

February 27, 2010

Industry View
In-Line

India Pharmaceuticals

Budget F11: As Usual, a Marginal Impact

Quick comment – What's new: In our view, the Union Budget for F2011 appears to have a marginal impact on India Pharmaceutical companies – a modest positive for regular tax-paying companies and a modest negative for MAT (Minimum Alternative Tax)-paying companies.

Favourable changes: An increase in weighted deduction in R&D expense for income tax calculations, a lowering of the surcharge on income tax, higher expenditures for healthcare infrastructure, and no increase in excise duty.

Adverse changes: An increase in MAT rate and an increase in input cost (5% higher petrol and petrol product prices).

Key Measures and Impact:

- **R&D expenditure:** Weighted deduction on expenditure incurred on in-house R&D (i.e., excluding outsourced R&D) has been increased to 200% from 150%. We view this move as beneficial across the sector, with major EPS upside ranging from 2% to 4% for our coverage universe.
- **Surcharge on income tax:** Reduction in surcharge for domestic companies to 7.5% from 10%; will marginally reduce corporate tax rate from 33.99% to 33.22%. This should benefit earnings by 1% or so.
- **Excise duty** on pharmaceutical products has been retained at 4% versus an increase across most other sectors (2%).
- **MAT rate:** Rate of MAT to increase to 18% of book profits from 15%. We estimate this will lower profits for Sun, Cipla, and Biocon by 2-3%.

The plan allocation for the Ministry of Health and Family Welfare has been increased to Rs223bn from Rs195bn for 2010-11, which should benefit longer-term industry growth.

India Pharma: Weighted Deduction on R&D Expenditure

	F9M10 data		
	Revenues	R&D expenditure	R&D expd as a % of revenues
Biocon	17,110	577	3.4%
Cipla *	52,343	2,355	4.5%
Dr Reddy's **	53,853	2,840	5.3%
Glaxo #	18,708	NA	NM
Lupin	34,557	2,445	7.1%
Ranbaxy #	73,294	4,875	6.7%
Sun Pharma	29,936	1,789	6.0%

India Pharma: MAT applicable for less than 17% Tax Rate

	F9M10 data
	Effective tax rate
Biocon	13.6%
Cipla *	14.0%
Dr Reddy's **	19.4%
Glaxo #	33.4%
Lupin	18.4%
Ranbaxy #	33.2%
Sun Pharma	6.7%

* For Cipla we have used actual FY09 data

** For Dr Reddy's effective tax rate excludes one time write offs

For Glaxo and Ranbaxy, we have used CY09 full year data

Source: Company data, Morgan Stanley Research

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Industry Coverage: India Pharmaceuticals

Company (Ticker)	Rating (as of)	Price* (02/26/2010)
Sameer Baisiwala, CFA		
Aventis (India) (AVPH.BO)	O (07/06/2005)	Rs1,610.1
Biocon Ltd (BION.BO)	U (10/24/2005)	Rs262.9
Cipla Ltd. (CIPL.BO)	E (01/29/2010)	Rs315.3
Dr. Reddy's Lab (REDY.BO)	O (09/24/2009)	Rs1,142.7
GlaxoSmithKline Pharma (GLAX.BO)	E (02/21/2010)	Rs1,715.5
Lupin Ltd. (LUPN.BO)	O (10/03/2006)	Rs1,497.65
Ranbaxy Laboratories (RANB.BO)	O (11/30/2009)	Rs467.05
Sun Pharmaceutical Industries (SUN.BO)	E (06/29/2009)	Rs1,540.9

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