

PIRAMAL HEALTHCARE



In transition

Financial performance impacted from sale of key businesses

Q2FY11 results reflect Piramal Healthcare's (PIHC) transitional phase, with operations impacted due to domestic formulations and diagnostic businesses sale during the quarter and hence are not reflective of the PIHC's continued potential in residual business. Revenues, at INR 7.5 bn, declined 25% Y-o-Y, while sales from residual business (excl OTC) declined 27% Y-o-Y. GCC reported a sharp decline in revenues—28% Y-o-Y and 41% Q-o-Q. CRAMs business grew 22% Q-o-Q to INR 2.7 bn from INR 1.75 bn in Q1FY11. EBITDA margin of (-1.7%) had impact from one-off undisclosed charges (including bonus paid to employees of INR 1.2 bn) from deal closure. PIHC recorded one-time gain of INR 162.2 bn and paid tax of INR 36 bn on total deal value; adjusted for these one-offs, adjusted net loss was ~INR 710 mn during Q2FY11. PIHC indicated that operations during the quarter have been unusually affected by business sell-offs and expects residual businesses to revert to normal operations in the coming quarters.

Buy back of shares will potentially be value accretive

PIHC's share buyback proposal (20% of outstanding shares at INR 600 per share) is more tax efficient and increases fair value per share compared to normal dividend payout, in our view. This will lead to a potential cash outflow of INR 25 bn (INR 120 per share), post which the company will have INR 35 bn of cash. The offer will be open for tendering shares by Jan-Feb 2011 and will include participation by promoters in the same proportion as minority shareholders, thereby maintaining the overall proportionate share holding. We estimate the (post share buyback) fair value of the stock at INR 500-600 per share, based on residual business (11x FY12E valued at INR 100) and cash retained (valued at 0.75-1.0x at INR 400-500), which provides downside support to CMP, in our view.

Outlook and valuations: Recommend buyback; 'Under Review'

We believe that shareholders should avail of the current open offer and tender shares given marginal upsides from current fair value of residual business. Moreover, option to not tender shares is dilutive to current shareholders and only marginally accretive at fair value of residual business. We also note that the share buyback would likely benefit long term investors in PIHC to short term investors. However, given the uncertainty and risks associated with cash utilization (PIHC has indicated that strategic utilization of cash proceeds would likely be medium-term and not necessarily in healthcare), we have put our TP and recommendation 'Under Review'.

Financials (Consolidated)

Year to March	Q2FY11	Q2FY10	% change	Q1FY11	% change	FY10	FY11E
Net revenue (INR mn)	7,520	10,000	(24.8)	8,424	(10.7)	36,711	24,575
EBITDA (INR mn)	(127)	1,774	(107.2)	1,290	(109.9)	7,268	2,340
Rep. net profit (INR mn)	125,404	1,063	NM	807	NM	4,819	128,138
Adj. diluted EPS (INR)	(3.4)	5.0		3.5		23.4	11.8
Diluted P/E (x)						22.0	43.5
EV/EBITDA (x)						16.5	14.2
ROAE (%)						32.5	2.9

October 22, 2010

Reuters: PIRA.BO Bloomberg: PIHC IN

EDELWEISS RATINGS

Absolute Rating **UNDER REVIEW**

MARKET DATA

CMP	:	INR 515
52-week range (INR)	:	599 / 331
Share in issue (mn)	:	209.0
M cap (INR bn/USD mn)	:	107 / 2,413
Avg. Daily Vol. BSE/NSE ('000):	:	1,577.6

SHARE HOLDING PATTERN (%)

Promoters*	:	52.0
MFs, FIs & Banks	:	6.9
FIIIs	:	21.4
Others	:	19.7
* Promoters pledged shares (% of share in issue)	:	Nil

RELATIVE PERFORMANCE (%)

	Sensex	Stock	Stock over Sensex
1 month	0.4	5.3	4.9
3 months	11.8	8.1	(3.6)
12 months	16.0	34.6	18.5

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Table 1: Revenue mix by segment- Consolidated

	(INR mn)							
Year to March	Q2FY11	Q2FY10	% change	Q1FY11	% change	FY10	FY11E	FY12E
Domestic formulations	4,078	5,218	(21.9)	4,613	(11.6)	20,002	9,300	1,500
Pharma solutions	2,136	2,701	(20.9)	1,748	22.2	9,809	8,900	9,830
- PSAI	858	1,194	(28.2)	660	29.9	4,718	3,700	4,440
- PSAO	1,279	1,508	(15.2)	1,088	17.5	5,091	5,200	5,390
Global critical care	640	885	(27.7)	1,082	(40.8)	3,277	4,000	5,158
Pathlabs	335	548	(38.9)	536	(37.6)	2,064	871	-
Others	331	647	(48.8)	445	(25.5)	1,558	1,504	1,524
Net sales	7,520	10,000	(24.8)	8,424	(10.7)	36,711	24,575	18,012

Residual business (Excl OTC)	Q2FY11	Q2FY10	% change	Q1FY11	% change	FY10	FY11E	FY12E
Pharma solutions	2,136	2,701	(20.9)	1,748	22.2	9,809	8,900	9,830
Global critical care	640	885	(27.7)	1,082	(40.8)	3,277	4,000	5,158
Others	331	647	(48.8)	445	(25.5)	1,558	1,504	1,524
Net sales	3,108	4,234	(26.6)	3,275	(5.1)	14,644	14,404	16,512

Source: Edelweiss research

Note: PSAI implies pharma solutions from India assets; PSAO implies pharma solutions outside India; OTC means over the counter products reported as part of domestic formulations business, the deal does not include OTC business.

Table 2: Deal value of Domestic formulations and Diagnostics business

Deal value - domestic business	
Payable at time of closure (USD mn)	2,200
Annuity payment (USD mn, FY12-15)	400
NPV of the annuity payment @ 12%	1,215
Total deal value (USD mn)*	3,415
@ INR /USD	47
Total deal value (INR mn)	159,431
EV/Sales	9.0
EV/EBITDA	29.7

Note: Deal value as stated by company is USD 3.8 bn/INR 170 bn (USD 2.2 bn upfront payment and cumulative annuity of USD 1.6 bn)

Deal value - diagnostics services		(INR mn)
Implied equity value	3,752	
Debt (in books of PDSL)	2,248	
Total enterprise value	6,000	
Deal consideration		
Upfront cash	3,000	
Non convertible debentures (10%)	1,650	
Equity (10% of SRL+PDSL with buyback over 3 years at 10% IRR)	1,350	
Total deal consideration	6,000	
EV/ Sales	2.9	
EV/EBITDA	15.8	

Source: Edelweiss research

Note: SRL is super Religare limited (acquiring entity) and PDSL is pharma diagnostics services Limited, a wholly owned subsidiary of Piramal healthcare being sold to SRL for consideration of INR 6.0 bn

Table 3: Fair value of business post deal

Fair value of Piramal Healthcare	(INR mn)		
Value of cash / share (0.8x to 1x)	400 to 500		
Value of residual business / share (11x FY12E Earnings)	100		
Fair value of business / share	500 to 600		
Value of cash retained in business	(INR mn)		
Deal value - domestic business	159,431		
Deal value - diagnostics business	6,000		
Tax outflow	36,677		
Tax rate - LTCG (%)	22.0		
Post tax deal consideration	128,754		
Utilization of proceeds			
Debt repayment	12,950		
Non compete fees	3,500		
Share buyback	25,080		
Total cash retained in business	87,224		
Shares outstanding (mn)	167		
Cash value per share (INR)	522		
Value of residual business	FY10	FY11E	FY12E
Retained businesses	15,644	15,604	18,012
EBITDA	2,022	2,060	2,474
Estimated margin (%)	12.9	13.2	13.7
PAT	1,410	1,373	1,517
Fair value of residual business @ 11x FY 12 earnings	16,683		
Shares outstanding (mn)	167		
Residual business value per share (INR)	100		

Source: Edelweiss research

Table 4: Buy back of shares

	Jun-10
Shares outstanding (mn)	209.0
% of holding for offered for buyback	20.0
Shares for buyback (mn)	41.8
Buy back price / share (INR)	600
Total cash outflow (INR mn)	25,080
Cash per share	120.0

Source: Edelweiss research

Financial snapshot - Consolidated

(INR mn)

Year to March	Q2FY11	Q2FY10	% change	Q1FY11	% change	FY10	FY11E	FY12E
Revenue	7,520	10,000	(24.8)	8,424	(10.7)	36,711	24,575	18,012
Raw material costs	2,956	3,931	(24.8)	3,278	(9.8)	13,972	9,953	7,745
Gross profit	4,564	6,069	(24.8)	5,146	(11.3)	22,739	14,622	10,267
Employee costs	1,633	1,725	(5.4)	1,575	3.7	5,853	4,300	2,200
R&D costs	166	198		166		702	632	756
Other expenses	2,892	2,372	21.9	2,116	36.7	8,916	7,350	4,836
Total operating expenses	4,691	4,295	9.2	3,856	21.7	15,470	12,282	7,793
EBITDA	(127)	1,774	(107.2)	1,290	(109.9)	7,268	2,340	2,474
EBITDA margin (%)	(1.7)	17.7		15.3		19.8	9.5	13.7
Net finance expense (income)	29	254	(88.6)	145	(80.2)	916	194	-
Depreciation	318	375	(15.2)	381	(16.4)	1,427	1,099	750
Other income	203	0.0		0		141	1,502	2,100
PBT	(271)	1,145	(123.7)	764	(135.5)	5,067	2,548	3,823
Income tax expense	439	94	367.0	27	NM	180	36,721	459
PAT	(710)	1,051	(167.6)	737	(196.3)	4,886	1,981	3,365
Extraordinaries (loss)/gain	126,114	12		70	NM	(68)	162,311	-
Net profit	125,404	1,063	NM	807	NM	4,819	128,138	3,365

as % of revenues

COGS	39.3	39.3		38.9		38.1	40.5	43.0
Employee costs	21.7	17.3		18.7		15.9	17.5	12.2
Other expenses	38.5	23.7		25.1		24.3	29.9	26.9
Total operating expenses	62.4	43.0		45.8		42.1	50.0	43.3
Gross profit	60.7	60.7		61.1		61.9	59.5	57.0
EBITDA	(1.7)	17.7		15.3		19.8	9.5	13.7
Net profit	1667.6	10.6		9.6		13.1	521.4	18.7
Tax rate	(161.5)	8.2		3.5		3.6	1441.0	12.0

Table 5: Exceptional items

(INR mn)

Profit from sale of formulation business	160,066
Sale of investmetn in diagnostics	2,858
Investment write-off in biosyntech	(223)
Plant closure cost	(407)
VRS NLDL and Morepeth	(74)
Tax payment	(36,000)
Total	126,220

Source: Company

Table 6: Profit on sale of domestic formulations business

Total sales consideration	171,400
Less: Expenses	
Fixed assets	3,918
Working capital	2,067
Promotor non compete fees	3,500
Employee related payments	1,315
Other expenses	535
Total expenditure	11,335
Total profit on sale of domestic business	160,065

Source: Company

■ Company Description

PIHC hived off its domestic formulation and diagnostics businesses which accounted for 60% of its total sales in FY10 for total consideration of USD 3.9 bn. The retained business has sales of INR 15.6 bn (~43% of total sales in FY10) and includes custom manufacturing (CRAMs), global critical care, and OTC business (including allergen JV). The company, through various acquisitions outside India, scaled up its CRAMs business (pharma solutions). The company has adopted a unique strategy in regulated markets by becoming a partner of choice for big pharma where it leverages its manufacturing skills to provide value to innovator companies. PIHC also has a niche presence in the global critical care business, comprising inhalation anesthetic (IA) products (sevoflurane, desflurane, halothene and isoflurane). The company acquired Minrad (IA) in FY09 and Injectibles anesthetics business from Bharat serums in FY10 to expand its critical care franchise. With these acquisitions, PIHC has a complete portfolio of product offerings in the IA segment.

■ Investment Theme

We estimate earnings from residual business to grow at 4% in FY10-12E. The sales are expected to grow at 7% CAGR in FY10-12E. We expect CRAMs to turnaround with 10% Y-o-Y growth in FY12E from a low base in FY10 and FY11. Further, Minrad acquisition provides visibility to GCC business and potential for growth post launch of desflurane by FY12. We expect critical care to grow at ~25% CAGR over medium term, led by 47% growth in Minrad to USD 95 mn by FY12. We believe company will pursue acquisitions to scale up the residual businesses and will also invest in new ventures, the impact of which cannot be currently estimated due to lack of visibility on these ventures. However the cash and investments are expected generate INR 1.5-2.1 bn of interest income in FY11-12 respectively.

■ Key Risks

Utilization of proceeds from deal consideration

The company post deal closure will likely have ~INR 107 bn in cash and expects it to utilize the proceeds for expanding current businesses with specific focus on CRAMs and OTC. We believe PIHC would continue to build current businesses through acquisitions. However with the large cash inflow from deal, management would likely pursue larger transactions which increases execution risk and impacts future earnings. Further management intent to pursue non-healthcare business will likely be perceived as negative, in our view.

Financial Statements

Income statement					(INR mn)
Year to March	FY08	FY09	FY10	FY11E	FY12E
Income from operations	28,735	32,815	36,711	24,575	18,012
Gross revenues	29,318	33,116	36,813	24,600	17,903
Less: excise	835	668	568	492	358
Net revenues	28,483	32,448	36,245	24,108	17,545
Other operating income	253	367	466	466	466
Total operating expenses	23,311	26,176	29,443	22,235	15,538
Materials cost	10,912	12,365	13,972	9,953	7,745
Employee cost	4,709	5,010	5,853	4,300	2,200
R&D cost	806	849	702	632	756
Selling, admin and general expenses	6,884	7,953	8,916	7,350	4,836
EBITDA	5,425	6,639	7,268	2,340	2,474
Depreciation and amortisation	947	1,196	1,427	1,099	750
EBIT	4,477	5,443	5,842	1,241	1,723
Net Interest expense/(income)	463	838	916	194	0
Other income	54	(752)	141	1,502	2,100
Profit before tax (excl extraordinary)	4,068	3,854	5,067	2,548	3,823
Provision for tax	377	219	180	36,721	459
Core profit	3,660	3,639	4,884	1,981	3,365
Extraordinary items	(339)	(446)	(69)	162,311	0
Reported profit after tax	3,352	3,188	4,817	128,138	3,365
Minority interest & others	14	26	(2)	0	0
Reported profit after minority interest	3,338	3,163	4,819	128,138	3,365
Equity shares outstanding (mn)	209	209	209	167	167
EPS (INR) basic	17.4	17.3	23.4	11.8	20.1
Diluted shares (mn)	209	209	209	167	167
EPS (INR) adjusted	17.4	17.3	23.4	11.8	20.1
CEPS (INR)	22.0	23.0	30.2	18.4	24.6
Dividend per share (INR)	4.2	4.2	5.4	2.5	4.3
Dividend payout (%)	24.1	24.3	23.1	21.4	21.4

Common size metrics- as % of net revenues

Year to March	FY08	FY09	FY10	FY11E	FY12E
Cost of revenues	38.0	37.7	38.1	40.5	43.0
Selling, admin and general expenses	24.0	24.2	24.3	29.9	26.9
R & D cost	2.8	2.6	1.9	2.6	4.2
Total operating expenses	81.1	79.8	80.2	90.5	86.3
Depreciation and amortisation	3.3	3.6	3.9	4.5	4.2
Interest expenditure	1.6	2.6	2.5	0.8	0.0
EBITDA margins	18.9	20.2	19.8	9.5	13.7
Net profit margins	12.9	11.2	13.5	8.2	19.2

Growth metrics (%)

Year to March	FY08	FY09	FY10	FY11E	FY12E
Revenues	17.1	14.2	11.9	(33.1)	(26.7)
EBITDA	48.2	22.4	9.5	(67.8)	5.7
Net profit	57.7	(0.6)	34.2	(59.4)	69.9
PBT	49.8	(5.3)	31.5	(49.7)	50.0
EPS	57.2	(0.9)	35.2	(49.3)	69.9

Balance sheet	(INR mn)				
As on 31st March	FY08	FY09E	FY10	FY11E	FY12E
Equity capital	418	418	418	334	334
Reserves & surplus	10,508	12,753	16,431	119,077	121,601
Common shareholders equity	10,926	13,171	16,849	119,412	121,935
Total shareholders funds	10,926	13,171	16,849	119,412	121,935
Borrowings	7,163	13,391	12,950	6,450	5,950
Deferred tax liability (net)	897	726	568	337	337
Minority interest	49	75	-	-	-
Sources of funds	19,035	27,362	30,366	126,199	128,223
Net block	12,005	19,464	19,774	14,903	16,653
Capital work in progress	581	927	1,357	-	-
Investments	653	278	326	51,560	51,560
Inventories	4,032	4,834	4,695	3,494	3,209
Sundry debtors	4,449	4,866	4,530	2,975	3,209
Cash and bank balances	551	946	412	7,716	20,180
Loans and advances	2,509	4,161	6,507	75,894	57,494
Other current assets	145	102	79	313	344
Total current assets	11,687	14,908	16,221	90,392	84,435
Total current liabilities and provisions	5,890	8,215	7,310	30,656	24,425
Net current assets	5,797	6,692	8,911	59,736	60,010
Uses of funds	19,035	27,362	30,366	126,199	128,223
Book value per share (INR)	52	63	81	714	729

Free cash flow	(INR mn)				
Year to March	FY08	FY09	FY10	FY11E	FY12E
Net profit	3,338	3,163	4,819	128,138	3,365
Depreciation	947	1,196	1,427	1,099	750
Others	78	(146)	(159)	(231)	-
Gross cash flow	4,364	4,213	6,086	129,006	4,115
Less: Changes in WC	(124)	(501)	(2,752)	(43,522)	12,191
Operating cash flow	4,240	3,711	3,334	85,485	16,306
Less: Capex	(1,295)	(9,001)	(2,166)	(500)	(2,500)
Free cash flow	2,945	(5,290)	1,168	84,985	13,806

Cash flow metrics	(INR mn)				
Year to March	FY08	FY09	FY10	FY11E	FY12E
Operating cash flow	4,240	3,711	3,334	85,485	16,306
Financing cash flow	(1,202)	6,052	529	(32,074)	(1,341)
Investing cash flow	(1,660)	(8,627)	(2,213)	(46,107)	(2,500)
Net cash flow	1,378	1,137	1,650	7,304	12,464
Capex	(1,295)	(9,001)	(2,166)	(500)	(2,500)
Dividends paid	(1,027)	(1,027)	(1,316)	(495)	(841)

Profitability and liquidity ratios

Year to March	FY08	FY09	FY10	FY11E	FY12E
ROAE (%)	33.5	30.0	32.5	2.9	2.8
ROACE (%)	22.4	22.6	19.7	2.1	2.0
Inventory days	141	131	124	150	158
Debtors days	52	52	47	56	63
Payable days	110	118	117	260	305
Cash conversion cycles	82	65	54	(54)	(85)
Current ratio	2.0	1.8	2.2	2.9	3.5
Debt/ EBITDA	1.3	2.0	1.8	2.8	2.4
Debt/equity	0.7	1.0	0.8	0.1	0.0
Adjusted debt/Equity	0.7	1.0	0.8	0.1	0.0

Operating ratios (x)

Year to March	FY08	FY09	FY10	FY11E	FY12E
Total asset turnover	1.5	1.4	1.3	0.3	0.1
Fixed asset turnover	2.4	2.1	1.8	1.4	1.1
Equity turnover	2.6	2.7	2.4	0.4	0.1

Du Pont Analysis

Year to March	FY08	FY09	FY10	FY11E	FY12E
NP margin	12.8	11.1	13.5	8.2	19.2
Total assets turnover	1.5	1.4	1.3	0.3	0.1
Leverage multiplier	1.7	1.9	1.9	1.1	1.1
ROAE	33.5	30.0	32.5	2.9	2.8

Valuation parameters

Year to March	FY08	FY09	FY10	FY11E	FY12E
Adjusted EPS (INR)	17.4	17.3	23.4	11.8	20.1
EPS YoY growth (%)	57.2	(0.9)	35.2	(49.3)	69.9
CEPS (INR)	22.0	23.0	30.2	18.4	24.6
Diluted PE (x)	29.5	29.8	22.0	43.5	25.6
Price/BV(x)	9.9	8.2	6.4	0.7	0.7
EV/Sales (x)	4.0	3.7	3.3	1.4	1.1
EV/EBITDA (x)	21.0	18.1	16.5	14.2	8.2
Dividend yield (%)	0.8	0.8	1.0	0.5	0.8

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Coverage group(s) of stocks by primary analyst(s): Pharmaceuticals

Aurobindo Pharma, Cipla, Dr.Reddys Laboratories, Lupin, Piramal Healthcare, Sun Pharmaceuticals Industries, Torrent Pharmaceuticals

Piramal Healthcare



Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	116	45	12	176
* 3 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	110	53	13	

Recent Research

Date	Company	Title	Price (INR)	Recons
06-Oct-10	Unichem Laboratories	On a firm footing; Visit Note	535	Not Rated
21-Sep-10	Sun Pharma.	Completed acquisition of Taro; event update	1,931	Hold
08-Sep-10	Sun Pharma.	Likely denouement in Taro saga; Event Update	1,723	Hold
02-Sep-10	Shasun Pharma.	Interesting times ahead; Visit Note	81	Not Rated

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

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