

Chemical segment to drive profitability; maintain Hold

We maintain our Hold rating on Merck with TP to Rs1,290 (earlier Rs1,080) based on 16x December'19E EPS of Rs80.6. Merck's pharma segment (74% of revenues) reported 14%YoY growth in revenues due to re-stocking by trade post successful GST implementation. Its chemical segment (26% of revenues) posted 27%YoY growth due to higher off-take. The company's EBIDTA margin grew 340bps to 15.8% and net profit declined by 47%YoY due to one-time charges. 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 11% YoY despite being under price control. We recommend a switch to Pfizer or Abbott India.

- **Chemical segment revenue grew 27%YoY:** Merck's pharma segment's revenue grew 14%YoY to Rs2.24bn from Rs1.96bn 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 (26% of revenues) grew by 27%YoY. We expect the high-margin pharma business to drive future growth.
- **Margin grew by 340bps YoY:** Merck's EBIDTA margin grew by 340bps YoY to 15.8% from 12.4% due to the decline in other expenses. The company's material cost grew by 150bps to 37.9% from 36.4% YoY due to a change in the product mix with higher sales of chemical business. Its personnel cost declined 70bps to 14.8% from 15.5%. Other expenses declined by 420bps to 31.5% from 35.7%. The pharma segment's EBIT margin declined to 5.7% from 8.2% a year ago, and that of its chemical business grew to 9.3% from 6.5%. 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 declined 47%YoY:** Merck's net profit for the quarter declined by 47% YoY to Rs103mn from Rs194mn due to impairment charges and higher tax rate. The company's other income declined by 34% YoY to Rs54mn from Rs82mn. Tax provision grew to 64.6% from 24.8% of PBT due to additional tax of Rs50mn for previous years. Merck is a debt-free company and had cash/share of ~Rs170. Merck has provided Rs172mn as impairment charges on power plant. 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 Rs1,290 based on 16x December'19E EPS of Rs80.6, and a downside of 13.4%. 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 Pfizer or Abbott India.

Particulars (Rs mn)	Q4CY17	Q4CY16	YoY%	Q3CY17	QoQ%	Q4CY17E	% Var.
Total Revenues	3,041	2,595	17.2	3,127	(2.8)	2,820	7.8
Raw material cost	1,154	944	22.2	1,298	(11.1)	1,060	8.9
Employee cost	449	403	11.4	422	6.4	430	4.4
Other expenses	958	926	3.5	840	14.0	871	10.0
EBIDTA	480	322	49.1	567	(15.3)	459	4.6
EBIDTA margin (%)	15.8	12.4	-	18.1	-	16.3	-
Depreciation	243	146	66.4	67	262.7	70	247.1
PBT	291	258	12.8	564	(48.4)	468	(37.8)
Prov. For tax	188	64	193.8	247	(23.9)	150	25.3
Adj. PAT	103	194	(46.9)	317	(67.5)	318	(67.6)

Source: Company, Centrum Research Estimates

Y/E Dec (Rs mn)	Revenue	YoY (%)	EBITDA	EBITDA (%)	Net profit	YoY (%)	DEPS Rs.	RoE (%)	RoCE (%)	P/E (x)	EV/EBITDA (x)
CY16	10,298	9.6	1,242	12.1	792	48.0	47.7	12.6	12.9	17.2	7.7
CY17	11,195	8.7	1,549	13.8	940	18.7	46.4	13.5	11.4	16.0	9.9
CY18E	12,280	9.7	1,758	14.3	1,089	15.8	65.6	14.1	14.7	16.6	12.1
CY19E	13,621	10.9	2,101	15.4	1,339	23.0	80.6	15.5	16.1	18.5	9.9
CY20E	15,108	10.9	2,355	15.6	1,444	7.9	87.0	14.8	15.5	17.1	8.4

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	Rs1,290	Key Data	
CMP*	Rs1,489	Bloomberg Code	EMERIN
Downside	13.4%	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)	24.7/381.9
Price Performance (%)*		52 Wk H / L (Rs)	1687.3/977
		5 Year H / L (Rs)	1687.3/522.6
EMER IN	(2.2) 26.7 37.0	Daily Vol. (3M NSE Avg.)	47335
Nifty	(4.4) 7.4 18.4		

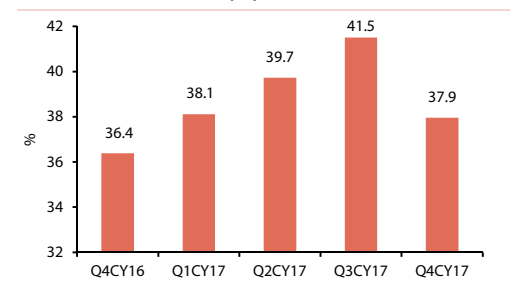
*as on 23rd February 2018; Source: Bloomberg, Centrum Research

Shareholding pattern (%)*

	Dec-17	Sept-17	June-17	Mar-17
Promoter	51.8	51.8	51.8	51.8
FIs	3.9	4.0	3.1	2.3
DIs	9.5	10.4	10.4	10.0
Others	34.8	33.8	34.7	35.9

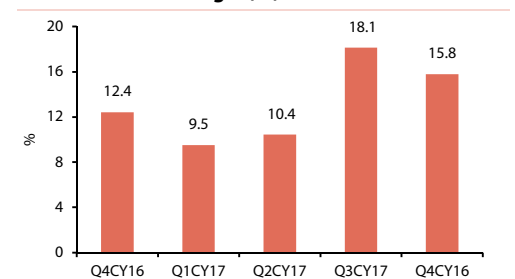
Source: BSE, as on 23rd February 2018

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 17% YoY in Q4CY17 to Rs3.04bn from Rs2.60bn in Q4CY16. The company's pharma segment (74% of revenues) grew by 14% YoY to Rs2.24bn from Rs1.96bn. Its chemical business (26% of revenues) grew by 27%YoY to Rs799mn from Rs631mn. EBIT margin for the pharma segment declined to 5.7% from 8.2% YoY, whereas that for the chemical business grew to 9.3% from 6.5%. Hence, the chemical business contributed to margin improvement. The details are as follows:

Exhibit 1: Sales composition

Particulars (Rs mn)	Q4CY17	Q4CY16	YoY%	Q3CY17	QoQ%	Q4CY17E	% Var.
Segmentwise revenues							
Pharma	2,242	1,964	14.2	2,453	(8.6)	2,120	5.8
Chemicals	799	631	26.6	674	18.5	700	14.1
Total	3,041	2,595	17.2	3,127	(2.8)	2,820	7.8
Less: intersegment	0	0	NA	-	NA	-	NA
Net sales	3,041	2,595	17.2	3,127	(2.8)	2,820	7.8

Source: Company, Centrum Research

Major brands and their performance

As per AIOCD AWACS monthly data for December'17, Merck's revenue declined marginally by 0.3% YoY, compared to the industry growth rate of 7.8% YoY. Merck's thirteen major brands contributed 79% to the company's pharma revenues. Four of the 13 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 ~57% of its revenues from the vitamin segment. The company's major brand Evion grew at 34.7% in December'17. The details are as follows:

Exhibit 2: Major brands and their performance

Major Products	Therapeutic category	October'17		November'17		December'17	
		Rs mn	Gr. rate %	Rs mn	Gr. rate %	Rs mn	Gr. rate %
Domestic pharma market		1,03,757	6.5	1,02,915	8.1	1,00,005	7.8
Merck		587	0.6	574	0.2	524	(0.3)
Neurobion Forte	Multivitamin	60	(19.2)	67	(0.3)	61	(8.8)
Polybion	Multivitamin	60	12.9	48	6.3	25	(7.4)
Evion	Vitamin E	63	57.7	66	51.3	61	34.7
Livogen	Liver Extract, vitamins	52	7.9	42	(10.6)	40	(9.8)
Livogen Z	Iron, folic acid	39	7.4	34	(3.6)	33	(1.0)
Concor	CVS	34	12.9	35	3.3	36	11.3
Evion LC	Vitamin E	27	(11.4)	28	1.0	29	7.4
Neurobion Forte RF	Vitamin	27	(2.6)	24	(7.1)	23	(7.9)
Polybion SF	Multivitamin	23	(21.7)	20	(15.8)	13	(29.1)
Nasivion	Nasal decongestant	24	(5.4)	35	18.8	36	15.6
Polybion LC	Vitamin	25	(6.9)	23	0.8	15	(2.6)
Concor AM	CVS	21	14.9	23	9.1	23	12.1
Concor COR	CVS	18	8.3	18	(4.8)	19	1.8
Total		473		463		414	

Source: AIOCD AWACS monthly data-October-December'17

Retain Hold rating

Merck's revenues and EBIDTA were in line with our estimates. However, net profit was lower than our estimates due to Rs172mn impairment charge on power plant assets and Rs50mn tax on earlier years. The PBIT margin for the pharma business (74% of revenues) declined YoY to 5.7% from 8.2%. The PBIT margin of the chemical business (26% of revenues) grew to 9.3% from 6.5%. Merck's pharma business had superior performance during Q3CY17 with PBIT margin of 19.7%. We expect the PBIT margin for the pharma businesses to improve further due to good growth of its major brands.

Valuations and recommendations

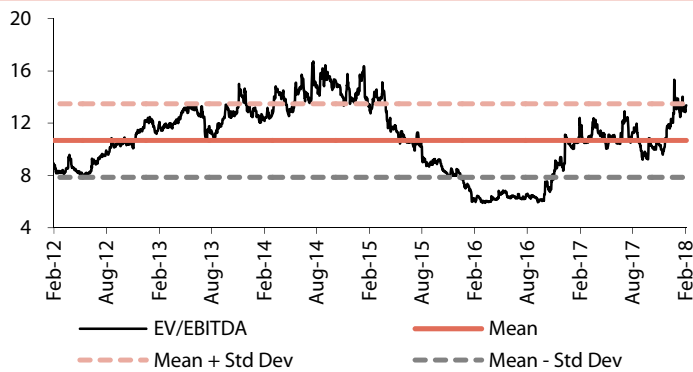
At the CMP of Rs1489, the stock trades at 16.6x CY18E EPS of Rs65.6 and 18.5x CY19E EPS of Rs80.6 and 17.1X CY20E EPS of Rs87.0. We have retained our Hold rating on the scrip, with a TP of Rs1,290 (earlier Rs1,080) based on 16x December'18 EPS of Rs80.6 (earlier 14x CY17E EPS Rs76.9), and with a downside of 13.4%. 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. We expect new product introduction and line extensions to drive future growth. 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 Pfizer or Abbott India.

Exhibit 3: Sensitivity Analysis

Sensitivity to key variables – CY18E	% change	% impact on EBITDA	% impact on EPS
Sales	1	13.9	22.5
Material cost	1	(2.7)	(4.4)

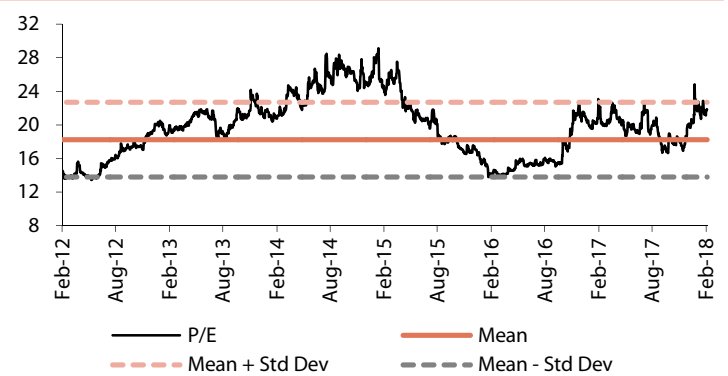
Source: Company, Centrum Research Estimates

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*	24,717	9.2	19.0	17.2	12.1	13.8	14.3	17.2	16.0	16.6	7.7	9.9	12.1	12.6	13.5	14.1	1.6	2.1	1.6
Abbott India	1,23,484	15.3	33.9	35.4	13.5	16.1	18.2	35.6	24.7	24.4	22.0	15.5	15.2	21.4	25.6	27.3	1.0	1.2	1.0
Pfizer	1,05,545	10.7	34.3	36.8	17.1	23.1	25.2	34.5	23.5	23.1	24.1	17.1	16.7	10.7	14.0	16.2	0.9	0.9	1.1
Sanofi India*	1,11,143	7.6	7.9	13.9	22.1	21.6	22.2	32.5	29.9	28.2	17.4	16.8	16.7	17.3	16.7	18.7	1.9	2.0	2.0

Source: Company, Centrum Research Estimates, * December ending, Prices as on 23rd February 2018

Quarterly financials, Operating Metrics and Key Performance Indicators

Exhibit 7: Quarterly Financials

PARTICULARS (Rs mn)	Q1CY16	Q2CY16	Q3CY16	Q4CY16	Q1CY17	Q2CY17	Q3CY17	Q4CY17
P & L								
Revenues	2,156	2,768	2,780	2,595	2,369	2,656	3,127	3,041
Material cost	853	1,225	1,115	944	903	1,055	1,298	1,154
Personnel expenses	351	394	395	403	410	415	422	449
Other Expenses	839	808	805	926	831	909	840	958
Total Expenditure	2,043	2,427	2,315	2,273	2,144	2,379	2,560	2,561
EBIDTA	113	341	465	322	225	277	567	480
Other income	54	66	42	82	67	54	64	54
PBDIT	167	407	507	404	292	331	631	534
Depreciation	63	62	62	146	62	64	67	243
Interest	-	-	-	-	-	-	-	-
Profit before tax	105	345	445	258	230	267	564	291
Tax provision	21	120	160	64	82	65	247	188
Net profit	84	225	285	194	148	202	317	103
EO items								170
Net profit aftr EO items	84	225	285	194	148	202	317	273
Growth (%)								
Revenues	8.5	11.9	8.6	9.3	9.9	(4.0)	12.5	17.2
EBIDTA	(12.5)	29.3	143.5	28.3	98.9	(18.8)	21.9	49.1
Net profit	(12.9)	33.5	127.6	32.9	76.8	(10.2)	11.2	(46.9)
Margin (%)								
EBIDTA	5.2	12.3	16.7	12.4	9.5	10.4	18.1	15.8
Profit before tax	4.9	12.5	16.0	9.9	9.7	10.1	18.0	9.6
Net margin	3.9	8.1	10.3	7.5	6.2	7.6	10.1	3.4

Source: Company, Centrum Research

Exhibit 8: Key performance indicators

Key performance indicator	CY16	CY17	CY18E	CY19E	CY20E
Pharma Revenue growth %	20.0	7.9	9.0	10.9	11.2
Chemicals Revenue growth %	(17.7)	11.4	12.0	11.0	10.0
Material cost (%)	40.0	39.4	39.2	38.8	38.7

Source: Centrum Research Estimates

Financials - standalone

Exhibit 9: Income Statement

Y/E Dec (Rs mn)	CY16	CY17	CY18E	CY19E	CY20E
Revenues	10,298	11,195	12,280	13,621	15,108
Material cost	4,115	4,411	4,810	5,280	5,850
% of revenues	40.0	39.4	39.2	38.8	38.7
Employee cost	1,542	1,696	1,838	2,030	2,250
% of revenues	15.0	15.1	15.0	14.9	14.9
Other Expenses	3,399	3,539	3,874	4,210	4,653
% of revenues	33.0	31.6	31.5	30.9	30.8
EBIDTA	1,242	1,549	1,758	2,101	2,355
EBIDTA margin (%)	12.1	13.8	14.3	15.4	15.6
Depreciation & Amortisation	333	436	349	405	476
EBIT	909	1,113	1,409	1,696	1,879
Interest Expenses	-	-	-	-	-
PBT from operations	909	1,113	1,409	1,696	1,879
Other income	244	240	280	323	345
PBT	1,153	1,353	1,689	2,019	2,224
Tax provision	361	583	600	680	780
Effective tax rate (%)	31.3	43.1	35.5	33.7	35.1
Net profit	792	770	1,089	1,339	1,444
Minority interest	-	-	-	-	-
Reported net profit	792	940	1,089	1,339	1,444
Adj. Net profit	792	940	1,089	1,339	1,444

Source: Company, Centrum Research Estimates

Exhibit 10: Key Ratios

Y/E Dec (Rs mn)	CY16	CY17	CY18E	CY19E	CY20E
Growth Ratios (%)					
Revenues	9.6	8.7	9.7	10.9	10.9
EBIDTA	49.1	24.7	13.5	19.5	12.1
Adj. Net Profit	48.0	18.7	15.8	23.0	7.9
Margin Ratios (%)					
EBIDTA margin	12.1	13.8	14.3	15.4	15.6
PBT from operations margin	8.8	9.9	11.5	12.4	12.4
Adj. PAT margin	7.7	8.4	8.9	9.8	9.6
Return Ratios (%)					
RoCE	12.9	11.4	14.7	16.1	15.5
RoE	12.6	13.5	14.1	15.5	14.8
RoIC	16.4	16.0	21.1	24.6	25.2
Turnover ratios (days)					
Gross Block Turnover (x)	3.7	3.8	3.8	3.9	4.1
Debtors	38	40	39	38	40
Creditors	27	27	29	31	31
Inventory	58	51	58	53	55
Cash Conversion Cycle	69	64	68	61	64
Solvency Ratio					
Debt-Equity	0.0	0.0	0.0	0.0	0.0
Net Debt-Equity	(0.4)	(0.4)	(0.4)	(0.4)	(0.5)
Current Ratio	3.2	3.0	3.0	3.0	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)	47.7	46.4	65.6	80.6	87.0
CEPS	67.8	72.6	86.6	105.0	115.7
Book Value	399.9	441.7	489.7	552.6	621.9
Dividend	11.0	13.0	15.0	18.0	20.0
Dividend Payout (%)	27.1	27.0	26.9	21.9	20.3
Valuations (x) (Avg Mkt Cap)					
PER	17.2	16.0	16.6	18.5	17.1
P/BV	2.1	1.7	2.2	2.7	2.4
EV/EBIDTA	7.7	9.9	12.1	9.9	8.4
Dividend Yield (%)	1.6	2.1	1.6	1.2	1.2
5-yr Avg AOCF/EV yield(%)	6.5	4.5	4.5	5.5	6.3

Source: Company, Centrum Research Estimates

Exhibit 11: Balance Sheet

Y/E Dec (Rs mn)	CY16	CY17	CY18E	CY19E	CY20E
Share capital	166	166	166	166	166
Reserves & surplus	6,472	7,167	7,963	9,008	10,157
Total shareholders Funds	6,638	7,333	8,129	9,174	10,323
Total Debt	-	-	-	-	-
Minority interest	-	-	-	-	-
Deferred tax Liab.	(192)	(308)	(330)	(380)	(440)
Total Liabilities	6,446	7,025	7,799	8,794	9,883
Gross Block	2,787	3,098	3,353	3,591	3,836
Less: Acc. Depreciation	(1,681)	(1,946)	(2,295)	(2,701)	(3,178)
Net Block	1,106	1,152	1,058	890	658
Capital WIP	300	89	150	170	190
Net Fixed Assets	1,406	1,241	1,208	1,060	848
Investments	278	700	750	1,000	850
Inventories	1,639	1,577	1,950	1,995	2,290
Debtors	1,070	1,227	1,320	1,430	1,650
Loans & Advances	1,413	2,078	2,125	2,620	2,930
Cash & Bank Balance	2,793	2,782	3,438	4,020	4,993
Other assets	-	-	-	-	-
Total Current Assets	6,915	7,664	8,833	10,065	11,863
Trade payable	751	833	980	1,139	1,280
Other current Liabilities	776	1,028	860	940	1,055
Provisions	626	719	1,153	1,253	1,343
Net Current Assets	4,762	5,084	5,840	6,733	8,185
Total Assets	6,446	7,025	7,799	8,794	9,883

Source: Company, Centrum Research Estimates

Exhibit 12: Cash Flow

Y/E Dec (Rs mn)	CY16	CY17	CY18E	CY19E	CY20E
CF before WC changes	990	1,260	1,416	1,693	1,858
Working Capital Changes	196	(333)	(100)	(311)	(479)
CF from Operations	1,186	927	1,315	1,382	1,379
Adj OCF (OCF-Interest)	1,186	927	1,315	1,382	1,379
Change in fixed assets	(352)	(271)	(316)	(257)	(264)
Adj. FCF (AOCF-Capex)	834	656	999	1,125	1,115
CF from Investing	(207)	(693)	(366)	(507)	(114)
CF from Financing	(215)	(254)	(293)	(293)	(293)
Net change in Cash	764	(20)	657	582	972

Source: Company, Centrum Research Estimates

Appendix A

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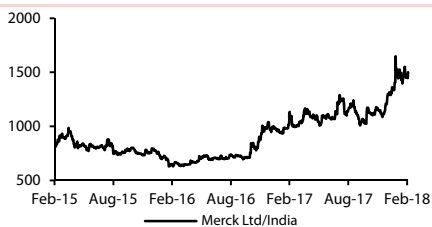
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Merck price chart



Source: Bloomberg, Centrum Research

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