

## RESULT UPDATE

## Shasun Chemicals

Maintain BUY

Price: Rs 109

BSE Index: 14986

03 August 2007

### Share Data

Reuters code	SHAS.BO
Bloomberg code	SSCD IN
Market cap. (US\$ mn)	130
6m avg. daily turnover (US\$ mn)	0.7
Issued shares (mn)	48

Performance (%)	1m	3m	12m
Absolute	(23)	11	55
Relative	(24)	3	11

### Valuation Ratios

Year to 31 Mar.	2008E	2009E
EPS (Rs.)	12.1	14.2
+/- (%)	10.7	17.7
PER (x)	9.0	7.7
PBV (x)	1.9	1.6
Dividend/Yield (%)	1.6	1.6
EV/Sales (x)	0.8	0.7
EV/EBITDA (x)	7.5	6.2

### Major shareholders (%)

Promoters	43
FII's	18
MF's	12
BFSI's	1
Public & Others	26

### Financial highlights (Consolidated)

(Rs mn)	1QFY07	1QFY08	YoY (%)	FY07	FY08E	YoY (%)	FY09E	YoY (%)
Net Sales	1,485	2,009	35.3	7,618	8,883	17.0	10,589	19.2
EBITDA	162	148	(8.6)	836	986	18.0	1,181	19.7
EBITDA Margin (%)	10.9	7.4	–	10.8	10.9	–	10.9	–
Other Income	4	18	350	86	86	–	86	–
Interest	14	31	121.4	91	116	27.5	112	(3.4)
Depreciation	69	79	14.5	259	306	18.1	374	18.2
PBT	84	57	(32.1)	572	651	13.8	781	19.9
Tax	9	8	(11.1)	45	68	51.1	95	39.77
Reported PAT	75	49	(34.7)	527	583	10.6	686	17.6
Adj. PAT margin (%)	5.0	2.4	–	6.9	6.6	–	6.5	–
EPS (Rs)	1.6	1	(0.4)	10.9	12.1	10.7	14.2	17.7
P/E (x)	–	–	–	10	9	–	7.7	–

### 1QFY08 Results – Synergy in acquisition

**Shasun's net sales were above our expectations due to significant ramp-up of CRAMS sales. However, PAT was disappointing due to decrease in margins and increase in interest cost. With acquisition of Rhodia's pharma business in February 2006, Shasun has given its CRAMS business the required scale. This facility caters to innovators and emerging pharmaceutical clients in the US, Europe and Asia. We expect the business to break-even and start generating profits from FY08. Long-term growth concern for the company still remains due to lack of new launches in API. As the company reduces its dependence on its three mature products and its CRAMS business gains momentum, operating margins is expected to expand going forward. At the current market price of Rs 109, the stock is trading at 9x FY08E and 8x FY09E earnings. We maintain Buy.**

### Highlights (Consolidated)

- The revenue for the quarter increased by 35% to Rs 2 bn on back of strong growth of 122% in CRAMS segment and 251% in Gabapentin. The revenue from Ibuprofen increased marginally by 8% to Rs 527 mn from Rs 488 mn on YoY basis.
- There was a significant fall in the sales of Nizatidine by 83% to Rs 35 mn from Rs 201 mn on YoY basis. This was mainly due to lower off take by the clients in the Japanese market.
- EBITDA dipped by 9% to Rs 148 mn while margins declined by 350 bps to 7.4% on account of increase in material cost by 154% to Rs 814 mn.
- The interest cost for the quarter increased significantly by 121% to Rs 31 mn. Depreciation was at Rs 79 mn.

- The company posted PAT of Rs 49 mn decreasing by 35% on account of lower margins and higher interest cost. PAT includes writing off a negative goodwill of Rs 24 mn.
- Shasun Pharma Solutions Ltd. (SPSL) posted sales revenue of GBP 12.8 mn and PAT of GBP 0.3 mn.

**We recently met the management of Shasun Chemicals and following are the key takeaways of our discussion:**

- SPSL is currently working on a NCE contract which is in Phase III trials. This could be a major growth trigger going forward. Shasun expects the innovator to launch the molecule by the end of 2008, worldwide. On launch, Shasun would be the exclusive supplier for the US market for the initial three years.
- The company also expects to grow its CRAMS presence through biotechnology business vertical as well. One of the new products, r-Streptokinase is scaled up for Phase III clinical testing in India and it is expected to launch this first biotech product by 2008-09.
- The company is investing to build capacities to the tune of Rs 1.2 bn in FY08, to develop Vizag facility, further improve Rhodia facility and development of formulation facility in Pondicherry.
- Shasun has identified a synthetic wet lab in the US to take it on a long-term lease. We expect that in the initial period of this lease there will be an increase in the company's research product portfolio with no ramping up of its revenue.
- Pricing pressures in matured APIs are expected to continue. We expect the sales of Gabapentin will pick up due to the supply agreement with two US players. Another growth trigger in short run is going to be revenues from Ibuprofen and Ranitidine.
- Shasun has entered into an agreement with H Lundbeck A/S, a Danish-based research company, to use its proprietary cross coupling technology 'Buchwald Technology' to manufacture and commercialise new APIs.

**Inorganic growth ramps up the revenue**

- SPSL registered a turnover of GBP 41 mn in FY07, contributed by CRAMS of GBP 35 mn and GBP 6 mn by WS-23. The Rhodia facility is expected to break-even in FY08 with topline of GBP 50 mn. The company expects to bag a revenue growth of GBP 52-53 mn in FY08. It is expected to grow at 30% YoY.
- In FY07, negative goodwill of GBP 6.48 mn had been released to the P&L account of SPSL. The remaining GBP 1.52 mn negative goodwill will be written off over the next two years.
- The company has made an investment of GBP 5 mn in FY07 and is expected to invest GBP 6 mn in the current year in its Rhodia facility.
- SPSL has a pipeline of around 17 products in Phase II-III stages and around 19 commercial products. It has a contract for a NCE which is in Phase-III trials that could be a key growth driver. It is under fast track clearance of US FDA. This will be a novel drug delivery in critical therapeutic segment. The commercialisation of product pipeline will aid long-term growth of the segment.

### Foray into biotechnology space

The company is into production of recombinant bio-pharmaceuticals using microbial expression platform. The company is involved in development of technologies for two bio pharmaceutical products in cardiovascular and anti-viral therapeutic segments. One of its products, r-Streptokinase is scaled up for Phase III clinical testing in India and the company is expected to launch this first biotech product in 2008-09. The company also expects to grow its CRAMS presence through this business vertical as well.

### Synthetic wet lab to scale-up CRAMS business

CRAMS contributed Rs 440 mn to the turnover of FY07 in India. In this, custom synthesis registered Rs 4.5 mn and is expected to increase by two-fold in FY08. Rhodia facility CRAMS contributed GBP 35.5 mn to the turnover of which contract manufacturing is GBP 12 mn and custom synthesis is GBP 17 mn and others contributed GBP 6.5 mn.

As a strategy to further grow its contract research and manufacturing services business, Shasun has identified a synthetic wet lab in the US to take it on a long-term lease. This lab is mainly for small drug innovator companies who would like to outsource their lab activities. The cost of lease will be US\$ 1 mn which works out to be less than 25% compared to setting up a new lab or acquiring one.

### API under pricing pressure

- **Ibuprofen:** With the largest capacity in the world of 5,000 tonnes and 100% capacity utilisation, this product contributed 50% on a standalone basis and 23% on a consolidation basis in FY07. It is expected to grow at 10%.
- **Ranitidine:** In FY07 it contributed Rs 197 mn to the sales revenue and is expected to grow at 83% in FY08.
- **Nizatidine:** In FY07 it contributed Rs 773 mn to the sales revenue and is expected to slowdown to Rs 320 mn in FY08, due to lower off take by its clients in Japanese market. Through its existing alliance with Eli Lilly, Shasun is servicing a deal in the Japanese market for Nizatidine.
- **Gabapentin:** Shasun supplies the APIs to two players in US. The global market for Gabapentin (CNS) API is around US\$ 2.8 bn. We expect volume growth to drive revenues in this product over the next three years.

### Expansion spree

The company has acquired 50 acres of land in Ramkey Pharma City, Vizag. The company plans to invest Rs 1.1 bn through internal accruals and long-term debt. The pilot plant is expected to commence business by November 2007 to register DMF followed by commercial plant.

### Capex

The company has plans to invest around Rs 1.2 bn for FY08 in its capex programme with, Rs 410 mn going to Vizag facility, Rs 110 mn to land, Rs 300 mn to building. Investment in Rhodia facility to be Rs 480 mn and Rs 300 mn for formulations development facility in Pondicherry.

## Outlook

Shasun is a leading CRAMS player from India catering to major international pharmaceutical companies. We believe that Shasun, on acquisition of Rhodia's CRAMS facility, is developing into a big player.

Early integration of Rhodia's plant in UK is driving growth for Shasun, where it is already among the leaders. The company has entered into a number of ongoing Rhodia contracts and bagged new contracts to enable the business to continue. Shasun having worked with several MNCs, has gained experience to expand its service.

While the API products are in matured stage, we believe that the company will better its product profile by commercialising more molecules.

The company has initiated an investment to the tune of Rs 1.1 bn for intermediates and API at Vizag facility. Currently, we have not factored in growth coming from this new facility in our estimates.

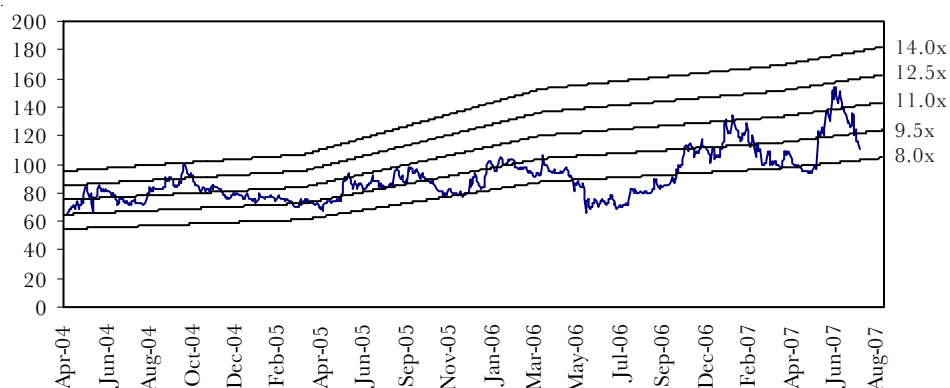
On consideration of Shasun's positioning in CRAMS, one should accumulate the stock for long run since it is trading at a discount to peers. However, key triggers pertaining to contract innovator and emerging pharma companies will trigger re-rating of the stock.

## Peer comparison

Company (x)	Price (Rs)	M Cap (Rs mn)	EPS (Rs)			EPS CAGR	P/E			ROCE			ROE			EV/EBITDA		
			FY 07	FY 08E	FY 09E		FY 07	FY 08E	FY 09E	FY 07	FY 08E	FY 09E	FY 07	FY 08E	FY 09E	FY 07	FY 08E	FY 09E
			(%)															
Dishman Pharma	311	21,328	11	15	18	27	27	21	17	15	15	15	36	26	22	23	15	12
Divi's Labs	6,697	85,852	149	200	252	30	40	34	27	43	39	38	51	43	39	32	26	20
Jubilant Organosys	310	44,192	16	20	19	9	27	21	16	11	12	14	18	18	18	18	12	9
Nicholas Piramal	261	54,636	10	13	16	26	24	20	16	20	18	20	22	23	25	18	14	12
<b>Shasun Chemicals</b>	<b>109</b>	<b>5,254</b>	<b>11</b>	<b>12</b>	<b>14</b>	<b>14</b>	<b>10</b>	<b>9</b>	<b>8</b>	<b>19</b>	<b>16</b>	<b>16</b>	<b>26</b>	<b>24</b>	<b>23</b>	<b>8</b>	<b>8</b>	<b>6</b>

Source: B&K Research

## PER Band



Source: B&K Research

## Valuations

With smooth integration of Rhodia and ramp-up in CRAMS from Indian and UK business, we expect Shasun to show earnings CAGR of 14% over FY07-09E. At the current market price of Rs 109, the stock is trading at 9x FY08E and 8x FY09E earnings. We maintain Buy.

**Income Statement**

Yr. ended 31 Mar. (Rs m)	FY06	FY07	FY08E	FY09E
Net sales	3,495	7,618	8,883	10,589
Growth (%)	12.3	118.0	16.6	19.2
Operating expenses	(2,945)	(6,883)	(8,096)	(9,659)
Operating profit	550	735	786	931
Other operating income	145	101	200	250
<b>EBITDA</b>	<b>694</b>	<b>836</b>	<b>986</b>	<b>1,181</b>
Growth (%)	8.7	20.4	18.0	19.7
Depreciation	(232)	(259)	(306)	(374)
Other income	20	86	86	86
<b>EBIT</b>	<b>482</b>	<b>662</b>	<b>766</b>	<b>893</b>
Interest paid	(49)	(91)	(116)	(112)
Pre-tax profit	433	572	651	781
(before non-recurring items)				
Pre-tax profit	433	572	651	781
(after non-recurring items)				
Tax (current + deferred)	(66)	(45)	(68)	(95)
<b>Net profit</b>	<b>367</b>	<b>527</b>	<b>583</b>	<b>686</b>
Adjusted net profit	367	527	583	686
Growth (%)	17.9	43.5	10.7	17.7
<b>Net income</b>	<b>367</b>	<b>527</b>	<b>583</b>	<b>686</b>

**Balance Sheet**

Yr. ended 31 Mar. (Rs m)	FY06	FY07	FY08E	FY09E
Current assets	1,688	3,969	4,220	4,934
Investments	55	1	1	1
Net fixed assets	1,770	2,348	3,119	3,389
<b>Total assets</b>	<b>3,513</b>	<b>6,318</b>	<b>7,339</b>	<b>8,324</b>
Current liabilities	733	1,929	2,140	2,610
Total debt	795	1,920	2,249	2,142
Other non-current liabilities	208	231	256	286
<b>Total liabilities</b>	<b>1,736</b>	<b>4,080</b>	<b>4,644</b>	<b>5,038</b>
Share capital	96	96	96	96
Reserves & surplus	1,681	2,146	2,603	3,194
Less: Misc. expenditure	(1)	(5)	(5)	(5)
<b>Shareholders' funds</b>	<b>1,777</b>	<b>2,238</b>	<b>2,695</b>	<b>3,286</b>
<b>Total equity &amp; liabilities</b>	<b>3,513</b>	<b>6,318</b>	<b>7,339</b>	<b>8,324</b>

**Cash Flow Statement**

Yr. ended 31 Mar. (Rs m)	FY06	FY07	FY08E	FY09E
Pre-tax profit	433	572	651	781
Depreciation	215	239	306	374
Chg in working capital	(325)	(964)	(131)	(264)
Total tax paid	(79)	(23)	(43)	(65)
Other operating activities	–	(3)	–	–
<b>Cash flow from oper. (a)</b>	<b>244</b>	<b>(179)</b>	<b>783</b>	<b>826</b>
Capital expenditure	(250)	(817)	(1,076)	(644)
Chg in investments	(54)	54	–	–
<b>Cash flow from inv. (b)</b>	<b>(303)</b>	<b>(763)</b>	<b>(1,076)</b>	<b>(644)</b>
<b>Free cash flow (a+b)</b>	<b>(59)</b>	<b>(942)</b>	<b>(294)</b>	<b>181</b>
Equity raised/(repaid)	161	2	0	0
Debt raised/(repaid)	(98)	1,125	328	(106)
Dividend (incl. tax)	(78)	(137)	(51)	(95)
Other financing activities	(18)	30	(31)	–
<b>Cash flow from fin. (c)</b>	<b>(34)</b>	<b>1,020</b>	<b>247</b>	<b>(201)</b>
<b>Net chg in cash (a+b+c)</b>	<b>(93)</b>	<b>78</b>	<b>(47)</b>	<b>(20)</b>

**Key Ratios**

Yr. ended 31 Mar. (%)	FY06	FY07	FY08E	FY09E
EPS (Rs)	7.6	10.9	12.1	14.2
EPS growth	12.2	43.3	10.7	17.7
EBITDA margin	19.1	10.8	10.9	10.9
EBIT margin	13.8	8.7	8.6	8.4
ROCE	18.4	18.5	16.0	16.4
Net debt/Equity	41.4	79.7	80.1	63.1

**Valuations**

Yr. ended 31 Mar. (x)	FY06	FY07	FY08E	FY09E
PER	14.3	10.0	9.0	7.7
PCE	8.8	6.7	5.9	5.0
Price/Book	3.0	2.3	1.9	1.6
Yield (%)	1.6	1.6	1.6	1.6
EV/Net sales	1.7	0.9	0.8	0.7
EV/EBITDA	8.6	8.4	7.5	6.2

**Du Pont Analysis – ROE**

Yr. ended 31 Mar. (x)	FY06	FY07	FY08E	FY09E
Net margin (%)	10.5	6.9	6.6	6.5
Asset turnover	1.0	1.5	1.3	1.4
Leverage factor	2.1	2.4	2.8	2.6
Return on equity (%)	23.4	26.2	23.6	22.9

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