



BROOKS LABORATORIES LIMITED

Issue Details

Brooks Laboratories Limited (Brooks) proposes to come out with an Initial Public Offer (IPO) of [*] equity shares of face value Rs. 10 each. The issue is being made through the Book Building Process, wherein not more than 50% of the Issue will be available for allocation on a proportionate basis to Qualified Institutional Bidders (QIBs), of which 5% shall be available for allocation on a proportionate basis to Mutual Funds only and the remainder shall be available for allocation on a proportionate basis to all QIB Bidders including Mutual Funds. Further, not less than 15% of the Net Issue will be available for allocation on a proportionate basis to Non-Institutional Bidders and not less than 35% of the Net Issue will be available for allocation on a proportionate basis to Retail individual bidders.

Proposed Use of IPO Proceeds

The IPO proceeds are proposed to be used primarily to:

- To set up our new manufacturing unit at JB SEZ Pvt Ltd, Panoli, Gujarat for manufacturing of various pharmaceuticals formulations.
- To meet Long Term Working Capital requirement
- To meet General Corporate Purpose
- To meet Issue Expenses and Listing of Shares on Stock Exchanges

Analyst Contacts:

Subrata Ray

subrata@icraindia.com
+91-22-3047 0027

Arvind V. Subramanian

arvind.subramanian@icraindia.com
+91-22-3048 1071

Relationship Contacts:

L. Shivakumar

shivakumar@icraindia.com
+91-22-3047 0005

Website:

www.icra.in

IPO Grading

ICRA has assigned an IPO Grade 2, indicating below average fundamentals, to the proposed initial public offering (IPO) of Brooks Laboratories Limited (Brooks). ICRA assigns IPO gradings on a scale of IPO Grade 5 to IPO Grade 1, with Grade 5 indicating strong fundamentals and Grade 1 indicating poor fundamentals.

An ICRA IPO Grade is a symbolic representation of ICRA's current assessment of the fundamentals of the issuer concerned. The fundamental factors assessed include, *inter alia*, business and competitive position, financial position and prospects, management quality, corporate governance, and history of compliance and litigation.

Disclaimer: Notwithstanding anything to the contrary: An ICRA IPO grade is a statement of current opinion of ICRA and is not a statement of appropriateness of the graded security for any of the investors. Such grade is assigned with due care and caution on the basis of analysis of information and clarifications obtained from the issuer concerned and also other sources considered reliable by ICRA. However, ICRA makes no representation or warranty, express or implied as to the accuracy, authenticity, timeliness, or completeness of such information. An ICRA IPO grade is not (a) a comment on the present or future price of the security concerned (b) a certificate of statutory compliance and/or (c) a credit rating. Further, the ICRA IPO grade is not a recommendation of any kind including but not limited to recommendation to buy, sell, or deal in the securities of such issuer nor can it be considered as an authentication of any of the financial statements of the company, and ICRA shall not be liable for any losses incurred by users from any use of the grade in any manner. It is advisable that the professional assistance be taken by any prospective investor in the securities of the company including in the fields of investment banking, tax or law while making such investment. All services and information provided by ICRA are provided on an "as is" basis, without representations and warranties of any nature.

Strengths

- Past track record of supplying pharmaceutical formulations to a fairly diversified customer base
- Improvement in profitability driven by manufacture of niche and differentiated products resulting in a high return on capital employed (RoCE)
- Established manufacturing capabilities with WHO-GMP approved plant located at Baddi, Himachal Pradesh

Concerns

- Small scale of operations limits economies of scale
- Domestic contract manufacturing industry characterised by high competitive intensity with pricing and quality being the key determinants in attracting new customers
- Project execution risk associated with Greenfield unit at Panoli, Gujarat
- Limited potential for revenue growth in the near term until commercialisation of new facility

Grading Rationale

The grading takes into account the past track record of the company in supplying pharmaceutical formulations to a fairly diversified customer base and the established manufacturing capabilities with a WHO-GMP approved plant located at Baddi, Himachal Pradesh. In the recent past, the company's profitability has witnessed a gradual improvement driven by increasing focus on manufacture of niche and differentiated products. The grading also factors in the small scale of operations having a single manufacturing facility and the highly competitive domestic contract manufacturing industry characterised by presence of numerous similar sized smaller players as well as large established players thereby resulting in heavy pricing pressure.

In order to begin catering to the export markets and augment manufacturing capacities, Brooks is proposing to setup a new manufacturing unit at JB SEZ Private Limited located at Panoli, Gujarat at an estimated cost of ~Rs. 60.0 crore to be funded entirely from the proceeds from the IPO. However, owing to the Greenfield nature of the project coupled with substantial time required for stabilisation of the manufacturing processes, the project execution risks remain high. Moreover, the company's ability to attract and partner clients in order to achieve sufficient orders in a highly competitive market and timely receipt of necessary approvals will also prove critical in attaining a strong revenue growth.

Company Profile

Brooks was incorporated on January 23, 2002 by Mr. Atul Ranchal and Mr. Rajesh Mahajan with the aim to set up a manufacturing facility for pharmaceutical formulations namely tablets, injections and dry syrups. Prior to this, the promoters were earlier involved in marketing of pharmaceutical products which they started in 1996. Subsequently in 2000, the promoters decided to enter into manufacturing of formulations and setup a manufacturing facility at Mohali, Punjab in their partnership firm named Brooks Pharmaceuticals. In order to expand their business and avail tax and other benefits extended by the Government to set up a manufacturing facility at Baddi, the promoters incorporated Brooks Laboratories Limited. The manufacturing facility at Baddi started commercial production in June 2006. In 2008, Brooks purchased certain assets from Brooks Pharmaceuticals (partnership firm promoted by Mr. Atul Ranchal and Mr. Rajesh Mahajan) at book value post which Brooks Pharmaceuticals ceased operations.

Brooks reported a net profit of Rs. 5.2 crore in FY 2010 on an operating income of Rs. 45.1 crore as compared to a net profit of Rs. 3.0 crore in the previous year on an operating income of Rs. 45.0 crore. For the six months ended 30th September 2010, the company reported a net profit of Rs. 3.2 crore on an operating income of Rs. 25.1 crore.

Promoters and Management

The shareholding pattern of Brooks pre-IPO and post-IPO issue is given in Table 1 below.

Table 1: Shareholding Pattern of Brooks (pre-IPO and post-IPO)

Category	Pre-Issue		Post IPO-Scenario	
	No. of Shares	%	No. of Shares	%
Promoter & Promoter Group	9,836,422	99.50%	9,836,422	[*]
Employees	50,000	0.50%	50,000	[*]
Public	0	0.00%	[*]	[*]
Total Shares	9,886,422	100.00%	[*]	100.00%

(Source: Draft Red Herring Prospectus)

Brooks is closely held by the promoter and promoter group who together account for 99.5% of the total equity shareholding. The founding promoters- Mr. Atul Ranchal and Mr. Rajesh Mahajan are the largest individual shareholders with a shareholding of 39.84% and 35.33% respectively. Both the promoters have prior experience in the pharmaceutical industry and are actively involved in the daily operations of the company.

The company's Board of Directors has six Directors, of which three are Independent Directors.

Business & Competitive Position

Engaged in providing contract manufacturing services to domestic pharmaceutical clients, scale of operations likely to remain modest in the near term

Brooks is currently engaged in providing contract manufacturing services from its WHO-GMP certified unit at Baddi, Himachal Pradesh. The company's product range includes dry powder injectables; ampoules and liquid vials; dry syrups and tablets catering largely to the antibiotic and anti-tuberculosis (anti-TB) therapeutic segments. The company caters principally to domestic pharmaceutical companies such as Aristo Pharmaceuticals Private Limited, Hetero Healthcare Limited, Zydus Cadila, Sanat Products Limited and Wockhardt Limited. In FY 2010, the top ten clients contributed 65.53% of total revenues for the company.

The offers contract manufacturing services to pharmaceutical companies for products which are newly launched in the market. Generally, pharmaceutical companies prefer to outsource the manufacturing of new products at the initial stage thereby lowering their upfront capital investment in addition to providing cost savings, and allowing them to focus solely on marketing and distribution. Brooks predominantly caters to such companies who are in the midst of launching a new product. As a result, the company also faces a continuous churn in customers since many products are taken in-house as the volumes begin to grow.

In addition to providing contract manufacturing services, the company also has a small presence in institutional sales which contributed ~Rs. 5 crore in FY 2010. These sales are targeted towards supplying products to Government Hospitals and are awarded through a tender process. Presently the company has won contracts with Government hospitals in the state of Tamil Nadu and Andhra Pradesh. Going forward, the contribution from this segment is expected to remain marginal as the company only participates in tenders for niche products wherein the competitive intensity is relatively lower.

The company's unit at Baddi, Himachal Pradesh is eligible for 100% tax holiday for the first five years starting from FY 2007 and 30% for the subsequent five years and full excise duty exemption for first ten years starting from FY 2007. Hence, the 100% tax exemption benefit is set to be withdrawn after FY 2011 thereby impacting the net profitability of the company. However, this could be offset by the tax exemptions which the company is eligible for at the proposed new facility at Panoli, Gujarat.

Highly competitive domestic contract manufacturing market thereby resulting in margin pressure

Brooks faces considerable competition in the domestic market from large number of similar sized players in a market wherein price and quality are the key determinants to attract and partner pharmaceutical companies. In addition, the company also faces competition from large and integrated contract research and manufacturing services (CRAMS) players who offer end to end solutions to customers encompassing R&D, API and formulation manufacturing services. As a result of the heightened competitive intensity, the ability of Brooks to supply products at economical prices while maintaining high quality standards will be the keys to sustaining a strong revenue growth. However, this is likely to result in extensive pressure on the operating margins in the future unless the company is able to continually develop differentiated product offerings in niche segments for its clients.

New manufacturing facility at Panoli, Gujarat in order to cater to the regulated markets; to be financed entirely from the proceeds of the IPO

In order to cater to the export markets and augment manufacturing capacities, Brooks is proposing to setup a new manufacturing unit at JB SEZ Private Limited located at Panoli, Gujarat. The estimated cost of the project is ~Rs. 60.0 crore to be funded entirely from the proceeds from the IPO. The company has already acquired the land for the project and expects to commence commercial production in December 2011. This manufacturing unit will be similar to the company's existing facility and will manufacture injectables, tablets and dry syrup formulations for the clients. However, unlike the Baddi facility which caters predominantly to the domestic and semi-regulated markets; the Panoli unit will seek approvals from WHO-GMP and EU-GMP in order to service clients in the regulated markets.

Table 2: Implementation schedule

Particulars	Month of Commencement	Month of Execution
Land Acquisition	January 2010	February 2011
Civil Work: Factory, administrative building etc.	March 2011	September 2011
Delivery of machinery & various other equipments	July 2011	September 2011
Installation & Commissioning of plant	August 2011	October 2011
Trial Run	October 2011	November 2011
Commencement of commercial production	November 2011	December 2011

(Source: Draft Red Herring Prospectus)

Owing to the Greenfield nature of the project coupled with substantial time required for stabilisation of the manufacturing processes, the project execution risks remain high. Moreover, the company's ability to attract and partner clients in order to achieve sufficient orders in a highly competitive market and timely receipt of necessary approvals will also prove critical in attaining a strong revenue growth.

Financial Position

Improvement in profitability witnessed in recent years owing to better product mix

Table 3: Revenue and profitability indicators

Particulars (Rs. crore)	FY 2007	FY 2008	FY 2009	FY 2010	6m, FY 2011
Operating Income	23.3	28.2	45.0	45.1	25.1
Growth (%)		20.8%	59.6%	0.2%	
OPBDITA	2.4	5.4	5.8	7.4	4.5
OPBDITA/OI (%)	10.4%	19.3%	12.8%	16.4%	17.8%
PAT	1.1	3.6	3.0	5.2	3.2
PAT/OI (%)	4.8%	12.7%	6.6%	11.5%	12.6%
EPS (Rs./share)	17.8	56.5	11.5	11.2	
EPS Growth (%)		218.2%	-79.7%	-2.5%	
NCA	1.4	4.0	3.4	5.7	3.5
RoCE (%)	42.7%	35.7%	24.6%	27.3%	30.3%
RoNW (%)	114.0%	101.7%	43.3%	47.4%	41.8%

Y-o-Y: Year-on-Year, OI: Operating Income; OPBDITA: Operating Profit before Depreciation, Interest, Taxes and Amortisation; PAT: Profit After Tax; RONW: Return on Net Worth; ROCE: Return on Capital Employed

Brooks operates a single manufacturing facility at Baddi for servicing the manufacturing requirements of clients. The company's facility is currently operating at near optimal levels except for the dry syrups and tablet division wherein the capacity remains underutilised. Hence, the potential for further revenue growth in the short term is likely to be modest. In the medium term, the company proposes to setup a new manufacturing facility at Panoli, Gujarat to cater to the international markets and the timely execution of this project (expected to be commissioned in December 2011) will be a key revenue growth driver for the company in the future. The operating margins of the company have been volatile in the past, largely owing to volatility in key raw material prices while the improvement in profitability witnessed in recent years has been largely driven by a better product mix with increased sales of niche products having higher realisations.

Moderate gearing provides financial flexibility to also raise debt to fund capacity expansion

Table 4: Capital structure

Particulars (Rs. crore)	FY 2007	FY 2008	FY 2009	FY 2010	6m, FY 2011
Total Debt	8.0	12.4	16.1	11.8	11.2
Tangible Net worth	1.7	5.3	8.4	13.6	16.7
Total Debt/ Net Worth	4.7	2.3	1.9	0.9	0.7
TD/ OPBDITA	3.3	2.3	2.8	1.6	1.3

Brook's debt profile consists almost entirely of working capital loans with minimal dependence on term loans to fund capital expenditure. As a result, the company's capital structure is fairly strong with a moderate gearing of 0.7x as on 30th September 2010. This provides the company with some financial flexibility to raise fresh term loans to partly fund the company's capacity expansion plans.

Working capital intensity remains fairly low

Table 5: Working capital indicators

Particulars (Rs. crore)	FY 2007	FY 2008	FY 2009	FY 2010	6m, FY 2011
Debtor Days	38	53	58	69	78
Payable Days	76	110	59	95	96
Inventory Days	36	80	34	48	33
NWC/OI (%)	7%	13%	13%	13%	16%

The company's working capital intensity is low with an NWC/OI of 16% owing to maintenance of low inventory levels and timely payments from customers. On an average the company offers credit of 60-90 days to domestic customers.

Contingent Liabilities

The company has no contingent liabilities outstanding as on 30th September 2010.

Corporate governance

The company has a board constituted in compliance with the Companies Act. The company's Board currently comprises six directors, of which three are independent directors. In terms of the clause 49 of the listing agreement, the company has also constituted the following committees:

- Audit Committee
- Remuneration Committee
- Shareholders/Investors Grievance Committee
- IPO Committee

Compliance and Litigation History

- There are three litigations pending against the company all of which are under the Drugs and Cosmetics Act, 1940 pertaining to substandard quality of certain drugs manufactured by Brooks.
- There is another potential litigation against the company having received a legal notice from ICMC Corporation for supply of substandard products.

February 2011

**ICRA Limited**

An Associate of Moody's Investors Service

CORPORATE OFFICE

Building No. 8, 2nd Floor, Tower A, DLF Cyber City, Phase II, Gurgaon – 122 002

Tel.: +91 124 4545300; Fax: +91 124 4545 350

Email: info@icraindia.com Website: www.icra.in

REGISTERED OFFICE

1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001

Tel.: +91 11 23357940-50; Fax: +91 11 23357014

Branches: **Mumbai:** Tel.: + (91 22) 24331046/53/62/74/86/87, Fax: + (91 22) 2433 1390 **Chennai:** Tel + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294, Fax + (91 44) 2434 3663 **Kolkata:** Tel + (91 33) 2287 0450, 2240 6617/8839, 2280 0008, Fax + (91 33) 2287 0728 **Bangalore:** Tel + (91 80) 2559 7401/4049 Fax + (91 80) 559 4065 **Ahmedabad:** Tel + (91 79) 2658 4924/5049/2008, Fax + (91 79) 2658 4924 **Hyderabad:** Tel +(91 40) 2373 5061/7251, Fax + (91 40) 2373 5152 **Pune:** Tel + (91 20) 2552 0194/95/96, Fax + (91 20) 2553 9231
