



Lupin

STOCK INFO.	BLOOMBERG
BSE SENSEX: 19,243	LPC IN
	REUTERS CODE
S&P CNX: 5,702	LUPN.BO

26 October 2007

Neutral

Previous Recommendation: Neutral

Rs623

Equity Shares (m)	80.3
52-Week Range	755/485
1,6,12 Rel. Perf. (%)	-6/-47/-28
M.Cap. (Rs b)	50.0
M.Cap. (US\$ b)	1.3

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
03/07A	20,057	3,086	35.0	63.1	17.8	5.7	41.3	27.1	2.7	18.8
03/08E	25,598	3,153	35.7	2.2	17.4	4.4	31.5	23.0	2.1	13.0
03/09E	27,973	3,345	37.9	6.1	16.4	3.6	26.6	20.8	1.9	12.6

*Consolidated

Lupin's 2QFY08 results were below our estimates. Key highlights:

- Net sales grew by 35% (v/s estimate of 33%) to Rs6.59b while PAT grew by 46% (v/s estimate of 86%) to Rs756m. Top-line growth was led by 126% growth in formulation exports to regulated markets at Rs1.57b. EBITDA margins expanded by 150bp to 17.1% (vs estimate of 20%). Margins were adversely impacted due to higher than estimated RM cost (up 39%) and a 49% increase in staff costs. Higher inventory in US coupled with currency appreciation has also impacted the performance for the quarter.
- Niche/IPR opportunities gaining visibility** – Lupin has launched Cefdinir (in May 2007) in the US and we expect it to record sales of US\$30-35m. It has recently received Euro20m from Servier (France) for sale of Perindropil patent rights taking the total IPR payment to Euro40m till date. The company is also awaiting clarity from the US FDA on its proposed 180-day exclusivity on Ramipril (US\$800m market) as it has already won the patent litigation in the US appeals court. This opportunity could result in a one-time PAT upside of US\$20-30m.

We expect a gradual improvement in the underlying fundamentals led by an expanding US generics pipeline and niche opportunities in the US. We expect 18% sales and 21% EPS CAGR in the FY07-09 period excluding one-time upsides. While we continue to remain positive about Lupin's growth prospects (particularly in regulated markets), we believe that current valuations are a fair reflection of the expected traction. Increased competition for Cefdinir and possibility of generic competition in Suprax, would impact growth prospects in FY09E. Lupin is currently valued at 17.4x FY08E and 16.4x FY09E earnings excluding upsides from IPRs & niche opportunities. Maintain **Neutral**.

QUARTERLY PERFORMANCE (CONSOLIDATED)

(Rs Million)

Y/E MARCH	FY07				FY08				FY07	FY08E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Net Sales	5,044	4,886	5,054	5,318	5,757	6,590	6,672	6,579	20,137	25,598
YoY Change (%)	-	-	-	-	14.1	34.9	32.0	23.7	18.8	27.1
Total Expenditure	4,395	4,123	4,154	4,542	4,936	5,464	5,440	5,576	17,215	21,416
EBITDA	649	763	901	776	821	1,126	1,232	1,004	2,922	4,182
Margins (%)	12.9	15.6	17.8	14.6	14.3	17.1	18.5	15.3	14.5	16.3
Depreciation	107	112	121	126	127	140	140	142	466	550
Interest	92	93	89	98	89	80	103	147	372	420
Other Income	217	171	99	1,338	159	188	170	211	1,991	728
PBT	667	728	789	1,890	764	1,094	1,159	925	4,075	3,941
Tax	131	210	169	479	206	338	110	135	988	788
Rate (%)	19.6	28.8	21.4	25.3	26.9	30.9	9.5	14.6	24.3	20.0
Reported PAT	536	518	620	1,411	558	756	1,049	790	3,086	3,153
Extra-Ordinary Exp/(Inc)	0	0	0	-759	0	0	0	0	-759	0
Recurring PAT	536	518	620	652	559	756	1,049	790	2,327	3,153
YoY Change (%)	-	-	-	-	4.4	45.9	69.1	21.1	34.5	35.5
Margins (%)	10.6	10.6	12.3	12.3	9.7	11.5	15.7	12.0	11.6	12.3

E: M0St Estimates

Higher inventory and currency appreciation impact performance

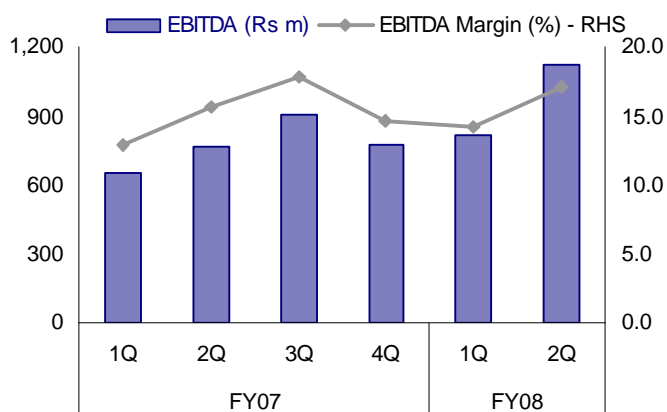
Consolidated net sales grew by 35% (v/s estimate of 33%) to Rs6.59b while PAT grew by 46% (v/s estimate of 86%) to Rs756m. Top-line growth was led by 126% growth in formulation exports to regulated markets to Rs1.57b. Higher inventory in US coupled with currency appreciation has also impacted the performance for the quarter. Management has indicated that it has built higher inventories in its US operations as it expects some new approvals in the near future as well as due to the onset of the flu season which results in higher Cephalosporin sales.

Higher API sales and commissioning of new facilities pull down margin

EBITDA margins expanded by 150bp to 17.1% (vs estimate of 20%). Margins were adversely impacted due to higher than estimated RM cost (up 39%) and a 49% increase in staff costs (as the company has increased its MR strength in India). We believe that currency appreciation would have also impacted EBITDA margins. Higher other expenses (linked to commissioning of new facilities) and higher API sales (which attract lower margins) has also impacted margin expansion.

PAT growth was restricted to 46% to Rs756m (vs estimate of Rs966m) due to higher inventories at the US operations and partly due to higher tax outgo (31% of PBT vs estimate of 20%).

TREND IN EBITDA MARGINS



Source: Company/Motilal Oswal Securities

Cefdinir revenues yet to pick up

Lupin launched Cefdinir in US market in 1st week of May 2007. The company enjoys a unique positioning in the Cefdinir market in the US as, till date; it is among very few companies to receive final US FDA approval for the product. Abbott is the innovator and sells the product under the “Omnicef” brand with \$800m annual revenues. Abbott’s patents on the drug expired in May-07 and we expect very low generic competition in the initial months as only 4 players are present in the market including authorized generic. We expect Cefdinir to be a major product for Lupin’s US initiative and expect it generate sales of about US\$30-35m in FY08E (factored in our estimates). However, Lupin’s Cefdinir sales are yet to pick up as the company has been able to garner only 14% market share till date post launch. Management has indicated that the pricing trends for Cefdinir are stable (details not disclosed).

... However, competition is expected to intensify over in the next 6 months

We note that other generic companies like Ranbaxy and Aurobindo have also filed for Cefdinir approval. We expect some of these players to receive final approval in the next 6 months. Our estimates include the impact of increased competition and we expect Lupin’s Cefdinir sales to decline to US\$12m in FY09E.

Expect generic competition for Suprax in FY09

A few generic companies have filed for generic versions of Suprax. While there is no clarity on launch of generic Suprax, we believe that the possibility cannot be ruled out in FY09, although generic players may have to prove non-infringement. Our estimates factor-in the possibility of generic Suprax launch in FY09E with sales of US\$18m compared to US\$20m in FY08E.

Decline in Cefdinir & Suprax sales to impact growth in FY09E

Increased competition in Cefdinir opportunity and possibility of generic competition in Suprax, would impact growth prospects in FY09E. Our estimates already factor-in for these possibilities, translating into 9.3% revenue growth (to

Rs28.5b) with margin decline of 110bp (to 15.4%) and EPS growth of just 6% (to Rs38). Our estimates, however do not factor-in, launch of any other niche product (like Cefdinir) in FY09E.

Acquisitions as entry vehicle

Lupin has recently announced two acquisitions - Kyowa in Japan & Rubamin Labs in India - as entry vehicles for its Japanese and CRAMS initiatives. Although, we believe that the Kyowa acquisition is expensive (11.6x EV/EBITDA), Kyowa's product portfolio and distribution network is likely to facilitate Lupin's entry into the Japanese generic market. Rubamin's client relationships are expected to help Lupin in strengthening its nascent CRAMS business. It has paid US\$60m (plus US\$50m debt) for Kyowa and about US\$10m for Rubamin acquisition.

NCE Research update

Lupin has 4 NCEs under development with two in Phase III, one in Phase II and one molecule undergoing Phase I. The company has indicated that it intends to out-license one NCE in next 12 months. We expect that the company can announce an out-licensing 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.

NCE PIPELINE

THERAPEUTIC SEGMENT	STAGE
Anti Psoriasis (Herbal)	Completed Phase II
Anti Migraine	Phase II
Anti Psoriasis (Chemical)	Phase II
Anti TB	Phase I

Source: Company

Future growth drivers

- ✍ **US business:** Lupin is expected to witness continued momentum in US business based on (a) Launch of around 8-10 products every year for the next few years. (b) Launch of niche products (like Cefdinir). While some of these launches may be for difficult-to-manufacture products, we currently do not have visibility on these launches and hence our estimates do not include the potential upsides from such products.
- ✍ **European business:** European business expected to benefit from regulatory filings done in last 2-3 years, as some revenue contribution is expected in FY08E and significant ramp-up in FY09E.
- ✍ 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 and developing markets to gain scale. However, the company is unlikely to bid very aggressively for acquiring generic assets.

Revising estimates downwards

Based on the lower than expected 1HFY08 performance, we have revised our earnings estimate downwards for FY08E by 2.4% and FY09E EPS estimates by 3.3%.

REVISED FORECAST (RS M)

	FY08E			FY09E		
	REV	OLD	CHG (%)	REV	OLD	CHG (%)
Net Sales	25,598	25,939	-1.3	27,973	28,467	-1.7
Net Profit	3,153	3,231	-2.4	3,345	3,460	-3.3
EPS (Rs)	35.7	36.6	-2.4	37.9	39.2	-3.3

Source: Motilal Oswal Securities

Valuations – stock is fairly valued

Lupin is likely to witness a gradual improvement in the underlying fundamentals led by an expanding US generics pipeline, unique opportunities like Cefdinir and pick up in Suprax prescription share. Incremental benefits are likely to be visible from the recently commissioned Jammu facility which enjoys fiscal benefits. Our estimates do not factor in the upsides from the Kyowa and Rubamin acquisitions, as we do not expect any significant upsides from them in the short-to-medium term.

We expect 18% sales and 21% EPS CAGR in the FY07-09 period. While we continue to remain positive about Lupin's growth prospects (particularly in regulated markets), we believe that current valuations are a fair reflection of the expected traction. Lupin is currently valued at 17.4x FY08E and 16.4x FY09E earnings. We maintain our **Neutral** rating with revised price target of Rs680. Out-licensing of NCEs and potential IPR-related income (as in case of Perindopril) are the key upside risks to our downgrade. We continue to value generic companies based on their core business earnings since the upsides from out-licensing/IPR are both uncertain and one-time in nature.

Lupin: an investment profile

Company description

Lupin is one of the second tier Pharma companies that is 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

- 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

- Acquired controlling stake in Kyowa (Japan) and Rubamin (India).

Valuation and view

- Valuations at 17.4x FY08E and 16.4x FY09E EPS are fair reflection of growth prospects of the company.
- Maintain **Neutral** with revised price target of Rs680.

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)	FY08E	17.4	24.5	14.3
	FY09E	16.4	20.5	13.5
P/BV (x)	FY08E	4.4	4.5	3.4
	FY09E	3.6	3.8	2.7
EV/Sales (x)	FY08E	2.1	7.5	2.5
	FY09E	1.9	6.1	2.2
EV/EBITDA (x)	FY08E	13.0	21.1	10.3
	FY09E	12.6	17.5	10.2

SHAREHOLDING PATTERN (%)

	SEP-07	JUN-07	SEP-06
Promoter	63.5	63.5	66.6
Domestic Inst	11.4	10.7	11.5
Foreign	16.3	16.9	13.7
Others	8.8	8.9	8.1

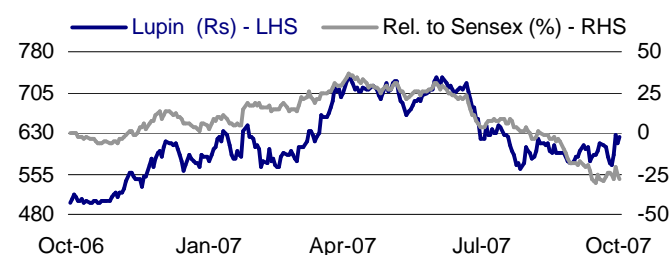
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VIATION (%)
FY08	35.7	37.4	-4.4
FY09	37.9	41.4	-8.5

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
623	680	9.1	Neutral

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs Million)				
Y/E MARCH	2005	2006	2007	2008E	2009E	
Net Sales	12,558	16,858	20,057	25,598	27,973	
Change (%)	3.9	34.2	19.0	27.6	9.3	
Total Expenditure	11,224	14,623	17,135	21,416	23,719	
EBITDA	1,334	2,236	2,922	4,182	4,254	
Margin (%)	10.6	13.3	14.6	16.3	15.2	
Depreciation	336	409	466	550	633	
Int. and Finance Charges	283	313	372	420	450	
Other Income - Rec.	234	741	1,991	728	908	
PBT before EO item	950	2,255	4,075	3,941	4,079	
EO Expense/(Income)	0	35	0	0	0	
PBT after EO item	950	2,221	4,075	3,941	4,079	
Tax	27	521	988	788	734	
Tax Rate (%)	2.9	23.5	24.0	20.0	18.0	
Reported PAT	922	1,699	3,086	3,153	3,345	
PAT Adj for EO items	922	1,726	3,086	3,153	3,345	
Change (%)	8.7	87.1	78.9	2.1	6.1	
Less: Minority Interest	4	4	1	0	0	
Adj Net Profit	918	1722	3086	3153	3345	

CONSOLIDATED BALANCE SHEET		(Rs Million)				
Y/E MARCH	2005	2006	2007	2008E	2009E	
Equity Share Capital	401	401	803	803	803	
Fully Diluted Equity Capital	401	401	882	882	882	
Total Reserves	4,492	5,831	7,930	10,518	13,022	
Net Worth	4,894	6,233	8,733	11,322	13,825	
Minority Interest	12	-1	-1	-1	-1	
Deferred liabilities	935	956	1,027	1,098	1,163	
Total Loans	4,572	9,249	8,648	9,200	9,200	
Capital Employed	10,413	16,437	18,407	21,618	24,187	
Gross Block	7,347	8,561	9,528	12,028	13,028	
Less: Accum. Deprn.	1,718	2,096	2,382	2,932	3,564	
Net Fixed Assets	5,629	6,466	7,146	9,096	9,463	
Capital WIP	698	252	826	250	250	
Investments	26	28	28	28	28	
Curr. Assets	7,189	13,315	14,629	18,099	21,078	
Inventory	2,615	3,429	4,298	5,120	5,595	
Account Receivables	2,550	3,112	4,039	5,632	6,993	
Cash and Bank Balance	271	4,774	3,845	4,887	5,801	
Others	1,754	2,000	2,448	2,460	2,688	
Curr. Liability & Prov.	3,130	3,624	4,222	5,855	6,632	
Account Payables	2,714	3,147	3,515	5,120	5,595	
Provisions	416	477	707	734	1,036	
Net Current Assets	4,059	9,691	10,407	12,244	14,446	
Appl. of Funds	10,413	16,437	18,407	21,618	24,187	

E: MOST Estimates

RATIOS						
Y/E MARCH	2005	2006	2007	2008E	2009E	
Basic (Rs)						
EPS (Fully Diluted)	11.4	21.4	35.0	35.7	37.9	
Cash EPS (Fully Diluted)	15.6	26.5	40.3	42.0	45.1	
BV/Share	60.8	77.5	108.6	140.8	172.0	
DPS	3.2	3.2	5.0	6.0	9.0	
Payout (%)	32.3	17.5	15.2	17.9	25.2	
Valuation (x)						
P/E (Fully Diluted)		29.0	17.8	17.4	16.4	
Cash P/E (Fully Diluted)		23.5	15.5	14.8	13.8	
P/BV		8.0	5.7	4.4	3.6	
EV/Sales		3.2	2.7	2.1	1.9	
EV/EBITDA		24.4	18.8	13.0	12.6	
Dividend Yield (%)		0.5	0.8	1.0	1.4	
Return Ratios (%)						
RoE	20.0	31.0	41.3	31.5	26.6	
RoCE	13.9	20.6	27.1	23.0	20.8	
Working Capital Ratios						
Asset Turnover (x)	12	10	1.1	1.2	1.2	
Debtor (Days)	71	65	71	78	89	
Inventory (Days)	76	74	78	73	73	
Wkg. Capital Turnover (Days)	118	210	189	175	188	
Leverage Ratio						
Debt/Equity (x)	0.9	1.5	1.0	0.8	0.7	

CASH FLOW STATEMENT		(Rs Million)				
Y/E MARCH	2005	2006	2007	2008E	2009E	
Oper. Profit/(Loss) before Tax	1,334	2,236	2,922	4,182	4,254	
Interest/Dividends Recd.	234	741	1,991	728	908	
Direct Taxes Paid	-35	-500	-917	-718	-669	
(Inc)/Dec in WC	-293	-1,128	-1,646	-794	-1,288	
EO expense	0	35	0	0	0	
CF from Op. incl EO Exp.	1,241	1,314	2,350	3,398	3,206	
(inc)/dec in FA	-1,281	-800	-1,720	-1,925	-1,000	
(Pur)/Sale of Investments	0	-2	0	0	0	
CF from Investments	-1,281	-801	-1,720	-1,925	-1,000	
Issue of Shares	-34	-76	-116	0	0	
(Inc)/Dec in Debt	624	4,677	-601	552	0	
Interest Paid	-283	-313	-372	-420	-450	
Dividend Paid	-298	-298	-470	-564	-841	
CF from Fin. Activity	9	3,991	-1,560	-431	-1,292	
Inc/Dec of Cash	-31	4,503	-930	1,043	914	
Add: Beginning Balance	302	271	4,774	3,845	4,887	
Closing Balance	271	4,774	3,845	4,887	5,801	

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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