

September 20, 2013

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NSE Code: WOCKPHARMA

Reuters Code: WCKH.NS

Bloomberg Code: WPL:IN

Wockhardt is a global pharmaceutical and biotechnology organization focusing on manufacturing and marketing high-quality pharmaceutical products and services. It is India's leading research-based global healthcare enterprise with relevance in the fields of Pharmaceuticals, Biotechnology and a chain of advanced Super Specialty Hospitals. Wockhardt has 12 manufacturing plants located in India, UK, Ireland, and is also having 3 research centres globally.

Investor's Rationale

Wockhardt has posted a flat revenue growth of 1.2% YoY at ₹3.23 bn in Q1FY'14 impacted by sluggish growth from US (11%) coupled with decline in sales from the Europe (-5%), Emerging markets and India (-5%). However, The company's consolidated net profit declined by 14.5% YoY to ₹3.23 bn in Q1FY14 weighed down by slower sales in emerging markets coupled with and higher input costs. The largest revenue contributing Chikalthana facility has come under US FDA radar, which already received import alert on its Waluj facility. Though the recent import restrictions on the Waluj facility by USFDA has raised concerns over the near term prospects, the company is determined to resolve the issue at the earliest and has initiated several preventive and corrective measures.

Research continues to be at the core for Wockhardt with the company has filed 4 new product applications with USFDA during Q1FY'14 taking the cumulative products pending approval with USFDA stood at 50 as on June 2013. Wockhardt has also filed for 27 patents during the quarter taking the cumulative filings to 1,773 and has been granted 11 patents during the year and the cumulative patents granted to 228.

With more than 80% of its global revenues, Wockhardt's US business (contributed 53% of the global revenues) continued its growth trajectory and has recorded a growth of 11% in Q1FY'14. We believe that the recent product launches of the company in US, European and Indian markets provides strong growth visibility for FY14E and FY15E.

Key concern:

The new drug pricing policy 2013 ordering pharm companies to slash cost of 348 medicines has raised concern for the pharma companies over lower profitability and margins. Wockhardt strongly against the policy believes that the company striving towards new product development coupled with higher volume sales would help to offset impact of pricing regulations on certain drugs.

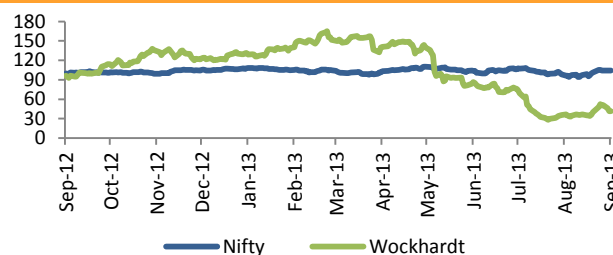
Market Data

Rating	BUY
CMP (₹)	589.3
Target (₹)	710
Potential Upside	~20%
Duration	Long Term
Face Value (₹)	5
52 week H/L (₹)	2,168.8/344.5
Adj. all time High (₹)	2,168.8
Decline from 52WH (%)	72.8
Rise from 52WL (%)	71.0
Beta	1.4
Mkt. Cap (₹bn)	64.6
Enterprise Value	70.2

Fiscal Year Ended

Y/E	FY12A	FY13A	FY14E	FY15E
Net Sales (₹bn)	43.5	56.1	65.3	75.2
EBITDA (₹bn)	13.6	20.6	24.6	28.2
Net Profit (₹bn)	3.4	15.9	18.7	22.0
Adj EPS (₹)	31.3	145.5	170.3	200.5
P/E (x)	18.8	4.1	3.5	2.9
P/BV (x)	65.5	15.4	9.5	6.6
EV/EBITDA (x)	72.6	20.5	16.8	14.3
ROCE (%)	16.2	43.4	40.5	36.6
ROE (%)	48.3	66.3	44.0	34.6

One year Price Chart



Shareholding Pattern

	Jun'13	Mar'13	Diff.
Promoters	73.54	73.54	-
FII	10.38	9.07	1.31
DII	3.24	3.25	(0.01)
Others	12.84	14.14	(1.3)

The company is India's leading research-based global healthcare enterprise with relevance in the fields of Pharmaceuticals, Biotechnology and a chain of advanced Super Speciality Hospitals.

The company's international business contributed a whopping 83% of the total revenues in FY'13, with the US accounting for 52%, EU accounting for 24% and other global markets accounting for 7%, while the India business accounted for 17%.

Wockhardt: India's leading research-based global healthcare enterprise

Wockhardt Ltd, a pharmaceutical company focused on improving the quality of healthcare by manufacturing and marketing high-quality pharmaceutical products and services, was founded in 1960. The company is engaged in the manufacturing and marketing high-quality pharmaceutical products and services. It is India's leading research-based global healthcare enterprise with relevance in the fields of Pharmaceuticals, Biotechnology and a chain of advanced Super Speciality Hospitals. Wockhardt has 12 manufacturing plants located in India, UK, Ireland, US that are well equipped with multi-technology and can manufacture all the dosage forms including sterile. The company is also having 3 research centres globally and manufacturing facilities across India, USA, UK and Ireland with over 578 scientists of which over 80 are doctorates. It has a multi-disciplinary R&D programme span across pharmaceutical formulations, biopharmaceutical bulk and formulations, novel drug delivery system, new drug discovery programme and process engineering for Active Pharmaceutical Ingredients. With 502 products sold across US and Europe, the company is one of the leading generic pharma companies in UK and Ireland.

The company's international business contributed a whopping 83% of the total revenues in FY'13, with the US accounting for 52%, EU accounting for 24% and other global markets accounting for 7%, while the India business accounted for 17%. The growth in the US market was mainly driven by a series of niche products including 1 First-to-file product launched in FY'13. Currently Wockhardt's 18 products enjoy a leadership position and 17 products are at 2nd position in the US market. The company has filed 162 patents in FY'13 and was awarded 52 patents, taking the total patent fillings to 1,733 and cumulative patents granted to 206 till September 2013.

Wockhardt's manufacturing facilities

Manufacturing Facility	No. of Units	Countries	Dosage Forms
Sterile Injectable & Ophthalmic products	5	UK, India	Vials, Ampoules, Large volume Parenteral, Pre-filled Syringes, Catridges, Lyophilised, Dry fill
Solid products	6	India	Tablets, Capsules, Powders, Sachets
Liquid products	4	USA, Ireland, India	Liquids, Suspension, Drops
Topical products	5	Ireland USA, India	Ointments, Creams, Gels
API (Active Pharmaceutical Ingredients)	2	India	API (Pharmaceuticals), API (Biotechnology)

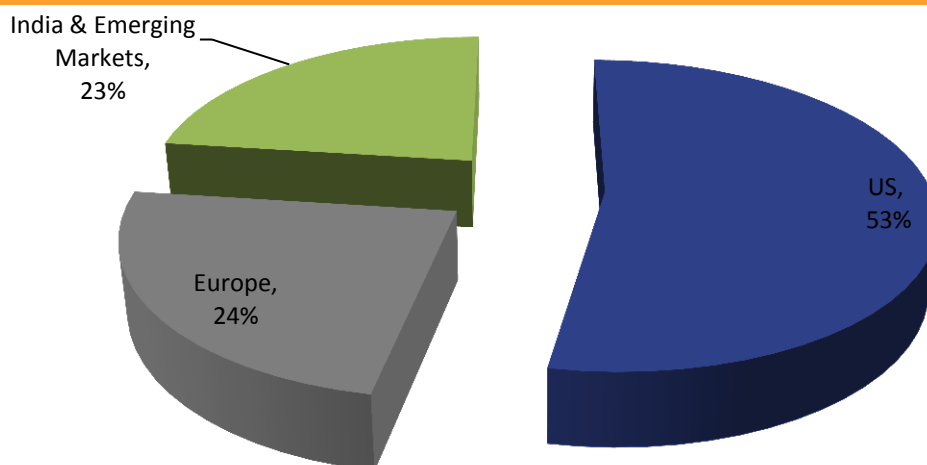
Wockhardt the 3rd largest generic company in the UK market has launched 3 new products during Q1FY'14 in the UK market.

Strong product pipeline

Wockhardt has filed 4 new product applications with USFDA during Q1FY'14. Cumulative products pending approval with USFDA stood at 50 as on June 2013. Wockhardt has also filed for 27 patents during the quarter taking the cumulative filings to 1,773 and has been granted 11 patents during the year taking the cumulative patents granted to 228. Wockhardt the 3rd largest generic company in the UK market has launched 3 new products during Q1FY'14 in the UK market. Wockhardt's US business (contributed 53% of the global revenues) continued its growth trajectory and has recorded a growth of 11% in Q1FY'14.

The UK business recorded a slower growth of 1% in Q1FY'14, mainly on account of negative growth witnessed at Pinewood's UK portfolio. The Irish market recorded a decline of 31% in Q1FY'14. The shift from branded generics to generic-generic has posed more challenges in the near term. India business grew by 3% impacted due to uncertainty in trade due to NLEM issues, strike by retailers in Maharashtra and suspended sale of Dextropropoxyphene by the Government of India. While, the Emerging Markets business declined by 28% in Q1FY14 due to orders from Russia getting pushed to Q2.

Geographical revenue contribution in Q1FY'14



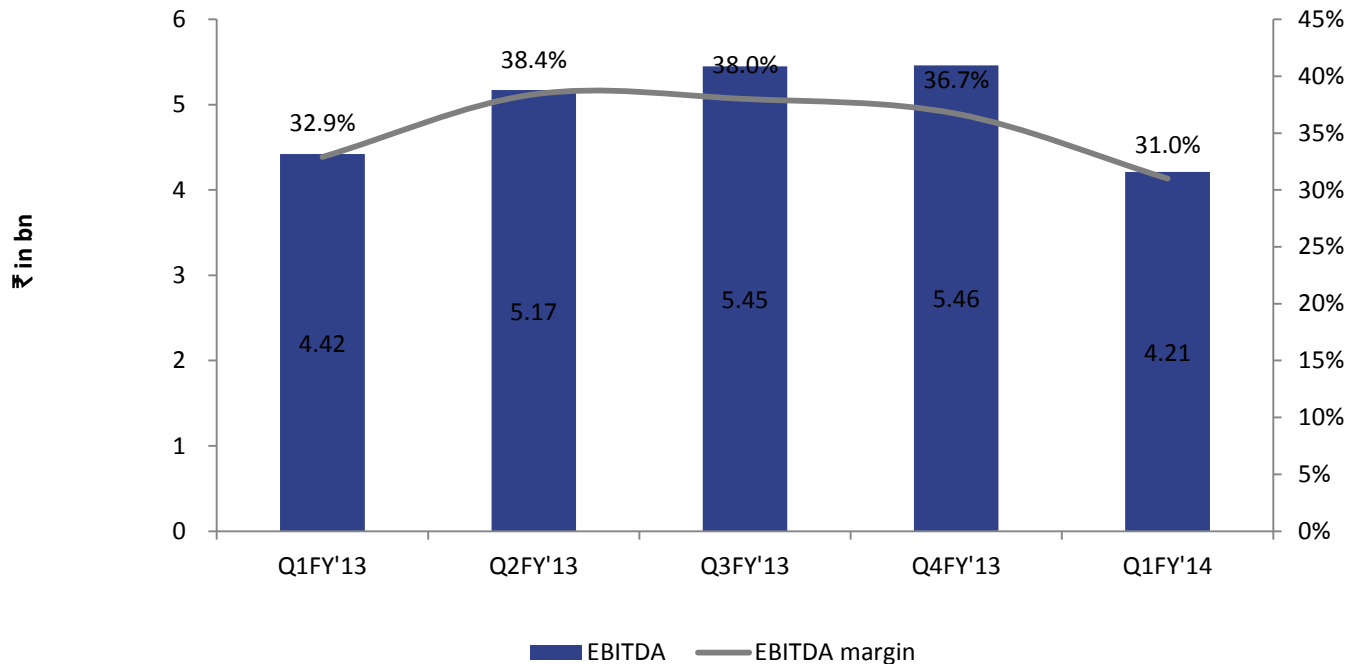
The company managed to retire a large part of the debt last year, the benefit of which is reflected in the interest cost part that has moderated quite significantly by ~68% to ₹0.17 bn in Q1FY'14.

Witnessed lower profit in Q1FY'14 impacted by sluggish sales in emerging markets

Wockhardt has posted a 14.46% YoY decline in its consolidated net profit at ₹3.23 bn in Q1FY'14, impacted by sluggish sales in emerging markets coupled with higher input costs. Consolidated revenue for the quarter increased by 1.3% to ₹13.58 bn. The company increased its research spends significantly (7.2% to sales) by 326% YoY at ₹0.98 bn. As a result, the company witnessed a 5% YoY decline in its EBITDA at ₹4.21 bn in Q1FY'14 against ₹4.42 bn in Q1FY'13 (after accounting for ₹0.41 bn of R&D expenses in Q1FY'13 for a like to like comparison). EBITDA margins during the quarter stood at 31.0% versus 32.9% in Q1FY'13. The company managed to retire a large part of the debt last year, the benefit of which is reflected in the interest cost part that has moderated quite significantly by ~68% to ₹0.17 bn in Q1FY'14. Besides, the company reported a foreign exchange loss of ₹0.21 bn in Q1FY'14, slightly up from ₹0.19 bn in Q1FY'13. Besides, the company reported an exceptional profit

of ₹47 mn, due to reversal of redundancy provision in France. Capital expenditure incurred during the quarter stood at ₹0.68 bn.

EBITDA & EBITDA margin trend



The research activity remain one the mainstay of the company with the R&D stood at 6.7% of sales in FY'13 that remain one of the best investments in the industry.

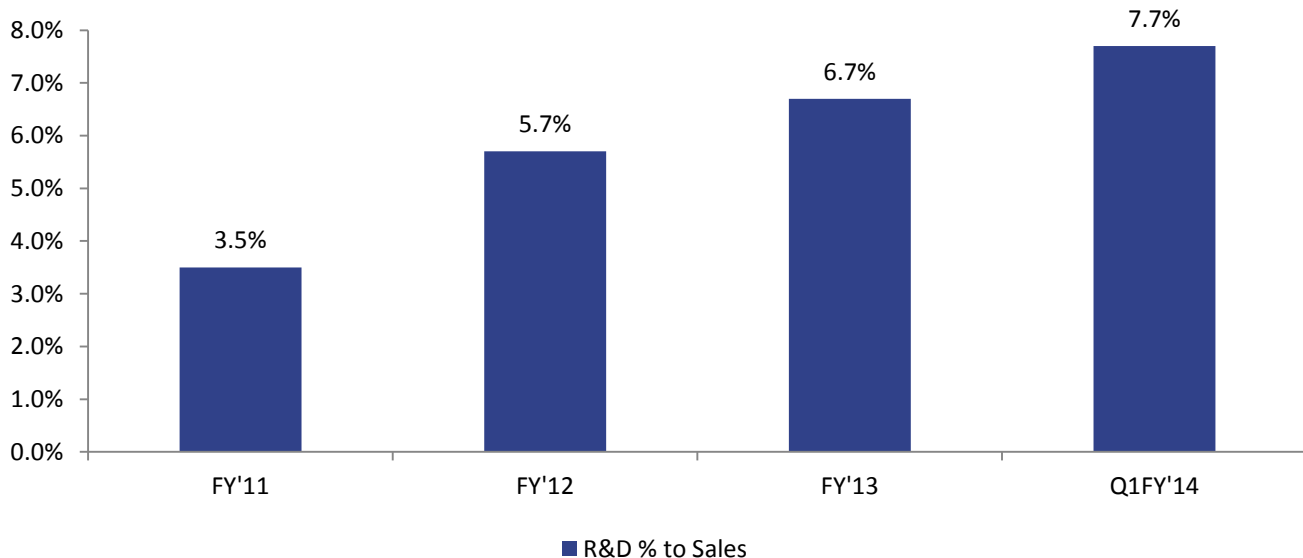
R&D has been the key focus of Wockhardt

Wockhardt has proved its technical excellence in the Research & Development (R&D) space and has developed various patented products, backed by 3 state-of-the-art Research and development Centres in India, UK and USA. The company's R&D also forays into Complex Technology Generics and Biotechnology. It has a multi-disciplinary R&D programme in the fields of Generics, Biotechnology & Genomics Research, Novel Drug Delivery Systems, New Drug Discovery Programme, and API Research. The company looks forward to enhance its scale and product offerings in complex technology generics. The research activity remain one the mainstay of the company with the R&D stood at 6.7% of sales in FY'13 that remain one of the best investments in the industry.

- ✓ This is clearly visible from the fact that the company has filled 20 new product applications with the USFDA in FY'13 and has received approvals for 12 products, taking the total product approvals to 130.
- ✓ The cumulative pending approvals with USFDA stood at 46 as of FY'13. The company has launched 13 new products in UK, 25 products in Ireland, and 21 products in India and emerging markets in FY'13
- ✓ In Biotechnology, the company has made significant progress in developing biosimilars of Insulin and its analogs and has already launched 2 products (Insulin and Glargine) in India as well as have product registrations in 34 countries for Insulin and 5 for Glargine.

The company's strong research background in attaining higher degree of complexity in products technologies has benefited it with the dividends of better product offerings, higher sales and margins and lower competition. The company intends to continue on this path in order to achieve greater heights.

Maintains one of the best industry investments in R&D



The company believes the shifting of manufacturing to other facility would help to reduce the financial fallout from the import alerts

USFDA recent action on its manufacturing site at Waluj raised doubts over the near term prospects

The short term outlook of the company is constrained by the recent FDA import alert on Wockhardt's manufacturing site at Waluj, which banned shipping of its products to the US. In July 2013, Wockhardt received an import alert from USFDA on its Waluj facility which was followed by a warning letter. Following the US concern, the Waluj unit came under UK regulatory scanner also. However, the company is in the process of initiating several mitigating measures and is determined to resolve the issue at the earliest.

- ✓ The company is undertaking measures towards improving the quality operations that will meet all regulatory norms and requirements.
- ✓ Meanwhile, the company is considering shifting US-bound products from the troubled Waluj unit to its plant at Shendra, Maharashtra.
- ✓ The company believes the shifting of manufacturing to other facility would help to reduce the financial fallout from the import alerts.
- ✓ However the company acknowledged the US alert on Waluj plant could cost the company up to \$100mn (~₹5.50 bn); while there would be a one-time impact from the UK ruling of about ₹135 mn.

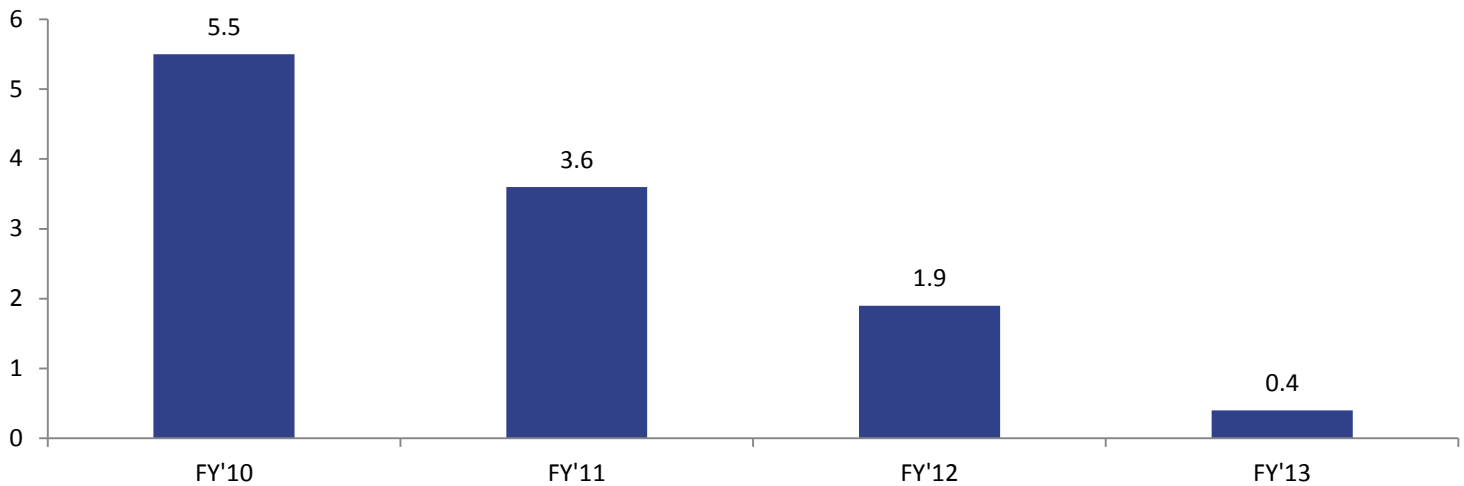
Apart from these concerns, fresh regulatory observations were made on Wockhardt's Chikalthana plant (Aurangabad), too. The company expects the total impact of existing regulatory concerns is likely to be seen over the next few quarters

The company's efforts towards new product development coupled with higher volume sales would help to offset impact of pricing regulations on certain drugs.

New drug pricing policy is key concern for the company

The new drug pricing policy 2013 ordering pharma companies to slash cost of 348 medicines in the National List of Essential Medicines and the decreased prices are made effective on the drugs which are already in the market. This declaration might bring cheer on customers face but put all the pharma companies in a wait and watch mode. It has raised concern for the pharma companies over lower profitability and margins. Wockhardt strongly against the policy believes that the company striving towards new product development coupled with higher volume sales would help to offset impact of pricing regulations on certain drugs.

Well focused towards debt leveraging



Key Concerns

- ✓ The Indian Pharmaceutical industry, being highly fragmented, is very competitive with various new players entering the lucrative Regulated Generics markets. Hence, there are challenges in sustaining leadership positions in therapy segments and thus significantly affecting the sales and margins of such products. However, Wockhardt has been very active on innovation front to mitigate such challenges.
- ✓ Delay in product approvals by USFDA, price controls by the government could adversely impact the profitability of the formulations business. However, the same is likely to offset from higher volumes, new product development and gaining traction in market share of existing products, while adhering to the Pricing regulations where applicable.
- ✓ Recent import restrictions on the company's Waluj facility by USFDA has raised concerns over the near term prospects. However, the company is determined to resolve the issue at the earliest and has initiated several preventive and corrective measures.
- ✓ Cost control is a major area where the company needs to look upon while developing new products. Meanwhile, the company has successfully met this challenging scenario and has brought forward many viable measures for cost control.

Balance Sheet (Consolidated)

Y/E (₹mn)	FY12A	FY13A	FY14E	FY15E
Share Capital	8,160.9	3,533.4	3,533.4	3,533.4
Reserve and surplus	6,549.30	23,508.40	40,401.8	59,722.8
Net Worth	14,710.2	27,041.8	43,935.2	63,256.2
Loans	29,671.9	16,571.5	10,771.0	7,001.0
Provisions	1,954.5	2,546.1	2,800.7	3,080.8
Current Liability	15,191.8	14,241.1	13,529.5	12,853.0
Deferred tax liability	1,010.0	0.0	0.0	0.0
Capital Employed	62,538.4	60,400.5	71,036.4	86,191.0
Fixed Asset	34,736.3	24,805.4	27,285.9	30,014.5
Investment	907.5	26.3	26.3	26.3
Long term loans & adv.	3,422.2	4,143.2	4,971.8	5,966.2
Current Assets	23,472.4	31,133.5	38,460.3	49,891.9
Deferred tax assets (net)	0.0	242.0	242.0	242.0
Other Assets	0.0	50.1	50.1	50.1
Capital Deployed	62,538.4	60,400.5	71,036.4	86,191.0

Key Ratios (Consolidated)

Y/E	FY12A	FY13A	FY14E	FY15E
EBITDA Margin (%)	31.2	36.8	37.6	37.6
EBIT Margin (%)	17.6	35.7	35.6	35.8
NPM (%)	7.9	28.4	28.6	29.2
ROCE (%)	16.2	43.4	40.5	36.6
ROE (%)	48.3	66.3	44.0	34.6
EPS (₹)	31.3	145.5	170.3	200.5
P/E (x)	18.8	4.1	3.5	2.9
BVPS(₹)	9.0	38.3	62.2	89.5
P/BVPS (x)	65.5	15.4	9.5	6.6
EV/Operating Income (x)	22.6	7.5	6.3	5.4
EV/EBITDA (x)	72.6	20.5	16.8	14.3
EBITDA Margin (%)	31.2	36.8	37.6	37.6

Profit & Loss Account (Consolidated)

Y/E (₹mn)	FY12A	FY13A	FY14E	FY15E
Operating Income	43,505.0	56,094.2	65,349.7	75,152.2
Operating Expense	29,947.6	35,469.5	40,789.9	46,908.4
EBITDA	13,557.4	20,624.7	24,559.8	28,243.8
Depreciation	1,150.7	1,221.4	1,294.7	1,372.4
Exceptional Items	4,737.7	(615.2)	0	0
EBIT	7,669.0	20,018.5	23,265.1	26,871.4
Interest	2,690.2	2,153.7	1,938.3	1,744.5
Other Income	233.1	512.10	614.5	706.7
Profit Before Tax	5,211.9	18,376.9	21,941.3	25,833.6
Tax	2,217.4	2,582.1	3,291.2	3,875.0
Extraordinary Item	421.4	152.1	0	0
Share of asso.	11.2	(5.7)	10.0	10.0
Net Profit	3,427.1	15,941.2	18,660.1	21,968.6

Valuation and view

The company's long term outlook continues to be promising driven by overall growth in the global pharmaceutical industry coupled with continued focus on R&D and strong product pipeline of niche & complex technology generics. However, the short term outlook of the company is constrained by the recent FDA import alert on its Waluj plant. We believe that with the company undertaking measures towards improving the quality operations to meet FDA Requirements, could have soothing effect onto the stock.

At a current CMP of ₹589, Wockhardt is attractively placed at P/E of ~3.3x FY14E and P/BV of 1.5x FY14BV. Considering the above aspects, we rate the stock as 'BUY' with a potential upside of 22% for the coming 12 months.



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