

## Disappointing quarter; Downgrade estimates

January 17, 2011

<b>Reco</b> Accumulate	<b>Previous Reco</b> Buy
<b>CMP</b> Rs 208	<b>Target Price</b> Rs 243
EPS change FY11E/12E (%)	9 / 9
Target Price change (%)	9
Nifty	5,655
Sensex	18,860

### Price Performance

(%)	1M	3M	6M	12M
Absolute	(20)	(7)	8	52
Rel. to Nifty	(17)	2	3	42

Source: Bloomberg

### Relative Price Chart



Source: Bloomberg

### Stock Details

Sector	Pharmaceuticals
Bloomberg	UL@IN
Equity Capital (Rs mn)	180
Face Value(Rs)	2
No of shares o/s (mn)	90
52 Week H/L	269/131
Market Cap (Rs bn/USD mn)	19/418
Daily Avg Volume (No of sh)	88314
Daily Avg Turnover (US\$m)	0.5

### Shareholding Pattern (%)

	S'10	J'10	M'10
Promoters	48.4	48.4	48.4
FII/NRI	5.7	3.8	3.8
Institutions	11.9	13.3	14.1
Private Corp	7.9	7.3	6.7
Public	26.2	27.3	27.1

Source: Capitaline

### Ashish Thavkar

ashish.thavkar@emkayglobal.com  
+91 22 6612 1254

### Rashmi Sancheti

rashmi.sancheti@emkayglobal.com  
+91 22 6612 1238

- **Unichem's Q3FY11 results were disappointing with a) Revenues at Rs1.97bn (estd. Rs1.93) b) EBITDA at Rs394mn (estd. Rs405mn) and c) PAT at Rs 256mn (estd. Rs269mn)**
- **Revenue growth was driven by 11% growth in domestic formulations (branded business up 12%, chronic portfolio up 14%) and 36% growth in export formulations**
- **EBITDA margins at 20% (down 692bps) was on account of a) higher raw material cost b) increase in sales and marketing cost and b) commissioning of new plants at Sikkim & Baddi**
- **Revise FY11/FY12 earnings downwards; cut target price to Rs243 (earlier Rs268); Downgrade to Accumulate**

### Revenue growth led by branded domestic and export formulations

Unichem has reported 14% growth (est. of 11%) in revenue to Rs1.97bn driven by a) 11% growth in the domestic formulations and b) 36% growth in the export formulations business. Within the domestic portfolio, Unichem's branded portfolio grew by 12% (up 16% in 9MFY11) and the chronic portfolio grew by 14% (up 20% in 9MFY11). Going ahead, we believe growth drivers for Unichem remain intact. Unichem continues to make small inroads in other markets, which would contribute gradually to the top line. The company is also negotiating generic supply agreements from the Ghaziabad formulations and the Baddi cephalosporin blocks. While the company expects CMO income from the two sites to start kicking-in from late Q4FY11 or early Q1FY12, we believe site approvals may take a while. While the UK subsidiary, Niche Generics, has reported improvement in performance during 9MFY11, it is unlikely to break-even in the current year (9MFY11 Sales GBP6.8mn; Net loss GBP 0.65mn).

### EBITDA margins at 20%, below expectations

Despite 14% growth in top line, EBITDA margins declined by 692bps to 20% on account of a) 24% increase in employee cost, mainly because of field force expansion in India, b) 18% increase in raw materials (due to higher API sales and adverse product mix), and c) 33% increase in other expenses, largely driven by increase in sales and marketing expenses and commissioning of plants at Baddi and Sikkim. Going forward, we expect its operating margins to remain under pressure for few more quarters because of the on-going commissioning of assets and new recruitment in India, Brazil and Mexico, the benefit of which will start reflecting from FY12E onwards.

### Revenue break-up

Rs mn	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	YoY Gr.
<b>Domestic</b>	<b>1383.2</b>	<b>1392.4</b>	<b>1539.9</b>	<b>1612.6</b>	<b>1547.4</b>	11.9%
Formulations	1342.6	1313.9	1471.6	1573.2	1490.9	11.0%
API	40.6	78.4	68.3	39.3	56.6	39.1%
<b>Exports</b>	<b>330.4</b>	<b>323.5</b>	<b>324.5</b>	<b>388.2</b>	<b>403.4</b>	22.1%
Formulations	197.5	204.3	206.1	294.3	268.4	35.9%
API	132.9	119.1	118.5	93.9	135.0	1.6%
<b>Total Sales</b>	<b>1713.6</b>	<b>1715.8</b>	<b>1864.5</b>	<b>2000.8</b>	<b>1950.9</b>	<b>13.8%</b>

### Financials

YE-Mar	Net Sales	EBITDA (Core)	EBITDA (%)	APAT	EPS (Rs)	EPS % chg	RoE (%)	P/E	EV/EBITDA	P/BV
FY10	7,473	1,730	23.2	1,249	13.9	19.6	23.4	15.0	11.0	3.3
FY11E	8,446	1,798	21.3	1,210	13.4	(3.1)	20.1	15.5	10.5	2.9
FY12E	10,558	2,394	22.7	1,682	18.7	39.1	24.2	11.1	7.8	2.5
FY13E	12,912	2,953	22.9	2,124	23.6	26.3	26.1	8.8	6.3	2.1

## Key Financials - Quarterly

Rs mn	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	YoY (%)	QoQ (%)	YTD'11	YTD'10	YoY (%)
<b>Revenue</b>	<b>1,728</b>	<b>1,739</b>	<b>1,875</b>	<b>2,020</b>	<b>1,971</b>	<b>14.1</b>	<b>(2.4)</b>	<b>5,866</b>	<b>5,167</b>	<b>13.5</b>
<b>Expenditure</b>	<b>1,263</b>	<b>1,323</b>	<b>1,393</b>	<b>1,524</b>	<b>1,577</b>	<b>24.9</b>	<b>3.5</b>	<b>4,494</b>	<b>3,786</b>	<b>18.7</b>
<i>as % of sales</i>	<i>73.1</i>	<i>76.1</i>	<i>74.3</i>	<i>75.5</i>	<i>80.0</i>			<i>76.6</i>	<i>73.3</i>	
Consumption of RM	568	560	599	647	671	18.2	3.7	1,916	1,774	8.0
<i>as % of sales</i>	<i>32.8</i>	<i>32.2</i>	<i>31.9</i>	<i>32.0</i>	<i>34.0</i>					
Employee Cost	224	212	258	276	278	23.9	0.5	812	655	24.0
<i>as % of sales</i>	<i>13.0</i>	<i>12.2</i>	<i>13.8</i>	<i>13.7</i>	<i>14.1</i>					
Other expenditure	471	551	536	601	629	33.4	4.6	1,765	1,357	30.1
<i>as % of sales</i>	<i>27.3</i>	<i>31.7</i>	<i>28.6</i>	<i>29.8</i>	<i>31.9</i>					
<b>EBITDA</b>	<b>465</b>	<b>415</b>	<b>482</b>	<b>496</b>	<b>394</b>	<b>(15.2)</b>	<b>(20.6)</b>	<b>1,372</b>	<b>1,381</b>	<b>(0.7)</b>
Depreciation	54	56	66	67	69	27.9	2.5	201	159	26.8
<b>EBIT</b>	<b>411</b>	<b>360</b>	<b>417</b>	<b>429</b>	<b>325</b>	<b>(20.9)</b>	<b>(24.2)</b>	<b>1,171</b>	<b>1,222</b>	<b>(4.2)</b>
Other Income	11	34	20	20	13	19.2	(35.8)	53	35	52.2
Interest	1	1	3	2	2	91.7	1.3	6	4	37.9
<b>PBT</b>	<b>421</b>	<b>393</b>	<b>434</b>	<b>447</b>	<b>336</b>	<b>(20.1)</b>	<b>(24.8)</b>	<b>1,217</b>	<b>1,253</b>	<b>(2.8)</b>
Total Tax	79	54	100	100	80	2.3	(19.7)	281	247	13.8
<b>Adjusted PAT</b>	<b>342</b>	<b>339</b>	<b>334</b>	<b>347</b>	<b>256</b>	<b>(25.2)</b>	<b>(26.3)</b>	<b>937</b>	<b>1,006</b>	<b>(6.9)</b>
(Profit)/loss from JV's/Ass/MI	0	0	0	0	0			0	0	
<b>APAT after MI</b>	<b>342</b>	<b>339</b>	<b>334</b>	<b>347</b>	<b>256</b>	<b>(25.2)</b>	<b>(26.3)</b>	<b>937</b>	<b>1,006</b>	<b>(6.9)</b>
Extra ordinary items	0	0	0	0	0			0	0	
<b>Reported PAT</b>	<b>342</b>	<b>339</b>	<b>334</b>	<b>347</b>	<b>256</b>	<b>(25.2)</b>	<b>(26.3)</b>	<b>937</b>	<b>1,006</b>	<b>(6.9)</b>
<b>AEPS</b>	<b>3.74</b>	<b>3.76</b>	<b>3.70</b>	<b>3.85</b>	<b>2.84</b>	<b>(24.1)</b>	<b>(26.3)</b>	<b>10.4</b>	<b>11.1</b>	<b>(6.4)</b>

Margins (%)						(bps)	(bps)			(bps)
EBIDTA	26.9	23.9	25.7	24.5	20.0	(692)	(456)	23.4	26.7	(334)
EBIT	23.8	20.7	22.2	21.2	16.5	(729)	(473)	20.0	23.7	(370)
EBT	24.4	22.6	23.1	22.1	17.1	(730)	(507)	20.8	24.2	(349)
PAT	19.8	19.5	17.8	17.2	13.0	(683)	(420)	16.0	19.5	(350)
Effective Tax rate	18.7	13.7	23.1	22.4	23.9	523	152	23.1	19.7	337

### Higher than expected rise in tax provision impacted PAT

Net profit for the quarter was down by 25% to Rs256mn (against our expectation of Rs269mn) on account of a) poor operating performance, b) higher tax provisioning (24% of PBT vs. est. of 22% and 19% of PBT in Q3FY10), and c) 28% YoY increase in depreciation charges. EPS for the quarter works out to Rs2.84 (est. of Rs2.98) and Rs10.4 for three quarters of FY11 against our full year estimation of Rs14.8.

### Cut earning estimates; Downgrade one notch to Accumulate

Owing to subdued performance in Q3FY11 and delay in break-even of its subsidiaries (primarily UK and US based), we cut our earning estimates for FY11E, FY12E and FY13E by 9.3%, 9.2% and 10.6% respectively. In the near term, margins could be adversely affected by increased costs from field force ramp up and commercialization of new facilities. We downgrade our rating by one notch from Buy to Accumulate with a revised price target of Rs243 (earlier Rs268). At CMP of Rs208, the stock is trading at 15.5x FY11E, 11.1x FY12E and 8.8x FY13E EPS.

We believe that the company would achieve revenue CAGR of 20% over FY10-13E and hence maintain our revenue estimates over the projected period.

### Revised Financials

Rs mn	FY11E			FY12E			FY13E		
	Old	New	% Chg	Old	New	% Chg	Old	New	% Chg
Sales *	8,446	8,446	-	10,558	10,558	-	12,912	12,912	-
EBITDA	1,952	1,798	-7.9	2,599	2,394	-7.9	3,255	2,953	-9.3
PAT	1,334	1,210	-9.3	1,852	1,682	-9.2	2,377	2,124	-10.6
EPS	14.8	13.4	-9.3	20.6	18.7	-9.2	26.4	23.6	-10.6

\* includes operating income

We have factored-in pressure on margins and delay in break-even for its subsidiaries in lowering our estimates. However, as we believe that the company's growth drivers remain intact and the valuations still attractive, we maintain our positive stance on the company. We have not factored possible upsides from the CMO business in our estimates.

## Financials

## Income Statement

Y/E, Mar (Rs. mn)	FY10	FY11E	FY12E	FY13E
<b>Net Sales</b>	<b>7,473</b>	<b>8,446</b>	<b>10,558</b>	<b>12,912</b>
<i>Growth (%)</i>	1.6	13.0	25.0	22.3
<b>Expenditure</b>	<b>5,743</b>	<b>6,648</b>	<b>8,164</b>	<b>9,959</b>
Raw Materials	2,579	2,956	3,678	4,505
SGA	1,952	2,261	2,767	3,350
Employee Cost	1,011	1,206	1,446	1,771
Other Exp	202	226	272	334
<b>EBITDA</b>	<b>1,730</b>	<b>1,798</b>	<b>2,394</b>	<b>2,953</b>
<i>Growth (%)</i>	64.7	21.7	3.9	33.2
<b>EBITDA margin (%)</b>	<b>23.2</b>	<b>21.3</b>	<b>22.7</b>	<b>22.9</b>
Depreciation	232	263	272	281
<b>EBIT</b>	<b>1,498</b>	<b>1,535</b>	<b>2,122</b>	<b>2,672</b>
<b>EBIT margin (%)</b>	<b>20.0</b>	<b>18.2</b>	<b>20.1</b>	<b>20.7</b>
Other Income	66	49	69	91
Interest expenses	10	11	3	1
<b>PBT</b>	<b>1,532</b>	<b>1,573</b>	<b>2,188</b>	<b>2,763</b>
Tax	304	363	505	638
<i>Effective tax rate (%)</i>	19.9	23.1	23.1	23.1
<b>Adjusted PAT</b>	<b>1,252</b>	<b>1,210</b>	<b>1,682</b>	<b>2,124</b>
(Profit)/loss from JV's/Ass/MI	3	0	0	0
<b>Adjusted PAT after MI</b>	<b>1,249</b>	<b>1,210</b>	<b>1,682</b>	<b>2,124</b>
<i>Growth (%)</i>	19.5	-3.1	39.1	26.3
<b>Net Margin (%)</b>	<b>16.7</b>	<b>14.3</b>	<b>15.9</b>	<b>16.5</b>
E/O items	-22	0	0	0
<b>Reported PAT</b>	<b>1,231</b>	<b>1,210</b>	<b>1,682</b>	<b>2,124</b>
<i>Growth (%)</i>	13.9	-1.7	39.1	26.3

## Cash Flow

Y/E, Mar (Rs. mn)	FY10	FY11E	FY12E	FY13E
<b>PBT (Ex-Other income)</b>	<b>1,466</b>	<b>1,524</b>	<b>2,119</b>	<b>2,672</b>
Depreciation	232	263	272	281
Interest Provided	10	11	3	1
Other Non-Cash items	0	0	0	0
Chg in working cap	-91	-183	-475	-476
Tax paid	-304	-363	-505	-638
<b>Operating Cashflow</b>	<b>1,312</b>	<b>1,251</b>	<b>1,414</b>	<b>1,838</b>
Capital expenditure	-435	-443	-533	-573
<b>Free Cash Flow</b>	<b>878</b>	<b>808</b>	<b>881</b>	<b>1,265</b>
Other income	66	49	69	91
Investments	-582	0	0	0
<b>Investing Cashflow</b>	<b>-950</b>	<b>-394</b>	<b>-464</b>	<b>-482</b>
Equity Capital Raised	-26	0	1	0
Loans Taken / (Repaid)	-40	-200	-110	-40
Interest Paid	-10	-11	-3	-1
Dividend paid (incl tax)	-421	-423	-589	-850
Income from investments	0	0	0	0
Others	27	0	0	0
<b>Financing Cashflow</b>	<b>-470</b>	<b>-634</b>	<b>-701</b>	<b>-890</b>
<b>Net chg in cash</b>	<b>-107</b>	<b>223</b>	<b>249</b>	<b>466</b>
Opening cash position	344	236	459	708
<b>Closing cash position</b>	<b>236</b>	<b>459</b>	<b>708</b>	<b>1,174</b>

## Balance Sheet

Y/E, Mar (Rs. mn)	FY10	FY11E	FY12E	FY13E
Equity share capital	180	180	180	180
Reserves & surplus	5,449	6,235	7,330	8,605
<b>Net worth</b>	<b>5,629</b>	<b>6,415</b>	<b>7,510</b>	<b>8,785</b>
<b>Minority Interest</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
Secured Loans	122	22	12	2
Unsecured Loans	236	136	36	6
<b>Loan Funds</b>	<b>358</b>	<b>158</b>	<b>48</b>	<b>8</b>
Net deferred tax liability	347	347	347	347
<b>Total Liabilities</b>	<b>6,333</b>	<b>6,920</b>	<b>7,905</b>	<b>9,139</b>
Gross Block	4,646	5,246	5,746	6,244
Less: Depreciation	1,312	1,515	1,737	1,978
<b>Net block</b>	<b>3,334</b>	<b>3,731</b>	<b>4,009</b>	<b>4,266</b>
Capital work in progress	636	420	402	437
<b>Investment</b>	<b>592</b>	<b>592</b>	<b>592</b>	<b>592</b>
<b>Current Assets</b>	<b>3,445</b>	<b>4,422</b>	<b>5,896</b>	<b>7,741</b>
Inventories	1,095	1,396	1,834	2,353
Sundry debtors	1,670	2,024	2,620	3,315
Cash & bank balance	236	459	708	1,174
Loans & advances	444	544	734	898
Other current assets	0	0	0	0
<b>Current lia &amp; Prov</b>	<b>1,673</b>	<b>2,245</b>	<b>2,994</b>	<b>3,897</b>
Current liabilities	1,316	1,568	2,050	2,617
Provisions	356	677	944	1,279
<b>Net current assets</b>	<b>1,772</b>	<b>2,177</b>	<b>2,902</b>	<b>3,844</b>
Misc. exp & Def. Assets	0	0	0	0
<b>Total Assets</b>	<b>6,333</b>	<b>6,920</b>	<b>7,905</b>	<b>9,139</b>

## Key Ratios

Y/E, Mar	FY10	FY11E	FY12E	FY13E
<b>Profitability (%)</b>				
EBITDA Margin	23.2	21.3	22.7	22.9
Net Margin	16.7	14.3	15.9	16.5
ROCE	27.9	25.2	31.0	33.8
ROE	23.4	20.1	24.2	26.1
RoIC	21.2	18.8	23.9	27.1
<b>Per Share Data (Rs)</b>				
EPS	13.9	13.4	18.7	23.6
CEPS	16.5	16.4	21.7	26.7
BVPS	62.5	71.3	83.4	97.6
DPS	4.0	4.0	5.6	8.1
<b>Valuations (x)</b>				
PER	15.0	15.5	11.1	8.8
P/CEPS	12.6	12.7	9.6	7.8
P/BV	3.3	2.9	2.5	2.1
EV / Sales	2.6	2.2	1.8	1.4
EV / EBITDA	11.0	10.5	7.8	6.3
Dividend Yield (%)	1.9	1.9	2.7	3.9
<b>Gearing Ratio (x)</b>				
Net Debt/ Equity	0.0	0.0	-0.1	-0.1
Net Debt/EBIDTA	0.1	-0.2	-0.4	-0.5
Working Cap Cycle (days)	92	104	108	112

**Recommendation History: Unichem Laboratories - UL@IN**

Date	Reports	Reco	CMP	Target
18/10/2010	<a href="#">Unichem Labs Initiating Coverage</a>	Buy	530	670

**Recent Research Reports**

Date	Reports	Reco	CMP	Target
12/01/2011	<a href="#">Pfizer Q4CY10 Result Update</a>	Accumulate	1,178	1,193
30/12/2010	<a href="#">Cipla Company Update</a>	Accumulate	367	350
15/11/2010	<a href="#">Lupin Pharma Q2FY11 Result Update</a>	Accumulate	469	496
15/11/2010	<a href="#">Glenmark Pharma Q2FY11 Result Update</a>	Accumulate	348	381

**Emkay Global Financial Services Ltd.**

Paragon Center, H -13 -16, 1st Floor, Pandurang Budhkar Marg, Worli, Mumbai – 400 013. Tel No. 6612 1212. Fax: 6624 2410

**DISCLAIMER:** This document is not for public distribution and has been furnished to you solely for your information and may not be reproduced or redistributed to any other person. The manner of circulation and distribution of this document may be restricted by law or regulation in certain countries, including the United States. Persons into whose possession this document may come are required to inform themselves of, and to observe, such restrictions. This material is for the personal information of the authorized recipient, and we are not soliciting any action based upon it. This report is not to be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. No person associated with Emkay Global Financial Services Ltd. is obligated to call or initiate contact with you for the purposes of elaborating or following up on the information contained in this document. The material is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon. Neither Emkay Global Financial Services Ltd., nor any person connected with it, accepts any liability arising from the use of this document. The recipient of this material should rely on their own investigations and take their own professional advice. Opinions expressed are our current opinions as of the date appearing on this material only. While we endeavor to update on a reasonable basis the information discussed in this material, there may be regulatory, compliance, or other reasons that prevent us from doing so. Prospective investors and others are cautioned that any forward-looking statements are not predictions and may be subject to change without notice. We and our affiliates, officers, directors, and employees world wide, including persons involved in the preparation or issuance of this material may; (a) from time to time, have long or short positions in, and buy or sell the securities thereof, of company (ies) mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as a market maker in the financial instruments of the company (ies) discussed herein or may perform or seek to perform investment banking services for such company(ies) or act as advisor or lender / borrower to such company(ies) or have other potential conflict of interest with respect to any recommendation and related information and opinions. The same persons may have acted upon the information contained here. No part of this material may be duplicated in any form and/or redistributed without Emkay Global Financial Services Ltd.'s prior written consent. No part of this document may be distributed in Canada or used by private customers in the United Kingdom. In so far as this report includes current or historical information, it is believed to be reliable, although its accuracy and completeness cannot be guaranteed.