Nicholas Piramal India (NICH.BO)

Target price change ☑

Buy: Guidance Raised Again; Raising Target Price to Rs455

- **Raising TP to Rs455** — as we raise our FY08-10E estimates by 2.4-0.3% & roll forward to FY09E EPS. 2Q results were ahead of expectations with significant traction in CRAMS & recovery in domestic formulations, and the company has raised its FY08 EPS guidance by 3%. We rate NPIL as the best Indian play on innovator CRAMS and reiterate it as our top pick in Indian pharma.
- **Robust 2Q** — Recurring sales & PAT grew 20% & 76% respectively, driven by a) ramp-up in higher margin CMG sales from Indian facilities; b) higher Indian formulations sales; and c) operating leverage as capacity utilization improved. EBIDTA margins (after charging off NCE R&D cost) improved by 231bps YoY while on a pre-NCE R&D basis, EBIDTA margins improved 342bps YoY.
- **Guidance revised** — NPIL raised its FY08 EPS guidance by 3% (to Rs17.5) to account for the greater traction in CRAMS and better sales mix. This is despite lower sales growth guidance (20% vs. 25% earlier) to adjust for potential disruptions in phensydyl sales, rupee appreciation & rationalisation of lower-margin sales. NPIL has already achieved 46% of the new EPS guidance in 1H.
- **Strong traction in CRAMS** — a) Started supplies to a Top 5 innovator for 2 contracts from India; b) 19% rise in number of projects over 1H; c) EBIDTA margins have improved to double-digit levels - likely to sustain in 2H & improve in FY09; d) Avecia turnaround complete: EBIDTA margins at c5% & improving.
- **NCE demerger on course** — NPIL has received approvals from stock exchanges and the Mumbai HC has convened a meeting of shareholders next month.

Buy/Medium Risk	**1M**
Price (25 Oct 07)	Rs285.80
Target price	Rs455.00
from Rs395.00	
Expected share price return	59.2%
Expected dividend yield	1.4%
Expected total return	**60.6%**
Market Cap	Rs59,736M
	US$1,512M

Price Performance (RIC: NICH.BO, BB: NP IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	1,210	5.79	-31.6	49.4	6.2	16.6	1.0
2007A	2,256	10.80	86.5	26.5	5.7	22.5	1.2
2008E	3,638	17.40	61.2	16.4	5.3	33.4	1.4
2009E	4,675	22.37	28.5	12.8	4.0	35.6	1.6
2010E	5,749	27.50	23.0	10.4	3.1	33.4	1.7

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

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Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	49.4	26.5	16.4	12.8	10.4
EV/EBITDA adjusted (x)	30.5	17.7	12.0	9.9	8.1
P/BV (x)	6.2	5.7	5.3	4.0	3.1
Dividend yield (%)	1.0	1.2	1.4	1.6	1.7
Per Share Data (Rs)					
EPS adjusted	5.79	10.80	17.40	22.37	27.50
EPS reported	5.79	10.80	17.40	22.37	27.50
BVPS	45.98	50.14	54.14	71.38	93.18
DPS	3.00	3.50	4.00	4.50	5.00
Profit & Loss (RsM)					
Net sales	15,944	24,541	29,709	33,961	37,080
Operating expenses	-14,537	-21,703	-25,116	-28,277	-30,379
EBIT	**1,408**	**2,839**	**4,592**	**5,684**	**6,701**
Net interest expense	-173	-305	-425	-351	-160
Non-operating/exceptionals	97	-39	14	12	31
Pre-tax profit	**1,331**	**2,494**	**4,181**	**5,344**	**6,571**
Tax	-238	-389	-523	-668	-821
Extraord./Min.Int./Pref.div.	116	151	-21	-1	-1
Reported net income	**1,210**	**2,256**	**3,638**	**4,675**	**5,749**
Adjusted earnings	1,210	2,256	3,638	4,675	5,749
Adjusted EBITDA	2,096	3,657	5,541	6,635	7,704
Growth Rates (%)					
Sales	19.5	53.9	21.1	14.3	9.2
EBIT adjusted	-1.5	101.7	61.8	23.8	17.9
EBITDA adjusted	7.3	74.5	51.5	19.7	16.1
EPS adjusted	-31.6	86.5	61.2	28.5	23.0
Cash Flow (RsM)					
Operating cash flow	**1,579**	**2,395**	**4,165**	**5,228**	**6,526**
Depreciation/amortization	688	818	949	951	1,004
Net working capital	-367	-740	-1,063	-1,006	-685
Investing cash flow	**-2,510**	**-4,012**	**-1,969**	**-1,110**	**-957**
Capital expenditure	-2,248	-217	-1,528	-1,122	-988
Acquisitions/disposals	-60	-2,000	0	0	0
Financing cash flow	**1,734**	**1,164**	**-1,324**	**-4,174**	**-4,552**
Borrowings	-863	2,778	33	-3,101	-3,360
Dividends paid	-685	-1,491	-973	-1,072	-1,192
Change in cash	**802**	**-453**	**-78**	**-56**	**1,016**
Balance Sheet (RsM)					
Total assets	**18,464**	**23,018**	**25,831**	**27,861**	**30,202**
Cash & cash equivalent	953	506	427	371	1,388
Accounts receivable	2,429	3,673	4,847	5,633	6,148
Net fixed assets	10,418	12,238	11,918	12,090	12,075
Total liabilities	**8,290**	**12,151**	**14,510**	**12,937**	**10,720**
Accounts payable	3,277	4,551	5,308	6,067	6,622
Total Debt	3,114	6,392	6,850	4,100	900
Shareholders' funds	**10,174**	**10,867**	**11,321**	**14,925**	**19,483**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	13.1	14.9	18.7	19.5	20.8
ROE adjusted	16.6	22.5	33.4	35.6	33.4
ROIC adjusted	9.6	15.5	22.0	25.1	27.9
Net debt to equity	21.2	54.2	56.7	25.0	-2.5
Total debt to capital	23.4	37.0	37.7	21.6	4.4

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Excellent 2Q; Raising Target Price to Rs455

We raise our target price for Nicholas Piramal (NPIL) by 15% to Rs455/share as we raise our FY08-10E estimates by 2.4-0.3% and roll forward to FY09E EPS. 2Q results were ahead of expectations with significant traction in CRAMS & recovery in domestic formulations and the company has raised its FY08 EPS guidance by 3%. More important, we see significant traction and qualitative improvement in the company's innovator CRAMS business. We rate NPIL as the best Indian play on innovator CRAMS and reiterate it as our top pick in Indian pharma.

2Q ahead of expectations; Guidance raised

NPIL's 2Q FY08 results were ahead of our (and street) expectations, primarily on the back of significant traction in the CRAMS business. The company has revised its FY08 earnings guidance upwards by 3% to Rs17.5, even as it lowered revenue growth guidance to 20% (from 25% earlier).

Key highlights of the results (see tables on pages 6-7)

- **Recurring sales grew 20%**, driven by ramp-up in CMG sales from India and normalization of the domestic formulations business after a tough 1Q. CMG sales from Indian facilities grew by 3x YoY and 2.5x QoQ to Rs694m as NPIL commenced supplies to one of the top 5 global pharma companies – leading to c22% YoY growth in global CRAMS revenues. The UK CRAMS business appears to have been hit by rupee appreciation and seasonality to some extent, clocking a mere 3% YoY growth in revenues. We also highlight that Indian CRAMS revenues were likely skewed on the higher side in 2Q due to initial supplies and will likely normalize over the next two quarters. The management once again reiterated that CRAMS revenues from Indian facilities would grow at over 100% in FY08.

- **EBIDTA margins (after charging off NCE R&D cost) improved by 231bps YoY** to 17.4%, as the benefits of high margin Indian CRAMS sales and operating leverage on higher revenues came through. NPIL continues to charge NCE R&D spend to its total expenditure pending the final approval for the demerger of this unit. On a pre-NCE R&D basis, EBIDTA margins improved 342bps YoY to 20.6% - well above its revised guidance of 18.7% for FY08.

- **EBIDTA margins are unlikely to sustain at 2Q levels in 2H** due to two reasons: a) Higher CRAMS sales from Indian facilities likely to normalize over the next two quarters; b) NPIL has incurred non NCE R&D spend of only Rs252m in 1H against its annual guidance of Rs1bn – with cost ramping up over the next two quarters, we expect margins to normalize.

- **Recurring net profit has increased by 76% YoY** to Rs875m as lower effective tax rate and flattish depreciation helped offset a 45% YoY increase in interest cost.

- **Guidance revised:** NPIL raised its FY08 EPS guidance by 3% (to Rs17.5) to account for the greater traction in CRAMS & better sales mix. This is despite lower sales growth guidance (20% vs. 25% earlier) to adjust for potential disruptions in phensydyl sales, rupee appreciation and rationalization of lower margin sales. Given that NPIL has already achieved 46% of the new EPS guidance in 1H, we believe the revised guidance is achievable.

Strong traction in CRAMS

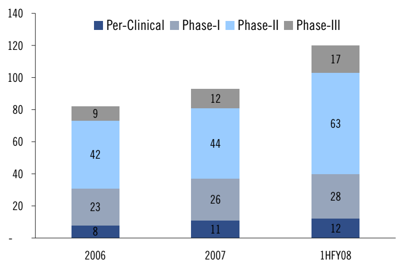
NPIL has been witnessing significant traction in the innovator CRAMS business, with some more evidence of the same coming through in 2Q. Apart from commencement of supplies to a Top 5 innovator pharma company, there has also been an increase in the number of projects it is working on. With the acquired Avecia business having turned around and growing capacity utilization across all facilities, NPIL looks well set to continue improving the profitability and capital efficiency of this business over the next few years.

Key highlights of the CRAMS business

- NPIL has commenced supplies for two contracts to one of the top 5 global innovator pharma companies from its Indian facilities. This is separate from the contracts that the company has announced in the past (Fortune 500 company; hospitals major; Pfizer) and is expected to scale up going forward. At the same time, initial supplies for the Fortune 500 contract would commence in 3QFY08. This augurs well for profitability, given that CRAMS revenues from Indian facilities enjoy higher margins of c25% vis-à-vis the business being done from UK and Canada.

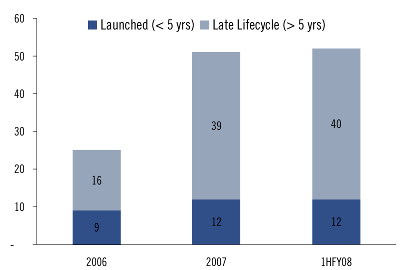
- There has been a significant pickup in the number of projects in NPIL's global CRAMS business – up 19% over the last six months. Most of the increase has come in the PDS (pharmaceutical development services) space – i.e. molecules in pre-clinical and clinical trials. 17 molecules are in Phase III, of which NPIL believes that there are 3 molecules where the innovator has favorable data from the trials and commercialization is likely. However, any upside on this front would come through only after the next 12 months.

Figure 1. Number of Molecules under PDS



Source: Company Reports and CIR

Figure 2. Number of Molecules under PMS



Source: Company Reports and CIR

Figure 3. No. of molecules NPIL is currently working on

Business Segment		2006	2007	1HFY08
PDS	Per-Clinical	8	11	12
	Phase-I	23	26	28
	Phase-II	42	44	63
	Phase-III	9	12	17
PMS	Launched (< 5 yrs)	9	12	12
	Late Lifecycle (> 5 yrs)	16	39	40
Total		**107**	**144**	**172**

Source: Company Reports and Citi Investment Research

- EBIDTA margins in the CRAMS business have improved to double-digit levels (single digit in FY07). The management indicated that current levels would sustain over the second half of FY08 and improve in FY09. The acquired Avecia business has turned around and has normalized margins of c5%. On the other hand, the Morpeth facility enjoys EBIDTA margins of c15% (at 50% capacity utilization) and projects serviced out of the Indian facilities enjoy EBIDTA margins of c25%. This implies that as revenues and capacity utilization scales up to peak levels, blended margins could improve to around 15-17%, in our view.

- NPIL's CRAMS business currently enjoys an RoCE of less than 10%, primarily due to the low capacity utilization. NPIL has invested around

Rs9bn in this business to date and expects peak asset turnover of 2.5-3x depending on the type of products being manufactured. The management indicated that it does not make any material investment in capacity for CRAMS at least till FY10 – although NPIL is evaluating an SEZ to service its international requirements. On full capacity utilization, we expect NPIL's CRAMs business to comfortably generate an ROCE in excess of 20%.

Holding on in the domestic market

NPIL has been grappling with multiple issues in the domestic market – the most critical being the disruption in sales of its flagship brand (phensydyl). At the same time, uncertainty related to sales of alleged "irrational" combinations has also created an overhang. NPIL was able to overcome these issues and record steady growth of 13% in domestic formulations in 2Q. While both issues bear close watching, we believe NPIL will be able to absorb any sporadic disruptions better going forward, given the growing contribution of CRAMS to revenues and profitability.

- **Pheynsydyl sales & codeine availability:** Codeine (a key ingredient in phensydyl) availability was not an issue in 2QFY08 and phensydyl sales were back on track. The management indicated that it does not expect the situation to be as bad as it was in 1Q in future. At this point, it has reasonable visibility for 3Q. The sudden shortage in manufacturing of codeine in India was the root cause of the problem, since the government was unable to get adequate imports in time. However, with the import procedure now regularized, the issue is unlikely to be as bad. Besides, the government has also invited tenders from local companies to set up codeine manufacturing facilities in India. NPIL was one of the 16 companies that submitted the tender and has been shortlisted along with three other companies. Of these, two companies would be allowed to manufacture codeine – however, this would be a long drawn-out process.
- **Policy on "irrational combinations":** The DCGI has been in the process of trying to weed out "alleged" irrational combinations from the Indian market. The industry, however, contends that these are not irrational and have significant therapeutic value. We believe the situation is likely to be resolved by dialogue – with the most likely scenario being companies having to submit data to support their claims on such combination products. As such, there does not appear to be any major issue in terms of continuation of current sales. However, while the issue is being sorted out, most companies have started approaching the DCGI – rather than state authorities – for new product approvals. This has created some delay in approvals for new products, which may lead to some slowdown in growth rates in the near term.

We believe that NPIL's lower revenue growth guidance in FY08 (20% vs. 25% earlier) is partly to account for these issues in the domestic market.

Revising Earnings & Target Price

We revise our earnings in-line with the company's revised guidance – by reducing revenues by 2% across FY08-10E and raising earnings estimates for FY08, FY09 and FY10 by 2.4%, 0.5% and 0.3% respectively. The higher earnings are on the back of superior margins, as NPIL's CRAMS business has gained traction faster than we expected earlier.

Revenue estimates revised downwards by 2% for FY08-FY10. Earnings estimates increased by 2.4%, 0.5% and 0.3% for FY08, FY09 and FY10 respectively

Figure 4. Earnings Revision

	FY08E	FY09E	FY10E
Revenues			
Previous	30,201	34,524	37,726
New	29,709	33,961	37,080
% Change	*-2%*	*-2%*	*-2%*
EPS			
Previous	17.0	22.3	27.4
New	17.4	22.4	27.5
% Change	*2.4%*	*0.5%*	*0.3%*

Source: Company Reports and Citi Estimates

Raising Target Price to Rs455/share

We revise our target price upwards by 15% to Rs455/share on the back of our revised estimates and by rolling forward our target valuation to March'09E earnings.

2QFY08 – Key Financial Tables

Figure 5. NPIL 2QFY08 Results Snapshot (Rupees in Millions; Percent)

Year Ended Mar 31	2QFY07	2QFY08	% ch YoY	1QFY08	% ch QoQ	1HFY07	1HFY08	% ch YoY	CIR Comments
Net Sales	**6,369**	**7,646**	***20.1***	**6,081**	***25.7***	**11,594**	**13,726**	***18.4***	**Higher CRAMS sales from India**
Expenditure (excl NCE R&D)	5,409	6,071	*12.2*	5,052	*20.2*	9,757	11,123	*14.0*	
EBIDTA (pre R&D)	**1,094**	**1,575**	**44.0**	**1,029**	**53.1**	**2,132**	**2,604**	**22.1**	**Shift in mix towards higher margin CRAMS sales from Indian facilities**
EBITDA Margins (%) – ex NCE	*17.2*	*20.6*	*342 bps*	*16.9*	*369 bps*	*18.4*	*19.0*	*58 bps*	
NCE R&D Spend	134	246	83.8	188	30.9	295	434	47.1	To be knocked out after the NCE demerger process is completed
EDITDA	960	1,329	*38.4*	841	*58.1*	1,837	2,170	*18.1*	
EBITDA Margins (%)	*15.1*	*17.4*	*231 bps*	*13.8*	*356 bps*	*15.8*	*15.8*	*-4 bps*	
Interest	76	111	*45.3*	111	*(0.4)*	122	222	*82.4*	Higher debt due to capex incurred
Depreciation	244	263	*8.1*	249	*5.8*	471	512	*8.7*	
Other income	2	-	*nm*	20	*nm*	2	20	*1,022.2*	
PBT	642	955	*48.8*	500	*90.8*	1,246	1,455	*16.8*	
Tax	145	80	*(45.1)*	63	*26.3*	210	143	*(31.9)*	
Effective tax rate (%)	*22.6*	*8.3*	*-1,426 bps*	*12.6*	*-426 bps*	*16.8*	*9.8*	*-703 bps*	Full year guidance of 10-12%
PAT	497	875	*76.2*	437	*100.1*	1,036	1,312	*26.7*	
Minority Interest	-	0	*nm*	(0)	*(233.3)*	1	0	*(87.5)*	
Recurring Net income	**497**	**875**	***76.1***	**438**	***99.9***	**1,035**	**1,312**	***26.7***	
One time items	40	(27)	*nm*	(3)	*nm*	40	(30)	*nm*	VRS provided in overseas facilities
Reported Net Income	**537**	**848**	***57.8***	**434**	***95.2***	**1,076**	**1,282**	***19.2***	

Source: Company Reports and Citi Investment Research

Figure 6. NPIL – 2QFY08 Expenditure Breakup (Rupees in Millions; Percent)

Year Ended Mar 31	2QFY07	2QFY08	*% ch YoY*	1QFY08	*% ch QoQ*	1HFY07	1HFY08	*% ch YoY*	CIR Comments
Raw materials consumed	2,383	2,932	*23.0*	2,188	*34.0*	4,227	5,120	*21.1*	Higher sales from Indian CRAMS, where RM cost is higher but conversion cost is lower
as a % of sales	*37.4*	*38.3*	*92 bps*	*36.0*	*237 bps*	*36.5*	*37.3*	*84 bps*	
Staff Cost	1,156	1,322	*14.3*	1,159	*14.1*	1,954	2,482	*27.0*	Restructuring of manpower in overseas facilities
as a % of sales	*18.2*	*17.3*	*-86 bps*	*19.1*	*-177 bps*	*16.9*	*18.1*	*123 bps*	
R&D Spend	288	359	24.8	327	9.9	600	686	14.3	Includes NCE R&D spend that will be taken out after the demerger is completed
as a % of sales	*4.5*	*4.7*	*18 bps*	*5.4*	*-68 bps*	*5.2*	*5.0*	*-18 bps*	
Other Expenditure	1,581	1,703	7.8	1,566	8.8	2,976	3,269	9.9	Productivity gains
as a % of sales	*24.8*	*22.3*	*-254 bps*	*25.8*	*-348 bps*	*25.7*	*23.8*	*-185 bps*	
Total Expenditure	**5,409**	**6,317**	***16.8***	**5,240**	***20.5***	**9,757**	**11,557**	***18.4***	
as a % of sales	***84.9***	***82.6***	***-231 bps***	***86.2***	***-356 bps***	***84.2***	***84.2***	***4 bps***	

Source: Company Reports and Citi Investment Research

Figure 7. NPIL – 2QFY08 Sales Breakup (Rupees in Millions; Percent)

Year Ended Mar 31	2QFY07	2QFY08	*% ch YoY*	1QFY08	*% ch QoQ*	1HFY07	1HFY08	*% ch YoY*	CIR Comments
India Sales	**3,739**	**4,418**	***18.2***	**3,666**	***20.5***	**7,199**	**8,084**	***12.3***	
Branded Formulations	3,130	3,543	*13.2*	2,907	*21.8*	6,073	6,450	*6.2*	Back on track after a slow 1Q as phensydyl sales normalize
CMO	247	286	*15.7*	235	*21.7*	415	521	*25.6*	
Path labs	176	312	*76.9*	252	*23.7*	317	564	*78.1*	Strong growth continues – small inorganic component
Others	186	278	*49.6*	271	*2.4*	395	549	*39.0*	
Global Sales	**2,630**	**3,228**	***22.7***	**2,415**	***33.6***	**4,395**	**5,643**	***28.4***	
CMG	2,554	3,137	*22.8*	2,392	*31.1*	4,254	5,528	*30.0*	
PDS	300	315	*5.1*	324	*(2.9)*	608	639	*5.1*	Low growth largely due to seasonality
PMS	1,704	2,222	*30.4*	1,661	*33.8*	2,593	3,884	*49.8*	Rs694m sales from Indian operations v/s 157m in 2QFY07
MMBB	550	599	*8.9*	406	*47.5*	1,053	1,006	*(4.5)*	
Others	76	91	*20.0*	23	*290.9*	142	114	*(19.4)*	
Total Net Sales	**6,369**	**7,646**	***20.1***	**6,081**	***25.7***	**11,594**	**13,726**	***18.4***	

Source: Company Reports and Citi Investment Research

Re-visiting NPIL's CMG business strategy

Pioneer in this space, among Indian pharma companies

NPIL was the pioneer among Indian pharma companies in adopting the outsourcing model for regulated markets, when optimism over generics was at its peak. While the strategy by itself does not guarantee success, it highlights NPIL's ability to focus on its strengths and stay ahead of the curve.

Positioned to emerge as a “partner of choice”

Offers services across the product life cycle and value chain … except support to early stage generics

NPIL has positioned itself as a 'partner of choice' for innovator companies across the life cycle of a product – from pre-launch to the in-market stage – pre and post patent expiry. It intends to avoid the 'early generics'/Para-IV stage (on its own and as a supplier to other generic players), as this would be in direct conflict with innovator companies. It has built the infrastructure to rapidly scale up this business and acquired abilities across the product value chain as well – from custom chemical synthesis (CCS) to APIs/intermediates and formulations.

Multiple contracts in hand with global players

Six CMG deals bagged from India with cumulative annual revenues of c.US$70m

NPIL has progressed both in terms of deals bagged and progress in negotiations with potential customers. Its ability to offer services across the value chain and at all stages of the product life cycle makes it a one-stop shop for custom research and manufacturing services. Most of its peers in India are smaller and do not have the capability to deliver in all the segments (especially finished dosages). NPIL's ability to offer services across the spectrum also gives it the option of widening the scope of a contract in due course.

Besides, the acquisitions of Avecia and Pfizer's facility at Morpeth, UK, cumulatively added around US$130m to annual revenues from FY07. This has propelled NPIL to among the top 10 CMOs in the world.

NPIL has several advantages over smaller Indian peers in the CMG space

In our view, NPIL's attractiveness as a partner for innovator companies stems from the following:

- Size and financial muscle: the largest Indian player in this space with the capability and willingness to invest for growth. Large scale of existing business also offers greater stability.
- Record of IPR compliance: good track record on IPR compliance and decision not to target generics gives added comfort to the innovators.
- Ability to offer end-to-end solutions: capabilities to undertake projects across the product value chain and life cycle.
- Relationships: NPIL has had good relationships with global majors such as Sanofi Aventis, Roche, Allergan, Boots, Astra Zeneca, Biogen Idec and Chiesi.

We expect CMG to emerge as a significant revenue and earnings driver for NPIL over the next few years. The company has already done the hard work and is now set to reap the benefits.

Nicholas Piramal India

Company description

Nicholas Piramal (NPIL), the fourth-largest company in the Indian formulations market, is targeting the regulated pharmaceutical markets through custom manufacturing (CMG). The company has scaled up in the domestic market through both organic and inorganic initiatives, and is looking at doing the same in the overseas markets. Some initial CMG successes have been achieved in the form of six diverse contracts with innovator companies and two acquisitions in overseas markets.

Investment strategy

We rate NPIL Buy/Medium Risk (1M) with a target price of Rs455/share (Rs395/share earlier). We believe NPIL is one of the best plays on custom manufacturing and the branded formulations market in India. Among the Indian mid-tier companies, NPIL has a unique approach to the domestic and export markets. Leveraging its manufacturing capabilities and relationships with global majors, the company has positioned itself as a 'partner of choice' for innovator companies across the product life cycle and value chain. On the domestic front, it has focused on building brands and strengthening its marketing and distribution network, making it less dependent than its peers on new product launches for growth. The move to demerge its NCE R&D unit would also add significant value for shareholders over the next 6-9 months, in our view. We are comfortable with valuations at current levels and expect significant upside potential as earnings momentum should continue in FY08 and beyond.

Valuation

We value NPIL on a sum of parts basis - valuing its core business on a P/E basis and the holding in the demerged NCE R&D entity, based on book value.

As pharmaceuticals is a growth sector, we use P/E in relation to earnings growth as our principal valuation methodology for a company's base business while applying a relative premium/discount for different companies. We use a target P/E multiple of 20x to value sector leaders, which is at a premium of about 40% to the broader market. This is justified, in our view, because the sector is intellectual property-driven and has potential to spring earnings triggers that could lead to significant growth opportunities in the future. We broadly value mid-sized Pharma stocks at a 10-20% discount range (16-18x) to sector leaders. Our fair value of Rs448/share (Rs388/share earlier) is based on 20x March'09E (v/s 20x Sept '08E earlier) revised earnings. This is at a premium to our target multiple for mid-sized pharma companies and in-line with our target multiple for sector leaders. We believe NPIL deserves a higher multiple given the nature of its CMG business and possible upside from inorganic initiatives. Revenue visibility and sustainability are high in the CMG business: these are long-term exclusive contracts with innovators with no risk of litigation-related delays and competitive pressures. However, given the 18-24 month time lag between doing a deal and commencement of revenues, the full upside is not captured in one-year forward earnings. As such, we believe it deserves a higher valuation multiple.

We assign a value to the holding in NPRC on the basis of NPRC's current book value. NPRC has a book value of Rs74.3 and each NPIL shareholder will get 1 share in NPRC for every 10 shares held in NPIL. As such, we assign a value of Rs7/share (1/10th of the book value) for the R&D company in our target price for NPIL. We believe this is conservative, but refrain from assigning a higher value for the R&D business at the moment as we await some third party validation of NPIL's R&D effort (in the form of a licensing deal / investment by a strategic partner).

Risks

We rate Nicholas Medium risk in contrast with our quantitative risk-rating system's Low risk to account for the integration-related issues of the Avecia and Morpeth acquisitions. The main downside risks to our target price are: 1) While custom manufacturing should drive NPIL's revenues and profitability, any slip-up in executing the contracts would be a big negative. 2) A break-up of any major association could have a short-term impact on revenues and earnings. 3) Any unfavorable trend in growth or pricing could have an adverse impact on the company's financials. The main upside risks to our target price are: 1) If NPIL bags new contracts that have a shorter lead time, it could have a positive impact on our estimates and target price; and 2) NPIL continues to scout for acquisitions, which could add further to its strengths in target businesses and our estimates.

Appendix A-1

Analyst Certification

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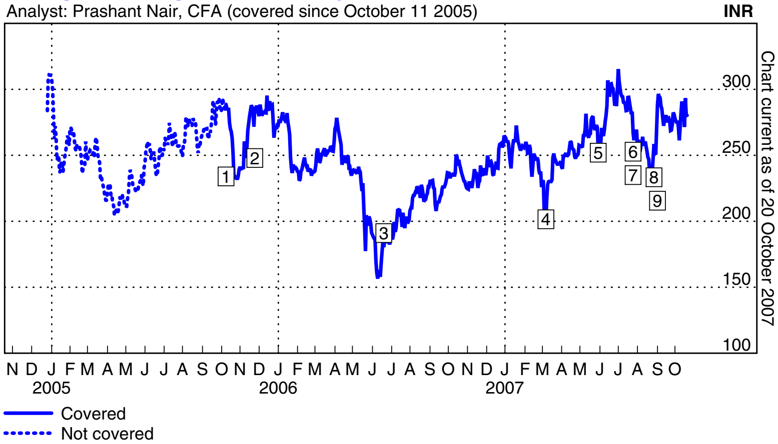
Ratings and Target Price History - Fundamental Research

Analyst: Prashant Nair, CFA (covered since October 11 2005)



#	Date	Rating	Target Price	Closing Price
1:	10 Oct 05	2L	318.00	288.60
2:	24 Nov 05	2L	*286.00	286.60
3:	20 Jun 06	*1M	*255.00	180.40
4:	7 Mar 07	1M	*300.00	201.50
5:	30 May 07	1M	*330.00	254.30
6:	25 Jul 07	1M	*345.00	267.20
7:	25 Jul 07	1M	*330.00	267.20
8:	28 Aug 07	1M	*345.00	258.55
9:	2 Sep 07	1M	*395.00	288.20

*Indicates change.

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