Batlivala & Karani

B&K SECURITIES
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VISIT NOTE

SMALL CAP

Bilcare

Not Rated

Price: Rs 369 | **BSE Index: 17,560** | **23 June 2011**

"Ineos" restructuring on...strong synergies in sight

Bilcare is a research driven packaging solutions company, primarily focusing on the pharma space. It has a dominant position in the domestic market with a market share in excess of 60%. Over the years, Bilcare has transformed from a mere packaging company to a partner providing various packaging solutions and hence moved up the value chain.

In September 2010, Bilcare acquired the global packaging business of "Ineos" for ~US$ 130 mn. Ineos would add ~US$ 320 mn in terms of incremental revenues and 1,900 new customers. It would also provide a platform for Bilcare to cross sell its business solutions. Bilcare is in the process of restructuring Ineos and expects the operating margins to move upwards to levels of ~8% this year (target is to improve margins to mid-teens over the next four years) from current levels of ~5%.

The company has also ventured into the global clinical services (GCS) business which has margins of ~25%+. While the lead time is generally high for setting up capacities (18-24 months), Bilcare, with capacities across US, Europe (acquisition of Proclinical Inc., USA and DHP Ltd., UK in 2006) and Asia, is well positioned to tap this US$ 1.4 bn market. It provides services such as clinical supplies, randomisation, pre-formulation studies, analytical, storage, packaging and logistics which are normally carried out by the companies internally.

With the acquisition of the Singapore-based Singular ID for ~SGD 20 mn, the company gains access to non-Clonable ID technologies which would authenticate track-trace products apart from reducing counterfeits. The company is in the process of rolling out this technology across various sectors like FMCG, agrochemicals and automobiles apart from pharma drugs.

Though packaging solutions still account for a lion's share of Bilcare's total income (>90%), new-age businesses like GCS and non-Clonable ID technologies will offer diversity to its earnings. With additional capacities globally that Ineos brings to Bilcare, we believe that the company is at an important juncture (inflection point) and needs to execute its plans well to capitalise on the opportunities.

As far as the stock price performance is concerned, the stock has corrected to current levels of Rs 369, from its highs of around Rs 700 over the last nine months (concerns arising over a leveraged balance sheet). At the current market price of Rs 369, the stock trades at 5.5x FY12E EPS of Rs 66.5 and 4.8x FY13E EPS (consensus) of Rs 76.8. The stock also trades below its book value of Rs 428. We do not have a rating on the stock.

Share Data

Reuters code	BIL.BO
Bloomberg code	BILC IN
Market cap. (US$ mn)	194
6M avg. daily turnover (US$ mn)	0.4
Issued shares (mn)	24

Performance (%)	1M	3M	12M
Absolute	(3)	(12)	(24)
Relative	2	(10)	(23)

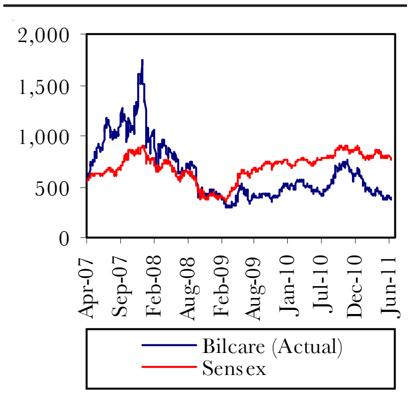
Valuation ratios

Yr to 31 Mar	FY10	FY11
EPS (Rs)	51.5	62.2
+/- (%)	7.0	20.7
PER (x)	7.2	5.9
PBV (x)	1.0	0.9
Dividend/Yield (%)	0.7	1.1
EV/Sales (x)	1.4	0.7
EV/EBITDA (x)	6.3	4.9

Major shareholders (%)

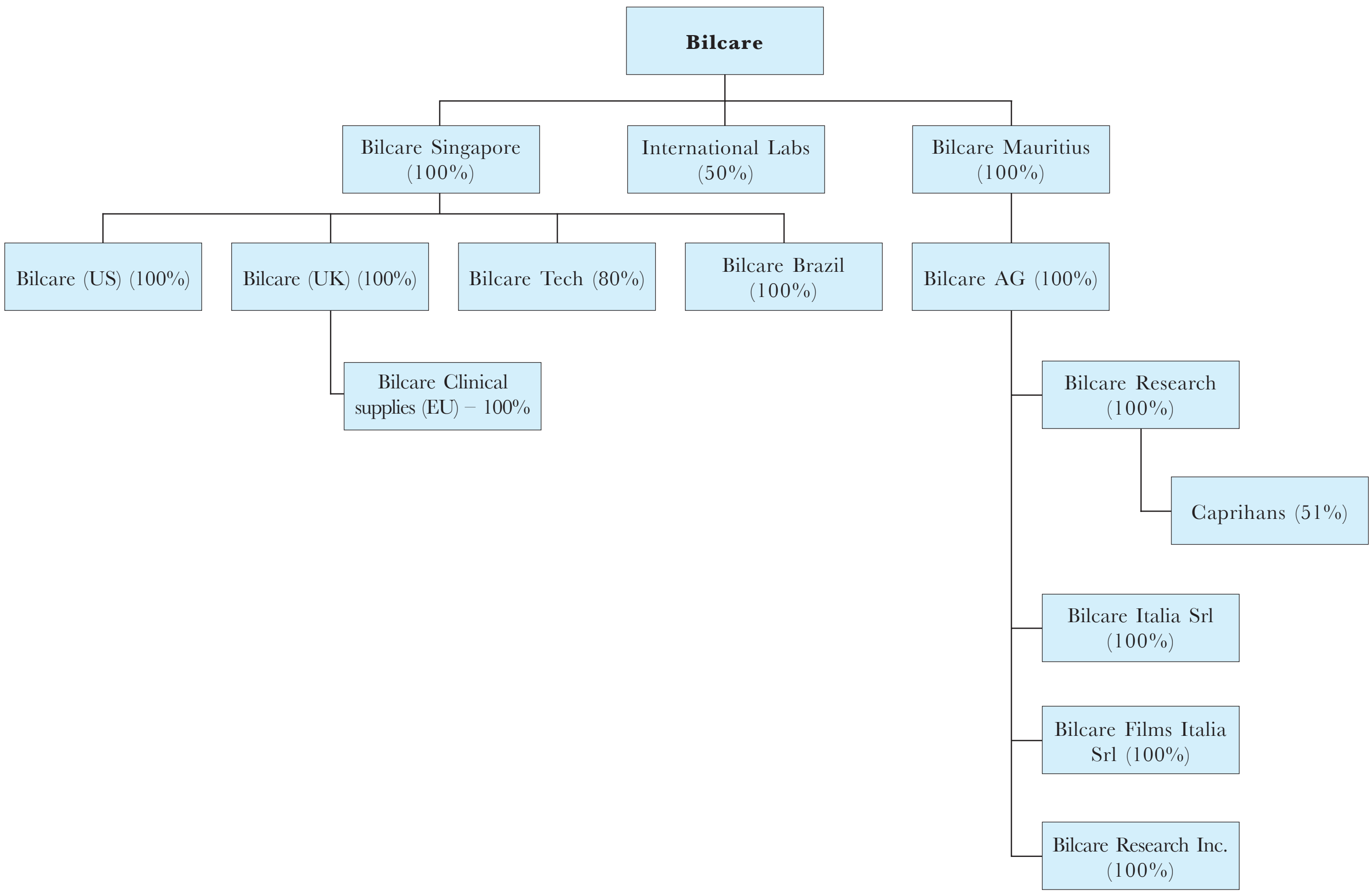
Promoters	34
FIIs	8
MFs	4
BFSI's	2
Public & Others	52

Relative performance



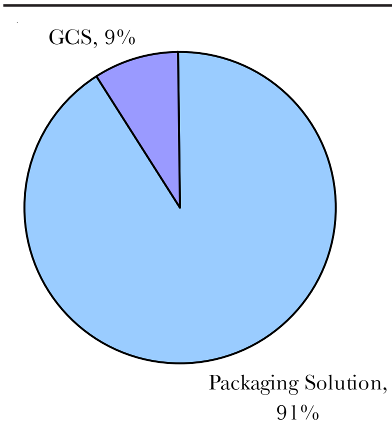
Key risk to the stock is the quality of balance sheet as it appears to be stretched with debt of nearly Rs 12.0 bn, as of March 2011 (higher than its current market cap). This debt was primarily taken for funding its Ineos acquisition. So, the key challenges for Bilcare remain how it improves its cash flows from operations and reduces its debt/leverage.

Organisational structure



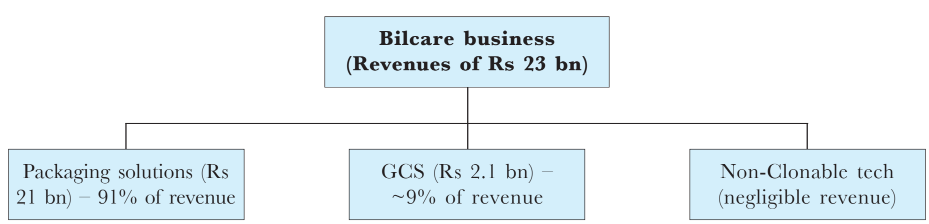
Source: B&K Research

Business mix FY11 – Rs 23 bn



Source: B&K Research

Business structure



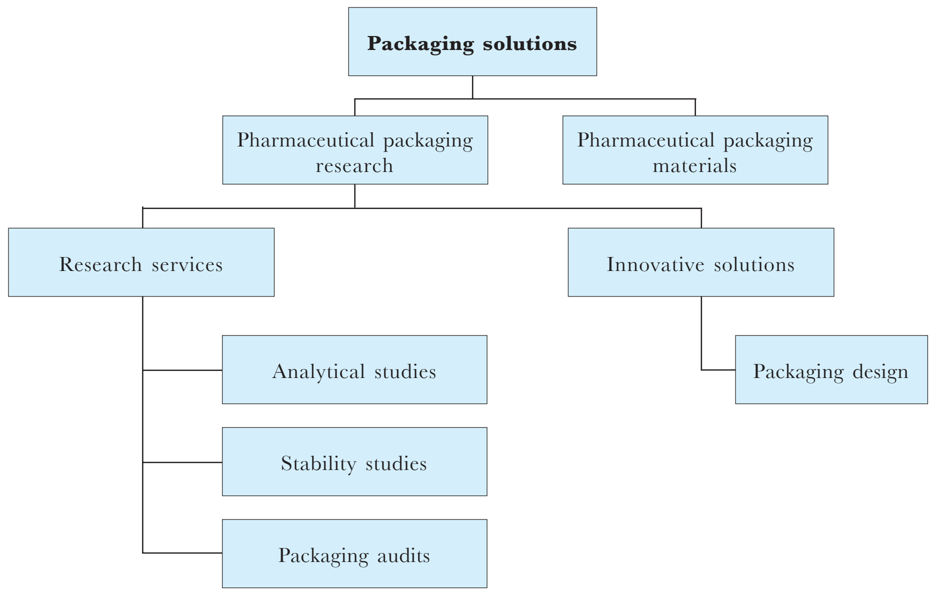
Source: B&K Research

We recently met the management of Bilcare and following are the key takeaways.

Packaging solutions – Becomes a global play with "Ineos"

This is the largest segment for Bilcare and contributes ~90% to the consolidated revenues (~Rs 21 bn). Bilcare partners with the R&D team of pharmaceutical companies right from the preclinical stages, to quantify the sensitivity of a drug and then decide upon the type of packaging material, through the following activities.

Packaging business gets a push



Source: Company, B&K Research

Differentiation in terms of technology/services offered

Bilcare Optima is a patented service being offered by Bilcare to facilitate research for solid dosage forms and now being developed further to include liquid formulation. Bilcare Optima provides solutions such as the type and quantity of materials that are needed for the specific formulation based on the properties of the drug, shelf life requirements, environment and climatic condition, emphasis required by clients (such as stability in colour, shape, etc.) and other specifications (child protection, environmental emphasis, easy to open, etc.).

Analytical Lab generates in depth details regarding the barrier properties of the film to be used in the packaging. With the details provided, Bilcare Optima would study the formulation with respect to various factors individually and in combination. Further, Bilcare considers all four climatic regions for the tests and uses these details to ensure that the drug is not over or under packed.

Brandpak Solution is another patented technology offered by Bilcare to provide packaging solutions to help pharmaceutical companies to differentiate its products against their competition. It provides unique product designs based on the client needs.

Faster and more effective viz. competition

Bilcare provides packaging solution details in 30 days as compared to the industry norms of six-nine months (which is the time to conduct drug stability studies), significantly reducing time to launch newer drugs. Further using Optima, it provides structured tests as compared to trial and error method used across the pharma industry.

Tie-up with Wal-Mart

Bilcare has entered into a long-term contract with Wal-Mart, for its US$ 4 treatment per month programme providing for contract packaging for private labels of Wal-Mart. This will be catered through its recent acquisition of International Labs vide a 50:50 JV with Mead Westwaco. The JV generated income of US$ 40 mn in FY11 (US$ 20 mn to Bilcare).

Rationalising client base

Bilcare is planning to focus and increase its client base in more value added space (such as providing critical packaging solution viz. mere packaging). It is also valuing the option of outsourcing certain non-critical activities to improve focus towards research and other high end services.

Strong synergies with "Ineos" – Timely restructuring is the key

Its recent acquisition of the global packaging business of "Ineos" would position Bilcare as a global play. Apart from contributing US$ 320 mn in the top line, it provides Bilcare a platform to access 1,900 additional customers (where it currently plans to cross sell its packaging solutions). It also gained access to eight new facilities across the globe (Three in Germany, Two – Italy, One – US, Two – India).

Ineos currently garners operating margins of ~5% (which has dragged the consolidated margins to levels of ~14%), however, with several restructuring initiatives in place, the management expects EBITDA margins at Ineos to move to ~9% in FY12E (aims on obtaining margins of 15-16% in the next four years). This should drastically improve the overall profitability of Bilcare from current levels.

Rationalising suppliers: Currently, Ineos sources substantial portion of its raw material requirements from Europe (which makes the RMC high), however, Bilcare plans to increase the number of vendors and plans to start sourcing materials from Far East (which would be far more cost effective).

Phasing out certain products/activities: Currently, Ineos carries out several activities that mere adds to the top line but does not have any impact to the bottom line. Bilcare plans to de-focus on those products/services and focus more on value added proposition (where the margins are higher).

Shifting certain high cost activities to India: Currently, all the business activities of Ineos is carried out in Europe, however, the management plans to shift some support/non-critical activities to India to reduce cost.

Benefits from Ineos

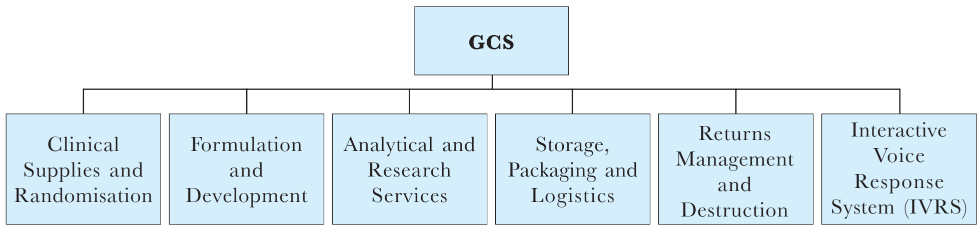
(US$ mn)	No change	Achieving target	Better performance
Multiplier effect – operational leverage kicking in	**Case I**	**Case II**	**Case III**
FY12E revenues – Assuming zero growth over FY11	325	325	325
OPM (%)	*5.0*	*8.5*	*10.0*
Operating profits	**16**	**28**	**33**
Depreciation	9	9	9
Interest cost	3	3	3
Other income	5	5	5
PBT	**10**	**21**	**26**
Tax – Assuming 20%	*2*	*4*	*5*
PAT	**8**	**17**	**21**
PAT in Rs/US$ – 45.5	**355**	**769**	**946**
No. of shares (mn)	23.5	23.5	23.5
Incremental EPS (Rs)	**15.1**	**32.7**	**40.3**

Source: B&K Research

Global clinical services – Currently small...big potential

Globally, complex clinical trial process necessitate CROs to focus on high end activities like patient enrollment, data management, documentation and hospitalisation, while outsourcing their basic clinical supplies needs to clinical trials service providers. Bilcare, with its specialised team, helps to accelerate clinical trials by catering to these specialised requirements of CROs and biotech companies through the following services. The company expects margins of 25%+ from this segment.

GCS business...good potential



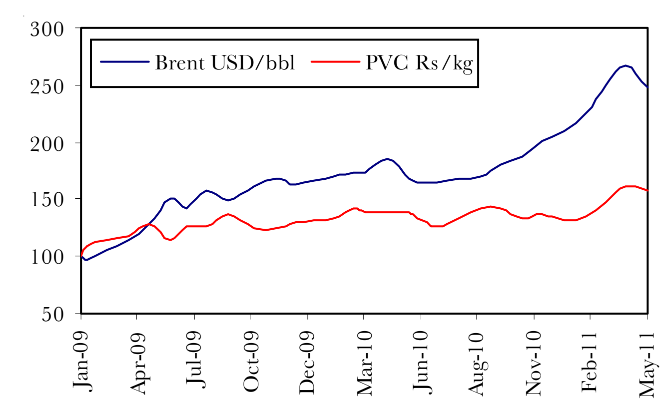
Source: Company, B&K Research

Key concerns

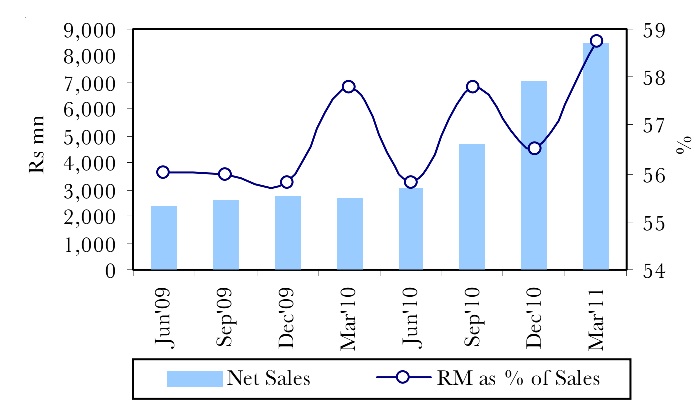
Rising crude prices would spike up the input costs

Raw materials comprise 60% of Bilcare's production costs. Owing to sharp movement in the prices of feedstock commodities like oil, domestic prices of PVC & PVDC (Polyvinyl chloride & Polyvinyl di-chloride) have remained volatile during the year. The company passes the increase in the price of raw materials to the buyer with a lag of three-four months.

Crude prices versus PVC prices



Raw material % of net sales (last eight quarters)



Source: B&K Research

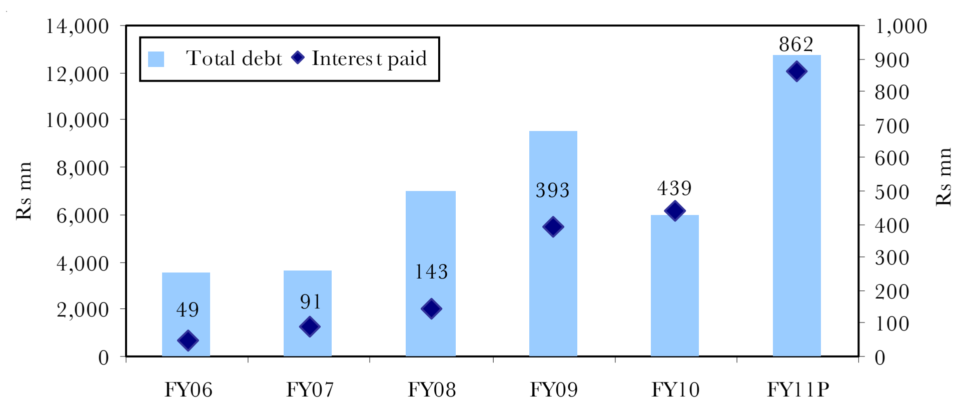
Increasing debt – Imperative to generate sufficient cash

The company has been increasing its debt from levels of Rs 2 bn in FY02 to Rs 12-13 bn in FY11, on account of expansion (both organic and inorganic). The company issued FCCBs worth US$ 50 mn in December 2005, which has been converted/repaid.

Further, Bilcare's Singapore subsidiary has created Foreign Currency Exchange Bonds (FCEB) in 2009 to the tune of US$ 54 mn (of which US$ 33 mn in GDRs and US$ 21 mn in equity). It currently has outstanding FCEB of US$ 39 mn (which has been accounted for in the current equity base) in the books of Monument PTE (SPV).

Apart from this, Bilcare recently raised around US$ 90 mn debt for the acquisition of Ineos. Currently a substantial portion is rupee denominated and hence the interest outgo on such debt is high. The management further plans to convert a part of this debt to ECBs (which would bring down the cost of borrowings).

Mounting debt and interest costs



Source: B&K Research

Asset utilisation needs to move upwards

Asset location	Utilisation (%)	Remarks
India	75	Continuous capex to increase capacities in Pune.
Singapore	50	Largest manufacturing base for PVDC, need for more volumes to create operational efficiencies.
US & EU	70	Higher asset base with acquisition of Ineos (eight new units). Plans are on to rationalise between these units.

Stretched working capital

Bilcare has high debtor days (currently 120 days). It is making efforts to reduce the working capital cycle to free cash flows. The management expects to bring down the debtor days from its current levels of 120 to 90 days by FY13E/FY14E.

Declining return-ratios – Need to drive higher volumes

Bilcare over the past four-five years has been expanding its capacities/capabilities through both organic and inorganic route. With such addition in capacities, its asset turnover has over the years fallen from levels of 2 to ~0.7. This has significantly impacted the return ratios over the last four-five years.

Continuous equity dilution

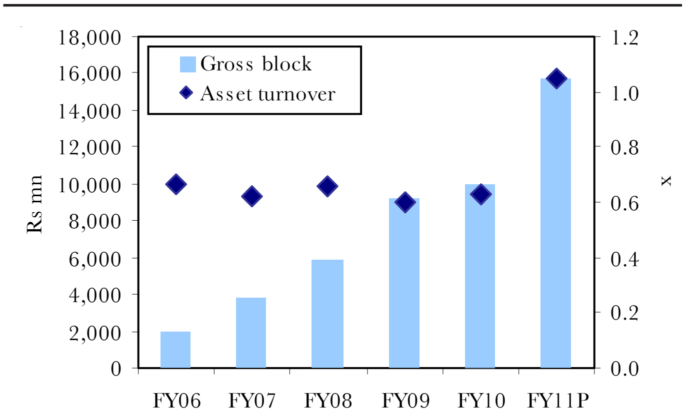
Bilcare has engaged in various activities resulting in equity dilution over the years. This has significantly impacted the EPS.

Constant equity dilution

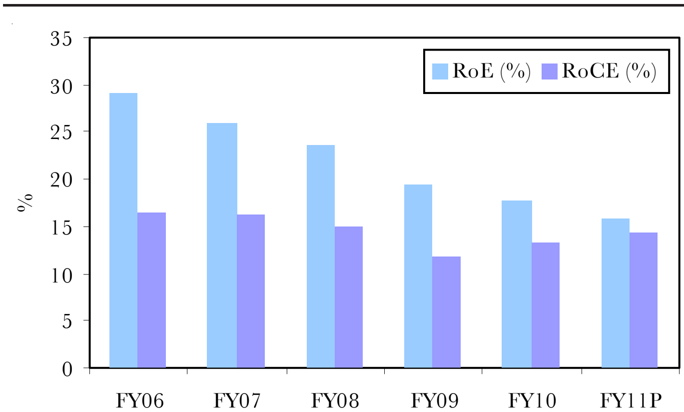
Date	Equity capital	Reason
11/22/2010	23.55	Bond Conversion
11/16/2010	23.07	Bond Conversion
10/18/2010	22.78	Bond Conversion
03/31/2010	22.70	FCCB converted into equity shares at reset conversion price of Rs 483.28
03/17/2010	22.69	Bond Conversion
01/12/2010	20.19	GDRs
06/20/2008	17.21	Warrants Option Exercised
12/31/2007	16.45	Bond Conversion
12/26/2007	16.24	Bond Conversion
12/19/2007	16.15	Bond Conversion
12/17/2007	16.10	Bond Conversion
10/17/2007	16.02	Conversion of Warrents/Bonds
09/20/2007	15.25	Bond Conversion
07/30/2007	15.22	Bond Conversion
05/17/2007	15.09	Conversion of Warrants
03/22/2006	14.20	Conversion of Warrants
09/13/2004	13.31	Preferential Issue of Shares
05/24/2004	11.56	Warrants Option Exercised
03/31/2004	11.25	Preferential Issue of Shares
12/15/2003	9.85	Bonus Issue

Source: B&K Research

Gross block/Asset turnover



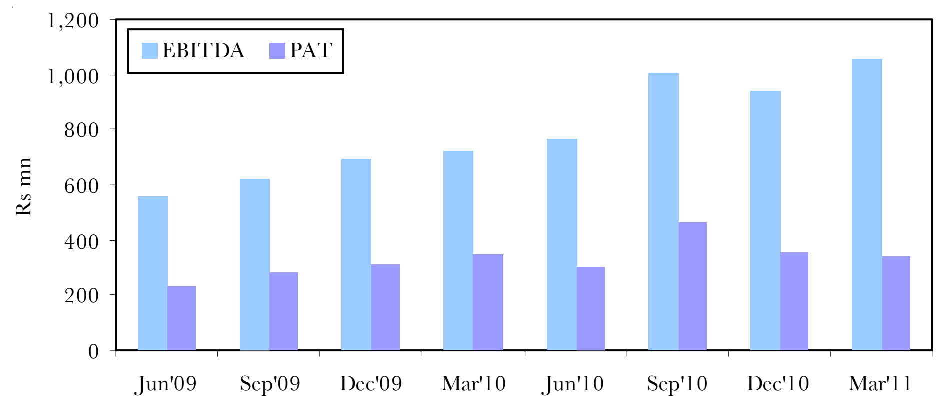
RoE versus RoCE



Source: B&K Research

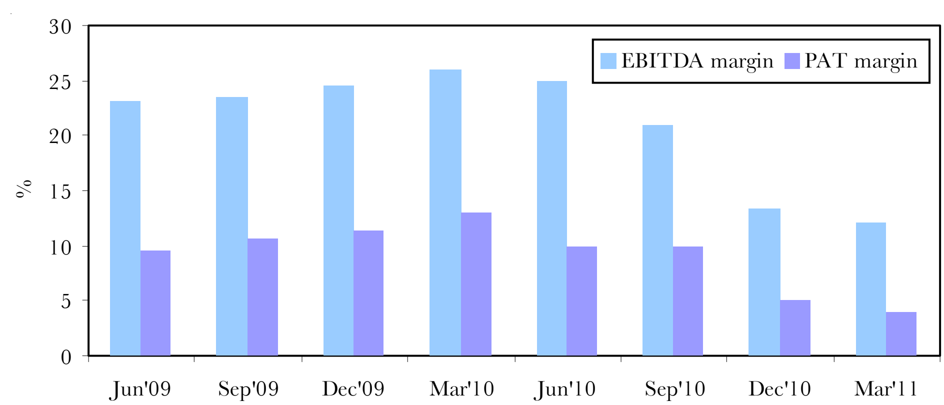
Financial performance

EBITDA and PAT quarterly



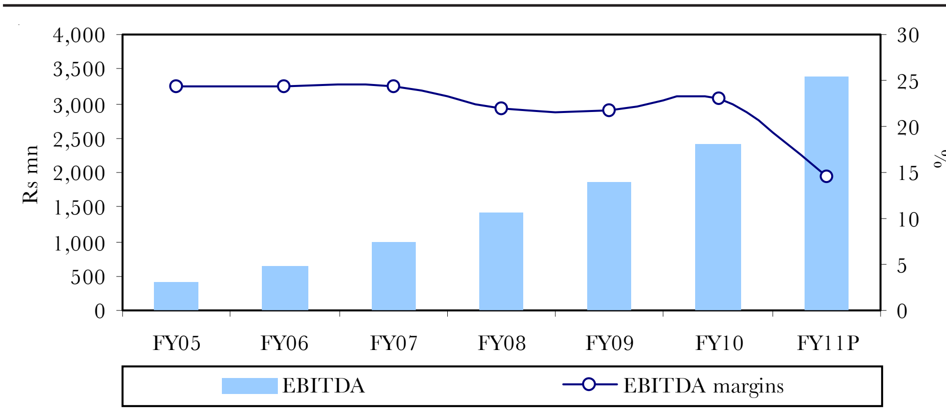
Source: B&K Research

EBITDA margins versus PAT margins



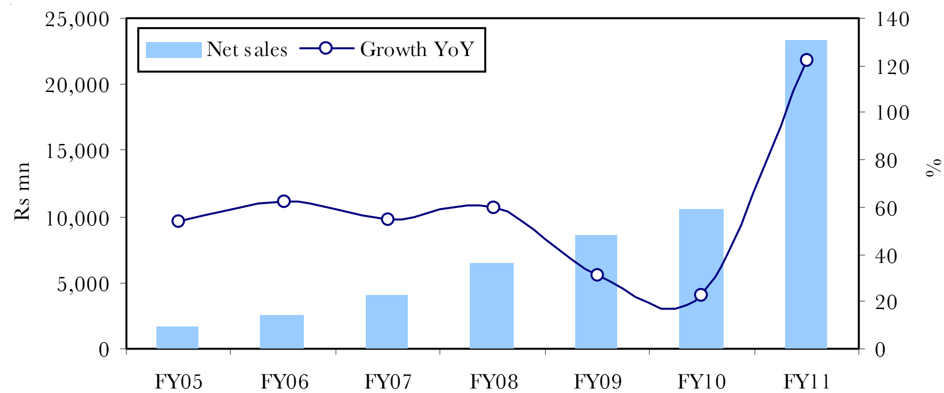
Source: B&K Research

(FY05-11)...EBITDA and EBITDA margins



Source: B&K Research

Last 5 years...Revenue mix and Growth



Source: B&K Research

Outlook and valuation

Bilcare is market leader in bilster packing, it with the acquisition of Ineos becomes more globally focused, 70% of its turnover comes from outside India.

On the international front, Bilcare competes with Klockner Pentaplast (manufactures polymer based materials) and Alcan (manufactures aluminum based materials) on the packaging front. On the services front (GCS business), it competes with Fisher, Aptuit and Almac.

Key positives/triggers for Bilcare

- Acquisition of Ineos makes Bilcare a global player and provides access to eight additional facilities worldwide. There are numerous synergies awaiting to play post the integration/ restructuring of Ineos.
- Pharma Focus (entire packaging solutions comes from pharma) where they have a dominant 62% share in India (Indian pharma market growing at 14%, one of the highest in the world).
- Singapore plant to cater to international markets (has faster turnaround time with state-of-the-art facilities). Further acquisition of Singular Id brings unique non-Clonable ID technology which would prevent spurious products not only in pharma but also across FMCG products.
- GCS is a niche segment and the company would cater to the international players. It provides services such as clinical supplies, randomisation, pre-formulation studies, analytical, storage, packaging and logistics which are normally carried out by the companies internally. Further, the company expects operating margins of ~25%+ from this space.
- Bilcare has entered into long-term contract with Wal-Mart, for its US$ 4 treatment per month programme providing for its private labeling requirements. This will be catered through its acquisition of international labs vide a 50:50 JV with Mead Westwaco.
- The company focuses more on the research front to provide packaging solutions to customers. The company has developed a 4 week programme for conducting stability study as compared to the usual six-nine months on account of its patented Bilcare Optima programme. Further it has developed products such as Patina (anti-counterfeiting), Duplex (PVC+PVDC), Triplex (PVC+PVDC+PE) which has been widely accepted by both global and domestic customers.

Key concerns

- High debtor days of 120 exerts pressure on the working capital cycle and hence continuous need for raising working capital debt.
- Increasing debt from Rs 2 bn in FY02 to Rs 12 bn in FY11 on account of various expansion plans (both organic as well as inorganic). The debt-to-equity currently stands at 1.2x which is on the higher side (hence imperative to start generating cash).
- Reducing return ratios on account of increasing equity base couple with lower capacity utilisation.

A the current market price of Rs 369, the stock trades at 5.5x FY12E EPS (consensus) of Rs 66.5 and 4.8x FY13E EPS (consensus) of Rs 76.8. We do not have any rating on the stock.

Industry overview

The pharmaceutical packaging industry has undergone a colossal change in the past few years. From loose packing, strip packing and blister packing to Alu-Alu packing, there's a wide range of packaging options available now in plastic, glass, aluminium, PET bottles or paper form. Packaging is now considered as an initial stage in the development of a drug and not merely a final stage in manufacturing.

World over packaging, is designed to address issues like low shelf life, impurities or moisture in the products leading to development of toxicity, over packaging or under packaging of tablets, erroneous labeling and printing, etc. These factors lead to a rising number of product recalls and delay in the clinical approval process, which increase the costs of pharmaceutical companies and impacts their profitability. As these factors became more palpable, companies have started focusing more on their packaging aspect. The global Pharma packaging industry size is nearly 1% of the global Pharma market of US$ 880 bn i.e. around US$ 8-9 bn.

Blister packaging

Within the pharmaceutical packaging segment, blister packing is expected to witness the highest growth momentum, influenced by innovations in materials and design, rising use of unit dose format, ease of use in clinical trials, need for patient drug compliance and favourable government regulations. In the blister segment, PVC is the most widely used material, due to its strong barrier properties and cost advantage.

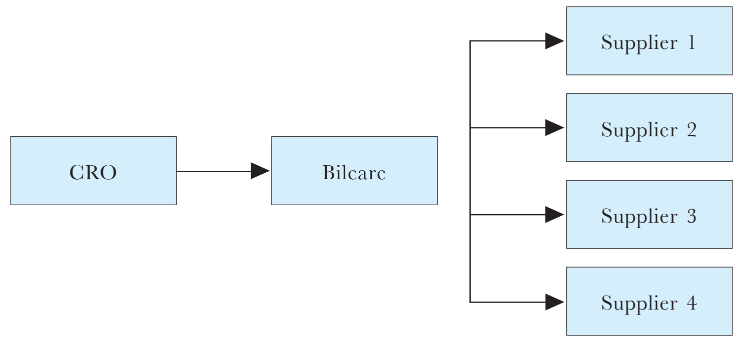
Also, complex nature of clinical trials across the globe, are compelling pharmaceutical companies to outsource their clinical trial activities to low cost destinations like India and china. In order to achieve major cost savings, MNC pharmaceutical companies are focusing on reducing the number of suppliers they work with.

Comprehensive requirements of clinical trials require CRO's and Biotech companies to focus on core activities like patient enrollment, data management, documentation, hospitalisation, etc, thereby outsourcing other specialised activities. In response, pharmaceutical companies are seeking innovative methods to enhance supply chain efficiency and are increasingly looking to clinical trials service providers for total management of their clinical supplies needs.

Clinical Supplies Management

Bilcare acts as a single source provider for all the project needs. This would enable the global pharma companies and CROs to concentrate on their core research work, while Bilcare would take care of activities such as sourcing the materials from various suppliers and make materials available to the pharmaceutical companies adhering to schedule and quality. Hence significant amount of time, effort and costs could be saved by the CROs and pharmaceutical companies.

Supply management



Source: B&K Research

Randomisation

Clinical trials involve blind tests administered to patients. The medicines consumed could be a genuine or a placebo. Bilcare provides randomisation services to the pharmaceutical and CRO companies. This activity needs to be done without error as the results of the test conducted would determine the efficacy of the drug.

Formulation and development

- **Pre-formulation:** Bilcare deals with studying and analysing the physical property, product characterisation, chemical compatibility, accelerated degradation studies and excipient compatibility studies.
- **Formulation development:** These activities deal with analysing the blending time required for tableting and encapsulation, developing suitable means of blinding comparators and developing matching placebo.

Analytical and Research Services

The company tests and analyses the results at all stages involved in the entire cycle of the clinical trial material.

- **Stability test:** Analysis regarding the core stability of the new drug substance and products under various practical situations and specific considerations and characteristics of the drug is being evaluated.
- **Stress testing:** This is used along the stability testing. Stress testing reveals details regarding the likely degradation of the drug under various other circumstances. Hydrolysis testing and photo stability testing is an integral part of stress testing. Results from these studies will form an integral part of the information provided to regulatory authorities.
- **Release testing:** The aims of this study are to evaluate the pharmacokinetics; safety and tolerability of the molecule under various forms top decide the form most suited for the drug.

Storage

The company undertakes storage of specific products as per pre-conditions mentioned. Different products based on their composition needs to be stored in specific environmental conditions such as regulated temperature, humidity and dust levels. Bilcare has facility to store drugs at temperatures as low as – 30 degrees Celsius and maintains a dust proof environment. Each compartment in the storage location is allocated for the specific drug based on the requirements.

Packaging

Packaging solutions required for clinical trials are much different from packaging solutions given for the final drug. Bilcare provides solutions to select the right packaging materials, complete production an delivers meeting standards given through comprehensive packaging research and innovative clinical trial packaging materials. The materials used are bottle, blisters, pouch, and blister card in liquid, semi liquid and powder form.

Labeling

Bilcare provides support with the following labeling services and innovations for the product.

- Label design and generation.
- Label production and printing.
- Text translation support.
- Label application and kit assembly

Logistics and distribution

Bilcare has the facility to ship the product worldwide. The company assigns a specific technicians and project managers for the product. The project manager would be responsible for timely delivery and available to update the company throughout the period.

Returns management and destruction services

Management of a product recall is an important activity involved with the company. The activities that Bilcare undertakes include:

- Customer and project specific returns and reconciliation protocols.
- Ample and secured storage.
- Regulatory compliance and documentation support.
- Updated and complete documentation on destruction.

Income Statement

Yr end 31 Mar (Rs mn)	FY08	FY09	FY10	FY11
Net sales	**6,507**	**8,560**	**10,478**	**23,285**
Growth (%)	*59.5*	*31.6*	*22.4*	*122.2*
Operating expenses	(5,072)	(6,695)	(8,059)	(19,893)
Operating profit	1,435	1,865	2,419	3,392
EBITDA	**1,435**	**1,865**	**2,419**	**3,392**
Growth (%)	*44.7*	*30.0*	*29.7*	*40.2*
Depreciation	(242)	(378)	(535)	(932)
Other income	192	77	180	369
EBIT	**1,386**	**1,564**	**2,064**	**2,829**
Interest paid	(143)	(393)	(439)	(862)
Pre-tax profit (before non-recurring)	1,243	1,171	1,625	1,967
Pre-tax profit (after non-recurring)	1,243	1,171	1,625	1,967
Tax (current + deferred)	(427)	(342)	(455)	(502)
Net profit (before Minority Interest, Pref. Dividend, etc.)	816	829	1,169	1,465
Reported PAT	816	829	1,169	1,465
Adjusted net profit	**816**	**829**	**1,169**	**1,465**
Growth (%)	*39.1*	*1.7*	*41.0*	*25.3*

Balance Sheet

Yr end 31 Mar (Rs mn)	FY08	FY09	FY10	FY11P
Cash & marketable securities	1,566	1,053	1,516	1,010
Other current assets	3,673	5,430	6,705	12,509
Investments	1,362	1,455	0	0
Net fixed assets	5,682	8,444	8,879	13,701
Total assets	**12,283**	**16,381**	**17,100**	**27,220**
Current liabilities	812	1,168	1,481	3,282
Total debt	7,037	9,505	5,993	12,699
Other non-current liabilities	630	984	1,171	1,171
Total liabilities	**8,479**	**11,657**	**8,645**	**17,152**
Share capital	165	172	227	235
Reserves & surplus	3,895	4,788	8,500	10,105
Less: Misc. expenditure	(255)	(235)	(272)	(272)
Shareholders' funds	**3,805**	**4,725**	**8,455**	**10,068**
Total equity & liabilities	**12,283**	**16,381**	**17,100**	**27,220**
Capital employed	**11,472**	**15,213**	**15,619**	**23,938**

Cash Flow Statement

Yr end 31 Mar (Rs mn)	FY08	FY09	FY10	FY11P
Pre-tax profit	1,243	1,171	1,625	1,967
Depreciation	242	378	535	932
Change in working capital	(1,151)	(1,342)	(1,001)	(4,046)
Total tax paid	(247)	(16)	(245)	(502)
Cash flow from oper. (a)	**86**	**191**	**914**	**(1,650)**
Capital expenditure	(2,404)	(3,118)	(916)	(5,754)
Change in investments	(495)	(93)	1,455	0
Others	(243)	(2)	(92)	0
Cash flow from inv. (b)	**(3,143)**	**(3,212)**	**446**	**(5,754)**
Free cash flow (a+b)	**(3,056)**	**(3,022)**	**1,360**	**(7,403)**
Equity raised/(repaid)	1,124	403	2,733	9
Debt raised/(repaid)	3,422	2,468	(3,511)	6,705
Dividend (incl. tax)	(71)	(81)	(50)	(66)
Others	(927)	0	0	0
Cash flow from fin. (c)	**3,548**	**2,791**	**(828)**	**6,648**
Net chg in cash (a+b+c)	**492**	**(231)**	**532**	**(756)**

Key Ratios

Yr end 31 Mar (%)	FY08	FY09	FY10	FY11P
Adjusted EPS (Rs)	49.6	48.2	51.5	62.2
Growth	20.1	(2.8)	7.0	20.7
Book NAV/share (Rs)	231.2	274.6	372.7	427.6
Dividend/share (Rs)	4.2	2.5	2.5	4.0
Dividend payout ratio	10.0	6.1	5.7	7.5
Tax	34.4	29.2	28.0	25.5
EBITDA margin	22.0	21.8	23.1	14.6
EBIT margin	21.3	18.3	19.7	12.2
RoCE	14.9	11.7	13.4	14.3
Net debt/Equity	143.8	178.9	53.0	116.1

Valuations

Yr end 31 Mar (x)	FY08	FY09	FY10	FY11P
PER	7.4	7.7	7.2	5.9
PCE	5.7	5.3	4.9	3.6
Price/Book	1.6	1.3	1.0	0.9
Yield (%)	1.1	0.7	0.7	1.1
EV/Net sales	2.0	1.8	1.4	0.7
EV/EBITDA	8.8	8.4	6.3	4.9

Du Pont Analysis – ROE

Yr end 31 Mar (x)	FY08	FY09	FY10	FY11P
Net margin (%)	12.5	9.7	11.2	6.3
Asset turnover	0.7	0.6	0.6	1.1
Leverage factor	2.9	3.4	2.5	2.4
Return on equity (%)	23.7	19.4	17.7	15.8

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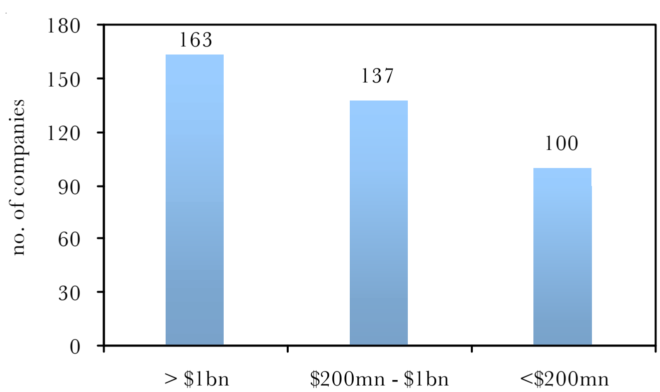
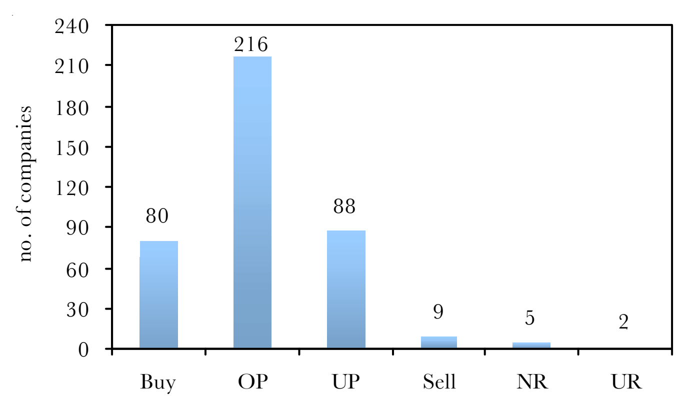
B&K Universe Profile

By Market Cap (US$ mn)



By Recommendation



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B&K Investment Ratings:

1. **BUY:** Potential upside of > +25% (absolute returns)
2. **OUTPERFORMER:** 0 to +25%
3. **UNDERPERFORMER:** 0 to -25%
4. **SELL:** Potential downside of < -25% (absolute returns)

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