

Lupin ----- Maintain OUTPERFORM
Margins continue to be subdued despite strong sales
EPS: ▼ TP: ◀▶

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- We liked strong sales growth across regions and adjusted for one-offs, sales beat was 4%. Sequential increase in US sales was due to (1) seasonally strong quarter for Suprax, (2) end of channel de-stocking of Dec quarter, (3) Antara sales start growing and (4) benefit of pick-up in Cephs sales due to reduced competition.
- India sales growth was tepid at 16% as Lupin has been shifting focus from anti-infectives to chronics and expects FY12 growth of 20% with launch of more than 40 products.
- Margins continue to be subdued. Gross margins declined QoQ by 180 bp as Lotrel pricing reduced further with the entry of Par Pharma in Jan 2011. EBITDA margin was impacted by (1) high R&D cost at 9.7% of sales versus 8.1% for 9MFY11; (2) expenses for the newly commissioned Indore SEZ. However, margins were weak as it benefitted from (1) forex gain of Rs130 mn (other expenses) & (2) benefit of Salix upfront payment included in sales.
- We maintain OUTPERFORM as FY13 EPS growth of 27% is significant and not yet priced in. FY12 EPS reduces by 4% as upfront payment from Salix has been factored in FY11.
- Sequential improvement in US sales was driven by (1) seasonally strong quarter for Suprax, (2) end of channel de-stocking in Dec quarter, (3) Antara sales have started growing and (4) benefit of pick-up in cephs sales as a competitor had manufacturing issues. The latter benefit should ramp up further in the June quarter.
- India sales growth was tepid at 16% as Lupin has been shifting focus from anti-infectives to chronics. However, the company expects to grow at 20% in FY12 with launch of more than 40 products. The secondary sales has been strong at 24% in March 2011 (AIOCD) and offers comfort on the guidance.
- Japanese sales growth of 28% was higher than expected. This growth was partly helped by Yen appreciation and new product introduction. Lupin introduced five new products in Japan in FY11 and plans to launch seven new products in FY12.
- Reconciliation of geographical sales split with the reported sales leaves a gap of Rs581 mn, which, we believe, includes the upfront payment from Salix.

Bbg/RIC	LPC IN / LUPN.BO	Price (12 May 11, Rs)	423.60		
Rating (prev. rating)	O (O)	TP (Prev. TP Rs)	480 (480)		
Shares outstanding (mn)	446.27	Est. pot. % chg. to TP	13		
Daily trad vol - 6m avg (mn)	0.1	52-wk range (Rs)	516.00 - 352.83		
Daily trad val - 6m avg (US\$ mn)	1.4	Mkt cap (Rs/US\$ bn)	189.0/ 4.2		
Free float (%)	47.0	Performance	1M	3M	12M
Major shareholders	Promoter 53%	Absolute (%)	3.7	3.1	19.4
Year	3/09A	3/10A	3/11E	3/12E	3/13E
Revenues (Rs mn)	37,759	47,405	56,959	65,195	74,759
EBITDA (Rs mn)	6,485	8,536	10,719	12,520	15,789
Net profit (Rs mn)	5,049	6,816	8,795	9,116	11,654
EPS (Rs)	12.1	15.9	19.7	20.5	26.2
- Change from prev. EPS (%)	n.a.	n.a.	2	(4)	0
- Consensus EPS (Rs)	n.a.	n.a.	19.1	22.4	27.4
EPS growth (%)	22.8	31.9	24.1	3.6	27.8
P/E (x)	35.1	26.6	21.5	20.7	16.2
Dividend yield (%)	0.7	0.8	1.0	1.0	1.3
EV/EBITDA (x)	30.9	23.2	18.3	15.6	12.2
P/B (x)	12.4	7.1	5.8	4.8	3.9
ROE (%)	37.3	34.1	30.2	25.2	26.3

Note 1: Lupin is a vertically integrated Indian pharmaceuticals manufacturer focussing on cephalosporins and anti-TB medicines. It is now expanding in regulated markets, and also changing product mix towards formulations. Note 2: Lupin is a vertically-integrated Indian pharmaceuticals manufacturer focussing on cephs and anti-TB medicines.

Figure 1: Sales split for 4Q11 versus CS estimates

Rs mn	4Q11A	4Q11E	Diff (%)	4Q10A	YoY %
Formulations	12,144	11,517	5%	10,729	13%
Developed markets	7,853	7,290	8%	7,136	10%
EU+US	6,235	5,826	7%	5,874	6%
Japan	1,618	1,464	11%	1,262	28%
Domestic	3,071	3,128	-2%	2,651	16%
Developing markets	1,220	1,099	11%	941	30%
API	2,489	2,493	0%	2,226	12%

Source: Company data, Credit Suisse estimates

Healthy sales trend across geographies

Overall sales were 9% higher than expected but benefitted from upfront payment from Salix. Adjusted for one-offs, sales beat was 4%.

Margins weaker than expected

Both gross and EBITDA margins were below our expectation. Gross margin declined sequentially by 180 bp as the pricing pressure on Lotrel, with the entry of Par Pharma in Jan 2011, has been significant. EBITDA margin was impacted by (1) high R&D cost which was higher at 9.7% of sales compared to 8.1% for first nine months (2) expenses related to Indore SEZ which has just been commissioned. However, margins benefitted from (1) forex gain of Rs130 mn included in other expenses and (2) benefit of Salix upfront payment has been included in sales. Overall, EBITDA margins were weaker than expected.

Figure 2: 4Q11 consolidated result versus CS estimates

Rs mn	4Q11A	4Q11E	Diff (%)	4Q10A	YoY %
Net sales	15,115	13,921	9%	12,848	18%
EBITDA	2,687	2,631	2%	2,491	8%
EBITDA margin	17.8%	18.9%	-1%	19.4%	-1.6%
Depreciation	463	414	12%	407	14%
Other income	453	334	36%	539	-16%
Interest cost	78	81	-4%	78	0%
Income taxes	312	346	-10%	293	6%
Minority interest	16	38	-58%	45	-64%
Net income	2,272	2,086	9%	2,207	3%

Source: Company data, Credit Suisse estimates

Key takeaways from the conference call

- Allernaze: The management confidence appeared low for the launch of Allernaze in FY12.
- FY12 ANDA filing target is more than 30 (versus 21 ANDAs filed in FY11) and FY12 launch target is 10 products in the US.
- Lupin has made an upfront payment to Abbott in settlement on fenofibrate patents and there will not be recurring royalty payments.
- FY12 capex is US\$100 mn, similar to FY11. Lupin has already spent more than US\$20 mn on biosimilars. Lupin has six products in the pipeline, of which two are entering clinics this month. One of them is a bio-better.

Companies Mentioned (Price as of 12 May 11)

Lupin Ltd (LUPN.BO, Rs423.60, OUTPERFORM, TP Rs480.00)
 Abbott Laboratories (ABT, \$53.05, NEUTRAL, TP \$47.00)
 Par Pharmaceutical (PRX, \$34.97)
 Salix Pharmaceuticals, Ltd. (SLXP, \$39.68, OUTPERFORM [V], TP \$45.00)

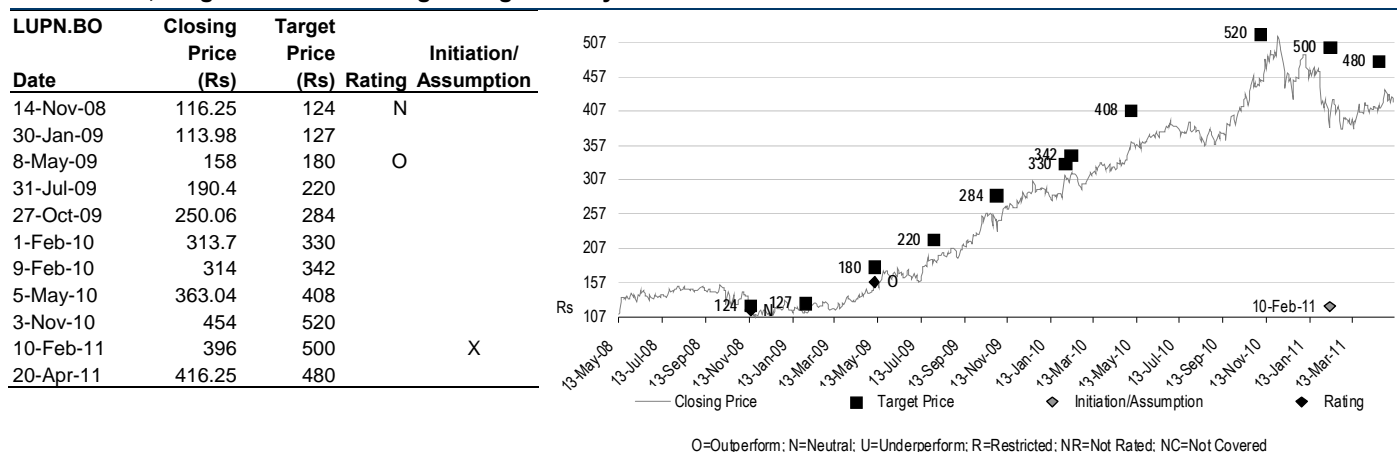
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3-Year Price, Target Price and Rating Change History Chart for LUPN.BO



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Price Target: (12 months) for (LUPN.BO)

Method: Our Rs480 target price for Lupin is arrived at applying 18x price to earning multiple to Lupin's financial year 2013 earnings which yields Rs 471/share and additionally a value of Rs 9/share to the value of first to file pipeline. The price to earning multiple used for Lupin is in line with sector average multiple.

Risks: Downside Risks to our Rs480 target price for Lupin include: 1) slowdown in domestic sales growth; 2) slowdown in new product approvals in United States - we expect the company to get approvals for its ANDA filings in OCs in FY12 3) sharp decline in Suprax sales due to increasing competition 4) Higher than expected competition in Lotrel and Oral Contraceptives leading to faster price erosion

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