Wockhardt

STOCK INFO.	BLOOMBERG
BSE Sensex: 10,680	WOCK IN
	REUTERS CODE
S&P CNX: 3,131	WCKH.BO

Equity Shares (m)	109.0
52-Week Range	562/318
1,6,12 Rel. Perf. (%)	-11/-38/-62
M.Cap. (Rs b)	37.2
M.Cap. (US$ b)	0.8

28 July 2006

Buy

Previous Recommendation: Buy

Rs342

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	13,660	2,110	17.7	8.6	19.3	4.6	29.5	16.0	2.9	13.9
12/06E	16,457	2,810	23.5	33.2	14.5	3.8	31.1	21.5	2.1	9.4
12/07E	18,791	3,639	30.5	29.5	11.2	3.0	32.4	26.4	1.7	6.8

'* Fully diluted EPS

Wockhardt's 2QCY06 results were slightly above our estimates as sales grew by 9.5% while recurring PAT de-grew by 18% (to Rs.640m). Key highlights of results and conference call includes:

- Sales grew by 9.5% YoY to Rs4.1b, primarily driven by domestic sales (up by 11% YoY despite high base of 2QCY05) and EU business (up 16% YoY driven by 5 product launches in UK). However, US business declined by 6% (due to transition from the partner product distribution to the own network) and RoW business declined by 6%.
- EBITDA margins declined by 380bp YoY to 21.7% due to higher R&D spend (up by 77%), higher staff cost (up by 29%) and other expenditure (up by 38%). Furthermore, higher tax provisioning (at 18.8% of PBT v/s 7.6% in 2QCY05) resulted in 18% YoY decline in PAT to Rs634m. During the quarter, Wockhardt acquired Farex and Protinex (domestic brands) along with technology for sugar free infant foods and manufacturing facility in Punjab.
- We have revised our CY06E EPS estimates downwards by 4.5% to Rs23.5, to factor in lower than expected traction in US business and higher fixed overheads on the new biotech park.

Wockhardt has emerged as a serious player in the regulated markets through its acquisitions in Europe and aggressive initiatives in the US. It however needs to display the ability to fully leverage its assets and scale up substantially in regulated markets, for a significant re-rating. At 14.5x CY06E and 11.2x CY07E fully diluted EPS, we maintain **Buy.**

CONSOLIDATED QUARTERLY PERFORMANCE (Rs Million)

Y/E DECEMBER	CY05				CY06E				CY05	CY06E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Gross Sales	**3,096**	**3,770**	**3,595**	**3,659**	**3,510**	**4,127**	**4,204**	**4,617**	**14,121**	**16,457**
YoY Change (%)	*6.5*	*28.8*	*12.0*	*5.4*	*13.4*	*9.5*	*17.0*	*26.2*	*12.8*	*16.5*
Total Expenditure	2,498	2,810	2,720	2,808	2,821	3,230	3,222	3,446	10,835	12,719
EBITDA	**598**	**960**	**875**	**851**	**689**	**897**	**983**	**1,171**	**3,286**	**3,738**
Margins (%)	*19.3*	*25.5*	*24.3*	*23.3*	*19.6*	*21.7*	*23.4*	*25.4*	*23.3*	*22.7*
Depreciation	103	107	118	98	137	140	145	146	426	568
Interest	58	46	41	-51	-77	-6	0	0	95	-84
Other Income	91	33	29	27	33	18	55	66	180	172
PBT before EO Items	**528**	**840**	**745**	**831**	**662**	**781**	**893**	**1,092**	**2,945**	**3,427**
EO Income	0	0	0	0	-604	0	0	0	0	-604
PBT after EO Items	**528**	**840**	**745**	**831**	**58**	**781**	**893**	**1,092**	**2,945**	**2,823**
Tax	68	95	75	116	53	126	71	54	356	305
Deferred Tax	43	-31	20	-15	42	21	54	87	18	203
Rate (%)	*21.0*	*7.6*	*12.8*	*12.2*	*163.8*	*18.8*	*14.0*	*12.9*	*12.7*	*18.0*
Reported PAT	**417**	**776**	**650**	**730**	**-37**	**634**	**768**	**951**	**2,571**	**2,315**
Adjusted PAT	**417**	**776**	**650**	**730**	**543**	**634**	**768**	**951**	**2,571**	**2,810**
YoY Change (%)	*-6.1*	*54.9*	*16.5*	*1.4*	*30.2*	*-18.3*	*18.1*	*30.3*	*15.2*	*9.3*
Margins (%)	*13.5*	*20.6*	*18.1*	*20.0*	*-1.1*	*15.4*	*18.3*	*20.6*	*18.2*	*14.1*

E: MOSt Estimates; Quarterly numbers don't match with annual report numbers due to re-classification of few items

Note: In the interest of timeliness, this report has not been edited.

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Domestic business drives growth

In 2QCY06, Wockhardt reported 9.5% YoY growth (to Rs4.1b) in revenues, primarily driven by domestic sales (up by 11% YoY despite high base of 2QCY05) and EU business (up 16% YoY driven by 5 product launches in UK). However, US business declined by 6% (due to transition from the partner product distribution to the own network) and RoW business declined by 6%.

Although domestic business was coming off from a high base, the power brands of the company grew by 16%. Further, the key business segments of diabetology and nephrology grew by 41% and 46% respectively. Also, it plans to launch Interferon in domestic market in the near future after receipt of regulatory approval. It has forged new alliances in the domestic market, including co-marketing agreements with Zydus Cadila, Bharat Biotech and Sun Pharma, to increase the penetration of its products.

TREND IN BUSINESS-MIX

SEGMENT-WISE	2QCY06	2QCY05	YOY (%)	1QCY06	QOQ (%)
Bulk/API					
India	72	38	89.5	28	157.1
Europe	59	74	-20.3	30	96.7
US	102	107	-4.7	156	-34.6
ROW	161	166	-3.0	209	-23.0
Total Bulk/API	**394**	**385**	**2.3**	**423**	**-6.9**
Contribution (%)	*9.6*	*10.2*		*12.1*	
Formulations					
India	1,670	1,531	9.1	1,320	26.5
Europe	1,593	1,351	17.9	1,266	25.8
US	278	297	-6.4	273	1.8
ROW	190	206	-7.8	228	-16.7
Total Formul.	**3,731**	**3,385**	**10.2**	**3,087**	**20.9**
Contribution (%)	*90.4*	*89.8*		*87.9*	
Total Revenue	**4,125**	**3,770**	**9.4**	**3,510**	**17.5**

Source: Company/Motilal Oswal Securities

In the EU market, revenues grew by 16% YoY to Rs1.65b primarily driven by 19% YoY growth in UK business. The UK business was boosted by day-1 launch of Ondansteron and new product launches (including 4 injectible products in oncology and 1 injectible product in cardiology). However, the German operations witnessed a 2% sales decline due to the recent price cuts mandated by the regulatory authorities.

In US, revenues declined by 6% YoY to Rs380m as a result of transition from the partner product distribution arrangement to the company's own sales and distribution network. Wockhardt used to market some of its products in the US through Ranbaxy. During the quarter, the company received 4 ANDA approvals (including Divalproex delayed release tablets to be launched in Jan-08).

Overheads on new facility impact EBITDA margins

EBITDA margins declined by 380bp YoY to 21.7% due to higher R&D spend (up by 77%), higher staff cost (up by 29%) and other expenditure (up by 38%), translating into 7% decline in EBITDA to Rs897m. The staff cost and other expenditure were higher due to commencement of operations at the new biotech park, without commensurate revenues from the new facility. Furthermore, higher tax provisioning (at 18.8% of PBT v/s 7.6% in 2QCY05) resulted in 18% YoY decline in PAT to Rs634m.
In our opinion, the benefit of growing synergies in Europe, new product launches in US market and increasing contribution from Baddi (from 25% in CY05 to around 50-55% in CY06) would result in a gradual improvement in EBITDA margins going forward.

Acquired Farex and Protinex brands in the domestic market

Wockhardt has recently acquired Dumex India Pvt Ltd along with its two products Protinex and Farex from Royal Numico NV of The Netherlands, for an undisclosed amount. Protinex is the market leader and the largest prescribed brand in its category, growing over 20% in volume in recent years. Farex is the third largest selling infant nutrition formula in the cereals category. The two brands currently generate annual sales of Rs.600m. These brands are around 50 years old and enjoy very strong brand equity.

With this acquisition, Wockhardt's sale from nutrition products would double to Rs1.2b. As a part of the deal, Wockhardt would also acquire a sales and marketing organization with 235 personnel. Royal Numico will also offer technical know-how to Wockhardt for the manufacture of specialized sugar-free infant food products currently marketed in India and internationally, under its brand names Dulac and Dupro. Currently these products are imported from New Zealand and Malaysia. Although the company hasn't disclosed purchase consideration, we do not rule out the possibility that Wockhardt would have paid higher price as these brands enjoy very high brand equity.

Expect a gradual growth in European business

European revenues for the 1HCY06 improved by 5% to Rs2.9b, based on 19% YoY growth in UK business. Restructuring of Esparma has been completed by transferring all the products to Wockhardt UK. Wockhardt's European business is expected to slow down as one-time benefits of past acquisitions wane out and future growth will now, be linked to new launches rather than on merger benefits. Wockhardt has a pipeline of 10 new products for the UK and 6 new products for Germany, which would drive the future growth for the company.

Also, the Exenatide (Byetta) business is expected to show good growth once the expanded capacity comes on-stream in September 2006. Currently, Wockhardt is the only supplier of Exenatide cartridges to Eli Lilly, based on its contract with Amylin.

Also, Wockhardt has started working on filings for Insulin (for regulated markets in EU) based on the guidelines issued by EMEA. We believe that a successful launch of bio-generics in EU will bring in significant benefits for the company, albeit in the long-term. Our estimates do not include any upsides from potential launch of bio-generics.

Trying to gain critical mass in USA

Wockhardt's nascent US business grew by just 5% to Rs809m in 1HCY06, as the company is in process of shifting distribution of its products on its own network from its partner's network. Wockhardt is expected to gain traction in its US business as it has more than 20 ANDAs pending approval (of which 8-9 are injectables which could witness relatively lower competition). It expects to file another 15-18 ANDAs in CY06E.

Although, the company has, in the past, guided about 50% growth in the US business, we do not expect the company to meet its guidance as the compliance issues with the US FDA (which have been now resolved) and the change in the distribution strategy, is likely to adversely impact its performance. It is in the process of establishing its own distribution network in the USA, which will include distribution channels for institutional sales (like hospitals). It should be noted that 40% of Wockhardt's US filings are in the injectable category - most of which will be sold in hospitals - where competition is relatively less severe. However, we believe that Wockhardt may not be able to gain significant market share in the injectable segment since, unlike its competitors, it will be distributing products on its own. This segment consists of large well established players like Baxter, Hospira, etc., and a new entrant may find it difficult to gain market share. However, unlike its other Indian competitors, it will not be required to share profits with the US partners.

Taking steps to build franchise in other international markets

Wockhardt has also started taking steps to tap other non-regulated markets – particularly for its biotech products. International (non-regulated markets) biotech portfolio is likely to receive further impetus from additional registrations. Wockhardt has over 60 biotech registrations pending approval in various non-regulated markets.

Targeting acquisitions in regulated markets

Wockhardt has already received shareholder approval to raise US$800m through an equity-linked issue to fund potential acquisitions. Management has indicated that the company is not looking to raise funds immediately. It is an enabling provision which can be leveraged so as to be prepared for any acquisition opportunity. Given Wockhardt's current size, we believe that this is a significant fund-raising being proposed by the company. It has already raised about US$110m through a FCCB issue in Sep-04, which is yet to be deployed.

It is pertinent to note that many generic players (including most of the Indian companies) are looking at acquisitions to boost their generic businesses. The need to resort to inorganic growth has been accentuated by the consolidation in the global generics space with Teva and Sandoz announcing significantly large acquisitions. This implies that, in their quest for inorganic growth, generic players may end up acquiring expensive assets (resulting in extended paybacks). We do not rule out this possibility in Wockhardt's case also. The acquisitions made by both Teva and Sandoz have valued the acquired company at about 3-4x sales. We believe that such expensive acquisitions may extend the pay-back period for the acquirer.

Making gradual progress – reasonable valuations

- Wockhardt has, over the last couple of years, emerged as a serious player in the regulated markets – largely through its acquisitions in Europe. These have now given it access to markets, which are expected to witness a sharp increase in generics penetration over the next few years. Wockhardt is one of the better-placed Indian companies to ride the genericisation wave in Europe. The company's efforts to tap the US markets through its own distribution infrastructure could also pay off significantly, particularly if it is able to crack the biogenerics opportunity.
- At the same time, we believe that Wockhardt still has to display the ability to fully leverage its assets and scale up substantially in regulated markets, for a further re-rating in its valuation multiples. We have revised our CY06E EPS estimates downwards by 4.5% to Rs23.5, to factor in lower than expected traction in US business and higher fixed overheads on the new biotech park. At 14.5x CY06E and 11.2x CY07E fully diluted earnings, we believe that valuations are reasonable. Maintain **Buy**

Wockhardt: an investment profile

Company description

Wockhardt is one of the largest pharmaceutical companies in India with a balanced presence in domestic (40% of sales) and international (60% of sales) markets. The company has emerged as the second largest Indian company in Europe, post acquisition of CP Pharma (UK) and Esparma GmbH (Germany).

Key investment arguments

- One of the pioneers in biogenerics in India, with three products launched in the domestic market; exports to unregulated markets to commence shortly.
- Established presence in Europe following the integration of CP Pharma and Esparma, to help it increase generic penetration in Europe.
- Restructuring of domestic market portfolio in favor of power brands to prop up domestic market performance.

Key investment risks

- Regulatory pathway for biogenerics in regulated markets not clear yet – leading to longer payback period.
- Past track record in the US has not been very impressive; ability to scale up is still not proven.
- Strategy to set up own distribution infrastructure would be an expensive affair and could pull down profitability.

Recent developments

- Acquired Farex and Protinex brands from Royal Numico.

Valuation and view

- Expect revenue and earnings CAGR of 17% and 31%, respectively over CY05-CY07E
- At 14.5x CY06E and 11.2x CY06E earnings, valuations do not fully reflect growth prospects
- We re-iterate **Buy** with a target price of Rs460

Sector view

- Regulated markets would remain the key drivers in the medium term. Europe would be the next growth driver for companies with a direct marketing presence.
- Despite intense price competition, CY06 to witness gradual improvement for generics led by new launches.
- We are overweight on companies that are towards the end of the investment phase, with benefits expected to start coming in from the next fiscal.

COMPARATIVE VALUATIONS

		WOCKHARDT	LUPIN	SUN PHARMA
P/E (x)	FY07E	14.5	15.0	26.7
	FY08E	11.2	12.2	21.8
P/BV (x)	FY07E	3.8	4.2	8.3
	FY08E	3.0	3.3	6.1
EV/Sales (x)	FY07E	2.1	1.9	7.7
	FY08E	1.7	1.6	6.2
EV/EBITDA (x)	FY07E	9.4	11.4	23.9
	FY08E	6.8	9.1	18.2

SHAREHOLDING PATTERN (%)

	MAR.06	DEC.05	MAR.05
Promoters	73.7	73.7	73.9
Domestic Institutions	9.1	8.1	7.8
FIIs/FDIs	5.8	6.5	6.8
Others	11.4	11.7	11.5

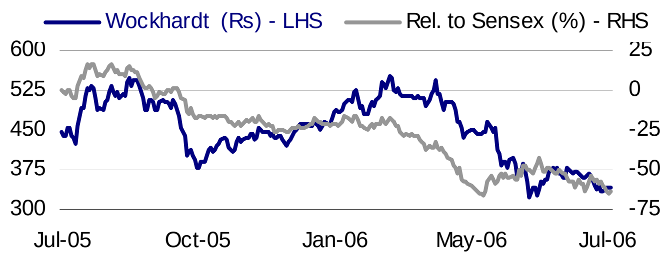
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
CY07	23.5	30.2	-22.1
CY08	30.5	35.8	-14.8

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
342	460	34.5	Buy

STOCK PERFORMANCE (1 YEAR)



CONSOLIDATED INCOME STATEMENT					(Rs Million)
Y/E DECEMBER	2003	2004	2005	2006E	2007E
Net Sales	**9,420**	**12,155**	**13,660**	**16,457**	**18,791**
Change (%)	*22.8*	*29.0*	*12.4*	*20.5*	*14.2*
EBITDA	**1,731**	**2,339**	**2,826**	**3,738**	**4,667**
Margin (%)	*18.4*	*19.2*	*20.7*	*22.7*	*24.8*
Depreciation	268	368	426	568	607
EBIT	**1,463**	**1,971**	**2,399**	**3,170**	**4,061**
Int. and Finance Charges	110	-16	95	169	60
Other Income - Rec.	181	158	180	425	437
PBT before EO Expense	**1,533**	**2,145**	**2,484**	**3,427**	**4,438**
EO Expense/(Income)	-64	0	0	604	0
PBT after EO Expense	**1,597**	**2,145**	**2,484**	**2,823**	**4,438**
Tax	171	371	374	508	799
Tax Rate (%)	*10.7*	*17.3*	*15.1*	*18.0*	*18.0*
Reported PAT	**1,426**	**1,775**	**2,110**	**2,315**	**3,639**
PAT Adj for EO items	**1,369**	**1,775**	**2,110**	**2,810**	**3,639**
Change (%)	*30.3*	*29.6*	*18.9*	*33.2*	*29.5*
Margin (%)	*14.5*	*14.6*	*15.4*	*17.1*	*19.4*

CONSOLIDATED BALANCE SHEET					(Rs Million)
Y/E DECEMBER	2003	2004	2005	2006E	2007E
Equity Share Capital	363	545	547	547	547
Fully Diluted Cap	*363*	*545*	*597*	*597*	*597*
Reserves	4,263	5,621	7,615	9,349	12,034
Net Worth	**4,626**	**6,166**	**8,161**	**9,895**	**12,580**
Deferred Liabilities	451	600	618	821	1140
Total Loans	3,302	8,914	9,065	6,340	5,280
Capital Employed	**8,378**	**15,680**	**17,844**	**17,056**	**19,001**
Gross Block	6,411	7,614	8,384	9,081	9,581
Less: Accum. Deprn.	2,557	2,631	2,906	3,473	4,080
Net Fixed Assets	**3,854**	**4,983**	**5,478**	**5,608**	**5,501**
Capital WIP	1,510	1,634	2,403	150	150
Investments	0	3	3	3	3
Curr. Assets	**5,764**	**12,568**	**13,605**	**15,419**	**18,369**
Inventory	1,755	2,164	2,747	3,153	3,601
Account Receivables	2,161	2,355	2,810	3,118	3,560
Cash and Bank Balance	1,530	7,355	7,139	8,586	10,567
Others	318	695	910	561	641
Curr. Liability & Prov.	**2,751**	**3,508**	**3,645**	**4,123**	**5,022**
Account Payables	2,362	2,479	2,561	3,382	3,862
Provisions	389	1,029	1,084	741	1,160
Net Current Assets	**3,014**	**9,060**	**9,960**	**11,295**	**13,346**
Misc Expenditure	0	0	0	0	0
Appl. of Funds	**8,378**	**15,680**	**17,844**	**17,056**	**19,001**

E: MOSt Estimates

RATIOS					(Rs Million)
Y/E DECEMBER	2003	2004	2005	2006E	2007E
Basic (Rs)					
EPS	**18.9**	**16.3**	**19.3**	**25.7**	**33.3**
Fully diluted EPS	**18.9**	**16.3**	**17.7**	**23.5**	**30.5**
Cash EPS	22.6	19.7	23.2	30.9	38.8
BV/Share	63.7	56.6	74.7	90.5	115.1
DPS	3.8	5.0	5.0	4.7	7.7
Payout (%)	216	34.8	29.6	25.1	26.2
Valuation (x)					
P/E (fully diluted)		21.0	19.3	14.5	11.2
Cash P/E		17.4	14.7	11.1	8.8
P/BV		6.0	4.6	3.8	3.0
EV/Sales		3.2	2.9	2.1	1.7
EV/EBITDA		16.6	13.9	9.4	6.8
Dividend Yield (%)		1.5	1.5	1.4	2.2
Return Ratios (%)					
RoE	33.8	32.9	29.5	31.1	32.4
RoCE	27.6	18.5	16.0	21.5	26.4
Working Capital Ratios					
Debtor (Days)	81	69	73	69	69
Creditor (Days)	209	173	162	197	203
Inventory (Days)	68	65	73	70	70
Working Capital Turnover (Days)	117	272	266	251	259
Leverage Ratio (x)					
Current Ratio	2.1	3.6	3.7	3.7	3.7
Debt/Equity	0.7	1.4	1.1	0.6	0.4

CASH FLOW STATEMENT					(Rs Million)
Y/E DECEMBER	2003	2004	2005	2006E	2007E
Oper. Profit/(Loss) before Tax	1,731	2,339	2,826	3,738	4,667
Interest/Dividends Recd.	181	158	180	425	437
Direct Taxes Paid	-171	-371	-374	-508	-799
(Inc)/Dec in WC	71	-222	-1,115	111	-70
CF from Operations	**1,812**	**1,904**	**1,516**	**3,766**	**4,235**
EO Expense	-64	0	0	604	0
CF from Oper. incl EO Exp.	**1,876**	**1,904**	**1,516**	**3,162**	**4,235**
(inc)/dec in FA	-2,940	-1,621	-1,689	1,555	-500
(Pur)/Sale of Investments	0	-3	0	0	0
CF from Investments	**-2,940**	**-1,624**	**-1,690**	**1,555**	**-500**
Issue of Shares	40	382	509	0	0
(Inc)/Dec in Debt	2,894	5,762	168	-2,522	-740
Interest Paid	-110	16	-95	-169	-60
Dividend Paid	-307	-617	-624	-581	-954
CF from Fin. Activity	**2,517**	**5,544**	**-42**	**-3,271**	**-1,755**
Inc/Dec of Cash	**1,452**	**5,824**	**-215**	**1,446**	**1,981**
Add: Beginning Balance	78	1,530	7,355	7,139	8,586
Closing Balance	**1,530**	**7,355**	**7,139**	**8,586**	**10,567**

E: MOSt Estimates

NOTES

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

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