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 Pharmaceuticals
 Asia | India

Lupin (LUPN.BO)

Results: EBITDA Miss on Higher R&D

- Citi's Take** — High R&D spend (13.3% of revenues) coupled with lower than expected growth in India led to EBITDA/earnings being lower than we expected. Management commentary indicated that initial price/MS loss in gFortamet is limited while gGlumetza remains stable as competitors have not launched yet. Pricing in the US was a key issue focused on during the earnings call, with management hinting at high single digit base business erosion over the near to medium term.
- Key To Note** — a) DOJ probe: Lupin has not received any subpoena as part of the proceedings; b) gFortamet: Mylan has garnered c6% share with limited pricing hit, management does not see too many additional competitors in the near term; c) US generics: gEpzicom, gMinastrin 24Fe, gBupropion XL are the key approvals to track in the near term, Sevelamer + Colesevelam franchise product approvals expected in 2HFY18; d) Gavis: Expect ramp up in methergine and approval of 4-5 new products (including some control substances) over next few quarters, toned down FY18 revenue guidance to US\$250m (now in line with our forecast).
- Implications** — We remain positive on Lupin, given its good geographic mix, large US pipeline and robust financial metrics. The EIR at Goa lifts a key compliance overhang and we expect a pick-up in pace of approvals. We acknowledge the likely optical weakness in earnings over the next few quarters, driven by competition in key products (gFortamet & gGlumetza) and absence of any chunky launch in the US, but would use any related weakness as an attractive buying opportunity.

Buy	1
Price (09 Nov 16)	Rs1,529.05
Target price	Rs1,970.00
Expected share price return	28.8%
Expected dividend yield	0.5%
Expected total return	29.3%
Market Cap	Rs689,973M
	US\$10,415M

Price Performance (RIC: LUPN.BO, BB: LPC IN)

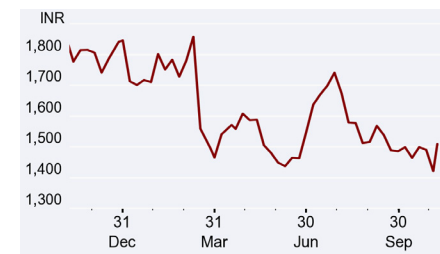


Figure 1. In-Line Revenue, Miss at EBITDA

Headline Numbers		Key Regions (Growth)		Operational Metrics	
Revenues	32%	US	73%	R&D (% of Sales)	13.6%
EBIDTA	62%	India	12%	ANDAs filed / total	2 / 149
Adj. Net Income	65%	APAC	24%	ANDA approvals / total	7 / 187
EBIDTA Margin	25% (+511)	EMEA	6.2%	FTFs / Sole FTFs	45 / 25

Source: Citi Research

Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2015A	24,032	53.16	30.3	28.8	7.7	30.4	0.5
2016A	22,934	50.73	-4.6	30.1	6.3	23.1	0.5
2017E	27,768	61.42	21.1	24.9	5.1	22.8	0.5
2018E	32,866	72.70	18.4	21.0	4.2	22.2	0.5
2019E	41,058	90.82	24.9	16.8	3.4	22.7	0.5

Source: Powered by dataCentral

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Figure 2. Lupin – 2QFY17 Consolidated Income Statement (Rs m, %)

	2QFY16	2QFY17	% Ch YoY	1QFY17	% Ch QoQ	Citi Research Comments
Net Sales	31,926	42,112	31.9	43,136	(2.4)	Revenue in-line, miss at EBITDA
Other Operating Income	1,371	793	(42.1)	1,259	(37.0)	Revenue remains in-line, decline in US sales was as expected following competition in key products
Total Revenues	33,297	42,905	28.9	44,394	(3.4)	
Raw material cost	11,249	12,429	10.5	12,719	(2.3)	High R&D spend and lower than expected growth in domestic business resulted in miss at EBITDA
as a % sales	33.8	29.0	-482 bps	28.7	32 bps	
Staff cost	5,328	7,124	33.7	7,059	0.9	R&D spent was at 13.6% of revenue, full year guidance of 12014%
as a % sales	16.0	16.6	60 bps	15.9	70 bps	
Other expenditure	10,094	12,622	25.1	11,535	9.4	Other expenses include Rs450m of forex component
as a % sales	30.3	29.4	-90 bps	26.0	343 bps	Tax rate guidance of c25% forFY17
Total expenditure	26,671	32,174	20.6	31,313	2.7	
EBITDA	6,626	10,731	61.9	13,081	(18.0)	
EBITDA Margins (%)	19.9	25.0	511 bps	29.5	-445 bps	
Depreciation	1,155	2,112	82.9	2,027	4.2	
Interest	241	263	9.3	320	(17.8)	
Other Income	578	271	(53.1)	826	(67.2)	
PBT	5,809	8,627	48.5	11,560	(25.4)	
Tax	1,591	1,589	(0.1)	2,734	(41.9)	
Effective Tax Rate (%)	27.4	18.4	-896 bps	23.7	-523 bps	
Minority Interest	(20)	(34)	68.6	6	(654.8)	
Recurring PAT	4,238	6,982	64.7	8,820	(20.8)	

Source: Company, Citi Research

Figure 3. Lupin – 2QFY17 Revenue Breakdown (Rs m)

	2QFY16	2QFY17	% Ch YoY	1QFY17	% Ch QoQ	Citi Research Comments
Formulations	28,596	39,193	37.1	40,267	(2.7)	US Sales: Fortamet came off post competition from Mylan, delay in competition in Glumetza can surprise positively, c25+ launches targeted in FY17
% of Total Sales	89.6	93.1		93.3		
North America	11,539	19,978	73.1	21,886	(8.7)	India remains challenging : NLEM and FDC ban, growth was lower than expectation
India	8,881	9,958	12.1	9,313	6.9	
Asia Pacific	4,462	5,520	23.7	5,416	1.9	Japan up 10.4% YoY in INR (10% YoY in constant currency).
EMEA	2,218	2,355	6.2	2,194	7.3	
LATAM	1,082	986	(8.9)	1,089	(9.5)	Latam and ROW sales have declined, currency impact
RoW	414	396	(4.3)	369	7.3	
APIs	3,330	2,919	(12.3)	2,869	1.7	
Total Sales	10.4	6.9		6.7		

Source: Company, Citi Research

Figure 4. Lupin – 2QFY17 Revenues in Constant Currency (mn)

	1QFY16	1QFY17	% Ch YoY	4QFY16	% Ch QoQ
North America (US\$)	172	292	69.8	322	(9.3)
Japan (JPY)	6071	6700	10.4	6868	(2.4)
Philippines (PHP)	536	448	(16.4)	487	(8.0)
South Africa (ZAR)	199	252	26.6	205	22.9
Germany (EUR)	4.9	6.4	30.6	6.4	-
Brazil (BRL)	28	31	10.7	31	-
Mexico (MXN)	136	93	(31.6)	132	(29.5)

Source: Company, Citi Research

Lupin

Valuation

Given that pharma is a growth sector, we use P/E as our primary method to value the base business of pharma companies. We value Lupin at 27x March'18E forward earnings, at a 20% premium to the upper-end of the valuation band (21-23x) for the sector. We believe this is warranted, given Lupin's consistent delivery (in terms of business mix, return ratios and execution) and superior preparedness to target longer-term growth opportunities. At 27x Mar'18E recurring FDEPS, we arrive at a target price of Rs1,970.

Risks

Key risks that could impede the stock from achieving our target price include: 1) Rising competitive intensity in its US business, given faster pace of approvals for the industry; 2) Delay in approval of products especially from the niche portfolio in the US, given 483s at Goa or compliance issues at any of its other sites; and 3) Inability to effectively scale up the Japanese operations would hurt one of the longer term growth drivers.

Appendix A-1

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Lupin (LUPN.BO)

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Analyst: Prashant Nair, CFA



	Date	Rating	Target Price	Closing Price
1	03-Feb-14 13:58:17	1	*1,240.00	921.90
2	21-Mar-14 14:01:31	1	*1,280.00	944.20
3	09-May-14 17:43:50	1	*1,290.00	966.35
4	31-Jul-14 22:22:04	1	*1,650.00	1,182.05

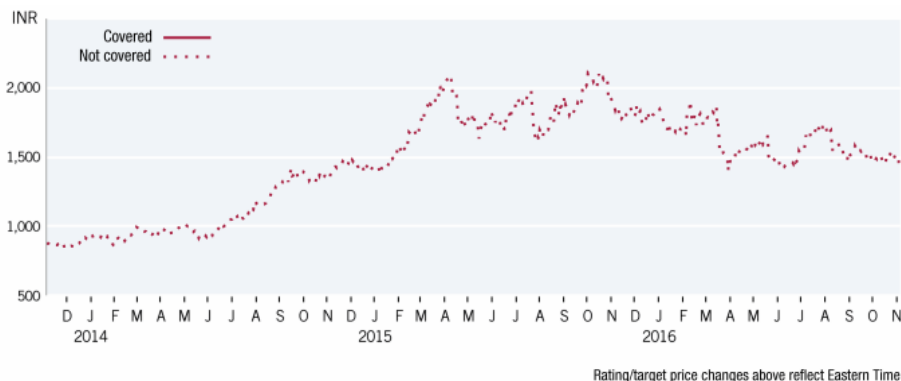
	Date	Rating	Target Price	Closing Price
5	28-Jan-15 07:04:49	1	*2,020.00	1,513.35
6	13-Aug-15 19:53:45	1	*2,270.00	1,757.00
7	24-Sep-15 18:24:09	1	*2,550.00	1,989.45
8	27-Oct-15 17:42:15	1	*2,360.00	1,945.65

	Date	Rating	Target Price	Closing Price
9	24-Feb-16 04:33:01	1	*2,130.00	1,762.15
10	19-May-16 21:28:11	1	*1,930.00	1,655.80
11	27-Oct-16 07:43:51	1	*1,970.00	1,485.00

*Indicates Change

Rating/target price changes above reflect Eastern Time

Lupin (LUPN.BO)
Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)
Analyst: Prashant Nair, CFA



*Indicates Change

Rating/target price changes above reflect Eastern Time

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