

3rd September 2010

**Piramal Healthcare Limited**

**CMP ₹ 512.55 | BUY**

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## Piramal Healthcare Limited

CMP ₹ 512.55

Initiating Coverage

**BUY**

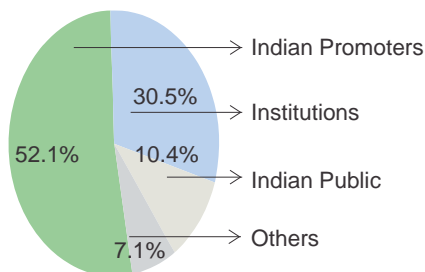
### Stock Codes

Bloomberg	: PIHC.IN
Reuters	: PIRA.BO
BSE Code	: 500302
NSE Code	: PRIHEALTH
BSE Group	: A

### Stock Data

Benchmark	: BSE 200
52 Week H/L	: ₹ 599.90/316.0
Float	: 53,470 Mn
Mkt Cap	: ₹ 105,580 Mn
Face Value	: ₹ 2.0

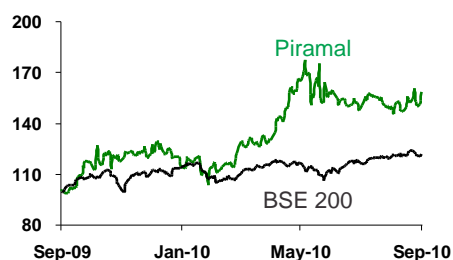
### Shareholding Pattern (as on June 10)



### Stock Returns

	1 Mth	3 Mths	6 Mths
Piramal	4.18	-1.77	20.57
BSE200	1.53	9.99	10.94

### Price Comparison



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### Attractive Valuation (Business available for free)

Piramal Healthcare through its asset sale will end up accumulating a large amount of cash. Due to such a large cash inflow, the enterprise value of this business at a price of ₹ 500.0 per share, is zero. That means the market is valuing the remaining businesses of Piramal Healthcare at near zero. The remaining businesses are profitable and surely have a value greater than zero.

### Quality of Business

Piramal is a 22 year old pharma company, which is one of the earliest players of the Indian Pharma Sector. Through strategic acquisitions in the early years, Piramal Healthcare has built up an enviable position in the Indian Pharma Sector. Their formulations business was purchased by Abbott at 10 times Sales (\$3.72 Bn) whereas their Diagnostics business was purchased by SRL at 3 times Sales (₹ 600 Crs). The management of Piramal Healthcare has proven its competence over the past couple of decades by making the company into one of the top 3 Pharma businesses in India.

### Strong Balance Sheet

After the two deals (Abbott and SRL), Piramal Healthcare's balance sheet will have huge cash balance and the management also intends to make the company debt-free. The cash might also be used to give a special dividend to shareholders or possibly a buyback might ensue.

### Future Prospects

With lots of cash comes a lot of responsibility to deploy it wisely. The management still hasn't finalized the target sector(s) to invest in. But judging by their track record of buying businesses at bargain prices and turning them into a globally acclaimed brands, a similar scenario can be expected.

### Summary Financials

Particulars (₹ Mn)	FY06	FY07	FY08	FY09	FY10
Revenues	16,784.60	25,203.00	29,318.10	33,116.10	36,813.00
PAT after MI	1,241.90	2,281.70	3,337.80	3,161.50	4,819.00
PAT (%)	7.40%	9.05%	11.38%	9.55%	13.09%
EPS (₹)	5.94	10.92	15.97	15.13	23.06
P/E (x)	42.75	20.43	17.41	13.35	18.37
Average ROCE (%)	11.82%	16.48%	16.03%	14.62%	16.24%
Average RONW (%)	12.24%	21.01%	20.93%	22.22%	22.39%
DPS (₹)	3.4	4.0	4.9	4.9	6.3
Dividend Payout (%)	57.57%	36.70%	30.77%	32.49%	27.31%

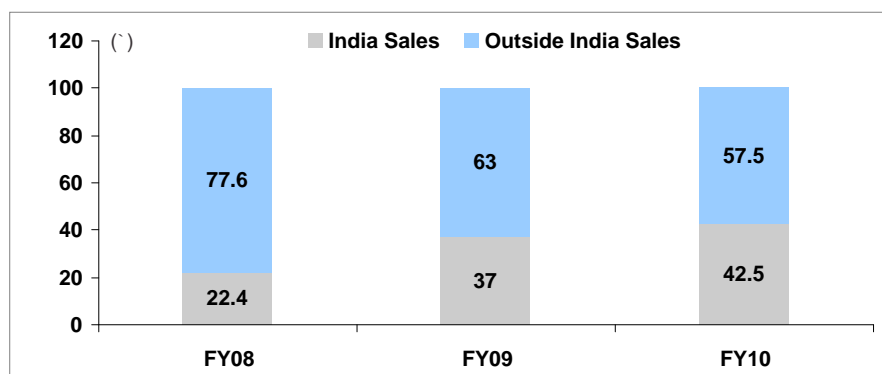
With the sale of business units, Piramal Healthcare is left with only three main business lines.

Piramal Healthcare (Post Deals)	
Estimated Total Revenues ( ` Mn)	FY10
Pharma Solutions	9,809
Piramal Critical Care	3,277
OTC & Others	1,558
<b>Total</b>	<b>14,644</b>

The total revenue of the remaining businesses amounts to ~40% of Total FY10 reported revenues. This is an estimate of how the financials might look like, since a lot of uncertainty still presides over revenue allocation to and from the sold units.

## Business Units

**Custom Manufacturing (Pharma Solutions)** – The custom manufacturing model works exactly like the IT offshoring model. Piramal Healthcare caters to the low cost manufacturing needs of MNC's like Pfizer, et al. This reduces the cost-to-market for the client firm. Piramal also has other manufacturing facilities apart from the one's in India, in US, UK and Canada. Over the years, the revenues from manufacturing in India have been increasing, resulting in more offshored production. This business represents 66% of the estimated total revenue for the firm.



Source: Company Presentation

**Piramal Critical Care** – Global critical care is one of the fastest growing segments of Piramal Healthcare. It caters to the global anaesthetics market. With a series of acquisitions in the past, the company has managed to become amongst the top five manufacturers in the world for some of its products (viz. Halothane & Isoflurane). Critical care business contributes to 23% of the estimated total revenues.

**OTC Products** – The remaining 10% of the business comes from OTC products. Piramal has a small kitty of diversified products like Lacto Calamine, Polycrol, Super Active, iPill and so on. The company has a good distribution network which might be useful for placing the products at more locations viz. 220,000 points of sale. This business unit might especially benefit after the deal since cash can be deployed to market the brands better. More complementary brands can be acquired to improve the OTC products portfolio.

## First Deal

Piramal Healthcare sold two of its business units in the first quarter of FY11. It announced by the end of May the sale of its domestic formulations unit to Abbott Laboratories for a sum of \$3.72 Bn. The sale is structured as follows:

<b>Abbott Deal ( ` Mn)</b>	
<b>Total Deal Size</b>	<b>167,400</b>
Payment Schedule	
Immediate Cash inflow	95,400
Subsequent Payments	
FY11	18,000
FY12	18,000
FY13	18,000
FY14	18,000
<b>Total Cash inflow ( ` Mn)</b>	<b>167,400</b>

The company stands to receive \$2.12 Bn ( ` 95,400 Mn) on an immediate basis just after the deal closes. It will then receive subsequent payments of \$400 Mn ( ` 18,000 Mn) every year for four years as part of the deal. An amount of ` 3,500 Mn has to be paid to the promoters (Piramal Enterprises Limited) as a non-compete fee out of the total \$3.72 Bn.

The deal attracts 22% tax. The tax implications further provide a better view as to how much cash can be estimated to be earned by the company. Here we have assumed a conservative discounting rate of 13% for the subsequent cash payments.

<b>Abbott Deal after Tax gains ( ` Mn)</b>	
<b>Total Deal Size</b>	<b>167,400</b>
Payment Schedule	
Immediate Cash inflow	74,412
Subsequent Payments	
FY11	12,425
FY12	10,995
FY13	9,730
FY14	8,611
(Less) Non compete fee	3,500
<b>Total Cash inflow ( ` Mn)</b>	<b>112,674</b>

The company can be expected to gain ` 1,12,674 Mn from the Abbott deal over the period of four years. This deal is scheduled to close in the second half of 2010. The numbers should probably start reflecting from the third quarter, or at the earliest by second quarter.

**Second Deal**

Further, in the second quarter of FY11, Piramal Healthcare announced a second deal with Super Religare Laboratories Ltd. This time the deal was the sale of Piramal's Diagnostics business (PDSL– Piramal Diagnostics Services Pvt Ltd), a subsidiary of Piramal Healthcare Ltd. According to the deal Piramal Healthcare will receive a sum of ₹ 6,000 Mn, with an immediate payment of ₹ 3,000 Mn on the closing of the deal and three subsequent annual payments of ₹ 1,000 Mn over a period of three years.

The deal is structured as follows.

<b>SRL Deal ( ₹ Mn)</b>	
<b>Total Deal Size</b>	<b>6,000</b>
Payment Schedule	
Immediate Cash inflow	3,000
Subsequent Payments	
FY11	1,000
FY12	1,000
FY13	1,000
<b>Total Cash Inflow ( ₹ Mn)</b>	<b>6,000</b>

The deal will attract a 22% tax, and we have assumed a 13% discounting rate on the subsequent incoming cash. The revised structure will be as follows.

<b>SRL Deal after Tax gains ( ₹ Mn)</b>	
<b>Total Deal Size</b>	<b>6,000</b>
Payment Schedule	
Immediate Cash inflow	2,340
Subsequent Payments	
FY11	690
FY12	611
FY13	541
<b>Total Cash Inflow ( ₹ Mn)</b>	<b>4,182</b>

**Overall Gain**

Piramal stands to gain a total cash of ₹ 1,16,855 Mn from both deals combined over the next four years. Clubbed with the existing cash we can estimate the total cash position of the company (after taxes) to be as follows.

<b>Cash ( ₹ Mn)</b>	
Existing Cash	425
Deal – taxes + Existing Cash	77,177
Subsequent Payments	(discounted at 13%)
FY11	13,115
FY12	11,606
FY13	10,271
FY14	8,611
(Less) Non compete fee	3,500
<b>Total Cash</b>	<b>117,280</b>

**Remaining business  
available for free**

What is an ideal valuation for a business that is given away for free?

Due to the cash inflow, the cash balances exceed the company's market value after adjusting for debt.

Estimated Cash position of Piramal Healthcare after the deals:

<b>Cash ( ` Mn)</b>	
Existing Cash	425
Deal – taxes + Existing Cash	77,177
Subsequent Payments	(discounted at 13%)
FY11	13,115
FY12	11,606
FY13	10,271
FY14	8,611
(Less) Non compete fee	3,500
<b>Total Cash</b>	<b>117,280</b>

The EV (Enterprise Value) determines the value of the business after adjusting for debt.

<b>Enterprise Value ( ` Mn)</b>	<b>@ ` 500 per share</b>
Mcap	104,331
Debt	12,949
(Less) Estimated Cash inflow	117,280
<b>EV</b>	<b>(0)</b>

At a Market Capitalization of ` 1,04,331 ( ` 500 per Share), with the estimated cash position and debt – the market value of the remaining business is zero.

Any business has some market value, even if it makes losses (value of assets, employees, brands, etc). In this case the remaining business, which is profitable, is available for free.

Even if we consider the remaining business to have a (very conservative) value of 1X Sales, it amounts to an estimated value of ` 14,644 Mn (~ ` 60 per share).

**Good quality business**

The quality of any business can be crudely determined by the ability of the management to sustain long term growth in value and good economics of the business. In both these cases, Piramal Healthcare stands at a vantage point. The promoter managed company has been run very well for the past 20 years. Over the past 10 years, the PAT has grown at a CAGR of 29%. The business has been generating an average Return on Net Worth of 22%.

The company has a history of good organic as well as good inorganic growth. With plenty of cash, they can augment the existing business by acquiring complementary businesses and also spend on internal growth.

**Dividend**

With so much cash the shareholders are bound to be rewarded. The company can also distribute some cash in the form of a special dividend. Its probability is high since even the promoters are moving their ownerships to other promoter owned companies in order to reduce the tax outgo on receiving dividend.

Besides the special dividend, the company has consistently maintained a dividend payout of more than 25%.

**Buyback of Shares**

*“When companies with outstanding businesses and comfortable financial positions find their shares selling far below intrinsic value in the marketplace, no alternative action can benefit shareholders as surely as repurchases”*

-Warren Buffett (*Berkshire Hathaway 1984 Annual Report*)

The company has to pay a 17% dividend distribution tax on the dividend distributed during a financial year. In order to avoid that, another alternative would be to buyback shares. In either case (dividend or a buyback), shareholders stand to gain.

It needs to be seen at what price the buyback will occur, if it happens.



Apart from healthy competition, the biggest concern about Piramal Healthcare at this moment is the cash deployment. It can hurt the long term value of the company if this cash isn't deployed wisely. It is a subjective matter and anybody's guess as to which businesses/sectors will be considered as wise investments.

Given the history of the management and their ability to turn investments into well recognized brands, the probability of irresponsible deployment of cash looks weak.

But given that, buying a business for less than its asset value can ensure some protection on the downside.

**NOTE:** The financial data is as at 31st March 2010, which doesn't include the sale of assets following the deal closure as well as the cash addition. It is provided just as a reference to gauge the business from an historical perspective.

P&L Account ( ` Mn)					
Particulars	FY06	FY07	FY08	FY09	FY10
Revenues	16,784.60	25,203.00	29,318.10	33,116.10	36,813.00
Less: Excise Duty	959.70	1,001.20	835.30	668.00	568.30
Net Sales	15,824.90	24,201.80	28,482.80	32,448.10	36,244.70
Growth (%)		52.93%	17.69%	13.92%	11.70%
Operating Expenditure	13,848.50	20,884.60	23,311.50	26,998.50	29,442.50
Operating Profit	1,976.40	3,317.20	5,171.30	5,449.60	6,802.20
Other Income	401.30	520.50	306.30	436.70	607.50
EBITDA	2,377.70	3,837.70	5,477.60	5,886.30	7,409.70
Depreciation	688.10	818.20	947.30	1,195.70	1,426.50
EBIT	1,689.60	3,019.50	4,530.30	4,690.60	5,983.20
Interest Expenses	173.00	305.10	463.10	838.00	916.40
PBT & EI	1,516.60	2,714.40	4,067.20	3,852.60	5,066.80
Exceptional Items	32.70	43.00	339.30	446.10	69.10
PBT	1,483.90	2,671.40	3,727.90	3,406.50	4,997.70
Taxes	238.10	388.90	376.60	219.40	180.30
PAT before MI	1,245.80	2,282.50	3,351.30	3,187.10	4,817.40
Minority Interest	3.90	0.80	13.50	25.60	(1.60)
PAT after MI	1,241.90	2,281.70	3,337.80	3,161.50	4,819.00
Growth (%)		83.73%	46.29%	-5.28%	52.43%
Ratio Analysis					
Particulars	FY06	FY07	FY08	FY09	FY10
OPM (%)	11.78%	13.16%	17.64%	16.46%	18.48%
EBITDA (%)	14.17%	15.23%	18.68%	17.77%	20.13%
PBT (%)	8.84%	10.60%	12.72%	10.29%	13.58%
PAT (%)	7.40%	9.05%	11.38%	9.55%	13.09%
Interest Cover (x)	9.77	9.90	9.78	5.60	6.53
EPS ( ` )	5.94	10.92	15.97	15.13	23.06
P/E (x)	42.75	20.43	17.41	13.35	18.37
P/BV (x)	3.71	2.54	3.02	1.51	2.84
BVPS ( ` )	68.40	87.65	91.92	133.54	149.36
Cash per Share ( ` )	4.56	2.42	2.64	4.52	1.97
Market Cap ( ` Mn.)	53,086.00	46,607.00	58,102.00	42,218.00	88,511.50
M Cap/Sales (x)	3.16	1.85	1.98	1.27	2.40
EV ( ` Mn.)	55,247.50	52,493.30	64,714.30	54,663.30	101,049.30
EV/EBITDA (x)	23.24	13.68	11.81	9.29	13.64
EV/Sales (x)	3.29	2.08	2.21	1.65	2.74
Average ROCE (%)	11.82%	16.48%	16.03%	14.62%	16.24%
Average RONW (%)	12.24%	21.01%	20.93%	22.22%	22.39%
Debt/Equity Ratio (x)	0.31	0.59	0.66	1.02	0.77
Debtors T/o Days	52	52	55	53	44
Advances T/o Days	33	26	31	45	64
Creditors T/o Days	106	106	94	107	90
Working Cap T/o Days	73	80	71	73	87
Fixed Assets T/o (Gross)	1.3	1.6	1.7	1.3	1.3
DPS ( ` )	3.4	4.0	4.9	4.9	6.3
Dividend Payout (%)	57.57%	36.70%	30.77%	32.49%	27.31%
Dividend Yield (%)	1.35%	1.80%	1.77%	2.43%	1.49%

<b>Balance Sheet ( ` Mn)</b>					
<b>Particulars</b>	<b>FY06</b>	<b>FY07</b>	<b>FY08</b>	<b>FY09</b>	<b>FY10</b>
Share Capital	418.00	418.00	418.00	418.00	418.00
Preference Shares	533.70	383.70	-	-	-
Reserves & Surplus	9,191.80	10,060.30	10,507.90	12,752.70	16,430.90
Shareholder's Funds	10,143.50	10,862.00	10,925.90	13,170.70	16,848.90
Minority Interest	30.20	5.00	48.60	74.50	-
Loan Funds	3,114.40	6,392.20	7,163.30	13,390.80	12,949.60
Deferred Tax Liability	1,007.10	1,060.00	1,074.20	1,274.50	1,418.20
<b>Total Liabilities</b>	<b>14,295.20</b>	<b>18,319.20</b>	<b>19,212.00</b>	<b>27,910.50</b>	<b>31,216.70</b>
Total Fixed Assets	10,417.70	12,237.50	12,585.40	20,390.90	21,130.10
Investments	287.30	287.30	652.50	278.30	325.50
Deferred Tax Asset	171.20	166.80	177.50	549.00	850.40
<b>Current Assets</b>					
Inventories	2,775.70	4,401.90	4,032.00	4,833.60	4,694.50
Sundry Debtors	2,429.30	3,673.40	4,449.40	4,866.30	4,529.50
Cash and Bank Balances	952.90	505.90	551.00	945.50	411.80
Other Current Assets	66.50	114.10	145.10	100.20	78.60
Loans and Advances	1,534.70	1,798.30	2,509.00	4,162.00	6,506.70
<b>Current Liabilities</b>					
Current Liabilities	3,276.50	4,550.50	4,668.40	6,306.70	5,744.50
Provisions	1,063.60	315.50	1,221.50	1,908.60	1,565.90
Net Current Assets	3,419.00	5,627.60	5,796.60	6,692.30	8,910.70
<b>Total Assets</b>	<b>14,295.20</b>	<b>18,319.20</b>	<b>19,212.00</b>	<b>27,910.50</b>	<b>31,216.70</b>
<b>Cash Flow Statement ( ` Mn)</b>					
<b>Particulars</b>	<b>FY07</b>	<b>FY08</b>	<b>FY09</b>	<b>FY10</b>	
PAT after MI	2,281.70	3,337.80	3,161.50	4,819.00	
Other Income	(520.50)	(306.30)	(436.70)	(607.50)	
Interest Paid	305.10	463.10	838.00	916.40	
Depreciation	818.20	947.30	1,195.70	1,426.50	
Others	(1,268.90)	(807.90)	3,555.80	(6,383.60)	
Change in Working Capital	(3,260.40)	(2,216.80)	(5,546.50)	(408.60)	
Change in Current Assets	(2,734.50)	(1,192.90)	(3,221.10)	(1,313.50)	
Change in Current Liabilities	(525.90)	(1,023.90)	(2,325.40)	904.90	
<b>Cash Flow from Operating Activities</b>	<b>(1,644.80)</b>	<b>1,417.20</b>	<b>2,767.80</b>	<b>(237.80)</b>	
Other Income	520.50	306.30	436.70	607.50	
Change in Fixed Assets	(2,176.60)	(1,023.20)	(9,417.20)	(1,907.90)	
<b>Cash Flow from Investing Activities</b>	<b>(1,656.10)</b>	<b>(716.90)</b>	<b>(8,980.50)</b>	<b>(1,300.40)</b>	
Increase in Equity	718.50	63.90	2,244.80	3,678.20	
Changes in Borrowings	3,277.80	771.10	6,227.50	(441.20)	
Interest Paid	(305.10)	(463.10)	(838.00)	(916.40)	
Dividend Paid	(837.30)	(1,027.10)	(1,027.10)	(1,316.10)	
<b>Cash Flow from Financing Activities</b>	<b>2,853.90</b>	<b>(655.20)</b>	<b>6,607.20</b>	<b>1,004.50</b>	
Net Change in Cash	(447.00)	45.10	394.50	(533.70)	
Openning Cash Balance	952.90	505.90	551.00	945.50	
Closing Cash Balance	505.90	551.00	945.50	411.80	

# Disclaimer

## Disclosure of Interest Statement

1. Analyst Ownership of the scrip
2. PPFAS ownership of the scrip
3. PMS ownership of the scrip

Piramal Healthcare Limited

- YES  
NO  
YES

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