

Pharma segment to drive profitability; maintain Hold

We maintain our Hold rating on Merck and retain our TP to Rs1,080 based on 14x December'18E EPS of Rs76.9. Merck's pharma segment (78% of revenues) reported 12%YoY growth in revenues due to re-stocking by trade post successful GST implementation. Its chemical segment (22% of revenues) posted 12%YoY growth. However, its pharma business performed better than its chemical business. The company's EBIDTA margin grew 140bps to 18.1% and net profit grew by 11%YoY due to margin improvement. We expect Merck's performance to improve as the vitamin E API and Evion brand are out of price control and are exhibiting good growth. Merck's CVS brand Concor grew 14% YoY despite being under price control. We recommend a switch to Sanofi India or Abbott India.

- **Pharma segment revenue grew 13%YoY:** Merck's pharma segment's revenue grew 13%YoY to Rs2.45bn from Rs2.18bn due to re-stocking by trade post successful GST implementation. Merck is a pioneer in the vitamin segment, with three major brands Neurobion, Polybion and Evion. Evion does not fall under the National List of Essential Medicines (NLEM) and hence its price hasn't been capped. The company's chemical business (22% of revenues) grew by 12%YoY. We expect the high-margin pharma business to drive future growth.
- **Margin grew by 140bps YoY:** Merck's EBIDTA margin grew by 140bps YoY to 18.1% from 16.7% due to the rise in material cost. The company's material cost grew by 140bps to 41.5% from 40.1% YoY due to a change in the product mix with higher sales of high margin pharma business. Its personnel cost declined 70bps to 13.5% from 14.2%. Other expenses declined by 210bps to 26.9% from 29.0%. The pharma segment's EBIT margin improved to 19.7% from 15.2% a year ago, and that of its chemical business declined to 9.2% from 13.0%. We expect margin improvement from higher growth in the high-margin pharma segment and shifting of the corporate office to Vikhroli, a low-cost destination as compared to its expensive environs of Worli.
- **Net profit grew 11%YoY:** Merck's net profit for the quarter grew by 11% YoY to Rs317mn from Rs285mn due to improvement in the margin. The company's other income grew by 52% YoY to Rs64mn from Rs42mn. Tax provision grew to 43.8% from 36.0% of PBT. Merck is a debt-free company and had cash/share of ~Rs170. We expect net profit to improve from the increasing sales of the high margin pharma business.
- **Recommendation and key risks:** We have retained our Hold rating on the scrip and maintained our TP to Rs1,080 based on 14x December'18E EPS of Rs76.9, and with a downside of 6.2%. We expect the company's performance to improve further. Merck's major brand Evion and API vitamin E are out of price control. However, its major CVS brand Concor is under price control. Key downside risks to our assumptions include a slowdown in the domestic pharma market and key upside risks include a reduction in material cost. We recommend a switch to Sanofi India or Abbott India.

Particulars (Rs mn)	Q3CY17	Q3CY16	YoY%	Q2CY17	QoQ%	Q3CY17E	% Var.
Total Revenues	3,127	2,780	12.5	2,656	17.7	2,970	5.3
Raw material cost	1,298	1,115	16.4	1,055	23.0	1,105	17.5
Employee cost	422	395	6.8	415	1.7	440	(4.1)
Other expenses	840	805	4.3	909	(7.6)	920	(8.7)
EBIDTA	567	465	21.9	277	104.7	505	12.3
EBIDTA margin (%)	18.1	16.7	-	10.4	-	17.0	-
Depreciation	67	62	8.1	64	4.7	65	3.1
PBT	564	445	26.7	267	111.2	510	10.6
Prov. For tax	247	160	54.4	65	280.0	170	45.3
Adj. PAT	317	285	11.2	202	56.9	340	(6.8)

Source: Company, Centrum Research Estimates

Y/E Dec (Rs mn)	Revenue	YoY (%)	EBIDTA	EBIDTA (%)	Net profit	YoY (%)	DEPS Rs.	RoE (%)	RoCE (%)	P/E (x)	EV/EBIDTA (x)
CY14	8,674	8.7	589	6.8	433	(22.6)	26.1	8.0	8.0	23.5	17.1
CY15	9,395	8.3	833	8.9	535	23.7	32.2	9.3	9.4	22.0	14.1
CY16	9,963	6.0	1,196	12.0	759	41.9	45.7	12.3	12.5	17.9	8.0
CY17E	11,317	13.6	1,528	13.5	985	29.8	59.4	14.4	14.9	12.5	10.4
CY18E	12,710	12.3	1,936	15.2	1,277	29.6	76.9	16.6	17.2	14.5	7.7

Source: Company, Centrum Research Estimates

In the interest of timeliness, this document is not edited.

Centrum Equity Research is available on Bloomberg, Thomson Reuters and FactSet

Target Price	Rs1,080	Key Data	
CMP*	Rs1,151	Bloomberg Code	EMERIN
Downside	6.2%	Curr Shares O/S (mn)	16.6
Previous Target	Rs1,080	Diluted Shares O/S(mn)	16.6
Previous Rating	Hold	Mkt Cap (Rsbn/USDmn)	19.1/292.4
Price Performance (%)*		52 Wk H / L (Rs)	1320/843.7
		5 Year H / L (Rs)	1320/522.6
EMER IN	12.3	6M	34.9
Nifty	(0.7)	1Yr	25.3
		Daily Vol. (3M NSE Avg.)	16369

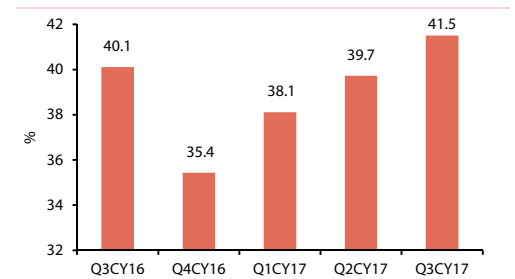
*as on 15th November 2017; Source: Bloomberg, Centrum Research

Shareholding pattern (%)*

	Sept-17	June-17	Mar-17	Dec-16
Promoter	51.8	51.8	51.8	51.8
FII	4.0	3.1	2.3	2.4
DII	10.4	10.4	10.0	10.1
Others	33.8	34.7	35.9	35.7

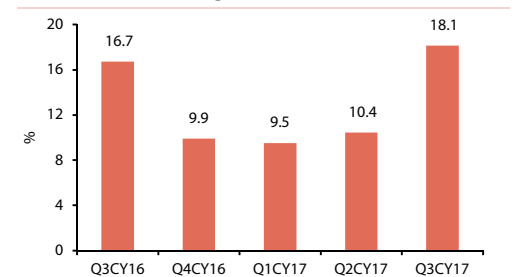
Source: BSE, as on 15th November 2017

Trend in material cost (%)



Source: Company, Centrum Research

Trend in EBITDA margin (%)



Source: Company, Centrum Research

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Sales composition

Merck's revenue grew by 13% YoY to Rs3.13bn from Rs2.78bn in Q3CY17. The company's pharma segment (78% of revenues) grew by 13% YoY to Rs2.45bn from Rs2.18bn. Its chemical business (22% of revenues) grew by 12%YoY to Rs674mn from Rs601mn. EBIT margin for the pharma segment grew to 19.7% from 15.2% YoY, whereas that for the chemical business declined to 9.2% from 13.0%. Hence, the pharma business contributed to margin improvement. The details are as follows:

Exhibit 1: Sales composition

Particulars (Rs mn)	Q3CY17	Q3CY16	YoY%	Q2CY17	QoQ%	Q3CY17E	% Var.
Segment wise revenues							
Pharma	2,453	2,179	12.6	2,047	19.8	2,300	6.7
Chemicals	674	601	12.1	610	10.5	670	0.6
Total	3,127	2,780	12.5	2,657	17.7	2,970	5.3
Less: intersegment	0	0	NA	-	NA	-	NA
Net sales	3,127	2,780	12.5	2,657	17.7	2,970	5.3

Source: Company, Centrum Research

Major brands and their performance

As per AIOCD AWACS monthly data for September'17, Merck's revenue declined marginally by 0.1% YoY, lower than the industry growth rate of 2.8% YoY. Merck's eleven major brands contributed 74% to the company's pharma revenues. Six of the 11 top brands grew faster in the domestic market and are likely to drive future growth. The company is highly dependent on the vitamin segment and derives ~45% of its revenues from the vitamin segment. The company's major brand Evion grew at 58.7% in September'17. The details are as follows:

Exhibit 2: Major brands and their performance

Major Products	Therapeutic category	July'17		August'17		September'17	
		Rs mn	Gr. rate %	Rs mn	Gr. rate %	Rs mn	Gr. rate %
Domestic pharma market		92,795	(2.4)	1,03,167	2.4	1,04,196	2.8
Merck		580	5.6	594	8.3	604	(0.1)
Neurobion Forte	Multivitamin	74	3.0	66	(4.6)	68	(12.9)
Livogen	neutraceutical	49	7.6	53	23.5	56	12.4
Polybion	Multivitamin	51	(19.4)	62	(9.4)	59	(0.6)
Evion	Vitamin	51	31.4	58	59.9	58	58.7
Livogen Z	neutraceutical	35	14.6	37	23.4	39	16.9
Concor	CVS	34	35.9	34	40.9	31	13.9
Polybion SF	vitamin	28	(4.5)	23	(22.5)	26	(13.2)
Polybion LC	Vitamin	27	(6.4)	25	(4.8)	26	(11.3)
Neurobion Forte RF	Vitamin	28	10.3	23	(14.4)	26	6.3
Evion LC	Vitamin	31	34.0	26	9.6	31	5.8
Nasivion	Nasal decongestant	23	16.3	22	0.5	24	(8.0)
Total		431		429		444	

Source: AIOCD AWACS monthly data-July-September'17

Retain Hold rating

Merck's revenues and net profit were in line with our estimates. However, the EBIDTA exceeded our estimates. The PBIT margin for the pharma business (78% of revenues) grew YoY to 19.7% from 15.2% and was higher due to re-stocking by trade after the successful GST implementation. The PBIT margin of the chemical business (22% of revenues) declined to 9.2% from 13.0%. Merck's chemical business had subdued performance during Q3CY17. We expect the PBIT margin for the pharma businesses to improve further due to good growth of its major brands.

Valuations and recommendations

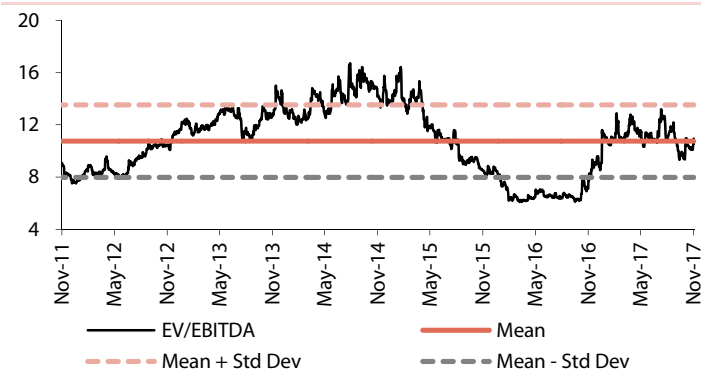
At the CMP of Rs1,151, the stock trades at 12.5x CY17E EPS of Rs59.4 and 14.5x CY18E EPS of Rs76.9. We have retained our Hold rating on the scrip, with a TP of Rs1,080 based on 14x December'18 EPS of Rs76.9, and with a downside of 6.2%. We expect the company's performance to improve further. Merck's major brand Evion and API vitamin E are out of price control. However, its major CVS brand Concor is under price control. Key downside risks to our assumptions include a slowdown in the domestic pharma market and key upside risk includes reduction in material cost. We recommend a switch to Sanofi India or Abbott India.

Exhibit 3: Sensitivity Analysis

Sensitivity to key variables – CY17E	% change	% impact on EBITDA	% impact on EPS
Sales	1	7.5	11.6
Material cost	1	(2.9)	(4.5)

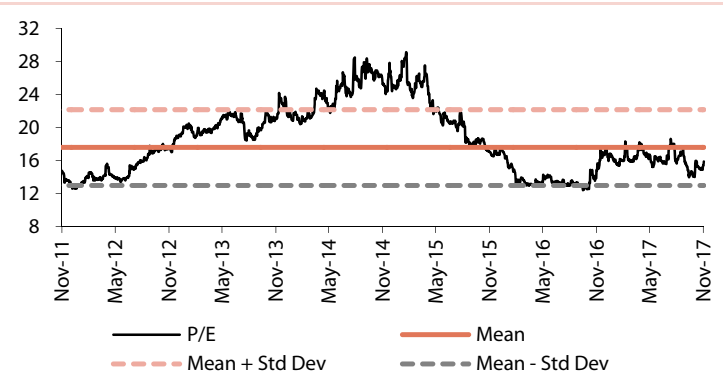
Source: Company, Centrum Research Estimates

Exhibit 4: 1 year forward EV/EBITDA chart



Source: Bloomberg, Company, Centrum Research Estimates

Exhibit 5: 1 year forward P/E chart



Source: Bloomberg, Company, Centrum Research Estimates

Exhibit 6: Comparative Valuations

Sector	Mkt Cap (Rs mn)	CAGR CY16-CY18E (%)			EBITDA Margin (%)			PE (x)			EV/EBITDA (x)			RoE (%)			Div Yield (%)		
		Rev.	EBITDA	PAT	CY16	CY17E	CY18E	CY16	CY17E	CY18E	CY16	CY17E	CY18E	CY16	CY17E	CY18E	CY16	CY17E	CY18E
Merck*	19,107	12.9	27.2	29.7	12.0	13.5	15.2	17.9	12.5	14.5	8.0	10.4	7.7	12.3	14.4	16.6	1.6	2.1	1.6
Abbott India	1,05,868	15.3	33.9	35.4	13.5	16.1	18.2	35.6	23.4	18.1	22.0	14.6	10.7	21.4	25.6	27.3	1.0	1.2	1.4
Pfizer	87,749	8.9	17.3	17.3	17.1	18.5	19.8	33.3	30.9	24.2	25.1	22.7	18.3	10.7	10.5	12.6	1.0	1.0	1.3
Sanofi India*	1,00,296	14.6	16.9	23.3	22.3	21.8	23.2	33.3	27.2	21.3	17.7	15.4	12.0	17.7	19.5	22.6	1.9	2.2	2.3

Source: Company, Centrum Research Estimates, * December ending, Prices as on 15th November 2017

Quarterly financials, Operating Metrics and Key Performance Indicators

Exhibit 7: Quarterly Financials

PARTICULARS (Rs mn)	Q4CY15	Q1CY16	Q2CY16	Q3CY16	Q4CY16	Q1CY17	Q2CY17	Q3CY17
P & L								
Revenues	2,375	2,156	2,768	2,780	2,515	2,369	2,656	3,127
Material cost	1,087	853	1,225	1,115	891	903	1,055	1,298
Personnel expenses	275	351	394	395	395	410	415	422
Other Expenses	762	839	808	805	980	831	909	840
Total Expenditure	2,124	2,043	2,427	2,315	2,266	2,144	2,379	2,560
EBIDTA	251	113	341	465	249	225	277	567
Other income	68	54	66	42	81	67	54	64
PBDIT	319	167	407	507	330	292	331	631
Depreciation	84	63	62	62	146	62	64	67
Interest	-	-	-	-	-	-	-	-
Profit before tax	235	105	345	445	184	230	267	564
Tax provision	89	21	120	160	57	82	65	247
Net profit	146	84	225	285	127	148	202	317
Growth (%)								
Revenues	10.9	8.5	11.9	8.6	5.9	9.9	(4.0)	12.5
EBIDTA	5,604.5	(12.5)	29.3	143.5	(0.8)	98.9	(18.8)	21.9
Net profit	1239.4	(12.9)	33.5	127.6	(13.0)	76.8	(10.2)	11.2
Margin (%)								
EBIDTA	10.6	5.2	12.3	16.7	9.9	9.5	10.4	18.1
Profit before tax	9.9	4.9	12.5	16.0	7.3	9.7	10.1	18.0
Net margin	6.1	3.9	8.1	10.3	5.0	6.2	7.6	10.1

Source: Company, Centrum Research

Exhibit 8: Key performance indicators

Key performance indicator	CY14	CY15	CY16	CY17E	CY18E
Pharma Revenue growth %	7.1	13.8	15.0	16.2	14.6
Chemicals Revenue growth %	10.7	(4.9)	(17.8)	5.0	4.0
Material cost (%)	46.2	46.3	41.4	38.8	37.8

Source: Centrum Research Estimates

Financials - standalone

Exhibit 9: Income Statement

Y/E Dec (Rs mn)	CY14	CY15	CY16	CY17E	CY18E
Revenues	8,674	9,395	9,963	11,317	12,710
Material cost	4,005	4,353	4,126	4,390	4,810
% of revenues	46.2	46.3	41.4	38.8	37.8
Employee cost	1,136	1,234	1,487	1,770	1,950
% of revenues	13.1	13.1	14.9	15.6	15.3
Other Expenses	2,944	2,975	3,154	3,628	4,014
% of revenues	33.9	31.7	31.7	32.1	31.6
EBIDTA	589	833	1,196	1,528	1,936
EBIDTA margin (%)	6.8	8.9	12.0	13.5	15.2
Depreciation & Amortisation	127	234	335	303	349
EBIT	462	599	861	1,225	1,587
Interest Expenses	-	-	-	-	-
PBT from operations	462	599	861	1,225	1,587
Other income	203	234	241	250	300
PBT	666	833	1,102	1,475	1,887
Tax provision	233	298	343	490	610
Effective tax rate (%)	35.0	35.8	31.1	33.2	32.3
Net profit	433	535	759	985	1,277
Minority interest	-	-	-	-	-
Reported net profit	433	535	759	985	1,277
Adj. Net profit	433	535	759	985	1,277

Source: Company, Centrum Research Estimates

Exhibit 10: Key Ratios

Y/E Dec	CY14	CY15	CY16	CY17E	CY18E
Growth Ratios (%)					
Revenues	8.7	8.3	6.0	13.6	12.3
EBIDTA	(23.4)	41.4	43.6	27.8	26.7
Adj. Net Profit	(22.6)	23.7	41.9	29.8	29.6
Margin Ratios (%)					
EBIDTA margin	6.8	8.9	12.0	13.5	15.2
PBT from operations margin	5.3	6.4	8.6	10.8	12.5
Adj. PAT margin	5.0	5.7	7.6	8.7	10.0
Return Ratios (%)					
RoCE	8.0	9.4	12.5	14.9	17.2
RoE	8.0	9.3	12.3	14.4	16.6
RoC	8.3	9.8	15.9	21.1	24.9
Turnover ratios (days)					
Gross Block Turnover (x)	3.8	3.6	3.6	3.9	4.0
Debtors	44	49	40	50	42
Creditors	23	25	28	27	27
Inventory	75	65	61	66	64
Cash Conversion Cycle	96	89	74	88	79
Solvency Ratio					
Debt-Equity	0.0	0.0	0.0	0.0	0.0
Net Debt-Equity	-0.3	-0.3	-0.4	-0.4	-0.4
Current Ratio	3.5	3.2	3.0	3.1	3.2
Interest Coverage Ratio	0.0	0.0	0.0	0.0	0.0
Gross Debt/EBIDTA	0.0	0.0	0.0	0.0	0.0
Per Share (Rs)					
FDEPS (adjusted)	26.1	32.2	45.7	59.4	76.9
CEPS	33.7	46.3	65.9	77.6	98.0
Book Value	333.9	356.4	388.8	433.2	492.5
Dividend	6.0	7.5	11.0	13.0	15.0
Dividend Payout (%)	27.1	30.7	28.3	25.7	22.9
Valuations (x) (Avg Mkt Cap)					
PER	23.5	22.0	17.9	12.5	14.5
P/BV	1.8	2.0	2.1	1.7	2.3
EV/EBIDTA	17.1	14.1	8.0	10.4	7.7
Dividend Yield (%)	1.2	1.4	1.6	2.1	1.6
5-yr Avg AOCF/EV yield(%)	3.8	3.5	6.7	3.7	5.9

Source: Company, Centrum Research Estimates

Exhibit 11: Balance Sheet

Y/E Dec (Rs mn)	CY14	CY15	CY16	CY17E	CY18E
Share capital	166	166	166	166	166
Reserves & surplus	5,377	5,750	6,288	7,025	8,010
Total shareholders Funds	5,543	5,916	6,454	7,191	8,176
Total Debt	-	-	-	-	-
Minority interest	-	-	-	-	-
Deferred tax Liab.	(21)	(57)	(174)	(210)	(270)
Total Liabilities	5,522	5,859	6,280	6,981	7,906
Gross Block	2,565	2,713	2,754	3,063	3,353
Less: Acc. Depreciation	(1,257)	(1,396)	(1,681)	(1,985)	(2,334)
Net Block	1,308	1,317	1,073	1,078	1,019
Capital WIP	60	70	300	200	150
Net Fixed Assets	1,368	1,387	1,373	1,278	1,169
Investments	239	423	278	200	300
Inventories	1,773	1,670	1,659	2,035	2,230
Debtors	1,045	1,265	1,104	1,555	1,470
Loans & Advances	990	1,105	1,396	1,865	2,125
Cash & Bank Balance	1,646	1,884	2,793	2,692	3,564
Other assets	-	-	-	-	-
Total Current Assets	5,454	5,924	6,952	8,147	9,389
Trade payable	541	656	751	850	940
Other current Liabilities	493	611	682	775	860
Provisions	505	608	890	1,019	1,153
Net Current Assets	3,915	4,049	4,629	5,503	6,436
Total Assets	5,522	5,859	6,280	6,981	7,906

Source: Company, Centrum Research Estimates

Exhibit 12: Cash Flow

Y/E Dec (Rs mn)	CY14	CY15	CY16	CY17E	CY18E
CF before WC changes	527	733	977	1,252	1,566
Working Capital Changes	(21)	104	329	(975)	(61)
CF from Operations	506	838	1,306	277	1,505
Adj OCF (OCF-Interest)	506	838	1,306	277	1,505
Change in fixed assets	(401)	(450)	(321)	(208)	(240)
Adj. FCF (AOCF-Capex)	105	388	985	69	1,265
CF from Investing	(595)	(437)	(176)	(130)	(340)
CF from Financing	(117)	(165)	(215)	(254)	(293)
Net change in Cash	(206)	236	915	(107)	872

Source: Company, Centrum Research Estimates

Appendix A

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Merck price chart



Source: Bloomberg, Centrum Research

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