MOTILAL OSWAL

3QFY06 Results Update
SECTOR: PHARMACEUTICALS

Shasun Chemicals

STOCK INFO.	BLOOMBERG
BSE Sensex: 9,465	SSCD IN
	REUTERS CODE
S&P CNX: 2,884	SHAS.BO

Equity Shares (m)	45.8
52-Week Range	107/67
1,6,12 Rel. Perf. (%)	15/-11/-29
M.Cap. (Rs b)	4.6
M.Cap. (US$ b)	0.1

23 January 2006

Buy

Previous Recommendation: Buy

Rs101

YEAR END	NET SALES (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES	EV/ EBITDA
03/05A	3,271	310	6.8	30.0	14.8	3.3	24.7	24.0	1.6	7.8
03/06E	3,539	309	6.8	-0.3	14.9	2.9	20.8	17.1	1.5	8.4
03/07E	4,043	387	8.5	25.0	11.9	2.5	22.4	20.1	1.3	6.8

Shasun Chemicals recorded 31% topline growth to Rs993m and 43% bottomline growth to Rs129m for 3QFY06. Key highlights:

- Net sales growth was driven primarily by a 49% jump in Ibuprofen supplies (which accounts for about 46% of sales) and a 138% growth in CRAMS revenues (albeit on a lower base). As expected, Ranitidine and Nizatidine sales recorded sales decline of 2% and 11% respectively.
- EBITDA margins declined by 320bp YoY to 20.5% primarily on account of higher Ibuprofen sales which attract lower margins. Higher staff costs and increase in other expenditure also adversely impacted EBITDA margins.
- We have not revised our estimates upwards despite good 3QFY06 performance, as we believe the growth in Ibuprofen sales is unlikely to be sustained in the coming quarters.

Shasun's operations are likely to undergo a gradual transformation, led by higher revenues from CRAMS and commercialization of the company's generics pipeline, resulting in a gradual increase in EBITDA margins. Valuations at 11.9x FY07E and 8.4x FY08E (based on stand-alone earnings) are not very demanding. Although, the recent acquisition of Rhodia's custom manufacturing business is likely to negatively impact Shasun's consolidated earnings for FY06E and FY07E, we believe this can bring in long-term benefits. Our estimates do not factorin this acquisition, as Shasun is yet to disclose the financial details of the transaction (pending the due diligence). We maintain **Buy**.

QUARTERLY PERFORMANCE (Rs Million)

Y/E MARCH	FY05				FY06				FY05	FY06E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Net Sales	**656**	**821**	**758**	**1,036**	**750**	**844**	**993**	**952**	**3,271**	**3,539**
YoY Change (%)	*14.8*	*22.8*	*11.3*	*37.2*	*14.3*	*2.8*	*31.0*	*-8.1*	*22.2*	*8.2*
Total Expenditure	549	684	578	778	628	698	789	791	2,587	2,907
EBITDA	**108**	**138**	**180**	**258**	**122**	**146**	**203**	**162**	**684**	**632**
Margins (%)	*16.4*	*16.8*	*23.7*	*24.9*	*16.2*	*17.3*	*20.5*	*17.0*	*20.9*	*17.9*
Depreciation	48	49	48	71	52	58	61	66	216	237
Interest	7	7	8	12	13	13	13	13	34	52
Other Income	4	1	1	4	2	3	2	2	8	9
PBT	**57**	**82**	**124**	**179**	**59**	**78**	**132**	**84**	**443**	**352**
Tax	18	26	31	-5	16	15	**4**	**3**	70	**39**
Deferred Tax	0	-1	3	60	0	1	-1	5	62	4
Rate (%)	*31.2*	*30.6*	*27.5*	*30.7*	*27.3*	*20.3*	*2.0*	*9.3*	*29.9*	*12.0*
PAT	**39**	**57**	**90**	**124**	**43**	**62**	**129**	**76**	**310**	**309**
YoY Change (%)	*26.5*	*16.1*	*62.3*	*21.0*	*8.7*	*8.6*	43.2	-38.8	*30.2*	-0.3
Margins (%)	*6.0*	*6.9*	*11.9*	*12.0*	*5.7*	*7.3*	*13.0*	*8.0*	*9.5*	*8.7*

E: MOSt Estimates

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Ibuprofen and CRAMS drive sales growth …

Sales growth for the quarter was led mainly by higher Ibuprofen sales (accounting for about 46% of sales) and increased CRAMS sales. Supply of Cyclosorine to Eli Lilly has boosted Shasun's CRAMS revenues for the quarter. Although, we were positively surprised by the 49% jump in Ibuprofen sales, we believe that this growth may not be sustainable in the coming quarters. We expect Ibuprofen to record 10% growth for FY06E and about 5% for FY07E.

TREND IN PRODUCT MIX (RS M)

	3Q FY06	3Q FY05	CHG. (%)	2Q FY06	CHG. (%)
Ibuprofen	476.6	320.8	48.6	380.4	25.3
Ranitidine	119.0	121.2	-1.8	119.5	-0.4
Nizatidine	109.1	122.2	-10.7	241.0	-54.7
CRAMS	238.4	100.1	138.1	45.3	426.3
Excipients	9.7	39.7	-75.7	17.2	-43.9
Others	31.3	34.8	-10.2	29.0	7.8
Total	**984.1**	**738.8**	**33.2**	**832.4**	**18.2**

Source: Company/Motilal Oswal Securities

As expected Nizatidine and Ranitidine sales have declined for the quarter. Glaxo SmithKline (GSK) has sourced additional quantities of Ranitidine from Shasun in FY05 which, we believe, was one-time in nature.

But EBITDA margins decline …

Despite significantly higher sales growth, Shasun's EBITDA margins for 3QFY06 have declined by about 320bp. Shasun's Ibuprofen business does not enjoy high margins and hence a significant increase in Ibuprofen sales has actually led to a decline in margins. The Ibuprofen business is facing input cost pressures as some of the key inputs are linked to the petrochemical cycle. Since the product has been made completely generic, Shasun is unable to pass on the price increase to its customers. However, increased CRAMS sales have positively impacted EBITDA margins as Shasun's CRAMS business enjoys better margins as compared with the older Ibuprofen business.

EBITDA margins were also adversely impacted due to higher staff costs (up by 27%) and higher other expenditure (up by 70%). Higher commission on CRAMS sales and increased discounts resulted in a significant jump in other expenditure.

Cuddalore EoU results in lower tax ...

Shasun has converted a part of its Cuddalore facility into an Export Oriented Unit (EoU) resulting in fiscal incentives for the company. Shasun's CRAMS and Nizatidine sales enjoy these fiscal benefits resulting in significant tax savings for the company. Effective tax rate for the quarter was only 2% compared to more than 20% in 1HFY06.

… translating into a 43% growth in profits

Higher sales growth coupled with lower tax outgo increased Shasun's bottomline for the quarter by 43%. A majority of net profit growth has come from lower tax outgo since the EBITDA has grown by only 13%.

Valuation and outlook

CRAMS and Generics to be the main growth drivers

We believe that Shasun's operations will be back on the growth path from FY07E onwards led mainly by the commencement of generic supplies as well as higher traction in its CRAMS business. Performance for FY06E will be adversely impacted due to input cost pressures as well as lower offtake for Ranitidine and Nizatidine. Net sales are expected to record a CAGR of about 13% for FY05-FY08 while earnings are expected to grow at 20.5% CAGR for the same period. Our estimates do not include upside from any potential contracts that the company may sign going forward (Shasun is negotiating contract manufacturing arrangements with 5 MNCs). We have also not included upside from any new partnership arrangements that the company may enter into for its generics business.

Higher input costs and decline in CRAMS will result in flat bottomline for FY06E

Shasun's FY06 performance is likely to be adversely impacted due to higher input costs (especially for Ibuprofen where it is not in a position to pass it on to its customers) and decline in offtake of Ranitidine and Nizatidine. We expect the company to report a flat bottomline growth for FY06E.

Changing sales mix to expand EBITDA margins

We forecast a 180bp expansion in Shasun's EBITDA margins for FY07E and a 100bp expansion for FY08E led by increased revenues from the CRAMS segment as well as commencement of generic exports from FY07E onwards. It should be noted that both these segments will enjoy better margins (20%+) compared with the 15%-20% margin for the company's mature products (which contributed about 85% of revenues for FY05). CRAMS (excluding mature products) contributed about 8% to Shasun's revenues in FY05. We expect CRAMS contribution to increase to about 13-14% by FY07E and generic exports to start contributing to revenues from FY07E. We expect mature product's contribution to decline from about 85% (for FY05) to about 73% in FY07E and 64% in FY08E, thus positively impacting EBITDA margins beginning FY07E.

MNC relationships will help in the long term

Shasun has existing relationships with MNCs like Eli Lilly, GSK Pharma, Boots Plc (now taken over by Reckitt Benckiser) for their global requirements. In India, the company has existing arrangements with Sanofi-Aventis and Abbott to supply Ibuprofen. We believe that, given the confidential nature of the CRAMS industry, having existing MNC relationships and a track record of servicing MNC clients will have long-term advantages for Shasun. The company is likely to leverage these relationships to expand its current CRAMS pipeline (by adding more products as well as by entering into new relationships).

CRAMS business has long gestation period

The CRAMS business has a long gestation period. As the Indian CRAMS industry is still evolving, potential customers take a long time to award contracts. Secondly, as a test case, the initial offtake by the customer may not be very high. It should also be noted that post the announcement of the contract it takes 18-24 months for the supplies to begin. This is due to the time-consuming registration process with various countries before which supplies cannot commence. Depending on the type of contract and the products to be manufactured, the contract manufacturer may also have to undertake front-ended capex to set up dedicated facilities for servicing the contract. We believe that Shasun's existing facilities are capable of servicing 2-3 new contracts.

Rhodia acquisition – Short term negative but will bring in long term benefits

Shasun has entered into a letter of intent with the Rhodia group of France to acquire the pharmaceutical customs synthesis business of Rhodia Pharma Solutions (RPS), UK. Both the parties have entered into an exclusivity agreement to progress towards the final Sale and Purchase Agreement, which is expected to be completed before 31 March 2006, subject to satisfactory due diligence and regulatory approvals.

Key highlights of the acquisition are:

- Shasun acquires the development and custom manufacturing services catering to innovator MNCs and other pharmaceutical clients in US, Europe and Asia. This is a part of Rhodia's pharmaceutical business.
- Shasun's CCS pipeline gets strengthened because of this acquisition.
- The proposed acquisition includes manufacturing sites at Dudley and Annan located in the UK.
- Shasun gets access to critical patented technologies like Hydrolytic Kinetic Resolution (HKR), Aromatic Bond Formation (ABF) and Radical Trifluoromethylation.
- Shasun has not disclosed any details related to the product pipeline (both CCS and contract manufacturing) for the acquired business pending the due diligence.
- Financial details as well as revenues related to the acquisition have not been disclosed. However, Shasun has indicated that the business is currently making losses.
- Depending on the funding requirement for this acquisition, we do not rule out a potential equity dilution. We await further details on this from the company.
- We believe that Shasun may not be able to immediately transfer the manufacturing to India, given some of the critical technologies involved and hence the acquired business may be drag on consolidated earnings in the short to medium term.
- Rhodia's pharmaceutical business (which includes the business acquired by Shasun and other businesses) has been reporting a decline in sales in the past 2 years due to delays in launch of new products by its partners.

- Shasun has indicated that it expects to turnaround this business by FY08E. Hence, if the acquisition goes through, Shasun's consolidated earnings for FY06E and FY07E are expected to be adversely impacted.

Valuations are reasonable; Buy

Shasun is currently valued at 11.9x FY07E and 8.4x FY08E earnings (stand-alone), which we believe is reasonable given the 20.5% CAGR in earnings for FY05-FY08. Our estimates do not include any upsides from potential contracts that the company may announce. Given the strong MNC relationships and the fact that the company will be back on the growth track in FY07E, we believe that valuations will gradually expand. Signing of new contract manufacturing deals can further re-rate the valuation multiples. It should be noted that our estimates do not include the impact of the Rhodia acquisition as Shasun is yet to disclose the financial details of the transaction (pending the due diligence). We maintain **Buy**.

Shasun Chemicals: an investment profile

Company description

Shasun has been focusing on the partnership model for all the segments of its operations. It has existing relationships with innovator pharmaceutical companies like GSK, Eli Lilly and Reliant Pharma, which augur well for future outsourcing opportunities. Shasun has leveraged its strength in manufacturing and relationships with global majors to position itself as a 'partner of choice' for innovator companies across the product life cycle and value chain.

Key investment arguments

- Business to undergo a gradual transformation led by higher revenues from CRAMS and generics resulting in EBITDA margin expansion over the next 2-3 years
- Likely beneficiary of the increased pharmaceutical outsourcing from India
- Existing relationships with MNCs and a partnership approach to augur well for the company

Key investment risks

- Execution risks in CRAMS business
- Delay in turn-around of Rhodia's custom manufacturing business may stretch the company's financials
- Funding of acquisitions and future capex may lead to equity dilution

Recent developments

- Has entered into a agreement with the Rhodia Group of France to acquire the latter's custom manufacturing business, subject to satisfactory due diligence and regulatory approvals.

Valuation and view

- Has existing relationships with innovators like GSK and Eli Lilly which can be leveraged for more outsourcing contracts in the future
- Partnerships with Actavis and Glenmark in the generics space to start contributing incrementally from FY07E onwards
- Valuations of 11.9x FY07E and 8.4x FY08E EPS (stand-alone) are reasonable; **Buy** with a target price of Rs120.

Sector view

- Very few players from India are adequately prepared for exploiting the huge outsourcing opportunity
- Expect a time-lag of about 18-24 months between signing of contracts and actual commencement of revenues
- We are overweight on companies that are towards the end of the investment phase

COMPARATIVE VALUATIONS

		SHASUN	JUBILANT	DIVI'S LABS
P/E (x)	FY06E	14.9	24.7	29.2
	FY07E	11.9	15.6	24.5
P/BV (x)	FY06E	2.9	3.7	6.0
	FY07E	2.5	3.0	5.0
EV/Sales (x)	FY06E	1.5	2.5	5.8
	FY07E	1.3	1.9	4.8
EV/EBITDA (x)	FY06E	8.4	15.8	19.6
	FY07E	6.8	10.4	15.7

SHAREHOLDING PATTERN (%)

	DEC.05	SEP.05	DEC.04
Promoters	42.4	40.1	40.8
Domestic Institutions	15.6	17.4	10.3
FIIs/FDIs	12.8	15.6	21.8
Others	29.2	26.9	27.1

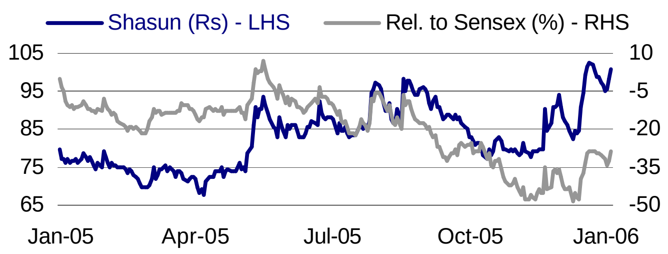
EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY06	6.8	-	-
FY07	8.5	-	-

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
101	120	19.3	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT (STANDALONE) (Rs Million)

Y/E MARCH	2004	2005	2006E	2007E	2008E
Gross Revenues	**2,774**	**3,373**	**3,655**	**4,162**	**4,934**
Less: Excise Duty	98	102	115	120	124
Net Sales	**2,676**	**3,271**	**3,539**	**4,043**	**4,810**
Change (%)	*12.7*	*22.2*	*8.2*	*14.2*	*19.0*
Total Expenditure	2,154	2,587	2,907	3,246	3,811
% of Sales	*80.5*	*79.1*	*82.1*	*80.3*	*79.2*
EBITDA	**522**	**684**	**632**	**797**	**998**
Margin (%)	*19.5*	*20.9*	*17.9*	*19.7*	*20.8*
Depreciation	169	216	237	284	310
Int. and Finance Charges	51	34	52	53	44
Other Income - Rec.	14	8	9	12	15
PBT after EO Expense	**316**	**443**	**352**	**472**	**660**
Current Tax	56	70	39	61	73
Deferred Tax	22	62	4	24	43
Tax Rate (%)	*24.6*	*29.9*	*12.0*	*18.0*	*17.5*
PAT Adj for EO Items	**238**	**310**	**309**	**387**	**545**
Change (%)	*47.7*	*30.2*	*-0.3*	*25.0*	*40.8*
Margin (%)	*8.9*	*9.5*	*8.7*	*9.6*	*11.3*

BALANCE SHEET (STANDALONE) (Rs Million)

Y/E MARCH	2004	2005	2006E	2007E	2008E
Equity Share Capital	91	92	92	92	92
Total Reserves	1,047	1,296	1,501	1,773	2,187
Net Worth	**1,139**	**1,387**	**1,592**	**1,864**	**2,279**
Deferred Liabilities	143	205	209	232	275
Total Loans	557	893	852	902	552
Capital Employed	**1,838**	**2,486**	**2,654**	**2,999**	**3,106**
Gross Block	2,085	2,517	2,817	3,367	3,517
Less: Accum. Deprn.	762	952	1,189	1,474	1,783
Net Fixed Assets	**1,323**	**1,565**	**1,627**	**1,893**	**1,733**
Capital WIP	39	170	200	300	150
Total Investments	2	2	2	2	2
Curr. Assets, Loans an	**1,159**	**1,496**	**1,556**	**1,638**	**2,203**
Inventory	459	471	497	555	651
Account Receivables	537	652	711	752	891
Cash and Bank Balance	27	150	125	123	414
Loans and Advances	135	222	223	208	247
Curr. Liability & Prov.	**693**	**749**	**735**	**836**	**984**
Account Payables	464	470	509	581	691
Other Current Liabilities	156	174	100	113	131
Provisions	73	104	125	142	162
Net Current Assets	**466**	**747**	**822**	**802**	**1,219**
Misc Expenditure	10	3	3	3	3
Appl. of Funds	**1,838**	**2,486**	**2,654**	**2,999**	**3,106**

E: MOSt Estimates

RATIOS (STANDALONE)

Y/E MARCH	2004	2005	2006E	2007E	2008E
Basic (Rs)					
EPS	**5.2**	**6.8**	**6.8**	**8.5**	**11.9**
Cash EPS	8.9	11.5	11.9	14.7	18.7
BV/Share	24.7	30.3	34.7	40.7	49.7
DPS	0.6	2.0	2.0	2.2	2.5
Payout (%)	24.4	25.3	33.7	29.7	23.9
Valuation (x)					
P/E		14.8	14.9	11.9	8.4
Cash P/E		8.7	8.4	6.9	5.4
P/BV		3.3	2.9	2.5	2.0
EV/Sales		1.6	1.5	1.3	1.0
EV/EBITDA		7.8	8.4	6.8	4.7
Dividend Yield (%)		2.0	2.0	2.2	2.5
Return Ratios (%)					
RoE	25.7	24.7	20.8	22.4	26.3
RoCE	24.0	24.0	17.1	20.1	25.2
Working Capital Ratios					
Debtor (Days)	71	71	71	66	66
Creditor (Days)	122	103	105	107	108
Inventory (Days)	63	53	51	50	49
Working Capital Turnover (D	60	67	72	61	61
Leverage Ratio (x)					
Debt/Equity	0.5	0.6	0.5	0.5	0.2

CASH FLOW STATEMENT (STANDALONE) (Rs Million)

Y/E MARCH	2004	2005	2006E	2007E	2008E
Oper. Profit/(Loss) before T	522	684	632	797	998
Interest/Dividends Recd.	14	8	9	12	15
Direct Taxes Paid	-56	-70	-39	-61	-73
(Inc)/Dec in WC	-40	-159	-100	18	-126
CF from Operations	**441**	**464**	**503**	**766**	**815**
(Inc)/Dec in FA	-447	-589	-330	-650	0
CF from Investments	**-447**	**-589**	**-330**	**-650**	**0**
Issue of Shares	225	23	0	0	0
(Inc)/Dec in Debt	-101	336	-41	50	-350
Interest Paid	-51	-34	-52	-53	-44
Dividend Paid	-58	-78	-104	-115	-130
CF from Fin. Activity	**15**	**248**	**-197**	**-117**	**-524**
Inc/Dec of Cash	**9**	**122**	**-25**	**-2**	**291**
Add: Beginning Balance	18	27	150	125	123
Closing Balance	**27**	**150**	**125**	**123**	**414**

N O T E S

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Disclosure of Interest Statement	Shasun Chemicals
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No

MOSt is not engaged in providing investment-banking services.