

CMP : Rs.348

Rating : BUY

Target : Rs.544

STOCK INFO

BSE	530549
NSE	SHILPAMED
Bloomberg	SLPA IN
Reuters	SHME.NS
Sector	Pharmaceutical
Face Value (Rs)	2
Equity Capital (Rs mn)	74
Mkt Cap (Rs mn)	12,949
52w H/L (Rs)	392/136
Avg Daily Vol (BSE+NSE)	7,544

SHAREHOLDING PATTERN

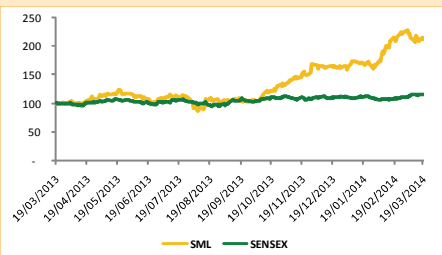
%	
<i>(as on 31st Dec. 2013)</i>	
Promoters	55.88
FII's	9.96
DII's	-
Public & Others	34.16

Source: Company, BSE

STOCK PERFORMANCE (%)			
	1m	3m	12m
SML	(0.8)	27.9	111.4
SENSEX	6.3	3.6	14.9

Source: Capitaline, IndiaNivesh Research

SML v/s SENSEX



Source: Capitaline, IndiaNivesh Research

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Shilpa Medicare Limited is Raichur Karnataka, India-based company engaged in manufacturing active pharmaceutical ingredients Fine chemicals, intermediates, herbal products and chemical products using technology. The Company's products include Bendamustin HCl, Bicalutamide, Bortezomib, Busulfan, Capecitabine, Carboplatin, Docetaxel, Gefitinib, Gemcitabine, Irinotecan HCl Trihydrate, Lenalidomide and Letrozole.

Investment Rationale

Increasing volume demand from existing customers: Due to the regulatory issues and corresponding change in strategy with a leading Oncology MNC, SML has secured large long term orders. The client has changed the strategy from in-house production to specialized vendor to diversify risk, which has helped SML report a healthy revenue growth of ~48% in the 9MFY14. SML has been supplying only 2-3 APIs to this client; however, more products are likely to be introduced, which would bode well for future growth of the company.

USFDA approval for Raichur API facility is awaited: SML has ~14 DMF filings with USFDA from Raichur plants but so far US market doesn't contribute any revenues to SML. In May 2013, SML's two plants in Raichur were inspected by USFDA and given certain corrections. We believe that SML will get the USFDA approval and supply to US market will commence in second half of FY15E. However, ramp up from these API plants would be in FY16E and onwards.

Anti-HIV drug manufacturing deal with Gilead: SML has recently signed a technology transfer agreement with Gilead for manufacturing Anti-HIV drugs. With this technology SML will be able to manufacture drugs at lower prices given cost advantage in India and still earn a healthy margin. SML has plans to focus on this segment & intends to grow the revenue to Rs 2 bn in next 3 years from this segment through more partnerships. In our view, this development would help SML to utilize its expanded capacities and to improve its operating leverage.

Jadcherla formulation facility to contribute in long term: At the total capex of ~Rs 1.50 bn, SML has constructed formulation manufacturing facility in Jadcherla, Andhra Pradesh (India). Successful inspection and approval by developed market authorities would allow SML to sell formulations in European & US market. Most of its existing API clients are interested to go for formulation contract with SML. It had already filed 4-5 ANDAs for clients from the same site. In our view, once the site approval is in place, the ramp up would be at healthy pace. We expect formulation supply to be significant for the company from 2016/17. At full capacity utilization Jadcherla facility can contribute Rs 4 to 5 bn in revenue terms.

Valuation

At CMP of Rs 348, the stock is trading at P/E multiple of 12.7x of FY15E & 9.7x of FY16E. **We value stock on the higher side of its P/E multiple range, at 15x of FY16E & arrive at the target price of Rs 544, which is ~50% upside from current level.** We initiate coverage on the stock with strong BUY recommendation.

Consolidated Financial Statements

<i>in Rs mn</i>	Sales	EBITDA	EBITDA %	PAT	EPS	ROE %	P/E	EV/EBITDA	P/BV
FY12	3,182	606	19.1	406	11.3	14.8	17.4	11.6	2.6
FY13	3,713	689	18.5	476	12.9	14.8	21.0	15.3	3.1
FY14E	5,689	1,209	21.3	811	22.1	20.2	16.0	11.1	3.2
FY15E	7,441	1,571	21.1	1,018	27.7	20.4	12.7	8.2	2.6
FY16E	9,421	2,015	21.4	1,335	36.3	21.3	9.7	6.0	2.1

Source: Company Filings; IndiaNivesh Research

Investment Rationale

Revenue Drivers:

Owing to regulatory problems customer's own sites, volume growth is likely to remain robust in future

a) Increasing volume demand from existing customers:

Shilpa Medicare Ltd (SML) is one of the leading manufacturer of oncology APIs (*Active Pharmaceuticals Ingredients*) in India. Company has created strong pipeline in oncology segment & it has developed more than ~50 products for selling across the world. SML supply its products majorly in European countries & domestic market so far. In FY13, ~75% of company's revenue was from European markets & rest was from domestic & other markets. In domestic market, Ranbaxy, DRL, & Fresenius Kabi India are its leading customers.

SML's Key Customers:

Domestic	MNCs
Dr Reddy's Labs	ICE s.r.l Ltd, Italy
Sun Pharma	Prodotti Chimici Alimentari Spain
Intas Pharma	Midas Pharma France
Cipla Ltd	NMS Italy
Fresenius Kabi India	Lynnbros Industrial Co. Ltd Taiwan
Zydus Cadila	Wieling Hamburg, Germany

Source: Source: Industry; IndiaNivesh Research

Due to the regulatory issues and corresponding change in strategy with a leading Oncology MNC, SML has secured large long term orders. The client has changed the strategy from in-house production to specialized vendor to diversify risk, which has helped SML report a healthy revenue growth of ~48% in the 9MFY14.

SML has been supplying only 2-3 APIs to this client; however, more products are likely to be introduced, which would bode well for future growth of the company.

Raichur plants would receive final ANDA approval within next 3-5 months

b) USFDA approval for Raichur API facility is awaited:

SML has ~14 DMF filings with USFDA from Raichur plants but so far US market doesn't contribute any revenues to SML. In May 2013, SML's two plants in Raichur were inspected by USFDA and given certain corrections. The inspector found few general findings related to cGMP. Company has submitted its corrective & preventive action (CAPA) plan with USFDA and currently awaiting for response letter. According to our understanding, SML may get response letter any time (*or within 3-5 months*).

We believe that SML will get the USFDA approval and supply to US market will commence in second half of FY15E. However, ramp up from these API plants would be in FY16E and onwards.

US DMF filings and status:

Sr. No.	Generic Name	DMF Filed date	Brand Name	Formulation Size \$ Mn	Uses	Innovator
1	TEMOZOLOMIDE	1/22/2010	Temodar	390	For brain tumour	Merck
2	IRINOTECAN HYDROCHLORIDE TRIHYDRATE	2/23/2010	Camtosar	200	For the treatment of Metastatic Colorectal Cancer	Pfizer
3	OXALIPLATIN	2/23/2010	Eloxatin	100	For Colorectal cancer	Sanofi Aventis
4	GEMCITABINE HYDROCHLORIDE	3/4/2011	Gemzar	512	Anti-cancer	Eli Lilly
5	CAPECITABINE	3/24/2011	XELODA	617	For treating tumors	Hoffman LaRoche
6	BICALUTAMIDE	5/11/2011	Casodex	100	To treat prostate cancer	Astra Zeneca
7	BORTEZOMIB	8/23/2011	Valcade	600	Treatment of Multiple Myeloma patients	Millennium Pharma
8	PEMETREXED DISODIUM (HEMIPENTA HYDRATE)	9/21/2011	Alimta	400	Pretreatment of patients with Vitamin B12 and Folic Acid prior to Pemetrexed disodium administration	Eli Lilly
9	BENDAMUSTINE HCL	11/9/2011	Trenda	780	For use in the treatment of patients with Chronic Lymphocytic Leukemia (CLL) and/or Indolent B-Cell Non-Hodgkin Lymphoma (NHL)	Cephalon
10	BUSULFAN USP	12/8/2011	Busulfex	150	Leukemia (for transplantation of bone marrow)	Otsuka
11	ZOLEDRONIC ACID	7/18/2012	Zometa/ Reclast	200	Anti cancer	
12	AZACITIDINE	9/23/2013	Vidaza	400	For blood cancer (Acute Myeloid Leukemia (AML),	Celgene
13	DECITABINE (ESUB)	9/26/2013	Dacogen	240	For blood cancer (Acute Myeloid Leukemia (AML),	Eisai Inc
14	LETROZOLE USP (ESUB)	9/26/2013	Femara	100	For breast cancer treatment	Novartis

Source: USFDA; Industry; Company Filings; IndiaNivesh Research

~14 DMF filing with USFDA to contribute significantly going forward

List of DMF filed with USFDA is given above in the table, out of which few products are already generic and other's patent are likely to expire. The total formulation size of the products above is ~\$5 bn & limited numbers of suppliers are available in the niche oncology space. Assuming fair market share (10-20%) gain for SML for the aforesaid APIs, we estimate US market to contribute ~\$100 mn (~Rs 6 bn) annually to SML. This effectively means that SML's revenue may double from current level. Regular filings and ramp up in supply would further lead to healthy growth.

Deal with Gilead to manufacture anti-HIV drugs segment may ramp up to Rs 2 bn in next 2-3 years

Jadcherla formulation facility to commence operations for emerging markets soon but significant contribution from developed markets to be only post 2016-2017

SML spreading its wings to Japanese & other markets too

c) Anti-HIV drug manufacturing deal with Gilead

SML has signed an agreement, in June 2013, with United Nation's backed Medicines Patent Pool (MPP) and Gilead Sciences to increase access to medicines for HIV/AIDS treatment. SML will manufacture 5 key medicines i.e. Tenofovir, Emtricitabine, Cobicistat, Elvitegravir & combination of the four known as "the Quad" for sale in over 100 countries, depending on the medicines. According to agreement, Gilead will transfer technology to SML for manufacturing the drugs, with this technology SML will be able to manufacture drugs at lower prices given cost advantage in India and still earn a healthy margin. SML has plans to focus on this segment & intends to grow the revenue to Rs 2 bn in next 3 years from this segment through more partnerships. In our view, this development would help SML to utilize its expanded capacities and to improve its operating leverage.

d) Jadcherla formulation facility to contribute in long term:

At the total capex of ~Rs 1.50 bn, SML has constructed formulation manufacturing facility in Jadcherla, Andhra Pradesh (*India*). The facility has 2 commercial tablet plants, 1 capsule plant & 1 small injectable unit, which is spread across 9 acre of land. Company has applied for cGMP, USFDA, EUGMP, TGA, MHRA & PMDA authorities for approval. It has completed trial batches and likely to commence its formulations for emerging markets soon (*within 6 months to 1 year*) once it receives approval from respective countries. Successful inspection and approval by developed market authorities would allow SML to sell formulations in European & US market. According to the management, this facility is likely to commence supply to developed market by 2016/17, albeit only after site approval. Due to trials and anticipating the commencement of formulations for emerging markets, facility's fixed cost has already increased without any contribution to topline. We are of the view, that going forward incremental revenue from formulation business would improve its operating leverage. Additionally, increase in contribution from formulation business would improve its gross margins also.

On the customer front and selling strategy, company is likely to opt formulation contract manufacturing business model. Most of its existing API clients are interested to go for formulation contract with SML. It had already filed 4-5 ANDAs for clients from the same site. Hence, in our view, once it gets site approval from the developed authorities than ramp up would be at healthy pace. We expect formulation supply to be significant for the company from 2016-2017 onwards. At full capacity utilization Jadcherla facility may contribute Rs 4 to 5 bn in revenue term.

e) Penetrating to Japan & other markets also:

Apart from US market, Japanese market is the other lucrative market for generic and API generic players. Due to regulatory constraints and quality point of view, Japanese market is very hard to crack for Indian pharmaceutical companies. SML is in advanced stage to finalize its client's order from Japan & South Korea. Additionally, company has filed for its key products in many other markets also including China, Austria, Australia, Korea etc. In our view, contribution from these markets is likely to help in managing SML healthy growth in long term.

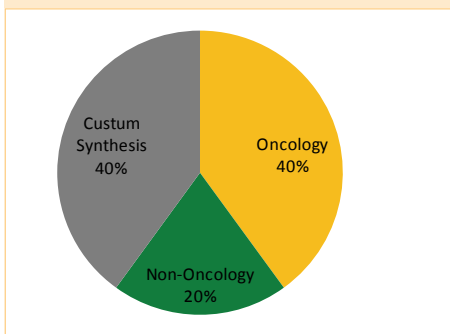
DMF Filings in other countries (in FY13):

Product	Country
ImatinibMesylate :	China
Bendamustine :	Austria, Cyprus, Denmark, Finland,Iceland, Ireland, Norway, Poland,Slovakia, Spain
Busulfan :	TGA-Australia
Irinotecan :	Hungary, Romania, Slovakia,
Temozolomide :	KFDA-Korea, Swedan.
Capecitabine :	TGA-Australia,
Zoledronic Acid -	Swedan.

Source: Company Filings; IndiaNivesh Research

Margins expansion drivers:

Revenue Mix (FY13)



Source: Company Filings; IndiaNivesh Research

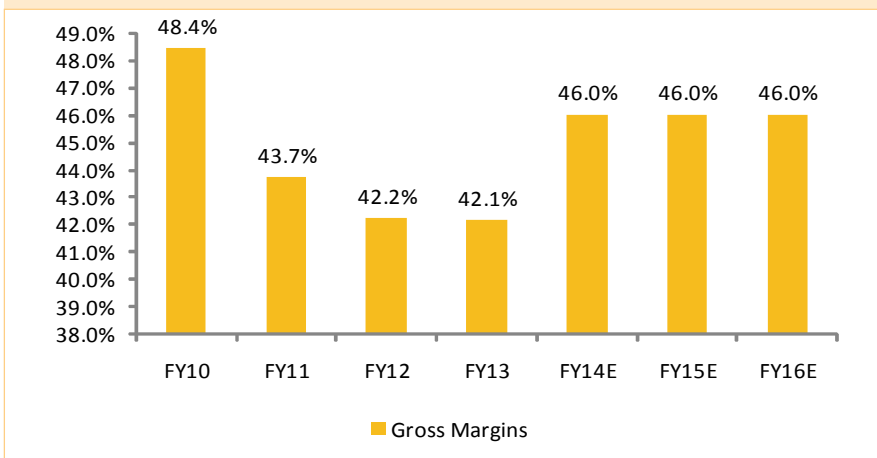
Favorable product mix to beef up Gross margins

Higher capacity utilization would lead to expansion in EBITDA margins, though we assume base case scenario of flat margins

a) Moving up the value chain:

We believe that favorable product mix (including higher contribution from anticancer drugs) and revenue contribution from formulation business would lead to improvement in gross margins of the company. Currently, (in FY13) company's ~40% business contribution was from Oncology products, ~20% from Non-oncology products & remaining 40% was from Custom Synthesis (non-oncology products). So far SML has filed more than 50 DMFs across the globe. Major contribution to its revenue was from Gemcitabine, Ambroxol & Ursodeoxycholic acid. We are of the view that going forward increase in contribution from anti-cancer APIs mainly linked with entry in US market & forward integration in formulation business would lead to improvement in margins.

Gross Margins

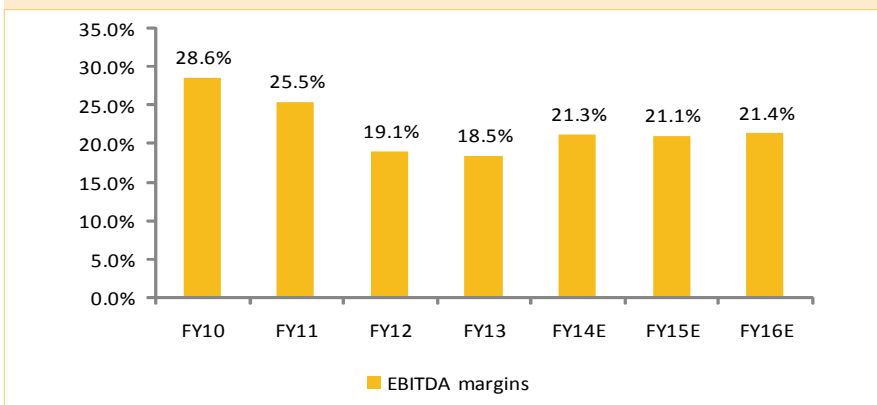


Source: Company Filings; IndiaNivesh Research

b) Increase in capacity utilization:

Anticipating penetration into US market & increase in volume from existing players, SML has expanded its facilities in the last 2-3 years. Company had invested ~Rs 2 bn in the last two years (FY12 & FY13) to expand its Raichur plants for the increasing orders of customer and for green field formulation plant in Jadcherla. Despite healthy growth of topline in 9MFY14 (~48% y-o-y), company's EBITDA margin had remained almost at same level (~21% level) mainly due to increase in staff cost & other fixed cost for expanded facilities. We believe that increase in capacity utilization would improve its operating leverage going forward.

EBITDA Margins



Source: Company Filings; IndiaNivesh Research

Financials

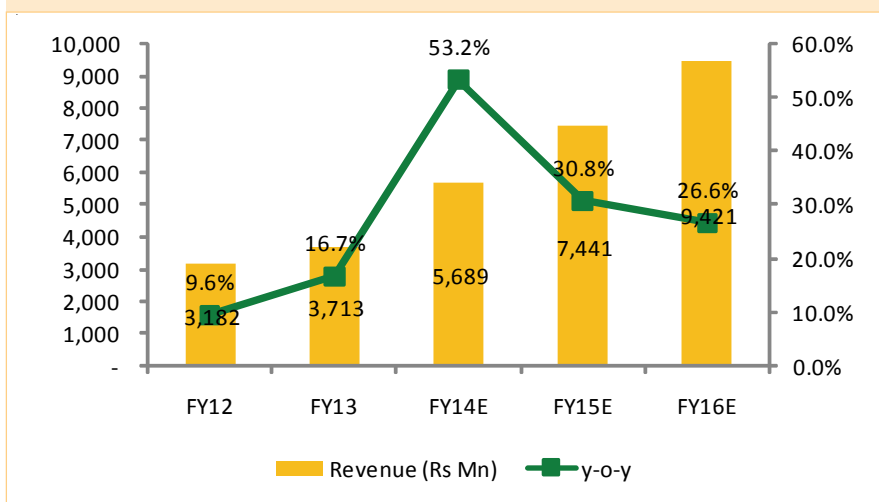
Consolidated revenue to grow @~36% CAGR over FY13-16E:

Consolidated revenue is expected to grow at 36% CAGR over FY13-16E

We expect company’s consolidated revenue to grow at ~36% CAGR over FY13-16E to Rs 9.42 bn mainly linked with increase in volume growth from existing customers, penetration across the markets (including entry in US in FY15E) & contribution from Gilead deal from FY15E onwards. Though SML’s revenue has grown only at ~12% CAGR during FY10-13 linked with regular and consistence flow of order from existing customers but in the 9M FY14, company’s revenue growth was robust ~48% y-o-y due to increase in volume for its existing customers owing to regulatory hurdles for their (customer’s) sources. This order is likely to remain in supply for near to medium term and additional approval of new products across the globe for the same customer may further add to the overall revenue growth.

We expect SML’s base business to grow at ~14% y-o-y rate in next two years. Incremental revenue growth is likely to come from the contribution of US oncology products (~Rs 700 mn in FY15E & ~Rs 1,700 mn in FY16E) & from Gilead deals and others (~Rs 250 mn in FY15E & ~Rs 370 mn in FY16E). Additionally, any revenue contribution from Jadcherla formulation facility for emerging markets would be positive surprise to our estimates. Though, we estimate Jadcherla facility to contribute post 2016-2017 from developed markets.

Consolidated revenue trend:



Source: Company Filings; IndiaNivesh Research

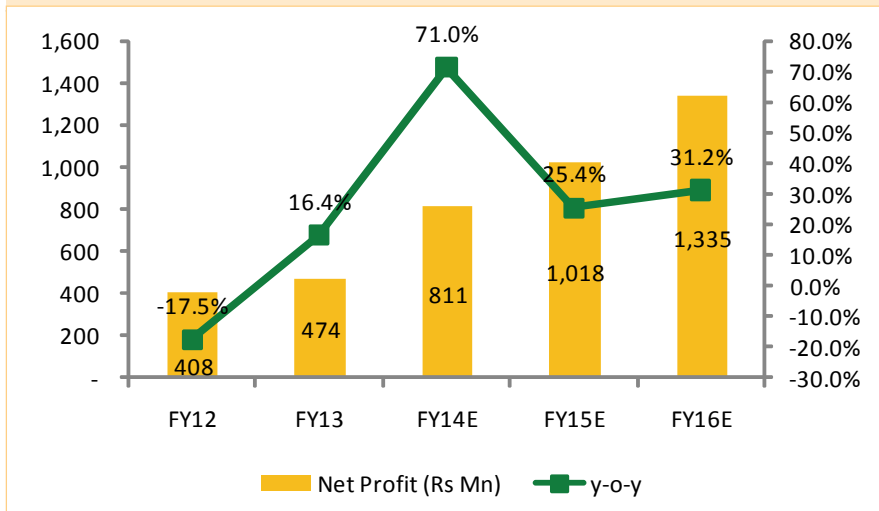
Consolidated net profit to grow above 40% CAGR over FY13-16E

Base case scenario

Consolidated net profit (base case scenario) is expected to grow above 40% CAGR during FY13-16E

Driven by healthy growth in topline, we expect SML’s consolidated net profit to grow above 40% CAGR over FY13-16E. On account of favorable product mix & improvement in operating leverage, company’s EBITDA margins are likely to improve going forward. However, conservatively (in base case scenario), we expect EBITDA margins to remain almost flat in the range of 21-22% level. Additionally, healthy ramp up in the subsidiaries would also add to its consolidated net profit.

Consolidated net profit trend:

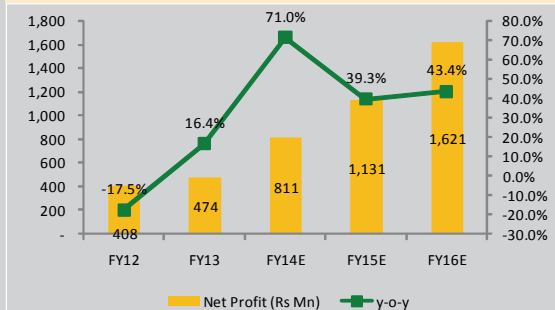


Source: Company Filings; IndiaNivesh Research

Alternative Profit scenarios:

Bull case scenario: In best case scenario, we expect margins expansion of ~300-400 bps in the next two years to ~25% level in FY16E. Margin expansion is likely to be account of better product mix from US market supply of oncology products & improvement in operating leverage partially offset by relatively lower margins in the ARV business. In this scenario, SML may report more than 50% earnings CAGR during FY13-16E to Rs 1,621 mn (~2x of FY14E).

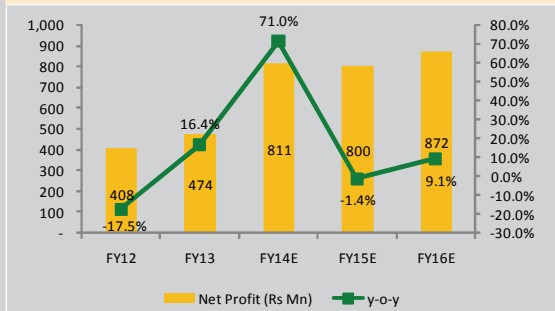
Net Profit (Bull case scenario)



Source: Company Filings; IndiaNivesh Research

Bear case scenario: In worst case scenario, we estimate company's base business to grow at 14% revenue CAGR over FY13-16E & margins to suppress ~200 bps to ~19% in FY16E. Accordingly, net profit would grow at ~22% CAGR over FY13-16E to Rs 870 mn (even in this case profit is likely to be higher of FY14E).

Net Profit (Bear case scenario)



Source: Company Filings; IndiaNivesh Research

Net debt to Equity ratio stands at 0.2x

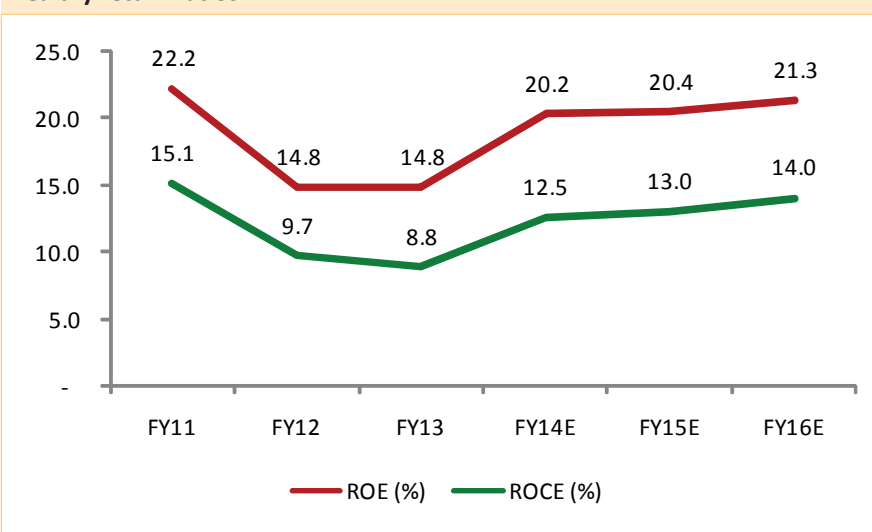
Strong balance sheet & healthy return ratios:

Management is conservative on capital structure part and had preferred equity root in the past for its expansion plans. At the end of Dec 2013, company has gross debt of ~Rs 1,155 mn (*Net Debt to Equity = 0.2x*). Out of this, ~\$10 mn are ECBs from Standard Chartered Bank London. Aforesaid debt was raised for Jadcherla formulation facility expansion. Company's major expansion plans seems over, hence free cash flow generation is likely going forward.

SML's earlier expansion was during 2007 to 2009, when it started supplying anti-cancer and other drugs to European markets. At peak capacity utilization (*in 2010 & 2011*), company's Return on Equity (*ROE*) was in the range of 22%- 30% level. USFDA approval for its Raichur plant would lead to ramp up in revenue. As a result, better utilization of expanded facility should translate into healthy return ratios, which had come down to 14.8% in the past.

Return ratios are expected to improve gradually

Healthy return ratios:



Source: Company Filings; IndiaNivesh Research

Capital History:

Equity as on	No of Shares Subs	Equity Capital (Rs Mn)	Face Value (Rs)	Event
31-Dec-13	36786247	73.57	2	
16-Jul-13	36786247	73.57	2	Bonus (1 for 2)
22-Mar-12	24524165	49.05	2	Allotment of Equity (5 Lakh) to promoters at adj. price of Rs. 232
24-Sep-10	24024165	48.05	2	Allotment of Equity To Barring (20 Lakh)
19-Jan-09	22024165	44.05	2	Amalgamation
30-Jun-08	18107500	36.22	2	Allotment of Equity (7.5 lakh) at adj. price of Rs.52
28-Sep-07	17357500	34.72	2	Stock Split
6-Feb-06	3471500	34.72	10	Reissue of Forfeited Shares
14-Oct-05	3121100	31.21	10	Allotment of Equity to Non-Promoters
14-Aug-03	2656100	26.56	10	Forfeited Shares
31-Mar-98	3006500	30.07	10	

Source: Company Filings; IndiaNivesh Research

Business Model

Shilpa Medicare Ltd (SML) was established in 1989 by the first generation entrepreneur Mr Vishnu Kant Bhutada, in Raichur, Karnataka, India. The company was established to manufacture and focus on niche APIs (*Active Pharmaceutical Ingredients*). Ambroxol & Ursodeoxycholic acid are the pioneer products of the company, which had been key contributor to its revenue in early years of 2000 to 2009. In the year 2009, company entered into European markets for supplying Oncology & other API products, including Gemcitabine, Carboplatin, Buslfan, Ticlopidine etc.

In FY13, company's ~20% revenue was from Non-oncology products (*major contributor is Ambroxol*), ~40% from Oncology products (*major contributor is Gemcitabine*) & remaining 40% was from CRAMS business. In CRAMS business, SML supply products to its European clients. On the geographical basis, company's ~70-75% revenue contribution was from Europe & rest was from domestic & other markets. In the domestic market, Fresenius Kabi India, Cipla Ltd, DRL, Zydus Cadila, Intas & Sun Pharma are company's major customers.

SML has strong pipeline of oncology products to drive its topline and bottom line in the future. In the European market, major contribution comes from Gemcitabine (*contributed ~10% of total revenue in 2013*) & Ambroxol.

Key DMF filings in European markets:

Product Name	Uses
Carboplatin	Anticancer
Ambroxol hydrochloride	Expectorant
Buflomedil Hydrochloride	Anticancer
Oxaliplatin	Anticancer
Gemcitabine hydrochloride	Anticancer
Ticlopidine hydrochloride	Anti-clotting agent
Busulfan	Anticancer

Source: EMA; IndiaNivesh Research

Subsidiary details:

Subsidiary name	Country	% Holding
Zatortia Holding Limited ('Zatortia')	Cyprus	100%
Loba Feinchemie GmbH ('Loba') (Stepdown Subsidiary)	Austria	99.99%
Raichem Medicare (P) Ltd ('RMPL')	India	50.01%
Nu Therapeutics Private Ltd ('Nu Therapeutics')	India	68.27%
Associates		
Reva Pharma Chem Private Limited ('Reva')	India	33.33%

Source: Company Filings; IndiaNivesh Research

LOBA Feinchemie GmbH Austria:

SML has ~100% stake in LOBA Feinchemie Austria through Zatortia Holding Ltd (*Zatortia*). SML acquired LOBA in year 2007. LOBA provides specialty APIs, organic intermediates, biochemical diagnostics & CRAMS. Acquisition was expected to provide marketing & European customer leverage to SML, which had not turned out as per anticipation so far. However, LOBA is still profit making subsidiary for SML & reported profit of Rs 16 mn in FY13.

Nu Therapeutics Private Ltd (NTPL):

SML holds ~68.3% in Nu therapeutics Pvt Ltd. Company is engaged in development of formulation products and it has received marketing rights from Drug Control General of India for Ondansetron (Orally Disintegrated Strips), used for Nausea & Vomiting, Simethicone (Anti-flatulent) & Sildenafil (for the treatment of erectile

dysfunction. All the formulations of the company are in Orally Disintegrated Strips and it is developing many new products. It has manufacturing plant in Cherlapally Hyderabad. Nu Therapeutics reported net profit of Rs 0.31 mn in FY13.

Raichem Medicare Pvt Ltd (RMPL):

RMPL is joint venture of company with Industria Chimica Emiliana Italy & Prodoti Chini Alimentari Italy to set up a manufacturing facility in India. The advantage to SML would of providing raw material to joint venture. On its investments of surplus funds, RMPL earned Rs 2.27 mn in FY13. Civil construction works for plant in Raichur, Karnataka, is nearly over and the plant should be completed by FY15E and should start contributing revenue.

Manufacturing plants:

At the end of FY13, company has 7 plants including its subsidiary LobaFienchemie- Austria. The details are as following:

Plant	Plant 1	Plant 2	Plant 3	Plant 4	Plant 5	Plant 6	Plant 7
Plant Names	Raichur Unit I	Raichur Unit II (100% EOU)	LobaFienchemie - Austria	Raichur	Jadcherla Formulation Unit (SEZ Unit)	Hyderabad Formulation Unit- Nu Therapeutics	R & D Centre Vizag
API / Formulations / R&D	API + R&D Unit	API	API + R&D Unit	Formulations	Formulations + R&D Unit	Formulations	API + Formulations
Production	Oncology / Non-Oncology APIs & CRAMS	Chiral technology, Reduction reactions Customized synthesis / CRAMS activities	API's, intermediates, reagents & diagnostics and control substances	Contract Manufacturing and Dosage Developments	CRAMS & Dosage Developments	Fast Dissolving Thin Strip	
Approved by Authorities	WHO-GMP/ EUGMP/ TGA/ PMDA/ KFDA/ TPD / EDQM / USFDA (Inspected)	ISO 14001:2004 / KFDA / WHO-GMP/ EUGMP / EDQM / USFDA (Inspected)	USFDA and Austrian Ministry	Complete Validations By End of Q1, 2014.	Applied cGMP, USFDA, EUGMP, TGA, MHRA, PMDA	NA	

Source: Company Filings; IndiaNivesh Research

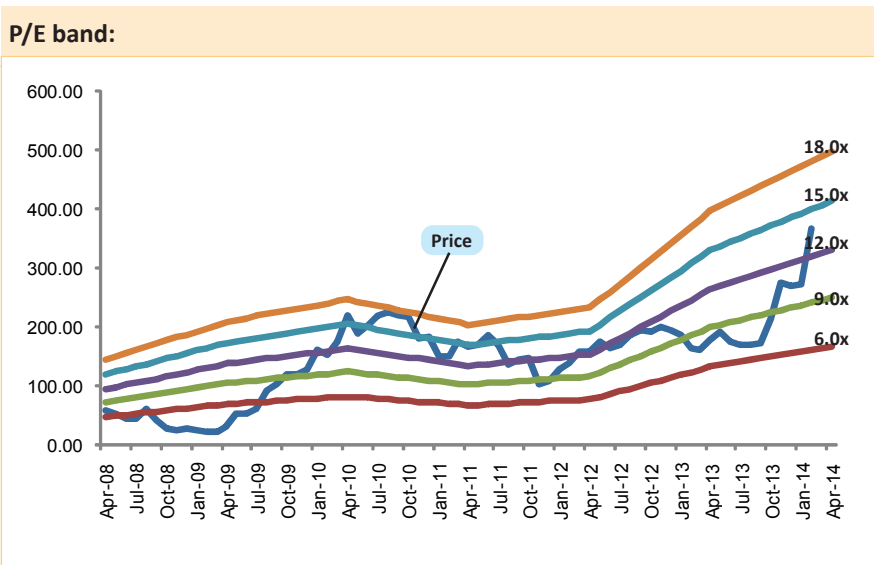
Outlook

In the last 2-3 years company had invested more than Rs 2 bn in the expansion of its manufacturing facilities, including Rs 1.50 bn for green field expansion of Jadcherla (Andhra Pradesh), Formulation (SEZ) unit. SML has filed for ~14 DMF with USFDA in the last 2-3 years from Raichur Plants (EOU 100%). However, none of its plant is approved from USFDA so far. USFDA inspected its facilities in Raichur in May-2013 and found few observations related to cGMP. According to our understanding, observations are not serious in nature and management has submitted corrective & preventive plans. We expect, SML to get final nod from USFDA by August 2014 to get entry into world's largest pharmaceutical market.

USFDA approval for Raichur plant would be near term trigger for the stock. Further, increase in volume from existing customers, ramp up in US market & Jadcherla formulation plant commencement would keep the momentum in the long term. We expect company's revenue to grow at ~36% CAGR during FY13-16E. Favorable product mix, upward move in value chain & healthy operating leverage would lead to improvement in EBITDA margins. However, conservatively we expect margins to remain in the range of 21-22%. As a result, company's net profit is expected to grow above 40% CAGR during FY13-16E.

Valuation

At CMP of Rs 348, the stock is trading at P/E multiple of 12.7x of FY15E & 9.7x of FY16E. Considering, robust growth, healthy balance sheet, improvement in return ratios and strong product pipeline (mainly oncology products), stock deserve to trade at the premium to its midsize peers. In the last 4-5 years, despite normal growth period of the company, stock had traded between P/E multiple of 10x to 15x. USFDA approval for Raichur plant & entry into formulation business post Jadcherla formulation plant would be re-rating phenomena for the stock. **We value stock on the higher side of its P/E multiple range, at 15x of FY16E & reached at the target price of Rs 544, which is ~50% upside from current level. We initiate coverage on the stock with strong BUY recommendation.**



Source: Cline; IndiaNivesh Research

Key Risk

Delay in Raichur plant approval by USFDA:

Our revenue and earnings growth are mainly dependent on the approval of its Raichur plant by USFDA in FY15E. Hence, any delay or adverse outcome for plant approval may have negative impact on our estimates and may lead to sharp correction in stock price. Additionally, any delay in orders from existing customers of the company may have negative impact.

INR appreciation:

Company's ~75% business is from exports, hence any unfavorable currency movement may impact operational performance of the company.

Consolidated Financial Statements

Income statement

Y E March (Rs m)	FY12	FY13	FY14E	FY15E	FY16E
Net sales	3,182	3,713	5,689	7,441	9,421
Growth %	9.6%	16.7%	53.2%	30.8%	26.6%
Expenditure					
Raw Material	1,840	2,149	3,072	4,018	5,087
Employee cost	363	455	703	941	1,186
Other expenses	373	421	705	911	1,132
EBITDA	606	689	1,209	1,571	2,015
Growth %	-18.0%	13.6%	75.5%	29.9%	28.3%
EBITDA Margin %	19.1%	18.5%	21.3%	21.1%	21.4%
Depreciation	144	153	235	287	324
EBIT	463	535	974	1,284	1,691
EBIT Margin %	14.5%	14.4%	17.1%	17.3%	18.0%
Other Income	83	50	70	80	90
Interest	17	14	30	25	25
PBT	529	571	1,014	1,339	1,756
Tax	122	95	203	321	421
Effective tax rate %	22.9%	16.8%	20.0%	24.0%	24.0%
Extraordinary items	6	(2)	-	-	-
Adjusted PAT	406	476	811	1,018	1,335
Growth %	-17.9%	17.0%	70.6%	25.4%	31.2%
PAT margin %	12.8%	12.8%	14.3%	13.7%	14.2%
Reported PAT	412	473	811	1,018	1,335
Growth %	-16.6%	14.8%	71.4%	25.4%	31.2%

Cash flow

Y E March (Rs m)	FY12	FY13	FY14E	FY15E	FY16E
PBT	535	570	1,014	1,339	1,756
Depreciation	144	153	235	287	324
Interest	17	14	30	25	25
Other non cash charges	(59)	(54)	-	-	-
Changes in working capital	8	(139)	(327)	(270)	(305)
Tax	(77)	(110)	(203)	(321)	(421)
Cash flow from operations	567	435	750	1,059	1,378
Capital expenditure	(791)	(974)	(626)	(446)	(565)
Free Cash Flow	(224)	(539)	124	613	813
Other income	(15)	(19)	-	-	-
Investments	(716)	177	-	-	-
Cash flow from investments	(1,523)	(817)	(626)	(446)	(565)
Equity capital raised	142	44	25	-	-
Loans availed or (repaid)	4	666	-	-	-
Interest paid	(17)	(22)	(30)	(25)	(25)
Dividend paid (incl tax)	(22)	(25)	(32)	(41)	(60)
Cash flow from Financing	106	663	(38)	(66)	(85)
Net change in cash	(849)	282	86	547	728
Cash at the beginning of the year	872	23	304	390	937
Cash at the end of the year	23	304	390	937	1,665

Source: Company Filings; IndiaNivesh Research

Balance sheet

Y E March (Rs m)	FY12	FY13	FY14E	FY15E	FY16E
Share Capital	49	49	74	74	74
Reserves & Surplus	2,711	3,155	3,934	4,911	6,186
Net Worth	2,760	3,204	4,008	4,985	6,259
Minority Interest	49	87	87	87	87
Non Current Liabilities					
Long term borrowing	51	705	705	705	705
Deferred Tax liabilities	197	209	209	209	209
Long term Provisions	63	71	71	71	71
	311	985	985	985	985
Current Liabilities					
Short term borrowings	412	451	451	451	451
Trade payables	567	524	757	991	1,254
Other current liabilities	203	223	341	446	565
Short term provisions	28	41	41	41	41
	1,211	1,238	1,590	1,928	2,311
Total Liabilities	4,331	5,514	6,670	7,985	9,643
Assets					
Net Block	2,243	3,098	3,489	3,649	3,890
Non Current Investments	1	1	1	1	1
Long term loans & Advances	208	295	295	295	295
Current Assets					
Current Investments	680	503	503	503	503
Inventories	673	743	1,122	1,468	1,858
Sundry Debtors	405	418	655	856	1,084
Cash & Bank Balances	23	304	390	937	1,665
Loans & Advances	97	152	215	276	345
	1,879	2,120	2,885	4,040	5,456
Total assets	4,331	5,514	6,670	7,985	9,643

Key ratios

Y E March	FY12	FY13	FY14E	FY15E	FY16E
EPS (Rs) Core	11.3	12.9	22.1	27.7	36.3
EPS Reported	11.4	12.9	22.1	27.7	36.3
Cash EPS (Rs)	15.3	17.1	28.4	35.5	45.1
DPS (Rs)	0.6	0.7	0.9	1.1	1.6
BVPS (Rs)	77	87	109	136	170
ROCE	13.0%	11.1%	16.0%	16.8%	18.2%
ROE	14.8%	14.8%	20.2%	20.4%	21.3%
Inventories Days	77	73	72	72	72
Sundry Debtors Days	46	41	42	42	42
Trades Payable Days	113	89	90	90	90
PER (x)	17.4	21.0	16.0	12.7	9.7
P/BV (x)	2.6	3.1	3.2	2.6	2.1
EV/EBITDA (x)	11.6	15.3	11.1	8.2	6.0
Dividend Yield %	0.3%	0.3%	0.3%	0.3%	0.5%
m cap/sales (x)	2.2	2.7	2.3	1.7	1.4
net debt/equity (x)	0.0	0.2	0.1	(0.0)	(0.1)
net debt/ebitda (x)	0.0	0.9	0.4	(0.0)	(0.4)

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Disclosure of Interest Statement	
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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