

Lupin

STOCK INFO.	BLOOMBERG
BSE Sensex: 12,907	LPC IN
	REUTERS CODE
S&P CNX: 3,739	LUPN.BO

27 October 2006

Buy

Rs510

Previous Recommendation: Buy

Equity Shares (m)	80.3
52-Week Range	638/343
1,6,12 Rel. Perf. (%)	6/-21/-18
M.Cap. (Rs b)	40.9
M.Cap. (US\$ b)	0.9

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END*	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
03/06A	16,858	1,722	21.4	87.5	23.8	6.6	31.0	20.6	2.7	20.3
03/07E	19,889	2,286	25.9	20.9	19.7	5.1	32.2	21.7	2.2	14.3
03/08E	22,444	3,073	34.9	34.4	14.6	4.0	33.6	25.0	1.9	11.2

*Consolidated

Lupin's 2QFY07 results (stand-alone) were below our estimates as EBITDA margins were flat (as against expectations of 150bp margin expansion) due to lower contribution from regulated markets. Key highlights include:

- Net sales grew by 22.4% (to Rs5b) while PAT grew by 29% (to Rs583m). EBITDA margins were almost flat at 16.8%. On consolidated basis, the company reported the net sales of Rs4.8b, with EBITDA margins of 15.6% and PAT of Rs518m.
- Performance was adversely impacted by a 2.3% decline in exports to regulated markets due to flat Suprax sales at Rs138m and increased competition for Ceftriaxone (both high-margins products for the company).
- Management has guided 2HFY07 to be better than 1HFY07 led by increased API exports (mainly Lisinopril) to regulated markets, ramp-up in formulation business in the US (due to the on-set of winter) and recovery in the Pen-G cycle. Increased sales of tender-based business for Lupin's anti-TB business will also help top-line growth.
- The company expects to out-license its anti-psoriasis NCE in the next 12 months. We believe that this could unlock value for shareholders as unlike other categories, there has been hardly any new research in the psoriasis segment for the past few decades.

We have lowered our FY07E and FY08E EPS estimates by 9.5% (to Rs25.9) and 1.1% (to Rs34.9) to factor in for lower than expected 2QFY07 results. Current valuations of 14.6x FY08E consolidated EPS (fully diluted) and 1.9x FY08E EV/Sales do not fully reflect improvement in base business and excludes any upsides from potential acquisitions and NCE out-licensing. Maintain **Buy**.

QUARTERLY PERFORMANCE (STANDALONE)

(Rs Million)

Y/E MARCH	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Net Sales	3,612	4,051	4,269	4,220	4,769	4,958	5,065	4,957	16,625	19,749
YoY Change (%)	24.4	34.1	52.7	45.9	32.0	22.4	18.6	17.5	43.2	18.8
Total Expenditure	2,903	3,378	3,693	3,804	4,118	4,123	4,223	4,128	13,778	16,592
EBITDA	709	673	576	416	651	835	842	830	2,847	3,157
Margins (%)	19.6	16.6	13.5	9.9	13.6	16.8	16.6	16.7	17.1	16.0
Depreciation	91	98	101	114	106	112	116	119	404	452
Interest	65	64	79	95	91	93	95	94	303	373
Other Income	39	89	96	410	182	163	167	167	161	680
PBT	591	601	492	618	637	793	798	784	2,302	3,012
Tax	160	149	51	116	130	210	176	162	475	678
Rate (%)	27.0	24.8	10.3	18.7	20.5	26.4	22.0	20.7	20.6	22.5
Profit after Tax	432	452	442	502	507	583	623	622	1,827	2,334
YoY Change (%)	109.1	158.4	80.3	131.0	17.4	29.0	40.9	23.9	116.6	27.7
Margins (%)	11.9	11.2	10.3	11.9	10.6	11.8	12.3	12.5	11.0	11.8

E: MOST Estimates

Regulated market sales decline

Net sales grew by 22% YoY to Rs5b primarily driven by domestic business (up 25%) and non-regulated market business (up 27.5%). Regulated market business declined by 2.3% due to flat Suprax sales at Rs138m and increased competition for Ceftriaxone.

BUSINESS BREAK UP - STANDALONE (RS M)

	2QFY07	2QFY06	YOY (%)	1QFY07	QOQ (%)
India					
APIs	754	596	26.5	776	-2.8
Formulations	2,130	1,713	24.3	2,066	3.1
Total India Sales	2,884	2,309	24.9	2,842	1.5
% of sales	58.2	57.0		58.9	
Regulated market					
APIs	192	331	-42.1	190	0.8
Formulations	766	514	49.0	527	45.4
Total regl. market sales	958	845	13.3	717	33.5
% of sales	19.3	20.9		14.9	
Un-regulated market					
APIs	896	784	14.3	873	2.6
Formulations	220	113	94.7	396	-44.4
Total un-reg. market	1,116	897	24.4	1,269	-12.1
% of sales	22.5	22.1		26.3	
Total Sales	4,958	4,051	22.4	4,828	2.7

Source: Company/ Motilal Oswal Securities

In regulated market, formulation sales grew by 49% YoY (to Rs766m) on account new product launches during the quarter. Suprax sales were flat at Rs138m due to winter seasonality. Lupin had recorded about \$15m in Suprax sales in FY06 and has guided a positive growth for this product for FY07E.

API exports to regulated markets declined by 42% due to delay in Lisinopril approvals to its clients. Management expects API exports to recover in the coming quarters based on ramp-up in Ceftriaxone and Lisinopril.

In domestic market, formulation business grew by 24% YoY (to Rs2.1b), whereas API business grew by 26.5% (to Rs754m). In other markets (non-regulated), formulations business grew by 95% (to Rs220m) and API business grew by 14% (to Rs896m).

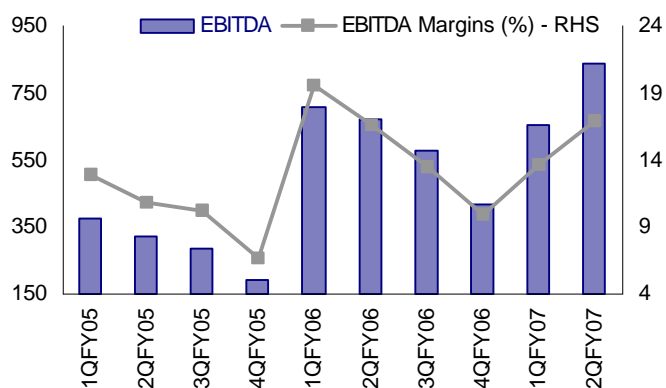
Ceftriaxone: more competition coming in

Lupin has not disclosed actual Ceftriaxone sales during the quarter, but has indicated that there has been pricing pressure due to entry of new players (Abraxis, Teva and Wockhardt). Our estimates factor in for the probable erosion in Ceftriaxone price.

Margins flat due to lower regulated market business contribution

In 2QFY07, EBITDA margins remained flat at 16.8% due to lower contribution from regulated market business. Performance was adversely impacted by a 2.3% decline in exports to regulated markets due to flat Suprax sales at Rs138m and increased competition for Ceftriaxone (both high-margins products for the company). However, higher other income (at Rs163m v/s Rs89m in 2QFY06) due to Rs100m income from take-or-pay contract, boosted PAT growth to 29% to Rs583m.

TREND IN EBITDA MARGINS



Source: Company/ Motilal Oswal Securities

Consolidated results

On consolidated basis, during the quarter Lupin reported the net sales of Rs4.8b, with EBITDA margins of 15.6%, culminating into PAT of Rs518m. Sales and PAT on consolidated basis are lower than standalone, as the company has built its inventory for launch of Lisinopril HCTZ tabs and Suprax inventory for winter season, for US market.

Boosting presence in US & Europe through increased filings

Lupin launched 7 generic products during FY06, with most of the launches in Dec-05 and hence the full benefits of these launches will be visible in FY07. The company is selling these products in the US generic markets under its own label. Also, sales in US markets are expected to get a boost from gradual increase in Suprax prescription resulting in sales of about US\$15-16m in FY07 (FY06-US\$14.9m) and improvement in Lisinopril sales during the year. It expects to launch about 6 generic and 1 branded generic products in the US in FY07. During the quarter, Lupin filed 3 ANDAs, taking total ANDA filings to 45, of which 38 are pending USFDA approval. During the quarter, the company also filed 3 DMFs and 3 MAA (EU), taking YTD filings to 7ANDAs, 4DMFs and 4 MAA.

Expects to out-license anti-psoriasis NCE in next 12 months

Lupin has 4 NCEs under development with two in Phase II (anti-psoriasis-herbal & anti-migraine), one about to commence Phase II (anti-psoriasis-chemical) and one molecule undergoing Phase I (anti-TB). The company has indicated that it intends to out-license its anti-psoriasis NCE in the next 12 months which is likely to result in up-front and milestone payments for the company. Our estimates do not include the potential upside from NCEs due to the uncertainties attached to NCE development. We believe that this could unlock value for shareholders as unlike other categories, there has been hardly any new research in the psoriasis segment for the past few decades. However, we believe that a successful out-licensing could be a re-rating trigger for the stock.

Future growth drivers

➤ **US business:** Lupin is expected to witness continuum momentum in US business based on a) gradual improvement in Suprax prescription translating into sales of US\$15-16m; b) Launch of around 6 generic and 1 branded generic product and c) partial recovery in Lisinopril sales.

- Lupin is developing its specialty products pipeline for regulated markets with focus on sustained release products.
- Increased API supplies to regulated markets coupled with higher sales of anti-TB products (under the WHO program) coupled with incremental contribution from the nascent CRAMS initiatives will also lead to higher top-line growth for the company.
- **Acquisitions:** Lupin is looking at acquisitions in the US branded space to strengthen its brand portfolio. It is also evaluating acquisitions in Europe to gain scale. However, the company is unlikely to bid very aggressively for acquiring generic assets. The company has already raised US\$100m through FCCB, which it intends to utilize for acquisitions.

Guidance

Management has guided for better 2HFY07 than 1HFY07 led by:

1. Increased API exports (mainly Lisinopril and Ceftriaxone) to regulated markets
2. Ramp-up in formulation business in the US through Suprax (due to the on-set of winter) and new product approval/launches
3. Recovery in the Pen-G cycle due to higher demand from China and closing of some capacities
4. Sustained momentum in domestic business with growth of around 25% for 2HFY07
5. Increased sales of tender-based business for Lupin's anti-TB business

Also, the management has indicated that the effective tax rate for 2HFY07 will be lower than that of the 1HFY07 (24%).

Revising estimates downwards

We are revising our FY07E and FY08E consolidated EPS estimates downwards by 9.5% (to Rs25.9) and 1.1% (to Rs34.9) respectively, to factor in for lower than expected 2QFY07 results and unfavorable market mix (lower than expected contribution from regulated market business and increase sales from tender base anti-TB business) resulting in lower margins.

REVISED FORECAST (RS M)

	FY07E			FY08E		
	REV	OLD	CHG (%)	REV	OLD	CHG (%)
Net Sales	19,889	20,021	-0.7	22,444	22,435	0.0
Net Profit	2,286	2,526	-9.5	3,073	3,108	-1.1
EPS (Rs)	25.9	28.7	-9.5	34.9	35.3	-1.1

Source: Motilal Oswal Securities

Valuations - stock is reasonably valued

Lupin is likely to witness a gradual improvement in the underlying fundamentals led by an expanding US generics

pipeline, pick up in Suprax prescription share and bottoming out of Pen-G business. While our estimates factors in dilution due to recent US\$100m FCCB issue, it doesn't factor in any upside from potential acquisition for which the company has already raised money. Also, a successful out-licensing could act as a re-rating trigger for the stock. Lupin is currently valued at 14.6x FY08E consolidated EPS (fully diluted) and 1.9x FY08E EV/Sales, excluding upsides from potential acquisitions and NCE out-licensing. Maintain **Buy**.

Lupin: an investment profile

Company description

Lupin is one of the second tier Pharma companies that are actively targeting the regulated generics markets. Historically very strong in the anti-TB segment, it has over the years built up expertise in fermentation-based products and segments like cephalosporins, prils and statins. Lupin is now a fully integrated company, with manufacturing capabilities in APIs and formulations and a direct marketing presence in the target markets.

Key investment arguments

- ✍ Only player worldwide with an approval for ceftriaxone – expected to be a major growth driver in FY06.
- ✍ In the process of building a strong pipeline for the US market through aggressive filings – benefits expected to flow in over the next couple of years.
- ✍ Pediatric opportunity (Suprax), statins offer significant potential upsides that are not factored into our estimates.

Key investment risks

- ✍ Short-term financial performance would remain under pressure given slow scale up in US business and ramping up of R&D and regulatory filing costs.
- ✍ Commodity like nature of its developing markets business could lead to volatility in earnings.

Recent developments

- ✍ Lupin has called-off its acquisition of 51% stake in Dafra Pharma, Belgium

Valuation and view

- ✍ Multiples of 14.6x FY08E and 1.9x FY08E EV/Sales valuations do not fully reflect the positives.
- ✍ Re-iterate **Buy** with price target of Rs565.

Sector view

- ✍ Regulated markets would remain the key sales and profit drivers in the medium term. Europe is expected to emerge as the next growth driver, particularly for companies with a direct marketing presence.
- ✍ We are overweight on companies that are towards the end of the investment phase, with benefits expected to start coming in from the next fiscal.

COMPARATIVE VALUATIONS

		LUPIN	SUN PHARMA	WOCKHARDT
P/E (x)	FY07E	19.7	28.6	16.7
	FY08E	14.6	23.0	12.9
P/BV (x)	FY07E	5.1	9.0	4.3
	FY08E	4.0	6.7	3.4
EV/Sales (x)	FY07E	2.2	8.4	3.2
	FY08E	1.9	6.7	2.6
EV/EBITDA (x)	FY07E	14.3	26.6	14.0
	FY08E	11.2	20.2	10.4

SHAREHOLDING PATTERN (%)

	JUN-06	MAR-06	JUN-05
Promoter	52.4	52.5	52.5
Domestic Inst	11.8	8.8	7.3
Foreign	21.9	25.5	26.6
Others	13.9	13.2	13.6

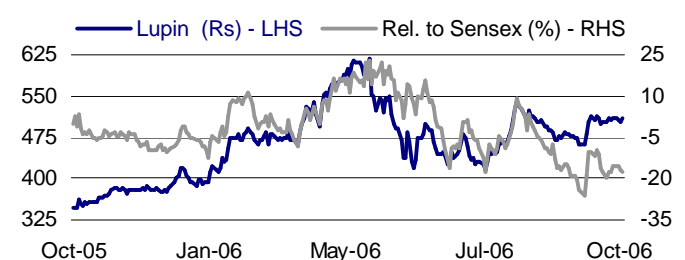
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	25.9	26.7	-3.0
FY08	34.9	33.9	3.1

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
510	565	10.8	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Net Sales	12,558	16,858	19,889	22,444	25,111
Change (%)	3.9	34.2	18.0	2.8	11.9
Total Expenditure	11,224	14,623	16,811	18,678	20,831
EBITDA	1,334	2,236	3,078	3,766	4,280
Margin (%)	10.6	13.3	15.5	16.8	17.0
Depreciation	336	409	464	514	553
Int. and Finance Charges	283	313	381	195	143
Other Income - Rec.	234	741	716	690	649
PBT before EO item	950	2,255	2,949	3,747	4,233
EO Expense/(Income)	0	35	0	0	0
PBT after EO item	950	2,221	2,949	3,747	4,233
Tax	27	521	664	675	720
Tax Rate (%)	2.9	23.5	22.5	18.0	17.0
Reported PAT	922	1,699	2,286	3,073	3,514
PAT Adj for EO items	922	1,726	2,286	3,073	3,514
Change (%)	8.7	87.1	32.4	34.4	14.3
Less: Minority Interest	4	4	0	0	0
Adj Net Profit	918	1722	2286	3073	3514

CONSOLIDATED BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Equity Share Capital	401	401	803	803	803
Fully Diluted Equity Capital	401	401	881	881	881
Total Reserves	4,492	5,831	7,179	9,518	12,170
Net Worth	4,894	6,233	7,982	10,321	12,973
Minority Interest	12	16	16	16	16
Deferred liabilities	935	939	998	1,059	1,123
Total Loans	4,572	9,249	7,200	6,100	6,100
Capital Employed	10,413	16,437	16,196	17,495	20,212
Gross Block	7,347	8,561	10,000	10,550	11,550
Less: Accum. Deprn.	1,718	2,096	2,560	3,073	3,626
Net Fixed Assets	5,629	6,466	7,441	7,477	7,924
Capital WIP	698	252	200	200	200
Investments	26	28	28	28	28
Curr. Assets	7,189	13,674	13,152	15,145	18,095
Inventory	2,615	3,429	3,543	3,998	4,473
Account Receivables	2,550	3,112	3,596	4,058	4,540
Cash and Bank Balance	271	4,774	4,102	4,932	6,669
Others	1,754	2,360	1,912	2,157	2,413
Curr. Liability & Prov.	3,130	3,984	4,625	5,355	6,035
Account Payables	2,714	3,147	3,978	4,490	5,023
Provisions	416	837	646	865	1,013
Net Current Assets	4,059	9,691	8,527	9,790	12,059
Appl. of Funds	10,413	16,437	16,196	17,495	20,212

E: MOST Estimates

RATIOS					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Basic (Rs)					
EPS (Fully Diluted)	11.4	21.4	25.9	34.9	39.9
Cash EPS (Fully Diluted)	15.6	26.5	31.2	40.7	46.1
BV/Share	60.8	77.5	99.3	128.4	161.5
DPS	3.2	3.2	5.9	8.0	9.4
Payout (%)	32.3	17.5	23.5	23.9	24.5
Valuation (x)					
P/E (Fully Diluted)	44.6	23.8	19.7	14.6	12.8
Cash P/E (Fully Diluted)	32.6	19.2	16.4	12.5	11.1
P/BV	8.4	6.6	5.1	4.0	3.2
EV/Sales	3.6	2.7	2.2	1.9	1.6
EV/EBITDA	33.9	20.3	14.3	11.2	9.4
Dividend Yield (%)	0.6	0.6	1.1	1.6	1.8
Return Ratios (%)					
RoE	20.0	31.0	32.2	33.6	30.2
RoCE	13.9	20.6	21.7	25.0	24.7
Working Capital Ratios					
Asset Turnover (x)	12	10	12	13	12
Debtor (Days)	71	65	64	64	63
Inventory (Days)	76	74	65	65	65
Wkg. Capital Turnover (Days)	18	210	156	159	175
Leverage Ratio					
Debt/Equity (x)	0.9	1.5	0.9	0.6	0.5

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Oper. Profit/(Loss) before Tax	1,334	2,236	3,078	3,766	4,280
Interest/Dividends Recd.	234	741	716	690	649
Direct Taxes Paid	-35	-517	-604	-614	-655
(Inc)/Dec in WC	-293	-1,128	491	-432	-533
EO expense	0	35	0	0	0
CF from Op. incl EO Exp.	1,241	1,297	3,681	3,409	3,740
(inc)/dec in FA	-1,281	-800	-1,387	-550	-1,000
(Pur)/Sale of Investments	0	-2	0	-6	-6
CF from Investments	-1,281	-801	-1,387	-556	-1,006
Issue of Shares	-34	-59	0	6	6
(Inc)/Dec in Debt	624	4,677	-2,049	-1,100	0
Interest Paid	-283	-313	-381	-195	-143
Dividend Paid	-298	-298	-537	-734	-861
CF from Fin. Activity	9	4,008	-2,966	-2,023	-998
Inc/Dec of Cash	-31	4,504	-672	831	1,737
Add: Beginning Balance	302	271	4,774	4,102	4,932
Closing Balance	271	4,774	4,102	4,932	6,669

N O T E S

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Disclosure of Interest Statement

	Lupin
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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