April 25, 2008

India
India Pharmaceuticals

Nicholas Piramal India Ltd (NICH.BO - INR 339.65) 1-Overweight

Earnings Review/Sales Analysis

In-line results and guidance

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Investment Conclusion

- NP reported in-line 4QFY08 results and FY09 guidance. The key positives are gaining traction in contract manufacturing business and stable domestic formulations business. We believe the EPS guidance of INR21.0 (21% YoY growth) is marginally conservative, and see possibility of an upwards revision during the course of FY09. With strong earnings growth (27% CAGR over FY08-FY10E) and rising profitability (ROE expected to be ~33%), NP presents attractive valuation in our view. We maintain 1-OW.

Summary

- Guidance for contract manufacturing revenues of INR 4bn from Indian assets in FY09 is much ahead of our expectation. Management expects the growth momentum to continue in FY10 as well.
- NP's focus on domestic formulations remains as it continues to invest in the field force (500 people added in FY08) and new introductions.
- Rising sales volume along with cost control has resulted in expansion of operating margins by 100bps in FY08. Management expects margins to improve 100bps every year in the medium term.

FY Mar	2007A	2008E		2009E		2010E	
Currency INR	Actual	Old	New	Old	New	Old	New
Revenue (bn)	24.7	28.7	28.7	32.3	32.3	36.5	36.5
Op. Profit (bn)	3.8	5.5	5.5	6.6	6.6	7.9	7.9
Rec. Prof. (bn)	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Net Income (bn)	2.2	3.5	3.5	4.5	4.5	5.7	5.7
EPS	10.4	16.8	16.8	21.4	21.4	27.2	27.2
EV/EBITDA	20.6	N/A	12.2	N/A	9.9	N/A	7.8
P/E	31.7	19.6	19.6	15.4	15.4	12.1	12.1

Market Data

Market Cap	68964
Market cap (US$ mn)	1726
Shares Outstanding (mn)	209.0
6-mo daily T/O (US$ mn)	1
Free Float (%)	50.06
Foreign Shareholding (%)	15.97

Financial Summary

Proj 5-Yr EPS Grth (%)	31.0
RoE (%)	22.1
Net Debt to Equity (%)	54.2

Stock Rating

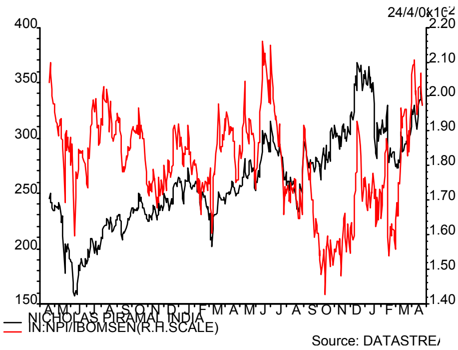
New:	1-Overweight
Old:	1-Overweight

Target Price

New:	INR 524.00
Old:	INR 524.00

Sector View: 1-Positive

Stock Overview



Source: DATASTREAM

Reuters	NICH.BO
Bloomberg	NNP IN
ADR	

Performance	1M	3M	12M
Absolute %	12.1	15.5	32.5
Rel. Market %	-0.8	22.8	4.3
Rel. Sector %	-	-	-

52 Week Range 368.10 - 233.30

NP's results for Q4FY08 and guidance are in line with our expectations. The key positives are gaining traction in the contract manufacturing business and stable growth in the domestic formulation business. The management has guided for contract manufacturing revenues from Indian assets to increase to INR 4 bn in FY09 much ahead of our expectation of INR 3bn. This represents ~75% YoY growth in FY09. The management expects this strong growth momentum to continue in FY10 as well. On the domestic formulations front, NP continues its focus by investing in the field force (one of the largest in the industry, with 500 people added in FY08) and new product introductions (30 in FY08). Rising sales volume along with cost containment has resulted in increase in operating margins which expanded 100 bps in FY08. The management expects margins to improve 100 bps every year in the medium term.

We believe the FY09 EPS guidance of INR 21.0 (21% YoY growth) is marginally conservative. We see strong possibility of the guidance being revised upwards during the course of FY09. With guidance of INR 21.0 in place, we expect little downside risk to the stock. The stock (ex-NCE R&D value) currently trades at 15.5x FY09 EPS guidance. We expect net profit CAGR of 27% over FY08-10E. With strong earnings growth and rising profitability (ROE expected to be ~33%), we reckon the valuation is attractive. We maintain our 1-OW.

PLEASE SEE ANALYST(S) CERTIFICATION(S) ON PAGE 4 AND IMPORTANT DISCLOSURES INCLUDING FOREIGN AFFILIATE DISCLOSURES BEGINNING ON PAGE 5

Results in-line with expectations

Nicholas Piramal just announced its 4QFY08 results. The results were in-line with our expectations and have met the management guidance. For FY08, Nicholas has reported results ex-NCE R&D (as the hive-off is effective April 01, 2007).

Q4FY08 – Exceptional items of INR 253mn relate to restructuring costs

Net sales for 4QFY08 were at INR 7.68bn, a 19% YoY growth (vs. our estimate of INR 7.62bn). Reported EBITDA was at INR 2.0bn. However EBITDA had NCE R&D cost write-backs from previous quarters of FY08. Adjusting for these, EBITDA was at INR 1.44bn against our expectation of INR 1.37bn. EBITDA margin (post-adjustments) was at 18.8%, an expansion of 340bps YoY. Reported PAT was at INR 1.33bn. However, this includes exceptional expenses of INR 253mn for the quarter related to restructuring costs. Adjusting for these exceptional items and write-backs, PAT was ~INR 940mn in-line with our expectations of INR 923mn. The restructuring costs incurred relate to voluntary retirement scheme (VRS) implemented in overseas acquisitions. The management expects this restructuring to help in margin expansion going forward.

Figure 1: Income statement – 4QFY08

	Like-to-like comparison - Ex-NCE R&D impact		
	4QFY07	**4QFY08**	**YoY Chg (%)**
Net Sales	**6,452**	**7,679**	**19.0%**
Core EBITDA	**1,015**	**1,443**	**42.1%**
EBITDA margins	15.7%	18.8%	
Other Income	-	0	
Interest	96	119	
Depreciation	140	231	
PBT	**779**	**1,092**	**40.2%**
Exceptional Items	**12**	**253**	
Income Tax	59	102	
Minority Interest	-	15	
PAT	**709**	**723**	**2.0%**

Source: Company reports

FY08 – EBITDA margins (ex-NCE R&D) expand by 100bps

For FY08, sales were at INR 28.7bn, a 16.2% YoY growth compared to 16% guidance. According to the management, NP has lost about INR 1bn sales due to rupee appreciation. Despite this rupee appreciation, EBITDA margins (ex-NCE R&D) for FY08 have expanded 100bps YoY from 17.9% in FY07 to 18.9% in FY08. This margin expansion is attributed to changing product mix and improving manufacturing efficiency. PAT was at INR 3.3bn growing at 53% YoY. Adjusting for the extraordinary items of INR 253mn in 4QFY08, PAT was in-line with our estimate of INR 3.5bn. EPS (ex-NCE R&D, extraordinary items) for FY08 was INR 17.4.

Figure 2: Income statement – FY08 (Reported numbers – Hive off of NCE R&D from FY08)

	FY07	**FY08**	**YoY Chg (%)**	**FY08E**
Net Sales	**24,719**	**28,728**	**16.2%**	**28,666**
Core EBITDA	**3,835**	**5,418**	**41.3%**	**5,498**
EBITDA margins	15.5%	18.9%		19.2%
Other Income	4	61		60
Interest	305	463		466
Depreciation	818	947		1,050
PBT	**2,715**	**4,068**	**49.8%**	**4,042**
Exceptional Items	**43**	**339**		**86**
Income Tax	389	377		435
Minority Interest	1	14		-
PAT after adjustments	**2,181**	**3,338**	**53.1%**	**3,521**

Source: Company reports, Lehman Brothers estimates

Sales break-up: Impressive growth in domestic formulations and Contract manufacturing from Indian assets

Figure 3: Sales break-up

	Q4FY07	Q3FY08	Q4FY08	% YoY	Growth Contribution (%)	FY07	FY08	% YoY
Branded Formulations	**2,624**	**3,372**	**3,092**	**17.8%**	**38.2%**	**11,565**	**12,913**	**11.7%**
CMG Total	**3,426**	**3,410**	**3,951**	**15.3%**	**42.8%**	**11,275**	**13,410**	**18.9%**
PDS	429	308	465	8.4%	2.9%	1,459	1,412	-3.2%
PMS	2,136	2,208	2,577	20.6%	36.0%	6,648	8,669	30.4%
MMBB	599	647	641	7.0%	3.4%	2,266	2,294	1.2%
CMO	262	247	268	2.3%	0.5%	902	1,036	14.9%
Pathlabs	**212**	**315**	**316**	**49.2%**	**8.5%**	**695**	**1,194**	**71.8%**
Others	191	227	320	67.6%	10.5%	1,185	1,211	2.2%
Total	**6,452**	**7,323**	**7,679**	**19.0%**	**100.0%**	**24,719**	**28,728**	**16.2%**
CMG - Indian Facilities	*227*	*554*	*736*	*224.2%*	*41.5%*	*768*	*2,263*	*194.7%*

Source: Company reports

Domestic formulations: Going strong

After lackluster Q1, the growth in domestic formulation has revived. For FY08, the domestic formulation has recorded growth of 12% YoY. Except for Q1, where sales were impacted by unavailability of codeine the growth for the remaining 9 months is 15% YoY. Except for respiratory therapy area, all the other key therapy areas have exhibited strong growth.

Domestic formulations remains one of the focus areas for Nicholas Piramal. It has added 500 people in the field force during the year. The number of new launches has moved up from 22 in FY07 to 30 in FY08. The new launches over the last two years contribute 4.4% of FY08 domestic formulation revenues. This accounts for almost a quarter of the growth registered over the last couple of years.

The company shall aggressively pursue growth opportunities in the domestic market - both organic and inorganic. The management believes that the Indian domestic market has seen consolidation and Nicholas will be an active participant in that. Nicholas has recently acquired two brands from Khandelwal Labs.

CRAMS: Gaining traction

As the table below indicates, the traction in the CRAMS business has risen significantly. The Contract manufacturing out of the India business has increased from INR 768mn in FY07 to INR 2263mn in FY08. The company has guided for revenues of INR 4 bn from Indian assets in FY09 which is far in excess of our expectation. We expected the revenues to increase to INR 3bn in FY09. The management indicated that the growth momentum shall continue even in FY10.

Similarly, the number of products under development has shown healthy growth. The company continues to pursue pipeline growth through business development. The management may also explore inorganic opportunities to expand the service offerings in CRAMS.

Figure 4: CRAMS – Gaining traction

	PDS				PMS		
Business segment	**Pre-clinical**	**Phase-I**	**Phase-II**	**Phase-III**	**Launched (<5 years)**	**Late Lifecycle (>5 years)**	**Total**
2006	8	23	42	9	9	16	107
2007	11	26	44	12	12	39	144
2008	12	29	64	18	12	45	180

Source: Company reports

FY09 guidance marginally conservative, in our view

The FY09 EPS guidance of INR 21.0 is in-line with our estimates of INR 21.4. However, given the outlook for contract manufacturing and domestic formulations (as detailed above), the guidance is marginally conservative, in our view. We see possibility of the guidance being revised upwards during the course of FY09. With guidance of INR 21.0 in place, we expect little downside risk to the stock. The stock (ex-NCE R&D value) currently trades at 15.5x FY09 EPS guidance.

Figure 5: FY09 guidance conservative in our view

	FY08	FY09 Guidance	FY09 Estimate
Net Sales	28,728	33,325	33,258
YoY growth		16.0%	15.8%
Core EBITDA	5,418	6,832	6,570
EBITDA margins	18.9%	20.5%	20.3%
PAT	3,338	4,389	4,476
EPS		21.0	21.4

Source: Company reports, Lehman Brothers estimates

Analyst Certification:

We, Saion Mukherjee and MLNPP Prasanth, hereby certify (1) that the views expressed in this research Company Note accurately reflect our personal views about any or all of the subject securities or issuers referred to in this Company Note and (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Company Note.

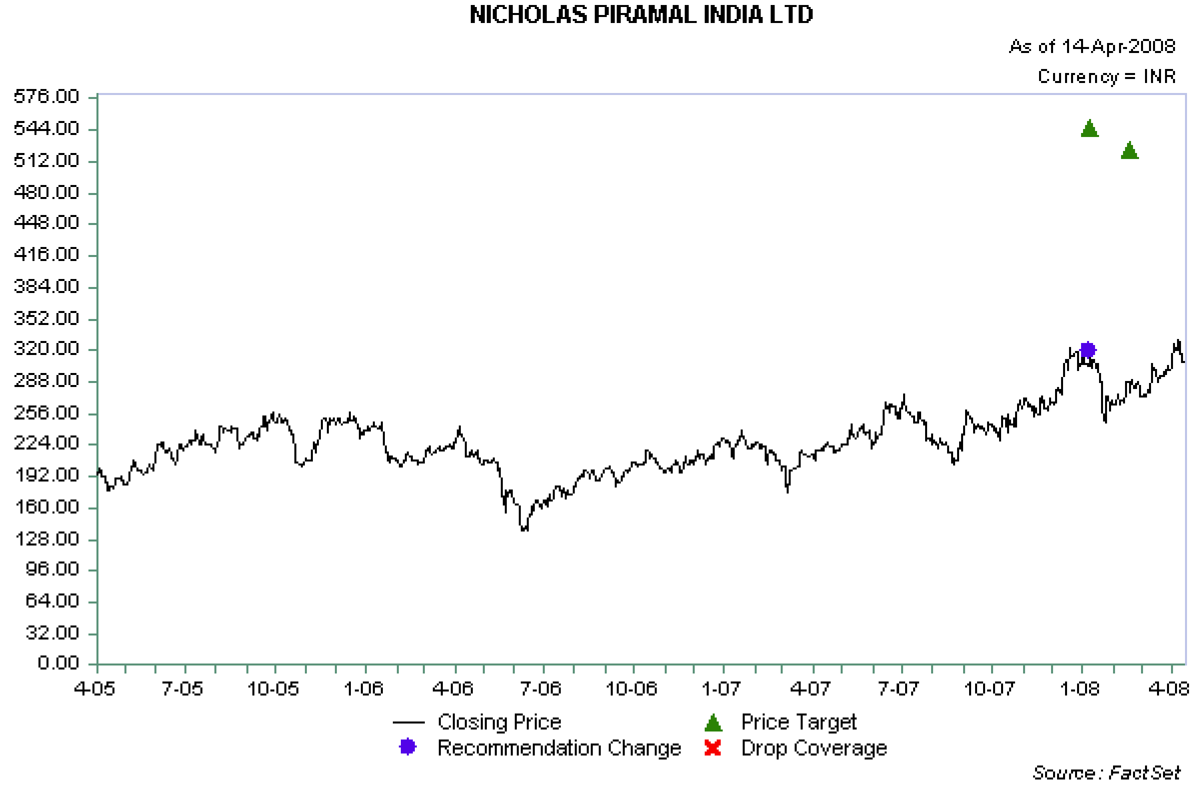
Company Description:

NP's businesses can be categorized into three segments- Domestic formulations, Contract Research and Manufacturing (CRAMS) and Innovation Research. NP is one of the best plays on the contract research and manufacturing (CRAMS) opportunity. Over the past few years, the company has made substantial investments in this space. Currently, Nicholas Piramal is among the top 10 contract manufacturing companies in the world. NP has one of the most populated and interesting NCE R&D pipelines in India with four molecules in clinical development and it is expected to increase to seven by end FY08. NP is the fourth largest player in the domestic formulations market. NP's domestic business is well-diversified, with drugs representing various therapeutic areas

Important Disclosures:

Nicholas Piramal India Ltd (NICH.BO) **INR 339.65 (23-Apr-2008)** **1-Overweight / 1-Positive**

Rating and Price Target Chart:



Currency=INR

Date	Closing Price	Rating	Price Target
18-Feb-08	277.30		524.00
09-Jan-08	318.32		547.13

Date	Closing Price	Rating	Price Target
09-Jan-08	318.32	1 -Overweight	

FOR EXPLANATIONS OF RATINGS REFER TO THE STOCK RATING KEYS LOCATED ON THE PAGE FOLLOWING THE LAST PRICE CHART.

Lehman Brothers Inc. and/or an affiliate trade regularly in the shares of Nicholas Piramal India Ltd.

Valuation Methodology: We value NP using the sum-of-parts valuations, determining the worth of its 1) base business, excluding the innovation R&D entity and 2) 18% stake in the innovation R&D entity. We value the base business using dividend discount model (DDM) to arrive at our Mar 2009 price target of INR 508/share. Our end-FY09 price target of INR 508/share implies a multiple of 18.6x FY10E earnings. We value the innovation R&D facility separately. NP has decided to hive off the innovation R&D entity effective 1st April 2007. We value the R&D entity value at US$ 488mn (end-FY09), or INR 91/share. Therefore, 18% stake in this entity would add INR 16/share to the base business value of INR 508/share, giving a end-FY09 price target INR 524/share.

Risks Which May Impede the Achievement of the Price Target: (1) Loss of key contracts. Loss in contracts can occur due to regulatory issues, increased competition and a drop in sales for innovator partner. (2) Significant appreciation in currency. NP is protected through natural hedge to a certain extent as it incurs cost in foreign currencies (primarily because of acquisitions). We believe a 10% appreciation in the rupee against export currency can result in a 10-11% drop in EBITDAR. However, if NP is able to negotiate a higher realization in CRAMS, the impact will be lower. (3) Greater control on combinations and new launches in India. Regulator in India has raised concerns on certain previously launched combination products. Our analysis indicates that the combinations under scanner account for 3.5% of NP's domestic revenues. (4) Drop in sales of key brands. In the recent past, sales of some of NP's key brands have been adversely affected by non-availability of raw materials. (5) Fail to meet FY08 guidance. This may present near-term earnings risks because of a lossnbranded formulation sales and/or higher restructuring costs. However, we believe such will not be recurring.

Important Disclosures Continued:
The analysts responsible for preparing this report have received compensation based upon various factors including the firm's total revenues, a portion of which is generated by investment banking activities

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Company Name	Ticker	Price (23-Apr-2008)	Stock / Sector Rating
Nicholas Piramal India Ltd	NICH.BO	INR 339.65	1-Overweight / 1-Positive

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Stock Rating
1-Overweight - The stock is expected to outperform the unweighted expected total return of the relevant country index over a 12-month investment horizon.
2-Equal weight - The stock is expected to perform in line with the unweighted expected total return of the relevant country index over a 12- month investment horizon.
3-Underweight - The stock is expected to underperform the unweighted expected total return of the relevant country index over a 12-month investment horizon.
RS-Rating Suspended - The rating and target price have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including when Lehman Brothers is acting in an advisory capacity in a merger or strategic transaction involving the company.

Sector View
1-Positive - sector coverage universe fundamentals/valuations are improving.
2-Neutral - sector coverage universe fundamentals/valuations are steady, neither improving nor deteriorating.
3-Negative - sector coverage universe fundamentals/valuations are deteriorating.

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