

COMPANY NOTE

Target | Estimate Change

India | Healthcare | Pharmaceuticals

9 November 2016

Jefferies

Lupin Ltd. (LPC IN)

2Q17: Weak Quarter and Outlook

Key Takeaway

Lupin reported weak results and guidance. Revenues were 3% and margins 300bps below expectation. The key disappointment was US business which declined 9% QoQ led by pricing and competition. It lowered Gavis FY18 revenue expectation by c20% and more importantly, key products launch timelines were pushed back to 2HFY18. Challenges for LPC are high led by pricing pressure, competition, higher R&D and approval delays. Retain Underperform.

Reported results below expectation - Lupin reported results well below expectation. Revenues were 3% and margins 300bps below expectation. EBITDA came in 15% below expectation. Lower tax rate helped reported net profit which was 9% below expectation.

US and margins the key disappointment - US business was the key disappointment and revenues declined 9% QoQ. Management indicated that this was led by increased competition in gFortamet and also pricing pressure in base portfolio. India business grew 12% YoY. Growth in other business was weaker than expected. In addition to weak revenues, margins also disappointed. While part of the miss was due to higher R&D (13.5% vs. 12% JEF), and forex losses, ex of these margins were still 70 bps below expectation led largely by pricing pressure.

Guidance cut, inorganic on cards - In addition to weak results, management also cut guidance. It now expects Gavis to be a USD250mn business by FY18 vs. USD300mn earlier. More importantly, it indicated that the Sevlamar and Welchol franchise are now 2HFY18 opportunities vs. 1HFY18 earlier. These opportunities have seen delays every quarter over the past 12m and we remain cautious on the new guidance. It indicated that price erosion in US will remain at high single digit. Further, management indicated that it remains on the lookout for acquisition opportunities and can do acquisitions up to USD1bn.

Challenges sustain - We expect Lupin growth and margins to remain under pressure led by: 1) pricing pressure in base business, 2) increased competition in key products, 3) approval delays, and 4) higher R&D. We see significant risks to earnings going forward and expect 13% EPS CAGR over FY16-19 led by margin decline of 250bps.

Valuation/Risks

We adjust our ests for the qtr, lower tax rate. Our FY17-19E EPS changes by -3%. Lupin is trading at 23.4x FY18E PE, a 17% premium to the sector. Given the increasing challenges and weak growth expected we retain our UNPF. Our revised DCF based TP stands at Rs1,350, implying a FY18 PE of 20.7x. Key risk: Faster approval of key products.

INR	Prev.	2016A	Prev.	2017E	Prev.	2018E	Prev.	2019E
Rev. (MM)	142,085	143,124	181,395	178,212	211,880	206,935	239,243	231,928
EBITDA (MM)	37,535.0	38,574.2	47,720.0	45,519.6	53,431.0	51,860.5	59,097.0	56,615.2
EV/EBITDA		19.5x		16.5x		14.5x		13.3x
Net Profit	22,707.0	23,444.1	28,509.0	27,641.7	30,477.0	29,746.6	34,775.0	33,828.7
Dividend	--	7.50	9.10	8.80	9.70	9.50	11.10	10.80
Div. Yield		0.49%		0.58%		0.62%		0.71%
BV/Share	244.40	243.78	298.00	296.37	359.00	355.89	425.20	420.25
P/B		6.3x		5.2x		4.3x		3.6x
EPS Growth	(5.5)%	2.7%	20.1%	17.9%	6.9%	7.6%	14.1%	13.7%
EPS								
FY Mar	50.50	52.16	63.40	61.50	67.80	66.18	77.40	75.26
FY P/E		29.3x		24.9x		23.1x		20.3x

UNDERPERFORM

Price target INR1,350.00
(from INR1,400.00)
Price INR1,529.65[^]

Financial Summary

Net Debt (MM): INR63,320.7

Market Data

52 Week Range: INR1,911.90 - INR1,280.00

Total Entprs. Value (MM): INR750.9BN

Market Cap. (MM): INR687.6BN

Shares Out. (MM): 449.5

Float (MM): 274.1

Avg. Daily Vol.: 1,241,470

Piyush Nahar *

Equity Analyst

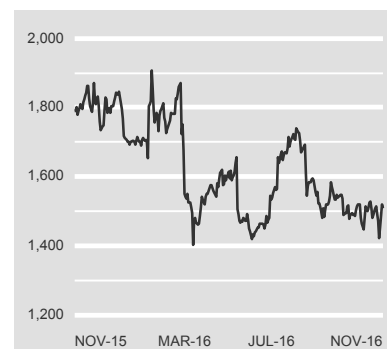
+91 22 4224 6113 pnahar@jefferies.com

Anurag Mantry *

Equity Associate

+91 22 4224 6129 amantry@jefferies.com

* Jefferies India Private Limited

Price Performance

[^]Prior trading day's closing price unless otherwise noted.

Other highlights

- Price erosion in US base business is at 8-9% levels.
- There was additional competition in Fortamet from Mylan, which came onto the market in September, which led to a 6% fall in market share for Lupin as well as an impact on pricing. We expect more impact to come through subsequently.
- Glumetza did not see additional competition due to which revenues were sequentially flat.
- Lupin expects to have per fiscal launches to the tune of 15+ during the current fiscal and 30+ during the next couple of years.
- New capacity at Gavis is expected to come online in 2H, given that it was completed last month, approved in the last couple of weeks and had validation batches being produced currently.
- Two key launches in the current year are gEpzicom and gMinastrin Fe. Both of these are 4Q launches.
- Lupin continues to look for opportunities in specialty and niche platforms for M&A.
- Lupin has been cautious on DPI due to challenges from the stability perspective, which has led to a delay in scaling up the product and starting the clinical trials.
- Tax rate guidance was lowered to 25% from 27% earlier.

Exhibit 1: Margins below expectation

(in Rs mn)	2QFY17A	2QFY16	YoY (%)	1QFY17	2QFY17E	vs. Est (%)
Revenues	42,905	33,297	28.9	44,677	44,425	-3.4
Raw Material	12,429	11,249	10.5	12,719	12,524	-0.8
Gross Profit	30,477	22,048	38.2	31,957	31,900	-4.5
Employee Cost	7,124	5,328	33.7	7,059	7,412	-3.9
Other operating Exp	13,072	10,094	29.5	11,818	12,450	5.0
EBITDA	10,281	6,626	55.2	13,080	12,038	-14.6
EBITDA Margin (%)	24.0	19.9	406.2	29.3	27.1	-313.6
EBIT	8,169	5,471	49.3	11,053	9,911	-17.6
PBT	8,177	5,809	40.8	11,560	9,940	-17.7
Tax	1,589	1,591	-0.1	2,734	2,684	-40.8
PAT	6,622	4,198	57.8	8,820	7,256	-8.7

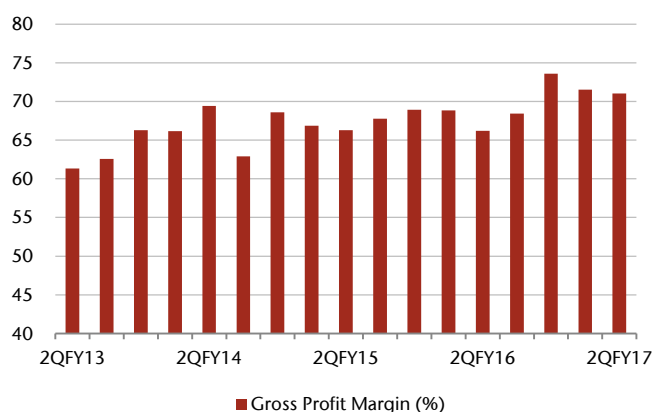
Source: Company Data, Jefferies estimates

Exhibit 2: US the key disappointment

	2QFY17A	2QFY16	YoY (%)	1QFY17	QoQ (%)
Revenues (in Rs mn)	42,323	32,044	32.1	43,336	-2.3
Formulation Sales	39,404	28,714	37.2	40,467	-2.6
US + EU	21,272	12,815	66.0	23,119	-8.0
FTF	8,265	3,569	131.6	8,498	-2.7
US	19,978	11,539	73.1	21,886	-8.7
EU	1,083	1,158	-6.5	1,033	4.9
Japan	4,159	3,234	28.6	4,255	-2.3
India	9,958	8,881	12.1	9,313	6.9
EM	4,015	3,784	6.1	3,780	6.2
SA	1,126	998	12.8	912	23.5
API	2,919	3,330	-12.3	2,869	1.7

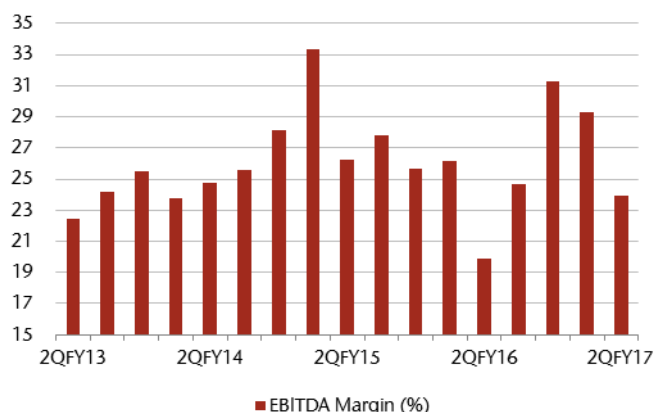
Source: Jefferies estimates, company data

Exhibit 3: Gross margins and EBITDA margins dip QoQ...



Source: Jefferies estimates, company data

Exhibit 4: ...despite exclusivity and full quarter Gavis



Source: Jefferies estimates, company data

Exhibit 5: Changes to estimates

	Old			New			% change		
	FY17E	FY18E	FY19E	FY17E	FY18E	FY19E	FY17E	FY18E	FY19E
Sales	181,395	211,880	239,243	178,212	206,935	231,928	-1.8	-2.3	-3.1
Operating profit	47,720	53,431	59,097	45,520	51,861	56,615	-4.6	-2.9	-4.2
OP margin (%)	26.3	25.2	24.7	25.5	25.1	24.4	-76 bps	-14 bps	-29 bps
Net profit	28,509	30,477	34,775	27,642	29,747	33,829	-3.0	-2.4	-2.7
NP margin (%)	15.7	14.4	14.5	15.5	14.4	14.6	-19 bps	-3 bps	9 bps
EPS	63.4	67.8	77.4	61.5	66.2	75.3	-3.0	-2.4	-2.8
EPS growth (%)	21.6	6.9	14.1	17.9	7.6	13.7	-370 bps	71 bps	-38 bps
DPS	9.1	9.7	11.1	8.8	9.5	10.8	-2.8	-1.9	-2.5
ROE (%)	21.2	18.8	18.2	20.7	18.5	17.9	-50 bps	-25 bps	-33 bps

Source: Jefferies estimates, company data

Financials

Exhibit 6: Profit and Loss Statement

Rs mn	2014	2015	2016	2017E	2018E	2019E
Net Sales	112,866	127,700	143,124	178,212	206,935	231,928
<i>Change (%)</i>	17.1	13.1	12.1	24.5	16.1	12.1
Material Cost	38,174	41,570	43,094	52,186	61,914	68,613
Employee Cost	14,647	17,473	21,077	28,206	33,001	38,611
SG&A	20,724	21,472	24,341	28,993	33,065	37,691
R&D Expenses	9,294	10,988	16,038	23,308	27,095	30,398
EBITDA	30,028	36,196	38,574	45,520	51,861	56,615
<i>% of net sales</i>	26.6	28.3	27.0	25.5	25.1	24.4
Depreciation	2,610	4,347	4,635	8,513	11,561	12,127
Interest	267	98	446	1,927	2,029	2,029
Other Income	1,165	2,398	1,877	1,893	2,637	4,002
EO Income / (Exp)	0	-1,210	-302	0	0	0
PBT	28,317	34,148	35,370	36,972	40,907	46,461
Tax	9,622	9,704	11,536	9,243	11,045	12,544
<i>Rate (%)</i>	34.0	28.4	32.6	25.0	27.0	27.0
Minority Interest	331	412	88	88	116	88
PAT	18,364	22,822	23,444	27,642	29,747	33,829
Adjusted PAT	18,364	24,032	23,747	27,642	29,747	33,829
<i>change (%)</i>	39.7	30.9	-1.2	16.4	7.6	13.7

Source: Jefferies estimates, company data

Exhibit 7: Balance Sheet Statement

Rs mn	2014	2015	2016	2017E	2018E	2019E
Share Capital	897	899	901	901	901	901
Minority Interest	669	241	321	408	496	584
Reserves	68,419	87,842	108,943	132,636	159,458	188,455
Net Worth	69,985	88,982	110,165	133,946	160,855	189,940
Deferred Tax Lia	2,487	2,024	2,045	2,045	2,045	2,045
Loans	6,537	5,371	71,775	82,855	82,855	82,855
Capital Employed	79,009	96,377	183,984	218,846	245,755	274,839
Gross Fixed Assets	52,839	67,011	116,737	157,667	176,396	189,396
Less: Depreciation	19,283	23,329	27,715	36,227	47,788	59,915
Net Fixed Assets	33,556	43,682	89,023	121,440	128,608	129,480
Capital WIP	3,041	5,760	27,000	18,406	9,812	9,812
Investments	1,785	16,584	75	75	75	75
Deferred Tax Asset	708	842	806	806	806	806
Current Assets	62,970	64,510	107,473	120,322	153,123	185,383
Inventory	21,295	25,036	31,787	32,884	42,758	47,384
Debtors	24,641	26,566	45,498	46,887	54,444	54,646
Cash & Bank Balance	7,975	4,814	8,379	18,742	35,807	53,581
Loans & Advances	9,060	8,095	21,808	21,808	20,115	29,773
Current Liabilities	23,051	35,001	40,393	42,203	46,669	50,717
Creditors	13,703	16,799	19,770	24,747	28,912	32,377
Other Liabilities	5,895	12,459	13,866	10,099	10,099	10,099
Provisions	3,454	5,743	6,758	7,357	7,658	8,241
Net Current Assets	39,919	29,509	67,080	78,119	106,454	134,667
Appl. Of fund	79,009	96,377	183,984	218,846	245,756	274,841

Source: Jefferies estimates, company data

Exhibit 8: Cash Flow Statement

(Rs mn)	2014	2015	2016	2017E	2018E	2019E
PAT	18,364	22,822	23,444	27,642	29,747	33,829
Depreciation	2,610	4,347	4,635	8,513	11,561	12,127
Interest Exp.	267	98	446	1,927	2,029	2,029
Other Income	1,165	2,398	1,877	1,893	2,637	4,002
Change in Wkg. Capital	-30,658	-27,973	-45,895	-22,385	-26,340	-15,069
CF from Op Activities	16,713	31,522	-7,300	35,513	29,429	33,544
Change in Fixed Assets	-6,099	-17,192	-71,217	-32,336	-10,135	-13,000
Change in Investments	-1,764	-14,799	16,509	0	0	0
Other Income	1,165	2,398	1,877	1,893	2,637	4,002
CF from Investing Activities	-6,698	-29,593	-52,831	-30,443	-7,498	-8,998
Change in equity	77	-426	82	0	0	0
Changes in debt	-5,108	-1,166	66,404	11,080	0	0
Interest Exp.	-267	-98	-446	-1,927	-2,029	-2,029
Dividend paid	-2,679	-3,348	-3,348	-3,948	-4,249	-4,832
Others	1,587	-51	1,005	88	1,412	88
CF from Financing Activities	-6,389	-5,090	63,697	5,293	-4,866	-6,773
Net change in Cash	3,626	-3,162	3,566	10,363	17,065	17,774

Source: Company Data, Jefferies estimates

Exhibit 9: Key Ratios

	2014	2015	2016	2017E	2018E	2019E
Basic (Rs)						
EPS	41.0	50.8	52.2	61.5	66.2	75.3
BPS	154.6	197.4	243.8	296.4	355.9	420.2
DPS	6.0	7.5	7.5	8.8	9.5	10.8
Payout (%)	14.6	14.8	14.4	14.4	14.4	14.4
Valuation (X)						
P/E	37.3	30.1	29.3	24.9	23.1	20.3
P/B	9.9	7.7	6.3	5.2	4.3	3.6
EV/EBITDA	22.7	18.9	17.7	15.0	13.2	12.1
EV/Sales	6.0	5.3	4.8	3.8	3.3	2.9
Dividend Yield (%)	0.4	0.5	0.5	0.6	0.6	0.7
Profit Ratios (%)						
RoE	26.5	27.1	21.6	20.7	18.5	17.9
RoCE	25.5	24.9	13.0	13.9	14.0	14.7
Turnover Ratios						
Debtor Days	80	76	116	96	96	86
Inventory Days	204	220	269	230	252	252
Creditor Days	73	83	86	86	86	86
Net Debt to Equity	0.0	-0.2	0.6	0.5	0.3	0.2

Source: Company Data, Jefferies estimates

Company Description

Lupin is a global pharmaceutical company. It has presence in 70 countries with its major markets being India, US, Japan and South Africa. In USA it has presence both in branded and generic markets.

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(Article 3(1)e and Article 7 of MAR)

Recommendation Published , 13:55 ET. November 9, 2016

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The expected total return (price appreciation plus yield) for Buy rated securities with an average security price consistently below \$10 is 20% or more within a 12-month period as these companies are typically more volatile than the overall stock market. For Hold rated securities with an average security price consistently below \$10, the expected total return (price appreciation plus yield) is plus or minus 20% within a 12-month period. For Underperform rated securities with an average security price consistently below \$10, the expected total return (price appreciation plus yield) is minus 20% or less within a 12-month period.

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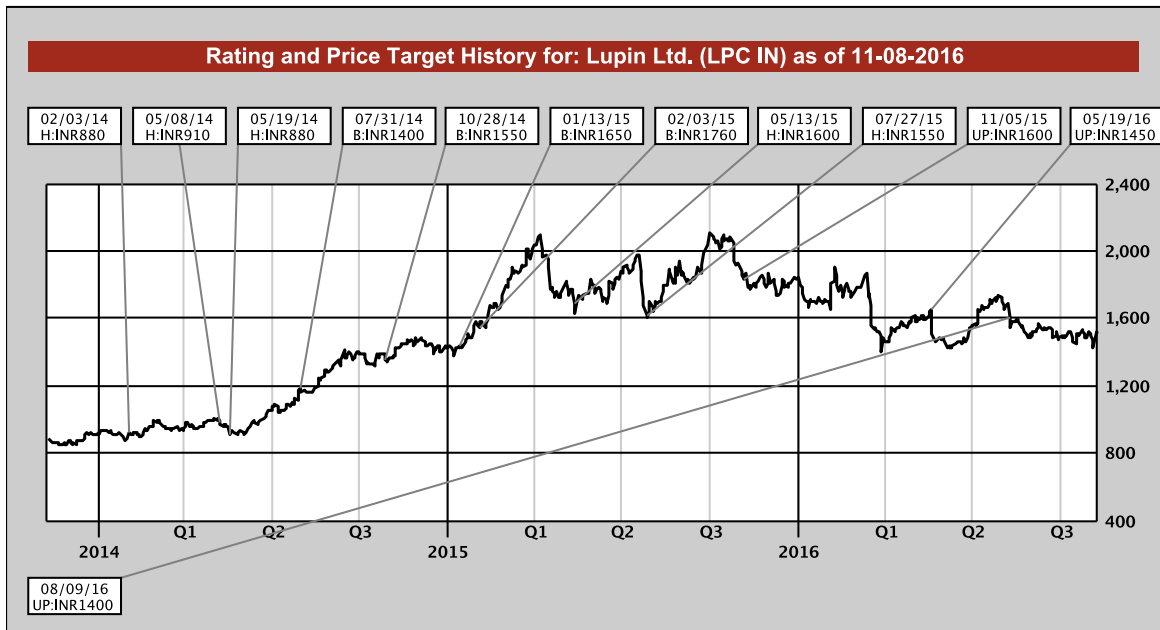
LPC IN

Target | Estimate Change

9 November 2016

Risks which may impede the achievement of our Price Target

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- D: Dropped Coverage
- B: Buy
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			Count	Percent
BUY	1108	51.92%	324	29.24%
HOLD	863	40.44%	171	19.81%
UNDERPERFORM	163	7.64%	17	10.43%

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