

LUPIN

INR 502

Strong pipeline for US generics market

BUY



We met the management of Lupin and were more than convinced that the company is on a high growth trajectory and could very well surpass our estimates for FY08.

Based on our discussions, we believe that the US generics business is likely to grow at a higher rate than our earlier estimate of 73% in FY08E. This is owing to the launch of major generic products—*Statins, Cefdinir, and Quinapril*. The other businesses consisting of API, developing market formulations and domestic formulations will continue to show good growth.

We have, therefore, revised our FY08 revenue estimate upwards by 2% and EPS estimate upwards by 7%. Our FY07 earnings estimate remains unchanged. At CMP of INR 502, the stock trades at a P/E of 16.7x and 13.1x on our FY07E and FY08E, respectively. We reiterate our 'BUY' recommendation.

* Regulated market generics: Strong pipeline for FY08

The discussion with management clearly brought out the strength in Lupin's US generics pipeline for FY08. The management stated that Lupin currently has approvals for both the 300 mg tablet and 5 ml oral suspension of Cefdinir, against the earlier approval for only the 300 mg tablet version. Apart from this, the company already has an approval for Quinapril and awaits one for Ceftiofur. Our estimates take into account revenues from Cefdinir and Quinapril but not Ceftiofur. Despite this the US generics business is expected to show a robust growth of 94% in FY08. An approval for Ceftiofur should only fuel the growth rate further.

The forthcoming quarters in FY07 will also see good growth in the US generics market owing to the launch of simvastatin and pravastatin. Even the branded generic product – Suprax will see decent growth as Lupin plans line extensions by the next quarter based on its NDDS technology. This will be a significant boost to *Suprax*'s profitability as the new product will add value without any higher incremental marketing costs.

We have estimated revenues of USD 65 mn and USD 117 mn in FY07 and FY08, respectively, from the US generics market.

Another growth driver for the regulated markets will be the European sales that have just commenced. Lupin already has 15 registrations and expects to continue filing at a robust pace. This might prove our revenues estimates of USD 6 mn for Europe in FY07E and USD 10 mn in FY08E conservative.

Financials

Year to March	FY05	FY06	FY07E	FY08E
Revenues (INR mn)	11,611	16,061	20,749	24,623
Rev.growth (%)	3.7	38.3	29.2	18.7
EBITDA (INR mn)	1,270	2,283	3,141	4,004
Net profit (INR mn)	844	1,827	2,412	3,080
Shares outstanding	80.3	80.3	80.3	80.3
EPS (INR)	10.5	22.8	30.0	38.4
EPS growth (%)	(13.1)	116.6	32.0	27.7
PE (x)	47.8	22.1	16.7	13.1
EV/EBITDA (x)	35.1	17.7	12.9	9.8
ROE (%)	16.9	28.4	30.8	31.4

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Reuters : LUPN.BO
Bloomberg : LPC IN

Market Data

52-week range (INR) : 1,275 / 460
Share in issue (mn) : 80.3
M cap (INR bn/USD mn) : 40.3 / 887.3
Avg. Daily Vol. BSE/NSE ('000) : 120.3

Share Holding Pattern (%)

Promoters : 52.4
MFs, Fls & Banks : 11.8
Fls : 12.1
Others : 23.7



* **Domestic market formulations: To maintain double-digit growth**

The domestic formulations market (40% of total sales) continues to grow at a consistent rate of 24-26%. This growth has been achieved by (1) increasing the sales force to 1800 (2) entering high value therapy areas like anti-Asthma and cardiovascular and (3) an overall buoyancy across the pharmaceutical industry in India. The management is confident of maintaining this growth rate over the next two years as it continues to expand its sales force along with its extended focus on high value therapy areas.

The anti-TB segment (22% of domestic formulations) has also seen some growth, albeit marginal, despite a decline in the segment as a whole. We believe this anti-TB market could see a revival on the back of increased incidence of AIDS disease.

Apart from this, the profitability of the domestic business is likely to improve as the company expects some excise and income-tax benefits from the J&K plant, which is expected to be commissioned in January 2007. The company's recent entry into the rural market should also augur well for the domestic formulations business.

* **Global TB tender: Business based on established strength**

The ROW formulations sales have seen robust growth of 100%+ in the first half mainly owing to the global TB tender business. TB is fast increasing on the back of increased incidence of AIDS especially in the African markets. With increased funding from global donor agencies Lupin is set to reap higher sales from this tender based business. The company reiterated its optimism on this opportunity although they did not mention about the current sales from this business. With TB being associated with AIDS, US too is likely to see incidences of TB which were otherwise absent. We have not factored this opportunity fully but believe this can offer great positive surprise for Lupin going forward.

* **Valuations**

We believe Lupin will deliver a strong performance over the next couple of years given the current steady performance of each of the business segments and a significant scale up for the US generics business in FY08E. At CMP of INR 502, the stock trades at a P/E of 16.7x and 13.1x on our FY07E and FY08E earnings, respectively. We reiterate our **'BUY'** recommendation.

Financial Statements

Income statement					(INR mn)
Year to March	FY04	FY05	FY06	FY07E	FY08E
Income from operations	11,193	11,611	16,061	20,749	24,623
Gross sales	11,679	12,123	16,610	21,394	25,494
Less: Excise	487	511	549	725	871
Net sales	11,193	11,611	16,061	20,669	24,623
Other operating income	-	-	-	81	-
Total operating expenses	8,847	10,341	13,778	17,608	20,619
Materials cost	5,281	5,684	7,568	10,097	11,686
Employee cost	1,048	1,257	1,557	1,842	2,303
R&D cost	-	798	986	1,328	1,724
Other expenses	2,518	2,602	3,667	4,342	4,906
EBITDA	2,346	1,270	2,283	3,141	4,004
Depreciation and amortisation	290	332	404	424	459
Interest	515	273	303	364	119
Other income	456	188	725	661	330
Extraordinary items [expenses/(gain)]	509	-	-	-	-
Profit before tax	1,487	853	2,302	3,015	3,756
Provision for tax	500	9	475	603	676
PAT(inc. excep. & pre minority int.)	987	844	1,827	2,412	3,080
Minority interest & others	16	-	-	-	-
PAT (inc. excep.) for equity shareholders	971	844	1,827	2,412	3,080

Common size metrics- as % of net revenues

Year to March	FY04	FY05	FY06	FY07E	FY08E
Material cost	47.2	49.0	47.1	48.9	47.5
Employee cost	9.4	10.8	9.7	8.9	9.4
Other expenses	22.5	22.4	22.8	21.0	19.9
Depreciation	2.6	2.9	2.5	2.0	1.9
Interest expenditure	4.6	2.4	1.9	1.8	0.5
EBITDA margins	21.0	10.9	14.2	15.1	16.3
Net profit margins	8.7	7.3	11.4	11.6	12.5

Growth metrics (%)

Year to March	FY05	FY06	FY07E	FY08E
Revenues	3.7	38.3	29.2	18.7
EBITDA	(45.9)	79.8	37.6	27.5
Net Profit	(13.1)	116.6	32.0	27.7
EPS	(13.1)	116.6	32.0	27.7

Cash flow statement					(INR mn)
Year to March	FY04	FY05	FY06	FY07E	FY08E
Cash flow from operations	2,279.6	1,345.4	2,558	3,008	3,612
Cash for working capital	1,550.3	(94.8)	(1,421)	(637)	(865)
Net operating cash (outflow) / inflow	3,829.9	1,251	1,137	2,371	2,747
Net (purchase) / sale of fixed assets	(832)	(1,283)	(820)	(2,098)	(350)
Net (purchase) / sale of investments	18	1	53	-	-
Net cash (outflow) / inflow from investing	(814.6)	(1,282)	(767)	(2,098)	(350)
Proceeds from equity capital	(231)	(294.5)	4,076	(298)	(1,016)
Proceeds from LTB/STB	(2,782)	353	(66)	(1,601)	(1,985)
Net cash (outflow) / inflow from financing	(3,013)	58.5	4,011	(1,898)	(3,000)
Free cash flow	2,998	(32)	317	273	2,397

Balance sheet		(INR mn)				
As on 31st March	FY04	FY05	FY06	FY07E	FY08E	
Shareholders funds	4,480	5,005	10,901	12,297	14,269	
Capital	401	401	401	803	803	
Reserves & surplus	4,079	4,604	6,038	7,033	9,005	
Other term liabilities			4,462	4,462	4,462	
Borrowings	3,771	4,406	4,665	3,064	1,079	
Secured loans	2,866	3,806	4,287	2,664	900	
Unsecured loans	906	600	378	400	179	
Deferred tax liability (net)	942	934	956	956	956	
Sources of funds	9,193	10,346	16,522	16,317	16,304	
Gross block	6,404	7,149	8,351	9,851	10,201	
Depreciation	1,232	1,559	1,927	2,350	2,809	
Net block	5,172	5,589	6,424	7,500	7,391	
Capital work in progress	172	698	252	850	850	
Investments	89	94	95	95	95	
Inventories	2,153	2,481	3,103	4,140	4,792	
Sundry debtors	2,158	2,354	3,484	4,501	5,341	
Cash and bank balances	150	178	4,558	2,933	2,329	
Loans and advances	2,000	1,726	2,329	1,900	1900	
Total current assets	6,462	6,739	13,474	13,473	14,362	
Current liabilities	1,967	2,374	2,995	3,983	4,611	
Provisions	734	400	728	1,618	1,784	
Total current liabilities and provisions	2,701	2,774	3,723	5,602	6,394	
Net current assets	3,760	3,965	9,751	7,872	7,968	
Uses of funds	9,193	10,346	16,522	16,317	16,304	
Book value per share (INR)	56	62	80	98	122	

Ratios

Year to March	FY04	FY05	FY06	FY07E	FY08E
ROE (%)	21.7	16.9	28.4	30.8	31.4
ROCE (%)	21.8	10.9	15.8	20.7	23.8
Inventory days	149	159	150	150	150
Debtors days	70	74	79	79	79
Fixed assets T/o (x)	1.7	1.6	1.9	2.1	2.4
Debt/equity	0.8	0.9	0.7	0.4	0.1

Valuations parameters

Year to March	FY04	FY05	FY06	FY07E	FY08E
EPS, inc. exceptionals (INR)	12.1	10.5	22.8	30.0	38.4
<i>Y-o-Y growth (%)</i>		<i>(13.1)</i>	<i>116.6</i>	<i>32.0</i>	<i>27.7</i>
CEPS (INR)	15.7	14.6	27.8	35.3	44.1
PE (x)	41.5	47.8	22.1	16.7	13.1
Price/BV(x)	9.0	8.1	6.3	5.1	4.1
EV/Sales (x)	3.9	3.8	2.5	1.9	1.6
EV/EBITDA (x)	18.7	35.1	17.7	12.9	9.8

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RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	Reduce	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	Sell	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	Trading Sell	Expected to depreciate more than 10% over a 45-day period

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