

# 2Q earnings beat; Raise PO

## Strong qtr, momentum to sustain

Q2 profit at Rs2.15bn (34% yoy) was 8% ahead of estimates due to lower taxes, while EBITDA at Rs 2.7bn was in line. Sales grew 26% yoy at Rs14bn (4% ahead of est), led by stronger US generics (up 55% yoy) and Japan (up 22%), although domestic formulation (up 16%) lagged industry. Retain estimates for FY11E, but raise forecasts by 2%/7% over FY12-13E. PO revised 19% to Rs 501.

## Sales outlook appears brighter

We moderate branded US sales by 3%/9% over FY11-13E (slower ramp up of Antara, delay in Allernaze), but still raise forecasts on (1) strong pipeline (87 ANDAs, 54 Para IVs, inc 15 FTFs) leading to increased US generic launches at 16/20 over FY12/13E compared to 12 earlier, and (2) better volumes in Japan (4 launches in H2). Retain domestic formulations growth at 17% CAGR on recent field force addition and new divisions i.e. female health, ophthalmology, oncology.

## Margin assumptions largely retained

We lower FY11E EBITDA margins by 20bps at 19.8%, but retain assumptions of 140bps increase over FY12-13E due to increased sales forecasts, mainly niche generic launches in US (oral contraceptives, Para IVs).

## Stock deserves to sustain higher multiples

Revised PO is based on 20x FY12E earnings (earlier 17x) in line with large cap peer average, given superior track record of execution and future visibility of 28% earnings CAGR (industry 25% CAGR). FTF opportunities like Fortamed (Jun-11) & Geodon (Mar-12) has not been included in our estimates.

### Estimates (Mar)

(Rs)	2009A	2010A	2011E	2012E	2013E
Net Income (Adjusted - mn)	5,016	6,817	8,533	11,251	13,776
EPS	11.31	15.34	19.05	25.11	30.75
EPS Change (YoY)	13.7%	35.6%	24.2%	31.9%	22.4%
Dividend / Share	2.50	2.70	3.00	3.75	4.00
Free Cash Flow / Share	9.41	(1.80)	18.39	16.00	21.30

### Valuation (Mar)

	2009A	2010A	2011E	2012E	2013E
P/E	39.24x	28.94x	23.30x	17.67x	14.43x
Dividend Yield	0.563%	0.608%	0.676%	0.845%	0.901%
EV / EBITDA*	30.48x	21.64x	17.71x	13.62x	11.33x
Free Cash Flow Yield*	1.96%	-0.402%	4.14%	3.60%	4.80%

\* For full definitions of *iQmethod*<sup>SM</sup> measures, see page 7.

## Bank of America Merrill Lynch

S.Arun >>

+91 22 6632 8657

Research Analyst  
DSP Merrill Lynch (India)  
s.arun@baml.com

Arvind Bothra >>

+91 22 6632 8685

Research Analyst  
DSP Merrill Lynch (India)  
arvind.bothra@baml.com

### Stock Data

Price	Rs443.80
Price Objective	Rs501.00
Date Established	2-Nov-2010
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs239.20-Rs460.40
Mkt Val / Shares Out (mn)	US\$4,471 / 448.0
Average Daily Volume	989,272
BofAML Ticker / Exchange	LPMCF / BSE
Bloomberg / Reuters	LPC IN / LUPN.BO
ROE (2011E)	29.3%
Net Dbt to Eqty (Mar-2010A)	36.2%
Est. 5-Yr EPS / DPS Growth	30.5% / 14.5%
Free Float	49.6%

### Key Changes

(Rs)	Previous	Current
Price Obj.	420.00	501.00
2011E Rev (m)	59,893.1	60,559.2
2012E Rev (m)	72,365.0	73,856.3
2013E Rev (m)	84,068.2	88,733.9
2011E EPS	19.07	19.05
2012E EPS	24.71	25.11
2013E EPS	28.67	30.75

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Refer to important disclosures on page 8 to 10. Analyst Certification on Page 6. Price Objective Basis/Risk on page 6. Link to Definitions on page 6. 10989417

02 November 2010

# *iQprofile*<sup>SM</sup> Lupin Limited

## Key Income Statement Data (Mar)

(Rs Millions)	2009A	2010A	2011E	2012E	2013E
Sales	38,260	48,708	60,559	73,856	88,734
Gross Profit	14,325	19,542	24,164	30,133	36,794
Sell General & Admin Expense	NA	NA	NA	NA	NA
Operating Profit	6,106	8,600	10,405	13,750	16,666
Net Interest & Other Income	(46)	(243)	(8)	(11)	45
Associates	NA	NA	NA	NA	NA
Pretax Income	6,061	8,357	10,398	13,739	16,711
Tax (expense) / Benefit	(983)	(1,360)	(1,681)	(2,286)	(2,716)
Net Income (Adjusted)	5,016	6,817	8,533	11,251	13,776
Average Fully Diluted Shares Outstanding	444	445	448	448	448

## Key Cash Flow Statement Data

Net Income	5,016	6,817	8,533	11,251	13,776
Depreciation & Amortization	880	1,239	1,615	1,879	2,133
Change in Working Capital	860	(4,478)	(1,252)	(4,620)	(2,981)
Deferred Taxation Charge	150	165	173	190	209
Other Adjustments, Net	1,609	1,534	1,843	2,466	2,854
Cash Flow from Operations	8,515	5,277	10,912	11,167	15,991
Capital Expenditure	(4,617)	(6,076)	(2,671)	(4,000)	(6,450)
(Acquisition) / Disposal of Investments	NA	NA	NA	NA	NA
Other Cash Inflow / (Outflow)	(157)	(49)	(5,048)	(1,576)	(3,732)
Cash Flow from Investing	(4,775)	(6,125)	(7,720)	(5,576)	(10,182)
Shares Issue / (Repurchase)	7	61	0	0	0
Cost of Dividends Paid	(1,213)	(1,404)	(1,572)	(1,966)	(2,097)
Cash Flow from Financing	(5,705)	2,085	(3,903)	(4,905)	(5,405)
Free Cash Flow	3,898	(799)	8,241	7,167	9,541
Net Debt	11,455	9,383	9,623	8,483	7,647
Change in Net Debt	2,168	(2,072)	240	(1,140)	(837)

## Key Balance Sheet Data

Property, Plant & Equipment	14,252	19,444	20,500	22,621	26,938
Other Non-Current Assets	3,389	3,461	8,509	10,086	13,818
Trade Receivables	9,180	11,266	15,657	19,507	23,459
Cash & Equivalents	778	2,015	1,305	1,990	2,394
Other Current Assets	12,351	14,474	17,940	22,891	26,331
Total Assets	39,950	50,659	63,911	77,095	92,940
Long-Term Debt	12,233	11,399	10,928	10,474	10,040
Other Non-Current Liabilities	2,992	3,678	4,224	5,068	5,733
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	10,335	9,649	15,853	19,348	23,267
Total Liabilities	25,559	24,726	31,005	34,889	39,040
Total Equity	14,391	25,933	32,906	42,206	53,899
Total Equity & Liabilities	39,950	50,659	63,911	77,095	92,940

## *iQmethod*<sup>SM</sup> - Bus Performance\*

Return On Capital Employed	17.9%	20.4%	19.6%	21.7%	21.9%
Return On Equity	37.1%	34.1%	29.3%	30.2%	28.8%
Operating Margin	16.2%	18.1%	17.5%	18.9%	19.1%
EBITDA Margin	18.3%	20.2%	19.8%	21.2%	21.2%

## *iQmethod*<sup>SM</sup> - Quality of Earnings\*

Cash Realization Ratio	1.7x	0.8x	1.3x	1.0x	1.2x
Asset Replacement Ratio	5.2x	4.9x	1.7x	2.1x	3.0x
Tax Rate (Reported)	16.2%	16.3%	16.2%	16.6%	16.3%
Net Debt-to-Equity Ratio	79.6%	36.2%	29.2%	20.1%	14.2%
Interest Cover	12.2x	22.3x	28.7x	34.3x	43.3x

## Key Metrics

\* For full definitions of *iQmethod*<sup>SM</sup> measures, see page 7.

## Company Description

Headquartered in Mumbai, Lupin has transformed itself into one of the largest generic companies based out of India. Ranking 5th in the domestic market, the company has made remarkable strides in the US market with generic as well as specialty formulations presence. With strengths in manufacturing and IP driven products, the company has expanded its geographic reach to RoW markets as well as advanced markets like EU and Japan. Formulations comprise 80% of its business while balance from API.

## Investment Thesis

We have a bullish stance on Lupin. We believe that Lupin will continue to deliver above industry average growth, driven by: (1) products in existing segments where it has major presence, as well as new therapies with limited competition, and (2) entry to newer markets with low penetration. The stock trades at a discount to domestic and global peers, despite stronger growth rates. We expect the stock to trade close to its large cap pharma peers.

## Stock Data

Price to Book Value

6.1x

## 2QFY11 Result Analysis

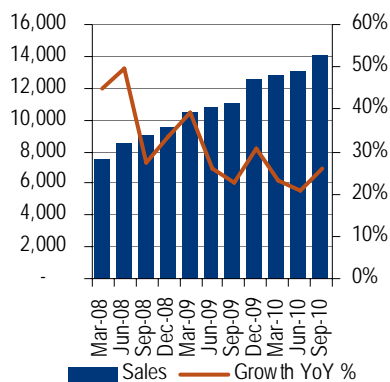
Table 1: Lupin Limited, 2QFY11 Result Analysis

Year to Mar (Rs mn)	Sep-09	Jun-10	Sep-10	YoY (% chg)	QoQ (% chg)	Comments for 2QFY11
<b>Formulations</b>	<b>9203</b>	<b>11245</b>	<b>12100</b>	<b>31%</b>	<b>8%</b>	Formulations continue to grow robustly, comprising 86% of total sales now (vs 83% earlier)
Domestic	3626	4172	4191	16%	0%	Slightly weaker domestic formulations growth affected by inventory correction in anti-infectives. New divisions like oncology, ophthalmology, female health would help ramp up growth 2H onwards
US	3349	4605	4611	38%	0%	Base business growth sustained, thanks to niche launches like Lotrel as well as existing products like Lisinopril, Famotidine. etc. The generics business (grew 55% YoY) is likely to sustain 30%+ growth on the back of recent ANDA approvals. Pickup in branded business was slower than expected as Antara prescriptions did not reflect uptrend as expected, however to pick up in 2H led by strong push by primary care.
EU	183	361	549	200%	52%	EU growth helped by recent launches
Japan	1283	1299	1568	22%	21%	Japan business grew on higher volume offtake as well as 1 new launch in May-10. In JPY terms, growth was 17% YoY (9% for 1H). Expect strong momentum to sustain on 4 new launches expected in Nov-10.
RoW	762	808	1181	55%	46%	South Africa grew strongly by 28% YoY (in line with past 4-5 qtrs), amongst fastest growing co. consistently
<b>API/CRAMS</b>	<b>1944</b>	<b>1876</b>	<b>1951</b>	<b>0%</b>	<b>4%</b>	Large part of API production used for captive production.
<b>Net sales</b>	<b>11147</b>	<b>13121</b>	<b>14051</b>	<b>26%</b>	<b>7%</b>	Robust growth led by US/EU growing at 44%. Beat our estimates by 4% led by stronger US generics despite slightly lower growth in India formulations
Raw material consumed % of revenues	5014 45.0%	5036 38.4%	5494 39.1%	10% (588bps)	9% 72bps	Gross margins improved YoY on better product mix in favour of formulations
Staff cost % of revenues	1405 12.6%	1781 13.6%	1916 13.6%	36% 103bps	8% 6bps	Staff cost surged as sales force in branded business expanded from 70 to 170 in Mar-10.
R&D Expenditure % of revenues	822 7.4%	1038 7.9%	1157 8.2%	41% 86bps	11% 32bps	R&D costs to remain high on increased filing plans in US. Filed 3 ANDAs during the quarter. New filings in ophthalmology, dermatology, etc to build niche US generic portfolio
Other Expenses % of revenues	2266 20.3%	2645 20.2%	2787 19.8%	23% (50bps)	5% (32bps)	Overheads largely grew in line with sales, to remain at similar levels
<b>Total Expenditure</b>	<b>9507</b>	<b>10499</b>	<b>11353</b>	<b>19%</b>	<b>8%</b>	
<b>EBITDA</b>	<b>1640</b>	<b>2622</b>	<b>2698</b>	<b>65%</b>	<b>3%</b>	Sharp gross margin gains helped EBITDA margin expansion, restricted somewhat by higher R&D and staff cost
<b>EBITDA margins (%)</b>	<b>14.7%</b>	<b>20.0%</b>	<b>19.2%</b>	<b>449bps</b>	<b>(78bps)</b>	EBITDA margins slightly below estimate of 20% due to lower India formulations, US branded sales
Other operating income	511	222	289	-43%	30%	On account of higher income from export incentives, dossier sales, etc.
<b>Operating profits</b>	<b>2150</b>	<b>2844</b>	<b>2987</b>	<b>39%</b>	<b>5%</b>	Strong margin expansion of ~238bps aided by higher gross margins
<b>OPM (%)</b>	<b>18.4%</b>	<b>21.3%</b>	<b>20.8%</b>	<b>238bps</b>	<b>(48bps)</b>	
Other income	29.9	8.3	14	-53%	69%	
Depreciation	242.4	400.7	435	79%	9%	Includes amortisation of Antara brand, to be sustained at current rate
<b>EBIT</b>	<b>1938</b>	<b>2452</b>	<b>2566</b>	<b>32%</b>	<b>5%</b>	
Interest expense	91.2	81.5	87.5	-4%	7%	Interest costs declined on repayment of high-cost loans
<b>Pre-tax profits</b>	<b>1847</b>	<b>2370</b>	<b>2479</b>	<b>34%</b>	<b>5%</b>	
Tax	200.3	349.5	271.2	35%	-22%	Tax remains lumpy on quarterly basis. Full year effective tax rate to remain at 14-15%
Effective tax rate (%)	10.8%	14.7%	10.9%	9bps	(381bps)	
<b>Net profit</b>	<b>1646</b>	<b>2021</b>	<b>2207</b>	<b>34%</b>	<b>9%</b>	
<b>Net profit after minority interest</b>	<b>1603</b>	<b>1963</b>	<b>2150</b>	<b>34%</b>	<b>10%</b>	Profits grew 34%, 8% above BofA-MLE largely on lower taxes

Source: Company, BofA-Merrill Lynch Research

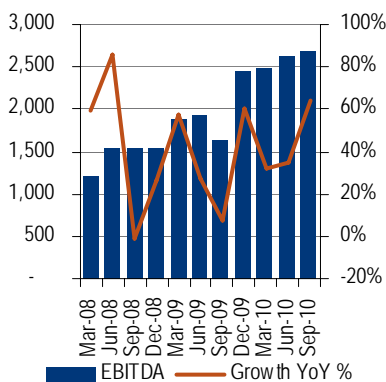
## Quarterly trends

Chart 1: Consistently robust sales growth



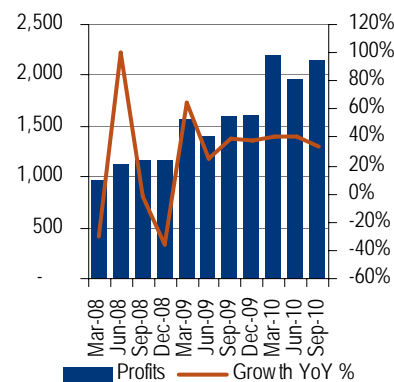
Source: Company

Chart 2: EBITDA trends



Source: Company

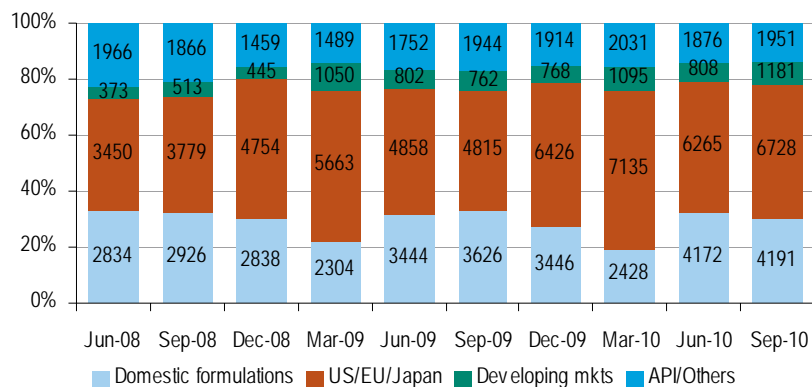
Chart 3: Focus on profit growth



Source: Company

Improving business mix in favour of formulations (86% of sales now) have led to steady margin expansion

Chart 4: Higher focus on Export formulations drive revenue mix improvement



Source: Company

## Comparative valuations

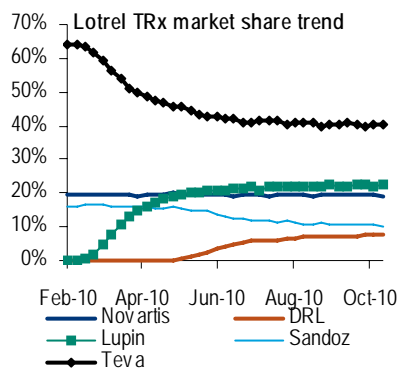
Table 2: Indian Pharma coverage valuation comparables

Stock	CMP Rs	Mkt Cap US\$mn	P/E (x)		EPS CAGR 10-12E	EV/EBITDA (x)		RoE (%)		EV/Sales (x)	
			FY11E	FY12E		FY11E	FY12E	FY11E	FY12E	FY11E	FY12E
Cipla	337	6101	23.1x	20.0x	11%	17.6x	15.3x	18%	18%	4.3x	3.8x
Sun Pharma	2064	9581	23.7x	22.5x	16%	23.2x	20.6x	18%	18%	8.3x	7.2x
Dr Reddys	1674	6,379	27.1x	20.0x	35%	17.2x	13.3x	28%	34%	3.3x	2.5x
Lupin	444	4,458	23.3x	17.7x	28%	17.0x	13.1x	29%	30%	3.5x	2.8x
Large cap generics average			24.6x	20.9x	21%	19.3x	16.4x	21%	23%	5.3x	4.5x
Cadila	710	3,276	20.6x	16.5x	27%	14.1x	11.8x	36%	33%	3.4x	2.8x
Divis	696	2,079	21.7x	16.2x	31%	17.1x	13.0x	25%	27%	7.6x	5.8x
Glenmark	365	2,218	18.7x	16.8x	29%	11.4x	10.4x	11%	16%	3.4x	2.7x
Biocon	424	1,912	21.8x	15.7x	36%	13.7x	10.6x	20%	23%	3.1x	2.5x
GSK Pharma^	2241	4,277	27.9x	24.1x	15%	18.2x	15.1x	29%	29%	6.5x	5.4x
IPCA	336	950	18.6x	13.8x	21%	11.2x	8.9x	24%	26%	2.3x	1.9x
India Pharma sector average (ex-Glenmark)			22.6x	18.3x	25%	16.1x	13.2x	24%	25%	4.6x	3.7x

Source: Bank of America - Merrill Lynch Research. ^ - Dec- ending, Bloomberg. For Dec ending companies, data taken for CY11 and CY12

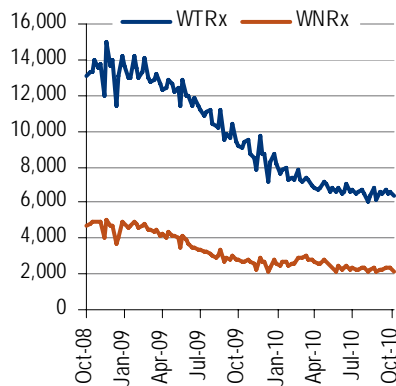
## IMS trends for key products

Chart 5: Lotrel- sustains 20%+ mkt share



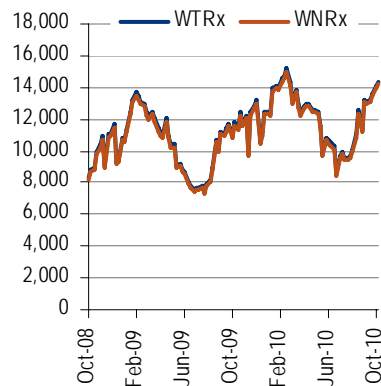
Source: IMS

Chart 6: Antara prescriptions decline arrested



Source: IMS

Chart 7: Expect no generic competition for a year atleast



Source: IMS

## Price objective basis & risk

### Lupin Limited (LPMCF)

Our PO of Rs501 is based on 20x FY12E EPS, which is at par with large pharma peers average. We expect the multiple to expand, compared to both historical and mid-cap companies, closer to large cap peers. We believe the stock should trade at a higher multiple due to: (1) stronger and sustainable growth rates (21% sales CAGR, 28% Profit CAGR), and (2) scale of operations. At our PO, the stock would trade at 14.7x EV/EBITDA FY12E, lower than the existing FY11E multiple.

Downside risks: (1) earlier than expected competition in US brands (Suprax) (2) slower approval from USFDA affecting US growth and (3) higher-than-expected price erosion.

## Link to Definitions

### Healthcare

Click [here](#) for definitions of commonly used terms.

## Analyst Certification

I, S.Arun, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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### India - Healthcare Coverage Cluster

Investment rating	Company	BofAML ticker	Bloomberg symbol	Analyst
BUY	BIOCON LTD	BCLTF	BIOS IN	Arvind Bothra
	CADILA HEALTHCAR	CDLHF	CDH IN	Arvind Bothra
	Divi's Lab	XXQPF	DIVI IN	Arvind Bothra

## India - Healthcare Coverage Cluster

Investment rating	Company	BofAML ticker	Bloomberg symbol	Analyst
	Dr Reddy's Lab	DRYBF	DRRD IN	S.Arun
	Dr Reddys Lab-A	RDY	RDY US	S.Arun
	Glenmark Pharm	XVQWF	GNP IN	Arvind Bothra
	IPCA Labs	XBLAF	IPCA IN	Arvind Bothra
	Lupin Limited	LPMCF	LPC IN	S.Arun
<b>UNDERPERFORM</b>				
	GSK India	GXOLF	GLXO IN	Arvind Bothra
	Piramal Healthcare Ltd	XNIGF	PIHC IN	Arvind Bothra

## iQmethod<sup>SM</sup> Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
<b>Quality of Earnings</b>		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
<b>Valuation Toolkit</b>		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

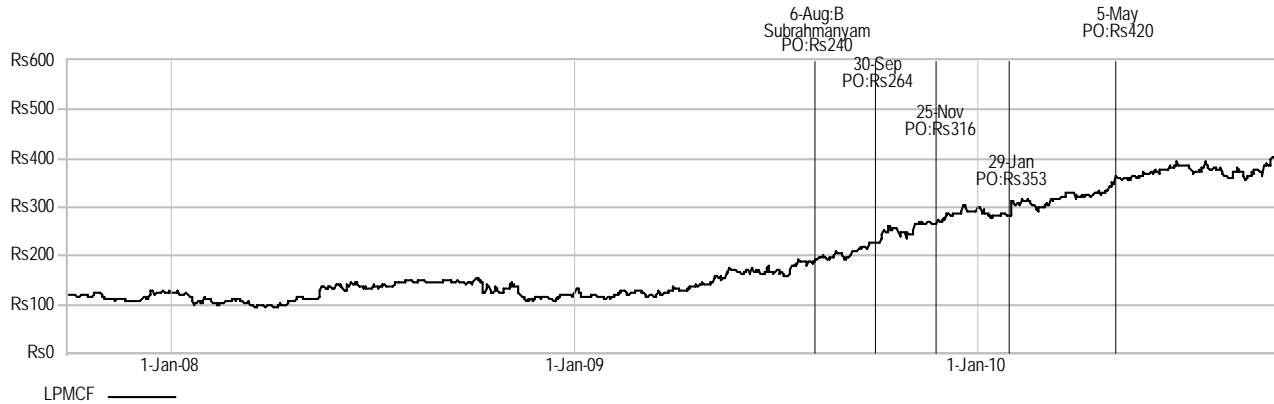
iQmethod<sup>SM</sup> is the set of BoFA Merrill Lynch standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and valuations. The key features of iQmethod are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

iQdatabase<sup>®</sup> is our real-time global research database that is sourced directly from our equity analysts' earnings models and includes forecasted as well as historical data for income statements, balance sheets, and cash flow statements for companies covered by BoFA Merrill Lynch.

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## Important Disclosures

### LPMCF Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid, NR: No Rating

\*Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of August 31, 2010 or such later date as indicated. BofA Merrill Lynch price charts do not reflect analysts' coverage of the stock at prior firms."

### Investment Rating Distribution: Health Care Group (as of 01 Oct 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	122	53.51%	Buy	52	45.61%
Neutral	55	24.12%	Neutral	31	59.62%
Sell	51	22.37%	Sell	16	32.00%

### Investment Rating Distribution: Global Group (as of 01 Oct 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1948	54.31%	Buy	821	46.73%
Neutral	891	24.84%	Neutral	397	49.07%
Sell	748	20.85%	Sell	259	37.16%

\* Companies in respect of which MLF&S or one of its affiliates has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

\* Ratings dispersions may vary from time to time where BofAML Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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