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Plethico Pharmaceuticals: Invest at cut-off

S. Vaidya Nathan

Track record of healthy profitability and an established presence in export markets with a product profile that is unlikely to be hurt by legal challenges make this offer attractive. Invest with a one/two-year perspective.

EXPORT PLAY... Mr Shashikant Patel, CMD, and Mr Chirag Patel, Director & CEO.

Plethico Pharmaceuticals holds promise of emerging as a strong small-size company in the healthcare segment. Its track record has been fairly good over the past five years with steady growth in revenues and earnings.

The company has also been on an investment mode, adding to its capacity and venturing into overseas markets with equity-stake acquisitions over the past two years.

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The company may not be present in the highly regulated and lucrative markets of the US and European Union; as a matter of strategy, it has pursued less-regulated markets in the CIS universe (a few of the countries carved out of the erstwhile Soviet Union), Africa and Asia. It intends to keep the business focus this way.

Even an established and demonstrably profitable presence in such geographies with products less vulnerable to legal and cyclical risks may not fetch Plethico a fancy valuation of the kind enjoyed by the frontline players.

What is, however, likely from such a presence is a steady growth in revenues and earnings. This could attract investors, as the scope for negative surprises is minimal.

Plethico Pharma is offering its shares in a narrow price band of Rs 280-300. Based on the likely FY-06 profits (the company now follows an October-September financial year), the IPO is offered at a price-earnings multiple of about 10-12 times, depending on the final pricing.

Even if it commands a valuation in the lower-to-mid-teens, there is likely to be scope for gains linked to fundamentals over a one/two-year period.

Plethico Pharma derives about 65 per cent of revenues from exports. A large proportion of its domestic revenues is from contract manufacturing; a few OTC products (including herbals/nutrition supplements) have also chipped in to make a modest contribution, but growth from this category is likely to be robust, albeit on a low base for the next few years.

Plethico exited the domestic formulations space about 18 months ago and focussed on exports. As a result of this move, the revenues from domestic markets now account for 35 per cent compared to about 85 per cent three years ago. Plethico has, however, not taken its eye off the domestic market . As it has a non-compete agreement for four years, it has indicated that it may venture into the domestic market in a bigger way, once this period is over. Plethico derives a substantial proportion of revenues from antibiotics, anti-virals and anti-malarial/TB products. It has a marginal presence in the high-growth lifestyle therapeutic segments such anti-diabetes, cardiovascular and oncology, to name a few. It has indicated its intent to pursue the acquisition route to gain a more significant presence across a range of therapeutic segments. Given the modest outlay earmarked for this purpose, we are sceptical of the earnings impact of any such acquisition.

Revenues from the export market are likely to remain the key driver of profitability over the next three to five years. The extent to which its investments, especially in the CIS countries, make incremental payoffs will have a critical bearing on key profitability parameters.

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and delivery forms is being planned from the proceeds of the offer. If the company adheres to the implementation plan indicated in the offer document, these facilities should start contributing to revenues from FY-08.

The full impact of the planned investments may be reflected in revenues and earnings only from FY-09 onwards. In the intervening period, the earnings growth from existing facilities is likely to more than adequately compensate for the 12-15 per cent expansion in equity that is imminent.]

Key risks

The principal risks to our recommendation are:

The sharp spurt in the level of receivables as well as the credit periods are likely to impose strain on cash flows and profitability. There will be concerns about the quality of revenue growth till such time it is clear that such liberal terms are necessary to grow the revenues

Plethico has invested about Rs 125 crore over the past two-and-half years to pick equity stakes in a pharmaceutical company that has outfits in several CIS countries. The investment process is not complete in the sense the ownership is still to vest with Plethico

Plethico is also embroiled in a legal spat with a domestic company to which it had sold its formulations business; it has been accused of acting in a manner that runs counter to the terms of the deal. If the verdict goes against Plethico, there may one-time charges that could have a significant bearing on earnings. We will track news flow on this closely.

Offer details: Plethico Pharmaceuticals plans to raise Rs 110 crore through this book built offer. The equity will expand by 12-15 per cent based on the final pricing. Plethico now has an equity base of Rs 30.4 crore. Anand Rathi Securities is the book running lead manager. The offer, which opened on April 10, closes on April 17.

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