BUY

SURYA PHARMACEUTICAL

Sunidhi

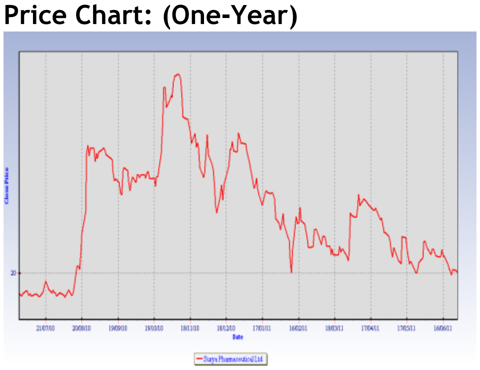
"In your prosperity lies our success"

Retail Desk

06 July 2011

Rating			Buy
CMP (₹)			21
Target Price (₹)			30
Upside (%)			42
Key Data			
BSE Code			532516
NSE Code			SURYAPHARM
Reuters code			SURP.BO
Bloomberg Code			SUPH IN
Sensex			18693
Face Value (₹)			1.00
Mcap (₹ Cr.)			302
52 week H/L (₹)			36/18
2 Wk Avg Qty			52000
Share holding, March 11			**Holding %**
Promoters			30.5
Foreign			18.5
DIs			1.3
Bodies Corporate			21.8
Public & Others			27.9
Performance (%)	**3M**	**6M**	**12M**
Stock (ISLL)	-4.6	-30.6	11.9
BSE 200	-1.7	-7.6	-3.5
BSE 500	-1.3	-7.5	3.0

Price Chart: (One-Year)



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Company Description:

Incorporated in 1992, SPL is a Chandigarh-based pharmaceutical company with six manufacturing facilities of bulk drugs and intermediaries spread across three states of Himachal Pradesh, Haryana and Punjab. In 2001, it ventured into manufacturing of active pharmaceutical ingredients (APIs) and formulations. SPL produces semi synthetic penicillin based products, first generation cephalosporins, anti histamines, drug intermediaries and formulations. It is predominantly a bulk drug or Active Pharmaceutical Ingredient (API) manufacturer. SPL is focused on the manufacture of tablets and capsules for Penicillin G based products. SPL is ranked among the top five in the country in the Betalactum and oral Cephalosporin range of anti-infective.

Surya Pharma Group:

Surya is an integrated group of companies with diversified interests in Pharmaceuticals, Healthcare, Education, Communications, Infrastructure and Retail. With its head quarters in Chandigarh, its group of companies has rapidly emerged as a leader across all its businesses and has gradually established a global footprint with customers in more than 90 countries across the globe.

Menthol and its Derivatives:

SPL has recently entered the business of manufacturing menthol and its derivatives. Menthol is a synthetic product with a wide array of applications in the pharmaceutical/FMCG industry. SPL is one of the largest exporters of mint/menthol derivatives. In the pharmaceutical space, menthol is primarily used for its cooling property in a variety of products to relieve skin irritation, sore throat and nasal congestion. It is also used to treat sunburn, fever and muscle aches as well.

National & International Expansion:

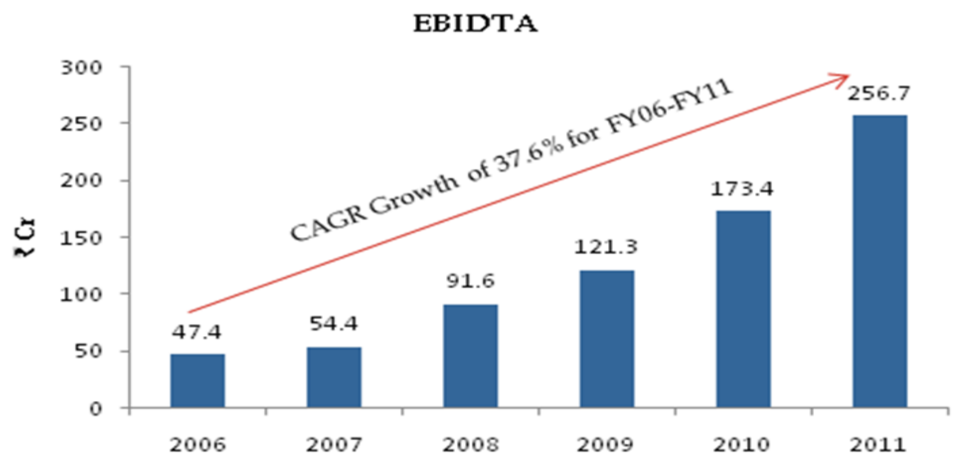
After demonstrating astounding business growth by ranking in the top Fortune 500 companies in India, the 20th largest pharmaceutical firm in India as well as one of ET 500 companies recently, Surya Pharmaceutical (SPL), is on its march to rapid glory via massive national and international expansion.

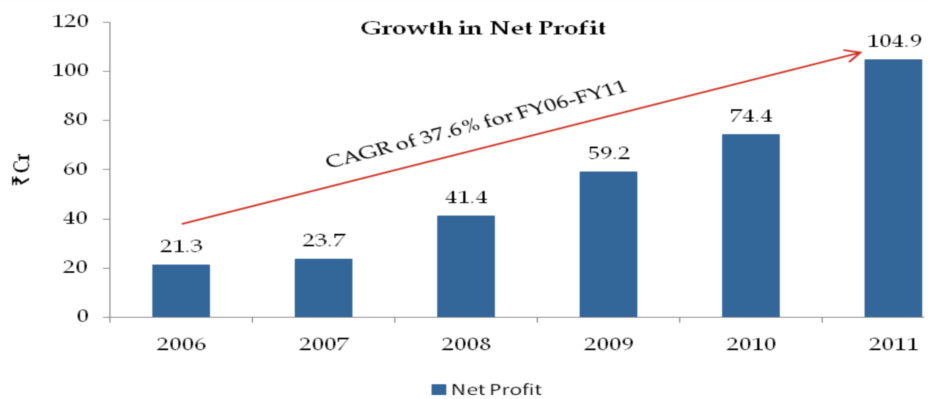
Key Financial: (Consolidated) (₹ crore)

Year-March	FY10A	FY11A	FY12E	FY13E
Sales	1134.1	1599.3	2010.0	2425.0
PBIDT	173.5	256.7	320.6	378.3
Interest	62.4	99.2	108.5	110.8
PBDT	111.1	157.5	212.1	267.5
Depreciation	20.6	26.5	29.0	31.0
PBT	90.5	131.0	183.1	236.5
Tax	14.4	26.1	43.1	66.2
PAT	76.1	104.9	140.0	170.3
Equity	14.5	*19.3	*23.1	23.1
Reserves	288.7	501.6	641.6	814.9
Book Value (₹)	20.9	27.0	28.8	36.2
EPS (₹)	5.2	5.4	6.1	7.4
OPM (%)	15.3	16.1	16.0	15.6
NPM (%)	6.7	6.6	7.0	7.0
P/E			3.4	2.8

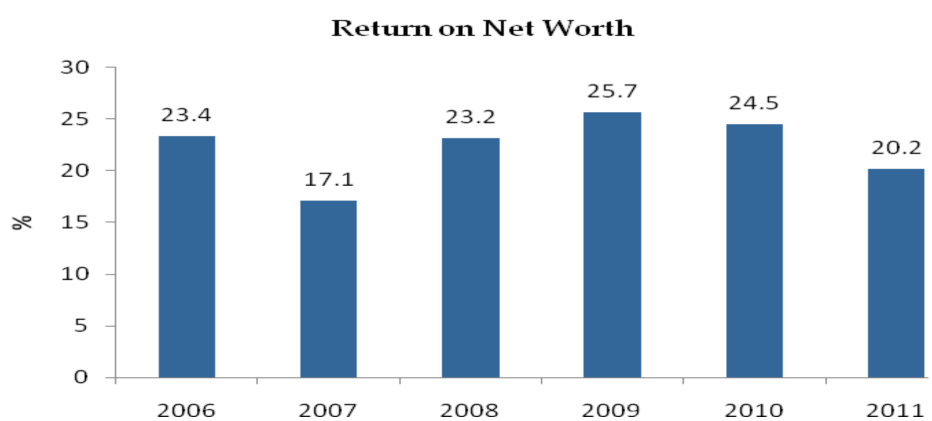
*Equity moved up to ₹19.3 cr. upon GDR conversion/warrant conversion. It will further move up t o ₹23.1 cr. in FY12 upon conversion of warrants.

Growth Charts





Return on Net Worth



Q4 & FY11 Results

During Q4FY11, net profit rose by 8% to ₹27.8 crore on 27% higher sales of ₹446.8 crore (YoY). OPM & NPM stood 15.9% and 6.2% respectively against 13.5% and 6.0% in Q4FY10.

During FY11, net profit soared by 38% to ₹104.9 crore on 41 per cent higher sales of ₹1599.3 crore. OPM & NPM stood 16.1% and 6.6% respectively against 15.3% and 6.7% in FY10.

Blue-chip Clients

SPL's key domestic clientele in India includes Zydus, Intas, German Remedies, Cipla, Piramal, Glenmark, FDC, Lupin, Emami, Hetero, etc.

Exports

About 40 per cent of the total production is exported to Europe, SE Asia, the Far East, Middle East, Latin America and Africa. Achieving high quality cost effective manufacturing solutions for its customers' needs is the basis of our business and essential to its success. Exports constitute over 35 per cent of sales.

Exports driving growth SPL exports to over 100 clients in 90 countries. It exports large quantities of menthol flakes and menthol crystals from India. The company registered a growth of 126% CAGR between FY06 and FY10 in exports, whose value grew from ₹60 crore in FY06 to over ₹600 crore in FY11. Exports contributed to 30% of revenues in FY10, vis-à-vis 11% in FY06.

Research & Development

With special emphasis of research & development activities at a dedicated well equipped R & D centre at Panchkula near Chandigarh, steered by highly qualified scientists from the industry, SPL assures quality optimization & cost effectiveness in product delivery.

SPL has set up a state of the art 25, 000 sq. ft. Surya Advanced Research & Development Centre at Banur near Chandigarh to meet emerging global pharmaceutical dynamics. It has set-up R&D centre in San Diego, USA to further strengthen its position in the research segment which will help it boost exports globally in the years to come. The focus areas of R & D are process developments and CRAMS.

Expansion

SPL has been on an expanding mode and has opened overseas offices in USA, China and Singapore. In FY10-11, SPL commissioned an API-and-sterile plant at Samba in Jammu and Kashmir. This plant is developed as per US FDA norms to manufacture APIs and sterile products.

This newly commissioned facility comprises two independent manufacturing streams. While Manufacturing Stream A - is a dedicated facility for Non Sterile, APIs and Intermediates, Manufacturing Stream B- is designed to cater to upcoming Sterile API Facility.

In Banur in Punjab, the company started its DMO processing unit, an R&D laboratory, a contract research and manufacturing services (CRAMS) unit and a new photochemical division.

SPL has already spent about ₹400 crore in expansion in the last 5 years.

US-based Acquisition

SPL has acquired the US-based Over-the-Counter (OTC) analgesic drug brand 'ActivOn' for $22 million (₹99.52 crore). The deal has provided SPL the established US market of ActivOn and global marketing rights. The brand comes with the acquisition of Ameshire Investment Corp USA.

ActivOn is a leading OTC analgesic brand in the topical analgesic category in the US market. It is used to provide relief of joint and muscle pain associated with arthritis, backache, strains, bruises and sprains. Through the acquisition, the SPL also adds to its portfolio brands namely Preferon, First On and Renewin. It would also have global marketing rights for HeadOn, another leading brand (except USA).

The acquisition provides SPL with a strategic competitive advantage to market its products in US through established market networking channels that include leading retailers like Walmart, Walgreen, CVS, Rite Aid etc. This also provides an opportunity to launch its OTC / FMCG products in US markets.

Contract Research

SPL has made impressive foray into contract research and manufacturing (CRAMS) space with order from Cipla, Elder Pharma and Ind-Swift Labs. The company intends to increase its business substantially in this space in the coming years. Development Centre at Banur to meet emerging global pharmaceutical dynamics.

Formulation division

Alexus, a dedicated hard core formulations division of SPL markets finished dosage forms in the general medicine segment. The product mix includes antibiotics, PPIs, cough & cold remedies, calcium & multi-vitamin supplements. Aegis Healthcare, yet another division caters to therapeutic segments like anti infectives, gastrointestinal, anti-allergic etc. Altair is the diagnostic and medical equipment division.

Pharma Retail

SPL has ambitiously embarked on a journey towards pharma retail. It has already begun operations by launching its pharma retail store under the brand ‘Viva’ through its subsidiary, Surya Healthcare. Starting with Delhi and NCR, it currently has 166 pharma retail stores under the brand name of ‘Viva’ and ‘Medimart’. SPL targets to create pan India presence in 3 years’ time by setting up 1500 stores.

Medical Footwear

SPL has a marketing tie-up with US-based footwear maker ‘CROCS’ to improve topline. Crocs has developed medical footwear 'Crocs Rx Medical', which is specially designed for individuals with general foot problems, diabetic and arthritic feet. SPL is eyeing revenue of over ₹ 100-150 crore in next two years with this tie up.

Diagnostic & Medical Equipment

Altair, the Diagnostic and Medical equipment Division of SPL provides home care devices for self testing of various medical parameters to cope with modern day hectic lifestyle and chronic diseases.

Altair markets the following Devices and products. Under the Point Of Care Testing Devices: BP Monitors, Monitors (wrist type and arm type model), Fever Alert (Flexi-tip Digital Thermometer), Gluco Alert (Glucose monitor) and Gluco Alert Strips.

Future launches in this category would include new products which have the ability to assess complex parameters such as cholesterol, lipid profile and uric acid. This also includes handheld ECG monitor devices.

The medical equipment and home care devices markets are quite fragmented in the country and such high end, patient friendly life saving devices are being introduced by SPL for the first time in the country.

Subsidiary begins operations at San Diego, USA

State-of-the-art R & D facility launched in USA under Surya Bio Pharma (SBP), a subsidiary of SPL has commenced operations in San Diego. SBP will be developing nutraceutical products for a number of chronic diseases that have no effective treatment available in the market.

Initially SBP product development will target Diabetes, Neurodegenerative diseases, including Alzheimer's, Cancer and Cardiovascular diseases. SBP will combine knowledge and expertise in the Ayurvedic system tried for thousands of years in India along with the rigorous experimental knowledge based upon both pre-clinical and clinical studies. SBP will also focus on generating IP positions in these areas for the nutraceuticals. In a long-term goal, SBP will also undertake research and development for drug discovery/development program for the above-mentioned diseases.

Opportunity in CMO+CRO

Surya's CRAMS business can offer a wholesome and lucrative deal of Custom synthesis, Analytical Development, Formulation Development and cGMP manufacturing for pivotal, clinical and large scale manufacturing requirements.

Global spending by the pharmaceuticals industry on outsourcing (including CMO and CRO), which was valued at USD 51 billion in 2008 is estimated to have reached USD 73 billion in 2011. The biggest global consumer USA contributes almost half the value (45%) with Europe following the next (24%) and Japan (11%). China contributes about 3% and Indian contribution is 1.8%.

Indian pharmaceutical companies are well equipped to capitalise on the global outsourcing opportunity. These companies have strengthened their presence in the market by acquiring better technologies and developing expertise in niche segments that offer high margins and have higher entry barriers. India offers tremendous advantage in terms of:

- World-class US FDA compliant infrastructure set up
- Large talent pool, low R&D and manufacturing cost
- High capital efficiency

Global pharmaceutical market

According to the industry analysts IMS health and BCC Research, the global pharmaceutical market would have grown CAGR of about 5-5.5 % to US$825 billion in 2010 and reach over US$950 billion by 2013.

Indian pharma market is projected to grow to $20 billion in 2015

The Indian pharmaceutical market is projected to grow to about US$ 20 billion by 2015 maintaining 12.3% CAGR, growing more than 300% from US$6 billion in 2005.

The Indian pharmaceutical market has seen a CAGR of about 14% in the last five years. In terms of scale, the India pharmaceutical market is ranked 14th in the world.

According to a McKinsey report, India will emerge as the 10th largest pharma market by 2015 overtaking Brazil, Mexico, South Korea and Turkey.

The industry continues to be highly fragmented and dominated by Indian companies. The domestic pharmaceutical industry grew by 18% in March 2010 (ORG's moving annual total, or MAT) versus 10% in March 2009. Acute therapy dominates, with a share of over 75% of the total market value.

The chronic segment has registered a growth of 21%, versus 16% in the acute segment. Anti-infectives grew by 14%, respiratory and dermatology by 21%, cardiac by 21% and CNS by 20%.

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Tier II cities (population <1-lakh) and rural areas currently account for 40% of the market, and are expected to grow faster than the rest of the country.

Global API Market

North America and Europe together account for more than 60% share in the global API market revenue. Asia-Pacific is the fastest growing API market in the world. The global API demand is led by China, India and Brazil. The innovator APIs are increasingly losing market share to generic sector APIs. On the basis of synthesis route, the synthetic APIs continue to dominate the global revenues.

The global API sales revenue was $91 billion in 2009 and is expected to grow at a CAGR of 5.9% from 2010 to 2015. The growth will be driven by the rise in demand of generic sector drugs and biological drugs. The global API sales revenue is expected to reach $126.3 billion in 2015.

Generic opportunity of $77 billion

Generics are increasing their market share in the global API market as many innovator drugs are losing their patents in the regulated markets. Also, due to the impact of the global economic slowdown, the focus on innovation has reduced, giving way to the growth of generics.

The combined generics market size is valued at approximately $77bn in the US, Japan, the five major EU markets (France, Germany, Italy, Spain, and the UK), the BRIC markets (Brazil, Russia, India, and China) and Australia combined. With branded pharmaceutical market set to lose approximately $100bn in sales due to the patent cliff, this presents a significant opportunity for generics players during 2011–15.

Generic drugs are also increasingly preferred because of their lower cost in comparison to the highly expensive innovator drugs. As a part of cost containment measures, the governments of many countries are encouraging the generic sector.

Due to the emergence of a large number of generic API-producing companies and innovator companies venturing into the generic market, the generic sector API is set for high growth.

Upcoming patent cliff provides opportunities for R&D focused pure play API companies. Increasing penetration of generics in the regulated markets (especially EU and Japan) will drive API demand from cheaper destinations. Recent announcement of free trade pact with Japan will open doors for Indian pharmaceutical exports to Japan. Currently China is the major pharmaceutical exporter to Japan.

Conversion of GDR

During FY10-11, SPL raised $25 million via GDR, which were converted into equity shares at a price of ₹29 (Premium of ₹28). This has resulted in reserves increasing by ₹108 crore. Consequently return on net worth has come down to the extent.

Further conversion of warrants to enhance equity capital

Further it also allotted 1.95 crore equity shares (FV Rs 1) upon conversion of warrants to Futuristic Garments, the promoter group company out of 47 lakh warrants of ₹10 each issued on 29 April 2010. The further conversion will enhance equity capital by ₹2.75 crore to ₹23.1 crore by FY12. The conversion is considered at par value.

Valuation & Recommendation

SPL is an ISO 9001-2000 WHO cGMP certified with state of the art manufacturing units positioned in multiple locations across the northern region. With a focus on innovation and quality, it has demonstrated unparallel growth to current sales of ₹16 billion.

SPL is all geared up to provide integrated solutions as complementing partner to the global pharmaceutical industry and this move is in line with that thought process and business model.

SPL continues to focus in markets like India, Middle East, Latin America and other markets where it is well poised as a preferred quality supplier.

The Greenfield multi-utility formulations and sterile plant at Jammu, now commissioned, complies with US FDA requirements and add substantially to the revenue & profitability going forward.

SPL is going on for a further major expansion of ₹500 crore to fuel its business plan, which involves setting up new API manufacturing unit near Chandigarh. The modalities are under process.

The proposed unit will manufacture the entire range of APIs including cardio-vascular products, CNS products, hormonal products, steroids etc. SPL is also expanding group's pharmaceutical retail chains.

SPL leverages its global network, resources and international associations to further expand its operations in its key vertical domains to define the path towards unprecedented growth in the future.

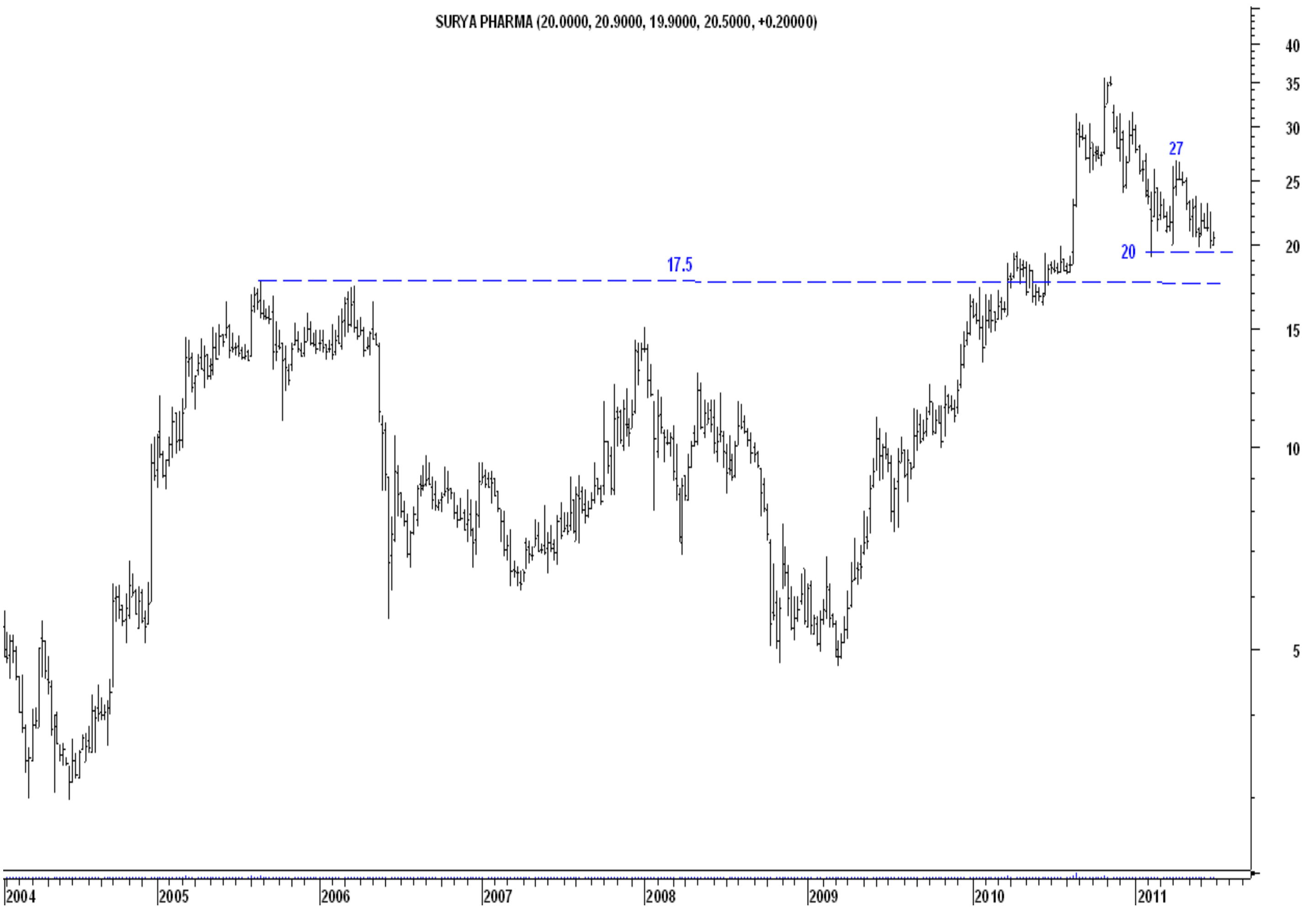
SPL's rapid expansion has been driven by its commitment to its key principles:

- Sustaining growth via entire value chain raw material (intermediates), APIs, Formulations, Distribution to retail
- Increasing operational efficiency
- Emerge as a leader in the integrated pharmaceuticals
- Focus on innovation and core values towards achieving excellence across all operations

SPL continued to maintain an upward, growing and successful track record and has well positioned in domestic as well as international market coupled with recent acquisition and expansion give strong revenue & profitability visibility going forward.

At CMP of ₹21, the share is trading at a P/E of 3.0x on FY12E and 2.5x on FY13E. We recommend BUY on the stock with a price target of ₹30 in the medium-to-long term.

Technicals-Surya Pharmaceutical



Surya Pharmaceutical stock in its weekly chart can be seen holding the crucial support of around ₹20 which it had tested in April 2011. The scrip can be expected to hold onto this support. The upside target is the high it made in April 2011 of ₹27. In case the scrip breaks the important support of around ₹20, it can witness a downfall to ₹17.5, which was the peak made in 2005. The view is that the scrip can be bought at the current level for a minimum target of ₹27 and to add to the position in the event the scrip falls to ₹17.5.

SUNIDHI SECURITIES & FINANCE LTD

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