Shasun Chemicals

STOCK INFO.	BLOOMBERG
BSE Sensex: 14,041	SSCD IN
	REUTERS CODE
S&P CNX: 4,066	SHAS.BO

Equity Shares (m)	48.1
52-Week Range	136/60
1,6,12 Rel. Perf. (%)	12/43/-25
M.Cap. (Rs b)	6.0
M.Cap. (US$ b)	0.1

23 January 2007

Buy

Previous Recommendation: Buy

Rs124

YEAR END	NET SALES* (RS M)	PAT* (RS M)	EPS* (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES	EV/ EBITDA
03/06A	3,578	365	7.6	11.7	16.3	3.3	23.0	19.7	1.9	9.6
03/07E	7,979	-99	-2.1	N.A.	-	2.9	19.4	16.5	1.7	9.5
03/08E	9,749	585	12.2	N.A.	10.2	2.4	23.7	20.9	1.3	6.7

*Consolidated

Shasun Chemicals 3QFY07 results were in-line with our estimates although top-line was below estimates. Key highlights:

- Net sales at Rs982m (down 1%) were below estimates due to deferment of some of the CRAMS business to 4Q and lower Ranitidine off-take by GSK. Stand-alone PAT declined by 22% to Rs100m.
- **Consolidated performance**: Sales were up almost 100% to Rs1.86b, mainly due to consolidation of the Rhodia UK units (RPS) which contributed about Rs900m to sales. EBITDA margins (at 6%) were adversely impacted due to losses at RPS which reported EBITDA loss of Rs61m. Management has indicated that RPS reported a net loss of Rs90m (excl goodwill write-back).
- RPS has commenced supplying validation batches for 3 new products. Commercial level supplies for these products are likely to commence from FY08 onwards. RPS' current capacity utilization is at 40-50%, which the management expects to increase to 50-60% by FY08E mainly through addition of new contracts and ramp-up of existing contracts. We believe that new contract additions should augur well for RPS' turnaround.

Shasun's operations are likely to undergo a gradual transformation, led by higher revenues from CRAMS and commercialization of the company's generics pipeline, thus resulting in a gradual increase in EBITDA margins. Although, the acquisition of Rhodia's custom manufacturing business is likely to negatively impact Shasun's consolidated earnings for FY07E, we believe that it can bring in long-term benefits. We expect the RPS to achieve break-even (at net level) by FY08E led by increased order flow from innovator and emerging pharma clients. At 10.2x FY08E consolidated EPS, we believe valuations are reasonable and do not factor-in the improved prospects for the UK operations. We maintain **Buy**.

QUARTERLY PERFORMANCE (STANDALONE) (Rs Million)

Y/E MARCH	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Net Sales	**750**	**844**	**993**	**991**	**955**	**1,030**	**982**	**1,357**	**3,578**	**4,324**
YoY Change (%)	*14.3*	*2.8*	*31.0*	*-4.3*	*27.3*	*22.0*	*-1.1*	*36.9*	*9.4*	*20.8*
Total Expenditure	628	698	789	764	809	864	805	1,087	2,880	3,565
EBITDA	**122**	**146**	**203**	**228**	**146**	**166**	**176**	**270**	**698**	**758**
Margins (%)	*16.2*	*17.3*	*20.5*	*23.0*	*15.3*	*16.1*	*18.0*	*19.9*	*19.5*	*17.5*
Depreciation	52	58	61	60	67	66	67	78	231	277
Interest	13	13	13	11	11	15	16	22	49	64
Other Income	2	3	2	6	3	5	12	-7	13	12
PBT	**59**	**78**	**132**	**163**	**71**	**89**	**105**	**164**	**431**	**429**
Tax	17	15	**4**	**28**	**15**	**14**	**1**	**25**	**63**	**56**
Deferred Tax	-1	1	-1	4	-6	-3	3	6	3	0
Rate (%)	*27.3*	*20.3*	*2.0*	*19.4*	*13.2*	*13.1*	*4.0*	*18.6*	*15.3*	*13.0*
PAT	**43**	**62**	**129**	**132**	**62**	**78**	**100**	**133**	**365**	**373**
YoY Change (%)	*8.7*	*8.6*	*43.2*	*6.0*	*44.8*	*25.5*	*-22.2*	*1.3*	*17.6*	*2.2*
Margins (%)	*5.7*	*7.3*	*13.0*	*13.3*	*6.5*	*7.5*	*10.2*	*9.8*	*10.2*	*8.6*

E: MOSt Estimates

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CRAMS and Ranitidine adversely impact sales

Stand-alone net sales at Rs982m (down 1%) were below estimates due to deferment of some of the CRAMS business to 4Q. The Ibuprofen portfolio has grown by 20% led by both higher volumes as well as increased realizations. As expected Ranitidine sales were down by 80% due to lower off-take from GSK. CRAMS revenues were down 70% as a major portion of sales have been deferred to 4Q.

Domestic operations (which contributed 43% of sales), grew by 97% while exports de-grew by 20%. Domestic sales were driven by higher sales of Ibuprofen.

TREND IN PRODUCT MIX (STANDALONE) (RS MILLION)

	3QFY07	3QFY06	YOY (%)	2QFY07	QOQ (%)
Ibuprofen	574	477	20.3	562	2.0
Ranitidine	23	119	-80.9	22	1.8
Nizatidine	168	109	53.9	239	-29.6
CRAMS	73	238	-69.6	66	9.3
Others	146	31	366.5	114	28.3
Excipients	22	10	124.9	34	-36.2
Gross Sales	**1,004**	**984**	**2.1**	**1,037**	**-3.2**

Source: Company

Ibuprofen sales were boosted by withdrawal of Valdecoxib and safety issues surrounding other Cox-II inhibitors. Furthermore, in domestic market, NPPA notified a 10.5% price increase for Ibuprofen to Rs408/kg in July 2006, which should augur well for Shasun in the coming quarters.

EBITDA margins decline

EBITDA margins for 3QFY07 declined by 250bp YoY to 18%, impacted by lower CRAMS sales and higher material costs (up 11%) and staff costs (up 25%). Shasun's Ibuprofen business does not enjoy high margins and hence a significant increase in Ibuprofen sales has actually led to a decline in margins. The Ibuprofen business is facing input cost pressures as some of the key inputs are linked to the petrochemical cycle. Since the product has been completely genericised, Shasun is unable to pass-on the price increase to its customers. However, the recent price increase granted by the NPPA in the domestic market should partly negate the adverse impact.

Lower tax tempers down adverse impact on PAT

Shasun's effective tax rate for 3QFY07 was only 4% compared to 13% in 1HFY07 which has partly compensated for the adverse sales growth. We believe that the company is likely to provide for tax at a much higher rate in 4QFY07.

Consolidated financials

Sales were up almost 100% to Rs1.86b, mainly due to consolidation of the Rhodia UK units (RPS) which contributed about Rs900m to sales. As expected consolidated EBITDA margins (at 6%) were adversely impacted due to losses at RPS which reported EBITDA loss of Rs61m. Management has indicated that the UK operations reported a net loss of Rs90m (excl the impact of goodwill write-back).

RPS has commenced supplying validation batches for 3 new products. Commercial level supplies for these products are likely to commence from FY08E onwards. RPS' current capacity utilization is at 40-50%, which the management expects to increase to 50-60% by FY08E mainly through addition of new contracts and ramp-up of existing contracts. We believe that new contract additions should augur well for RPS' turnaround.

RPS losses on a decline

Post its take-over by Shasun, RPS has gradually reduced its losses over the last three quarters which have come down from a high of Rs220m in 1QFY07 to Rs90m for 3QFY07. Increasing top-line, led by new contracts and traction in existing clients, coupled with tight cost control has helped RPS to reduce its losses.

Equity dilution not ruled out

Shasun has guided a consolidated capex (including RPS) of about Rs1.7b over FY07-08. RPS is likely to spend GBP5m in FY07E and GBP3m in FY08E towards capital expenditure. The India operations are likely to incur Rs400m capex for FY07E and Rs600m for FY08E (mainly for setting up new SEZ at Vizag). Although, Shasun may not require external funds immediately, we believe that it may resort to equity dilution in FY08E to part-fund its capex.

Valuation and outlook

CRAMS and Generics to be the main growth drivers

We believe that Shasun's operations will be back on the growth path from FY08E onwards led mainly by the commencement of generic supplies as well as higher traction in its CRAMS business. Our estimates do not include upsides from any potential contracts that the company may sign going forward (Shasun has indicated supply of validation batches to some of the innovator companies). We have also not included upsides from any new partnership arrangements that the company may enter into for its generics business.

Changing sales mix to expand EBITDA margins

We expect a gradual improvement in Shasun's EBITDA margins (stand-alone) led by increased revenues from the CRAMS segment as well as commencement of generic exports from FY07E onwards. It should be noted that both these segments will enjoy better margins (20%+) as compared to the 15-20% margin for the company's mature products (which contributed about 80% of revenues for FY06). We expect mature product's contribution to decline from about 80% (for FY06) to about 65-70% in FY08E, thus positively impacting EBITDA margins beginning FY08E onwards.

MNC relationships will help in the long-term

Shasun has existing relationships with MNCs like Eli Lilly, GSK Pharma, Boots Plc (now taken over by Reckitt Benckiser) for their global requirements. In India, the company has existing arrangements with Sanofi-Aventis and Abbott for supplying Ibuprofen. We believe that, given the confidential nature of the CRAMS industry, having existing MNC relationships and a track record of servicing MNC clients will have long-term advantages for Shasun. The company is likely to leverage these relationships to expand its current CRAMS pipeline (by adding more products as well as by entering into new relationships).

CRAMS business has long gestation period

The CRAMS business has a long gestation period. As the Indian CRAMS industry is still evolving, potential customers take a long time to award contracts. Secondly, as a test case, the initial off-take by the customer may not be very high. It should also be noted that post the announcement of the contract it takes 18-24 months for the supplies to begin. This is due to the time-consuming registration process with various countries before which supplies cannot commence. Depending on the type of contract and the products to be manufactured, the contract manufacturer may also have to undertake front-ended capex to set up dedicated facilities for servicing the contract. We believe that Shasun's existing facilities are capable of servicing 2-3 new contracts.

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

Shasun acquired the pharmaceutical customs synthesis business of Rhodia Pharma Solutions (RPS), UK in early 2006.

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. RPS had revenues of Euro 60m in CY05 and had operating loss of Euro 9m. Shasun would retain existing management along with existing 349 employees.
- Shasun would be investing around US$35m in RPS, including purchase consideration, working capital requirement and enhancing capabilities. Of investment of US$35m for RPS, Shasun would be making equity investment of around US$10m in RPS and balance US$25m would be in form of debt.
- RPS has a pipeline of 14 products in Phase II(B) and Phase III, with around 12 products already commercialized. Shasun's CCS pipeline gets strengthened because of this acquisition.
- Also, this acquisition brings in customer base which primarily consists of emerging pharmaceutical companies. About 98% of customers have continued

their relationship with RPS post the take-over by Shasun.

- RPS has been making loss at operating level as it has only around 12 products commercialized and was operating at around 40-50% capacity utilization. Shasun is hopeful of turning around RPS in FY08E by improving capacity utilization as 14 products are in late stage of development. The company is hopeful of achieving higher growth in revenues of RPS (led by increased order flow from big pharma and emerging pharma clients) and marginal savings in cost arising out of sourcing some raw material from India. We believe that top-line growth is critical to RPS' turnaround.

New contracts and ramp-up in existing contracts to drive top-line for RPS

Shasun has indicated that RPS has commenced supplying validation batches for 3 new products. Commercial level supplies for these products are likely to commence from FY08 onwards. RPS' current capacity utilization is at 40-50%, which the management expects to increase to 60% by FY08E mainly through addition of new contracts and ramp-up of existing contracts. We believe that new contract additions should augur well for RPS' turnaround.

Commercialized pipeline

RPS is a preferred supplier for 4 of the top 5 pharmaceutical companies and supplies to 18 of the top 20 companies globally. It has indicated significant traction in this segment driven by progression of some products through the clinical development pipeline.

US presence to gain client proximity

RPS 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.

Guides RPS break-even in FY08E

Shasun management has guided that RPS is likely to turnaround in FY08E and may generate minor profits. We believe that Shasun may not be able to immediately transfer the RPS manufacturing to India, given the regulatory issues involved as well as some of the critical technologies involved and hence top-line growth becomes imperative for RPS' turnaround. We have forecast revenues of GBP43m for FY07E and GBP 55m for FY08E. We estimate break-even for RPS by FY08E (PAT of GBP 0.6m), and hence in the interim, it would drag down the consolidated earnings in the short-term. On consolidation with RPS (and factoring in the increased funding requirements), we expect a net loss of Rs100m (excl. write back of goodwill) as against stand-alone EPS of Rs11. For FY08E EPS we expect consolidated EPS of Rs12.2.

FINANCIAL STATEMENTS (RS M)

	FY07E			FY08E		
	RPS	SHASUN	CONSOL.	RPS	SHASUN	CONSOL.
Sales	3,655	4,318	7,973	4,642	5,109	9,751
EBITDA	-370	757	387	274	1,016	1,289
Depreciation	43	277	320	85	315	400
PBIT	-412	491	79	189	716	904
Interest	43	64	107	77	70	147
Tax	17	56	73	60	113	172
PAT	-472	372	-100	53	532	585
EPS (Rs)		7.7	-2.1		11.1	12.2

Source: Motilal Oswal Securities

This acquisition would aid transformation of Shasun's operations in favor of CRAMS business. Through the RPS 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.

Shasun's operations are likely to undergo a gradual transformation, led by higher revenues from CRAMS and commercialization of the company's generics pipeline, thus resulting in a gradual increase in EBITDA margins. Although, the acquisition of Rhodia's custom manufacturing business is likely to negatively impact Shasun's consolidated earnings for FY07E (net loss of Rs100m), we believe that it can bring in long-term benefits. We expect the UK operations to achieve break-even (at net level) by FY08E led by increased order flow from innovator and emerging pharma clients. At 10.2x FY08E consolidated EPS, we believe valuations are reasonable and do not factor-in the improved prospects for the UK operations. We maintain **Buy** with target price of Rs140.

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

Recent developments

- Has acquired Rhodia's custom manufacturing business in early 2006 – a significant acquisition given its current size.

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 FY08E onwards
- Valuations at 10.2x FY08E EPS (consolidated) are reasonable; **Buy** with a target price of Rs140.

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	-	35.4	22.5
	FY08E	10.2	26.2	16.9
P/BV (x)	FY07E	2.9	9.2	3.4
	FY08E	2.4	7.2	2.8
EV/Sales (x)	FY07E	1.7	6.3	2.2
	FY08E	1.3	5.2	1.9
EV/EBITDA (x)	FY07E	9.5	22.6	12.6
	FY08E	6.7	17.6	9.4

SHAREHOLDING PATTERN (%)

	DEC.06	SEP.06	DEC.05
Promoter	42.7	42.5	42.4
Domestic Inst	12.4	11.6	15.6
Foreign	17.2	16.2	12.8
Others	27.7	29.7	29.2

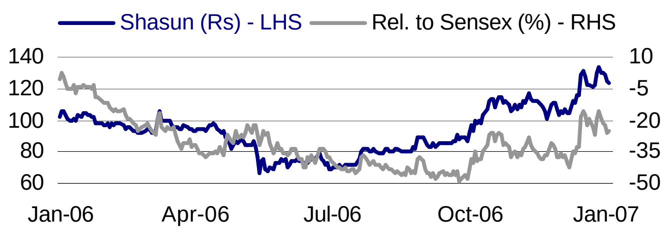
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	-2.1	2.7	-
FY08	12.2	10.0	22.2

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
124	140	12.9	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					(Rs Million)
Y/E MARCH	2005	2006	2007E	2008E	2009E
Net Sales	**3,271**	**3,578**	**4,324**	**5,107**	**5,735**
Net Sales (incl RPS)	***3,271***	***3,578***	***7,979***	***9,749***	***10,841***
Change (%)	*22.2*	*9.4*	*20.8*	*18.1*	*12.3*
Total Expenditure	2,587	2,880	3,565	4,092	4,540
% of Sales	*79.1*	*80.5*	*82.5*	*80.1*	*79.2*
EBITDA	**684**	**698**	**758**	**1,015**	**1,196**
Margin (%)	*20.9*	*19.5*	*17.5*	*19.9*	*20.8*
Depreciation	216	231	277	315	351
Int. and Finance Charges	34	49	64	70	60
Other Income - Rec.	8	13	12	15	20
PBT	**443**	**431**	**429**	**645**	**805**
Current Tax	70	63	56	71	89
Deferred Tax	62	3	0	42	52
Tax Rate (%)	*29.9*	*15.2*	*13.0*	*17.5*	*17.5*
PAT Adj for EO Items	**310**	**365**	**373**	**532**	**664**
Change (%)	*30.2*	*17.7*	*2.1*	*42.7*	*24.9*
Margin (%)	*9.5*	*10.2*	*8.6*	*10.4*	*11.6*
Add: Share of RPS profits	0	0	-472	53	174
Net Profit (incl RPS)	**310**	**365**	**-99**	**585**	**838**

BALANCE SHEET (STANDALONE)					(Rs Million)
Y/E MARCH	2005	2006	2007E	2008E	2009E
Equity Share Capital	91	96	96	96	96
Total Reserves	1,296	1,703	1,955	2,350	2,878
Net Worth	**1,387**	**1,799**	**2,052**	**2,447**	**2,974**
Deferred Liabilities	205	208	208	250	302
Total Loans	893	795	1,345	995	995
Capital Employed	**2,485**	**2,802**	**3,605**	**3,692**	**4,272**
Gross Block	2,517	2,914	3,464	3,864	4,014
Less: Accum. Deprn.	952	1,166	1,444	1,759	2,109
Net Fixed Assets	**1,565**	**1,747**	**2,020**	**2,105**	**1,904**
Capital WIP	170	22	300	150	151
Total Investments	2	59	445	445	445
Curr. Assets, Loans an	**1,496**	**1,706**	**1,732**	**2,036**	**2,927**
Inventory	471	450	594	691	775
Account Receivables	652	918	804	946	1,061
Cash and Bank Balance	150	50	112	137	798
Loans and Advances	222	288	223	262	294
Curr. Liability & Prov.	**749**	**733**	**892**	**1,045**	**1,156**
Account Payables	470	421	509	601	675
Other Current Liabilities	174	204	233	272	304
Provisions	104	108	150	171	177
Net Current Assets	**747**	**973**	**840**	**992**	**1,771**
Misc Expenditure	3	1	1	1	1
Appl. of Funds	**2,486**	**2,802**	**3,605**	**3,692**	**4,272**

E: MOSt Estimates; RPS=Shasun Pharma SolutionsUK

RATIOS (STANDALONE)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Basic (Rs)					
EPS-consolidated	**6.8**	**7.6**	**-2.1**	**12.2**	**17.4**
Cash EPS	11.5	12.4	3.7	18.7	24.7
BV/Share	30.3	37.4	42.6	50.8	61.8
DPS	1.5	1.7	2.2	2.5	2.5
Payout (%)	25.3	25.5	32.3	25.8	20.6
Valuation (x)					
P/E		16.3	-	10.2	7.1
Cash P/E		10.0	33.4	6.6	5.0
P/BV		3.3	2.9	2.4	2.0
EV/Sales		1.9	1.7	1.3	1.1
EV/EBITDA		9.6	9.5	6.7	5.2
Dividend Yield (%)		1.4	1.8	2.0	2.0
Return Ratios (%)					
RoE	24.7	23.0	19.4	23.7	24.5
RoCE	24.0	19.7	16.5	20.9	23.4
Working Capital Ratios					
Debtor (Days)	71	91	66	66	66
Creditor (Days)	103	87	83	86	89
Inventory (Days)	53	46	50	49	49.3
Wkg. Cap. Turnover (Days)	67	94	61	61	62
Leverage Ratio (x)					
Debt/Equity	0.6	0.4	0.7	0.4	0.3

CASH FLOW STATEMENT (STANDALONE)					(Rs Million)
Y/E MARCH	2005	2006	2007E	2008E	2009E
Oper. Profit/(Loss) before T	684	698	758	1,015	1,196
Interest/Dividends Recd.	8	13	12	15	20
Direct Taxes Paid	-70	-63	-56	-71	-89
(Inc)/Dec in WC	-159	-326	195	-127	-119
CF from Operations	**464**	**323**	**910**	**833**	**1,008**
(Inc)/Dec in FA	-589	-266	-828	-250	-151
CF from Investments	**-589**	**-323**	**-1,214**	**-250**	**-151**
					857
Issue of Shares	23	142	0	0	0
(Inc)/Dec in Debt	336	-98	551	-350	0
Interest Paid	-34	-49	-64	-70	-60
Dividend Paid	-78	-93	-121	-137	-137
CF from Fin. Activity	**247**	**-99**	**366**	**-557**	**-197**
Inc/Dec of Cash	**122**	**-99**	**62**	**25**	**661**
Add: Beginning Balance	27	150	50	112	137
Closing Balance	**149**	**50**	**112**	**137**	**798**

NOTES

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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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