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December 13, 2006

Fem Care Pharma

Ugly Duckling

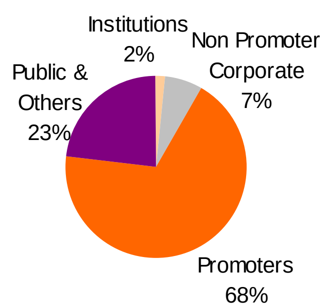
A name *FEM*(*mes*) trust

Buy; CMP: Rs358

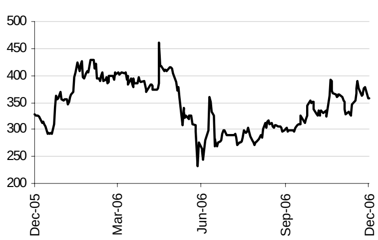
Company details

Price target:	Rs500
Market cap:	Rs111 cr
52 week high/low:	Rs464/220
BSE volume: (No of shares)	3,332
BSE code:	524608
Sharekhan code:	FEMCRPHM
Free float: (No of shares)	10 lakh

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-2.1	19.9	38.4	11.0
Relative to Sensex	0.1	7.5	0.0	-23.1

Key points

- **Leadership position in a niche category:** Fem Care Pharma Ltd (FCPL) has a dominant market share (around 65%) in the niche segment of bleach cream. It is also among the leading players in the liquid soap and hair-removing categories. To boost its overall growth, the company has introduced several product variants at various price points to effectively tap the expected growth in the FMCG industry, especially the fast growing beauty treatment and skin care segments.
- **Incremental growth from exports:** In FY2006, FCPL acquired a US-registered premium bleaching cream brand, *Jaquline*, which has an established presence in the UAE and Middle-East markets. The company plans to utilise it as an umbrella brand to introduce skin care and beauty products, and boost the overall growth of its export business.
- **Margins to firm up:** The introduction of high-margin premium products has positively affected its operating margins. The company has also commissioned a new manufacturing facility in the tax-blessed region of Baddi, Himachal Pradesh. The fiscal incentives in the form of income tax and excise duty exemptions are further boosting its overall profitability.
- **Consolidation of its marketing arm:** The distribution of FCPL's products is done exclusively by its 60% subsidiary, Mirasu Marketing. FCPL is expected to acquire the remaining 40% stake (held directly by the promoters) in Mirasu Marketing over the next one year. The consolidation is likely to result in marginal dilution in its equity base (about 1-1.5% on the higher side) but would be earnings accretive.
- **Attractive valuation:** The consolidated revenues and earnings are estimated to grow at a CAGR of 17.5% and 48.3% respectively during FY2006-08. Currently the stock trades at 9.9x FY2007E and 8x FY2008E earnings. We recommend a Buy on FCPL with a price target of Rs500.

Company background

Incorporated in 1982, FCPL operates in the three broad segments of personal care, healthcare and speciality chemicals. The personal care product portfolio includes bleach cream, hair removing cream and liquid soap that are marketed under its flagship brand, *FEM*.

Key financials (consolidated)

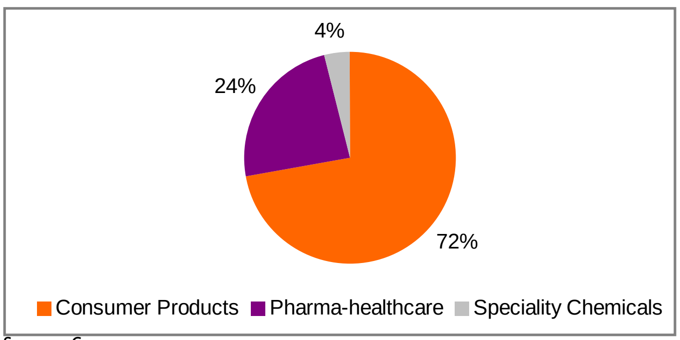
Particulars	FY2005	FY2006	FY2007E	FY2008E
Net profit (Rs crore)	5.2	6.1	10.9	13.5
Shares in issue (crore)	0.3	0.3	0.3	0.3
EPS (Rs)	17.4	20.3	36.1	44.7
% y-o-y change		*17.1*	*77.5*	*23.9*
PER	20.6	17.6	9.9	8.0
P/BV	10.3	7.7	4.8	3.2
EV/EBIDTA	12.3	9.5	7.3	5.9
Dividend yield	0.0	1.4	1.7	1.8
RoCE	61.5	58.7	52.3	45.3
RoNW	49.9	43.6	48.0	40.0

It also offers herbal beauty products under the brand name of *Botanica*, and fabric wash and care products under the brand name of *Bambi*. The distribution of the personal care and consumer products is handled through a 60% subsidiary, Mirasu Marketing. The distribution network is spread across the country with 1,075 stockists and direct sales force of 200 people. The company also has two wholly-owned subsidiaries, Jaquline Inc and Fem Exports.

Under the pharmaceutical (healthcare) division, the company offers various dermatological products (like *Femcinol-A*, *Climdan Lotion* and *Jula*). It also has over-the-counter products like *Nozee*, *Dermotriad*, *Restoderm* and *Diclopace* gel in the dermatological and hair care segments. The specialty chemical business involves largely contract manufacturing of chemicals, creams and ointments for pharma and other personal care product companies. Its corporate client list includes leading domestic companies like Ranbaxy Laboratories, Wockhardt and Wipro Healthcare.

The manufacturing plants are located at Nasik, Maharashtra and Baddi, Himachal Pradesh.

Revenue mix



Source: Company

Investment arguments

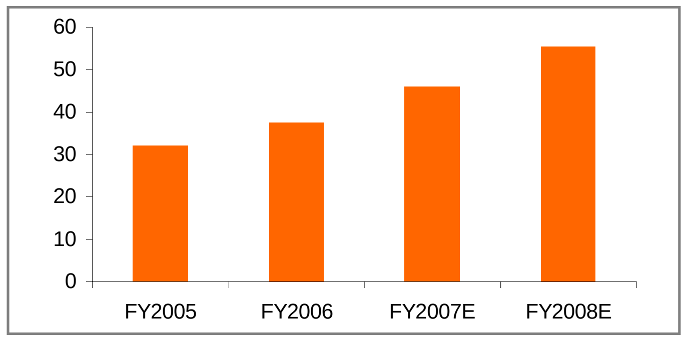
Market leadership in niche products

FCPL has a dominant market share in the niche segment of bleach cream and also offers a variety of other skin care and personal care products. In the hair-removal and liquid hand-wash categories also, the company is among the top three players in the segment.

It is further consolidating its market dominance in the bleach cream segment by introducing several product variants at different price points to effectively tap the growing demand for the skin care products due to increasing awareness and beauty consciousness (especially among the young generation). Among the new product launches, the company introduced "*Oxy Bleach*", a premium category bleach cream product that has received extremely encouraging response from the consumers. The product was introduced in the second half of FY2006 through beauty saloons/parlours initially. But FCPL has also recently introduced the product through retail channels in a big way. Apart from this, the company has re-launched the *Botanica* range of herbal beauty products (with revamped attractive packing), which are also received well in the market.

The growth in the personal care segment is also expected to be boosted by the acquisition of *Jaquline*, a premium category bleach cream that has an established presence in the Middle-East markets. FCPL plans to utilise the same as an umbrella brand and introduce several skin care products in the overseas markets, thereby boosting the overall growth of its export business. The management is targeting export revenues of Rs5 crore in the current fiscal, up from around Rs2 crore in FY2006. Consequently, the personal care (largely consumer products) business is estimated to grow at a compounded annual growth rate (CAGR) of 21.6% over the period FY2006-08.

New products to drive growth in consumer product business



Source: Company, Sharekhan Research

Over the long term, the specialty chemical business is also expected to grow significantly. The management is quite optimistic and is setting up a new manufacturing unit near Nashik with an investment of Rs6 crore. It has signed long-term outsourcing contracts with some of the leading healthcare companies to supply specialty chemicals and is expected to bag some more such contracts. The benefits of the same would accrue from the second half of FY2008 and have not been factored in our estimates.

Improving profitability

The successful introduction of personal care products in the high-margin premium category has positively affected the operating profit margin (OPM) due to the favourable shift in the revenue mix. On a stand-alone basis, the OPM has firmed up by 320 basis points in the first half of this fiscal in spite of the additional expenditure on advertisements related to the promotion of its newly-launched products. We expect this trend to be maintained in the coming quarters.

In addition to this, the commencement of its manufacturing unit in the tax-blessed region of Baddi,

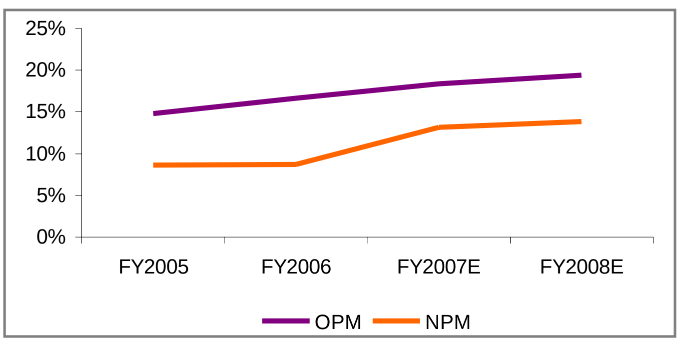
Favourable macro scenario

The demand for consumer goods has picked up considerably on the back of the robust economic growth in India. The fast moving consumer goods (FMCG) sector is expected to continue to grow at a healthy rate of 8-10% over the next couple of years. Apart from the overall growth in the economy, the higher disposable income leading to higher spending, an upsurge in the demand from the rural markets and the growth in the organised retailing are some of the other factors that would drive the demand in the personal care segment.

Moreover, the personal care segment has witnessed an even healthier growth rate of 15-17% in the past few quarters. The growth in this segment is contributed by the relatively faster growing skin care products (creams and lotions) due to the increasing beauty consciousness (especially among the teenagers). Although traditionally, female customers have dominated the skin care segment, yet of late males too have been patronising the company's skin care products, thanks to the growing awareness of beauty among them. FCPL is an established player in the skin care category and would benefit from this trend.

Himachal Pradesh is boosting the company's overall profitability. The manufacturing unit has been set up with an investment of Rs11 crore and been funded through internal accruals. Hence the same shall not result in any additional interest outgo. FCPL enjoys fiscal incentives in the form of 100% excise duty and income tax exemption for the next five years as well as a 30% income tax exemption for the following five years. The tax benefits and a higher contribution from the export business are expected to reduce the company's effective tax rate to 17-18% (down from 35% now). Moreover, the proximity to the manufacturing facilities of its clients, like Ranbaxy Laboratories, Wockhardt and Wipro Healthcare, is likely to boost the contract manufacturing business going forward. We expect the consolidated OPM to improve by 280 basis points in the two-year period FY2006-08. The impact on the net margin would be all the more better due to the steep reduction in the effective tax rate.

Margins to firm up



Source: Company, Sharekhan Research

Consolidation of its stake in Mirasu

FCPL owns a 60% stake in Mirasu Marketing and the remaining 40% stake is held directly by the promoters of FCPL. Mirasu Marketing has a strong network of five branches spread across various regions along with 24 depots and 1,075 stockists. The company directly employs over 200 people to tap the major retail outlets and beauty parlors across the country. Currently, FCPL sells its products to Mirasu Marketing and the latter, in turn, sells the products in the open market at a fixed margin of around 17%. However, the management has initiated the process to consolidate the entire 100% stake of Mirasu Marketing under FCPL. This is likely to result in equity dilution to the extent of 1.5% of FCPL's paid-up share capital of Rs3.09 crore. In spite of the same, the acquisition of the remaining 40% stake is estimated to be earnings accretive on a consolidated basis. Mirasu Marketing recorded revenues and earnings of Rs55.2 crore and Rs2.2 crore respectively in FY2006.

Addressing liquidity concerns

Given the rather small equity base and a high promoter stake (68.5%), the relatively low level of floating stock has been a concern and a drag on the stock's valuations. However, the management intends to address the same by splitting the stock (ie by reducing its face value to Rs1 per share from Rs10 per share). The stock-split proposal was already approved in the last annual general meeting and the management is expected to take a decision on it by the end of the current fiscal.

Key risk

The key risk to our estimates is the higher-than-expected competition-led pricing pressure in the skin care segment. Moreover, the continued success of its recently launched products is also important to meet our estimates.

Valuation

The consolidated revenues and earnings are estimated to grow at CAGR of 17.5% and 48.3% respectively during FY2006-08. At the current market price the stock trades at 9.9x FY2007 and 8x FY2008 earnings estimates. We recommend a Buy on FCPL with a price target of Rs500 (slightly over 11x FY2008E, which is a steep discount of over 50-55% to the prevailing valuations of the large FMCG companies).

Financials

Profit and loss account

Rs (cr)

Particulars	FY2005	FY2006	FY2007E	FY2008E
Net sales	60.5	70.4	82.3	97.2
Expenditure	51.5	58.7	67.2	78.3
Operating profit	9.0	11.7	15.1	18.9
Other income	0.8	1.2	1.8	1.8
PBIDT	9.8	12.9	16.9	20.7
Interest	0.2	0.2	0.4	0.4
Depreciation	0.7	0.7	1.3	1.4
Amortisation	0.2	0.2	0.3	0.3
PBT	8.6	11.7	14.9	18.6
Tax	3.2	4.7	3.4	4.2
PAT	5.4	7.0	11.6	14.3
PPI	0.0	0.0	0.0	0.0
PAT	5.3	7.0	11.6	14.3
Minority interest	0.1	0.9	0.7	0.9
APAT	5.2	6.1	10.9	13.5

Balance sheet

Rs (cr)

Particulars	FY2005	FY2006	FY2007E	FY2008E
Share capital	3.0	3.0	3.0	3.0
Reserves & surplus	7.5	11.0	19.6	30.6
Shareholders' funds	10.5	14.0	22.6	33.6
Minority interest	0.5	1.4	2.1	2.9
Total debt	2.9	3.0	3.0	3.0
Deferred tax	0.3	0.3	0.3	0.3
Total liabilities	**14.2**	**18.8**	**28.1**	**39.9**
Net fixed assets	9.4	9.7	19.1	20.8
CWIP	3.2	10.1	3.0	2.0
Goodwill	1.5	1.2	0.9	0.6
Investments	1.5	1.2	3.4	6.0
Net working capital	-1.5	-3.5	1.7	10.5
Total assets	**14.2**	**18.8**	**28.1**	**39.9**

Valuations

Particulars	FY2005	FY2006	FY2007E	FY2008E
EPS	17.4	20.3	36.1	44.7
Cash EPS	20.4	23.5	41.3	50.4
PER	20.6	17.6	9.9	8.0
P/BV	10.3	7.7	4.8	3.2
EV/EBIDTA	12.3	9.5	7.3	5.9
Mcap/Sales	1.8	1.5	1.3	1.1

Key ratios

Particulars	FY2005	FY2006	FY2007E	FY2008E
OPM (%)	14.8	16.6	18.4	19.4
NPM (%)	8.6	8.7	13.2	13.8
RoCE (%)	61.5	58.7	52.3	45.3
RoNW (%)	49.9	43.6	48.0	40.0

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

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