

All round growth; outlook hinges on new launches

Lupin reported robust 3Q numbers on account of stronger than expected US performance driven by resilience in its key anti-diabetes drug – gGlumetza – resulting in Revenue/EBITDA/PAT beating our estimates by 9%/17%/9%. We remain comfortable with our gGlumetza and Fortamet erosion estimates and hence make limited changes to our FY18 numbers. However, we flag that growth hinges on execution of the pipeline, especially the GAVIS portfolio, which is dependent on successful commercialization of recent approvals of gNorco and other controlled substances. We maintain our buy recommendation and increase our TP to ₹1,760 as we roll over to FY19.

- Key operating details: US business outperforms:** US was the key driver of the strong 3Q performance as US revenues grew by \$24m q/q to \$316m (vs. JMFe \$270m). Ramp up of Methergine sales besides the resilient gGlumetza performance was the key positive for the US geography this quarter. **Growth across markets:** Lupin's domestic sales grew 12% y/y, despite demonetization concerns, and are expected to grow at 15%+ over the next few years. EMEA (+17% y/y), Japan (+5% y/y in constant currency terms), and LatAm (+33% y/y) also witnessed good growth and this momentum is expected to continue. **Operating efficiency improves:** EBITDA margin improved by over 300bps in 3Q to 27.1%, driven by strong US contribution and lower manufacturing and other expenses, and is expected to remain at c.26-28% in the near term.
- What next?** The fear is that this is the last good quarter, especially with increasing competition in the anti-diabetes franchise. While we acknowledge competition, we had penciled in gGlumetza/Fortamet declining 55%/20% in FY18. However, in order to sustain its growth momentum in the US, Lupin requires significant traction with new launches. Lupin continues to stay among the highest filer/recipient of approvals (6/11 in 3Q) and has 25+ product launch potential in next 12 months including challenging, limited competition products (like Minastrin FE, Epzicom, Vigamox, KCL) and needs to ramp-up commercialization to continue with its US growth trajectory. The controlled substance opportunity (c. \$20bn market for Lupin) is interesting but awaits sizeable launches. Although Lupin remains on a lookout for inorganic growth opportunities in the specialty space, it is constrained by

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Key Data

Market cap (bn)	₹ 673.2 / US\$ 10.1
Shares in issue (mn)	448.2
Diluted share (mn)	448.2
3-mon avg daily val (mn)	₹ 1384.8/US\$ 20.7
52-week range	₹ 1911.9/1280.0
Sensex/Nifty	28,330/8,778
₹/US\$	66.9

Daily Performance



%	1M	3M	12M
Absolute	0.1	-2.5	-21.7
Relative	-5.9	-6.5	-39.7

* To the BSE Sensex

Shareholding Pattern (%)

	Dec-16	Sep-16
Promoters	46.7	46.7
FII	33.6	35.0
DII	7.7	6.8
Public / Others	12.0	11.6

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	FY 15A	FY 16A	FY 17E	FY 18E	FY 19E
Net sales	125,997	136,539	170,364	189,094	210,083
Sales growth (%)	13.6	8.4	24.8	11.0	11.1
EBITDA	36,197	36,756	45,658	51,123	59,227
EBITDA (%)	28.3	26.0	26.2	26.5	27.7
Adjusted net profit	24,032	22,607	27,533	30,741	36,076
EPS (₹)	53.6	50.4	61.0	68.1	79.9
EPS growth (%)	30.8	-5.9	21.0	11.6	17.4
ROIC (%)	35.1	18.8	15.3	15.5	17.2
ROE (%)	30.4	22.8	22.6	21.0	20.6
PE (x)	27.8	29.6	24.4	21.9	18.7
Price/Book value (x)	7.5	6.1	5.0	4.2	3.5
EV/EBITDA (x)	18.0	19.9	16.2	14.1	11.9

Source: Company data, JM Financial. Note: Valuations as of 09/02/2017

limited commercial-stage targets and prohibitive valuations.

- **Key numbers:** Net sales increased 31% y/y to ₹44,049m (9% ahead of JMFe) driven by 58% y/y growth in US (9% q/q). Gross margin stood at 71.0%, +263 bps y/y but flat q/q, in-line with expectations. EBITDA grew 44% y/y to ₹12,158m (17% above our est.), up 18% q/q, driven by expansion of EBITDA margin to 27.1% (+327bps y/y; +316 bps q/q), beating our est. by 189bps due to higher US contribution and lower than expected cost ratios (staff costs and manufacturing & other expenses). R&D expenses stood at ₹5,682m (12.9% of sales vs. 13.6% in 2Q). PAT stood at ₹6,331m (9% above est.) although growth was limited to 21% y/y (-4% q/q) due to higher than expected D&A costs and effective tax rate (39% vs. JMFe 28%; on account of unwinding of DTAs, subsidiary losses and inventory de-stocking).

Exhibit 2. Lupin's FY17-19 revenue and earnings split

		FY17	FY18	FY19
Revenue	Lupin consolidated	174,151	193,070	214,058
	- Lupin ex-Gavis, ex-price hikes	150,390	171,709	193,236
	- Fortamet	6,564	5,356	2,900
	- Glumetza	7,113	3,397	2,717
	- Gavis contribution	10,084	12,609	15,205
EBITDA	Lupin consolidated	45,658	51,123	59,227
	- Lupin ex-Gavis, ex-price hikes	31,691	41,692	50,951
	- Fortamet	4,595	3,214	1,595
	- Glumetza	5,945	1,868	1,359
	- Gavis contribution	3,428	4,350	5,322
EPS	Lupin consolidated	61.0	68.1	79.9
	- Lupin ex-Gavis, ex-price hikes	44.6	58.1	71.3
	- Fortamet	7.1	5.0	2.5
	- Glumetza	9.2	2.9	2.1
	- Gavis contribution	0.1	2.1	4.0

Source: Company, JM Financial

Key takeaways from conference call

- **US:** Branded business sales at \$22m; gone up 25% sequentially. Methergine is the largest followed by Antara and then Suprax.

Glumetza: Glumetza grew q/q; took more share from the brand. Expect generic market to expand; Lupin has converted 75% to generic. Sun and Teva will launch over 12 months. Sun will launch in 3QCY17; Teva in 2QCY17.

Fortamet: Aurobindo launch after 30 months since covering patents valid. Lost some share to Mylan and saw some price decrease too.

Methergine: Brand is 50% of Rx as per Lupin data whereas IMS shows 33%. Overall Rx down 20%; when Lupin took over, it was declining at same pace. Lupin expected product to stabilize and then grow due to promotion efforts.

\$4m/month level; continues to grow. Injectable methergine is the only alternative. Amneal expected to be Day 181 entrant.

Smaller products did well; contribution small but added to numbers.

Pipeline: Should file 30+ ANDAs for FY17 (from Somerset and India); higher filings in 4Q; includes few FTFs. Potential for 25+ launches in next 12 months. Includes Minastrin FE, Epzicom (limited competition), Vigamox (Jul '17 launch; limited competition; Actavis was FTF but there is forfeiture clause too), potassium chloride. Some Somerset products (Hydrocodone). Namenda XR, Restasis are pending litigation and could be interesting opportunities next year. Launches in next few months to determine run rate.

Significant progress on complex generic pipeline (Biosimilars and Inhalation). Filed Albuterol MDI in 3Q (ANDA to ProAir; \$3bn market; Perrigo 1st competition; expect 3-4 players) and have multiple DPI in development and also have etanercept under development (Ph. III trials). Advair - batches starting and clinical trials should start soon; if everything goes well, it will be FY18 filing.

Price Erosion: High single-digit price erosion; depends on exposure to McKesson-Walmart.

GAVIS: Shaping well; good results expected in next few quarters; received number of approvals in last few months; preparing for launch in 4Q. Launched 4 products (2 from India, 2 from US); will launch another 3 next quarter.

Controlled substances market: \$30bn market; ~\$12bn through Somerset and India filings (for US) covers another ~\$7-8 bn. Morphine manufactured and released and in process of launch. Hydrocodone (gNorco) later. See significant impact in FY19. Currently Somerset has small quota. Will gain more quota with gain in market share.

FDA approval: Simpler products getting approved fast. Delays on product no clear FDA guidance or evolving thought. Had good dialogue on inhalation products. Working on easier pathway for biosimilars.

CRLs pending in pretty much all (Welchol and Renvela) and respond in the coming quarter. Still hopeful of late FY18 launch or early FY19 launch. All companies in the same bucket.

- **India:** Branded business grew 14%; impacted by 2-3% due to demonetization. Will turn around completely by Apr and see 15-20% secular growth in next few years. GST to be disruptive; will result in temporary volatility.
- **Japan:** Shionogi contribution limited in Q3; full impact in Q4. Reforms in generic substitution which impacted sales Strong double digit growth next year.
- **Financial:** EBITDA Margins to hover around 26-28%; apart from R&D bumps.

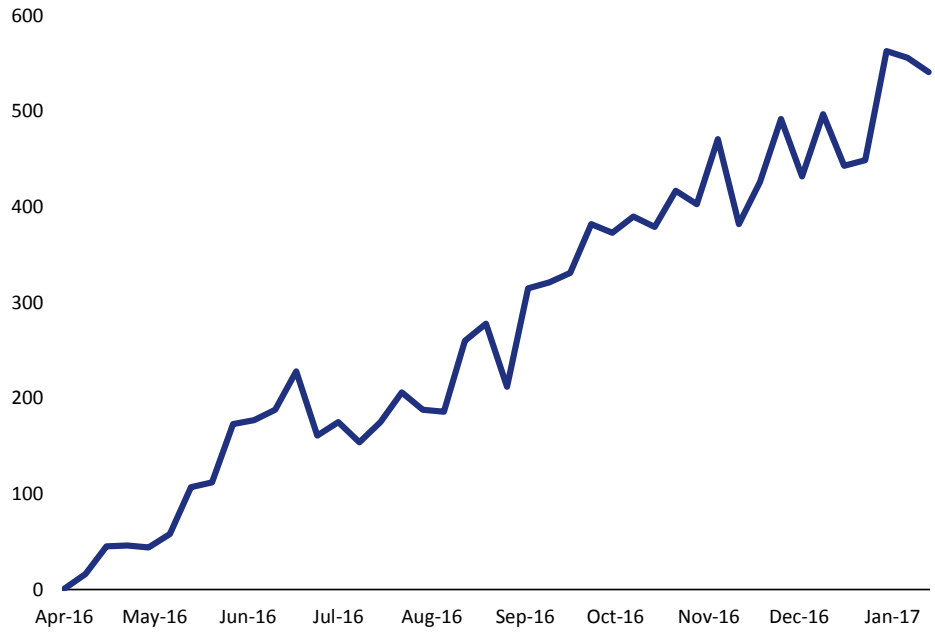
Tax: Higher tax in 3Q due to unwinding of deferred tax assets and subsidiary losses across geographies. Lowering of inventory. Tax rate for FY17 will be 28%.

Capex: Guided ₹1,900cr for FY17 and ₹1,300-1,400cr; To be utilized for its injectable facility, investments in Japan and R&D facility in Pune.

Debt: Loans have come down from 4Q16 (from ₹6,400cr to ₹5,400cr) but gone up q/q due to Shionogi acquisition. Interest cost higher due to increase in interest rates in dollar loans.

FX impact: ₹27cr. positive in 3Q and ₹72cr movement q/q.

Exhibit 3. Methergine TRx



Source: Bloomberg

Exhibit 4. Lupin 3Q17 P&L snapshot

Lupin	Q3FY16A	Q3FY17A	% YoY	Q3FY17E	% Delta vs JMFe	Q3FY17E (cons)	% Delta vs cons	Q2FY17A	% QoQ
Net sales	33,503	44,049	31%	40,333	9%			42,112	5%
Other op. income	1,973	779	-61%	955	-18%			793	-2%
Net Total Income	35,477	44,829	26%	41,288	9%	42,523	5%	42,905	4%
Expenses									
Raw material	11,232	13,016	16%	12,155	7%			12,429	5%
Staff cost	5,434	7,312	35%	7,013	4%			7,124	3%
Other expense	10,349	12,343	19%	11,704	5%			13,072	-6%
EBITDA	8,461	12,158	44%	10,416	17%	10,651	14%	10,281	18%
% EBITDA Margin	23.8%	27.1%	327 bps	25.2%	189 bps	25.0%		24.0%	316 bps
% EBITDA Margin (excl. OOI)	19.4%	25.8%		23.5%				22.5%	
Other income	664	1,036		271	282%			271	282%
Interest expense	99	459		340				263	
Depreciation	1,216	2,309	90%	2,175	6%			2,112	9%
Extraordinary income (expense)	0	0						0	
Profit Before Tax (PBT)	7,811	10,426	33%	8,172	28%			8,177	28%
Tax	2,557	4,095	60%	2,288	79%			1,589	158%
% Tax rate	33%	39%		28%				19%	
JV share	5	24						42	
Minority interest*	13	24		50				8	
Reported PAT	5,246	6,331	21%	5,834	9%	6,407	-1%	6,622	-4%

(* positive number represents minority's share of company's profits or company's share of associate profit)

% Cost Ratios	Q3FY16A	Q3FY17A	% YoY	Q3FY17E	% Delta vs JMFe	Q3FY17E (cons)	% Delta vs JMFe	Q2FY17A	% QoQ
Raw Materials	31.7	29.0	-263 bps	29.4	-41 bps			29.0	7 bps
Staff cost	15.3	16.3	99 bps	17.0	-67 bps			16.6	-29 bps
Mfg & Other expense	29.2	27.5	-164 bps	28.3	-81 bps			30.5	-293 bps

Sales Break-up	Q3FY16A	Q3FY17A	% YoY	Q3FY17E	% Delta vs JMFe	Q3FY17E (cons)	% Delta vs JMFe	Q2FY17A	% QoQ
Formulations	30,668	41,365	35%	37,435	10%			39,193	6%
Domestic	8,860	9,912	12%	9,932	0%			9,958	0%
US	13,805	21,755	58%	18,083	20%			19,978	9%
Japan	3,734	4,492	20%	4,926	-9%			4,368	3%
Rest of Asia	900	1,109	23%	368	202%			1,152	-4%
EMEA	2,187	2,555	17%	2,470	3%			2,355	8%
LatAm	885	1,175	33%	1,173	0%			986	19%
RoW	297	367	24%	483	-24%			396	-7%
API	2,835	2,684	-5%	2,898	-7%			2,919	-8%
Net sales	33,503	44,049	31%	40,333	9%			42,112	5%

Source: Company, JM Financial

Exhibit 5. 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	99	87	92%	-12%	114	100	15%	-12%	119	105	5%	-12%	Strong 3Q; 25% q/q increase mainly from Methergine. We maintain our peak sales estimate of ~\$50m. Expect competition to continue in other products
US - branded business INR % total revenue	6,624 4%	5,801 3%	99%	-12%	7,620 4%	6,674 3%	15%	-12%	8,001 4%	7,008 3%	5%	-12%	
US - generic generic USD	931	985	19%	6%	1,006	1,005	2%	0%	1,137	1,096	9%	-4%	Slower erosion in Glumetza (3Q) and Fortamet (lower price erosion in FY17). Expect a fairly long tail for Minastrin FE, Epzicom.
US - generic generic INR % total revenue	62,712 36%	66,341 38%	20%	6%	67,389 35%	67,348 35%	2%	0%	76,150 35%	73,409 34%	9%	-4%	
Gavis - INR % total revenue	10,330 6%	10,084 6%	836%	-2%	12,916 7%	12,609 7%	25%	-2%	15,575 7%	15,205 7%	21%	-2%	Launch of gNorco should help drive growth from FY18. We forecast Gavis (ex-Methergine) sales at ~\$185m
Total US % total revenue	79,665 46%	82,226 47%	38%	3%	87,925 45%	86,631 45%	5%	-1%	99,726 46%	95,621 45%	10%	-4%	
Japan - JPY	29,943	29,512	18%	-1%	38,737	38,263	30%	-1%	42,611	42,090	10%	-1%	3Q growth ~5% in cc. We model 10% secular growth going forward. Expect full integration of Shionogi portfolio from 4Q17 (~\$80m sales at manufacturer level)
Japan - INR % total revenue	19,161 11%	18,238 10%	34%	-5%	23,242 12%	22,958 12%	26%	-1%	25,567 12%	25,254 12%	10%	-1%	
South Africa - INR % total revenue	4,554 3%	4,482 3%	12%	-2%	5,100 3%	5,020 3%	12%	-2%	5,610 3%	5,522 3%	10%	-2%	Growth slowed to 16.5% y/y vs. 27% y/y growth in cc. Expect it to grow at 10-12%, slightly ahead of the overall market growth.
Others - INR % total revenue	10,316 6%	10,997 6%	20%	7%	11,863 6%	12,646 7%	15%	7%	13,287 6%	14,164 7%	12%	7%	
India % total revenue	37,822 22%	37,803 22%	12%	0%	44,252 23%	44,229 23%	17%	0%	50,890 23%	50,863 24%	15%	0%	After disappointing 1Q, 2Q and 3Q witnessed 14%/12% growth, with growth in 3Q impacted by 2-3% due to demonetization. We expect Lupin to outperform IPM given its strong chronic franchise
Total API % total revenue	11,672 7%	11,458 7%	-5%	-2%	12,256 6%	12,031 6%	5%	-2%	12,869 6%	12,633 6%	5%	-2%	
Total operating revenue	172,430	174,151	23%	1%	194,594	193,070	11%	-1%	218,366	214,058	11%	-2%	
Gross profit	122,088	123,587			136,163	135,207			152,704	148,871			Gross margin largely unchanged. Slight decline in FY19 as some product launches gets delayed and may face higher competition. Mid-teens growth in domestic market will help stem margin decline
- margin	70.8%	71.0%			70.0%	70.0%			69.9%	69.5%			
EBITDA	44,824	45,658	24%	2%	52,033	51,123	12%	-2%	63,329	59,227	16%	-6%	Despite higher gross margin, we cut EBITDA margin as employee and R&D expenses remain high in the short-term
- margin	26.0%	26.2%			26.7%	26.5%			29.0%	27.7%			
PAT (Reported)	27,393	27,533		1%	31,384	30,741		-2%	39,120	36,076		-8%	
EPS(Rs)	61.1	61.0	21%	0%	70.0	68.1	12%	-3%	87.3	79.9	17%	-8%	

Source: Company, JM Financial

Financial Tables (Consolidated)

Profit & Loss Statement					
	(₹ mn)				
Y/E March	FY 15A	FY 16A	FY 17E	FY 18E	FY 19E
Net sales (Net of excise)	125,997	136,539	170,364	189,094	210,083
Growth (%)	13.6	8.4	24.8	11.0	11.1
Other operational income	1,702	4,977	3,786	3,976	3,976
Raw material (or COGS)	41,570	43,326	50,564	57,863	65,188
Personnel cost	17,473	21,514	28,695	30,015	32,545
Other expenses (or SG&A)	32,460	39,920	49,233	54,068	57,099
EBITDA	36,197	36,756	45,658	51,123	59,227
EBITDA (%)	28.3	26.0	26.2	26.5	27.7
Growth (%)	24.8	1.5	24.2	12.0	15.9
Other non-op. income	2,397	1,901	2,737	1,890	1,899
Depreciation and amort.	4,347	4,871	8,575	8,877	9,483
EBIT	34,247	33,785	39,820	44,136	51,643
Add: Net interest income	-99	-497	-1,271	-1,178	-1,086
Pre tax profit	34,149	33,288	38,549	42,958	50,557
Taxes	9,705	10,593	10,929	11,960	14,078
Add: Extraordinary items	0	0	0	0	0
Less: Minority interest	413	88	88	257	404
Reported net profit	24,031	22,607	27,533	30,741	36,076
Adjusted net profit	24,032	22,607	27,533	30,741	36,076
Margin (%)	18.8	16.0	15.8	15.9	16.9
Diluted share cap. (mn)	448	448	451	451	451
Diluted EPS (₹)	53.6	50.4	61.0	68.1	79.9
Growth (%)	30.8	-5.9	2.10	11.6	17.4
Total Dividend + Tax	3,334	3,334	3,334	3,334	3,334

Source: Company, JM Financial

Balance Sheet					
	(₹ mn)				
Y/E March	FY 15A	FY 16A	FY 17E	FY 18E	FY 19E
Share capital	899	901	901	901	901
Other capital	0	0	0	0	0
Reserves and surplus	87,842	108,943	132,456	158,355	189,578
Networth	88,741	109,844	133,357	159,256	190,479
Total loans	4,710	71,193	66,193	61,193	56,193
Minority interest	241	321	408	666	1,069
Sources of funds	93,691	181,358	199,959	221,115	247,741
Intangible assets	22,129	81,272	81,622	81,972	82,322
Fixed assets	45,445	57,754	78,652	92,167	106,081
Less: Depn. and amort.	23,329	28,200	36,776	45,653	55,135
Net block	44,245	110,826	123,499	128,487	133,268
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	108,674	129,839	156,699
Inventories	25,036	31,787	39,118	43,368	48,082
Sundry debtors	26,566	45,498	55,990	62,073	68,821
Cash & bank balances	21,372	8,399	1,313	11,995	27,239
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	41,374	46,371	51,386
Current liabilities	27,858	29,661	34,616	39,613	44,628
Provisions and others	5,743	6,758	6,758	6,758	6,758
Net current assets	44,723	61,372	67,300	83,468	105,313
Others (net)	684	5,146	5,146	5,146	5,146
Application of funds	93,691	181,357	199,958	221,114	247,741

Source: Company, JM Financial

Cash flow statement					
	(₹ mn)				
Y/E March	FY 15A	FY 16A	FY 17E	FY 18E	FY 19E
Reported net profit	24,031	22,607	27,533	30,741	36,076
Depreciation and amort.	4,046	4,871	8,575	8,877	9,483
-Inc/dec in working cap.	-2,047	-23,326	-14,161	-6,640	-7,757
Others	-428	80	88	257	404
Cash from operations (a)	25,603	4,232	22,035	33,235	38,205
-Inc/dec in investments	-5	-30	0	0	0
Capex	-16,890	-71,453	-21,248	-13,865	-14,264
Others	7,690	-6,296	1,146	1,154	1,156
Cash flow from inv. (b)	-9,205	-77,779	-20,102	-12,711	-13,108
Inc/-dec in capital	-1,273	1,829	-686	-1,508	-1,519
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	-9,020	-9,842	-9,853
Inc/-dec in cash (a+b+c)	11,633	-12,973	-7,087	10,683	15,244
Opening cash balance	9,739	21,372	8,399	1,313	11,995
Closing cash balance	21,372	8,400	1,313	11,995	27,239

Source: Company, JM Financial

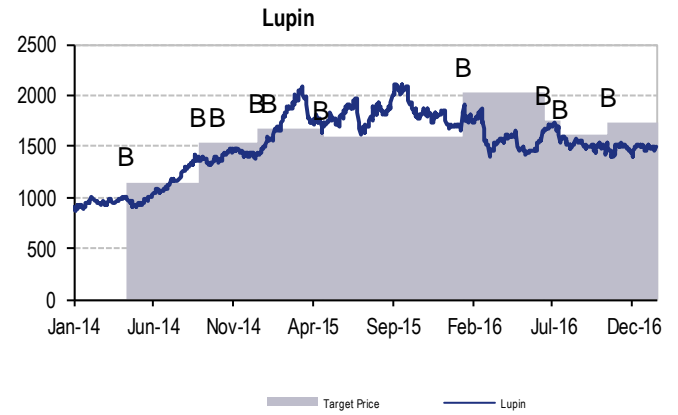
Key Ratios					
Y/E March	FY 15A	FY 16A	FY 17E	FY 18E	FY 19E
BV/Share (₹)	198.0	245.1	295.5	352.8	421.9
ROIC (%)	35.1	18.8	15.3	15.5	17.2
ROE (%)	30.4	22.8	22.6	21.0	20.6
Net Debt/equity ratio (x)	-0.2	0.6	0.5	0.3	0.2
Valuation ratios (x)					
PER	27.8	29.6	24.4	21.9	18.7
PBV	7.5	6.1	5.0	4.2	3.5
EV/EBITDA	18.0	19.9	16.2	14.1	11.9
EV/Sales	5.2	5.4	4.3	3.8	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
10-Nov-16	61.1	-3.0	70.0	-4.4	1,730	7.5

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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