18 January 2013 │ 32 pages

Pharmaceuticals (GICS) │ Drugs (Citi)
Asia Pacific │ India

Wockhardt (WCKH.BO)

Initiate at Buy: Back from the Brink and Going Strong

- **Initiation of Coverage**

- **Ample room to re-rate further** — We initiate on Wockhardt with a Buy and TP of Rs2,300 (FY14E P/E of 16x vs. 20x for sector leaders). Although the stock is up sharply over the past year, we believe valuations remain attractive at 12x FY14E P/E (35% discount to the sector) and do not fully price in a strong business recovery, improved B/S and healthy return ratios. We expect the valuation gap to the sector to narrow as the Street gets more comfort on the sustainability of Wockhardt's earnings, especially with a relatively low institutional shareholder base.
- **In Much Better Health** — Wockhardt has emerged from severe financial stress to turn around its fortunes over the last 3 years, and now has a sound B/S (FY13E net D/E: 0.2x), strong FCF (Rs40bn over FY13-15E) and industry-leading financial metrics. B/S concerns relating to high leverage and intangibles have been addressed through a combination of improving operations (largely in the US), business restructuring and more conservative accounting.
- **Healthy and Sustainable Growth** — We expect Wockhardt to report steady growth and healthy margins, despite rising competition in its largest product (Toprol XL), driven by niche launches in the US and steady growth in other markets. Earnings CAGR of 9% over FY13-15E appears low due to high base of Toprol XL. Ex-Toprol XL, growth is healthy at 20% CAGR. Our FY13-15 EPS forecasts are c11-15% ahead of consensus and we expect earnings beats to act as catalysts for the stock.
- **Industry-leading Metrics** — Wockhardt's RoCE (c28%) is the highest in the industry and its EBIDTA margin (c33%) ranks second only to Sun Pharma. This is the result of strong growth over the past few years, the writing down of intangibles related to the Negma acquisition in France and capex being kept under control.
- **Key Risks** — 1) Faster-than-expected decline in Toprol XL revenues due to entry of more players; 2) Sustained rupee appreciation vs. US$, with c80% of revenues coming from international markets; 3) Tougher regulatory oversight in EU (c25% of sales) that further pressures pricing.

Buy	**1**
Price (17 Jan 13)	Rs1,685.05
Target price	Rs2,300.00
Expected share price return	36.5%
Expected dividend yield	0.0%
Expected total return	**36.5%**
Market Cap	Rs184,611M
	US$3,396M

Price Performance
(RIC: WCKH.BO, BB: WPL IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2011A	5,865	53.59	na	31.4	19.6	na	0.0
2012A	9,479	86.62	61.6	19.5	12.5	78.5	0.0
2013E	14,516	132.64	53.1	12.7	6.7	68.9	0.0
2014E	15,760	144.01	8.6	11.7	4.3	44.7	0.0
2015E	17,291	157.99	9.7	10.7	3.0	33.4	0.0

Source: Powered by dataCentral

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WCKH.BO: Fiscal year end 31-Mar — **Price: Rs1,685.05; TP: Rs2,300.00; Market Cap: Rs184,611m; Recomm: Buy**

Profit & Loss (Rsm)	2011	2012	2013E	2014E	2015E
Sales revenue	37,512	46,138	55,345	62,482	69,144
Cost of sales	-21,753	-23,939	-26,057	-30,105	-33,656
Gross profit	15,760	22,199	29,288	32,378	35,488
Gross Margin (%)	42.0	48.1	52.9	51.8	51.3
EBITDA (Adj)	**9,160**	**14,399**	**19,666**	**21,015**	**22,598**
EBITDA Margin (Adj) (%)	24.4	31.2	35.5	33.6	32.7
Depreciation	-1,166	-1,225	-1,128	-1,204	-1,294
Amortisation	0	0	0	0	0
EBIT (Adj)	**7,994**	**13,174**	**18,538**	**19,811**	**21,304**
EBIT Margin (Adj) (%)	21.3	28.6	33.5	31.7	30.8
Net interest	-2,671	-2,144	-1,694	-1,421	-1,193
Associates	-52	11	0	0	0
Non-op/Except	-4,280	-5,262	548	598	721
Pre-tax profit	**992**	**5,778**	**17,391**	**18,988**	**20,832**
Tax	-87	-2,351	-2,765	-3,228	-3,541
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net profit	**905**	**3,427**	**14,626**	**15,760**	**17,291**
Net Margin (%)	2.4	7.4	26.4	25.2	25.0
Core NPAT	5,865	9,479	14,516	15,760	17,291

Per share data	2011	2012	2013E	2014E	2015E
Reported EPS (Rs)	8.27	31.31	133.64	144.01	157.99
Core EPS (Rs)	53.59	86.62	132.64	144.01	157.99
DPS (Rs)	0	0	0	0	0
CFPS (Rs)	58.64	108.22	127.16	149.26	166.86
FCFPS (Rs)	31.19	79.20	103.53	125.61	143.20
BVPS (Rs)	86.18	134.41	250.51	394.52	552.52
Wtd avg ord shares (m)	109	109	109	109	109
Wtd avg diluted shares (m)	109	109	109	109	109

Growth rates	2011	2012	2013E	2014E	2015E
Sales revenue (%)	na	23.0	20.0	12.9	10.7
EBIT (Adj) (%)	na	64.8	40.7	6.9	7.5
Core NPAT (%)	na	61.6	53.1	8.6	9.7
Core EPS (%)	na	61.6	53.1	8.6	9.7

Balance Sheet (Rsm)	2011	2012	2013E	2014E	2015E
Cash & cash equiv.	4,829	7,000	5,292	11,167	17,196
Accounts receivables	6,052	7,587	8,340	9,415	10,419
Inventory	7,137	8,886	9,098	10,271	11,366
Net fixed & other tangibles	33,396	33,694	23,857	25,199	26,456
Goodwill & intangibles	1,033	1,042	738	779	818
Financial & other assets	3,856	4,330	18,764	20,641	24,555
Total assets	**56,304**	**62,538**	**66,088**	**77,473**	**90,810**
Accounts payable	4,366	5,408	6,065	6,847	7,577
Short-term debt	4,680	2,201	91	91	91
Long-term debt	28,469	30,613	25,681	20,731	15,781
Provisions & other liab	9,359	9,606	6,834	6,627	6,893
Total liabilities	**46,873**	**47,828**	**38,672**	**34,296**	**30,342**
Shareholders' equity	9,431	14,710	27,416	43,177	60,468
Minority interests	0	0	0	0	0
Total equity	**9,431**	**14,710**	**27,416**	**43,177**	**60,468**
Net debt	**28,319**	**25,814**	**20,480**	**9,655**	**-1,324**
Net debt to equity (%)	300.3	175.5	74.7	22.4	-2.2

Valuation ratios	2011	2012	2013E	2014E	2015E
PE (x)	31.4	19.5	12.7	11.7	10.7
PB (x)	19.6	12.5	6.7	4.3	3.0
EV/EBITDA (x)	na	14.6	10.2	8.8	7.5
FCF yield (%)	1.9	4.7	6.1	7.5	8.5
Dividend yield (%)	0	0	0	0	0
Payout ratio (%)	0	0	0	0	0
ROE (%)	na	28.4	69.4	44.7	33.4

Cashflow (Rsm)	2011	2012	2013E	2014E	2015E
EBITDA	9,160	14,399	19,666	21,015	22,598
Working capital	450	-2,894	-3,422	-2,051	-1,517
Other	-3,192	339	-2,327	-2,630	-2,820
Operating cashflow	**6,418**	**11,843**	**13,917**	**16,335**	**18,261**
Capex	-3,004	-3,175	-2,586	-2,588	-2,590
Net acq/disposals	7	12	11,870	0	0
Other	231	117	-14,093	-1,500	-3,500
Investing cashflow	**-2,766**	**-3,047**	**-4,809**	**-4,088**	**-6,090**
Dividends paid	-1	-1	0	0	0
Financing cashflow	**-3,730**	**-8,266**	**-10,816**	**-6,371**	**-6,143**
Net change in cash	**1,405**	**2,126**	**-1,708**	**5,875**	**6,029**
Free cashflow to s/holders	**3,414**	**8,668**	**11,331**	**13,747**	**15,671**

Segmental Revenue (Rs m)	2011	2012	2013E	2014E	2015E
India	10,410	11,720	11,370	11,594	12,986
Growth (in %)	12	13	-3	2	12
US	10,740	19,080	25,868	30,830	33,951
Growth (in %)	5	78	36	19	10
Europe	14,210	12,420	13,836	15,145	16,605
Growth (in %)	-20	-13	11	9	10
RoW	2,150	2,920	4,270	4,913	5,602
Growth (in %)	1	36	46	15	14
Total	37,512	46,138	55,345	62,482	69,144
Growth (in %)	3	23	20	13	11

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For definitions of the items in this table, please click here.

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Contents

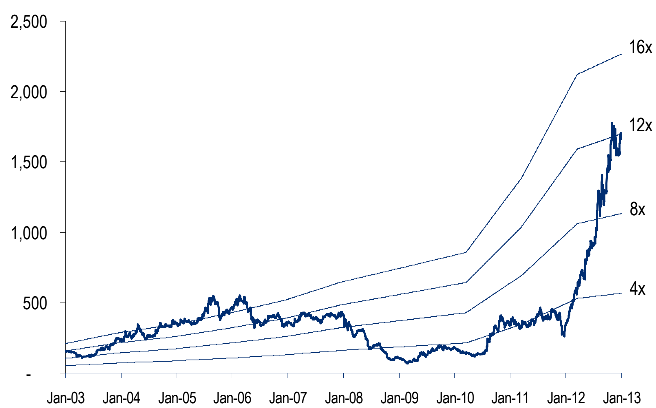
Investment Thesis

We initiate coverage on Wockhardt, with a Buy rating and target price of Rs2,300 / share and include it in our list of top Indian pharma picks. We believe that the stock has ample room to re-rate further despite the sharp appreciation over the last year. Valuations, at 12x FY14E P/E (35% discount to the sector), are still attractive and do not appear to fully factor in the strong turnaround in the business, an improved balance sheet and industry-leading financial metrics. We expect the valuation gap to the sector to narrow as the Street gets more comfort on the sustainability of earnings, especially with a relatively low institutional shareholder base.

Ample room to re-rate further

We believe that Wockhardt has ample room to re-rate further, despite a sharp appreciation (500+%) over the last year. While the move appears very steep in absolute terms, it must be viewed in light of the stock coming off a very low base – when the company's balance sheet was under severe stress and the stock was virtually priced for bankruptcy. At the same time, the business has improved significantly, with industry-leading profitability and return-on-capital metrics as well as strong free cash generation.

Figure 1. PE Band Chart (10 Years)



Source: Citi Research

Figure 2. Relative PE Band Chart

Source: Citi Research

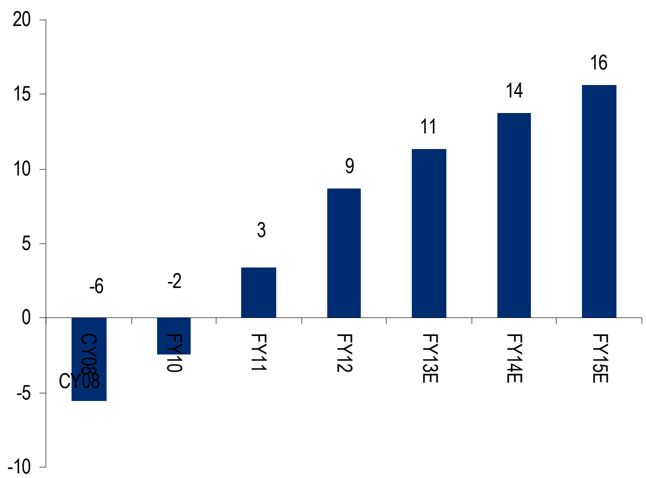
Valuations at 12x FY14E EPS and 9x FY14E EBIDTA are at steep discounts (35% and 25%, respectively) to the sector averages. This is unwarranted and does not reflect the improved business fundamentals, in our view. We expect the gap to narrow going forward, as the Street gets more comfort over the sustainability of earnings and supported by relatively low institutional ownership and improved management access (for investors and analysts). Our target price of Rs2,300 values Wockhardt at 16x FY14E earnings, implying 37% upside from current levels, and is set a discount to the 20x we use for sector leaders such as Lupin and Ranbaxy given the company's lower growth (on a high base) and a checkered track record.

In Much Better Health

Wockhardt has seen a strong turnaround in fortunes over the last three years, from being a company under severe financial stress, to one with a sound balance sheet, strong free cash flow generation and industry-leading financial metrics. The main concerns on the balance sheet – high leverage and intangibles – have both been addressed to a great extent through a combination of improving operations (largely in the US), business restructuring and more conservative accounting.

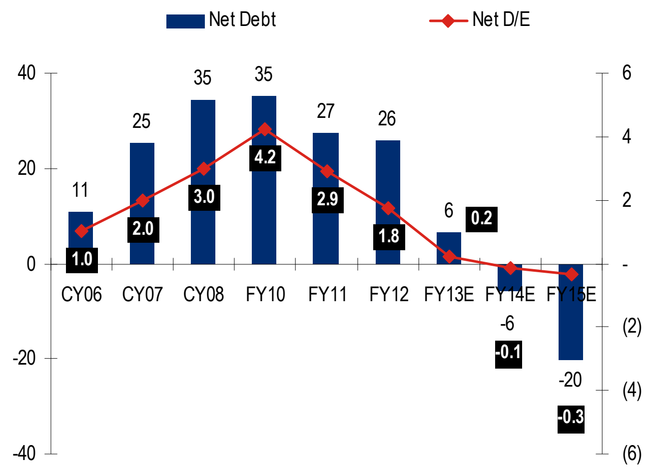
While the launch of generic Toprol XL and other niche products in the US led to improvement in operating profitability and cash generation, Wockhardt was able to further accelerate debt (including FCCBs) repayment through a series of asset divestitures (India nutrition, Germany – Esparma & Animal Health). It also significantly downsized its loss-making operations in France and reduced the drag on overall profitability.

Figure 3. FCF Generation Healthy



Source: Company data, Citi Research estimates

Figure 4. Net D/E Lower – Net Cash by FY14E



Source: Company data, Citi Research estimates

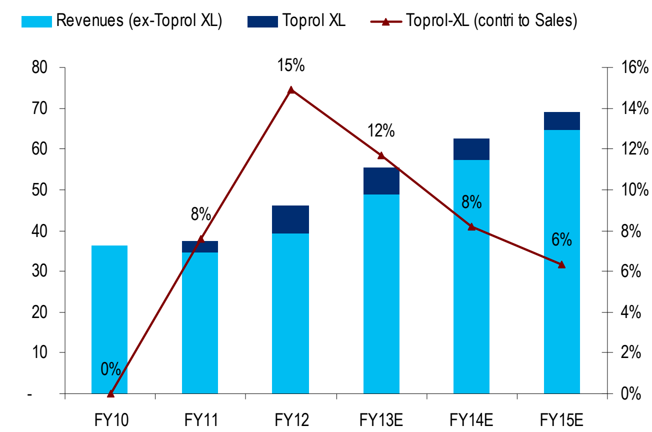
Consequently, FCF has improved from a negative Rs6bn in CY08 to Rs11bn in FY13E. This, along with proceeds from asset divestments, has led to net debt and net debt / equity declining considerably, from Rs37bn and 4.2x respectively in FY10 to Rs6bn and 0.2x respectively in FY13E. We expect these trends to continue and forecast cRs40bn FCF generation over FY12-15E and the balance sheet to turn net cash by the end of FY14E.

At the same time, the company has also addressed concerns related to its financial statements by changing its accounting treatment for R&D (fully expensed now, in line with most of its peers, as against capitalized earlier) and writing off a large part of its intangibles (mainly related to its French business and R&D capitalized earlier) – intangibles now account for c20% of capital employed vs. c45% in FY11.

Healthy and Sustainable Growth

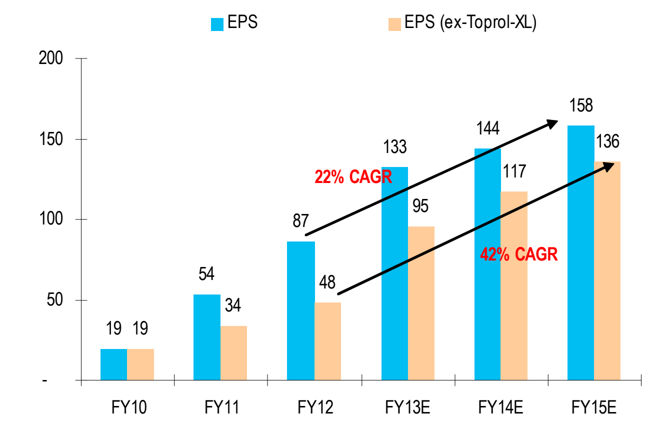
We believe that concerns over Wockhardt's ability to sustain growth and profitability are overdone. The seemingly low 9% earnings CAGR over FY13E-15E is entirely due to the high base created by semi exclusive sales of Toprol XL in the US, which has started easing off and would continue to do so over the next few years. Normalized for this, earnings growth trajectory is in line with its Indian pharma peers. We estimate that EPS, ex Toprol, grew at 59% CAGR over FY10-12 and expect it to remain robust at c42% CAGR over FY12-15E, driven by niche launches in the US along with steady growth and improving profitability in non-US markets.

Figure 5. Falling Dependence on Toprol XL (Rs m)



Source: Company data, Citi Research estimates

Figure 6. EPS (Rs/sh) Growth to Remain Strong

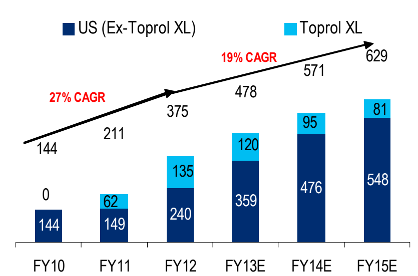


Source: Company data, Citi Research estimates

US Generics: niche portfolio kicking in

Wockhardt's focus on complex products has started paying off, with c20 niche / limited competition launches over the last three years. This led to a smart ramp up in US revenues from US$144m in FY10 to US$375m in FY12 and we expect them to grow further to cUS$629m in FY15. Revenue / product increased from US$2.3m in FY10 to US$5.4m in FY12, in turn leading to better profitability and cash flows; we expect this to improve further to US$5.5m in FY15.

Figure 7. US Sales (US$m) Trend



Source: Company data, Citi Research estimates

A lot beyond Toprol XL

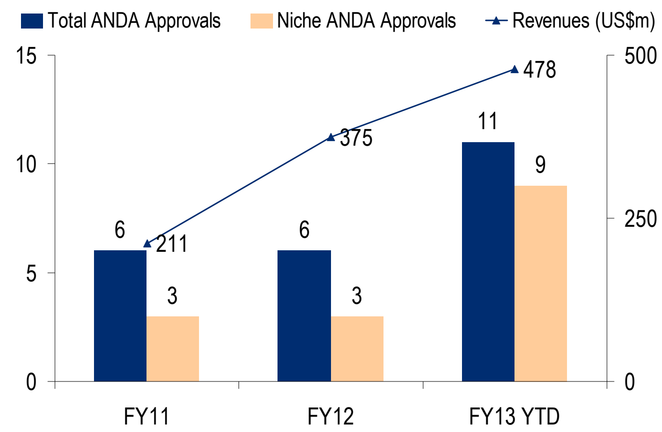
A large part of the growth over the last few years came from one product (generic Toprol XL) which, we believe, contributed cUS$135m to sales in FY12 – i.e. c58% of incremental US revenues over FY10-12. However, we highlight that US sales (ex Toprol XL) also saw healthy growth (c29% CAGR) over the same period.

In fact, over FY12-15E, despite a likely 40% drop in Toprol XL sales (as more competitors enter the market), we see the US business growing at a 19% CAGR, led by other niche products in the portfolio. Products other than Toprol XL now contribute c75% of US revenues, up from 64% in FY12, and we expect this trend to continue going forward – we forecast Toprol XL to be 13% of Wockhardt's US sales in FY15E.

Improving pace and quality of launches

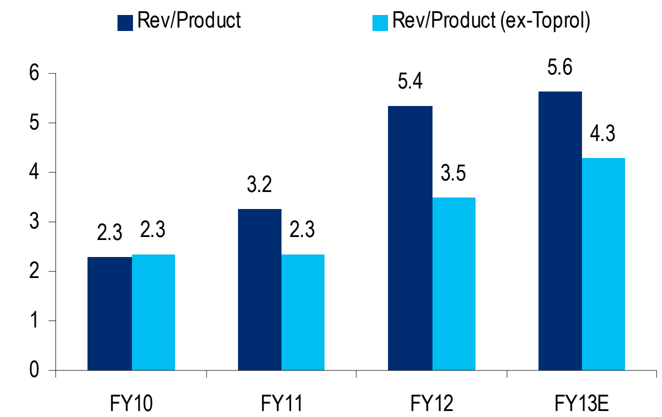
Wockhardt received eleven approvals in 9mFY13, compared to just six each in FY11 and FY12. More importantly, recent launches include several limited competition products such as *Flonase, Comtan, Stalevo, Lamictal XR, Geodon*, two OTC products, etc. that improve the quality of the company's product basket. The recent launches have witnessed limited competition, enabling healthy market share gains and profitability.

Figure 8. Niche Product Count Increasing



Source: Company data, Citi Research estimates

Figure 9. Rev/Product Rising (US$m)



Source: Company data, Citi Research estimates

Additionally, some of its older niche launches, especially *Bromfed-DM*, *Flomax*, *Zithromax*, *Augmentin* etc. will continue to contribute handsomely to the topline. Going forward, we expect Wockhardt to launch 12-15 products over the next two years, some of which are likely to be niche, limited competition opportunities.

Steady growth outside US

Wockhardt is likely to clock steady growth in almost all its non US markets. We believe the company is a lot more focused now, especially in international markets, following the difficulties faced with respect to the Negma Lerads acquisition in France. It does not intend to spread itself too thin in terms of geographical expansion and the strategy in most markets (including India) appears to be focused on improving productivity while striving for growth.

Figure 10. Growth in non US Businesses

	FY10-12	FY12-FY15E
India (ex-nutrition)	13%	13%
RoW	17%	24%
Europe	-16%	10%

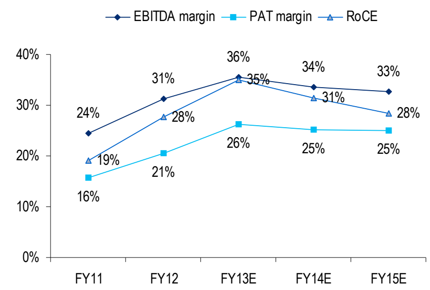
Source: Company data, Citi Research estimates

For instance, it has leveraged its UK facilities to supply to RoW markets as well as for contract manufacturing business. At the same time, after a large sales force expansion in India, the focus has shifted to increasing the share of chronic therapies and improving sales force productivity. It has also significantly downsized its struggling business in France and stopped it from being a drag on profits. We expect this approach to ensure steady growth at healthy margins in these markets.

Industry Leading Metrics

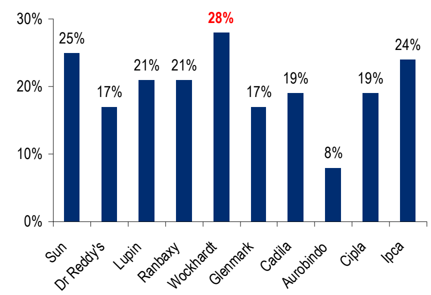
Wockhardt also compares very favorably *vis-à-vis* its peers on most financial metrics such as margins and capital efficiency. Strong growth over the last few years, its decision to write down intangibles related to the Negma Lerads acquisition in France and controlled capex have helped. Wockhardt now ranks just behind Sun Pharma on margins (EBIDTA and net) and has the highest RoCE in the industry.

Figure 11. Wockhardt – Key Ratios



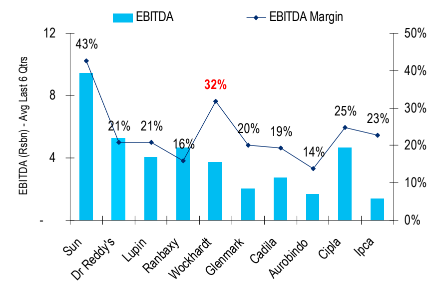
Source: Company data, Citi Research estimates

Figure 12. Highest RoCE (FY12 Reported Nos)



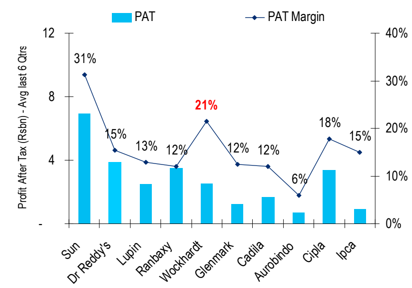
Source: Company data

Figure 13. 2nd Highest EBITDA Margin



Source: Company data

Figure 14. 2nd Highest PAT Margin



Source: Company data

We expect the high profitability (30%+ EBIDTA margins) and return ratios (25%+ RoCE) to sustain going forward. Encouragingly, Wockhardt is able to maintain high margins and return ratios despite shifting to a more conservative approach on R&D – being fully expensed now as against some portion being capitalized earlier.

Key Risk Factors

- **Faster than expected decline in Toprol XL revenues** – Toprol XL continues to be an important product for Wockhardt. We have seen two more players enter the Toprol XL market in recent times and expect competition to rise. Hence, we are building in a 40% decline in revenues from Toprol XL (from US$135m in FY12 to US$81m in FY15) over FY12-FY15E given that this market could become more competitive. If more players enter the market or there are very aggressive price cuts by players to gain share, there could be downside to our estimates.

- **Pricing in EU** – EU is going through a tough macro environment and there have been pricing cuts on drugs across Europe given the high regulatory oversight in these markets. Given c25% of Wockhardt's revenues come from Europe, any further deterioration in the business environment in Europe could hurt earnings.

- **Currency volatility** – Over 80% of Wockhardt's revenues come from international markets (US, EU and several emerging markets) and any sustained rupee appreciation vs. the US$ would hurt.

Financial Analysis

We expect Wockhardt to report steady growth and healthy margins, despite rising competition in its largest product (Toprol XL), led by new launches in the US and steady growth in other markets. Its financial troubles are behind and return ratios are better than for most peers. We forecast 12% revenue CAGR (15% ex-Toprol XL) over FY13-15. Earnings CAGR of 9% appears low due to high base of Toprol XL; ex-Toprol XL, earnings CAGR is 20%.

Steady Revenue Growth – US the Key Driver

We expect the US market to be the key growth driver over FY13-15E, with new launches and ramp-up in recent niche launches, making up for lower sales of generic Toprol XL. The business in RoW markets would continue to see good momentum, especially supported by supplies from UK, whereas India, UK and Ireland would remain steady.

Figure 15. Wockhardt Revenue Model (Rs m, %)

	FY11	FY12	FY13E	FY14E	FY15E
US (Ex-Toprol XL)	7,467	12,211	19,388	25,727	29,577
YoY Growth	*5*	*64*	*59*	*33*	*15*
Toprol XL	3,273	6,869	6,480	5,103	4,374
YoY Growth	*na*	*110*	*(6)*	*(21)*	*(14)*
US	**10,740**	**19,080**	**25,868**	**30,830**	**33,951**
YoY Growth	*5*	*78*	*36*	*19*	*10*
India (Ex- Nutrition)	8,060	9,080	10,260	11,594	12,986
YoY Growth	*13*	*13*	*13*	*13*	*12*
Nutrition	2,350	2,640	1,110	-	-
India	**10,410**	**11,720**	**11,370**	**11,594**	**12,986**
YoY Growth	*12*	*13*	*-3*	*2*	*12*
RoW	**2,150**	**2,920**	**4,270**	**4,913**	**5,602**
YoY Growth	*1*	*36*	*46*	*15*	*14*
UK	7,669	8,202	9,274	10,386	11,633
France	4,720	2,290	2,380	2,380	2,380
Ireland	1,821	1,928	2,182	2,379	2,593
Europe	**14,210**	**12,420**	**13,836**	**15,145**	**16,605**
YoY Growth	*(20)*	*(13)*	*11*	*9*	*10*
Total	**37,510**	**46,140**	**55,345**	**62,482**	**69,144**
YoY Growth	*3*	*23*	*20*	*13*	*11*

Source: Company data, Citi Research estimates

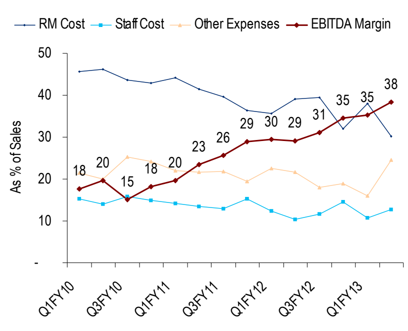
Margins to Stay Healthy

We expect Wockhardt's EBIDTA margin to stay in the 30+% range over the next few years, despite its decision to expense all R&D spend going forward and a consistent decline in sales of generic Toprol XL in the US. The rising number of niche product launches in the US, as well as the focus on improving productivity in non-US markets, would contribute to keeping margins healthy.

Overall, we forecast EBIDTA margin to improve from 31% in FY12 to 36% in FY13E before declining to 33% in FY15E. The 300bps dip over FY13-15 is entirely due to lower sales and profitability of generic Toprol XL, as competition drives market share and pricing lower. Excluding Toprol XL, we forecast EBIDTA margin to remain steady, improving from 30% in FY13E to 31% in FY15E.

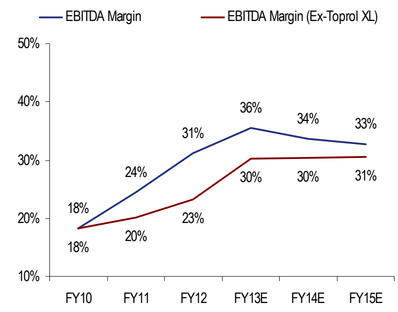
Higher operating margins along with falling interest cost (lower debt levels) would translate into a 22% CAGR in earnings over FY12-15E – 42% CAGR, ex Toprol XL.

Figure 16. Improvement in Most Costs



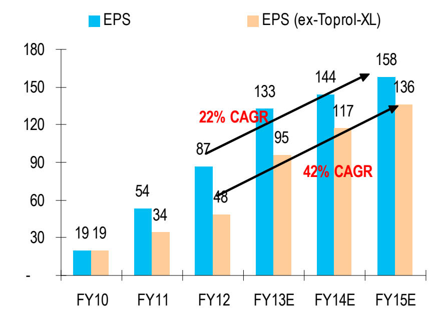
Source: Company data

Figure 17. EBITDA Margin Improvement



Source: Company data, Citi Research estimates

Figure 18. Strong EPS Growth



Source: Company data, Citi Research estimates

Stronger and Cleaner Balance Sheet

Some restructuring of operations and improved business performance, especially in the US, have led to a sharp decline in net D/E (now below 0.3x) and improved free cash flow generation. Wockhardt has also written off R&D spend of Rs4bn, which was capitalized earlier, and the entire goodwill arising from the Negma acquisition. It has also decided to expense R&D spend going forward, making profitability more comparable with peers. Return ratios are among the best in the industry.

Improving profitability and cash flows to further improve balance sheet

From Rs37bn net debt in FY10 to net cash by FY14E

Net D/E to continue to decline sharply on improving business & cash flows

Debt Metrics (Rs m, x)

	FY11	FY12	FY13E	FY14E	FY15E
Net Debt / (Cash)	27,423	25,917	6,490	(5,835)	(20,314)
Net Debt/Equity	2.91	1.76	0.24	(0.14)	(0.34)
Net Debt/EBITDA	2.99	1.80	0.33	(0.28)	(0.90)
Interest Coverage (PBIT)	3.1x	6.3x	11.2x	14.4x	18.5x
Interest Coverage (EBITDA)	3.4x	6.7x	11.6x	14.8x	18.9x

Source: Company data, Citi Research estimates

Healthy Return Ratios

RoCE improved with improving profitability

High RoEs due to low equity – to normalize going forward

Asset turnover has improved on strong growth

Wockhardt - Capital Efficiency Meter

	FY11	FY12	FY13E	FY14E	FY15E
Return on Capital Employed (RoCE)	**19%**	**28%**	**35%**	**31%**	**28%**
PBIT Margin	**22%**	**29%**	**34%**	**33%**	**32%**
EBITDA/Sales	24%	31%	36%	34%	33%
Depreciation/Sales	3%	3%	2%	2%	2%
Total Assets Turnover (Sales/CE)	**0.88**	**0.95**	**1.02**	**0.96**	**0.89**
Sales/Fixed Assets	1.09	1.33	2.25	2.41	2.54
Sales/Net Current Assets	5.17	3.58	3.79	2.77	2.30
Inventory Days	69	70	60	60	60
Debtor Days	59	60	55	55	55
Investments /Capital Employed	**2%**	**2%**	**28%**	**25%**	**26%**
Return on Equity (RoE)	**57%**	**61%**	**53%**	**37%**	**29%**
Net Margin	14%	19%	26%	25%	25%
Asset Turnover	0.88	0.95	1.02	0.96	0.89
Leverage (CE/Equity)	4.5	3.3	2.0	1.5	1.3

Source: Company data, Citi Research estimates

B/S stress – what went wrong & the recovery

What went wrong?

Wockhardt acquired three companies during 2006-2007, for a total value of US$455m, in a bid to expand into Europe (Pinewood, Ireland & Negma, France) and the US (Morton Grove). This led to significantly higher debt levels, with net D/E rising to 2x by the end of CY07. To compound matters, the two acquisitions in Europe did not work out as planned due to significant pricing and reimbursement challenges in these countries.

Figure 19. Acquisitions in US & EU

Company	Acquisition Value (US$m)
Pinewood, Ireland (2006)	150
Negma, France (2007)	265
Morton Grove, US (2007)	40

Source: Company

At the same time, in CY08, Wockhardt incurred huge losses on currency derivative contracts, thus further aggravating the debt situation. With the stock price declining and balance sheet already stretched, it had to default on its FCCB redemption obligations in 2009. Over this period, net D/E rose to 4x by end of FY10. Consequently, in 2009, Wockhardt decided to enter into a Corporate Debt Restructuring (CDR) Scheme, in a bid to bail itself out of the mess.

What worked – Toprol XL launch and execution of CDR

Even during this period of financial stress, each of Wockhardt's businesses (except France and Ireland) continued to deliver steady growth and profitability. The big pick-up in operations was driven by the launch Toprol-XL, a technically complex product, in the US in July 2010. Wockhardt was only the third player to enter the market (after Watson & Par – AG) and was able to generate very good sales (US$62m & US$135m in FY11 and FY12 respectively) with high profitability (gross margin >75%). The US business also saw several other good launches and market share gains, leading to further improvement in profitability and cash flows.

Figure 20. Wockhardt's Corporate Debt Restructuring (CDR) Scheme – A Snapshot of Progress

Elements	Details	Impact
FCCB Liabilities	Under the CDR, the FCCBs were to be converted into a) Preference Shares redeemable in 2018 or b) repaid at 35 cents to the dollar SBI bank opted for pref shares whereas some other FCCB holders filed a winding up petition against the company. The High Court directed the company to repay the FCCBs before Aug12 in installments	All FCCB liabilities (Rs4.5bn) paid on time. No FCCB related liabilities remain on the balance sheet
Derivative Liabilities	Crystallized derivative liabilities were converted to Preference Shares - (Rs5bn) Disputed derivatives (Rs3.3bn) were settled with respective banks at a substantial discount	Pref shares to be redeemed in 2018 Disputed liabilities settled & paid
Divestments	Divested three businesses: Esparma, Germany (Rs1.2bn); Animal Health (Rs1.7bn); India Nutrition (Rs12.8bn) - commitment to CDR scheme was lower at Rs7.9bn	Over Rs13bn (post tax) inflow
Restructuring	As part of restructuring Negma (France) operations, it was put through the Administrative Process under the aegis of the Commercial Courts at Paris. Under this: a) debt of Euros88m was restructured telescopically over a 10 year period ending 2020. b) mfg facilities sold, sourcing shifted to India; large part of sales organization sold. c) headcount of the company reduced from 497 to 63	Restructuring benefits visible as EBITDA margins improved on lower employee cost and other expenses
Other Loans	As part of CDR, Indian debt repayment rescheduled with extended maturities going up to 2018; also interest rate capped at 10% with 2% being paid in the form of pref shares redeemable in 2018 As part of CDR, EU loan of US$250m restructured for repayment between 2013 and 2015	**a total of Rs9bn of loans outstanding as of Sep'12 as part of the CDR scheme**

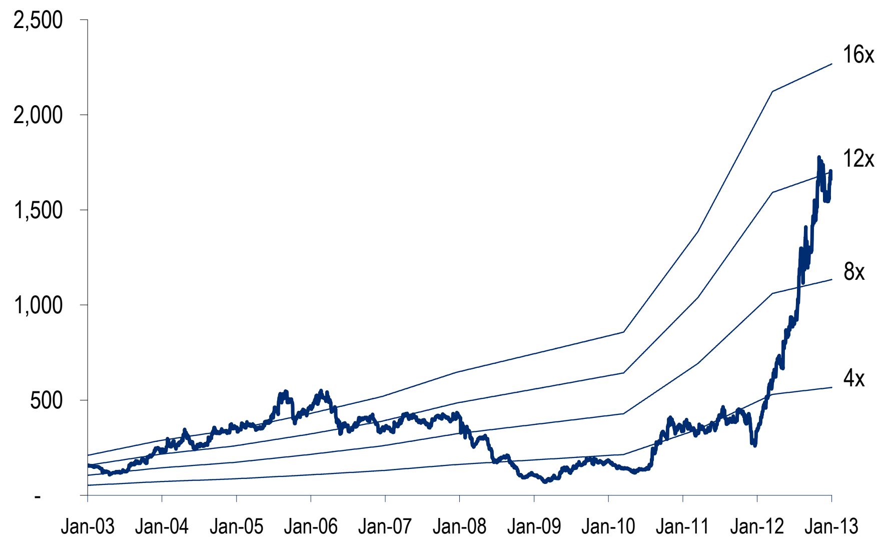
Source: Company data, Citi Research

At the same time, the CDR scheme got it focused on cleaning up the mess on its balance sheet. This involved divestment of certain businesses, downsizing and restructuring the ailing France business as well as settlement and restructuring of FCCB and currency derivative liabilities (details in Fig. 20). Wockhardt has now met all its obligations and timelines under the scheme and intends to exit the same before FY13 end.

Valuation

Since Indian pharma is a steady, growing sector, we use P/E as our primary valuation methodology. For Wockhardt we use a P/E of 16x FY14E FDEPS, which is at a 20% discount to the target multiple of 20x we use for sector leaders such as Lupin and Ranbaxy. We believe that the discount is justified at this point, given the company's lower growth (on a high base) and a checkered track record.

Figure 21. PE Band Chart (Last 10 years)



Source: Citi Research

Wockhardt has traded in a very wide range of 2 - 22x one year forward earnings over 2001-12. However, we need to look at valuation ranges in two distinct phases: a) during the severe financial crisis it went through & b) pre crisis. In the first phase (CY07-11), the stock traded in a one year forward P/E range of 2 - 12x, whereas it traded in the 7 - 22 x range in the six years preceding the crisis. With Wockhardt having emerged from its crisis and being back on the growth path, we believe the *pre-crisis* trading range is the more relevant reference benchmark. While earnings growth appears subdued, this is primarily due to the high base (Toprol XL led) in FY12; this is offset by industry leading return ratios and healthy earnings growth, ex Toprol.

Figure 22. Indian Generic Pharma – Comparative Valuations

Company Name	RIC Code	Rating	Mkt cap (US$m)	Price 17-Jan-13	Target price	EPS FY13E	EPS FY14E	PE (x) FY13E	PE (x) FY14E	EV/EBITDA (x) FY13E	EV/EBITDA (x) FY14E	EV/Sales (x) FY13E	EV/Sales (x) FY14E	RoCE FY13E	RoCE FY14E	RoE FY13E	RoE FY14E
Aurobindo Pharma	ARBN.BO	1	1,010	189	210	11.8	17.4	15.9	10.8	11.6	9.1	1.6	1.4	8%	10%	14%	18%
Biocon	BION.BO	1	1,034	281	300	15.4	19.9	18.2	14.1	9.9	8.0	2.1	1.8	9%	11%	13%	15%
Cadila Healthcare	CADI.BO	2	3,307	878	910	40.8	50.3	21.5	17.4	13.7	11.1	3.0	2.5	18%	20%	29%	29%
Cipla	CIPL.BO	2	6,015	407	390	19.9	21.5	20.5	19.0	13.8	12.6	3.7	3.1	21%	21%	19%	18%
Dr Reddy	REDY.BO	1	6,054	1,937	2,035	94.5	110.2	20.5	17.6	14.7	13.0	2.9	2.6	21%	22%	26%	23%
Glenmark Pharma	GLEN.BO	1	2,563	514	560	22.3	29.2	23.0	17.6	16.2	12.8	3.3	2.7	16%	18%	22%	24%
Ipca Labs	IPCA.BO	1	1,185	511	515	30.9	36.7	16.5	13.9	11.0	9.2	2.5	2.1	20%	20%	27%	26%
Lupin	LUPN.BO	1	4,823	586	655	25.8	32.5	22.7	18.0	14.2	11.4	3.1	2.6	19%	21%	26%	26%
Ranbaxy*	RANB.BO	1H	3,802	489	650	24.7	31.9	19.8	15.3	10.1	11.5	1.8	1.8	20%	15%	43%	30%
Wockhardt	WCKH.BO	1	3,396	1,685	2,300	132.6	144.0	12.7	11.7	9.7	8.5	3.4	2.8	35%	32%	69%	45%

Source: Citi Research estimates

Consolidated Financial Summary

Figure 23. Wockhardt – Consolidated Profit & Loss Statement (Rs m)

Year to 31st March	FY11	FY12	FY13E	FY14E	FY15E
Revenues	**37,512**	**46,138**	**55,345**	**62,482**	**69,144**
YoY Growth	*-17%*	*23%*	*20%*	*13%*	*11%*
RM Consumed	15,162	16,821	17,745	20,581	23,035
Employee Cost	13,190	14,919	17,933	20,886	23,512
EBITDA	**9,160**	**14,399**	**19,666**	**21,015**	**22,598**
EBIDTA Margins (%)	*24.4%*	*31.2%*	*35.5%*	*33.6%*	*32.7%*
Interest	2,671	2,144	1,612	1,399	1,127
Depreciation	1,166	1,225	1,203	1,101	1,184
Other Income	159	235	431	473	470
PBT	5,482	11,264	17,281	18,988	20,757
Tax	87	2,351	2,765	3,228	3,529
Reported Net Income	905	3,427	14,626	15,760	17,229
Recurring Net Income	**5,865**	**9,479**	**14,516**	**15,760**	**17,291**
YoY Growth	*179%*	*62%*	*53%*	*9%*	*9%*
Recurring EPS (Rs)	**53.6**	**86.6**	**132.6**	**144.0**	**158.0**

Source: Company data, Citi Research estimates

Figure 24. Wockhardt – Consolidated Balance Sheet (Rs m)

Year to 31st March	FY11	FY12	FY13E	FY14E	FY15E
Capital	547	547	547	547	547
Reserves and surplus	8,884	14,163	26,869	42,630	59,920
Shareholders funds	**9,431**	**14,710**	**27,416**	**43,177**	**60,468**
Deferred Tax Liabilities	(749)	1,010	1,010	1,010	1,010
Secured	29,217	30,613	25,681	20,731	15,781
Unsecured	4,680	2,201	91	91	91
Loan funds	**33,897**	**32,814**	**25,772**	**20,822**	**15,872**
Total Liabilities	**42,579**	**48,534**	**54,198**	**65,009**	**77,349**
Gross block	40,487	42,116	33,102	35,690	38,280
Less - depreciation	14,684	16,403	17,531	18,735	20,029
Net block	**25,802**	**25,713**	**15,571**	**16,956**	**18,251**
CWIP	8,627	9,023	9,023	9,023	9,023
Investments	896	908	15,000	16,500	20,000
Current assets	**20,979**	**26,895**	**26,493**	**34,994**	**43,536**
Inventories	7,137	8,886	9,098	10,271	11,366
Sundry debtors	6,052	7,587	8,340	9,415	10,419
Cash and bank balances	4,829	7,000	5,292	11,167	17,196
Loans and advances	2,960	3,422	3,764	4,141	4,555
Current Liabilities	**13,725**	**14,004**	**11,890**	**12,464**	**13,460**
Liabilities	13,003	12,050	9,446	9,779	10,509
Provisions	722	1,955	2,443	2,685	2,952
Net current assets	**7,254**	**12,890**	**14,604**	**22,530**	**30,075**
Total Assets	**42,579**	**48,534**	**54,198**	**65,009**	**77,349**

Source: Company data, Citi Research estimates

Figure 25. Wockhardt – Cash Flow Statement (Rs m)

Year to 31st March	FY11	FY12	FY13E	FY14E	FY15E
Profit bef xtra items	1,044	5,767	17,281	18,988	20,832
Depreciation	1,166	1,225	1,128	1,204	1,294
Working Cap Changes	450	(2,894)	(3,422)	(2,051)	(1,517)
Others	(30)	1,395	(2,765)	(3,228)	(3,541)
Operating Cash Flows	**2,630**	**5,493**	**12,223**	**14,914**	**17,069**
Capex	(3,004)	(3,175)	(2,586)	(2,588)	(2,590)
Investments	0	-	(14,093)	(1,500)	(3,500)
Others	238	129	11,870	-	-
Investing Cash Flows	**(2,766)**	**(3,047)**	**(4,809)**	**(4,088)**	**(6,090)**
Shares Issued	100	-	-	-	-
Change in loans	(1,718)	(6,509)	(9,122)	(4,950)	(4,950)
Divd (incl divd tax)	(1)	(1)	-	-	-
Financing Cash Flows	(1,619)	(6,511)	(9,122)	(4,950)	(4,950)
Total Cash flows	**(1,755)**	**(4,065)**	**(1,708)**	**5,875**	**6,029**
Opening cash/Equivalents	3,141	4,701	7,000	5,292	11,167
Closing cash balance	**2,869**	**2,231**	**5,292**	**11,167**	**17,196**

Source: Company data, Citi Research estimates

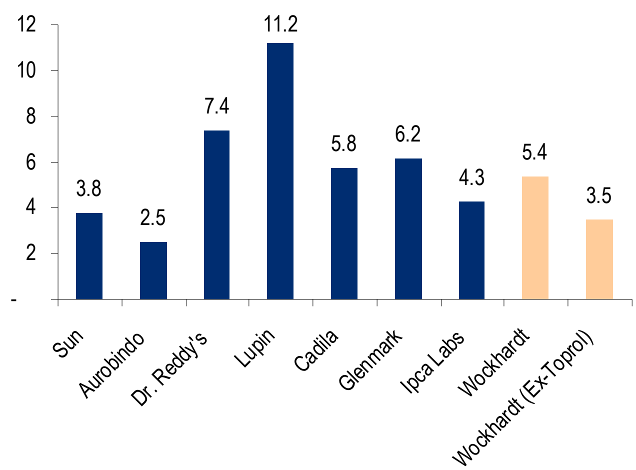
Business Analysis

Wockhardt is one of the leading Indian players in the US generics market and has a reasonable presence in India, UK, Ireland and France. These markets contribute over 90% of its revenues. It also has a small, and growing, presence in multiple RoW markets. While predominantly focused on the generics space, it also has some contract manufacturing business. Wockhardt was also one of the first Indian companies to target the biosimilars space but this part of the business appears to be still in the infancy stage in terms of ability to target the regulated markets.

US – Focus on Complex Generics Paying Off

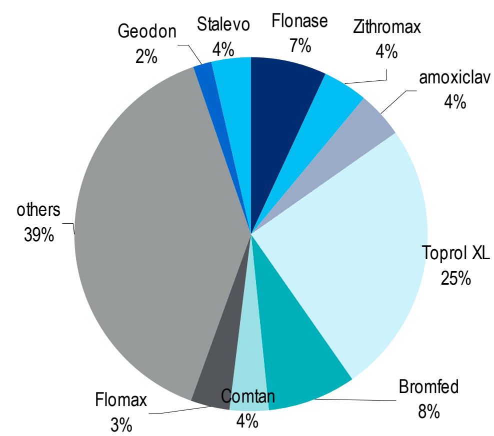
The US market now contributes c46% of Wockhardt's revenues and was the main contributor to the strong growth in revenues & earnings post FY10. After a sedate beginning, this business has expanded significantly on the back of several niche launches (including the very successful Toprol XL) over the last three years (52% CAGR over FY10-13E). The company intends to stay focused on complex products & profitability. We expect this to translate into steady 15% revenue CAGR over FY13E-15E despite the adverse impact of competition on its Toprol XL franchise.

Figure 26. US - Rev/Product FY12 (US$m)



Source: Company data

Figure 27. Key US Products (as % of US FY13E Revenues)

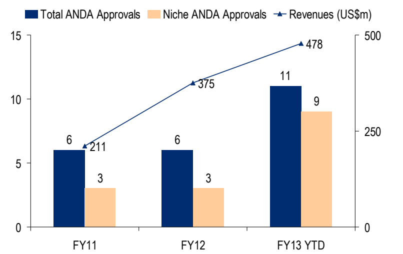


Source: Citi Research estimates

Reasonable product basket & pipeline

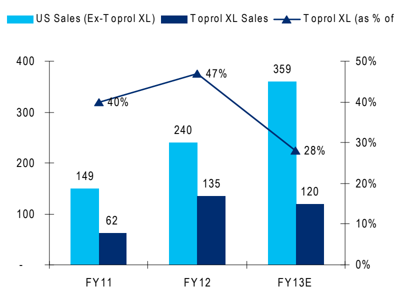
Wockhardt has c70 products in the US market, which is in line with most other leading Indian companies. Its annual revenue / product (cUS$4.2m in FY13E) has improved steadily over the years and compares favorably with most other Indian companies. This metric is buoyed by its success in building generic Toprol XL (a complex product with limited competition) into a large product. Excluding Toprol XL, annual revenue / product stands at US$240m (FY12) – lower than most peers but improving consistently on the back of better quality launches.

Figure 28. Niche Product Count Increasing



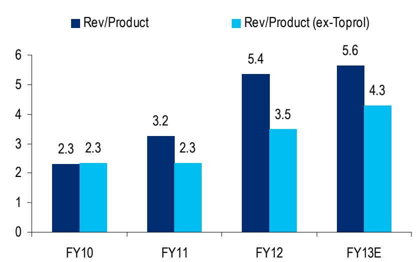
Source: Company data

Figure 29. Toprol-XL Revenues (US$m)



Source: Company data, Citi Research estimates

Figure 30. Rev/Product Going Up (US$m)



Source: Company data, Citi Research estimates

Improving pace & quality of launches

Wockhardt received eleven approvals in 9mFY13, compared to just six each in FY11 and FY12. More importantly, recent launches include several limited competition products such as *Flonase, Comtan, Stalevo, Lamictal XR, Geodon*, two OTC products, etc. that improve the quality of the company's product basket.

The company has 30+ ANDAs awaiting approval with the US FDA, including c10 patent challenges (P-IVs) and a few FTF opportunities. While this is lower than most of its peers, it appears to be a result of Wockhardt's strategy to focus on complex products. Going forward, it expects to file c10-15 ANDAs every year and get a similar number of approvals each year.

Generic Toprol XL was the big catalyst

Wockhardt's launch of generic Toprol-XL (in Jul 2010) was the biggest driver of growth over the last few years. Since its launch, we estimate that this product scaled up to touch peak sales of cUS$135m in FY12; we expect revenues to decline a tad, on competition from Dr Reddy's, to cUS$120m in FY13E i.e. 25% & 12% of US & overall revenues respectively.

We expect some more competitors to enter the fray in future viz. Cadila, Sandoz, Intas, leading to some more decline in revenues going forward. We forecast generic Toprol sales for Wockhardt to decline to US$81m in FY15E, at which point it would contribute c13% & c6% to US and overall revenues respectively.

Other interesting products to provide buffer

However, we also highlight that Wockhardt's US portfolio has been improving ex-Toprol as well – as reflected in the improving revenue / product (ex Toprol) metric – up from US$2.3m in FY10 to US$4.3m in FY13E. Some of the recent successful launches include *Flonase, Stalevo, Comtan* (the latter two being AGs), which have contributed to the healthy growth in US revenues. Products other than Toprol XL now contribute c75% of US revenues, up from 64% in FY12.

Figure 31. c25 ANDA Approvals over past three years – Niche complex focus

Type	Innovator Brand Name (Molecule)
Extended Release	**Toprol XL**(Metoprolol Succinate XL), **Prevacid** (Lansoprazole DR), **Wellbutrin** (Bupropion SR), Plendil (Felodipine ER), **Lamictal XR** (Lamotrigine XR), Uroxatral (Alfuzosin ER)
OTC	Allegra OTC (Fexofenadine), Prevacid OTC (Lansoprazole DR)
Complex generic	**Flonase** (Fluticasone Nasal Spray), **Flomax** (Tamsulosin HCl), **Geodon** (Ziprasidone), Sandostatin (Octreotide)
Authorised Generic	**Comtan** (Entacapone), **Stalevo** (Levodopa, Carbidopa, Entacapone)
Blockbuster (heavily genericised)	Plavix (Clopidogrel), Topamax (Topiramate), Protonix (Pantaprazole Na), Levaquin (Levofloxacin), Aricept (Donepezil), Effexor XR (Venlafaxine XR), Valtrex (Valacyclovir)

Source: Company data, Citi Research

Figure 32. Key US Products – Competitive Dynamics

Innovator Brand Name (Molecule)	Launch	Market (US$m)	Generic Competition	Comments
Toprol XL(Metoprolol Succinate XL)	Jul-10	750	5 + 1 AG	Largest product in the US and a key contributor to profitability; c20% M/S; Pricing stable so far but recent competition could change that; Cadila, Intas, Sandoz also expected to launch
Stalevo (Levodopa, Carbidopa, Entacapone)	Apr-12	60	1 + 1 AG	Launched as an authorized generic; expected to remain a limited competition product even post 180d exclusivity as the last OB patent expires in 2020
Flonase (Fluticasone Nasal Spray)	Jan-12	550	4	No more listed patents in the OB; expected to remain limited competition product as entry barriers remain high – additional clinical studies & device devpmnt are expensive & lengthy
Comtan (Entacapone)	Sep-12	100	1 + 1 AG	Launched as an authorized generic; expected to remain a limited competition product even post 180d exclusivity as the last OB patent expires in 2018
Bromfed-DM (Cough/Cold Syrup)	Jun-85	39*	Only player	Branded generic product from Morton Grove's stable with no other product approved with the same active ingredients; expected to remain a limited competition product
Prevacid (Lansoprazole DR)	Sep-12	250	6	No more listed patents in the OB; Complex generic with limited competition so far
Geodon (Ziprasidone)	Sep-12	800	6	Only generic approved post 180d exclusivity; expected to remain a limited competition product
Flomax (Tamsulosin HCl)	Apr-10	17*	8	No more listed patents in the OB; Complex generic with limited competition so far
Zithromax (Azithromycin)	Feb-08	21*	6	No more listed patents in the OB; Complex generic with limited competition so far
Augmentin (Amoxi Clav)	Nov-08	30*	6	No more listed patents in the OB; Complex generic with limited competition so far

Source: Citi Research; *estimated Wockhardt revenues from the product; AG = Authorized Generic

Figure 33. A Snapshot of Key Pipeline Products

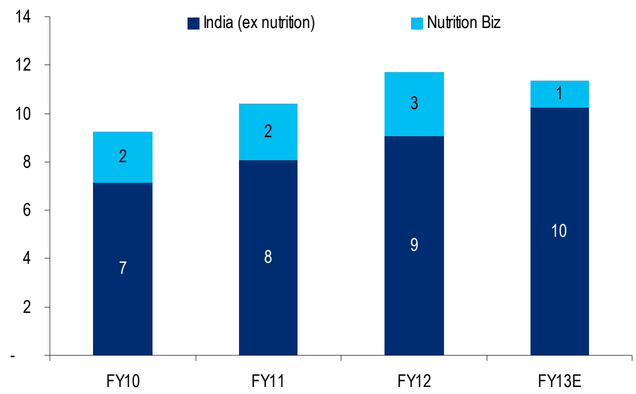
Innovator Brand (Molecule)	Market (US$bn)	FTF Status	Expected Launch	Comments
Tricor (fenofibrate)	1.2	No	FY15	Depends on final approval; 30m stay expires in Apr-14
Actos (pioglitazone)	2.5	No	Apr -13	Settled; 181d launch; reasonably competitive post 181d
Namenda (memantine)	1.0	Yes	Jan-15	Settled; competitive during 180d excl period – at least 15 generics
Cymbalta (duloxetine)	2.5	Yes	Jun-13	Settled; competitive during 180d excl period – at least 8 generics
Adenoscan (adenosine)	0.2	Yes	2015	Settled; expected to be a limited competition product on launch with ~5 generic
Lyrica (pregabalin)	1.5	Yes	NA	Generics lost in lower court; expect at least 8 generics on launch
Pristiq (desvenlafaxine)	0.5	Yes	Sep-15	Litigation ongoing; competitive during 180d exclusivity ~ 11 generics
Zometa (zoledronic acid)	0.5	No	NA	
Reclast (zoledronic acid)	0.1	No	NA	
Cambia (diclofenac pot)	NA	Yes	NA	
Patanol (olapatadine)	0.2	No	Dec-15	Litigation outcome unfavorable to generics; Launch post Dec-15 patent expiry; expect limited competition

Source: Company data, Citi Research

India – Steady, in Consolidation Mode

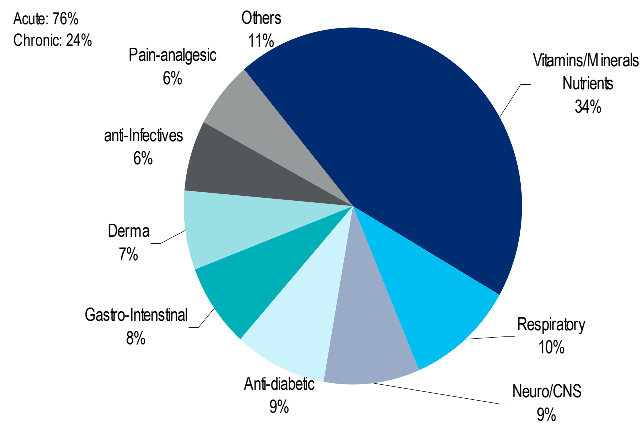
Wockhardt has a steady business in India, which forms c20% of its overall revenues. It ranks No 16, with c2% market share, as per AIOCD-AWACS MAT Nov-12. It has one brand (Spasmo Proxyvon) in the Top-100 (seven in the top-300) list of brands in India. We expect India revenues to grow at a 13% CAGR over FY12-15E

Figure 34. India Sales Trend (Rs bn)



Source: Company data, Citi Research estimates

Figure 35. Therapy Break-up



Source: Company data, Citi Research estimates

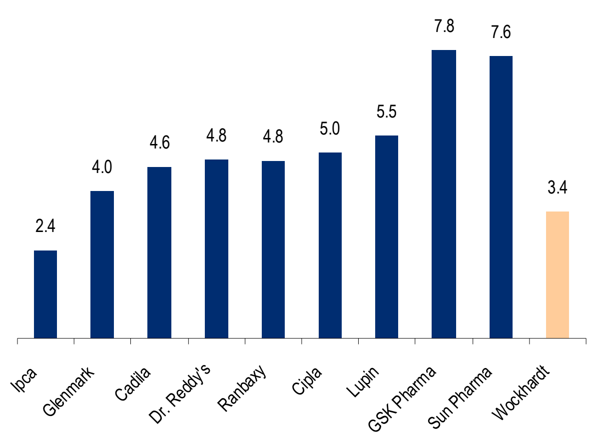
Growth (c12.5% CAGR over FY10-12) is lower than most peers as c76% of its revenues come from acute therapies. The company has doubled its sales force to around 3,000 people over the last three years and restructured its divisions last year in order to improve growth rates – the former has led to a dip in sales per representative to Rs3.4m/year from cRs4m/year three years ago.

Figure 36. Wockhardt – Long Term Growth Inline with Market

	FY06-FY12 CAGR	Rank (1FY08)	Rank (3QFY13)
Cadila	12%	4	6
Cipla	14%	1	3
Dr. Reddy's	15%	9	16
Glenmark	17%	18	17
GSK	8%	2	2
Ipca	17%	23	21
Lupin	21%	11	7
Ranbaxy	11%	3	4
Sun	20%	6	1
Wockhardt	**14%**	**7**	**20**

Source: Company data, AIOCD-AWACS

Figure 37. Wockhardt - Revenues / Rep Among the Lowest (Rsm/year)



Source: Company data

The restructuring in 1HFY13 has led to a lot of personnel movement in order to create more customer focused divisions. This caused a temporary disruption in relationships between the field force and doctors, leading to a slowdown in growth (c4% in 2Q13). However the management expects the impact of restructuring to subside in the coming quarters and growth in line with the Indian market.

Going forward, Wockhardt intends to focus on chronic therapies and launch more products in pain management, respiratory, anti-diabetics and CNS segments. The business does not need major investments or sales force addition and the focus is on improving productivity. Consequently, any growth pick up should aid profitability.

Impact of Proposed Pricing Policy – c2% of FY14E PBT

Wockhardt will not be affected much by the current proposal to expand the price control net in India. As per AIOCD-AWACS estimates, Wockhardt's four brands Aziwok, Wokadine, Decdan & Tryptomer are the most impacted in terms of value. The value impact is low - Rs400m (3% / 0.6% of India / Overall FY14E revenues), translating into a potential c2% impact on FY14E PBT.

Figure 38. Wockhardt - Impact of Proposed Pricing Policy

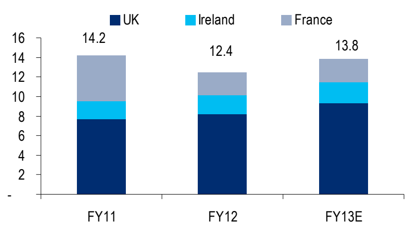
Generic	Brand	Value Loss (Rs m)
Wokadine	Povidone Iodine 2.5%, 5%, 10% Solution	157
Decdan	Dexamethasone 4mg Injection	125
Aziwok	Azithromycin Tablet 100/ 250/ 500mg; Azithromycin Susp 100mg	74
Tryptomer	Amitryptyline Tablet 25mg	34
Others		9
Total		**400**

Source: Citi Research, AIOCD-AWACS

Europe – Reducing Dependence

Wockhardt has a larger presence in Europe than most of its peers, though revenue contribution from this region has been going down over the years. Europe now contributes c25% of revenues (>50% in 2008). UK is the largest market and has seen consistent growth; however, it has struggled in France & Ireland. We expect steady, low double digit growth in Europe going forward. We expect Wockhardt's EU business to grow at a CAGR of 10% over FY12-15E.

Figure 39. Europe Revenues (Rs bn)



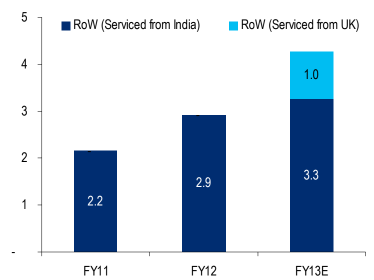
Source: Company data, Citi Research

UK – Wockhardt is the third largest generic player in UK and second largest in the hospitals segment, with heparins as its key products. It also has a contract manufacturing business, servicing global pharma companies. It has managed to grow consistently (12% CAGR over FY10-13E) over the last few years, led by new launches and contract manufacturing contracts. In order to improve capacity utilization and profitability in UK, it has started supplies to RoW markets as well.

France – Wockhardt acquired Negma, France in 2007 for US$265m to strengthen its presence in Europe. Negma's patented product, Diacerin (an osteoprosis drug), faced generic competition in FY12 and loss of reimbursements, causing sales to decline by over 50% in FY12. Wockhardt has restructured its operations by selling the manufacturing facility and reducing headcount (from 497 employees to 63 employees). The business is now P&L neutral, as per management, and is not expected to make further losses. It is also trying to add new products but we expect things to remain tough given the difficult pricing and reimbursement environment.

Ireland – Pinewood continues to be ranked as the No. 1 generic company in Ireland, with 30% market share. It enjoys a niche position in the dialysis segment. Ireland continues to witness pricing pressure due to regulatory changes in the market which led to a 6% decline in revenues in FY12 over FY11. While the company continues to launch new products (5+ launches in 1HFY13), it does not expect the business to show significant growth given the pricing pressure.

Figure 40. RoW Revenues (Rs bn)



Source: Company data, Citi Research

RoW Markets – Steady Growth

Wockhardt's presence in emerging markets (excl India) spreads across South-East Asia, Far–East Asia, Africa, Russia/CIS and Latin America. It follows a mix of own front end presence (in a few large markets) and distributor based model for marketing its products.

It has out-licensed it products both pharma and biosimilars in these countries and expanding its base through offering more products in these markets. Wockhardt has witnessed significant growth in the RoW markets over the years. We expect this to continue, as it has now initiated supplies from its UK facility as well.

We expect Wockhardt's RoW sales to grow at a CAGR of 24% over FY12-15E.

Biosimilars – Early Days Yet

Wockhardt was one of the earliest entrants in biotechnology among Indian companies but lost momentum along the way. It has launched a few products - Wepox (recombinant human erythropoietin), Wosulin (recombinant human insulin) and Glaritus (long-acting Insulin Glargine) in India and other emerging markets.

Glaritus was the first biosimilar of glargine to be launched globally. Similarly, Wosulin was the first r-DNA insulin developed and manufactured outside the US and Europe. It currently markets the three products in India – contributes c6% to India revenues.

Figure 41. Three Biosimilars on the Indian Market

Brand	Sales* (Rs m)	Product Characteristics
Wosulin Launch: 2003	296	- first r-DNA insulin developed and manufactured outside the US/EU - manufactured through the latest yeast based expression system - also launched the patented Wosulin Pen & Cartridge, an automatic insulin delivery device for the convenience of patients.
Wepox Launch: 2002	192	- a recombinant erythropoietin - treatment of anemia caused by cancer and chronic renal failure - created by mammalian cell culture and meets EU standards
Glaritus Launch: 2009	155	- first Company in the world after the innovator to launch glargine - recombinant long-acting human insulin analog based on E.Coli platform - upstream and downstream processes match international cGMP norms

Source: Citi Research; Company reports; *AIOCD-AWACS Mat Nov-12

It also has c40 registrations in emerging markets, including South America, Russia & Africa. Wockhardt is keen to enter strategic alliances with other companies to market these products in some of the bigger markets around the world. It is in the process of identifying companies with a very strong presence in diabetology and will look at forging a partnership for each market.

The company's long term goal is to launch biosimilars in the high potential US & EU markets, starting with Human Insulin. However, development plans had slowed down when the company faced financial challenges. The management indicated that development is now back on track and it is working on developing human insulin for the US market, with a possible launch in three to four years. We believe it is too early to build in any upside from this part of the business – especially in emerging markets.

Quants View - Glamour

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Data as of: 11-Jan-13

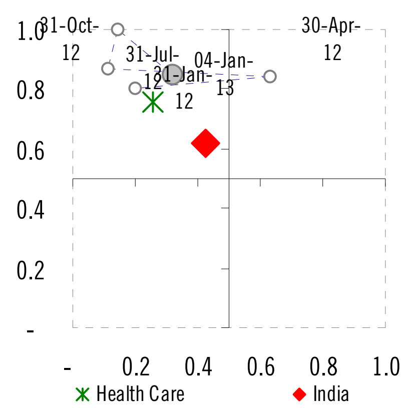
Radar Screen Quadrant Definitions

Glamour *Poor relative value but superior relative momentum*	**Attractive** *Superior relative value and superior relative momentum*
Unattractive *Poor relative value and poor relative momentum*	**Contrarian** *Superior relative value but poor relative momentum*

Wockhardt lies in the Glamour quadrant of our Value-Momentum map with strong momentum but relatively weak value scores. It has been a resident there for the past five months. Compared with its peers in the Health Care sector, Wockhardt fares better on the valuation metric and on the momentum metric. On the other hand, compared with its peers in its home market of India, Wockhardt fares worse on the valuation metric but better on the momentum metric.

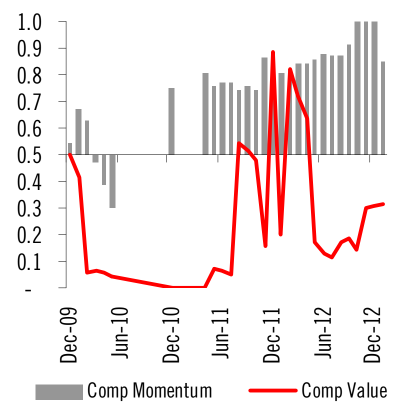
From a macro perspective, Wockhardt has a low beta to the region, so can be expected to hold its own given a decline in the regional market. It is also likely to benefit from growth underperformance, large cap outperformance, tightening Asian interest rates, and a weaker US dollar.

Figure 42. Radar Quadrant Chart History



Source: Citi Research

Figure 43. Radar Valuation and Momentum Scores



Source: Citi Research

Figure 44. Radar Model Inputs

IBES EPS (Actual and Estimates)			
FY(-2)	(12.69)	Implied Trend Growth (%)	53.00
FY(-1)	0.00	Trailing PE (x)	21.01
FY0	79.16	Implied Cost of Debt (%)	5.74
FY1	118.17	Standardised MCap	(0.13)
FY2	126.20		

Note: Standardised MCap calculated as a Z score – (mkt cap - mean)/std dev – capped at 3

Source: Citi Research, Worldscope, I/B/E/S

Figure 45. Stock Performance Sensitivity to Key Macro Factors

Region	0.63	Commodity ex Oil	(0.04)
Widening APACxJ CDS	(0.12)	Rising Oil Prices	0.02
Growth	(1.00)	Rising Asian IR's	(0.43)
Value	0.06	Rising EM Yields	0.11
Small Caps Outperform Large Caps	(1.05)	Weaker US$ (vs Asia)	1.53
Widening US Credit Spreads	0.04	Weaker ¥ (vs US$)	0.34

Source: Citi Research

Wockhardt

Company description

Wockhardt is a leading Indian pharma company with over 80% of revenues coming from international markets. The US is its largest market and together with India it contributes c65% of revenues. Wockhardt has three research centres and 12 manufacturing plants, with both pharmaceuticals and biotechnology products. Wockhardt had a good track record in the past but aggressive expansion and large derivative losses led to a steep decline in its financial health and business operations. Entry into a Corporate Debt Restructuring scheme, restructuring initiatives and the scale-up of its niche portfolio in the US have turned around the business in recent years.

Investment strategy

We rate Wockhardt a Buy with a target price of Rs2,300/sh. Wockhardt has emerged from severe financial stress to turn around its fortunes over the past three years, and it now has a sound B/S (FY13E net D/E: 0.2x), strong FCF (Rs40bn over FY13-15E) and industry-leading financial metrics. Growth should continue to be steady and margins healthy, as we forecast a 20% EPS CAGR (ex-Toprol XL) for FY13-15E on a high base (9% CAGR including Toprol XL). Valuations, at 12x FY14E P/E (35% discount to the sector), are still attractive and do not appear to fully factor in the strong turnaround.

Valuation

Our target price for Wockhardt of Rs2,300/sh is set at 16x FY14E FDEPS, which reflects a discount to the 20x target we use for sector leaders such as Lupin & Ranbaxy given the company's lower growth (on a high base) and a checkered track record. Since Indian pharma is a steady, growing sector, we use P/E as our primary valuation methodology. Wockhardt has traded in a very wide range of 2-22x one-year forward earnings over 2001-12. However, the valuation range should be looked at in two distinct phases: a) during the company's financial crisis (CY07-11), the stock traded in a one-year forward P/E range of 2-12x; b) in the six years preceding the crisis, it traded in the 7-22x range. With Wockhardt having emerged from its crisis and being back on the growth path, we believe the *pre-crisis* trading range is the more relevant reference benchmark.

Risks

Key downside risks that could prevent the stock from reaching our target price include (1) faster-than-expected decline in Toprol XL revenues; (2) sustained rupee appreciation vs. US$, which would be structurally negative given that c80% of revenues come from international markets; (3) further deterioration in the business environment in Europe, given c25% of revenues come from Europe. Key upside risks include: (1) ramp-up of niche product portfolio with new launches in the US and market share gains; (2) faster progress on approval of biosimilars in the US and Europe.

Appendix A-1

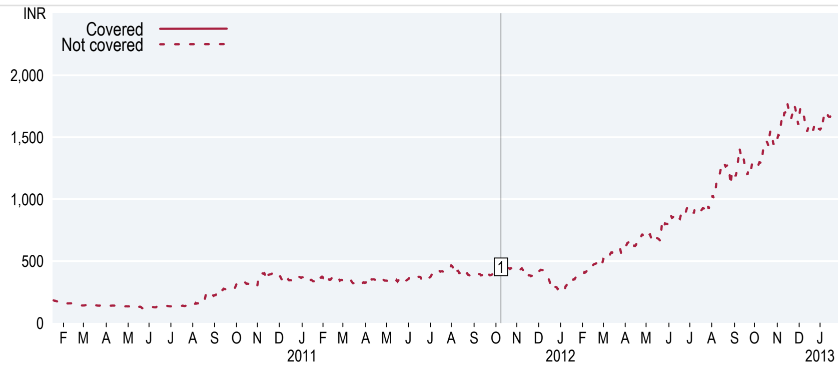
Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

IMPORTANT DISCLOSURES

Wockhardt (WCKH.BO)

Ratings and Target Price History
Fundamental Research



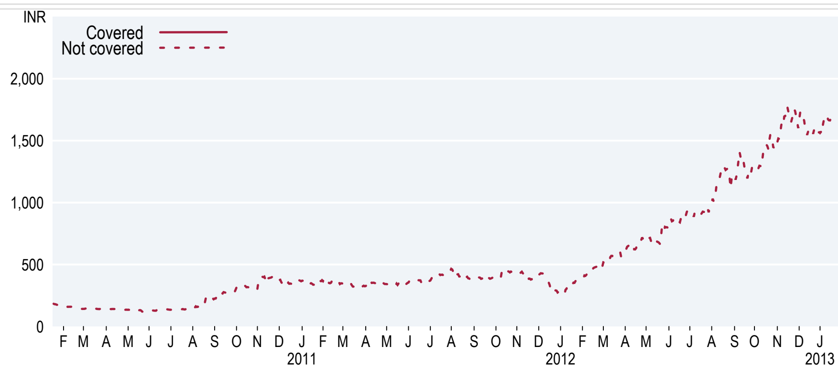
Date	Rating	Target Price	Closing Price
1 8-Oct-11	Stock rating system changed		

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Wockhardt (WCKH.BO)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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	12 Month Rating			*Relative Rating*		
Data current as of 31 Dec 2012	**Buy**	**Hold**	**Sell**	**Buy**	**Hold**	**Sell**
Citi Research Global Fundamental Coverage	49%	38%	12%	7%	86%	7%
% of companies in each rating category that are investment banking clients	53%	49%	45%	60%	49%	55%
Citi Research Quantitative World Radar Screen Model Coverage	30%	40%	30%			
% of companies in each rating category that are investment banking clients	31%	28%	24%			
Citi Research Quantitative Decision Tree Model Coverage	46%	0%	54%			
% of companies in each rating category that are investment banking clients	64%	0%	50%			
Citi Research Asia Quantitative Radar Screen Model Coverage	20%	60%	20%			
% of companies in each rating category that are investment banking clients	33%	26%	26%			
Citi Research Australia Radar Model Coverage	42%	0%	58%			
% of companies in each rating category that are investment banking clients	33%	0%	19%			

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Investment ratings are determined by the ranges described above at the time of initiation of coverage, a change in investment and/or risk rating, or a change in target price (subject to limited management discretion). At other times, the expected total returns may fall outside of these ranges because of market price movements and/or other short-term volatility or trading patterns. Such interim deviations from specified ranges will be permitted but will become subject to review by Research Management. Your decision to buy or sell a security should be based upon your personal investment objectives and should be made only after evaluating the stock's expected performance and risk.

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Citi Research Asia Quantitative Radar Screen model recommendations are based on a regionally consistent framework to measure relative value and momentum for a large number of stocks across regional developed and emerging markets. Relative value and momentum rankings are equally weighted to produce a global attractiveness score for each stock. The scores are then ranked and put into quintiles. A stock with a quintile rating of 1 denotes an attractiveness score in the top 20% of the universe (most attractive). A stock with a quintile rating of 5 denotes an attractiveness score in the bottom 20% of the universe (least attractive).
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For purposes of NASD/NYSE ratings-distribution-disclosure rules, a Citi Research Quantitative Research Decision Tree model or Quantitative Research Australia Radar Screen recommendation of "attractive" (1) most closely corresponds to a buy recommendation. All other stocks in the sector are considered to be "unattractive" (10) which most closely corresponds to a sell recommendation. An (NR)/(0) recommendation indicates that the stock is no longer in the screen.
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