

3<sup>rd</sup> March, 2009

## BUY

Price **Rs 632** Target **Rs 789**

Sensex - 8,607

### Price Performance

| (%)            | 1M | 3M | 6M   | 12M |
|----------------|----|----|------|-----|
| Absolute       | 12 | 9  | (13) | 15  |
| Rel. to Sensex | 22 | 15 | 47   | 136 |

Source: Bloomberg

### Stock Details

|                              |                 |
|------------------------------|-----------------|
| Sector                       | Pharmaceuticals |
| Reuters                      | LUPN.BO         |
| Bloomberg                    | LPC@IN          |
| Equity Capital (Rs mn)       | 828             |
| Face Value (Rs)              | 10              |
| No of shares o/s (mn)        | 83              |
| 52 Week H/L (Rs)             | 780/448         |
| Market Cap (Rs bn/USD mn)    | 53/1,022        |
| Daily Avg Vol (No of shares) | 106920.57       |
| Daily Avg Turnover (US\$ mn) | 1.2             |

### Shareholding Pattern (%)

|              | 31/12/08 | 30/09/08 | 30/06/08 |
|--------------|----------|----------|----------|
| Promoters    | 50.7     | 51.0     | 51.1     |
| FII/NRI      | 14.8     | 16.2     | 17.2     |
| Institutions | 23.1     | 21.2     | 20.4     |
| Private Corp | 1.9      | 1.9      | 1.7      |
| Public       | 9.6      | 9.7      | 9.6      |

Source: Capitaline

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# Lupin

## Hunt for earnings growth ends here...

Initiating  
Coverage

Lupin deserves a re-rating in valuations given its strong presence across the entire pharmaceutical gamut, outperformance of peers and just mid cap valuations. Lupin is entering the big league, with its businesses spread across the entire pharmaceutical gamut ranging from API to branded formulation to NCE research. Over the last eight years, Lupin has recorded an impressive growth of 63% CAGR. Despite Lupin reaching the scale and size of the big pharmaceutical companies, it has been valued as a mid-cap pharma company. With Lupin expected to outperform its large cap peers in both revenue (CAGR of 24% vs average CAGR of 21% of its peers) as well as earnings growth (CAGR of 28% vs average CAGR of 17% of its peers) coupled with highest RoE among its peers (25% RoE in FY10E vs avg. RoE of 20% of its peers), we believe that a re-rating in its valuations is inevitable. We believe that Lupin should command at par valuations to its large Indian peers. A re-rating of Lupin at par, if not at a premium, to its large cap peers, presents a huge upside potential from the current levels. We initiate coverage on the stock with a Buy rating and a price target of Rs789. The adverse outcome of the USFDA 483 observations remain a key risk to our call.

### Attained the scale and size of big pharma companies

Lupin has attained sizable revenues across markets, pushing it into the league of big pharma companies. Over FY00-08, Lupin has registered a CAGR of 63% vs. an average CAGR of 24% for large Indian peers. Moreover, it has moved up the value chain from the base pyramid of API manufacturing to the top of the pharma value chain, i.e. discovery research. Lupin's ranking in the domestic formulation market has improved from 10th position in 2006 to 5th in 9M2009. In terms of revenues, Lupin has surpassed Sun Pharma (Base business), which is the number one Indian pharma company, in terms of M Cap.

### Expanding across the globe; growing faster than peers

Apart from gaining scale and size across the product value chain, it is also on a geographical expansion spree to fuel its future growth. Along with its fast growing franchise in India and US, Lupin is making early inroads into Japan (acquisition of Kyowa- 7th largest generic company), globally the second largest market. Lupin is also present across a whole host of semi-regulated markets including the CIS, Australia, Latin America, Africa, GCC and South East Asia. Lupin's presence in certain geographies gives it an edge over other large pharma companies, who are yet to establish their presence in those markets. Lupin is one of the fastest growing companies among its Indian peers. In the domestic and international market, it grew at a CAGR of 22% and 131% vs avg. CAGR of 15% and 41% for large Indian peers over FY03-08. Lupin has consistently outperformed its Indian peers. We expect Lupin to sustain outperformance and report a CAGR of 24%, 27% and 28% vs 21%, 25% and 18% avg. CAGR of its Indian peers in revenue, EBIDTA and PAT respectively over FY08-10E.

### Midcap perception - Valuation way beind large cap peers

Lupin trades at a 35% discount to its eight year average PER multiple. While Lupin has reached the scale and size of the big pharmaceutical companies, it is still perceived as a midcap stock resulting in it trading at a discount. With Lupin expected to outperform its large cap peers in both revenue (CAGR of 24% vs avg. CAGR of 21% of its peers) as well as earnings growth (CAGR of 28% vs average CAGR of 17% of its peers) and highest RoE among its peers, we believe that a re-rating in its valuations is inevitable. We have valued Lupin on PER, P/BV and EV/EBIDTA based valuation methodology. We assign a Buy rating on the stock with a target price Rs789.

### Key Financials (Rs mn)

| YE-Mar  | Net Sales | EBITDA (Core) | (%)  | APAT  | EPS (Rs) | ROE (%) | P/E (x) | EV/ EBITDA | P/BV (x) | Div. Yld (%) |
|---------|-----------|---------------|------|-------|----------|---------|---------|------------|----------|--------------|
| FY2008  | 26,862    | 4,517         | 16.8 | 3,350 | 37.8     | 31      | 16.7    | 12.1       | 4.1      | 1.6          |
| FY2009E | 35,967    | 6,254         | 17.4 | 4,541 | 51.3     | 28      | 12.3    | 9.6        | 2.8      | 1.6          |
| FY2010E | 41,440    | 7,301         | 17.6 | 5,486 | 61.9     | 25      | 10.2    | 8.3        | 2.3      | 1.6          |
| FY2011E | 46,396    | 8,374         | 18.1 | 6,395 | 72.2     | 24      | 8.8     | 7.0        | 1.9      | 1.6          |

## Investment argument

### Lupin- attained scale and size to enter the league of big pharma companies

*Lupin's business interests spread across the entire pharmaceutical chain*

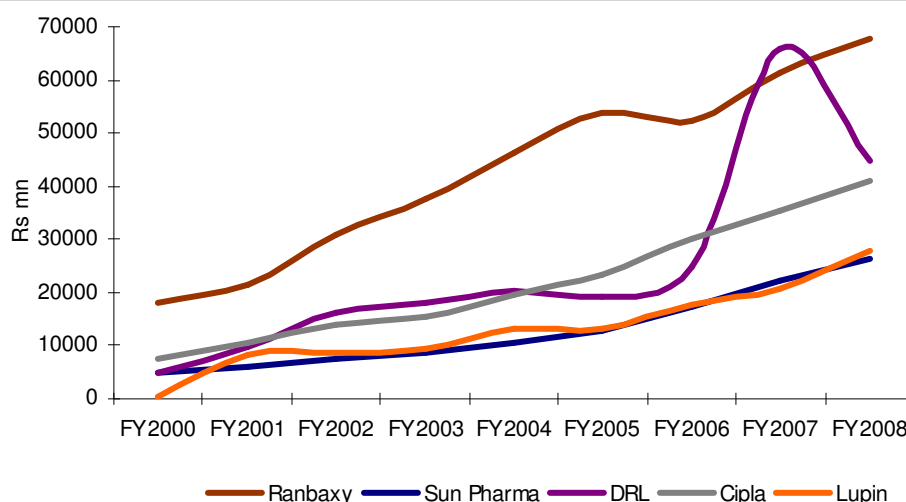
Over the last five years, Lupin has reported robust growth and outperformed its peers, on the back of its vertically integrated business model coupled with its large scale of operations. It has made good progress in its efforts to move up the value chain in terms of product (APIs to Formulations to higher end of value chain in NCE research) as well as markets (semi-regulated to regulated). Within a short span of time, Lupin has quickly scaled up its operations with presence across segments as well as geographies. Lupin's scale, range and geographical presence is comparable to that of the large pharma companies, marking its entry into the big league.

### Attained size comparable to large Indian peers

*Over FY00-08, Lupin grew at a CAGR of 63% vs an avg. CAGR of 24% for its peers*

In terms of size, Lupin has attained sizable revenues across markets, pushing it into the league of big pharma companies. Over FY00-08, Lupin has registered a CAGR of 63% vs. an average CAGR of 24% for large Indian peers. Lupin is one of the fastest growing companies among its Indian peers- both in domestic as well as in the international market. In terms of revenues, Lupin has surpassed Sun Pharma, which is the number one Indian pharma company, in terms of M Cap.

#### Revenue progress over FY00-08- Journey towards entering the big league

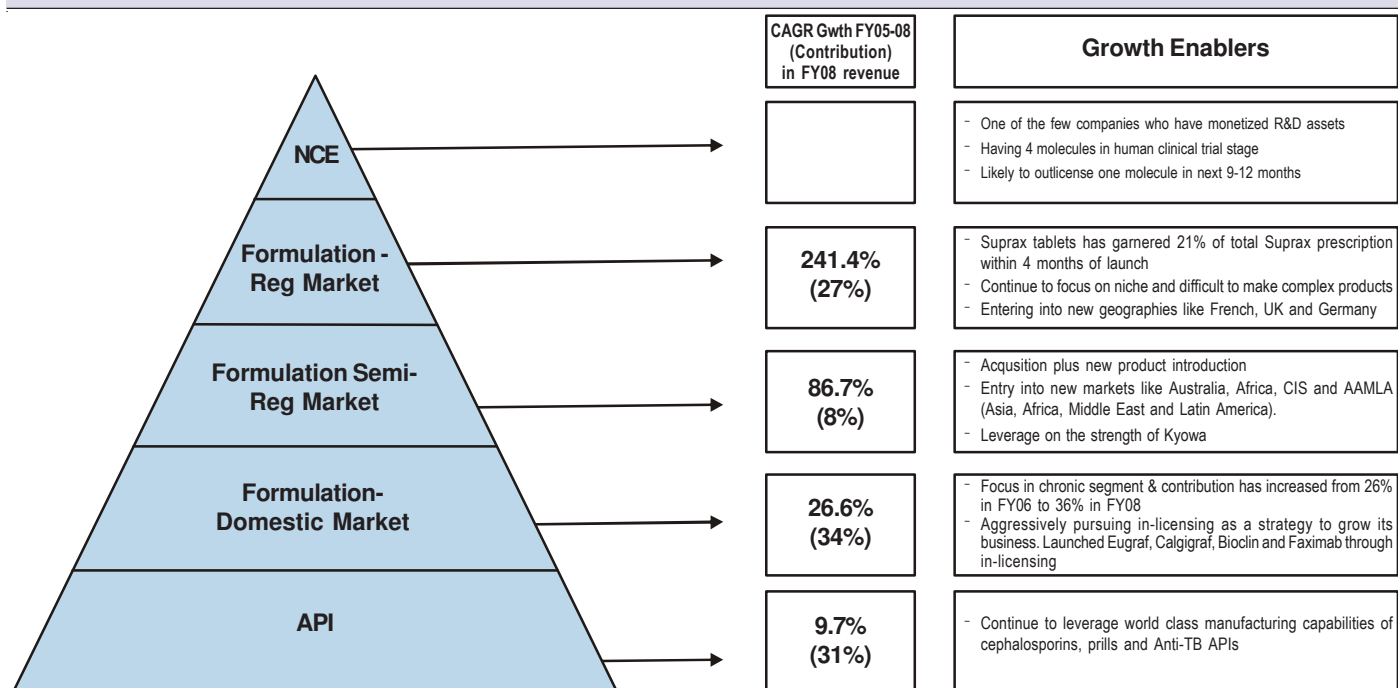


Source: Company, Emkay Research

### Presence across the value chain

Lupin has transformed itself from an API manufacturer to a fully integrated global pharmaceutical company. Today, its business interests are spread across the entire pharmaceutical chain- spanning API manufacturing, formulations (domestic, regulated as well as semi-regulated markets), CRAMS and the top-most pyramid of the pharma value chain, i.e., New Chemical Entities (NCE). Lupin has been steadily moving up the value chain and at the same time, has strengthened its presence in each of the business segments. The API segment can boast of being the world's largest manufacturers of Anti-Tuberculosis. Similarly, in the domestic formulation business, it ranks 5th as per ORG ratings. The contribution of the high margin formulation business has increased from 42% in FY05 to 70% in FY08. From being a major TB player, Lupin has been gaining prominence in various segments, with a focus on the fast growing chronic segments. Today, the contribution of the lifestyle segment has increased from 26% in FY06 to 36% in FY08 (CAGR growth of 41% over FY06-08).

## Moving up the value chain



Source: Emkay Research

*Lupin is consistently strengthening its presence in the domestic market as well as international markets*

## Geographical presence

We believe Lupin is one of the better diversified Indian companies from a geographical perspective. In addition to a fast growing franchise in India and US, Lupin is making early inroads into Japan (acquisition of Kyowa has made it the 7th largest generic company in Japan), the second largest pharmaceutical market of the world. Lupin is also present across a whole host of semi-regulated markets including the CIS, Australia, Latin America, Africa, GCC and South East Asia. Lupin's presence in certain geographies gives it an edge over other large pharma companies, who are yet to establish their presence in those markets. Lupin has made a good beginning in the European countries (though its base is small). In terms of presence in key geographies, Lupin has been consistently strengthening its presence in the domestic market while simultaneously making forays into newer geographies in the international market.

## Presence across the globe- building blocks for future growth

|              | US                                                                                                                                                                                                                             | EU                                                                                                                                                                                                                                                                                  | Japan                                                                                                                                                                                                                                                                                        | CIS                                                                                                                                                                                                                                                                             | GCC                                                                                                                                                                                                                                                                            | AAMLA                                                                                                                                                                                                                                                                                                                    |
|--------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Ranbaxy      | ✓                                                                                                                                                                                                                              | ✓                                                                                                                                                                                                                                                                                   | ✓                                                                                                                                                                                                                                                                                            | ✓                                                                                                                                                                                                                                                                               | ✓                                                                                                                                                                                                                                                                              | ✓                                                                                                                                                                                                                                                                                                                        |
| Sun Pharma   | ✓                                                                                                                                                                                                                              | ✓                                                                                                                                                                                                                                                                                   |                                                                                                                                                                                                                                                                                              | ✓                                                                                                                                                                                                                                                                               |                                                                                                                                                                                                                                                                                |                                                                                                                                                                                                                                                                                                                          |
| DRL          | ✓                                                                                                                                                                                                                              | ✓                                                                                                                                                                                                                                                                                   |                                                                                                                                                                                                                                                                                              | ✓                                                                                                                                                                                                                                                                               | ✓                                                                                                                                                                                                                                                                              | ✓                                                                                                                                                                                                                                                                                                                        |
| Cipla        | ✓                                                                                                                                                                                                                              | ✓                                                                                                                                                                                                                                                                                   |                                                                                                                                                                                                                                                                                              | ✓                                                                                                                                                                                                                                                                               |                                                                                                                                                                                                                                                                                | ✓                                                                                                                                                                                                                                                                                                                        |
| Lupin        | ✓                                                                                                                                                                                                                              | ✓                                                                                                                                                                                                                                                                                   | ✓                                                                                                                                                                                                                                                                                            | ✓                                                                                                                                                                                                                                                                               | ✓                                                                                                                                                                                                                                                                              | ✓                                                                                                                                                                                                                                                                                                                        |
| Key features | <ul style="list-style-type: none"> <li>Largest pharma market</li> <li>Lupin has been growing at a faster clip than its Indian peers in the US market</li> <li>US business has grown at a CAGR of 189% over FY05-08.</li> </ul> | <ul style="list-style-type: none"> <li>Lupin is primarily targeting the French, UK and German markets for entering the EU market</li> <li>Hormosan acquisition will provide front end in the German market.</li> <li>We expect EU to grow at a CAGR of 68% over FY08-10E</li> </ul> | <ul style="list-style-type: none"> <li>Most attractive generic destination</li> <li>Generic penetration is as low as 5%</li> <li>Lupin's acquisition of Kyowa will enable it to penetrate the highly regulated, fairly complex and rapidly transitioning generic market of Japan.</li> </ul> | <ul style="list-style-type: none"> <li>Market potential of CIS region is US\$15.5bn</li> <li>Changing lifestyle, ageing population and increased government spend, enhance the opportunity in the region</li> <li>Lupin has 98 representatives working in the region</li> </ul> | <ul style="list-style-type: none"> <li>Lupin is one of the 3 Indian companies having presence in GCC markets</li> <li>Introduced the third generation antibiotic Cefdinir, as first-to-market product</li> <li>Lupin has presence in UAE, Lebanon, Kuwait and Yemen</li> </ul> | <ul style="list-style-type: none"> <li>Lupin has sizable presence in other markets such as Latin America, Australia, Africa and South East Asia</li> <li>IMS has projected double digit growth in these emerging markets</li> <li>Most of the markets are branded generics, where margins are relatively high</li> </ul> |

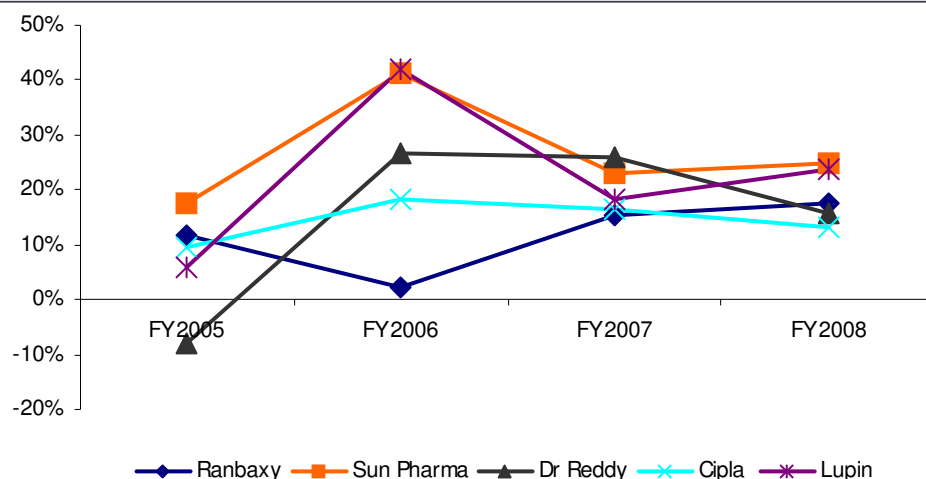
Source: Company, Emkay Research

*Lupin is the fastest growing company among the top 10 players in the domestic market*

### Lupin- fastest growth among top 10 players in domestic market

In the domestic market, Lupin's growth was the highest among the top 10 players and it has been consistently outperforming the industry growth. Lupin's ranking in the domestic formulation market has improved from 10th position in 2006 to 5th in 9M2009, demonstrating the underlying strength in its business model. Moreover, in terms of absolute prescription growth, Lupin grew twice the market (9.3% vs. 4.7% of the industry).

#### Growth in Domestic Formulation



Source: Company, Emkay Research

Going ahead, we expect Lupin's domestic formulations business to witness 17% CAGR over FY08-10E, ahead of the estimated 12-13% industry CAGR.

*Lupin is the fastest growing generic company in the US among its Indian peers*

### US- Lupin is the best play among Indian peers

Lupin's two pronged strategy of building brands through front end marketing and attaining scale through generic penetration by leveraging its low cost manufacturing has yielded rich dividends. Lupin has been growing at a faster clip than its Indian peers in the US market. Its US business has grown at a CAGR of 189% over FY05-08. Over the last three years, Lupin has built a strong foothold in the paediatric branded market and is an emerging market leader in the generic space.

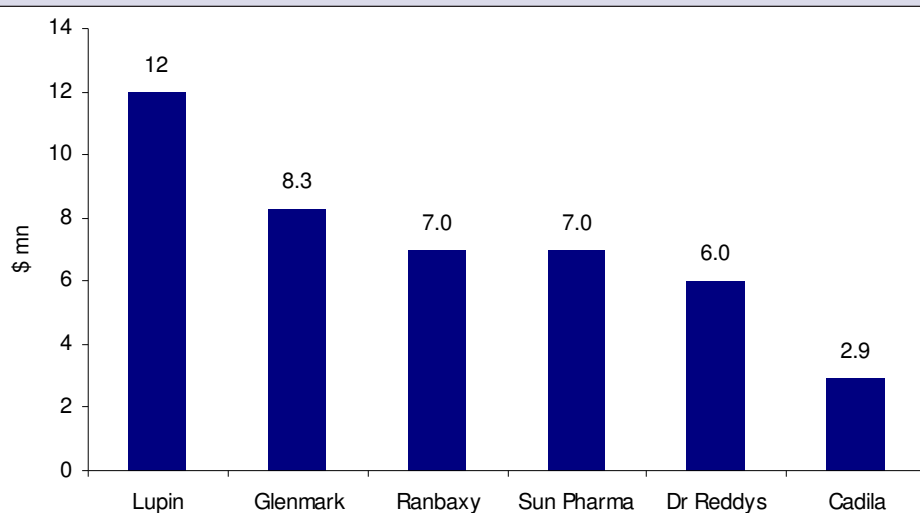
*Lupin per product revenue in US is US\$12mn, highest among its Indian peers*

### Highest revenue per product in US

Despite being a late entrant in the US market (world's largest pharmaceutical market), Lupin has ramped up its US business very fast. Lupin's prescription growth and penetration has been faster and deeper than any other large Indian player. Apart from Ranbaxy, Lupin is the only company to have invested on developing front end marketing capabilities, which is paying them huge rewards. Today, Lupin has developed a strong product basket led by branded and complex product focus. Its strong relationship with key specialists like paediatricians and trade partners to ensure wider market penetration has enabled it to have the most profitable product portfolio among peers in the US. Lupin's revenue per product is highest among its Indian peers (shown in the graph) and its US business is growing at a faster pace than its competitors like Sun Pharma, Ranbaxy, Dr Reddys, Glenmark, etc. Lupin's per product revenue in FY08 was US\$12mn vis-à-vis US\$5-8mn for its peers, despite no FTF launches. Moreover, out of its product basket of 21 products, Lupin has leadership in 7 products and 12 products are among the top 3 players in their segments.

We firmly believe that its two pronged strategy of building brands through its front end marketing team and attaining scale and size through focus on complex products such as oral contraceptives, steroids, sustained release formulations, etc., would continue to drive growth in the US market in the future also.

## Revenue per product in the US



Source: Industry, Emkay Research

## YoY performance of Lupin in US

| (US\$ mn)        | FY2006 | FY2007 | FY2008 | 9MFY09 |
|------------------|--------|--------|--------|--------|
| US sales         | 56     | 89     | 180    | 161    |
| YoY growth       |        | 59%    | 103%   | 64%    |
| % of total sales | 13%    | 18%    | 27%    | 29%    |
| No of products   | 5      | 10     | 15     | 19     |
| Sales/product    | 11     | 9      | 12     | 11     |
| New launches     |        | 5      | 5      | 4      |

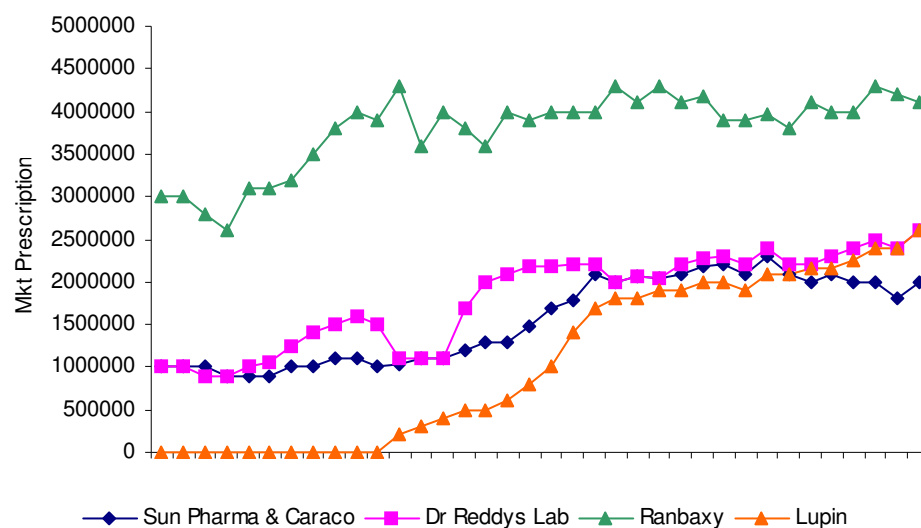
Source: Industry, Emkay Research

## Performance of Indian Peers in the US market

|            | US contribution to total revenues (1QY09) | Total US product portfolio | No of key products | Share of key products in total US prescriptions |
|------------|-------------------------------------------|----------------------------|--------------------|-------------------------------------------------|
| Dr Reddy's | 19%                                       | 37                         | 8                  | 72%                                             |
| Lupin      | 27%                                       | 17                         | 7                  | 87%                                             |
| Sun Pharma | 43%                                       | 52                         | 9                  | 54%                                             |

Source: Industry, Emkay Research

## Prescription growth vs. peers (US)



Source: Industry, Emkay Research

*Apart from Ranbaxy, Lupin is the only other company among its large Indian peers, who is well set to capitalize the growing generic opportunity in the Japanese market*

## Lupin-the largest Indian player in the Japanese market, post Kyowa acquisition

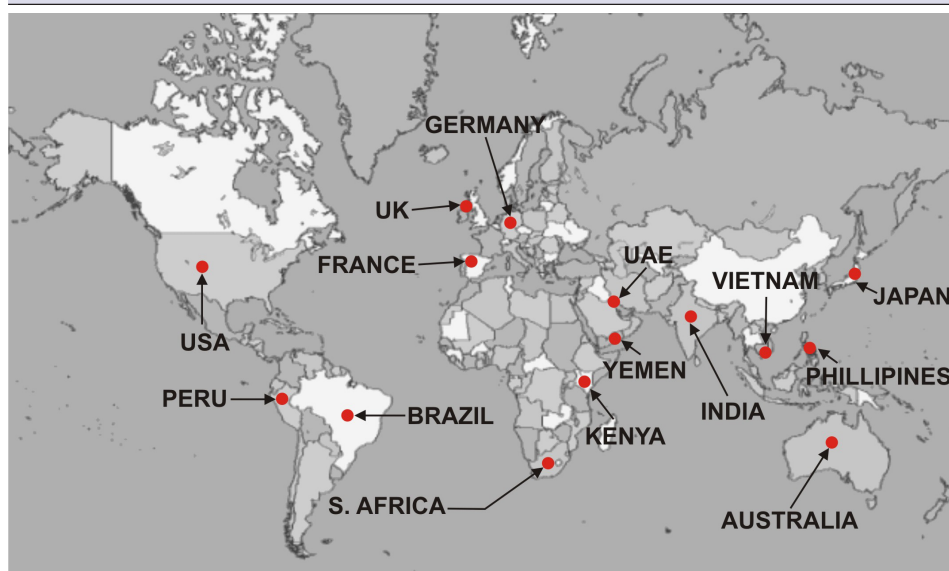
Japan is one of the most attractive generic markets globally, in view of the abysmally low generic penetration, and especially the efforts being undertaken by the government to enhance the generic penetration. Currently, generics account for only about 5% of the US\$65bn Japanese pharma market by value and around 15% by volumes. This is significantly lower than the 50% generic penetration in markets like USA, UK, Germany, etc.

Given the Japanese government's concerted efforts to increase generic penetration in the country, the market is expected to scale up sharply i.e. to grow by 30% in volumes by 2012. However, the Japanese regulatory framework is fairly complex and makes for a very high entry barrier. Consequently, it is imperative for overseas players to partner with local Japanese players. Apart from Ranbaxy, Lupin is the only other company among its large Indian peers who is well set to capitalize the growing generic opportunity in the Japanese market. We believe Lupin's acquisition of Kyowa (7th largest generic player) will enable it to penetrate the highly regulated, fairly complex and rapidly transitioning generic market of Japan. Over the medium term, we expect Japan to be a key growth market for Lupin.

## RoW

This is a relatively small but rapidly growing segment for Lupin and refers to the sales outside the regulated markets of USA, EU and Japan. Lupin has been a recent entrant in these RoW markets, and thereby has a small base. Key RoW geographies include CIS and AAMLA (Asia, Africa, Middle East and Latin America). Lupin's focus in the AAMLA region is to introduce world class value-added products in multiple therapy areas. Over the last three years, Lupin has built a presence in several key markets of these regions such as, Australia, UAE, Yemen, Kenya, Kuwait, Lebanon, Peru, Vietnam and Philippines. Lupin is one of the few companies in India, who has presence in Australia and Middle East. We believe that Lupin is well set to replicate its success in the US market in other key markets by leveraging its strong vertically integrated manufacturing capabilities and will emerge as a formidable player with a wide global footprint.

### Wide geographical presence



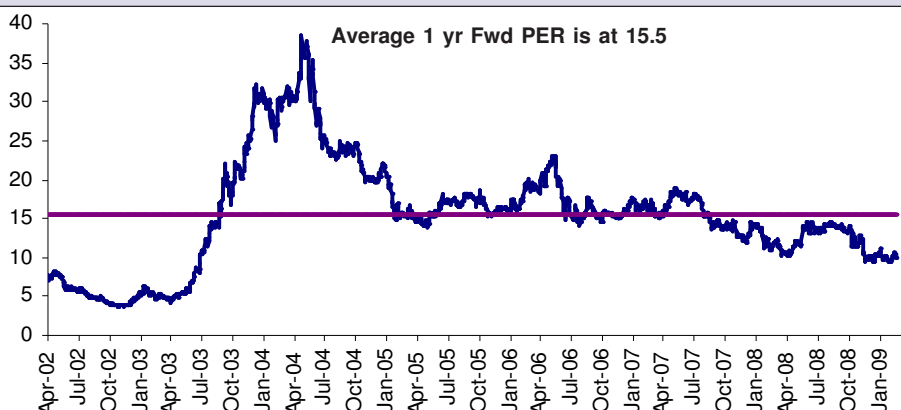
Source: Emkay Research

Global diversification is one of the key factors that we look for in a successful generics business and we believe, Lupin is very well placed in this respect vis-à-vis its Indian peers. We expect Lupin to continue to outperform large Indian peers in revenues and earnings going forward.

## Valuations- still way behind large Indian peers

Lupin trades at a 35% discount to its eight year average PER multiple.

### Lupin - trading at a 35% discount to its 8-year mean multiples.



Source: Emkay Research

*Lupin is still perceived as a mid-cap pharma company*

While Lupin has reached the scale and size of the big pharmaceutical companies, it is still perceived as a mid cap company by the street. As a result, its valuations are way below its large cap peers. Strong growth across segments and strong outperformance are likely to ensure a change in perception, resulting in better valuations. We believe, with positive newsflow from FDA on 483s, the stock will trade near to its long-term multiple.

### Peer comparison

|                     | CMP | Sales (Rs mn) |        | EBIDTAM% |        | EPS (Rs) |        | ROE (%) |        | EV/EBIDTA(x) |            | P/E(x)      |             |
|---------------------|-----|---------------|--------|----------|--------|----------|--------|---------|--------|--------------|------------|-------------|-------------|
|                     |     | FY2009        | FY2010 | FY2009   | FY2010 | FY2009   | FY2010 | FY2009  | FY2010 | FY2009       | FY2010     | FY2009      | FY2010      |
| Ranbaxy*            | 160 | 77252         | 89484  | 12%      | 16%    | 11.2     | 17.7   | 8.4     | 12.3   | 11.6         | 7.5        | 14.3        | 9.1         |
| Dr Reddy*           | 398 | 63873         | 69406  | 17%      | 16%    | 33.9     | 37.7   | 11.4    | 11.5   | 7.5          | 7.1        | 11.7        | 10.6        |
| Cipla*              | 191 | 52903         | 60413  | 22%      | 22%    | 9.4      | 13.4   | 18.1    | 22.2   | 13.4         | 11.4       | 20.3        | 14.2        |
| Sun Pharma*         | 994 | 39856         | 42316  | 46%      | 41%    | 80.9     | 74.5   | 29.4    | 22.5   | 10.8         | 11.4       | 12.3        | 13.4        |
| <b>Industry Avg</b> |     |               |        |          |        |          |        |         |        | <b>10.8</b>  | <b>9.4</b> | <b>14.7</b> | <b>12.0</b> |
| Lupin               | 632 | 35967         | 41440  | 17%      | 18%    | 51.3     | 61.9   | 27.7    | 24.7   | 9.5          | 8.2        | 12.3        | 10.2        |

Source: \*Bloomberg, Emkay Research

From the above table, it is evident that Lupin has been trading at a discount to its large Indian peers by 18% on PE basis and 15% on EV/EBIDTA basis. We believe that Lupin's differentiated business model (vertically integrated, geographically diversified and presence in branded segment in US) calls for at par valuations to its large Indian peers, if not at a premium. Lupin has not only attained size and scale which is comparable to large Indian players but also has a superior growth profile, in terms of revenues and earnings.

## Expect Lupin to continue to outperform its Indian peers

Lupin is one of the fastest growing companies among its Indian peers- both in domestic as well as in the international market. In the domestic and international formulation market, company grew at a CAGR of 21.6% and 131.5% over FY03-08, highest among large Indian peers.

### Has consistently outperformed its peers

| FY03-08             | Domestic Formulation | Exports Formulation | API       | Revenue CAGR (FY03-08) |
|---------------------|----------------------|---------------------|-----------|------------------------|
| Ranbaxy             | 10%                  | 15%                 | -2%       | 12%                    |
| DRL                 | 13%                  | 27%                 | 13%       | 20%                    |
| Cipla               | 15%                  | 38%                 | 16%       | 21%                    |
| Sun Pharma          | 21%                  | 82%                 | 8%        | 25%                    |
| <b>Industry Avg</b> | <b>15%</b>           | <b>41%</b>          | <b>9%</b> | <b>20%</b>             |
| <b>Lupin</b>        | <b>22%</b>           | <b>131%</b>         | <b>8%</b> | <b>24%</b>             |

Source: Company, Emkay Research

*Lupin has consistently outperformed its Indian peers*

Going forward, we expect Lupin to continue to outperform large Indian peers in revenues and earnings. We expect Lupin to report a CAGR of 24%, 27% and 28% vis-à-vis 21%, 25% and 18% average CAGR of its Indian peers in revenue, EBIDTA and PAT respectively over FY08-10E. RoE of Lupin is expected to be highest among all comparable peers over FY08-10E.

#### To sustain outperformance in revenues and earnings growth

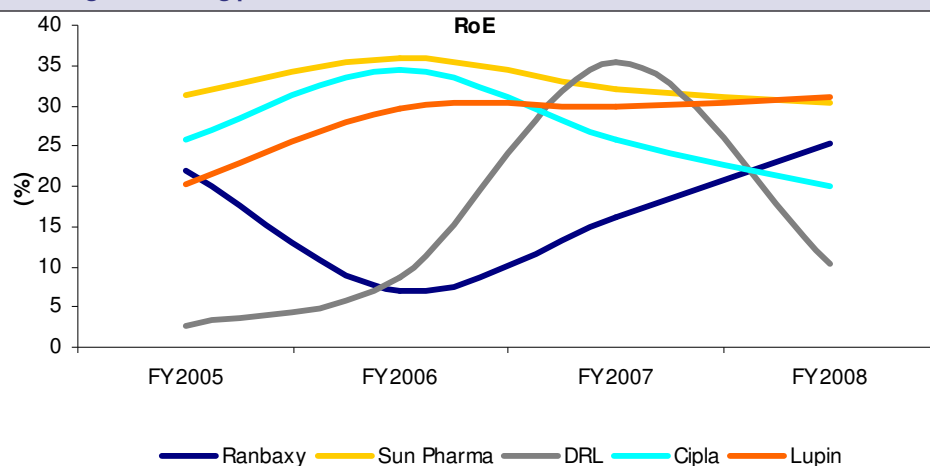
|                     | Sales<br>CAGR | EBIDTA<br>CAGR | PAT<br>CAGR% | EPS<br>CAGR% | ROE<br>(FY10E) |
|---------------------|---------------|----------------|--------------|--------------|----------------|
| Ranbaxy*            | 16%           | 20%            | 1%           | -5%          | 12.3           |
| DRL*                | 20%           | 25%            | 22%          | 22%          | 22.2           |
| Cipla*              | 20%           | 25%            | 22%          | 22%          | 22.2           |
| Sun Pharma*         | 27%           | 29%            | 27%          | 27%          | 22.5           |
| <b>Industry Avg</b> | <b>21%</b>    | <b>25%</b>     | <b>18%</b>   | <b>17%</b>   | <b>20%</b>     |
| <b>Lupin</b>        | <b>24%</b>    | <b>27%</b>     | <b>28%</b>   | <b>28%</b>   | <b>24.7</b>    |

Source: Emkay Research \*Bloomberg estimates

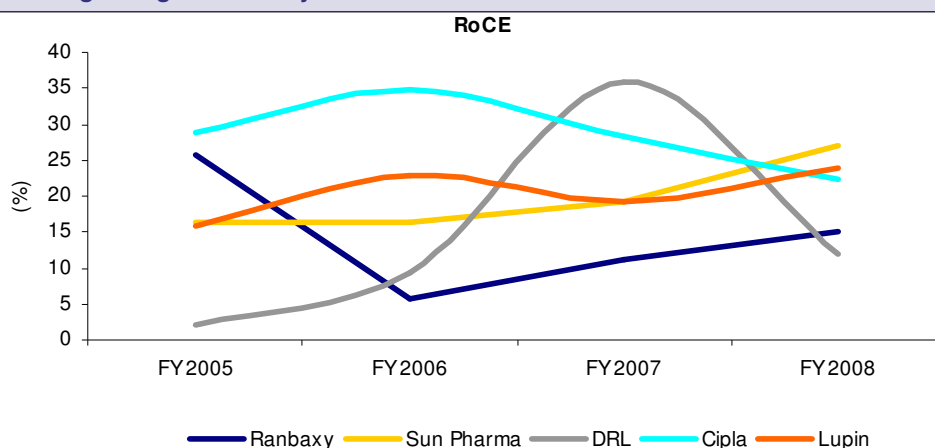
#### Return ratios - best among the peers

Lupin enjoys strong return ratios among its comparable peers. We expect RoCE to remain stable at 25% over the next two years. However, we expect RoE to decline from 31% in FY08 to 25% in FY10E. The decline in RoE is mainly because of a) absence of research income (Lupin had research income of Rs1127mn in FY08) b) We have assumed conversion of FCCB into equity in FY09E. (Outstanding FCCB \$72mn; Conversion price @574). As a result, we expect an increase in net worth by Rs6750mn in FY09E. Lupin's RoE is highest among its Indian peers (25% RoE in FY10E vs avg. RoE of 20% of its peers).

#### RoE- highest among peers



#### RoCE- growing consistently



Source: Company, Emkay Research

### Assign Buy rating with a target price of Rs789

With Lupin expected to outperform its large cap peers in both revenue (CAGR of 24% vs average CAGR of 21% of its peers) as well as earnings growth (CAGR of 28% vs average CAGR of 17% of its peers) and superior return profile, we believe that a re-rating in its valuations is inevitable. We believe that Lupin should command at par valuations to its large Indian peers. A re-rating of Lupin at par, if not at a premium, to its large cap peers, presents a huge upside potential from the current levels.

We have valued Lupin on PER, P/BV and EV/EBIDTA based valuation methodology. On the basis of historical average forward PER, P/BV and EV/EBIDTA of 15.5x, 2.5x and 8.6x, the target price comes to Rs959 per share, Rs702 per share and Rs707 per share respectively. Our target price using average of these three methods of valuations comes to Rs789. We assign a Buy rating on the stock. At our target price, Lupin discounts FY09E and FY10E EPS of Rs51.3 and Rs61.9 by 15.4x & 12.7x respectively.

#### PER based valuation

|                             |            |
|-----------------------------|------------|
| FY10E EPS                   | 61.9       |
| Historical 1yr Fwd PE       | 15.5       |
| <b>Per Value share (Rs)</b> | <b>959</b> |

#### EV/EBITDA based valuation

|                                            |            |
|--------------------------------------------|------------|
| FY10E EBITDA (Rs mn)                       | 7918       |
| Historical 1yr Fwd EV/EBIDTA               | 8.6        |
| 1yr fwd EV based on 1yr fwd EBITDA (Rs mn) | 68084      |
| Net Debt                                   | 9529       |
| Equity Value (Rs mn)                       | 58556      |
| <b>Per Value share (Rs)</b>                | <b>707</b> |

#### P/BV based valuation

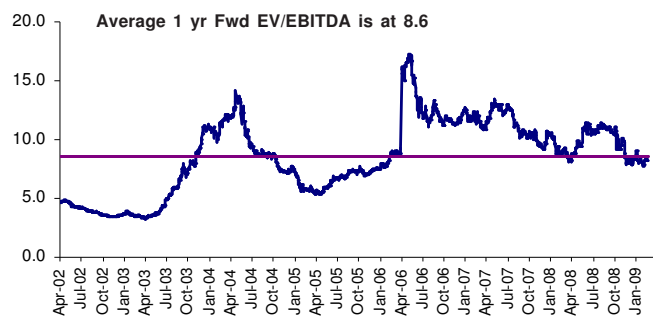
|                             |            |
|-----------------------------|------------|
| FY10E EPS                   | 276.1      |
| Historical 1yr Fwd P/BV     | 2.5        |
| <b>Per Value share (Rs)</b> | <b>702</b> |

#### Target price calculation

|                                             |            |
|---------------------------------------------|------------|
| EV/EBITDA based (Rs)                        | 707        |
| P/BV based (Rs)                             | 702        |
| PER based (Rs)                              | 959        |
| <b>1 yr fwd Target Price (Rs) (Average)</b> | <b>789</b> |

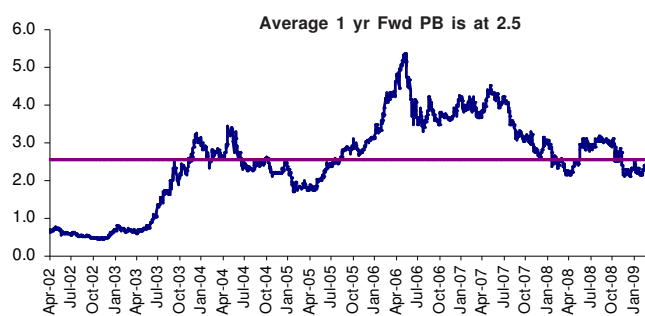
Source: Emkay Research

#### Lupin - 1yr Fwd EV/EBITDA band



Source: Emkay Research

#### Lupin - 1yr Fwd PB band



Source: Emkay Research

*Adverse outcome of FDA 483 is a key risk to our call*

### Unresolved 483s by FDA will continue to drag the stock price

Lupin's Mandideep facility, which accounts for 25% of US revenue, was audited by FDA on November 13, 2008. FDA has served Form 483 with 15 observations. Management has reiterated that they have replied to all the queries made by US FDA and are waiting to hear from the US FDA. Lupin is hopeful that the issue will be resolved fully in the next two months.

Issue of 483s by itself is different from a warning letter (as with Ranbaxy and Caraco Pharma) and does not impact sales and further approvals from the facility. Lupin has 40 products awaiting approval with USFDA. Most new products are to be produced at Indore and Goa plants and Mandideep facility has only one pending approval. Post issuance of Form 483 by the USFDA in Nov'08 also, Lupin has got an approval for launching Levitracetaram during January'09. In fact, in the past also, Lupin had received some 483s for this facility in 2003 and resolved the same without hiccups. However, if the company is unable to resolve the issue raised by the FDA, it could lead to issuance of a warning letter.

Though the management has been exhibiting high degree of comfort in the successful resolution of this issue, we expect the market to wait for a formal confirmation of this issue. Market concerns about the likely implication of USFDA actions are heightened after the recent episode of Ranbaxy Labs.

We view these observation reports to be benign compared to Ranbaxy, which was issued a import alert on data fabrication charges. Moreover, it is now more than three months and Lupin has been getting new approvals from the USFDA. Therefore, we see the current weakness in stock prices as an opportunity to buy into Lupin's strong growth prospects. Though in the near term, this issue will continue to drag the stock price.

## Financials

We expect Lupin's net sales to increase by 34% in FY09E and 15.2% in FY10E. Higher growth in revenue in FY09 is mainly driven by consolidation of newly acquired businesses and 25% depreciation in rupee. We expect EBITDA margins to increase by 80bps over FY08-10E, largely driven by expansion in margins from Kyowa, contribution from CMO business and expansion from Indian formulation business because of higher contribution of chronic segment. We expect APAT to increase by 36% in FY09E to Rs4,541mn and 21% in FY10E to Rs5,486mn.

### Growth momentum to continue

*We expect revenues to grow at a CAGR of 23.1% over FY08-10E*

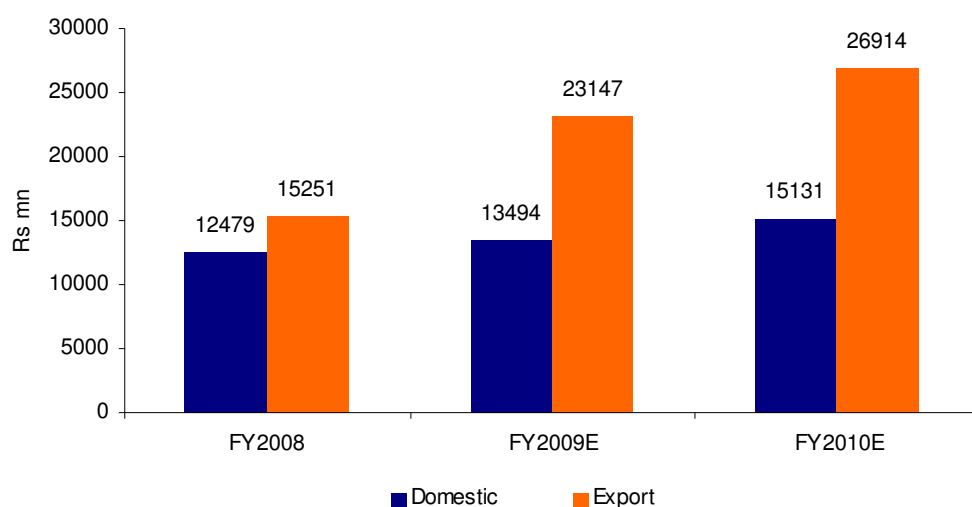
Lupin has shown consistent growth over the last five years, with revenue and PAT growing at a CAGR of 22% and 41% to Rs26.9bn and Rs4.1bn over FY03-08.

Going forward, we expect a 23.1% CAGR in Lupin's consolidated revenues over FY08-10E to Rs41.1bn. We expect its international business to grow at a CAGR of 33% to Rs26.9bn and domestic business to grow at a CAGR of 10% to Rs15.1bn over FY08-10E respectively. We expect overall contribution of exports to go up to 64% in FY10E from 54% in FY2008.

Growth in export business is on the back of strong growth in the regulated markets (expected to grow at a CAGR of 40%). The growth in regulated markets would be on the back of 38% CAGR growth from the US market and increased revenue contribution from the EU region because of organic and in-organic initiatives. We expect its European business to grow at a CAGR of 68% (albeit on a low base) largely driven by consolidation of Hormosan revenues (45% contribution in total EU sales in FY10E).

Domestic market on the other hand, is expected to grow at a CAGR of 10% over FY2008-10E on the back of 17% CAGR growth in the formulation segment. The growth in the domestic formulation is mainly on the back of increased contribution from chronic segment, which is expected to go up from 36% in FY08 to 42% in FY10E. We expect the chronic segment to record a CAGR growth of 25.7% over FY08-10E.

### Segment wise Revenue break-up



Source: Company, Emkay Research

## Expect robust growth across all segments

(Rs mn)

|                             | FY2008       | FY2009E      | FY2010E      | CAGR%        |
|-----------------------------|--------------|--------------|--------------|--------------|
| <b>Domestic</b>             | <b>12479</b> | <b>13494</b> | <b>15131</b> | <b>10.1%</b> |
| Formulation                 | 9496         | 11257        | 13006        | 17.0%        |
| API                         | 2983         | 2237         | 2125         | -15.6%       |
| <b>Exports</b>              | <b>15251</b> | <b>23147</b> | <b>26914</b> | <b>32.8%</b> |
| <b>Formulation Reg</b>      | <b>7558</b>  | <b>11793</b> | <b>14750</b> | <b>39.7%</b> |
| US                          | 7205         | 10965        | 13755        | 38.2%        |
| EU                          | 353          | 828          | 995          | 67.9%        |
| <b>Formulation Semi Reg</b> | <b>2147</b>  | <b>5889</b>  | <b>6699</b>  | <b>76.6%</b> |
| Kyowa (Japan)               | 1315         | 4428         | 5048         | 95.9%        |
| ROW                         | 832          | 1461         | 1651         | 40.9%        |
| <b>CRAMS</b>                | <b>220</b>   | <b>330</b>   | <b>495</b>   | <b>50.0%</b> |
| <b>API</b>                  | <b>5546</b>  | <b>5136</b>  | <b>4970</b>  | <b>-5.3%</b> |
| <b>Gross Sales</b>          | <b>27730</b> | <b>36641</b> | <b>42046</b> | <b>23.1%</b> |

Source: Company, Emkay Research

## Robust performance in Q3/9M FY09

Lupin continued to maintain its growth momentum, with its revenues and recurring PAT growing by 33% (Rs9.6bn) and 26.7% (Rs1.16bn) respectively in Q3FY09. Forex loss of Rs400mn on outstanding forward contracts resulted in recurring PAT growth lagging revenue growth. Formulation business in advanced markets grew by 48%, driven by a 46% growth in the US market. On QoQ basis, Kyowa's revenue grew by 30% to Rs1,319mn. In the domestic formulation market, revenue grew by 22% to Rs279mn, ahead of industry growth of 11-12%. EBIDTA margins for the quarter contracted by 80 bps to 16% on the back of 100 bps increase in employee cost and 340 bps expansion in other expenses. RPAT, which declined by 35.6% yoy in Q3FY09, was mainly on account of Q3FY08 numbers including one time licensing income of Rs1.17bn from Servier (France).

For 9MFY09, revenue and recurring PAT grew by 40% (Rs27.3bn) and 65% (Rs3.69bn) respectively, buoyed by 310 bps expansion in gross margins. YoY results are not comparable as revenue of Rs3833mn from Kyowa and other acquisitions were not there last year. On like to like basis, revenue grew by 20% to Rs23.5bn. Revenue growth was largely driven by 97% growth in advanced markets (US, Europe and Japan). US revenue grew by 64%, driven by new launch of Depakote ER, significant share in Ramipril (50% share in an 11 player market) and co-promotion agreement with Forest Labs for Aerochambers. On the domestic front, Lupin outpaced industry growth and grew by 18% (industry growth of 11-12%) to Rs8.75bn. Gross margins expanded by 310 bps on the back of improved product and market mix and lower raw material cost because of softening of crude oil prices. EBIDTA margins for 9MFY09 expanded by 60 bps to 16.8%. The lower expansion in EBIDTA margin was because of Rs400mn loss on forward contracts, which the company has adjusted from the revenue itself. Recurring PAT grew by 65% to Rs3.69bn.

We believe that strong performance of Lupin in 9MFY09 demonstrates the strength of Lupin's underlying business model in the challenging global environment and highly competitive pharma market.

## Income statement

| Y/E, Mar (Rs. mn)        | Q3FY09        | Q3FY08       | Y-o-Y Gr.(%) | 9MFY09        | 9MFY08        | Y-o-Y Gr.(%) |
|--------------------------|---------------|--------------|--------------|---------------|---------------|--------------|
| Net Sales                | 9618          | 7213         | 33.3%        | 27325         | 19560         | 39.7%        |
| Expenses                 | 8079          | 5998         | 35%          | 22730         | 16398         | 39%          |
| Raw Materials            | 3858          | 3125         | 23%          | 11133         | 8558          | 30%          |
| % of sales               | 40.1          | 43.3         | -7%          | 40.7          | 43.8          | -7%          |
| Employee cost            | 1205          | 830          | 45%          | 3508          | 2236          | 57%          |
| % of sales               | 12.5          | 11.5         | 9%           | 12.8          | 11.4          | 12%          |
| Other expenses           | 3016          | 2043         | 48%          | 8089          | 5605          | 44%          |
| % of sales               | 31.4          | 28           | 11%          | 29.6          | 29            | 3%           |
| EBIDTA (adj)             | 1540          | 1214.8       | 27%          | 4595          | 3161.5        | 45%          |
| EBIDTA%                  | 16.0          | 16.8         | (80) bps     | 16.8          | 16.2          | 60 bps       |
| Other income             | 221           | 1389         | -84%         | 696           | 1736          | -60%         |
| Interest                 | 146           | 101          | 44%          | 375           | 270           | 39%          |
| Depreciation             | 219           | 175          | 26%          | 614           | 442           | 39%          |
| MiscExp W/O              | 0             | 0            |              | 0             | 0             |              |
| PBT                      | 1396.3        | 2328.5       | -40%         | 4302.9        | 4186.0        | 3%           |
| Total Tax                | 219.0         | 519.9        | -58%         | 844.2         | 1063.4        | -21%         |
| Effective tax rate (%)   | 15.7          | 22.3         | -30%         | 19.6          | 25.4          | -23%         |
| RPAT                     | 1165.3        | 1808.6       | -36%         | 3458.7        | 3122.6        | 11%          |
| E/O items                |               | 1170.0*      |              | 29.7**        | 1170.0*       |              |
| E/O items (Minority Int) |               |              |              |               |               |              |
| <b>APAT</b>              | <b>1165.3</b> | <b>919.4</b> | <b>27%</b>   | <b>3693.3</b> | <b>2233.4</b> | <b>65%</b>   |
| Net Margin (%)           | 12.1          | 12.7         | (60) bps     | 13.5          | 11.4          | 210 bps      |
| EPS (diluted)            | 14.1          | 11.1         | 27%          | 44.6          | 27.0          | 65%          |

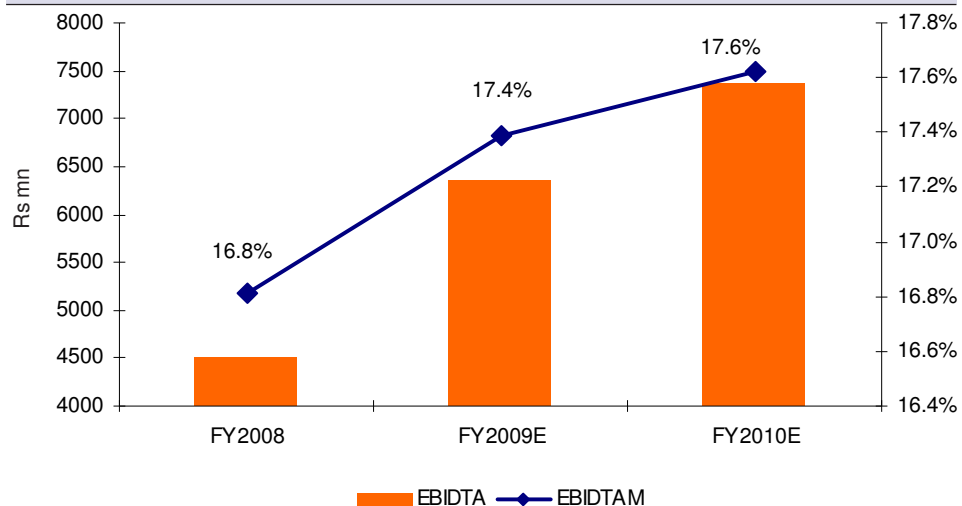
Source: Company, Emkay Research \*Licence income \*\*VRS

## EBIDTA margins to expand by 80 bps in FY10E

Higher contribution from the regulated markets and improved sales mix to expand margins by 80 bps

On the operating front, we expect the operating profit margins (excluding other operating income) to expand by 80 bps to 17.6% in FY10E (16.8% in FY08) on the back of higher contribution from the regulated markets and improved sales mix. We believe that the margins will further improve once Lupin integrates the newly acquired businesses and brings their cost structure in line. Lupin's standalone operating margin was 19% in FY08. Moreover, margins will further expand as the contribution of the chronic segment to overall sales increases and its recent entry into the high margin CRO space starts contributing meaningfully.

## Healthier sales mix and higher export revenues to boost margins



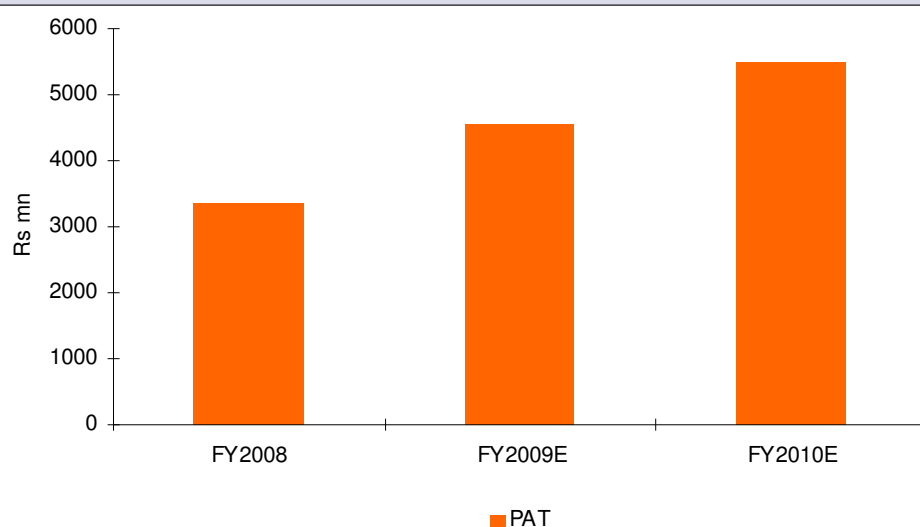
Source: Company, Emkay Research

*Strong growth in earning is driven by revenue growth as well as expansion in operating margins*

### 28% earning CAGR over FY08-10E

We expect consolidated net profit to grow at a 28% CAGR over FY2008-10E to Rs5.5bn, driven by strong revenue growth from the international markets and consolidation of newly acquired businesses in Japan, Germany, Australia and South Africa. Further, reduction in effective tax rate from 24.4% in FY08 to 16% in FY10E, because of increased usage of SEZ (Special Economic Zone) and EOU (Export Orientated Units) benefits will improve profitability. We expect Net Margins to improve by 70bps to 13.2% in FY10E on the back of strong revenue growth and improved operating performance. With strong sales momentum, we expect EPS to increase at a CAGR of 28% to Rs51.3 in FY09E and Rs61.9 in FY10E respectively.

#### Steady revenue growth to drive 28% CAGR in PAT



Source: Company, Emkay Research

## Key risks

### Suprax generic launch

Suprax is likely to face generic competition in the US by 2010 or 2011. Though management has taken adequate steps by launching line extensions of Suprax as well as expanding the portfolio, we believe that generic launch of Suprax is likely to erode revenue and profitability of the company.

### Price erosion in the generic market

To mitigate the price erosion risk in the generic market, Lupin is focusing on value added and complex products that face lower competition. Strict control over cost and backward integration, coupled with economies of scale have enabled Lupin to compete in the generic market in the past.

### Highly volatile Pen-G prices

The prices of Pen-G, a major raw material for Cephalosporins (contribute 10% of sales) have been highly volatile. Any wider fluctuations in the price of Pen-G can adversely affect the margins of the company.

### Exposure to domestic market

Domestic formulation segment contributes 34% of sales. Any change in policy by DPCO can impact Lupin's revenue and profitability. In order to mitigate this risk, Lupin is concentrating more on life style segment products, which is out of DPCO control.

### Integration risk

Lupin has acquired five companies over the last one year, in order to expand its geographical reach. Some of the markets such as Japan and Germany are altogether different markets, which offer new challenges for Lupin. Similarly, with the acquisition of Rubamin, Lupin has forayed into CMO. Growing these businesses profitably will bring its own challenges.

### Contribution of acute therapy is still high

Over the years, the revenue from high growth life style segment has increased from 18% in FY05 to 36% in FY08 in the domestic formulation segment. However, acute segment still contributes 64% of the total domestic formulation revenue. Slowdown in demand in acute segment can impact our earnings estimates.

### Foreign currency risk

62% of its revenues come from international markets. Currency fluctuation can impact the profitability of the company. In order to mitigate this risk, Lupin is hedging through forward contracts, denominating imports in US\$ and increasing raw material purchases from China.

## Annexure

### Business model- Road map to big pharma league

Lupin has transformed itself from an API manufacturer to a fully integrated pharmaceutical company. It has moved up the value chain from the base pyramid of API manufacturing to the top of the pharma value chain, i.e. discovery research. Lupin has been consistently strengthening its presence in the domestic market while simultaneously making forays into newer geographies. Lupin today, has presence across varied markets like US, Europe, Japan, GCC and AAMLA countries.

We have reviewed each of its businesses in detail- in order to understand their current position and their future growth drivers. We believe that most of its businesses have attained scale and size comparable to large Indian players and reached an inflexion point, from where they can grow significantly.

### Domestic business- outpacing the industry growth by 2 times

*Lupin has been growing at 28% compared to 15% industry growth*

Over FY05-08, Lupin's domestic formulations business registered a 28% CAGR, almost twice the market growth rate of 15% over the same period. The company has transformed itself from a predominantly anti-TB and malaria player to focus on lifestyle segments and chronic therapies, such as, Diabetics, Cardiovascular, Respiratory, Wound management and CNS. The contribution of the life style segment has increased from 26% in FY05 to 36% in FY08.

Over the years, Lupin has not only strengthened its franchises in the chronic segments but also in the acute segments. In the Anti-TB segment (17% of Lupin's domestic formulation sales), ~ where Lupin is a market leader with 48% share, its growth was almost double in FY08 (8.3% growth vs. 4.5% market growth). Similarly, in the Anti-infective segment (15% of Lupin's domestic formulation revenue), Lupin's growth was 28% vs. 15.2% of the industry. In chronic segments like CVS, CNS, Diabetes and respiratory, Lupin's growth was exemplary to the industry. In a short span of 4 years, Lupin has attained 16% market share in the respiratory segment with a growth of 48% vs. industry growth of 20.4%. Today, Lupin ranks second in this segment, which so far, was largely dominated by Cipla. Lupin grew by 34% vs. the industry growth of 23.4% in the cardiac segment. Cardiac is the third largest and fastest growing segment in the Indian pharmaceutical industry. We believe Lupin's strategy to build relations with key opinion makers through various academic initiatives such as Continuous Medical Education (CME), bringing internationally acclaimed speakers in India and participation in international conferences has led to its splendid performance in the domestic market.

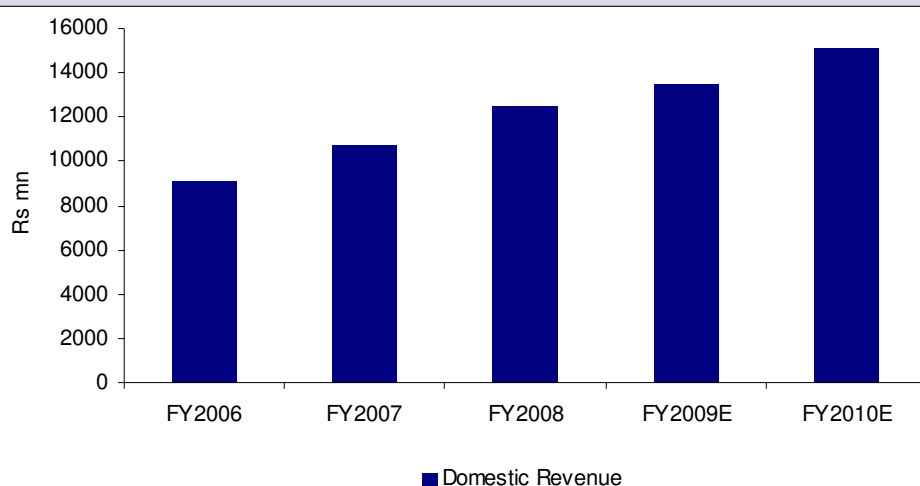
### Segment wise performance

| Segment            | Type    | Cont. to Domestic formulation (%) | Market growth (%) | Lupin growth (%) |
|--------------------|---------|-----------------------------------|-------------------|------------------|
| CVS                | Chronic | 19                                | 23.4              | 34               |
| Anti- asthma       | Chronic | 8                                 | 20.4              | 48               |
| Anti-diabetic      | Chronic | 5                                 | 22.3              | 42               |
| CNS                | Chronic | 4                                 | 16.6              | 38               |
| Gastro- Intestinal | Acute   | 6                                 | 14.1              | 31               |
| Anti-infective     | Acute   | 15                                | 15.2              | 28               |
| Anti-TB            | Acute   | 19                                | 4.5               | 8.3              |

Source: Company, Emkay Research

Going ahead, we expect Lupin's domestic formulations business to witness 17% CAGR over FY08-10E, ahead of the estimated 12-13% industry CAGR.

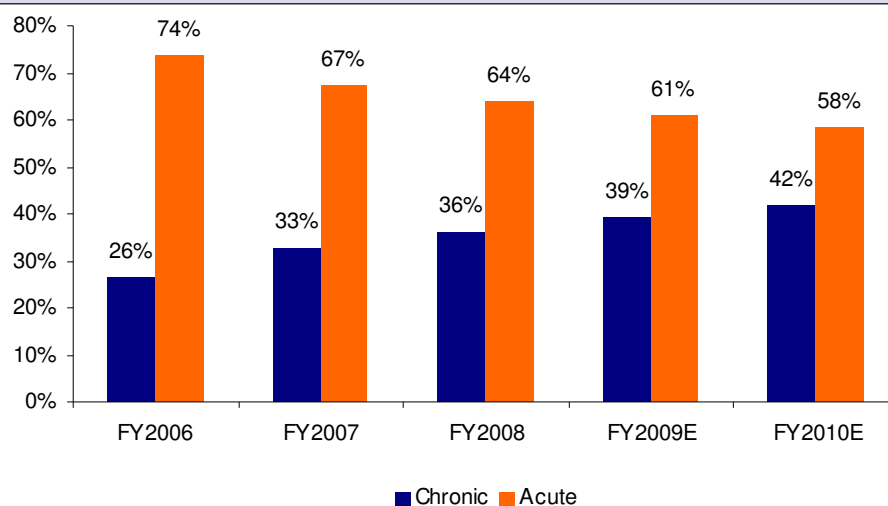
## Revenue progress (Domestic segment)



Source: Company, Emkay Research

Going forward, Lupin's growth will be driven by entry into newer therapies, continued fast growth in therapies like respiratory, CVS and anti-diabetics, expansion of the field force as well as increasing distribution reach. Lupin is also aggressively pursuing in-licensing as a strategy to grow its business, as the impact of the patent regime starts unfolding in terms of fewer new product launches. The company has also recently launched Lupenox, which has become the second largest brand in its category within six months of launch with a 20% market share. The company has also launched Eugraf, Calgigraf, Bioclin and Faximab through in-licensing deals.

## Segment wise contribution (Domestic formulation)



Source: Company, Emkay Research

*Lupin has been striving to achieve considerable scale and size in the international markets*

## International business- Rapidly diversifying across geographies

Lupin has been focusing on rapidly expanding its international business to drive its future growth. After establishing its stronghold in the domestic formulations and API business, Lupin has been striving to achieve considerable scale and size in the international markets. Lupin's US operations are fairly established and it is among the fastest growing companies in the US, in terms of prescriptions. Apart from a decent generic business in the US, Lupin has also entered the US branded market through the relaunch of Suprax. We expect its US business to grow at a 38% CAGR, aided by strong growth in generic as well as Suprax sales. Lupin has aggressively forayed into newer markets over the last three years through organic (France, UK, Brazil) as well as inorganic initiatives (Japan, South Africa, Australia,

Germany). In the last one year, Lupin has acquired five companies across the globe to build its future growth engine. While acquiring, the focus of the management is to look for a target, which can provide them front end marketing and distribution infrastructure, on which the company can leverage its development, manufacturing & commercialisation capabilities. We expect Lupin's international business (including US) to grow at a 33% CAGR over FY08-10E.

### US- continues to remain key growth driver

Lupin's two pronged strategy of building brands through front end marketing and attaining scale through generic penetration by leveraging its low cost manufacturing has yielded rich dividends. Its US business has grown at a CAGR of 189% over FY05-08. Over the last three years, Lupin has built a strong foothold in the paediatric branded market and is an emerging market leader in the generic space.

The branded formulation business of the company has recorded a CAGR of 81% over FY05-08. Moreover, Lupin's generic business has ramped up at a significant pace, resulting in a CAGR growth of 492% (lower base) over FY05-08. Lupin's revenue per product is highest among its Indian peers and it is growing at a faster pace than its competitors like Sun Pharma, Ranbaxy etc. We expect its US business to be one of the key growth drivers for the next 2-3 years. We estimate Lupin's US business to expand at a CAGR of 38% over FY08-10E.

### Branded sales - paediatric focus paying off

Lupin is the second Indian company, after Ranbaxy, to have a branded product in its portfolio in the US market. Lupin entered the US branded market with the relaunch of Suprax (paediatric anti-infective) by licensing it from Fujisawa. Its (Fujisawa) US partner (Wyeth) had stopped promoting the drug since 2003. Suprax had achieved peak sales of around US\$90-100m in 2002 and was clocking sales of around US\$51m (suspension - US\$34m; tablets - US\$17m) just before being withdrawn from the market. Given that Wyeth had stopped promoting the drug in March 2003, Lupin had to practically start afresh. Suprax's taste masking property and strong brand identity have helped Lupin grow fast and regain most of the lost market. Today, Suprax has become a \$36mn plus brand. During 2007-08, Suprax continued to chart strong growth, recording a prescription growth of 55% and revenue growth of 52%.

### Generic threat to Suprax

In order to pre-empt the generic competition in 100mg Suprax suspension, which is likely to set in by 2010-2011 (Two Indian companies have filed ANDA), Lupin has introduced two line extensions- Suprax double strength (Suprax 200mg dry powder suspension) and Suprax 400mg tablets. Concentrated efforts have enabled Lupin to shift 45% of the prescription to double strength. Moreover, the management also believes that, with the introduction of Suprax-400 mg tablet, they will be able to address another huge market of Urinary Tract Infection (UTI). Approximately 70% of this US\$710mn market is with gynecologists and surgeons and before Wyeth stopped marketing this brand, Suprax tablet used to contribute US\$17mn. To address the UTI market, Lupin has entered into a marketing tie-up with Ascent Therapeutic, which has strong franchises with gynecs and surgeons. Within 4 months of its launch, the Suprax 400mg tablet has garnered 21% of total Suprax prescriptions. Lupin expects to launch one more line extension by this year end.

### Marketing alliance with Forest Labs to leverage its relationship with paediatricians

In-order to further leverage its strong franchise with paediatricians, Lupin has entered into a marketing tie-up with Forest Labs to promote Aerochambers to paediatricians. The tie-up is on a profit sharing basis (exact terms are not disclosed) and the profit percent will

*Lupin has built up strong franchises with paediatricians in branded segment*

*Suprax is likely to face generic competition in FY2011*

increase after achieving certain milestones in terms of sales. Given that Lupin already enjoys a relationship with paediatricians, this arrangement does not entail any incremental investment. Management has also indicated that in FY10E, they will add one more product to this division, which has been developed in-house and will improve the profitability of the division significantly. We do believe that Lupin's Suprax sales will be impacted by generic launch but the management has taken adequate steps to improve the overall revenue and profitability of this division.

We believe Lupin can add significant value to its existing products by leveraging its own proprietary oral controlled release, taste masking platforms and innovative dosage forms. We expect a CAGR of 18.5% in branded sales over FY08-10E, on the back of launch of new Suprax line extensions and marketing tie-up with Forest Labs. New product acquisitions will provide further upside to our estimates.

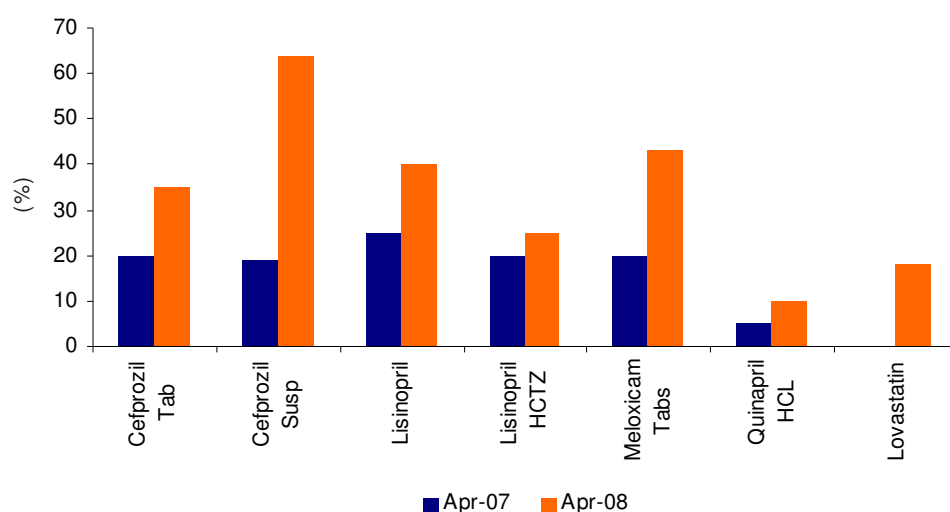
### Generics business- focus on niche segments to continue to drive growth

*Lupin has focused on building a pipeline of niche, low competition products for the US market*

Lupin's focus on developing 'difficult to make' complex and innovative products, in addition to niche (low-competition) and Para-IV products, has made it one of the fastest growing generic companies among its large Indian peers. Unlike many other generic companies, Lupin has focused on building a pipeline of niche, low-competition products for the US market rather than opting for a large number of filings. This strategy is evident from the fact that Lupin's revenue per product is highest among its Indian peers and it is growing at a faster pace than its competitors like Sun Phama, Ranbaxy etc. Out of its product basket of 21 products, Lupin has leadership in 7 products and 12 products are among the top 3 players in their respective segments. Further, Lupin has had a good success rate with its Para IV challenges, particularly with its recent positive verdicts on Cefdinir and Ramipril. Lupin's Para IV challenge strategy is primarily based on leveraging its superior process skills to create innovative non-infringing processes. In the coming quarters, we expect steady news flow on Lupin's Para IV challenge portfolio.

Key focus segments in the US include Cephalosporins (including injectables), CVS and CNS areas. We strongly believe that Lupin will continue to reap the benefits of its superior product selection strategy with 1-2 niche product launches every year. Lupin expects to file ANDAs in the oral contraceptive segment in March'09 and currently has around 35 products pending approval and expects to launch 7-10 new products every year. This would drive an estimated 31.4% CAGR in US generic sales over FY08-10E.

#### Rx trend in US market



Source: Company, Emkay Research

*Lupin has faster and deeper prescription growth and penetration than any other large Indian player*

## Key brands performance

Lupin's prescription growth and penetration has been faster and deeper than any other large Indian player. The table below clearly indicates that the 7 key brands contribute 87% of total US revenue. Even in products like Lovastatin, where the market is highly crowded, Lupin a relatively late entrant, currently enjoys 25% market share.

### Key brands continue to report robust growth

|                           | Share of Total TRx | Brand sales before generics (US\$ mn) | Lupin launch date | First generic launch date | Lupin's share |
|---------------------------|--------------------|---------------------------------------|-------------------|---------------------------|---------------|
| Cefdinir                  | 1%                 | 850                                   | May-07            | May-07                    | 11%           |
| Lisinopril                | 52%                | 1200                                  | Feb-06            | Jun-02                    | 43%           |
| Lisinopril HCTZ           | 8%                 | 400                                   | Oct-06            | Jun-02                    | 26%           |
| Lovastatin                | 6%                 | 425                                   | Jan-08            | Dec-01                    | 25%           |
| Simvastatin               | 14%                | 4500                                  | Jun-07            | Jun-06                    | 13%           |
| Ramipril                  | 5%                 | 700                                   | Jun-08            | Jan-08                    | 34%           |
| Suprax                    | 1%                 | 40                                    | Mar-04            | na                        | 100%          |
| <b>Total Key Products</b> | <b>87%</b>         |                                       |                   |                           |               |
| Others                    | 13%                |                                       |                   |                           |               |
| <b>Total</b>              | <b>100%</b>        |                                       |                   |                           |               |

Source: Company, Emkay Research

*Lupin is well set to replicate its US success in the EU region*

## Europe- Promising start

Lupin is primarily targeting the French, UK and German markets for entering the EU market. Like in USA, Lupin is putting in place a high quality product pipeline in the EU, with focus on relatively complex molecules as well as creating a strong distribution network. The company's product portfolio for Europe consists of Anti-infective, Cardiovascular and CNS segments. The focus is on leveraging the company's development, manufacturing and commercialisation capabilities and offer complex products, which provide a natural hedge against competition and price erosion. The company has a strong pipeline of 21 MAAs for various products and is expected to launch 7 more products by FY09.

Lupin is forging ahead in France and other markets, leveraging its partnership business model. During the year, Cefpodoxime Proxetil tablets introduced in France through multiple partners garnered over 50% market share. The company is looking forward to replicate this success with the launch of Cefpodoxime Proxetil powder for suspension, amongst other products. Similarly, in UK, Lupin launched 'Lisinopril' through direct to market initiatives and garnered 15% market share within four months of its launch.

## Hormosan acquisition marks foray into the German market

Lupin recently acquired Hormosan Pharma GmbH (Hormosan), a German sales and marketing generic company for Euro 7mn (sales of Euro 6.8mn). Hormosan has presence in Central Nervous System (CNS) and Cardiovascular therapeutic segments (CVS). 60% of the revenues of Hormosan come from insurance segment and it has a team of 25 people in the field. Hormosan has fairly good operating margins because of low fixed cost. Hormosan has created a strong brand identity in the German generics market. We believe Hormosan acquisition will provide Lupin a front end in Germany.

We view this acquisition as a strategic one for Lupin on many fronts a) It provides Lupin an opportunity to participate in Europe's largest generic market (Euro 4.8bn in CY06), b) The

combined entity can participate in insurance bidding more aggressively, c) Lupin's competitive structure for commodity markets like US will enable Hormosan to compete more aggressively and d) Lupin will be able to add significant value through its strengths in R&D and strong, complementary pipeline leading to major synergies and growth. Moreover, as Hormosan outsources manufacturing, Lupin will gradually shift manufacturing to India to leverage on its cost competitiveness. We expect this acquisition to be earning neutral in FY09 and accretive in FY10E.

We expect the company to pursue inorganic growth in the EU geography to create marketing front-ends in different branded generic geographies. Any such acquisition will be an upside to our estimates. We expect EU to grow at a CAGR of 68% over FY08-10E.

### Japan -Key market in Lupin's portfolio

Japan is one of the most attractive generic markets globally, in view of the abysmally low generic penetration, and especially the efforts being undertaken by the government to enhance the generic penetration. Japanese regulatory framework is fairly complex and makes for a very high entry barrier. Consequently, it is imperative for overseas players to partner with local Japanese players. Given this context, Lupin has acquired 90% of Kyowa (2xEV, 12x EBITDA), 7th largest generic company in Japan. Kyowa had sales of \$75m in FY08 with EBITDA margin of 15%. Kyowa is one of the stronger generic players in Japan and has a rich product portfolio (more than 100 products), particularly in the CNS arena. Kyowa's manufacturing operations are currently based in Japan and it has 60 representatives with nationwide coverage. In Q3FY09, company has launched all 10 products for which it has recently got approval. Kyowa spends around 8% of its revenues on R&D and the combined entity is expected to file around 8-10 new products every year.

Lupin's focus would be to improve Kyowa's growth rate from single digit to mid-teens by augmenting its product basket through its own portfolio and cross selling from Hormosan (Hormosan has strong CVS and CNS portfolio). In the long term, Lupin will shift manufacturing of some of the products to India, in order to expand Kyowa's gross margins. Management has also indicated that they are looking at acquiring a company, having significant presence in hospital segment, as hospital stays in Japan are ~45 days, which is 4 times more than other developed countries.

Over the medium term, we expect Japan to be a key growth market for Lupin. We expect Kyowa to register a CAGR of 96% over FY08-10E (Sale of Kyowa in FY08 was for 5 months, annualized CAGR 26.5%).

### RoW - building block for future growth

In order to build its presence across the ROW, Lupin has taken various organic as well as in-organic initiatives (acquired companies in Australia and Africa). Lupin is the second Indian company having presence in leading global market of Australia. Similarly in Middle East, Lupin is one among the three Indian companies having sizable presence. Over the last three years, Lupin has built a presence in several key markets of these regions such as, Australia, UAE, Yemen, Kenya, Kuwait, Lebanon, Peru, Vietnam and Philippines. With 344 filings across the region, the AAMLA division is gearing for accelerated growth in the years to come.

During FY08, the company achieved first to launch status on many products in the Nigerian market. Besides Africa, CIS is a high-focus geography and Lupin has an 80-people sales force promoting products in that region. Currently, Lupin has around 25 products in the market with more than 10 products awaiting approval. Lupin has been steadily building up its filings in the AAMLA region. The company launched 6 products in FY08 in CIS countries. The revenue from CIS countries in FY08 was Rs.348mn.

We believe that Lupin's strategy to build a global presence through small acquisitions and developing franchises in key geographies should enable them to expand the value added high margin international formulation business. We have briefly described Lupin's recent acquisitions in ROW markets and its strategic fit in Lupin's future growth plan.

### **Acquisition of Generic health - an opportunity to participate in the high growth market of Australia**

Lupin has acquired 30% stake (consideration undisclosed) in Generic Health, Australia, one of the top 10 generic drug suppliers in the Australian market with sales of A\$ 9mn. Generic Health has a mix of generic prescription and OTC products, in a partnership model with established global generic drug makers. It has 20 product approvals, out of which 11 have already been launched. The Australian generic market, which is worth A\$ 3bn, is a high margin high growth market. Lupin has 16 product registrations in Australia, with 14 approvals in segments such as CVS, CNS drugs and cephalosporins. We view this acquisition as EPS accretive from FY09 onwards and believe that it will provide Lupin an opportunity to participate in the high growth generic market.

### **Acquisition of Pharma Dynamic to strengthen Lupin's South African presence**

In order to strengthen its presence in the South African market, Lupin acquired 60% stake in Pharma Dynamics (PD)- ~ 6th largest generic player in SA with sales of US\$15mn (2xEV and 9-10x EBITDA) and 3% market share. PD is primarily a marketing and distribution company with strong presence in the CVS segment. It has a mix of branded generics and OTC products (30-35 products, 12-14 will be launched in the next year) and has EBITDA margins of 20%. Its product portfolio mainly consists of CVS, CNS and Herbal products. PD has been rated as the fastest growing generic company in South Africa for the last five years (sales up 4x), which management has indicated is likely to sustain. PD is currently growing at 34% per annum as per IMS.

The South African market is estimated at US\$2.5bn, of which OTC and generic accounts for US\$900mn. We believe this acquisition is a strategic one for Lupin because- a) PD currently outsources from EU and local suppliers- which can now be sourced from Lupin in India, b) Expanding PD's pipeline by launching products from Lupin's product basket. We believe that the deal will be accretive in FY09 itself.

We estimate its ROW markets to grow at a CAGR of 41% to Rs1651mn over FY08-10E.

### **CRAMS: Relatively new initiative to leverage strong chemistry skills**

*In order to leverage its chemistry skills, Lupin has entered into CRAMS space*

Lupin has taken a strategic decision to leverage its superior chemistry skills to target the attractive CRAMS opportunity. Looking at the opportunity in the CRAMS segment, Lupin has recently acquired Rubamin, a Baroda based small but very fast growing CRAMS player. Rubamin has sales of \$10mn and has a strong roster of clients based in USA/ EU including 8-10 large pharma companies. The company exports over 90% of its products to global pharmaceutical and specialty chemical companies in EU, North America, Japan and other parts of the world. The company plans to enter into JVs and strategic alliances to expand its CRAMS business. Going ahead, we expect 50% CAGR in its CRAMS business over FY08-10E.

### **Investment in R&D- monetizing successfully**

*Lupin is one of the few Indian companies who have monetized its R&D assets*

Lupin is one of the very few Indian companies, who have been able to monetize its R&D investment successfully. Apart from entering into a settlement with Servier (France) for Perindopril for Rs2.6bn, Lupin has successfully been able to develop a non-infringing process for Ramipril, Cefdinir and Ceftriaxone. Lupin has also developed a strong pipeline of Para IV products, including 5 controlled released products.

## NCE Research

*NCE outlicensing deal can provide upside to our estimates*

Lupin has an active NCE research programme for discovery of new chemical entities through the herbal-based as well as the chemical synthesis route. Lupin currently has 1 molecule in Phase III, 2 molecules in Phase II and 1 molecule in Phase I addressing Migraine, Psoriasis and Tuberculosis disease segments respectively. All the clinical development programmes on these molecules are being run out of India. Management has indicated that it intends to monetize its R&D assets in the next 9-12 months. We believe that its Anti- Psoriasis molecule (LL4218) seems to be the most promising candidate for out-licensing. Company plans to launch its Anti-migraine molecule (LL2011), which is currently in Phase III, on its own in India and other emerging markets over the next 12 months. After that, they will decide to either out-license or launch this molecule themselves in the regulated markets. Any such outlicensing deal will be a significant upside. The company also has 4 molecules in Pre-clinical trials, mainly catering to the Anti-inflammatory and anti-diabetic segments.

### NCE Pipeline

|                    |         |                           | Stages of development |         |          |           |        |
|--------------------|---------|---------------------------|-----------------------|---------|----------|-----------|--------|
| Therapeutic        | Target  | Compound                  | Preclinical           | Phase I | Phase II | Phase III | Market |
| Anti-migraine      | LL 2011 | Amigra                    |                       |         |          |           |        |
| Anti-psoriasis     | LL 3348 | Desoris                   |                       |         |          |           |        |
| Anti-psoriasis     | LL 4218 | Desoside-P                |                       |         |          |           |        |
| Anti- TB           | LL 3858 | Sudoterb                  |                       |         |          |           |        |
| Anti-diabetic      | LL 6531 | PPAR Modulators           |                       |         |          |           |        |
| Anti-diabetic      |         | DPP-IV Inhibitors         |                       |         |          |           |        |
| Anti-diabetic      |         | PTP1B Inhibitors          |                       |         |          |           |        |
| Anti -Inflammatory |         | P38 Alpha MAPK Inhibitors |                       |         |          |           |        |

Source: Company, Emkay Research

## Income Statement

| Y/E, Mar (Rs. mn)                      | FY08         | FY09E        | FY10E        | FY11E        |
|----------------------------------------|--------------|--------------|--------------|--------------|
| <b>Net Sales</b>                       | <b>26862</b> | <b>35967</b> | <b>41440</b> | <b>46396</b> |
| Growth (%)                             | 33.9         | 33.9         | 15.2         | 12.0         |
| Other related income                   | 529          | 568          | 618          | 668          |
| <b>Total Operating Income</b>          | <b>27392</b> | <b>36534</b> | <b>42058</b> | <b>47064</b> |
| <b>Expenses</b>                        | <b>22346</b> | <b>29713</b> | <b>34140</b> | <b>38022</b> |
| Growth (%)                             | 23           | 33.0         | 14.9         | 11.4         |
| Raw Materials                          | 11638        | 14948        | 17073        | 19022        |
| % of sales                             | 43           | 42           | 41           | 41           |
| Employee cost                          | 3076         | 4496         | 5222         | 5846         |
| % of sales                             | 11           | 13           | 13           | 13           |
| Manufacturing exps                     | 1549         | 1969         | 2273         | 2660         |
| % of sales                             | 6            | 5            | 5            | 6            |
| R&D                                    | 1572         | 1572         | 2320         | 2772         |
| % of sales                             | 6            | 4            | 6            | 6            |
| Selling & Dist exps                    | 4511         | 6728         | 7252         | 7721         |
| % of sales                             | 17           | 19           | 18           | 17           |
| <b>EBIDTA</b> (Excl Other Related Inc) | <b>4517</b>  | <b>6254</b>  | <b>7301</b>  | <b>8374</b>  |
| Growth (%)                             | 22           | 38           | 17           | 15           |
| <b>EBIDTA % (W/O Other OI)</b>         | <b>16.8%</b> | <b>17.4%</b> | <b>17.6%</b> | <b>18.1%</b> |
| Other income                           | 1535         | 78           | 77           | 108          |
| Interest                               | 374          | 578          | 570          | 510          |
| Depreciation                           | 647          | 781          | 893          | 1025         |
| Non-recurring Expense                  | 158          | 0            | 0            | 0            |
| Non-recurring Income                   | 1127         | 0            | 0            | 0            |
| <b>PBT</b>                             | <b>5402</b>  | <b>5540</b>  | <b>6533</b>  | <b>7616</b>  |
| Total Tax                              | 1318         | 997          | 1045         | 1218         |
| Effective tax rate (%)                 | 24           | 18           | 16           | 16           |
| Minority Int                           | 2            | 2            | 2            | 2            |
| <b>PAT</b> (Before E/O items)          | <b>4082</b>  | <b>4541</b>  | <b>5486</b>  | <b>6395</b>  |
| <b>E/O items</b>                       | <b>733</b>   | <b>0</b>     | <b>0</b>     | <b>0</b>     |
| <b>APAT</b>                            | <b>3350</b>  | <b>4541</b>  | <b>5486</b>  | <b>6395</b>  |
| Growth (%)                             | 50           | 36           | 21           | 17           |
| <b>NPM</b>                             | <b>12.5</b>  | <b>12.6</b>  | <b>13.2</b>  | <b>13.8</b>  |

Source: Emkay Research

## Balance Sheet

| Y/E, Mar (Rs. mn)               | FY08         | FY09E        | FY10E        | FY11E        |
|---------------------------------|--------------|--------------|--------------|--------------|
| Equity share capital            | 821          | 886          | 886          | 886          |
| Share Premim                    | 1361         | 4983         | 4983         | 4983         |
| Other Reserves                  | 10615        | 14125        | 18574        | 23932        |
| Minority Intrest                | 95           | 96           | 98           | 99           |
| <b>Networth</b>                 | <b>12891</b> | <b>20090</b> | <b>24540</b> | <b>29900</b> |
| <b>Deferred tax liability</b>   | <b>1107</b>  | <b>1107</b>  | <b>1107</b>  | <b>1107</b>  |
| <b>Diventure/pref. Share</b>    |              |              |              |              |
| Secured Loans                   | 6124         | 3137         | 2987         | 1987         |
| Unsecured Loans                 | 5905         | 7005         | 7005         | 6505         |
| <b>Loan Funds</b>               | <b>12029</b> | <b>10142</b> | <b>9992</b>  | <b>8492</b>  |
| <b>Total Liabilities</b>        | <b>26027</b> | <b>31339</b> | <b>35639</b> | <b>39499</b> |
| Gross Block                     | 14859        | 17359        | 19859        | 22359        |
| Less: Depreciation              | 4698         | 5479         | 6371         | 7396         |
| <b>Net block</b>                | <b>10161</b> | <b>11880</b> | <b>13487</b> | <b>14963</b> |
| <b>Capital work in progress</b> | <b>964</b>   | <b>964</b>   | <b>964</b>   | <b>964</b>   |
| <b>Goodwill</b>                 | <b>1872</b>  | <b>1872</b>  | <b>1872</b>  | <b>1872</b>  |
| <b>Investment</b>               | <b>58</b>    | <b>1758</b>  | <b>1758</b>  | <b>1758</b>  |
| <b>Current Assets</b>           | <b>20441</b> | <b>23848</b> | <b>27505</b> | <b>30935</b> |
| Inventories                     | 7892         | 10430        | 11893        | 13223        |
| Sundry debtors                  | 7440         | 10071        | 11645        | 12991        |
| Cash & bank balance             | 2742         | 470          | 444          | 1010         |
| Loans & advances                | 2367         | 2877         | 3522         | 3712         |
| Other assets                    | 0            | 0            | 0            | 0            |
| <b>Current liabilities</b>      | <b>7470</b>  | <b>8984</b>  | <b>9947</b>  | <b>10993</b> |
| Current liabilities             | 6019         | 7442         | 8315         | 9512         |
| Provisions                      | 1451         | 1542         | 1632         | 1482         |
| <b>Net current assets</b>       | <b>12971</b> | <b>14864</b> | <b>17557</b> | <b>19942</b> |
| <b>Misc expenditure</b>         | <b>0</b>     | <b>0</b>     | <b>0</b>     | <b>0</b>     |
| <b>Total Assets</b>             | <b>26027</b> | <b>31339</b> | <b>35639</b> | <b>39499</b> |

Source: Emkay Research

## Cash Flow

| Y/E, Mar (Rs. mn)            | FY08          | FY09E         | FY10E        | FY11E        |
|------------------------------|---------------|---------------|--------------|--------------|
| <b>Y/E, Mar (Rs. mn)</b>     | <b>FY08</b>   | <b>FY09E</b>  | <b>FY10E</b> | <b>FY11E</b> |
| Pre-tax profit               | 5402          | 5540          | 6533         | 7616         |
| Depreciation                 | 647           | 781           | 893          | 1025         |
| Chg in working cap           | (3666)        | (4165)        | (2719)       | (1819)       |
| Tax paid                     | (1137)        | (997)         | (1045)       | (1218)       |
| <b>Operating cash Inflow</b> | <b>1246</b>   | <b>1159</b>   | <b>3661</b>  | <b>5603</b>  |
| Capital expenditure          | (5674)        | (2500)        | (2500)       | (2500)       |
| <b>Free Cash Flow</b>        | <b>(4428)</b> | <b>(1341)</b> | <b>1161</b>  | <b>3103</b>  |
| Investments                  | (30)          | (1700)        | 0            | 0            |
| Equity Capital Raised        | 965           | 3687          | 0            | 0            |
| Loans Taken / (Repaid)       | 3381          | (1887)        | (150)        | (1500)       |
| Dividend (incl tax)          | (961)         | (1037)        | (1037)       | (1037)       |
| Minority Interest            | 95            | 2             | 2            | 2            |
| Forex reserve                | 129           | 0             | 0            | 0            |
| Others                       | (253)         | 0             | 0            | 0            |
| Increase in Msc Exp          |               |               |              |              |
| <b>Net chg in cash</b>       | <b>(1102)</b> | <b>(2272)</b> | <b>(26)</b>  | <b>566</b>   |
| <b>Opening cash position</b> | <b>3845</b>   | <b>2742</b>   | <b>470</b>   | <b>444</b>   |
| <b>Closing cash position</b> | <b>2742</b>   | <b>470</b>    | <b>444</b>   | <b>1010</b>  |

Source: Emkay Research

## Ratios

| Y/E, Mar                    | FY08        | FY09E       | FY10E       | FY11E       |
|-----------------------------|-------------|-------------|-------------|-------------|
| <b>Profitability (%)</b>    |             |             |             |             |
| EBIDTA margin               | 16.8%       | 17.4%       | 17.6%       | 18.1%       |
| PAT margin                  | 12.5        | 12.6        | 13.2        | 13.8        |
| ROCE                        | 24          | 25          | 24          | 25          |
| ROE                         | 31          | 28          | 25          | 24          |
| <b>Per share data (Rs.)</b> |             |             |             |             |
| <b>EPS (Consolidated)</b>   | <b>37.8</b> | <b>51.3</b> | <b>61.9</b> | <b>72.2</b> |
| CEPS                        | 45.1        | 60.1        | 72.0        | 83.8        |
| BVPS                        | 155.9       | 225.7       | 275.9       | 336.4       |
| DPS (Rs)                    | 10.0        | 10.0        | 10.0        | 10.0        |
| <b>Valuations</b>           |             |             |             |             |
| P/E                         | 16.7        | 12.3        | 10.2        | 8.8         |
| Cash PE                     | 14.0        | 10.5        | 8.8         | 7.5         |
| P/BV                        | 4.1         | 2.8         | 2.3         | 1.9         |
| EV / Net Sales              | 2.3         | 1.8         | 1.6         | 1.4         |
| EV / EBITDA                 | 12.1        | 9.6         | 8.3         | 7.0         |
| Dividend Yield (%)          | 1.6         | 1.6         | 1.6         | 1.6         |
| <b>Turnover (x) Days</b>    |             |             |             |             |
| Debtors T/O                 | 99.7        | 100.8       | 101.2       | 100.8       |
| Inventory T/O               | 105.8       | 104.4       | 103.3       | 102.6       |
| <b>Gearing Ratio</b>        |             |             |             |             |
| Total Debt/Equity (x)       | 0.9         | 0.5         | 0.4         | 0.3         |

Source: Emkay Research

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## Emkay Rating Distribution

|            |                                                                                                                       |
|------------|-----------------------------------------------------------------------------------------------------------------------|
| BUY        | Expected total return (%) of stock price appreciation and dividend yield) of over 25% within the next 12-18 months.   |
| ACCUMULATE | Expected total return (%) of stock price appreciation and dividend yield) of over 10% within the next 12-18 months.   |
| REDUCE     | Expected total return (%) of stock price appreciation and dividend yield) of below 10% within the next 12-18 months.  |
| SELL       | The stock is believed to under perform the broad market indices or its related universe within the next 12-18 months. |

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