

ORCHID CHEMICALS AND PHARMACEUTICALS LTD.

Precarious dose...
Q2 FY 2007 update

COMPANY DETAILS

Auditors	M/S SNB Associates
Chairman	Mr. R. Narayanan
Regd. Office	'Orchid Towers', 313, Valluvar Kottam High Road, Chennai - 600034, Tamil Nadu.
Website	www.orchidpharma.com

SCRIPT DETAILS

Market Capitalisation	Rs 14.9 bn
Book Value per share	Rs 121
Equity Shares O/S (F.V. Rs 10)	65.8 mn
Median Volumes (12 mths)	695,185 (BSE+NSE)
52 Week High/Low	Rs. 400 / 142
BSE Scrip Code	524372
NSE Scrip Code	ORCHIDCHEM
Reuters Code	ORCD.BO
Bloomberg Code	OCP@IN

SHAREHOLDING PATTERN (%)

Qtr. Ended	Mar-06	Jun-06	Sep-06
Promoters	17.8	17.6	17.9
MFs/FIs	11.2	14.5	16.0
FIIIs/NRIs/OCBs	52.9	42.6	38.7
PCB	3.5	5.4	6.6
Indian Public/ Others	14.6	19.8	20.9
No. of shares (mn)	64.6	65.8	65.8

KEY FINANCIALS (STANDALONE)

Rs Mn	Quarter Ended			Year Ended		
	Mar-06	Jun-06	Sep-06	2005	2006	2007E
Net Sales	2,398	2,017	2,457	6,893	8,887	10,939
YoY Gr (%)	34.7	18.5	2.7	(3.4)	28.9	23.1
Op Profits	691	580	778	1,623	2,592	3,201
Op. Marg. (%)	28.8	28.8	31.7	23.5	29.2	29.3
Net Profit #	194	146	295	310	829	1,190
Eq Capital	646	658	658	341	646	646

KEY RATIOS

Year Ended (March)	EPS# (Rs.)	ROCE (%)	RONW (%)	P/E (x)	EV/Sales (x)	EV/EBDIT (x)
2005	9.1	8.8	7.0	25.4	2.5	10.8
2006	11.9	12.6	13.2	19.3	2.8	9.6
2007E	17.1	13.0	14.1	13.5	2.3	7.8

Note: #EPS is calculated on fully diluted equity capital of Rs 694 mn

SUMMARY

- Orchid Chemicals & Pharmaceuticals Ltd. (Orchid) posted a 22% QoQ growth in net sales to Rs 2.5 bn on standalone basis in Q2FY07. The same was at 3% on YoY basis due to higher base effect, as Orchid had entered lucrative US generic market in Q2FY06.
- Revenue growth was driven by contribution from regulated markets. Orchid has entered into US generic market in a phased manner starting Q2FY06, and currently has seven products in the market.
- Operating profit grew on the same lines at 5% YoY to Rs 778 mn in Q2FY07. Operating margins improved by 90 bps YoY to 31.7%, due to increased contribution from regulated markets and increase in proportion of formulations.
- Interest was 6% higher at Rs 256 mn and depreciation was down 6% YoY to Rs 201 mn during the quarter
- Net profit went up 8% on YoY basis to Rs 295 mn, on back of higher operating profits and lower depreciation costs.
- On a consolidated basis, net sales at Rs 2.6 bn (+3% YoY), was higher by Rs 144 mn than standalone numbers. However, EBITDA and net profit were lower by Rs 41 mn and Rs 50 mn respectively.
- In Q2FY07, Orchid received three ANDA approvals and launched two new products in US market. It filed for 4 DMFs and 2 ANDAs in the quarter. Its API and formulation sterile Cephalosporin facilities got approved by UKMHRA.
- Orchid has successfully transformed itself from bulk drug supplier to unregulated market to finished dosage supplier to regulated market. Considering the scalability potential in regulated markets and changing product-mix, Orchid is available at a discount to its peers. Hence, we maintain our 'BUY' recommendation.

Nov 13, 2006

Sensex : 13399

Nifty : 3859

CMP : Rs . 231

Recomm : BUY

Orchid is an integrated pharmaceutical company with presence across the pharma value chain (APIs, Formulations and New Drug discovery). It is focussed on antibiotic segment with an expertise in cephalosporin products. As opposed to focus on API products (mainly Cephalosporins) in unregulated markets, Orchid has moved up the value chain by introducing formulations. Additionally, it also files ANDAs in US markets. Infact, it has already introduced seven products in US generic market in last one year, through its marketing partners.

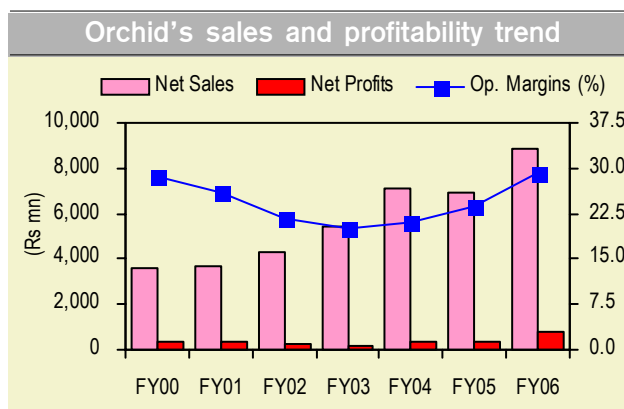
Orchid is currently working on the following strategy.

1. To reduce it's dependence on Cephalosporin products, with introduction of products of diverse therapeutic areas related to lifestyle diseases.
2. To focus on regulated markets, as the same represent 75% of the global generic market (worth US\$ 75 bn in CY05). Orchid plans to concentrate on product development and manufacture, leaving front end marketing to alliances.
3. Develop in-house research capabilities and out-license the molecules.
4. Leverage research capabilities by entering into contract research partnerships.

Orchid has a blue print ready for the growth drivers. It introduced Cephalosporin products in regulated markets from FY06 onwards, plans to launch Betalactam products and Non antibiotics from FY08 onwards and Carbapenams from FY09 onwards.

New product launches

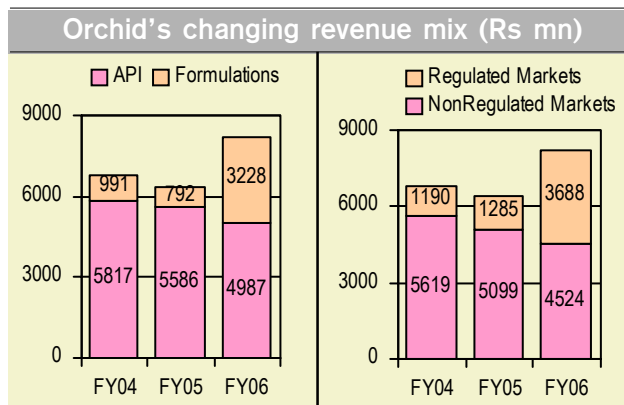
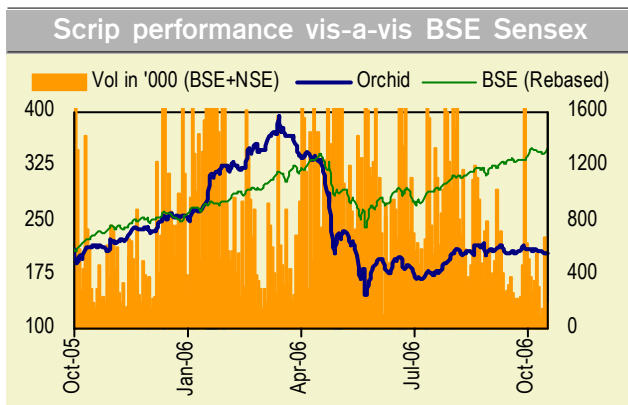
Orchid has launched seven cephalosporin products in US market since Q2FY06. Of these, Ceftriaxone and Cefprozil represent premium products, which accounted for annual retail market size of US\$ 525 mn and US\$ 250 mn respectively before patent expiry.



Tazo+pipe is a good potential molecule, which is delayed due to litigation. Innovator company has filed for new patent on the product, which is challenged by Orchid and Sandoz. Orchid has filed the dossier for this product in the European market. Orchid expects to launch the product in European markets on day one, as there are no regulatory issues there. Two other products of the pipeline provide Para-IV / first-to-file (FTF) opportunities. As on Sep'30, 06 Orchid has filed for 35 DMFs and 32 ANDAs. Orchid hopes to capitalise on these opportunities.

Bexel Pharmaceuticals Inc. (Orchid's drug discovery subsidiary in US) has completed limited proof-of-concept, Phase 2 (a) clinical trials for its anti diabetes molecule (BLX – 1002) in Europe, and can now potentially be outlicensed. The subsidiary is also conducting clinical trials on its anti – obesity and anti – inflammatory molecules.

In all, Orchid has a pipeline of 16 lead molecules in discovery stages covering inflammation, oncology, obesity, and infectives. Orchid aims to bring three molecules to phase 1 clinical trials in FY07.



Products launched in US Market			
Product	Dosage Form	Lauch	Market Share Gained
Cephalexin	Capsules	Jul. 05	~5%
Ceftriaxone	Injections	Aug. 05	~20%
Cefazolin	Injections	Oct. 05	~85%
Cefprozil	Tablets	Dec. 05	~20%
Cefprozil	Oral Suspension	Jan. 06	~20%
Cefoxitin	Injections	Feb. 06	~50%
Cephalexin	Oral Suspension		N.A.

Orchid's Partners		
Product	Market	Partner
Injectables	US/ Canada	Apotex
Oral	US	Par
Non Ceph	US	Stada
Antibiotics	Europe/ Aus	Mayne

Orchid's revenue of Rs 2.6 bn (+3% YoY, +22% QoQ) should be seen in light of increasing competition and the fact that Q2FY06 had an exceptional growth of 46% YoY marking Orchid's entry into US markets. In short span of one year, Orchid has launched seven products in 17 dosage forms and 45 dosage strengths in the US market, including two in the quarter and is ready with a pipeline to drive its growth in regulated markets. Orchid plans to apply for two ANDA every month for next twelve months.

In Q2FY07, Orchid received 3 ANDA approvals taking total ANDA approvals to 18. Total DMFs and ANDAs filed by Orchid as of now stand at 35 and 32.

Orchid received UKMHRA approval for its API and formulations facilities. This will enable Orchid to enter the European markets.

Orchid's subsidiaries continue to be in red, thereby adversely affecting the performance of the company on consolidated basis. Recent price control in China has further aggravated the situation.

In the new development, Orchid has started looking at CRAMS space seriously. It has three projects in place now. It already had two projects with Pfizer in place (one for animal health and one for human health) and flagged off one more project in partnership with Biovitrum, Sweden this quarter.

In H1FY07, Orchid netted Rs 4.7 bn (+8% YoY), marginally below our expectations. However, on profitability front Orchid put a good show with operating margin expanding by 290 bps.

We have factored in 23% topline growth to Rs 11 bn. We also expect the operating margins to remain stable at 29.3%. We expect net profits to increase at a faster pace of 44% YoY to Rs 1.2 bn in FY07.

Orchid's entry into regulated market is accompanied with a price crash in the markets. However, Orchid

could weather the storm based on its expertise in complex chemistry Cephalosporin products and time to market capabilities with an average ANDA approval time of 13 months as against an industry average of 18 months. We expect Orchid to continue with success, with new product launches lined up next year with a price erosion of 70% and significant market share. Considering the fact, that all the investments required to launch the new products is already in place and no further capex is required for the same is a comforting factor.

The company raised US\$ 85 mn in Nov'05. Out of this, \$45 mn was via GDR, raising its equity capital from Rs 523 mn to Rs 615 mn then. Balance US\$40 mn was via FCCBs, which are convertible at Rs 244/share and have a coupon of 0% and YTM of ~7.8%. On conversion of all FCCB's, eq. cap. will be diluted to ~Rs 694 mn.

At CMP of 231, Orchid is trading at a P/E of 10.5x and EV/EBITDA of 6.8x, discounting its FY07E standalone numbers. We maintain our "BUY" recommendation on the stock.

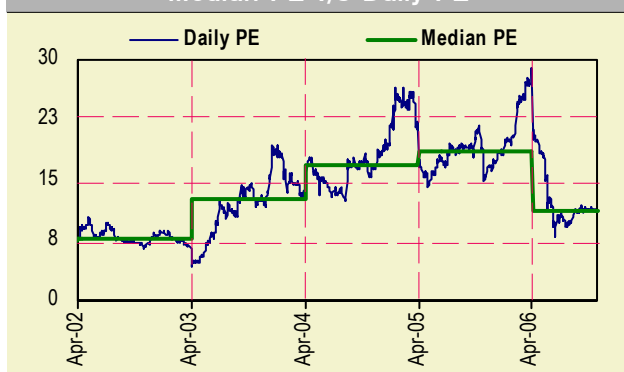
Concerns:

Delay in regulatory approvals/launch by partners for its products, pricing pressure in regulated generics markets, rising interest rate and expected equity dilution (the company has taken board approval to raise upto \$200 mn) that goes with the track record of the company are some of the concerns.

New product pipeline		
Product	Dosage Form	IMS Retail Market Size
Cefazolin	Capsules	US\$ 20 mn
Cefotaxime	Injections	US\$ 25 mn
Cefuroxime	Tablets	N.A.
Cefixime	Tablets	N.A.
Cefadroxyl	Oral Suspension	N.A.
Ceftiofur	Injectable	US\$ 150 mn
Cefdinir	Oral Suspension	US\$ 380 mn
Tazo+Pipe	Injectable	US\$ 480 mn
Cefepime	Tablets	US\$ 120 mn

Financial results for the quarter & half year ended Sep 30, 2006 (Standalone)

Particulars (Rs mn)	Quarter Ended			Half Year Ended			Yr Ended
	30/09/06	30/09/05	Gr %	30/09/06	30/09/05	Gr %	31/03/06
Net Sales	2,457	2,393	2.7	4,474	4,096	9.2	8,887
Total Expenditure	1,679	1,656	1.4	3,116	2,904	7.3	6,295
(Inc)/dec in Stock	(605)	(114)		(940)	(347)		(191)
Consumption of RM	1,349	1,049	28.6	2,399	1,988	20.7	3,644
Staff cost	209	155	35.0	381	296	28.8	653
Other Expenditure	726	566	28.3	1,276	968	31.8	2,189
Operating Profit	778	738	5.5	1,358	1,192	14.0	2,592
Other income	2	11	(80.1)	10	16	(35.4)	14
PBDIT	780	749	4.2	1,368	1,207	13.3	2,606
Interest (Net)	256	241	6.3	476	448	6.2	870
Depreciation	201	213	(5.9)	394	382	3.1	830
PBT	324	295	9.8	498	377	32.2	906
(-) Provision for current tax	0	0		0	5		-
(-) Provision for deferred tax	25	18		50	18		59
(-) Provision for fringe benefit tax	4	5		8	9		18
Net Profit	295	272	8.2	440	346	27.5	829
Equity Capital	658	521		658	521		646
Reserves(excl rev res)	-	-		-	-		7,204
Basic EPS (Rs.)	4.5	5.2	(14.3)	6.7	6.6	1.0	12.8
Diluted EPS (Rs.)	4.2	5.2	(19.4)	6.3	6.6	(5.1)	11.8
Book Value (Rs.)	-	-		-	-		121.5
OPM (%)	31.7	30.8		30.4	29.1		29.2
NPM (%)	12.0	11.4		9.8	8.4		9.3
Expenditure as % of Net Sales							
RM Consumed	30.3	39.0		32.6	40.1		38.9
Staff cost	8.5	6.5		8.5	7.2		7.3
Other Expenditure	29.6	23.7		28.5	23.6		24.6

Median PE v/s Daily PE

PE Band


Financial results for the quarter & half year ended Sep 30, 2006 (Consolidated)

Particulars (Rs mn)	Quarter Ended			Half Year Ended			Yr Ended
	30/09/06	30/09/05	Gr %	30/09/06	30/09/05	Gr %	31/03/06
Net Sales	2,602	2,517	3.4	4,728	4,395	7.6	9,519
Total Expenditure	1,868	1,864	0.2	3,442	3,326	3.5	7,145
(Inc)/dec in Stock	(586)	(48)		(934)	(369)		(205)
Consumption of RM	1,456	1,080		2,617	2,254		4,295
Staff cost	200	159	25.8	388	303	28.3	696
Other Expenditure	798	674	18.5	1,371	1,138	20.4	2,359
Operating Profit	734	653	12.5	1,286	1,069	20.3	2,375
Other income	5	11	(54.9)	13	15	(15.7)	12
PBDIT	739	664	11.3	1,299	1,084	19.8	2,387
Interest (Net)	258	243	6.2	481	452	6.4	878
Depreciation	208	220	(5.4)	407	394	3.4	858
PBT	273	201	35.8	410	237	72.9	650
(-) Provision for current tax	0	0		0	5		-
(-) Provision for deferred tax	25	18		50	18		59
(-) Provision for fringe benefit tax	4	5		8	9		18
Net Profit	244	179	36.7	352	206	71.1	573
Equity Capital	658	521		658	521		646
Reserves(excl rev res)	-	-		-	-		7,110
Basic EPS (Rs.)	3.7	3.4	8.3	5.4	4.0	35.5	8.9
Diluted EPS (Rs.)	3.5	3.4	1.8	5.0	4.0	27.4	8.2
Book Value (Rs.)	-	-		-	-		120
OPM (%)	28.2	25.9		27.2	24.3		24.9
NPM (%)	9.4	7.1		7.5	4.7		6.0
Expenditure as % of Net Sales							
RM Consumed	33.4	41.0		35.6	42.9		43.0
Staff cost	7.7	6.3		8.2	6.9		7.3
Other Expenditure	30.7	26.8		29.0	25.9		24.8

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