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March 07, 2006

Marksans Pharma

Making its mark

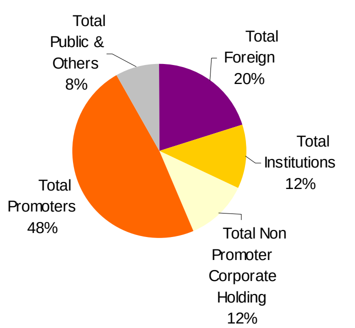
Emerging Star

Buy; CMP: Rs236

Company details

Price target:	Rs360
Market cap:	Rs847 cr
52 week high/low:	Rs398/200
NSE volume: (No of shares)	99,503
BSE code:	524404
NSE code:	MARKSANS
Sharekhan code:	TASCPH
Free float: (No of shares)	1.8 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	3.8	13.5	-20.3	-28.4
Relative to Sensex	-3.8	-6.9	-41.1	-55.1

Key points

- Marksans Pharma Ltd (MPL) has been formed by amalgamating Tasc Pharma (a bulk drug maker) and Glenmark Labs (a formulation manufacturer). Thus MPL has emerged as a vertically integrated player in the pharma space. Its transition to a wholly integrated player will bring synergistic benefits and calls for higher valuations.
- MPL has secured orders from big international pharma companies like Stada, Ivax and Goldshield based in regulated markets. These contract-manufacturing orders amount to over Rs100 crore yearly. We expect formulation exports to increase to Rs155.9 crore in FY2008 at a compounded annual growth rate (CAGR) of 71% from FY2006.
- MPL has also set up a new unit to manufacture lifestyle bulk drugs for regulated markets. It expects to supply these bulk drugs when these molecules go off patent from FY2007 onwards. We estimate bulk drug exports to increase to Rs131.1 crore in FY2008 at a CAGR of 101% from FY2006.
- MPL is carrying out research of a male contraceptive molecule (RISUG), which when commercialised will revolutionise the method of male contraception. This molecule is expected to be launched by December 2007. Once launched it should reap bumper profits for the company, as it will be the patented solution to male contraception.
- The forays of MPL into niche segments and lifestyle bulk drugs will help it to improve its margins significantly. We expect its consolidated net profits to grow at a CAGR of 72% from FY2005 to FY2008. At the current market price of Rs236, its is trading at 8.2x its FY2008 earnings estimate, which is a deep discount to its peers. Considering the transition of the company to a wholly integrated player along with its enormous growth prospects, we initiate our Buy recommendation on MPL with a price target of Rs360.

Company background

MPL manufactures formulations and bulk drugs, and carries out active research in new chemical entities (NCEs). It was formed in March 2005 by amalgamating Glenmark Labs with Tasc Pharmaceuticals. It is now venturing into contract manufacturing business as well as spreading its wings in the regulated high-margin bulk drug markets while constantly growing its niche businesses in the domestic pharma space.

Key financials Rs (cr)

Particulars	FY2004	FY2005	FY2006E	FY2007E	FY2008E
Net sales stand-alone	133.1	246.4	306.7	420.7	585.3
Net profit consolidated	8.2	20.4	29.8	58.8	103.2
Shares in issue (cr)	3.6	3.6	3.6	3.6	3.6
EPS	2.3	5.7	8.3	16.4	28.7
PE	102.9	41.5	28.4	14.4	8.2
BV/share	11.6	27.9	36.2	49.9	75.4
P/BV	20.4	8.5	6.5	4.7	3.1
EV	132.7	179.9	303.0	341.3	384.2
EBITDA	26.7	43.4	53.1	80.1	126.2
EV/EBITDA	5.0	4.1	5.7	4.3	3.0

Investment arguments

Amalgamation to result in synergistic benefits

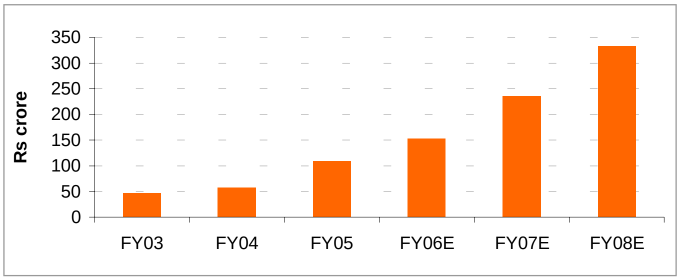
MPL was formed as a result of the amalgamation of Tasc Pharma (a bulk drug manufacturer) and Glenmark Labs (a formulation manufacturer). Hence the amalgamation was a form of forward integration for Tasc Pharma and backward integration for Glenmark Labs. Thus MPL has emerged as a vertically integrated player in the pharmaceutical sector, capable of producing bulk drugs and formulations, and actively carrying out research in NCEs. This is an ideal combination that makes the company a partner of choice for the foreign firms looking for CRAMS (contract research and manufacturing service) opportunity in India. This transition of MPL to a wholly integrated player will bring synergistic benefits like reduction in costs and increase in margins. Hence this transition calls for higher valuations.

CRAMS business to provide major boost

MPL has been able to leverage its new status as the partner of choice in the contract manufacturing space to secure orders from big international pharma companies like Stada, Ivax and Goldshield based in regulated markets. These contract-manufacturing orders are for formulations and amount to over Rs100 crore yearly. Currently the orders are for drugs to be marketed to Europe and Australia. We expect revenues from these orders to accrue steadily over FY2007 and FY2008.

The contracts are part of a partnership agreement between MPL and the foreign companies, and are expected to continue for a long term, providing MPL a healthy source of revenue. As these orders involve the sale of drugs to regulated markets, we expect high earnings before interest, tax, depreciation and amortisation margins to accrue from them, resulting from better realisations for the company. We expect formulation exports to increase from Rs53.4 crore in FY2006 to Rs155.9 crore in FY2008 at a CAGR of 71%.

Formulation sales



Domestic formulations to provide a strong base

On the domestic formulation front too, MPL has shown a good focus and intelligent management of resources. It is involved in the marketing of niche drugs like anti-psychotics, anti-depressants, respiratory and anti-gastro intestinal drugs. It has also ventured in the high-margin biotech drugs like Interferon and Enoxaparin apart from having a continued presence in the over-the-counter and prescription drug segments. The company outsources the manufacturing for the domestic market while using the in-house manufacturing primarily for exports. Its biopharmaceutical drugs are in-licenced from the other countries and cater to specific high-margin segments. We expect these niche segments of the company to show an exponential growth in the coming years due to less competition and specialty focus.

Thus the formulation businesses of MPL, including both CRAMS and domestic formulations, are expected to provide a strong base for growth of the company. We expect the formulation revenues to increase from Rs152.7 crore in FY2006 to Rs332.3 crore in FY2008 at a healthy CAGR of 48%.

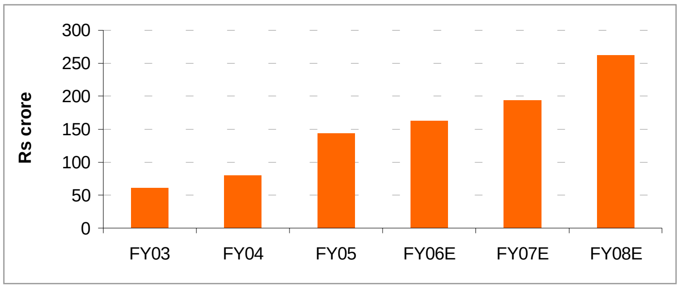
Lifestyle bulk drugs to provide robust growth

MPL has been one of the major producers of Ciprofloxacin and Ranitidine in the country. The increased realisation of Ciprofloxacin and Ranitidine along with the persistent demand for the two drugs has encouraged the company to increase its capacity in these segments.

MPL has also set up two new units at Kurkumbh. One of the units is already making low-volume, high-value drugs while the second unit has been set up to manufacture lifestyle bulk drugs for the regulated markets. We expect the new capacities together to have the ability to generate four times the revenues earned by the earlier set capacities.

MPL has already begun trial batches for 15 lifestyle drugs in the cardiovascular and central nervous system segments, and expects to supply them to companies in the regulated markets when these molecules go off patent from FY2007 onwards. As a result we will expect a major jump in the bulk drug exports of the company from FY2007 onwards. However, keeping a conservative stance we have factored these incremental revenues only from FY2008 onwards in our estimates. We estimate MPL's bulk drug exports to increase from Rs32.5 crore in FY2006 to Rs131.1 crore in FY2008 at a CAGR of 101%.

Bulk drug sales



RISUG: the Wild card

MPL is carrying out research in new molecules, such as an oncology drug being developed in association with the government of the UK and a male contraceptive molecule that is currently under phase III clinical trials. This contraceptive molecule (RISUG: reversible inhibition of sperm under guidance) when commercialised will introduce a new method of male contraception and can be used as a much more effective substitute to vasectomy (*Nusbandi*) and condoms. We expect this molecule to be launched in December 2007. Once launched we expect it to reap bumper profits for the company, as it will be the patented solution to male contraception.

The company already has a tie-up with the government of India for marketing this drug. Considering it as a substitute to only Vasectomy within the country (and not even factoring in the revenues that it can generate as a substitute to condoms), we expect the molecule alone to increase the profits of the company by close to 57% within the last six months of FY2008. However as of now we have factored only a 15% probability of the launch of the molecule in FY2009 in our estimates. We will factor the full upside from this molecule once it passes the phase III clinical trials that are expected to complete in the next five months.

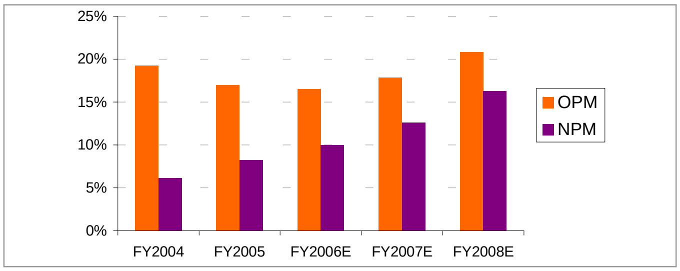
Open to future acquisitions

MPL recently acquired an Australian marketing and research firm having sales of close to US$10 million in CY2005. This is a profit making company and will help increase the penetration of MPL in the Australian market, which is the second largest export market for the company. MPL has stated that it is open to any future acquisitions in the regulated markets. It has already raised US$50 million through foreign currency convertible bonds (FCCBs) and plans to use the majority of this to fund acquisitions. We expect these acquisitions to result in a substantial increase in its revenues.

Margins to improve significantly

MPL has been operating at very low margins traditionally. Hence the movement into niche segments and lifestyle bulk drugs in regulated markets will help it to improve the margins significantly. The net profit margin of the company has shown a continued uptrend and we expect this to continue in the future. The company has repaid close to Rs20 crore of its high-cost debt from the proceeds of its US$50-million FCCB issue, thereby reducing its interest cost. We expect its net profit margin to jump from 9.9% in FY2006 to 15.5% in FY2008.

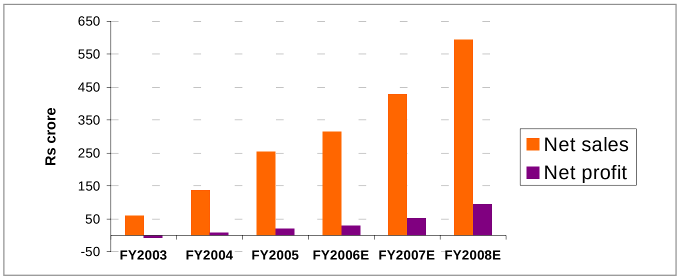
Margins



PAT to increase at a CAGR of 72% from FY2005 to FY2008

We expect the formulations and CRAMS revenues to drive MPL's growth in the medium term and the bulk drug business to yield high revenues in the long term. As a result, we expect the stand-alone net sales to increase at a CAGR of 33% from FY2005 to FY2008. We expect the consolidated net profits to jump at a CAGR of 72% from FY2005 to FY2008. The return on capital employed for FY2008 is expected to be 19.8% as compared with 10.5% in FY2006.

Sales against profits



Future potential and cushion to our estimates

We believe that compared with the revenues that we have factored in our estimates, MPL has the potential to generate significantly higher revenues. We will factor these revenues in our future updates. As of now they provide a huge cushion to our projections. These include:

1. ***The full realisations of the CRAMS order book of over Rs100 crore per year***. As we have considered only a small proportion of the realisations in our estimates, we see a substantial potential for revenue increment due to the CRAMS business.
2. ***Potential orders from increased sale of lifestyle bulk drugs*** to regulated markets from FY2007. The company is working on 15 such molecules: each having more than Rs50 crore revenue generating capacity. We have considered only a fraction of launches in our estimates and we expect a significant upside in this case too.
3. ***RISUG is a wild card that the company possesses***. The launch of this injection will definitely result in the re-rating of the company. Since the molecule is close to completing its phase III clinical trials and the tie-ups are already in place for production, we are confident about the launch of the molecule.
4. ***A possible acquisition ahead*** that can result in increased revenues that will be factored in when the acquisition actually takes place.

Valuations

MPL has emerged as a wholly integrated player in the Indian pharmaceutical business. With synergistic bulk drug and formulation manufacturing capacities, and the ability to actively carry out research in NCEs and market them, we believe that MPL commands a multiple higher than that enjoyed by the average formulation company in the unregulated markets and slightly lower than that of a big CRAMS manufacturing company.

We estimate the company's stand-alone net revenues at Rs585.3 crore for FY2008 with an adjusted consolidated net profit of Rs103.2 crore. This leads to earnings per share estimate of Rs28.7 for FY2008. At the current market price of Rs236, the stock is trading at 8.2x its FY2008 earnings estimate. When compared with its peers like Dishman Pharma and Nicholas Piramal that are in the contract manufacturing space and trading at 15.8x and 15.7x their FY2008 earnings estimates respectively, MPL appears to be trading at a deep discount.

PE (%)	FY2006	FY2007	FY2008
CRAMS			
Nicholas Piramal	33.9	18.7	15.3
Dishman Pharma	27.2	21.3	15.7
Formulation manufacturers			
Alembic	16.9	13.7	11.3
Dabur Pharma	32.5	16.8	13.0
Marksans	**28.4**	**14.4**	**8.2**

Also when we compare it with the other domestic formulation manufacturers like Alembic and Unichem Laboratories, we find that it is trading at a discount.

With the strong synergistic benefits and tremendous growth potential that the company has, we believe that a multiple of 11.5x its FY2008 earnings estimate is a fair valuation for the core operations of the company. A 15% probability of the launch of RISUG in FY2009 gives an additional upside of Rs29 to our estimates. Hence we put forth our 18-month price target as Rs360.

A vertically integrated company, MPL has emerged as a partner of choice for big international companies worldwide, and at the same time has grown its conventional bulk and formulation business streams. Considering its transition along with its enormous growth prospects, we initiate our Buy recommendation on Marksans Pharma with a price target of Rs360, expecting a 52% upside to the current market price of Rs236.

Key financials Rs (cr)

Particulars	FY04	FY05	FY06E	FY07E	FY08E
Net sales stand-alone	133.1	246.4	306.7	420.7	585.3
Net profit consolidated	8.2	20.4	29.8	58.8	103.2
Shares in issue (cr)	3.6	3.6	3.6	3.6	3.6
EPS	2.3	5.7	8.3	16.4	28.7
PE	102.9	41.5	28.4	14.4	8.2
BV/share	11.6	27.9	36.2	49.9	75.4
P/BV	20.4	8.5	6.5	4.7	3.1
EV	132.7	179.9	303.0	341.3	384.2
EBITDA	26.7	43.4	53.1	80.1	126.2
EV/EBITDA	5.0	4.1	5.7	4.3	3.0

Profit and loss account Rs (cr)

Particulars	FY04	FY05	FY06E	FY07E	FY08E
Gross sales	137.7	252.9	315.2	428.9	594.5
Excise duty	4.6	6.5	8.5	8.1	9.2
Net sales	133.1	246.4	306.7	420.7	585.3
Other income	1.1	1.6	2.6	5.0	4.4
Total income	134.2	248.0	309.3	425.7	589.7
Total Expenditure	107.5	204.6	256.2	345.7	463.5
Operating profit	25.6	41.8	50.5	75.1	121.8
EBITDA	26.7	43.4	53.1	80.1	126.2
Interest	11.6	9.6	5.1	4.7	
Depreciation	6.2	6.9	8.4	14.8	15.4
Profit before tax	10.2	24.9	35.1	60.2	106.2
Total tax	2.0	4.5	4.3	11.2	14.7
PAT	8.2	20.4	30.8	49.0	91.5
Consolidated PAT	8.2	20.4	29.8	58.8	103.2

Balance sheet Rs (cr)

Particulars	FY04	FY05	FY06E	FY07E	FY08E
Sources of funds					
Share capital	33.5	49.4	49.4	49.4	49.4
Reserves total	10.7	52.7	82.5	130.6	221.1
Total shareholders funds	44.2	102.1	132.0	180.0	270.6
Secured loans	87.6	83.4	288.4	288.4	283.4
Unsecured loans	5.4	4.2	4.2	4.2	5.0
Total debt	93.0	87.6	292.6	292.6	288.4
Total liabilities	137.2	189.7	424.5	472.6	558.9
Application of funds					
Net block	81.0	101.6	108.0	203.3	207.9
Investments	0.3	0.3	110.0	110.0	110.0
Cash and bank	4.2	9.5	11.6	21.2	64.8
Total current assets	93.5	127.9	146.5	199.3	294.9
Total current liabilities	38.2	38.0	47.9	56.9	69.8
Net current assets	55.3	89.9	98.6	142.4	225.1
Total assets	137.2	189.7	424.5	472.6	558.9

Key ratios

Particulars	FY04	FY05	FY06E	FY07E	FY08E
OPM (%)	19.2	17.0	16.5	17.8	20.8
NPM (%)	6.1	8.2	9.9	11.5	15.5
ROCE (%)	15.0	19.2	10.5	13.8	19.8
RONW (%)	18.6	20.0	23.3	27.2	33.8

The author doesn't hold any investment in any of the companies mentioned in the article.