PRESS INFORMATION BUREAU
पत्र सूचना कार्यालय
GOVERNMENT OF INDIA
भारत सरकार

Business Line, Delhi
Sunday, 2nd January 2011, Page: 5
Width: 22.10 cms Height: 32.47 cms, Ref: pmin.2011-01-02.28.32

Three sector picks for 2011

32-5-1

If the stock market were to resume its upward journey in 2011, which sectors will lead the charge — those that led the race in 2010 or the underdogs? Here are a few potential winners for 2011.

Pharma

Pharma stocks have seen their valuation multiples expand over the year and not without good reason as companies have managed to deliver on the earnings front. While the coming year may not see such a massive re-rating of the sector again, the strong earnings potential of companies in the space offers adequate investment opportunities.

Continued benefits from an increased generic incursion in global markets and a robust domestic market are likely to translating in to steady growth in core businesses and exports for the drug companies. Investors nonetheless may have to be meticulous in choosing stocks as the sector does not offer value picks.

GROWTH TRIGGERS

Patent cliff: The next few years promise to be among the most action-packed for generic drug makers as global pharma majors stare at significant drug patent expiries. In 2011 alone as per IMS Health, products having sales of more than $30 billion are estimated to go off-patent.

Regulatory steps taken by the developed countries such as US, Japan and UK towards limiting growing healthcare budgets too would spur the demand for generics. These in turn are expected to fuel the growth prospects of the Indian pharmaceutical sector, which boasts of a growing product pipeline, regulatory-compliant manufacturing facilities and cost advantages.

While the extent to which Indian companies stand to gain depends on regulatory

32-5-2

approvals and favourable litigation and court outcomes, growth opportunities seem aplenty. For instance, the expiry of Pfizer's cholesterol-lowering drug Lipitor in November 2011 (had generated $8.1 billion in sales in the first nine months) opens up a significant money-making opportunity for India's Ranbaxy, which being the first-filer would have a six-month period of market exclusivity starting November 2011. It's another matter than Ranbaxy would need to necessarily resolve its pending issue with the US FDA over its manufacturing facilities before then.

Strong domestic market: A robust domestic market too is expected to provide a growth thrust, with both Indian and MNCs drug makers increasingly focusing on the domestic market (esp. tier II and III cities). Companies such as Ranbaxy, IPCA Labs, AstraZeneca India and Cadila Healthcare have also aggressively added on to their field force.

Industry estimates peg the domestic market growth at about 16 per cent. The year therefore may see improving penetration and productivity of field agents, as also competition. Larger companies with strong product portfolios and presence across major therapeutic areas (such as Sun Pharma, Cipla, and Lupin) and Indian arms of MNCs (such as GSK Pharma) might have an edge.

Revival in CRAMs: CRAMs companies have had a forgettable year so far following destocking by global pharma, rationalising of R&D pipelines and M&As.

The coming year however promises to be much better with industry trends now pointing towards a pick up in this demand towards the sec-

Jubilant Life Sciences and Divi's Laboratories may be the leading beneficiaries.

Expanded capacities, firm trends in capex and a growing pipeline of new drug applications in the US too promise to fuel the sector's growth. For instance, Sun Pharma alone has a more than 363 products filed in the US, of which 146 await FDA approval.

Among other significant stock-specific growth triggers are — Allegra D 24 and Arixtra for

32-5-3

Outperformer

- Expiring patents of global pharma companies
- Strong pipeline of drug applications
- Rising competition in domestic market
- Likely increase in licensing and supply deals

PRESS INFORMATION BUREAU
पत्र सूचना कार्यालय
GOVERNMENT OF INDIA
भारत सरकार

Business Line, Delhi
Sunday, 2nd January 2011, Page: 5
Width: 8.76 cms Height: 29.68 cms, Ref: pmin.2011-01-02.28.32

Dr Reddys Laboratories, Docetaxel for Sun Pharma, AllerNaze and oral-contraceptive products for Lupin.Another earnings trigger during the year would be the resolution of FDA overhang on Ranbaxy and Sun Pharmaceuticals; Sun would also see benefits accruing from its now completed acquisition of Taro.

If 2010 saw Indian drug makers forge global alliances and deals, 2011 promises to be the year when these companies would begin reaping the benefits therefrom. Companies such as Aurobindo Pharma (Pfizer and AstraZeneca), Dr Reddys (GSK) and Biocon (Pfizer) will begin monetising their licensing deals with the big pharma in the next few years, thus providing support to valuations. Similar deals that are struck by other companies (Cipla rumoured to be next) therefore may bear a watch.

SRIVIDHYA SIVAKUMAR

Infrastructure

Looking up

- Road asset owners offer opportunities
- Water-related infrastructure to see growth
- Interest rates could hurt profit margins

It would only be appropriate to classify the infrastructure and construction sector among the underdogs of the 2010 equity markets. Over two-thirds of our 40 infrastructure stock universe delivered negative returns in 2010. Erstwhile stock market favourites such as IVRCL Infrastructures & Projects and B.L. Kashyap & Sons nosedived in 2010 declining about 30 per cent.

With a median return of -15 per cent (up to December 27) for a universe of about 40 stocks, the sector was way off the Sensex performance of 15 per cent. Slower execution of projects in some segments and resultant drag on revenue growth and tepid order inflows have all resulted in the markets viewing stocks from the sector unfavourably.

TAILWINDS

However, new regulations in the road space, more funding channels besides the compulsion to achieve at least a respectable part of the targeted twelfth plan which ends in FY-12 are macro factors that may turn the tide in favour of infrastructure companies in certain business segments in 2011.

The first half of FY-11 has already shown proof of this:

portantly, higher working capital suggests reasonable project implementation, albeit at early stages. Infrastructure developers who own a portfolio of highways, contractors in the road and water management space as well as technology providers for water may be the key beneficiaries of the turnaround expected in the sector in 2011.

PORTFOLIO OWNERS

Road developers, such as IRB infrastructure Developers, IL&FS Transportation Network, Jaypee Infratech or Sadbhav Engineers who own a portfolio of roads on a build-own-operate-transfer basis could emerge as good bets in the road space.

The dual combination of a steady stream of annuity/toll revenues besides revenue from project execution provide these companies with a model that also helps combat slowdown; as against the pure execution contractors.

With pick-up in economic activity, toll revenues of players such as IRB have already seen a 22 per cent increase, largely driven by higher traffic.

With modest traffic estimations done initially, the higher traffic for many of the players in the industrial belts have made their projects more lucrative. Trailing price-earnings multiple of anywhere between 10-16 times also offer attractive entry points.

On the macro front, the government has stated its intent to award the remaining 5000-5500 km planned this year by the end of this fiscal. This could mean a higher level of order inflow in the next few months than what was seen in the last eight months. Contractors such as C&C Constructions or Unity Infraprojects with presence in road work too may benefit from the sudden surge in order inflows.

That said, the first half of this year has seen marginal pressure to operating profit margins (an average of 19.5 per cent now) despite lower input costs as a result of higher labour and subcontracting costs.

While the net margins remain intact, higher interest costs could be an irritant. A healthy spurt in the top line, higher than an average 15 per cent clocked in the latest ended half-year would be crucial to avert any pressure on margins.

Activity in the irrigation segment, dominated by spending in States such as Andhra

moil. Besides lull in order inflows, execution of existing projects too suffered as a result of slower payments to contractors. Players such as IVRCL Infrastructure & Projects, Nagarjuna Construction and Hindustan Construction consciously slowed their activity in this space but have seen higher levels of debt in their balance sheets. These companies may therefore need to be kept on the watch list for any positive developments.

However, another large state-expenditure area - water supply and sanitation- though, has seen brisk business in areas of sewerage treatment, water recycling and desalination.

Companies such as Pratibha Industries, Ramky Infrastructure which execute significant projects in the water and waste management space besides water-related technology providers such as Hindustan Dorr Oliver and VA Tech Wabag can also be expected to ride the infrastructure wave.

VIDYA BALA