

Piramal Healthcare Ltd

HOLD
CMP Rs480
TP Rs540

Q1FY2011 Update

Weak 1Q; Uncertainty over use of cash remains

Piramal Healthcare reported weak Q1FY11 results with 2.5% increase in sales and 12% decline in EBITDA. We believe Q1FY11 results are not relevant as Piramal has sold businesses that contribute 61% of its sales. While we estimate an NPV of ~Rs500/share for both the deals, the larger issue of the end use of cash remains unaddressed. We re-iterate our Hold with TP of Rs540.

India formulations & CRAMS disappoint; Critical care on track

Piramal's India formulations (55% of sales) grew 5% growth (v/s our estimate of 18%) due to the change in the ownership. CMG (20% of sales) continues to be under pressure and declined 17% YoY. Critical care business improved by 49% YoY and 22% QoQ on the back of higher Sevoflurane sales.

Lower profitability in Q1; expect to improve further

Piramal's EBITDA margin has contracted by 276bps on lower sales in India and payment of performance bonus. Lower interest, depreciation and taxes led to a 1% growth in recurring earnings.

Key Call Takeaways

1) Cash from the deal with Abbott is expected to be received by the end of Sep'10, 2) Flat growth with higher profitability of CRAMS business in FY11 while 15-20% growth guidance for FY12, 3) Desflurane will be launched earliest in FY12 and 4) Profitability of Minrad is currently at the mid-teens levels and will improve to high teens in the coming quarters.

VALUATIONS AND RECOMMENDATION

We believe Piramal's CRAMS business will strong growth with higher profitability in FY12 as innovator pharma companies come out of the mode of inventory de-stocking. However, we retain 'HOLD' as we await further clarity on the use of cash. As of now we maintain our earlier estimates as we await greater details of the eventual impact on the profitability and balance sheet.

KEY FINANCIALS (Rs mn)

	FY08	FY09	FY10	FY11E	FY12E
Net Sales	28,789	32,885	36,852	42,713	48,838
YoY Gr.(%)	17.3	14.2	12.1	15.9	14.3
Op. Profit	5,478	5,889	7,409	9,923	11,643
Op. Marg.(%)	19.0	17.9	20.1	23.2	23.8
Adj. Net Profit	3,677	3,611	4,887	6,725	8,669
YoY Gr.(%)	71.2	(1.8)	35.4	37.6	28.9

KEY RATIOS

Dil. EPS (Rs)	17.6	17.3	23.4	32.2	41.5
ROCE (%)	22.0	19.0	20.0	23.7	26.9
RoE (%)	33.8	30.0	32.6	34.5	33.6
PER (x)	27.3	27.8	20.5	14.9	11.6
EV/ Net Sales (x)	3.7	3.4	3.1	2.5	2.1
EV/EBDITA (x)	19.5	19.1	15.2	10.8	8.7

10 August 2010

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QUARTERLY SNAPSHOT (Rs mn)

	Quarter Ended		
	Dec-09	Mar-10	Jun-10
Net sales	9,077	9,418	8,424
YoY Gr. (%)	9.0	10.7	2.5
Op. Profit	1,807	2,212	1,379
OPM (%)	19.9	23.5	16.4
Adj.Net Profit	995	1,609	826
YoY Gr. (%)	66.1	10.3	(22.5)

STOCK DATA

Market cap	Rs101bn
Book Value per share	Rs81
Shares O/S (F.V. Rs2)	209mn
Free Float	48%
Avg. Trade Value (6 months)	Rs916mn
52 week High/Low	Rs600/300
Bloomberg Code	PIHC IN
Reuters Code	PIRA.BO

PERFORMANCE (%)

	1M	3M	12M
Absolute	(6.1)	(5.5)	54.6
Relative	(8.1)	(11.1)	27.9

RELATIVE PERFORMANCE

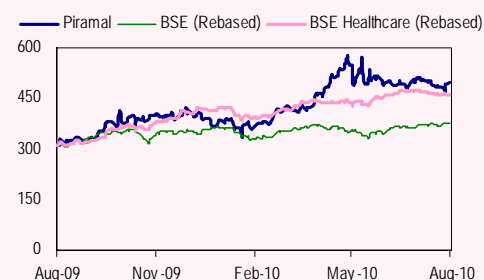


Exhibit 1 - NPV Calculation

NPV of Selloffs (Rs m)	FY11	FY12	FY13	FY14	FY15	PINC Comments
USD rate	46					
Discount rate	10%					
Inflows						
Cash from Abbott	97,774	18,448	18,448	18,448	18,448	Assumed at Rs46/USD
Cash from sales of Pathlabs	3,000	1,000	1,000	1,000	-	Upfront cash of Rs3bn and balance spread over 3 years
Total Inflows	100,774	19,448	19,448	19,448	18,448	
Outflows						
Income Tax	37,587					Payment for the whole deal will have to be made in FY11; Tax liability for Pathlabs assumed at Rs700m
Non Compete to Promoter	3,500					
Staff payments	900					Gratuity payments to Staff
Debt Repayment	10,000					Repayment of the high cost debt
Total Outflows	51,987	-	-	-	-	
Net Cash flows	48,788	19,448	19,448	19,448	18,448	
PV	48,788	16,131	14,692	13,380	11,559	Discounted at 10%
NPV	104,550					
NPV Per share	500					

Source: Company, PINC Research

Exhibit 2 - Q1FY11 Earnings Summary (Rs mn)

Year to 31 March	Q1FY10	Q1FY11	% Ch YoY	Q4FY10	% Ch QoQ	PINC Comments
Net Sales	8,215	8,424	2.5	9,418	(10.6)	Healthcare Solutions business led the growth
Expenditure	6,644	7,045	6.0	7,206	(2.2)	
Operating profits	1,571	1,379	(12.3)	2,212	(37.7)	
OPM (%)	19.1	16.4	-276 bps	23.5	(30.3)	Gross margin reduction and higher staff cost has contracted margins
Interest	254	145	(42.8)	192	(24.3)	Debt repayment has reduced the interest burden; Quarterly run rate of Rs200m
Depreciation	385	381	(1.1)	233	63.5	
Other income	0	0	(100.0)	0		
Exceptional Items	30	(19)		(66)		VRS payment in Q1FY11 while exchange gain in Q1FY10
PBT	963	833	(13.5)	1,721	(51.6)	
Tax	113	27	(76.4)	178	(85.1)	
Tax rate (%)	11.7	3.2	-850 bps	10.3	(69.2)	
Minority Interest	0	0	-	0	#DIV/0!	
Reported Profit	851	807	(5.1)	1,543	(47.7)	
Adjusted Net profit	820	826	0.7	1,609	(48.7)	Exclude the exceptional items

Source: Company, PINC Research

Exhibit 3 - Q1FY11 Expenditure Breakup (Rs mn)

Year to 31 March	Q1FY10	Q1FY11	% Ch YoY	Q4FY10	% Ch QoQ	PINC Comments
Net Sales	8,215	8,424	2.5	9,418	(10.6)	Overall sales growth muted due to Indian Formulations and CRAMS
Consumption of Raw Materials	3,117	3,278	5.2	3,486	(6.0)	
% of Net sales	37.9	38.9	97 bps	37.0	5.1	Higher RM costs due to higher contribution from the India sales
Staff Cost	1,360	1,575	15.8	1,352	16.5	Performance bonus and increases were paid in Q1FY11
% of Net sales	16.6	18.7	214 bps	14.4	30.2	
Other Expenses	2,167	2,193	1.2	2,369	(7.4)	
% of Net sales	26.4	26.0	-35 bps	25.2	3.5	
Total Expenditure	6,644	7,045	6.0	7,206	(2.2)	
% of Net sales	80.9	83.6	276 bps	76.5	9.3	

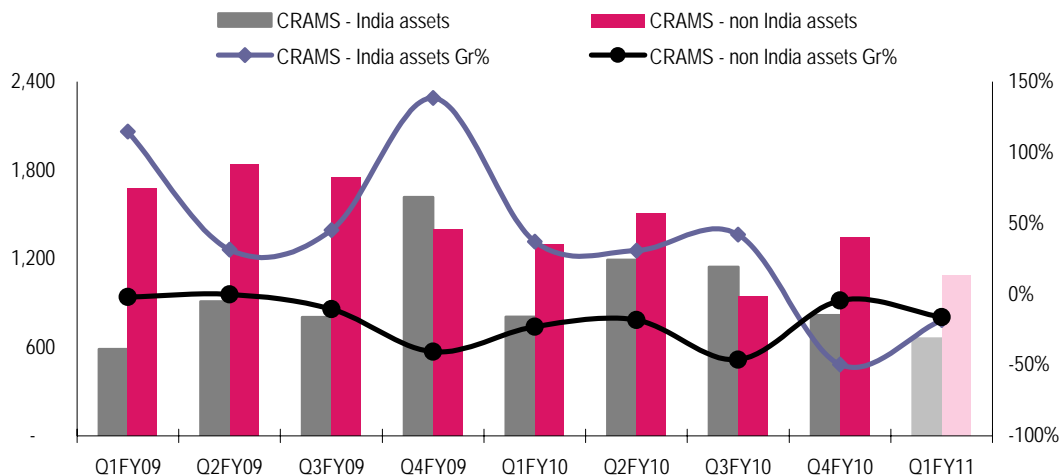
Source: Company, PINC Research

Exhibit 4 - Q1FY11 Revenue Classification (Rs mn)

Year to 31 March	Q1FY10	Q1FY11	% Ch YoY	Q4FY10	% Ch QoQ	PINC Comments
Healthcare	4,397	4,613	4.9	5,394	(14.5)	Growth impacted by the change in ownership
CMG	2,104	1,748	(16.9)	2,160	(19.1)	Flat for FY11 for both assets;
India	807	660	(18.3)	818	(19.3)	Lumpy order last year that will be in Q3/4 in FY11
Outside India	1,297	1,088	(16.1)	1,342	(18.9)	
Pathlabs	485	536	10.6	529	1.3	Tepid growth; Business has been sold to Super Religare Ltd
Global Critical care	729	1,082	48.5	884	22.4	Higher Sevoflurane sales; Filed 27 registrations; Similar quarterly run rate
Others { MMBB (inhalation anesthetic, Vitamin A, APIs), diagnostic devices, other op income}	501	445	(11.1)	451	(1.4)	Not a focus area
Total	8,215	8,424	2.5	9,418	(10.6)	Overall growth driven by Global Criticare

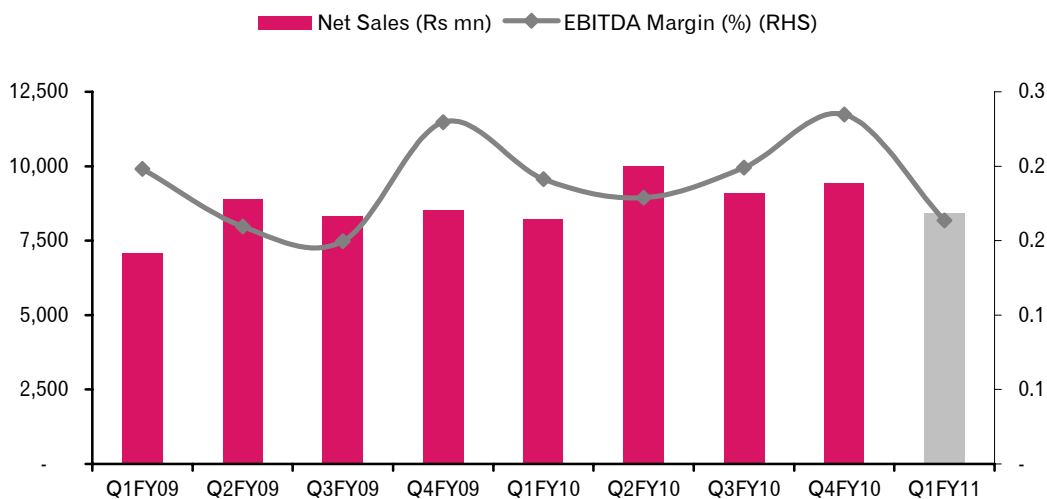
Source: Company, PINC Research

Exhibit 5 - CRAMS Sales from India and Non-India Assets



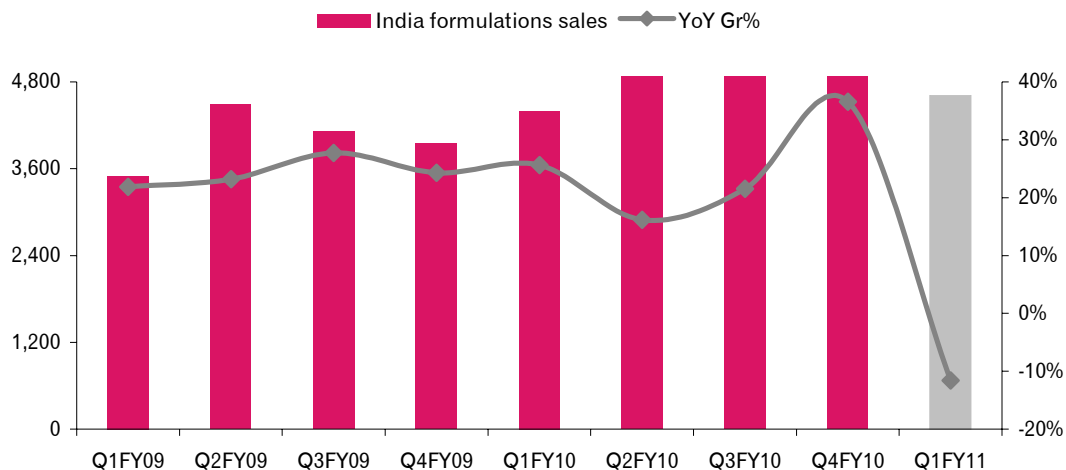
Source: Company, PINC Research

Exhibit 6 - Net Sales (Rs mn) and EBITDA Margin (%)



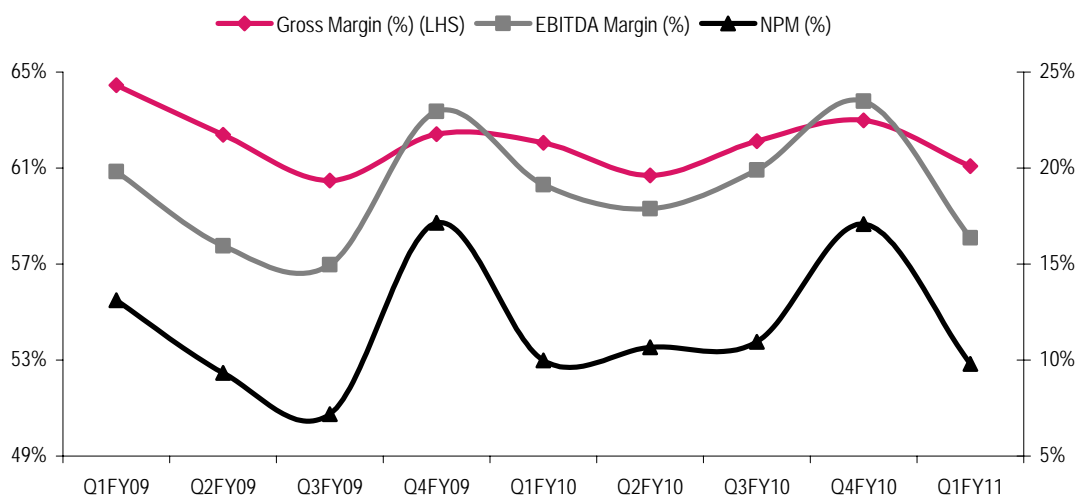
Source: Company, PINC Research

Exhibit 7 - India Formulation Sales (Rs mn) and Growth (%)



Source: Company, PINC Research

Exhibit 8 - Gross Margin and EBITDA Margin (%)



Source: Company, PINC Research

Year Ended March (Figures in Rs mn)

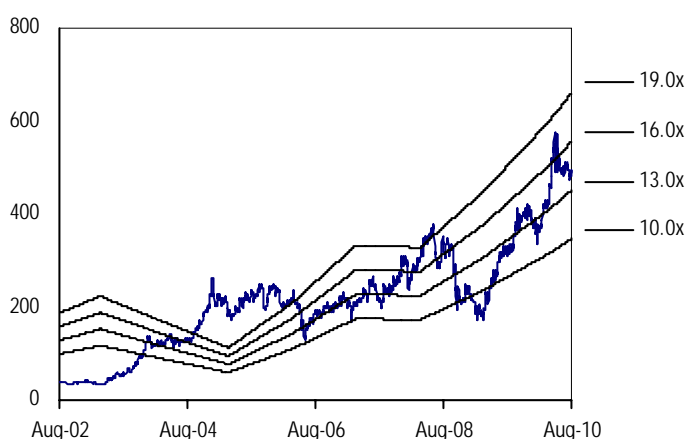
Income Statement	FY08	FY09	FY10	FY11E	FY12E
Net sales	28,483	32,448	36,244	42,105	48,231
Other operating income	306	437	608	608	608
Total revenues	28,789	32,885	36,852	42,713	48,838
Growth (%)	17.3	14.2	12.1	15.9	14.3
EBITDA	5,478	5,889	7,409	9,923	11,643
Growth (%)	49.8	7.5	25.8	33.9	17.3
Depreciation	947	1,196	1,427	1,624	1,653
Other Income	-	0	0	119	203
EBIT	4,530	4,694	5,983	8,418	10,192
Interest Paid	463	838	916	757	313
PBT (before E/o items)	4,067	3,856	5,067	7,660	9,879
Tax Provision	377	219	181	911	1,185
E/o income/(loss)	(339)	(446)	(69)	(69)	-
Reported Net Profit	3,338	3,164	4,818	6,655	8,669
Adjusted Net Profit	3,677	3,611	4,887	6,725	8,669
Growth (%)	71.2	(1.8)	35.4	37.6	28.9
Diluted EPS (Rs)	17.6	17.3	23.4	32.2	41.5
Diluted EPS Growth (%)	71.2	(1.8)	35.4	37.6	28.9

Cash Flow Statement	FY08	FY09	FY10	FY11E	FY12E
Pre-tax profit	3,728	3,408	4,998	7,591	9,879
Depreciation	947	1,196	1,427	1,624	1,653
Total Tax Paid	(492)	(864)	(1,077)	(683)	(889)
Chg in working capital	(1,474)	(853)	(2,316)	137	(1,329)
Other operating activities	650	864	1,207	757	313
Cash flow from oper (a)	3,359	3,750	4,239	9,427	9,627
Capital Expenditure	(2,307)	(4,437)	(2,617)	(1,651)	(2,017)
Chg in invetments	(368)	345	(47)	-	-
Other investing activities	(134)	320	1,089	119	203
Cash flow from inv.(b)	(2,809)	(3,771)	(1,575)	(1,532)	(1,815)
Free cash flow (a+b)	549	(21)	2,664	7,895	7,812
Equity raised/(repaid)	-	-	-	-	-
Debt raised/(repaid)	1,163	3,100	460	(4,000)	(5,000)
Change in Minority Int	-	-	-	-	-
Dividend (incl. Tax)	(140)	(1,027)	(1,027)	(1,311)	(1,311)
Other financing activities	(1,583)	(2,170)	(2,568)	(876)	(516)
Cash flow from fin. (c)	(560)	(97)	(3,135)	(6,187)	(6,827)
Net chg in cash (a+b+c)	(11)	(118)	(471)	1,708	985

Balance Sheet	FY08	FY09	FY10	FY11E	FY12E
Equity Share Capital	418	418	418	418	418
Reserves & surplus	10,508	12,753	16,429	21,719	29,077
Shareholders' funds	10,926	13,171	16,847	22,137	29,495
Minorities interests	49	75	-	-	-
Total Debt	7,163	13,391	12,949	8,949	3,949
Capital Employed	18,138	26,636	29,796	31,086	33,444
Net fixed assets	12,585	20,391	21,130	21,157	21,521
Cash & Cash Eq.	551	946	412	2,196	3,182
Net Other current assets	5,246	5,747	8,499	8,362	9,691
Investments	653	278	326	326	326
Net Deferred tax Assets	(897)	(726)	(568)	(796)	(1,092)
Total Assets	18,138	26,636	29,798	31,244	33,627

Key Ratios	FY08	FY09	FY10	FY11E	FY12E
OPM (%)	19.0	17.9	20.1	23.2	23.8
Net Margin (%)	12.8	11.0	13.3	15.7	17.7
Div. Yield (%)	0.9	0.9	1.1	1.1	1.1
Net debt/Equity (x)	0.5	0.9	0.7	0.3	0.0
Net Working Capital (days)	66.5	63.8	84.2	71.5	72.4
ROCE (%)	22.0	19.0	20.0	23.7	26.9
RoE (%)	33.8	30.0	32.6	34.5	33.6
EV/Net Sales (x)	3.7	3.4	3.1	2.5	2.1
EV/EBITDA (x)	19.5	19.1	15.2	10.8	8.7
PER (x)	27.3	27.8	20.5	14.9	11.6
PCE (x)	23.4	22.9	16.1	12.1	9.7
Price/Book (x)	9.2	7.6	6.0	4.5	3.4

P/E Band



Key Assumptions	FY 08	FY 09	FY 10	FY 11 e	FY12 e
Domestic Sales (Rsm)	13,278	16,263	19,732	22,397	25,446
CMG (% chng YoY)	24.3	5.2	(16.7)	11.9	9.7
CMG - India assets	194.5	73.7	(4.2)	34.9	18.9
CMG - global assets	6.6	(14.6)	(24.0)	(5.1)	-
CMG margins	12.0	13.5	17.5	19.6	20.0
Domestic Sales (% chng YoY)	3.4	22.5	21.3	13.5	13.6
Contract Manufacturing (Rsm)	10,084	10,605	8,838	9,893	10,853
Non CMG margins	21.3	22.0	22.2	24.3	24.9
R & D/Sales (%)	2.8	2.6	1.9	2.5	2.5
EBITDA margin (%)	19.0	17.9	20.1	23.2	23.8

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