

Annexure - I

Rationale

Parabolic Drugs Ltd.

IPO Grading

CARE IPO Grade 2

CARE has assigned '**CARE IPO Grade 2**' to the proposed Initial Public Offer (IPO) of Parabolic Drugs Ltd. (PDL). CARE IPO Grade 2 indicates 'Below Average Fundamentals'. **CARE assigns IPO grade on a scale of Grade 5 to Grade 1, with Grade 5 indicating strong fundamentals and Grade 1 indicating poor fundamentals.** CARE's IPO grading is an opinion on the fundamentals of the issuer. The grade assigned to any individual issue represents a relative assessment of the fundamentals of the issuer. PDL proposes an IPO aggregating up to Rs.200 cr, each share having a face value of Rs.10 per share.

The grading is constrained by PDL's unfavourable capital structure, project stabilization risk, volatility in prices of imported raw material along-with exposure to exchange risk on account of imports and liabilities denominated in foreign currency, though partially mitigated because of direct exports. The grading factors in the strong growth in revenue reported in past, experienced management, approvals and certificates of suitability for few products from regulatory authorities in USA, EU and other regulated markets, reputed client base, strong focus on R&D activities and the company's strategy to diversify into CRAMS business.

Background

PDL was incorporated as a public limited company in 1996 promoted by Mr. Pranav Gupta and Mr. Vineet Gupta, with financial assistance from Punjab State Industrial Development Corporation (PSIDC).

In FY07, M/s Minivet Ltd and M/s Exquisite Result International Ltd invested an aggregate amount of Rs.9 cr in convertible preference shares in PDL which were converted into equity shares in FY08. In April 2008, BTS India Private Equity Fund Ltd (BTS), a Swiss Private Equity Fund invested Rs.25 cr in convertible preference shares in PDL which were converted into equity shares in September 2009.

Promoters & Management

The Board of PDL comprises 8 members, including 3 Independent Directors and one nominee Director of BTS. Mr. Pranav Gupta, the promoter and the Managing Director of PDL, is actively involved in day to day operations of the company specifically involved in production, finance and technology related areas. The promoters and promoter group held 63.20% shareholding in the company as on Jan 22, 2010.

Operations

PDL commenced operations as a manufacturer of Active Pharmaceutical Ingredients (APIs) and Intermediates of Oral Semi-Synthetic-Penicillin (SSP), a class of antibiotics, in 1998. It was primarily involved in the contract manufacturing (for a few leading pharma companies), at its manufacturing facility located in Derabassi, Punjab. In 2004, PDL commissioned a new manufacturing facility in Panchkula, Haryana for manufacturing 6-APA, an API Intermediate.

PDL has the United States Food and Drug Administration (USFDA) approval for supplying 6-APA to the USA market. PDL has also been granted Certificates of Suitability by European Directorate for the Quality of Medicines (EDQM) for two of its products ie Amoxycillin Trihydrate and Flucloxacillin Sodium. The manufacturing site at Derabassi, Punjab has been accredited with the WHO Good Manufacturing Practice (GMP) certificate by the Central Drugs Standards Control Organization, DGHS, Ministry of Health & Family Welfare and ISO 14001:2004 certificate for meeting the Environmental Management System Standards. As on February 25, 2010, PDL had filed 17 Drug Master Files (DMF) applications in EU, US and other markets. PDL has also filed nine provisional patent applications with the Indian Patent Office.

Over the years, PDL diversified its client and revenue base and added high-margin products including Oral Cephalosporin (a class of antibiotics) and Sterile (Injectible) Products (of both SSPs and Cephalosporin type) in the calendar years 2005 and 2007 respectively. In FY09, Oral SSPs and Oral Cephalosporins contributed to 41% and 28% of the revenue respectively. The balance was contributed by API Intermediates (15%), Sterile Products (11%) and others (4%).

PDL has completed the setting up of a state-of-the-art R&D centre at Barwala, Haryana in Jan'10 to gain entry in Contract Research and Manufacturing Services (CRAMS) business and expand in-house research activities. PDL has also completed the up-gradation work at the existing Plants in Derabassi, Punjab and Panchkula, Haryana as per US FDA standards.

PDL plans to further diversify its product base and is setting up a facility for the manufacturing of Non-Beta Lactam APIs at Lalru, Punjab. PDL is also undertaking the expansion in the current facility at Derabassi, Punjab which includes setting up a block for the manufacture of new Cephalosporin products i.e. Cefdinir, Cefprozil etc. Thus, PDL is exposed to project related risk for completion with aggregate project cost of Rs.73.36 cr to be funded through Debt:Equity (D:E) mix of 2.37:1. The financial closure for all these projects has been achieved.

Corporate Governance

The Board of PDL comprises 8 members, including 3 Independent Directors, 1 nominee Director of BTS, and 2 promoter directors Mr. Pranav Gupta, and Mr. Vineet Gupta who look after the day to day operations of PDL. The total shareholding of promoters and promoter group in PDL was 63.20% as on Jan 22, 2010. There is not much separation in the ownership and management of PDL.

The company has complied with Securities & Exchange Board of India (SEBI) guidelines in respect of Corporate Governance including appointment of independent Directors and constituting committees such as Audit Committee, Remuneration Committee and Share Holders'/Investors' Grievances Committee.

Conflict of interest with Promoters and Group entities

Parabolic Labs Ltd (a subsidiary of PDL) and PNG Trading Pvt Ltd (a group entity) is authorized under its Articles of Association to engage in similar business as PDL. The concerned companies have no significant operations and as and when any conflicts or competition may arise, PDL's Board shall determine appropriate conflict management policies in accordance with applicable law.

Contingent Liabilities

The contingent liabilities of PDL were reported at Rs.102.55 cr as on September 30, 2009 out of which a major part (Rs.99.36 cr) was on account of Letter of Credit.

Pending Legal cases

As disclosed in Draft Red Herring Prospectus (DHRP), except for the 7 statutory notices from Central Excise and Income Tax authorities and a civil case, PDL has no significant outstanding litigations.

IPO Issue

PDL proposes an IPO aggregating up to Rs.200 cr having a face value of Rs.10 per share and an Offer for Sale of 20,25,702 Equity Shares by the Selling Shareholders. The Offer for Sale comprises an offer for sale of 15,33,742 and 4,91,960 Equity Shares, by BTS and Alden Global Mauritius Limited, respectively. The Issue comprises an Employee Reservation Portion of up to 5,00,000 Equity Shares for subscription by Eligible Employees. PDL is considering a Pre-IPO Placement of up to Rs. 50 cr with certain investors. The Pre-IPO Placement is at the discretion of PDL.

The *objects of the issue* are:

- Establishment of Multi-purpose block III at Derabassi, Punjab (Rs.20.32 cr)
- Establishment of Sterile cephalosporin plant at Derabassi, Punjab (Rs.32.55 cr)
- Establishment of Chachrauli plant at Lalru, Punjab (Rs.16.04 cr)
- Establishment of Custom synthesis and manufacturing site II at IT Park, Panchkula, Haryana (Rs.46.62 cr)
- Repayment / prepayment of identified loan facilities (Rs.37.71 cr)
- General corporate purposes

Financial Performance

During the period FY 2006-2009, PDL's operating income has grown at a healthy Compounded Annual Growth Rate (CAGR) of 64.66% on account of introduction of expanded product range including Oral Cephalosporin and Sterile (Injectible) products and expansion of existing facilities.

PDL's PBILDT margin declined marginally in FY09 on account of the more-than-proportionate increase in raw material prices from the exchange fluctuation in FY09 (PDL imports around 60-70% of its raw material requirements). PAT margin declined in FY09 on account of increase in interest charges on additional working capital borrowings

and term loans, and losses on derivative contracts. The realized loss on derivative contracts was reported at Rs.4.66 cr for FY09.

In FY07, M/s. Minivet Ltd and M/s Exquisite Result International Ltd invested Rs.4 cr and Rs.5cr respectively as convertible preference shares in PDL. In FY08, these preference shares were converted into equity shares and allotted to M/s. Minivet Ltd and M/s. Exquisite Result International Ltd. However, the increased profitability resulted in an increase in EPS in FY08.

In FY09, BTS India Private Equity Fund Ltd, a Swiss Private Equity Fund invested Rs.25 cr as convertible preference shares in PDL. The lower profitability along with infusion of funds by BTS resulted in decline in RONW in FY09. In Sep'09, these preference shares were converted into equity shares and allotted to BTS.

The overall gearing ratio remained high, though it improved marginally as on March 31, 2009 on account of infusion of convertible preference shares in FY09 by BTS. The interest coverage ratio declined in FY09 on account of higher interest charges.

The liquidity position as indicated by the current ratio was barely above unity as on March 31, 2009 on account of increase in creditors for supply of raw materials. PDL's liquidity remained stretched in FY09 on account of delay in realization of payments from export sales due to global economic crisis and credit squeeze. This has resulted in an elongated operating cycle in FY09.

In 9MFY10, PDL has reported the total operating income of Rs.346 cr. The increase in sales is mainly on account of increase in volume sales from the Cephalosporin segment. The PBILDT margin has improved to 18.58% in 9MFY10 on account of increase in concentration of high margin products in sales of Cephalosporin segment. The PAT Margin has improved to 6.43% in 9MFY10.

Industry

The Indian Pharmaceutical Industry (IPI), valued at around US\$ 20 bn (~ Rs.95,000 crore), is ranked 11th in value terms and 4th in volume terms in the world. The industry has been growing at a healthy rate of 11-12% annually over the last few years with the growth in exports outstripping steady growth in the domestic market.

Exports, which constituted 41% of IPI's FY09 sales, have shown a robust growth of nearly 22% per annum over the five years period preceding FY09. Share of exports to regulated markets of North America and Europe was 21% and 24% respectively in FY09

and the same has seen an increasing trend over the past few years. This can be primarily attributed to increasing generalization in the regulated markets and growing trend in outsourcing of pharmaceutical production by global pharma companies to low cost destinations like India.

The Indian API manufacturing industry is currently the third largest in the world and is expected to generate sales of US\$ 4.83 bn by CY2010 from approximately US\$ 2.00 bn in CY2005, representing a CAGR of 19.28%.

India has a large number of world-class pharmaceutical manufacturing facilities, large patient population and cheap skilled manpower. All these attributes are attracting big global innovator and generic pharmaceutical companies to tie-up with Indian companies for production of formulations, bulk drugs and intermediates and also for conducting clinical research. This trend is catching up as big global companies are shifting focus to high-value operations like marketing and shifting the manufacturing operations to low-cost destinations like India and China. The global CRAMS market is estimated at US\$25-30 bn and is set to grow to US\$45 bn by 2010. It is estimated that the industry will generate US\$3 bn in revenues by 2012.

Going forward, the key drivers for IPI's growth would be the large generic opportunity arising out of significant patent expiries in the regulated markets (drugs worth ~US\$ 250 bn in sales are expected to go off-patent by 2015), opportunity presented by biosimilars and outsourcing by global pharma companies.

Prospects

The strategy to diversify into CRAMS business augur well for PDL as API companies are better placed to take advantage of CRAMS opportunity from regulated markets. However, PDL's prospects would be driven by successful stabilization of its recently completed and on-going capital expenditure program, performance of new product segments, and management of foreign exchange risk and liquidity position.

Financial Results

(Rs. Crore)

For the period ended / as at Mar.31,

2007 2008 2009
(12m, A) (12m, A) (12m, A)

Working Results

Net Sales	149	273	394
Total operating income	150	273	395
PBILDT	23	43	60
Interest	6	12	28
Depreciation	1	2	4
PBT	16	30	30
PAT (after deferred tax)	14	25	24
Gross Cash Accruals*	11	29	23

Financial Position

Equity Share Capital	8	10	11
Networth**	35	66	111
Total Capital Employed	104	225	375

Key Ratios

Growth

Growth in Total Op. Income (%)	69.73	82.04	44.49
Growth in PAT (after D.Tax) (%)	68.71	80.84	-3.64

Profitability

PBILDT/Total Op. income (%)	15.08	15.84	15.15
PAT (after deferred tax)/ Total income (%)	9.22	9.16	6.09
ROCE (%)	27.36	25.56	19.42
RONW (%)	55.04	50.12	27.42
EPS	18.02	23.92	22.50
Average cost of borrowing (%)	10.50	10.57	13.38

Solvency

Long Term Debt Equity** (times)	0.55	0.62	0.40
Overall Gearing** (times)	2.01	2.43	2.38
Interest Coverage (times)	3.73	3.42	1.98

Liquidity

Current Ratio (times)	1.16	1.12	1.07
Quick Ratio (times)	0.57	0.57	0.52

Turnover

Average Collection Period (days)	70	80	97
Average Creditors (days)	64	63	78
Average Inventory (days)	122	126	159

Average Inventory (days)	122	126	159
Operating cycle (days)	128	143	178

**After deducting for miscellaneous expenditure (not written off or adjusted) which includes the gains/losses on derivative exposures, research and development expenses and preliminary expenses.*

*** Convertible Preference Shares in FY07 and FY09 have been treated as part of Networth*

DISCLAIMER:

CARE's IPO grading is a one time assessment and the analysis draws heavily from the information provided by the issuer as well as information obtained from sources believed by CARE to be accurate and reliable. However, CARE, does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. CARE's IPO grading does not take cognizance of the price of the security and it is not a recommendation to buy, sell or hold shares/securities. It is also not a comment on the offer price or the listed price of the scrip. It does not imply that CARE performs an audit function or forensic exercise to detect fraud. It is also not a forecast of the future market performance and the earnings prospects of the issuer; also it does not indicate compliance/violation of various statutory requirements. CARE shall not be liable for any losses incurred by users from any use of the IPO grading.

Annexure- II

Press Release

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Company Profile

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During the period FY 2006-2009, PDL's operating income has grown at a healthy CAGR of 64.66% on account of introduction of expanded product range including Oral Cephalosporin and Sterile (Injectible) products and expansion of existing facilities. PDL recorded operating income of Rs.395 crore with PBILDT and PAT of Rs.60 crore and Rs. 24 crore respectively in FY09.

In 9MFY10, PDL has reported a total operating income of Rs.346 cr, and earned PAT of Rs.23 cr.

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