Aventis Pharma

STOCK INFO.	BLOOMBERG
BSE Sensex: 15,290	HOEC IN
	REUTERS CODE
S&P CNX: 4,497	AVPH.BO

Equity Shares (m)	23.0
52-Week Range	1,886/1,160
1,6,12 Rel. Perf. (%)	-4/-8/-48
M.Cap. (Rs b)	32.6
M.Cap. (US$ b)	0.8

17 July 2007 **Buy**

Previous Recommendation: Buy Rs1,416

YEAR END	NET SALES (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES	EV/ EBITDA
12/06A	8,821	1,693	73.5	3.2	19.3	5.5	28.6	42.0	3.3	13.0
12/07E	9,480	1,664	72.3	-1.7	19.6	4.7	24.0	36.3	2.9	13.1
12/08E	10,655	2,052	89.1	23.3	15.9	3.9	24.8	37.6	2.5	9.9

Aventis Pharma's 2QCY07 results are lower than our estimates, with sales growth of just 3.3% (vs est. of 11.1%) and EBITDA margins at 19.3% (vs est. of 26.7%). Key highlights include:

- Net sales grew by just 3.3% to Rs2.3b, due to export de-growth of 9% YoY to Rs469m and domestic sales growth of 7% to Rs1.8b. Supplies to Russia and sourcing by the parent are the two main components of exports for the company. Domestic sales growth would have been higher but for lower supplies of Rabipur (~Rs780m product) due to production related issues.
- EBITDA margins declined by 850bp to 19.3% due to lower Rabipur sales (a high margin product), higher staff cost (up 44% YoY, partly due to AS15 provisioning) and higher expenses linked to services rendered to the parent (income being part of other income). However, higher other income (up 102% to Rs182m, including service income of Rs67m) restricted PAT decline to 15% at Rs373m.
- We are revising our estimates for CY07E and CY08E downward by 10.7% to Rs72.3 and 2.3% to Rs89.1 respectively, to factor in for lower exports, Rabipur supply issues and AS15 provisioning.

We believe that APL will be one of the key beneficiaries of the patent regime in the long-term. The parent has a strong R&D pipeline with a total of 125 products under development, of which 25 are in Phase-III. It plans to file 40 NDAs by CY10E. While the 2Q results were below estimates, we continue to remain positive on APL's long-term prospects. We believe that, at 16x CY08E earnings, valuations are not demanding. Maintain **Buy** with a revised target price of Rs1,750.

QUARTERLY PERFORMANCE (Rs Million)

Y/E DECEMBER	CY06				CY07				CY06	CY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Net Sales	**2,005**	**2,228**	**2,431**	**2,176**	**2,129**	**2,302**	**2,700**	**2,349**	**8,840**	**9,480**
YoY Change (%)	*16.2*	*4.4*	*8.8*	*11.2*	*6.2*	*3.3*	*11.0*	*8.0*	*9.4*	*7.2*
Total Expenditure	1,513	1,609	1,744	1,749	1,635	1,857	2,023	1,859	6,633	7,375
EBITDA	**492**	**619**	**687**	**427**	**494**	**445**	**676**	**490**	**2,207**	**2,105**
Margins (%)	*24.5*	*27.8*	*28.3*	*19.6*	*23.2*	*19.3*	*25.1*	*20.9*	*25.0*	*22.2*
Depreciation	43	42	43	51	45	47	47	56	179	195
Interest	0	1	0	1	0	0	0	0	2	0
Other Income	96	90	156	111	200	182	123	110	471	615
PBT before EO Items	**545**	**666**	**800**	**486**	**649**	**580**	**753**	**544**	**2,497**	**2,526**
Extra-Ord Expense	0	0	0	0	0	0	0	0	0	0
PBT after EO Items	**545**	**666**	**800**	**486**	**649**	**580**	**753**	**544**	**2,497**	**2,526**
Tax	176	227	262	139	216	207	257	182	804	862
Effective tax Rate (%)	*32.3*	*34.1*	*32.8*	*28.6*	*33.3*	*35.7*	*34.1*	*33.4*	*32.2*	*34.1*
Reported PAT	**369**	**439**	**538**	**347**	**433**	**373**	**496**	**363**	**1,693**	**1,664**
Adj PAT	**369**	**439**	**538**	**347**	**433**	**373**	**496**	**363**	**1,693**	**1,664**
YoY Change (%)	*56.4*	*28.4*	*8.2*	*-7.7*	*17.3*	*-15.0*	*-7.8*	*4.5*	*16.7*	*-1.7*
Margins (%)	*18.4*	*19.7*	*22.1*	*15.9*	*20.3*	*16.2*	*18.4*	*15.4*	*19.2*	*17.6*

E: MOSt Estimates

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Decline in exports and Rabipur supply issues restricts sales growth

Aventis's net sales for 2QCY07 grew just by 3.3% to Rs2.3b, primarily impacted by 9% YoY decline in exports to Rs469m and domestic sales growth of just 7% to Rs1.8b. Exports, partly impacted by rupee appreciation, continued with its lackluster performance and has declined in 6 of the last 7 quarters. Supplies to Russia and sourcing by the parent are the two main components of exports for the company. Domestic sales growth would have been higher but for lower supplies of Rabipur (~Rs780m product) due to production related issues.

TREND IN MARKET MIX (RS M)

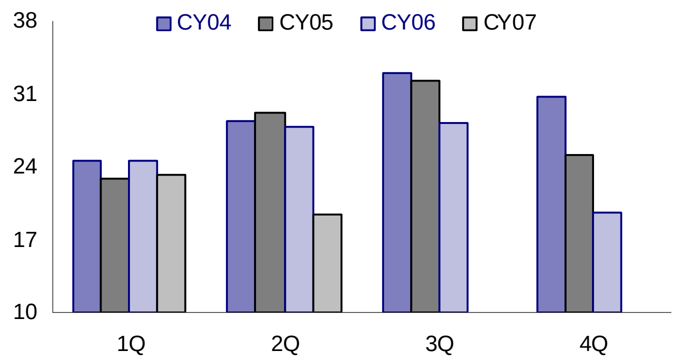
	2QCY07	2QCY06	YOY (%)	1QCY07	QOQ (%)
Net Domestic Sales	1,833	1,712	7.1	1,706	7.4
% of Sales	*79.6*	*76.8*		*80.1*	
Exports	469	516	-9.1	423	10.9
% of Sales	*20.4*	*23.2*		*19.9*	
Net Sales	2,302	2,228	3.3	2,129	8.1

Source: Company/Motilal Oswal Securities

EBITDA margins decline

EBITDA margins declined by 850bp to 19.3% due to lower Rabipur sales (a high margin product), higher staff cost (up 44% YoY, partly due to AS15 provisioning) and higher expenses linked to services rendered to the parent (income being part of other income). Adjusting for low-margin service income, EBITDA margins would have been around 22%. Also, appreciating rupee would have had also impacted margins, as ~20% of the company sales are from international markets.

TREND IN EBITDA MARGIN (%)



Source: Company/Motilal Oswal Securities

Parent committed to listed entity

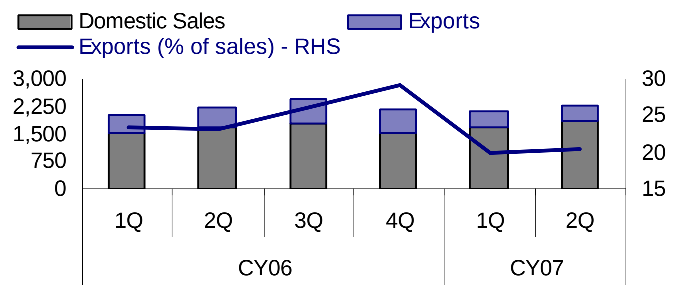
APL management (at the recent AGM) has reiterated the parent's commitment to the listed entity despite the existence of Sanofi's 100% subsidiary. Management clearly mentioned that the interests of the listed entity will not be compromised as far as new launches are concerned. This is also vindicated from the company's past track record wherein most of the new launches have come through the listed entity. In fact, APL has been one of the most aggressive companies in the MNC category as far as launch of new products are concerned.

AVENTIS – PORTFOLIO MAPPING WITH PARENT

PRODUCT	INDIA LAUNCH	LAUNCH YEAR	POSSIBILITY OF LAUNCH IN INDIA
Lovenox/Clexane	Y		N.A.
Plavix/Iscover - Sanofi Product	Y		N.A.
Allegra	Y	1998	N.A.
Taxotere	Y		N.A.
Stilnox/Ambien/Myslee - Sanofi Product	N		No - Global launch in 1992. Old product
Eloxatin - Sanofi Product	N		Yes - Global launch in 1996
Delix/Tritace/Triatec	Y	1994	N.A.
Lantus	Y	2003	N.A.
Aprovel/Avapro/Karvea - Sanofi Product	N		Yes - Global launch in 1997 But Indian companies have already launched this product
Copaxone	N		No – Product belongs to Teva
Amaryl	Y	1999	N.A.
Actonel	Y	2003	N.A.
Depakine - Sanofi Product	Y		N.A.
Nasacort - Sanofi Product	Status not known		
Xatral - Sanofi Product	N		Unlikely - It is a 1988 product

Source: Company/Motilal Oswal Securities

TREND IN MARKET MIX



Source: Company/Motilal Oswal Securities

Exports to gradually improve going forward

APL indicated that the outsourcing by the parent is likely to increase in the coming years. It has already commenced export of APIs like Articaine, Glibenclamide and Lasamide to the parent. It also commenced exporting Paracetamol in 1QCY07. APL's exports have de-grown in six of the last seven quarters as some of its products were removed from the Federal Reimbursement List in Russia. Management indicated that export performance is likely to improve in the future due to increased outsourcing by the parent.

Negotiating for renewal of Rabipur agreement with Chiron

Rabipur (anti-rabies vaccine) is currently manufactured through a JV between APL & Chiron (now Novartis) and marketed by APL. The JV agreement has expired recently and it was generally expected that Rabipur will revert back to Chiron. Management has indicated that it is currently negotiating with Novartis to renew the agreement for future. Rabipur recorded sales of Rs780m on annualized basis.

Withdrawal of Cox-II inhibitors may benefit Aventis India

We believe that the withdrawal of Rofecoxib and Valdecoxib (cox-II inhibitors) from the global and Indian markets due to adverse side effects may have a positive impact on the sales of older (and proven) painkillers like APL's Combiflam. Historically, Combiflam has grown in single digits.

Well placed to benefit from the patent regime

Over the longer term, APL is well placed to benefit from the introduction of product patents, given its strengths in marketing, a supportive parent and a healthy product pipeline (of NCEs) following the formation of Sanofi-Aventis. APL's history of launching patented products in India, a well mapped portfolio vis-à-vis the parent and ability to build them into big brands make it one of the biggest potential beneficiaries of the product patent regime in India.

We believe that the patent regime will bring-in significant benefits for APL, albeit in the long-term. We expect launch of patented products from the parent's portfolio by 2008/09. The company is yet to give visibility on launch of patented products in India.

To benefit from the parent's R&D pipeline

Sanofi-Aventis currently has 125 projects in research and development, including about 38 in pre-clinical development and 58 in late stage (Phase II & III) development. It is planning to file about 31 NDAs and 9 vaccines with the regulatory authorities by CY10E. The table below gives details on the parent's R&D pipeline:

SANOFI-AVENTIS R&D PIPELINE

NO. OF	PRE-	PHASE				TOTAL
DRUGS	CLINICAL	I	IIA	IIB	III	
Metabolic Disorders	2	1	2	4	0	9
Thrombosis	3	1	0	3	2	9
Cardiovascular	2	5	1	4	1	13
Central Nervous System	8	8	1	4	6	27
Internal Medicine	9	5	5	4	2	25
Oncology	7	4	1	0	6	18
Vaccines	7	5	2	2	8	24
Total	**38**	**29**	**12**	**21**	**25**	**125**

Source: Sanofi-Aventis (as of February 07)

Although, clarity on launch of these drugs will emerge only over a period of time, we believe that some of these products could be relevant for the Indian markets and are likely to be launched in India with a time-lag. However, uncertainty still remains on whether these products will be launched through the listed subsidiary or the 100% subsidiary.

New drug policy still remains uncertain

We believe that the biggest risk to our positive stance on APL could be the implementation of the new pharmaceutical policy in the current form. The new policy proposes to significantly increase the span of control by bringing in additional 354 drugs under price control. This could severely impact the profitability of APL's domestic business. Industry has taken strong objection to the proposed policy and we believe that the policy is unlikely to be implemented in the current form. Given the strong opposition from the industry, the government has formed a Group on Ministers (GoM), which would give final recommendations to the government regarding the new pharmaceutical policy. However, the uncertainty related to this will remain till the government finally notifies the new pharmaceutical policy.

Revising estimates downwards

We are revising our estimates for CY07E and CY08E downward by 10.8% to Rs72.3 and 2.3% to Rs89.1 respectively, to factor in for lower exports, Rabipur supply issues and AS15 provisioning.

REVISED FORECAST (RS M)

	CY07			CY08		
	REV	OLD	CHG (%)	REV	OLD	CHG (%)
Net Sales	9,480	9,661	-1.9	10,655	10,750	-0.9
Net Profit	1,664	1,867	-10.8	2,052	2,101	-2.3
EPS (Rs)	72.3	81.0	-10.8	89.1	91.2	-2.3

Source: Motilal Oswal Securities

Valuation and outlook

APL has an impeccable track record of brand building in the domestic market with its strategic brands recording double digit growth consistently. In the long-term, focus on growing strategic brands and strong support from the parent will augur well for the company. We believe that it is very well positioned to take advantage of the patent regime in the long-term. It is in the process of integrating Sanofi's domestic operation with itself (post the global merger). We believe that there is very little over-lap between APL and Sanofi's portfolio in India.

We believe that APL will be one of the key beneficiaries of the patent regime in the long-term. The parent has a strong R&D pipeline with a total of 125 products under development, of which 25 are in Phase-III. It plans to file 40 NDAs by CY10E. Although, the 2Q performance was below estimates, we continue to remain positive on APL's long-term prospects. We believe valuations are not demanding at 15.9x CY08E earnings. Maintain **Buy** with a revised target price of Rs1,750 (~20x CY08E EPS).

Aventis Pharma: an investment profile

Company description

Aventis (50% subsidiary of Aventis SA) is the second largest MNC and among the top 10 formulations players in India. The company has built a very strong franchise in chronic therapy areas like anti-diabetes, oncology and CVS, in the process realigning its domestic portfolio with that of its parent. Aventis is currently undergoing transformation, with the parent being taken over by Sanofi Synthelabo worldwide.

Key investment arguments

- Significant improvement in product mix, with enhanced focus on strategic products and rationalization of older products has put it back on the growth path.
- Aggressive cost cutting and improved efficiencies to add to revenue growth and boost operating performance.
- Strong parental commitment and excellent brand equity among doctors make it the best placed MNC to gain from the IPR regime. Parent plans 18 NDA filings by CY08.

Key investment risks

- Sanofi's acquisition of Aventis SA could hamper Indian operations if new parent is not committed.
- Exports have been de-growing for the last four quarters.
- The proposed new drug policy could adversely impact APL.

Valuation and view

- Valuations of 15.9x CY08E earnings do not fully factor-in the future prospects, excellent return ratios and free cash on books (around Rs 218/share in CY07E).
- Maintain **Buy** with a target price of Rs1,750

Sector view

- Indian Pharma market expected to witness steady growth, on the back of gradual increase in the low penetration levels – companies with strong brands and marketing muscle to benefit the most
- IPR regime unlikely to lead to any major change in the near term; MNCs and large Indian players to benefit over the longer term.
- Among MNCs, we are bullish on companies where risk of conflict with 100% subsidiaries is limited.

COMPARATIVE VALUATIONS

		AVENTIS	GSK	PFIZER
P/E(x)	CY07E	19.6	26.0	21.1
	CY08E	15.9	22.3	21.1
P/BV(x)	CY07E	4.7	7.3	3.3
	CY08E	3.9	6.0	3.1
EV/Sales(x)	CY07E	2.9	5.5	2.7
	CY08E	2.5	4.6	2.8
EV/EBITDA(x)	CY07E	13.1	17.1	11.9
	CY08E	9.9	14.3	11.9

SHAREHOLDING PATTERN (%)

	JUN-07	MAR-07	JUN-06
Promoter	60.4	60.4	60.4
Domestic Inst	20.2	18.9	15.8
Foreign	9.1	9.3	13.1
Others	10.3	11.4	10.7

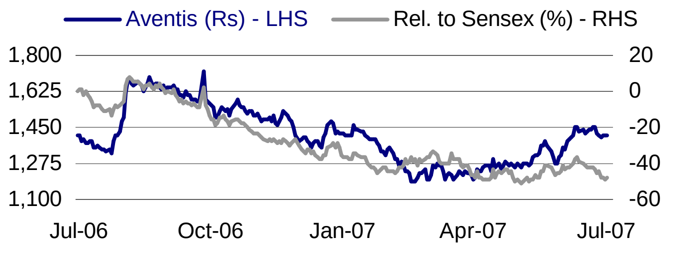
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
CY07	72.3	84.8	-14.8
CY08	89.1	94.2	-5.5

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
1,416	1,750	23.6	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					(Rs Million)
Y/E DECEMBER	2004	2005	2006	2007E	2008E
Exports	2,041	2,287	2,258	2,258	2,710
Net Domestic Sales	5,266	5,735	6,563	7,222	7,946
Net Sales	**7,307**	**8,022**	**8,821**	**9,480**	**10,655**
Change (%)	*12.0*	*9.8*	*10.0*	*7.5*	*12.4*
Total Expenditure	5,162	5,741	6,615	7,375	7,996
EBITDA	**2,145**	**2,281**	**2,206**	**2,105**	**2,660**
Change (%)	*53.5*	*6.3*	*-3.3*	*-4.6*	*26.3*
Margin (%)	*29.4*	*28.4*	*25.0*	*22.2*	*25.0*
Depreciation	168	172	178	195	205
Int. and Finance Charges	1	0	2	0	0
Other Income - Rec.	218	331	471	615	659
PBT & EO Items	**2,194**	**2,440**	**2,497**	**2,526**	**3,113**
Change (%)	*58.9*	*11.2*	*2.3*	*1.2*	*23.3*
Extra Ordinary Income/(Exp)	68	0	0	0	0
PBT after EO Items	**2,262**	**2,440**	**2,497**	**2,526**	**3,113**
Tax	777	799	804	862	1,062
Tax Rate (%)	*34.4*	*32.7*	*32.2*	*34.1*	*34.1*
Reported PAT	**1,485**	**1,641**	**1,693**	**1,664**	**2,052**
PAT Adj for EO Items	**1,440**	**1,641**	**1,693**	**1,664**	**2,052**
Change (%)	*53.5*	*13.9*	*3.2*	*-1.7*	*23.3*
Margin (%)	*19.7*	*20.5*	*19.2*	*17.6*	*19.3*

BALANCE SHEET					(Rs Million)
Y/E DECEMBER	2004	2005	2006	2007E	2008E
Equity Share Capital	230	230	230	230	230
Reserves	3,810	4,838	5,690	6,698	8,028
Revaluation Reserves	178	170	161	153	145
Net Worth	**4,218**	**5,238**	**6,082**	**7,082**	**8,403**
Loans	0	0	0	0	0
Deferred Tax Liabilities	-5	-57	-131	-131	-131
Capital Employed	**4,213**	**5,181**	**5,951**	**6,951**	**8,272**
Gross Block	2,742	2,794	2,841	3,074	3,233
Less: Accum. Deprn.	1,225	1,389	1,517	1,772	1,985
Net Fixed Assets	**1,517**	**1,405**	**1,324**	**1,303**	**1,248**
Capital WIP	28	13	132	25	25
Investments	53	53	53	53	53
Curr. Assets	**4,111**	**5,419**	**6,942**	**7,103**	**8,649**
Inventory	1,016	1,363	1,588	955	964
Account Receivables	918	510	685	962	1,079
Cash and Bank Balance	1,673	2,944	3,861	4,962	6,374
Others	504	601	808	225	231
Curr. Liability & Prov.	**1,496**	**1,710**	**2,500**	**1,533**	**1,703**
Account Payables	665	846	1,104	877	981
Provisions	831	864	1,396	656	722
Net Current Assets	**2,616**	**3,709**	**4,442**	**5,570**	**6,946**
Appl. of Funds	**4,213**	**5,181**	**5,951**	**6,951**	**8,272**

E: MOSt Estimates

RATIOS					
Y/E DECEMBER	2004	2005	2006	2007E	2008E
Basic (Rs)					
EPS	**62.5**	**71.3**	**73.5**	**72.3**	**89.1**
Cash EPS	69.8	78.7	81.3	80.7	98.0
BV/Share	175.4	220.1	257.1	300.9	358.6
DPS	16.0	16.0	32.0	25.0	27.5
Payout (%)	28.1	25.8	49.6	39.4	35.2
Valuation (x)					
P/E		19.9	19.3	19.6	15.9
Cash P/E		18.0	17.4	17.5	14.5
P/BV		6.4	5.5	4.7	3.9
EV/Sales		3.7	3.3	2.9	2.5
EV/EBITDA		13.0	13.0	13.1	9.9
Dividend Yield (%)		1.1	2.3	1.8	1.9
Return Ratios (%)					
RoE	35.6	32.4	28.6	24.0	24.8
RoCE	52.1	47.1	42.0	36.3	37.6
Working Capital Ratios					
Asset Turnover (x)	1.7	1.5	1.5	1.4	1.3
Debtor (Days)	46	23	28	37	37
Inventory (Days)	51	62	66	37	33
Working Capital (Days)	47	35	24	23	20
Leverage Ratio					
Current Ratio	2.7	3.2	2.8	4.6	5.1
Debt/Equity	0.0	0.0	0.0	0.0	0.0

CASH FLOW STATEMENT					(Rs Million)
Y/E DECEMBER	2004	2005	2006	2007E	2008E
OP/(Loss) before Tax	2,145	2,281	2,206	2,105	2,660
Interest/Dividends Recd.	218	331	471	615	659
Direct Taxes Paid	-772	-851	-878	-862	-1,062
(Inc)/Dec in WC	-560	177	185	-28	36
CF from Operations	**1,032**	**1,939**	**1,984**	**1,831**	**2,293**
EO Items	68	0	0	0	0
CF from Ope (EO items)	**1,100**	**1,939**	**1,984**	**1,831**	**2,293**
(Inc)/Dec in FA	-73	-54	-225	-74	-158
(Pur)/Sale of Investments	0	0	0	0	0
CF from Investments	**-73**	**-54**	**-225**	**-74**	**-158**
Issue of Shares	-54	-190	0	0	0
(Inc)/Dec in Debt	-152	0	0	0	0
Interest Paid	-1	0	-2	0	0
Dividend Paid	-417	-423	-840	-656	-722
CF from Fin. Activity	**-625**	**-614**	**-842**	**-656**	**-722**
Inc/Dec of Cash	**402**	**1,271**	**917**	**1,101**	**1,412**
Add: Beginning Balance	1,271	1,673	2,944	3,861	4,962
Closing Balance	**1,673**	**2,944**	**3,861**	**4,962**	**6,374**

NOTES

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Disclosure of Interest Statement	Aventis Pharma
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	Yes
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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