

9 February 2017

HOLD

TP: INR 1,660.00

▲ 11.3%

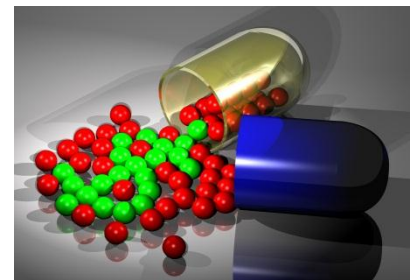
Lupin

LPC IN

Performance peaked out; Q3 to top next few quarters

A strong EBITDA margin beat (27% vs. RCMLe 24%) and sharp QoQ growth in the US business (+US\$ 24mn QoQ) were key positives for LPC in Q3FY17. However, with incremental competition in key products (g *Glumetza*, g *Fortamet*, g *Suprax*) and a delay in key launches (g *Renagel*, g *Renvela*, g *Welchol*), Q3 may well be the company's peak performance for the next few quarters. We retain HOLD on the stock and we roll over to a Mar'18 TP of Rs 1,660 (from a Sep'17 TP of Rs 1,700).

- ➔ **US business drives topline:** LPC's Q3 sales of Rs 44.8bn (+26% YoY) came in line with RCMLe but 4% above consensus driven by healthy growth across geographies. US sales were solid at Rs 21.8bn (+US\$ 24mn QoQ) owing to (a) market share gains in *gGlumetza*, (b) improved seasonality in the *Ceph*s portfolio, (c) a robust branded business (+25% QoQ) largely led by *Methergene* and (d) new launches. Domestic business grew by a healthy 12% YoY despite the demonetisation impact (~2-3%), in sync with industry trends. On a YoY basis, Q3 witnessed strong growth for APAC (+21%), EMEA (17%) and LatAm (33%) markets.
- ➔ **Improved operating performance:** EBITDA margins at 27% beat our/consensus estimates of 24%/25% on lower other expenses (-230bps QoQ; Rs 700mn absolute decline). R&D spends at Rs 5.7bn (12.7% of sales) were flat QoQ in absolute terms. A spike in interest costs (+Rs 200mn QoQ) and tax rate (39% vs 25% est.) restricted PAT to Rs 6.3bn (19.5% YoY), which however benefitted from higher other income (+Rs 1.1bn). Tax rate sharply rose due to higher deferred tax provision.
- ➔ **Management outlook:** (a) LPC maintained its full-year EBITDA guidance at 26-28%. (b) Management expects to end FY17 with a tax rate of 28% (earlier 25%). (c) The FY17 capex guidance is at Rs1.9bn and the company has guided for a FY18 capex of Rs 1.3bn-Rs 1.4bn.



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PRICE CLOSE (09 Feb 17)

INR 1,491.35

MARKET CAP

INR 673.2 bln

USD 10.0 bln

SHARES O/S

449.9 mln

FREE FLOAT

28.5%

3M AVG DAILY VOLUME/VALUE

0.9 mln / USD 20.6 mln

52 WK HIGH

INR 1,911.90

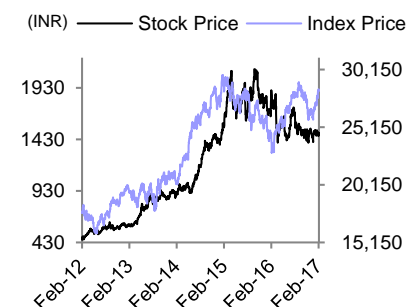
52 WK LOW

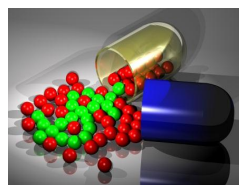
INR 1,280.00

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) | 27.9 | 29.6 | 25.0 | 20.9 | 17.9 |
| EV/EBITDA (x) | 18.4 | 17.4 | 16.4 | 13.5 | 11.5 |
| P/BV (x) | 7.6 | 6.1 | 5.1 | 4.3 | 3.6 |

Source: Company, Bloomberg, RCML Research





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%).
- Key products:** (a) **gGlumetza:** Post the recent AG approval to Valeant, LPC expects competition to increase on launches by SUNP (likely by Q3) and Teva (likely by Q2). (b) **gFortamet:** Increased competition (Mylan) led to price erosion and further loss in market share for LPC. (c) **Albuterol:** LPC has filed the product. (d) **gMinastrin:** LPC has a FTF on the product and expects this to be a FY18 launch. (e) **Epzicom:** Likely to be launched next month. (f) **Advair:** LPC is hopeful of a FY18 filing. (g) **Vigamox:** The company sees a potential launch by Jul'17.
- Branded business sales for Q3 stood at US\$ 22mn (Q2: US\$ 18mn) largely driven by *Methergene*.
- Product pipeline:** (a) LPC filed six ANDAs and received eleven product approvals in Q3FY17. (b) The total cumulative ANDA filings till date are 344 (207 approved, including 44 exclusive FTF opportunities). (c) LPC maintained its guidance of filing 30+ ANDAs in FY17. (d) It targets to launch 25+ products in the next 12 months.

Other highlights

- Domestic business:** Management expects the impact of demonetisation to normalise from Apr'17 and anticipates the domestic business to grow at 15-20% in the longer run.
- Japan:** Q3 factors in consolidation of the Shinogi business for only one month and expects Q4 to see the full impact.
- For Q3, capex stood at Rs 2.1bn and D/E ratio at 0.41x. Working capital days increased to 105 in Q3 from 103 in Q2.
- Q3 benefitted from the forex impact of Rs 270mn above the EBITDA level. Other income includes forex gains of Rs 740mn.
- Interest costs rose by 75% YoY to Rs 459mn led by loans taken for the Shinogi acquisition and higher interest rates. LPC expects interest costs to decline going forward on repayment of loans.

Fig 1 - Actuals vs. RCML and Bloomberg consensus

| Particulars (Rs mn) | Actuals | RCML | Var (%) | Cons. | Var (%) |
|---------------------|---------|--------|---------|--------|---------|
| Revenues | 44,829 | 44,746 | 0.2 | 42,933 | 4.4 |
| EBITDA | 12,158 | 10,739 | 13.2 | 10,891 | 11.6 |
| EBITDA margin (%) | 27.1 | 24.0 | 312bps | 25.4 | 176bps |
| Reported PAT | 6,331 | 6,392 | (1.0) | 6,407 | (1.2) |

Source: Bloomberg, Company, RCML Research

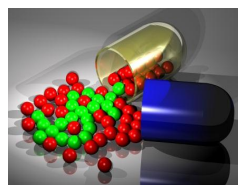


Fig 2 - Quarterly performance

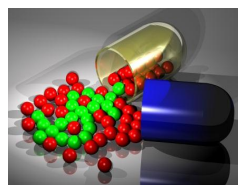
| (Rs mn) | Q3FY17 | Q3FY16 | YoY (%) | Q2FY17 | QoQ (%) |
|----------------------|--------|--------|---------|--------|---------|
| Net revenue | 44,829 | 35,558 | 26.1 | 42,905 | 4.5 |
| Total material costs | 13,016 | 11,230 | 15.9 | 12,429 | 4.7 |
| % of net revenue | 29.0 | 31.6 | | 29.0 | |
| Staff costs | 7,312 | 5,284 | 38.4 | 7,124 | 2.6 |
| % of net revenue | 16.3 | 14.9 | | 16.6 | |
| R&D expenses | 5,682 | 3,916 | 45.1 | 5,716 | (0.6) |
| % of revenue | 12.7 | 11.0 | | 13.3 | |
| Other expenses | 6,662 | 6,357 | 4.8 | 7,356 | (9.4) |
| % of net revenue | 14.9 | 17.9 | | 17.1 | |
| EBITDA | 12,158 | 8,772 | 38.6 | 10,281 | 18.3 |
| EBITDA margin (%) | 27.1 | 24.7 | 245bps | 24.0 | 316bps |
| Other income | 1,036 | 653 | 58.6 | 271 | 282.1 |
| Interest | 459 | 92 | 400.3 | 263 | 74.6 |
| Depreciation | 2,309 | 1,114 | 107.3 | 2,112 | 9.3 |
| PBT | 10,426 | 8,219 | 26.8 | 8,177 | 27.5 |
| Tax | 4,095 | 2,909 | 40.8 | 1,589 | 157.6 |
| Tax rate (%) | 39.3 | 35.4 | | 19.4 | |
| Minority Interest | (0) | 13 | | (34) | |
| Reported PAT | 6,331 | 5,298 | 19.5 | 6,622 | (4.4) |

Source: Company, RCML Research

Fig 3 - Revenue summary

| (Rs mn) | Q3FY17 | Q3FY16 | YoY (%) | Q2FY17 | QoQ (%) |
|--------------|---------------|---------------|-------------|---------------|------------|
| US | 21,755 | 13,805 | 57.6 | 19,978 | 8.9 |
| India | 9,912 | 8,860 | 11.9 | 9,958 | (0.5) |
| APAC | 5,601 | 4,634 | 20.9 | 5,520 | 1.5 |
| EMEA | 2,555 | 2,187 | 16.8 | 2,355 | 8.5 |
| LATAM | 1,175 | 885 | 32.8 | 986 | 19.2 |
| ROW | 367 | 297 | 23.6 | 396 | (7.3) |
| API | 2,684 | 2,835 | (5.3) | 2,919 | (8.1) |
| Total | 44,049 | 33,503 | 31.5 | 42,112 | 4.6 |

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

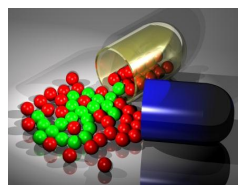
| Y/E 31 Mar (x) | FY15A | FY16A | FY17E | FY18E | FY19E |
|----------------|-------|-------|-------|-------|-------|
| EV/Sales | 5.2 | 4.6 | 4.3 | 3.5 | 3.2 |
| EV/EBITDA | 18.4 | 17.4 | 16.4 | 13.5 | 11.5 |
| Adjusted P/E | 27.9 | 29.6 | 25.0 | 20.9 | 17.9 |
| P/BV | 7.6 | 6.1 | 5.1 | 4.3 | 3.6 |

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 | 218,062 | 233,385 | 259,003 |

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 | 8,399 | 3,976 | 3,873 | 18,460 |

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| Recommendation | Expected absolute returns (%) over 12 months |
|----------------|--|
| Buy | More than 15% |
| Hold | Between 15% and -5% |
| Sell | Less than -5% |

Expected absolute returns are based on the share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

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