



Q4FY2007 Pharma earnings preview

Indian pharma companies maintain growth at sustainable levels during Q4FY2007

Key points

- ◆ We remain positive on the Indian pharmaceutical sector on account of the continued domestic growth, steady contributions from exports and synergies arising out of integration of acquisitions. Further, the increased focus on drug discovery and collaborative research with the global players enhances the medium-term earnings visibility for the sector.
- ◆ In line with the business trend, the growth of the domestic market moderated to around 9% in Q4FY2007 from over 15% in the previous couple of quarters. But the ramp-up in the formulation export segment continues to be robust and the successful integration of acquisitions (viz Ranbaxy Laboratories' Terapia, Wockhardt's Pinewood and Nicholas Piramal's Morpeth) would drive the revenue growth for the sector. Further, Dr Reddy's Laboratories' 180-day exclusivity for Ondansetron would also boost the overall industry growth. We expect the pharmaceutical companies under our coverage to report a revenue growth of 20.3% in Q4FY2007.
- ◆ With a greater number of players entering the generic space in the USA and the European Union, pricing pressures are likely to continue. But thanks to the cost-cutting efforts, improvement in the product mix and larger thrust on branded formulation business by the local players, stable margins are likely to be ensured. The pharmaceutical companies under our coverage are expected to report a 420-basis-point expansion in the operating profit margin (OPM), leading to a 30% growth in their net profit in Q4FY2007.
- ◆ Research and development (R&D) was the highlight of the fourth quarter as Indian pharma space witnessed impressive developments on the R&D front. Sun Pharmaceuticals de-merged its R&D unit into a separate entity called Sun Pharma Advance Research Company and unveiled its new chemical entity (NCE)/novel drug delivery system (NDDS) pipeline (comprising four NCEs and four NDDS). Alongside, Ranbaxy Laboratories has expanded its collaborative research partnership with GlaxoSmithKline Plc (GSK), as per which the Indian company would identify the new chemical leads and take them up to Phase-II proof of concept study. The Ranbaxy Laboratories-GSK alliance would focus on therapies like anti-infectives, metabolic disorders, respiratory and oncology. As per the deal, Ranbaxy Laboratories could receive over \$100 million in potential milestone payments for a single product. We expect further positive news flow on the innovative R&D front from Lupin, Dr Reddy's Laboratories and Glenmark Pharmaceuticals in the coming quarters, which would act as a strong growth trigger in the medium to long term.

Quarterly estimates: January-March 2007

Company	Net sales (Rs cr)			Operating margin (%)		Net profit (Rs cr)		
	Jan-Mar 07	Jan-Mar 06	% yoy growth	Jan-Mar 07	Chg(bps)	Jan-Mar 07	Jan-Mar 06	% yoy growth
Ranbaxy Labs	1,437.2	1,263.1	13.8	12.0	304.0	131.5	71.40	84.2
Cipla	961.7	870.6	10.5	26.0	534.0	199.6	190.8	4.6
Sun Pharma	557.9	405.4	37.6	31.6	766.0	184.4	142.9	29.1
Wockhardt	505.3	351.0	44.0	20.8	113.0	67.1	56.7	18.3
Lupin	486.6	422.0	15.3	17.9	750.0	57.5	50.2	14.6
Nicholas Piramal	602.6	425.4	41.7	15.6	691.0	50.5	15.2	230.8
Orchid Chemicals	242.2	239.8	1.0	30.7	189.0	25.7	19.4	32.4
Cadila Healthcare	411.2	346.0	18.9	19.4	42.0	44.4	34.2	29.7
Elder Pharmaceuticals	121.5	93.4	30.1	17.9	-234.0	15.2	12.7	19.5
Unichem Laboratories	124.2	105.8	17.5	17.5	-57.0	15.5	15.6	-0.4
Total	5,326.4	4,416.8	20.6	20.3	420.0	775.9	593.5	30.7

Ranbaxy Laboratories

Ranbaxy Laboratories is expected to report a 13.8% increase in its net sales to Rs1,437 crore for Q4FY2007, driven largely by the integration of the Terapia acquisition. The cost-cutting efforts by the company would result in a 300-basis-point expansion in the OPM to 12% on a lower base. The rupee appreciation vis-à-vis the dollar would also result in foreign exchange gains on its outstanding \$440 million foreign currency convertible bonds. We expect Ranbaxy Laboratories to deliver an 84% jump in its net profit to Rs131.5 crore.

Cipla

We expect Cipla to deliver a lacklustre revenue growth of 10.5% in Q4FY2007 mainly due to the high base effect of Q4FY2006. The revenue growth would be led by a 12% rise in the domestic business and a modest 6% growth in the exports (as active pharmaceutical ingredient [API] exports in Q4FY2006 were inflated by the supply of Sertraline API to Teva). With the improving product and market mixes, Cipla's OPM will expand by 480 basis points to 25.5% during Q4FY2007. With higher both depreciation cost and tax incidence, the net profit before extraordinary items is expected to grow by 16.7% to Rs199.6 crore in Q4FY2007. In Q4FY2006, Cipla had an extraordinary income of Rs19.7 crore; including the same the bottom line growth will be restricted to 4.6% at Rs199.6 crore.

Sun Pharmaceuticals

Sun Pharmaceuticals is likely to report a 37.6% revenue growth on the back of a 16.6% improvement in its domestic business and an impressive 46.7% jump in its exports. Despite pricing concerns, Caraco (the US outfit of the company) is expected to maintain its momentum primarily supported by new product launches (like Glipizide, Baclofen, Gabapentin and Phenytoin) and progressive improvement in its share of the US market. With vertical integration in some of its products, cost-cutting efforts and increasing revenues flowing in from the regulated markets, the OPM is likely to expand by 770 basis points (on a lower base) to 31.6%. This would lead to an impressive growth of 29.1% in the net profit to Rs184.4 crore in Q4FY2007.

Nicholas Piramal

Nicholas Piramal is expected to deliver a top line growth of over 41.7% to Rs602.6 crore, driven mainly by the acquisition of Pfizer's manufacturing facility at Morpeth, UK and the increased momentum in the contract research and manufacturing service (CRAMS) business. Also the strong revival of its largest brand, *Phensedyl*, is likely to fuel the revenue growth in Q4FY2007 (*Phensedyl* sales were hit by the unfortunate controversy caused by the Narcotic Control Bureau in the corresponding quarter of the previous year). Despite margin pressure from the integration of the loss-making Avecia, Nicholas Piramal (supported by the

increasing CRAMS revenue, improved product mix and progressive shifting of manufacturing to excise-exempt facilities) would expand its OPM by 690 basis points to 15.6%. With the rising top line and expanding OPM, we expect Nicholas Piramal to deliver a whopping 230.8% jump in its net profit to Rs50.5 crore in Q4FY2007.

Wockhardt

Wockhardt is expected to show a strong growth of 44% in its sales to Rs505.3 crore, driven by the consolidation of the Pinewood and Dumex businesses, a ramp-up in its US business on account of new launches such as Ondansetron and Darvocet, and the steady growth in its domestic and UK businesses. The earnings before interest, tax, depreciation and amortisation margin is likely to expand by 113 basis points to 20.8%, aided partly by the capitalisation of abbreviated new drug application (ANDA) development costs. However, the increase in depreciation (due to the commissioning of the new biotech facility at Aurangabad) along with the higher interest expenses (due to the acquisitions) and the higher tax rate (due to an increase in the minimum alternative tax) will restrict Wockhardt's net profit growth to 18.3% to Rs67.1 crore.

Lupin

We expect Lupin's sales to grow by 15.3% year on year (yoy) to Rs486.6 crore in Q4FY007, driven by the continued momentum in its domestic formulation business and formulation exports to the semi-regulated markets and the USA. The sales in the USA are likely to be boosted by the recently launched Sertraline tablets and the strong sales of Lupin's branded formulation, *Suprax*. Lupin's OPM is expected to jump by 750 basis points due to a sharp improvement in the gross margin as the company's product and geographical mixes improve. A substantially lower other income coupled with higher tax provisioning is likely to cause the net profit to grow by 14.6% to Rs57.5 crore. Our profit estimate does not include the 20 million euros received from the sale of Perindopril intellectual property right to Laboratories Servier of France.

Cadila Healthcare

An improvement in the branded domestic formulation business post-restructuring, a strong growth in the consumer product business off a low base in Q4FY2006 and steady contributions from the export markets are likely to drive up Cadila Healthcare's revenues by 18.9% to Rs411.2 crore in Q4FY2007. On the export front, we expect the growth to be driven largely by the growing revenues from the French and US businesses. The US revenues are likely to witness a substantial jump due to a full quarter impact of the revenues from Simvastatin tablets, which were launched on December 24, 2006. Revenues from the company's joint venture with Altana which had dipped due

to the closure of the facilities in Q3FY2007 are expected to bounce back. Despite the sharp improvement in the gross margin, as the product and market mixes of the company improve we expect the margin to remain flat with the significant rise in the R&D cost due to an increase in the number of ANDA filings for the US market. We expect the company to report a 29.7% rise in its net profit to Rs44.4 crore in Q3FY2007.

Orchid Chemicals

We expect Orchid Chemicals' revenues to grow by a meagre 1% in Q4FY2007, as the company has had no major launches in the US market during the quarter. The US market is the main growth driver for the company. However, with the flu season having set in the USA, we expect the contributions from the other antibiotics like Cefozitin and Cefazolin (where Orchid Chemicals has already captured a dominant share of the market) to improve. An improving product mix, with a higher share of formulations, is expected to improve the OPM by 190 basis points yoy to 30.7%. Orchid Chemicals' net profit growth on a year-on-year basis is likely to be strong at 32.4% to Rs25.7 crore due to the relatively lower base of Q4FY2006.

Elder Pharmaceuticals

Elder Pharmaceuticals is expected to show a strong growth of 30.1% yoy in its revenues, led by the continued momentum in its key brands, such as *Shelcal*, *Chymoral* and *Eldervit*, growing sales of the *Fair One* brand and rising revenues

from its in-licenced portfolio. We expect the company's OPM to decline by 230 basis points yoy to 17.9% on account of the higher selling and marketing expenses incurred during the quarter on account of the sponsorship of the Filmfare awards and the increased marketing spend to promote new in-licenced products such as *Bonviva*. Higher interest and depreciation costs (as the company has just commissioned its Paonta Sahib plant) along with a lower tax outgo (as the company continues to derive an increasing proportion of its income from tax-free areas) will cause Elder Pharmaceuticals' net profit to grow by 19.5% yoy to Rs15.2 crore.

Unichem Laboratories

We expect Unichem Laboratories' top line to report a growth of 17.5% to Rs124.2 crore, driven by a 19% rise in its domestic business and an 11.6% surge in its exports. A steady growth in the company's power brands coupled with a stream of new launches will drive the domestic business while the increase in the number of product registrations in the semi-regulated markets will boost the exports. The increase in the R&D costs due to a ramp-up in the ANDA filings for the USA is likely to exert pressure on the margin, which is likely to decline by 60 basis points yoy to 17.5%. An increase in the depreciation charge (due to the commissioning of the expanded capacity at Baddi) and a substantially higher tax provisioning (at 18% of the profit before tax [PBT] versus 7.5% of PBT in Q4FY2006) will cause the net profit before extraordinary items to decline by 0.4% to Rs15.5 crore.

Valuation table: Sharekhan pharma universe

Company	CMP (Rs)	FY06	EPS FY07E	FY08E	FY06	P/E multiple FY07E	FY08E
Ranbaxy Labs **	353	7.0	13.8	20.8	50.2	25.5	17.0
Cipla	236	7.8	9.8	12.0	30.2	24.2	19.6
Sun Pharma	1,095	30.9	38.3	47.9	35.5	28.6	22.8
Wockhardt **	407	23.5	27.6	30.2	17.3	14.8	13.5
Lupin	622	20.7	26.8	37.2	30.0	23.2	16.7
Nicholas Piramal	250	6.0	11.0	16.4	41.9	22.7	15.2
Orchid Chemicals	275	12.8	13.3	26.1	21.4	20.7	10.5
Cadila Healthcare	350	13.1	17.8	22.0	26.7	19.7	15.9
Elder Pharmaceuticals	416	21.0	29.9	40.2	19.8	13.9	10.3
Unichem Laboratories	256	19.5	23.8	28.5	13.2	10.8	9.0

** EPS and P/E multiple are for CY06, CY07 and CY08

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

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