2QFY12 Preview

HEALTH CARE & PHARMACEUTICALS

NOMURA
EQUITY RESEARCH

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2QFY12 Preview – expect moderate growth

Slower domestic growth, no material US launch and forex losses; remain selective

2QFY12F performance likely to be muted

We expect revenue growth of 15.8% y-y for the sector. Excluding the impact of the Taro acquisition by Sun Pharma, we expect moderate growth of 11.3% in revenue and 13.4% in EBITDA, due to: 1) a slower anti infective season this year and a high base in the domestic formulation market; 2) no significant launches and lack of material exclusivities in 2QFY12. We have not projected mark to market (MTM) gains/losses on currency movements. The steep depreciation of the INR against the USD in 2QFY12 could result in losses on account of hedges and forex loans.

Catalysts: INR depreciation a fundamental positive; but companies could incur MTM losses in the quarter

The India pharmaceutical sector is a net exporter and hence, is a beneficiary of INR depreciation. Our economics team recently cut the forecast of INR vs USD by 12-15%. We believe the extent of benefit is a function of 1) proportion of non India sales; 2) extent of natural hedge in terms of costs incurred in foreign currencies and 3) current margins. We believe the depreciating INR is most positive for RBXY and JOL, among our coverage. SUN and CDH are least impacted in our assessment. However, we believe RBXY and JOL risk recording large MTM losses on forex loans and outstanding hedges in the near term.

Remain selective

The BSETHC Index has outperformed the broader market YTD, as it fell 14% against the Sensex's decline of 21%. We find that the valuation premium of Indian stocks have expanded against global peers YTD. We remain selective and prefer companies that provide valuation comfort. Our top picks include DRRD, GNP, LPC and JOL. As far as the 2QFY12 results are concerned, we believe Cipla is able to surprise positively on higher olanzapine active ingredient (API) sales and favourable currency movements.

Fig. 1: Our target price and recommendations

Target price and recommendations

Company	Ticker	Recommendation	Market cap (US$ bn)	Base business valuation (A) (INR/share)	Others (B) (INR/share)	Target price (=A+B) (INR/share)	CMP (INR/share)	% upside
Sun Pharma	SUNP IN	NEUTRAL	10.2	508	5	513	470	9%
Cipla	CIPLA IN	NEUTRAL	4.8	313	-	313	285	10%
Ranbaxy	RBXY IN	REDUCE	4.6	373	108	480	517	-7%
Dr. Reddy's	DRRD IN	BUY	5.4	1,831	80	1,911	1,503	27%
GlaxoSmithKline	GLXO IN	NEUTRAL	3.8	2,292	-	2,292	2,099	9%
Lupin	LPC IN	BUY	4.3	570	-	570	459	24%
Glenmark	GNP IN	BUY	1.7	398	34	432	294	47%
Cadila Healthcare	CDH IN	BUY	3.4	937	-	937	762	23%
Jubilant Organosys	JOL IN	BUY	0.6	290	-	290	182	60%

Note: Pricing as of 7th October 2011

Source: Bloomberg, Nomura estimates

Anchor themes

Medium term growth drivers intact; expect 2QFY12 to be muted in terms of growth and margins

Nomura vs consensus

Our top picks are DRRD, GNP, LPC and JOL. Our target prices are 12-31% ahead of consensus for these stocks.

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2QFY12- Expect moderate growth

We expect performance of the sector in 2QFY12 to be moderate, due to: 1) a weak anti-infective season in India and a high base, which should result in a slowdown in domestic formulation growth rates; 2) lack of major launches in the US by companies under our coverage during the quarter and lack of exclusivities; and 3) sharp depreciation in the rupee against export currencies, which could result in forex losses on MTM of outstanding hedges and forex loans. We have not projected such forex gain/losses in our estimates.

We expect the sector to post revenue growth of 15.8% but negative net profit growth of 0.7%. We note that a material proportion of the y-y growth rate in the sector's revenue is sourced from Sun's acquisition of Taro. Ex Taro, we estimate the sector's revenue growth would moderate to 11.3% y-y. Sequentially, we pencil in a growth rate of 7.1% in revenue and a decline of 2.7% in net profit.

We believe Cipla could surprise on the upside on potential olanzapine API sales and favorable currency movements. Meanwhile, we believe MTM losses on hedges and forex loans in the quarter can be significant for Ranbaxy and Jubilant Lifesciences.

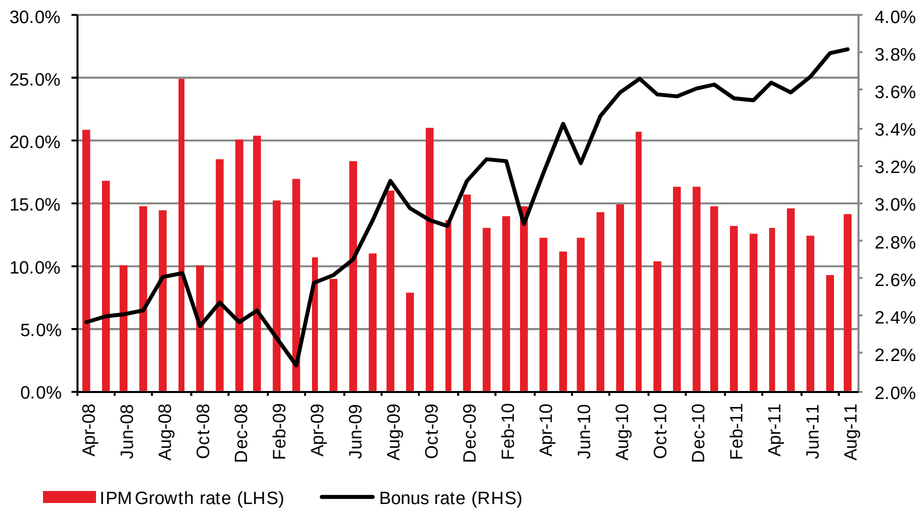
Domestic formulations – sales growth slowing, margins to decline; RBXY, CIPLA and DRRD likely to underperform

The Indian pharma market (IPM) has shown some signs of slowing down in the recent past, according to All Indian Origin Chemists and Distributors (AIOCD) data and industry channel checks. We attribute the slowdown to a high base and the anti infective season this year. As shown in figure 2, growth in net sales has slowed to low teens over the past six months vs mid-high teens earlier. During Jul-Aug 2011, net sales grew 1.7% and we expect growth to hover in low teens in September given the high base (Sep 2010 net sales grew >20%).

AIOCD data suggests that the chronic segment (28% of the IPM's net sales as of Aug 2011) has been able to sustain mid–high teens growth, whereas the acute segment (72% of net sales as of Aug 2011) has slowed down to low teens. In our opinion, the sustained growth in the chronic segment augurs well for companies that have a high share of chronic therapies, such as Sun Pharma (chronic contributed 59% of net sales as of Aug 2011) and Lupin (Chronic contributed 45% of net sales as of Aug 2011).

Fig. 2: IPM Growth rates and Bonus rates since April 2008

Growth in IPM has slowed to low teens over the past 6 months; bonus rates have increased

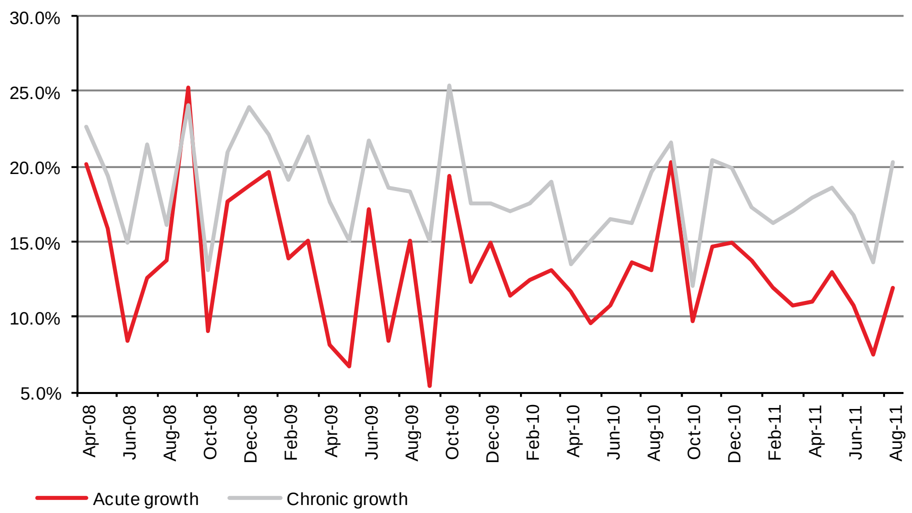


Source: AIOCD data, Nomura estimates

Intense competitive pressure and pricing regulations remain the key risks to the long-term growth story, in our view. The increase in bonus rates to 3.8% in Aug 2011 from 2.4% in April 2008 indicates increased competitive pressure. Moreover, we observe that the bonus rates are significantly higher in the acute segment compared to that in the chronic segment.

Fig. 3: Acute vs Chronic Net Sales growth

Acute segment has slowed to low double digits whereas the chronic segment has been able to sustain mid - high teens growth



Source: AIOCD data, Nomura estimates

Fig. 4: Expected net sales growth in domestic formulations for 2QFY12F for our coverage companies

We expect Lupin and Sun Pharma to register net sales growth of >20% in domestic formulations

Domestic formulations sales growth in %	2QFY12F	1QFY12	2QFY11	Jul-Aug 11 AIOCD
Cipla	8.0%	10.1%	19.8%	3.5%
Dr. Reddy's	10.0%	5.7%	25.4%	2.9%
Glaxo	10.0%	13.0%	13.6%	8.4%
Glenmark	16.4%	20.0%	21.5%	8.5%
Lupin	22.1%	17.8%	21.1%	19.0%
Ranbaxy	11.0%	10.6%	12.8%	13.6%
Sun Pharma	20.0%	14.9%	36.1%	18.5%
Cadila Healthcare	11.1%	4.9%	19.1%	7.4%

Source: Company data, AIOCD data, Nomura estimates

We expect Lupin and Sun Pharma to register net sales growth of ~ 20% each in 2QFY12F for domestic formulations. Noticeable laggards would be Cipla, Dr. Reddy's and Cadila Healthcare, in our view.

US generics – outlook positive; DRRD and GNP leveraging on ANDA pipeline

We note that there have been no major exclusive launches during the quarter by the companies under our coverage. We expect most of the growth in 2QFY12 to be driven by a ramp-up in recently launched products. According to IMS data, the Indian companies had attained a market share of 19.7% in Aug 2011 compared with 16.3% a year ago. In the exhibit below, we show y-y growth in total prescriptions (TRx) for the companies under our coverage.

Lack of exclusivities and one-off products in the US shall help to assess the core business margins and profitability, in our view. This will be particularly true for Ranbaxy, Sun Pharma and Dr Reddy's.

Fig. 5: TRx growth in the US generics market

Dr. Reddy's, Glenmark and Zydus Cadila have exhibited strong growth in TRx over Jul-Aug 2011 as per IMS data

US generics TRx growth in %	Jan-11	Feb-11	Mar-11	Apr-11	May-11	Jun-11	Jul-11	Aug-11
Dr. Reddy's	10.6%	14.6%	23.8%	26.9%	31.6%	31.8%	32.5%	33.2%
Glenmark	-13.2%	-12.5%	-9.9%	-3.5%	23.4%	22.2%	18.4%	25.5%
Lupin	46.4%	39.9%	34.1%	23.1%	18.7%	10.9%	9.9%	14.9%
Ranbaxy	44.2%	41.0%	40.5%	38.0%	33.2%	21.1%	1.7%	5.3%
Sun Pharma	23.3%	17.7%	18.3%	10.0%	12.8%	9.0%	5.9%	11.5%
Cadila Healthcare	40.2%	37.9%	35.1%	36.2%	39.1%	27.4%	26.3%	42.3%

Source: IMS, Nomura research

We expect new launches to accelerate starting 2HFY12F. Some of the large launches expected in the near term include generic Lipitor (USD7.5bn sales) by FTF (first to file) Ranbaxy, generic Seroquel (USD4.4bn sales) by Dr. Reddy's (limited competition opportunity), generic Fortamet (USD90mn sales) by Lupin, generic Prandin (USD200mn) by FTF Sun Pharma and generic Geodon (USD1.3bn) by FTFs Dr. Reddy's and Lupin. We expect sales growth in the US to be strong for Dr Reddy's and Glenmark. For Sun Pharma ex-Taro we estimate US growth to fall to 10% y-y in 2QFY12. 2QFY11 had sales from generic Eloxatin, which was withdrawn later.

Fig. 6: Expected net sales in US generic for 2QFY12F for our coverage companies
We expect Dr. Reddy's and Glenmark to register healthy growth during the current quarter

US sales (US$ mn)	2QFY12F	1QFY12	2QFY11
Dr. Reddy's	138	128	98
Glenmark	62	56	50
Lupin	111	110	104
Ranbaxy	75	95	86
Sun Pharma	156	171	99
Cadila Healthcare	59	53	50

Source: Company data, IMS, Nomura estimates

INR/USD – forex tailwinds to revenues and margins; expect materially adverse impact on balance sheet

The rupee has depreciated against most export currencies recently. Indian pharmaceutical companies are most exposed to the US dollar and the euro. During 2QFY12 (July-Sept 2011) the rupee depreciated 9.7% and 2.1% against the US dollar and the euro, respectively. As the industry is a net exporter, a depreciating rupee is a positive for revenues and margins. The impact of INR depreciation against export currencies on earnings is a function of three key factors, in our assessment.

a) Proportion of non India sales: The greater the proportion of non India sales, the greater is the positive impact on financials. DRRD has the least proportion of sales in INR among our coverage universe. Lupin and Ranbaxy also has less than 30% of overall sales in INR terms, on our numbers.

b) Extent of natural hedge or costs incurred in foreign currencies: Companies with manufacturing and sales and marketing divisions outside of India will, to an extent, see gains derived from a weakening rupee negated by rising costs denominated in foreign currencies. In this situation, we believe Cipla is best placed as most of the costs are incurred in INR terms. Cipla has not established any manufacturing and sales divisions outside of India. Glenmark, Sun Pharma and Ranbaxy incur most of their costs in foreign currencies, according to our assessment.

c) Margins: Companies with lower margins, on account of revenue cost mismatch, and higher leverage are likely to benefit more from INR depreciation, in our view Among our coverage universe, we note that the margins of base business (ex one-off gains) are low for Ranbaxy, Jubilant Organosys, Glenmark and Dr Reddy's.

Putting all these factors together, we believe INR depreciation against export currencies will be most positive for Ranbaxy and Jubilant Lifesciences.

Fig. 7: Estimated impact on Sales, EBITDA and Net profit for each 5% depreciation in INR

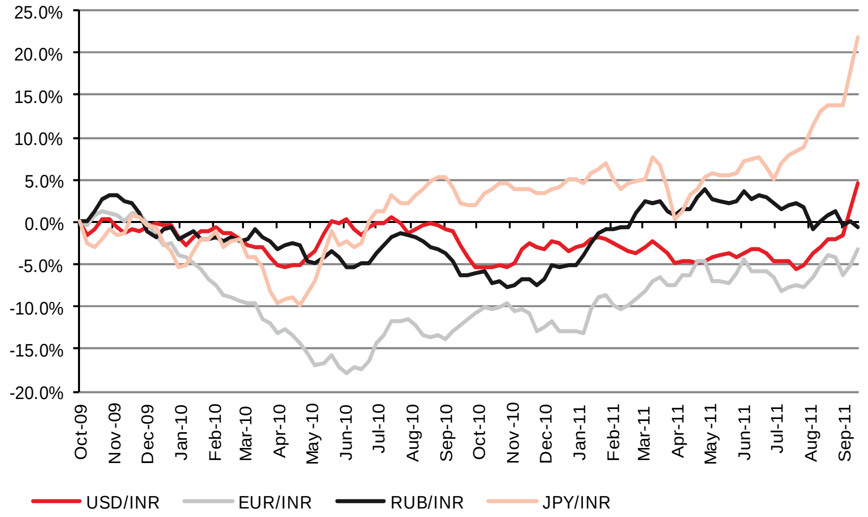
	% impact of 5% depreciation in INR		
Company	**Sales**	**EBITDA**	**Net Profit**
Dr. Reddy's	4.0	10.5	14.5
Glenmark	3.5	4.0	5.0
Lupin	3.5	10.0	11.5
Ranbaxy	4.0	13.0	19.0
Sun Pharma	3.0	2.5	2.5
Cadila Healthcare	2.5	3.5	3.5
Cipla	3.0	8.0	9.0
Jubilant Life Sciences	3.5	9.5	18.5

Source: Company data, Nomura estimates

The assessment above does not take into cognizance cash flow hedges. The recent depreciation of INR could result in MTM losses booked on: 1) outstanding hedges and 2) forex loans. The loss could be more pronounced for Ranbaxy and Jubilant Lifesciences for the quarter, on our estimates.

Fig. 8: Currency movements against the INR over the past 24 months

USD has appreciated significantly vs INR over the past 24 months



Source: www.oanda.com, Nomura research

SUN PHARMA (SUNP IN, TP: INR513, NEUTRAL)

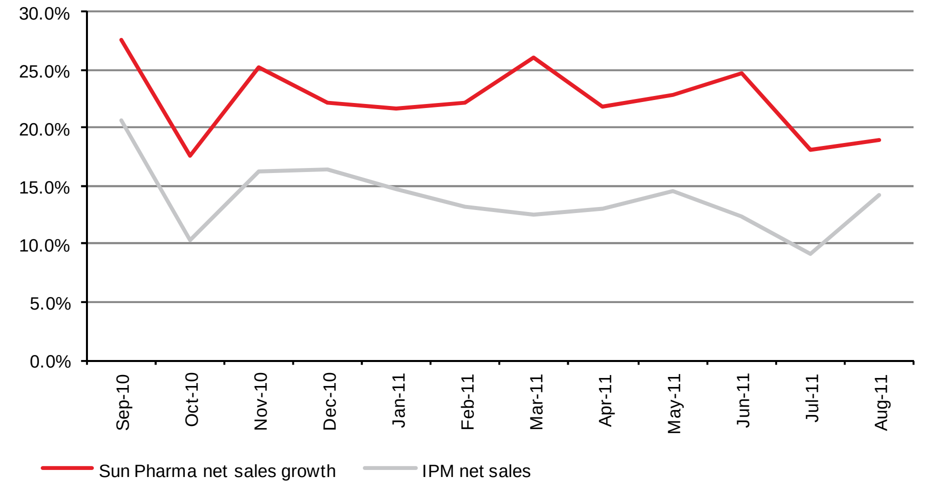
Fig. 9: Sun Pharma 2QFY12 Preview

(INR mn)	2QFY11	1QFY12	2QFY12F	q-q %	y-y %
Revenues	13,701	16,357	18,161	11.0%	32.6%
EBITDA	4,670	5,474	6,584	20.3%	41.0%
Net Profit	5,037	5,010	5,605	11.9%	11.3%

Source: Company data, Nomura estimates

For the domestic market, AIOCD data suggests a marginal slowdown for SUNP's net sales over the last two months from >20% to 18-19%. However, this is still substantially higher than the average industry growth rate. Note that the company had discontinued its contract manufacturing business during 1QFY12, which was earlier reported under domestic formulation. Excluding the contract manufacturing business, which contributed INR150mn in 2QFY11, we project net sales growth of 19% y-y (vs 18% y-y growth in 1QFY12) for 2QFY12. Including the loss in contract manufacturing revenues, we estimate domestic formulation growth of 16%.

Fig. 10: Sun Pharma vs IPM net sales growth over the past 12 months

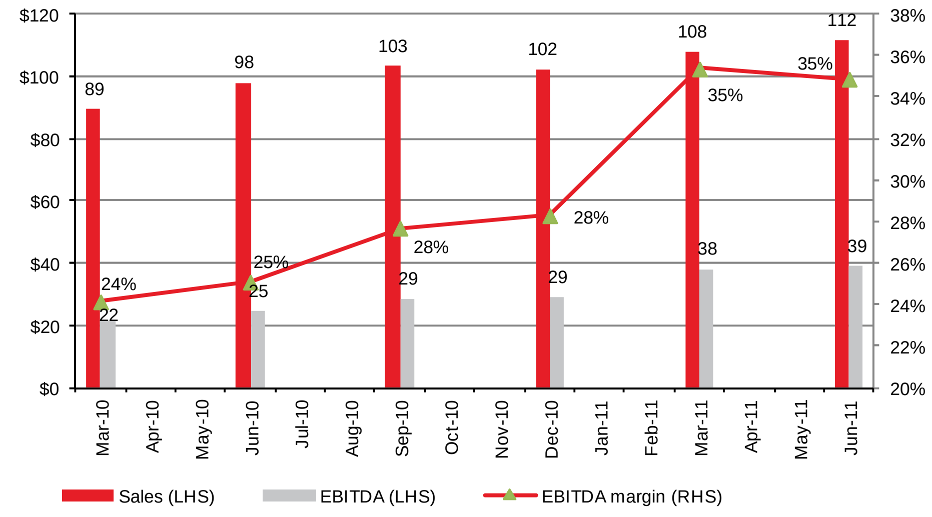


Source: AIOCD, Nomura research

In the US, some of the recent approvals for SUNP include Femara, Uroxatral (180 days exclusivity shared among four players), Arimidex, Gemzar, Imitrex injection and Taxotere. We expect sequential growth to be driven by Uroxatral, Gemzar, Imitrex injection and Taxotere. As per the IMS data released so far, SUNP gained a 10% market share in Uroxatral in Aug 2011. Industry feedback suggests that pricing has been relatively strong in Gemzar and this can be a positive for SUNP.

Fig. 11: Taro's quarterly performance (USD mn)

Taro has exhibited substantial improvement in margins and sales since its acquisition



Source: Company data, Nomura estimates

We expect overall revenue growth to accelerate to 32% y-y in 2QFY12, primarily on the back of Taro acquisition (in 1QFY11, only nine days of Taro operations were consolidated). Further, absence of significant contribution from exclusivity related sales in the year ago period presents an advantage of low base. Excluding Taro, sales are likely to be flat y-y.

SUNP's gross margin has been volatile in the past. However, in general we find that INR depreciation has positively impacted margins, which we believe could be the case in 2QFY12 as well. Further, y-y improvement in margins will be assisted by Taro's expanded margins in the recent past on lower overheads. Accordingly, we project EBITDA growth will be 41%, ahead of the revenue growth rate at 32.6%.

However, we are projecting 11.3% y-y growth in net profits on lower other income, higher tax rate (5% vs 3%) and higher minority interest. We have not projected any translation gain or loss. The translation can possibly have a positive impact as the company is lean on foreign loans. Gains can be on account of translation of receivables and cash on books.

DR. REDDY'S (DRRD IN, TP: INR1,911, BUY)

Fig. 12: Dr. Reddy's 2QFY12 Preview

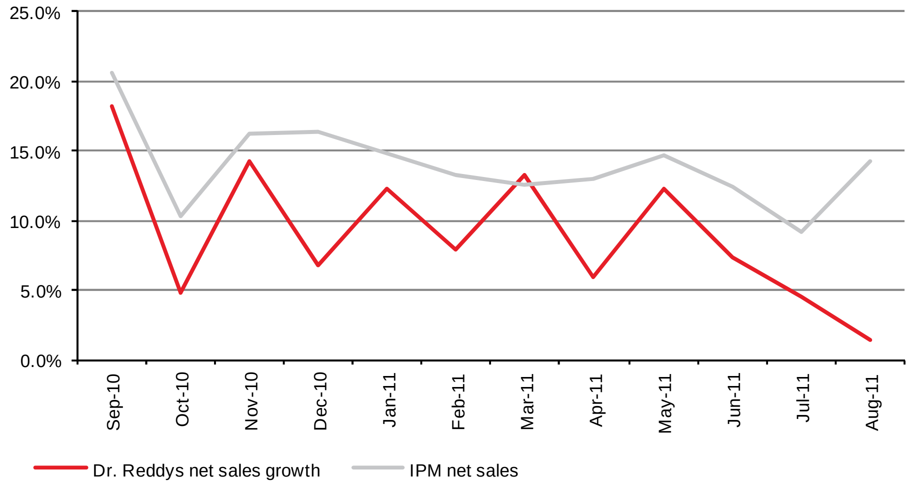
(INR mn)	2QFY11	1QFY12	2QFY12F	q-q %	y-y %
Revenues	18,704	19,783	21,263	7.5%	13.7%
EBITDA	4,200	4,201	4,789	14.0%	14.0%
Net Profit	2,866	2,626	2,969	13.1%	3.6%

Source: Company data, Nomura estimates

The US remains the most dominating growth theme for Dr Reddy's. As per IMS, Dr Reddy's has recorded acceleration in Rx growth over the past six months. There are several new launches over the past six months, which included Arixtra, Allegra D24 OTC, Effexor XR, Aricept, Femara, Lotrel (Higher strength), Exelon and Gemzar. Of these launches, Gemzar, which was launched in Jul 2011, can be a material contributor on higher pricing, in our view. For generic Arixtra, DRRD's market share has been low at ~7% due to supply constraints, much lower than the 60% share garnered by Apotex, the authorized generics. This is a negative surprise as we expect DRRD to gain a 30-40% market share.

Fig. 13: DRRD vs IPM net sales growth over the past 12 months

Dr. Reddys growth in domestic formulations has been subdued.



Source: AIOCD, Nomura research

We believe DRRD's sales in India are likely to be adversely impacted by: 1) a drop in Nise (a drug name) sales, which accounted for ~6% of India revenue in FY11 and 2) the large base, as DRRD recorded 25% revenue growth in 2QFY11. We expect growth in Russia to remain in high teens, driven by ~3% y-y appreciation in RUB against.

CIPLA (CIPLA IN, TP: INR313, NEUTRAL)

Fig. 14: Cipla 2QFY12 Preview

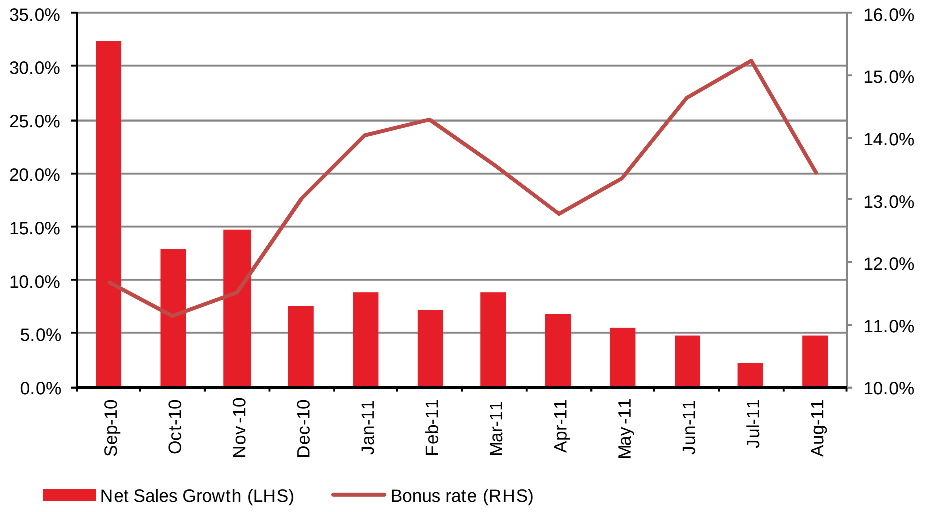
(INR mn)	2QFY11	1QFY12	2QFY12F	q-q %	y-y %
Revenues	16,154	15,914	17,611	10.7%	9.0%
EBITDA	3,832	3,944	4,423	12.1%	15.4%
Net Profit	2,630	2,533	3,020	19.2%	14.8%

Source: Company data, Nomura estimates

We project domestic sales growth of 8% y-y for 2QFY12. The domestic formulation, as per AIOCD, is showing a sustained slowdown in the branded segment with net sales growth of ~3.5% for Jul-Aug 2011. Moreover, there is a high base as 2QFY11 recorded 20% growth in domestic formulations.

Fig. 15: Cipla net sales growth and bonus rates

Cipla's net sales grew ~3.5% y-y for months of Jul - Aug 2011; bonus rates have been increasing.



Source: AIOCD data, Nomura research

AIOCD data suggests that Cipla has struggled to hold on to its >5% market share in IPM (based on net sales Aug 2011). We believe this is mostly attributed to a slowdown in the acute segment (55% of net sales as of Aug 2011) and competition in the respiratory therapeutic area. Data also suggests that Cipla has been increasing bonuses, which again indicates increased competitive pressure. Cipla's presence in the hospital segment and unbranded generics (18-20% of sales) has been volatile in the past and presents some uncertainties to growth estimates.

We are pencilling in 9% y-y export growth on the back of a pick-up in API sales momentum recorded in 1QFY12. Potential olanzapine API sales can present potential upside in the quarter. Please note that Teva is scheduled to introduce Olazapine generics on Oct 24 2011, post the expiry of the base patent. We expect formulation growth to pick up on the ramp-up of Indore SEZ. In 1QFY12, the company recorded a steep ramp-up in sales from Indore SEZ at INR1.4bn compared to INR1bn in FY11.

We believe Cipla will be a beneficiary of INR depreciation against export currencies primarily as costs are largely in INR terms. Regarding cash flow heading, the company takes hedging contracts month to month and does not have long-term hedges. As per disclosures made by the company in its FY11 annual report, net unhedged forex exposure (receivables- payables) is ~INR5.9bn (~USD130mn). Translation of monetary items could result in forex gains, which are not projected in our estimates. We expect a 15.4% y-y increase in EBITDA and a 90bps q-q improvement in EBITDA margin, as we build in the upside from INR depreciation against the USD and expect a ramp-up in the Indore SEZ operations.

Ranbaxy (RBXY IN, TP: INR480, REDUCE)

Fig. 16: Ranbaxy 3QCY11 Preview

(INR mn)	3QCY10	2QCY11	3QCY11F	q-q %	y-y %
Revenues	18,838	20,545	21,334	3.8%	13.2%
EBITDA	1,386	2,136	1,810	-15.3%	30.6%
Net Profit	3,128	2,455	1,100	-55.2%	-64.8%

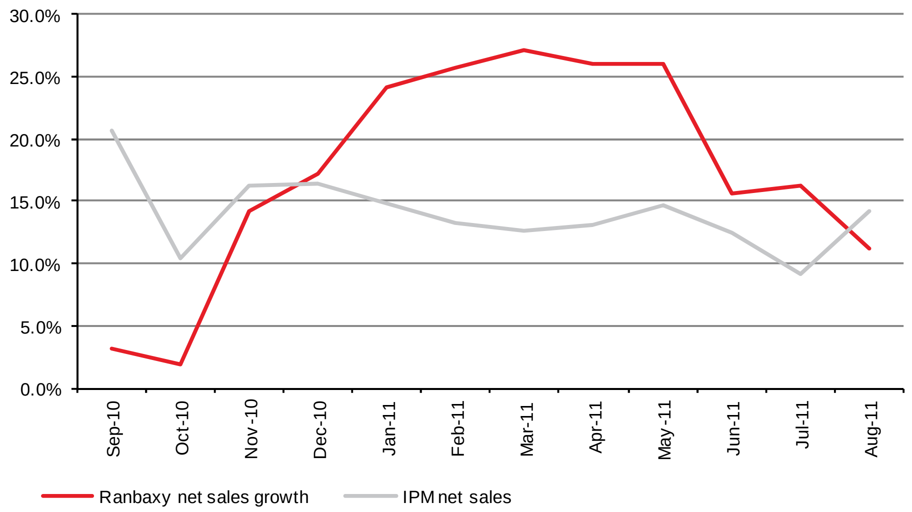
Source: Company data, Nomura estimates

We expect Ranbaxy to deliver 13% revenue growth y-y. There are no exclusivity sales in the current quarter. Therefore, we believe that the quarterly results shall assist in making as assessment of the core business (ex exclusivities) margins and profitability. We look forward to commentary on progress on resolution of outstanding issues with the United States Food and Drug Association (USFDA) and the Department of Justice (DOJ) and the potential launch of generic Lipitor on 30 Nov 2011. On our estimates, we are factoring in Lipitor launch in Nov 2011. We highlighted in our report "Stock building in High Expectations" dated 9 Sept 2011, that the agency can carve out the Lipitor ANDA from the ongoing resolution of manufacturing and AIP issues and approve it independently.

We estimate growth in the domestic business will moderate to 11%, as the anti infective season has been slow to pick up during the quarter. Data from AIOCD suggests that net sales for Ranbaxy grew 13.6% y-y vs the IPM at 11.7% over Jul-Aug'11.

Fig. 17: Ranbaxy vs IPM net sales growth over the past 12 months

Recent data suggests that Ranbaxy's growth has slowed down; is the VirAAT impact over?



Source: AIOCD data, Nomura research

On loss of Aricept exclusivity, we project a sequential decline in EBITDA of 15% q-q. We have not factored in any forex loss/gain in our estimates. However, on account for the sharp depreciation in INR against USD, we expect losses on account of outstanding loans and MTM of derivative valuations.

LUPIN (LPC IN, TP: INR570, BUY)

Fig. 18: Lupin 2QFY12 Preview

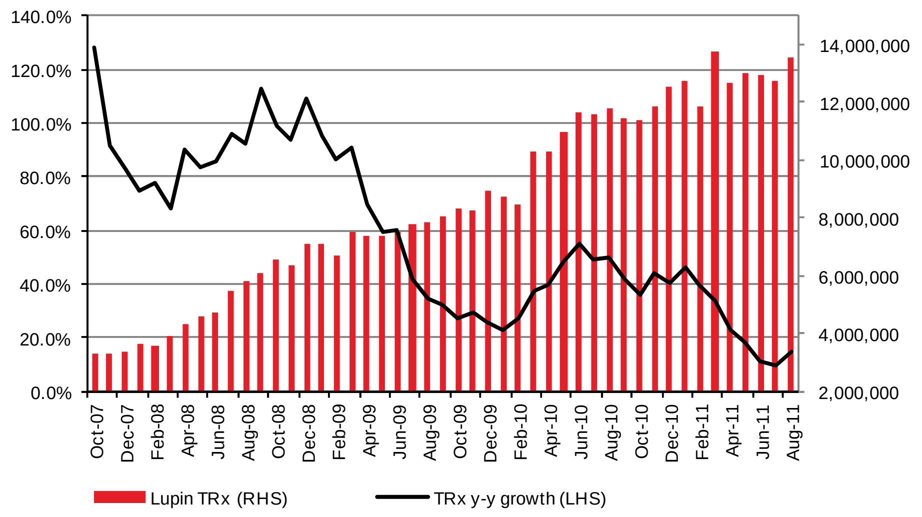
(INR mn)	2QFY11	1QFY12	2QFY12F	q-q %	y-y %
Revenues	14,050	15,432	17,128	11.0%	21.9%
EBITDA	2,986	2,944	3,822	29.8%	28.0%
Net Profit	2,150	2,101	2,767	31.7%	28.7%

Source: Company data, Nomura estimates

US: Growth slowing on large base; contribution from new introductions likely to be limited

For sales in the US, we expect growth rate to slowdown on a large base. The prescription trend as reported by IMS indicate volume growth in the range of 10-15% currently, compared with >40% growth recorded earlier.

Fig. 19: Lupin – US TRx and y-y growth



Source: IMS, Nomura research

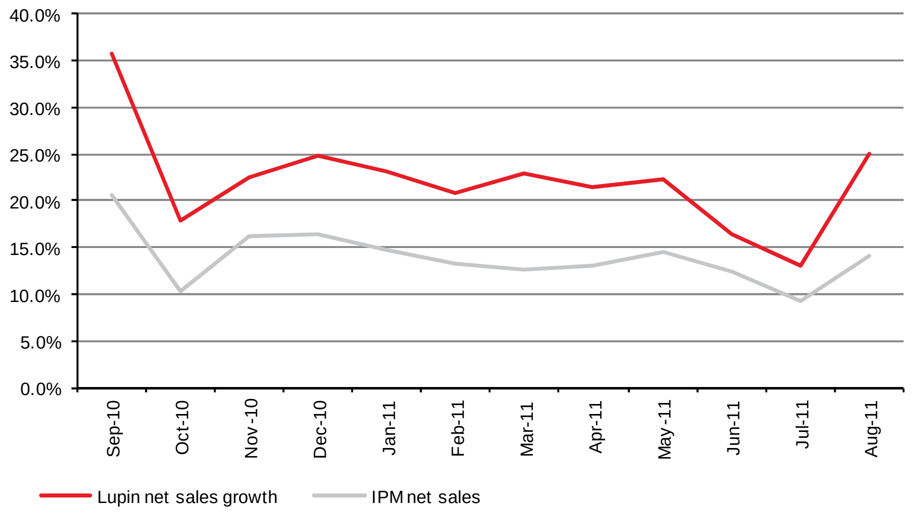
Key launches/approvals in the recent past include Levofloxacin (Jun 2011), Tramadol HCl ER, Keppra XR. The company has gained a 40% market share in Levofloxacin, which was launched in Jun 2011. However, its price fall is substantial based on industry feedback and hence is unlikely to be a key contributor. The competition in Tramadol and Keppra XR are relatively low, and we expect contribution in the quarter to be limited.

India growth to benefit from low base, chronic growth and addition of Eli Lilly's Insulin franchise

We expect Lupin to record 22% growth in India. Q2 is a seasonally strong quarter for Lupin. We believe Lupin is likely to benefit from a low base, as last year's anti-infective sales were adversely impacted due to channel inventory correction (2QFY11 sales were down q-q). We also build in INR180mn from Insulin sales, which is part of the recently announced partnership. We expect margins to be lower compared to overall domestic formulation margins.

Fig. 20: Lupin vs IPM net sales growth over the past 12 months

Lupin has grown above IPM consistently over the past 12 months; Eli lilly's diabetes portfolio to fuel more growth going forward



Source: AIOCD data, Nomura research

Medicis licensing income can boost EBITDA/bottom line

Overall, we project Lupin to record revenue growth of 22%, including USD20mn licensing from Medicis. We expect robust growth in India and relatively muted growth in the US. In Japan, assisted by INR depreciation, we expect Lupin to record revenue growth of 20%. The y-y depreciation of INR over JPY is ~9%. Over the last six quarters, EBITDA has been in the narrow range of INR2.9-3.1bn. Excluding licensing income from Medicis, we expect 2QFY12 to be largely in the similar range. We have factored in USD20mn as licensing fees in 2QFY12. Ex licensing income, we estimate net profit will be at INR2bn, within the INR2.0-2.3bn recorded in the previous six quarters. We have not accounted for forex gain/loss in our estimates. As per the company annual report, there is an un-hedged position of ~USD170m liabilities, which can potentially lead to forex loss for the period.

GLAXO (GLXO IN, TP: INR2,292, NEUTRAL)

Fig. 21: Glaxosmithkline 3QCY11 Preview

(INR mn)	3QCY10	2QCY11	3QCY11F	q-q %	y-y %
Revenues	5,820	5,615	6,383	13.7%	9.7%
EBITDA	2,160	1,993	2,327	16.8%	7.7%
Net Profit	1,578	1,517	1,740	14.7%	10.3%

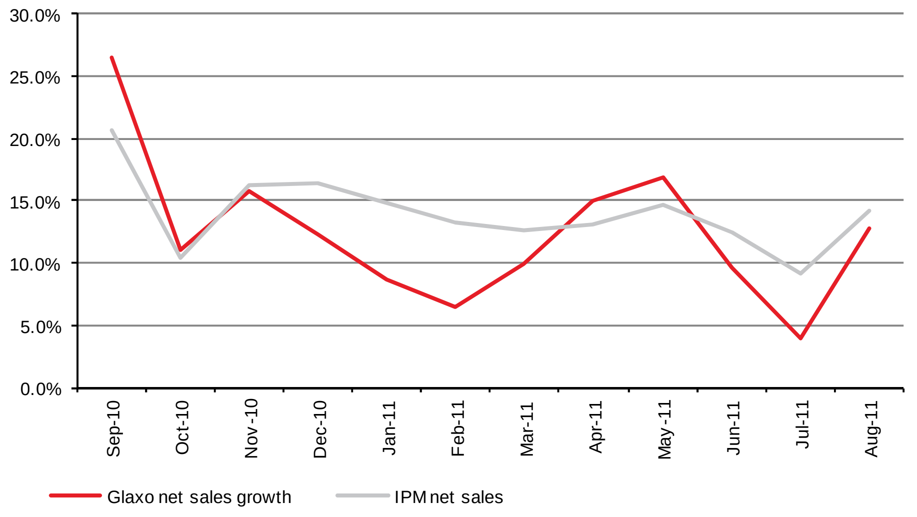
Source: Company data, Nomura estimates

We pencil in 9.7% y-y growth in net sales for Glaxo in 3QCY11. A benign anti infective season and lacklustre performance of branded generic launches have depressed growth, in our view. Also, we believe the previous year sales were positively impacted by non availability of vaccines in 2QCY10.

We estimate sales to accelerate sequentially in 3QCY11 (13.7% q-q), as it tends to be the strongest quarter seasonally. The recent AIOCD data also suggests some acceleration in sequential growth in net sales for Aug 2011. Glaxo launched two novel oncology products in April 2011 (Votrient and Revolade). We expect some traction from these products in 3QCY11.

Fig. 22: Glaxo vs IPM net sales growth over the past 12 months

A benign anti Infective season and lacklustre performance of branded generic launches have depressed growth.



Source: AIOCD, Nomura research

We project a decline in EBITDA margins, as what has happened in the recent past. Rising raw material prices and changed product mix due to its entrance into branded generics space would have undermined its margins, in our view.

We estimate net profit growth of 10.3% y-y, aided by higher interest income. We have not projected the actuarial gains explicitly. Given the rise in yields, we expect some gains to be booked on that count.

CADILA HEALTHCARE (CDH IN, TP: INR937, BUY)

Fig. 23: Cadila 2QFY12 Preview

(INR mn)	2QFY11	1QFY12	2QFY12F	q-q %	y-y %
Revenues	11,063	11,735	12,437	6.0%	12.4%
EBITDA	2,449	3,024	2,580	-14.7%	5.3%
Net Profit	1,768	2,343	1,737	-25.9%	-1.8%

Source: Company data, Nomura estimates

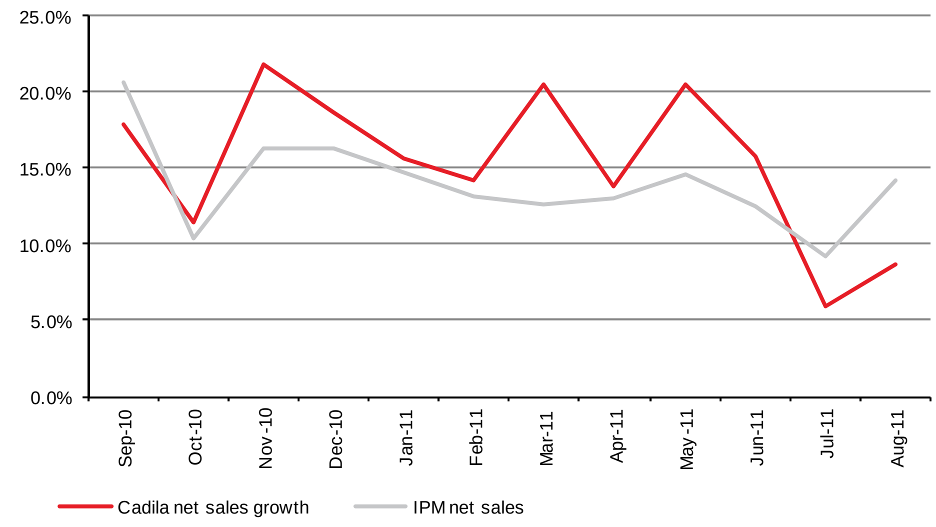
We expect Cadila to report 12.4% y-y growth in revenues and -1.8% growth in net profit. We expect EBITDA to grow 5.3% y-y. The expected margin pressure can be largely attributed to: 1) increased competitive pressure in the Indian acute segment (66% of net the sales as of Aug 2011) and 2) erosion of market share and pricing in generic Taxotere in US. During the quarter, we would watch out for commentary from Hospira on the Taxotere market share and pricing trends and commentary from Cadila on the domestic market growth and any guidance on that front.

We pencil in growth of 15% y-y in domestic formulation sales (excluding the portfolio allocated to the Bayer JV) vs. 9% y-y growth reported in 1QFY12. Management commented that 1QFY12 sales were impacted due to pre-booking of sales during 4QFY11. Recent AIOCD data suggests some slowdown in growth for Jul and Aug 2011. As per the company, there is increased competitive activity in the cardiovascular space (20% of net sales for Cadila as of Aug 2011).

We expect the consumer business in India to grow 15% y-y and 4% q-q vs 5% y-y in 1QFY12.

Fig. 24: Cadila vs IPM net sales growth over the past 12 months

Recent data suggests that Cadila has underperformed the IPM during Jul-Aug 2011.



Source: AIOCD data, Nomura research

We factor in a sequential drop in Hospira JV sales, as we expect lower Taxotere sales during the quarter due to increased competition from Sandoz (single vial), Sun and Accord (Both double vial). For North America, we take into account the Nesher acquisition that was consummated during 2QFY12 (mid Aug 2011).

We expect EBITDA margins to decline sequentially (adjusted for forex gains and higher other income) and y-y on higher material costs. There can be potential forex losses on foreign loans.

GLENMARK (GNP IN, TP: INR432, BUY)

Fig. 25: Glenmark 2QFY12 Preview

(INR mn)	2QFY11	1QFY12	2QFY12F	q-q %	y-y %
Revenues	7,414	8,685	8,244	-5.1%	11.2%
EBITDA	1,870	2,969	1,964	-33.8%	5.0%
Net Profit	1,116	2,101	1,151	-45.2%	3.1%

Source: Company data, Nomura estimates

We expect Glenmark to report 16% y-y growth in domestic formulation sales. Management had guided for a full-year growth greater than that of IPM. However, AIOCD data suggests some slowdown for Glenmark in the domestic market over the past few months, which we attribute to a high base, as the company recorded growth of 21.5% y-y a year ago.

Fig. 26: Glenmark vs IPM net sales growth over the past 12 months

Over the recent past, Glenmark's net sales growth has underperformed IPM as per AIOCD data.

Source: AIOCD, Nomura research

We expect GNP to continue to record strong sales growth in the US on new launches. Some of the key launches in the recent past include Malarone, Levocetirizine, Felodipine and oral contraceptives (OCs). Malarone is launched under exclusivity and there are no authorized generics at this stage. There is unlikely to be any additional competition in the foreseeable future, in our view.

We project EBITDA margins will be at 1QFY12 levels. According to management, Glenmark shall book USD25mn in licensing income, which however, will be nullified by USD28mn paid to Paul Partners as part of the termination of the royalty agreement. We believe that the company may report some forex losses in 2QFY12 on forex debt, as the company increased external commercial borrowing (ECB) in 1QFY12.

We look forward to management commentary on Tarka litigation. Bloomberg reported that Glenmark has lost the Tarka case in the District court, and this we believe have contributed to the stock's poor performance in recent past (the stock has fallen 9% since the verdict vs the market's returns of -1%). The verdict is not surprising as jury had earlier given a decision against Glenmark. Glenmark had stopped selling Tarka since Jan 2011 and therefore no longer figures in ours and street estimates. The court decision implies that there can be additional damages over and above USD16mn earlier decided by the Jury. The additional damage is likely to be linked to sales realized by Glenmark since Jan 2011. Given that Glenmark had stopped selling Tarka towards the end of Jan, the additional liability will be a fraction of USD16mn and not a multiple, in our view. Thus, we see limited impact of the event on the stock.

JUBILANT LIFE SCIENCES (JOL IN, TP: INR290, BUY)

Fig. 27: Jubilant Life Sciences 2QFY12 Preview

(INR mn)	2QFY11	1QFY12	2QFY12F	q-q %	y-y %
Revenues	8,533	9,485	9,718	2.5%	13.9%
EBITDA	1,460	1,862	1,846	-0.9%	26.4%
Net Profit	735	771	780	1.2%	6.1%

Source: Company data, Nomura estimates

We expect Jubilant to register sequential growth of 2.5% in sales. Jubilant launched generic Aricept in the US in June and Pantoprazole in early September. We expect the generics segment to continue to grow robustly (30% y-y). We expect the EBITDA margin to rise ~190bps y-y, and decline marginally q-q. We note that 2QFY11 numbers have been adjusted to exclude the APP business. JOL may book certain MTM losses on foreign debt. As per the company in Jun 2011, foreign debt was ~USD600mn, or 80% of the outstanding debt.

FORTIS HEALTHCARE (FORH IN, TP: INR170, NEUTRAL)

Fig. 28: Fortis 2QFY12 Preview

(INR mn)	2QFY11	1QFY12	2QFY12F	q-q %	y-y %
Revenues	3,579	4,833	5,943	23.0%	66.1%
EBITDA	(1,149)	618	737	19.3%	n/a
Net Profit	748	140	139	-0.7%	n/a

Source: Company data, Nomura estimates

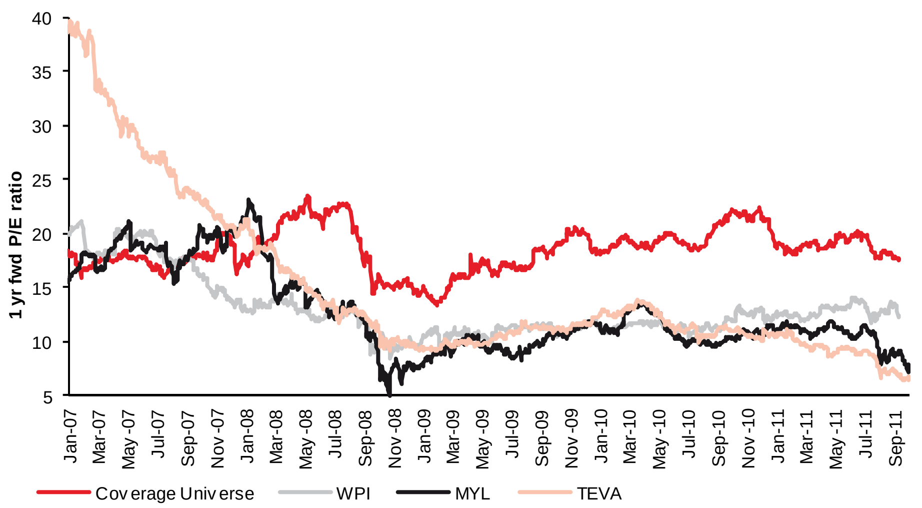
We expect Fortis to report revenue and EBITDA growth of 23% and 19.3% q-q, respectively, as Super Religare laboratories (SRL) would be consolidated for the full quarter. We note that SRL was consolidated for only half a quarter in 1QFY12.

We believe that the key catalyst for the stock remains on the valuation of the international acquisition and the profitability of the business. As per management, the valuation report is due within a month.

We remain selective

The BSETHC Index has outperformed the broader market YTD, as it is down 14% against the Sensex's fall of 21%. We find that the valuation premium of Indian stocks have expanded against global peers YTD. We believe the four key growth drivers are: 1) domestic market; 2) US opportunities; 3) emerging market opportunities; and 4) contract research and manufacturing largely remain in place. The weakening rupee in the recent past can further add to growth for most companies, in our view. However, we believe most valuations have started to factor in the opportunities. We remain selective and prefer companies that provide valuation comfort. Our top picks include DRRD, GNP, LPC and JOL.

Fig. 29: Coverage universe 1 yr fwd P/E vs international peers



Source: Bloomberg, Company data, Nomura estimates

Fig. 30: Current valuation multiples of our coverage and international generic pharmaceuticals stocks

Current trading multiples - Actual													
			Market Cap	CMP	P/E			EV/EBITDA			EV/Sales		
Company	Ticker	Recommendation	(INR mn)	(INR/share)*	FY11F	FY12F	FY13F	FY11F	FY12F	FY13F	FY11F	FY12F	FY13F
Sun Pharma	SUNP IN	NEUTRAL	483,644	470	26.8	23.2	20.2	23.8	19.0	16.2	8.2	6.1	5.1
Cipla	CIPLA IN	NEUTRAL	228,913	285	23.7	19.8	17.1	17.7	13.8	11.8	3.7	3.2	2.8
Ranbaxy	RBXY IN	REDUCE	218,003	517	14.6	14.2	11.9	10.1	10.4	4.8	2.4	2.2	1.6
Dr. Reddy's	DRRD IN	BUY	254,705	1,503	23.0	16.6	15.4	15.9	10.8	9.8	3.6	2.8	2.4
GlaxoSmithKline	GLXO IN	NEUTRAL	177,779	2,099	31.7	27.7	24.5	20.4	18.1	15.8	7.3	6.4	5.6
Lupin	LPC IN	BUY	205,125	459	24.4	22.8	17.4	17.7	15.8	12.3	3.8	3.2	2.7
Glenmark	GNP IN	BUY	79,410	294	17.3	11.9	13.3	16.5	9.9	10.5	3.3	2.6	2.2
Cadila Healthcare	CDH IN	BUY	157,871	762	23.5	19.1	15.5	16.4	13.7	11.2	3.8	3.1	2.6
Jubilant Organosys	JOL IN	BUY	28,910	182	6.6	12.1	10.7	8.4	10.6	7.9	1.5	1.7	1.5
Sector Average					25.4	21.4	18.6	19.7	15.6	13.4	5.6	4.5	3.8
		Reporting	Market Cap	CMP (report	P/E			EV/EBITDA			EV/Sales		
Company	Ticker	Currency	(USD mn)	currency)	FY11F	FY12F	FY13F	FY11F	FY12F	FY13F	FY11F	FY12F	FY13F
Teva	TEVA US	USD	35,364	38	8.5	7.9	6.9	7.0	6.8	5.7	2.5	2.2	1.9
Mylan	MYL US	USD	7,477	18	10.8	8.4	7.2	8.5	7.5	6.6	2.3	2.1	1.9
Watson	WPI US	USD	8,952	67	21.7	15.9	12.1	11.8	9.1	7.3	2.8	2.2	1.9
Stada	SAZ GR	EUR	1,211	15	7.3	7.7	5.8	6.4	6.0	4.9	1.1	1.0	1.0
Krka	KRKG SV	EUR	2,472	52	10.8	10.9	10.4	6.4	6.2	5.8	1.9	1.8	1.7
Ritcher Gedeon	RICHT HB	HUF	2,745	32,490	9.7	13.2	13.6	7.3	7.9	7.5	2.0	2.0	1.9
International Average					10.9	9.5	8.2	7.9	7.2	6.2	2.4	2.1	1.8

Note: stocks not listed in India are non rated (NR) stocks; pricing as of 7th October 2011

Source: Bloomberg consensus estimates for non rated stocks, Nomura estimates

Fig. 31: Our recommendations and target prices

Target price and recommendations								
Company	Ticker	Recommendation	Market cap (US$ bn)	Base business valuation (A) (INR/share)	Others (B)	Target price (=A+B)	CMP	% upside
Sun Pharma	SUNP IN	NEUTRAL	10.2	508	5	513	470	9%
Cipla	CIPLA IN	NEUTRAL	4.8	313	-	313	285	10%
Ranbaxy	RBXY IN	REDUCE	4.6	373	108	480	517	-7%
Dr. Reddy's	DRRD IN	BUY	5.4	1,831	80	1,911	1,503	27%
GlaxoSmithKline	GLXO IN	NEUTRAL	3.8	2,292	-	2,292	2,099	9%
Lupin	LPC IN	BUY	4.3	570	-	570	459	24%
Glenmark	GNP IN	BUY	1.7	398	34	432	294	47%
Cadila Healthcare	CDH IN	BUY	3.4	937	-	937	762	23%
Jubilant Organosys	JOL IN	BUY	0.6	290	-	290	182	60%

Note: pricing as of 7 Oct.

Source: Bloomberg, Nomura estimates

Appendix A-1

Analyst Certification

We, Saion Mukherjee and Aditya Khemka, hereby certify (1) that the views expressed in this Research report accurately reflect our personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of our compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

Issuer Specific Regulatory Disclosures

Mentioned companies

Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Cadila Healthcare	CDH IN	INR 762	07-Oct-2011	Buy	Not rated	
Cipla	CIPLA IN	INR 285	07-Oct-2011	Neutral	Not rated	
Dr Reddy's Laboratories	DRRD IN	INR 1503	07-Oct-2011	Buy	Not rated	
Fortis Healthcare	FORH IN	INR 121	07-Oct-2011	Neutral	Not rated	49
GlaxoSmithKline Pharmaceuticals	GLXO IN	INR 2098	07-Oct-2011	Neutral	Not rated	
Glenmark Pharmaceuticals	GNP IN	INR 293	07-Oct-2011	Buy	Not rated	1
Jubilant Lifesciences	JOL IN	INR 181	07-Oct-2011	Buy	Not rated	
Lupin	LPC IN	INR 459	07-Oct-2011	Buy	Not rated	
Ranbaxy Laboratories	RBXY IN	INR 517	07-Oct-2011	Reduce	Not rated	4
Sun Pharmaceutical Industries	SUNP IN	INR 469	07-Oct-2011	Neutral	Not rated	

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Previous Rating

Issuer name	Previous Rating	Date of change
Cadila Healthcare	Not Rated	11-Jan-2011
Cipla	Reduce	17-Mar-2011
Dr Reddy's Laboratories	Not Rated	11-Dec-2008
Fortis Healthcare	Not Rated	21-Jul-2011
GlaxoSmithKline Pharmaceuticals	Buy	19-May-2010
Glenmark Pharmaceuticals	Not Rated	16-Dec-2008
Jubilant Lifesciences	Not Rated	04-Feb-2010
Lupin	Not Rated	30-Jan-2009
Ranbaxy Laboratories	Neutral	29-Apr-2009
Sun Pharmaceutical Industries	Reduce	28-May-2010

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A rating of '**Buy**', indicates that the analyst expects the stock to outperform the Benchmark over the next 12 months. A rating of '**Neutral**', indicates that the analyst expects the stock to perform in line with the Benchmark over the next 12 months. A rating of '**Reduce**', indicates that the analyst expects the stock to underperform the Benchmark over the next 12 months. A rating of '**Suspended**', indicates that the rating, target price and estimates have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including, but not limited to, when Nomura is acting in an advisory capacity in a merger or strategic transaction involving the company.
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Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published from 30 October 2008 and in Japan from 6 January 2009

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Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published prior to 30 October 2008

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