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On-line Share Trading

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RESULT UPDATE √

Piramal Healthcare (NICPIR)

Current Price	Target Price
Rs 327	Rs 373
Potential upside	Time Frame
14 %	12-15 months

PERFORMER

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WHAT'S CHANGED...

PRICE TARGET..Changed to Rs 373
EPS (FY10E)...Changed to Rs 20.9 from Rs 24.3
EPS (FY11E)...Changed to Rs 26.6 from Rs 28.7
RATING...Changed to performer from hold

CRAMS revenue under pressure...

Piramal Healthcare (PHIL) Q1FY10 results were below our expectations. The company reported 25% YoY net profit growth in Q1FY10 to Rs 85 crore, however the adjusted net profit de-grew by ~11% YoY to Rs 80.6 crore on making adjustments for the Q1FY09 Rs 23 crore forex loss and Rs 4.06 crore exceptional item, and Q1FY10 Rs 4.4 crore forex gain. EBITDA margins from core operations declined 100bps to ~19% while after making forex related adjustments, the EBITDA margin improved by ~260bps to 19.5%. Total revenue improved 16% YoY to Rs 821.5 crore in Q1FY10 on the back of momentum in domestic formulation and Pathlab business. CRAMS business remained under pressure with Q1FY10 revenue falling by ~17% YoY to Rs 190 crore, due to the continuing trend among CRAMS clients to reduce channel inventory. We rate the stock as PERFORMER.

Highlight of the quarter

PHIL's domestic business grew 26% YoY (~13% industry growth) to ~Rs 440 crore on account of ~50% & ~36% YoY growth in anti-infective & respiratory. CRAMS declined on closure of Huddersfield plant and channel inventory issues. Minrad break even at EBITDA. Higher debt level raised interest cost.

Valuations

PHIL is currently trading at 12.28x FY11E EPS of Rs 26.63. With robust growth in domestic revenue and guidance of better performance in H2FY10 in the CRAMS space, we expect PHIL to improve its performance. We rate the stock as **PERFORMER** with a target of Rs 373, 14x FY11E EPS.

Stock Data....	
Market Cap.	Rs 6834 crore
Debt (FY09)	Rs 713 crore
Cash (FY08)	Rs 52 crore
EV	Rs 7443 crore
52 week H/L	Rs 366/163
Equity capital	Rs 42 crore
Face value	2
MF Holding (%)	5.55%
FII Holding (%)	21.60%

Price performance (%)

	Returns			
	1M	3M	6M	12M
Biocon	12	40	89	22
Glenmark	6	20	-16	-64
Elder	7	26	10	-15
Sun	-6	1	9	-7
Alembic	-7	1	18	-15
Dishman	10	63	43	-26
IPCA	1	29	42	-4

Exhibit 1: Key Financials Rs Crore

	Q1FY10A	Q1FY10E	Q1FY09	Q4FY09	YoY Gr. (%)	QoQ Gr. (%)	FY09	FY10E	FY11E
Net Sales	821.5	861.0	708.3	850.9	16.0	-3.5	3281.1	3448.7	3819.7
EBIDTA	160.2	182.0	119.5	195.3	34.0	-18.0	581.3	738.4	869.3
EBIDTA Margin (%)	19.5	21.1	16.9	23.0	2.62	-3.5	17.7	21.4	22.8
Depreciation	38.5	33.4	27.0	34.3	42.8	12.2	119.6	128.7	116.9
Interest	25.4	23.0	12.0	28.6	111.1	-11.3	83.9	92.0	95.0
Other Income/Extraordinary item	0.0	1.2	0.1	7.2	-63.6	-99.4	7.4	5.0	36.7
Reported Net Profit	85.1	105.5	68.1	114.9	25.0	-25.9	316.2	437.5	556.5
EPS (Rs)	4.1	5.0	3.3	5.5			15.1	20.9	26.6
Valuation									
PE (x)	-	-	-	-	-	-	21.6	15.6	12.3
Target PE (x)	-	-	-	-	-	-	24.7	17.8	14.0
EV to EBIDTA (x)	-	-	-	-	-	-	13.9	11.0	9.0
Price to book (x)	-	-	-	-	-	-	5.2	4.1	3.2
RoNW (%)	-	-	-	-	-	-	24.0	26.3	26.2
RoCE (%)	-	-	-	-	-	-	17.7	20.2	22.5

Source: Company, ICICIdirect.com Research

Result analysis

Topline growth below our expectations, but still robust

PHIL's consolidated revenue grew ~16% YoY to Rs 821 crore on account of better-than-expected performance in the domestic market and contribution from recently acquired Minrad. Lower than expected growth of the CRAMS operation led the revenue grow slower than our expectation of Rs 861 crore. The domestic formulations division, which is the largest contributor to PHIL's consolidated revenue at ~54%, reported strong growth of ~26% YoY to Rs 440 crore on account of good performance from the Anti-Infective, Respiratory, Anti-diabetic and Dermatology therapies. The top 10 brands and lifestyle products together contributed ~61% to the overall revenues. We believe the domestic formulations business continues to remain an attractive growth avenue for the company.

All therapy areas witnessed robust growth

On a YoY basis, PHIL's domestic formulation business showed a robust 26% increase in revenues. The company grew much ahead of the industry growth rate of 13.3%. This performance was achieved on the back of solid growth from across all the therapeutic areas. Respiratory, CVS and anti-infective grew aggressively contributing over 44% to the total domestic sales.

Exhibit 2: Key Therapeutic Areas

	Q1FY10	Q1FY09	% Growth
Respiratory	59.5	43.8	36.0
Anti-Infective	73.7	49.1	50.2
CVS	62.2	52.3	18.8
CNS	50.0	44.7	12.0
Nutitionals	29.2	24.5	19.3
Biotek	7.0	7.1	-1.4
Anti-Diabetic	30.5	24.6	24.3
Gastrointestinal	22.6	17.3	30.2
Dermatology	17.3	13.9	24.3
NSAID's	23.2	21.7	7.0
OTC	26.2	18.2	43.5
Others	24.1	18.9	27.6
Opthalmology	14.3	14.1	1.8

Source: Company, ICICIdirect.com Research

CMG from assets abroad got impacted

The custom manufacturing division (CMG) of the company, which accounts for ~ 23% of the consolidated revenue, de-grew by 16% YoY to Rs 190 crore during Q1FY10. The CMG revenues from facilities in India grew at a flat rate of ~2% YoY to Rs 60.2 crore but the CRAMS from assets abroad (Avecia and Morepeth) de-grew by ~23%. Some of the big CRAMS clients of the company outsourced less in order to keep a check on the channel inventory. Also, the closure of CRAMS facility at the company's Huddersfield facility due to low operational efficiency impacted the overseas CRAMS revenue negatively.

The company lost sales of ~Rs 33-34 crore with the closure of the Huddersfield operations during the last quarter. For FY09, revenues from the Huddersfield facility stood at Rs 134 crore with operating margins of as low as 3%. The Huddersfield operation is planned to be shifted to India, which would result in increase in margins and effectively no loss of revenue in the longer run. We believe the restructuring will likely be value accretive and the full impact will likely visible from FY11.

The consolidation of the shifted Huddersfield operations with other facilities would lead to utilization of extra capacities at other plants. During last few quarters, PHIL had already started shifting part of the Avecia operations (Huddersfield facility is a part of Avecia) to India in Digwal, which helped the company to improve margins.

PHIL's, Pathlab and the Global Critical Care business grew strongly by ~20% and ~353% YoY to ~Rs 49 crore and ~Rs 73 crore, respectively. Global Critical Care business comprises the recently acquired Minrad contributed ~US$10mn during Q1FY10.

Exhibit 3: Key business segments **Rs Crore**

Net Sales break-up	% Sales Contribution	Q1FY10	Q1FY09	Growth	FY09	FY08	Growth
Healthcare Solutions	53.5	439.7	350.0	25.6	1604.9	1291.4	24.3
Pharma Solutions	23.1	189.8	227.1	-16.4	1060.7	1008.1	5.2
From Assets in India	7.3	60.2	58.9	2.2	392.5	225.9	73.8
From Assets o/s India	15.8	129.7	168.2	-22.9	668.1	782.2	-14.6
Pathlabs	5.9	48.5	40.5	19.7	169.0	119.4	41.5
Global Critical Care	8.9	72.9	16.1	352.7	131.6	98.5	33.7
Others	8.6	70.7	74.6	-5.3	315.0	350.2	-10.1
Total		**821.55**	**708.31**	**16.0**	**3281.1**	**2867.5**	**14.4**

Source: Company, ICICIdirect.com Research

EBITDA margins showing strong improvement

PHIL reported expansion in EBITDA margin in Q1FY10 by 262bps YoY due to: I) forex gain of Rs 4.4 crore in Q1FY10 against the forex loss of Rs 23 crore in Q1FY09, II) decline in R&D expenditure by 21% YoY and III) closure of Huddersfield facility, which led to better cost structure. Adjusting for the forex related transactions, the EBITDA margin declined by 100 bps. The decline was due to consolidation of Minrad International in its GCC division, which has a lower gross contribution on account of higher raw material cost and higher marketing & selling expenses. Decline in R&D expenditure by 21% YoY also led to improvement in EBITDA margin. Process development R&D pertains to the R&D, which the company undertakes to find out non-infringing processes from CRAMS order. With subdued business in the CRAMS space (due to closure of Huddersfield facility) the company reduced the R&D expenditure. Although the company rationalised its R&D and the staff cost, the material cost and other expenses grew by ~23% and 19% YoY respectively and hence did not get the benefit of operational efficiency.

Depreciation and interest expense put pressure on bottomline

During Q1FY10, depreciation cost for PHIL increased by 43% YoY to Rs 38.5 crore due to integration of Minrad assets into the company. Moreover, interest cost rose by 111% to Rs 25.4 crore as against Rs 12 crore YoY, due to the rise in debt of the company coupled with the rise in average cost of debt funds during Q1FY10. For the quarter, the average debt was at Rs 1300 crore as against Rs 850 crore during the Q1FY09. Also the current cost of debt of 8.5% was higher than the cost of debt in Q1FY10. Rise in the depreciation and interest cost coupled with decline in EBITDA margin YoY from the core business led to decline in net profit from core business by 11% YoY. However, the reported net profit of the company increased by 25% YoY to ~Rs 85 crore.

Detailed Valuations

We believe the domestic formulations business to continue to remain an attractive growth driver for Indian players. Moreover, the CRAMS space is a high growth opportunity but is impacted by the global slowdown currently. PHIL has a very balanced mix of steady domestic formulation business and high growth CRAMS business. PHIL generates ~54% of consolidated revenue from domestic markets (49~% from formulations and 6% from Pathlabs) and the rest from exports, mostly CRAMS. In the domestic market, the company has outpaced the industry growth by growing at 26% against industry growth of ~13% during Q1FY10 with long term outlook of 14-15% growth.

In the contract manufacturing space, though PHIL grew at a slower pace on account of a control over the channel inventory by PHIL's CRAMS clients, closure of Huddersfield plant and lower capacity utilisation of Morepeth, the outlook is robust in the light of significant cost saving to the CRAMS clients via outsourcing to players like PHIL. We believe growth would remain moderate during the few coming quarters in the CRAMS space. In the long run we expect the CRAMS space to see robust growth.

We expect PHIL's consolidated revenue and net profit to grow at a CAGR of ~8% and ~33% over FY09-11E. We believe PHIL with robust business model (diversified to absorb geography or product based shocks) provides a good investment avenue. Moreover, the pharma sector being defensive in nature provides a good investment alternative in such a volatile environment. At the current market price of Rs 327, the stock is trading at 12x FY11E EPS of 26.6 and 9x FY11E EV/EBITDA. We maintain our **PERFORMER** rating with a target price of Rs 373.

Exhibit 4: Valuation Summary

	Sales (Rs Cr)	Sales Growth (%)	EPS (Rs)	EPS Growth (%)	PE(x)	EV/EBIDTA (x)	RoNW (%)	RoCE (%)
FY08	2867.5	18.5	16.0	44.8	20.5	13.7	30.7	24.6
FY09E	3281.1	14.4	15.1	-5.3	21.6	13.9	24.0	17.7
FY10E	3448.7	5.1	20.9	38.4	15.6	11.0	26.3	20.2
FY11E	3819.7	10.8	26.6	27.2	12.3	9.0	26.2	22.5

Source: Company, ICICIdirect.com Research

ICICIdirect.com Coverage Universe

Exhibit 5: Valuation Matrix

Elder					**Sales (Rs Cr)**	**EPS (Rs)**	**PE (x)**	**EV/E* (x)**	**RoNW (%)**	**RoCE (%)**
Idirect Code	ELDPHA	**CMP**	254.0	**FY08**	547.7	36.5	7.0	7.2	18.9	13.6
		Target	267	**FY09E**	608.8	29.6	8.6	7.7	13.2	11.9
MCap	478.1	**Upside (%)**	5	**FY10E**	691.9	37.1	6.8	6.9	14.4	13.0
				FY11E	764.6	44.5	5.7	6.2	14.9	13.2
Alembic					**Sales (Rs Cr)**	**EPS (Rs)**	**PE(x)**	**EV/E* (x)**	**RoNW (%)**	**RoCE (%)**
Idirect Code	ALECHE	**CMP**	37	**FY08**	990.0	6.1	6.1	6.5	24.7	16.2
		Target	30	**FY09E**	1116.1	3.4	10.8	6.0	9.7	11.6
MCap	515.0	**Upside (%)**	-19	**FY10E**	1240.0	4.5	8.3	5.2	12.8	12.3
				FY10E	1421.1	7.1	5.2	3.6	17.7	15.8
Biocon					**Sales (Rs Cr)**	**EPS (Rs)**	**PE(x)**	**EV/E* (x)**	**RoNW (%)**	**RoCE (%)**
Idirect Code	BIOCON	**CMP**	222	**FY08**	1108.2	11.6	19.1	14.3	17.4	14.5
		Target	TA	**FY09E**	1608.7	-9.3	12.0	115.1	-12.7	0.0
MCap	4435.0	**Upside (%)**	TA	**FY10E**	2371.0	17.4	12.7	9.6	18.5	22.0
				FY11E	2838.3	20.3	10.9	8.8	25.8	30.8
Dishman					**Sales (Rs Cr)**	**EPS (Rs)**	**PE(x)**	**EV/E* (x)**	**RoNW (%)**	**RoCE (%)**
Idirect Code	DISHPHA	**CMP**	170	**FY08**	788.4	14.1	12.0	13.1	26.5	10.4
		Target	213	**FY09**	1062.4	18.2	9.3	7.5	25.4	16.0
MCap	1371.9	**Upside (%)**	25	**FY10E**	1325.7	23.7	7.2	5.8	24.9	17.7
IPCA Labs					**Sales (Rs Cr)**	**EPS (Rs)**	**PE(x)**	**EV/E* (x)**	**RoNW (%)**	**RoCE (%)**
Idirect Code	IPCLAB	**CMP**	502	**FY08**	1085.0	55.2	9.1	7.7	23.4	19.4
		Target	627	**FY09E**	1283.8	40.3	12.5	6.4	15.5	20.0
MCap	1255.0	**Upside (%)**	25	**FY10E**	1476.6	78.4	6.4	5.7	24.2	22.1
				FY11E	1702.5	92.5	5.4	4.4	23.0	20.7
Piramal Healthcare					**Sales (Rs Cr)**	**EPS (Rs)**	**PE(x)**	**EV/E* (x)**	**RoNW (%)**	**RoCE (%)**
Idirect Code	NICPIR	**CMP**	327	**FY08**	2867.5	16.0	20.5	13.7	30.7	24.6
		Target	268	**FY09E**	3281.1	15.1	21.6	13.9	24.0	17.7
MCap	6834.3	**Upside (%)**	TA	**FY10E**	3448.7	20.9	15.6	11.0	26.3	20.2
				FY11E	3819.7	26.6	12.3	9.0	26.2	22.5
Glenmark					**Sales (Rs Cr)**	**EPS (Rs)**	**PE(x)**	**EV/E* (x)**	**RoNW (%)**	**RoCE (%)**
Idirect Code	GLEPHA	**CMP**	227	**FY08**	2035.3	25.4	9.0	8.2	41.6	34.1
		Target	UR	**FY09E**	2093.0	7.8	29.2	14.8	11.4	12.1
MCap	5720.7	**Upside (%)**	-	**FY10E**	2483.8	16.7	13.6	9.5	20.1	17.9
Sun Pharma					**Sales (Rs Cr)**	**EPS (Rs)**	**PE(x)**	**EV/E* (x)**	**RoNW (%)**	**RoCE (%)**
Idirect Code	SUNPHA	**CMP**	1151	**FY08**	3356.7	71.8	16.0	15.4	29.8	30.4
		Target	1274	**FY09E**	4271.4	88.1	13.1	13.5	28.1	28.2

** EV / E = EV to EBITDA*

*** post adjustment*

Source: Company, ICICIdirect.com Research

Peer Valuation

Exhibit 6: Peer Valuation

	CMP (Rs)	EPS		PE		EV/E		RONW (%)	
		FY10E	FY11E	FY10E	FY11E	FY10E	FY11E	FY10E	FY11E
Lupin	960	68.3	78.3	14.1	12.3	11.1	9.6	30.4	27.8
Cadila Health	380	29.1	34.8	13.1	10.9	9.1	7.8	26.8	26.4
Jubilant Orga	168	23.7	30.8	7.1	5.5	5.0	4.3	24.4	23.5
Aurobindo	543	76.9	86.4	7.1	6.3	6.3	5.0	31.3	28.3
Ranbaxy	275	9.9	23.8	27.9	11.6	14.9	9.6	8.5	13.6
Dr. Reddy	771	43.4	52.5	17.8	14.7	NA	NA	17.0	17.1
GSK Pharma	1338	68.9	76.8	19.4	17.4	13.1	11.6	30.8	30.7

Source: Company, Consensus estimates and ICICIdirect.com Research

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