MOTILAL OSWAL

Aventis Pharma

STOCK INFO.	BLOOMBERG
BSE Sensex: 13,607	HOEC IN
	REUTERS CODE
S&P CNX: 3,985	AVPH.BO

Equity Shares (m)	23.0
52-Week Range	2,125/1,160
1,6,12 Rel. Perf. (%)	-11/-28/-55
M.Cap. (Rs b)	27.6
M.Cap. (US$ b)	0.7

17 April 2007 — **Buy**

Previous Recommendation: Buy — Rs1,200

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	8,840	1,693	73.5	5.7	16.3	4.7	28.6	41.5	2.6	10.6
12/07E	9,661	1,866	81.0	10.2	14.8	3.9	26.2	39.2	2.3	9.1
12/08E	10,750	2,098	91.1	12.4	13.2	3.2	24.7	37.0	1.9	7.6

Aventis Pharma's 1QCY07 results were lower than our estimates with sales growth of 6.2% and PAT growth of 17.3%. Key highlights:

- Net sales grew by 6.2%, driven by 11% domestic sales growth to Rs1.7b. However export sales de-grew by 10% to Rs423m, restricting sales growth.
- EBITDA margins declined by 130bp to 23.2% mainly due to adverse product-mix and higher staff cost which increased by 17.3% YoY.
- However, higher other income (up by 108% to Rs200m), including a one-time write-back of Rs50m related to excess provisions in the past, boosted PAT to Rs433m, a growth of 17.3%.
- We are downgrading our CY07E and CY08E EPS estimates by 3.5% and 5% respectively, to factor in lower than expected export sales. The company is yet to give any clarity on the erratic growth in export revenues. Subsequently, we have downgraded our price target by 13% to Rs1,800 (~20x CY08E EPS).

We believe that Aventis will be one of the key beneficiaries of the patent regime in the long-term. The parent has a strong R&D pipeline and plans to file 40 NDAs by CY10E. We continue to remain positive on Aventis' long-term prospects. Despite the cut in our earnings estimates, we believe that, at 14.8x CY07E and 13.2x CY08E earnings, valuations are reasonable. Maintain **Buy**.

QUARTERLY PERFORMANCE (Rs Million)

Y/E DECEMBER	CY06				CY07				CY06	CY07E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
Net Sales	**2,005**	**2,228**	**2,431**	**2,176**	**2,129**	**2,476**	**2,681**	**2,376**	**8,840**	**9,661**
YoY Change (%)	*16.2*	*4.4*	*8.8*	*11.2*	*6.2*	*11.1*	*10.3*	*9.2*	*9.4*	*9.3*
Total Expenditure	1,513	1,609	1,744	1,749	1,635	1,815	1,957	1,790	6,633	7,196
EBITDA	**492**	**619**	**687**	**427**	**494**	**661**	**724**	**586**	**2,207**	**2,465**
Margins (%)	*24.5*	*27.8*	*28.3*	*19.6*	*23.2*	*26.7*	*27.0*	*24.7*	*25.0*	*25.5*
Depreciation	43	42	43	51	45	46	47	57	179	195
Interest	0	1	0	1	0	0	0	0	2	0
Other Income	96	90	156	111	200	118	146	98	471	561
PBT before EO Items	**545**	**666**	**800**	**486**	**649**	**733**	**824**	**627**	**2,497**	**2,832**
Extra-Ord Expense	0	0	0	0	0	0	0	0	0	0
PBT after EO Items	**545**	**666**	**800**	**486**	**649**	**733**	**824**	**627**	**2,497**	**2,832**
Tax	176	227	262	139	216	250	281	219	804	966
Effective tax Rate (%)	*32.3*	*34.1*	*32.8*	*28.6*	*33.3*	*34.1*	*34.1*	*35.0*	*32.2*	*34.1*
Reported PAT	**369**	**439**	**538**	**347**	**433**	**483**	**543**	**407**	**1,693**	**1,866**
Adj PAT	**369**	**439**	**538**	**347**	**433**	**483**	**543**	**407**	**1,693**	**1,866**
YoY Change (%)	*56.4*	*28.4*	*8.2*	*-7.7*	*17.3*	*10.0*	*0.9*	*17.4*	*16.7*	*10.2*
Margins (%)	*18.4*	*19.7*	*22.1*	*15.9*	*20.3*	*19.5*	*20.2*	*17.2*	*19.2*	*19.3*

E: MOSt Estimates

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Decline in exports restricts sales growth

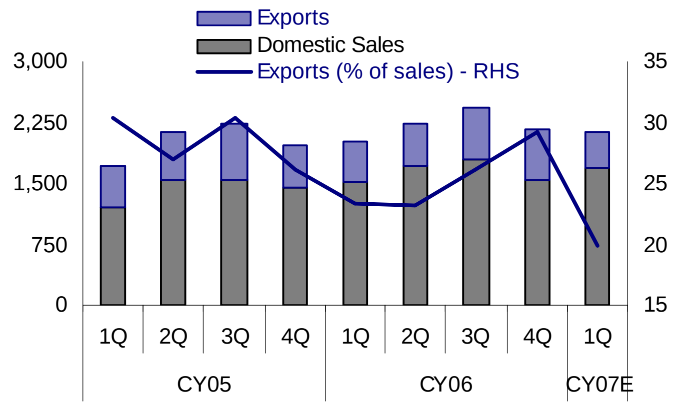
Aventis's net sales for 1QCY07 grew by 6.2% to Rs2.1b, primarily driven by 11% YoY growth in domestic sales to Rs1.7b. However, exports business de-grew by 10% to Rs423m, the lowest export sales since 1QCY04.

TREND IN MARKET MIX (RS M)

	1Q CY07	1Q CY06	YOY (%)	4Q CY06	QOQ (%)
Net Domestic Sales	1,706	1,535	11.1	1,540	10.8
% of Sales	*80.1*	*76.6*		*70.8*	
Exports	423	470	-10.0	636	-33.5
% of Sales	*19.9*	*23.4*		*29.2*	
Net Sales	**2,129**	**2,005**	**6.2**	**2,176**	**-2.2**

Source: Company/Motilal Oswal Securities

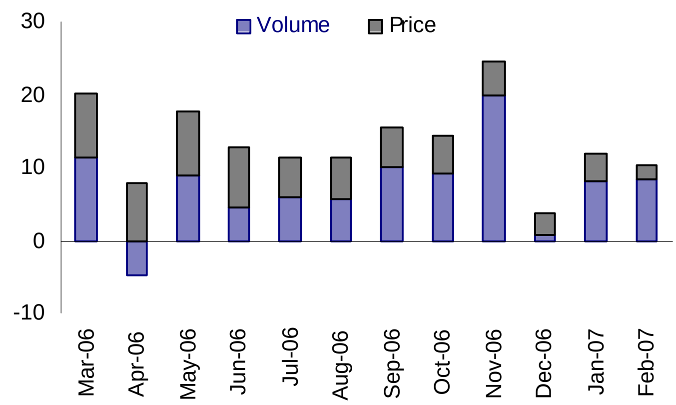
TREND IN MARKET MIX



Source: Company/Motilal Oswal Securities

Domestic business continues to do well, despite high base of 1QCY06 which witnessed recovery in sales post-VAT implementation.

TREND IN DOMESTIC BUSINESS GROWTH (%)

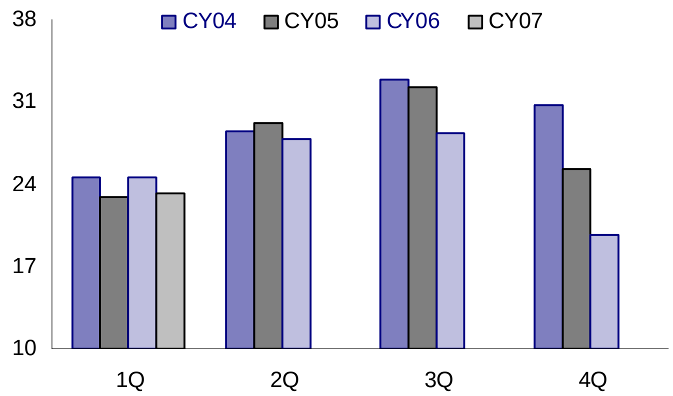


Source: ORG-IMS/Motilal Oswal Securities

EBITDA margins decline; higher other income boosts PAT

EBITDA margins declined by 130bp to 23.2% mainly due to adverse product-mix and higher staff cost which increased by 17.3% YoY. However, higher other income (up by 108% to Rs200m), including a one-time write-back of Rs50m related to excess provisions in the past, boosted PAT to Rs433m, a growth of 17.3%.

TREND IN EBITDA MARGIN (%)



Source: Company/Motilal Oswal Securities

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. Higher growth for Combiflam can have a positive impact on EBITDA margins since it commands a very high brand-equity. Products such as Combiflam are cash cows, and the company does not spend on promotion for such products.

Aventis-Sanofi – Global merger

Sanofi has a 100% subsidiary in India, which is engaged in the marketing of the parent's products, especially in the CVS and CNS segments. APL's management had indicated that if this arm were to be merged with APL, it would be earnings accretive. While APL has not indicated any figures, we believe that Sanofi India has a small business generating about Rs1b of revenues.

On the positive side, there seems to be very little over-lap (except in the CVS segment) between APL's and Sanofi's product portfolios in the Indian market with the latter focusing on CVS and CNS segments. APL will draw strength from the combined R&D pipeline of the global parent, which has become the third largest player in the global pharmaceutical industry.

Sanofi (India) specializes in 4 main therapeutic groups, Thrombosis (major brands- Faxiparine, Tyklid and Plavix) Cardiovascular (Adenocor, Primacor) Neurlogy, (Valparin, Jume) and Internal Medicine (Ladogal Lactacyd, Fortagesic and Calcium Resonium).

New product launches may slow down

APL has been most aggressive in new launches amongst its peers and has launched most of the top products of the parent in India. Aventis launched Lantus (anti-diabetic) and Actonel (Osteoporosis) in the anti-diabetic and pain management segments in CY03. It has not launched any new products in CY04 and launched Apidra (anti-diabetic) in CY05. We believe that the parent's portfolio is very well mapped in the domestic entity, which leaves little scope of aggressive new launches going forward. The table below indicates the details on past launches as well as the status for potential new products.

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

Well placed to benefit from the patent regime

Over the longer term, Aventis 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. Aventis' 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 Aventis, 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 DRUGS	PRE-CLINICAL	PHASE I	PHASE IIA	PHASE IIB	PHASE III	TOTAL
Cardiovascular	2	5	1	4	1	13
Thrombosis	3	1	0	3	2	9
Central Nervous System	8	8	1	4	6	27
Oncology	7	4	1	0	6	18
Metabolic Disorders	2	1	2	4	0	9
Internal Medicine	9	5	5	4	2	25
Vaccines	7	5	2	2	8	24
Total	**38**	**29**	**12**	**21**	**25**	**125**

Source: Sanofi-Aventis

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.

Revising estimates downwards

We are revising our earnings estimates for CY07E and CY08E downwards, by 3.5% and 5% respectively. Revision in estimates is primarily to factor in for lower than expected export sales. Our estimates now factor in for growth in export sales of 8% (v/s 15% earlier) in CY07E. Also, we have marginally increased our assumptions for domestic sales growth to 10% (v/s 9% earlier). Domestic sales growth of 10% in CY07E is on high base of CY06, where sales were boosted in pain management segment due to outbreak of Chikungunya.

REVISED FORECAST (RS M)

	CY07			CY08		
	REV	OLD	CHG (%)	REV	OLD	CHG (%)
Net Sales	9,661	9,975	-3.1	10,750	11,120	-3.3
Net Profit	1,866	1,935	-3.5	2,098	2,214	-5.2
EPS (Rs)	81.0	84.0	-3.5	91.1	96.1	-5.2

Source: Company/Motilal Oswal Securities

New drug policy still remains uncertain

We believe that the biggest risk to our positive stance on Aventis 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.

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 Aventis will be one of the key beneficiaries of the patent regime in the long-term. The parent has a strong R&D pipeline and plans to file 40 NDAs (incl. vaccines) by CY10E. We continue to remain positive on Aventis' long-term prospects. Despite the cut in our earnings estimates, we believe that, at 14.8x CY07E and 13.2x CY08E earnings, valuations are reasonable. We have also revised our target price downwards by 13% to Rs1,800 to take into account the reduction in earnings estimates as well as low visibility of future (management has not interacted with investors for almost 2 years). Maintain **Buy**.

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 40 NDA filings by CY10.

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 14.8x CY07E and 13.2x CY08E earnings do not fully factor-in the future prospects, excellent return ratios and free cash on books (around Rs186/share in CY06E).
- Maintain **Buy** with a revised target price of Rs1,800.

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	14.8	24.2	23.1
	CY08E	13.2	20.9	19.6
P/BV (x)	CY07E	3.9	6.9	3.7
	CY08E	3.2	5.7	3.4
EV/Sales (x)	CY07E	2.3	5.0	3.1
	CY08E	1.9	4.3	2.7
EV/EBITDA (x)	CY07E	9.1	15.9	13.4
	CY08E	7.6	13.3	11.1

SHAREHOLDING PATTERN (%)

	MAR.07	DEC.06	MAR.06
Promoter	60.4	60.4	60.4
Domestic Inst	18.9	19.6	15.6
Foreign	9.3	9.5	13.9
Others	11.4	10.6	10.2

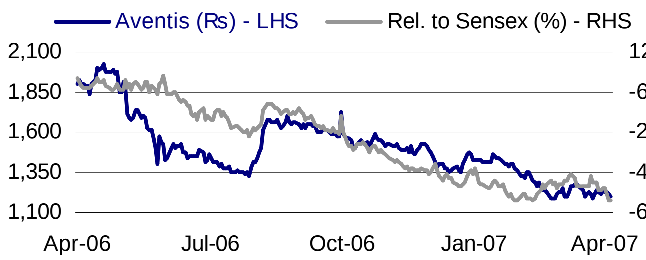
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
CY07	81.0	87.0	-6.9
CY08	91.1	96.7	-5.8

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
1,200	1,800	50.0	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					(Rs Million)
Y/E DECEMBER	**2004**	**2005**	**2006**	**2007E**	**2008E**
Exports	2,041	2,287	2,258	2,439	2,804
Net Domestic Sales	5,266	5,732	6,582	7,223	7,945
Net Sales	**7,307**	**8,019**	**8,840**	**9,661**	**10,750**
Change (%)	*12.0*	*9.8*	*10.2*	*9.3*	*11.3*
Total Expenditure	5,162	5,741	6,633	7,196	8,004
EBITDA	**2,145**	**2,278**	**2,207**	**2,465**	**2,746**
Change (%)	*53.5*	*6.2*	*-3.1*	*11.7*	*11.4*
Margin (%)	*29.4*	*28.4*	*25.0*	*25.5*	*25.5*
Depreciation	168	172	179	195	205
Int. and Finance Charges	1	0	2	0	0
Other Income - Rec.	218	295	471	561	643
PBT & EO Items	**2,194**	**2,401**	**2,497**	**2,832**	**3,184**
Change (%)	*58.9*	*9.4*	*4.0*	*13.4*	*12.4*
Extra Ordinary Income/(Exp)	68	0	0	0	0
PBT after EO Items	**2,262**	**2,401**	**2,497**	**2,832**	**3,184**
Tax	777	799	804	966	1,086
Tax Rate (%)	*34.4*	*33.3*	*32.2*	*34.1*	*34.1*
Reported PAT	**1,485**	**1,602**	**1,693**	**1,866**	**2,098**
PAT Adj for EO Items	**1,440**	**1,602**	**1,693**	**1,866**	**2,098**
Change (%)	*53.5*	*11.2*	*5.7*	*10.2*	*12.4*
Margin (%)	*19.7*	*20.0*	*19.2*	*19.3*	*19.5*

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	5,691	6,901	8,276
Revaluation Reserves	178	170	161	153	145
Net Worth	**4,218**	**5,238**	**6,082**	**7,284**	**8,651**
Loans	0	0	0	0	0
Deferred Tax Liabilities	-5	-57	-57	-57	-57
Capital Employed	**4,213**	**5,181**	**6,025**	**7,227**	**8,594**
Gross Block	2,742	2,794	2,924	3,074	3,233
Less: Accum. Deprn.	1,225	1,389	1,569	1,772	1,985
Net Fixed Assets	**1,517**	**1,405**	**1,356**	**1,303**	**1,248**
Capital WIP	28	13	25	25	25
Investments	53	53	53	53	53
Curr. Assets	**4,111**	**5,419**	**6,240**	**7,398**	**8,980**
Inventory	1,016	1,363	853	932	953
Account Receivables	918	510	898	979	1,089
Cash and Bank Balance	1,673	2,944	4,265	5,261	6,707
Others	504	601	223	226	231
Curr. Liability & Prov.	**1,496**	**1,710**	**1,648**	**1,552**	**1,711**
Account Payables	665	846	808	896	989
Provisions	831	864	840	656	722
Net Current Assets	**2,616**	**3,709**	**4,592**	**5,846**	**7,268**
Appl. of Funds	**4,213**	**5,181**	**6,025**	**7,227**	**8,594**

E: MOSt Estimates

RATIOS					
Y/E DECEMBER	**2004**	**2005**	**2006**	**2007E**	**2008E**
Basic (Rs)					
EPS	**62.5**	**69.6**	**73.5**	**81.0**	**91.1**
Cash EPS	69.8	77.0	81.3	89.5	100.0
BV/Share	175.4	220.1	257.1	309.6	369.4
DPS	16.0	16.0	32.0	25.0	27.5
Payout (%)	28.1	26.4	49.6	35.2	34.4
Valuation (x)					
P/E		17.2	16.3	14.8	13.2
Cash P/E		15.6	14.8	13.4	12.0
P/BV		5.5	4.7	3.9	3.2
EV/Sales		3.1	2.6	2.3	1.9
EV/EBITDA		10.8	10.6	9.1	7.6
Dividend Yield (%)		1.3	2.7	2.1	2.3
Return Ratios (%)					
RoE	35.6	31.6	28.6	26.2	24.7
RoCE	52.1	46.4	41.5	39.2	37.0
Working Capital Ratios					
Asset Turnover (x)	1.7	1.5	1.5	1.3	1.3
Debtor (Days)	46	23	37	37	37
Inventory (Days)	51	62	35	35	32
Working Capital (Days)	47	35	13	22	19
Leverage Ratio					
Current Ratio	2.7	3.2	3.8	4.8	5.2
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	2,278	2,207	2,465	2,746
Interest/Dividends Recd.	218	295	471	561	643
Direct Taxes Paid	-772	-851	-804	-966	-1,086
(Inc)/Dec in WC	-560	177	438	-259	24
CF from Operations	**1,032**	**1,900**	**2,312**	**1,802**	**2,326**
EO Items	68	0	0	0	0
CF from Ope (EO items)	**1,100**	**1,900**	**2,312**	**1,802**	**2,326**
(Inc)/Dec in FA	-73	-54	-150	-150	-158
(Pur)/Sale of Investments	0	0	0	0	0
CF from Investments	**-73**	**-54**	**-149**	**-150**	**-158**
Issue of Shares	-54	-151	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**	**-574**	**-842**	**-656**	**-722**
Inc/Dec of Cash	**402**	**1,271**	**1,321**	**996**	**1,446**
Add: Beginning Balance	1,271	1,673	2,944	4,265	5,261
Closing Balance	**1,673**	**2,944**	**4,265**	**5,261**	**6,707**

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