WOCKHARDT LTD.

BUY

STOCK POINTER

Target Price ₹ 978 | CMP ₹ 565 | FY14 PE 5.8x

Index Details	
Sensex	17,122
Nifty	5,195
BSE 100	8,981
Industry	Pharma

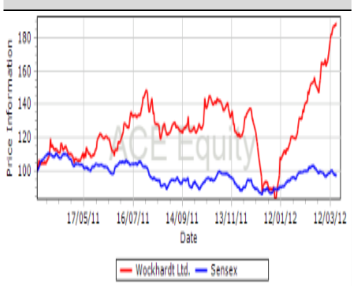
Scrip Details	
Mkt Cap (₹ cr)	6,184
BVPS (₹)	103.0
O/s Shares (Cr)	10.9
Av Vol (Lacs)	2.2
52 Week H/L	622/251
Div Yield (%)	0.0
FVPS (₹)	5.0

We initiate coverage on Wockhardt Limited (Wockhardt) as a BUY with a Price Objective of ₹ 978 (target 10.0x FY14 P/E). At CMP of ₹ 565 the stock is trading at 3.4x and 5.8x its estimated earnings for FY2013E & FY2014E representing a potential upside of ~73% over a period of 18 months. With the contingent liability concerns addressed and bulk of FCCBs already repaid, the sale of nutrition business will lead to a substantial increase in cash which could be used to draw down debt or pursue organic / inorganic grow opportunities. Further its portfolio of high margin niche products and impressive FTF launches should provide for strong growth in revenues (12.3% FY11-14 CAGR) to ₹ 5311.2 crore and earnings (123.6% FY11-14 CAGR) of ₹ 97.8 /share by FY14.

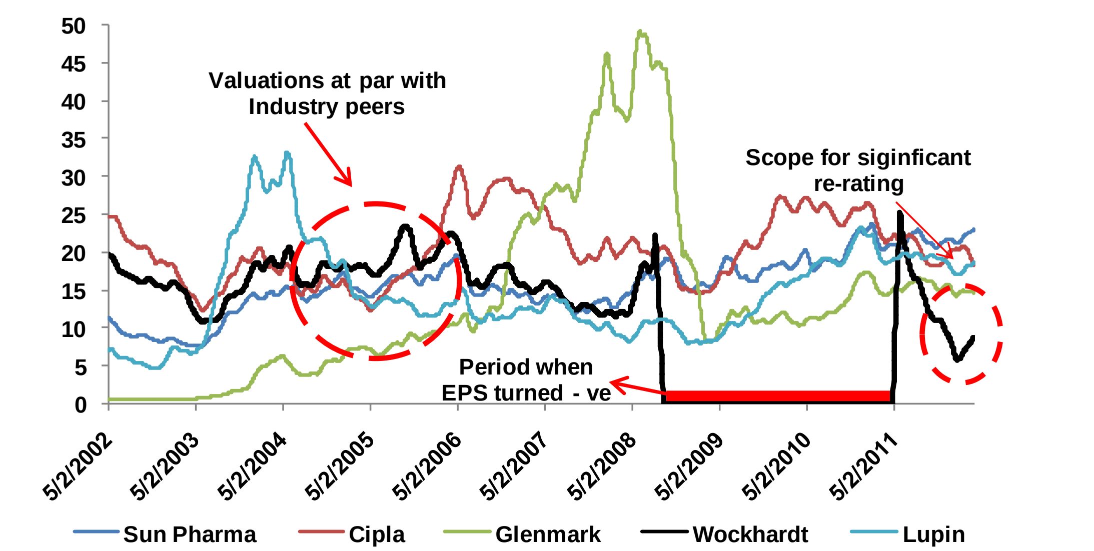
During the period 2003 through 2008, Wockhardt has traded mostly in line with the 1 Year forward PE multiple of its peers viz: Sun Pharma, Cipla, Lupin and Glenmark. However, post its derivative losses, Wockhardt's EPS turned negative. Now that the balance sheet is all cleaned up and all contingent liabilities addressed, we expect that going forward, Wockhardt will catch up with its peers leading to a substantial re-rating of the stock.

Shareholding Pattern	
Shareholders	%
Promoters	73.6
DIIs	6.1
FIIs	1.3
Public	18.9
Total	100

Wockhardt vs. Sensex



Comparison of Wockhardt's One Year Forward P/E with peers



Source: Wockhardt, Ventura Research

Key Financials (₹ in Cr)

Y/E Mar	Net Revenue	EBITDA	PAT	EPS	EPS Growth (%)	RONW (%)	ROCE (%)	P/E (x)	EV/EBITDA (x)
2011	3751.2	908.7	95.7	8.7	-	8.5	9.8	64.6	10.1
2012E	4583.9	1361.8	719.0	65.7	651.3	38.8	23.3	8.6	6.7
2013E	4881.0	1387.9	1833.6*	167.6	155.0	49.7	46.8	3.4	6.6
2014E	5311.2	1572.8	1070.1	97.8	-41.6	22.5	27.4	5.8	5.8

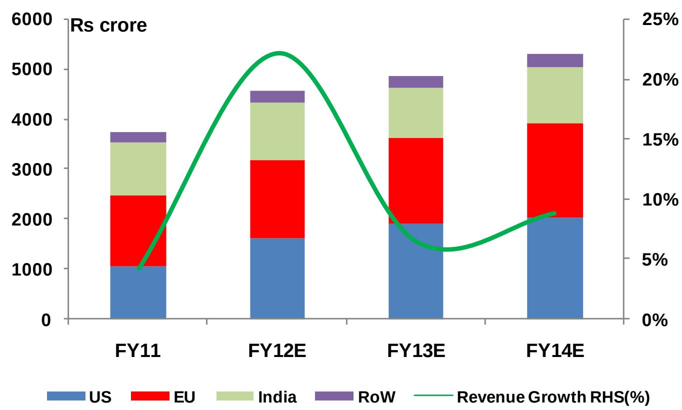
**FY13E PAT includes Rs 944 crore on account of sale of nutrition business to Danone*

Wednesday 28th Mar, 2012

❖ Integrated assets, niche positioning and monetization capability to heighten growth pace

Wockhardt's revenues are expected to grow at a CAGR of 12.3% to ₹ 5,311.2 crore by FY14 on the back of strong traction in high margin niche product sales and FTF product launches in the rewarding markets of EU and the US. Driven by gradually improving operational efficiencies on the back of better raw material sourcing, cost optimization and increasing contribution of high margin products and FTF opportunities, we expect margins to improve by 540 bps to 29.6% in FY14. Consequently earnings are expected to grow at a CAGR of 123.6% to ₹ 1,070.1 crore over the forecast period. Further, strong focus on R&D and development of complex products would ensure future sustenance of this growth trajectory.

Revenue & Revenue Growth (%)

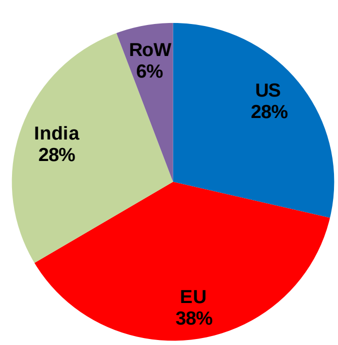


Source: Wockhardt, Ventura Research

Strong traction in revenues from regulated markets to boost profitability

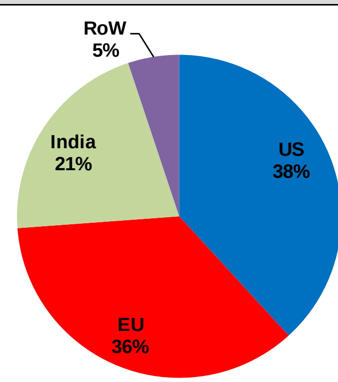
Currently, Wockhardt's sales mix is tilted towards the regulated markets with US and EU markets contributing a significant 66.5% of the revenues. With strong FTF opportunities emanating from these markets over the next couple of years, we expect the sales mix to tilt further in favour of these markets with US and EU contributing 73.8% (US- 38.2% and EU-35.6%) of the overall revenues in FY14.

Sales mix- FY11



Source: Wockhardt, Ventura Research

Sales Mix- FY14



Source: Wockhardt, Ventura Research

US business to grow on the back of robust product portfolio and FTF opportunities

The growth in the US markets is driven by its niche product portfolio consisting of Metaprolol (CVS), Divalproex (CNS), Flonase (Respiratory) and a slew of FTF opportunities in Stalevo (CNS), Comtan (CNS) and Lunesta (Anti Depressant). We expect these niche products and FTF opportunities to contribute ₹ 768.3 crore and ₹ 424.4 crore to the revenues in FY13 and FY14 respectively. Further, the base business contribution is expected to be ~ ₹ 1152.0 crore and ₹ 1497.6 crore to the US revenues in FY13 and FY14 respectively.

FTF Opportunities and Recent launches

Particulars	FTF						Niche Products			
	Lunesta		Stalevo		Comtan		Flonase		Toprol	
	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
Market Size ($ Mn)	250		150		580		580		1180	
Price Erosion	80%	90%	55%	90%		60%	-	-	-	-
Patent expiry	Aug ,2013		Apr , 2012		Apr, 2013		-		-	
FTF Players	Teva, Orchid, DRL, Roxane,		WL, Sun Pharma		WL		-		-	
Market Size ($ Mn)	38	25	67.5	15		232	-	-	-	-
Market Share	7%	8%	29%	23%		38%	8%	8%	8%	5%
Revenue ($ Mn)	2.5	2	19.4	3.5		88.5	43.5	46.4	91.5	59.0
EBIDTA ($ Mn)	0.5	0.4	5.4	0.6		17.5	21.8	22.5	45.7	27.7

Source: Wockhardt, Ventura Research

Strong presence in EU markets to drive growth

Wockhardt has a strong presence in the EU markets through its subsidiaries Wockhardt (UK), Pinewood Healthcare (Ireland) and Negma Laboratories (France). Wockhardt (UK) has a strong foothold in the exports and CRAMs segment and is one of the major suppliers of healthcare products to the Retail Pharmacy and Hospitals in the UK as well as European markets. Growth in Wockhardt (UK) is supported by its strong product pipeline in key high growth therapeutic segments of diabetes, oncology, pain management, anti infectives and anti-coagulants coupled with numero uno position in Animal Insulin. Pinewood, too, continues to deliver robust numbers driven by the successful launch of product Nexazole (GI) and strong growth in the hospital business.

However, performance of Negma remains under pressure on account of lost patent cover of ART 50. In order to address the underperformance of the French unit significant restructuring initiatives are being implemented in addition to enhanced focus on novel drugs. We expect these initiates to lead to positive outcomes in the medium term.

On the back of the strong business model in place, we expect the European business to contribute ₹ 1,719.7 crore and ₹ 1,891.6 crore to the overall revenues in FY13 and FY14 respectively.

Two way growth strategy to drive domestic business

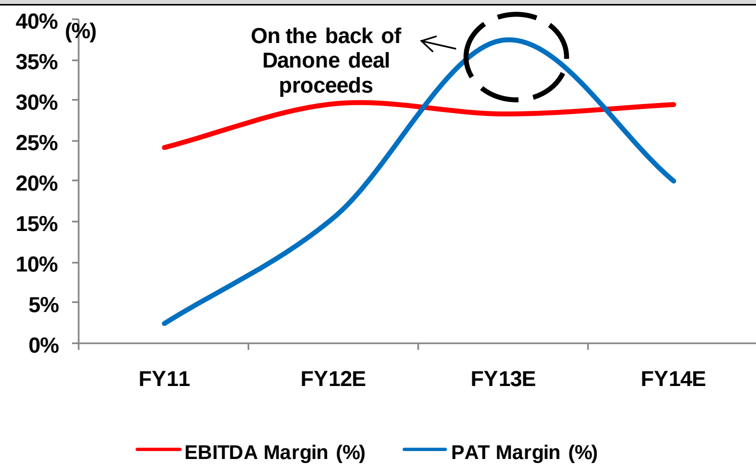
Wockhardt's domestic business (sans Nutrition segment) is expected to outperform the industry growth and grow at a CAGR of 13% to ₹ 1,118.9 crore in FY14 on the back of its entry into the high margin chronic therapy product portfolio and enhancement of its field force strength.

Operational efficiencies and effective funds management to drive margin expansion

Driven by gradually improving operational efficiencies on the back of better raw material sourcing, cost optimizations and increasing contribution of high margin products and FTF opportunities, we expect EBITDA margins to expand by 540 bps to 29.6% in FY14. Already the margins in Q3FY12 have improved by 200 bps over Q2FY12 on account of strong performance of high margin product Toprol XL in the US markets.

The net margins are also expected to improve by 1750 bps to 20.1% over the forecast period as the impact of settlement of contingent liabilities, repayment of debt and better funds management kicks in.

EBITDA & PAT Margin (%)

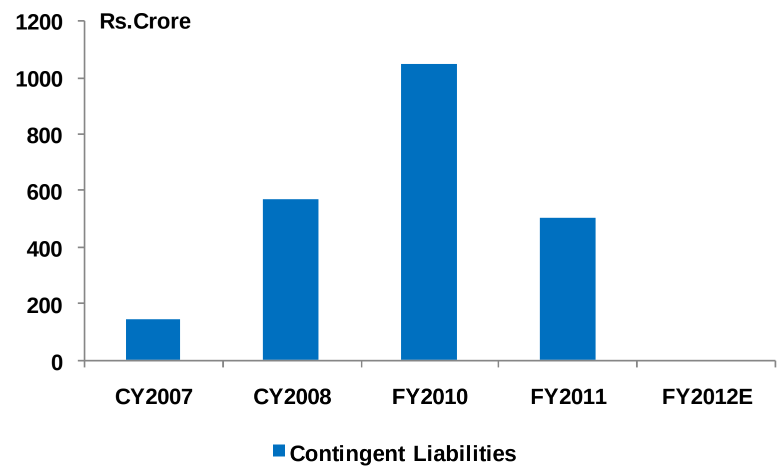


Source: Wockhardt, Ventura Research

❖ Contingent liabilities stand resolved

The contingent liabilities have been bought down to zero after addressing the claims in full of Rs 240 crore of liabilities with Deutsche Bank and a USD 24 mn with Lehman Brothers. This balance sheet clean up exercise should help boost investor sentiment and lead to further re-rating of the stock.

Contingent Liabilities Trend

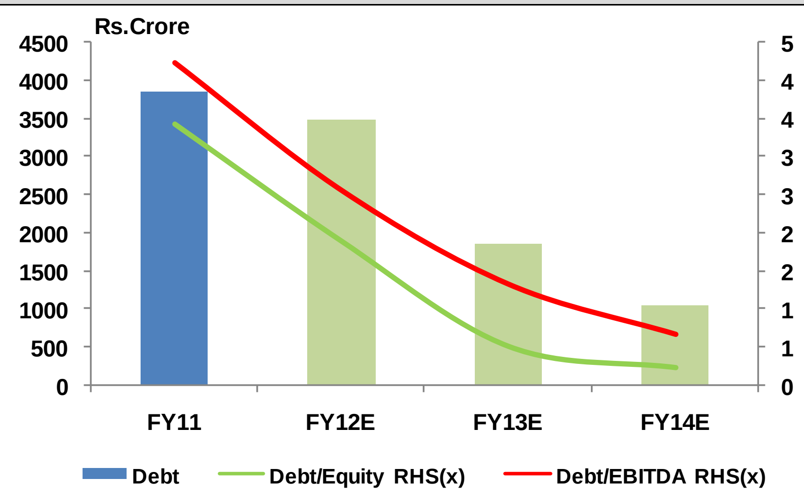


Source: Wockhardt, Ventura Research

❖ Sale of non-core assets to ease debt pressure burden

Post sale of its nutrition business to Danone, we expect significant liquidity to be injected in the company helping it tide over the current debt issues and pursue other organic and inorganic growth opportunities. Out of the proceeds of its divesture, we expect Wockhardt to settle the remaining FCCB dues and reduce the debt to ₹ 1052.1 crore in FY14 from the current ₹ 3,849.5 crore thus deleveraging the balance sheet considerably. Post clearance of the contingent liabilities, we foresee no major hindrance and expect the deal to be completed in the stipulated time frame.

Debt , Debt/Equity & Debt/EBITDA



Source: Wockhardt, Ventura Research

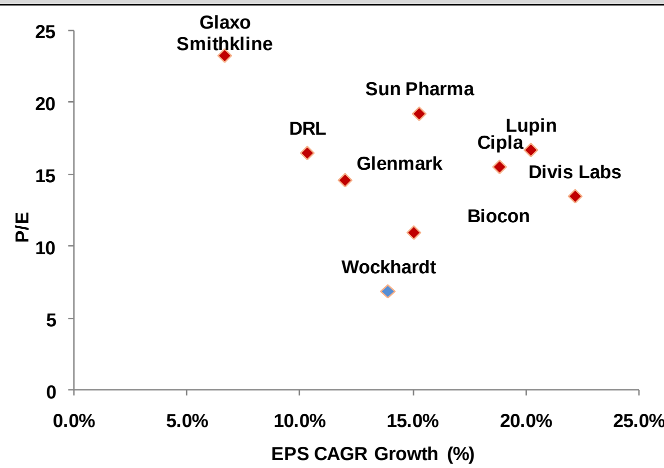
❖ Valuations: Re-rating of the stocks on cards

At the CMP of ₹ 565, Wockhardt is trading at 3.4x and 5.8x its estimated earnings for FY13 and FY14. We initiate coverage on Wockhardt Ltd as a BUY with a Price Objective of ₹ 978 (10x FY14 EPS) over a period of 18 months.

Currently, Wockhardt weighed by high debt is trading at a considerable discount to peers. However with the contingent liabilities settled, repayment of FCCB debt on track and the sale of the nutrition business, we expect the stock to be re-rated substantially in the medium term.

Wockhardt is trading at a significant discount of 54% to the industry average, and we expect the discount to narrow down substantially over time.

Peer Comparison



Source: Wockhardt, Ventura Research

Financials and Projections

Y/E March, Fig in Rs. Cr	FY 2011	FY 2012e	FY 2013e	FY 2014e
Profit & Loss Statement				
Net Sales	**3751.2**	**4583.9**	**4881.0**	**5311.2**
% Chg.		22.2	6.5	8.8
Total Expenditure	**2842.5**	**3222.0**	**3493.2**	**3738.3**
% Chg.		13.4	8.4	7.0
EBITDA	**908.7**	**1361.8**	**1387.9**	**1572.8**
EBITDA Margin %	24.2	29.7	28.4	29.6
Other Income**	15.9	19.9	1200.5	20.6
Exceptional items	436.6	137.8	0.0	0.0
PBDIT	488.1	1243.9	2588.3	1593.5
Depreciation	116.6	116.1	121.5	129.6
Interest	267.1	278.7	174.9	126.2
PBT	**104.3**	**849.1**	**2292.0**	**1337.6**
Tax Provisions	8.6	130.2	458.4	267.5
Reported PAT	**95.7**	**719.0**	**1833.6**	**1070.1**
PAT Margin (%)	2.6	15.7	37.6	20.1
Manpower cost / Sales (%)	14.0	11.6	11.5	11.5
Other Exp / Sales (%)	20.1	18.8	18.6	18.5
Tax Rate (%)	8.3	15.3	20.0	20.0

*** Other Income includes Rs 1180 crore from the sell of Nutrition Business*

Y/E March, Fig in Rs. Cr	FY 2011	FY 2012e	FY 2013e	FY 2014e
Balance Sheet				
Share Capital	**799.9**	**805.4**	**805.4**	**805.4**
Reserves & Surplus	326.5	1049.4	2883.0	3953.0
Minority Interest & Others	0.0	0.0	0.0	0.0
Total Loans	3849.5	3483.7	1840.7	1052.1
Deferred Tax liability	0.0	0.0	0.0	0.0
Total Liabilities	**4975.9**	**5338.4**	**5529.1**	**5810.5**
Goodwill	0.0	0.0	0.0	0.0
Gross Block	**4048.7**	**4298.6**	**4498.6**	**4798.6**
Less: Acc. Depreciation	1468.4	1584.5	1706.0	1835.5
Net Block	**2580.2**	**2714.1**	**2792.7**	**2963.1**
Capital Work in Progress	887.4	896.3	878.4	887.1
Investments	89.6	90.5	91.4	92.3
Net Current Assets	**1160.5**	**1371.9**	**1501.0**	**1602.3**
Deferred Tax Assets	258.2	265.6	265.6	265.6
Total Assets	**4975.9**	**5338.4**	**5529.1**	**5810.5**

Y/E March, Fig in Rs. Cr	FY 2011	FY 2012e	FY 2013e	FY 2014e
Per Share Data (Rs)				
EPS	8.7	65.7	167.6	97.8
Cash EPS	19.4	76.3	178.7	109.7
DPS	0.0	0.0	0.0	0.0
Book Value	103.0	169.5	337.1	435.0
Capital, Liquidity, Returns Ratio				
Debt / Equity (x)	3.4	1.9	0.5	0.2
Current Ratio (x)	2.3	2.3	2.3	2.2
ROE (%)	8.5	38.8	49.7	22.5
ROCE (%)	9.8	23.3	46.8	27.4
Dividend Yield (%)	0.0	0.0	0.0	0.0
Valuation Ratio (x)				
P/E	64.6	8.6	3.4	5.8
P/BV	5.5	3.3	1.7	1.3
EV/Sales	2.4	2.0	1.9	1.7
EV/EBIDTA	10.1	6.7	6.6	5.8
Efficiency Ratio (x)				
Inventory (days)	69.4	70.0	70.0	70.0
Debtors (days)	58.9	60.0	60.0	60.0
Creditors (days)	42.5	45.0	45.0	45.0

Y/E March, Fig in Rs. Cr	FY 2011	FY 2012e	FY 2013e	FY 2014e
Cash Flow statement				
Profit After Tax	**90.5**	**722.9**	**1833.7**	**1070.0**
Depreciation	116.6	116.1	121.5	129.6
Working Capital Changes	258.0	-191.2	-42.2	-74.5
Others	151.1	0.0	0.0	0.0
Operating Cash Flow	**616.2**	**647.7**	**1913.0**	**1125.1**
Capital Expenditure	-214.3	-250.0	-200.0	-300.0
Change in Investment	-174.6	-9.8	17.0	-9.7
Cash Flow from Investing	**-389.0**	**-259.8**	**-183.0**	**-309.7**
Proceeds from equity issue	76.6	5.5	0.0	0.0
Inc/ Dec in Debt	-168.0	-365.8	-1643.0	-788.6
Dividend and DDT	0.0	0.0	0.0	0.0
Cash Flow from Financing	**-91.4**	**-360.4**	**-1643.0**	**-788.6**
Net Change in Cash	**135.9**	**27.6**	**87.0**	**26.8**
Opening Cash Balance	**347.0**	**482.9**	**510.5**	**597.5**
Closing Cash Balance	**482.9**	**510.5**	**597.5**	**624.2**

Ventura Securities Limited

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