



# Opto Circuits

BSE SENSEX 17,622	S&P CNX 5,335	CMP: INR261	TP: INR249	Neutral								
Bloomberg Equity Shares (m)	OPTC IN 186.4	<b>Year</b>	<b>Net Sales</b>	<b>PAT</b>	<b>EPS</b>	<b>EPS</b>	<b>P/E</b>	<b>P/BV</b>	<b>RoE</b>	<b>RoCE</b>	<b>EV/</b>	<b>EV/</b>
52-Week Range (INR)	310/183	<b>End</b>	<b>(INR M)</b>	<b>(INR M)</b>	<b>(INR)</b>	<b>Growth (%)</b>	<b>(X)</b>	<b>(X)</b>	<b>(%)</b>	<b>(%)</b>	<b>Sales</b>	<b>EBITDA</b>
1,6,12 Rel. Perf. (%)	19/-8/11	03/10A	10,776	2,452	13.2	55.0	19.8	4.6	33.9	28.5	4.6	13.6
M.Cap. (INR b)	48.7	03/11A	15,856	3,661	19.6	49.3	13.3	3.5	30.4	24.1	3.5	12.4
M.Cap. (USD b)	1.0	03/12E	23,034	4,597	24.7	25.6	10.6	2.9	30.2	22.0	2.6	9.3
		03/13E	27,562	5,791	31.1	26.0	8.4	2.3	31.2	22.7	2.1	7.5

Opto Circuits' 3QFY11 results were above our estimates. Key highlights of the results:

- Opto Circuits' revenue grew 46% YoY to INR6.1b (v/s est of INR5.8b), EBITDA grew 39% YoY to INR1.7b (v/s est of INR1.6b) while EBITDA margins contracted by 140bp to 28% (v/s est of 27%). Adjusted PAT grew 30% YoY to INR1.25b (v/s est INR980m) led by better operational performance.
- Topline growth was led primarily by acquisition of CSC. Ex-CSC, OPTC's topline is estimated to have grown 25% YoY led by non-invasive segment which is estimated to have reported growth of 27%. Invasive business reported healthy revenue growth of 24.5% YoY.
- EBITDA growth was 39% YoY to INR1.7b (v/s est. of INR1.57b) while EBITDA margins contracted by 140bp to 28%. EBITDA growth was muted compared to topline growth because of higher staff cost and other expenses related to CSC acquisition.
- Adjusted PAT recorded 30% YoY growth to INR1.25b (v/s est INR980m), in line with strong operational performance but tempered down by higher interest cost and forex losses.

OPTC has delivered strong revenue and earnings growth over the last few years. It has consistently maintained its high return ratios. Despite rapid growth, the company still remains a marginal player in the global medical devices industry, which gives OPTC the opportunity to sustain its high revenue growth rate for the next couple of years. However, large accumulated goodwill in the books on account of past acquisitions, increasing working capital requirements thereby rapidly rising debt and very low free cash flow generation remain our major concerns. Further, the company is planning to raise money through equity dilution in one of its subsidiaries, which may lead to sizable EPS dilution going forward. Based on our revised EPS estimates, the stock trades at 10.6x FY12E and 8.4x FY13E EPS. We maintain **Neutral** with target price of INR249 (8x FY13E EPS).

Y/E March	Quarterly Performance (Consolidated)								(INR Million)	
	FY11				FY12				FY11	FY12E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
<b>Net Revenues</b>	<b>2,920</b>	<b>3,314</b>	<b>4,177</b>	<b>5,445</b>	<b>5,208</b>	<b>5,620</b>	<b>6,113</b>	<b>6,091</b>	<b>15,856</b>	<b>23,034</b>
YoY Change (%)	26.7	29.6	62.5	62.8	78.4	69.6	46.4	11.9	47.1	45.3
Total Expenditure	1,949	2,257	2,948	4,255	3,776	4,074	4,403	4,422	11,409	16,674
<b>EBITDA</b>	<b>971</b>	<b>1,057</b>	<b>1,228</b>	<b>1,190</b>	<b>1,432</b>	<b>1,547</b>	<b>1,710</b>	<b>1,669</b>	<b>4,446</b>	<b>6,359</b>
Margins (%)	33.2	31.9	29.4	21.8	27.5	27.5	28.0	27.4	28.0	27.6
Depreciation	91	115	153	150	150	109	141	192	508	592
Interest	52	62	88	119	109	138	168	269	321	685
Other Income	94	-82	105	188	49	-51	-42	19	304	-25
<b>PBT before EO Income</b>	<b>922</b>	<b>799</b>	<b>1,091</b>	<b>1,109</b>	<b>1,222</b>	<b>1,248</b>	<b>1,359</b>	<b>1,227</b>	<b>3,922</b>	<b>5,058</b>
EO Exp/(Inc)	-4	1	4	-14	0	0	-5	0	-12	-5
<b>PBT after EO Income</b>	<b>926</b>	<b>798</b>	<b>1,087</b>	<b>1,123</b>	<b>1,222</b>	<b>1,249</b>	<b>1,364</b>	<b>1,227</b>	<b>3,934</b>	<b>5,063</b>
Tax	92	23	127	6	57	33	109	256	249	456
Rate (%)	10.0	2.9	11.7	0.6	4.7	2.7	8.0	20.8	6.3	9.0
Minority Int/Adj on Consol	3	1	3	6	1	5	3	3	13	5
<b>Reported PAT</b>	<b>831</b>	<b>774</b>	<b>957</b>	<b>1,110</b>	<b>1,164</b>	<b>1,210</b>	<b>1,251</b>	<b>969</b>	<b>3,672</b>	<b>4,602</b>
<b>Adj PAT</b>	<b>828</b>	<b>774</b>	<b>961</b>	<b>1,097</b>	<b>1,164</b>	<b>1,210</b>	<b>1,253</b>	<b>969</b>	<b>3,661</b>	<b>4,597</b>
YoY Change (%)	39.7	12.3	45.8	57.5	40.6	56.3	30.4	-11.7	39.1	25.6
Margins (%)	28.3	23.4	23.0	20.1	22.4	21.5	20.5	15.9	23.1	20.0

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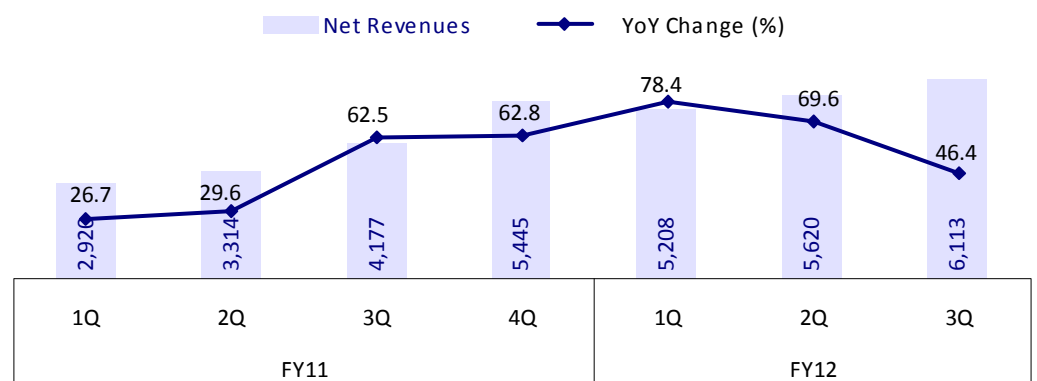
**Non-invasive business drives revenue growth on the back of CSC acquisition**

Opto Circuits' revenue grew 46% YoY to INR6.1b (v/s est of INR5.8b), EBITDA grew 39% YoY to INR1.7b (v/s est of INR1.6b) while EBITDA margins contracted by 140bp to 28% (v/s est of 27%). Adjusted PAT grew 30% YoY to INR1.25b (v/s est INR980m) led by better operational performance.

Topline growth was led primarily by acquisition of CSC. Though the management has not disclosed CSC revenues, we estimate it at INR1.7b. Management has guided for revenues of USD140m/INR6.8b for FY12.

Ex-CSC, OPTC's topline is estimated to have grown by 24.8% YoY to INR4.41b led by non-invasive segment which is estimated to have reported growth of 27.2% YoY to INR3.1b (above est). Invasive business reported healthy revenue growth of 24.5% YoY to INR1.3b (above our est).

**Revenue Trend (INR M)**

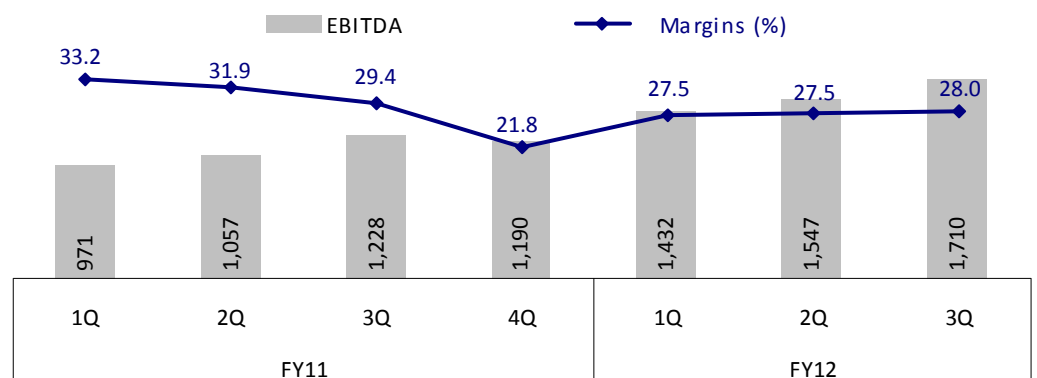


Source: Company/MOSL

**EBITDA grew by 39.3%YoY to INR1.71b**

EBITDA growth was 39% YoY to INR1.7b (v/s est. of INR1.57b) while EBITDA margins contracted by 140bp to 28%. EBITDA growth was muted compared to topline growth because of higher staff cost and other expenses related to CSC acquisition. EBITDA was above our estimates due to better than estimated EBITDA margins led by lower than estimated Staff cost.

**Trend in EBITDA margins (INR M)**



Source: Company/MOSL

Adjusted PAT recorded 30% YoY growth to INR1.25b (v/s est INR980m), in line with strong operational performance but tempered down by higher interest cost and forex losses.

### **OPTC aims at USD1b annual revenue by FY15; Guidance of 20-25% top-line growth**

The management aims at annual revenue of USD1b by FY15 and has guided topline growth of 20-25% CAGR over the medium term. The FY15 revenue target looks tough, as it entails over 25% revenue CAGR after FY12. The management has revised its FY12 revenue growth guidance from 40% to 45% due to better than expected performance in 9MFY12. The 45% growth guidance is partly led by consolidation of its newly acquired US company, Cardiac Science Corp (CSC). Excluding this acquisition, growth of the other businesses is indicated at 25% in FY12. For CSC, the management has guided revenue of USD140m in FY12. Growth will be led mainly by the invasive segment due to the large size of the opportunity, increasing penetration, brand building efforts and low base.

The management expects the invasive business to post over 30% CAGR in the medium term. Growth in the non-invasive segment will come from increased penetration in various markets, leveraging the distribution network of acquired companies and new product launches.

### **Equity dilution in subsidiary on the cards; May lead to sizeable EPS dilution**

The management proposes to raise up to INR10b through an initial public offering (IPO) of Opto Eurocor Healthcare Limited (OEHL), a wholly owned subsidiary in the invasive segment. The funds raised will be used for clinical trials and on OEHL's marketing and distribution activities. OPTC is looking to dilute at least 25% of OPTC's stake in OEHL. The management hopes to get a ~USD800m valuation for OEHL, which appears stiff, in our view. A market cap of USD800m values OEHL at ~8x FY11 revenue and ~40x FY11 PAT. The management may look to dilute stake in other subsidiaries in future to achieve its target of USD1b in revenue by FY15.

### **High debt, goodwill and deteriorating working capital remain concerns**

We estimate INR13b loan on the books of the OPTO by the end of FY12 up from INR8.8b reported in FY11. This will translate into a debt/equity ratio of 0.8x. We believe that OPTC will have to raise further debt to fund its higher growth guidance, which will push interest cost higher. Also, goodwill on the company's books stands at INR4.45b, which is ~35% of its net worth. Any deterioration in market dynamics leading to intangible write-offs may impact OPTC's financials.

Further, its working capital cycle deteriorated in FY11, with INR3.7b increase in non-cash net current assets. We expect further deterioration in working capital as OPTC's inventory days and debtor days had increased sharply during the year. As of 31st Dec 2011, the Net Working Capital of the company stands at 251days. We are estimating working capital at 254days by the end of FY12.

### Upgrading EPS estimates by 5%

Post the better than estimates 3QFY12 results, we are upgrading our earnings estimates. We are upgrading our EBITDA estimates for FY12 and FY13 by 3% and 2.5% respectively to budget increased revenue guidance and better than estimated EBITDA margins for the quarter. Further, we are revising our earnings estimates upwards for FY12 and FY13 by 5.5% respectively led by better operational performance, lower than estimated depreciation & tax rate and higher interest cost. We now estimate EPS at INR24.7 (up 25.6%) for FY12 and at INR31.1 (up 26%) for FY13

### Outlook and valuation

OPTC has delivered strong revenue and earnings growth over the last few years. It has consistently maintained its high return ratios. Despite rapid growth, the company still remains a marginal player in the global medical devices industry, which gives OPTC the opportunity to sustain its high revenue growth rate for the next couple of years. However, large accumulated goodwill in the books on account of past acquisitions, increasing working capital requirements thereby rapidly rising debt and very low free cash flow generation remain our major concerns.

Further, the company is planning to raise money through equity dilution in one of its subsidiaries, which may lead to sizable EPS dilution going forward. Based on our revised EPS estimates, the stock trades at 10.6x FY12E and 8.4x FY13E EPS. We maintain **Neutral** with target price of INR249 (8x FY13E EPS).

## Opto Circuits: an investment profile

### Company description

Opto Circuits is the largest medical device maker from India. The company started its business as a supplier of sensors to large OEMs. Over the years, Opto catapulted itself into a full fledged producer and supplier of patient monitoring devices in the non-invasive segment and stents in the invasive segment, led by acquisitions. The company has a strong distribution network of 1300 distributors across more than 50 countries.

### Key investment arguments

- Opto's core business of non-invasive devices is getting stronger due to favorable market dynamics, diversified product offerings, cost competitiveness and expanding distribution reach. The non-invasive business segment is expected to grow 36% CAGR over FY11-13.
- The invasive business is a key long term growth driver due to large market opportunity, new product launches and increasing product awareness. This business is expected to grow 22% CAGR over FY11-13.
- Opto has delivered strong growth in revenues and earnings in the past few years. It has consistently maintained its high return ratios.

### Key investment risks

- High working capital eats away large portions of the company's profits. Therefore the company has not generated adequate free cash-flows.

- Product approvals in regulated markets and product acceptance especially in the invasive segment is difficult and time consuming.
- Higher than expected rupee appreciation could adversely impact future earnings.
- Technological advancement especially in the invasive segment may reduce the size of opportunity significantly to enhance profitability of acquired companies which currently have lower margins.

### Recent developments

- Acquired Cardiac Science Corporation (manufacturer of non-invasive medical devices) in US.
- Tied up with Omron to distribute Automated External Defibrillators (AED) in Japan

### Valuation and view

- Valuations Stable profitability and working capital days are likely to sustain the high return ratios. It is likely to report 26% earnings CAGR over FY11-13.
- The stock trades at 10.6x FY12E EPS of INR24.7 and 8.4x FY13E EPS of INR31.1.

### Sector view

- The global patient monitoring device market size is estimated at USD5.7b in 2011, up from USD2.8b in 2002 representing a CAGR of 6.6%. The size of the global coronary stent market is estimated at USD7b with top-4 players accounting for 85% of the market. Market growth will be driven by emerging markets in the future.

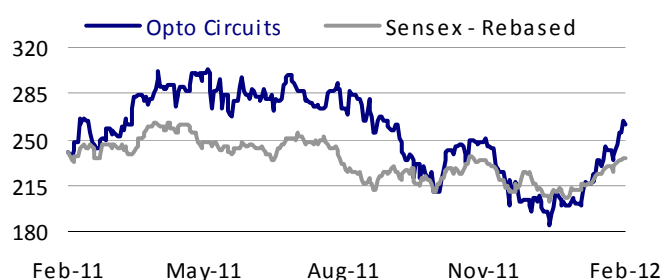
### EPS: MOSL forecast v/s consensus (INR)

	MOSL forecast	Consensus forecast	Variation (%)
FY12	24.7	24.7	0.0
FY13	1.1	30.3	2.8

### Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
261	249	-5.0	Neutral

### Stock performance (1 year)



### Shareholding pattern (%)

	Dec-11	Sep-11	Dec-10
Promoter	28.1	28.1	27.4
Domestic Inst	1.2	1.3	2.2
Foreign	45.2	46.0	45.0
Others	25.5	24.7	25.4

## Financials and Valuation

Income Statement		(INR Million)				
Y/E March	2009	2010	2011	2012E	2013E	
<b>Net Sales</b>	<b>8,185</b>	<b>10,776</b>	<b>15,856</b>	<b>23,034</b>	<b>27,562</b>	
Change (%)	74.9	31.7	47.1	45.3	19.7	
<b>EBITDA</b>	<b>2,591</b>	<b>3,669</b>	<b>4,446</b>	<b>6,359</b>	<b>7,910</b>	
Margin (%)	31.6	34.0	28.0	27.6	28.7	
<b>R&amp;D Adjustment</b>	<b>558</b>	<b>200</b>	<b>0</b>	<b>0</b>	<b>0</b>	
<b>Adjusted EBITDA</b>	<b>2,032</b>	<b>3,469</b>	<b>4,446</b>	<b>6,359</b>	<b>7,910</b>	
Margin (%)	24.8	32.2	28.0	27.6	28.7	
Depreciation	138	278	508	592	721	
<b>EBIT</b>	<b>2,452</b>	<b>3,391</b>	<b>3,938</b>	<b>5,767</b>	<b>7,188</b>	
Int. and Finance Charges	537	382	321	685	849	
Other Income - Rec.	288	-76	304	-25	30	
<b>PBT before EO Expense</b>	<b>2,203</b>	<b>2,933</b>	<b>3,922</b>	<b>5,058</b>	<b>6,369</b>	
Extra Ordinary Expense/(	35	32	-12	-5	0	
<b>PBT after EO Expense</b>	<b>2,168</b>	<b>2,901</b>	<b>3,934</b>	<b>5,063</b>	<b>6,369</b>	
Current Tax	77	298	249	456	510	
Deferred Tax	-2	-1	0	0	0	
Tax	75	296	249	456	510	
Tax Rate (%)	3.5	10.2	6.3	9.0	8.0	
<b>Reported PAT</b>	<b>2,093</b>	<b>2,604</b>	<b>3,685</b>	<b>4,607</b>	<b>5,860</b>	
Less: Mionrity Interest	6	1	13	5	5	
<b>Adj PAT</b>	<b>1,582</b>	<b>2,452</b>	<b>3,661</b>	<b>4,597</b>	<b>5,791</b>	

Balance Sheet		(INR Million)				
Y/E March	2009	2010	2011	2012E	2013E	
Equity Share Capital	1,615	1,829	1,864	1,864	1,864	
Total Reserves	3,551	8,615	11,911	14,898	19,040	
<b>Net Worth</b>	<b>5,166</b>	<b>10,444</b>	<b>13,775</b>	<b>16,762</b>	<b>20,904</b>	
Minority Interest	134	135	235	235	235	
Deferred liabilities	3	2	234	234	234	
Total Loans	5,379	2,328	8,844	13,064	13,064	
<b>Capital Employed</b>	<b>10,682</b>	<b>12,909</b>	<b>23,087</b>	<b>30,294</b>	<b>34,436</b>	
Gross Block	5,035	5,948	13,473	15,352	17,152	
Less: Accum. Deprn.	666	853	3,110	3,702	4,423	
<b>Net Fixed Assets</b>	<b>4,369</b>	<b>5,095</b>	<b>10,363</b>	<b>11,650</b>	<b>12,729</b>	
Capital WIP	172	261	252	172	172	
Investments	3	3	0	0	0	
<b>Curr. Assets</b>	<b>9,843</b>	<b>10,886</b>	<b>19,265</b>	<b>25,407</b>	<b>29,899</b>	
Inventory	2,305	2,213	4,324	5,995	7,174	
Account Receivables	4,060	4,396	6,793	9,466	10,949	
Cash and Bank Balance	913	1,223	2,342	2,373	2,715	
Loans & Advances	2,565	3,054	5,806	7,573	9,061	
<b>Curr. Liability &amp; Prov.</b>	<b>3,709</b>	<b>3,395</b>	<b>6,860</b>	<b>7,003</b>	<b>8,432</b>	
Account Payables	2,510	1,782	5,164	5,427	6,494	
Provisions	1,198	1,613	1,696	1,576	1,938	
<b>Net Current Assets</b>	<b>6,134</b>	<b>7,491</b>	<b>12,405</b>	<b>18,404</b>	<b>21,467</b>	
Misc Expenditure	3	59	68	68	68	
<b>Appl. of Funds</b>	<b>10,682</b>	<b>12,909</b>	<b>23,087</b>	<b>30,294</b>	<b>34,436</b>	

E: MOSL Estimates

Ratios						
Y/E March	2009	2010	2011	2012E	2013E	
<b>EPS (INR)</b>	<b>8.5</b>	<b>13.2</b>	<b>19.6</b>	<b>24.7</b>	<b>31.1</b>	
Cash EPS	13.8	15.8	22.4	27.9	35.3	
BV/Share	32.0	56.8	73.5	89.6	111.8	
DPS	4.0	4.5	4.5	7.4	7.9	
Payout (%)	36.1	36.8	26.6	35.1	29.2	
<b>Valuation (x)</b>						
P/E	30.7	19.8	13.3	10.6	8.4	
Cash P/E	18.9	16.6	11.6	9.4	7.4	
P/BV	8.2	4.6	3.5	2.9	2.3	
EV/Sales	6.5	4.6	3.5	2.6	2.1	
EV/EBITDA	20.5	13.6	12.4	9.3	7.5	
Dividend Yield (%)	1.5	1.7	1.7	2.8	3.0	
FCF per Share	-24.5	6.6	-35.2	-10.1	15.6	
<b>Return Ratios (%)</b>						
EBITDA Margins (%)	31.6	34.0	28.0	27.6	28.7	
Net Profit Margins (%)	19.3	22.8	23.1	20.0	21.0	
RoE	51.7	33.9	30.4	30.2	31.2	
RoCE	37.4	28.5	24.1	22.0	22.7	
<b>Working Capital Ratios</b>						
Accumulated Dep/Gross Blk	0.1	0.1	0.2	0.2	0.3	
Asset Turnover (x)	0.8	0.8	0.7	0.8	0.8	
Fixed Asset Turnover (x)	3.1	2.3	2.1	2.1	2.3	
Debtor (Days)	181	149	156	150	145	
Inventory (Days)	103	75	100	95	95	
Working Capital Turnover (C	233	212	232	254	248	
<b>Leverage Ratio (x)</b>						
Current Ratio	2.7	3.2	2.8	3.6	3.5	
Interest Cover Ratio	4.6	8.9	12.3	8.4	8.5	
Debt/Equity	1.1	0.2	0.7	0.8	0.6	

\* Ratios adjusted for bonus issue

Cash Flow Statement		(INR Million)				
Y/E March	2009	2010	2011	2012E	2013E	
Oper. Profit/(Loss) before T	2,591	3,669	4,446	6,359	7,910	
Interest/Dividends Recd.	288	-76	304	-25	30	
Direct Taxes Paid	-77	-298	-17	-456	-510	
(Inc)/Dec in WVC	-2,733	-1,047	-3,795	-5,968	-2,721	
<b>CF from Operations</b>	<b>68</b>	<b>2,248</b>	<b>938</b>	<b>-89</b>	<b>4,709</b>	
EO Expense / (Income)	35	32	-12	-5	0	
<b>CF fr. Oper. incl EO Exp.</b>	<b>33</b>	<b>2,216</b>	<b>950</b>	<b>-84</b>	<b>4,709</b>	
(inc)/dec in FA	-3,981	-1,002	-7,515	-1,800	-1,800	
(Pur)/Sale of Investments	0	0	3	0	0	
<b>CF from Investments</b>	<b>-3,981</b>	<b>-1,002</b>	<b>-7,512</b>	<b>-1,800</b>	<b>-1,800</b>	
Change in networth	1,046	3,487	2,367	-5	-5	
Inc/(Dec) in Debt	4,422	-3,050	6,616	4,220	0	
Interest Paid	-537	-382	-321	-685	-849	
Dividend Paid	-755	-959	-981	-1,615	-1,713	
<b>CF from Fin. Activity</b>	<b>4,176</b>	<b>-904</b>	<b>7,681</b>	<b>1,915</b>	<b>-2,567</b>	
<b>Inc/Dec of Cash</b>	<b>228</b>	<b>310</b>	<b>1,119</b>	<b>31</b>	<b>342</b>	
Add: Beginning Balance	686	913	1,223	2,342	2,373	
<b>Closing Balance</b>	<b>913</b>	<b>1,223</b>	<b>2,342</b>	<b>2,373</b>	<b>2,715</b>	

**N O T E S**

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