

# Lupin

## Management optimistic on US, in line with our view

In 2QFY17, Lupin reported revenue of Rs42.1bn, 29% YoY growth, led by lower-than-expected competition in Fortamet and Glumetza in the US business. Management lowered Gavis revenue guidance from US\$300mn to US\$250mn for FY18E (our estimate of US\$256mn) due to delayed integration. However, with Goa facility cleared, management has provided optimistic guidance of ~10 ANDA approvals in FY17E and ~30 in FY18E (vs our estimate of ~40). We continue to remain optimistic on Lupin's US business and believe the company is one of the biggest beneficiaries of GDUFA due to presence in complex generics and large pipeline of ANDAs (~140) pending approval. We expect company to report US revenue CAGR of 30% over FY16-19E. Over FY16-19E, we see 250bps margin expansion to 28.8% due to higher revenue from limited competition complex generics and operating leverage in RoW; partially offset by increase in R&D spend (12% in FY18E). Retain BUY with TP of Rs1,851 (21% upside).

### Results overview: Higher sales growth led by lower-than-expected competition in US business

Lupin reported 2QFY17 revenue of Rs42.1 bn, 29% YoY growth, 3% decline QoQ, led by lower-than-expected competition in specific products in the US business. The company reported limited impact from incremental competition in generic Fortamet which led to lower loss of market share and decline in prices. Gross margins were flat QoQ at 70.5% (despite Q1FY17 reporting one-off due to limited competition revenue) led by Gavis portfolio and Fortamet pricing. EBITDA margins increased by 600bps YoY to 22.5%, primarily due to Gavis portfolio partially offset by 2Q being seasonally higher due to weak cephalosporin sales. Also, other expenses included Rs450mn of forex losses, excluding which EBITDA margin was at 23.6%. R&D spends for the quarter was 13.6% of sales vs 11.6% in 1QFY17. Tax rate for the quarter was at 19% of PBT vs 1QFY17 at 24% due to change in accounting to IND AS and higher R&D spends resulting in tax breaks. The management guided for a tax rate of 25% for FY17E.

### Key takeaways from the conference call

- US business – lower-than-expected competition in Fortamet:** The company reported US sales of Rs19.9bn, 9% decline QoQ, as limited competition opportunity ends in Glumetza and entry of additional player in Fortamet. Mylan launched generic version of Fortamet during 2QFY17 which led to pricing pressure and 6% loss of market share for Lupin. The management said Glumetza sales for 2QFY17 were flat (~US\$200mn as per our estimate). Further, two additional players were expected in Glumetza but failed to receive approval. Considering Glumetza is difficult to formulate, management expects incremental competition to be restricted to two and the product will be limited competition/high-margin opportunity. Base business continues to report price erosion of 8-9% on annual basis which is in line with our expectations.
- Gavis business revenue guidance revised downwards but in line with our expectations:** In 2QFY17, revenues from Gavis business were higher sequentially due to launch of branded product, Mithergine. The US branded business for 2QFY17 was at US\$20mn vs US\$22mn in 1QFY17. The management said that close to 100% of generic patients have shifted to Methergine and is expected to compensate for the loss in Suprax sales witnessed in FY16. However, the management has lowered its guidance for Gavis business from US\$300mn in FY18E to US\$250mn. The lower guidance is due to delay in integration and expansion of capacities of Gavis especially for cephalosporin, which has lead time in product development. The lowered guidance has no impact on our estimate as we have projected Gavis business to report revenue of US\$256mn led by launch of ~15 products in FY18E.

# BUY

## Result Update

### Stock Information

Bloomberg Code:	LPC IN
CMP (Rs):	1,530
TP (Rs):	1,851
Mcap (Rs bn/US\$ bn):	690/10.4
3M ADV (Rs mn/US\$ mn):	1906/28.6

### Stock Performance (%)

	1M	3M	12M	YTD
Absolute	2	(5)	(18)	(17)
Rel. to Sensex	5	(2)	(22)	(21)

Source: Bloomberg, Ambit Capital research

### Ambit Estimates (Rs mn)

	FY17E	FY18E	FY19E
Revenues	175355	220382	278723
EBITDA	46948	62534	73299
EPS (Rs)	65.2	90.7	105.9

Source: Bloomberg, Ambit Capital research

### Research Analyst

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- Management optimistic on US business; expect ~30 product approvals in FY18E:** With Goa facility cleared by the USFDA and all its plants now approved, the management has provided optimistic guidance on number of product approvals expected over 12-15 months. The management expects to receive ten ANDA approvals from USFDA in FY17E with ~5 ANDAs from Goa and Indore facilities and ~5 from Gavis portfolio. Moreover, the management has guided for 'good part' of ANDA backlog to be cleared in the next two years (FY18E/19E). Lupin has ~140 ANDAs pending approval with annual filing rate of ~25 ANDAs. Whilst this is positive, it is in line with our expectation of company receiving ~40 approvals annually from FY18E. At current base of US\$1.2bn, the management expects to garner additional revenue of US\$350mn which would be partially offset by US\$100mn of base business erosion. This implies US revenue growth rate of ~20% over FY17-19E. We continue to remain optimistic on Lupin's US business and believe the company is one of the biggest beneficiaries of GDUFA due to presence in complex generics and large pipeline of ANDAs pending approval. We expect company to report US revenue CAGR of 30% over FY16-19E.
- Positive impact of change in government in the USA:** Despite change in government in the USA, the management does not expect any material change in the course of business. According to the management, Republican Party coming to power is mildly positive for the generic pharma companies. We believe Mr Tump coming to power is positive for Indian generics as Mr Trump in the run up to the election has guided to reduce health care cost by increasing outsourcing to low-cost manufacturing nations like India.

### Where do we go from here?

With Goa facility now cleared, we believe that Lupin is best placed to reap benefits of GDUFA given presence in complex generics and large pipeline of ~140 ANDAs pending approval. Also, Lupin has the first-mover advantage in Japan and we expect the company to benefit from increasing generic penetration. Over FY16-19E, we see 250bps margin expansion to 28.8% due to higher revenue from limited competition complex generics and operating leverage in RoW; partially offset by increase in R&D spend (12% in FY18E). At CMP, Lupin trades at 17x FY18E EPS. We believe valuations will improve, given: (a) earnings growth momentum – we expect 25% net profit CAGR over FY16-18E due to GDUFA timelines resulting in large product approvals in FY17-18E; (b) investments in long-term growth drivers – the company is investing in differentiated products like complex injectables, ophthalmics and dermatology, biosimilars in Japan and respiratory in the USA and Japan; and (c) high visibility of earnings through large pipeline in the USA and growth acceleration in India. Our DCF-based analysis suggests a target price of Rs1,851/share, retain BUY.

### Revenue mix

(Rs mn)	2QFY17	YoY (%)	2QFY16	QoQ (%)	1QFY17	Divergence (%)	2QFY17E
<b>Advanced market formulations</b>	<b>25,592</b>	<b>61%</b>	<b>15,942</b>	<b>-7%</b>	<b>27,395</b>	<b>24%</b>	<b>20,663</b>
US	19,978	73%	11,550	-9%	21,886	30%	15,320
Europe	1,246	8%	1,158	-2%	1,277	-4%	1,300
Japan	4,368	35%	3,234	3%	4,232	8%	4,043
<b>India formulations</b>	<b>9,958</b>	<b>14%</b>	<b>8,738</b>	<b>7%</b>	<b>9,313</b>	<b>4%</b>	<b>9,612</b>
<b>Other formulations</b>	<b>3,643</b>	<b>-6%</b>	<b>3,884</b>	<b>2%</b>	<b>3,559</b>	<b>4%</b>	<b>3,500</b>
<b>API</b>	<b>2,919</b>	<b>-9%</b>	<b>3,219</b>	<b>2%</b>	<b>2,869</b>	<b>6%</b>	<b>2,750</b>
<b>Total net sales</b>	<b>42,112</b>	<b>32%</b>	<b>31,783</b>	<b>-2%</b>	<b>43,136</b>	<b>15%</b>	<b>36,525</b>

Source: Company, Ambit Capital research

**Income Statement**

(Rs mn)	2QFY17	YoY (%)	2QFY16	QoQ (%)	1QFY17	Divergence (%)	2QFY17E
<b>Net Sales</b>	<b>42,112</b>	<b>32%</b>	<b>31,783</b>	<b>-2%</b>	<b>43,136</b>	<b>15%</b>	<b>36,525</b>
Other Operating income	793	-45%	1,430	-37%	1,259	-37%	1,250
<b>Total operating income</b>	<b>42,905</b>	<b>29%</b>	<b>33,213</b>	<b>-3%</b>	<b>44,394</b>	<b>14%</b>	<b>37,775</b>
Material costs	12,429	10%	11,294	-2%	12,719	6%	11,688
Staff costs	7,124	36%	5,242	1%	7,059	-1%	7,207
Other expenditure	13,072	31%	9,956	13%	11,535	23%	10,592
<b>Total Expenditure</b>	<b>32,624</b>	<b>23%</b>	<b>26,491</b>	<b>4%</b>	<b>31,314</b>	<b>11%</b>	<b>29,487</b>
<b>EBITDA</b>	<b>10,281</b>	<b>53%</b>	<b>6,721</b>	<b>-21%</b>	<b>13,080</b>	<b>24%</b>	<b>8,287</b>
Core EBITDA margins (ex-OOI)	22.5%		16.6%		27.4%		19.3%
Other income	271	-35%	415	-67%	826		750
Interest	263	159%	102	-18%	320	-25%	350
Depreciation	2,112	98%	1,068	4%	2,027	6%	2,000
<b>PBT</b>	<b>8,177</b>	<b>37%</b>	<b>5,967</b>	<b>-29%</b>	<b>11,560</b>	<b>22%</b>	<b>6,687</b>
Tax	1,589	-14%	1,851	-42%	2,734	-12%	1,806
Tax rate	19.4%		31.0%		23.7%		27.0%
MI + Share of associates	(34)	-229%	27	-673%	6		-
<b>PAT</b>	<b>6,622</b>	<b>62%</b>	<b>4,088</b>	<b>-25%</b>	<b>8,820</b>	<b>36%</b>	<b>4,882</b>
<b>(% of Operating Income)</b>							
Material costs	29.5%	-602bps	35.5%	3bps	29.5%	-249bps	32.0%
Staff costs	16.6%	82bps	15.8%	70bps	15.9%	-248bps	19.1%
Other Expenditure	30.5%	49bps	30.0%	448bps	26.0%	243bps	28.0%
EBITDA Margin	22.5%	588bps	16.6%	-488bps	27.4%	326bps	19.3%

Source: Company, Ambit Capital research

**Revenue mix (Rs mn)**

Year ended 31 Mar	FY15	FY16	FY17E	FY18E	FY19E
Formulations	1,12,884	1,24,597	1,58,932	2,03,434	2,61,242
India (Gross)	30,614	34,956	40,213	46,244	53,181
US generics	49,596	53,751	70,476	1,00,757	1,42,203
US brand	4,873	4,271	11,218	12,827	14,144
Japan	13,239	13,646	15,693	18,047	20,754
Europe	3,279	4,278	3,611	3,860	4,259
RoW	11,283	13,695	17,721	21,700	26,701
API	11,941	12,074	12,678	13,312	13,977
<b>Total</b>	<b>1,24,825</b>	<b>1,36,671</b>	<b>1,71,610</b>	<b>2,16,746</b>	<b>2,75,219</b>

Source: Company, Ambit Capital research

**Income Statement**

Year to March (Rs mn)	FY15	FY16	FY17E	FY18E	FY19E
Net revenues	1,27,700	1,42,085	1,75,355	2,20,382	2,78,723
Material costs	41,570	43,094	54,162	67,149	93,161
Employee costs	13,949	17,260	19,744	22,063	24,710
Other mfg. costs	35,985	44,196	54,501	68,636	87,553
Core EBITDA	36,196	37,535	46,948	62,534	73,299
Depreciation	4,347	4,635	6,149	7,124	7,936
Interest expense	98	446	1,669	1,419	1,169
Adjusted PBT	34,149	34,331	40,538	56,351	65,794
Tax	9,705	11,536	10,945	15,215	17,764
Net profit	24,032	22,707	29,367	40,886	47,733

Source: Company, Ambit Capital research

**Balance Sheet**

Year to Mar (Rs mn)	FY15	FY16	FY17E	FY18E	FY19E
Total Assets	96,377	1,83,984	1,98,978	2,23,776	2,54,402
Fixed Assets	32,961	86,379	95,231	1,03,107	1,05,171
Current Assets (incl Cash)	64,507	1,07,473	1,20,088	1,46,302	1,85,552
Cash	4,814	8,379	30,767	35,542	46,752
Investments	16,584	75	75	75	75
Total Liabilities	96,377	1,83,984	1,98,978	2,23,776	2,54,402
Total networkth	88,741	1,09,844	1,34,837	1,69,635	2,10,261
Total debt	5,371	71,775	61,775	51,775	41,775
Current liabilities	35,001	40,393	46,866	56,159	66,846
Deferred tax liability	2,024	2,045	2,045	2,045	2,045

Source: Company, Ambit Capital research

**Cash Flow Statement**

Year to March (Rs mn)	FY15	FY16	FY17E	FY18E	FY19E
PBT	34,149	34,331	40,538	56,351	65,794
Depreciation	4,347	4,635	6,149	7,124	7,936
Tax	(9,436)	(11,662)	(10,945)	(15,215)	(17,764)
Net Working Capital	(1,378)	(22,946)	9,856	(12,317)	(16,048)
Others	(351)	(8,047)	7,756	(124)	(1,153)
CFO	27,331	(3,689)	53,354	35,819	38,765
Capital Expenditure	(14,970)	(70,028)	(15,000)	(15,000)	(10,000)
Investment and Others	4,425	593	-	-	-
CFI	(10,545)	(69,435)	(15,000)	(15,000)	(10,000)
Issuance of Equity	413	536	-	-	-
Inc/Dec in Borrowings	(700)	62,081	(10,000)	(10,000)	(10,000)
Net Dividends	(1,573)	(4,055)	(4,071)	(4,374)	(6,088)
Interest paid	(109)	(436)	(1,669)	(1,419)	(1,169)
Others	-	-	(226)	(250)	(297)
CFF	(1,969)	58,126	(15,966)	(16,043)	(17,554)
Net change in cash	14,817	(14,998)	22,387	4,776	11,210
Closing cash balance	4,814	8,379	30,767	35,542	46,752
FCFF	<b>12,361</b>	<b>(73,717)</b>	<b>38,354</b>	<b>20,819</b>	<b>28,765</b>

Source: Company, Ambit Capital research

**Valuation parameters**

Year to March	FY15	FY16	FY17E	FY18E	FY19E
EPS	53.5	50.4	65.2	90.7	105.9
Book Value (per share)	197.4	243.8	299.3	376.5	466.6
P/E (x)	28.1	29.8	23.0	16.5	14.2
P/BV (x)	7.6	6.2	5.0	4.0	3.2
EV/EBITDA(x)	18.6	19.7	15.1	11.1	9.2
EV/Sales (x)	5.3	5.2	4.0	3.1	2.4
EV/EBIT (x)	21.2	22.4	17.3	12.5	10.3

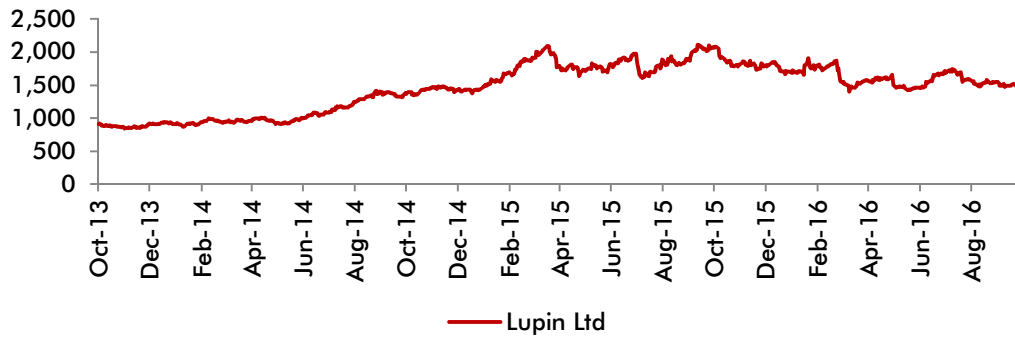
Source: Company, Ambit Capital research

**Ratios**

<b>Year to March</b>	<b>FY15</b>	<b>FY16</b>	<b>FY17E</b>	<b>FY18E</b>	<b>FY19E</b>
Revenue growth	13.1	11.3	23.4	25.7	26.5
Core EBITDA growth	20.5	3.7	25.1	33.2	17.2
APAT growth	30.9	-5.5	29.3	39.2	16.7
EPS growth	31.1	-5.7	29.3	39.2	16.7
Core EBITDA margin	28.3	26.4	26.8	28.4	26.3
EBIT margin	24.9	23.2	23.3	25.1	23.5
Net profit margin	18.8	16.0	16.7	18.6	17.1
ROCE (%)	26.7	15.8	15.7	19.3	20.1
Reported RoE (%)	30.4	22.9	24.0	26.9	25.1
Debt Equity ratio (X)	0.1	0.7	0.5	0.3	0.2
Current Ratio	1.8	2.7	2.6	2.6	2.8
Gross Block turnover (x)	2.7	2.1	1.9	2.0	2.3
Working Capital Turnover (x)	3.7	2.9	2.5	2.7	2.7
CFO/EBITDA (x)	0.8	-0.1	1.1	0.6	0.5

Source: Company, Ambit Capital research

**Lupin Ltd (LPC IN, BUY)**



Source: Bloomberg, Ambit Capital research

**Explanation of Investment Rating**

Investment Rating	Expected return (over 12-month)
BUY	>10%
SELL	≤10%
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