Initiation of Coverage

Indian Pharma Sector
Growth intact, quality improving, rerating ahead

Equities

India
Pharmaceuticals

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Earnings quality improvement not priced in; we see rerating ahead

We expect a strong performance by the Indian pharma sector over FY15-17E based on a strengthening presence in the US generics market and upside potential from M&As. Over the past five years, the sector's performance has largely been driven by earnings growth and marginally higher PE multiples. Improvement in earnings quality (ie, better cash flows) is not yet reflected, in our view, with pharma stocks trading at a five-year average on price-to-cash flow. We assume coverage of the sector and estimate a 21% net profit CAGR for our coverage universe over FY15-17 with potential for earnings surprises. We initiate coverage of Lupin, Torrent and Cadila with Buy and of Cipla and IPCA with Neutral ratings; Lupin, Sun Pharma and Dr Reddy's are our preferred picks.

Indian pharma well-placed to take a larger slice of the US generics pie

We expect US generics to be the fastest growing as well as the most profitable segment for leading Indian pharma companies over FY15-17. We estimate US$79bn of patent expirations over the next four years and expect India pharma companies to gain market share from new launches. We forecast a 15-19% CAGR in US generics revenue for leading India pharma companies over FY15-17. Proprietary products and biosimilars could add to the opportunity. We expect steady growth prospects in emerging markets, led by improving affordability, although currency volatility could impact growth in the near term.

Large pharmas to gain from channel consolidation; negative for small firms

Pharmacy benefit managers (PBMs) have strengthened their bargaining power in the US. We expect PBMs to drive penetration of complex segments, which could benefit large India pharma companies like Cipla in the inhalational segment and Dr Reddy's in biosimilars. At the same time, PBMs are likely to cut prices of multi-source generics, which may be negative for small generic companies.

M&A could enhance competitiveness and add to growth

Rising free cash flows should allow pharma companies to enhance scale and fill in gaps in their coverage of the US complex generic segment. We believe India pharma companies will improve their competitive positions in the US via M&A. We note that Sun Pharma's acquisitions have contributed c10% of the 30% sales CAGR over the past five years along with an 8% expansion in RoIC during this period.

India pharma sector valuations (in order of preference)

	Price	Market cap	Rating		Price target			EPS (Rs) FY17E		PE (x)	EPS CAGR	ROIC (%)	EV/IC (x)	P/CF (x)
	(Rs)	(US$ m)	Old	New	Old	New	Upside	Old	New	FY17E	FY15-17E	FY17E	FY17E	FY17E
Lupin	1,503	10,854	Not Rated	Buy	N/A	1,825	21%	N/A	75.8	19.6	19%	60%	8.1	15.3
Sun	918	30,820	Buy	Buy	980	1,100	20%	43.7	42.1	21.1	17%	65%	10.9	19.1
Dr Reddy's	3,361	9,265	Buy	Buy	4,000	4,000	19%	193.3	179.8	18.5	19%	31%	4.7	14.8
Torrent	1,148	3,148	Not Rated	Buy	N/A	1,425	24%	N/A	67.7	16.6	23%	35%	4.3	12.5
Cadila	1,638	5,433	Not Rated	Buy	N/A	2,040	25%	N/A	89.1	18.5	30%	31%	4.4	20.0
Glenmark	745	3,274	Buy	Buy	920	900	21%	53.3	50.0	14.7	40%	26%	2.9	16.5
Cipla	654	8,511	Not Rated	Neutral	N/A	725	11%	N/A	26.8	24.0	26%	30%	5.3	25.0
IPCA	699	1,429	Not Rated	Neutral	N/A	810	16%	N/A	50.3	14.0	24%	27%	2.9	9.4
Sector										20.0	21%	49%	7.7	18.2

Note: Prices as of 22 January 2015. Source: Reuters, UBS estimates

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We would like to thank Aditya Sharma, an employee of Cognizant Group, for his assistance in preparing this research report. Cognizant staff provide research support services to UBS.

Executive summary

Indian firms well-placed to take a larger slice of the US generics market

The US could be the fastest growing segment for Indian pharma companies

Major India pharma companies derived 40-60% of total revenues in FY14 from the US generics segment, making it their most important market. We expect the US generics market to be the fastest growing as well as the most profitable segment for leading Indian pharma companies over FY15-17. We believe India companies will grow earnings from new product launches (as patents expire) and a higher penetration in products that are already generic. We expect the value of patent expirations to be nearly flat at US$79bn over the next four years versus US$81bn over the past four years. Indian firms should have a higher share of new approvals based on an increase in product applications (Abbreviated New Drug Applications [ANDA]) filed in previous years. We forecast a 15-19% CAGR in US generics revenue for leading India pharma companies over FY15-17.

Margins expected to expand based on a rise in the proportion of revenue from the complex product segment

In recent years, many of the product filings by large Indian pharma firms have been for complex generic products. As the complex product segment has limited competition, an increase in the proportion of revenue from this segment should lead to margin expansion for Indian pharma firms over the next two years. In addition, we assume an Rs62/US$1 exchange rate, and rupee weakness would result in an improvement in realisations and vice versa.

Strong opportunity in complex segments, specifically injectables

Within complex products, we see a strong opportunity for Indian generic companies to grow from injectable launches, as US$16bn of injectable product patents will expire in the US over the next four years. Sales in the US injectable generic market are US$7.6bn and we expect the segment to grow faster than orals and other generic categories. In addition, pricing dynamics in this segment have improved due to frequent supply disruptions (accounting for over half of total products in short supply in the IS) over the past 10 years. We note that rising product prices have strongly benefited the manufacturers.

Modest growth expected from emerging market, including India

The fast growth of the US market has dwarfed the proportion of business derived from branded generic emerging markets. While emerging markets (EMs) offer steady growth, we do not view them as major drivers of stock performance. We believe Cipla, Glenmark, Lupin and Sun Pharma are well-positioned in branded markets, especially India. Currency fluctuations in EMs (excluding India) could pose a risk to growth in the near term for companies like Cipla, Dr Reddy's, Glenmark and IPCA Laboratories (IPCA) that have reasonable exposure to EMs.

Large pharma companies to benefit from channel consolidation

Over the past three years, there have been a number of big-ticket M&As among pharmacy benefit managers (PBMs) in the US. This has resulted in higher bargaining power for PBMs vis-à-vis manufacturers. In the case of single source products (patented products), PBMs have started to exclude expensive products (brand exclusion) and have opted for cheaper alternatives. In the case of multi-source products (generics), PBMs have attempted to drive down prices.

We believe large generic companies have gained an edge over smaller generic companies in the US generics space due to channel consolidation. Large firms benefit on two counts. Firstly, they have been working on complex segments like inhalational and biosimilars (copies of biologics) where we believe large PBMs could drive penetration versus the brands. We expect large pharma companies like Cipla and Dr Reddy's, who could be in a position to launch such products, to benefit. Secondly, large firms derive a higher proportion of revenues from complex generics where the number of manufacturers/suppliers is limited. Hence, PBMs would not be able to force down prices, in our view.

M&A could enhance competitiveness and add to growth

M&A likely to enhance competitive positions in the US generics market, in our view

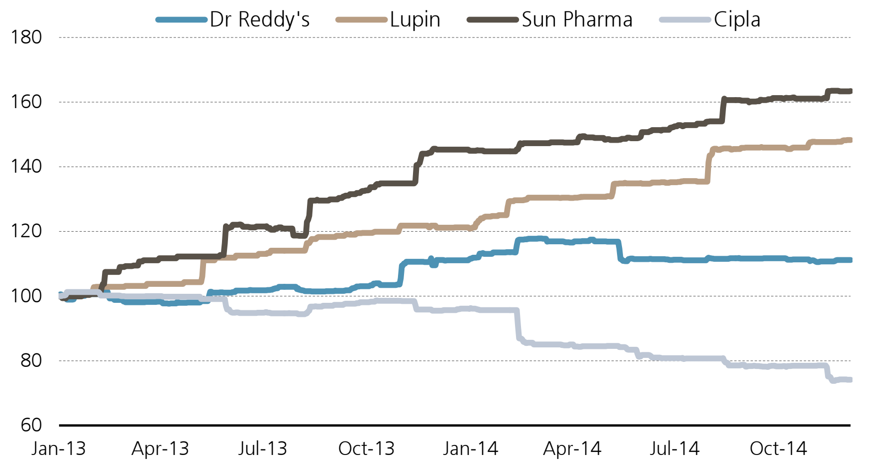
With rising scale and profitability, Indian pharma companies are generating strong free cash flows. Most of the companies have begun to deploy cash flow generated into buying R&D assets. This is likely to enhance their competitive position in the US generics market, in our view. We note the strong benefit of R&D asset acquisitions for Sun Pharma, which contributed c10% of the 30% sales CAGR recorded over the past five years. The acquisitions were also value-accretive as reflected by the 8% expansion of the company's RoIC during this period.

Earnings quality improvement not yet priced in

Earnings growth remains strong; RoIC to improve for most companies, in our view

We note that the India pharma sector performance has largely been led by earnings growth over the past five years. Consensus estimates for most of the leading Indian pharma companies have moved up over the past two years due to limited launches in the US generics market. We believe there is further upgrade potential for most of the leading Indian pharmaceutical companies and we expect sector performance to be strong over the next two years.

Figure 1: Movement of consensus FY15 EPS estimates over the past two years

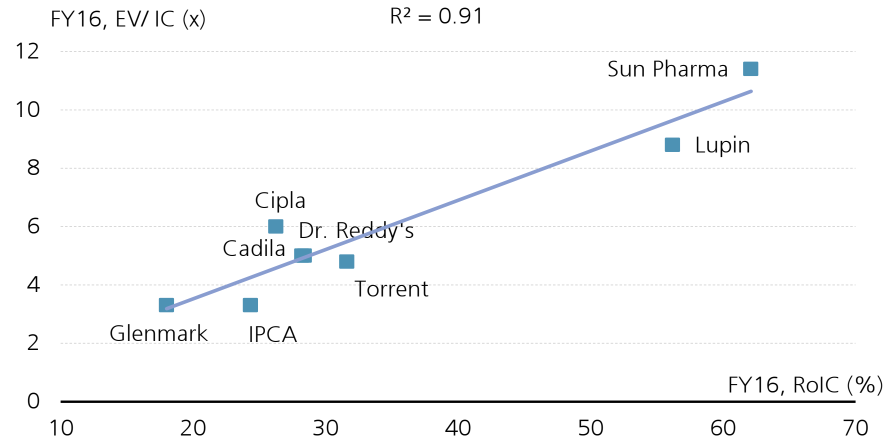


Source: Bloomberg

Furthermore, earnings growth should remain robust and we estimate a 21% net profit CAGR for our coverage universe over FY15-17 with the potential for earnings surprises. We expect the pharma sector to trade at a premium to the Nifty based on consistent earnings growth versus other sectors. Another helpful trend has been the uptick in valuations of US generic companies over the past two years, the result of strong growth and a high M&A activity.

While India pharma stocks' PE has risen somewhat, we believe consensus has not factored in the improvement in earnings quality: there has been a substantial rise in RoICs of India pharma companies over the past five years.

Figure 2: Valuation scatter graph



Source: Reuters, UBS estimates

Strong correlation between returns and valuations

Stock preferences

Key parameters for assessing Indian generics business

We use nine parameters to determine the order of our stock preferences that reflect presence across markets, pipeline, earnings CAGR and valuations. We assign equal weight to each parameter. Based on these parameters, our preference is for large-cap companies over mid-caps, as we believe large caps are better positioned for longer term growth and as risks to earnings are lower. Furthermore, the valuation discount has nearly disappeared in the case of mid-caps over the past one year. Lupin, Sun Pharma and Dr Reddy's are our preferred picks based on their strengthening presence in complex generics, channel consolidation in the US and potential M&A benefits.

Figure 3: How Indian generic companies score on our key parameters

	US pipeline	Complex generics	Biosimilars	PBM consolidation	EM portfolio	M&A	Core earnings CAGR	Returns	Valuation	Total score
Sun Pharma	4	4	0	4	2	5	2	5	3	29
Dr Reddy's	4	4	3	4	3	2	2	3	4	29
Lupin	4	3	1	3	3	4	3	4	2	27
Cadila	3	2	1	2	2	2	4	2	2	20
Torrent Pharma	2	1	0	1	3	3	3	3	3	19
Cipla	1	2	1	4	3	1	4	2	1	19
Glenmark	2	1	0	1	2	2	4	2	2	16
IPCA	1	1	0	1	2	2	3	2	3	15

Note: 0 = low, 5= high. We have not included innovative R&D in this scheme for generics. Source: UBS estimates

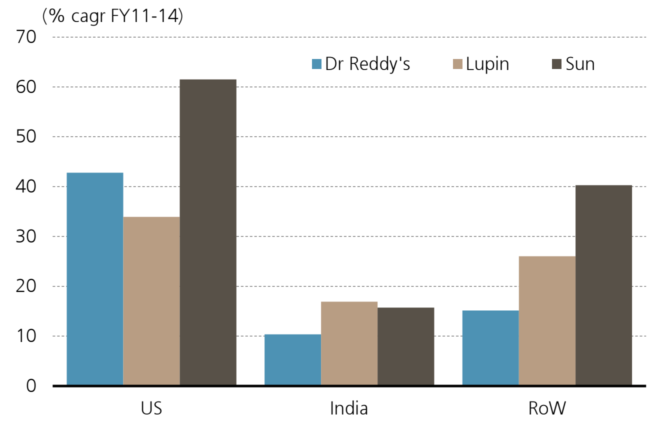
Indian firms well-placed to take a larger slice of the US generics pie

The US is the fastest growing and most profitable segment for leading Indian pharma companies

US generics remain the most important growth driver for Indian pharma companies, as it is the fastest growing as well as the most profitable segment for the leading pharma companies. We estimate cUS$79bn worth of products are set to go off-patent in the US over the next four years. This should provide generic companies with a reasonable opportunity for product launches over the next four years versus the previous four years.

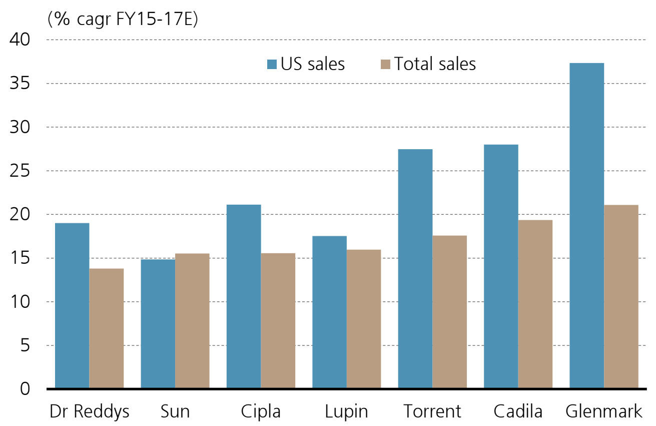
We expect market share gains for Indian firms from new approvals as well as higher penetration by products that have gone generic. We forecast a 15-19% CAGR in US generics revenue for leading India pharma companies over FY15-17. Complex generic products should rise as a proportion of revenues for Indian pharmas, in our view, thereby driving margin expansion. We expect earnings surprises from proprietary products and biosimilars, although we have not factored these into our estimates. We view Dr Reddy's, Lupin and Sun Pharma as well-positioned to grow in the US over FY15-17 based on a strong product pipeline, and we expect margins at these companies US businesses to expand.

Figure 4: Geographical sales CAGR of pharma companies over FY11-14



Source: Company data

Figure 5: We estimate higher sales growth for the US business



Source: Company data, UBS estimates

Indian generic companies' revenue growth double that of the generics market in the US

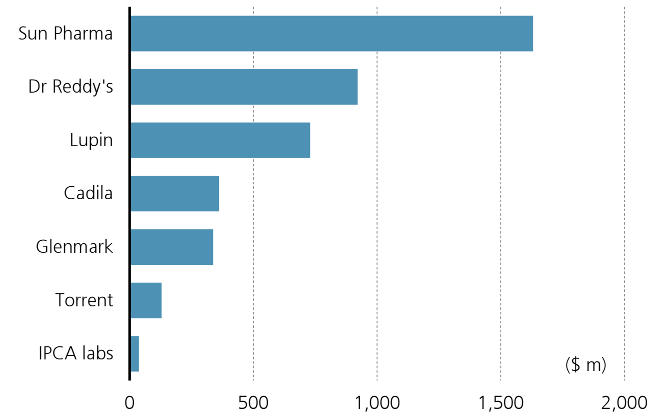
The US generics market has recorded an 11.1% CAGR in revenue over the past decade, according to IMS Health data. At the same time, Indian generic companies have grown at more than double the rate in the US. We expect the trend to continue with Indian pharma companies gaining market share from an increasing share of product approvals. Being net exporters, Indian pharma manufacturers are exposed to currency movements, and most lock in near-term net receivable foreign currency exposure. We currently assume an Rs62/US$1 exchange rate, and rupee weakness would result in an improvement in realisations and vice versa.

High exposure to the US market to benefit large companies

Large pharma companies derived 40-60% of total revenues from the US in FY14

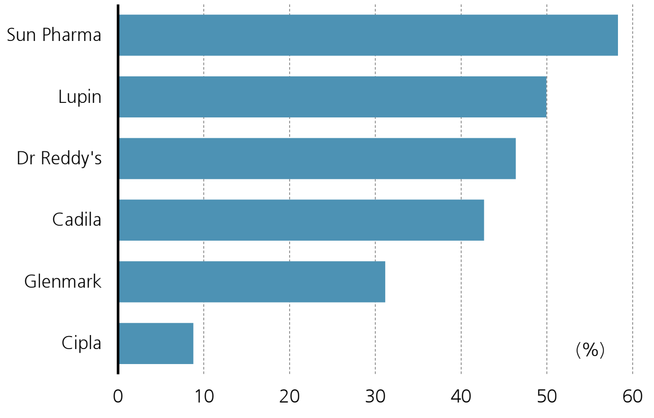
Most large Indian pharma companies derived 40-60% of total revenues from the US generics market in FY14. Hence, growth in the US business is critical for overall top-line growth. While Indian pharma companies do not release geographical margins, our discussions with the companies indicate that the US is the most profitable business, especially for the larger firms like Dr Reddy's, Lupin and Sun Pharma.

Figure 6: US revenues of pharma companies (FY14)



Source: Company data

Figure 7: US sales as a % of total sales (FY14)



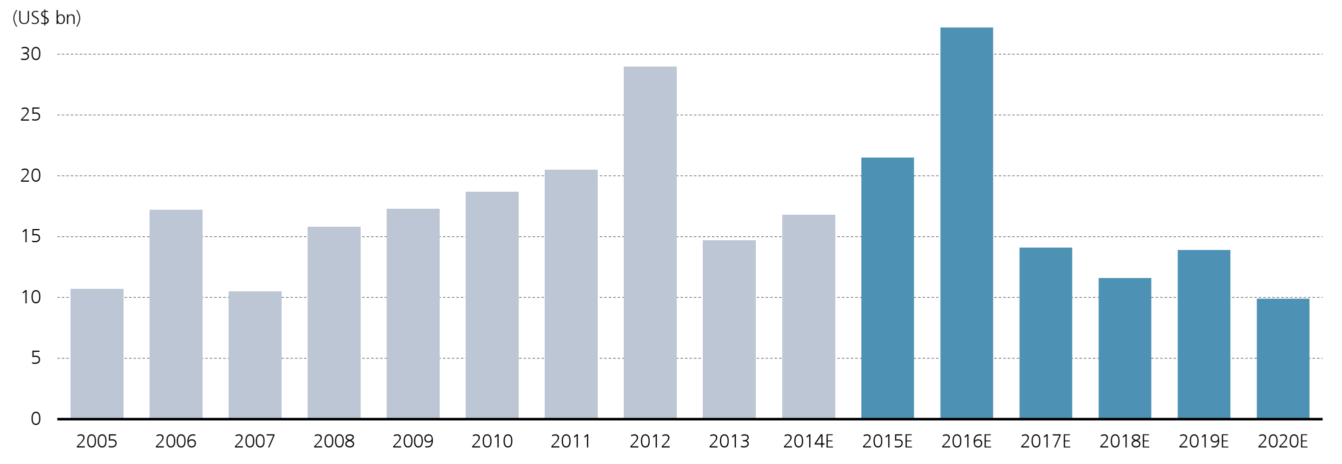
Source: Company data

Is there a patent cliff?

Reasonable market opportunity up to 2017E

New product launches contribute a large proportion to the growth of US generics whereas volume and pricing are typically small contributors. Generic companies are able to launch their versions when product patents expire or when they are able to win patent litigation. Considering that the value of products going off-patent in the US will decline, there has been a debate about whether growth rates for generic companies will fall significantly or even move towards negative territory. However, we expect strong growth potential for generics over the next four years, as incremental patent expiries will be for complex products where margins are likely to be higher. We believe the market opportunity will remain fairly strong until 2017.

Figure 8: Brand value going off-patent



Source: Company data, Paragraph Four database, Orange Book, UBS estimates

Proprietary products and biosimilars to add to growth over and above the US$79bn in patent expirations

We estimate US$79bn of patent expirations in the US over the next four years compared to US$81bn over the past four years. We note that this number does not include potential revenues that firms could generate from proprietary products and biosimilars.

Figure 9: Potential top-five products that could go generic in 2014-20E

Year	2014E	2015E	2016E	2017E	2018E	2019E	2020E
Top 5 products going generic	Oxycontin	Abilify	Advair Diskus	Novolog	Atripla	Revlimid	Prezista
	Celebrex	Copaxone	Lantus	Symbicort	Spiriva	Lyrica	Gilenya
	Diovan	Nexium	Crestor	Victoza	Truvada	Levemir	Androgel 1.62%
	Lovaza	Epipen	Gleevec	Cialis	Cubicin	Afinitor	Lialda
	Evista	Namenda	Humalog	Viagra	Vesicare	Invega Sustenna	Sprycel
Sales (US$ bn)	7.2	12.4	17.0	7.3	8.0	9.2	6.3

Note: Shaded products reflect first launch opportunities for Indian companies.
Source: Company data, UBS estimates

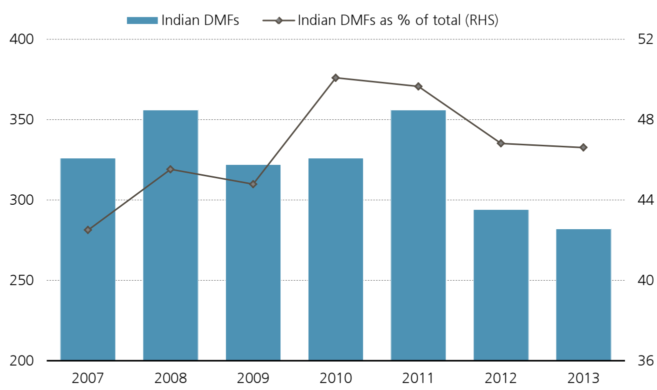
Indian firms appear well-placed to gain market share

India's early focus on self-sufficiency in drugs helped the development of the sector

Indian companies are the second-largest suppliers of drugs to the US, and globally few countries have such a well-developed pharma sector, in our view. This was the result of the early development of the sector due to the Indian government's focus on self-reliance in medicines. In addition, a lack of product patents allowed Indian firms to develop and launch a wide range of products locally, even though the products were under patent protection in other major global markets (the US, the EU, etc).

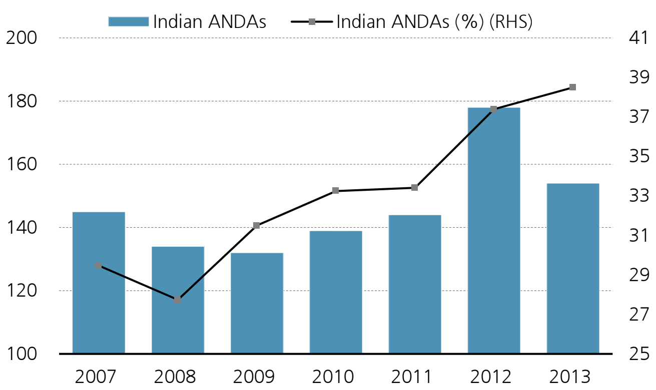
Helped by the wide range of products launched in the domestic market, Indian pharmaceutical companies started filing in developed markets, including the US, in the early 1990s and have gradually increased the proportion of total products filed each year (the figure below highlights the high share commanded by Indian firms in total drug master filings in the US). As Indian firms continue to file aggressively, share of product (ANDA) approvals has been rising (currently at around 40%) and we expect this trend to continue.

Figure 10: Indian drug master filings (DMF) in the US



Source: US FDA

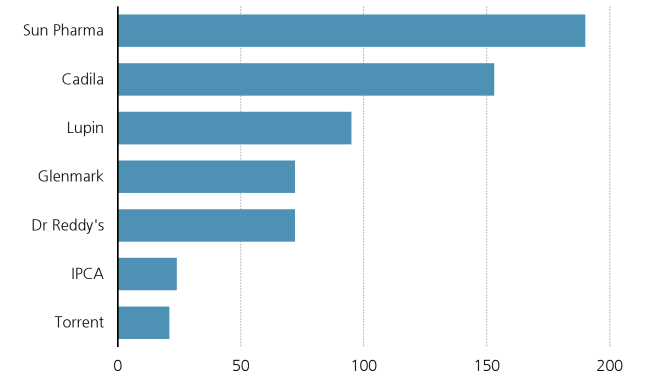
Figure 11: Indian ANDAs approved as a % of total



Source: US FDA

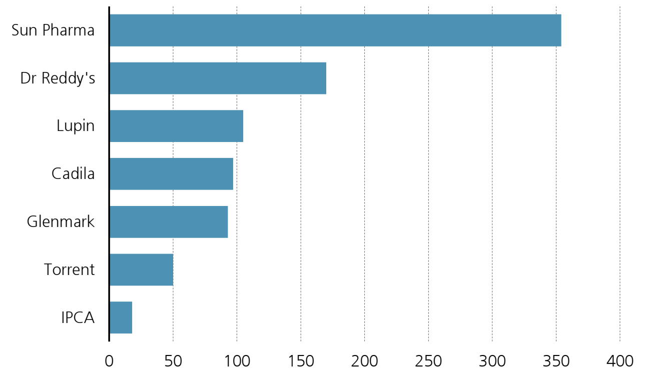
Indian pharma companies now spend a substantial proportion of R&D on developing product filings for the US market, and have caught up with their US counterparts in terms of the number of ANDA filings per annum. Among Indian pharma companies, Sun Pharma has the highest number of ANDAs approved as well as in the pipeline (including the URL portfolio). Led by the rapid pace of filings over the past two to three years, Cadila has moved towards the top of the pending approval table, while other large companies like Dr Reddy's and Lupin have been focussing on difficult to formulate products.

Figure 12: ANDAs pending approval



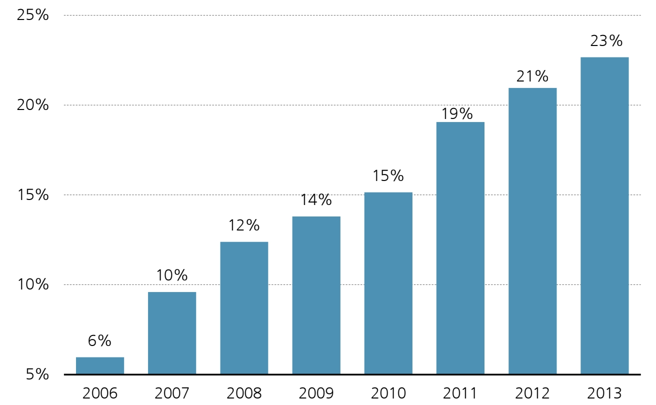
Source: Company data (Q2 FY15)

Figure 13: Cumulative ANDAs approved



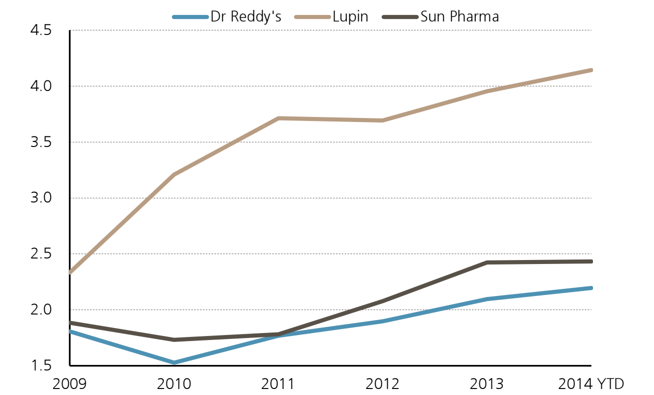
Source: Source: Company data (Q2 FY15))

Figure 14: India's volume share of US generics



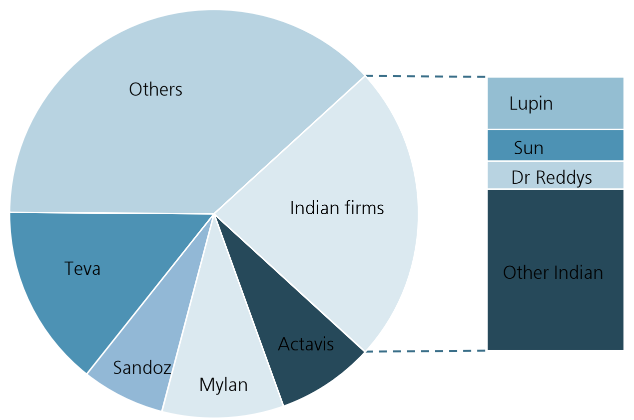
Source: IMS Health

Figure 15: Volume share of key Indian firms in the US



Source: IMS Health

Figure 16: Volume (TRx) share of US generics (2014)



Source: IMS Health

High proportion of manufacturing and R&D in low cost location enhances cost competitiveness of Indian generics

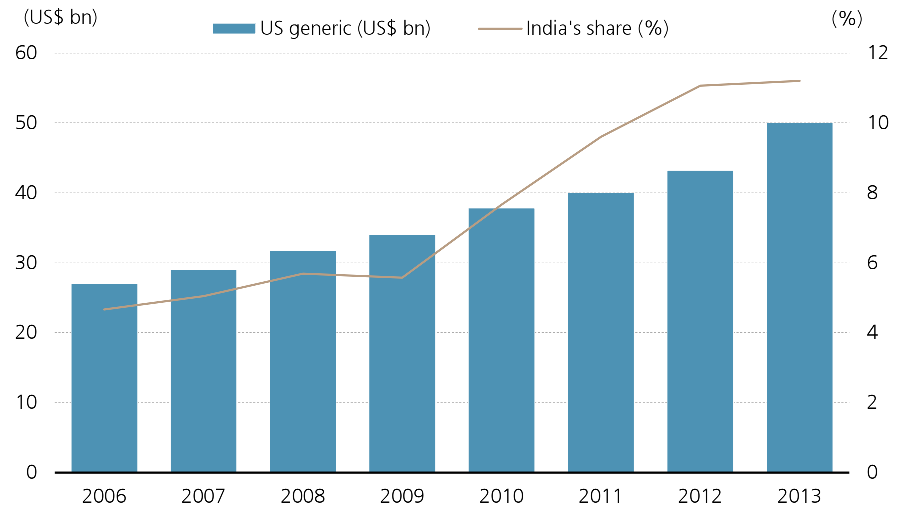
Low-cost manufacturing is another major advantage for Indian companies combined with a cost advantage in R&D. Most Indian companies manufacture 80-100% of their products in India whereas international generic companies have a smaller proportion outsourced to cheaper locations. Hence, in comparison Indian firms' cost structures are superior. To this end, International generic companies have been attempting to increase the proportion of manufacturing and R&D in India and other low-cost locations via organic as well as inorganic routes.

Opportunity from products that have gone generic

Apart from product patent expirations that provide new launch opportunities, we expect Indian firms to launch products where only a few generics exist. We note that Indian firms only had an 11% share of the US generics market in 2013.

Indian companies yet to tap a large proportion of the already generic market

Figure 17: India's share of the US generics market

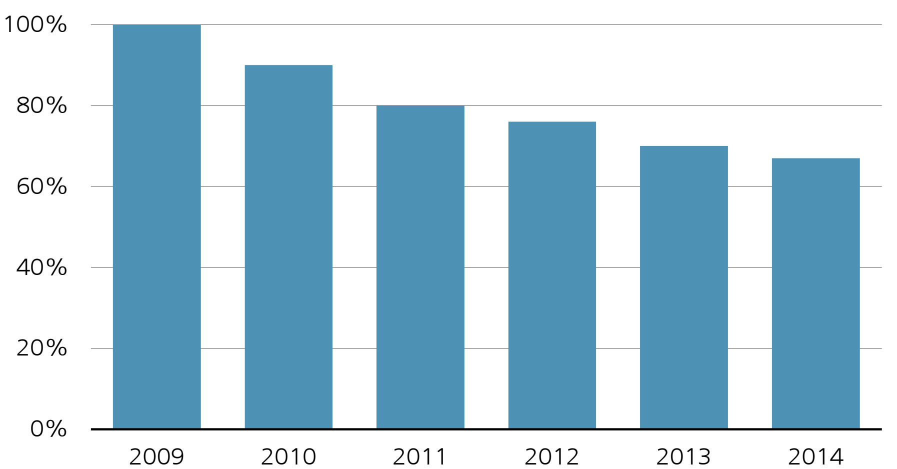


Source: IMS Health, Indian commerce ministry

We believe there is a sizeable opportunity in already genericized products in segments like injectables, oral contraceptives and ophthalmics where only few generic companies are present. Many are high value products due to the limited competition. The figure below shows how revenues of Actavis' top-10 products in US generics have been well sustained over the past five years. We expect Indian firms to gain share from large US generic companies like Actavis, Mylan and Teva in terms of their top products.

Figure 18: Contribution of top-10 products of Actavis to its US generic sales

Opportunity for Indian firms to launch and gain share from large US firms like Actavis



Source: Company data, IMS Health

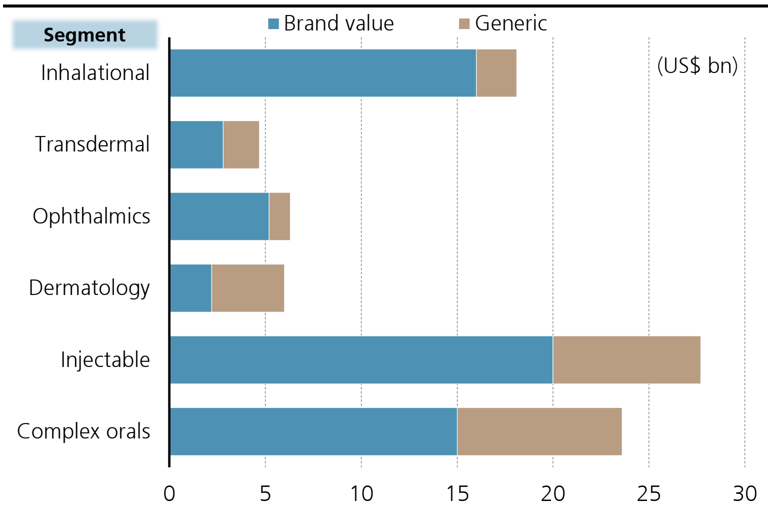
Complex generics

Indian pharmaceutical companies have targeted various complex segments where entry barriers are high. As complex generics increase in proportion to Indian firms' US business, we expect margins to rise. Investors have queried whether profitability will remain high with so many firms targeting complex generics. It is important to note that each firm involved in complex generics is targeting select segments and not the entire complex segment. Therefore we believe there will be a limited number of companies in most segments and that profitability will remain high.

Individual pharma companies targeting select complex generic segments

The figure below highlights key complex generic segments, their size, the major Indian firms targeting the opportunity and the probability of success in each segment. Historically, Indian pharma companies mainly launched oral products. In future, we expect large Indian pharma companies to launch a higher number of products in injectables, ophthalmics and transdermals. Over time, we expect inhalational launches to emerge. We also highlight that the probability of approval and successful launch declines with increasing complexity; inhalational products are highly complex due to differences in the device.

Figure 19: Key complex generic segments



Segment	Key companies	Success probability
Inhalational	Cipla, Lupin, Sun Pharma	Low
Transdermal	Cadila, Dr Reddy's	Moderate
Ophthalmics	Sun Pharma, Lupin, Wockhardt	High
Dermatology	Sun Pharma, Lupin , Glenmark	High
Injectable	Sun Pharma, Dr Reddy's, Lupin	High
Complex orals	Most companies	High

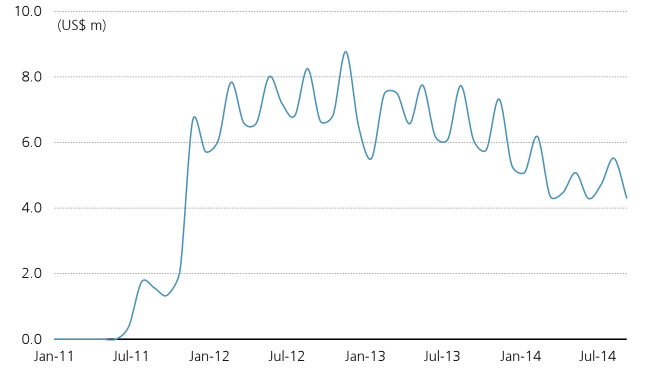
Source: Company data, IMS Health (MAT 2014), UBS estimates

Better margins and portfolio durability

Complex generics typically have greater durability in a product portfolio, and market share and pricing trends are more stable than for simple oral solids. For example, we note only a gradual increase in competition for products like *Fondaparinux* (brand Arixtra), *Decitabine* (Dacogen), *Tacrolimus* (Prograf) for Dr Reddy's and *liposomal doxorubicin* (Doxil), *sumatriptan autoinjector* (Imitrex statdose) for Sun Pharma.

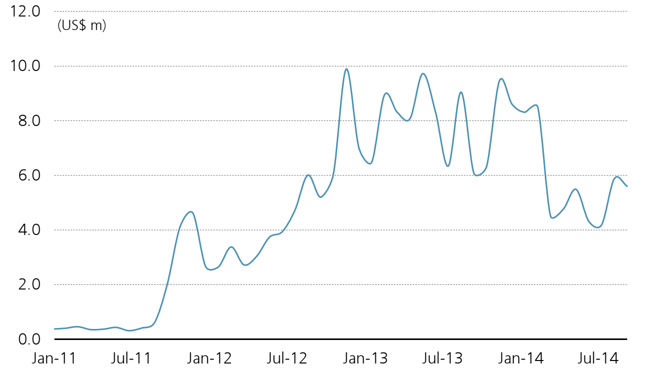
Potential for margins to improve with increasing proportion of limited competition products

Figure 20: Monthly fondaparinux sales for Dr Reddy's



Source: IMS Health

Figure 21: Monthly sumatriptan autoinjector sales for Sun



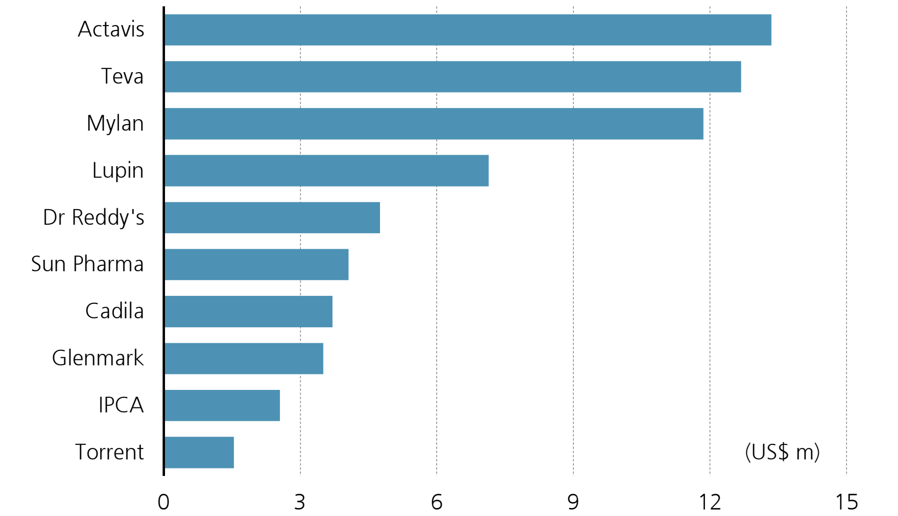
Source: IMS Health

Indian companies' product revenue to increase

Due to the lower contribution of complex generics to revenues, Indian firms record lower revenue per product than the US generic majors, as highlighted in the figure below. While US generic majors like Actavis and Teva derive over 50% of US generic revenues from complex products, the comparable figure for Indian companies is 10-20%. However, we expect the gap to narrow as product portfolios of India companies evolve.

US generic majors have higher revenue per approved product

Figure 22: US revenue per ANDA approved (FY14)



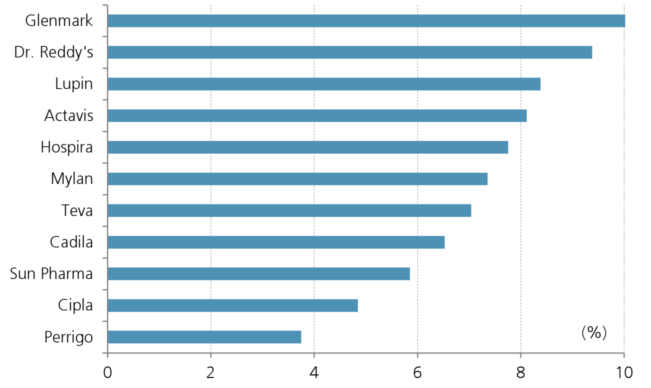
Source: Company data, IMS Health

Investing in product development

As complexity increases, R&D spend per molecule rises

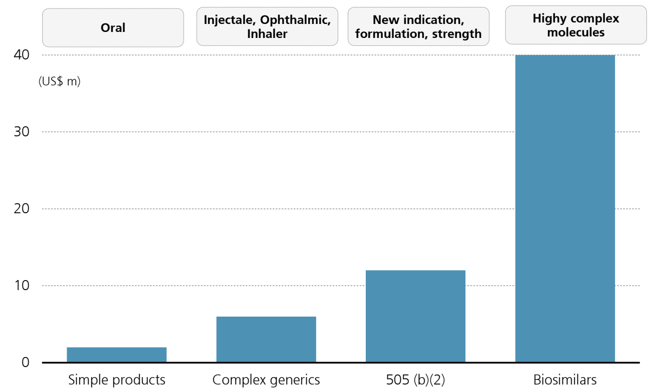
With the increase in product segment complexity, R&D spend per molecule and the time required to establish bio-equivalence has risen. Indian pharmaceutical companies have increased R&D spend over the past five years, in absolute as well as percentage of sales terms. While absolute spend is obviously lower than international generic majors like Actavis, Mylan and Teva, a number of India pharma companies spend higher in terms of percentage of sales. Large India pharma companies are able to plan multiple research programmes to develop and file for complex generics in the US, as they have strong cash flows to deploy to target complex segments. Each complex generic product development costs around US$5m versus US$1m-2m for a simple product. Developmental spend on an inhalational or a biosimilar product is much higher.

Figure 23: R&D spend as a% of total revenues (FY14)



Source: Company data

Figure 24: Current typical R&D spend per molecule



Source: UBS estimates

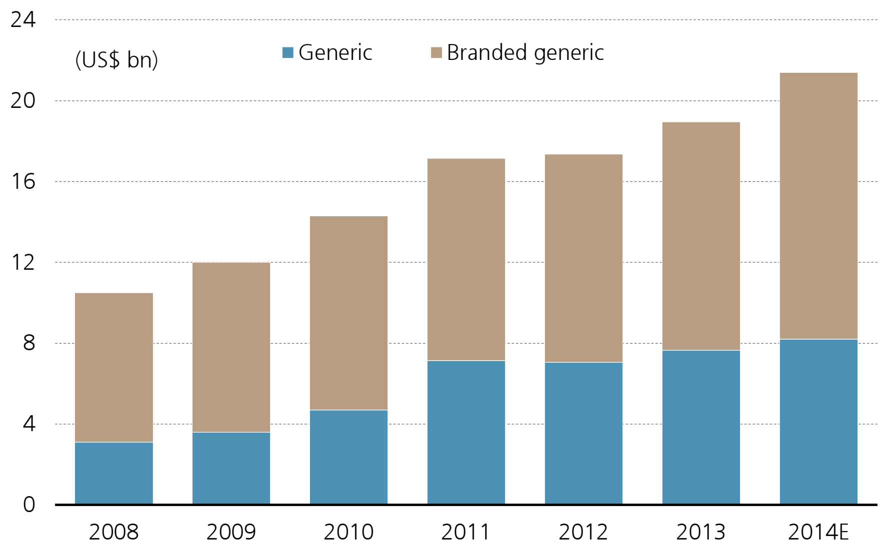
The success of higher R&D spend is beginning to show with US FDA approvals for complex products like Doxil (Sun Pharma) and Vidaza (Dr Reddy's). We expect a high probability of success in segments like dermatology, injectables and ophthalmics. At the same time, we believe risk is higher in the inhalational segment and biosimilars where the investment required per product is higher and the probability of success lower.

Strong growth opportunity in the injectables segment

We think injectables is one of the largest opportunities within complex generics

In the near to medium term, we believe there is a good opportunity for Indian generic companies to grow from injectable launches. US$16bn of injectable product patents will expire in the US over the next four years. The US injectable generic market is worth cUS$7.6bn in sales and we expect it to grow at c10% annually, faster than orals and other generic categories. In addition, many injectable products are in short supply (accounting for over half of total products currently in short supply) due to supply disruptions over the past 10 years, which has increased the attractiveness of the opportunity, in our view. The shortage has meant that much of the M&A activity is focussed on the injectable segment as generics companies target expanding in this segment.

Figure 25: US injectables market value

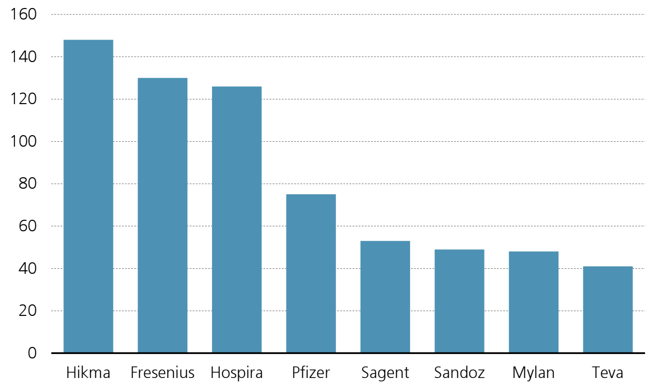


Source: IMS Health, UBS estimates

International generic companies like Hospira, Mylan, Sandoz and Fresenius dominate the injectables segment, while Indian companies have a small share of the generic injectable segment. Among Indian companies, Sun Pharma and Dr Reddy's are in the top 10 in terms of revenue, and sales have increased in recent years led by product launches like Arixtra, Dacogen and Vidaza generics for Dr Reddy's, and Doxil for Sun Pharma.

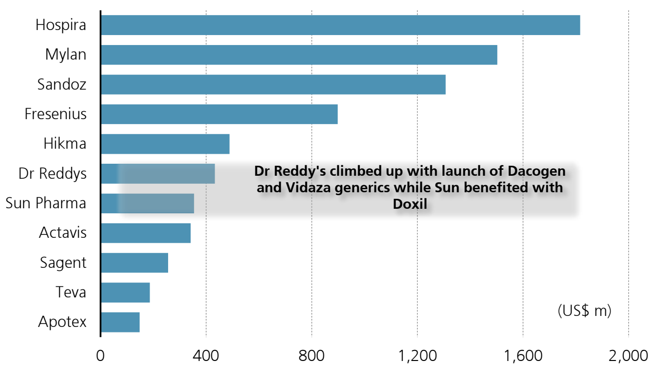
Margins of Indian companies to improve with rising presence in injectables

Figure 26: No. of injectable products in the US by company



Source: IMS Health (2013), Hikma filing

Figure 27: Sales of generic injectables (as of October 2014)



Source: IMS Health (MAT as of October 2014))

Aurobindo, Cadila, Glenmark and Lupin have launched a few injectables and are developing products to establish themselves in this segment. We expect Indian companies to gain share in the segment, led by strong product launches. As a result, we believe there will be an improvement in realisations and margins for Indian generic companies.

We expect a number of injectable launches

Figure 28: Key injectable opportunities for Indian companies

Year	Brand	Molecule	Size (US$ m)	Company
2015	Copaxone (20mg)	*Glatiramer*	2,100	Natco, Dr Reddy's
2015	Aloxi	*Palonosetron*	475	Dr Reddy's
2015	Velcade	*Bortezomib*	700	Dr Reddy's, Glenmark
2015	Emend	*Aprepitant + Fosaprepitant Dimeglumine*	450	Dr Reddy's, Glenmark
2015	Propofol	*Diprivan*	400	Dr Reddy's
2016	Cubicin	*Daptomycin*	600	Strides
2017	Risperdal Consta	*Risperidone*	500	Sun, Dr Reddy's
2017	Sandostatin	*OcTreotide*	575	Sun, Wockhardt
2017	Alimta	*Pemetrexed*	1,200	Intas, Glenmark, Sun
2017	Copaxone (40mg)	*Glatiramer*	2,300	Dr Reddy's
2017	Lupon	*Leuprolide*	700	Sun
2019	Revlimid	*Lenalidomide*	4,100	Natco
2019	Angiomax	*Bivalirudin*	435	Sun, Dr Reddy's
2023	Boniva	*Ibandronate*	610	Sun, Dr Reddy's
2026	Treanda	*Bendamustine*	800	Dr Reddy's, Intas, Lupin, Sun

Source: IMS Health, company data, US FDA

Apart from the key opportunities listed above, we think Indian companies may have or could file for several other products like Enoxaprain, Liposomal Paclitaxel, Mirena and Victoza.

The number of deals in injectables has risen over the past two years

Figure 29: Increased M&A in the US injectables segment

Date	Acquirer	Target	Price (US$ m)	Price to sales (x)
Oct-14	Sagent	Omega	85.3	2.6
Jul-14	Sun Pharma	Pharmalucence	-	-
May-14	Hikma	Bedford	300	15.8
Feb-14	Lupin	Nanomi	-	-
Jan-14	Par Pharma	JHP Group	490	3.3
Feb-13	Mylan	Agila	1,700	7.6
Oct-12	Dr Reddy's	Octoplus	31.6	-
Oct-10	Hikma	Baxter US generic injectables business	110	0.6
Jul-10	Mylan	Bioniche	550	4.2
Dec-09	Hospira	Orchid	400	4.5
May-09	Sandoz	Ebewe	1,200	4.4
Jul-08	Fresenius	APP Pharma	3,700	5.7
Sept-06	Hospira	Mayne	2,625	3.8
Jun-06	Barr	Pliva	2,500	2.1

Source: Company data

Over the past two years, there has been an increase in M&A activity in the injectables segment. The industry has undergone a degree of consolidation, aided by increasing regulatory pressure and product shortages that have made existing products attractive. As a result, companies with small portfolios in the US injectables space have sold out, allowing the big companies to increase in size.

Dr Reddy's, Lupin and Sun Pharma well-positioned in the US

We prefer large-cap Indian pharma companies and forecast a 15-19% CAGR in US generics revenue over FY15-17. Based on an increase in the proportion of revenue derived from high-margin complex generics, we expect margins to rise and for earnings to grow faster than our revenue growth estimates. We believe proprietary products and biosimilars will become significant sources of revenue growth over the next five years.

Figure 30: Key launches for Indian pharma companies in the US

Company	Key products	Expected launch date					Estimated earnings potential (FY16-17)
		4Q15	1Q16	2Q16	3Q16	4Q16	(US$ m)
Cadila	Rapamune						37
	Asacol HD						65
Dr Reddy's	Aloxi						218
	Copaxone						218
Glenmark	Desmopressin						23
	Welchol						54
Lupin	Welchol						54
	Glumetza						30
Sun Pharma	Coreg CR						61
	Gleevec						390

Source: FDA, company filings, UBS estimates

Slow and steady growth in emerging markets

We expect slow and steady growth in emerging markets, including India

India pharma companies' fast-paced growth in the US has dwarfed the branded generics business in emerging markets. Due to the branded nature of these markets, revenues are quite sticky. We expect steady and sustainable growth in the branded markets for India pharma companies: Cipla, Glenmark, Lupin and Sun Pharma are well-positioned in branded markets, especially India, in our view.

Increased access and improving affordability are key drivers of growth for pharmaceuticals in emerging markets. Both have been negatively affected in recent years by the global economic slowdown. Accordingly, IMS Health has cut its growth forecasts for emerging market pharmaceuticals, and it now expects total spending on drugs in emerging markets to record an 8-11% CAGR over 2014-18. Apart from the economic slowdown, regulatory changes in a number of these countries (eg, India expanded price controls in 2013) have hampered growth. We discuss emerging market prospects in detail in Appendix 1.

Large pharma companies to benefit from channel consolidation

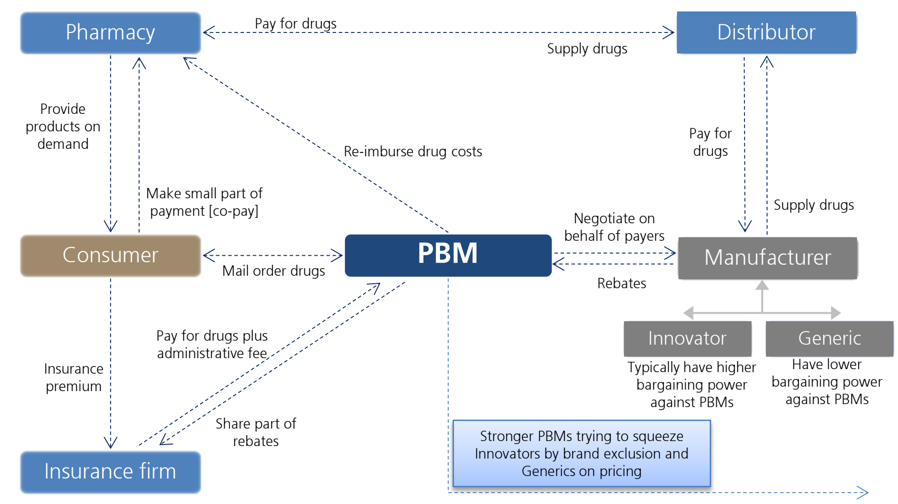
Pharmacy benefit managers (PBMs) in the US have been consolidating recently, resulting in higher bargaining power over manufacturers. PBMs are now attempting to extract more out of the manufacturers (innovators and generics) via higher discounts and rebates. In the case of patented products with a single source, PBMs have started to exclude expensive products and find cheaper alternatives that they will reimburse. In the case of multi-source products (generics), PBMs are driving down prices.

With higher bargaining power, PBMs can enhance penetration of generics in complex segments

The exclusion of brands by PBMs could benefit generic companies, as they should have a better chance of gaining share in complex segments like inhalational products and biosimilars because of a lack of substitutability in these segments. We expect large pharma companies who could be in a position to launch such products like Cipla and Dr Reddy's to benefit.

Figure 31: US pharmaceutical supply chain

PBMs have become crucial in the pharmaceutical supply chain



Source: UBS

Pharmaceutical purchasers are consolidating

Although PBMs originally had limited functionality as claims administrators, over the past few decades they have taken over several functions including designing drug formulary and negotiating rebates with manufacturers. PBMs are able to get higher discounts for the payers versus cash-paying customers. Hence PBMs have become more prevalent and their share of pharmaceutical business has increased. Over the recent past, aggressive M&As have enabled PBMs to increase in size and/or expand into other functions of the pharmaceutical supply chain. This has endowed them with higher bargaining power vis-à-vis manufacturers.

PBMs have gained share of the pharma business

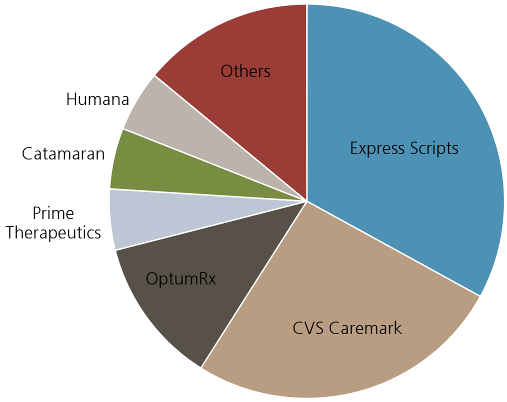
Figure 32: PBM consolidation in the US

Big-ticket M&As in the pharma supply chain in the US

Acquirer	Target	Timeline
Express Scripts	Medco Health	July 2011
Catamaran	Catalyst Health	Apr 2012
Cardinal Health	CVS Caremark	Nov 2013
PharMerica	BGS Pharmacy	Jan 2014

Source: Bloomberg

Figure 33: PBM market share in the US (2013)



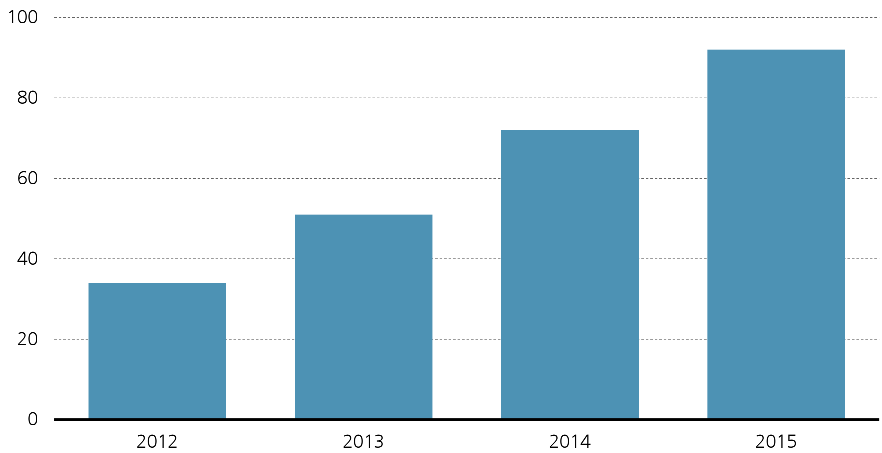
Source: CVS Caremark

Two large PBMs control over half of the market

PBMs aggressively searching for cheaper alternatives

PBMs have in the past switched from brand to generics to drive down costs. However, over the past couple of years, they have been switching from brand to brand as well if they assess that the incremental benefit is not worth the extra costs. PBMs are excluding branded products from formulary lists, adding hurdles for patients to access expensive products, and refusing to reimburse expensive products when a cheaper and effective variant is available.

Figure 34: CVS Caremark drug (brand) exclusions



Source: Company data

Brand exclusions going up as PBMs become stronger

GSK's Advair excluded by some major PBMs

The figure above is for CVS Caremark, one of major PBMs that started excluding brands from coverage in 2012, and has more than doubled the number of brands excluded over the four years in order to cut costs. In 2014, Express Scripts started excluding brand-name drugs (48 in number) from its main formulary list and has upped the number to 66 for 2015. GSK's key brand, Advair, was one of the products excluded (although it was reinstated for 2015 after GSK offered price discounts). Express Scripts recently excluded efficacious Hepatitis C drug, Sovaldi, in favour of AbbVie's newly approved Viekira Pak after AbbVie offered discounted prices. Furthermore, PBMs have stated that new products (brands) will only be included on the formulary list after a proper review of benefits versus existing products (including generics). This trend could actually benefit generics where new products do not have substantially higher efficacy and generics would a cheaper and an effective alternative.

Trade consolidation negative for generic pricing...

PBMs pushing generic companies to reduce product prices

Pharmaceutical manufacturers in the US have seen varying negative impacts on sales and margins due to consolidation in the pharmaceutical supply chain. PBMs are putting pressure on manufacturers, especially generic companies, to lower pricing in new contracts. The top seven buying entities (including pharmacies, distributors and PBMs) in the US now comprise nearly 85% of the generic market by value. Indian generic firms like Dr Reddy's, Glenmark and Lupin have cited consolidation among PBMs as one reason for the dip in US growth in recent quarters.

Although we expect further pricing pressure in generics, especially for products where supply is not constrained, we think generic companies with limited competition/specialty products should continue to record high profitability. We believe this trend clearly favours large-cap pharma companies that have higher revenues from limited competition products compared to small- and mid-size firms.

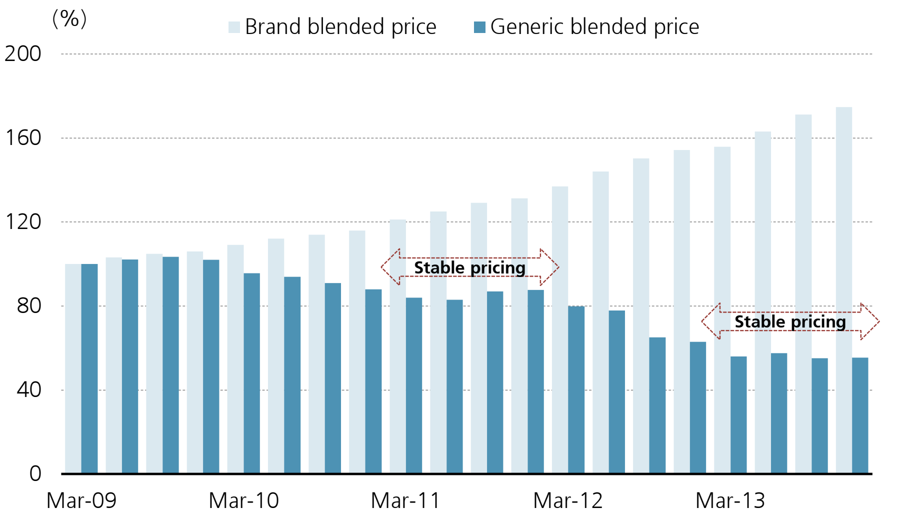
...partly offset by supply disruption and niche products

Supply disruption, shortage of drugs and industry consolidation leading to rise in generic drug prices

Contrary to the historical trend of annual declines in generic pricing, we note sharp price increases for a range of generic products over the past two to three years caused by among others supply disruption, a shortage of drugs and industry consolidation. We believe that generic drug inflation trends will persist for more than a year, driven by the generic application backlog at the FDA and the slow resolution of issues affecting manufacturing plants. We think manufacturers are likely to resort to aggressive price increases for older products affected by supply disruption.

Generic pricing has been stable in phases as some drugs saw price increases

Figure 35: Generics pricing trend



Source: IMS Health

As show in the figure above, the pricing of generics has usually recorded a declining trend. In 2013-14, we note a slowdown in this trend because of supply disruptions. Price declines in generics are a function of the types of products going off-patent. Simple oral products are usually competitive, especially in the initial six months, and can lead to a sharp decline in generic pricing for a particular quarter/year if the brand going generic is large.

Generic firms have cited a tighter regulatory environment as one of the key reasons for supply disruptions, a trend that is likely to continue, in our view. FDA penalties for generic firms have increased over recent years with the regulator demanding stricter implementation of manufacturing protocols. In response, generic companies have been forced to resort to higher levels of automation at their manufacturing plants, resulting in an increase in capital expenditure. Operating costs have also gone up as a result of the stricter compliance regime.

Figure 36: Price rises for some generic drugs in the US

Product prices have risen sharply due to supply disruption

Drug	Price rise (%)	Generics in the market
Albuterol	3,500	Actavis, Mylan
Amitriptyline	2,100	Endo, Mylan, Sun Pharma
Captopril	2,800	Mylan, Wockhardt
Clobetasol	1,500	Taro
Digoxin	500	Impax, Lannett
Divalproex ER	730	Cadila Healthcare, Dr Reddy's
Doxycycline	1,830	Actavis, Hikma, Sun Pharma
Nystatin and triamcinolone	4,000	Taro
Tizanadine	210	Apotex, Mylan

Source: IMS Health

Proposed legislation in the US unlikely to impact pricing dynamics

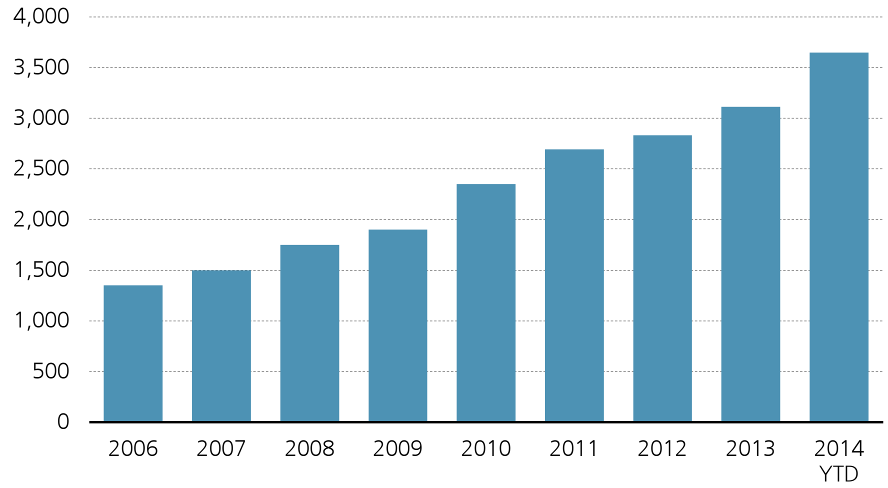
Federal legislation has been proposed that includes provisions to make generic companies give rebates to Medicare (government-run insurers) if companies hike drug prices higher than inflation. Maine allows residents to mail order drugs from cheaper locales like Australia, the UK and Canada. In our view, these measures (legislation and mail order imports) will not make a difference to the pricing of generic drugs. We believe there is potential for generic companies to rise prices or maintain higher-than-average pricing in the case of limited competition and specialty products. Products where supply disruption leads to price rises would typically see price normalisation as and when the disruption is fixed or a new company enters the market.

FDA attempting to balance quality versus affordability

FDA under pressure to resolve product quality issues

The FDA has faced criticism from Congress for letting poor quality drugs enter the US market. Under Dr Margaret Hamburg, the FDA has undertaken to weed out these manufacturing deficiencies. Due to the high number of manufacturing plants in India supplying the US, the FDA has opened an office in India to increase the frequency of inspections and speed up compliance. This has resulted in a higher frequency and intensity of penalties for pharmaceutical firms globally, including Indian companies.

Figure 37: Backlog of pending ANDAs



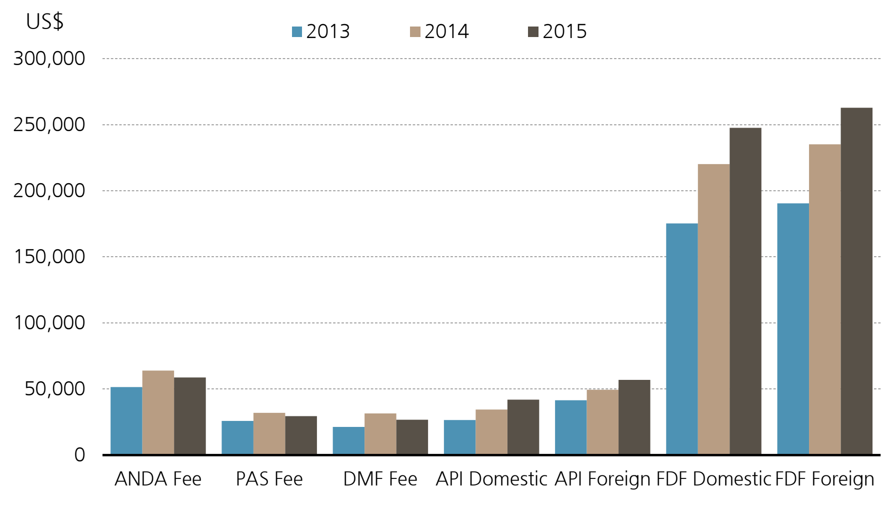
Source: CMS, UBS estimates

Intention to speed up approval process to enhance savings by early generic launches

At the same time, the FDA is attempting to clear the backlog of generic drug applications via implementation of the Generic Drug User Fee (GDUFA) that allows the FDA to collect fees for the filing of drug applications and the inspection of manufacturing facilities. These fees have now been hiked twice (in 2013 and 2014). While the regulator has been able to increase funding via the fees, there has not been an impact on the approval rate due to budget sequestration in early 2013. The FDA intends to bring down the median ANDA approval timeline from over 30 months currently to less than 10 months by 2017.

Fees to be used to reduce approval timelines by adding staff

Figure 38: Generic drug user fees



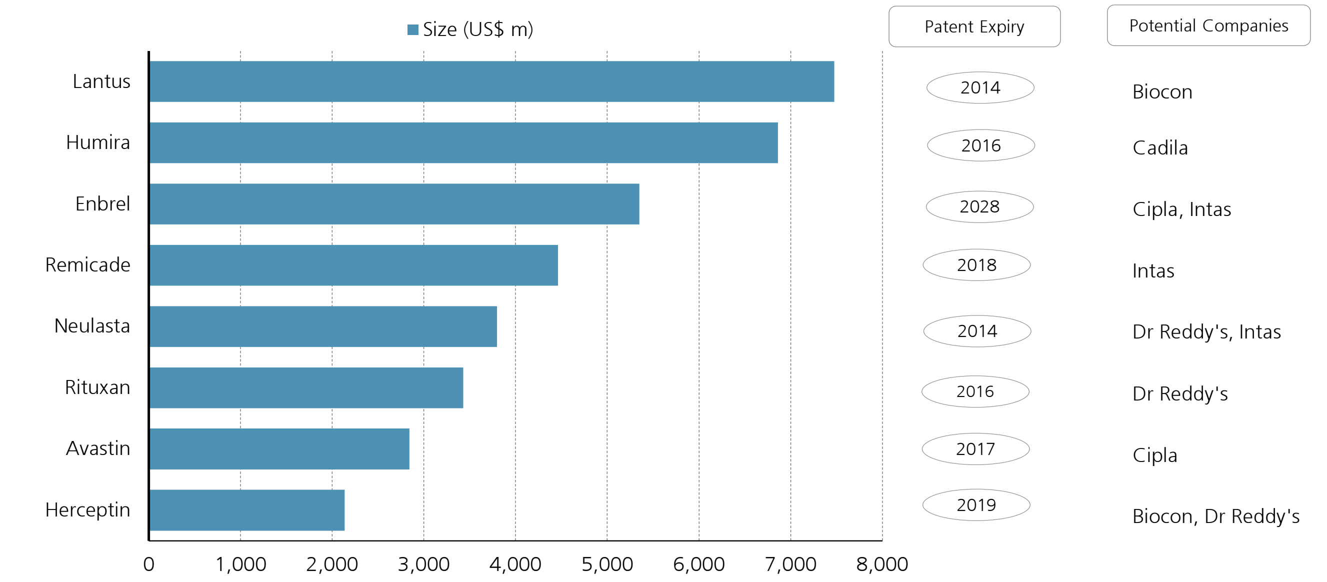
Note: PAS – Prior approval supplement, FDF – Finished dosage form, DMF – Drug master file. Source: FDA

Stronger PBMs and regulation change could enhance biosimilar prospects

Biosimilar opportunity chequered due to regulatory hurdles

Biosimilars represent a long-term opportunity over and above the pharmaceutical product patent expirations discussed above, in our view. However, while several biologic patents will expire over the next five years, there are unlikely to be many launches of similar versions due to the tough regulatory framework in the US. Only a few companies have begun clinical trials that are required to gain approvals for products in the US.

Figure 39: Biosimilar sales opportunity in the US



Source: FDA, IMS Health (MAT as of November 2014), company data, UBS estimates

Compatibility between biologic and biosimilars: the key hurdle

Lack of substitution a key concern for generic companies

The difficulty with biologic products is replication. The molecules are fairly large in size and often have complicated manufacturing processes compared to pharmaceutical products (small molecules). Due to this, the FDA has not allowed substitution in the case of biosimilars whereas it is allowed for pharmaceutical generics. This implies that companies that launch biosimilars would have to market their version to doctors via the sales force, increasing the investment required for this category of products. Additionally, development of biosimilar products requires technical expertise as well as significant financial investment.

Figure 40: Biosimilar key requirements: what are Indian firms doing?

Function	Requirement	Indian firms
Technology	▪ Develop the product ▪ Optimize yields	Indian firms have launched only in EMs yet
Financial investment	▪ Upfront development costs ▪ Clinical trial costs	Spend on R&D supported by high cash generation
Regulatory	▪ Filings across markets ▪ FDA and EMEA regulations	Partnering for access to regulatory expertise for filings in developed markets
Marketing	▪ Specialists ▪ Tie up with institutions	Partnering for access to field force in developed markets

Source: Company data, UBS

The FDA recently indicated that it will issue additional guidance on biosimilars in the near future regarding labelling issues, interchangeability and some questions that it intends to put to the industry. However, it appears that the FDA will probably not allow biosimilars to use the same name, which is a negative as biosimilars will be approved under different brand names and will have to be marketed by the companies. A few states (North Dakota, Florida, Oregon, Utah and Virginia) in the US have begun to allow substitution under specified conditions. We believe PBMs will drive higher penetration despite the FDA not approving substitutability.

FDA may not allow biosimilars to use the same name; a few states allow substitution under specified conditions

In the US, growth hormones were the first segment to undergo biosimilar launches, although without much initial success. Over the next few years, we expect biosimilar launches in human insulin, analogues and some of the early expiring mabs, followed by larger mabs like *adalimumab* and *infliximab*. Recently, Apotex announced that the FDA had accepted its application for a biosimilar of Neulasta. In the EU, we note a few approvals such as *filgrastim* and *infliximab*.

Divergent strategies by India pharma companies

Due to tough regulations and the amount of investment required, companies have adopted different strategies. Among Indian firms, Biocon and Dr Reddy's have been at the forefront of biosimilar development, although they have initially targeted the European market primarily due to regulatory clarity. Some companies like Sun Pharma and Glenmark have not taken part due to the uncertain outcome. Because of the marketing effort required for biosimilars, Indian companies have entered into collaboration with multinationals like Biocon with Mylan, and Dr Reddy's with Merck KgaA.

Select Indian pharma companies are working on biosimilars

Dr Reddy's has a strategy to bring six biosimilars to developed markets, including products (*Darbepoetin alpha*, *Pegfilgrastim* and *Rituximab*) that have been launched in emerging markets. The company has two products in the advanced stage of clinical studies in the EU.

Dr Reddy's has two products in pipeline for developed markets

Figure 41: Top-10 biosimilars in India

Brand	Molecule	Company	Sales (Rs m) (MAT Nov-2014)
Reditux	Rituximab	Dr Reddy's	543
Zyrop	Epoetin Alfa	Cadila Healthcare	520
Epofit	Epoetin Alfa	Intas	465
Pegihep	Pegy Interferon Alpha 2b	Cadila Healthcare	395
Neukine	Filgrastim	Intas	249
Grafeel	Filgrastim	Dr Reddy's	173
Colstim	Filgrastim	Cadila Healthcare	159
Mabtas	Rituximab	Intas	109
Pegstim	Pegfilgrastim	Cadila Healthcare	89

Source: IMS Health

Large firms to benefit from channel consolidation

Large pharma companies with a focus on complex segments are likely to be beneficiaries of stronger PBMs. We expect potential benefits for Indian pharma companies like Cipla, Dr Reddy's and Sun Pharma. Despite the high technical complexity, we view the marketing of biosimilars as a challenge for Indian companies. However, we expect stronger PBMs will be able to drive a switch in the case of segments like inhalational or biosimilars where substitution is not a given, unlike simple generics where substitution rates are very high. PBMs are already proponents of biosimilars and want the FDA to allow substitutability.

Cipla and Dr Reddy's could benefit from channel consolidation

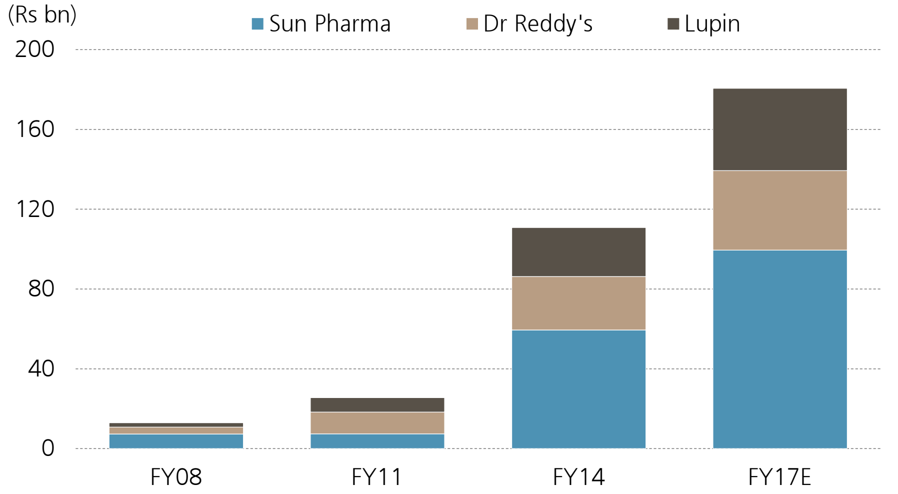
M&A could enhance competitiveness and drive growth

The ability of Indian pharmaceutical firms to generate cash has expanded greatly as they scaled up in the US generics market since FY08. Gross margin improvement led by an improving product mix and positive operating leverage have been the twin drivers of earnings growth for Indian pharmaceutical companies. Cash flows have improved dramatically as volumes were scaled up and supply chain linkages improved. The trend will accelerate with an increasing proportion of revenues coming from high margin limited competition products, in our view. While Indian companies have already upped M&A activity, we expect an increase in the number and size of deals, which should allow companies to enhance their competitive position in the US market.

Pharma firms to add to R&D capabilities and growth via M&A

Figure 42: Free cash flow of select pharma companies

Cash generation has gone up



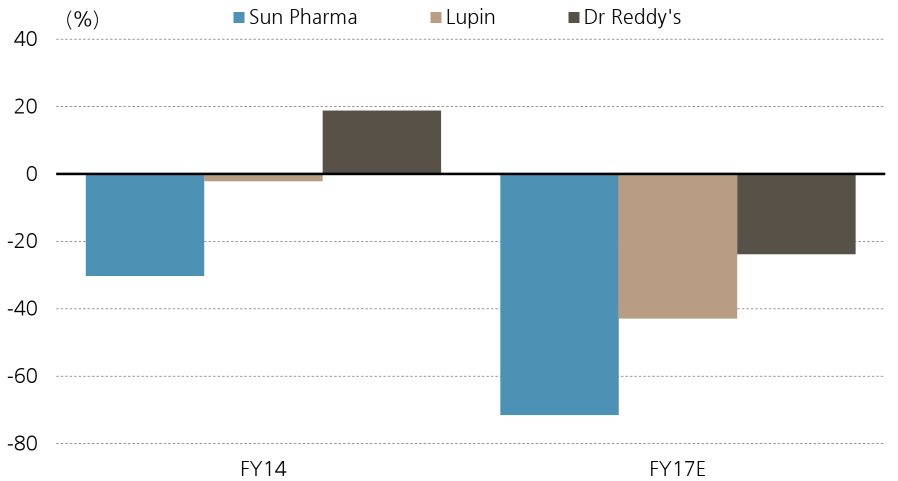
Source: Company data, UBS estimates

Balance sheets approaching net cash positions

Most Indian pharma companies are in a net cash position, or will be in the near future, in our opinion. This should increase the likelihood of M&As. Over the past five years, Indian companies have acquired companies to gain entry or enhance scale in a market, and to enhance R&D capabilities. Based on stronger balance sheets, we think Indian pharma companies will look to consolidate their presence and gain scale in existing markets, while continuing the search for R&D assets, especially in the US.

Net cash balance sheets enhance ability to acquire

Figure 43: Net debt-to-equity of select pharma companies



Source: Company data, UBS estimates

Figure 44: Recent M&A activity by Indian pharma companies

M&A activity has increased, especially for Sun Pharma

Acquirer	Target	Date	Deal size (US$ m)	Sales multiple (x)	Purpose
Cadila Healthcare	Nesher	Jun 2011	60	-	Capability in controlled substances
Cadila Healthcare	Biochem	Dec 2011	70	1.3	Adds scale to India business
Dr Reddy's	Octoplus	Oct 2012	35	5.7	Boost R&D capability
Lupin	I'rom	Nov 2011	41	0.6	Scales up Japan operations
Sun Pharma	DUSA Pharma	Nov 2012	230	5	Boost R&D capability
Sun Pharma	URL portfolio	Dec 2012	90	1.0	Scale up US generics portfolio
Cipla	Medpro	Jul 2013	440		Consolidate front end
Torrent Pharma	Elder India portfolio	Dec 2013	65	5.0	Scales up India business
Lupin	Nanomi	Feb 2014	-	-	Boost R&D capability
Lupin	Lab Grin	Mar 2014	-	-	Boost R&D capability, entry in to Mexico
Sun Pharma	Ranbaxy	Apr 2014	3,200	1.5	Scale multiple geographies
Sun Pharma	Pharmalucence	July 2014	-	-	Boost R&D capability

Source: Company data

Historically, Indian companies have made acquisitions to enter new markets rather than enhance their therapeutic range or expertise. Lately though, we note acquisitions that provide access to specific therapeutic segments that the acquirer might find it difficult or time-consuming to replicate on its own. For example, Dr Reddy's purchase of Germany's Betapharm, Cadila buying Nikkho in Brazil and Lupin buying Kyowa in Japan were all market-entry acquisitions, whereas Sun Pharma bought Able Labs, Cadila purchased Nesher Pharma and, more recently, Dr Reddy's bought Octoplus to add to their capabilities.

Acquisitions largely value-accretive over the past five years

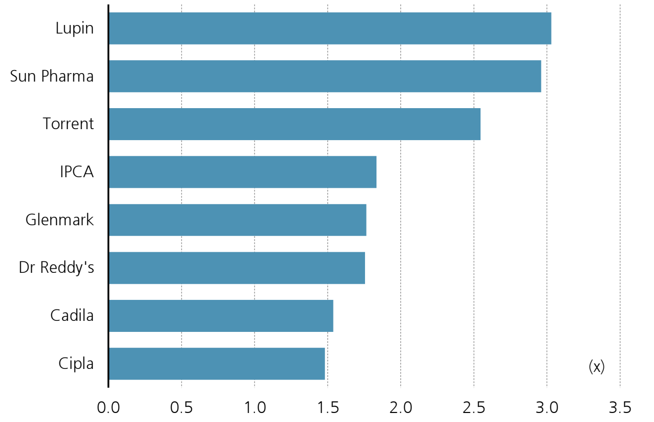
Sun Pharma and Lupin have carried out accretive acquisitions

The outcome of acquisitions in the sector has largely been value-accretive over the past five years; for example, Sun Pharma's acquisition of Taro and URL, and Lupin's acquisition of Kyowa. In the case of Sun Pharma, acquisitions have contributed c10% of the 30% sales CAGR over the past five years. The acquisitions were also value-accretive as reflected by the 8% expansion in the company's RoIC during this period. However, if we look back over 10 years, we note value destruction in the case of Dr Reddy's acquisition of Betapharm and Wockhardt's acquisition of Negma.

In order to look at the efficiency of capital deployed, we use the ratio of incremental revenues generated over FY11-14 to capital expenditure incurred over FY10-13 for each of the companies under coverage. Lupin, Sun Pharma and Torrent Pharma stand out in both cases whether one looks at total revenues and capex or if one excludes acquisitions. In the case of total revenues and capex, the figures are skewed in the case of an acquisition because there is a chance that a major part of revenue is not counted in the latest year while the cost is captured. Hence, we also calculate the ratio using organic revenues added during FY11-14 against capex incurred over FY10-13 (excluding money spent on acquisitions).

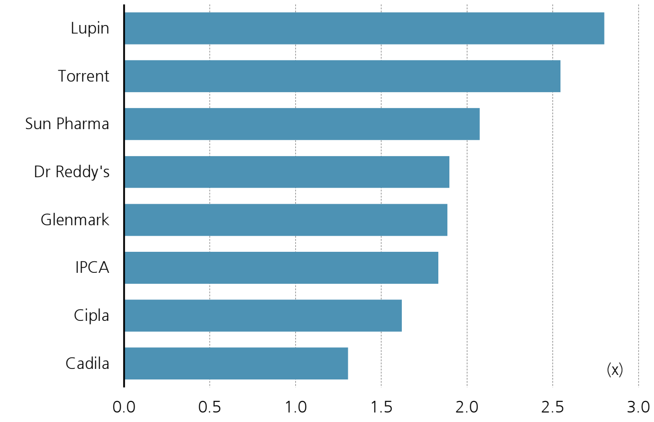
Lupin, Sun and Torrent have generated higher sales from capex incurred over the past five years

Figure 45: Incremental revenues (FY11-14)/incremental capex (organic growth FY10-13)



Source: Company data

Figure 46: Incremental revenues (FY11-14) to incremental capex (total growth FY10-13)



Source: Company data

Compared to global generic counterparts like Actavis, Mylan and Teva, Indian firms have stronger balance sheets. However, we note a substantially higher level of M&A activity among global generic companies primarily for two reasons. One is that Indian pharma companies are all family-run businesses where the idea of dilution or loss of control of the business is not entertained. The other factor that has driven deals in the US has been tax inversion. Many US-based multinational firms have acquired companies located in low-tax countries (eg, Ireland and the Netherlands) and restructured to replace the US parent with a foreign parent in order to reduce their overall tax rates.

Improved management teams

Most companies have expanded top-level management in recent years

Most leading Indian pharma companies have expanded top-level management personnel over recent years in order to manage the expanding scale and diversity of their businesses. We observe a fairly strong link between management focus and shareholder returns. Sun Pharma has delivered consistent returns for over a decade as it has been led by the controlling shareholder, Dilip Shanghvi, in our view. The company has expanded management capability with the addition of Kal Sundaram (ex-GSK) and Israel Makov (ex-Teva) in recent years. Lupin has seen Vinita Gupta and Nilesh Gupta take up key management roles. Cipla has seen strong additions to top and middle management over the past two years after the departure of Amar Lulla. Earlier the company had limited senior management experience and its performance had suffered. Cipla has seen undergone a transition with Kamil Hamied and Samina Vaziralli now controlling the business and providing clarity on the succession. In addition, the company has brought in top professional managers such as Subhanu Saxena (ex-Novartis) and Rajesh Garg (ex-Tesco).

Apart from beefing up management, Indian pharma companies have also brought in technical expertise in various fields. Lupin hired Dr Maurice Chagnaud to enhance its skill set in the respiratory segment. He was senior vice president of Central and Eastern Europe for Teva. Lupin also hired Paul McGarthy (ex-Nycomed) as President of its US subsidiary. Cipla brought in Frank Pieters (ex-Teva) as head of the European region and the global respiratory business, while Cadila hired Dr Sharad Govil (ex-Mylan) to lead product development in the transdermal segment.

Controlling families have a strong hold in the pharma sector

Figure 47: Management summary

Company	Controlling shareholder	Top management
Cadila	Pankaj Patel	Pankaj Patel and his son hold the top positions
Cipla	Y K Hamied	Subhanu Saxena as CEO, Rajesh Garg as CFO have been the key additions
Dr Reddy's	Reddy family	G V Prasad continues to be the CEO, Umang Vohra has taken role of head of North America generics
Glenmark	Glenn Saldanha	Mr Saldanha is the key person driving the business
IPCA	Godha family	Premchand Godha is the CEO. Both of his sons have taken over management responsibilities
Lupin	Gupta family	Vinita Gupta and Nilesh Gupta have taken over top management positions
Sun Pharma	Dilip Shanghvi	Mr Shanghvi continues to be MD; Kal Sundaram and Israel Makov have been added to key roles
Torrent	Mehta family	Samir Mehta is the key person driving the business

Source: Company data

Improved earnings quality not priced in

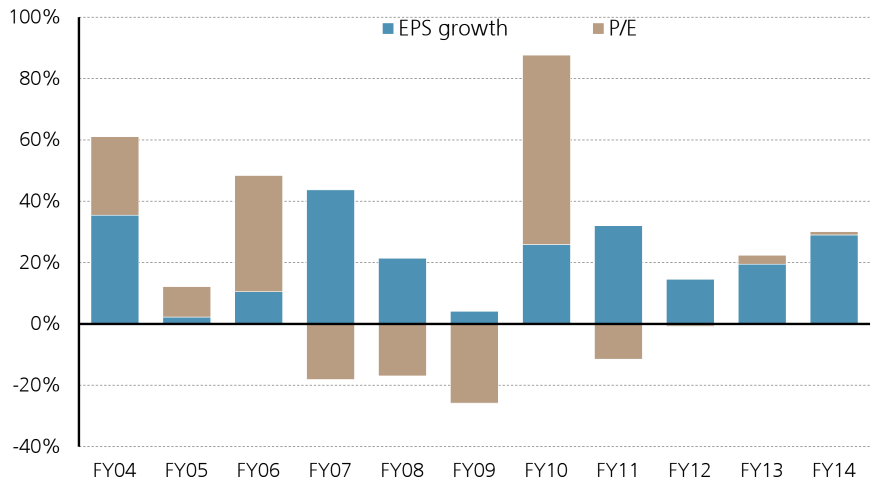
Earnings growth has driven performance of pharma stocks over past five years

Indian pharma companies have delivered a strong performance over the past five years due to earnings growth. While pharma PE multiples have moved up somewhat, they are at a five-year average in most cases on a cash flow basis. We expect earnings surprises to remain the biggest contributor to stock performance. We forecast a 21% CAGR in earnings over FY15-17 for our coverage universe. Dr Reddy's, Lupin and Sun Pharma are our preferred picks based on a strengthening presence in complex generics, channel consolidation in the US and potential benefits from M&A. We have Buy ratings on Cadila and Glenmark based on a strong US pipeline, and a Buy on Torrent due to acquisition synergies. We rate Cipla and IPCA Neutral due to high valuations and regulatory risks, respectively.

Pharma stocks attractive on price to cash flow

Large part of pharma performance over past four years has been led by earnings growth

Figure 48: Pharma sector performance: EPS growth versus PE multiple



Source: Datastream, Bloomberg

Figure 49: India pharma valuations

Company	Price	Market cap	Rating		Price Target			EPS (Rs), FY17E		PE (x)	EPS CAGR	ROIC (%)	EV/IC (x)	P/CF (x)
	(Rs)	(US$ m)	Old	New	Old	New	Upside	Old	New	FY17E	FY15-17E	FY17E	FY17E	FY17E
Lupin	1,503	10,854	Not Rated	Buy	N/A	1,825	21%	N/A	75.8	19.6	19%	60%	8.1	15.3
Sun	918	30,820	Buy	Buy	980	1,100	20%	43.7	42.1	21.1	17%	65%	10.9	19.1
Dr Reddy's	3,361	9,265	Buy	Buy	4,000	4,000	19%	193.3	179.8	18.5	19%	31%	4.7	14.8
Torrent	1,148	3,148	Not Rated	Buy	N/A	1,425	24%	N/A	67.7	16.6	23%	35%	4.3	12.5
Cadila	1,638	5,433	Not Rated	Buy	N/A	2,040	25%	N/A	89.1	18.5	30%	31%	4.4	20.0
Glenmark	745	3,274	Buy	Buy	920	900	21%	53.3	50.0	14.7	40%	26%	2.9	16.5
Cipla	654	8,511	Not Rated	Neutral	N/A	725	11%	N/A	26.8	24.0	26%	30%	5.3	25.0
IPCA	699	1,429	Not Rated	Neutral	N/A	810	16%	N/A	50.3	14.0	24%	27%	2.9	9.4
Sector										20.0	21%	49%	7.7	18.2

Note: Prices as 22 January 2015. Source: Reuters, UBS estimates

The figure above shows that leading pharma companies trade at 23.8x FY16E PE, although the average is skewed somewhat by Cipla as valuations have risen on expectations of a pick-up in the US business and inhaler launches. By excluding them, most companies in the sector trade at 18-24x FY16E PE.

We are positive on large-cap Indian pharma companies

We use nine parameters reflecting presence across markets, pipeline, earnings CAGR and valuation to determine our preference order. We assign equal weights to each parameter. Based on these parameters, our preference is for large-cap companies over mid-caps, as we believe the former are better positioned for longer term growth and that the risks to earnings are lower. Over the past one year, we note mid-cap valuations rerate to near large cap multiples, and we believe they are no longer attractive.

Key parameters for assessing Indian generics business

Figure 50: How Indian generic companies score on key parameters

	US pipeline	Complex generics	Biosimilars	PBM consolidation	EM portfolio	M&A	Core earnings CAGR	Returns	Valuation	Total score
Sun Pharma	4	4	0	4	2	5	2	5	3	29
Dr Reddy's	4	4	3	4	3	2	2	3	4	29
Lupin	4	3	1	3	3	4	3	4	2	27
Cadila	3	2	1	2	2	2	4	2	2	20
Torrent Pharma	2	1	0	1	3	3	3	3	3	19
Cipla	1	2	1	4	3	1	4	2	1	19
Glenmark	2	1	0	1	2	2	4	2	2	16
IPCA	1	1	0	1	2	2	3	2	3	15

Note: 0 = low, 5 = high. We have not included innovative R&D in this scheme for generics.
Source: UBS estimates

We use our multi-factor assessment of India pharma companies (including earnings growth and return ratios) to value Indian pharma stocks. We assign a higher PE to companies that compare well to our model. We use PE multiple on core earnings and add present value of cash flow for unsustainable and short-term opportunities (we do not assign a multiple). Furthermore, we corroborate our valuation on an EV/IC basis, as it values the strength of business models as reflected by RoIC. Some pharma companies have net cash balance sheets that result in suppressed ROE.

- We use 24x one-year forward PE for Cadila based on a strong US product pipeline and one of highest core earnings growth (a 30% EPS CAGR over FY15-17E) in the sector, even though its return ratios are lower than other pharma companies in our coverage universe.
- Similarly for Cipla, we use 25x one-year forward PE based on its extensive inhalational product franchise and a 26% FY15-17E earnings CAGR, despite comparatively low return ratios.
- While Dr Reddy's EPS growth is reasonably strong, we use 23x one-year forward PE because of potential risks from its exposure to Russia and comparatively lower return ratios. We see potential for earnings surprises from its niche US generics pipeline and from its biosimilars portfolio over the long term.
- Our estimate of Glenmark's earnings growth looks high at 40% in FY15-17E because of the launch of the Zetia generic (exclusive generic for six months). We exclude non-recurring earnings opportunities. While return ratios could be low over FY16 and FY17, we use 22x one-year forward PE because of potential surprises from the drug discovery pipeline (Glenmark is the only company with a focus on new drug discovery).

- We use a low PE for IPCA primarily on account of the potential risk to earnings in case of an escalation of the FDA's observation letter for its Ratlam plant to an import alert. IPCA's US pipeline is weak and we estimate return ratios will be lower than sector peers.

- Lupin's PE has risen on consistent earnings growth and strong expansion in return ratios (a 12% rise in ROE over FY10-15E) over the past five years. It has an extensive US pipeline and potential to grow from M&As, and use 25x one-year forward PE.

- Sun Pharma's PE has always been at a premium to peers because of its high growth rate and exceptionally high return ratios. We use a 25x one-year forward PE based on the five-year historical average. While Sun Pharma's FY15-17E earnings growth could be lower than peers, it could surprise on the upside via its strong US pipeline and potential M&As (substantial net cash balance sheet).

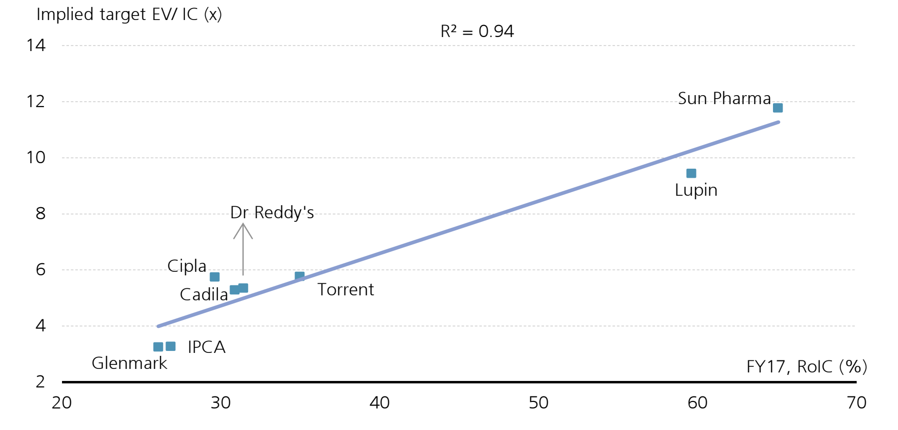
- We use 22x one-year forward PE for Torrent Pharma primarily as it is a mid-cap pharma stock and has a fairly low presence in complex generics in the US among stocks in our coverage universe.

Figure 51: Valuation parameters

Company	Target multiple, 1-yr forward (x)	Implied long term growth (%) *	Implied EV/IC (x) on price target	Price target (Rs)	Implied Upside (%)	Rating
Cadila	24x	7.5	5.3	2,040	25%	Buy
Cipla	25x	7.6	5.7	725	11%	Neutral
Dr Reddy's	23x	7.6	5.3	4,000	19%	Buy
Glenmark	22x	7	3.2	900	21%	Buy
IPCA	17x	5.7	3.3	810	16%	Neutral
Lupin	25x	7.5	9.4	1,825	21%	Buy
Sun Pharma	25x	7.1	11.8	1,100	20%	Buy
Torrent Pharma	22x	6.4	5.8	1,425	24%	Buy

* For long-term growth we use FY19-40E. Source: UBS estimates

Figure 52: Valuation based on EV/IC



Source: UBS estimates

We like Sun for potential synergies with Ranbaxy

Among Indian pharma companies, we prefer Sun Pharma based on potential synergies with Ranbaxy, its limited competition portfolio in the US and a profitable domestic franchise. We believe management has shown its astuteness in acquiring and turning around various businesses. We estimate 17% core earnings growth for FY15-17 and rate the stock a Buy with a price target of Rs1,10. We expect strong upside from a weaker rupee as Sun Pharma has a large US dollar exposure.

Dr Reddy's has typically traded at a small discount to the other large cap Indian pharma stocks. Its valuation has been further impacted due to the weaker rouble. We forecast a 19% profit CAGR over FY15-17. We rate the stock a Buy with a price target of Rs4,000, which is based on 23x one-year forward PE. We believe the company will be a strong beneficiary of the biosimilars opportunity over the long term, especially as PBMs become stronger within the healthcare value chain.

Stronger PBMs could open up biosimilars opportunity for generics. Dr Reddy's may be a strong beneficiary

We rate Lupin a Buy as we expect the strongest organic growth due to an extensive pipeline in the US and strong execution in branded generics markets, namely India, Japan and South Africa. While Lupin's valuation at about 23x FY16E PE is higher than its five-year average, we forecast 19% earnings growth over FY15-17 coupled with RoIC expansion. The key risk remains a potential generic for Suprax, which contributes about 6% of profits, although this has been mitigated by the recent addition of the Alinia and Locoid brands.

Strong generics pipeline and emerging market presence makes it attractive

Cipla trades substantially above its five-year historical PE, as we believe the market expects strong earnings accretion from the launch of its inhaler portfolio (especially combination products) in developed markets. We rate the stock a Neutral with a price target of Rs725, based on 25x one-year forward PE, as near-term growth looks weak and accretion from the inhaler portfolio is likely to be gradual. Cipla is likely to benefit from PBM consolidation, as the trend could aid market share in the inhalational portfolio. However, Cipla has yet to file its inhaler products in the US, and accordingly the launches and earnings are at least three years away.

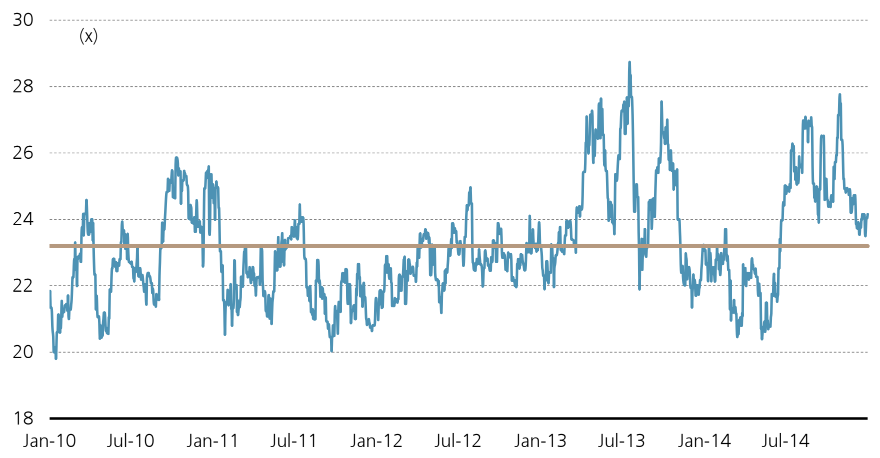
While valuations are high, Cipla could benefit from the launch of inhalers in the US over the long term

Potential for pharmas to rerate

Given the strong performance of Indian pharma stocks, a frequently asked question is whether the sector can rerate further. In our view, the pharma sector has done well over the past five years largely from earnings surprising on the upside rather than valuations moving up. While we have seen large cap pharma PE multiples move between 18x to 26x, earning upgrades have been far greater, eg, 20-30% each year in the case of Sun Pharma. We continue to expect a strong performance by Indian pharmas, largely led by earnings growth, and do not incorporate an expansion in price-to-earnings multiples.

Pharma sector performance has been driven primarily by earnings upgrades

Figure 53: Sun Pharma one-year forward PE based on consensus estimates



Source: Bloomberg

Sun Pharma one-year forward PE multiple is in line with historical average

We have also been asked whether pharma multiples could come down as and when the high growth phase is over. This could be similar to when the IT sector's PE came off in 2011 when demand visibility fell as the banking and financial services (BFSI) vertical faced issues. BFSI demand recovered in 2012 resulting in a pick-up in IT sector multiples. In our view, the pharma sector will continue to deliver strong growth and expansion in return ratios, and we do not expect valuations to come off meaningfully.

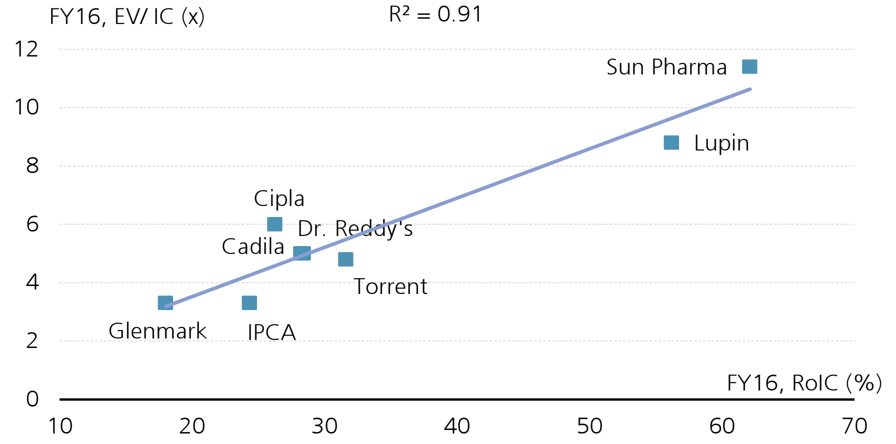
Strong correlation between valuations and returns

Pharma valuations have high correlation to RoICs

India pharma companies' valuations strongly correlate with the return ratio. The trend has held up well over the past several years and companies with improving RoIC have recorded a rise in valuations: the stronger the expansion in the return ratio, the higher the expansion in valuations. We have noted improvements for Lupin and Sun Pharma over the past five years while Cadila, Cipla and Glenmark have lagged due to company-specific factors.

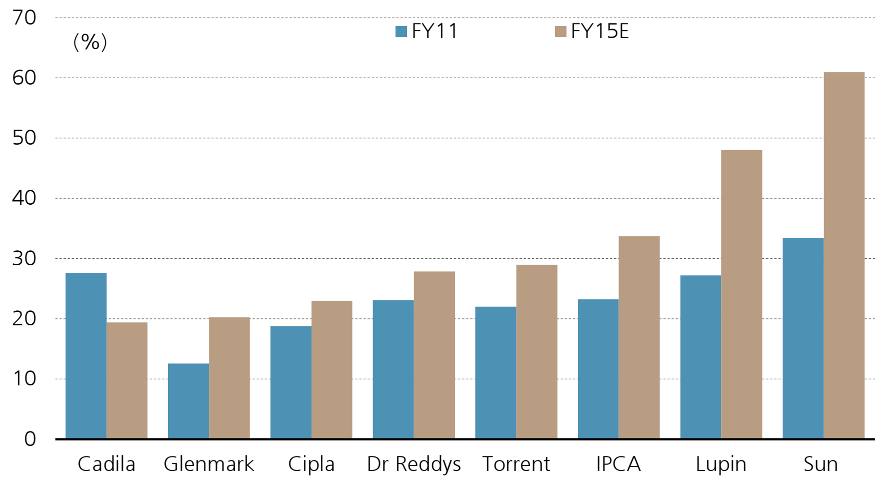
Over the past two years, Indian companies have increased operating margin due to product launches where competition was limited and pricing was better in the US, and operating leverage. Despite capacity additions and R&D investments to enhance presence in new segments, we note impressive growth in cash flows and improvements in return ratios.

Figure 54: Valuation scatter chart



Source: UBS estimates

Figure 55: RoIC expansion for Indian pharma companies

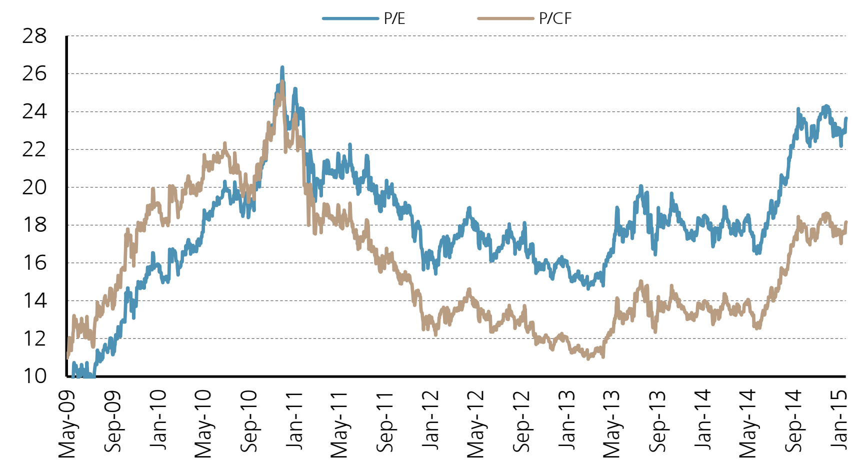


Source: Company data, UBS estimates

Indian pharma companies have recorded expansion in RoIC, led by increasing gross margin and rising capital turnover as capex plateaus. Most companies have undergone reasonable capacity expansion recently, and we do not expect a jump in capex in the immediate future. This, coupled with margin expansion aided by limited competition launches in the US, should continue to drive return ratios. With the rise in return ratios, Indian pharma companies have recorded expansion in EV/IC as well as price-to-book multiples.

Most companies have delivered strong RoIC expansion led by US business ramp up

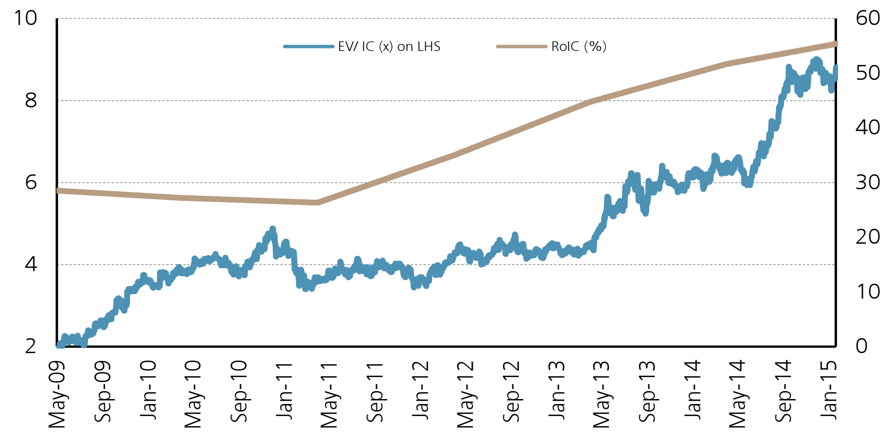
Figure 56: Lupin's PE versus price-to-cash flow



Source: Company data, UBS

Large India pharma firms (Lupin for example) inexpensive on price-to-cash flow

Figure 57: Lupin's valuations have moved up as return ratios expanded



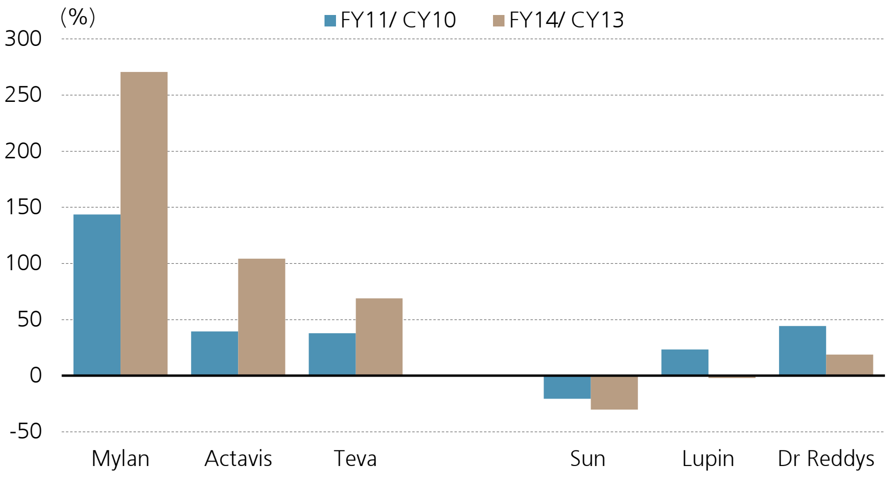
Source: Company data

Expansion in return ratio led to increase in valuation multiple over time

We believe valuation premium to global peers is justified

Indian pharmaceutical companies have been delivering strong organic growth in the US with market share gains led by an increase in the number of filings and approvals. We expect the gains to continue versus global peers like Actavis, Mylan and Teva on an organic basis.

Figure 58: Net gearing of select generic companies

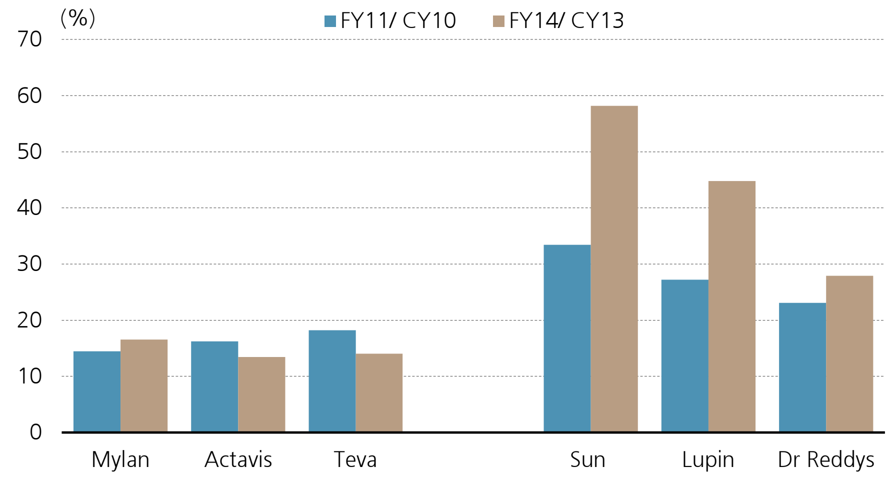


Source: Company data, Bloomberg

At the same time, Indian firms have stronger balance sheets than their Western counterparts that allows them to grow via inorganic means. Return on invested capital for Indian companies has expanded substantial over FY11-14 and also remains higher than Actavis, Mylan and Teva.

Return ratios for India firms are much higher as well

Figure 59: RoIC (pre-tax) comparison of select generic companies



Source: Company data, Bloomberg

Figure 60: International generic companies

Company	Price (LC)	Market cap (US$ m)	Rating	Price target (LC)	Upside	EPS (US$) FY16E	EPS (US$) FY17E	PE (x) FY16E	PE (x) FY17E	EPS CAGR FY15-17E	EV/Sales (x) FY17E	ROIC (%) FY17E	EV/IC (x) FY17E	P/CF (x) FY17E
Teva	58	50,360	Neutral	57	-3%	5.2	5.1	11.4	11.4	-1%	3.5	14%	1.7	7.8
Mylan	55	21,694	Buy	65	19%	4.8	5.4	11.4	10.1	14%	2.5	18%	1.5	5.6
Actavis	276	47,432	Buy	333	21%	20.5	24.4	13.5	11.3	19%	3.0	67%	4.2	3.7
Impax	37	2,587	Neutral	36	-2%	2.4	2.9	14.9	12.5	14%	2.8	22%	2.1	8.7
Hospira	64	10,983	Neutral	57	-11%	3.1	3.5	20.9	18.0	19%	2.1	18%	2.2	13.7
Perrigo	159	20,020	Buy	190	20%	9.0	10.4	17.7	15.3	18%	2.6	18%	1.7	9.6

Note: Prices as of 22 January 2015. Source: Reuters, UBS estimates

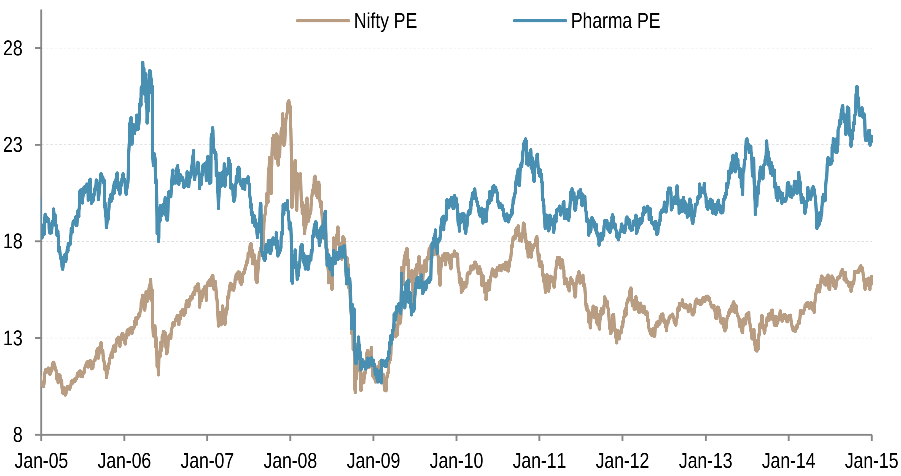
We believe Indian pharma companies will continue to trade at higher PE multiples than international generic companies because of higher organic growth, better return ratios and stronger balance sheets.

Premium to the broader index

For most of the past 10 years, the Indian pharma sector traded at a premium to the broader Nifty due to consistent earnings growth and superior return ratios. We believe the premium was justified and is sustainable based on strong underlying growth and expanding return ratios. However, the premium has expanded recently due the expansion of Cadila and Cipla's multiples on expectations of an earnings uptick. We believe the gap will narrow with the normalisation of PE earnings multiples in the case of these two stocks in particular.

Pharma PE to remain at premium to Nifty PE

Figure 61: Pharma versus the Nifty PE(x)



Note: Pharma includes UBS coverage. Source: Bloomberg

Low volatility in pharma earnings aids the premium to the broader index

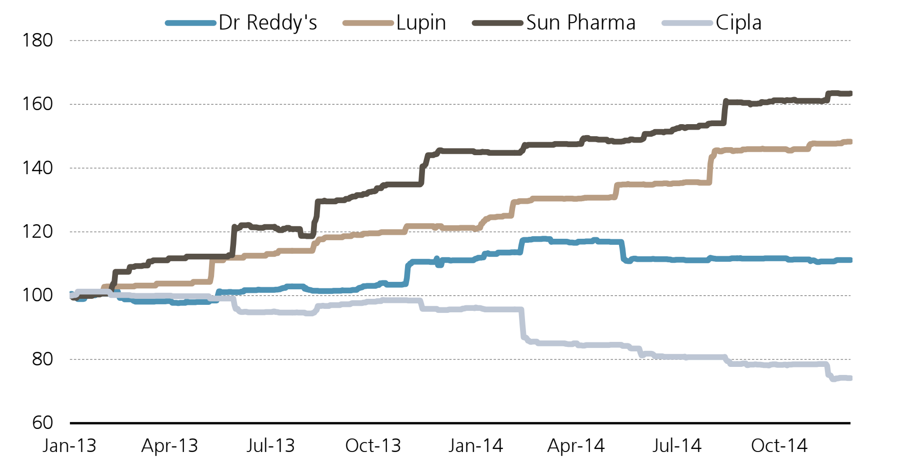
The pharma sector's PE remains high in comparison to the Nifty as well as other sectors, as volatility in sector earnings growth is much lower. Consumer staples, utilities and pharma have the least volatility in earnings growth.

Potential for earnings surprises

Consensus estimates for most of the leading Indian pharma companies have moved up over the past two years due to limited competition launches in the US generics market. We expect upgrade potential for most of the leading Indian pharmaceutical companies and for sector performance to remain strong.

Further upgrades likely on limited competition launches

Figure 62: Movement of consensus FY15 EPS estimates over the past two years



Source: Bloomberg

Strong upgrades for most large-caps over the past two years

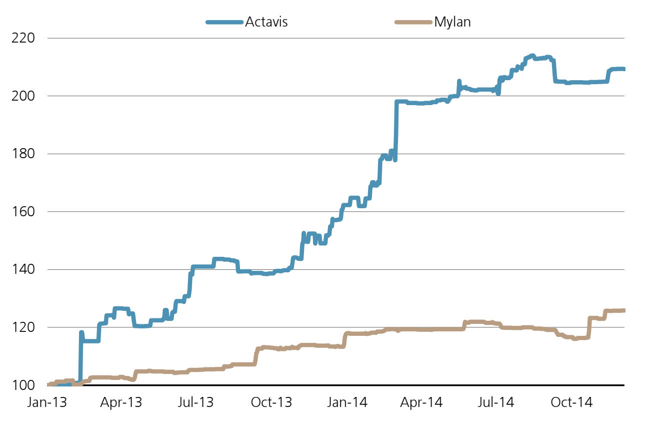
Sun Pharma has recorded the highest upgrades due to limited competition product launches and favourable pricing for subsidiary Taro's dermatology portfolio. Similarly Dr Reddy's and Lupin benefited for niche product launches in their US businesses. On the other hand, Cipla recorded downgrades as the company's costs rose due to new hires coupled and impact of the domestic pricing policy. As a result, stock performance was subdued until the middle of 2014. Its share price performance has picked with expectations of product (inhaler) launches in the EU and the US, however.

Upgrades visible at US generic companies as well

The earnings upgrade cycle is also visible in the case of Actavis and Mylan that have a strong presence in the US generics sector. While these firms had slower organic growth over the past three years than their Indian peers due to their larger base in the US, a flurry of M&A deals (along with tax inversion deals) resulted in strong accretion to earnings and as a result facilitated share price performance. At the same time, there has also been some expansion in PE multiples.

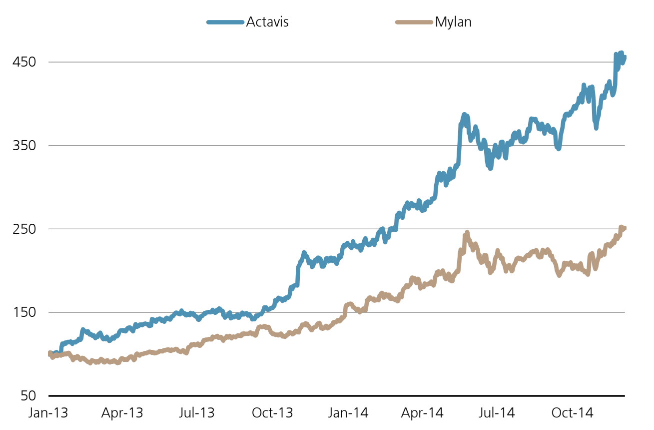
US generic companies have done well on earnings upgrades as well as PE expansion

Figure 63: Consensus EPS for Actavis and Mylan



Source: Bloomberg

Figure 64: Stock performance (rebased)



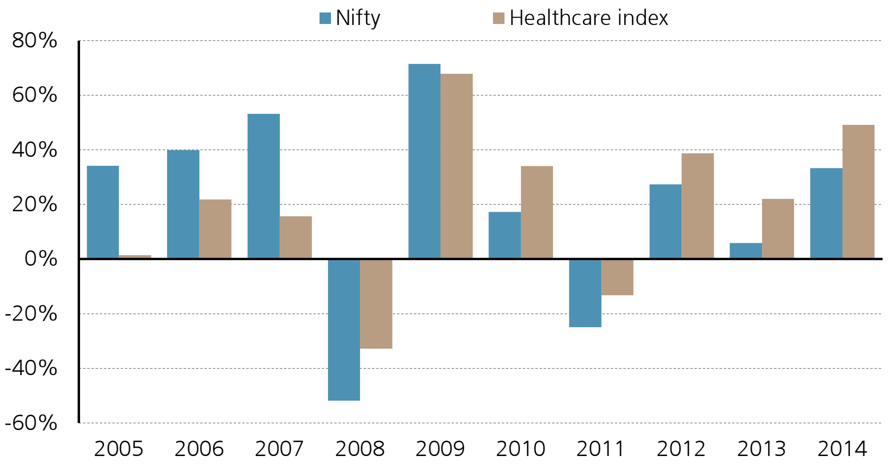
Source: Bloomberg

Large caps have outperformed over the past decade

We note that the healthcare index performance against the Sensex has been fairly strong over recent years. At the same time, the sectorial index underperformed in 2005-08 when the broader markets were performing strongly, as earnings growth at some of the large stocks like Cipla, Dr Reddy's and Ranbaxy suffered due to stock-specific issues. While the index has shown periods of outperformance and underperformance, we highlight that Lupin and Sun Pharma have been consistent outperformers. Even Cadila and Dr Reddy's show up as better performers than the Sensex, although the extent is not as great. We continue to expect Sun Pharma and Lupin to outperform the broader index over the next two years as their US pipeline remains robust.

Lupin and Sun have been consistent performers

Figure 65: Nifty versus Healthcare index returns

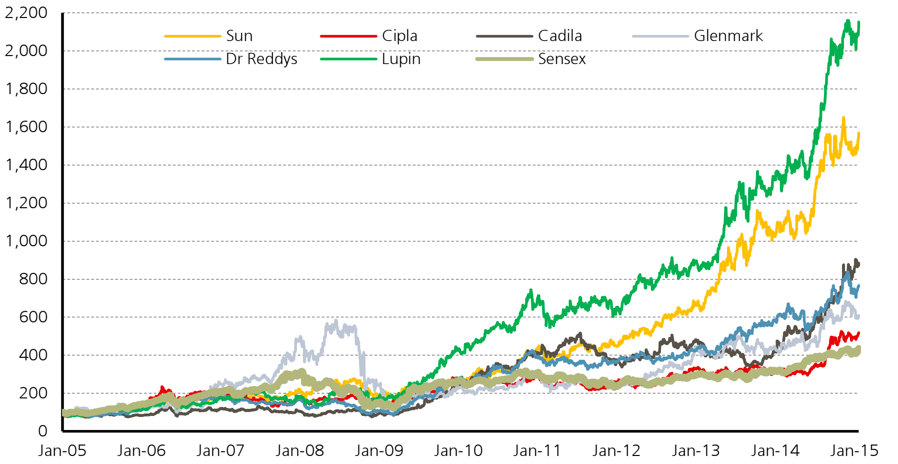


Source: Bloomberg

Healthcare has outperformed each year over the past five years

Cipla and Ranbaxy (the latter should be part of Sun Pharma soon) have underperformed as earnings growth lagged peers. Cipla's growth was lower in comparison to other leading India companies as its US market exposure was fairly small and the company had not put effort into building a pipeline for the US market. Ranbaxy suffered due to the FDA's import ban and faced issues at its other businesses (India and emerging markets) where it grew slower than peers.

Figure 66: Long-term performance of Indian pharma companies



Source: Bloomberg

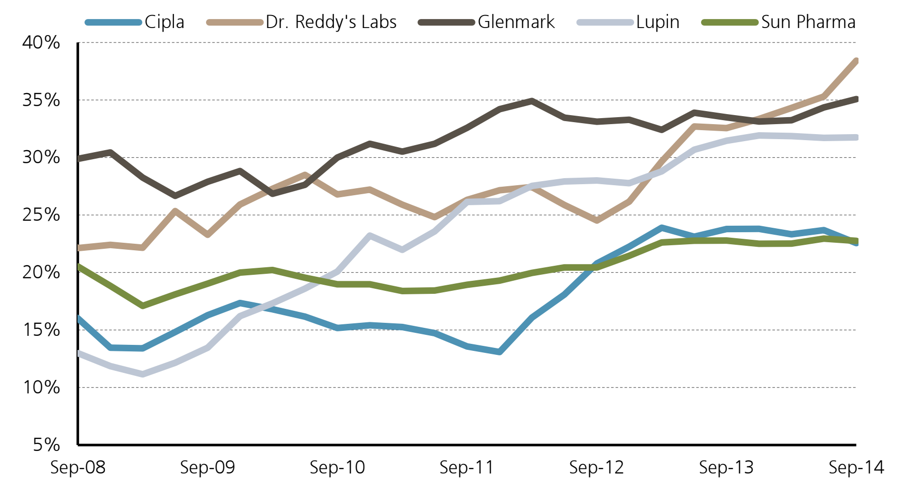
Most large pharmas have materially outperformed the Sensex over the long term

Uptick in foreign holdings of Indian pharma stocks

FII holding has increased in recent quarters

The Indian pharma sector has recorded one of highest rises in foreign institutional investor (FII) holdings over the past five years; holdings increased in the quarter ending September 2014 as well. However, FII ownership of the sector is underweight relative to the weight in the index (Nifty), and the underweight has been increasing over the past two years. Notwithstanding that increase, the Indian pharma sector continued to do well over the past two years, as earnings growth remained well above overall earnings growth of index companies.

Figure 67: FII holding in key pharma names



Source: Capitaline

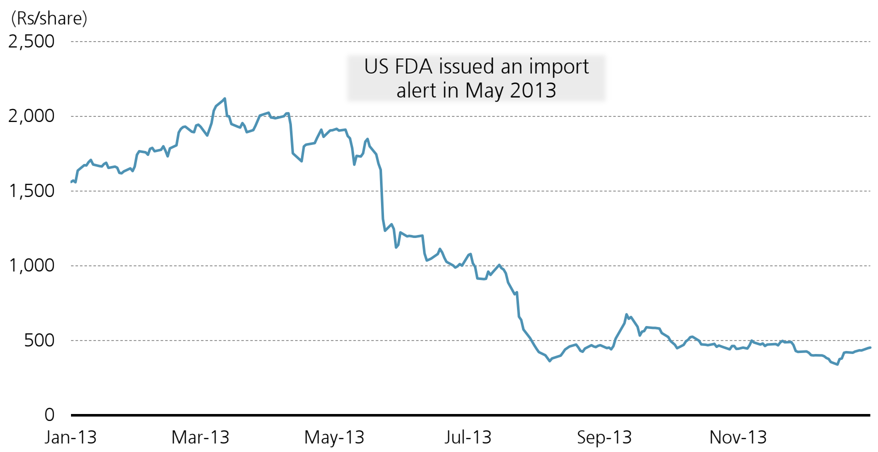
Risks to our investment view

Increasing expectations at the FDA

Over the years, the FDA has been under increasing pressure from Congress to monitor the manufacturing standards of drugs imported into the US. After the appointment of Dr Margaret Hamburg as FDA Commissioner in 2009, she acknowledged the need to strengthen vigilance and enforcement, and the regulator has been stricter in the implementation of protocols. This has resulted in various companies getting penalised. We note varying reactions to news flow on stock prices depending on the seriousness of the penalty and the importance of the manufacturing facility involved.

FDA has strengthened vigilance and enforcement

Figure 68: Wockhardt's stock price fell following FDA action



Source: Bloomberg

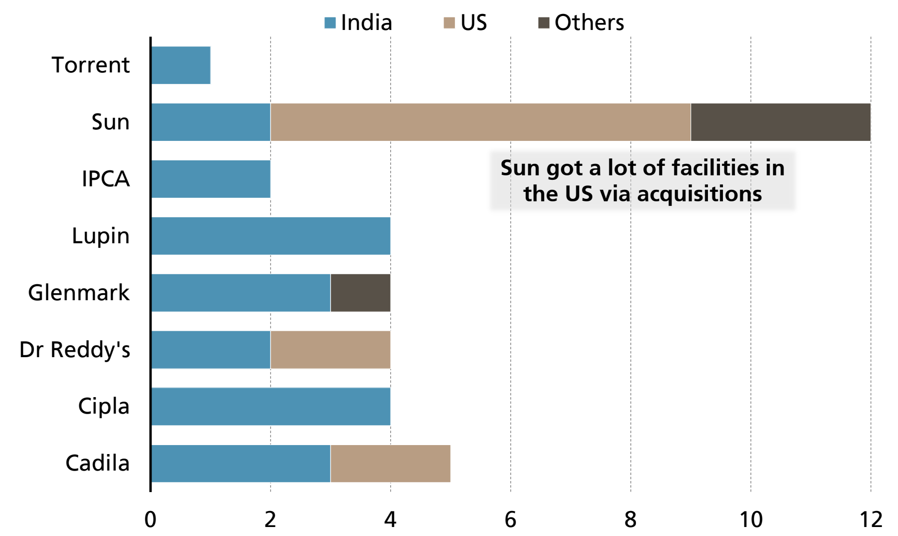
Figure 69: US FDA penalties for Indian firms

Apart from Indian firms, a number of MNC companies have been penalised

Company	Date	Penalty	Resolution
IPCA	July-14	No penalty, voluntary shutdown by IPCA of Ratlam facility	Pending
Sun Pharma	Mar-14	Import alert on Karkhadi	Pending
Ranbaxy	Jan-14	Import alert on Toansa facility	Pending
Ranbaxy	Sep-13	Import alert on Mohali facility	Pending
Wockhardt	May-13	Import alert on Aurangabad facility	Pending
Cadila Healthcare	Jun-11	Warning letter on Moraiya plant	Resolved by Jul-12
Caraco	Jun-09	Seizure of Detroit facility	Reapproved in Aug-12
Lupin	May-09	Warning letter on Mandideep plant	Resolved by Jan-10
Ranbaxy	Sep-08	Import alert on Dewas and Paonta Sahib facilities and Application Integrity Policy at Paonta Sahib	Pending

Source: FDA, Company data

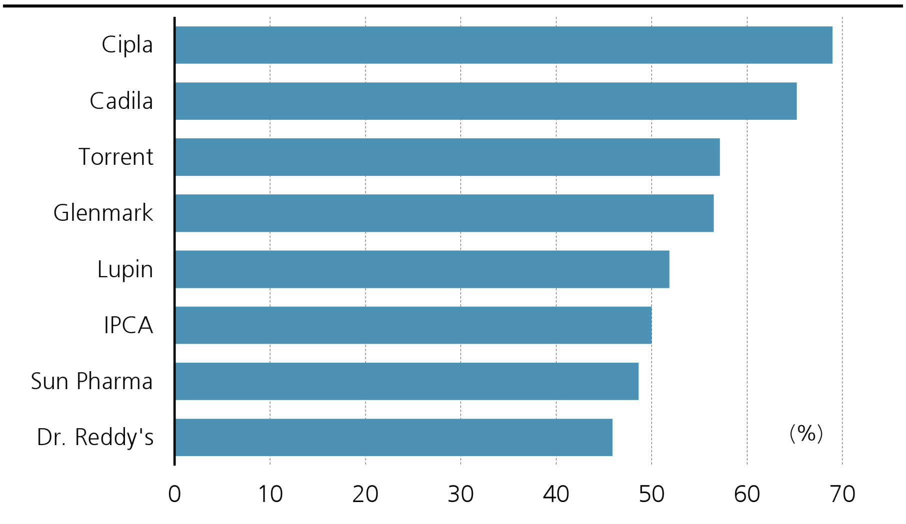
Figure 70: Location of FDA approved facilities of Indian companies



Source: Company data

Indian firms are de-risking by diversifying manufacturing locations

Figure 71: Percentage of inspections resulting in observation letter (Form 483)



Source: FDA

Larger firms better off in general

Potential measures to control generic pricing in the US

Legislation to control generic pricing unlikely to impact the industry

With the sharp rise in prices for some of generic products in the US over the past two years, there has been a debate about measures to contain the increases. One proposal is to make generic companies give rebates to government-run insurers if companies hike drug prices higher than inflation. With the debate in the US regarding price rises for generic products, we see the possibility for measures to deter generic companies from raising prices sharply. However, we do not view this as a material threat to companies with a strong pipeline of limited competition products.

Currency movements could impact financial performance

High proportion of revenues are US$-based

Exports comprise 50-80% of total revenues for leading Indian pharma companies with c50% of sales being US-dollar denominated. Weakness in the rupee versus the US$ results in more rupee for the same dollar income and vice versa. Every one percent weakness in the rupee against the US dollar could result in a 0.2-0.4% upgrade to operating earnings and vice versa. Some pharmaceutical companies hedge their foreign currency exposure in the near to medium term. In the case of sharper currency movements, companies try to alter product prices in the affected geographies.

Indian pharma companies have a patchy presence in emerging markets and business is usually done in local currencies. Hence, when there are sharp movements in these currencies, growth can be affected. Dr Reddy's has a fairly large presence in Russia and the CIS (15% of total revenue) while Lupin has exposure to South Africa. Sun Pharma should have higher exposure to emerging markets if the Ranbaxy acquisition is completed. Cadila, Cipla, IPCA and Torrent have diverse emerging market exposure as well.

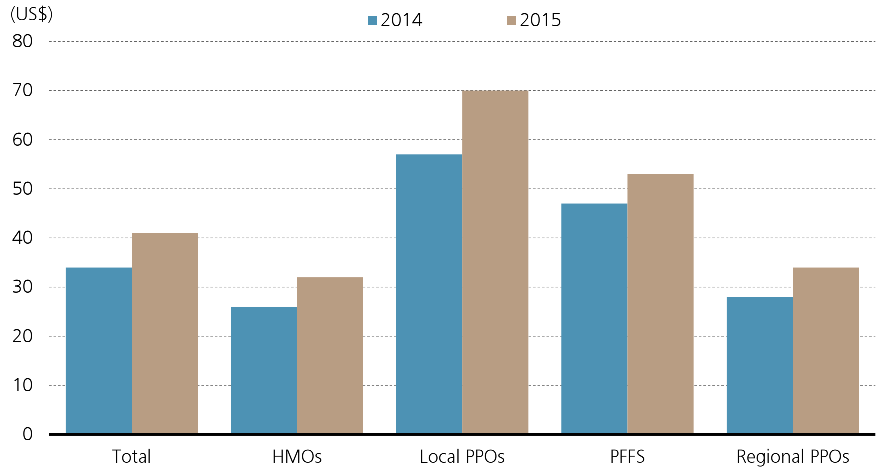
Will the threat to Obamacare change our view?

Obamacare is not a major determinant of growth of the generics industry

We do not view the Affordable Care Act ("Obamacare") as a major determinant of our investment view on the sector. Obamacare is a mild positive for the generics sector, in our view, as the expansion of insurance cover to the lower income population should be positive for volumes in the generics sector. However, it will not change drug penetration materially in the US, in our view. There has been much debate over rising insurance premiums and healthcare costs under Obamacare. With the Republicans attaining a majority in both houses, there might be some change to healthcare policy in the future.

Healthcare premiums have increased due to implementation of Obamacare

Figure 72: Weighted average monthly premiums for Medicare Advantage plans



Source: Centre for Medicare and Medicaid Services

Our positive view of the sector is based on the strong pipelines of generic companies in the US. Companies with the right product profile are likely to make substantially more money than companies targeting large volume products, in our view.

Consolidation among PBMs could impact pricing further

We expect further pricing pressure in the US especially for drugs where multiple suppliers are present. The performance of companies with large exposures to these products could be affected, as PBMs continue to squeeze prices. Companies with higher exposure to limited competition products should remain largely insulated from the pressure. In order to save money, PBMs are trying to force a switch to generic alternatives of similar molecules for products where generics have not come to market.

Threat to pay-for-delay deals

We do not foresee major penalties on generic companies

The noise against pay-for-delay deals has been increasing and investors have questioned whether there will be penalties for generic companies or lower benefit for generic companies. Pay-for-delay deals involve a generic company agreeing to delay a launch if the innovator (brand) company compensates the generic company partly or wholly for the loss of income of the generic company launched earlier. However, this is usually more complicated than it sounds. In most cases, product patent litigation is ongoing when an innovator defends its intellectual property while a generic company would argue against the validity, etc, of the patent. Such litigation can go on for years. Even if a company loses, it could choose to appeal and so on. A settlement between a brand and a generic company closes the litigation and the concerned parties decide on the generic product launch date. Courts are burdened with several cases and litigation settlements are an optimal way out for the parties involved. In our view, the character of the deals has changed and will change further so that no direct or in-direct payments are involved; instead parties agree to a generic launch and end the patent litigation on that particular product. We do not foresee major penalties or lower benefits for generic companies.

Price controls in emerging markets

Various markets have implemented price controls recently, negatively impacting growth

Emerging markets have adopted or extended price controls over the past few years due to the tough global economic situation. In April 2010, Russia implemented price controls for prescription drugs covering nearly 40% of the market by value. This negatively impacted firms like Dr Reddy's, IPCA and Ranbaxy. In 2013, India enhanced the scope of price controls from 74 (12% of the market by value) to 350+ molecules (34% of the market by value). The National Pharmaceutical Pricing Authority (NPPA), the key regulator of drug prices, plans to extend price controls to more product that are based on molecules already under price control. These measures have slowed down India market growth rates and negatively impacted most firms.

Penalties in case of at-risk launches

Generics firms regularly challenge product patents in the US as part of their business strategy. Generic companies typically launch products either after winning or settling the litigation with innovators. In some cases where a firm thinks it has a strong case, it launches the generic version while the litigation is on-going. However, in the case of an adverse outcome of the litigation, generic firms have to pay a penalty to the drug innovator for damaging the product's prospects. Last year, Sun Pharma lost such a case for Protonix and had to pay US$550m as a penalty to Pfizer, the innovator of the product.

Company pages

Lupin Limited
Geared up

Equities

India
Pharmaceuticals

12-month rating	**Buy**
	Prior: Not Rated
12m price target	**Rs1,825.00**
	Prior: -
Price	**Rs1,503.30**

RIC: LUPN.BO **BBG:** LPC IB

Trading data and key metrics

52-wk range	Rs1,503.30-866.25
Market cap.	Rs670bn/US$10.9bn
Shares o/s	446m (ORD)
Free float	52%
Avg. daily volume ('000)	467
Avg. daily value (m)	Rs663.9
Common s/h equity (03/15E)	Rs87.5bn
P/BV (03/15E)	7.7x
Net debt / EBITDA (03/15E)	NM

EPS (UBS, diluted) (Rs)

	From	To	% ch	Cons.
03/15E	-	53.5	-	52.7
03/16E	-	64.6	-	62.3
03/17E	-	75.8	-	72.5

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Moving towards complex generics
Lupin's management has been increasing R&D over the past five years to build a presence in the complex generics market in the US, despite being a late entrant among large Indian pharma companies. The company has demonstrated better-than-peer execution and cost leadership that has enabled it to grow rapidly in the US generics market. We expect an increase in the number of product launches as well as a rise in the proportion of revenues from complex products in the US. Lupin has a strong set of filings for oral contraceptives and ophthalmics, and is expanding in dermatology and injectables. We forecast a 19% CAGR in US generics revenue over FY15-17. We incorporate a Rs62/US$1.00 exchange rate; rupee weakness would therefore improve realisations.

Good execution in branded markets
Within the branded generics markets, Lupin has grown by entering new segments where competition was limited. Over the past 10 years, Lupin has built a presence in inhalers from scratch and is now No. 2 in the Indian market. It has scaled up its presence in Japan through acquisitions and intends to enhance margins via better sourcing. We expect Lupin to record a 17% sales CAGR in India and a 14% CAGR in Japan sales over FY15-17E.

Cash flow to rise
The company's expected strong launch calendar over the next three years should result in high earnings growth. With a number of limited competition launches, we expect Lupin's US portfolio to improve and profitability to rise substantially. Progress in the US generics business along with sustained momentum in India and other emerging markets could drive a 19% profit CAGR over FY15-17E. We expect Lupin to generate strong free cash flow over FY15-17, translating to higher dividend payouts or potential M&As. Lupin said it intends to enhance its presence in the US branded segment via acquisitions. And it may look at technology platforms that would boost its reach in complex generics.

Valuation: Initiate coverage with a Buy rating
Strong growth rates and improving ROIC should help Lupin sustain valuation and we expect near-term triggers from the launch of limited competition products in the US. Our Rs1,825 price target is based on 25x one-year forward PE, in line with peers. We note that the launch of the Suprax generic could be a risk to recurring earnings.

Highlights (Rsm)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Revenues	68,204	93,694	110,866	130,909	152,013	176,030	203,133	230,845
EBIT (UBS)	12,223	19,399	27,529	34,456	40,386	46,740	54,326	63,973
Net earnings (UBS)	8,677	13,142	18,364	23,990	28,976	34,008	40,244	48,140
EPS (UBS, diluted) (Rs)	19.4	29.4	41.0	53.5	64.6	75.8	89.8	107.4
DPS (Rs)	3.2	4.0	6.0	7.5	9.0	11.0	13.0	15.0
Net (debt) / cash	(12,375)	(7,296)	1,438	20,028	37,944	59,987	87,201	120,875

Profitability/valuation	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
EBIT margin %	17.9	20.7	24.8	26.3	26.6	26.6	26.7	27.7
ROIC (EBIT) %	26.3	35.0	44.8	51.7	56.2	59.6	64.0	69.8
EV/EBITDA (core) x	14.8	11.7	12.8	17.1	14.2	12.3	10.6	8.0
P/E (UBS, diluted) x	23.5	19.6	20.6	28.1	23.3	19.8	16.7	14.0
Equity FCF (UBS) yield %	(2.3)	3.2	3.5	3.1	3.4	4.2	5.1	6.2
Net dividend yield %	0.7	0.7	0.7	0.5	0.6	0.7	0.9	1.0

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of Rs1,503.30 on 22 Jan 2015 22:38 HKT

Investment Thesis

Lupin Limited

12-month rating **Buy**

12m price target **Rs1,825.00**

Investment case

Lupin's solid execution in its key markets—India and the US—has driven strong revenue growth. The company's US generics business has a strong ANDA (abbreviated new drug application) pipeline with a focus on oral contraceptives, ophthalmics, and potential first-to-file opportunities. Management targets US$5bn in revenue by FY18. The company continues to look for acquisition opportunities in the US branded space and in emerging markets. We estimate a 19% profit CAGR over FY15-17 and expect strong free cash flow.

Upside scenario

In our upside scenario, we factor in faster approvals in the US and do not assume an erosion in branded business, resulting in 25% YoY growth in sales for the US business in FY16-17 compared to our base case of 17.5% YoY growth. This suggests an EPS of Rs79 for FY17E. The stock could trade at 26x one-year forward PE, implying an upside scenario of Rs2,015.

Downside scenario

In our downside scenario, we assume generic competition for Suprax and slower approvals in the US to result in 10% YoY growth in sales in the US business in FY16-17 compared to our base case of 19% YoY growth. This suggests an EPS of Rs69 for FY17E. The stock could trade at 20x one-year forward PE, implying a downside scenario of Rs1,340.

Upcoming catalysts

The recent launch of Celebrex and Diovan could drive earnings. Launches of Nexium and Welchol could be key catalysts.

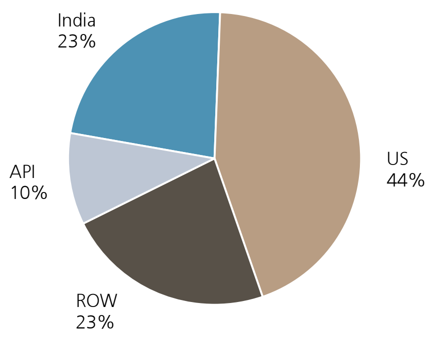
Business description

Lupin is an India-based pharmaceutical company focused on the manufacture and global marketing of finished dosages and active pharmaceutical ingredients (APIs). Lupin is one of the largest pharma companies in the domestic market as well as the US. The company is also increasing its presence in Japan and Europe. Recently, Lupin established two dedicated centers of excellence for research in inhalation and complex injectable.

Industry outlook

We are positive on Indian pharma companies based on strong growth in the US generic market. We expect market share gains in the US, as India firms launch more new products and technological capabilities improve with higher investment in R&D. We expect the Indian pharma market to grow at a 12% CAGR in sales over the next five years. We also expect Indian companies to increase their presence in emerging markets through a combination of organic and inorganic growth.

Revenues by region (FY14)



Source: Company data

EBIT by product segment

The company does not release segmental margins.

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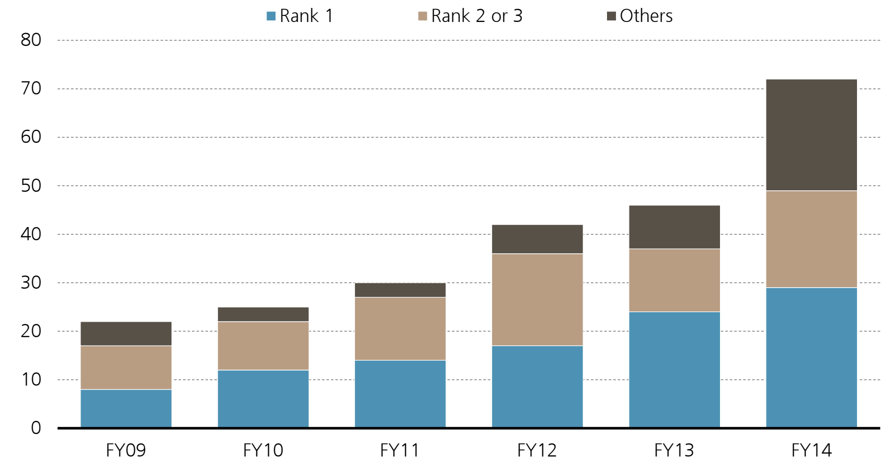
Markets share led by cost competitiveness and execution

Lupin has had one of the best execution track records among Indian firms in the US, aided by its cost leadership and effective supply chain management. We expect market share to remain high based on the fact that its product filings in complex segments are backed by its own active ingredients.

Figure 73: Lupin's market share ranks for products launched in the US

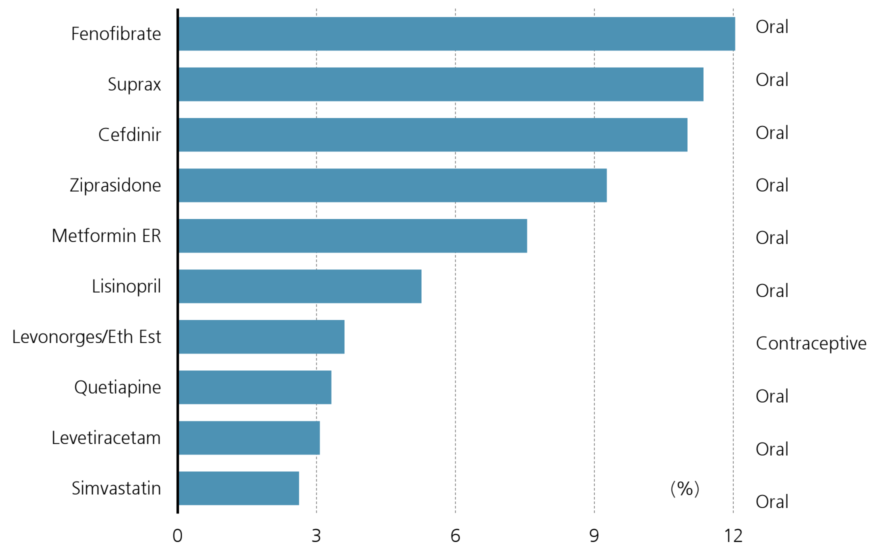


Source: Company data

Building presence in complex generics

Management is increasing R&D to build a presence in the complex generics segment in the US, despite being a late entrant among large Indian pharma companies.

Figure 74: Top-10 products in the US (% of total US revenue)



Source: IMS Health (Oct-2014 moving annual total)

Figure 75: Lupin's target segments

Injectables	Ophthalmics	Oral contraceptive	Dermatology
• Lupin has little presence in injectable segment as compared to peers • It is targeting select injectable products via recently acquired Nanomi B.V.	• Has more than ten filings in this segment. • Zymaxid was Lupin's first launch. • We expect more such launches over next two years.	• Has a broad portfoio of filings (30+) for this US$3.5bn segment in the US. • Has launched more than 10 out of these.	• Has done three filings in dermatology. • Has done tie-ups to develop products in the segment.

Source: Company data, UBS estimates

Figure 76: Lupin's product pipeline

Brand	Generic	Mkt size (US$ m)	Expected timing	Status	Competition
Celebrex	Celecoxib	2,000	3QFY15	Launched	Teva, Actavis, Mylan and Lupin
Renvela	Sevelamer	700	2015	Settled	Impax is first to file
Detrol LA	Tolterodine	600	4QFY15	Waiting for approval	3-5 players
Nexium	Esomeprazole	2,300	2015	Waiting for approval	4-7 competitors
Welchol	Colesevelam	550	1QFY16	Patent blocking	Impax, Lupin and Actavis
Ortho Tricyclen Lo	Estradiol and Norgestimate	450	3QFY16	Settled	Teva is FTF then Sun, Lupin and Mylan
Glumetza	Metformin ER	150	4QFY16	Approved and settled for Jan 2016 launch	Exclusive for six months
Generess	Norethindrone and ethinyl estradiol	75	FY16		Mylan is FTF and has settled in Apr 2014 for launch in Oct 2015
Coreg CR	Carvedilol CR	200	FY17	Settled	Sun Pharma (FTF), Lupin and Anchen
Prolensa	Bromfenac	30	FY17	Patent blocking	Sole filer
Prezista	Darunavir	850	FY17	Tentative approval	Lupin, Mylan
Epzicom	Abacavir and Lamivudine	500	FY17	Patent blocking	Teva (FTF), Lupin
Fosrenol	Lanthanum	110	FY17	Settled	Natco is FTF (Lupin will market)
Apriso	Mesalamine ER	75	FY17	Waiting for approval	Lupin is first to file
Tykerb	Lapatinib	110	FY17	Patent blocking, waiting for approval	Natco is FTF (Lupin will market)
Prevacid solutab	Lansoprazole ODT	250	Unclear	Patent blocking	3-5 competitors
Ranexa	Ranolazine	450	FY19	Settled	Lupin is FTF
Lumigan	Bimatoprost	500	-	Patent blocking	Sandoz (FTF), Lupin
Minastrin 24 Fe	Ethinyl estradiol and norethindrone	200	FY20	Patent blocking	Lupin is FTF

Source: FDA, IMS Health, company data

Reducing dependence on the US branded business

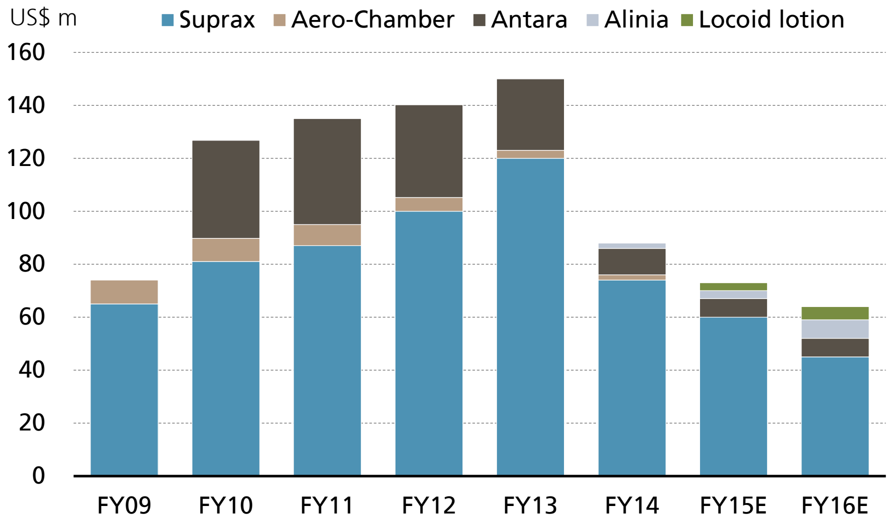
Lupin is one of few Indian pharmaceutical companies to have successfully developed a portfolio of branded products in the US market. While margins in this segment are usually higher, growth is threatened by generic launches. Over the past three years, there was a reduction in branded sales as a percentage of total revenue as well as profits, thereby reducing the concomitant risks.

Figure 77: US branded business built via acquisitions or licensing

Brands	Mode	Time	Cost (Rs m)	Risk to brands
Suprax	Bought	2003	750	Generic competition potentially in FY16
Antara	Bought	Sep-09	1,814	Mylan entered in Feb-13
Aerochamber	In-licensed	Aug-08	-	-
Alinia	In-licensed	Aug-13	-	-
Locoid Lotion	In-licensed	Sep-13	-	-

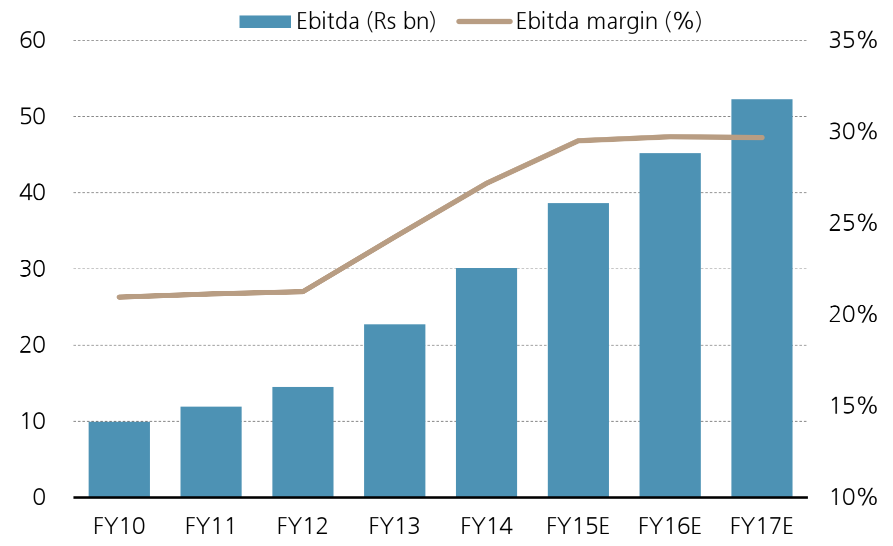
Source: Company data

Figure 78: Lupin's US branded business



Source: Company data, UBS estimates

Figure 79: Lupin's EBITDA margin

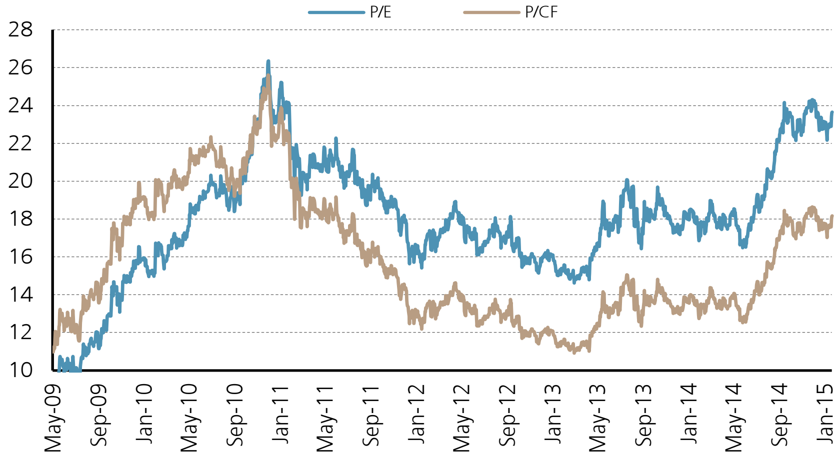


Source: Company data, UBS estimates

Strong growth and rising return ratios driving valuations

An increasing number of limited competition launches in the US have driving earnings upgrades. Lupin benefitted strongly from the Niaspan and Cymbalta generics last year. We expect to see a strong pipeline and for earnings upgrades to continue. Lupin's RoIC has expanded 14% over the past three years, resulting in an increase in its valuation.

Figure 80: Lupin's PE and P/CF ratio



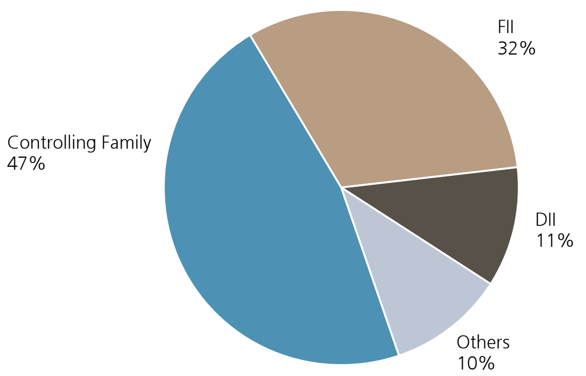
Source: Reuters, UBS

Figure 81: UBS versus consensus

(Rs m)		FY15	FY16	FY17
Revenue	UBS	130,909	152,013	176,030
	Consensus	133,572	156,034	179,809
	Diff	-2%	-3%	-2%
EBITDA	UBS	38,631	45,188	52,262
	Consensus	37,874	45,131	51,775
	Diff	2%	0%	1%
PAT	UBS	23,990	28,976	34,008
	Consensus	23,578	27,824	32,348
	Diff	2%	4%	5%

Source: Bloomberg, UBS estimates

Figure 82: Lupin's shareholding pattern (Q2 FY15)



Source: BSE

Lupin Limited (LUPN.BO)

Income statement (Rsm)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
Revenues	**68,204**	**93,694**	**110,866**	**130,909**	18.1	**152,013**	16.1	**176,030**	**203,133**	**230,845**
Gross profit	42,165	58,214	72,693	88,733	22.1	101,960	14.9	116,440	132,406	151,777
EBITDA (UBS)	**14,498**	**22,720**	**30,138**	**38,631**	28.2	**45,188**	17.0	**52,262**	**60,676**	**71,276**
Depreciation & amortisation	(2,275)	(3,322)	(2,610)	(4,176)	60.0	(4,802)	15.0	(5,522)	(6,350)	(7,303)
EBIT (UBS)	**12,223**	**19,399**	**27,529**	**34,456**	25.2	**40,386**	17.2	**46,740**	**54,326**	**63,973**
Associates & investment income	92	258	1,054	1,638	55.4	1,682	2.7	2,517	3,839	5,472
Other non-operating income	0	0	0	0	-	0	-	0	0	0
Net interest	(355)	(410)	(266)	(327)	-22.7	(200)	38.8	(200)	(200)	(200)
Exceptionals (incl goodwill)	0	0	0	0	-	0	-	0	0	0
Profit before tax	**11,961**	**19,246**	**28,317**	**35,767**	26.3	**41,868**	17.1	**49,057**	**57,965**	**69,245**
Tax	(3,086)	(5,842)	(9,621)	(11,445)	-19.0	(12,560)	-9.7	(14,717)	(17,390)	(20,774)
Profit after tax	**8,875**	**13,404**	**18,695**	**24,322**	30.1	**29,308**	20.5	**34,340**	**40,576**	**48,472**
Preference dividends	0	0	0	0	-	0	-	0	0	0
Minorities	(199)	(263)	(331)	(331)	0.0	(331)	0.0	(331)	(331)	(331)
Extraordinary items	0	0	0	0	-	0	-	0	0	0
Net earnings (local GAAP)	**8,677**	**13,142**	**18,364**	**23,990**	30.6	**28,976**	20.8	**34,008**	**40,244**	**48,140**
Net earnings (UBS)	**8,677**	**13,142**	**18,364**	**23,990**	30.6	**28,976**	20.8	**34,008**	**40,244**	**48,140**
Tax rate (%)	25.8	30.4	34.0	32.0	-5.8	30.0	-6.2	30.0	30.0	30.0

Per share (Rs)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
EPS (UBS, diluted)	19.4	29.4	41.0	53.5	30.5	64.6	20.8	75.8	89.8	107.4
EPS (local GAAP, diluted)	19.4	29.4	41.0	53.5	30.5	64.6	20.8	75.8	89.8	107.4
EPS (UBS, basic)	19.4	29.4	41.0	53.5	30.5	64.6	20.8	75.8	89.8	107.4
Net DPS (Rs)	3.2	4.0	6.0	7.5	24.9	9.0	20.0	11.0	13.0	15.0
Cash EPS (UBS, diluted)[1]	24.5	36.8	46.8	62.8	34.2	75.3	19.9	88.2	103.9	123.7
Book value per share	89.0	112.7	151.4	195.2	28.9	249.3	27.7	312.3	386.8	476.6
Average shares (diluted)	446.5	447.1	448.0	448.4	0.1	448.4	0.0	448.4	448.4	448.4

Balance sheet (Rsm)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
Cash and equivalents	4,025	4,349	7,975	24,028	201.3	41,944	74.6	63,987	91,201	124,875
Other current assets	41,675	48,630	52,682	59,353	12.7	66,900	12.7	75,444	85,121	96,086
Total current assets	**45,700**	**52,978**	**60,657**	**83,380**	37.5	**108,844**	30.5	**139,431**	**176,322**	**220,960**
Net tangible fixed assets	26,863	27,425	29,820	31,812	6.7	35,010	10.1	37,988	40,638	43,335
Net intangible fixed assets	5,071	5,683	6,777	6,777	0.0	6,777	0.0	6,777	6,777	6,777
Investments / other assets	28	21	1,785	21	-98.8	21	0.0	21	21	21
Total assets	**77,662**	**86,108**	**99,039**	**121,990**	23.2	**150,652**	23.5	**184,217**	**223,758**	**271,093**
Trade payables & other ST liabilities	19,445	22,019	22,593	27,694	22.6	31,769	14.7	36,765	42,550	49,281
Short term debt	0	0	0	0	-	0	-	0	0	0
Total current liabilities	**19,445**	**22,019**	**22,593**	**27,694**	22.6	**31,769**	14.7	**36,765**	**42,550**	**49,281**
Long term debt	16,400	11,645	6,537	4,000	-38.8	4,000	0.0	4,000	4,000	4,000
Other long term liabilities	1,442	1,632	1,779	1,779	0.0	1,779	0.0	1,779	1,779	1,779
Preferred shares	0	0	0	0	-	0	-	0	0	0
Total liabilities (incl pref shares)	**37,288**	**35,297**	**30,909**	**33,472**	8.3	**37,548**	12.2	**42,543**	**48,328**	**55,060**
Common s/h equity	39,651	50,216	67,461	87,517	29.7	111,772	27.7	140,010	173,435	213,707
Minority interests	723	595	669	1,001	49.5	1,332	33.1	1,663	1,995	2,326
Total liabilities & equity	**77,662**	**86,108**	**99,039**	**121,990**	23.2	**150,652**	23.5	**184,217**	**223,758**	**271,093**

Cash flow (Rsm)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
Net income (before pref divs)	8,677	13,142	18,364	23,990	30.6	28,976	20.8	34,008	40,244	48,140
Depreciation & amortisation	2,275	3,322	2,610	4,176	60.0	4,802	15.0	5,522	6,350	7,303
Net change in working capital	(6,270)	(5,496)	(3,466)	(1,569)	54.7	(3,472)	-121.3	(3,549)	(3,892)	(4,232)
Other operating	528	275	417	331	-20.5	331	0.0	331	331	331
Operating cash flow	**5,210**	**11,243**	**17,924**	**26,928**	50.2	**30,637**	13.8	**36,313**	**43,034**	**51,542**
Tangible capital expenditure	(9,992)	(2,981)	(4,837)	(6,168)	-27.5	(8,000)	-29.7	(8,500)	(9,000)	(10,000)
Intangible capital expenditure	0	0	0	0	-	0	-	0	0	0
Net (acquisitions) / disposals	0	0	0	0	-	0	-	0	0	0
Other investing	0	0	0	0	-	0	-	0	0	0
Investing cash flow	**(9,992)**	**(2,981)**	**(4,837)**	**(6,168)**	-27.5	**(8,000)**	-29.7	**(8,500)**	**(9,000)**	**(10,000)**
Equity dividends paid	(1,684)	(2,094)	(2,938)	(3,934)	-33.9	(4,721)	-20.0	(5,770)	(6,820)	(7,869)
Share issues / (buybacks)	52	2	386	0	-	0	-	0	0	0
Other financing	0	0	0	0	-	0	-	0	0	0
Change in debt & pref shares	4,776	(4,755)	(5,107)	(2,537)	50.32	0	-	0	0	0
Financing cash flow	**3,144**	**(6,848)**	**(7,659)**	**(6,472)**	15.5	**(4,721)**	27.0	**(5,770)**	**(6,820)**	**(7,869)**
Cash flow inc/(dec) in cash	**(1,638)**	**1,414**	**5,428**	**14,289**	163.2	**17,916**	25.4	**22,043**	**27,214**	**33,674**
FX / non cash items	1,461	(1,090)	(1,802)	1,764	-	0	-	0	0	0
Balance sheet inc/(dec) in cash	**(177)**	**324**	**3,626**	**16,053**	342.7	**17,916**	11.6	**22,043**	**27,214**	**33,674**

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.[1]Cash EPS (UBS, diluted) is calculated using UBS net income adding back depreciation and amortization.

Lupin Limited (LUPN.BO)

Valuation (x)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
P/E (local GAAP, diluted)	23.5	19.6	20.6	28.1	23.3	19.8	16.7	14.0
P/E (UBS, diluted)	23.5	19.6	20.6	28.1	23.3	19.8	16.7	14.0
P/CEPS	18.6	15.6	18.1	23.9	20.0	17.1	14.5	12.2
Equity FCF (UBS) yield %	(2.3)	3.2	3.5	3.1	3.4	4.2	5.1	6.2
Net dividend yield (%)	0.7	0.7	0.7	0.5	0.6	0.7	0.9	1.0
P/BV x	5.1	5.1	5.6	7.7	6.0	4.8	3.9	3.2
EV/revenues (core)	3.1	2.8	3.5	5.0	4.2	3.6	3.2	2.5
EV/EBITDA (core)	14.8	11.7	12.8	17.1	14.2	12.3	10.6	8.0
EV/EBIT (core)	17.5	13.7	14.0	19.2	15.9	13.7	11.8	8.9
EV/OpFCF (core)	22.0	15.8	15.7	21.0	17.2	14.7	12.5	9.3
EV/op. invested capital	4.6	4.8	6.3	9.9	8.9	8.2	7.6	6.2

Enterprise value (Rsm)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Market cap.	203,530	256,091	376,983	669,825	669,825	669,825	669,825	669,825
Net debt (cash)	9,899	9,836	9,836	(10,733)	(28,986)	(28,986)	(28,986)	(104,038)
Buy out of minorities	619	659	632	835	1,166	1,498	1,829	2,326
Pension provisions/other	0	0	0	0	0	0	0	0
Total enterprise value	**214,048**	**266,585**	**387,450**	**659,928**	**642,006**	**642,337**	**642,669**	**568,113**
Non core assets	(28)	(21)	(1,785)	(21)	(21)	(21)	(21)	(21)
Core enterprise value	**214,020**	**266,564**	**385,666**	**659,907**	**641,985**	**642,317**	**642,648**	**568,093**

Growth (%)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Revenue	20.8	37.4	18.3	18.1	16.1	15.8	15.4	13.6
EBITDA (UBS)	21.5	56.7	32.6	28.2	17.0	15.7	16.1	17.5
EBIT (UBS)	19.5	58.7	41.9	25.2	17.2	15.7	16.2	17.8
EPS (UBS, diluted)	0.4	51.2	39.5	30.5	20.8	17.4	18.3	19.6
Net DPS	6.6	25.1	50.0	24.9	20.0	22.2	18.2	15.4

Margins & Profitability (%)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Gross profit margin	61.8	62.1	65.6	67.8	67.1	66.1	65.2	65.7
EBITDA margin	21.3	24.2	27.2	29.5	29.7	29.7	29.9	30.9
EBIT margin	17.9	20.7	24.8	26.3	26.6	26.6	26.7	27.7
Net earnings (UBS) margin	12.7	14.0	16.6	18.3	19.1	19.3	19.8	20.9
ROIC (EBIT)	26.3	35.0	44.8	51.7	56.2	59.6	64.0	69.8
ROIC post tax	19.5	24.4	29.6	35.1	39.4	41.7	44.8	48.8
ROE (UBS)	24.2	29.2	31.2	31.0	29.1	27.0	25.7	24.9

Capital structure & Coverage (x)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Net debt / EBITDA	0.9	0.3	(.0)	(0.5)	(0.8)	(1.1)	(1.4)	(1.7)
Net debt / total equity %	30.7	14.4	(2.1)	(22.6)	(33.5)	(42.3)	(49.7)	(56.0)
Net debt / (net debt + total equity) %	23.5	12.6	(2.2)	(29.2)	(50.5)	(73.4)	(98.8)	NM
Net debt/EV	5.8	2.7	(0.4)	(3.0)	(5.9)	(9.3)	(13.6)	(21.3)
Capex / depreciation %	NM	89.7	185.4	147.7	166.6	153.9	141.7	136.9
Capex / revenue %	14.7	3.2	4.4	4.7	5.3	4.8	4.4	4.3
EBIT / net interest	34.5	47.3	NM	NM	NM	NM	NM	NM
Dividend cover (UBS)	6.1	7.3	6.8	7.1	7.2	6.9	6.9	7.2
Div. payout ratio (UBS) %	16.5	13.6	14.6	14.0	13.9	14.5	14.5	14.0

Revenues by division (Rsm)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Others	68,204	93,694	110,866	130,909	152,013	176,030	203,133	230,845
Total	**68,204**	**93,694**	**110,866**	**130,909**	**152,013**	**176,030**	**203,133**	**230,845**

EBIT (UBS) by division (Rsm)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Others	12,223	19,399	27,529	34,456	40,386	46,740	54,326	63,973
Total	**12,223**	**19,399**	**27,529**	**34,456**	**40,386**	**46,740**	**54,326**	**63,973**

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

Sun Pharmaceuticals Industries Limited

Time to reap the benefits

Equities

India
Pharmaceuticals

12-month rating	**Buy**
12m price target	**Rs1,100.00**
	Prior: Rs980.00
Price	**Rs918.35**

RIC: SUN.BO **BBG:** SUNP IB

Trading data and key metrics

52-wk range	Rs918.35-560.75
Market cap.	Rs1,902bn/US$30.9bn
Shares o/s	2,071m (ORD)
Free float	36%
Avg. daily volume ('000)	2,224
Avg. daily value (m)	Rs1,881.6
Common s/h equity (03/15E)	Rs237bn
P/BV (03/15E)	8.0x
Net debt / EBITDA (03/15E)	NM

EPS (UBS, diluted) (Rs)

	From	To	% ch	Cons.
03/15E	33.5	31.0	-7.51	30.7
03/16E	38.4	37.5	-2.15	35.9
03/17E	43.7	42.1	-3.75	42.1

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We expect strong synergies from the potential Ranbaxy merger

We see strong potential for synergies for both Sun Pharma and Ranbaxy if the flagged merger goes ahead. In the initial two years after the deal, we believe cost reductions will be the key area and expect faster revenue growth over the longer term. We forecast over US$300m in cost reductions over two to three years that should help the combined entity enhance margins and deliver high earnings growth. Sun Pharma's management has always focussed on capital efficiency, as highlighted by its acquisition track record. Sun's high net cash position could allow it to buy more specialty assets.

Margin leverage from its portfolio

We believe Sun's US business will drive margins over FY15-17**,** led by niche launches in the US. We estimate a 15% revenue CAGR for Sun's core US business over FY15-17. In India, Sun has been one of the fastest-growing drug manufacturers in the past 10 years with a 19% revenue CAGR versus the industry's 12%. It is a leader in lifestyle-related therapies for cardiologic, neurological and metabolic disorders that make up more than 70% of its domestic revenue. We expect India growth to deliver a 17% revenue CAGR over FY15-17E.

Return ratios expanding

Niche US launches (especially of *Gleevec*), rising profitability at subsidiary Taro and steady business in emerging markets should lead to a 17% CAGR in operating earnings over FY15-17E. This would boost Sun's RoIC. Sun has outperformed its guidance in most of the past 10 years. With a substantial net cash balance sheet, we think Sun is likely to go for more acquisitions.

Valuation: We assume coverage; raise price target from Rs980 to Rs1,100

Sun's superior earnings growth and high return ratios should provide support for its valuation. We use 25x one-year forward PE to derive our price target. We expect substantial synergies from the potential acquisition of Ranbaxy and expect it to be EPS-accretive in the first year after acquisition. The key risk to our investment view is an escalation of the FDA's observation letter for the Halol facility to a harsher penalty.

Highlights (Rsm)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Revenues	80,054	112,389	160,044	184,394	220,641	246,136	277,916	314,140
EBIT (UBS)	30,083	45,777	67,073	79,460	96,009	106,911	122,218	140,226
Net earnings (UBS)	26,578	35,666	56,589	64,208	77,748	87,156	100,665	116,607
EPS (UBS, diluted) (Rs)	12.8	17.2	27.3	31.0	37.5	42.1	48.6	56.3
DPS (Rs)	2.1	2.5	1.5	4.5	6.0	7.0	8.0	9.5
Net (debt) / cash	30,465	37,990	50,293	92,216	152,053	222,775	302,879	394,470

Profitability/valuation	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
EBIT margin %	37.6	40.7	41.9	43.1	43.5	43.4	44.0	44.6
ROIC (EBIT) %	41.9	49.6	58.2	58.6	63.3	65.1	69.1	73.1
EV/EBITDA (core) x	14.6	13.5	15.4	21.6	18.1	16.4	14.5	10.9
P/E (UBS, diluted) x	19.4	19.7	20.2	29.6	24.5	21.8	18.9	16.3
Equity FCF (UBS) yield %	1.5	1.4	2.9	2.3	3.3	3.9	4.5	5.2
Net dividend yield %	0.9	0.7	0.3	0.5	0.7	0.8	0.9	1.0

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of Rs918.35 on 22 Jan 2015 22:38 HKT

Investment Thesis

Sun Pharma

12-month rating **Buy**

12m price target **Rs1,100.00**

Investment case

We expect Sun Pharma to deliver strong growth driven by potential synergies with Ranbaxy. We believe there is substantial scope for cost reductions and estimate over US$300m in cost cuts over a two to three year period. This should help the combined entity enhance margins and deliver high earnings growth. Management continues to drive growth in the US via acquisitions, a trend that is likely to continue based on substantial cash generation. Niche US launches (especially of Gleevec), rising profitability at subsidiary Taro and steady business in emerging markets could lead to an 18.5% CAGR in operating earnings over FY15-17E. This should boost Sun's already-high ROIC.

Upside scenario

In our upside scenario, we factor in 20% YoY growth in the US business led by new launches and URL product introductions, and further price hikes by Taro. Sun could trade at 28x one-year forward PE, translating to an upside scenario of Rs1,180. Acquisitions could provide further upside, especially in the case of Sun Pharma with over US$1.5bn of net cash on its balance sheet.

Downside scenario

Regulatory action on its manufacturing plants could lead to flat to declining revenues from the US. Sun Pharma received an observation letter from the FDA for its Halol facility, which contributes c20 of net profits. In such a case, the stock could trade at 20x one-year forward PE for a downside scenario of Rs660.

Upcoming catalysts

The completion of the Ranbaxy acquisition, the Gleevec launch in February 2016 and the re-introduction of URL products.

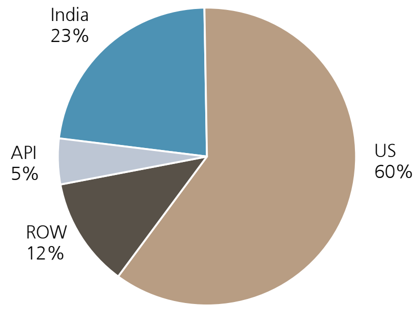
Business description

Sun Pharmaceuticals Industries (Sun Pharma) is India's largest pharmaceutical company with a strong presence in chronic segments such as cardiology, diabetology, and the central nervous system. Sun Pharma acquired a majority stake in US-listed Taro Pharma in September 2010. It acquired DUSA and URL Pharma in FY13. In September 2014, it in-licensed Merck's tildrakizumab. The founders, the Shanghvi family, own 64% of of the company.

Industry outlook

We are positive on Indian pharma companies based on strong growth in the US generic market. We expect market share gains in the US, as India firms launch more new products and technological capabilities improve with higher investment in R&D. We expect the Indian pharma market to grow at a 12% CAGR in sales over the next five years. We also expect Indian companies to increase their presence in emerging markets through a combination of organic and inorganic growth.

Revenues by region (FY14)



Source: Company data

EBIT by product segment

The company does not release segmental margins.

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We expect strong synergies with Ranbaxy

We see strong potential for synergies for both Sun Pharma and Ranbaxy if the flagged merger goes ahead with the potential for over US$300m in cost reductions over a two to three year period. This should help the combined entity enhance margins and deliver high earnings growth.

Figure 83: Pro forma P&L: Sun and Ranbaxy combined

(Rs m)	FY16E	FY17E	FY18E	FY19E
Net sales	**349,005**	**368,694**	**407,649**	**451,683**
Growth (%)	*14%*	*6%*	*11%*	*11%*
Material cost	91,711	99,444	109,474	119,547
SG&A	66,167	64,220	66,941	70,134
Staff costs	46,467	46,345	49,780	53,404
R&D	20,313	22,685	24,688	26,113
Ebitda	**127,211**	**138,865**	**159,633**	**185,349**
Margins (%)	*36.4%*	*37.7%*	*39.2%*	*41.0%*
PAT	92,802	104,984	123,639	146,207
EPS (Rs)	**38.4**	**43.5**	**51.2**	**60.6**
EPS growth (%)	*31.9*	*13.1*	*17.8*	*18.3*

Source: UBS estimates

We believe the potential for cost savings in India followed by the US is high. Considering the relatively small presence of Sun in emerging markets, cost savings would likely be limited. Rationalisation of manufacturing facilities would be another area where the combined entity could be able to realise savings.

Figure 84: Potential synergies for the combined entity

	Growth enhancement	Cost savings	Potential contribution
India	Moderate	High	US$100m+
US	Low	Moderate	US$80m+
Emerging markets	High	Low	US$50m+
Non-apportioned costs			US$70m+
Upside from regulatory cost reduction		High	US$80-100m

Source: UBS estimates

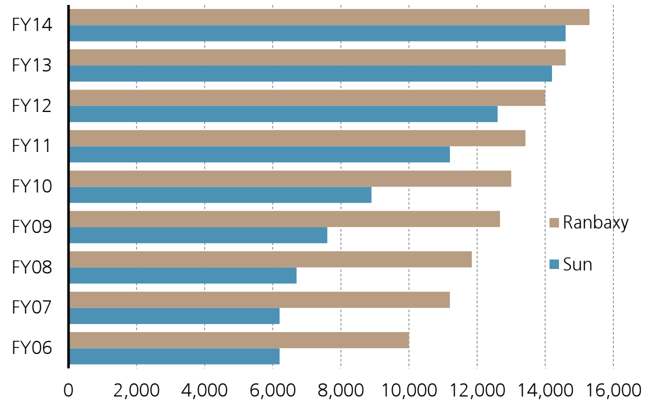
Figure 85: FY16E P&L for the merged entities

(Rs m)	Sun Pharma	Ranbaxy
Sales	**216,455**	**126,964**
Raw materials	(37,212)	(44,956)
Staff costs	(27,434)	(25,189)
R&D	(14,070)	(5,713)
SG&A	(38,962)	(35,822)
Total costs	(117,678)	(111,681)
Ebtida	**98,777**	**15,283**
Ebtida margin (%)	*45.6*	*12.0*

Source: Company data, UBS estimates

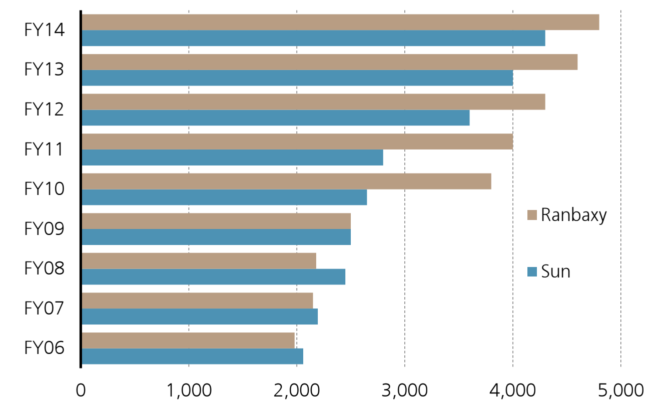
Ranbaxy has been spending large sums to address issues at its plants flagged by the FDA. Savings would occur if and when management is able to clear up the issues.

Figure 86: Total employee base



Source: Company data

Figure 87: Sales force in India



Source: Company data

Figure 88: Sun Pharma revenue growth: guidance versus actual

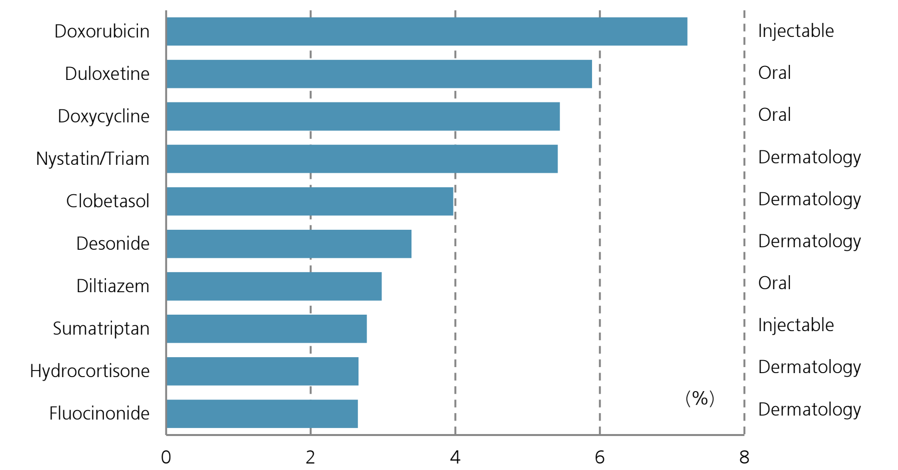
(%)	Guidance	Actual	Comment
FY15E	13-15	-	-
FY14	18-20	42.0	Taro price hike plus Doxil
FY13	18-20	40.5	Lipodox/ Doxil
FY12	18-20	39.8	Taro price hike
FY11	18+	42.5	Taro integration
FY10	13-15	(6.8)	Caraco shut down
FY09	20+	26.4	-
FY08	30	54.7	Protonix at-risk launch
FY07	18-20	28.8	-

Source: Company data

Increasing presence in complex segments

Sun has a fairly strong presence in complex segments with seven out of the top 10 products in the US. We expect more launches in complex segments like injectables, controlled substances and oral contraceptives to allow Sun to expand margins further.

Figure 89: Top-10 products of Sun Pharma (consolidated) in the US



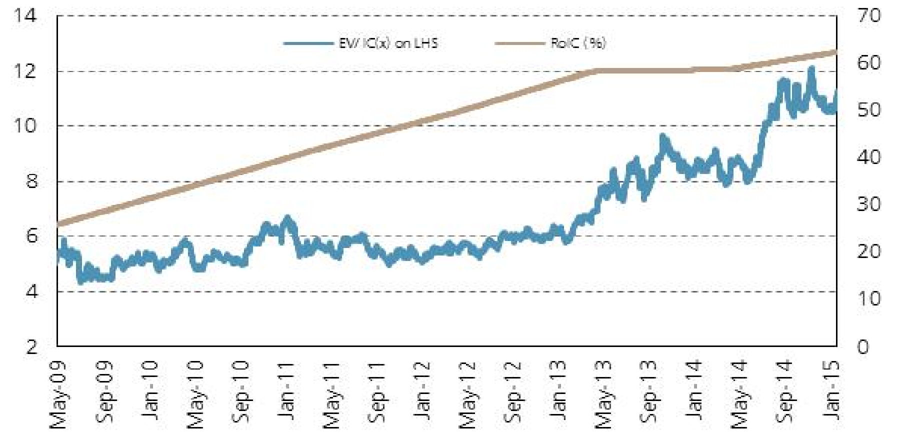
Source: IMS Health (Oct 2014 moving annual total)

Figure 90: Sun Pharma's competition product pipeline

Brand	Generic	Market size (US$ m)	Expected timing	Competition
Reclast	Zoledronic acid	325	2015	Five players including Dr Reddy's in the market
Protonix IV	Pantoprazole	100	2015	Teva, Sun, Apotex and Sandoz
Yaz	Drospirenone and ethinyl estradiol	350	2015	Will be six player market
Ryzolt	Tramadol ER	20	2015	First entrant
Zemplar	Paricalcitol	300	2015	Teva, Hospira, Sandoz, Sun
Actonel	Risedronate	750	2015	Teva, Mylan, Apotex and Sun
Focalin	Dexmethylpenidate	500	2015	Teva in the market, Being a controlled substance market share accretion difficult
Precedex	Dexmedetomidine	160	May 15	Five player market
Coreg CR	Carvedilol CR	200	Nov 15	First entrant
Ortho Tricyclen Lo	Estradiol and norgestimate	450	3QFY16	Teva is FTF then Sun, Lupin and Mylan
Gleevec	Imatinib	1,900	Feb 16	First entrant
Multaq	Dronedarone	300	3QFY16	Glenmark, Actavis, Sun Pharma
Uloric	Febuxostat	270	FY17	8 filers
Januvia	Sitagliptin	2,900	After Feb 2019	Mylan, Sandoz and Sun have tentative approvals

Source: FDA, IMS Health, company data

Figure 91: Sun Pharma's EV/IC to RoIC trend



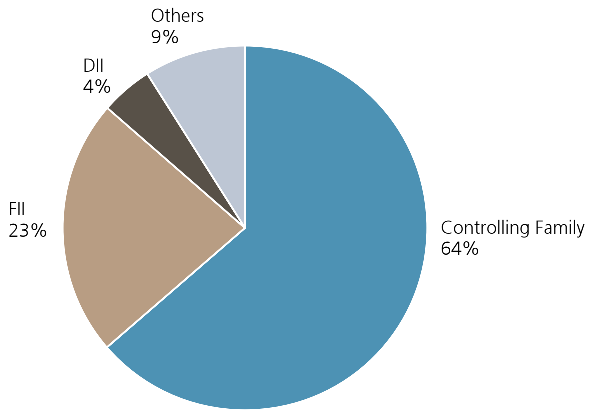
Source: Reuters, UBS

Figure 92: UBS versus consensus

(Rs m)		FY15E	FY16E	FY17E
Revenue	UBS	184,394	220,641	246,136
	Consensus	186,023	231,922	258,098
	Diff	-1%	-5%	-5%
EBITDA	UBS	84,920	101,809	113,150
	Consensus	82,904	99,427	112,693
	Diff	2%	2%	0%
PAT	UBS	64,208	77,748	87,156
	Consensus	63,260	75,254	87,853
	Diff	1%	3%	-1%

Source: Bloomberg, UBS estimates

Figure 93: Sun Pharma's shareholding pattern (Q2 FY15)



Source: BSE

Figure 94: Sun Pharma's PE and P/CF ratios

Source: Reuters, UBS

Sun Pharmaceuticals Industries Limited (SUN.BO)

Income statement (Rsm)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
Revenues	**80,054**	**112,389**	**160,044**	**184,394**	*15.2*	**220,641**	*19.7*	**246,136**	**277,916**	**314,140**
Gross profit	63,655	91,656	132,251	152,125	*15.0*	182,249	*19.8*	204,293	229,976	260,422
EBITDA (UBS)	**32,994**	**49,139**	**71,165**	**84,920**	*19.3*	**101,809**	*19.9*	**113,150**	**128,809**	**147,447**
Depreciation & amortisation	(2,912)	(3,362)	(4,092)	(5,460)	*33.4*	(5,800)	*6.2*	(6,239)	(6,592)	(7,221)
EBIT (UBS)	**30,083**	**45,777**	**67,073**	**79,460**	*18.5*	**96,009**	*20.8*	**106,911**	**122,218**	**140,226**
Associates & investment income	1,786	1,335	2,310	2,287	*-1.0*	3,287	*43.7*	3,287	3,287	3,287
Other non-operating income	0	(65)	(19)	0	-	0	-	0	0	0
Net interest	1,696	1,937	1,622	2,108	*30.0*	2,244	*6.4*	3,441	4,855	6,457
Exceptionals (incl goodwill)	0	0	0	0	-	0	-	0	0	0
Profit before tax	**33,565**	**48,985**	**70,986**	**83,855**	*18.1*	**101,540**	*21.1*	**113,639**	**130,360**	**149,970**
Tax	(3,132)	(8,455)	(7,022)	(10,641)	*-51.5*	(13,200)	*-24.0*	(14,773)	(16,947)	(19,496)
Profit after tax	**30,433**	**40,529**	**63,964**	**73,214**	*14.5*	**88,339**	*20.7*	**98,866**	**113,413**	**130,474**
Preference dividends	0	0	0	0	-	0	-	0	0	0
Minorities	(3,855)	(4,863)	(7,375)	(9,006)	*-22.1*	(10,592)	*-17.6*	(11,710)	(12,748)	(13,867)
Extraordinary items	(11)	(5,836)	(25,174)	0	-	0	-	0	0	0
Net earnings (local GAAP)	**26,567**	**29,831**	**31,415**	**64,208**	*104.4*	**77,748**	*21.1*	**87,156**	**100,665**	**116,607**
Net earnings (UBS)	**26,578**	**35,666**	**56,589**	**64,208**	*13.5*	**77,748**	*21.1*	**87,156**	**100,665**	**116,607**
Tax rate (%)	9.3	17.3	9.9	12.7	*28.3*	13.0	*2.4*	13.0	13.0	13.0

Per share (Rs)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
EPS (UBS, diluted)	12.8	17.2	27.3	31.0	*13.5*	37.5	*21.1*	42.1	48.6	56.3
EPS (local GAAP, diluted)	12.8	14.4	15.2	31.0	*104.4*	37.5	*21.1*	42.1	48.6	56.3
EPS (UBS, basic)	12.8	17.2	27.3	31.0	*13.5*	37.5	*21.1*	42.1	48.6	56.3
Net DPS (Rs)	2.1	2.5	1.5	4.5	*200.0*	6.0	*33.3*	7.0	8.0	9.5
Cash EPS (UBS, diluted)[1]	14.2	18.8	29.3	33.6	*14.8*	40.3	*19.9*	45.1	51.8	59.8
Book value per share	58.7	72.4	89.5	114.3	*27.7*	144.8	*26.7*	178.7	217.9	263.1
Average shares (diluted)	2,071.2	2,071.2	2,071.2	2,071.2	*0.0*	2,071.2	*0.0*	2,071.2	2,071.2	2,071.2

Balance sheet (Rsm)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
Cash and equivalents	33,672	40,587	75,902	93,216	*22.8*	153,053	*64.2*	223,775	303,879	395,470
Other current assets	56,834	72,754	101,490	119,672	*17.9*	133,670	*11.7*	143,556	155,874	169,916
Total current assets	**90,506**	**113,341**	**177,392**	**212,889**	*20.0*	**286,723**	*34.7*	**367,330**	**459,753**	**565,386**
Net tangible fixed assets	32,742	50,771	58,242	61,782	*6.1*	64,981	*5.2*	68,642	72,941	77,699
Net intangible fixed assets	10,218	11,330	18,346	18,346	*0.0*	18,346	*0.0*	18,346	18,346	18,346
Investments / other assets	22,129	24,116	27,860	27,860	*0.0*	27,860	*0.0*	27,860	27,860	27,860
Total assets	**155,595**	**199,558**	**281,840**	**320,877**	*13.9*	**397,911**	*24.0*	**482,179**	**578,900**	**689,292**
Trade payables & other ST liabilities	19,194	30,702	51,680	55,015	*6.5*	58,249	*5.9*	60,614	63,307	66,245
Short term debt	0	0	0	0	-	0	-	0	0	0
Total current liabilities	**19,194**	**30,702**	**51,680**	**55,015**	*6.5*	**58,249**	*5.9*	**60,614**	**63,307**	**66,245**
Long term debt	3,207	2,597	25,609	1,000	*-96.1*	1,000	*0.0*	1,000	1,000	1,000
Other long term liabilities	0	0	0	0	-	0	-	0	0	0
Preferred shares	0	0	0	0	-	0	-	0	0	0
Total liabilities (incl pref shares)	**22,402**	**33,299**	**77,289**	**56,015**	*-27.5*	**59,249**	*5.8*	**61,614**	**64,307**	**67,245**
Common s/h equity	121,579	149,908	185,340	236,644	*27.7*	299,853	*26.7*	370,047	451,327	544,913
Minority interests	11,615	16,351	19,212	28,217	*46.9*	38,809	*37.5*	50,519	63,266	77,133
Total liabilities & equity	**155,595**	**199,558**	**281,840**	**320,877**	*13.9*	**397,911**	*24.0*	**482,179**	**578,900**	**689,292**

Cash flow (Rsm)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
Net income (before pref divs)	26,567	29,831	31,415	64,208	*104.4*	77,748	*21.1*	87,156	100,665	116,607
Depreciation & amortisation	2,912	3,362	4,092	5,460	*33.4*	5,800	*6.2*	6,239	6,592	7,221
Net change in working capital	(8,360)	(2,489)	(5,770)	(14,846)	*-157.3*	(10,764)	*27.5*	(7,521)	(9,625)	(11,104)
Other operating	(3,401)	2,681	16,810	(1,287)	-	(1,287)	*0.0*	(1,287)	(1,287)	(1,287)
Operating cash flow	**17,717**	**33,384**	**46,547**	**53,535**	*15.0*	**71,497**	*33.6*	**84,588**	**96,345**	**111,436**
Tangible capital expenditure	(9,887)	(23,674)	(13,532)	(9,000)	*33.5*	(9,000)	*0.0*	(9,900)	(10,890)	(11,979)
Intangible capital expenditure	0	0	0	0	-	0	-	0	0	0
Net (acquisitions) / disposals	0	0	0	0	-	0	-	0	0	0
Other investing	169	(1,987)	(3,744)	0	-	0	-	0	0	0
Investing cash flow	**(9,718)**	**(25,661)**	**(17,276)**	**(9,000)**	*47.9*	**(9,000)**	*0.0*	**(9,900)**	**(10,890)**	**(11,979)**
Equity dividends paid	(5,039)	(5,929)	(3,635)	(10,904)	*-200.0*	(14,539)	*-33.3*	(16,962)	(19,385)	(23,020)
Share issues / (buybacks)	0	0	0	0	-	0	-	0	0	0
Other financing	3,166	4,736	2,863	9,006	*214.55*	10,592	*17.61*	11,710	12,748	13,867
Change in debt & pref shares	(1,048)	(610)	23,012	(24,609)	-	0	-	0	0	0
Financing cash flow	**(2,922)**	**(1,802)**	**22,240**	**(26,507)**	-	**(3,947)**	*85.1*	**(5,253)**	**(6,637)**	**(9,153)**
Cash flow inc/(dec) in cash	**5,076**	**5,921**	**51,510**	**18,028**	*-65.0*	**58,550**	*224.8*	**69,435**	**78,817**	**90,304**
FX / non cash items	6,549	994	(16,196)	(713)	*95.6*	1,287	-	1,287	1,287	1,287
Balance sheet inc/(dec) in cash	**11,626**	**6,915**	**35,314**	**17,315**	*-51.0*	**59,836**	*245.6*	**70,722**	**80,104**	**91,591**

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.[1]Cash EPS (UBS, diluted) is calculated using UBS net income adding back depreciation and amortization.

Sun Pharmaceuticals Industries Limited (SUN.BO)

Valuation (x)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
P/E (local GAAP, diluted)	19.4	23.6	36.5	29.6	24.5	21.8	18.9	16.3
P/E (UBS, diluted)	19.4	19.7	20.2	29.6	24.5	21.8	18.9	16.3
P/CEPS	17.5	18.0	18.9	27.3	22.8	20.4	17.7	15.4
Equity FCF (UBS) yield %	1.5	1.4	2.9	2.3	3.3	3.9	4.5	5.2
Net dividend yield (%)	0.9	0.7	0.3	0.5	0.7	0.8	0.9	1.0
P/BV x	4.2	4.7	6.2	8.0	6.3	5.1	4.2	3.5
EV/revenues (core)	6.0	5.9	6.8	9.9	8.3	7.5	6.7	5.1
EV/EBITDA (core)	14.6	13.5	15.4	21.6	18.1	16.4	14.5	10.9
EV/EBIT (core)	16.0	14.5	16.3	23.0	19.2	17.3	15.3	11.4
EV/OpFCF (core)	24.0	16.1	18.4	28.3	21.6	18.6	16.6	12.4
EV/op. invested capital	6.7	7.2	9.5	NM	NM	NM	NM	8.4

Enterprise value (Rsm)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Market cap.	515,278	704,359	1,145,249	1,902,050	1,902,050	1,902,050	1,902,050	1,902,050
Net debt (cash)	(24,128)	(34,227)	(44,141)	(71,255)	(71,255)	(71,255)	(71,255)	(348,674)
Buy out of minorities	11,615	16,351	19,212	28,217	38,809	50,519	63,266	77,133
Pension provisions/other	0	0	0	0	0	0	0	0
Total enterprise value	**502,765**	**686,482**	**1,120,319**	**1,859,012**	**1,869,604**	**1,881,314**	**1,894,061**	**1,630,509**
Non core assets	(22,129)	(24,116)	(27,860)	(27,860)	(27,860)	(27,860)	(27,860)	(27,860)
Core enterprise value	**480,636**	**662,367**	**1,092,459**	**1,831,152**	**1,841,744**	**1,853,453**	**1,866,201**	**1,602,648**

Growth (%)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Revenue	39.9	40.4	42.4	15.2	19.7	11.6	12.9	13.0
EBITDA (UBS)	64.0	48.9	44.8	19.3	19.9	11.1	13.8	14.5
EBIT (UBS)	66.4	52.2	46.5	18.5	20.8	11.4	14.3	14.7
EPS (UBS, diluted)	46.1	34.2	58.7	13.5	21.1	12.1	15.5	15.8
Net DPS	21.4	17.6	-40.0	200.0	33.3	16.7	14.3	18.8

Margins & Profitability (%)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Gross profit margin	NM	NM	NM	NM	NM	NM	NM	NM
EBITDA margin	41.2	43.7	44.5	46.1	46.1	46.0	46.3	46.9
EBIT margin	37.6	40.7	41.9	43.1	43.5	43.4	44.0	44.6
Net earnings (UBS) margin	33.2	31.7	35.4	34.8	35.2	35.4	36.2	37.1
ROIC (EBIT)	41.9	49.6	58.2	58.6	63.3	65.1	69.1	73.1
ROIC post tax	38.0	41.0	52.4	51.2	55.0	56.6	60.1	63.6
ROE (UBS)	24.6	26.3	33.8	30.4	29.0	26.0	24.5	23.4

Capital structure & Coverage (x)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Net debt / EBITDA	(0.9)	(0.8)	(0.7)	(1.1)	(1.5)	(2.0)	(2.4)	(2.7)
Net debt / total equity %	(22.9)	(22.8)	(24.6)	(34.8)	(44.9)	(53.0)	(58.9)	(63.4)
Net debt / (net debt + total equity) %	(29.7)	(29.6)	(32.6)	(53.4)	(81.5)	NM	NM	NM
Net debt/EV	(6.3)	(5.7)	(4.6)	(5.0)	(8.3)	(12.0)	(16.2)	(24.6)
Capex / depreciation %	NM	NM	NM	164.8	155.2	158.7	165.2	165.9
Capex / revenue %	12.4	21.1	8.5	4.9	4.1	4.0	3.9	3.8
EBIT / net interest	NM	NM	NM	NM	NM	NM	NM	NM
Dividend cover (UBS)	6.0	6.9	18.2	6.9	6.3	6.0	6.1	5.9
Div. payout ratio (UBS) %	16.6	14.5	5.5	14.5	16.0	16.6	16.5	16.9

Revenues by division (Rsm)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Others	80,054	112,389	160,044	184,394	220,641	246,136	277,916	314,140
Total	**80,054**	**112,389**	**160,044**	**184,394**	**220,641**	**246,136**	**277,916**	**314,140**

EBIT (UBS) by division (Rsm)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Others	30,083	45,777	67,073	79,460	96,009	106,911	122,218	140,226
Total	**30,083**	**45,777**	**67,073**	**79,460**	**96,009**	**106,911**	**122,218**	**140,226**

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

Dr. Reddy's Labs

Long-term outperformer

Equities	
India	
Pharmaceuticals	
12-month rating	**Buy**
12m price target	**Rs4,000.00**
Price	**Rs3,361.45**
RIC: REDY.BO **BBG:** DRRD IB	

Trading data and key metrics

52-wk range	Rs3,626.65-2,283.15
Market cap.	Rs572bn/US$9.18bn
Shares o/s	170m (ORD)
Free float	75%
Avg. daily volume ('000)	345
Avg. daily value (m)	Rs1,132.0
Common s/h equity (03/15E)	Rs108bn
P/BV (03/15E)	5.3x
Net debt / EBITDA (03/15E)	NM

EPS (UBS, diluted) (Rs)

	From	To	% ch	Cons.
03/15E	142.4	126.6	-11.14	134.0
03/16E	173.3	152.9	-11.77	156.6
03/17E	193.3	179.8	-7.00	182.1

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High quality US pipeline

Dr Reddy's US pipeline is one of the best among Indian pharma companies, in our view, and it continues to expand with a substantial proportion of R&D spend targeted at complex generics, proprietary molecules and biosimilars. We estimate a 19% CAGR in US revenue over FY15-17 and we expect a strong rise in margins as the company rolls out proprietary molecules and biosimilars in that market. Among Indian pharma companies, we view Dr Reddy's as a key beneficiary of stronger pharmacy benefit managers (PBMs), as they should be able to drive a higher use of biosimilars.

Business mix improving

We expect the proportion of total revenues from high-profitability segments to increase over FY15-17, led by a ramp up in complex generics, the launch of proprietary molecules and biosimilars, and a fall in the percentage of bulk chemicals.

Near-term headwinds in the emerging market business

Dr Reddy's has a strong presence in Russia, and the recent decline in the rouble against other currencies including the rupee should impact growth as well as margins in FY15-16, apart from the one-time write-down of receivables. We have factored the above into our estimates. Possible currency devaluation in Venezuela is another risk for Dr Reddy's emerging market revenue stream. In India, we expect a steady 15% CAGR in revenue over FY15-17E.

Valuation: we assume coverage; price target of Rs4,000

Dr Reddy's has traded at a discount to leading Indian pharma companies over the past five years. This was partly because the low-margin bulk chemical business made up a high proportion of total revenue, and the company's earnings growth and return ratios lagged large-cap peers. We believe this trend will reverse over the next three to five years once the biosimilars portfolio is rolled out in developed markets and bulk chemicals' proportion of total revenue falls. We forecast a 19% earnings CAGR over FY15-17. Our price target is based on 23x one-year forward PE.

Highlights (Rsm)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Revenues	96,737	116,266	132,170	143,413	163,905	185,730	208,365	234,736
EBIT (UBS)	19,293	21,800	25,534	25,737	31,528	37,213	42,634	49,551
Net earnings (UBS)	15,303	17,465	21,017	21,533	26,008	30,583	34,626	40,708
EPS (UBS, diluted) (Rs)	90.2	103.0	123.5	126.6	152.9	179.8	203.6	239.3
DPS (Rs)	13.7	15.0	18.0	20.0	24.0	26.0	30.0	36.0
Net (debt) / cash	(15,110)	(17,654)	(15,828)	368	13,918	32,518	54,252	77,673
Profitability/valuation	**03/12**	**03/13**	**03/14**	**03/15E**	**03/16E**	**03/17E**	**03/18E**	**03/19E**
EBIT margin %	19.9	18.8	19.3	17.9	19.2	20.0	20.5	21.1
ROIC (EBIT) %	31.6	29.3	27.9	24.9	28.4	31.4	34.0	37.0
EV/EBITDA (core) x	11.5	11.3	12.6	16.9	13.7	11.8	10.4	8.2
P/E (UBS, diluted) x	17.5	16.9	19.0	26.6	22.0	18.7	16.5	14.0
Equity FCF (UBS) yield %	2.8	1.6	2.7	3.5	3.2	4.1	4.8	5.3
Net dividend yield %	0.9	0.9	0.8	0.6	0.7	0.8	0.9	1.1

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of Rs3,361.45 on 22 Jan 2015 22:38 HKT

Investment Thesis

Dr. Reddy's Labs

12-month rating **Buy**

12m price target **Rs4,000.00**

Investment case

We believe Dr Reddy's US pipeline is one of the best among Indian pharma companies. We expect the launch of generic Copaxone to take place in H2 FY16, while Dr Reddy's is developing biosimilars for developed markets in partnership with Merck Serono. We expect launches to begin in FY17 in the EU. While US launches are some time away, we expect biosimilars to provide a strong boost to long-term growth. We view stronger PBMs as a positive for specialty pharma companies like Dr Reddy's, as they should be able to drive the uptake of biosimilars.

Upside scenario

Our upside scenario assumes Nexium will be a semi-exclusive opportunity for Dr Reddy's in FY16 and FY17. We assume an FY16/17E EPS of Rs160/185 in this scenario and expect the stock to trade at 24x FY17E PE for an upside scenario of Rs4,290.

Downside scenario

Our downside scenario assumes no contribution from Copaxone in FY16 and a further deterioration in the emerging market business. We assume FY16/17E EPS of Rs145/165 in this scenario and expect the stock to trade at 16x FY17E PE for a downside scenario of Rs2,560.

Upcoming catalysts

Positive newsflow on Copaxone and other niche product approvals could be a catalyst.

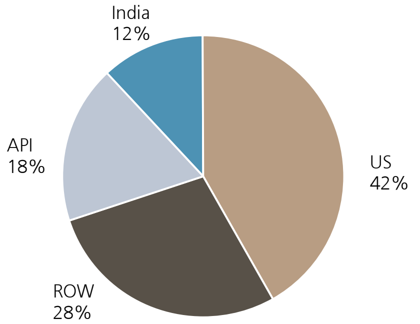
Business description

Founded as a bulk drug firm in the 1980s, Dr Reddy's Labs (DRL) is now an integrated company with a presence in the domestic and global formulation segments; it also supplies APIs to other generics companies to help them bring medicines to market quickly and create alternatives to high-cost medicines. Dr. Reddy's also provides products and services to innovator companies to get their proprietary medicines to patients faster. Its R&D focuses on pain management, anti-infectives and anti-inflammatories.

Industry outlook

We are positive on Indian pharma companies based on strong growth in the US generic market. We expect market share gains in the US, as India firms launch more new products and technological capabilities improve with higher investment in R&D. We expect the Indian pharma market to grow at a 12% CAGR in sales over the next five years. We also expect Indian companies to increase their presence in emerging markets through a combination of organic and inorganic growth.

Revenues by region (FY14)



Source: Company data

EBIT by product segment

The company does not release segmental margins.

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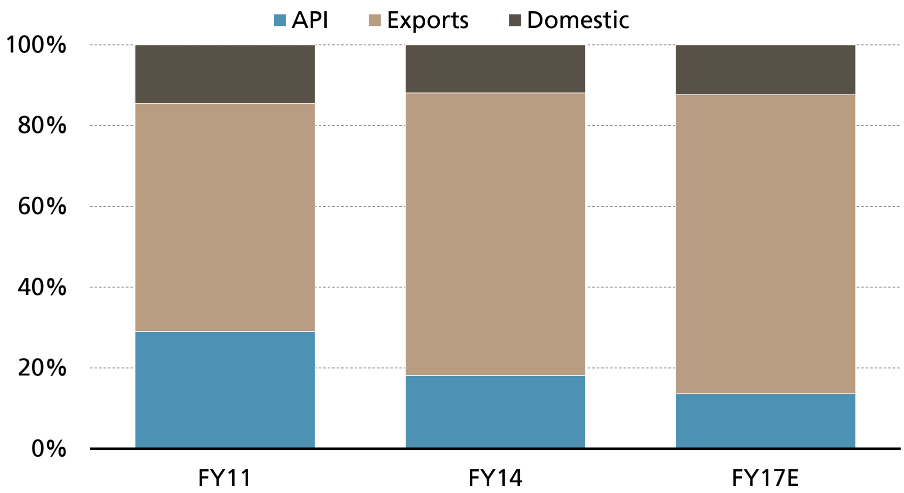
Improving business mix

We believe a rising proportion of revenues from complex segments in the US and a lower contribution from the bulk chemical business (Pharmaceutical Services and Active Ingredients, PSAI) will help improve Dr Reddy's sales mix.

Figure 95: Reducing proportion of low margin API business (bulk chemicals)

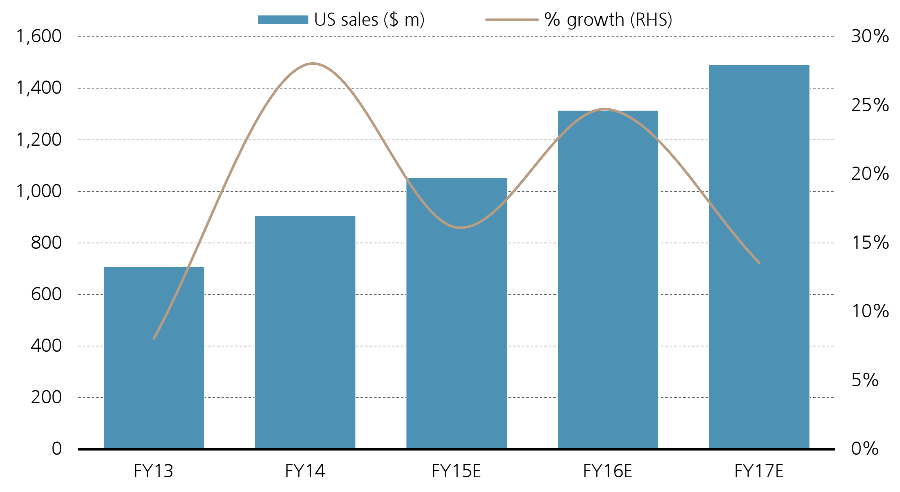


Source: Company data, UBS estimates

High quality US pipeline and potential in biosimilars

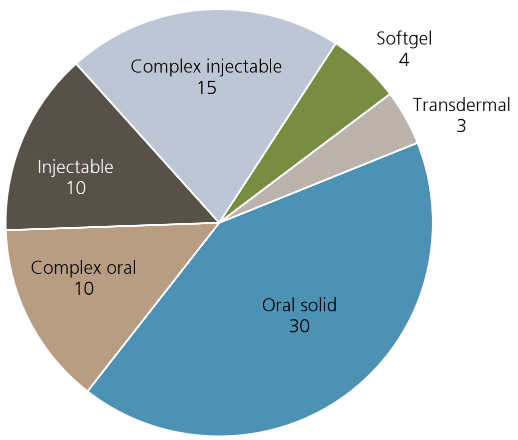
Dr Reddy's US pipeline is one of the best among Indian pharma companies, in our view, and it continues to expand with a substantial proportion of R&D spend targeted at complex generics, proprietary molecules and biosimilars.

Figure 96: US business growth



Source: Company data, UBS estimates

Figure 97: ANDA filings by segment (Q2 FY15)



Source: Company data

Dr Reddy's is one of few Indian pharma companies developing biosimilars. It has six products planned for launch in developed markets (the US and the EU) and is in advanced stage trials for two of those products. We believe stronger PBMs will drive the uptake of biosimilars and enable generic companies to achieve higher market shares.

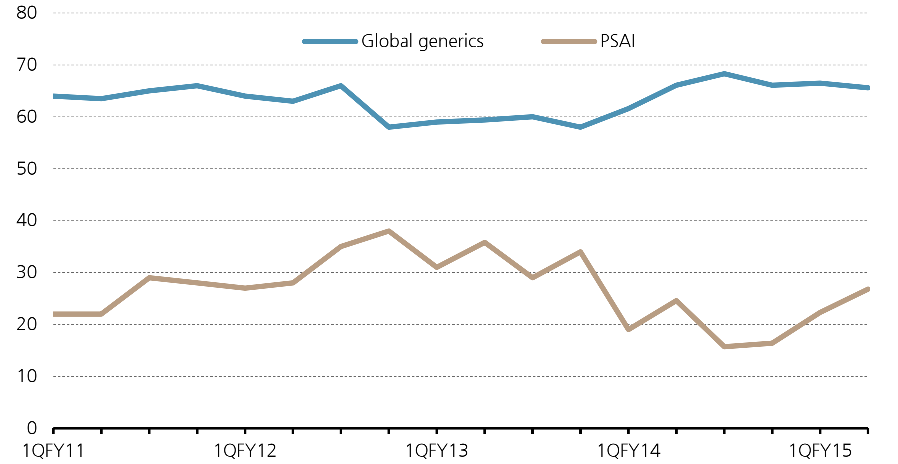
Figure 98: Dr Reddy's US pipeline

Brand	Generics	Sales (US$ m)	Expected timing	Status	Competition
Nexium	Esomeprazole	2,300	2015	Approval awaited	4-7 competitors
Copaxone (20mg)	Glatiramer	1,700	Late FY16	Approval awaited	Sandoz and Mylan
Aloxi	Palonosetron	450	Apr-15	Launch in Apr 2015	Shared first entrant with Sandoz and Teva
Vimovo	Esomeprazole + Naproxen	50	2015	Final approval	Likely first entrant
Diprivan	Propofol	250	Oct-15	Approval awaited	Fourth entrant
Zemplar	Paricalcitol	300	2016	Approval awaited	Teva, Hospira, Sandoz
Gleevec	Imatinib	1,900	Feb 16	Launch after Sun	Limited number of filers at present
Vimpat	Lacosamide	280	FY17	Approval awaited	Multiple players
Ixempra	Ixabepilone	150	FY19	Settled	Limited number of filers
Copaxone (40mg)	Glatiramer	2,300	Jan -17	Patent blocking	Shared first to file

Source: FDA, IMS Health, company data

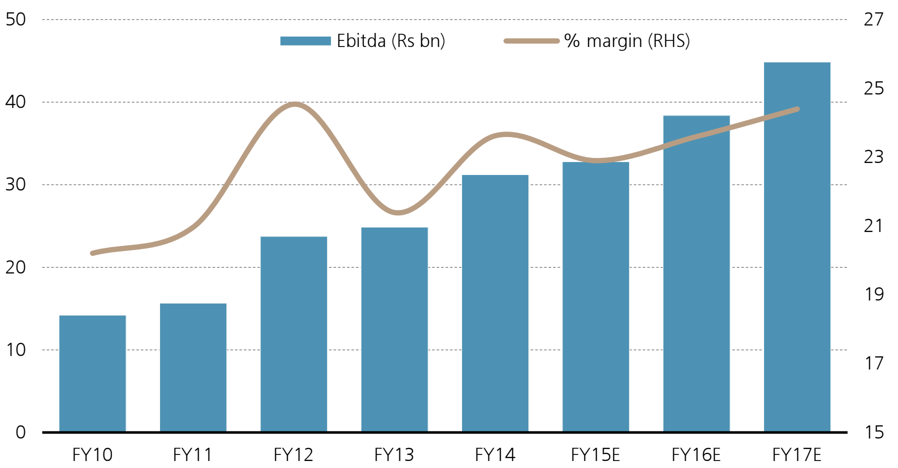
We expect operating margins to improve gradually over FY15-17E, although there may be near-term hit from rouble volatility. This could impact growth as well as margins in FY15-16, apart from the one-time write-down of receivables. We have factored this into our estimates. Possible currency devaluation in Venezuela is another risk for Dr Reddy's emerging market revenue stream.

Figure 99: Gross margins (%)



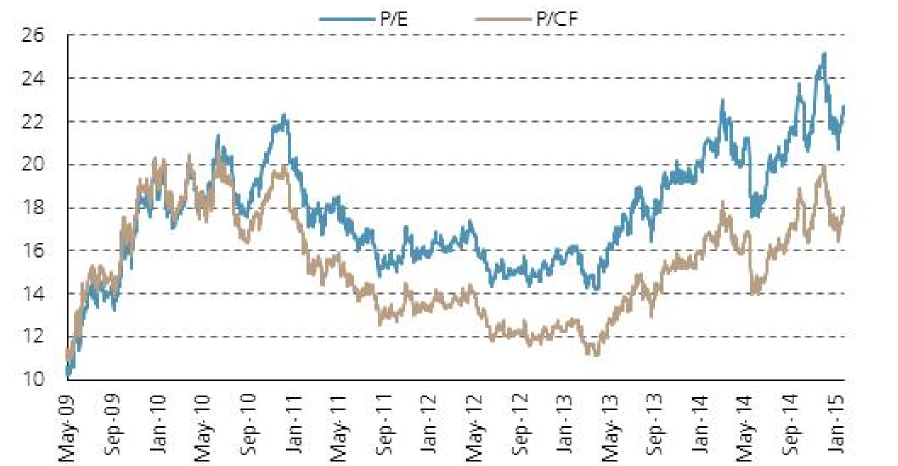
Source: Company data

Figure 100: Operating margins



Source: Company data, UBS estimates

Figure 101: One-year forward PE and P/CF (x)



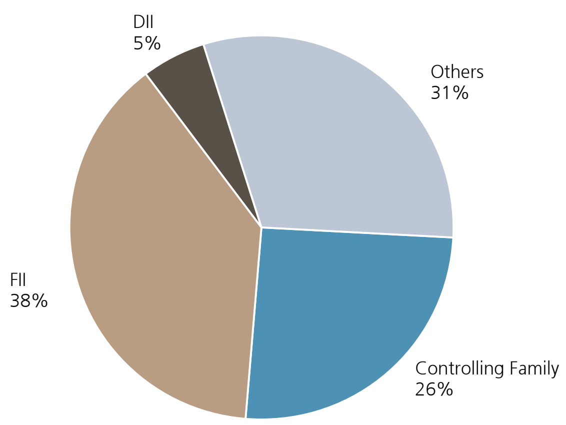
Source: Reuters, UBS

Figure 102: UBS versus consensus

(Rs m)		FY15E	FY16E	FY17E
Revenue	UBS	143,413	163,905	185,730
	Consensus	148,295	168,678	189,272
	Diff	-3%	-3%	-2%
EBITDA	UBS	34,314	41,046	47,813
	Consensus	34,185	39,804	45,554
	Diff	0%	3%	5%
PAT	UBS	21,533	26,008	30,583
	Consensus	22,809	26,790	31,083
	Diff	-6%	-3%	-2%

Source: Bloomberg, UBS estimates

Figure 103: Dr Reddy's shareholding pattern (Q2 FY15)



Source: BSE

Dr. Reddy's Labs (REDY.BO)

Income statement (Rsm)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
Revenues	**96,737**	**116,266**	**132,170**	**143,413**	*8.5*	**163,905**	*14.3*	**185,730**	**208,365**	**234,736**
Gross profit	53,306	60,579	75,801	89,659	*18.3*	100,845	*12.5*	112,532	123,160	135,693
EBITDA (UBS)	**24,507**	**27,350**	**32,639**	**34,314**	*5.1*	**41,046**	*19.6*	**47,813**	**54,065**	**61,894**
Depreciation & amortisation	(5,214)	(5,549)	(7,105)	(8,577)	*20.7*	(9,518)	*11.0*	(10,600)	(11,430)	(12,343)
EBIT (UBS)	**19,293**	**21,800**	**25,534**	**25,737**	*0.8*	**31,528**	*22.5*	**37,213**	**42,634**	**49,551**
Associates & investment income	54	104	174	174	*0.0*	174	*0.0*	174	174	174
Other non-operating income	0	0	0	2,347	-	2,984	*27.1*	3,164	4,094	5,181
Net interest	160	460	400	(1,342)	-	(1,342)	*0.0*	(1,342)	(1,342)	(1,342)
Exceptionals (incl goodwill)	(1,040)	(688)	497	0	-	0	-	0	0	0
Profit before tax	**18,467**	**21,677**	**26,605**	**26,917**	*1.2*	**33,344**	*23.9*	**39,209**	**45,560**	**53,564**
Tax	(4,204)	(4,900)	(5,094)	(5,383)	*-5.7*	(7,336)	*-36.3*	(8,626)	(10,934)	(12,855)
Profit after tax	**14,262**	**16,777**	**21,512**	**21,533**	*0.1*	**26,008**	*20.8*	**30,583**	**34,626**	**40,708**
Preference dividends	0	0	0	0	-	0	-	0	0	0
Minorities	0	1	3	0	-	0	-	0	0	0
Extraordinary items	0	0	0	0	-	0	-	0	0	0
Net earnings (local GAAP)	**14,262**	**16,778**	**21,514**	**21,533**	*0.1*	**26,008**	*20.8*	**30,583**	**34,626**	**40,708**
Net earnings (UBS)	**15,303**	**17,465**	**21,017**	**21,533**	*2.5*	**26,008**	*20.8*	**30,583**	**34,626**	**40,708**
Tax rate (%)	22.8	22.6	19.1	20.0	*4.5*	22.0	*10.0*	22.0	24.0	24.0

Per share (Rs)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
EPS (UBS, diluted)	90.2	103.0	123.5	126.6	*2.5*	152.9	*20.8*	179.8	203.6	239.3
EPS (local GAAP, diluted)	84.1	98.9	126.5	126.6	*0.1*	152.9	*20.8*	179.8	203.6	239.3
EPS (UBS, basic)	90.2	103.0	123.5	126.6	*2.5*	152.9	*20.8*	179.8	203.6	239.3
Net DPS (Rs)	13.7	15.0	18.0	20.0	*11.1*	24.0	*20.0*	26.0	30.0	36.0
Cash EPS (UBS, diluted)[1]	121.0	135.7	165.3	177.0	*7.1*	208.8	*18.0*	242.1	270.7	311.9
Book value per share	297.8	397.9	494.5	637.4	*28.9*	762.7	*19.7*	912.5	1,081.6	1,279.5
Average shares (diluted)	169.6	169.6	170.1	170.1	*0.0*	170.1	*0.0*	170.1	170.1	170.1

Balance sheet (Rsm)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
Cash and equivalents	18,159	22,099	33,534	49,730	*48.3*	63,280	*27.2*	81,879	103,614	127,034
Other current assets	51,793	63,614	70,213	77,720	*10.7*	86,942	*11.9*	96,763	106,948	118,816
Total current assets	**69,952**	**85,713**	**103,747**	**127,450**	*22.8*	**150,221**	*17.9*	**178,642**	**210,562**	**245,850**
Net tangible fixed assets	28,360	35,884	44,298	53,022	*19.7*	57,806	*9.0*	61,506	65,377	69,335
Net intangible fixed assets	13,529	14,021	14,697	12,396	*-15.7*	10,095	*-18.6*	7,794	5,493	5,188
Investments / other assets	368	681	806	806	*0.0*	806	*0.0*	806	806	806
Total assets	**112,209**	**136,299**	**163,548**	**193,675**	*18.4*	**218,928**	*13.0*	**248,748**	**282,238**	**321,178**
Trade payables & other ST liabilities	27,632	29,511	30,061	35,892	*19.4*	39,832	*11.0*	44,156	48,889	54,163
Short term debt	0	0	0	0	-	0	-	0	0	0
Total current liabilities	**27,632**	**29,511**	**30,061**	**35,892**	*19.4*	**39,832**	*11.0*	**44,156**	**48,889**	**54,163**
Long term debt	33,269	39,753	49,362	49,362	*0.0*	49,362	*0.0*	49,362	49,362	49,362
Other long term liabilities	1,132	0	0	0	-	0	-	0	0	0
Preferred shares	0	0	0	0	-	0	-	0	0	0
Total liabilities (incl pref shares)	**62,033**	**69,265**	**79,423**	**85,254**	*7.3*	**89,194**	*4.6*	**93,518**	**98,251**	**103,525**
Common s/h equity	50,176	67,035	84,125	108,421	*28.9*	129,734	*19.7*	155,230	183,987	217,653
Minority interests	0	0	0	0	-	0	-	0	0	0
Total liabilities & equity	**112,209**	**136,299**	**163,548**	**193,675**	*18.4*	**218,928**	*13.0*	**248,748**	**282,238**	**321,178**

Cash flow (Rsm)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
Net income (before pref divs)	14,262	16,778	21,514	21,533	*0.1*	26,008	*20.8*	30,583	34,626	40,708
Depreciation & amortisation	5,214	5,549	7,105	8,577	*20.7*	9,518	*11.0*	10,600	11,430	12,343
Net change in working capital	(5,869)	(9,941)	(6,050)	(1,676)	*72.3*	(5,281)	*-215.1*	(5,497)	(5,453)	(6,593)
Other operating	0	(1)	(2)	0	-	0	-	0	0	0
Operating cash flow	**14,648**	**13,072**	**22,070**	**28,434**	*28.8*	**30,245**	*6.4*	**35,686**	**40,603**	**46,459**
Tangible capital expenditure	(7,232)	(8,427)	(11,414)	(8,325)	*27.1*	(12,000)	*-44.1*	(12,000)	(13,000)	(14,000)
Intangible capital expenditure	0	0	0	0	-	0	-	0	0	(1,995)
Net (acquisitions) / disposals	131	(2,183)	(2,977)	0	-	0	-	0	0	(1,995)
Other investing	(55)	(313)	(125)	0	-	0	-	0	0	0
Investing cash flow	**(7,156)**	**(10,923)**	**(14,516)**	**(8,325)**	*42.6*	**(12,000)**	*-44.1*	**(12,000)**	**(13,000)**	**(17,991)**
Equity dividends paid	(2,709)	(2,925)	(3,582)	(3,913)	*-9.2*	(4,695)	*-20.0*	(5,086)	(5,869)	(7,043)
Share issues / (buybacks)	(99)	1,808	(236)	0	-	0	-	0	0	0
Other financing	0	0	0	0	-	0	-	0	0	0
Change in debt & pref shares	9,031	6,484	9,608	0	-	0	-	0	0	0
Financing cash flow	**6,223**	**5,367**	**5,790**	**(3,913)**	-	**(4,695)**	*-20.0*	**(5,086)**	**(5,869)**	**(7,043)**
Cash flow inc/(dec) in cash	**13,715**	**7,517**	**13,344**	**16,197**	*21.4*	**13,550**	*-16.3*	**18,600**	**21,735**	**21,425**
FX / non cash items	(2,101)	(3,576)	(1,909)	0	*100.0*	0	*100.0*	0	0	1,996
Balance sheet inc/(dec) in cash	**11,613**	**3,940**	**11,435**	**16,196**	*41.6*	**13,550**	*-16.3*	**18,600**	**21,735**	**23,421**

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.[1]Cash EPS (UBS, diluted) is calculated using UBS net income adding back depreciation and amortization.

Dr. Reddy's Labs (REDY.BO)

Valuation (x)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
P/E (local GAAP, diluted)	18.8	17.6	18.6	26.6	22.0	18.7	16.5	14.0
P/E (UBS, diluted)	17.5	16.9	19.0	26.6	22.0	18.7	16.5	14.0
P/CEPS	13.1	12.8	14.2	19.0	16.1	13.9	12.4	10.8
Equity FCF (UBS) yield %	2.8	1.6	2.7	3.5	3.2	4.1	4.8	5.3
Net dividend yield (%)	0.9	0.9	0.8	0.6	0.7	0.8	0.9	1.1
P/BV x	5.3	4.4	4.8	5.3	4.4	3.7	3.1	2.6
EV/revenues (core)	2.9	2.7	3.1	4.0	3.4	3.0	2.7	2.2
EV/EBITDA (core)	11.5	11.3	12.6	16.9	13.7	11.8	10.4	8.2
EV/EBIT (core)	14.7	14.2	16.1	22.5	17.9	15.2	13.2	10.2
EV/OpFCF (core)	15.8	14.7	15.4	21.4	17.2	14.6	12.8	9.9
EV/op. invested capital	4.6	4.1	4.5	5.6	5.1	4.8	4.5	3.8

Enterprise value (Rsm)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Market cap.	266,637	293,196	396,343	571,812	571,812	571,812	571,812	571,812
Net debt (cash)	16,401	16,382	16,741	7,730	(7,143)	(7,143)	(7,143)	(65,963)
Buy out of minorities	0	0	0	0	0	0	0	0
Pension provisions/other	0	0	0	0	0	0	0	0
Total enterprise value	**283,038**	**309,578**	**413,084**	**579,542**	**564,669**	**564,669**	**564,669**	**505,850**
Non core assets	(368)	(681)	(806)	(806)	(806)	(806)	(806)	(806)
Core enterprise value	**282,670**	**308,897**	**412,278**	**578,736**	**563,863**	**563,863**	**563,863**	**505,044**

Growth (%)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Revenue	29.5	20.2	13.7	8.5	14.3	13.3	12.2	12.7
EBITDA (UBS)	56.5	11.6	19.3	5.1	19.6	16.5	13.1	14.5
EBIT (UBS)	67.6	13.0	17.1	0.8	22.5	18.0	14.6	16.2
EPS (UBS, diluted)	38.3	14.1	19.9	2.5	20.8	17.6	13.2	17.6
Net DPS	22.2	9.1	20.0	11.1	20.0	8.3	15.4	20.0

Margins & Profitability (%)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Gross profit margin	55.1	52.1	57.4	62.5	61.5	60.6	59.1	57.8
EBITDA margin	25.3	23.5	24.7	23.9	25.0	25.7	25.9	26.4
EBIT margin	19.9	18.8	19.3	17.9	19.2	20.0	20.5	21.1
Net earnings (UBS) margin	15.8	15.0	15.9	15.0	15.9	16.5	16.6	17.3
ROIC (EBIT)	31.6	29.3	27.9	24.9	28.4	31.4	34.0	37.0
ROIC post tax	24.8	22.9	22.4	20.0	22.1	24.5	25.8	28.1
ROE (UBS)	33.9	29.8	27.8	22.4	21.8	21.5	20.4	20.3

Capital structure & Coverage (x)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Net debt / EBITDA	0.6	0.6	0.5	(.0)	(0.3)	(0.7)	(1.0)	(1.3)
Net debt / total equity %	30.1	26.3	18.8	(0.3)	(10.7)	(20.9)	(29.5)	(35.7)
Net debt / (net debt + total equity) %	23.1	20.8	15.8	(0.3)	(12.0)	(26.5)	(41.8)	(55.5)
Net debt/EV	5.3	5.7	3.8	(0.1)	(2.5)	(5.8)	(9.6)	(15.4)
Capex / depreciation %	199.3	NM	NM	132.7	166.3	144.6	142.4	139.4
Capex / revenue %	7.5	7.2	8.6	5.8	7.3	6.5	6.2	6.0
EBIT / net interest	NM	NM	NM	19.2	23.5	27.7	31.8	36.9
Dividend cover (UBS)	6.6	6.9	6.9	6.3	6.4	6.9	6.8	6.6
Div. payout ratio (UBS) %	15.2	14.6	14.6	15.8	15.7	14.5	14.7	15.0

Revenues by division (Rsm)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Others	96,737	116,266	132,170	143,413	163,905	185,730	208,365	234,736
Total	**96,737**	**116,266**	**132,170**	**143,413**	**163,905**	**185,730**	**208,365**	**234,736**

EBIT (UBS) by division (Rsm)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Others	19,293	21,800	25,534	25,737	31,528	37,213	42,634	49,551
Total	**19,293**	**21,800**	**25,534**	**25,737**	**31,528**	**37,213**	**42,634**	**49,551**

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

Torrent Pharmaceuticals
Synergy benefits

Equities

India
Pharmaceuticals

12-month rating	**Buy**
	Prior: Not Rated
12m price target	**Rs1,425.00**
	Prior: -
Price	**Rs1,143.95**

RIC: TORP.BO **BBG:** TORP IB

Trading data and key metrics

52-wk range	Rs1,188.20-513.50
Market cap.	Rs194bn/US$3.14bn
Shares o/s	169m (ORD)
Free float	26%
Avg. daily volume ('000)	63
Avg. daily value (m)	Rs64.4
Common s/h equity (03/15E)	Rs23.8bn
P/BV (03/15E)	8.1x
Net debt / EBITDA (03/15E)	1.5x

EPS (UBS, diluted) (Rs)

	From	To	% ch	Cons.
03/15E	-	45.1	-	45.5
03/16E	-	55.4	-	51.1
03/17E	-	67.7	-	63.7

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Synergies with Elder to drive margins

The integration of Elder's India business and the resulting synergies should drive a substantial part of Torrent's earnings growth over the next two to three years, in our view. The majority of the acquired revenues are concentrated in two products: Shelcal and Chymoral. We see scope for cost reductions as well as sales growth improvement at the combined business. This along with improving core margins (ex-Elder) will likely drive strong operating earnings growth.

Strong outlook for developed markets

Torrent has worked to build an extensive US pipeline relative to its size, and has made some inroads in a number of complex oral solids. The company has been able to increase prices for certain products where it is the dominant supplier. While Torrent will launch largely oral products in the US, we view those as material considering the company's market size in the US. We expect management to enhance R&D spend in order to expand in other complex segments. We estimate 25% annual growth in sales for the US business over FY15-17, largely led by oral products.

Modest growth in emerging markets

After the acquisition of Elder's domestic portfolio, Torrent derives c35% of total revenue from India with a large proportion from the chronic therapy segments. We expect the combined portfolio revenue to record a 14% CAGR over FY15-17E, adjusting for the addition of one quarter of Elder's portfolio. Among other emerging markets, Torrent has a sizeable presence in Brazil, and we estimate c12% of total revenue will be derived from that market in FY15. We assume a 15% CAGR in sales over FY15-17E in Brazil.

Valuation: Initiate coverage with a Buy rating

We estimate Torrent's reported earnings to record a 22% CAGR over FY15-17, although from a high base (due to the expected high contribution from Cymbalta in FY15). While the buyout of Elder's portfolio has suppressed return ratios, we expect a substantial recovery over the next two years. Our price target of Rs1,425 is based on 22x one-year forward PE.

Highlights (Rsm)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Revenues	25,944	30,535	40,360	47,070	55,909	65,085	75,852	86,918
EBIT (UBS)	4,634	6,528	9,023	11,419	13,376	15,528	18,333	21,045
Net earnings (UBS)	3,517	4,723	6,636	7,630	9,367	11,452	14,200	16,650
EPS (UBS, diluted) (Rs)	41.6	55.8	39.2	45.1	55.4	67.7	83.9	98.4
DPS (Rs)	8.5	23.0	7.5	9.0	10.0	12.0	15.0	18.0
Net (debt) / cash	955	(660)	(3,623)	(19,320)	(13,701)	(6,601)	1,759	11,878

Profitability/valuation	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
EBIT margin %	17.9	21.4	22.4	24.3	23.9	23.9	24.2	24.2
ROIC (EBIT) %	49.7	57.3	54.3	37.6	31.6	35.0	38.9	41.7
EV/EBITDA (core) x	8.5	7.6	7.6	15.9	13.2	11.0	9.0	7.4
P/E (UBS, diluted) x	7.1	6.0	11.4	25.4	20.7	16.9	13.6	11.6
Equity FCF (UBS) yield %	7.7	0.3	1.2	2.0	3.8	4.7	5.7	6.8
Net dividend yield %	2.9	6.9	1.7	0.8	0.9	1.0	1.3	1.6

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of Rs1,143.95 on 22 Jan 2015 22:38 HKT

Investment Thesis

Torrent Pharmaceuticals

12-month rating **Buy**

12m price target **Rs1,425.00**

Investment case

We expect strong growth in Torrent's earnings over the coming years, led by the India and US businesses. With the acquisition of Elder's India portfolio, Torrent has enhanced its domestic scale, which should derive cost synergies in the Indian market. Torrent has worked to build an extensive US pipeline relative to its size and has made inroads in some complex oral solids. The company has been able to increase prices for certain products where it is the dominant supplier. Increasing scale in the US should help margins expand further. We estimate a 25% earnings CAGR over FY15-17, despite a high base, due to the expected high contribution from Cymbalta in FY15.

Upside scenario

On upside scenario assumes India (led by a better performance of the chronic portfolio) and US growth (higher market share and pricing) is better than our base case with margins higher by 200bp, resulting in an earnings CAGR of 29% over FY15-17E. Torrent could trade at 24x one-year forward PE for an upside scenario of Rs1,800.

Downside scenario

Assuming limited integration benefits and slower US growth, and margins off by 100bp, we estimate a 16.5% earnings CAGR over FY15-17. The stock could trade at 16x one-year forward PE for a downside scenario of Rs985.

Upcoming catalysts

Product launches in the US could act as a catalyst

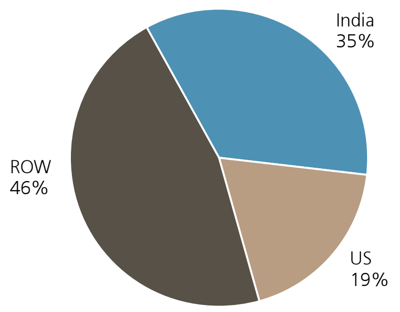
Business description

Torrent Pharmaceuticals is a leading company in the Indian formulations market, especially after the acquisition of Elder's India portfolio. It is dominant in the therapeutic cardiovascular and central nervous system areas. Torrent has a strong international presence spanning over 70 countries across five continents with over 1,200 product registrations.

Industry outlook

We are positive on Indian pharma companies based on strong growth in the US generic market. We expect market share gains in the US, as India firms launch more new products and technological capabilities improve with higher investment in R&D. We expect the Indian pharma market to grow at a 12% CAGR in sales over the next five years. We also expect Indian companies to increase their presence in emerging markets through a combination of organic and inorganic growth.

Revenues by region (FY14)



Source: Company data

EBIT by product segment

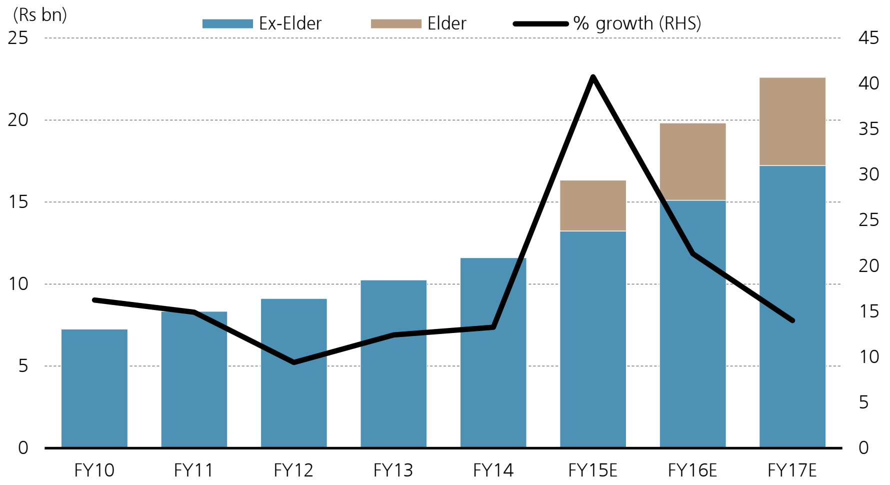
The company does not share segmental margins.

Hemant Bakhru, Analyst, hemant.bakhru@ubs.com, +91-22-61556 057

Synergies with Elder to drive margins

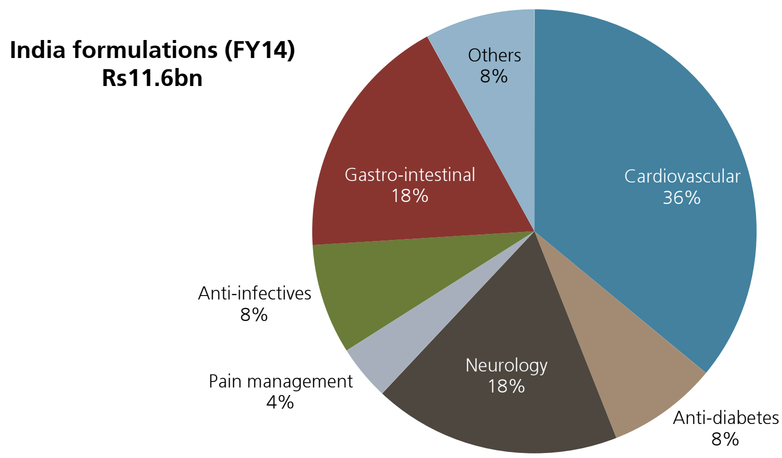
Torrent's India business has largely been focussed on the chronic segment, although domestic growth is slower than peers. Management intends to change this by enhancing product launches in key segments and being early to market. The acquisition of Elder's domestic portfolio not only adds size, but deepens Torrent's presence in attractive segments. Furthermore, we expect cost synergies from the combination and earnings growth over the next two to three years. The majority of the acquired revenues are concentrated in two products: Shelcal and Chymoral. We see scope for cost reductions as well as sales growth improvement from the combined business.

Figure 104: India sales growth including Elder acquisition



Source: Company data, UBS estimates

Figure 105: India business therapy mix

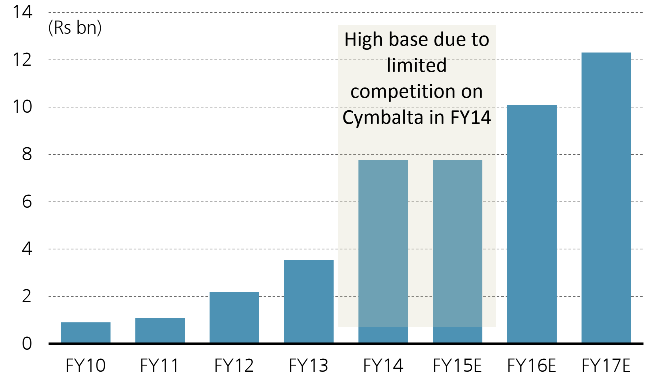


Source: Company data

Strong ramp up of the US business

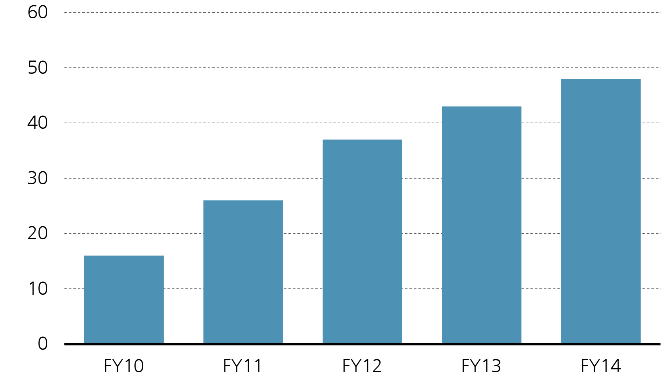
Torrent only recently entered the US market and is present in oral solid products where competition is typically high. Nonetheless, we believe it has done well to vertically integrate and be competitive in a number of products, and has been able to increase prices for products where it is the dominant supplier.

Figure 106: US business revenue ramp up



Source: Company data, UBS estimates

Figure 107: Cumulative approved ANDAs



Source: Company data

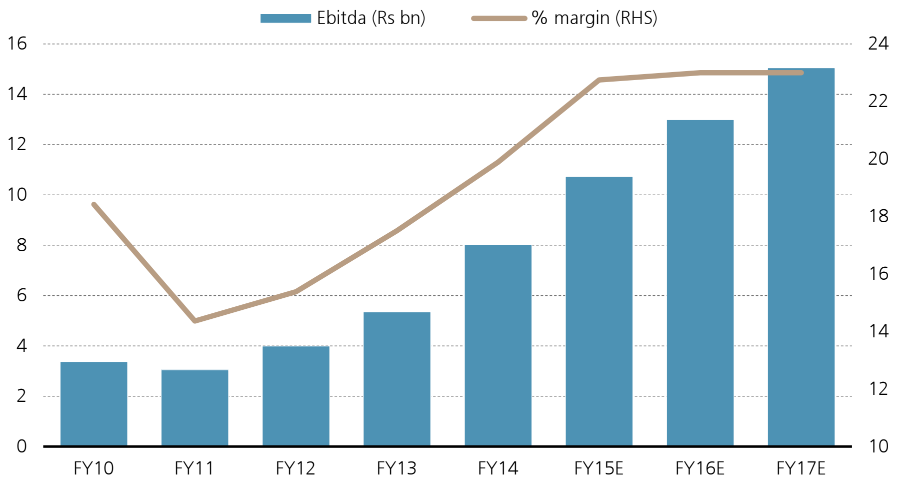
Management is working to build an extensive US pipeline relative to its size and has made some inroads in some complex oral solids. While Torrent will launch largely oral products in the US, we view them as material considering Torrent's market size. We expect management to enhance R&D spend in order to expand presence in other complex segments as the US business scales up.

Figure 108: Expected product launches in the US

Brand	Generic	Market size (US$ m)	Expected timing	Competition
Exforge HCT	Valsartan, Amlodipine, Hydrochlorthiazide	125	1QFY16	Teva FTF, others launch in May 2015
Abilify	Aripiprazole	1,500	1QFY16	Multiple
Detrol LA	Tolterodine	600	FY16	Multiple
Nexium	Esomeprazole	2,300	FY16	Multiple
Crestor	Rosuvastatin	3,200	FY17	Multiple
Enablex	Darifenacin	160	FY17	Multiple
Seroquel XR	Quetiapine	800	FY18	Multiple
Viagra	Sildenafil	1,125	FY19	Multiple
Bystolic	Nebivolol	450	FY22	Multiple

Source: FDA, IMS Health, company data

Figure 109: EBITDA margin



Source: Company data, UBS estimates

Figure 110: One-year forward PE and P/CF (x)

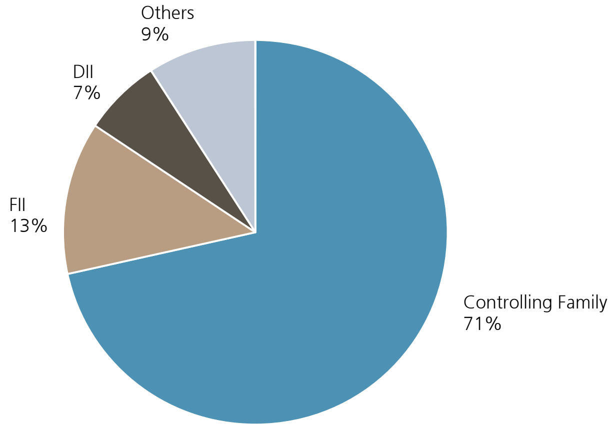
Source: Reuters, UBS

Figure 111: UBS versus consensus

(Rs m)		FY15	FY16	FY17
Revenue	UBS	47,070	55,909	65,085
	Consensus	48,905	57,543	66,369
	Diff	-4%	-3%	-2%
EBITDA	UBS	13,151	15,377	17,799
	Consensus	12,181	14,422	17,231
	Diff	8%	7%	3%
PAT	UBS	7,630	9,367	11,452
	Consensus	7,643	8,720	10,703
	Diff	0%	7%	7%

Source: Bloomberg, UBS estimates

Figure 112: Torrent's shareholding pattern (Q2 FY15)



Source: BSE

Torrent Pharmaceuticals (TORP.BO)

Income statement (Rsm)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
Revenues	**25,944**	**30,535**	**40,360**	**47,070**	*16.6*	**55,909**	*18.8*	**65,085**	**75,852**	**86,918**
Gross profit	7,826	10,064	14,631	18,711	*27.9*	22,364	*19.5*	26,197	30,720	35,202
EBITDA (UBS)	**5,452**	**7,355**	**9,893**	**13,151**	*32.9*	**15,377**	*16.9*	**17,799**	**20,919**	**23,992**
Depreciation & amortisation	(817)	(827)	(870)	(1,732)	*99.0*	(2,002)	*15.6*	(2,272)	(2,587)	(2,947)
EBIT (UBS)	**4,634**	**6,528**	**9,023**	**11,419**	*26.6*	**13,376**	*17.1*	**15,528**	**18,333**	**21,045**
Associates & investment income	0	0	0	0	-	0	-	0	0	0
Other non-operating income	0	0	0	0	-	0	-	0	0	0
Net interest	(395)	(338)	(586)	(1,882)	*-221.0*	(1,667)	*11.4*	(1,212)	(582)	(232)
Exceptionals (incl goodwill)	0	0	0	0	-	0	-	0	0	0
Profit before tax	**4,240**	**6,190**	**8,437**	**9,538**	*13.0*	**11,708**	*22.8*	**14,315**	**17,750**	**20,813**
Tax	(723)	(1,467)	(1,801)	(1,908)	*-5.9*	(2,342)	*-22.8*	(2,863)	(3,550)	(4,163)
Profit after tax	**3,517**	**4,723**	**6,636**	**7,630**	*15.0*	**9,367**	*22.8*	**11,452**	**14,200**	**16,650**
Preference dividends	0	0	0	0	-	0	-	0	0	0
Minorities	0	0	0	0	-	0	-	0	0	0
Extraordinary items	(654)	(375)	0	0	-	0	-	0	0	0
Net earnings (local GAAP)	**2,863**	**4,348**	**6,636**	**7,630**	*15.0*	**9,367**	*22.8*	**11,452**	**14,200**	**16,650**
Net earnings (UBS)	**3,517**	**4,723**	**6,636**	**7,630**	*15.0*	**9,367**	*22.8*	**11,452**	**14,200**	**16,650**
Tax rate (%)	17.1	23.7	21.3	20.0	*-6.3*	20.0	*0.0*	20.0	20.0	20.0

Per share (Rs)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
EPS (UBS, diluted)	41.6	55.8	39.2	45.1	*15.0*	55.4	*22.8*	67.7	83.9	98.4
EPS (local GAAP, diluted)	33.8	51.4	39.2	45.1	*15.0*	55.4	*22.8*	67.7	83.9	98.4
EPS (UBS, basic)	41.6	55.8	39.2	45.1	*15.0*	55.4	*22.8*	67.7	83.9	98.4
Net DPS (Rs)	8.5	23.0	7.5	9.0	*20.0*	10.0	*11.1*	12.0	15.0	18.0
Cash EPS (UBS, diluted)[1]	51.2	65.6	44.4	55.3	*24.7*	67.2	*21.4*	81.1	99.2	115.8
Book value per share	66.3	80.8	105.0	140.7	*34.1*	185.7	*32.0*	241.1	309.6	389.7
Average shares (diluted)	84.6	84.6	169.2	169.2	*0.0*	169.2	*0.0*	169.2	169.2	169.2

Balance sheet (Rsm)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
Cash and equivalents	6,743	6,270	7,694	6,998	*-9.1*	7,616	*8.8*	6,716	5,076	15,196
Other current assets	12,877	19,363	25,789	31,365	*21.6*	36,260	*15.6*	42,086	48,896	56,012
Total current assets	**19,620**	**25,633**	**33,483**	**38,363**	*14.6*	**43,876**	*14.4*	**48,802**	**53,972**	**71,208**
Net tangible fixed assets	9,156	11,051	14,095	14,562	*3.3*	15,560	*6.9*	16,288	17,202	18,255
Net intangible fixed assets	0	0	0	18,000	-	18,000	*0.0*	18,000	18,000	18,000
Investments / other assets	1,240	605	1,857	1,857	*0.0*	1,857	*0.0*	1,857	1,857	1,857
Total assets	**30,016**	**37,289**	**49,434**	**72,781**	*47.2*	**79,293**	*8.9*	**84,947**	**91,031**	**109,320**
Trade payables & other ST liabilities	12,166	16,017	19,777	22,074	*11.6*	25,970	*17.6*	30,259	34,738	39,480
Short term debt	0	0	0	0	-	0	-	0	0	0
Total current liabilities	**12,166**	**16,017**	**19,777**	**22,074**	*11.6*	**25,970**	*17.6*	**30,259**	**34,738**	**39,480**
Long term debt	5,787	6,930	11,318	26,318	*132.5*	21,318	*-19.0*	13,318	3,318	3,318
Other long term liabilities	809	669	575	575	*0.0*	575	*0.0*	575	575	575
Preferred shares	0	0	0	0	-	0	-	0	0	0
Total liabilities (incl pref shares)	**18,762**	**23,616**	**31,670**	**48,967**	*54.6*	**47,862**	*-2.3*	**44,152**	**38,631**	**43,373**
Common s/h equity	11,219	13,669	17,761	23,810	*34.1*	31,427	*32.0*	40,791	52,396	65,943
Minority interests	35	4	4	4	*0.0*	4	*0.0*	4	4	4
Total liabilities & equity	**30,016**	**37,289**	**49,434**	**72,781**	*47.2*	**79,293**	*8.9*	**84,947**	**91,031**	**109,320**

Cash flow (Rsm)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
Net income (before pref divs)	2,863	4,348	6,636	7,630	*15.0*	9,367	*22.8*	11,452	14,200	16,650
Depreciation & amortisation	817	827	870	1,732	*99.0*	2,002	*15.6*	2,272	2,587	2,947
Net change in working capital	941	(2,635)	(2,666)	(3,279)	*-23.0*	(1,000)	*69.5*	(1,536)	(2,331)	(2,374)
Other operating	654	375	0	0	-	0	-	0	0	0
Operating cash flow	**5,275**	**2,915**	**4,840**	**6,083**	*25.7*	**10,369**	*70.5*	**12,188**	**14,456**	**17,223**
Tangible capital expenditure	(1,433)	(2,721)	(3,913)	(2,199)	*43.8*	(3,000)	*-36.4*	(3,000)	(3,500)	(4,000)
Intangible capital expenditure	0	0	0	0	-	0	-	0	0	0
Net (acquisitions) / disposals	0	0	0	0	-	0	-	0	0	0
Other investing	219	636	(1,252)	0	-	0	-	0	0	0
Investing cash flow	**(1,213)**	**(2,086)**	**(5,165)**	**(2,199)**	*57.4*	**(3,000)**	*-36.4*	**(3,000)**	**(3,500)**	**(4,000)**
Equity dividends paid	(836)	(2,273)	(1,557)	(1,581)	*-1.5*	(1,750)	*-10.7*	(2,088)	(2,596)	(3,104)
Share issues / (buybacks)	(353)	462	139	0	*-100.0*	0	-	0	0	0
Other financing	0	0	0	0	-	0	-	0	0	0
Change in debt & pref shares	294	971	4,294	15,000	*249.32*	(5,000)	-	(8,000)	(10,000)	0
Financing cash flow	**(896)**	**(840)**	**2,876**	**13,419**	*366.6*	**(6,750)**	-	**(10,088)**	**(12,596)**	**(3,104)**
Cash flow inc/(dec) in cash	**3,166**	**(10)**	**2,551**	**17,303**	*NM*	**619**	*-96.4*	**(900)**	**(1,640)**	**10,119**
FX / non cash items	(1,211)	(463)	(1,126)	(18,000)	*NM*	0	-	0	0	0
Balance sheet inc/(dec) in cash	**1,955**	**(473)**	**1,425**	**(697)**	-	**619**	-	**(900)**	**(1,640)**	**10,119**

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.[1]Cash EPS (UBS, diluted) is calculated using UBS net income adding back depreciation and amortization.

Torrent Pharmaceuticals (TORP.BO)

Valuation (x)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
P/E (local GAAP, diluted)	8.7	6.5	11.4	25.4	20.7	16.9	13.6	11.6
P/E (UBS, diluted)	7.1	6.0	11.4	25.4	20.7	16.9	13.6	11.6
P/CEPS	5.7	5.1	10.1	20.7	17.0	14.1	11.5	9.9
Equity FCF (UBS) yield %	7.7	0.3	1.2	2.0	3.8	4.7	5.7	6.8
Net dividend yield (%)	2.9	6.9	1.7	0.8	0.9	1.0	1.3	1.6
P/BV x	4.4	4.2	4.3	8.1	6.2	4.7	3.7	2.9
EV/revenues (core)	1.8	1.8	1.9	4.4	3.6	3.0	2.5	2.0
EV/EBITDA (core)	8.5	7.6	7.6	15.9	13.2	11.0	9.0	7.4
EV/EBIT (core)	10.0	8.6	8.4	18.3	15.2	12.7	10.3	8.5
EV/OpFCF (core)	10.0	8.6	8.4	18.3	15.2	12.7	10.3	8.5
EV/op. invested capital	5.0	4.9	4.5	6.9	4.8	4.4	4.0	3.5

Enterprise value (Rsm)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Market cap.	49,697	56,727	75,517	193,579	193,579	193,579	193,579	193,579
Net debt (cash)	(2,196)	55	1,767	17,463	11,845	4,745	(3,615)	(13,735)
Buy out of minorities	35	4	4	4	4	4	4	4
Pension provisions/other	0	0	0	0	0	0	0	0
Total enterprise value	**47,537**	**56,786**	**77,288**	**211,047**	**205,428**	**198,328**	**189,968**	**179,849**
Non core assets	(1,240)	(605)	(1,857)	(1,857)	(1,857)	(1,857)	(1,857)	(1,857)
Core enterprise value	**46,296**	**56,181**	**75,431**	**209,190**	**203,571**	**196,471**	**188,111**	**177,992**

Growth (%)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Revenue	22.3	17.7	32.2	16.6	18.8	16.4	16.5	14.6
EBITDA (UBS)	30.6	34.9	34.5	32.9	16.9	15.8	17.5	14.7
EBIT (UBS)	30.6	40.9	38.2	26.6	17.1	16.1	18.1	14.8
EPS (UBS, diluted)	30.1	34.3	-29.8	15.0	22.8	22.3	24.0	17.3
Net DPS	6.3	170.6	-67.4	20.0	11.1	20.0	25.0	20.0

Margins & Profitability (%)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Gross profit margin	30.2	33.0	36.3	39.8	40.0	40.3	40.5	40.5
EBITDA margin	21.0	24.1	24.5	27.9	27.5	27.3	27.6	27.6
EBIT margin	17.9	21.4	22.4	24.3	23.9	23.9	24.2	24.2
Net earnings (UBS) margin	13.6	15.5	16.4	16.2	16.8	17.6	18.7	19.2
ROIC (EBIT)	49.7	57.3	54.3	37.6	31.6	35.0	38.9	41.7
ROIC post tax	41.3	43.7	42.7	30.0	25.3	28.0	31.1	33.3
ROE (UBS)	33.0	38.0	42.2	36.7	33.9	31.7	30.5	28.1

Capital structure & Coverage (x)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Net debt / EBITDA	(0.2)	0.1	0.4	1.5	0.9	0.4	(0.1)	(0.5)
Net debt / total equity %	(8.5)	4.8	20.4	81.1	43.6	16.2	(3.4)	(18.0)
Net debt / (net debt + total equity) %	(9.3)	4.6	16.9	44.8	30.4	13.9	(3.5)	(22.0)
Net debt/EV	(2.1)	1.2	4.8	9.2	6.7	3.4	(0.9)	(6.7)
Capex / depreciation %	175.3	NM	NM	127.0	149.9	132.1	135.3	135.7
Capex / revenue %	5.5	8.9	9.7	4.7	5.4	4.6	4.6	4.6
EBIT / net interest	11.7	19.3	15.4	6.1	8.0	12.8	31.5	NM
Dividend cover (UBS)	4.9	2.4	5.2	5.0	5.5	5.6	5.6	5.5
Div. payout ratio (UBS) %	20.5	41.2	19.1	20.0	18.1	17.7	17.9	18.3

Revenues by division (Rsm)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Others	25,944	30,535	40,360	47,070	55,909	65,085	75,852	86,918
Total	**25,944**	**30,535**	**40,360**	**47,070**	**55,909**	**65,085**	**75,852**	**86,918**

EBIT (UBS) by division (Rsm)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Others	4,634	6,528	9,023	11,419	13,376	15,528	18,333	21,045
Total	**4,634**	**6,528**	**9,023**	**11,419**	**13,376**	**15,528**	**18,333**	**21,045**

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

Cadila Healthcare
A US-led recovery

Equities

India
Pharmaceuticals

12-month rating	**Buy**
	Prior: Not Rated
12m price target	**Rs2,040.00**
	Prior: -
Price	**Rs1,642.45**

RIC: CADI.BO **BBG:** CDH IB

Trading data and key metrics

52-wk range	Rs1,697.25-809.15
Market cap.	Rs336bn/US$5.46bn
Shares o/s	205m (ORD)
Free float	25%
Avg. daily volume ('000)	108
Avg. daily value (m)	Rs170.8
Common s/h equity (03/15E)	Rs46.6bn
P/BV (03/15E)	7.2x
Net debt / EBITDA (03/15E)	1.1x

EPS (UBS, diluted) (Rs)

	From	To	% ch	Cons.
03/15E	-	53.1	-	52.9
03/16E	-	72.8	-	68.9
03/17E	-	89.1	-	86.0

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Robust growth in the US business

Cadila has been filing aggressively over the past two years and has 153 ANDAs pending approval. It has increased filings in complex generic segments like injectables and transdermals. Cadila has launched products in the limited competition controlled substance segment via Nesher (acquired in 2011) and guides for one more launch over the next six months. Management is also guiding for key product launches like sirolimus and lansoprazole ODT. We estimate a 29% CAGR in US revenue over FY15-17.

Modest expectations for the domestic business

With a high proportion of revenue coming from the acute segment, Cadila's growth in India is likely to be in line with the market. The drug price control order in 2013 impacted Cadila's domestic growth because of the inclusion of a higher number of its products compared to peers. Furthermore, its consumer business (eg, *Sugarfree)* has been facing headwinds due to slowing discretionary spend. We estimate a 13% CAGR in India revenue over FY15-17. We believe Cadila has made the right moves in the biosimilars segment. While we note a number of launches in India, we do not expect any launches in developed markets over the next three years.

Revival in return ratios

A combination of factors such as a warning letter from the FDA, low profitability at two acquired companies and drug price controls in India impacted Cadila's margins over FY11-14. We expect margins to revive with a substantial pick up in the US business led by key products launches. This should translate to improving return ratios.

Valuation: Initiate coverage with a Buy rating

Our price target of Rs2,040 is based on 24x one-year forward PE. We estimate a 30% CAGR in earnings over FY15-17, largely led by growth in the US business. Big-ticket launches like transdermals or Asacol HD where Cadila may be the first to file could lead to substantial earnings upgrades. However, an adverse ruling regarding Mylan's case against Cadila could negatively impact the stock price.

Highlights (Rsm)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Revenues	50,900	61,552	70,600	84,526	105,705	120,437	135,977	151,288
EBIT (UBS)	9,398	8,937	10,107	14,248	20,116	24,763	29,689	34,317
Net earnings (UBS)	6,526	6,535	8,189	10,869	14,914	18,249	22,303	26,270
EPS (UBS, diluted) (Rs)	31.9	31.9	40.0	53.1	72.8	89.1	108.9	128.3
DPS (Rs)	7.5	7.5	9.0	10.0	13.0	16.0	20.0	25.0
Net (debt) / cash	(18,227)	(23,340)	(21,516)	(19,485)	(15,308)	(8,593)	1,166	14,439

Profitability/valuation	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
EBIT margin %	18.5	14.5	14.3	16.9	19.0	20.6	21.8	22.7
ROIC (EBIT) %	23.4	17.3	17.5	22.4	28.2	30.9	33.3	35.0
EV/EBITDA (core) x	16.0	17.4	15.1	20.8	15.1	12.2	10.3	8.4
P/E (UBS, diluted) x	24.8	25.5	19.5	30.9	22.5	18.4	15.1	12.8
Equity FCF (UBS) yield %	(5.0)	(0.9)	3.0	1.3	2.2	3.1	4.3	5.7
Net dividend yield %	0.9	0.9	1.2	0.6	0.8	1.0	1.2	1.5

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of Rs1,642.45 on 22 Jan 2015 22:38 HKT

Investment Thesis

Cadila Healthcare

12-month rating	Buy
12m price target	Rs2,040.00

Investment case

Cadila has high exposure to the Indian market, and is ranked fifth in pharmaceuticals by market share while it is an emerging presence in the consumer business. The company is looking to rapidly expand the US business over the next three years and has built a strong pipeline with 153 abbreviated new drug applications pending approval. It intends to increase focus on the limited competition segment including controlled substances, dermatology, transdermal, injectables and inhalation. We estimate a 29% CAGR in US revenues and for margins to recover.

Upside scenario

Assuming the US launch of Prevacid Solutab takes place in FY16, we expect earnings to increase 12%, while a pick-up in sales growth in the domestic business to 16% could drive a 3-4% earnings upgrade. The stock could trade at 25x one-year forward PE for an upside scenario of Rs2,268.

Downside scenario

A delay in key product launches and lower domestic sales growth of c10%) could result in 7-12% lower earnings. Assigning a one-year forward PE of 18x, we arrive at our downside scenario of Rs1,410.

Upcoming catalysts

Possible catalysts include limited product launches by the competition in the US and a pick up in domestic growth as guided by management.

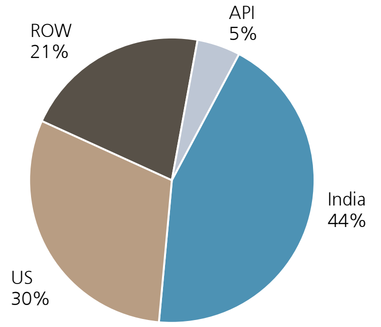
Business description

Cadila Healthcare is the fifth-largest pharmaceutical company in India by market share, with a strong presence in therapeutic segments such as cardiovascular, gastrointestinal and respiratory. Apart from India, Cadila is gaining scale in the US and planning to expand in complex generic segments. Further, it has operations in Brazil, Europe and some emerging markets. Cadila is also developing a range of biosimilar products and intends to launch those across markets, beginning with emerging markets, where regulatory barriers are low.

Industry outlook

We are positive on Indian pharma companies based on strong growth in the US generic market. We expect market share gains in the US, as India firms launch more new products and technological capabilities improve with higher investment in R&D. We expect the Indian pharma market to grow at a 12% CAGR in sales over the next five years. We also expect Indian companies to increase their presence in emerging markets through a combination of organic and inorganic growth.

Revenues by region (FY14)



Source: Company data

EBIT by product segment

The company does not release segmental margins.

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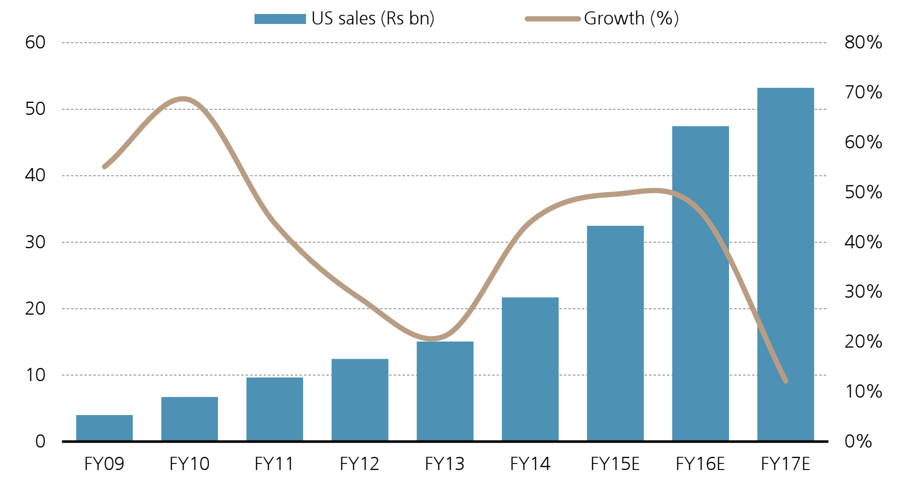
Extensive US pipeline

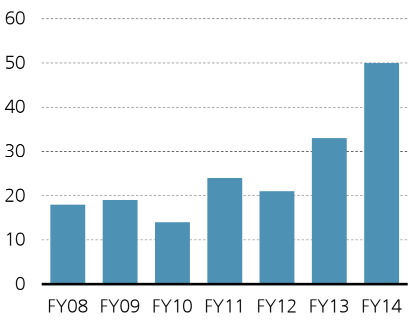
Cadila has been filing aggressively over the past two years and has 153 ANDAs pending approval, one of highest among peers. It has been increasing filings in complex generics segments like injectables and transdermals. Cadila has introduced products in the limited competition controlled substances segment via Nesher (acquired in 2011) and guides for one more launch over the next six months. Management is also guiding for ley product launches like sirolimus and lansoprazole ODT. We estimate a 29% CAGR in US revenue over FY15-17.

Figure 114: US sales growth



Source: Company data, UBS estimates

Figure 113: Annual filings in the US



Source: Company data

Figure 115: Cadila's US pipeline

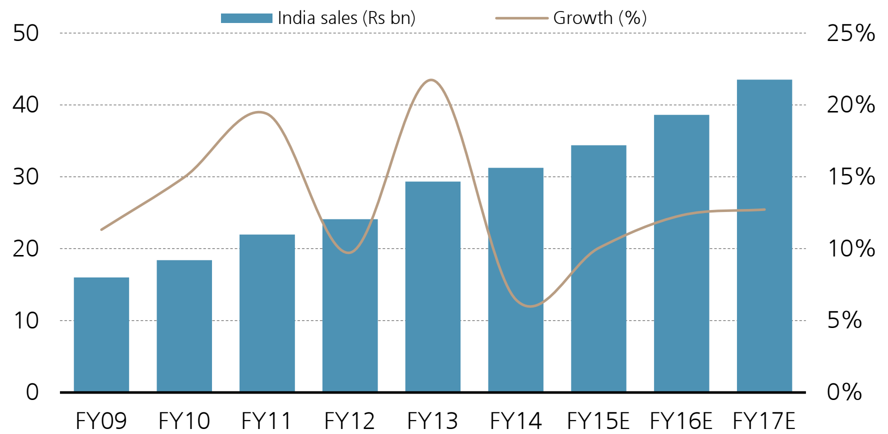
Brand	Generic	Sales (US$ m)	Timing	Competition
Abilify	Aripipazole	1,500	Apr-15	Multiple players
Asacol HD	Mesalamine	250	Nov-15	Cadila is FTF
Zegerid	Omeprazole plus Sodium bicarbonate	60	Jul-16	Three player market
Ritalin LA	Methylphenidate ER	40	FY17	Two player market
Exelon patch	Rivastigmine	250	FY19	2-4 player market
Prevacid solutab	Lansoprazole ODT	250	Unclear	3-5 competitors

Source: FDA, IMS Health, company data

Modest expectations for the domestic business

We expect Cadila's India business to grow in line with the market. The drug price control order in 2013 impacted Cadila's domestic growth because of the inclusion of a higher number of its products compared to peers. We think Cadila has reasonable exposure to the consumer business via its subsidiary, Zydus Wellness (key brands: Sugarfree, Nutralite and Everyuth). This segment has been facing headwinds from slowing discretionary spend and competition from big consumer companies. Overall, we estimate a 13% CAGR in India revenue (including the pharma and consumer segments) over FY15-17. Cadila has introduced a number of biosimilars in India, which could help drive domestic growth over the next years.

Figure 116: India sales growth

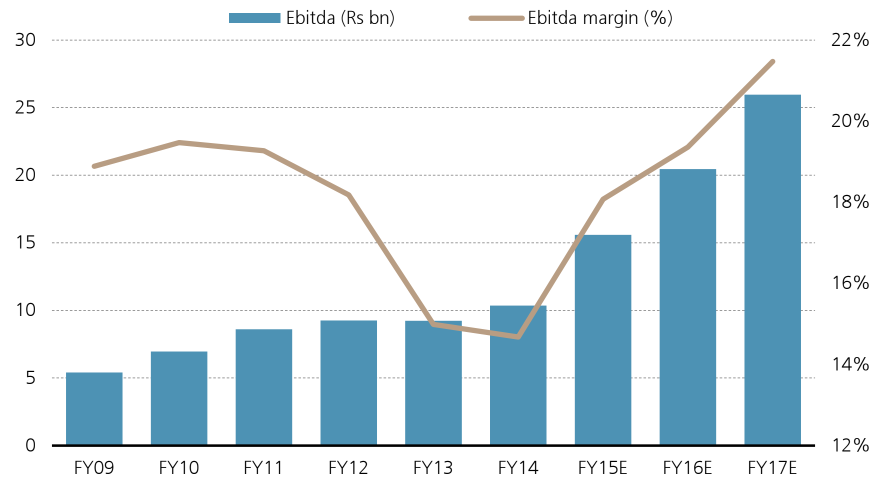


Source: Company data, UBS estimates

Margin recovery to result in strong earnings growth

A combination of factors such as a warning letter from the FDA, low profitability at two acquired companies and drug price controls in India negatively affected Cadila's margins over FY11-14. We expect margins to recover primarily from a higher number of product launches in the US and some limited competition product launches.

Figure 117: EBITDA margin trend



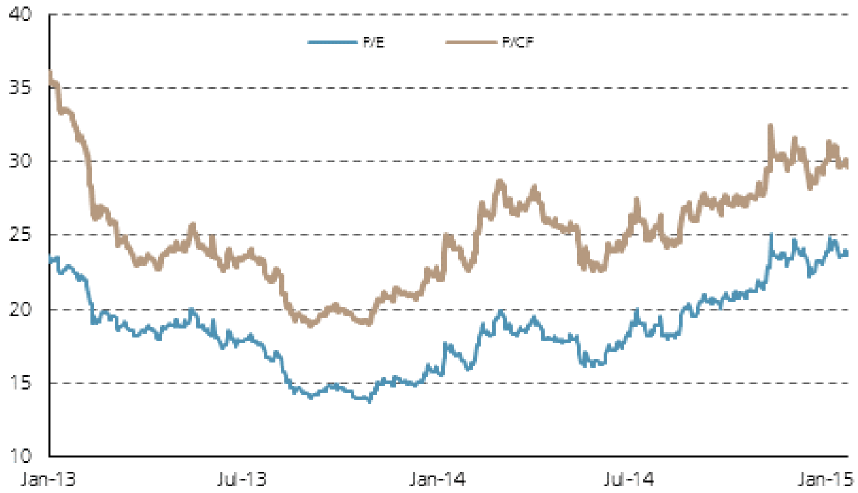
Source: Company data, UBS estimates

Figure 118: UBS versus consensus

(Rs m)		FY15	FY16	FY17
Revenue	UBS	84,526	105,705	120,437
	Consensus	84,977	99,991	117,125
	Diff	-1%	6%	3%
EBITDA	UBS	17,217	23,574	28,702
	Consensus	16,432	20,926	25,623
	Diff	5%	13%	12%
PAT	UBS	10,869	14,914	18,249
	Consensus	10,811	14,105	17,619
	Diff	1%	6%	4%

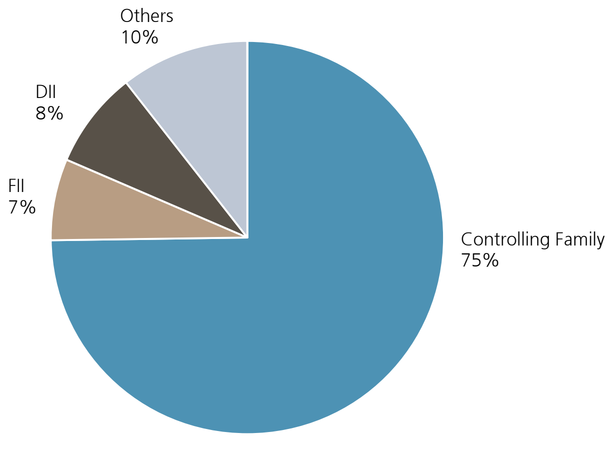
Source: Bloomberg, UBS estimates

Figure 119: One-year forward PE and P/CF ratios (x)



Source: Reuters. UBS

Figure 120: Cadila's shareholding pattern (Q2 FY15)



Source: BSE

Cadila Healthcare (CADI.BO)

Income statement (Rsm)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
Revenues	**50,900**	**61,552**	**70,600**	**84,526**	19.7	**105,705**	25.1	**120,437**	**135,977**	**151,288**
Gross profit	34,107	38,350	43,464	51,138	17.7	64,480	26.1	75,875	88,385	101,363
EBITDA (UBS)	**10,977**	**10,784**	**12,119**	**17,217**	42.1	**23,574**	36.9	**28,702**	**34,137**	**39,276**
Depreciation & amortisation	(1,579)	(1,847)	(2,012)	(2,969)	47.6	(3,458)	16.5	(3,938)	(4,448)	(4,958)
EBIT (UBS)	**9,398**	**8,937**	**10,107**	**14,248**	41.0	**20,116**	41.2	**24,763**	**29,689**	**34,317**
Associates & investment income	393	837	389	321	-17.6	502	56.6	758	1,166	1,758
Other non-operating income	0	0	0	0	-	0	-	0	0	0
Net interest	(1,849)	(1,687)	(902)	(1,080)	-19.8	(1,080)	0.0	(1,080)	(1,080)	(1,080)
Exceptionals (incl goodwill)	0	0	(172)	0	-	0	-	0	0	0
Profit before tax	**7,942**	**8,087**	**9,422**	**13,488**	43.2	**19,538**	44.9	**24,441**	**29,775**	**34,995**
Tax	(1,130)	(1,188)	(1,060)	(2,293)	-116.3	(4,298)	-87.5	(5,866)	(7,146)	(8,399)
Profit after tax	**6,812**	**6,899**	**8,362**	**11,195**	33.9	**15,240**	36.1	**18,575**	**22,629**	**26,596**
Preference dividends	0	0	0	0	-	0	-	0	0	0
Minorities	(286)	(364)	(326)	(326)	0.0	(326)	0.0	(326)	(326)	(326)
Extraordinary items	0	0	0	0	-	0	-	0	0	0
Net earnings (local GAAP)	**6,526**	**6,535**	**8,036**	**10,869**	35.3	**14,914**	37.2	**18,249**	**22,303**	**26,270**
Net earnings (UBS)	**6,526**	**6,535**	**8,189**	**10,869**	32.7	**14,914**	37.2	**18,249**	**22,303**	**26,270**
Tax rate (%)	14.2	14.7	11.3	17.0	51.1	22.0	29.4	24.0	24.0	24.0

Per share (Rs)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
EPS (UBS, diluted)	31.9	31.9	40.0	53.1	32.7	72.8	37.2	89.1	108.9	128.3
EPS (local GAAP, diluted)	31.9	31.9	39.2	53.1	35.3	72.8	37.2	89.1	108.9	128.3
EPS (UBS, basic)	31.9	31.9	40.0	53.1	32.7	72.8	37.2	89.1	108.9	128.3
Net DPS (Rs)	7.5	7.5	9.0	10.0	11.1	13.0	30.0	16.0	20.0	25.0
Cash EPS (UBS, diluted)[1]	39.6	40.9	49.8	67.6	35.7	89.7	32.8	108.4	130.7	152.5
Book value per share	140.7	158.1	185.3	227.7	22.9	289.2	27.0	363.6	454.2	559.7
Average shares (diluted)	204.7	204.7	204.7	204.7	0.0	204.7	0.0	204.7	204.7	204.7

Balance sheet (Rsm)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
Cash and equivalents	4,666	5,838	5,488	7,519	37.0	11,696	55.5	18,411	28,170	41,443
Other current assets	25,145	28,458	32,672	38,924	19.1	47,378	21.7	53,613	60,234	66,880
Total current assets	**29,811**	**34,296**	**38,160**	**46,443**	21.7	**59,074**	27.2	**72,024**	**88,404**	**108,323**
Net tangible fixed assets	32,971	37,612	40,153	42,184	5.1	44,725	6.0	48,787	52,839	56,380
Net intangible fixed assets	347	0	0	0	-	0	-	0	0	0
Investments / other assets	242	1,145	866	866	0.0	866	0.0	866	866	866
Total assets	**63,371**	**73,053**	**79,179**	**89,493**	13.0	**104,666**	17.0	**121,677**	**142,108**	**165,569**
Trade payables & other ST liabilities	9,580	9,313	11,831	13,142	11.1	15,391	17.1	16,853	18,391	19,941
Short term debt	0	0	0	0	-	0	-	0	0	0
Total current liabilities	**9,580**	**9,313**	**11,831**	**13,142**	11.1	**15,391**	17.1	**16,853**	**18,391**	**19,941**
Long term debt	22,893	29,178	27,004	27,004	0.0	27,004	0.0	27,004	27,004	27,004
Other long term liabilities	1,185	1,005	961	961	0.0	961	0.0	961	961	961
Preferred shares	0	0	0	0	-	0	-	0	0	0
Total liabilities (incl pref shares)	**33,658**	**39,496**	**39,796**	**41,107**	3.3	**43,356**	5.5	**44,818**	**46,356**	**47,906**
Common s/h equity	28,809	32,364	37,940	46,617	22.9	59,215	27.0	74,438	93,005	114,591
Minority interests	904	1,193	1,443	1,769	22.6	2,095	18.4	2,421	2,747	3,073
Total liabilities & equity	**63,371**	**73,053**	**79,179**	**89,493**	13.0	**104,666**	17.0	**121,677**	**142,108**	**165,569**

Cash flow (Rsm)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
Net income (before pref divs)	6,526	6,535	8,036	10,869	35.3	14,914	37.2	18,249	22,303	26,270
Depreciation & amortisation	1,579	1,847	2,012	2,969	47.6	3,458	16.5	3,938	4,448	4,958
Net change in working capital	(4,129)	(3,747)	(1,143)	(4,737)	-314.4	(5,406)	-14.1	(3,965)	(4,026)	(3,791)
Other operating	344	222	305	326	6.9	326	0.0	326	326	326
Operating cash flow	**4,320**	**4,857**	**9,210**	**9,427**	2.4	**13,292**	41.0	**18,549**	**23,051**	**27,764**
Tangible capital expenditure	(12,436)	(6,397)	(4,437)	(5,000)	-12.7	(6,000)	-20.0	(8,000)	(8,500)	(8,500)
Intangible capital expenditure	0	0	0	0	-	0	-	0	0	0
Net (acquisitions) / disposals	0	0	0	0	-	0	-	0	0	0
Other investing	0	0	0	0	-	0	-	0	0	0
Investing cash flow	**(12,436)**	**(6,397)**	**(4,437)**	**(5,000)**	-12.7	**(6,000)**	-20.0	**(8,000)**	**(8,500)**	**(8,500)**
Equity dividends paid	(2,066)	(2,105)	(2,266)	(2,396)	-5.7	(3,115)	-30.0	(3,834)	(4,792)	(5,990)
Share issues / (buybacks)	(466)	(610)	(804)	0	-	0	-	0	0	0
Other financing	0	0	0	0	-	0	-	0	0	0
Change in debt & pref shares	-	-	-	-	-	-	-	-	-	-
Financing cash flow	**-**	**-**	**-**	**-**	-	**-**	-	**-**	**-**	**-**
Cash flow inc/(dec) in cash	**-**	**-**	**-**	**-**	-	**-**	-	**-**	**-**	**-**
FX / non cash items	-	-	-	-	-	-	-	-	-	-
Balance sheet inc/(dec) in cash	**1,714**	**1,172**	**(350)**	**2,031**	-	**4,177**	105.6	**6,715**	**9,759**	**13,273**

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.[1]Cash EPS (UBS, diluted) is calculated using UBS net income adding back depreciation and amortization.

Cadila Healthcare (CADI.BO)

Valuation (x)	**03/12**	**03/13**	**03/14**	**03/15E**	**03/16E**	**03/17E**	**03/18E**	**03/19E**
P/E (local GAAP, diluted)	24.8	25.5	19.8	30.9	22.5	18.4	15.1	12.8
P/E (UBS, diluted)	24.8	25.5	19.5	30.9	22.5	18.4	15.1	12.8
P/CEPS	20.0	19.9	15.6	24.3	18.3	15.2	12.6	10.8
Equity FCF (UBS) yield %	(5.0)	(0.9)	3.0	1.3	2.2	3.1	4.3	5.7
Net dividend yield (%)	0.9	0.9	1.2	0.6	0.8	1.0	1.2	1.5
P/BV x	5.6	5.2	4.2	7.2	5.7	4.5	3.6	2.9
EV/revenues (core)	3.4	3.0	2.6	4.2	3.4	2.9	2.6	2.2
EV/EBITDA (core)	16.0	17.4	15.1	20.8	15.1	12.2	10.3	8.4
EV/EBIT (core)	18.7	21.0	18.1	25.1	17.6	14.1	11.8	9.6
EV/OpFCF (core)	NM	NM	28.0	NM	29.2	20.9	16.2	12.3
EV/op. invested capital	4.4	3.6	3.2	5.6	5.0	4.4	3.9	3.4

Enterprise value (Rsm)	**03/12**	**03/13**	**03/14**	**03/15E**	**03/16E**	**03/17E**	**03/18E**	**03/19E**
Market cap.	161,828	166,697	159,484	336,292	336,292	336,292	336,292	336,292
Net debt (cash)	13,096	20,784	22,428	20,500	17,396	11,951	11,951	(7,802)
Buy out of minorities	904	1,193	1,443	1,769	2,095	2,421	2,747	3,073
Pension provisions/other	0	0	0	0	0	0	0	0
Total enterprise value	**175,827**	**188,674**	**183,355**	**358,561**	**355,783**	**350,663**	**350,989**	**331,562**
Non core assets	(242)	(1,145)	(866)	(866)	(866)	(866)	(866)	(866)
Core enterprise value	**175,585**	**187,529**	**182,489**	**357,695**	**354,917**	**349,797**	**350,123**	**330,696**

Growth (%)	**03/12**	**03/13**	**03/14**	**03/15E**	**03/16E**	**03/17E**	**03/18E**	**03/19E**
Revenue	14.0	20.9	14.7	19.7	25.1	13.9	12.9	11.3
EBITDA (UBS)	15.9	-1.8	12.4	42.1	36.9	21.7	18.9	15.1
EBIT (UBS)	14.6	-4.9	13.1	41.0	41.2	23.1	19.9	15.6
EPS (UBS, diluted)	-8.2	0.1	25.3	32.7	37.2	22.4	22.2	17.8
Net DPS	20.0	0.0	20.0	11.1	30.0	23.1	25.0	25.0

Margins & Profitability (%)	**03/12**	**03/13**	**03/14**	**03/15E**	**03/16E**	**03/17E**	**03/18E**	**03/19E**
Gross profit margin	67.0	62.3	61.6	60.5	61.0	63.0	65.0	67.0
EBITDA margin	21.6	17.5	17.2	20.4	22.3	23.8	25.1	26.0
EBIT margin	18.5	14.5	14.3	16.9	19.0	20.6	21.8	22.7
Net earnings (UBS) margin	12.8	10.6	11.6	12.9	14.1	15.2	16.4	17.4
ROIC (EBIT)	23.4	17.3	17.5	22.4	28.2	30.9	33.3	35.0
ROIC post tax	20.1	14.7	15.5	18.6	22.0	23.5	25.3	26.6
ROE (UBS)	24.6	21.4	23.3	25.7	28.2	27.3	26.6	25.3

Capital structure & Coverage (x)	**03/12**	**03/13**	**03/14**	**03/15E**	**03/16E**	**03/17E**	**03/18E**	**03/19E**
Net debt / EBITDA	1.7	2.2	1.8	1.1	0.6	0.3	(.0)	(0.4)
Net debt / total equity %	61.3	69.6	54.6	40.3	25.0	11.2	(1.2)	(12.3)
Net debt / (net debt + total equity) %	38.0	41.0	35.3	28.7	20.0	10.1	(1.2)	(14.0)
Net debt/EV	10.4	12.4	11.8	5.4	4.3	2.5	(0.3)	(4.4)
Capex / depreciation %	NM	NM	NM	168.4	173.5	NM	191.1	171.4
Capex / revenue %	24.4	10.4	6.3	5.9	5.7	6.6	6.3	5.6
EBIT / net interest	5.1	5.3	11.2	13.2	18.6	22.9	27.5	31.8
Dividend cover (UBS)	4.2	4.3	4.4	5.3	5.6	5.6	5.4	5.1
Div. payout ratio (UBS) %	23.5	23.5	22.5	18.8	17.8	18.0	18.4	19.5

Revenues by division (Rsm)	**03/12**	**03/13**	**03/14**	**03/15E**	**03/16E**	**03/17E**	**03/18E**	**03/19E**
Others	50,900	61,552	70,600	84,526	105,705	120,437	135,977	151,288
Total	**50,900**	**61,552**	**70,600**	**84,526**	**105,705**	**120,437**	**135,977**	**151,288**

EBIT (UBS) by division (Rsm)	**03/12**	**03/13**	**03/14**	**03/15E**	**03/16E**	**03/17E**	**03/18E**	**03/19E**
Others	9,398	8,937	10,107	14,248	20,116	24,763	29,689	34,317
Total	**9,398**	**8,937**	**10,107**	**14,248**	**20,116**	**24,763**	**29,689**	**34,317**

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

Glenmark Pharmaceuticals
Changing trajectory

Equities

India
Pharmaceuticals

12-month rating	**Buy**
12m price target	**Rs900.00**
	Prior: Rs920.00
Price	**Rs744.95**

RIC: GLEN.BO **BBG:** GNP IB

Trading data and key metrics

52-wk range	Rs828.50-508.35
Market cap.	Rs202bn/US$3.28bn
Shares o/s	271m (ORD)
Free float	55%
Avg. daily volume ('000)	718
Avg. daily value (m)	Rs553.2
Common s/h equity (03/15E)	Rs36.5bn
P/BV (03/15E)	5.5x
Net debt / EBITDA (03/15E)	2.1x

EPS (UBS, diluted) (Rs)

	From	To	% ch	Cons.
03/15E	30.2	25.4	-15.88	30.4
03/16E	37.6	31.2	-17.14	39.1
03/17E	53.3	50.0	-6.14	51.5

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US business to pick up with a slew of launches

Glenmark's growth in the US has been muted over the past eight quarters due to a limited number of new product launches. We expect launches to increase in FY16-17, and for big-ticket launches to drive a 37% CAGR in US sales over FY15-17E. Glenmark's margins should rise strongly due to limited competition launches like Finacea, Ortho Tri-Cyclen Lo and Zetia.

India growth to remain strong; other EMs may see currency impact

Glenmark's India franchise largely comprises the fast growing dermatology, cardiovascular and gynaecology segments. We expect more launches in these segments and for Glenmark to record strong domestic revenue growth. We estimate an 18% revenue CAGR over FY15-17 for the India business, but only an 11% CAGR in revenue from other emerging markets due to currency fluctuations and a high base. Management is building a pipeline of respiratory products to fuel growth in emerging markets. It has filed for Advair in over 10 geographies and a generic for Alimta in two LatAm markets.

Cash flow yield weaker than peers, although we expect improvements

We expect operating cash flow to rise over the next two years as a result of key US launches, although part may be used for capital expenditure for the US factory. We expect capex of Rs5bn-6bn in each of FY16E and FY17E. While a small base allows for high organic growth, a high debt position may limit Glenmark's ability for M&A.

Valuation: Assume coverage; cut price target from Rs920 to Rs900

We expect earnings growth to improve from a low base in FY15, led primarily by a recovery in US formulations, although emerging market growth might be weak due to adverse currency movements. The India business continues to grow robustly due to its niche franchise. We estimate a 24% core earnings CAGR over FY15-17 (or 40% reported profit growth including a full contribution from Zetia). Our price target is based on 22x one-year forward core earnings (excluding non-recurring earnings from Zetia) plus the perceived value of its innovative research (Rs30/ share). We have a Buy rating. Glenmark could benefit from innovative R&D over the next year with the potential out licensing of GRC17356. We do not factor this into our estimates.

Highlights (Rsm)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Revenues	37,671	49,630	59,686	66,466	76,258	97,460	100,920	115,739
EBIT (UBS)	6,257	8,895	10,964	10,434	12,259	20,786	18,735	21,754
Net earnings (UBS)	4,514	6,147	7,163	6,902	8,449	13,574	13,099	15,600
EPS (UBS, diluted) (Rs)	16.7	22.7	26.4	25.4	31.2	50.0	48.3	57.5
DPS (Rs)	2.0	2.0	2.0	2.5	3.0	5.0	5.0	5.0
Net (debt) / cash	(19,226)	(21,576)	(24,663)	(27,471)	(28,501)	(30,904)	(26,239)	(24,835)

Profitability/valuation	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
EBIT margin %	16.6	17.9	18.4	15.7	16.1	21.3	18.6	18.8
ROIC (EBIT) %	14.9	18.9	20.9	17.6	18.0	26.1	20.7	21.7
EV/EBITDA (core) x	14.1	13.2	12.8	17.5	15.2	9.6	10.2	8.8
P/E (UBS, diluted) x	18.4	18.6	20.4	29.3	23.9	14.9	15.4	13.0
Equity FCF (UBS) yield %	(2.0)	(1.3)	1.2	0.2	(.0)	(0.4)	3.1	1.5
Net dividend yield %	0.7	0.5	0.4	0.3	0.4	0.7	0.7	0.7

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of Rs744.95 on 22 Jan 2015 22:38 HKT

Investment Thesis

Glenmark Pharmaceuticals

12-month rating **Buy**

12m price target **Rs900.00**

Investment case

We believe Glenmark is performing well in all key markets—India, the US and the rest of the world (ROW). We think management's guidance of above 15% revenue CAGR in the medium term is achievable. In the US, we expect growth to be driven by launches in the niche dermatology and oral contraceptive segments. Glenmark's innovative R&D efforts remain a source of potential growth, given its consistent track record of out-licensing early stage molecules.

Upside scenario

Stronger revenue growth for the India (a 22% CAGR) and the US businesses (a 42% CAGR) could result in a 12% EPS upgrade, assuming lower competition for Welchol in FY16. Earnings upside could come via out-licensing deals, and substantial upside may be driven by progress in new chemical entities (NCE) from clinical trial to launch. Assuming 24x one-year forward PE, we arrive at an upside scenario of Rs1,130.

Downside scenario

We assume domestic sales growth slows to a 14% CAGR and the US to a 25% CAGR in FY16, assuming desmoprsessin is not approved. Our downside scenario is Rs626 and based on 18x one-year forward PE.

Upcoming catalysts

Catalysts include the out-licensing of GRC17356 and the launch of the Finacea generic.

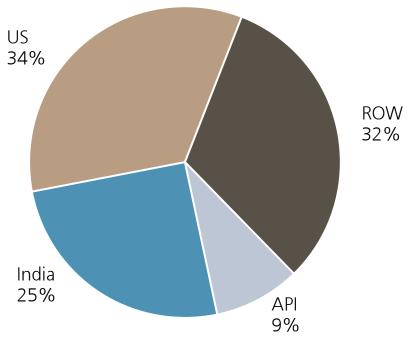
Business description

Glenmark Pharmaceuticals (Glenmark), incorporated in 1977, focuses on the manufacture and global marketing of finished dosages and active pharmaceutical ingredients (API). Glenmark is among a few Indian companies investing in new drug discovery research. The global API business contributed 8% of sales. Its main markets are India, the US and Latin America. The company is increasing its presence in the EU and semi-regulated markets.

Industry outlook

We are positive on Indian pharma companies based on strong growth in the US generic market. We expect market share gains in the US, as India firms launch more new products and technological capabilities improve with higher investment in R&D. We expect the Indian pharma market to grow at a 12% CAGR in sales over the next five years. We also expect Indian companies to increase their presence in emerging markets through a combination of organic and inorganic growth.

Revenues by region (FY14)



Source: Company data

EBIT by product segment

The company does not release segmental margins.

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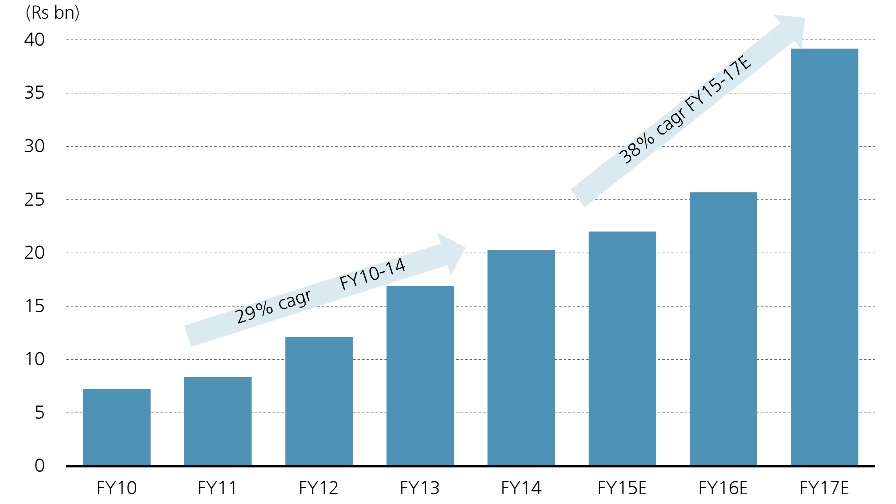
We expect a pick up in US launches

A limited number of new product launches has limited Glenmark's US generics sales over the past eight quarters. We expect an increase in the number of launches in FY16-17, and for big-ticket launches to drive a 34% CAGR in US sales over FY15-17E. Glenmark's margins should rise strongly based on limited competition launches. The company was the first to file on Finacea and Zetia, and should have six months as the sole generic (barring authorised generic) supplier in the US. This could provide substantial cash flow and aid in the reduction of debt.

Figure 121: US business sales growth

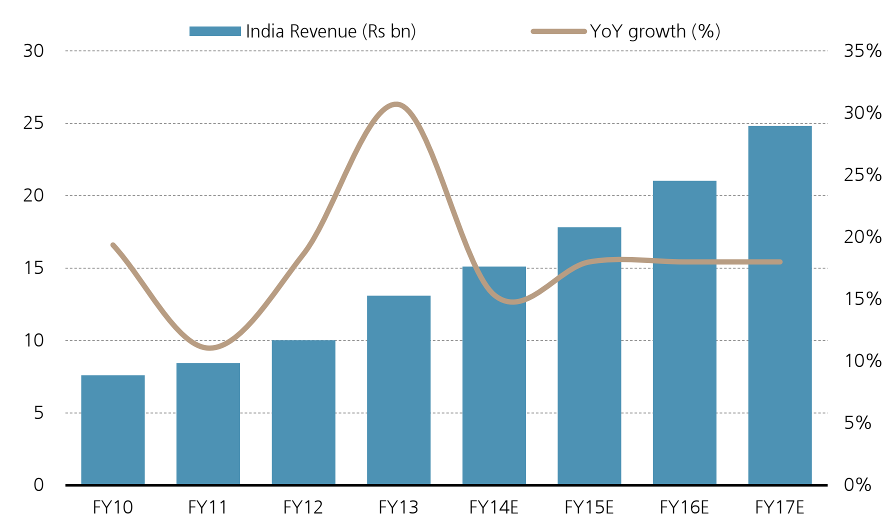


Source: Company data, UBS estimates

Strong growth in the domestic market

Glenmark's India franchise largely comprises the fast growing dermatology, cardiovascular and gynaecology segments. We expect further launches in these segments and for strong sales growth in the domestic market. We estimate an 18% sales CAGR over FY15-17 for the India business.

Figure 122: India revenue performance



Source: Company data, UBS estimates

Figure 123: Glenmark's innovative pipeline

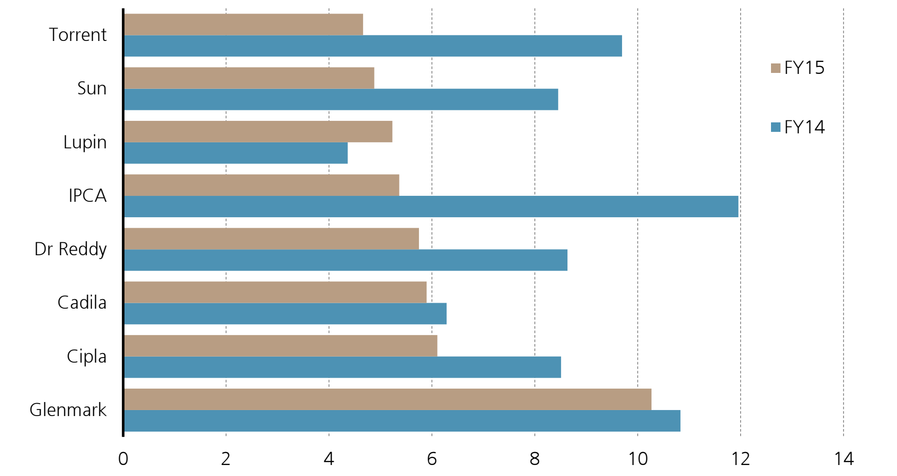
Compound	Indication	Partner	Status
Outlicensing prospects			
GRC 17536	Neuropathic pain	-	Phase IIa
GRC 27864	Pain management	-	Phase I
Vatelizumab (GBR 500)	Multiple Sclerosis	Out licensed to Sanofi	Phase II started
GBR 900	Chronic pain	-	Phase I
GBR 830	Auto-immune diseases	-	Phase I
GBR 1302	Oncology	-	Pre-clinical
In-licensing			
Crofelemer	HIV related diarrhoea	-	In-licensed for 140 countries

Source: Company data

Cash flow yield weaker than peers, although we expect an improvement

We expect operating cash flows to rise over the next two years as a result of key US launches, although part could be used for capital expenditure for the US factory. We expect capex of Rs5bn-6bn in each of FY16E and FY17E. While a small base allows for high organic growth, a high debt position may limit Glenmark's ability for M&A.

Figure 124: Capex as a % of total revenues



Source: Company data, UBS estimates

Figure 125: One year forward PE and P/CF ratios

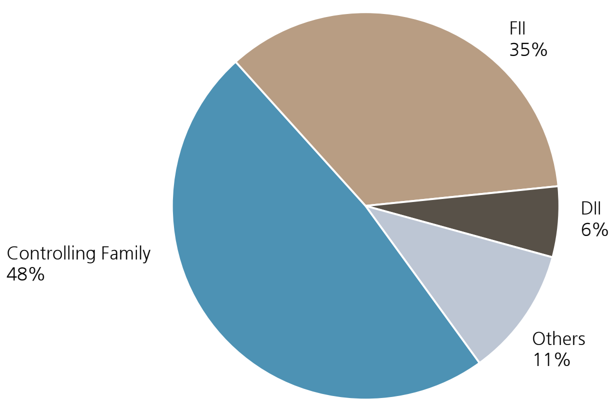
Source: Reuters, UBS

Figure 126: UBS versus consensus

(Rs m)		FY15	FY16	FY17
Revenue	UBS	66,466	76,258	97,460
	Consensus	69,617	81,662	99,045
	Diff	-5%	-7%	-2%
EBITDA	UBS	12,999	15,181	24,120
	Consensus	14,955	18,117	23,269
	Diff	-13%	-16%	4%
PAT	UBS	6,902	8,449	13,574
	Consensus	8,237	10,463	14,017
	Diff	-16%	-19%	-3%

Source: Bloomberg, UBS estimates

Figure 127: Glenmark's shareholding pattern (Q2 FY15)



Source: BSE

Glenmark Pharmaceuticals (GLEN.BO)

Income statement (Rsm)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
Revenues	**37,671**	**49,630**	**59,686**	**66,466**	*11.4*	**76,258**	*14.7*	**97,460**	**100,920**	**115,739**
Gross profit	24,217	33,094	40,956	44,732	*9.2*	52,208	*16.7*	67,735	69,635	79,860
EBITDA (UBS)	**7,236**	**10,165**	**13,132**	**12,999**	*-1.0*	**15,181**	*16.8*	**24,120**	**22,565**	**26,175**
Depreciation & amortisation	(979)	(1,270)	(2,168)	(2,565)	*18.3*	(2,922)	*13.9*	(3,335)	(3,830)	(4,421)
EBIT (UBS)	**6,257**	**8,895**	**10,964**	**10,434**	*-4.8*	**12,259**	*17.5*	**20,786**	**18,735**	**21,754**
Associates & investment income	0	0	0	0	-	0	-	0	0	0
Other non-operating income	0	0	0	0	-	0	-	0	0	0
Net interest	(1,466)	(1,557)	(1,819)	(1,800)	*1.1*	(1,648)	*8.4*	(1,877)	(1,890)	(1,703)
Exceptionals (incl goodwill)	0	0	(2,175)	0	-	0	-	0	0	0
Profit before tax	**4,792**	**7,337**	**6,969**	**8,634**	*23.9*	**10,611**	*22.9*	**18,909**	**16,845**	**20,051**
Tax	(238)	(1,107)	(1,513)	(1,693)	*-11.9*	(2,122)	*-25.4*	(5,295)	(3,706)	(4,411)
Profit after tax	**4,554**	**6,230**	**5,456**	**6,942**	*27.2*	**8,489**	*22.3*	**13,614**	**13,139**	**15,640**
Preference dividends	0	0	0	0	-	0	-	0	0	0
Minorities	(40)	(83)	(33)	(40)	*-20.2*	(40)	*0.0*	(40)	(40)	(40)
Extraordinary items	0	0	0	0	-	0	-	0	0	0
Net earnings (local GAAP)	**4,514**	**6,147**	**5,423**	**6,902**	*27.3*	**8,449**	*22.4*	**13,574**	**13,099**	**15,600**
Net earnings (UBS)	**4,514**	**6,147**	**7,163**	**6,902**	*-3.7*	**8,449**	*22.4*	**13,574**	**13,099**	**15,600**
Tax rate (%)	5.0	15.1	21.7	19.6	*-9.7*	20.0	*2.0*	28.0	22.0	22.0

Per share (Rs)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
EPS (UBS, diluted)	16.7	22.7	26.4	25.4	*-3.7*	31.2	*22.4*	50.0	48.3	57.5
EPS (local GAAP, diluted)	16.7	22.7	20.0	25.4	*27.3*	31.2	*22.4*	50.0	48.3	57.5
EPS (UBS, basic)	16.7	22.7	26.4	25.4	*-3.7*	31.2	*22.4*	50.0	48.3	57.5
Net DPS (Rs)	2.0	2.0	2.0	2.5	*25.0*	3.0	*20.0*	5.0	5.0	5.0
Cash EPS (UBS, diluted)[1]	20.3	27.4	34.4	34.9	*1.4*	41.9	*20.1*	62.3	62.4	73.8
Book value per share	92.5	106.4	111.9	134.4	*20.1*	162.1	*20.6*	206.3	248.7	300.4
Average shares (diluted)	270.4	270.7	271.2	271.2	*0.0*	271.2	*0.0*	271.2	271.2	271.2

Balance sheet (Rsm)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
Cash and equivalents	3,219	6,073	8,007	5,199	*-35.1*	4,169	*-19.8*	1,766	6,431	7,835
Other current assets	26,252	31,420	39,807	43,289	*8.7*	49,212	*13.7*	62,350	65,313	74,304
Total current assets	**29,472**	**37,493**	**47,814**	**48,488**	*1.4*	**53,381**	*10.1*	**64,116**	**71,744**	**82,139**
Net tangible fixed assets	13,029	15,584	17,648	21,261	*20.5*	25,598	*20.4*	30,601	36,206	43,331
Net intangible fixed assets	11,862	12,739	13,331	13,153	*-1.3*	12,894	*-2.0*	12,756	12,722	12,575
Investments / other assets	4,472	5,894	7,544	7,363	*-2.4*	7,363	*0.0*	7,363	7,363	7,363
Total assets	**58,834**	**71,710**	**86,336**	**90,265**	*4.6*	**99,236**	*9.9*	**114,836**	**128,034**	**145,409**
Trade payables & other ST liabilities	9,697	13,359	21,109	18,717	*-11.3*	19,939	*6.5*	23,133	24,442	27,363
Short term debt	0	0	0	0	-	0	-	0	0	0
Total current liabilities	**9,697**	**13,359**	**21,109**	**18,717**	*-11.3*	**19,939**	*6.5*	**23,133**	**24,442**	**27,363**
Long term debt	22,445	27,649	32,670	32,670	*0.0*	32,670	*0.0*	32,670	32,670	32,670
Other long term liabilities	1,500	1,768	2,071	2,244	*8.3*	2,456	*9.5*	2,834	3,171	3,572
Preferred shares	0	0	0	0	-	0	-	0	0	0
Total liabilities (incl pref shares)	**33,642**	**42,776**	**55,849**	**53,630**	*-4.0*	**55,064**	*2.7*	**58,637**	**60,283**	**63,604**
Common s/h equity	24,942	28,690	30,354	36,462	*20.1*	43,959	*20.6*	55,946	67,459	81,472
Minority interests	250	244	133	173	*30.1*	213	*23.1*	253	293	333
Total liabilities & equity	**58,834**	**71,710**	**86,336**	**90,265**	*4.6*	**99,236**	*9.9*	**114,836**	**128,034**	**145,409**

Cash flow (Rsm)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
Net income (before pref divs)	4,514	6,147	5,423	6,902	*27.3*	8,449	*22.4*	13,574	13,099	15,600
Depreciation & amortisation	979	1,270	2,168	2,565	*18.3*	2,922	*13.9*	3,335	3,830	4,421
Net change in working capital	(2,448)	(2,377)	(59)	(3,265)	*NM*	(4,701)	*-44.0*	(9,943)	(1,654)	(6,071)
Other operating	(979)	(439)	731	213	*-70.9*	252	*18.6*	418	377	441
Operating cash flow	**2,066**	**4,601**	**8,263**	**6,414**	*-22.4*	**6,922**	*7.9*	**7,384**	**15,652**	**14,391**
Tangible capital expenditure	(1,983)	(4,819)	(4,773)	(5,000)	*-4.8*	(6,000)	*-20.0*	(7,000)	(8,000)	(10,000)
Intangible capital expenditure	(1,729)	(1,280)	(1,693)	(1,000)	*40.9*	(1,000)	*0.0*	(1,200)	(1,400)	(1,400)
Net (acquisitions) / disposals	(1,640)	(25)	(7)	181	-	0	-	0	0	0
Other investing	0	0	0	0	-	0	-	0	0	0
Investing cash flow	**(5,351)**	**(6,125)**	**(6,473)**	**(5,819)**	*10.1*	**(7,000)**	*-20.3*	**(8,200)**	**(9,400)**	**(11,400)**
Equity dividends paid	(629)	(2,951)	(3,823)	(3,403)	*11.0*	(952)	*72.0*	(1,587)	(1,587)	(1,587)
Share issues / (buybacks)	(370)	(1,982)	(2,619)	(40)	*98.5*	(40)	*0.0*	(40)	(40)	(40)
Other financing	2,041	918	1,130	40	*-96.46*	40	*0.00*	40	40	40
Change in debt & pref shares	1,188	5,204	5,021	0	-	0	-	0	0	0
Financing cash flow	**2,229**	**1,189**	**(291)**	**(3,403)**	*NM*	**(952)**	*72.0*	**(1,587)**	**(1,587)**	**(1,587)**
Cash flow inc/(dec) in cash	**(1,056)**	**(335)**	**1,500**	**(2,808)**	-	**(1,030)**	*63.3*	**(2,403)**	**4,665**	**1,404**
FX / non cash items	2,317	3,189	434	0	*-100.0*	0	*45.2*	0	0	0
Balance sheet inc/(dec) in cash	**1,261**	**2,854**	**1,934**	**(2,808)**	-	**(1,030)**	*63.3*	**(2,403)**	**4,665**	**1,404**

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.[1]Cash EPS (UBS, diluted) is calculated using UBS net income adding back depreciation and amortization.

Glenmark Pharmaceuticals (GLEN.BO)

Valuation (x)	**03/12**	**03/13**	**03/14**	**03/15E**	**03/16E**	**03/17E**	**03/18E**	**03/19E**
P/E (local GAAP, diluted)	18.4	18.6	27.0	29.3	23.9	14.9	15.4	13.0
P/E (UBS, diluted)	18.4	18.6	20.4	29.3	23.9	14.9	15.4	13.0
P/CEPS	15.1	15.4	15.7	21.3	17.8	11.9	11.9	10.1
Equity FCF (UBS) yield %	(2.0)	(1.3)	1.2	0.2	(.0)	(0.4)	3.1	1.5
Net dividend yield (%)	0.7	0.5	0.4	0.3	0.4	0.7	0.7	0.7
P/BV x	3.3	4.0	4.8	5.5	4.6	3.6	3.0	2.5
EV/revenues (core)	2.7	2.7	2.8	3.4	3.0	2.4	2.3	2.0
EV/EBITDA (core)	14.1	13.2	12.8	17.5	15.2	9.6	10.2	8.8
EV/EBIT (core)	16.3	15.1	15.4	21.9	18.8	11.2	12.3	10.6
EV/OpFCF (core)	24.9	19.1	13.9	27.0	25.8	18.9	12.4	13.3
EV/op. invested capital	2.4	2.8	3.2	3.8	3.4	2.9	2.6	2.3

Enterprise value (Rsm)	**03/12**	**03/13**	**03/14**	**03/15E**	**03/16E**	**03/17E**	**03/18E**	**03/19E**
Market cap.	82,860	114,029	145,603	202,048	202,048	202,048	202,048	202,048
Net debt (cash)	19,262	20,401	23,119	26,067	27,986	29,702	28,571	28,571
Buy out of minorities	258	247	188	153	193	233	293	333
Pension provisions/other	0	0	0	0	0	0	0	0
Total enterprise value	**102,381**	**134,676**	**168,911**	**228,268**	**230,227**	**231,983**	**230,912**	**230,952**
Non core assets	(298)	(323)	(331)	(150)	(150)	(150)	(150)	(150)
Core enterprise value	**102,083**	**134,353**	**168,580**	**228,118**	**230,077**	**231,833**	**230,762**	**230,802**

Growth (%)	**03/12**	**03/13**	**03/14**	**03/15E**	**03/16E**	**03/17E**	**03/18E**	**03/19E**
Revenue	31.7	31.7	20.3	11.4	14.7	27.8	3.6	14.7
EBITDA (UBS)	20.1	40.5	29.2	-1.0	16.8	58.9	-6.4	16.0
EBIT (UBS)	23.2	42.1	23.3	-4.8	17.5	69.6	-9.9	16.1
EPS (UBS, diluted)	-0.4	36.0	16.3	-3.7	22.4	60.7	-3.5	19.1
Net DPS	NM	0.0	-0.1	25.0	20.0	66.7	0.0	0.0

Margins & Profitability (%)	**03/12**	**03/13**	**03/14**	**03/15E**	**03/16E**	**03/17E**	**03/18E**	**03/19E**
Gross profit margin	64.3	66.7	68.6	67.3	68.5	69.5	69.0	69.0
EBITDA margin	19.2	20.5	22.0	19.6	19.9	24.7	22.4	22.6
EBIT margin	16.6	17.9	18.4	15.7	16.1	21.3	18.6	18.8
Net earnings (UBS) margin	12.0	12.4	12.0	10.4	11.1	13.9	13.0	13.5
ROIC (EBIT)	14.9	18.9	20.9	17.6	18.0	26.1	20.7	21.7
ROIC post tax	14.2	16.0	16.4	14.1	14.4	18.8	16.2	16.9
ROE (UBS)	19.9	22.9	24.3	20.7	21.0	27.2	21.2	20.9

Capital structure & Coverage (x)	**03/12**	**03/13**	**03/14**	**03/15E**	**03/16E**	**03/17E**	**03/18E**	**03/19E**
Net debt / EBITDA	2.7	2.1	1.9	2.1	1.9	1.3	1.2	0.9
Net debt / total equity %	76.3	74.6	80.9	75.0	64.5	55.0	38.7	30.4
Net debt / (net debt + total equity) %	43.3	42.7	44.7	42.9	39.2	35.5	27.9	23.3
Net debt/EV	18.8	16.1	14.6	12.0	12.4	13.3	11.4	10.8
Capex / depreciation %	NM	NM	NM	NM	NM	NM	NM	NM
Capex / revenue %	5.3	9.7	8.0	7.5	7.9	7.2	7.9	8.6
EBIT / net interest	4.3	5.7	6.0	5.8	7.4	11.1	9.9	12.8
Dividend cover (UBS)	8.3	11.3	13.2	10.2	10.4	10.0	9.7	11.5
Div. payout ratio (UBS) %	12.0	8.8	7.6	9.8	9.6	10.0	10.4	8.7

Revenues by division (Rsm)	**03/12**	**03/13**	**03/14**	**03/15E**	**03/16E**	**03/17E**	**03/18E**	**03/19E**
Others	37,671	49,630	59,686	66,466	76,258	97,460	100,920	115,739
Total	**37,671**	**49,630**	**59,686**	**66,466**	**76,258**	**97,460**	**100,920**	**115,739**

EBIT (UBS) by division (Rsm)	**03/12**	**03/13**	**03/14**	**03/15E**	**03/16E**	**03/17E**	**03/18E**	**03/19E**
Others	6,257	8,895	10,964	10,434	12,259	20,786	18,735	21,754
Total	**6,257**	**8,895**	**10,964**	**10,434**	**12,259**	**20,786**	**18,735**	**21,754**

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

Cipla Ltd.
Medium-term pressure

Channel consolidation could help uptake of inhalational products in the US
It has been difficult, or at least expensive, for Indian generic companies to gain market share in the US respiratory segment due to device differences. However, we believe the situation is changing due to stronger pharmacy benefit managers (PBMs) pushing for cheaper generic versions versus branded ones. In such a scenario, Cipla would need to spend less on the sales force to promote its product franchise. However, Cipla has yet to start US trials for its inhalational products, and we expect product launches are three to five years away based on the time required for clinical trials and gaining approvals.

Steady growth in emerging markets
Management targets strong growth in India and South Africa over the next five years. We expect Cipla to grow in line or slightly ahead of industry growth estimates in India and we forecast a 15% sales CAGR over FY15-17. The company has expanded the sales force over the past two years and guides for improving productivity. This should translate to better margins for the domestic business.

Stronger management team to aid recovery
There has been a major transition in Cipla's top management team. The controlling family has increased their involvement with Mr Kamil Hamied and Ms Samina Vaziralli taking up strategic roles. The company has also increased professional managers at the top level: Mr Subhanu Saxena (ex-Novartis) was hired as CEO and several top level hires have been made across various geographical segments. As a result, staff costs have increased sharply in recent years. We expect this to reverse, however, as increasing scale and an improving product profile drive up margins.

Valuations: Initiate coverage with a Neutral rating
We initiate coverage with a Neutral rating and a price target of Rs725, which is based on 25x one-year forward PE plus the present implied value of the inhaler pipeline. Cipla is trading well above historical average multiples, as management has guided for strong revenues from the inhalational portfolio. We expect a gradual increase in market share for the inhalational portfolio in the EU market. In our view, however, a US launch would be more important, but is two years away at least.

Equities

India
Pharmaceuticals

12-month rating	**Neutral**
	Prior: Not Rated
12m price target	**Rs725.00**
	Prior: -
Price	**Rs654.15**

RIC: CIPL.BO **BBG:** CIPLA IB

Trading data and key metrics	
52-wk range	Rs667.10-367.50
Market cap.	Rs525bn/US$8.53bn
Shares o/s	803m (ORD)
Free float	64%
Avg. daily volume ('000)	1,725
Avg. daily value (m)	Rs1,092.2
Common s/h equity (03/15E)	Rs86.0bn
P/BV (03/15E)	6.1x
Net debt / EBITDA (03/15E)	0.2x

EPS (UBS, diluted) (Rs)

	From	To	% ch	Cons.
03/15E	-	16.9	-	17.3
03/16E	-	21.0	-	23.7
03/17E	-	26.8	-	29.7

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Highlights (Rsm)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Revenues	68,477	80,868	97,528	114,676	132,661	153,172	179,196	209,757
EBIT (UBS)	13,718	18,961	17,844	18,874	22,760	28,323	35,984	44,842
Net earnings (UBS)	11,421	14,976	13,535	13,576	16,886	21,485	27,667	34,892
EPS (UBS, diluted) (Rs)	14.2	18.7	16.9	16.9	21.0	26.8	34.5	43.5
DPS (Rs)	2.0	2.0	2.0	2.0	2.0	3.0	4.0	5.0
Net (debt) / cash	613	(8,241)	(10,727)	(3,777)	3,164	12,210	24,377	40,909

Profitability/valuation	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
EBIT margin %	20.0	23.4	18.3	16.5	17.2	18.5	20.1	21.4
ROIC (EBIT) %	21.3	27.8	23.5	23.4	26.2	29.6	33.9	37.7
EV/EBITDA (core) x	14.3	12.1	15.1	22.4	18.7	15.3	12.3	10.0
P/E (UBS, diluted) x	22.0	19.4	23.9	38.7	31.1	24.4	19.0	15.1
Equity FCF (UBS) yield %	5.4	1.7	2.6	1.8	1.7	2.3	3.0	4.0
Net dividend yield %	0.6	0.6	0.5	0.3	0.3	0.5	0.6	0.8

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of Rs654.15 on 22 Jan 2015 22:38 HKT

Investment Thesis

Cipla Ltd.

12-month rating **Neutral**

12m price target **Rs725.00**

Investment case

We like Cipla's emerging market exposure based on strong positions in the Indian and South African pharmaceutical markets, which account for over 75% of revenue. While we are positive on Cipla's move to enter the US market on its own, its US pipeline remains limited and will require an increase in R&D spend, in our view. In addition, Cipla's move to set up its own sales and marketing force in other key markets is likely to pressure margins in the medium term, as we expect revenues to increase only gradually.

Upside scenario

Our upside scenario assumes double-digit market shares for inhalers in most EU markets and for revenues to grow 20% in FY15 versus our base case of 15%. We assume an EPS of Rs24/Rs32 for FY16/17E in this scenario. This implies 26x one-year forward PE for an upside scenario of Rs775.

Downside scenario

In our downside scenario, we assume poor inhaler uptake, resulting in a 12% sales CAGR and a 100bp lower margin. We assume 20x one-year forward PE, implying a downside scenario of Rs510.

Upcoming catalysts

Potential catalysts include inhaler launches in EU markets and possible M&A deals.

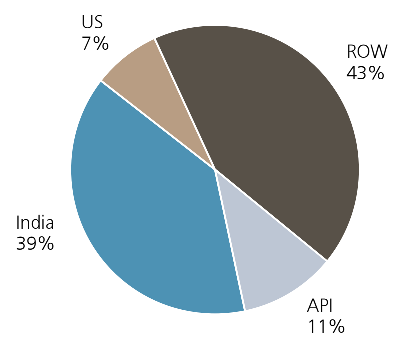
Business description

Cipla is one of the top pharmaceutical companies in India, and has a footprint across five continents. Recently, the company has embarked upon a strategy of consolidation of its international operations by building the right organisational and governance models, focusing on key markets and optimising operations. It has acquired stakes in companies with which it had partnerships. In July 2013, Cipla acquired Cipla Medpro in South Africa. The founding family owns 37% of Cipla.

Industry outlook

We are positive on Indian pharma companies based on strong growth in the US generic market. We expect market share gains in the US, as India firms launch more new products and technological capabilities improve with higher investment in R&D. We expect the Indian pharma market to grow at a 12% CAGR in sales over the next five years. We also expect Indian companies to increase their presence in emerging markets through a combination of organic and inorganic growth.

Revenues by region (FY14)



Source: Company data

EBIT by product segment

The company does not release segmental margins.

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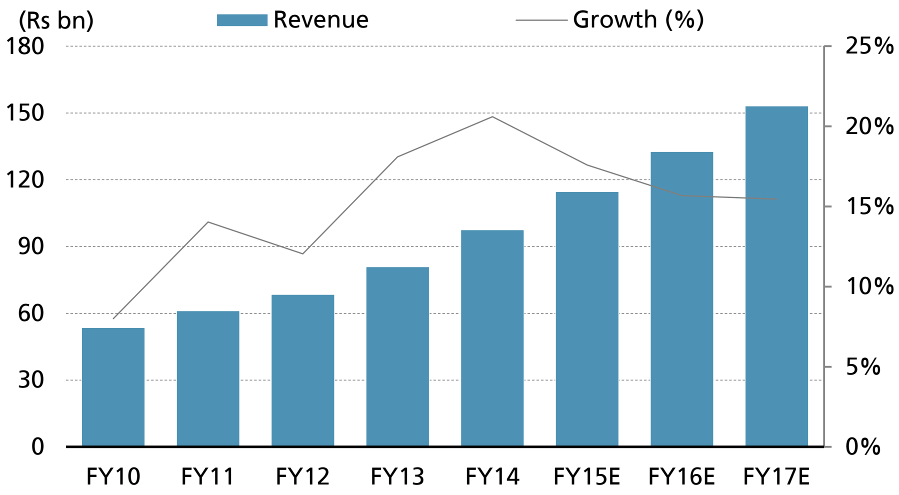
Inhalational opportunity

Cipla is the leader in the inhaler market in India with a 65%+ market share, and has made in-roads in inhaler markets in emerging markets. Over the past three years, it has entered EU markets but has struggled to gain market share. While Cipla has no presence in the US inhaler market, we believe the market would be better than the EU, as stronger PBMs will likely push for cheaper generic versions versus branded products in the US. In such a scenario, Cipla may need to spend less on the sales force to promote its product franchise. However, Cipla has yet to start US trials for its inhalational products, and we expect product launches to be three to five years away based on the time required to conduct clinical trials and gain approvals.

We expect Cipla to outstrip industry growth in India and estimate a 15% revenue CAGR over FY15-17. The company has expanded the sales force over the past three years and guides for productivity to improve.

Figure 128: Cipla's revenue growth

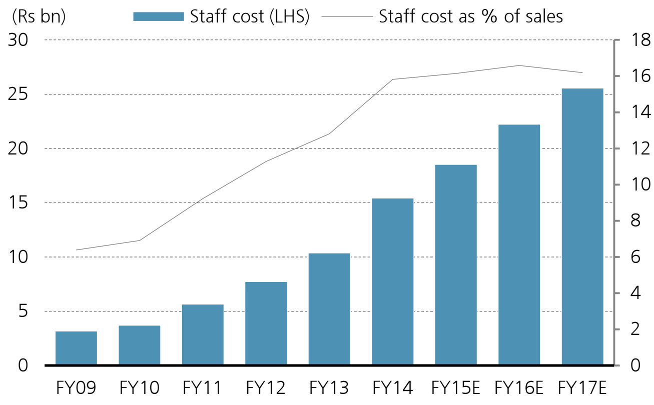


Source: Company data, UBS estimates

Transition from partnership model to own front end

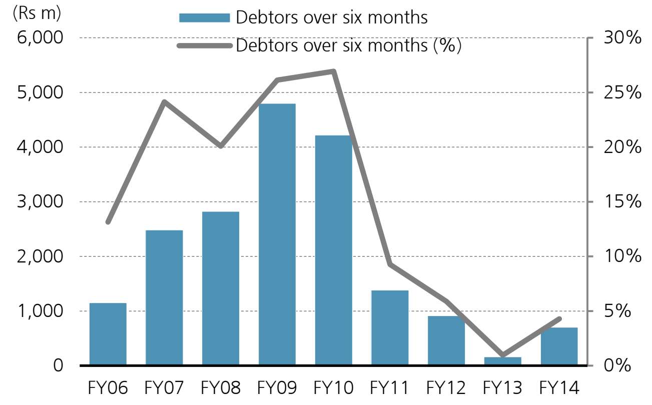
Cipla was one of the few Indian firms to develop an export model wholly based on partnerships with local firms in the markets it intended to expand in. Management is now transitioning from the partnership model to owning the front end. It has carried out acquisitions in geographies that have contributed materially to revenues. The company has also hired extensively to develop its front end in the US and the EU. Cipla's staff costs have gone up sharply as a result of this transition. Management guides that team building is nearly complete and that it plans to increase investment in R&D.

Figure 129: Staff costs



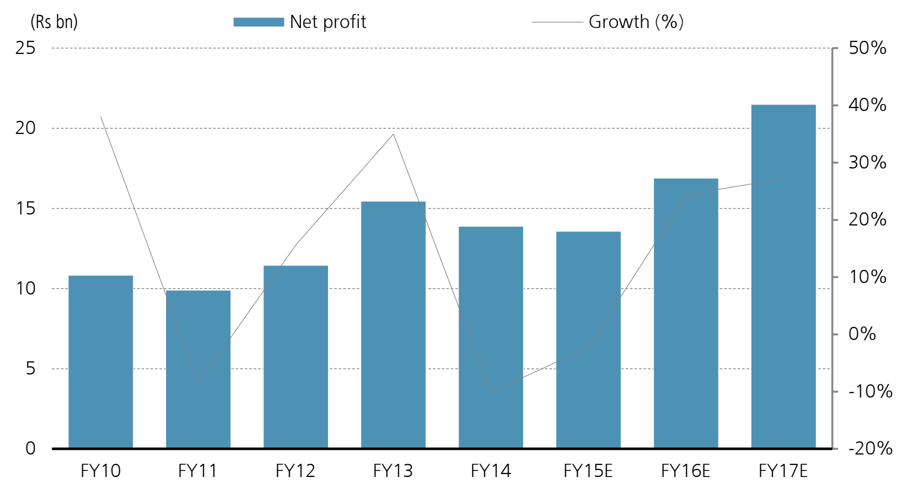
Source: Company data, UBS estimates

Figure 130: Debtors over six months



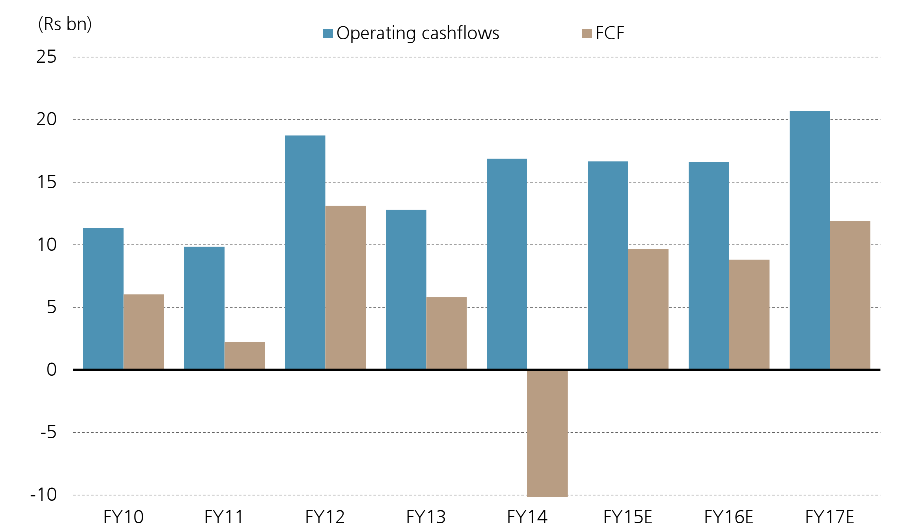
Source: Company data

Figure 131: Cipla's profit growth



Source: Company data, UBS estimates

Figure 132: Cash flows



Source: Company data, UBS estimates

Figure 133: One year forward PE

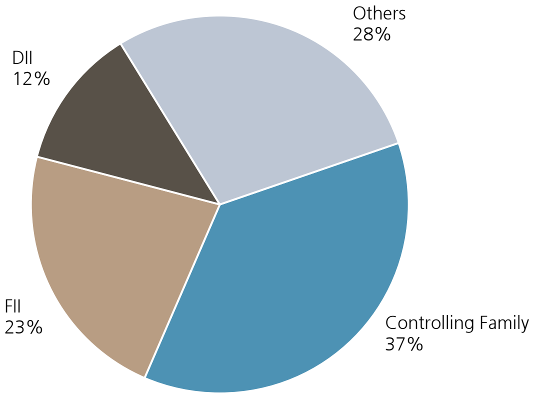
Source: Bloomberg

Figure 134: UBS versus consensus

(Rs m)		FY15	FY16	FY17
Revenue	UBS	114,676	132,661	153,172
	Consensus	114,646	136,017	159,195
	Diff	0%	-2%	-4%
EBITDA	UBS	23,417	27,735	33,873
	Consensus	23,800	30,441	37,408
	Diff	-2%	-9%	-9%
PAT	UBS	13,576	16,886	21,485
	Consensus	14,068	19,214	24,503
	Diff	-4%	-12%	-12%

Source: Bloomberg, UBS estimates

Figure 135: Cipla's shareholding pattern (Q2 FY15)



Source: BSE

Cipla Ltd. (CIPL.BO)

Income statement (Rsm)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
Revenues	**68,477**	**80,868**	**97,528**	**114,676**	*17.6*	**132,661**	*15.7*	**153,172**	**179,196**	**209,757**
Gross profit	41,084	51,342	58,780	70,755	*20.4*	82,913	*17.2*	97,264	114,685	134,244
EBITDA (UBS)	**16,840**	**22,266**	**21,571**	**23,417**	*8.6*	**27,735**	*18.4*	**33,873**	**42,167**	**51,735**
Depreciation & amortisation	(3,122)	(3,305)	(3,726)	(4,543)	*21.9*	(4,975)	*9.5*	(5,550)	(6,183)	(6,892)
EBIT (UBS)	**13,718**	**18,961**	**17,844**	**18,874**	*5.8*	**22,760**	*20.6*	**28,323**	**35,984**	**44,842**
Associates & investment income	674	898	1,154	0	-	0	-	0	0	0
Other non-operating income	0	0	0	0	-	0	-	0	0	0
Net interest	65	621	(547)	(858)	*-56.8*	(351)	*59.1*	190	733	1,463
Exceptionals (incl goodwill)	22	473	349	0	-	0	-	0	0	0
Profit before tax	**14,478**	**20,954**	**18,800**	**18,016**	*-4.2*	**22,409**	*24.4*	**28,513**	**36,716**	**46,305**
Tax	(3,065)	(5,443)	(4,634)	(4,440)	*4.2*	(5,523)	*-24.4*	(7,028)	(9,050)	(11,413)
Profit after tax	**11,413**	**15,511**	**14,167**	**13,576**	*-4.2*	**16,886**	*24.4*	**21,485**	**27,667**	**34,892**
Preference dividends	0	0	0	0	-	0	-	0	0	0
Minorities	29	(62)	(282)	0	-	0	-	0	0	0
Extraordinary items	0	0	0	0	-	0	-	0	0	0
Net earnings (local GAAP)	**11,442**	**15,449**	**13,884**	**13,576**	*-2.2*	**16,886**	*24.4*	**21,485**	**27,667**	**34,892**
Net earnings (UBS)	**11,421**	**14,976**	**13,535**	**13,576**	*0.3*	**16,886**	*24.4*	**21,485**	**27,667**	**34,892**
Tax rate (%)	21.2	26.0	24.6	24.6	*0.0*	24.6	*0.0*	24.6	24.6	24.6

Per share (Rs)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
EPS (UBS, diluted)	14.2	18.7	16.9	16.9	*0.3*	21.0	*24.4*	26.8	34.5	43.5
EPS (local GAAP, diluted)	14.3	19.2	17.3	16.9	*-2.2*	21.0	*24.4*	26.8	34.5	43.5
EPS (UBS, basic)	14.2	18.7	16.9	16.9	*0.3*	21.0	*24.4*	26.8	34.5	43.5
Net DPS (Rs)	2.0	2.0	2.0	2.0	*0.0*	2.0	*0.0*	3.0	4.0	5.0
Cash EPS (UBS, diluted)[1]	18.1	22.8	21.5	22.6	*5.0*	27.2	*20.7*	33.7	42.2	52.0
Book value per share	95.3	112.5	93.6	107.1	*14.5*	125.8	*17.4*	149.1	178.9	216.5
Average shares (diluted)	802.9	802.9	802.9	802.9	*0.0*	802.9	*0.0*	802.9	802.9	802.9

Balance sheet (Rsm)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
Cash and equivalents	905	1,430	1,752	8,702	*396.8*	15,643	*79.8*	24,689	36,856	53,388
Other current assets	43,982	49,895	54,663	58,370	*6.8*	66,024	*13.1*	74,789	85,905	98,957
Total current assets	**44,886**	**51,325**	**56,414**	**67,072**	*18.9*	**81,667**	*21.8*	**99,478**	**122,760**	**152,345**
Net tangible fixed assets	35,777	39,788	44,363	46,820	*5.5*	49,545	*5.8*	52,850	56,407	60,424
Net intangible fixed assets	0	0	0	0	-	0	-	0	0	0
Investments / other assets	12,691	25,324	7,086	7,086	*0.0*	7,086	*0.0*	7,086	7,086	7,086
Total assets	**93,354**	**116,437**	**107,863**	**120,978**	*12.2*	**138,297**	*14.3*	**159,414**	**186,253**	**219,855**
Trade payables & other ST liabilities	14,184	13,615	17,110	19,350	*13.1*	21,663	*12.0*	24,112	27,042	30,448
Short term debt	0	0	0	0	-	0	-	0	0	0
Total current liabilities	**14,184**	**13,615**	**17,110**	**19,350**	*13.1*	**21,663**	*12.0*	**24,112**	**27,042**	**30,448**
Long term debt	292	9,671	12,479	12,479	*0.0*	12,479	*0.0*	12,479	12,479	12,479
Other long term liabilities	2,332	2,805	3,119	3,119	*0.0*	3,119	*0.0*	3,119	3,119	3,119
Preferred shares	0	0	0	0	-	0	-	0	0	0
Total liabilities (incl pref shares)	**16,809**	**26,091**	**32,707**	**34,947**	*6.8*	**37,260**	*6.6*	**39,709**	**42,640**	**46,046**
Common s/h equity	76,546	90,346	75,155	86,030	*14.5*	101,037	*17.4*	119,704	143,613	173,808
Minority interests	0	0	0	0	-	0	-	0	0	0
Total liabilities & equity	**93,354**	**116,437**	**107,863**	**120,978**	*12.2*	**138,297**	*14.3*	**159,414**	**186,253**	**219,855**

Cash flow (Rsm)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
Net income (before pref divs)	11,442	15,449	13,884	13,576	*-2.2*	16,886	*24.4*	21,485	27,667	34,892
Depreciation & amortisation	3,122	3,305	3,726	4,543	*21.9*	4,975	*9.5*	5,550	6,183	6,892
Net change in working capital	4,001	(6,482)	(1,273)	(1,468)	*-15.3*	(5,341)	*-263.9*	(6,316)	(8,185)	(9,646)
Other operating	150	60	198	0	-	0	-	0	0	0
Operating cash flow	**18,716**	**12,331**	**16,535**	**16,651**	*0.7*	**16,519**	*-0.8*	**20,720**	**25,665**	**32,138**
Tangible capital expenditure	(5,194)	(7,316)	(8,301)	(7,000)	*15.7*	(7,700)	*-10.0*	(8,855)	(9,740)	(10,909)
Intangible capital expenditure	0	0	0	0	-	0	-	0	0	0
Net (acquisitions) / disposals	0	0	0	0	-	0	-	0	0	0
Other investing	(6,783)	(12,633)	18,239	0	-	0	-	0	0	0
Investing cash flow	**(11,977)**	**(19,949)**	**9,938**	**(7,000)**	-	**(7,700)**	*-10.0*	**(8,855)**	**(9,740)**	**(10,909)**
Equity dividends paid	(1,866)	(1,879)	(1,879)	(1,879)	*0.0*	(1,879)	*0.0*	(2,818)	(3,758)	(4,697)
Share issues / (buybacks)	(20)	(305)	(1,740)	(496)	*71.5*	0	-	0	0	0
Other financing	0	0	0	0	-	0	-	0	0	0
Change in debt & pref shares	(5,427)	9,379	2,808	0	-	0	-	0	0	0
Financing cash flow	**(7,313)**	**7,195**	**(810)**	**(2,375)**	*-193.2*	**(1,879)**	*20.9*	**(2,818)**	**(3,758)**	**(4,697)**
Cash flow inc/(dec) in cash	**(575)**	**(423)**	**25,663**	**7,276**	*-71.6*	**6,941**	*-4.6*	**9,046**	**12,167**	**16,532**
FX / non cash items	520	948	(25,341)	(326)	*98.7*	0	*100.0*	0	0	0
Balance sheet inc/(dec) in cash	**(55)**	**526**	**322**	**6,950**	*NM*	**6,941**	*-0.1*	**9,046**	**12,167**	**16,532**

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.[1]Cash EPS (UBS, diluted) is calculated using UBS net income adding back depreciation and amortization.

Cipla Ltd. (CIPL.BO)

Valuation (x)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
P/E (local GAAP, diluted)	21.9	18.8	23.3	38.7	31.1	24.4	19.0	15.1
P/E (UBS, diluted)	22.0	19.4	23.9	38.7	31.1	24.4	19.0	15.1
P/CEPS	17.3	15.9	18.7	29.0	24.0	19.4	15.5	12.6
Equity FCF (UBS) yield %	5.4	1.7	2.6	1.8	1.7	2.3	3.0	4.0
Net dividend yield (%)	0.6	0.6	0.5	0.3	0.3	0.5	0.6	0.8
P/BV x	3.3	3.2	4.3	6.1	5.2	4.4	3.7	3.0
EV/revenues (core)	3.5	3.3	3.3	4.6	3.9	3.4	2.9	2.5
EV/EBITDA (core)	14.3	12.1	15.1	22.4	18.7	15.3	12.3	10.0
EV/EBIT (core)	17.5	14.2	18.2	27.8	22.8	18.3	14.4	11.6
EV/OpFCF (core)	29.2	21.9	NM	NM	NM	24.7	18.2	14.1
EV/op. invested capital	3.7	3.9	4.3	6.5	6.0	5.4	4.9	4.4

Enterprise value (Rsm)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Market cap.	250,979	290,518	322,888	525,230	525,230	525,230	525,230	525,230
Net debt (cash)	2,073	3,814	9,484	7,252	307	307	307	307
Buy out of minorities	0	0	0	0	0	0	0	0
Pension provisions/other	0	0	0	0	0	0	0	0
Total enterprise value	**253,053**	**294,332**	**332,372**	**532,482**	**525,537**	**525,537**	**525,537**	**525,537**
Non core assets	(12,691)	(25,324)	(7,086)	(7,086)	(7,086)	(7,086)	(7,086)	(7,086)
Core enterprise value	**240,361**	**269,007**	**325,286**	**525,397**	**518,451**	**518,451**	**518,451**	**518,451**

Growth (%)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Revenue	12.0	18.1	20.6	17.6	15.7	15.5	17.0	17.1
EBITDA (UBS)	19.2	32.2	-3.1	8.6	18.4	22.1	24.5	22.7
EBIT (UBS)	20.3	38.2	-5.9	5.8	20.6	24.4	27.0	24.6
EPS (UBS, diluted)	16.7	31.1	-9.6	0.3	24.4	27.2	28.8	26.1
Net DPS	0.0	0.0	0.0	0.0	0.0	50.0	33.3	25.0

Margins & Profitability (%)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Gross profit margin	60.0	63.5	60.3	61.7	62.5	63.5	64.0	64.0
EBITDA margin	24.6	27.5	22.1	20.4	20.9	22.1	23.5	24.7
EBIT margin	20.0	23.4	18.3	16.5	17.2	18.5	20.1	21.4
Net earnings (UBS) margin	16.7	18.5	13.9	11.8	12.7	14.0	15.4	16.6
ROIC (EBIT)	21.3	27.8	23.5	23.4	26.2	29.6	33.9	37.7
ROIC post tax	16.8	20.4	17.6	17.6	19.8	22.3	25.5	28.4
ROE (UBS)	16.0	17.9	16.4	16.8	18.1	19.5	21.0	22.0

Capital structure & Coverage (x)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Net debt / EBITDA	(.0)	0.4	0.5	0.2	(0.1)	(0.4)	(0.6)	(0.8)
Net debt / total equity %	(0.8)	9.1	14.3	4.4	(3.1)	(10.2)	(17.0)	(23.5)
Net debt / (net debt + total equity) %	(0.8)	8.4	12.5	4.2	(3.2)	(11.4)	(20.4)	(30.8)
Net debt/EV	(0.3)	3.1	3.3	0.7	(0.6)	(2.4)	(4.7)	(7.9)
Capex / depreciation %	166.3	NM	NM	154.1	154.8	159.5	157.5	158.3
Capex / revenue %	7.6	9.0	8.5	6.1	5.8	5.8	5.4	5.2
EBIT / net interest	NM	NM	32.6	22.0	64.8	NM	NM	NM
Dividend cover (UBS)	7.1	9.3	8.4	8.5	10.5	8.9	8.6	8.7
Div. payout ratio (UBS) %	14.1	10.7	11.9	11.8	9.5	11.2	11.6	11.5

Revenues by division (Rsm)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Others	68,477	80,868	97,528	114,676	132,661	153,172	179,196	209,757
Total	**68,477**	**80,868**	**97,528**	**114,676**	**132,661**	**153,172**	**179,196**	**209,757**

EBIT (UBS) by division (Rsm)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Others	13,718	18,961	17,844	18,874	22,760	28,323	35,984	44,842
Total	**13,718**	**18,961**	**17,844**	**18,874**	**22,760**	**28,323**	**35,984**	**44,842**

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

Ipca Laboratories
Mixed trends

Equities

India
Pharmaceuticals

12-month rating	**Neutral**
	Prior: Not Rated
12m price target	**Rs810.00**
	Prior: -
Price	**Rs699.30**

RIC: IPCA.BO **BBG:** IPCA IB

Trading data and key metrics

52-wk range	Rs899.80-637.25
Market cap.	Rs88.2bn/US$1.43bn
Shares o/s	126m (ORD)
Free float	53%
Avg. daily volume ('000)	273
Avg. daily value (m)	Rs188.6
Common s/h equity (03/15E)	Rs23.0bn
P/BV (03/15E)	3.8x
Net debt / EBITDA (03/15E)	0.3x

EPS (UBS, diluted) (Rs)

	From	To	% ch	Cons.
03/15E	-	32.6	-	34.0
03/16E	-	39.6	-	42.6
03/17E	-	50.3	-	51.5

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Multiple headwinds to export growth

IPCA's export growth has suffered in FY15 due to the impact of regulatory issues as well as currency fluctuations. Due to an FDA import alert at its Ratlam plant, there is uncertainty over US business growth and new launches will be delayed for at least two to three years. Regaining lost market share in existing products is usually difficult if the time gap is long. Furthermore, due to a largely commodity product profile, IPCA's profitability in the US may be negatively impacted by channel consolidation.

Strong execution in the India business

Despite an adverse portfolio, IPCA has done well over the past the decade to outpace industry growth in the domestic formulations market. Growth has slowed in the past three years due to the impact of the drug pricing control policy and weak anti-malarial seasons. IPCA derives c30% of total revenue from the local market with a high proportion from the slow growing acute therapy segments. However, we believe management has done well to introduce a number of products in the chronic therapeutic segments, and has enhanced new launch marketing efforts. We estimate a 15% CAGR in IPCA's domestic formulations sales growth over FY15-17.

Tender business to pick up

IPCA has supplied over 20% of total AMFM oral anti-malarial tenders (Artemisinin combinations) in the past three years. Revenues from the tender business are likely to be flat in FY15 due to a reduction in the price of Artemisinin, although we expect a pick up in FY16 as volumes increase. With increasing competition in the space, IPCA's growth is likely to be affected. In order to ensure sustainable growth in the tender business, management has been working on newer formulations as well categories of products. IPCA has filed for injectable Artemisinin-based products and is also working on a range of anti-infective products aimed at future growth.

Valuation: Initiate coverage with a Neutral rating

With the US business affected by regulatory scrutiny and currency fluctuations likely to impact the emerging market business, IPCA's growth outlook is uncertain. We initiate coverage with a Neutral rating and a price target of Rs810, which is based on 17x one-year forward PE.

Highlights (Rsm)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Revenues	23,587	28,131	32,818	33,541	37,790	43,448	50,486	58,203
EBIT (UBS)	4,464	5,365	7,074	5,489	6,539	8,251	9,900	12,148
Net earnings (UBS)	3,298	3,867	5,508	4,119	4,993	6,350	7,726	9,635
EPS (UBS, diluted) (Rs)	26.1	30.6	43.6	32.6	39.6	50.3	61.2	76.3
DPS (Rs)	3.7	4.7	5.8	5.7	6.9	8.8	10.7	13.4
Net (debt) / cash	(5,292)	(4,780)	(3,779)	(2,216)	(1,629)	(563)	989	4,256

Profitability/valuation	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
EBIT margin %	18.9	19.1	21.6	16.4	17.3	19.0	19.6	20.9
ROIC (EBIT) %	27.8	28.4	32.5	22.7	24.3	26.8	28.1	30.4
EV/EBITDA (core) x	7.7	9.0	10.9	12.8	10.9	8.7	7.4	6.1
P/E (UBS, diluted) x	11.5	14.0	15.7	21.4	17.7	13.9	11.4	9.2
Equity FCF (UBS) yield %	0.5	3.0	1.6	2.8	1.8	2.6	3.5	6.0
Net dividend yield %	1.2	1.1	0.9	0.8	1.0	1.3	1.5	1.9

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of Rs699.30 on 22 Jan 2015 22:38 HKT

Investment Thesis

Ipca Laboratories

12-month rating **Neutral**

12m price target **Rs810.00**

Investment case

IPCA's growth is likely to be unpredictable in the near to medium term considering pending FDA observation letters at three plants. The observation letter for the Ratlam plant is serious and could lead to an escalation of regulatory penalties. However, a recovery of the domestic branded business and international generics product registrations may help sales growth. We expect an improvement in business prospects over the long term once the regulatory uncertainties are over.

Upside scenario

We assume resolution of all FDA issues over the next year. This would result in an improved growth outlook based on product approvals in the US. At the same time, India sales could grow 18% annually. We assume margins to improve 200bp in such a scenario. This could lead to an 8% rise in earnings. Using 20x one-year forward PE, we arrive at our upside scenario of Rs1,014.

Downside scenario

Our downside scenario assumes the FDA import alert on the Ratlam facility is not resolved over the next three years. In addition, there is the possibility of other regulators (such as from the EU) inspecting and imposing penalties. This could lead to a 10-12% decline in earnings and IPCA's PE multiple could fall to 14x one-year forward PE, resulting in a downside scenario of Rs585.

Upcoming catalysts

Key share price catalysts are 1) an improvement in sales at the domestic branded business and new product launches; 2) the resolution of FDA 483s at various plants; and 3) WHO pre-qualification for anti-malarial injectable products.

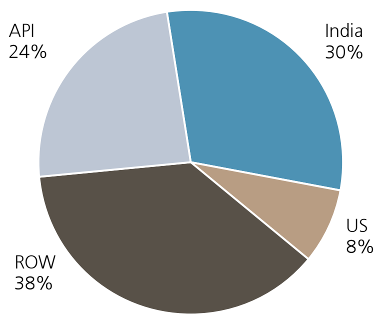
Business description

Incorporated in 1949, Ipca Laboratories is an integrated pharmaceutical company that manufactures formulations and active pharmaceutical ingredients and drug intermediates for various therapeutic segments. The company has formed partnerships in the healthcare industry in diverse markets such as Asia, Africa, Europe and the US. Apart from US Food & Drug Administration approval of the Indore and Ratlam plants, IPCA awaits WHO pre-qualification for anti-malarial injectibles and new product registrations.

Industry outlook

We are positive on Indian pharma companies based on strong growth in the US generic market. We expect market share gains in the US, as India firms launch more new products and technological capabilities improve with higher investment in R&D. We expect the Indian pharma market to record a 12% CAGR in sales over the next five years. We also expect Indian companies to increase their presence in emerging markets through a combination of organic and inorganic growth.

Revenues by region (FY14)



Source: Company data

EBIT by product segment

The company does not release segmental margins.

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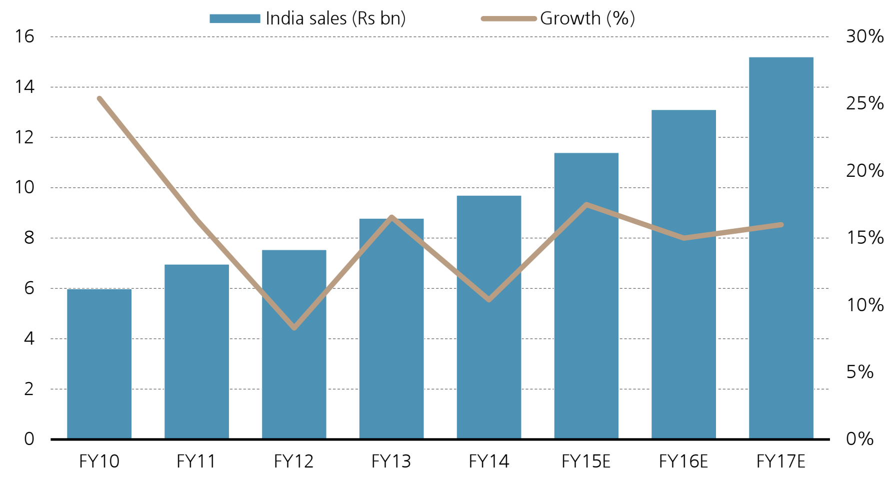
Steady growth in domestic revenues

IPCA derives c30% of total revenue from the domestic market with a high proportion from the slow growing acute therapy segments. Nonetheless, the company has been able to deliver good growth in India due to its entry into newer segments like pain management and cardiovascular. We estimate a 15% CAGR in IPCA's domestic formulations sales growth over FY15-17.

Figure 136: IPCA's India formulations sales

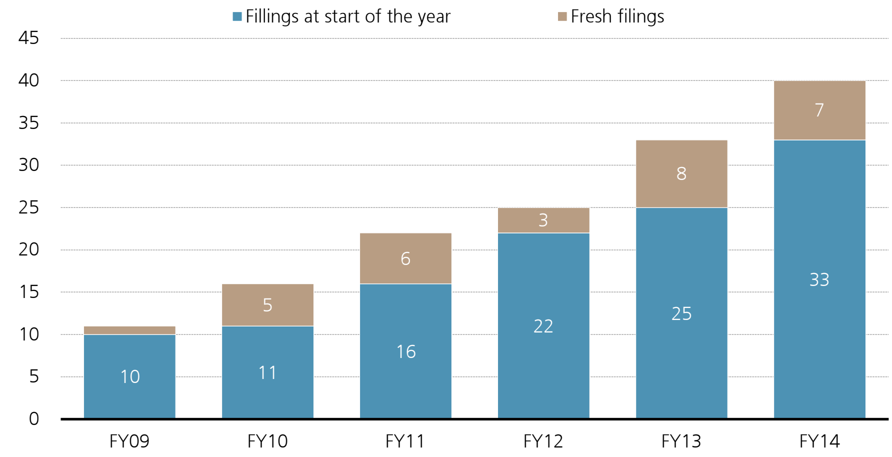


Source: Company data, UBS estimates

Headwinds to exports

IPCA's export growth has suffered in FY15 due to the impact of regulatory issues as well as currency fluctuations. As a result, IPCA's filings over the past several years are unlikely to be approved anytime soon.

Figure 137: IPCA's ANDA filings in the US



Source: Company data

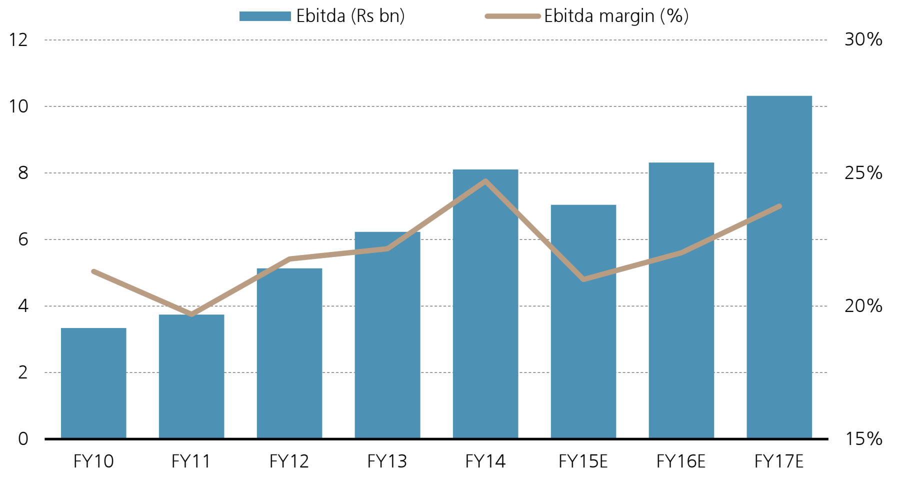
IPCA voluntarily stopped shipments to the US last year due to an FDA observation letter for its active pharmaceutical ingredient (API) plant in Ratlam. The company had four main products in the US for which API was supplied by the Ratlam plant. Due to the regulatory issues at Ratlam, there is uncertainty over US business growth and new launches will be delayed. Regaining lost market share in existing products is usually difficult if the time gap is long. Furthermore, due to a largely commodity product profile, IPCA's profitability in the US could be negatively impacted by channel consolidation.

Figure 138: IPCA's product sales in the US

Molecule	FY14 sales (US$ m)
Hydroxychloroquine	27.0
Furosemide	5.0
Atenolol	5.0
Metoprolol	5.0

Source: IMS Health

Figure 139: EBITDA margin trend



Source: Company data, UBS estimates

Figure 140: One year forward PE and P/CF ratios (x)

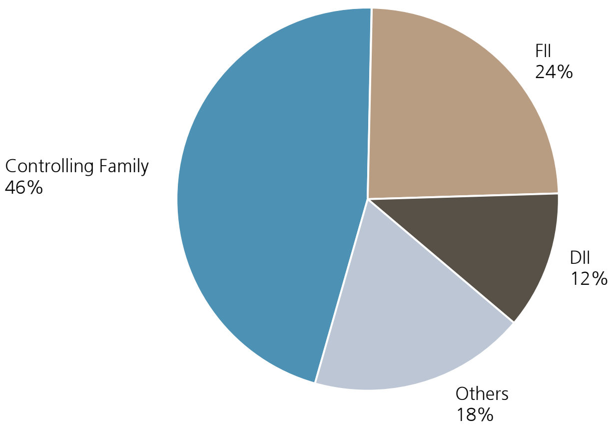
Source: Reuters, UBS

Figure 141: UBS versus consensus

(Rs m)		FY15	FY16	FY17
Revenue	UBS	33,541	37,790	43,448
	Consensus	34,528	39,884	46,460
	Diff	-3%	-5%	-6%
EBITDA	UBS	7,044	8,314	10,319
	Consensus	7,221	8,704	10,554
	Diff	-2%	-4%	-2%
PAT	UBS	4,119	4,993	6,350
	Consensus	4,379	5,363	6,488
	Diff	-6%	-7%	-2%

Source: Bloomberg, UBS estimates

Figure 142: IPCA's shareholding pattern (Q2 FY15)



Source: BSE

Ipca Laboratories (IPCA.BO)

Income statement (Rsm)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
Revenues	**23,587**	**28,131**	**32,818**	**33,541**	*2.2*	**37,790**	*12.7*	**43,448**	**50,486**	**58,203**
Gross profit	14,456	17,165	21,452	21,298	*-0.7*	24,185	*13.6*	28,241	32,816	38,414
EBITDA (UBS)	**5,135**	**6,232**	**8,106**	**7,044**	*-13.1*	**8,314**	*18.0*	**10,319**	**12,243**	**14,842**
Depreciation & amortisation	(671)	(867)	(1,031)	(1,554)	*50.7*	(1,775)	*14.2*	(2,068)	(2,343)	(2,693)
EBIT (UBS)	**4,464**	**5,365**	**7,074**	**5,489**	*-22.4*	**6,539**	*19.1*	**8,251**	**9,900**	**12,148**
Associates & investment income	45	37	92	69	*-25.1*	111	*61.0*	244	482	814
Other non-operating income	0	0	0	0	-	0	-	0	0	0
Net interest	(330)	(235)	(135)	(143)	*-5.8*	(85)	*40.6*	(146)	(223)	(295)
Exceptionals (incl goodwill)	(527)	(631)	(722)	0	-	0	-	0	0	0
Profit before tax	**3,652**	**4,535**	**6,309**	**5,415**	*-14.2*	**6,565**	*21.2*	**8,349**	**10,159**	**12,668**
Tax	(881)	(1,299)	(1,524)	(1,297)	*14.9*	(1,572)	*-21.2*	(1,999)	(2,433)	(3,033)
Profit after tax	**2,771**	**3,236**	**4,785**	**4,119**	*-13.9*	**4,993**	*21.2*	**6,350**	**7,726**	**9,635**
Preference dividends	0	0	0	0	-	0	-	0	0	0
Minorities	0	0	0	0	-	0	-	0	0	0
Extraordinary items	0	0	0	0	-	0	-	0	0	0
Net earnings (local GAAP)	**2,771**	**3,236**	**4,785**	**4,119**	*-13.9*	**4,993**	*21.2*	**6,350**	**7,726**	**9,635**
Net earnings (UBS)	**3,298**	**3,867**	**5,508**	**4,119**	*-25.2*	**4,993**	*21.2*	**6,350**	**7,726**	**9,635**
Tax rate (%)	24.1	28.7	24.2	23.9	*-0.9*	23.9	*0.0*	23.9	23.9	23.9

Per share (Rs)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
EPS (UBS, diluted)	26.1	30.6	43.6	32.6	*-25.2*	39.6	*21.2*	50.3	61.2	76.3
EPS (local GAAP, diluted)	22.0	25.6	37.9	32.6	*-13.9*	39.6	*21.2*	50.3	61.2	76.3
EPS (UBS, basic)	26.1	30.6	43.6	32.6	*-25.2*	39.6	*21.2*	50.3	61.2	76.3
Net DPS (Rs)	3.7	4.7	5.8	5.7	*-2.1*	6.9	*21.2*	8.8	10.7	13.4
Cash EPS (UBS, diluted)[1]	31.5	37.5	51.8	45.0	*-13.2*	53.6	*19.3*	66.7	79.8	97.7
Book value per share	100.1	123.2	155.3	182.3	*17.3*	214.9	*17.9*	256.4	306.9	369.9
Average shares (diluted)	126.2	126.2	126.2	126.2	*0.0*	126.2	*0.0*	126.2	126.2	126.2

Balance sheet (Rsm)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
Cash and equivalents	122	582	763	671	*-12.1*	1,889	*181.7*	4,345	8,583	13,678
Other current assets	11,977	13,389	15,259	16,938	*11.0*	19,084	*12.7*	21,941	25,495	29,393
Total current assets	**12,099**	**13,971**	**16,022**	**17,609**	*9.9*	**20,973**	*19.1*	**26,286**	**34,078**	**43,070**
Net tangible fixed assets	10,150	12,098	14,841	15,137	*2.0*	17,363	*14.7*	19,794	22,451	24,758
Net intangible fixed assets	236	236	344	344	*0.0*	344	*0.0*	344	344	344
Investments / other assets	788	664	896	896	*0.0*	896	*0.0*	896	896	896
Total assets	**23,273**	**26,970**	**32,103**	**33,987**	*5.9*	**39,576**	*16.4*	**47,321**	**57,769**	**69,069**
Trade payables & other ST liabilities	4,388	4,765	6,494	6,637	*2.2*	7,477	*12.7*	8,597	9,989	11,516
Short term debt	2,014	1,571	1,439	1,439	*0.00*	1,439	*0.00*	1,439	1,439	1,439
Total current liabilities	**6,402**	**6,337**	**7,933**	**8,076**	*1.8*	**8,917**	*10.4*	**10,036**	**11,429**	**12,956**
Long term debt	3,400	3,791	3,102	1,447	*-53.4*	2,079	*43.7*	3,469	6,154	7,982
Other long term liabilities	932	1,304	1,471	1,471	*0.0*	1,471	*0.0*	1,471	1,471	1,471
Preferred shares	0	0	0	0	-	0	-	0	0	0
Total liabilities (incl pref shares)	**10,733**	**11,432**	**12,506**	**10,994**	*-12.1*	**12,467**	*13.4*	**14,976**	**19,054**	**22,409**
Common s/h equity	12,540	15,538	19,597	22,993	*17.3*	27,110	*17.9*	32,345	38,715	46,659
Minority interests	0	0	0	0	-	0	-	0	0	0
Total liabilities & equity	**23,273**	**26,970**	**32,103**	**33,987**	*5.9*	**39,576**	*16.4*	**47,321**	**57,769**	**69,069**

Cash flow (Rsm)	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
Net income (before pref divs)	2,771	3,236	4,785	4,119	*-13.9*	4,993	*21.2*	6,350	7,726	9,635
Depreciation & amortisation	671	867	1,031	1,554	*50.7*	1,775	*14.2*	2,068	2,343	2,693
Net change in working capital	(1,609)	(1,001)	(1,041)	(1,536)	*-47.6*	(1,305)	*15.0*	(1,738)	(2,161)	(2,370)
Other operating	950	786	570	143	*-75.0*	85	*-40.6*	146	223	295
Operating cash flow	**2,783**	**3,888**	**5,346**	**4,280**	*-19.9*	**5,548**	*29.6*	**6,825**	**8,131**	**10,253**
Tangible capital expenditure	(2,605)	(2,294)	(3,924)	(1,851)	*52.8*	(4,000)	*-116.1*	(4,500)	(5,000)	(5,000)
Intangible capital expenditure	0	0	0	0	-	0	-	0	0	0
Net (acquisitions) / disposals	0	0	0	0	-	0	-	0	0	0
Other investing	(254)	240	0	0	-	0	-	0	0	0
Investing cash flow	**(2,859)**	**(2,054)**	**(3,924)**	**(1,851)**	*52.8*	**(4,000)**	*-116.1*	**(4,500)**	**(5,000)**	**(5,000)**
Equity dividends paid	(467)	(468)	(661)	(723)	*-9.3*	(876)	*-21.2*	(1,114)	(1,356)	(1,691)
Share issues / (buybacks)	8	3	0	0	-	0	-	0	0	0
Other financing	(386)	(339)	(306)	(143)	*53.40*	(85)	*40.58*	(146)	(223)	(295)
Change in debt & pref shares	882	(1)	(394)	(1,655)	*-319.93*	632	-	1,390	2,686	1,828
Financing cash flow	**37**	**(804)**	**(1,361)**	**(2,521)**	*-85.2*	**(329)**	*87.0*	**130**	**1,107**	**(157)**
Cash flow inc/(dec) in cash	**(39)**	**1,029**	**61**	**(92)**	-	**1,219**	-	**2,455**	**4,238**	**5,095**
FX / non cash items	57	(568)	120	0	-	0	-	0	0	0
Balance sheet inc/(dec) in cash	**18**	**461**	**180**	**(92)**	-	**1,219**	-	**2,455**	**4,238**	**5,095**

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.[1]Cash EPS (UBS, diluted) is calculated using UBS net income adding back depreciation and amortization.

Ipca Laboratories (IPCA.BO)

Valuation (x)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
P/E (local GAAP, diluted)	13.7	16.7	18.0	21.4	17.7	13.9	11.4	9.2
P/E (UBS, diluted)	11.5	14.0	15.7	21.4	17.7	13.9	11.4	9.2
P/CEPS	9.6	11.4	13.2	15.6	13.0	10.5	8.8	7.2
Equity FCF (UBS) yield %	0.5	3.0	1.6	2.8	1.8	2.6	3.5	6.0
Net dividend yield (%)	1.2	1.1	0.9	0.8	1.0	1.3	1.5	1.9
P/BV x	3.0	3.5	4.4	3.8	3.3	2.7	2.3	1.9
EV/revenues (core)	1.7	2.0	2.7	2.7	2.4	2.1	1.8	1.6
EV/EBITDA (core)	7.7	9.0	10.9	12.8	10.9	8.7	7.4	6.1
EV/EBIT (core)	8.8	10.4	12.5	16.4	13.8	10.9	9.1	7.4
EV/OpFCF (core)	8.3	9.7	11.7	14.2	12.0	9.6	8.1	6.6
EV/op. invested capital	2.5	3.0	4.1	3.7	3.4	2.9	2.6	2.3

Enterprise value (Rsm)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Market cap.	37,690	54,009	86,316	88,217	88,217	88,217	88,217	88,217
Net debt (cash)	2,101	2,101	2,101	2,101	2,101	2,101	2,101	2,101
Buy out of minorities	0	0	0	0	0	0	0	0
Pension provisions/other	0	0	0	0	0	0	0	0
Total enterprise value	**39,791**	**56,110**	**88,417**	**90,318**	**90,318**	**90,318**	**90,318**	**90,318**
Non core assets	(341)	(90)	(91)	(91)	(91)	(91)	(91)	(91)
Core enterprise value	**39,450**	**56,020**	**88,326**	**90,226**	**90,226**	**90,226**	**90,226**	**90,226**

Growth (%)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Revenue	24.2	19.3	16.7	2.2	12.7	15.0	16.2	15.3
EBITDA (UBS)	37.3	21.4	30.1	-13.1	18.0	24.1	18.6	21.2
EBIT (UBS)	40.2	20.2	31.9	-22.4	19.1	26.2	20.0	22.7
EPS (UBS, diluted)	49.8	17.2	42.4	-25.2	21.2	27.2	21.7	24.7
Net DPS	-0.4	25.6	25.4	-2.1	21.2	27.2	21.7	24.7

Margins & Profitability (%)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Gross profit margin	61.3	61.0	65.4	63.5	64.0	65.0	65.0	66.0
EBITDA margin	21.8	22.2	24.7	21.0	22.0	23.8	24.3	25.5
EBIT margin	18.9	19.1	21.6	16.4	17.3	19.0	19.6	20.9
Net earnings (UBS) margin	14.0	13.7	16.8	12.3	13.2	14.6	15.3	16.6
ROIC (EBIT)	27.8	28.4	32.5	22.7	24.3	26.8	28.1	30.4
ROIC post tax	21.9	21.3	25.5	17.2	18.5	20.4	21.4	23.1
ROE (UBS)	28.6	27.5	31.4	19.3	19.9	21.4	21.7	22.6

Capital structure & Coverage (x)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Net debt / EBITDA	1.0	0.8	0.5	0.3	0.2	0.1	(0.1)	(0.3)
Net debt / total equity %	42.2	30.8	19.3	9.6	6.0	1.7	(2.6)	(9.1)
Net debt / (net debt + total equity) %	29.7	23.5	16.2	8.8	5.7	1.7	(2.6)	(10.0)
Net debt/EV	13.4	8.5	4.3	2.5	1.8	0.6	(1.1)	(4.7)
Capex / depreciation %	NM	NM	NM	119.1	NM	NM	NM	185.6
Capex / revenue %	11.0	8.2	12.0	5.5	10.6	10.4	9.9	8.6
EBIT / net interest	13.5	22.8	52.5	38.5	NM	56.7	44.4	41.2
Dividend cover (UBS)	7.0	6.6	7.5	5.7	5.7	5.7	5.7	5.7
Div. payout ratio (UBS) %	14.2	15.2	13.4	17.5	17.5	17.5	17.5	17.5

Revenues by division (Rsm)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Others	23,587	28,131	32,818	33,541	37,790	43,448	50,486	58,203
Total	**23,587**	**28,131**	**32,818**	**33,541**	**37,790**	**43,448**	**50,486**	**58,203**

EBIT (UBS) by division (Rsm)	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Others	4,464	5,365	7,074	5,489	6,539	8,251	9,900	12,148
Total	**4,464**	**5,365**	**7,074**	**5,489**	**6,539**	**8,251**	**9,900**	**12,148**

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

Appendix 1: growth prospects in emerging markets

Indian pharma's fast-paced growth in the US has dwarfed the proportion of business coming from branded generic emerging markets. Due to the branded nature of these markets, revenues are quite sticky. We expect steady and sustainable growth from branded markets for India pharma companies. Cipla, Glenmark, Lupin and Sun Pharma are well-positioned in branded markets, especially India, in our view.

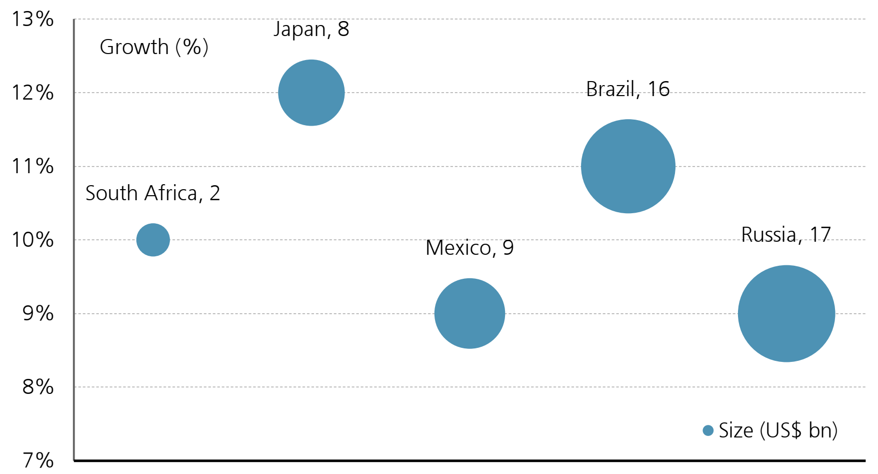
Lupin and Sun Pharma most consistent in branded markets

Increased access and improving affordability are key drivers of growth for pharmaceuticals in emerging markets. Both factors have been negatively impacted in recent years due to the global economic slowdown. Accordingly, IMS Health has cut its growth forecasts for emerging market pharmaceuticals. It expects total spending on drugs in emerging markets to record an 8-11% CAGR for 2014-18. Apart from the economic slowdown, regulatory changes in a number of countries (eg, India expanded price controls in 2013) have hampered growth.

Growth forecasts for EM pharma have been going down due to weak economic environment

While the Indian market is a reasonably large component for most Indian pharmaceutical companies, among other emerging markets Cipla has a strong presence in South Africa, Dr Reddy's in Russia and Lupin in Japan. Sun Pharma (after the addition of Ranbaxy) will have a presence in some key emerging markets like Romania, Russia and South Africa.

Figure 143: Emerging market growth potential (2014-18)



Source: IMS Health

Entry barriers are high

Building a presence or gaining market share in a branded generic market is fairly difficult. Branding allows revenues to be sticky and with multiple brands for each molecule, new entrants face an uphill task to dislodge existing brands and establish an presence. Hence, most Indian companies acquire companies to enter emerging markets and gain immediate access to the market.

Growth in branded markets is more consistent than unbranded

For Indian companies, the major emerging markets are Brazil, Japan (emerging from a generic pharmaceuticals perspective), Mexico, Russia and South Africa. We expect double-digit sales growth in the branded generics segment (over the long term) in most of these countries, led by rising penetration. However, currency movements can affect growth in the near term as Indian manufacturers derive revenue in the local currency. Over the medium to long term, manufacturers are usually able to make up lost ground by changing product pricing.

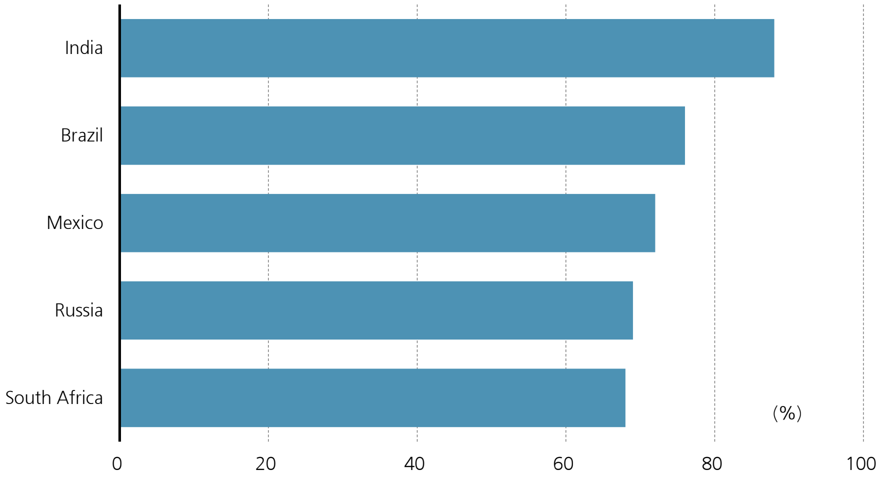
Currency fluctuations likely to adversely impact near-term growth in most EMs

High out-of-pocket spending drives healthier margins

In most branded markets, out-of-pocket spending on healthcare remains high. Margins are usually better in such markets due to a high proportion of retail-driven revenue than in markets where tenders or insurance reimbursements drive the pharmaceutical business. Government interference is typically lower in high out-of-pocket spend markets than in regions where institutions (governments or insurance companies) are involved.

Government intervention is typically low in high out-of-pocket spending markets

Figure 144: Out-of-pocket spending as a portion of total healthcare expense



Source: Swiss Re

India: exposure to chronic and execution the key factors

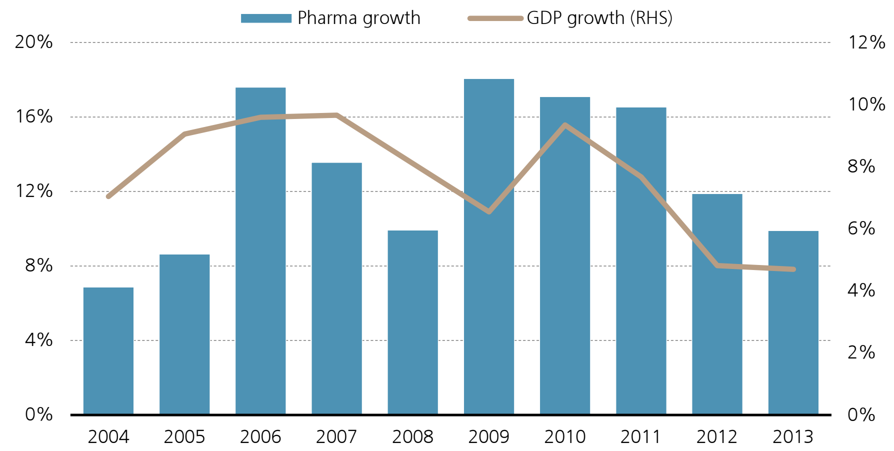
While India is a largely an out-of-pocket spend-driven healthcare market, the government did intervene in the market last year. The government introduced in a new drug pricing policy that expanded price controls from 74 molecules to 348 molecules covering 34% of the market by value. India's pharma market revenue grew 11% YoY to US$14bn in 2014 (November 2014 moving annual total), according to IMS Health. The majority of the growth was led by volume and new launches as prices were impacted by the new drug pricing policy implemented late last year.

Government intervention to bring more drugs under price control

The India pharma market comprises 1.3% of the global pharma industry and is ranked 13th in value terms. The factors helping pharma growth have been a rising population, increasing access to modern medicine and greater affordability. The market has been witnessing a gradual shift from largely acute therapies (anti-infectives) to chronic therapies (lifestyle-related ailments). Chronic therapies are likely to comprise more than half of the Indian market by 2020E, with cardiovascular and anti-diabetic therapies accounting for about 30% of sales value.

Chronic segments continue to grow fast and likely to be nearly half of the market value by 2020E

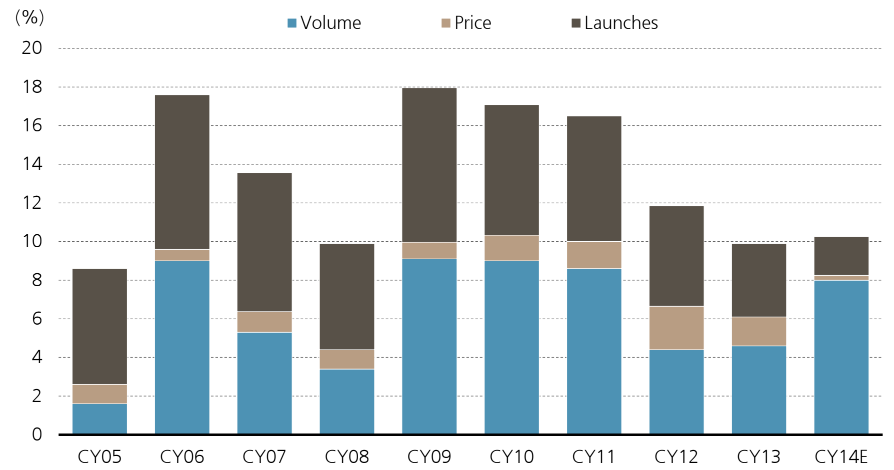
Figure 145: India pharma versus GDP growth



Source: IMS Health, Ministry of Chemicals and Fertilizers

Figure 146: Drivers of India pharma growth

Growth largely volume led as pricing under pressure



Source: IMS Health, UBS

Exposure to chronic therapy segments

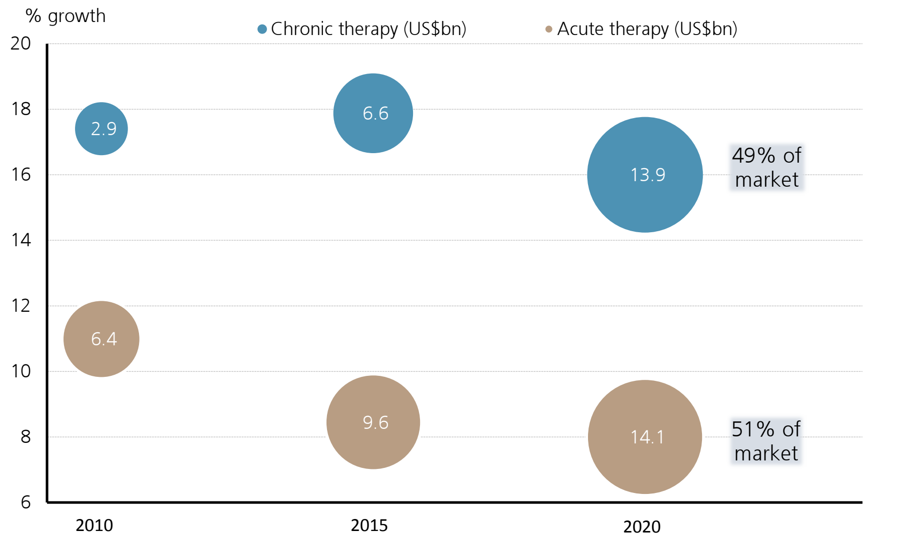
Sun Pharma has consistently grown ahead of the market due to high chronic exposure

Chronic therapies comprise one-third of the Indian pharma market by value and have grown at 18-20% annually for more than a decade. This is much higher than less than 10% CAGR in acute segments over the same period. Hence, companies (like Sun Pharma) with higher exposure to chronic segments have been able to grow at a faster pace than ones with high proportion of India business in acute segments. Revenues from chronic therapies are stickier as patients have to consume those drugs for many years and at times life-long and they do not switch brands as frequently as in acute.

Therapies addressing ailments like blood pressure, cholesterol and diabetes are the biggest in terms of revenue world-wide. However, in India, anti-infective (acute segment) is the largest at 17% of total the market by value. Brands like Augmentin, Corex and Voveran, which belong to acute therapy areas, are among the top-10 in value. We expect this to change over time and for an increase in the number of brands belonging to chronic segments among the top-10 in India. We expect industry growth rates to improve with the increasing proportion of the total market being comprised of the faster growing chronic segment. We expect strong growth potential in the anti-diabetic, cardiovascular, neurology and oncology segments over the next 10 years.

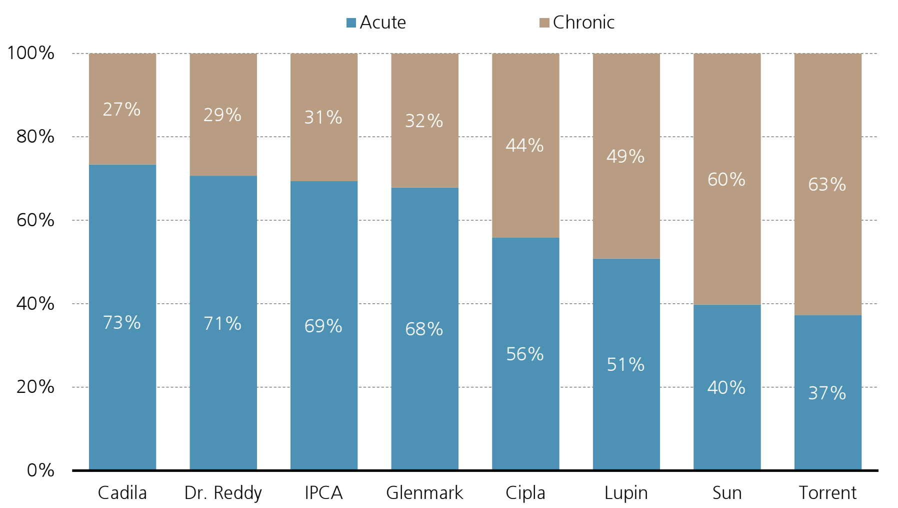
Chronic segments to become nearly half of the market by value

Figure 147: India market: acute versus chronic therapy



Source: IMS Health

Figure 148: Share of chronic versus acute therapy in domestic sales (FY14)



Source: IMS Health

Sun, Lupin and Torrent have high exposure to chronic segments

With one of the highest exposures to chronic therapy segments, we think Sun Pharma is well-positioned in the domestic formulations business. The company should continue to gain market share in India on faster growth rates in these therapy segments. The composition will change with the addition of Ranbaxy's portfolio that is more acute. After Sun, Lupin and Torrent derive a high proportion of revenues from the chronic portfolio. While Lupin has done well in India, Torrent's growth has been lacklustre due to loss of market share in key segments like gastro-intestinal and cardiovascular. However, with acquisition of Elder's India business, Torrent should move up the ranks. Lupin has done well in launching new products to expand reach in more the profitable and faster-growing chronic therapy. It has been able to build a strong presence in inhalational products and is second to Cipla in terms of market share (although a distant second). Cipla's domestic growth has slowed due to management disruptions, but seems to be picking up again.

Superior execution

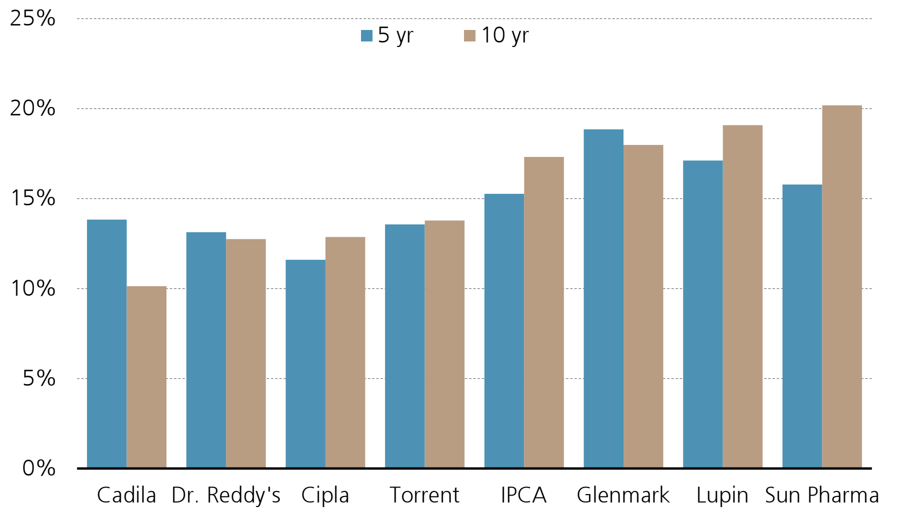
Apart from a superior therapy mix, Lupin and Sun Pharma have grown on consistent execution. They have been among the fastest growing companies in the Indian market over the past decade. Early to market in relevant therapy segments and product categories, a low risk portfolio and high sales force productivity are the key factors that have helped them maintain a consistent track record, in our view.

Early to market helps retain market share despite competition

Among the smaller companies, we believe IPCA has done well by entering the newer therapy segments (pain management and cardiovascular). Glenmark's domestic revenue growth has accelerated over the past five years (five-year CAGR higher than 10-year CAGR), led by strong performances in high-growth segments like dermatology and cardiovascular. Cadila's five-year sales CAGR should increase due to the acquisition of Biochem in December 2011.

Sun and Lupin have recorded consistent growth in the domestic market

Figure 149: Historical revenue CAGR of domestic companies



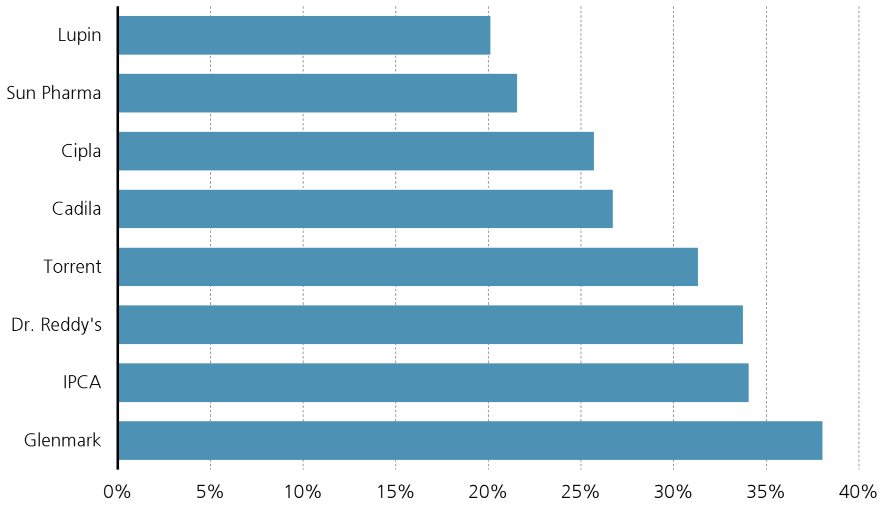
Source: Company filings

Sun Pharma and Lupin have well diversified product portfolios with the top-10 products contributing 20-22% of domestic revenues. This has helped mitigate the implementation of the new drug price control policy in 2013.

While Sun Pharma has by far the highest sales force productivity, Cipla, Lupin, Glenmark and Cadila fare well. Sun's sales force productivity has increased over the past five years, as sales growth continued at a high pace with intensive coverage of existing medical professionals.

Lupin and Sun have well diversified portfolios

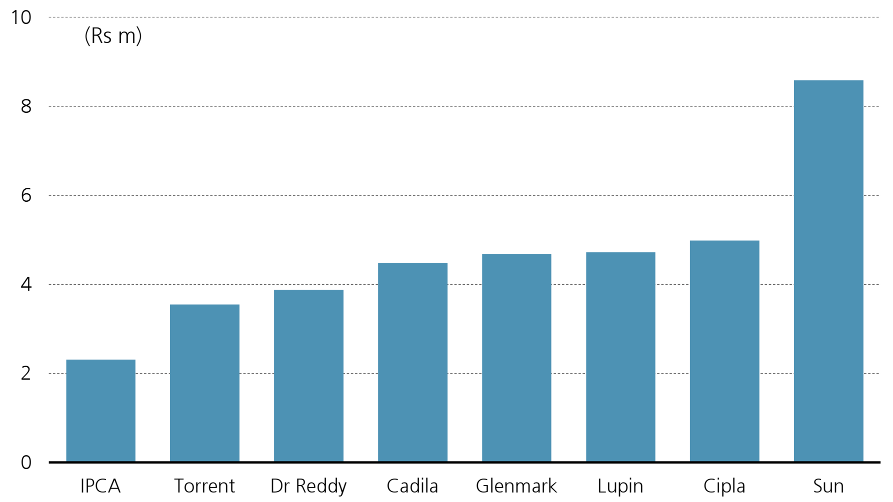
Figure 150: Top-10 products in India as a % of domestic formulation sales



Source: IMS Health (MAT November 2014)

Sun Pharma has the highest sales force productivity due to high proportion of sales from urban centres

Figure 151: Sales force productivity in FY14 (Rs m per sales personnel)



Source: Company data

With the addition of Ranbaxy, Sun should become the top-ranked company in India

Figure 152: Top-10 companies in India in past decade (% market share)

	2004		2009		2014
Cipla	5.5	Cipla	5.3	Abbott India	6.4
GSK India	5.5	Ranbaxy	5.0	Cipla	5.2
Ranbaxy	4.6	GSK India	4.3	Sun Pharma	4.7
Piramal Healthcare	4.3	Piramal Healthcare	4.1	Ranbaxy	3.7
Sun Pharma	3.2	Zydus Cadila	3.6	Zydus Cadila	3.7
Dr.Reddy's	2.5	Sun Pharma	3.5	GSK India	3.5
Zydus Cadila	2.4	Alkem	3.1	Alkem	3.5
Abbott India	2.3	Lupin	2.7	Mankind	3.5
Aristo Pharma	2.3	Aristo Pharma	2.4	MacLeods	3.1
Alkem	2.2	Abbott India	2.3	Pfizer	3.0

Source: IMS Health

Over the past 10 years, Indian manufacturers have gained market share over MNCs. Among the top-10 companies by market share, three are MNCs and one of those (Abbott) is at top because of the acquisition of Piramal's domestic business. This is due to the lower number of product launches by foreign companies. We believe local companies will continue to extend market shares due to a combination of higher product launches and aggressive marketing.

Growth rates might be dampened by increasing price controls

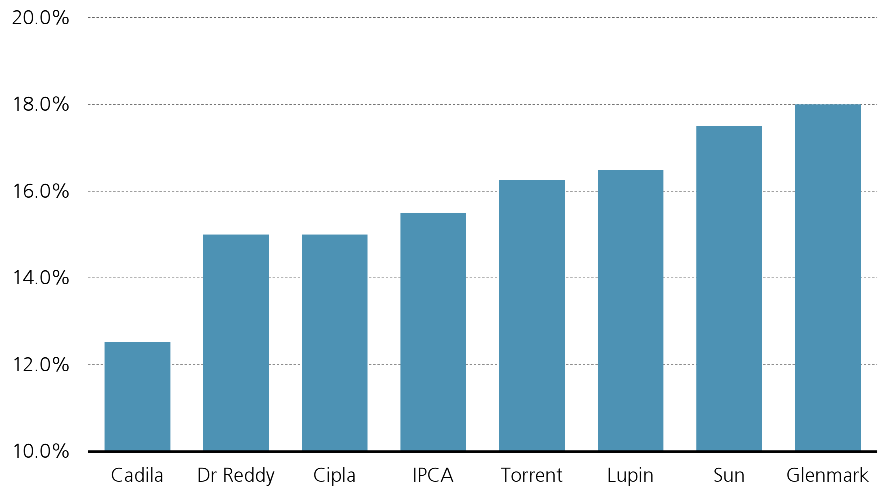
Pharma authority continues to bring more brands under price controls

In 2013, India enhanced the scope of price controls from 74 (12% of market by value) to 350+ molecules (34% of market by value). The National Pharmaceutical Pricing Authority (NPPA), the key regulator of drug prices, plans to extend price controls to more products that are based on molecules already under price control. These measures have slowed India market growth and negatively impacted most firms.

We like Lupin and Sun Pharma based on their domestic business

We like Lupin and Sun Pharma for their high exposure to chronic therapy segments and strong execution. We expect both companies to continue to grow well above the market average. Domestic profitability should continue to increase based on operating leverage. We think the risk of sales erosion due to incremental price controls is lower for both due to their diversified portfolios.

Figure 153: Domestic profit growth estimates for pharma companies (FY15-17E CAGR)



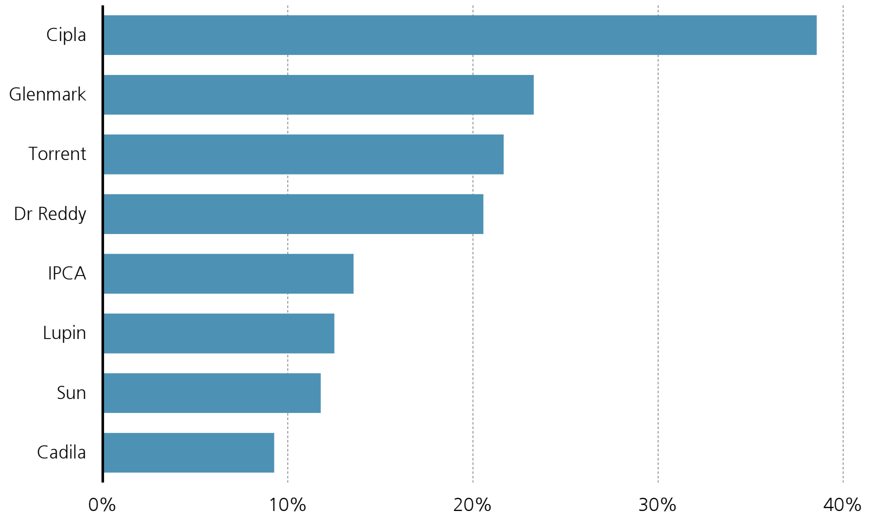
Source: UBS estimates

Patchy presence in other EMs

Apart from India, Brazil, Japan, Mexico, Russia, South Africa and Venezuela are the other key markets for Indian companies. Indian companies derive a relatively small proportion of total revenues from these markets. While the companies initially acquired or built-up the businesses from scratch, they have been able to scale up to profitable levels more recently. Generally, margins continue to improve as the portfolio of products in these markets increases for each company.

The emerging market opportunity has been discussed often and we will not go into detail about each market. Below we highlight Indian pharma companies' presence in key markets.

Figure 154: EMs (excl India) as a % of total revenues (FY14)



Source: Company data

EM exposure particularly large for Cipla

After the acquisition of Medpro, Cipla became the largest Indian company in the South Africa market (a US$2bn generics market). Lupin (via Pharmadynamics) and Ranbaxy have a presence in South Africa. Lupin is the fifth-largest generics company in the country (14th overall) and leads in the cardiovascular segment.

Lupin, via its subsidiary Kyowa, is the eighth-largest drug company in Japan's generics market. It expanded its footprint in the hospital segment via the acquisition of I'rom in November 2011. Lupin's management has been able to enhance profitability at the Japanese operations over time.

Notwithstanding bad debt and high receivables, we believe Dr Reddy's has done well in the Russian and CIS markets after rationalising its supply chain. Due to the implementation of price controls in 2010, the company embarked on a plan to enhance its OTC portfolio, which has increased from 20% to 35% of total sales in Russia. Russia is also a sizeable market for Ranbaxy, IPCA, Glenmark and Torrent.

Torrent Pharma has a sizeable presence in Russia, deriving 16% of total revenue from this market. Cadila, Glenmark and Ranbaxy also have a presence. Dr Reddy's has been growing well in Venezuela, while Sun Pharma and Lupin have expressed their interest in potential acquisitions in Brazil.

Appendix 2: glossary of key terms

Active Pharmaceutical Ingredient (API): Any ingredient that provides pharmacological activity which affects the structure or function of the body or any other direct effect in the cure, treatment, diagnosis, mitigation or prevention of disease.

ANDA: Abbreviated New Drug Application (ANDA) is an application submitted to the FDA for a US generic drug approval for an existing patented drug.

Bio-similar: A biological medicine made by a different sponsor, similar to another biological medicine (generally, an innovator product) whose patent and exclusivity has expired. Compared to small molecules which consist of chemically identical active ingredients, biologics are vastly more complex. Thus, biosimilars require a different regulatory framework compared to small-molecule generics.

Clinical trial: A study undertaken to check the safety or efficacy of a drug.

EMA: The European Union's drug regulatory agency, responsible for overseeing all aspects related to pharmaceutical regulation, starting from clinical trials & registration, through till the manufacturing standards and promotional claims.

FDA: The US regulatory agency, responsible for overseeing all aspects related to pharmaceutical regulation, starting from clinical trials & registration, through till the manufacturing standards and promotional claims.

Form 483: A form used by the US FDA to document & communicate their concerns about certain observations made during an inspection.

Generic drug (generics): A regulator approved drug which can be used interchangeably with an existing branded product. A generic drug is priced at a discount to the branded product and generally enters the market after expiry of patent protection on the branded drug.

Generic Drug User Fee Act (GDUFA): An Act that requires industry to pay user fees to supplement the costs of reviewing generic drug applications and inspecting facilities.

IND: Investigational New Drug (IND) is a new drug candidate for which the sponsor has the required permissions from the region's regulatory authorities, like the FDA in the US and EMA in the EU, to test a particular compound in clinical trials.

Injectable: Prescription drugs which are administered via injection or infusion. The term is often used as a synonym for high cost specialty or biotech drugs.

NDA: New Drug Application is a filing done with the FDA for approval of a small molecule drug.

New Chemical Entity (NCE): A newly synthesized compound for which the sponsor company will undertake drug development.

Orange Book: List of patents recognized by the US FDA.

OTC: Over-the-Counter (OTC) drugs are those drugs that are safe and effective for use by the public without a doctor's prescription.

Paragraph IV: A Paragraph IV or Para IV filing is done to get approval of a generic drug in the US when the branded version of the drug is still patent protected. The applicant must certify that one or more patents of the branded drug are invalid and hence not infringed by its generic version.

Patent: A set of exclusive rights and legal protection against copying granted to a company that has discovered a new molecule or a new scientific process. Usually the duration of a patent is 20 years.

PBM: Pharmacy Benefit Manager are organizations that are dedicated towards providing prescription benefit management services to third party administrators, employers, union groups and other plan sponsors. Typically, a PBM maintains eligibility, resolves prescription claims, provides clinical services and support, contracts & manages pharmacy networks and provides management reports.

Receptor: A protein molecule within the plasma membrane of a cell that recognizes and responds to endogenous chemical signals.

sNDA: Supplementary New Drug Application (sNDA) is an application filed with the US FDA for regulatory approval for a new indication or formulation for use in the USA.

Warning Letter: A correspondence issued by the FDA to notify the regulated industry about violations that FDA has documented during its inspection or investigation.

Statement of Risk

Indian pharmaceutical companies operate in important generic markets in the world. We believe general risks include FDA approval, the timing of approvals, competition from rival drug therapies, litigation (including the appeal process), accounting/disclosure, and product-pricing from generic competition. There is severe pricing pressure in the US generic market because of intense competition. Profits in the generic pharmaceutical business in the US and Europe are volatile, depending on product prices and competition levels. The pharmaceutical business remains highly regulated and subject to changes in government policy especially pricing and reimbursement. Considering that exports contribute to a large proportion of revenues and profits of Indian pharma companies, a strengthening of the rupee against major currencies could negatively impact revenues and profits in rupee terms.

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12-Month Rating	Definition	Coverage[1]	IB Services[2]
Buy	FSR is > 6% above the MRA.	47%	37%
Neutral	FSR is between -6% and 6% of the MRA.	42%	32%
Sell	FSR is > 6% below the MRA.	11%	21%
Short-Term Rating	**Definition**	**Coverage[3]**	**IB Services[4]**
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%

Source: UBS. Rating allocations are as of 31 December 2014.
1:Percentage of companies under coverage globally within the 12-month rating category. 2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.
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UBS Securities India Private Ltd: Hemant Bakhru.

Company Disclosures

Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Cadila Healthcare	CADI.BO	Not Rated	N/A	Rs1,642.45	22 Jan 2015
Cipla Ltd.	CIPL.BO	Not Rated	N/A	Rs654.15	22 Jan 2015
Dr. Reddy's Labs[16]	REDY.BO	Buy	N/A	Rs3,361.45	22 Jan 2015
Glenmark Pharmaceuticals	GLEN.BO	Buy	N/A	Rs744.95	22 Jan 2015
Ipca Laboratories	IPCA.BO	Not Rated	N/A	Rs699.30	22 Jan 2015
Lupin Limited[5, 8]	LUPN.BO	Not Rated	N/A	Rs1,503.30	22 Jan 2015
Sun Pharmaceuticals Industries Limited	SUN.BO	Buy	N/A	Rs918.35	22 Jan 2015
Torrent Pharmaceuticals	TORP.BO	Not Rated	N/A	Rs1,143.95	22 Jan 2015

Source: UBS. All prices as of local market close.
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