

Morgan Stanley India Company
Private Limited+

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May 13, 2011

Stock Rating
Overweight

Industry View
In-Line

Lupin Ltd.

In-line 4Q; Buy Now for 2012 Product Flow; OW

Quick Comment: By and large, Lupin reported an in-line 4Q. Sales rose 17.6% yoy (up 3% qoq) driven by developed and developing market dosage form exports. Operating margin compressed 200bp to 20% (30bp qoq expansion) on higher R&D spending (11 ANDA filings) and start-up expenses at new Indore SEZ. This led to a 3% yoy rise in net profit to Rs2.27bn (Rs2.17bn excluding US\$6mn Salix payment, MSe – Rs2.12bn).

Future Outlook: Chairman DB Gupta noted that Lupin is at an inflection point and is well placed to maintain growth momentum. It is targeting US\$3bn sales by F2014 (US\$1.3bn in F2011), which we believe could be aspirational. Lupin continues to believe that it can expand OPM 50-75bp p.a. for the foreseeable future. Tax rate will likely rise meaningfully in F2012 on the expiration of EOU benefits for Mandideep and Goa. R&D will remain at 8.5% of sales, one of the highest in rates in the group. F2012 capex will be the same as in F2011 at US\$100mn.

How to think about the stock: We believe that the US product flow for the next 4-6 months may not be exciting as levofloxacin, Effexor XR, Fortamet (sole excl), and Suprax tabs expansion are either too competitive or small. But lucrative launches including ziprasidone, combivir and OCs in the US should pick up in 2012. As such, we believe that the stock may be flat for the next few months, which should be a buying opportunity on 2012-13 growth momentum. The valuation is reasonable at 18x F2012 EPSe – a 5% discount to group valuations.

Other Highlights – Branded business: Allernaze (no timeline given by the company) launch appears distant. However, Suprax life cycle management appears impressive with PDUFA for drop form scheduled for September 2011. Bio-similar pipeline includes six candidates, two of which are likely to enter clinicals soon. Longer-term US pipeline is shaping up nicely – 148 ANDAs filed, 48 approved, of the remaining 100, 60 are Para IVs and 15 are FTFs (4 are sole exclusivity).

Key Ratios and Statistics

Reuters: LUPN.BO Bloomberg: LPC IN

India Pharmaceuticals

Shr price, close (May 12, 2011)	Rs423.60
52-Week Range	Rs519.80-344.00
Sh out, dil, curr (mn)	445
Mkt cap, curr (mn)	Rs188,617
EV, curr (mn)	Rs198,360
Avg daily trading value (mn)	Rs62

Fiscal Year ending	03/10	03/11e	03/12e	03/13e
ModelWare EPS (Rs)	15.33	19.11	22.85	27.31
Prior ModelWare EPS (Rs)	-	-	-	-
Consensus EPS (Rs)\$	15.42	19.11	22.75	27.42
Revenue, net (Rs mn)	48,707	56,502	65,372	75,997
EBITDA (Rs mn)	9,770	11,436	14,172	17,108
ModelWare net inc (Rs mn)	6,816	8,509	10,176	12,160
P/E	21.2	21.7	18.5	15.5
P/BV	5.6	6.4	5.6	4.6
RNOA (%)	-	24.8	27.8	30.9
ROE (%)	-	33.1	35.1	35.8
EV/EBITDA	15.8	17.0	13.8	11.4
Div yld (%)	3.1	2.4	2.4	2.4
FCF yld ratio (%)	4.1	3.1	4.0	3.0
Leverage (EOP) (%)	36.9	30.0	18.1	13.6

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).

\$ = Consensus data is provided by FactSet Estimates.

e = Morgan Stanley Research estimates

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Analyst meet highlights

- **Outlook:** Management expects:
 - 50-75bps margin expansion p.a. in the coming years.
 - To file over 30 ANDAs in FY12.
 - Capex of approximately US\$100mn for FY12.
 - To launch of over 10 products in the US generic market in FY12.
- **US branded business:** US branded business accounted for 30% of the overall US business (of Rs20.2bn for FY11). Lupin has a total field force of 160 representatives, of which 70 are focused in pediatric market (Suprax suspension) and the remaining 90 on Suprax tablet and Antara.
 - **Suprax:** Suprax clocked gross revenues of US\$85mn in FY11. For FY11, prescriptions for suspension form were up 10.6% while that for tablet form were up 60%.
 - **Antara:** Since the acquisition of Antara, for the first time it grew both in prescription and sales terms in F4Q11.
- **US Generics:**
 - US generics business accounted for about 70% of the overall US business (of Rs20.2bn for FY11).
 - Lupin targets to launch over 10 products in FY12 including Fortamet ER, levofloxacin, a couple of products from the oral contraceptives portfolio, and Geodon (shared exclusivity).
 - The company filed 21 ANDAs in FY11 (including 11 in F4Q11) taking total filings to 148 ANDAs, of which 48 have been approved so far.
 - The pipeline for the US market includes 60 Para IV opportunities, of which 15 are FTF opportunities (four are sole FTF).
 - According to management, it is on schedule to file for ophthalmology products in US.
 - **Oral contraceptives:** According to management, it will be the fourth entrant and expects an additional 2-3 players to enter after Lupin. Lupin is fully integrated (API and formulations from Indore SEZ) for oral contraceptives.

- **Asthma strategy:** Management initially targets to focus on MDI for the US and EU market.
 - During FY11, Lupin settled the patent litigations for Lunesta, Memantine, Loestrin and Femcon.
- **Europe performance:** Europe segment clocked revenues of Rs1.8bn for FY11, up 30% driven by France. It launched Clarithromycin XL in France in FY11. Management is currently awaiting registration approval for the German market, after which it targets to participate in the tender business. Lupin made 33 product filings in the European market in FY11.

Exhibit 1

Lupin: Lupin: Regulatory filings Status

	US	Europe
Filed	148	91
Approved	48	44

Source: Company data, Morgan Stanley Research

- **Domestic formulations market:** Lupin posted revenue of Rs15.5bn for FY11. About 70% of the domestic business is the chronic segment (up 30% in FY11) and 30% is acute segment (mainly anti-infectives and anti-TB). Management expects the domestic segment to grow at about 20% in the near term. It launched 41 products in FY11 and expects the launch momentum to continue in FY12. Lupin has total field force of approximately 4,200 medical representatives.
- **Japan:** Japan segment clocked revenue of Rs6.2bn, up 16.3%, despite a 15% price cut. The company launched five products in FY11 and targets to launch seven products in FY12.
- **Other markets:**
 - **South Africa:** Lupin clocked revenue of Rs1.8bn, up 38%, in the South African market. It's subsidiary is now the sixth-largest generic company in South Africa.
 - **CIS:** Lupin launched three products in Russia in FY11.
- **Biologics:** Lupin has invested over Rs1bn on the biologics segment so far. It has a pipeline of six products, two of which are expected to enter clinical trials shortly.
- **Patent license agreement with Abbott:** Lupin entered a patent license agreement with Abbott covering certain fenofibrate patents including Antara. According to

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management, it made a one-time payment (insignificant) to Abbott toward this agreement.

- USFDA has inspected and approved its CRO facility.
- **Acquisition strategy:** Management highlighted that it continues to evaluate acquisition targets and future acquisitions will be bigger than the acquisitions done so far.

- **R&D activity:** R&D expenditure for FY11 stood at Rs4.83bn, about 8.5% of net sales, of which about 25% was spent on drug discovery. Lupin has a total pool of over 1,000 scientists, 210 of which are involved in drug discovery. Management expects R&D expenditure to be in the range of 8.5% of sales in the near term.
- **Working capital cycle** is down to 83 days in FY11 from 91 days in FY10.

Exhibit 2

Lupin: F4Q11 Results

(Rs mn)	F4Q11	F4Q10	%chg	F3Q11	%chg	FY11	FY10	%chg
(period ending)	31-Mar-11	31-Mar-10	YoY	31-Dec-10	QoQ	31-Mar-11	31-Mar-10	YoY
Sales (Gross)	15214	12912	17.8%	14766	3.0%	57422	48010	19.6%
Less Excise Duty	99	64	54.1%	94	5.3%	354	273	29.4%
Other Operating Income	420	434	-3.1%	430	-2.3%	1,252	972	28.9%
Net Sales	15536	13282	17.0%	15102	2.9%	58320	48708	19.7%
Material Cost	6150	4882	26.0%	5700	7.9%	22379	19694	13.6%
Staff Costs	2004	1624	23.4%	1977	1.4%	7677	5872	30.8%
R&D Expenditure	1461	1125	29.9%	1178	24.0%	4834	3570	35.4%
Other Expenditure	4274	3852	11.0%	4453	-4.0%	16353	13303	22.9%
Total Expenditure	12428	10358	20.0%	12130	2.5%	46410	38869	19.4%
Operating profit	3108	2924	6.3%	2973	4.5%	11911	9839	21.1%
Other Income	33	105	-68.8%	34	-3.2%	89	142	-37.3%
EBITDA	3140	3029	3.7%	3007	4.5%	12000	9981	20.2%
Interest (Net)	78	78	0.1%	78	0.5%	325	385	-15.7%
Depreciation	463	408	13.5%	413	12.0%	1712	1239	38.1%
PBT and Extra-ordinaries	2600	2543	2.2%	2516	3.3%	9963	8357	19.2%
Tax	312	293	6.5%	237	31.4%	1169	1360	-14.0%
Core PAT	2288	2251	1.6%	2279	0.4%	8794	6997	25.7%
Minority interest and share of loss in associates	16	45	-64.2%	38	-58.2%	168	180	-6.7%
Reported PAT	2272	2206	3.0%	2240	1.4%	8626	6816	26.5%
<i>GPM (%)</i>	<i>60.4</i>	<i>63.2</i>	<i>-2.8</i>	<i>62.3</i>	<i>-1.8</i>	<i>61.6</i>	<i>59.6</i>	<i>2.1</i>
<i>OPM (%)</i>	<i>20.0</i>	<i>22.0</i>	<i>-2.0</i>	<i>19.7</i>	<i>0.3</i>	<i>20.4</i>	<i>20.2</i>	<i>0.2</i>
<i>NPM (%)</i>	<i>14.6</i>	<i>16.6</i>	<i>-2.0</i>	<i>14.8</i>	<i>-0.2</i>	<i>14.8</i>	<i>14.0</i>	<i>0.8</i>
<i>Effective tax rate (%)</i>	<i>12.0</i>	<i>11.5</i>	<i>0.5</i>	<i>9.4</i>	<i>2.6</i>	<i>11.7</i>	<i>16.3</i>	<i>-4.5</i>

Source: Company data, Morgan Stanley Research

Exhibit 3

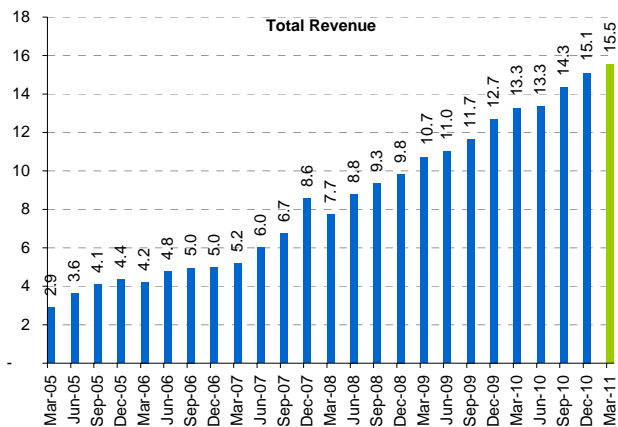
Lupin: F4Q11 Revenue Breakdown

(Rs mn)	F4Q11	F4Q10	%chg	F3Q11	%chg	F2011	F2010	%chg	Revenue Share
Formulations	12668	10820	17.1%	12398	2.2%	48479	39836	21.7%	84.9%
Domestic	3033	2845	6.6%	4005	-24.3%	15509	13498	14.9%	27.2%
Developing Mkt	1783	842	111.8%	1011	76.3%	4741	3192	48.5%	8.3%
Advanced Mkt	7853	7134	10.1%	7382	6.4%	28229	23145	22.0%	49.5%
Bulk Active	2472	2092	18.2%	2273	8.8%	8589	7842	9.5%	15.1%
Domestic	874	418	109.2%	836	4.5%	2741	2235	22.6%	4.8%
Developing Mkt	NA	NA	NA	NA	NA	NA	5390	NM	NA
Advanced Mkt	NA	NA	NA	NA	NA	NA	217	NM	NA
Domestic	3907	3263	19.8%	4842	-19.3%	18250	15734	16.0%	32.0%
Exports	11234	9649	16.4%	9830	14.3%	38818	31944	21.5%	68.0%
Grand Total	15141	12912	17.3%	14672	3.2%	57068	47678	19.7%	

Source: Company data, Morgan Stanley Research

Exhibit 4

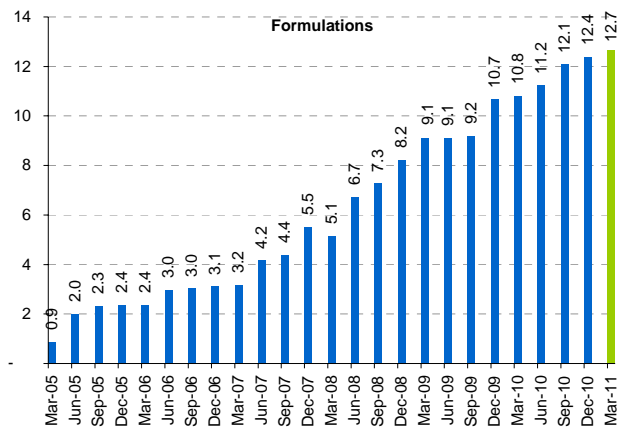
Lupin: Total Revenue Trend (Rs bn)



Source: Company data, Morgan Stanley Research

Exhibit 5

Lupin: Formulation Sales Trend (Rs bn)

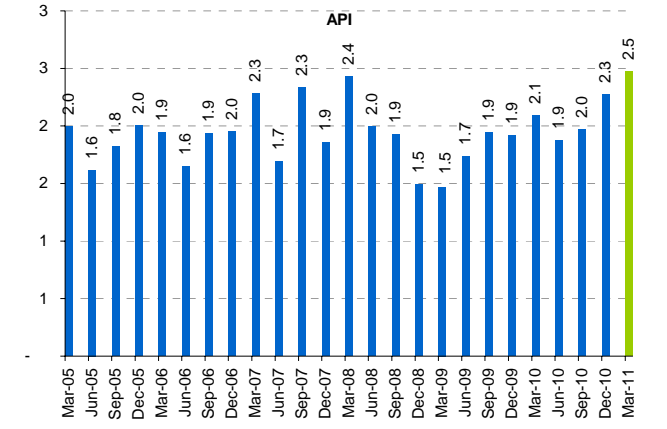


Source: Company data, Morgan Stanley Research

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Exhibit 6

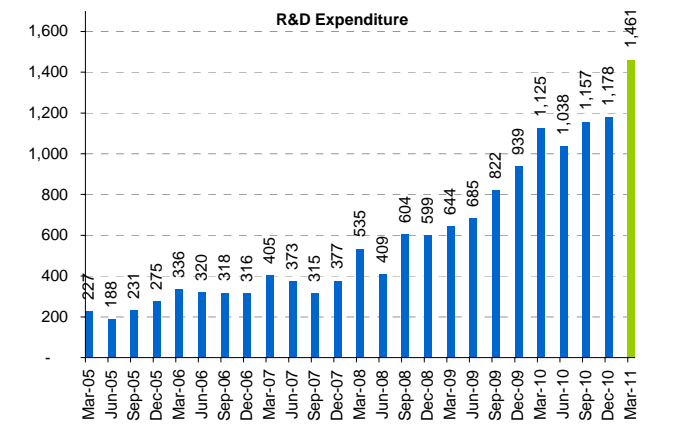
Lupin: API Sales Trend (Rs bn)



Source: Company data, Morgan Stanley Research

Exhibit 8

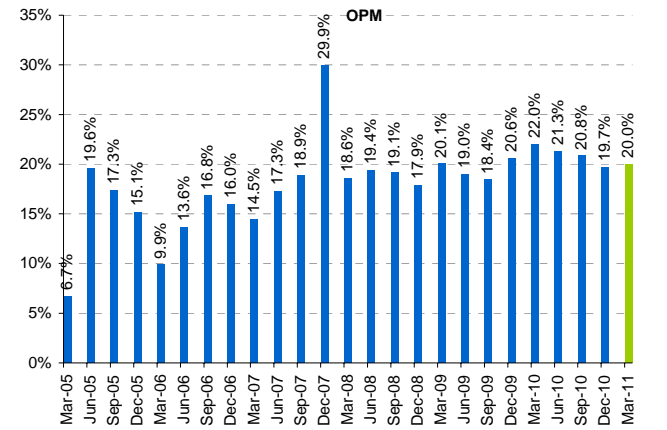
Lupin: R&D Expenditure (Rs mn)



Source: Company data, Morgan Stanley Research

Exhibit 7

Lupin: Operating Profit Margin (%)



Source: Company data, Morgan Stanley Research

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Morgan Stanley ModelWare is a proprietary analytic framework that helps clients uncover value, adjusting for distortions and ambiguities created by local accounting regulations. For example, ModelWare EPS adjusts for one-time events, capitalizes operating leases (where their use is significant), and converts inventory from LIFO costing to a FIFO basis. ModelWare also emphasizes the separation of operating performance of a company from its financing for a more complete view of how a company generates earnings.

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(as of April 30, 2011)

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Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)		
	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight/Buy	1172	41%	470	48%	40%
Equal-weight/Hold	1158	41%	386	39%	33%
Not-Rated/Hold	114	4%	20	2%	18%
Underweight/Sell	384	14%	102	10%	27%
Total	2,828		978		

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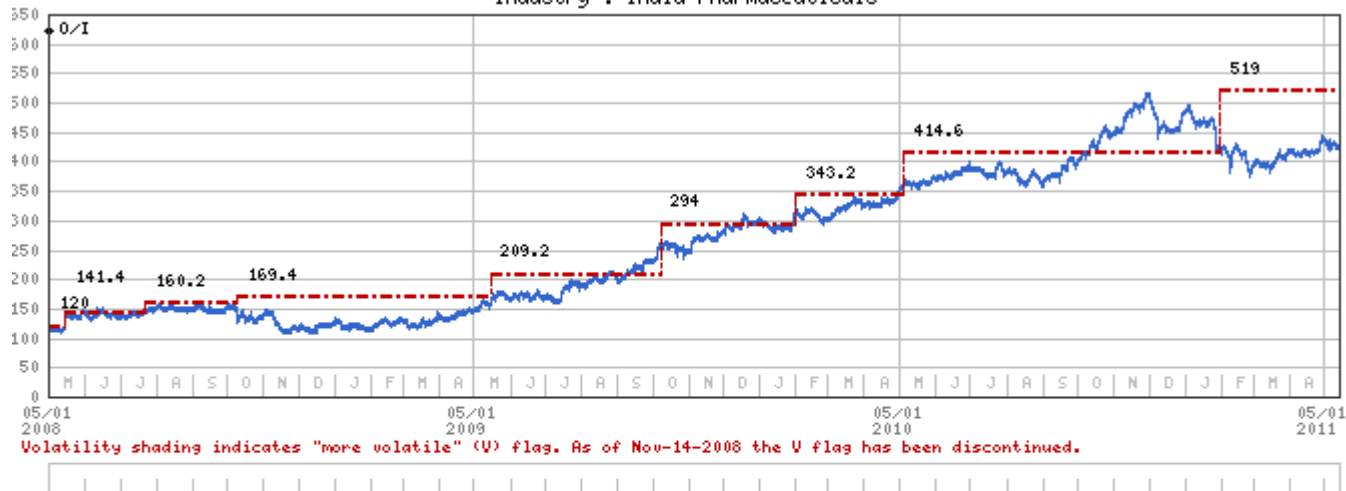
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Stock Price, Price Target and Rating History (See Rating Definitions)

Lupin Ltd. (LUPN.BO) - As of 5/12/11 in INR
Industry : India Pharmaceuticals



Stock Rating History: 5/1/08 : 0/I

Price Target History: 10/3/06 : 120; 5/15/08 : 141.4; 7/23/08 : 160.2; 10/9/08 : 169.4; 5/15/09 : 209.2; 10/8/09 : 294; 2/1/10 : 343.2; 5/4/10 : 414.6; 1/31/11 : 519

Source: Morgan Stanley Research Date Format: MM/DD/YY Price Target -- No Price Target Assigned (NA)
 Stock Price (Not Covered by Current Analyst) — Stock Price (Covered by Current Analyst) ■
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 Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) More Volatile (U) No Rating Available (NA)
 Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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Industry Coverage:India Pharmaceuticals

Company (Ticker)	Rating (as of)	Price* (05/12/2011)
Sameer Baisiwala, CFA		
Biocon Ltd (BION.BO)	E (10/27/2010)	Rs359.6
Cipla Ltd. (CIPL.BO)	E (01/29/2010)	Rs303.65
Dr. Reddy's Lab (REDY.BO)	O (09/13/2010)	Rs1,602.65
GlaxoSmithKline Pharma (GLAX.BO)	E (02/21/2010)	Rs2,339.8
Lupin Ltd. (LUPN.BO)	O (10/03/2006)	Rs423.6
Ranbaxy Laboratories (RANB.BO)	O (11/30/2009)	Rs479.85
Sun Pharmaceutical Industries (SUN.BO)	O (09/29/2010)	Rs430.4
Saniel Chandrawat		
Fortis Healthcare Limited (FOHE.BO)	O (10/21/2010)	Rs156.3

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* Historical prices are not split adjusted.