MOTILAL OSWAL

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Pharmaceuticals

Taking Root

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Pharmaceuticals

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The global generics industry is currently passing through one of the worst phases in its history. On the one hand, intense competition has led to significant reduction in profitability. On the other, wholesalers and distributors have become more demanding. This has resulted in a huge consolidation wave, with generics companies racing ahead to gain scale through the inorganic route despite demanding valuations. However, we believe that several markets, which still offer high profitability, have not been fully exploited. Also, there exist certain niche opportunities, which could offer higher volumes with stable margins. Addressing these markets and opportunities along with stringent cost control should help the generics companies tide over their current difficult period. We also believe that most of these adverse developments are already discounted in current valuations and the sector holds potential for the long-term investor.

Global generics – demand to remain buoyant

Pressure on global healthcare budgets and ageing population would ensure buoyant demand for generics: Globally, governments are under constant pressure to lower healthcare costs and to increase access to medicines. This is likely to result in more favorable legislation for generics globally, although it could also result in lower generics prices in some markets. Generics would continue to see robust demand across markets, led by macroeconomic factors such as ageing population, pressure on global healthcare budgets, increasing penetration of generic drugs (especially in some EU and semi-regulated markets) and patent expiries.

Patent expiries would drive generics growth in regulated markets: We expect US$45b-50b worth of products to go off-patent in the US alone by 2009. At an average of 97% price discount, this is likely to result in a potential market worth US$1.5b for the generics players over the next three years. Western Europe would witness patent expiries worth about US$6b in the same period. Many countries (e.g. Japan) are likely to encourage generics to reduce their healthcare costs. All this would ensure that generics volumes continue to expand further.

US generics prices already at 97% discount, further declines would only be slight: Prices for patent-expired products in the US are already at 97% discount to the innovator's price. While we do not expect any significant improvement in the competitive landscape in the short-to-medium term, we believe that further price declines would not be very significant. Price deflation commenced in CY04 and we are already into the fourth year of successive price decline.

Low penetration should drive double-digit growth in many European markets: We believe that the generics penetration in several European markets is extremely low. Barring Germany and the UK, generics penetration in most of the regulated markets in Europe (France, Spain, Italy, Belgium) is in single digits. Japan, the second largest pharmaceutical market, also has a generics penetration of merely 5%. This implies that as more drugs go off-patent in these markets and as respective governments enact favorable legislations, the generics penetration in these markets would improve significantly. The larger Indian generics players have already entered these markets (either via the inorganic route or through partnerships), which should augur well for these companies in the long term.

RoW markets offer an attractive opportunity, with higher margins: The size of the semi-regulated markets is expected to increase from US$40b in 2005 to US$50b-60b by 2009. The opportunity spans more than 150 markets through Latin America, Asia, Eastern Europe and Australia. The current market share of Indian companies is merely about 6%, implying that there is substantial room for growth. Secondly, most of these markets are branded generics markets, thus, resulting in better margins compared with the US generics market (GPM of about 60-70% compared with 40-50% for the US). Indian generics companies have already established a reasonable presence in some of these markets (like Russia, Latam) while they are in the process of strengthening their presence in some of the other markets (like China, Australia, New Zealand).

Anti-AIDS also presents a large volume opportunity with stable margins: Unlike popular belief, we believe that that the anti-AIDS market offers a reasonable upside to Indian companies like Ranbaxy and Cipla. Besides Indian companies, no other generics player is active in this market, as it was assumed that the supplies would entail significantly lower margins. Contrary to this belief, the anti-AIDS opportunity offers large volumes with reasonable margins (EBITDA margins of 15-20%) for the Indian players.

✍ Consolidation – what to expect in 2007-08

Consolidation to gain further steam: Intense price competition in the traditional generics markets of the US and UK has forced most generics players to expand geographically and also focus on backward integration. This has led to a big consolidation wave in the global generics industry, with large players such as Teva and Sandoz successfully polarizing the market in their favor (via big-ticket acquisitions).

Risks of extended payback remain: While acquisitions are imperative to gain scale, we believe that current valuations for generics assets are extremely demanding, implying that inorganic growth for Indian players is likely to arise at the cost of extended paybacks of 8-10 years. Also, regulatory changes post acquisitions (like the case of Betapharm in Germany) has extended the paybacks further. However, the recent withdrawal by Indian generics companies from the bidding for Merck Generics indicates a more pragmatic approach towards inorganic initiatives.

Our prognosis –combination therapy to work best

Our prognosis for generics markets is based on two main parameters – product pipeline and cost control. While large and geographically diversified product baskets (along with some niche products) are needed for topline growth, cost control through vertical integration will determine sustainability in the intensely competitive generics markets.

Which generics models will succeed?

In our opinion, the winning business model will include a combination of:

1. Vertical integration
2. Low cost of manufacture
3. Geographically diversified presence
4. Wide product basket
5. Strong balance sheet

INDIAN GENERICS - CURRENT STATUS

PARAMETER	PRE-REQUISITE	STATUS OF INDIAN PLAYERS
Vertical Integration	Complete integration from manufacturing of inter-mediates to formulations	Most Indian players are vertically integrated
Manufacturing Locations	Access to low-cost manufacturing base like India	Most Indian players have a strong manufacturing base in India
Geographical Diversification	Right mix of regulated and semi-regulated markets	Ranbaxy & Cipla have a fairly diversified geographical portfolio
Product Basket	Wide product basket including various dosage forms with some niche products & FTFs	The top four Indian generics players have large product baskets. Other Indian companies are in the process of widening their portfolios
Financial Health	Strong balance sheet to manage litigation risks, acquisitions, etc.	Amongst the leading players, only Sun Pharma has the balance sheet strength to fund large acquisitions without significantly diluting equity

Source: Motilal Oswal Securities

Cost structures are being re-aligned/de-risked: To counter the pricing pressure in regulated markets, Indian generics companies have embarked on a cost control cum de-risking drive. They are reducing costs by conducting in-house bio-equivalence studies, controlling SG&A costs and adopting a pragmatic approach towards patent challenges (leading to out-of-court settlements, thus capping litigation costs). E.g. settlement for Provigil (Cephalon-Teva, Ranbaxy & others), Imitrex (GSK-Dr Reddy's). Ranbaxy has reduced costs through more in-house work (compared to more outsourcing in the past), while Dr Reddy's Laboratories has de-risked its R&D and fixed costs by resorting to external funding and partnering with private equity investor. Sun Pharma has recently de-risked its NCE/ NDDS research by demerging it into a seperate company.

NCE research – risks still high

Indian NCE efforts have till date yielded upfront and milestone payments of about US$70m spread across 6-7 NCE out-licensing deals. While Indian NCE research efforts have met with initial success (as well as failures), we believe that the risks attached to NCE research are very high. Recognizing this, Indian players are de-risking their NCE research operations through partnerships with either pharmaceutical MNCs or with private equity investors. Indian chemistry skills are being leveraged through in-licensing NCE molecules from innovator companies (e.g. the Ranbaxy-GSK partnership, Nicholas Piramal-Eli Lilly partnership).

Valuation and view

US pricing pressure, costly acquisitions – already discounted in current valuations: The past underperformance for Ranbaxy and Dr Reddy's Laboratories was led by intense generics pricing pressure and expensive acquisitions made by these companies. Cipla and Sun Pharma have fared releatively better reflecting the consistency of performance over the past seven years and their conservative management style. The recent US FDA survey at Ranbaxy's US operations is also serving as an overhang on its valuations.

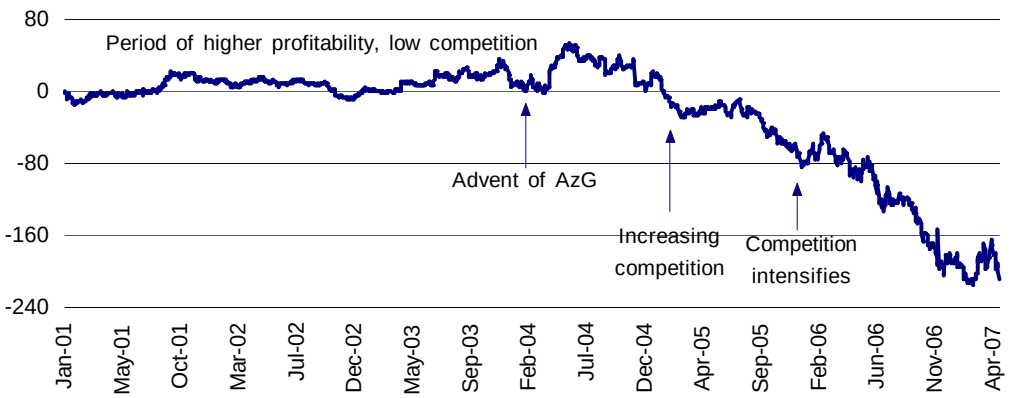
Sensitivity to US revenues likely to reduce for Ranbaxy and Dr Reddy's: We believe that the underperformance over the past two years discount the 97% price erosion in the US generics markets. However, the sensitivity to US generics revenues is likely to decline in the coming years, as initiatives in other markets (which enjoy better margins) start contributing to revenues and profits.

Sector has underperformed the broader markets by 200% in last two years: The pharmaceutical sector has underperformed the broader markets significantly (by almost 200%) over the last two years. The commencement of the underperformance coincided with the end of the golden period for generics in 2004. The main reasons for the end of the golden era were the entry of more players (leading to significant price erosion) and the aggressive stance adopted by the innovators, who launched authorized generics.

BSE HEALTHCARE MKT CAP TO BSE SENSEX MKT CAP (%)

Source: Companies/ Motilal Oswal Securities

BSE HEALTHCARE MKT CAP RELATIVE TO BSE SENSEX (%)



Source: Companies/ Motilal Oswal Securities

Valuations have corrected, with P/E multiples lower than median P/E of last five years: P/E multiples for leading generics companies are currently lower than their historic median P/E.

CURRENT P/E LOWER THAN LAST 5-YEARS' MEDIAN P/E

COMPANY	CURRENT P/E		MEDIAN P/E
	FY08E/CY07E	FY09E/CY08E	(FOR LAST 5 YEARS)
Ranbaxy	21.8	16.9	23.7
Dr. Reddy's Labs**	20.1	17.4	23.6
Sun Pharma	24.7	20.2	37.9
Cipla	20.0	16.2	21.4

*** - Only FY01-04 considered due to extreme values for FY05/06* *Source: Motilal Oswal Securities*

Sector offers upside for long-term investors: We are positive on all the four leading pharmaceutical companies – Ranbaxy, Dr Reddy's, Cipla and Sun Pharma. Our estimates do not include any upsides from potential patent challenges and NCE research. We believe that these stocks have the potential to deliver good returns over the next 18 months. Aggressive bidding for generics assets and aggravation of US FDA issues (for Ranbaxy) remain the key risks to our positive stance.

INDIAN GENERICS (RS M)

COMPANY	YEAR	CMP (RS)	SALES	PAT	EPS (RS)	CHG. (%)	P/E (X)	EV/EBITDA (X)	EV/SALES (X)	ROE (%)	ROCE (%)
Cipla	2007E	234	36,260	7,304	9.4	20.2	24.9	19.3	4.9	21.9	25.5
	2008E		42,540	9,099	11.7	24.6	20.0	15.7	4.1	22.4	25.1
	2009E		51,196	11,250	14.5	23.6	16.2	12.7	3.3	22.7	25.6
Dr Reddy's	2007E	720	43,086	4,152	24.8	202.8	29.1	17.7	3.1	11.7	6.5
	2008E		49,660	6,001	35.8	44.5	20.1	14.5	2.6	14.9	8.8
	2009E		58,046	6,939	41.4	15.6	17.4	12.9	2.2	15.3	9.5
Ranbaxy (Dec YE)	2006	343	60,213	5,418	13.6	150.3	25.3	11.8	1.8	20.1	13.8
	2007E		69,391	6,302	15.8	16.3	21.8	10.6	1.7	20.9	12.9
	2008E		84,791	8,130	20.3	29.0	16.9	11.4	1.9	23.7	15.7
Sun Pharma	2007E	1,048	20,664	7,364	35.6	37.9	29.5	27.1	9.1	39.0	22.0
	2008E		25,060	8,788	42.4	19.1	24.7	21.9	7.4	36.3	23.7
	2009E		30,661	10,750	51.9	21.7	20.2	17.7	5.8	34.8	24.7

Source: Company/Motilal Oswal Securities

GLOBAL PEERS (US$ M)

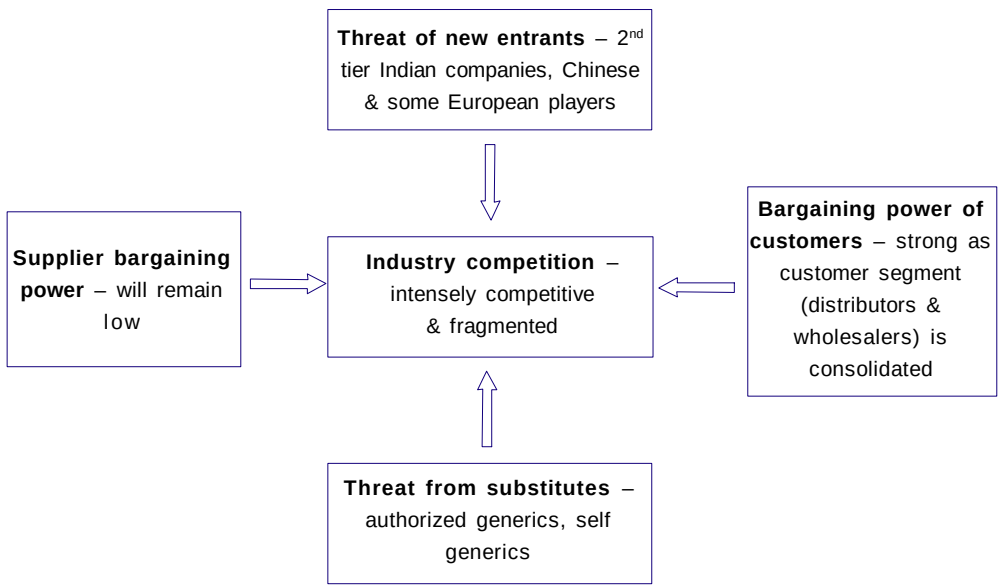
COMPANY Y/E DECEMBER	YEAR	CMP (US$)	SALES	PAT	EPS (RS)	CHG. (%)	P/E (X)	EV/EBITDA (X)	EV/SALES (X)	ROE (%)	ROCE (%)
Teva	2006A	36	8,445	1,859	2.3		15.6	12.2	3.9	19.6	12.4
	2007E		9,116	1,757	2.2	-5.5	16.7	11.9	3.5	17.1	8.1
	2008E		10,197	2,091	2.5	19.0	14.3	9.6	3.0	18.3	8.8
Watson	2006A	28	1,952	126	1.1		24.9	7.4	1.3	7.9	3.9
	2007E		2,500	149	1.3	18.2	21.5	8.3	1.5	8.0	5.1
	2008E		2,655	219	1.9	46.8	14.7	7.4	1.4	9.5	7.0
Mylan (Y/E March)	2007E	22	1,500	323	1.4		15.0	9.3	3.3	30.0	14.2
	2008E		1,681	322	1.4	-0.2	15.0	8.6	2.8	25.3	13.6
	2009E		1,705	338	1.5	4.8	14.1	8.0	2.7	23.1	13.2
Barr Labs	2006A	48	1,486	322	3.1		15.4	11.4	4.5	34.4	19.0
	2007E		2,558	336	3.1	4.2	15.3	7.4	2.5	9.7	6.0
	2008E		2,722	390	3.7	16.1	13.1	6.5	2.2	14.1	14.7

Source: Bloomberg

Global generics – demand to remain buoyant

The global generics industry is currently going through one of worst phases of its history. On the one hand, intense competition has led to significant reduction in profitability. On the other, customers have become more demanding. This has resulted in a huge consolidation wave, with generics companies racing ahead to gain scale through the inorganic route despite demanding valuations. However, we believe that several markets, which still offer high profitability, have not been fully exploited. Also, there exist certain niche opportunities, which could offer higher volumes with stable margins. Addressing these markets and opportunities along with stringent cost control should help the generics companies to tide over the current difficult times.

US GENERICS - INTENSELY COMPETITIVE ENVIRONMENT



Source: Motilal Oswal Securities

Global healthcare budgets are under constant pressure to reduce costs

Legislative changes favoring generics would open up new markets and gradually increase penetration

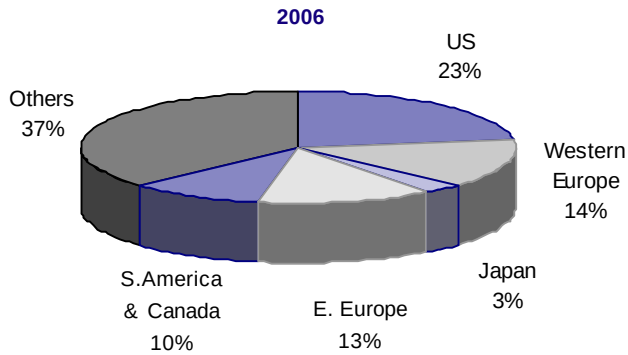
Globally, governments are under constant pressure to lower healthcare costs and to increase access to medicines. In fact, it was this pressure, which prompted the US government to introduce the Hatch-Waxman Act 1984, which led to the evolution of the generics market in the US. These pressures act like a double-edged sword as, on the one hand, they lead to favorable legislations for the generics markets, on the other hand, they may restrict the pricing power for generics (Germany is a recent case in point). However, we believe that, overall, these legislative changes are likely to open up new markets for generics and gradually increase their penetration.

Demand for generics to remain buoyant

We expect demand for generics to remain robust…

Generics will continue to see robust demand across markets, led by macroeconomic factors like ageing population, pressure on global healthcare budgets, increasing penetration of generic drugs (especially in some EU and semi-regulated markets) and patent expiries. Ageing populations are likely to drive the demand for drugs for chronic ailments (diabetes, cardiovascular, nervous-system-related, etc). This demand is likely to further pressurize global healthcare budgets (both personal and government), leading to favorable legislation for generics.

COMPOSITION OF GENERICS MARKETS



Source: Sandoz/Novartis

Vastly different market models across generics markets…

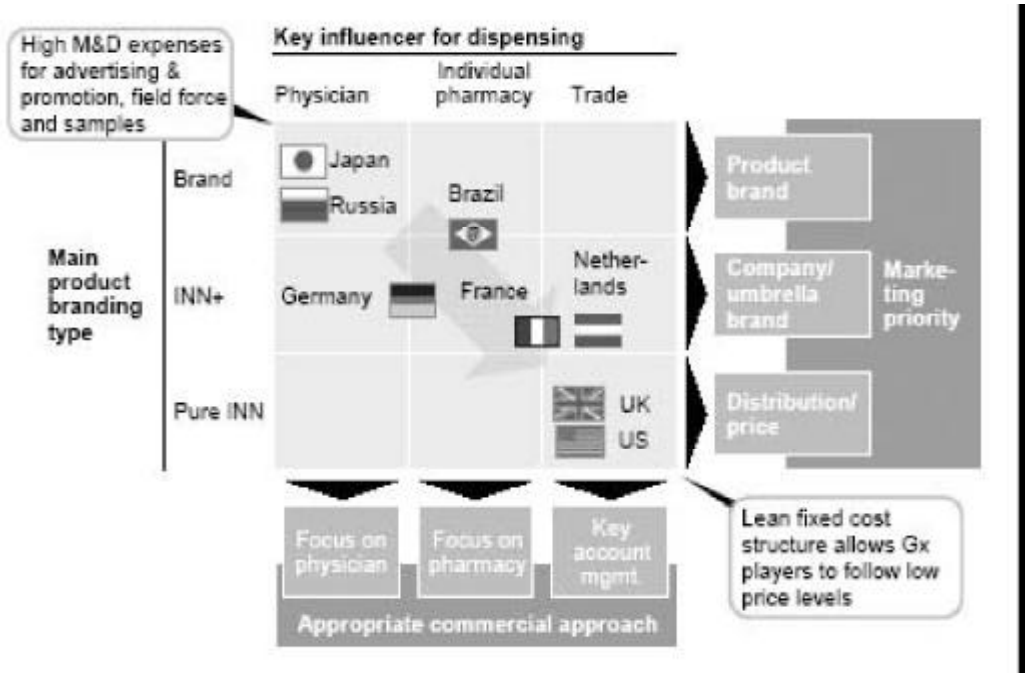
Generics markets globally have vastly different market models determined by various parties involved in influencing drug purchases. We classify the global generics markets into two main categories - Pure Generics and Branded Generics. The US and the UK markets are pure generics markets where the trade and health maintenance organizations (HMO) are the key influencers for dispensing decisions. In contrast, the Japanese and the Russian markets are brand driven and the doctor is the key influencer in drug purchases. The German, French and the Benelux markets fall in between these two categories wherein brands are important but the trade and pharmacies can also influence drug dispensing.

…resulting in vastly different profitability

…but maintaining / improving profitability is a challenge

Generics companies have to adopt different marketing models for each of these markets depending on who the target customer is for them e.g., in case of pure generics markets like the US and the UK, the target customers are the distributors, pharma and retail chains. In Japan, Russia and Germany, the doctor is the target customer for the generics company. Many of the non-regulated (RoW) markets are also branded, market making the doctors, a very important customer. The profitability across these markets varies depending on the marketing strategies - branded markets will involve high promotional and marketing costs while these would be absent in pure generics markets. In the current competitive environment, the branded generics markets are likely to command better profitability (despite higher promotional expenses) due to the brand value attached to the product, underlying the importance of sales force in these markets. While the US generic market enjoys GPM of 40-50%, the branded generics markets enjoy GPM of 50-70%.

DIFFERENT MARKET MODELS ACROSS MARKETS

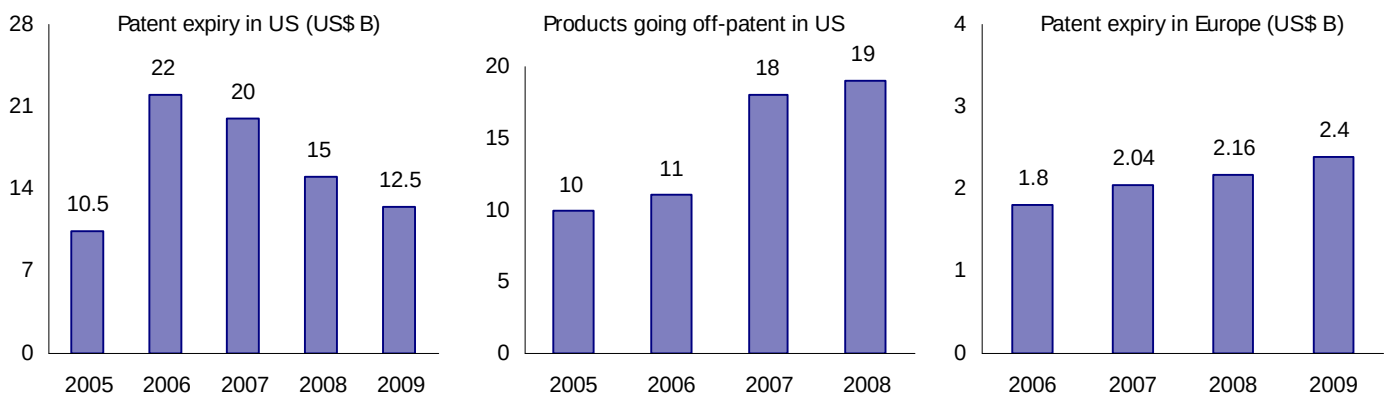


Source: Sandoz/Novartis

Regulated markets

Patent expiries to drive generics growth in the regulated markets of US & EU: We expect US$45-50b worth of products to go off-patent in the US alone by 2009. At an average of 97% price discount, this is likely to result in a potential market worth US$1.5b for the generics players. We believe that the number of products subjected to patent expiry is as important as the value of drugs going off-patent. This would take into account some of the generics opportunities, which some players have not been able to access, as they may not be the focus areas for these companies (e.g. statins in case of Cipla and Sun Pharma). Similarly, patent expiries in the EU region are also expected to increase gradually, which is likely to open up further opportunities for generics.

PATENT EXPIRIES – BOTH US & EU



Source: Industry/Motilal Oswal Securities

1. US generics market

In the US, generics prices have fallen to record lows…

US generics prices are already at 97% discount to innovator prices…

Prices of patent-expired products in the US are typically at 95-97% discount to the innovator's price. We believe that this would hold true for most of the products likely to go off-patent in the coming years. The discount rates have incresed from about 70% in 2003 to the current 97%. Recent products, which have witnessed such discounts include Simvastatin and Meloxicam.

…and there may not be significant declines hereon

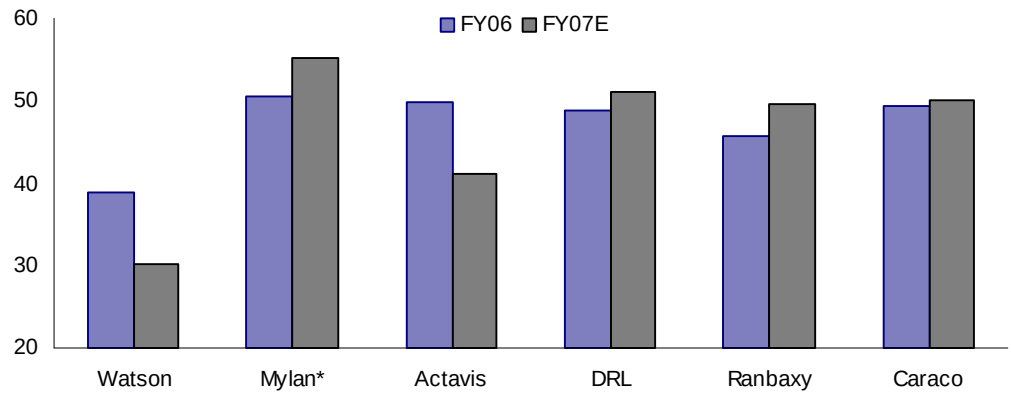
…and may not decline significantly in future

We believe that pricing pressure in regulated markets (especially the US and UK) may not aggravate further, as there is already 95-97% price erosion for highly competitive products. However, we do not expect any improvement in the pricing scenario till the much-needed consolidation takes place. The US market is still a very crowded market, with smaller players still aggressively filing and launching products.

GPMs near the levels reached during the previous industry downturn in 1998-99

Our interaction with the industry indicates that during the previous downturn (in 1998-99), gross margins for the generics industry fell to 35-40% before taking an upward trend. We believe that the GPMs for most players in the US are in the 40-50% range (excluding exclusivity based opportunities which are one-time in nature).

GENERICS GPM (%)



** for 9MFY07* *Source: Company/Motilal Oswal Securities*

Proposal to ban authorized generics in the US

Three US senators have introduced a bill in the US senate, proposing a ban on authorized generics. The Fair Prescription Drug Act of 2007, introduced in the Senate on 30 January 2007, aims to ban the sale of authorized generic drugs during a successful generic drug applicant's 180-day exclusivity period. Current regulations in the US permit launch of authorized generics during the exclusivity period.

The key argument put forth by the generics players is that authorized generics make patent challenges less attractive. Hence, in the long run, generics companies may not aggressively challenge patents, leading to lower competition and higher drug prices for consumers. Pharmaceutical MNCs are, however, arguing that authorized generics help in lowering the cost to the consumers during the exclusivity period.

The US Federal Trade Commission (FTC) has taken up a detailed study on the "Impact of Authorized Generics" and is likely to come out with a detailed report in 2008.

Upside could be significant for Indian companies but implementation seems difficult and time-consuming: A ban on authorized generics (if implemented) will be a positive for Indian generics players who have been focusing on patent challenges (mainly Ranbaxy and Dr Reddy's and Sun Pharma). The table below indicates upsides from a typical patent challenge (in the 180-day exclusivity period), both with and without an authorized generic in the market:

UPSIDE FROM A TYPICAL PATENT CHALLENGE

BRAND SIZE (US$500M)	WITH AZG	WITHOUT AZG	INCREMENTAL UPSIDE (%)
No. of players - assumed	3.0	2.0	
Price Erosion (%)	70.0	40.0	
Generic Market Share (%)	50.0	70.0	
Sales	37.5	105.0	180
PAT margin (%) – assumed	60.0	70.0	
PAT	22.5	73.5	227

Source: Motilal Oswal Securities

However, this is only a proposal and is yet to be cleared by the US government. The MNC lobby is likely to aggressively oppose this recommendation, as launch of authorized generics is one of the key mechanisms to discourage patent challenges. It should also be noted that the pharmaceutical MNCs wield significant clout in the US and getting the Senate approval for this recommendation is likely to be extremely difficult and time-consuming.

Centers for Medicare and Medicaid Services (CMS) to include authorized generics in innovator's best price list: In February 2006, the US federal regulations closed another loophole that brands use to benefit from authorized generics. The new law contains a provision that will require brand pharmaceutical companies to include authorized generics in the "best price" calculation that is provided to the Centers for Medicare and Medicaid Services. Due to an ambiguity in the existing law, some brand companies were not required to include authorized generics in their best price calculation, diverting government and taxpayer savings. The change has come into effect in January 2007. We believe that the next few quarters will give us an idea if this change of regulation will slacken the pace of authorized generics launches.

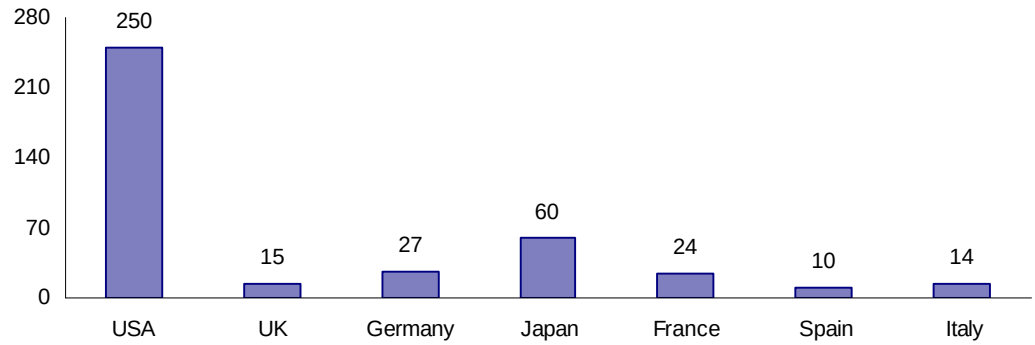
2. EU generics markets

Penetration still low in many large markets in Europe

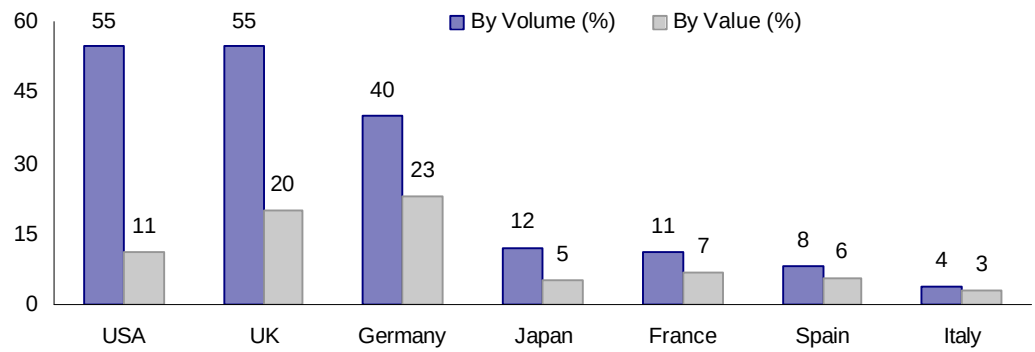
In several large markets in Europe, generics penetration is still low…

We believe that the penetration of generics is still very low in many of the large pharmaceutical markets in Europe. Although France, Italy and Spain feature amongst the top-10 markets, the penetration of generics in these markets is in single-digits, leaving ample room for expansion.

GLOBAL PHARMACEUTICAL MARKET SIZE (US$B)



GENERICS PENETRATION BY VOLUMES AND VALUES



Source: Industry/Motilal Oswal Securities

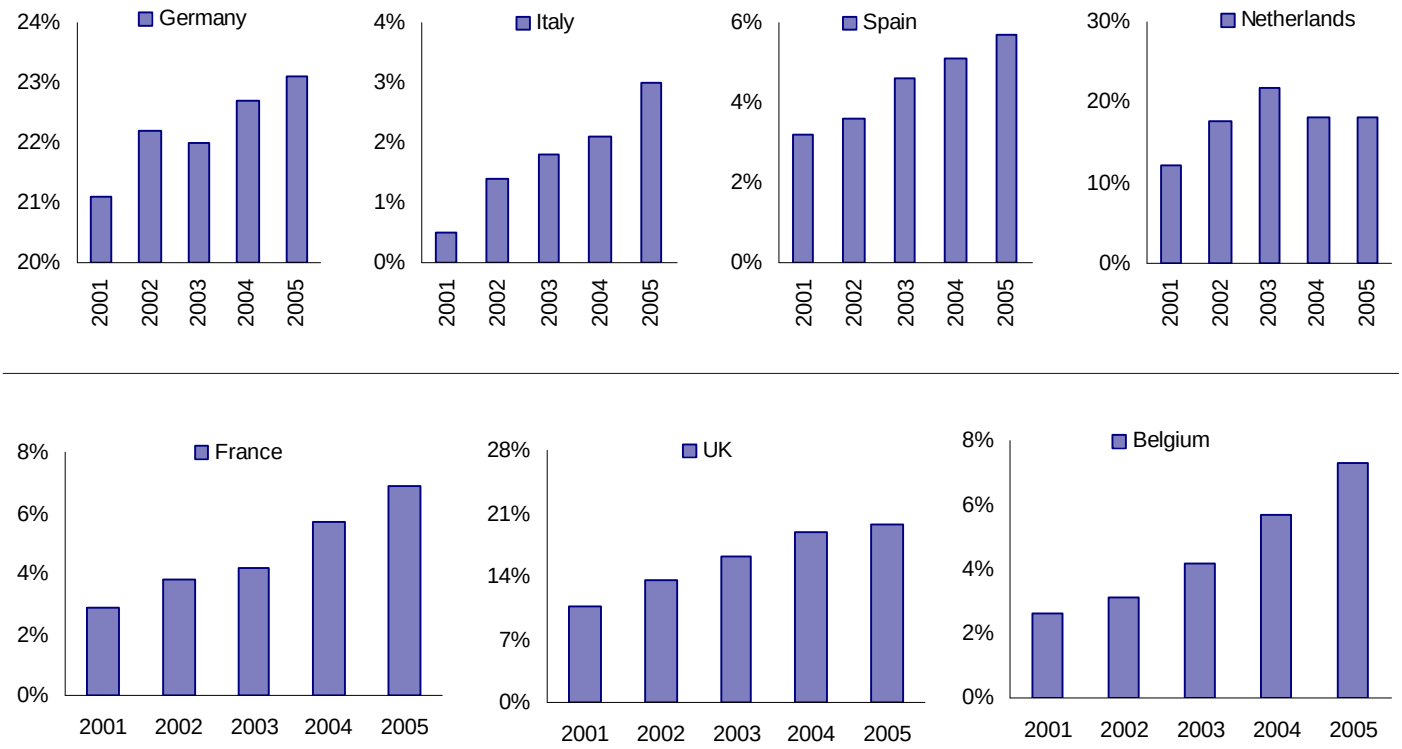
Low penetration to enable generics to record CAGR of 10-12%+ in Europe

…which we believe should see a significant increase

Most European markets (except UK) have a branded generics market, resulting in higher entry barriers and lower price discounting post patent expiry. Hence, volume penetration in these markets is significantly below that in the US and the UK.

We believe that the penetration of generics should see a significant increase in the European region (although gradually), driven by increasing pressure on healthcare budgets and significant room available for greater penetration.

GENERICS PENETRATION IN INDIVIDUAL MARKETS IN EUROPE (BY VALUE)



Source: Industry/Motilal Oswal Securities

3. Japan generics market

Significant potential in Japan, but only over the long term

With pro generics reforms commencing, Japan too offers significant potential

Japan is the 2nd largest pharmaceuticals market globally (size – US$60b for 2005), but has very low generics penetration – 5% by value and 17% by volume. It is estimated that the Japanese generics market is likely to expand from US$3b (for 2005) to about US$14b by 2010. Hence, there is tremendous potential for generic drugs in the country. However, as Japan requires extensive structural/regulatory changes, we believe that this potential will be unleashed only in the long-term. The Japanese government has commenced reforms in the healthcare system with the purpose of lowering healthcare costs by encouraging generics.

Indian companies like Ranbaxy, Lupin and Strides Arcolab have already formed JVs with local Japanese players

Very few Indian players have commenced operations in Japan. Ranbaxy, Lupin, Cadila Healthcare and Strides Arcolab have formed joint ventures with local players to tap this market. Ranbaxy has already launched a few products through the JV in Japan.

JAPAN - INDIAN JVS

COMPANY	LOCAL PARTNER
Ranbaxy	Nippon Chemiphar
Lupin	Kuowa
Strides Arcolab	Sorm
Cadila Healthcare	Acquired Nippon Universal

Source: Motilal Oswal Securities

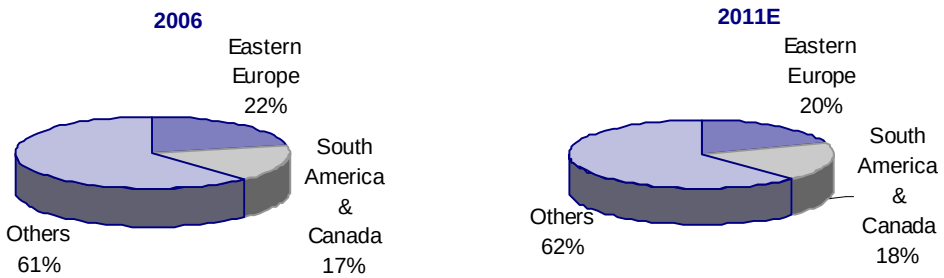
Rest of the World (RoW)

RoW generics market opportunity is attractive

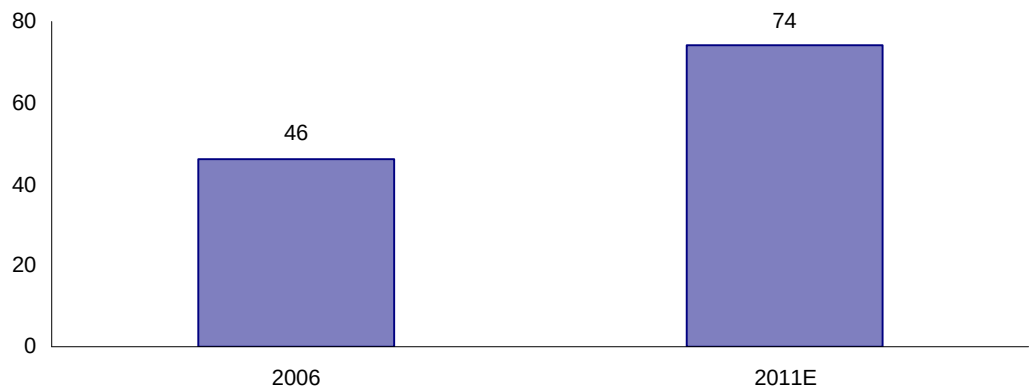
There is still large room for growth in semi-regulated markets…

The size of the semi-regulated markets is expected to increase from about US$46b in 2006 to US$74b by 2011. The opportunity spans across more than 150 markets through Latin America, Asia, Eastern Europe and Australia. The current market share of Indian companies is only about 6%. Thus, there is still large room for growth.

ROW GENERICS MARKET COMPOSITION

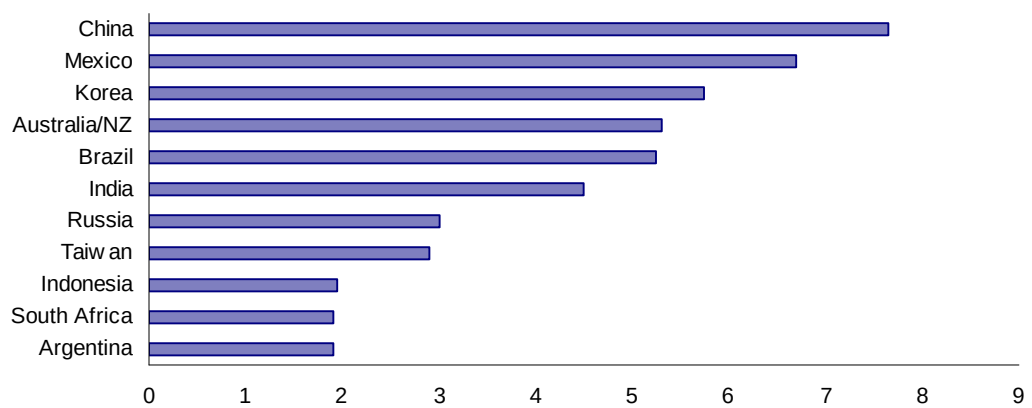


ROW GENERICS MARKETS (US$B)



Source: Sandoz/Motilal Oswal Securities

TOP 10 ROW GENERICS MARKETS (US$B)

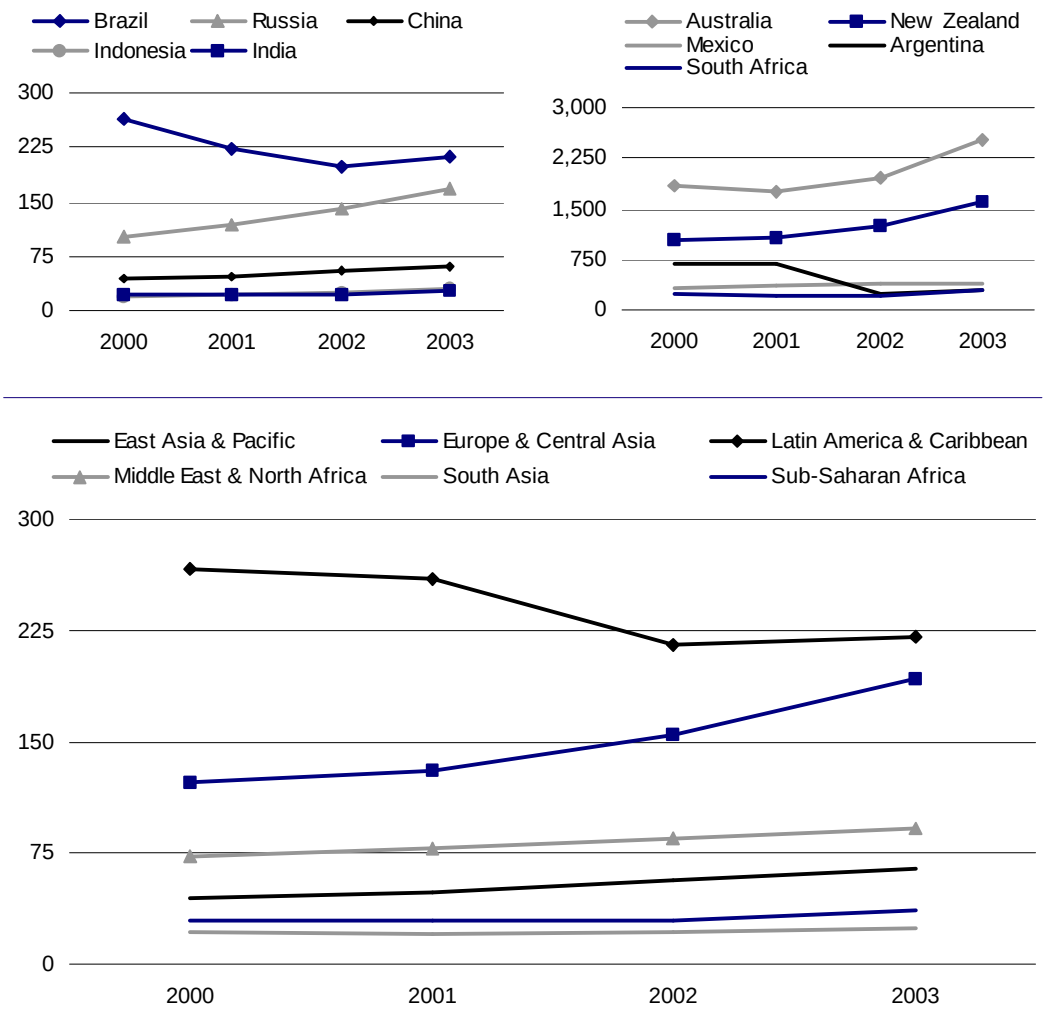


Source: Industry/Motilal Oswal Securities

Growing per capita incomes to drive demand in RoW markets

The per capita healthcare spend in regulated markets is significantly higher than RoW markets on account of support from the government and high per capita incomes that support high-quality healthcare infrastructure. We believe that the entry of private sector insurance companies in most RoW markets and the high growth of per capita incomes in these markets will drive healthcare spend in RoW markets.

PER CAPITA HEALTHCARE SPEND IN EMERGING ECONOMIES (US$)



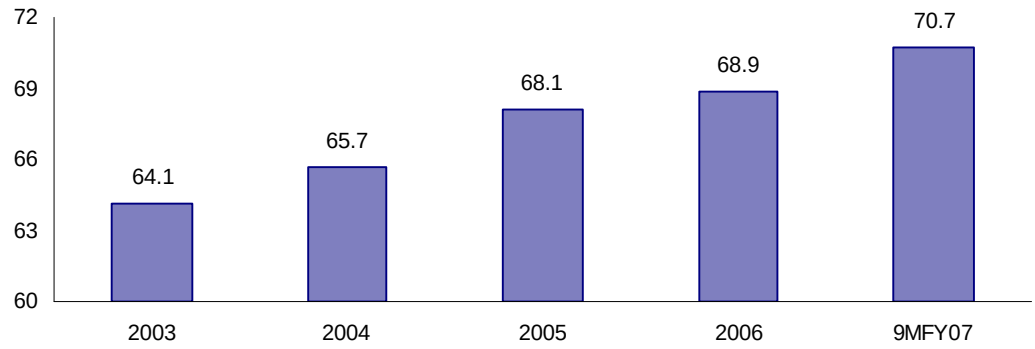
Source: WHO/ Motilal Oswal Securities

RoW markets offer higher margins

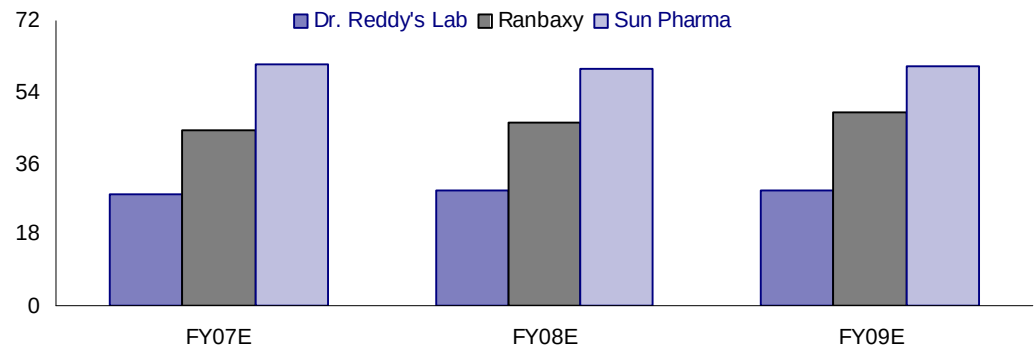
…which also offer higher margins

Most of the RoW markets fall under the branded generics category, and hence offer stable and relatively higher margins (GPM of 60-70%) than the intensely competitive regulated generics markets of the UK and US. We have used Dr Reddy's gross margins as a proxy to indicate the attractiveness of the RoW markets below. We believe that most Indian companies would be enjoying similar margins in the RoW markets.

DR REDDY'S: TREND IN GPM FOR BRANDED FORMULATIONS BUSINESS (%)



CONTRIBUTION OF ROW MARKETS (% OF TOTAL SALES)



Source: Company/Motilal Oswal Securities

Entry strategy is a critical determinant for success

The RoW potential is spread across more than 150 countries with significant differences in regulatory environment, pricing systems, competitive environment and credit cycles. Hence, Indian generics companies are unlikely to target all these markets through the same entry strategy. We believe that tapping this opportunity is likely to involve a mix of direct presence and partnerships.

Indian companies can target this opportunity in two ways:

1. Setup own marketing and distribution in these countries and capture the full value chain. This involves front-ended investments, high fixed costs and long gestation periods. It also involves taking the credit risk on one's own books. In the past, companies have faced credit related risks in markets like Russia. Ranbaxy has followed this strategy in many of the RoW markets where it has a presence.

2. Develop partnerships with the local players in these markets. Each of these markets has its own regulatory and pricing systems. The competitive landscape is also very different in each of these markets. Hence, it may be prudent to enter into partnerships with well-established local players who understand the markets. Cipla is a typical example of this strategy with over 200 partners in various countries.

Anti-AIDS: an attractive market, contrary to popular belief

The anti-retroviral (ARV) opportunity is a sizeable and largely unmet one. Around 48m patients globally are infected with the HIV virus, of which around 90% are not treated. The African sub-continent houses 40-50% of AIDS patients. Almost 3m people are infected with the AIDS virus each year. The demand for ARV drugs is expected to grow at a fast pace, as initiatives from sponsors like WHO, PEPFAR, the Clinton Foundation and Medicins sans Frontier to increase access to low-cost drugs gather momentum. These programs were mainly initiated to make ARV drugs more affordable to the population of the least-developed countries – particularly the African sub-continent, which is facing a public health emergency. Companies like Ranbaxy and Cipla have been at the forefront of the battle against AIDS and in making ARV drugs more affordable. These companies have significantly reduced the prices of its ARV drugs both in the domestic and the international markets.

Large opportunity for Indian players

Despite the sharp reduction in ARV prices, these drugs remain unaffordable to a large section of the population in regions like Africa. There is constant pressure on the manufacturers of ARV drugs (including the innovators) to further reduce the cost of their ARV therapies. Cipla was the first company to quote an annual price of US$365 per patient for supply of ARVs to the African markets. Subsequently, other Indian companies like Ranbaxy and Aurobindo have also shown interest in supplying the drugs at prices lower than US$300 per patient. Innovator pharmaceutical companies like GSK, BMS, and Boehringer have announced special prices for the African markets and have also issued licenses for manufacturing ARVs to local players like Aspen. The WTO TRIPS provisions have also been amended to facilitate manufacture and export of ARVs to African nations from low-cost bases like India. This has resulted in a large opportunity for low-cost manufacturers such as Cipla, Ranbaxy and Aurobindo.

In March 2005, South Africa's government awarded contracts to seven pharmaceutical companies to supply the country's public health system with ARV drugs spread over the next three years. The national ARV drug treatment program aims to provide drugs to 1.2m patients (i.e. about 25% of the country's HIV-positive population) by 2008. This US$500m tender should supply drugs for 500,000 patients that the program aims to cover by 2007. The larger part of the deal is with Aspen Pharmacare, a South African generics company, which will supply the program with eight out of the 15 required anti-retroviral formulations. Only one other generics manufacturer was included in the tender, Cipla Medpro (Cipla's JV in South Africa), which will produce a proportion of the program's supply of d4T tablets.

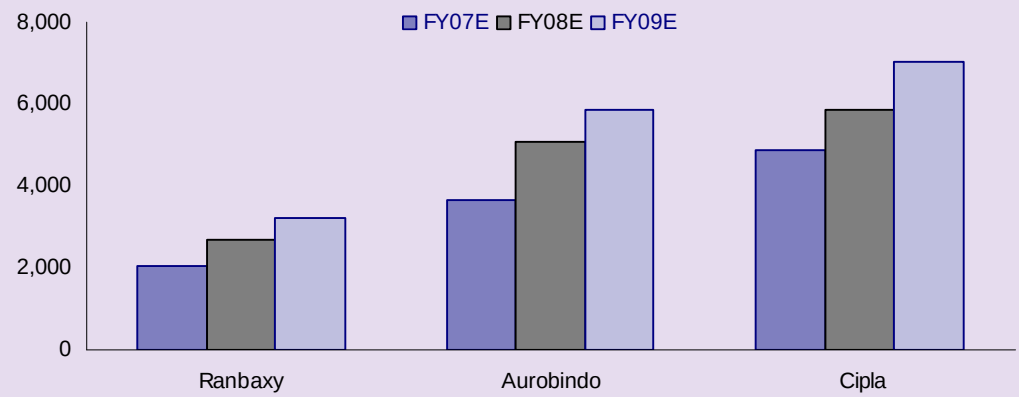
The remainder of the drugs will be purchased from the innovator pharmaceutical companies. We believe that supplies from the generics companies – Aspen and Cipla Medpro – would have an approximate annual cost of US$200 per patient. The size of the contract (US$500m spread over next three years) indicates that the overall potential

of the South African market alone is US$1.5-2b spread over the next 5-10 years. Hence, the supply of ARVs to African markets will be a significantly large opportunity for generics companies like Cipla.

Stable revenue streams

Unlike popular belief, we believe that the anti-AIDS opportunity will result in stable revenues and margins for Indian players as none of the other generics companies have shown interest in participation in the anti-AIDS programs. We believe that this will be a high volume opportunity, with EBITDA margins of about 15%, which could result in a reasonable upside for Indian players like Ranbaxy, Cipla, Aurobindo.

CONTRIBUTION OF ARVS TO REVENUES (RS M)

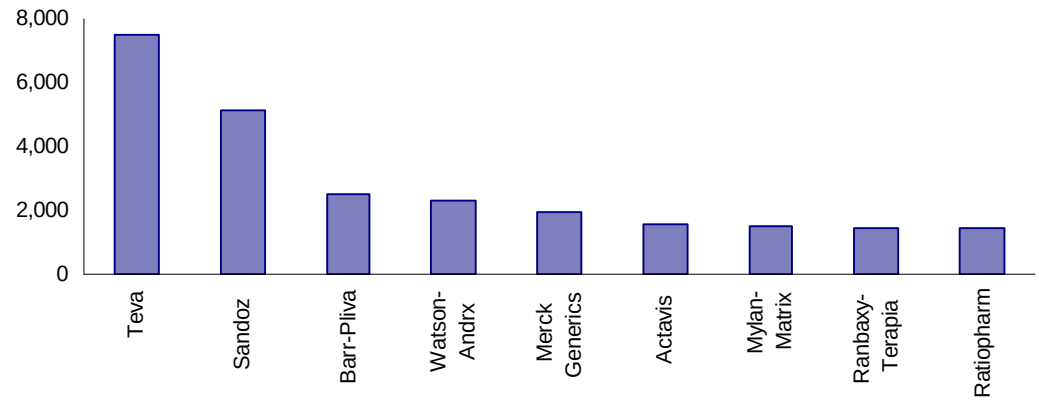


Source: Company/Motilal Oswal Securities

Consolidation – what to expect in 2007-08

The global generics business is witnessing increased competition, leading to a consolidation wave. We believe that the consolidation efforts will further intensify and are likely to result in significant changes in the global landscape for the generics players. Barring the top-2 players (i.e. Teva and Sandoz), the global rankings for most of the other generic players are likely to undergo a major change over the next two years.

GLOBAL GENERICS SALES RANKINGS (US$M)



Source: Company/Motilal Oswal Securities

The global generics industry has witnessed a spate of high-value acquisitions in the past two years. The key reasons for these acquisitions were:

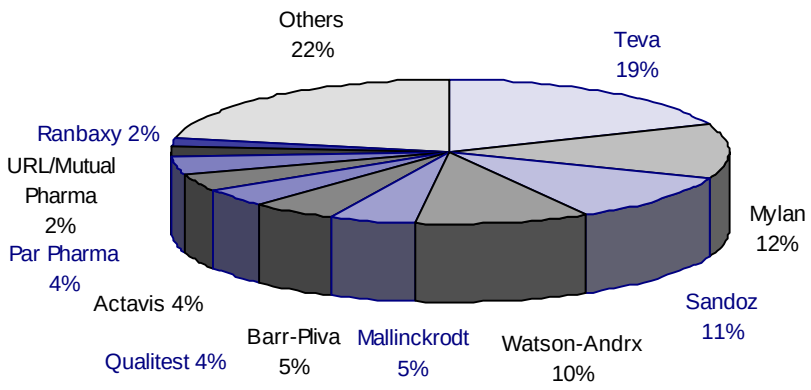
- To acquire scale in the global generics industry and expand product offerings, primarily driven by increased competition
- To exploit backward integration synergies in manufacturing
- To prevent competitors from entering/strengthening presence in key markets (mainly USA & Europe).

Significant industry polarization making size and scale critical

The global generics industry is getting increasingly polarized…

The global generics industry is getting increasingly polarized, with Teva and Sandoz being the largest players. Other players like Barr Labs, Actavis and Watson have become aggressive over the last one year in the global M&A space and have increased their size and scale significantly. Teva – the largest generics company - is about 5x the size of Ranbaxy, which is the largest generics company from India. The third largest generics player is also about 2x the size of Ranbaxy. The top-5 generics companies in the US account for almost 60% of the market share.

US GENERICS MARKET SHARE



Source: IMS/Motilal Oswal Securities

…making it imperative for players to gain in size and scale

Intense price competition and polarization is making it imperative for players to gain in size and scale. Scale and geographical diversification have become important in order to spread risks over a number of geographies and products.

Recent acquisitions mainly directed towards branded generics markets

During the past year, acquisitions were mainly targeted towards the branded generics markets

During the past year, we have witnessed an increasing trend towards acquisitions in the branded generics markets (and not in the traditional generics markets of US and UK). We believe that the intense price competition in the US and UK generics markets has resulted in acquisitions being targeted towards the branded generics markets (mainly Europe), as the latter enjoy better margins compared to the former. This trend has been more pronounced in the last 12 months, with Ranbaxy, Dr Reddy's, Barr Labs and Hospira making significant acquisitions in the branded generics space.

DETAILS OF KEY ACQUISITIONS

ACQUIRER	ACQUIRED COMPANY	COUNTRY	ACQUISITION DATE	COST OF ACQUISITION (US$M)	EV/ SALES (X)	EV/ EBITDA (X)
Sandoz	Hexal & Eon	Hexal - Germany, Eon - USA	Feb-05	7,769	3.7	11.9
Matrix Labs	DocPharma	Belgium	Jun-05	238	2.0	17.4
Teva	Ivax	USA	Jul-05	7,400	3.3	24.6
Actavis	Alpharma	USA	Oct-05	810	1.0	10.4
Dr. Reddy's Labs	**Betapharm**	**Germany**	**Feb-06**	**576**	**2.9**	**11.7**
Watson	Andrx	USA	Mar-06	1,900	1.8	52.8
Ranbaxy	**Terapia**	**Romania**	**Mar-06**	**324**	**4.1**	**11.6**
Barr Labs	Pliva	Croatia	Jun-06	2,578	2.1	18.3
Mylan Labs	Matrix Labs	India	Aug-06	736	2.7	18.3
Hospira	Mayne Pharma	Australia	Sep-06	2,000	2.9	17.9

Source: Company/Motilal Oswal Securities

Western players gaining access to India advantage

Post consolidation of front-end operations…

We believe that tying up the backend will be the most logical step for some of the larger global generics companies post the consolidation of their front-end operations. It is pertinent to note that although Teva, Sandoz, Merck Generics, Actavis, etc., currently outsource manufacturing from India, they still do not have any significant presence of their own in the country. After gaining scale in the global generics market, we expect these players to focus on establishing a significant manufacturing presence in India (to gain the India advantage) by acquiring mid-size generics companies in the coming years.

…most global generics players would look to acquire Indian players with manufacturing infrastructure

We believe that these global players will typically be interested in acquiring Indian players that have the manufacturing infrastructure but do not have a strong distribution network of their own. Most of these Indian companies (e.g. Aurobindo Pharma, Orchid Chemicals, Neuland Labs, etc) are currently supplying/distributing their products in regulated markets through tie-ups with local players. News flow related to such acquisitions is likely to drive the valuations for these mid-size Indian generics companies.

Mylan has recently acquired 71% stake in Matrix Labs

In recognition of the high quality skill base available in India (at relatively lower costs), global generics companies are evaluating the possibility of having a manufacturing base in India. This move, with the other emergent trend of buying existing API units or setting up greenfield API units in India and collaborating with Indian players, will offer companies from the regulated markets an opportunity to compete on the same cost base and access the same expertise. This would enable western players to sustain over the entire life cycle of generic products. This also implies that the competition for talent is increasing as also the pressure on resources required for staying world class. Mylan's recent acquisition of 71% stake in Matrix Labs is a case in point.

GLOBAL GENERICS - INDIA PRESENCE

	INDIA PRESENCE		
COMPANY	ACQUISITIONS	PARTNERSHIPS	OWN FACILITY
Teva	Acquired Regent Drugs	Cipla (Ivax)	R&D Centre
Sandoz			API, Formulations & R&D facilities
Mylan	Acquired majority stake in Matrix Labs		
Watson	Acquired DRL's Goa formulation facility	Cipla	
Apotex		Orchid	Mfg & R&D facility
Barr (Pliva)		DRL (for injectables), Unichem	Formulations facility
KV Pharma		Glenmark	
Par Pharma		Orchid, DRL	

Source: Companies,/Motilal Oswal Securities

Bidding for generic assets becoming more competitive

The past few acquisitions have been made under intense competitive bidding as is evident from the valuation multiples. Typically, acquisitions have been made at 2-3x sales and 10-

15x EBITDA. We believe that the intention to achieve rapid scale-up in the global generics markets and increased pressure on the traditionally profitable markets of the US and the UK is forcing generics companies to bid aggressively for assets.

We are concerned that generics companies could overpay for their generics initiatives

Scale and integration v/s payback: We are concerned that in the quest to gain scale, there will be a tendency on the part of the generics companies to overpay for their inorganic initiatives. Generics companies are likely to give more priority to enhancing their scale of operations rather than the paybacks from acquired companies. This is particularly true of the generics acquisitions made in the past two years wherein enhancement in scale and integration has resulted in paybacks of at least 8-10 years, exposing the acquirers to any adverse changes in the market and regulations.

DETAILS OF RECENT ACQUISITIONS

ACQUIRER	ACQUIRED COMPANY	COST OF ACQUISITION (US$M)	REMARKS
Sandoz	Hexal & Eon	7,769	Higher scale in Europe & USA. Synergies from backward integration as Sandoz is fully integrated **Valuations:** 3.7x sales and 11.9x EBITDA
Matrix Labs	DocPharma	238	Access to European markets **Valuations:** 2x sales and 17.4x EBITDA
Teva	Ivax	7,400	Higher scale in USA and access to Latam, Central Europe. Synergies from backward integration as Teva is fully integrated **Valuations:** 3.3x sales and 24.6x EBITDA
Actavis	Alpharma	810	Strengthens presence in US & Europe **Valuations:** 1x sales and 10.4x EBITDA
Dr. Reddy's Labs	Betapharm	576	Establishes strong foothold in Germany. Can access other EU markets. Manufacturing synergies in long-term as DRL is fully integrated and Betapharm does not have any manufacturing facilities of its own **Valuations:** 2.9x sales and 11.7x EBITDA
Watson	Andrx	1,900	Gains scale and expands product pipeline for US. **Valuations:** 1.8x sales and 52.8x EBITDA
Barr Labs	Pliva	2,578	Strong presence in Croatia, Poland & Germany. Also has presence in Russia, UK, Italy & Spain. Access to facilities in Central & Eastern Europe. Has presence in about 30 countries. **Valuations:** 2.1x sales and 18.3x EBITDA
Ranbaxy	Terapia	324	Makes Ranbaxy the largest generic player in Romania. It is fully integrated and has presence in Russia, Ukraine & Poland besides Romania. It has 157 marketing authorizations and has a pipeline of 60 new authorizations to be commercialized over the next 3 years. **Valuations:** 4.1x sales and 11.6x EBITDA
Mylan	Matrix Labs	736	Ties up a strong back-end API sourcing for Mylan **Valuations:** 2.7x sales and 18.3x EBITDA

Source: Companies,/Motilal Oswal Securities

Balance sheet strength critical for future M&As

Given that generics acquisitions have turned into bidding wars, we believe that balance sheet strength becomes a critical determinant of the ability of Indian generics companies to participate in future M&A transactions. We believe that Sun Pharma is best placed in this respect, with about US$500m of cash on its books. However, given its conservative stance on acquisitions, it is unlikely to be an aggressive bidder for generics assets.

INDIAN GENERICS: KEY FINANCIALS (RS M)

FY07E	RANBAXY	DRL	SUN PHARMA	CIPLA
Debt	29,461	32,361	16,000	1,302
Cash	16,823	21,428	22,262	6,860
Debt/Equity	1.1	0.9	0.8	0.0
RoE (%)	20.1	11.7	38.6	21.9
RoCE (%)	13.8	6.5	21.8	25.5
Promoter's stake (%)*	34.9	25.2	68.3	39.4

**as on Dec'06* *Source: Companies,/Motilal Oswal Securities*

Lower promoter holdings may constrain ability to participate in future M&A: We believe that ability of Indian generics companies to participate in future M&A deals may be constrained by lower promoter holdings and their unwillingness to dilute their stakes further. We, however, believe that it will become imperative for promoters of Indian generics companies to dilute their holdings if they are to participate in the global M&A deals.

Are inorganic initiatives masking pressure on organic business?

We believe that given the on-going US FDA issues for Ranbaxy, inorganic initiatives are likely to contribute more to the company's topline in CY07 as compared to its organic growth. However, CY08 is likely to witness higher contribution from organic initiatives as contribution from RoW markets increases. For Dr Reddy's, however, the organic growth is likely to be higher than that contributed by acquired companies due to higher growth in both RoW markets and sustainable upsides from its US business. Cipla and Sun Pharma are expected to continue growing at 18-22% led mainly by higher growth in their non-US operations. This implies that non-US markets will be the key growth drivers for all these companies (except Dr Reddy's where US will also contribute albeit on a low base).

CONTRIBUTION TO REVENUE GROWTH (%)

	FY07E			FY08E			FY09E		
	ORGANIC	INORGANIC	TOTAL	ORGANIC	INORGANIC	TOTAL	ORGANIC	INORGANIC	TOTAL
DRL	23.3	54.3	77.6	11.7	3.5	15.2	13.0	3.9	16.9
Ranbaxy	12.4	5.7	18.1	6.8	8.4	15.2	19.7	2.5	22.2
Cipla	23.1		23.1	18.6		18.6	20.2		20.2
Sun	29.5		29.5	21.3		21.3	22.4		22.4

Source: Companies,/Motilal Oswal Securities

Our prognosis – combination therapy to work best

Our prognosis for generics markets is based on two main parameters – product pipeline and cost control. While large and geographically diversified product baskets (along with some niche products) are needed for top-line growth, cost control through vertical integration will determine sustainability in the intensely competitive generics markets.

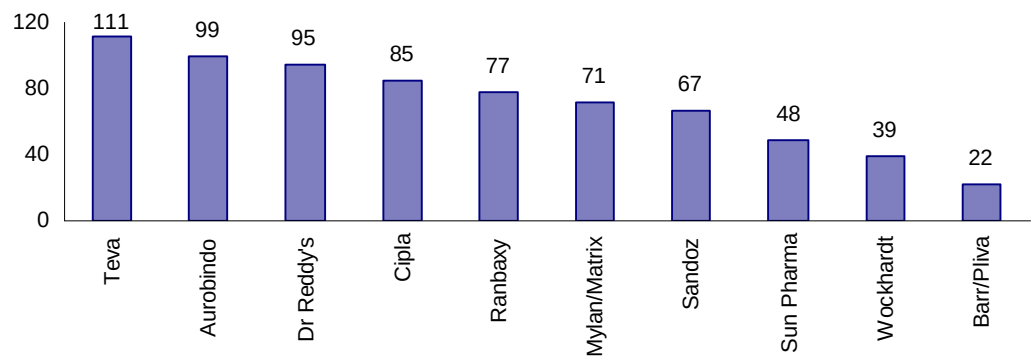
Large product baskets becoming more important

While a wide product basket has become imperative for success in the global generics space…

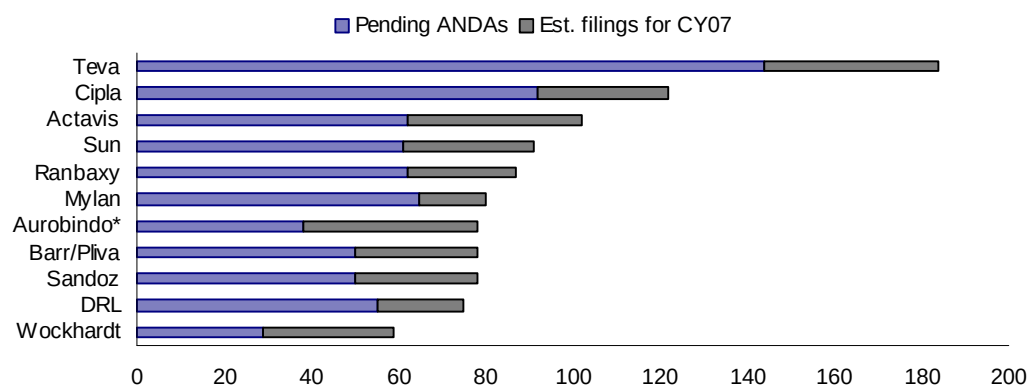
Given the intense competition in the regulated generic markets, we believe that a wide product basket has become imperative. A wide product basket achieves two objectives:

1. **De-risking of product portfolio:** A wide product basket is likely to have a judicious mix of exclusive, difficult-to-manufacture and commoditized products. This helps in de-risking the portfolio, especially in view of the current prevalent pricing pressure in the regulated markets.
2. **Acceptability by customers:** The trade channels in regulated markets have become more discerning and are likely to prefer suppliers that can offer a complete basket of products in order to minimize resource allocation towards marginal/smaller suppliers.

DMF FILINGS



ANDA STATISTICS



Source: Companies/USFDA,/Motilal Oswal Securities

Niche products still offer better profitability

…complex or niche drugs can partly compensate for the intense pricing pressure

We believe that complex or niche drugs can partly compensate for the intense pricing pressure in the generics markets. Most generics companies mainly target medium-large drugs (revenues of US$250m+) that are relatively easy to manufacture. This has resulted in opportunities with quite a few niches, which include:

1. **Peptides** (potential API market of about US$500m), **hormones** (US$3b+ market) and **biogenerics** have a highly complex production process and require specialized production capacities. However, it needs to be noted that the biogenerics markets will take another 2-3 years to open up, given the regulatory uncertainty and the requirement to conduct clinical trials.
2. **Inhalers** (US$3-4b formulate market) require special delivery mechanisms. Globally, the inhaler market is shifting towards CFC-free inhalers as mandated by the Kyoto Protocol to control green-house gases. This will open up a significant opportunity for companies that can develop such inhalers (like Cipla with a pipeline of 8-9 different inhalers under development).
3. **Injectibles** that not only require specialized manufacturing set-up but also special distribution network, as these are mainly institutional drugs.
4. **Gels, creams and liquids** require different manufacturing units and are typically low-volume products.

Given their inherent barriers to entry, companies that have already invested significant resources in these products and have a significant product basket and pipeline would be able to capture significant upsides.

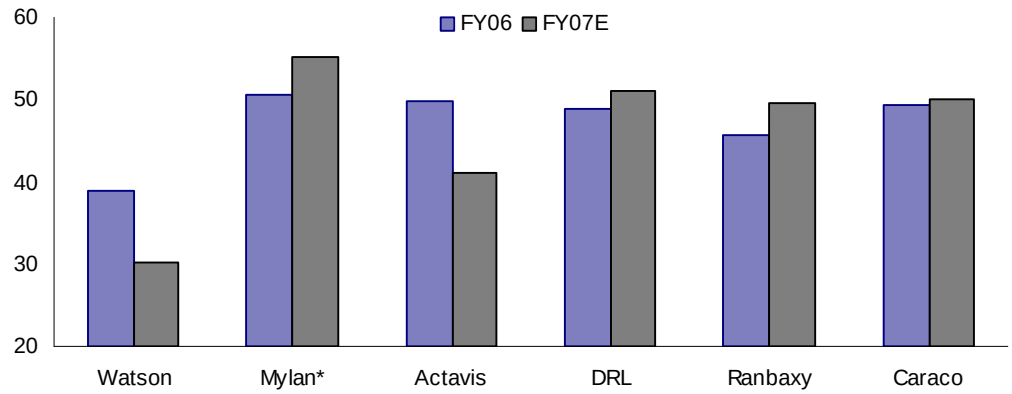
While many companies have announced plans for exploiting these niche opportunities (especially biogenerics), we believe that companies that have already invested significant resources in development of these products will continue to enjoy the first-mover advantage (eg. Cipla in the CFC-free inhaler market). We expect these niche opportunities to deliver better profitability as compared to the normal generic products as, unlike generics, we do not expect a large number of players to enter these markets.

Vertical integration to determine sustainability

Fully integrated manufacturing operations are also becoming a critical success factor

Given the intense competition, vertical integration is likely to play a significant role and will be a key determinant for long-term sustainability in the generics space. We believe that having fully integrated manufacturing operations – from intermediates to formulations – is becoming a critical factor. Since the larger Indian generics companies are vertically integrated, we believe that they are likely to have relatively higher sustaining power as compared to some of the global generics companies like Watson, Barr Labs, Actavis, etc. However, the top two global generics companies – Teva and Sandoz – are reasonably well integrated.

GENERICS GPM (%)



** for 9MFY07* *Source: Companies,/Motilal Oswal Securities*

Filings pace has stabilized for the larger Indian players

The filing pace for the larger Indian generics players has stabilized at 20-30 ANDA filings per year. Hence, we do not expect significant increase in their filing costs. However, the 2nd and 3rd tier generics companies are targeting aggressive filings to boost their pipelines and their filing costs are likely to go up.

ANDA FILINGS TARGETED

COMPANY	FILINGS TARGETED PER ANNUM
Companies covered in this report	
Ranbaxy	20-25
Dr Reddy's	15-20
Sun	30
Cipla (through partners)	20-30
Companies not covered in this report	
Aurobindo	40
Cadila	15-20
Wockhardt	30
Orchid	15
Glenmark	20
Jubilant	10

Source: Companies/Motilal Oswal Securities

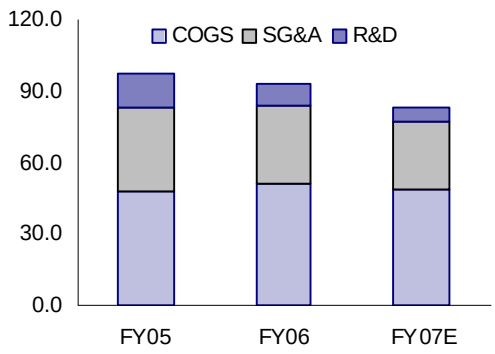
Cost structures being re-aligned/de-risked to counter price competition

Generics players across the world are on a cost-cutting drive to counter price competition

Generics players across the world have been on a cost-cutting drive to counter price competition. This includes Indian players too; they have employed both cost reduction and de-risking measures. Dr Reddy's, for instance, has resorted to external funding (from ICICI Ventures) to part-fund its generics R&D while a similar arrangement was used to de-risk its NCE research. Sun Pharma has resorted to a de-merger of its NCE/NDDS research. Ranbaxy has significantly reduced its costs by doing more R&D in-house and reducing fixed costs.

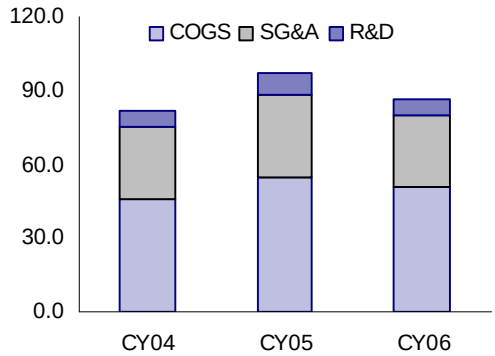
COMPOSITION OF COSTS (% OF SALES)

DR REDDY'S LABORATORIES



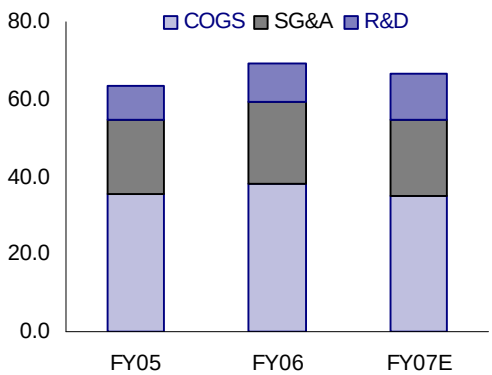
Cost reductions reflect de-risking undertaken over past three years.

RANBAXY LABORATORIES



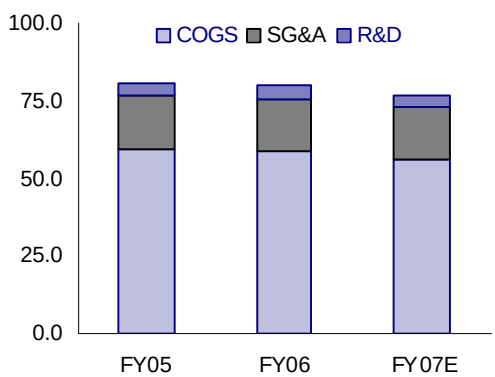
Benefits of cost reductions visible in CY06.

SUN PHARMACEUTICALS



Lower COGS reflects better margins in semi-regulated markets. Increasing R&D cost to fund build-up of regulated market portfolio.

CIPLA



Improving COGS reflects gradual increase in contribution from regulated markets. Lower SG&A and R&D reflects de-risked strategy.

Note: for Sun Pharma and Cipla, COGS includes RM costs and other manufacturing costs. SG&A includes employee costs.

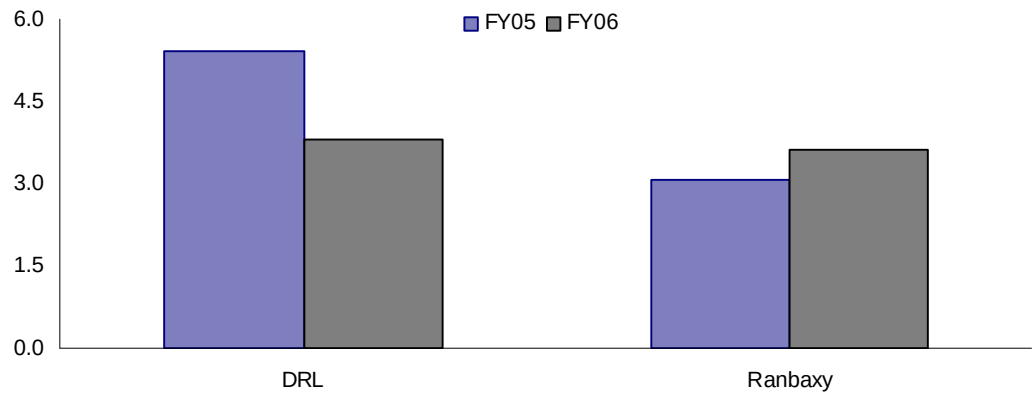
Source: Companies/Motilal Oswal Securities

Pragmatic approach to patent litigations to enable cost control

Intensifying generics competition coupled with major patent challenge losses has resulted in generics companies resorting to patent settlements with the innovators for certain products. E.g. settlement for Provigil (Cephalon-Teva, Ranbaxy & others), Lexapro (Forest-AlphaPharma), Effexor XR (Wyeth-Teva), Lamictal (GSK-Teva) and Imitrex (GSK-DRL).

Also, since the easier to challenge patents are already under litigation, generics companies are likely to resort to more pragmatic patent challenges. This is also likely to reduce litigation expenses in the coming years.

FOR DR REDDY'S AND RANBAXY LITIGATION COSTS (% OF SALES)



Source: Companies/Motilal Oswal Securities

Which generics model will succeed?

In our opinion, the winning business model will include a combination of:

1. Vertical integration
2. Low cost manufacturing
3. Geographically diversified presence
4. Wide product basket
5. Strong balance sheet

INDIAN GENERICS - CURRENT STATUS

PARAMETER	PRE-REQUISITE	STATUS OF INDIAN PLAYERS
Vertical Integration	Complete integration from manufacturing of inter-mediates to formulations	Most Indian players are vertically integrated
Manufacturing Locations	Access to low-cost manufacturing base like India	Most Indian players have a strong manufacturing base in India
Geographical Diversification	Right mix of regulated and semi-regulated markets	Ranbaxy & Cipla have a fairly diversified geographical portfolio
Product Basket	Wide product basket including various dosage forms with some niche products & FTFs	The top four Indian generics players have large product baskets. Other Indian companies are in the process of widening their portfolios
Financial Health	Strong balance sheet to manage litigation risks, acquisitions, etc.	Amongst the leading players, only Sun Pharma has the balance sheet strength to fund large acquisitions without significantly diluting equity

Source: Motilal Oswal Securities

NCE research – risks still high

Although Indian efforts in New Chemical Entity (NCE) research are still at a nascent stage, some of these efforts have started generating value. Both Ranbaxy and Dr Reddy's have out-licensed their NCEs to MNCs in the past and have also experienced the failures associated with NCE research. Glenmark, till date, has been the most successful Indian company in the NCE research space – it has already out-licensed two of its NCEs and is targeting to announce one more out-licensing deal shortly.

NCE research is a high-risk proposition

NCE research is a high-risk proposition…

It takes 10-12 years for a new drug to be commercialized and the probability that a new drug would be a commercial success is one in 10,000 drugs. Hence, we believe that NCE research is an extremely high-risk proposition. This is especially true for Indian companies, given the limited size of their balance sheets and their inability to fully fund the expensive clinical trials. It is estimated that globally a new drug costs about US$800m in development and clinical trial costs. This includes the costs of failures as well. At Indian costs, we believe that the same drug can be developed at 50-60% lower cost, but is still very expensive for Indian players.

Indian players have tasted nascent success and subsequent failures…

…and Indian players have had their share of failures

We believe that successful out-licensing of NCEs by Ranbaxy, Dr Reddy's and Glenmark has resulted in nascent success for the Indian players. Other companies awaiting out-licensing opportunities include Lupin, Sun Pharmaceuticals and Orchid. Ranbaxy and Dr Reddy's have witnessed successes as well as subsequent failures – post out-licensing, their NCEs have failed in the clinical trials, which we believe, is normal in NCE research.

…leading to a more pragmatic and collaborative approach to NCE research

Companies like Ranbaxy and Dr Reddy's have chosen a collaborative route to cut risks…

High development costs and failure of the initial out-licensed NCEs have forced Indian companies like Ranbaxy and Dr Reddy's to adopt a more pragmatic and de-risked approach for NCE research. While Dr Reddy's has entered into a partnership with financial investors (by forming Perlecan Pharma) to de-risk its NCE research, Ranbaxy has entered into a tie-up with GSK to carry out the latter's NCE research in India. Similarly, Nicholas Piramal has also entered into a collaborative research with Eli Lilly for the latter's NCE development in India.

…while Sun Pharma has de-merged its NCE/NDDS research

Sun Pharma has announced a de-merger of its NCE/NDDS research into a separate company to de-risk its existing pharmaceutical business from the risks attached to NCE development. The de-merger will also pave the way for Sun Pharma to bring in a partner in the research company at a later date as and when the need arises. Cipla has clearly stayed away from NCE development citing the high risks and costs associated with such

operations. The table below details the current status of Indian NCE research efforts and the value generated:

NCE RESEARCH PIPELINE OF INDIAN COMPANIES

COMPANY	PRE-CLINICAL	PHASE-I	PHASE-II	PHASE-III	TOTAL	NCES OUT-LICENSED TILL DATE	NCES FAILURE/MILESTONES RETURNED BY PARTNER TILL DATE	TOTAL RECEIVED (US$M)
Ranbaxy	5	0	2		7	1	1	14.20
Dr. Reddy's	4	2	3		9	3	3	15.25
Sun	ND	ND	1		1			
Wockhardt	4	1	1		6			
Lupin	ND		2	1	3			
Nicholas	10	1	2		13			
Glenmark	3	1	2		6	2		48.00
Total		**5**	**13**	**1**	**19**	**6**	**4**	**77.45**

ND: Not Disclosed *Source: Company/Motilal Oswal Securities*

NCE RESEARCH - MNC COLLABORATIONS

COMPANY	DETAILS
Ranbaxy	Agreement with GSK with upfront, milestones payments totaling to US$100m if NCE successfully commercialized
Nicholas Piramal	Agreement with Eli Lilly with upfront, milestones payments totaling to US$100m if NCE successfully commercialized

Source: Companies,/Motilal Oswal Securities

While the table above shows that Indian NCE research has started generating some value for shareholders, given the high risks attached to NCE research, we have not included the NCE upsides in our estimates. However, we believe that given Indian chemistry skills and relatively lower costs, we may see an Indian NCE being commercialized over the next 5-7 years.

Valuation and view

The pharmaceutical sector has underperformed the broader markets significantly over the last two years. We believe that current valuations factor in most of the negatives – pricing pressure, expensive acquisitions and US FDA manufacturing issues. P/E multiples for leading generics companies are currently lower than their historic median P/E. We believe that the four leading pharmaceuticals stocks have the potential of delivering good returns over the next 18 months.

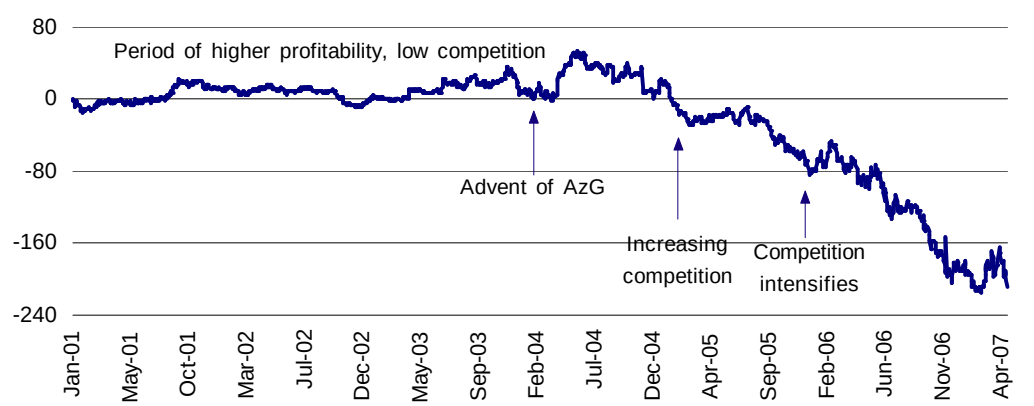
Sector has significantly underperformed the broader markets

Indian pharmaceuticals have underperformed the broader markets significantly over the last two years

The pharmaceuticals sector has underperformed the broader markets significantly (by almost 200%) over the last two years. The commencement of the underperformance coincided with the end of the golden period for generics in 2004. The main reasons for the end of the golden era were the entry of more players (leading to significant price erosion) and the aggressive stance adopted by the innovators, who launched authorized generics.

HEALTHCARE MKT CAP TO BSE SENSEX MKT CAP (%)

BSE HEALTHCARE MKT CAP RELATIVE TO BSE SENSEX (%)



Source: Companies,/Motilal Oswal Securities

Pricing pressure, expensive acquisitions already discounted

We believe that current valuations already discount the negatives…

While none of the above two factors (competition and authorized generics) have been reversed, we believe that these negatives are already discounted in the current stock prices. The stock markets are currently discounting 97% price erosion in the US for drugs going off-patent. Since we believe that generics prices in the US are unlikely to decline significantly in the coming years, current valuations already discount the worst scenario.

The stock markets have already discounted the intense pricing pressure in the US and some European markets. Recent acquisitions by Ranbaxy (Terapia) and Dr Reddy's (Betapharm) have been expensive, as they occurred under intense bidding pressure, leading to extended paybacks. We believe that markets have already discounted these factors.

Valuations are now reasonable – current P/E lower than median P/E

The recent correction in stock prices has made valuations of the large generics companies reasonable. P/E multiples for leading generic companies are currently lower than their historic median P/E as shown in the table below:

CURRENT P/E LOWER THAN LAST 5-YEARS' MEDIAN P/E

COMPANY	CURRENT P/E		MEDIAN P/E
	FY08E/CY07E	FY09E/CY08E	(FOR LAST 5 YEARS)
Ranbaxy	21.8	16.9	23.7
Dr. Reddy's Labs**	20.1	17.4	23.6
Sun Pharma	24.7	20.2	37.9
Cipla	20.0	16.2	21.4

*** - Only FY01-04 considered due to extreme values for FY05/06* *Source: Motilal Oswal Securities*

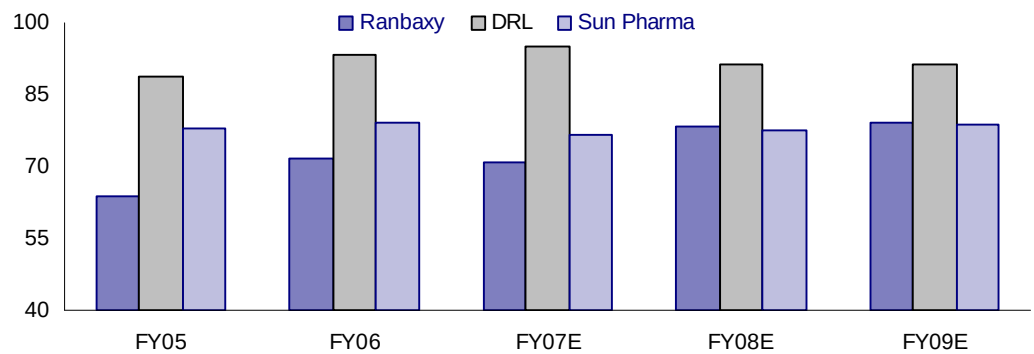
US no longer the main growth driver…

The stock markets are discounting 97% price erosion for US generics markets while valuing Indian generics. However, for the larger Indian players, the US generics markets (although important) have ceased to be the main growth driver. Intense competition has reduced GPM in the US to 40-50% compared to GPM of 50-70% in other branded generics markets. Recognizing this, Indian companies have also commenced their expansions in the branded generics markets of Europe and other semi-regulated markets. This is also vindicated by the fact that the biggest acquisitions (Betapharm and Terapia) done by the Indian pharmaceutical companies have been in non-US markets. Some of the semi-regulated branded generics markets have GPM of 60-70%.

…contribution of non-US markets to increase over the next few years

Given the organic and inorganic initiatives in non-US markets (including the branded generics markets), the contribution of these markets to the overall sales of the large generics companies (especially Ranbaxy and Dr Reddy's) is likely to increase gradually over the next few years. This is likely to partly de-risk their operations from the intensely competitive US generics markets.

CONTRIBUTION OF NON-US MARKETS (% OF SALES)



Source: Companies,/Motilal Oswal Securities

We are positive on the sector

…and have a positive view on Indian pharmaceuticals

We are positive on all the four leading pharmaceutical companies – Ranbaxy, Dr Reddy's, Cipla and Sun Pharma. While valuations for Ranbaxy and Dr Reddy's arleady reflect extreme pessimism led by intense generics pricing pressure and expensive acquisitions made by these companies, those for Cipla and Sun Pharma reflect the consistency of performance over the past 7 years and their conservative management style. The recent US FDA survey at Ranbaxy's US operations is also acting as an overhang on its valuations. Our estimates do not include any upsides from potential patent challenges and NCE research. Aggressive bidding for generics assets and aggravation of US FDA issues (for Ranbaxy) remain the key risks to our positive stance.

INDIAN GENERICS (RS M)

COMPANY	YEAR	CMP (RS)	SALES	PAT	EPS (RS)	CHG. (%)	P/E (X)	EV/EBITDA (X)	EV/SALES (X)	ROE (%)	ROCE (%)
Cipla	2007E	234	36,260	7,304	9.4	20.2	24.9	19.3	4.9	21.9	25.5
	2008E		42,540	9,099	11.7	24.6	20.0	15.7	4.1	22.4	25.1
	2009E		51,196	11,250	14.5	23.6	16.2	12.7	3.3	22.7	25.6
Dr Reddy's	2007E	720	43,086	4,152	24.8	202.8	29.1	17.7	3.1	11.7	6.5
	2008E		49,660	6,001	35.8	44.5	20.1	14.5	2.6	14.9	8.8
	2009E		58,046	6,939	41.4	15.6	17.4	12.9	2.2	15.3	9.5
Ranbaxy (Dec YE)	2006	343	60,213	5,418	13.6	150.3	25.3	11.8	1.8	20.1	13.8
	2007E		69,391	6,302	15.8	16.3	21.8	10.6	1.7	20.9	12.9
	2008E		84,791	8,130	20.3	29.0	16.9	11.4	1.9	23.7	15.7
Sun Pharma	2007E	1,048	20,664	7,364	35.6	37.9	29.5	27.1	9.1	39.0	22.0
	2008E		25,060	8,788	42.4	19.1	24.7	21.9	7.4	36.3	23.7
	2009E		30,661	10,750	51.9	21.7	20.2	17.7	5.8	34.8	24.7

Source: Company/Motilal Oswal Securities

Companies

BSE Sensex: 13,928 S&P CNX: 4,085 23 April 2007

Cipla

STOCK INFO.	BLOOMBERG
BSE Sensex: 13,928	CIPLA IN
S&P CNX: 4,085	REUTERS CODE CIPL.BO

23 April 2007

Buy

Previous Recommendation: Buy Rs234

Y/E MARCH	2006	2007E	2008E	2009E
Net Sales (Rs m)	29,814	36,260	42,540	51,196
EBITDA (Rs m)	6,692	9,215	11,032	13,316
NP (Rs m)	6,076	7,304	9,099	11,250
EPS (Rs)	8.1	9.4	11.7	14.5
EPS Growth (%)	48.4	15.9	24.6	23.6
BV/Share (Rs)	26.3	42.9	52.2	63.7
P/E (x)	28.9	24.9	20.0	16.2
P/BV (x)	8.9	5.5	4.5	3.7
EV/EBITDA (x)	27.8	19.2	15.7	12.7
EV/Sales (x)	6.2	4.9	4.1	3.3
RoE (%)	30.8	21.9	22.4	22.7
RoCE (%)	28.3	25.7	25.1	25.6

One of the strongest generics pipelines: Cipla has about 160 products in various stages of development. It has entered into partnerships for 123 products (only 18 have been commercialized until date) with eight partners in the US alone. It has filed over 170 registrations in the EU and over 4,000 formulation approvals in semi-regulated markets (including South and Central America, the Middle East and Africa).

Unique low-risk partnership model: Cipla has tied up with various generics companies (e.g. Teva, Sandoz, Watson) for its generics products. It has a policy of being only a supplier to the global generics companies. This has helped the company de-risk its business model, by not getting directly involved, in the event of patent challenges.

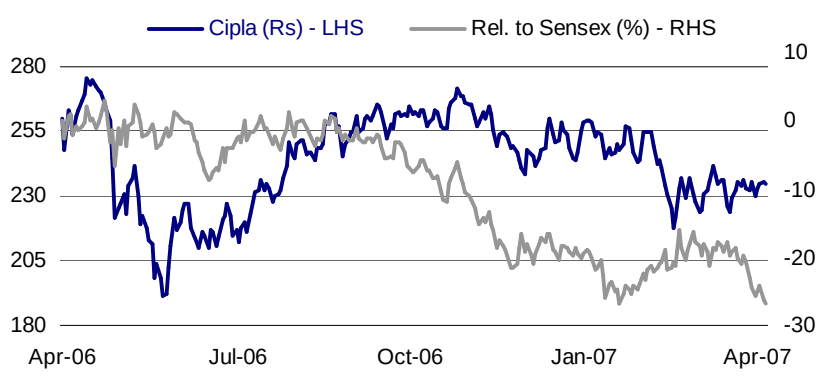
Strongly positioned for future growth: Cipla has incurred capex of Rs7b in the last two years and has raised US$170m last year to partly fund its future capex (about Rs6b). This indicates management's confidence regarding the company's long-term future.

Good long-term potential; Buy: We expect sales CAGR of 19% and earnings CAGR of 24% during FY07-FY09. We believe that Cipla has one of the best track records of profit growth in the Indian pharmaceutical sector with relatively better RoE and RoCE v/s peers. Valuations at 20x FY08E and 16.2x FY09E earnings do not fully reflect the potential of Cipla's large generics pipeline and the leverage arising out of the significant capex. Our estimates do not include any uncertain upsides linked to patent challenges filed by Cipla's partners. Maintain **Buy** with a price target of Rs280.

KEY FINANCIALS	
Shares Outstanding (m)	777.3
Market Cap. (Rs b)	181.9
Market Cap. (US$ b)	4.4
Past 3 yrs. Sales Growth (%)	26.9
Past 3 yrs. NP Growth (%)	34.9
Dividend Payout (%)	29.2
Dividend Yield (%)	0.3

STOCK DATA	
52-Week Range	280/178
Major Shareholders (as of March 2007)	%
Promoters	39.4
Domestic Institutions	11.4
FIIs/FDIs	21.5
Others	27.8
Average Daily Turnover	
Volume ('000 shares)	1,762.1
Value (Rs million)	422.3
1/6/12 Month Rel. Performance (%)	-8/-19/-27
1/6/12 Month Abs. Performance (%)	-3/-9/-10

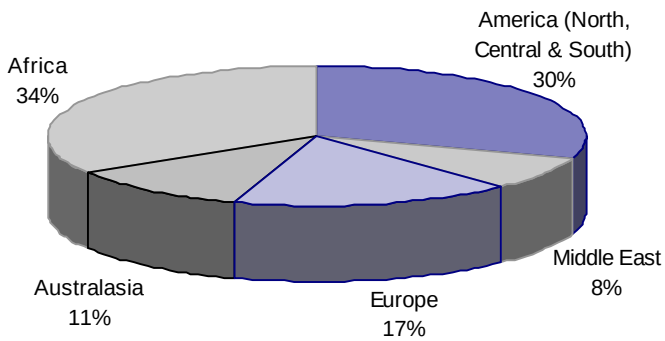
STOCK PERFORMANCE (1 YEAR)



Strong generics pipeline

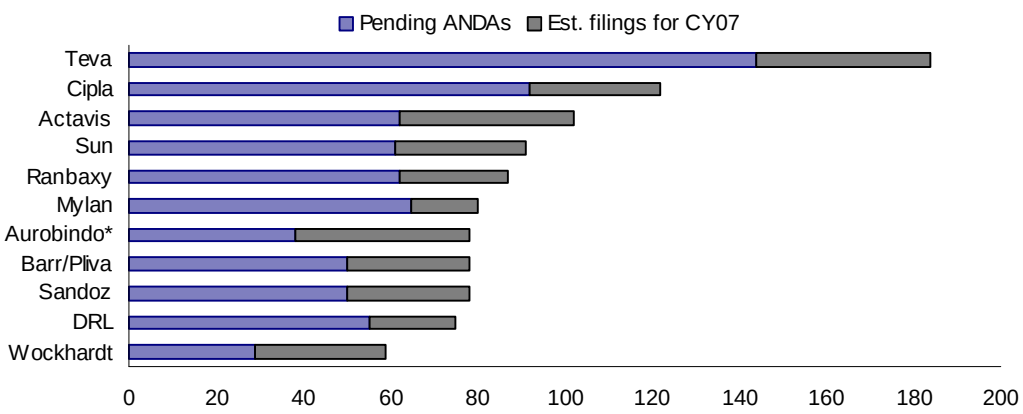
Cipla has one of the strongest generic pipelines in India with about 160 products at various stages of development. Cipla has entered into partnerships for 123 products with 7-8 partners in the US. Cipla's partners will have filed about 110 ANDAs cumulatively (35 in FY07E) with the US FDA by March 2007. We expect this pipeline to start generating revenues from FY07E onwards with scale-up expected in FY08E and FY09E. While more clarity on these products will emerge over a period of time, we believe that this is one of the strongest generic pipelines amongst Indian companies. It is currently selling about 18 products in the US market through its partners. Supplies linked to Para-IV filings will remain uncertain until resolution of patent litigations; hence we do not include this in our estimates. Refer Annexure 1 for details on Cipla's generic pipeline.

CIPLA: EXPORT BREAK-UP



Source: Motilal Oswal Securities

CIPLA – DMF FILINGS (Y/E MAR)



Source: USFDA

Significant product opportunities

CFC-free inhalers – good long-term potential

Cipla is in the process of developing nine anti-asthma inhalers using non-CFC propellants. It has already developed a few CFC-free inhalers including Budesonide, Formeterol, Salbutamol, and a combination of Budesonide and Formeterol. It has initiated the process of registering these inhalers in Europe's leading markets. However, the company may have to conduct limited clinical trials for obtaining registrations, implying that the launch of most of these inhalers is still some time away. Our estimates do not include upside from CFC-free inhalers expect for the Budesonide inhaler, which Cipla has already launched in Germany and Portugal.

EU regulations are aimed at encouraging CFC-free inhalers

Although the Montreal Protocol (on phasing out CFC-based products) has set 2010 as the deadline for complete eradication of CFC inhalers, its current regulations are aimed at encouraging CFC-free inhalers. The regulations require a complete shift from CFC to non-CFC inhalers subject to the two conditions mentioned below:

1) At least two CFC-free alternatives are available in the market
2) The CFC-free inhalers have undergone post-marketing surveillance of at least 12 months

The above conditions reflect a clear focus on total phase-out of CFC inhalers, much ahead of the 2010 deadline.

Shift to CFC-free inhalers to throw open a huge market

The global market for Asthma and Chronic Obstructive Pulmonary Disease (COPD) was about US$20b in 2005 (up 16%) with the US accounting for about 50% of the market. The total market size for asthma inhalers in the EU is estimated at US$3b-US$4b. This includes both CFC and CFC-free products, with the former accounting for a significant share. The gradual shift to CFC-free products is expected to open up a huge market for the manufacturers of these products over the next five years.

Multinationals have already introduced CFC-free inhalers …

As a consequence of the 2010 deadline and a favorable regulatory environment, multinational companies (the patent holders) have already started introducing CFC-free inhalers in various European markets. The shift of prescriptions in favor of CFC-free products has already commenced.

… but there is good long-term potential for players like Cipla

We believe that export of CFC-free inhalers to Europe can contribute significantly to Cipla's revenues in the long term, as we expect limited competition. Since, even the delivery mechanisms for these inhalers are patented, we believe it will difficult for generic companies to circumvent these patents and hence generic competition may not be as intense as in normal generics. The company has done significant work on developing these inhalers over the past few years. It launched its Budesonide asthma inhaler in Germany in FY05

through three generics companies, although it lost the first mover advantage to an Italian company. It has also received approval for its Budesonide inhaler in Portugal and Spain. Cipla has a total of nine CFC-free inhalers under various stages of regulatory submissions, which will be launched over the next few years.

However, patent infringement issues cannot be ruled out

Cipla believes that it has developed non-infringing inhalers for Budesonide and Formeterol. We do not rule out patent litigation (between Cipla's partners and the innovators) in case of the remaining nine CFC-free inhalers being developed by Cipla. For instance, AstraZeneca has patents for the Budesonide-Formeterol combination in a few countries in Europe. Given the huge opportunity that the CFC-free inhaler market offers, we believe that the patent holders (multinational companies) will be extremely aggressive in protecting their IPRs and preventing entry of cheaper generic versions. Hence, exploiting this generics opportunity will not be easy for companies like Cipla.

Multiple opportunities for generic Seretide

Cipla has entered into a tie-up with Neolab (UK) to supply a combination of Salmeterol and Fluticasone Propionate (useful for asthma treatment). GSK is the innovator of the drug and sells it under the *Seretide/Advair* brand. Neolab has challenged GSK's patent, expiring in 2013. This patent relates to the combination of Salmeterol and Fluticasone Propionate. Individual patents on Salmeterol and Fluticasone Propionate have expired in 2005. Other patents on Seretide include the Diskus device patent expiring in 2011 and the CFC-free MDI patent expiring in 2012, which have not been challenged.

The London Court has given its ruling in favor of generics companies (this ruling applies only to the UK). GSK has appealed against this ruling. We believe that GSK's data exclusivity (valid until 2008) will prevent any generic entry unless generic companies conduct their own limited clinical trials for the product. We believe that Cipla/Neolab may have already commenced clinical trials for this product and hence a commercial launch may be possible in the UK before 2008 (provided the London Court ruling is upheld in the higher court).

The UK market for Seretide is estimated at US$250m-US$300m while global sales are estimated at about US$6.5b, with USA accounting for 55% of the sales. Europe accounts for about US$2b of Seretide sales. We believe that Cipla will try to address the US opportunity, also (through its partners). GSK's US patents on the product expire in August 2008, 2010 and 2011. It also holds data exclusivity on the product expiring on 21 April 2007. We have not included any upside from Seretide in our estimates since it is linked to the successful outcome of a patent challenge. However, we believe that the upsides for Cipla could be significant depending on the various markets wherein its partner is able to win the patent challenge.

Anti-AIDS products represent a high-volume opportunity with stable margins

The anti-retroviral (ARV) opportunity is a sizeable and largely unmet one. Around 48m patients globally are infected with the HIV virus, of which around 90% are not treated. The African sub-continent houses 40-50% of AIDS patients. Almost 3m people are infected with the AIDS virus each year. The demand for ARV drugs is expected to grow at a fast pace, as initiatives from sponsors like WHO, PEPFAR, the Clinton Foundation and Medicins sans Frontier to increase access to low-cost drugs gather momentum. These programs were mainly initiated to make ARV drugs more affordable to the population of the least-developed countries – particularly the African sub-continent, which is facing a public health emergency. Companies like Ranbaxy and Cipla have been at the forefront of the battle against AIDS and in making ARV drugs more affordable. These companies have significantly reduced the prices of their ARV drugs both in the domestic and international markets.

Despite the sharp reduction in ARV prices, these drugs remain unaffordable to a large section of the population in regions such as Africa. There is constant pressure on the manufacturers of ARV drugs (including the innovators) to further reduce the cost of their ARV therapies. Cipla was the first company to quote an annual price of US$365 per patient for supply of ARVs to the African markets. Subsequently, other Indian companies like Ranbaxy and Aurobindo have also shown interest in supplying the drugs at prices lower than US$300 per patient. Innovator pharmaceutical companies like GSK, BMS, and Boehringer have announced special prices for the African markets and have also issued licenses for manufacturing ARVs to local players like Aspen. The WTO TRIPS provisions have also been amended to facilitate manufacture and export of ARVs to African nations from low-cost bases like India. This has resulted in a large opportunity for low-cost manufacturers such as Cipla.

African governments have started awarding tenders

In March 2005, the South African government awarded contracts to seven pharmaceutical companies to supply the country's public health system with ARV drugs spread over the next three years. The national ARV drug treatment program aims to provide drugs to 1.2m patients (i.e. about 25% of the country's HIV-positive population) by 2008. This US$500m tender should supply drugs for 500,000 patients that the program aims to cover by 2007. The larger part of the deal is with Aspen Pharmacare, a South African generics company, which will supply the program with eight out of the 15 required anti-retroviral formulations. Only one other generics manufacturer was included in the tender, Cipla Medpro (Cipla's JV in South Africa), which will produce a proportion of the program's supply of d4T tablets.

The remainder of the drugs will be purchased from the innovator pharmaceutical companies. We believe that supplies from the generics companies – Aspen and Cipla Medpro – would have an approximate annual cost of US$200 per patient. The size of the contract (US$500m spread over next three years) indicates that the overall potential of the South African

market alone is US$1.5b-US$2b spread over the next 5-10 years. Hence, the supply of ARVs to African markets will be a significantly large opportunity for generic companies like Cipla.

Unlike popular belief, we believe that the Anti-AIDS opportunity will result in stable revenues and margins for Indian players, as none of the other generic companies have shown interest in participation in the anti-AIDS programs. We believe that this will be a high volume opportunity with EBITDA margins of about 15% which could result in a reasonable upside for Indian players like Ranbaxy, Cipla, Aurobindo.

Cipla is a leading supplier

Cipla is one of the leading players in the anti-AIDS market and is likely to participate in the US government's PEPFAR program for supplying low-priced ARVs to under-developed nations facing a healthcare emergency (like the African subcontinent). The company has commenced registering its own ARV drugs with the US-FDA to enable it to participate in the US government's PEPFAR program. This fund initiative has made it mandatory for suppliers to register their drugs with the US-FDA to qualify as a supplier. It should be noted that although Cipla is late in getting its products registered with the US-FDA, its joint venture with Medpro Pharmaceutica – known as Cipla Medpro – is one of leading generic companies in South Africa. Cipla supplies various drugs to Medpro, including ARVs.

Cipla Medpro's ownership change will not impact supplies

Cipla's supply of drugs to South Africa and its neighboring regions will not be derailed by South African drug company, Enaleni Pharmaceuticals' decision to buy Cipla Medpro for Rand1.2b (about Rs8.2b). Cipla does not have an equity participation in Cipla Medpro; it is only a marketing alliance for the region. It has an existing 10-year exclusive distribution agreement with Cipla Medpro and this will now be shifted to the new company.

Partnering with global generics players: a low risk strategy

Cipla follows a low-risk strategy through its partnership model for the regulated generics market. Cipla has tied up with various generic companies (in the USA and EU) for supplying about 160 products over the next few years. This has helped the company spread its risks associated with the generic markets. We believe that the company has also attempted to spread risks across product categories like plain vanilla generics, patent challenges and first to files. It should be noted that Cipla, as a policy, does not get directly involved in patent challenges and remains only a supplier to the generic company filing the patent challenge. Hence, the company does not carry any litigation risks linked to patent challenges. To sum up, we believe that Cipla follows a de-risked strategy for the generic markets.

Not focusing on NCE research in a big way

As a policy, Cipla has not focused on NCE research due to the significantly higher risks attached with such research. We believe this is also a part of Cipla's conservative approach

towards the pharmaceutical sector. However, it also implies that Cipla is unlikely to generate any value for its investors from NCE research. It should be noted that some Indian companies like Glenmark, Dr. Reddy's Labs. and Ranbaxy have met with nascent success in this area in the past. Many MNC pharmaceutical players like GSK Pharma, Eli Lilly etc. are taking an active interest in tie-ups with Indian NCE research players for co-development of NCEs. Recent partnership arrangements like Ranbaxy-GSK, Nicholas Piramal-Eli Lilly are examples of such arrangements. As Cipla has not focused on NCE research in the past, it is likely to miss out on these opportunities.

Significant capex for future growth

Cipla has undertaken significant capex for setting up facilities to drive future growth. The company has already incurred capex of about Rs7b in the last two years for expanding and upgrading its existing facilities as well as to set up new facilities in excise-exempt zones like Baddi. It plans to further expand its facilities for which it raised about US$170m through a GDR issue (@Rs274 per share). The company has raised these funds for financing future capex (Rs6b) for its facilities at Goa, Kurkumbh, Patalganga etc. The company is proposing to invest in an 80-acre SEZ in Goa at a capital outlay of about Rs6.5b. Incremental capex at Goa is likely to enjoy fiscal incentives regarding excise duty, income tax and sales tax. We believe that such a significant capex is an indication of management's confidence regarding the long-term future of the company.

Looking at acquisitions in niche segment

In addition to aggressive capex plans, Cipla is also looking out for acquisition opportunities in niche business segments, not necessarily adding to sales, but intending to enhance and expand its newer business segments such as biotechnology. We believe that the company is close to acquiring a fermentation/biotech company in China, with deal size of about $60-70m. However, Cipla is yet to confirm this development.

Domestic market – sustaining leadership a challenge

Cipla commands a dominant position in the Indian formulations market and has been consistently outperforming average industry growth in the past few years. It is ranked second in the domestic pharmaceutical segment after GSK Pharma. Its market share has risen from 4.43% to 5.17% in the last two years purely through organic growth. However, we believe that sustaining leadership could prove challenging for Cipla.

New patent regime to restrict product launches

Prolific new product launches and aggressive marketing have enabled Cipla to record higher growth in the domestic market. The new patent regime will ensure that the pace of prolific new introductions gradually reduces. Hence we believe, sustaining its leadership position could be quite challenging for Cipla.

Shifting focus to high-margin categories

Cipla is gradually shifting focus to high-margin categories like the cardiovascular (CVS) products to reduce dependence on the fiercely competitive anti-infective products market. However, the CVS segment has witnessed the entry of a large number of players, encouraged by strong growth recorded by the segment in the last two years. Creating strong brand equity in such segments may not be easy even for leading players like Cipla.

Key risks

- Cipla has received a notice from the National Pharmaceutical Pricing Authority (NPPA) demanding Rs7.48b regarding overcharging for 5 drugs in the domestic market. The demand relates to the pricing of these drugs over a span of many years (till July-2003) for which the NPPA had already sent notices to Cipla demanding Rs1.8b (50% of the overcharged amount). The fresh notice now demands a payment of Rs7.48b from Cipla which includes 100% of the overcharged amount and interest on it. These 5 drugs were under the DPCO and the NPPA has alleged that the company's prices for these drugs were more than that mandated by the DPCO. The company has indicated that as per the NPPA's pricing formula prevalent at that time, these drugs would have been outside the purview of DPCO and the company was free to charge any price for these drugs. Cipla's legal advisors have indicated that the NPPA demands are untenable. Many companies (including Ranbaxy) have faced such charges from the government in the past.

  The liability is equivalent to Cipla's FY07E PAT of Rs7.3b. Cipla has indicated its intention of not paying up this amount till the final court verdict is delivered (time-frame not available). In a worst-case scenario, if Cipla loses the court case, it will have to raise debt of Rs7.48b for this payment as it cannot utilize the GDR funds lying idle with it. While the company can easily raise this debt as it has a strong balance sheet, it could result in a 6-7% downgrade in our FY08E EPS. We believe that the fresh NPPA demand may act as a overhang on the stock in the short-term.
- The global generics space is witnessing significant consolidation as larger generic companies try to gain scale through inorganic initiatives. The intense pricing pressure in regulated markets has accentuated the need for consolidation. Cipla has clearly indicated that it intends to remain a supplier of generic products (the partnership model) and is unlikely to have a front-end in the regulated markets. This implies that it will have to rely completely on its partners for its supplies to the regulated markets. This raises uncertainties on the sustainability of the partnership arrangement in the event of Cipla's partners being taken over by other large generics companies.

Although, the global consolidation in the generics market has had some adverse impact on the number of products which Cipla can supply, it has also resulted in Cipla's tie-ups with leading generic companies like Sandoz and Watson. These companies typically command higher market shares in the generic markets given their distribution clout. Although, apprehensions have arisen about the sustainability of Cipla's product sourcing arrangement with Ivax (post the latter's acquisition by Teva), we do not expect any major alterations in the sourcing arrangement.

Valuation and view

Cipla is currently valued at 20x FY08E and 16.2x FY09E earnings. Generic supplies to partners in regulated markets remain long-term triggers. Cipla has tied up with various generic companies to supply more than 160 products over the next few years. While more clarity on these products will emerge over a period of time, we believe that this is one of the strongest generic pipelines amongst Indian companies. This coupled with the company's low-risk strategy should ensure good long-term potential.

A consistent performer

Cipla has been a consistent performer over the past six years, with sales CAGR of 27% and PAT CAGR of 28%. Unlike some of its peers, it has never recorded sales decline in in the last six years. We believe that the company's de-risked strategy has helped it consistently grow the bottomline. We note that Cipla recorded this performance entirely via organic growth (has not resorted to acquisitions) and sans any equity dilution.

It has raised US$170m through a GDR issue, resulting in equity dilution of about 3.5%. This is the only equity issue by the company since the rights issue in 1992. Very low equity dilution has also resulted in the company recording better RoE and RoCE (upward of 20%) versus peers such as Ranbaxy and Dr Reddy's Labs. We believe Cipla has one of the best profit growth track record in the Indian pharmaceutical sector.

We expect sales CAGR of 19% and PAT CAGR of 24% during FY07-FY09 for Cipla, led mainly by a 30% CAGR in formulation exports and a 22.5% CAGR in API exports. Our estimates do not include upsides from patent challenges filed by Cipla's partners due to uncertainties linked with patent litigations.

CIPLA: REVENUE MODEL (RS M)

	FY05	FY06	FY07E	FY08E	FY09E
Domestic	**12,758**	**15,014**	**17,417**	**19,507**	**21,457**
% YoY growth	*10*	*18*	*16*	*12.0*	*10*
Exports	10,518	15,182	18,277	23,517	29,963
% YoY growth	*29*	*44*	*20*	*29*	*27*
-Formulations	7,622	10,315	13,409	17,432	22,662
% YoY growth	*79*	*35*	*30*	*30*	*30*
- APIs	2,896	4,868	4,868	6,084	7,301
% YoY growth	*-25*	*68*	*0*	*25*	*20*
Total Sales	**23,276**	**30,197**	**35,694**	**43,023**	**51,420**
% YoY growth	*18*	*30*	*18*	*21*	*20*
Other Operating Income	733	839	1,427	1,570	1,727
% YoY growth	*-9*	*15*	*70*	*10*	*10*
Income from Operations	24,009	31,036	37,121	44,593	53,147
% YoY growth	*17*	*29*	*20*	*20*	*19*

Source: Company/ Motilal Oswal Securities

Raising estimates

We have raised our FY08E and FY09E estimates for Cipla to take into account the following:

1. Better-than-expected growth for the domestic formulations portfolio
2. Higher other income

REVISED FORECAST (RS M)

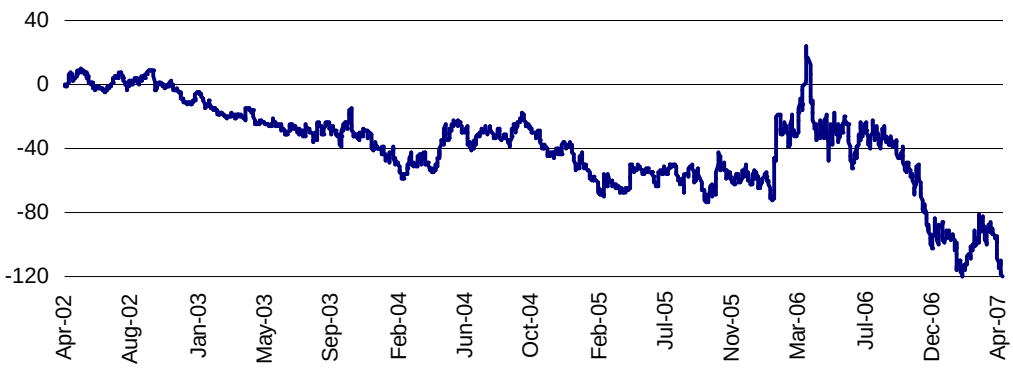
	FY08E			FY09E		
	REV	OLD	CHG (%)	REV	OLD	CHG (%)
Net Sales	42,540	43,539	-2.3	51,196	52,322	-2.2
Net Profit	9,099	8,597	5.8	11,250	10,450	7.7
EPS (Rs)	11.7	11.1	5.8	14.5	13.4	8.0

Source: Motilal Oswal Securities

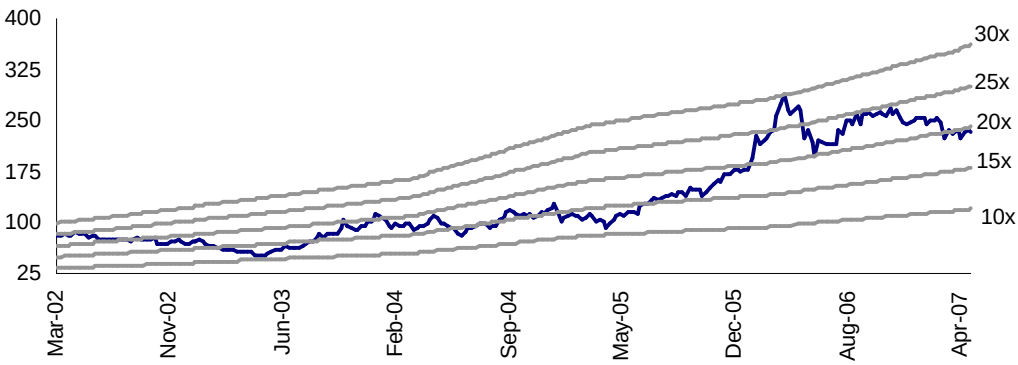
Stock has underperformed in last 5 years

Cipla's stock price has underperformed the BSE Sensex in the last five years. However, we believe that it is likely to outperform the market over the next few years as the company leverages the significant capex that it has already undertaken and which it has proposed in the coming years. The company will be spending about Rs6b during FY07-FY09 to enhance its manufacturing capacities (mainly directed towards regulated markets). Considering its FY06 asset turnover of 1.2x, the new facilities can potentially generate incremental revenues of Rs7b-Rs8b (20-25% of FY07E revenues) over the next few years. This is likely to be achieved without any significant equity dilution or increase in debt. We reiterate **Buy** with a price target of Rs280.

RELATIVE PERFORMANCE (5 YEARS)



P/E BANDS



Annexure I

CIPLA'S CURRENT PRODUCT PIPELINE AND POTENTIAL OVERLAP WITH TEVA

SUBJECT	DMF FILING	BRAND NAME	INNOVATOR	MKT. SIZE (US$M)	PATENT EXPIRY	REMARKS	TEVA OVERLAP
Alendronate Sodium Trihydrate	6-Aug-99	Fosamax	Merck	1900	2008, 2013	Ivax, Teva, Barr, Mylan & Watson hold tentative approvals. Ivax and Teva have filed patent challenges and may be eligible for shared exc-lusivity. Merck is shifting patients to the weekly dosage form. The US Appeals Court has invalidated the 2013 patent for weekly version of the drug. Teva expects to launch in Feb-2008 post patent expiry	Y
Sertraline Hydrochloride	5-Oct-99	Zoloft	Pfizer	2200	30-Jun-2006, 2009, 2012	Already generic	Y
Olanzapine	18-Sep-00	Zyprexa	ELI Lilly	2500	2008	US Appeals Court has ruled in favour of Eli Lilly thus preventing . generic entryMylan, Teva & Sandoz hold tentative approvals	Y-DMF outsourced
Cetirizine Dihydrochloride	17-Nov-00	Zyrtec	Pfizer	1200	25-Dec-07	Teva and Par Pharma hold tentative approvals. Teva has Para-III filing	Y-DMF outsourced
Topiramate	31-Oct-01	Topamax	Ortho Mcneil	1129	2008,2015. The 2008 patent is is the subst ance patent. New dosing exclusivity expires on 16-Dec-06. Orphan drug exclusivity expires on 28-Aug-08.	Para-IV was filed on 26-Dec-2001. Cipla's partner may have FTF status. Ranbaxy holds tentative approval and has outsourced DMF but may not have FTF. Teva, Roxane, Mylan, Barr, Par Pharma, Ranbaxy and Cobalt hold tentative approvals	
Salmeterol Xinafoate (MDI & DPI)	8-Nov-01	Serevent	GSK	600	2008, 2011	Cipla and Natco are the only two DMFs till date. No ANDAs approved till date	
Ondansetron HCl	15-Nov-01	Zofran	GSK	1300	Dec-2006, 2015	Dr. Reddy's has 180-day exclusivity for tablets with exclusivity ending in Jun-07. Injectable version already generic.	Y
Levofloxacin	15-Feb-02	Levaquin	Ortho Mcneil	1200	Dec-2010.	The US District Court has upheld the 2010 patent in its ruling on 23-Dec-04. Teva has tentative approval for tablets & injections	Y
Valacyclovir Hydrochloride	10-Mar-03	Valtrex	GSK	1200	2009, 2016	Ranbaxy has FTF status and has its own DMF. GSK has sued Ranbaxy. Patent litigation yet to be resolved. Ranbaxy holds final US FDA approval	Y

(CONTD...)

CIPLA'S CURRENT PRODUCT PIPELINE AND POTENTIAL OVERLAP WITH TEVA (CONTD...)

SUBJECT	DMF FILING	BRAND NAME	INNOVATOR	MKT. SIZE (US$M)	PATENT EXPIRY	REMARKS	TEVA OVERLAP
Escitalopram Oxalate	12-Jun-03	Lexapro	Lundbeck/ Forest labs	1900	N.A.	Innovator has entered into a settlmnt with Alphapharma. It has won in lower court against Ivax. Appeals process is on. Caraco also has para-IV filing and Forest has sued it.	
Pioglitazone Hydrochloride	30-Jun-03	Actos	Takeda	1813	2011, 2016.	Mylan & Alphapharm hold tentative approvals. Ranbaxy and Mylan may be eligible for shared exclusivity. Court ruled that Takeda's basic patent was valid	Y
Rabeprazole Sodium	18-Aug-03	Aciphex	Esai	1200	2009	Dr. Reddy's & Teva likely to have shared exclusivity. Esai won summ ary judgement in Oct-06. Teva holds final US FDA approval and can tech nically launch-at-risk if it so desires. Only Dr. Reddy's and Cipla have early DMFs on the product. Others have filed DMF later on	
Risperidone	17-Nov-03	Risperdal	J&J	2218	29-Dec-07	DRL & Mylan have filed patent chall enges. Barr has Para-IV for ODT which was filed on 27-Jun-2005. Mylan, Roxane hold tentative approvals. Many DMF filers. District court upheld patent validity. Generics likely to appeal the ruling	
Tolterodine Tartrate	11-Dec-03	Detrol	Pfizer	950	2012	Ranbaxy has Para-IV but not FTF. It holds tentative approval. Ranbaxy, Cipla, DRL, Hisun and Teva have filed DMFs. Cipla's partner may not have FTF status	Y
Amlodipine Besylate	17-Dec-03	Norvasc	Pfizer	1800	2007	Mylan has Para-IV and has launched on 23-Mar-07 with 180-day exclusitivity. Apotex, Roxane, Watson & Teva hold tentative approvals	Y-DMF out-sourced
Rivastigmine Hydrogen Tartrate	29-Dec-03	Exelon	Novartis	187	14-Aug-07, 2014	Cipla's partner filed patent challenge on 21-Apr-04 and has FTF status. Other generics have also filed Para-IV filings	
Carvedilol	25-Feb-04	Coreg	GSK	670 2017	Mar-2007, 2015,	Teva, Ranbaxy and DRL hold tentative approvals. Teva has Para-III filing	Y
Clopidogrel Bisulphate	25-May-04	Plavix	Sanofi	1900	2011, 2014	Cipla has partnered with Watson. Apotex and DRL have filed before Watson. Apotex launched in US and was later on forced to withdraw from the market by US courts	Y
Sumatriptan Succinate	25-May-04	Imitrex	GSK	836	28-Jun-2007, 2009, 2012, 2016	Ranbaxy, Cobalt hold tentative approv. Dr. Reddy's settled out-of-court with GSK and has become the authorized generic with launch scheduled in Feb-09	

(CONTD...)

CIPLA'S CURRENT PRODUCT PIPELINE AND THE POTENTIAL OVERLAP WITH TEVA (CONTD...)

SUBJECT	DMF FILING	BRAND NAME	INNOVATOR	MKT. SIZE (US$M)	PATENT EXPIRY	REMARKS	TEVA OVERLAP
Irinotecan Hydrochloride Trihydrate	8-Jun-04	Camptosar	Pfizer		20-Feb-2008, 2020	No ANDAs approved till date	
Rizatriptan Benzoate	30-Aug-04	Maxalt	Merck	N.A.	2012	Cipla's partner has filed Para-IV on 02-Sep-2004 with FTF status. Cipla was the first DMF filer. Dr. Reddy's & Matrix have also filed DMFs	
Pantoprazole Sodium Sesquihydrate	30-Sep-04	Protonix	Altana (mktd in US by Wyeth)	2000	2010, 2016	Para-IV filed on 02-Feb-2004. Cipla's partner may not have FTF. Sun Pharma also has para-IV filing. No ANDAs appr oved till date	Y
Granisetron Hydrochloride	25-Oct-04	Kytril	Roche		Dec-07	Para-IV filed in June & July 2004. Cipla's partner may not have FTF. Baxter & Sicor hold tentative approval	Y
Zolpidem Tartrate	8-Nov-04	Ambien	Sanofi	2000	21-Apr-07	Teva, Mylan, Par Pharma, Caraco, Pliva, Roxane, Biovail already hold tentative approval. Expect a few more players	Y
Nateglinide	13-Dec-04	Starlix	Novartis	120	2012	Para-IV filed on 22-Dec-2004. No ANDAs approved till date. DRL, Cipla and Teva are the only DMFs till date	Y
Tamsulosin HCl	11-Mar-05	Flomax	Boehringer Ingelheim/ Astellas Pharma (Japan)	724	Oct-04, Feb-06, Sep-06, Oct-09	Ranbaxy has Para-IV with FTF. Cipla's partner may not have FTF since Para-IV was filed on 20-Dec-04 and Cipla's DMF was filed on 11-Mar-2005. Ranbaxy lost in lower court in Feb-07. Many DMFs have been filed	
Donepezil HCl (form-I)	9-Jun-05	Aricept	Eaisi	935	2010	Ranbaxy holds tentative approval. Cipla's partner may not have FTF status	
Lamotrigine	9-Jun-05	Lamictal	GSK	870	22-Jul-08	No ANDAs approved till date. Cipla's partner may not have FTF status. Teva had a para-IV filing and has entered into a settlement with GSK allowing it to launch chewable tablets in Jun-05 and normal tablets in 2008	Y
Pramipexole Dihydrochloride Monohydrate	25-Aug-05	Mirapex	Boehringer Ingelheim	244	23-Nov-2007, 2011	Barr Labs has FTF status. Barr filed Para-IV in May and June 2005. The 30-month stay period for Barr was triggered in Sep-05. Cipla's DMF filed after Barr's Para-IV and hence Cipla's partner may not have FTF status. No ANDAs approved till date	
Bicalutamide	31-Aug-05	Casodex	Astrazeneca		Oct-08	No ANDAs approved till date	Y

(CONTD...)

CIPLA'S CURRENT PRODUCT PIPELINE AND THE POTENTIAL OVERLAP WITH TEVA (CONTD...)

SUBJECT	DMF FILING	BRAND NAME	INNOVATOR	MKT. SIZE (US$M)	PATENT EXPIRY	REMARKS	TEVA OVERLAP
Esomeprazole Magnesium Dihydrate	28-Sep-05	Nexium	Astrazeneca	3125	Oct-07, 2014, 2016, 2018, 2019, 2020	Ranbaxy has Para IV FTF filing. Astra Zeneca sued Ranbaxy on 22-Nov-05 triggering the 30-month stay period. Only 3 DMFs till date - Dr. Reddy's, Ranbaxy, Cipla.	
Granisetron Hydrochloride	28-Sep-05	Kytril	Roche		Dec-07	Para-IV filed in June & July 2004. Cipla's partner may not have FTF. Baxter & Sicor hold tentative approval	
Rosiglitazone Maleate	4-Nov-05	Avandia	GSK	1870	2008, 2015, 2017	Dr. Reddy's, USV, Cipla, Biocon & Sondoz have filed DMFs. DRL has Para-IV filing with shared exclusivity	
Levo Salbutamol HCl	25-Jan-06					Only DMF till date	
Famciclovir	9-Mar-06	Famvir	Novartis	166	2010, 2014,	Teva, Hisun have filed DMFs before Cipla	Y
Desloratadine	18-May-06	Clarinex	Schering Plough		Oct-07, 2015	Many DMFs.	Y
					Mar-09, 2020		
Alfuzosin	7-Aug-06	Uroxatral	Sanofi-Aventis		27-May-07, 2017. NCE exclusivity expires on 12-Jun-08	Many DMFs. Heumann (Germany) & Farmark have filed DMFs before Cipla	
Zoledronic Acid	24-Aug-06	Zometa Injections	Novartis	696	24-Jul-07, Substance patent expires in 2012	Teva & Natco have filed DMFs before Cipla	Y
Beclomethsone Dipropionate	24-Aug-06	Qvar Inhaler	3M		Nov-09, 2010,	Sicor (Teva) has DMF filing before Cipla. Only two generic DMF filings till date	Y
Lansoprazole	1-Sep-06	Prevacid	TAP Pharma	1700	25-Jun-08, 3-Sep-08, May-09	Many DMFs.	Y
Telmisartan	22-Nov-06	Micardis	Boehringer Ingelheim		2014, 2020	Only 3 DMFs till date. Dr. Reddy's & Glenmark have filed before Cipla	
Tenofovir Disoproxil Fumarate	29-Nov-06	Viread	Gilead		2017	Only DMF till date. Can be a PEPFAR filing	

INCOME STATEMENT (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Net Income	**22,545**	**29,814**	**36,260**	**42,540**	**51,196**
Change (%)	*17.2*	*32.2*	*21.6*	*17.3*	*20.3*
Total Expenditure	17,592	23,121	27,044	31,508	37,880
EBITDA	**4,953**	**6,692**	**9,215**	**11,032**	**13,316**
Margin (%)	*22.0*	*22.4*	*25.4*	*25.9*	*26.0*
Depreciation	551	802	1,078	1,246	1,364
Int. and Finance Charges	76	114	75	84	90
Other Income - Rec.	820	1,322	900	878	1,220
PBT before EO Items	**5,146**	**7,098**	**8,962**	**10,580**	**13,082**
Extra Ordinary Expense	0	0	0	0	0
PBT but after EO Exp.	**5,146**	**7,098**	**8,962**	**10,580**	**13,082**
Tax	1,050	1,022	1,658	1,481	1,831
Tax Rate (%)	*20.4*	*14.4*	*18.5*	*14.0*	*14.0*
Reported PAT	**4,096**	**6,076**	**7,304**	**9,099**	**11,250**
Adj PAT	**4,096**	**6,076**	**7,304**	**9,099**	**11,250**
Change (%)	*25.1*	*48.3*	*20.2*	*24.6*	*23.6*
Margin (%)	*18.2*	*20.4*	*20.1*	*21.4*	*22.0*

BALANCE SHEET (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Equity Share Capital	600	600	1,555	1,555	1,555
Reserves	14,836	19,140	31,791	39,029	47,977
Revaluation Reserves	101	93	93	93	93
Net Worth	**15,536**	**19,833**	**33,439**	**40,677**	**49,625**
Loans	1,912	4,689	1,302	1,502	1,500
Deferred Liabilities	889	980	487	381	250
Capital Employed	**18,338**	**25,501**	**35,228**	**42,559**	**51,375**
Gross Block	9,867	13,667	15,667	17,667	19,667
Less: Accum. Deprn.	2,478	3,101	4,179	5,425	6,789
Net Fixed Assets	**7,389**	**10,566**	**11,488**	**12,242**	**12,878**
Capital WIP	1,060	870	450	500	750
Investments	183	224	1,266	1,266	1,266
Curr. Assets	**17,491**	**22,923**	**33,158**	**42,010**	**52,655**
Inventory	7,457	9,570	10,975	12,909	15,586
Account Receivables	5,873	8,760	10,366	12,494	14,933
Cash and Bank Balance	112	445	6,322	9,867	14,030
Others	4,049	4,148	5,496	6,740	8,105
Curr. Liability & Prov.	**7,785**	**9,082**	**11,135**	**13,458**	**16,174**
Account Payables	7,785	9,082	11,135	13,458	16,174
Net Current Assets	**9,706**	**13,841**	**22,024**	**28,552**	**36,481**
Appl. of Funds	**18,338**	**25,501**	**35,228**	**42,559**	**51,375**

E: MOSt Estimates

RATIOS

Y/E MARCH	2005	2006	2007E	2008E	2009E
Basic (Rs)					
EPS	5.5	8.1	9.4	11.7	14.5
Cash EPS	6.2	9.2	10.8	13.3	16.2
BV/Share	20.6	26.3	42.9	52.2	63.7
DPS	1.4	0.8	3.0	4.2	5.2
Payout (%)	29.3	29.2	18.3	20.5	20.5
Valuation (x)					
P/E	42.8	28.9	24.9	20.0	16.2
Cash P/E		25.5	21.7	17.6	14.4
P/BV		8.9	5.5	4.5	3.7
EV/Sales		6.2	4.9	4.1	3.3
EV/EBITDA		27.8	19.2	15.7	12.7
Dividend Yield (%)		0.3	1.3	1.8	2.2
Return Ratios (%)					
RoE	26.5	30.8	21.9	22.4	22.7
RoCE	28.5	28.3	25.7	25.1	25.6
Working Capital Ratios					
Debtor (Days)	95	107	104	107	106
Inventory (Days)	121	117	110	111	111
Working Capital (Days)	157	169	222	245	260
Leverage Ratio (x)					
Current Ratio	2.2	2.5	3.0	3.1	3.3
Debt/Equity	0.1	0.2	0.0	0.0	0.0

CASH FLOW STATEMENT (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Op. Profit/(Loss) before Tax	4,953	6,692	9,215	11,032	13,316
Interest/Dividends Recd.	820	1,322	900	878	1,220
Direct Taxes Paid	-820	-932	-2,151	-1,587	-1,962
(Inc)/Dec in WC	-2,090	-3,802	-2,306	-2,983	-3,767
CF from Operations	**2,863**	**3,280**	**5,659**	**7,341**	**8,807**
(inc)/dec in FA	-2,964	-3,789	-1,580	-2,050	-2,250
(Pur)/Sale of Investments	1,621	-41	-1,042	0	0
CF from Investments	**-1,343**	**-3,831**	**-2,622**	**-2,050**	**-2,250**
(Inc)/Dec in Debt	-194	2,777	-3,387	200	-2
Interest Paid	-76	-114	-75	-84	-90
Dividend Paid	-1,199	-1,773	-1,340	-1,862	-2,302
CF from Fin. Activity	**-1,470**	**883**	**2,840**	**-1,746**	**-2,394**
Inc/Dec of Cash	**50**	**333**	**5,877**	**3,545**	**4,163**
Add: Beginning Balance	62	112	445	6,322	9,867
Closing Balance	**112**	**445**	**6,322**	**9,867**	**14,030**

Dr Reddy's Laboratories

STOCK INFO.	BLOOMBERG
BSE Sensex: 13,928	DRRD IN
	REUTERS CODE
S&P CNX: 4,085	REDY.BO

23 April 2007 — **Buy**

Previous Recommendation: Buy — Rs720

Y/E MARCH	2006	2007E	2008E	2009E
Sales (Rs m)	24,267	43,086	49,660	58,046
EBITDA (Rs m)	1,600	7,459	8,885	9,752
Adj. NP	1,371	4,152	6,001	6,939
EPS (Rs)	8.9	24.8	35.8	41.4
EPS Growth (%)	579.6	177.0	44.5	15.6
BV/Share (Rs)	145.2	212.5	239.5	270.6
P/E (x)	80.5	29.1	20.1	17.4
P/BV (x)	5.0	3.4	3.0	2.7
EV/EBITDA (x)	91.7	17.7	14.5	12.9
EV/Sales (x)	6.0	3.1	2.6	2.2
RoE (%)	6.2	11.7	14.9	15.3
RoCE (%)	2.5	6.5	8.8	9.5

Core business showing improvement: We expect DRL's core business (excluding one-time opportunities and acquisitions) to record 23% CAGR over FY07E-FY09E, led by higher growth in the branded formulation business and the US generic business (albeit on a lower base). Revenues (excl. one-time opportunities but including acquisitions) are expected to record CAGR of 16% between FY07E-09E.

Strong generic pipeline: DRL has significantly strengthened its product pipeline for regulated markets (58 ANDAs pending approval) with a pragmatic mix of normal products and Para-IV filings. It also has one of the strongest API pipelines of 95 DMFs, some of which can offer large one-time upsides if linked with exclusivity based supplies.

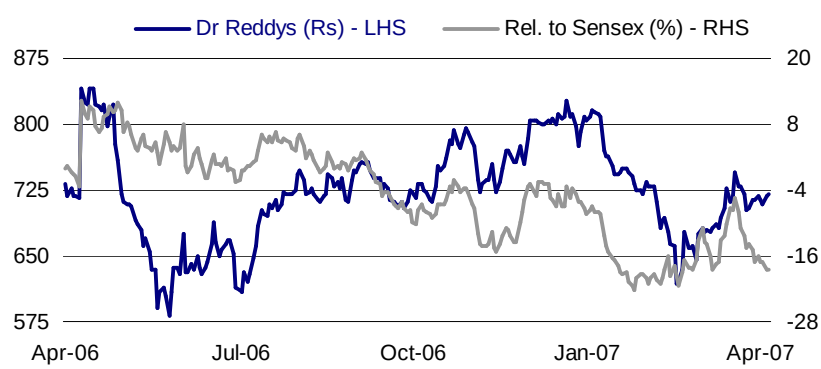
Potential listing of Perlecan can unlock value: We believe that DRL may list Perlecan in the future, thus unlocking value for share holders in the long-term. Our estimates, however, do not include this potential upside.

Valuations are reasonable: We expect DRL's revenues and earnings to record 16% and 29% CAGR for FY07-09. Valuations have recently corrected to 20.1x FY08E and 17.4x FY09E (excl. one-time upsides). We believe that the current valuations reflect the intense pricing pressure in regulated generic markets and are not discounting the improvement in DRL's core business and the growth traction in the semi-regulated markets (which enjoy better margins compared with the US generic markets). We reiterate **Buy** with a price target of Rs800.

KEY FINANCIALS	
Shares Outstanding (m)	167.7
Market Cap. (Rs b)	120.7
Market Cap. (US$ b)	2.9
Past 3 yrs. Sales Growth (%)	10.3
Past 3 yrs. NP Growth (%)	-26.2
Dividend Payout (%)	31.9
Dividend Yield (%)	0.3

STOCK DATA	
52-Week Range	877/579
Major Shareholders (as of March 2007)	%
Promoters	25.2
Domestic Institutions	15.1
FIIs/FDIs	46.1
Others	13.6
Average Daily Turnover	
Volume ('000 shares)	144.6
Value (Rs million)	31.6
1/6/12 Month Rel. Performance (%)	0/-9/-18
1/6/12 Month Abs. Performance (%)	5/1/-1

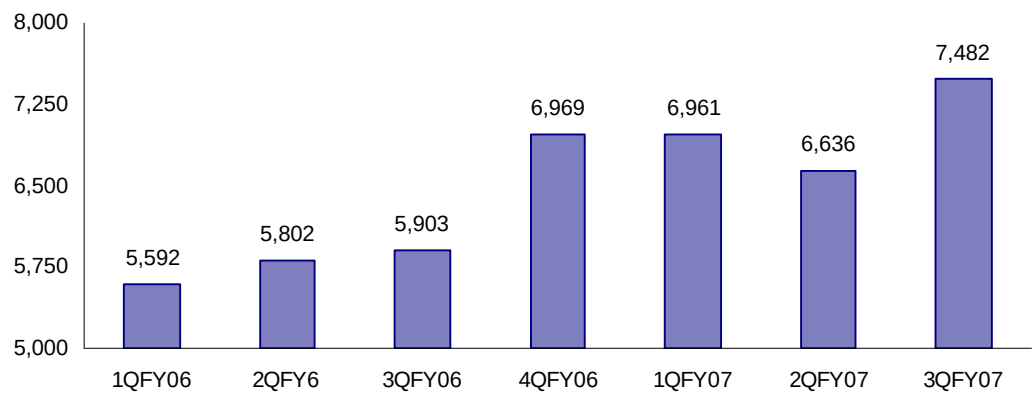
STOCK PERFORMANCE (1 YEAR)



Core business (excl. one-time upsides) shows improvement

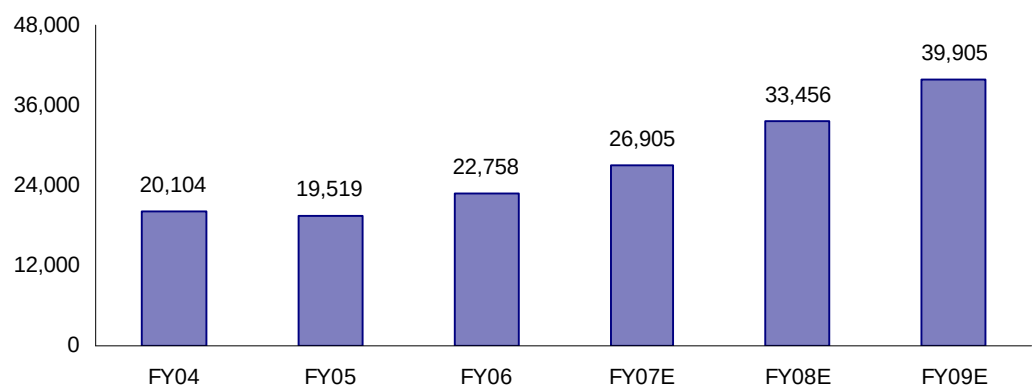
DRL's core business (excl. acquisitions, authorized generics, Sertraline Para-IV supplies and Allegra) has been improving gradually beginning 4QFY06 led mainly by higher growth in the branded formulation business across semi-regulated markets. Its US business is also showing an improvement albeit on a low base, led by more new launches. For 9MFY07, DRL's core business recorded 22% revenue growth to Rs21.1b, led mainly by 35% growth in core US generic business and 22% growth in branded formulation exports. We estimate gross margins for the core business at about 53% with branded formulations enjoying gross margins of about 60-70%. We expect 23% CAGR in DRL's core revenues over FY07-FY09. While we are positively enthused by the growth in the core business, we also note that DRL's branded formulation sales in India and Russia are likely to follow the seasonal decline pattern in 4QFY07.

TREND IN CORE REVENUES (RS M)



Source: Company/ Motilal Oswal Securities

TREND IN CORE REVENUES (RS M) FOR FY04-09



Source: Company/ Motilal Oswal Securities

Betapharm acquisition: Extended payback but strategic entry to Germany

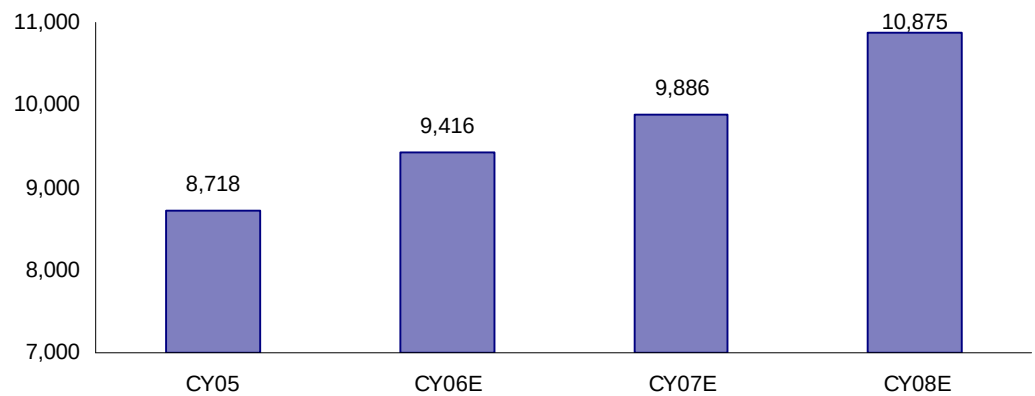
DRL acquired 100% stake in Betapharm Group from 3i (a private equity investor) in March 2006 at a cost of Euro480m (~ US$576m), which was funded through a combination of internal accruals and debt.

Betapharm recorded sales of Euro164m (~ US$197m) in 2005 and has a portfolio of 145 products. It has about 370 employees (including 250 in the sales team). The company is the fourth largest generic player and commands a share of about 3.5% in the German market. It has a pipeline of about 20 products to be launched in the coming years.

While the acquisition cost (at 3x sales) appears on the higher side, we believe Betapharm was one of the better generic assets available in Europe given its strong positioning in Germany (fourth largest generic company). Fierce competitive bidding from various generic companies has increased the acquisition cost for DRL and extended the payback period (about 8-10 years).

DRL is likely to leverage its product development skills and low-cost manufacturing in India to boost Betapharm's EBITDA margins. However, this outsourcing will be feasible only for Betapharm's future product pipeline and hence EBITDA margin expansion may not be visible in the short-to-medium term. Since Germany is more of a branded generic market, brand equity and doctor relationships are important determinants of success. Betapharm brings in these critical assets through a sales force of about 250 people.

BETAPHARM – TREND IN SALES



Source: Company/ Motilal Oswal Securities

BETAPHARM – KEY FINANCIALS (RS M)

	CY05	CY06E	CY07E	CY08E
Sales	8,718.2	9,415.7	9,886.5	10,875
EBITDA	2,179.6	2,165.6	1,977.3	2,175.0
EBITDA Margin (%) - assumed	25.0	23.0	20.0	20.0
Net Profit (before interest cost on acquisition)	1,307.7	1,129.9	1,186.4	1,196.3

Source: Company/ Motilal Oswal Securities

German GKV-WSG reforms - Raises uncertainty on drug pricing

The act for strengthening competition in the public health insurance (GKV-WSG) has come into effect in Germany from 01-Apr-07. Amongst other changes, the new rules will allow for possibilities for direct contractual price agreements between health insurance organizations, individual service providers and suppliers. This will again lead to comprehensive structural changes of the German health care system and the markets associated with this.

While the actual impact of this change will be visible over a period of time, we do not rule out further price cuts as the changes aim at direct price negotiations between the insurance companies and the pharmaceutical manufacturers through competitive tendering.

Germany's largest health insurance company - AOK - has already made a beginning in this direction by recently floating a tender inviting competitive bids from pharmaceutical companies for a set of 10-15 drugs. Other insurance companies may adopt a similar strategy over a period of time. As per the new changes, the insurance companies will invite bids for a set of drugs which will be supplied to the wholesalers/retailers at the prices decided in the tendering process.

We believe that if the entire healthcare system in Germany shifts to this new sourcing arrangement, then the nature of the market will undergo a change from being a branded generic market to a pure generic market (like the US) in the long-term. This implies that while drug prices may become more competitive, cost savings in branding & promotion as well as volume expansion for generics (due to lower prices) will partly compensate for the margin decline in the long-term.

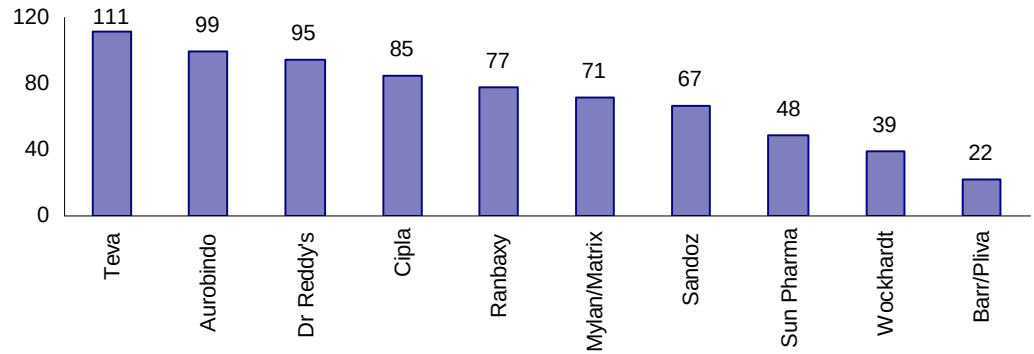
Also, given the fact that the German generic market witnessed two price cuts (in quick succession) in 2006, the industry is likely to offer stiff resistance to any further significant price cuts. As of now, there are no indications regarding the extent of price cuts and the proportion of the German market which will be covered by the new system.

Strong product pipeline

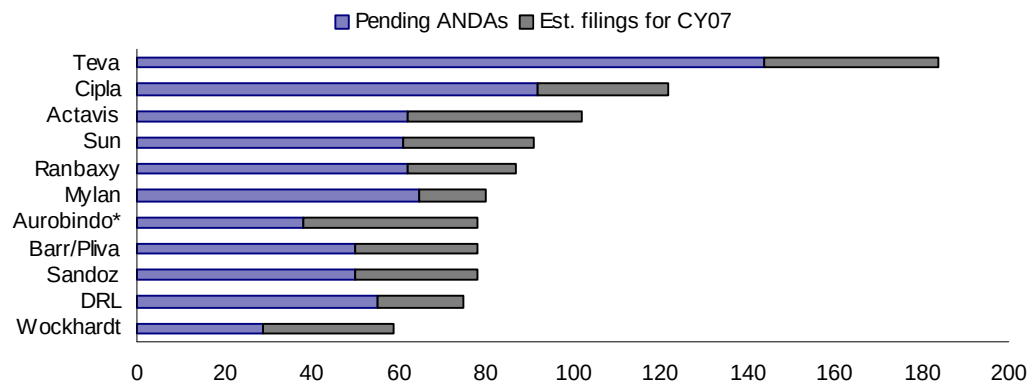
Over the last two years, DRL has undertaken a critical evaluation of its product pipeline with the intention of reducing its dependence on patent challenges. We believe that the company has significantly strengthened its product pipeline for regulated markets with a pragmatic mix of normal products and Para-IV filings. It also has one of the strongest API pipelines, some of which can offer large one-time upsides if linked with exclusivity based supplies (for e.g. supply of Sertraline to Teva with expected revenues of Rs1.5b for FY07E).

We believe that there could be some newsflow related to DRL's other patent litigations like Risperdal (J&J's US$2.3b brand), Aciphex (Eisai's US$1.2b brand), Avandia (GSK's US$1.8b brand) and Avelox (Bayer's US$261m brand) in 2007. The following table details DRL's para-IV product pipeline.

DMF FILINGS



ANDA STATISTICS



Source: Companies,/Motilal Oswal Securities

DRLS: KEY PARA-IV PRODUCTS

GENERIC INNOVATOR BRAND	2005 SALES (US M)	PATENT EXPIRY	CURRENT STATUS	2007 NEWS-FLOW EXPECTED
Sumatriptan (GSK's Imitrex)	836	Jun-2007, Feb-2009, 2012, 2016	Settled Para IV with GSK, awaiting FTC clearance; Authorized Generic launch in late Q4CY08	No
Finasteride tablets 1 mg (Merck's Propecia)	138	Nov-2013	Final approval received; patent expiry in Nov 2013. Settlement with Merck for early entry launch	No
Risperidone tablets (Janssen's Risperdal)	2,218	Dec-07	Lost in District Court. Appeal process under evaluation	Likely
Levetiracetam tablets (UCB's Keppra)	492	Jan-09	Sued in April 2004; Discovery in progress	No
Rosiglitazone Maleate (GSK's Avandia)	1,870	2008, 2015, 2017	Sued in September 2003 (shared exclusivity); Awaiting a trial date	No
Rabeprazole Sodium (Eisai's Aciphex)	1,198	04-Apr-2009, 2013	Sued in November 2003 (shared exclusivity). Teva and DRL filed a Para IV challenge on '552 patent. Only Teva asserted the patent invalidity defence. Teva and DRL are asserting unenforceability based on inequitable conduct. Eisai won summary judgement for patent validity but judge gave a mixed ruling on the unenforceability claim. Outcome of Mar-07 trial expected in near-term	Yes
Moxifloxacin HCl (Bayer's Avelox)	261	2011, 2014, 2016, 2019	Awaiting District Court decision	Yes
Rivastigmine Tartrate (Novartis' Exelon)	216	14-Aug-07, 2014	Sued in August 2004 (shared exclusivity)	Likely
Total	**7,843**			

Source: Company/ Motilal Oswal Securities

Generic Zofran exclusivity to add US$46m in sales over next 2 quarters

DRL launched generic Zofran in the last week of December 2006 and has recorded sales of about Rs222m from this product for 3QFY07. We expect one-time upside of US$46m in revenues and incremental EPS of Rs9/share from this opportunity (not included in our estimates). DRL enjoys 180-day exclusivity for generic Zofran tablets (branded market size of US$614m).

ZOFRAN (ONDANSETRON TABLETS) 180-DAY SENSITIVITY (US$ M)
BRAND SIZE (US $M) 614

	4QFY07E	1QFY08E
No. of players - assumed	3.0	3.0
Price Erosion (%)	*70.0*	*70.0*
DRL Market Share (%)	*50.0*	*50.0*
Sales	23.0	23.0
PAT margin (%) - assumed	*70.0*	*70.0*
PAT	16.1	16.1
PAT (Rs m)	741.4	741.4
Incremental EPS (Rs)	4.4	4.4

Source: Company/ Motilal Oswal Securities

Generic Aciphex - Significant upside but launch uncertain

Both DRL and Teva has filed Para-IV ANDA on Rabeprazole (Aciphex - Eisai's US$1.2b brand). Teva and DRL filed a Para IV challenge on Eisai's '552 patent expiring in 2013. Both Teva and DRL are asserting unenforceability based on inequitable conduct. Eisai won summary judgement for patent validity but the judge gave a mixed ruling on the unenforceability claim based on inequitable conduct. Outcome of Mar-07 district court trial is expected in near-term. Teva has already received final US FDA approval for its ANDA filing.

We believe that both Teva and DRL may contemplate a launch-at-risk if they win in the lower court (with Eisai appealing in the higher court) based on the strong wordings (in favour of generics) used by the judge regarding inequitable conduct on Eisai's part. We visualize two different scenarios for generics:

1. Both Teva and DRL launch with share 180-day exclusivity
2. Only Teva launches (as it is the only company to have received final US FDA approval) but sources the API from DRL as it does not have its own DMF filing

We present below, the potential upsides to DRL in both the above scenarios:

ACIPHEX (RABEPRAZOLE) 180-DAY SENSITIVITY WITH SHARED EXCLUSIVITY (US$ M)

BRAND SIZE (US $M): 1,200

PARTICULARS	6-MONTHS
No. of players - assumed	4.0
Price Erosion (%)	80.0
DRL Market Share (%)	25.0
Sales	30.0
PAT margin (%) - assumed	50.0
PAT	15.0
PAT (Rs m)	660.0
Incremental EPS (Rs)	3.9

Source: Motilal Oswal Securities

ACIPHEX (RABEPRAZOLE) 180-DAY SENSITIVITY WITH API SUPPLY TO TEVA (US$ M)

BRAND SIZE (US$M): 1,200

PARTICULARS	6-MONTHS
No. of players - assumed	3.0
Price Erosion (%)	70.0
Teva Market Share (%)	70.0
Teva Sales	126.0
PAT margin (%) - assumed	70.0
Teva PAT	88.2
DRL share (%)	25.0
DRL PAT	22.1
PAT (Rs m)	970.2
Incremental EPS (Rs)	5.8

Source: Motilal Oswal Securities

Looking at new unique opportunities

DRL has indicated that it is currently under negotiations with some players in the US to identify more unique/authorized generic opportunities for FY08 and expects some newsflow on this by 1HFY08. We view this as a sentiment booster for the stock.

Balaglitazone development timeline delayed

DRL's development timeline for Balaglitazone (diabetes NCE) has been delayed, as the company will have to conduct further clinical studies as mandated by the EU regulatory authorities. This is likely to delay commencement of Phase-III trials for this NCE by about 10-12 months. Progress of this molecule into further stages of clinical trials was one of the events being eagerly awaited by the investing community.

DRL has entered into an agreement with Rheoscience, which will fund all costs associated with the Phase-III clinical trials of Balaglitazone. It will pay Rheoscience a predetermined amount for its share of the development costs. While it is too early to attach any value for this molecule, we believe that sentiment in the stock will get a boost as the molecule enters Phase-III trials. The following table details DRL's current NCE pipeline:

DRL – NCE PIPELINE

DISEASE	MOLECULE	DEVELOPMENT STAGE	REMARKS
Atherosclerosis	RUS 3108	Phase I	Assigned to Perlecan Pharma
	DRL 16805	Pre-clinical	
Diabetes	DRF 2593	Late Phase II	Co-development with Rheoscience, Denmark. Phase III trials delayed by 10-12 months
	DRL 16536	Pre-clinical	Assigned to Perlecan Pharma
Dyslipidemia	DRF 10945	Early Phase II	Assigned to Perlecan Pharma
	DRL 12424	Pre-clinical	
Obesity	DRL 11605	Phase I	Assigned to Perlecan Pharma
Rheumatoid Arthritis	DRL 15725	Pre-clinical	
Solid Tumors	DRF 1042	Phase II	Co-development with ClinTec Intl. UK

As of Feb 2007 *Source: Company*

Core business to grow at 23% CAGR for FY07-FY09

We expect DRL's core business (excluding one-time opportunities and acquisitions) to record 23% CAGR over FY07-FY09, led mainly by higher growth in the company's branded formulation business (with 18.4% CAGR) and the US generic business (with 54% CAGR albeit on a lower base). Revenues (excl. one-time opportunities but including acquisitions) are expected to record CAGR of 16% between FY07E-09E.

TREND IN BUSINESS MIX

	FY06	CHG (%)	FY07E	CHG (%)	FY08E	CHG (%)	FY09E	CHG (%)	CAGR (FY07-09) %
APIs	8,238	*18.6*	10,207	*23.9*	10,470	*2.6*	11,932	*14.0*	8.12
India	2,296	15.0	2,066	-10.0	2,170	5.0	2,387	10.0	7.47
International	5,942	19.5	8,141	37.0	8,301	2.0	9,546	15.0	8.29
Branded Formulations	9,926	*10.0*	12,180	*22.7*	14,403	*18.2*	17,082	*18.6*	18.42
India	5,526	12.0	6,328	14.5	7,088	12.0	7,938	12.0	12.00
International	4,400	23.0	5,852	33.0	7,315	25.0	9,144	25.0	25.00
Generics	4,056	*13.4*	13,310	*228.1*	16,055	*20.6*	19,074	*18.8*	19.71
USA	1,631	*-26.9*	2,174	*33.3*	4,449	*104.6*	5,147	*15.7*	53.86
Europe	2,425	*22.0*	11,136	*359.2*	11,606	*4.2*	13,928	*20.0*	11.84
Emerging Business	691	*35.0*	829	*20.0*	912	*10.0*	1,003	*10.0*	10.00
Custom Chemicals	1,327	*25.0*	6,300	*374.8*	7,560	*20.0*	8,694	*15.0*	17.47
Others	29	*-30.0*	260	*0.0*	260	*0.0*	260	*0.0*	0.00
Total Revenues	**24,267**	***24.3***	**43,086**	***77.6***	**49,660**	***15.3***	**58,046**	***16.9***	**16.1**

Note: Above figures exclude one time opportunities *Source: Company/ Motilal Oswal Securities*

Maintain Buy

Over the last two years, DRL has taken significant steps to revitalize its business. These have been directed mainly at reducing risks and achieving scale. The first obvious step by DRL was to reduce costs and the risks attendant with its generic business and NCE research. This was achieved by resorting to external funding from financial investors and is likely to reduce DRL's SG&A expenses from as high as 35% of sales in FY05 to 28% by FY08E. R&D expenses will likely reduce from 13% of sales to 6-7% by FY08E.

In the past, DRL's generic strategy was skewed in favor of patent challenges and the company suffered substantial setbacks (omeprazole & amlodipine), which prevented the

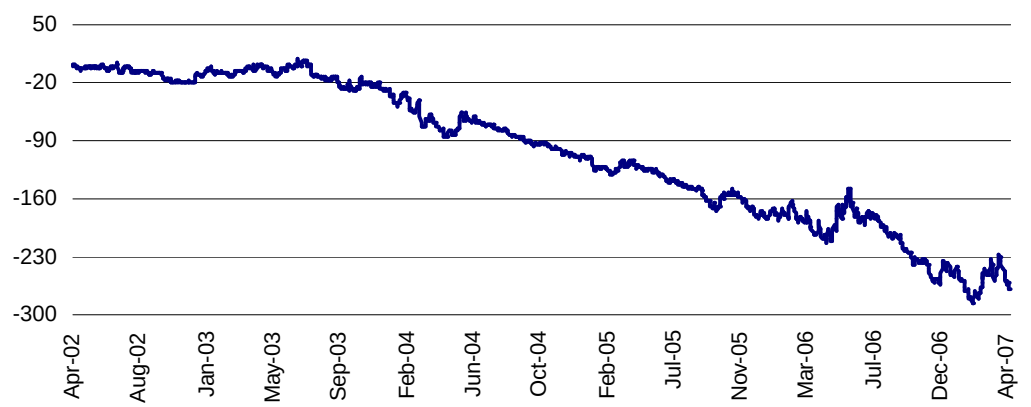
company from gaining critical mass in the global generic markets. Hence, the company has resorted to inorganic growth to gain scale. It has recently acquired Betapharm for Euro480m to gain a strong foothold in the German market.

While the benefits of de-risking and cost reduction are evident from the improvement in financials, the impact of acquisitions will be visible only in the long term. While improvement in core business is likely to result in increased traction, large one-time opportunities like Fexofenadine, Simvastatin (authorized generic), Ondansetron and Finasteride will result in increased cash flows for the company. The German operations are likely to contribute positively to margins despite the price cuts of 2006.

DRL has underperformed the broader markets

DRL has underperformed the broader markets significantly over the past five years by about 225%. Increasing price competition in the US coupled with significantly higher costs has resulted in the underperformance. The overall bearishness in the performance of the pharmaceutical sector over the past two years has also contributed to the decline in DRL's stock price.

DRL RELATIVE TO BSE SENSEX (5 YEARS)



Generic pricing pressure, expensive acquisitions; already discounted in current valuations

DRL's valuations are currently discounting 97% price erosion in the US for drugs going off patent. Since, we believe that generic prices in the US are unlikely to decline significantly in the coming years, current valuations already discount the worst scenario.

The stock markets have already discounted the intense pricing pressure in the US and some European markets. DRL's Betapharm acquisition was expensive (at about 3x Sales and 11.7x EBITDA) as it was made under intense bidding pressure, leading to extended paybacks. We believe that current valuations have already discounted these factors.

Valuations have corrected

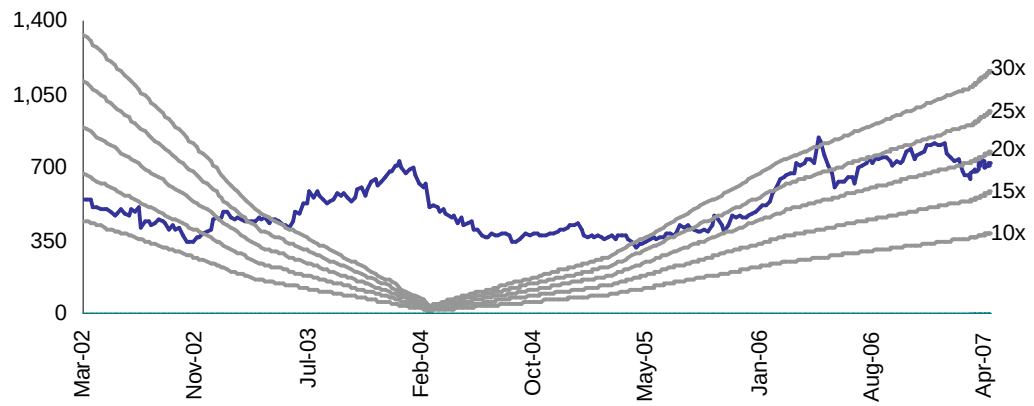
Valuations have recently corrected to 20.1x FY08E and 17.4x FY09E (excl. one-time upsides). We believe that the current valuations reflect the intense pricing pressure in regulated generic markets and are not discounting DRL's growth traction in the semi-regulated markets (which enjoy better margins compared with the US generic markets). P/E multiples are currently lower than their historic median P/E.

CURRENT P/E LOWER THAN LAST 5-YEARS' MEDIAN P/E

COMPANY	CURRENT P/E		MEDIAN P/E
	FY08E/CY07E	FY09E/CY08E	(FOR LAST 5 YEARS)
Ranbaxy	21.8	16.9	23.7
Dr. Reddy's Labs**	20.1	17.4	23.6
Sun Pharma	24.7	20.2	37.9
Cipla	20.0	16.2	21.4

*** - Only FY01-04 considered due to extreme values for FY05/06* *Source: Motilal Oswal Securities*

DRL PE BAND



DRL is currently valued at 20.1x FY08E and 17.4x FY09E earnings (excl. one-time upsides). We expect strong newsflow for DRL over the next few quarters related to tapping of some of the unique opportunities/litigation settlements. One-time upsides (authorized generics & 180-day exclusivities) could potentially add Rs18/share to DRL's EPS for FY07E & Rs4-5/share for FY08E. It should be noted that most of these upsides are short term in nature and will not be contributing significantly to the FY08E performance (except Ondansetron). We reiterate **Buy** with a price target of Rs800.

INCOME STATEMENT (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Net Sales	**19,519**	**24,267**	**43,086**	**49,660**	**58,046**
Change (%)	*-2.9*	*24.3*	*77.6*	*15.3*	*16.9*
Total Expenditure	18,970	22,667	35,627	40,776	48,294
EBITDA	**550**	**1,600**	**7,459**	**8,885**	**9,752**
Change (%)	*-74.4*	*191.1*	*366.2*	*19.1*	*9.8*
Margin (%)	*2.8*	*6.6*	*17.3*	*17.9*	*16.8*
Amortization	350	420	1,564	1,350	1,240
EBIT	**200**	**1,180**	**5,895**	**7,535**	**8,512**
Other Income - Rec.*	-93	319	-1,095	-637	-537
PBT & EO Expense	**107**	**1,499**	**4,800**	**6,898**	**7,976**
Change (%)	*-95.8*	*1,300.8*	*220.2*	*43.7*	*15.6*
Extra Ordinary Expense	0	-388	-63	0	0
PBT after EO Expense	**107**	**1,887**	**4,863**	**6,898**	**7,976**
Tax	-94	258	657	897	1,037
Tax Rate (%)	*-88.1*	*13.7*	*13.5*	*13.0*	*13.0*
Minority Interest	-10	0	-4	0	0
Reported PAT	**211**	**1,629**	**4,211**	**6,001**	**6,939**
Adjusted Net Profit	**201**	**1,371**	**4,152**	**6,001**	**6,939**
Change (%)	*-91.9*	*581.1*	*202.8*	*44.5*	*15.6*
Margin (%)	*1.0*	*5.7*	*9.6*	*12.1*	*12.0*

**Other Income (incl Forex Gains/Losses)*

BALANCE SHEET (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Equity Share Capital *	383	383	838	838	838
Reserves	20,571	21,888	34,800	39,319	44,545
Net Worth	**20,953**	**22,272**	**35,638**	**40,158**	**45,383**
Loans	2,827	30,995	32,361	32,361	32,361
Deferred Liabilities/Tax	373	6,229	6,229	6,229	6,229
Capital Employed	**24,154**	**59,496**	**74,228**	**78,747**	**83,973**
Net Fixed Assets	**7,160**	**9,311**	**12,991**	**13,911**	**14,831**
Investments	1,487	1,238	1,238	1,238	1,238
Goodwill/Intangible Assets	2,588	33,669	33,669	33,669	33,669
Curr. Assets	**17,816**	**24,377**	**38,179**	**43,586**	**50,198**
Inventory	3,500	6,895	6,463	7,449	8,707
Account Receivables	3,609	5,054	7,971	9,187	10,739
Cash and Bank Balance	9,288	3,713	20,191	22,853	25,964
Others	1,419	8,715	3,555	4,097	4,789
Curr. Liability & Prov.	**4,898**	**9,098**	**11,849**	**13,657**	**15,963**
Account Payables	1,555	3,791	10,772	12,415	14,512
Other Current Liabilities	3,343	5,307	1,077	1,242	1,451
Net Current Assets	**12,918**	**15,278**	**26,330**	**29,930**	**34,235**
Appl. of Funds	**24,154**	**59,496**	**74,228**	**78,747**	**83,973**

*E: MOSt Estimates; * Equity has increased due to 1:1 bonus & ADR issue.*

RATIOS

Y/E MARCH	2005	2006	2007E	2008E	2009E
Basic (Rs)					
EPS	1.3	8.9	24.8	35.8	41.4
Cash EPS	3.6	11.7	34.1	43.8	48.8
BV/Share	136.9	145.2	212.5	239.5	270.6
DPS	2.5	2.5	3.2	4.4	5.1
Payout (%)	216.7	31.9	29.7	28.2	28.2
Valuation (x)					
P/E	547.4	80.5	29.1	20.1	17.4
Cash P/E		61.7	21.1	16.4	14.8
P/BV		5.0	3.4	3.0	2.7
EV/Sales		6.0	3.1	2.6	2.2
EV/EBITDA		91.7	17.7	14.5	12.9
Dividend Yield (%)		0.3	0.4	0.6	0.7
Return Ratios (%)					
RoE	1.0	6.2	11.7	14.9	15.3
RoCE	0.4	2.5	6.5	8.8	9.5
Working Capital Ratios					
Asset Turnover (x)	0.8	0.4	0.6	0.6	0.7
Working Capital (Days)	68	174	52	52	52
Leverage Ratio					
Current Ratio (x)	3.6	2.7	3.2	3.2	3.1
Debt/Equity (x)	0.1	1.4	0.9	0.8	0.7

** Adjusted for bonus issue*

CASH FLOW STATEMENT (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Oper. Profit/(Loss) before Tax	550	1,600	7,459	8,885	9,752
Interest/Dividends Recd.	-93	319	-1,095	-637	-537
Direct Taxes Paid	94	-258	-657	-897	-1,037
(Inc)/Dec in WC	902	-7,935	5,426	-937	-1,195
CF from Operations	**1,454**	**-6,274**	**11,133**	**6,415**	**6,983**
EO Expense	0	-388	-63	0	0
CF from Oper. incl EO Exp.	**1,454**	**-5,886**	**11,196**	**6,415**	**6,983**
(inc)/dec in FA	-1,012	-33,652	-5,244	-2,270	-2,160
(Pur)/Sale of Investments	2,892	250	0	0	0
CF from Investments	**1,880**	**-33,402**	**-5,244**	**-2,270**	**-2,160**
Issue of Shares	139	127	10,389	207	240
(Inc)/Dec in Debt	1,865	34,024	1,366	0	0
Other Items	10	0	0	0	0
Dividend Paid	-436	-437	-1,233	-1,689	-1,953
CF from Fin. Activity	**1,578**	**33,714**	**10,521**	**-1,482**	**-1,713**
Inc/Dec of Cash	**4,912**	**-5,575**	**16,474**	**2,663**	**3,110**
Add: Beginning Balance	4,376	9,288	3,713	20,191	22,853
Closing Balance	**9,288**	**3,713**	**20,187**	**22,853**	**25,964**

Note: Reported cashflow differs due to acquisition

Ranbaxy Laboratories

STOCK INFO.	BLOOMBERG
BSE Sensex: 13,928	RBXY IN
	REUTERS CODE
S&P CNX: 4,085	RANB.BO

23 April 2007 — **Buy**

Previous Recommendation: Buy — Rs343

Y/E DECEMBER	2005	2006	2007E	2008E
Sales (Rs m)	52,770	61,337	70,625	86,241
EBITDA (Rs m)	3,111	9,430	11,322	14,260
Adj. NP (Rs m)	2,164	5,418	6,302	8,130
Adj. EPS (Rs)	5.4	13.6	15.8	20.3
EPS Growth (%)	-70.3	150.3	16.3	29.0
BV/Share (Rs)	65.4	72.5	81.1	92.2
P/E (x)	63.4	25.3	21.8	16.9
P/BV (x)	5.2	4.7	4.2	3.7
EV/EBITDA (x)	46.7	16.9	14.1	11.4
EV/Sales (x)	2.8	2.6	2.3	1.9
RoE (%)	8.9	20.1	20.9	23.7
RoCE (%)	5.1	11.7	12.9	15.7

KEY FINANCIALS	
Shares Outstanding (m)	372.4
Market Cap. (Rs b)	127.8
Market Cap. (US$ b)	3.1
Past 3 yrs. Sales Growth (%)	12.1
Past 3 yrs. NP Growth (%)	-28.0
Dividend Payout (%)	45.5
Dividend Yield (%)	1.8

STOCK DATA	
52-Week Range	530/305
Major Shareholders (as of March 2007)	%
Promoters	34.9
Domestic Institutions	20.2
FIIs/FDIs	21.9
Others	23.1
Average Daily Turnover	
Volume ('000 shares)	1,510.8
Value (Rs million)	595.1
1/6/12 Month Rel. Performance (%)	-1/-27/-48
1/6/12 Month Abs. Performance (%)	4/-16/-31

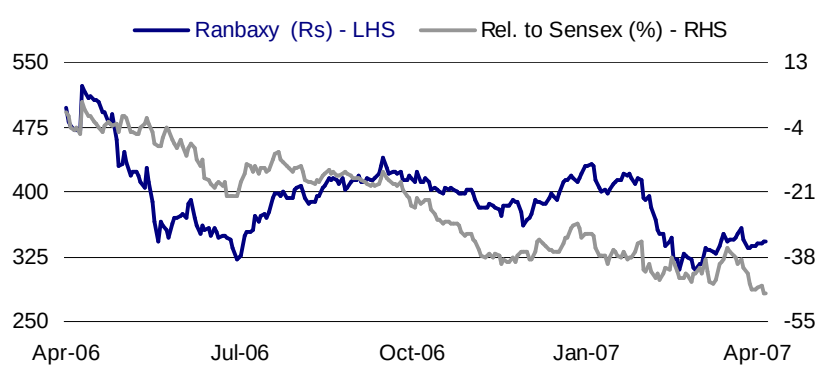
Strong generic pipeline: Ranbaxy has one of the strongest generic pipelines with about 76 ANDAs pending approval. About 60% of this pipeline is likely to be commercialized in CY07-CY08 period. The company has 20 Para-IV FTF targeting a branded market of about US$25b. Lipitor exclusivity in US has an option value of about US$250-300m for the company.

CY07E performance to improve despite loss of Simvastatin exclusivity: CY07E EPS is likely to improve by 27% despite the loss of Simvastatin 80mg exclusivity (which added Rs3.5/share to CY06 EPS) led by full year impact of acquired companies and 20-30% growth for semi-regulated markets. We expect Terapia revenues to grow at 25% CAGR for CY06-08 to US$150m with 25% EBITDA margin.

US FDA issues getting diluted: Shifting of larger products from Paonta facility to other units and receipt of three approvals from Ohm facility post the US FDA survey has diluted the potential adverse impact of compliance problems faced by the company.

Valuations not demanding: We expect revenue and earnings to record 19% and 22.5% CAGR for CY06-08. Current valuations at 21.8x CY07E and 16.9x CY08E (excl. one-time upsides) are not factoring-in the potential leverage arising out of a strong product pipeline, the incremental value of a potential hive-off of NCE/NDDS research and the option value from Lipitor exclusivity. We reiterate **Buy** with a price target of Rs460.

STOCK PERFORMANCE (1 YEAR)



We believe that CY05-CY06 were the worst years for Ranbaxy in recent years (except for successful launch of Simvastatin under exclusivity). It has witnessed various adverse developments such as:

1) Loss of Lipitor patent challenge in various markets leading to certain write-offs
2) Intensifying competition in the US resulting in significant drop in profitability
3) Higher R&D spend due to additional studies conducted for anti-AIDS drugs
4) Lack of any major new launches
5) Delay in product launches in the US due to US FDA related issues

CY07E-CY08E performance to improve

We expect Ranbaxy's CY07E-CY08E performance to be better led mainly by:

1) More new product launches in regulated markets
2) Higher growth in Europe, LatAm and India
3) Cost control measures adopted by the company
4) Contribution from the recent acquisitions

It should be noted that the improvement will be visible despite the higher base effect of CY06 arising out of the Simvastatin 80mg exclusivity (which has added incremental EPS of Rs3.5/share to CY06 earnings).

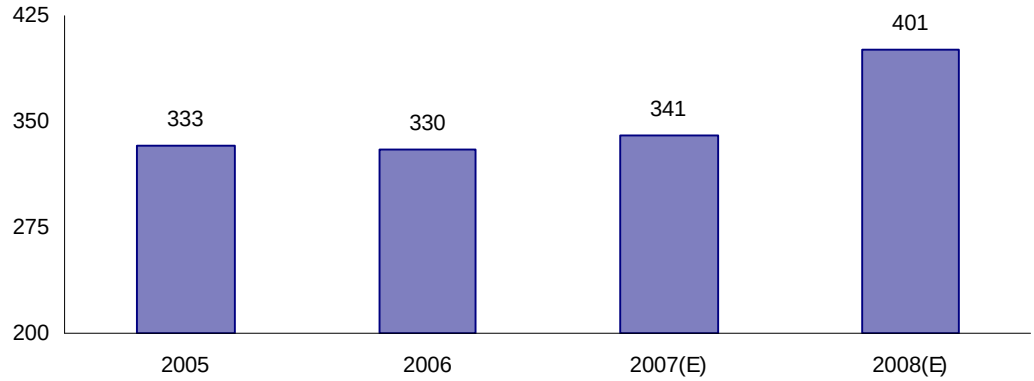
Pricing pressure in US to stay, but may not worsen further …

We do not expect any let up in the pricing pressure in the US over the next 12 months as the second and third tier generic players enter the market. We believe that since these companies would be late entrants into the generic markets, they are likely to play the price game to gain market share. However, pricing for most of the off-patent products are at about 97% discount to the innovator's price. We do not expect prices to deteriorate significantly from these levels. We believe that given the severe price erosion in USA, it will be difficult for companies with smaller product pipelines to grow their existing portfolios (in fact they will witness declines). This implies that only those companies that can introduce a large number of new products will be able to show positive growth in this market. In this respect, Ranbaxy is well placed, with about 76 ANDAs pending approval with the US FDA.

… significant launches to drive growth going forward

We expect several new launches in the US in CY07E (the number of launches will be in double digits) with most of them coming from facilities other than Paonta Sahib. The company currently has 76 ANDAs pending US FDA approval — one of the strongest generic pipelines. It filed 27 ANDAs in CY06. About 60% of this pipeline is likely to be commercialized over CY07-CY08. The company currently has about 20 FTFs (targeting innovator sales of about US$25b) in its pipeline, some of which could be commercialized in the CY07-CY08 period.

TREND IN US SALES (US$ M)*

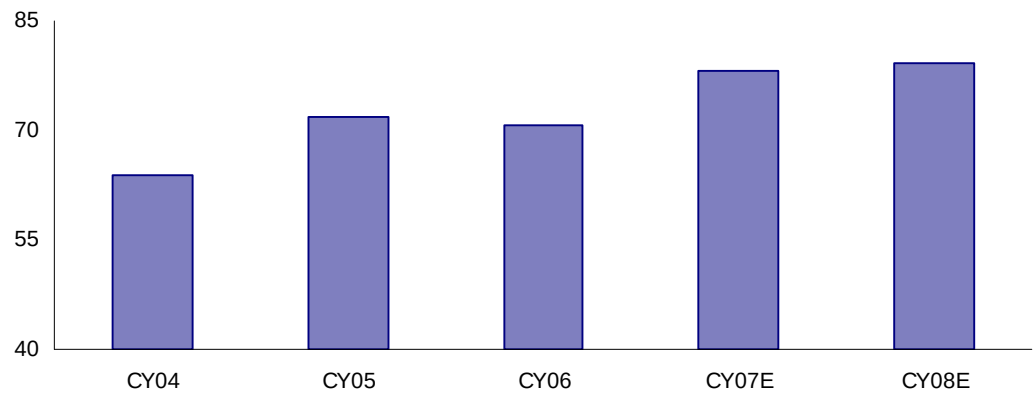


*Excl one-time opportunities Source: Company/Motilal Oswal Securities

Sensitivity to US sales gradually reducing

We expect Ranbaxy's non-US sales to increase gradually over the next few years given its initiatives in the branded generic markets of Europe and other semi-regulated markets. Contribution of US sales is likely to decline from 25% in CY06 (excluding Simvastatin) to 21% by CY08E. The increase in non-US sales will be led by the full impact of various acquisitions (mainly Terapia and Be-Tabs in South Africa), increased sales of anti-AIDS products as well as higher growth in the CIS, Latin America and Asia (including India).

CONTRIBUTION OF NON-US SALES (% OF TOTAL SALES)



Source: Company/Motilal Oswal Securities

Ranbaxy has a strong FTF pipeline

Ranbaxy has about 20 FTF Para-IV filings targeting a total innovator market size of about US$25bn. The following table indicates the status of Ranbaxy's patent challenges:

RANBAXY PARA-IV PIPELINE

MOLECULE	BRAND	COMPANY	SALES $M	REMARKS	PATENT EXPIRY STATUS
Atorvastatin	Lipitor	Pfizer	8000	Para IV FTF filing. Ranbaxy lost in lower court but won on one patent in Appeals Court. Can launch in March 2010 with 180-day exclusivity	2006, 2009, 2010, 2011, 2013
Pioglitazone**	Actos	Takeda	1813	Para IV filing with shared exclusivity. Takeda sued generic players on 17-Oct-03 and a bench trial was held in Jan-06 for Mylan and Alphapharm. On 21-Feb-06, the court ruled that Takeda's basic patent was valid. A separate trial for Ranbaxy and other generics has not been scheduled	2011, 2016. NCE exclusivity expired in Jul-2004. Miscellaneous exclusivity regarding combination of Actos with Metformin or Insulin expires on 26-Nov-2006
Valacyclovir	Valtrex	GSK	1200	Para IV filing with FTF status on three GSK patents. GSK sued Ranbaxy on 09-May-03 for only the basic patent. It has not been sued for the other two patents. Ranbaxy received final US FDA approval for 500mg & 1gm dosage on 01-Feb-07. Launch status unknown. GSK filed for summary injunction within stipulated 45 days and hence as per the agreement between the two companies, Ranbaxy will not launch till the outcome of the patent litigation or the summary injunction (expected by Dec-07)	2009, 2016
Fenofibrate**	Tricor	Abbott	714	Para IV filing with possibility of shared exclusivity. No time-frame for court case. Final US FDA approval received on 01-Nov-2005. Innovator has shifted prescriptions to other dosage & hence the opportunity is lost	2009, 2018
Modafinil	Provigil	Cephalon	349	Para IV filing but has entered into out-of-court settlement with innovator	22-May-2007, 2014. Cephalon's ODE expired on 24-Dec-2005. It has applied for PED which will expire in Jun-2006
Sumatriptan	Imitrex	GSK	836	Para IV filing with FTF status. DRL is the authorized generic and can launch in 4QCY08	28-Jun-07 (incl.PED), 06-Feb-2009, 2012, 2016
Pravastatin 80mg	Pravachol	BMS	225	RLL claims FTF status on the 80mg dosage. Teva received exclusivity for 10, 20 & 40mg and launched on 25-Apr-06. Ranbaxy is yet awaiting approval for the 80mg on which it claims FTF. Approval delayed due to warning letter issued by the US FDA for Ranbaxy's Paonta Sahib facility	Apr-06
Valganciclovir HCl	Valcyte	Roche	200	RLL has para-IV filing with FTF status.Roche used RLL on 28-Apr-06 triggering 30-month stay period	28-Jul-2014

(CONTD...)

RANBAXY PARA-IV PIPELINE (CONTD...)

MOLECULE	BRAND	COMPANY	SALES $M	REMARKS	PATENT EXPIRY STATUS
Tamsulosin	Flomax	BMS	800	RLL has para-IV filing with FTF status. Astellas Pharma & others sued Ranbaxy on 13-May-05. Ranbaxy is claiming invalid ation due to double patenting. Ranbaxy lost in lower court on 26-Feb-07. It has appealed the ruling	27-Oct-2009
Esomeprazole Magnesium 20 & 40mg capsules	Nexium	AstraZeneca	3,125	Para IV FTF filing. AstraZeneca sued Ranb axy on 22-Nov-05 triggering the 30-month stay period	
Clarithromycin XL 500mg		Abbott	300	In preliminary injunction in Sep-05 for the 1g version, two of Abbott's patents were held to be likely invalid but Ranbaxy's product was found to be infringing on a third patent. Ranbaxy has filed an appeal brief in the US court of Appeals. However, 500mg version is the most important and Ranbaxy is awaiting final US FDA approval. Abbott has not yet filed for any preliminary injunction on the 500mg dosage but can do so after some of the generic companies receive final approval which can delay the product launch. Expect 1-2 more players besides Ranbaxy in the market. All generic players may have to prove non-infringement for a successful launch if Abbott goes in for litigation	
Ibuprofen + Pseudoephedrine	Advil	Wyeth, Scherer, Cardinal Health	small opportunity	Para IV filing. Innovators used Ranbaxy on 22-Apr-05	June-09
Loperamide HCl & Simethicone tablets	Imodium	McNeil	25	Para IV filing with FTF status. Received US FDA approval with 180-day exclusivity on 11-Sep-06. Drug launched in Oct-06	
Amlodipine + Atorvastatin	Caduet	Pfizer	370	Para IV filing with FTF status. Pfizer sued Ranbaxy on 09-Mar-07	Sep-07 (Amlodipine), 2010, 2013, 2015, 2017, 2018
Subtotal			17,957		
Other 7 Molecules			7,000		
Total			**24,957**		

** Possibility of shared exclusivity* *Source: Company/Motilal Oswal Securities*

While, the launch of these FTF products is uncertain and dependent on the favorable outcome of court cases, some of these opportunities are likely to be commercialized. Due to the uncertainty attached with such patent challenges, we have not included the upsides from them in our estimates. We would also like to point out that these FTF opportunities are likely to be short term in nature (lasting 180 days) and are unlikely to be sustained in the long term. We view them more as an opportunity for cash inflow into the company and hence are not including such upsides in our core estimates.

Full impact of acquisitions to reflect in CY07

Ranbaxy has made many acquisitions in CY06 – all targeted towards strengthening its European operations. Key acquisition includes Terapia (in Romania for US$324m), Allen

S.p.A (GSK's generic unit in Italy) Ethimed (in Belgium), Be-Tabs (South Africa) and Mundogen (GSK's generic unit in Spain). We believe that the total consideration for these acquisitions to be about US$430m. These inorganic initiatives are likely to add Rs7.9b and Rs9.6b to Ranbaxy's revenues and Rs3-4 to its EPS for CY07E and CY08E respectively.

The Terapia acquisition is the biggest in Ranbaxy's history

Ranbaxy acquired Terapia (Romania) for US$324m in CY06 at 3.3x CY06 sales and 10x CY06 EBITDA. While, we believe that the acquisition was expensive with a payback of 8-10 years, it significantly enhances Ranbaxy's positioning in the EU markets. Terapia is the sixth largest generic company in Romania. The acquisition makes Ranbaxy the largest generic company in Romania. Terapia had 157 marketing authorizations and has a pipeline of 60 new authorizations to be commercialized over the next three years. It is a fully integrated player with low-cost operations and two manufacturing facilities. It also has inhouse R&D and clinical trials capabilities.

Besides Romania, Terapia also sells its products to markets such as Russia, Ukraine and Poland. The acquisition will strengthen Ranbaxy's presence in these markets also.
Since Terapia is an integrated player and already enjoys high EBITDA margins (30% for CY07E), we do not expect any major manufacturing synergies for Ranbaxy. However, Terapia's product pipeline and geographical presence will strengthen Ranbaxy's position in Europe and Russia. Since Romania has become a part of the European Union (EU) w.e.f. 1 January 2007, Terapia's product pipeline can be leveraged to service the entire EU market.

Terapia's sales force has been doubled

Post acquisition, Ranbaxy has doubled Terapia's sales force to 300, which we believe is a positive indicator. Barring any significant price cuts announced by the government, we believe that Terapia will continue to enjoy about 25-30% EBITDA margins as: (1) most markets the company addresses are branded generic markets (enjoys better margins); and (2) owing to cost savings based on its backward integration. We have already forecast a 5% drop in EBITDA margins for CY08E in anticipation of any future price cuts.

TERAPIA – KEY FINANCIALS (US$ M)

	CY06	CY07E	CY08E
Sales	96.0	124.8	149.8
Effective Sales**	48.0	124.8	149.8
EBITDA Margin - assumed (%)	35.0	30.0	25.0
EBITDA	16.8	37.4	37.4
NPM - assumed (%)	25.0	22.0	20.0
Net Profit	12.0	27.5	30.0
Net Profit (Rs m)	534.0	1221.8	1332.9
Incremental Net Profit for Ranbaxy##	516.4	1181.5	1288.9
Incremental EPS for Ranbaxy (Rs)	1.3	3.1	3.3

*** - Acquisition contributed only for 6 months in CY06* *## - Ranbaxy holds 96.7% stake in Terapia*

Source: Company/Motilal Oswal Securities

We expect the Terapia acquisition to add about Rs3 per share to Ranbaxy's earnings for CY07E. We believe that the Allen, Ethimed, Be-Tabs and Mundogen acquisitions will be minuscule contributors to the company's bottomline, given their smaller sizes. The table below indicates the incremental benefit to Ranbaxy from these acquisitions:

RANBAXY SALES (RS M)

	CY07E	CY08E
Ranbaxy Sales	61,431	75,109
Acquisitions:		
Terapia (Romania)	5,554	6,664
Allen (Italy)	434	521
Ethimed (Belgium)	512	589
Mundogen (Spain)	459	574
Be-Tabs (South Africa)	1,001	1,335
Total Sales	**69,391**	**84,791**
Growth (%)	*15.2*	*22.2*
Ranbaxy Core EPS (Rs)	12.2	16.4
Incremental EPS:		
Terapia (Romania)	3.0	3.2
Allen (Italy)	0.1	0.1
Ethimed (Belgium)	0.1	0.1
Mundogen (Spain)	0.1	0.1
Be-Tabs (South Africa)	0.3	0.3
Total EPS (Rs)	**15.8**	**20.3**

Source: Motilal Oswal Securities

Has withdrawn from bidding for Merck Generics

Given its vast scale of operations and size, intense bidding was expected for Merck Generics from various generic companies including Teva, Actavis, Mylan, Ranbaxy as well as some large private equity investors. We believe that there is a high probability that the bidders are likely to outbid one another, and in the process, value Merck Generics at a significant premium. Media sources have indicated that Ranbaxy has withdrawn from the bidding process of Merck Generics due to expensive valuations. The company is yet to confirm this development. A successful bid would have entailed a significant equity dilution for Ranbaxy as the asking price would have been close to US$6b. **While the withdrawal from the bidding process does not have immediate financial implications for Ranbaxy, it is a sentiment booster since the overhang of equity dilution and acquiring expensive generic assets (with extended pay-backs) is now removed.**

Lipitor 180-day exclusivity upside will be significant

The US Federal Circuit Court has already ruled that Ranbaxy does not infringe Pfizer's Lipitor patent expiring in 2011 making Ranbaxy eligible for 180-day exclusivity post expiry of the 2010 patent. Although, we believe that it is too early to start discounting the Lipitor upsides for Ranbaxy, we believe that the upside would be significant for Ranbaxy:

LIPITOR: US OPPORTUNITY 180-DAY EXCLUSIVITY SENSITIVITY

(US$ M)	6-MONTHS
Brand Size (US $m)	**8,000**
No. of players – assumed	3.0
Price Erosion (%)	70.0
Ranbaxy Market Share (%)	60.0
Sales	720.0
PAT margin (%) – assumed	60.0
PAT	432.0
PAT (Rs m)	19,440.0
Incremental EPS (Rs)	**48.6**

Source: Company/Motilal Oswal Securities

Lipitor – mixed outcome on patent challenges

Ranbaxy has enjoyed limited success in its global patent challenge on Pfizer's Lipitor. Recently, the Canadian lower court awarded a mixed verdict regarding Ranbaxy's patent challenge on Pfizer's Lipitor in Canada (market size US$500m). The court ruled that while Ranbaxy infringes the '768 patent (expiring on 7 May 2007), the '546 patent, expiring in July 2010 was invalid. It has also ordered that the Canadian Health Ministry should not issue the Notice of Compliance (NOC) to Ranbaxy till the expiry of the '768 patent. Pfizer has decided to appeal against the ruling on the '546 patent.

The company has had similar experiences in various other countries, the most important being the US ruling. Ranbaxy has been successful in invalidating one of Pfizer's patents on Lipitor in the US in both the lower and the federal circuit courts. This ruling implies that Ranbaxy can launch its version of generic Lipitor in the US market in March 2010 with 180-day exclusivity.

LIPITOR: COUNTRYWISE PATENT CHALLENGE STATUS

S.NO	COUNTRY	MARKET SIZE (US$ M)	STATUS OF LITIGATION	REMARKS
1	USA	8000	Lower court ruled in Pfizer's favor on 16-Dec-05. RLL had appealed the decision. The Appeals Court ruled in favor of Pfizer for one patent and in favor of Ranbaxy for the other. Ranbaxy can launch in Mar-2010 with 180-day exclusivity	Ranbaxy can launch in Mar-2010 with 180-day exclusivity
2	Canada	800	Lower court ruled on 26-Jan-07 that Ranb axy infringes the '768 patent (substance patent expiring on 07-May-07). Pfizer's '546 patent (covering the calcium salt of Atorva statin) expiring in Jul-2010 was held invalid by the court. Other patents are under litigation. Outcome on these expected in 1HCY07. Ranbaxy's product approval will be held back till expiry of '768 patent.	

(CONTD...)

LIPITOR: COUNTRYWISE PATENT CHALLENGE STATUS (CONTD...)

S.NO	COUNTRY	MARKET SIZE (US$ M)	STATUS OF LITIGATION	REMARKS
3	United Kingdom	450	Lost one patent challenge and won the other at the lower court. Lower court ruled in Oct-06. Both Ranbaxy and Pfizer appealed in high court. UK Appeals Court ruled in favor of Pfizer delaying generic entry till 2011.	Ranbaxy entry delayed till 2011
4	Spain	300	The Mercantile Court of Barcelona No.2, ruled in favor of Lek Pharma (Sandoz) and Cinfa Labs in two separate rulings on 26-Sep-06. While the European Patent Office has ruled Pfizer's patents as valid, it is not considered as a legal judgment as only the courts are allowed to decide on these issues. Ranbaxy is currently awaiting ruling on its patent challenge with the Mercantile Court of Barcelona No.4	
5	Netherlands	140	Lost basic patent challenge ('633 patent) and the other patent challenge ('281 patent) in lower court on 13-Sep-06	
6	Norway	45	Lost one patent challenge and won the other at the lower court. Lower court ruling awarded on 10-Nov-05. The ruling will prevent Ranbaxy's entry till 2009 unless successfully appealed in the higher court. Also won patent challenge for two intermediates of Lipitor. Both parties have gone for appeal	Awaiting outcome of appeals process
7	Finland	40	Won in lower court. But court granted a preliminary injunction against Ranbaxy on 21-Feb-06.	Ranbaxy launched-at-risk on 12-Feb-07 without waiting for the outcome of the
8	Ireland	40	Status not known	preliminary injunction and had to
9	Denmark	30	Patent litigation pending. Pfizer requested for a pr eliminary injunction pending the outcome of the patent litigation. Preliminary injunction ruling granted in Feb-07 forcing Ranbaxy to withdraw its version from the market within a week of its launch	withdraw the product as the preliminary injunction was awarded in Pfizer's favor
10	Austria	27	Ranbaxy won in both lower and upper court. However, the Austrian Patent Office said on 17-Oct-06, that Ranbaxy infringes Pfizer's basic patent on Atorvastatin. Ranbaxy can appeal the ruling. The basic patent expires on 07-Nov-2011. Ranbaxy's response on this is not yet known	
11	Peru, Ecuador & Venezuela	N.A.	The Andean Court of Justice in Quito has ruled in favor of Pfizer. The court decision is not appealable	Ranbaxy entry delayed till final patent expiry
12	Australia	N.A.	Lower court ruled in Pfizer's favor on 20-Dec-06 and upheld Pfizer's substance patent preventing Ranbaxy's entry till 2012. However, the court ruled in favor of Ranbaxy for the other patent concerning the calcium salt of Atorvastatin. Both Pfizer and Ranbaxy can appeal in the higher court	
13	France	N.A.	Status not known	
14	Germany	N.A.	Status not known	
15	Italy	N.A.	Status not known	

Source: Company/Motilal Oswal Securities

Ranbaxy was recently forced to withdraw is generic version of Lipitor in Denmark as Pfizer was successful in getting a preliminary injunction issued in its favor. Ranbaxy had launched the generic version in the US$30m Denmark market without waiting for the outcome of the patent litigation (which is still pending). While this will not have any financial implications for Ranbaxy, it reflects the aggressiveness on the part of Pfizer to defend its Lipitor IPR across markets and even in smaller markets such as Denmark.

Pfizer files for re-issue of Lipitor '995 patent

Pfizer (USA) has filed for re-issue of one of its Lipitor patents ('995 patent) with the US PTO. This patent was invalidated by the US Appeals Court (in 2006) in the patent challenge filed by Ranbaxy. Pfizer has requested for a re-issue of the patent as it believes that this patent was invalidated due to a minor technical problem (details not disclosed) and hence has filed for a re-issue of the patent.

We believe that this is a part of Pfizer's strategy to defend its IPR rights on Lipitor. Ranbaxy is eligible for 180-day exclusivity on generic Lipitor wef Mar-2010 onwards as it has invalidated the '995 patent expiring in 2011.

Pfizer is trying to get the patent re-issued (after correcting the technical problems) and we expect it to again initiate the patent litigation for Lipitor based on the re-issued patent. If the '995 patent is re-issued by the US PTO, Pfizer may force Ranbaxy to prove its invalidation/ non-infringement claim all over again. However, since Ranbaxy is likely to launch it generic version in 2010, we believe that there is enough time for the US courts to give their ruling on the fresh patent litigation.

Worst case scenario will delay Ranbaxy's exclusivity by 15 months

If Ranbaxy loses the patent litigation on the re-issued patent, it will still be eligible for the 180-day exclusivity on Lipitor which will then commence in Jun-2011 as the company has already proven non-infringement/invalidation on other Lipitor patents expiring post-2011. Hence, in a worst case scenario, Ranbaxy's exclusivity will be delayed by about 15 months.

Torcetrapib failure – Lipitor extremely important for Pfizer

The failure of Torcetrapib in Phase-III clinical trials has made Lipitor an extremely important product for Pfizer. It was developing Torcetrapib as a substitute for Lipitor and was planning to shift Lipitor prescriptions to the new drug, as its Lipitor patents expire in various markets in 2010-2011. With the failure of Torcetrapib, Lipitor has become extremely important for Pfizer and hence we expect the company to adopt an aggressive stance to defend its Lipitor IPR. This implies that it may not be easy for Ranbaxy to launch generic Lipitor in many markets; and we can expect a protracted legal battle between the two parties in almost every market.

Manufacturing issues – need to be sorted out

Ohm facility: Recently, the US Federal officials conducted a search at Ranbaxy's Ohm facility (US) and offices, and seized various documents. The company has clarified that none of its employees has been arrested and that its US operations continue as normal. Ranbaxy's US sales (including Simvastatin) were US$392m in CY06 (~29% of total sales), of which around 25% of US sales would be from the Ohm plant. Any adverse finding from this investigation can have a significant impact on its US business. We await further clarity on this issue from the company/US FDA.

It must be noted that the search was conducted by the Office of Criminal Investigation (OCI) of the US FDA; it was not the normal US FDA inspection. This implies that it could be a serious issue for Ranbaxy. Although, both the parties are silent on the issue, we have listed below the conditions under which the OCI has conducted similar searches in past:

1. Withholding of information and providing false information to the US FDA
2. Adulteration of products leading to adverse side-effects
3. Theft of drugs
4. Conspiracy to distribute misbranded drugs
5. Unlawful distribution/dispensing of controlled substances
6. Trafficking in controlled substances
7. Selling counterfeit labels
8. Illegal sale of products
9. Kickbacks offered for generating prescriptions for drugs

While we are unaware of the exact reason for the OCI's search of Ranbaxy's US offices, it should be noted that, the USFDA has already approved three products from the Ohm facility post the search. This implies that the USFDA is not holding back product approvals from the Ohm facility.

Paonta Sahib facility: Ranbaxy's Paonta Sahib facility, which had received a warning from the US FDA in CY06, has recently undergone a repeat inspection by the US FDA. The company has indicated that the US FDA team did not issue any adverse remarks and hence is hopeful of receiving the final clearance from the US FDA in the short term. However, we do not rule out further delays, given the search conducted by the US FDA at the company's US facility.

US FDA issues gradually getting diluted

Despite the significant US FDA issues faced by the company, we view two main positives in this regard. 1) Ranbaxy has shifted the larger products (stuck due to the Paonta Sahib US FDA issues) to its US facility. With this shift, we believe that most of the large products have been shifted to the US facility making the Paonta Sahib US FDA issue relatively less important. The APIs from this facility are already US FDA approved with the problem confined only to the formulations manufacturing. 2) Already some products have been approved from the Ohm Labs facility in the US post the US FDA raids some months back. While it is difficult to analyse whether the two issues are interconnected, the grant of

approval implies that, as of now, Ranbaxy's US business is functioning normally. The company has indicated that they are awaiting US FDA response on the criminal investigation (which could take few more months).

Potential partnership for NCE/NDDS research to be positive

Ranbaxy is currently evaluating the option of de-risking its NCE/NDDS research by entering into tie-ups with external parties for partnering its NCE/NDDS research. Such a partnership could result in reducing Ranbaxy's R&D costs and mitigate the risks attached to NCE/NDDS research. We present below our sensitivity analysis related to such a potential partnership arrangement. We have assumed that Ranbaxy will be transferring its NCE/NDDS assets to the partnership venture while the partners are likely to fund the operations.

SENSITIVITY FOR POTENTIAL HIVE-OFF OF NCE/NDDS RESEARCH (RS M)

	CY07E	CY08E
Total R&D Exp	4,580	5,766
Generic R&D Exp (%) – assumed	75	75
NCE/NDDS R&D Exp (%) – assumed	25	25
NCE/NDDS R&D Exp	1,145	1,441
Reduction in R&D Exp due to NCE/NDDS hive-off	1,145	1,441
Tax adjustment for hive-off	309	389
Incremental PAT due to hive-off	836	1,052
Incremental EPS due to hive-off (Rs)	**2.1**	**2.6**

Source: Motilal Oswal Securities

It should be noted that our estimates do not factor in any potential de-risking arrangement for Ranbaxy's NCE/NDDS research.

NCE partnership with GSK should augur well in the long term

Ranbaxy has recently expanded its existing R&D agreement with GlaxoSmithKline (GSK), which enhances Ranbaxy's role in the drug development process for GSK. Under the original agreement, Ranbaxy's role in drug development was limited up to the pre-clinical stage. Under the new agreement, it will further advance the leads beyond pre-clinical stage to clinical proof of concept (i.e. up to Phase-IIa). Thereafter GSK will conduct further clinical development and take the products through the regulatory approval process to final commercialization.

Ranbaxy has indicated that, it could receive over US$100m in potential milestone payments (for all NCEs covered under the agreement), subject to a successful launch by GSK in multiple indications and up to double-digit royalties on worldwide net sales. Key milestones that could trigger payments to Ranbaxy, include completion of various stages of drug development, regulatory filings, final approval and commercialization of the NCE. Ranbaxy will retain the right to co-commercialize the products in India. The milestones and royalties will apply both to future NCEs and to the two ongoing programs that were commenced under the original agreement with GSK. The R&D efforts would be targeted for NCEs in the anti-infectives, metabolic, respiratory and oncology segments.

While we expect this development to be a long-term positive for Ranbaxy, we do not expect any immediate financial upsides. We believe that the first milestone payment could accrue in 2008. It should be noted that milestones will be spread over the next 4-5 years.

To maintain EBITDA margins in CY07E despite loss of Simvastatin exclusivity

The company has guided revenue growth of 15%+ and flat EBITDA margins at 16% for CY07E (despite loss of Simvastatin exclusivity with estimated EBITDA contribution of about US$45m for CY06). The company is likely to increase focus on non-regulated branded generic markets beginning CY07E as these markets command higher margins than some of the intensely competitive regulated markets. The company also indicated that a majority of its capex is already through and future capex is expected to be much lower (not quantified) than that in CY05-CY06.

CY07E-CY08E performance to improve

We expect Ranbaxy's CY07E-CY08E performance to be better, led mainly by:

1) More new product launches in regulated markets
2) Higher growth in Europe, LatAm and India
3) Cost control measures adopted by the company
4) Contribution from the recent acquisitions

It should be noted that the improvement will be visible despite the higher base effect of CY06 arising out of the Simvastatin 80mg exclusivity (this has added incremental EPS of Rs3.5/share to CY06 earnings).

TREND IN BUSINESS MIX (US$ M)

	2005	2006	2007(E)	2008(E)
Dosage Form				
India	238	275	308	339
Growth (%)	*9.7*	*15.5*	*12.0*	*10.0*
Europe, CIS and Africa	335	420	603	816
Growth (%)	*13.2*	*25.4*	*43.5*	*35.4*
Asia Pacific & Middle East	68	89	107	128
Growth (%)	*17.2*	*30.9*	*20.0*	*20.0*
Latin America	42	49	64	83
Growth (%)	*-12.5*	*16.7*	*30.0*	*30.0*
USA	333	392	341	401
Growth (%)	*-21.8*	*17.7*	*-13.1*	*17.6*
Total dosage	1,016	1,225	1,422	1,767
Growth (%)	*-2.8*	*20.6*	*16.1*	*24.2*
API	129	115	138	159
Growth (%)	*28*	*-11*	*20*	*15*
Allied business	33	0	0	0
Growth (%)	*0*	*-100*	*-100*	*-100*
Total Sales	**1,178**	**1,340**	**1,560**	**1,925**

Source: Company/Motilal Oswal Securities

Valuation and outlook

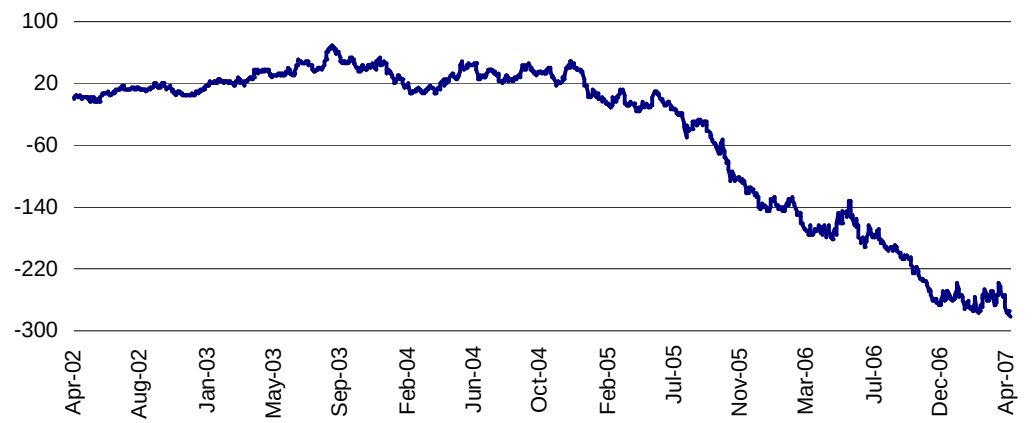
We believe that CY05-CY06 have been the worst years for Ranbaxy in recent years (except for successful launch of Simvastatin under exclusivity). It has witnessed various adverse developments such as:

1) Loss of Lipitor patent challenge in various markets leading to certain write-offs
2) Intensifying competition in the US resulting in significant drop in profitability
3) Higher R&D spend due to additional studies conducted for anti-AIDS drugs
4) Lack of any major new launches
5) Delay in product launches in the US due to US FDA related issues

Ranbaxy has underperformed the broader market significantly

Ranbaxy has underperformed the broader markets significantly over the past two years by almost 250%. Increasing price competition in the US coupled with significantly higher costs has resulted in the underperformance. The overall bearishness in the performance of the pharmaceutical sector over the past two years has also contributed to the decline in Ranbaxy's stock price.

RANBAXY RELATIVE PERFORMANCE (5 YEARS)



Generic pricing pressure, expensive acquisitions, discounted in current valuations

Ranbaxy's valuations are currently discounting 97% price erosion in the US for drugs going off patent. Since, we believe generic prices in the US are unlikely to decline significantly in forthcoming years; the current valuations already discount the worst scenario.

We believe that current valuations already discount the intense pricing pressure in the US and some European markets. Ranbaxy's Terapia acquisition was expensive (at about 4.1x sales and 11.6x EBITDA) as it was made under intense bidding pressure, leading to extended paybacks. We believe that valuations have already discounted these factors.

Valuations have corrected

The recent correction in Ranbaxy's stock price has resulted in valuations correcting to 21.8x CY07E and 16.9x CY08E earnings. Current valuations reflect both, the pressure on margins due to generic pricing as well as the US FDA issues which the company is

currently facing. P/E multiples are currently lower than their historic median P/E as shown in the table below:

CURRENT P/E LOWER THAN LAST 5-YEARS' MEDIAN P/E

COMPANY	CURRENT P/E		MEDIAN P/E
	FY08E/CY07E	FY09E/CY08E	(FOR LAST 5 YEARS)
Ranbaxy	21.8	16.9	23.7
Dr. Reddy's Labs**	20.1	17.4	23.6
Sun Pharma	24.7	20.2	37.9
Cipla	20.0	16.2	21.4

*** - Only FY01-04 considered due to extreme values for FY05/06* *Source: Motilal Oswal Securities*

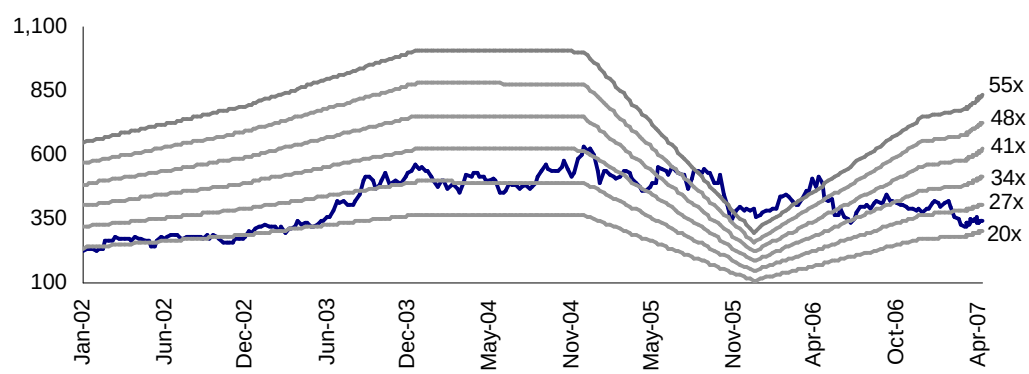
Recommendation

Current valuations for Ranbaxy reflect extreme pessimism led by intense generic pricing pressure and expensive acquisitions made in the past. The recent US FDA survey at Ranbaxy's US operations is also acting as an overhang on its valuations.

We believe that the worst is over for Ranbaxy and expect a gradual improvement in performance beginning CY07E. Higher number of patent expires (leading to more new launches) coupled with full benefits of the acquisition will be visible in CY07E. We believe that Ranbaxy's current stock price is not factoring in the potential leverage arising from a strong product pipeline and the incremental value which Ranbaxy could generate as a result of relevant acquisitions and potential hive-off of NCE/NDDS research. About 60% of the 76 ANDAs pending approval are likely to be commercialized in CY07-CY08. Current valuations at 21.8x CY07E and 16.9x CY08E earnings are already discounting the worst for Ranbaxy.

Although, the stock may not perform till the overhang of the US FDA issues is resolved, we believe that valuations do not capture the full potential of Ranbaxy's rich product pipeline. We believe that the company is reasonably valued at EV/Sales of 2.3x CY07E and 1.9x CY08E. Our estimates do not include any upside from potential patent challenges and NCE research. Aggressive bidding for generic assets and aggravation of US FDA (for Ranbaxy) issues remain the key risk to our positive stance on the sector. We reiterate **Buy** with a price target of Rs460.

RANBAXY P/E BAND



INCOME STATEMENT (RS MILLION)

Y/E DECEMBER	2004	2005	2006E	2007E	2008E
Net Sales	**52,351**	**50,974**	**60,213**	**69,391**	**84,791**
Change (%)	*17.5*	*-2.6*	*18.1*	*15.2*	*22.2*
Other Operating Income	1,870	1,796	1,124	1,234	1,450
Total Expenditure	44,407	49,659	51,907	59,303	71,982
EBITDA	**9,814**	**3,111**	**9,430**	**11,322**	**14,260**
Margin (%)	*18.1*	*5.9*	*15.4*	*16.0*	*16.5*
Depreciation	1,215	1,445	1,911	2,406	2,779
Int. and Forex loss	335	671	1,028	1,193	1,470
Other Income - Rec.	1,000	616	297	229	252
PBT & EO Expense	**9,264**	**1,612**	**6,788**	**7,952**	**10,263**
Change (%)	*-5.4*	*-82.6*	*321.2*	*17.1*	*29.1*
Extra Ordinary Expense	372	-333	-226	0	0
PBT after EO Exp.	**8,892**	**1,945**	**7,014**	**7,952**	**10,263**
Tax	1,881	-698	1,361	1,590	2,053
Tax Rate (%)	*21.2*	*-35.9*	*19.4*	*20.0*	*20.0*
Reported PAT	**7,011**	**2,642**	**5,653**	**6,362**	**8,210**
Minority Interest	26	26	53	60	80
Adj PAT after Minority Interest	**7,279**	**2,164**	**5,418**	**6,302**	**8,130**
Change (%)	*-0.7*	*-70.3*	*150.3*	*16.3*	*29.0*
Margin (%)	*13.9*	*4.2*	*9.0*	*9.1*	*9.6*

BALANCE SHEET (RS MILLION)

Y/E DECEMBER	2004	2005	2006E	2007E	2008E
Equity Share Capital	1,859	1,862	1,862	1,862	1,862
Fully Diluted Eq Cap	1,998	1,998	1,998	1,998	1,998
Reserves	23,140	22,503	25,130	28,341	32,486
Revaluation Reserves	107	105	105	105	105
Net Worth	**25,106**	**24,470**	**27,097**	**30,308**	**34,453**
Minority Interest	180	166	113	53	-27
Loans	8,527	20,043	39,461	40,461	40,461
Deferred liabilities	1072	-49	-49	-49	-49
Capital Employed	**34,885**	**44,629**	**66,622**	**70,773**	**74,838**
Gross Block	23,132	29,920	52,174	55,174	56,674
Less: Accum. Deprn.	7,838	9,329	11,240	13,646	16,425
Net Fixed Assets	**15,294**	**20,591**	**40,934**	**41,528**	**40,249**
Capital WIP	2,876	5,595	1,000	750	750
Investments	184	172	172	172	172
Curr. Assets	**34,921**	**33,279**	**45,894**	**52,011**	**60,393**
Inventory	14,351	13,624	15,507	17,870	21,837
Account Receivables	11,357	11,404	12,971	14,948	18,734
Cash and Bank Balance	1,339	2,430	7,819	8,133	6,308
Others	7,874	5,821	9,597	11,060	13,515
Curr. Liability & Prov.	**18,389**	**15,008**	**21,378**	**23,688**	**26,726**
Account Payables	12,144	10,600	11,878	13,688	16,726
Provisions	6,245	4,408	9,500	10,000	10,000
Net Current Assets	**16,532**	**18,271**	**24,516**	**28,323**	**33,667**
Appl. of Funds	**34,885**	**44,629**	**66,622**	**70,773**	**74,838**

E: MOSt Estimates

RATIOS

Y/E DECEMBER	2004	2005	2006E	2007E	2008E
Basic (Rs)					
EPS (Fully diluted)*	**18.2**	**5.4**	**13.6**	**15.8**	**20.3**
Cash EPS	21.3	9.0	18.3	21.8	27.3
BV/Share	67.2	65.4	72.5	81.1	92.2
DPS	8.5	8.5	6.1	7.4	9.6
Payout (%)	51.4	136.8	45.5	49.5	49.5
Valuation (x)					
P/E (Fully diluted)	18.8	63.4	25.3	21.8	16.9
PEG (x)		-0.9	0.2	1.3	0.6
Cash P/E		38.0	18.7	15.7	12.6
P/BV		5.2	4.7	4.2	3.7
EV/Sales		2.8	2.6	2.3	1.9
EV/EBITDA		46.7	16.9	14.1	11.4
Dividend Yield (%)		2.5	1.8	2.2	2.8
Return Ratios (%)					
RoE	29.1	8.9	20.1	20.9	23.7
RoCE	27.5	5.1	11.7	12.9	15.7
Working Capital Ratios					
Asset Turnover (x)	1.5	1.1	0.9	1.0	1.1
Working Capital (Days)	106	113	101	106	118
Leverage Ratio (x)					
Current Ratio	1.9	2.2	2.1	2.2	2.3
Debt/Equity	0.3	0.8	1.5	1.3	1.2

CASH FLOW STATEMENT (RS MILLION)

Y/E DECEMBER	2004	2005	2006E	2007E	2008E
Op. Profit/(Loss) before Tax	9,814	3,111	9,430	11,322	14,260
Interest/Dividends Recd.	1,000	616	297	229	252
Direct Taxes Paid	-1,752	-423	-1,361	-1,590	-2,053
(Inc)/Dec in WC	558	-648	-856	-3,494	-7,169
CF from Operations	**9,620**	**2,656**	**7,510**	**6,467**	**5,290**
EO Expense	372	-333	-226	0	0
CF from Oper. incl EO Exp.	**9,248**	**2,989**	**7,736**	**6,467**	**5,290**
(Inc)/Dec in FA	-8,342	-9,462	-17,658	-2,750	-1,500
(Pur)/Sale of Investments	-16	12	0	0	0
CF from Investments	**-8,358**	**-9,450**	**-17,658**	**-2,750**	**-1,500**
Issue of Shares	116	336	-452	0	0
(Inc)/Dec in Debt	2,691	11,501	19,366	940	-80
Interest Paid	-335	-671	-1,028	-1,193	-1,470
Dividend Paid	-3,603	-3,614	-2,574	-3,151	-4,065
CF from Fin. Activity	**-1,130**	**7,552**	**15,311**	**-3,404**	**-5,615**
Inc/Dec of Cash	**-240**	**1,091**	**5,389**	**313**	**-1,825**
Add: Beginning Balance	1,580	1,339	2,430	7,819	8,133
Closing Balance	**1,339**	**2,430**	**7,819**	**8,133**	**6,308**

Sun Pharmaceuticals

STOCK INFO.	BLOOMBERG
BSE Sensex: 13,928	SUNP IN
	REUTERS CODE
S&P CNX: 4,085	SUN.BO

23 April 2007

Buy

Previous Recommendation: Buy

Rs1,048

Y/E MARCH	2006	2007E	2008E	2009E
Sales (Rs m)	15,957	20,664	25,060	30,661
EBITDA (Rs m)	4,917	6,957	8,404	10,030
NP (Rs m)	5,733	7,364	8,788	10,750
EPS (Rs)	27.7	35.6	42.4	51.9
EPS Growth (%)	44.8	28.5	19.3	22.3
BV/Share (Rs)	85.5	117.8	142.7	189.8
P/E (x)	37.9	29.5	24.7	20.2
P/BV (x)	12.3	8.9	7.4	5.5
EV/EBITDA (x)	39.6	27.1	21.9	17.7
EV/Sales (x)	12.2	9.1	7.4	5.8
RoE (%)	42.1	39.0	36.3	34.8
RoCE (%)	19.1	22.0	23.7	24.7

KEY FINANCIALS	
Shares Outstanding (m)	185.7
Market Cap. (Rs b)	194.7
Market Cap. (US$ b)	4.7
Past 3 yrs. Sales Growth (%)	20.5
Past 3 yrs. NP Growth (%)	34.6
Dividend Payout (%)	18.4
Dividend Yield (%)	0.0

STOCK DATA	
52-Week Range	1,196/ 640
Major Shareholders (as of March 2007)	%
Promoters	68.3
Domestic Institutions	4.5
FIIs/FDIs	16.8
Others	10.5
Average Daily Turnover	
Volume ('000 shares)	244.7
Value (Rs million)	229.3
1/6/12 Month Rel. Performance (%)	-3/5/3
1/6/12 Month Abs. Performance (%)	1/15/20

US pipeline has been strengthened significantly: SPIL has 66 ANDAs pending approval with the US FDA and plans to file 30 more over the next 12.months. The company continues to have a pragmatic mix of normal, niche and patent challenge filings.

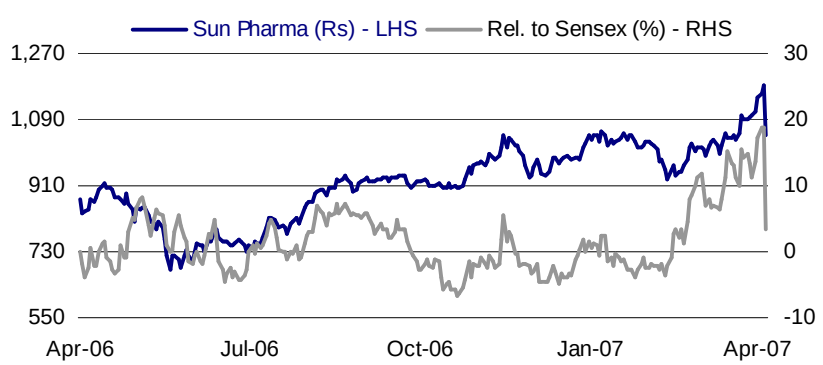
Valeant & Able Labs acquisitions to be leveraged FY09E onwards: With controlled substances and semi solid products targeted through these acquisitions which are currently contributing negatively to the bottom-line.

Conservative management style results in consistent performance: SPIL's conservatism is clearly visible in its acquisition stance, its US strategy and its R&D efforts. This has ensured consistent performance for the company over the past 5 years.

Demerger of NCE/NDDS research: We have valued SPIL's demerged R&D company at Rs50-65/share. The R&D pipeline currently includes 4 NCEs and about 12 NDDS products.

Valuation: While valuations at 24.7x FY08E and 20.2x FY09E appear rich, they do not fully reflect the expected ramp-up in US business, value-unlocking from R&D demerger and the value that SPIL could add by using its strong cash chest of US$450m. Valuations also do not factor in the leverage arising out of the Valeant and Able Labs acquisitions, as these are currently loss-making. Maintain **Buy** with a FY08 price target of Rs1,280 (excl. R&D).

STOCK PERFORMANCE (1 YEAR)



The key factors which will determine Sun Pharma's future valuations include:

1. Sustainability of growth and profitability for its domestic formulations business
2. Scale-up in its US business including some of the niche opportunities being targeted
3. Turnaround time lines and scale-up in operations of acquired companies, which currently are making minor losses
4. De-merger of the company's NCE/NDDS research

Sun Pharma enjoys top rankings in the domestic lifestyle segment …

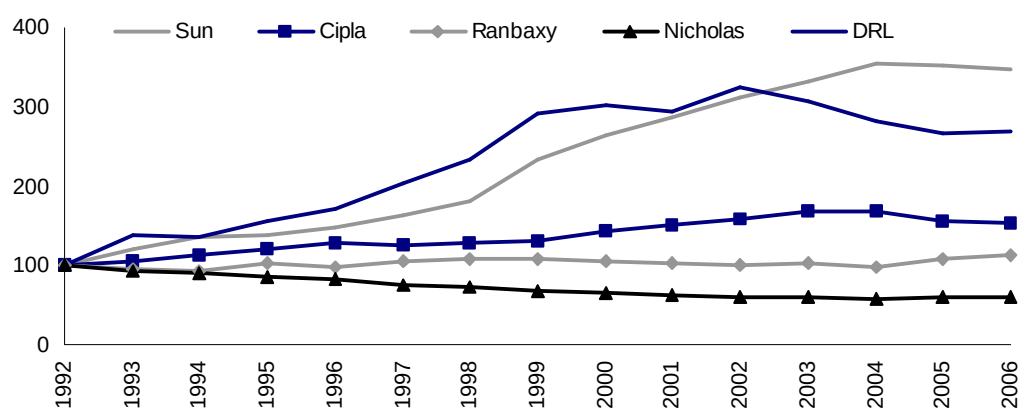
Sun Pharma enjoys top rankings in the lifestyle segment of the domestic formulations market (accounts for 52% of consolidated revenues). It enjoys strong brand equity in lifestyle segments such as psychiatry, neurology, cardiology, diabetology and gastroenterology. It currently enjoys the No.1 prescription ranking in all these segments, which account for about 72% of its total domestic formulation sales. The company improved its share in the domestic formulations market from 0.93% in 1992 to 3.2% currently. It expects this share to increase further to about 4% over the next two years.

TABLE: SUN PHARMA – THERAPEUTIC SEGMENT RANKINGS

THERAPEUTIC SEGMENT	RANKING		
	1998	FEB-06	OCT-06
Psychiatrists	1	1	1
Neurologists	1	1	1
Cardiologists	5	1	1
Ophthalmologists	NA	1	1
Diabetologists	6	1	1
Gastroenterologists	6	2	2
Orthopaedicians	31	2	1
Nephrologists	NA	4	4
Oncologists	20	4	4
Consultant Physicians	8	5	5
Chest Physicians	16	5	5

Source: Company

DOMESTIC MARKET - SUN PHARMA V/S PEERS MARKET SHARE (INDEXED TO 100)

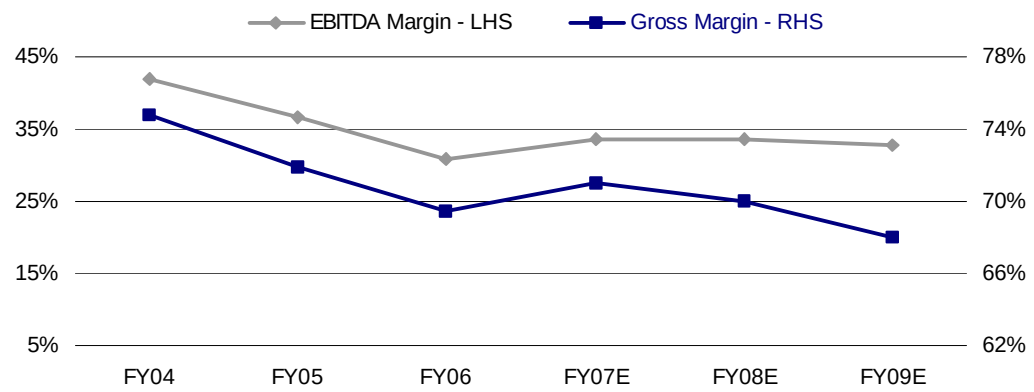


Source: Company

… making domestic formulations business highly profitable

We believe that the top positioning enjoyed by the company in the high-growth lifestyle segments has helped the company record higher margins for its domestic formulations business (GPM of about 70%). Sun Pharma has about 8 brands amongst India's largest selling prescription brands. The top 10 brands account for 23% of prescription sales in India, thereby reducing dependence on any single brand.

SUN PHARMA: MARGINS



Source: Company/Motilal Oswal Securities

Domestic market getting competitive: We expect the domestic market to get increasingly more competitive as, on one side there is intense competition in key therapeutic areas, and on other side, avenues for launching new products would decline in the long term due to the introduction of the product patent regime. We see an increasing competitive interest in chronic therapy areas, from large Indian companies and MNCs as well as regional companies. Increasing competition translates into higher promotional costs across the sector and would impact margins.

Although SPIL has an adequate number of interesting new products lined up for launch over the next few years (which are pre-1995 products), the pipeline may gradually dry out in the long-term as the company exhausts its pipeline of pre-1995 products. However, given SPIL's strong field force and expertise in generating prescriptions in the chronic therapy segments (which is the focus area for most companies); it may be an ideal candidate for in-licensing of products.

Expect double-digit growth for the domestic formulations portfolio

Given SPIL's strong positioning in the lifestyle segment, we expect double-digit growth in its domestic formulations portfolio. We believe that the company is likely to sustain its top rankings in its key therapeutic segments mainly due to the strong brand equity enjoyed by the company with specialist doctors. We expect 15% CAGR for SPIL's domestic formulations business over FY07-FY09.

DOMESTIC REVENUE BREAK-UP (RS M)

	FY04	FY05	FY06	FY07E	FY08E	FY09E	CAGR (%)
Domestic Formulation	5,778	6,800	9,596	11,323	13,022	14,975	15.0
Growth (%)	*0*	*18*	*41*	*18*	*15*	*15*	
Domestic Bulk (net)	960	908	815	937	1,031	1,134	
Growth (%)		*-5*	*-10*	*15*	*10*	*10*	
Others domestic (net)	-	8	3	13	15	18	
Growth (%)			*30*	*398*	*15*	*20*	
Total Domestic Sales	6,739	7,716	10,414	12,273	14,068	16,127	14.6
Growth (%)	*-1*	*15*	*35*	*18*	*15*	*15*	

Source: Company/Motilal Oswal Securities

US generics – the main focus area in regulated markets

SPIL has been gradually building up its presence in the US generic markets in the past decade. It acquired Caraco Pharma in the US in 1997 and has gradually raised its stake in the company to the current 64%. SPIL gained access to the front end in the US generic market through Caraco, as the latter had existing relationships with pharmaceutical wholesalers and distributors in the US. SPIL has adopted a dual strategy for the US:

1. Transfer products to Caraco, which would then sell them in the US market. This involved a compensation to SPIL (in the form of Caraco shares) for every product transferred thus helping SPIL to increase its stake in Caraco. The latter gained access to SPIL's product pipeline helping its turnaround. This arrangement involved a total of 25 products, most of which have already been transferred.
2. SPIL has recently entered into a new pure distribution agreement with Caraco wherein the latter would receive a distribution margin for SPIL's products.

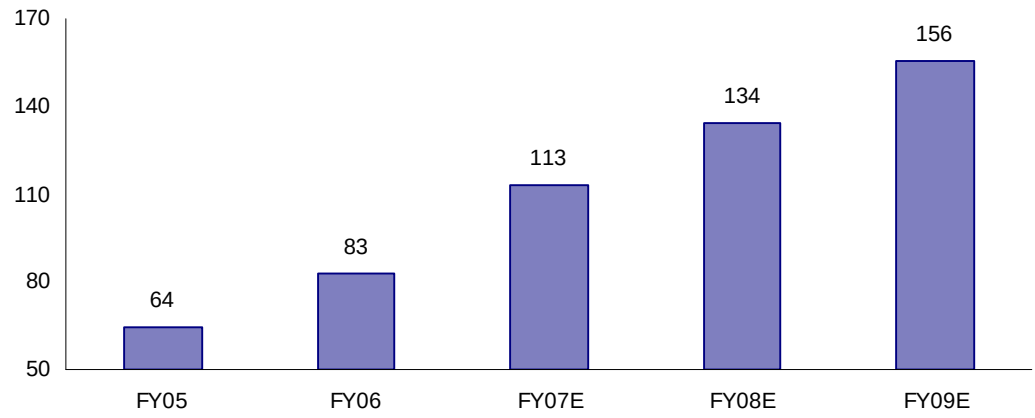
Generic pipeline being strengthened

SPIL (along with Caraco) has about 61 ANDAs pending US FDA approval. In FY07 it expects to file about 30 ANDAs including Caraco's filings with the US FDA (25 already filed for YTD December 2006). Management has in the past, indicated that the filings will be a mix of Para-III and Para-IV, but will not be skewed in favor of patent challenges. We expect SPIL's generic pipeline to acquire significant strength in the US market by end-FY07E with about 65-70 ANDAs pending US FDA approval.

Caraco guides for 30% sales growth in FY07E

Caraco reported strong 9MFY07 results with topline growth of 45% to US$84m and gross margins of 50.2% (improved by 160bp YoY), translating into EBITDA margins (before R&D cost-affiliate) of 33.8%, an improvement of 450bp YoY. During 9MFY07, Caraco filed 7 ANDAs with the US FDA taking the total pipeline to 19 ANDAs pending approval. Caraco has recently entered into a 3-year marketing agreement with Sun Pharma, through which it will purchase select products offered by Sun Pharma and will market and distribute the same as part of its own product offerings. The net sales for distributed products (under this new agreement) were US$1m while GPM on these sales was at 24%. Caraco's management retained its past guidance of 30% topline growth for FY07. We believe this guidance is conservative given that Caraco's topline has grown by about 45% YTD FY07.

TREND IN CARACO SALES (US$ M)



Source: Company/Motilal Oswal Securities

Competition for Ultracet yet to build up

Caraco had received favorable ruling in a summary motion from the US lower court for its patent challenge on Ultracet (Acetaminophen and Tramadol HCl) tablets. J&J is the innovator of this product, for which the patent expires in August 2011. At innovator prices, Ultracet commanded revenues of about US$330m-US$350m.

The US Appeals Court has recently upheld Caraco's non-infringement/invalidation claims regarding certain patents on Ortho Mcneil's Ultracet. Caraco has already launched generic Ultracet (in Decemeber 2005) and the US Appeals Court verdict vindicates its launch-at-risk stance on the product. The only patent now remaining in contention is the re-issued patent listed by the innovator in 2006 on which, all generic companies will have to prove non-infringement.

US-based Par Pharma was eligible for 180-day exclusivity on the product and had launched the generic version in April 2005. Its exclusivity expired in October 2005. Ivax has launched an authorized generic for the product along with Par Pharma. Hence, the market currently has two generic players. Teva has also filed a patent challenge on this drug and is awaiting a court ruling. However, Teva may or may not go ahead with the litigation since it already has a presence in the market through Ivax (now taken over by Teva). Teva is expected to garner a major share of the market, given its dominant presence and distribution strengths.

Caraco launched generic Ultracet (it was a launch-at-risk at that time) in December 2005. Despite receiving US FDA approval, Barr Labs is yet to launch its version of Ultracet. Although Barr has not officially commented on its strategy for generic Ultracet, we believe that it has not launched its generic version, as it may be facing some supply issues and is yet to get a favorable summary motion ruling from the US courts. We expect Caraco to generate about US$12m in sales from generic Ultracet for FY07E.

Dependence on patent challenges is not very high

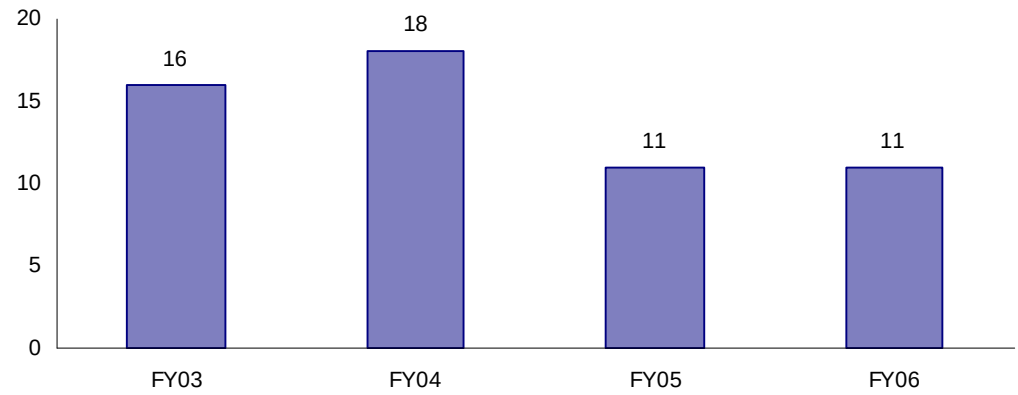
SPIL (along with Caraco) has adopted a judicious mix of normal generics, niche opportunities and patent challenges. Unlike, some of the other generic players, SPIL is not overly dependent on patent challenges although it has some Para-IV filings. Some interesting Para-IV opportunities have been discussed below:

1. **Escitalopram:** Caraco has filed Para IV filing on Forest Lab's US$1.9b Lexapro (Generic - Escitalopram), challenging Forest's '712 patent which is expiring in September 2011. Subsequently in July 2006, Forest has sued Caraco for patent infringement. Earlier, Forest had filed two lawsuits against Alphapharm and Ivax. While Forest entered into an out-of-court settlement with Alphapharm, it successfully upheld its patent case against Ivax. The latter has currently appealed in the lower court ruling.
2. **Repaglinide:** Caraco has a Para IV FTF filing on Novo Nordisk's Paradin (Generic – Repaglinide), for treatment of type II diabetes. Caraco is challenging Novo's '358 patent which is expiring in June 2018. If Caraco prevails in its challenge, then the earliest it can launch would be by March 2009.
3. **Clarinex:** Schering sued SPIL and Caraco in October 2006, for infringing the '274 patent (expiring in July 2019). The Para-IV ANDA for this product was filed by SPIL. We believe that the litigation for this product will be a long drawn process and will take about two more years to resolve.
4. **Pantoprazole:** SPIL filed a patent challenge on Pantoprazole (Altana's US$2b Protonix brand). Its US patents expire in 2010. Teva has also filed a patent challenge (before Sun Pharma) and its 30-month stay period expires in August 2007. SPIL's 30-month stay period is expected to expire after Teva.
5. **Amifostine:** The U.S. District Court (in January 2007) has rejected SPIL's summary motion to end the patent infringement action regarding its Para-IV filing for generic Ethyol (Amifostine). MedImmune Oncology (the innovator) initially filed a suit against SPIL in August-2004. Ethyol is used to reduce mouth ulcers and other side effects of certain types of chemotherapy. Ethyol generated sales of about US$93m for 12 months ended September 2006. The District Court denied SPIL's motion for summary judgment of non-infringement of MedImmune's '731 patent. At the same time, it granted SPIL's motion for summary judgment regarding the '471 patent. Both the patents expire in 2012. The ruling implies that the patent litigation will now have to go through the lengthy patent discovery process (which is likely to take at least 24 months). A successful summary motion on both the patents would have given SPIL the opportunity to launch-at-risk.
6. **Rivastigmine:** Rivastigmine is Novartis' US$216m Exelon brand with US patent expiry in August 2007 and 2014. The litigation for this is currently at a discovery stage.
7. **Gemcitabine:** SPIL has filed the patent challenge on Gemcitabine (Eli Lilly's US$600m Gemzar) with US patent expiry in 2010. Eli Lilly sued SPIL in Dec ember 2006 triggering the 30-month stay period. Sicor (Teva's subsidiary) has also filed a patent challenge, but before SPIL. We believe that it will take another two years for this patent litigation to be resolved.

Differentiated products being developed to counter price competition

SPIL is in the process of developing a differentiated product pipeline for the regulated markets. It has already launched many products in the domestic formulations market, which offer a delivery advantage over existing therapies. The chart below indicates SPIL's differentiated product portfolio in the domestic market (we believe that some of these products will also be launched in the regulated generic markets):

SUN PHARMA: NDDS PRODUCT PORTFOLIO FOR DOMESTIC MARKET



Source: Company/Motilal Oswal Securities

An example of this NDDS pipeline being leveraged for the regulated markets lies in the effort to exploit the global Leuprolide Depot market (global sales of US$1.6b). We believe that this is a difficult product to manufacture, as the technology to deliver the medicine in a specially designed microsphere-based delivery system is not easy to develop. However, it should be noted that the regulatory authorities may mandate conducting limited clinical trials to prove bio-equivalence for some of these NDDS products, which could escalate the costs as well as delay final approvals for the generic players. This implies that for some of these products, the generic competition may not be as intense as for a normal generic, thus leading to better profitability for the manufacturers of such products.

Evaluating partnership route for European regulated markets

Unlike the US market, we do not expect SPIL to establish a front-end across European markets. The company is likely to focus more on the partnership route to exploit these markets. The acquisition of Valeant Pharma's Hungary facility will help the company cater to the API requirements for both its European and US initiatives. The company is evaluating the partnership route for the European regulated markets. It, however, is yet to make any concrete announcements in this direction.

Revenues from semi-regulated markets to record 45% CAGR

SPIL markets its products in 26 semi-regulated markets across South East Asia, Russia, China, Middle East and Africa. It has commenced operations in Latin American markets like Brazil, Mexico, Peru and Columbia. The company has a sales force of about 300

people which promote its products in these markets. It also sells products through representatives in some of these markets. In all, at this point in time, 740 products are being marketed in these countries, with another 350 products under registration. Since, most of these are branded generic markets; we believe that SPIL enjoys relatively higher profitability (GPM of about 70%) in these markets compared with the regulated markets. We expect Sun Pharma to record ~45% revenue CAGR in these markets over FY07-09.

Conservative acquisition stance – topline addition not the criteria

Sun Pharma has, until date, followed a strictly conservative acquisition strategy by focusing on access to manufacturing facilities (with critical technologies in some cases) and strengthening its branded formulations portfolio, rather than focusing on just adding to the topline. We believe that some of the acquisitions in India have also resulted in tax benefits for the company.

SUN PHARMA – ACQUISITION HISTORY

COMPANY	FACILITY/ PRODUCTS	COST (US$M)	DATE	REMARKS
Knoll Pharma	API Plant	2-3	FY96	Access to mgf facility
Gujarat Lyka	API facility at Ankleshwar (India)	N.A.	FY96	Access to mgf facility
MJ Pharma	Formulations facility	N.A.	Nov-96	Access to mgf facility
TDPL	API & formulation units + Gynaecology & Oncology brands	N.A.	Apr-97	Access to mgf facility & strengthening of domestic formulations portfolio
Caraco	Detroit formulations facility	52	Aug-97	Front-end in US
Natco Pharma	Respiratory brands	N.A.	FY99	Strengthening domestic formulations portfolio
Milmet Labs	Ophthalmology brands	1-2	Nov-99	Access to Ophthalmology portfolio with annual sales of Rs100m
Pradeep Drugs	API facility at Chennai (India)	N.A.	Apr-00	Access to mgf facility
Phlox Pharma	API facility in Baroda (India)	N.A.	Jul-04	Access to Cephalosporin API facility
	3 brands in US	5.4	Sep-04	Entry into branded business in US. Brands had annual sales of $7.6m
Valeant Pharma	API & formulation unit in Hungary	10	Aug-05	Access to facility for mfg controlled substance APIs
Valeant Pharma	Formulations facility in Ohio (USA)		Sep-05	Access to facility for mfg lotions, ointments & liquids
Able Labs	Formulations facility in NJ (USA) & IP	23	Dec-05	Access to facility for mfg controlled substance formulations
Total		**125**		

Note- Acquisition costs are approximate *Source: Company/Motilal Oswal Securities*

Valeant & Able Labs acquisitions to be leveraged FY09E onward

We believe that product filings are likely to pick up out of the acquired Valeant facility (situated at Ohio, USA). This facility gives SPIL the capability to manufacture liquids and semi-solids. It is pertinent to note that Caraco does not have such capabilities and that it

would have been economically uncompetitive for SPIL to transport such products from India to the USA. The acquisition of Valeant's Hungary facility is expected to help SPIL in filings for the European markets and also gives it access to manufacturing of controlled substances.

SPIL had also acquired the assets of US-based Able Laboratories Ltd. for US$23.15m. Able Labs had filed for bankruptcy as per US regulations and had invited bids for its assets. SPIL will be acquiring the manufacturing facilities of Able Labs through this acquisition. The purchase also includes a lease for Able's premises in New Jersey, some contracts and purchase of another property in New Jersey. Able Labs had faced problems with US FDA compliance in the past and had to recall all of its 30 products from the US market. In August 2005, the US FDA denied Able's proposal that it be permitted to revalidate its data and re-launch its product line without full US FDA review.

Able was in the process of transferring its manufacturing lines to a new 225,000 sq. ft. facility from its old 50,000 sq. ft. plant. We believe that this new facility will be utilized by SPIL to launch its own products in the US generics market. SPIL will also have the option to re-launch Able's products after rectifying the deficiencies identified by the US FDA. Able Labs had generated sales of about US$100m from its generic portfolio in 2004 (value of this portfolio would have reduced significantly due to competitive forces). We, however, do not have details on Able's product portfolio and hence are not aware about any possible overlaps with SPIL's existing portfolio.

We believe that SPIL is cautiously acquiring generic assets (with specific focus on distressed assets). This is evident from SPIL's recent acquisitions of Valeant Pharma's facilities in Hungary and USA (cost: about US$10m). The acquisition of Able Labs'. assets is also a step in this direction. With this acquisition, SPIL has, till date, spent about US$30-US$40m of the US$350m raised via the FCCB route some time ago. Unlike its other generic peers, SPIL is looking at acquiring assets with reasonable valuations and hence has targeted distress sellers in the past. In fact, SPIL's acquisitions in India have also been along similar lines.

While we do not expect any immediate financial benefits to SPIL from the acquisition of Able Lab's facilities (since it will have to rectify the deficiencies identified by the US FDA), we believe that it will be long-term positive for the company going by SPIL's past track record of acquisitions. SPIL is currently in the process of re-filing some of the products of Able Labs. with the US FDA and we expect these products to start contributing to SPIL's revenues from FY09E onwards.

Acquisitions to adversely impact FY07 consolidated earnings

All the acquisitions made by Sun Pharma in the past 12 months have been for distressed assets. While these acquisitions will have positive implications for the company in the long term, we believe they are likely to drag down consolidated earnings in FY07. SPIL has

indicated a timeline of at least 18 months for effecting a turnaround at these units. Our estimates have been accordingly adjusted to take into account the impact of these acquisitions.

De-merger of NCE & NDDS research activities to de-risk existing business

SPIL has proposed a de-merger of its NCE/NDDS research into a separate company in order to de-risk the existing business. Key highlights of the de-merger include:

1. NCE & NDDS research activities would be de-merged into a separate company. These activities are likely to involve R&D expenditure of Rs700m-Rs800m in FY07E, which will now be incurred in the new R&D company.
2. SPIL will transfer cash of Rs2b and other assets of Rs550m to the new R&D company. The cash will enable the company to sustain its operations for the next two years. SPIL's book value will reduce accordingly. About 120-140 employees (including 100 scientists) will also be transferred to the new R&D company. The de-merger would be effective from 1 April 2006. The new R&D company will be listed separately on the stock exchanges by March 2007.
3. All IPRs related to the NCE/NDDS projects will also be transferred to the new R&D company. SPIL will not have any first-right of refusal on the IPRs or geographical licenses related to these products. Since NDDS products have also been transferred to the new R&D company, SPIL is unlikely to launch branded products in regulated markets on its own.
4. New R&D company may not have any revenues for the next two years until the NCE/NDDS are out-licensed or commercialized. However, it is likely to earn interest income on the unutilized portion of Rs2b cash transferred by SPIL.

Impact of de-merger of NCE & NDDS research

We believe that the de-merger will de-risk SPIL's current operations from the uncertainties related to innovative R&D activities. It will also help SPIL to de-risk its existing business from the high R&D expenses, which the company is likely to incur whilst conducting clinical trials. We believe that the de-merger will result in:

- Savings in R&D costs related to NCE/NDDS research (approx. Rs700m-Rs800m p.a.).
- Reduction in other income due to transfer of Rs2.0b cash to the new R&D company.
- Reduction in SPIL's book value to reflect transfer of assets worth Rs2.55b (including cash) to the new R&D company.

Valuation of R&D company at Rs50-65 per share

SPIL is currently working on 4 NCEs & 12 NDDS products which are at various stages of development. Its R&D strategy again highlights the conservative, low-risk approach towards business which it has also been following for its existing businesses. Its main focus seems to work on known molecules but which can offer better efficacy/side effect profile over existing drugs. We believe that this is likely to minimize the probability of

failure significantly. The demerger of Sun Pharma's R&D business into a seperate entity (christened Sun Pharma Advanced Research Centre) is a step towards de-risking SPIL's existing business from the R&D risks.

Estimated R&D spend in the new company will be about US$60-75m spread over the next three years. The US$45m cash will enable the company to sustain its operations for the next two years. It expects to start generating some revenues from 2009 onwards post the launch of some of its NDDS products. Out-licensing income is likely to be the other source of revenue for the new company. For instance, a similar drug to SPIL's Sun-44 NCE was out-licensed by its developer (Xenoport Inc) to GSK & Astellas separately for up-front payment of about US$100m. The new R&D company is expected to enjoy 3-year exclusivity on some of its NDDS dosage forms in the US, subject to a successful launch (some of these may involve patent litigations).

We are in the process of estimating the value for the new R&D company. We believe that Xenoport Inc.'s NCE research is partly similar to that of SPIL (both are targeting improvement in existing molecules through prodruct research). However, Xenoport does not have a NDDS pipeline (where revenue streams are more predictable) as compared to SPIL's pipeline of about 12 NDDS projects. On the other hand, Xenoport has successfully out-licensed one of its NCE to GSK & Astellas which has boosted its valuations. Xenoport is currently valued at 5x cash and 8x annual expenses for CY06. Our preliminary valuations at 7x cash and 10x annual expenses imply that SPIL's NCE & NDDS pipeline will be valued at about US$225-315m (Rs50-65/share). Our estimates do not include upsides from any potential out-licensing agreement.

NCE PIPELINE AS ON MAR-07

NCE	INDICATION	DOSAGE	CURRENT STATUS	EFFICACY	SIDE EFFECTS PROFILE	REMARKS
Sun-1334H	Anti-allergy (selective H-1 receptor anta gonist)	Oral, once -a-day	Currently in Phase-II trials in US. Phase I trials completed in India & Europe.Phase-III trials to begin in 2008	Comparable to existing drugs	Non-sedating, no cardio toxicity	USP - lower side effects with same efficacy. Competition-Sanofi developing Levocetrizine with planned launch in 2009. Global market for anti-allergy products estimated at $5.5b. Will need significant investments in studies to prove superiority over existing drugs.
Sun-461 (Glucocorticoid receptor agonist)	Asthma, COPD	Inhaler	Currently undergoing pre -clinical studies. IND filing expected in 2008	Comparable to existing drugs	Reduced systemic side effects due to inactivation in plasma	USP - lower side effects with same efficacy. Global market for Asthma/ COPD products estimated at US$8b.

CONTD...

NCE PIPELINE AS ON MAR-07 CONTD...

NCE	INDICATION	DOSAGE	CURRENT STATUS	EFFICACY	SIDE EFFECTS PROFILE	REMARKS
Sun-44	Gabapentin prodrug for Seizure/ CNS related disorders	Oral, once-a-day	Currently undergoing pre-clinical studies. IND filing expected in 2008. Will directly move to Phase-III (in 2009) after completing Phase-I trials	Better than existing drug	N.A.	USP - higher bioavailability, enhanced absorption and reduced dosing frequency. Competition - Xenoport (USA) developing similar drug which is currently in Phase-III trials. SPIL's version has better toxicity profile than that of Xenoport. GSK & Astellas recently paid Xenoport US$100m for in-licensing this drug.
Sun-09	Prodrug of muscle relaxant	Oral / Injectable	Currently undergoing pre-clinical studies. IND filing expected in 2008. Will directly move to Phase-III (in 2009) after completing Phase-I trials	Better than existing drug		USP - Higher drug absorption than existing drugs. Global market estimated at $200m as all existing products are generic

NDDS PIPELINE AS ON MAR-07

NCE	INDICATION	DOSAGE	CURRENT STATUS	EFFICACY	SIDE EFFECTS PROFILE	REMARKS
Dry Powder Inhalers - Combination of a steroid & bronch-odilator	Asthma/ COPD	Inhaler	Clinical trials in 2007. Launch in semi-regulated markets targeted in 2009. NDA filing in regulated markets targeted in 2011	N.A.	N.A.	USP - Better dosing & convenience for patients. Global market estimated at US$8b.
GRIS Baclofen	Muscle relaxant	Oral, once-a-day	IND filing in US in 2007. Already approved in India	Comparable to existing drugs	Reduced sedation	USP - Longer retention in stomach using multi-layer coating. Can be used for different types of relaese profiles
Wrap Matrix System	Suitable for highly soluble and high dosage drugs	Oral, once-a-day	Few ANDAs for controld. release dosage form filed with US FDA. MetoprololXL based on this technology already approved in India	Relatively smaller size of dosage form required for same efficacy	Lower than existing normal drugs	USP - Reduces side effects & requires smaller size of dosage. Can be used for different types of relaese profiles. SPIL is working on about 5-6 products using this technology
Nanoem--ulsion	Oncology		Currently at pre-clinical stage	More drug can be delivered at the target	Lower than existing normal drugs	USP - Reduces side effects & avoids toxic excipients. SPIL is working on 2 products using this technology
Biodegradable implants /injections	GnRH analogue for inducing ovulation	Injection	Currently at pre-clinical stage. Clinical trials in India expected in 2008. Will be a 505b(2) filing in the US	Comparable to existing drugs	N.A.	USP - Less painful, easy to use and does not need local anaesthesia
	Somatostatin analogue		Currently undergoing Phase-I trials in India	Comparable to existing drugs	N.A.	USP - Easy to use
Tobra + Dexa Ophthalmic Solution	Anti-infective used post cataract surgery	Eye Drops	Completed Pre-IND meeting with USFDA. IND filing in 2007	Comparable to existing drugs	N.A.	USP - clear solution as compared to existing drugs which are suspensions. US $150m market in the US

GRIS: Gastro Retentive Innovative System

Source: Company/Motilal Oswal Securities

Manufacturing facilities well positioned to leverage future opportunities: Recent acquisitions and timely capex have strengthened SPIL's ability to compete in interesting new opportunities in both API and formulation segments. SPIL now has 16 plants (7 APIs and 9 formulation plants). Of the 7 API plants, 2 of them already hold USFDA and European approvals. While the Hungarian facility is approved for Europe, SPIL is planning for USFDA approval as well. In formulation segment, of the 9 plants, 4 plants (1 in India and 3 in US) have been USFDA approved. During FY07, its Halol plant received approvals for injectibles and nasal sprays, apart from the earlier approval for its tablet facility. Also, SPIL is preparing its Dadra site for submission for regulated markets this year.

Best positioned to undertake large acquisitions

SPIL has US$500m of cash on its balance sheet (including FCCB funds). We believe the company may be looking at expanding its presence in the US generics market through an acquisition to be funded by the FCCB. Sun Pharma is likely to follow a conservative policy for acquisitions in regulated markets. It has recently acquired Able Pharma and the facilities of Valeant Pharma in the US and Hungary. It has until date spent about US$40m-US$50m to acquire these assets. These acquisitions reflect the characteristic SPIL policy of acquiring loss-making units and effecting a turnaround.

This may depress return ratios in the short term (as the benefits of acquisition will accrue over a period of time). Delay in deploying the excess cash may also have an adverse impact on these ratios in the short term. However, we believe that expanding its presence in the regulated markets is imperative for SPIL in order to gain critical mass in the regulated markets. We also draw comfort from the company's past successes in acquiring other players.

Lower taxes also help the company to boost bottomline

Due to various tax covers and exemptions available to the company, SPIL's overall tax rate has been negligible (about 4-5%). The company is confident that it will be able to keep the tax rate at these low levels for the coming years as well. A major portion of its domestic formulations are manufactured at the J&K facility (which has been floated as a partnership firm in which SPIL holds 96% stake), resulting in significant savings in income tax. These facilities also enjoy exemptions from payment of excise duty and sales tax. These benefits are helping the company boost the bottomline.

Our estimates factor in 22% CAGR (FY07E-09E) in revenues driven by 28% CAGR in international business and 15% CAGR in domestic revenues. However, with EBITDA margins are likely to be stable at 32-33%, while PAT is expected to record 21% CAGR.

TREND IN BUSINESS MIX

	FY05	FY06	FY07E	FY08E	FY09E
Domestic					
Domestic Formulation	6,800	9,596	11,323	13,022	14,975
Growth (%)	17.7	41.1	18.0	15.0	15.0
Domestic Bulk	917	818	950	1,046	1,152
Growth (%)	-5.4	-10.8	16.2	10.1	10.1
Total Domestic Sales	**7,716**	**10,414**	**12,273**	**14,068**	**16,127**
Growth (%)	*14.5*	*35.0*	*17.9*	*14.6*	*14.6*
Exports					
Formulations					
Caraco	*2,795*	*3,601*	*5,141*	*6,053*	*6,943*
Growth (%)	*22.0*	*28.9*	*42.8*	*17.7*	*14.7*
Export (excl Caraco)	*886*	*1,435*	*2,224*	*3,113*	*4,670*
Growth (%)	53.2	45.4	62.0	55.0	40.0
Total Export Formulations	**3,681**	**5,036**	**7,365**	**9,166**	**11,613**
Export Bulk (Net)	1,347	1,922	2,551	3,444	4,649
Growth (%)	*39.9*	*42.7*	*32.7*	*35.0*	*35.0*
Total exports	**5,027**	**6,958**	**9,916**	**12,610**	**16,261**
Growth (%)	*30.1*	*38.4*	*42.5*	*27.2*	*29.0*
Total Gross Sales	**12,744**	**17,372**	**22,190**	**26,678**	**32,388**
Growth (%)	*20.2*	*36.3*	*27.7*	*20.2*	*21.4*

Source: Company/Motilal Oswal Securities

Valuation and outlook

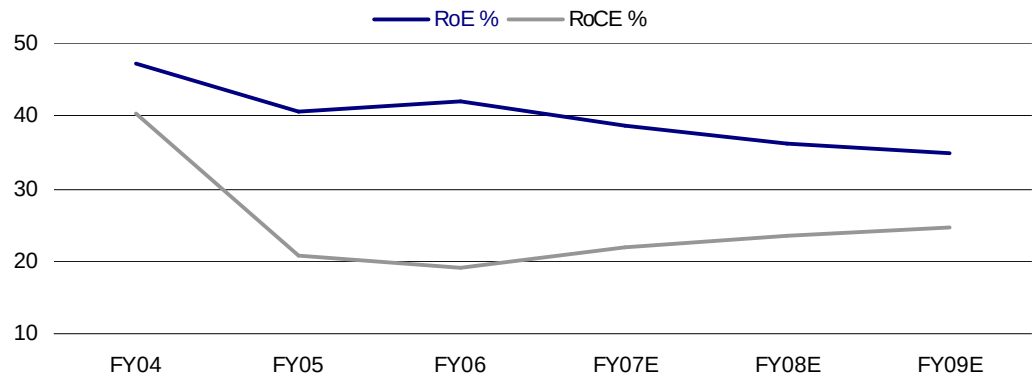
An expanding generic portfolio coupled with change in product mix in favor of high-margin exports (particularly the semi-regulated markets) is likely to bring in long-term benefits for SPIL. As investors start focusing on SPIL's generics business, concerns about a slowdown in the company's domestic formulations business (due to the patent regime) are already being discounted.

SPIL's ability to sustain high growth rates at superior margins even on a high base is a clear positive. With the domestic business progressing well and increasing traction on the US front (both in Caraco and from India), the possibility of a rapid scale-up over the next couple of years is high.

Consistent value generator

SPIL has been consistently generating value for its investors led by its highly profitable domestic formulations business as well as ramp-up in exports to semi-regulated markets. A conservative approach towards regulated generic markets and the ability to generate value out of loss-making acquisitions has also augured well for the company.

TREND IN RETURN RATIO



Source: Company/ Motilal Oswal Securities

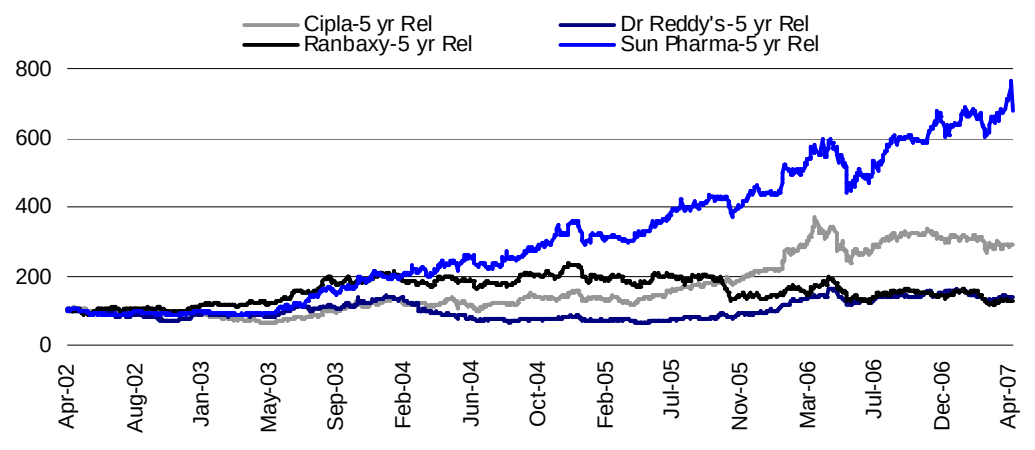
Best placed for value-added M&As

We believe that SPIL is best placed to undertake value-added acquisitions as it has a strong cash position of about US$450m on its books. We believe that SPIL is better placed than most other generic companies since any potentially large acquisition will imply significant equity dilution for the other generic companies. However, it is unlikely that SPIL will be acquiring generic assets in a hurry, given their expensive valuations.

Significant outperformance against peers

SPIL's stock price has significantly outperformed its peers such as Ranbaxy, DRL and Cipla in the last five years. We believe that SPIL's ability to consistently generate high-margin growth coupled with management's conservative stance on inorganic growth has helped it deliver such outperformance. We believe that the company will be able to sustain its profitable growth in the future as well.

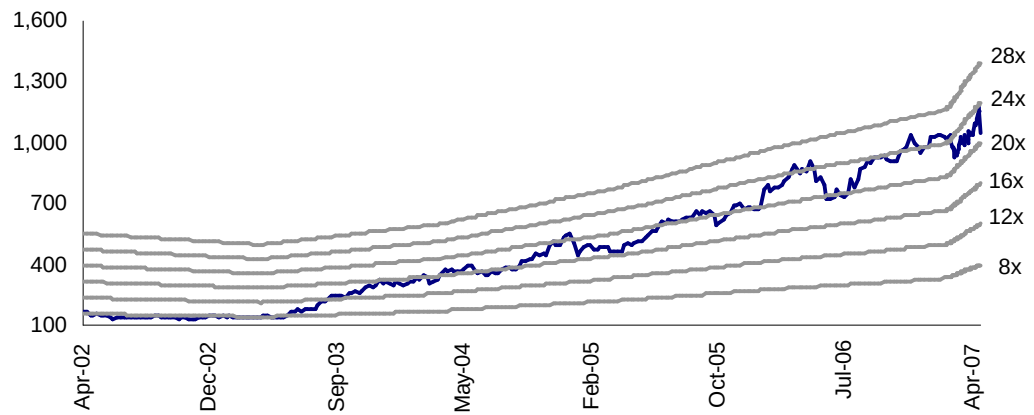
SUN PHARMA: RELATIVE TO PEERS



SUN PHARMA: RELATIVE TO BSE SENSEX (5 YEARS)

While valuations at 24.7x FY08E and 20.2x FY09E fully diluted EPS appear rich, they do not fully factor in the expected ramp-up in SPIL's US business, value unlocking due to the R&D demerger and the value that SPIL could add by using its strong cash chest of US$450m through the inorganic route. Valuations also do not factor in the leverage arising out of the Valeant and Able Labs acquisitions, as these are currently loss-making. Maintain **Buy** with a price target of Rs1,280 (excl. R&D).

P/E BANDS



CONSOLIDATED INCOME STATEMENT (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Net Sales	**11,448**	**15,957**	**20,664**	**25,060**	**30,661**
Change (%)	*21.0*	*39.4*	*29.5*	*21.3*	*22.4*
Total Expenditure	7,266	11,040	13,707	16,655	20,631
EBITDA	**4,182**	**4,917**	**6,957**	**8,404**	**10,030**
Margin (%)	*36.5*	*30.8*	*33.7*	*33.5*	*32.7*
Depreciation	406	610	867	950	1,000
EBIT	**3,776**	**4,307**	**6,090**	**7,455**	**9,029**
Int. and Finance Charges	129	156	160	200	240
Other Income - Rec.	563	1,818	1,895	2,063	2,551
PBT	4,209	5,969	7,825	9,318	11,340
Tax	207	239	-78	-93	-113
Tax Rate (%)	*4.9*	*4.0*	*-1.0*	*-1.0*	*-1.0*
Profit after Tax	**4,002**	**5,730**	**7,903**	**9,411**	**11,454**
Change (%)	*16.2*	*43.2*	*37.9*	*19.1*	*21.7*
Margin (%)	*35*	*36*	*38*	*38*	*37*
Less: Mionrity Interest	42	-3	539	623	704
Net Profit	**3,960**	**5,733**	**7,364**	**8,788**	**10,750**

CONSOLIDATED BALANCE SHEET (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Equity Share Capital	928	929	929	929	929
Preference Share Capital	14	14	14	14	14
Total Reserves	10,366	14,959	20,960	25,572	34,334
Net Worth	**11,307**	**15,902**	**21,903**	**26,515**	**35,276**
Minority Interest	161	332	871	1,494	2,198
Deferred Liabilities	896	1053	873	658	398
Total Loans	18,230	18,745	16,000	16,000	16,000
Capital Employed	**30,595**	**36,031**	**39,646**	**44,667**	**53,872**
Gross Block	7,806	12,342	13,342	13,792	14,792
Less: Accum. Deprn.	2,087	3,779	4,646	5,595	6,596
Net Fixed Assets	**5,719**	**8,563**	**8,696**	**8,196**	**8,196**
Capital WIP	493	414	414	414	414
Goodwill	1,538	507	507	507	507
Investments	6,485	3,541	3,541	3,541	3,541
Curr. Assets	**18,946**	**26,520**	**29,640**	**35,880**	**46,133**
Inventory	3,173	5,117	3,201	4,016	5,242
Account Receivables	2,511	3,609	4,529	5,493	6,720
Cash and Bank Balance	11,809	15,323	18,796	22,732	29,719
Curr. Liability & Prov.	**2,587**	**3,515**	**3,153**	**3,872**	**4,920**
Account Payables	1,741	2,279	1,790	2,245	2,930
Provisions	845	1,236	1,363	1,627	1,990
Net Current Assets	**16,360**	**23,006**	**26,488**	**32,009**	**41,213**
Appl. of Funds	**30,595**	**36,031**	**39,646**	**44,667**	**53,872**

E: MOst Estimates

RATIOS

Y/E MARCH	2005	2006	2007E	2008E	2009E
Basic (Rs)					
EPS	**21.3**	**30.9**	**39.6**	**47.3**	**57.9**
Fully Diluted EPS	**21.3**	**27.7**	**35.6**	**42.4**	**51.9**
Cash EPS	23.5	30.6	39.7	47.0	56.7
BV/Share	60.9	85.5	117.8	142.7	189.8
DPS	3.8	5.5	6.4	7.7	9.4
Payout (%)	18.2	20.4	17.2	17.3	17.4
Valuation (x)					
P/E	54.8	37.9	29.5	24.7	20.2
Cash P/E		34.2	26.4	22.3	18.5
P/BV		12.3	8.9	7.3	5.5
EV/Sales		12.2	9.1	7.4	5.8
EV/EBITDA		39.6	27.1	21.9	17.7
Dividend Yield (%)		0.5	0.6	0.7	0.9
Return Ratios (%)					
RoE	40.7	42.1	39.0	36.3	34.8
RoCE	20.7	19.1	22.0	23.7	24.7
Working Capital Ratios					
Asset Turnover (x)	0.4	0.4	0.5	0.6	0.6
Debtor (Days)	84	87	84	84	84
Inventory (Days)	107	123	60	62	66
Working Capital T/O (Days)	550	555	494	492	518
Leverage Ratio					
Debt/Equity (x)	1.6	1.2	0.8	0.6	0.5

CASH FLOW STATEMENT (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Oper. Profit/(Loss) before Tax	4,271	4,168	6,957	8,404	10,030
Interest/Dividends Recd.	247	1,025	1,895	2,063	2,551
Direct Taxes Paid	-107	-165	-102	-121	-147
(Inc)/Dec in WC	-658	-3,177	-8	-1,585	-2,218
CF from Operations	**3,754**	**1,852**	**8,741**	**8,762**	**10,215**
(inc)/dec in FA	-1,623	-3,384	-1,000	-450	-1,000
(Pur)/Sale of Investments	-4,908	5,173	0	0	0
CF from investments	**-6,531**	**1,789**	**-1,000**	**-450**	**-1,000**
Issue of Shares	0	0	1	-2,549	1
(Inc)/Dec in Debt	14,349	801	-2,745	0	0
Interest Paid	-84	-156	-160	-200	-240
Dividend Paid	-625	-793	-1,363	-1,627	-1,990
CF from Fin. Activity	**13,640**	**-148**	**-4,268**	**-4,376**	**-2,229**
Inc/Dec of Cash	**10,864**	**3,493**	**3,473**	**3,936**	**6,986**
Add: Beginning Balance	945	11,809	15,323	18,796	22,732
Closing Balance	**11,809**	**15,302**	**18,796**	**22,732**	**29,719**

Note: Cashflows do not tally due to acquisition

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Disclosure of Interest Statement	Cipla	Dr Reddy's Lab	Ranbaxy Laboratories	Sun Pharma
1. Analyst ownership of the stock	No	No	No	No
2. Group/Directors ownership of the stock	No	No	No	No
3. Broking relationship with company covered	No	No	No	No
4. Investment Banking relationship with company covered	Yes	No	No	No

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