Aventis Pharma

STOCK INFO.	BLOOMBERG
BSE Sensex: 10,215	HOEC IN
	REUTERS CODE
S&P CNX: 2,986	AVPH.BO

Equity Shares (m)	23.0
52-Week Range	2,140/1,241
1,6,12 Rel. Perf. (%)	-8/-25/-42
M.Cap. (Rs b)	31.5
M.Cap. (US$ b)	0.7

24 July 2006 — **Buy**

Previous Recommendation: Buy — Rs1,370

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
12/05A	8,019	1,602	69.6	11.2	19.7	6.2	31.6	46.4	3.6	12.6
12/06E	9,010	1,808	78.5	12.9	17.4	5.0	28.8	41.7	3.0	10.6
12/07E	9,975	1,983	86.1	9.6	15.9	4.1	26.0	37.9	2.6	9.2

Aventis Pharma's 2QCY06 results were in line with our estimates with sales and earnings growth of 4% and 28% respectively. Key highlights include:

- Net sales grew by 4% to Rs2.2b, primarily driven by 10% YoY growth in domestic business to Rs1.7b (despite the high base of 2QCY05 where sales had witnessed recovery due to VAT issue in 1QCY05). However, exports de-grew by 10% to Rs516m (third consecutive quarter of de-growth). Domestic business accounted for about 77% of revenues.
- EBITDA margins declined by 140bp to 27.8% YoY, as the benefits of lower RM cost (down by 170bp due to better market mix in favor of domestic market), were negated by higher other expenditure (up 300bp) resulting in flat EBITDA at Rs619m.
- However, higher other income (up by 48%) and lower tax provisioning (at 34.1% of PBT v/s 46.7% in 2QCY05) resulted in 28% YoY growth in recurring PAT growth to Rs439m.

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 18 NDAs by CY08E. We continue to remain positive on Aventis' long-term prospects. Aventis is currently valued at 17.4x CY06E and 15.9x CY07E earnings. Maintain **Buy**.

QUARTERLY PERFORMANCE (Rs Million)

Y/E DECEMBER	CY05				CY06				CY05	CY06E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Net Sales	**1,725**	**2,134**	**2,234**	**1,929**	**2,005**	**2,228**	**2,407**	**2,370**	**8,022**	**9,010**
YoY Change (%)	*5.4*	*17.1*	*19.1*	*-2.2*	*16.2*	*4.4*	*7.8*	*22.8*	*9.8*	*12.3*
Total Expenditure	1,330	1,510	1,515	1,426	1,503	1,609	1,662	1,665	5,781	6,439
EBITDA	**395**	**624**	**719**	**503**	**502**	**619**	**745**	**704**	**2,241**	**2,571**
Margins (%)	*22.9*	*29.2*	*32.2*	*26.1*	*25.0*	*27.8*	*31.0*	*29.7*	*27.9*	*28.5*
Depreciation	44	43	43	42	43	42	44	48	172	177
Interest	0	0	0	0	0	1	0	0	0	0
Other Income	74	61	78	82	86	90	81	13	295	270
PBT before EO Items	**425**	**642**	**754**	**543**	**545**	**666**	**782**	**669**	**2,364**	**2,663**
Extra-Ord Expense	0	0	0	0	0	0	0	0	0	0
PBT after EO Items	**425**	**642**	**754**	**543**	**545**	**666**	**782**	**669**	**2,364**	**2,663**
Tax	189	300	257	167	176	227	251	201	913	855
Effective tax Rate (%)	*44.5*	*46.7*	*34.1*	*30.8*	*32.3*	*34.1*	*32.1*	*30.0*	*38.6*	*32.1*
Reported PAT	**236**	**342**	**497**	**376**	**369**	**439**	**531**	**468**	**1,451**	**1,808**
Adj PAT	**236**	**342**	**497**	**376**	**369**	**439**	**531**	**468**	**1,451**	**1,808**
YoY Change (%)	*-13.5*	*2.4*	*16.9*	*-7.4*	*56.4*	*28.4*	*6.8*	*24.5*	*0.7*	*24.6*
Margins (%)	*13.7*	*16.0*	*22.2*	*19.5*	*18.4*	*19.7*	*22.1*	*19.8*	*18.1*	*20.1*

E: MOSt Estimates

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Decline in exports restricts sales growth

Aventis's net sales for 2QCY06 grew by 4% to Rs2.2b, primarily driven by 10% YoY growth to Rs1.7b in domestic market (on high base of 2QCY05 where sales had witnessed recovery due to VAT issue in 1QCY05). However, exports business recorded a sales decline (for third quarter in a row) by 10% to Rs516m.

TREND IN MARKET MIX (RS M)

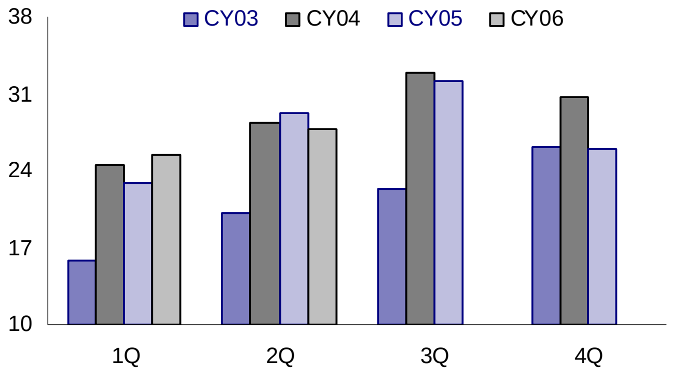
	2QCY06	2QCY05	YOY (%)	1QCY06	QOQ (%)
Net Domestic Sales	1,712	1,560	9.7	1,506	13.7
% of Sales	*76.8*	*73.1*		*76.2*	
Exports	516	574	-10.1	470	9.8
% of Sales	*23.2*	*26.9*		*23.8*	
Net Sales	2,228	2,134	4.4	1,976	12.8

Source: Company/Motilal Oswal Securities

EBITDA margins decline; lower tax boosts PAT

EBITDA margins declined by 140bp to 27.8% YoY, resulting in flat EBITDA at Rs619m. Better market mix in favor of domestic market ~76.8% of sales v/s 73.1% in 2QCY05 resulted in lower RM cost (down by 170bp). However, these benefits were negated by higher other expenditure (up by 300 bp) translating into flat EBITDA. Higher other income (up by 48%) and lower tax provisioning (at 34.1% of PBT v/s 46.7% in 2QCY05) resulted in 28% YoY growth in recurring PAT growth to Rs439m.

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. Doctors and patients may not be willing to resort to cox-II inhibitors (including Rofecoxib, Celecoxib, Valdecoxib.) unless absolutely necessary. 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 recorded revenues of about Rs.900m for CY04. Revenue figures for CY05 are not yet available.

On the positive side, there seems to be very little overlap (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. It 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 for aggressive new launches going forward. The table below indicates the details on past launches as well as the status of 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. Although clarity on this will emerge only by 2007, we present below our estimates of the potential upside to Aventis from the patent regime table 1.

To benefit from the parent's R&D pipeline

Sanofi-Aventis currently has 127 projects in research and development, including about 71 in clinical development and 56 in late stage (Phase II & III) development. It is plans to file about 11 NDAs and 7 vaccines by CY08E. Table 2 gives details the parent's R&D pipeline.

TABLE 1: AVENTIS - UPSIDE FROM PATENTED PRODUCTS (RS M)

	CY08	CY09	CY10	CY11	CY12	CY13	CY14	CY15
No. of Patented Products Launched	1	2	2	1	1	1	1	1
Total No. of Patented Products on Market	1	3	5	6	7	8	9	10
Product A	250	500	1,000	1,200	1,440	1,584	1,742	1,917
Product B	0	250	500	1,000	1,200	1,440	1,584	1,742
Product C	0	250	500	1,000	1,200	1,440	1,584	1,742
Product D	0	0	250	500	1,000	1,200	1,440	1,584
Product E	0	0	250	500	1,000	1,200	1,440	1,584
Product F	0	0	0	250	500	1,000	1,200	1,440
Product G	0	0	0	0	250	500	1,000	1,200
Product H	0	0	0	0	0	250	500	1,000
Product I	0	0	0	0	0	0	250	500
Product J	0	0	0	0	0	0	0	250
Total Sales	**250**	**1,000**	**2,500**	**4,450**	**6,590**	**8,614**	**10,740**	**12,959**
NPM (%) - Assumed	20	20	20	20	20	20	20	20
Net Profit	**50**	**200**	**500**	**890**	**1,318**	**1,723**	**2,148**	**2,592**
Incremental EPS (Rs)	2	9	22	39	57	75	93	113
P/E for patented products (x)	40	40	40	40	40	40	40	40
Valuation for patented products (Rs/share)	87	347	868	1,546	2,289	2,992	3,731	4,502

Source: Motilal Oswal Securities

TABLE 2: SANOFI-AVENTIS R&D PIPELINE

NO. OF DRUGS	PRE-CLINICAL	PHASE I	PHASE IIA	PHASE IIB	PHASE III	TOTAL
Cardiovascular	5	3	2	4	1	15
Thrombosis	4	1	1	3	1	10
Central Nervous System	10	6	3	2	7	28
Oncology	7	4	3	1	4	19
Metabolic Disorders	4	4	3	2	1	14
Internal Medicine	6	6	4	2	2	20
Vaccines	9	2	4	4	2	21
Total	**45**	**26**	**20**	**18**	**18**	**127**

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.

New drug policy could be a dampener

We expect more drugs to come under price control if the recommendations of the New Pharmaceutical Policy (proposed) are accepted by the government, thus adversely impacting the domestic operations of all companies. The industry is lobbying with the government for a more pragmatic approach towards price controls. We believe that APL can get adversely impacted if the proposed new drug policy is implemented in the current form. We await announcement of the final policy from the government.

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 operations with itself (post the global merger). We believe that there is very little overlap between APL and Sanofi's portfolio in India.

We expect Aventis to be among the best performing pharma MNCs over the next few years. APL is currently valued at 17.4x CY06E and 15.9x CY07E earnings. Maintain **Buy**.

Aventis Pharma: an investment profile

Company description

Aventis Pharma (50% subsidiary of Aventis SA) is the second largest MNC and among the top 10 formulation players in India. The company has built a strong franchise in chronic therapy areas such as 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 thrust it back on the growth path.
- Aggressive cost cutting and improved efficiencies will boost 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 the new parent is not committed
- The proposed new drug policy could adversely impact APL.

Valuation and view

- Valuations of 17.4x CY06E and 15.9x CY07E earnings is very attractive, given high growth, excellent return ratios and free cash on books (around Rs 186/share in CY06E).
- Maintain **Buy** with a target price of Rs2,100

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)	FY07E	17.4	21.9	18.9
	FY08E	15.9	21.5	19.7
P/BV (x)	FY07E	5.0	7.2	4.7
	FY08E	4.1	6.0	4.3
EV/Sales (x)	FY07E	3.0	4.4	2.6
	FY08E	2.6	4.2	2.8
EV/EBITDA(x)	FY07E	10.6	14.1	11.1
	FY08E	9.2	13.8	11.2

SHAREHOLDING PATTERN (%)

	JUN.06	MAR.06	JUN.05
Promoters	60.4	60.4	60.4
Domestic Institutions	15.8	15.6	16.7
FIIs/FDIs	13.1	13.9	11.8
Others	10.7	10.1	11.1

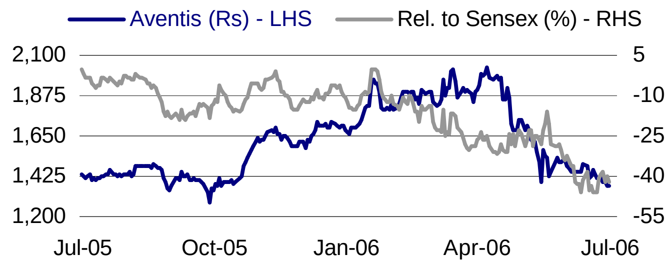
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
CY06	78.5	79.9	-1.8
CY07	86.1	91.1	-5.5

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
1,370	2,100	53.3	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					(Rs Million)
Y/E DECEMBER	2003	2004	2005	2006E	2007E
Exports	1,561	2,041	2,287	2,566	2,951
Net Domestic Sales	4,963	5,266	5,732	6,444	7,024
Net Sales	**6,524**	**7,307**	**8,019**	**9,010**	**9,975**
Change (%)	*6.7*	*12.0*	*9.8*	*12.3*	*10.7*
Total Expenditure	5,126	5,162	5,741	6,439	7,171
EBITDA	**1,398**	**2,145**	**2,278**	**2,571**	**2,803**
Change (%)	*43.9*	*53.5*	*6.2*	*12.9*	*9.1*
Margin (%)	*21.4*	*29.4*	*28.4*	*28.5*	*28.1*
Depreciation	174	168	172	177	195
Int. and Finance Charges	2	1	0	0	0
Other Income - Rec.	160	218	295	270	311
PBT & EO Items	**1,381**	**2,194**	**2,401**	**2,663**	**2,920**
Change (%)	*54.2*	*58.9*	*9.4*	*10.9*	*9.6*
Extra Ordinary Income/(Exp)	70	68	0	0	0
PBT after EO Items	**1,451**	**2,262**	**2,401**	**2,663**	**2,920**
Tax	465	777	799	855	937
Tax Rate (%)	*32.1*	*34.4*	*33.3*	*32.1*	*32.1*
Reported PAT	**986**	**1,485**	**1,602**	**1,808**	**1,983**
PAT Adj for EO Items	**938**	**1,440**	**1,602**	**1,808**	**1,983**
Change (%)	*55.5*	*53.5*	*11.2*	*12.9*	*9.6*
Margin (%)	*14.4*	*19.7*	*20.0*	*20.1*	*19.9*

BALANCE SHEET					
Y/E DECEMBER	2003	2004	2005	2006E	2007E
Equity Share Capital	230	230	230	230	230
Reserves	2,797	3,810	4,838	6,055	7,381
Revaluation Reserves	186	178	170	161	153
Net Worth	**3,213**	**4,218**	**5,238**	**6,447**	**7,765**
Loans	152	0	0	0	0
Deferred Tax Liabilities	-10	-5	-57	-57	-57
Capital Employed	**3,355**	**4,213**	**5,181**	**6,390**	**7,708**
Gross Block	2,627	2,742	2,794	2,924	3,074
Less: Accum. Deprn.	1,087	1,225	1,389	1,575	1,778
Net Fixed Assets	**1,540**	**1,517**	**1,405**	**1,349**	**1,296**
Capital WIP	108	28	13	25	25
Investments	53	53	53	53	53
Curr. Assets	**2,985**	**4,111**	**5,419**	**6,376**	**7,907**
Inventory	871	1,016	1,363	916	944
Account Receivables	460	918	510	924	1,022
Cash and Bank Balance	1,271	1,673	2,944	4,309	5,708
Others	383	504	601	228	233
Curr. Liability & Prov.	**1,331**	**1,496**	**1,710**	**1,414**	**1,574**
Account Payables	1,006	665	846	823	917
Provisions	325	831	864	591	656
Net Current Assets	**1,654**	**2,616**	**3,709**	**4,962**	**6,333**
Appl. of Funds	**3,355**	**4,213**	**5,181**	**6,390**	**7,708**

E: MOSt Estimates

RATIOS					
Y/E DECEMBER	2003	2004	2005	2006E	2007E
Basic (Rs)					
EPS	**40.7**	**62.5**	**69.6**	**78.5**	**86.1**
Cash EPS	48.3	69.8	77.0	86.2	94.5
BV/Share	131.4	175.4	220.1	272.9	330.5
DPS	16.0	16.0	16.0	22.5	25.0
Payout (%)	46.2	28.1	26.4	32.7	33.1
Valuation (x)					
P/E		21.9	19.7	17.4	15.9
Cash P/E		19.6	17.8	15.9	14.5
P/BV		7.8	6.2	5.0	4.1
EV/Sales		4.1	3.6	3.0	2.6
EV/EBITDA		13.9	12.6	10.6	9.2
Dividend Yield (%)		1.2	1.2	1.6	1.8
Return Ratios (%)					
RoE	31.0	35.6	31.6	28.8	26.0
RoCE	41.2	52.1	46.4	41.7	37.9
Working Capital Ratios					
Asset Turnover (x)	1.9	1.7	1.5	1.4	1.3
Debtor (Days)	26	46	23	37	37
Inventory (Days)	49	51	62	37	35
Working Capital (Days)	21	47	35	26	23
Leverage Ratio					
Current Ratio	2.2	2.7	3.2	4.5	5.0
Debt/Equity	0.0	0.0	0.0	0.0	0.0

CASH FLOW STATEMENT					
Y/E DECEMBER	2003	2004	2005	2006E	2007E
OP/(Loss) before Tax	1,398	2,145	2,278	2,571	2,803
Interest/Dividends Recd.	160	218	295	270	311
Direct Taxes Paid	-478	-772	-851	-855	-937
(Inc)/Dec in WC	-320	-560	177	112	28
CF from Operations	**760**	**1,032**	**1,900**	**2,097**	**2,206**
EO Items	70	68	0	0	0
CF from Ope (EO items)	**830**	**1,100**	**1,900**	**2,097**	**2,206**
(Inc)/Dec in FA	-206	-73	-54	-142	-150
(Pur)/Sale of Investments	-1	0	0	0	0
CF from Investments	**-207**	**-73**	**-54**	**-141**	**-150**
Issue of Shares	0	-54	-151	0	0
(Inc)/Dec in Debt	-48	-152	0	0	0
Interest Paid	-2	-1	0	0	0
Dividend Paid	-456	-417	-423	-591	-656
CF from Fin. Activity	**-506**	**-625**	**-574**	**-591**	**-656**
Inc/Dec of Cash	**117**	**402**	**1,271**	**1,365**	**1,399**
Add: Beginning Balance	1,154	1,271	1,673	2,944	4,309
Closing Balance	**1,271**	**1,673**	**2,944**	**4,309**	**5,708**

N O T E S

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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

This information is subject to change without any prior notice. MOSt reserves the right to make modifications and alternations to this statement as may be required from time to time. Nevertheless, MOSt is committed to providing independent and transparent recommendations to its clients, and would be happy to provide information in response to specific client queries.