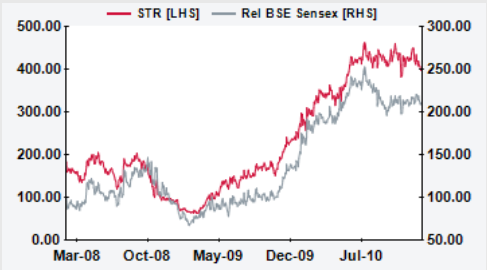
INDIA

STR IN		Outperform
Price 17 Feb 11		Rs379.00
12-month target	**Rs**	**485.00**
Upside/Downside	**%**	**28.0**
Valuation - DCF	**Rs**	**492.00**
GICS sector		**Pharmaceuticals, Biotechnology & Life Sciences**
Market cap	**Rsm**	**25,128**
30-day avg turnover	**US$m**	**2.0**
Market cap	**US$m**	**552**
Number shares on issue	**m**	**66.30**

Investment fundamentals

Year end 31 Dec		2009A	2010E	2011E	2012E
Revenue	m	13,283	18,019	22,936	27,532
EBIT	m	1,613	3,404	3,899	4,935
EBIT growth	%	80.9	111.0	14.5	26.6
Recurring profit	m	854	2,072	2,768	3,769
Reported profit	m	1,097	1,550	1,990	2,710
Adjusted profit	m	521	1,550	1,990	2,710
EPS rep	Rs	19.92	23.40	30.03	40.91
EPS rep growth	%	-20.2	17.5	28.4	36.2
EPS adj	Rs	9.47	23.40	30.03	40.91
EPS adj growth	%	nmf	147.1	28.4	36.2
PER rep	x	19.0	16.2	12.6	9.3
PER adj	x	40.0	16.2	12.6	9.3
Total DPS	Rs	0.00	0.00	0.00	0.00
Total div yield	%	0.0	0.0	0.0	0.0
ROA	%	5.8	8.9	8.2	9.2
ROE	%	8.4	13.6	12.9	15.3
EV/EBITDA	x	14.4	9.1	7.7	6.2
Net debt/equity	%	125.3	91.6	75.7	58.1
P/BV	x	1.8	1.5	1.3	1.1

STR IN rel BSE Sensex performance



Source: FactSet, Macquarie Research, February 2011

(all figures in INR unless noted)

Abhishek Singhal
+91 22 6653 3052 abhishek.singhal@macquarie.com
Amit Sinha
+91 22 6653 3059 amit.sinha@macquarie.com

18 February 2011

Strides Arcolab

Specialist: Sterile injectable play

Event

- We initiate coverage on Strides (STR IN) with an Outperform rating and a target price of Rs485, implying upside potential of 28%. We like STR for its strength in sterile injectable manufacturing. STR has increased its injectable capacity by around 5x and is now poised for growth, in our view.
- Limited FDA-approved capacities, longer timelines to set up facilities, changes in regulation (auto-handling is now mandatory in the EU) and manufacturing complexities make injectables a limited competition opportunity. We estimate the injectable franchise to contribute ~50% and 70% of sales and EBITDA, respectively, by CY12 (up from 27% and 40% in CY09). This transition into a sterile injectable play will lead to further multiple re-rating, in our view.

Impact

- **Partnering big Pharma:** STR has two major licensing deals with Pfizer and GSK, which we view as a testament to the high quality of its sterile assets. PFE plans to commercialize 67 off-patent products (to be licensed/supplied by STR), primarily injectables, in the regulated market. GSK will source products for emerging markets. Contracts are structured using a pick-or-pay mechanism, guaranteeing minimum revenues to STR and a share in end profits.
- **Niche portfolio:** STR has 140 cumulative filings with the US FDA of which 104 are in the sterile injectable space. The addressable local market value (LMV) of these filed specialty products in the US is US$6.3bn. The LMV of products filed or under development that have already been licensed to global partners is currently US$12bn, providing a significant opportunity for growth. Global injectable market is worth an estimated US$200b (up ~10% YoY).
- **Operating leverage:** Capacity utilization is ~30%, primarily because newer facilities are awaiting regulatory approvals. Of the current 428m sterile dose unit capacity, just 167m is FDA approved. FDA approval for the new-facility (expected 1H CY11) and ramp-up of products launched under the big pharma deals should help increase utilization thereby rationalizing fixed costs. A significant capex cycle (Rs8bn from CY06–09) is now behind STR, and recent QIP of US$100m has helped to significantly reduce its debt/equity.

Earnings and target price revision

- Initiating coverage.

Price catalyst

- 12-month price target: Rs485.00 based on a EV/EBITDA methodology.
- Catalyst: FDA approval for the new manufacturing facility, likely in 1H CY11.

Action and recommendation

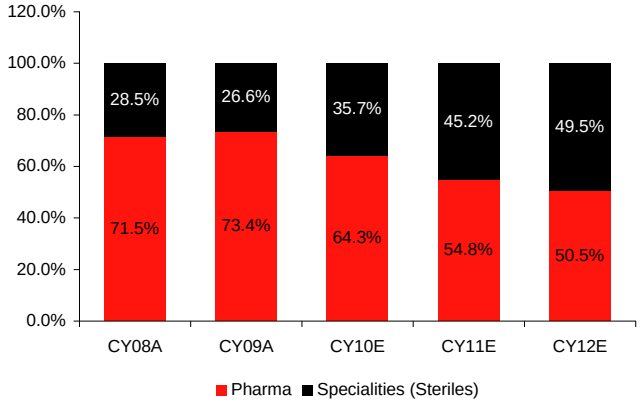
- Valuations are attractive, in our view, with STR trading at a PER of 12.6x CY11E earnings and at an EV/EBITDA of 7.7x CY11E, significant discounts to its peers.
- Risks to our thesis are a lack of financial discipline, a delay in FDA approval for facilities and significant goodwill of Rs10bn (vs net worth of Rs14bn).

Company description

STR is among the largest manufacturers globally of sterile injectables, particularly for use in the area of oncology. Over the last 3-4 years, it has increased its injectable capacity by ~5x, as it has reorganised itself with an enhanced focus on sterile injectables. STR has 14 manufacturing sites in Asia, Europe, Latin America and Africa and has a marketing presence in 60 unregulated and semi-regulated markets. Currently, STR has 1,500+ employees, including 350+ research staff. Also, STR is a manufacturer and exporter of finished pharmaceutical dosage forms, both branded and generic, and it is one of the significant global players in soft gelatine capsules.

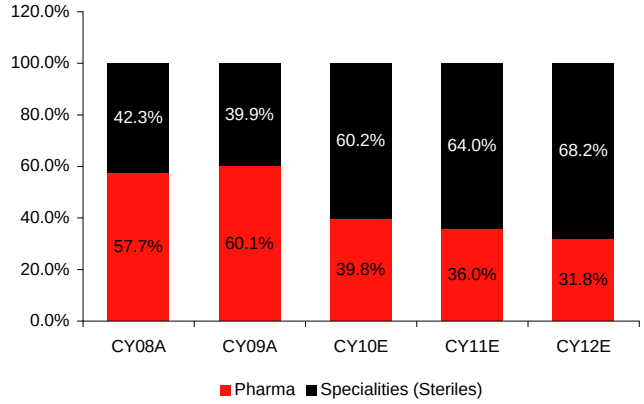
Business evolution: sterile injectables focus

Fig 1 Revenue breakdown: Specialties to contribute~50% of revenue by CY12E



Source: Company data, Macquarie Research, February 2011

Fig 2 EBITDA breakdown: Specialties to contribute ~ 70% of EBITDA by CY12E



Source: Company data, Macquarie Research, February 2011

Fig 3 Specialties could continue to be a high margin business in the medium term

Specialties
High barriers to entry because of long gestation period and complex manufacturing system
Accounts for majority of the drug shortages in the US
Sector undergoing consolidation across the globe due to scarcity of assets
High margin business

Pharma
Focus on select areas in oral solid pharmaceuticals where Strides can achieve a competitive position
Leveraging technical capabilities in softgels
Leveraging brand value in branded generics markets
Broad portfolio servicing needs of Governments / NGOs
Generic formulations to mature markets in Europe, US etc.

Source: Company data, Macquarie Research, February 2011

Fig 4 Management Details

Mr. Arun Kumar	Founder & Promoter Director and on the board as Managing Director since inception. He previously worked as the General Manager of British Pharmaceuticals. Currently, promoters group owns 28% of shares in the company.
Mr. Venkat Iyer	Joined the board as the Executive Director. Joined Strides in 1999 and was CEO – India Operations before induction to board. Has over 28 years of experience in the Indian pharmaceutical industry
Mr. Ravi Seth	CEO International Operations
Mr. Manish Gupta	CEO- Pharma
Mr. T.S. Rangan	Group CFO

Source: Company data, Macquarie Research, February 2011

Attractively valued – injectables franchise key valuation driver

STR is trading at 7.7x CY11E EV/EBITDA and a 12.6x CY11E PER, substantial discounts to its international injectable peers. With strong business fundamentals, a robust earnings profile and an improving balance sheet, STR's valuation discount to the peer average should narrow, we believe.

In our view, the strong injectables franchise is the key valuation driver for the stock. STR has among the largest sterile capacities in low-cost locations (India, Brazil and Poland), with multiple ANDA filings. STR has tied up the front-end with large international players and JV partners, thus providing comfort about its ability to take market share.

Given the high leverage, we value STR based on an EV/EBITDA methodology, and we assign different multiples to the two existing segments. Given the company's opportunities and the high barriers to entry in the speciality segment, we assign a higher EV/EBITDA multiple to the speciality segment than to the pharma segment. We assign a 10.0x EV/EBITDA to the speciality segment and a 7.0x EV/EBITDA to the pharma segment to arrive at our target price of Rs485.

Fig 5 Target price calculation : Assigning higher multiple to the specialty segment

Segment (Rs m)	CY11E EBITDA	EV/EBITDA	EV	Comment
Pharma	1,727	7.0x	12,092	
Specialty (Agila)	3,072	10.0x	30,720	
Target EV (Rs m)			42,811	
Net debt/cash (Rs m)	(15,709)			
Minority Interest / Other operating Liability (Rs m)	(2,755)			
Associates / investments (Rs m)	3,414			
Implied Equity Value			27,761	
Shares Outstanding (assuming FCCB is debt) million	57			
Target Price (Rs/share)			485	

Source: Company data, Macquarie Research, February 2011

STR trading at a discount to its global sterile peers: The average EV/EBITDA for the injectable companies in Figure 6 is 12x CY11E, and the average EV/Sales is 2.7x CY11E. Strides is currently trading at an EV/EBITDA of 7.7x CY11E and an EV/Sales of 1.6x CY11E, large discount to its peers.

Fig 6 STR trading at significant discount to its global peers

	Mkt.Cap	PER			EV/EBITDA			EV/Sales		
Companies	**(US$ m)**	**CY10**	**CY11**	**CY12**	**CY10**	**CY11**	**CY12**	**CY10**	**CY11**	**CY12**
Strides	**547**	**16.1**	**12.5**	**9.2**	**8.8**	**7.7**	**5.9**	**2.0**	**1.6**	**1.3**
Hospira	9,157	14.0	12.2	10.7	9.0	8.0	7.4	2.5	2.3	2.1
Hikma	2,616	25.3	21.6	18.2	15.4	13.2	11.3	3.8	3.1	2.5
Akorn	499	45.0	29.6	16.1	20.1	16.1	na	3.0	2.6	na

Source: Bloomberg, Company data, Macquarie Research, February 2011

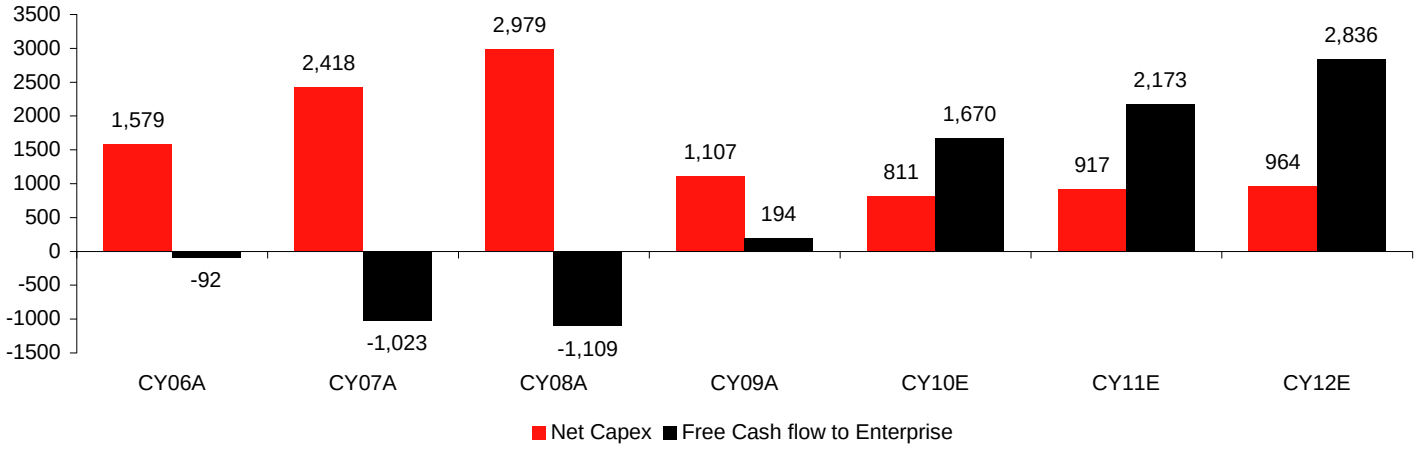
Fig 7 Premium transaction valuation for injectable companies

Acquirer	Target	Announcement Date	Deal Size (US$ m)	Trailing EV/EBITDA	Trailing EV/Sales
Fresenius	Dabur Pharma	Apr-08	200	43.6	4.8
Novartis	Ebewe	May-09	1240	17.1	4.5
Hospira	Orchid Pharma	Dec-09	400	53.8	4.3
Hopira	Mayne Pharma	Sep-06	2000	15.7	3.3

Source: Company data, Macquarie Research, February 2011

What went wrong? Given the large debt position of STR, concerns surfaced during the credit crisis about its ability to repay its debt obligation, and this resulted in a substantial de-rating by the market. Return ratios worsened due to weakness in the flagship pharma business and due to aggressive capex during CY07–09. The HIV portfolio in Africa (part of the pharma business) worsened due to pricing pressure in the tender business during 2007. STR invested aggressively in capex (Rs8bn during CY06–09) given that upfront investment was required to build up a high-quality manufacturing facility for complex sterile products. High debt levels to fund the capex resulted in high interest costs, which, in turn, affected profitability during CY07–09. Also, working capital issues during the credit crisis (2008/09) deteriorated and had an impact on the ratios.

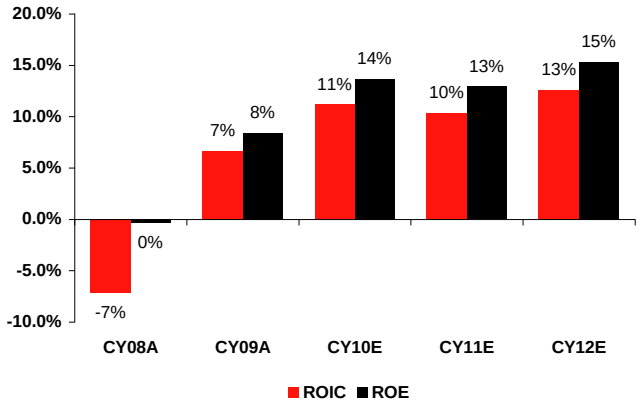
Fig 8 Large capex cycle behind STR



Source: Company data, Macquarie Research, February 2011

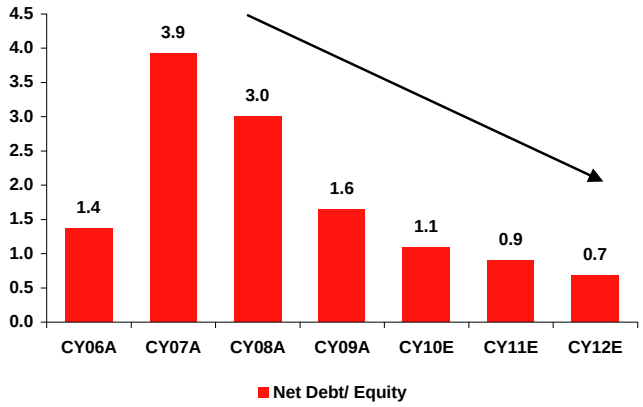
On the road to recovery: With the capex cycle now behind the company, we estimate CY11–12 capex of Rs1.9bn, significantly less than the Rs8bn during CY06–09. Licensing Income, recent equity placement of US$100m through QIP and free cash-flow generation have given STR leeway to address leverage further. We estimate FCFE of ~US$70m during CY10-12 compared to negative FCFE (~US$100m) during CY06-09. Reduced capex plays a significant role in free cash-flow generation. We expect ROE to improve to ~15% by CY12 from 8% in CY09.

Fig 9 Improving return ratios



Source: Company data, Macquarie Research, February 2011

Fig 10 Licensing income and QIP helped deleverage

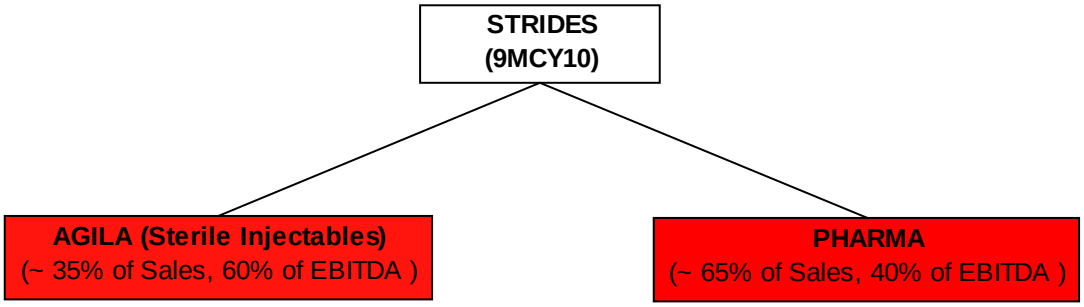


Source: Company data, Macquarie Research, February 2011

Specialist – Sterile injectable play

We like STR for its strength in sterile injectable manufacturing (particularly in its oncology portfolio). Having increased its injectable capacity by around 5x, STR is poised for growth, we believe.

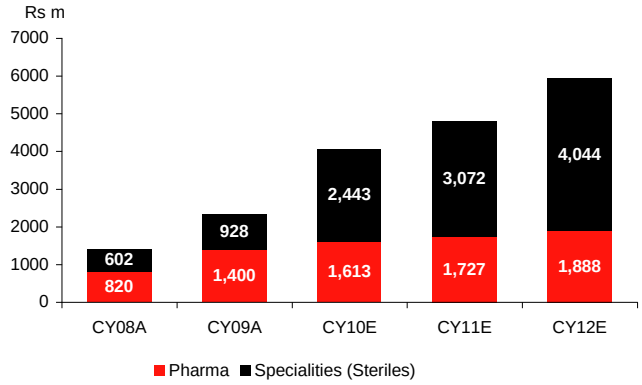
Fig 11 Agila (sterile injectables segment) contributes 60% of EBITDA margin



Source: Company data, Macquarie Research, February 2011

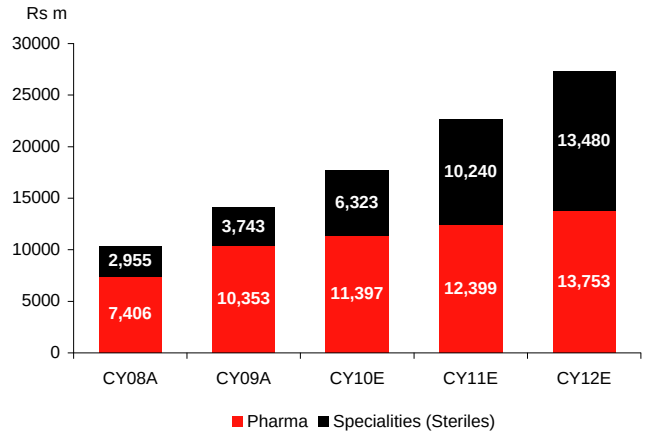
Injectables is a specialized and niche area within the pharmaceuticals industry due to the high complexity involved in formulating a large and complex product portfolio across various therapies based on multiple technology platforms and delivery mechanisms. While the regulatory framework for bio-generics is still complex, we believe that injectable manufacturing and a commercial skill-set will become increasingly important as the bio-generic market takes shape in the regulated markets.

Fig 12 ~70% of EBITDA from sterile by CY12E



Source: Company data, Macquarie Research, February 2011

Fig 13 ~50% of sales from sterile by CY12E

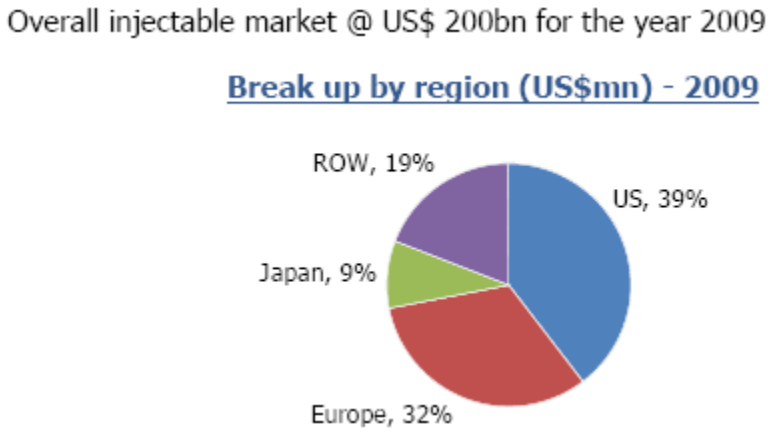


Source: Company data, Macquarie Research, February 2011

Limited FDA-approved capacities, capital intensive facilities with long timelines to set up, changes in regulation (auto-handling is now mandatory in the EU), and manufacturing complexities make injectables a limited pricing pressure opportunity. The customer segment is almost exclusively hospitals, with a distinct decision-making process and criteria. Hard-to-penetrate GPO's (Group Purchasing Organizations) play a critical role (GPO's dominate ~75% of hospital purchases).

Overall, the injectable market globally is worth an estimated US$200bn and is growing at ~11% per year, with the generic injectable opportunity (ex-biotech) at ~US$20bn. The US is the largest market for generic and non-biological injectables, accounting for about 50% of the global market, whereas emerging markets account for 20% of the global generics injectables market.

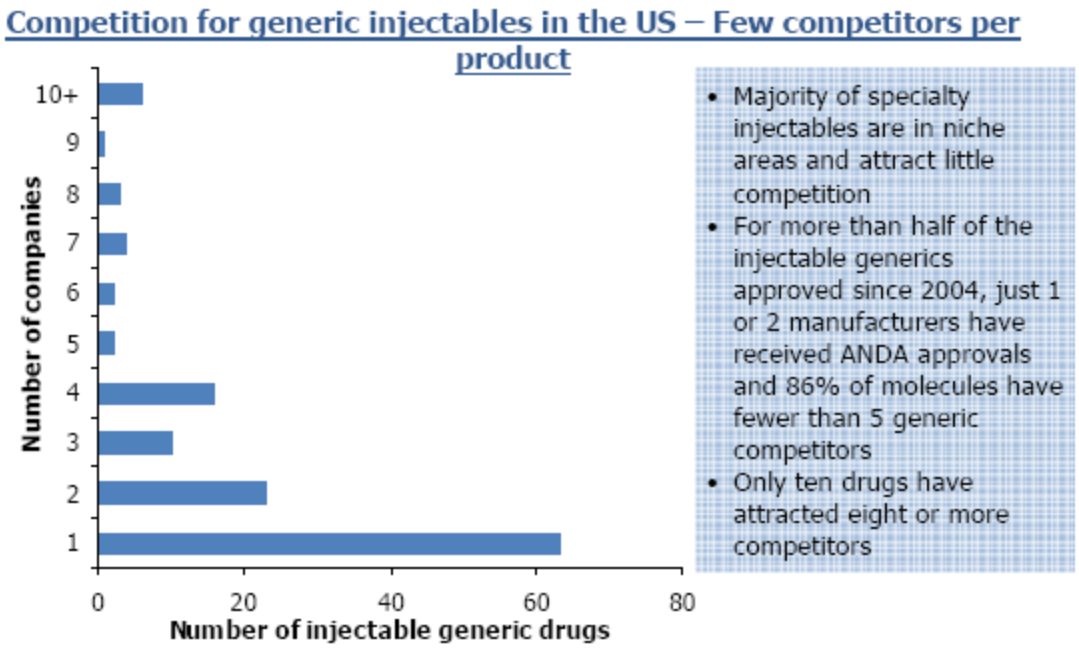
Fig 14 Overall Injectable market



Source: Company presentation, February 2011

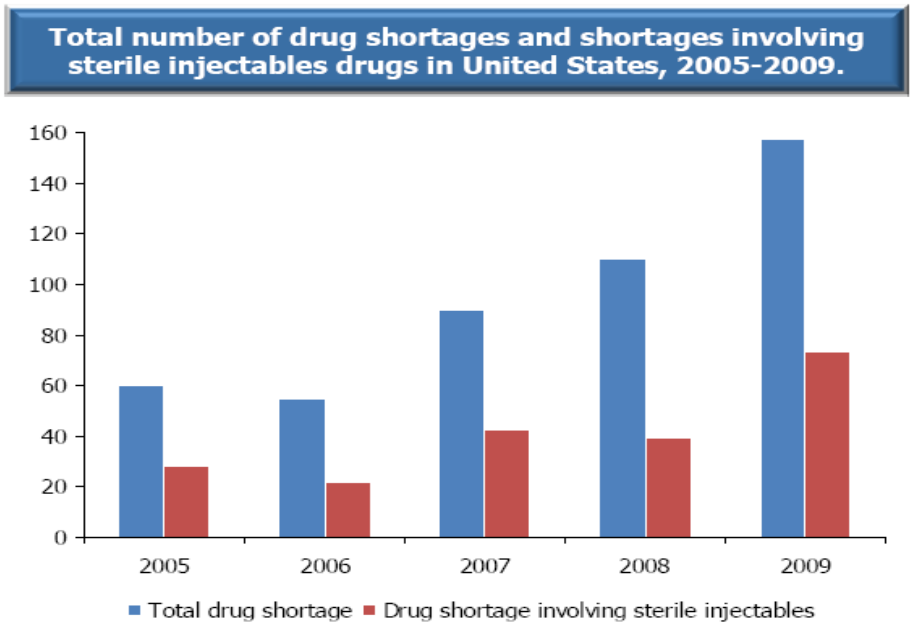
Historically, there have been limited USFDA approved capacities for injectable manufacturing – in particular, for lyophilized products. Given most biotech products are in lyophilized format, there has been a reliance on contract manufacturing by global pharma and biotech companies, further accentuating the capacity constraint for the generic injectable products.

Fig 15 Few competitors for sterile injectables in US



Source: Company presentation, February 2011

Fig 16 Approximately 40% of drugs under shortage in US in past five yrs were sterile

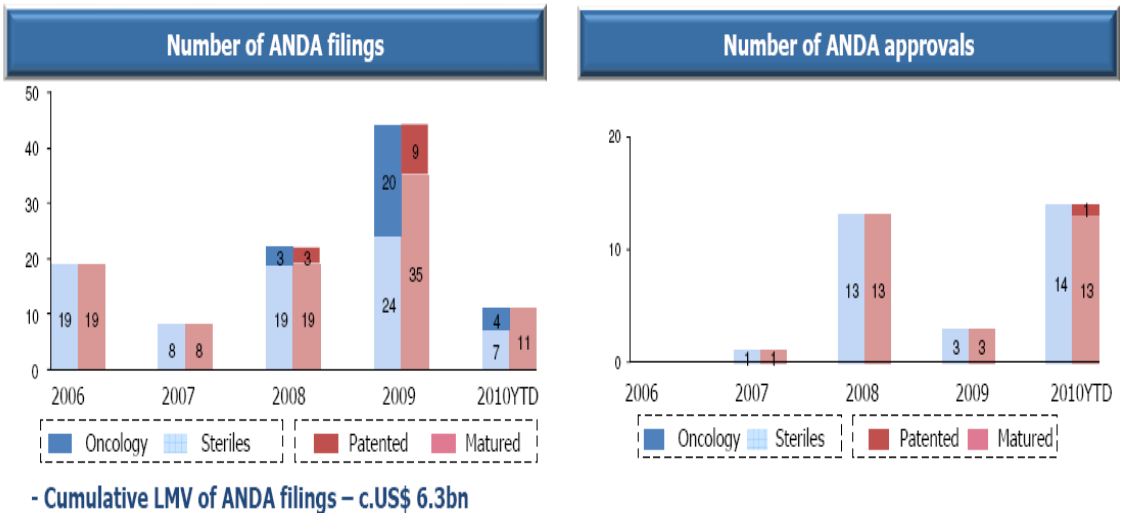


Source: Company presentation, February 2011

US sterile injectables pipeline and approvals – Striding ahead

STR has 140 cumulative filings with the US FDA of which 104 are in the sterile injectable space. The addressable local market value (LMV) of these filed specialty products in the US is US$6.3bn.

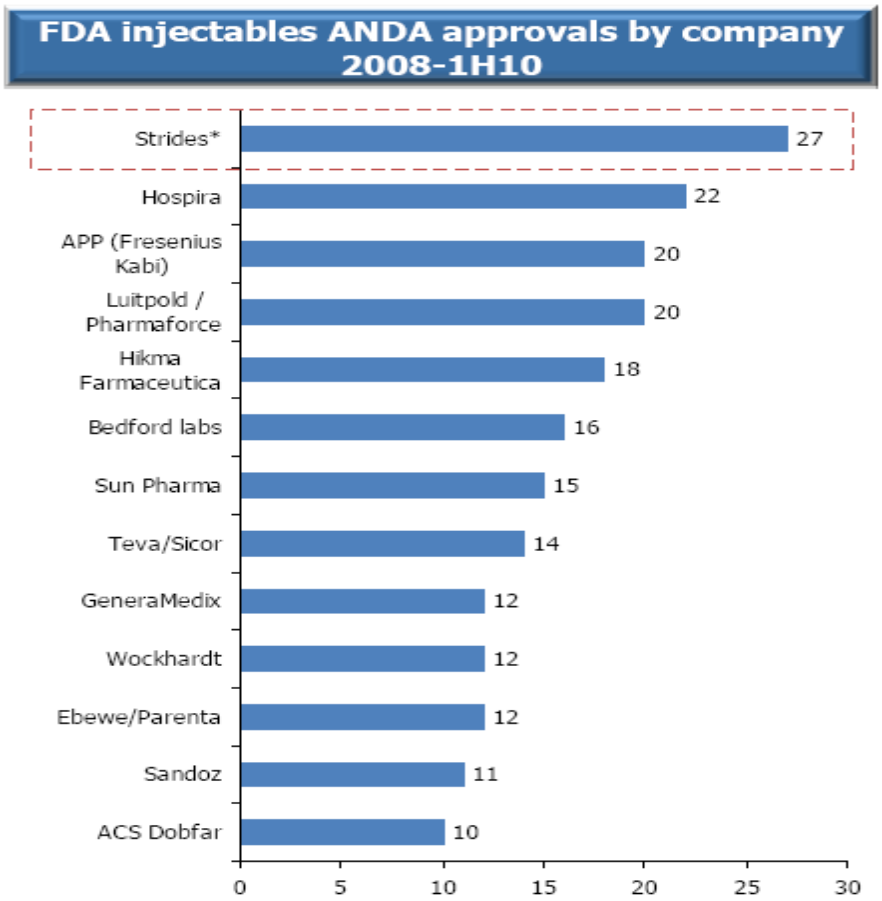
Fig 17 One of the largest sterile ANDA pipelines in the US



Source: Company presentation, February 2011

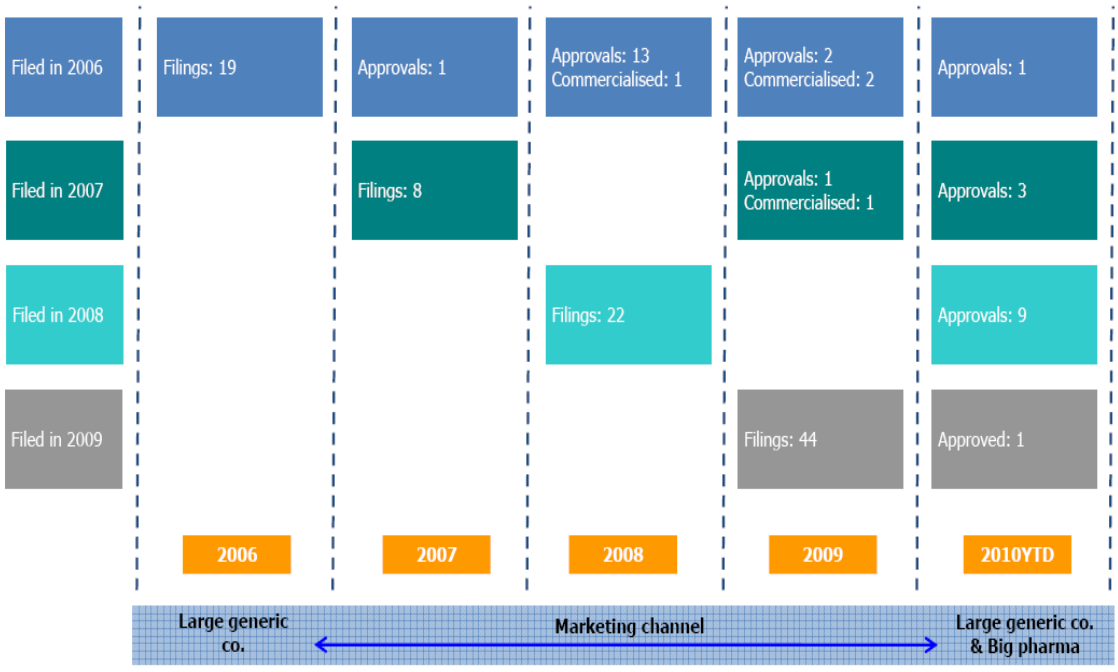
To-date, STR has received approvals from the US FDA for 31 sterile products, of which just four have been commercialized (27 approvals yet to launch) due to capacity constraints. With STR getting the maximum approvals for injectable ANDAs over the last three years in the US (v/s any peer), there is some comfort that the focus on sterile filings will now start paying rich dividends once the FDA approves the new capacity (likely 1H CY11).

Fig 18 Highest FDA approvals for sterile injectable products by the US FDA (2008-1H10)



Source: Company presentation, February 2011

Fig 19 Long gestation period offers high entry barriers – STR niche portfolio

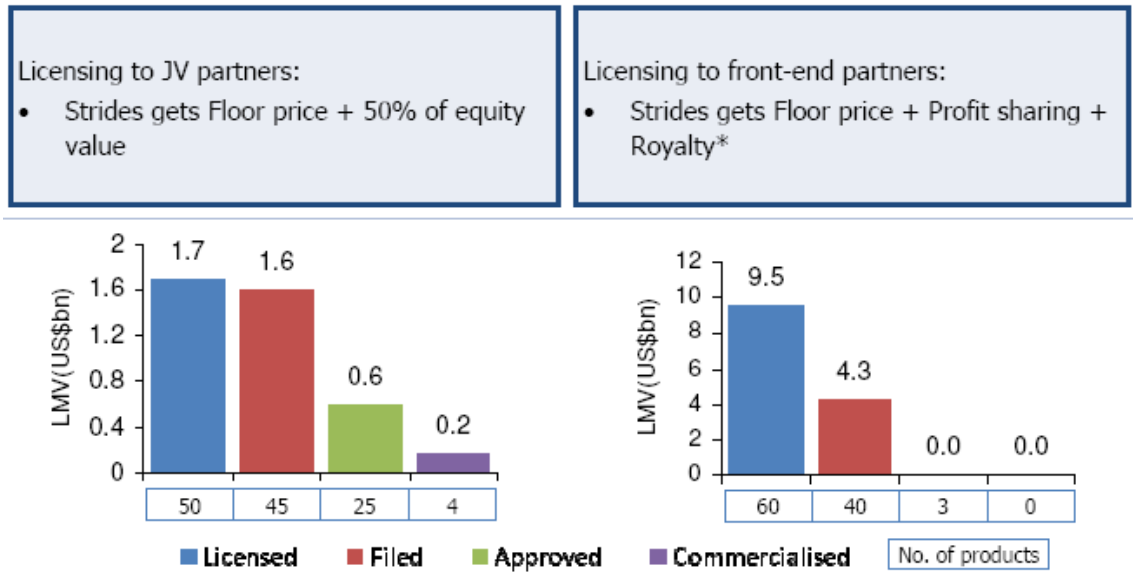


Source: Company presentation, February 2011

Tying up the front end – If you can't beat them, join them

The LMV of products filed or under development that have already been licensed to global partners is currently ~US$12bn, providing a significant opportunity for growth. Historically, Strides has had two JV partners (Sagent and Akorn) for commercialization of sterile products. Strides used to get a floor price and, on top of that, 50% of equity value. However, in the last two years, STR has signed two major licensing arrangements with big pharma firms (Pfizer and Glaxo Smithkline).

Fig 20 Evolving business model for the front end



Source: Company presentation, February 2011

Contracts with big pharma companies are structured using a pick-or-pay mechanism, guaranteeing that STR receives a minimum level of revenues and a share in end profits. In addition to providing credibility to the business model, these deals with big pharma companies also provide significant upfront licensing income. This, to us, reflects Strides's ability to negotiate deals from a position of strength, given its niche product portfolio and the difficulty of building manufacturing assets.

Pfizer (Not rated) deal: PFE plans to commercialize 45 off-patent products (to be licensed/supplied by Strides), primarily injectable oncology medications and a few niche sterile injectable products, in the United States, the European Union, Australia, Japan, Korea and Canada. PFE looked at more than 100 companies before settling on the deal with STR, thus providing further credibility to Strides's niche portfolio and manufacturing assets. The first product under the deal (product not disclosed yet) was supplied beginning in 4Q CY10. The 40 oncology drugs out-licensed to Pfizer for the US market covers >50% of the US$9bn oncology injectables that are likely to go off-patent by 2015. While Strides has not shared the financial details, we believe that PFE paid significant upfront licensing income, given the substantial licensing income booked by Strides in CY10.

Also, Akorn-Strides LLC (a JV between Akorn, Inc. and Strides) recently entered into an agreement with PFE to sell 16 approved ANDAs and six filed ANDAs. STR got US$28m in cash as its share of the consideration, in addition to entering into a supply agreement with Pfizer for the manufacture and supply of these products. Including this, PFE will distribute a portfolio of 67 sterile products for Strides. Given the marketing strength of PFE (strong relationships with the GPOs), we believe this should result in a substantial market share gain for Strides.

GSK deal: GlaxoSmithKline (GSK LN, £11.75, Neutral, TP: £13.90, covered by Carri Duncan) plans to source 10 oncology products for emerging markets (95 countries) from Strides, with an option to expand the relationship further. Strides will be responsible for the manufacturing of the products, while GSK will be responsible for distribution and commercialization**.** GSK shares profits and pays licensing fees for these products.

Recent strategic deals – to help consolidate sterile space dominance

Buyback of Aspen's stake in the Onco JV

Strides bought back Aspen's 50% stake in two oncology joint ventures (Onco Therapies Ltd (OTL), India, and Onco Laboratories Ltd (OLL), Cyprus) for a consideration of US$117m to be paid before 30 April 2011. In 2007, Aspen had paid US$42m to Strides to acquire the 50% stake in the entire oncology business (OTL and OLL), including the manufacturing plant and IP.

The rationale to buy back the Onco JV stake is to boost Strides's focus and ownership of the key oncology domain in the specialties space. Along with the deal, STR agreed to license existing and future oncology products to Aspen for territories where Aspen has substantial commercialization strength. While the near-term cash outflow affects STR's stretched balance sheet, we believe this is an excellent long-term strategy given the growth potential of the global oncology business.

Acquisition of Penems and Penicillin manufacturing facility, Campos

Strides also bought back from Aspen the facility in Campos, Brazil (manufactures Penems and Penicillins) with related products and IP's for a total consideration of US$75m (after adjusting for US$10m working capital and its 49% equity stake in the LATAM holding company, Pharmalatina). The facility was originally divested to Aspen in 2007, when STR exited from LATAM operations. Annual sales from the facility are currently around US$40m.

With this plant, STR gets access to Penems and Penicillins, and because of the entry barriers, STR should face limited competition going forward, we believe. These thus constitute a key sterile domain for Strides to provide a complete portfolio of sterile products. We anticipate carbapenem to be a limited competition opportunity (a US$1.8bn current market size, including brands and generics) with attractive margins, given that not many filings are currently pending approval. Other major Indian players with carbapenem filings include Ranbaxy, Aurobindo and Orchid.

Fig 21 Global market size for Penems

Products	Sales in US$ m				API volume in tons			
	US	EU	RoW	Global	US	EU	RoW	Global
Mero-penem	223	413	477	1113	8	19	27	55
Imi-Cila	165	218	217	600	9	16	14	39

Source: IMS Midas (2009), Macquarie Research, February 2011

STR already has the licensing and supply agreements in place with global partners for regulated (US and Europe) and semi-regulated markets (RoW). Also, STR has already filed for Penems in the regulated market (US and EU) and a launch post approval would be a major driver for growth in CY12 and after, in our view. The Campos facility has yet to be approved by the FDA, while all other major regulatory authorities have already provided their approvals.

JV with BioChimico in Brazil for hospital market (Agila to be 52% partner in JV)

STR has signed an agreement with BioChimico of Brazil to set up a JV company for the Brazilian hospital market. As part of the agreement, BioChimico and Agila will transfer selected Brazilian IPs to the JV to market products jointly. The Campos facility of STR and BioChimico's two manufacturing plants will manufacture products using a pre-determined cost model, and the partners will transfer the products to the JV for distribution in the Brazilian hospital market. Given BioChimico is a dedicated hospital player in Brazil with a leadership position in anaesthetics (a domain in which Strides has not operated until now), the JV helps STR to broaden its product portfolio and provides it with economies of scope and scale. The JV complements Strides's existing licensing and supply arrangements with Aspen Pharma to fully tap the Brazilian hospital market opportunity.

Acquisition of controlling stake in Inbiopro (Biogenerics)

Strides acquired a 70% stake in Inbiopro (a Bangalore-based biotechnology-focused company) through a combination of direct subscription and acquisition of shares from existing shareholders, with an investment of US$15m to be paid over a three-year period in the form of growth capital for the development and commercialization of eight products. The current promoters/management team of Inbiopro will continue to lead development.

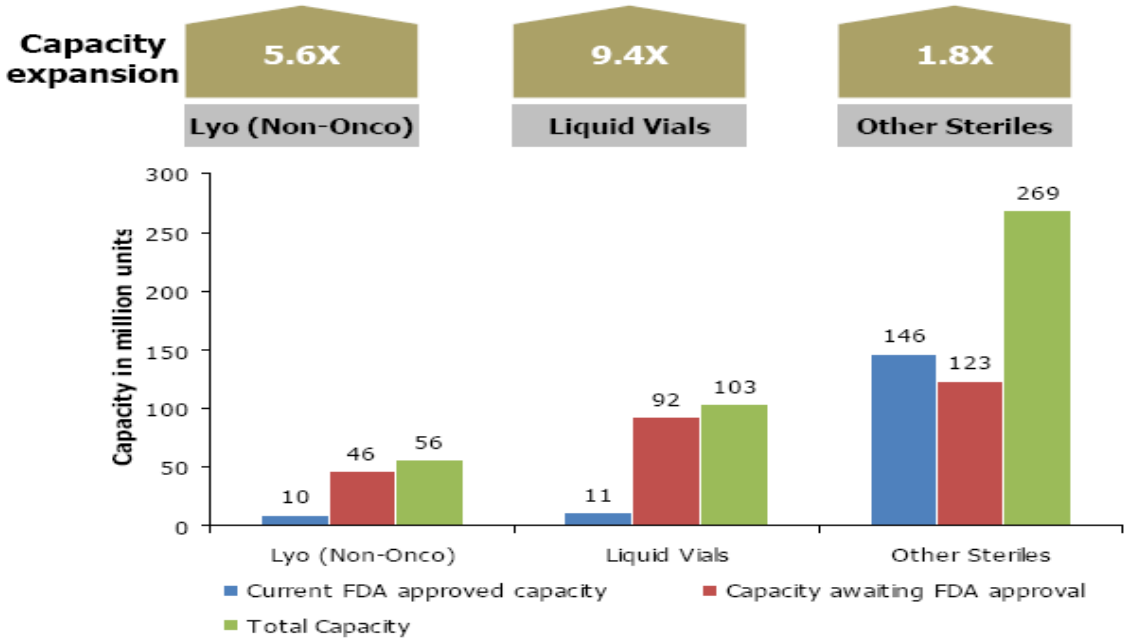
Biologics worth US$59bn will lose patent protection by 2015. The Inbiopro acquisition gives STR a three-year head start in the biogeneric space, which is characterised by specialized expertise in recombinant DNA technology and manufacturing process development with stringent and well-defined regulatory guidelines, resulting in long gestation periods for product development. Inbiopro has expertise in both high-expression mammalian and microbial platform-based development capabilities. STR thus gains immediate access to a pipeline of eight products estimated to have global sales of US$28bn, with commercialization expected to begin in 2013.

We believe the strong injectable manufacturing/regulatory and commercialization capabilities of Strides will be synergistic with Inbiopro's strong development capabilities. Out of the eight products that Strides gets immediate access to, five are monoclonal antibodies for oncology treatment, thus strengthening Strides's oncology products basket. The investment will be made through **Agila** Specialties, and a significant portion of this is to be used for the further development and commercialization of the products. STR could look to monetize this pipeline through its own front-end operations in India, Africa and Australasia. For regulated markets, STR could monetize this pipeline through partnerships with global pharma majors.

Operating leverage at play - FDA approval for the new facility is key

STR has been facing capacity constraints given the lack of FDA approved capacity. Despite roughly 31 approvals, STR has been able to commercialize only four ANDAs. Given the substantial investment in capex to increase the capacity manifold, Strides's speciality sterile business is currently operating at capacity utilization of around ~30%.

Fig 22 USFDA approval for capacity awaiting approval will be key



Source: Company presentation, February 2011

STR has sterile facilities in the low-cost locations of Bangalore, Poland and Brazil. However, only the smallest legacy facility, SPD-I (Bangalore) currently has the requisite FDA approval. SPD-I is currently running to full capacity and, hence, STR has not been able to commercialize many approvals from this facility. While the Cephalosporin facility has been approved by the FDA in Bangalore, STR is still awaiting approvals for products from that facility. Once the other facilities are approved, it could take 30 days for site transfer to the new facility, and STR should then be able to launch. The new facilities with the bulk of the capacity (~70% of the total capacity) are still awaiting USFDA approval. The facilities include SPD II and a dedicated Onco facility in Bangalore, the Penems and Penicillin facility in Campos Brazil, and a sterile plant in Poland.

The capacities for specialty, lyophilisation and soft-gel products are among the largest in the world for STR. Among Indian peers, Strides has the largest sterile facility.

Fig 23 Approval status of different facilities and products

Manufacturing site particulars		Existing facilities			New facilities			Poland
		Steriles	Penicillins	Cephalosporins	Steriles	Penicillins/ Penems	Oncology	
Location		Bangalore India	Bangalore India	Bangalore India	Bangalore India	Campos Brazil (1)	Bangalore India	Warsaw Poland
USFDA approval status	Plant	✓	✓	✓	Awaited	Awaited	Awaited	Primary focus on European Mkt
	Products	✓	Awaited	Awaited	Awaited	Awaited	Awaited	Approved by MHRA
Total capacity (mn units)		64	33	44	140	66	25	56(2)
Filings (US)	Nos	52	7	5	10	2	28	N.A.
Approvals (US)	Nos	31	Nil	Nil	Nil	Nil	Nil	N.A.
Commercialized (US)	Nos	4	Nil	Nil	Nil	Nil	Nil	N.A.

All FDA approved products can be moved from one FDA approved plant to another in 30 days

Note: (1) Acquisition expected to be completed in 2H10
(2) Includes existing ampoules capacity of 26mn units

Source: Company presentation, February 2011

Fig 24 USFDA approvals in facilities to significantly increase capacity utilization

Facilities	Location	Regulatory Approvals
SPD I	Bangalore	USFDA, Health Canada, TGA, PIC, ANVISA, MHRA
SPD II	Bangalore	TGA, ANVISA, MHRA
SPCS	Poland	EU, PIC
Betalactum Facility	Bangalore	USFDA, Health Canada, TGA, ANVISA, MHRA
Cephalosporins Facility	Bangalore	USFDA, TGA, PIC, ANVISA, MHRA
Oncology Facility	Bangalore	TGA, MHRA, ANVISA
Penicillins/Penem Block	Campos, Brazil	ANVISA

Note: SPD= Sterile product division; SPCS= Sterile products and control SUBS.

Source: Company data, February 2011

We believe FDA approval for these facilities will significantly enhance STR's capacity to service the US market, which we view as a key growth driver. Management has been guiding for the facility's approval by 1H CY11, and we think this remains the biggest catalyst for the stock going forward.

We believe the approval of SPD-II and the dedicated Onco facility in Bangalore will be the first data points to watch for, as that would enable STR to launch 27 ANDAs in the US for which FDA approvals are already in place, but which STR is unable to supply because of capacity constraints.

Approvals of the Campos facility (likely before/by 1H CY12) will enable STR to launch Penems and Penicillin in the US market, and this should also represent a limited competition opportunity and be a significant growth driver. The facility in Poland is also capable of manufacturing controlled substances and would be used to service the EU markets. The Poland plant has been partly dedicated to a global pharma major for select products. Any delay in FDA approval will be a key near-term risk to STR's earnings growth, in our view.

Fig 25 Sterile injectables: capacity utilization ~30%

Format	Facility	Location	Current FDA Approved capacity	Current Capacity
Lyophilization (Non-Onco)	SPD I	Bangalore	10	10
	SPD II	Bangalore	0	40
	SPD III	Warsaw, Poland	0	6
Pre- Filled Syringes	SPD I	Bangalore	9	9
	SPD III	Warsaw, Poland	0	18
	OTL	Bangalore	0	2
Liquid Vials	SPD I	Bangalore	11	11
	SPD II	Bangalore	0	70
	SPD III	Warsaw, Poland	0	6
	OTL	Bangalore	0	16
Ampoules	SPD I	Bangalore	20	20
	SPD III	Warsaw, Poland	26	26
Lyophilization (Onco)	OTL	Bangalore	0	7
DPP (Non Pen & Ceph)	SPD I	Bangalore	14	14
	SPD II	Bangalore	0	30
DPP (Penicillins)	Betalactum	Bangalore	33	33
	Penicillins Block	Campos, Brazil	0	33
DPP (Cephalosporins)	Cepha Block	Bangalore	44	44
DPP (Penems)	Penem Block	Campos, Brazil	0	33
Total			**167**	**428**

Source: Company data, Macquarie Research, February 2011

Successful commercialization of the few products launched

Given the approved capacity constraints, Strides has currently commercialized only three products, mainly through the JVs in the US market. However, STR has been able to gain its fair market share depending on the number of players in the market. It has almost a 50% market share in Rifampicin, given limited competition. Also, STR has managed to garner a ~15% market share in other products (Vancomycin and Azithromycin), even though there are around six players in the market.

Fig 26 Products commercialized by STR

Commercialised 3 products (4 approvals)

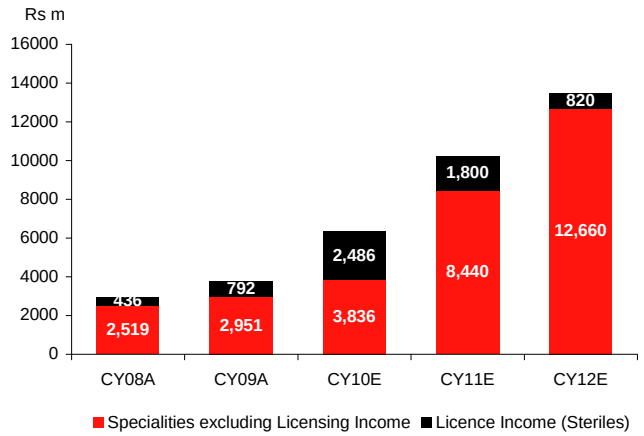
	Vancomycin	Rifampicin	Azithromycin
Addressable market value (LMV)	$157 mn	$8 mn	$28 mn
No. of Players	6	3	6
Filing year	2006	2006	2007
Approval date	Dec 2008	May 2008	Mar 2009
Commercialized date	Feb 2009	June 2008	April 2009
Market share(1) (1Q2010)	15%	52%	18%

Source: Company presentation, February 2011

Sterile speciality major contributor to incremental sales and OP

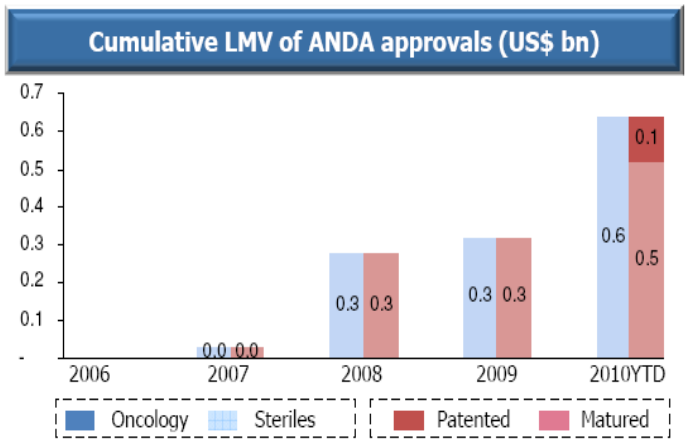
We estimate that the non-licensing income portion of the sterile business will increasingly become a major contributor to sales growth. Starting in 2H CY11, we anticipate the launch of 27 FDA approved products (the LMV of these products is ~US$900m) that are currently facing capacity constraints. Further consolidation of the Campos facility sales in CY11 could contribute ~US$40m in sales to the sterile business, in our view. We think sales in EU and RoW should be further boosted by incremental sales from the new facilities. We expect the specialties business to contribute Rs13.5bn by CY12, and we have assumed that licensing income will contribute only around ~6%. Any delay in the approval of the new facility (SPD II and OTL) could be a risk to our near-term earnings estimate.

Fig 27 Specialty growth the key driver



Source: Company data, Macquarie Research, February 2011

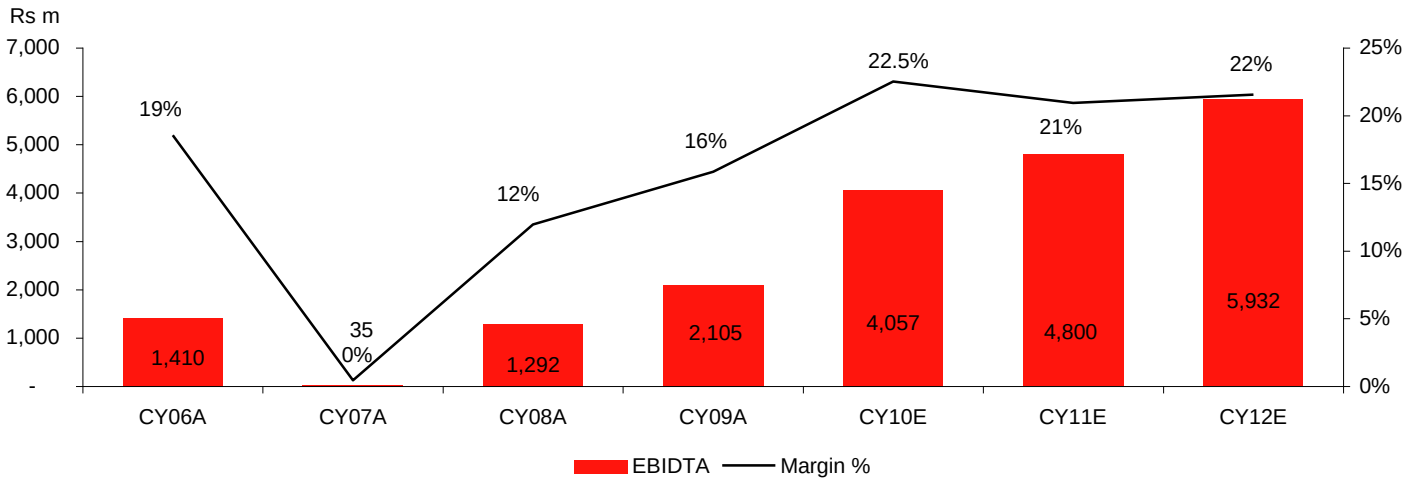
Fig 28 Facility approval to allow commercialization



Source: Company presentation, February 2011

Sustainable margins due to high entry barrier: Pfizer is entering into a deal with Strides (in sterile injectable oncology drugs) after screening more than 100 companies, a testament to the quality of the assets that STR owns, we believe. We estimate the top line to grow at a 27% CAGR between CY09–12 on the commercialization of products filed from new facilities. We think expansion in margins of ~550bps by CY12E vs 15.8% in CY09 will be driven by the sterile injectable business.

Fig 29 EBITDA margin improved significantly in CY10 on higher contributions from sterile products

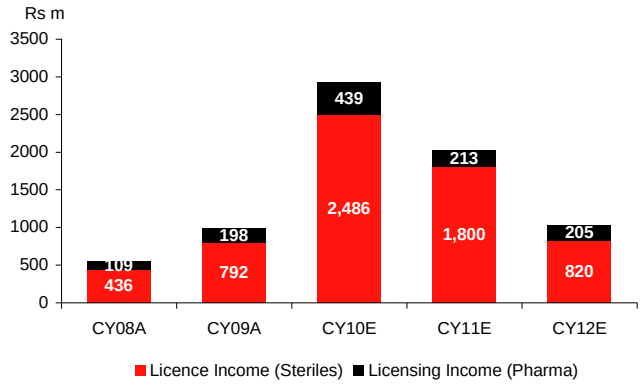


Source: Company data, Macquarie Research, February 2011

Licensing income – core part of the business model

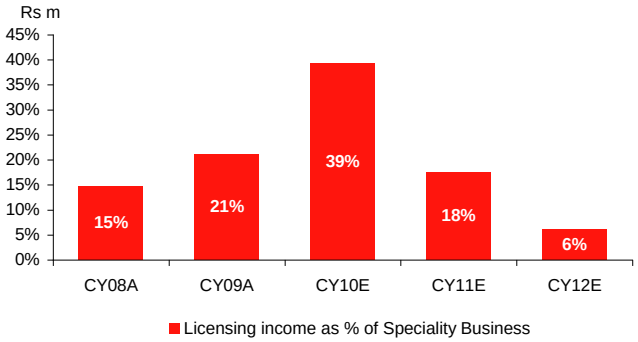
Strides has followed a partnering approach, in that it has obtained front-end partners in regulated markets to commercialize its speciality product portfolio. STR has seen a significant rise in upfront licensing income with the recent signing of deals with large pharma companies. Management is guiding for licensing income to be sustained at current levels for the next couple of years. However, we have taken a conservative view given the volatility of such income and have assumed that the contribution of licensing income to the specialty business will decline to 6% of sterile segment sales in CY12 from 40% expected for CY10.

Fig 30 >80% of licensing fees from sterile products



Source: Company data, Macquarie Research, February 2011

Fig 31 Licensing income as % of specialty business



Source: Company data, Macquarie Research, February 2011

Fig 32 Summary consolidated P&L

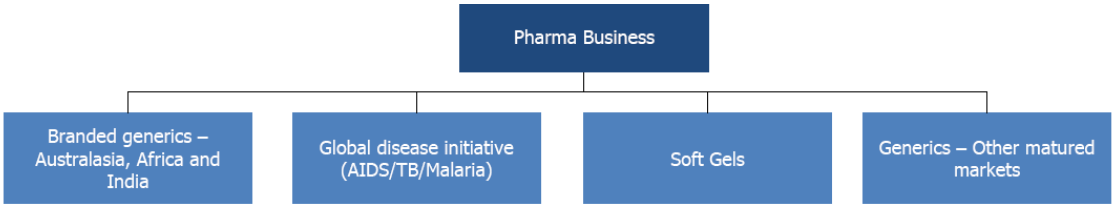
Rs bn	CY08A	CY09A	CY10A	CY11E	CY12E
Total Revenue	**10.8**	**13.3**	**18.0**	**22.9**	**27.5**
Specialities	7.4	10.4	11.4	12.4	13.8
Pharma	3.0	3.7	6.3	10.2	13.5
COGS	-5.2	-7.0	-8.6	-11.4	-13.6
Gross Profit	5.6	6.3	9.4	11.6	13.9
Gross Profit Margin	*51.5%*	*47.2%*	*52.0%*	*50.5%*	*50.5%*
EBITDA	1.3	2.1	4.1	5.1	6.2
EBITDA Margin	*12.0%*	*15.8%*	*22.5%*	*21.0%*	*21.5%*
EBIT	0.9	1.6	3.4	3.9	4.9
PAT	0.0	0.5	1.6	2.0	2.7
EPS(Rs)	(0.3)	9.5	23.4	30	40.9

Source: Company data, Macquarie Research, February 2011

Pharma business – stable growth

Strides's pharma business includes the branded generics business (in the Australasia region, Africa and India), and the oral formulation manufacturing business, with a focus on specific therapy formulations like ARVs/TB/Malaria. The pharma business contributed Rs10.3bn to the top line in CY09, and we expect it to grow at a ~10% CAGR in the medium term.

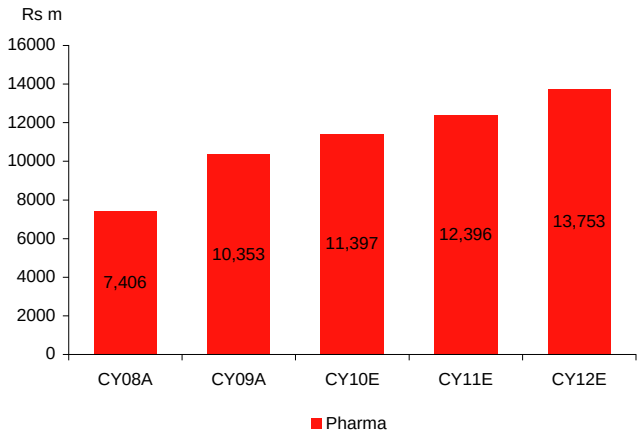
Fig 33 Pharma business overview



Globally competitive	Amongst the leading manufacturers of soft gelatin capsules in the world Supplies oral products to regulated markets
Product development capability	Develops and manufactures different orals presentation forms and therapeutic categories – Softgel caps, tablets & capsules and semi solids – Strength in Immunosuppressants 36 ANDA filings till date of which 20 have already been approved
Stable revenue stream	Orals plants – can support growth with limited capex requirements going forward Large number of product filings completed Long term customer contracts to provide stable revenue stream
Manufacturing overview	Facility approved by major regulatory authorities such as USFDA, MHRA, MCC, TGA and ANVISA EU approved semi solids facility in Milan, Italy

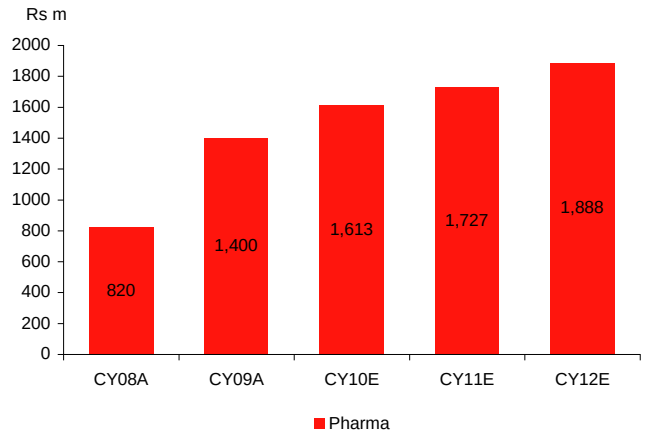
Source: Company presentation, February 2011

Fig 34 Pharma business stable sales



Source: Company data, Macquarie Research, February 2011

Fig 35 Pharma business healthy EBITDA



Source: Company data, Macquarie Research, February 2011

Branded Generics - Regional play (Australasia, Africa and India)

STR's branded generic business contributed ~US$125m to the top line in CY09. Operations are primarily spread across Australasia (through Ascent Pharma), Africa (with manufacturing operations in India and Lagos) and India (with the acquisition of the Grandix portfolio in 2007).

Based on Strides's presence in some of the fastest-growing branded generics markets, we believe this business will be characterized by flat margins and steady growth; thus, we believe STR is well-positioned to deliver mid–teen sales growth.

Fig 36 Branded generics: Regional play

	Australasia	Africa	India
Description	Operating as Ascent Pharmahealth, a leading pharmaceutical, generic and consumer health company listed on the ASX	Leading player manufacturing and marketing volume driven generics and margins driven branded products	Emerging as a niche player in branded pharmaceutical products Two major businesses: Grandix and Ray of Life
Manufacturing	Dedicated facility in Jurong, Singapore	3 dedicated facilities: 1 in Lagos, Nigeria and 2 in India	Orals plant in Bangalore also used for manufacturing branded generics
Footprint	Australia (5th largest) & Singapore (Largest) with growing operations in 5 other Emerging South-East Asian markets	West Africa, French Africa & other parts of Africa	Grandix has presence in 5 states in South India
Products	Ethically promoted generic pharmaceuticals, OTC and skincare (prescription and consumer) products with some well established consumer brands such as Avene (Skincare), Hairy Lemon (OTC) and Estelle (Prescription medicine) and Dermorganics (Organic Skincare)	Branded generics, Commodity generics and OTC products marketed through own sales team in partnership with local distributors French Africa business is front ended comprising ethically promoted and OTC products	Grandix covers therapeutic areas of diabetes, cardiovascular diseases, neurology and female healthcare Ray of Life covers critical care health products in oncology segment
Sales (2009)	US$89mn	US$20mn	US$16mn
Ownership	Owns 60.3% stake in Ascent Pharmahealth Discussions ongoing with Ascent in relation to a scheme of arrangement to acquire the remaining minority shares in APH at a price of $0.35 per share	100% stake	100% stake

Source: Company presentation, February 2011

Australasia (US$90m sales in CY09): STR's interests in Australasia are represented through its equity stake in Ascent Pharmahealth (currently holds 60% and is in discussions to acquire the remaining minority stake). Through Genepharm, STR has built its presence in the Australian generic market. Genepharm is among the top-5 generic companies in Australia. The Asia business is managed through Singapore (including a manufacturing facility in the region). STR's Singapore entity – Drug Houses of Australia (Asia) – is the largest generic company in that market. The future pipeline includes all major patent expiries across the region until 2014. With over 40 registrations in Australia and over 400 registered Rx and OTC products across Southeast Asian markets, STR is well positioned, we believe.

Africa (US$20m sales in CY09): STR's African business spans the entire continent, except some SADC countries. In some markets, STR has a direct presence, while in others the company uses a distribution model and participates in tenders. The company has over 300 product registrations in place in the region. The African business is supported by the company's manufacturing operations in Lagos (Nigeria) and India. Revenues from the African business exceeded Rs1bn in 2009.

India (US$16m sales in CY09): STR's Indian front-end operations took shape with the acquisition of the branded business of Grandix for Rs1bn in 2007. At the time of acquisition, Grandix had a registered turnover of under INR500m. Current revenues from Grandix stand at over Rs750m. In December 2009, STR launched its organic domestic market foray with Ray of Life (RoL), which specializes in hospital products. STR's India formulation operations (Grandix and RoL) employ over 400 medical representatives, predominantly focused on south India. Product introductions and expanding regional penetration in India are likely to help grow the domestic portfolio, in our view.

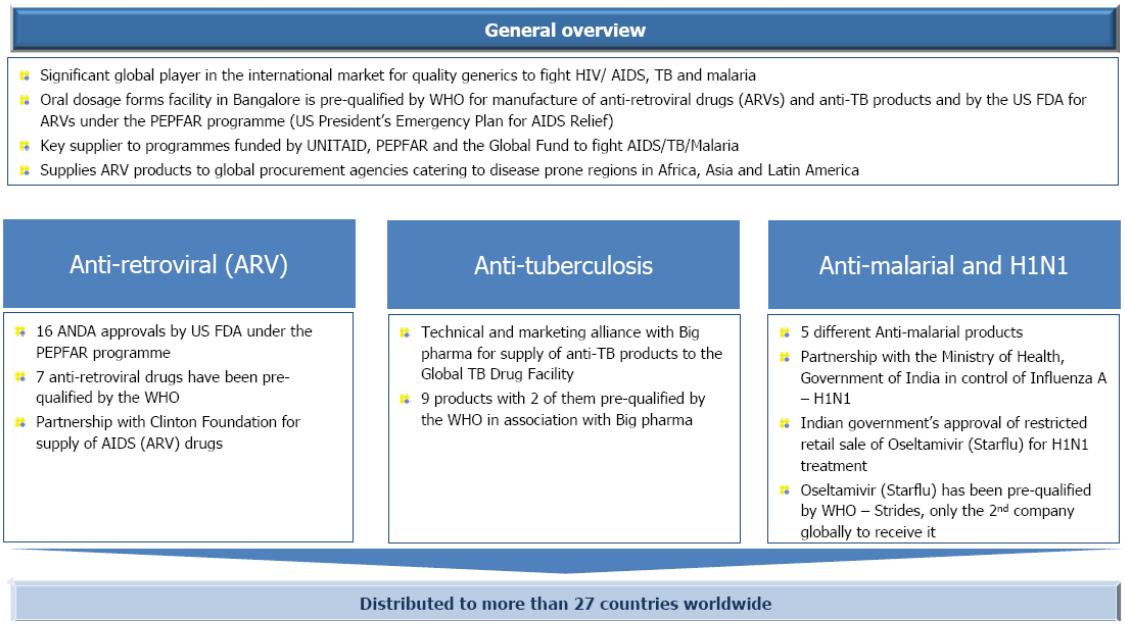
Other pharma operation – Largest softgel capacity and HIV /TB/ Malaria disease play

The company's other pharma SBU, comprising revenues from AIDS, TB and malaria, is a drag on consolidated operations. STR may thus look to sell the business. However, we believe that finding buyers for the low-margin segment may be difficult. Besides, the company is not vertically integrated, which makes margin expansion challenging.

The company's softgel capacity at Bangalore and its EU-approved semi-solid facility in Italy are also part of the pharma business. The pharma business is largely volume-driven and operates on low margins. For the ARV business STR has 16 ANDA approvals under the PEPFAR programme. STR is among the world's top 5 softgel manufacturers. In August 2010, STR obtained its first ANDA approval for a softgel product: ERGOCALCIFEROL capsules, 1.25mg.

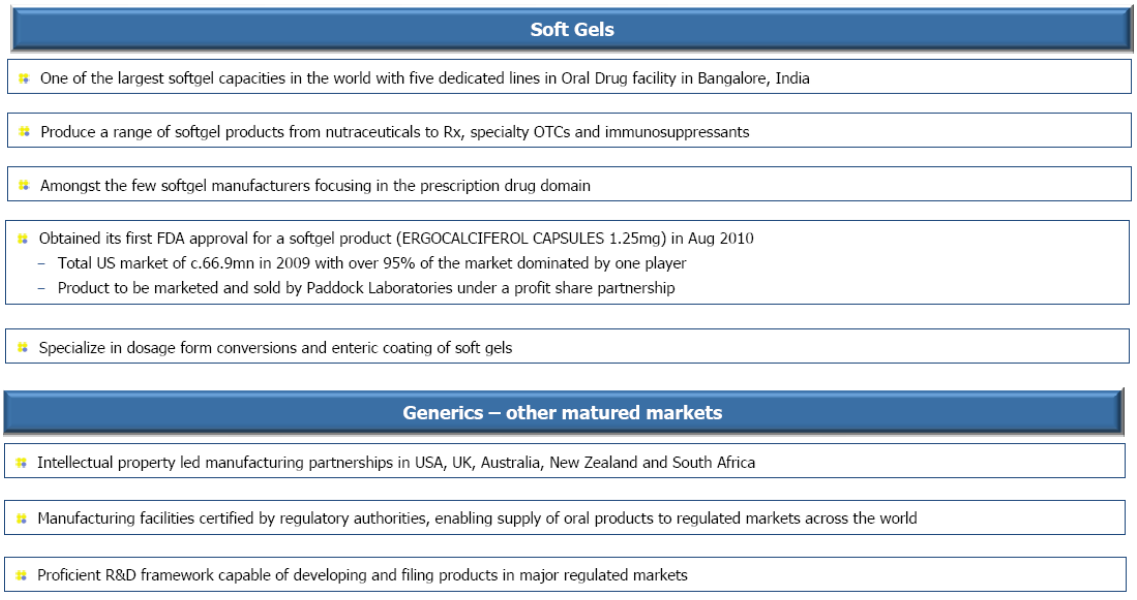
The total US market for the product was US$67m in 2009, with over 95% of the market dominated by one player. STR has launched this product in partnership with Paddock Laboratories under a profit share partnership, and we expect this to be a substantial earnings driver in CY11.

Fig 37 Significant presence in ARV, anti-TB & anti-Malarial drugs



Source: Company presentation, February 2011

Fig 38 Softgel manufacturing capabilities



Source: Company presentation, February 2011

DCF valuation @Rs492/sh

Given the sensitivity of the DCF to input assumptions, we use it as an alternative valuation methodology, to compare it with our relative valuation-derived target price. Our DCF-based fair value for STR is Rs492/sh. We use an interim growth rate of 6% for FY16–22 and a 3% terminal growth rate (to perpetuity). We have used a discount rate (WACC) of 12.5% for our analysis.

Fig 39 DCF Value @ Rs492/Sh

Year End	31-Dec-11
Date of Valuation	15-Feb-11
No of days to next FY end:	319
Adjustment Factor	0.87

Year-end Mar (Rs m)	**2011E**	**2012E**	**2013E**	**2014E**	**2015E**	**2016E**	**2017E**	**2018E**	**2019E**	**2020E**	**2021E**	**2022E**
Average Cash Flow Date	24-Jul	1-Jul	1-Jul	1-Jul	1-Jul	1-Jul	1-Jul	1-Jul	1-Jul	1-Jul	1-Jul	1-Jul
Time Factor (fraction of year to next FY end)	0.44	1.38	2.38	3.38	4.38	5.38	6.38	7.38	8.38	9.38	10.38	11.38
EBITDA	4,800	5,932	6,644	7,441	8,185	9,003						
Tax expense	(554)	(754)	(844)	(946)	(1,040)	(1,144)						
Change in working capital	(1,155)	(1,378)	(1,543)	(1,729)	(1,901)	(2,092)						
Cash flow from operations	**3,091**	**3,800**	**4,256**	**4,767**	**5,243**	**5,768**						
Capital expenditure	(917)	(964)	(1,079)	(1,209)	(1,330)	(1,463)						
Free cash flow	**2,173**	**2,836**	**3,177**	**3,558**	**3,914**	**4,305**	**4,563**	**4,837**	**5,127**	**5,435**	**5,761**	**6,107**
Growth %		*31%*	*12%*	*12%*	*10%*	*10%*						
Free cash flow for valuation purposes	**1,899**	**2,836**	**3,177**	**3,558**	**3,914**	**4,305**	**4,563**	**4,837**	**5,127**	**5,435**	**5,761**	**6,107**
Present Value of Cash flows	1,804	2,412	2,401	2,391	2,338	2,285	2,153	2,028	1,911	1,800	1,696	1,598

Risk Free Rate	8%
Equity Risk Premium	6%
Target Capital Structure D:E	50%:50%
Cost of Debt	9%
Adj Beta assumed	1.30
WACC (Discount rate (%))	**12.50%**
1. Present value of cash flow till 2016	
Total PV of free cash flow till 2016{a}	**13,631**
2. Present value of cash flow from 2017 to 2022	
Growth from 2017 to 2022	**6%**
PV of free cash flow from 2016-2022 {b}	**11,187**
3. Terminal value calculation	
Growth from 2021 to perpetuity (%)	**3.0%**
FCF in FY2022	6,107
Exit P/E multiple (X)	**10.8**
Terminal value	66,207
PV of terminal value {c}	**17,327**
Total company value {a} + {b} + {c}	**42,145**
Net debt/cash	**(14,683)**
Minority Interest / Other operating Liability	**(2,755)**
Associates / investments	**3,414**
Value to equity holders	**28,121**
Value to equity holders (Rs/share)	**492**
Current price	**380**
Stock price upside/(downside)	**29.4%**

Sensitivity of 12-month DCF to WACC and Terminal Growth

Assuming terminal growth rate of 4%, if WACC and 2015-2021 growth rate changes

Interim Growth \ WACC	11.5%	12.0%	12.5%	13.0%	13.5%
4.0%	532	487	447	411	378
5.0%	558	511	469	431	397
6.0%	586	536	**492**	452	416
7.0%	614	562	515	474	436
8.0%	644	589	540	496	457

Assuming growth rate from 2015-2021 remains 10%, if terminal growth rate changes

Terminal Growth \ WACC	9.5%	10.5%	12.5%	13.5%	14.5%
2.5%	818	674	475	404	344
2.8%	840	689	483	410	349
3.0%	863	706	**492**	416	354
3.3%	889	723	501	423	359
3.5%	917	742	510	430	364

Source: Macquarie Research, February 2011

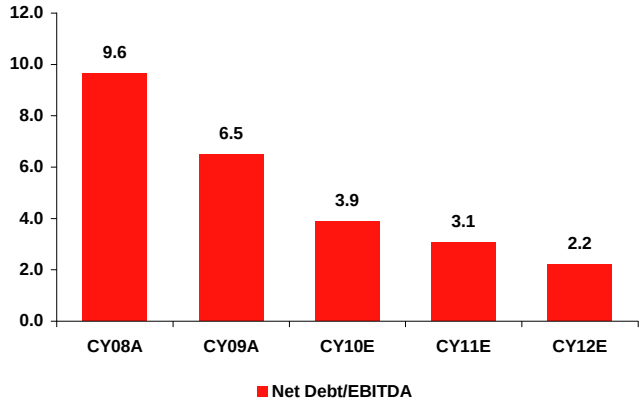
Debt overhang receding, improving B/S

We believe the stock market has been concerned about the high leverage levels at STR. However, with the strong capex cycle behind the company and with visibility emerging for a strong earnings profile and free cash flow generation, we think STR can eventually reduce debt and strengthen the balance sheet.

Strong capex cycle over

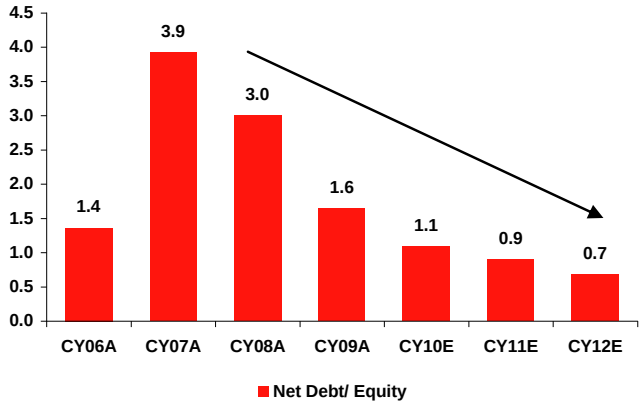
With the strong capex cycle behind the company, we believe the balance sheet will improve going forward. We estimate a capex of Rs2.6bn (an average of Rs0.8bn/year) for CY10-12 vs Rs8bn (an average of Rs2bn per year) for CY06-09.

Fig 40 Net debt to EBITDA to fall to 2x in CY12E



Source: Company data, Macquarie Research, February 2011

Fig 41 Net debt to equity to go below 1x by CY11

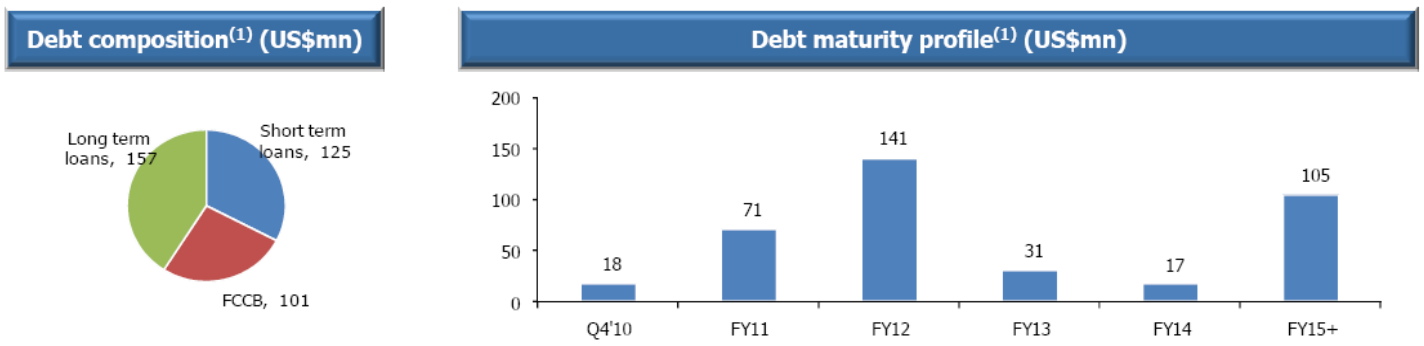


Source: Company data, Macquarie Research, February 2011

Strong cash flow generation to meet future debt commitments

Strides's debt composition as of 30 Sept 10: US$157m in long-term loans, US$125m in short-term loans and FCCBs (including YTM) of US$101m. The company redeemed US$34m of the FCCBs on 19 April 2010. After the redemption of these FCCBs, the company now has outstanding FCCBs worth US$80m. FCCBs are redeemable at a premium of 145% and a conversion price of Rs461.6/share.

Fig 42 Debt profile as of 30 Sep 2010 (does not include QIP proceeds of US$100m)



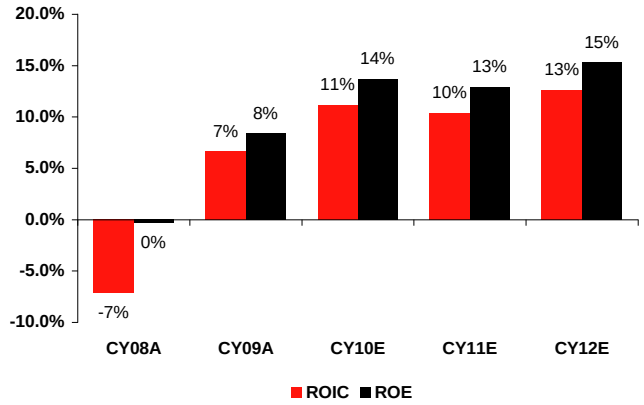
Source: Company data, February 2011

Fig 43 FCCBs (including YTM) outstanding ~US$101m as of 30 Sept 2010

Instrument	Amount at the time of issue (US$ m)	Outstanding Amount (US$ m)	Date of Issue	Date of conversion	Conversion Price (Rs)	Conversion Rate (USD/Rs)
Zero-coupon FCCBs	**100**	**80**	**26-Jun-07**	**27-Jun-12**	**461.6**	**40.7**

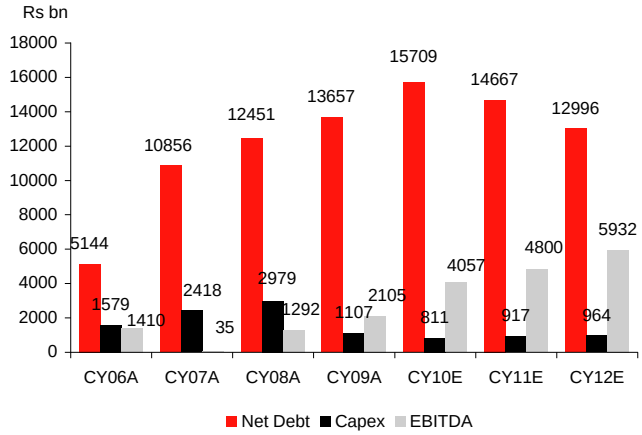
Source: Company data, Macquarie Research, February 2011

Fig 44 Improving balance sheet ratios……



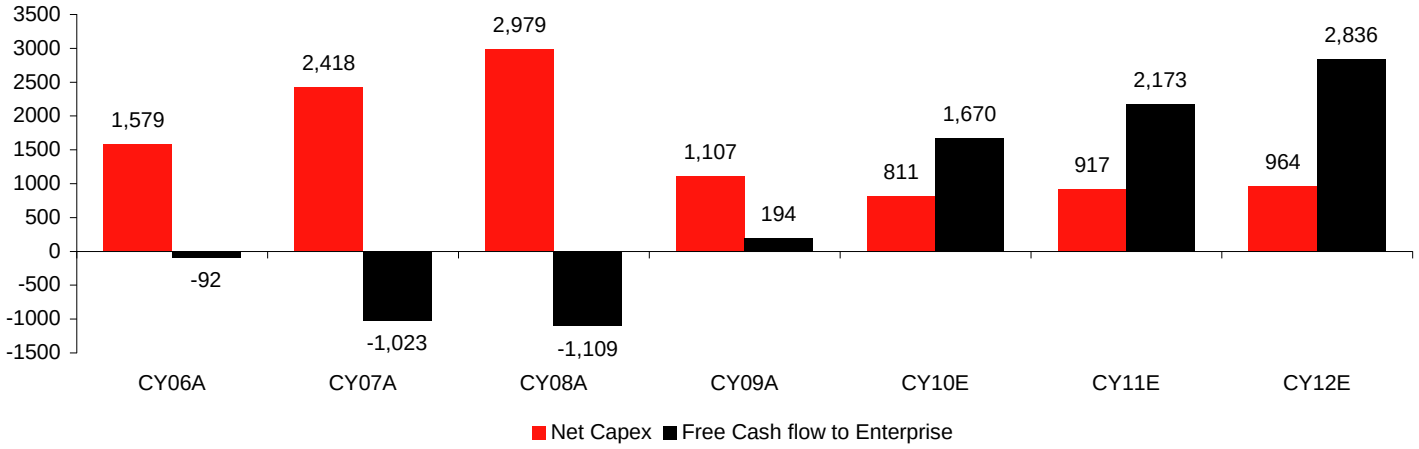
Source: Company data, Macquarie Research, February 2011

Fig 45 …due to higher margin and lower capex



Source: Company data, Macquarie Research, February 2011

Fig 46 With capex cycle over, STR to generate strong free cash flow



Source: Company data, Macquarie Research, February 2011

Risks to our Outperform rating

- **Delay in USFDA approval of the Bangalore facility** can affect our earnings estimates significantly. We have built USFDA approval (for the Bangalore new sterile facility) into our estimates for 1H CY11. We believe there is a high probability of USFDA approval based on: Pfizer choosing STR as a partner after screening more than 100 companies gives credibility to STR's manufacturing facility standards; the facility has been approved by other regulatory bodies (TGA, ANVISA, MHRA); and STR has a good track record in terms of regulatory approval for its other sterile facilities.
- **Rupee appreciation against USD/Euro/AUD:** North America, Europe and Australia contribute ~43% of total revenue. Rupee appreciation would thus have a negative impact on the stock's valuation.
- **Increased competition in key products,** contrary to our expectations, remains a risk to our investment thesis.
- **Lack of financial discipline** is a potential risk. STR's inability to reduce its debt/equity ratio might be an overhang on the stock. Also, we think significant goodwill of Rs10bn (vs net worth of Rs14bn) on balance sheet remains a key risk.

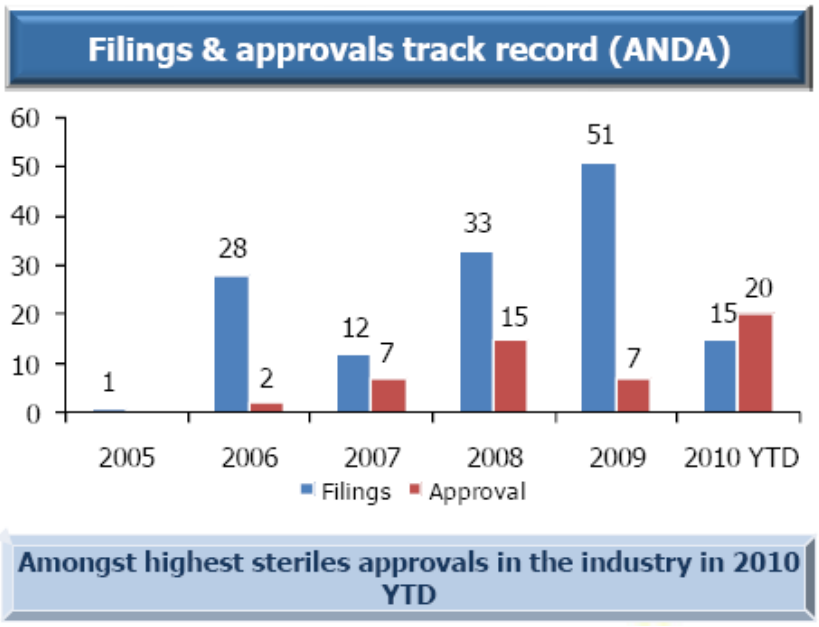
Appendix-I: STR's recent ANDA approvals

Fig 47 Recent US FDA approvals for STR in the sterile space

Product Name	Dosage Form
Ketorolac Tromethamine Injection USP	Liquid Injection
Tobramycin Injection USP	Liquid Injection
Fosphenytoin Sod. Injection	Liquid Injection
Ondansetron Injection USP (MDV)	Liquid Injection
Ondansetron Injection USP (SDV)	Liquid Injection
Flumazenil Injection USP	Liquid Injection
Rifampin for Injection USP	Liquid Injection
Famotidine Injection (MDV)	Liquid Injection
Famotidine Injection (SDV)	Liquid Injection
Dexamethasone Sod. Phosphate Injection USP 10 mg	Liquid Injection
Dexamethasone Sod. Phosphate Injection USP 4 mg	Liquid Injection
Pamidronate Disodium Injection	Liquid Injection
Sterile Vancomycin HCl USP, 5 g	Liquid Injection
Sterile Vancomycin HCl USP, 500 mg and 1 g	Liquid Injection
Azithromycin for Injection	Lyo
Adenosine Injection USP, 3 mg/mL, 2 mL Vial	Injection
Haloperidol Injection USP	Liquid injection
Labetalol Hydrochloride Injection, USP	Liquid injection
Granisetron Hydrochloride Injection (MDV)	Liquid Injection
Granisetron Hydrochloride Injection (SDV)	Liquid Injection
Mesna Injection	Liquid Injection
Metoprolol tartrate Injection, USP	Liquid Injection
Adenosine Injection, USP	Liquid injection
Vecuronium bromide for Injection	Liquid Injection
Bacitracin for Injection USP	Powder for Injection
Fosphenytoin Na Injection USP 75 mg/mL-2 mL&10mL Vials	Injection
Sumatriptan Injection, USP	Liquid injection
Rocuronium Bromide Injection 10 mg/mL - 5 mL & 10 mL	Liquid Injection
Sumatriptan Injection, USP	Liquid Injection
Lidocaine HCl Injection, USP (SDV), 2.0 %	Injection
Lidocaine HCl Injection, USP, 0.5% & 1.0%, 30mL, 50mL Vial	Injection
Midazolam Hydrochloride Injection - SDV (Preservative-free)	Liquid Injection
Lidocaine HCl Injection, USP (MDV), 0.5 % & 1.0 %	Injection

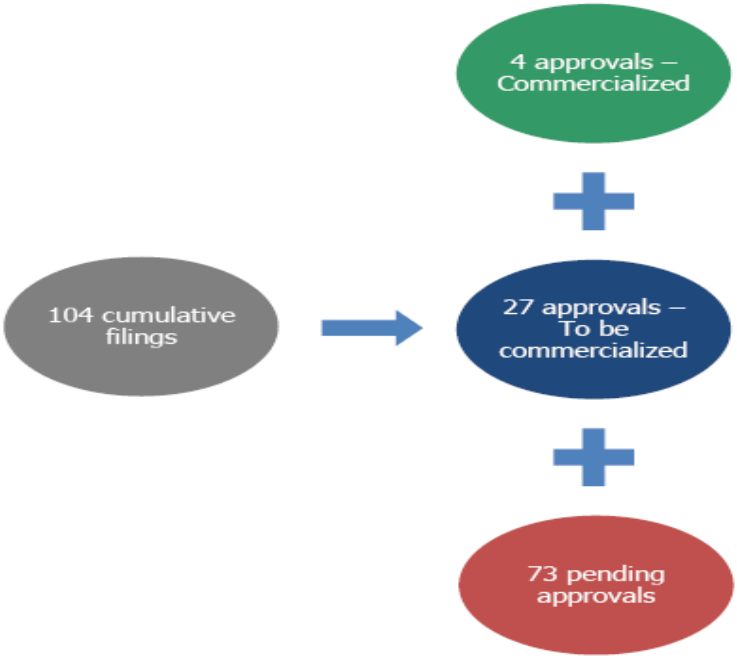
Source: Company data, Macquarie Research, February 2011

Fig 48 Filings and approval track record



Source: Company data, February 2011

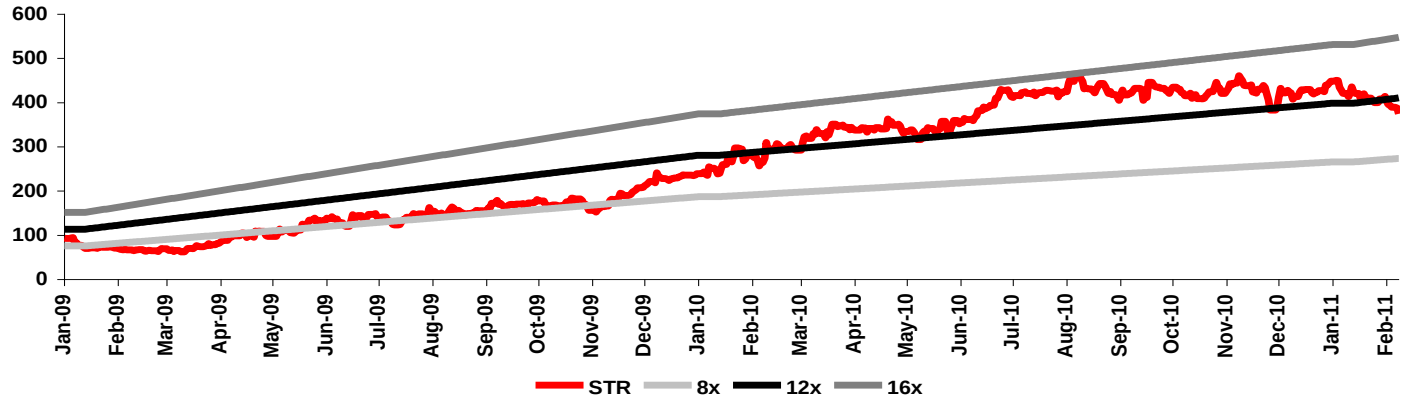
Fig 49 Cumulative Sterile filings of STR, strong pipeline



Source: Company data, February 2011

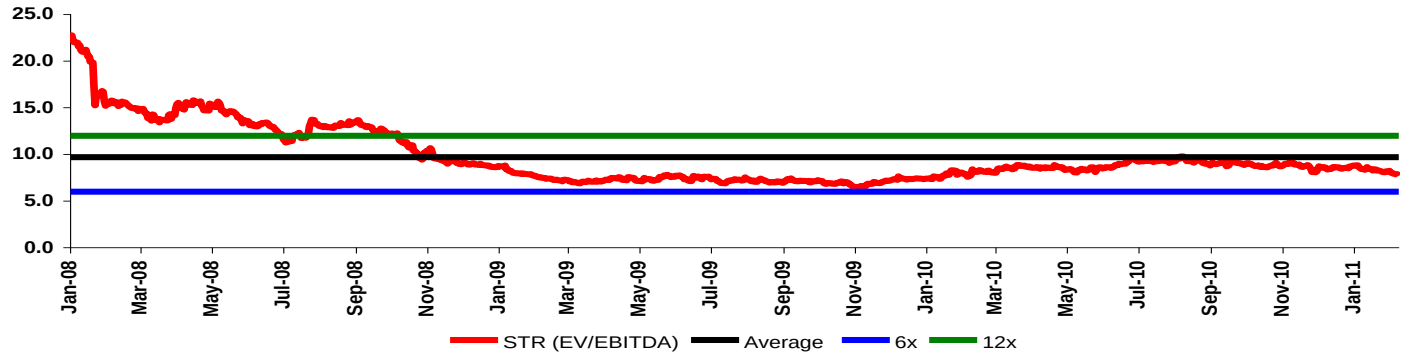
Appendix-II: Valuation charts

Fig 50 1 Yr forward PER chart : STR trading at 10.5x CY11E earnings



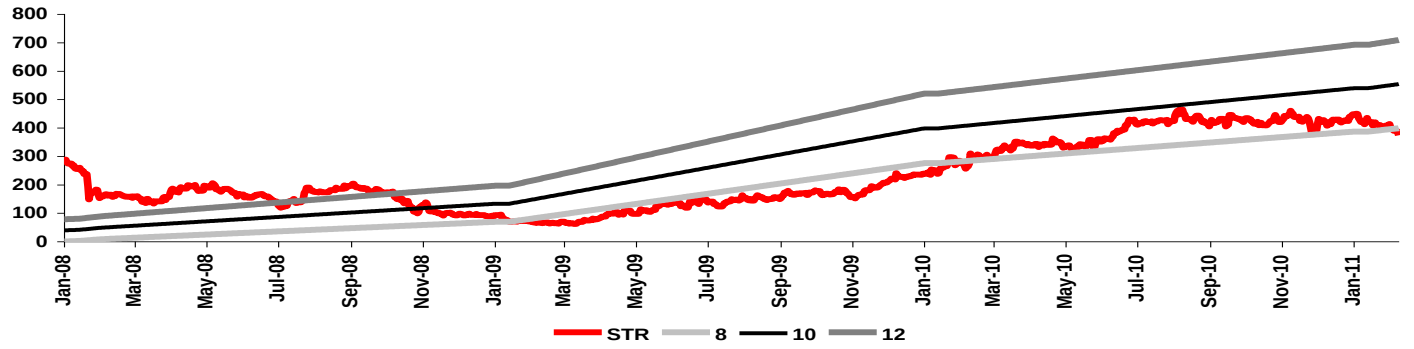
Source: Company data, Macquarie Research, February 2011

Fig 51 STR is trading 30% below the three-year average 1-yr fwd EV/EBITDA



Source: Company data, Macquarie Research, February 2011

Fig 112 1 Yr fwd EV/EBITDA chart : Trading @ 6.9x EV/EBITDA



Source: Company data, Macquarie Research, February 2011

Appendix-III: USFDA inspection status

Fig 53 No FDA audit observation to-date

USFDA Inspection Status

Plant	Year	FDA Audit Observation
Sterile Product Division -I	2007	None
	2009	None
Penicillin	2008	None
Cephalosporin	2009	None
Oncology	Inspection awaited	
Sterile Product Division -II		

✓ Strides' high regulatory compliance standards positions it well for partnership with the Big Pharma

Source: Company presentation, February 2011

Fig 54 Revenue breakdown by geographic region

Region	US$ m	% of total revenue
North America, Europe and Australia	123	43.0%
Africa	43	15.0%
India	33	11.5%
South and Central America	24	8.4%
ROW	63	22.0%
Total	**286**	**100.0%**

Source: Company data, Macquarie Research, February 2011

Appendix-IV: Reserve for business restructure

Reserves for business re-structure (BRR) Scheme

The company has entered into a Business Transfer Agreement (BTA) with Strides Specialties Private Limited (SSPL), a wholly owned subsidiary of the company, for the transfer of a specialty business undertaking (including the R&D business), on a slump sale basis. After this action, fixed assets pertaining to the above business – to the extent of a gross block of Rs2336m and accumulated depreciation of Rs.268m – have been transferred to Strides Specialties Private Limited.

The accounting treatment effected for the scheme is as follows

The following have been credited to the BRR: the excess of fair value of the assets and liabilities over the carrying value of the investment in the Transferor Companies and the equity shares of the Transferee Company issued to the minority shareholders of the Transferor Companies, amounting to Rs146m.

Upon the Scheme that is becoming effective, and based on legal advice received, the assets and liabilities of the Transferee Company have been fair valued, as determined by the Board of Directors of the company, and the net surplus arising out of such fair valuation (over the carrying value of the respective assets and liabilities prior to the fair valuation) has been credited to the BRR as follows:

Fig 55 Reserve for business restructure: Net surplus from fair valuation

Particulars of assets and liabilities' fair value	Amount credited to BRR(Rs m)
Investment in SSPL	5856
Land	754
Machineries	281
Net Amount Credited to BRR	6892
Excess of fair value of assets and liabilities over the carrying value	147
Net Surplus on Fair Valuation of Assets	7039

Source: Company data, Macquarie Research, February 2011

Subsequent to the above-referred fair valuation of investment in SSPL, the goodwill in these consolidated financial statements is higher to the extent of Rs5856m.

Had the Scheme not prescribed the above accounting treatment, in terms of the company's accounting policy, land and machineries would have continued to be carried at cost, and goodwill in these consolidated financial statements would have been lower, as referred to in the previous paragraph.

Fig 56 Adjusted against BRR during the year

Impairment of:	Amount (Rs m)
Fixed Assets	73
Goodwill	1934
Current Assets	903
Amortisation of Brands	115
Compensation in respect of product	365
Long term Employee Compensation	678
Restructuring & Others Expenses	117
Total Expense debited to BRR	4184
Closing balance for Reserve for Business Restructure	2854

Source: Company data, Macquarie Research, February 2011

Had the Scheme not prescribed the above accounting treatment, these expenses would have been charged to the Profit & Loss Account for the year.

Had the Scheme not provided for recording fair value of assets and liabilities of the Transferee Company and charging the expenses to the BRR, the effect of accounting as per the Accounting Standards issued under the Companies (Accounting Standards) Rules, 2006, would have been as highlighted in the below table.

Fig 57 Profit and loss account if BRR scheme were not in place

Particulars	Amount (Rs m)
Materials consumed	245
Personnel costs	678
Operating and Other expenses	1140
Depreciation and Amortisation	188
Impairment of Goodwill	1934
Net Profit after tax	-4184
Earnings/ (Loss) per share	
Basic	-78
Diluted	-78

Source: Company data, Macquarie Research, February 2011

Fig 58 Balance sheet if BRR scheme were not in place

Particulars	Amount (Rs m)
BRR	-2854
Profit & Loss Account	-4184
Goodwill	-5856
Land	-754
Machineries	-281
BRR Reserves and Surplus	**147**

Source: Company data, Macquarie Research, February 2011

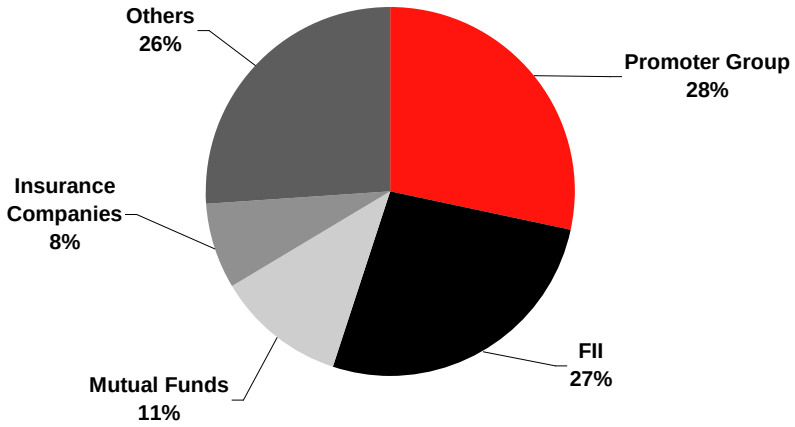
Appendix-V: Others

Fig 59 Scarcity value in the injectables space leading to consolidation

Year	Acquirer	Target	Deal Size
2010	Mylan	Bioniche (USA)	US$550m
2010	Recipharm	Madaus (Germany)	n.a.
2009	Hospira	Orchid (India)	US$400m
2009	Novartis	Ebewe(Austria)	US$1.2bn

Source: Company data, Macquarie Research, February 2011

Fig 60 Shareholding pattern: Promoter group holds~ 28%



Source: Macquarie Research, February 2011

Strides Arcolab (STR IN, Outperform, Target Price: Rs485.00)

Quarterly Results		3Q/10A	4Q/10E	1Q/11E	2Q/11E
Revenue	**m**	**4,505**	**4,505**	**5,734**	**5,734**
Gross Profit	**m**	**2,343**	**2,343**	**2,893**	**2,893**
Cost of Goods Sold	m	2,162	2,162	2,841	2,841
EBITDA	**m**	**1,014**	**1,014**	**1,200**	**1,200**
Depreciation	m	163	163	225	225
Amortisation of Goodwill	m	0	0	0	0
Other Amortisation	m	0	0	0	0
EBIT	**m**	**851**	**851**	**975**	**975**
Net Interest Income	m	-347	-347	-300	-300
Associates	m	0	0	0	0
Exceptionals	m	0	0	0	0
Forex Gains / Losses	m	0	0	0	0
Other Pre-Tax Income	m	14	14	17	17
Pre-Tax Profit	**m**	**518**	**518**	**692**	**692**
Tax Expense	m	-88	-88	-138	-138
Net Profit	**m**	**430**	**430**	**554**	**554**
Minority Interests	m	-43	-43	-56	-56
Reported Earnings	**m**	**388**	**388**	**497**	**497**
Adjusted Earnings	**m**	**388**	**388**	**497**	**497**
EPS (rep)		5.85	5.85	7.51	7.51
EPS (adj)		5.85	5.85	7.51	7.51
EPS Growth YoY (adj)	%	147.1	147.1	28.4	28.4
EBITDA Margin	%	22.5	22.5	20.9	20.9
EBIT Margin	%	18.9	18.9	17.0	17.0
Earnings Split	%	25.0	25.0	25.0	25.0
Revenue Growth	%	35.7	35.7	27.3	27.3
EBIT Growth	%	111.0	111.0	14.5	14.5

Profit and Loss Ratios		2009A	2010E	2011E	2012E
Revenue Growth	%	23.0	35.7	27.3	20.0
EBITDA Growth	%	62.9	92.7	18.3	23.6
EBIT Growth	%	80.9	111.0	14.5	26.6
Gross Profit Margin	%	47.2	52.0	50.5	50.5
EBITDA Margin	%	15.8	22.5	20.9	21.5
EBIT Margin	%	12.1	18.9	17.0	17.9
Net Profit Margin	%	9.1	9.5	9.7	11.0
Payout Ratio	%	0.0	0.0	0.0	0.0
EV/EBITDA	x	14.4	9.1	7.7	6.2
EV/EBIT	x	18.8	10.8	9.5	7.5
Balance Sheet Ratios					
ROE	%	8.4	13.6	12.9	15.3
ROA	%	5.8	8.9	8.2	9.2
ROIC	%	7.4	11.5	9.5	11.6
Net Debt/Equity	%	125.3	91.6	75.7	58.1
Interest Cover	x	2.1	2.5	3.2	4.1
Price/Book	x	1.8	1.5	1.3	1.1
Book Value per Share		207.3	251.8	286.5	333.9

Profit & Loss		2009A	2010E	2011E	2012E
Revenue	**m**	**13,283**	**18,019**	**22,936**	**27,532**
Gross Profit	**m**	**6,276**	**9,372**	**11,573**	**13,916**
Cost of Goods Sold	m	7,008	8,647	11,363	13,616
EBITDA	**m**	**2,105**	**4,057**	**4,800**	**5,932**
Depreciation	m	492	652	900	997
Amortisation of Goodwill	m	0	0	0	0
Other Amortisation	m	0	0	0	0
EBIT	**m**	**1,613**	**3,404**	**3,899**	**4,935**
Net Interest Income	m	-759	-1,386	-1,200	-1,200
Associates	m	0	0	0	0
Exceptionals	m	575	0	0	0
Forex Gains / Losses	m	0	0	0	0
Other Pre-Tax Income	m	-0	54	69	34
Pre-Tax Profit	**m**	**1,429**	**2,072**	**2,768**	**3,769**
Tax Expense	m	-219	-352	-554	-754
Net Profit	**m**	**1,210**	**1,720**	**2,215**	**3,015**
Minority Interests	m	-114	-170	-225	-305
Reported Earnings	**m**	**1,097**	**1,550**	**1,990**	**2,710**
Adjusted Earnings	**m**	**521**	**1,550**	**1,990**	**2,710**
EPS (rep)		19.92	23.40	30.03	40.91
EPS (adj)		9.47	23.40	30.03	40.91
EPS Growth (adj)	%	nmf	147.1	28.4	36.2
PE (rep)	x	19.0	16.2	12.6	9.3
PE (adj)	x	40.0	16.2	12.6	9.3
Total DPS		0.00	0.00	0.00	0.00
Total Div Yield	%	0.0	0.0	0.0	0.0
Weighted Average Shares	m	55	66	66	66
Period End Shares	m	40	57	57	57

Cashflow Analysis		2009A	2010E	2011E	2012E
EBITDA	**m**	**2,105**	**4,057**	**4,800**	**5,932**
Tax Paid	m	-88	-352	-554	-754
Chgs in Working Cap	m	-1,130	-1,224	-1,155	-1,378
Net Interest Paid	m	-662	-1,386	-1,200	-1,200
Other	m	414	0	0	0
Operating Cashflow	**m**	**639**	**1,095**	**1,891**	**2,600**
Acquisitions	m	0	-6,930	0	0
Capex	m	-1,107	-811	-917	-964
Asset Sales	m	0	0	0	0
Other	m	-370	54	69	34
Investing Cashflow	**m**	**-1,476**	**-7,687**	**-849**	**-929**
Dividend (Ordinary)	m	0	0	0	0
Equity Raised	m	0	4,540	0	0
Debt Movements	m	750	-2,600	-450	-5,270
Other	m	166	0	0	0
Financing Cashflow	**m**	**916**	**1,940**	**-450**	**-5,270**
Net Chg in Cash/Debt	**m**	**-665**	**4,652**	**-592**	**3,599**
Free Cashflow	**m**	**-468**	**284**	**973**	**1,636**

Balance Sheet		2009A	2010E	2011E	2012E
Cash	m	912	0	0	0
Receivables	m	4,161	7,071	9,819	13,096
Inventories	m	2,334	3,967	5,509	7,347
Investments	m	3,414	3,414	3,414	3,414
Fixed Assets	m	9,319	16,407	16,424	16,391
Intangibles	m	10,094	10,094	10,094	10,094
Other Assets	m	2,054	3,491	4,847	6,465
Total Assets	**m**	**32,287**	**44,444**	**50,106**	**56,807**
Payables	m	4,410	7,495	10,408	13,882
Short Term Debt	m	3,118	3,118	3,118	3,118
Long Term Debt	m	11,451	12,591	11,549	9,878
Provisions	m	0	0	0	0
Other Liabilities	m	2,412	4,083	5,661	7,543
Total Liabilities	**m**	**21,391**	**27,288**	**30,736**	**34,421**
Shareholders' Funds	m	8,311	14,401	16,390	19,101
Minority Interests	m	2,585	2,755	2,980	3,285
Other	m	0	0	0	0
Total S/H Equity	**m**	**10,896**	**17,156**	**19,370**	**22,386**
Total Liab & S/H Funds	**m**	**32,287**	**44,444**	**50,106**	**56,807**

All figures in INR unless noted.
Source: Company data, Macquarie Research, February 2011

Important disclosures:

Recommendation definitions

Macquarie - Australia/New Zealand
Outperform – return >3% in excess of benchmark return
Neutral – return within 3% of benchmark return
Underperform – return >3% below benchmark return

Benchmark return is determined by long term nominal GDP growth plus 12 month forward market dividend yield

Macquarie – Asia/Europe
Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

Macquarie First South - South Africa
Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

Macquarie - Canada
Outperform – return >5% in excess of benchmark return
Neutral – return within 5% of benchmark return
Underperform – return >5% below benchmark return

Macquarie - USA
Outperform (Buy) – return >5% in excess of Russell 3000 index return
Neutral (Hold) – return within 5% of Russell 3000 index return
Underperform (Sell)– return >5% below Russell 3000 index return

Volatility index definition*

This is calculated from the volatility of historical price movements.

Very high–highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

Medium – stock should be expected to move up or down at least 30–40% in a year.

Low–medium – stock should be expected to move up or down at least 25–30% in a year.

Low – stock should be expected to move up or down at least 15–25% in a year.
* Applicable to Australian/NZ/Canada stocks only

Recommendations – 12 months
Note: Quant recommendations may differ from Fundamental Analyst recommendations

Financial definitions

All "Adjusted" data items have had the following adjustments made:
Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense
Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

EPS = adjusted net profit / efpowa*
ROA = adjusted ebit / average total assets
ROA Banks/Insurance = adjusted net profit /average total assets
ROE = adjusted net profit / average shareholders funds
Gross cashflow = adjusted net profit + depreciation
*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

Recommendation proportions – For quarter ending 31 December 2010

	AU/NZ	Asia	RSA	USA	CA	EUR	
Outperform	46.38%	62.62%	52.17%	44.99%	67.57%	50.90%	(for US coverage by MCUSA, 13.59% of stocks covered are investment banking clients)
Neutral	37.68%	18.58%	34.78%	50.61%	28.83%	35.48%	(for US coverage by MCUSA, 15.22% of stocks covered are investment banking clients)
Underperform	15.94%	18.80%	13.04%	4.40%	3.60%	13.62%	(for US coverage by MCUSA, 0.00% of stocks covered are investment banking clients)

Company Specific Disclosures:

Important disclosure information regarding the subject companies covered in this report is available at www.macquarie.com/disclosures.

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Tim Smart (Asia – Deputy Head)	(852) 3922 3565

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Linda Huang (Hong Kong)	(852) 3922 4068
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Rob Fabbro (UK/Europe)	(44) 20 3037 4865
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