

Lupin

Glumetza continues to drive growth

In 3QFY17, Lupin reported revenue of Rs44.8bn, 26% YoY growth, led by market-share gain from Glumetza and four launches in the US business. Ex-forex gains, EBITDA margin was ~130bps ahead of our estimate due to lower SG&A spends and continued limited competition in the US business. With Goa facility cleared, the management guided for 25+ approvals in FY18E versus our estimate of 30. We remain optimistic on Lupin's US business and believe the company is one of the biggest beneficiaries of GDUFA due to presence in complex generics and large pipeline of ANDAs (~140) pending approval. Lupin should report US revenue CAGR of 30% over FY16-19E. Over FY16-19E, we see 230bps margin expansion to 28.7% due to higher revenue from limited-competition complex generics and operating leverage in RoW; partially offset by increase in R&D spends (12% in FY18E). Retain BUY with a TP of Rs1,871 (2% increase vs previous TP of Rs1,834).

Results overview: In-line revenue, core EBITDA margin beat driven by lower SG&A spend

Lupin reported 3QFY17 revenue of Rs44.8bn, 26% YoY growth, 4% QoQ growth, led by lower-than-expected competition in specific products in the US business. The company reported higher sales in gGlumetza as it gained market share from the innovator. Gross margins were flat QoQ at 70.5% due to Glumetza. EBITDA margins increased by 560bps YoY to 25.8%, primarily due to forex gain of Rs270mn vs forex loss of Rs560mn in Q2FY17. Excluding forex gain impact, margin increased by ~130bps QoQ due to control in SG&A spends. R&D spends for the quarter was 12.9% of sales vs 13.6% in 2QFY17. Tax rate for the quarter was at 39% of PBT vs 19% in 2QFY17 due to unwinding of deferred tax. The management guided for a tax rate of 28% for FY17E.

Key takeaways from the conference call

- US business – Gain market share in Glumetza:** The company reported US sales of Rs21.8bn, 9% increase QoQ, as it gained market share in limited competition gGlumetza from the innovator. Also, Lupin launched four of the ten ANDAs approved during the quarter. Two of which were from Lupin and other two from Somerset (Gavis). In the US branded business, recently launched Methergine reported 25% QoQ growth at ~US\$12mn, which also aided sequential increase in US sales. These tailwinds were partially offset by incremental competition in Fortamet. Mylan launched generic version of Fortamet during 2QFY17 which led to pricing pressure and loss of market share for Lupin. In Glumetza, two additional players (Sun and Teva) are expected in 2HCY17. Considering Glumetza is difficult to formulate, management expects incremental competition to be restricted to two and the product will be limited-competition/high-margin opportunity. Base business continues to report price erosion of 8-9% on annual basis which is in line with our expectations.
- Management optimistic on US business; we expect ~30 product approvals in FY18E:** With Goa facility cleared by the USFDA and all its plants now approved, the management has provided optimistic guidance on a number of product approvals expected in FY18. The management expects to receive 25+ approvals in FY18E. Moreover, the management has guided for 'good part' of ANDA backlog to be cleared in the next two years (FY18E/19E). Lupin has ~140 ANDAs pending approval with annual filing rate of ~25 ANDAs. Whilst this is positive, it is in line with our expectation of the company receiving ~30 approvals annually from FY18E. We remain optimistic on Lupin's US business and believe the company is one of the biggest beneficiaries of GDUFA due to presence in complex generics and large pipeline of ANDAs pending approval. The company should report US revenue CAGR of 21% over FY16-19E.

BUY

Result Update

Stock Information

Bloomberg Code:	LPC IN
CMP (Rs):	1,490
TP (Rs):	1,871
Mcap (Rs bn/US\$ bn):	690/10.4
3M ADV (Rs mn/US\$ mn):	1906/28.6

Stock Performance (%)

	1M	3M	12M	YTD
Absolute	2	(5)	(18)	(17)
Rel. to Sensex	5	(2)	(22)	(21)

Source: Bloomberg, Ambit Capital research

Ambit Estimates (Rs mn)

	FY17E	FY18E	FY19E
Revenues	175355	220382	278723
EBITDA	46948	62534	73299
EPS (Rs)	65.2	90.7	105.9

Source: Bloomberg, Ambit Capital research

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- **Border tax charges, if any, will be passed on to end consumer:** Despite change in government in the USA, the management does not expect any material change in the course of business. If there is any border tax being levied by the US government, it will be passed on to the end consumer. However, the management does not expect any border tax to be levied on generic companies as generics are vital for lowering healthcare burden for the US government.
- **Indian business impacted by demonetisation:** The Indian business reported sales of Rs9.9bn, reporting YoY growth of 14%. Growth in Q3FY17 was impacted by demonetisation. The management has highlighted that challenges will remain in Q4FY17 as well but expect to return to >15% YoY growth from Q1FY18 onwards.

Exhibit 1: Change in our FY17E estimates to incorporate 25% EBITDA beat led by forex income

Rs mn Particulars	Revised			Previous			Change		
	FY17E	FY18E	FY19E	FY17E	FY18E	FY19E	FY17E	FY18E	FY19E
Sales assumptions									
India	39,163	45,038	51,794	40,213	46,244	53,181	-2.6%	-2.6%	-2.6%
US generics	74,928	90,346	114,208	66,820	89,301	111,832	12.1%	1.2%	2.1%
US brand	11,564	13,221	14,579	11,218	12,827	14,144	3.1%	3.1%	3.1%
Japan	18,422	22,107	26,528	16,375	19,650	23,580	12.5%	12.5%	12.5%
Europe	5,336	5,360	5,759	3,611	3,860	4,259	47.8%	38.9%	35.2%
RoW	15,299	18,644	22,915	17,721	21,700	26,701	-13.7%	-14.1%	-14.2%
API	11,591	12,171	12,779	12,678	13,312	13,977	-8.6%	-8.6%	-8.6%
Total revenue	176,304	206,886	248,562	168,636	206,893	247,674	4.5%	0.0%	0.4%
EBITDA	49,619	56,451	72,408	42,534	55,498	69,722	16.7%	1.7%	3.9%
EBITDA margins (%)	27.6%	26.8%	28.7%	25.4%	27.0%	28.3%	215bps	-20bps	39bps
PAT	30,333	35,993	46,690	26,129	35,656	45,149	16.1%	0.9%	3.4%

Source: Company, Ambit Capital research

Where do we go from here?

With the Goa facility cleared, Lupin is best placed to reap benefits of GDUFA given presence in complex generics and large pipeline of ~140 ANDAs pending approval. Also, Lupin has the first-mover advantage in Japan and we expect the company to benefit from increasing generic penetration. Over FY16-19E, we see 230bps margin expansion to 28.7% due to higher revenue from limited-competition complex generics and operating leverage in RoW; partially offset by increase in R&D spend (12% in FY18E). At CMP, Lupin trades at 18.7x FY18E EPS. The valuations should improve, given: (a) earnings growth momentum – we expect 27% net profit CAGR over FY16-19E due to GDUFA timelines resulting in large product approvals in FY18-19E; (b) investments in long-term growth drivers – the company is investing in differentiated products like complex injectables, ophthalmics and dermatology, biosimilars in Japan and respiratory in the USA and Japan; and (c) high visibility of earnings through large pipeline in the USA and growth acceleration in India. Our DCF-based analysis suggests a target price of Rs1,871/share (up 2% vs previous estimate), retain BUY.

Exhibit 2: Revenue mix

(Rs mn)	3QFY17	YoY (%)	3QFY16	QoQ (%)	2QFY17	Divergence (%)	3QFY17E
Advanced market formulations	27,790	48%	18,798	9%	25,592	9%	25,433
US	21,755	55%	14,049	9%	19,978	15%	18,979
Europe	1,543	53%	1,010	24%	1,246	27%	1,212
Japan	4,492	20%	3,739	3%	4,368	-14%	5,242
India formulations	9,912	14%	8,712	0%	9,958	-5%	10,454
Other formulations	3,663	11%	3,307	1%	3,643	1%	3,638
API	2,684	-3%	2,760	-8%	2,919	-12%	3,036
Total net sales	44,049	31%	33,577	5%	42,112	3%	42,561

Source: Company, Ambit Capital research

Exhibit 3: Income Statement

(Rs mn)	3QFY17	YoY (%)	3QFY16	QoQ (%)	2QFY17	Divergence (%)	3QFY17E
Net Sales	44,049	31%	33,577	5%	42,112	3%	42,561
Other Operating income	779	-61%	1,982	-2%	793	-22%	1,000
Total operating income	44,829	26%	35,558	4%	42,905	3%	43,561
Material costs	13,016	16%	11,230	5%	12,429	-1%	13,194
Staff costs	7,312	38%	5,284	3%	7,124	2%	7,133
Other expenditure	12,343	20%	10,273	-6%	13,072	-9%	13,504
Total Expenditure	32,670	22%	26,787	0%	32,624	-3%	33,831
EBITDA	12,158	39%	8,772	18%	10,281	25%	9,730
Core EBITDA margins (ex-OOI)	25.8%		20.2%		22.5%		20.5%
Other income	1,036	59%	653	282%	271		250
Interest	459	400%	92	75%	263	31%	350
Depreciation	2,309	107%	1,114	9%	2,112	5%	2,200
PBT	10,426	27%	8,219	28%	8,177	40%	7,430
Tax	4,095	41%	2,909	158%	1,589	120%	1,857
Tax rate	39.3%		35.4%		19.4%		25.0%
MI + Share of associates	(0)	-102%	13	-99%	(34)		100
PAT	6,331	20%	5,298	-4%	6,622	16%	5,472
(% of Operating Income)							
Material costs	29.5%	-390bps	33.4%	3bps	29.5%	-145bps	31.0%
Staff costs	16.3%	145bps	14.9%	-29bps	16.6%	-7bps	16.4%
Other Expenditure	27.5%	-136bps	28.9%	-293bps	30.5%	-347bps	31.0%
EBITDA Margin	25.8%	561bps	20.2%	330bps	22.5%	532bps	20.5%

Source: Company, Ambit Capital research

Exhibit 4: Revenue mix (Rs mn)

Year ended 31 Mar	FY15	FY16	FY17E	FY18E	FY19E
Formulations	112,884	124,597	164,713	194,715	235,782
India (Gross)	30,614	34,956	39,163	45,038	51,794
US generics	49,596	53,751	74,928	90,346	114,208
US brand	4,873	4,271	11,564	13,221	14,579
Japan	13,239	13,646	18,422	22,107	26,528
Europe	3,279	4,278	5,336	5,360	5,759
RoW	11,283	13,695	15,299	18,644	22,915
API	11,941	12,074	11,591	12,171	12,779
Total	124,825	136,671	176,304	206,886	248,562

Source: Company, Ambit Capital research

Income Statement

Year to March (Rs mn)	FY15	FY16	FY17E	FY18E	FY19E
Net revenues	127,700	142,085	180,080	210,558	252,107
Material costs	41,570	43,094	51,885	57,653	66,486
Employee costs	13,949	17,260	28,206	31,808	35,625
Other mfg. costs	35,985	44,196	50,371	64,647	77,589
Core EBITDA	36,196	37,535	49,619	56,451	72,408
Depreciation	4,347	4,635	8,513	7,124	7,936
Interest expense	98	446	1,336	1,419	1,169
Adjusted PBT	34,149	34,331	42,020	50,121	64,833
Tax	9,705	11,536	11,345	13,533	17,505
Net profit	24,032	22,707	30,333	35,993	46,690

Source: Company, Ambit Capital research

Balance Sheet

Year to Mar (Rs mn)	FY15	FY16	FY17E	FY18E	FY19E
Total Assets	96,377	183,984	199,800	220,433	250,172
Fixed Assets	32,961	86,379	92,866	100,742	102,806
Current Assets (incl Cash)	64,507	107,473	125,336	144,314	180,707
Cash	4,814	8,379	33,827	38,414	55,131
Investments	16,584	75	75	75	75
Total Liabilities	96,377	183,984	199,800	220,433	250,172
Total networth	88,741	109,844	135,660	166,293	206,031
Total debt	5,371	71,775	61,775	51,775	41,775
Current liabilities	35,001	40,393	48,927	55,148	63,866
Deferred tax liability	2,024	2,045	2,045	2,045	2,045

Source: Company, Ambit Capital research

Cash Flow Statement

Year to March (Rs mn)	FY15	FY16	FY17E	FY18E	FY19E
PBT	34,149	34,331	42,020	50,121	64,833
Depreciation	4,347	4,635	8,513	7,124	7,936
Tax	(9,436)	(11,662)	(11,345)	(13,533)	(17,505)
Net Working Capital	(1,378)	(22,946)	8,575	(8,345)	(11,464)
Others	(351)	(8,047)	8,433	752	84
CFO	27,331	(3,689)	56,196	36,119	43,883
Capital Expenditure	(14,970)	(70,028)	(15,000)	(15,000)	(10,000)
Investment and Others	4,425	593	-	-	-
CFI	(10,545)	(69,435)	(15,000)	(15,000)	(10,000)
Issuance of Equity	413	536	-	-	-
Inc/Dec in Borrowings	(700)	62,081	(10,000)	(10,000)	(10,000)
Net Dividends	(1,573)	(4,055)	(4,071)	(4,517)	(5,360)
Interest paid	(109)	(436)	(1,336)	(1,419)	(1,169)
Others	-	-	(341)	(596)	(638)
CFF	(1,969)	58,126	(15,748)	(16,532)	(17,166)
Net change in cash	14,817	(14,998)	25,448	4,586	16,717
Closing cash balance	4,814	8,379	33,827	38,414	55,131
FCFF	12,361	(73,717)	41,196	21,119	33,883

Source: Company, Ambit Capital research

Valuation parameters

Year to March	FY15	FY16	FY17E	FY18E	FY19E
EPS (Rs)	53.5	50.4	67.3	79.9	103.6
Book Value (per share)	197.4	243.8	301.1	369.1	457.3
P/E (x)	27.9	29.6	22.1	18.7	14.4
P/BV (x)	7.6	6.1	4.9	4.0	3.3
EV/EBITDA(x)	18.5	19.6	14.1	12.1	9.1
EV/Sales (x)	5.2	5.2	3.9	3.3	2.6
EV/EBIT (x)	21.1	22.3	17.0	13.9	10.2

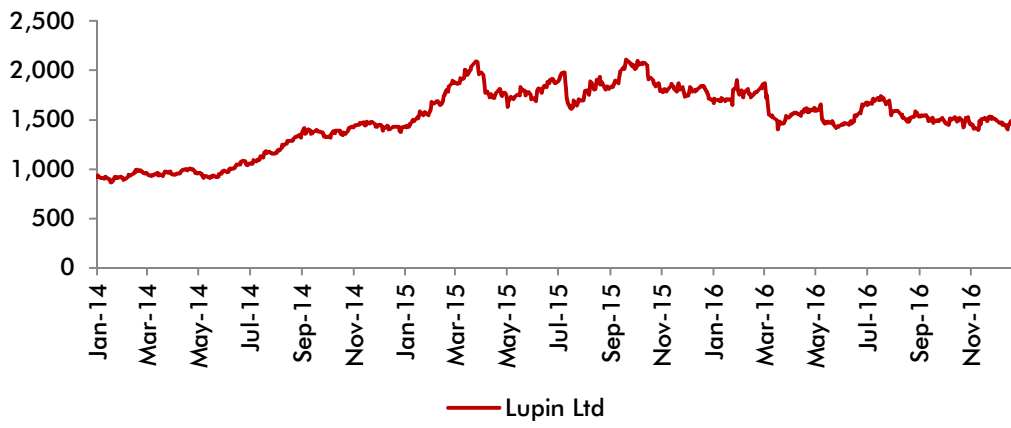
Source: Company, Ambit Capital research

Ratios

Year to March	FY15	FY16	FY17E	FY18E	FY19E
Revenue growth	13.1	11.3	26.7	16.9	19.7
Core EBITDA growth	20.5	3.7	32.2	13.8	28.3
APAT growth	30.9	-5.5	33.6	18.7	29.7
EPS growth	31.1	-5.7	33.6	18.7	29.7
Core EBITDA margin	28.3	26.4	27.6	26.8	28.7
EBIT margin	24.9	23.2	22.8	23.4	25.6
Net profit margin	18.8	16.0	16.8	17.1	18.5
ROCE (%)	26.7	15.8	15.8	17.3	20.2
Reported RoE (%)	30.4	22.9	24.7	23.8	25.1
Debt Equity ratio (X)	0.1	0.7	0.5	0.3	0.2
Current Ratio	1.8	2.7	2.6	2.6	2.8
Gross Block turnover (x)	2.7	2.1	1.9	1.9	2.1
Working Capital Turnover (x)	3.7	2.9	2.5	2.5	2.4
CFO/EBITDA (x)	0.8	-0.1	1.1	0.6	0.6

Source: Company, Ambit Capital research

Lupin Ltd (LPC IN, BUY)



Source: Bloomberg, Ambit Capital research

Explanation of Investment Rating

Investment Rating	Expected return (over 12-month)
BUY	>10%
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UNDER REVIEW	We will revisit our recommendation, valuation and estimates on the stock following recent events
NOT RATED	We do not have any forward looking estimates, valuation or recommendation for the stock
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Each of the analysts identified in this report certifies, with respect to the companies or securities that the individual analyses, that (1) the views expressed in this report reflect his or her personal views about all of the subject companies and securities and (2) no part of his or her compensation was, is or will be directly or indirectly dependent on the specific recommendations or views expressed in this report.

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