

Steady quarter;

Notwithstanding disappointing profitability which saw EBITDA margins shrink to 24%, Lupin's revenues and gross margins remained resilient. While we concede that sectoral headwinds are unlikely to abate in the near future, we see several factors playing out in the near-term – a) Goa remediation is likely to improve approval pace; b) Fortamet and Glumetza will remain low competition and the products share market share in Metformin XR seems to have plateaued; c) gross margin is unlikely to slide as Minastrin FE launch in 4Q and improving domestic business will help offset base business pricing erosion. Our new TP of Rs,1,730 is based on 22x FY18/19 blended earnings.

- Key operating details:** Unlike 1Q where the US as well as domestic business were below par, 2Q was a far stronger quarter. US business strong: US declined 9.3% q/q to \$292m, which was a strong performance considering that Lupin lost ~6% share to Mylan in Fortamet, Gavis sales were flattish q/q and seasonal impact from cephalosporin (2Q is the weakest). Sun is yet to launch gGlumetza and with gGlumetza's market share in metformin XR space stabilizing, there seems limited threat in 3Q. Minastrin FE launch in 4Q should compensate for the decline in gGlumetza 4Q onwards. Domestic franchise recovers: Lupin reported a 12% y/y growth in the domestic market. While we acknowledge a strong anti-infective season, we expect Lupin to continue to outperform the IPM given its strong chronic franchise (60-65%). Going forward, management is confident of double-digit growth.
- Multiple growth levers but macro headwinds remain:** Lupin faces industry-wide headwinds in the form of US pricing pressures and its problems have been compounded by a slower ramp-up in Gavis products which has led to a guidance cut (from \$300m to \$250m) in FY18. However, a robust domestic franchise, presence in stable developed markets (Japan) and EMs (South Africa and Brazil), a big US basket complemented by a strong pipeline and an anticipated 20-25 annual launches should ensure sustainable growth. Methergine is showing potential, with ~27% TRx share within 6 months of launch; management is confident of generating annual sales of ~\$65-70m. Our FY18 and FY19 numbers assume monetization of its key pipeline products (Renagel, Renvela, Welchol and Prevacid besides Minastrin). In the

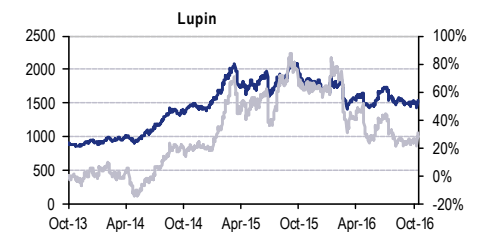
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Key Data

Market cap (bn)	₹ 689.6 / US\$ 10.4
Shares in issue (mn)	448.2
Diluted share (mn)	448.2
3-mon avg daily val (mn)	₹ 1906.4/US\$ 28.7
52-week range	₹ 1911.9/1280.0
Sensex/Nifty	27,253/8,432
₹/US\$	66.4

Daily Performance



%	1M	3M	12M
Absolute	2.0	-4.8	-18.1
Relative	4.8	-1.9	-22.5

* To the BSE Sensex

Shareholding Pattern (%)

	Jun-16	Mar-16
Promoters	46.8	46.5
FII	34.9	35.1
DII	7.4	7.0
Public / Others	11.0	11.4

JM Financial Research is also available on: Bloomberg - JMFR <GO>, Thomson Publisher & Reuters, S&P Capital IQ and FactSet

Please see Appendix I at the end of this report for Important Disclosures and Disclaimers and Research Analyst Certification.

Exhibit 1. Financial Summary

(₹ mn)

Y/E March	FY15A	FY16A	FY17E	FY18E	FY19E
Net sales	1,25,997	1,36,539	1,68,450	1,90,415	2,14,187
Sales growth (%)	13.6	8.4	23.4	13.0	12.5
EBITDA	36,197	36,756	44,824	52,033	63,329
EBITDA (%)	28.3	26.0	26.0	26.7	29.0
Adjusted net profit	24,032	22,607	27,393	31,384	39,120
EPS (₹)	53.6	50.4	61.1	70.0	87.3
EPS growth (%)	30.8	-5.9	21.2	14.6	24.6
ROIC (%)	35.1	18.8	15.3	15.9	18.5
ROE (%)	30.4	22.8	22.5	21.4	22.1
PE (x)	28.5	30.3	25.0	21.8	17.5
Price/Book value (x)	7.7	6.2	5.1	4.3	3.5
EV/EBITDA (x)	18.5	20.4	16.7	14.1	11.3

Source: Company data, JM Financial. Note: Valuations as of 09/11/2016

event of further launch delays, price erosion reaching double digits, and price cuts in Shionogi portfolio, there is risk of further earnings downgrade. We take note of increased R&D spend on complex generics, topicals, inhalers and specialty injectables, as that is the best way to fight off the base business erosion. However, a majority of these opportunities face a high hurdle rate and we see a period of 2-3 years before Lupin begins to monetize them.

- **Key numbers:** Net sales stood at Rs.42,112m, +32% y/y (1% ahead of JMFe) and 2% q/q decline mainly due to metformin franchise peaking out in the previous quarter. Despite lower other operating income (Rs.793m vs. JMFe 1,430m), gross margins surprised at 71% only 30bps lower q/q; this, in our view, was on account of strong domestic performance. Despite gross profit being 0.6% ahead of estimates, EBITDA was 14% behind our est. (24% margin vs. JMFe 27.8%) as employee expenses grew 34% y/y (7,124m vs. JMFe 6,453m) and other expenses by 30% (130,72m vs. JMFe 11,867m) mainly due to higher R&D (13.6% of sales). Lower other income was set off against lower interest expense. Reported PAT stood at Rs.6,622m as tax rate was surprisingly low (19% vs. JMFe 29%) despite high US contribution.

Key takeaways from conference call

- **US:** 2Q wrap: Branded biz was ~\$22m. Methergine is largest product, followed by Antara which has grown quite well. Cephalosporin sales lowest in 2Q. Base business down 'little bit' q/q.

Expect 30 ANDAs filing. Expect ~4-5 product approvals from Goa and Indore each and 4-5 from Somerset. Expect good part of backlog to clear in FY18 and FY19. 15-16 launches in FY18 and hope 30+ launches in next couple of years. 20% growth in 2 yrs time, net of price erosion

Pricing - High single-digit price erosion. Expect to continue at this level. Could go to double-digits if there is some event eg Mckesson-Walmart

No subpoena from the US DoJ. Risk is limited

Fortamet: Given up 6% share to Mylan. Pricing decline but reasonable. On annual basis, Fortamet will continue to contribute nicely. More reasonable impact going forward. Nostrum is a smaller player with smaller capacity; not sure when it will launch

Glumetza: No additional competition; flat q/q. Not sure when competition will come in; hope to get through this quarter. Upside if competition is slow

Tamiflu: FY18 launch. Prezista: Launch is tot in next 2 years. FTF on certain strengths. Renagel/Renvela and Welchol: On track for late FY18 launch (filing in 2H17). Hope to be in the first wave. Potassium chloride: Expect launch in next couple of months. Epzicom and Prevacid ODT will be in FY18.

Inhalation: Albuterol trial strong; 3Q filing. It is a \$3bn market. Perrigo has filed but not approved yet. On track for tiotropium. Have done pilot studies and PK studies. Expect to scale up before doing PD studies Biosimilar etanercept going strong; developing for EU and Japan. Trial will continue till next year

- **Gavis:** 2Q - marginally up sequentially. Capacity in place; so launches in couple of months incl. controlled substances

Methergine - represented in brands. Will be a growth driver. Could go upto \$70m annual sales. No patent protection. Limited API suppliers which act as natural barriers. Started developing XR.

Little delayed in growth. 6 months behind when Lupin started. Expect \$250m in sales by FY18

- **India:** 23% of products under NLEM. 8-9 products launched in 1H excl. line extensions
- **Financial:** Larger quantum of fx losses (45cr in 2Q17 under "manufacturing and other expense") and R&D cost rise. Normalized for this, EBITDA margin would be 26-28%. Expect the margin range to sustain.

Tax rate for FY17 will be ~25%.

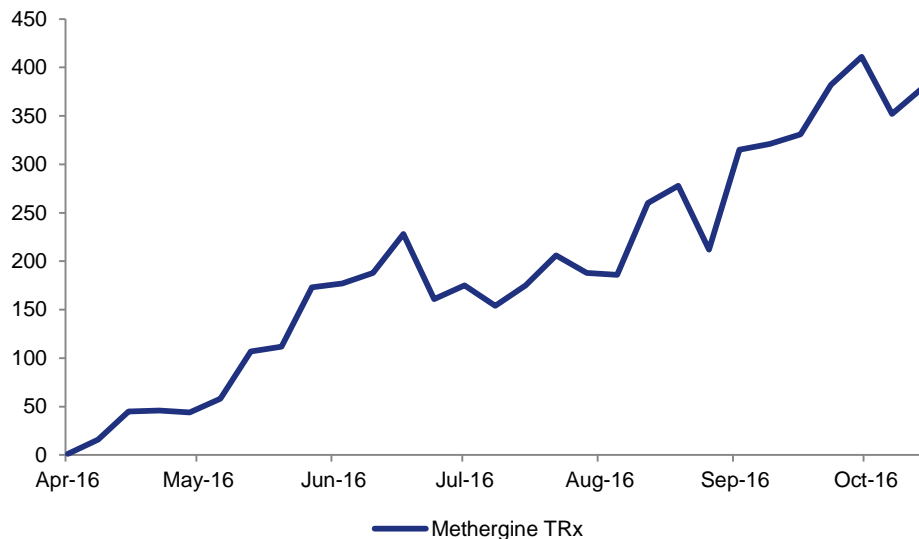
Capex: \$250-300m in FY17; injectable facility + investments in Japan + R&D facility in Japan. Expect it to be lower in last year; around Rs.15bn.

Exhibit 2. Lupin 2Q17 P&L snapshot

Lupin	Q2FY16A	Q2FY17A	% YoY	Q2FY17E	Q2FY17E (cons)	% Delta vs JMFe	Q1FY17A	% QoQ
Net sales	31,926	42,112	32%	41,565		1%	43,136	-2%
Other op. income	1,371	793	-42%	1,430		-45%	1,259	-37%
Net Total Income	33,297	42,905	29%	42,995	42,982	0%	44,394	-3%
Expenses								
Raw material	11,249	12,429	10%	12,716		-2%	12,719	-2%
Staff cost	5,328	7,124	34%	6,453		10%	7,059	1%
Other expense	10,094	13,072	30%	11,867		10%	11,535	13%
EBITDA	6,626	10,281	55%	11,958	11,684	-14%	13,080	-21%
% EBITDA Margin	19.9%	24.0%	406 bps	27.8%	27.2%	-385 bps	29.5%	-550 bps
% EBITDA Margin (excl. OOI)	16.5%	22.5%		25.3%			27.4%	
Other income	578	271		500		-46%	826	-67%
Interest expense	241	263		360			320	
Depreciation	1,155	2,112	83%	2,088		1%	2,027	4%
Extraordinary income (expense)	0	0					0	
Profit Before Tax (PBT)	5,809	8,177	41%	10,010		-18%	11,560	-29%
Tax	1,591	1,589	0%	2,903		-45%	2,734	-42%
% Tax rate	27%	19%		29%			24%	
JV share	6	42					0	
Minority interest*	27	8		50			6	
Reported PAT	4,197	6,622	58%	7,057	7,074	-6%	8,820	-25%
(* positive number represents minority's share of company's profits or company's share of associate profit)								
% Cost Ratios								
Raw Materials	33.8	29.0	-482 bps	29.6		-61 bps	28.7	32 bps
Staff cost	16.0	16.6	60 bps	15.0		159 bps	15.9	70 bps
Mfg & Other expense	30.3	30.5	15 bps	27.6		287 bps	26.0	448 bps
Sales Break-up								
Formulations	28,596	39,193	37%	38,186		3%	40,266	-3%
Domestic	8,881	9,958	12%	9,700		3%	9,313	7%
- US	11,539	19,978	73%	17,874		12%	21,886	-9%
Japan	3,234	4,368	35%	4,722		-7%	4,258	3%
Rest of Asia	1,228	1,152	-6%	1,764		-35%	1,158	
EMEA	2,218	2,355	6%	2,470		-5%	2,194	
LatAm	1,082	986	-9%	1,173		-16%	1,089	
RoW	414	396	-4%	483		-18%	368	
API	3,330	2,919	-12%	3,379		-14%	2,869	2%
Net sales	31,926	42,112	32%	41,565		1%	43,135	-2%

Source: Company, JM Financial

Exhibit 3. Methergine TRx



Source: Bloomberg

Exhibit 4. Lupin P&L changes

	FY17e				FY18e				FY19e				Drivers for change
	Old	New	growth	change %	Old	New	growth	change %	Old	New	growth	change %	
US - branded business USD	84	99	120%	17%	97	114	15%	17%	102	119	5%	17%	Strong 2Q where it maintained 1Q tempo. Increase mainly from Methergine where we raise our peak sales estimates from \$40m to \$50m
Growth y/y													
US - branded business INR % total revenue Growth y/y	5,647 3%	6,624 4%	127%	17%	6,497 2%	7,620 4%	15%	17%	6,822 2%	8,001 4%	5%	17%	
US - generic generic USD	876	931	13%	6%	999	1,006	8%	1%	1,119	1,137	13%	2%	Slower erosion in Glumetza (3Q) and Fortamet (lower price erosion in FY17). Expect a fairly long tail for Minastrin FE
Growth y/y													
US - generic generic INR % total revenue Growth y/y	59,035 43%	62,712 36%	13%	6%	66,941 45%	67,389 35%	7%	1%	74,974 45%	76,150 35%	13%	2%	
Gavis - INR % total revenue	11,883 0%	10,330 6%	859%	-13%	16,074 0%	12,916 7%	25%	-20%	19,383 0%	15,575 7%	21%	-20%	Company has revised guidance for FY18 to \$250m (from \$300m). We doreset \$190m ex-Methergine
Total US % total revenue Growth y/y	76,565 45%	79,665 46%	34%	4%	89,512 47%	87,925 45%	10%	-2%	1,01,179 47%	99,726 46%	13%	-1%	
Japan - JPY	30,339	29,943	19%	-1%	39,173	38,737	29%	-1%	43,091	42,611	10%	-1%	2Q growth ~10% in cc. We model 10-12% secular growth going forward. Expect integration of Shionogi portfolio from 4Q16 (~\$80m sales at manufacturer level)
Growth y/y													
Japan - INR % total revenue Growth y/y	18,341 10%	19,161 11%	40%	4%	23,504 9%	23,242 12%	21%	-1%	25,854 9%	25,567 12%	10%	-1%	
South Africa - INR % total revenue Growth y/y	4,442 3%	4,554 3%	14%	3%	4,886 3%	5,100 3%	12%	4%	5,375 3%	5,610 3%	10%	4%	Strong 2Q with 27% y/y growth in cc. Expect it to grow at 10-12%, slightly ahead of overall market growth
Others - INR % total revenue Growth y/y	11,429 6%	10,316 6%	13%	-10%	13,144 6%	11,863 6%	15%	-10%	14,721 6%	13,287 6%	12%	-10%	
India % total revenue Growth y/y	37,565 24%	37,822 22%	12%	1%	43,950 24%	44,252 23%	17%	1%	50,543 24%	50,890 23%	15%	1%	After a disappointing 1Q, 2Q reported 14% growth. We expect Lupin to outperform IPM given its strong chronic franchise
Total API % total revenue Growth y/y	12,132 9%	11,672 7%	-4%	-4%	12,739 8%	12,256 6%	5%	-4%	13,376 8%	12,869 6%	5%	-4%	
Total operating revenue	1,71,305	1,72,430	22%	1%	1,99,361	1,94,594	13%	-2%	2,23,136	2,18,366	12%	-2%	Decline mainly due to Gavis
Gross profit - margin	1,19,858 70.0%	1,22,088 70.8%			1,38,563 69.5%	1,36,163 70.0%			1,55,951 68.7%	1,52,704 69.9%			Gross margin upgrade due to multiple beats. 3Q should be trough quarter and 4Q will have Minastrin FE launch. High-teens growth in domestic market will help margins
EBITDA - margin	46,909 27.4%	44,824 26.0%	22%	-4%	55,223 27.7%	52,033 26.7%	16%	-6%	68,676 30.8%	63,329 29.0%	22%	-8%	
PAT (Reported)	28,243	27,393		-3%	32,822	31,384		-4%	41,844	39,120		-7%	Despite higher gross margin, we cut EBITDA margin as higher employee and other operating expenses remain high in the short-term
EPS(Rs)	63.0	61.1	21%	-3%	73.2	70.0	15%	-4%	93.4	87.3	25%	-7%	

Source: Company, JM Financial

Financial Tables (Consolidated)

Profit & Loss Statement					
	(₹ mn)				
Y/E March	FY15A	FY16A	FY17E	FY18E	FY19E
Net sales (Net of excise)	1,25,997	1,36,539	1,68,450	1,90,415	2,14,187
Growth (%)	13.6	8.4	23.4	13.0	12.5
Other operational income	1,702	4,977	3,980	4,179	4,179
Raw material (or COGS)	41,570	43,326	50,342	58,431	65,662
Personnel cost	17,473	21,514	28,510	30,208	32,771
Other expenses (or SG&A)	32,460	39,920	48,754	53,922	56,604
EBITDA	36,197	36,756	44,824	52,033	63,329
EBITDA (%)	28.3	26.0	26.0	26.7	29.0
Growth (%)	24.8	1.5	22.0	16.1	21.7
Other non-op. income	2,397	1,901	1,722	1,680	1,688
Depreciation and amort.	4,347	4,871	8,563	8,927	9,582
EBIT	34,247	33,785	37,983	44,787	55,435
Add: Net interest income	-99	-497	-1,321	-1,228	-1,136
Pre tax profit	34,149	33,288	36,662	43,558	54,299
Taxes	9,705	10,593	9,155	11,739	14,637
Add: Extraordinary items	0	0	0	0	0
Less: Minority interest	413	88	114	435	542
Reported net profit	24,031	22,607	27,393	31,384	39,120
Adjusted net profit	24,032	22,607	27,393	31,384	39,120
Margin (%)	18.8	16.0	15.9	16.1	17.9
Diluted share cap. (mn)	448	448	448	448	448
Diluted EPS (₹)	53.6	50.4	61.1	70.0	87.3
Growth (%)	30.8	-5.9	21.2	14.6	24.6
Total Dividend + Tax	3,334	3,334	3,334	3,334	3,334

Source: Company, JM Financial

Balance Sheet					
	(₹ mn)				
Y/E March	FY15A	FY16A	FY17E	FY18E	FY19E
Share capital	899	901	901	901	901
Other capital	0	0	0	0	0
Reserves and surplus	87,842	1,08,943	1,32,320	1,58,904	1,93,215
Networth	88,741	1,09,844	1,33,221	1,59,805	1,94,117
Total loans	4,710	71,193	66,193	61,193	56,193
Minority interest	241	321	435	869	1,412
Sources of funds	93,691	1,81,358	1,99,849	2,21,868	2,51,721
Intangible assets	22,129	81,272	81,622	81,972	82,322
Fixed assets	45,445	57,754	78,446	93,041	1,07,889
Less: Depn. and amort.	23,329	28,200	36,763	45,690	55,272
Net block	44,245	1,10,826	1,23,305	1,29,323	1,34,939
Capital WIP	5,197	5,197	5,197	5,197	5,197
Investments	25	55	55	55	55
Def tax assets/- liability	-1,182	-1,239	-1,239	-1,239	-1,239
Current assets	78,324	97,790	1,08,606	1,30,145	1,59,332
Inventories	25,036	31,787	38,731	43,710	49,049
Sundry debtors	26,566	45,498	55,437	62,563	70,206
Cash & bank balances	21,372	8,399	2,184	11,469	27,520
Other current assets	1,929	4,734	4,734	4,734	4,734
Loans & advances	3,421	7,372	7,519	7,670	7,823
Current liabilities & prov.	33,601	36,419	41,222	46,760	51,710
Current liabilities	27,858	29,661	34,464	40,002	44,953
Provisions and others	5,743	6,758	6,758	6,758	6,758
Net current assets	44,723	61,372	67,384	83,385	1,07,622
Others (net)	684	5,146	5,146	5,146	5,146
Application of funds	93,691	1,81,357	1,99,848	2,21,867	2,51,721

Source: Company, JM Financial

Cash flow statement					
	(₹ mn)				
Y/E March	FY15A	FY16A	FY17E	FY18E	FY19E
Reported net profit	24,031	22,607	27,393	31,384	39,120
Depreciation and amort.	4,046	4,871	8,563	8,927	9,582
-Inc/dec in working cap.	-2,047	-23,326	-13,334	-8,012	-9,324
Others	-428	80	114	435	542
Cash from operations (a)	25,603	4,232	22,736	32,734	39,920
-Inc/dec in investments	-5	-30	0	0	0
Capex	-16,890	-71,453	-21,042	-14,945	-15,199
Others	7,690	-6,296	1,106	1,295	1,139
Cash flow from inv. (b)	-9,205	-77,779	-19,935	-13,649	-14,060
Inc/-dec in capital	-1,273	1,829	-682	-1,466	-1,474
Dividend+Tax thereon	-3,334	-3,334	-3,334	-3,334	-3,334
Inc/-dec in loans	-824	66,483	-5,000	-5,000	-5,000
Others	666	-4,405	0	0	0
Financial cash flow (c)	-4,764	60,574	-9,016	-9,800	-9,808
Inc/-dec in cash (a+b+c)	11,633	-12,973	-6,215	9,285	16,051
Opening cash balance	9,739	21,372	8,399	2,184	11,469
Closing cash balance	21,372	8,400	2,184	11,469	27,520

Source: Company, JM Financial

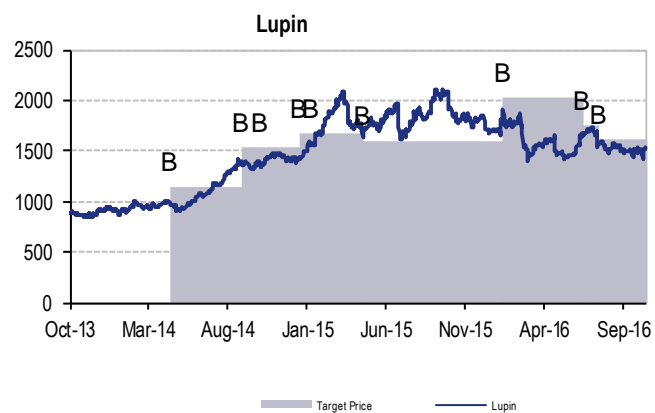
Key Ratios					
Y/E March	FY15A	FY16A	FY17E	FY18E	FY19E
BV/Share (₹)	198.0	245.1	297.2	356.5	433.1
ROIC (%)	35.1	18.8	15.3	15.9	18.5
ROE (%)	30.4	22.8	22.5	21.4	22.1
Net Debt/equity ratio (x)	-0.2	0.6	0.5	0.3	0.1
Valuation ratios (x)					
PER	28.5	30.3	25.0	21.8	17.5
PBV	7.7	6.2	5.1	4.3	3.5
EV/EBITDA	18.5	20.4	16.7	14.1	11.3
EV/Sales	5.3	5.5	4.4	3.9	3.3
Turnover ratios (no.)					
Debtor days	77	122	120	120	120
Inventory days	73	85	84	84	84
Creditor days	172	185	185	185	185

Source: Company, JM Financial

History of earnings estimates and target price

Date	FY17E EPS (₹)	% Chg.	FY18E EPS (₹)	% Chg.	Target Price	% Chg.
8-May-14					1,150	
22-Sep-14	71.7				1,530	33.0
29-Oct-14	70.6	-1.5			1,530	0.0
12-Jan-15	74.2	5.1			1,670	9.2
4-Feb-15	72.7	-2.0			1,670	0.0
14-May-15	92.3	27.0			1,600	-4.2
8-Feb-16	72.4	-21.6	91.6		2,020	26.3
9-Jul-16	65.5	-9.5	79.1	-13.6	1,750	-13.4
10-Aug-16	63.0	-3.8	73.2	-7.5	1,610	-8.0

Recommendation history



APPENDIX I

JM Financial Institutional Securities Limited

Corporate Identity Number: U65192MH1995PLC092522

Member of BSE Ltd. and National Stock Exchange of India Ltd. and Metropolitan Stock Exchange of India Ltd.

SEBI Registration Nos.: BSE - INZ010012532, NSE - INZ230012536 and MSEI - INZ260012539, Research Analyst - INH000000610

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Definition of ratings	
Rating	Meaning
Buy	Total expected returns of more than 15%. Total expected return includes dividend yields.
Hold	Price expected to move in the range of 10% downside to 15% upside from the current market price.
Sell	Price expected to move downwards by more than 10%

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