

10 November 2016

HOLD

TP: INR 1,700.00

▲ 11.1%

Lupin

LPC IN

Operational metrics weak, commentary mixed – HOLD

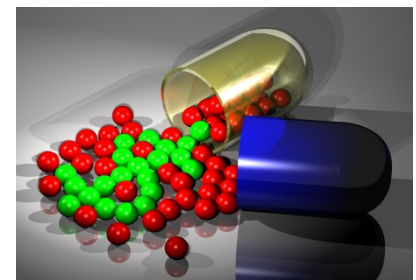
LPC's Q2 results were operationally weak while management commentary was mixed. LPC pointed to a potential delay in g*Glumetza's* launch by competitors and good progress in its respiratory portfolio (*Albuterol* filing in Q3; *Advair* DPI trials from Q4). However, further delay in the *Sevelamer* franchise launch to H2FY18 (H1 earlier) and a FY18 guidance cut for its *Gavis* portfolio (from US\$ 300mn to US\$ 250mn) were negatives. We restate our HOLD rating and roll over to a Sep'17 of Rs 1,700 (Mar'17 TP: Rs 1,660).

- ➔ **Topline, bottomline miss:** LPC's Q2 sales/PAT declined 3.4%/24.9% QoQ (+29.2%/+62% YoY) to Rs 42.9bn/Rs 6.6bn. Revenues missed RCMLe by 4% due to weakness in the US and LatAm markets even as other geographies posted modest growth. US sales fell by ~US\$ 29mn QoQ owing to (a) lower *Cephs* and *Gavis* sales, (b) price erosion in the base portfolio, and (c) increased competition in g*Fortamet* (*Mylan* launched in Sep'16). Domestic sales grew 12% YoY, in line with industry trends. In CC terms, the Japan business (Kyowa + KCC) grew 10.4% YoY but declined 2.5% sequentially. A lower tax rate of 20% (vs. 30% on average) restricted the decline in PAT to Rs 6.6bn, which still came in 9.6%/6.5% below our/street estimates.
- ➔ **Weak operational comparables:** EBITDA margins at 24% missed our/consensus estimates of 28%/27.1% on increased R&D spends (13.3% of sales vs. 11.2% in Q1) and higher other expenses (+240bps QoQ). Forex losses for the quarter stood at Rs 450mn and drove the increase in other expenses.
- ➔ **Retain HOLD:** Even as the Goa plant clearance should accelerate approvals while removing a key overhang on the stock, LPC continues to witness delays in key product launches (*Sevelamer* franchise) and ramp-ups in its *Gavis* portfolio. Our FY17/FY18 earnings estimates thus remain 9%/8% below consensus. HOLD.

Financial Highlights

Y/E 31 Mar	FY15A	FY16A	FY17E	FY18E	FY19E
Revenue (INR mln)	127,700	142,085	172,239	199,669	218,975
EBITDA (INR mln)	36,196	37,535	44,816	52,340	60,590
Adjusted net profit (INR mln)	24,032	22,707	26,874	32,076	37,471
Adjusted EPS (INR)	53.5	50.4	59.6	71.2	83.2
Adjusted EPS growth (%)	30.5	(5.7)	18.4	19.4	16.8
DPS (INR)	3.8	3.7	5.0	6.0	7.0
ROIC (%)	28.8	16.4	14.8	17.2	19.1
Adjusted ROAE (%)	30.4	22.9	22.3	22.2	21.8
Adjusted P/E (x)	28.6	30.4	25.6	21.5	18.4
EV/EBITDA (x)	18.9	17.9	16.8	13.9	11.7
P/BV (x)	7.7	6.3	5.2	4.4	3.7

Source: Company, Bloomberg, RCML Research



REPORT AUTHORS

Praful Bohra

+91 22 6766 3463

praful.bohra@religare.com

Aarti Rao

+91 22 6766 3436

aarti.rao@religare.com

PRICE CLOSE (09 Nov 16)

INR 1,529.65

MARKET CAP

INR 689.6 bln

USD 10.4 bln

SHARES O/S

449.9 mln

FREE FLOAT

28.5%

3M AVG DAILY VOLUME/VALUE

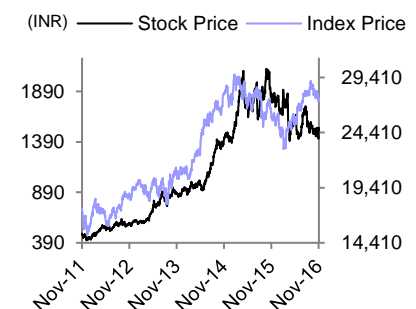
1.2 mln / USD 28.6 mln

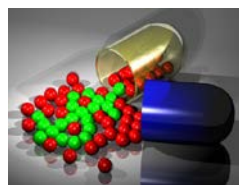
52 WK HIGH

INR 1,911.90

52 WK LOW

INR 1,280.00





Earnings call takeaways

US business

- Management expects joint sourcing with McKesson-Walmart to further impact pricing, and has guided for high single-digit price erosion (8-9%) ahead.
- LPC expects to clock 20% growth over the next 2-3 years led by the launch of key products, viz. *Minastrin*, *Metehogene*, *Epzicon* and potassium chloride, with an annual revenue run-rate of US\$ 70mn from **Methergene**. We feel this is a tall task and expect the US business to grow at an 11% CAGR over the next two years.
- LPC's CRL (complete response letter) for **Sevelamer** is pending and the launch has been pushed to H2FY18. However, the company believes it will still be in the first wave of the drug's generic launch.
- Key products:** (a) **gGlumetza**: LPC expects 1-2 entrants (SUNP yet to launch) by FY17-end. (b) **gFortamet**: LPC has lost 6% market share to Mylan (launched in Sep'16) though pricing remains rational. (c) **Tamiflu**: Expected to be a FY18 launch. (d) **Methergene**: To ramp up from Q3 onwards. (e) **Potassium chloride**: LPC is scaling up capacities for the launch. (f) **gMinastrin**: LPC has FTF on the product and expects this to be a Q4 launch (US\$ 350mn market). (g) **gPrezista** (settled) launch is unlikely over the next two years.
- Branded business sales for Q2 stood at US\$ 20mn (Q1FY17: US\$ 22mn) largely driven by *Methergene* and higher *Antara* sales, while *Suprax* sales were affected due to seasonality.

Product pipeline:

- LPC filed four ANDAs and received nine product approvals in Q2FY17. The total cumulative ANDA filings till date are 338 (196 approved, including 45 exclusive FTF opportunities).
- LPC maintained its guidance of filing 30+ ANDAs (derma, controlled substances and niche products) and 15+ launches (5 launched; 4-5 launches from Goa and Somerset each) in FY17. Management expects the number of ANDA launches to double to 30+ in FY18.

Other markets

- Domestic business:** With the recent hires and streamlining of sales divisions, management expects the domestic business to grow at 15-20% going forward.
- About 23% of the domestic business is under NLEM.
- Japan:** LPC anticipates revenue growth of 10-15% led by new launches. More than half of Kyowa sales come from the CNS segment. Post the Shinogi deal closure (likely in the next two months), segment sales should strengthen further on transition of branded generics to specialty products.

Other highlights

- The company guided for FY17 capex of US\$ 250mn-300mn, to be incurred on its Japan facility, Florida R&D unit, Pune facility and injectable plant.
- LPC maintained its EBITDA guidance at 26-28%. It has set aside R&D spends of Rs 25bn for FY17 and expects the tax rate to normalise to 25% for the full year.

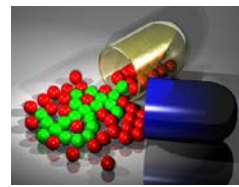


Fig 1 - Actuals vs. RCMLe and Bloomberg consensus

Particulars (Rs mn)	Actuals	RCML	Var (%)	Cons.	Var (%)
Revenues	42,905	44,746	(4.1)	43,589	(1.6)
EBITDA	10,281	12,529	(17.9)	11,801	(12.9)
EBITDA margin (%)	24.0	28.0	(404bps)	27.1	(311bps)
Reported PAT	6,622	7,323	(9.6)	7,084	(6.5)

Source: Bloomberg, Company, RCML Research

Fig 2 - Quarterly performance

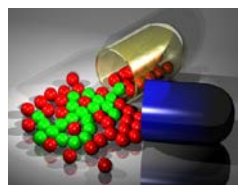
(Rs mn)	Q2FY17	Q2FY16	YoY (%)	Q1FY17	QoQ (%)
Net revenue	42,905	33,213	29.2	44,394	(3.4)
Total material costs	12,429	11,294	10.0	12,719	(2.3)
% of net revenue	29.0	34.0	-	28.7	-
Staff costs	7,124	5,242	35.9	7,059	0.9
% of net revenue	16.6	15.8	-	15.9	-
R&D expenses	5,716	3,878	47.4	4,994	14.5
% of revenue	13.3	11.7	-	11.2	-
Other expenses	7,356	6,078	21.0	6,541	12.5
% of net revenue	17.1	18.3	-	14.7	-
EBITDA	10,281	6,721	53.0	13,080	(21.4)
EBITDA margin (%)	24.0	20.2	372bps	29.5	(550bps)
Other income	271	415	(34.7)	826	(67.2)
Interest	263	102	159.1	320	(17.8)
Depreciation	2,112	1,068	97.7	2,027	4.2
PBT	8,177	5,967	37.0	11,560	(29.3)
Exceptional Item	-	-	-	-	-
Tax	1,589	1,851	(14.1)	2,734	(41.9)
Tax rate (%)	19.4	31.0	-	23.7	-
Minority Interest	(34)	27	-	6	-
Reported PAT	6,622	4,088	62.0	8,819	(24.9)

Source: Company, RCML Research

Fig 3 - Revenue summary

(Rs mn)	Q2FY17	Q2FY16	YoY (%)	Q1FY17	QoQ (%)
US	19,978	11,539	73.1	21,886	(8.7)
India	9,958	8,881	12.1	9,499	4.8
APAC	5,520	4,462	23.7	5,416	1.9
EMEA	2,355	2,218	6.2	2,194	7.3
LATAM	986	1,082	(8.9)	1,089	(9.5)
ROW	396	414	(4.3)	368	7.6
API	2,919	3,330	(12.3)	2,966	(1.6)
Total	42,112	31,926	31.9	43,418	(3.0)

Source: Company, RCML Research



Per Share Data

Y/E 31 Mar (INR)	FY15A	FY16A	FY17E	FY18E	FY19E
Reported EPS	53.5	50.4	59.6	71.2	83.2
Adjusted EPS	53.5	50.4	59.6	71.2	83.2
DPS	3.8	3.7	5.0	6.0	7.0
BVPS	197.4	243.8	291.7	348.8	415.6

Valuation Ratios

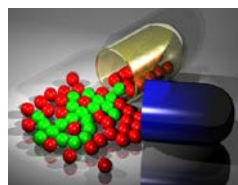
Y/E 31 Mar (x)	FY15A	FY16A	FY17E	FY18E	FY19E
EV/Sales	5.4	4.7	4.4	3.6	3.2
EV/EBITDA	18.9	17.9	16.8	13.9	11.7
Adjusted P/E	28.6	30.4	25.6	21.5	18.4
P/BV	7.7	6.3	5.2	4.4	3.7

Financial Ratios

Y/E 31 Mar	FY15A	FY16A	FY17E	FY18E	FY19E
Profitability & Return Ratios (%)					
EBITDA margin	28.3	26.4	26.0	26.2	27.7
EBIT margin	24.9	23.2	20.8	21.3	22.7
Adjusted profit margin	18.8	16.0	15.6	16.1	17.1
Adjusted ROAE	30.4	22.9	22.3	22.2	21.8
ROCE	26.7	15.8	14.5	17.1	18.3
YoY Growth (%)					
Revenue	13.1	11.3	21.2	15.9	9.7
EBITDA	20.5	3.7	19.4	16.8	15.8
Adjusted EPS	30.5	(5.7)	18.4	19.4	16.8
Invested capital	31.4	95.8	(2.3)	6.3	4.4
Working Capital & Liquidity Ratios					
Receivables (days)	73	93	88	74	76
Inventory (days)	66	73	70	68	70
Payables (days)	61	64	61	61	63
Current ratio (x)	2.1	1.9	1.6	1.7	2.0
Quick ratio (x)	0.5	0.2	0.1	0.1	0.3
Turnover & Leverage Ratios (x)					
Gross asset turnover	2.1	1.5	1.4	1.4	1.4
Total asset turnover	1.1	0.8	0.8	0.9	0.9
Net interest coverage ratio	0.0	0.0	0.0	0.0	0.0
Adjusted debt/equity	(0.2)	0.6	0.3	0.1	0.0

DuPont Analysis

Y/E 31 Mar (%)	FY15A	FY16A	FY17E	FY18E	FY19E
Tax burden (Net income/PBT)	70.4	66.1	71.3	71.3	71.3
Interest burden (PBT/EBIT)	107.2	104.3	105.4	106.0	105.9
EBIT margin (EBIT/Revenue)	24.9	23.2	20.8	21.3	22.7
Asset turnover (Revenue/Avg TA)	111.6	80.8	78.2	88.5	88.9
Leverage (Avg TA/Avg equities)	144.8	177.1	182.5	156.4	143.0
Adjusted ROAE	30.4	22.9	22.3	22.2	21.8



Income Statement

Y/E 31 Mar (INR mln)	FY15A	FY16A	FY17E	FY18E	FY19E
Total revenue	127,700	142,085	172,239	199,669	218,975
EBITDA	36,196	37,535	44,816	52,340	60,590
EBIT	31,849	32,900	35,787	42,456	49,626
Net interest income/(expenses)	2,299	1,431	1,915	2,545	2,942
Other income/(expenses)	0	0	0	0	0
Exceptional items	0	0	0	0	0
EBT	34,148	34,330	37,702	45,000	52,569
Income taxes	(9,704)	(11,536)	(10,557)	(12,600)	(14,719)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	(412)	(88)	(271)	(324)	(378)
Reported net profit	24,032	22,707	26,874	32,076	37,471
Adjustments	0	0	0	0	0
Adjusted net profit	24,032	22,707	26,874	32,076	37,471

Balance Sheet

Y/E 31 Mar (INR mln)	FY15A	FY16A	FY17E	FY18E	FY19E
Accounts payables	16,799	19,770	22,692	26,237	28,205
Other current liabilities	10,398	9,309	9,309	9,309	9,309
Provisions	7,363	8,658	9,887	10,913	11,976
Debt funds	5,371	71,775	41,775	26,775	19,275
Other liabilities	441	2,657	2,657	2,657	2,657
Equity capital	899	901	901	901	901
Reserves & surplus	87,842	108,943	130,519	156,273	186,358
Shareholders' fund	88,741	109,844	131,421	157,174	187,259
Total liabilities and equities	129,353	222,333	218,062	233,385	259,003
Cash and cash eq.	21,372	8,399	3,996	3,893	18,460
Accounts receivables	26,566	45,498	37,568	43,551	47,761
Inventories	25,036	31,787	34,361	39,833	43,684
Other current assets	8,092	21,808	18,326	20,182	22,133
Investments	25	55	55	55	55
Net fixed assets	43,682	89,023	98,994	102,110	104,146
CWIP	5,760	27,000	26,000	25,000	24,000
Intangible assets	0	0	0	0	0
Deferred tax assets, net	(1,182)	(1,239)	(1,239)	(1,239)	(1,239)
Other assets	3	0	0	0	0
Total assets	129,353	222,333	218,061	233,385	259,002

Cash Flow Statement

Y/E 31 Mar (INR mln)	FY15A	FY16A	FY17E	FY18E	FY19E
Net income + Depreciation	28,379	27,342	35,903	41,961	48,435
Interest expenses	(2,299)	(1,431)	(1,915)	(2,545)	(2,942)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	4,340	(36,364)	11,762	(9,766)	(8,045)
Other operating cash flows	(3,089)	6,764	0	0	0
Cash flow from operations	27,331	(3,690)	45,749	29,650	37,447
Capital expenditures	(16,890)	(70,967)	(18,000)	(12,000)	(12,000)
Change in investments	(14,799)	16,509	0	0	0
Other investing cash flows	21,145	(14,976)	2,542	2,947	3,231
Cash flow from investing	(10,545)	(69,434)	(15,458)	(9,053)	(8,769)
Equities issued	413	642	0	0	0
Debt raised/repaid	(1,751)	66,483	(30,000)	(15,000)	(7,500)
Interest expenses	(98)	(446)	(627)	(402)	(289)
Dividends paid	(2,939)	(4,058)	(4,068)	(5,297)	(6,323)
Other financing cash flows	(15,575)	14,068	0	0	0
Cash flow from financing	(19,950)	76,690	(34,695)	(20,699)	(14,112)
Changes in cash and cash eq	(3,165)	3,566	(4,404)	(102)	14,567
Closing cash and cash eq	4,814	8,379	3,975	3,873	18,440

RESEARCH TEAM

ANALYST	SECTOR	EMAIL	TELEPHONE
Varun Lohchab (Head – India Research)	Consumer, Strategy	varun.lohchab@religare.com	+91 22 6766 3470
Navin Sahadeo	Cement	navin.sahadeo@religare.com	+91 22 6766 3439
Siddharth Vora, CFA	Auto, Auto Ancillaries, Cement	siddharth.vora@religare.com	+91 22 6766 3435
Prashant Tiwari, CFA	Capital Goods, Infrastructure, Utilities	prashant.tiwari@religare.com	+91 22 6766 3485
Manish Poddar	Consumer	manish.poddar@religare.com	+91 22 6766 3468
Aditya Joshi	Consumer	aditya.joshi@religare.com	+91 22 6766 3469
Rohit Ahuja	Energy	ahuja.rohit@religare.com	+91 22 6766 3437
Akshay Mane	Energy	akshay.mane@religare.com	+91 22 6766 3438
Parag Jariwala, CFA	Financials	parag.jariwala@religare.com	+91 22 6766 3442
Vikesh Mehta	Financials	vikesh.mehta@religare.com	+91 22 6766 3474
Akash Nainani	Financials	akash.nainani@religare.com	+91 22 6766 3466
Rumit Dugar	IT, Telecom, Media	rumit.dugar@religare.com	+91 22 6766 3444
Saumya Shrivastava	IT, Telecom, Media	saumya.shrivastava@religare.com	+91 22 6766 3445
Pritesh Jani	Metals	pritesh.jani@religare.com	+91 22 6766 3467
Arun Baid	Mid-caps	arun.baid@religare.com	+91 22 6766 3446
Manish Mahawar	Mid-caps	manish.mahawar@religare.com	+91 22 6766 3471
Saurabh Rathi	Mid-caps	saurabh.rathi@religare.com	+91 22 6766 3451
Praful Bohra	Pharmaceuticals	praful.bohra@religare.com	+91 22 6766 3463
Aarti Rao	Pharmaceuticals	aarti.rao@religare.com	+91 22 6766 3436
Jay Shankar	Economics & Strategy	shankar.jay@religare.com	+91 11 3912 5109
Rahul Agrawal	Economics & Strategy	ag.rahul@religare.com	+91 22 6766 3433

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Buy	More than 15%
Hold	Between 15% and -5%
Sell	Less than -5%

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