

## **Parabolic Drugs Limited**

## **IPO Grading: BWR IPO Grade 3 (Average Fundamentals)**

Brickwork Ratings (BWR) has assigned BWR IPO Grade 3 to the proposed IPO of PARABOLIC DRUGS LIMITED (PDL). Brickwork Ratings' BWR IPO Grade 3 indicates average fundamentals for the issue in relation to the other listed equity securities in India. BWR assigns IPO grading on a scale of IPO Grade 5 to IPO Grade 1, with Grade 5 signifying strong fundamentals and Grade 1 signifies poor fundamentals of the issue in relation to the other listed equity securities in India.

The grading factors in PDL's well qualified Management and Board with substantial domain knowledge and experience, good corporate governance practices, significant R&D efforts, substantial growth in core sales, WHO-GMP (Good Manufacturing Practices) Accreditation to one of the facility, focus on Contract Research and Manufacturing Services (CRAMS) segment and focus towards entering regulated markets as key future strategies. The grading is constrained by company's track record of negative cash flows from operating activities, moderately diversified product portfolio, exposure to exchange rate risk, stringent norms for entering regulated markets and highly competitive industry especially in CRAMS segment. In absence of funding or appraisal by a bank or term lending institution, the project cost is estimated by the company management. Prior to issue, there has been a 2:1 bonus issue in Dec 2009 to promoters and other private investors.

### **Company Profile:**

Parabolic Drugs Limited was founded in 1996 by Mr. Pranav Gupta & Mr. Vineet Gupta, the first generation entrepreneurs. The commercial operations commenced in the year 1998 from Derabassi, Punjab. Spread over 21 acres, PDL's Derabassi facility has six manufacturing units and has been certified WHO – GMP (Good Manufacturing Practices) and ISO-14001 complaint. In 2005 company started another facility having two units at Panchkula, Haryana. PDL is engaged in manufacturing of *Active Pharmaceutical Ingredients* (APIs) and API Intermediates for the domestic and export markets. PDL currently has exports to approximately 45 countries. The overall product portfolio of PDL comprises of 42 APIs and seven API intermediates.

PDL has two R&D centers, one at Derabassi with chemical and analytical research laboratories with focus on developing non-infringing processes for new molecules, existing process improvements and production cost efficiencies. The other R&D centre is at Barwala, Haryana. In future Barwala centre will be developed as the core R&D center for PDL. On the back of substantial R&D efforts company has made eight applications for process patents, of which seven patent applications have been filed with the Indian Patent Office, and one international process patent for manufacturing Cefuroxime Axetil filed under the Patent Cooperation Treaty (the "PCT")

In addition, company is in the process of setting up more manufacturing facilities at Chachrauli, and Derabassi, to manufacture the non-antibiotic range of APIs, which is expected to commence commercial operations in the third quarter of fiscal 2011.

Company employees approximately 968 employees which include 81 scientists, 24 of whom hold PhDs.

## **Management:**

PDL was founded by Mr. Pranav Gupta, aged 42 years. He is the Managing Director of company and has over 18 years of experience in the pharmaceutical industry. He holds a bachelors' degree in mechanical engineering and a masters' degree in business administration from Kansas, USA. Before relocating to India in 1994 he worked with the Ford Motor Company, USA as a financial analyst.

Mr Vineet Gupta, aged 40 years, is a younger brother of Mr Pranav Gupta and is a Whole Time Director and promoter of company; he helps in developing future strategy and marketing network of PDL. He is also the promoter and director of Jamboree Education which is into coaching of GRE, GMAT, and TOEFL etc.

Mrs. Deepali Gupta aged 39 years, is wife of Mr Pranav Gupta, and promoter of PDL. She is a Dentist and was a Government doctor for 17 years. She has been instrumental in all major expansion projects of PDL including the new R&D center at Barwala. Her current responsibilities include heading PDL's project management team and negotiating and finalizing purchase orders.

PDL's organizational structure has strong second line of management comprising of significantly experienced professionals from pharmaceutical companies like Sun Pharma, Orchid Chemicals, Nectar Life sciences, J.K. Drugs & Pharmaceuticals Limited, Dabur India Limited, Kanasco Limited (USA), Ranbaxy Laboratories Limited etc.

The marketing team of PDL has approximately 18 persons. The team is headed by Mr Ajit Nigam, who has significant experience in Pharma and other companies like Ranbaxy Laboratories Limited, Oman Chemicals & Pharmaceuticals Limited (Oman), Max India Limited etc. The Managing Director heads the marketing efforts in regulated markets across the globe.

## **Directors other than promoters of company:**

**Dr. Inder Bir Singh Passi**, 70 years, is company's **Chairman and an independent Director**. He has Masters in mathematics from Punjab University, Ph.D. from the University of Exeter, UK and he is also a fellow of the Indian National Science Academy. Since 2005, he has been Professor Emeritus at Punjab University, Chandigarh. He is also a member of the editorial board of the Indian Journal of Pure and Applied Mathematics, a publication of the Indian National Science Academy. He has received many awards like Shanti Swarup Bhatnagar Prize for Mathematical Science in 1983 from the Council of Scientific and Industrial Research, the Meghnad Saha Award for Research in Theoretical Sciences in 1988 from the UGC, New Delhi, and the Distinguished Service Award in 2003 from the Mathematical Association of India.

**Dr. Ram Kumar**, 63 years, is an independent Director. He holds a bachelors' degree in medicine and a masters' degree in surgery and is an eye specialist. He is ex-President of the Chandigarh Ophthalmic Society. He has also authored various books in the field of medical science and has published articles in various newspapers.

**Mr. Pardeep Diwan**, 47 years, is an independent Director. Mr. Diwan holds a bachelors' degree in commerce from Punjab University, Chandigarh, and is a fellow of the Institute of Chartered Accountants of India. He is a practicing chartered accountant and is partner at the accounting firm of Vinod Kumar and Associates, Chartered Accountants. He has over 15 years of experience in the field of audit, income tax and company law.

**Mr. Arun Kumar Mathur**, 61 years, is a non-executive Director. He is a chemical engineering graduate from IIT, Kanpur and has over 35 years of experience in reputed pharmaceutical companies like Lupin, Ranbaxy Laboratories Limited as director - operations, Beximco Pharmaceuticals Limited and Matrix Laboratories Limited as global manufacturing head.

**Mr. Koppisetty Srinivas**, 46 years, is the Nominee Director. He graduated with a bachelors' degree in engineering and a masters' degree in business administration from Andhra University, Hyderabad. He has over 18 years of experience in the private equity industry and about four years experience in the airlines industry. Mr. Srinivas is the vice chairman and managing partner of BTS Investment Advisors Private Limited, a part of the BTS group of Switzerland.

**Table 1: Pre Issue vs. Post Issue holding structure (as on Jan 28, 2010)**

	Pre-Issue (%)	Pre-Issue No. of Shares	Post Issue* No. of Shares	Post Issue (%)	Post issue holding cost/share (Rs.)
Promoter and promoter Group	63.2%	2,35,45,020	[•]	~46.5%	~Rs 4 / Share
Private Investors	36.8%	1,37,06,029	[•]	~26.0%	~44.71/ Share
Public	--	--	[•]	~27.5%	
<b>Grand Total</b>	<b>100%</b>	<b>3,72,51,049</b>	<b>[•]</b>	<b>100%</b>	

~ indicates approximately

\*The final Post Issue Shareholding pattern will be determined after the Book-Building Process

### Objectives of the Issue:

Company is undertaking two expansion projects at existing facilities of Derabassi, and two green field projects at Chachrauli and Panchkula. Company will also be using part of IPO proceeds to repay loans taken from ICICI bank due to the high interest cost.

The expansion and green field projects will be constructed on existing land owned by the company. The company has not placed any orders for machinery and project appraisal is not done by any independent party. Company is planning to deploy approximately 70% of funds in FY11 and remaining in FY12.

**Table 2: Breakup of total project cost**

USE of IPO Proceeds		
Sl No	Particulars	Amount (in Cr)
1	Multi-purpose block III at Derabassi;	20.32
2	Sterile cephalosporin plant at Derabassi	32.55
3	Establishment of Chachrauli plant	16.03
4	Custom synthesis and manufacturing site II at IT Park, Panchkula	46.62
5	Repayment / prepayment of identified loan facilities	37.71
6	General corporate purposes	[.]
7	Issue Expenses	[.]
	<b>Total</b>	<b>~200</b>

Source: DRHP

### Project Funding:

To meet the funding requirements, Parabolic Drugs Ltd. plans to raise Rs. 200 Crores (including Issue Expenses) by way of Initial Public Offering of equity shares with Face Value of Rs.10/- at a premium to be decided later. The issue comprises a Fresh Issue of [•] equity shares inclusive of a reservation of 5, 00,000 equity shares for subscription by eligible employees, and an Offer for Sale of 20,25,702 shares by BTS India Private Equity Fund Limited (15,33,742 shares) and Alden Global Mauritius Limited (4,91,960 shares).

The Promoters, together with the Promoter Group own approximately 63.20% of the paid-up capital of the company. The total post-issue dilution (including Promoter Group and Selling Shareholders) is expected to be in the range of 25 – 30 %. An aggregate of 20% of the post-Issue equity capital of the Company, held by the Promoters shall be locked in for a period of three years from the date of Allotment in the Issue, which as per SEBI guidelines will be considered as Promoters' Contribution.

The fund requirements and funding plans have not been appraised by any bank / financial institution. The deployment of funds for the projects is therefore, entirely at the discretion of the company.

### Corporate Governance:

Parabolic Drugs Limited is compliant with the provisions of Clause 49 of the Listing Agreement. There are currently 8 Directors on the Board of PDL, which includes 3 Executive Directors, 4 Independent Directors and 1 Nominee Director.

The Chairman, Dr. Inder Bir Singh Passi, an Independent Director. Brickwork considers this to be a good corporate governance practice. Dr.Passi was appointed chairman of the board on Dec 10<sup>th</sup> 2009. Mr. Koppisetty Srinivas, Nominee Director is the Vice Chairman and Managing

Partner of BTS Investment Advisors Private Limited, the PE firm that currently holds 19% stake in PDL. He has been on the Board since April 30<sup>th</sup> 2008. All the Independent Directors were appointed in September/October 2009 except for Mr. Pardeep Diwan who was appointed on September 28<sup>th</sup> 2008.

The Audit committee is chaired by Mr.Pardeep Diwan, an Independent Director. The Remuneration Committee was re-constituted on October 12<sup>th</sup> 2009 and all the members of this committee are Independent Directors - Dr. Inder Bir Singh Passi (Chairman), Dr. Ram Kumar and Mr. Pardeep Diwan. The above mentioned members also constitute the Shareholders' / Investors' Grievance Committee which is in place to address shareholders' complaints.

The board members bring with them rich experience in the fields of Healthcare, Accounting and Management. Among the shareholders of PDL are 3 Private Equity Funds – BTS India Private Equity Fund Limited, Exquisite Result International Limited and Alden Global Mauritius Limited.

The company had related party transactions to the tune of Rs.2.92 crores in fiscal 2009 and Rs. 2.51 crores for the six months ended September 30<sup>th</sup> 2009.

We observe that in May 2009, CRISIL has downgraded the Bank Loan Rating of PDL from BBB- to D. We also understand from the company that this was due to the general unstable economic conditions during fiscal 2009 which resulted in a situation where financial institutions / banks were unable to timely release the loans sanctioned to the company. This has caused delay by few days in meeting certain debt obligations of PDL. We understand that company is currently holding a BB bank loan rating from CARE and also maintaining good relationship with its all the nine consortium bankers. Company has also provided good conduct / no default letter from all the consortium bankers to the BRLM. Brickwork Ratings take cognizance of the above while grading the company IPO.

### **Industry Analysis:**

The Indian Pharmaceutical industry is one of the world's largest, ranking 4<sup>th</sup> in Volume terms and 13<sup>th</sup> in Value terms and expected to grow at a CAGR of 14.2% to around USD 50 billion in 2015-16. In the API segment, India ranks third in the world, producing about 500 different APIs. It has the largest number of USFDA approved plants outside US (approximately 119) and around 844 UK MHRA approved plants.

Exports are a particularly lucrative segment of the pharmaceutical industry and are expected to grow at a CAGR of 16.2% while the domestic market is expected to grow by 12.5%. International markets account for more than half of the total revenues of Indian pharma players, and a significant part of this activity is in the API and API Intermediaries segment. India's bulk drug/API exports account for 21% of India's pharmaceutical industry and around 64% of total outsourcing is in the area of APIs and Intermediates.

The key growth drivers for the Indian Pharmaceutical Industry are the large number of products going off-patent in developed markets, pressure to contain rising healthcare costs, intensifying competition and a shift to the networked pharmaceutical operating model. India, with its low-cost manufacturing facilities, abundant talent pool and significant presence in the generics market is an attractive destination for global Contract Research and Manufacturing Services (CRAMS). The total market for CRAMS activities in India, estimated at approximately \$1.5 billion - \$2 billion in 2010, accounts for only 3% share of the USD 51 billion global outsourcing market, indicating significant opportunity for growth in this segment. The Contract Research segment in India, is growing at 65% - more than three-and-half times the global growth rate.

The Indian Pharmaceutical industry is the beneficiary of several policy initiatives by the Government of India. These include fiscal incentives to R&D pharmaceutical units, reduction in Customs Duty on select life-saving drugs, the launch of New Millennium Indian Technology Leadership Initiative (NMITLI), and the Drugs and Pharmaceuticals Research Programme (DPRP), infrastructure support such as building 'Pharmazones' and the streamlining of regulatory procedures.

PDL is currently engaged in manufacturing (including contract manufacturing) of APIs and API Intermediates, and its key strategies for future growth include the manufacturing of non-antibiotic range of APIs, entering into the CRAMS segment with a focus on partnering with Innovator companies and increased penetration in regulated markets where margins are significantly higher.

### **Business Risk:**

The pharmaceutical industry is highly regulated. Quality standards, pricing of drugs and intermediaries, licensing arrangements, manufacturing & testing facilities and marketing of pharmaceutical products are subject to regulatory approvals which can be costly and time-consuming. The company is exposed to these risks.

PDL's future strategy involves expanding in the CRAMS segment and increasing its share of export revenue from regulated markets. Entry barriers in regulated markets are very high. Successful execution of its strategy is dependent on the company's success in obtaining relevant Certifications / Licenses and also in expanding its customer base. Despite of natural hedging the company could experience increased foreign currency risk as it increases its share of export revenue.

The Indian pharmaceutical industry and the Active Pharmaceutical Ingredient ("API") product segment are highly competitive. Indian pharma industry consists of more than 20'000 manufacturers producing over 100,000 drugs. It is also a technologically demanding industry, as rapid advances in technology and scientific discoveries require up-gradations of the existing facilities retain cost advantages.

Parabolic Drugs Limited has moderate customer diversification, with the top 5 customers contributing 40% of total sales.

**Table 3: No of customers and percentage of sales derived from top customers**

Particulars	6- months ended September 30, 2009	FY 09	FY 08	FY 07
Total number of customers served	368	487	379	244
Sales to top customer	12.86%	13.56%	20.04%	39.33%
Sales to top 5 customers	40.46%	34.84%	45.14%	57.59%

Source: DRHP

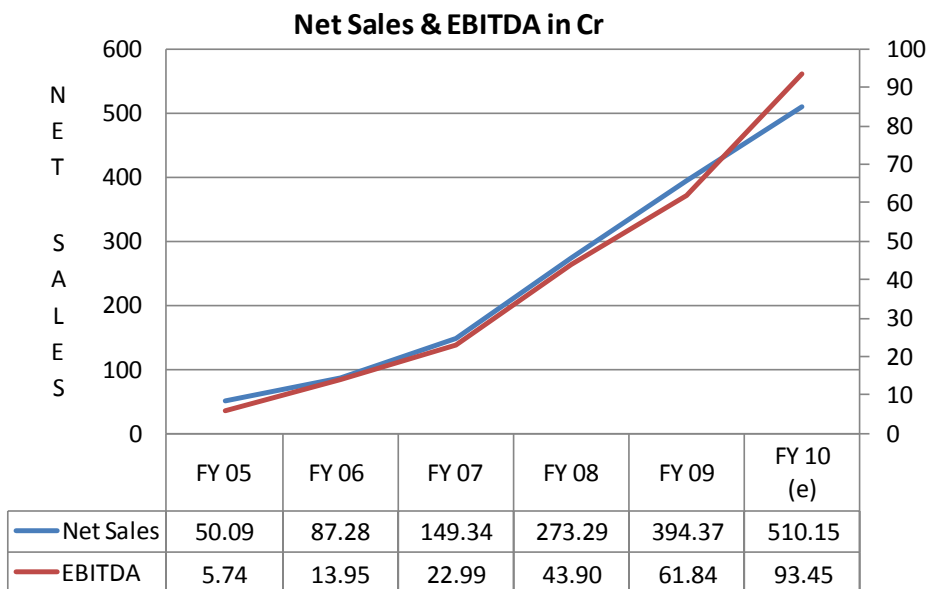
PDL has significant dependence on imports, particularly from China, for raw materials. Currently about 75 to 80% of its raw material supply is sourced from China. The company does not have long term contracts or supply arrangements with any of their vendors, and is exposed



to supply chain risk. The name, business and logo of 'Parabolic' are not registered trademarks of the company. This can place the company at a disadvantage in respect of Intellectual Property rights.

### Financial Performance:

Net Sales for PDL increased from Rs 273.9 Cr in FY08 to Rs. 394.3 Cr in FY09, to Rs 346.1 Cr for 9 months ended as on Dec 09. The sales are expected to be approximately Rs 510 Cr for FY10. Core Sales of company mainly comprise of income from sale of APIs such as SSPs and



Cephalosporin's in both oral and sterile forms and sale of API intermediates such as 6-APA. Company's net sales have been growing at about 55% CAGR since 2004-05, while EBITDA grew at 72.5% CAGR in same period. As on FY 09 Ranbaxy is the biggest customer with about 13% revenue share and the top 5 customers contribute about 40% to total

revenues. The Top 3 products of company contribute 39% to revenues.

*Source: Company Data*

Direct exports constituted 27.65% of net sales in FY09, and are expected to be about 40% for FY10. The share of exports has been continuously increasing since FY07 and company expect it to be almost 75% in next few years. In FY09 Company sold 14.85 Lakh Kgs of API and API intermediaries at an avg. realization of Rs 2540 / Kg. Average realization per Kg has increased from Rs 1538 / Kg in FY 07 to Rs 2827 /Kg as of Sept 2009. This is due to introduction of some high margin low volume products in portfolio.

The major expenses for company are as follows

- Raw material expenses: ~ 75% of Core Sales
- Manufacturing Expenses: ~ 4.5% of Core sales
- Employee Cost: ~ 3.0% of Core Sales
- Selling & Admin expenses: ~3.0% of Core sales
- Interest cost for company: ~ 7.0% of Core sales

The majority of raw material is imported from China, to a certain extent this helps in natural hedging as all billing is in USD but in long run rupee appreciation can significantly affect company sales as in next few years approximately 75% income is expected to be from exports.

The average OPM & NPM for last five years is at 15.0% & 8.0% respectively which is below industry averages of 25% and 14% respectively. However, company is focused on entering regulated markets where margins are substantially higher than non regulated markets. The proposed entry in CRAMS segment (where gross margins are as high as 50%) can enhance operating margins. The average return on capital employed (ROCE) for last 5 years is at 10.3%, while average return on net worth (RONW) for same period is at 30.7% this is higher than industry averages of 8.79% & 13.8% respectively. Parabolic's total debt to equity (D/E) ratio stands at 2.57 as on Dec 2009 which is higher than most of its peers.

PDL has negative Cash Flow from Operation (CFO) for FY 08 and FY 09 due to their huge working capital requirements. However, company has good fixed asset turnover ratio of approximately 3.5 – 4.0x for past few years, compared to industry average of 2x. The Capex for year 2010 is expected to be Rs 60 Cr and company expects additional capital expenditure of Rs 80 Cr in 2011 and 2012 each. We believe with successful deployment of IPO Proceeds the company can have fixed assets of Rs 300 Cr by FY12 and with same efficiency level company can see approximately Rs 1000 Cr of sales by FY12.

**Table 4: Consolidated Profit and Loss (in Rs Crs)**

	<b>Dec 09 (9 mths)</b>	<b>FY 09</b>	<b>FY 08</b>	<b>FY 07</b>	<b>FY 06</b>	<b>FY 05</b>
Net Sales	<b>346.10</b>	<b>394.37</b>	<b>273.29</b>	<b>149.34</b>	<b>87.28</b>	<b>50.09</b>
Income From Job Work	0.12	0.55	0.03	0.80	1.18	0.70
Other Income	3.94	2.02	0.62	0.35	1.75	2.72
<b>Total Income</b>	<b>350.15</b>	<b>396.94</b>	<b>273.94</b>	<b>150.50</b>	<b>90.21</b>	<b>53.52</b>
<b>Total Expenditure</b>	<b>287.48</b>	<b>335.09</b>	<b>230.04</b>	<b>127.51</b>	<b>76.26</b>	<b>47.78</b>
<b>EBITDA</b>	<b>62.67</b>	<b>61.84</b>	<b>43.90</b>	<b>22.99</b>	<b>13.95</b>	<b>5.74</b>
Depreciation	4.05	3.61	1.83	0.90	0.62	0.39
<b>EBIT</b>	<b>58.62</b>	<b>58.23</b>	<b>42.07</b>	<b>22.09</b>	<b>13.33</b>	<b>5.35</b>
Financial Expenses (Including Derivative Expenses)	29.57	28.34	12.11	5.83	4.15	1.72
Profit Before Tax	29.05	29.90	29.97	16.26	9.19	3.63
Less: <b>Provision For Taxation:</b>	6.53	5.73	4.87	2.38	0.96	0.48
<b>Profit After Tax</b>	<b>22.52</b>	<b>24.17</b>	<b>25.09</b>	<b>13.88</b>	<b>8.23</b>	<b>3.16</b>



<b>Growth in Net Sales</b>	**	44.30%	83.00%	71.11%	74.23%	--
<b>Growth in EBITDA</b>	**	40.88%	90.96%	64.80%	143.11%	--
<b>Growth in PAT</b>	**	-3.67%	80.82%	68.71%	160.53%	--

\*\* 9 mth ended figures not comparable to previous year

**Table 5: Key Financial Indicators**

in Rs Cr	Dec 09 (9 mths)	FY 09	FY 08	FY 07	FY 06	FY 05
Net Sales	346.10	394.37	273.29	149.34	87.28	50.09
EBDITA	62.67	61.84	43.90	22.99	13.95	5.74
PAT	22.52	24.17	25.09	13.88	8.23	3.16
OPM (%)	16.94%	15.68%	16.06%	15.39%	15.98%	11.45%
NPM (%)	5.34%	6.13%	9.18%	9.29%	9.42%	6.30%
Networth	142.91	125.05	74.69	46.17	23.30	8.98
Borrowings	367.68	264.03	159.42	69.66	41.33	22.29
Net fixed assets	152.84	119.89	73.58	32.40	13.43	9.23
Fixed Asset Turnover	2.54	4.08	5.16	6.52	7.70	5.43
RONW	12.92%	19.33%	33.60%	30.05%	35.30%	35.17%
ROCE	3.62%	6.21%	10.72%	11.98%	12.73%	10.10%
Current Ratio	3.01	2.97	3.27	2.61	3.32	2.21
Debt / Equity	2.57	2.11	2.13	1.51	1.77	2.48
Interest Cover	2.12	2.18	3.63	3.95	3.36	3.34
Total No. of Shares	36849726	10749500	10492540	7699500	7699500	4000000
Book Value per Share	38.36	116.33	71.18	59.97	30.26	22.44
Diluted EPS	17.1#	22.49	23.91	18.02	10.68	7.89

# Diluted EPS calculated using wt. avg. no of shares issued at various times during the year

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