

COMPANY NOTE

Target | Estimate Change

India | Healthcare | Pharmaceuticals

9 February 2017

Jefferies

Lupin Ltd. (LPC IN)

Good Quarter but Challenges Ahead

Key Takeaway

Lupin reported results ahead of expectation led by strong margin beat. US business grew 8% QoQ led by seasonality and market share gain in gGlumetza. Challenges for the company though sustain and we expect growth and margins to face pressure going forward led by increased competition in Metformin franchise (key earnings contributor), approval delays, rising R&D and pricing pressure. Retain Underperform

Results ahead of expectation - Lupin reported results ahead of our expectation led by margin beat. Revenues were 2% ahead of expectation while margins came 400bps ahead. Higher tax rate led to net profits only 4% ahead of expectation

Margins the key positive - Across businesses, US and India were the key positive while Japan was the key disappointment. US business came 5% ahead of expectation led by market share gain in gGlumetza and seasonality. India business grew 12% and will likely see similar growth in 4Q. Japan business grew only 5% YoY below expectation. The key positive though was margins which improved 300bps QoQ. Gross margins came 200bps ahead of expectation led by better mix (higher Glumetza and India sales). EBITDA margins were 400bps ahead of expectation. While part of the beat was led by cost control, major part was driven by mix, forex and lower R&D (12.9% vs 13.5% JFe).

Near term growth to be weak - Management indicated that near term growth will be below 10% in US given high base and delay in key approvals. Key product approval guidance was again delayed and gSevelamer and gWelchol are now end-FY18/early-FY19 opportunities. Management expects high single digit price erosion to continue. It expects 1 new competition every quarter in CY17 in gGlumetza. It expects 25+ product launches in next 12m (below our expectation).

Challenges remain - We expect growth and margin to be under pressure for Lupin going forward led by 1) increased competition in Glumetza, 2) full impact of Fortamet competition, 3) pricing pressure in US, 3) approval delays and 4) increased R&D. We expect margins to decline 220bps over FY16-19 driving EPS CAGR of 14%.

Valuation/Risks

We adjust our estimates for the quarter. Our FY17-19 EPS changes by 1-4%. Lupin is in our view, trailing peers in developing a speciality/complex generic pipeline and has higher pricing risk given high product concentration. It though is trading at 22.5x FY18 PE, a premium to sector. We retain Underperform with revised TP of Rs 1250 implying FY19 PE of 16x. Key risk: Faster approval of key products

INR	Prev.	2016A	Prev.	2017E	Prev.	2018E	Prev.	2019E
Rev. (MM)	--	143,124	178,212	178,002	206,935	206,855	231,928	235,445
EBITDA (MM)	--	38,574.2	45,519.6	47,111.6	51,860.5	52,395.0	56,615.2	58,552.9
EV/EBITDA		19.0x		15.6x		14.0x		12.5x
Net Profit	--	23,444.1	27,641.7	28,748.6	29,746.6	30,035.6	33,828.7	35,320.6
Dividend	--	7.50	--	8.80	--	9.50	--	10.80
Div. Yield		0.50%		0.59%		0.64%		0.72%
BV/Share	--	243.78	296.37	298.47	355.89	358.58	420.25	425.77
P/B		6.1x		5.0x		4.2x		3.5x
EPS Growth	--	2.7%	17.9%	22.6%	7.6%	4.5%	13.7%	17.6%
EPS								
FY Mar	--	52.16	61.50	63.96	66.18	66.82	75.26	78.58
FY P/E		28.6x		23.3x		22.3x		19.0x

UNDERPERFORM

Price target INR1,250.00
(from INR1,350.00)
Price INR1,491.35^

Financial Summary

Net Debt (MM): INR63,320.7

Market Data

52 Week Range: INR1,911.90 - INR1,280.00

Total Entprs. Value (MM): INR733.7BN

Market Cap. (MM): INR670.4BN

Shares Out. (MM): 449.5

Float (MM): 274.6

Avg. Daily Vol.: 931,610

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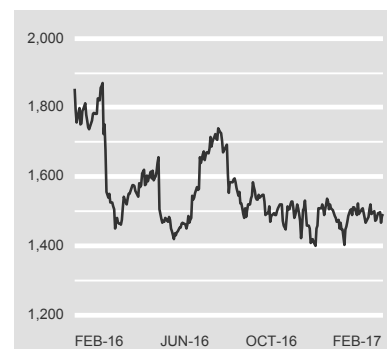
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Price Performance

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

LPC IN

Target | Estimate Change

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[Lupin Ltd]

Underperform: INR 1250 Price Target

Scenarios

Target Investment Thesis

- Domestic FY16-19 growth ahead of industry at 14%
- Emerging markets FY16-19 growth at 21%
- US revenues growth FY16-19 at 24%
- Margins at 24.8% in FY19
- R&D spend at 13.2%
- USDINR at 68
- 2019 EPS: 77.8; Target Multiple: 16x; Target Price Rs1,250

Upside Scenario

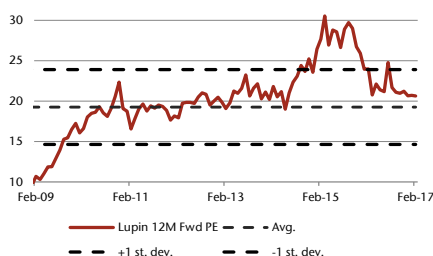
- Domestic FY16-19 growth ahead of industry at 17%
- Emerging markets FY16-19 growth at 23%
- US revenues FY16-19 growth at 27%
- Margins at 27% in FY19
- R&D spend at 13.2%
- USDINR at 68
- 2019 EPS: 85.6; Target Multiple: 18x; Target Price Rs1,540

Downside Scenario

- Domestic growth FY16-19 at 12%
- Emerging markets FY16-19 growth at 17%
- US revenues FY16-19 growth at 22%
- Margins at 22% in FY19
- R&D spend at 13.2%
- USDINR at 68
- 2019 EPS: 70; Target Multiple: 18x; Target Price Rs980

Long Term Analysis

1 Year Forward P/E



Source: Factset, Jefferies estimates

Long Term Financial Model Drivers

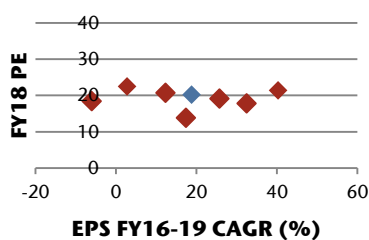
LT Earnings CAGR (3 yr)	9%
Organic Revenue Growth	20%
Operating Margin Expansion	10bps

Other Considerations

Lupin has strong presence in US markets with a branded business presence. It is focussing on the US markets and has aggressive launch plans which would drive growth. India growth has been boosted by marketing of Lily products

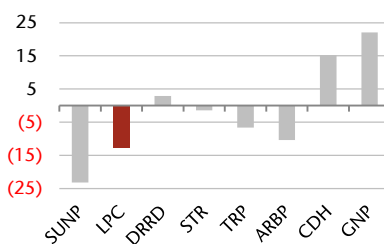
Peer Group

Group P/Es vs Growth



Source: Company Data, Jefferies estimates

12m stock performance



Source: Bloomberg

Recommendation / Price Target

Ticker	Rec.	PT
SUNP	Hold	720
LPC	Underperform	1,350
DRRD	Hold	2,800
STR	Buy	1,250
ARBP	Buy	1,100
CDH	NC	NA
GNP	NC	NA
TRP	NC	NA

Catalysts

- INR/USD exchange rate
- Acquisition in US branded business
- Significant acquisition in the generic space
- Competition in key products in US generics
- Pick-up in approvals in US

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..

Other highlights

- Glumetza – Lupin gained market share which is now at 75%
 - There though has been an AG launch which will lead to market share fall
 - Management expects Teva and Sun to launch in 2Q and 3Q CY17
- The strong qoq US growth in the quarter was driven by a higher share in Glumetza, new launches from India and Somerset, higher sales in Methergine and seasonality.
- The branded business sales this quarter were \$22mn versus \$18mn yoy.
- Japan – Shionogi portfolio had a minimal impact on the 3Q numbers. However, 4Q will see the full effect, and could lead to a strong double digit growth.
- Price erosion in US base business remains at high single digit
- The management expects 25+ launches next year.
- Renvela/Renagel/welchol – The management hopes to get approvals by late FY18 / early FY19
- 2 key launches in the current fiscal are gEpzicom and gMinastrin Fe. Management expects both these to be 4Q launches.
- Advair – Management indicated that they hope to commence clinical trials in the next fiscal and are on track for an FY18 filing.
- Lupin filed Albetrol MDI ANDA (gProair) in the quarter.
- Management guided for a FY17 tax rate of 26-28%. The higher rate this quarter was a result of unwinding of deferred tax assets from the previous quarters, during which the tax rate was low.
- Lower other expenses QoQ was a result of forex (Rs270mn), which lead to a QoQ swing of Rs720mn, lower R&D costs and better cost control.
- Capex guidance – Rs19bn for FY17, Rs13-14bn for FY18

Exhibit 1: Better mix, lower costs lead to EBITDA beat

	3QFY17	3QFY16	YoY (%)	2QFY17	3QFY17E	vs. Est (%)
Revenues	44,829	35,477	26.4	42,905	43,940	2.0
Raw Material	13,016	11,232	15.9	12,429	13,582	-4.2
Gross Profit	31,813	24,245	31.2	30,477	30,358	4.8
Employee Cost	7,312	5,435	34.5	7,124	7,053	3.7
Other operating Exp	12,343	10,349	19.3	13,072	13,310	-7.3
EBITDA	12,158	8,461	43.7	10,281	9,995	21.6
EBITDA Margin (%)	27.1	23.8	327.2	24.0	22.7	437.4
EBIT	9,849	7,245	35.9	8,169	7,883	24.9
PBT	10,426	7,810	33.5	8,177	7,891	32.1
Tax	4,095	2,557	60.1	1,589	1,815	125.6
PAT	6,331	5,246	20.7	6,622	6,076	4.2

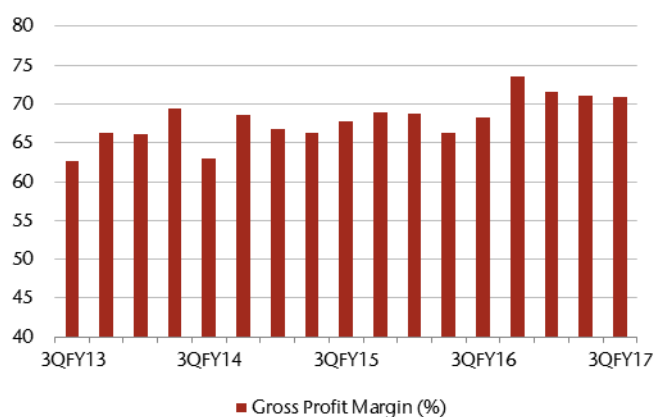
Source: Jefferies estimates, company data

Exhibit 2: US revenues up 8% QoQ

	3QFY17	3QFY16	YoY (%)	2QFY17	QoQ (%)
Revenues (in Rs mn)	44,271	33,727	31.3	42,323	4.6
Formulation Sales	41,587	30,967	34.3	39,404	5.5
US + EU	22,971	15,209	51.0	21,272	8.0
FTF	8,395	3,261	157.4	8,333	0.7
US	21,755	14,049	54.9	19,978	8.9
EU	993	1,010	-1.7	1,083	-8.3
Japan	4,474	3,739	19.7	4,159	7.6
India	9,912	8,712	13.8	9,958	-0.5
EM	4,230	3,307	27.9	4,015	5.4
SA	1,114	1,048	6.3	1,126	-1.1
API	2,684	2,760	-2.8	2,919	-8.1

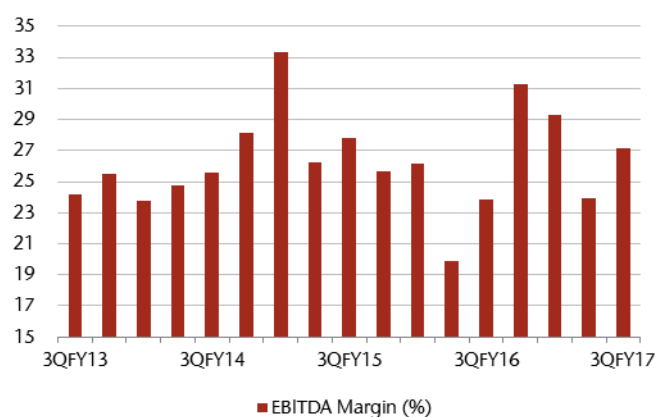
Source: Jefferies estimates, company data

Exhibit 3: On a QoQ basis, gross margins flat...



Source: Jefferies estimates, company data

Exhibit 4: ... while EBITDA margins sharply improve



Source: Jefferies estimates, company data

Exhibit 5: Changes to estimates

	Old			New			% change		
	FY17E	FY18E	FY19E	FY17E	FY18E	FY19E	FY17E	FY18E	FY19E
Sales	178,212	206,935	231,928	178,077	206,051	234,532	-0.1	-0.4	1.1
Operating profit	45,520	51,861	56,615	47,130	51,965	58,071	3.5	0.2	2.6
OP margin (%)	25.5	25.1	24.4	26.5	25.2	24.8	97bps	12bps	36bps
Net profit	27,642	29,747	33,829	28,762	29,721	34,964	4.1	-0.1	3.4
NP margin (%)	15.5	14.4	14.6	16.2	14.4	14.9	65bps	2bps	31bps
EPS	61.5	66.2	75.3	64.0	66.1	77.8	4.0	-0.1	3.3
EPS growth (%)	17.9	7.6	13.7	22.7	3.3	17.6	478bps	-426bps	394bps
DPS	8.8	9.5	10.8	9.2	9.5	11.2	4.6	0.1	3.6
ROE (%)	20.7	18.5	17.9	21.4	18.4	18.3	68bps	-7bps	38bps

Source: Jefferies estimates, company data

Financials

Exhibit 6: Profit and Loss Statement

Rs mn	2015	2016	2017E	2018E	2019E
Net Sales	127,700	143,124	178,002	206,855	235,445
<i>Change (%)</i>	13.1	12.1	24.4	16.2	13.8
Material Cost	41,570	43,094	51,672	61,691	69,991
Employee Cost	17,473	21,077	28,206	33,001	38,611
SG&A	21,472	24,341	28,356	32,526	37,275
R&D Expenses	10,988	16,038	22,657	27,243	31,015
EBITDA	36,196	38,574	47,112	52,395	58,553
<i>% of net sales</i>	28.3	27.0	26.5	25.3	24.9
Depreciation	4,347	4,635	8,742	11,648	12,127
Interest	98	446	1,480	1,582	1,582
Other Income	2,398	1,877	2,613	2,137	3,006
EO Income / (Exp)	-1,210	-302	0	0	0
PBT	34,148	35,370	39,502	41,302	47,849
Tax	9,704	11,536	10,665	11,152	12,441
<i>Rate (%)</i>	28.4	32.6	27.0	27.0	26.0
Minority Interest	412	88	88	115	88
PAT	22,822	23,444	28,749	30,036	35,321
Adjusted PAT	24,032	23,747	28,749	30,036	35,321
<i>change (%)</i>	30.9	-1.2	21.1	4.5	17.6

Source: Jefferies estimates, company data

Exhibit 7: Balance Sheet Statement

Rs mn	2015	2016	2017E	2018E	2019E
Share Capital	899	901	901	901	901
Minority Interest	241	321	408	496	584
Reserves	87,842	108,943	133,585	160,667	190,943
Net Worth	88,982	110,165	134,895	162,064	192,428
Deferred Tax Lia	2,024	2,045	2,045	2,045	2,045
Loans	5,371	71,775	82,855	82,855	82,855
Capital Employed	96,377	183,984	219,794	246,964	277,328
Gross Fixed Assets	67,011	116,737	157,667	176,396	189,396
Less: Depreciation	23,329	27,715	36,457	48,104	60,232
Net Fixed Assets	43,682	89,023	121,210	128,291	129,164
Capital WIP	5,760	27,000	18,406	9,812	9,812
Investments	16,584	75	75	75	75
Deferred Tax Asset	842	806	806	806	806
Current Assets	64,510	107,473	121,231	154,545	188,775
Inventory	25,036	31,787	32,561	42,677	48,419
Debtors	26,566	45,498	46,832	54,423	55,475
Cash & Bank Balance	4,814	8,379	20,030	37,407	55,208
Loans & Advances	8,095	21,808	21,808	20,039	29,673
Current Liabilities	35,001	40,393	41,934	46,565	51,304
Creditors	16,799	19,770	24,320	28,767	32,751
Other Liabilities	12,459	13,866	10,099	10,099	10,099
Provisions	5,743	6,758	7,515	7,699	8,454
Net Current Assets	29,509	67,080	79,297	107,980	137,471
Appl. Of fund	96,377	183,984	219,795	246,965	277,329

Source: Jefferies estimates, company data

Exhibit 8: Cash Flow Statement

(Rs mn)	2015	2016	2017E	2018E	2019E
PAT	22,822	23,444	28,749	30,036	35,321
Depreciation	4,347	4,635	8,742	11,648	12,127
Interest Exp	98	446	1,480	1,582	1,582
Other Income	2,398	1,877	2,613	2,137	3,006
Change in Wkg Capital	-27,863	-45,821	-23,562	-27,948	-16,641
CF from Op Activities	31,522	-7,300	35,793	29,822	34,335
Change in Fixed Assets	-17,192	-71,217	-32,336	-10,135	-13,000
Change in Investments	-14,799	16,509	0	0	0
Other Income	2,398	1,877	2,613	2,137	3,006
CF from Investing Activities	-29,593	-52,831	-29,723	-7,998	-9,994
Change in equity	-426	82	0	0	0
Changes in debt	-1,166	66,404	11,080	0	0
Interest Exp	-98	-446	-1,480	-1,582	-1,582
Dividend paid	-3,348	-3,348	-4,106	-4,290	-5,045
Others	-51	1,005	88	1,424	88
CF from Financing Activities	-5,090	63,697	5,582	-4,448	-6,539
Net change in Cash	-3,162	3,566	11,651	17,376	17,802

Source: Jefferies estimates, company data

Exhibit 9: Key Ratios

	2015	2016	2017E	2018E	2019E
Basic (Rs)					
EPS	50.8	52.2	64.0	66.8	78.6
BPS	197.4	243.8	298.5	358.6	425.8
DPS	7.5	7.5	9.2	9.6	11.3
Payout (%)	14.8	14.4	14.4	14.4	14.4
Valuation (X)					
P/E	29.4	28.6	23.3	22.3	19.0
P/B	7.6	6.1	5.0	4.2	3.5
EV/EBITDA	18.4	17.3	14.1	12.7	11.4
EV/Sales	5.2	4.6	3.7	3.2	2.8
Dividend Yield (%)	0.5	0.5	0.6	0.6	0.8
Profit Ratios (%)					
RoE	27.1	21.6	21.4	18.6	18.4
RoCE	24.9	13.0	14.0	14.2	15.5
Turnover Ratios					
Debtor Days	76	116	96	96	86
Inventory Days	220	269	230	253	253
Creditor Days	83	86	86	86	86
Net Debt to Equity	-0.2	0.6	0.5	0.3	0.1

Source: Jefferies estimates, company data

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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Investment Recommendation Record

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

Recommendation Published , 13:11 ET. February 9, 2017

Recommendation Distributed , 13:11 ET. February 9, 2017

Company Specific Disclosures

For Important Disclosure information on companies recommended in this report, please visit our website at [https://javatar.bluematrix.com/sellside/ Disclosures.action](https://javatar.bluematrix.com/sellside/Disclosures.action) or call 212.284.2300.

Explanation of Jefferies Ratings

Buy - Describes securities that we expect to provide a total return (price appreciation plus yield) of 15% or more within a 12-month period.

Hold - Describes securities that we expect to provide a total return (price appreciation plus yield) of plus 15% or minus 10% within a 12-month period.

Underperform - Describes securities that we expect to provide a total return (price appreciation plus yield) of minus 10% or less within a 12-month period.

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.

NR - The investment rating and price target have been temporarily suspended. Such suspensions are in compliance with applicable regulations and/or Jefferies policies.

CS - Coverage Suspended. Jefferies has suspended coverage of this company.

NC - Not covered. Jefferies does not cover this company.

Restricted - Describes issuers where, in conjunction with Jefferies engagement in certain transactions, company policy or applicable securities regulations prohibit certain types of communications, including investment recommendations.

Monitor - Describes securities whose company fundamentals and financials are being monitored, and for which no financial projections or opinions on the investment merits of the company are provided.

Valuation Methodology

Jefferies' methodology for assigning ratings may include the following: market capitalization, maturity, growth/value, volatility and expected total return over the next 12 months. The price targets are based on several methodologies, which may include, but are not restricted to, analyses of market risk, growth rate, revenue stream, discounted cash flow (DCF), EBITDA, EPS, cash flow (CF), free cash flow (FCF), EV/EBITDA, P/E, PE/growth, P/CF, P/FCF, premium (discount)/average group EV/EBITDA, premium (discount)/average group P/E, sum of the parts, net asset value, dividend returns, and return on equity (ROE) over the next 12 months.

Jefferies Franchise Picks

Jefferies Franchise Picks include stock selections from among the best stock ideas from our equity analysts over a 12 month period. Stock selection is based on fundamental analysis and may take into account other factors such as analyst conviction, differentiated analysis, a favorable risk/reward ratio and investment themes that Jefferies analysts are recommending. Jefferies Franchise Picks will include only Buy rated stocks and the number can vary depending on analyst recommendations for inclusion. Stocks will be added as new opportunities arise and removed when the reason for

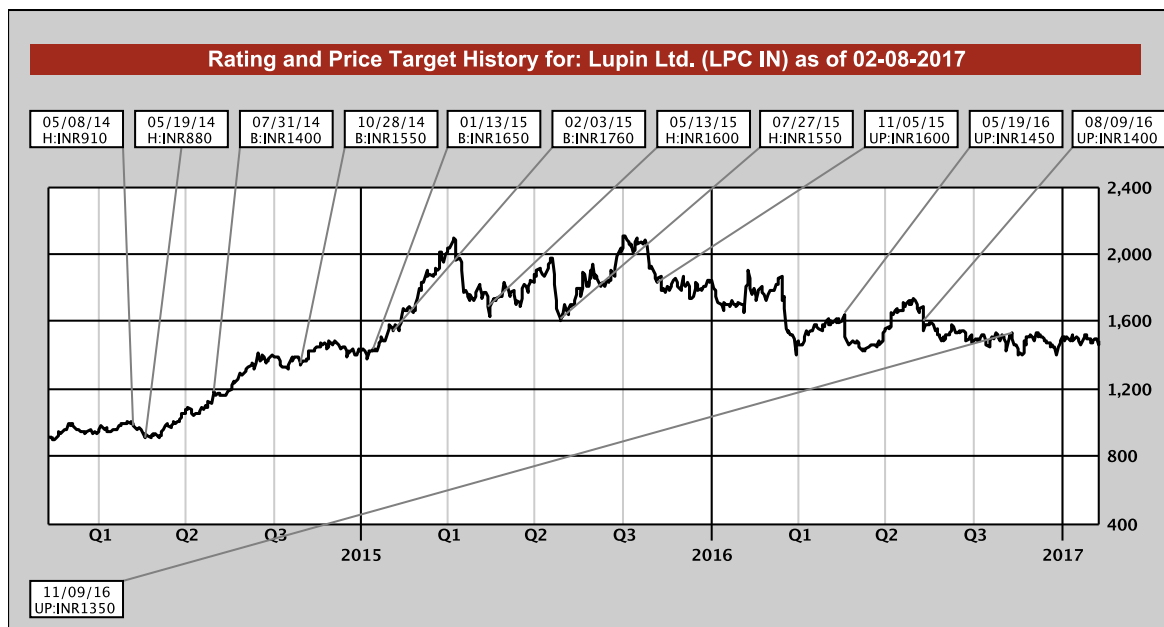
inclusion changes, the stock has met its desired return, if it is no longer rated Buy and/or if it triggers a stop loss. Stocks having 120 day volatility in the bottom quartile of S&P stocks will continue to have a 15% stop loss, and the remainder will have a 20% stop. Franchise Picks are not intended to represent a recommended portfolio of stocks and is not sector based, but we may note where we believe a Pick falls within an investment style such as growth or value.

Risks which may impede the achievement of our Price Target

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Other Companies Mentioned in This Report

- Aurobindo Pharma (ARBP IN: INR706.75, BUY)
- Dr. Reddy's Laboratories (DRRD IN: INR3,023.10, UNDERPERFORM)
- Larsen & Toubro (LT IN: INR1,490.70, BUY)
- Lupin Ltd. (LPC IN: INR1,491.35, UNDERPERFORM)
- Strides Arcolab Ltd (STR IN: INR1,205.35, HOLD)
- Sun Pharmaceutical Industries Ltd (SUNP IN: INR655.50, HOLD)



Notes: Each box in the Rating and Price Target History chart above represents actions over the past three years in which an analyst initiated on a company, made a change to a rating or price target of a company or discontinued coverage of a company.

Legend:

- I: Initiating Coverage
- D: Dropped Coverage
- B: Buy
- H: Hold
- UP: Underperform

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Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
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HOLD	901	41.07%	174	19.31%
UNDERPERFORM	181	8.25%	16	8.84%

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