

US ramp up slower than expectation

Gavis guidance cut and delay in key launches disappointing

Action: Neutral with 12m price target of INR 1626.

LPC 2QFY17 results were below our expectations as net earnings missed our estimates by 23%. Greater than expected pricing pressure in the US, lower sales of gFortamet and forex loss of INR 450m led to the miss. The management commentary suggests that gFortamet and gGlumetza will remain a key contributor to earnings. Management indicated that the launch of gGlumetza by its competition was only likely in 4QFY17F. The price erosion in gFortamet is not significant after Mylan's entry. However, the key approvals-gRenvela, gWelchol are delayed to 2HFY18F. The management toned down its FY18F sales expectations for Gavis from USD300m to USD250mn. On the respiratory front- Albuterol MDI ANDA is expected to be filed in the US in 3QFY17F, but the trials for gAdvair are yet to commence. We have cut our earnings estimate after the 2QFY17 results and management commentary. We have cut our EPS estimates for FY17F/FY18F/FY19F by 7%/5%/1% respectively. We value LPC at 19x (unchanged) FY19F EPS to arrive at our target price of INR 1698. We roll back to Nov 2017, to arrive at 12m price target of INR1626. We retain our Neutral rating.

Valuations.

We value LPC at 19x one year forward earnings, which is at a discount to peers valued at 20-25x. Relatively higher earning dependence on a few key products and limited visibility of high value approvals in the near to medium term limits multiple expansions, in our view. Exclusive or low competition products – gFortamet, gGlumetza, Methergine, gMinastrin 24Fe and gRanexa exclusivity, contribute 55% and 46% of our consolidated earnings estimates for FY18F and FY19F respectively.

Year-end 31 Mar	FY16		FY17F		FY18F		FY19F	
Currency (INR)	Actual	Old	New	Old	New	Old	New	
Revenue (mn)	142,085	187,222	179,935	215,863	208,871	244,676	238,271	
Reported net profit (mn)	22,707	34,534	32,092	37,107	35,322	41,049	40,613	
Normalised net profit (mn)	22,707	34,534	32,092	37,107	35,322	41,049	40,613	
FD normalised EPS	49.99	76.02	70.64	81.68	77.76	90.36	89.40	
FD norm. EPS growth (%)	-5.5	52.1	41.3	7.5	10.1	10.6	15.0	
FD normalised P/E (x)	29.9	N/A	21.1	N/A	19.2	N/A	16.7	
EV/EBITDA (x)	19.7	N/A	14.6	N/A	12.5	N/A	10.6	
Price/book (x)	6.2	N/A	4.9	N/A	4.0	N/A	3.2	
Dividend yield (%)	0.6	N/A	0.6	N/A	0.6	N/A	0.6	
ROE (%)	22.9	27.6	25.9	23.7	23.0	21.4	21.7	
Net debt/equity (%)	57.7	42.1	42.6	21.1	22.6	5.0	6.2	

Source: Company data, Nomura estimates

Key company data: See next page for company data and detailed price/index chart.

Global Markets Research

11 November 2016

Rating Remains	Neutral
Target Price Reduced from 1634	INR 1626
Closing price 10 November 2016	INR 1494
Potential upside	+8.8%

Anchor themes

We see LPC as a play on: 1) generic opportunities in the US, where it is pursuing niche and limited-competition opportunities; 2) the rise in medicine consumption in India and 3) the potential rise in generic opportunities in Japan, where LPC is the largest India pharma name.

Nomura vs consensus

Our FY17F/FY18F/FY19F EPS is 9%/4%/4% ahead of consensus respectively.

Research analysts

India Pharmaceuticals

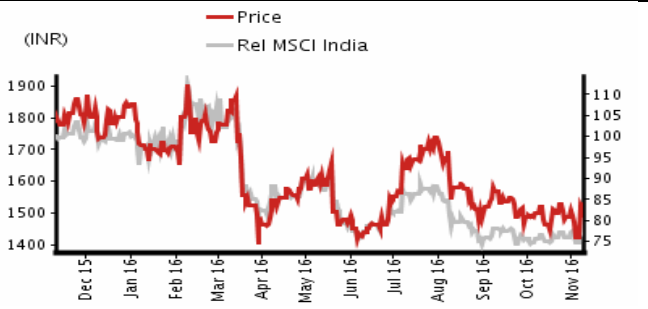
Saion Mukherjee - NFASL
saion.mukherjee@nomura.com
+91 22 4037 4184

Ayan Deb - NFASL
ayan.deb@nomura.com
+91 22 4037 4023

See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

Key data on Lupin

Relative performance chart



Source: Thomson Reuters, Nomura research

Notes:

Performance

(%)	1M	3M	12M		
Absolute (INR)	-1.7	-3.3	-16.6	M cap (USDmn)	10,128.7
Absolute (USD)	-1.7	-3.0	-16.7	Free float (%)	0.7
Rel to MSCI India	2.7	-0.2	-22.6	3-mth ADT (USDmn)	27.5

Income statement (INRmn)

Year-end 31 Mar	FY15	FY16	FY17F	FY18F	FY19F
Revenue	127,700	142,085	179,935	208,871	238,271
Cost of goods sold	-41,570	-43,094	-51,355	-62,999	-72,998
Gross profit	86,130	98,991	128,580	145,871	165,272
SG&A	-40,104	-49,826	-64,359	-73,358	-82,471
Employee share expense	-14,177	-16,265	-22,519	-25,720	-29,346
Operating profit	31,849	32,900	41,702	46,793	53,456
EBITDA	36,196	37,535	50,329	57,196	64,873
Depreciation	-4,347	-4,635	-8,627	-10,403	-11,417
Amortisation					
EBIT	31,849	32,900	41,702	46,793	53,456
Net interest expense	-98	-446	-1,123	-905	-514
Associates & JCEs					
Other income	2,398	1,877	2,326	1,326	1,326
Earnings before tax	34,148	34,331	42,906	47,213	54,268
Income tax	-9,704	-11,536	-10,726	-11,803	-13,567
Net profit after tax	24,444	22,795	32,179	35,410	40,701
Minority interests	-412	-88	-88	-88	-88
Other items					
Preferred dividends					
Normalised NPAT	24,032	22,707	32,092	35,322	40,613
Extraordinary items					
Reported NPAT	24,032	22,707	32,092	35,322	40,613
Dividends	-4,058	-4,068	-4,068	-4,068	-4,068
Transfer to reserves	19,974	18,640	28,024	31,255	36,546

Valuations and ratios

Reported P/E (x)	28.2	29.9	21.1	19.2	16.7
Normalised P/E (x)	28.2	29.9	21.1	19.2	16.7
FD normalised P/E (x)	28.2	29.9	21.1	19.2	16.7
Dividend yield (%)	0.6	0.6	0.6	0.6	0.6
Price/cashflow (x)	24.8	na	17.4	18.6	16.5
Price/book (x)	7.6	6.2	4.9	4.0	3.2
EV/EBITDA (x)	18.6	19.7	14.6	12.5	10.6
EV/EBIT (x)	21.2	22.4	17.6	15.2	12.9
Gross margin (%)	67.4	69.7	71.5	69.8	69.4
EBITDA margin (%)	28.3	26.4	28.0	27.4	27.2
EBIT margin (%)	24.9	23.2	23.2	22.4	22.4
Net margin (%)	18.8	16.0	17.8	16.9	17.0
Effective tax rate (%)	28.4	33.6	25.0	25.0	25.0
Dividend payout (%)	16.9	17.9	12.7	11.5	10.0
ROE (%)	30.4	22.9	25.9	23.0	21.7
ROA (pretax %)	28.9	19.2	18.5	19.4	20.8

Growth (%)

Revenue	13.1	11.3	26.6	16.1	14.1
EBITDA	20.5	3.7	34.1	13.6	13.4
Normalised EPS	30.5	-5.5	41.3	10.1	15.0
Normalised FDEPS	30.9	-5.5	41.3	10.1	15.0

Source: Company data, Nomura estimates

Cashflow statement (INRmn)

Year-end 31 Mar	FY15	FY16	FY17F	FY18F	FY19F
EBITDA	36,196	37,535	50,329	57,196	64,873
Change in working capital	7,248	-34,039	-1,519	-8,763	-9,956
Other operating cashflow	-16,114	-7,186	-9,785	-11,859	-13,684
Cashflow from operations	27,331	-3,690	39,026	36,574	41,233
Capital expenditure	-8,712	-58,157	-30,050	-12,000	-12,000
Free cashflow	18,619	-61,847	8,976	24,574	29,233
Reduction in investments	-1	8	0	0	0
Net acquisitions					
Dec in other LT assets	36	412	0	0	0
Inc in other LT liabilities					-472
Adjustments	-19,847	6,867	971	971	1,443
CF after investing acts	-1,193	-54,560	9,946	25,545	30,204
Cash dividends	-1,573	-4,055	-4,067	-4,068	-4,068
Equity issue					
Debt issue	-700	62,081	-4,249	-22,732	-25,803
Convertible debt issue					
Others	304	100	-1,210	-993	-602
CF from financial acts	-1,969	58,126	-9,527	-27,793	-30,472
Net cashflow	-3,161	3,566	420	-2,247	-268
Beginning cash	7,975	4,814	8,379	8,799	6,552
Ending cash	4,814	8,379	8,799	6,552	6,284
Ending net debt	558	63,396	58,727	38,243	12,708

Balance sheet (INRmn)

As at 31 Mar	FY15	FY16	FY17F	FY18F	FY19F
Cash & equivalents	4,814	8,379	8,799	6,552	6,284
Marketable securities					
Accounts receivable	26,566	45,272	43,301	50,434	57,688
Inventories	25,036	31,791	32,361	37,972	43,999
Other current assets	8,092	21,809	20,123	21,217	22,349
Total current assets	64,507	107,251	104,584	116,175	130,320
LT investments	16,584	75	75	75	75
Fixed assets	32,961	86,379	107,802	109,399	109,982
Goodwill	16,481	29,610	29,610	29,610	29,610
Other intangible assets					
Other LT assets	842	806	806	806	806
Total assets	131,374	224,122	242,877	256,065	270,793
Short-term debt	4,353	18,036	18,036	18,036	18,036
Accounts payable	27,634	31,480	26,022	30,680	34,681
Other current liabilities	7,363	8,658	9,509	9,926	10,383
Total current liabilities	39,350	58,174	53,567	58,643	63,100
Long-term debt	1,018	53,739	49,490	26,758	955
Convertible debt					
Other LT liabilities	2,024	2,045	1,671	1,261	789
Total liabilities	42,393	113,957	104,728	86,661	64,844
Minority interest	241	321	321	321	321
Preferred stock					
Common stock	899	901	901	901	901
Retained earnings	87,842	108,943	136,927	168,182	204,727
Proposed dividends					
Other equity and reserves					
Total shareholders' equity	88,741	109,844	137,828	169,083	205,628
Total equity & liabilities	131,374	224,122	242,877	256,065	270,793

Liquidity (x)

Current ratio	1.64	1.84	1.95	1.98	2.07
Interest cover	324.7	73.7	37.1	51.7	104.0

Leverage

Net debt/EBITDA (x)	0.02	1.69	1.17	0.67	0.20
Net debt/equity (%)	0.6	57.7	42.6	22.6	6.2

Per share

Reported EPS (INR)	52.90	49.99	70.64	77.76	89.40
Norm EPS (INR)	52.90	49.99	70.64	77.76	89.40
FD norm EPS (INR)	52.90	49.99	70.64	77.76	89.40
BVPS (INR)	195.35	241.80	303.40	372.21	463.39
DPS (INR)	8.93	8.95	8.95	8.95	9.17

Activity (days)

Days receivable	73.2	92.5	89.8	81.9	82.8
Days inventory	203.4	241.3	228.0	203.7	204.9
Days payable	201.5	251.0	204.3	164.3	163.4
Cash cycle	75.0	82.8	113.5	121.4	124.3

Source: Company data, Nomura estimates

LPC's 2Q misses our estimates

LPC's 2QFY17 results failed to meet our expectations. The quarterly financials and our estimates are in Fig 1 and Fig 2 below. We believe high erosion in US generics business and lower contribution from gFortamet led to the earnings miss. The US sales declined USD 30m Q-Q, which was almost entirely on account of lower pricing, in our view. Further the company incurred forex loss of INR450m in Q2FY17 and R&D costs were USD7mn higher than our estimates. All these factors led to net earnings missing our estimates by 23%.

Fig. 1: Revenue split

INRm	2QFY17	1QFY17	2QFY16	% Chg (Y-Y)	% Chg (Q-Q)	2QFY17 Nom ests	vs Nom ests (%)
Formulations	39,193	40,453	28,596	37.1%	-3.1%	41,596	-6%
<i>US</i>	19,978	21,886	11,539	73.1%	-8.7%	21,800	-8%
<i>Europe + Middle East</i>	1,155	1,280	1,223	-5.5%	-9.7%	1,408	-18%
<i>Japan</i>	4,384	4,258	3,227	35.9%	3.0%	4,295	2%
<i>RoW (incl South Africa)</i>	3,717	3,530	3,726	-0.2%	5.3%	4,307	-14%
<i>India</i>	9,958	9,499	8,881	12.1%	4.8%	9,787	2%
API	2,919	2,966	3,330	-12.3%	-1.6%	2,900	1%
Total Sales	42,112	43,419	31,926	31.9%	-3.0%	44,496	-5%

Source: Company, Nomura estimates

Fig. 2: P&L

INRm	2QFY17	1QFY17	2QFY16	% Chg (Y-Y)	% Chg (Q-Q)	1QFY17 Nom ests	vs Nom ests (%)
Net Sales	42,112	43,418	31,926	31.9%	-3.0%	44,496	-5%
Other Operating Income	794	1,259	1,371	-42.1%	-36.9%	1,000	-21%
Total Revenue	42,906	44,677	33,297	28.9%	-4.0%	45,496	-6%
Material Cost	12,429	12,719	11,249	10.5%	-2.3%	12,681	-2%
Staff Cost	7,124	7,059	5,328	33.7%	0.9%	7,483	-5%
Other Expense	13,072	11,818	10,094	29.5%	10.6%	12,000	9%
EBITDA	10,281	13,080	6,626	55.2%	-21.4%	13,332	-23%
Other Income	271	826	578	-53.1%	-67.2%	500	-46%
Interest Expense	263	320	241	9.3%	-17.8%	320	-18%
Depreciation	2,112	2,027	1,155	82.9%	4.2%	2,100	1%
PBT	8,177	11,560	5,809	40.8%	-29.3%	11,412	-28%
Tax	1,589	2,734	1,591	-0.1%	-41.9%	2,853	-44%
Net Profit	6,588	8,826	4,218	56.2%	-25.4%	8,559	-23%
Minority interest	8	6	27			10	-23%
Share of Profit from JVs	42	0	6				
Net profit after MI	6,622	8,820	4,198	57.8%	-24.9%	8,549	-23%
				bps Chg (Y-Y)	bps Chg (Q-Q)		
Gross margin (%)	70.5%	70.7%	64.8%	572	(22)	71.5%	
EBITDA margin (%)	24.0%	29.3%	19.9%	406	(532)	29.3%	
Tax rate (%)	19.4%	23.7%	27.4%	(795)	(422)	25.0%	

Source: Company, Nomura estimates

Other key highlights from the post result conference call

- In the US base business pricing pressure is in high single digits.
- During the quarter, the company was adversely affected by competition in gFortamet. Mostly by the entry of Mylan, prices have come down, but it is not significant. The pricing is still attractive and the company lost ~6% market share. Management expects, gFortamet to be a significant contributor in the near to medium term. Nostrum is the only other known filer. With smaller capacity at Nostrum, its entry may not be disruptive.
- In gGlumetza, LPC continues to enjoy exclusivity as additional generics have failed to enter the market. Sun Pharma and Teva have generic approvals, but have not entered the market so far. The delay in launch is due to manufacturing issues. The company does not expect additional competition in gGlumetza in Q3FY17F.
- Management expects eight-10 product launches in the US in 2HFY17F. Four to five launches are expected each of India and Gavis' US sites. Management expects the launch momentum to pick up in FY18 with 30+ approvals.

- The launch of gRenvela, gRenagel and gWelchol is likely only in 2HFY18F. The company expects approval for gPrevacid ODT in H1FY18F.
- LPC has concluded the clinical trial for Albuterol MDI (USD 2bn market) and expects to file ANDA in 3QFY17. The scale up for gAdvair and gSpiriva DPI is in progress. The clinical trials for gAdvair are yet to start but are likely by end FY17F.
- In Gavis, Methergine sales are expected to ramp up from 3QFY17F. Management expects the product to achieve peak sales of ~USD 70mn. LPC is working on a possible life cycle extension strategy for Methergine. There are risks of generic competition in Methergine over time. However, limited number of API supplier presents an entry barrier, according to management.
- Gavis sales over the next two years will grow on back of approvals for controlled substances and derma products. However, management has reduced its FY18F Gavis sales guidance to USD 250m from USD 300m.
- Management expects R&D to be 12-14% of sales. The company intends to file 30 ANDAs in FY17F. So far LPC has filed six ANDAs in H1FY17.
- The Shionogi acquisition in Japan will be consolidated from 3QFY17 onwards. The acquisition of 21 long listed drugs from Shionogi will make LPC the seventh largest generic manufacturer in Japan. The company aspires to gain top five position in Japan, according to management.
- The capex for FY17F is estimated at USD 250-300m. Capex in H1FY17 was USD 130mn. The capex intensity is expected to fall to USD220m in FY18F according to management.
- Management estimate the tax rate is 25% in FY17F.

We trim our earnings estimates; Maintain Neutral with 12m price target of INR 1626/sh (from INR 1634/sh)

We trim our earnings model to factor in 2QFY17 results and management commentary. Our earning estimates for FY17F/FY18F/FY19F are reduced by 7%/5%/1% respectively. The earnings cut is driven primarily due to reduction in US revenues including Gavis.

Fig. 3: Estimate changes

	New Ests			Old Ests			% Chg		
	FY17F	FY18F	FY19F	FY17F	FY18F	FY19F	FY17F	FY18F	FY19F
Net sales	179,935	208,871	238,271	187,222	215,863	244,676	-4%	-3%	-3%
EBITDA	50,329	57,196	64,873	55,014	61,066	67,031	-9%	-6%	-3%
Net profit	32,092	35,322	40,613	34,534	37,107	41,049	-7%	-5%	-1%

Source: Nomura estimates

The product concentration risk is relatively high at Lupin. Exclusive or low competition products – gFortamet, gGlumetza, Methergine, gMinastrin 24Fe and gRanexa exclusivity, contribute 55% and 46% of our consolidated earnings estimates for FY18F and FY19F respectively.

On US generics, delay in approval of key products, higher pricing pressure on the base business and lowering of Gavis revenue guidance for FY18F are our key concern areas. In our report “Complex generics: right move, but a bit late” dated 3 Nov 2016, we highlighted the delay in the move into complex products. Till FY15, LPC’s sales per ANDA improved and remained healthy at above USD7mn/approved ANDA. LPC’s cost leadership through vertical integration and participation in the first wave launches were key success factors. However, since FY16, delay in approvals of key products, increased competition and lower contribution from new launches has led to a significant drop in sales per approved ANDA. To counter the growth challenges, Lupin has rightly stepped up investment in complex generics, in our view. However, the high-value launches from these investments are unlikely over the next two to three years. On specialty, there is

greater dependence on acquisitions as there is limited success with in-house developments.

Given the higher contribution from select products over FY17-19F, we value LPC at 19x (unchanged) one year forward earnings. This compares to valuation range of 20-25x for peers. We arrive at Mar 2018 target based on 19x FY19 EPS of INR 89.4/sh. We roll back the Mar 2018 target to Nov 2017 to arrive at our 12m price target of INR 1626/sh.

Key risks

Upside risks: Product specific opportunities that emerges in the US are currently not factored into our estimates.

Downside risks: Failure to gain timely approval for key products in the US as currently projected; adverse currency movements, particularly USD and JPY; regulatory concerns following USFDA inspection.

Appendix A-1

Analyst Certification

We, Saion Mukherjee and Ayan Deb, hereby certify (1) that the views expressed in this Research report accurately reflect our personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of our compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

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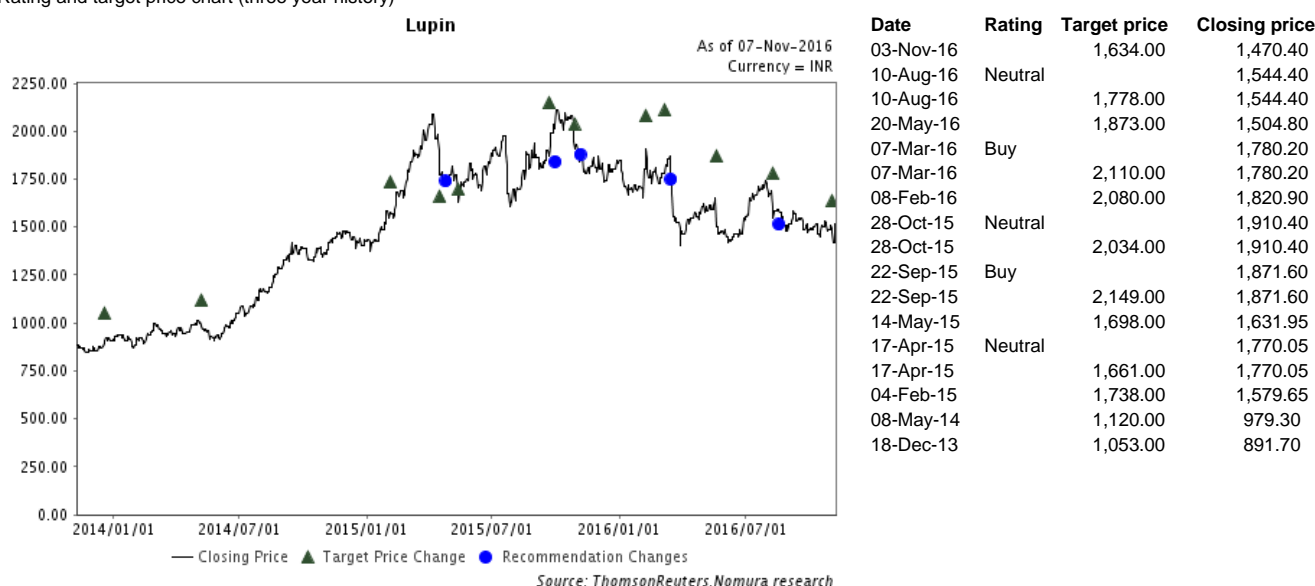
Materially mentioned issuers

Issuer	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Lupin	LPC IN	INR 1494	10-Nov-2016	Neutral	N/A	

Lupin (LPC IN)

INR 1494 (10-Nov-2016) Neutral (Sector rating: N/A)

Rating and target price chart (three year history)



For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We attribute 19x Mar 2019 EPS to arrive at Mar 2018 target price of INR 1698/sh. We roll back to Nov 2017 at 11% cost of equity to arrive at 12m (Nov 2017) price target of INR 1626/sh. The benchmark index for this stock is the MSCI India.

Risks that may impede the achievement of the target price Upside risk: positive surprise from US product approvals and launches. Downside risks: failure to gain timely approval for key products in the US; adverse currency movements, particularly USD and JPY; and regulatory concerns following USFDA inspection.

Important Disclosures

Online availability of research and conflict-of-interest disclosures

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42% have been assigned a Neutral rating which, for purposes of mandatory disclosures, is classified as a Hold rating; 53% of companies with this rating are investment banking clients of the Nomura Group*. 0% of companies (which are admitted to trading on a regulated market in the EEA) with this rating were supplied material services by the Nomura Group

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As at 30 September 2016.

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** As defined by the EU Market Abuse Regulation

Explanation of Nomura's equity research rating system in Europe, Middle East and Africa, US and Latin America, and Japan and Asia ex-Japan from 21 October 2013

The rating system is a relative system, indicating expected performance against a specific benchmark identified for each individual stock, subject to limited management discretion. An analyst's target price is an assessment of the current intrinsic fair value of the stock based on an appropriate valuation methodology determined by the analyst. Valuation methodologies include, but are not limited to, discounted cash flow analysis, expected return on equity and multiple analysis. Analysts may also indicate expected absolute upside/downside relative to the stated target price, defined as (target price - current price)/current price.

STOCKS

A rating of **'Buy'**, indicates that the analyst expects the stock to outperform the Benchmark over the next 12 months. A rating of **'Neutral'**, indicates that the analyst expects the stock to perform in line with the Benchmark over the next 12 months. A rating of **'Reduce'**, indicates that the analyst expects the stock to underperform the Benchmark over the next 12 months. A rating of **'Suspended'**, indicates that the rating, target price and estimates have been suspended temporarily to comply with applicable regulations and/or firm policies. Securities and/or companies that are labelled as **'Not rated'** or shown as **'No rating'** are not in regular research coverage. Investors should not expect continuing or additional information from Nomura relating to such securities and/or companies. Benchmarks are as follows: **United States/Europe/Asia ex-Japan**: please see valuation methodologies for explanations of relevant benchmarks for stocks, which can be accessed at: <http://go.nomuranow.com/research/globalresearchportal/pages/disclosures/disclosures.aspx>; **Global Emerging Markets (ex-Asia)**: MSCI Emerging Markets ex-Asia, unless otherwise stated in the valuation methodology; **Japan**: Russell/Nomura Large Cap.

SECTORS

A **'Bullish'** stance, indicates that the analyst expects the sector to outperform the Benchmark during the next 12 months. A **'Neutral'** stance, indicates that the analyst expects the sector to perform in line with the Benchmark during the next 12 months. A **'Bearish'** stance, indicates that the analyst expects the sector to underperform the Benchmark during the next 12 months. Sectors that are labelled as **'Not rated'** or shown as **'N/A'** are not assigned ratings. Benchmarks are as follows: **United States**: S&P 500; **Europe**: Dow Jones STOXX 600; **Global Emerging Markets (ex-Asia)**: MSCI Emerging Markets ex-Asia. **Japan/Asia ex-Japan**: Sector ratings are not assigned.

Explanation of Nomura's equity research rating system in Japan and Asia ex-Japan prior to 21 October 2013

STOCKS

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SECTORS

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Target Price

A Target Price, if discussed, indicates the analyst's forecast for the share price with a 12-month time horizon, reflecting in part the analyst's estimates for the company's earnings. The achievement of any target price may be impeded by general market and macroeconomic trends, and by other risks related to the company or the market, and may not occur if the company's earnings differ from estimates.

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