

Wockhardt Limited

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BUY
Rs373

Wockhardt has bought C P Pharma in an all-cash deal. In the Analyst Meet held by the company on 11 July 2003, it elaborated on the ramifications of the acquisition and spoke about its strategy going ahead. C P Pharma 's business profile is similar to Wockhardt. Hence, a lot of synergies can be worked out in the entire process. Key takeaways from the meeting are as follows:

Acquisition

Wockhardt has bought C P Pharma in an all-cash deal. C P Pharma, a profit-making entity clocked revenues of Pound Sterling 34mn (Rs2.60bn) for FY02 (YE June). Wockhardt has acquired C P Pharma for a consideration of Pound Sterling 10.85mn. The entire acquisition costing Rs840mn has been done through the ECB route at 2.75%. The additional debt on Wockhardt's books would be to the tune of Rs1.1bn, which includes working capital requirements for C P Pharma.

Positives for Wockhardt

- This deal will catapult Wockhardt among the Top-10 generic companies in the UK market with the UK business generating close to Rs3.82bn revenues.
- C P Pharma will be Wockhardt's vehicle for growth in the UK as well as Europe.
- Wockhardt stands to gain from C P Pharma's presence in Insulin. This will help Wockhardt understand the marketing of Biotech products.

C P Pharma: Financials

- C P Pharma clocked revenues of Rs2.60bn (Pound Sterling 34mn) and exports of Rs230mn (Pound Sterling 3mn) in FY 2002. The company's revenues have been growing at a CAGR of 9.2 % in the last 5 years.

Key figures (2002)	In Pound Sterling
EBDITA	13.5%
Employee Cost	30% of Revenues
Mfg Cost	45%
Selling, Admin & Marketing	11.5 %
Interest	0.8mn
Depreciation	2mn
PBT	1.5mn
PAT	0.7mn
Net Worth	13mn
Equity	3 mn
Debt	13 mn
Deferred Tax	1.5-2 mn

Source: Company

- C P Pharma has spent Pound Sterling 7mn towards product development.
- Its working capital requirement is to the tune of Pound Sterling 8mn.
- The company has 430 employees on its payroll of which 70 % are workers.



- C P Pharma would need fund infusion of a couple of million Pound Sterling in the current year and would generate positive cash flows from 2004.
- The company should manage a PBT of Pound Sterling 1.8mn for the year ended June 2003 and a PAT of around Pound Sterling 1mn.

Key Positives

The company has one manufacturing facility in the UK, which makes solids, liquids and injectibles. The company has another unit, which is a USFDA approved plant, which is expected to contract manufacture for the US market.

Business Split

Hospitals	46%
High Value Generics	34%
Contract Mfg	12%
Exports	8%

Source: Company

C P Pharma has 225 product licences in the UK of which 60-70 are active. The company also has 258 export registrations and exports mainly to Africa, Saudia and East Europe. CP Pharma's MCA approval and mutual recognition for EU members will enable it to tap existing European Union (EU) as well as the other export markets. The approval process can be completed in a span of 3-4 months as against the normal approval process of more than 1 year.

The previous management had invested Pound Sterling 16-18mn in the existing facility in the last three years.

C P Pharma has a Class I facility for manufacturing *Morphine*, which is under the Narcotic Control Order. As few plants have this permission, the company has the option to exploit this potential.

Outlook

The Wockhardt team is keen to understand the business in detail and is planning to send a team to C P Pharma to assess the cost management issues, synergies in manufacturing and take a relook at the whole unit.

Upside in Margins

The current EBDITA margins are expected to move up from 13.5 % presently. Currently the company is importing raw materials from Europe and US while the same can be sourced from Wockhardt, hence enabling improvement in margins.

Contract Manufacturing

Wockhardt is currently working on three deals viz.,

- *Amylin* for Diabetics is in Phase II. This Diabetics product is expected to be marketed by Eli Lily.
- *Provinces* (subsidiary of British Technology group) for vericose veins is in Phase III stage
- *Hylas*, an ophthalmic product, is awaiting approval in the US while the same is being sold in the UK market. The company has a tie-up with American Pharmaceutical Products.

Research

Wockhardt's *Sepsis* molecule should go into Phase II by the end of the year.
Compound 1153, which is a broad spectrum anti-infective should complete pre-clinical trials soon.

US market

The company has filed 6 ANDAs of which 2 are injectibles. The company proposes to file some more by the end of the current year.

Hepatitis B exports

Wockhardt has already started exporting *Hepatitis B* to the unregulated markets and should scale up the same by the last quarter of CY2003. In CY2004, the company should get the WHO approval and would be one among the 6-7 companies vying for the US \$100mn market. The company also plans to file for combination vaccines where the competition is limited to 2-3 players and addresses a market size of US \$60-80mn.

View and Valuation

This deal appears to be a win-win situation for Wockhardt, for even after taking debt into its valuation; the company has paid 0.70x sales, which is far lower than the industry yardstick of Rs1.3x-1.4x. We are positive on Wockhardt on account of this deal as the time to market and scale up has considerably reduced in the export markets of the UK and Europe. The other positives are: turnaround in the domestic formulations business due to recruitment of marketing personnel, return of stability in the domestic business and expected new product introductions in the US generics markets. Though issues of corporate governance remain, we recommend **BUY** at current levels. The stock is quoting at 13.6x FY2003 and 9.9x FY2004 earnings.

Financials

Rs Million

	2001	2002	2003E	2004E
Total Net Revenue	6116	7012	7505	8621
Operating Profits	1328	1400	1330	1747
OPM (%)	21.7%	20.0%	17.7%	20.3%
PAT	1022	1088	993	1366
Equity	363	363	363	363
EPS(Rs)	28.2	30.0	27.4	37.6
RoCE (%)	31.6%	32.4%	24.2%	27.1%
RoE (%)	35.8%	31.5%	26.0%	30.8%

Source: Karvy Estimates



15 July 2003
Analyst Meet

Stock Ratings Absolute Returns

Buy : > 25%
Out Performer : 16 - 25%
Market Performer : 0 - 15%
Under Performer : < 0%

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