



Lupin

Loop in

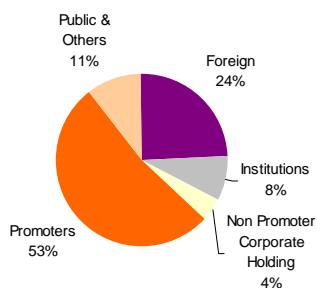
Apple Green

Buy; CMP: Rs807

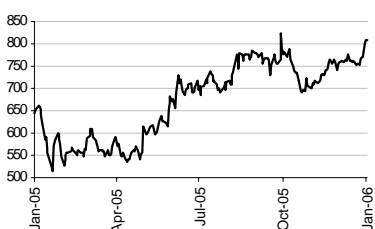
Company details

Price target:	Rs1,130
Market cap:	Rs3,208 cr
52 week high/low:	Rs833/482
NSE volume: (No of shares)	79,144
BSE code:	500257
NSE code:	LUPIN
Sharekhan code:	LUPLTD
Free float: (No of shares)	1.9 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	9.2	2.3	17.1	20.3
Relative to Sensex	0.1	-7.3	-12.8	-20.5

Key points

- Lupin has a vast reach in the domestic formulation segment. The company is now focusing on high growth lifestyle segments and with aggressive new launches in FY2006 we expect the revenues from the domestic formulations segment to increase by 33% from Rs455 crore in FY2005 to Rs608 crore in FY2006.
- The company has received approvals for eight formulation products from the US Food and Drug Administration (USFDA). As a result of the successful launches in the high-margin US market we expect the revenues to increase from Rs19 crore in FY2005 to Rs165 crore in FY2006 representing a growth of 769%.
- The boost in Lupin's regulated bulk revenues will come in FY2007 as two drugs—Simvastatin and Pravastatin—go off patent during this year having a market size of USD5.5 billion in the USA. Overall, we expect the sale of bulk drugs in advanced markets to increase by 61.7% from FY2006 to FY2007 on the back of the exports of statins.
- We expect the consolidated net sales to increase to Rs1,741 crore in FY2007. The foray into the regulated markets and the margin improvement is expected to boost the net profit to Rs230.6 crore in FY2007 at a compounded annual growth rate (CAGR) of 61.8% from FY2005. At the current market price of Rs807, Lupin is trading at 14x its FY2007 earnings estimate. Lupin's valuation looks very cheap and attractive when compared to its peers.
- Keeping in mind this overall growth of Lupin in all the areas like formulations, bulk drugs and research, we initiate a BUY recommendation on Lupin with an 18-month price target of Rs1,130.

Company background

Lupin is one of the leading integrated pharmaceutical companies in India, ranked eighth in the country in terms of net sales for FY2004. It has a significant presence in formulations in the domestic market and in bulk drugs in the export market. Having manufacturing facilities in Aurangabad, Mandideep and Tarapur, the company consolidated its position in anti-TB drugs by developing strong fermentation capabilities. Already the largest manufacturer of anti-TB drugs and lisinoprials in the world, Lupin is now foraying into the high margin regulated formulation markets in the USA and the European Union (EU).

Key financials

Year ended 31st March	FY2004	FY2005	FY2006E	FY2007E
Net sales	1,119.3	1,161.1	1,461.8	1,741.5
PAT	152.2	88.1	154.3	230.6
EPS	37.9	22.0	38.5	57.4
PE	21.3	36.8	21.0	14.0
EV/EBIDTA	12.7	24.9	14.1	10.0
P/BV	7.2	6.5	5.0	3.7
RONW (%)	33.4	16.9	23.1	25.8
ROCE (%)	27.3	10.9	13.2	16.0

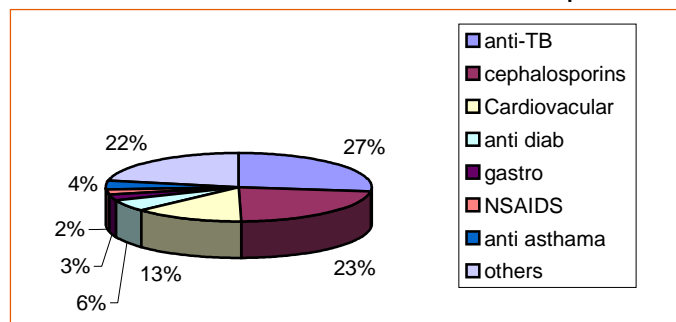
Investment arguments

Domestic formulation business to provide a strong base

Lupin has a vast reach in the domestic formulation segment. It has presence in therapeutic areas like anti-TB drugs and anti-infectives, as well as in high growth segments like cardiovascular, anti-diabetes and anti-asthma drugs. It is now concentrating on the lifestyle segments that yield higher margins. In the cardiovascular segment the company has launched three new products this year while in the high growth anti-diabetes segment it has launched four new products to capture a substantial market share. Overall, in the domestic market the company has launched a total of 18 products in the first half of FY2006 and has planned an equal number of launches in the second half.

The domestic formulation segment had witnessed lower revenues in FY2005 on account of the implementation of value-added tax and destocking. With the effect of the VAT related destocking now having diminished and with the company now focusing on high growth lifestyle segments with aggressive new launches, we expect the revenues from the domestic formulation segment to increase by 33% from Rs455 crore in FY2005 to Rs608 crore in FY2006.

Estimated FY2007 Domestic Formulations Breakup



Foray into the regulated markets to boost the bottom line

Lupin has been one of the most aggressive patent filers in FY2006. The company has received approvals for eight products (seven cephalosporins and one pril) from the USFDA. The major products amongst these are discussed below.

Suprax: Lupin markets cefixime (a third generation cephalosporin) under the brand name Suprax in the US markets. It has tied up with a US-based company Cornerstone Biopharma to develop a new drug delivery system (NDDS) for Suprax in the US markets. The sales of Suprax have picked up recently due to better marketing by the company and the advent of the flu season. Lupin has already notched up USD6.2 million from the sales of Suprax in H1FY2006. We estimate revenues of Rs59.8 crore from the sales of Suprax in the USA in FY2007. Lupin has increased the price of Suprax by 6% that has resulted in higher realisations.

The company will receive milestone payments of USD10.2 million from Cornerstone Biopharma over a period of time. These revenues have not been factored in our estimates and provide a cushion to the stock's valuations.

Ceftriaxone: Ceftriaxone, an antibiotic, is the world's largest selling cephalosporin with an estimated market size of around USD800 million in the USA. It became generic in July 2005. Lupin has been marketing Ceftriaxone in the US markets through tie-ups with Baxter Travineol in the hospital segment. Baxter Travineol's marketing network provides good penetration and hence we expect revenues of Rs90 crore from the sales of Ceftriaxone in the USA in FY2006.

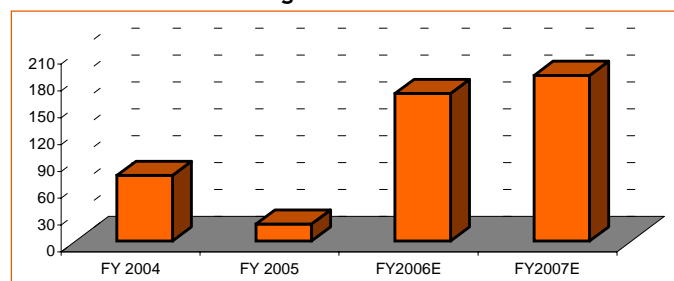
Lisinopril and others: Lupin received the USFDA approval to launch the Lisinopril formulation in September 2005. It will also market Cefprozil (another cephalosporin) in the USA from December 2006. Several products in the pril and cephalosporin segments and a few in the statin segment are scheduled for launch in the upcoming years.

As a result of these successful launches in the high margin US markets, we expect tremendous boost in the sales of formulations in the advanced markets. We expect these revenues to increase from Rs19 crore in FY2005 to Rs165 crore in FY2006, representing a growth of 769%. The effect of this increase on the bottom line will be significant due to the high margins obtained.

Figures in Rs crore

Advanced formulation exports	FY05	FY06E	FY07E
Suprax	6.8	56.3	59.8
Lisinopril		15.0	25.0
Ceftriaxone		90.0	89.8
Other Cephalosporins	12.2	3.9	10.8
Total	19.0	165.1	185.3

Formulation Sales to Regulated Markets



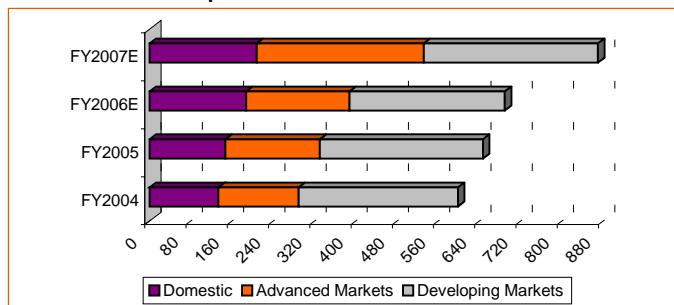
API sales to advanced markets to rocket in FY2007

Lupin is the largest manufacturer of bulk Lisinopril in the world. It has close to 27% market share in the US market and a significant share in Europe as well. We expect the revenues from lisinopril to remain almost flat.

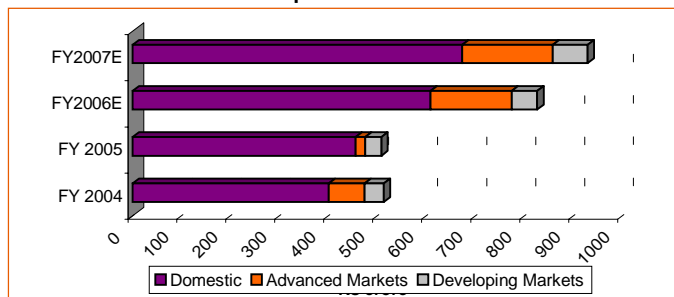
The major growth in the regulated bulk revenues will come in FY2007 as two drugs, Simvastatin and Pravastatin, go off patent during this year. These two molecules

cumulatively represent a market size of USD5.5 billion in the USA. With a price erosion of 91% and a modest market share of 5% for Lupin, we expect the revenues from the sale of bulk statins to go up to Rs108 crore for Lupin in FY2007. Overall, we expect the sales of bulk drugs in advanced markets to increase by 61.7% from FY2006 to FY2007 on the back of statin exports.

Bulk Sales Breakup



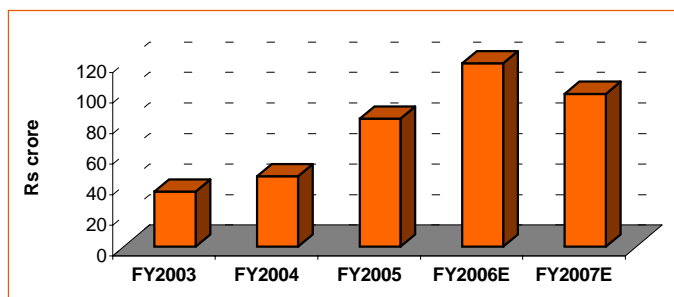
Formulation Sales breakup



Aggressive R&D spending to yield results

Lupin has aggressively started investing in research and development (R&D) and is filing for a large number of products in the US markets to exploit the increasing generic opportunity in the USA and the EU. It has planned 16 abbreviated new drug application (ANDA) filings for FY2006 and an equal number for FY2007. These filings are in high growth, high revenue lifestyle therapeutic groups like prils and statins along with the conventional anti-infective segment. Lupin has developed one of the largest pril capacities in the world and is all set to take advantage of this opportunity.

R&D expense



On R&D, Lupin plans to spend close to Rs120 crore in FY2006 and a similar amount in the forthcoming years. Research in new drug delivery systems (NDDS) is already gaining

momentum with the building of three oral controlled release platforms and the out-licencing of NDDS in the anti-infective category to Cornerstone Biopharma. In new chemical entity (NCE) research, Lupin is working on four new molecules. The anti-migraine molecule has reached phase 2 trials and the anti-Psoriasis molecule has completed phase 1 research. These molecules have high potential to become big revenue drugs of the future. The company is looking forward to out licence these drugs and this can be a good revenue source.

Some key DMFs filed

Type	Name	Date of filing	US market size USD (million)	Patent expiry
Cephalosporin	Cefdinir	Sep-04	255	2007
Cephalosporin	Cefprozil	Sep-04	120	Dec-07
Pril	Ramipril	Dec-04	820	Oct-08
Pril	Quinapril	Dec-04	555	Litigation
Pril	Lisinopril	Dec-04	470	Sep-05
Statin	Simvastatin	Dec-04	3000	Jun-06

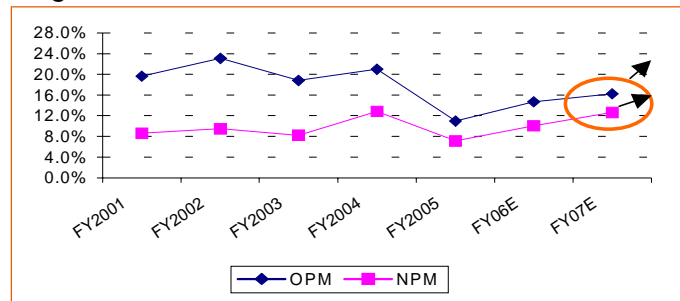
Capacity expansions expected through inorganic route

Lupin issued foreign currency convertible bonds (FCCBs) worth USD100 million in December 2005. This would provide the cash reserves required to go for an acquisition in either the USA or India. The company has started short-listing acquisition candidates and we expect the acquisition to happen in the near to medium term.

Margins to make the upward move

Lupin's bottom line will benefit significantly due to its foray in the regulated markets of the USA and Europe. Lupin operated at very low margins in FY2005 (OPM = 10.9%). The entry in the high margin formulation segment of regulated markets and the increased presence in the regulated bulk market will result in a significant increase in the margins. On a very conservative estimate we expect the company's margins to improve to 14.7% in FY2006 and to 16.2% in FY2007. Lupin has managed to achieve margins of 17% in the first half of FY2006. This is before the launch of the generic versions of Ceftriaxone, Lisinopril formulations and Cefprozil in the USA. Hence we have provided a significant cushion to our estimates and might see the margins for the year surpass our estimates.

Margins



PAT to grow at 61.8% CAGR from FY2005 to FY2007

We expect the consolidated net sales to increase from Rs1,161 crore in FY2005 to Rs1,741 crore in FY2007 at a CAGR of 22.5%. The sales from the regulated markets are expected to increase at a CAGR of 59% from FY2005 to FY2007. The foray in the regulated markets and the margin improvement are expected to boost the net profit to Rs230.6 crore in FY2007 at 61.8% CAGR from FY2005 to FY2007. Lupin's return on net worth (RoNW) for FY2007 is estimated at 25.8% as against 16.5% in FY2005. These estimates indicate the huge potential that the company possesses and that will be realised in the upcoming quarters.

Valuation table

Figures in Rs crore	FY2004	FY2005	FY06E	FY07E
Share price	800			
Net sales	1119.3	1161.1	1461.8	1741.5
PAT	152.2	88.1	154.3	230.6
EPS	37.9	22.0	38.5	57.4
PE	21.3	36.8	21.0	14.0
EV/EBIDTA	12.7	24.9	14.1	10.0
BV/share	111.6	124.7	162.2	218.6
P/BV	7.2	6.5	5.0	3.7

Valuation

We have valued Lupin using three valuation parameters that we think are important for any pharmaceutical company.

Method1: Price/Earnings ratio

At the current market price of Rs807, Lupin is trading at 14x its FY2007 earnings estimate. This valuation is extremely cheap as compared with that of its peers like Cipla and Dr Reddy's Laboratories who are trading at close to 21x FY2007 earnings. We expect the valuation of these companies to grow to 24x their FY2007 earnings in 18 months' time. Considering the developing research pipeline that Lupin has, we have assigned Lupin a valuation of 19.25x its FY2007 earnings multiple as against that of 24x to its peers. This results in an 18-month forward price of Rs1,105, which indicates a 38% upside to the current market price.

PE

Company	Ranbaxy	Sun Pharma	Cipla	Dr.Reddy's	Lupin
CY05/FY06	46.1	22.2	25.2	29.8	21.0
CY06/FY07	23.1	19.7	20.3	22.1	14.0

Method 2: Mkt cap/EBIDTR analysis

The big companies in the pharmaceutical sector spend significantly on R&D. The benefit of this spending is seen in the long run in the form of a strong product pipeline.

Hence to analyse the core operations of a pharmaceutical company, we compare the market capitalisation (mkt cap)/earnings before interest, depreciation, tax and research (EBIDTR) of the peers. A comparison of the mkt cap/EBIDTR shows that Lupin is trading at 7.1x its FY2007 mkt cap/EBIDTR. That is a steep discount to its peers, who are trading at close to 13x their FY2007 mkt cap/EBIDTR. We believe that at least a multiple of 10.2 should be assigned to Lupin, keeping in mind the areas and the markets of its operation. This translates to an 18-month forward price of Rs1,149, which is a 44% upside to the current price.

Mkt cap/EBIDTR

Company	Nicholas	Sun Pharma	Cipla	Dr.Reddy's	Lupin
CY05/FY06	19.9	18.2	20.0	13.1	8.76
CY06/FY07	13.1	15.0	14.6	10.5	7.16

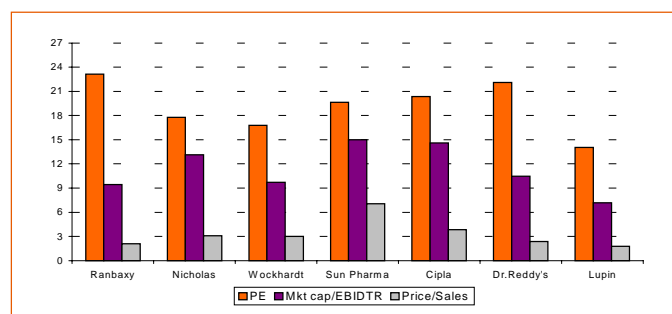
Method 3: Price/Sales ratio

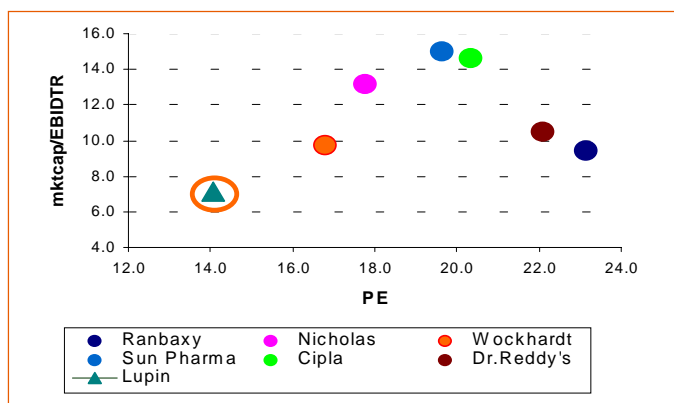
We believe that because of the complex business models that the top pharma companies are following, the revenue becomes the main growth driver in the long term as the margins start to stabilise. Hence the ability to generate sales consistently in the future is of essence and should be valued. That is why we use the price/sales ratio as a parameter to value these companies. A comparison with its peers on this parameter shows that Lupin is trading at 1.8x its FY2007 price/sales ratio. That is again a significant discount to its peers who are trading at over 3x their FY2007 price/sales ratio. We believe that with the strong product portfolio that Lupin is developing, it should trade at least at 2.6x its FY2007 price/sales ratio. This valuation gives it a price estimate of Rs1,128, ie a 40% upside to the current price.

Price/Sales

Company	Nicholas	Wockhardt	Cipla	Dr.Reddy's	Lupin
CY05/FY06	3.7	3.2	4.5	3.0	2.1
CY06/FY07	3.1	3.0	3.9	2.4	1.8

Since we believe that these three valuation parameters are of utmost importance, we assign them equal weightage and arrive at our 18-month price target of Rs1,130, estimating a 40% upside to the current market price.





The cushion to our estimates comes from:

1. Milestone payments of Rs46 crore to be obtained from Cornerstone over a period of time;
2. The sale of finished dosages of statins like Simvastatin and Pravastatin in the USA in FY2007;
3. Possible revenues from the acquisition that Lupin is planning to make in the near future.
4. Revenues from out licencing of the molecules being developed by the company.

On the whole, Lupin's valuation looks very cheap and attractive when compared with that of its peers on every count. The company is consolidating its presence in the domestic market with lifestyle drugs and forging its way in the regulated markets with a large product portfolio backed by a strong research pipeline. Keeping in mind the overall growth of Lupin in all the areas like formulations, bulk drugs and research, we initiate a Buy recommendation on Lupin with an 18-month price target of Rs1,130.

P&L account (stand-alone)

Rs (cr)

Particulars	FY2004	FY2005	FY2006E	FY2007E
Sales (gross)	1167.9	1212.3	1514.9	1798.6
Less excise duty	48.7	51.1	53.1	57.1
Sales (Net)	1119.3	1161.1	1461.8	1741.5
OtherIncome	45.6	18.8	34.7	49.9
TotalIncome	1164.8	1179.9	1496.5	1791.5
Total expenses	884.7	1034.1	1246.9	1459.2
Operating profit	234.6	127.0	214.9	282.4
EBIDTA	280.2	145.8	249.6	332.3
Interest	51.5	27.3	25.9	26.5
Depreciation	29.0	33.2	33.8	36.1
PBT	199.6	85.3	189.9	269.7
Total tax	50.0	0.9	39.5	43.3
PAT	149.6	84.4	150.5	226.5

Balance sheet (stand-alone)

Rs (cr)

Particulars	FY2004	FY2005	FY2006E	FY2007E
Equity capital	40.1	40.1	40.1	40.1
Reserves & surplus	407.9	460.4	610.8	837.3
Shareholders' fund	448.0	500.5	651.0	877.5
Total loans	377.1	440.6	895.6	905.6
Total LIAB	919.3	1034.6	1640.1	1876.5
Net fixed assets	534.4	628.8	595.0	558.9
Investments	8.9	9.4	573.6	769.3
Current assets	646.2	673.9	764.2	851.6
Current liabilities	270.1	277.4	300.3	330.1
Net current assets	376.0	396.5	463.9	521.5
Total ASSETS	919.3	1034.6	1632.5	1849.6

Key ratios

Particulars	FY2004	FY2005	FY2006E	FY2007E
OPM (%)	21.0	10.9	14.7	16.2
NPM (%)	12.8	7.1	10.0	12.6
Debt:Equity	0.8	0.9	1.4	1.0
RONW (%)	33.4	16.9	23.1	25.8
ROCE (%)	27.3	10.9	13.2	16.0

The author doesn't hold any investment in any of the companies mentioned in the article.

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