



EQUITY STRATEGIST

FUNDAMENTAL PICK

LOW RISK/SUPER RETURN

HOLDING PERIOD – 6 MONTHS to 1 YEAR

DATE 4th April 2003

MATRIX LAB (Listed only at BSE Code No.24794)

Present Price – Rs. 289.25

Projected Price - Rs.500

- Matrix Laboratories Ltd was earlier known as Herren Drugs & Pharmaceuticals Ltd. In May 2000, the company changed hands and new management took control. Mr. N. Prasad, former MD & CEO of Vorin Laboratories Ltd, and Mr. M. Ravinder took controlling interest in the company.
- The new management reoriented the entire company and stopped making run-of-the-mill commodity bulk drugs like Ibuprofen and Sulpha-methoxazole.. It set the business focus on regulated markets for bulk drugs. Regulated markets offer much higher profitability, as entry barriers are very high.
- While there is substantial over capacity in the bulk drugs business, there is a severe under capacity for regulated markets. There are only a handful plants in India that meet stringent requirements of regulated markets like the US and Europe. Drugs having sales in billions of dollars are going off patent over the next few years. Low cost, high quality producers of bulk drugs will be able to seize this opportunity.
- After taking control, the new management immediately initiated the process of upgrading the manufacturing facilities to meet regulated markets' standards. It started R&D, which was non-existent earlier. It cleaned up balance sheet, made write-offs and provisions to present the right picture. It brought in professionals to manage each and every aspect of business.
- There are a few pre-requisites to enter regulated markets. For the US market, a bulk drug producer has to have USFDA approved facilities. For the European markets, each buyer has to approve the facility. There are stringent requirements for these approvals. The producer needs to have products for the regulated markets and it needs to have tie-up with either the innovator or generic formulations companies to whom it can supply the bulk drug, or else it needs to forward integrate into formulations.
- The company has already upgraded two out of three blocks at Jeedimetla plant to USFDA standard at the cost of Rs.250mn. Certification is expected by Dec-03. European buyers have already approved the facilities.

THE CATALYST

- Matrix has developed a non-infringing patentable process to make anti-depressant Citalopram. It made an application under Paris Convention Treaty, which covers 153 countries, and applied for patent in the UK.
- Citalopram currently contributes around 50% to the company's revenues. Citalopram sales are expected to be around Rs.1.5bn in FY03. It has the potential to grow to about Rs.2.5bn by FY06. It is one of the fastest growing molecules in the world. It's current annual growth is around 30%. The innovator Lundbeck, a Danish company, has annual sales of \$1.6bn from Citalopram. However, the market is shifting from Citalopram to Escitalopram. This may lower the growth of Citalopram. We, however, expect Matrix's growth for Citalopram to remain high because of low cost, and entry into new markets. Moreover, the company is developing Escitalopram also.
- The company is in the process of developing three non-infringing patentable processes for the therapeutic segments of Cardiovascular and Central Nervous System. We expect that the company will be able to launch one molecule in each of the next three financial years. It plans to file four process patent applications under PCT and/or India shortly. In all, it plans to file 10 such applications in the calendar 2003.
- As the company launches more products going forward, its dependence on Citalopram will come down to around 20-25% by FY06/FY07. Other major contributors to current revenue are anti-histamine Montelukast (expected FY03 sales Rs.300mn) and anti-AIDS drugs like Indinavir, Nevapine, and Lamivudine (expected FY03 sales Rs.200mn).
- The company's R&D has already proven itself by developing a non-infringing process for Citalopram. This drug had over 100 process patents. There are 70 personnel in the R&D including 30 doctorates. Besides, there are 70-80 personnel to look after regulatory affairs. R&D spend is expected to double from present 2% of revenues to 4% of revenues next year. The company's R&D is headed by Dr. Satyanarayana. He has over 15 years experience in the industry. He has been with Ranbaxy and Vorin Laboratories.
- Promoters have raised their stake from 23.26% at end March-02 to 38.36% at end Sep-02. We expect it to go up further to over 43% after the preferential allotment of 2.53mn shares in Nov-02 (Price Rs.107) and merger of Medicorp and Vorin with the company. The swap ratio is two shares of Matrix for 13 shares of Medicorp or 13 shares of Vorin. The merger formalities are expected to be completed by Feb-03.
- Equity – Rs.7.20 cr : Fully Diluted Equity – Rs.12.30 cr : It has already reported a net profit of Rs.77.80 cr for the first nine months and for the full year FY2003 the expected profit will be in the region of Rs100-125 cr. Net Profit for FY2004 will be over Rs.200 cr.
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