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MARK TO MARKET

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Acquisition worries weigh on Torrent Pharma shares

The Torrent Pharmaceuticals Ltd stock has lost 6% since 12 December, underperforming the BSE healthcare index's 6% gain, after the company said that it will purchase **Elder Pharmaceuticals Ltd's** domestic formulations business for ₹2,000 crore.

The acquisition will strengthen Torrent's product portfolio but there are concerns over the impact the purchase will have on Torrent's finances. Its debt-equity ratio, from a comfortable level of less than 0.5 times, is expected to rise to 1.2 times. As a result, interest costs will more than double.

The acquired asset has a strong profit margin of 35%,

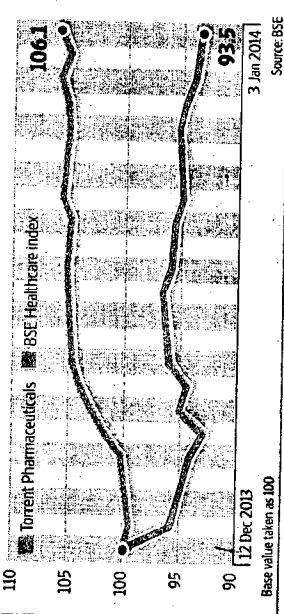
which will lift Torrent's operating profit. The incremental gains, however, may not be sufficient to service the debt and amortization of the acquired assets' goodwill.

"We highlight that the accretion to Ebitda (earnings before interest, taxes, depreciation, and amortization) is expected to be ₹1.03 billion (in FY14E), while the cash loss from interest expense and amortization is likely to be ₹2.25 billion, resulting in deeper cut in earnings," Edelweiss Securities said in a note.

The concerns are leading to cuts to brokerages' earnings estimates. **Karvy Stock Broking Ltd**, for instance, reduced its earnings per share (EPS)

AFTER EFFECTS

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estimate on Torrent by 5.6% for the next fiscal year.

Torrent's management expects the transaction to add value to the company's EPS from the third year onwards (2015-16). To achieve the target, sales and profits at the acquired brands need to be scaled up immensely. Considering that the sales of some of the acquired brands have been hit by supply constraints, there are concerns on whether the management will be able to achieve the said targets quickly.

"While management has indicated that the acquisition would be cash accretive in second year (FY15) and earnings accretive in third year of

operations (FY16), it would require the acquired business to yield 2x (two times) the current profitability and more than 25% CAGR in acquired business, which would be challenging, in our view," Edelweiss added.

Thus, the acquisition may be good for Torrent's business in the long run, but analysts are worried about the impact it can have on the company's finances and return ratios in the next 1-2 years. The stock is reflecting some of these concerns and will be able to shake them off only when Torrent can show proof that the acquisition is delivering the benefits it projected at the time of the acquisition.

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