Bilcare Ltd.

BLOOMBERG: BILC IN EQUITY | **BSE:** 526853 | **NSE:**

Vikas Sonawale (91-22) 6766 3447
vikas.sonawale@religare.com

Vineet Agrawal (91-22) 6766 3448
vineet.agrawal@religare.com

Attractive entry point; Initiate with BUY

We initiate coverage on BILC with a BUY and a Mar '12 target price of Rs 600 (52% upside). BILC, one of India's leading companies in the pharma packaging space, has seen a ~37% correction in its stock over the past 6 months due to below-expected performance of Ineos, a recently acquired entity in Europe (54%/11% of sales/EBITDA in second half of FY11). Going ahead, Ineos would likely see better performance led by passing on of input cost hikes to its customers and several cost-cutting initiatives. BILC's base business is on a strong growth path. Based on our earnings estimates (significantly below the management expectations), the stock is trading at attractive valuations (PER of 5.9x/4.6x FY12E/13E) and offers a good entry point. Any meaningful revenues from *nonClonable* technology will offer further upside.

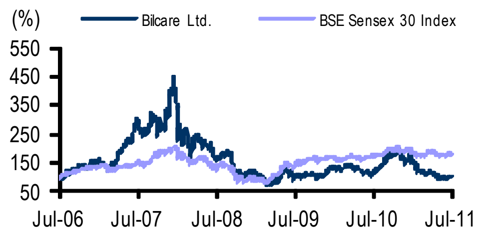
- **Ineos – the worst is over:** Ineos, acquired in Sept '10, reported below-expected EBITDA margins of 2.7% (vs. ~5-6% at acquisition). We see margin improvement ahead as Ineos passes on the input cost hike to customers. Cost-cutting initiatives (such as relocation of RM procurement to low-cost destinations) would also support margins. We factor in EBITDA margins of 4.4%/4.5% for FY12E/13E, significantly below management estimates of 8%/12%, as we await a few quarters of execution.
- **Base business growth to continue with stable margin outlook:** We expect the base business (domestic and subsidiaries; ex-Ineos), which has grown at a 39% CAGR over the last 5 years, to continue reporting strong growth of 18% over FY11–FY13E led by (a) strong domestic demand and (b) good traction in international subsidiaries.
- **Valuations at a significant discount to historical levels, entry point attractive:** BILC is trading at ~5.9x/4.6x FY12E/13E earnings, a significant discount to its historical average of ~11x. We value the stock at 7x FY13E earnings, a 35% discount to its average multiple, to factor in the lower than historical return ratios. Our DCF based target price is Rs 633 which means an implied target PE multiple of 7.4x based on Mar '13E earnings.
- **Key concern**: Any decline in Ineos' revenues would impact margins significantly.

CMP	**Rs 394**
Target	**Rs 600**
Rating	**BUY**
% Upside / (Downside)	**52%**
+ Dividend yield	1%
Total return	**53%**

Company data

Market cap (Rs mn / US$ mn)	9,274 / 208
Outstanding equity shares (mn)	23.6
BVPS (Rs)	516
Free float (%)	65.9
52-week high / low (Rs)	773 / 360
2-month avg. daily vol (mn)/ value (US$ mn)	0 / 0
ADR/GDR premium (%)	NA

Stock performance



Financial highlights

Year End: 31 Mar	FY09A	FY10A	FY11A	FY12E	FY13E
Revenue (Rs mn)	8,560	10,478	23,285	31,181	33,982
EBITDA (Rs mn)	1,865	2,419	3,394	4,382	5,091
Adj. PAT (Rs mn)	829	1,172	1,267	1,563	2,024
Adj. EPS (Rs)	42.1	49.2	53.8	66.4	85.9
Growth (%)	(0.9)	16.8	9.3	23.4	29.5
DPS (Rs)	2.5	2.5	2.5	2.5	2.5
ROIC (%)	10.7	11.1	10.7	10.5	11.9
ROE (%)	18.7	17.1	13.1	13.7	15.4
P/E (x)	12.6	13.4	7.3	5.9	4.6
EV/EBITDA (x)	8.7	8.0	5.9	4.6	3.8
P/BV (x)	1.8	1.7	0.9	0.8	0.7

Investment rationale

BILC is primarily engaged in manufacturing specialty pharmaceutical packaging barrier films and providing clinical supplies. The company enjoys a dominant position in the domestic blister packaging market (with over 60% share). In its quest to build an international presence, BILC has been expanding inorganically with acquisition of companies across the globe. More recently in Sept '10, BILC acquired Ineos through its Swiss subsidiary Bilcare AG. This has been the company's largest-ever acquisition, with Ineos' revenues (~€ 240mn / Rs 15bn) greater than BILC's FY10 sales of ~Rs 10.5bn. The acquisition of Ineos has not only added significant muscle to BILC's core focus area (pharma packaging) but also expanded its presence in new non-pharma verticals. However, Ineos' low-margin profile (with further disappointments) impacted BILC's overall margins. We see a strong case for margin recovery going ahead. Given that the base business remains on a strong growth path, the current valuations, we believe, offer an attractive entry point.

Ineos – the worst is over

Ineos gives BILC a global footprint, but drags financial performance

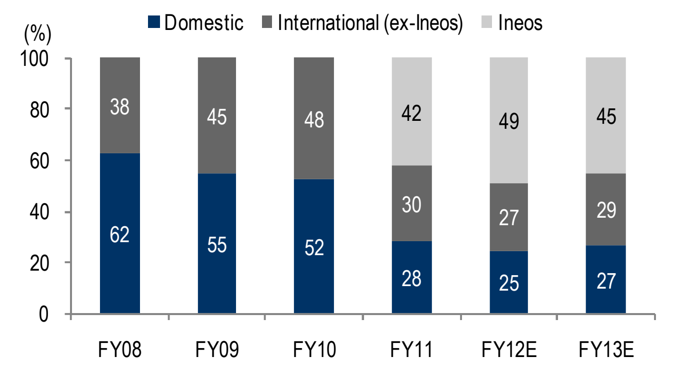
Acquisition of Ineos, which was reeling under input cost pressures and high interest charges, impacted BILC's financial performance

In Sept '10, BILC acquired the Europe-based INEOS Films GmbH (Ineos) from INEOS Group for ~€ 100mn. The acquisition, while significantly adding to BILC's international business, has dented its overall financial performance.

Ineos reported weak numbers over the past two quarters on higher input costs (due to the crude price spike) and certain one-time expenses in Q4FY11. However, we expect margins to recover from the current low levels of ~2% as part of this increase is passed on to customers. We believe this pass-through would not be a significant challenge for Ineos since the crude price hike has impacted several global packaging players and most of them have indicated product price increases. Moreover, we do not expect any negative surprises at the topline as demand for pharma packaging (a segment forming ~40% of Ineos' total sales) is expected to remain stable, driven by the growing pharmaceuticals market. Packaging demand for other segments (food, non-food and other specialty packaging) would also be firm given that the economic cycle is close to bottoming out.

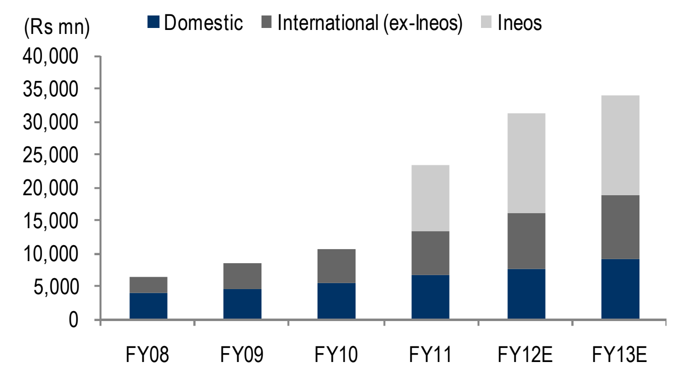
However, we prefer to adopt a conservative stance as we await a few quarters of execution. We therefore model for a flat topline and a modest margin expansion (to 4.4%/4.5%) for FY12/FY13—significantly below the management estimates for these years.

Fig 1 - Ineos to contribute ~50% of total sales in FY12E



Source: Company, RCML Research

Fig 2 - Segment-wise revenue breakup



Source: Company, RCML Research

Inorganic growth has been BILC's mainstay, with the company making five acquisitions over the last few years

Inorganic growth – BILC's strategy to expand globally

BILC, founded in 1995, is primarily engaged in manufacturing specialty pharmaceutical packaging barrier films and providing clinical supplies. The company enjoys a dominant position in the domestic blister packaging market (with over 60% share) and its clientele includes marquee players like Ranbaxy and Dr Reddy's Laboratories as well as innovators like GSK, Wyeth, Novartis and Aventis among others.

In its quest to build an international presence, BILC has been expanding inorganically with acquisition of companies across the globe. It acquired ProClinal Inc. (US) in July '05 and DHP (UK) in Sept '06. These acquisitions helped BILC to establish itself in the global pharmaceutical packaging and clinical supplies markets. In July '08, it formed a 50:50 JV with MeadWestVaco Corporation to acquire International Labs (US), which helped BILC to win an important and exclusive contract with Wal-Mart. More recently in Sept '10, BILC acquired Ineos through its Swiss subsidiary Bilcare AG. This has been the company's largest-ever acquisition, with Ineos' revenues (~€ 240mn / Rs 15bn) greater than BILC's FY10 sales of ~Rs 10.5bn.

Strong domestic growth combined with inorganic expansions has enabled BILC to grow multifold over the past few years, with its revenues crossing Rs 23bn in FY11 (from Rs 4bn in FY07). While inorganic expansion has been the company's mainstay over the past few years, we note that even organic growth has been strong at 20%+ CAGR in the last five years.

Fig 3 - Inorganic expansion has added muscle to international business

Company	Period	Amount	Region	Rationale	Comments
Ineos Films GmbH	Sept-10	Euro 100mn	Europe, US	Helped BILC to (a) expand its product portfolio beyond pharma packaging; (b) get access to 8 manufacturing facilities and ~1900 additional customers – a potential target for cross-selling	Expansion of the pharma packaging portfolio with access to global pharmacos and entry into non-pharma businesses
International Labs (50:50 JV with MeadWestVaco Corporation, US)	Jul-08	na	US	Key focus areas: Generic and private label drugs packaging for pharmaceutical and nutraceutical companies. With this acquisition, BILC got into an exclusive packaging contract with Wal-Mart	
Singular ID	Jan-08	SGD 20mn	Singapore	Got access to *nonClonable* technology to help in anti-counterfeiting	
DHP Limited	Sep-06	US$ 5mn	UK	Key focus areas: Clinical trial supplies, clinical manufacturing, packaging & labeling. DHP had a strong clientele including MNC pharma companies, CROs, publicly funded clinical research teams, NHS trusts as well as individual professionals in the private, public and academic sectors	DHP had revenues of US$ 3mn for YE Mar '06; company has changed its name to Bilcare Global Clinical Supplies (Europe)
ProClinical, Inc	Jul-05	na	US	Key focus areas: clinical trial supplies, formulation development, analytical & research services, clinical manufacturing, packaging & labeling ProClinical had one USFDA approved manufacturing facility and license for controlled release substances BILC got access to clients like Johnson & Johnson, AstraZeneca, Bayer, Takeda and Merck, and biotech companies like Genzyme and Progenics among several others	Company has changed its name to Bilcare Inc

Source: Company, RCML Research

Ineos acquisition broadens product, geographic and customer portfolio...

The acquisition of Ineos has not only added significant muscle to BILC's core focus area (pharma packaging) but also expanded its presence in new non-pharma verticals. These include food packaging, specialty packaging for shrink films, visual packaging and packaging films for banking, mobile, club membership & casino cards. Ineos has 8 manufacturing facilities— 3 in Germany, 2 in Italy, 2 in India and 1 in the US.

Ineos' acquisition significantly expands BILC's product basket while giving it access to additional 1900 clients to cross-sell products

Fig 4 - The Ineos deal: a snapshot

Total consideration (€ mn)	100
Sales at time of acquisition (€ mn)	240
Operating margin at the time of acquisition	5-6%

Source: Company

Fig 5 - Ineos: Business breakup

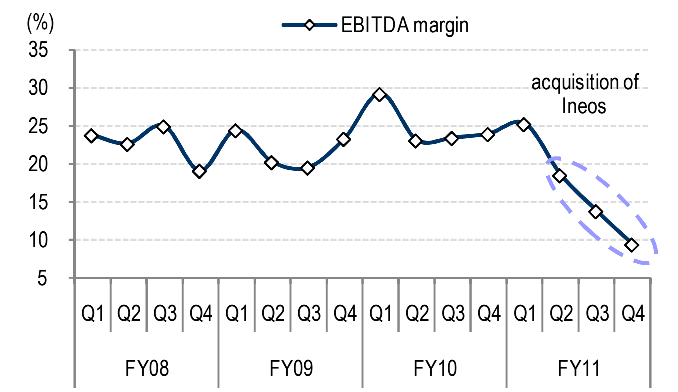
Segment	Contribution to Ineos sales, %	Comments
Pharma Packaging	40	Provides a wide range of pharmaceutical films & foils
Packaging Films	15	Supplies rigid mono and multilayer films for food & FMCG industry
Cards	20	Provides overlay films for various kinds of cards for banking, mobile, club membership cards and casino cards
Specialty Films	25	Provides specialty packaging films for sectors such as printing/ decoration, shrink films, visual packaging, technical applications, office materials and furniture

Source: Company

...but drags down financial performance; we believe the worst is over though

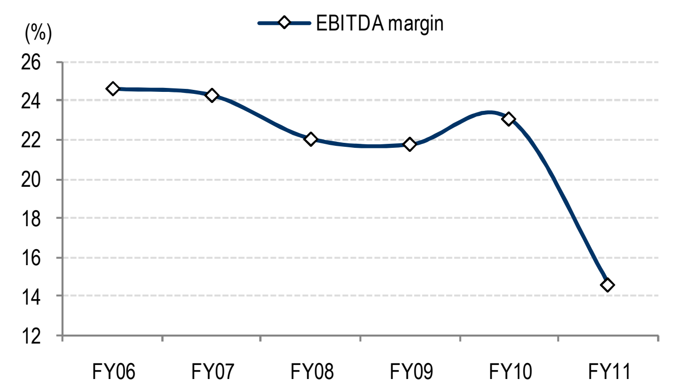
Ineos has severely dented BILC's financial profile over the last two quarters. Nevertheless, we see several triggers ahead for BILC, helping it post a robust financial performance over the next two years.

Fig 6 - BILC's margin nosedives post Ineos' acquisition



Source: Company, RCML Research

Fig 7 - BILC's annual EBITDA margin trend



Source: Company, RCML Research

BILC's stock has corrected sharply due to below-expected performance of Ineos

Fig 8 - BILC: stock performance

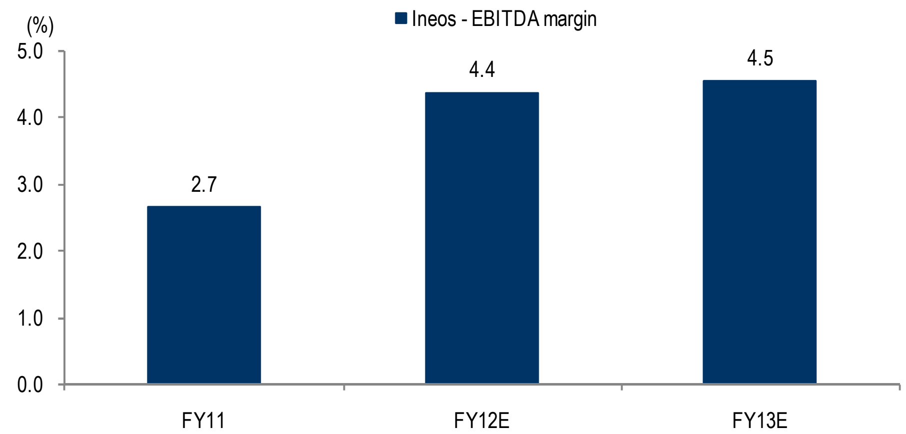
Source: Company, RCML Research

Ineos, which is currently generating revenues of ~€ 240mn on an annual basis, has seen a sharp erosion in its operating margins (from ~5-6% at the time of acquisition to less than 2% in Q4FY11) over the past couple of quarters. This decline has primarily been on account of higher input costs (due to spike in prices of crude). Certain one-time expenditure related to financial audit also impacted last quarter margins.

While Ineos' margins should recover, we conservatively model for a moderate expansion as we await a few quarters of execution

However, we believe that the worst is over and Ineos would see a margin uptick from current levels driven by (a) passing on of input costs hike to its customers and (b) various cost cutting initiatives that will unfold over the next few quarters. We expect Ineos' margins to recover from ~2.7% in FY11 to 4.4%/4.5% in FY12E/FY13E. Our numbers are conservative and significantly below the management's guidance of ~7–8% for FY12E and ~10–12% for FY13E, as we await a few quarters of execution.

Fig 9 - Ineos: margin trend



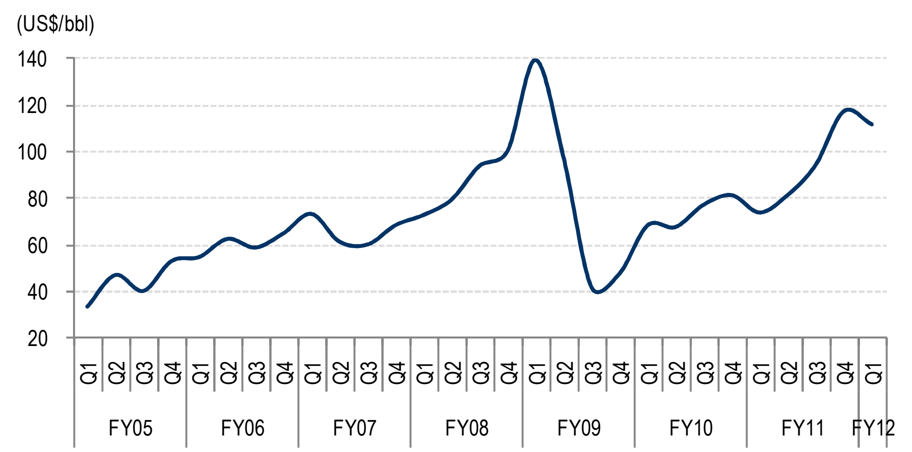
Source: Company, RCML Research

Passing of input cost hike to customers

Over the past few years, Ineos' operating margins have plummeted due to higher input costs of PVC resins which are linked to crude prices. Going forward, the management has indicated that it would pass on this hike to customers. However, since a large part of this business is institutional in nature, the pass-through takes some time, leading to a delayed/lag effect in attaining higher price realisations.

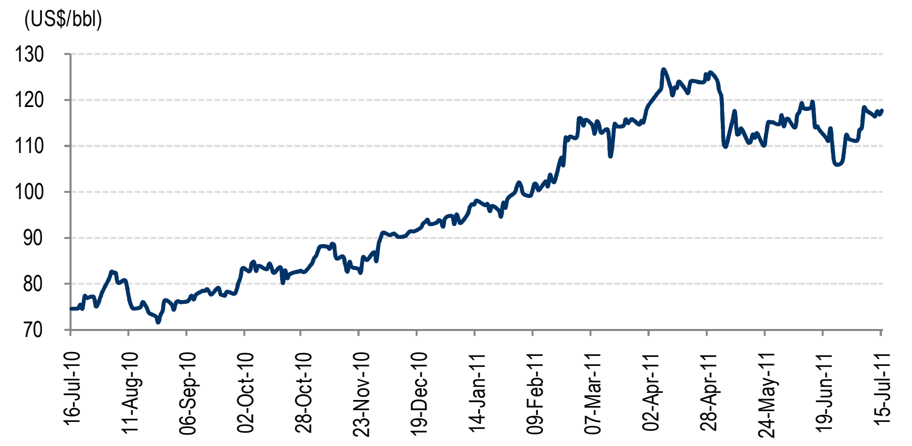
While crude has risen sharply over the past one year, it has softened from March levels. Crude is expected to average US$ 111/bbl by Mar '12 and to remain at these levels over FY13

Fig 10 - Crude price trend



Source: Bloomberg, RCML Research

Fig 11 - Crude price trend the over past one year



Source: Bloomberg, RCML Research

RM cost impact a global phenomena; major players indicate/effect price hikes

In India, packaging costs have risen by over 11% on an average for most companies in the FMCG segment, indicating the price hikes taken by suppliers of packaging products. We note that packaging companies globally too have been impacted by crude price increases and a pass-on is now inevitable with majority of them clearly echoing this sentiment:

Most global packaging majors have indicated price increases

Global packaging majors including **Amcor, Bemis, Rexam** and the **RPC Group**, which are much bigger than Ineos in size, have such pass-on clauses built-in to ensure margin protection in case of adverse RM price movements.

Linpac Packaging, a leading European and global food packaging company, recently indicated that packaging costs for its customers could increase in view of the rising input costs—thereby signaling a price hike for its products.

Crown Holdings, another global packaging company, in its annual report for CY10, indicated that it has taken price increases in various products due to rise in raw material prices.

Cost cutting initiatives to be main thrust going forward

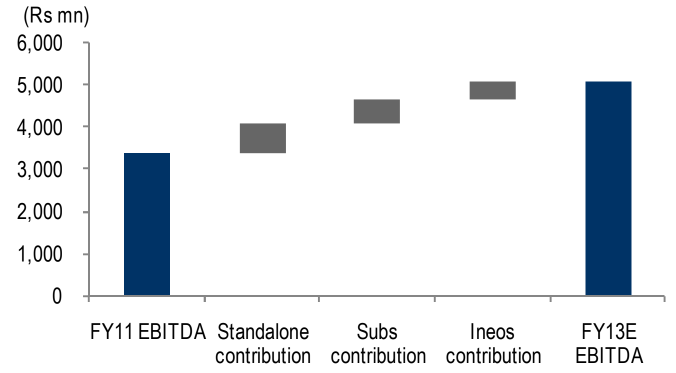
The management has clearly indicated that integration of Ineos would be its key focus and that it would strive to improve the acquired company's profitability by: (a) shifting the procurement base from EU to regions in the Far East like South Korea; (b) optimising the recipe cost of polymer making; (c) improving the yield; and (d) tilting the product mix.

Besides the crude hike pass-through, there are other levers for margin improvement

We believe the above initiatives will lead to significant savings over the next 3–4 years, improving Ineos' margins considerably. While we commend the management for these initiatives, we await a few quarters of execution. Therefore, even as the management expects EBITDA margins to touch ~7–8% in FY12E and ~10–12% in FY13E, we adopt a more conservative approach and model for margins at 4.4% and 4.5% for these years respectively (up from 2.7% in FY11). BILC has set a target to take Ineos' operating margins to ~14–15% over the next 4–5 years.

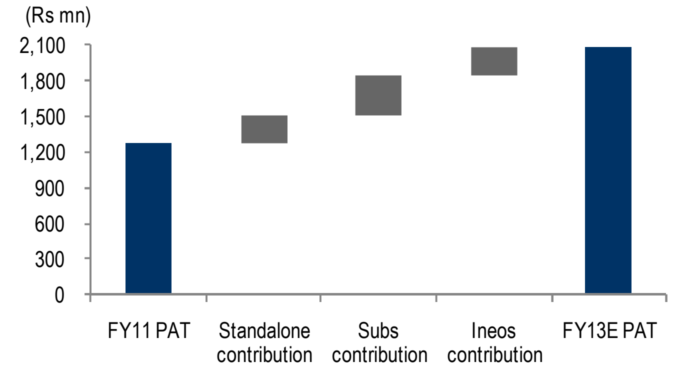
We expect Ineos to contribute 25%/28% of BILC's incremental EBITDA/PAT over FY11–FY13E.

Fig 12 - Ineos to contribute 25% of incremental EBITDA over FY11–FY13E



Source: Company, RCML Research

Fig 13 - Ineos to contribute 28% of incremental PAT over FY11–FY13E



Source: Company, RCML Research

A sensitivity analysis indicates that BILC's consolidated earnings are highly sensitive to Ineos' EBITDA margins. A one percentage point reduction in Ineos' FY12E/FY13E EBITDA margins could impact BILC's overall earnings by ~10%/8%.

BILC's consolidated earnings highly sensitive to Ineos' operating margins

Fig 14 - Sensitivity analysis of Ineos' margins to BILC's FY12E/FY13E earnings

	-2%	-1%	Base case	+1%	+2%
FY12E					
EBITDA Margin of Ineos	2.4%	3.4%	4.4%	5.4%	6.4%
Consolidated EPS	53.5	59.9	66.4	72.8	79.3
change from base case, %	(19.4)	(9.7)	-	9.7	19.4
FY13E					
EBITDA Margin of Ineos	2.5%	3.5%	4.5%	5.5%	6.5%
Consolidated EPS	73.0	79.5	85.9	92.4	98.8
change from base case, %	(15.0)	(7.5)	-	7.5	15.0

Source: RCML Research

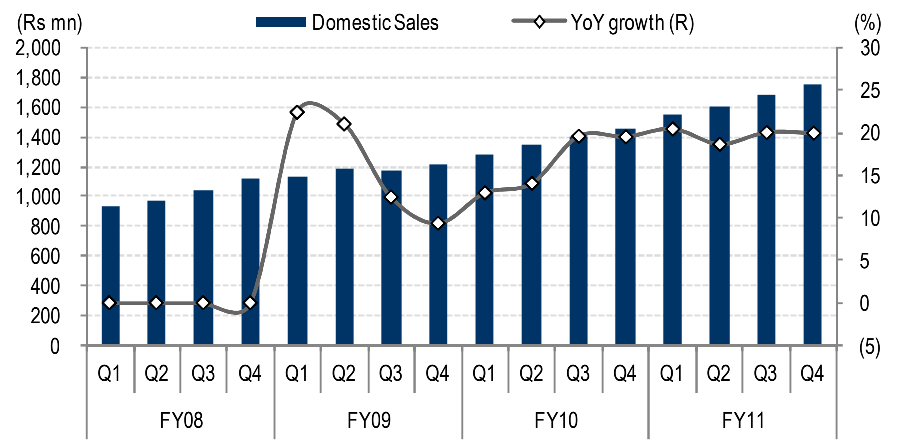
Base business to remain on growth track

Stellar performance in domestic business to continue

BILC's domestic business remains on a strong footing, with the company enjoying a dominant position in the blister barrier market (~60%+ share). Over the past five years (FY06–FY11), revenues from the domestic business have grown at a healthy 22% CAGR to touch Rs 6.6bn in FY11. We believe that the demand dynamics for pharma packaging remains strong in India, on expectations of a robust market for pharmaceutical sales. The domestic pharma market is expected to touch US$ 25bn–30bn by 2015, implying a strong 14–17% CAGR over 2011-2015. This in turn augurs well for the pharma packaging industry.

Domestic revenues have grown at a 22% CAGR to touch Rs 6.6bn in FY11

Fig 15 - Domestic revenue trend (quarterly)

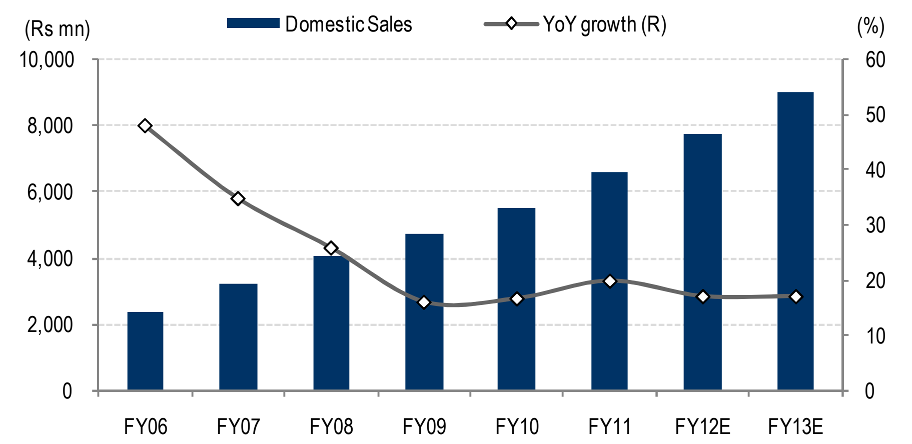


Source: Company, RCML Research

Also, we note that packaging demand for pharmaceutical products is increasing with enhanced focus on prevention of product tampering and counterfeiting, assurance of product dispensing accuracy and other product differentiating factors (e.g. highlighting dosage schedules on the pack). In this backdrop, we believe BILC would continue posting healthy growth in its domestic business, with 17% revenue CAGR over FY11E–FY13E.

Domestic revenues are expected to grow at 17% CAGR over FY11-FY13E as demand for pharma packaging remains high

Fig 16 - Domestic revenue trend – annual



Source: Company, RCML Research

Differentiated product offerings – a long-term lever

To create a niche for itself in the pharma packaging business, BILC has developed differentiated product offerings and offers customised solutions to its clients. This strategy has enabled it to capture higher growth and generate better margins. Some of these customised solutions are outlined below:

Optima – a unique sensitivity profiling method

BILC has developed a patented packaging development method, *Optima*, which is a sensitivity profiling method that helps in understanding the packaging needs of a particular formulation through scientifically designed protocols. This method identifies the optimum packaging requirement for drugs depending on various parameters, including environmental and dimensional sensitivity of the drug, shelf life requirement, size and shape of the drug and any other specific requirement of customers.

Differentiated product offerings ensure higher growth and better margins

Brandpak Building Solutions – a-customer centric solution

BILC has also developed *Brandpak,* another patented packaging solution, which helps the company offer customised packaging services to its clients and in providing innovative solutions for companies transitioning from the prescription segment to the OTC medium.

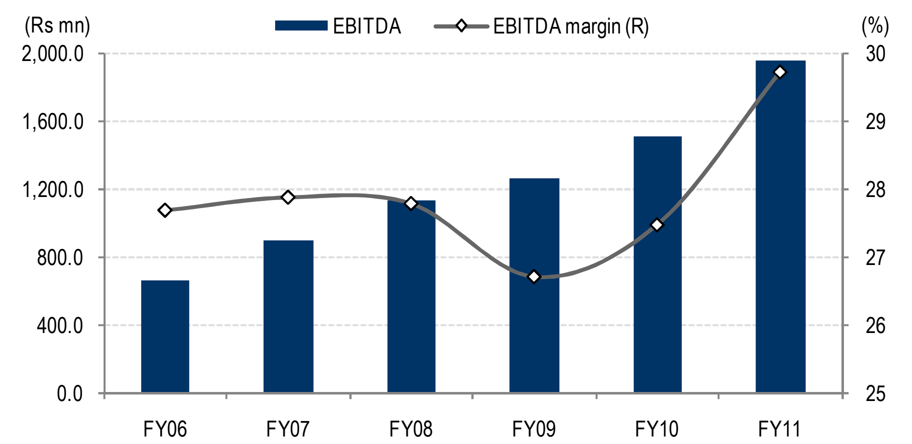
Patented products: anti-counterfeiting and cost-effective solutions

BILC has developed several patented packaging materials like *Patina*, *Metnova* and others, which ensure protection against counterfeiting of drugs. Also, its patented products like *Metnova* offer a cost-effective alternative to the standard aluminium foil, thereby reducing the cost of packaging for clients significantly. Currently, patented products contribute ~8–10% of total domestic sales and we expect this share to increase with higher acceptance of such products.

In the domestic business, BILC enjoys a high EBITDA margin of ~28–30% primarily due to its differentiated product offerings.

High margins in the domestic business are backed by a "solutions" based approach

Fig 17 - EBITDA margin trend in domestic business



Source: Company, RCML Research

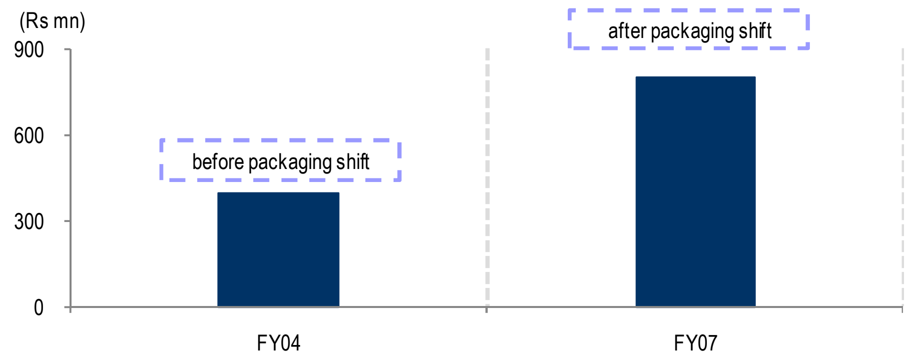
We highlight below three case studies where BILC, with its differentiated and customer centric approach, has helped its customers gain significantly in their respective product offerings.

Case I: Innovative packaging solution to prevent counterfeiting of the brand – _ShelCal_

ShelCal, a branded formulation of Elder Pharmaceuticals (Elder) used for treating calcium and vitamin D deficiency, started losing ground to counterfeited drugs and consequently saw stagnation in its sales. BILC, entrusted with the task of eliminating the counterfeiting problem for the brand, did extensive sensitivity profiling of the drug and changed the packaging materials. The new packaging design also helped enhance the branding of *ShelCal* and eventually led to doubling of its revenues over FY04–FY07.

New packaging design for *ShelCal* helped doubling of revenues from the brand over FY04 to FY07

Fig 18 - Revenues from *ShelCal*



Source: Company, RCML Research

Case II: Innovative packaging solution to ensure compliance for *Helicobacter pylori*

Helicobacter pylori (*H. pylori*) is a microaerophilic bacterium that can inhabit various areas of the stomach and can cause duodenal and gastric ulcers and stomach cancer. The challenge in its dosage was that three different drugs had separate dosage schedules. BILC developed a unique packaging solution which ensured effective compliance with the product's complicated dosage schedules.

BILC's innovative packaging solution for *H.pylori* ensures compliance with the product's complicated dosage schedule

Fig 19 - Packaging solution for *H. pylori*

Source: Company, RCML Research

Case III: Innovative packaging solution to ensure effective communication

Pfizer India's (Pfizer) Bovical product—a calcium and vitamin supplement—faced the challenge of creating a niche for itself in a highly competitive market. BILC developed an innovative packaging design that resembled a milk container. This became a key differentiating feature, boosting the brand's market acceptance.

Bovical is one of the examples of BILC's innovative solutions approach

Fig 20 - BILC's innovative packaging solution for *Bovical*

Source: Company, RCML Research

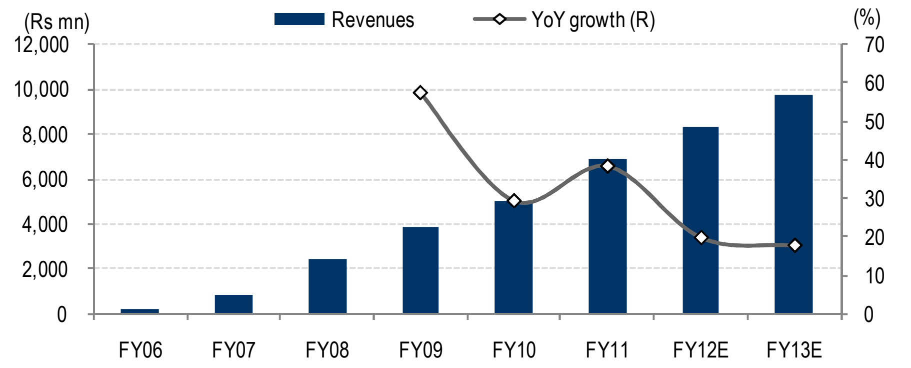
International business (ex-Ineos) gaining momentum

BILC's international business (ex-Ineos) has gained significant strength over the past few years, helped by its inorganic expansion. BILC has almost doubled its international revenues (ex-Ineos) over FY06–FY11 to Rs 7bn.

The company's revenue growth was particularly impressive at 34% CAGR over FY09–FY11, partly helped by packaging supplies to Wal-Mart in the US. BILC gained access to a long-term contract with Wal-Mart with the acquisition of International Labs in July '08. Currently, supplies to Wal-Mart amount to ~US$ 40mn, of which BILC's share is ~US$ 20mn (50% share since it's a 50:50 JV with MeadWestVaco). According to BILC, the contract is renewable after three years and the company has guided for a similar run-rate for the next year.

Inorganic expansions aided the near doubling of international revenues (ex-Ineos) to Rs 7bn in FY11

Fig 21 - International business (ex-Ineos) revenue trend



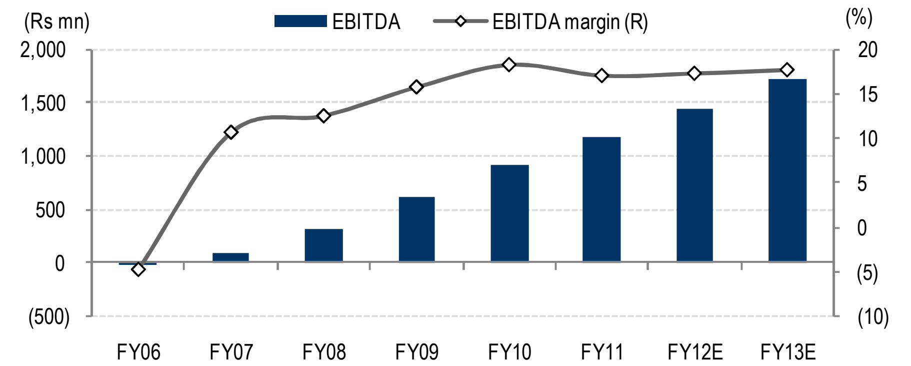
Source: Company, RCML Research

Going forward, we expect the company's international revenues to benefit from the following:

- The growing global pharmaceuticals market would lead to higher demand for pharmaceutical packaging.
- While the overall pharma market in developed countries of the US and EU would grow at a slower pace of 1–4%, the large size of these markets would offer BILC ample scope for growth.
- Growth in the generics segment would be stronger, supporting international revenues.
- Several contracts like Wal-Mart could provide further upside to revenues from this segment.
- Additionally, we note that pharma packaging demand is less volatile and does not experience any significant volume declines in adverse economic conditions. This provides greater revenue visibility. We forecast a 19% revenue CAGR from international business (ex-Ineos) over FY11–FY13E.

Operating level performance of BILC's international subsidiaries (ex-Ineos) has been consistently improving

Fig 22 - EBITDA margin trend of subsidiaries (ex-Ineos)



Source: Company, RCML Research

GCS segment

BILC's GCS division offers a range of support services to biotech and other drug development companies across the US (through ProClinical's acquisition), Europe (through DHP's acquisition) and Asia. Its services include clinical studies support, pre-formulation studies, formulation development, analytical research, stability studies,clinical packaging and storage & packaging of clinical trial kits. The company also provides infrastructure for the monitoring of clinical trials (IVRS) and is engaged in batch manufacturing for clinical trials.

BILC has 30–35% exposure to potential drug candidates in Phase III clinical trials, a stage that typically does not see R&D budget cuts

While the clinical research outsourcing space remains attractive, we note that the outlook has changed considerably over the past one year with global pharma majors cutting their R&D budget. This implies lower outsourcing to CROs. However, we note that BILC has significant exposure (~30–35%) to potential drug candidates in Phase-III clinical trials, a stage at which companies often resist R&D budget cuts. Moreover, the company would tend to benefit once clinical research outsourcing picks up again. For FY11, BILC generated revenues of Rs 2.1bn from its GCS division.

Anti-counterfeiting technology to be a long-term driver

BILC got access to *nonClonable* technology through the acquisition of Singular ID, a Singapore based firm, in Jan '08 for ~SGD 20mn. The technology comprises unique materials-based fingerprints which are difficult to copy and can track and trace products, thus curtailing counterfeiting of pharmaceutical products—an issue which has been plaguing the industry for a long time now. Besides ensuring effective supply chain management in the pharmaceutical market, BILC's track-and-trace technology can be extended to several other industries including high value/luxury products, agro chemicals, automotive and engineering. Also, the company's authentication-based systems can be used for extending security solutions to various government-related activities, including enhanced currency security, authenticated registration of property-related documents and others.

Beltron deal: instills confidence in the technology; value accretion will be in long term though

In June '11, BILC entered into an agreement with Beltron Telecom (Beltron), a Government undertaking of Bihar, engaged in providing public utility and renewable energy products and services in the State of Bihar. Under the deal, Beltron would use BILC's *nonClonable* technology for various security-related projects. Moreover, it would also secure its e-government projects run in Bihar, Jharkhand, and India's north eastern regions.

BILC's *nonClonable* technology would be used in Beltron's various security-related and e-governance projects

According to BILC, the collaboration can generate revenues in excess of Rs 2bn–2.5bn over the next 3-4 years. We, however, are not building in any revenues from the deal as we wait for execution to begin. It may be noted that in the past, the company has entered into deals with various other companies such as a Japanese auto ancillary manufacturer (Sanden Corporation), Indofil Chemicals and a Europe-based FMCG company. However, majority of these deals are under trials/testing phase and have not generated significant earnings as yet.

According to the 'Centre for Medicine in the Public Interest', one of America's leading research agencies, medicines worth ~US$ 75bn are counterfeited currently— this represents close to 10% of the overall pharmaceuticals market globally. The problem of counterfeiting is more acute in developing countries like India where the governing regulations are less stringent. While the market size is huge and offers tremendous growth potential, we note that growth in this segment would be slow and gradual. This is because there are a number of large competitors in this space including IBM and Oracle and other niche players like Axway and Excellis Health Solutions.

Financial overview

Expect 26% earnings CAGR driven by strong operating performance

We estimate BILC to report a 21% revenue CAGR over FY11–FY13E, driven by the full-year integration of Ineos from FY12E (vs. 7 months in FY11) and a strong 18% topline CAGR in the base business (ex-Ineos). Going forward, we have built in stable margins for BILC's base business (ex-Ineos). For Ineos, margin levers would play out, aided by the ongoing restructuring. However, we conservatively model for a modest margin expansion in FY12E and have assumed flat margins for FY13E. Overall, we estimate only a ~40bps expansion in Ineos' EBITDA margin over FY11-FY13E (22% EBITDA CAGR). We estimate the company to clock a 26% earnings CAGR over FY11–FY13E mainly supported by its operating performance.

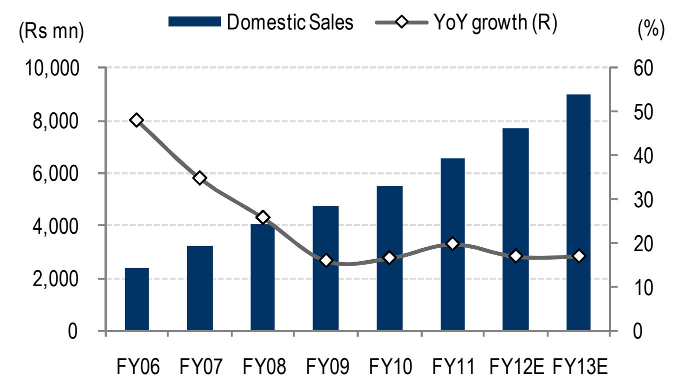
Over FY11–FY13, we have built in strong base business growth for BILC (ex-Ineos) but only flat numbers for Ineos

Fig 23 - Key assumptions

	FY11	FY12E	FY13E
Revenues			
Domestic, Rs mn	6,586	7,705	9,015
YoY growth, %	20	17	17
contribution to total sales, %	28	25	27
International (ex-Ineos), Rs mn	6,899	8,279	9,769
YoY growth, %	38	20	18
contribution to total sales, %	30	27	29
Ineos, Euro mn	155	241	241
YoY growth, %	n/a	55	-
contribution to total sales, %	42	49	45
EBITDA margin, %			
Domestic	29.7	29.7	29.7
International (ex-Ineos)	17.0	17.3	17.7
Ineos	2.7	4.4	4.5

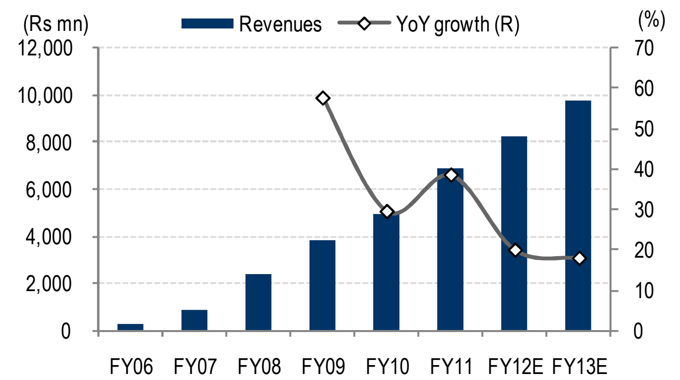
Source: Company, RCML Research

Fig 24 - Revenue trend: Domestic business



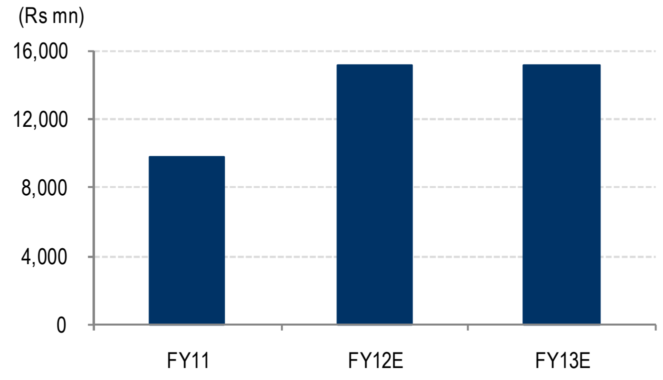
Source: Company, RCML Research

Fig 25 - Revenue trend: international business' (ex-Ineos)



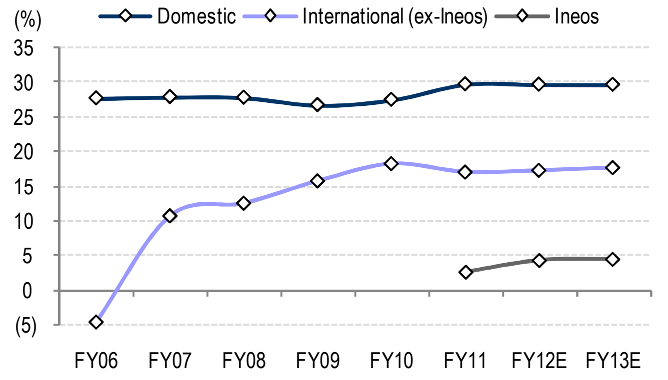
Source: Company, RCML Research

Fig 26 - Revenues from Ineos



Source: Company, RCML Research

Fig 27 - Margin trend



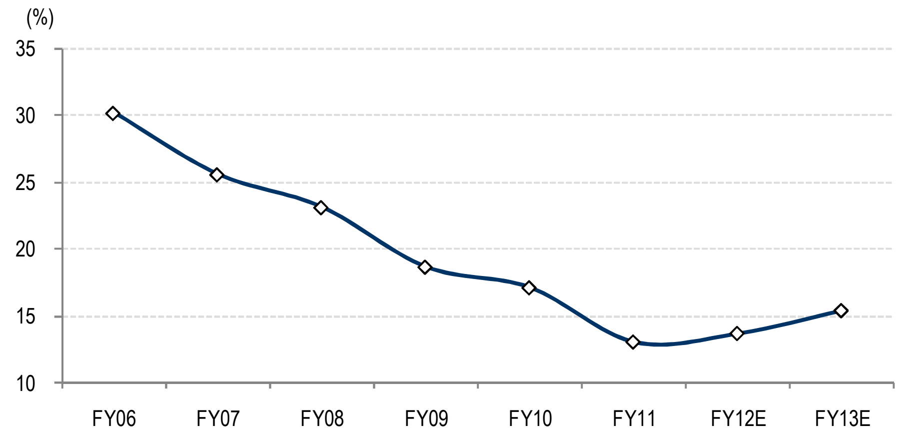
Source: Company, RCML Research

Return ratios to improve but gradually

BILC's return ratios have deteriorated sharply over the past few years mainly due to consistent equity dilution. Over FY06-FY11, ~40% of the equity has been diluted, pulling down ROE from ~30% in FY06 to 13.1% in FY11. A part of the ROE decline is also explained by BILC's acquisition of Ineos' low-margin business in FY11, which impacted the former's overall financial performance. For FY12E, improvement in ROE would be restricted as Ineos is fully integrated into the company. However, we expect return ratios to improve from FY13E driven by strong earnings growth that would be backed by an improved operating performance at Ineos. Also, we do not foresee any further equity dilution by BILC given that it (a) has plans to first fully integrate Ineos and (b) has a targeted capital expenditure of only ~US$ 20mn per annum.

Strong earnings growth would support ROEs going ahead

Fig 28 - ROE trend



Source: Company, RCML Research

Q4FY11 results impacted by low margins of Ineos

For Q4FY11, BILC reported sharp rise in topline driven by integration of Ineos acquisition. The revenue increased from Rs 2.7bn in Q4FY10 to Rs 8.5bn in Q4FY11. Ineos reported revenues of ~Rs 4.6bn. Domestic revenues surged 20% to Rs 1.8bn.

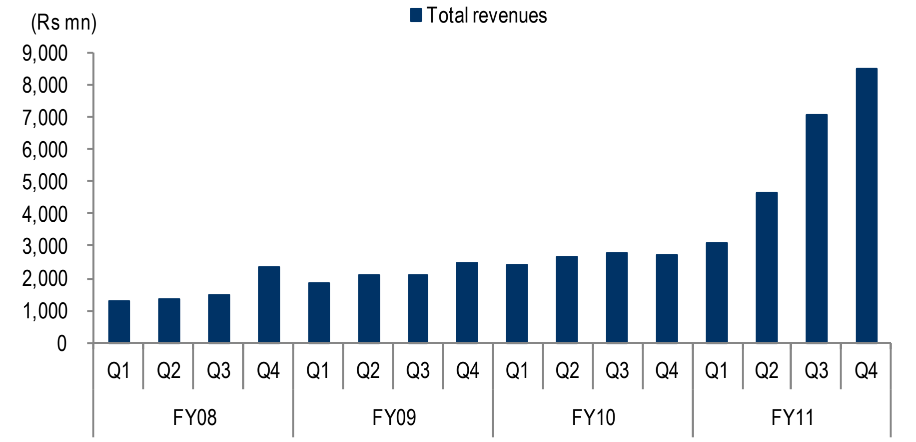
For Q4FY11, BILC reported strong topline growth but weak margins – the Ineos integration effect

While Ineos led to a significant YoY growth in BILC's topline, it also led to its EBITDA margin decline from 23.9% in Q4FY10 to 9.3% in Q4FY11. Ineos, already a low-margin business, suffered during the quarter due to a rise in crude prices which sharply escalated input costs and certain one-time expenditure related to financial audit. Ineos reported operating margins of ~2% for Q4FY11, significantly below ~5.6% at time of acquisition. On the positive side, the domestic operations reported a 90bps YoY EBITDA margin expansion.

For Q4FY11, BILC's adj. PAT declined 31% YoY to Rs 241mn, primarily reflecting a sharp deterioration in operating margins and higher depreciation and interest costs (due to Ineos' acquisition).

Ineos' acquisition has significantly increased BILC's revenues over the last two quarters…

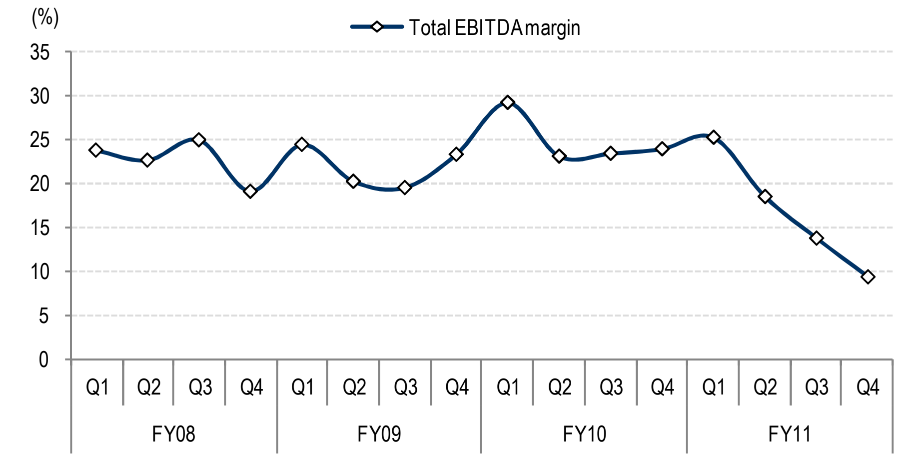
Fig 29 - BILC: Revenue trend



Source: Company, RCML Research

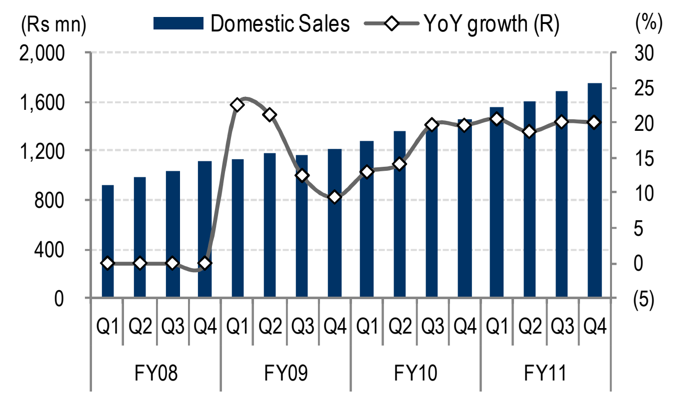
…but dented its operating margins

Fig 30 - BILC: EBITDA margin trend



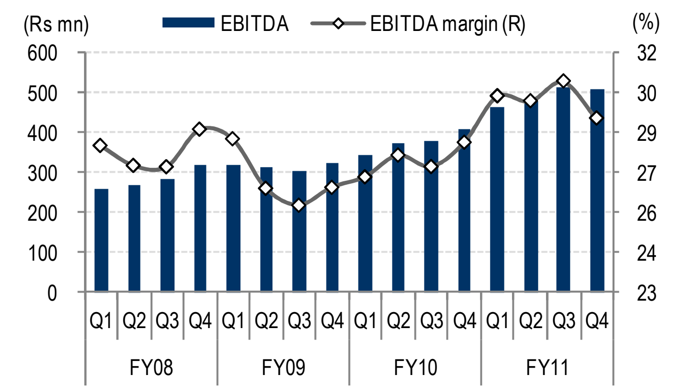
Source: Company, RCML Research

Fig 31 - Growth in domestic business remains strong



Source: Company, RCML Research

Fig 32 - Domestic business EBITDA margin trend



Source: Company, RCML Research

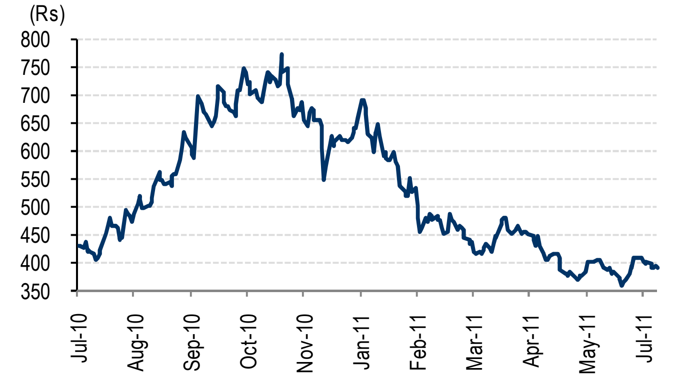
Valuations offer an attractive entry point

BILC has underperformed the BSE Sensex/BSE HC Index by 40%/47% over the past 8 months. The underperformance has largely been due (a) to the leveraged buy-out of Ineos, increasing BILC's debt burden and (b) margin deterioration at Ineos over the past two quarters. We believe this underperformance largely captures the negatives while ignoring the potential margin upsides from company's ongoing restructuring initiatives. We believe Ineos' margins would improve from current levels, though gradually. Even if we assume conservative margin expansion for Ineos, BILC would report a strong earnings growth over the next two years.

BILC's recent underperformance captures all negatives but ignores potential margin upsides

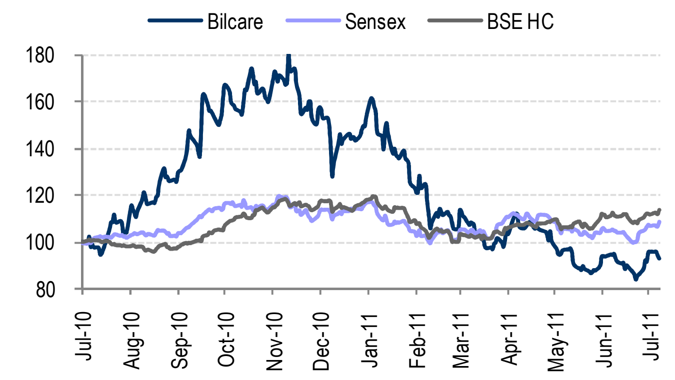
Moreover, we do not see any major headwinds to our topline assumptions for Ineos, as our checks for several global pharma companies suggest that demand for pharma packaging (a segment making up ~40% of Ineos' total sales) would remain stable driven by the growing pharmaceuticals market. Also, demand in this segment is less volatile and does not experience any significant volume decline, even in adverse economic conditions. Packaging demand for other segments (food, non-food packaging, and other specialty packaging) is also expected to remain stable given that the economic cycle is close to bottoming out. Therefore, consumption demand in these segments is expected to remain fairly stable. Also, since customers typically stick to suppliers, we do not see any major risk on this front. We have conservatively built in flat FY12/FY13E revenues for Ineos.

Fig 33 - BILC's stock has sharply corrected over the past 7–8 months



Source: Bloomberg, RCML Research

Fig 34 - BILC has underperformed BSE Sensex and BSE HC Index over the past one year



Source: Bloomberg, RCML Research

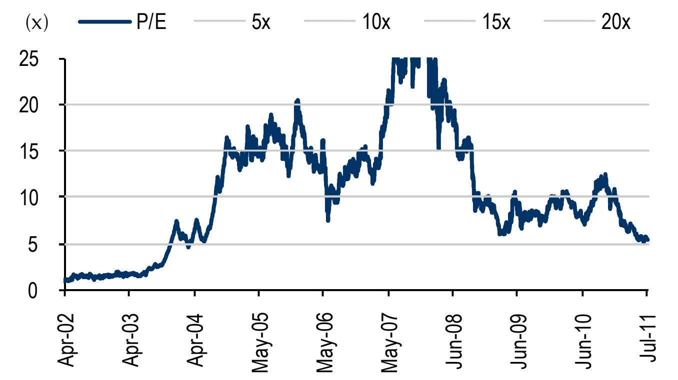
Fig 35 - Revenue growth expectations for select global and domestic companies

%	FY11	FY12	FY13
Rexam PLC	1	9	3
Bemis Company Inc.	38	12	4
Sonoco Products Corp.	15	11	5
Ball Corp.	14	17	4
Crown Holdings Inc.	0	8	7
Global average	13	11	4

Source: Bloomberg

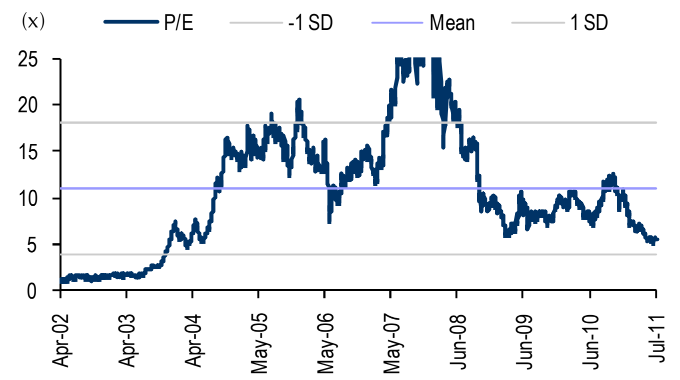
BILC is currently trading at a PER of ~5.4x one-year forward earnings, at a significant discount to its historical average of ~11x. While a part of this discount is warranted, given that the company's returns profile has deteriorated sharply over the past few years, the current valuations appear cheap and offer an attractive entry point to investors (in view of an anticipated recovery in Ineos' margins which would boost BILC's financial performance).

Fig 36 - BILC is trading at 5.4x one-year fwd earnings



Source: Bloomberg, Company, RCML Research

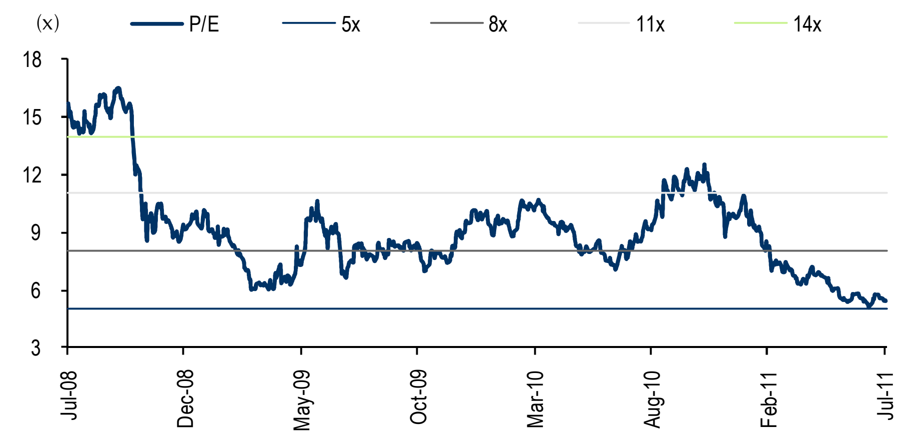
Fig 37 - BILC is trading close to -1 SD – an all-time low



Source: Bloomberg, Company, RCML Research

Over the past 3 years the stock has traded in the range of 5x-14x one year forward earnings

Fig 38 - BILC's PE trading band over past 3 years



Source: Bloomberg, Company, RCML Research

Fig 39 - On an EV/EBITDA basis, the stock is trading at ~4x one-year forward EBITDA, over 50% discount to its historical average of ~8x

Source: Company, Bloomberg, RCML Research

We note that BILC's consolidated earnings would be highly sensitive to the operating performance of Ineos. A sharp reduction in Ineos' operating margins would impact BILC's earnings significantly and leave limited scope for valuation multiples to expand from current levels.

Fig 40 - Valuations would be highly sensitive to performance of Ineos

	-5% from Base	-2% from Base	Base case	+2% from Base	+5% from Base
FY12E					
Ineos' EBITDA margin	-0.6%	2.4%	4.4%	6.4%	9.4%
Consolidated EPS	34.1	53.5	66.4	79.3	98.6
P/E at above EPS @ CMP	11.5	7.3	5.9	4.9	4.0
Target multiple, x	7.0	7.0	7.0	7.0	7.0
Target price, Rs	240	380	470	560	690
FY13E					
Ineos' EBITDA margin	-0.5%	2.5%	4.5%	6.5%	9.5%
Consolidated EPS	53.7	73.0	85.9	98.8	118.2
P/E at above EPS @ CMP	7.3	5.4	4.6	4.0	3.3
Target multiple, x	7.0	7.0	7.0	7.0	7.0
Target price, Rs	380	510	600	700	830

Source: RCML Research

DCF valuation

Our DCF based target price is Rs 633 which means an implied target PE multiple of 7.4x Mar '13 earnings.

Fig 41 - DCF Valuation – Key output table

Key Assumptions		WACC Assumptions	
10 year Revenue CAGR (FY11-21E)	9.1%	Cost of equity	13.8%
10 year EBITDA CAGR (FY11-21E)	9.0%	Risk free rate	8.0%
10 year NOPAT CAGR (FY11-21E)	12.4%	Beta	1.15
EBITDA margin (FY11; FY21E)	14.6% , 14.5%	Equity risk premium	5.0%
NOPAT margin (FY11; FY21E)	7.9% , 7.9%	Cost of debt	9.0%
ROIC (FY11; FY21E)	10.5% , 13%	Tax	34.0%
Terminal assumptions		Debt/capital	40.1%
Terminal Revenue growth Rate %	3.0%	Equity/capital	70.0%
Terminal EBITDA Margin	14.0%	**WACC**	**11.4%**
Terminal NOPAT Margin	7.5%	DCF output	
Terminal ROIC	12.4%	Current EV	25,464
Long Term Capex / Sales	4.0%	Net debt	10,562
Terminal value as % of EV	45.7%	Current Equity value	14,902
Implied FY22E exit FCF multiple (x)	11.9	Current equity value/share	391
Implied FY22E exit EBITDA multiple (x)	4.0	Mar-12 equity value/share	633

Source: Bloomberg, Company, RCML Research

Fig 42 - Sensitivity analysis – WACC and terminal growth on target price

Terminal growth	WACC 9.4%	10.4%	11.43%	12.4%	13.4%
2.0%	855	699	576	477	395
2.5%	906	735	603	497	411
3.0%	966	777	633	519	428
3.5%	1,035	824	667	544	446
4.0%	1,117	879	705	572	467

Source: Bloomberg, Company, RCML Research

Peer comparison

No similar play is seen globally in terms of product portfolio, scale and geographic presence. Valuations are at a significant discount to global packaging players

The packaging industry is highly fragmented, both in India and globally. There is no company that matches BILC's business model, in terms of product offerings or geographical exposure.

We have looked at the valuations of global packaging majors like Amcor, Rexan, Bemis, Sonoco and PRC, and note that BILC is the cheapest on most valuation parameters. Also, the scale and product offerings of these companies are starkly different from BILC.

Fig 43 - Peer comparison

Company	MCAP, (US$ mn)	P/E, x		P/Sales, x		EV/EBITDA, x		EV/Sales, x		ROE,%		
		FY12e	FY13e	FY12e	FY13e	FY12e	FY13e	FY12e	FY13e	FY11	FY12e	FY13e
Amcor Ltd.	9,430	16.2	13.2	0.72	0.70	7.3	6.5	0.90	0.87	5.2	13.0	16.7
Rexam PLC	5,553	11.2	10.1	0.71	0.69	5.9	5.6	0.94	0.91	5.3	12.7	13.0
Bemis Company Inc.	3,588	15.1	13.2	0.66	0.64	7.3	6.8	0.91	0.87	11.1	12.3	13.5
Sonoco Products Corp. *	3,594	13.6	12.3	0.78	0.75	7.3	6.8	0.93	0.89	14.1	15.8	15.8
RPC Group PLC	960	12.0	10.4	0.53	0.51	4.5	4.2	0.56	0.54	12.2	14.9	15.2
Global average		**13.6**	**11.8**	**0.68**	**0.66**	**6.5**	**6.0**	**0.85**	**0.82**	**9.6**	**13.8**	**14.8**
Bilcare	207	5.9	4.6	0.30	0.27	4.5	3.7	0.63	0.55	13.1	13.7	15.4

*Source: Company, Bloomberg, RCML Research, * primarily paper based packaging*

Key risks

50% of Ineos' revenues are derived from segments linked to economic activity

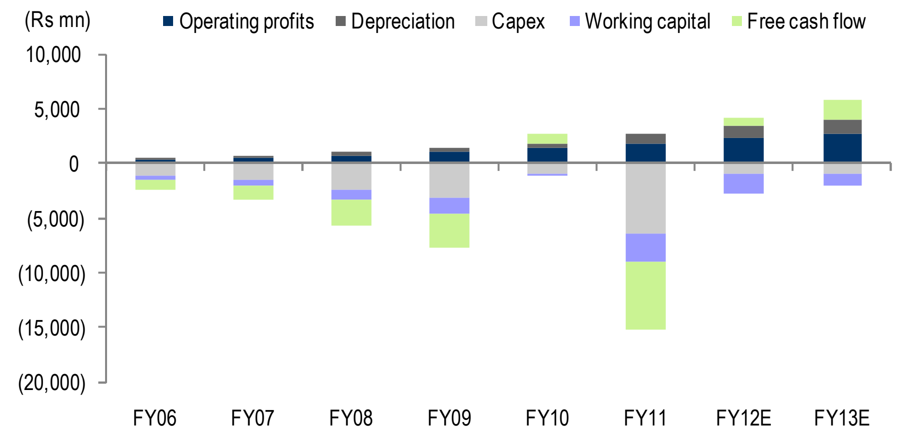
Any significant downturn in global economy could impact topline growth

While the pharmaceuticals packaging segment remains a relatively defensive play, we note that over 50% Ineos' revenues (~25% of BILC's total sales) are derived from segments such as credit card packaging, gift and casino playing cards packaging, and specialty packaging (including printing and decoration and various other applications). Since the demand for these products is linked to economic activity, a downturn can impact volumes and thereby the company's financial performance.

Any working capital strain could impact free cash flows

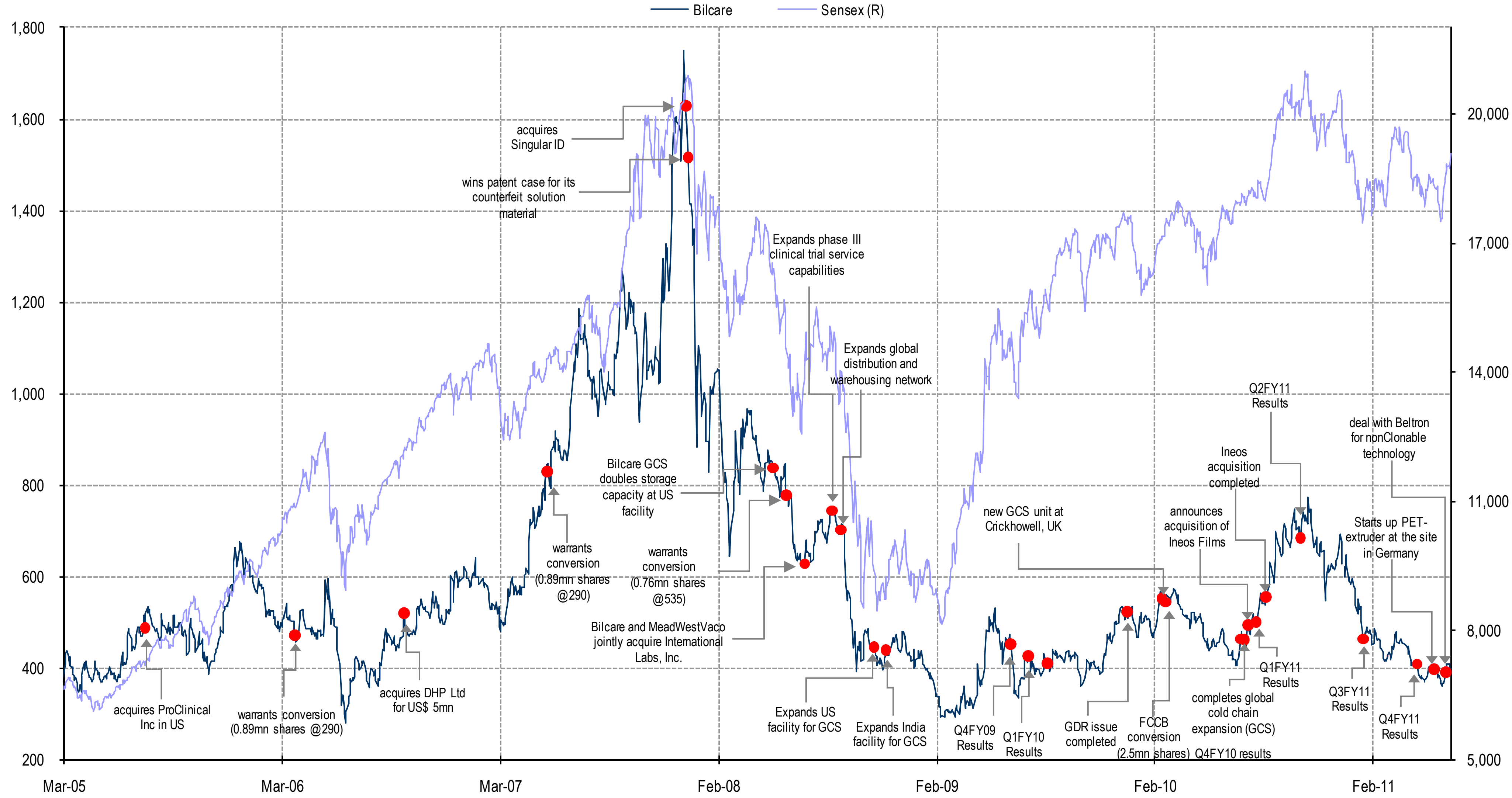
BILC intends to focus on the integration of Ineos and does not plan to incur any significant capex over the next few years. However, if the company fails to control its high working capital requirements, free cash flow generation could be restricted.

Fig 44 - Significant strain on working capital could restrict cash flow generation



Source: Company, RCML Research

Fig 45 - Event Tracker



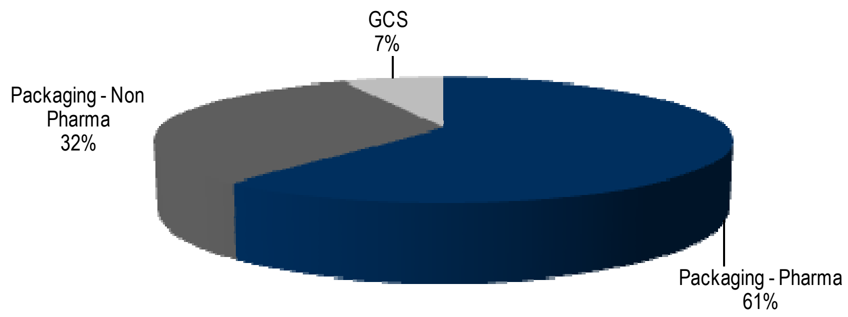
Source: Company, RCML Research

Company background

BILC was founded in 1995 by Mr Mohan Bhandari – a first generation technocrat entrepreneur. Mr Bhandari holds degree in Physics from the University of Pune and a post-graduate diploma in both Management Studies and Packaging Science. He has over 27 years of experience in the global pharmaceutical packaging industry.

BILC has two main business areas – a) Packaging Solutions (pharma and non-pharma) and b) Global Clinical Supplies.

Fig 46 - BILC's revenue breakup (H2FY11)



Source: RCML Research

The company has a total employee strength of over 2300 people. BILC which serves over 2500 customers worldwide has its manufacturing plants located across US, Europe and Asia.

Fig 47 - Key manufacturing locations of BILC

Location	Country	Activity
Staufen	Germany	Specialty Films Solutions
Bötzingen	Germany	Pharma Packaging Innovations
Weißandt-Gölzau	Germany	Packaging Films Solutions and Specialty Films Solutions
Castiglione Olona (Varese)	Italy	Cards Solutions
Fucine di Ossana TN	Italy	Packaging Films Solutions
Delaware City	USA	Production of films for Specialty Films Solutions, Pharma Packaging Innovations , Packaging Fims Solutions and Cards Solutions Businesses:
Changi South Street	Singapore	Production of films for Pharma Packaging Innovations, Pharmaceutical packaging services, research services and innovative solutions
Nasik	India	Production of films for Specialty Films Solutions, Pharma Packaging Innovations and Packaging Films Solutions Businesses:
Thane	India	Production of flexible PVC films for the stationary, printing and toy markets in India.
Pune	India	Production of films for Pharma Packaging Innovations pharmaceutical packaging services, packaging audits, research services and innovative solutions

Source: Company

Profit and Loss statement

Y/E 31 Mar (Rs mn)	FY09A	FY10A	FY11A	FY12E	FY13E
Total revenue	**8,560**	**10,478**	**23,285**	**31,181**	**33,982**
EBITDA	1,865	2,419	3,394	4,382	5,091
EBIT	1,487	1,884	2,562	3,288	3,937
Interest	(393)	(439)	(862)	(1,167)	(1,167)
Other income/(Expense)	77	180	69	80	80
Exceptional items	0	0	0	0	0
EBT	1,171	1,625	1,769	2,202	2,850
Income taxes	(342)	(453)	(502)	(638)	(827)
Extraordinary items	0	0	200	0	0
Min int./Inc. from associates	0	0	0	0	0
Reported net profit	**829**	**1,172**	**1,467**	**1,563**	**2,024**
Adjustments	0	0	(200)	0	0
Adjusted net profit	829	1,172	1,267	1,563	2,024

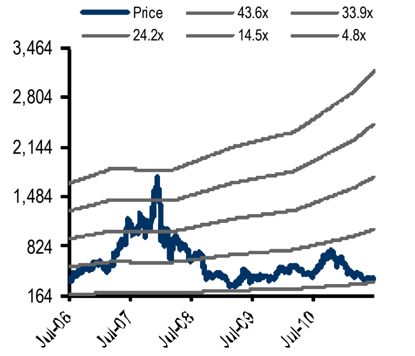
Balance sheet

Y/E 31 Mar (Rs mn)	FY09A	FY10A	FY11A	FY12E	FY13E
Accounts payable	840	1,016	4,819	6,997	7,272
Other current liabilities	270	368	1,363	1,937	2,021
Provisions	58	97	97	97	97
Debt funds	9,505	5,993	12,197	12,197	12,197
Other liabilities	0	0	488	488	488
Equity capital	172	227	236	236	236
Reserves & surplus	4,788	8,500	10,424	11,918	13,873
Shareholder's funds	4,960	8,727	10,659	12,153	14,108
Total liabilities	**15,633**	**16,201**	**29,622**	**33,869**	**36,184**
Cash and cash eq	1,053	1,516	1,778	1,635	2,685
Accounts receivable	3,295	3,530	8,228	11,095	12,054
Inventories	1,415	1,705	4,342	5,958	6,419
Other current assets	720	1,469	2,163	2,163	2,163
Investments	1,455	0	2	2	2
Net fixed assets	6,980	7,207	12,677	12,583	12,428
CWIP	160	332	332	332	332
Intangible assets	1,304	1,340	1,430	1,430	1,430
Deferred tax assets, net	(984)	(1,171)	(1,572)	(1,572)	(1,572)
Other assets	235	272	243	243	243
Total assets	**15,633**	**16,201**	**29,622**	**33,869**	**36,184**

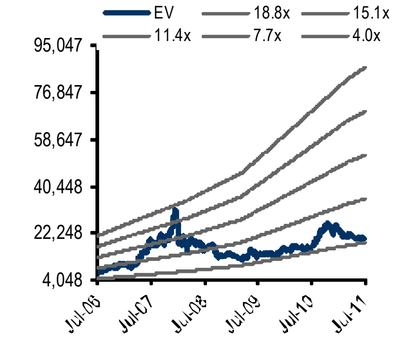
Cash flow statement

Y/E 31 Mar (Rs mn)	FY09A	FY10A	FY11A	FY12E	FY13E
Net income + Depreciation	1,208	1,707	2,298	2,657	3,178
Interest expenses	393	439	862	1,167	1,167
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(1,417)	(213)	(2,537)	(1,731)	(1,060)
Other operating cash flow	(5)	(696)	(664)	0	0
Cash flow from operations	178	1,236	(40)	2,093	3,285
Capital expenditure	(3,118)	(916)	(6,392)	(1,000)	(1,000)
Change in investments	(227)	1,455	(2)	0	0
Other investing cash flow	51	21	526	0	0
Cash flow from investing	(3,293)	559	(5,868)	(1,000)	(1,000)
Issue of equity	98	2,733	9	0	0
Issue/repay debt	2,468	(3,511)	6,204	0	0
Interest expenses	(393)	(439)	(862)	(1,167)	(1,167)
Dividends paid	(50)	(66)	(69)	(69)	(69)
Other financing cash flow	581	118	889	0	0
Cash flow from financing	2,704	(1,165)	6,171	(1,235)	(1,235)
Change in cash & cash eq	(411)	631	262	(142)	1,049
Closing cash & cash eq	1,053	1,516	1,778	1,635	2,685

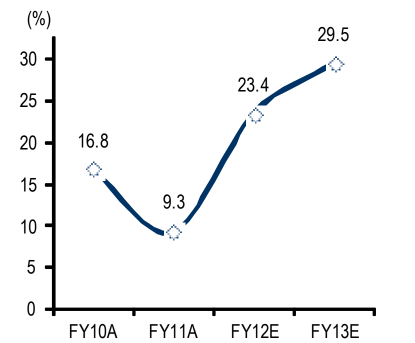
1-yr fwd P/E band



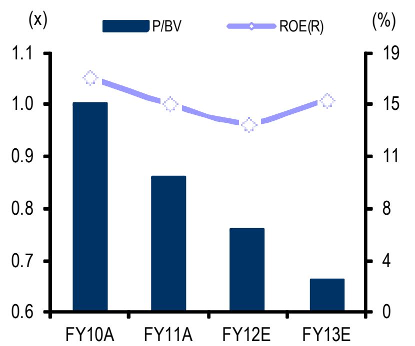
1-yr fwd EV/EBITDA band



EPS growth



ROE vs P/BV



Per share data

Y/E 31 Mar (Rs)	FY09A	FY10A	FY11A	FY12E	FY13E
Reported EPS	42.1	49.2	62.3	66.4	85.9
Adjusted EPS	42.1	49.2	53.8	66.4	85.9
DPS	2.5	2.5	2.5	2.5	2.5
BVPS	288.2	384.7	452.6	516.1	599.1

Valuation ratios

Y/E 31 Mar (x)	FY09A	FY10A	FY11A	FY12E	FY13E
EV/Sales	1.9	1.9	0.9	0.7	0.6
EV/EBITDA	8.7	8.0	5.9	4.6	3.8
P/E	12.6	13.4	7.3	5.9	4.6
P/BV	1.8	1.7	0.9	0.8	0.7

Financial ratios

Y/E 31 Mar	FY09A	FY10A	FY11A	FY12E	FY13E
Profitability & Return ratios (%)					
EBITDA margin	21.8	23.1	14.6	14.1	15.0
EBIT margin	17.4	18.0	11.0	10.5	11.6
Net profit margin	9.7	11.2	5.4	5.0	6.0
ROE	18.7	17.1	13.1	13.7	15.4
ROCE	8.3	9.3	9.6	9.7	10.8
Working Capital & Liquidity ratios					
Receivables (days)	115	119	92	113	124
Inventory (days)	86	96	82	106	118
Payables (days)	56	57	80	122	136
Current ratio (x)	4.1	4.8	2.5	2.2	2.4
Quick ratio (x)	3.2	3.8	1.9	1.6	1.8
Turnover & Leverage ratios (x)					
Gross asset turnover	1.2	1.3	2.0	2.0	2.1
Total asset turnover	0.6	0.7	1.0	1.0	1.0
Interest coverage ratio	3.8	4.3	3.0	2.8	3.4
Adjusted debt/equity	1.9	0.7	1.1	1.0	0.9

Quarterly trend

Particulars	Q4FY10	Q1FY11	Q2FY11	Q3FY11	Q4FY11
Revenue (Rs mn)	2,696	3,085	4,660	7,035	8,505
YoY growth (%)	*9.2*	*29.4*	*77.0*	*154.4*	*215.5*
QoQ growth (%)	*(2.5)*	*14.5*	*51.0*	*51.0*	*20.9*
EBITDA (Rs mn)	643	776	859	965	793
EBITDA margin (%)	23.9	25.2	18.4	13.7	9.3
Adj PAT (Rs mn)	349	307	365	353	241
YoY growth (%)	*21.1*	*(22.9)*	*31.2*	*12.5*	*(30.8)*
QoQ growth (%)	*11.1*	*(12.0)*	*19.1*	*(3.4)*	*(31.6)*

DuPont analysis

(%)	FY09A	FY10A	FY11A	FY12E	FY13E
Tax burden (Net income/PBT)	70.8	72.1	71.6	71.0	71.0
Interest burden (PBT/EBIT)	78.8	86.2	69.0	67.0	72.4
EBIT margin (EBIT/Revenue)	17.4	18.0	11.0	10.5	11.6
Asset turnover (Revenue/Avg TA)	62.5	65.8	101.6	98.2	97.0
Leverage (Avg TA/Avg equtiy)	308.4	232.6	236.4	278.3	266.8
Return on equity	**18.7**	**17.1**	**13.1**	**13.7**	**15.4**

Company profile

Bilcare Ltd (BILC), a Pune based research-driven company, is a leading player in domestic blister barrier packaging market (with over 60% market share). Founded in 1995, the company has grown multifold over the past few years with its revenues crossing Rs 23bn in FY11 (from Rs 4bn in FY07). The company has expanded globally with acquisition of companies in the US, Europe and Asia. In Sept '10 it acquired Ineos which has broadened BILC's product portfolio and gave BILC an entry into non-pharma businesses such as foods, FMCG, credit cards, medical appliances packaging etc.

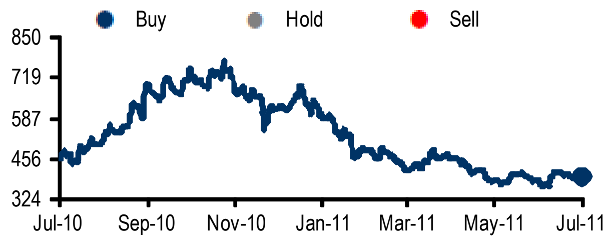
Shareholding pattern

(%)	Sep-2010	Dec-2010	Mar-2011
Promoters	35.4	34.1	34.1
FIIs	3.9	9.9	8.0
Banks and FIs	2.0	3.8	5.8
Public	58.7	52.2	52.1

Recommendation history

Date	Event	Reco price	Tgt price	Reco
19-Jul-11	Company Initiation	394	600	Buy

Stock performance



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Recommendation Interpretation

Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and –5%
Sell	Less than –5%

Recommendation structure changed with effect from March 1, 2009

Expected absolute returns are based on share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

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