

MAY 05, 2010

RESULT

Coverage view: **Attractive**

Price (Rs): **1,819**

Target price (Rs): **1,920**

BSE-30: **17,088**

Improving outlook for US business to drive share price. A lower tax rate was the only surprise in Lupin's 4Q results. Strong performance of generic Lotrel, brand extensions and price/volume growth in brands boost sales growth prospects in FY2011E. Oral contraceptives will likely drive revenues and margin in FY2012E. We raise FY2011-12E PAT by 13-17% and roll forward our TP to Rs1,920 (from Rs1,600). Maintain ADD. Planned stock split (5:1) may lift retail interest in the short term.

Company data and valuation summary

Lupin

Stock data		Forecasts/Valuations					
52-week range (Rs) (high,low)	1,835-704	2010	2011E	2012E			
Market Cap. (Rs bn)	161.2	EPS (Rs)	77.0	104.3	122.7		
Shareholding pattern (%)		EPS growth (%)	27.9	35.3	17.6		
Promoters	47.2	P/E (X)	23.6	17.4	14.8		
FIs	16.2	Sales (Rs bn)	47.4	56.8	67.4		
MFs	15.0	Net profits (Rs bn)	6.8	9.2	10.9		
Price performance (%)		EBITDA (Rs bn)	8.5	11.7	14.6		
Absolute	1M	3M	12M	EV/EBITDA (X)	20.2	14.7	11.5
Rel. to BSE-30	11.1	18.5	149.9	ROE (%)	36.6	34.4	30.7
	16.6	9.5	77.4	Div. Yield (%)	0.7	0.8	0.9

4QFY10 revenues Rs12.8 bn against our estimate of Rs13.1 bn

US and European finished dosage revenues at Rs5.9 bn were ahead of our forecast Rs5.6 bn. LPC now has 25 products in the US market, of which 12 are market leaders and 22 rank in the top three by market share. According to the company, the US branded business grew 72% yoy in FY2010 and reached US\$127 mn. Japanese revenues were Rs1.3 bn, in line with forecasts. Sales grew 8% yoy in rupee terms and 13% in local currency. India finished dosage sales, at Rs2.7 bn, grew 42% yoy. A year ago, sales had declined 4%, hence our expectations for sharper growth.

Adjusted EBITDA margin 50 bps lower but lower tax rate helps

Adjusted EBITDA margin before R&D was 28%. Gross margin at 62% was higher than our estimate of 59%. We think this was due to higher sales of generic Lotrel in US. Other expenses at 21% were 200 bps higher than forecast. Personnel cost at Rs1.6 bn was higher than our estimate of Rs1.4 bn. The margin improvement seen in 2HFY10 is due to (1) product mix (2) addition of Antara sales, which enjoy higher margin in line with branded margins (3) bunching up of personnel costs in 2Q (4) higher sales of generic Lotrel. R&D costs at 7.5% of sales were higher than estimate of 7%. In the previous quarter, the tax rate was higher due to a higher tax in India where sales have been booked but subsidiaries have not sold the product yet. This appears to have reversed in 4Q.

Raising FY2011E PAT estimate by 13% and FY2012E by 17%

We increase sales growth to 20% in FY2011E from 19% earlier. Our estimate of FY2012E sales growth is now 19% (earlier 14%). This increase is due to the inclusion of oral contraceptive segment revenues and higher brand revenues due to new brand extensions. We forecast adjusted EBITDA margins at 28% for FY2011E and 29% in FY2012E. This is comparable for the past two quarters. We are forecasting 35% EPS growth in FY2011E and muted 18% growth in FY2012E.

QUICK NUMBERS

- **4QFY10 revenues below forecast at Rs12.8 bn**
- **PAT was 12% higher than our estimate**
- **Raise FY2011E PAT by 13% and FY2012E by 17%**

Prashant Vaishampayan
prashant.vaishampayan@kotak.com
Mumbai: +91-22-6634-1127

Priti Arora
priti.arora@kotak.com
Mumbai: +91-22-6634-1551

Kotak Institutional Equities Research
kotak.research@kotak.com
Mumbai: +91-22-6634-1100

4QFY10 revenues Rs12.8 bn against our estimate of Rs13.1 bn

- ▶ US and European finished dosage revenues at Rs5.9 bn were ahead of our forecast Rs5.6 bn. LPC now has 25 products in the US market, of which 12 are market leaders and 22 rank in the top three by market share. According to the company, US branded business grew 72% yoy in FY2010 and reached US \$127 mn. The growth in branded business was due to addition of Antara revenues from 3QFY10. LPC has made 37 ANDA filings in FY2010 and 22 were filed in 4QFY10. This has to be seen in context of 28 total filings in FY2009. LPC now has 127 ANDAs awaiting approval and has received 41 approvals.
- ▶ Settling litigation with Novartis on Lotrel (Benazepril/Amlodipine) capsules, LPC launched its version in February, 2010. LPC has also reached a settlement relating to Memantine tablets, a generic version of Alzheimer treatment Namenda of Forest Labs. Lotrel helped it reach US\$83 mn revenues in US in this quarter against US\$49 mn in the previous quarter.
- ▶ Lupin's branded business comprises of (1) Suprax brand and its line extensions, (2) Aerochamber Plus which LPC started marketing in a co-promotion agreement with Forest in 2QFY09, (3) LPC acquired worldwide rights for intranasal steroid product, AllerNaze from Collegium Pharmaceuticals. LPC believes that their product has superior side effect profile and will be launched in 2QFY11E, and (4) Antara has been promoted from September 2009. LPC has ramped up its US sales force to 170 from 70 earlier with 100 dedicated to primary care.
- ▶ Japanese revenues were Rs1.3 bn, in line with forecast. Sales grew 8% yoy in rupee terms and 13% in local currency. Growth rate was muted in the past two quarters compared to above 20% growth in rupee terms seen in previous two quarters was due to (1) lack of new blockbusters going off patent and (2) decline in overall Japanese market growth rate due to the slowdown. According to LPC, plans are underway to (1) manufacture certain APIs for the Japanese market in its Indian facilities (2) backend production in order to free up capacity in its Kyowa plant. LPC expects these measures to increase margins in FY2012E.
- ▶ India finished dosage sales at Rs2.7 bn grew 42% yoy. A year ago sales had declined 4% so we expected sharper growth rate. Our forecast was Rs3.2 bn.

Adjusted EBITDA margin at 28% was 50 bps lower than our estimate

Adjusted EBITDA margin before R&D was 28%. Gross margin at 62% was higher than our estimate of 59%. We think this was due to higher sales of generic Lotrel in US. Other expenses at 21% were 200bps higher than forecast. Personnel cost at Rs1.6 bn was higher than our estimate of Rs1.4 bn. The margin improvement seen in 2HFY2010 is due to (1) product mix (2) addition of Antara sales which enjoys higher margin inline with branded products margins (3) bunching up of personnel cost in 2Q (4) higher sales of generic Lotrel. R&D costs at 7.5% of sales were higher than estimate of 7%.

PAT at Rs2.2 bn against our estimate of Rs2 bn due to lower tax rate

PAT was higher than our estimate due to (1) higher other income at Rs539 mn versus our estimate of Rs150 mn on account of dossier sales (2) higher depreciation at Rs408 mn versus Rs400 mn and (3) lower tax at 12% versus 18%. In the previous quarter, the tax rate was higher due to the higher tax in India where sales have been booked but subsidiaries have not sold the product yet. This appears to have reversed in 4Q. LPC expected FY2010E tax rate to be around 17% but ended the year with 16%.

Interim results- Lupin, March fiscal year-ends (Rs mn)

	4QFY10	4QFY10E	4QFY09	3QFY10	% change		
					4QFY10E	4QFY09	3QFY10
Net sales	12,848	13,168	10,552	12,554	(2)	22	2
Net material cost	4,882	5,465	4,910	5,122	(11)	(1)	(5)
Personnel cost	1,624	1,450	1,363	1,528	12	19	6
R&D	1,124	922	644	939	22	75	20
Other expenses	2,728	2,500	1,626	2,502	9	68	9
Total expenditure	10,358	10,336	8,544	10,090	—	21	3
EBITDA	2,491	2,831	2,009	2,464	(12)	24	1
Other income	539	150	258	155	259	109	247
Interest expense	78	110	124	109	(29)	(37)	(28)
Depreciation	408	400	266	358	2	53	14
PBT	2,543	2,471	1,876	2,152	3	36	18
Tax	293	445	139	504	(34)	110	(42)
Minority interest	24	35	28	30	(32)	(15)	(20)
PAT	2,227	1,992	1,709	1,619	12	30	38
Share of associate	21	15	17	13	40	27	64
Reported PAT	2,206	1,977	1,693	1,606	12	30	37
API	1,700	2,088	2,042	1,914	(19)	(17)	(11)
Finished dosages	9,541	9,595	7,174	8,799	(1)	33	8
India	2,651	3,248	1,870	3,446	(18)	42	(23)
Developing markets	1,016	740	355	416	37	186	144
Advanced markets	5,874	5,606	4,949	4,937	5	19	19
Others	1,607	1,557	1,408	1,841	3	14	(13)
Kyowa (Japan)	1,262	1,257	1,173	1,489	—	8	(15)
South Africa	345	300	—	352	15	NM	(2)
Total	12,848	13,239	10,625	12,554	(3)	21	2

Source: Kotak Institutional Equities estimates, Company

LPC guided for sales growth of ~25% in FY2011E in early 2010

LPC expected to register sales growth of ~25% in FY2011E with all key markets of India, US, Europe contributing to this growth. Acquisitions are not included in this guidance.

LPC expects to improve EBITDA margin by 100 bps each year. This is despite an increase in personnel cost due to (1) addition to sales force in branded segment in US and (2) increase in R&D personnel to 700 as of March 2010.

Capex is expected at Rs5 bn in FY2010-11E.

Key takeaways from analyst meeting

US product pipeline in F2011E. LPC expects to launch six generic products in FY2011E. LPC expects to launch Allernaze in August 2010 in the branded segment. LPC expects to launch 2-3 products with limited competition. One of them—generic Lotrel was launched in February 2010. A second prospective launch involves a brand (yet undisclosed) with a market size of US\$500 mn.

US product pipeline in FY2012E. LPC has made 22 filings in the oral contraceptives category with US FDA. It expects to file some additional OC products in FY2011E. LPC expects the first set of OC approvals starting Jan 2011E. In FY2011E, LPC expects to file number of products in ophthalmic segment. In FY2013E, LPC expects certain FTF filings to get commercialized to be followed by launches in ophthalmology segment in FY2014E. We have now included US\$50 m revenues from oral contraceptive segment in FY2012E.

LPC has two biosimilar products in pre clinical stage and expects to launch them in domestic market first followed by ROW.

LPC has entered two new markets in Latin America—Brazil and Mexico. LPC expects to maintain the same financial discipline shown in earlier five acquisitions/ collaborations while exploring inorganic strategies for entering into these markets. It is also looking at another acquisition in Japanese market to broaden its product portfolio since Kyowa has a focus in CNS category.

We increase PAT estimates for FY2011E by 13% and FY2012E by 17%

We are using Rs/US\$ forecast of Rs45 for FY2010E, Rs45.25 for FY2011-12E.

- ▶ We increase sales growth to 20% in FY2011E versus 19% earlier. Our estimate of FY2012E sales growth is now 19% (was 14%) due to the inclusion of oral contraceptive segment revenues and higher brand revenues due to new brand extensions. Our sales growth estimate in FY2011E is lower than the earlier management guidance of 25-30% due to management guidance of 6 product launches in FY2011E in US generics. This has to be seen in the context of 2 product approvals in FY2010. We expect LPC's India finished dosage business to grow at 20% in FY2011E and 18% in FY2012E.
- ▶ We forecast adjusted EBITDA margins at 28% for FY2011E and 29% in FY2012E. This has to be compared with the previous quarters which are comparable as revenues from generic Lotrel and branded Antara are included in these periods. We think margin expansion in FY2012E is largely due to US business, specifically the oral contraceptive segment.
- ▶ We are forecasting 35% EPS growth in FY2011E and a muted 18% growth in FY2012E. We do not factor forex related losses in FY2010-11E estimates.

Maintain rating at ADD with TP at Rs1,920 (from Rs1,600)

We estimate sales growth of around 20% in FY2011E and FY2012E. Due to a PAT increase of 17% in FY2012E, we increase our target price to Rs1,920.

SOTP based price target, 2011-2012E

	PAT (Rs mn)		P/E (X)	Valuation (Rs mn)	
	2011E	2012E		2011E	2012E
India FD	2,321	2,706	16.0	37,138	43,292
India API - others	448	385	10.0	4,481	3,853
Advanced market FD-USA	2,482	3,193	15.0	37,233	47,890
Branded business USA	2,504	2,928	15.8	39,431	46,122
Advanced market FD-EU	259	290	15.0	3,885	4,348
Developing market API	260	261	10.0	2,603	2,606
Developing market FD	642	712	17.8	11,434	12,681
Kyowa	475	569	15.8	7,484	8,955
Total				143,689	169,745
Value per share (Rs)				1,624	1,919
Share price target (Rs)					1,919

Source: Kotak Institutional Equities estimates, Company

Profit and loss statement, March fiscal year-ends, 2007-2012E (Rs mn)

	2007	2008	2009	2010	2011E	2012E
Net sales	20,137	27,064	37,759	47,405	56,808	67,417
Operating expenses						
Materials	(10,250)	(12,897)	(17,770)	(19,694)	(24,627)	(28,800)
Selling and administration	(3,406)	(5,075)	(6,727)	(9,733)	(9,658)	(11,461)
Employee cost	(2,200)	(3,076)	(4,549)	(5,872)	(6,550)	(7,533)
R&D	(1,359)	(1,657)	(2,228)	(3,570)	(4,260)	(5,056)
Total expenditure	(17,215)	(22,705)	(31,274)	(38,869)	(45,095)	(52,850)
EBITDA	2,922	4,358	6,485	8,536	11,714	14,568
Depreciation and amortisation	(466)	(647)	(880)	(1,239)	(1,600)	(1,800)
EBIT	2,456	3,711	5,605	7,297	10,114	12,768
Net finance cost	(372)	(374)	(499)	(385)	(360)	(300)
Other income	1,991	2,065	954	1,445	1,600	1,000
Pretax profits before extra-ordinaries	4,074	5,402	6,060	8,357	11,354	13,468
Current tax	(860)	(1,137)	(877)	(1,360)	(1,728)	(2,224)
Deferred tax	(129)	(181)	(106)	0	(200)	(200)
Reported net profit	3,086	4,084	5,077	6,997	9,426	11,043
Minority interests/share of loss in ass	1	1	62	180	200	191
Reported net profit after minority inte	3,086	4,083	5,015	6,816	9,226	10,852

Source: Kotak Institutional Equities, Kotak Institutional Equities estimates, Company

Balance sheet, cash model, March fiscal year-ends, 2007-2012E (Rs mn)

	2007	2008	2009	2010E	2011E	2012E
Balance sheet						
Total equity	8,733	12,797	14,249	22,961	30,686	39,934
Total debt	8,648	12,029	12,232	11,908	11,231	7,401
Current liabilities	4,222	7,470	13,331	10,181	11,882	13,485
Minority Interests	—	95	143	254	394	555
Deferred tax liabilities	1,026	1,107	1,164	1,164	1,364	1,564
Total equity and liabilities	22,629	33,497	41,119	46,468	55,557	62,939
Cash and cash equivalents	3,845	2,742	778	200	300	400
Current assets	10,785	17,699	22,700	23,542	29,132	35,714
Net fixed assets	7,146	10,161	12,012	15,273	18,673	19,373
Intangible assets	—	1,872	3,174	4,998	4,998	4,998
Capital -WIP	826	964	2,240	2,240	2,240	2,240
Investments	28	58	216	216	216	216
Total assets	22,629	33,497	41,119	46,468	55,557	62,939
Free cash flow						
Operating cash flow, excl. working capital	2,327	3,453	5,576	7,348	9,996	12,269
Working capital	(1,819)	(4,157)	610	(4,181)	(3,989)	(5,082)
Capital expenditure	(1,540)	(5,469)	(4,617)	(4,500)	(5,000)	(2,500)
Investments	—	(59)	(157)	—	—	—
Free cash flow	(1,032)	(6,232)	1,411	(1,333)	1,007	4,687

Source: Kotak Institutional Equities estimates, Company

Change in estimates (Rs mn)

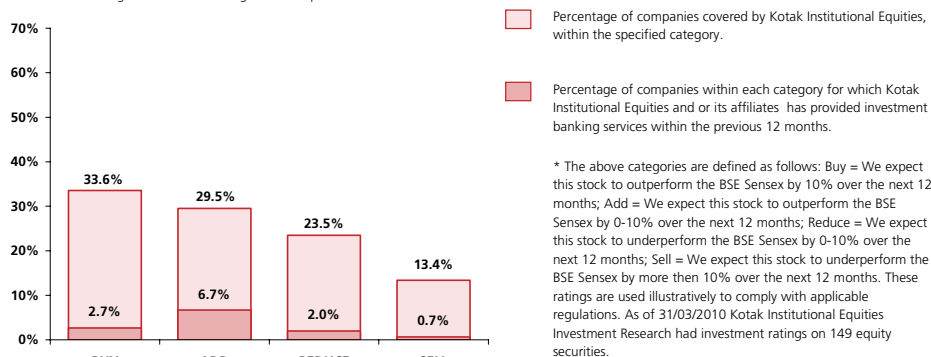
	Current estimates		Previous estimates		% change	
	FY2011E	FY2012E	FY2011E	FY2012E	FY2011E	FY2012E
Net sales	56,808	67,417	56,797	64,822	—	4
Consumption of RM	(23,285)	(25,766)	(24,143)	(25,598)	(4)	1
Personnel cost	(6,550)	(7,533)	(6,500)	(7,475)	1	1
R&D	(4,260)	(5,056)	(3,977)	(4,538)	7	11
Other expenses	(11,000)	(14,495)	(11,000)	(14,261)	—	2
Total Expenditure	(45,095)	(52,850)	(45,620)	(51,872)	(1)	2
EBITDA	11,714	14,568	11,177	12,950	5	12
Other income	1,600	1,000	800	600	100	67
Interest expense	(360)	(300)	(400)	(400)	(10)	(25)
Depreciation	(1,600)	(1,800)	(1,400)	(1,500)	14	20
PBT	11,354	13,468	10,177	11,650	12	16
Tax	(1,928)	(2,424)	(1,832)	(2,214)	5	10
PAT	9,426	11,043	8,345	9,437	13	17
PAT post exceptionals	9,426	11,043	8,345	9,437	13	17
Minority Interest	(140)	(161)	(140)	(161)	—	—
Net profit post MI	9,286	10,882	8,205	9,276	13	17
Share of loss in associate	(60)	(30)	(60)	(30)	—	—
Reported PAT	9,226	10,852	8,145	9,246	13	17

Source: Kotak Institutional Equities, Kotak Institutional Equities estimates, Company

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As of March 31, 2010

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Corporate Office

Kotak Securities Ltd.
Bakhtawar, 1st Floor
229, Nariman Point
Mumbai 400 021, India
Tel: +91-22-6634-1100

Overseas Offices

Kotak Mahindra (UK) Ltd
6th Floor, Portsoken House
155-157 The Minories
London EC 3N 1 LS
Tel: +44-20-7977-6900 / 6940

Kotak Mahindra Inc
50 Main Street, Suite No.310
Westchester Financial Centre
White Plains, New York 10606
Tel:+1-914-997-6120

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