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Quantum Information Services Limited
Independent Investment Research
15 April, 2006

Pfizer India Limited

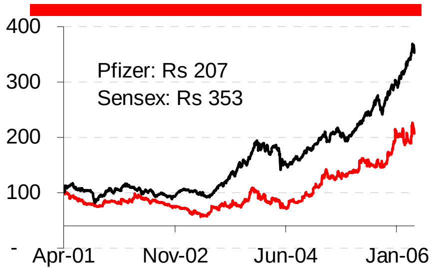
Hold **Target price: Rs 1,543**

Market data

Current price	Rs 1,097 (BSE)
Market cap	Rs 32,691 m
Face value (Rs)	10
CY05 Div/share	10.0
NSE symbol	PFIZER
No of shares	29.8 m
Free float	58.8%
52 week H/L	Rs 1,225 / 664

Share price chart

Rs 100 invested is worth



Shareholding

Category	(%)
Promoters	41.2
FIIs	5.4
Public	24.5
MFs & UTI	13.8
Banks	12.6
Others	2.5
Total	100.0

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Investment Rationale

- **New products - the main attraction:** Pfizer India has unveiled plans of stepping up the pace of its new product launches, which will be the key growth driver. The company has already launched three of its parent's products in the Indian markets in the last three months. Despite the fact that 'Viagra' is priced at a significant premium to the generic versions available in the market, it has already captured 1.8% market share within two months of its launch (market size pegged at Rs 800 m). The management is aiming to capture around 10% to 15% market share in the next two years.

  'Lyrica' has already gained more than 7% market share (among new prescriptions) in the U.S. as of December 2005, making the drug one of Pfizer Inc's (the parent) most successful launches. Pfizer Inc. expects this drug to generate global revenues to the tune of US$ 900 m in CY06. In the Indian markets, both 'Caduet' and 'Lyrica' (both launched in Feb 2006) generated revenues to the tune of Rs 10 m in 1QCY06 (around 1% of Pfizer India's pharma revenues during the said period). These products are also expected to gain market share going forward.

- **Product patent law to provide further boost:** The introduction of the product patent law in India is a positive, especially for the MNC pharma companies. Pfizer India plans to launch its first patented product in the country 2008 onwards (though it has not disclosed the names or the details of these products). Having said that, globally, Pfizer Inc. currently has 5 potential products in its pipeline, which it is planning to launch. Out of these, 'Sutent' (treatment for advanced kidney cancer) and 'Exubera' (inhaled insulin treatment for diabetes) have received regulatory approvals. Other drugs such as 'Champix' (smoking cessation) and 'Indiplon' (for insomnia) are currently under US FDA review. If these products get approved in the global markets, there is a possibility that these patented products might be launched in the Indian markets as well.

- **Key brands to propel revenues:** Pfizer India has a very strong brand portfolio and many of its products like 'Corex', 'Becosules', 'Gelusil', 'Benadryl' and 'Minipress XL' command very high brand equity. 7 of its key brands posted a combined growth of 15.6% in CY05 and are expected to continue contributing to Pfizer's topline going forward. Taking into account the existing products and new product launches, we expect Pfizer's revenues to grow at a CAGR of 15% over the next three years.

- **Restructuring benefits:** As part of its restructuring initiative, Pfizer India is aiming to align its portfolio with that of its global parent. The company has identified seven strategic business units (SBUs) on the basis of the core therapeutic areas. Another important step taken by the company is to reduce the time gap between the global product launch and the Indian launches to six months and one year (as against six months and two years). To put things in perspective, the company launched the global parent's product 'Lyrica' in the domestic markets in February 2006 (globally the product was launched in September 2005). We perceive this as a positive step, indicating Pfizer's commitment in launching new products into the country.

- **Margin improvement visible:** Pfizer's restructuring exercises are beginning to reap benefits, as can be gauged by the improvement in margins from 12.5% in CY03 to 21.2% in CY05. Efforts to improve efficiencies at the operating level and a better product mix are paying off and are expected to contribute to the margin expansion going forward. Besides this, Pfizer has also been undertaking field-force restructuring in a bid to improve productivity. We believe that these initiatives, along with an increase in topline, will lead to margin expansion from 21.2% in CY05 to 28.1% in CY08.

- **Strong parent background:** Pfizer India's parent, Pfizer Inc., is the world's largest pharma company. In 2005, Pfizer Inc recorded revenues of US$ 51.3 bn and net profits of US$ 8 bn. The company has a very strong product portfolio with 'Lipitor', 'Norvasc', 'Zoloft' and 'Zithromax' being the major drugs. While 'Lipitor' generated revenues to the tune of US$ 12 bn in CY05, the other three drugs delivered revenues of atleast US$2 bn. Going forward, India is expected to be a focus region for Pfizer, which will result in the introduction of new products in the Indian market. Besides product launches, Pfizer India has been conducting clinical trials for its parent in the country, which has been contributing around 4% to the former's revenues. We believe this business is important in the sense that Pfizer India will gain more relevance to the parent company going forward.

Investment Concerns

- **Presence of 100% subsidiary:** Presence of a 100% subsidiary poses a risk because if new products are launched through this subsidiary, the shareholders of the listed entity (in this case Pfizer India) stand to lose out. Currently, Pfizer Inc has a 100% subsidiary called Pharmacia, which is very strong in the oncology segment. The management of Pfizer has indicated that products will be launched through that entity, wherein the value will be maximum. Having said that, the launch of the recent three products was through Pfizer India and not Pharmacia, which is a positive sign.

- **Old products portfolio – a concern:** Pfizer's product portfolio comprises of old products. Though its key brands 'Corex', 'Becosules' and 'Benadryl' have been growing at a healthy pace, these products are likely to face intense competition going forward, which can be countered only by the launch of new products.

- **High dependence on OTC segment:** The merger with Parke-Davis has increased Pfizer's exposure in the OTC segment. Among the company's key brands, 'Becosules', 'Gelusil', 'Listerine' and 'Benadryl' (accounting for roughly 54% of total revenues) are in the OTC segment. Given the fact that there are a large number of players present in this segment, these products could face intense competition going forward.

Comparative valuations

	Pfizer*	GSK Pharma	Aventis
Valuation metrics **			
Current price (Rs)	1,097	1,447	1,860
Price to earnings (x)	47.8	24.2	29.6
Price to book value (x)	9.6	12.9	8.1
Price to sales (x)	5.2	8.1	5.3
EV/EBIDTA (x)	23.1	27.6	17.9
Performance metrics (CY05)			
EBIDTA margin (%)	21.2%	29.1%	27.7%
Net margin (%)	10.9%	33.4%	17.9%
Sales/NFA (x)	8.3	16.8	5.4
Return on equity (%)	20.1%	53.2%	27.5%
Return on assets (%)	12.7%	33.7%	21.0%

* Pfizer is a November ending company
** Valuations are based on CY05 numbers

Background

Pfizer India is a 41% subsidiary of the world's largest pharmaceuticals company - Pfizer Inc. The company is ranked ninth in the Indian pharma industry with a market share of 2.6% in CY05. Pfizer derives a larger share of its revenues from the pharmaceuticals division (86%). The company also has presence in the animal health (10%) and clinical development operations (4%) segments. In the animal health segment, Pfizer plans to capitalize on its parent's global leader status and become a major player. Pfizer also carries out clinical trials on behalf of its parent.

Industry Prospects

The global pharma market grew by 7% in 2005 to reach US$ 602 bn (Source: IMS). Growth in North America, which accounts for almost half of the global market, lagged at 5.2%. The size of the Indian pharmaceutical market in CY05 was Rs 220 bn and grew by 5.3% YoY (Source: Pfizer annual report). While MNC pharma companies grew at 4%, their domestic counterparts clocked a 5.8% growth. India's per capita health expenditure at US$ 20 is very low as compared to China (US$ 33), Brazil (US$ 309) and Malaysia (US$ 81) (Source: World Bank). However, with growing health awareness coupled with the growth of the health insurance schemes, the per capita health expenditure is bound to rise.

As far as the therapeutic segments are concerned, though the acute segment enjoys a larger chunk of the domestic market (about 72%), it has been growing by a marginal 5%. As against this, the chronic segment, which has been growing at a faster pace of around 20% to 25%, has increased its share to 28% of the market. The product patent came into force in India with effect from January 1, 2005, which will result in the introduction of patented drugs into the country and possibly, higher growth rates for the MNC pharma companies in the long term.

Valuations

We had recommended a BUY on Pfizer in December 2003 at Rs 488 with a target price of Rs 650. The stock has significantly outperformed our expectations since then. At the current price of Rs 1,097, the stock is trading at a price to earnings multiple of 17.8 times our estimated CY08 earnings. Given the visibility on the revenue front and the scope for margin expansion, we recommend a HOLD** on the stock with a price target of Rs 1,543 from a three year perspective. However, the new product launches will take time to capture significant market share and therefore to realise the opportunity, investors have to attune their investment horizon to the management's long-term strategy.

***By this recommendation of HOLD, what we mean is that existing shareholders would be better off holding onto the stock with a three year perspective. However, if an investor would like to BUY this stock, then the upside from the current levels is about 41% point to point (13% CAGR). Investors could take the investment decision based on this premise.*

Valuation table

(Rs m)	CY05	CY06E	CY07E	CY08E
Total revenues	6,253	7,132	8,194	9,488
Net profit	683	954	1,267	1,842
EPS (Rs)	22.9	32.0	42.5	61.8
Price to earnings (x)	47.8	34.3	25.8	17.7
Price to sales (x)	5.2	4.6	4.0	3.4

Financials at a glance

(Rs m)	CY05	CY06E	CY07E	CY08E
Sales	6,253	7,132	8,194	9,488
Sales growth (%)	*7.3%*	*14.0%*	*14.9%*	*15.8%*
Operating profit	1,324	1,712	2,172	2,666
Operating profit margin (%)	*21.2%*	*24.0%*	*26.5%*	*28.1%*
Net profit	683	954	1,267	1,842
Net profit margin (%)	*10.9%*	*13.4%*	*15.5%*	*19.4%*
Balance Sheet				
Net fixed assets	777	827	856	870
Investments	-	-	-	-
Current assets	4,606	4,732	5,532	6,706
Total assets	**5,384**	**5,559**	**6,388**	**7,576**
Current liabilities	1,985	1,691	1,897	2,149
Net worth	3,399	3,868	4,491	5,427
Total debt	-	-	-	-
Total liabilities	**5,384**	**5,559**	**6,388**	**7,576**