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Unichem Laboratories

Gearing for growth

Initiating Coverage

18 October, 2010

Reco	Changed from
BUY	**-**
CMP	Target Price
Rs530	**Rs670**

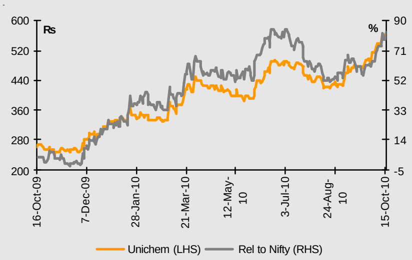
EPS change FY11E/12E (%)	-
Target price change (%)	-
Nifty	6,063
Sensex	20,125

Price Performance

(%)	1M	3M	6M	12M
Absolute	13	9	25	103
Rel. to Sensex	9	(3)	9	75

Source: Bloomberg

Relative price chart



Source: Bloomberg

Stock details

Sector	Pharmaceuticals
Bloomberg	UL@IN
Equity Capital (Rs mn)	180
Face Value (Rs)	5
No of shares o/s (mn)	36
52 Week H/L (Rs)	581/238
Market Cap (Rs bn/USD mn)	245/5,534
Daily Avg Vol (No of shares)	45588
Daily Avg Turnover (US$ mn)	0.5

Shareholding Pattern (%)

	Jun-10	Mar-10	Dec-09
Promoters	48.4	48.4	48.4
FII/NRI	3.8	3.4	2.4
Institutions	14.1	13.7	15.8
Private Corp	6.7	6.9	5.5
Public	27.1	27.6	28.0

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- **Increased focus on prescription generation, penetration into tier-II to tier-IV markets and turnaround in Niche Generics to drive 25% earnings CAGR over FY10-13E**
- **International business to start contributing positively from FY12E, expect 38% revenue CAGR over FY10-13E**
- **Potential new contracts with MNCs to drive growth on account of higher capacity utilization and operational leverage**
- **Strong balance sheet, zero debt and robust return ratios provide key comfort to investors; initiate coverage with Buy**

Gearing up for a strong growth trajectory

In order to counter underperformance in the domestic business, management has taken various initiatives such as increased focus on prescription generation, strong addition to the field force, nurturing a second-tier of power brands and penetration into tier-II to tier-IV markets. We believe that the phase of turbulence is behind us and that Unichem is gearing up for a strong growth trajectory. Going forward, we expect earnings CAGR of 25% over FY10-13E driven by 16% growth in domestic formulation business and turnaround in Niche Generics.

International business at inflexion point

Unichem's international business (25% contribution to topline), which was so far, in investment mode, is at an inflexion point as we expect them to start contributing profitably from FY12E onwards. Losses incurred in international subsidiaries are expected to come down to ~Rs50mn in FY11E and we expect a profitable contribution of Rs50mn in FY12E. Overall, we expect its international business revenues to grow at a CAGR of 38% over FY10-13E.

Tie-up with MNCs will drive growth in medium term

Unichem is in advanced stages of negotiations with 2-3 large MNCs for licensing and supply contracts of Cephalosporins, Beta Lactam and other products. We expect these to be signed in FY11E itself and likely start materializing from FY12E onwards. At an optimum level, these contracts can contribute incremental revenue of over Rs2.5bn for Unichem.

Healthy balance sheet - key comfort for investors; Initiate coverage with a Buy

Unichem is a zero debt company and has positive free cash flows. It has a strong balance sheet with cash and investment equivalent to Rs23/ share (4% of CMP). The zero leverage strategy offers stability to operations and positive operating cash flows implies headroom for valuations to expand. Moreover, a shorter working capital cycle of 77 days as compared to industry average of 115 days has kept the return ratios at healthy levels. Strong ratios are also driven by a) higher contribution of formulation business, b) steady operating margins and c) faster cash conversion cycle. We expect significant expansion in RoCE and RoE from 28% and 23.4% in FY10 to 37% and 28% in FY13E. Revenues and earnings are expected to clock 20% and 25% CAGR respectively over FY10-13E, with an EPS of Rs51.4 in FY12E. At CMP, the stock is trading at 10.3xFY12E EPS. Initiate coverage with a Buy rating and a target price of Rs670.

Financial Snapshot **Rs Mn**

YE-Mar	Total Sales	EBITDA (Core)	(%)	APAT	EPS (Rs)	EPS % chg	RoE (%)	P/E	EV/ EBITDA	P/BV
FY10	7,473	1,730	23.2	1,249	34.6	85.9	23.4	15.3	11.3	3.4
FY11E	8,446	1,952	23.1	1,334	37.0	19.5	22.0	14.3	9.9	2.9
FY12E	10,558	2,599	24.6	1,852	51.4	6.9	26.1	10.3	7.4	2.5
FY13E	12,912	3,255	25.2	2,377	65.9	38.8	28.2	8.0	5.9	2.1

Underperformance is history; gearing up for a strong growth trajectory

Various initiatives taken by the management and a turnaround in Niche Generics to drive earnings CAGR of 25% over FY10-13E

Unichem's underperformance in the domestic market and operational losses at Niche Generics are behind us. The various initiatives taken by the management to restructure/ re-organise their operations have already started yielding positive results. We expect these initiatives and the turnaround of Niche Generics to drive Unichem's future growth.

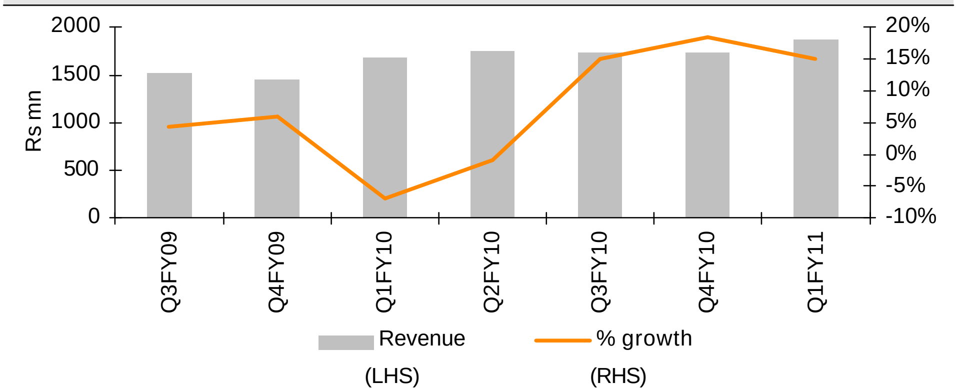
Despite strong franchises with the key opinion builders, the withdrawal of Cox-2 inhibitors (contribution of Rs200 mn before withdrawal) and two price cuts of 30% and 10% in Ampoxin in 2006 and 2007 respectively impacted Unichem's domestic performance (11% CAGR vs. 14% industry CAGR over FY06-10) . Adjusting to this, the growth of its domestic formulation business has been in-line with industry growth. Similarly, the severe pricing environment in Europe, coupled with economic recession, has impacted Niche's operations significantly. We believe that the phase of turbulence is behind us and that Unichem is gearing up for a strong growth trajectory. Going forward, we expect Unichem to report an earnings CAGR of 25% over FY10-13E driven by growth of a) 16% in domestic formulation business, b) 40% in export formulation, c) 29% in export API and d) Rs1.6bn (12% of FY13E revenue) contribution from new CRAMS contracts.

Restructuring initiatives have started yielding positive results

A series of restructuring/ reorganising initiatives has led to 15% growth in the domestic formulation business

In order to address the sluggish growth rates and reduce its dependence on top contributing brands in the domestic market, Unichem has embarked on a series of restructuring/ reorganising initiatives, the benefits of which, have already started yielding positive results. The revenue growth from the domestic formulation business has improved to 15-17% in the last four quarters from a decline of 7% in Q1FY10. Going forward, company is confident of outpacing the industry growth by 100-200bps on the back of various initiatives, which it has taken.

Domestic revenue growth (QoQ)



Source: Company, Emkay Research

Focus on prescription generation

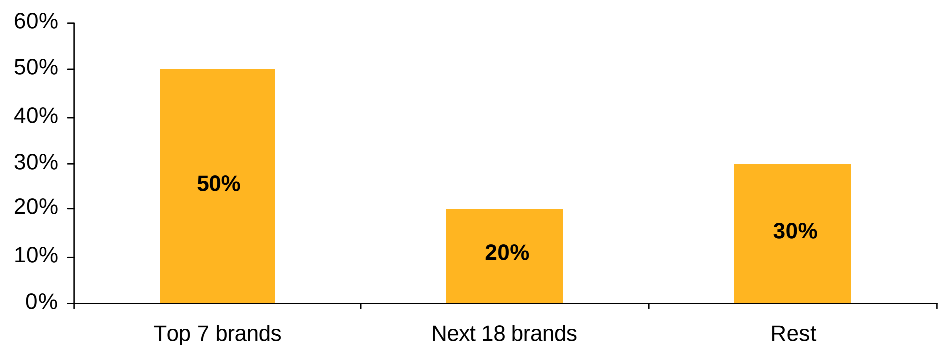
Unichem has started focussing more on prescription generation rather than emphasising on the primary sales. This pull strategy has not only sharpened the sales force's focus on the prescribers but has also given them better understanding of doctor's prescription habits, leading to better productivity. Though this change in strategy initially impacted company's primary revenue to distributors, we have seen healthy growth in prescription generation in the last two quarters. As per ORG IMS August MAT'10, Unichem repoted 23% MAT growth in domestic business.

Telsar & Olsar group to emerge as new power brands with expected revenues of Rs400-500 mn each by FY13E

Nurturing a second tier of power brands

To de-risk its business model from selective brands, company has identified a second tier of brands, which have been well received by the prescribers. As of now, its top 7 brands contribute around 50% to revenues and next 18 brands contribute 20% to revenues. Unichem has identified these 18 brands as the focus brands to help it propel its growth and de-risk its current concentration on a select few brands. To put things in perspective, in order to reduce its dependency on Losar (Losartan) group, company has identified Telsar (Telmisartan) and Olsar (Olmesartan) group as key focus brands in Angio Tensin -II Receptor Blockers (ARB) therapy, which has already well accepted by key prescribers. Telsar group and Olsar group have now become Rs290mn and Rs120mn brands for Unichem and company expects them to touch Rs400-500mn each by FY13E.

Top 10 brands contribute 50% of domestic revenues



Source: Company, Emkay Research

Taking key brands to mass prescribers

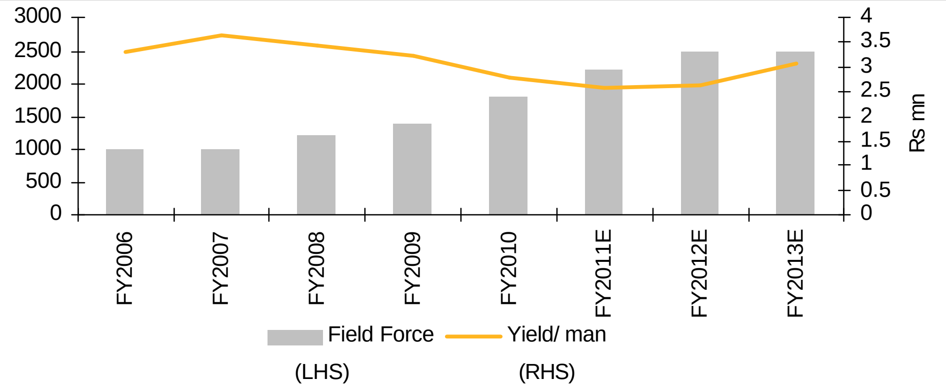
In order to manage the lifecycle of its key brands (Losar, Trika and TG-Tor) and grow further, company is taking these brands to mass prescribers such as Physicians and General Practitioners, who also prescribe anti-hypertensive drugs. This strategy has already started showing encouraging response for Unichem as its largest brand, Losar, which struggled in FY09 (grew by 5%) has recorded 20% growth in FY10.

Focus on Tier II to Tier IV towns; to add 700 people in next 18 months

Increasing reach and penetration by expanding field force

In order to capture the strong growth prospects in Tier II to Tier IV towns, Unichem is expanding its field force by 70% to 2,500 in next 12-18 months. Company has already expanded its field force by 400 to 1800 in last six months and is adding an incremental 700 people in the next 18 months. We believe this will further improve its domestic growth prospects.

Field force expansion



Source: Company, Emkay Research

Focus on high growth segments will continue to drive growth

Unichem has identified few new segments such as Opthal, Derma and Nephro and has plans to have a separate division for hospitals.

Unichem enjoys strong presence in chronic segment and 57% of its domestic revenues come from segments like CVS (42%), CNS (12%) and Diabetes (4%). These segments not only offer higher growth prospects but are also more profitable as they enjoy higher margins. Moreover, Unichem's key strength lies in its ability to market products and build successful brands. Unichem has been able to strongly establish itself in the therapeutic segments that it operates in, on the back of its strong brand positioning. Unichem owns some of the biggest brands in the industry and its top 7 brands contribute ~ 50% to its total revenues. While Unichem represents only 20% of the IPM, it is the 8th largest player in the represented market with a market share of 2.72% (ORG IMS August MAT'10). In order to increase its representation of the IPM, Unichem has identified few new segments such as Opthal, Derma and Nephro which offer higher growth potential. We expect Unichem's strong brand building abilities to quickly establish itself in these new therapeutic areas. Company also plans to have a separate division for hospitals as the influence of the same is growing in the domestic formulation market. We are of the view that their focus on high growth segments within the domestic space, is likely to help Unichem outpace industry growth, going forward.

Induction of new and experienced team at the top

In order to strengthen its management team and successfully chart a future growth strategy, Unichem has inducted several professionals at top levels from reputed MNCs as well as Indian pharma companies. It has roped in Mr. Harcharan Singh as CEO (domestic and emerging markets) from GSK India, where he was leading the acute therapy division (c95% of GSK's formulation revenue). Under his guidance, the company has already started focussing on prescription driven sales. Similarly, it has also roped in Mr. M Gundurao as Executive Vice president – Corporate Affairs, from Pfizer where he was Director- Finance. Mr. R Parikh (CFO) has worked with J&J before joining Unichem. Unichem has also roped in other functionary heads in R&D, HR, manufacturing, finance, projects, Q&A from other leading companies to strengthen its top management layer.

Various initiatives to enable Unichem to outpace industry growth; 16% CAGR in domestic branded formulation business

Expect Unichem to outpace industry growth going forward

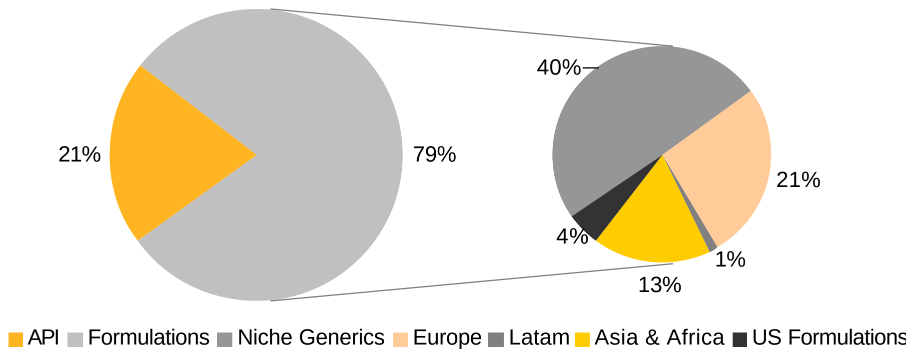
We are of the view that the various initiatives taken by Unichem will enable it to outpace industry growth and expect revenue CAGR of 16% over FY10-13E. The initial signs of recovery in its domestic business are already visible and it will further escalate going forward. Moreover, Unichem is also gradually phasing out its generic business (contributed 5% of domestic revenue) as it is a non-core and margin dilutive business.

International business at inflexion point

International operations, which were so far, in investment mode, to start contributing profitably from FY12E onwards.

International business, which currently contributes 25% of overall revenues, is at an inflexion point. 75% of Unichem's export revenues come from the formulation business, out of which, Niche Generics (UK) contributes 50% of export formulation. Besides Niche Generics, Unichem's international presence is spread over the emerging markets of south east Asia, CIS/Russia and Africa (contributes 18% of export formulation revenue) as well as regulated markets such as US and rest of Europe (ex. Niche). International operations, which were so far, in investment mode, are at an inflexion point as we expect them to start contributing profitably from FY12E onwards. International subsidiaries incurred a loss of Rs180mn in FY09 and Rs110mn in FY10. This loss is expected to come down to ~Rs50mn in FY11E. Overall we expect a profitable contribution of Rs50mn in FY12E. We expect its international business revenues to grow at a CAGR of 38% over FY10-13E.

International business (Revenue breakup %)



Source: Company, Emkay Research

Slow down in Europe impacted Niche turnaround; Expect positive contribution in FY12E

The severe pricing environment in the Europe, especially in UK, coupled with economic recession, had impacted Niche's operations significantly. Unichem's management has taken several initiatives to cut the losses at Niche Generics and turn it around into a profitable entity.

Unichem acquired 60% stake in Niche Generics, UK in 2002 with an initial investment of GBP3mn. This marked its entry in the European market. Later on. in 2007, the company bought out the balance stake in Niche, making it a wholly owned subsidiary.

Niche develops, manufactures and sells pharmaceutical formulations in the EU union. Niche derives 70% of its revenues from Western Europe and has expanded its operations to other EU territories including Australia, Canada and South Africa.

The severe pricing environment in Europe, especially in UK (30% of revenues), coupled with economic recession, had impacted Niche's operations significantly. The subsidiary incurred a loss of Rs145mn in FY07, which further intensified to Rs203mn in FY08.

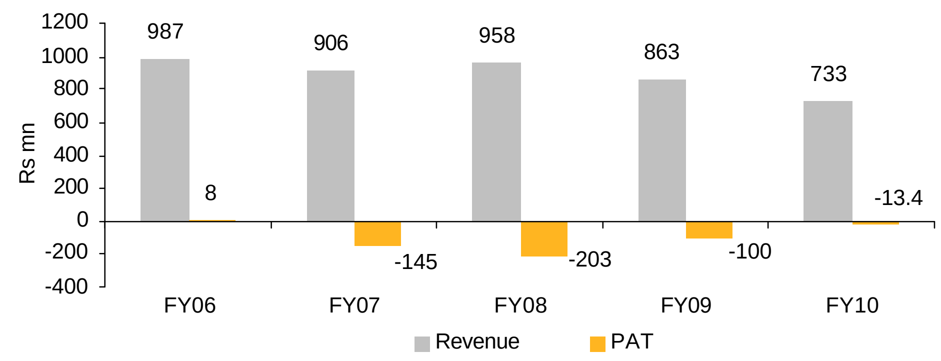
Unichem management has taken several initiatives to cut the losses of Niche Generics and to turn it around into a profitable entity. Few of the initiatives which the management has taken so far are:

- Company has reduced its headcount from 100 people to 70 people. Unichem has also closed down its manufacturing facility in Ireland. These initiatives have resulted in annual savings of 1mn GBP.
- 30% of Niche products (earlier manufactured in its Ireland facility) have been shifted to India, enabling it to reduce its manufacturing cost
- Dossier development work has moved to India, which has resulted in increased filing by Niche across different countries (earlier Niche had stopped developing new products because of slow down)
- Unichem management has infused much needed working capital, which enabled Niche Generics to expand its geographical reach to other Eastern European countries rather than just depending upon UK. As a result the company has started getting approvals from these countries. In FY12E, we expect the first wave of Niche products' launches, which should give them decent upsides.
- Product rationalisations as few of the products were contributing too little
- Unichem has also invested GBP1.2mn for a packaging facility in Ireland, which will enhance its bargaining power while competing with the local brands

Going forward, we expect Niche Generics to report a topline of 10.5mn GBP and 11.5mn GBP in FY12E and FY13E respectively.

Though all these initiatives have already started showing early signs of recovery, the complete turnaround of Niche Generics has been delayed by a year because of economic turmoil in European countries. Despite 10% decline in top line, the losses have reduced significantly from Rs100mn in FY09 (loss of Rs208mn in FY08) to Rs13mn in FY10 (had a positive EBIDTA of GBP 50K in FY10). Company expects this business to break even at PAT level in FY11E and start contributing profitably from FY12E onwards. Going forward, we expect Niche Generics to report a topline of 10.5mn GBP and 11.5mn GBP in FY12E and FY13E respectively.

Niche Generics- Revenue & Net Income



Source: Company, Emkay Research

Tie-up with MNCs will drive growth in medium term

Unichem is in advanced stages of negotiations with 2-3 large MNC companies for licensing and supply contracts of Cephalosporins, Beta Lactam and other products, for which, it has already invested over Rs1bn to create capacities. Company expects these contracts to be signed in FY11E itself and to start contributing to revenues from FY12E onwards. At an optimum level, these contracts can contribute incremental revenue of over Rs2.5bn for Unichem. On the margins front, though the gross contribution from these contracts would be lower than company level but higher capacity utilization and operational leverage will improve the overall profitability of the company. We are of the view that these contracts will drive growth in the medium term, i.e, in FY12E and FY13E respectively.

US subsidiary to break even in FY12E; drive growth from FY13E onwards

In the US, Unichem has filed 15 ANDAs- out of which- 9 have been approved and 5 launched so far. The company expects to attain revenue of US$5mn in FY12E and US$10mn in FY13E.

In the US generic market, Unichem has filed 15 ANDAs- out of which- 9 have been approved and 5 launched so far. Unichem has started dispatching its products in the US from Q3FY10 onwards (revenue of US$.7mn in FY10). Its US subsidiary had a loss of US$1.5mn in FY10. FY11E would be the first full year of its operations in the US and company is likely to attain revenue of US$5mn in FY12E and US$10mn in FY13E. Company expects its US business to break even in FY12E itself. Company expects to file another 30-35 ANDAs in the next 3-4 years and build a portfolio of 20-25 products by FY13E. We believe that US will start contributing sizable revenue from FY13E onwards.

Expect company to generate FCF of Rs3.8bn over the next three years.

Strong balance sheet; healthy return ratios

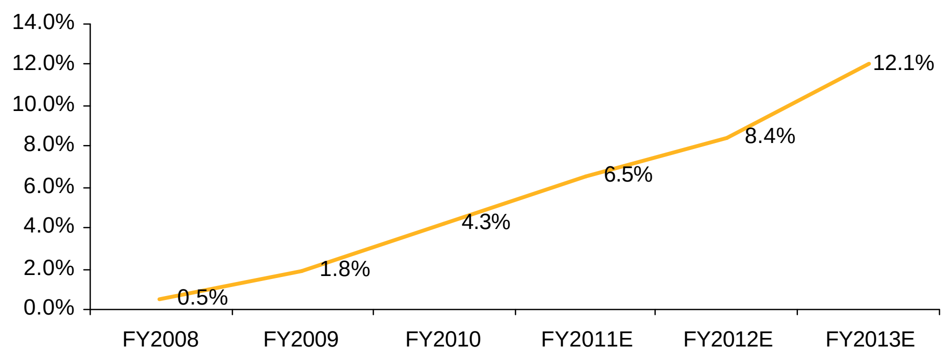
Unichem has a strong balance sheet with cash and investment equivalent to Rs23 per share (4% of CMP) and negative DE of 0.4x (FY10). With incremental capex of Rs1.5bn over FY11-13E (funded through internal accruals), we expect company to generate free cash flow of Rs3.8bn (20% of current m cap) over the next three years. Unichem is investing on setting up a SEZ at Pitampura and a pilot biotec facility (Rs350mn, targeting a domestic launch in FY13E) and a new packaging line at Goa. Moreover, company also has a shorter cash conversion cycle of 77 days as compared to industry average of 115 days. This is primarily driven by the fact that significant portion of the business is from the domestic market. Unichem has strong financial ratios largely driven by a) higher contribution of formulation business, b) steady operating margins and c) faster cash conversion cycle. RoCE and RoE are expected to move from 28% and 23% in FY10 to 37% and 28% in FY13E.

Cash conversion (CC) cycle comparison with peers

	CC (days)	RoE (%)	RoCE (%)	Net D/E (x)	Assets TO (x)
Ipca Labs	157.8	28.0	22.1	0.5	1.9
Elder	150.1	16.2	13.1	0.6	0.8
FDC	46.0	31.0	38.0	0.0	2.0
Indoco Remedies	106.0	14.0	13.0	0.2	1.6
Average	115.0	22.3	21.6	0.3	1.6
Unichem	77.1	23.4	28.0	0.0	1.9

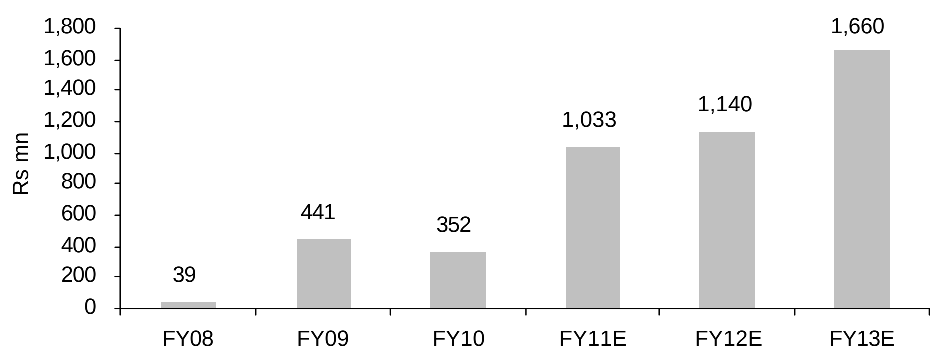
Source: Emkay Research

Cash & cash equivalents as a % of M Cap



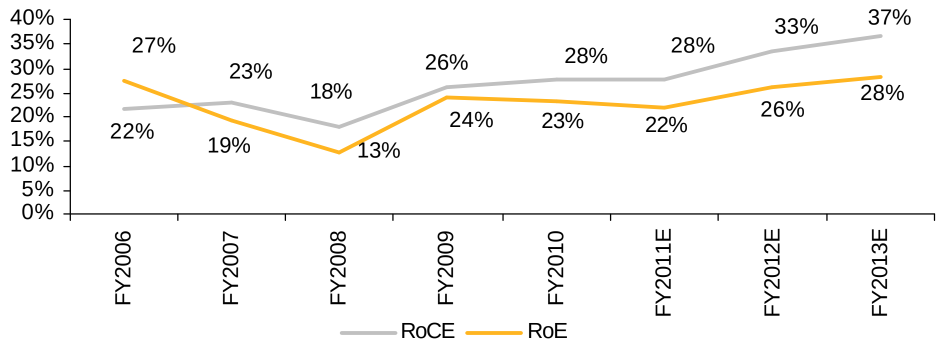
Source: Emkay Research

Free Cash Flow Generation



Source: Emkay Research

Strong financial profile



Source: Emkay Research

Financials

We expect revenues to grow at a CAGR of 20% over FY10-13E, driven by a) 38% growth in the export business, and b) 16% growth in the domestic formulation business. On the operating front, we expect margins to expand by 200bps, driven by profitable contribution from international subsidiaries and higher growth from high margin domestic formulation business. On the back of steady revenue growth and improved operating performance, we expect 25% earnings CAGR over FY10-13E. We expect company to generate free cash flow of Rs3.8bn over FY10-13E and expect RoCE to improve from 28% in FY10 to 37% in FY13E. Unichem will have cash and cash equivalent of Rs2.3bn (12% of current M Cap) by FY13E.

20% revenue CAGR over FY10-13E

We expect Unichem to record revenue CAGR of 20% over FY10-13E. We believe overall growth would be primarily aided by a) 16% growth in domestic formulation business, b) 40% growth in export formulation, c) 29% growth in export API and d) Rs1.6bn (12% of FY13E revenue) contribution from new CRAMS contracts.

New product launches and consolidation of existing brands are likely to drive future growth. We expect US business, which currently contributes Rs30mn, to grow at a CAGR of 91% (albeit on a low base) to Rs450mn (4% contribution) by FY13E. Overall, we expect international business to drive growth and the contribution of the same is likely to increase from 25% in FY10 to 37% in FY13E. On the other hand, we expect domestic formulation business to grow 100-150bps higher than the industry growth to Rs7.8bn by FY13E.

Revenue breakup

	FY08	FY09	FY10	FY11E	FY12E	FY13E	CAGR (FY10-13E)
Domestc Sales	**4631**	**5060**	**5605**	**6176**	**7060**	**8096**	**13%**
Formulations	**4443**	**4869**	**5366**	**5920**	**6789**	**7808**	**13%**
Branded	4143	4534	4996	5698	6611	7640	15%
Generics	300	335	370	222	178	169	-23%
API	**188**	**191**	**239**	**256**	**271**	**287**	**6%**
Exports	**2158.0**	**2283.0**	**1830.0**	**2222.9**	**3436.8**	**4763.9**	**38%**
Formulations	**1768.0**	**1713.0**	**1451.0**	**1622.9**	**2746.8**	**3970.4**	**40%**
Asia & Africa	176.8	239.8	246.7	283.7	323.4	368.7	14%
Europe & UK	1573.5	1456.1	1117.3	1126.7	1247.0	1411.3	8%
Niceh generics	958	863	733.0	696.4	752.1	827.3	4%
Rest of Europe	615.5	593.1	384.3	430.4	494.9	584.0	15%
Latam	0.0	0.0	14.5	29.0	58.0	87.1	82%
US & Canada	17.7	17.1	72.6	183.5	318.4	503.4	91%
API	**390.0**	**570.0**	**379.0**	**600.0**	**690.0**	**793.5**	**28%**
Total Revenue	**6789.1**	**7342.9**	**7435.0**	**8398.6**	**10496.9**	**12859.5**	**20%**

Source: Emkay Research

Ramp-up in the field force impacted 1HFY11 performance

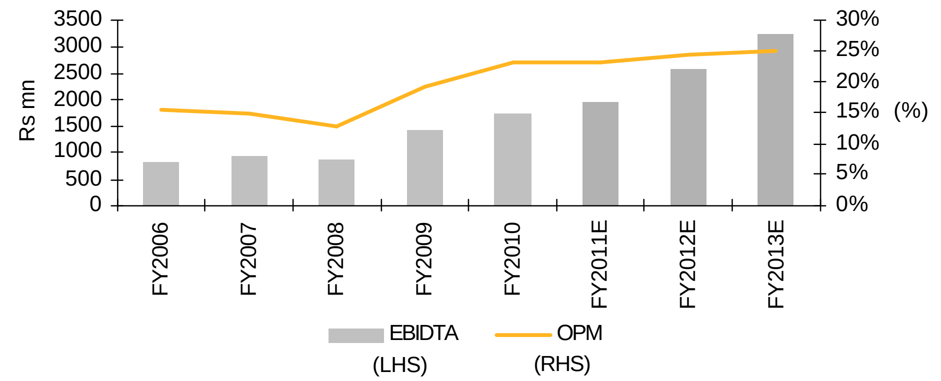
Unichem has reported subdued performance in 1HFY11. Revenue and PAT during 1HFY11 grew by 13.5% and 2.2% respectively. Despite 17% growth in domestic formulation branded business, operating performance was impacted (contracted by 150bps) mainly because of higher employee (up by 25%) and SGA cost (28%). Unichem has expanded 500 sales force in the domestic market in last six months, where the revenue contribution of the same is going to come post Q3FY11E onwards. Going forward, we expect operating margins to improve as the ramp-up in the sales force will start contributing incremental revenues. The lower growth in PAT was mainly on account of a) 150bps contraction in operating margins, b) 26% increase in depreciation cost and c) 21% increase in tax provision due to increase in MAT. Overall for FY11E, we expect Unichem to report a EPS of Rs37 at consolidated level.

200bps expansion in operating margins

Expect subdued margins in FY11E due to addition of 500 people to sales force

Despite 8% revenue growth over FY06-10, Unichem's operating margins have expanded by 770bps to 23.2%. The expansion in operating margins was largely driven by change in product mix in the domestic market. In fact, the contribution of the high margin chronic segment has gone up from 30% in FY06 to 57% in FY10. Moreover, the dependency on products under DPCO has also reduced significantly and currently only 15% of domestic formulation business comes under DPCO products. However, in the international operations, company has so far been in the investment phase. Now with international subsidiaries likely to contribute profitably from FY12E onwards, we expect operating margins to expand by 200bps to 25.2% in FY13E. Though the margins are likely to remain subdued in FY11E because of addition of 500 people in the domestic market, profitable contribution from international subsidiaries (FY12E onwards) and operational leverages from new contracts will lead to 200bps expansion over FY10-13E.

OPM has expanded by 770bps over FY06-10



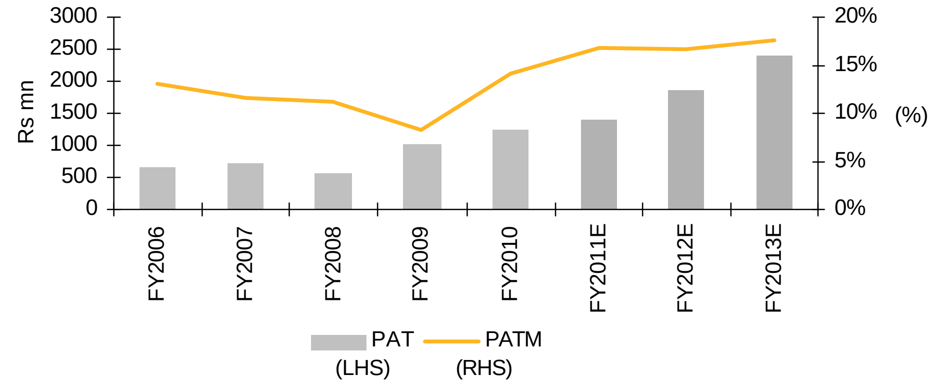
Source: Emkay Research

25% CAGR in earnings, EPS of Rs51.4 in FY12E

Robust revenue growth and expansion in operating margins will enable Unichem to report 25% CAGR in EPS. We expect EPS of Rs51.4 in FY12E.

Robust revenue growth and expansion in the operating margins will enable Unichem to report 25% CAGR in EPS. We expect the PAT CAGR at 25% to be slightly lower than PBT growth of 28% CAGR on account of higher tax provision (23.1% vs. 19.1% in FY10) due to change in MAT. We expect Unichem to report an EPS of Rs37 in FY11E and Rs51.4 in FY12E. Unichem has a history of uninterrupted dividend payment since listing and in FY10; company had paid dividend of Rs10 per share (2% of CMP), 1/3rd of its reported profit.

Expect 200bps expansion in PAT



Source: Emkay Research

Valuations

25% earnings CAGR over FY10-13E; attractive valuations

We believe that Unichem, backed by multiple growth triggers and trading at attractive valuations, is a sound investment option. Despite strong outperformance to the broader market (up by 110% in last one year), Unichem is still trading at 10-15% discount to comparable peers. Unichem has historically traded at a discount to peers because of investor concerns on a) under performance in the high margin domestic formulation business, b) losses in Niche Generics and c) lower operating margins. With the international business margins at an inflection point, domestic business back on track and turnaround in Niche's operations, we are of the view that Unichem should command a similar multiple as its peers. With earnings CAGR of 25% over FY10-13E, cash and cash equivalent of Rs44 per share at FY12E, the stock is extremely attractive at around 10x FY12E with around 2% dividend yield. Strong balance sheet, steady cash flow coupled with strong return profile should provide comfort to investors. We initiate coverage on Unichem with a Buy rating and a price target of Rs670 (13xFY12E). At CMP of Rs530, the stock is trading at 14.3x FY11E EPS of Rs37 and 10.3x FY12E EPS of Rs51.4.

Key Risks

Heavy dependence on key brands: 33% of Unichem's domestic revenues come from its top 2 brands. Losar group is the largest brand contributing over 21% of Unichem's domestic revenue. The dependence on key brands will continue to be a concern for the company. In order to de-risk this, company has already started focussing on second tier of brands and the results of same are already visible.

Turnaround of Niche Generics taking longer than expected: We have factored positive contribution of Niche Generics in our earnings from FY12E onwards. If the turnaround of the same takes longer than expected, then there could be risk to our estimates.

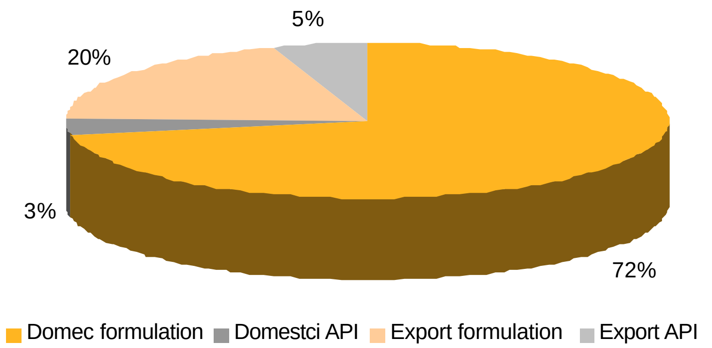
If DPCO expands its coverage list: Currently 15% of Unichem's domestic revenues come from DPCO impacted price. If DPCO decides to expand its list from 74 to 354 molecules then it can impact our earning estimates significantly as Unichem is pre-dominantly a domestic focus company.

Annexure

Domestic business: backbone of the company

Unichem is a strong play on Indian domestic consumption story. Though ranked a modest 25th in overall domestic formulation market, it is the 8th largest player in the represented market with a market share of 2.72% (ORG IMS MAT AUG '10). Unichem enjoys strong presence in the chronic segments (c57%) such as CVS (43%) and CNS (12%), resulting in higher profitability from the domestic operations (operating margins in excess of 30% from domestic formulation business). Right from the beginning, company has focussed on building brands, which is evident from the fact that three of its brands feature among the top 100 and five among the top 300.

75% of revenue comes from domestic market

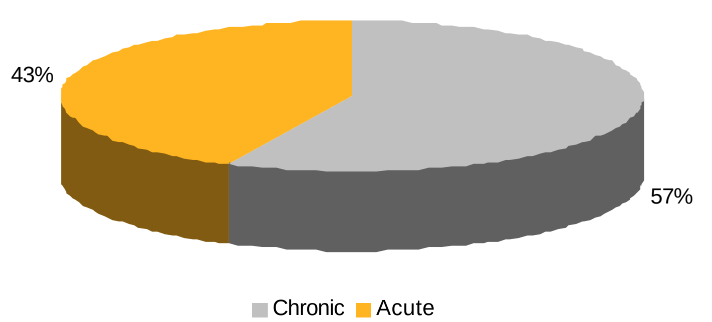


Source: Company, Emkay Research

Chronic contributes 57% of overall domestic revenue

Unichem enjoys strong presence in chronic segment and 57% of its domestic revenue comes from segments like CVS (42%), CNS (12%) and Diabetes (4%). These segments not only offer higher growth prospects but they are more profitable too as they enjoy higher margins. Within CVS, company is the 4th largest player and it is ranked number one in ARB (Angiotensin-II Receptor Blocker) category. Anti-infective (21%), GI (8%) and Nutritional (7%) are other key therapeutic segments for Unichem.

Therapy contribution in FY10



Source: Company, Emkay Research

Therapy wise break-up 2010 (Domestic formulation %)

Segment	FY06	FY07	FY08	FY09	FY10
CVS and Diabetes	37.0	41.5	46.1	42.0	46.0
CNS	12.0	13.5	12.0	12.0	12.0
Anti-infective	25.0	22.0	21.0	21.0	20.0
GI	8.6	7.0	5.5	8.0	7.0
Musculo Skeletal	4.5	4.5	3.5	6.0	5.0
Nutritional	8.0	8.0	7.0	7.0	6.0
Respiratory	3.0	3.0	3.0	3.0	2.5
Others	1.9	0.5	1.9	1.0	1.5

Source: Company, Emkay Research

…… has ability to build strong brands

Unichem's key strength lies in its ability to market products and build successful brands. Unichem has been able to strongly establish itself in the therapeutic segments that it operates in, on the back of its strong brand positioning. Unichem owns some of the biggest brands in the industry and its top 7 brands contribute ~ 50% to its total revenues.

Right from the beginning, company has focussed on building brands, which is evident from the fact that three of its brands feature among top 100 and five among the top 300. The top 10 brands of the company contributes 60% of overall revenue and Losar group being the largest one contributes 21% of company's domestic revenue. Amoxin is the second largest contributor to its domestic revenue (c 13% of domestic revenue)

Top10 brands revenue progress with growth

	Revenue MAT June 2010	% Growth	% cont. of domestic revenue
Losar	142	20.8	21.4
Ampoxin	79	-28.7	11.9
Trika	38	5.3	5.7
Unienzyme	30	46.1	4.5
Telsar	29	76.1	4.4
TG-Tor	27	41.5	4.1
Vizylac	18	32.6	2.7
Metride	18	56.9	2.7
Corvadil	12	17.1	1.8
Clodrel	12	27.9	1.8

Financial tables

Income Statement (Rs. Mn)

(Year Ending Mar 31)	FY10	FY11E	FY12	FY13E
Net Sales	**7,473**	**8,446**	**10,558**	**12,912**
Growth (%)	1.6	13.0	25.0	22.3
Expenditure	**5,743**	**6,493**	**7,960**	**9,658**
Raw Materials	2,579	2,847	3,532	4,306
SGA	1,952	2,236	2,735	3,298
Employee Cost	1,011	1,189	1,446	1,758
Other Exp	202	222	246	295
EBITDA	**1,730**	**1,952**	**2,599**	**3,255**
Growth (%)	64.7	21.7	12.8	33.1
EBITDA margin (%)	**23.2**	**23.1**	**24.6**	**25.2**
Depreciation	232	263	272	281
EBIT	**1,498**	**1,690**	**2,327**	**2,974**
EBIT margin (%)	**20.0**	**20.0**	**22.0**	**23.0**
Other Income	66	56	86	117
Interest expenses	10	11	3	1
PBT	**1,532**	**1,735**	**2,409**	**3,091**
Tax	304	401	556	714
Effective tax rate (%)	19.9	23.1	23.1	23.1
Adjusted PAT	**1,252**	**1,334**	**1,852**	**2,377**
(Profit)/loss from JV's/Ass/MI	3	0	0	0
Adjusted PAT after MI	**1,249**	**1,334**	**1,852**	**2,377**
Growth (%)	19.5	6.9	38.8	28.3
Net Margin (%)	**16.7**	**15.8**	**17.5**	**18.4**
E/O items	-22	0	0	0
Reported PAT	**1,231**	**1,334**	**1,852**	**2,377**
Growth (%)	13.9	8.4	38.8	28.3

Balance Sheet (Rs. Mn)

(Year Ending Mar 31)	FY10	FY11E	FY12	FY13E
Equity share capital	180	180	180	180
Reserves & surplus	5,449	6,316	7,521	8,947
Net worth	**5,629**	**6,496**	**7,702**	**9,128**
Minority Interest	**0**	**0**	**0**	**0**
Secured Loans	122	22	12	2
Unsecured Loans	236	136	36	6
Loan Funds	**358**	**158**	**48**	**8**
Net deferred tax liability	347	347	347	347
Total Liabilities	**6,333**	**7,001**	**8,096**	**9,482**
Gross Block	4,646	5,246	5,746	6,244
Less: Depreciation	1,312	1,515	1,737	1,978
Net block	**3,334**	**3,731**	**4,009**	**4,266**
Capital work in progress	636	420	402	437
Investment	**592**	**592**	**592**	**592**
Current Assets	**3,445**	**4,566**	**6,174**	**8,222**
Inventories	1,095	1,396	1,834	2,353
Sundry debtors	1,670	2,024	2,620	3,315
Cash & bank balance	236	603	986	1,655
Loans & advances	444	544	734	898
Other current assets	0	0	0	0
Current lia & Prov	**1,673**	**2,308**	**3,080**	**4,035**
Current liabilities	1,316	1,568	2,050	2,617
Provisions	356	739	1,030	1,418
Net current assets	**1,772**	**2,258**	**3,093**	**4,187**
Misc. exp & Def. Assets	0	0	0	0
Total Assets	**6,334**	**7,001**	**8,097**	**9,483**

Cash Flow (Rs. Mn)

(Year Ending Mar 31)	FY10	FY11E	FY12	FY13E
PBT (Ex-Other income)	**1,466**	**1,679**	**2,323**	**2,973**
Depreciation	232	263	272	281
Interest Provided	10	11	3	1
Other Non-Cash items	0	0	0	0
Chg in working cap	-91	-120	-451	-425
Tax paid	-304	-401	-556	-714
Operating Cashflow	**1,312**	**1,431**	**1,591**	**2,116**
Capital expenditure	-435	-443	-533	-573
Free Cash Flow	878	988	1,058	1,543
Other income	66	56	86	117
Investments	-582	0	0	0
Investing Cashflow	**-950**	**-387**	**-447**	**-456**
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	-467	-648	-951
Income from investments	0	0	0	0
Others	27	0	0	0
Financing Cashflow	**-470**	**-678**	**-760**	**-991**
Net chg in cash	**-107**	**366**	**383**	**669**
Opening cash position	344	236	603	986
Closing cash position	**236**	**603**	**986**	**1,655**

Key ratios

(Year Ending Mar 31)	FY10	FY11E	FY12	FY13E
Profitability (%)				
EBITDA Margin	23.2	23.1	24.6	25.2
Net Margin	16.7	15.8	17.5	18.4
ROCE	27.9	27.6	33.5	36.6
ROE	23.4	22.0	26.1	28.2
RoIC	21.2	20.8	26.5	64.3
Per Share Data (Rs)				
EPS	34.6	37.0	51.4	65.9
CEPS	41.2	44.3	58.9	73.7
BVPS	156.1	180.2	213.6	253.1
DPS	10.0	11.1	15.4	22.5
Valuations (x)				
PER	15.3	14.3	10.3	8.0
P/CEPS	12.9	12.0	9.0	7.2
P/BV	3.4	2.9	2.5	2.1
EV / Sales	2.6	2.3	1.8	1.5
EV / EBITDA	11.3	9.9	7.4	5.9
Dividend Yield (%)	1.9	2.1	2.9	4.3
Gearing Ratio (x)				
Net Debt/ Equity	0.0	-0.1	-0.1	-0.2
Net Debt/EBIDTA	0.1	-0.3	-0.5	-0.6
Working Cap Cycle (days)	92	104	108	112

Source: Company, Emkay Research

Emkay Rating Distribution

BUY	Expected total return (%) (stock price appreciation and dividend yield) of over 25% within the next 12-18 months.
ACCUMULATE	Expected total return (%) (stock price appreciation and dividend yield) of over 10% within the next 12-18 months.
HOLD	Expected total return (%) (stock price appreciation and dividend yield) of upto 10% within the next 12-18 months.
REDUCE	Expected total return (%) (stock price depreciation) of upto (-)10% within the next 12-18 months.
SELL	The stock is believed to under perform the broad market indices or its related universe within the next 12-18 months.

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