

Upgraded earnings and target price

8th October 2009

BUY

Price	Target Price
Rs1274	Rs1550

Sensex –	16,807
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Price Performance

(%)	1M	3M	6M	12M
Absolute	26	53	95	71
Rel. to Sensex	20	29	25	19

Source: Bloomberg

Stock Details

Sector	Pharmaceuticals
Reuters	LUPN.BO
Bloomberg	LPC@IN
Equity Capital (Rs mn)	862
Face Value (Rs)	10
No of shares o/s (mn)	86
52 Week H/L (Rs)	1287/518
Market Cap (Rs bn /USD mn)	110/1,571
Daily Avg Vol (No of shares)	241695
Daily Avg Turnover (US\$ mn)	5.2

Shareholding Pattern (%)

	30/06/09	31/03/09	31/12/08
Promoters	50.4	50.6	50.7
FII/NRI	13.9	14.1	14.8
Institutions	24.8	24.5	23.1
Private Corp.	1.3	1.5	1.9
Public	9.6	9.4	9.6

Source: Capitaline

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We had initiated coverage on Lupin with a buy as we strongly felt that it deserved a re-rating, given its presence across the entire value chain, strong peer outperformance and a hefty 55-60% valuation discount to its peers (Refer our report "Hunt for earnings growth ends here" dated 3rd Mar'09). While its recent outperformance has narrowed down the gap between Lupin and its comparable peers to a great extent, we believe the gap (25-30%) still offers strong upsides for Lupin. Moreover, we believe that Lupin, armed with its recent Antara acquisition and its outlicensing deal with Salix Pharma, has the potential to emerge as one of the largest pharma companies in India. Its outperformance across segments along with its well charted growth strategy makes it our best bet in the Indian pharma space. We have upgraded our earning estimates by 3% and 10% for FY10E and FY11E on the back of Antara acquisition and introduced our FY12E numbers. We have upgraded our target price by 29% to Rs1550 (16x FY11E; 15-20% discount to comparable peers because of pending FDA issue at Mandideep facility). The NPV of Para IV pipeline is Rs30/share. At CMP of Rs 1274, the stock is trading at 17.2x FY10E and 13.4x FY11E. Adverse outcome at Mandideep facility will remain a key risk to our call.

Antara acquisition will strengthen Lupin's presence in the US market.....

Lupin has acquired US marketing rights for Antara (Fenofibrate; US\$90mn revenue) from Oscient Pharmaceutical for a total consideration of US\$39mn (0.43x sales). Antara which was initially developed by Ethypharma had licensed the marketing and distribution rights to Reliant in 2001. Reliant launched this molecule in 2005 and sold the rights to Oscient Pharma for US\$78mn in mid2006 (~revenue of US\$30-35mn). In the last three years, Antara revenue grew from US\$17mn in 2006 to US\$70mn in 2008. The revenue year till June'09 was US\$90mn (20% growth). However, due to bankruptcy woes (Oscient Pharma filed for bankruptcy in July 2009) and non-promotion of Antara, the prescription of Antara has come down by 30% in last six months. We believe that Antara's acquisition will strengthen Lupin's presence in the branded segment (US\$74mn revenue in FY09) and increased the visibility of US revenue. Lupin's management has indicated that they will use existing field force (60 people) to promote Antara and will double its marketing team in next 1 year.

..... Acquisition is earnings accretive in the first year itself

Despite assuming 25% reduction in the revenue of Antara because of gap in promotion, we believe that acquisition will be EPS accretive with in first year of launch. After analyzing the cost structure of Oscient Pharma (gross margins- 75-77% ex. Amortization, higher SGA cost because of 250 sales team), we believe that Lupin will have incremental EPS of Rs 3.8 and Rs 9.5 in FY10E and FY11E respectively (detailed working in table-1).

Antara acquisition is EPS accretive

	FY10E	FY11E	FY12E
Revenue (US\$ mn)	30	68	68
Revenue (Rs mn)	1440	3264	3128
Cost of good sold	7.5	17.0	17.0
GM	75%	75%	75%
Gross profit	22.5	51	51
SG&A cost (Incremental) @25% of revenue	7.5	17	17
EBIDTA (US\$ mn)	15	34	34
EBIDTA (Rs mn)	720	1632	1564
Amortization cost	309	618	618
PBT	411	1014	946
PBT margin %	28.5%	31.1%	30.2%
PAT (Tax @18%)	341.13	841.62	785.18
Incremental EPS	3.8	9.5	8.8

Lupin's drug development deal with Salix Pharma demonstrates underlying strength in its R&D capability

Lupin has out-licensed its bioadhesive technology to Salix pharmaceutical to develop and commercialize the extended release product Rifaximin. Rifaximin which is sold under the brand name of XIFAXAN in the US by Salix has revenue of \$80mn in 2008. As per the agreement Lupin has received an Up-front payment from Salix Pharmaceutical of \$5mn and is expected receive additional milestone payment in the months going ahead (additional US\$40-45mn, depending on successful commercialization) along with royalty on the sales of the bioadhesive product – Rifaximin. The company has also entered in to an exclusive API supply agreement with Salix Pharmaceutical for Rifaximin.

We believe that if the drug will be launched successfully in the US market (it may take 24-30months to launch this molecule), Lupin will have recurring earning upside of Rs3-4 per share (assuming US\$50-60mn revenue from this new product) because of a) Assured API supply and b) Royalty on sales. Apart from this, company (Lupin) will also get additional milestone of US\$40-45mn in next couple of months.

Launch of Oral Contraceptives in US will be next key growth driver

Lupin is building up a portfolio of 22 OC products for US market, out of which 7 ANDAs have filed in H2FY09 and expects to file 14 more in FY10. The OC market in Us is worth US\$3bn, with genericised products constituting about US\$1bn. Currently this market is currently dominated by two players, Teva and Watson (currently sourcing API from third party). Owing to limited competition (3-4 operators per product) and due to vertical integration (in-house API), we expect Lupin to generate US\$150-160mn revenue from OC range in next 3-4 years starting from FY12E onwards. Moreover, Lupin is also eyeing opportunities in the emerging markets to capitalize on its OC portfolio.

Para IV opportunities provide further upside potential

Lupin has built up an interesting pipeline of 17 Para IV products, of which, 6 products have FTF status (market size of US\$5bn). We expect company to launch 3-4 limited competition products till FY12, includes product like Lotrel (already settled), Fortamet and Combivir. We assign an optional value of Rs30 per share for its Para IV pipeline.

Para IV pipeline table:

Molecule	Brand	Innovator	30-month stay	Sales (US\$mn)	Status
Venlafaxine Hydrochloride	Effexor XR	Wyeth	N/A	2600	
Amlodipine Besylate; Benazepril Hydrochloride	Lotrel	Novartis	Apr-09	1400	
Amlodipine Besylate; Benazepril Hydrochloride	Lotrel	Novartis	May-09	315	
Zolpidem Tartarate	Ambien CR	Sanofi Avenits	N/A	690	
Lamivudine; Zidovudine	Combivir	GlaxoSmithKline	Jan-11	307	
Sevelamer Hydrochloride	Renagel	Genzyme	Jul-11	500	
Sevelamer Carbonate	Renvela	Genzyme	Jun-11		
Metformin Hydrochloride	Fortamet	Andrx	Jun-11	70	First-To-File
Niacin	Niaspan	Abbott	Jul-11	660	
Memantine Hydrochloride	Namenda	Forest	Apr-11	800	First-To-File
Duloxetine Hydrochloride	Cymbalta	Eli Lilly	Feb-12	1850	First-To-File
Pregabalin	Lyrica	Pfizer	Jun-12	1500	First-To-File
Eszopiclone	Lunesta	Sepracor	Jun-12	600	First-To-File
Norethindrone Acetate; Ethinyl Estradiol	Loestrin 24 FE	Warner Chilcott	Early 2012	245	
Norethindrone; Ethinyl Estradiol	Femcon FE	Warner Chilcott	Early 2012	65	
Lanthanum Carbonate	Forsenol	Shire	Apr-12	108	

Japan- Next big opportunity in generic space

Japan is the second largest market in the world with sales of over US\$65bn. With an increasing aging population, the Japanese govt. is taking measures to curb healthcare costs and is targeting a 30% generic penetration by FY13 from the current level of 17% penetration. Lupin, through its acquisition of Kyowa, is the 7th largest generic company in Japan and well set to capitalize the growing generic opportunity in the Japanese market. The Company is also looking to enter in the hospital segment as Japan has highest rate of average days of stay in the hospital. We expect Lupin to report a CAGR of 15% over FY10-14E.

Upgrade earnings estimates and raise target price to Rs1455.

We have upgraded our earning estimates by 3% and 10% for FY10E and FY11E on the back of Antara acquisition and introduced our FY12E numbers. We expect Lupin to report earnings CAGR of 26% over CY09-12E. Our EPS for FY10E, FY11E and FY12E are Rs73.9, Rs95.1 and Rs113.9 respectively.

Revised earning estimates

	FY10E	FY11E	FY12E
Revenue (Rs mn)			
Old Estimate	45905	53262	N/A
New Estimate	47346	56526	64749
% Change	3%	6%	
EBIDTA Margins			
Old Estimate	18.6	19.1	N/A
New Estimate	20.2	21.7	21.9
% Change	160 bps	160 bps	
PAT			
Old Estimate	6359	7643	N/A
New Estimate	6559	8438	10109
% Change	3%	10%	
EPS (Rs)			
Old Estimate	71.8	86.3	N/A
New Estimate	73.9	95.1	113.9
% Change	3%	10%	

We have upgraded our target price by 29% to Rs1550 (16x FY11E; 20% discount to comparable peers because of pending FDA issue). The NPV of Para IV pipeline is Rs30/share. At CMP of Rs 1274, the stock is trading at 17.3x FY10E and 13.4x FY11E.

We expect Lupin to continue to outperform its peers and expect it to command premium valuations in the long run. While the stock has re-rated from 10x one year forward PE (at the time of our initiating coverage report) to 13.5x one year forward PE, its still way below the 20x multiple enjoyed by the large caps. Our revised target price of Rs1550, discount one year forward earnings by 16x, which fairly discounts the pending issue at Mandideep. Once the mandideep issue gets resolved, we expect Lupin to see further re-rating on account of strong growth visibility.

Peer Comparison

	CMP	Sales		EBIDTA		EPS		ROE		EV/Sales		EV/EBIDTA		P/E	
		FY10	FY11	FY10	FY11	FY10	FY11	FY10	FY11	FY10	FY11	FY10	FY11	FY10	FY2011
Ranbaxy*	399	80781	93610	7229	13383	10.0	14.5	10.0	17.4	2.3	2.0	25.9	14.0	39.9	27.5
Dr Reddy	948	71697	80882	13571	15234	52.4	60.8	22.6	21.8	2.3	2.0	12.4	10.7	18.1	15.6
Cipla*	282	59748	68754	12704	14648	13.1	15.4	22.4	21.7	3.7	3.3	17.6	15.3	21.5	18.3
Sun Pharma*	1412	40212	45347	13329	14740	66.5	74.9	19.3	18.8	7.0	6.2	21.0	19.0	21.2	18.9
									Avg	3.8	3.4	19.2	14.7	25.2	20.1
Lupin Pharma	1274	47346	56526	9565	12241	74	95	36.0	33.0	2.6	2.2	13.5	11.0	17.2	13.4

Income Statement

Y/E, Mar (Rs. mn)	FY09	FY10E	FY11E	FY12E
Net Sales	37761	46747	55889	64062
Growth (%)	40.6	23.8	19.6	14.6
Other related income	762	599	637	687
Total Operating Income	38523	47346	56526	64749
Expenses	31239	37061	42652	49021
Growth (%)	39.8	18.6	15.1	14.9
Raw Materials	16043	18757	21576	24800
% of sales	42	40	39	39
Employee cost	4871	4871	4871	4871
% of sales	13	10	9	8
Manufacturing exp	2662	3171	3578	4083
% of sales	7	7	6	6
R&D	2228	2809	3263	3778
% of sales	6	6	6	6
Selling & Dist exp	5435	7452	9364	11489
% of sales	14	16	17	18
EBIDTA	7284	9565	12241	14163
Growth (%)	61	31	28	16
EBIDTA % (W/O Other OI)	18.9%	20.2%	21.7%	21.9%
Other income	192	244	219	286
Interest	499	612	494	344
Depreciation	880	1293	1736	1850
Non-recurring Expense	37	0	0	0
Non-recurring Income				
PBT	6060	7904	10230	12256
Total Tax	983	1344	1790	2145
Effective tax rate (%)	16	17	18	18
Minority Int	62	2	2	2
PAT (Before E/O items)	5015	6559	8438	10109
E/O items	-43	0	0	0
APAT	5058	6559	8438	10109
Growth (%)	51	30	29	20
NPM	13.4	14.0	15.1	15.8

Balance Sheet

Y/E, Mar (Rs. mn)	FY09	FY10E	FY11E	FY12E
Equity share capital	828	888	888	888
Share Premium	127	127	127	127
Other Reserves	13294	21236	27204	34354
Minority Interest	143	141	139	138
Networth	14391	22391	28357	35506
Deferred tax liability	1164	1164	1164	1164
Diventure/pref. Share				
Secured Loans	5767	7767	6267	4767
Unsecured Loans	6466	2966	1966	966
Loan Funds	12233	10733	8233	5733
Total Liabilities	27788	34288	37755	42403
Gross Block	18200	21700	24200	26700
Less: Depreciation	6188	7172	8290	9522
Net block	12012	14528	15910	17178
Capital work in progress	2240	964	964	964
Goodwill	3174	3174	3174	3174
Investment	216	1128	2040	2040
Current Assets	23478	31265	35475	42108
Inventories	9572	11463	13314	15416
Sundry debtors	10349	12369	14314	16574
Cash & bank balance	778	4263	4163	5852
Loans & advances	2780	3171	3684	4265
Other assets	0	0	0	0
Current liabilities	13331	16771	19808	23059
Current liabilities	11504	14045	16314	18889
Provisions	1827	2726	3494	4170
Net current assets	10147	14494	15667	19048
Misc expenditure	0	0	0	0
Total Assets	27788	34288	37754	42403

Cash Flow

Y/E, Mar (Rs. mn)	FY09	FY10E	FY11E	FY12E
Pre-tax profit	6060	7904	10230	12256
Depreciation	880	1293	1736	1850
Chg in working cap	860	(863)	(1272)	(1692)
Tax paid	(1068)	(1344)	(1790)	(2145)
Operating cash Inflow	6732	6991	8904	10269
Capital expenditure	(5308)	(2533)	(3118)	(3118)
Free Cash Flow	1424	4458	5786	7151
Investments	(157)	(912)	(912)	0
Equity Capital Raised	377	3363	0	0
Loans Taken / (Repaid)	204	(1500)	(2500)	(2500)
Dividend (incl tax)	(1235)	(1921)	(2471)	(2960)
Minority Interest	48	(2)	(2)	(2)
Forex reserve	59	0	0	0
Cash flow hedge (for. Cont)	(2773)	0	0	0
Others	89	-2	-1	-1
Net chg in cash	-1965	3485	(99)	1689
Opening cash position	2742	778	4263	4163
Closing cash position	778	4263	4163	5852

Key Ratios (%)

Y/E, Mar	FY09	FY10E	FY11E	FY12E
Profitability (%)				
EBIDTA margin	18.9%	20.2%	21.7%	21.9%
PAT margin	13.4	14.0	15.1	15.8
ROCE	25	28	30	32
ROE	37	36	33	32
Per share data (Rs.)				
EPS (Consolidated)	57.0	73.9	95.1	113.9
CEPS	66.9	88.5	114.6	134.8
BVPS	172.0	250.7	317.9	398.5
DPS (Rs)	12.8	18.5	23.8	28.5
Valuations				
P/E	22.4	17.2	13.4	11.2
Cash PE	19.0	14.4	11.1	9.5
P/BV	7.4	5.1	4.0	3.2
EV / Net Sales	3.1	2.6	2.2	1.9
EV / EBITDA	16.1	13.5	11.0	9.0
Dividend Yield (%)	1.0	1.5	1.9	2.2
Turnover (x) Days				
Debtors T/O	98.7	98.3	97.9	97.9
Inventory T/O	91.3	91.1	91.1	91.1
Gearing Ratio				
Net Debt/Equity (x)	0.8	0.3	0.1	0.0

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