

Glumetza is masking the base erosion in US

Lupin's 2Q Ebitda missed our estimates by 7% due to higher R&D and other expenses. US revenue declined 9% QoQ, led by market share loss and price erosion in gFortamet. The company will see the full impact of gFortamet competition in 3QFY17. However, the windfall in gGlumetza will continue for at least one more quarter as competition is yet to enter the market. With these two products expected to erode in the near term, Lupin's margins will decline in 2HFY17. Lupin depends on its Colesevelam/Sevelamer launches for growth in FY18 and the company cut its FY18 Gavis revenue guidance by 17%. We downgrade FY17/18ii EPS by 1%/2%.

Partial impact from gFortamet competition; gGlumetza windfall will continue for another quarter: Lupin's US business declined 9% sequentially in 2Q, led by market share loss of 6% points in gFortamet due to Mylan's entry in Sep-2016. However, the QoQ decline in US revenues was still on the higher side, considering that gGlumetza remained competition free during the quarter. Lupin sees high single-digit price erosion in its base US portfolio. Although gFortamet is expected to face full impact in 3QFY17, the company expects gGlumetza revenues to sustain as Actavis/Sun Pharma are yet to enter the market. Although Lupin is expecting 8-10 new launches in the US in 2HFY17, the only material one is Minastrin expected towards end of 4QFY17.

Gavis FY18 revenue guidance trimmed to USD250mn: Gavis revenue has been flat since Lupin completed the acquisition in Mar-2016. Revenue ramp-up at Gavis has been slow due to capacity issues. Although Lupin has put up additional capacity at Gavis and is taking validation batches at the facility, the company is six months behind on its scheduled revenue ramp-up targets. Lupin has cut its Gavis FY18 revenue guidance from USD300mn to USD250mn. This is in line with our view that guidance of USD300mn was aggressive, given Gavis's limited product portfolio.

Colesevelam/Sevelamer launches expected in 2HFY18: FY18 growth in Lupin's US business depends on a few critical FTF launches (Welchol, Renagel, Renvela) coming through, given the high base of FY17 due to gFortamet and gGlumetza. Lupin expects to launch these products in 2HFY18. There has already been significant delay in these products (2-3 years) due to product development issues. Our FY18 estimates for Lupin face a 10% downside risk if these products are delayed further.

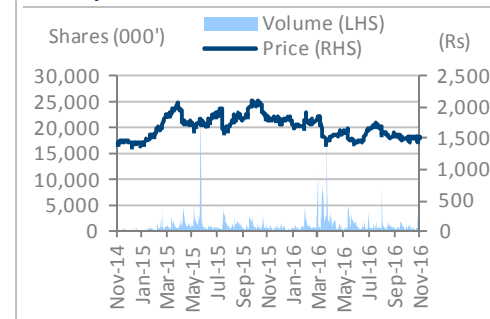
Result update

CMP	Rs1530	Price performance (%)			
12-mth TP (Rs)	1545 (1%)		1M	3M	1Y
Market cap (US\$m)	10,380	Absolute (Rs)	2.0	(4.8)	(18.1)
Enterprise value(US\$m)	11,314	Absolute (US\$)	2.3	(4.3)	(17.8)
Bloomberg	LPC IN	Rel. to Sensex	4.8	(1.9)	(22.5)
Sector	Pharma	Cagr (%)		3 yrs	5 yrs
		EPS		19.9	21.2

Shareholding pattern (%)

Promoter	46.7
FII	34.7
DII	7.1
Others	11.5
52Wk High/Low (Rs)	1912/1280
Shares o/s (m)	451
Daily volume (US\$ m)	28.7
Dividend yield FY17ii (%)	0.5
Free float (%)	53.3

Stock performance



Financial summary (Rs m)

Y/e 31 Mar, Consolidated	FY15A	FY16A	FY17ii	FY18ii	FY19ii
Revenues (Rs m)	127,700	142,085	173,953	194,598	210,754
Ebitda margins (%)	29.2	26.4	25.6	25.5	25.5
Pre-exceptional PAT (Rs m)	24,032	22,707	27,336	30,056	32,475
Reported PAT (Rs m)	24,032	22,707	27,336	30,056	32,475
Pre-exceptional EPS (Rs)	53.2	50.1	60.0	65.8	71.0
Growth (%)	31.2	(5.7)	19.6	9.7	7.8
IIFL vs consensus (%)			(9.3)	(14.4)	(18.1)
PER (x)	28.8	30.5	25.5	23.2	21.6
ROE (%)	30.2	22.8	22.4	20.5	18.7
Net debt/equity (x)	(0.2)	0.6	0.5	0.4	0.2
EV/Ebitda (x)	18.0	20.0	17.1	15.2	13.8
Price/book (x)	7.7	6.2	5.2	4.3	3.7

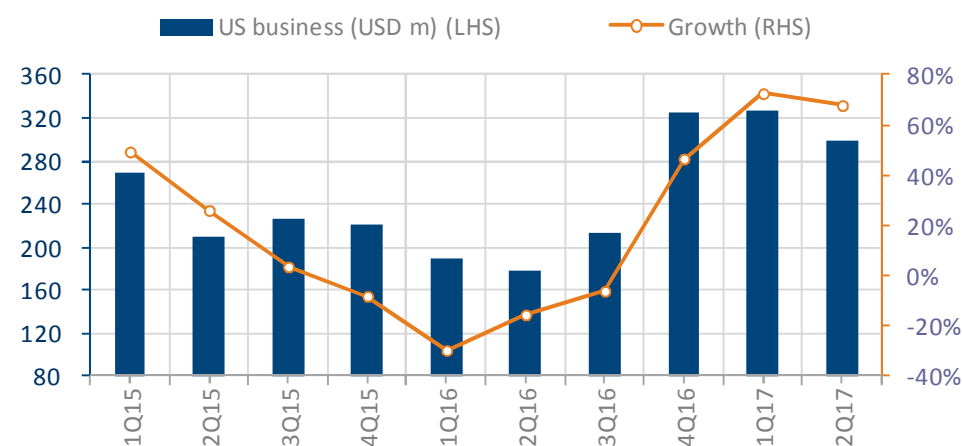
Source: Company, IIFL Research. Priced as on 09 November 2016

Figure 1: Lupin’s 2QFY17 result summary – Revenue was in line with our forecasts; however, Ebitda was 7% below estimates due to higher R&D and other expenses

Rs mn except EPS	2QFY16	1QFY17	2QFY17	QoQ	YoY
Sales break-up					
US	11,539	21,886	19,978	-9%	73%
India	8,881	9,499	9,958	5%	12%
Japan	3,234	4,232	4,368	3%	35%
South Africa	998	912	1,196	31%	20%
RoW	3,944	3,923	3,693	-6%	-6%
API business	3,330	2,966	2,919	-2%	-12%
Net Sales	31,926	43,418	42,112	-3%	32%
Other operating income	1,371	1,259	793	-37%	-42%
Total Revenue	33,297	44,677	42,905	-4%	29%
Raw material costs	(11,249)	(12,719)	(12,429)	-2%	10%
Employee costs	(5,328)	(7,059)	(7,124)	1%	34%
R&D expenses	(3,878)	(4,994)	(5,716)	14%	47%
Manufacturing & other expenses	(6,216)	(6,824)	(6,906)	1%	11%
Ebitda	6,626	13,080	10,731	-18%	62%
Ebitda margins	19.9%	29.3%	25.0%	-427 bps	511 bps
Depreciation & Amortisation	(1,155)	(2,027)	(2,112)	4%	83%
Interest & Finance charges	(241)	(320)	(263)	-18%	9%
Other income	578	826	(179)	-122%	-131%
PBT	5,809	11,560	8,177	-29%	41%
Taxes	(1,591)	(2,734)	(1,589)	-42%	0%
Tax rate	27.4%	23.7%	19.4%	-421 bps	-795 bps
Minority Interest/JV profit share	(20)	(6)	34	-673%	-269%
PAT	4,198	8,820	6,622	-25%	58%
Diluted shares outstanding	452.7	452.9	452.8	0%	0%
Diluted EPS	9.3	19.5	14.6	-25%	58%

Source: Company, IIFL Research

Figure 2: Lupin’s US business declined 9% QoQ due to market share loss in gFortamet and a seasonally weak cephalosporin business; gGlumetza was almost flat QoQ



Source: Company, IIFL Research

Figure 3: Estimates revision summary for Lupin

Estimates Revision	FY17ii	FY18ii	FY19ii
Total Revenue - old	172,847	194,372	211,351
Total Revenue - new	173,953	194,598	210,754
% Change in Revenue	1%	0%	0%
Ebitda - old	45,235	51,415	55,867
Ebitda - new	44,541	49,609	53,643
% Change in Ebitda	-2%	-4%	-4%
Diluted EPS - old	60.4	67.0	73.6
Diluted EPS - new	60.0	65.8	71.0
% Change in EPS	-1%	-2%	-4%

Source: Company, IIFL Research

Background: Lupin, the second largest Indian pharma company in terms of market capitalisation, actively targets the generics opportunity in regulated markets. Currently, the chronic-therapy business contributes 66% of total revenue in the domestic market, which makes Lupin a strong player in the specialties segment. Lupin has emerged as a fully-integrated company, with manufacturing capabilities in APIs and formulations and a direct marketing presence in its target markets, including the US, Europe and Japan. In the US market, apart from being one of the fastest-growing companies in the generic space, Lupin is also one of the few Indian companies to have a strong presence in the branded generics segment as well.

Management

Name	Designation
Dr. Kamal K Sharma	Vice Chairman
Vinita Gupta	CEO
Nilesh Gupta	MD

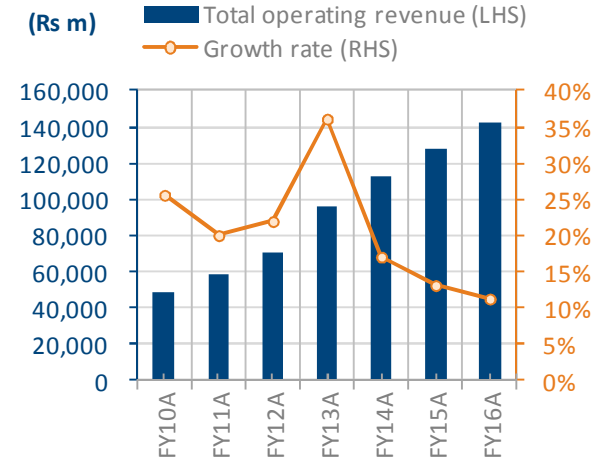
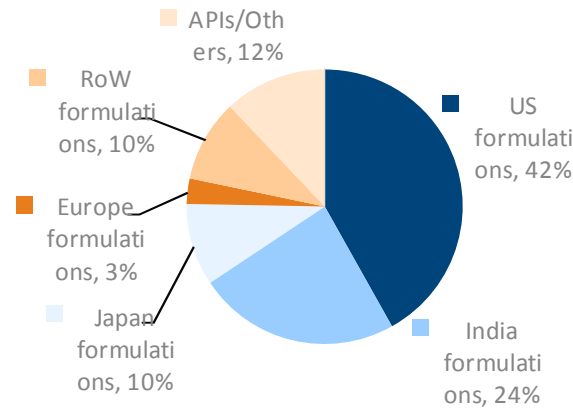
Sun Pharma, Dr. Reddy's, Cipla, Cadila, Glenmark:

Assumptions

Y/e 31 Mar, Consolidated	FY15A	FY16A	FY17ii	FY18ii	FY19ii
US business growth (%)	15.8	5.0	36.8	6.9	4.0
Japanese business growth (%)	2.2	3.1	39.5	31.6	10.0
Domestic growth (%)	19.7	14.3	11.1	14.0	14.0
API business growth (%)	7.2	1.1	(3.9)	5.0	5.0
EBITDA margin (%)	29.2	26.4	25.6	25.5	25.5
Tax rate (%)	28.4	33.6	24.8	25.0	25.0

Source: Company data, IIFL Research

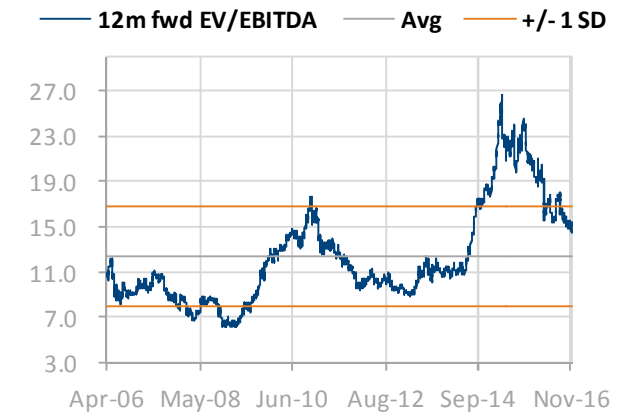
Revenue break-up - FY16



PE chart



EV/Ebitda



Financial summary

Income statement summary (Rs m)

Y/e 31 Mar, Consolidated	FY15A	FY16A	FY17ii	FY18ii	FY19ii
Revenues	127,700	142,085	173,953	194,598	210,754
Ebitda	37,342	37,535	44,541	49,609	53,643
Depreciation and amortisation	(4,347)	(4,635)	(8,205)	(8,845)	(9,443)
Ebit	32,995	32,900	36,336	40,763	44,201
Non-operating income	1,252	1,877	1,260	698	189
Financial expense	(98)	(446)	(1,293)	(1,441)	(1,147)
PBT	34,148	34,330	36,302	40,021	43,243
Exceptionals	0	0	0	0	0
Reported PBT	34,148	34,330	36,302	40,021	43,243
Tax expense	(9,704)	(11,536)	(9,012)	(10,005)	(10,811)
PAT	24,444	22,795	27,291	30,016	32,432
Minorities, Associates etc.	(412)	(88)	45	40	43
Attributable PAT	24,032	22,707	27,336	30,056	32,475

Ratio analysis

Y/e 31 Mar, Consolidated	FY15A	FY16A	FY17ii	FY18ii	FY19ii
Per share data (Rs)					
Pre-exceptional EPS	53.2	50.1	60.0	65.8	71.0
DPS	7.5	7.5	7.5	7.5	7.5
BVPS	198.0	244.8	295.7	352.4	414.2
Growth ratios (%)					
Revenues	13.1	11.3	22.4	11.9	8.3
Ebitda	24.4	0.5	18.7	11.4	8.1
EPS	31.2	(5.7)	19.6	9.7	7.8
Profitability ratios (%)					
Ebitda margin	29.2	26.4	25.6	25.5	25.5
Ebit margin	25.8	23.2	20.9	20.9	21.0
Tax rate	28.4	33.6	24.8	25.0	25.0
Net profit margin	19.1	16.0	15.7	15.4	15.4
Return ratios (%)					
ROE	30.2	22.8	22.4	20.5	18.7
ROCE	38.2	24.2	18.4	18.4	18.9
Solvency ratios (x)					
Net debt-equity	(0.2)	0.6	0.5	0.4	0.2
Net debt to Ebitda	(0.4)	1.7	1.6	1.2	0.9
Interest coverage	NM	NM	28.1	28.3	38.5

Source: Company data, IIFL Research

Balance sheet summary (Rs m)

Y/e 31 Mar, Consolidated	FY15A	FY16A	FY17ii	FY18ii	FY19ii
Cash & cash equivalents	21,372	8,399	7,348	1,994	1,030
Inventories	25,036	31,787	40,009	44,757	48,473
Receivables	26,566	45,498	55,665	62,271	67,441
Other current assets	5,350	12,106	16,666	19,762	22,186
Creditors	27,166	29,006	37,460	42,290	46,047
Other current liabilities	5,743	6,758	8,638	9,417	10,023
Net current assets	45,415	62,027	73,590	77,079	83,061
Fixed assets	32,031	59,625	79,470	85,624	91,181
Intangibles	17,411	56,398	56,398	56,398	56,398
Investments	25	55	55	55	55
Other long-term assets	3,587	10,509	10,509	10,509	10,509
Total net assets	98,469	188,614	220,021	229,665	241,204
Borrowings	5,402	71,848	80,032	63,732	46,921
Other long-term liabilities	4,085	6,602	6,602	6,602	6,602
Shareholders' equity	88,982	110,165	133,387	159,331	187,682
Total liabilities	98,469	188,614	220,021	229,665	241,204

Cash flow summary (Rs m)

Y/e 31 Mar, Consolidated	FY15A	FY16A	FY17ii	FY18ii	FY19ii
Ebit	32,995	32,900	36,336	40,763	44,201
Tax paid	(9,436)	(11,662)	(9,012)	(10,005)	(10,811)
Depreciation and amortization	4,347	4,635	8,205	8,845	9,443
Net working capital change	(949)	(31,537)	(12,614)	(8,844)	(6,946)
Other operating items	374	1,974	0	0	0
Operating cash flow before interest	27,331	(3,690)	22,916	30,760	35,887
Financial expense	(109)	(436)	(1,293)	(1,441)	(1,147)
Non-operating income	1,242	2,559	1,260	698	189
Operating cash flow after interest	28,463	(1,567)	22,883	30,017	34,929
Capital expenditure	(8,676)	(57,746)	(18,000)	(15,000)	(15,000)
Long-term investments	(6,294)	(12,223)	(10,050)	0	0
Others	0	0	0	0	0
Free cash flow	13,493	(71,535)	(5,167)	15,017	19,929
Equity raising	413	536	0	0	0
Borrowings	(700)	62,081	8,185	(16,300)	(16,812)
Dividend	(1,573)	(4,055)	(4,068)	(4,072)	(4,081)
Net chg in cash and equivalents	11,633	(12,973)	(1,051)	(5,355)	(963)

Source: Company data, IIFL Research

Disclosure : Published in 2016, © India Infoline Ltd 2016

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BUY - Absolute - Stock expected to give a positive return of over 20% over a 1-year horizon.

SELL - Absolute - Stock expected to fall by more than 10% over a 1-year horizon.

In addition, **Add** and **Reduce** recommendations are based on expected returns relative to a hurdle rate. Investment horizon for **Add** and **Reduce** recommendations is up to a year. We assume the current hurdle rate at 10%, this being the average return on a debt instrument available for investment.

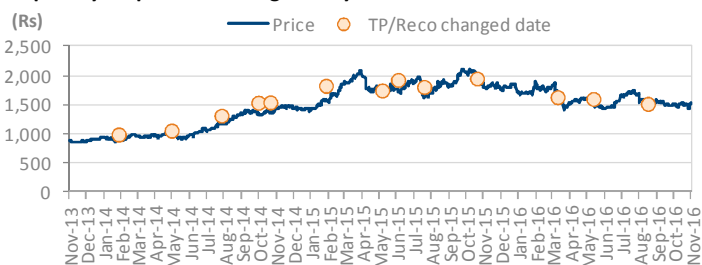
Add - Stock expected to give a return of 0-10% over the hurdle rate, i.e. a positive return of 10%+.

Reduce - Stock expected to return less than the hurdle rate, i.e. return of less than 10%.

Distribution of Ratings: Out of 205 stocks rated in the IIFL coverage universe, 120 have BUY ratings, 9 have SELL ratings, 53 have ADD ratings and 23 have REDUCE ratings.

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Lupin: 3 year price and rating history



Date	Close price (Rs)	Target price (Rs)	Rating	Date	Close price (Rs)	Target price (Rs)	Rating
04 Feb 2014	922	989	ADD	24 Aug 2016	1556	1515	ADD
08 May 2014	990	1056	ADD				
04 Aug 2014	1165	1312	ADD				
08 Oct 2014	1368	1535	BUY				
29 Oct 2014	1358	1540	BUY				
04 Feb 2015	1546	1825	BUY				
14 May 2015	1690	1745	BUY				
11 Jun 2015	1795	1925	BUY				
27 Jul 2015	1672	1805	BUY				
28 Oct 2015	1946	1950	BUY				
18 Mar 2016	1674	1630	ADD				
20 May 2016	1655	1600	ADD				