INVESTING

Ajay Piramal's Plays

With a slew of bold measures and innovative strategies, the Piramal group is back in the reckoning

CLIFFORD ALVARES

You can't help wondering where Ajay Piramal will invest the $3.7 billion (about Rs 17,000 crore) Piramal Healthcare has received (including annuity) for its formulations division. Last year's slump sale lifted not just a few eyebrows. Besides, there is the undeniable fact that Piramal has a nose for buying businesses on the cheap and selling them at a price. So the buzz in this stock's counter is unlikely to die down.

Moreover, given that part of the plot has yet to unfold and his top management is busy scouting for an appropriate buyout, the stockmarket's not paying too much attention to his residual businesses. Ajay Piramal maintains that he will continue to invest in his current business and the company will continue to be a pharmaceutical one.

Currently, Piramal Healthcare's CRAMS (contract research and manufacturing services) business, and OTC (over-the-counter) and Global Critical Care (anaesthetic) businesses are valued at a little over Rs 100 a share according to analysts' estimates. Receipts from the sale of its formulations and diagnostics businesses amount to nearly Rs 500-525. This works out to a combined valuation of Rs 600-625, against the current market price of Rs 440.

Gaining traction. Things are falling in place for the company in the present environment. First, after the initial slump in the financial year 2009, the CRAMS business is making a comeback. Globally, pharma outsourcing to India is slowly gaining momentum as the advantage of low-cost operations drive home bottomline benefits. The incremental sales in the coming year would largely arise from the pharma business. On the other hand, the management clearly envisages that it will continue to invest in pharma solutions.

Besides, it has a growing interest in OTC drugs and pills, which has grown by 32 per cent to Rs 5.46 crore in Q3FY11. The company has been investing in the OTC business, leveraging on its over two-lakh-strong distribution network, as well as on brands such as i-Pill and Saridon. While this business will take about 4-5 years to consolidate, the company is on the lookout for more brands to add to its range.

In its other segment, that of critical care, the company clocked growth of 27 per cent to Rs 9.94 crore in Q3FY11. The combined market size of the globalcare business is over $2 billion (about Rs 886 crore, and the company's positioning as it taps into the global opportunities in this business gives it an edge.

The wait for numbers. While a clearer picture will emerge later in April 2011, when the company declares its financial results, some analysts are holding back their views and waiting for the company to make an acquisition in order to determine the future course the stock could take. There's no denying that there is great anticipation regarding this investment. Yet, some analysts aren't worried that the company should be able to make the best buys as Ajay Piramal has time and again made judicious investments and has been able to deliver shareholder returns. Long-time value-seeker Rajeev Thakkar, CEO and director, Parag Parikh Financial Advisory Services, is bullish on the stock: "There's no denying that Piramal secured a good price for its formulations business, and there's also no denying that the group has been good at identifying new underpriced growth opportunities."

If indeed the company does manage to bag a few good businesses and manages to scale up its aspirations in the next few years, there could be a few positive surprises in store.

Tapping opportunities. One such bargain acquisition has been Gujarat Glass, which the company acquired in the late 1980s for a song, when it was just an ordinary manufacturer of bottles for pharmaceutical companies. The company has since been rechristened Piramal Glass. Over the years, a shift in focus to supplying bottles to the cosmetics and perfumery industries and a few overseas acquisitions helped it bag significant business in the lucrative Western market, transforming it into one of the top three glass bottle manufacturers in the world, with high profit margins.

Piramal Glass acquired the bankrupt Glass Group, US, in 2006 for $20 million, when it was going through a severe liquidity crunch, but had a lucrative franchise in the European and American cosmetics markets. The Piramals infused $60 million and turned around the US operations through some stringent cost-cutting and downsizing of employee strength. This helped the company gain access to a large chunk of the premium global cosmetics market in the US. In fact, the company even shifted some of its production capacities to India. A little earlier, it was planning to shut down two lines of production in the US out of its existing six lines and transfer production to India; since then, though, the business has gained traction and, due to lack of capacity, the company has shelved this shutdown plan and is continuing with its existing lines of production.

Glass bottles in the cosmetic and perfumery business command better prices. Even in this segment, Piramal Glass is focusing on the higher end of this segment, where the margins are better. On the other hand, demand for specialty food and beverage bottles has gained ground in recent years. The Sri Lankan operations command over 90 per cent of the market share in the specialty foods segment. To cater to the mounting demand, the company is increasing capacity by another 160 million tpd, to be commissioned in the latter half of FY 2013, and which will be funded through loans and internal cash flows.

Future stock. Operationally, the company's business has significantly turned around from a few years ago. With business back in bloom, the shift in production to low-cost operations in India helps in making the extra buck. Piramal Glass estimates that the company could see around 16 per cent CAGR in the next two years. Plus, the global demand for higher-end bottles is on the rise and should lift its operating margins to around 28 per cent. The only hitch is the rise in energy prices, particularly of gas. Besides, the company is planning to prune its debt, which should boost the return on capital.

What's worked for Piramal Glass is that it has managed to shift from being a pure commodity player to a high-margin value-added packaging company that caters to big brands, worldwide. That does merit some attention.

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clifford AT outlookindia.com

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