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Key Investment Arguments **<u>In Favour</u>** of Hikal Ltd. :

- ✔ **<u>Baba Kalyani</u>** (Bharat Forge fame) group company who, alongwith Hiremath family ***owns 73.52 % equity*** in the company.

- ✔ Highly ***competent and distinguished management team*** as well as Board of Advisors - most of whom are PhDs and distinguished personalities in their respective field - including **ex-CEO of Aventis**, Mr. Kannan Unni, **ex-Head of Bayer**, Dr. Wolfgang Walter, **Padma Shri** Prof. Goverdhan Mehta, etc.

- ✔ ***Exclusive supplier-relationship*** with **<u>Syngenta</u>** (for Thiabendazole), **<u>Bayer</u>** (for Fenamidone) and **<u>BASF</u>** (for Initium)

- ✔ **World's Largest Producer** of **Gabapentin** molecule enjoying 45 % of world marketshare

- ✔ Strong IPR-building focus which is evident from **<u>6 Process Patents</u>** already under company's portfolio in addition to **4 Process Patents filed for approval**

- ✔ **Batch Quantities** of AI Initium and API Venlafaxine supplied in FY12 **received approval** - **<u>commercial production</u>** of which to **<u>commence from Q4FY13</u>**

- ✔ **<u>Panoli Plant received USFDA approval in September'2012</u>** which is expected to provide significant boost to non-Gabapentin business starting FY14

- ✔ Exceptional focus on high margin products which is evident from **last 10 years' average EBITDA margins at 27.64%** - one of the best in the industry.

- ✔ Company has made heavy upfront investment in building assets and forging strong relationships with global innovators over last decade - fruits of which likely to accrue from FY14 onwards as **<u>heavy CAPEX phase got concluded in FY11</u>** and **<u>commercial production of major molecules to commence from Q4FY13</u>**

- ✔ Consolidated Tangible Net **<u>Fixed Asset base at INR 714.87 cr.</u>** (including CWP of 75 cr.) - **higher than current market-cap of INR 697 cr.** - a Rare thing for such a high caliber company

- ✔ ***Asset Utilisation to significantly improve starting Q4FY13*** as delivery of signed contracts begin

- ✔ ***PAT to get significant boost going forward*** as all **forward covers and derivative contracts** meant for hedging (80% of revenue comes from exports) **expire in October'2012** post which PAT margin will improve considerably

- ✔ **Valuations compelling** at **0.99 x FY12 Net Fixed Asset base**; **1 x FY12 Sales**; **8.7 x FY12 EPS** (without forex loss) and **15.1 x FY12 EPS** (with forex loss); **1.52 x FY12 Book Value**

- ✔ If we extrapolate further, company trading at **MCAP/FY14e EBITDA** ratio of just **2.5** and **MCAP/FY14e Sales** of **0.68** with **FY14e Price/B.V.** of just **1.16** which signifies **<u>gross undervaluation for a company like Hikal</u>** which is on the verge of entering growth phase starting FY14.

Key Investment Arguments **<u>Against</u>** Hikal Ltd. :

- ✗ **Product & Client Concentration.** Company's 76% revenue comes from just 3 molecules, viz., API Gabapentin and AIs Thiabendazole and Fenamidone wherein AIs are supplied to largely single client.

  However, this product and client concentration risk gets largely nullified by Hikal's **dominant world leadership status** in Gabapentin business (**45 % world marketshare**) and proprietary nature of molecules (AIs) to respective clients (**Syngenta and Bayer**) wherein **Hikal is the exclusive supplier**.

- ✗ **High Debt.** As at FY12, debt on books of Hikal is to the tune of ~INR 550 crores. It is worthwhile to note here the reasons of such high debt on books :

  (a) API, AI and CRAMS business model **requires significant upfront investment** for building assets and winning trust of global innovators so as to win preferred or exclusive supplier-relationship with them. Time-frame involved for upfront investments is normally ***8-10 years post which there is significant improvement in asset utilisation***. [For Detailed Explanation of Business Model Refer Page 7-8 of this Research Note]

  (b) **Hikal has spent last decade doing upfront investment for future growth** which is evident from **large Net Fixed Tangible Asset base at INR 714.87 cr.** (including CWP of 75 cr.) -- 500 crores of which were spent in last 5 years. Since asset utilisation is low in initial phase and company went for debt-funded capex, its debt has increased proportionately.

  (c) Company acquired Marsing & Co. in 2004 that didn't materialise as expected which resulted in **one time write-off of the acquisition in FY10**.

  (d) Since 80% of company's sales are from exports, it took forward covers and derivative contracts **for hedging 30% of its future exports** because of which there were **significant forex losses booked in P&L** as INR depreciated sharply. These **contracts expire in October'2012** post which **<u>management expects significant improvement in PAT</u>**.

  Owing to reasons stated above, debt as at FY12 stands at **~550 crores**. However, since CAPEX phase is already concluded in FY11 and no substantial CAPEX is planned till FY15, there is unlikely to be much addition in debt going forward. Also, since forward covers and derivative contracts expire in October'2012, pressure on profitability will significantly ease up starting Q4FY13.

  With current EBITDA at 180 cr.+ and FY14e EBITDA at 250 cr.+ in addition to low equity base of just 16.4 crores (1.64 crore shares) with 73.52% promoter holding, servicing debt should not be a problem for Hikal.

- ✗ **Low Liquidity in Company's stock** because of 73.52 % promoters' shareholding and another 13.02 % held by International Finance Corporation and Reliance Capital (acquired in 2008 & 2006 respectively at INR 464 and INR 360). Hence, **effective free public float is just 13.46 %**.

Why Hikal Ltd. [NSE – HIKAL ; BSE – 524735] deserves to be a part of one's core portfolio :

(1) When we construct our portfolio with a clear medium-to-long-term wealth creation goal in mind, we look for investment opportunities that possess most of the below-mentioned qualities :

- ✔ **Credible and Ethical Core Promoter Group** which has high repute in marketplace
- ✔ **Competent and Able Management Team** which has a will to see the company reach formidable position in its operating segment
- ✔ **High Corporate Governance** standards
- ✔ **Track Record** of Concern towards Generating **Minority Shareholders' Wealth**
- ✔ **Lucrative and Scalable** operating segment that has **high growth prospects**
- ✔ ***Sweet Positioning of the company in its operating segment*** by virtue of its past efforts and growth strategy
- ✔ Focus on Profitability and relatively **<u>high EBITDA margins</u>**
- ✔ **Manageable Debt** position
- ✔ **<u>Low Equity base with high Promoter Holding</u>** which leaves scope for judicious balance between equity and debt
- ✔ Company on verge of **entering a Growth Phase**, or, in other words, past efforts of the company likely to begin bearing fruits
- ✔ **Reasonable Valuations** on bourses that has scope for **<u>significant re-rating once growth phase starts getting discounted by the market</u>**.

Its rare to find a company satisfying all of the above-mentioned criterias, but, if they are found in one, and still such company is available at reasonable valuations then its termed as an **'Exceptional Situation'** which should turn into a **'Normal Situation'** once the **re-rating process for such company is enacted by the markets.**

Hikal Ltd. is such a company which satisfies almost all (except one) of the given criterias and therefore deserves a serious look by any of the prudent fund manager.

(2) One of the most important factor working in favour of Hikal Ltd. is its core promoter group led by ***Baba Kalyani group*** (Bharat Forge fame) and Hiremath family. Each hold 34.4 % equity in the company thereby placing their combined direct holding at 68.8 %. If indirect holding is also taken into consideration which is in the form of 'Hikal Employee Welfare Trust' then **<u>total promoter holding in the company stands at 73.52 %</u>**.

Also present amongst esteemed shareholders' list is **International Finance Corporation**, an arm of World Bank, which holds **8.27 % equity stake** in the company (having acquired the stake ***at INR 464*** in 2008) as well as **Reliance Capital Trustee** via Reliance Growth Fund which holds **4.75 % stake** (acquired in 2006 at ~***INR 360***). Hence, effective **free public float in the company is just 13.46 %** thereby making it a strong candidate to **command a scarcity premium** once its growth phase starts commencing Q4FY13.

(3) Company follows very high corporate governance standards which is evident from consistent disclosures and management commentary presented in last 10 years' Annual Reports - **a Rare thing to find in mid-cap companies**.

(4) Management quality, capability and competency is unquestionable in case of Hikal Ltd. considering the profile of its Senior Management Team, Board of Directors and Board of Advisors. Provided below is a glimpse of each individual's profile :

Name	Brief Profile
Baba Kalyani (Promoter & Board of Director)	Chairman and Managing Director of Bharat Forge Ltd Awarded CEO of the year 2004 by Business Standard, Entrepreneur of the Year (Manufacturing) 2005 by Ernst & Young and Businessman of the Year 2006 by Business India magazine. He has been honored by the Government of India which conferred the Padma Bhushan on Mr. Kalyani in 2008 and by the French Government which honored him with the distinction, Chevalier l'Ordre de la Légion d'Honneur (Knight of the National Order) in 2011
Jai Hiremath (Promoter & CMD)	Past President of the Indian Chemical Council (ICC) and the former Chairman of the Chemical Committee of the Federation of Indian Chamber of Commerce and Industry (FICCI). Board member of DCAT (Drug, Chemical and Associated Technology Association) headquartered in New Jersey, U.S.A. Board member of Novartis (India) Ltd and National Safety Council (NSC) of India
Amit Kalyani (Board of Director)	Executive Director on the board of Bharat Forge Limited,
Sameer Hiremath (President & JMD)	Over the years, he has held various positions at Hikal including that of Executive Director. He has over 16 years of experience in plant operations and manufacturing at Hikal.
Kannan Unni (Board of Director)	Was the Chairman of Bilag Industries Pvt. Ltd., a 100% subsidiary of Bayer CropScience. He was also the CEO of Aventis CropScience in India
Dr. Wolfgang Welter (Board of Director)	Head of Industrial Operations at Bayer CropScience AG. Senior positions in Crop Protection and Fine Chemicals divisions Hoechst AG Head of Production at AgrEvo overseeing manufacturing operations at Aventis CropScience in France.
Dr. Peter Pollak (Board of Director)	Internationally recognized as a pioneer in the development of the modern fine chemicals industry. He has more than 38 years of experience in fine chemicals, notably at Lonza in Switzerland and U.S.A. He has published numerous articles in several prestigious chemical publications worldwide. He is a consultant to some of the world's leading fine chemical and pharmaceutical companies and has recently published the second edition of his book 'Fine Chemicals, the Industry and the Business

Prof. Goverdhan Mehta (Scientific Advisor)	Awarded the Padma Shri in 2000 by the President of India and Chevalier de la Légion d'Honneur in 2004. He is a Fellow of the Royal Society and a member of the Scientific Advisory Committee to the Prime Minister of India.
Dr. Takayuki Shioiri (Scientific Advisor)	Recipient of the Pharmaceutical Society of Japan (PSJ) Award, the Abbott Prize and the Japanese Peptide Society Award. Honorary President of the Japanese Society for Process Chemistry
Dr. K. Nagarajan (Scientific Advisor)	Recipient of the Bhatnagar Prize in Chemistry and Lifetime Research Award from the Chemical Research Society of India Held various positions as Head, Medicinal Chemistry, Ciba Research Center; Director, R&D of Searle India, among others
Prof Axel Kleemann (Scientific Advisor)	Co-author of the standard reference book, 'Pharmaceutical Substances'. Chairman of the Board of Directors of Protagen AG and a member of the Board of Directors of several non-listed and listed biotech and fine chemical companies Was a member of the Management Board of ASTA Medica AG from 1987 to 2000.
Satish Sohoni (SVP - Crop Protection)	Held senior positions in Hindustan Lever and its parent company, Unilever in Central and Eastern Europe; Rallis India and Tata Chemicals.
Ashok Anand (President - Pharmaceuticals)	Held senior marketing positions in various pharmaceutical companies such as Nicholas Piramal and Johnson & Johnson
Dr. Peter Nightingale (President - CRAMS)	An experienced scientist who has held senior managerial positions at Development Chemicals, USA; Synprotec Ltd., and Coalite Group, UK.
Anish Swadi (VP – Business Development)	Worked as an International Financial Advisor with Merrill Lynch

(5) Having looked above at the promoter and management quality and capability, it's necessary to look at the operating segment(s) of the Company, viz.,

- **Active Pharmaceutical Ingredients - API** (catering Pharmaceutical industry)
- **Active Ingredients & Intermediates - AI** (catering Crop Protection industry)
- **Custom Research & Manufacturing Services - CRAMS** (Custom Synthesis & Manufacturing - CSM)

Segmentwise Revenue Breakup

Segment	FY12 Revenue
AI (Crop Protection)	246.5
API (Pharmaceuticals)	447.7
CRAMS	15.3

Total Consolidated Revenue	709.5

(fig. In ₹ cr.)

Although each operating segment is different in terms of offerings, still, there are two common aspects which bind all three operating segments together and make them complementary. Those two aspects are :

- Research-driven Approach
- Business Model

First aspect speaks by itself but second aspect needs some detailed understanding for us to **gauge the significant scale of opportunity Hikal is likely to climb starting FY14**.

All the three operating segments share a common business model which stands on 4 pillars, viz.,

Asset Building

(First Stage)

Winning Trust and Establishing long-term supply-relationships with global MNCs, most of whom are Innovators

(Second Stage)

Product Selection and Focus

(Third Stage)

Product Commercialisation & Delivery

(Fourth Stage)

First two stages take a lengthy time that can be counted in years (normally **8-10 years**) and involve ***significant upfront investment on part of the company*** (for building assets). Once the assets are built and long-term relationships are in place then comes the **product focus and selection phase** in which management ability and vision comes into play wherein it has to choose between ***high volume or high margin products***. There is a third offshoot, which is ***patented or on-patent products*** which offer both, high volume and high margins, in the initial phase of launch. Once product selection is done and focus outlined, there comes the **commercialisation and delivery of products** which ***improves asset utilisation considerably***.

Now, talking specifically for Hikal, the company, till FY11 has successfully passed the first two stages and FY12 marked the beginning of third stage which is an ongoing affair. Q4FY13 should see the beginning of fourth stage past which there will be pronounced effect (of last decade's efforts) in the financials of the company in the form of robust topline and bottomline growth.

Evolution of Hikal :

1999 **till** 2011 → **Asset Building** (First Stage) → Fixed Assets swelled from meagre 136.40 cr. in FY99 to current 714.87 cr.

1999 till 2011	**Winning Trust and Establishing long-term supply-relationships with global MNCs, most of whom are Innovators** (Second Stage)	Signed Exclusive Supplier Relationships with Syngenta (for Thiabendazole), Bayer (for Fenamidone) & BASF (for Initium) and Preferred Supplier Relationship (for Gabapentin) with Pfizer, Apotex, Cleo Singapore & Teva Canada. Also forged strong long-term supplier-relationship with a leading European Biopharma Innovator for manufacturing multiple large volume molecules commencing FY13.
From 2010 **till** 2012 & Beyond	**Product Selection & Focus** (Third Stage - an ongoing stage)	Focus has been on high margin products while at the same time ensuring right mix of high volume products to impart stability to revenue. Have also added certain patented products in the portfolio like Initium, which ensure both high volume & high margins in initial phase of launch. Multiple large volume products are selected for catering to single European Biopharma Innovator ; an API Venlafaxine is selected for manufacture ; two APIs whose patent is due for expiry are selected for large scale manufacture ; Initium, a patented molecule, is selected for manufacture ; two large volume crop protection AIs are selected for manufacture
2012 **onwards**	**Product Commercialisation & Delivery** (Fourth Stage)	Initium delivery to commence from Q3FY13 ; two large volume Crop Protection AIs' delivery to commence from Q4FY13 ; Venlafaxine delivery to commence from Q3FY13 ; delivery of two APIs whose patent is due for expiry to commence from Q4FY13 ; delivery for European Biopharma Innovator's multiple large volume products to commence from Q4FY13

(6) To elaborate, let's now take each operating segment one-by-one. Under **AI** space, Hikal contract manufactures Active Ingredients and Intermediates for agrochemical (Crop Protection) industry including herbicides, insecticides and fungicides. Company made a small beginning in 1991 in this space and went on to aggressively build assets at its current two state-of-the-art manufacturing plants over last two decades as also forged exclusive supplier-relationship with global innovators.

Global crop protection industry in itself is a very concentrated one which is dominated by 5 players, viz., Bayer, BASF, Syngenta, Dow and Monsanto. Hikal successfully built a great amount of trust with top 3 of only 5 major global players and as a result became **exclusive supplier of Thiabendazole (TBZ) to Syngenta since 1999 and Fenamidone to Bayer since 2009.** Now, in FY12, company supplied validation batch quantities of patented Initium to BASF which is now approved and commercial production of which is expected to start from Q3FY13 onwards.

AI (Crop Protection) Segment Revenue Breakup	
Molecule	**FY12 Revenue**
Thiabendazole (TBZ)	92
Fenamidone	91
Others	63.5
Total Segment Revenue	**246.5**

(fig. In ₹ cr.)

(7) Under **API** segment, Hikal contract manufactures active pharmaceutical ingredients for pharmaceutical industry with it being **world's largest supplier of Gabapentin** - other key suppliers being Divis, Shasun & Brazil's Zamon. Hikal ventured into this space in 2001 with acquisition of Wintac's plant and went on to aggressively build strong supplier-relationship with global MNCs like Pfizer, Apotex, Cleo Singapore & Teva Canada. Company's focus on Gabapentin paid off well with its pharma API business growing at a **CAGR of 43.25 % over last decade**. Even as at FY12, Gabapentin contributes ~70 % to Hikal pharma API revenues with ~45 % global marketshare. The molecule 'Gabapentin' belongs to CNS therapeutic area and is one of the few molecules which has grown in demand (volume) after going off patent in 2002. It is still projected to grow 7 % p.a. in volume terms till FY15.

API (Pharmaceuticals) Segment Revenue Breakup	
Molecule	**FY12 Revenue**
Gabapentin	314
Others	133.7
Total Segment Revenue	**447.7**

(fig. In ₹ cr.)

(8) Hikal's API-segment's ***dependence on Gabapentin is expected to decline significantly starting FY14*** as commercial production of **Venlafaxine** (validation batch quantities of which were supplied in FY12 and was approved) and one other undisclosed molecule is expected to **start from Q4FY13 onwards**. Also, as per company sources, **Hikal's Panoli plant has, in September'2012, received USFDA approval** which will add a significant boost to company's non-Gabapentin business in the medium term starting FY14. However, FY13 might be a muted year as far as pharma API business of Hikal is concerned as Gabapentin is expected to register only modest growth in FY13 because of temporary inventory issues faced by one of its key supplier which could keep prices under pressure till CY2012.

(9) Under **CRAMS** (CSM), Hikal provides contract research to innovator companies pertaining to chemistry skills primarily chemical synthesis for NCE prior to pre clinical stage and developing process for scaling up. Various services offered by Hikal includes Route Scouting, Contract Research, Process Development, Scale up, Analytical Method Development and cGMP (kilo) Manufacturing. It provides customized services, from Full Time Equivalent (FTE) to Fee for Service (FfS) contracts. Under FTE model entire lab is given on rent for few days to few weeks. The risk of successfully synthesizing chemical lies with the innovator or innovator already has the processes and wants to evaluate the same. In FfS, the innovator company gives a molecule and asks Hikal to develop a process for same. Higher fees are paid under fee for service model as Hikal develops the process.

(10) Hikal started CRAMS operations from FY09 onwards and has committed significant resources, for both, building assets and forging relationships. CRAMS is normally a medium gestation business and Hikal's CRAMS operation generated revenues of 15.3 crores in FY12 with operational break-even. However, importance of CRAMS to other two segments, viz., AI and API, is worth talking about. **Molecules which come under CRAMS for process development normally migrate to AI and API segments for full scale commercial production. Relationships built out of such migration are very strong and margins on such molecules are relatively high as Hikal gets involved with such molecules at very early stage**.

CRAMS Segment Revenue

Total FY12 Segment Revenue	15.3

(fig. In ₹ cr.)

(11) Having discussed above prospects of each operational segments of Hikal as also efforts company has made over last decade to establish a solid foothold in each operating segment because of which the company is sitting on verge of the start of a robust growth phase starting FY14; it is imperative to take note of the fact that this journey over last decade has not been without any pitfalls. The main pitfall came in the form of a failed acquisition of Marsing & Co. in 2004 which didn't materialize as expected and management took a decision to take a one-time hit by writing it off the books in FY10. This failed acquisition coupled with pressure on profitability because of sudden depreciation of INR (as export contracts were hedged) led to significant **rise in debt which stands at ~INR 550 crores** as at FY12.

Two key things need to be noted from this episode :

(a) Management took quick and judicious decision to write-off the failed acquisition and instead ***concentrate on humongous opportunity existing organic business provided***.

(b) CAPEX for building assets for existing organic AI, API and CRAMS business was not curtailed signifying clear focus and vision of the management to ***build a strong foundation for company's future growth***.

(12) Past is past and today, Hikal sits on a lucrative position wherein **all hedge contracts are expiring in October'2012** which will limit booking of forex losses only till Q3FY13 post which there will be **significant rebound in profitability starting Q4FY13** which coincides with rising scale because of company's major AI and API molecules beginning commercial production from Q3FY13. Also, CAPEX requirement for coming two years (till FY15) is relatively low as assets are already built over last decade and ***focus going forward is to be on increased utilisation***.

Debt of ~550 crores should also not be a major concern as its likely to remain stagnant atleast till next two years and considering the fact that internal cash generation should be in excess of 125-140 crores each year till FY15 and the low equity base at just 1.64 crore shares with 73.52 % promoter holding, provide good scope for the management to ***retire debt once equity markets start discounting its post-Q4FY13 growth phase***.

(13) Since we have touched upon the past of Hikal in above discussions, two key things need to be observed :

(a) Margin Focus

(b) Concern towards Minority Shareholders' Wealth Creation

Let's take the first aspect **'Margin Focus'** - whatever difficulties company faced in the past, its focus on margin never went off. **Over last 10 years, company operated at an average EBITDA margin of 27.64 %** which, although is lower than super-normal 35-40% EBITDA margins company enjoyed in initial years (because of monopolistic environment when it was the only TBZ producer in the world), still, is a very healthy margin as compared to peers. Over the years, company made many conscious decisions of phasing out low margin products and instead concentrating on high margin products as also focusing on relationships which can generate healthy margins in the long term. Provided below is a glimpse of last 10 years EBITDA margins of Hikal :

	FY12	FY11	FY10	FY09	FY08	FY07	FY06	FY05	FY04	FY03
EBITDA Margins	26.55 %	25.97 %	33.39 %	27.46 %	27.47 %	26.78 %	28.22 %	26.44 %	24.88 %	29.28 %

10 Years' Avg. EBITDA Margins = 27.64 %

(14) Now comes the crucial **'Minority Shareholders' Wealth Creation'** aspect : Inspite of company facing pressures because of heavy CAPEX plans, failed acquisition and forex losses due to sudden depreciation of INR, company continued paying handsome dividends each year over last 10 years, except one year in which it skipped dividend. These dividends are in addition to two bonus issuances that company has done in last 12 years – one in FY01 (1:1) and other in FY04 (1:2).

Such handsome rewards signify management's strong confidence in future growth of the company as also their concern towards minority shareholders' wealth creation. Provided below is a glimpse of dividends paid by Hikal over last 12 years :

Dividend History

Year	Dividend Paid in ₹	Dividend Payout as % of PAT
FY12	6 (60 %)	21.07 %
FY11	6 (60 %)	25.73 %
FY10	8 (80 %)	25.58 %
FY09	0 (0 %)	0 %
FY08	7 (70 %)	26.01 %
FY07	6.5 (65 %)	44.67 % (includes Dividend Paid for Pref. Shares)
FY06	6.5 (65 %)	30.19 %
FY05	6.5 (65 %)	32.55 %
FY04	5 (50 %) [on enhanced equity post 1:2 Bonus Issue]	30.66 %
FY03	6.5 (65 %)	31.64 %
FY02	6.5 (65 %)	33.87 %
FY01	5 (50 %)	32.52 %

Bonus History

Year	Ratio	Equity Capital Before Bonus Issue	Equity Capital Post Bonus Issue
FY04	1 : 2	10.05 cr. (1.00 cr. shares)	15.08 cr. (1.5 cr. shares)
FY01	1 : 1	5.03 cr. (0.50 cr. shares)	10.05 cr. (1.00 cr. shares)

(15) Time is now ripe to look at most critical factor ignoring which no investment decision can be made - the factor is **'Valuation'**. If we omit forex losses booked by Hikal in FY12, it results in gross relative undervaluation of the company on bourses. However, it will not be proper for us to look at financials of Hikal in isolation of forex losses and still, even after considering the final reported financials (including forex losses), we find that **scarcity premium is totally missing which makes it a strong candidate for re-rating.**

Without discussing further, let's straightaway look at peer comparision of Hikal below :

	Hikal Ltd.	**Divis Labs**	**PI Industries**	**Shasun Pharma**
FY12 Revenue	707.82 cr.	1864 cr.	879.1 cr. (L-t-L = 374 cr.)	1066 cr.
EBITDA Margins (FY12)	26.55 %	37.04 %	16.81 %	12.86 %
Fixed Assets (FY12)	639.3 cr.	738.41 cr.	295.7 cr.	276.82 cr.
MCAP/Fixed Assets Ratio (FY12 Fixed Assets)	1.09	20.08	4.68	3.28
Mcap/Sales (FY12 Sales)	0.98	7.95	1.55	0.85
EV/EBITDA	5.65	13.41	8.91	7.48
EV/Sales	1.34	7.79	1.69	0.89
Price-to-Book Value	1.52	6.68	4.31	3.39

Five key things need to be noted from above :

(a) **PI Industries**, which started its CSM (CRAMS) operations early, had successfully **passed first two stages** of upfront asset building and forging supply-relationships **till FY09** and **today is into the fourth stage** of improving asset utilisation. Also, PI's financials also include its agri-input business without which the scale of pure CSM segment of PI is INR 374 crores as at FY12.

(b) **Divis entered CRAMS space much early** (even earlier than PI) and so enjoys much better operational efficiencies than any of the peers.

(c) Low **ROCE and ROE** of Hikal are the result of it being in asset building phase till FY11 as also its failed acquisition in the past and booking of forex losses. Going forward these parameters are **expected to improve significantly starting FY14**.

(d) **EBITDA margins of Hikal are one of the best in the industry** which signifies its clear focus on margins inspite of all odds as also sets stage for **robust cash generation during higher asset utilisation phase starting FY14**.

(e) All forward covers and derivative contracts taken by Hikal are **due for expiry in October'2012** post which there will be **significant improvement in Net Profitability**.

Conclusion :

A company which has

- Most **Ethical & Trusted Promoters** & Management Team
- **Track Record of exceptional** concern towards **Minority Shareholders' Wealth Creation** even in worst times
- Has **Exclusive Supplier-Relationships with Syngenta, Bayer & BASF** - Top 3 of only 5 major global crop protection companies
- Is **World's Largest Producer of promising molecule Gabapentin** which itself is projected to grow at 7 % p.a. in volume terms till FY15
- Has significantly built Asset Base which is evident from **FY12's Fixed Asset base of INR 714.87 cr.** which is even **higher than current market-cap of the company**
- Even in **Asset-Building (heavy CAPEX) phase**, grown its **Revenues at 10 years' CAGR of 19.55 %** and **EBITDA at 10 years' CAGR of 15.94 %** is now ***entering Asset-Utilisation phase starting Q4FY13***
- With **FY14e Revenues at INR 1040 cr. @ 27 % + EBITDA margins**
- With **73.52 % promoter holding**

is available at :

just **INR 697 cr. market-cap** which translates to :

- **MCAP/FY14e EBITDA** ratio of just **2.5**
- **MCAP/FY14e Sales** ratio of just **0.68**
- **TTM (FY12) Price/BV** of just **1.55**, & **FY14e Price/BV** of just **1.16**

is an anomaly which can't exist for long.

Markets are still discounting Hikal Ltd based on its past when it was in heavy CAPEX phase wherein it invested 500 crores in just last five years to build significant assets (consolidated Net Fixed Asset base including 75 cr. CWP = 714.87 cr.). With :

- **no substantial CAPEX plans for next two years**,
- management focus on **improving Asset Utilisation**,
- with **long-term supply-relationships already sealed** in FY12,
- **delivery of which expected to commence from Q4FY13**

there should be **significant and sharp improvement in revenues and profitability starting FY14** which makes Hikal a strong candidate for **Re-Rating** - a process which should ***commence from Q3FY13*** when all its derivative and forward contracts approach expiry.

Scarcity Premium is completely missing from company's commanded valuations inspite of just 13.46 % free-float as 73.52 % is held by promoters and 13.02 % held by International Finance Corporation and Reliance Capital combine (acquired at INR 464 and INR 360 respectively). Absence of scarcity premium limits downside considerably and leaves ample scope for sharp re-rating on whiff of smallest positive trigger.

Views are Invited from fellow members on this Promising Investment Opportunity.