

Company Flash

3 May 2007 | 6 pages

Wockhardt (WCKH.BO)

Buy: The Next Step Up in Europe

- Another Acquisition** — Wockhardt has announced the acquisition of Negma-Lerads SAS, a French company with annual revenues of US\$150m and its own patented products. It has paid a total consideration of US\$250m, translating into an EV/Sales valuation of 1.7x. This is Wockhardt's 5th acquisition in Europe, which has now emerged as a key region for the company. We maintain Buy (1L)
- Entry into France** — This acquisition provides Wockhardt an entry into the growing French market through a branded vehicle. Negma Lerads is the fourth largest independent pharmaceutical company in France with its own patented products and manufacturing facilities. While Wockhardt has not provided details, Negma Lerads appears to have products in the therapy areas of osteoarthritis, anti-hypertension, anti-hemorrhoids and vesical instability.
- Key Questions** — Wockhardt is holding an analyst meet this afternoon, where we expect more details to be provided. Key questions include the profitability of the acquired business and ability to exploit synergies, if any. Besides, with Negma Lerads having its own patented products, the life cycle of these patents and generic risk are the other issues that we would need clarity on.
- Integration Challenges** — France has historically been a tough market for Indian companies to integrate acquisitions – Ranbaxy: RPG Aventis and Cadila: Alpharma are cases in point. At the same time, Wockhardt has been successful in integrating large acquisitions in the past, with all of them being earnings accretive from the first year itself. We shall come out with a more detailed update post the company's analyst meet.

Buy/Low Risk	1L
Price (03 May 07)	Rs436.00
Target price	Rs522.00
Expected share price return	19.7%
Expected dividend yield	1.4%
Expected total return	21.1%
Market Cap	Rs47,714M US\$1,162M

Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Dec	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2004A	2,248	20.56	56.9	21.2	7.7	41.7	0.9
2005A	2,571	23.52	14.4	18.5	5.8	35.9	1.1
2006E	2,927	26.78	13.9	16.3	5.1	33.4	1.4
2007E	3,564	32.61	21.8	13.4	4.1	33.9	1.6
2008E	3,974	36.36	11.5	12.0	3.4	30.8	1.8

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

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Wockhardt

Company description

Wockhardt is a leading player in the Indian market which has carved a niche for itself in bio-generic products. In the domestic market, it largely follows a strategy of offering products at substantial discounts to competing products, allowing it to rake up large volumes. In its pharma portfolio, Wockhardt has placed emphasis on new products in the chronic-care segments. In overseas markets, Wockhardt has adopted the inorganic route to build a sizeable presence in Europe, with focus on the formulations segment. The company continues to focus on acquisitions as a means to grow in US and Europe.

Investment thesis

We rate Wockhardt as Buy/Low Risk (1L) with a target price of Rs522. We see Wockhardt as an emerging global bio-generics company with strong earnings growth potential over the long term. The company has had several disappointments over the past 2 years – especially related to its US market initiatives. However, with most of these being addressed, we expect improving fundamentals and earnings growth to once again drive good upside over the long term. Wockhardt is making steady progress in filing bio-generics for approval in several emerging and developing countries. It has already launched the products in some markets and expects to extend them to other markets in the next 12 months. In the developed markets, the regulatory framework is still being established. The EU is leading the way, and the US has still to come up with tangible guidelines. The company is working on erythropoietin and insulin for the EU market and expects to file its first registration by end CY07. We believe this will be positively perceived in the market. However, we also caution that the trials would be expensive and could be a drain on profitability in the near term. We expect Wockhardt to introduce its first bio-generic product in the EU in CY09. We believe that current low valuations and robust growth in Wockhardt's core business make it a good investment, with the biogenerics opportunity in regulated markets being an added source of option value.

Valuation

We expect the company's earnings growth to remain steady and, therefore, believe P/E is the best method to value the stock. As the company gains momentum in the export business, we expect its valuation discount to frontline pharma companies to narrow. Wockhardt is a mid-sized pharma company and, as such, could trade at a 20% discount to the frontline names in the sector in the long term. We have been valuing Wockhardt in line with sector leaders on expectations of strong growth momentum and sustained earnings. However, with several issues dogging the company and hurting investor sentiment, we believe it could take some time before Wockhardt is able to once again command premium valuations. As such, we now value Wockhardt at 18x 12-month forward earnings (within its six year trading range of 7-40x), which is in line with the multiple that we use for other mid-cap Pharma stocks and arrive at a target price of Rs522.

Risks

We rate Wockhardt Low Risk in recognition of its steady growth and visible earnings stream. It has sufficient cash flows to internally fund expansions. Factors that could impede the stock from reaching our target price include: (1) Inability to drive organic growth in Europe could hurt overall earnings growth,

especially if the currency moves against it; (2) US exports are crucial to the company's overall export strategy. The generic market for biotechnology products is not well established and there could be roadblocks; and (3) While the domestic market appears to be recovering, growth has slowed to the mid-single-digits. Competition is becoming keener, and hence margins could come under pressure.

Appendix A-1

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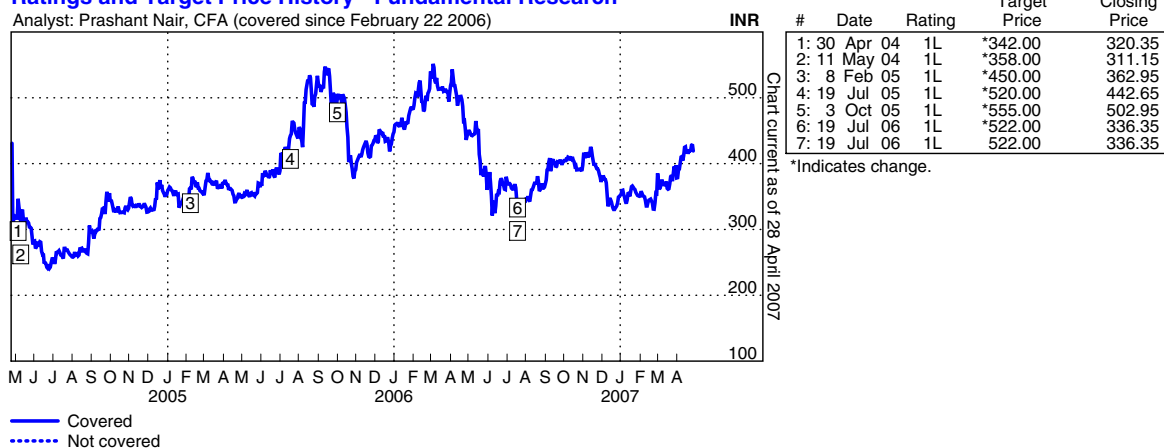
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Wockhardt (WCKH.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Prashant Nair, CFA (covered since February 22 2006)



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