RESULT NOTE

Lupin

EBITDA miss; back ended growth

OUTPERFORMER

9 November 2016
BSE Sensex: 27253
Sector: Pharmaceuticals

Q2FY17 result highlights

- Lupin's revenues grew 32% yoy to Rs41.7bn, marginally below est of Rs42.2bn aided by Gavis consolidation and strong contribution from gGlumetza and gFortamet. US sales came in at $292m (Q1 sales of $322m) vs est of $302m. India sales grew 12% yoy while Japan sales grew 10% in CC terms. Growth was broadly in line in other markets
- EBITDA (with licensing inc of ~Rs440m) grew 52% yoy to Rs10.28bn - 12% below est of Rs11.7bn. Consolidated EBITDA margins came in at 24% vs est of 27%. Margins were primarily impacted by higher R&D costs and higher SGA costs. R&D costs continue to stay higher at 13.7% of sales (up 48% yoy) to Rs5.7bn.
- PBT came at Rs8.2bn vs est Rs9.6bn. Tax rate was lower at 19.4% vs est of 30%. PAT increased by 62% yoy to Rs6.6bn in line with est.

Key positives: Strong gross margins; lower tax rate

Key negatives: Lower US sales; higher other expenses

Impact on financials: Maintain earnings estimates

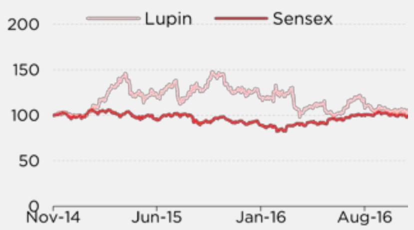
Valuations & view

While Lupin seems to have put the Goa plant related concerns behind it, we believe the lack of material new ANDA launches over the next few months combined with the impact of competition in gFortamet / gGlumetza will continue to subdue Lupin's near growth prospects. However, we remain positive on the medium term growth potential and expect strong recovery in US from Q4FY17 onwards as the pace of big ticket approvals begins to pick up. With 45 FTF products including 25 exclusive FTF opportunities Lupin has one of the strongest ANDA pipelines (arguably with the most visibility) among peers. Further, Lupin's strong R&D and regulatory capabilities and an aggressive and competent management team continue to provide confidence on its ability to successfully manage its transition to a complex generics-focused player and eventually a global specialty major. Maintain Outperformer and recommend buying into the weakness with a medium term view. Severe than expected price erosion in leading drugs and inability to secure approvals for key drugs like gRenvela, gRenagel etc. in FY18 are key risks to our call.

Stock data

CMP (Rs)	1,530
Mkt Cap (Rs bn/USD m)	689.6 /10,372
Target Price (Rs)	1,694
Change in TP (%)	⇔
Potential from CMP (%)	10.7
Earnings change (%)	
FY17E	⇔
FY18E	⇔
Bloomberg code	LPC IN
1-yr high/low (Rs)	1,912/1,280
6-mth avg. daily volumes (m)	1.3
6-mth avg. daily traded value	
(Rsm/USDm)	2,002.7/30.1
Shares outstanding (m)	450.8
Free float (%)	53.3
Promoter holding (%)	46.7

Price performance – relative & absolute



(%)	3-mth	6-mth	1-yr
LPC IN	(4.8)	(4.7)	(18.1)
BSE Sensex	(3.0)	6.1	4.3

Key financials (quarterly)

(Rs m)	Q2FY16	Q1FY17	Q2FY17	% ch qoq	% ch yoy	% var from est
Net sales	31,508	42,792	41,669	(2.6)	32.2	(1.4)
EBITDA	5,017	11,479	9,044	(21.2)	80.3	(14.2)
OPM (%)	15.9	26.8	21.7	(5.1)	5.8	(3.2)
Other inc.	2,120	2,429	1,507	(37.9)	(28.9)	50.7
Interest	102	320	263	(17.8)	159.1	(24.9)
Dep. & Amort.	1,068	2,027	2,111	4.1	97.6	0.5
PBT	5,967	11,561	8,177	(29.3)	37.1	(14.7)
PAT	4,088	8,821	6,622	(24.9)	62.0	(1.0)
Reported PAT	4,088	8,821	6,622	(24.9)	62.0	(1.0)
EPS (Rs)	9.2	19.8	14.8	(24.9)	62.0	(1.0)

Source: Company, IDFC Securities Research

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Exhibit 1: Quarterly results

(Rs m)	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	FY16	FY17E	Comments
Net Sales	**31,508**	**33,214**	**40,727**	**42,792**	**41,669**	**142,084**	**176,932**	Marginally below est; US sales disappoint
Expenses								
Cost of sales	11,294	11,230	11,010	12,719	12,429	56,842	65,884	
SG&A expenses	11,328	11,641	12,535	13,600	14,480	31,679	44,300	
R&D expenses	3,870	3,916	5,113	4,994	5,716	16,030	19,236	13.7% of sales
Total Expenses	**26,491**	**26,787**	**28,657**	**31,313**	**32,624**	**104,550**	**129,420**	
EBITDA	**5,017**	**6,427**	**12,070**	**11,479**	**9,044**	**37,534**	**47,513**	Below estimates due to higher SGA
OPM (%)	15.9	19.4	29.6	26.8	21.7	26.4	26.9	
Other Income	2,120	2,997	1,329	2,429	1,507	1,877	1,930	Includes Other op inc / IP income of Rs793m / Rs443m
Interest	102	92	213	320	263	446	837	
Depreciation	1,068	1,114	1,487	2,027	2,111	4,635	8,497	In-line
PBT	**5,967**	**8,219**	**11,699**	**11,561**	**8,177**	**34,330**	**40,108**	
Current Tax	1,851	2,909	4,188	2,734	1,589	11,536	10,912	
Deferred tax						-	-	
Tax Rate (%)	31.0	35.4	35.8	23.6	19.4	33.6	27.2	We est 30%
Minority interest	27	13	33	6	(34)	88	60	
PAT	**4,088**	**5,298**	**7,479**	**8,821**	**6,622**	**22,706**	**29,136**	**In line**
Extraordinary expenses	-	-	-	-	-	-	-	
Extraordinary Income								
Reported PAT	**4,088**	**5,298**	**7,479**	**8,821**	**6,622**	**22,706**	**29,136**	
% chg yoy								
Sales	**2.7**	**7.8**	**36.5**	**41.2**	**32.2**	**11.3**	**24.5**	
EBITDA	**(30.9)**	**(18.3)**	**73.5**	**64.2**	**80.3**	**3.7**	**26.6**	
Other Income	(2.2)	67.1	19.7	20.5	(28.9)	(21.7)	2.8	
Interest	376.5	246.4	765.0	355.6	159.1	355.3	87.5	
Depreciation	(1.7)	1.0	38.8	100.0	97.6	6.6	83.3	
PBT	**(28.3)**	**(3.7)**	**67.9**	**45.9**	**37.1**	**0.5**	**16.8**	
PAT	(35.1)	(11.9)	36.7	55.1	62.0	(5.5)	28.3	
Reported PAT	**(35.1)**	**(11.9)**	**36.7**	**55.1**	**62.0**	**(5.5)**	**28.3**	
EPS								
Equity	446.2	446.2	446.2	446.2	446.2	450.6	450.6	
EPS	9.2	11.9	16.8	19.8	14.8	50.4	64.7	

Source: Company, IDFC Securities Research

Other key highlights

- Lupin's US formulations (including IP income) business reported 73% yoy (9% lower qoq) growth in revenues to Rs19.9bn. In constant currency US revenues grew 70% yoy at US$292m vs $322m in Q1FY17 below our estimate of $302m. We estimate that Lupin booked Rs443m of IP income during the quarter.
- US revenues growth was aided by Gavis consolidation and continued strong contributions from

gGlumetza / gFortamet during the quarter.

- We estimate GAVIS contributed ~$40m revenues during the quarter
- Mgt attributed the qoq decline in ex-GAVIS business to seasonality, price erosion in gFortamet apart from other ongoing pricing pressure in the base business.

Ex-GAVIS business

- gGlumetza sales continued to stay strong as the two generic competitors delayed their launches despite receipt of approvals. Mgt remains hopeful that the situation might continue for next couple of months or so (an unexpected bonanza for the company!)and believes that any incremental approvals are not likely in the near term. This should continue to keep gGlumetza as an attractive opportunity for the company.
- gFortamet sales were lower qoq due to impact of shelf inventory adjustments as well as slight loss of market share post Mylan's generic launch in Sept'16. Mgt cited that Mylan has been reasonable with its pricing / market share strategy. Therefore it believes that while gFortamet will witness some decline in H2FY17, it is unlikely to erode in a material way. It doesn't have any visibility on the launch by Nostrum labs, another known filer on gFortamet.
- Our view is that that next few months, Lupin seems to have limited levers to counteract any potential price erosion in Glumetza / Fortamet as there is no visibility of any key launches over this period
- Expect two big launches only in March'17 – Minastrin 24 Fe (~$300m sales; FTF launch) and Epzicom (~$550m sales; limited competition launch); this should help to boost growth from Q4FY17 onwards
- Additionally, with the receipt of the EIR for the Goa facility, mgt expects some other key launches / approvals including Bupropion XL, gPaxil CR etc over the next few months. This should further boost growth and help to counteract the pricing pressure on the two frontline drugs.

GAVIS

- On GAVIS portfolio, mgt cited that revenues have been broadly flat on a qoq basis. We had estimate ~10% qoq growth on the back of new launches
- Mgt cited that the enhanced capacity has come on stream in September'16. The company is currently undertaking validation batches for key drugs such as Potassium Chloride and the same should get commercialized over the next few months
- Mgt remains very positive on the growth outlook for Methergene as the primary driver for GAVIS sales. Methergene Oral tablet is the only drug available for postpartum hemorrhage (PPH). Till recently, GAVIS had been selling this drug a generic and based on market research, Lupin saw significant growth potential in promoting it as a branded drug; Lupin believes it can become a major brand like Suprax and help to rejuvenate the specialty franchise. Mgt stated that it has managed to stabilize the Rx on the drug and is now looking to obtain branded pricing for these prescriptions. Mgt cited excellent response from the prescribing doctors to generics to Rx shift. Notably, as per mgt estimates, successful conversion of all the current prescriptions can generate revenues of ~$70m or so.
- Apart from Methergine, company is banking of approvals for some controlled substances in the near term to accelerate growth in GAVIS portfolio
- Overall, the performance of GAVIS in terms of scale-up of existing drugs as well as new ANDA approvals has been much softer than initial management guidance. The company has reduced its guidance for FY18 GAVIS to ~$250m from $300m as guided earlier. This is a disappointment.

Way forward in US

- With the receipt of EIR in Goa facility, in H2FY17 the company is expecting 4-5 new ANDA approvals from its India facilities and similar nos in GAVIS
- It expects to launch ~30 new drugs each in FY18 and FY19 respectively - driving 20% CAGR growth over the period.
- While FY17 seems like a soft year barring these few big launches, mgt remains positive on the outlook for some big ticket launches in FY18 including gRenvela, gRenagel, gWelchol
- Management reiterated confidence on the potential of its ANDA pipeline to deliver strongly over

FY18-19 on the back of multiple sole / shared FTF opportunities as well as launch of dermatology / controlled release drugs.

- In Q2FY17 Lupin got nine approvals and filed 4 new ANDAs. Lupin now has 338 (including Gavis) cumulative filings of which, 196 have been approved by the USFDA. Lupin is currently the leader in 42 products and the top 3 player in 79 of its marketed products.
  - The company has 45 FTF products which includes 25 exclusive FTF opportunities.
- US branded sales – Branded sales accounted for ~ 5% of overall US sales in FY16, much below the company's aspiration of maintaining 25-30% for branded sales in the US. The management indicated that it aspires to return to 20-25% levels in the US over the next two years or so. This implies branded sales of over US$200m, which would be a fairly stretched target.
  - Lupin is banking on the expected scale-up in Methergene Oral tablets to rejuvenate this business.
- Japan revenues grew 10% yoy in CC terms.
  - Management remain confident of maintain 10-15% growth in JPY terms
  - Positive on the Shionogi brand acquisitions; believe it's a fairly strategic transaction as it help to cross sell the generic products as also create foundation for building a specialty business
  - Shionogi portfolio margins are slightly better than company margins
  - The $150m acquisition will be funded through JPY denominated debt; cost to be pretty low
- India business grew 12% yoy to Rs9.9bn, in line with estimates. The company expects growth momentum to sustain as the business has begun to stabilize post a spate of regulatory interventions which has impacted growth across the industry
- Among other markets, South Africa sales grew by 27% yoy in CC terms while Lat-Am sales declined 8.9% yoy.
- Gross margins came in at ~70% (flat qoq), for the quarter, aided by higher high margin Glumteza and Fortamet sales.
- Employee cost (up 36% qoq) was higher on account of Gavis consolidation among other things
- R&D spends increased sharply 48% yoy to Rs5.7bn (13.7% of sales vs 12.3% in Q2FY16).
  - Lupin has been indicating it seeks to materially step up investments in development of complex drugs, including injectables, inhalation drugs and dermatology as also biosimilars.
  - Specifically, it has been indicating that they are seeking to imitate clinical trials on couple of inhaler products (DPI as well MDI) from FY16.
  - The company has already filed its first nasal spray product in Dec-15 and is aiming to file its first MDI (Albuterol) in FY17 followed by two DPI flings in FY18. Additionally, they also seek to initiate trials for gAdvair over the next 2-3 quarters.
  - Consequently, R&D spends is likely to remain higher in FY17 at 12-15% of sales.
- Other operating income (OOI) including IP income in at Rs1.2bn in line with estimates
- The consolidated OPM including OOI came at 24% vs our est of 27%. OPM was impacted by higher other expenses (up Rs1.5bn qoq; +440bps qoq as % of revs) on account of higher R&D expenses (up ~Rs700m qoq; +200bps qoq as % of revs) among other things.
- Tax rate came in lower at 20% vs our estimate of 30%. Resultant, PAT at Rs6.6bn was in line with estimates. The company has now guided for 25% (vs 27% as guided earlier) tax rate in FY17.
- The company has maintained its capex guidance – Rs18-20bn in FY17 which will temper down to Rs12-15bn in subsequent years. This was a big surprise and management ascribed it to a phase of fairly limited capex spends over FY15-16 and a major ramp-up in capacity addition projects across India and Japan
- Net debt / equity was 0.41x as of Sept'16 vs 0.34x as of March'16.

Income statement

Year to 31 Mar (Rs m)	FY14	FY15	FY16	FY17E	FY18E
Net sales	**111,872**	**127,700**	**142,084**	**176,932**	**201,713**
% growth	16.0	14.1	11.3	24.5	14.0
Operating expenses	82,838	91,504	104,550	129,420	147,711
EBITDA	**29,034**	**36,196**	**37,534**	**47,513**	**54,002**
% change	27.9	24.7	3.7	26.6	13.7
Other income	1,165	2,397	1,877	1,430	930
Net interest	(266)	(98)	(446)	(837)	(846)
Depreciation	2,610	4,347	4,635	8,497	9,739
Pre-tax profit	27,323	34,148	34,330	39,608	44,346
Deferred tax	86	0	0	0	0
Current tax	9,536	9,704	11,536	10,912	11,549
Profit after tax	**17,702**	**24,444**	**22,794**	**28,696**	**32,797**
Preference dividend	0	0	0	0	0
Minorities	(331)	(412)	(88)	(60)	(60)
Adjusted net profit	**17,371**	**24,032**	**22,706**	**28,636**	**32,737**
Non-recurring items	0	0	0	0	0
Reported net profit	**17,371**	**24,032**	**22,706**	**28,636**	**32,737**
% change	32.2	38.3	(5.5)	26.1	14.3

Balance sheet

As on 31 Mar (Rs m)	FY14	FY15	FY16	FY17E	FY18E
Paid-up capital	**897**	**899**	**901**	**901**	**901**
Preference capital	0	0	0	0	0
Reserves & surplus	68,421	87,844	108,945	131,781	158,193
Shareholders' equity	**69,987**	**88,984**	**110,167**	**133,063**	**159,534**
Total current liabilities	17,446	27,699	31,787	36,551	39,156
Total debt	**7,363**	**5,310**	**71,724**	**61,724**	**46,724**
Deferred tax liabilities	1,779	1,182	1,239	1,239	1,239
Other non-current liabilities	4,777	7,361	8,656	8,656	8,656
Total liabilities	31,365	41,552	113,405	108,169	95,774
Total equity & liabilities	**101,352**	**130,535**	**223,572**	**241,232**	**255,307**
Net fixed assets	30,019	32,961	86,379	95,882	101,142
Investments	1,785	16,584	75	75	75
Cash	7,975	4,814	8,379	7,467	12,140
Other current assets	54,995	59,696	99,094	98,114	102,256
Deferred tax assets	0	0	0	0	0
Other non-current assets	6,579	16,481	29,644	39,694	39,694
Net working capital	45,524	36,811	75,686	69,030	75,240
Total assets	**101,352**	**130,535**	**223,572**	**241,232**	**255,307**

Cash flow

Year to 31 Mar (Rs m)	FY14	FY15	FY16	FY17E	FY18E
Pre-tax profit	27,323	34,148	34,330	39,608	44,346
Depreciation	(2,610)	(4,347)	(4,635)	(8,497)	(9,739)
Chg in Working capital	(4,505)	5,552	(35,310)	5,743	(1,537)
Total tax paid	(9,536)	(9,704)	(11,536)	(10,912)	(11,549)
Interest Received	0	0	0	0	0
Ext ord. Items	0	0	0	0	0
Operating cash flow	**16,253**	**37,024**	**(6,140)**	**43,774**	**41,846**
Capital expenditure	(6,098)	(17,191)	(71,217)	(28,050)	(15,000)
Free cash flow (a+b)	**10,155**	**19,833**	**(77,356)**	**15,724**	**26,846**
Chg in investments	(1,764)	(14,799)	16,509	0	0
Debt raised/(repaid)	(4,206)	(2,053)	66,414	(10,000)	(15,000)
Interest Paid	(266)	(98)	(446)	(837)	(846)
Capital raised/(repaid)	2	2	2	0	0
Dividend (incl. tax)	(3,148)	(3,944)	(4,067)	(5,799)	(6,326)
Other items	3,110	(1,261)	2,518	0	1
Net chg in cash	**3,626**	**(3,161)**	**3,565**	**(912)**	**4,673**

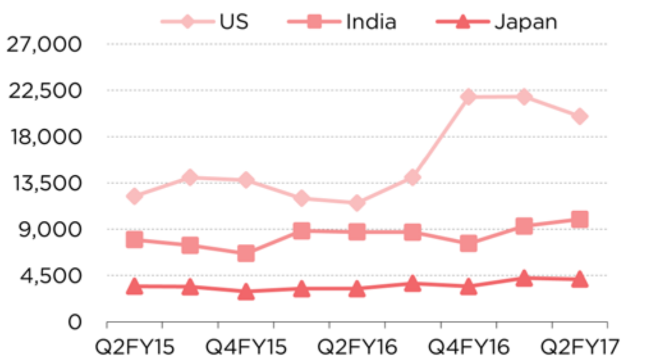
Key ratios

Year to 31 Mar	FY14	FY15	FY16	FY17E	FY18E
EBITDA margin (%)	26.0	28.3	26.4	26.9	26.8
EBIT margin (%)	23.6	24.9	23.2	22.1	21.9
PAT margin (%)	15.5	18.8	16.0	16.2	16.2
RoE (%)	28.3	30.2	22.8	23.5	22.4
RoCE (%)	34.2	34.1	22.3	19.7	21.0
Gearing (x)	0.0	0.0	0.6	0.4	0.2
Net debt/ EBITDA (x)	0.0	0.0	1.7	1.1	0.6
FCF yield (%)	1.5	2.9	(11.2)	2.3	3.9
Dividend yield (%)	0.5	0.6	0.6	0.8	0.9

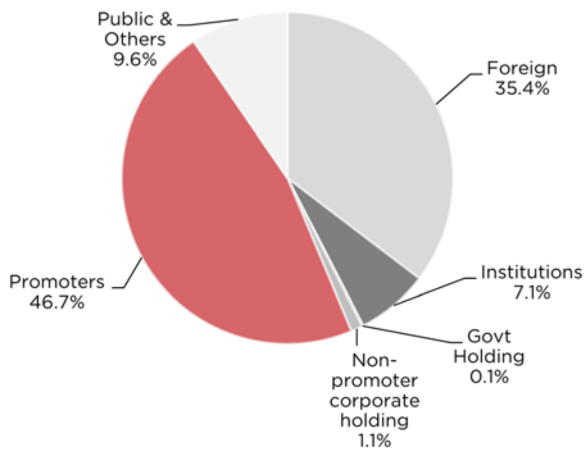
Valuations

Year to 31 Mar	FY14	FY15	FY16	FY17E	FY18E
Reported EPS (Rs)	**38.7**	**53.5**	**50.4**	**63.6**	**72.7**
Adj. EPS (Rs)	38.7	53.5	50.4	63.6	72.7
PE (x)	39.5	28.6	30.3	24.1	21.0
Price/ Book (x)	9.8	7.7	6.3	5.2	4.3
EV/ Net sales (x)	6.1	5.4	5.3	4.2	3.6
EV/ EBITDA (x)	23.6	19.0	20.1	15.7	13.4
EV/ CE (x)	8.2	6.7	3.9	3.6	3.3

Segmental break-up



Shareholding pattern



As of Sep 16

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