

INDUSTRY PHARMA
CMP (as on 09 Nov 2016) Rs 1,530
Target Price Rs 2,050

Nifty 8,432

Sensex 27,253

KEY STOCK DATA

Bloomberg LPC IN

No. of Shares (mn) 451

MCap (Rs bn) / (\$ mn) 690/10,360

6m avg traded value (Rs mn) 2,031

STOCK PERFORMANCE (%)
52 Week high / low Rs 1,912/1,280

3M 6M 12M

Absolute (%) (1.0) (5.3) (14.6)

Relative (%) 0.9 (11.0) (20.4)

SHAREHOLDING PATTERN (%)

Promoters 46.74

FIs & Local MFs 7.07

FIIs 34.65

Public & Others 11.55

Source : BSE

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Deep pipeline to fructify

Elevated staff cost post Gavis acquisition and higher than expected R&D expenses (13.3% of sales) led to a surprise sequential drop in margins at 25.0% in 2QFY17. As a result, net profits declined 15%YoY to Rs 6.6bn, despite lower taxes during the quarter. On the flip side, revenue performance was buoyant with robust US sales. Top line grew 29%YoY to Rs 42.9bn.

With the Goa facility receiving clearance from the US FDA in 3QFY17, we expect a steady scale up in the US base business that will absorb the increased spend in the quarters ahead. We believe that the high profitability of 1HFY17 is likely to be maintained in 2HFY17 considering – (1) semi exclusivity in gGlumetza and gFortamet (2) Scale up in the Gavis portfolio, and (3) new product launches in 2HFY17. LPC has a deep pipeline of 142 ANDAs which will drive revenue growth at ~21% CAGR over FY16-19E.

- LPC is investing close to Rs 2.2-2.5bn/year in R&D to develop complex generic products in Injecatable, Respiratory and Biosimilar categories. Benefits of these investments are likely to be visible from FY19 with approvals expected from the US FDA. Meanwhile, over FY18-19E, we expect LPC to launch 60+ products in the

Financial Summary

(Rs mn)	2QFY17	2QFY16	YoY (%)	1QFY17	QoQ (%)	FY16	FY17E	FY18E	FY19E
Net Sales	42,905	33,297	28.9	44,394	(3.4)	1,42,085	1,80,702	2,12,073	2,48,645
EBIDTA	10,741	6,626	62.1	13,080	(17.9)	37,534	49,151	58,744	70,864
APAT	6,622	4,221	56.9	8,774	(24.5)	22,706	30,934	37,622	46,180
Diluted adj. EPS (Rs)	14.7	9.4	56.9	19.5	(24.5)	50.4	68.6	83.4	102.4
P/E (x)						31.8	22.7	18.6	15.2
RoE (%)						22.9	25.2	24.7	24.4

Source: Company, HDFC sec Inst Research # Consolidated

US market. It will include exclusive products like – gFosrenol, gRenvela, gMinastrin, gWelchol, gRenagel, gTamiflu and gTruvada. The US sales will grow at ~25% CAGR over FY16-19E.

- At CMP, the stock trades at 18.6x FY18E and 15.2x FY19E, a 20-25% discount to the historical average. With the Goa facility clearance and expected pick up in ANDA launches, LPC is likely to re-rate in the near term. Reiterate BUY with a TP of Rs 2,050 (22x on Sep-18E).

Highlights of the quarter

- **Concall takeaways:** (1) gGlumetza sales were flat QoQ, (2) gFortamet sales felt modest impact of Mylan's entry, (3) Gavis sales are likely to pick up from 2HFY17 with the new facility coming to the fore in 3QFY17, (4) LPC to launch 10-12 products and file 30 products in 2HFY17, (5) Methergine to ramp up from 3QFY17, (6) Launched 8 new products in India, (7) Expect EBITDA margins to be in the range of 26-28% in 2HFY17, (8) Tax rate to be lower going ahead (25% in FY17).
- **Near term outlook:** Steady pick up in ANDA approvals to drive share price.

US and India drove top line in 2QFY17

Sequential jump in R&D expenses is on the back of clinical trials for inhalers and biosimilar products

Guided for 25% tax rate in FY17 owing to change in accounting policy and higher tax benefits from R&D

Quarterly Financials Snapshot (Consolidated)

Particulars	2QFY17	2QFY16	YoY (%)	1QFY17	QoQ (%)	2QFY17E	Var (%)
Net Sales	42,905	33,297	28.9	44,394	(3.4)	44,830	(4.3)
Material Expenses	12,429	11,249	10.5	12,719	(2.3)	12,827	(3.1)
Employee Expenses	7,124	5,328	33.7	7,059	0.9	6,957	2.4
R&D Expenses	5,716	3,878	47.4	4,994	14.5	5,435	5.2
Other Expenses	6,896	6,216	10.9	6,541	5.4	6,957	(0.9)
EBITDA	10,741	6,626	62.1	13,080	(17.9)	12,655	(15.1)
Depreciation	2,112	1,155		2,027		2,200	
EBIT	8,629	5,471	57.7	11,053	(21.9)	10,455	(17.5)
Other Income	271	578		826		550	
Interest Cost	263	241		320		330	
Forex gain/(loss)	(460)						
PBT	8,177	5,809	40.8	11,560	(29.3)	10,675	(23.4)
Tax	1,589	1,591		2,734		2,750	
RPAT	6,588	4,218	56.2	8,826	(25.4)	7,925	(16.9)
Minority interest + Share of Asso.	(34)	(3)		51		-	
APAT	6,622	4,221	56.9	8,774	(24.5)	7,925	(16.4)

Source: Company, HDFC sec Inst Research

Margin Analysis

	2QFY17	2QFY16	YoY (%)	1QFY17	QoQ (%)	2QFY17E	Var (bps)
Material Expenses % Net Sales	29.0	33.8	(482)	28.7	32	28.6	36
Employee Expenses % Net Sales	16.6	16.0	60	15.9	70	15.5	109
R&D Expenses % Net Sales	13.3	11.6	168	11.2	207	12.1	120
Other Expenses % Net Sales	16.1	18.7	(260)	14.7	134	15.5	55
EBITDA Margin (%)	25.0	19.9	513	29.5	(443)	28.2	(319)
Tax Rate (%)	19.4	27.4	(795)	23.7	(421)	25.8	(632)
APAT Margin (%)	15.4	12.7	276	19.8	(433)	17.7	(224)

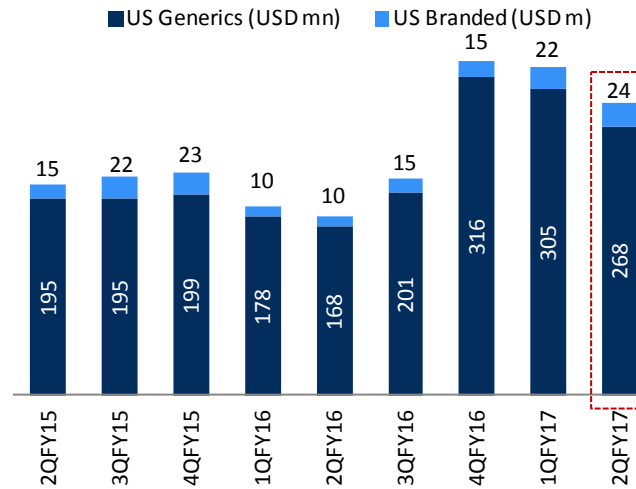
Source: Company, HDFC sec Inst Research

US business grew 64%YoY, led by gGlumetza and gFortamet

India sales recovered from NLEM impact, grew 13%YoY

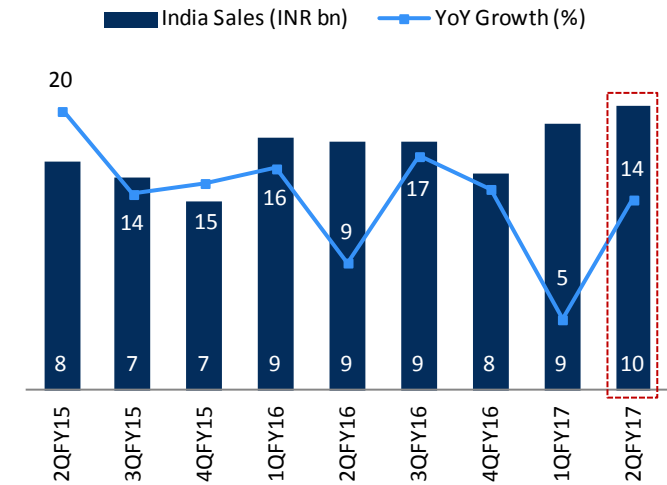
R&D expense was at 13.3% of sales. It is likely to remain at elevated levels for next few quarters

US Formulations Growth Trajectory



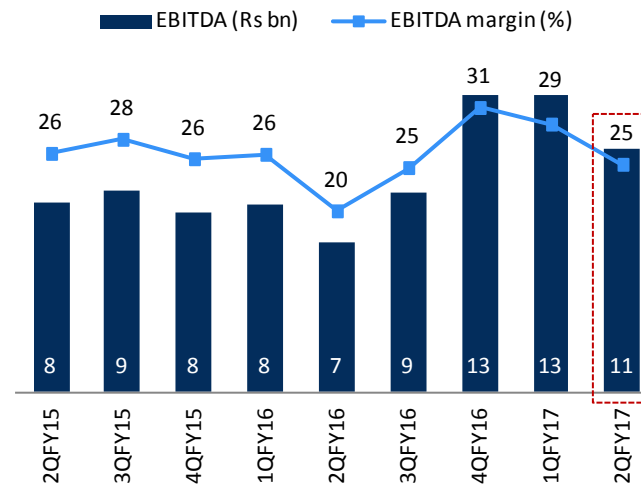
Source: Company, HDFC sec Inst Research

India-branded Formulation Growth Trajectory



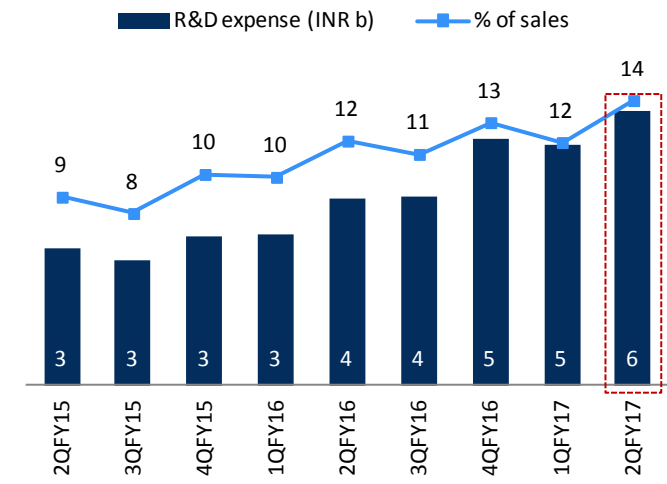
Source: Company, HDFC sec Inst Research

EBITDA Margin Trajectory



Source: Company, HDFC sec Inst Research

R&D Expense As % Of Sales



Source: Company, HDFC sec Inst Research

US business grew 73%YoY (rupee terms) led by gGlumetza and gFortamet in 2Q

Growth in APAC was contributed by Japan and Philippines segments

The US and India businesses are likely to drive top-line over FY17-19E.

Segmental Quarterly Performance

(Rs mn)	2QFY17	2QFY16	YoY (%)	1QFY17	QoQ (%)
India	9,958	8,881	12.1	9,499	4.8
US	19,978	11,539	73.1	21,886	(8.7)
APAC	5,520	4,462	23.7	5,416	1.9
EMEA	2,355	2,218	6.2	2,194	7.3
RoW	396	414	(4.3)	368	7.6
Latam	986	1,082	(8.9)	1,089	(9.5)
API & others	2,919	3,330	(12.3)	2,966	(1.6)
Total	42,112	31,926	31.9	43,418	(3.0)

Source: HDFC sec Inst Research

Assumptions

	FY16	FY17E	FY18E	FY19E
India	33,916	39,003	45,829	53,849
<i>Growth (%)</i>	14.3	15.0	17.5	17.5
US	59,407	81,766	94,868	1,15,671
<i>Growth (%)</i>	5.0	37.6	16.0	21.9
Japan	13,646	20,389	25,617	28,179
<i>Growth (%)</i>	3.1	49.4	25.6	10.0
Europe	4,278	5,378	6,092	6,702
<i>Growth (%)</i>	30.5	25.7	13.3	10.0
RoW	13,695	16,229	19,220	22,103
<i>Growth (%)</i>	21.4	18.5	18.4	15.0
API & Others	12,074	13,437	14,945	16,141
<i>Growth (%)</i>	1.1	11.3	11.2	8.0
Total	1,37,016	1,76,202	2,06,573	2,42,645
<i>Growth (%)</i>	8.7	28.6	17.2	17.5

Source: HDFC sec Inst Research

Income Statement (Consolidated)

Year ending March (Rs mn)	FY15	FY16	FY17E	FY18E	FY19E
Net Revenues	1,27,700	1,42,085	1,80,702	2,12,073	2,48,645
Growth (%)	13.1	11.3	27.2	17.4	17.2
Material Expenses	41,570	43,094	52,946	61,925	70,864
Employee Expenses	17,473	21,077	28,370	30,751	34,064
SG&A Expenses	6,946	11,935	11,746	15,057	18,897
Other Expenses	25,515	28,444	38,490	45,596	53,956
EBITDA	36,196	37,534	49,151	58,744	70,864
EBITDA Margin (%)	28.3	26.4	27.2	27.7	28.5
EBITDA Growth (%)	20.5	3.7	30.9	19.5	20.6
Depreciation	4,347	4,635	8,689	10,239	10,826
EBIT	31,849	32,899	40,463	48,505	60,038
Other Income (Incl EO Items)	2,398	1,877	2,250	3,800	4,200
Interest	98	447	1,201	1,127	1,000
PBT	34,148	34,329	41,512	51,178	63,238
Tax (Incl Deferred)	9,704	11,536	10,378	13,306	16,758
RPAT	24,444	22,794	31,134	37,872	46,480
EO (Loss) / Profit (Net Of Tax)	412	88	200	250	300
APAT	24,032	22,706	30,934	37,622	46,180
APAT Growth (%)	30.9	(5.5)	36.2	21.6	22.7
Adjusted EPS (Rs)	53.5	50.4	68.6	83.4	102.4

Source: Company, HDFC sec Inst Research

Balance Sheet (Consolidated)

Year ending March (Rs mn)	FY15	FY16	FY17E	FY18E	FY19E
SOURCES OF FUNDS					
Share Capital - Equity	899	901	902	902	902
Reserves	87,842	1,08,943	1,35,129	1,68,002	2,09,434
Total Shareholders' Funds	88,741	1,09,844	1,36,030	1,68,904	2,10,336
Minority Interest	241	321	521	771	771
Long-term Debt	1,018	53,739	58,119	53,119	48,119
Short-term Debt	3,692	17,454	11,954	9,454	6,954
Total Debt	4,710	71,193	70,073	62,573	55,073
Net Deferred Taxes	1,182	1,239	1,239	1,239	1,239
Long-term Provisions & Others	2,496	3,651	3,651	3,651	3,651
TOTAL SOURCES OF FUNDS	97,370	1,86,247	2,11,514	2,37,138	2,71,070
APPLICATION OF FUNDS					
Net Block	26,636	59,379	78,435	81,397	83,771
CWIP	6,745	32,122	27,300	25,600	25,600
Intangible assets	17,046	29,644	29,644	29,644	29,644
Investments	16,584	75	150	225	225
LT Loans & Advances	1,760	4,581	4,750	4,750	4,750
Total Non-current Assets	68,771	1,25,801	1,40,279	1,41,615	1,43,990
Inventories	25,036	31,787	34,415	39,013	44,644
Debtors	26,566	45,498	43,341	46,623	54,663
Other Current Assets	5,350	12,106	10,349	11,410	12,302
Cash & Equivalents	4,814	8,379	18,243	38,818	61,090
Total Current Assets	61,765	97,770	1,06,348	1,35,864	1,72,700
Creditors	19,561	21,919	21,178	24,770	28,345
Other Current Liabilities & Provisions	13,605	15,406	13,935	15,572	17,275
Total Current Liabilities	33,166	37,324	35,113	40,342	45,620
Net Current Assets	28,599	60,446	71,234	95,522	1,27,080
TOTAL APPLICATION OF FUNDS	97,370	1,86,247	2,11,514	2,37,138	2,71,070

Source: Company, HDFC sec Inst Research

Cash Flow

Year ending March (Rs mn)	FY15	FY16	FY17E	FY18E	FY19E
Reported PBT	34,148	34,329	41,512	51,178	63,238
Non-operating & EO items	(129)	(36)	(2,561)	(3,576)	(3,576)
Interest expenses	98	447	1,201	1,127	1,000
Depreciation	4,347	4,635	8,689	10,239	10,826
Working Capital Change	7,364	(34,084)	(971)	(3,713)	(9,285)
Tax Paid	(10,300)	(11,479)	(10,378)	(13,306)	(16,758)
OPERATING CASH FLOW (a)	35,528	(6,188)	37,491	41,949	45,444
Capex	(16,726)	(70,670)	(23,045)	(11,500)	(13,200)
Free cash flow (FCF)	18,802	(76,858)	14,446	30,449	32,244
Investments	(14,799)	16,509	(75)	(75)	-
Non-operating Income	131	189	2,561	3,576	3,576
INVESTING CASH FLOW (b)	(31,395)	(53,972)	(20,558)	(7,999)	(9,624)
Debt Issuance/(Repaid)	(1,282)	66,483	(1,120)	(7,500)	(7,500)
Interest Expenses	(98)	(447)	(1,201)	(1,127)	(1,000)
FCFE	2,753	5,876	14,611	25,323	27,320
Share Capital Issuance	(1,766)	2,343	1	-	-
Dividend	(3,681)	(3,954)	(4,748)	(4,748)	(4,748)
FINANCING CASH FLOW (c)	(6,828)	64,425	(7,068)	(13,375)	(13,248)
NET CASH FLOW (a+b+c)	(2,694)	4,265	9,864	20,575	22,572
EO Items, Others	(467)	(700)	-	-	(300)
Closing Cash & Equivalents	(3,161)	3,565	9,864	20,575	22,272

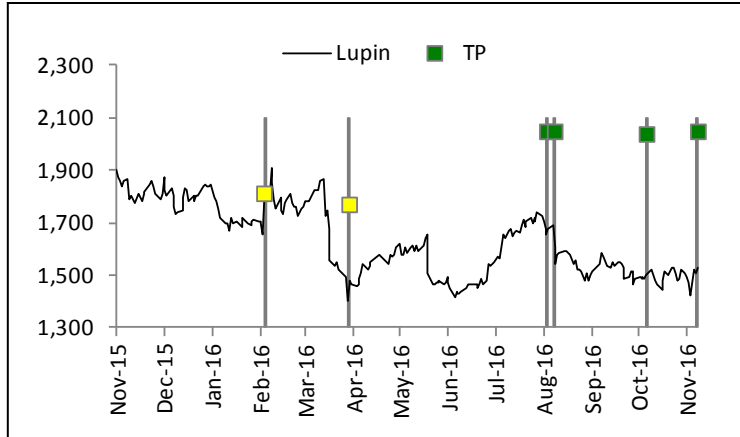
Source: Company, HDFC sec Inst Research

Key Ratios

	FY15	FY16	FY17E	FY18E	FY19E
PROFITABILITY (%)					
GPM	67.4	69.7	70.7	70.8	71.5
EBITDA Margin	28.3	26.4	27.2	27.7	28.5
APAT Margin	18.8	16.0	17.1	17.7	18.6
RoE	30.4	22.9	25.2	24.7	24.4
RoIC (or Core RoCE)	30.7	12.6	16.1	18.6	21.5
RoCE	27.2	16.2	16.0	17.1	18.5
EFFICIENCY					
Tax Rate (%)	28.4	33.6	25.0	26.0	26.5
Fixed Asset Turnover (x)	2.8	2.5	2.5	2.5	2.6
Inventory (days)	71.6	81.7	69.5	67.1	65.5
Debtors (days)	75.9	116.9	87.5	80.2	80.2
Other Current Assets (days)	15.3	31.1	20.9	19.6	18.1
Payables (days)	55.9	56.3	42.8	42.6	41.6
Other Current Liab & Provns (days)	38.9	39.6	28.1	26.8	25.4
Cash Conversion Cycle (days)	68.0	133.8	107.0	97.6	96.9
Debt/EBITDA (x)	0.1	1.9	1.4	1.1	0.8
Net D/E (x)	(0.0)	0.6	0.4	0.1	(0.0)
Interest Coverage (x)	324.7	73.6	33.7	43.0	60.0
PER SHARE DATA (Rs)					
EPS	53.5	50.4	68.6	83.4	102.4
Dividend	7.0	7.5	9.0	9.0	9.0
Book Value	197.4	243.8	301.7	374.6	466.5
VALUATION					
P/E (x)	29.1	30.9	22.7	18.6	15.2
P/BV (x)	7.9	6.4	5.2	4.2	3.3
EV/EBITDA (x)	19.3	20.3	15.3	12.3	9.8
EV/Revenues (x)	5.5	5.4	4.2	3.4	2.8
OCF/EV (%)	5.1	(0.8)	5.0	5.8	6.5
FCF/EV (%)	2.7	(10.1)	1.9	4.2	4.6
FCFE/Mkt Cap (%)	0.4	0.8	2.1	3.6	3.9
Dividend Yield (%)	0.5	0.5	0.6	0.6	0.6

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
8-Feb-16	1,803	NEU	1,810
30-Mar-16	1,475	NEU	1,767
4-Aug-16	1,658	BUY	2,050
10-Aug-16	1,607	BUY	2,050
8-Oct-16	1,498	BUY	2,040
10-Nov-16	1,530	BUY	2,050

Rating Definitions

- BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period
- NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
- SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

Disclosure:

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