

SMS Pharmaceuticals
Neutral
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Issue Open: 5 February 2007
Issue Close: 8 February 2007
Issue Details*

Pre-Issue Equity Share Capital:
Rs 7.4cr

Issue size: 99cr

Fresh issue:
2,577,000 equity shares of Rs 10 each

Post issue Equity Share Capital:
Rs 10 cr

Offer Price Band:
Rs 360 -380

Book Building (excluding Reserved for Employees Portion)

MF/QIBs	Atleast 55%
Retail	Atleast 35%
Non-Institutional	Atleast 15%

Shareholding Pattern

	Pre-Issue	Post-Issue
Promoters / Promoter Group	62.2%	46.2%
Others	37.8%	53.8%
Total	100.0%	100.0%

IPO Note
Objects of the issue

The key objectives of the issue are:

- Setting up of facilities for manufacturing Active Pharmaceuticals Ingredients (APIs) at Andhra Pradesh.
- To meet the requirement for Additional Working Capital

The details of the usage of IPO proceeds are as follow:

Particulars	Rs cr
Setting up of facilities for manufacturing APIs at AP	99.0
Public Issue Expenses & Others	*
Total	*

Source: Company RHP

The cost of the project at Rs 113cr has been appraised by EXIM Bank, which has sanctioned a term loan of Rs 30cr. The company has also raised Rs 14cr through pre-IPO placement (4, 00,000 equity shares were placed with Gulf Pharmaceutical Industries at a price of Rs 350 / share).

The company would be utilising the fund in setting up an API manufacturing facility at Vizianagaram Dist., Andhra Pradesh and for this purpose it has already acquired a 72.6 acres land. Out of the Rs 113cr., company plans to utilize Rs 68.4 cr. for Plant & Machinery & other equipments, Rs 4.2 cr. on Research & Development (i.e. In-House R&D facilities and FDA & Other consulting fee) and the balance would be utilized for Other expenses (like furniture& fixtures, buildings etc). The facility would be used for manufacturing new products which presently are in Lab scale testing stage in its Research and Development Centre.

Company Background

SMS Pharmaceuticals Limited is a leading manufacturer of Active Pharma Ingredients (API), Pharmaceutical Intermediates, Nutraceutical and Consumer Healthcare market. Currently the company is the largest producer of Anti-ulcer API Ranitidine HCL. Besides Ranitidine, the company sells bulk drugs like Sumatriptan Succinate, Sildenafil Citrate, Omeprazole Magnesium, Ramipril, Almotriptan maleate, Gemcitabine HCL and their intermediates. The company has also started producing ACE Inhibitors like Perindopril Erubamine and Imidapril and Anti-Cancer drug Capecitabine and Bicalutamide. Apart from the above commercialized products the company has 30 products in the R & D stage of which around 7 products are in the advance stages of commercialization.

In terms of infrastructure, the company has 4 plants including a USFDA approved API plant and a pilot plant which is basically used for scaling up the new products developed by the research center.

Global Pharmaceutical Industry

The Global Pharmaceutical market has been growing at CAGR of 11.3% to \$660bn in 2006 from \$387bn in 2001. The global pharmaceuticals market can be classified into two categories i.e. Regulated and Unregulated/Semi regulated. The Regulated markets, which accounts for almost 75% of the Global Pharmaceutical Industry, are governed by Government Regulations like Intellectual Property Protection, including product patent recognition. The Unregulated/Semi-regulated markets on the other hand have lower entry barriers in terms of regulatory requirements hence are highly competitive.

Indian Pharmaceutical Industry

The Indian Pharmaceutical Industry is a highly organized sector which is estimated to be worth \$10bn growing at about 8-9% p.a. Of the total Indian pharmaceutical market, domestic formulation contributes around \$5bn which has been growing predominantly on the back of new product launches in the market. In terms of Therapeutic segments- CVS, CNS, Respiratory Systems and Alimentary Tract and Metabolism segments have been registering growth higher than the overall Industry growth. CVS and CNS drugs are lifestyle drugs, which have been gaining market share due to increasing urbanization and the resulting change in lifestyles, which have led to increased stress and physiological changes. Exports at around \$ 5 bn. have been growing robustly, aided by increased presence in Regulated Markets.

Industry Growth Drivers

- **Cost advantage:** India enjoys a distinct cost advantages which has aided the companies in the sector to be highly competitive in the exports markets. Further, Indian has a skilled manpower, well known for its Chemistry Skills. This has enabled Indian companies to be competitive in the Generic Markets. Apart from Generic Industry the Indian companies are leveraging the same to emerge as the key player in the CRAMS segment. CRAMS, which currently is a \$ 200 mn industry is expected to grow to \$1bn in by 2010.
- **World class infrastructure:** The Indian pharmaceutical industry has the highest number of plants approved by the US Food and Drug Administration (FDA) outside the US. It also has the largest number of Drug Master Files (DMFs) filed which gives it access to the high growth generic bulk drugs market. Till December 2006, the Indian companies filed almost 25% of the total DMF filing i.e. 149 DMF filing out of the overall total of 590 DMF filed.
- **Research & Development:** The investments on R&D by innovators are around 10–16% of their sales. However, Indian companies have lagged their global peers in terms of investment in Basic Research. R&D expenditure Indian pharmaceutical industry is estimated to be around 1.9% of the turnover. However, going forward, a numbers of companies have scaled up their investments in basic R&D and could see some unlocking of the value through the out-licensing deals.

Investment Arguments

- Widening the product basket:** Earlier the company has been pre-dominantly dependent on Ranitidine HCL. However, the company has over the years consciously reduced its dependency on single product by taking initiatives to foray into the existing market with new products like Sumatriptan Succinate, Almotriptan, Zolmitriptan, Rizatriptan, Ramipril, Imidapril, Perindopril as well as Gemcitabine and others. Ranitidine contribution reduced to 45% of the sales in FY2006 from 75% in FY2004. Going forward, the dependence on the product would reduce further. Currently, the company has a pipeline of 30 products under development, of which around 7 are at advanced stages. Majority of these products face patent expiries from 2008-16 and belong to the High growth Life-Style segments. Of these some of products could provide company with Para-IV opportunities.

Exhibit 1: Future Product Pipeline

Therapeutic segment	API and Intermediates	US Patent Expiry
CNS Stimulants	Rizatriptan	2014
	Frovatriptan	2016
	Naratriptan	2011
Oncology	Geftinib	2015
Anti Emetic	Ondansetron	2007
Gastro	Rabeprazole	2011
	Lansoprazole	Off patent(2006)
	Pentaprazole	2008
Analgesic & NSAID	Meloxicam	off patent (2000)
Anti Depressant	Sertraline	off patent (2005)
Anti Alzheimer	Galantamine	2008
Anti-Asthma	Montelukast	2016
CNS Stimulants	Eletriptan	2016
Cardiac & Anti-Hypertensive	Amlodipine	off patent (2006)
	Lisinopril	off patent (2003)
Anti Bacterial	Moxifloxacin	2011
	Gattifloxacin	2010
	Rosiglitazone	2011
Anti Diabetic	Pioglitazone	2007
	Aripiprazole	2011
Benign Prostrate Hyperplasia	Tamsulosin	2009
Analgesic & NSAID	Tramadol	2019

Source: Company, Note- The above list not exhaustive list of company's product Pipeline

- Infrastructure in place to Tap opportunities:** Company already has a USFDA approved API plant, which would aid company to tap near term opportunities. To cater to its future pipeline the company is setting up another API facility. The plant would comply with the key Regulated markets manufacturing guidelines. The plant is expected to go on stream by Dec2007. Thus with this expansion and product pipeline in place; we believe that company is well placed to leverage the opportunities in the Regulated Markets.

- **Tie up with key players:** Company has tie-ups with key players both in the Domestic and Exports market. For example in Domestic markets it has tie-ups with key players like Ranbaxy Laboratories, Cadila Pharmaceuticals, Dabur Pharma and in Exports it has Alliance with Generic companies like Teva, Chemagis, Zentiva, FIS Italy, Scino Pharma, Quimica Sintetica, Apotex to name a few.
- **Non-infringing products to supplement growth:** Some of the products of the company have been developed with a non-infringing process. This would aid the company to leverage the same for any Para-IV opportunities in US. The company has developed a non-infringing process for Sumatriptan Succinate, for which it has tied up with Ranbaxy, which has filed for a Para-IV filing using the SMS DMF. Apart from this the company has developed non-infringing process for Ramipril, Gemcitabine, Gefitinib. The company has also filed 6 process and 1 product patent under PCT and filed 10 process patents with the Indian Patents Office.
- **Sumatriptan Succinate- A near term opportunity for the company:** Sumatriptan Succinate, is an Anti Migraine drug and falls within the family of Triptan drugs. Sumatriptan Succinate has been growing at CAGR of 92% contributing 12% of the sales for the FY2006 as compared to 4% in FY2004. Going ahead the company expects the contribution to increase further. For Regulated markets like USFDA, Canadian and European market the company has filed Sumatriptan Succinate with non-infringing process. SMS Pharmaceutical is one of the few Indian manufacturers of Sumatriptan Succinate adhering to European pharmacopial standard product (EP grade). Currently the company is selling this product to non-regulatory market and also the Regulatory Market.

For US, the company has an agreement with Ranbaxy Laboratories, which has filed for a Para-IV filing using the SMS DMF. The product which belongs to Glaxo had sales of \$ 890 mn. in US (MAT sales in June'06) goes off-patent in Feb 2009. As per the agreement, SMS pharmaceutical would supply Ranbaxy the API, while Ranbaxy would be Marketing and Distributing the product in US. Any 180-day exclusivity on the product could further supplement the overall growth momentum.

Concern

High Product & Client Concentration

At present the company has a considerable amount of its Revenues coming from one product i.e. Ranitidine which still contributes 45% of the sales during FY2006. Similarly the Top 10 customers of the company contribute a significant portion of its sales. For example, in domestic markets Top 10 customers' account for 40% of the domestic sales, while in export market they account for 46% of the exports sales. While in the long run, the robust pipeline of the company would address the same, in near term higher dependence on few products is a concern.

Valuation and Outlook

At the high price band the stock trades at 17.3x FY2007E earnings. While we believe that the company would be able to scale-up its business on back of robust product pipeline, however at current price band of Rs. 360-380 the same is fairly factored in and leaves little room for an upside in near term. Further, any major triggers would come in through by FY2010. **Hence we are Neutral on the issue.**

Financial Highlights

Exhibit 2: Balance Sheet				
Y/E March (Rs cr)	FY2004	FY2005	FY2006	H12007
SOURCES OF FUNDS				
Equity Share Capital	4.1	4.1	4.1	7.0
Reserves & Surplus	36.6	44.0	51.5	62.1
Shareholders Funds	40.7	48.1	55.6	69.2
Total Loans	51.8	62.8	65.4	62.0
Deferred Tax Liability	0.0	0.0	0.0	-
Total Liabilities	92.5	110.9	121.0	131.1
APPLICATION OF FUNDS				
Gross Block	65.9	79.5	83.6	85.5
Less: Acc. Depreciation	14.0	17.6	21.6	23.7
Net Block	51.8	61.9	62.0	61.8
Capital Work-in-Progress	4.6	2.8	1.7	2.8
Advance for Capital Items	0.0	0.0	0.0	-
Investments	0.3	0.4	0.4	3.3
Current Assets	66.7	82.4	95.2	102.2
Current liabilities	24.9	30.2	32.2	33.3
Net Current Assets	41.8	52.2	63.0	68.9
Misc Exp	4.8	6.3	6.8	7.4
Deferred Tax Asset	(10.9)	(12.7)	(12.8)	(13.1)
Total Assets	92.5	110.9	121.0	131.1

Source: Company RHP

Exhibit 3: Profit & Loss Statement				
Y/E March (Rs cr)	FY2004	FY2005	FY2006	H12007
Net Sales	115.9	118.7	129.0	92.9
% chg	121.1	2.4	8.7	
Total Expenditure	97.4	99.8	105.3	73.4
EBIDTA	18.4	18.8	23.7	19.5
(% of Net Sales)	15.9	15.9	18.4	21.0
Other Income	0.3	1.0	0.4	1.6
Depreciation & Amortisation	3.1	3.5	4.4	2.1
Interest	4.1	4.5	6.6	3.8
PBT	11.5	11.8	13.1	15.2
(% of Net Sales)	9.9	9.9	10.2	16.4
Extraordinary Expense/(Inc.)	0.3	0.2	0.0	0.0
Tax	4.0	3.3	4.6	4.6
(% of PBT)	35.0	28.3	35.1	30.4
PAT	7.2	8.3	8.5	10.6
% chg	210.4	14.3	3.0	
EPS	17.6	20.1	20.7	15.1
ROE (%)	17.7	17.2	15.3	15.3
ROCE (%)	17.5	13.8	16.0	13.3
Valuations(Price @ 380)				
P/E	21.6	18.9	18.3	25.2
P/BV	38.3	32.4	28.0	38.6
EV / Sales	1.7	1.8	1.7	3.5
EV / EBITDA	10.9	11.4	9.1	16.7

Source: Company RHP, Angel Research



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