Management Meet Update

Unichem Laboratories

December 23, 2011

NEUTRAL

CMP*	Rs156
Target Price	-

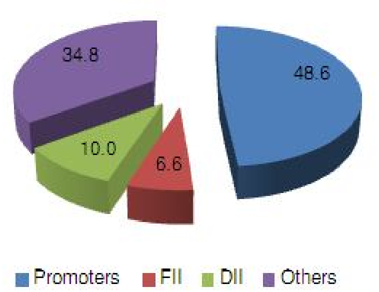
Stock Info

Sector	Pharmaceuticals
Market Cap (Rs cr)	1,412
52 Week High/Low	270/100
Avg. Daily Volume (3m, '000)	111
Avg. Daily Value (3m, cr)	1.5
Dividend Yield (%)	2.5
Sensex	15,738
Nifty	4,714
BSE Code	506690
NSE Code	UNICHEMLAB

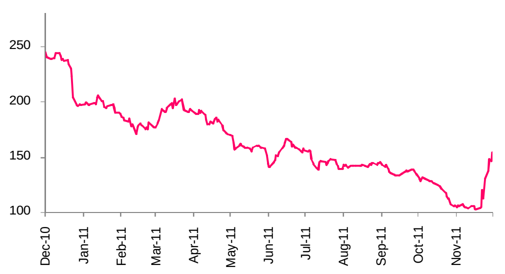
Stock Performance

(%)	UNICHEM	NIFTY
1-week	37.3	(0.3)
1-month	44.7	(1.6)
1-year	(37.1)	(20.9)

Shareholding Pattern (%)



Stock Price Chart



*Note: *CMP as on December 23, 2011*

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Revival still 2-3 quarters ahead

Key points

We recently met the management of Unichem Labs to get an insight on business. Following are the key excerpts:

- **Domestic revival 2-3 quarters away:** The transition of domestic business model from distributors' end to C&F agents continues steadily. The inventory level at the distributor's end has come down to 40 days from 60 earlier. Management intends to bring it lower to ~20-30 days in the next 2-3 quarters post which growth normalcy shall resume to 15-16% yoy. Attrition rate has come down to industry levels of 17-18% from 30% earlier.
- **Exports business to hold on the growth cycle:** While a strong order book from MNCs drive the growth in the CRAMS segment (following the P2P model), the emerging markets also continue to do well. However the UK subsidiary, Niche Generics, continue to struggle and the much awaited break-even in its operations is still 12-18 months away, in our view. With over 7 commercialized and 10 pending ANDA filings, US market is expected to grow at ~40% CAGR on a lower base.
- **Balance Sheet Update:** The D/E ratio stands at 0.1x making it virtually debt free. The company plans to do a capex of ~Rs100-120cr for FY2012 largely for its manufacturing facilities at the Indore SEZ and the R&D centre in Goa. Further, Unichem management has denied any rumors of stake sale or equity dilution.

Outlook and Valuation

We remain positive about the initiatives that Unichem has introduced in the domestic business, which is the core revenue and profit centre of the company. While the core strengths of the business remain intact, the challenges pose a threat in the near term. However, new CRAMS orders on the export formulations front could save the day for the company in 2HFY2012. Inventory rationalization and increasing cost pressure (addition in field force, increased promotion spend and commissioning of new plants) may continue to impact margins and profitability in the near term.

A strong domestic franchise along with strong balance sheet makes Unichem an attractive prospect for tie-ups and/or buyout by MNCs to gain access to Indian markets as well as capitalize on efficient manufacturing for sourcing key product globally. Despite the management's denial of any such deal, we believe that newsflow of such nature could support the stock price. **Though we believe that the near term hurdles have been price in, citing no new trigger in the medium term, we maintain Neutral rating on the stock. At the CMP of Rs156 the stock is trading at 12.8x FY2013E EPS.**

Risks to the view

- Slippage in the domestic growth, besides restricting expansion in valuations, could aggravate margin pressure
- Slowdown in the ramp up of new distribution model could also pose its own set of challenges

Year End	Net Revenues		EBITDA		Net income (adjusted)		RoE	RoCE	EPS	Valuations (X)	
	(Rs cr)	% growth	(Rs cr)	% margin	(Rs cr)	% growth	%	%	(Rs)	P/E	EV/EBITDA
FY2010	741	0.7	164	22.2	123	13.5	23.5	25.9	13.6	11.5	8.8
FY2011	817	10.3	143	17.5	95	(22.5)	16.1	19.1	10.5	14.9	10.2
FY2012E	859	5.1	145	16.9	89	(6.8)	13.8	15.9	9.8	16.0	10.1
FY2013E	971	13.1	180	18.5	110	24.1	15.7	18.0	12.2	12.8	8.3

Domestic formulations revival still 2-3 quarters away

Unichem obtains ~70% of its total revenues from the domestic formulations with hefty gross margins. However the business has been suffering from past 3 quarters owing to the transition of its domestic business model from distributor to C&F agents for cost savings and better inventory management in the long run.

- Unichem is reducing its inventory at the distributor level inorder to improve its working capital cycle as well as reducing the commission from the distributor's (~4.5%) vis-à-vis ~3% charged by the C&F agents. They have managed to reduce the inventory level to ~40-45 days as compared to 60 days post Q2FY12. The management further targets it to bring lower at 30 days by the end of FY2012.
- Besides, Unichem has also been facing higher attrition rate over the past year at ~30%. However the management has been able to keep a check at the attrition issue managing it to bring down to 17-18%, at the average industry levels.
- Unichem's domestic franchise comprises 60% chronic and 40% of acute therapies. Amongst these 40% of acute, almost 50% is dominated by the matured portfolio (Ampoxin, Trika, Vizylac). With the revival in the acute segment post the 2QFY2012, we expect Unichem's domestic franchise to pick up gradually.
- The company continues to invest in field force where the current MR count for the domestic formulations stand at 2300 up from ~800 over the last 8 quarters. The MRs are distributed amongst therapeutic categories like CVS, CNS, Diabetology, Nephrology, Gynecology, matured products portfolio, hospital and generic products.
- Ramp up in the MR productivity sales along with completion of domestic model restructuring will enable company's domestic business to revive its double digit growth thereby helping the operating margins.
- Company has guided for a revenue growth of ~15-16% for domestic business post the completion of restructuring exercise. Given the current pace of the restructuring, we expect the revival to come no sooner than 2HFY2013E.

CRAMS business moving ahead steadily

Unichem follows a P2P model for its CRAMS business which is spread across US, Canada and European regions.

- The capacity utilization of the Ghaziabad plant has scaled upto ~80% from 20% earlier with the commencement of contract agreement of a US based MNC.
- Unichem's Greenfield plant at Baddi (Cephalosporin) is also expected to start manufacturing sampling batches for another US based MNC post the latter's site inspection. The company expects the commercial dispatches to start by 4QFY2013E.
- The Indore facility is expected to get completed by April 2012, which will provide more upside to its CRAMS business.

Niche Generics: revival looks difficult in the near term

- Unichem's European subsidiary, Niche Generics, continues its struggle to achieve break-even even in FY2012.
- The current business environment is not favorable in Europe and Germany despite the increasing volume growth owing to receiving concerns. The management has spread itself across South Africa, Australia and other parts of Europe.

- The company has a total basket of 25 total products but markets only 10 odd products currently due to high price erosion in the European market.
- Despite improving gross margin at its packaging facility at ~50%, the company continues to make losses due to inconsistent operations and high payroll cost.
- Although the company has initiated various measures for product rationalization and pruning its product pipeline, the profitability and more so even the break-even in operations is still 12-18 months away, in our view.

Brazilian subsidiary: Still at nascent stage

- Unichem's subsidiary in Brazil is still at a very nascent stage with only 2 ANDA approvals and 3 pending approval in its kitty.
- However the company has not launched any product as of yet due to the changing regulatory scenario in the geography.
- Unichem plans to set up a QC lab in Brazil as required by the regulators and is confident of achieving break-even and profitability by FY2014.

Exports to grow at 25-30%

- Unichem's export business has been driven by strong performance from US and Latam markets.
- Till date, the company has launched 7 products in the US, has 10 approvals out of total 20 filings made to the USFDA.
- The market size of these filings range from ~US$100-500mn each and Unichem estimates revenue of ~US$1-2mn from each of these products upon commercialization.
- The company aims at filing atleast 2 ANDA every quarter finishing up with 25-30 filings per year. Besides these the company has also identified ~10-15 molecules for ANDA filings.
- We expect the US market to grow at ~40%+ CAGR over the next 2 years on a lower base.

Balance Sheet Update

- Unichem is virtually a debt free company with net debt at ~Rs10-15cr and a D/E ratio of 0.1x.
- Owing to current rupee depreciation, the company anticipates a loss on imports against gain on exports which could lead to lower profits but no exchange losses.
- The company has earmarked a Capex of Rs100-120cr for FY2012 and has already expensed Rs75-80cr till date. The capex would be utilized for expansion of SEZ, building of an R&D centre in Goa and normal working capital requirements.
- As per the Unichem management, it does not intend to dilute or raise equity or any stake sale in the company.

Outlook and Valuation

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Profit & Loss Statement (Consolidated)

Y/E March (Rs cr)	FY2010	FY2011	FY2012E	FY2013E
Net Sales	741	817	859	971
Total Expenditure	**577**	**674**	**714**	**792**
Cost of Materials	276	306	294	325
Personnel	103	124	149	165
Others	197	244	271	301
EBITDA	**164**	**143**	**145**	**180**
% chg		*(12.8)*	*1.4*	*23.8*
(% of Net Sales)	*22.2*	*17.5*	*16.9*	*18.5*
Depreciation& Amortization	23	29	33	39
EBIT	**141**	**114**	**112**	**140**
% chg		*(19.1)*	*(1.4)*	*24.9*
(% of Net Sales)	*19.0*	*13.9*	*13.1*	*14.4*
Interest & other Charges	1	1	2	2
Other Income	13	14	5	5
(% of PBT)	*8.7*	*10.9*	*4.3*	*3.5*
Share in profit of Associates	-	-	-	-
Recurring PBT	**153**	**127**	**115**	**143**
% chg		*(17.3)*	*(9.1)*	*24.1*
Prior Period & Extraordinary Expense/(Inc.)	-	-	-	-
PBT (reported)	**153**	**127**	**115**	**143**
Tax	30	32	27	33
(% of PBT)	*19.9*	*24.9*	*23.0*	*23.0*
Minority Interest	-	-	-	-
PAT (adjusted)	**123**	**95**	**89**	**110**
Add: Share of earnings of associate	-	-	-	-
Less: Extraordinary item(EI)	1.9	(0.5)	(2.3)	-
PAT after MI (reported)	**121**	**96**	**91**	**110**
% chg		*(20.8)*	*(4.8)*	*21.0*
(% of Net Sales)	*16.3*	*11.7*	*10.6*	*11.3*
Basic EPS (Rs)	**13.6**	**10.5**	**9.8**	**12.2**
Fully Diluted EPS (Rs)	**13.6**	**10.5**	**9.8**	**12.2**
% chg		*(22.5)*	*(6.8)*	*24.1*

Balance Sheet (Consolidated)

Y/E March (Rs cr)	FY2010	FY2011	FY2012E	FY2013E
SOURCES OF FUNDS				
Equity Share Capital	18	18	18	18
Preference Capital	-	-	-	-
Reserves& Surplus	545	600	649	717
Shareholders' Funds	**563**	**618**	**667**	**735**
Minority Interest	-	-	-	-
Total Loans	36	50	65	65
Total Liabilities	**599**	**668**	**732**	**800**
APPLICATION OF FUNDS				
Gross Block	465	537	657	757
Less: Acc. Depreciation	131	160	193	232
Net Block	**333**	**377**	**464**	**525**
Capital Work-in-Progress	64	79	70	70
Goodwill on consolidation	-	-	-	-
Investments	**59**	**21**	**23**	**26**
Current Assets	344	404	411	441
Cash	24	15	27	6
Loans & Advances	44	52	55	62
Other	-	-	-	-
Current liabilities	167	176	197	218
Net Current Assets	**177**	**228**	**215**	**223**
Miscellaneous Expenditure	-	-	-	-
Net Deferred Tax	(35)	(38)	(41)	(44)
Total Assets	**599**	**668**	**732**	**800**

Cash Flow Statement

Y/E March (Rs cr)	FY2010	FY2011	FY2012E	FY2013E
Profit before tax	153	127	115	143
Depreciation	23	29	33	39
Change in Working Capital	9	59	(25)	29
Interest / Dividend (Net)	1	1	2	2
Direct taxes paid	30	32	27	33
Others	(53)	(76)	(38)	(63)
Cash Flow from Operations	**146**	**53**	**163**	**125**
(Inc.)/ Dec. in Fixed Assets	50	72	120	100
(Inc.)/ Dec. in Investments	58	(38)	2	2
Cash Flow from Investing	**(109)**	**(35)**	**(122)**	**(102)**
Issue of Equity	-	1	-	-
Inc./(Dec.) in loans	(4)	14	15	-
Dividend Paid (Incl. Tax)	42	42	42	42
Interest / Dividend (Net)	1	1	2	2
Cash Flow from Financing	**(47)**	**(28)**	**(29)**	**(44)**
Inc./(Dec.) in Cash	(10)	(9)	12	(21)
Opening Cash balances	**34**	**24**	**15**	**27**
Closing Cash balances	**24**	**15**	**27**	**6**

Key Ratios

Y/E March	FY2010	FY2011	FY2012E	FY2013E
Valuation Ratio (x)				
P/E (on FDEPS)	11.5	14.9	16.0	12.8
P/CEPS	9.8	11.5	11.7	9.5
P/BV	2.5	2.3	2.1	1.9
Dividend yield (%)	2.5	2.5	2.5	2.5
EV/Sales	1.9	1.8	1.7	1.5
EV/EBITDA	8.8	10.2	10.1	8.3
EV / Total Assets	2.3	2.1	1.9	1.8
Per Share Data (Rs)				
EPS (Basic)	13.6	10.5	9.8	12.2
EPS (fully diluted)	13.6	10.5	9.8	12.2
Cash EPS	16.2	13.8	13.5	16.6
DPS	4.0	4.0	4.0	4.0
Book Value	62.4	68.5	73.9	81.4
Returns (%)				
RoCE	25.9	19.1	15.9	18.0
RoIC	30.0	23.4	21.5	23.4
RoE	23.5	16.1	13.8	15.7
Turnover ratios (x)				
Asset Turnover (Gross Block)	1.2	1.2	1.2	1.2
Inventory / Sales (days)	52	58	60	60
Receivables (days)	78	79	80	80
Payables (days)	79	73	80	80
WCC (days)	76	95	80	82