

ACCUMULATE

| | |
|--------------------------|------------------|
| Price | Rs366 |
| Target Price | Rs397 |
| Investment Period | 12 months |

| Stock Info | |
|--------------------|----------------|
| Sector | Pharmaceutical |
| Market Cap (Rs cr) | 7,650 |
| Beta | 0.4 |
| 52 WK High / Low | 423 / 164 |
| Avg. Daily Volume | 86620 |
| Face Value (Rs) | 2 |
| BSE Sensex | 16,790 |
| Nifty | 4,989 |
| BSE Code | 500302 |
| NSE Code | PIRHEALTH |
| Reuters Code | PIRA.BO |
| Bloomberg Code | PIHC@IN |

| Shareholding Pattern (%) | |
|---------------------------------|------|
| Promoters | 49.6 |
| MF/Banks/Indian FIs | 15.8 |
| FII/ NRIs/ OCBs | 23.4 |
| Indian Public/others | 11.2 |

| Abs. | 3m | 1yr | 3yr |
|-------------|-----------|------------|------------|
| Sensex (%) | 13.1 | 65.1 | 31.8 |
| PHL (%) | 10.1 | 66.7 | 51.8 |

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Performance Highlights

■ **Net Sales up 12%:** Piramal Healthcare (PHL) reported 12.5% yoy growth in Net Sales of Rs1,000.0cr (Rs889.3cr) for 2QFY2010, which surpassed our estimate of Rs978.6cr. This robust growth in Top-line was driven by all the company's business segments. For 2QFY2010, the company's Domestic Formulation Sales exceeded the industry average and registered 16.2% growth to Rs521.8cr (Rs449.1cr) on the back of strong traction witnessed by the company's Respiratory, Anti-Infective, Anti-Diabetic, Dermatology and OTC Segments. However, the Pharma Solution (CRAMS) Segment de-grew albeit by a mere 1.9% to Rs270.1cr (Rs275.3cr) with sales from Indian Assets growing 30.8% to Rs119.4cr (Rs91.2cr). The Global Critical Care (GCC) Segment contributed Rs88.5cr (Rs29.5cr) with Minrad contributing around US \$14.1mn. For 1HFY2010, PHL's Net Sales grew 14.0% to Rs1,821.5cr (Rs1,597.6cr) on the back of strong traction seen in the Domestic Formulation business and increasing contribution from the GCC Segment.

For FY2010E, the company has reiterated its Top-line guidance of 16-17% growth. PHL achieved 48% of its guidance during 1HFY2010 and expects 2HFY2010 to be more robust than 1HFY2010.

■ **Operating Margin contracts by 281bp:** PHL reported a disappointing 281bp contraction in OPM to 17.7% (20.5%) yoy for 2QFY2010. Margins fell basically on account of the change in product mix and 21.4% increase in Employee expenses to Rs172.5cr (Rs142.1cr). For 1HFY2010, PHL's OPM fell by 207bp to 18.3% (20.4%). For FY2010E, the company expects to clock OPM of 21-22% on the back of cost savings at its Huddersfield facility, improving profitability at Minrad and robust Top-line growth.

■ **Net profit spikes 44%:** PHL reported Net Profit of Rs106.2cr (Rs73.8cr), up by 43.8%, which was however below our estimate of Rs117.2cr basically on account of lower OPMs. For 1HFY2010, Net Profit came in higher by 34.7% to Rs191.2cr (Rs141.9cr) on a low-base. For FY2010E, PHL has guided for EPS of Rs23.5-24. The company achieved 38% of its guidance during 1HFY2010.

Key Financials (Consolidated)

| Y E March (Rs cr) | FY2008 | FY2009 | FY2010E | FY2011E |
|--------------------------|---------------|---------------|----------------|----------------|
| Net Sales | 2,848 | 3,281 | 3,722 | 4,237 |
| % chg | 17.7 | 15.2 | 13.5 | 13.8 |
| Net Profit | 333.7 | 316.0 | 469.6 | 553.4 |
| % chg | 53.1 | (5.3) | 48.6 | 17.8 |
| EPS (Rs) | 16.0 | 15.1 | 22.5 | 26.5 |
| EBITDA Margin (%) | 18.2 | 20.2 | 20.4 | 20.1 |
| P/E (x) | 22.9 | 24.2 | 16.3 | 13.8 |
| RoE (%) | 30.6 | 27.4 | 32.2 | 30.9 |
| RoCE (%) | 24.6 | 23.6 | 22.1 | 22.9 |
| P/BV (x) | 7.0 | 5.9 | 4.7 | 3.9 |
| EV/Sales (x) | 2.9 | 2.7 | 2.3 | 2.0 |
| EV/EBITDA (x) | 14.1 | 12.8 | 10.9 | 9.5 |

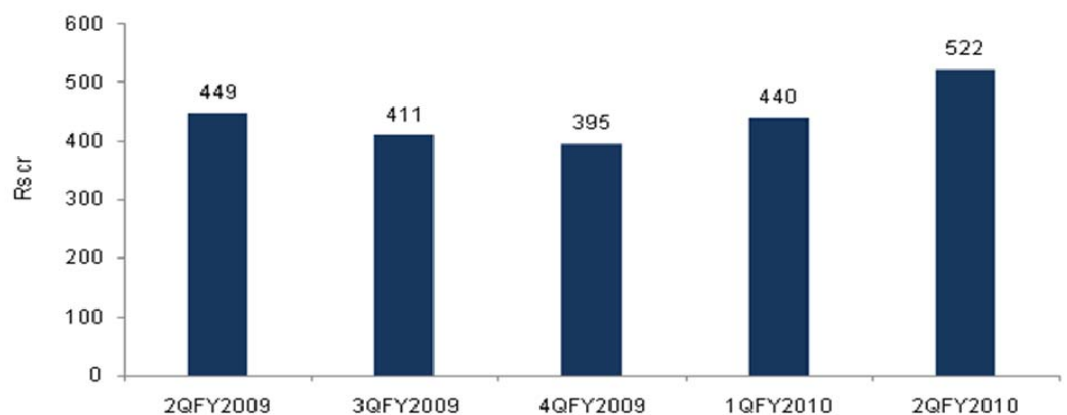
Source: Company, Angel Research

Business Performance

Healthcare and Pathlabs Segments

For 2QFY2010, PHL's overall Healthcare (Domestic Formulation) business, which contributed around 52.2% of Total Sales grew by a strong 16.2% to Rs521.8cr (Rs449.1cr) on the back of higher penetration in Tier II and Rural areas. PHL's Therapeutic business registered strong growth across the Respiratory, Anti-Infective, Anti-Diabetic, Dermatology and OTC Segments. During the quarter, the company launched 9 new products. For 1HFY2010, the Domestic Formulation business grew by a whopping 20.3% to Rs961.5cr (Rs799.1cr) exceeding the Industry average of 12.4%. PHL's Top-10 products contributed around 27.6% of 1HFY2010 Sales while New products launched in last 24 months contributed 7.4% of 1HFY2010 Sales. For FY2010E, management continued to guide a conservative Top-line growth of 14-16% as against 20.3% achieved in 1HFY2010. The Pathlabs Segment grew 20.7% during the quarter to Rs54.8cr (Rs45.4cr).

Exhibit 1: Healthcare Segment - Sales Trend

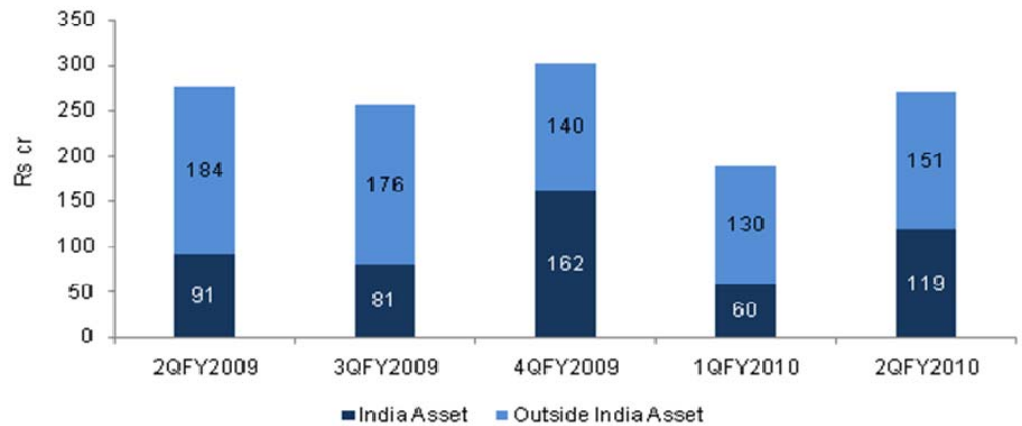


Source: Company, Angel Research

Pharma Solutions Segment

The CRAMS business de-grew by a mere 1.9% to Rs270.1cr (Rs275.3cr), but exceeded our estimate. PHL's Indian Assets recorded stellar Sales to Rs119.4cr (Rs91.2cr), while Outside India Asset Sales de-grew by 18.1% to Rs150.8cr (Rs184.0cr) on the back of closure of the Huddersfield facility. For 1HFY2010, the company registered de-growth of 8.4% to Rs460.0cr (Rs 502.4cr). Excluding Huddersfield, CRAMS Segment Sales grew by 8.2% during 1HFY2010. Regards the slowdown in the CRAMS space, management has indicated that the environment continues to be a bit challenging with the Big pharmacos hesitant to place new orders and Mid-size pharmacos continuing to be dogged by funding issue. However, PHL expects its CRAMS Segment to witness growth in FY2011. On the Pfizer contract, management indicated that they are through with the negotiations and the renewal contract would be signed in the near future with longer tenure and at slightly lower price points. For FY2010E, PHL has guided for Revenues of Rs1,000cr from the Segment.

Exhibit 2: Pharma Solution Segment Sales Trend



Source: Company, Angel Research

Global Critical Care (GCC)

For 2QFY2010, the company's GCC Segment reported Revenues of Rs88.5cr (Rs29.6cr) with Minrad contributing around US \$14.1mn. The company expects contribution from Minrad to increase going forward on the back of volume ramp up, new supply contracts (US \$15mn and large veterinary contracts) commencing in 2HFY2010 and launch of Sevoflurane in Europe. PHL expects to launch Desflurane in the US over next 12-18 months, which has a current market size of US \$250mn. For 1HFY2010, GCC business contributed around Rs161.3cr (Rs45.7cr). PHL has guided for Revenue of Rs450cr from the GCC Segment in FY2010E. PHL expects its Inhalation Anesthetic Segment to commands 15% market share of the addressable market size of US \$435mn by end of FY2010.

Other Key Takeaways

- PHL reduced its Debt/Equity ratio to 0.9x from 1.0x in FY2009 and expects it to decline further to 0.7x by the end of FY2010.
- PHL incurred capex of Rs64.7cr during 1HFY2010 and expects savings in capex during the year as against the guidance of Rs180cr for FY2010.

Exhibit 3: 2QFY2010 Performance (Consolidated)

| Y/E March (Rs cr) | 2QFY2010 | 2QFY2009 | % chg | 1HFY2010 | 1HFY2009 | % chg |
|---------------------------------------|--------------|--------------|-------------|---------------|---------------|-------------|
| Net Sales | 1,000 | 889 | 12.5 | 1,821 | 1,598 | 14.0 |
| Other Income | 1.5 | (40.3) | | 6.0 | (63.3) | |
| Total Income | 858.0 | 849.0 | 1.1 | 1827.4 | 1534.3 | 19.1 |
| PBIDT | 177.4 | 182.7 | (2.9) | 333.0 | 325.2 | 2.4 |
| Operating Margin (%) | 17.7 | 20.5 | | 18.3 | 20.4 | |
| Interest | 25.4 | 17.0 | 49.0 | 50.8 | 29.1 | 74.7 |
| Depreciation | 37.5 | 28.8 | 30.2 | 76.0 | 55.8 | 36.3 |
| PBT | 116.0 | 96.5 | 20.2 | 212.2 | 177.1 | 19.8 |
| Provision for Taxation | 9.4 | 11.4 | (17.6) | 20.7 | 20.1 | 2.9 |
| PAT before Extra-ordinary item | 106.6 | 85.1 | 25.3 | 191.6 | 157.0 | 22.0 |
| Extra-ordinary Items | 0.4 | 9.6 | | 0.4 | 13.6 | (97.4) |
| Minority Interest | 0.0 | 1.7 | (101.2) | (0.1) | 1.5 | (103.2) |
| PAT after Extra-ordinary item | 106.3 | 73.8 | 43.9 | 191.2 | 141.9 | 34.7 |
| EPS (Rs) | 5.1 | 3.5 | | 9.1 | 6.8 | |

Source: Company, Angel Research

Outlook and Valuation

Though 2QFY2010 was a tad disappointing on the Operating front indicating pricing pressure in the CRAMS space, PHL has maintained its FY2010E Top-line guidance of 16-17%, OPM of 21-22% and EPS of Rs23.5-24 indicating a robust 2HFY2010. However, we are not revising our estimates (Top-line growth of 13.5%, OPM of 20.4% and EPS of Rs22.5) downwards post the dismal performance on the Bottom-line front in 2QFY2010 as we expect Domestic Formulation and Minrad to alleviate matters for the company going ahead.

On the bourses, the stock has corrected by 9% in the last few trading sessions and is currently trading at 16.3x FY2010E and 13.8x FY2011E Earnings. **We maintain our Accumulate rating on the stock, with a Target Price of Rs397. PHL continues to be one of our Top Picks in the Pharma Sector given its robust Domestic Formulation business (posted 20.3% growth in 1HFY2010 as against the Industry average of 12.4%) and positive surprises are expected on the Minrad front in FY2011E (Desflurane launch in US and production ramp up which will more than double the addressable market for PHL from current the US \$435mn to US \$1,000mn).**



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Ratings (Returns): Buy (> 15%)
Reduce (-5% to -15%)

Accumulate (5% to 15%)
Sell (< -15%)

Neutral (-5% to 5%)