

July 22, 2008

Rating	BUY
Price	Rs727
Target Price	Rs954
Implied Upside	31.3%
Sensex	14,104

(Prices as on July 22, 2008)
Trading Data

Market Cap. (Rs bn)	59.7
Shares o/s (m)	82.1
Free Float	48.9%
3M Avg. Daily Vol ('000)	111.9
3M Avg. Daily Value (Rs m)	76.7

Major Shareholders

Promoters	51.1%
Foreign	12.4%
Domestic Inst.	20.4%
Public & Others	16.1%

Stock Performance

(%)	1M	6M	12M
Absolute	5.4	45.3	5.0
Relative	8.6	61.0	14.4

Price Performance (RIC: LUPN.BO, BB: LPC IN)



Source: Bloomberg

■ **Results:** Lupin's Q1FY09 results were well above our expectations. Net sales grew by 50% YoY from Rs5.76bn to Rs8.62bn (we expected Rs7.72bn), mainly due to good growth on domestic and export fronts. Lupin reported 25% growth in the domestic market and 88% in exports. The company's EBIDTA margin improved by 340bps from 14.3% to 17.7% YoY (we expected 16.3%), mainly due to reduction in other expenses. Other expenses declined by 570bps from 33.1% to 27.4% of net sales due to strong sales growth during the quarter. The company's net profit grew by 100% YoY from Rs559m to Rs1,119m (we expected Rs964m).

■ **Capex update:** Lupin plans to spend over Rs2.6bn on the development of an SEZ in Indore, for the manufacture of API and formulations. This unit will be operational by end of FY09. The company also has plans to spend Rs2.6bn in FY10 on capex.

■ **Valuation:** We expect the company to report 36% CAGR in net sales and 42% CAGR in net profit over FY08-10. We also expect its EBIDTA margin to improve from 16.1% in FY08 to 17.4% in FY10 due to the Japanese acquisition, introduction of new products, higher exports and entry into new geographies.

At the CMP of Rs727, the stock trades at 14.0x FY09E EPS of Rs52.1 and 9.9x FY10E EPS of Rs73.6. We reiterate BUY rating on the stock with a price target of Rs954 (13x FY10 earnings) over the next 12 months.

Key financials (Y/e March)	FY07	FY08	FY09E	FY10E
Revenue (Rs m)	20,138	27,064	36,909	50,152
Growth (%)	18.8	34.4	36.4	35.9
EBITDA (Rs m)	2,923	4,359	6,183	8,730
PAT (Rs m)	2,199	3,209	4,586	6,478
EPS (Rs)	25.0	36.5	52.1	73.6
Growth (%)	27.1	45.9	42.9	41.3
Net DPS (Rs)	5.0	10.1	12.0	15.0

Source: Company Data; PL Research

Profitability & valuation	FY07	FY08	FY09E	FY10E
EBITDA margin (%)	14.5	16.1	16.8	17.4
RoE (%)	41.2	37.9	28.3	29.4
RoCE (%)	10.6	11.8	15.1	19.7
EV / sales (x)	3.3	2.6	1.9	1.4
EV / EBITDA (x)	22.9	16.4	11.5	8.0
PE (x)	29.1	19.9	14.0	9.9
P / BV (x)	6.7	4.7	3.3	2.6
Net dividend yield (%)	0.7	1.4	1.7	2.1

Source: Company Data; PL Research

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Highlights

Excellent export growth

Lupin posted growth of 25% YoY in net revenue in the domestic market and 88% growth in exports. The formulations business reported sales of Rs6.75bn consisting 77% of revenue. API business had sales of Rs2.05bn forming 23% of revenue. Domestic sales were Rs3.62bn (41% of total), whereas exports were Rs5.18bn (59% of total). Lupin's exports grew by 88% from Rs2.75bn to Rs5.18bn. The US formulations business grew by 56% from Rs1.49bn to Rs2.32bn. The Japanese market contributed around 10.9% of net sales. Lupin's sales composition is shown in the following table:

Sales composition

	Formulation	API
- Advanced market	2,530	201
- US	2,324	
- Europe	206	
- Emerging market	3,287	1,795
- India	2,926	642
- ROW	361	1,153
- Japan	940	41
Total	6,757	2,037
Total	8,794	
Less xcise	169	
Net sales	8,625	

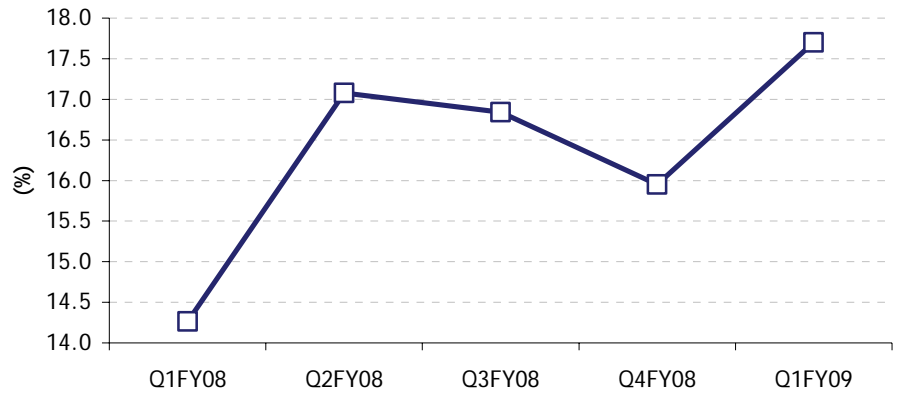
Source: Company Data, PL Research

Margin improved by 340bps

Lupin's EBIDTA margin improved by 340bps from 14.3% to 17.7% YoY. Other expenses declined by 570bps from 33.1% to 27.4% of net sales, mainly due to strong sales growth. Material cost increased by 160bps from 41.5% to 43.1% of net sales due to the increase in price of Chinese materials and crude based chemicals. Personnel cost increased by 70bps from 11.1% to 11.8% of net sales due to the increase in field force.

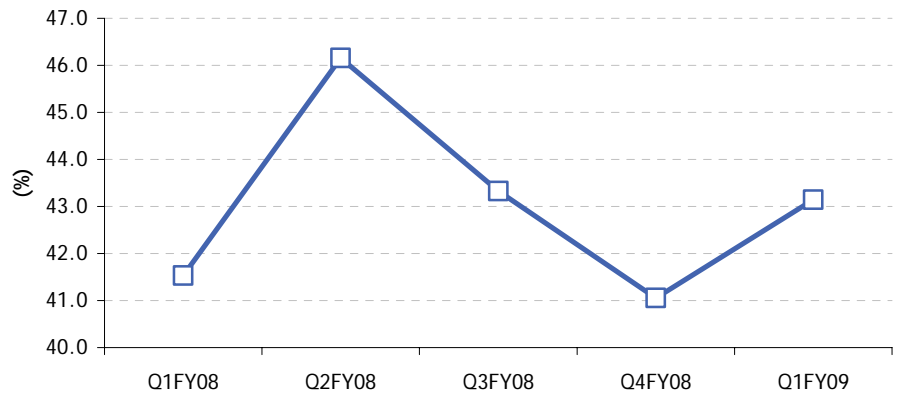
Material cost and EBIDTA margin of Lupin over the last five quarters are shown in the following graphs:

EBITDA margin



Source: Company Data, PL Research

Material cost as percentage of sales



Source: Company Data, PL Research

As seen from the above graphs, the company's EBITDA margin declined from 17.1% in Q2FY08 to 16.0% in Q4FY08 and improved to 17.7% in Q1FY09. Hence, the current quarter has the highest margin in the last five quarters. Similarly, material cost had declined from 46.2% in Q2FY08 to 41.1% in Q4FY08, and then increased to 43.1% in Q1FY09. This indicates that the current quarter had the highest margin, despite the increase in material cost, due to strong sales growth.



PAT grew by 100%YoY

Lupin's depreciation increased by 52% from Rs127m to Rs193m due to the acquisition of Kyowa, Japan and Novodigm, Gujarat during the year. Interest cost increased by 14% from Rs89m to Rs102m during the quarter due to increase in working capital. Lupin's PBT for the quarter grew by 88% from Rs764m to Rs1,433m. Effective tax rate declined from 26.9% to 21.9% during the quarter due to higher exports. This has resulted in PAT growth of 100% from Rs559m to Rs1,119m.

Outlook

The domestic formulations business grew by 25% against the market growth rate of 14% during the quarter. The company reported good performance in the CVS, CNS, diabetes, asthma and GI segments. The company has achieved 13% MS in anti-asthma segment.

API revenue from advanced markets grew by 47% from Rs137m to Rs201m.

Kyowa, Japan, acquired in October 2007, reported sales of Rs920m (10.7% of total) and Rs80m net profit during the quarter. Kyowa received marketing approval for 10 products in Japan. The company has launched these products in the Japanese market.

The US formulations business grew by 56% from Rs1.49bn to Rs2.32bn. Lupin launched Ramipril Capsules in the US in June 2008 after successfully challenging the patent of King Pharma. Lupin was the second generic player in the US and has achieved 45% MS in the US. Currently, there are 6-7 generic players in this segment.

Lupin's US subsidiary launched Suprax 400mg tablets during the quarter as a line extension of Suprax. The company's ANDA for Escitalopram Oxalate tablets and Topiramate tablets have received approval from the US FDA. The same will be marketed after their patents expire.

Lupin is setting up a new SEZ at Indore with a capital outlay of over Rs2.6bn for the manufacture of API and formulations. Benefits from the same are likely to accrue from FY10 onwards.

Lupin's CRAMS business, through its acquisition of Novodigm, reported sales of Rs82m during the quarter.

Concerns



The company is likely to face competition for Ramipril in the US, as currently there are 6-7 generic players. Hence, the market will be divided. However, Lupin has the first mover advantage.

The rise in material cost due to increase in the prices of crude-based chemicals and Chinese raw materials may affect the company's margin.

Valuation

We expect the company to report 36% CAGR in net sales and 42% CAGR in net profit over the next two years. We also expect the company's EBIDTA margin to improve from 16.1% in FY08 to 17.4% in FY10 due to the decline in raw material cost and other expenses. The company's RoE is likely to decline from 37.9% in FY08 to 29.4% in FY10. Lupin's RoCE is likely to improve from 11.8% in FY08 to 19.7% in FY10.

At the CMP of Rs727, the stock trades at 14.0x FY09E EPS of Rs52.1 and 9.9x FY10E EPS of Rs73.6. We reiterate BUY rating on the stock with a price target of Rs954 (13x FY10 earnings) over the next 12 months with an upside of 31.2% over CMP.



Q1FY09 result overview

(Rs m)

Y/e March	Q1FY09	Q1FY08	YoY gr. (%)	Q4FY08	QoQ gr. (%)
Net sales	8,623	5,757	49.8	7,504	14.9
Expenditure					
Raw materials	3,720	2,391	55.6	3,080	20.8
<i>as % of net sales</i>	<i>43.1</i>	<i>41.5</i>		<i>41.1</i>	
Personnel expenses	1,014	637	59.2	840	20.7
<i>as % of net sales</i>	<i>11.8</i>	<i>11.1</i>		<i>11.2</i>	
Other expenses	2,363	1,908	23.8	2,387	(1.0)
<i>as % of net sales</i>	<i>27.4</i>	<i>33.1</i>		<i>31.8</i>	
Total expenditure	7,097	4,936	43.8	6,307	12.5
EBIDTA	1,526	821	85.9	1,197	27.5
<i>EBIDTA margin (%)</i>	<i>17.7</i>	<i>14.3</i>		<i>16.0</i>	
Depreciation	193	127	51.6	206	(6.0)
EBIT	1,333	694	92.2	991	34.5
Other income	202	159	26.6	328	(38.5)
Interest	102	89	14.4	104	(1.7)
PBT	1,433	764	87.6	1,216	17.9
Prov. for tax	313	206	52.3	255	23.0
<i>% of PBT</i>	<i>21.9</i>	<i>26.9</i>		<i>20.9</i>	
PAT	1,120	558	100.5	961	16.5
Minority interest	1	(0)	NA	2	(79.2)
Reported PAT	1,119	559	100.3	959	16.8



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PL's Recommendation Nomenclature

BUY	: > 15% Outperformance to BSE Sensex	Outperformer (OP)	: 5 to 15% Outperformance to Sensex
Market Performer (MP)	: -5 to 5% of Sensex Movement	Underperformer (UP)	: -5 to -15% of Underperformance to Sensex
Sell	: <-15% Relative to Sensex		
Not Rated (NR)	: No specific call on the stock	Under Review (UR)	: Rating likely to change shortly

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