

Lupin

STOCK INFO.	BLOOMBERG
BSE Sensex: 10,617	LPC IN
	REUTERS CODE
S&P CNX: 3,110	LUPN.BO

26 July 2006

Buy
Rs851
Previous Recommendation: Buy

Equity Shares (m)	40.1
52-Week Range	1,275/678
1,6,12 Rel. Perf. (%)	-14/-2/-19
M.Cap. (Rs b)	34.2
M.Cap. (US\$ b)	0.7

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END*	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
03/06A	16,858	1,722	42.9	87.5	19.8	5.5	31.0	20.6	2.3	17.3
03/07E	20,021	2,526	57.3	33.6	14.9	4.2	35.1	22.8	1.9	11.3
03/08E	22,435	3,108	70.5	23.0	12.1	3.2	33.3	25.5	1.6	9.1

**Consolidated*

Lupin's 1QFY07 results (stand-alone) were below our estimates as EBITDA was impacted by one-time provisions of Rs107m. Adjusted for this one-time impact, performance was in-line with estimates. Key highlights include:

- Net sales grew by 32% YoY to Rs4.8b primarily driven by regulated market formulation sales grew by 88% YoY (to Rs527m) on account of Ceftriaxone sales and 29% YoY growth in domestic market formulation business (to Rs2.1b).
- EBITDA margins declined by 600bp YoY to 13.6%, due to one-time provision of Rs107m, higher RM cost (up by 310bp) and higher R&D Exp (incl Rs82m litigation exp - up by 150bp), translating into 8% decline in EBITDA to Rs651m.
- However, higher other income (at Rs182m v/s Rs39m in 1QFY06) and lower tax provisioning (at 20.5% of PBT v/s 27% in 1QFY06) boosted net profit growth to 17% to Rs507m.
- On consolidated basis, the company reported the net sales of Rs5b, with EBITDA margins of 12.9%, culminating into PAT of Rs536m.

Lupin is currently valued at 14.9x and 12.1x FY07E and FY08E fully diluted consolidated EPS excluding upsides from potential acquisitions and NCE out-licensing. Lupin is likely to witness a gradual improvement in the underlying fundamentals (led by an expanding US generics pipeline, pick up in Suprax prescription share and bottoming out of Pen-G business). Maintain **Buy**.

QUARTERLY PERFORMANCE (STANDALONE)

(Rs Million)

Y/E MARCH	FY 06				FY 07				FY 06	FY 07E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
Net Sales	3,612	4,051	4,269	4,220	4,769	4,773	4,972	5,386	16,625	19,901
YoY Change (%)	24.4	34.1	52.7	45.9	32.0	17.8	16.5	27.6	43.2	19.7
Total Expenditure	2,903	3,378	3,693	3,804	4,118	3,882	3,995	4,220	13,778	16,563
EBITDA	709	673	576	416	651	892	976	1,167	2,847	3,337
Margins (%)	19.6	16.6	13.5	9.9	13.6	18.7	19.6	21.7	17.1	16.8
Depreciation	91	98	101	114	106	110	111	108	404	434
Interest	65	64	79	95	91	90	88	86	303	355
Other Income	39	89	96	410	182	135	165	180	161	662
PBT	591	601	492	618	637	827	942	1,152	2,302	3,209
Tax	160	149	51	116	130	165	188	158	475	642
Rate (%)	27.0	24.8	10.3	18.7	20.5	20.0	20.0	13.7	20.6	20.0
Profit after Tax	432	452	442	502	507	661	754	994	1,827	2,568
YoY Change (%)	109.1	158.4	80.3	131.0	17.4	46.3	70.7	98.1	116.6	40.5
Margins (%)	11.9	11.2	10.3	11.9	10.6	13.9	15.2	18.5	11.0	12.9

E: MOST Estimates

Note: In the interest of timeliness, this report has not been edited.

New product launches in US and domestic API business props up sales

Net sales grew by 32% YoY to Rs4.8b (v/s estimate of Rs4.65b) primarily driven by regulated market formulation sales grew by 88% YoY (to Rs527m) on account of Ceftriaxone sales and 29% YoY growth in domestic market formulation business (to Rs2.1b).

BUSINESS BREAK UP - STANDALONE (RS M)

	1QFY07	1QFY06	YOY (%)	4QFY06	QOQ (%)
India					
APIs	776	443	75.2	836	-7.2
Formulations	2,066	1,601	29.0	1,288	60.4
Total India Sales	2,842	2,044	39.0	2,124	33.8
% of sales	58.9	56.3		49.2	
Regulated markets					
APIs	190	452	-58.0	338	-43.8
Formulations	527	280	88.2	776	-32.1
Total of Reg. market	717	732	-2.0	1,114	-35.6
% of sales	14.9	20.2		25.8	
Un-regulated markets					
APIs	873	723	20.7	769	13.5
Formulations	396	131	202.3	306	29.4
Total of Un-reg.markets	1,269	854	48.6	1,075	18.0
% of sales	26.3	23.5		24.9	
Total Sales	4,828	3,630	33.0	4,313	11.9

Source: Company/Motilal Oswal Securities

In regulated market, formulation sales grew by 88% YoY (to Rs527m) on account of Ceftriaxone, which witnessed steady market share at 25% in the hospital market. In 1QFY07, US subsidiary registered sales of US\$14.4 (incl Suprax sales of US\$2.7m). Suprax sales declined by 20% to \$2.7m due to winter seasonality. Lupin had recorded about \$15m in Suprax sales in FY06 and has guided a positive growth for this product for FY07E. The company has commenced formulation supplies to regulated markets in the EU, although sales were negligible at Rs30m.

API exports to regulated markets declined by 58% due to deferred sales of Ceftriaxone API (to Baxter) in to the next quarter. Management expects API exports to recover in the coming quarters.

In domestic market, formulation business grew by 29% YoY (to Rs2.1b), whereas API business grew by 75% (to Rs776m). In other markets (non-regulated), formulations business grew by 202% (to Rs396m) and API business grew by 21% (to Rs873m).

Ceftriaxone: more competition coming in

Lupin has not disclosed actual Ceftriaxone sales during the quarter, but has indicated that its partner's market share in hospital segment was at around 25%. With competition intensifying with more players (AM Pharm, Teva and Wockhardt) getting approval, we believe prices would have eroded further to the extent of 90-95%. Our estimates factor in for the probable erosion in Ceftriaxone price.

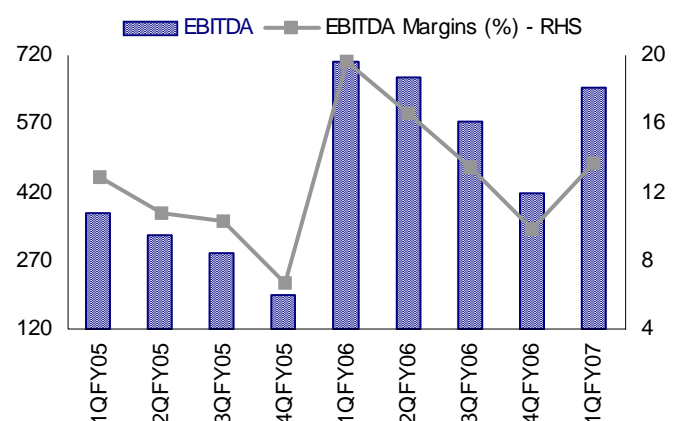
One-time provisions & higher marketing and R&D costs restrict margin expansion

In 1QFY07, EBITDA margins have declined by 600bp YoY to 13.6%, due to the following factors:

- 1) One-time provisioning of Rs77m related to withdrawal of the export benefits under the Target Plus Scheme of the government. This provisioning is related to the export benefits booked by the company for FY06 and hence we believe that it is a one-time provision. The company has also provided for Rs29m for employee benefits.
- 2) Higher RM cost (up by 310bp), higher other expenditure (up by 130bp) and higher R&D Exp (incl Rs82m litigation exp - up by 150bp), translating into 8% decline in EBITDA to Rs651m.

However, higher other income (at Rs182m v/s Rs39m in 1QFY06) and lower tax provisioning (at 20.5% of PBT v/s 27% in 1QFY06) boosted net profit growth to 17% to Rs507m.

TREND IN EBITDA MARGINS



Source: Company/Motilal Oswal Securities

Consolidated results

For the first time company declared quarterly results on consolidated basis. On consolidated basis, during the quarter Lupin reported the net sales of Rs5b, with EBITDA margins of 12.9%, culminating into PAT of Rs536m.

Acquires 51% stake in Dafra, Belgium

Lupin Ltd has signed a MoU to acquire 51% equity in Artifex Finance CVA, Belgium, along with its subsidiaries including Dafra Pharma Ltd (Dafra), a Belgian pharmaceutical company focused on anti-malarial segment. Dafra is a dedicated anti-malarial company that provides a complete basket of Artemisinin based Combination Therapies (ACT's) including a unique pediatric suspension and also holds a patent on a new combination therapy that cures malaria in 24 hours. Dafra has a marketing and distribution network covering over 25 countries in Africa (where malaria is endemic with around 85% of global malaria cases) and works closely with the National Malaria Boards in various countries.

Although, this acquisition would not be contribute to Lupin's profit in the short-term, it gives Lupin entry in malaria market and also gives access the existing Dafra infrastructure and distribution network in Africa. Lupin can expand its existing strong anti-TB linkages with WHO/other multilateral organizations to malaria as well. Also, Lupin can use its WHO pre-qualified plants for malaria drugs as well, there by catering to WHO's requirement for anti-malaria drugs.

Boosting presence in US & Europe through increased filings

Lupin launched 7 generic products during FY06, with most of the launches in Dec-05 and hence the full benefits of these launches will be visible in FY07. The company is selling these products in the US generic markets under its own label. Also, sales in US markets are expected to get a boost from gradual increase in Suprax prescription resulting in sales of about US\$15-16m in FY07 (FY06-US\$14.9m) and improvement in Lisinopril sales during the year. It expects to launch about 6 generic and 1 branded generic

product in the US in FY07. During the year, Lupin filed 18 ANDAs, taking total ANDA filings to 35. During the quarter, the company filed 4 ANDAs, 2 DMFs, 3 EDMFs/COS and 1 MAA (EU).

NCE out-licensing on the cards

Lupin has 4 NCEs under development with two in Phase II (anti-psoriasis-herbal & anti-migraine), one about to commence Phase II (anti-psoriasis-chemical) and one molecule undergoing Phase I (anti-TB). The company has indicated that it intends to out-license at least one of the NCEs over the next 12-18 months which is likely to result in up-front and milestone payments for the company. Our estimates do not include the potential upside from NCEs due to the uncertainties attached to NCE development. However, we believe that a successful out-licensing could be a re-rating trigger for the stock.

Future growth drivers

- **US business:** Lupin is expected to witness continuum momentum in US business based on a) gradual improvement in Suprax prescription translating into sales of US\$15-16m; b) Launch of around 6 generic and 1 branded generic product and c) partial recovery in Lisinopril sales.
- Lupin is developing its specialty products pipeline for regulated markets with focus on sustained release products.
- Increased API supplies to regulated markets coupled with higher sales of anti-TB products (under the WHO program) coupled with incremental contribution from the nascent CRAMS initiatives will also lead to higher top-line growth for the company.
- **Acquisitions:** Lupin is looking at acquisitions in the US branded space to strengthen its brand portfolio. It is also evaluating acquisitions in Europe to gain scale. However, the company is unlikely to bid very aggressively for acquiring generic assets. The company has already raised US\$100m through FCCB, which it intends to utilize for acquisitions.

Guidance

Management has guided an improvement in performance in the next 3 quarters of FY07E led by increased API exports, new ANDA launches in the US and higher Suprax sales. However, it has indicated that PAT growth for FY07E may be impacted due to the increased R&D investments (Rs1.4b for FY07E compared to Rs1.03b for FY06) and higher litigation expenses related to patent challenges in the US. Our estimates take into account these factors.

Valuations – stock is reasonably valued

Lupin is likely to witness a gradual improvement in the underlying fundamentals led by an expanding US generics pipeline, pick up in Suprax prescription share and bottoming out of Pen-G business. While our estimates factors in dilution due to recent US\$100m FCCB issue, it doesn't factor in any upside from potential acquisition for which the company has already raised money. Also, a successful out-licensing could act as a re-rating trigger for the stock.

Valuations of 14.9x FY07E and 12.1x FY08E earnings do not fully reflect the above positives. Maintain **Buy**.

Lupin: an investment profile

Company description

Lupin is one of the second tier Pharma companies that are actively targeting the regulated generics markets. Historically very strong in the anti-TB segment, it has over the years built up expertise in fermentation-based products and segments like cephalosporins, prils and statins. Lupin is now a fully integrated company, with manufacturing capabilities in APIs and formulations and a direct marketing presence in the target markets.

Key investment arguments

- Only player worldwide with an approval for ceftriaxone – expected to be a major growth driver in FY06.
- In the process of building a strong pipeline for the US market through aggressive filings – benefits expected to flow in over the next couple of years.
- Pediatric opportunity (Suprax), statins offer significant potential upsides that are not factored into our estimates.

Key investment risks

- Short-term financial performance would remain under pressure given slow scale up in US business and ramping up of R&D and regulatory filing costs.
- Higher-than-expected competition for *ceftriaxone* would be a negative for growth rates and profitability.
- Commodity like nature of its developing markets business could lead to volatility in earnings.

Recent developments

- Received permission to commence Phase-II clinical trials for its Psoriasis NCE
- Acquired 51% stake in Dafra Pharma, a Belgian based pharma company focused on anti-malarial segment.

Valuation and view

- Multiples of 14.9x FY07E and 12.1x FY08E earnings do not fully reflect the positives.
- Re-iterate Buy with price target of Rs1,130.

Sector view

- Regulated markets would remain the key sales and profit drivers in the medium term. Europe is expected to emerge as the next growth driver, particularly for companies with a direct marketing presence.
- We are overweight on companies that are towards the end of the investment phase, with benefits expected to start coming in from the next fiscal.

COMPARATIVE VALUATIONS

		LUPIN	SUN PHARMA	WOCKHARDT
P/E (x)	FY07E	14.9	25.3	13.8
	FY08E	12.1	20.9	11.1
P/BV (x)	FY07E	4.2	7.9	3.7
	FY08E	3.2	5.9	2.9
EV/Sales (x)	FY07E	1.9	7.6	2.8
	FY08E	1.6	6.1	2.2
EV/EBITDA (x)	FY07E	11.3	24.1	11.8
	FY08E	9.1	18.1	8.9

SHAREHOLDING PATTERN (%)

	MAR.06	DEC.05	MAR.05
Promoters	52.5	52.5	52.5
Domestic Institutions	8.8	8.4	6.0
FII's/FDIs	25.5	25.1	29.7
Others	13.2	14.0	11.8

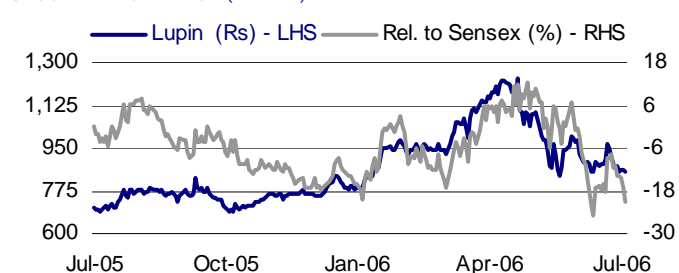
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	57.3	54.8	4.6
FY08	70.5	66.8	5.6

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
851	1,130	32.8	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Net Sales	12,083	12,558	16,858	20,021	22,435
Change (%)	18.7	3.9	34.2	18.8	2.1
Total Expenditure	9,864	11,224	14,623	16,752	18,552
EBITDA	2,219	1,334	2,236	3,269	3,883
Margin (%)	18.4	10.6	13.3	16.3	17.3
Depreciation	295	336	409	445	493
Int. and Finance Charges	526	283	313	362	195
Other Income - Rec.	514	234	741	697	690
PBT before EO item	1,911	950	2,255	3,157	3,885
EO Expense/(Income)	509	0	35	0	0
PBT after EO item	1,402	950	2,221	3,157	3,885
Tax	554	27	521	631	777
Tax Rate (%)	36.9	2.9	23.5	20.0	20.0
Reported PAT	848	922	1,699	2,526	3,108
PAT Adj for EO items	848	922	1,726	2,526	3,108
Change (%)	11.1	8.7	87.1	46.4	23.0
Less: Minority Interest	16	4	4	0	0
Adj Net Profit	832	918	1,722	2,526	3,108

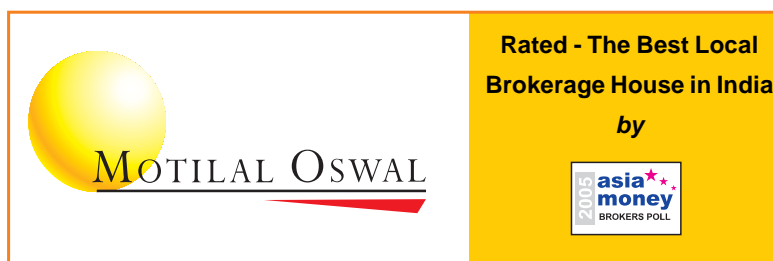
CONSOLIDATED BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Equity Share Capital	401	401	401	401	401
Fully Diluted Equity Capital	401	401	401	441	441
Total Reserves	3,906	4,492	5,831	7,769	10,141
Net Worth	4,308	4,894	6,233	8,170	10,542
Minority Interest	8	12	16	16	16
Deferred liabilities	942	935	939	996	1,065
Total Loans	3,948	4,572	9,249	7,200	6,100
Capital Employed	9,206	10,413	16,437	16,382	17,723
Gross Block	6,600	7,347	8,561	10,000	10,550
Less: Accum. Deprn.	1,390	1,718	2,096	2,541	3,034
Net Fixed Assets	5,211	5,629	6,466	7,459	7,516
Capital WIP	172	698	252	200	200
Investments	26	26	28	28	28
Curr. Assets	6,891	7,189	13,674	13,396	15,328
Inventory	2,310	2,615	3,429	3,566	3,996
Account Receivables	2,276	2,550	3,112	3,620	4,056
Cash and Bank Balance	302	271	4,774	4,286	5,119
Others	2,004	1,754	2,360	1,924	2,156
Curr. Liability & Prov.	3,094	3,130	3,984	4,702	5,349
Account Payables	2,345	2,714	3,147	4,005	4,488
Provisions	750	416	837	697	861
Net Current Assets	3,797	4,059	9,691	8,694	9,979
Appl. of Funds	9,206	10,413	16,437	16,382	17,723

E: MOST Estimates

RATIOS					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Basic (Rs)					
EPS (Fully Diluted)	20.7	22.9	42.9	57.3	70.5
Cash EPS (Fully Diluted)	28.1	31.3	53.1	67.4	81.7
BV/Share	107.1	121.7	155.0	203.3	262.4
DPS	6.5	6.5	6.5	13.0	16.2
Payout (%)	34.7	32.3	17.5	23.3	23.7
Valuation (x)					
P/E (Fully Diluted)		37.2	19.8	14.9	12.1
Cash P/E (Fully Diluted)		27.2	16.0	12.6	10.4
P/BV		7.0	5.5	4.2	3.2
EV/Sales		3.1	2.3	1.9	1.6
EV/EBITDA		28.8	17.3	11.3	9.1
Dividend Yield (%)		0.8	0.8	1.5	1.9
Return Ratios (%)					
RoE	20.7	20.0	31.0	35.1	33.3
RoCE	26.1	13.9	20.6	22.8	25.5
Working Capital Ratios					
Asset Turnover (x)	1.3	1.2	1.0	1.2	1.3
Debtor (Days)	66	71	65	64	64
Inventory (Days)	70	76	74	65	65
Wkg. Capital Turnover (Days)	15	18	210	159	162
Leverage Ratio					
Debt/Equity (x)	0.9	0.9	1.5	0.9	0.6

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Oper. Profit/(Loss) before Tax	2,219	1,334	2,236	3,269	3,883
Interest/Dividends Recd.	514	234	741	697	690
Direct Taxes Paid	-508	-35	-517	-575	-708
(Inc)/Dec in WC	2,599	-293	-1,128	509	-451
EO expense	509	0	35	0	0
CF from Op. incl EO Exp.	4,314	1,241	1,297	3,899	3,414
(inc)/dec in FA	-674	-1,281	-800	-1,387	-550
(Pur)/Sale of Investments	10	0	-2	0	-6
CF from Investments	-663	-1,281	-801	-1,387	-556
Issue of Shares	6	-34	-59	0	6
(Inc)/Dec in Debt	-2,729	624	4,677	-2,049	-1,100
Interest Paid	-526	-283	-313	-362	-195
Dividend Paid	-294	-298	-298	-588	-736
CF from Fin. Activity	-3,543	9	4,008	-3,000	-2,025
Inc/Dec of Cash	108	-31	4,504	-488	833
Add: Beginning Balance	193	302	271	4,774	4,286
Closing Balance	302	271	4,774	4,286	5,119

N O T E S



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Disclosure of Interest Statement

	Lupin
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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