

LUPIN

Improving outlook

India Equity Research | Pharmaceuticals



Lupin's Q2FY13 PBT at INR4.4bn (27%YoY) was ahead of the estimated INR3.9bn while PAT at INR2.9bn was in-line (higher tax rate of 32% versus estimated 25%). Revenue growth remains strong at 30% (in-line) while core EBITDA margins improved by 286bps YoY. Margins benefited from a reduction in R&D costs (48% QoQ), partly offset by forex losses. Post FDA inspection at Indore SEZ, we expect bunching of FDA approvals over H2FY13 which would render strong operating leverage. Maintain 'BUY'.

Core operating margins (adjusted for R&D benefit) remain intact

Core EBITDA margins (excl other operating inc.) at 20.3% was up 123bps QoQ, however it benefited from lower R&D costs (4% of sales versus average 6-7%). Margins also had a negative impact of INR250mn on account of forex losses. Adjusted for these, decline in core margins was marginal (-50bps QoQ), largely from lower exclusivity sales of Geodon. Going forward, we expect margins to improve from new launches in the US.

Strong growth projected over near term and long term

Management foresees a strong growth in the US, India and Japan. India is expected to maintain 18-20% growth with a higher focus on chronic segment while Japan will see ramp-up from hospital segment (Irom) and new launches. Post FDA inspection of Indore SEZ, Lupin expects higher number of approvals in the US over FY13 including high value launches such as OCs (6-7 products), controlled release products and Tricor.

Multiple levers for margin expansion

On the back of strong product opportunities and ramp-up in capacities, Lupin has guided 300 bps margins expansion over FY13-15E. We have build 70bps margins expansion during FY13E and 110bps over FY14-15E.

Outlook and Valuations: Strong growth visibility; Maintain 'BUY'

We believe that growth drivers remain intact and the management cites strong growth traction in near term with multiple levers for margin expansion. We thus maintain 'BUY/SO' rating on the stock. During past three months, Lupin has underperformed Healthcare Index by 12% and is currently trading at 15% discount to peers. We expect this valuation gap to narrow going forward.

| Financials (Consolidated) | | | | | | (INR mn) | | |
|---------------------------|--------|--------|----------|--------|----------|----------|--------|---------|
| Year to March | Q2FY13 | Q2FY12 | % change | Q1FY13 | % change | FY12 | FY13E | FY14E |
| Net revenue | 23,007 | 17,724 | 29.8 | 22,537 | 2.1 | 70,829 | 94,156 | 111,629 |
| EBITDA | 5,159 | 4,120 | 25.2 | 4,576 | 12.7 | 14,757 | 18,949 | 23,096 |
| Adj. net profit | 2,905 | 2,736 | 6.2 | 2,804 | 3.6 | 9,486 | 11,744 | 14,741 |
| Adj. dil EPS (INR) | 6.5 | 6.1 | | 6.3 | | 21.2 | 26.3 | 33.0 |
| Diluted P/E (x) | | | | | | 26.5 | 21.4 | 17.1 |
| EV/EBITDA (x) | | | | | | 17.5 | 13.7 | 11.0 |
| ROAE(%) | | | | | | 25.5 | 25.9 | 26.8 |

EDELWEISS 4D RATINGS

| | |
|--------------------------------|--------------|
| Absolute Rating | BUY |
| Rating Relative to Sector | Outperformer |
| Risk Rating Relative to Sector | Medium |
| Sector Relative to Market | Underweight |

MARKET DATA (R: LUPN.BO, B: LPC IN)

| | |
|------------------------------|--------------|
| CMP | : INR 563 |
| Target Price | : INR 642 |
| 52-week range (INR) | : 632 / 408 |
| Share in issue (mn) | : 447.2 |
| M cap (INR bn/USD mn) | : 252/ 4,675 |
| Avg. Daily Vol.BSE/NSE('000) | : 826.4 |

SHARE HOLDING PATTERN (%)

| | Current | Q1FY13 | Q4FY12 |
|-------------------|---------|--------|--------|
| Promoters* | 46.9 | 46.9 | 46.9 |
| MF's, FI's & BK's | 15.4 | 16.1 | 16.5 |
| FII's | 28.0 | 27.9 | 27.5 |
| Others | 9.7 | 9.1 | 9.0 |

* Promoters pledged shares : NIL
(% of share in issue)

PRICE PERFORMANCE (%)

| | Stock | Nifty | EW Pharma Index |
|-----------|-------|-------|-----------------|
| 1 month | (3.5) | 0.0 | (0.4) |
| 3 months | (1.3) | 11.2 | 11.3 |
| 12 months | 20.7 | 12.7 | 50.0 |

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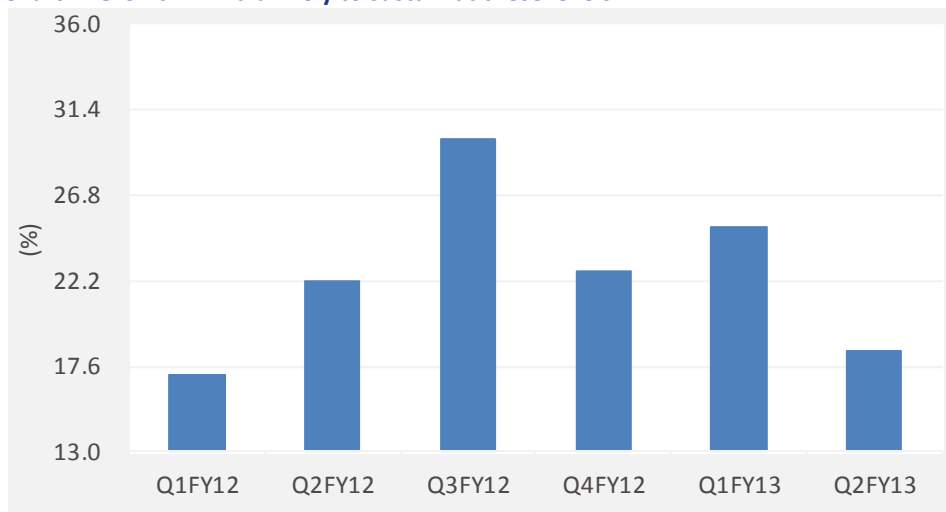
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All round performance on revenue front

Revenue at INR23bn grew 30%YoY, marginally higher than our estimate of INR22.6bn. Most of the segments depicted a strong growth momentum. Moreover, other operating income doubled to INR 614mn from INR346mn in Q1FY13.

India business grew by 18%YoY, higher than the industry growth of 9% (as per IMS) and 13.6% (as per AIOCD). While growth has been ahead of the industry, it has likely decelerated from 23-25% in last two quarters. This is due to lower growth in acute segment, which also impacted from a slowdown in the industry. However, increasing focus on chronic segments should continue to render an above market growth over the long term, as per the management which has guided for 18%-20% growth on a sustainable basis.

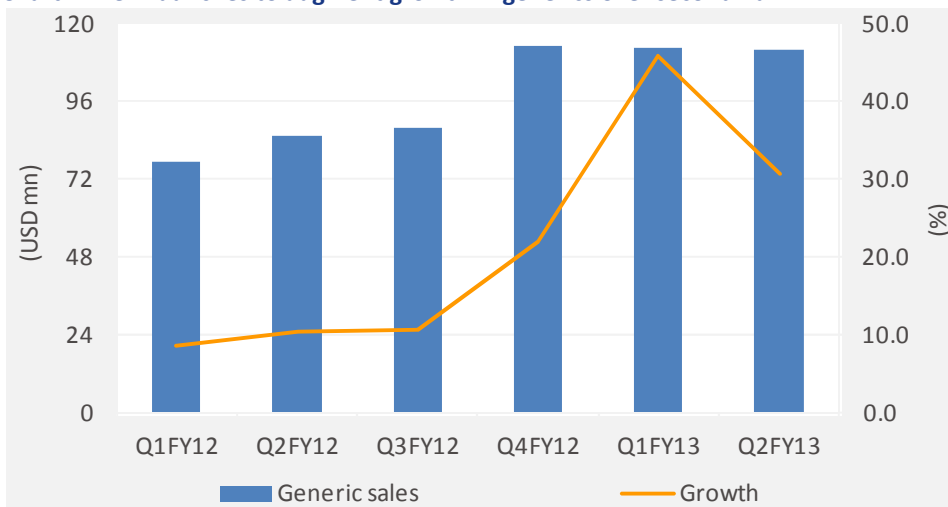
Chart 1: Growth in India likely to sustain at these levels



Source: Company, Edelweiss research

US business at USD144mn was flat QoQ as it grew by 19% YoY (constant currency growth). Generics grew by 31%YoY led by a continued traction in products launched over Q4FY12-Q1FY13. However, incremental approvals have slowed due to FDA inspection carried during the quarter. Lupin management maintains its guidance of 20 product launches over the year including certain high value launches such as OCs (6-7 products including Lutera, Seasonale, Yasmin among others), couple of controlled release products and Tricor (during FY13). Management expects new approvals to kick-in at a faster pace, as FDA inspection has been successfully completed at Indore SEZ.

Chart 2: New launches to augment growth in generics over second half



Source: Company, Edelweiss research

Table 1: Anticipated launches over next six months within US

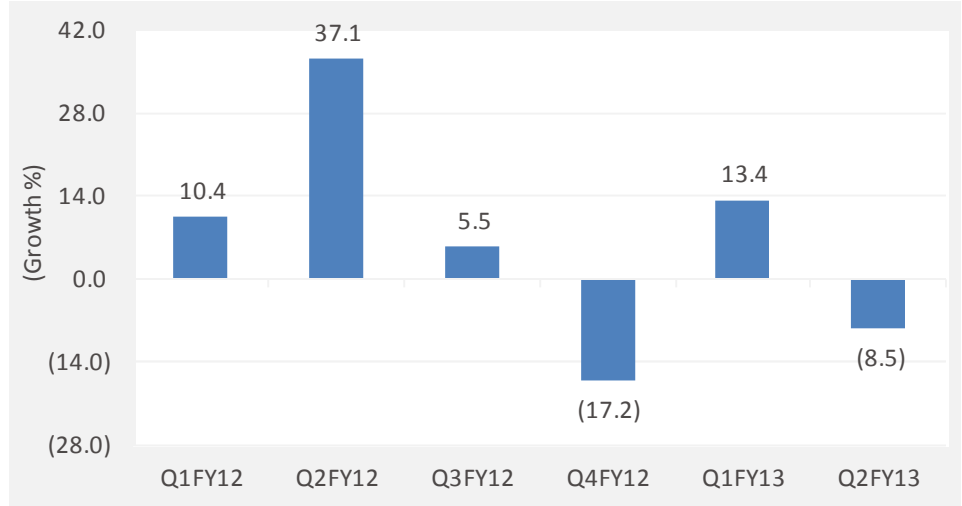
| Generic | Brand | FTF | Market size (USD mn) |
|--------------------------------------|---------------------|------|----------------------|
| Irbesartan | Avapro/Avalide | | 642 |
| Ciprofloxacin (suspension) | Cipro | Sole | 200 |
| Fenofibrate | Tricor (48/145 mg) | | 1,355 |
| Levonorgestrel and Ethinyl estradiol | Seasonique | | 64 |
| Ethinyl Estradiol And Drospirenone | Yasmin | | 96 |
| Armodafinil | Nuvigil | | 190 |
| Abacavir + lamivudine | Epzicom | | 325 |
| Valsartan & amlodipine | Exforge | | 284 |
| Desloratadine | Clarinx | | 203 |
| Pioglitazone | Actos | | 3,534 |
| Tolterodine | Detrol & Detrol LA | | 689 |
| Valsartan & Valsartan HCL | Diovan & Diovan HCT | | 2,520 |

Source: Company, Edelweiss research

US branded business at USD32mn has been down 15% QoQ and 8.5% YoY. Suprax growth has been stable with flat growth QoQ for suspension (2-3rd of the franchise) and 8% sequential growth in tablets. Management expects the base business growth in Suprax to improve from a strong flu season in H2FY13, better than the previous year. Incrementally, growth will also be augmented from launch of certain extensions such as chewable tablets (in process of launching), capsules and drops (expect approval over next six months).

Antara sales are to face some risk from Tricor as certain number of formularies would likely to push generics over branded. We highlight that we have taken a reduction in sales from the product to USD35mn from USD44mn in FY12.

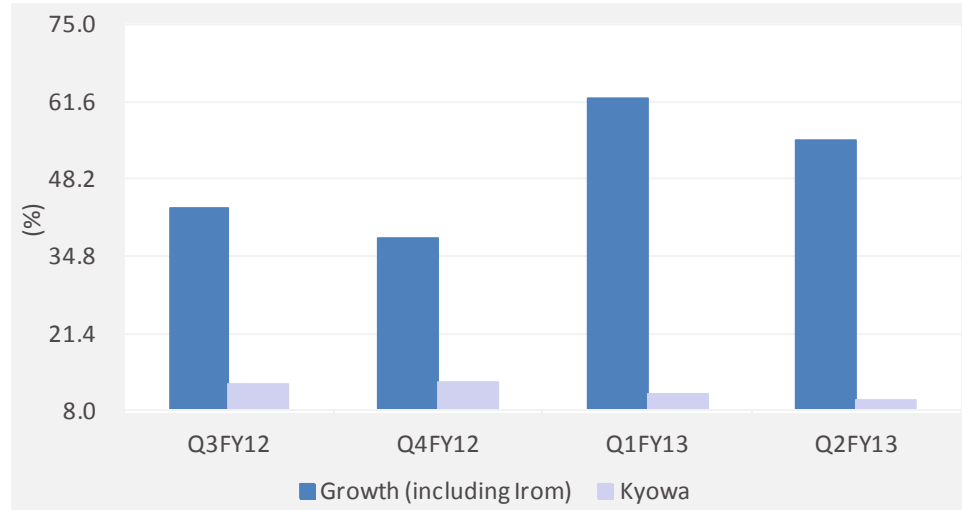
Chart 3: Strong seasonal growth in Suprax to benefit branded sales over second half



Source: Company, Edelweiss research

Japan business has been growing ahead of the market. Growth (including Irom) was 55% YoY (in constant currency) while Kyowa grew by 10% YoY during the same period. Japan, going forward, will see an improvement in margins from back-ended production.

Chart 4: Kyowa sales to pick-up from new launches going forward



Source: Company, Edelweiss research

ROW markets continue to grow at a strong double-digit (38%YoY) with 19% growth in Pharma Dynamics (South Africa) and a sharp growth in Australia from niche launches and brand development. Management has guided for a 22-25% growth in South Africa during the current fiscal with a considerable improvement over H2FY13.

Table 2: Revenue mix by segment – Consolidated

| | (INR mn) | | | | |
|--|---------------|---------------|-------------|---------------|------------|
| Year to March | Q2FY13 | Q2FY12 | % change | Q1FY13 | % change |
| Formulations | 20,001 | 14,472 | 38.2 | 19,875 | 0.6 |
| Domestic | 6,064 | 5,120 | 18.4 | 6,212 | (2.4) |
| US | 7,818 | 5,520 | 41.6 | 8,024 | (2.6) |
| - Branded | 1,737 | 1,601 | 8.5 | 2,006 | (13.4) |
| - Generics | 6,081 | 3,919 | 55.2 | 6,018 | 1.0 |
| EU | 626 | 461 | 35.8 | 473 | 32.3 |
| Japan | 3,301 | 1,780 | 85.4 | 3,329 | (0.8) |
| ROW | 2,192 | 1,591 | 37.8 | 1,837 | 19.3 |
| API | 2,392 | 1,976 | 21.1 | 2,317 | 3.2 |
| Net sales (excl - other operating income) | 22,393 | 16,448 | 36.1 | 22,192 | 0.9 |

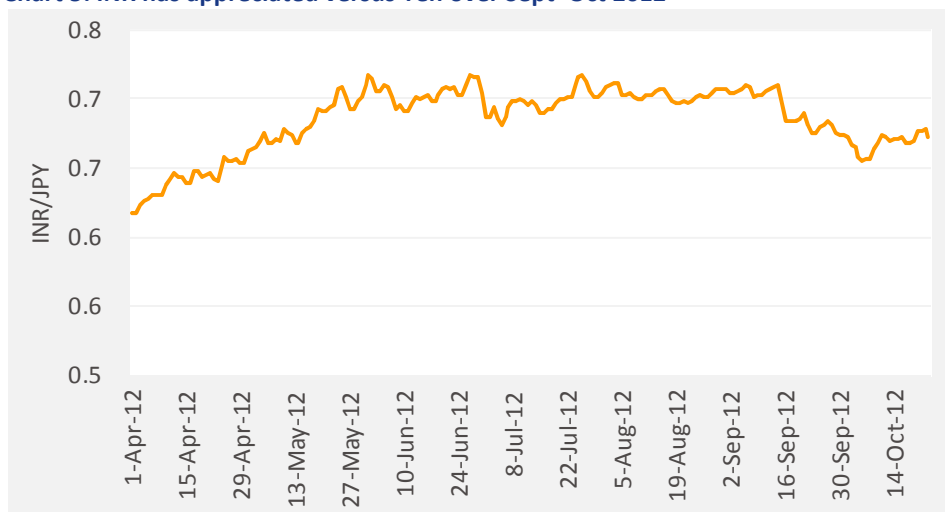
| | (INR mn) | | | | | |
|--|---------------|-------------|---------------|-------------|----------------|-------------|
| Year to March | FY12 | % change | FY13E | % change | FY14E | % change |
| Formulations | 60,477 | 24.8 | 82,773 | 36.9 | 99,184 | 19.8 |
| Domestic | 18,434 | 18.9 | 22,121 | 20.0 | 26,103 | 18.0 |
| US | 25,303 | 21.7 | 36,879 | 45.7 | 45,486 | 23.3 |
| - Branded | 7,085 | 14.2 | 8,704 | 22.8 | 8,955 | 2.9 |
| - Generics | 18,218 | 24.9 | 28,176 | 54.7 | 36,531 | 29.7 |
| EU | 1,975 | 9.2 | 2,469 | 25.0 | 3,086 | 25.0 |
| Japan | 8,607 | 38.6 | 13,915 | 61.7 | 15,863 | 14.0 |
| ROW | 6,158 | 48.4 | 7,390 | 20.0 | 8,646 | 17.0 |
| API | 8,491 | (1.1) | 9,170 | 8.0 | 9,904 | 8.0 |
| Net sales (excl - other operating income) | 69,077 | 20.3 | 93,319 | 35.1 | 110,669 | 18.6 |

Source: Company, Edelweiss research

Multiple levers for margin expansion

Lupin EBITDA margins (excluding other operating income) improved by 123bps QoQ and 286bps YoY. However, the margin improvement was partly aided by lower R&D costs (-48% QoQ) that went down from INR1.78bn in Q1FY13 to INR935m during Q2FY13. This benefit was offset from forex losses of INR250mn primarily from transitional losses in Japan, as average INR realizations versus JPY (yen) has appreciated by 3% QoQ (see chart below).

Chart 5: INR has appreciated versus Yen over Sept–Oct 2012



Source: Edelweiss research

Adjusted for the R&D benefit and forex losses, the margins were 18.6% marginally lower than 19.1% in Q1FY13 (which also includes some benefit from hedging gain from Japanese operations). We have tried to estimate the normalized margins for the quarter; by assuming 7% R&D costs (versus 4% of sales in current quarter) and have reduced the impact of forex loss of INR250mn from material and other expenses (see table below).

Table 3: Proforma margins for Q2FY13

| | Q2FY13 | Q2FY12 | YoY (bps) | Q1FY13 | QoQ (bps) |
|-------------------------------------|--------|--------|-----------|--------|-----------|
| Sales (excl other operating income) | 22,393 | 16,477 | | 22,192 | |
| Material costs | 8,898 | 5,979 | | 8,187 | |
| Gross margins | 60.3 | 63.7 | | 63.1 | |
| R&D costs | 935 | 1,380 | | 1,782 | |
| % of sales | 4.2 | 8.4 | (419.9) | 8.0 | (385.5) |
| Other expenses | 8,015 | 6,245 | | 7,992 | |
| Reported EBITDA (core) | 4,545 | 2,873 | | 4,230 | |
| margin (%) | 20.3 | 17.4 | 286.0 | 19.1 | 123.4 |

Proforma for R&D costs and forex loss during Q2FY13

| | | | | | |
|------------------------------|--------------|--------------|--------------|--------------|---------------|
| EBITDA (pre R&D costs) | 5,480 | 4,253 | | 6,013 | |
| Less: R&D costs | 1,567 | 1,380 | | 1,782 | |
| % of sales | 7.0 | 8.4 | (137.5) | 8.0 | (103.1) |
| Add/Less: Forex loss (gain) | 250 | | | | |
| Adjusted EBITDA | 4,163 | 2,873 | | 4,230 | |
| Normalized margin (%) | 18.6 | 17.4 | 115.2 | 19.1 | (47.4) |

Source: Edelweiss research

Note: R&D costs for proforma numbers is estimated at 7% of sales

We believe that company has build significant fixed costs with increased investments, ahead of the curve. These include a) ramp-up of Indore SEZ, b) strong pipeline of niche products in US (25-30 ANDA filing each year) and related litigation costs and c) brand building in branded generics markets of India, South Africa and Australia. Incrementally the integration of Irom in Japan has further put pressure on the margins. Japan now constitutes 15% of business with relatively lower margins.

Given, the incremental product launches over next few years across regions, the margin benefit will flow from higher operating leverage. Management has guided for 100 bps core margin improvement in FY13 and overall 300bps over FY13-15E.

Financial snapshot

(INR mn)

| Year to March | Q2FY13 | Q2FY12 | % Change | Q1FY13 | % Change | FY12 | FY13E | FY14E |
|--------------------------------------|--------|--------|----------|--------|----------|--------|--------|---------|
| Net revenues | 23,007 | 17,724 | 29.8 | 22,537 | 2.1 | 70,829 | 94,156 | 111,629 |
| Operating income | 614 | 1,247 | (50.8) | 346 | 77.6 | 2,172 | 1,307 | 1,514 |
| Net revenues (excl tech income) | 22,393 | 16,477 | 35.9 | 22,192 | 0.9 | 68,657 | 92,849 | 110,115 |
| Raw material costs | 8,898 | 5,979 | 48.8 | 8,187 | 8.7 | 25,809 | 36,025 | 44,376 |
| Staff costs | 3,000 | 2,276 | 31.8 | 3,014 | (0.4) | 9,695 | 12,999 | 13,875 |
| Gross profit | 14,109 | 11,745 | 20.1 | 14,350 | (1.7) | 45,020 | 58,131 | 67,252 |
| SG&A | 5,014 | 3,969 | 26.3 | 4,978 | 0.7 | 15,339 | 19,127 | 21,913 |
| R&D | 935 | 1,380 | (32.2) | 1,782 | (47.5) | 5,228 | 7,056 | 8,369 |
| Total expenditure | 8,950 | 7,625 | 17.4 | 9,774 | (8.4) | 30,263 | 39,182 | 44,156 |
| EBITDA | 5,159 | 4,120 | 25.2 | 4,576 | 12.7 | 14,757 | 18,949 | 23,096 |
| Operating margin (%) | 22.4 | 23.2 | | 20.3 | | 20.8 | 20.1 | 20.7 |
| EBITDA margin - excl tech income (%) | 20.3 | 17.4 | | 19.1 | | 18.3 | 19.0 | 19.6 |
| Depreciation | 690 | 522 | 32.2 | 654 | 5.6 | 2,275 | 2,631 | 2,554 |
| Other income | 43 | 16 | 166.7 | 236 | (81.7) | 144 | 158 | 264 |
| Interest | 101 | 66 | 51.5 | 101 | 0.0 | 355 | 399 | 354 |
| Profit before tax | 4,412 | 3,548 | 24.3 | 4,058 | 8.7 | 12,271 | 16,076 | 20,451 |
| Tax | 1,438 | 751 | 91.6 | 1,208 | 19.1 | 2,522 | 4,019 | 5,317 |
| Core profit | 2,974 | 2,798 | 6.3 | 2,850 | 4.3 | 9,749 | 12,057 | 15,134 |
| Extraordinary items | | (80) | (100.0) | | | (873) | | |
| Minority interest | (69) | (49) | NA | (46) | NA | (199) | (313) | (393) |
| Net profit | 2,905 | 2,669 | 8.8 | 2,804 | 3.6 | 8,677 | 11,744 | 14,741 |
| Net profit | 2,905 | 2,736 | 6.2 | 2,804 | 3.6 | 9,486 | 11,744 | 14,741 |

As % of net revenues

| | | | | | | | | |
|---------------------|------|------|--|------|--|------|------|------|
| COGS | 38.7 | 33.7 | | 36.3 | | 36.4 | 38.3 | 39.8 |
| Gross profit | 61.3 | 66.3 | | 63.7 | | 63.6 | 61.7 | 60.2 |
| Employee cost | 13.0 | 12.8 | | 13.4 | | 13.7 | 13.8 | 12.4 |
| SG&A | 21.8 | 22.4 | | 22.1 | | 21.7 | 20.3 | 19.6 |
| R&D | 4.1 | 7.8 | | 7.9 | | 7.4 | 7.5 | 7.5 |
| Total expenses | 38.9 | 43.0 | | 43.4 | | 42.7 | 41.6 | 39.6 |
| EBITDA | 22.4 | 23.2 | | 20.3 | | 20.8 | 20.1 | 20.7 |
| Reported net profit | 12.9 | 15.8 | | 12.6 | | 13.8 | 12.8 | 13.6 |
| Tax rate | 32.6 | 21.2 | | 29.8 | | 20.6 | 25.0 | 26.0 |

Company description

Promoted by Dr. Desh Bandhu Gupta, a first generation entrepreneur, Lupin Pharmaceuticals (LPC) is India's fifth largest company by domestic sales. LPC's revenues and profits (ex IP related revenues) have posted 29% and 40% CAGR in FY06-10, to INR 49 bn and INR 6.8 bn in FY10, respectively. LPC's domestic formulations contribute 28% to total FY10 revenues and have posted 22% CAGR in FY06-10, to INR 13.3 bn in FY10. With a market share of ~2.8%, LPC is the tenth largest player in the domestic market with six products in the top 300 pharma brands in the country. LPC's export sales have posted 39% CAGR during FY06-10, growing to INR 32 bn in FY10. US formulations contributed 35% to total sales, with Japan and Europe formulations contributing 14% to FY10 sales.

Investment theme

We expect LPC's total sales to grow at 25% CAGR between FY12-14E led by strong growth in US generics business over FY12-15E primarily exclusive product launches (expect to launch 120 products over next 3-4 years). Domestic business is expected to grow at 19%Y-o-Y. Net profits are expected to grow at 24% CAGR over FY14. LPC's regulated branded formulation play reduces volatility in US operations while Kyowa acquisition provides it a strategic foothold in crucial Japanese market. Management expects to target potential acquisition opportunities in high growth emerging markets like Brazil and Mexico which will give kick start to non regulated markets sales and also would continue to look for potential brand acquisitions in US branded formulation space.

Key risks

Price erosion from changing competitive dynamics in US.Slowdown in domestic formulation market.

Financial Statements

Key assumptions

| | FY10 | FY11 | FY12 | FY13E | FY14E |
|---|------|------|------|-------|-------|
| Macro - GDP (Y-o-Y %) | 8.4 | 8.4 | 6.5 | 5.8 | 6.5 |
| Inflation (Avg) | 3.6 | 9.9 | 8.8 | 7.8 | 6.0 |
| Repo rate (exit rate) | 5.0 | 6.8 | 8.5 | 7.5 | 6.8 |
| USD/INR (Avg) | 47.4 | 45.6 | 47.9 | 53.5 | 52.0 |
| Sector - Domestic growth (Y-o-Y %) | 13.3 | 14.2 | 16.0 | 16.5 | 15.0 |
| Company - India growth (Y-o-Y %) | 18.3 | 20.0 | 18.9 | 20.0 | 18.0 |
| Suprax sales (USD mn) | 66.0 | 85.0 | 94.0 | 100.0 | 95.0 |
| US generics growth Y-o-Y % (Const. curr) | 21.4 | 35.5 | 11.0 | 42.3 | 25.6 |
| R&D (% of sales) | 7.3 | 8.5 | 7.6 | 7.6 | 7.6 |
| Tax rate (%) | 16.3 | 12.0 | 22.1 | 25.0 | 26.0 |
| USD/INR (Avg) | 46.7 | 45.6 | 48.0 | 51.5 | 50.0 |

Income statement

| | (INR mn) | | | | |
|---|----------|--------|--------|--------|---------|
| Year to March | FY10 | FY11 | FY12 | FY13E | FY14E |
| Income from operations | 48,359 | 58,195 | 70,829 | 94,156 | 111,629 |
| Materials cost | 19,694 | 22,379 | 25,809 | 36,025 | 44,376 |
| Employee cost | 5,872 | 7,677 | 9,695 | 12,999 | 13,875 |
| R&D cost | 3,438 | 4,834 | 5,228 | 7,056 | 8,369 |
| Selling, admin and general expenses | 9,627 | 11,519 | 15,339 | 19,127 | 21,913 |
| EBITDA | 9,728 | 11,786 | 14,757 | 18,949 | 23,096 |
| Depreciation and amortisation | 1,239 | 1,712 | 2,275 | 2,631 | 2,554 |
| EBIT | 8,489 | 10,074 | 12,482 | 16,318 | 20,542 |
| Interest expense/(income) | 385 | 325 | 355 | 399 | 354 |
| Other income (incl. forex gain/(loss)) | 282 | 214 | 144 | 158 | 264 |
| Profit before tax | 8,386 | 9,963 | 12,271 | 16,076 | 20,451 |
| Provision for tax | 1,360 | 1,169 | 2,522 | 4,019 | 5,317 |
| Core profit | 7,026 | 8,794 | 9,749 | 12,057 | 15,134 |
| Minority interest & others | 180 | 168 | 199 | 313 | 393 |
| Reported profit after minority interest | 6,816 | 8,626 | 8,677 | 11,744 | 14,741 |
| Adjusted PAT after Minority interest | 6,841 | 8,626 | 9,486 | 11,744 | 14,741 |
| Adjusted EPS (INR) diluted | 15.4 | 19.3 | 21.2 | 26.3 | 33.0 |
| CEPS (INR) | 18.2 | 23.2 | 26.5 | 32.2 | 38.7 |
| Dividend per share (INR) | 2.9 | 3.2 | 3.5 | 4.5 | 5.2 |

Common size metrics- as % of net revenues

| Year to March | FY10 | FY11 | FY12 | FY13E | FY14E |
|--------------------|------|------|------|-------|-------|
| Cost of revenues | 40.7 | 38.5 | 36.4 | 38.3 | 39.8 |
| R & D cost | 7.1 | 8.3 | 7.4 | 7.5 | 7.5 |
| EBITDA margins | 20.1 | 20.3 | 20.8 | 20.1 | 20.7 |
| Net profit margins | 14.8 | 15.4 | 14.2 | 13.0 | 13.7 |

Growth metrics (%)

| Year to March | FY10 | FY11 | FY12 | FY13E | FY14E |
|---------------|------|------|------|-------|-------|
| Revenues | 25.5 | 20.3 | 21.7 | 32.9 | 18.6 |
| EBITDA | 29.0 | 21.1 | 25.2 | 28.4 | 21.9 |
| Net profit | 30.8 | 25.2 | 10.9 | 23.7 | 25.5 |
| PBT | 32.0 | 18.8 | 23.2 | 31.0 | 27.2 |
| Adjusted EPS | 21.0 | 25.7 | 9.9 | 23.8 | 25.5 |

| Balance sheet | | | | | |
|--|---------------|---------------|---------------|---------------|---------------|
| (INR mn) | | | | | |
| As on 31st March | FY10 | FY11 | FY12 | FY13E | FY14E |
| Equity capital | 889 | 892 | 893 | 893 | 893 |
| Reserves & surplus | 24,789 | 31,918 | 40,638 | 48,154 | 60,175 |
| Common shareholders equity | 25,678 | 32,811 | 41,532 | 49,048 | 61,069 |
| Total Shareholders Funds | 25,678 | 32,811 | 41,532 | 49,048 | 61,069 |
| Borrowings | 11,399 | 11,624 | 14,809 | 13,309 | 11,809 |
| Deferred tax liability (net) | 1,435 | 1,411 | 1,442 | 1,442 | 1,442 |
| Minority interest | 255 | 515 | 723 | 1,036 | 1,430 |
| Sources of funds | 38,767 | 46,361 | 58,505 | 64,835 | 75,749 |
| Gross block | 22,937 | 26,389 | 31,486 | 36,986 | 42,986 |
| Depreciation | 7,072 | 9,075 | 10,829 | 12,834 | 14,713 |
| Net block | 15,865 | 17,313 | 20,657 | 24,151 | 28,272 |
| Capital work in progress | 3,579 | 5,312 | 6,237 | 5,312 | 5,312 |
| Intangible assets & Goodwill | 3,197 | 3,255 | 5,040 | 5,040 | 5,040 |
| Investments | 264 | 32 | 3,967 | 3,967 | 3,967 |
| Inventories | 9,715 | 12,000 | 17,327 | 21,355 | 24,225 |
| Sundry debtors | 11,266 | 12,558 | 17,318 | 21,355 | 24,225 |
| Cash and bank balances | 2,015 | 4,201 | 4,025 | 2,775 | 7,137 |
| Loans and advances | 4,759 | 6,208 | 4,302 | 6,499 | 7,708 |
| Total current assets | 27,755 | 34,967 | 42,972 | 51,985 | 63,296 |
| Current liabilities | 9,649 | 11,800 | 17,750 | 22,742 | 26,971 |
| Provisions | 2,243 | 2,718 | 2,617 | 2,879 | 3,167 |
| Total current liabilities and provisions | 11,893 | 14,518 | 20,367 | 25,621 | 30,138 |
| Net current assets | 15,862 | 20,449 | 22,605 | 26,365 | 33,158 |
| Uses of funds | 38,767 | 46,361 | 58,505 | 64,835 | 75,749 |
| Book value per share (INR) | 58 | 74 | 93 | 110 | 137 |

| Free cash flow | | | | | |
|-----------------------|----------------|--------------|--------------|--------------|--------------|
| Year to March | FY10 | FY11 | FY12 | FY13E | FY14E |
| Net profit | 7,026 | 8,794 | 9,749 | 12,057 | 15,134 |
| Depreciation | 1,239 | 1,712 | 2,275 | 2,631 | 2,554 |
| Others | 221 | (27) | (873) | 0 | - |
| Gross cash flow | 8,486 | 10,479 | 11,150 | 14,688 | 17,688 |
| Less:Changes in WC | 4,478 | 2,401 | 2,332 | 5,009 | 2,432 |
| Operating cash flow | 4,009 | 8,078 | 8,818 | 9,679 | 15,256 |
| Less: Capex | 6,431 | 4,894 | 6,543 | 5,200 | 6,675 |
| Free cash flow | (2,422) | 3,184 | 2,275 | 4,478 | 8,581 |

| Cash flow metrics | | | | | |
|--------------------------|-------------|-------------|-------------|--------------|--------------|
| Year to March | FY10 | FY11 | FY12 | FY13E | FY14E |
| Operating cash flow | 4,009 | 8,078 | 8,818 | 9,679 | 15,256 |
| Financing cash flow | 3,780 | (1,267) | 3,229 | (5,728) | (4,220) |
| Investing cash flow | (6,503) | (4,719) | (12,264) | (5,200) | (6,675) |
| Net cash flow | 1,285 | 2,091 | (217) | (1,249) | 4,361 |
| Capex | (6,431) | (4,894) | (6,543) | (5,200) | (6,675) |
| Dividends paid | (1,483) | (1,658) | (1,831) | (2,354) | (2,720) |

Profitability and liquidity ratios

| Year to March | FY10 | FY11 | FY12 | FY13E | FY14E |
|------------------------|------|------|------|-------|-------|
| ROAE (%) | 34.3 | 29.5 | 25.5 | 25.9 | 26.8 |
| ROACE (%) | 26.8 | 25.6 | 26.9 | 30.0 | 33.5 |
| Inventory days | 176 | 175 | 205 | 193 | 185 |
| Debtors days | 76 | 74 | 76 | 74 | 73 |
| Payable days | 183 | 173 | 206 | 202 | 202 |
| Cash conversion cycles | 70 | 76 | 74 | 65 | 57 |
| Current ratio | 2.3 | 2.4 | 2.1 | 2.0 | 2.1 |
| Debt/ EBITDA | 1.2 | 1.0 | 1.0 | 0.7 | 0.5 |
| Debt/equity | 0.4 | 0.4 | 0.4 | 0.3 | 0.2 |
| Adjusted debt/Equity | 0.4 | 0.4 | 0.4 | 0.3 | 0.2 |

Operating ratios (x)

| Year to March | FY10 | FY11 | FY12 | FY13E | FY14E |
|----------------------|------|------|------|-------|-------|
| Total asset turnover | 1.4 | 1.3 | 1.3 | 1.5 | 1.6 |
| Fixed asset turnover | 3.4 | 3.4 | 3.6 | 4.1 | 4.2 |
| Equity turnover | 2.4 | 2.0 | 1.8 | 2.1 | 2.0 |

Valuation parameters

| Year to March | FY10 | FY11 | FY12 | FY13E | FY14E |
|------------------------|------|------|------|-------|-------|
| Adj. diluted EPS (INR) | 15.4 | 19.3 | 21.2 | 26.3 | 33.0 |
| EPS YoY growth (%) | 21.0 | 25.7 | 9.9 | 23.8 | 25.5 |
| CEPS (INR) | 18.2 | 23.2 | 26.5 | 32.2 | 38.7 |
| Diluted PE (x) | 36.6 | 29.1 | 26.5 | 21.4 | 17.1 |
| Price/BV(x) | 9.7 | 7.7 | 6.1 | 5.1 | 4.1 |
| EV/Sales (x) | 5.4 | 4.5 | 3.7 | 2.8 | 2.3 |
| EV/EBITDA (x) | 26.7 | 22.0 | 17.5 | 13.7 | 11.0 |
| Dividend yield (%) | 0.5 | 0.6 | 0.6 | 0.8 | 0.9 |

Peer comparison valuation

| | Price INR | Market cap (INR bn) | EPS (INR) | | P/E (x) | | EV/EBITDA (x) | | ROAE (%) | |
|------------------|--------------|------------------------|-----------|-------|-------------|-------------|---------------|-------------|----------|-------|
| | | | FY13E | FY14E | FY13E | FY14E | FY13E | FY14E | FY13E | FY14E |
| Sun Pharma | 699 | 723 | 26.6 | 30.3 | 25.6 | 22.5 | 13.9 | 14.4 | 26.2 | 21.3 |
| Cipla | 365 | 293 | 18.5 | 20.6 | 19.8 | 17.7 | 13.2 | 11.6 | 18.1 | 17.7 |
| Ranbaxy | 540 | 228 | 14.3 | 19.5 | 33.7 | 24.7 | 9.7 | 13.3 | 52.0 | 25.6 |
| Cadila | 864 | 177 | 38.2 | 47.6 | 22.6 | 18.2 | 14.7 | 12.0 | 27.1 | 27.1 |
| Dr. Reddy's | 1,731 | 294 | 89.0 | 98.1 | 19.0 | 17.2 | 11.0 | 9.8 | 26.6 | 23.4 |
| Lupin | 570 | 255 | 26.3 | 33.0 | 21.7 | 17.3 | 13.8 | 11.1 | 25.9 | 26.8 |
| Large Cap | | | | | 23.7 | 19.6 | 12.7 | 12.0 | | |
| Glenmark | 396 | 107 | 19.9 | 24.6 | 18.4 | 14.9 | 12.8 | 10.7 | 23.4 | 22.5 |
| Torrent pharma | 683 | 58 | 49.5 | 59.0 | 13.8 | 11.6 | 9.0 | 7.4 | 31.0 | 29.5 |
| IPCA | 463 | 56 | 32.8 | 41.6 | 14.1 | 11.1 | 9.0 | 7.2 | 28.4 | 30.9 |
| Aurobindo | 160 | 38 | 11.9 | 17.0 | 13.5 | 9.4 | 8.5 | 6.3 | 13.7 | 17.0 |
| Overall | | | | | 16.7 | 13.3 | 10.4 | 8.7 | | |

Source: Edelweiss research

| Company | Absolute reco | Relative reco | Relative risk | Company | Absolute reco | Relative reco | Relative Risk |
|-----------------------------|---------------|---------------|---------------|--------------------------------|---------------|---------------|---------------|
| Apollo Hospitals Enterprise | BUY | None | None | Aurobindo Pharma | BUY | SP | H |
| Cadila Healthcare | BUY | SO | L | Cipla | BUY | SO | L |
| Divi's Laboratories | BUY | SP | M | Dr.Reddys Laboratories | HOLD | SP | M |
| Glenmark Pharmaceuticals | BUY | SO | H | Ipca Laboratories | BUY | SO | L |
| Jubilant Life Sciences | BUY | SP | M | Lupin | BUY | SO | M |
| Ranbaxy Laboratories | REDUCE | SU | H | Sun Pharmaceuticals Industries | HOLD | SO | L |
| Torrent Pharmaceuticals | BUY | SO | H | | | | |

ABSOLUTE RATING

| Ratings | Expected absolute returns over 12 months |
|---------|--|
| Buy | More than 15% |
| Hold | Between 15% and - 5% |
| Reduce | Less than -5% |

RELATIVE RETURNS RATING

| Ratings | Criteria |
|----------------------------|-------------------------------------|
| Sector Outperformer (SO) | Stock return > 1.25 x Sector return |
| Sector Performer (SP) | Stock return > 0.75 x Sector return |
| | Stock return < 1.25 x Sector return |
| Sector Underperformer (SU) | Stock return < 0.75 x Sector return |

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

| Ratings | Criteria |
|------------|---------------------------------------|
| Low (L) | Bottom 1/3rd percentile in the sector |
| Medium (M) | Middle 1/3rd percentile in the sector |
| High (H) | Top 1/3rd percentile in the sector |

Risk ratings are based on Edelweiss risk model

SECTOR RATING

| Ratings | Criteria |
|------------------|-------------------------------------|
| Overweight (OW) | Sector return > 1.25 x Nifty return |
| Equalweight (EW) | Sector return > 0.75 x Nifty return |
| | Sector return < 1.25 x Nifty return |
| Underweight (UW) | Sector return < 0.75 x Nifty return |

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Coverage group(s) of stocks by primary analyst(s): Pharmaceuticals

Apollo Hospitals Enterprise, Aurobindo Pharma, Cadila Healthcare, Cipla, Divi's Laboratories, Dr.Reddys Laboratories, Glenmark Pharmaceuticals, Ipca Laboratories, Jubilant Life Sciences, Lupin, Ranbaxy Laboratories, Sun Pharmaceuticals Industries, Torrent Pharmaceuticals

Recent Research

| Date | Company | Title | Price (INR) | Recos |
|-----------|--------------------------------|--|-------------|-------|
| 23-Oct-12 | Dr Reddy's Laboratories | OctoPlus acquisition to augment R&D capabilities; <i>Event Update</i> | 1,729 | Hold |
| 22-Oct-12 | Pharma | Domestic Pharma Monthly Review; <i>Monthly Update</i> | | |
| 18-Oct-12 | Sun Pharma | J&J's renewed Doxil supplies cloud Sun in US; <i>EdelFlash</i> | 712 | Hold |

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

| | Buy | Hold | Reduce | Total |
|-------------------------|--------|------------------------|--------|-------|
| Rating Distribution* | 113 | 53 | 19 | 186 |
| * 1 stocks under review | | | | |
| | > 50bn | Between 10bn and 50 bn | < 10bn | |
| Market Cap (INR) | 114 | 58 | 14 | |

Rating Interpretation

| Rating | Expected to |
|---------------|---|
| Buy | appreciate more than 15% over a 12-month period |
| Hold | appreciate up to 15% over a 12-month period |
| Reduce | depreciate more than 5% over a 12-month period |

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