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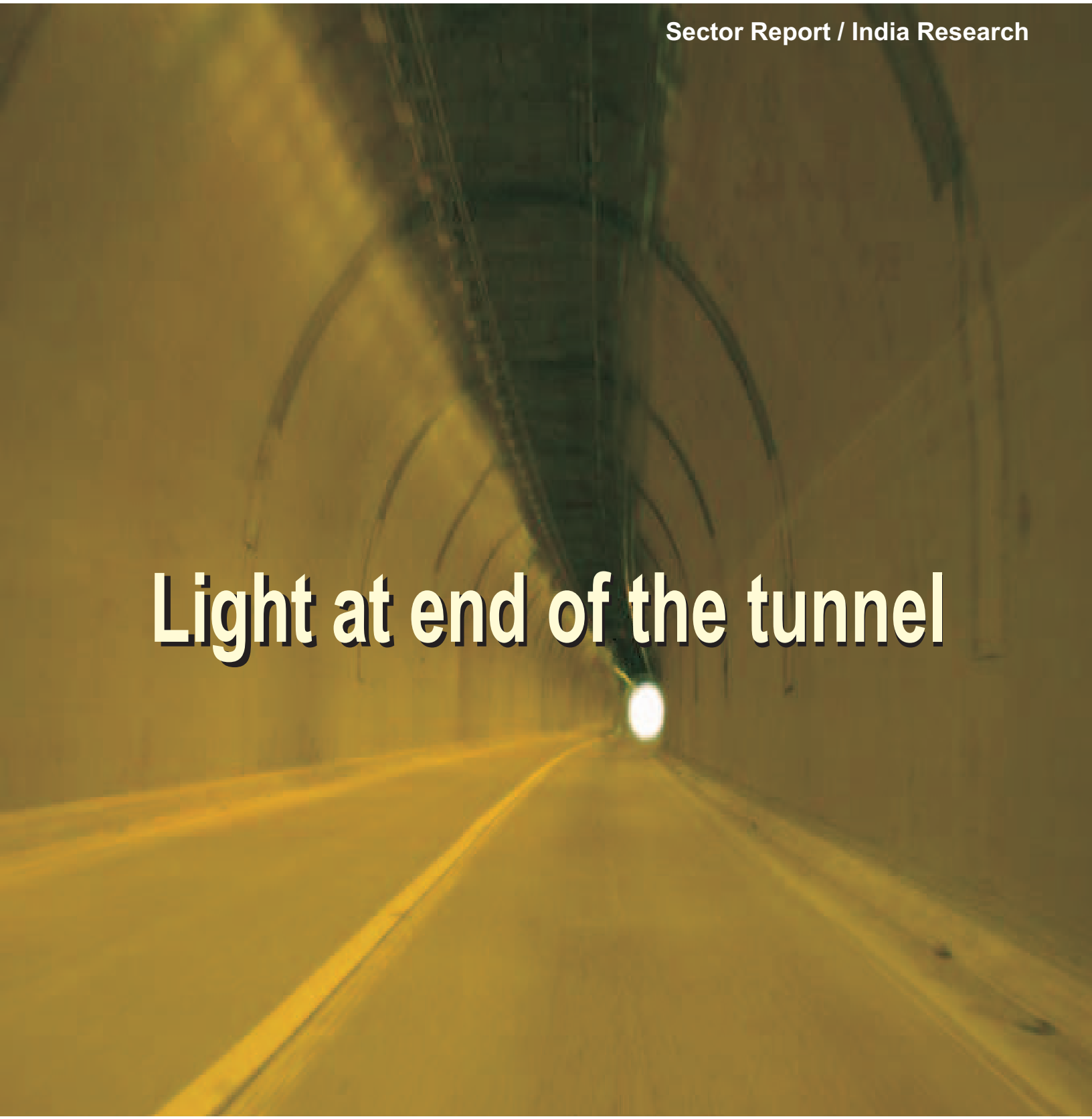

Light at end of the tunnel

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Light at the end of tunnel

A case for good risk-adjusted returns: The BSE Healthcare (HC) Index, over the last two years, has witnessed a significant underperformance vis-à-vis the broader Indices. The earlier leg of underperformance was justified as it came on the back of most generic players clocking poor financial performance. While the Industry pricing woes continue abated, we believe the worst is over as the Industry has consolidated significantly. The Indian players continue to be highly competitive compared to their global counterparts and the trend emerging in the global Generic Industry favours some of them. Hence, we believe that underperformance of some of these companies on the Indian bourses despite their robust performance provides a case for good risk-adjusted returns for investors going ahead.

Consolidation and Out-of-Court Settlements Natural fallout: Pressures in the Generic markets over the last two years have enhanced the pace of consolidation in the sector. This can be gauged from the fact that the Top-4 players command 55% share of the overall market, vis-a-vis 34% in 1997. This has also facilitated many generic companies to opt for out-of court settlements for their Para-IV filings and increase visibility for their pipeline. The innovator companies are also favouring this as they are facing challenging times on account of low R&D productivity and large blockbuster products facing shortened lifecycle.

Generic Markets expected to post a CAGR growth of 10% till 2011: According to IMS, with large blockbuster drugs going off patents and new markets opening up, the generic markets are expected to grow at a CAGR of 10% to touch US $124bn in size by 2011. Majority (60%) of the contribution is expected to come from the Rest of the World (RoW) and the US markets whereas the European and Asian markets would contribute the balance 40%. The Domestic Formulation industry is expected to grow at a CAGR of 10.6% over 2007-12 to US $11.4bn. This growth is expected to be driven primarily by volumes and new product introductions in Chronic Therapeutic Segments like anti-Diabetic, CNS, Cardiovascular systems and Gastrointestinal.

Niche opportunities on the anvil: While the overall generics landscape remains competitive, Therapeutic Segments like Dermatology, Opthalmic and Oncology are encountering lesser competition on account of high entry barriers. Further, Bio-generics is the next big opportunity. Biotech drugs, which contribute 10-15% of the global pharmaceutical industry, have been growing at a faster clip compared to other traditional drugs. The 20-year patent protection on the first batch of biotech drugs that entered the Regulated markets in the late 1980s is set to expire in the ensuing years. This should provide an estimated bio-generic opportunity of around US $ 5bn over the next five-six years to the bio-generic players.

Research & Development- New Funding options emerging: Investments in NCE R&D have become imperative for Pharmaceutical companies with the advent of Products Patent Regime in India in 2005. Overall, the Indian Pharma companies are spending 8% of their revenues on R&D up from the earlier 4% of revenues five years back, with NCE accounting for almost 20-25% of the same. Earlier, companies funded their R&D pursuits through their core operations. But now, with competition intensifying in the generic space, companies are evolving models to mitigate the risks associated with R&D and are aligning their funds towards the generic markets. This has forced many Indian players to re-structure their operations. In line with this, majority of the pharma players have de-merged their R&D units and their R&D pipeline has been widening. Further, their fund requirement for NCE R&D is expected to increase as more products move into clinical trials (clinical trials account for almost two/thirds of the R&D expenditure).Hence, the companies expect the de-merger of their R&D units to help enhance their funding options including out-licensing of molecules and getting strategic and/or financial investor, among others.

Outlook and Valuation: The overall competitive landscape in the Generic markets remains intense. Hence, all the players might find the going tough. However, we believe that the trends emerging or opportunities being witnessed in the Industry favour select players. Hence, we recommend stock-specific investments, with a focus on large caps and companies leveraging Niche opportunities. Pertinently, most of the players have taken initiatives to improve their profitability. Hence, against this backdrop, we believe the underperformance and under ownership of the Sector in the last two years would provide good risk-adjusted rewards to investors. **Among the large caps, we prefer Ranbaxy and DRL. However amongst both we prefer Ranbaxy, which has taken steps to diversify its presence across markets and its operating performance is all set for an uptrend. In the Mid and Small-cap space, we prefer Orchid Chemicals and Indoco Remedies as the companies are focused on Niche Therapeutic Segments.**

Exhibit 1: Comparative Valuation

		CMP	MCap	Target	P/E (x)			EV/EBITDA (x)			RoE (%)			RoCE(%)		
Company	Recos	(Rs)	(Rs cr)	Price (Rs)	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E
Dr Reddy	Buy	558	9377	755	19.7	13.4	13.0	10.5	7.3	6.6	11.3	14.8	13.4	8.7	14.8	12.7
Ranbaxy**	Buy	450	16807	580	29.4	24.8	18.8	19.5	16.5	13.4	20.1	20.9	24.3	16.0	17.5	19.3
Sun Pharma	Neutral	1253	25250	-	28.3	18.3	18.2	25.5	16.3	15.6	26.5	28.8	23.5	19.4	24.5	20.1
Indoco Remedies*	Buy	264	324	460	7.5	5.2	4.6	5.5	3.8	3.0	21.4	24.0	23.8	20.2	24.6	24.5
Orchid	Buy	242	1592	370	18.5	8.4	6.3	8.6	5.4	3.7	12.0	16.5	19.9	15.5	21.0	25.4

*Source: Company, Angel Research, * June Ending, ** Dec Ending; Note: 18 months Target Price*

INDUSTRY

Global Generic Industry trends favour large Generic players

Over the last few years, the generic market has outpaced the overall Branded Pharmaceutical industry on the back of a number of patent expiries and more countries encouraging Generics to aid cost containment measures. The US $77bn generic market registered a growth of 10% in 2006, higher than the 8% growth registered by the overall US $550bn Branded Pharmaceutical industry. Thus, the generics space has been growing robustly. But, competitive pressures have also intensified in the last two years resulting in mega M&A deals and out-of-court settlements being struck.

Consolidation- A natural fall out

Growth continues to be robust, but the high competitive pressures in the industry has seen CY2005-07 to be a period of consolidation. The current pace of consolidation has been primarily focused on US markets with the global players looking at consolidating their position in the market. This is evident from the fact that earlier in 1997, the Top-4 generic companies constituted around 35% of the market and now account for around 55% of the market. Going ahead, the M&A activities are likely to continue but action could be more in the European markets where the generic penetration continues to be lower than the other regions.

While the Global generic pharmaceutical companies were trying to consolidate their overall marketshare in Industry, M&A activity of the Indian players was more focused on enhancing thier presence in the European and other lower penetrated generic markets and diversify their presence. Going forward, while the companies would continue to scout for such opportunities to diversify their presence in other Regulated markets, we believe majority of the transactions henceforth would be for acquiring assets/ products, which provide the companies access to product portfolio in the Niche Therapeutic Area – the point in case being Sun Pharmaceutical's acquisition of Taro, which provided the company an access to the Dermatology segment, where the competitive pressures are lower.

Exhibit 1: M&A Activity

Acquirer	Target	Year	Sales of the Target US $bn	Cost of Acquisition US $bn	Valuation (x) EV/ Sales	EV/ EBDITA	P/S	P/E
Sandoz	Hexal	2005	1.7	5.5	3.4	5.5	3.4	-
Sandoz	Eon Labs	2005	0.4	2.8	6.1	15.2	6.6	23.7
Teva	Ivax Ltd.	2005	1.9	7.4	4.3	32.1	4.0	37.4
Meda	Viatris	2005	0.4	1.0	-	-	2.3	-
Actavis	Alpharma	2005	0.8	0.8	1.0	-	1.0	-
Dr Reddys	BetaPharm	2006	0.2	0.6	2.9	12.6	2.9	-
Watson	Andrx	2006	1.1	1.9	1.7	21.7	1.7	-
Mylan	Matrix	2006	0.3	1.0	5.0	19.6	4.0	-
Ranbaxy	Terapia	2006	0.1	0.3	4.2	12.0	4.2	-
Ranbaxy	Be-tabs	2006	-	0.1	2.2	7.7	-	-
Wockhardt	Pinewood	2006	0.1	0.2	2.1	10.0	-	-
Wockhardt	Negma	2007	0.2	0.3	1.8	9.7	-	-
Sun Pharma	Taro	2007	0.2	0.5	1.5	-	-	-

Source: Industry

Innovators favour Out-of-Court Settlements / Authorised Generics

Heightened competition in the Generic space coupled with low R&D productivity has aggravated the problems for the Innovator companies. Also, most of the generic players are aggressively filing Para-IVs for blockbuster drugs. Due largely to this, the Innovator companies have been opting for out-of-court settlements to protect their profitability and delay entry of the generic players. The generic players have also opted for the same as it provides better revenue visibility in a highly competitive macro environment. Going forward, such deals, which monetizes the generics' product pipeline will create a win-win situation for both players. The trend is already well established as is evident from the number of deals that the Indian Pharmaceutical companies have inked in 2007, notable among them being Ranbaxy's deal with GSK and Astellas & Boehringer Ingelheim's deal for *Valtrex* and *Flomax*, which have a market size of US $1.3bn and US $1.2bn, respectively. Other major Indian drug companies such as DRL, Sun Pharma and Lupin have also opted for settling patent challenges with the Innovator companies.

Exhibit 2: Key Out-Of-Court settlements

Generic firm	Innovator	Patented Drug	Sales (US $ bn)
Sun Pharmaceutical	Novartis	Exelon	0.2
Ranbaxy	Astellas & Boehringer	Flomax	1.2
Ranbaxy	GSK	Valtrex	1.3
Lupin	Abbott & Astellas	Omnicef	0.6
Dr Reddys	GSK	Imitrex	1.1
Dr Reddys	UCB	Keppra	1.0

Source: Industry

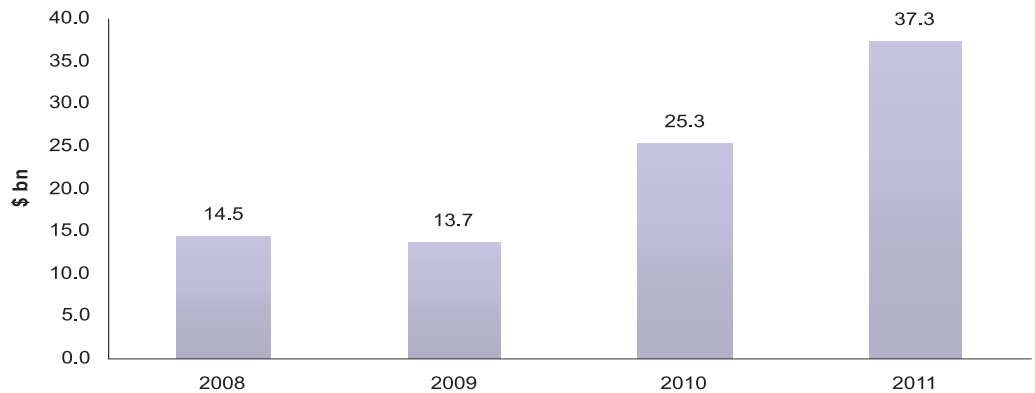
Export Opportunities galore

Generic markets provide ample opportunities despite the macro challenges. According to IMS, with large blockbuster drugs going off patent and new markets opening up, the generic markets are expected to grow at a CAGR of 10% to touch US $124bn in size by 2011 vis-à-vis the 9% growth the Branded Pharmaceutical Segment is expected to clock during the period. Majority (60%) of the contribution is expected to come from the Rest of the World (RoW) and the US markets whereas the European and Asian markets would contribute the balance 40%.

US to maintain its dominance

At US $29.6bn, the US market is still by far the largest pharmaceutical market in the world and accounts for over 28% of the world's generics market. In 2006, unbranded generics in US captured 10% share of sales, while they cornered 54% share of prescriptions, registering growth of 20%, which was well above the growth of Branded products, which grew by 7%. Going ahead, over the next four years, a large number of drugs estimated at US $100bn, are expected to go off patents. According to an estimate, overall the region would clock a CAGR growth of 10% over the next five years.

Exhibit 3: Patent Expiries in the US



Source: C-line, Angel Research

European Union (EU) – Regulatory reforms to drive growth

At US $18bn (in 2006), Europe is the second largest market after the US. However, unlike the US, the EU is a heterogeneous market and the Regulatory framework to encourage generics is still evolving. Pertinently, definition of a generics market differs from country to country. In many markets like France, generics are sold under brand names and branded generics are not a substitute for Innovator drugs. These markets are largely Branded generics and hence pricing pressure is limited as compared to the US market.The UK and Netherland are the most generic friendly markets, similar to the US. European markets such as France, Belgium and Germany are highly Regulated and have low levels of generic penetration. An evolving Regulatory environment coupled with a significant number of drugs going off patents over the next few years, has opened up a big opportunity for the Indian generic players.

Many Indian companies have already made their mark in these markets while many others are pursuing aggressive strategies to foray into these markets, primarily through their inorganic initiatives. Notable among them is Ranbaxy (Italy), Zydus Cadila (France), Torrent Pharma (Germany), DRL (Betapharm) and Wockhardt (CP Pharmaceuticals, Pinewood and Negma). Going ahead, we believe that the region would continue to be an M&A hub for the Indian players to gain access to the new and less penetrated markets. Overall, the region is expected to register a growth of 10% to US $30.2bn by 2011.

Exhibit4 : European Generic markets - Key Features

Parameters	Germany	UK	France	Italy	Spain
Generic market size (US $bn)	7.0	4.7	3.4	0.8	0.4
Expected Growth (%)	8-10			12-18	
Type of Market	Generic Generic			Branded Generic	
Operating Margins (%)	5-10			10-15	
Competition (Pricing Pressure)	High			Low	
Regulatory environment	Favourable			Moderate	
Overall Market assessment	Less favourable			Favourable	

Source: Cris Infac

Japan – A new vista for generic players

Japan, at US $65.2bn(Branded Market), is one the largest Regulated markets and is fast emerging as the latest destination for the Indian players. However, Japan still lags some of the other Regulated markets in terms of generic penetration. At present, generics account for approximately 17% of the market by volume and 7% by value. The Japanese government is however, actively introducing reforms and measures to encourage low cost-high quality generics drugs to facilitate the increasing ageing population and keep a check on high healthcare expenses. The Generic Substitution Law, which was introduced in April 2006, is one such step taken by the government. Overall, the Japanese generic market which was around US$ 4.8bn in 2006 is expected to grow at a CAGR of 7.9% to US$ 10.8bn by 2011. During 2006-07, many Indian companies forayed into the Japanese market either through acquisitions or collaborations. Pertinently, while the low generic penetration would work for the companies, we believe that the Japanese markets have a high gestation period in terms of scalability.

Exhibit 5: Indian foray into Japan

Companies	Comments
Ranbaxy	Entered into a JV with Nippon Chemiphar, a medium sized pharma company focused on generics.
Lupin	Acquired Kyowa, a Japanese generics company ranked amongst the Top-10 generics companies.
Strides Arcolab	Entered into a JV with SORM Co., for long term supply of generic drugs, over-the-counter (OTC) and Nutraceutical products.
Zydus Cadila Healthcare	Acquired Nippon Universal to gain access to a manufacturing base and distribution network.

Source: Industry

Semi- Regulated Markets to be in the radar

Besides the Regulated market, Indian companies are also looking at Emerging markets such as Russia and the CIS Nations, Eastern Europe, Brazil and other Latin American countries (Argentina, Mexico and Chile) and South Africa, as well. These markets account for a substantial part of the sales of the Indian Pharmaceutical companies. These markets like the Indian markets have branded generics and high entry barriers leading to lesser competition and higher profitability. Thus, many Indian companies are looking at enhancing there presence in these markets notable being Ranbaxy (acquisitions in Romania and Africa), Torrent Pharma (Brazil and Russia) and Glenmark (Brazil, Argentina). Going ahead, Indian companies may continue to enhance their presence especially in Eastern Europe.

Niche opportunities

While the overall Generics landscape remains competitive, Therapeutic segments like Dermatology, Opthalmic and Oncology face lesser competition on account of high entry barriers, and hence higher profitability. Unlike other Therapeutic segments where there are 9-10 players post the expiry of the patents and witness 90-95% price erosion, the afore-mentioned segments do not have more than 4-5 players. Further, while the Dermatology and Opthalmic segments constitute a minuscule portion of overall sales, requirement of dedicated facilities has kept competition low and price erosions have also been low. Overall, the Dermatology and Opthalmic Segments have a market of US $4.6 and US $4bn in the US markets, respectively. Both the segments are expected to see some products going off-patent till 2011-12. Some of the Indian companies that are looking at these segments include Indoco Remedies, Glenmark and Sun Pharma (through acquisition of Taro).

In Oncology, the entry barriers are much higher as most of the drugs are Injectables and require specialised and dedicated facilities. Further, these products are difficult to reverse engineer and have lower obsolesce ie., the older products do not go out of fashion unlike in other Therapeutic segments. Some of the Indian companies that are targeting the segment include Ranbaxy (through Zenotech), Sun Pharmaceuticals and Dabur Pharmaceuticals. An estimate puts the overall opportunity in Oncology at US $8-10bn (Innovator sales) upto 2010.

Bio-generics - Opportunity on the anvil

Biotech drugs, which contribute 10-15% of the global pharmaceutical industry, have been growing faster than other traditional drugs. The 20-year patent protection on the first batch of biotech drugs that entered the Regulated markets in the late 1980s is set to expire in the ensuing years. This would provide an estimated opportunity of around US $5bn over the next five-six years to the bio-generic players. However, unlike the traditional drugs, biotech drugs are

complex to manufacture and hence it is difficult to establish the comparability of the generics with the innovator drugs. This has also posed Regulatory hurdles for approval of the generic drugs. Europe has legislation for the same on a drug specific basis. The US however, is yet to have legislation in place for the same since biotechnology products are extremely difficult to replicate. The US has however, been trying to overcome the scientific hurdles to pave wave for the introduction of the bio-generic drugs. Recently, the US Senate incorporated sufficient safeguards against poor quality products. Indian companies like Wockhardt, Ranbaxy, DRL and Biocon have been looking at tapping the bio-generic opportunity and have made investments for the same. The companies are looking at the Regulated Markets for product launches around FY2009 / FY2010.

India to remain at the front end of the opportunity

In the last five years, India's exports have more than doubled and currently accounts for 30% of overall revenues. Going ahead, the momentum is likely to further strengthen with exports expected to triple over the next five years to cross the US$22bn mark (*Source: Cris Infac*). The Formulation Segment would be driven by the Regulated markets, which are expected to post a CAGR growth of 34% over the next five years, while the semi-Regulated markets are expected to grow at a CAGR of 17.3% in the mentioned period. The share of Formulation exports to the Regulated markets is estimated to increase to 54% in 2012 from 37% in 2007. This is evident from the steady rise in ANDA approvals (around 23% of the overall Approvals) and the number of USFDA plants (India has large USFDA approved plants). Apart from the huge opportunities provided by the patent expiries, higher penetration in the Regulated markets are expected to drive the growth. Going ahead, penetration of the Indian players in the US market is expected to increase from 2% in 2006-07 to around 6% in 2011-12, in Europe it is expected to scale up from 2.7% in 2006-07 to 5.7% in 2011-12.

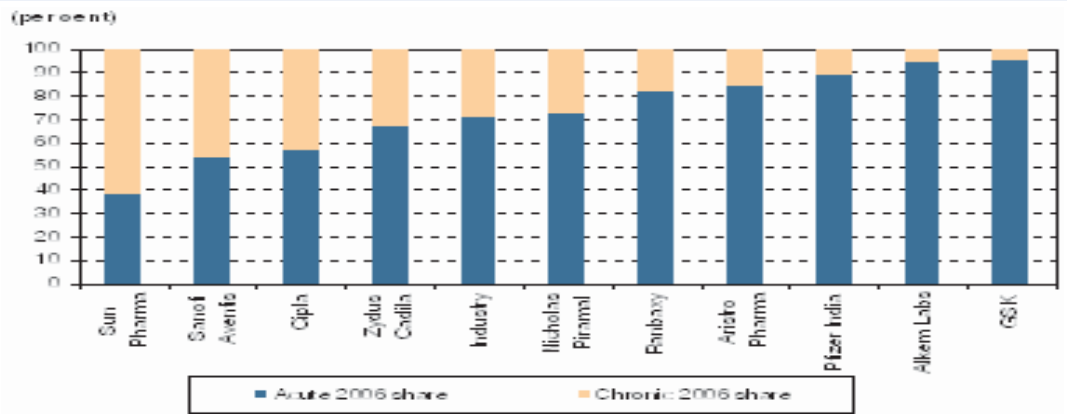
Bulk exports, on the other hand, are expected to log in a CAGR growth of 28% over the next five years. Exports to the Regulated markets are estimated to post a CAGR growth of 37% in the mentioned period, while exports to the Innovator companies are expected to increase from US$0.25bn in 2007 to US $1.9bn in 2012 .

Domestic Formulation- Shift towards Chronic segment

During 2005-2007, the Domestic Formulation market grew at a CAGR of 14.5% to US$6.2bn. The growth was aided by Chronic Therapeutic categories like Anti-diabetic, CNS and Dermatology. Acute therapeutic categories like anti-infective and pain/analgesics and lifestyle diseases segments like gastrointestinal exceeded industry growth. Going ahead, we estimate the Domestic Formulation industry to grow at a CAGR of 10.6% over 2007 - 2012 to US$11.4bn. This growth is expected to be driven primarily by volumes and new product introductions in the Chronic

Therapeutic segments like Anti-diabetic, CNS, cardiovascular systems and lifestyle segments like gastrointestinal. Globally, 56% of the top therapy classes (accounting for 37% of global sales) belong to the Chronic diseases segment. Additionally, sales of this segment are growing faster than sales in the Acute diseases segment due to escalating stress levels resulting from changing lifestyles. By contrast, in India, only 22% of the top Therapy classes (accounting for 35% of domestic sales) belong to the Chronic diseases segment. Among the Top-10 players, sales of Sun, Sanofi-Aventis, Cipla and Zydus Cadila had a higher proportion of Chronic Segment sales.

Exhibit 6: Share of Chronic Segment for Top-10 players



Source: Cris Infac

Exhibit 7: Domestic Formulation according to Therapeutic Segments

(Rs bn)	2004-05	2006-07	2011-12	2004-05 to 2006-07	2006-07 to 2011-12
				CAGR (%)	
Anti-Diabetic	9.0	12.5	24.3	17.9	14.2
Anti-Infective	36.9	49.7	80.8	16.0	10.2
Cardiovascular system	21.7	28.2	48.0	14.0	11.2
Dermatology	11.4	15.5	25.0	16.8	10.0
Gastrointestinal	23.1	30.5	51.4	15.0	11.0
Gynecological	11.9	15.2	25.6	13.1	11.0
Neurology/CNS	10.9	15.0	25.6	17.5	11.2
Pain/analgesics	19.6	26.3	46.2	15.7	12.0
Respiratory	20.2	25.8	42.0	13.1	10.2
Vitamins/minerals/nutrients	19.5	23.8	35.0	10.7	8.0
Others	28.6	36.4	58.8	29.7	10.1
Total	**212.7**	**279.1**	**462.7**	**14.5**	**10.6**

Source: Cris Infac

Consolidation Imminent

The Indian Formulation Industry, which is dominated by domestic companies, is highly fragmented, with 300-400 units in the organised segment and 15,000 units in the unorganised segment. As for marketshare, the Top-5 and Top-10 players account for 23% and 37% of the total Formulation sales, respectively. Further, New Product introductions would be lesser than it was earlier. Hence, going forward, we believe that the Indian Formulation market is set for consolidation given the challenges ahead. However, we believe that the consolidation, though imminent could take longer as valuations of most of the companies remain expensive.

Lack of clarity in Patent could slow New Product introductions by MNCs

Currently, MNC Pharmaceutical companies account for 20% of the overall Domestic Formulation market. The MNC pharmaceutical players were expected to launch their new products with the advent of the Product Patent regime in 2005 (products discovered after 1995 to be eligible for Patents) and hence increase their share in the overall Formulation market. But, the same has not been witnessed primarily due to the lack of clarity on issues like Compulsory licensing, Data exclusivity, Pricing issues and denial of patents for incremental innovation. That apart, many MNC players have 100% subsidiaries through whom the new products could get launched.

Research & Development - New Funding options emerging

Investments in NCE R&D have become imperative for Pharmaceutical companies with the advent of Products Patent Regime in India in 2005. While earlier R&D Investments in NCE molecules was restricted to the large-cap companies, now even Mid-cap companies like Cadila, Nicholas Piramal and Wockhardt are investing in building their R&D assets. At present, as many as 10-12 companies have molecules under various stages of development. The R&D spend of major Indian companies has grown at a CAGR of 38% during 2001 - 2006. Overall, the Indian Pharma companies are spending 8% of revenues on R&D, up from the earlier 4% of revenues in the last five years. A large share of the investments continue to be in Generic Formulations. But, the scenario is rapidly changing and investments are also being deployed towards NDDS and NCE Research. The NCE R&D typically accounts for almost 20-25% of the sales of the companies. However, this far, none of the companies have been able to commercialise the products and only three products are in Phase-III Clinical Trials. As for out-licensing, Glenmark has been most successful by out-licensing three molecules, with cummulative milestone payments of US $1bn.

Exhibit 8: R&D Spend (FY2007)

Company	R&D (% of Sales)
Biocon	4.9
Cadila Health	6.9
Dr Reddy's	4.5
Glenmark Pharma	4.2
Nicholas Piramal	5.2
Ranbaxy	6.6
Sun Pharma	11.7
Wockhardt	3.5

Source: Industry

Earlier companies funded their R&D pursuits through their core operations. But now, with competition intensifying in the generic space, companies are evolving models to mitigate the risks associated with R&D and are aligning their funds towards the generic markets. This has forced many Indian players to re-structure their operations. In line with this, many of the pharma players have de-merged their R&D units and their R&D pipeline has been widening. Further, their fund requirement for NCE R&D is expected to increase as more products move into clinical trials (clinical trials account for almost two/thirds of the R&D expenditure). Overall, with more products moving into clinical trials, these investments are likely to increase going ahead. Hence, the companies expect the de-merger of their R&D units to help enhance their funding options including out-licensing of molecules and getting strategic and/or financial investor, among others.

The trend was set by Sun Pharmaceuticals, which recently hived off its R&D unit into a separate entity (SPARC). SPARC attracted valuations of US $500mn, which has made other Pharmaceutical companies follow suit. Recently, Nicholas Piramal also announced hiving off its NCE R&D unit (NPRC). Ranbaxy, India's largest pharmaceutical company is also opting for de-merger of its NCE unit. Glenmark Pharma (GPL) has also unveiled plans to re-organise its business into two distinct groups viz., Generics (mostly non-branded to be listed as Glenmark Generics by 1QFY2009) and Specialty (NCE and branded generics).This is the first time that any Indian pharma company has split its business in such a manner. Glenmark Generics will be a wholly-owned subsidiary of GPL, which plans to make an IPO in 1QFY2009. Dr Reddys has opted for venture funding while Sun Pharmaceutical has de-merged its R&D unit.

The reason for the same are that while its much cheaper to develop a product in India compared to any other place globally, as in India, skilled manpower is available at lower rates. But, the risks of failure in R&D are also very high. Hence, we believe that the standalone entities would initially focus on adopting out-licensing / collaborative methods for their products due to lack of experience and to maximize the funding options for their R&D pipeline.

Exhibit 9: R&D Pipeline

Company	Preclinical	Phase I	Phase II	Phase III
Dr Reddys	DRL 16048	RUS 3108, DRL 16536, DRF 1042		DRF 2593
Ranbaxy		RBX 10558, RBx 9841	Arterolane, RBx 11160	
Sun Pharma	SUN 461, SUN 44, SUN 09		SUN 1334H	
Glenmark	GRC 10801,GRC 10693, GRC 4093	GRC 6211	GRC 3886,GRC 8200	
Lupin	Type II Diabetes, RA	LL3858/ 4858	LLL4218	LLL 2011, LLL 3348
Cadila Healthcare		ZY01, ZYH2	ZYH1, ZYI1	
Wockhardt		WCK1152	WCK771	
Nicholas Piramal	P1446,KM80, Pxxx, Microbial leads, P979, P1539, P2026,P1736, PM181104		P276,PP-05, PP-04	
Orchid Chemicals	Oncology, Inflammation, Obesity		BLX1002	
Biocon	BVX-10,BVX20,Oral BNP	T1 h	IN 105	
Dabur Pharma	DRF 4012, NDR/ C32, NDR/NCE20,NDR/ NCE18, DRF/VDO01, DRF/VDO02, DRF/ VDO03		DRF7295	

Source: Industry

Risks

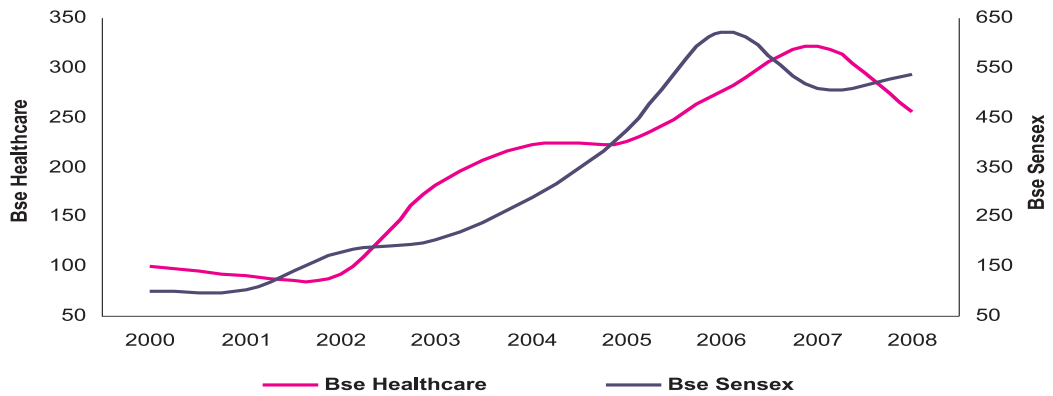
Price Control: Since the introduction of Drug Price Control (DPCO) Policy in 1970, the number of bulk drugs under price control have declined gradually from 347 in 1987 to 163 in 1994 to 74 at present, which is believed to cover only 25% of the market. However, recently the Chemicals Ministry announced it's intentions to cover additional 354 drugs mentioned in the "National List of Essential Medicines 2003" (NLEM 2003) under price control. It is estimated that drugs under NLEM 2003 comprise 20% of the market. Reduction in the prices of these drugs is expected to have an impact on other related formulations. Overall, the Policy is expected to impact as much as 40% of the market. Therefore, with existing price control on 74 drugs, the price control will be on as much as 60% of the market. The Policy has witnessed a strong resistance from the Industry and hence we believe that the same would not be passed in its current state.

Currency Appreciation: Year 2007 witnessed significant 12% yoy appreciation in the Rupee. An appreciating Rupee has added to the pricing woes of the pharma players, which drive majority of the Revenues through exports. However, these companies have some natural hedges in terms of raw material imports, foreign currency loans and a front-end presence. Hence, none of the companies have been badly impacted on account of hedging their open positions. Thus, overall impact would have to be gauged on a case-to-case basis. Going ahead, we have factored in 5% pa., currency appreciation in our projections.

Outlook

A case for good risk-adjusted returns: The BSE Healthcare (HC) Index, over the last two years, has witnessed a significant underperformance vis-à-vis the broader Indices. The earlier leg of underperformance was justified as it came on the back of most generic players clocking poor financial performance. While the Industry pricing woes continue abated, we believe the worst is over as the Industry has consolidated significantly. The Indian players continue to be highly competitive compared to their global counterparts and the trend emerging in the global Generic Industry favours some of them. Hence, we believe that underperformance of some of these companies on the Indian bourses despite their robust performance provides a case for good risk-adjusted returns for investors going ahead.

Exhibit 10 : BSE Healthcare v/s Sensex



Source: C-line

The overall competitive landscape in the Generic markets remains intense. Hence, all the players might find the going tough. However, we believe that the trends emerging or opportunities being witnessed in the Industry favour select players. Hence, we recommend stock-specific investments, with a focus on large caps and companies leveraging Niche opportunities. Pertinently, most of the players have taken initiatives to improve their profitability. Hence, against this backdrop, we believe the underperformance and under ownership of the Sector in the last two years would provide good risk-adjusted rewards to investors. **Among the large caps, we prefer Ranbaxy and DRL.However amongs the both we prefer Ranbaxy, which has taken steps to diversify its presence across markets and its operating performance is all set for an uptrend. In the Mid and Small-cap space, we prefer Orchid Chemicals and Indoco Remedies as the companies are focused on Niche Therapeutic Segments.**

Exhibit 11: Comparative Valuation

		CMP	MCap	Target	P/E (x)			EV/EBITDA (x)			RoE (%)			RoCE(%)		
Company	Recos	(Rs)	(Rs cr)	Price (Rs)	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E
Dr Reddy	Buy	558	9377	755	19.7	13.4	13.0	10.5	7.3	6.6	11.3	14.8	13.4	8.7	14.8	12.7
Ranbaxy**	Buy	450	16807	580	29.4	24.8	18.8	19.5	16.5	13.4	20.1	20.9	24.3	16.0	17.5	19.3
Sun Pharma	Neutral	1253	25250	-	28.3	18.3	18.2	25.5	16.3	15.6	26.5	28.8	23.5	19.4	24.5	20.1
Indoco Remedies*	Buy	264	324	460	7.5	5.2	4.6	5.5	3.8	3.0	21.4	24.0	23.8	20.2	24.6	24.5
Orchid	Buy	242	1592	370	18.5	8.4	6.3	8.6	5.4	3.7	12.0	16.5	19.9	15.5	21.0	25.4

*Source: Company, Angel Research, * June Ending, ** Dec Ending; Note: 18 months Target Price*

Company

BUY

Price	**Rs558**
Target Price	**Rs755**
Investment Period	**18 months**

Stock Info

Sector	Pharmaceutical
Market Cap (Rs cr)	9,377
Beta	0.48
52 Week High / Low	760/501
Avg Daily Volume	104562
Face Value (Rs)	5
BSE Sensex	16,340
Nifty	4,864
BSE Code	500124
NSE Code	DRREDDY
Reuters Code	REDY.BO
Bloomberg Code	DRRD IN

Shareholding Pattern (%)

Promoters	25.2
MF / Banks / Indian FIs	19.1
FII / NRIs / OCBs	44.9
Indian Public / Others	10.9

Abs.	3m	1yr	3yr
Sensex (%)	(7)	36	162
Dr Reddy (%)	(5)	14	62

	3m	1yr	3yr
Rel.to Sen. (%)	(2)	(50)	(100)

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Betapharm overhang persists

A focus on Para-IV opportunities in the US markets and high R&D spend have been primarily responsible for Dr. Reddy's (DRL) fluctuating performance. However, post its dismal showing in FY2005, DRL took initiatives to reduce the variability through monetising its ANDA pipeline, diversifying into newer markets and taking the collaborative route for R&D investments. But, DRL's acquisition of Betapharm once again raised concerns about its profitability and took a toll on the stock price . At the CMP, the stock is trading at 13.4x FY2009E and 13.0x FY2010E Earnings, which is at a steep discount to its peers and fairly discounts the concerns. ***We recommend a Buy on the stock, with a Target Price of Rs755.***

- **Emerging Markets to be at the forefront:** During FY2007-10E, emerging markets like Russia and India would be the key growth drivers for DRL. The domestic markets are expected to post a CAGR growth of 12.0%, while Russia is expected to post a CAGR growth of 16.2% in the mentioned period. Generics, adjusting for the one-time upsides, are expected to remain flat during the period.

- **US - Robust Pipeline:** In the US, DRL has a robust product pipeline with around 69 ANDAs pending approval (FY2007), addressing a market opportunity of US $57bn. In its pipeline the company has around 29 Para-IV filings, with 18 FTFs. The 18 FTFs target a market opportunity of US $12bn. We believe that given the trend towards out-of-court settlements and Authorised Generic (AG), DRL is well placed to leverage the same on back of its pipeline.

- **Net Sales growth to post a 9.5% CAGR over FY2007-10E:** Excluding one-time upsides in FY2007, DRL is expected to post a CAGR growth of 9.5% in Sales over FY2007-10E. On the Operating front, we expect OPMs to be muted in FY2008 mainly on account of Betapharm acquisition and lack of any bigger one-time opportunity for the company. However, in FY2009, DRL is expected to post an improvement on the Operating front mainly on the back of launch of *Imitrex* and *Levetiracetam* in the US markets. Overall, we have built in a 50bp improvement in OPMs during FY2007-10E.

Key Financials (IGAAP Consolidated)

Y/E March (Rs cr)	FY2007	FY2008E	FY2009E	FY2010E
Net Sales	**6,422.9**	**5,313.2**	**6,072.0**	**6,644.7**
% chg	*174.6*	*(17.3)*	*14.3*	*9.4*
Net Profit	**965.9**	**474.5**	**701.3**	**721.5**
% chg	*558.3*	*(50.9)*	*47.8*	*2.9*
EPS (Rs)	**57.5**	**28.3**	**41.8**	**43.0**
EBITDA Margin (%)	24.5	17.0	19.3	17.5
P/E (x)	9.7	19.7	13.4	13.0
P/CEPS (x)	7.0	10.5	8.3	8.1
RoE (%)	31.8	11.3	14.8	13.4
RoCE (%)	20.5	8.7	14.8	12.7
P/BV (x)	2.3	2.1	1.8	1.6
EV/Sales (x)	1.6	1.8	1.4	1.2
EV/EBITDA (x)	6.4	10.5	7.3	6.6

Source: Company, Angel Research

Investment Argument

Emerging Markets to be at the forefront

Exports constitute a major 86% of DRL's overall Sales. Exports posted a CAGR growth of 48% (including one-time upsides through AG and 180- day exclusivity) over FY2003-07. DRL was earlier confined to the US and Russian markets. However, the recent acquisition of Betapharm and the Mexican Custom Pharma Services (CPS) business has diversified DRL's exports.

US- Robust pipeline

In the US, DRL has a robust product pipeline with around 69 ANDAs pending approval (FY2007). However unlike its peers, DRL has been focused on Para-IV opportunities. Overall, DRL's product pipeline addresses a market opportunity of around US $57bn, with 29 Para-IV filings and 18 First-To-File (FTFs) opportunities. These 18 FTFs target a market opportunity of $12bn. A high concentration of Para-IVs unlike its peers, who have a diversified product portfolio, had led to higher volatility in DRL's US business. The company however, over the last few years, has been working at improving visibility of its pipeline through monetising the same through out-of-court settlements and authorised generic (AG) deals. In FY2007, this strategy paid rich dividends. During FY2007, DRL launched the AG of *Simvastatin* and *Finasteride*. The company also entered into an out-of-court settlement for *Imitrex* (to be launched towards late 2008). Going ahead, we believe that DRL will continue to monetise the upcoming opportunities and enhance visibility of its pipeline. For FY2007-10E, we have factored in upsides from *Imitrex* and *Levetiracetam*.

Exhibit 1: Select Para-IV opportunities

Product	Brand	Market Size (US $mn)	Earliest Launch	Comments
Galantamine	Razadyne	250	Dec 2008	Shared Exclusivity
Levetiracetam	Keppra	742	Dec 2009	Settled the case
Rivastigmine Hydrogen Tartrate	Exelon	230	Aug 2012	The Inovator has settled the case with Sun
Ibandronate sodium	Boniva	628	March 2012	Shared Exclusivity
Moxifloxacin	Avelox	230	March 2014	Shared Exclusivity

Source: Industry, Angel Research

Acquisitions to impact profitability

In FY2006, DRL acquired Betapharm (the fourth largest generic player in Germany) and the Mexican CPS business. DRL acquired Betapharm for US $570mn with the aim of getting the much required scale in the European markets (posted Sales of Euro 164mn in 2005). However, since the acquisition, the Regulatory environment has resulted in severe price cuts and supply constraints in turn impacting overall profitability of Betapharm. Going forward however, DRL expects to improve its profitability through outsourcing of products from its Indian facilities.

Management expects 80-85% offtake of its products from the Indian markets by March 2008. However, given the pricing scenario in Germany, we have not factored in any improvement in our financials.

India & Russia to drive growth

Going ahead, while the Regulated markets are expected to post lacklustre performance, we expect Emerging markets like Russia and India to drive DRL's growth. India contributes around 52% of DRL's overall Formulation Sales. DRL derives around 70% of its overall Formulation Sales from the Chronic Segments, which are expected to grow at a CAGR of 17.8% over FY2007-10E period. Overall, we expect Indian Formulations to post a CAGR of 14.1% over FY2007-10E, with the Top-10 brands registering a growth of 13.0%. After India, Russia accounts for a major chunk of DRL's Formulation Sales (28%). DRL is one of the largest players in Russia. DRL has plans to enhance its positioning in Russia through its entry into the Hospitals and OTC segments. Overall, we expect the company to clock a CAGR growth of 16.4% in the region during the mentioned period.

R&D - Focus on Basic Research

Unlike its peers, DRL has been investing heavily in Basic Research. However, to mitigate the risks associated with investments in NCE Research, the company has adopted a collaboration route. Currently, DRL has an alliance with Prelecan, Rheosceinec, Argenta and ClinTec. These collaborations have reduced DRL's overall spend on R&D. As for Therapeutic segments its focused on segments like Metabolic Disorders and Cardiovascular. Currently DRL has 7 NCEs, with five at various stages of clinical trials and 2 at pre-clinical stages. DRL expects its lead molecule (Balaglitazone) in the Anti-Diabetics segment, which is currently at Phase-III, to enter the markets by 2011. However, given the risk profile of the molecule, we have currently not included the same in our financial assumption.

Exhibit 2: NCE Pipeline

Compound	Therapeutic Area	Status	Development Partner	Remarks
DRF 2593	Metabolic Disorders	Ph III	Rheoscience	
DRF 10945	Metabolic Disorders	Ph II	Assigned to Perlecan	Completed proof of concept study for Type IV/V Dyslipidemia
RUS 3108	Cardiovascular Disorders	Ph I	Assigned to Perlecan	Scheduled to enter Phase II
DRL 16536	Metabolic Disorders	Ph I	Assigned to Perlecan	Scheduled to enter Phase I Multiple Ascending Dose Study
DRF 1042	Oncology	Ph I	ClinTec	Scheduled to enter Phase II for Solid Tumors

Source: Company

Financial Performance

Emerging Markets to drive growth

Excluding the one-time upsides in FY2007, DRL is expected to post a CAGR growth of 9.5% in sales FY2007-10E driven by Emerging Markets. India contributes around 52% of DRL's overall Formulation Sales, which is expected to post a CAGR growth of 14% in the mentioned period. After India, Russia accounts for a major chunk of DRL's Formulation Sales (28% in FY2007) and is expected to post a CAGR growth of 16.2% during FY2007-10E. The Generics Segment on the other hand is expected to witness a de-growth mainly on account of a high base effect. We have factored a decline of 19.4% for the Segment for the period.

On the Operating front, we expect OPMs to be muted in FY2008 mainly on account of Betapharm acquisition and lack of any bigger one-time opportunity for the company. However, in FY2009, DRL is expected to post an improvement in OPMs mainly on the back of launch of *Imitrex* and *Levetiracetam* in the US markets. Overall, we have built in 230bp improvement in operating margins in FY2009 to 19.3%. However, lack of any exclusivities in FY2010 would prove to be a drag on Margins. Overall, we have factored in a 50bp improvement in OPMs over FY2007-10E. On the profitability front, DRL's RoE and RoCE would remain volatile, with Betapharm expected to register lower profits during FY2007-10E, and due to DRL's high exposure to exclusivity products in the US.

Concern

Betapharm likely to post lacklustre performance : Betapharm, which contributes around 12% of DRL's overall sales, would continue to impact DRL's overall performance. Currently, the company has taken initiatives to improve the same through a shift of manufacturing towards India. However, we have not factored the same in our projections.

Outlook and Valuation

Lack of Para-IV opportunities and high R&D spend had resulted in DRL hitting its nadir in terms of profitability and clocking OPMs of 4.7% in FY2005. However, since then DRL has taken initiatives to reduce the variability through monetising its pipeline, diversifying into newer markets and taking a collaborative route for R&D investments. These led to DRL's out-performance in CY2006. However, its acquisition of Betapharm once again raised concerns about its profitability and the stock has since been taking a severe beating on the bourses. At the CMP, the stock is trading at 13.4x FY2009E (including the Para-IV opportunities) and 13.0x FY2010E Earnings . On EV/EBDITA basis, the stock has been trading at 9x one-year forward (after 2005), which is at a steep discount to its peers. At these valuations, we believe that the prevailing concerns are fairly discounted. Further there could be upsides on back of Para-IV oppurunities. **We recommend a Buy on the stock, with a Target Price of Rs 755.**

Profit & Loss Statement (IGAAP Consolidated) Rs crore

March	FY2007	FY2008E	FY2009E	FY2010E
Net Sales	**6,423**	**5,313**	**6,072**	**6,645**
% chg	*174.6*	*(17.3)*	*14.3*	*9.4*
Total Expenditure	4,850	4,408	4,903	5,482
EBIDTA	**1,573.1**	**904.8**	**1,168.9**	**1,162.6**
(% of Net Sales)	*24.5*	*17.0*	*19.3*	*17.5*
Other Income	207.1	108.2	39.8	83.8
Depreciation& Amortisation	379.1	416.0	421.2	436.6
Interest	152.6	75.9	17.3	17.3
PBT	**1,239.9**	**521.1**	**770.2**	**792.4**
(% of Net Sales)	*19.3*	*9.8*	*12.7*	*11.9*
Extraordinary Expense/(Inc.)	-	-	-	-
Tax	274.4	46.9	69.3	71.3
(% of PBT)	**22.1**	**9.0**	**9.0**	**9.0**
PAT	**965.9**	**474.6**	**701.3**	**721.5**
% chg	*558.3*	*(50.9)*	*47.8*	*2.9*

Balance Sheet (IGAAP Consolidated) Rs crore

March	FY2007	FY2008E	FY2009E	FY2010E
SOURCES OF FUNDS				
Equity Share Capital	84.0	84.0	84.0	84.0
Reserves& Surplus	3,913.4	4,313.5	4,985.7	5,632.9
Shareholders Funds	**3,997.4**	**4,397.5**	**5,069.7**	**5,716.9**
Total Loans	2,490.7	321.1	321.1	321.1
Deffered Tax Liability	106.2	104.9	104.6	109.5
Total Liabilities	**6,594**	**4,823**	**5,495**	**6,147**
APPLICATION OF FUNDS				
Gross Block	4,720.3	5,126.6	5,178.8	5,327.1
Less: Acc. Depreciation	1,183.9	1,513.3	1,936.2	2,372.8
Net Block	**3,536.4**	**3,613.3**	**3,242.6**	**2,954.3**
Advance for Capital Itmes	-	-	-	-
Capital Work-in-Progress	289.8	-	-	-
Investments	**134.1**	**134.1**	**134.1**	**134.1**
Current Assets	3,755.9	1,968.5	3,128.1	4,158.1
Current liabilities	1,122.9	893.4	1,010.4	1,100.0
Net Current Assets	**2,633.0**	**1,075.1**	**2,117.7**	**3,058.1**
Deferred Tax Asset	1.0	1.0	1.0	1.0
Total Assets	**6,594**	**4,823**	**5,495**	**6,147**

Cash Flow Statement (IGAAP Consolidated) Rs crore

March	FY2007	FY2008E	FY2009E	FY2010E
Profit before tax	1,239.9	521.1	770.2	792.4
Depreciation	379.1	416.0	421.2	436.6
Change in Working Capital	155.4	103.8	117.8	103.8
Direct taxes paid	250.6	150.8	173.0	179.9
Cash Flow from Operations	**1,213.0**	**682.5**	**900.6**	**945.4**
Inc./ (Dec.) in Fixed Assets	669.0	116.5	52.2	148.3
Free Cash Flow	**544.0**	**566.0**	**848.4**	**797.1**
Inc./ (Dec.) in Investments	0.5	-	-	-
Issue of Equity	1,009.8	-	-	-
Inc./(Dec.) in loans	(626.2)	(2,169.6)	-	-
Dividend Paid (Incl. Tax)	73.7	73.7	73.7	73.7
Others	(28.0)	(15.5)	(150.1)	(113.2)
Cash Flow from Financing	**338.3**	**(2,227.7)**	**76.4**	**39.5**
Inc./(Dec.) in Cash	881.4	(1,661.7)	924.9	836.6
Opening Cash balances	**979.6**	**1,861.0**	**199.3**	**1,124.1**
Closing Cash balances	**1,861.0**	**199.3**	**1,124.1**	**1,960.8**

Key Ratios

March	FY2007	FY2008E	FY2009E	FY2010E
Per Share Data (Rs)				
Diluted EPS	57.5	28.3	41.8	43.0
Diluted Cash EPS	80.1	53.0	66.8	69.0
DPS	7.5	7.5	7.5	7.5
Book Value	238.1	261.9	301.9	340.5
Operating Ratio (%)				
Raw Material / Sales (%)	42.7	42.7	40.0	40.6
Inventory (days)	42.3	40.7	39.6	39.8
Debtors (days)	43.8	43.2	43.2	43.2
Debt / Equity (x)	0.6	0.1	0.1	0.1
Returns (%)				
RoE	31.8	11.3	14.8	13.4
RoCE	20.5	8.7	14.8	12.7
Dividend Payout	13.0	26.5	18.0	17.5
Valuation Ratio (x)				
P/E	9.7	19.7	13.4	13.0
P/E (Cash EPS)	7.0	10.5	8.3	8.1
P/BV	2.3	2.1	1.8	1.6
EV / Sales	1.6	1.8	1.4	1.2
EV / EBITDA	6.4	10.5	7.3	6.6

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Ranbaxy Laboratories

Sector Report / India Research

BUY

Price	**Rs450**
Target Price	**Rs580**
Investment Period	**18 months**

Stock Info

Sector	Pharmaceutical
Market Cap (Rs cr)	16,807
Beta	0.65
52 Week High / Low	490/300
Avg Daily Volume	347991
Face Value (Rs)	5
BSE Sensex	16,340
Nifty	4,864
BSE Code	500359
NSE Code	RANBAXY
Reuters Code	RANB.BO
Bloomberg Code	RBXY IN

Shareholding Pattern (%)

Promoters	34.8
MF / Banks / Indian FIs	28.3
FII / NRIs / OCBs	17.2
Indian Public / Others	19.7

Abs.	3m	1yr	3yr
Sensex (%)	(7)	36	162
Ranbaxy (%)	18	32	(13)

	3m	1yr	3yr
Rel.to Sen. (%)	25	(4)	(174)

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Rise of the Phoenix

The Ranbaxy stock has been on a comeback trail post touching its nadir in CY2005. We believe that the company is well placed to take advantage of the emerging macro-level opportunities, and some of its initiatives kicked off in the interim would start panning out from CY2008. Ranbaxy has a well-diversified business model and robust pipeline, which makes it our preferred pick in the Indian Pharmaceutical Sector. At the CMP, the stock is trading at 24.8x CY2008E and 18.8x CY2009E. ***Hence, we believe that Ranbaxy is the best bet in the space and recommend a Buy, with a Target Price of Rs580.***

- **US Market- Robust product pipeline:** The US, which is the single largest market for Ranbaxy, is expected to register a CAGR growth of 13.8% over CY2007-09E. Ranbaxy currently has a robust product pipeline (second largest) with 98 ANDAs pending approvals, of which the company has 18 FTF Para-IV opportunities. Overall, these products have an addressable market of US$55bn and US$26bn, respectively. The company expects to launch at least one Para-IV each year.

- **Non-US regions to aid 13.8% CAGR in Sales over CY2007-09E:** Management has guided towards a 20% (US $ terms) growth in CY2008. We expect, Ranbaxy to post a CAGR growth of 19.8% (US $ terms) over CY2007-09E. Growth would be mainly aided by the non-US regions like Russia and Africa, which are expected to clock growth of 19.3% and 41.9%, respectively. Overall contribution of the European, CIS and African regions would increase to 46% in CY2009 from 27% in CY2006.

- **Improvement on Operating front to continue:** In CY2005, the company hit its nadir in terms of operating performance, with its core Margins declining to a low of 2.6%. During CY2006, significant cost containment measures aided the company to improve its operating performance. Going into CY2007-09E, improvement on the operating front is likely to continue. Overall, we estimate Ranbaxy to end CY2009 with core Operating Margins of 15.8%, an improvement of 226bp over CY2007. This would aid company's Net Profit outpace Sales growth at a CAGR of 25% over CY2007-09E.

Key Financials (Consolidated)

Y/E December (Rs cr)	CY2006	CY2007	CY2008E	CY2009E
Net Sales	**6,012.6**	**6,590.4**	**7,412.8**	**8,542.5**
% chg	*17.9*	*9.6*	*12.5*	*15.2*
Adj Net Profit	**510.9**	**570.1**	**676.2**	**890.2**
% chg	*95.2*	*11.6*	*18.6*	*31.6*
EPS (Rs)	**13.7**	**15.3**	**18.2**	**23.9**
EBITDA Margin (%)	12.4	13.6	14.5	15.8
P/E (x)	32.8	29.4	24.8	18.8
P/CEPS (x)	24.1	16.5	18.5	14.8
ROE (%)	20.1	20.1	20.9	24.3
ROCE (%)	16.3	16.0	17.5	19.3
P/BV (x)	6.4	5.5	4.9	4.3
EV/Sales (x)	3.4	3.1	2.7	2.4
EV/EBITDA (x)	23.2	19.5	16.5	13.4

Source: Company, Angel Research, Note-CY2007 Excludes translational gains on FCCB

Investment Argument

Robust growth in key markets to aid 13.8% growth over CY2007-09E

US Markets: Robust pipeline

CY2008 would mark the beginning of an accelerated growth momentum for Ranbaxy in the US. Currently, the company has 98 ANDAs pending approvals addressing market of US $ 55bn, comprising a well-balanced mix of plain vanilla generics, niche products and 18 potential FTF opportunities (addressing a market opportunity of US $26bn.).The company expects a Para-IV launch in the US markets every year. Ranbaxy's existing pipeline has strong visibility of Para-IV product launches till CY2012. The commitment to monetise the opportunity can be gauged from the fact that the company has undergone three out-of-court settlements last year. These product launches apart from spurring growth would also enhance overall profitability of the company. Ranbaxy's key Para-IV FTF launches during CY2008-10 include: CY2008 – *Imitrex* - US $985mn, *Razadyne* - US $130mn; CY2009 – *Valtrex* - US $1.3bn; and CY2010 – *Tamosulin* - US $1.2bn, *Lipitor* - US $10bn. However, major part of the upsides from Para-IVs would accrue from CY2009. Overall, we expect the region to clock growth of 13.8% during CY2007-09E. Given the one time nature of these Para-IVs, we have valued the disclosed opportunities at Rs50/share.

European, CIS and African Markets to maintain momentum

Over the last one year, Ranbaxy has been active in the M&A space in the region to diversify and enhance its presence in the less penetrated markets. In line with this, it acquired companies in the niche markets of Italy, Romania and South Africa. Significant among these being Terapia of Romania. Romania is the fastest growing market in the central eastern European region having an annual growth of around 34%. Terapia, with sales of around US $80mn, was acquired by Ranbaxy for US $324mn. Terapia has EBDITA Margins in excess of 35%. The region posted growth of 37% during CY2007. Going forward, we expect the European, CIS and African regions to register a CAGR growth of 35.2% over CY2007-09E mainly aided by CIS and Africa registering a growth of 19.3% and 41.9%, respectively. The other key market of India is expected to post CAGR growth of 11% during the period.

Building Blocks for future opportunities – Biotech

During CY2007, the company made investments in Niche segments like Oncology and Biotech to the tune of Rs289cr by acquiring stakes in Zenotech, Kerbs Biochem and Jupiter Biosciences. Zenotech is primarily focused on the Oncology and Biotech Segments and provides the company with 2 R&D and injectable manufacturing facilities. In terms of pipeline, the company has a pipeline of 10 and 3 products in the Oncology and Biological segments, respectively. Apart from this, the company has around 7 Biological products under various stages of development, addressing one/third of the overall opportunity in the global Biological market of US $65bn. With this, the company is now well placed to tap the opportunities in the Oncology and Bio-similar

markets. Ranbaxy has also made strategic investments in Jupiter Biosciences, which provides it an entry into another high-barrier Peptide business. While the company expects the Zenotech product to start contributing from CY2009, we have however, not factored in any upsides from the same.

Research & Development – De-merger to unlock value

Ranbaxy has decided to de-merge its R&D unit to enhance its funding options (through multiple options like out-licensing of the molecule by getting a strategic and/or financial investor). The trend started off with the de-merger of the Sun Pharmaceuticals NCE unit. We believe de-merger of Ranbaxy's NCE R&D unit would aid unlocking value of its IPR assets and also aid Profitability. Further, de-merger of the Basic R&D unit would enhance Ranbaxy's earnings by 9.5%.

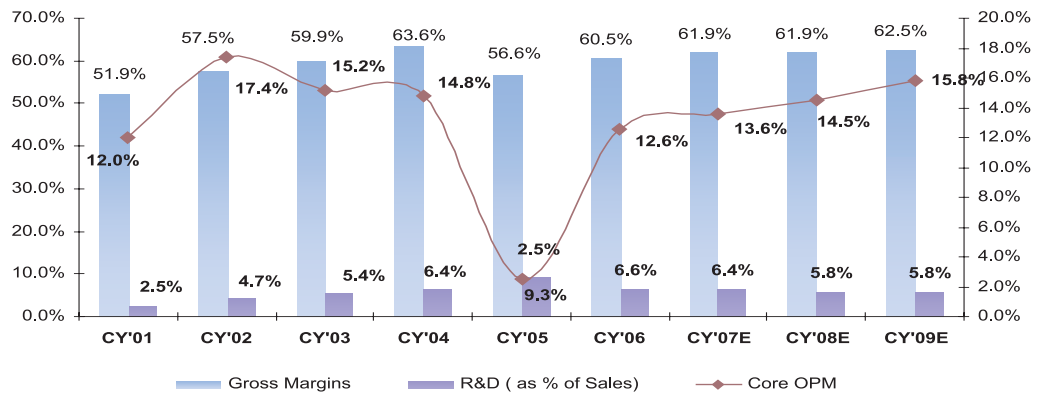
Overall, the company's R&D revenue expenditure stood at 6.8% in CY2007 with more than 20-25% being accounted by Basic Research. On the NCE front, the company is mainly focused on infectious, metabolic, inflammatory and respiratory illnesses and Oncology segments. While full disclosures are not available regards its R&D pipeline, the company has around two products at the Clinical stage - RBx 11160 (Malaria, PhaseII B) and RBx 9841 (Phase-I trials). Apart from these, Ranbaxy has out-licensed one of its molecules RBx 10558 (a statin molecule for Dyslipidemia) to PPD Inc., and is developing one molecule for COPD and Asthma in collaboration with GSK (Ranbaxy has the responsibility of advancing select compounds to 'proof of concept', whereby the total milestone payments, excluding royalties, could exceed over US $100mn.). While SPARC has provided a benchmark, we believe that these are early days, as the depth of the pipeline of these companies remains low and current valuations do not fully reflect the risk of failures as also the productivity of the R&D efforts. At the current market cap**,** SPARC trades at 20x its expenses. Taking the same as the benchmark, Ranbaxy's R&D would be valued at Rs2,000cr. However, due to lack of details regards the company's pipeline, we have valued it at Rs1,000cr, providing an upside of Rs30/share.

Financial Performance - Profitability set to improve

After the debacle of CY2005, Ranbaxy initiated certain measures to enhance its Profitability. Robust growth in key regions has aided the secular rise in Operating Margins. This improvement is expected to continue on the back of an improvement in Gross Margins, lower R&D expenses (on the back of de-merger of the NCE unit) and containment of other costs. We have factored in a 226bp improvement on the operating front to 15.8% over CY2007-09E. Higher OPMs would aid Ranbaxy post a CAGR growth of 25% in Net Profits over CY2007-09E. Along with expansion in OPMs, capex requirements are also expected to decline. It is expected to be a moderate to US $80-100mn from an average of US $160mn spent by the company in the last

three years. This is expected to improve the company's Return Ratios. Ranbaxy's RoE and RoCE is expected to improve to 24.3% and 19.3% in CY2009, respectively.

Exhibit 1: Operating Performance



Source: Company, Angel Research

Outlook and Valuation

At the CMP, the stock is trading at 24.8x CY2008E and 18.8x CY2009E Earnings (including the FTF product launches). Over the last two years, the stock has been an underperformer on the back of concerns about its ability to improve its Profitability following intense competitive pressures in the Generic space. However, we believe that the markets have over done the concerns as the company has taken measures to mitigate the same by enhancing its presence in Generic markets with low generic penetration and competitive pressures. Further, in the US markets where the pricing pressures are intense, the company has diversified its product basket to include a combination of blockbuster and Niche product opportunities (in the form of Para-IV opportunities). Currently, the company has around 18 FTF products, and expects to launch around 1 FTF product every year.

Ranbaxy is also making investments to foray into Niche product categories like Biotech, Peptide and Oncology Segments through strategic investments in Zenotech and Jupiter Bioscience. We believe that these initiatives would improve Ranbaxy's overall profitability CY2008 onwards. **Hence, we believe that Ranbaxy is the best bet in the space and recommend a Buy, with an 18-month Target Price of Rs580. Our Target Price is based on the sum-of-the-parts (SOTP) valuation, with the core business valued at 16x EV/EBDITA and Rs50 and Rs30 for the one-time upsides and R&D de-merged unit, respectively. At our Target Price, the stock would trade at 24.3x CY2009E Earnings.**

Profit & Loss Statement (Consolidated) — Rs crore

Y/E December (Rs cr)	CY2006	CY2007	CY2008E	CY2009E
Net Sales	**6,013**	**6,590**	**7,413**	**8,543**
% chg	*17.9*	*9.6*	*12.5*	*15.2*
Total Expenditure	5,255	5,680	6,316	7,168
EBIDTA	**757.4**	**910.4**	**1,096.9**	**1,374.1**
(% of Net Sales)	*12.6*	*13.6*	*14.5*	*15.8*
Other Income	182.1	494.5	185.2	196.0
Depreciation& Amortisation	184.3	222.9	230.7	242.1
Interest	103.6	144.3	195.4	201.1
PBT	**651.6**	**1,037.7**	**855.9**	**1,126.8**
(% of Net Sales)	*10.8*	*15.7*	*11.5*	*13.2*
Extraordinary Expense/(Inc.)	-	-	-	-
Tax	135.7	207.0	179.7	236.6
(% of PBT)	*20.8*	*19.9*	*21.0*	*21.0*
Adjusted PAT	**510.9**	**570.1**	**676.2**	**890.2**
% chg	*95.2*	*11.6*	*18.6*	*31.6*

Note-CY2007 Excludes translational gains on FCCB

Balance Sheet (Consolidated) — Rs crore

Y/E December (Rs cr)	CY2006	CY2007E	CY2008E	CY2009E
SOURCES OF FUNDS				
Equity Share Capital	186.2	186.2	186.2	186.2
Reserves& Surplus	2,433.0	2,874.6	3,234.7	3,708.8
Shareholders Funds	**2,619.2**	**3,060.8**	**3,420.9**	**3,895.0**
Total Loans	3,955.6	4,039.9	4,103.2	4,277.4
Deffered Tax Liability	255.5	268.6	280.3	297.7
Total Liabilities	**6,830**	**7,369**	**7,804**	**8,470**
APPLICATION OF FUNDS				
Gross Block	5,117.4	5,667.9	5,918.0	6,287.9
Less: Acc. Depreciation	1,222.1	1,460.3	1,669.9	1,887.3
Net Block	**3,895.3**	**4,207.6**	**4,248.0**	**4,400.6**
Provision for written down value	-	-	-	-
Capital Work-in-Progress	358.1	46.9	46.9	46.9
Investments	**36.2**	**305.1**	**305.1**	**305.1**
Current Assets	4,110.3	4,705.0	5,202.5	6,057.0
Current liabilities	1,759.7	2,035.1	2,152.4	2,514.0
Net Current Assets	**2,350.6**	**2,669.8**	**3,050.1**	**3,543.1**
Deferred Tax Asset	190.0	139.9	154.5	174.6
Total Assets	**6,830**	**7,369**	**7,804**	**8,470**

Cash Flow Statement (Consolidated) — Rs crore

Y/E December (Rs cr)	CY2006	CY2007E	CY2008E	CY2009E
Profit before tax	651.6	747.7	855.9	1,126.8
Depreciation	184.3	222.9	230.7	242.1
Change in Working Capital	471.4	98.6	399.0	347.9
Direct taxes paid	53.5	143.8	182.5	239.3
Cash Flow from Operations	**311.0**	**728.1**	**505.1**	**781.7**
Inc./ (Dec.) in Fixed Assets	1,923.9	239.3	250.1	370.0
Free Cash Flow	**(1,612.9)**	**488.8**	**255.0**	**411.7**
Inc./ (Dec.) in Investments	19.1	268.8	-	-
Issue of Equity	-	-	-	-
Inc./(Dec.) in loans	1,951.4	84.3	63.3	174.2
Dividend Paid (Incl. Tax)	361.3	369.5	316.2	416.3
Others	(94.0)	4.2	20.9	24.6
Cash Flow from Financing	**1,703.1**	**(20.6)**	**(273.8)**	**(266.6)**
Inc./(Dec.) in Cash	90.2	468.2	(18.8)	145.1
Opening Cash balances	**243.0**	**295.1**	**515.7**	**496.9**
Closing Cash balances	**295.1**	**515.7**	**496.9**	**642.0**

Key Ratios

Y/E December (Rs cr)	CY2006	CY2007E	CY2008E	CY2009E
Per Share Data (Rs)				
EPS	13.7	15.3	18.2	23.9
Cash EPS	18.7	27.3	24.4	30.5
DPS	8.5	8.5	7.3	9.6
Book Value	70.3	82.2	91.8	104.6
Operating Ratio (%)				
Raw Material / Sales (%)	39.5	38.1	38.1	37.5
Inventory (days)	96.5	98.6	98.6	98.6
Debtors (days)	94.1	92.5	92.5	92.5
Debt / Equity (x)	1.5	1.3	1.2	1.1
Returns(%)				
RoE	20.1	20.1	20.9	24.3
RoCE	16.3	16.0	17.5	19.3
Dividend Payout	62.0	55.4	40.0	40.0
Valuation Ratio (x)				
P/E	32.8	29.4	24.8	18.8
P/E (Cash EPS)	24.1	16.5	18.5	14.8
P/BV	6.4	5.5	4.9	4.3
EV / Sales	3.4	3.1	2.7	2.4
EV / EBITDA	23.2	19.5	16.5	13.4

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Sun Pharmaceutical

Sector Report / India Research

Neutral

Price	**Rs1,253**
Target Price	**-**
Investment Period	

Stock Info

Sector	Parmaceuticals
Market Cap (Rs cr)	25,250
Beta	0.46
52 Week High / Low	1280/886
Avg Daily Volume	49956
Face Value (Rs)	5
BSE Sensex	16,340
Nifty	4,864
BSE Code	524715
NSE Code	SUNPHARMA
Reuters Code	SUN.BO
Bloomberg Code	SUNP IN

Shareholding Pattern (%)

Promoters	65.6
MF / Banks / Indian FIs	8.9
FII / NRIs / OCBs	19.4
Indian Public / Others	6.3

Abs.	3m	1yr	3yr
Sensex (%)	(7)	36	162
Sun Pharma(%)	99	81	156

	3m	1yr	3yr
Rel.to Sen. (%)	106	45	(5)

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Shining at a Peak

Sun Pharmaceutical has been one of the most profitable and fast growing companies in the Indian Pharmaceutical space. A highly profitable Domestic business along with focus on controlling costs has aided the company clock higher profitability compared to its peers. As a result, the stock has witnessed significant re-rating. At the CMP, the stock is trading at 18.3x FY2009E and 18.2x FY2010E Earnings (including the Para-IV opportunities). Excluding the one-time upsides, the stock seems to be in fair zone, leaving little upsides. Further, with the impact of Taro still unclear, ***Hence, we are Neutral on the stock.***

- **US to remain the key driver for Exports:** The US markets constitute a major chunk of Sun's overall exports unlike its peers. Over the last two years the region has posted a CAGR growth of 37.4% and going ahead it is expected to continue to be a major growth driver for company on the back of new product introductions. In FY2007, Sun had around 34 products in the market with around 87 ANDAs pending approval. Sun also has a diversified product mix with Para-IV opportunities (which are difficult to make) and niche controlled release products. The Para-IV opportunities factored in during FY2007-2010E include *Pantaprazole* and *Oxcarbazapine*.

- **Taro to scale up Sun's US business:** During FY2008, Sun acquired a stake in Taro. While currently the acquisition awaits shareholder approval, acquisition of the same would catapult Sun Pharma's marketshare in the US markets and provide access to the niche Dermatology Segments. On the financial front, management expects Taro to be EPS accretive in 12-18 months. Currently, we have not factored in Taro's acquisition in our projections.

- **Net Profit to grow at a CAGR of 22% over FY2007-10E:** During FY2007-10E, robust growth in Exports (37.6%) and Domestic Formulations (21.4%) would aid the company post a 26.7% CAGR in Sales. On the Operating front, we expect Sun to clock expansion of 218bp to end the period with OPMs of 34.5%. Overall Sun would post a Net Profit CAGR of 22% during the period.

Key Financials (Consolidated)

Y/E March (Rs cr)	FY2007	FY2008E	FY2009E	FY2010E
Net Sales	**2,079.2**	**2,759.5**	**3,773.1**	**4,229.6**
% chg	*30.3*	*32.7*	*36.7*	*12.1*
Net Profit	**784.2**	**906.3**	**1,401.7**	**1,403.7**
% chg	*36.8*	*15.6*	*54.7*	*0.1*
FDEPS (Rs)	**40.5**	**44.3**	**68.6**	**68.7**
EBITDA Margin (%)	32.4	34.4	38.5	34.5
P/E (x)	30.9	28.3	18.3	18.2
P/CEPS (x)	28.0	25.7	17.1	17.0
ROE (%)	38.5	26.5	28.8	23.5
ROCE (%)	15.9	19.4	24.5	20.1
P/BV (x)	8.7	5.7	4.5	3.8
EV/Sales (x)	11.5	8.8	6.3	5.4
EV/EBITDA (x)	35.6	25.5	16.3	15.6

Source: Company, Angel Research; Note: FCCB has been treated as Equity

Investment Argument

US dominates Exports' pie

Sun has been focused on enhancing its presence in the US markets, unlike its peers, through a series of acquisitions. The company has been able to identify stressed assets in the US and turn them around. Company has done acquisation starting from Caraco to acquisition of assets in Hungary (controlled substance), Ohio (liquid ointments and gels) and Able Labs (controlled substance). The company has successfully turned around Caraco since its acquisition. The other assets have been recent acquisitions and are yet to contribute.

Robust pipeline

Sun's Formulation Exports (75% of Exports) are currently dominated by the US contributing 73% of the same. Despite being a late entrant in the US Generic space, the company has been able to scale up its US business significantly over the last few years. Caraco, the US arm of Sun Pharma (Sun has 69% stake in Caraco), clocked revenues of US $117mn in FY2007. Sun has managed to grow Caraco at a scorching pace over the last two years registering a CAGR of 37.4% and contributing 25% of overall Sales in FY2007. With this, the company has emerged as a major Indian Pharmaceutical company in the US markets. Going ahead, the US markets would continue to post robust growth on the back of a robust product pipeline. In FY2007, Sun had around 34 products in the market with 87 ANDAs pending approval. In the US, Sun's strategy has been to focus on niche products and garner share for its products. In around eight products viz., Metformin, Metoprolol, Tramadol, Salsalate, Tramadol with Acetaminophen, Clonazepam, Mirtazapine and Tizanidine, Sun is ranked third or higher compared to its generic competitors.

Para-IV opportunities...to supplement growth

Apart from plain vanilla generics, the company has built a pipeline of Para-IV and niche opportunities (controlled substances). We believe that like Ranbaxy, Sun Pharmaceuticals can also launch a Para-IV product per year either through an out-of-court settlement or launch of products . For FY2008-10E, we have factored in *Oxcarbazine* and *Pantaprazole*. While in *Oxcarbazine* the company had shared exclusivity with four players, *Pantaprazole* is a launch at risk with three players being present including the Authorised Generics. We have factored in Sales of US $200mn from *Pantaprazole* during the 180-day exclusivity. In December 2007, the company sealed an out-of-court settlement with Novartis for *Exelon*. According to the agreement, the company would launch the product some time earlier to the patent expiry of the products (August 2012). Further, during October 2007 for *Effexor ER (sold in capsules),* Wyeth decided not to sue the company for its Tablet version of the drug. The drug will not qualify for an AB rating. We expect a launch post the patent expiry in June 2008. But, since Sun is yet to get approval for the drug, we have factored in the upsides in FY2009. Overall, we have factored in Rs50/share from these one-time opportunities.

Exhibit 1: Select Para-IV opportunities

Product	Brand	Market Size ($ mn)	Earliest Launch	Comments
Amifostine	Eythol	100	March 2010	FTF status. The contested patent expires in July 2012
Atomoxetin	Strattera	500	March 2010	Shared Exclusivity
Desloratidine	Clarinex	400	March 2009	Shared Exclusivity
Imatinib Mesylate	Gleevec	700	July 2015	FTF
Repaglinide	Prandin	140	March 2009	FTF
Tiagabine HCL	Gabitril	102	September 2011	FTF

Source: Industry, Angel Research

Taro Acquisition to scale up the US business

During FY2007 Sun acquired 34.9% stake in Taro Pharmaceuticals. Currently, the deal is being contested by some of Taro's minority stake-holders. Acquisition of Taro would cost US $230mn, putting the overall valuations at US $454mn (Debt - US $224mn) and 1.5x EV/Sales. Taro, an Israel based company, grossed Sales of US $200mn in CY2006. The company derives majority of its revenues from the US markets. The acquisition would scale up Sun's US business and catapult it to one of the key players in the region.

Further, the acquisition would provide Sun access to the niche Dermatology segment (69%). On the financial front, Taro posted Net loss of US $140mn in CY2006 on the back of re-statement of accounts. For January - September 2007, as per the company's un-audited results, it reported Net Sales of US $232m, GPM of 54% and PAT of US$14mn.

Sun Pharma expects Taro to start contributing to Net Profit in 12-18 months with a payback period of 5.5-6 years. The main reason for the losses has been lower provision for the chargeback during earlier years. Also, the company had been on aggressive capacity expansion mode investing around US $215mn during CY2003-05. However, lower capacity utilisation of the facilities had led to bankruptcy. Currently, on account of lack of clarity on the financial front, we have not factored the same in our projections.

Domestic Markets - Dominance in the Chronic Segment to drive growth

Sun's presence in the Chronic Segment has aided its Formulation Segment (contributes 93% of overall Domestic sales) to outpace overall Industry growth (registered a CAGR growth of 20.4% over FY2002-07). This also aided the company garner larger marketshare (3.3%) and emerge the sixth largest player. High growth segments like CNS, Diabetology and CVS contribute around 70% of its Sales. Going ahead, we expect Sun's Domestic Formulation Segment to register a CAGR growth of 22.7% over FY2007-10E.

Financial Performance

Exports to aid 26.7% CAGR sales growth

During FY2007-10E, robust growth in Exports (37.6%) and the Domestic Formulation Segment (21.4%) is expected to aid the company post 26.7% Sales growth. US generics, which constitute a substantial portion of overall Exports (54.7% in FY2007) is expected to post a growth of 36.6% during FY2007-10E.This growth would be primarily driven by *Pantaprazole* and *Effexor ER* Tablets in FY2009E. Overall, Exports are expected to contribute 49.9% of the company's overall sales in FY2010 v/s 43.3% in FY2007.

Operating Margins to be driven by Para-IV opportunities

On the Operating front, we expect Sun to post an expansion of 400bp in OPM in FY2009E over FY2008E driven mainly by the launch of the 180-day exclusivity product viz., *Pantaprazole*. For the FY2007-10E period, we have factored in a 218bp expansion in OPM to end the period at 34.5% and resulting in a 29.5% improvement in Operating Profits. However, Net Profit is expected to increase 22% over FY2007-10E, which is lower than the Sales growth mainly on account of lower Other Income and a higher Tax out-go. On the Profitability front, RoE is expected to decline following the FCCB conversion and lower non-Operating Income.

Concerns

High Exposure to US markets: The company derives a major portion of its Revenue from the US markets. Hence, appreciation of the Rupee would impact its performance. Currently however, the company has a hedge with the FCCB loans on its books.

Outlook and Valuation

Sun Pharmaceutical has been one of the most profitable and fast growing companies in the Indian Pharmaceutical space. A highly profitable Domestic business along with prudent management of the costs has aided the company clock better profits compared to its peers. Higher visibility of Earnings has also aided Sun to buck the underperformance of the Sector. Thus, while the other stocks in the space got de-rated on back of concerns, Sun got re-rated on account of higher Earnings visibility and profitability. De-merger of its R&D unit has only aided the re-rating process.

At the CMP, the stock is trading at 18.3x FY2009E and 18.2x FY2010E Earnings (including the Para-IV opportunities). On an EV/EBDITA basis, the stock has been trading at 24.2x 1-year forward (after 2005) v/s 20.9x earlier. While the Taro acquisition would catapult the company into a different league going ahead, in the short-term however, it would continue to be an overhang on the company's profitability. **Hence, we are Neutral on the stock.**

Profit & Loss Statement

Rs crore

Y/E March (Rs cr)	FY2007	FY2008E	FY2009E	FY2010E
Net Sales	**2,079**	**2,759**	**3,773**	**4,230**
% chg	*30.3*	*32.7*	*36.7*	*12.1*
Total Expenditure	1,407	1,811	2,321	2,769
EBIDTA	**672.2**	**948.7**	**1,452.0**	**1,461.0**
(% of Net Sales)	*32.3*	*34.4*	*38.5*	*34.5*
Other Income	242.5	124.6	142.2	142.3
Depreciation& Amortisation	81.3	90.6	97.2	104.2
Interest	-	-	-	-
PBT	**833.4**	**982.7**	**1,497.0**	**1,499.1**
(% of Net Sales)	*40.1*	*35.6*	*39.7*	*35.4*
Extraordinary Expense/(Inc.)	-	-	-	-
Tax	(6.7)	20.6	39.5	39.6
(% of PBT)	*(0.8)*	*2.1*	*2.6*	*2.6*
PAT	**784.2**	**906.3**	**1,401.7**	**1,403.7**
% chg	*36.8*	*15.6*	*54.7*	*0.1*

Balance Sheet

Rs crore

Y/E March (Rs cr)	FY2007	FY2008E	FY2009E	FY2010E
SOURCES OF FUNDS				
Equity Share Capital	96.7	102.2	102.2	102.2
Prefrence Shares	1.4	1.4	1.4	1.4
Reserves& Surplus	2,675.2	4,388.4	5,538.9	6,691.1
Shareholders Funds	**2,773.3**	**4,492.0**	**5,642.5**	**6,794.7**
Minority Int	43.8	43.8	43.8	43.8
Total Loans	1,114.9	366.7	468.3	514.0
Deffered Tax Liability	118.8	122.7	131.6	139.5
Total Liabilities	**4,051**	**5,025**	**6,286**	**7,492**
APPLICATION OF FUNDS				
Gross Block	1,494.6	1,659.8	1,783.8	1,903.0
Less: Acc. Depreciation	473.6	564.1	661.3	765.5
Net Block	**1,021.0**	**1,095.7**	**1,122.4**	**1,137.5**
Provision for written down value	-	-	-	-
Capital Work-in-Progress	60.7	14.4	14.4	14.4
Investments	**254.2**	**490.2**	**490.2**	**490.2**
Current Assets	2,990.0	3,996.3	5,477.8	6,736.5
Current liabilities	304.4	600.8	848.0	916.2
Net Current Assets	**2,685.6**	**3,395.6**	**4,629.8**	**5,820.3**
Deferred Tax Asset	29.3	29.3	29.5	29.5
Total Assets	**4,051**	**5,025**	**6,286**	**7,492**

Cash Flow Statement

Rs crore

Y/E March (Rs cr)	FY2007	FY2008E	FY2009E	FY2010E
Profit before tax	833.4	982.7	1,497.0	1,499.1
Depreciation	81.3	90.6	97.2	104.2
Change in Working Capital	536.3	280.5	555.5	293.4
Direct taxes paid	9.1	10.8	16.5	16.5
Cash Flow from Operations	**369.3**	**781.9**	**1,022.2**	**1,293.4**
Inc./ (Dec.) in Fixed Assets	228.9	119.0	123.9	119.3
Free Cash Flow	**140.4**	**662.9**	**898.3**	**1,174.1**
Inc./ (Dec.) in Investments	100.0	(236.0)	-	-
Issue of Equity	504.8	957.8	-	-
Inc./(Dec.) in loans	(760.5)	(748.2)	101.7	45.6
Dividend Paid (Incl. Tax)	148.3	202.6	306.9	307.4
Others	(11.6)	4.4	14.3	15.2
Cash Flow from Financing	**(292.5)**	**(233.5)**	**(219.6)**	**(276.9)**
Inc./(Dec.) in Cash	(152.1)	429.5	678.7	897.2
Opening Cash balances	**1,532.3**	**1,380.2**	**1,809.7**	**2,488.3**
Closing Cash balances	**1,380.2**	**1,809.7**	**2,488.3**	**3,385.5**

Key Ratios

Y/E March (Rs cr)	FY2007	FY2008E	FY2009E	FY2010E
Per Share Data (Rs)				
FDEPS	40.5	44.3	68.6	68.7
Cash EPS	44.8	48.8	73.3	73.8
DPS	13.5	16.9	25.7	25.7
Book Value	143.4	219.8	276.1	332.4
Operating Ratio (%)				
Raw Material / Sales (%)	27.7	27.7	27.7	27.7
Inventory (days)	115.2	115.0	114.9	114.9
Debtors (days)	117.5	117.7	117.7	117.7
Debt / Equity (x)	0.4	0.1	0.1	0.1
Returns %				
RoE	38.5	26.5	28.8	23.5
RoCE	15.9	19.4	24.5	20.1
Dividend Payout	33.2	38.2	37.4	37.4
Valuation Ratio (x)				
P/E	30.9	28.3	18.3	18.2
P/E (Cash EPS)	28.0	25.7	17.1	17.0
P/BV	8.7	5.7	4.5	3.8
EV / Sales	11.5	8.8	6.3	5.4
EV / EBITDA	35.6	25.5	16.3	15.6

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Indoco Remedies

Sector Report / India Research

BUY

Price	**Rs264**
Target Price	**Rs460**
Investment Period	**18 months**

Stock Info

Sector	Pharmaceutical
Market Cap (Rs cr)	324
Beta	0.51
52 Week High / Low	384/222
Avg Daily Volume	6348
Face Value (Rs)	10
BSE Sensex	16,340
Nifty	4,864
BSE Code	532612
NSE Code	INDOCO
Reuters Code	INRM.BO
Bloomberg Code	INDR IN

Shareholding Pattern (%)

Promoters	60.2
MF / Banks / Indian FIs	14.4
FII / NRIs / OCBs	6.0
Indian Public / Others	19.4

Abs.	3m	1yr	3yr
Sensex (%)	(7)	36	162
Indoco (%)	(6)	(9)	(10)

	3m	1yr	3yr
Rel.to Sen. (%)	1	(45)	(172)

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Value Play

Indoco Remedies has been traditionally focused on the Domestic Formulations business. In the International markets, Indoco has been focusing on the CRAMS segment to enhance its presence in the Regulated markets. This has resulted in contribution from the International market increasing from 13.5% in FY2005 to 20.3% in FY2007. In the Regulated Markets, Indoco is leveraging its strength in the Opthalmic and Dermatology Segments, where the competitive pressures are lower. At the CMP, the stock is trading at 5.2x FY2008E and 4.6x FY2009E Earnings. **We maintain a Buy on the stock, with an Target Price of Rs460.**

- **Exports to post Robust growth:** While a late entrant, the company has been focused on enhancing its presence in the Regulated market. Growth in the International market has primarily been on the back of Regulated markets, which is growing at a CAGR of 160%. Going ahead it is expected to grow by 37% over FY2007-09E on the back of New Product launches and entry into New markets. With this, Exports' contribution is expected to increase from 20.3% in FY2007 to 25% in FY2009E.

- **Domestic Market - Momentum to continue:** During the last three years, Indoco's growth momentum in the Domestic Formulation market has accelerated on the back of New Product launches in the Lifestyle Segment. Going ahead, we expect the company's Domestic Formulations Segment to grow at a CAGR of 13.8% over FY2007-09E contributing 96% to Domestic Sales. The growth would be aided by New Product introductions and the company's Top brands clocking robust growth.

- **Net Profit to post CAGR of 21% over FY2007-09E:** On the Profitability front, we expect Indoco's OPMs to expand by 195bp on the back of an improved Sales mix. Even after factoring in R&D expenses at 3% of Sales in FY2009E (1.5% in FY2007), we estimate OPMs to be around 19.6% in FY2009E. Improvement in OPMs would aid expansion in Net Margins. We expect an improvement of around 80bp in Net Margins, leading to a 21% CAGR growth in Net Profits over FY2007-09E.

Key Financials (Consolidated)

Y/E June (Rs cr)	FY2006	FY2007	FY2008E	FY2009E
Net Sales	**241.0**	**324.0**	**397.6**	**451.7**
% chg	*24.9*	*34.4*	*22.7*	*13.6*
Net Profit	**31.5**	**46.1**	**59.3**	**67.9**
% chg	*25.2*	*46.4*	*28.8*	*14.4*
EPS (Rs)	**26.7**	**35.2**	**50.3**	**57.5**
EBITDA Margin (%)	19.8	17.7	19.6	19.6
P/E (x)	9.9	7.5	5.2	4.6
P/CEPS (x)	8.3	5.7	4.5	4.0
RoE (%)	17.0	21.4	24.0	23.8
RoCE (%)	19.0	20.2	24.6	24.5
P/BV (x)	1.6	1.3	1.2	1.0
EV/Sales (x)	1.3	1.0	0.8	0.6
EV/EBITDA (x)	6.4	5.5	3.8	3.0

Source: Company, Angel Research

Investment Argument

Contract manufacturing a key growth driver

Exports - Focus on enhancing presence in Regulated markets

Unlike its peers, Indoco Remedies, has been a late entrant in the International markets and has been focused on the Contract Research & Manufacturing Services (CRAMS) segment to enhance its presence especially in the Regulated market. The company, given its size, has been focused on CRAMS in Generic drugs in the Regulated Markets. Over FY2002-07, the company's exports registered a CAGR growth of 68.2%, with its CRAMS activities contributing around 88% of the Regulated Market sales. Indoco had initiated its contract manufacturing activity in FY2003 with its UK firm and around 10 products. Thereafter, the company enhanced its presence and commenced activities in other regions within Europe. In FY2006, Indoco entered into a 5-year contract with a German company for 18 products of which 8 are commercialized, and going ahead Indoco expects to scale it up to 24 products. We expect UK and Germany region to post a CAGR growth of 37% and 25% over FY2007-09E, respectively. Apart from UK and Germany, the company is also diversifying into other East European regions like Slovenia, Romania and Bulgaria. Over FY2007-09E, Indoco expects to grow at a CAGR of 30% primarily on the back of the Regulated markets, which are expected to grow at a CAGR of 37% in the mentioned period.

US - Focused on Dermatology and Opthalmic Generic opportunity

Apart from Europe, the company is also looking at tapping the Generic opportunity in the US markets through collaborations. In the US, the company is looking at niche opportunities in areas like Ophthalmology and Dermatology. While these segments constitute smaller proportion of the Pharmaceutical Markets, the same require dedicated facilities. These factors have led to lower competitive pressures. Generally, post the patent expiry, there are 4-5 players in the segment vis-à-vis 9-10 players in other Therapeutic segments. Overall, the US Ophthalmic market is estimated to be around US $3bn and is dominated by players like Alcon, Allegran, Santen and Bausch & Lomb, while US Dermatology has Sales of around US $4.6bn (*Source: IMS- Health December 2005*).

Joint venture with Amneal Pharmaceuticals to contribute FY2010E onwards

In FY2007, Indoco entered into a joint venture (JV) with Amneal Pharmaceuticals. Amneal is a New Jersey-based developer, manufacturer and distributor of generic pharmaceuticals with a turnover of around US $50mn. The companies entered into a JV to develop, manufacture, market and distribute several products to the US. The initial product pipeline will include at least 10 ophthalmic products, having a market size of around US $1.8bn (Innovator sales), with around 5 of them already through with the development stage. As per the JV, Amneal's role in the partnership is to prepare and file the ANDAs for USFDA approval and to exclusively sell, market and distribute the products throughout the US market across segments. Indoco would be eligible for the mark–up over the cost of development and manufacture of the product along with profit sharing from the sales of the products post deducting the selling and marketing expenses. Products from the JV would start contributing FY2010 onwards.

Domestic Business to outpace Industry growth

New product introductions accelerate growth

Indoco's domestic business, which contributed around 80% of is overall Sales, registered a CAGR growth of 12.7% during FY2000-07, mainly driven by Domestic Formulations. In the last three years, the company has accelerated its growth momentum in the Domestic Formulation market, through New Product introductions in the Lifestyle Segment. In FY2007, the company launched around 20 products and going ahead it expects to launch around 20 products pa., during over the next couple of years.The Top-10 brands of the company have grown at a CAGR of 13.5% over FY2004-07 and contributed around 45% to overall domestic sales. During FY2007-09E, we expect Indoco's Domestic Formulation Segment to clock a CAGR growth of 13.8% contributing 96% to domestic sales. The growth would be aided by New Product introductions and robust growth clocked by the company's Top brands.

Financial Performance

Exports to aid 18% CAGR growth in Net Sales

During FY2007-09E, we expect the company to report 18% CAGR growth in Net Sales, mainly on back of a 30% rise in exports. Exports growth would be aided by 37% growth in the Regulated markets. With this, overall contribution of Exports would increase to 25% in FY2009E. The Domestic market, on the other hand, is expected to grow at a CAGR of 13.9% over the mentioned period. On the Profitability front, we expect Indoco's Gross Profit Margins to remain stable at 56%. However, on account of the higher R&D expenses, we have factored in only a 195bp expansion in OPM (19.6% in FY2009E). We estimate R&D expenses to be around 3.0% of Sales in FY2008 and FY2009, respectively.

Improvement in OPMs aid 21% CAGR in Net Profit over FY2007-09E

Improvement in OPMs would aid significant expansion in Net Margins. We expect Net Margins to improve by around 80bp leading to a 21% CAGR in Net Profits. Over the last 2-3 years, the company was in investment mode to set up infrastructure and facilities, which we believe would improve the company's RoE from 21.4% in FY2007 to 23.8% in FY2009E.

Concern

High dependence on Domestic Markets: Despite higher contribution from Exports, the domestic markets are expected to continue to form a major chunk of the company's overall revenues. Going ahead , the Domestic markets are expected to continue to dominate accounting for almost majority of the Sales mix. Thus, any changes in the Pricing Policy, which could have negative repercussion for the Industry, would impact the company's performance.

Outlook and Valuation

While the Indoco stock has underperformed in the recent past, we believe that unlike its peers the company is well insulated from pricing pressures in the US markets on account of its focus on niche low competitive segments like Dermatology and Ophthalmic. Besides, the company has higher exposure to the Domestic Formulation markets, which reduces the variability of Earnings. Further, Indoco has already completed its investments in setting up the Infrastructure and is gearing up its product pipeline and marketing to leverage on the opportunities arising in the US markets. Indoco is also well placed in the Opthalmic and Dermatology Segments and is well placed to leverage the same to scale up its Exports and improve Profitability in the medium term. At the CMP, the stock is trading at 5.2x FY2008E and 4.6x FY2009E Earnings. Further, at EV/Sales and EV/EBDITA of 0.6x FY2009E and 3.0x FY2009E, the stock provides significant margin of safety. **We maintain a Buy on the stock, with an 18-month Target Price of Rs460.** At our Target Price, the stock would trade at 8x FY2009E Earnings.

Profit & Loss Statement (Consolidated) — Rs crore

Y/E June	FY2006	FY2007	FY2008E	FY2009E
Net Sales	**241**	**324**	**398**	**452**
% chg	*24.9*	*34.4*	*22.7*	*13.6*
Total Expenditure	193	267	320	363
EBIDTA	**47.8**	**57.2**	**77.9**	**88.5**
(% of Net Sales)	*19.8*	*17.7*	*19.6*	*19.6*
Other Income	7.2	4.8	5.9	6.4
Depreciation & Amortisation	6.3	9.0	9.5	10.0
Interest	5.8	5.1	7.4	8.3
PBT	**42.9**	**47.9**	**66.9**	**76.6**
(% of Net Sales)	*17.8*	*14.8*	*16.8*	*17.0*
Extraordinary Expense/(Inc.)	-	2.7	-	-
Tax	11.5	4.6	7.6	8.7
(% of PBT)	*26.7*	*9.5*	*11.3*	*11.3*
PAT	**31.5**	**46.1**	**59.3**	**67.9**
% chg	*25.2*	*46.4*	*28.8*	*14.4*

Balance Sheet (Consolidated) — Rs crore

Y/E June	FY2006	FY2007	FY2008E	FY2009E
SOURCES OF FUNDS				
Equity Share Capital	11.8	11.8	11.8	11.8
Reserves & Surplus	185.6	220.7	249.0	298.3
Shareholders Funds	**197.5**	**232.5**	**260.8**	**310.1**
Total Loans	36.3	35.6	40.3	46.1
Deffered Tax Liability	18.0	24.5	28.2	31.9
Total Liabilities	**252**	**293**	**329**	**388**
APPLICATION OF FUNDS				
Gross Block	165.6	206.7	218.2	229.7
Less: Acc. Depreciation	26.6	39.6	49.2	59.2
Net Block	**139.0**	**167.1**	**169.0**	**170.5**
Provision for written down value	-	-	-	-
Capital Work-in-Progress	4.5	1.7	-	-
Investments	**6.3**	**0.0**	**0.0**	**0.0**
Current Assets	159.9	181.1	259.6	327.3
Current liabilities	58.5	57.7	99.9	110.2
Net Current Assets	**101.4**	**120.0**	**153.4**	**210.8**
Deferred Tax Asset	0.5	0.5	0.5	0.5
Total Assets	**252**	**293**	**329**	**388**

Cash Flow Statement (Consolidated) — Rs crore

Y/E June	FY2006	FY2007	FY2008E	FY2009E
Profit before tax	43.1	50.7	66.9	76.6
Depreciation	6.3	9.0	9.5	10.0
Change in Working Capital	2.9	28.3	2.2	19.5
Direct taxes paid	3.7	1.8	3.9	4.9
Cash Flow from Operations	**42.8**	**29.5**	**70.3**	**62.2**
Inc./ (Dec.) in Fixed Assets	53.4	38.3	9.8	11.5
Free Cash Flow	**(10.5)**	**(8.8)**	**60.5**	**50.7**
Inc./ (Dec.) in Investments	(33.7)	(6.3)	-	-
Issue of Equity	-	-	-	-
Inc./(Dec.) in loans	(18.1)	(0.7)	4.7	5.8
Dividend Paid (Incl. Tax)	8.2	12.3	16.3	18.6
Others	0.3	(5.7)	11.4	0.0
Cash Flow from Financing	**7.2**	**(1.0)**	**(23.0)**	**(12.8)**
Inc./(Dec.) in Cash	(3.4)	(9.7)	37.5	37.9
Opening Cash balances	**28.6**	**25.2**	**15.5**	**53.0**
Closing Cash balances	**25.2**	**15.5**	**53.0**	**90.9**

Key Ratios

Y/E June	FY2006	FY2007	FY2008E	FY2009E
Per Share Data (Rs)				
EPS	26.7	35.2	50.3	57.5
Cash EPS	32.0	46.6	58.3	65.9
DPS	6.3	9.1	11.8	13.5
Book Value	167.1	196.7	220.7	262.4
Operating Ratio (%)				
Raw Material / Sales (%)	41.1	43.6	43.9	43.9
Inventory (days)	53.9	42.7	58.5	58.6
Debtors (days)	126.3	116.8	103.8	105.0
Debt / Equity (x)	0.2	0.2	0.2	0.1
Returns %				
RoE	17.0	21.4	24.0	23.8
RoCE	19.0	20.2	24.6	24.5
Dividend Payout	23.4	26.0	23.4	23.4
Valuation Ratio (x)				
P/E	9.9	7.5	5.2	4.6
P/E (Cash EPS)	8.3	5.7	4.5	4.0
P/BV	1.6	1.3	1.2	1.0
EV / Sales	1.3	1.0	0.8	0.6
EV / EBITDA	6.4	5.5	3.8	3.0

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Orchid Chemicals

Sector Report / India Research

BUY

Price	**Rs242**
Target Price	**Rs370**
Investment Period	**18 months**

Stock Info

Sector	Pharmaceutical
Market Cap (Rs cr)	1,592
Beta	0.90
52 Week High / Low	328/176
Avg Daily Volume	337295
Face Value (Rs)	10
BSE Sensex	16,340
Nifty	4,864
BSE Code	524372
NSE Code	ORCHIDCHEM
Reuters Code	ORCD.BO
Bloomberg Code	OCP IN

Shareholding Pattern (%)

Promoters	23.7
MF / Banks / Indian FIs	26.8
FII / NRIs / OCBs	33.7
Indian Public / Others	15.8

Abs.	3m	1yr	3yr
Sensex (%)	(7)	36	162
Orchid (%)	(6)	11	16

	3m	1yr	3yr
Rel.to Sen. (%)	2	(25)	(146)

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'Orchid' all set to blossom

Orchid Chemicals is all set to reap the benefits of the investments done over the last few years. Apart from the traditional Cephalosporin, other segments like Betalactum and NPNC products would aid this growth as well as reduce its dependence on one segment. Overall, improved cash flows and scalability of the company's Regulated markets' business is expected to aid significant out-performance of the stock. At the CMP, the stock is trading at 8.4x FY2009E and 6.3x FY2010E Earnings. ***We maintain a Buy on the company, with a 18-month Target Price of Rs370.***

- **Robust Product Pipeline for Regulated Markets:** Orchid has built a robust product pipeline for the Regulated markets. Its cumulative filings, at the end of 3QFY2008, stood at 47 DMFs and 43 ANDAs. Among the ANDA filings, 28 are in the Cephalosporin Segment, 13 in Non-Penicillin, Non-Cephalosporin (NPNC) and 2 in the Betalactam Product Segments. Going ahead, Orchid has more than 40 products to be filed in the US markets.

- **Regulated markets to remain key growth driver over FY2007-10E:** The Regulated markets have been a key growth driver for Orchid over the last four years. These markets would continue to be a key growth driver for the company going ahead as well on account of a robust product pipeline. These markets are expected to register a CAGR growth of 32.8% over FY2007-10E driven by Cephalosporins, Betalactum, Carbapenems and NPNC Segments. Going ahead, we believe contribution of the Regulated markets would increase from 42% in FY2007 to 54% in FY2010E.

- **Improved Operating performance to aid 64.5% CAGR growth in Net Profit:** Increased exposure to the Regulated markets and reduction in Interest expenses would aid Orchid's Net Profit to register a CAGR growth of 64.5% outpacing Sales growth over FY2007-10E. OPMs are expected to witness an improvement to 30% in FY2010E from 26% in FY2007.

Key Financials (Consolidated)

Y/E March (Rs cr)	FY2007	FY2008E	FY2009E	FY2010E
Net Sales	**926.5**	**1,114.0**	**1,485.2**	**1,689.0**
% chg	*2.9*	*20.2*	*33.3*	*13.7*
Net Profit	**78.5**	**119.9**	**262.2**	**349.7**
% chg	*37.1*	*52.7*	*118.7*	*33.4*
FDEPS (Rs)	**8.6**	**13.1**	**28.6**	**38.2**
EBITDA Margin (%)	25.8	28.0	29.5	30.4
P/E (x)	28.2	18.5	8.4	6.3
P/CEPS (x)	13.5	9.0	5.6	4.5
RoE (%)	12.5	12.0	16.5	19.9
RoCE (%)	13.7	15.5	21.0	25.4
P/BV (x)	6.2	2.0	1.8	1.6
EV/Sales (x)	3.4	2.7	1.7	1.2
EV/EBITDA (x)	11.6	8.6	5.4	3.7

Source: Company, Angel Research

Investment Argument

Regulated Markets to remain key growth driver

Product Pipeline and Marketing tie-ups in place

Regulated Markets, which contributed 42% of the overall sales mix in FY2007 are expected to continue to be the key growth drivers for the company going ahead. Currently, Orchid has launched 18 ANDAs in the US in the Cephalosporin segment mainly Sterile (12 products). Going ahead, it expects to build a robust product pipeline to tap the Regulated Markets including the US and Europe. During 3QFY2008, the company made another Para-IV first-to-file (FTF) filing (*Memantine*) taking its cumulative ANDA filings to 43. Of the total ANDAs filed, 28 are in the Cephalosporin Segment, 13 in the NPNC Segment and 2 in the Betalactam space. Total ANDAs approved till date increased to 23, out of which 22 are in the *Cephalosporin* Segment and 1 in the NPNC Segment. To propel its EU generics' foray, Orchid has this far filed 14 dossiers for Marketing Authorisations (MAs) comprising 12 in the *Cephalosporin* space and 1 each in the NPNC and Betalactam Segments. Cephalosporins had been the key growth driver for the company. However, going ahead, Betalactum, Carbapenem and NPNC products would drive the company's growth. The company has also formed marketing alliances with reputed global companies such as Apotex, Actavis, Dava, Hospira, etc., which have a good marketing reach.

Cephalosporin …focus on Sterile products

Currently, though majority of the company's filings are in the Cephalosporin segment, most of them are Sterile products (around 12). Sterile products have high barriers, as they are difficult to manufacture and require dedicated facilities, which acts as an entry barrier and hence witnesses lower price erosions compared to other products. This is evident from the marketshare enjoyed by the company in key products like Ceftriaxone, Cefepime and Cefazolin, which have a marketshare of 25%, 20% and 85%, respectively.

Betalactum - Tazobactum big near term opportunity

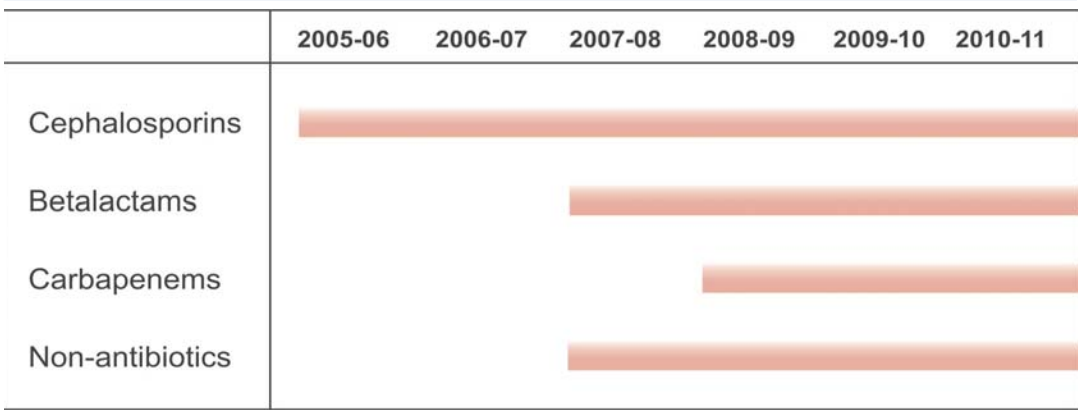
Tazobactum Piperacillin, which was to be launched in February 2007 in the US, was delayed due to the FDA judgment on the citizen petition filed by the company in November 2005. A citizen petition, which has also been filed by Sandoz because of the originator phasing out the original molecule, is under the Patent law and phasing in a modified version of *Tazobactum Piperacillin* molecule. The company expects to launch Tazobactum in the US in FY2009 as it has received approval for a bulk plant. However, the company is awaiting the microbiology review, post which would receive final approval and decision on the citizen petition also. We expect around US $28.2mn in FY2009 and US $23.5mn in FY2010 in US to gross Sales. We expect the company to gross Sales of around US $27.4mn in FY2009 and US $36.5mn in FY2010 respectively, in EU.

Apart from Betalactum, during FY2009-10, Orchid will be launching Penem products, which is also expected to have limited competition. The company will launch the Penem products in the US and EU in the same period. We believe launch of Penem products in FY2009-2010 will fetch Orchid US $16mn and US $9mn from the EU and US markets, respectively.

NPNC - focus on Niche opportunités

Orchid has identified 87 molecules in the US and EU markets in the NPNC segment (covering diverse therapeutic areas such as cardiac, neurology, urology and osteoporosis) having a retail opportunity of US $85bn and US $191bn, respectively. Orchid has also entered into a supply agreement with some prominent players including Alpharma, Stada and Par for 20 molecules and expects to cash in on a retail opportunity to the tune of US $25bn. Among these molecules, Orchid has 4 FTF Para-IV opportunities. The company has been sued for one of the products and hence, expects these Para-IV opportunities to materialise over FY2009-11E. Excluding Para-IV opportunities, we expect the NPNC Segment to register a CAGR growth of 86.7% over FY2007-10E, contributing 11% of the company's overall US sales.

Exhibit 1: Product Launch schedule



Source: Company

R&D - looking at unlocking value

Over the years, Orchid has seen an increase in its R&D expenditure following higher expenses incurred on product development and filings in the Regulated Markets and enhanced expenditure on Basic Research. Currently, the company is focused on the Inflammation, Oncology and Dietetics Segments, with a pipeline of eight molecules under various stages of development. Among these molecules, the Diatetics molecule (*BLX - 1002*) is at advanced stages of development. The company expects to out-license the molecule during FY2009. Going forward, the company expects its R&D expenses to rise, with more molecules entering the clinical stage and planned filings in the US markets. Overall, the company's R&D expenditure is expected to increase at a CAGR of 29.3% and constitute 6% of Sales over FY2007-10E.

Financial Performance - Profitability set to improve

Regulated Markets to drive growth

Over the years, Orchid has made significant investments to tap the Regulated markets. These investments are likely to fructify over the next couple of years and would be the key growth driver for the company. The company's Regulated market sales are expected to grow at a CAGR of 32.8% over FY2007-10E and contribute 54.4% of overall Sales. The non- Regulated markets are expected to clock a CAGR growth of 11.6% over the mentioned period.

Reduced Debt & improved operating performance to enhance profitability

Enhanced exposure to the Regulated markets would aid improvement on the Operating front. Over FY2007-10E, Orchid's OPMs are expected to improve by 460bp to 30.4% (25.8% during FY2007). Over the years, the company has been on a major capex drive which had exerted pressure on its Balance Sheet. Going ahead, Orchid expects to further reduce its debt on the back of its cash flows. Cash flow is expected to improve, and the Debt /Equity of the company is expected to be 0.2x in FY2010E (treating FCCB as the equity and reduction in debt) from 3.4x in FY2007. This would improve overall Profitability of the company.

Net Profit to grow at a CAGR of 64.5% over FY2007-09E

Going ahead, reduction in high-cost debt and improvement on the operating front would result in Net Profit growth outpacing Sales growth. Over FY2007-10E, the company's Net Profit is expected to grow at a CAGR of 64.5%.

Concern

Near term growth of the company is highly dependent on *Tazobactum* and *Cefdinir*. Hence, any delays in the launch of the same would impact the company's profitability. Further, with the company's working cycle being high, any delay in the product launches would strain its Balance Sheet.

Outlook and Valuation

At the CMP, the stock is trading at 8.4x FY2009E and 6.3x FY2010E on fully diluted Earnings, which we believe is attractive given the robust Earnings growth. Further, improved cash flows and scalability of the company's Regulated markets business would aid a significant out-performance in the long run. **We maintain a Buy on the company, with a 18-month Target Price of Rs370.**

Profit & Loss Statement (Consolidated) — Rs crore

Y/E March (Rs cr)	FY2007	FY2008E	FY2009E	FY2010E
Net Sales	**926**	**1,114**	**1,485**	**1,689**
% chg	*2.9*	*20.2*	*33.3*	*13.7*
Total Expenditure	687	802	1,047	1,175
EBIDTA	**239.2**	**312.3**	**438.3**	**514.1**
(% of Net Sales)	*25.8*	*28.0*	*29.5*	*30.4*
Other Income	5.5	5.5	5.5	5.5
Depreciation& Amortisation	85.1	125.9	131.9	137.3
Interest	99.3	90.9	52.9	26.0
PBT	**92.5**	**133.2**	**291.3**	**388.5**
(% of Net Sales)	*10.0*	*12.0*	*19.6*	*23.0*
Extraordinary Expense/(Inc.)	-	-	-	-
Tax	14.0	13.3	29.1	38.9
(% of PBT)	*15.1*	*10.0*	*10.0*	*10.0*
PAT	**78.5**	**119.9**	**262.2**	**349.7**
% chg	*37.1*	*52.7*	*118.7*	*33.4*

Balance Sheet (Consolidated) — Rs crore

Y/E March (Rs cr)	FY2007	FY2008E	FY2009E	FY2010E
SOURCES OF FUNDS				
Equity Share Capital	65.8	91.5	91.5	91.5
Reserves& Surplus	419.3	1,419.1	1,567.8	1,766.2
Shareholders Funds	**485.1**	**1,510.6**	**1,659.3**	**1,857.7**
Total Loans	1,648.8	814.5	496.6	290.0
Deffered Tax Liability	92.4	95.0	100.9	108.6
Total Liabilities	**2,226**	**2,420**	**2,257**	**2,256**
APPLICATION OF FUNDS				
Gross Block	1,563.4	2,294.2	2,400.4	2,496.4
Less: Acc. Depreciation	458.0	583.8	715.7	853.0
Net Block	**1,105.4**	**1,710.4**	**1,684.7**	**1,643.4**
Advance for Capital Items	96.0	-	-	-
Capital Work-in-Progress	457.1	16.2	10.0	10.0
Investments	**0.1**	**0.1**	**0.1**	**0.1**
Current Assets	1,232.5	1,064.8	1,107.4	1,247.1
Current liabilities	664.7	371.3	545.5	644.3
Net Current Assets	**567.7**	**693.4**	**562.0**	**602.8**
Deferred Tax Asset	-	-	-	-
Total Assets	**2,226**	**2,420**	**2,257**	**2,256**

Cash Flow Statement (Consolidated) — Rs crore

Y/E March (Rs cr)	FY2007	FY2008E	FY2009E	FY2010E
Profit before tax	92.5	133.2	291.3	388.5
Depreciation	85.1	125.9	131.9	137.3
Change in Working Capital	193.4	(37.8)	(248.1)	(229.4)
Direct taxes paid	1.7	10.7	23.3	31.1
Cash Flow from Operations	**(17.5)**	**286.2**	**648.0**	**724.1**
Inc./ (Dec.) in Fixed Assets	482.1	194.0	100.0	96.0
Free Cash Flow	**(499.6)**	**92.2**	**548.0**	**628.1**
Inc./ (Dec.) in Investments	-	-	-	-
Issue of Equity	29.1	620.9	-	-
Inc./(Dec.) in loans	603.8	(834.3)	(317.9)	(206.6)
Dividend Paid (Incl. Tax)	34.4	51.9	113.4	151.2
Others	(3.8)	(127.4)	0.1	0.1
Cash Flow from Financing	**602.3**	**(137.8)**	**(431.4)**	**(357.9)**
Inc./(Dec.) in Cash	102.7	(45.6)	116.6	270.2
Opening Cash balances	**16.3**	**118.9**	**73.4**	**190.0**
Closing Cash balances	**118.9**	**73.4**	**190.0**	**460.2**

Key Ratios

Y/E March (Rs cr)	FY2007	FY2008E	FY2009E	FY2010E
Per Share Data (Rs)				
Diluted EPS	8.6	13.1	28.6	38.2
Diluted Cash EPS	17.9	26.9	43.1	53.2
DPS	4.0	4.0	3.4	4.5
Book Value	39.2	122.1	134.1	150.2
Operating Ratio (%)				
Raw Material / Sales (%)	38.2	36.6	36.0	35.5
Inventory (days)	237.7	166.3	111.5	80.5
Debtors (days)	148.9	108.0	64.8	41.2
Debt / Equity (x)	3.4	0.5	0.3	0.2
Returns %				
RoE	12.5	12.0	16.5	19.9
RoCE	13.7	15.5	21.0	25.4
Dividend Payout	37.4	37.0	37.0	37.0
Valuation Ratio (x)				
P/E	28.2	18.5	8.4	6.3
P/E (Cash EPS)	13.5	9.0	5.6	4.5
P/BV	6.2	2.0	1.8	1.6
EV / Sales	3.4	2.7	1.7	1.2
EV / EBITDA	11.6	8.6	5.4	3.7

Glossary

ANDA (Abbreviated New Drug Application)

Abbreviated New Drug Application is a collection of supporting documents submitted by an intending formulator, to the US FDA, requesting approval to market a generic drug.

Active Pharmaceutical Ingredients (API)

Active Pharmaceutical Ingredients (API) are active chemicals used in the manufacture of drugs.

Bioequivalence

The relationship between two preparations pf the same drug in the same dosage form that have a similar degree of availability to target tissue after administration.

Biotechnology

The development of techniques in the application of biological processes for the production of materials used in medicine and industry.

Bulk drug

Any component that is intended to furnish pharmacological activity or other direct effect in the diagnosis, cure, mitigation, treatment, or prevention of disease, or to affect the structure or any function of humans.

cGMP

Current Good Manufacturing Practices.

Chronic

Long lasting.

DMF

Drug Master File is a submission to the regulatory authority, providing confidential information about the manufacturing process and other details. A DMF is submitted solely at the discretion of the holder.

Dosage Forms

Different forms of drug administration such as capsule, tablets, injectible and aerosols.

FDA

Food and Drug Administration of different countries.

FTF

First - to - File.

Formulation

The product or act to prepare in accordance with a prescribed or specified method.

Generic

A drug whose patent has expired.

GMP

Good Manufacturing Practice is a part of Quality Assurance aimed at ensuring that products are consistently manufactured to meet an appropriate quality.

IND (Investigational New Drug)

Investigational New Drug filed by a producer in the US before the start of a drug's development stage.

IPR (Intellectual Property Rights)

Intellectual Property Rights are the rights of the originator of an innovative idea or product to hold sole international commercial rights for a period of time.

NCE (New Chemical Entity)

A new chemical entity that is discovered through research with modification in structure of a known and existing molecule entity.

NDA (New Drug Application)

New Drug Application filed by a producer in US with its FDA for its marketing approval.

NME (New Molecular Entity)

Essentially a new molecule discovered through research.

OTC (Over the Counter)

Drug that can be purchased without prescription

Patent

A patent is a government grant giving the owner the right to exclude others from making, using, or selling his invention or discovery.

Para I

The application states that the required patent information relating to such patent has not been filed, i.e. the drug is not patented.

Para II

It says that the patent has expired.

Para III

It says that the patent will expire on a particular date.

Para IV

It says that that such patent is invalid or will not be infringed by the drug, for which approval is being sought.

Phase I of clinical trial

Tolerability and dose-fitting study on healthy volunteers.

Phase II of clinical trial

Comparative studies with established drugs in a small number of patients.

Phase III of clinical trial

Enlarged Phase II studies with particular reference to efficacy and tolerability of the drug on larger number of patients.

Therapeutic

Therapeutic is a branch of medicine concerned with cure or relief of diseases with drug treatment.

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