



Q1FY2008 Pharma earnings preview

Rising rupee to hurt margins

- ♦ The domestic pharmaceutical industry price hikes maintained its double-digit growth trajectory in the formulation segment in Q1FY2008. While the growth has been primarily driven by higher volumes, we also note that the industry is witnessing in the range of 1-2%. Thanks to a continuous stream of new launches, we believe Indian companies will manage to grow at above industry growth rates.
- ♦ Even though the volume-led export growth has been good during the first quarter, the appreciation of the rupee vis-à-vis US Dollar is likely to hit the exports of the pharmaceutical companies. The Indian Rupee has appreciated by almost 9.5% to Rs41.2 against the USD during Q1FY2008. Companies with a high share of export revenues like Ranbaxy Laboratories (Ranbaxy), Dr Reddy's Laboratories, Orchid Chemicals and Pharmaceuticals (Orchid), Sun Pharmaceuticals (Sun Pharma) and Cipla will be hit the most.
- ♦ Taking a sharp hit on their export revenues on the one hand, pharmaceutical companies with outstanding foreign currency convertible bonds (FCCBs) are also likely to benefit from the appreciation of the rupee against the USD. Companies such as Ranbaxy, Sun Pharma, Orchid, Lupin and Aurobindo Pharma are likely to benefit from the currency translation gains on their outstanding FCCBs.
- ♦ The trend of global consolidation continued during the quarter, with Mylan acquiring the generic business of Merck KgA. Indian companies too have continued their merger and acquisition (M&A) spree, is evident from by Sun Pharma's acquisition of Taro in a \$454-million all-cash deal. Companies such as Wockhardt and Cadila Healthcare (Cadila) too have been aggressive on the M&A front and are likely to witness a strong revenue growth, driven by the consolidation of their acquisitions.
- ♦ Companies under our coverage are expected to report a 28.6% growth in profits on the back of a 19.6% increase in revenues. However, we believe that the operating profit margins (OPMs) of the companies under our coverage will decline by 260 basis points, largely due to the impact of the rupee appreciation.

Ranbaxy

Ranbaxy is expected to report a 10.6% growth in its net sales to Rs1,586.59 crore for Q1FY2008, driven largely by the integration of the Terapia acquisition. The sales growth was modest due the impact of the rupee's appreciation against the dollar; otherwise the sales would have grown by 21.9%. Though the company launched Pravastatin-80mg under 180-day exclusivity, it faces competitive scenario in the US market. The OPM is expected to decline by 410 basis points to 12.8% due to currency appreciation and one-

Quarterly estimates: April-June 2007

Company	Net sales (Rs cr)			Operating margin (%)		Net profit (Rs cr)		
	Apr-Jun 07	Apr-Jun 06	% yoy chg	Apr-Jun 07	Change (bps)	Apr-Jun 07	Apr-Jun 06	% yoy chg
Ranbaxy Labs	1,586.6	1,433.9	10.6	12.8	-410	189.6	121.1	56.6
Cipla	972.3	863.6	12.6	20.0	-650	176.8	170.4	3.7
Sun Pharma	587.9	511.6	14.9	31.2	-420	227.8	176.7	28.9
Wockhardt	643.7	412.7	56.0	21.4	-30	82.2	63.4	29.7
Lupin	592.5	468.9	26.4	18.4	300	80.0	58.9	36.0
Nicholas Piramal	659.9	522.6	26.3	15.3	-150	59.3	53.9	10.1
Aurobindo Pharma	542.4	438.6	23.7	13.5	-150	63.9	36.2	76.5
Orchid Chemicals	223.2	201.7	10.7	29.8	100	20.2	14.6	38.6
Cadila Healthcare	529.9	445.8	18.9	19.3	-80	65.2	58.4	11.6
Total	6,338.4	5,299.3	19.6	20.3	420	965.0	753.6	28.1

time impact of the high-margin Simvastatin 80mg sales under exclusivity in Q2CY2006. The rupee's appreciation vis-à-vis the dollar would also result in foreign exchange gains to the tune of Rs98.2 crore on its outstanding \$440-million FCCB, resulting in a 56.6% growth in its net profit to Rs189.5 crore in Q1FY2008.

Cipla

We expect Cipla to deliver a nominal revenue growth of 12.6% to Rs972.3 crore in Q1FY2008 on a higher revenue base. (Its active pharmaceutical ingredient [API] exports in Q1FY2007 were inflated by the supply of sertraline API to Teva). We estimate a 23.8% growth in the export revenues during the quarter. With the increasing revenues from the low-margin business of anti-retrovirals (ARVs) and lower realisation due to currency appreciation, Cipla's OPM will decline sharply by 650 basis points to 20%. The resultant net profit is estimated to show a flattish growth (ie a 3.7% growth) to Rs176.8 crore during Q1FY2008.

Sun Pharma

Sun Pharma is likely to report a 15% revenue growth to Rs587.9 crore on the back of a 17.4% improvement in its domestic business and an impressive 12.6% rise in its exports. Despite pricing concerns, Caraco, the US subsidiary of the company, is expected to maintain its momentum and grow by 25%, primarily supported by new product launches (viz Phenytoin, Nimodipine etc). Driven by a lower realisation caused by the rupee's appreciation, the OPM is likely to fall by 420 basis points (on a higher base) to 31.2%, resulting in a 28.9% growth in the net profit to Rs227.8 crore in Q1FY2008.

Nicholas Piramal

Nicholas Piramal is expected to deliver over 26% top line growth to Rs657.6 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 business. The OPM is expected to decline by 160 basis points yoy to 15.2% due to the short supply of Codeine (an important input for Phensedyl, an over Rs150-crore brand), higher costs at Morpeth and currency appreciation. With higher interest (up 110%) and rising tax incidence (up from 11% in Q1FY2007 to 15%), the net profit would report a 10% growth to Rs59.3 crore for Q1FY2008.

Aurobindo Pharma

Aurobindo Pharma is likely to report a 23.7% revenue growth to Rs542.4 crore, mainly led by the incremental revenue flowing from the US generic and ARV formulation businesses. The formulation business is expected to deliver

a 90% jump in the quarter. The OPM is expected to fall by 150 basis points yoy due to the merger of the low-margin subsidiaries, APL Life Science and Senor Organics. The FCCB translation gain due to the rupee's appreciation will raise the other income by 180% to Rs47.9 crore, resulting in a 76.5% growth in the net profit to Rs63.9 crore.

Aurobindo Pharma does not declare its consolidated quarterly results. Our quarterly estimates are stand-alone, while the annual estimates are on a consolidated basis. We expect the consolidated margin to see stronger growth compared to the stand-alone performance on the back of the galloping Penicillin-G prices from Q1FY2008 onwards.

Wockhardt

Wockhardt is expected to show a strong growth of 56% in its sales to Rs643.7 crore, driven by the consolidation of the Negma, Pinewood and Dumex businesses, a ramp-up in its US business on account of the new launches such as Furosemide and Ketorolac injections, and the steady growth in its domestic and UK businesses. The OPM margins are likely to decline marginally by 30 basis points to 21.4%, due to the acquisition of the relatively lower-margin Negma, Pinewood and Dumex businesses. However, the increase in the depreciation charge (due to the commissioning of the new biotech facility at Aurangabad and the consolidation of the acquired businesses) along with the higher interest expenses (due to the acquisitions) will restrict Wockhardt's net profit growth to 29.7% to Rs82.2 crore.

Lupin

We expect Lupin's sales to grow by 26.4% yoy to Rs592.5 crore in Q1FY008, driven by a 10.8% growth in the domestic business and a 48.8% surge in exports. The export growth will primarily be driven by the strong growth in the US business, which will be boosted by the revenues from the launch of Cefdinir (estimated to contribute \$8 million approximately). The launches of Trandolapril and Simvastatin will also aid the US business. Lupin's OPM is expected to jump by 300 basis points due to substantial contribution from the sales of the high-margin Cefdinir in the USA. The expanding margins along with the marked-to-market gains on the outstanding FCCBs are likely to result in a strong profit growth of 36% to Rs80 crore during the quarter.

Cadila

A rebound in the domestic formulation business post-restructuring, the consolidation of the recently acquired Liva Healthcare, a 25% growth in the consumer product business and a 30.6% rise in the exports are likely to drive up Cadila's revenues by 18.9% to Rs529.9 crore in Q1FY2008. On the export front, we expect the growth to be driven

largely by the growing revenues from the French and US businesses and the steady contribution from the Altana joint venture. The OPM is likely to dip by 80 basis points due to the appreciation of the rupee and a decline in the share of the revenues from the high-margin Altana joint venture. We expect the company to report a subdued 11.6% rise in its net profit to Rs65.2 crore in Q1FY2008 (due to higher interest and depreciation costs on account of acquisitions).

Orchid

We expect Orchid's revenues to grow by a modest 10.7% in Q1FY2008 to Rs223.3 crore, on a low base, as the company has had no major launches in the US market during the

quarter. On a sequential basis, we expect the revenues to show a seasonal decline as the antibiotic season in the USA (which is the major market for the company) is over. An improving product mix, with a higher share of formulations, is expected to improve the OPM by 100 basis points yoy to 29.8%. However, on a sequential basis, we expect the margin to decline by 100 basis points on account of the higher prices of Penicillin-G (which is one of the main raw materials for the company). Orchid's net profit growth on a year-on-year basis is likely to be strong at 38.6% to Rs20.2 crore. The profit growth will be aided by the savings of approximately Rs9 crore in the interest cost during the quarter on account of the repayment of debt from the FCCB funds.

Valuation table: Sharekhan pharma universe

Company	CMP (Rs)	FY07	EPS FY08E	FY09E	FY07	P/E multiple FY08E	FY09E
Ranbaxy Labs **	361.9	13.8	20.8	-	26.2	17.4	-
Cipla	211.2	8.5	10.9	12.8	24.8	19.4	16.4
Sun Pharma	1010.5	40.0	47.9	-	25.2	21.1	-
Wockhardt **	380.2	27.6	30.2	34.8	13.8	12.6	10.9
Lupin	719.0	34.2	37.3	46.5	21.0	19.3	15.4
Nicholas Piramal	294.5	11.0	14.1	16.9	26.7	20.9	17.4
Aurobindo Pharma	742.0	38.1	45.8	57.1	19.5	16.2	13.0
Orchid Chemicals	244.4	14.7	17.3	23.5	16.6	14.2	10.4
Cadila Healthcare	359.9	18.6	22.1	26.7	19.3	16.3	13.5

** EPS and P/E multiple are for CY06, CY07E and CY08E

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

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