

India: Healthcare

Q2 '09: Pharma to outperform, yet modest by own recent standards

Industry Context

Amidst the current turbulence, our three-pronged view of the Indian pharma sector is unshaken – steady sales growth, increasing EBIT growth and healthy cash flows continue to be the themes for the sector. We expect Indian pharma to outperform in comparison with the rest of the GIR India coverage groups.

Showcasing its operationally sound fundamentals in Q2 FY09, we expect the sector to deliver:

a) **Sales growth of 17% and EBIT growth of 23%**, which stands out in the context of Q2 FY08 (sales growth of 8% and EBIT growth of 6%).

b) **EBIT margin of 18.8%**: We expect an 80bps improvement in EBIT margins yoy and a 50 bps decrease qoq. We expect this mild reduction in EBIT margin to be transient, owing to the increased API costs during Q1 FY09E and do not expect EBIT margins to be impacted in the next quarter.

c) **Net income growth of 16%** (excluding Dr Reddy's from the equation, as its one-time tax gain of Rs1450 mn in Q2 FY08 creates a distorted base comparison for this quarter). This rate of net income growth contrasts with our GIR India coverage figure of 10% for this quarter.

Three companies which we believe will stand out: **Glenmark (GLEN.BO, Buy)**, with 50% sales and 65% EBIT growth yoy and **Dr Reddy's (REDY.BO, Buy)**, with 16% sales and 77% EBIT growth yoy. We believe **Sun Pharmaceuticals (SUN.BO, Neutral)** will post around 57% sales and 73% EBIT growth, primarily on the back of growth in the US markets.

In Dr Reddy's case, we believe this quarter could witness the beginning of a modest turnaround as it focuses on consolidating its business and steadying its margins. We believe that modestly good results from it should see the market revisit its growth expectations for Dr Reddys.

We expect Ranbaxy (RANB.BO, Sell), Biocon (BION.BO, Neutral) and Cadila (CADI.BO, Sell) to experience a loss in earnings. We have lowered our target price for Biocon by 10% to Rs181 on the back of lowered medium-term growth expectations, especially from its Biopharma business.

Risks

The sector derives around 65% of its revenues from exports which are exposed to the translational impact of any strengthening in the rupee.

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INDIAN PHARMA STOCKS: Q2 FY2009* ESTIMATES

Company	Expected reporting date	Ticker	Rating
Healthcare			
Biocon	16-Oct-08	BION.BO	Neutral
Cadila	22-Oct-08	CADI.BO	Sell
Cipla	3rd/4th wk - Oct	CIPL.BO	Sell
Dr Reddys	22-Oct-08	REDY.BO	Buy
Glenmark	4th wk Oct	GLEN.BO	Buy
Lupin	~ Mid-Oct	LUPN.BO	Neutral
Piramal	22-Oct-08	PIRA.BO	Buy
Ranbaxy*	3rd wk - Oct	RANB.BO	Sell
Sun	3rd/4th wk - Oct	SUN.BO	Neutral
Wockhardt*	21-Oct-08	WCKH.BO	Neutral

Company	Sales		EBIT	
	Rs. Mn	yoy (%)	Rs. Mn	yoy (%)
Biocon	2,898	4%	568	1%
Cadila	6,481	9%	987	-17%
Cipla	11,359	3%	1,852	-3%
Dr Reddys	14,653	16%	1,867	77%
Glenmark	5,629	50%	1,681	65%
Lupin	8,356	17%	1,474	-7%
Piramal	8,094	6%	1,251	17%
Ranbaxy*	19,354	18%	2,450	10%
Sun	10,485	57%	4,150	73%
Wockhardt*	8,182	11%	1,697	5%
Average for the sector				23%

Company	Net Income		EPS	
	Rs. Mn	yoy (%)	Rs/Share	yoy (%)
Biocon	492	-9%	2.54	-6%
Cadila	704	-23%	5.60	-23%
Cipla	1,823	-4%	2.35	-4%
Dr Reddys	1,494	-44%	8.90	-44%
Glenmark	1,319	76%	5.30	68%
Lupin	1,196	1%	14.89	2%
Piramal	1,021	20%	4.89	19%
Ranbaxy*	1,483	-29%	3.98	-29%
Sun	4,231	94%	20.43	93%
Wockhardt*	1,158	7%	10.58	7%
Average for the sector				4%
Average (ex Dr Reddys)				17%

*Q3 FY2008 for Ranbaxy and Wockhardt

Source for all tables above: Company data, Goldman Sachs Research estimates.

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Exhibit 1: Three companies we think investors should look out for: Glenmark (50% sales and 65% EBIT growth), Sun (57% sales and 73% EBIT growth) and Dr Reddy's (beginning of a modest turnaround operationally)

2Q FY2009 estimates for our coverage stocks

India Pharmaceuticals					Estimates for the 2Q FY2009*							
Company	Expected reporting date	Ticker	Rating	Target price (Rs/Share)	Sales		EBIT		Net Income		EPS	
					Rs. Mn	yoy (%)	Rs. Mn	yoy (%)	Rs. Mn	yoy (%)	Rs/Share	yoy (%)
Biocon	16-Oct-08	BION.BO	Neutral	181	2,898	4%	568	1%	492	-9%	2.54	-6%
Cadila	22-Oct-08	CADI.BO	Sell	270	6,481	9%	987	-17%	704	-23%	5.60	-23%
Cipla	3rd/4th wk - Oct	CIPL.BO	Sell	158	11,359	3%	1,852	-3%	1,823	-4%	2.35	-4%
Dr Reddys	22-Oct-08	REDY.BO	Buy	805	14,653	16%	1,867	77%	1,494	-44%	8.90	-44%
Glenmark	4th wk Oct	GLEN.BO	Buy	755	5,629	50%	1,681	65%	1,319	76%	5.30	68%
Lupin	~ Mid-Oct	LUPN.BO	Neutral	726	8,356	17%	1,474	-7%	1,196	1%	14.89	2%
Piramal	22-Oct-08	PIRA.BO	Buy	381	8,094	6%	1,251	17%	1,021	20%	4.89	19%
Ranbaxy*	3rd wk - Oct	RANB.BO	Sell	330	19,354	18%	2,450	10%	1,483	-29%	3.98	-29%
Sun	3rd/4th wk - Oct	SUN.BO	Neutral	1,243	10,485	57%	4,150	73%	4,231	94%	20.43	93%
Wockhardt*	21-Oct-08	WCKH.BO	Neutral	207	8,182	11%	1,697	5%	1,158	7%	10.58	7%
Average for the sector						17%		23%		5%		4%
Average (ex Dr Reddys)						18%		19%		17%		17%

*Q3 FY2008 for Ranbaxy and Wockhardt; ** - FY2008 for Ranbaxy and Wockhardt

India Hospitals					Estimates for the 2Q FY2009							
Apollo	30-Oct-08	APLH.BO	Sell	458	3,286	49%	353	21%	195	10%	3.33	-6%
Fortis	3rd wk - Oct	FOHE.BO	Neutral	93	1,584	31%	40	-	5	-	0.02	-

DCF-based 12-month target prices. Risks to our investment view: (1) adverse amendments to the domestic drug pricing policy, (2) sector's export revenues exposed to translational effects of currency movements.

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Source: Company data, Datastream, Goldman Sachs Research estimates.

Lowering target price for Biocon to Rs181; retain Neutral

We are revising our medium-term growth estimates on the back of our revised expectations for Biocon, especially in the Biopharma business (Biopharma sales growth of 10% in FY2008). Our 12-month DCF-based target price thus stands revised by 10% from Rs202 per share to Rs181 per share. The keys risks to this price target are accelerated growth in the Biopharma business and progress in the development of its Oral Insulin molecule. We retain our Neutral rating for the stock.

Reg AC

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