Company

13 May 2010 | 13 pages

Equity ☑
Rating change ☑
Target price change ☑
Estimate change ☑

Piramal Healthcare (PIRA.BO)

Needs a Breather; Downgrade to Hold

- **Time for a breather** — We downgrade PIRA to Hold (2M) from Buy (1M) with a TP of Rs560. We remain positive on PIRA's prospects given its presence in India & outsourcing - both high growth areas. However, the stock has had a sharp run-up (+21% since April) on rumours of being sold out. With valuations at 18xFY11E EPS, we see limited near-term upside. Prefer Lupin, Aurobindo & Glenmark.
- **Guidance: Decent but we expected more** — PIRA guided to c14-16% sales growth & higher EBIDTA margin. Sales growth appears muted given the low base in CRAMS, ramp-up at Minrad, recent brand buys & growth trend in India. We see this as partly conservative (on India, as in the past) & partly reflecting the backended recovery in CRAMS. We cut EPS estimates by 10/8% for FY11/12 & raise TP to Rs560 (18xJun'11E EPS).
- **India: solid, but can it beat every time?** — PIRA's guidance seems to imply c15% growth in India. While this may be conservative (began FY10 with 16% guidance & ended at 25% growth), we also note that the market is getting more competitive, with most players stepping up their efforts. While the 'i-pill' acquisition & new launches should help, growth is unlikely to sustain in the 20+% range for long.
- **CRAMS recovery to be backended** — PIRA indicated that it expects CRAMS sales to grow 12-15% in FY11, indicating that recovery is more backended than we expected. On the positive side, it has extended its Pfizer contract indefinitely & acquired some new contracts at its Indian facilities. We believe outsourcing needs to ramp up for a further re-rating.
- **Key analyst meet takeaways** — 1) Pfizer contracts at Morpeth extended indefinitely - 5% lower pricing; 2) Production at Minrad ramped up to 20MT (6MT in FY09); US market share in sevoflurane up to 18% from 5%; 3) To expand India field force by 500; 4) FY11 capex of Rs3.5bn

Hold/Medium Risk	2M
from Buy/Medium Risk	
Price (13 May 10)	Rs510.65
Target price	Rs560.00
from Rs515.00	
Expected share price return	9.7%
Expected dividend yield	1.0%
Expected total return	**10.6%**
Market Cap	Rs106,733M
	US$2,373M

Price Performance (RIC: PIRA.BO, BB: PIHC IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2008A	3,633	17.38	61.0	29.4	9.8	33.9	0.8
2009A	4,348	20.80	19.7	24.5	8.1	36.1	0.8
2010E	4,885	23.37	12.4	21.8	6.4	32.6	1.0
2011E	6,090	29.14	24.7	17.5	4.9	31.7	1.1
2012E	7,971	38.14	30.9	13.4	3.8	32.1	1.2

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Fiscal year end 31-Mar	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	29.4	24.5	21.8	17.5	13.4
EV/EBITDA adjusted (x)	20.7	17.5	16.2	12.8	10.3
P/BV (x)	9.8	8.1	6.4	4.9	3.8
Dividend yield (%)	0.8	0.8	1.0	1.1	1.2
Per Share Data (Rs)					
EPS adjusted	17.38	20.80	23.37	29.14	38.14
EPS reported	15.92	15.13	23.06	29.14	38.14
BVPS	52.28	63.02	80.37	103.24	134.54
DPS	4.20	4.20	5.00	5.50	6.00
Profit & Loss (RsM)					
Net sales	28,789	32,885	36,711	42,548	49,813
Operating expenses	-24,259	-27,372	-30,728	-34,893	-40,379
EBIT	**4,530**	**5,513**	**5,983**	**7,655**	**9,433**
Net interest expense	-463	-838	-916	-735	-375
Non-operating/exceptionals	-305	-1,186	0	0	0
Pre-tax profit	**3,762**	**3,489**	**5,066**	**6,920**	**9,058**
Tax	-405	-301	-183	-830	-1,087
Extraord./Min.Int./Pref.div.	-29	-26	-65	0	0
Reported net income	**3,328**	**3,163**	**4,819**	**6,090**	**7,971**
Adjusted earnings	3,633	4,348	4,885	6,090	7,971
Adjusted EBITDA	5,478	6,708	7,409	9,145	10,982
Growth Rates (%)					
Sales	17.3	14.2	11.6	15.9	17.1
EBIT adjusted	59.6	21.7	8.5	27.9	23.2
EBITDA adjusted	49.8	22.5	10.4	23.4	20.1
EPS adjusted	61.0	19.7	12.4	24.7	30.9
Cash Flow (RsM)					
Operating cash flow	**3,081**	**3,728**	**5,475**	**7,276**	**8,474**
Depreciation/amortization	947	1,196	1,427	1,491	1,549
Net working capital	-1,474	-853	-1,567	-1,319	-1,808
Investing cash flow	**-2,531**	**-3,771**	**-1,882**	**-1,434**	**-1,934**
Capital expenditure	-2,307	-4,437	-2,000	-1,500	-2,000
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**-560**	**-98**	**-3,485**	**-6,046**	**-6,805**
Borrowings	-77	930	-2,293	-4,735	-5,375
Dividends paid	-140	-1,027	-1,192	-1,311	-1,430
Change in cash	**-960**	**-141**	**108**	**-204**	**-264**
Balance Sheet (RsM)					
Total assets	**24,924**	**35,577**	**37,462**	**38,966**	**42,112**
Cash & cash equivalent	551	946	1,054	850	586
Accounts receivable	4,449	4,866	5,569	6,224	7,288
Net fixed assets	12,585	20,391	20,964	20,974	21,425
Total liabilities	**13,950**	**22,332**	**20,591**	**17,317**	**13,921**
Accounts payable	4,668	6,307	6,352	6,731	7,882
Total Debt	7,163	13,391	12,014	8,014	3,014
Shareholders' funds	**10,975**	**13,245**	**16,871**	**21,649**	**28,191**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	19.0	20.4	20.2	21.5	22.0
ROE adjusted	33.9	36.1	32.6	31.7	32.1
ROIC adjusted	22.5	22.1	20.1	22.4	25.9
Net debt to equity	60.3	94.0	65.0	33.1	8.6
Total debt to capital	39.5	50.3	41.6	27.0	9.7

For further data queries on Citi's full coverage universe please contact CIR Data Services Asia Pacific at CIRDataServicesAsiaPacific@citi.com or +852-2501-2791

Powered by: dataCentral

Needs a Breather; Downgrade to Hold

We downgrade PIRA to Hold (2M) from Buy (1M), with a TP of Rs560. We remain positive on PIRA's prospects given its presence in India & outsourcing - both high growth areas. However, the stock has had a sharp run-up (+21% since April) on rumours of being sold out. With valuations at 18xFY11E EPS, we see limited near-term upside. Prefer Lupin, Aurobindo & Glenmark.

Revising Estimates

We lower our FY11 & 12E estimates, as we incorporate the company's guidance for FY11.

Our revenue estimates are lower by 5% & 4% for FY11E & 12E, as we choose to go by the company's current guidance for the time being, despite it appearing a tad conservative. We incorporate a revenue growth of 16% in FY11E.

We lower our EBITDA estimates by 10% & 9% for FY11E & 12E, as we adjust margins down to account for the lower top line. Consequently our EPS estimates are also lower by 10% & 8% for FY11E & 12E respectively.

Figure 1. Earnings Revision

	FY11E	FY12E
Revenues		
New	42,548	49,813
Old	44,653	52,106
Change (%)	*-4.7%*	*-4.4%*
EBITDA		
New	9,145	10,982
Old	10,175	11,965
Change (%)	*-10.1%*	*-8.2%*
EPS		
New	29.1	38.1
Old	32.3	41.2
Change (%)	*-9.8%*	*-7.5%*

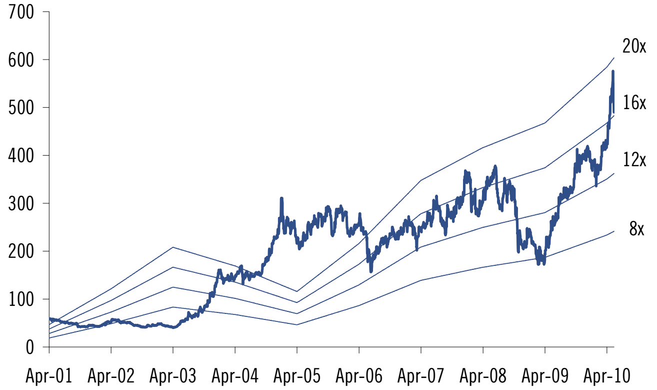
Source: Citi Investment Research and Analysis

Downgrade to Hold; New TP Rs560/sh

We raise our target price on Piramal to Rs560/sh, based on our revised estimates, rolling over to June '11E earnings (March '11E earlier) and using a higher target multiple (18x vs. 16x earlier). The higher multiple is in line with the changes we are making across our coverage stocks in the sector. We expect the valuation premium for Indian pharma vis-à-vis the broader market to expand, given the improving growth prospects for the sector as well as its defensive nature.

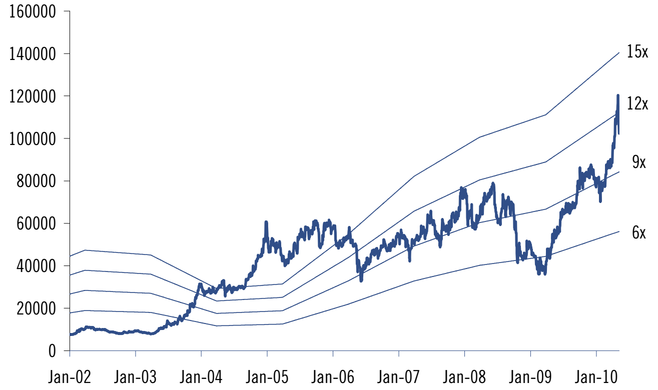
We remain positive on Piramal Healhcare's longer-term prospects. However, post the recent run-up in the stock (+21% since Apr '10) on rumours of being sold out, it trades quite close to our target price. Valuations do not leave adequate room for material upside in the near term, leading us to downgrade to Hold/Medium Risk.

Figure 2. Piramal HC – P/E Bands



Source: dataCentral, CIRA

Figure 3. Piramal HC – EV/EBITDA Bands



Source: dataCentral, CIRA

Financial Summary

Figure 4. Piramal HC – Consolidated P&L (Rs m)

Year to 31st March	FY 07	FY 08	FY 09	FY 10E	FY 11E	FY 12E
Revenues	**24,541**	**28,789**	**32,885**	**36,711**	**42,548**	**49,813**
Material Costs	6,117	6,891	8,254	10,632	12,174	14,131
Manufacturing Expenses	5,862	6,679	7,937	10,545	11,916	13,589
Research & Development	1,265	806	849	702	1,052	1,281
Other Operating Expenses	7,641	8,936	9,137	7,423	8,260	9,829
Total operating expenses	20,885	23,312	26,176	29,301	33,403	38,830
EBITDA	**3,657**	**5,478**	**6,708**	**7,409**	**9,145**	**10,982**
EBITDA Margins (%)	***14.9***	***19.0***	***20.4***	***20.2***	***21.5***	***22.0***
Interest	305	463	838	916	735	375
Depreciation	818	947	1,196	1,427	1,491	1,549
Other Income	4	-	-	-	-	-
PBT	2,537	4,067	4,675	5,066	6,920	9,058
Tax	389	405	301	183	830	1,087
Tax rate (%)	*15.3*	*10.0*	*6.4*	*3.6*	*12.0*	*12.0*
PAT	2,148	3,662	4,374	4,884	6,090	7,971
Minority Interest	1	14	26	-2	-	-
PAT After Minority Interest	**2,148**	**3,649**	**4,348**	**4,885**	**6,090**	**7,971**
Preferred Dividend	26	16	-	-	-	-
Extraordinary/Exceptional Items	135	-305	-1,186	-67	0	0
Reported Net Income	2,256	3,328	3,162	4,819	6,090	7,971

Source: Citi Investment Research and Analysis estimates, Company

Figure 5. Piramal HC – Consolidated Balance Sheet (Rs m)

Year to 31st March	FY 07	FY 08	FY 09	FY 10E	FY 11E	FY 12E
Shareholders funds	**10,478**	**10,926**	**13,171**	**16,798**	**21,577**	**28,118**
Equity Capital	418	418	418	418	418	418
Reserves and surplus	10,060	10,508	12,753	16,380	21,159	27,700
Preferred Equity	384	-	-	-	-	-
Deferred Tax Liabilities	893	897	726	726	1,071	1,524
Minority interest	5	49	75	73	73	73
Loan funds	**6,392**	**7,163**	**13,391**	**12,014**	**8,014**	**3,014**
Secured	4,216	3,469	8,090	7,514	6,014	1,014
Unsecured	2,176	3,694	5,301	4,500	2,000	2,000
Total liabilities	**18,152**	**19,035**	**27,362**	**29,610**	**30,735**	**32,729**
Gross block	16,013	16,987	26,059	28,059	29,559	31,559
Less - depreciation	4,308	4,983	6,595	8,021	9,512	11,061
Net block	**11,705**	**12,005**	**19,464**	**20,038**	**20,047**	**20,498**
CWIP	533	581	927	927	927	927
Investments	287	653	278	278	278	278
Current assets						
Inventories	4,402	4,032	4,834	5,270	5,994	7,018
Sundry debtors	3,673	4,449	4,866	5,569	6,224	7,288
Cash and bank balances	506	551	946	1,054	850	586
Loans and advances	1,912	2,654	4,262	4,326	4,646	5,516
Current liabilities & provisions						
Liabilities	4,551	4,668	6,307	6,352	6,731	7,882
Provisions	316	1,222	1,909	1,500	1,500	1,500
Net current assets	**5,628**	**5,797**	**6,692**	**8,368**	**9,483**	**11,026**
Total assets	**18,152**	**19,035**	**27,362**	**29,610**	**30,735**	**32,729**

Source: Citi Investment Research and Analysis estimates, Company

Figure 6. Piramal HC – Consolidated Cash Flows (Rs m)

Year to 31st March	FY 07	FY 08	FY 09	FY 10E	FY 11E	FY 12E
Profit before EO items and MI	2,165	2,957	2,544	4,817	6,436	8,424
Depreciation /Amortisation	818	947	1,196	1,427	1,491	1,549
Working Capital Changes	-877	-1,474	-853	-1,567	-1,319	-1,808
Others	289	651	841	798	669	309
Operating Cash Flows	**2,395**	**3,081**	**3,728**	**5,475**	**7,276**	**8,474**
Capex	-2,217	-2,307	-4,437	-2,000	-1,500	-2,000
Investments	0	-368	345	0	0	0
Others	-1,795	144	320	118	66	66
Investing Cash Flows	**-4,012**	**-2,531**	**-3,771**	**-1,882**	**-1,434**	**-1,934**
Shares Issued	-123	-344	0	0	0	0
Borrowings	2,778	-77	930	-2,293	-4,735	-5,375
Dividend (incl dividend tax)	-1,491	-140	-1,027	-1,192	-1,311	-1,430
Financing Cash Flows	**1,164**	**-560**	**-98**	**-3,485**	**-6,046**	**-6,805**
Net Change in cash	**-453**	**-10**	**-141**	**108**	**-204**	**-264**
Opening Cash	953	506	551	946	1054	850
Additions pursuant to acquisitions	5	55	536	0	0	0
Closing cash	**506**	**551**	**945**	**1,054**	**850**	**586**

Source: Citi Investment Research and Analysis estimates, Company

Figure 7. Piramal HC – Consolidated Key Ratios (Rs m)

Year to 31st March	FY 07	FY 08	FY 09	FY 10E	FY 11E	FY 12E
EPS (Rs)	10.8	15.9	15.1	23.1	29.1	38.1
Recurring EPS (Rs)	**10.2**	**17.4**	**20.8**	**23.4**	**29.1**	**38.1**
CFPS (Rs)	14.7	20.5	21.0	29.9	36.3	45.6
BVPS (Rs)	52.0	52.3	63.0	80.4	103.2	134.5
ROAE (%)	*21.4*	*34.1*	*36.1*	*32.6*	*31.7*	*32.1*
ROACE (%)	*14.9*	*21.9*	*22.1*	*20.3*	*22.3*	*26.2*
Debt/Equity (x)	0.6	0.7	1.0	0.7	0.4	0.1
Inventory Days	65.5	51.1	53.6	52.4	51.4	51.4
Debtor Days	54.6	56.4	54.0	55.4	53.4	53.4
Creditor Days	67.7	59.2	70.0	63.2	57.7	57.8
P/E (x)	50.2	29.3	24.5	21.8	17.5	13.4
P/B (x)	9.8	9.8	8.1	6.3	4.9	3.8
EV/EBITDA (x)	30.8	20.7	17.7	15.9	12.4	9.9

Source: Citi Investment Research and Analysis estimates, Company

Aurobindo Pharma (ARBN.BO; Rs895.60; 1M)
Glenmark Pharmaceuticals (GLEN.BO; Rs278.70; 1M)
Lupin (LUPN.BO; Rs1,795.80; 1L)

Piramal Healthcare

Company description

Piramal Healthcare (PIHC), the fourth-largest company in the Indian formulations market, is targeting the regulated pharmaceutical markets through custom manufacturing (CMG). The company has scaled up in the domestic market through both organic and inorganic initiatives, and is looking at doing the same in overseas markets. Some initial CMG successes have been achieved in the form of six diverse contracts with innovator companies and two acquisitions in overseas markets.

Investment strategy

We rate PIHC Hold/Medium Risk. This is a valuation call post the recent run up in the stock (+21% since Apr 2010). We remain positive on Piramal's long term prospects and consider it as one of the best plays on custom manufacturing and the branded formulations market in India. Among the Indian mid-tier companies, Piramal has a unique approach to the domestic and export markets. Leveraging its manufacturing capabilities and relationships with global majors, the company has positioned itself as a 'partner of choice' for innovator companies across the product life cycle and value chain. On the domestic front, it has focused on building brands and strengthening its marketing and distribution network, making it less dependent than its peers on new product launches for growth.

Valuation

Our target price for Piramal of Rs560 is based on 18x June 11E earnings. This is at a premium to our target multiple for mid-sized Indian pharma companies and in line with our target multiple for sector leaders. We believe Piramal deserves a higher multiple than other mid-sized Indian pharma companies given its leadership in innovator CRAMS and superior return ratios. Revenue visibility and sustainability are high in the CRAMS business: these are long-term exclusive contracts with innovators with no risk of litigation-related delays and competitive pressures - these would continue to boost valuations in an environment where outsourcing as a theme is gaining traction.

Risks

We rate Piramal Medium Risk, as suggested by our quantitative risk-rating system. The main downside risks to our target price are: 1) While custom manufacturing should drive Piramal's revenues and profitability, any slip-up in executing the contracts would be a big negative. 2) A break-up of any major association could have a short-term impact on revenues and earnings. 3) Any unfavorable trend in growth or pricing could have an adverse impact on the company's financials. Key upside risks to our target price are: 1) Faster than expected recovery in the CRAMS business; 2) A victory in the patent litigation with Baxter on Desflurane; 3) Better than anticipated performance in the critical care business.

Aurobindo Pharma

Valuation

Given that pharma is a growth sector, we use P/E as our primary method to value the base business of pharma companies. Our target price of Rs1,350 is based on 13x FY11E FDEPS - a 30% discount to the target multiple of 18x that we use for sector leaders such as Cipla and DRL. This is also at a marginal discount to the multiple of 15x that we use for mid sized generic companies such as Biocon and Cadila. We believe that the discount is justified at this point, given the possibility of equity dilution (to redeem FCCBs in case they do not get converted), risk of an appreciating rupee (c20-25% net exposure) and higher customer concentration (the Pfizer deal heavily to growth).

Risks

We rate Aurobindo Medium Risk, as against the High Risk suggested by our quantitative risk-rating system, which tracks 260-day historical share price volatility. The company's improving fundamentals and stronger balance sheet merit a lower risk rating going forward, in our view. Key downside risks to our target price include (1) Fresh equity dilution if FCCBs do not get converted; (2) Execution hiccups in the supply deal with Pfizer; (3) Currency Risk - an appreciating INR would be structurally negative

Glenmark Pharmaceuticals

Valuation

Our target price for Glenmark Pharmaceuticals of Rs335 is based on 16x June-11E EPS for the base business. We are now more comfortable with the sustainability of the positive trends seen in Glenmark's key markets. This along with the improvement in balance sheet (lower leverage, tighter working capital) lead us to use a slightly higher multiple of 16x (15x earlier), which is still at a c10-20% discount to what we use for sector leaders such as Sun Pharma, Cipla, Dr Reddy's & Lupin. At 16x June '11E EPS we arrive at a value of Rs310/sh for the base business. Our target price also includes an option value of Rs25/sh for Glenmark's R&D deal with Sanofi for GRC-15300. Cumulatively we arrive at a target price of Rs335/sh.

Risks

We rate Glenmark as Medium Risk, lower than the High Risk rating assigned by our quantitative risk rating model, as we do not see any major downside on the R&D front in the near to medium term. Downside risks to our target price include: (1) Continued delay in product approvals would impact sales and profitability; (2) Glenmark's efforts to build its own front-end in regulated markets, if poorly executed, could prove to be a drag on earnings; and (3) Growing competition, rapid price erosion, and fragmented market share are risks inherent to the generics business.

Lupin

Valuation

Given that pharma is a growth sector, we use P/E as our primary method to value the base business of pharma companies. Lupin has historically (last six to seven years) traded in a band of 10-34x one-year forward earnings. We believe that Lupin deserves to be valued in line with the sector leaders (18-20x 12m forward earnings) such as Cipla, Dr Reddy's & Sun Pharma due to its leadership in key markets/products & robust financial metrics. At 20x June 11E recurring FDEPS, we arrive at a target price of Rs2,100.

Risks

We rate Lupin Low Risk, inline with the recommendation of our quantitative risk-rating system, which tracks 260-day historical share price volatility. Key downside risks to achieving our target price include: 1) Generic competition in Suprax (c5% and 15% of FY10 sales & PBT): This is possible in either FY11 or

FY12. Two other players (both Indian companies) have filed DMFs for cefixime and either one or both companies could prove to be competitors. 2) INR appreciation would hurt, given its exposure to global markets; 3) Reasonable exposure to the domestic formulations market (33% of sales) leaves Lupin vulnerable to any significant widening of the price control net. 4) Inability to effectively scale up the Kyowa operations could take a heavy toll on profitability as well as return ratios.

Appendix A-1

Analyst Certification

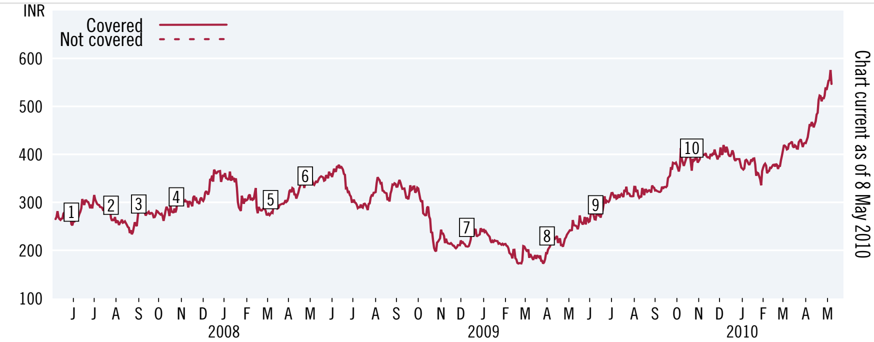
The research analyst(s) primarily responsible for the preparation and content of all or any identified portion of this research report hereby certifies that, with respect to each issuer or security or any identified portion of the report with respect to an issuer or security that the research analyst covers in this research report, all of the views expressed in this research report accurately reflect their personal views about those issuer(s) or securities. The research analyst(s) also certify that no part of their compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this research report.

IMPORTANT DISCLOSURES

Piramal Healthcare (PIRA.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Prashant Nair, CFA



	Date	Rating	Target Price	Closing Price
1	30-May-07	1M	*330.00	254.30
2	25-Jul-07	1M	*345.00	267.20
3	2-Sep-07	1M	*395.00	270.00
4	25-Oct-07	1M	*455.00	285.80
5	6-Mar-08	1M	*448.00	273.40
6	24-Apr-08	1M	*469.00	339.65
7	9-Dec-08	1M	*345.00	208.40
8	1-Apr-09	1M	*335.00	193.75
9	9-Jun-09	1M	*420.00	264.00
10	22-Oct-09	1M	*515.00	366.05

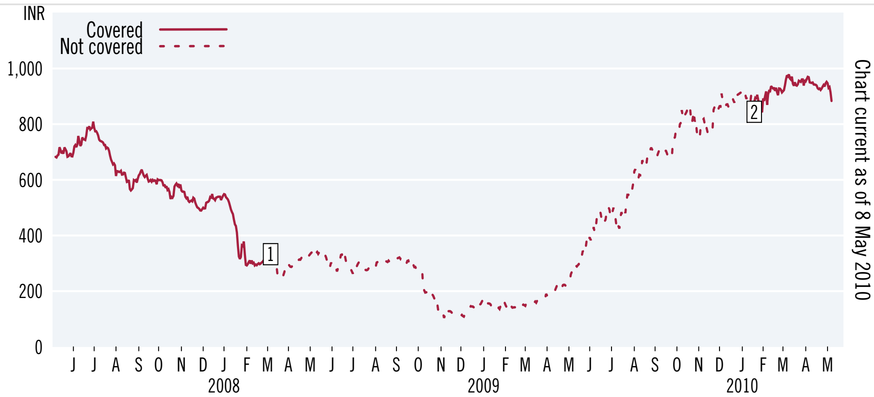
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Aurobindo Pharma (ARBN.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Prashant Nair, CFA
Covered since January 19 2010



	Date	Rating	Target Price	Closing Price
1	6-Mar-08	Coverage suspended		
2	19-Jan-10	*1M	*1,350.00	879.85

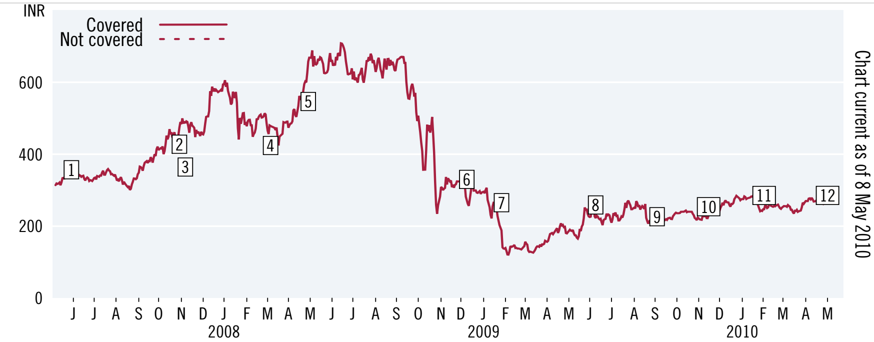
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Glenmark Pharmaceuticals (GLEN.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Prashant Nair, CFA



	Date	Rating	Target Price	Closing Price
1	30-May-07	1M	*427.00	336.58
2	30-Oct-07	1M	*575.00	474.20
3	7-Nov-07	1M	*632.00	486.45
4	6-Mar-08	1M	*592.00	480.20
5	29-Apr-08	1M	*770.00	657.75
6	9-Dec-08	*1H	*467.00	281.75
7	27-Jan-09	*3H	*180.00	188.15
8	9-Jun-09	3H	*225.00	222.40
9	3-Sep-09	*2M	*250.00	226.25
10	16-Nov-09	2M	*275.00	230.05
11	2-Feb-10	*1M	*300.00	247.05
12	3-May-10	1M	*335.00	279.65

* Indicates change

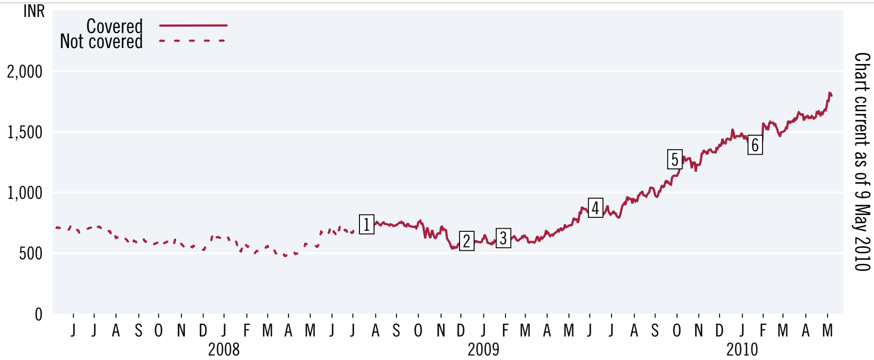
Rating/target price changes above reflect Eastern Standard Time

Lupin (LUPN.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Prashant Nair, CFA

Covered since July 22 2008



	Date	Rating	Target Price	Closing Price
1	21-Jul-08	*1M	*938.00	697.30
2	9-Dec-08	1M	*823.00	557.00
3	29-Jan-09	1M	*894.00	561.15
4	9-Jun-09	1M	*1,065.00	839.00
5	29-Sep-09	1M	*1,415.00	1,139.80
6	20-Jan-10	1M	*1,700.00	1,424.10
7	9-May-10	*1L	*2,100.00	1,797.10

* Indicates change

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