Prabhudas Lilladher

Pfizer

Strong sales growth

Q1FY09 Result Update

March 30, 2009

Rating	**Accumulate**
Price	Rs581
Target Price	Rs652
Implied Upside	12.2%
Sensex	9,568

(Prices as on March 30, 2009)

Trading Data

Market Cap. (Rs bn)	17.3
Shares o/s (m)	29.8
Free Float	58.8%
3M Avg. Daily Vol ('000)	2.8
3M Avg. Daily Value (Rs m)	1.4

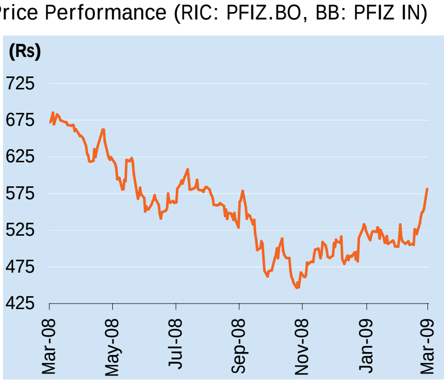
Major Shareholders

Promoters	41.2%
Foreign	2.5%
Domestic Inst.	31.6%
Public & Others	24.7%

Stock Performance

(%)	1M	6M	12M
Absolute	15.6	3.1	(10.1)
Relative	8.0	28.7	31.4

Price Performance (RIC: PFIZ.BO, BB: PFIZ IN)



Source: Bloomberg

- **Results:** Pfizer's Q1FY09 results were better than our expectations due to strong growth in pharma and animal healthcare (AHC) segments. Net sales for the quarter grew by 22% YoY - from Rs1.56bn to Rs1.90bn (we expected Rs1.71bn) due to a low base in Q1FY08. The company's EBITDA margin declined up by 220bps - from 25.1% to 22.9% YoY (we expected 15.8%) mainly due to a sharp increase in the material cost. Material cost enhanced by 570bps - from 31.8% to 37.5% of net sales due to an increase in the major ingredient - vitamin C prices during the year. Personnel expenses increased by 90bps - from 14.6% to 15.5% of net sales due to an increase in the salaries during the year. Other expenses declined by 430bps from 28.4% to 24.1% of net sales due to lower promotion expenses, resulting from the divestment of OTC brands. Pfizer's net profit before EO improved by 39% YoY - from Rs280m to Rs389m (we expected Rs280m) due to a strong top-line growth, higher other income and lower tax rate.
- **Capex update:** There is no major capex for Pfizer as it has restructured its manufacturing activities. However, the normal capex would be Rs150-200m per annum. The company is actively looking at brand acquisitions.
- **Valuation:** We expect Pfizer to report 13% CAGR net sales and 19% CAGR net profit over FY08-10. We also expect its EBITDA margin to improve from 21.6% in FY08 to 27.3% in FY10 due to restructuring.

At the CMP of Rs581, the stock trades at 10.3x FY09E EPS of Rs56.6 and 8.9x FY10E EPS of Rs65.2. We maintain '**Accumulate**' rating on the scrip, with a price target of Rs652 (10x FY10 earnings) over the next 12 months, with an upside of 12.2% over the CMP.

Key financials (Y/e Nov)	FY07	FY08	FY09E	FY10E
Revenues (Rs m)	6,979	7,047	7,933	8,949
Growth (%)	*0.7*	*1.0*	*12.6*	*12.8*
EBITDA (Rs m)	1,564	1,523	2,025	2,447
PAT (Rs m)	1,299	1,368	1,690	1,944
EPS (Rs)	43.5	45.8	56.6	65.2
Growth (%)	*0.2*	*5.3*	*23.6*	*15.1*
Net DPS (Rs)	27.5	12.5	15.0	17.5

Source: Company Data; PL Research

Profitability & valuation	FY07	FY08	FY09E	FY10E
EBITDA margin (%)	*22.4*	*21.6*	*25.5*	*27.3*
RoE (%)	*24.6*	*17.6*	*17.6*	*17.9*
RoCE (%)	*25.3*	*17.9*	*17.8*	*18.1*
EV / sales (x)	2.6	2.5	2.3	2.0
EV / EBITDA (x)	11.1	11.4	8.6	7.1
PE (x)	13.4	12.7	10.3	8.9
P / BV (x)	2.7	1.9	1.7	1.5
Net dividend yield (%)	*4.7*	*2.2*	*2.6*	*3.0*

Source: Company Data; PL Research

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Q1FY09 result overview (quarter ended February'09) **(Rs m)**

Y/e Nov	Q1FY09	Q1FY08	YoY gr. (%)	Q4FY08	QoQ gr. (%)
Net sales	**1,901**	**1,557**	*22.1*	**1,848**	*2.8*
Expenditure					
Raw materials	712	495	*43.8*	641	*11.1*
as % of net sales	*37.5*	*31.8*		*34.7*	
Personnel expenses	295	228	*29.5*	299	*(1.4)*
as % of net sales	*15.5*	*14.6*		*16.2*	
Other expenses	459	443	*3.7*	640	*(28.3)*
as % of net sales	*24.1*	*28.4*		*34.6*	
Total Expenditure	1,466	1,166	*25.8*	1,581	*(7.2)*
OPBDIT	**435**	**392**	*11.0*	**268**	*62.3*
OP Margin (%)	*22.9*	*25.1*		*14.5*	
Other income	185	128	*45.3*	201	*(7.6)*
PBDIT	**620**	**519**	*19.5*	**469**	*32.4*
Depreciation	20	22	*(10.3)*	44	*(54.6)*
Interest	-	-	*NA*	-	*NA*
PBT	**600**	**497**	*20.8*	**424**	*41.4*
Prov. For tax	212	217	*(2.6)*	114	*85.0*
% of PBT	*35.3*	*43.7*		*26.9*	
PAT	**389**	**280**	*39.0*	**310**	*25.4*
Extraordinary item	-	1,649	*NA*	(8)	*NA*
Reported PAT	**389**	**1,929**	*(79.9)*	**302**	*28.5*

Highlights

Strong sales growth across segments

For Q1FY09, Pfizer posted a 22% YoY growth from Rs1.56bn to Rs1.90bn. The strong sales growth can be attributed to 21% growth in pharma - from Rs1.30bn to Rs1.58bn and 38% growth in AHC segment - from Rs201m to Rs277m. The clinical services business reported a decline of 21% - from Rs51m to Rs41m. The company's pharma business accounts for 83% of sales, the AHC accounts for 15% of sales and clinical services 2% of sales in the quarter. The sales composition has been shown in the following table:

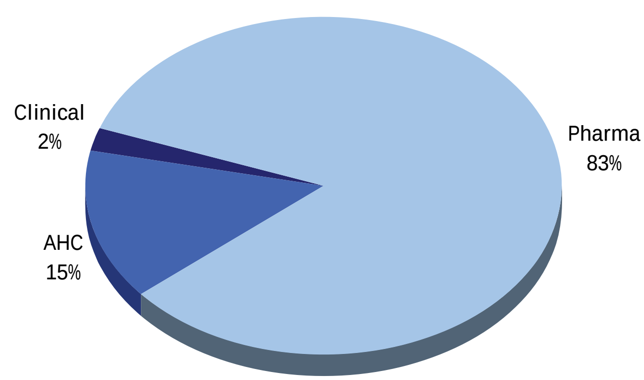
Sales composition **(Rs m)**

Y/e Nov	Q1FY09	Q1FY08	*YoY gr. (%)*	Q4FY08	*QoQ gr. (%)*
Pharmaceuticals	1,583	1,304	*21.4*	1,554	*1.9*
Animal Healthcare	277	201	*38.0*	209	*32.7*
Services-clinical Devt	41	51	*(20.5)*	81	*(50.0)*
Total sales	**1,901**	**1,556**	*22.2*	**1,845**	*3.1*

Source: Company Data, PL Research

The sales composition for Q1FY09 is represented in the following chart:

Q1FY09 sales composition



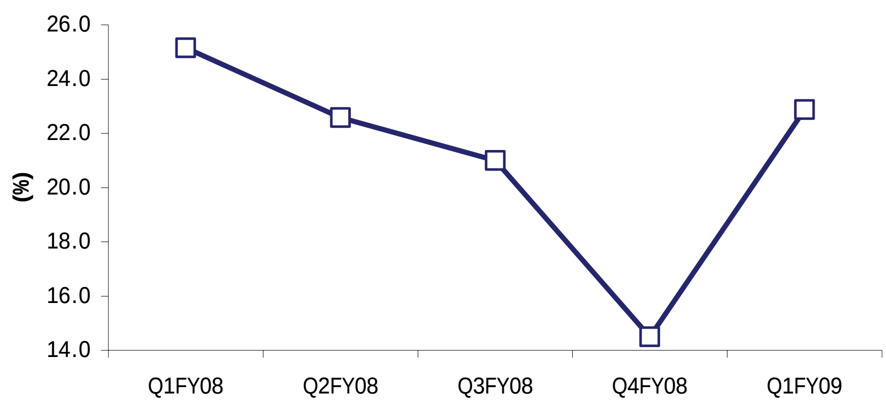
Source: Company Data, PL Research

Margins declined by 220bps

Pfizer's EBITDA margin declined by 220bps - from 25.1% to 22.9% YoY, mainly due to an increase in the material cost. The company's material cost enhanced by 570bps - from 31.8% to 37.5% of net sales due to an increase in the prices of major raw material - vitamin C during the year. Personnel expenses increased by 90bps - from 14.6% to 15.5% of net sales due to an increase in the salaries during the year. Other expenses declined by 430bps - from 28.4% to 24.1% of net sales due to the divestment of OTC products, which required high promotion.

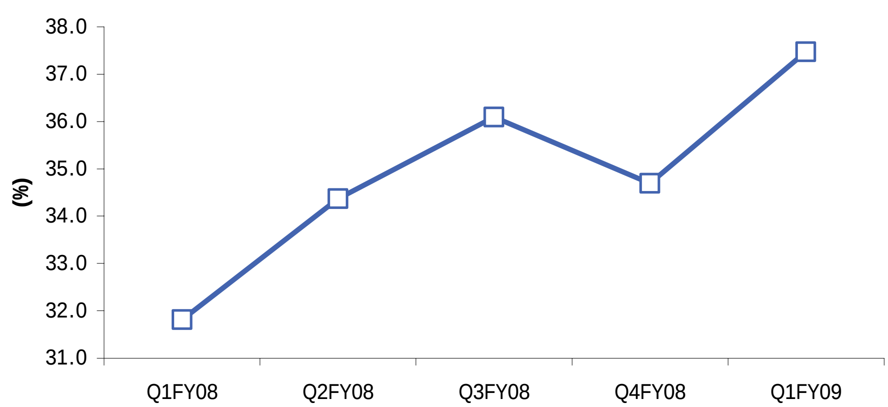
The company's EBITDA margin and material cost over the last five quarters are shown in the following graphs:

EBITDA margin



Source: Company Data, PL Research

Material cost as % of net sales



Source: Company Data, PL Research

As seen from the above graphs, the company's EBITDA margin declined from 25.1% in Q1FY08 to 14.5% in Q4FY08 due to an increase in the material cost. The EBITDA margin improved by 840bps QoQ to 22.9% in Q1FY09 due to a reduction in other expenses. Pfizer's material cost increased from 31.8% in Q1FY08 to 36.1% of net sales in Q3FY08 due to lower sales of high margin OTC products. The material cost declined to 34.7% in Q4FY08 due to a reduction in the prices of crude-based solvents and Chinese raw materials. However, the material cost increased by 280bps QoQ due to a sharp increase in major raw material – vitamin C cost during the quarter.

PAT improved 39% YoY

Pfizer's other income from treasury increased by 45% - from Rs128m to Rs185m. The company's depreciation declined by 10% - from Rs22m to Rs20m. Its PBT for the quarter grew by 21% - from Rs497m to Rs600m. Effective tax rate declined from 43.7% to 35.3% of PBT. This has resulted in 39% growth in PAT before EO items - from Rs280m to Rs389m.Net profit after EO items declined by 80% - from Rs1,929m to Rs389m. EO item refers to the divestment of four brands to Johnson & Johnson for Rs1,929m (net of tax).

Outlook

Pfizer has plans to establish 600 smoking cessation clinics in India. It has a tie-up with Fortis Healthcare in the NCR and Delhi region. The company is targeting corporate and has enrolled 150 members under the program. Pfizer has also introduced Cycklokapron - used for reducing the blood flow during surgery.

Pfizer's AHC business grew by 38% during the quarter and has a promising future. The company has introduced a new product Bovicon in this segment in Q1FY08. It has also entered into an agreement with DuPont to market its AHC products in India.

Pfizer has plans to introduce two new products in anti-infective and CVS segments. These new introductions are likely to be future growth drivers for the company.

The company is currently carrying out 44 clinical trials in India for its parent company.

Pfizer has plans to enter into 2-3 in-licensing deals in FY09.

Pfizer has cash of over Rs765m in its books and is looking for acquiring brands in the domestic market.

Merger with Wyeth

In view of international acquisition of Wyeth by Pfizer, the Indian arms of both the companies are likely to merge. The merged entity is likely to become the second largest MNC pharma company in India with sales of over Rs10.0bn. The combined entity would rank 8th in the domestic market and is likely to have cash of over Rs8.0bn. Hence, it can look for acquisitions in the domestic market. There is likely to be share-swap between Wyeth and Pfizer shares. The companies will have to appoint two independent valuers for the share-swap ratio. The details are likely to be disclosed in the due course.

Concerns

The government has plans to increase the number of drugs under price control from 74 to 354, based on WHO list of essential drugs. The inclusion of additional products under DPCO would affect sales and profitability of the company.

One of Pfizer's key raw materials, Codeine Phosphate, is invariably in short supply. This may affect sales and profitability of its major brand Corex.

Valuation

We expect Pfizer to report 13% CAGR net sales and 19% CAGR net profit over FY08-10. We also expect its EBITDA margin to improve from 21.6% in FY08 to 27.3% in FY10 due to the re-structuring and new product launches.

We expect the company's RoE to improve from 17.6% in FY08 to 17.9% in FY10 due to a sharp rise in the reserves. Its RoCE is also likely to improve from 17.9% in FY08 to 18.1% in FY10 due to a rise in the capital employed.

At the CMP of Rs581, the stock trades at 10.3x FY09E EPS of Rs56.6 and 8.9x FY10E EPS of Rs65.2. We maintain '**Accumulate**' rating on the scrip, with a price target of Rs652 (10x FY10 earnings) over the next 12 months, with an upside of 12.2% over the CMP.

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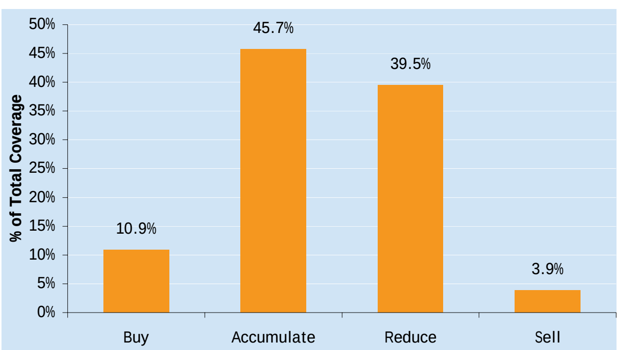
Rating Distribution of Research Coverage



PL's Recommendation Nomenclature

BUY	:	Over 15% Outperformance to Sensex over 12-months	**Accumulate**	:	Outperformance to Sensex over 12-months
Reduce	:	Underperformance to Sensex over 12-months	**Sell**	:	Over 15% underperformance to Sensex over 12-months
Trading Buy	:	Over 10% absolute upside in 1-month	**Trading Sell**	:	Over 10% absolute decline in 1-month
Not Rated (NR)	:	No specific call on the stock	**Under Review (UR)**	:	Rating likely to change shortly