

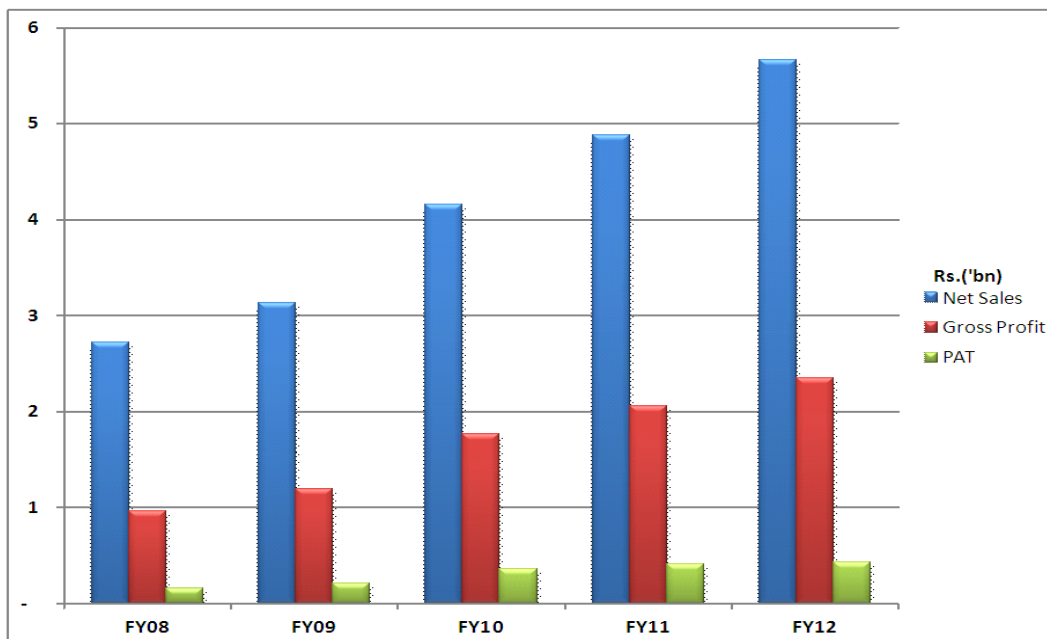


The Searle Company: Re-rating needed ~ presents the case of 14% earnings growth - BUY

Synopsis

Extending our coverage in relation to lowest PE companies, we see SEARL is one which is price play and hence relegated at FY13 PE of 3.7x and future outlook of the company looks good. The company presents possible 'earnings growth' option of 14% in FY13 in line with overall corporate sector profitability (hence presents the case of re-rating).

SEARL is glowing with cash cow brands like *Pediteral*, *Rotec*, *Hydrillin* and *Lumark* which could be witnessed by consistent topline growth in last 5-years with margins also continuously on the increasing side. Though spate of financial charges has spoiled the bottom line growth to a great degree. However, growth in bottom line of some other FMCGs and pharma companies has rejuvenated our belief that SEARL also presents value investment option.



Nevertheless, growth in profits is countered by compound growth of 20% over 5 years reflecting the price play in several key flag products. Earlier, we also reported our expectation of price increase in Ventek Tablets (which are used for the prophylaxis and chronic treatment of asthma) to increase from Rs252/packet(Rs18/tablet) to Rs310/packet(Rs22/tablet). This will be reflected in upcoming results.

It should be noted that the prices of medicines as per WPI index grew by 22% over Dec 2011-12 period and 11% growth over the same period as per CPI.

Triggers: ORS sales and inauguration of new plant

- It is also worth discussing the fact that "Dehydration" caused by diarrhoea is a major cause of mortality among children and Oral Rehydration Salts (ORS) are used for the prevention and treatment. According to survey, the overall percentage of children who have suffered from diarrhoea is increased from 10% in FY09 to 11% in FY11. Balochistan and Punjab have shown increase in diarrhoea cases while Sindh and Khyber Pakhtunkhwa have same trend. Mianwali with 26%, Sanghar with 33%, Bannu with 33% and Harnai with 65% are the most affected districts in Punjab, Sindh, Khyber Pakhtunkhwa and Balochistan respectively.

SEARL specializes in the production of ORS under the brand name called Peditral which driving revenue both from demand increase and price inflation. As reported earlier a Rs10/packet of ORS increased to Rs25/packet over 6-8 months period.

- Moreover, SEARL also inaugurated its new high-tech manufacturing plant in the city of Lahore, which is the second manufacturing unit after Karachi. This would allow Searle to benefit from economies of scale and also allow increasing market share.

P&L (Rs.'000)	FY08	FY09	FY10	FY11	FY12	1QFY13	FY13E
Net Sales	2,721,883	3,123,856	4,154,163	4,876,869	5,659,437	1,260,023	6,678,136
Cost of Sales	1,756,062	1,927,370	2,389,703	2,817,966	3,312,050	705,536	3,672,975
Gross Profit	965,821	1,196,486	1,764,460	2,058,903	2,347,387	554,487	2,804,817
Selling and Dist. Exp	538,866	697,611	992,550	1,092,377	1,211,880	282,520	1,333,068
Admin Exp	82,991	87,466	104,045	129,015	142,993	36,225	157,292
Amortisation	13,400	13,498	12,998	15,093	17,782	3,480	19,735
Operating Profit	330,564	397,911	654,867	822,418	974,732	232,262	1,294,722
Oth. Op. Inc.	53,798	64,769	64,545	115,437	28,145	11,401	8,444
Oth. Op. Exp	18,820	31,846	49,630	67,938	76,094	11,661	83,703
PBIT	365,542	430,834	669,782	869,917	926,783	232,002	1,219,462
Finance Cost	112,228	105,078	112,355	306,520	307,960	75,872	466,071
PBT	253,314	325,756	557,427	563,397	618,823	156,130	753,391
Tax	96,035	109,669	191,268	149,824	188,952	46,572	263,687
PAT	157,279	216,087	366,159	413,573	429,871	109,558	489,704
EPS- Basic	5.91	8.11	11.96	13.50	12.76	3.25	14.54
EPS- Diluted	4.67	6.41	10.87	12.28	12.76	3.25	14.54
DPS	1.00	1.50	3.00	1.50	1.00	-	2.00
Bonus	-	15%	-	10%	40%	-	-

Source: Company Results & Research Desk

Financial operations improving albeit margins

Decreasing current and quick ratio could provide vacuum to worry about the liquidity position of SEARL wherein it is repaying its fixed debt. Whereas other measures like inventory turnover days reflect better cycle in FY12. It should also be noted that the Gearing Ratio has been increased from 0.8% to 28% due arrangement of syndicate debt finance of Rs1bn at a rate of 12% which will be repaid in 5 years time. However, this would not affect significantly in long term as interest cover is still showing a better number than benchmark. This financing facility has been arranged by ultimate parent company.

Sales and margins	FY09	FY10	FY11	FY12	FY13E
Sales Growth	14.8%	33.0%	17.4%	16.0%	18.0%
GP Margin	38.3%	42.5%	42.2%	41.5%	42.0%
NP Margin	6.9%	8.8%	8.5%	7.6%	7.3%

Research Desk

As per said points, it seems that SEARL is relying more on long term finance rather short term. We can hope that this measure of raising finance will improve the current liquidity position as SEARL heavily relies on imported raw material for production; the increase in international prices of raw material along with further devaluation of the Pak Rupee has resulted in higher material costs. This measure could allow SEARL to chop out its reliance on imported raw material by having expansions measures.

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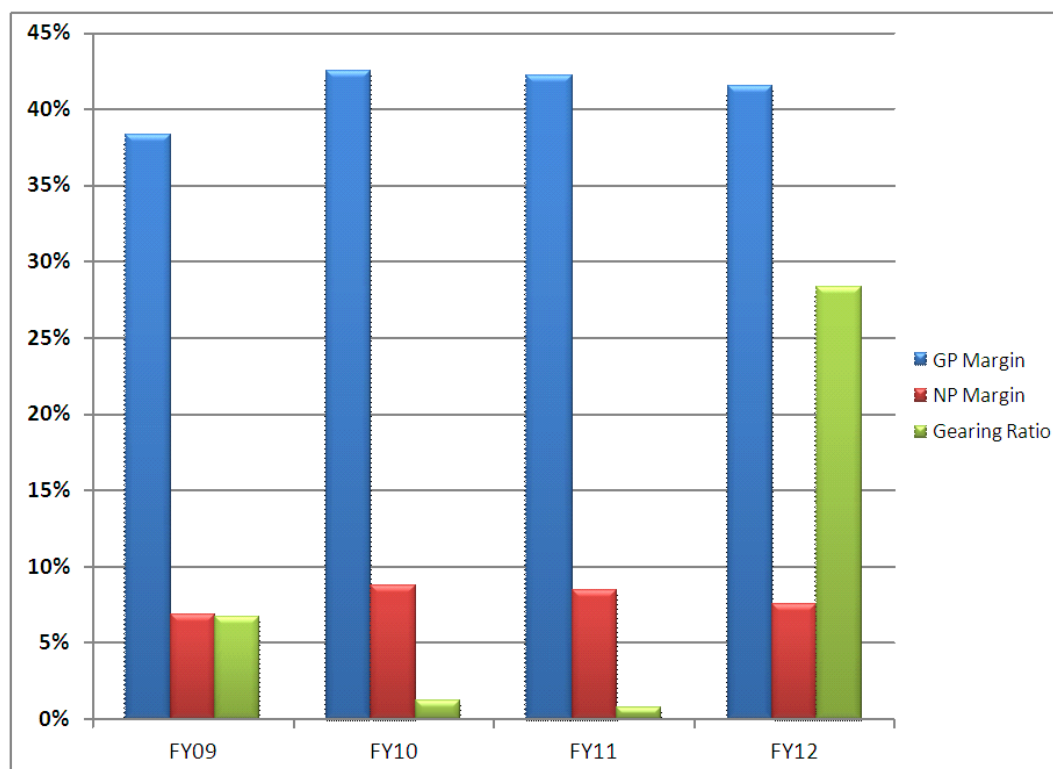
Key Highlights	FY09	FY10	FY11	FY12
Current Ratio	1.9	1.7	1.6	1.3
Quick Ratio	1.5	1.3	1.2	0.9
Inventory Turnover(Days)	72.9	83.3	110.1	86.0
Gearing Ratio	6.8%	1.3%	0.8%	28.3%
ROCE	27%	37%	41%	27%
ROE	16%	22%	21%	18%

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Valuation

SEARL is yielding lowest P/E among peers and in the overall corporate sector which include FMCGs i.e. 3.7x where as Wyeth having the same market share is yielding at a rate of 7x whereas industry average is 8.6x which makes 'SEARL' quite an attractive proposition.

We consider SEARL a value investment opportunity and hence we do not see spate of dividend payout more than Rs 2/sh.



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