

MAY 28, 2010

UPDATE

Coverage view: **Attractive**

Price (Rs): **512**

Target price (Rs): **490**

BSE-30: **16,666**

**Uncertainty on use of cash; maintain REDUCE.** We value PIHC stock at Rs490/share which includes (1) business value per share of Rs127 (11.5X FY2012E estimated earnings) and (2) NPV of Rs364/share (post 30% discount due to no clarity on use of cash). PIHC intends to invest in other businesses which may include non-healthcare businesses; details of which have not been divulged. PIHC will pay out a special dividend upon closure of the deal, but the amount remains unknown hence we do not assume a dividend payout in our NPV calculations. We believe a higher payout will increase the value. We maintain REDUCE with PT of Rs490 (from Rs475).

#### Company data and valuation summary

Piramal Healthcare

##### Stock data

52-week range (Rs) (high,low) 600-252

Market Cap. (Rs bn) 107.0

##### Shareholding pattern (%)

Promoters 49.2

FIs 26.1

MFs 3.3

##### Price performance (%)

Absolute (0.7) 28.7 90.2

Rel. to BSE-30 5.4 26.9 61.0

##### Forecasts/Valuations

	2010	2011E	2012E
EPS (Rs)	23.4	13.4	11.0
EPS growth (%)	35.5	(42.9)	(17.6)
P/E (X)	21.9	38.3	46.5
Sales (Rs bn)	36.7	31.4	23.8
Net profits (Rs bn)	4.9	2.8	2.3
EBITDA (Rs bn)	7.4	5.6	4.3
EV/EBITDA (X)	16.1	6.6	5.0
ROE (%)	32.1	141.2	16.6
Div. Yield (%)	1.1	1.2	0.7

#### QUICK NUMBERS

- We value the remaining businesses at Rs127/share
- We value cash at Rs364/share
- We value the stock at Rs490/share

#### We value the remaining businesses at Rs127/share

Piramal's remaining business will include CMO business, anesthetics inhalation business and supply of API, vitamin and fine chemicals and Indian OTC business. These businesses reported sales of Rs18.4 bn in FY2010 including OTC sales of Rs1.25 bn and Ophthalmology sales of Rs524 mn. We expect sales of remaining businesses to increase at a CAGR of 14% to reach Rs24 bn in FY2012E with operating margin of 18% in FY2012E. We estimate these businesses to report PAT of Rs2.3 bn in FY2012E and assume tax rate at 17%. We value the remaining businesses at Rs127/share (11.5X FY2012E estimated earnings).

#### We value cash at Rs364/share (30% discount to NPV/share due to no clarity on use of cash)

We estimate the NPV of the amount available to shareholders at Rs109 bn from a gross amount of Rs170 bn or at Rs520/share after (1) debt repayment, (2) payment to Piramal Enterprises (3) capital gains tax of 21.5%. However, it remains unclear to us as to where the remaining cash pool will be invested. PIHC intends to invest in other businesses which may include non healthcare businesses; details of which have not been divulged. Due to no clarity on dividend amount and businesses to be invested in future, we (1) do not assume a dividend payout in our NPV calculations and (2) apply a 30% discount to NPV/share which gives cash value of Rs364/share.

#### We value the stock at Rs490/share (from Rs475); assuming no dividend; maintain REDUCE

We value PIHC stock at Rs490/share which includes (1) business value per share of Rs127 (11.5X FY2012E estimated earnings) and (2) NPV of Rs364/share, we apply a 30% discount due to the lack of clarity on the use of cash. PIHC will payout a special dividend upon closure of the deal, the amount remains unknown, hence we do not assume dividend payout in our NPV calculations. We believe a higher payout will increase the value.

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### Going beyond the numbers

PIHC has got great value for its Indian finished dosage business in its sale of the segment to Abbott. This will lead to cash of Rs520 per share, higher than the current market price. Some may argue that PIHC is a Buy for this reason alone as investors are getting the remaining business for free. We do not agree with this logic for the following reasons:

1. **Selling the most attractive business.** Indian finished dosage was the fastest growing and highest margin business for PIHC. It provided valuation floor when CMO business faced challenges in 2009.
2. **What business will PIHC enter?** It remains unclear to us as to where the remaining cash pool post dividend payment will be invested. PIHC intends to invest in other businesses which may include non healthcare businesses; details of which have not been divulged. We think investors would prefer buying businesses that create cash flows rather than buying pool of cash in the hope that attractive business will be bought.
3. **Profitability of existing businesses is not clear.** Profitability of the remaining businesses has not been shared by PIHC. These numbers are based on our estimates. Real picture may be substantially different when PIHC starts reporting numbers for this business from 3QFY2011E. Thus, investors have no clear picture of future business of PIHC as well as profitability of current businesses.

### Abbott acquires Piramal Healthcare solutions for US\$3.7 bn

Piramal Healthcare solutions business has been sold to Abbot for US\$3.7 bn. Out of this (1) US\$2.12 bn will be received upon the closure of the deal (expected by 2HCY10) and (2) four installments of US\$400 mn each, payable upon each of the four anniversaries of the closure of the deal. Assets to be transferred to Abbott include (1) Baddi facility transferred, (2) rights to 350 brands and (3) around 5,250 employees. Total value of assets transferred is Rs7 bn.

### Results of postal ballot to be announced on June 25, 2010

Although the board of Directors of PIHC has approved the sale, the above sale is conditional upon shareholder approval which is to be conducted through postal ballot. A form has been posted to shareholders and the result will be announced on June 25, 2010. The form maintains that the resolution on sale shall be considered passed if votes cast in favor of resolution exceed those cast against the resolutions.

### We value the remaining businesses at Rs127/share

Piramal's remaining businesses reported sales of Rs18.4 bn in FY2010. We expect this to grow to Rs24 bn at a CAGR of 14% over FY2010-12E. We expect operating margin at 18% for the remaining businesses and assume tax rate of 17% in FY2012E. We expect R&D costs to decline to Rs450 mn in FY2012E from Rs700 mn in FY2010. We do not take into account interest income likely to be generated on US\$2.1 bn likely to be received by 2HCY10. We estimate this business to report PAT of Rs2.3 bn or EPS of Rs11 in FY2012E.

We expect the transaction to close by 2QFY11 and accordingly remove sales of healthcare solutions business from 3QFY11E.

## Business value per share, FY2012E, Rs

	PAT (Rs mn)	P/E	Valuation (Rs mn)
	2012E	(X)	2012E
OTC+Ophthalmology	296	16.0	4,729
Pharma solutions	1,280	10.0	12,798
Diagnostic services	347	12.0	4,159
PCC	399	12.0	4,785
<b>Total</b>	<b>2,321</b>		<b>26,472</b>
<b>Business share price value (Rs)</b>			<b>127</b>

Source: Kotak Institutional Equities estimates, Company

## Profit and loss statement, March fiscal year-ends, 2007-2012E (Rs mn)

	2007	2008	2009	2010	2011E	2012E
<b>Net sales</b>	<b>24,198</b>	<b>28,675</b>	<b>32,811</b>	<b>36,711</b>	<b>31,385</b>	<b>23,848</b>
<b>Operating expenses</b>						
Materials	(10,829)	(10,912)	(12,365)	(13,972)	(12,621)	(9,679)
Selling and administration	(4,591)	(6,885)	(7,953)	(8,916)	(7,691)	(5,843)
Employee cost	(4,200)	(4,709)	(5,010)	(5,853)	(4,850)	(3,577)
R&D/other exp	(1,265)	(752)	(1,670)	(560)	(596)	(453)
<b>Total expenditure</b>	<b>(20,885)</b>	<b>(23,258)</b>	<b>(26,998)</b>	<b>(29,301)</b>	<b>(25,758)</b>	<b>(19,552)</b>
<b>EBITDA</b>	<b>3,313</b>	<b>5,417</b>	<b>5,813</b>	<b>7,410</b>	<b>5,627</b>	<b>4,296</b>
Depreciation and amortisation	(818)	(947)	(1,196)	(1,427)	(1,575)	(1,500)
<b>EBIT</b>	<b>2,495</b>	<b>4,470</b>	<b>4,618</b>	<b>5,983</b>	<b>4,052</b>	<b>2,796</b>
Net finance cost	(305)	(463)	(838)	(916)	(675)	—
Other income	525	61	74	—	—	—
<b>Pretax profits before extra-ordinaries</b>	<b>2,715</b>	<b>4,067</b>	<b>3,853</b>	<b>5,067</b>	<b>3,378</b>	<b>2,796</b>
Current tax	(315)	(445)	(452)	(180)	(575)	(475)
Deferred tax	(45)	105	492	—	—	—
Fringe benefit tax	(29)	(37)	(259)	—	—	—
<b>Reported profit</b>	<b>2,327</b>	<b>3,691</b>	<b>3,634</b>	<b>4,887</b>	<b>2,803</b>	<b>2,321</b>
Minority interests	(1)	(14)	(26)	2	(10)	(20)
<b>Reported net profit after MI</b>	<b>2,402</b>	<b>3,677</b>	<b>3,608</b>	<b>4,888</b>	<b>2,793</b>	<b>2,301</b>
Exceptional income	(43)	(339)	(446)	(69)	74,558	14,444
<b>Reported net profit</b>	<b>2,358</b>	<b>3,338</b>	<b>3,162</b>	<b>4,819</b>	<b>77,351</b>	<b>16,745</b>

Source Kotak Institutional Equities estimates, Company

### We value cash at Rs364/share (30% discount to NPV/share due to no clarity on use of cash)

PIHC intends to repay outstanding debt of Rs13bn with the initial tranche of US\$2.12 bn. In addition, Rs3.5 bn will be paid to Piramal Enterprises for the guarantees it has provided on behalf of PIHC. We estimate the NPV of the amount available to shareholders at Rs109 bn from gross amount of Rs170 bn or at Rs520/share after (1) debt repayment, (2) payment to Piramal Enterprises (3) capital gains tax of 21.5%.

However, it remains unclear to us as to where the remaining cash pool post dividend payment will be invested. PIHC intends to invest in other businesses which may include non healthcare businesses; details of which have not been divulged. Due to a lack of clarity on dividend amount and businesses to be invested in future we (1) do not assume a dividend payout in our NPV calculations and (2) apply a 30% discount to NPV value of cash.

## We value cash at Rs364/share

		2011E	2012E	2013E	2014E	2015E
Payments	US\$ mn	2,120	400	400	400	400
	Rs mn	97,520	18,400	18,400	18,400	18,400
Book value of assets sold	Rs mn	7,000				
Profit on sale	Rs mn	90,520	18,400	18,400	18,400	18,400
Capital gains tax	21.5%	19,462	3,956	3,956	3,956	3,956
Net debt repaid	Rs mn	12,949				
Amount payable to PEL	Rs mn	3,500				
Available for shareholders	Rs mn	61,609	14,444	14,444	14,444	14,444
Dividend incl div tax	NIL					
Available for shareholders	Rs mn	61,609	14,444	14,444	14,444	14,444
NPV	Rs mn	61,609	14,444	11,934	10,849	9,863
Total NPV	Rs mn	108,699				
NPV/share	Rs	520				
Discounted NPV/share	30%	364				

Source: Kotak Institutional Equities estimates, Company

## We value the stock at Rs490/share; assuming no dividend

## Price target, FY2012E

	Valuation (Rs)
	2012E
Business share price value	127
Discounted cash NPV/share	364
<b>Total</b>	<b>491</b>

Source: Kotak Institutional Equities estimates, Company

## Balance sheet statement, March fiscal year-ends, 2007-2012E (Rs mn)

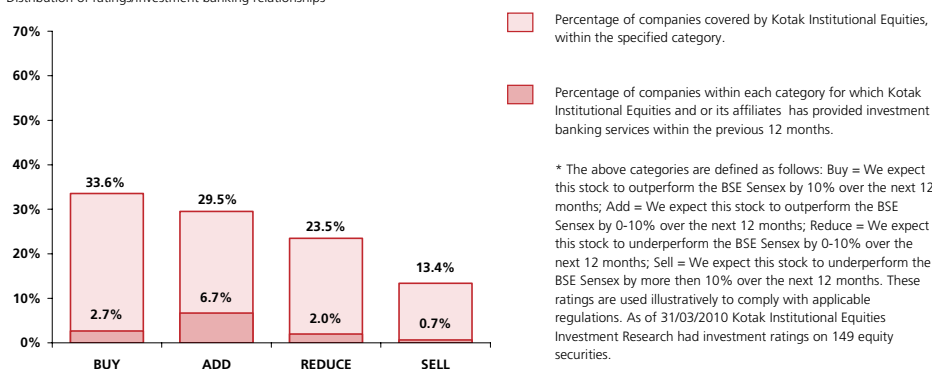
	2007	2008	2009	2010	2011E	2012E
<b>Balance sheet</b>						
Net worth	10,862	10,926	13,171	16,849	92,743	108,652
Debt	6,392	7,163	13,391	12,949	—	—
Current liabilities	4,866	5,890	8,215	7,310	6,603	4,875
Deferred tax liabilities	898	945	800	568	578	598
<b>Total equity and liabilities</b>	<b>23,018</b>	<b>24,924</b>	<b>35,577</b>	<b>37,676</b>	<b>99,924</b>	<b>114,125</b>
Cash and cash equivalents	506	551	946	497	500	500
Current assets	9,988	11,136	13,962	15,724	14,490	12,522
Net assets incl CWIP	12,238	12,585	20,391	21,130	15,613	16,113
Investments	287	653	278	326	69,321	84,989
<b>Total uses of funds</b>	<b>23,018</b>	<b>24,924</b>	<b>35,577</b>	<b>37,676</b>	<b>99,924</b>	<b>114,125</b>
<b>Free cash flow</b>						
Operating cash flow, excl. working c€	2,667	4,728	5,160	6,797	4,587	3,520
Working capital	(2,105)	(1,047)	(501)	(2,985)	405	851
Capital expenditure	(1,745)	(588)	(3,699)	(2,166)	1,942	(2,000)
Investments	—	(365)	374	(47)	(68,995)	(15,668)
<b>Free cash flow</b>	<b>(1,183)</b>	<b>2,728</b>	<b>1,335</b>	<b>1,599</b>	<b>(62,061)</b>	<b>(13,297)</b>

Source: Kotak Institutional Equities estimates, Company

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#### Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



Source: Kotak Institutional Equities

As of March 31, 2010

## Ratings and other definitions/identifiers

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**BUY.** We expect this stock to outperform the BSE Sensex by 10% over the next 12 months.

**ADD.** We expect this stock to outperform the BSE Sensex by 0-10% over the next 12 months.

**REDUCE.** We expect this stock to underperform the BSE Sensex by 0-10% over the next 12 months.

**SELL.** We expect this stock to underperform the BSE Sensex by more than 10% over the next 12 months.

Our target price are also on 12-month horizon basis.

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