Prabhudas Lilladher

Pfizer

New products to drive growth

Q2FY08 Result Update

July 1, 2008

Rating	**Outperformer**
Price	Rs551
Target Price	Rs732
Implied Upside	33.0%
Sensex	12,962

(Prices as on July 1, 2008)

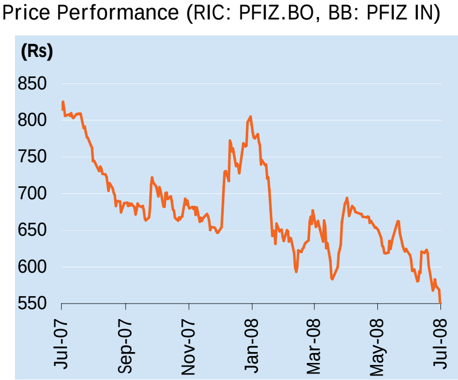
Trading Data	
Market Cap. (Rs bn)	16.4
Shares o/s (m)	29.8
Free Float	58.8%
3M Avg. Daily Vol ('000)	6.0
3M Avg. Daily Value (Rs m)	3.8

Major Shareholders	
Promoters	41.2%
Foreign	2.1%
Domestic Inst.	31.6%
Public & Others	25.1%

Stock Performance

(%)	1M	6M	12M
Absolute	(11.5)	(30.6)	(31.5)
Relative	9.5	5.5	(20.0)

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



Source: Bloomberg

- **Results:** Pfizer's Q2FY08 results were affected by the restructuring of transfer of brands to Johnson & Johnson (J&J). Net sales for the quarter declined by 0.7% YoY from Rs1.65bn to Rs1.63bn. On one-on-one basis, sales grew by 8.8% after considering the sale of four divested brands to J&J. The company's EBIDTA margin improved by 120bps from 21.4% to 22.6% YoY, mainly due to the decline in material cost. Material cost declined by 390bps from 38.3% to 34.4% of net sales due to the change in product mix with higher sale of AHC products. Personnel expenses increased by 240bps from 14.0% to 16.4% of net sales due to lower sales growth and annual rise in salary. Other expenses were up by 40bps from 26.3% to 26.7% of net sales due to increase in advertisement and promotion expenses for the new launches. Pfizer's net profit before EO grew by 17.4% YoY from Rs329m to Rs386m due to improvement in margin and higher other income.
- **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 the company to report 7% CAGR net sales and 14% CAGR net profit over FY07-09. We also expect its EBIDTA margin to improve from 22.5% in FY07 to 24.7% in FY09 due to the restructuring.

  At the CMP of Rs551, the stock trades at 11.3x FY08E EPS of Rs48.9 and 9.8x FY09E EPS of Rs56.3. We maintain Outperformer rating on the scrip with a price target of Rs732 (13x FY09 earnings) over the next 12 months, an upside of 33.0% over the CMP.

Key financials (Y/e Nov)	**FY06**	**FY07**	**FY08E**	**FY09E**
Revenue (Rs m)	6,885	6,942	7,326	7,992
Growth (%)	*10.1*	*0.8*	*5.5*	*9.1*
EBITDA (Rs m)	1,653	1,559	1,753	1,974
PAT (Rs m)	1,291	1,290	1,459	1,680
EPS (Rs)	43.3	43.2	48.9	56.3
Growth (%)	*41.1*	*(0.1)*	*13.1*	*15.1*
Net DPS (Rs)	22.5	27.5	17.0	20.0

Source: Company Data; PL Research

Profitability & valuation	**FY06**	**FY07**	**FY08E**	**FY09E**
EBITDA margin (%)	*24.0*	*22.5*	*23.9*	*24.7*
RoE (%)	*33.1*	*24.5*	*18.5*	*17.2*
RoCE (%)	*34.1*	*25.2*	*18.8*	*17.4*
EV / sales (x)	2.5	2.4	2.3	2.1
EV / EBITDA (x)	9.9	10.5	9.4	8.3
PE (x)	12.7	12.7	11.3	9.8
P / BV (x)	4.1	2.5	1.8	1.6
Net dividend yield (%)	*4.1*	*5.0*	*3.1*	*3.6*

Source: Company Data; PL Research

Ranjit Kapadia
Ranjit Kapadia@PLIndia.com
+91-22-6632 2300

Tushar Maudhane
TusharManudhane@PLIndia.com
+91-22-6632 2238

Highlights

Low sales growth

For Q2FY08, Pfizer posted 0.7% YoY decline in net revenue from Rs1.65bn to Rs1.63bn. The lower sales growth can be attributed to restructuring during the year. In January 2008, the company sold its four major brands Benadryl, Caladryl, Listerine and Benylin to J&J for Rs2.15bn. These products had combined sales of Rs600m per annum. On one-on-one basis, excluding these brands, sales grew by 8.8%. During the quarter, pharma business sales declined by 2.1% YoY, whereas AHC business reported sales growth of 10.3% YoY. Clinical services business reported a decline of 5.7%.

Sales composition *(Rs m)*

Y/e Nov	Q2FY08	Q2FY07	*YoY gr. (%)*	Q1FY08	H1FY08	H1FY07	*YoY gr. (%)*
Pharmaceuticals	1436	1468	*(2.1)*	1304	2740	2851	*(3.9)*
Animal Healthcare	199	180	*10.3*	201	399	349	*14.5*
Services-clinical dev.	54	58	*(5.7)*	51	106	110	*(3.8)*
Total sales	**1,689**	**1,705**	*(0.9)*	**1,556**	**3,245**	**3,309**	*(1.9)*

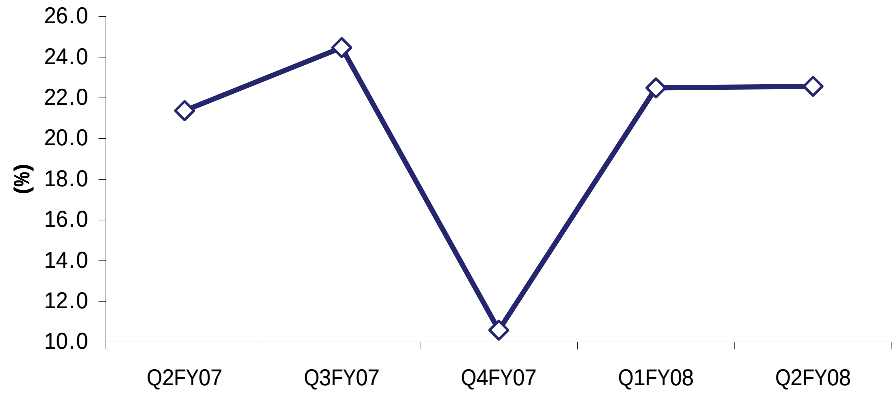
Source: Company Data, PL Research

Margins improved by 120bps

Pfizer's EBIDTA margin improved by 120bps from 21.4% to 22.6% YoY, mainly due to decline in material cost. The company's material cost declined by 390bps from 38.3% to 34.4% of net sales due to higher sales of AHC products. Personnel expenses increased by 240bps from 14.0% to 16.4% of net sales due to lower sales growth and annual rise in salary. Other expenses also increased by 40bps from 26.3% to 26.7% of net sales due to restructuring, higher advertisement cost and increase in freight .

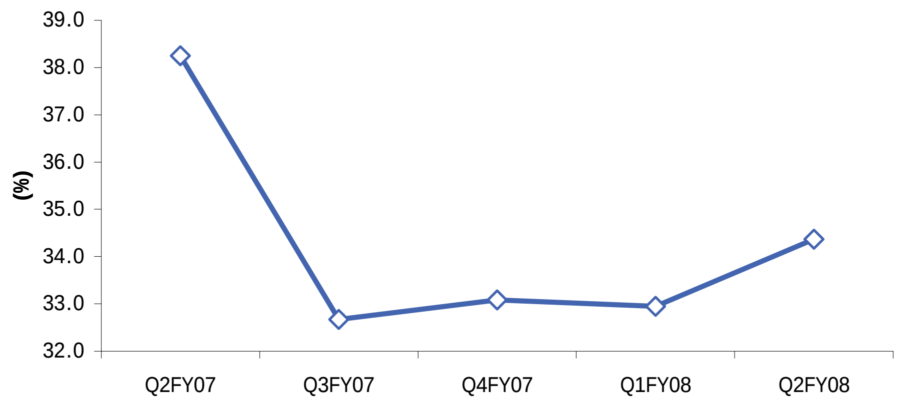
The company's EBIDTA margin and material cost over the last five quarters are shown in the following graphs:

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 EBIDTA margin has improved from 21.4% in Q2FY07 to 24.5% in Q3FY07 and then declined sharply to 10.6% in Q4FY07. However, the same has again improved to 22.5% in Q1FY08 and then improved marginally to 22.6% in Q2FY08. Pfizer's material cost fell from 38.3% in Q2FY07 to 32.9% of net sales in Q1FY08 but increased to 34.4% in Q2FY08. Material cost for the last three quarters were in the narrow range of 32.9-34.4%.

PAT grew 17%YoY

Pfizer's other income from treasury and clinical development increased by 45% from Rs174m to Rs251m. The company's depreciation declined by 18% from Rs30m to Rs24m due to the divestment of its Chandigarh plant. Its PBT for the quarter grew by 20% from Rs496m to Rs596m. Effective tax rate increased from 33.8% to 35.3% of PBT. This has resulted in 17% improvement in PAT before EO items from Rs329m to Rs386m. Pfizer had reported Rs2,249m as EO income from the sale of its Chandigarh property in Q2FY08. Net profit after EO items declined by 85% from Rs2,578m to Rs379m.

Outlook

The company sold its four OTC brands to J&J for Rs2.15bn. These brands had combined sale of Rs600m. The transfer was done at 3.6x sales. The amount was shown as EO item in Q1FY08 after adjusting for Rs450m for income tax. With this restructuring, personnel and advertisement expenses are likely to decline and would result in higher margins. The QoQ margin improved by 10bps from 22.5% to 22.6%.

Pfizer has launched its first patented anti-smoking drug in India in February 2008. The company has launched this drug under the brand Champix. This product will be imported from Germany and will be marketed by Pfizer. The product is priced at Rs9,500 for a 12-week treatment. The advantage of Champix over the other drugs is that it does not contain nicotine. With the large number of smokers in India, the drug has a promising future. Champix has a success rate of 44% in the US. Pfizer has also introduced Cycklokapron used for reducing blood flow during surgery.

Pfizer's AHC business grew by 10% during the quarter and has a promising future. The company 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 45 clinical trials in India for its parent company.

Pfizer has cash of over Rs5.0bn in its books and is looking at acquiring brands in the domestic market.

Concerns

The government 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 in short supply. This may affect sales and profitability of the company.

Valuation

We expect the company to report 7% CAGR net sales and 14% CAGR net profit over FY07-09. We also expect its EBIDTA margin to improve from 22.5% in FY07 to 24.7% in FY09 due to restructuring and new product launches.

We expect Pfizer's RoE to decline from 24.5% in FY07 to 17.2% in FY09 due to sharp rise in reserves. Its RoCE is also likely to decline from 25.2% in FY07 to 17.4% in FY09 due to the rise in capital employed.

At the CMP of Rs551, the stock trades at 11.3x FY08E EPS of Rs48.9 and 9.8x FY09E EPS of Rs56.3. We maintain Outperformer rating on the scrip with a price target of Rs732 (13x FY09 earnings) over the next 12 months, an upside of 33.0% over the CMP.

Q2FY08 result overview *(Rs m)*

Y/e November	Q2FY08	Q2FY07	YoY gr. (%)	Q1FY08	H1FY08	H1FY07	YoY gr. (%)
Net sales	**1,634**	**1,647**	*(0.7)*	**1,504**	**3,138**	**3,197**	*(1.8)*
Expenditure							
Raw materials	562	630	*(10.8)*	495	1,057	1,154	*(8.4)*
as % of net sales	*34.4*	*38.3*		*32.9*	*33.7*	*36.1*	
Personnel expenses	268	231	*15.7*	228	495	451	*9.7*
as % of net sales	*16.4*	*14.0*		*15.1*	*15.8*	*14.1*	
Other expenses	436	433	*0.6*	443	879	865	*1.5*
as % of net sales	*26.7*	*26.3*		*29.4*	*28.0*	*27.1*	
Total expenditure	1,265	1,295	*(2.3)*	1,166	2,431	2,471	*(1.6)*
OPBDIT	**369**	**352**	*4.8*	**338**	**707**	**726**	*(2.6)*
OP margin (%)	*22.6*	*21.4*		*22.5*	*22.5*	*22.7*	
Other income	251	174	*44.6*	181	432	294	*47.1*
PBDIT	**620**	**526**	*17.9*	**519**	**1,140**	**1,020**	*11.7*
Depreciation	24	30	*(18.4)*	22	47	57	*(17.8)*
Interest	-	-	*NA*	-	-	-	*NA*
PBT	**596**	**496**	*20.1*	**497**	**1,093**	**963**	*13.5*
Prov. for tax	210	168	*25.5*	217	428	326	*31.3*
% of PBT	*35.3*	*33.8*		*43.7*	*39.1*	*33.8*	
PAT	**386**	**329**	*17.4*	**280**	**665**	**638**	*4.3*
Extraordinary item	6	2,249	*NA*	1,649	1,643	2,223	*(26.1)*
Reported PAT	**379**	**2,578**	*(85.3)*	**1,929**	**2,308**	**2,861**	*(19.3)*

Prabhudas Lilladher Pvt. Ltd.
3rd Floor, Sadhana House, 570, P. B. Marg, Worli, Mumbai-400 018, India.
Tel: (91 22) 6632 2222 Fax: (91 22) 6632 2209

PL's Recommendation Nomenclature

BUY	:	> 15% Outperformance to BSE Sensex	**Outperformer** (OP)	:	5 to 15% Outperformance to Sensex
Market Performer (MP)	:	-5 to 5% of Sensex Movement	**Underperformer** (UP)	:	-5 to -15% of Underperformace to Sensex
Sell	:	<-15% Relative to Sensex			
Not Rated (NR)	:	No specific call on the stock	**Under Review** (UR)	:	Rating likely to change shortly