

Source of Future Growth changing in Favor of Geographically Diversified Companies:

Since 2008, the Indian pharma sector has enjoyed 20%+ p.a. revenue growth and related re-rating of large cap companies driven by exports to the US and a few emerging markets (generics play), as well as 15%+ growth in the domestic market (increasing penetration in Urban and Tier-II cities). We expect the next wave of growth to come from domestic rural markets and emerging markets, including pharmerging markets and expansion into a few developed markets such as Japan, Spain, Italy and France.

Niche Indian pharma Companies to Benefit from New Market Opportunities: Most large Indian companies have weaker presence in new growth segments (except Ranbaxy and Lupin) and may lag in performance. We have identified select mid-cap companies that should benefit from low cost domestic markets and niche but growing new international markets. We prefer sustainable growth in base business compared to the US market (Para IV opportunities) dependency which can be lumpy.

Strategic Tie-ups with Big Pharma a Significant Future Opportunity for Generic Companies:

Big pharma have shown increasing interest in strategic tie-ups with Indian generics companies (which have own brands in emerging markets) instead of pure play contract manufacturers. In the last two years MNCs' interest in outsourcing manufacturing to Indian companies has gained momentum. While pure contract manufacturing companies should have been positioned the best for these contracts; a closer look reveals that the outsourcing partners for choice for the MNCs tends to be generic companies and not pure play contract manufacturers.

Our top picks are IPCA, Cadila, and Torrent: We initiate coverage on select mid-cap pharma companies that have more than 35% of sales from the domestic market with a better portfolio of brands and are geographically well diversified. IPCA, Torrent and Cadila are our top pick in the mid cap pharma space while we have an Sell rating on pure play contract manufacturer Dishman.

April 6, 2011

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Key Financial Parameters

(INR mn)

	Cadila	IPCA	Torrent	Dishman
Net Sales (FY11E)	44,227	18,498	21,666	9,116
EBITDA Margin (FY11E)	23.1%	20.1%	20.8%	16.1%
PAT (FY11E)	6,805	2,521	2,954	731
NPM (FY11E)	15.4%	13.6%	13.6%	8.0%
P/E (FY12E)	20.4	13.5	13.9	9.5
EV/EBITDA (FY12E)	14.1	9.5	10.2	9.2
Mcap/Sales (FY12E)	3.1	1.7	1.9	0.8

Source: Company Filings, MAPE Securities

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Summary of Companies

Cadila

We initiate coverage with a Buy rating on Cadila Healthcare, based on its management's commitment to a long term strategy along with near and mid-term promises that will likely catapult Cadila into the league of the top three Indian generics companies.

We expect an 18-20% sales and EBITDA CAGR over FY11-13E, driven by

- The US revenue driven by 8-10 new launches in FY12E and FY13E each,
- 17% revenue CAGR in the domestic formulations business,
- Hospira JV to contribute INR2,150m and INR4,050m in FY12 and FY13 (5% and 7% in FY12 and FY13 respectively, and
- Abbot JV to start contributing to top-line from FY12.

IPCA

We initiate coverage with a buy rating on IPCA as we expect an 18-20% Sales and EBITDA CAGR over FY11-13E, driven by both domestic and export formulations. The domestic formulations business is set to witness a more than industry average growth of 20% over the next two years due to the addition of new products and a shift in product mix towards lifestyle segments. Meanwhile export formulation will grow due to recovery in the Russian market, filing of new products in the European countries that are approved in the UK, the launch of more products in the US market (once Indore SEZ is approved) and an increase in sales of generic co-artem (artemether/lumefantrine) to African countries.

Torrent Pharma

We initiate coverage of Torrent Pharma with a buy rating based on a strong belief in the potential of the company in delivering sustainable performance both in the near term and long term. Torrent has one of the best portfolios in the Indian market and addition of gynecology and respiratory therapies to its portfolio would take it on a higher trajectory. We expect its domestic formulations will grow at around 17% for the next two years. Its international revenues (which comprise over 50% of total revenues) should continue growing on the back of its entry to the US, its strategic tie up with AstraZeneca (along with another MNC for emerging markets) and its growing presence in emerging countries such as Brazil, Mexico and Thailand.

Dishman Pharma

We initiate coverage with a SELL rating on Dishman on the back of delays in the commencement of new CRAMS contracts; major restructuring at Carbogen Amcis; postponement of commercialization of the HIPO & China facility; increased financial leverage; and a higher tax rate of 18-20% (since EOU status will expire in March 2011) as against 10% over last five years.

Management guidance of single digit growth from the Marketable Molecules division (30% of total sales) and flat growth in Carbogen Amcis (35% of total sales), makes the overall 15% top-line growth in FY12 seems optimistic. To achieve a 15% growth in FY12, the Indian CRAMS business should grow by more than 35%; however it has remained flat over the last couple of years.

Exhibit 1: Presence of Indian Companies in Key Markets

Country	Nature	Key Players	Key Indian Players
Russia	Market Share in 2009 : Retail -74%, Reimbursement Program - 18%, Hospital - 7%	Pharmstandard, Novartis, Sanofi-Aventis, BayerHealthcare, Berlin-Ch/Menarini, Roche,Sandoz, GeodonRichter, KRKA	Dr.Reddy's, Lupin, Ranbaxy , Glenmark,Torrent, IPCA
Poland	Generics share highest among prescription share which constitute 60% share, OTC constitutues 30%. Wholesalers account for 75% of value	Jelfa Pharmaceuticals (Sanitas Group),Polpharma, GSK, Sandoz, KRKA	Ranbaxy
Turkey	Generics and reference drugs constituted 35.3% and 64.7% of total Turkish market by value in 2009	EastPharma, Abdilbrahim, Bilim, Sanovel, AZN, GSK, Pfizer, Novartis, Bayer	
Brazil	Similar (not require bioequivalence) exceeds branded, branded generics and pure generics sales. Bioequivalent generics value share at 13%, to increase over 20% in next 2 years – fastest growing segment	Ahce', Eurofarma, EMSSigma, Novartis,Schering, Pfizer,Medley, AstraZeneca,Sanofi	Torrent, Cadila ,Glenmark, Dr.Reddy's, Ranbaxy , Wockhardt, Strides Arcolab
South Africa	Ethical/branded share (50%), Generics (20%) and OTC (30%)	Sanofi-Aventis, Aspen, AZN, Cipla-Medpro, MSD, Pfizer, Adco-Generics, Adcock OTC,Roche Ethicals	Cipla, Ranbaxy , Lupin
Australia	Generics market 30% by volume but 14% by value	Alphapharm, Sigma, Halcygen, Sandoz, CSL, Sanofi-Aventis, GSK, Novartis, Teva, Abbott	Ranbaxy , Lupin
Romania	Generics share around 45% by volume	Roche, Sanofi, GSK, Novartis, Pfizer, Ranbaxy, Zentiva	Ranbaxy
China	Rx market accounts for 80% of total value excluding Traditional Chinese Medicines (TCM) TCM grows at faster rate	Simcere, United Laboratories, SinoBiopharma, Tong RenTang	
Mexico	Bioequivalent generics at mere 4% of total sales	BI, Bayer, Schering,Lilly, GSK, Merck, Dr.Reddy's, Ranbaxy	Wockhardt, Ranbaxy , Dr.Reddy's, Glenmark, Torrent

Source: Company Filings, IMS Reports, MAPE Securities

Exhibit 2: Key Parameters - Large Cap

Company name	Mkt Cap \$m	Domestic Market	US	Europe	Russia	ROW	API	Formulation	Key therapy Area	Comments
Cipla	5,581	48.0%	13.0%	9.0%		30.0%	10.0%	90.0%	Respiratory	Domestic Market, Respiratory in Europe
Dr.Reddy's	5,803	13.0%	31.0%	12.0%	10.0%		30.0%	70.0%	Antidiabetic, Antiinfective,	Biogenerics, Para IV pipeline,
Lupin	4,212	28.0%	33.0%	4.0%		20.0%	15.0%	85.0%	Cephalosporins	Suprax, Antara, Oral Contraceptive and Domestic market
Ranbaxy	4,815	20.0%	28.0%	15.0%	10.0%	20.0%	7.0%	93.0%	Cephalosporins	Domestic market, USFDA Resolution
Sun Pharma	9,864	48.0%	25.0%			12.0%	15.0%	85.0%	CNS	US, Taro, Para IV in Injectable Onco and Domestic market

Source: Company Filings, MAPE Securities

Exhibit 3: Key Parameters - Mid Cap

Company Name	Mkt Cap \$m	Domestic Market	US	Europe	Russia	ROW	API	Formulation	Key therapy Area	Comments
Aurobindo	1,290		25.0%	7.0%		7.0%	47.0%		53% ARV	Strategic tie-ups - Likely takeover candidate
Biocon	1,615	25.0%	15.0%	35.0%					Statins & Immunosuppressants	Oral Insulin, Biogenerics, Statins, Custom Synthesis
Cadila	3,678	40.0%	18.0%	8.0%		13.0%	10.0%		80.0% CVS, Respiratory, Female Healthcare, Gastro	Hospira JV, Bayer JV, Domestic Market, US Market
Elder	176	75.0%					16.0%		84.0% Women healthcare, antiinfective	Domestic market Play
FDC	443	90.0%							ORS (Oral rehydration salt) and Ophthalmics	Electral is the leading brand. Company is also into infant foods
Glenmark	1,794	30.0%	30.0%	8.0%		21.0%	11.0%		89.0% Anti-infective, Derma, Respiratory, Pain Management	Domestic and US markets
Indoco	120	67.0%		15.0%		12.0%	5.0%		95.0% Anti-infectives, Gastro-intestinal, Respiratory, Derma, Anti-diabetics	Domestic Market Play and Tie up with Watson
Ipca	846	37.0%	3.0%	5.0%	8.0%	19.0%	28.0%		72.0% CVS, antidiabetic, Non steroidal anti inflammatory drugs, Malaria	Domestic and Emerging markets - branded
Orchid	503									Pure API manufacturer
Panacea	278									Majority from Vaccines
Piramal	1,619									Holding Cash
Strides Arcolab	475	12.0%	35.0%	15.0%		38.0%			100.0% Antibiotic, oncology, Antibacterial & HIV, Malaria	Speciality injectible including Beta-lactams, Cephalosporins, oncolytics and penems. Tie up with Pfizer
Torrent	1,081	39.0%	6.0%	20.0%	3.0%	22.0%	2.0%		98.0% CNS, CVS, Gastro Intestinal	Strong portfolio, Tie up for emerging markets, Likely takeover candidate

Source: Company Filings, MAPE Securities

Reasons of Indian Pharmaceutical Companies' Performance

Until now, Indian companies have done extremely well in the US, the domestic market and a few emerging markets. The main reasons for their commendable performance in the US have been the large market size, patent expiries and exclusivities. In domestic and emerging markets on the other hand, Indian companies have done well due to increasing GDP growth (high disposable income), a similarity in manufacturing standard, purchasing power, hygiene condition and disease profiles (Dr.Reddy's in Russia, Cadila and Torrent in Brazil). In addition, many countries lack the local capacity to manufacture every generic product, thus permitting entry of Indian companies.

Indian companies are the only class of companies in the world to have dual distinction of being:

- Efficient manufacturers of almost any synthetic product
- Marketers and developers of brands in emerging markets, including India.

Exhibit 4: Dr.Reddy's Performance from 2007-2011

(INR mn)

Particulars	2007	2008	2009	2010	2011E
North America	22,054	7,873	19,843	16,817	17,450
% of Sales	33.9%	15.7%	28.6%	23.9%	24.6%
% Change		-64.3%	152.0%	-15.2%	3.8%
India	6,964	8,060	8,478	10,158	11,930
% of Sales	10.7%	16.1%	12.2%	14.5%	16.8%
% Change		15.7%	5.2%	19.8%	17.4%
Europe	9,504	10,216	11,886	9,643	8,570
% of Sales	14.6%	20.4%	17.1%	13.7%	12.1%
% Change		7.5%	16.3%	-18.9%	-11.1%
Russia	4,752	5,525	7,624	9,119	10,900
% of Sales	7.3%	11.0%	11.0%	13.0%	15.3%
% Change		16.3%	38.0%	19.6%	19.5%
Others	998	1,197	1,959	2,868	3,400
% of Sales	1.5%	2.4%	2.8%	4.1%	4.8%
% Change		19.9%	63.7%	46.4%	18.5%
API	20,823	17,135	19,651	21,672	18,800
% of Sales	32.0%	34.3%	28.3%	30.8%	26.5%
% Change		-17.7%	14.7%	10.3%	-13.3%
Total Sales	65,095	50,006	69,441	70,277	71,050
Growth		-23.2%	38.9%	1.2%	1.1%

Source: Company Filings, MAPE Securities

Growth largely due to North American, Russian and domestic markets

Exhibit 5: Sun Pharma's Performance from 2007-2011**(INR mn)**

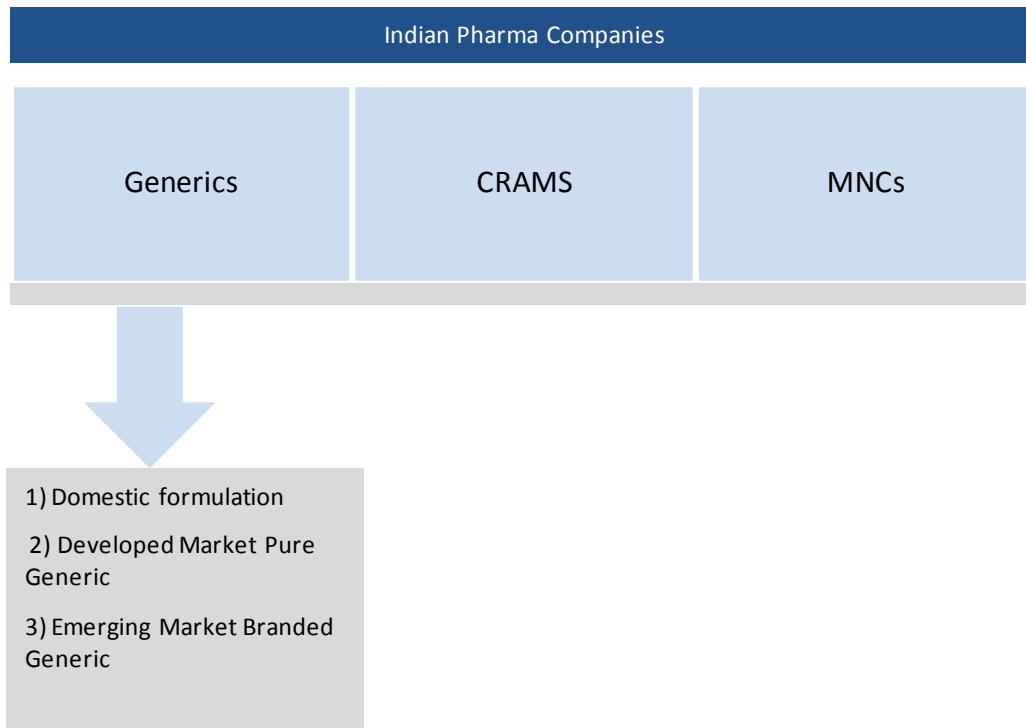
Particulars	2007	2008	2009	2010	2011E
Domestic	11,810	14,762	19,597	18,301	25,000
% of sales	49.7%	42.7%	44.8%	46.1%	43.4%
% Change		25.0%	32.8%	-6.6%	36.6%
US	5,409	14,139	15,460	11,062	19,500
% of sales	22.8%	40.9%	35.4%	27.8%	33.8%
% Change		161.4%	9.3%	-28.4%	76.3%
API	4,532	3,463	4,846	5,491	5,476
% of sales	19.1%	10.0%	11.1%	13.8%	9.5%
% Change		-23.6%	39.9%	13.3%	-0.3%
ROW	1,994	2,200	3,795	4,885	7,680
% of sales	8.4%	6.4%	8.7%	12.3%	13.3%
% Change		10.3%	72.5%	28.7%	57.2%
Total	23,745	34,564	43,698	39,739	57,656
% Change		45.6%	26.4%	-9.1%	45.1%

Source: Company Filings, MAPE Securities

Growth largely due to US and domestic markets

Global Generics - Opportunity for Indian Companies

Indian Pharma companies can be divided into three broad categories



Source: MAPE Securities

Generics – A Global Opportunity: In many developed nations, a higher healthcare burden (healthcare cost as a percentage of GDP) is driving generics penetration as the need for low cost medicine has been growing. On the other hand, emerging markets growth (including pharmerging markets) is being driven by the need for better quality products driven by superior GDP growth. The growth drivers of these two markets are significantly different from each other.

Regulated markets - Focus on cost, quality of manufacturing and complex chemistry skills are the most important aspects for survival and growth.

Emerging markets – Branding and Sales promotion form the critical success factor for the markets that is willing to pay a price for better quality due to weak manufacturing standard.

Developed Markets Opportunities

Going forward, we believe selection of market will be the key in developed markets, as structural changes may adversely impact the growth.

Selection of Market in Developed Markets – Key to Success: It is evident from the many acquisitions made by Indian companies in 2003 to 2008 that attractive markets can often prove to be dangerous. The best example is that of Betapharm acquired by Dr.Reddy's in 2006, a company which is still dampening Dr.Reddy's performance. This is attributed to the fact that regulatory changes often lead to structural reforms in several markets, so that the existing business models becomes ineffective. This poses the biggest risk to the international business growth model. On the other hand, Cadila's first overseas acquisition in 2005 of Alpharma SAS, France demonstrates a more effective acquisition. This acquisition was made when the pure generics market in France had just picked up.

Exhibit 6: Selection of Markets – Developed Markets

Countries	GDP Growth (%)	Exp on health as % of GDP	Out of pocket exp. as % of total exp. on health	Pharmaceutical exp on health as % of total exp. On health	Total Pharma Market \$b	Generics Penetration Value \$b	Generics Penetration Value %	Generics Penetration Volume	Comments
Australia	2.7	8.5	18.0	14.3	8.0	1.0	14.0	30.0%	Volumes will increase
Canada	3.2	10.1	14.8	17.2	22.6	5.6	24.8	60.0%	Double digit price erosion due to government intervention
France	1.5	11.2	7.4	16.4	30.0	3.5	11.7	25.0%	Significant price cuts in 2010. Pricing scenario remains unclear in 2011
Germany	4.0	10.5	13.0	15.1	35.0	7.0	20.0	60.0%	Tender Based Market
Italy	1.5	9.5	19.5	18.3	16.5	1.0	6.1	18.0%	Generics Penetration to increase
Japan	2.2	8.1	14.6	20.1	90.0	5.0	5.6	19.0%	Government supporting generics penetration
Spain	0.6	9.0	20.7	20.5	14.5	1.2	8.3	20.0%	Increasing generics penetration
UK	1.5	8.7	11.1	11.8	22.0	4.5	20.5	60.0%	Substituting immediate release instead of costlier sustained release
US	2.7	16.0	12.1	11.9	320.0	54.4	17.0	70.0%	Most Commoditized market. Para IV opportunities

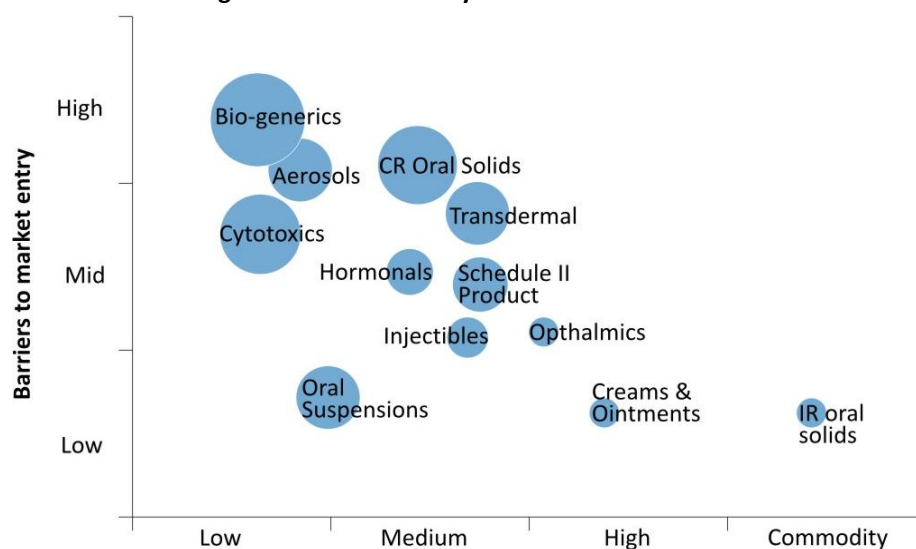
France, Italy, Japan and Spain are ripe for generic penetration

Source: OECD, WHO, Bloomberg, Company Filings, MAPE Securities

The table indicates that markets such as Italy, Spain, France and Japan are ripe for high growth in generics sales. Until now the volume of generics penetration has been low with high government spending on healthcare and extremely low GDP growth. It is important to note that the countries that have a lower generics penetration are likely to have a branded generics market. However, with strong regulatory systems and a high healthcare burden, the regulatory agencies are inclined towards making it a pure generics market.

For other developed countries, the generics market is largely commoditized, leaving an open opportunity only for those companies who focus on complex technologies to command premium. To that end, the US generics market - which is by far the most commoditized - will give higher returns for complex technologies.

Exhibit-7 lists the technologies with their relative entry barrier, while Exhibit-8 lists the Indian companies that are focusing on key technology areas for their future growth.

Exhibit 7: Technologies with relative entry barrier

Source: Actavis Presentation, 2006, MAPE Securities

Exhibit 8: Indian Companies Focused on Complex Technology

Technology	Indian Companies
Biogenerics	Dr.Reddy's, Biocon
Aerosols	Cipla, Cadila
Hormonals	Cadila, Sun Pharma,
Cytotoxic	Natco, Dabur, Dr.Reddy's, Sun Pharma
Transdermals	Cadila, Dr.Reddy's, Troikaa
Schedule II Products	Piramal, Sun Pharma, Ankur Drugs
Injectibles	Sun Pharma, Lupin
Ophthalmics	Allergan, Alcon, Intas

Source: Company Filings, MAPE Securities

Exhibit 9: Different Markets – Different Challenges

Country	Regulatory Environment	Opportunities	Challenges	Indian Companies Presence
Germany	Structural changes in the market from branded generics to Tender based market. Government supporting pure generics market	Small size opportunities as market is tender based.	Low margins, intense competition	Dr.Reddy's, Biocon
Japan	Rapidly aging population and the ever increasing healthcare costs have forced the Japanese government to think seriously about the need to reduce the healthcare costs by promoting generics	Second largest market after the US. Generics penetration to increase. Lower penetration levels and encouragement from the government provide significant opportunities for the generic players to expand and grow.	Japanese consumers tend to choose quality over price. Changing public perception about generic drugs. not to use generic drugs	Ranbaxy , Lupin, Cadila
Spain	Continued government initiatives to drive generics usage and capture cost savings	Expansion of reference price system from 15 to 27 EU countries. Generics penetration to increase	Generics prices cut by 25%	Cadila
France	Continued government initiatives to drive generics usage and capture cost savings	Increasing incentives for physicians and pharmacy chains to substitute. Relatively small generics market with ~ 25% by volume and < 10% by value	Significant price cuts in 2010. Pricing for 2011 remains unclear	Cadila
UK	Government supporting generics	Predominantly pure generics market with high level of substitution	Changes in prescribing advice to contain costs, i.e., substituting immediate release instead of more expensive sustained release. Low Margins	Many companies including smaller companies like IPCA, Wockhardt
US	Generics friendly market	Biggest pharma market. Para IV opportunities.	Intense competition. More than 90% price erosion after patent expiry.	Almost all the large and mid cap companies

Ranbaxy will be the beneficiary of rising penetration in Japan

Cadila will be the beneficiary for its presence in Spain and France

Source: Company Filings, OECD, MAPE Securities

Emerging Markets Opportunities

Emerging Markets – Focus on Branding: The characteristics of the healthcare system of an emerging market are largely opposite to that of a developed country. These include

- Lower insurance penetration
- Low government burden of healthcare expenditure
- Weaker manufacturing standards
- Physicians influence the buying decision
- Barriers to generic replacement
- High out of pocket expenditure

Exhibit 10: Emerging Markets – Key Characteristics (USD bn)

	GDP Growth (%)	Exp on health as % of GDP	Out of pocket exp. as % of total exp. on health	Total Pharma Market 2010	Total Pharma Market 2015E
Brazil	5.0	8.4	60.0	15.0	20.0
China	9.8	4.3	60.0	31.0	38.0
India	8.2	4.1	80.0	10.0	20.0
Russia	2.7	5.4	50.0	13.0	18.0
Mexico	4.6	5.9	48.8	10.0	19.0
Turkey	9.2	6.2	21.8	12.0	15.0
South Korea	4.8	6.5	35.0	10.0	15.0
South Africa	4.4	8.6	50.0	2.5	4.0

Source: OECD, WHO, Bloomberg, Company Filings, McKinsey Report, MAPE Securities

The growth drivers for branded generics market in the emerging markets are the rising GDP and preference for quality products due to weak manufacturing standards. Quality requirements lead to branding of products. For a manufacturer, branded products have significant advantages such as:

- Predictable sales
- Limited working capital investment
- Better margins.

However the biggest disadvantage of the emerging markets is that it is a result of an inefficient healthcare system. As countries develop and become more efficient, these markets tend to shift to pure generics. While this is a long-term risk, the near-term challenges are weak regulations related to receivables, a likelihood of sudden changes in government policies, etc.

Major Growth Opportunities in Emerging Markets including Pharmerging Markets**1. Pharmemerging Markets to Drive Growth**

Though emerging markets are small, the rapid growth of emerging pharmaceutical markets against slowing regulated markets makes them an attractive target. Higher GDP growth, increasing population and greater health awareness combined with higher incomes to spend on healthcare will drive the growth of pharmaceuticals in emerging markets. By 2017, IMS forecasts revenues from emerging markets to be between US\$ 290 bn and US\$ 320 bn, with a CAGR of 12- 15%

Seven 'pharmerging' countries — Brazil, Russia, India, China, South Korea, Turkey and Mexico — are expected in aggregate to grow by 12-14% in 2011, at a CAGR of 13-16% over the next five years. China's pharmaceuticals market is expected to grow at over 20% annually, and contribute 21% of overall global growth up to 2013. Meanwhile, Russia and Turkey may be negatively impacted by new measures intended to reduce the level of healthcare spending.

The Brazilian pharmaceuticals market is valued at over \$15 bn and has been growing at approximately 11%. Within this market, the branded generics market is valued at over \$13 bn, and has been growing at over 9%, while unbranded generics market is valued at over \$2 bn and has been growing at a much higher rate of approximately 20%. (Source: IMS Health).

A. China – The Main Growth Driver

With GDP of more than US\$8 tn in 2010 and a pharmaceuticals market that is expected to drive US\$40 bn in growth through 2013, China is leading the growth of the pharmerging markets. Fueled by a massive population of 1.3 bn people, aggressive government spending on healthcare and an increasing demand for drugs to treat chronic diseases, China's pharmaceuticals sector grew by over a 20% CAGR in the last three years. At the heart of its healthcare transformation is a landmark

US\$125 bn in incremental government funding, with the aim of improving the nation's healthcare infrastructure and achieving near universal health coverage by 2011 – a move that is projected to double the size of China's pharmaceuticals market through 2013. Nevertheless, the operating environment remains complex and challenging, exacerbated by increased local competition, evolving government intervention on drug pricing and uncertainty around healthcare reforms.

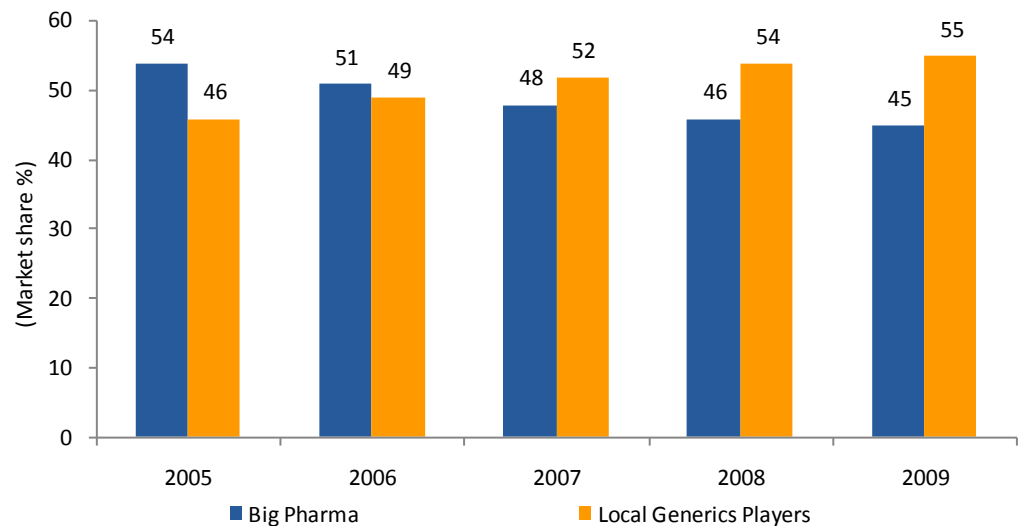
No major Indian companies are present in China.

B. Brazil – Local Players Growing Faster

Brazil has achieved consistent double-digit pharmaceuticals growth over the last few years, continuing at 20% in 2009. Out-of-pocket healthcare costs are high (75%) and income distribution is poor, limiting the number of people who can pay for innovative therapies. The local environment has seen a number of recent changes, including growing competition from generics, increased government investment in state-owned pharmaceutical plants, and greater emphasis on cost-containment initiatives that tend to favor local companies. Local companies have gained significant market share over the last five years. The top multinational companies lost around 9% market share to the local players in five years. The Brazilian market is expected to grow at a 12-14% CAGR from 2010-2015.

Cadila and Torrent are present in Brazil market and that may help them to grow.

Exhibit 11: Market share of Brazil



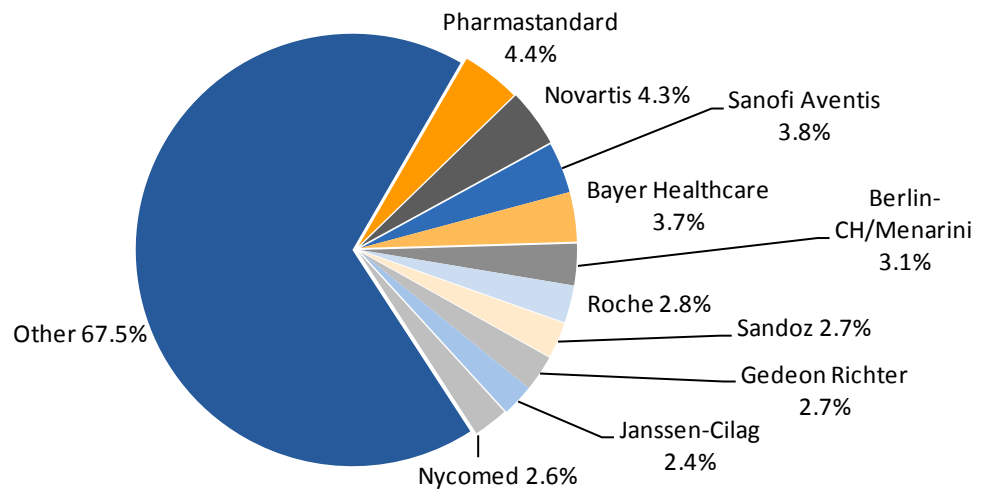
Source: Company Filings, MAPE Securities

C. Russia – Government Supporting Local Players

The Russian market has also experienced high double-digit growth in recent years and offers further growth potential due to increased private insurance and positive developments in the reimbursement system. Physician education is also improving although poor knowledge of prevention, diagnosis and treatment at primary care level, along with the overall lack of clinical standards and guidelines still impede the successful management of chronic disease. High prices, increasing government influence over drug prescriptions, and powerful lobbies in favor of local manufacturers are also some key characteristics of this market.

Dr.Reddy's, Ranbaxy, JB chemicals and IPCA are the major Indian players present in the Russian market.

Exhibit 12: Market Share - Russian Market



Source: Sanofi Aventis Presentation, Company Filings, MAPE Securities

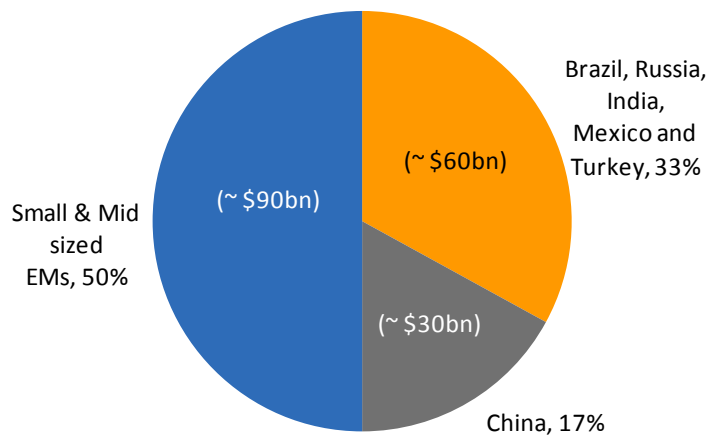
2. Small and Mid-sized Markets Offer the Opportunity to Build Sizeable Businesses

Emerging markets, excluding pharmerging markets consist of:

- more than 50 markets with a total market size of more than \$90b in 2010
- growing at 10-12%, these could add \$30-40b in absolute growth by 2014

There are a large number of small but high growth markets that together present a significant opportunity. As not all companies can afford the infrastructure and investment costs required for such a wide presence. Companies like Dr.Reddy’s, CDH and Torrent entered into strategic alliances with innovator companies in these growing emerging markets (Dr.Reddy’s-GSK, Cadila-Abbot, Torrent-AstraZeneca).

Exhibit 13: Emerging markets pharma sales - 2009



Source: Sanofi Aventis, Company Filings, MAPE Securities

Exhibit 14: Different Countries Different Challenges

Country	Regulatory Environment	Opportunities	Challenges
Russia	Earlier drug prices were not regulated, even those on Essential Drugs List (EDL). Government has, however, increasingly shown interest in regulated pricing for drugs in EDL. Regulating mark-ups – trade margins	Gross margins in the region are considerably high than other emerging markets. However EBITDA Margins are lower than India due to high promotional cost. OTC market is large and growing	High fragmentation with largest player with less than 5% share signifying intense competition, Currency volatility
Poland	The pharma industry is likely to be fully privatised in the near future. Most state owned companies are now privatised. Local laws favourable for generics, providing shorter period to innovators data exclusivity	Large share of imports. Generics incentives	Large number of small units Concentration among distributors
Turkey	Turkish government announced price reductions in Q409. New pricing mechanism puts 60% reference pricing	EBITDA margin above 20%	Tough competition Channel concentration
Brazil	ANVISA is main regulatory body. IP laws are strong and create few barriers to entry. Current law establishes 20-yr patent protection and 10-yr market exclusivity. Compulsory licensing has been a long-used tool for pricing decisions – famous instance of Merck's efavirenz drug price control. Generic price to be at least 35% lower than branded	Branded generics sales have doubled in last four years. Generics share is still low against patented drugs. Demographic shift towards elderly to increase demand	Generics are still very new and hence are difficult to position. OTC too subjected to price restrictions often higher, reaching 70-80% in some cases. Similar sales represent 90% manufactured drugs of market for locally
South Africa	Single exit price under Draft Regulations to Medicines and Related Substances Act, 1965, fixed price as reflected in Blue Book as at Jan 2004. Thereafter, extent of increase of determined annually by price Pricing Committee	ARV market is huge. Chronic diseases projected to double in next 8 years. Population growth, ageing profile. Low generics penetration	Local players have distinct edge. Government focus on NHI but implementation not clear. Currency volatility. Low entry barrier
Australia	12.5% price cuts in 2005 From Aug 2008, 25% reduction in bigger products	Generics size is very low Volumes will increase	Concentrated market. Pricing can be an issue
Romania	Reference pricing, price of generics not to be higher than 65% of brand price	Growth Outlook Strong	Currency volatility
China	Reforms in 2007 made it more difficult and costly to develop and register new drugs. Cost of re-registration is a considerable burden on smaller players	Industry growth CAGR expected at 25% + over 2008-12. To emerge as leading pharmaceutical market	Large number of local players dominate manufacturing. Highly fragmented market
Mexico	Government programs focusing on procurement of generics. Bioequivalence standards fully implemented	Bioequivalent generics to increase significantly over next few years	Concentrated distributors

Source: Company Filings, MAPE Securities

Domestic Market:

The Indian Pharmaceutical sector, which has expanded significantly in the last two decades, is highly fragmented with more than 20,000 registered units. The leading 250 pharmaceutical companies control 70% of the market with market leader holding nearly 7% of the market share. On top of being a fragmented market, there is severe price competition and government price control.

The pharmaceuticals industry in India meets around 70% of the country's demand for bulk drugs, drug intermediates, pharmaceutical formulations, chemicals, tablets, capsules, orals and injectables. There are about 250 large units and about 8000 small scale units that form the core of the pharmaceuticals industry in India. These units produce the complete range of pharmaceutical formulations, which included medicines ready for consumption by patients and about 350 bulk drugs, i.e., chemicals with therapeutic value that are used for the production of pharmaceutical formulations.

Driven by rising income and increased government spending on healthcare, India's domestic pharmaceuticals market also continued to grow and crossed INR 41,000 bn (\$9 bn) in 2009-10 with over 17% growth compared to 10% growth in 2008-09. (Source: ORG IMS MAT Mar-10.). Chronic therapies continued to outpace acute therapies in terms of growth, and key therapeutic areas such as the anti-diabetic, CVS, respiratory, gynecology, neuropsychiatry and dermatology segments continued to grow above the average market growth. New product introductions continued to drive the growth for most of the therapeutic areas and contributed to about 8% of the overall market growth. Metro cities (with population above 1mn) and Class-I towns (with population between 0.1 mn to 1 mn) were the key contributors to the growth of the market. However, the 'rural' market (towns with population above 20,000 to 100,000) gained momentum and is expected to grow at a faster pace in the near future. (Source: ORG IMS)

India

- Income growth to drive affordability, health awareness and treatment intent (85% of health expenditures are private)
- Market to expand from cities to Tier II (with 65% of population lacking access to essential medicines)
- Chronic diseases and life style disorders will increase
- Improving medical infrastructure, insurance and investment in health care to drive hospital based treatments
- Brands currently under price control are among the lowest prices in the world
- Pricing, implementation of intellectual property rights and regulatory data protection remain issues

A. Majority of Indian Companies are Focusing on Expanding Manufacturing Capacities

India is on its way to becoming a global pharma manufacturing hub despite competition from Chinese manufacturers. The only risk is the timing, as competition could increase while Indian pharma companies are incurring in heavy capex to expand manufacturing capacity.

We are witnessing a continuous expansion of manufacturing capacity among Indian companies, including those that are already in branded generics sales in anticipation of transactions with global pharma MNCs. Exhibit-15 below summarizes the capital expenditure between 2009-11E for some leading Indian generics companies.

The more established players with a track record are the ones making this type of investment. A good example is Biocon, which is investing \$350m into new production capacity and technology for insulin.

Exhibit 15: Major Indian Companies Capex in Last Three Years

Company (INR mn)	2009	2010	2011E
Aurobindo	5,509	4,743	4,000
Biocon	2,820	1,670	1,700
Cadila	4,070	3,040	2,500
Cipla	7,030	5,030	5,000
Dishman	1,685	3,058	1,500
Dr.Reddy's	6,400	9,660	8,000
Ipca	900	1,340	2,200
Lupin	2,240	3,321	4,500
Ranbaxy	5,750	5,220	5,000
Sun Pharma	6,101	2,841	3,000
Torrent	627	1,501	2,400
Unichem	593	459	500

Source: Company Filings, MAPE Securities

B. Indian Companies have Added Large Amount of Sales Force to Cater to Suburban and Rural Markets

We have highlighted in Exhibit 16 that Indian companies are focused on sales force expansion to take advantage of untapped rural and semi-urban markets as well as to establish a pan India presence.

Exhibit 16: Indian companies are increasing sales force

Company	Sales Force		FY11E Domestic Formulation Sales	INR M Productivity/Employee/Year
	2007	Q3FY11	INR. Million	
Cadila	1,900	4,500	16,000	3.56
Cipla	3,000	5,000	25,000	5.00
Dr.Reddy's	1,300	2,500	11,000	4.40
Glenmark	1,800	2,300	10,000	4.35
Ipca	2,000	5,000	7,000	1.40
Lupin	1,800	3,800	16,000	4.21
Mankind	3,00	5,000	13,000	2.60
Ranbaxy	2,200	4,500	18,000	4.00
SUNP	2,000	3,000	17,500	5.83
Torrent	2,200	3,600	8,500	2.36
Unichem	1,000	2,000	3,000	1.50

Source: Company Filings, MAPE Securities

Rural Market Penetration – May Hit Margins

We expect the domestic market to continue to grow at 15% over the next five years; however, larger companies will find it difficult to grow above the market rate. The low hanging fruit has already been captured by most of the companies from Tier I and Tier II cities. The next wave of growth will come from customer upgrades, Tier III cities and rural market. Larger companies which are developing new products and moving towards complex technologies will be benefited by customer upgrades; however, larger companies will find it difficult to compete against the regional smaller players in the Tier III cities and rural market. Larger companies need to change their business model to suit the rural market as against the Urban and Tier II cities. The companies should look at different pricing and costing structures for the rural market and may look at a contract sales force instead of having its own sales force. In the near term, the companies expanding their own sales force to target the rural market will face margin pressure due to (1) lower doctor and chemist calls per day, (2) lower intake per chemist and (3) intense price competition from smaller players.

Contract Manufacturers

Big Pharma have shown interest in strategic tie-ups with Indian generics companies (which have own brands in emerging markets) instead of pure play contract manufacturers

In the last two years, the interest shown by multinationals in outsourcing manufacturing to Indian companies has gained momentum. On the face of it, contract manufacturing companies should have been positioned the best for these contracts and rapid growth.

However a closer look at the deals reveals that the outsourcing partners of choice for multinationals are the Indian generic companies and not the pure play contract manufacturer (Exhibit 17). The key reasons for this are:

- Generics facilities are capable of producing products across various therapeutics segments, unlike the pure play contract manufacturers that develop cost efficiencies through one or two technologies at a time.
- Generics facilities are already running and manufacturing products for less regulated or emerging markets.

- Generics companies have already built regulatory expertise across regulated and semi regulated markets, something that is lacking in pure contract manufacturers.
- Generics companies may be able to offer a better price, since they can spread their fixed overheads as they manufacture for other markets too. In comparison the contract manufacturers only rely on multinationals' contracts to recover their investments

We therefore strongly believe that pure play contract manufacturers will continue to face hurdles related to scale up and will not be able to effectively compete against the generics companies for strategic tie-ups.

Exhibit 17: Strategic Deals with Indian Companies

Date	MNC	Indian Co.	Deal Type	Rationale
Mar-09	Pfizer	Aurobindo	Contract manufacturing	60 Products for Regulated Markets
Apr-09	Fresenius	Dabur Pharma	Company acquisition	Access to Oncology Manufacturing
May-09	Pfizer	Claris Lifesciences	Contract manufacturing	Access to sterile injectible drugs manufacturing for US market
Jun-09	Mylan	Biocon	Development & manufacturing deal	Develop monoclonal antibody and contract manufacturing
Jun-09	GSK	Dr.Reddy's	To gain access to Dr.Reddy's portfolio	Strategic marketing deal for emerging market
Aug-09	Mylan	Famycare	Bought 15% stake	Access to oral contraceptive manufacturing
Aug-09	Sanofi Aventis	Shantha Biotech	Controlling stake bought	Access to vaccine manufacturing
Dec-09	Hospira	Orchid	Bought Injectible business	Access to injectible manufactruing
Jan-10	Pfizer	Strides Arcolab	Collaboration of existing product portfolio	Pfizer to commercialize off-patent drugs
Mar-10	Astrazeneca	Torrent	Supply of generics medicine in emerging markets	Enhance product portfolio in emerging markets
Mar-10	Aspen	Indoco	Drug supply pact	Indoco to manufacture and Aspen to carry out marketing
May-10	Abbot	Cadila	Drug Supply pact	Abbot to market 24 products of Cadila
Sep-10	Astrazeneca	Aurobindo	Drug Supply pact	Astrazeneca to market drugs in emerging markets
Oct-10	Pfizer	Biocon	Development & manufacturing deal	Worldwide rights of Insulin Products except few countries
Jan-11	Bayer	Cadila	JV to market pharmaceutical products in India	JV to concentrate on Women healthcare, oncology, CVS, segments

Source: Company Filings, MAPE Securities

	(INR mn)																		
	M.Cap	EV	Revenue	2010	2011	2012	P/E	EV/EBITDA	M.Cap/Sales	EV/Sales	P/BV	Last Price	1	3	6	1 Year	YTD		
												4/5/2011	Month	Months	Months				
Large Caps																			
Cadila	164,004	172,820	35,741	44,896	51,869	24.4	19.8	16.0	13.2	3.2	3.3	7.5	801.0	5	4	16	46	3	
Cipla	257,898	254,874	53,595	61,252	69,671	25.3	21.0	18.7	15.8	3.7	3.7	3.8	321.2	6	(15)	(2)	(8)	(13)	
Dr.Reddy	277,335	282,018	70,175	75,622	89,511	25.4	19.2	18.7	14.1	3.1	3.2	5.5	1,639.4	4	(4)	9	29	(1)	
Lupin	183,389	193,354	47,405	56,856	66,692	21.5	18.1	16.8	14.0	2.7	2.9	5.7	411.0	3	(16)	0	25	(15)	
Ranbaxy	196,367	212,585	85,355	94,626	109,830	18.8	13.3	11.8	8.6	1.8	1.9	3.0	466.2	3	(23)	(22)	(4)	(22)	
Sun Pharma	462,788	449,045	39,040	56,792	70,154	26.6	22.5	23.1	19.6	6.6	6.4	4.9	449.4	4	(8)	9	22	(7)	
Average						23.7	19.0	17.5	14.2	3.5	3.6	5.1							
MINCs																			
Glaxo	178,300	158,296	21,511	24,465	27,899	27.0	23.5	18.1	15.8	6.4	5.7	8.0	2,105.0	(3)	(12)	(8)	18	(10)	
Abbot	18,420	16,295	9,407	NA	NA	NA	NA	NA	NA	-	-	NA	1,347.0	6	2	18	49	3	
Pfizer	36,914	31,478	7,723	10,096	11,156	18.6	16.9	12.9	14.9	3.3	2.8	2.8	1,237.0	2	11	12	23	9	
Average						22.8	20.2	15.5	15.4	3.2	2.8	5.4							
Contract Manufacturer																			
Dishman	8,304	16,007	9,154	9,120	10,369	11.1	9.2	9.6	7.5	0.8	1.5	1.0	102.9	8	(31)	(46)	(53)	(34)	
Divis	90,483	90,335	9,416	11,575	14,125	24.4	19.7	19.9	15.5	6.4	6.4	5.1	682.4	11	2	(5)	(1)	5	
Jubilant	28,272	56,673	37,813	37,438	42,015	9.6	7.9	8.5	7.1	0.7	1.3	1.2	177.5	5	(37)	(45)	(49)	(36)	
Shasun	2,687	5,802	8,009	8,748	9,769	9.2	5.6	6.0	4.8	0.3	0.6	NA	55.4	(10)	(26)	(37)	0	(15)	
Hikal	5,231	10,184	5,390	NA	NA	NA	NA	NA	NA	-	-	NA	318.2	6	(16)	(28)	(17)	(13)	
Average						13.6	10.6	11.0	8.7	1.6	2.0	2.4							
Mid-Cap																			
Aurobindo	57,496	79,023	35,754	42,376	49,127	10.5	9.0	8.5	7.2	1.2	1.6	2.4	197.5	7	(27)	(9)	2	(25)	
Biocon	72,010	72,251	20,364	27,513	30,960	19.5	16.6	12.5	10.7	2.3	2.3	3.5	360.1	10	(14)	(6)	18	(14)	
Ipca	37,718	42,647	15,596	18,484	22,122	15.5	12.4	11.4	9.2	1.7	1.9	3.5	300.1	10	(10)	(4)	10	(13)	
Strides	21,172	39,808	16,958	21,901	25,689	10.8	8.1	8.8	7.6	0.8	1.5	1.6	366.5	(3)	(16)	(15)	7	(18)	
Torrent	48,189	49,480	18,329	21,813	25,555	16.3	13.5	11.7	9.7	1.9	1.9	4.5	569.6	11	(1)	(5)	6	(2)	
Wockhardt	37,318	74,909	35,926	NA	NA	NA	NA	NA	NA	-	-	NA	341.0	(2)	(7)	5	136	(7)	
Unichem	17,596	17,138	7,474	8,487	10,046	14.3	10.9	9.6	7.6	1.8	1.7	2.7	195.0	8	(18)	(7)	11	(20)	
Elder	7,827	12,776	7,216	9,203	12,644	11.2	8.0	7.6	6.3	0.6	1.0	NA	380.0	3	(1)	(5)	5	1	
FDC	19,764	17,337	6,615	NA	NA	NA	NA	NA	NA	-	-	NA	106.1	(1)	(3)	4	28	(5)	
Orchid	22,411	36,889	13,021	16,251	20,224	17.7	14.2	9.9	7.9	1.1	1.8	2.3	318.2	18	4	10	100	5	
Glenmark	79,988	95,817	25,006	29,260	33,949	17.5	15.2	12.3	11.0	2.4	2.8	2.8	296.0	(2)	(19)	(6)	10	(18)	
Piramal	72,176	47,389	36,245	35,657	29,875	21.1	18.0	4.6	7.7	2.4	1.6	0.9	431.7	(7)	(11)	(17)	(1)	(8)	
Average						15.4	12.6	9.7	8.5	1.3	1.5	2.7							
Average of Pharma sector						18.0	14.7	12.6	10.7	2.1	2.2	3.6							

Source: Bloomberg, Company Filings, MAPE Securities



MAPE
Securities Private Limited

CADILA HEALTHCARE

Poised To Become Top Three Indian Generic Player

We initiate coverage with a Buy rating on Cadila Healthcare, based on its management's commitment to a long-term strategy, along with near and mid-term promises that will likely catapult Cadila into the top three league of Indian generics companies.

We expect an 18-20% Sales and EBITDA CAGR over FY11-13E, driven by

- the prospect of 8-10 new launches in both FY12E and FY13E in the US,
- a 17% revenue CAGR in the domestic formulation business,
- Hospira JV to contribute INR2,150m and INR4,050m in FY12 and FY13 (5% and 7% in FY12 and FY13 respectively),
- Abbot JV to start contributing to top-line in FY12.

Investment Rationale

Strong Domestic Formulations Sales: In the near future, CDH's domestic formulations will grow by 17% based on improving local market conditions – with increasing margins.

Hospira – To Contribute Significantly in FY12 and FY13: CDH's near term outlook appears healthy because of a promising joint venture with Hospira, for injectable oncology products that will go full steam in FY12 and FY13. Injectable oncology is a unique space that does not witness price erosion of more than 85% (vs 95% for other generic drugs) due to high entry barriers.

International Efforts to Pay in the Medium Term: We estimate 20% midterm growth, including the subsidiaries acquired for CDH's international efforts, based on its two-pronged international strategy of

- concentrating on branded generics in countries that are witnessing an increased in purchasing power.
- concentrating on pure generics in countries that are burdened with high healthcare costs.

Attractive Valuations: We expect 19%, 19% and 27% growth in FY12 sales, EBITDA and EPS respectively. Additionally, we see visible earnings post FY12, due to the Hospira and Abbot joint venture, and we expect CDH to turn around its subsidiary in Spain by FY 12.

At the current price of INR801, CDH trades at a PE of 20x FY12 EPS at almost a 20% discount to Sun Pharma. With a 25% earnings CAGR over FY11-13E (one of the best among its comparable peers), best in class return ratios (RoCE and RoE over 30%) and a healthy balance sheet (Net D/E 0.5x), we believe the valuation discount to front-line generics peers should narrow over time, as visibility improves. We value Cadila at 23x FY12E earnings based on the above mentioned positives, to arrive at a target price of INR900.

Investment Basis

Domestic Market Sales to Pick Up: We believe that higher GDP, reduced unemployment and increased spending by the government, particularly in the improvement of health in the rural areas, will boost the sales of domestic formulations. The domestic formulations business has higher profitability with minimum capex and working capital needs as compared to the other business interests of the company. Additionally, we believe that the domestic formulations are a more stable market.

Initiating Coverage

April 6, 2011

BBG code : CDH IN

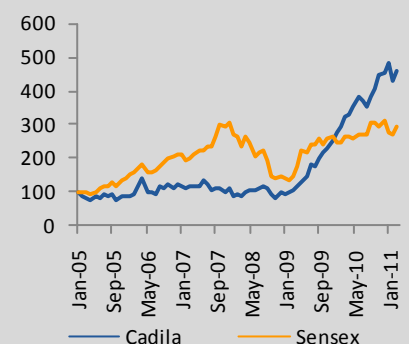
Market Data

Rating	BUY
Price (5 Apr'11) (INR)	801
52 Week Range (INR)	865/ 542
Target Price (INR)	900
Outstanding Shares (Mn)	205
Mkt Cap (INR Mn)	164,004
Mkt Cap (US\$ Mn)	3,678
Daily average volume	90,254

Share Holding Pattern : 31-Dec-2010

Promoter and Promoter Group	74.79%
FII	4.90%
DII	13.75%
Non-Institutions	6.56%

Relative performance to Sensex



We expect the domestic formulations sales to grow at the rate of 17% for the next couple of years. CDH spearheaded several initiatives, which included the launch of new specialty divisions foray into new therapeutic areas, expansion of existing business and launch of new products.

New Launches to Drive Growth

CDH is one of the leading players in the domestic respiratory, cardiovascular (CVS), gastrointestinal (GI) and female healthcare segments. It is the fifth-largest domestic player with a ~3.7% market share, as per IMS ORG. In total, 16 of its brands feature among India's top-300 pharma brands in FY10. From April 2009 to December 2010, CDH has launched nearly 120 products, including 36 first launches. This led to favorable results that were visible from the first nine months of FY11, with ~18% YoY growth this time period..

Exhibit 18: Product Launches in the Domestic Market

	FY08	FY09	FY10	9mFY11
New Products	35	25	30	30
Line Extension	25	30	30	29
First in India	10	15	17	19

Source: Company Filings, MAPE Securities

Focus on Chronic Segment Provides Sales Visibility

CDH's product portfolio is tilted towards the chronic segment (57% of domestic formulations revenues in FY10). With longer treatment periods associated with chronic diseases (vis-à-vis acute diseases), we believe this focus, will drive the overall formulations growth. In recent years, CDH has strengthened its position in this segment through the creation of specialty divisions and a ramp up in field force. CDH formed Zydus Cardiva in FY10 with 300 personnel to focus on urban markets with a range of anti-hypertensive and aspirin combinations. The size of the respiratory sales force was also increased by 100 personnel.

Expansion of Doctor Coverage Through a Large Sales Force

To increase its domestic market share, CDH is focusing on expanding its penetration, especially in semi-urban and rural areas. With a sales force of 4,500 medical representatives (MRs) CDH plans to increase its doctor coverage to 200,000 doctors in the next six to nine months from the current coverage of ~125,000.

US Continues to Outperform

Although CDH's foray into the US market in FY05 was late, its performance has been impressive. With 39 product launches in the US to date, CDH is among the top-20 generic companies in the US. CDH enjoys over ~20% market share in at least 12 products. Sales in the US region have grown at a CAGR of more than 90% between FY06 and FY10 to INR 6.7bn. In 9mFY11, the company launched eight new products (FY11 target is 9-10) and filed for 11 ANDAs. Going forward, the company targets to file for 12-15 ANDAs and seven to eight product launches every year in the US. We project CDH's US sales will grow at a CAGR of ~23% to INR1.3b between FY11 and FY13E.

Exhibit 19: ANDA Filed and Approved

	FY08	FY09	FY10	9mFY11
ANDA Filed	78	92	106	118
ANDA Approved	39	42	54	59
Products Launched	16	25	29	39

Source: Company Filings, MAPE Securities

International Strategy Based on Smart Acquisition: We can divide the opportunities in the generics market of different geographies into two separate categories: developed nations and emerging economies.

A developed market is characterized by: (1) high healthcare costs, (2) strong regulatory systems ensuring robust quality norms for all manufacturers, and (3) deep insurance penetration. These markets are burdened with high healthcare costs due to a slowdown in their economy. Countries that are changing their regulations to bring down costs by promoting generics become more attractive markets for pure generic manufacturers.

Emerging markets are characterized by (1) weak regulatory systems with less stringent quality norms, (2) relatively low insurance penetration, and (3) a large branded generics market created from varied perceptions on the quality of products of different manufacturers. Countries that are witnessing robust economic growth leading to higher disposable incomes are attractive for branded generics.

In conclusion it makes sense to focus on branded generics in emerging markets and pure generics in developed markets. CDH has been following exactly this strategy, which has been validated in their successful integration of Alpharma, France and Nikkho, Brazil.

In France, CDH divested its branded generic business – a key factor that brought about its planned turnaround in FY08. In Brazil, CDH focused on the branded generics market through Nikkho, but focused on the pure generics on its own, thus effecting a robust growth in the Brazilian market. These measures boost our confidence in the CDH management's ability to successfully integrate all of its subsequent acquisitions.

New Product Launches – To Drive Growth in France's Pure Generic Market

CDH has a presence in the French generics market through its acquired subsidiary Zydus France SAS. It is one of the top 10 generics companies in France, holding a 2.7% market share. The overall French generics market was valued at €2.5 bn in 2009, growing at ~15% per annum. The healthy growth is due to patent expiration of many blockbuster drugs such as Pantoprazole, Clopidogrel, etc. In FY10, CDH launched 14 new molecules, including eight day one launches.

Leveraging France Portfolio in the Spanish Market

In FY08 CDH acquired Combix (Spain), a pure generics player. Although Spain is a developed market with low generics penetration, the government is encouraging generics players as healthcare costs are borne by the government/insurance companies. The generics market is growing at more than 20% as compared to 6% for the overall pharmaceutical market. As CDH is already present in the French market with a leadership position, it should not be difficult to gain market share in the Spanish market.

To date, CDH has launched 30 products in this market. Additionally, the company filed for 22 new product dossiers in FY10, providing attractive growth opportunities. We believe that going forward, CDH will ramp up the product filings and product launches, to tap into this less penetrated market.

Generic Opportunities to Unfold in Japanese Market

With a size of nearly US\$80bn, Japan is the second-largest pharma market globally. With the country's rapidly aging population and spiraling healthcare costs, substantial opportunities exist for generic drug manufacturers. Currently, the Japanese generic market is worth US\$3.5bn (penetration is still low).

CDH entered the Japanese market in FY07 through the acquisition of Nippon Universal (which had a manufacturing facility in Japan). To capture the high generics growth in this market, CDH plans to launch in-house products in Japan over the next five years. Currently CDH is following a strategy of in-licensing products and acquiring of brands. With a portfolio of 25 in licensed products, one in-house product in Japan and plans to expand, we believe CDH is well placed to capture incremental opportunities in Japan. We project sales in the Japanese market to grow at a CAGR of 40% between FY11 and FY13, on a smaller base.

Brazil – A Key Market

CDH is present in both the branded and pure generics segments in the Brazilian market. CDH has filed for 60 dossiers for branded and pure generics products and has a portfolio of 25 branded and 14 generics products. With the strong growth prospects in the Brazilian market and plans to launch 8-10 products annually, we expect CDH sales to grow at a CAGR of 20% between FY11 and FY13.

ROW Including South Africa – To Drive Growth

CDH has presence in more than 20 smaller emerging pharma markets (5% of total sales) such as Sri Lanka, Myanmar, Uganda, Taiwan, the Philippines and South Africa. As a leading player in some of these markets, CDH has garnered strong growth in revenues at a CAGR of 17% between FY06 and FY10.

In FY10 sales from these smaller markets declined by 10% due to the shifting of production from Moraiya facility to developed markets from emerging market. With the new dedicated manufacturing facility in Goa (to commence operations in FY12) for the emerging markets, issue of supply constraints will be resolved. So far, it has filed 68 products with SA MCC (South African Agency) and has received approvals for 28 products and launched 20. With a strong focus on the South African pharmaceutical market (Africa's largest and only regulated market), CDH made Simayla Pharmaceuticals a wholly-owned subsidiary in FY10. Leveraging on Simayla's marketing capabilities, CDH is developing a strong product pipeline from India to capture the demand for generic drugs in South Africa. We expect sales from emerging markets to grow at a CAGR of 20% in FY11-13.

Zydus Hospira JV – Provides an Entry into High-Margin Oncology Injectable Segment

Not only will Hospira replace Nycomed's 10% contribution to EBITDA post FY11, we expect Hospira to be a long term opportunity for CDH. As Hospira is a market leader in the supply of injectables to hospitals, it may open a new market for CDH in the form of hospitals. The Hospira JV is exposed to the pricing value of a product. In the generic injectables space, average pricing is 20% of the branded price while it would be less than 10% in other generic space.

While the contract manufacturing segment has been an attractive opportunity for Indian companies (because of its low cost base), the success rate has been far from encouraging. **This is because of a lack of commitment from the innovator, which results in a lack of guaranteed off take. We thus like CDH's strategy of setting up joint ventures with innovators for contract manufacturing deals. Its Nycomed joint venture is the best example. Despite generics entry in Protonix, CDH's sales have not been affected, as the joint venture received additional orders from the authorized generics. This would not have been possible without the involvement of the innovator in the joint venture.**

The Hospira joint venture includes six products in the injectable oncology space. The joint venture will supply formulation to Hospira and Hospira will market the products. However CDH will market the products where Hospira does not have a presence.

Out of the six products, the JV has already begun the supply of three products to Hospira to be marketed in the European region. With the USFDA and Health Canada approving the oncology products facility in FY11, the JV also commenced initial shipments to the US market during Q3FY11. Additionally, management has indicated plans to launch the remaining products in FY12 and FY13. We expect sales from this JV (CDH's share) to grow at a CAGR of more than 50% to INR3.3bn between FY11 and FY13.

Nycomed JV – Expansion to New Products

After the patent expiry of Pantoprazole, the scope of the JV has been expanded to supply intermediates for 14 additional APIs for both patented and generic products. Additionally Nycomed is shifting its entire API production of three products to India (Pantoprazole, Urapidil

and Lornoxicam). The supply of these products will begin from FY12. There are plans to expand the portfolio by adding another 11 APIs in FY12.

We expect sales from Altana JV's APIs to pick up slowly. We expect CDH's share in the Nycomed JV sales to de-grow by 40% (due to patent expiry of Pantoprazole) which is the worst case scenario.

Abbot Out Licensing Agreement – for Branded Generics in Emerging Markets

In Q1FY11, CDH entered into an out licensing agreement with Abbott Laboratories. As a part of this deal, CDH will develop and manufacture 24 generic drugs (in pain management, oncology and cardiovascular), which Abbot will sell under its brand name in 15 emerging markets where it has a strong presence (including Brazil, Russia, Turkey, etc). Abbott has the option to increase the scope of the agreement to 40 drugs. This alliance presents attractive growth opportunities for CDH given the potential for growth in the emerging markets (as discussed in our macro theme). In Q1FY11, as part of the agreement, CDH received a licensing fee of INR 470m from Abbott. We expect sales of INR500m from this alliance in FY12.

Bayer-Zydus JV for Domestic Market:

Cadila entered into a joint venture with Bayer Healthcare in January 2011 to cater to the domestic market. The venture will operate in segments of women's healthcare, metabolic disorders, diagnostic imaging, cardiovascular diseases, anti-diabetic treatments and oncology.

The Bayer-Zydus JV will commence operations with Bayer HealthCare's Pharmaceutical Division contributing its existing sales and marketing business in India to the new company, and Zydus contributing its women's healthcare products, diagnostic imaging business and other products.

Bayer Zydus Pharma's future product portfolio will not only include in-licensed and originator brands, but also patented products from Bayer HealthCare's pipeline.

We have not factored in any revenue from this JV in the next couple of years.

Presence in High Growth Consumer Business through Zydus Wellness

Through Zydus Wellness Ltd (72% holding), CDH has a presence in the rapidly-growing Indian consumer wellness market. With an increasing focus towards health and wellness from Indian consumers, rising income levels and greater product awareness, the Indian consumer healthcare market holds substantial potential for growth. CDH has a considerable distribution network with a team of 500 sales personnel and is market leader in products such as Sugar Free and Nutralite.

Sugar Free: With more than 75% market share, Sugar Free is India's largest selling sugar substitute. The product has witnessed robust sales growth at a 25% CAGR in FY07-10, driven by the increased health consciousness and promotional expenses.

EverYuth: It enjoys a leadership position in domestic peel-offs (~90% market share), scrubs (~65%) and face wash (~14%) with sales growing at a 35% CAGR between FY07 –FY10.

In House Production – To Add margin

CDH has set up a manufacturing facility in Sikkim for 'Sugar Free' and 'EverYuth' (currently being outsourced). We expect this to improve margin along with continuous supply of these products. CDH is expecting sales of INR5bn in FY13 from INR3.5bn in FY11 from the consumer wellness segment. We believe the company is on track to achieve the target given the robust demand for the company's products and strong brand loyalty.

Exhibit 20: Sales Breakdown (INR mn)

	2008	2009	2010	2011E	2012E	2013E
Domestic Formulations Total	10,785	12,342	14,058	16,398	19,187	22,450
<i>% Change</i>		14.4%	13.9%	16.7%	17.0%	17.0%
<i>% of total sales</i>	46.3%	42.2%	38.1%	37.1%	35.8%	35.1%
Domestic Bulk Drug	506	426	318	334	351	368
<i>% Change</i>		-15.8%	-25.4%	5.0%	5.0%	5.0%
<i>% of total sales</i>	2.2%	1.5%	0.9%	0.8%	0.7%	0.6%
Consumers and Others	2,618	3,120	3,948	4,817	5,876	7,051
<i>% Change</i>		19.2%	26.5%	22.0%	22.0%	20.0%
<i>% of total sales</i>	11.2%	10.7%	10.7%	10.9%	11.0%	11.0%
Export formulations	6,465	9,458	12,863	16,075	19,749	23,535
<i>% Change</i>		46.3%	36.0%	25.0%	22.9%	19.2%
<i>% of total sales</i>	27.8%	32.3%	34.9%	36.3%	36.9%	36.8%
US	2,568	3,984	6,715	9,200	11,499	13,799
<i>% Change</i>		55.1%	68.5%	37.0%	25.0%	20.0%
<i>% of total sales</i>	11.0%	13.6%	18.2%	20.8%	21.5%	21.6%
France/Spain	1,647	2,094	2,740	2,740	3,288	3,781
<i>% change</i>		27.1%	30.9%	0.0%	20.0%	15.0%
<i>% of total sales</i>	7.1%	7.2%	7.4%	6.2%	6.1%	5.9%
Brazil	1,230	1,628	1,818	2,227	2,672	3,207
<i>% change</i>		32.4%	11.7%	22.5%	20.0%	20.0%
<i>% of total sales</i>	5.3%	5.6%	4.9%	5.0%	5.0%	5.0%
Japan	50	219	316	395	553	774.2
<i>% change</i>		338.0%	44.3%	25.0%	40.0%	40.0%
<i>% of total sales</i>	0.2%	0.7%	0.9%	0.9%	1.0%	1.2%
Other Markets	1,020	1,752	1,590	1,908	2,290	2,748
<i>% change</i>		71.7%	-9.2%	20.0%	20.0%	20.0%
<i>% of total sales</i>	4.4%	6.0%	4.3%	4.3%	4.3%	4.3%
Revenues from Nycomed JV	668	999	758	606	364	400
<i>% Change</i>		49.6%	-24.1%	-20.0%	-40.0%	10.0%
<i>% of total sales</i>	2.9%	3.4%	2.1%	1.4%	0.7%	0.6%
Revenues from Hospira JV	0	0	839	1,215	2,150	3,375
<i>% Change</i>		NA	NA	44.8%	77.0%	57.0%
<i>% of total sales</i>		0.0%	2.3%	2.7%	4.0%	5.3%
Revenues from Abbot Alliance					500	750
<i>% Change</i>						50.0%
<i>% of total sales</i>					0.9%	1.2%
Bulk Drugs Exports	1,618	2,061	2,642	3,091	3,400	3,740
<i>% Change</i>		27.4%	28.2%	17.0%	10.0%	10.0%
<i>% of total sales</i>	6.9%	7.0%	7.2%	7.0%	6.3%	5.8%
Other Operating Income	585	651	1,127	1,296	1,425	1,497
<i>% Change</i>		11.3%	73.1%	15.0%	10.0%	5.0%
<i>% of total sales</i>	2.5%	2.2%	3.1%	2.9%	2.7%	2.3%
Total Sales	23,295	29,275	36,868	44,227	53,556	63,941
<i>% Change</i>		25.7%	25.9%	20.0%	21.1%	19.4%

Source: Company Filings, MAPE Securities

Exhibit 21: Ratios		(INR mn)						
Particulars	FY06	FY07	FY08	FY09	FY10	FY11E	FY12E	FY13E
Gross Margin	61.7	65.2	66.0	67.3	68.0	69.5	69.0	69.0
EBITDA Margin	14.0	19.3	19.8	20.9	21.9	23.1	22.5	22.5
Net Profit Margin	4.9	11.8	11.2	10.5	13.7	14.8	15.0	15.5
Fixed Asset Turnover	1.8	1.9	1.7	1.7	1.9	2.0	2.3	2.5
Equity Multiplier	1.2	1.1	1.3	1.4	1.2	1.0	0.8	0.7
ROE	10.4	25.0	24.5	24.9	31.0	29.5	27.3	25.9
ROCE	10.4	18.5	17.8	18.8	23.5	26.0	26.0	26.1
Inventory Days	157	220	215	226	229	225	225	225
Debtor Days	48	53	54	60	46	50	50	50
Creditor Days	152	259	166	198	188	180	175	175
Working Capital Cycle	52	14	104	88	88	95	100	100
Debt/Equity	0.6	0.5	0.8	1.0	0.7	0.4	0.3	0.2
Operating Cash flow excluding extraordinary items	1,111	2,431	1,853	3,225	7,363	7,411	8,757	10,636
Capex	-1,223	-2,355	-5,035	-4,069	-3,041	-3,750	-3,750	-3,500
Free Cash Flow	-112	76	-3,182	-844	4,322	3,661	5,007	7,136

Source: Company Filings, MAPE Securities

Financial Summary

Income Statement (INR mn)

Particulars	2009	2010	2011E	2012E	2013E
Net Sales	12,735	15,666	18,498	22,182	26,266
COGS	4,982	6,456	7,492	9,094	10,769
Gross Profit	7,753	9,210	11,007	13,087	15,497
<i>Gross Margin</i>	60.9%	58.8%	59.5%	59.0%	59.0%
<i>Growth %</i>	30.7%	18.8%	19.5%	18.9%	18.4%
Total Operating Exp.	5,074	5,904	7,289	8,632	10,094
Personnal Cost	1,843	2,207	2,664	3,087	3,527
% of Sales	14.5%	14.1%	14.4%	13.9%	13.4%
<i>Growth %</i>	28.1%	19.8%	20.7%	15.9%	14.3%
SG&A Expenditure	3,231	3,697	4,625	5,545	6,566
% of Sales	25.4%	23.6%	25.0%	25.0%	25.0%
<i>Growth %</i>	21.6%	14.4%	25.1%	19.9%	18.4%
EBITDA	2,680	3,306	3,718	4,455	5,403
<i>EBITDA Margin</i>	21.0%	21.1%	20.1%	20.1%	20.6%
<i>Growth %</i>	45.9%	23.4%	12.5%	19.8%	21.3%
Depreciation	392.8	467.4	580.9	677.1	732.1
EBIT	2,287	2,838	3,137	3,778	4,671
<i>EBIT Margin</i>	18.0%	18.1%	17.0%	17.0%	17.8%
<i>Growth %</i>	51.0%	24.1%	10.5%	20.4%	23.6%
Financial Cost	303.9	263.8	259.5	274.5	274.5
Other Income	-736.2	88.1	396.6	25.4	25.4
PBT	1,247	2,663	3,274	3,529	4,422
Tax	240.0	627.2	753.1	741.0	928.6
<i>Tax rate</i>	19.2%	23.6%	23.0%	21.0%	21.0%
Other Extraordinary Items	-101.9				
PAT	905	2,035	2,521	2,788	3,493
<i>PAT Margin</i>	7.1%	13.0%	13.6%	12.6%	13.3%
<i>Growth %</i>	-35.9%	124.9%	23.9%	10.6%	25.3%

Cash Flow (INR mn)

Particulars	2009	2010	2011E	2012E	2013E
Net cash from Operating Activities	1,524	1,913	2,066	2,035	2,671
Net cash from Investing Activities	-1,087	-1,172	-1,805	-1,809	-1,064
Net cash from Financing Activities	-424	-740	457	113	-188
Net Increase or Decrease	13	0	718	339	1,419
Free cash flow	626	533	99	373	1,751

Source: Company Filings, MAPE Securities

Balance Sheet (INR mn)

Particulars	2009	2010	2011E	2012E	2013E
Sources of Fund					
Share Capital	682	682	682	682	682
Res&Surplus	11,670	15,603	21,498	28,718	37,633
Total Shareholders fund	12,352	16,285	22,180	29,400	38,315
Minority Interest	228	392	412	432	452
Secured Loan	10,684	9,782	8,804	7,923	7,131
Unsecured Loan	1,990	1,123	1,011	910	819
Total Debt	12,674	10,905	9,815	8,833	7,950
Current Liabilities & Provisions	6,915	8,661	9,483	11,053	12,885
Provision for Deffered Provision	1,316	1,141	1,255	1,280	1,306
Total Liabilities	33,485	37,384	43,145	50,998	60,908
Uses of Fund					
Fixed Assets	17,436	19,533	21,837	23,956	25,652
Gross Block	22,870	25,578	29,328	33,078	36,578
Depriciation	7,572	8,734	10,200	11,854	13,683
Net Block	15,298	16,844	19,128	21,224	22,895
Work In Progress	1,889	2,482	2,482	2,482	2,482
Investments	249	207	228	250	276
Current Assets,	16,049	17,851	21,307	27,042	35,256
Inventories	6,012	7,504	8,431	10,376	12,389
Sundry Debtors	4,845	4,668	6,035	7,324	8,771
Cash & Bank	2,517	2,507	3,363	5,524	9,722
Loans & Advances	2,237	3,070	3,377	3,715	4,272
Total Assets	33,485	37,384	43,145	50,998	60,908

We initiate coverage with a Buy rating on IPCA as we believe it is uniquely positioned among the midcap generics companies to benefit from both near- and long-term opportunities.

We expect an 18-20% Sales and EBITDA CAGR over FY11-13E, driven by both domestic and export formulations. The domestic formulations business is set to witness a more than industry average growth of 20% over next the two years due to the addition of new products and a shift in product mix towards lifestyle segments. Meanwhile, we expect export formulations to grow due to a recovery in the Russian market, the filing of new products in the European countries that are approved in the UK, the launch of more products in the US market (once Indore SEZ is approved) and an increase in sales of generic co-artem (artemether/lumefantrine) to African countries.

Investment Rationale

The outlook for IPCA remains robust with a diversified business model and several growth triggers such as:

Domestic Formulations to Grow: We expect domestic formulations (39% of total sales) to continue to grow at a healthy 20% based on

- new products introduction in the lifestyle disease segment.
- increased focus on individual brands through the creation of more divisions for existing products
- gaining entry into the newer cities
- an increase of sales force from 2,500 to 5,000 over the last two years.

Traditionally, IPCA is regarded as a company that uses simple technology; however, IPCA is now making a concentrated effort to focus more on complex technologies such as combination drugs and controlled releases. In the domestic market, IPCA has increased its product basket from anti malaria to cardiovascular and CNS.

International Branded Generic Formulations (11% of total sales) should continue to grow on account of higher GDP growth in geographies such as CIS and Africa. The increase in oil price is helping the Russian market to stabilize and the company expects more than 20% growth in the CIS/Russian region.

Europe Pure Generic Formulations (15% of total sales) should grow at 15% for the next three years, driven by an increase in penetration resulting from IPCA expanding the list of generics that are supported by its own APIs. Dossiers developed by the company approved in UK are being taken for MRP registration in other EU countries.

US Generics – To Contribute Significantly from FY13: IPCA is expected to generate revenue of INR100m from the US market in FY11 through a marketing partnership with Ranbaxy. IPCA has set up a new formulation manufacturing facility that meets US regulatory requirements at a special economic zone near Indore, with an initial capital outlay of INR1,500m. The company is awaiting inspection from USFDA for Indore SEZ, but it has already received approval from UK MHRA for this facility.

Expanding Leadership in APIs: International APIs (18% of total sales) should grow as IPCA adds more generics customers and files for new (yet to expire) products. In the international market, IPCA is using non-infringing process patent for APIs such as clopidogrel, metoprolol succinate, valsartan, glimepride, carvedilol and tramadol.

Initiating Coverage

April 6, 2011

BBG code : IPCA IN

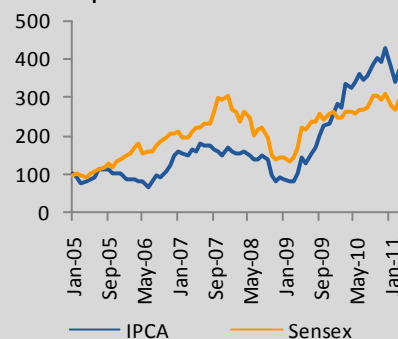
Market Data

Rating	BUY
Price (5 Apr'11) (INR)	300
52 Week Range (INR)	352/ 228
Target Price (INR)	360
Outsanding Shares (Mn)	126
Mkt Cap (INR Mn)	37,718
Mkt Cap (US\$ Mn)	846
Daily average volume	132,123

Share Holding Pattern : 31-Dec-2010

Promoter and Promoter Group	46.09%
FII	9.43%
DII	22.79%
Non-Institutions	21.69%

Relative performance to Sensex



Few MNCs have applied for ANDA approvals on IPCA's API and company expects to earn \$10m from this in next couple of years. In ten APIs, IPCA is ranked amongst the top three producers in the world, and it aims to expand its leadership to 25 APIs.

Co-artem – A High Margin Low Competition Opportunity: IPCA's anti-malarial finished dose combination formulation (Artemether+Lumefantrine) has been approved under the WHO pre-qualification, making it the fourth company to be approved. IPCA will generate revenue of INR750m in FY11 and INR1500m in FY12 from this opportunity. According to management, the margins in this business are the highest among all of IPCA's businesses.

Attractive Valuation: While we have factored a lower EBITDA margin of 20% for FY12 and FY13 (as against management guidance of 21%) due to an increase in sales force and expenses at Indore SEZ, the robust growth in high margin formulations sales indicates a strong likelihood of a better margin. In addition, sales from US generics and anti malarial drugs will come without any significant incremental capex. In summary both margins and ROCE are likely to grow for the company that is trading at an attractive valuation of 13.5x PE on our FY12 estimates (40% discount to large caps). Our 12-month target price of INR360 implies a forward PE of 16x FY12 EPS of INR21.9.

Investment Basis

Domestic Formulations – Continued Robust Performance: After having grown at a CAGR of 15% in the last three years through increasing numbers of divisions and sales force, IPCA will now consolidate its position in FY12. IPCA currently has eleven marketing divisions and a sales force of 5,000, however it will now focus on improving the productivity of these increased divisions and sales force. We expect IPCA to continue posting better than industry performance with a growth rate of 20%, which might be conservative given management's guidance of 22% growth in FY12. IPCA is planning to launch six to eight products annually for the next two years, which should lead to a higher EBITDA margin, as IPCA will leverage its sales force. IPCA's four brands - HCQS, Lariago, Raptiher and Perinorm - are among the top 300 brands in the domestic market. IPCA is a leader in Lariago and sells the product at a mid price (Exhibit 22).

IPCA is currently ranked 27th by ORG-IMS in the domestic market, with a leadership position in anti-malarial and rheumatoid arthritis (RA). With active efforts from the company, contribution from non-malarials products has increased with cardiovascular and diabetes being the largest contributor (Exhibit 23).

IPCA increased its Sales force from 2500 to 5000 in the last couple of years. This increase is to call on more doctors and chemists in Tier II and Tier III cities and to expand its geographical reach. Productivity per employee was INR 2.0m which has come down to INR 1.4m due to increase in sales force. Nevertheless productivity per employee will reach INR 2.0m in the next couple of years, which means IPCA's domestic market sales will reach INR 10b in the next two years from the current INR 7bn.

New products launched by the company in the last five years have accounted for 15% of its total domestic formulations sales and the segment's future growth is expected to be driven by increasing penetration and the launch of its niche NDDS products. Currently, IPCA has 19 ongoing NDDS projects in the pipeline.

Exhibit 22: IPCA Pricing Strategy of Lariago (500 mg)

BRAND NAME	INR/ 10 units	Marketer
QUINEX	120.8	Intra Labs
MALABEST	20.0	Talent Laboratories
MALAQVIN	18.6	PCI Pharmaceuticals
LARIAGO	13.3	IPCA Laboratories
RESOCHIN	12.1	Bayer (India)
QUINROSS	12.1	Merind
PARAQUIN	12.1	Shreya (Plethico Pharmaceuticals)
MALARBIN	12.1	Acron Pharmaceuticals
QUINOWIN	12.1	Taurus Laboratories
CHLOROLEX	11.7	Lexica Drugs
E - VIVAX	10.7	Themis Pharmaceuticals
LARQUIN	10.4	Lark Laboratories
CLOQUIN	10.4	Indoco Remedies
EMQUIN	10.4	E.Merck (India)
NIVAQUINE - P	6.0	Nicholas Piramal

Source: Patient India, MAPE Securities

Exhibit 23: Therapeutic Distribution

Therapeutic Segment	FY07	FY08	FY09	FY10
Cardiovasculars & Anti-diabetics	27.0%	28.0%	29.0%	28.0%
Non Steroidal anti-inflammatory drugs	20.0%	23.0%	24.0%	26.0%
Anti-malarials	22.0%	17.0%	17.0%	17.0%
Anti-bacterials	12.0%	11.0%	10.0%	10.0%
Gastro Intestinal Products	7.0%	8.0%	7.0%	7.0%
Neuro Psychiatry	4.0%	4.0%	4.0%	4.0%
Cough preparations	3.0%	3.0%	4.0%	3.0%
Dermatology	3.0%	3.0%	3.0%	3.0%
Others	2.0%	3.0%	2.0%	2.0%
Total	100.0%	100.0%	100.0%	100.0%

Source: Company Filings, MAPE Securities

International Branded Formulation – Russia Key Growth Driver: Branded formulations sales, which accounted for 12% of the total sales grew at a healthy CAGR of 23% over the FY07-09 period, but declined 23% Y-o-Y in FY10. Nevertheless, the segment's growth is likely to improve with the Russian market improving due to higher oil prices and more products expected to be launched, going forward. The company is focusing on brand building in the pain, CVS, CNS, anti-infective and anti-malarial segments. Furthermore it plans to geographically expand in the countries it currently covers through additional field force, enter into newer geographies – (South & Central American and West African countries) and introduce new products. The company has identified around 50 existing developed formulations for registration and launch across all continents.

Europe Generics: Europe is currently, the key contributor to IPCA's export formulations sales (22% of total sales). The company's aggressive filings will enable it to ramp up revenue in the European market. Out of the 45 dossiers registered by the company in Europe, 29 dossiers have been approved and an additional 24 molecules are under development. The company is filing product registrations in European countries that are already approved in UK markets, and it has also filed its own dossier in Portugal. Most of the formulations registered in the European market are backed by its own API. IPCA is also looking at contract manufacturing arrangement with few innovator companies.

International generics – US to be the next growth driver: IPCA has already launched seven products in US markets with marketing partners such as Ranbaxy, Heritage and one more partner, and it is looking for more partners in US markets. IPCA has approvals for 13 products and has filed 22 ANDAs, but it has not been able to launch the remaining product due to capacity constraint. However, once the Indore SEZ obtains the approval IPCA will launch more products (IPCA is expecting the inspection in the next three months). IPCA has its own API for most of the products approved in the US and it plans to file about 10-15 ANDAs in FY12. We expect the company's US business to pick up significantly, but only after the approval of its Indore SEZ facility. IPCA will clock revenue of INR900 m from the US market in FY11, which will increase to INR 2 bn in FY13.

Co-artem – A Long Term Opportunity: IPCA started supplying co-artem to African nations in FY11, and we expect it to generate revenue of INR750m in FY11 and INR1.50bn in FY12 from this opportunity. Novartis, Cipla and Ajantha are the other competitors in this product, though Cipla and Ajantha do not have their own API for this product and they sometimes source it from IPCA. IPCA doesn't see any other competitor for the next three years as no one has filed for approval of this product. The margins for this product are the highest among all of IPCA's businesses

International API: In the intermediate and API business, IPCA reported revenues of INR4.6 bn in FY10, with a strong growth of 30% Y-o-Y however, in the first nine months of FY11 the growth has come down to 10%. The company's API exports business was driven by strong sales from its US and European Union (EU) clients who received ANDA approvals. IPCA has also entered into a long-term business agreement with some MNC Pharma companies for manufacturing their late Phase III products. The company has signed a contract with a multinational and expects revenues to begin from FY12 onwards, which could trigger a strong growth in the API business. We believe that going forward; the company will maintain its strong growth momentum and continue moving up the value curve, with an increase in the proportion of formulation sales.

A Better Sales Mix Might Lead to Improvement in Margin: An increase in formulations sales (domestic and branded international) had a significant positive impact on the overall company margin. In addition phasing out of low margin intermediate sales helped to give the margin a boost. However, management maintained its guidance of 21% EBITDA margin for FY12. While our conservative estimates have not factored this improvement, there is a strong likelihood of it happening.

Exhibit 24: Formulations & API Sales Breakdown							(INR mn)
Particulars	FY07	FY08	FY09	FY10	FY11E	FY12E	FY13E
Domestic Formulation	3,540	4,319	4,766	5,978	7,114	8,537	10,245
<i>% Growth</i>		22.0	10.4	25.4	19.0	20.0	20.0
<i>% of Total Sales</i>	38.9	41.4	37.7	38.7	38.7	38.7	39.2
Export Formulation	2,732	3,420	4,372	4,892	6,499	8,278	10,124
<i>% Growth</i>		25.2	27.8	11.9	32.9	27.4	22.3
<i>% of Total Sales</i>	30.1	32.8	34.6	31.6	35.4	37.5	38.8
Total Formulation	6,272	7,739	9,138	10,870	13,614	16,815	20,369
<i>% Growth</i>		23.4	18.1	19.0	25.2	23.5	21.1
<i>% of Total Sales</i>	69.0	74.3	72.2	70.3	74.1	76.3	78.0
Domestic API	707	741	1,083	1,416	1,430	1,574	1,731
<i>% Growth</i>		4.9	46.2	30.7	1.0	10.0	10.0
<i>% of Total Sales</i>	7.8	7.1	8.6	9.2	7.8	7.1	6.6
Export API	2,113	1,943	2,432	3,169	3,328	3,661	4,027
<i>% Growth</i>		-8.0	25.2	30.3	5.0	10.0	10.0
<i>% of Total Sales</i>	23.2	18.6	19.2	20.5	18.1	16.6	15.4
Total API	2,819	2,684	3,516	4,586	4,758	5,234	5,757
<i>% Growth</i>		-4.8	31.0	30.4	3.8	10.0	10.0
<i>% of Total Sales</i>	31.0	25.7	27.8	29.7	25.9	23.7	22.0
Total Sales	9,091	10,422	12,653	15,456	18,372	22,049	26,126
<i>% Growth</i>		14.6	21.4	22.1	18.9	20.0	18.5

Source: Company Filings, MAPE Securities

Debt, Working Capital and Capex: The Company has debt of INR 4,500m that will remain constant for the next couple of years. IPCA has a working capital cycle of 170 days. 90 days inventory, 90 days debtors and 10 days of creditors. IPCA normally pays for the material in cash to avail cash discounts. Debtor days in India and the US are 30 days; however, it's higher in API and other branded generic markets like Russia. IPCA has guided for capex to be of INR150-200 bn in the next couple of years, which will mostly be allocated for Sikkim and Baroda plant – both green field projects.

Exhibit 25: Formulations, Breakdown by Country								(INR mn)
	FY07	FY08	FY09	FY10	FY11E	FY12E	FY13E	
Domestic	3,540	4,319	4,766	5,978	7,114	8,537	10,245	
<i>% Growth</i>		22.0	10.4	25.4	19.0	20.0	20.0	
<i>% of Formulations Sales</i>		55.8	52.2	55.0	52.3	50.8	50.3	
Europe	1,191	1,873	1,741	2,483	2,856	3,284	3,777	
<i>% Growth</i>		57.2	-7.1	42.7	15.0	15.0	15.0	
<i>% of Formulations Sales</i>		24.2	19.1	22.8	21.0	19.5	18.5	
America	12	34	242	664	929	1,208	1,812	
<i>% Growth</i>		184.9	615.0	173.8	40.0	30.0	50.0	
<i>% of Formulations Sales</i>		0.4	2.7	6.1	6.8	7.2	8.9	
CIS	691	557	1,023	658	724	869	1,042	
<i>% Growth</i>		-19.4	83.7	-35.6	10.0	20.0	20.0	
<i>% of Formulations Sales</i>		7.2	11.2	6.1	5.3	5.2	5.1	
Asia	170	204	177	173	194	217	243	
<i>% Growth</i>		20.3	-13.3	-2.4	12.0	12.0	12.0	
<i>% of Formulations Sales</i>		2.6	1.9	1.6	1.4	1.3	1.2	
Africa	628	696	1,099	794	913	1,050	1,207	
<i>% Growth</i>		10.9	57.8	-27.8	15.0	15.0	15.0	
<i>% of Formulations Sales</i>		9.0	12.0	7.3	6.7	6.2	5.9	
Australasia	41	55	90	120	135	151	169	
<i>% Growth</i>		36.8	63.0	33.0	12.0	12.0	12.0	
<i>% of Formulations Sales</i>		0.7	1.0	1.1	1.0	0.9	0.8	
Co-artem					750	1,500	1,875	
<i>% Growth</i>						100.0	25.0	
<i>% of Formulations Sales</i>					5.5	8.9	9.2	
Total	6,272	7,739	9,138	10,870	13,614	16,815	20,369	
<i>% Growth</i>		23.4	18.1	19.0	25.2	23.5	21.1	

Source: Company Filings, MAPE Securities

Exhibit 26: Ratios								(INR mn)
Particulars	FY06	FY07	FY08	FY09	FY10	FY11E	FY12E	FY13E
Gross Margin	43.8	56.8	56.9	61.2	59.1	59.5	59.0	59.0
EBITDA Margin	15.3	21.5	17.6	21.1	21.2	20.2	20.2	20.7
Net Profit Margin	8.5	13.3	13.5	7.1	13.1	13.7	12.6	13.4
Fixed Asset Turnover	2.0	2.1	1.9	2.1	2.3	2.3	2.4	2.8
Equity Multiplier	1.0	0.9	0.9	0.9	0.8	0.7	0.7	0.6
ROE	16.6%	25.8%	23.9%	14.3%	23.5%	23.0%	20.5%	20.7%
ROCE	15.5%	23.7%	16.1%	21.0%	21.5%	19.4%	19.8%	20.9%
Inventory Days	156	214	208	221	212	208	208	208
Debtor Days	68	71	92	96	90	90	90	90
Creditor Days	49	61	53	47	39	40	40	40
Working Capital Cycle	175	224	248	270	263	258	258	258
Operating Cash Flow	1,212	1,154	1,060	1,524	1,913	2,066	2,035	2,671
Capex	-779	-895	-1,438	-898	-1,341	-1,788	-1,792	-1,046
Free Cash Flow	433	260	-378	626	572	278	243	1,625

Source: Company Filings, MAPE Securities



We initiate coverage of Torrent Pharma with a Buy rating driven by the potential of the company in delivering sustainable performance in the near as well as long term. Torrent has one of the best portfolios in the Indian market and the addition of gynecology and respiratory therapies to its portfolio should take Torrent on a different trajectory. We expect its domestic formulation segment to grow at around 17% for the next two years. Its international revenues (over 50% of total revenues) should continue to grow on the back of its strategic tie up with Astrazeneca (and one more MNC for emerging markets) along with its growing presence in emerging countries such as Brazil, Mexico and Thailand.

Investment Rationale:

Domestic Formulations: We expect Torrent Pharma’s domestic sales to grow at around 17% for the next two years, higher than the industry rate of 14% on the back of:

- Torrent’s entry into rural markets and its strategy of different pricing and branding from urban markets
- Entry into new therapy areas such as gynecology and respiratory
- An increase in sales force from 2,400 to 3,600 which would provide better reach to doctors across widening urban areas and rural areas

Rural India: Torrent aims to have a pan India presence and thus has taken the initiative to cater to rural India with therapy focus in anti-infective and pain management. The company has increased its sales from 2,200 to 3,600 in the last couple of years and has set up a different division for rural markets. It will sell the products at different prices and under different brand names from the urban areas. However, margins in the rural areas would remain low.

Entry into new therapy areas: The company has forayed into the gynecology segment and has plans to enter the respiratory segment. At present, the company will only market gynecology products and its manufacturing will be outsourced, but going forward, it will set up a manufacturing facility.

International Branded Generic – Widening Presence: Branded generics form around 25% of Torrent Pharma’s total revenue and we expect the branded generics segment to grow by around 19% over the next two years. Brazil forms around 17% of total revenues and is expected to grow at 20% for the next two years. It seems to be strategically focused on the branded generics segment and accordingly has plans to expand to Sri Lanka, Myanmar, Mexico, Thailand and Canada. In Mexico, its therapy focus remains on CVS and CNS and it has launched six products with a field force of 35 people. In future years, it will be these mid-sized emerging economies which will provide further growth opportunities for branded generics, giving Torrent Pharma an edge over the other players due to its early entry into these markets.

Strategic Tie up with Astra Zeneca: In 2010, the company entered into a strategic tie-up with Astra Zeneca for 18 products in 19 emerging countries (where by AstraZeneca will sell the products under its brand name), from which revenue will start flowing in late FY12. In addition, the company has also entered into a contract with another MNC (whose name it has not disclosed). We believe such tie ups for the supply of products to emerging markets will boost its revenue growth in the future.

Presence in the Pure Generics Market: Around 26% of its revenues come from Europe and US. The launch of new products and the expansion of therapy areas in the European market, together with its entry into the US market (the largest generics market) will augment its revenue growth from pure generic markets.

Initiating Coverage

April 6, 2011

BBG code : TRP IN

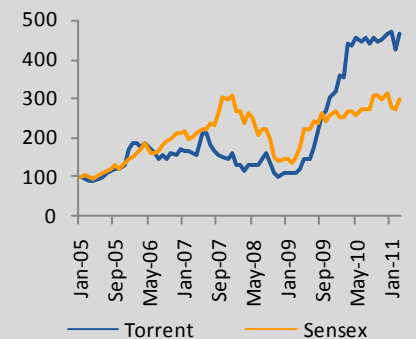
Market Data

Rating	BUY
Price (5 Apr'11) (INR)	569
52 Week Range (INR)	654/ 488
Target Price (INR)	655
Outstanding Shares (Mn)	85
Mkt Cap (INR Mn)	48,189
Mkt Cap (US\$ Mn)	1,081
Daily average volume	47,500

Share Holding Pattern : 31-Dec-2010

Promoter and Promoter Group	71.51%
FII	3.33%
DII	13.03%
Non-Institutions	12.13%

Relative performance to Sensex



We expect revenues from these markets will grow at around 17% for the next two years.

Contract Manufacturing: Torrent Pharma has extended its manufacturing contract with Novo Nordisk for the next ten years, garnering stable revenues each year. With human insulin being a growing market in India (at over 30%), revenues from contract manufacturing might also see an increase. We expect the growth from contract manufacturing will be around 15% in the next two years; however margins remain lower than the consolidated EBITDA margins.

Valuation: We expect 18-20% growth in FY12 sales, EBITDA and EPS. Additionally, we see visible earning post FY12, due to the AstraZeneca tie-up.

At the current price of INR569, Torrent trades at an attractive PE of 14x FY12 EPS at almost a 20% discount to its peers. With an 18% earnings CAGR over FY11-13E (one of the best among comparable peers), one of the best in class return ratios (RoCE and RoE over 20%) and a healthy balance sheet (Net debt – zero), we believe the valuation discount to its peers should narrow over time. We value Torrent at 16x FY12E earnings based on the above mentioned positives, to arrive at a target price of INR655.

The company has been free cash flow positive for the last three years in spite of having capex of around INR 340bn in the same time period. The company has capex plans of INR 10 bn for the next five years but we still expect the company to be free cash flow positive for the coming years.

Investment Basis:

Strengthening its presence in domestic formulations with entry into new therapy areas and rural India

Strong Focus on Lifestyle Segment: The Indian formulations business has been growing at a CAGR of 14% over the last four years and has a market size of INR 417 bn. Torrent Pharma has one of the best portfolio (among Indian pharma players) having presence in the high growth lifestyle segments such as cardio vascular, central nervous system, diabetes, gastro-intestinal and in other areas of anti-infective and pain management. The chronic therapy areas contribute around 62% of the company's revenues. Torrent is one of the leading players in the areas of cardio vascular (No 2 position) and CNS (No 3 position). The Exhibit (27 and 28) below shows that Torrent Pharma's top leading brands are the most expensive products in their respective product categories, indicating that Torrent Pharma is not playing a volume game by selling products at low prices.

Exhibit 27: Alprax - CNS (Alprazolam) Pricing Strategy (0.5 mg)

Brand Name	INR/ 10 units	Marketer
KAPROLAM	9.5	Karnataka Antibiotics
ALRIF	10.0	Intra Labs
TRANISOL	10.6	Glenmark Pharmaceuticals
ZOZO	10.9	Globus
NITRIL	11.0	Core Healthcare
QUIET	11.4	Ind - Swift
ZOPIC	11.6	Centaur Laboratories
ALMAX	11.9	Anthus Pharmaceuticals
MALCOZ	11.9	Ashok Pharmaceuticals
PROCALM	12.0	Novamed
WELNORM	12.0	Bestochem Formulations
TENSYL	12.8	Bal Pharma
ZENAX	12.9	Dr. Reddy's Laboratories
BIO ZOLAM	13.5	Bio - Drug Laboratories
SOWEL	13.5	Indoco Remedies
ALPRAX	37.4	Torrent Pharmaceuticals

Source: Patient India, MAPE Securities

Exhibit 28: Dilzem – CVS (Diltiazem) Pricing Strategy (60 mg)

Brand Name	INR/ 10 units	Marketer
DILTIME	21.1	Zydus Cadila
DILTP	22.9	Taurus Laboratories
DZ	24.3	Sunij Pharma
DILTIAZ	27.3	Shreya (Plethico Pharmaceuticals)
DILTER CD	29.0	Sun Pharmaceuticals
KAIZEM CD	30.0	Wockhardt
CARDIOREX	30.2	Ashok Pharmaceuticals
DICARD	30.6	Intas Pharmaceuticals
DTM	31.5	Biochem Pharmaceutical
MASDIL	35.2	Lupin Laboratories
DILGARD	36.0	Cipla
CHANNEL	36.0	Microlabs (Cardicare Division)
DILCOR	36.7	Mano Pharmaceuticals
DILCARDIA	37.8	J.B Chemicals & Pharmaceuticals
ISKI	37.8	Stadmed
DILZEM	57.1	Torrent Pharmaceuticals

Source: Patient India, MAPE Securities

Increased Sales Force to Improve its Reach in the Urban and Semi-urban Markets: After seeing moderate growth of around 7% in domestic sales for FY08 and FY09 - primarily due to the high attrition rate of sales personnel, the company has taken corrective actions and has subsequently increased the sales force from 2,200 to 3,600 in the last couple of years. They have also added to the field force for the CNS and diabetes portfolio in the urban and semi-urban market to make more calls to the same physician and also to explore newer areas as urban cities are becoming bigger and bigger. On account of the increase in the sales force, the company's margins might be affected in the near term. We expect its EBITDA margins to remain at 20% (200bps lower than in FY10) similar to Q3FY11, as in this quarter the increase in sales force has already been reflected.

Rural Market – Will Torrent be Successful with Different Pricing Strategy?: In order to be a pan India pharma player, the company forayed into rural India by expanding its reach to smaller cities. It has launched a separate dedicated division for the rural markets and will be

focusing on anti-infective and pain management areas. For the rural markets, it will be following a different pricing strategy than the strategy for urban markets and the same molecules will be sold under different brand names in each market. The different pricing strategy for the rural market might work in its favor because rural markets are dominated by pure generics that are sold at extremely low prices. However, with a rise in sales force for rural markets and the lower pricing of products, the margins should decline in the near term. Torrent might face problems in gaining market share in the rural markets as this market is predominantly dominated by unorganized players. These players have dominance in their respective territories, and have a better reach with the doctors due to local representatives and sell pure generics at minimal prices. The Exhibit (29 and 30) below indicates the prices of generics in the anti-infective area, primarily for the urban market. Players targeting the rural market will have to reduce their prices substantially in order to remain competitive with the local players who enjoy a strong dominance in rural areas.

Anti Infective

Exhibit 29- Qunitor – Anti Infective (Ciprofloxacin) Pricing Strategy (750 mg)

Brand Name	INR/ 10 units	Marketer
BAYCIP	101.5	Bayer (India)
CIPRODAC	101.6	Cadila Pharmaceuticals
CIPROBID	101.6	Zydus Cadila
CIFRAN	119.1	Ranbaxy
QUNITOR	99.8	Torrent Pharmaceuticals
ABACT	100.7	Sarabhai Chemicals
CIFOMED	70.0	Aglowmed Limited
CIFRAN	137.3	Ranbaxy
CEPLOX	55.0	Mimec Pharma
COFLOX	59.5	Macleods Pharmaceuticals
CIPRODEX	60.0	Parenteral Drugs
CIPROQUIN	101.3	Kramer
CEBRAN	61.0	Blue Cross Laboratories
CIPROLAR	62.0	Lark Laboratories
CIPROLET	63.0	Dr. Reddy's Laboratories

Source: Patient India, MAPE Securities

Exhibit 30: Droxyl – Anti Infective (Cefadroxil) Pricing Strategy (125 mg)

Brand Name	INR/ 10 units	Marketer
NESDROX	10.2	Nestor Pharmaceuticals
DROXYL	10.3	Torrent Pharmaceuticals
CEFADUR	10.6	Cipla (Protec Division)
WALADROX	10.6	Wallace Pharmaceuticals
ZADRO	11.1	FDC
ACUDROX	12.9	Macleods Pharmaceuticals
SUNIDROX	13.8	Sunij Pharma
DAX.LA	30.0	DWD Pharmaceuticals
Q CEPH	18.0	Emcure Pharmaceuticals
KIDROX	18.0	Cadila Newgen
CETRON	18.1	CFL Pharmaceuticals (Cosme Healthcare Division)
CEFOXIL	18.2	Bal Pharma
VISTADROX	18.2	Cadila Pharmaceuticals
MODCEF	18.3	Nicholas Piramal (Sarabhai Piramal)
MONODROX	18.8	Profic Organic

Source: Patient India, MAPE Securities

Continued Focus on Lifestyle Segment with Entry into Gynecology and Respiratory: Torrent Pharma plans to expand in the domestic market by adding new therapy areas to its portfolio and launching new products in the market. In FY10, it forayed into gynecology and launched eight products in that year. Initially, it will focus on the obstetrics and gynecology market and aims to have a basket of 19 products in FY11. Currently, the company will only market gynecology products and will outsource its manufacturing, but going forward, the company plans to develop its gynecology portfolio in-house. The gynecology market in India remains an attractive opportunity and has a market size of INR 24 bn and is growing at 18%. However, being a new entrant, it may take some time for Torrent Pharma to get a foothold in the gynecology market, but the move will definitely benefit its top line growth since it is a growing market in India. The company also has plans to foray into the respiratory area.

Presence in the Branded Generics Market:

Branded generics forms around 25% of the total revenues of the company and will grow at around 19% for the next two years with growing presence in Brazil and entry into growing emerging markets such as Mexico and Thailand. Having expertise in the chronic therapy areas such as CVS and CNS, Torrent Pharma is focusing on the same therapy areas (chronic therapy) for its international markets as well, and extending its current portfolio of therapies to these markets. Torrent Pharma is wisely expanding into mid size and growing markets such as Mexico, Thailand and South Africa, which will provide it with an edge over other players in the long term.

Brazil Continues to Boost Growth for its Branded Generics Portfolio: Brazil's pharmaceutical market is one of the largest emerging markets with size of around \$12bn, growing at a five year CAGR of 15%. Torrent has a portfolio of around 28 products in the areas of CNS and CV with a sales force of 450 people. It enjoys a market share of 7% in its covered market of US \$1bn. This covered market is growing at 14% and the company plans to launch 35-40 new products by 2014-15, which will further augment its revenues from Brazil. We expect revenues from Brazil to grow at around 20% for the next couple of years.

Expanding into the Emerging Markets having High Growth Potential in Future: Torrent seem to be strategically focused on the branded generic story and accordingly has plans to expand its presence in Mexico, Sri Lanka, Myanmar, Thailand, Philippines and a few other countries. Mexico is a promising branded generics market with a size of US\$9 bn. In Mexico, the company has launched six products in the CNS portfolio with a field force of 35 people. It is planning to launch more products in the CVS portfolio in FY10 and in the next four to five years the portfolio will be expanded to 30 products with a field force of 200 people. It will also expand in its existing territories of Sri Lanka, Myanmar and Philippines. In the coming future, Torrent Pharma will also focus on regulated markets such as Australia and semi regulated market like South Africa. Currently, most of the players are focusing on the BRIC emerging countries for growth in branded generics, but in the later years, it will be these mid size emerging countries where the companies will have to shift their focus for further growth opportunities. An early entry into these markets will give Torrent Pharma an edge over the other players in the future.

Presence in the Pure Generics Market:

Pure generics contribute around 26% of the total revenues of the company and we expect it to grow at around 17% over the next two years on account of its entry into the US market and the strengthening of its foothold in the European markets by launching new products and extending its therapy areas. Formerly, Europe was a significant region for Torrent Pharma for its international operations, as it had acquired Heumann Pharma from Pfizer in 2005 in Germany, the largest growing market in Europe at that time. However, the stringent regulations regarding the pricing of the products and the conversion to a tender based market in 2008 hampered the growth of many pharma players in the European market. Compared to other players though, Torrent Pharma recovered faster from the crisis and was able to come back to a growth trajectory. Its revenues from Europe increased to INR 1400m in FY10 from 380m in FY07.

A Late Entrant into the US Market: Torrent Pharma entered the US market in 2008, by which time most of the Indian pharma players had gained a foothold in the US generic market by grabbing many Para IV opportunities. However, the size of US generic market would provide huge volume growth opportunities to the low cost generic players. As of Dec 2010, the company had 25 ANDA approvals, of which it has launched 11 products. The company is awaiting approval of 28 ANDAs and 40 are under development. Torrent is expecting to reach a breakeven level in the US market in FY12 and has three-four Para IV opportunities but they are shared with six seven other players. We believe Torrent will grow at around 30% in the US market on a low base for the next couple of years in the US. However, it's to be seen that being a late entrant into the US market, how well can the company capitalize on the opportunities in US, a strong competitive generic market.

Europe: Europe (excluding Germany) accounts for around 7% of the total sales of the company. In Europe, the company plans to expand through dossiers out-licensing, product supply contracts with MNC players and the addition of new products to its portfolio. Torrent Pharma plans to launch 50 products from now to 2014-15. The company also has plans to expand in the UK and Romania which is the fifth largest pharmaceutical market in Central and Eastern Europe with a size of over US\$ 2.8bn. We expect revenues from Europe (excluding Germany) would grow at around 15% for the next two years.

Stringent Regulations Will Continue to Moderate Growth from Germany: Though Germany's generic market is severely hampered by the tender based pricing, Torrent Pharma has still managed to perform better there than the other players. In response to the regulation of tender based pricing introduced in 2007, the company shifted its manufacturing to India in 2008 and restructured its sales force from 120 people to 12 people which helped it to sustain its operations in Germany. We expect Germany will continue to grow at 10% but margins will continue to remain low (PBT margins at around 8%). Torrent Pharma has won five tenders and expects the number to improve in the coming years with the advantage of low cost manufacturing in India.

Strategic Tie Ups: In 2010, AstraZeneca tied up with Torrent Pharma for the supply of 18 generics products for 19 emerging markets (nine countries in the initial stage) including Latin American markets. Torrent has already received INR 100m from AstraZeneca as licensing income in Q2FY11 and there will be more licensing income in FY12. The supply of the products will start from Q4FY12 and will pick up in FY13. With 18 generic products being supplied by Torrent Pharma, we expect the revenue from the tie up to be around INR 1,000m in FY13, which means for the next two years, each product should generate INR 6m in every country (nine countries in the initial stage). Going forward, the revenue from this tie up will increase significantly on account of its exposure to the emerging markets. Torrent has also done a similar type of tie-up with one more MNC (the name has not been disclosed) and is in talks with innovator companies for contract manufacturing tie-ups for the products that are going off-patent. Such contracts for the supply of generics to emerging markets would be an attractive source of revenues for the company.

Contract Manufacturing: Torrent Pharma has a contract for supplying human insulin to Novo Nordisk since 1992 for its Indian operations. Novo Nordisk has extended the contract for the next ten years and Torrent Pharma has set up a facility of human insulin with a capacity of 26m vials p.a. at Indrad, Gujarat. Contract manufacturing will continue to corner stable revenues for the next ten years and with growing human insulin demand in India, we expect contract manufacturing to grow at around 15% for the next two years. The human insulin market in India is about US \$80m and is growing at over 30%.

Capex Plans of the Company: In FY10, the company commissioned a new injectable formulation facility (for INR 450m) for human insulin for its contract manufacturing with Novo Nordisk. The company has completed expansion of its API and formulation capacity at Chatral Plant in Gujarat, incurring capex of INR 1,690m. The capacity at these plants was increased to meet the growing demands in its international markets of US and Europe. Further, the company is also setting up a formulation facility at SEZ Dahej for INR 8,000m, on which work

has already been initiated. It is setting up a new formulations plant at Sikkim for INR 1,350m and expects it to be operational in FY12. This plant will primarily cater to the domestic market.

In summary, Torrent Pharma plans to incur capex of around INR 10bn over the next five years including its facility at SEZ. However, these robust expansion plans will not hurt its margins since it is a cash rich company and therefore, we don't expect it to raise a high level of debt to meet its robust expansion plans.

Exhibit 31: Formulations Country wise Breakup (INR mn)

	FY07	FY08	FY09	FY10	FY11E	FY12E	FY13E
Domestic Sales	5444	5813	6240	7260	8494	9938	11528
<i>% of Growth</i>	22.0%	7.0%	7.0%	16.0%	17.0%	17.0%	16.0%
<i>% of Total Sales</i>	43.0%	44.0%	38.0%	38.0%	38.0%	38.0%	38.0%
Contract Manufacturing	1185	1490	1639	2050	2296	2572	2880
<i>% of Growth</i>	-5.0%	26.0%	10.0%	25.0%	12.0%	12.0%	12.0%
<i>% of Total Sales</i>	9.0%	11.0%	10.0%	11.0%	10.0%	10.0%	9.0%
Brazil	1668	1771	2610	3080	3696	4250	4888
<i>% of Growth</i>	45.0%	6.0%	47.0%	18.0%	20.0%	15.0%	15.0%
<i>% of Total Sales</i>	13.0%	14.0%	16.0%	16.0%	17.0%	16.0%	16.0%
Russia	574	594	680	440	537	617	679
<i>% of Growth</i>	65.0%	4.0%	15.0%	-35.0%	22.0%	15.0%	10.0%
<i>% of Total Sales</i>	5.0%	5.0%	4.0%	2.0%	2.0%	2.0%	2.0%
Europe (Exc Germany)	389	635	1250	1400	1395	1674	1925
<i>% of Growth</i>	-28.0%	63.0%	97.0%	12.0%	-0.4%	20.0%	15.0%
<i>% of Total Sales</i>	3.0%	5.0%	8.0%	7.0%	6.0%	6.0%	6.0%
US		18	290	940	1363	1908	2671
<i>% of Growth</i>			1476.0%	224.0%	45.0%	40.0%	40.0%
<i>% of Total Sales</i>		65.0%	65.0%	65.0%	65.0%	65.0%	65.0%
Germany	2680	2095	2660	2640	2957	3193	3385
<i>% of Growth</i>	61.0%	-22.0%	27.0%	-1.0%	12.0%	8.0%	6.0%
<i>% of Total Sales</i>	21.0%	16.0%	16.0%	14.0%	13.0%	12.0%	11.0%
ROW	677	670	930	1200	1320	1518	1822
<i>% of Growth</i>	9.0%	-1.0%	39.0%	29.0%	10.0%	15.0%	20.0%
<i>% of Total Sales</i>	5.0%	5.0%	6.0%	6.0%	6.0%	6.0%	6.0%

Source: Company Filings, MAPE Securities

Exhibit 32: Ratios		(INR mn)					
Particulars	FY08	FY09	FY10	FY11E	FY12E	FY13E	FY14E
Gross Margin	65.0	67.2	69.8	69.0	69.0	69.0	69.0
EBITDA Margin	15.0	15.9	22.0	20.0	20.0	20.0	20.0
Net Profit Margin	9.9	11.3	12.1	13.1	13.0	13.1	13.2
Fixed Asset Turnover	2.2	2.3	2.3	2.3	2.4	2.6	2.8
Equity Multiplier	2.5	2.6	2.4	2.2	2.0	1.8	1.7
ROE	26.4	28.3	27.8	27.5	25.3	23.9	22.6
ROCE	17.6	18.0	25.1	22.4	22.9	23.3	23.3
Inventory Days	175	178	201	200	200	200	200
Debtor Days	58	60	59	60	60	60	60
Creditor Days	191	211	235	235	235	235	235
Working Capital Cycle	42	28	25	25	25	25	25
Debt/Equity	0.7	0.7	0.6	0.5	0.4	0.3	0.2
Operating Cash Flow	2,374	2,579	2,870	3,100	3,765	4,420	5,224
Capex	-1,284	-627	-1,501	-2,400	-2,000	-2,000	-2,000
Free Cash Flow	1,090	1,952	1,369	700	1,765	2,420	3,224

Source: Company Filings, MAPE Securities

Financial Summary

Income Statement						Balance Sheet					
						(INR mn)					
Particulars	2008	2009	2010	2011E	2012E	Particulars	2008	2009	2010	2011E	2012E
Total Revenue	13,548	16,307	19,160	22,539	26,707	Sources Of Funds					
Net Sales	13,123	15,865	18,329	21,666	25,791	Total Shareholders fund	5,096	6,509	8,310	10,757	13,727
Other Operating Income	426	441	831	873	916	Secured	3,366	3,183	3,646	4,401	4,181
COGS	4,741	5,348	5,790	6,987	8,279	Unsecured	231	1,643	1,578	1,499	1,424
Gross Profit	8,807	10,958	13,370	15,552	18,428	Total Debt	3,598	4,826	5,224	5,900	5,605
<i>Gross Margin</i>	67.1%	69.1%	72.9%	71.8%	71.5%	Current Liab & Provisions	3,342	4,656	5,496	6,344	7,261
<i>Growth%</i>	3.6%	24.4%	22.0%	16.3%	18.5%	Deffered Tax Liabilities	623	683	622	653	686
Staff Cost	2,325	2,565	3,162	3,832	4,540	Total Liabilities	12,659	16,675	19,652	23,654	27,279
<i>% of Sales</i>	17.7%	16.2%	17.2%	17.7%	17.6%	Uses of Fund					
<i>Growth%</i>	-6.6%	10.3%	23.3%	21.2%	18.5%	Fixed Assets					
SG&A	3,482	4,687	4,799	5,860	6,944	Gross Block	6,461	7,206	8,129	10,529	12,529
<i>% of Sales</i>	26.5%	29.5%	26.2%	27.0%	26.9%	<i>Less: Accumulated Depreciation</i>	1,762	2,094	2,718	3,350	4,101
<i>Growth%</i>	-5.6%	34.6%	2.4%	22.1%	18.5%	Net Block	4,699	5,113	5,411	7,180	8,428
R&D	972	1,119	1,202	1,352	1,602	Capital Work In Progress	821	534	1,098	1,098	1,098
<i>% of Sales</i>	7.4%	7.1%	6.6%	6.2%	6.2%	Investments	546	1,494	1,535	1,535	1,535
<i>Growth%</i>	26.2%	15.2%	7.4%	12.5%	18.5%	Current Assets,					
EBITDA	2,028	2,587	4,208	4,508	5,341	Loans & Advances					
<i>EBITDA Margin</i>	15.5%	16.3%	23.0%	20.8%	20.7%	Inventories	2,310	2,645	3,236	3,882	4,600
<i>Growth %</i>	30.2%	27.6%	62.6%	7.1%	18.5%	Sundry Debtors	2,111	2,666	2,982	3,683	4,382
Depreciation	388	423	661	632	752	Cash & Bank	1,183	2,300	3,883	4,620	5,414
EBIT	1,640	2,164	3,547	3,876	4,590	Loans & Advances	761	1,579	1,138	1,252	1,377
<i>EBIT Margin</i>	12.5%	13.6%	19.4%	17.9%	17.8%	Others	227	343	368	405	445
<i>Growth%</i>	33.5%	32.0%	63.9%	9.3%	18.4%	Total Assets	12,659	16,675	19,652	23,654	27,279
Other Income/ (Expenditure)	47.4	35.1	90.4	93.1	95.9	Cash Flow					
Interest	196	190	165	132	168	Particulars	2008	2009	2010	2011E	2012E
PBT	1,491	2,009	3,472	3,837	4,517	Net cash from Operating Activities	2,374	2,579	2,870	3,100	3,765
<i>PBT Margin</i>	11.4%	12.7%	18.9%	17.7%	17.5%	Net cash from Investing Activities	-1,346	-396	-1,287	-2,400	-2,000
<i>Growth%</i>	36.7%	34.8%	72.8%	10.5%	17.7%	Net cash from Financing Activities	313	-182	-52	36	-971
Tax	144	78	1,160	883	1,039	Net Increase or Decrease	1,342	2,001	1,530	737	795
<i>Tax %</i>	9.7%	3.9%	33.4%	23.0%	23.0%	Free cash flow	1,090	1,952	1,369	700	1,765
PAT	1,347	1,931	2,312	2,954	3,478						
<i>PAT Margin</i>	10.3%	12.2%	12.6%	13.6%	13.5%						
<i>Growth%</i>	44.0%	43.4%	19.7%	27.8%	17.7%						

Source: Company Filings, MAPE Securities

We initiate coverage on Dishman with a Sell rating on the back of a delay in commencement of the new CRAMS contract; major restructuring at Carbogen Amcis, the postponement of commercialization of the HIPO & China facility, increased financial leverage and a higher tax rate of 18-20% (as EOU status will expire in March 2011) compared to 10% over the last five years.

Management guidance of single digit growth from Marketable Molecules (30% of total sales) and flat growth in Carbogen Amcis (35% of total sales), makes the overall guidance of 15% top-line growth in FY12 seems optimistic. To achieve 15% growth in FY12, the Indian CRAMS business should grow by more than 35%, but it has remained flat over the last couple of years.

Investment Rationale

Carbogen Amcis in Trouble: Carbogen Amcis's EBITDA margin has come down to 18-20% in FY11 compared to over 25% in FY09 and FY10. Due to the poor performance of Carbogen Amcis, Dishman has carved out a strategy to downsize its employee strength to 280 from 340 by March 2011. Dishman will incur a onetime cost of USD1m (2% of quarterly sales) in the next couple of quarters. We note that such restructuring exercises are not easily achieved in the West; it is a long-drawn painful process which Dishman's Indian peers have gone through. There may be a case of employees losing focus, which would thereby have a direct impact on sales during the restructuring period. We are expecting flat growth for Carbogen Amcis in FY12, however, there is a high probability that it might post lower sales in FY12 compared to FY11.

Reducing Manufacturing Efficiency: Dishman has earned the respect of being a perfect executor of contracts, despite a drastic deterioration in its fixed assets turnover ratio. (Sales/Fixed Assets) Our analysis suggests that Dishman's capex funding, which has been responsible for the entire growth from 2007-2009 has been acquired largely through external sources (debt and/or equity) Dishman is currently at a stage where ability to acquire further leverage is greatly reduced (current debt-equity is 1:1), especially with the increasing interest rate scenario.

Dishman – In a Debt Trap: We believe that Dishman is in a debt trap (repaying old debt through new) owing to continuous capex and negative free cash flow over the last four years, along with a deteriorating fixed asset turnover. With a US\$12m annual repayment installment, Dishman will be in a catch-22 situation. The company will either have to compromise on growth by holding back capex plans, or it will have to borrow at an exorbitant rate, which might put pressure on earnings. Therefore, we expect Dishman's earning to remain muted in FY12.

Expensive Valuation: Dishman is currently trading at an EV/EBITDA of 9x on our FY12 earnings, which is much higher than its peer group. We believe the valuation of companies like Dishman (where capex plans are massive through external funding) should be done on the basis of EV/EBITDA, as it will capture the debt scenario as well.

Investment Basis

Carbogen Amcis – A Real Worry: Carbogen Amcis is into contract research for innovative drugs, however due to the dwindling R&D productivity of MNC's, Dishman is not getting new contracts. The liquidity crisis of 2008 and 2009 has curtailed the funding for many virtual unprofitable R&D companies. This has resulted in the holding back of research programs, ultimately hitting contract research companies such as Carbogen Amcis. At the time of the acquisition, ~30-35% of Carbogen Amcis sales were registered from such small unprofitable companies.

Initiating Coverage

April 6, 2011

BBG code : DISH IN

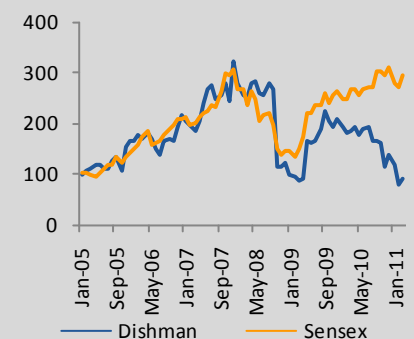
Market Data

Rating	SELL
Price (5 Apr'11) (INR)	103
52 Week Range (INR)	235/ 85
Target Price (INR)	70
Outsanding Shares (Mn)	81
Mkt Cap (INR Mn)	8,304
Mkt Cap (US\$ Mn)	186
Daily average volume	187,335

Share Holding Pattern : 31-Dec-2010

Promoter and Promoter Group	60.90%
FII	8.64%
DII	9.34%
Non-Institutions	21.12%

Relative performance to Sensex



Carbogen Amcis's EBITDA margin has come down to 18-20% in FY11 compared to over 25% in FY09 and FY10. Due to the deteriorating operational performance, Dishman is undertaking a massive restructuring exercise with a focus on improving profitability rather than growing its topline. The fact that Dishman has already fired two CEO's in the last three years for non-performance indicates that there are still plenty of problems at Carbogen Amcis. Dishman is also planning to downsize its employee strength to 280 from 340 by March 2011. Dishman will incur a onetime cost of US\$1m (2% of quarterly sales) in the next couple of quarters.

Additionally Dishman was badly hit due to appreciation of the Swiss Franc against the US Dollar, as it is receiving revenue in US Dollars and expenses are in Swiss Francs.

Contract Manufacturing – Delay of Contracts: The Company continues to remain upbeat about its long term contracts, such as-

- intermediate supplies for AstraZeneca's *Brilinta*,
- contract with a US based MNC (revenue contribution of US\$ 5-10m in FY12),
- contract with a Japanese company
- long- term potential of the Hi-Po facility in India.

Nevertheless, we will await the execution of these contracts before building them into our estimates. A hi-potency facility which was to commence operation in FY11 has been postponed. The management expects validation of batches in Q2FY12 and commercialization to start from Q4FY12.

Deteriorating Fixed Asset Turnover: We have observed that Dishman's fixed asset turnover ratio deteriorated sharply from 1.4x in FY05 to 0.8x in FY10 despite depreciating INR, giving an indication of under utilization of assets. This further leads to the conclusion that the entire sales growth over the years (FY06-FY08) has been only due to incremental capex. The real worry for Dishman is that it not able to get contracts despite incurring heavy capex. This is largely due to dwindling R&D productivity of innovator companies, and MNCs tying up directly with generic players for generic formulations.

Dishman may see a turnaround in its business if the product for which Dishman has entered into custom synthesis reaches the commercialization stage.

Exhibit 33: Deteriorating Fixed Asset Turnover

Particulars	(INR mn)						
	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY2010	Accumulated
Total Debt	1,183	1,023	5,610	6,580	7,237	7,739	
Incremental Debt		-160	4,587	970	657	503	6,054
Fixed Assets	1,357	2,124	6,030	8,329	10,008	12,004	
Capex	323	832	4,160	2,700	1,685	3,058	9,377
Total Sales	1,886	2,774	5,786	8,031	10,624	9,154	
Incremental Sales		889	3,011	2,245	2,593	-1,470	8,738
Capex/ Incremental Debt			0.9	2.8	2.6	6.1	1.5
Incremental Sales/Capex		1.1	0.7	0.8	1.5		0.9
Incremental Sales/Incremental Debt			0.7	2.3	3.9		1.4
Sales/Fixed Assets	1.4	1.3	1.0	1.0	1.1	0.8	

Source: Company Reports, MAPE Securities

Debt: The annual debt repayment cycle of US \$12m for Carbogen Amcis had started in August 2009. If we assume the INR at the rate of INR47per USD, then the repayment was INR564m annually. Despite repaying more than INR1,000m in the last two years, the debt level has not come down.

Dishman has a debt of INR8,600m as of 31st December 2010, and it will need to pay INR750m (for Carbogen Amcis) annually over the next three years to repay it. It is expecting to repay this

from internal accruals of INR1,250m, estimated by management. Dishman will incur INR500m for maintenance capex, and for the addition of new facilities the company will need to borrow. The new debt will come at a higher interest rate as the company already has a high debt/equity ratio of more than 1x.

EBITDA Margins: Dishman is expecting an EBITDA margin of 23% in FY12 which we believe is on the higher side as restructuring at Carbogen Amcis will hit their margins. We have witnessed in the case of Dr.Reddy's-Betapharm that restructuring in European countries usually takes longer than anticipated.

Valuation: We initiate coverage on Dishman with a target price of INR70 at EV/EBITDA of 7x FY12 earnings similar to Jubilant Life sciences.

Exhibit 34: Ratios**(INR mn)**

Particulars	FY06	FY07	FY08	FY09	FY10	FY11E	FY12E	FY13E
Gross Margin	45.2	65.5	63.5	69.5	69.8	68.2	69.0	69.0
EBITDA Margin	23.3	19.9	19.0	24.6	22.3	16.1	18.0	19.0
Net Profit Margin	18.3	15.9	14.9	13.8	12.8	8.0	9.0	10.1
Fixed Asset Turnover	1.4	1.0	1.0	1.1	0.8	0.8	0.8	0.9
Equity Multiplier	0.5	1.9	1.4	1.4	1.5	1.5	1.4	1.4
ROE	12.3	28.8	20.9	20.8	15.0	9.1	10.5	12.2
ROCE	10.2	9.9	8.5	13.6	9.0	4.7	6.1	7.2
Inventory Days	256	537	374	338	315	315	315	315
Debtor Days	112	78	92	51	44	45	45	45
Creditor Days	155	439	241	176	210	210	210	210
Working Capital Cycle	213	176	225	212	149	150	150	150
Debt/Equity	0.2	1.8	1.1	1.0	1.0	1.1	1.0	1.0
Operating Cash Flow	154.0	427.3	494.4	1,317.6	3,022.1	954.4	1,149.6	1,275.8
Capex	-832.2	-4,159.5	-2,699.9	-1,685.4	-3,058.4	-800.0	-800.0	-800.0
Free Cash Flow	-678.1	-3,732.3	-2,205.6	-367.8	-36.3	154.4	349.6	475.8

Source: Company Filings, MAPE Securities

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