Source: Planning Commission of India and Global Markets Direct

Invasive Products

The global market for coronary stents is expected to grow to ~USD7bn by the end of 2015 from USD6bn in 2008 (CAGR of 3.4%). Of this, the market for DES market is expected to touch ~USD4bn by 2010.

Competitive Scenario

The Indian stent market is currently dominated by *J&J* and *Medtronic*. However, smaller companies like OCIL, *Translumina* and *Sahajanand* are making inroads by selling products at a lower price band and heightened marketing activities.

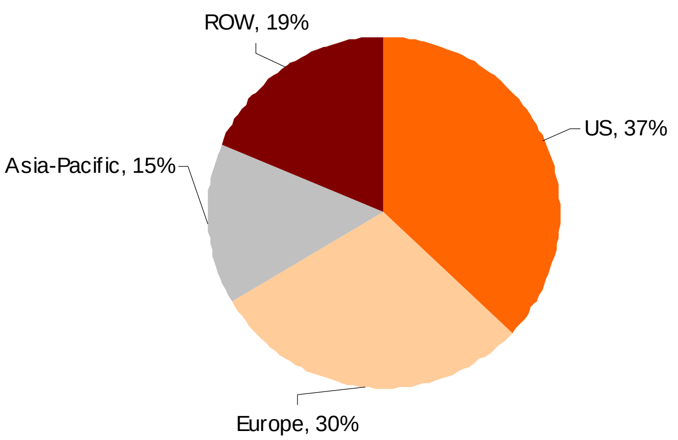
Growth Drivers for Invasive Devices

Increasing occurrence of lifestyle diseases: Globally, there has been a rise in the incidence of lifestyle related diseases such as diabetes, obesity, high blood pressure and high cholesterol, providing growth impetus for advanced cardiovascular care.

Shift in demographics: A growing number of people aged over sixty in the US and the developed world is expected to lead to an increase in the occurrence of age-related diseases, including cardiovascular diseases since its prevalence rate increases with age.

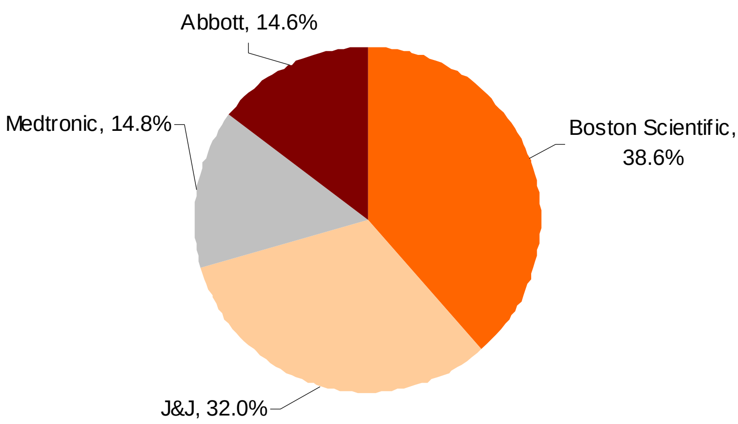
Increasing acceptance of minimally invasive surgery: Stents form the largest product segment of the minimally invasive surgery segment. Their acceptance is growing rapidly on account of better clinical performance, faster patient recovery time and fewer medical complications. Additionally, technological advances in stent design and cost effectiveness of the same vis-a-vis bypass surgery is fuelling the demand for coronary stents.

Geographical break-up of Global DES market



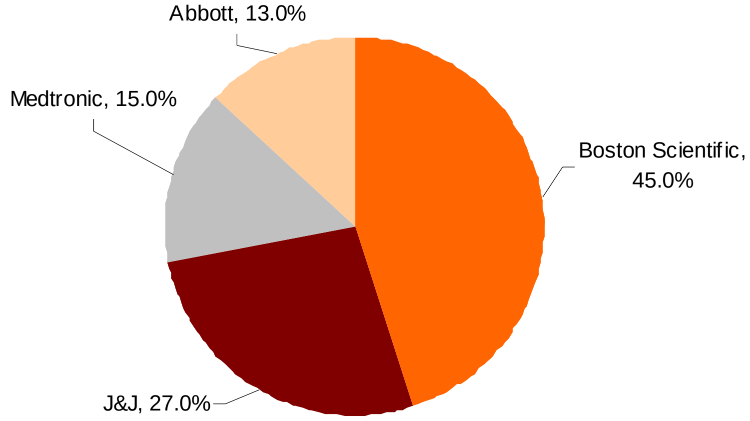
Source: Industry estimates

Market share of Global DES market



Source: Industry estimates

Competitive Scenario: US DES Market



Source: Industry estimates

Inorganic Growth

OCIL commenced operations in 1992 by manufacturing pulse oximetry sensors for OEMs. Since then, the management has effected a series of acquisitions in order to fuel growth. The common thread that OCIL maintained throughout these acquisitions for the same was:

1. Achievement of growth through synergies of OCIL's product line and that of the target company

2. The existing product line of the acquired company had to be rooted in proprietary technology, which would drive pricing power, profitability and future growth.

3. The manufacturing process had the potential of being migrated to India.

A brief summary of the same is enclosed in the table below.

Chronology and Details of Inorganic Growth

Acquisiton	Date	Shareholding	Product/ Service Profile Acquired	Consideration
AMDL	CY01	59.71	Vast domestic distribution network	INR50m
Mediaid	CY02	100%	Development of non-invasive devices alongwith global dealership network	USD1m
Altron	CY04	100%	Manufacturing facilities of non-invasive devices	INR5m
Eurocor	CY06	100%	Invasive products viz. BMS, DES & DBS	Euro4.31m (Shares to promoters) + Euro1.5m (Earn & Payout)
Devon	CY07	100%	Invasive products, catheters	INR40m
Ormed	CY07	100%	Orthopaedic implants	
Criticare	CY08	100%	Patient Monitors	USD68m

Source: Company, Antique

Strength

Product Range and value chain presence

The company has built up a formidable range of product offerings for a player of its size. Beginning operations as a OEM supplier of sensors for pulse oxymeters sensors, it capitalized on the opportunity which emerged on account of the product going off patent in 2002, emerging as a sensor supplier of choice not only in the OE segment, but also in the replacement segment.

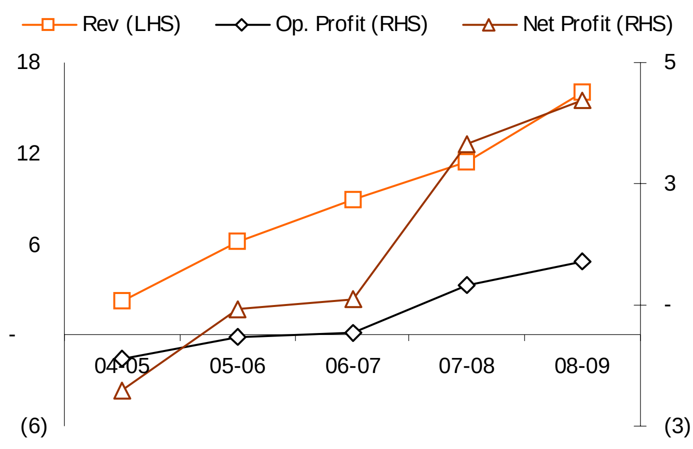
Its subsequent acquisitions in the patient monitoring and multi parameter monitoring arenas have enabled it to tackle competitive pressures and practices as its presence over a larger value chain enables it to garner a large share of spend of the capital expenditure (largely by service providers like hospitals and clinics, which form a highly cost sensitive segment) as well as the operating expenditure (largely by patients, who form the least sensitive segment to pricing vagaries).

OCIL has simultaneously nurtured a skill set which has enabled it to develop innovative modular products like the gas bench, networked multi parameter monitors etc. which are not only cost effective, but also offer high usage convenience.

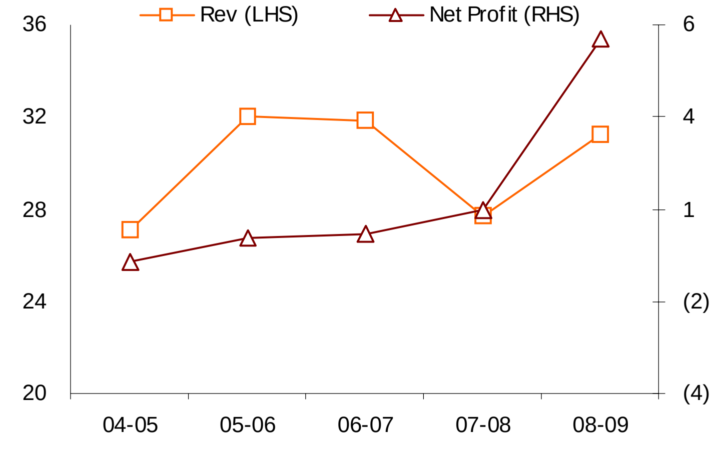
Proven capability of successful inorganic growth

In its endeavor to capture a larger part of the capital and operational expenditure spends, OCIL has institutionalized the process of not only identifying and consummating acquisitions, but also scaling up and turning around of the same in a short period of time. The same can be inferred from the table below when the positive traction in operational metrics can be seen.

Financial Performance of Eurocor (Euro m)



Financial Performance of Criticare (USD m)



Source: Company

Strong positioning as a cost-effective, technology player

Over the past few years, the company has refined its ability to spot niches and conceive and develop practical solution for the same. It has managed to accomplish the same in a cost effective manner while simultaneously nurturing the domain expertise of its acquisitions like Criticare and Eurocor in critical functions like front end engineering, since the same cannot be achieved in India in a cost-effective manner. However, it has always succeeded in fanning out operational functions like design, engineering, circuitry, modularisation etc to India, which like the Indian IT sector, generates benefits on fronts like product costing and turnaround time.

Emphasis on development of proprietary technology through R&D

Availability of skilled pool of manpower at an effective price point has been a traditional advantage of the Indian engineering and technology sector. OCIL has managed to capitalise on this to not only set up cost effective operations, but also secure an advantage on the lifecycle management. This has resulted in a lower designing and development costs for products and lower lead time to commercialise and market products. Its spend on R&D for the FY07, FY08 and FY09 has been INR92m, INR600m, INR 1.05bn, constituting 3.6%, 1.3% and 12.3% of revenues respectively.

Derisked revenue streams:

OCIL's revenue streams are diversified, from the product as well as geographical perspectives. The same can be seen from the table below.

This has de-risked it from any threat emanating from periodic uncertainties which could emerge due to tariff, non-tariff as well as legal and statutory glitches on the geographical front.

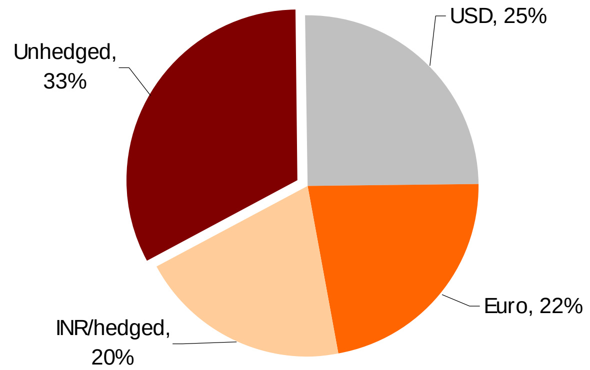
Additionally, as the product and revenue streams have broadened over the past few years, on account of the traction being exhibited by acquisitions like *Eurocor* and *Criticare*, the company is well placed to tide over any unforeseen factors which could impact a particular range of products or geography.

Weakness

Multi currency revenue streams

OCIL's revenues accrue from various geographies viz. US, Europe and Asia. Its domestic/ INR denominated revenues are miniscule. Almost half of its revenues originating from overseas entities have natural hedges as income and expenses are both in same currency. Of the balance, almost 20% is backed by commensurate imports i.e. largely raw materials. Its the rest i.e. 30% of the revenues are technically exposed to currency gyrations. Furthermore, any unforeseen currency divergence between the USD and Euro could adversely impact revenues and cash flows. However the company has a strong mechanism in place to tackle the same.

Currency Profile of OCIL's revenues (FY09)



Source: Company

Balance sheet

OCIL has to incur markedly high expenses whenever it enters new markets, on account of setting up marketing infrastructure. Another aspect is the line of credit extended to various channels and incentives provided for increasing product usage. These factors serve as significant challenges for entry and growth for many players. As the company is in initial stages of growth it will have to be effectively manage its balance sheet for not only seeding and penetrating markets, but also to ensure that its primary growth engine viz. its innovation capability does not get stifled by inadequate allocation of scarce capital.

OEM tie ups could stifle innovation:

OCIL had started out as an OE supplier to dominant players in the medical equipments sector. It subsequently capitalized on the shift in the industry trend and built up skill sets and emerged as a player to reckon with in many segments of healthcare. While OEM supply and becoming a replacement requirement supplier is an easy business with relatively lower time for operational stabilisation, the ease of business operations could end up stifling innovation. While the company has crossed critical inflection points in its lifecycle and its innovation ability has not been stifled, going forward, the company would have to avoid the pitfall of capital scarcity, which could result in lack of focus on innovation and ultimately impact its growth prospects.

Brand equity: yet in a nascent stage.

Though the medical equipments business is cost competitive, it is highly brand conscious, more so in case of the invasive segment. In order for OCIL ramp up significantly to tap the burgeoning addressable, it will have to simultaneously be at the forefront of technological innovation and considerably fortify and develop strong brand equity and recognition.

This could prove to be a challenge, especially in developed economies, as it would entail innovative marketing and judicious capital allocation. While the company has demonstrated strong skills in managing such challenges in several geographies, it could be tested as it forays into more mature markets.

Opportunities

US markets to open up post FDA approval.

The US is the largest market for healthcare services and products and is accessible to players having the inclination and capability to cater to it. However, stringent guidelines relating to manufacturing, quality, design and approvals are a formidable entry barrier.

The total market for all invasive products is estimated at USD10.5bn (2008), of which the US accounts for ~60%. This market is not only huge but also insensitive to pricing pressure as most of the treatment costs are borne by insurance companies and not by patients themselves.

While OCIL currently has CE certification for its entire range of stents, it is pursuing FDA approval and does not have any presence in the sizeable and lucrative US market. Fructification of the same would not only boost sales volumes of this product line, but also serve to improve the per unit realizations. US FDA approval generally entails an expense of ~USD12-15m and could take ~30-36 months to secure.

Indian markets hold promise

India currently undertakes around 90,000 cardiac bypass surgeries and a similar amount of invasive surgeries per annum. While the average cost of a bypass surgery used to be ~INR0.3m and entail hospitalization of 12-21 days a decade ago, the same has now slid to INR0.1m with hospitalization of 7-10 days. This, coupled with the healthy distribution of superior quality tertiary care hospitals across Indian metros has brought cardiac care within the reach of ~4m patients.

While there is global consensus that India will emerge as a country having the largest number of the cardiac patients by 2015, the number of people requiring critical treatments would be ~1.5-2m a year, there by spawning a huge addressable market for a player like OCIL which offers competitively priced products which are also at the forefront of technological innovation.

Emergence as a disruptive player

The stent markets has evolved considerably, from bare metal stents, to drug eluting stents, to biodegradable to drug eluting balloons. OCIL has consistently taken efforts to secure breakthrough in the drug eluting stents and balloons, with the latter being a cost effective innovation for cardiac care as well as post operative care (since it drastically reduces post treatment medicinal ingestion). Going forward, OCIL can capitalise on these capabilities to emerge as a player which can have disruptive effect in the most cost competitive segments of cardiac care.

Threats

Global players can play a predatory pricing game.

Global giants in medical equipments (Phillips, Tyco, Siemens etc) and invasive cardiac care (J&J, Boston Scientific, Abbot etc) have multi billion dollar balance sheets and tremendous brand equity. Their marketing strength and reach could prove to be a tough deterrent for a new player with the potential emerge as sizeable competition.

Till lately, OCIL was a fringe player and an OE supplier (for medical equipments and devices), however, it has scaled up its product profile to encompass a larger part of the consumption/value chain. It also has been taking firm steps to emerge as a cost competitive player offering contemporary technological options in the cardiac care invasive market. While OCIL has not made a foray into the home turf of the large players i.e. US, it would do so upon securing the FDA approval in the coming years. This has the potential to bring it in direct confrontation with well entrenched players who have the requisite strength to fight a long drawn marketing war and indulge in predatory pricing game.

While there has been no indication of the same, but the possibility of the same cannot be ignored. In case the same materialises, OCIL could be seriously impacted on the operational As well as the balance sheet fronts.

Technological shifts

Medical science is one of the most dynamic streams of science wherein there has been constant endeavor by committed participants to invent and innovate both on almost all fronts, especially since its capital is not a constraint in most developed countries.

While obesity, diabetes and genetic predispositions have been the prime reasons for the upsurge in cardiac care cases (especially in India and the Far East), there has been a multitude of efforts to discover cures and treatments for cardiac afflictions, despite best efforts to adopt preventive life-style practices. This is proving to be a addressable market for players like OCIL.

However, any discoveries of drugs or treatments which could reduce chances of cardiac afflictions (like a vaccine) or cure diabetes and hypertension, would ensure that the above addressable market would shrink. In case of any disruptive treatment discovery (like polio or small pox vaccine) the impact on companies like OCIL and many other could be substantial. While there is no inkling of any such discoveries or innovation, history has been replete with instances of medical science spawning groundbreaking treatment and discoveries when least expected. Thus despite best efforts at desrisking, no company in this sector can be truly said to be insulated from any technological discoveries and innovation.

Impact of non tariff barriers, duties, ad spends

While technological capability and innovation serve as strong barriers, players like OCIL have managed to build a strong and enviable product range by virtue of their focus on developing cost effective technological options in an innovative manner. While the current deterrent could be the size and deep pockets of its competitors, equal danger could emanate from non traffic barriers which could emerge in some of the countries.

Usually high statutory duties and anti dumping duties are imposed in many sectors by developed countries when large incumbents express reservations about overseas and foreign upstarts foraying into their markets. While these incidents have not occurred, the possibility of the same cannot be ruled out. In such case, critical resources like management bandwidth and financial strength would get utilized in an extremely wasteful manner thereby impairing the profitability as well as the growth prospects of the company.

Our View

OCIL posted net sales of INR8bn with an OPM of 32% and operating profits of INR2.6bn in FY09. Its revenues and operating profit CAGR for the past 3 years has been 80% and 77% respectively. While a substantial part of this growth could be attributed to acquisitions, the company's skill in identifying niche acquisitions, integrating the same in a reasonable short time frame is what has set it apart from others.

The geographical quality of revenues has also improved as despite the net sales scaling up over 325%, the share of highly developed, most quality conscious and competitive markets namely US and EU has increased from 36% and 8% in FY07 to 46% and 15% in FY09 respectively. This underscores not only the acceptance of its technological skills in these markets, but also emphasis the success of its marketing strategy.

On the products front, Its 'bread and butter' product i.e. sensors constituted only 35% of its revenues in FY09, as opposed to 49% in FY07 While sensors enjoyed high OPM sustained for an extended period of time, the successful assimilation of acquisitions like *Palco (now MediAid), Criticare* and *Eurocor* have ensured that the high complexity and realization segments like Monitors and Invasives now account for almost 62% of revenues in FY09, as against 41% in FY07. Viewed in the back drop of revenues itself getting scaled up from INR2.5bn to INR8bn, it conveys the tremendous traction successfully exhibited by these high complexity acquisitions.

Considering the acceptance of its monitor as well as invasive products, the revenue ramp up potential is still high for these product ranges. OCIL has not been focussing on the large healthcare service providers/ hospital chains in the developed countries, as the global majors drive down prices by bundling in several products together. The majors have huge balance sheet strength and usually adopt the policy of offering soft terms of purchase for capital equipments but manage to draw a large annuity stream from the consumables and spares supply. However, their ability to service installations is limited as they restrict them selves to high density agglomerations and are not too keen to tap low density areas. This has resulted in them ignoring almost 35% of the market, thereby providing a window of opportunity for upstarts like OCIL.

Penetrating these markets and moving into least competitive market segments in metro agglomerations has the potential to offer huge growth opportunity for OCIL. As it has got the marketing framework and infrastructure in place, the operating leverage is extremely high. Thus we estimate the company to post revenues of INR11bn in FY10 and INR14bn in FY11 a growth of 35% and 30% respectively.

The OPM during these years is expected to be maintained @ 31% levels. Our assumption accounts for the constraint of not being able to foray into the most lucrative market for Stents i.e. US for the next two years. However, this growth will also entail enhanced requirement of working capital.

Over FY10 and FY11, we expect the to report net profits of INR2.8bn and INR3.9bn respectively, a growth of 34% and 41% respectively

At a CMP of INR184, the stock is ruling at an EV/EBIDTA of 6.9x and PER of 7.7x its FY11e numbers. Considering the peerset valuations, elaborated in the table below, these metrics are at the lower end of the spectrum, despite considering the size differential. Extrapolating a PE multiple of 12.5x, we arrive at a fair price of INR295 for the company based on FY11e earnings. Hence, we recommend a buy with a price target of INR295, which represents an upside of 60% from current levels.

Peerset Comparison of Medical Equipment Players

	Biosensors International	Terumo Corp.	Becton Dickinson	Medtronic Corporation	Johnson & Johnson	Baxter
USDm	**FY09**	**FY09**	**Sep-08**	**Apr-09**	**CY08**	**CY08**
Revenues	119	3,012	7,156	14,599	63,747	12,348
EBITDA	25	740	2,029	5,273	19,001	3,195
Net Profit	(1)	367	1,127	2,169	12,949	2,014
P/E(x)	**N.A**	**26.0**	**13.9**	**12.8**	**13.5**	**15.6**
EV/EBITDA(x)	**10.2**	**12.5**	**7.8**	**9.1**	**8.8**	**10.8**
Market Cap(USD bn)	**0.4**	**10**	**16**	**42**	**168**	**34**

Financials (INR m)

Profit and Loss Account

Year ended 31st March	2008a	2009a	2010e	2011e	2012e
Revenues	4,681	8,185	11,060	14,408	18,663
Expenses	3,309	5,595	7,542	9,688	12,395
Operating Profit	1,372	2,591	3,518	4,721	6,268
Other income	171	288	100	100	100
EBIDT	1,543	2,878	3,618	4,821	6,368
Depreciation	63	138	245	340	400
Interest expense	109	537	449	358	417
Profit before tax	1,371	2,203	2,924	4,123	5,550
Taxes incl deferred taxation	38	75	102	144	194
PAT before MI & EO Items	1,333	2,128	2,822	3,978	5,356
Extra ordinary Items	(20)	(35)	-	-	-
Minority Interest	7	6	7	8	10
Profit after tax	1,307	2,087	2,815	3,970	5,347
Diluted EPS (INR)	7.8	12.5	16.8	23.7	31.9

Balance Sheet

Year ended 31st March	2008a	2009a	2010e	2011e	2012e
Share Capital	942	1,615	1,675	1,675	1,675
Reserves & Surplus	2,404	3,551	6,586	9,577	13,552
Networth	3,346	5,166	8,261	11,252	15,226
Minority Interest	79	134	141	149	158
Debt	1,012	5,379	3,609	3,553	4,796
Deferred Tax Liability	5	3	3	3	3
Capital Employed	4,442	10,682	12,014	14,956	20,184
Gross Fixed Assets	778	2,660	4,460	5,860	7,060
Accumulated Depreciation	222	666	911	1,251	1,651
Net Assets	556	1,995	3,550	4,610	5,410
Capital work in progress	17	172	600	600	400
Goodwill	431	2,374	2,374	2,374	2,374
Investments	3	3	3	3	3
Current Assets, Loans & Advances					
Inventory	1,456	2,305	2,200	2,826	4,132
Debtors	2,376	4,060	4,915	6,404	9,331
Cash & Bank balance	686	913	707	875	2,162
Loans & advances and others	558	2,565	628	807	1,033
Current Liabilities & Provisions					
Creditors	1,100	2,510	1,885	2,422	3,099
Other liabilities & provisions	801	1,198	1,082	1,124	1,566
Net Current Assets	3,174	6,134	5,483	7,366	11,994
Misc.Expenses	261	3	3	3	3
Application of Funds	4,442	10,682	12,014	14,956	20,184

Per share data

Year ended 31st March	2008a	2009a	2010e	2011e	2012e
No. of shares (m)	94	161	167	167	167
BVPS (INR)	35.5	32.0	49.3	67.2	90.9
CEPS (INR)	14.5	13.8	18.3	25.7	34.3
DPS (INR)	1.0	4.0	5.0	5.0	7.0

Margins (%)

Year ended 31st March	2008a	2009a	2010e	2011e	2012e
EBITDA	29.3%	31.6%	31.8%	32.8%	33.6%
EBIT	31.6%	33.5%	30.5%	31.1%	32.0%
PAT	27.9%	25.5%	25.5%	27.6%	28.6%

Source: Antique

Profit and Loss Account

Year ended 31st March	2008a	2009a	2010e	2011e	2012e
Year ended 31st March	2008a	2009a	2010e	2011e	2012e
EBT	1,371	2,203	2,917	4,115	5,541
Depreciation & amortisation	63	138	245	340	400
Interest expense	85	516	449	358	417
Interest / Dividend Recd	(3)	(0)	(100)	(100)	(100)
Other Adjustments	18	323	-	-	-
Minority Interest	7	49	7	8	10
(Inc)/Dec in working capital	(1,093)	(1,953)	445	(1,715)	(3,341)
Tax paid	(38)	(75)	(102)	(144)	(194)
CF from operating activities	409	1,202	3,861	2,862	2,733
Capital expenditure	(211)	(2,672)	(1,328)	(500)	(100)
Goodwill & Prod Dev Exp	(320)	(1,572)	(900)	(900)	(900)
Income from investments	26	21	100	100	100
CF from investing activities	(505)	(4,224)	(2,128)	(1,300)	(900)
Inc/(Dec) in share capital	459	175	1,260	-	-
Inc/(Dec) in debt	367	4,367	(1,770)	(56)	1,243
Dividends & Interest paid	(429)	(1,292)	(1,429)	(1,338)	(1,789)
CF from financing activities	397	3,250	(1,939)	(1,394)	(546)
Net cash flow	301	228	(206)	168	1,287
Opening balance	384	686	913	707	875
Closing balance	686	913	707	875	2,162

Growth Indicators (%)

Year ended 31st March	2008a	2009a	2010e	2011e	2012e
Revenue	86.1	74.9	35.1	30.3	29.5
EBITDA	66.3	88.8	35.8	34.2	32.8
PAT	78.9	59.7	34.9	41.1	34.7
EPS	78.9	59.7	34.9	41.1	34.7

Valuation (x)

Year ended 31st March	2008a	2009a	2010e	2011e	2012e
PE	13.2	14.2	10.9	7.7	5.7
P/BV	5.2	5.7	3.7	2.7	2.0
EV/EBITDA	11.4	11.8	9.3	6.9	5.2
EV/Sales	3.8	4.2	3.0	2.3	1.8
Dividend Yield (%)	0.6	2.2	2.7	2.7	3.8

Financial Ratios

Year ended 31st March	2008a	2009a	2010e	2011e	2012e
RoE (%)	48.0	49.2	42.0	40.8	40.5
RoCE (%)	40.8	36.7	30.8	34.8	35.0
Debt/Equity (x)	0.3	1.0	0.4	0.3	0.3
EBIT/Interest (x)	13.7	5.2	7.8	13.1	14.8

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