

K.J. Somaiya Institute of Management Studies & Research

Course: PGDM Executive Tri IV

Sub: Investment Management

Date of Exam: 14/09/2017

Time: 3 Hours

Marks:

50

Please Note:

- 1. Each question in Section A carries 25 marks. Attempt any one.**
- 2. Each question in Section B carries 15 marks. Attempt any one.**
- 3. Each question in Section C carries 10 marks. Attempt any one.**
- 4. The exam is Excel-based but the solution and explanation for each question has to be written in the answer sheet.**

SECTION A

Q1. Valuation of CIPLA

Company Background

Cipla Limited is a leading pharmaceutical company in India with a strong presence in both, the export and domestic markets. It has well diversified pharma product portfolio that includes Over the Counter (OTC) products, prescription products, flavors and fragrances, and pesticides.

Cipla is one of the largest players in the domestic formulation market with a market share of around 5.3%. It also has a presence across most therapeutic areas. Domestic formulations contributed 40% to the company's total turnover in FY2016. The company is the market leader in key therapeutic areas such as respiratory care, anti-viral and urological. Cipla's distribution network in India consists of a field force of around 7,000-8,000 employees. The company also has robust exports to several markets including US, Europe, South Africa, Australia and the Middle East. Cipla's strategy for regulated

markets (Europe and US) exports is built around supply tie-ups with global players. On the exports front, where it follows the partnership model, it has 5,700 product registrations in around 180 countries.

The key growth drivers are anticipated to be:

Export segment

Cipla exports to more than 180 countries, with growth coming through marketing alliances and distribution tie-ups in various markets. Exports contributed 60% to the total turnover in FY2016, with Africa, US and Latin America constituting more than ~60% of total exports. In the US, Cipla has a strong product pipeline of 168 ANDAs (Abbreviated New Drug Application), out of which, 950 are approved. Another long term growth driver for the company is the launch of the CFC-free inhalers in the regulated markets. CFC-free inhalers in Europe and US address a potential market size of more than US\$3bn. The company is likely to continue on the growth trajectory owing to its entry into the inhalers market in the EU and potential new long-term manufacturing contracts with Global Innovators.

Increasing penetration in the domestic market

Cipla plans to increase its focus on domestic markets with new therapies such as oncology and neuro-psychiatry in the offing. It also plans to focus on growing its market share and sales by increasing penetration in the Indian market, especially in rural areas, and plans to expand its product portfolio by launching biosimilars, particularly relating to the oncology, anti-asthmatic and anti-arthritis categories.

STRENGTH

[1] Export segment to be the growth driver: Cipla exports to more than 180 countries, exports contributed 61% to the total turnover in FY2015, with Africa, US and Latin America constituting more than ~60% of total exports. In the U.S., Cipla has a strong product pipeline of 147 Abbreviated New Drug Application (ANDA), out of which, 79 are approved. ANDA is submitted to the Food & Drug Administration (FDA) in the United States for seeking approval of a generic drug product.

[2] Increasing penetration in the domestic market Cipla is one of the largest players in the domestic formulation market, with a market share of around 5.3%. Domestic formulations contributed 43% to the company's total turnover in FY2015. The company is the market leader in key therapeutic areas such as respiratory care, anti-viral and urological.

[3] Launch of CFC-free inhalers Another potential long term growth driver for the company is the CFC-free inhalers in the regulated markets. CFC-free inhalers in Europe and U.S. address a potential market size of more than U.S. \$3 billion.

CHALLENGES

[1] Intense Competition: Competes with various pharmaceutical companies that have similar products in the same market but manufactured at facilities which have been approved by the highest regulatory authorities in the United States and Europe.

[2] Regulatory Environment Risk due to adverse developments in regulatory environment and statutory provisions. National Pharmaceutical Pricing Authority (NPPA) controls and regulates the prices of pharmaceutical drugs in India. Price controls imposed by the authority are unpredictable and have a negative impact on company's profitability margins.

Use the data given in folder Q1 to generate FCFF for CIPLA LTD. and comment on the results. Annual reports for the years 2016 & 2017, investor presentation and other text are given in the folder Q1 for your reference.

OR

Q2. Portfolio Creation

Sana is an analyst working for ACK Securities Limited. She has joined ACK recently. The first task that she faces is to create an equity portfolio that can be offered to her company's clients who

have varied risk profile. After undertaking extensive security analysis, she short lists following 19 stocks:

1. WHIRLPOOL
2. SYMPHONY
3. MARICO
4. GODREJ
5. KIRLOSKAR
6. ADF
7. BAMBINO
8. VIP
9. JKTYRE
10. ESCORT
11. KICL
12. DECCAN
13. TECH MAHINDRA
14. ASTEC LIFE
15. DIVIS LAB
16. FINOLEX CABLES
17. RAMCO CEMENT
18. GUJARAT ALKALINE
19. VOLTAS

However, with adequate diversification always being debated and a general trend towards a more concentrated portfolio, her unit head advises her to prune the list and make a six security portfolio. Help Sana create minimum variance portfolio and optimal risky portfolio, using risk-free rate of 6.5%. Also trace the efficient frontier. Use stock price information given in file 'Q2'. Explain how ACK will identify the optimal portfolio for each of its clients from the efficient set created by Sana using mean variance optimization.

SECTION B

Q3. Use the *case text and case data* given in folder 'Q3' to answer the following questions:

- a. Estimate and compare the annualized returns and risk of Reynolds and Hasbro with that of the S&P 500 Index. Which stock appears to be the riskiest?
- b. Suppose Sharpe's position had been 99% of equity funds invested in the S&P 500 and either 1% in Reynolds or 1% in Hasbro. Estimate the resulting portfolio position. How does each stock impact the risk of the equity investment?
- c. Perform a regression of each stock's monthly return on the Index return to compute a 'beta' for each stock.

OR

Q4. Use data given in the file Q4 to chart PE band for Larsen & Toubro Ltd. Comment on the stock's valuation using the PE band chart and weekly adjusted closing price data.

SECTION C

Q5. KWB Transformers Ltd.(KWB) has a ROE of 9% and beta of 1.20. Analysts expect the company to maintain indefinitely its retention ratio of 2/3. The company has just paid the current dividend on an earning of Rs.3 per share. Market is expected to return 13% in the coming year and T-bills yield 6% return. Use this information to answer the following:

- a. What is the correct price at which KWB should sell?
- b. What is its trailing and forward P/E ratio?

Data is also given the file 'Q5'.

Q6. Use the information given below to determine which securities are overvalued, undervalued or fairly valued. Illustrate the result graphically. The risk-free rate is 6% and the return on the market portfolio is 9 percent.

Stock	Current Price (P_t)(Rs.)	Expected Price (P_{t+1})(Rs.)	Expected Dividend (D_{t+1})(Rs.)	Beta
TWT Ltd	26	27	1.1	0.8
KBG Ltd.	41	43	0.5	1

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CWR Ltd.	34	38	1.3	1.2
DRT Ltd.	65	67	1.12	1.38
WEW Ltd.	49	52	-	-0.35

Data is also given the file 'Q6'.