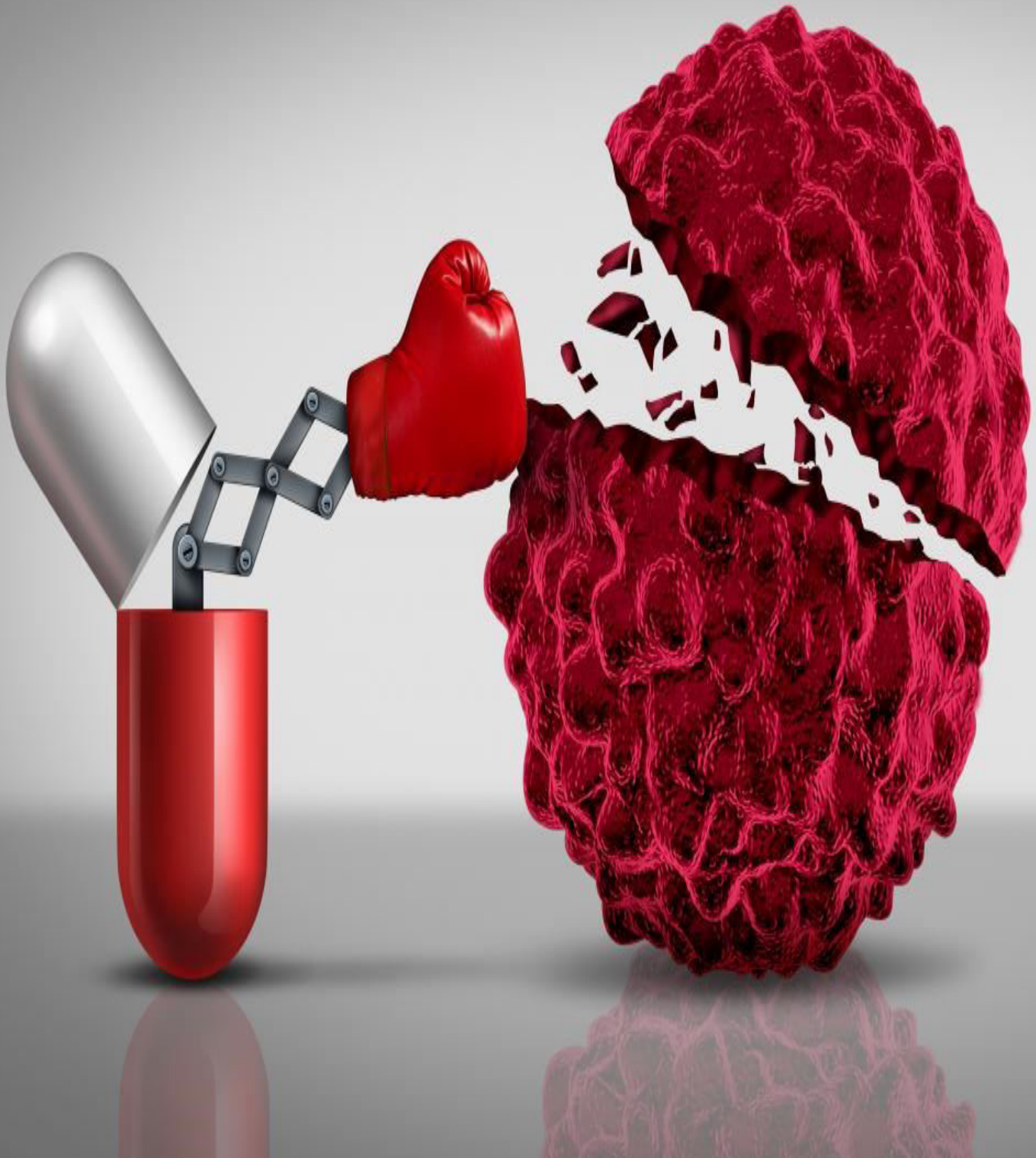


B

BP WEALTH

Shilpa Medicare Ltd

Initiating Coverage



Best Oncology Play

May 2018



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Company Background

Shilpa Medicare Ltd (SML) was established in 1987 as Shilpa Antibiotics Ltd. The company was converted into a public limited company in 1993. Being in the pharmaceutical industry, they deal in high-quality APIs, intermediates, formulations, new drug delivery systems, peptides / biotech products and specialty chemicals among others. SML specialises in oncology, AntiRetroVirals (ARV) and other therapeutic areas such as multiple sclerosis, immunosuppressant therapies. The company operates eight manufacturing facilities across Raichur, Telangana and Austria and also operates its R&D units in Raichur and Vizag. As on Mar 2017, SML had seven subsidiaries, out of which three are located in India and rest four in Austria.

Investment Rationale

Growth rate to accelerate with formulation supply to US

SPL has more than 15 years of experience and expertise in development and manufacturing of oncology API, with first ANDA filing in 2013 the company moved up the value chain and became formidable player in oncology formulations. Currently, SML has filed 31 ANDA's using its DMF's until the end of Q4FY18. Out of these 31 filings, about 8 are owned and the rest are for its partners i.e., where the dossier development and manufacturing will be done by SML and the drug will be registered in the customer's name. With regulatory clearance in place and its expected 5-6 new launches in the next 2 years, we expect significant contribution from US formulation business going forward. The revenue contribution from formulation business is expected to grow from 3% in FY17 to 37% in FY20E. We modeled an exponential growth in US revenue on the back of low base higher number of approvals in medium term. Revenue is expected to grow from Rs 219 mn in FY17 to Rs 4.2 bn by FY20E.

CRAMS: Strong relationship with customer to ensure sustained growth

CRAMS is the other leading segment with a revenue contribution of ~Rs 3.8bn (52% of sales) in FY17. Under this segment, it manufactures and supplies only Ursodeoxycholic acid intermediate to Italy based Industria Chimica Emiliana (ICE) and its subsidiary Prodotti Chimicie Alimentari (PCA) under a long term supply contract. ICE is the global leader in bile acid derivatives such as cholic acid and Ursodeoxycholic acid APIs. Ursodeoxycholic acid is used in dissolving gallstones and treating primary biliary cirrhosis. It reduces cholesterol secretion from the liver and reduces fractional re-absorption of cholesterol by the intestines. Though the operation has maintained a healthy growth rate of around 20% over the last few years, the one product for single customer nature of the alliance seems a risk (customer/product concentration) for the company. SML's facility is ICE's only facility outside Italy to source this product, which underlines the confidence and trust ICE has in SML. We estimate CRAMS revenue to grow at steady pace of 5% for next 2 years and expect to reach Rs 3.56 bn revenue by FY20E.

Leading player in India's oncology API

Although CRAMS is the leading revenue contributor for SML, the development and manufacturing of high potency oncology APIs is the prime focus of the company. It has a broad portfolio of over 42 oncology APIs with 30 DMFs filed for the US and few for European markets. Its key oncology products are – Gemcitabine, Capecitabine, Carboplatin, Oxaliplatin, and Busulfan. Out of these, Gemcitabine and Capecitabine are its leading products where Shilpa holds around 30-35% market share in Europe. Its key oncology API customers are – Actavis, Intas Pharma, Dr Reddy's Lab, Cipla, Fresenius Kabi, Sun Pharma, etc. Shilpa has one of the largest oncology API manufacturing capacities in India with six fully-equipped cytotoxic blocks, supplying to some of the leading global pharmaceutical companies in important markets such as Europe, Brazil, Japan, Russia and Australia in addition to other emerging markets. The company has also received USFDA and PMDA (Japan) approvals for its two API facilities (in Raichur, Karnataka). During FY17, oncology API business contributed ~33% to SML's overall revenues. We expect revenues from this segment to grow at 12.5% CAGR over FY18-FY20E led by increasing supplies to the US and steady growth in other geographies. SML generates ~12% of its total revenues from base non-oncology API business. We expect API business to grow at 7.5% CAGR over FY18-20E. The growth would be driven by launch of new products and capacity addition in existing portfolio.

Stock Rating

BUY	HOLD	SELL
> 15%	-5% to 15%	< -5%

Sector Outlook

Positive

Stock

CMP (Rs)	440
Target Price (Rs)	592
BSE code	530549
NSE Symbol	SHILPAMED
Bloomberg	SLPA IN
Reuters	SHME.BO

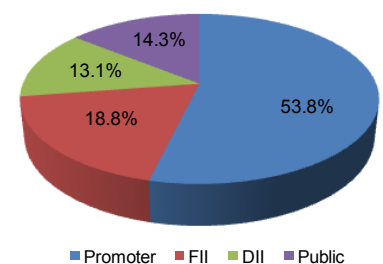
Key Data

Nifty	10,741
52 Week H/L (Rs)	725/401
O/s Shares (Mn)	80
Market Cap (Bn)	36.5
Face Value (Rs)	1

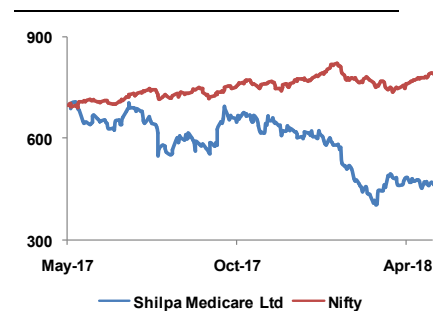
Average volume

3 months	73,520
6 months	54,680
1 year	46,140

Share Holding Pattern (%)



Relative Price Chart



Research Analyst

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Financial performance to improve further

The Company have witnessed strong growth in revenue of 17.9% CAGR, whereas operating profit has shown growth of 15.3% CAGR over FY11 to FY17. Despite improved operating efficiency, we expect the EBITDA margin to expand at a lower rate than the gross margin due to higher R&D spending for future product development (R&D spend 3% in FY17 to reach 5.1% in FY20E of total revenue). PAT has grown at a rate lower to EBITDA due to increase in the effective tax rate from 22.8% in FY11 to 28.6% in FY17. Going ahead, the management expects tax rate to remain at 25% level. There has been deterioration in RoCE and RoE over the past 5 years. This is mainly because of the delay in entering the US market due to regulatory hurdles, leading to lower asset turnover. RoE dropped from 30% in FY11 to 14.9% in FY17. With regulatory issues resolved and product approvals kicking in, we expect commercial production to pick up from FY19, facilitating return ratio improvement. We expect RoE/RoCEs to improve from 14.9%/17.4% in FY17 to 15.3%/19.3% in FY20E. As a measure, it is making efforts to increase revenue by expanding existing and new product pipeline. This will cost ~Rs1.5 bn which will be funded by internal accruals. Owing to expansion, revenue expected to grow at 24.7% CAGR and EBITDA at 34.6% CAGR over FY18 to FY20E.

Why we like this stock & valuation methodology

SML has its strength in manufacture and sale of Oncology APIs across Europe, partnering international companies for custom synthesis. The company has also geared up for the expansion improving the asset base in the last 5 years and expect to incur same amount of capex for FY18-20E. The current valuations are riding on the company's ability to execute the above plans based on the strengths accumulated. Moreover, SML is better positioned compared to peers as it has USFDA clearance in place. Operating in oncology space where products are relatively complex, face low competition which also separates SML from its peers operating in US market. We estimate Revenue/EBITDA/PAT to grow at 24.7%/34.6%/35.6% CAGR during FY18-20E. At the CMP (Rs 440), the stock is trading at 24.7x its FY19E EPS of Rs 17.8 and 18.6x its FY20E EPS of Rs 23.7. We initiate coverage on the stock & recommend 'BUY' rating by assigning 25x to its FY20E earning (in line with 5 year average PE). We arrive at a target price of Rs 592 (potential upside of 34% from CMP) for an investment horizon of 15-18 months.

Key Financials						
YE March (Rs. mn)	FY15	FY16	FY17	FY18E	FY19E	FY20E
Revenue	6,138	7,164	7,789	7,617	9,540	11,836
Revenue Growth (Y-o-Y)	7.4%	16.7%	8.7%	(2.2%)	25.2%	24.1%
EBITDA	1,264	1,600	1,657	1,605	2,210	2,906
EBITDA Growth (Y-o-Y)	9.0%	26.6%	3.6%	(3.2%)	37.8%	31.5%
Net Profit	726	1,062	1,115	1,032	1,426	1,896
Net Profit Growth (Y-o-Y)	(3.4%)	46.3%	5.0%	(7.5%)	38.2%	33.0%
Diluted EPS	9.1	13.3	13.9	12.9	17.8	23.7
Diluted EPS Growth (Y-o-Y)	-3.4%	46.3%	5.0%	-7.5%	38.2%	33.0%
No of Diluted shares (mn)	80	80	80	80	80	80
Key Ratios						
EBITDA (%)	20.6%	22.3%	21.3%	21.1%	23.2%	24.6%
NPM (%)	11.8%	14.8%	14.3%	13.5%	14.9%	16.0%
RoE (%)	15.4%	18.3%	14.9%	10.7%	13.2%	15.3%
RoCE (%)	17.4%	20.3%	17.4%	12.8%	16.2%	19.3%
Tax Rate %	32.7%	25.1%	28.6%	25.0%	25.0%	25.0%
Book Value Per share (Rs.)	68.3	79.8	114.3	126.4	143.1	165.4
Valuation Ratios						
P/E (x)	48.5x	33.2x	31.6x	34.2x	24.7x	18.6x
EV/EBITDA	29.2x	22.5x	22.1x	22.5x	16.6x	12.6x
P/BV (x)	6.4x	5.5x	3.8x	3.5x	3.1x	2.7x
Market Cap. / Sales (x)	5.7x	4.9x	4.5x	4.6x	3.7x	3.0x

Source: Company, BP Equities Research

We have valued SML by assigning 25x to its FY20 earning estimates. We arrive at a target price of Rs 592 (potential upside of 34% from CMP) for an investment horizon of 15-18 months.

Investment Rationale

Growth rate to accelerate with formulation supply to US

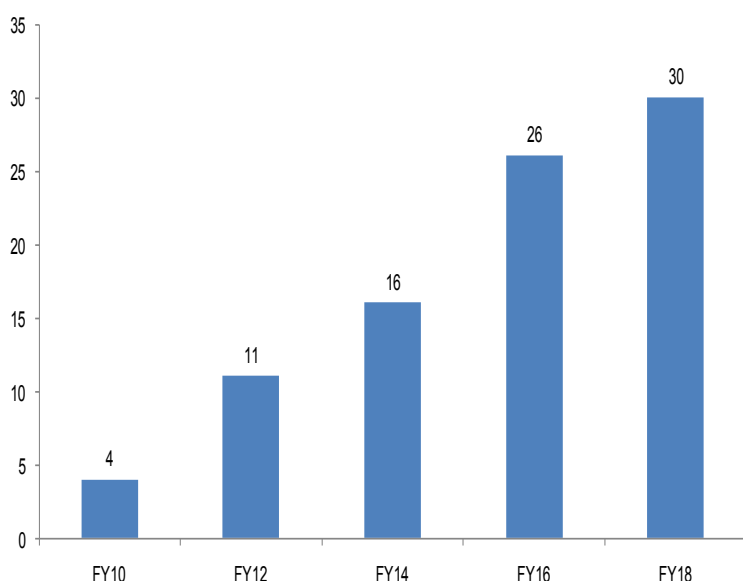
SPL has more than 15 years of experience and expertise in development and manufacturing of oncology API. With first ANDA filing in 2013, the company moved up the value chain and became formidable player in oncology formulations. Currently, SML has filled 31 ANDA's using its DMF's until end Q4FY18. Out of these 25 filings, about 8 are owned and the rest are for its partners i.e., where the dossier development and manufacturing will be done by SML and the drug will be registered in the customer's name. With regulatory clearance in place we expect significant contribution from US formulation business going forward. We expect revenue contribution from formulation business to grow from 4% in FY17 to 25%, subject to timely approval.

Given that oncology API development and manufacturing facilities involve highly specialised technical capabilities and high capital investments, there is relatively a lower competitive intensity in the space, which ensures better profitability for the manufacturer. The company would be sourcing a significant part of the API from its own facilities, which would provide good visibility for its oncology API business.

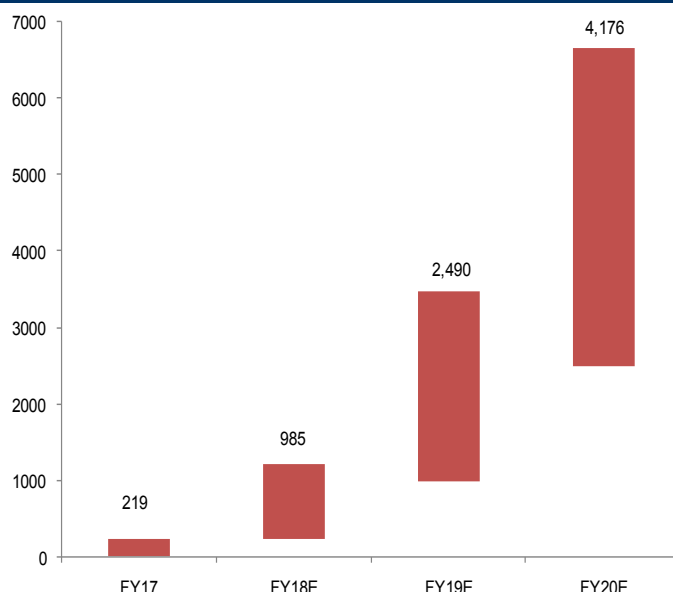
SML has received approvals for 2 ANDA's (g-Vidaza and g-Xeloda) during 2HFY17. During FY18, we can see full year effect from g-Vidaza and we expect SML to garner revenue of Rs 569mn (USD 8.8 mn) from g Xeloda and Rs 416 mn (USD 6.4mn) from g-Vidaza with 5% and 10% market share respectively. Given that there is expected limited generic competition in g-Vidaza during FY19, we expect SML to garner Rs 16.8mn (USD 1.9 bn) (full year). However, in FY20 we expect due to increased competition based on higher number of DMF filings, which could be result into higher price erosion (Our est. FY18: 30% to FY20: 50%). As a result of that, revenue from g-Vidaza to remain at Rs 780mn (USD 12mn) in FY20E. We expect g-Xeloda to clock Rs 910mn (USD 14mn) and during FY19, with 8% market share and 50% price erosion due to 9 companies having final approval for this product. With 28 DMF filings in g-Xeloda, we expect price erosion to continue in FY20, due to which we expect revenue of Rs 728mn (USD 11.2 mn). The company has ~31 pending ANDAs in the US and even higher number of filings in the EU with an estimate of 5-6 new launches in the next 2 years, indicating strong growth potential in the formulations space in near to mid-term. We modeled exponential growth in US revenue on the back of low base higher number of approvals in medium term. Revenue is expected to grow from Rs 219mn in FY17 to Rs 4.17bn by FY20E.

Formulation contribution in total revenue is expected to reach 37% in FY20E from 3% in FY17

Cumulative US DMF's Filled (in Numbers)



Exponential growth in US formulation revenue (Rs in mn)



Source: USFDA, Company, BP Equities Research

Shilpa Medicare Ltd.

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Shilpa Medicare's DMF Filings till April 2018

Appl Type/ Number	Holder	Subject	No. of DMF Fillers	Brand	Patent Owner	Patent Expi- ry US	Therapy
MF 023479	SHILPA MEDICARE LTD	TEMOZOLOMIDE USP	16	Temodar	Merck	Expired	Oncology
MF 023562	SHILPA MEDICARE LTD	IRINOTECAN HYDROCHLORIDE TRI- HYDRATE USP	33	Camptosar	Pfizer	Expired	Oncology
MF 023563	SHILPA MEDICARE LTD	OXALIPLATIN USP	26	Eloxatin	Sanofi Aventis	Expired	Oncology
MF 024136	SHILPA MEDICARE LTD	GEMCITABINE HYDROCHLORIDE USP	29	Gemzar	Eli Lilly	Expired	Oncology
MF 024689	SHILPA MEDICARE LTD	CAPECITABINE USP	28	Xeloda	Hoffman LaRoche	Expired	Oncology
MF 024690	SHILPA MEDICARE LTD	BICALUTAMIDE USP	29	Casodex	Astra Zeneca	Expired	Oncology
MF 024944	SHILPA MEDICARE LTD	BORTEZOMIB	20	Valcade	Millennium Pharma	Expired	Oncology
MF 025102	SHILPA MEDICARE LTD	PEMETREXED DISODIUM (HEMIPENTA HYDRATE)	22	Alimta	Eli Lilly	Expired	Oncology
MF 025222	SHILPA MEDICARE LTD	BENDAMUSTINE HCL	22	Treanda	Cephalon	Expired	Oncology
MF 025491	SHILPA MEDICARE LTD	BUSULFAN USP	10	Busulfex	Otsuka America Pharma- ceuticals Inc	Expired	Oncology
MF 025905	SHILPA MEDICARE LTD	ZOLEDRONIC ACID	25	Reclast/Zometa	Novartis Pharma	Expired	Oncology
MF 027487	SHILPA MEDICARE LTD	AZACITIDINE	14	Vidaza	Celgene	Expired	Oncology
MF 027488	SHILPA MEDICARE LTD	DECITABINE	17	Dacogen	Otsuka America Pharma- ceuticals Inc	Expired	Oncology
MF 027489	SHILPA MEDICARE LTD	LETROZOLE USP	24	Femara	Novartis Pharma	Expired	Oncology
MF 027927	SHILPA MEDICARE LTD	IMATINIB MESYLATE	33	Gleevec	Novartis Pharma	Expired	Oncology
MF 028162	SHILPA MEDICARE LTD	FINGOLIMOD HYDROCHLORIDE	19	Gilenya	Novartis Pharma	18/02/2019	Multiple Sclerosis
MF 028349	SHILPA MEDICARE LTD	IMATINIB MESYLATE (IMN)	1	-	-	-	Oncology
MF 028930	SHILPA MEDICARE LTD	MELPHALAN HYDROCHLORIDE (MPH)	9	Evomela	Spectrum Pharmaceuticals	Mar-29	Oncology
MF 029124	SHILPA MEDICARE LTD	ERLOTINIB HYDROCHLORIDE (ET)	23	Tarceva	OSI Pharma	8/11/2018	Oncology
MF 029652	SHILPA MEDICARE LTD	PEMETREXED DIPOTASSIUM (NONA HYDRATE) (PMN)	2	Alimta	Eli Lilly	24/11/2021	Oncology
MF 029654	SHILPA MEDICARE LTD	ANASTROZOLE USP	11	Arimidex	AstraZeneca	Expired	Oncology
MF 029655	SHILPA MEDICARE LTD	DIMETHYL FUMARATE	28	Tecfidera	Biogen IDEC Inc	FY2028	Multiple Sclerosis
MF 029806	SHILPA MEDICARE LTD	CLOFARABINE	11	Clolar	Genzyme Corp.	Jul-18	Oncology
MF 030104	SHILPA MEDICARE LTD	AXITINIB	4	Iniyta	Pfizer	Expired	Oncology
MF 030260	SHILPA MEDICARE LTD	ENZALUTAMIDE	9	Xtandi	Medivation Inc. and Astellas Pharma Inc.	Aug-27	Oncology
MF 030952	SHILPA MEDICARE LTD	PIRFENIDONE	16	Esbriet	Genentech Inc	22/04/2029	Respiratory
MF 031892	SHILPA MEDICARE LTD	GEMCITABINE HYDROCHLORIDE USP (PROCESS -2)	21	Gemzar	Eli Lilly	-	Oncology
MF 032122	SHILPA MEDICARE LTD	IBRUTINIB	13	Imbruvica	Pharmacyclics Inc	2026	Oncology
MF 032172	SHILPA MEDICARE LTD	TERIFLUNOMIDE	19	Aubagio	Genzyme Corp.	2030	Multiple Sclerosis
MF 032309	SHILPA MEDICARE LTD	POMALIDOMIDE	10	Pomalyst	Celgene	2024	Oncology

Source: USFDA, BP Equities Research

Oncology Industry Overview

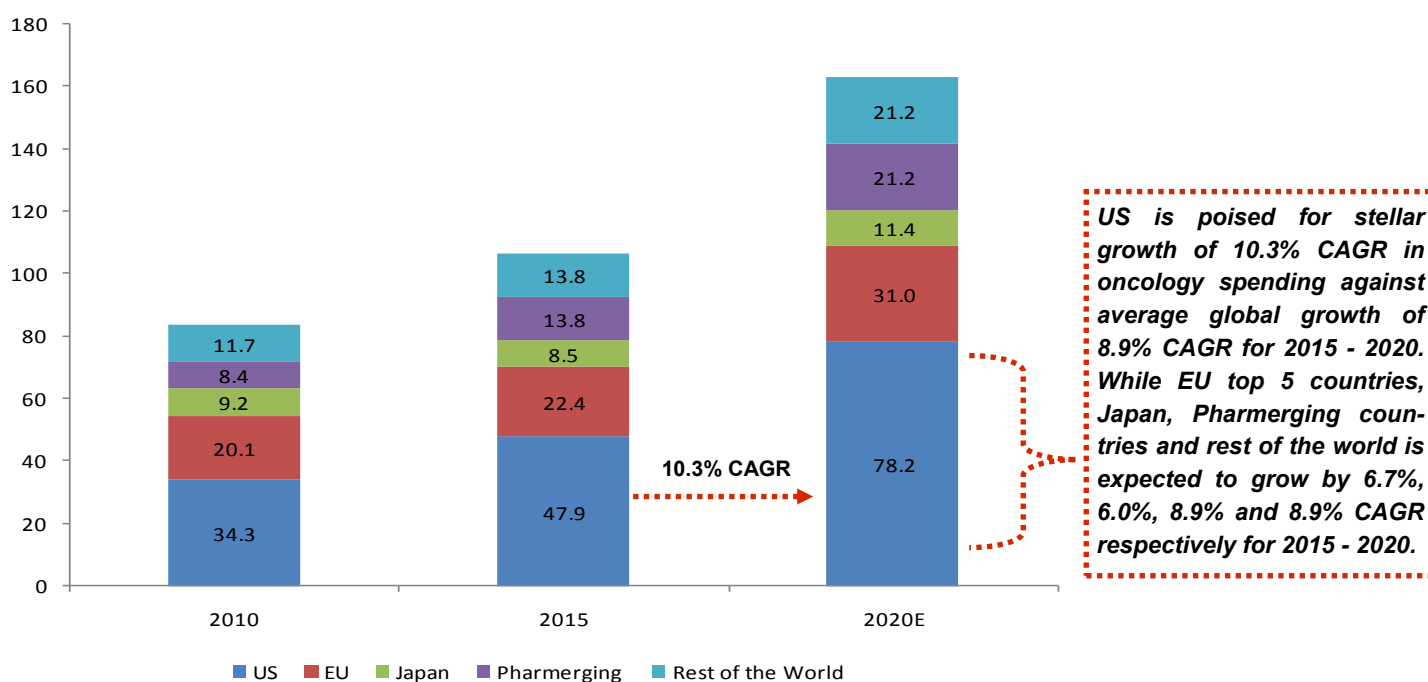
Oncology is a key driver of growth for the pharmaceutical industry. The global oncology drug market is expected to reach \$ 150 billion by 2020 from \$ 107 billion in 2015 – registering annual growth rate of 7.5-10.5 percent, according to a new study released by the IMS Institute for Healthcare Informatics. It is poised to account for about 30% of product pipeline and 25% of pharmaceutical-industry revenue by 2020.

The U.S. accounts for 46% of the global total market for therapeutics, up from 39% in 2011, due in part to a strengthening U.S. Dollar over this time period and more rapid adoption of newer therapies. The EU5 and Japan registered constant dollar compound annual growth rates of 5.3% and 5.4% respectively over the past 5 years, compared to 7.4% for the U.S. The pharmerging markets, comprising 13% of the global total in 2015, increased their medicine costs annually by 15% on average over the past 5 years.

Over the past 5 years, the cost of oncology medicines in the U.S. increased by \$15.9 billion, or 72% over the 2010 level. Over \$9 billion of total growth came from the adoption of new therapies introduced since 2010 and due to increased volume and price of existing branded drugs. Switching to generics and loss of patent exclusivity for some older brands have resulted in partial reduction of overall spending.

Annual growth globally in the cost of oncology drugs is expected in the 7.5% – 10.5% range through 2020, and will exceed \$150 billion. Wider usage of new products – especially immunotherapies – will drive much of this growth, and will be partially offset by reduced use of some existing treatments with inferior clinical outcomes.

Global Oncology Spend (2010-20, USD billion)



Source: KPMG Report, BP Equities Research

Therapy Area	2016 WW sales (US\$ Bn)	Projected WW sales 2022 (US\$ Bn)
Oncology	93.7	192.2
Antidiabetics	43.6	57.9
Anti-rheumatics	53.3	55.4
Anti-virals	48.5	42.8
Vaccines	27.5	35.3
Bronchodilators	28.3	30.1
Sensory Organs	20.2	28.3
Immunosuppressants	11.6	26.3
Anti-hypertensives	24.8	24.4
Anti-coagulants	14.1	23.2
MS therapies	21.6	21.7
Dermatologicals	10.5	19.9
Anti-fibrinolytics	11.6	17.1
Anti-hyperlipidaemics	13.8	13.4
Anti-bacteria	10.5	12.8
Top 15	434	601
Other	369	500
Total	803	1100

The global oncology drug market is expected to reach \$192.2 billion by 2022 from \$93.7 billion in 2016 – registering annual growth rate of 12.7% CAGR. It is poised to account for about 30% of product pipeline and 25% of pharmaceutical-industry revenue by 2022.

Source: Industry, BP Equities Research

The global pharma industry is expected to witness an encouraging growth in the coming years. Emerging and lower-income countries are likely to drive the rise in healthcare expenditures, with a potential for expansion of services in developed countries. Global medicines spend is expected to reach nearly \$1100 billion by 2022, which is up by \$297 billion from the 2016 levels.

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Major global healthcare drivers

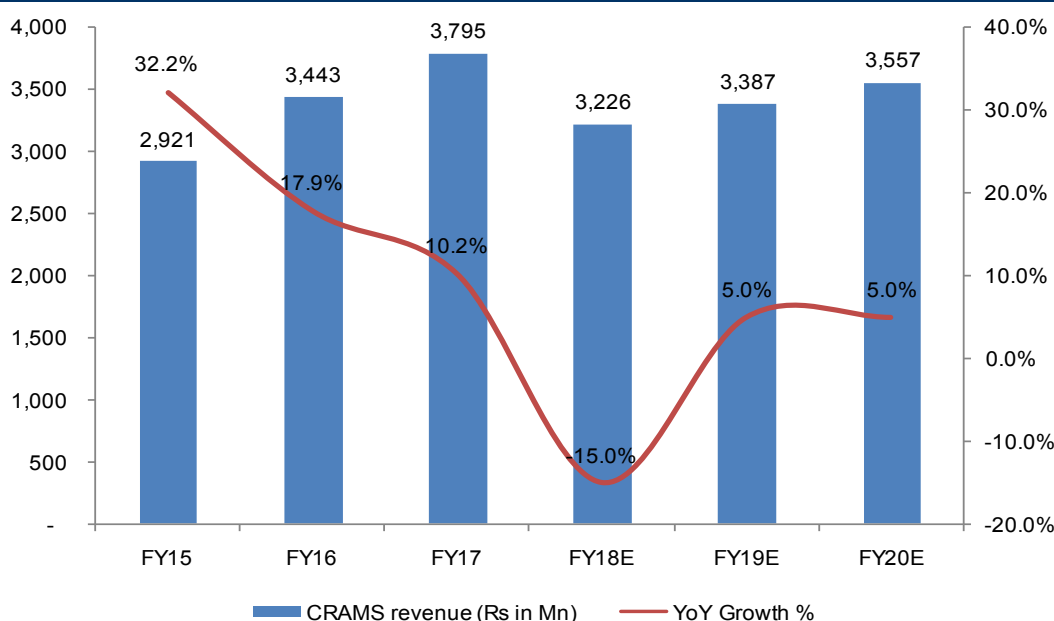
- ⇒ By 2020, 50% of global healthcare expenditures – about US\$ 4 trillion – will be spent on 3 leading causes of death: cardiovascular diseases, cancer and respiratory diseases.
- ⇒ Oncology, autoimmune and diabetes treatments will drive much of the growth in future.
- ⇒ Innovation in specialty medicines will continue lifting the share of global spending from 30% in 2016 to 35% in 2021.

CRAMS: Strong relationship with customer to ensure sustained growth

CRAMS is its other leading segment with a revenue contribution of ~Rs 3.8bn (52% of sales). Under this segment, it manufactures and supplies only Ursodeoxycholic acid intermediate to Italy-based Industria Chimica Emiliana (ICE) and its subsidiary Prodotti Chimicic Alimentari (PCA) under a long-term supply contract. ICE is the global leader in bile acid derivatives such as cholic acid and Ursodeoxycholic acid APIs. Ursodeoxycholic acid is used in dissolving gallstones and treating primary biliary cirrhosis. It reduces cholesterol secretion from the liver and reduces fractional reabsorption of cholesterol by the intestines. Though the operation has maintained a healthy growth rate of around 20% over the last few years, the one-product-for-single-customer nature of the alliance seems a risk (customer/product concentration) for the company. SML's facility is the only facility for ICE outside Italy to source this product, which underlines the confidence and trust ICE has in SML. Given SML's good execution track record and the robust demand-supply scenario for ursodeoxycholic acid, ICE has entered into a JV with SML under name of Raichem Medicare Ltd in mid FY15, which has invested in a state-of-the-art facility at Raichur for manufacturing the product. However, due to incurring loss over the past 2 years (FY16 & FY17) and the uncertain future outlook, SML has decided to sell its stake in Raichem Medicare to ICE for the consideration of Rs 20.2 bn (USD 1.3bn).

Raichem Medicare (JV between SML and ICE) has been incurring losses over the past 2 years and the outlook, too, remains uncertain. Consequently, SLPA has decided to sell its stake in Raichem Medicare to ICE for a consideration of INR1.3bn (USD 20.2mn). Prior to the stake sale, SML has invested ~Rs800mn in JV. Process of stake sale expected to conclude by Oct 2018. As per management, exiting JV will not affect the decade old relationship with ICE and company will continue to supply Ursodeoxycholic acid intermediate to ICE. However, due to exit from JV, CRAMS revenue will decrease for FY18E (Rs 3.2bn vs Rs 3.8bn in FY17). We estimate CRAMS revenue to grow at steady pace of 5% for next 2 years and expected to reach Rs 3.56bn revenue by FY20E.

CRAMS revenue to recover and remain steady going forward



Source: Industry, BP Equities Research

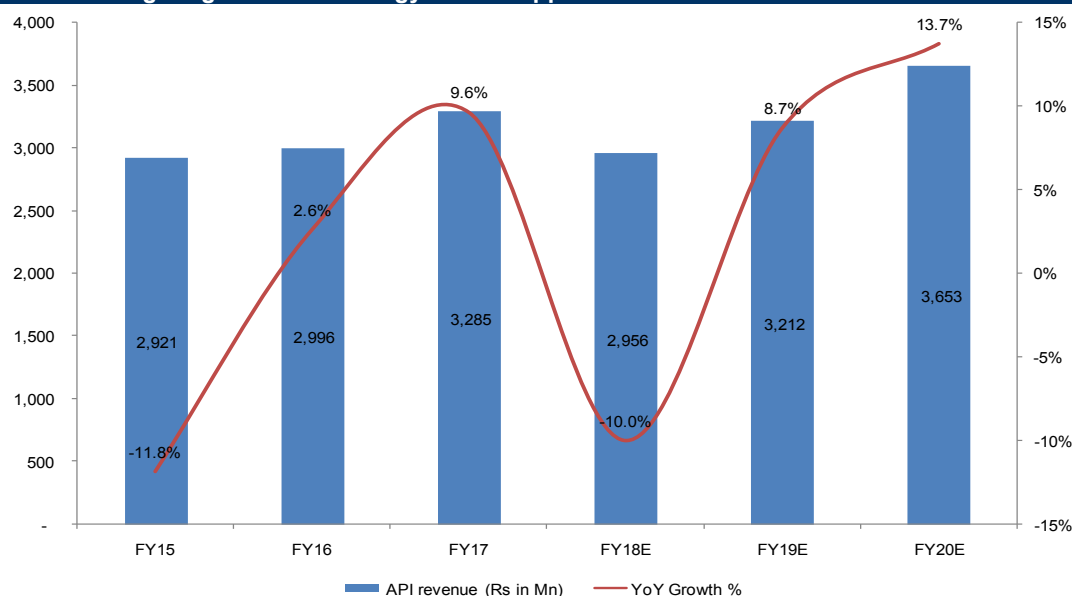
Leading player in India's oncology API

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Non-oncology API business

SML generates ~12% of its total revenues from base non-oncology API business. We expect this business to grow at 7.5% CAGR over FY18 - FY20E. The growth would be driven by launch of new products and capacity addition in existing portfolio. The company has developed APIs like acebrophylline, ambroxol, fingolimod, nifedipine, sildenafil citrate, etc.

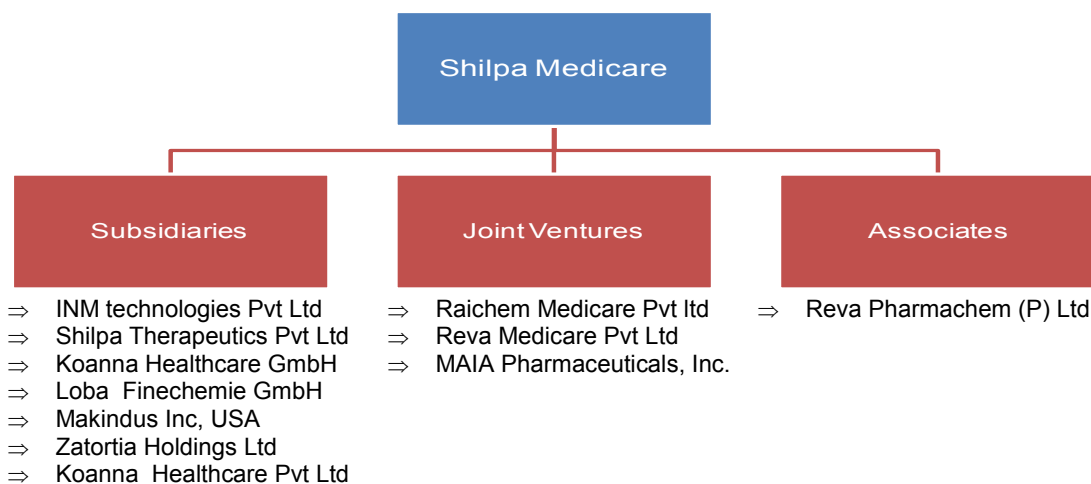
Higher growth in oncology API to support 11.6% CAGR over FY18E to 20E



Source: Company, BP Equities Research

Future value creation through strategic investments

SML has made several strategic investments over the past few years into niche segments such as disintegrating strips, NDDS and ophthalmic drug with orphan status. This would enable company to launch new and differentiated products in the coming years and would also provide diversification from oncology concentration. We have not built any upside from these investments in our estimates or valuation; hence the same may provide an upside. Following is a rundown of the investments:



Source: Company, BP Equities Research

INM Technologies Pvt Ltd – Subsidiary Company

Innovative Nano & Micro Technologies Private Limited a subsidiary of SML was incorporated in the FY 2014-2015. Based on research activity and experience in the chemistry, materials science and engineering, pharmaceutical technology sectors, it develops and integrates nanostructured materials as required by customers. INM Technologies has initiated the process to obtain ISO 9001 certification from prestigious TUV Group. After completion of 3 years of establishment i.e., by January 2018, it will apply for DSIR certification. It is working on dosage forms in ophthalmics, NDDS, SR oral thin film, parenteral and dermatology. They are under various stages of development. Specifically, confirmative animal studies are going on for select formulations, and a few ophthalmic formulations are planned to scale up using contract manufacturing facilities.

Shilpa Therapeutics Pvt Ltd – Subsidiary Company

As a result of continued efforts in the research and product development, Shilpa Therapeutics had developed the most sought after novel drug delivery system. It has commercialized prescription products on orally disintegrating strip/film and obtained the manufacturing and marketing licenses for dosage form in India and abroad. Shilpa Therapeutics facility is capable of meeting the demand from manufacturing to secondary packing with its compliance to meet the latest Schedule 'M', cGMP/WHO GMP compliant systems, procedures and practices. Moreover, it has obtained manufacturing and marketing license from the Drugs Control General (India), New Delhi for the following products :

Molecule	Category
Ondansetron Hydrochloride 2mg , 4mg & 8mg Orally Disintegrating Strips	For the prevention of chemotherapy induced nausea and vomiting (CINV)
Simethicone 62.5mg Orally Disintegrating Strips	Anti-Flatulent.
Sildenafil Citrate 25mg & 50mg Orally Disintegrating Strips	For the treatment of erectile dysfunction (ED)
Tadalafil 20mg & 10mg Orally Disintegrating Strips	For the treatment of erectile dysfunction (ED)
Methylcobalamin 1500mcg ODS	Treatment of various neuropathic conditions and vitamin deficiency

Source: Company, BP Equities Research

Koanaa Healthcare GmbH – Wholly owned subsidiary

Koanaa Healthcare GmbH was incorporated in July 2016 as 100% subsidiary of SML. It distributes and sells SML Ltd's oncology products. The company would start with Austrian and German markets before exploring other European markets.

Loba Finechemie GmbH – Step down subsidiary

Main strategy of Loba Feinchemie GmbH is to enhance the focus in terms of resources on business development and Sales & Marketing within the next business years to support sales and profit growth.

Reva Pharmachem (P) Ltd – Associate Company

Reva Pharmachem (P) Ltd is specialised in API business with operations in Regulated and Emerging markets. The core markets are; Japan, Korea, Vietnam, Italy & Greece. The customer base has increased across markets but Japan & Korea are the front runners. Moreover, company secured foothold with the largest Oncology "Generic" Co of Japan which controls over 70% of the market.

MAIA Pharmaceuticals, Inc. ("MAIA") – Joint Venture

MAIA is based in USA, which is engaged in the research, development and commercialization of pharmaceutical products. The Company has made an investment into MAIA Pharmaceuticals, Inc. in 2013 and 2014 respectively. The product pipeline consists of 15 niche generic and proprietary pharmaceutical products focused on the US, Canada and Europe. MAIA has received 2 product approval in the US and Canada and it is expected to increase production in FY18-19.

Makindus Inc, USA – Subsidiary Company

Makindus is a specialty pharmaceutical development company focused on ophthalmology and rare diseases. Makindus lead asset is MI-100, a novel ophthalmic formulation of a legacy compound being developed for Stargardt disease, a rare form of juvenile macular degeneration. The estimated prevalence in the U.S. and Europe is approximately 1 in 10,000 individuals. Mankindus has been granted orphan drug designation for MI- 100 for the treatment of Stargardt Disease in both the United States and Europe. The Company will benefit from a number of incentives related to orphan drug designation including market exclusivity in the US for 7 years and 10 years in Europe.

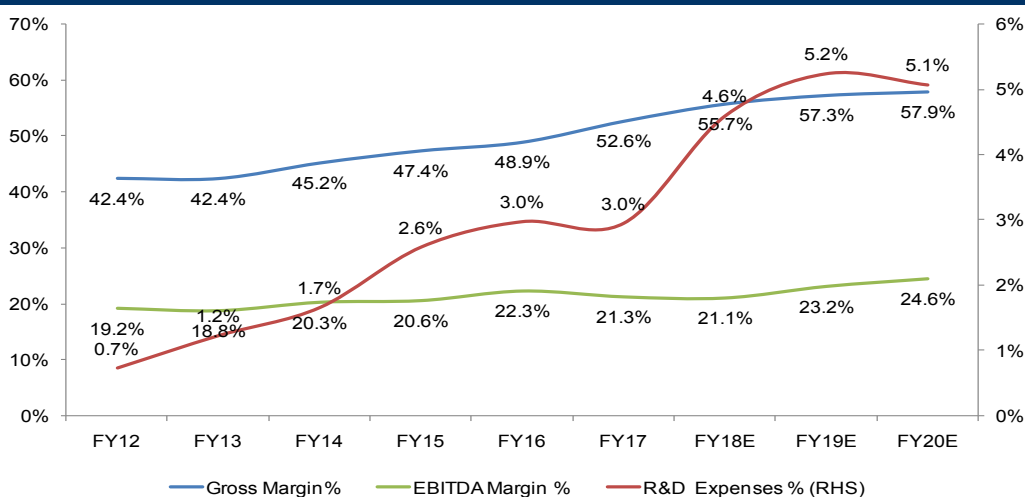
Sr. No.	Name	Relation	Holding	Investment	FY15		FY16		FY17	
					Revenue	PAT	Revenue	PAT	Revenue	PAT
				Rs in cr						
1	Raichem Medicare Pvt Ltd	JV	50%	14.02	-	0.83	8.12	-14.03	-	-7.66
2	INM Technologies Pvt Ltd	Subsidiary	75%	1.12	-	-	-	-0.51	-	-6.89
3	Shilpa Therapeutics Pvt Ltd	Subsidiary	100%	10.3	2.67	-0.56	2.45	-1.46	3.66	-1.64
4	Koanaa Healthcare GmbH	Subsidiary	100%	1.52	-	-	-	-	-	-6.35
5	Loba Finechemie GmbH	Subsidiary	100%	0	45.72	-1.12	38.19	3.17	43.8	2.97
6	Reva Pharmachem (P) Ltd	Associate	33%	0	-	-	-	-	-	-0.01
7	Reva Medicare Private Ltd	JV	50%	0.005	-	-	-	0.2	-	0.3
8	MAIA Pharmaceuticals, Inc.	JV	35%	9.28	-	-3.89	-	-0.97	-	2.23
9	Makindus Inc, USA	Subsidiary	56%	4.54	-	-4.34	-	-7.11	-	-1.79
10	Zatortia Holdings Ltd	Subsidiary	100%	20.28	-	-0.3	-	-0.03	-	-0.03
11	Koanaa Healthcare Pvt Ltd	Subsidiary	100%	-	-	-	-	-1.22	-	-0.03

Source: Company

Financial performance to improve further

SML have witnessed strong growth in revenue of 17.9% CAGR, whereas operating profit has shown growth of 15.3% CAGR over FY11 to FY17. Despite improved operating efficiency, we expect the EBITDA margin to expand at a lower rate than the gross margin due to higher R&D spending for future product development (R&D spend 3% in FY17 to reach 5.1% in FY20E of total revenue). PAT has grown at a rate lower to EBITDA due to increase in the effective tax rate from 22.8% in FY11 to 28.6% in FY17. Going ahead, the management expects tax rate to remain at 25% level. There has been deterioration in RoCE and RoE over the past 5 years. This is mainly because of the delay in entering the US market due to regulatory hurdles, leading to lower asset turnover. RoE dropped from 30% in FY11 to 14.9% in FY17. With regulatory issues resolved and product approvals kicking in, we expect commercial production to pick up from FY19, facilitating return ratio improvement. We expect RoE/RoCEs to improve from 14.9%/17.4% in FY17 to 15.3%/19.3% in FY20E. As a measure, it is making efforts to increase revenue by expanding existing and new product pipeline. This will cost ~Rs1.5 bn which will be funded by internal accruals. Owing to expansion, revenue expected to grow at 24.7% CAGR and EBITDA at 34.6% CAGR over FY18 to FY20E.

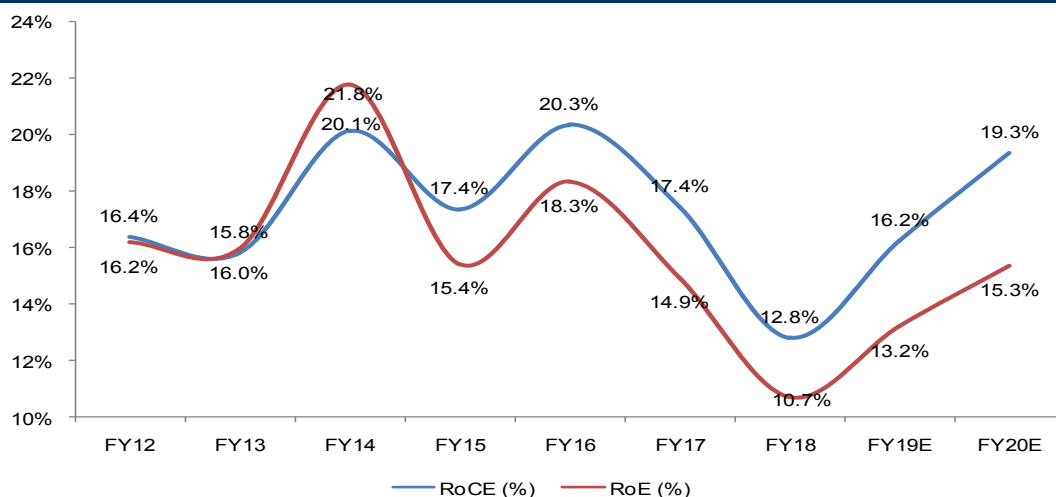
Margins to improve further as increase in formulation contribution



Despite acceleration in R&D spending, Margins to improve on the back of expected approvals in FY19-20E.

Source: Company, BP Equities Research

RoE and RoCE trend



Source: Company, BP Equities Research

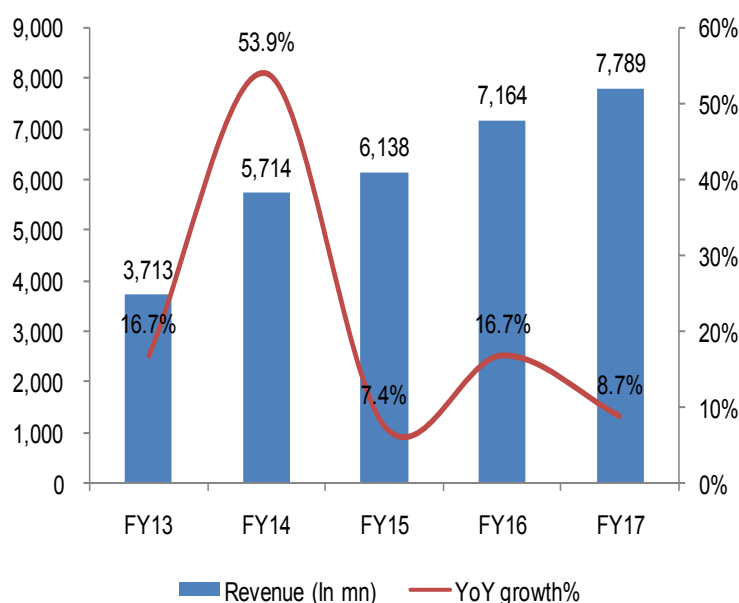
Shilpa Medicare Ltd.

Initiating Coverage

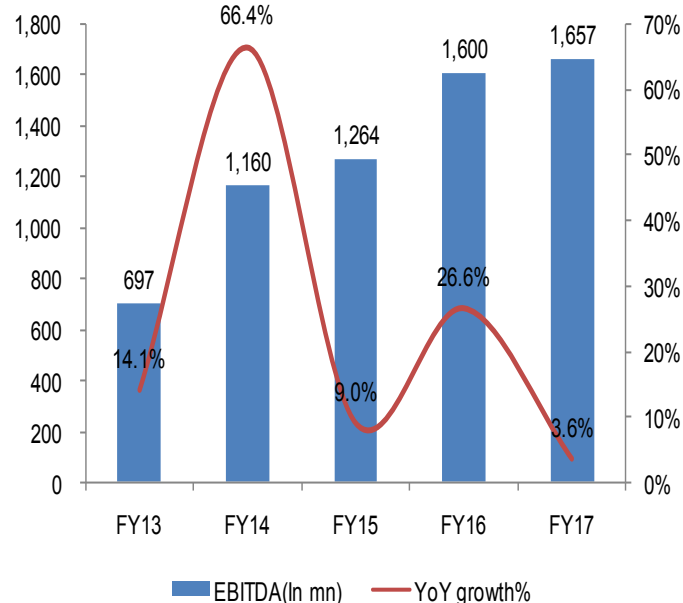
Company Background

Shilpa Medicare Ltd (SML) was established in 1987 as Shilpa Antibiotics Ltd. The company was converted into a public limited company in 1993. It operates in the pharmaceutical industry and deals in high-quality APIs, intermediates, formulations, new drug delivery systems, peptides / biotech products and specialty chemicals among others. The company specialises in oncology, AntiRetroVirals (ARV) and other therapeutic areas such as multiple sclerosis, immunosuppressant therapies. The company operates eight manufacturing facilities across Raichur, Telangana and Austria. It also operates R&D units in Raichur and Vizag. As on Mar 2017, it had seven subsidiaries, out of which three are located in India and rest four are located overseas.

Revenue trend

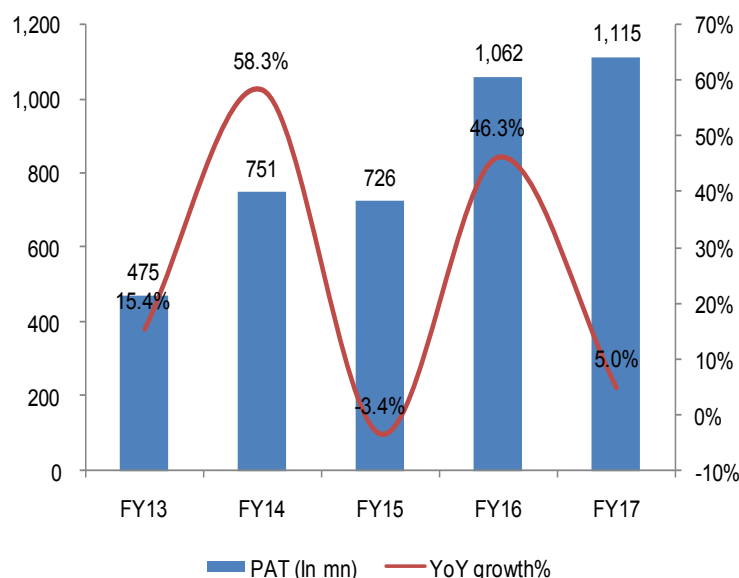


EBITDA trend

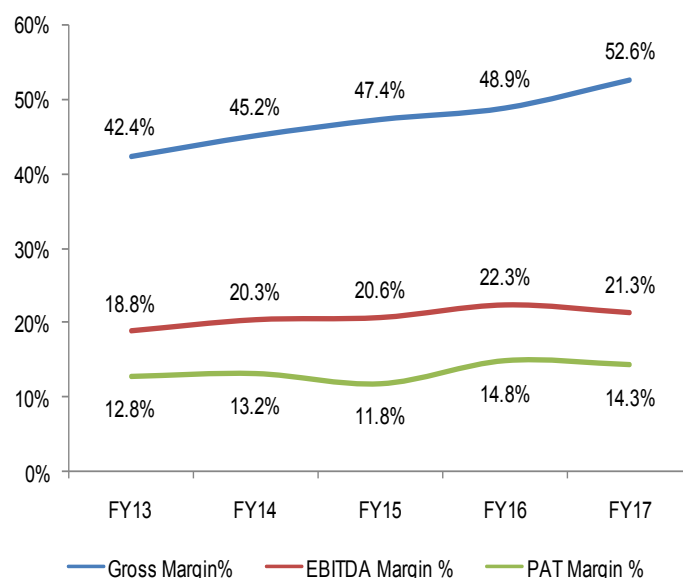


Source: Company, BP Equities Research

Net profit trend



Gross /EBITDA/ PAT Margin trend



Source: Company, BP Equities Research

Shilpa Medicare Ltd.

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Key Milestones

1987	Shilpa Medicare Ltd established as Shilpa Antibiotics Ltd
1989	Shilpa Medicare Ltd started its first commercial production of Trimethoprim
1992	Antibacterial products manufacturing started for companies such as Bombay Drug House Pvt Ltd and Glaxosmith klein Pharmaceuticals Ltd
1993	Shilpa Medicare was converted into a public limited company
1995	Shilpa Medicare was listed on BSE on June 19, 1995
2004	First patent application filed
2007	Shilpa Medicare acquired 100% stake in Loba Feinchemie GmbH, Austria
2009	Shilpa Medicare was listed on NSE on Dec 03, 2009 - Shilpa Medicare entered 50:50 JV with Industria Chimica SRL, Italy (ICE) and Proditti Chini Alimetari SpA, Italy (PCA) - 1st DMF filed for oncology API - Anastrozole
2010	Shilpa Medicare successfully setup a 100% EOU project incurring a capital expenditure of nearly Rs.1000 million
2011	Shilpa Medicare acquired a controlling stake in Hyderabad based "Shilpa Therapeutics" - State of the Art R&D Research Center established in Vizag and started its operations - "M/s Raichem Lifesciences Pvt Ltd, a 100% subsidiary of Shilpa Medicare Ltd., merged with Shilpa Medicare Ltd. - US operations started
2013	Shilpa Medicare formulations facility (Manufacturing of Oral and Injectable Onco Products) at pharma park Jadcheria (SEZ) near Mahboobnagar (Telangana) became fully operational

Source: Company, BP Equities Research

Shilpa Medicare Ltd - Management Details

Name	Designation	Details
Mr. Vishnukant C. Bhutada	Managing Director	He has vast and diverse Business experience of API and Intermediates and presently leads the core Business and functional teams which accelerate growth and performance by Innovating for Affordable solutions at Shilpa Medicare. He is the key decision maker for successful API and Generics formulation strategies. His untiring efforts have led the company to a leadership position in the Indian pharmaceutical domain and helped create a prominent presence for Oncology APIs globally.
Dr. Vimal Kumar Shrawat	Chief Operating Officer	By qualification, he holds degrees of M.Sc (Organic Chemistry), Ph.D. (from Delhi University) and joined Shilpa Medicare in 2009. He has vast experience of more than 25 years of working in large pharma industries like Ranbaxy/ Dabur Pharma- presently known as Fresenius Kabi Oncology Ltd., spanning across activities of R&D, Pilot and Plant Productions, QA/QC, Administration, CRAMS, Project management etc. Presently, Dr. Shrawat is spearheading the entire Operations/ Control of Shilpa Medicare. His vision of team work and time bound approach always guides and motivates teams at all operational sites. His keen interest and consistent efforts for R&D has led him to become one of key contributor in large number of Patent/applications of Shilpa Medicare.
Mr. Prashant Purohit	VP-Chemical R&D	By qualification, he holds degrees of, M.Sc.(Organic Chemistry) and Diploma in Business Management and joined Shilpa Medicare in 1996. He is presently heading Chemical R&D wings of Shilpa Medicare Group. He has vast experience of handling CRAMS and Generics APIs R&D. His vast experience of nearly 35 years in R & D and production in Pharmaceutical Industry has consistently enriched the portfolio of Shilpa Medicare Group of Companies. He is one of key contributor in large number of Patent/applications of Shilpa Medicare.
Mr. R K Somani	VP-Formulation Business Development	He is a professional Chartered Accountant and holds a Diploma in Central Excise.He has overall business experience of more than 21 years predominately in the field of pharmaceuticals. Mr. Somani is one of the key drivers of Formulation business besides handling various key Contract Businesses of advanced oncology/ Non-Oncology APIs. He is known for successfully building formulations portfolio and spearheading the Generic sales operation.

Source: Company, BP Equities Research

Shilpa Medicare Ltd.

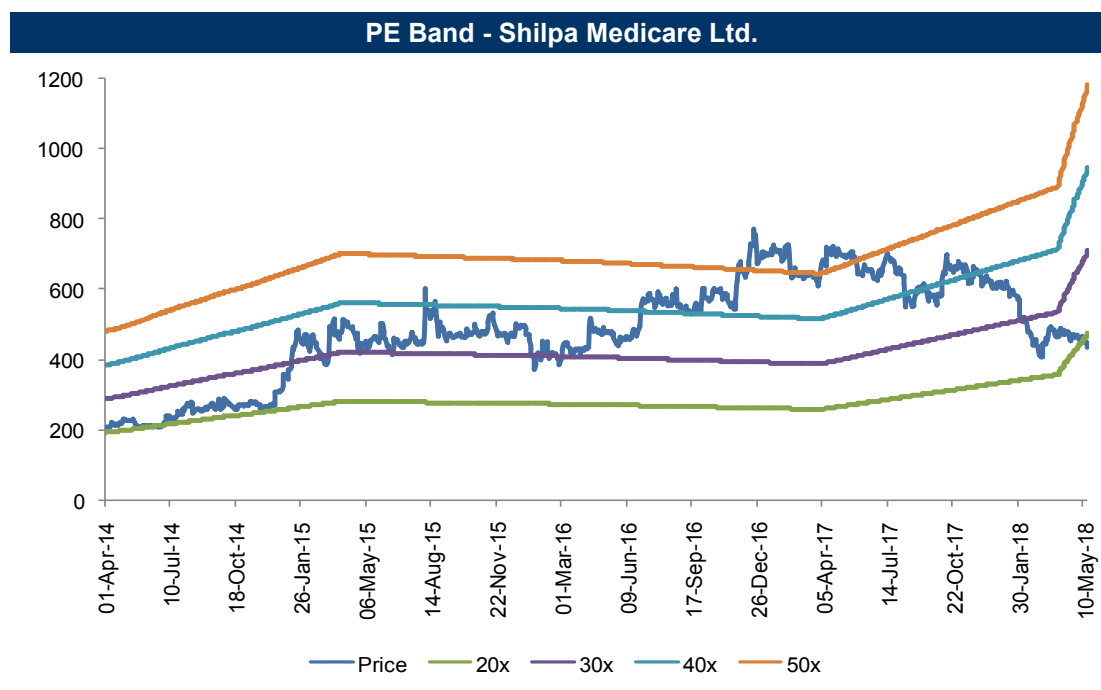
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⇒ Peer group comparison

Company	CMP	M Cap	P/E		EPS		EV/EBITDA		RoE (%)	
	(Rs.)	(Rs. Bn)	FY19E	FY20E	FY19E	FY20E	FY19E	FY20E	FY19E	FY20E
Shilpa Medicare	440	35	24.7	18.6	17.8	23.7	16.6	12.6	13.2	15.3
Natco Pharma *	799	147	17.8	19.2	45.0	41.6	13.0	14.2	27.8	21.7
Suven Life Sciences*	186	24	20.3	17.3	9.2	10.8	11.8	10.1	14.8	15.4
Divis Laboratories *	1158	307	26.8	22.8	43.3	50.8	18.2	15.6	18.5	19.1

Source: BP Equities Research, * Bloomberg estimate

⇒ PE Band



Source: BP Equities Research, Ace Equity

Key Risks and concerns:

- ⇒ A significant up/downside potential is hinged on the upcoming FDA approvals.
- ⇒ Delay in original patent expiration will have an impact on the revenue potential of the company.
- ⇒ Major part of revenue comes from exports and foreign currency fluctuations may impose risks to profitability.

Shilpa Medicare Ltd.

Initiating Coverage

Valuation and Outlook

Valuation	Basis	FY18E	FY19E	FY20E
Shilpa Medicare Ltd				
EPS	-	13	18	24
Growth in EPS (YoY %)	-	-7%	38%	33%
Implied PE	-	34	25	19
Assigned PE	(25x PE)	25	25	25
Target Price	-	-	-	592
(Implied PEG Ratio considering next 2 years: 0.7)				
CMP	-	-	-	440
Upside Potential (%)	-	-	-	34.5%

Source: Company, BP Equities Research

We have valued SML by assigning 25x to its FY20 earning estimates. We arrive at a target price of Rs 592 (potential upside of 34% from CMP) for an investment horizon of 15-18 months.

SML has its strength in manufacture and sale of Oncology APIs across Europe, partnering international companies for custom synthesis. The company has also geared up for the expansion improving the asset base in the last 5 years and expect to incur same amount of capex for FY18-20E. The current valuations are riding on the company's ability to execute the above plans based on the strengths accumulated. Moreover, SML is better positioned compared to peers as it has USFDA clearance in place. Operating in oncology space where products are relatively complex, face low competition which also separates SML from its peers operating in US market. We estimate Revenue/EBITDA/PAT to grow at 24.7%/34.6%/35.6% CAGR during FY18-20E. At the CMP(Rs 440), the stock is trading at 24.7x its FY19E EPS of Rs 17.8 and 18.6x its FY20E EPS of Rs 23.7. We initiate coverage on the stock & recommend 'BUY' rating by assigning 25x to its FY20E earning (in line with 5 year average PE) . We arrive at a target price of Rs 592 (potential upside of 34% from CMP) for an investment horizon of 15-18 months.

Profit & Loss A/c (Consolidated)						
YE March (Rs. mn)	FY15	FY16	FY17	FY18E	FY19E	FY20E
Revenue	6,138	7,164	7,789	7,617	9,540	11,836
<i>Growth %</i>	7.4%	16.7%	8.7%	-2.2%	25.2%	24.1%
Total Revenue	6,138	7,164	7,789	7,617	9,540	11,836
Less:						
Raw Material Consumed	3,232	3,662	3,688	3,372	4,076	4,981
Employee Cost	823	901	1,264	1,390	1,668	2,002
Other Expenses	819	1,002	1,180	1,250	1,585	1,947
Total Operating Expenditure	4,874	5,564	6,132	6,012	7,330	8,929
EBITDA	1,264	1,600	1,657	1,605	2,210	2,906
<i>Growth %</i>	9.0%	26.6%	3.6%	-3.2%	37.8%	31.5%
Less: Depreciation	214	231	300	369	449	518
EBIT	1,050	1,369	1,357	1,236	1,761	2,388
<i>Growth %</i>	13.2%	30.3%	-0.9%	-8.9%	42.5%	35.6%
Interest Paid	41	39	27	60	60	60
Non-operating Income	69	114	277	200	200	200
Extraordinary Income	(0)	(24)	(45)	0	0	0
Profit Before tax	1,078	1,419	1,562	1,376	1,901	2,529
Tax	352	356	447	344	475	632
Net Profit	726	1,062	1,115	1,032	1,426	1,896
Adjusted Profit	727	1,087	1,160	1,032	1,426	1,896
Reported Diluted EPS Rs	9.1	13.3	13.9	12.9	17.8	23.7
<i>Growth %</i>	-3.4%	46.3%	5.0%	-7.5%	38.2%	33.0%
Adjusted Diluted EPS Rs	9.1	13.6	14.5	12.9	17.8	23.7
<i>Growth %</i>	-6.9%	49.5%	6.8%	-11.1%	38.2%	33.0%

Source: Company, BP Equities Research

Common Sized Profit & Loss Account						
YE March (Rs. mn)	FY15	FY16	FY17	FY18E	FY19E	FY20E
Total Revenues	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Less:						
Raw Material Consumed	52.6%	51.1%	47.4%	44.3%	42.7%	42.1%
Employee Cost	13.4%	12.6%	16.2%	18.3%	17.5%	16.9%
Other Expenses	13.3%	14.0%	15.2%	16.4%	16.6%	16.4%
Total Operating Expenditure	79.4%	77.7%	78.7%	78.9%	76.8%	75.4%
EBITDA	20.6%	22.3%	21.3%	21.1%	23.2%	24.6%
Depreciation	3.5%	3.2%	3.9%	4.8%	4.7%	4.4%
Interest Paid	0.7%	0.5%	0.3%	0.8%	0.6%	0.5%
Non-operating Income	1.1%	1.6%	3.6%	2.6%	2.1%	1.7%
Extraordinary Items	0.0%	-0.3%	-0.6%	0.0%	0.0%	0.0%
Profit Before Tax	17.6%	19.8%	20.1%	18.1%	19.9%	21.4%
Current tax	5.7%	5.0%	5.7%	4.5%	5.0%	5.3%
Profit After Tax	11.8%	14.8%	14.3%	13.5%	14.9%	16.0%
Adjusted Profit	11.8%	15.2%	14.9%	13.5%	14.9%	16.0%

Source: Company, BP Equities Research

Shilpa Medicare Ltd.

Initiating Coverage

Cash Flows (Consolidated)						
YE March (Rs. Mn)	FY15	FY16	FY17	FY18E	FY19E	FY20E
PAT	726.2	1,062.4	1,115.0	1,031.8	1,426.0	1,896.4
(Less)/Add: Extraordinary Income/Expense	0.5	24.2	45.4	0.0	0.0	0.0
Less: Non Operating Income	(69.3)	(113.6)	(277.4)	(200.0)	(200.0)	(200.0)
Add: Depreciation	214.1	231.4	300.2	369.0	449.1	517.9
Add: Interest Paid	40.5	39.3	26.9	59.9	59.9	59.9
Tax Adjustment	0.0	0.0	0.0	0.0	0.0	0.0
Operating Profit before Working Capital Changes	912.0	1,243.7	1,210.1	1,260.6	1,735.1	2,274.2
(Inc)/Dec in Current Assets	(771.2)	(305.4)	(2,384.0)	283.6	(490.7)	(585.8)
Inc/(Dec) in Current Liabilities	(131.1)	285.8	63.6	277.9	417.9	498.9
Changes in Inventory	(75.3)	(34.4)	(555.7)	41.9	(468.6)	(559.4)
Net Cash Generated From Operations	(65.5)	1,189.6	(1,666.0)	1,864.0	1,193.7	1,627.8
Cash Flow from Investing Activities						
(Inc)/Dec in Fixed Assets	(279.5)	(1,058.7)	(729.1)	(1,500.0)	(1,750.0)	(1,500.0)
(Inc)/Dec in Capital Work In Progress	(1,106.0)	1,297.2	(6.6)	0.0	0.0	0.0
(Inc)/Dec in Investment (Strategic)	0.0	0.0	0.0	0.0	0.0	0.0
(Inc)/Dec in Investment (Others)	(5.6)	(131.2)	(208.9)	158.8	(56.9)	(62.6)
Add: Non Operating Income	69.3	113.6	277.4	200.0	200.0	200.0
(Inc)/Dec in Intangible Assets	(0.5)	(390.0)	52.2	0.0	0.0	0.0
Net Cash Flow from/(used in) Investing Activities	(1,322.3)	(169.0)	(615.0)	(1,141.2)	(1,606.9)	(1,362.6)
Cash Flow from Financing Activities						
Inc/(Dec) in Total Loans	849.5	(825.0)	1,663.4	0.0	0.0	0.0
Inc/(Dec) in Reserves & Surplus	823.0	(75.3)	1,719.7	0.0	(0.0)	0.0
Inc/(Dec) in Equity	47.3	(120.5)	(44.4)	24.1	0.0	0.0
Dividend Paid	(47.8)	(63.9)	(68.1)	(63.0)	(87.1)	(115.8)
Less: Interest Paid	(40.5)	(39.3)	(26.9)	(59.9)	(59.9)	(59.9)
Adjustments	(150.9)	53.7	(62.6)	(0.0)	(0.0)	(0.0)
Exceptional Item	(0.5)	(24.2)	(45.4)	0.0	0.0	0.0
Net Cash Flow from Financing Activities	1,480.0	(1,094.5)	3,135.7	(98.9)	(147.0)	(175.7)
Net Inc/Dec in cash equivalents	92.2	(73.9)	854.8	623.9	(560.2)	89.6
Opening Balance	91.9	184.2	110.3	965.0	1,589.0	1,028.8
Closing Balance Cash and Cash Equivalents	184.2	110.3	965.0	1,589.0	1,028.8	1,118.3

Source: Company, BP Equities Research



Balance Sheet (Consolidated)

YE March(Rs. mn)	FY15	FY16	FY17	FY18E	FY19E	FY20E
Liabilities						
Equity Capital	77	77	80	80	80	80
Reserves & Surplus	5,392	6,316	9,082	10,051	11,390	13,171
Equity	5,469	6,393	9,162	10,131	11,470	13,251
Net Worth	5,469	6,393	9,162	10,131	11,470	13,251
Minority Interest	144	23	(24)	0	0	0
Net Deferred tax liability/(Asset)	518	672	846	846	846	846
Total Loans	1,886	907	2,397	2,397	2,397	2,397
Capital Employed	8,018	7,995	12,381	13,374	14,713	16,493
Assets						
Gross Block	4,763	5,822	6,551	8,051	9,801	11,301
Less: Depreciation	1,603	1,888	2,126	2,494	2,944	3,462
Net Block	3,161	3,934	4,426	5,557	6,858	7,840
Capital WIP	2,216	919	926	926	926	926
Investments	387	519	728	569	626	688
Others - A	2	341	290	290	290	290
Current Assets						
Inventories	1,308	1,342	1,898	1,856	2,325	2,884
Sundry Debtors	814	1,254	1,709	1,671	2,093	2,597
Cash and Bank Balance	184	110	965	1,589	1,029	1,118
Loans and Advances	49	89	333	91	114	142
Other Current Assets	268	150	185	181	226	281
Current Investments	654	596	2246	2246	2246	2246
Total Current Assets	3,276	3,542	7,337	7,635	8,034	9,269
Less: Current Liabilities & Provisions						
Sundry Creditors	755	1,065	1,112	1,381	1,730	2,146
Provisions	58	50	56	70	87	108
Other Current Liabilities	215	199	209	204	256	317
Total Current Liabilities & Provisions	1,028	1,314	1,377	1,655	2,073	2,572

Source: Company, BP Equities Research



Shilpa Medicare Ltd.

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Key Ratios (Consolidated)						
YE March (Rs. mn)	FY15	FY16	FY17	FY18E	FY19E	FY20E
Key Operating Ratios						
EBITDA Margin (%)	20.6%	22.3%	21.3%	21.1%	23.2%	24.6%
Tax / PBT (%)	32.7%	25.1%	28.6%	25.0%	25.0%	25.0%
Net Profit Margin (%)	11.8%	14.8%	14.3%	13.5%	14.9%	16.0%
RoE (%)	15.4%	18.3%	14.9%	10.7%	13.2%	15.3%
RoCE (%)	17.4%	20.3%	17.4%	12.8%	16.2%	19.3%
Current Ratio (x)	3.2x	2.7x	5.3x	4.6x	3.9x	3.6x
Dividend Payout (%)	6.6%	6.0%	6.0%	6.0%	6.0%	6.0%
Book Value Per Share (Rs.)	68.3	79.8	114.3	126.4	143.1	165.4
Financial Leverage Ratios						
Debt/ Equity (x)	0.3x	0.1x	0.3x	0.2x	0.2x	0.2x
Interest Coverage (x)	31.2x	40.7x	61.5x	26.8x	36.9x	48.5x
Growth Indicators %						
Growth in Gross Block (%)	6.2%	22.2%	12.5%	22.9%	21.7%	15.3%
Sales Growth (%)	7.4%	16.7%	8.7%	(2.2%)	25.2%	24.1%
EBITDA Growth (%)	9.0%	26.6%	3.6%	(3.2%)	37.8%	31.5%
Net Profit Growth (%)	(3.4%)	46.3%	5.0%	(7.5%)	38.2%	33.0%
Diluted EPS Growth (%)	(3.4%)	46.3%	5.0%	(7.5%)	38.2%	33.0%
Turnover Ratios						
Debtors Days	48	64	80	80	80	80
Creditors Days	45	54	66	66	66	66
Inventory Days	78	68	89	89	89	89

Source: Company, BP Equities Research



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Disclaimer Appendix

Analyst (s) holding in the Stock : Nil**Analyst (s) Certification:**

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