Industry Flash

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Indian Pharma – Protonix in Play

Positive for Sun Pharma; Negative for Cadila

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- Protonix in Play — A US court has denied a bid by Wyeth & Nycomed to stop generic companies (Teva & Sun) from launching Protonix (US$2.5bn drug). We believe this significantly enhances the risk for Cadila, which has a very lucrative JV with Nycomed (formerly Altana) for the supply of two intermediates for Protonix. Sun, on the other hand, could potentially have shared exclusivity and get a one time boost to its earnings during the exclusivity period.

- Background — Teva and Sun had made Para IV filings on Protonix, following which they had been sued by the innovator, leading to 30-month stays for both companies. Subsequently, Teva's 30-month stay has expired and it has received final approval. Sun's 30-month stay expires on 7 Sept 07 and approval should follow. With Wyeth's preliminary injunction being denied, it opens up the window of an 'at risk' launch by the generic companies.

- Where does Sun come in? — While the company has yet to comment, we believe Sun could be joint first to file with Teva and thus enjoy shared exclusivity. If Teva launches 'at risk', we believe Sun could follow suit. This could lead to a one-time upside of Rs14-20/share to earnings.

- Negative for Cadila — Cadila has a lucrative JV with Nycomed to supply two intermediates for Protonix. This JV accounted for c.28% of earnings in FY07 and we expected this to remain material over the next two years (24% of FY08E & 20% of FY09E earnings) as well. This earnings stream is at risk. We have an NPV value of Rs16/share for this JV, factored into our target price, which could disappear on genericisation.

- Likely scenarios — Teva has announced that it will study the judgment before deciding its next course of action. If Teva launches 'at risk', we expect Sun to follow suit. However, if Teva does not launch 'at risk', we believe genericisation to be delayed by over a year at least. We think it is unlikely that Sun will launch 'at risk' on its own.

- Maintain Ratings — We reiterate our Sell (3L) rating on Cadila and Hold (2L) rating on Sun Pharma.

See Appendix A-1 for Analyst Certification and important disclosures.

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Cadila Healthcare (CADI.BO - Rs320.00; 3L)

Valuation

Our target price for Cadila is Rs335. A large share of Cadila's earnings (we estimate 24% in FY08) would come from Altana JV, which is unlikely to continue beyond FY10. Thus, we do not give a multiple to the JV's earnings. We value Cadila on a sum-of-parts basis by using DCF for Zydus Altana, and P/E relative to growth for the rest of the business. We value Cadila's non-Altana business on a P/E basis in view of the healthy growth expected in earnings. We use 18x 12-month forward earnings to value the business. With the growth rate moderating to 24% CAGR (in line with most mid-sized Pharma companies), we prefer to value Cadila in line with other mid-sized Pharma stocks - i.e. at a 10% discount to sector leaders. At 18x June'08E earnings, we value Cadila's non-Zydus Altana business at Rs319/share (v/s Rs258/share earlier). We value the Zydus Altana JV on DCF given that we expect this business to witness sharp erosion when Protonix goes off patent. We use a three-stage DCF model to value this business with explicit forecasts to FY10, beyond which we assume 95% decline in cash flows (on patent expiry) for one year and 5% terminal growth. Based on the above assumptions and a 12.5% discount rate, we value Cadila's stake in the JV at Rs16/share (v/s Rs14/share earlier). We thus arrive at a sum-of-the-parts value of Rs335/share: Rs16 for Zydus Altana and Rs319/share for the rest of the business.

Risks

We rate Cadila Healthcare Low Risk according to our quantitative risk-rating system. The main downside risks to our target price include: 1) If generic competition in pantoprazole comes in before the scheduled patent expiry in 2010, it would severely hit our estimates; 2) We have estimated Cadila's French business to break even in CY07 (FY08E); any delay would put our estimates at risk; 3) Greater-than-anticipated price erosion / competition in the US; and 4) Break-up of any of its alliances. The main upside risks to our target price include: 1) Cadila may be able to bag sizable contract manufacturing deals; 2) We have factored in only US$15m revenues from the Mayne Pharma JV in FY09E; actual revenues could come in higher; and 3) Any value accretive acquisition by the company in Europe.

Sun Pharmaceuticals (SUN.BO - Rs1,007.90; 2L)

Valuation

Our target price of Rs1,150 is based on a sum-of-the-parts approach. We continue to value Sun's base business using a P/E vs. earnings CAGR approach and ascribe an option value for its patent challenge pipeline. We value Sun's base business at 20x FY09E earnings. With a steadily growing profit line, we believe P/E is the best method to value Sun Pharma. We value frontline pharma stocks at a premium of around 40% to the broad market, due to the intellectual property built into the business models, faster growth as well as the potential to deliver positive earnings surprises. This works out to a multiple of 20x that we use for Sun Pharma as well as its peers such as Dr Reddy's and Cipla. Our estimates do not incorporate the Taro acquisition. However, we believe that it would be dilutive in the short term, i.e. FY08E, before being earnings neutral or mildly accretive in FY09E. As such, we believe that it is relevant to value Sun based on FY09E estimates as the earnings dilution phase is transient, and should not affect fair value. At 20x FY09E earnings, we arrive at a value of

Rs1,136 for the base business. We also ascribe an option value of Rs14 to Sun's patent challenge pipeline, using a 15% success rate on the company's patent challenges that are in the public domain.

Risks

We rate Sun Pharma as Low Risk because of its steady growth and visible earnings stream. This is also consistent with our quantitative risk-rating system, which tracks 260-day historical share price volatility. The key downside risks to our target price are: (1) Price deterioration in any of its key markets; (2) Inability to effectively integrate the Taro acquisition and exploit synergies could keep earnings depressed for longer than we have anticipated; (3) A stronger IPR law in India could lead to a gradual slowdown in growth rates for the Indian market. Upside risks to our target price include a faster-than-expected integration of the Taro acquisition and a win in any patent challenge.

Appendix A-1

Analyst Certification

We, Prashant Nair, CFA and Chirag Dagli, research analysts and the authors of this report, hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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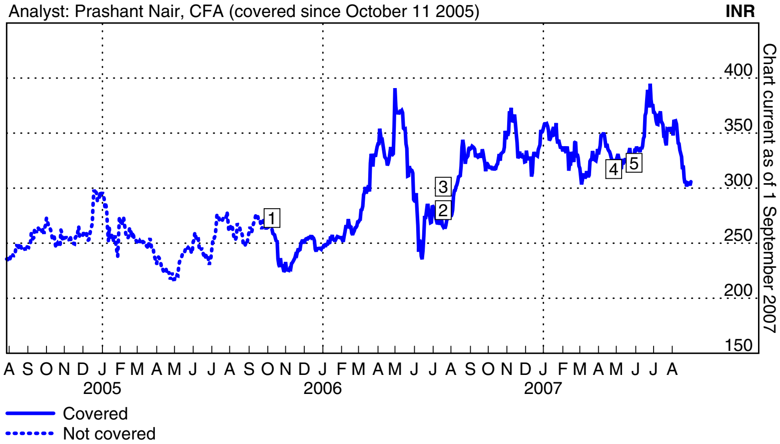
Ratings and Target Price History - Fundamental Research

Analyst: Prashant Nair, CFA (covered since October 11 2005)



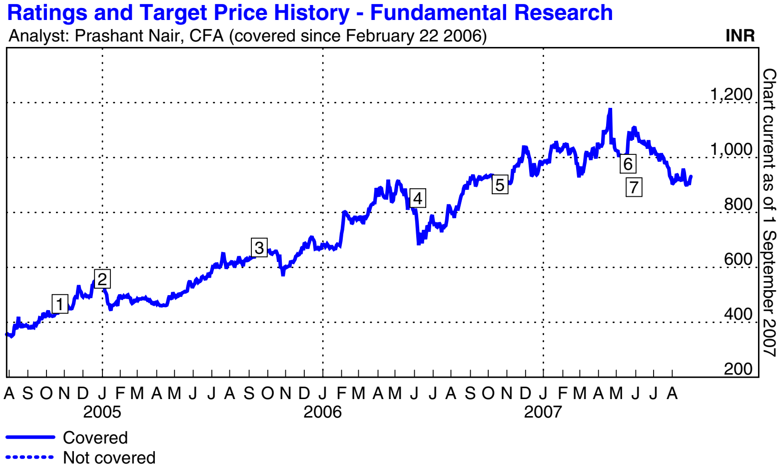
#	Date	Rating	Target Price	Closing Price
1:	10 Oct 05	3L	208.00	262.50
2:	19 Jul 06	3L	*272.00	264.75
3:	19 Jul 06	3L	272.00	264.75
4:	26 Apr 07	3L	272.00	326.55
5:	30 May 07	3L	*335.00	328.25

*Indicates change.

Sun Pharmaceuticals (SUN.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Prashant Nair, CFA (covered since February 22 2006)



#	Date	Rating	Target Price	Closing Price
1:	25 Oct 04	2L	*408.53	453.10
2:	3 Jan 05	*3L	408.53	555.30
3:	19 Sep 05	3L	*426.29	663.10
4:	7 Jun 06	3L	*617.23	721.40
5:	20 Oct 06	3L	*678.51	912.45
6:	21 May 07	3L	*678.46	1,064.15
7:	30 May 07	*2L	*1,150.00	1,109.20

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