Emkay

Private Client Research

7 December 2007

Plethico Pharma Ltd.

Initiating Coverage

Growing herbal way

BUY

Price	Target
Rs 436	**Rs 569**

Sensex - 19,796

Price Performance

(%)	1M	3M	6M	1YR
Plethico	4.6	4.6	30.4	21.8
Rel. to Sensex	1.9	-22.4	-10.3	-19.9

Source: Capitaline

Stock Details

Sector	Pharmaceuticals
Reuters/ Bllomberg	PLBP.BO/PELP.IN
Shares Outstanding (RS Mn)	34.01
Face Value (Rs)	10
52 week H/L Rs	507.7/298
Market Cap (Rs bn)	14.9
Daily Avg Volumes(No of Shares)	55,363.0
Daily Avg Turnover (Rs Mn)	24.4

Shareholding Pattern (%)

Promoters	87.01
FIIS	2.41
Banks/MFs	6.69
Public	3.89

Souce (30th September '07)
Source: Capitaline

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Unlike other pharmaceutical players in the Indian market who are fighting for a pie of the available export generics opportunity, Plethico Pharma Ltd (PPL) has adopted a completely different path by focusing on high margin Herbals and Nutraceuticals in the International markets. After initially focusing on the unregulated markets such as the CIS and Africa, the company is now all set to enter the regulated markets like the US and Europe. PPL recently acquired Natrol Inc., a leading manufacturer and marketer of nationally branded nutritional products in USA. Globally, regulated markets account for over two thirds of the herbal / nutraceuticals product markets. Plethico was primarily present in semi regulated markets. We believe these to be huge untapped potential for the company. Considering that sales from the US market are expected to gather momentum in by FY08E and given the company's continued strong performance in other markets, the outlook for Plethico appears quite optimistic. We expect PPL to report strong growth in revenues of CAGR 36% during FY07-FY09E. We expect the company to record Net profit growth of CAGR 17% during FY07-FY09E. At current market price, the scrip discounts FY08E EPS of Rs 43.8 by 9.9 x and looks attractive for long term investment. We initiate our coverage on the company with a 'BUY' at target price of Rs 569.

Herbals and Nutraceuticals : Key revenue driver

This is the focus segment for Plethico contributing 49% of total revenue. Plethico has a strong international marketing and distribution presence for its herbal formulations. On account of being well vertically integrated player, Plethico has been able to garner a decent gross margin of 70-75% from the Herbal business. On the back of the strong sales from the Herbal/Nutraceutical business, we expect total exports to grow at CAGR 49% over FY07-FY09E.

US market - Acquisition would boost revenues

PPL recently acquired Natrol Inc., a leading manufacturer and marketer of nationally branded nutritional products in the USA for US $ 80.7 mn. This acquisition will not only expand PPL's product portfolio but also provide ready retail and distribution network in high value markets of US and Europe. This acquisition will increase its revenue substantially. We expect US market to contribute 38% to total sales in FY08E. We expect PPL to report strong growth in revenues of CAGR 36% during FY07-FY09E.

New product launches to drive growth

The Company has plans to launch series of new products in both herbal as well as allopathic segments to drive growth going forward. The Company is also increasing its R&D spend from 4.2% of sales to around 6%.

Attractive Valuation

The stock is currently trading at 9.9x FY08E EPS of Rs 43.8 and 8.5x FY09E EPS of Rs. 51.5. It is trading at 8.3x FY08E and 6.4x FY09E EV/EBDITA. We believe these valuations are reasonable and offer excellent long term investment opportunity. We recommend 'BUY' on the stock with target price of Rs. 569. At our target price, the stock discounts FY08E EPS by 13 times.

Key Financials (Rs Mn)

(Rs Mn)	Net Sales	EBDITA	EBDITA (%)	PAT (Rs)	EPS (Rs)	EPS Grth (%)	ROCE (%)	P/E (x)	EV/EBDITA (x)
FY06	3174.6	989.4	31.2	860.3	25.3	-65.8	18.0	17.3	15.3
FY07E*	5067.6	1560.3	30.8	1454.9	42.7	69.1	16.0	10.2	11.7
FY08E	8146.4	1982.0	24.3	1703.3	43.8	2.5	17.5	9.9	8.3
FY09E	9451.3	2306.3	24.4	2001.9	51.5	17.5	17.4	8.5	6.4

*Source: Emkay PCG Research * Adjusted to 15 month period*

Company Background

PPL is one of the leading pharmaceutical player with major focus on Herbals and Nutraceuticals

Incorporated in 1991, Plethico Pharmaceuticals Ltd. (PPL) manufactures herbals, pharmaceuticals and nutraceuticals. The Group came into existence in 1964 to undertake the manufacture and sale of formulations in the domestic market. However, over 90% of the products fell under the purview of the DPCO, which in turn, squeezed the company's margins. Hence, this division was entirely sold off in 2003 to Shreya Life sciences. The entire consideration, coupled with internal accruals, was invested in fuelling inorganic growth and the company is currently focusing primarily on Herbal & Nutraceuticals formulations. The company has three state-of-the-art WHO-GMP certified manufacturing plants. Two plants are located at Kalaria and Manglia near Indore, in the state of Madhya Pradesh and one another unit is located in a Special Economic Zone, Kandla in the state of Gujarat. These plants are fully equipped to manufacture tablets, capsules, liquid orals, powders, ointments and creams.

PPL is a leading player in Anti - TB and Anti - Malarial segments

The company currently has presence in niche segments like Herbal medication, NDDS, Cardiovascular, Diabetology and other life style drugs, Nutraceuticals, Medicated candies, Food supplements and OTC/ Consumer products besides Branded generic formulations. PPL also offers Contract manufacturing as one of the business areas of growth and offer both toll manufacturing and packaging operations to several domestic as well as International companies of repute. PPL was the first company to introduce doxycycline based anti-bacterial formulation as well as co-trimoxazole based formulation in the domestic market. The company is leading player in anti-TB and anti malarial segments. PPL's major brands include: Travisil, Therasil, Mountain Herbz, Effertabz and Coach's Formula etc. In 2003, PPL launched Coach's Formula – a branded protein health drink. The company has also introduced for the first time in India, novel ayurvedic/ herbal preparation under the brand name Syndrex – single herb methi extract.

PPL has strong foothold in CIS, GCC, Eastern Europe, African and ASEAN markets

The company has developed strong global presence with established brands in the CIS (Commonwealth of Independent States), Eastern Europe, Gulf Cooperation Council (GCC), African, Latin American and South-East Asian markets. Its exports constituted 68% of revenues as on year ended September 2007. In the domestic market, PPL sells the products in sport nutrition, confectionery, Pharma OTC and Herbal supplements segments.

Exports accounts for 68% of total revenues

The company always adopted the 'Branded Generic' model for marketing its allopathic formulation in India. It has replicated the same model in the semi-regulated markets spanning Asia, Africa, Latin America and Russia / CIS regions. Its formulation Business operates in over 45 countries including India. PPL employs approximately 250 sales personnel across the markets; of these over 150 sales representatives and front-line mangers are employed in markets outside India.

Product range in form of delivery type and market details

Delivery Type	Product Name	Markets
Capsules	BCAA Plus,Chronium Piclonate,Orfedipine, Red Horse,Tone and Tighten,X-Trim Cut	Domestic and Export
Cream / Ointments	Travisil cold rub,Tricort G.C.Cream	Exports
Dry Powder	Dexamethasone sodium,Diclofanac FD injection, Falquin,Fenagesic,Furosemide,Gentamycin, Plenalgin,RezQ 500,Togesic 30	Exports
Powder	Coach's formula,Energizer,L-Glutamate Suspension / Syrup Bendam,Coolz,Emigyl,Faramax,Fastorik,Nimez, Recofast,Releivo,Therasil	Domestic and Export
Tabs / Lozenges	Actifresh,Amino Power,Coolz,Bytes,Octoliv, Therasil Sore Throat,Travisil Loz.	Domestic and Export

Source: Company, Emkay Private Client Research

Financial Performance

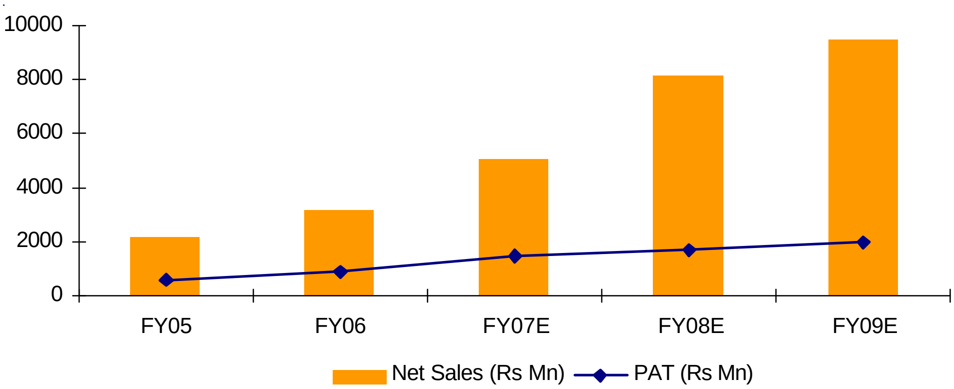
Particulars	Q4FY07	Q4FY06	%YoY	FY07	FY06	%YoY
Net sales	1233.5	1061.3	16.2	4351.2	3284.2	32.5
Other Income	3.3	1.9	75.8	11.1	12.9	-14.2
Total Income	1236.8	1063.1	16.3	4362.3	3297.1	32.3
Total Expenditure	856.2	778.8	9.9	3078.5	2303.0	33.7
EBDITA	380.6	284.3	33.9	1283.8	994.1	29.1
EBDITA (%)	30.6	26.6	14.9	29.3	29.9	-2.1
Interest	20.1	19.3	4.3	66.6	54.3	22.6
Depreciation	16.6	6.1	171.6	68.4	57.5	18.9
PBT	343.9	258.9	32.8	1148.8	882.3	30.2
Provision for tax	6.2	0.0	-	29.9	22.0	35.8
PAT	337.7	258.9	30.4	1119.0	860.3	30.1
Extraordinary Items	164.6	0.0	-	164.6	0.0	-
ADJ PAT	502.3	258.9	94.0	1283.6	860.3	49.2
Equity Capital	340.7	340.7	0.0	340.7	340.7	0.0
EPS (Rs)	14.7	7.6	93.9	37.7	26.9	39.9

Source: Company, Emkay Private Client Research

The company reported decent performance during the last quarter for the year ended September 2007. Its top line grew by 16.2% YoY to Rs 1233.5 mn during Q4FY07. On a cumulative basis for FY07, Total revenue increased by 32.5% YoY Rs 4351.2 mn. The company's top line growth in Q4FY07 would have been much higher, but for the tightening of debtors in Russia, which in turn, impacted Russian sales in the quarter. Its heavy dependence on this market has been affecting its debtor position severely. Plethico is now making serious efforts to bring down its debtor days and thereby, reduce its dependence even on the Russian and CIS markets. As a result, the company's overall sales from Russia and CIS were impacted in Q4 FY07. Sales from the CIS markets were consciously brought down from 34% of overall sales in FY06 to 31% in FY07. Also, the overall growth from the CIS markets was up just 22% Y-o-Y as against a Y-o-Y growth of 100%(+) recorded earlier. With PPL's efforts to enter newer markets, such as the US and Europe, the company's dependence on the CIS markets will decline further going forward, and in turn, help bring down its debtor days.

In Q4FY07, PPL reported EBDITA growth of 33.9% YoY to Rs 380.6 mn compared to Rs 284.3 mn in corresponding quarter last year. For FY07, EBDITA growth stood at 29% YoY to Rs 1283.8 mn. PPL's EBDITA margin grew by 400 basis points to 30.6% during the quarter. PPL recorded 30.4% YoY growth at net profit level to Rs 337.7 mn during Q4FY07 and 30.0% YoY growth to Rs 1119 mn for FY07. Plethico had 30th September as it's Year ending, but have decided to change their year ending to 31st December. So, consequently, FY07 would be a 15-month period.

Revenue and PAT Growth



Source: Company, Emkay Private Client Research

Investment Rationale

Herbals & Nutraceuticals : Key revenue driver

Herbals and Nutraceuticas is major focus area for PPL and contributes 49% of total revenue

This is the focus segment for Plethico contributing 49% of total revenue. PPL has a total of 45 products in this segment with 'Travisil' being the leader. This highly successful segment has a range of herbal products in the Cough and Cold category. Travisil alone contributes to over 15% of the total sales. Plethico has a strong international marketing and distribution presence for its herbal formulations and is vertically integrated with its herbal preparations coming from its own organic farms in Jammu & Kashmir. Organic farming will help the company source important herbs, which will enhance the quality of the end products. This will enable it to source herbs with uniform level of potency. Availability of uniform quality of herbs is important in attaining high consistency of extracts. Besides, the entry into regulated markets like US and Europe would become easier with well-integrated set-up. With recent acquisition of US based herbal manufacturing and distributing company Natrol Inc., we expect share of the segment to increase substantially going forward. On account of being well vertically integrated, Plethico has been able to garner a decent gross margin of 70-75% from the Herbal business.

On account of being well vertically integrated, PPL enjoys gross margins of 70-75% from herbal business

PPL has over 400 different formulations in 39 therapeutic segments

In line with its focus on Herbals, the company also has a good portfolio of Consumer Healthcare Products & Nutraceuticals, Pharmaceutical Formulations, Hospital Consumables, and Disposable & Veterinary Products, with over 400 different formulations in 39 therapeutic segments.

PPL owns best selling brand in Sports Nutrition segment - Coach's Formula

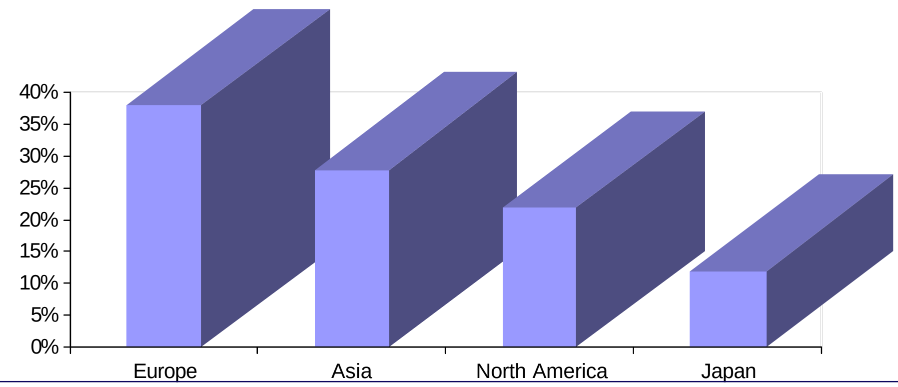
In the Consumer Healthcare segment, Plethico offers Confectionary, Pharma OTC and Herbal supplements. The other products in this segment include those in the Oral Hygiene, Foot Care, Digestive Care, Actifresh and Cough & Cold categories. In Nutraceuticals, the company owns one of the best selling brands in the Sports Nutrition segment - Coach's Formula, which includes an entire range of sports and health nutrition products, such as Super Protein, Creatine, Tone & Tighten, Amino Power, etc.. The Indian Nutraceutical market is still in a nascent stage and its value is pegged at approximately $40 mn, excluding multi-vitamin formulations and ayurvedic formulations. The market is likely to reach $270 mn in the next three years. As per study conducted by the Department of ISM&H, the total turnover of ayurveda, siddha, unani and homeopathy was Rs. 4,200 crores of which ayurveda and siddha together accounted for Rs. 3,596 crores and it is growing at an average annual compound growth of 10 percent. Also, The Over-The- Counter (OTC) market in India has been reporting a growth of 7.7% Y-o-Y and grew steadily at a CAGR of 8.3% over the period 2002-2006. Valued at $2.5 bn in 2006, the market is expected to grow at a CAGR of 6.3% over 2006-2011 to reach $3.4 bn by 2011.

Indian nutraceuticals market value pegged at $ 40 mn and expected to reach $270 mn in next 3 years

Global herbal markets is estimated at $ 60 bn growing at 7% per annum

WHO estimates put the global market for herbal products, including medicines, health supplements, and herbal beauty and toiletry products at over US$ 60 billion, which is growing at 7% per annum. Europe is the largest market (38%), with Germany contributing as big as 49% of the licensed herbal sales, followed by Asia (28%), North America (22%) and Japan (12%). Some of the leading manufacturers of herbals come from Germany, China, France, Italy and India.

Region wise share of Global Herbal Products market



Source: Company, Emkay Private Client Research

India accounts for only 1% of global herbal exports market provides PPL huge growth opportunity

The population and income growth in the developing world and increasing interest in the industrialized nations has greatly expanded the demand and importance of medicinal plants and the products derived from them, inspite of the growth of the pharmaceutical industry and the unceasing development of new and more effective synthetic and biological medicinal products. Also according to Kate and Laird, about 42% of the sales of the top 25 selling drugs worldwide are either biologicals, natural products, or entries derived from natural products. Modern pharmacopoeia still contains at least 25% of drugs derived from plants. The Pharmaceutical industry's attitude to medicinal plants and natural products has also changed dramatically over the past few years taking into account the increased awareness and interest in medicinal plants and natural treatments amongst both the scientific community as well as the general public. The world is undergoing transformation by going green both in term of food habits and alternate forms of medication. The popularity of Yoga, Ayurveda and Chinese medications is on the rise especially in the west. The Herbal market is likely to expand further with increase in its awareness. Today India accounts for only around one percent of global herbals export market. We believe that these macro factors provide PPL huge growth opportunity going forward.

Allopathy

Allopathic division contributes nearly 20% of PPL top line

With over 400 different formulations in more than 39 therapeutic segments, Plethico has a strong presence in the Antimalarials, Anti-tubercular, Anti-infectives, Pain, Cardiac, Gastro, Contraceptives and Cough & Cold segments. The Allopathic division contributes nearly 20% to the company's topline. Plethico has its product presence in 45 countries with a well-qualified fleet of 350 sales personnel. The company has plans to launch series of new products in this segment such as effervescent tablets, mouth dissolving tablets, and centre-filled lozenges for diabetic and cancer patients.

Segment wise Revenue Break Up

Particulars (Rs Mn)	FY06	FY07E*	FY08E	FY09E	CAGR (%) FY07E - FY09E
Herbal / Nutraceutical	1540.0	2638.9	5780.0	6804.9	60.0
% Share	*47.0*	*51.7*	*70.5*	*71.5*	
Allopathy	640.0	998.5	942.6	1112.2	6.0
% Share	*19.5*	*19.6*	*11.5*	*11.7*	
OTC	210.0	383.2	398.5	518.1	16.0
% Share	*6.4*	*7.5*	*4.9*	*5.4*	
Contract Manufacturing	890.0	1082.7	1082.7	1082.7	-
% Share	*27.1*	*21.2*	*13.2*	*11.4*	
Total Revenue	**3280.0**	**5103.3**	**8203.8**	**9517.9**	**36.0**

*Source: Emkay Private Client Research * Adjusted to 15 month period*

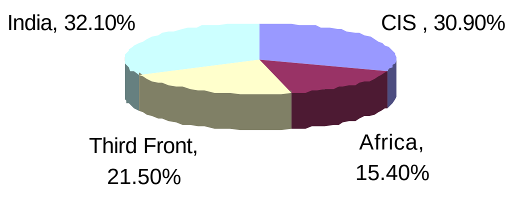
Exports

Exports accounts for 68% of total revenue of the company

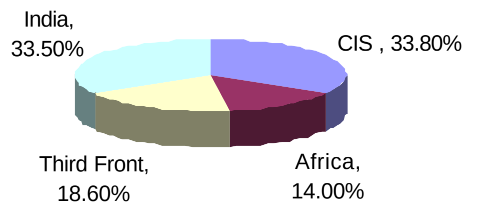
70% of total exports were from Herbals and Nutraceuticals

Exports accounts for around 68% of total revenue of the company. PPL has a strong foothold in semi-regulated markets such as CIS, Africa, Middle East and South – East Asia. Due to fewer regulations and underdevelopment, these markets are easy to penetrate and lucrative to operate. Thus these markets offer high realizations and margins. Over 70% of the company's total exports were from Herbals/ Nutraceuticals. Also, The Company has sound hedging mechanism in place to mitigate Export and Import risk.

Geographical Sales Mix - FY07



Geographical Sales Mix - FY06



Source: Company, Emkay Private Client Research

CIS Markets

CIS and Russian exports accounts for 31% of PPL revenue

With sales of Rs 1350 mn for FY07, CIS accounts for 31% of Plethico's revenue. 87% of CIS sales are from herbal / nutraceutical products with balance coming from allopathic products. Travisil has been a huge success in the CIS countries.

With major exports coming from credit markets like CIS, PPL had a problem of high debtor days. The long working capital cycle was the main concern due to large number of credit transaction. This region was also characterized with default risk. PPL focused to move towards cash –based pharmacy business to address above issues. As a forward integration measure, in FY04 PPL began acquiring majority stake in marketing and distribution (M&D) units in CIS countries. It had remitted $29.9m to Pharmqual Investments - FZC towards acquisition of shares in 6 entities of Rezlov group of companies, a pharmaceutical distribution chain, with a network in Russia, Kazakhstan, Moldova, Kyrghyzstan, Ukraine and Azerbaijan. Holding the majority stake in the M&D units, Plethico planed to have better control over the customers of these units and desired to reduce the debtor levels significantly. It had plans to fund these debtors at the respective country level by bank financing, which would have lower the burden on Plethico. Under these arrangements, Plethico was able to get 2 to 4 times per unit realization for some of its major products as compared to pre-acquisition levels.

PPL forayed into high value US market to de-risk itself from the high concentration in CIS countries

The company has recently divested part of its stake in its marketing and distribution subsidiaries located in CIS countries at a premium of 40% above its cost of acquisition. The proceeds of this investment along with US $ 75 mn FCCB was used to fund its recent acquisition in US. The company forayed into high value US market to de-risk itself from the high concentration on the CIS countries.

US market - Acquisition would boost revenues

Natrol Inc acquisition will not only expand PPL's product portfolio but also provide ready retail and distribution network in high value markets of US and Europe

PPL recently acquired Natrol Inc., a leading manufacturer and marketer of nationally branded nutritional products in the United States of America for US $ 80.7 mn. Natrol has a portfolio of health and wellness brands representing nutritional supplements, functional herbal teas and sports nutrition products. The company also manufactures supplements for its own brands and on behalf of third parties. Natrol distributes products in the USA through more than 50,000 retailers as well as internationally in over 40 other countries through distribution partners and subsidiaries in the United Kingdom and Hong Kong. Natrol has earned it an "A" rating from the Natural Products Association's Good Manufacturing Practices ("GMP") Certification Program — a designation achieved by less than ten percent of USA nutrition companies. With this acquisition, PPL would be able to consolidate its position as a leading global Herbal / Nutraceutical player with access to high value markets of USA, UK and Hong Kong. The acquisition will not only expand PPL's product portfolio but also provide ready retail and distribution network in high value markets of US and Europe. Considering that sales from the US market are expected to gather momentum by FY08, which, in turn, will help Plethico reduce its dependence on the Russian and CIS markets, and given the continued strong performance in other markets, the outlook for the company continues to appear quite optimistic. This acquisition will increase its revenue substantially. We expect US market to contribute 38% to total sales in FY08E.

On the back of the strong sales from the Herbal / Nutraceutical business, We expect total exports to grow at CAGR 49% over FY07-FY09E. A continued strong performance is expected going forward.

Domestic Sales

Domestic sales accounts for 32% of total revenue

Domestic Sales account for around 32% of total revenue of the company. Around 80% of Plethico's domestic sales are from contract manufacturing activities while the remaining from domestic OTC sales.

After the sale of the company's Rx brands in 2003, the plants were utilized for contract manufacturing activities. This is not a focus business for Plethico and is occurring by default due to the availability of readymade plants. As Plethico is able to develop the export markets, it will cut down the facility usage for contract manufacturing. Post November 2008, it plans to re-enter domestic allopathic market by launching niche off-patent lifestyle segment products for cardiovascular, diabetes, neuro-psychiatry diseases, through the expanded distribution network. It plans to differentiate by basing these products on NDDS, projects for the same are already on. It plans to increase its field force from current level of 100 to 500 over next two years. It distributes its product through a network of consignment agents, 20 stockists covering 5000 retailers. It plans to steadily expand its distribution network to all India bases to a level similar to what it exited in 2003.

New product launches to drive growth

PPL is increasing its R&D spend from 4.2% to 6%

The Company has plans to launch series of new products in both herbal as well as allopathic segments to drive growth going forward. The Company is also increasing its R&D spend from 4.2% of sales to around 6%.

Herbals	Allopathic
Centre filled sugar free lozenges	Mouth dissolving tablets (pediatric)
Vegetable Capsules-extension for Mountain Herbs	Centre filled Lozenzes as support medicine for Diabetic and Cancer patients
Formula for Liver ailment, Kidney stone,and anti-stress	Cephalosporin
Herbal Tea	Activity enhancing drugs

Source: Company, Emkay Private Client Research

Industry Overview

Global Scenario

Global pharmaceutical Industry is estimated at US$ 602 bn and is growing at around 9%

The global pharmaceutical industry has grown at the rate of 10% over the last seven years. The size of the global pharmaceutical industry is estimated at US$602 bn which is growing at around 9% and is concentrated in the developed world. Around 48% of the market is cornered by North America, 28% by the European Union and 11% by Japan as of December 2004. IMS Health projects that the global industry would register strong growth even in the face of continued government pressure on pricing and a number of widely used drugs going off patent. It is estimated to touch US$ 950 bn by 2010.

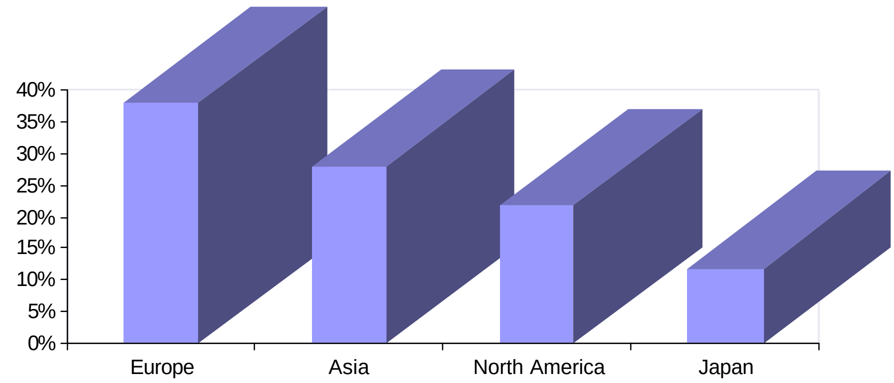
In the wake of hosts of drugs going off patent in the U.S., approximately US$80bn, higher purchasing power, increasing health care costs and well developed insurance and reimbursement system in developed countries, Indian pharma companies can sieze this opportunity and increase the market share in the global market. Due to low costs in nature and availability of skilled personnel, India has marked its presence in the global pharma industry and emerging as the R&D hub.

Herbal Market

Global herbal markets is estimated at $ 60 bn growing at 7% per annum

WHO estimates put the global market for herbal products, including medicines, health supplements, and herbal beauty and toiletry products at over US$ 60 billion and is growing at 7% per annum. Europe is the largest market (37%) followed by Asia (28%), North America (22%) and Japan (12%). Germany is one of the biggest markets in Europe accounting for 49% of the licensed herbal sales. Some of the leading manufacturers of herbals come from Germany, China, France, Italy and India.

Region wise share of Global Herbal Products market



Source: Company, Emkay Private Client Research

The key characteristics that differentiate the herbals from pharmaceuticals are:

1. Herbal products are at evolving stage of regulations for product development/approvals.,
2. Herbal product selling practices are very similar to the FMCG sector.
3. Herbals do not go through the process of product patenting
4. Herbals are very successful in targeting lifestyle space (Weight loss/gain, Memory loss, Stress relief, Nutritional supplements, cosmetic applications, cholesterol reduction, digestives, etc.).

The vitamins and herbs / botanicals have dominated the US dietary supplement market, garnering a combined share of 68% or almost US$ 10 billion of the total US$ 14.7 billion US market. Since most of the Ayurvedic products exported to the US fall into the herbs / botanicals category, this opens up an immense opportunity for the domestic Indian manufacturers of Ayurveda and Siddha products to exploit this market condition to their advantage. In the US $45.07 billion global OTC market, herbal supplements and vitamins were the strongest performing sectors reflecting the increasing worldwide interest in self medication.

The growth of the pharmaceutical industry and the unceasing development of new and more effective synthetic and biological medicinal products have not diminished the importance of medicinal plants/ herbals in many societies. On the contrary, population and income growth in the developing world and increasing interest in the industrialized nations has greatly expanded the demand for medicinal plants themselves and the products derived from them.

About 42% of the sales of the top 25 selling drugs worldwide are either biologicals, natural products, or entries derived from natural products.

India accounts for only around one percent of global herbals export market

According to Kate and Laird, about 42% of the sales of the top 25 selling drugs worldwide are either biologicals, natural products, or entries derived from natural products. Modern pharmacopoeia still contains at least 25% of drugs derived from plants. A comprehensive review of plant derived drugs identified a total of 119 drugs, obtained from fewer than 90 plant species. The Pharmaceutical industry's attitude to medicinal plants and natural products has also changed dramatically over the past few years. This is very much in line with the increased awareness and interest in medicinal plants and natural treatments amongst both the general public (especially in the area of self medication and functional cosmetic / food ingredients) and the scientific community. As a reflection of this, in 1980, none of the top 250 pharmaceutical companies had research activities involving higher plants, but by the early 1990's more than half of them had introduced such programs. Reflecting the strong commercial precedence for drug derived from natural products, there are a number of companies specializing specifically in centering their technology platforms on active pharmaceutical ingredients derived from natural products. The world is undergoing transformation by going green both in term of food habits and alternate forms of medication. The popularity of Yoga, Ayurveda and Chinese medications is on the rise especially in the west. The Herbal market is likely to expand further with increase in its awareness. Today India accounts for only around one percent of global herbals export market. We believe that these macro factors provide Indian Herbal / Ayurveda manufacturers huge growth opportunity going forward.

Nutraceutical Market

Nutracetical market for functional foods in the United States stands alone at US$ 14.7 billion, rising to US$ 91.7 billion for a 'broader' nutraceuticals market, including natural / organic foods, foods consumed primarily for health benefits and lesser evil foods. The same report valued the US supplements market at US$ 12.7 billion (Nutrition Business Journal). If the term 'nutraceutical' is taken in its broadest sense, including health foods, dietary supplements and natural foods, the global market has been put at around US$ 504 billion (Cited in RIRDC). US$504 billion of this market is split equally between the US and Europe. Herbal extracts are predicted to show the fastest global growth in the nutraceutical field, largely due to their perceived health benefits, but also reflecting the relatively less stringent regulations in place in many countries. According to one study, Imports of medicinal plans to EU from India amounted to US$ 14 Million.

Global Regulatory Standards for Nutraceuticals

In the U.S., both herbal and non-herbal Nutraceuticals which have not been developed as drugs through an NDA route can be marketed only as food supplements. The U.S.FDA allows food manufacturers to list health claims on labels even before they are scientifically proven, but will crack down on false or misleading claims. With estimated annual sales of $ 18 billion and 29000 products in the market and another 1000 added every year, the problem of monitoring them has become very complex. The Association further recommends that food supplements may be placed on the market without the requirements of notifications as long as the ingredients, claims and labels adhere to the standards set for dietary supplements and the products are manufactured according to cGMP standards. It is thus obvious that in the global scenario, nutraceuticals are treated as functional foods or as food supplements and the relatively thin line of distinction between these products and drugs are based on the specific claims made for their use as healthcare products.

Risks to Recommendation

High debtors

With increase in share of other Non-CIS markets and recent US acquisition, debtors days will go down to 166 days

As mentioned earlier debtor levels are high due to high share of CIS markets in total revenue which is primarily credit market. Company plans to reduce high debtor level by increasing share of other markets which are primarily cash market in total revenue and by stringent actions in CIS markets. It also expects debtor levels to go down with its recent acquisition of Natrol in USA. We expect debtor turnover days to go down to 166 days in FY09E from present 254 days.

Managing growth

Based on the past track record we trust on the management's ability to drive growth. Going forward company's performance depends on management's ability to grow on a rising base.

High segment concentration

Cough and Cold segment accounts for 47% of revenue

Cough and cold accounts for 47% of its FY06 revenue, indicating high segment / product concentration risk. Plethico plans to grow on the products launched in lifestyle segments like Aphrodisiacs, Nutraceuticals-sport supplements, Diabetes and Psychiatry.

Entry barriers

Herbals manufacturing involves very complex process which in turn acts as a natural entry barrier

Company is exposed to low entry barriers as it is not covered by patent protection or high capital requirement. To cover the risk, PPL has entered into alliance with Regional Research Laboratory, Jammu and has plans to participate in the government initiatives to develop regulatory standards and enter into organic farming. However, Herbal products are natural products unlike synthetic chemicals which behave same under all circumstances. Their potency would vary depending on conditions like soil, temperature, manure, irrigation, method of agriculture and time of cultivation. Availability of uniform quality of herbs is important in attaining high consistency of extracts. Herbals manufacturing involves very complex process, which in turn acts as a natural entry barrier.

Business Outlook & Valuation

Unlike other pharmaceuticals company, PPL adopted different model by focusing on high margin Herbals and Nutraceuticals in International markets

Unlike other players in the Indian pharmaceutical market who are fighting for a pie of the available export generics opportunity, PPL has adopted a completely different path by focusing on high margin Herbals and Nutraceuticals in the International markets. After initially focusing on the unregulated markets such as the CIS and Africa, the company is now all set to enter the regulated markets like the US and Europe. PPL recently acquired Natrol Inc., a leading manufacturer and marketer of nationally branded nutritional products in USA for US $ 80.7 mn. With this acquisition, PPL would be able to consolidate its position as a leading global Herbal / Nutraceutical player with access to high value markets of USA, UK and Hong Kong. The acquisition will not only expand PPL's product portfolio but also provide ready retail and distribution network in high value markets of US and Europe. Considering that sales from the US market are expected to gather momentum in by FY08 and given the company's continued strong performance in other markets, the outlook for Plethico appears quite optimistic. We expect PPL to report strong growth in revenues of CAGR 36% during FY07-FY09E. PPL's EBDITA margins will fall to 24.3% in FY08E from 30.8% in FY07E on account of lower margins enjoyed by its US subsidiary. US market in general enjoys lower margins than what would be in semi-regulated markets like CIS. But regulated markets are primarily cash markets with high competition and have lower default risk. We expect the company to record Net profit growth of CAGR 17% during FY07- FY09E.

Also, PPL's working capital situation in past, especially high debtor days had not been very healthy on account of its larger percentage of export sales of Herabals/ Nutraceuticals into the CIS markets which is primarily credit market. Now, with its entry into the cash market like US and reducing dependence on the CIS markets, the company's working capital situation is set to improve going forward. We expect debtor turnover days to go down to 166 days in FY09E from present 254 days.

The company has also lined up series of new product launches to drive growth going forward. We are quite optimistic about Plethico's future revenue growth. The stock is currently trading at 9.9x FY08E EPS of Rs 43.8 and 8.5x FY09E EPS of Rs. 51.5. It is trading at 8.3x FY08E and 6.4x FY09E EV/EBDITA. We believe these valuations are reasonable and offer excellent long term investment opportunity considering its strong presence in niche segments, higher EBDITA margins, increasing global demand for herbals/ nutraceuticals, strong expected growth from regulated and semi-regulated markets and its potential to improve its revenues and operating margins going forward. We recommend 'BUY' on the stock with target price of Rs. 569. At our target price, the stock discounts FY08E EPS by 13 times.

We recommend BUY with target price of Rs 569.

Peer Comparision

Particulars	PPL*	Amrutanjan*	Dabur India*	Zandu Pharma*
Net Sales (Rs Mn)	4351.2	723.9	17410.9	1289.1
EBDITA (Rs Mn)	1283.8	132.1	3130.0	241.6
EBDITA (%)	29.5	20.0	17.6	16.4
PAT (Rs Mn)	1283.6	59.1	2520.8	146.0
Paid up Equity Capital (Rs Mn)	340.7	32.0	862.9	80.6
FV (Rs)	10.0	10.0	1.0	100.0
EPS (Rs)	37.7	17.6	2.7	168.1
P/E (x)	12.1	13.3	33.0	23.3
EV/EBDITA (x)	9.5	7.8	26.8	14.3
P/BV (x)	2.4	5.5	22.7	5.5

*Source: Capital Line, Emkay Private Client Research * TTM Basis*

Profit & Loss statement (Rs Mn)

Particulars	FY06	FY07E*	FY08E	FY09E
Net Sales	3174.6	5067.6	8146.4	9451.3
Material Cost	1943.6	2939.2	4887.8	5670.8
Employee Cost	127.7	202.7	374.7	434.8
Other Expes	140.9	388.1	974.3	1128.3
Total Expenditure	2212.3	3529.9	6236.9	7233.8
Operating profit	962.3	1537.6	1909.6	2217.5
Other income	27.1	22.7	72.5	88.8
PBDIT	989.4	1560.3	1982.0	2306.3
Interest Expense	55.5	174.2	85.1	85.1
PBDT	933.9	1386.1	1896.9	2221.2
Depreciation	51.6	62.7	84.9	91.5
PBT	882.3	1323.4	1812.0	2129.7
Exceptional Items	0.0	164.6	0.0	0.0
Tax	22.0	33.1	108.7	127.8
PAT	860.3	1454.9	1703.3	2001.9

Source: Company, Emkay PCG Research

Balance sheet (Rs Mn)

Particulars	FY06	FY07E*	FY08E	FY09E
Equity Capital	340.7	340.7	389.0**	389.0
Reserves	4097.3	5455.1	9924.0	11815.0
Shareholders Funds	4438.0	5795.7	10313.1	12204.1
Total Borrowed Funds	945.9	3870.9	945.9	945.9
Defered Tax Liability	101.1	101.1	101.1	101.1
Total Liabilities	**5484.9**	**9767.7**	**11360.0**	**13251.0**
Fixed Assests	1168.9	1256.1	1291.2	1319.7
Investments	1382.5	4529.8	4529.8	4529.8
Inventory	141.7	226.0	366.6	421.5
Sundry Debtors	2227.4	3550.3	4268.7	4347.6
Cash Balance	702.8	465.5	1448.8	3286.2
Loans And Advances	68.1	108.5	174.3	202.3
Total Current Assests	3140.0	4350.2	6258.5	8257.6
Current Liabilities	172.0	274.7	488.8	567.1
Provisions	99.5	158.9	282.7	328.0
Total Current Liabilities	271.5	433.5	771.5	895.1
Net Working Capital	2868.5	3916.7	5487.0	7362.5
Miscellaneous Expenses	65.1	65.1	52.1	39.1
Total Assests	**5484.9**	**9767.7**	**11360.0**	**13251.0**

*Source: Company, Emkay PCG Research ** Fully diluted Equity Capital*

Ratio Analysis

Particulars	FY06	FY07E*	FY08E	FY09E
EBDITA%	31.2	30.8	24.3	24.4
PAT%	27.1	28.7	20.9	21.2
ROCE(%)	18.0	16.0	17.5	17.4
D/E (x)	0.2	0.7	0.1	0.1
Inventory days	16.3	16.3	16.4	16.3
Debtors days	255.0	254.0	190.0	166.0
Creditors days	32.3	34.0	36.5	36.5
Valuation Ratios				
EPS (Rs)	25.3	42.7	43.8	51.5
CEPS (Rs)	26.8	44.6	46.0	53.8
P/E (x)	17.3	10.2	9.9	8.5
EV/EBDITA (x)	15.3	11.7	8.3	6.4
EV/Sales	4.8	3.6	2.0	1.6
Mcap/Sales (x)	4.7	2.9	2.1	1.8
P/BV (x)	3.4	2.6	1.7	1.4

Source: Company, Emkay PCG Research

Cash Flow Statement (Rs Mn)

Particulars	FY06	FY07E*	FY08E	FY09E
Opening Cash & Bank Balance	**31.0**	**702.8**	**465.5**	**1448.8**
Profit after Tax	860.3	1454.9	1703.3	2001.9
Investment Income Adjustment	-27.1	-22.7	-72.5	-88.8
Interest Paid Adj	55.5	174.2	85.1	85.1
Depreciation	51.6	62.7	84.9	91.5
Defered Taxation	20.9	0.0	0.0	0.0
Misc Exps	-65.1	0.0	13.0	13.0
Others	711.0	0.0	0.0	0.0
Net Change in Wkg.Capital	-1051.9	-1285.4	-586.9	-38.2
CF-Operating Activities	**555.2**	**383.7**	**1226.9**	**2064.6**
Change In Fixed Assests	-234.6	-150.0	-120.0	-120.0
Change In Investments	-131.4	-3147.3	0.0	0.0
Investment Income Adjustment	27.1	22.7	72.5	88.8
CF-Investing Activities	**-338.9**	**-3274.7**	**-47.5**	**-31.2**
Increase in Equity	264.7	0.0	2925.0	0.0
Changes in Borrowings	268.0	2925.0	-2925.0	0.0
Interest Paid Adj	-55.5	-174.2	-85.1	-85.1
Dividend Paid	-21.7	-97.1	-110.9	-110.9
CF-Financing Activities	**455.6**	**2653.7**	**-196.0**	**-196.0**
NET change in Cash	671.8	-237.3	983.3	1837.3
Closing Cash & Bank Balance	**702.8**	**465.5**	**1448.8**	**3286.2**

Source: Company, Emkay PCG Research

Note :

* *Plethico had 30th September as it's Year ending, but have decided to change their year ending to 31st December. So consequently, FY07E numbers are adjusted to 15-month period.*

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