Lupin

Strong quarter driven by gGlumetza upsides

OUTPERFORMER

RESULT NOTE

9 February 2017

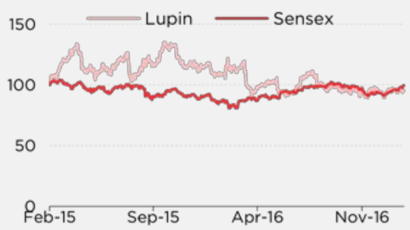
BSE Sensex: 28330

Sector: Pharmaceuticals

Stock data

CMP (Rs)	1,491
Mkt Cap (Rs bn/USD m)	673.2 /10,053
Target Price (Rs)	1,628
Change in TP (%)	-3.9
Potential from CMP (%)	9.2
Earnings change (%)	
FY17E	-1.1
FY18E	-10.4
Bloomberg code	LPC IN
1-yr high/low (Rs)	1,912/1,280
6-mth avg. daily volumes (m)	1.1
6-mth avg. daily traded value (Rsm/USDm)	1,635.3/24.4
Shares outstanding (m)	451.4
Free float (%)	53.3
Promoter holding (%)	46.7

Price performance – relative & absolute



(%)	3-mth	6-mth	1-yr
LPC IN	(2.5)	(7.2)	(21.7)
BSE Sensex	4.0	0.9	17.9

Q3FY17 result highlights

- Lupin's revenues grew 26% yoy to Rs44.8bn, ahead est of Rs42.1bn driven by higher US sales of $316m (up sharply qoq from $292m) vs est of $302m. The surprise was largely driven by higher gGlumetza sales. India sales grew 12% yoy vs est 10%, while Japan sales grew 5% in CC terms. Growth was broadly in line in other markets
- EBITDA grew 39% yoy to Rs12.1bn above est of Rs10.3bn. Consolidated EBITDA margins came in at 27.1% vs est of 23.8%. Margins were driven by higher GMs (70.1% vs est 69%) and lower SGA costs which stood Rs12.3b vs 13b in Q2FY17. R&D costs stayed high at 13% of sales and came at Rs5.7bn (down 1% qoq).
- Rs740m forex gains boosted other income. PBT came at Rs10.4bn vs est Rs8.1bn. Tax rate came higher at 39% vs est of 25%. PAT increased 19.5% yoy to Rs6.3bn vs est of Rs6.1b.

Key positives: High US sales, Strong GMs and lower other expenses

Key negatives: Higher tax rate; Delay in gRenvela / Renagel approvals

Impact on financials: We have reduced our FY117/18 earnings by 1% / 10% to account for delays in niche approvals. Introduce FY19 estimates.

Valuations & view

Uncertainty on the pace and extent of erosion across gFortamet / gGlumetza will continue to subdue Lupin's near growth prospects. However, we remain positive on the medium term growth potential and expect steady recovery in US sales (ex-Fortamet / gGlumetza) from Q4FY17 onwards with the commercialization of some big ticket launches over the next few quarters. With 44 FTF products including 23 exclusive FTF opportunities Lupin has one of the strongest ANDA pipelines (arguably with the most visibility) among peers. Further, Lupin's strong R&D and regulatory capabilities and an aggressive and competent management team continue to provide confidence on its ability to successfully manage its transition to a complex generics-focused player and eventually a global specialty major. Maintain Outperformer and recommend buying into the weakness with a medium term view. Severe than expected price erosion in leading drugs and delay in niche launches are key risks to our call.

Key financials (quarterly)

(Rs m)	Q3FY16	Q2FY17	Q3FY17	% ch qoq	% ch yoy	% var from est
Net sales	35,558	42,905	44,829	4.5	26.1	3.7
EBITDA	8,772	10,281	12,158	18.3	38.6	19.1
OPM (%)	24.7	24.0	27.1	3.2	2.5	3.5
Other inc.	653	271	1,036	282.2	58.6	245.3
Interest	92	263	459	74.6	400.3	64.0
Dep. & Amort.	1,114	2,111	2,309	9.4	107.3	7.4
PBT	8,219	8,177	10,426	27.5	26.8	29.0
PAT	5,298	6,622	6,331	(4.4)	19.5	4.9
Reported PAT	5,298	6,622	6,331	(4.4)	19.5	4.9
EPS (Rs)	12	15	14	(4.4)	19.5	4.9

Source: Company, IDFC Securities Research

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Exhibit 1: Quarterly results

(Rs m)	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	FY16	FY17E	Comments
Net Sales	**35,558**	**41,707**	**44,395**	**42,905**	**44,829**	**1,41,430**	**1,77,173**	Ahead of est led by US
Expenses								
Cost of sales	11,230	11,010	12,719	12,429	13,016	56,842	67,129	GMs remained flat qoq
SG&A expenses	11,641	12,535	13,600	14,480	13,973	31,679	40,534	
R&D expenses	3,916	5,113	4,994	5,716	5,682	16,030	21,961	13% of sales
Total Expenses	**26,787**	**28,657**	**31,313**	**32,624**	**32,670**	**1,04,550**	**1,29,624**	
EBITDA	**8,772**	**13,050**	**13,082**	**10,281**	**12,158**	**36,880**	**47,550**	Above est led by lower cost, higher revenues
OPM (%)	24.7	31.3	29.5	24.0	27.1	26.1	26.8	above est of 23.8%
Other Income	653	349	826	271	1,036	1,877	3,673	
Interest	92	213	320	263	459	446	1,442	
Depreciation	1,114	1,487	2,027	2,111	2,309	4,635	8,847	above est
PBT	**8,219**	**11,699**	**11,561**	**8,177**	**10,426**	**33,675**	**40,934**	
Current Tax	2,909	4,188	2,734	1,589	4,095	11,536	11,307	
Deferred tax						-	-	
Tax Rate (%)	35.4	35.8	23.6	19.4	39.3	34.3	27.6	We est 25%
Minority interest	13	33	6	(34)	(0)	88	30	
PAT	**5,298**	**7,479**	**8,821**	**6,622**	**6,331**	**22,052**	**29,597**	ahead of est despite a higher tax rate
Extraordinary expenses	-	-	-	-	-	-	-	
Extraordinary Income								
Reported PAT	5,298	7,479	8,821	6,622	6,331	22,052	29,597	
% chg yoy								
Sales	**15.4**	**39.8**	**40.7**	**29.2**	**26.1**	**8.0**	**25.3**	
EBITDA	**11.5**	**87.6**	**58.6**	**53.0**	**38.6**	**(6.5)**	**28.9**	
Other Income	(63.6)	(68.6)	9.2	(34.7)	58.6	(21.7)	95.7	
Interest	246.4	765.0	355.6	159.1	400.3	355.3	223.2	
Depreciation	1.0	38.8	100.0	97.6	107.3	6.6	90.9	
PBT	**(3.7)**	**67.9**	**45.9**	**37.1**	**26.8**	**(10.0)**	**21.6**	
PAT	(11.9)	36.7	55.1	62.0	19.5	(19.2)	34.2	
Reported PAT	**(11.9)**	**36.7**	**55.1**	**62.0**	**19.5**	**(19.2)**	**34.2**	
EPS								
Equity	446.2	446.2	446.2	446.2	446.2	450.6	450.6	
EPS	11.9	16.8	19.8	14.8	14.2	48.9	65.7	

Source: Company, IDFC Securities Research

Other key highlights

- Lupin's US formulations (including IP income) business reported 56% yoy / 9% qoq growth in revenues to Rs21.3bn. In constant currency US revenues grew 52% yoy at US$316m vs $292m in Q2FY17 (for Q1FY17 it stood at US$322m) well above our estimate of $302m. We estimate that Lupin booked Rs457m of IP income during the quarter.
- The management attributed the sequential growth in the US business was primarily led by the growth in gGlumetza (company increased its market share to 75% during the quarter). Other drivers for the qoq revenue increase include 25% increase in branded sales led by Methergine, some favourable

seasonality impact and 4 new launches during the quarter

- We estimate gGlumetza and gFortamet would have accounted for $110-130m of Lupin's$312m sales during the quarter at significantly high margins and continue to be the dominant contributor to profitability in the near term.
- gGlumetza
  - Sales continued to stay strong during Q3 as the two generic competitors haven't launched despite receipt of approvals as they continue to face challenges in scaling up the product.
  - However, in a recent development, Valeant has launched an AG thereby increasing the generic completion. Currently, the generic share stands at 75% and the management expects the same to increase at the expense of the branded product. AG launch should lead to some bit of price erosion and loss of market share for Lupin starting Q4FY17 onwards.
  - As far as the other two generic approvals are concerned the management expects the product to be launched in the next 12 months with Sun Pharma expected to launch by 2H'2017 and Teva by 2QCY17. There is no specific visibility of any
  - Assuming onset of incremental generic competition form 2QFY18, we estimate gGlumetza revenues to decline sharply from ~$201m in FY17 to $83m/$49m in FY18/119
  - There could be upsides in case of delay in generic launches.
- gFortamet
  - Currently, it's a 3 player market with Lupin, Mylan and AG. Mylan had got the approval in Sept'16 and is steadily increasing its market share. The material impact of Mylan's entry in form of lower market share at a reduced price should be visible from Q4FY17 onwards. Current quarter hasn't quite reflected the impact of Mylan's entry
  - In terms of follow-on competition, the innovator has sued Aurobindo which recently filed a P-IV challenge. This will effectively block Aurobindo's entry for 30m. Innovator's decision to litigate against Aurobindo indicates its intent to keep fighting against incremental generic competition as it continues to enjoy significant share of the market through the AG
  - Currently, there is no visibility on the approval timelines for another P-IV filer Nostrum Labs
  - Given this construct, it is quite likely that no other generic might enter gFortmet over the next couple of years.
  - We have assumed gFortamet sales of $100m / $80m in FY18/FY19 from ~$200m in FY17.
- Key expected launches – which can help to mitigate the price erosion on gFortamet / gGlumetza
  - Expect two big launches only in March'17 – Minastrin 24 Fe (~$300m sales; FTF launch) and Epzicom (~$550m sales; limited competition launch); this should help to partially mitigate the challenge from the erosion on gFortamet / gGlumetza sales.
  - Another key product will be gVigamox (Moxifloxacin) - ~$300m sales ophthalmology drug which can be launched in July'17 as per settlement with the innovator. Given the litigation landscape it to be fairly limited competition in the initial phase and can contribute materially.
  - Scale-uo in Methergine – Product has begun to generate ~$4m/ month revenues with the branded drug accounting for 50% of the Rx. The company sees significant scope to further grow the product and is also working on a lifecycle management strategy for the drug. Currently, Methergine is the largest drug in Lupin's branded portfolio - $22m sales vs $18m in q2.
  - Some other key growth drivers during next few quarters include gBupropion XL (approval expected shortly), scale-up in gPAxil CR and / Potassium Chloride (launched recently)
  - Additionally, management remains pretty positive on the scale-up in controlled substances drugs (filed by GAVIS). The company has received for several of these products over the last couple of quarters and is in the process of launching the same. Over the medium term, controlled substances is a key growth area for the company as they believe they have a portfolio (across Lupin and GAVIS) covering ~65% of the $30bn market in the US.
  - Lupin also expects multiple dermatology approvals in FY18

- GAVIS portfolio
    - Mgt cited that the enhanced capacity has come on stream in September'16. The company has got a number of product approvals from the Gavis portfolio in the past 6 months and has launched 4 products in the current quarter and expects to launch 3 more products in 4QFY17. Therefore the ex-Methergene portfolio should start to make a growing contribution from Q4 onwards.
    - It further highlighted that the validation batches are on for launches.
    - Mgt remains very positive on the growth outlook for Methergene as the primary driver for GAVIS sales. Methergene Oral tablet is the only drug available for postpartum hemorrhage (PPH). Till recently, GAVIS had been selling this drug a generic and based on market research, Lupin saw significant growth potential in promoting it as a branded drug; Lupin believes it can become a major brand like Suprax and help to rejuvenate the specialty franchise. Mgt stated that it has managed to stabilize the Rx on the drug and is now looking to obtain branded pricing for these prescriptions. Mgt cited excellent response from the prescribing doctors to generics to Rx shift. Notably, as per mgt estimates, successful conversion of all the current prescriptions can generate revenues of ~$70m or so.
    - Currently Methergine is a US$4m brand a month and is looking to grow it further. The company continues to develop this product as a brand and does not witness any risk from generic competition as there are certain complexities and barriers involved in the manufacturing of the API.
    - Overall, the performance of GAVIS in terms of scale-up of existing drugs as well as new ANDA approvals has been much softer than initial management guidance. Earlier the company has reduced its guidance for FY18 GAVIS to ~$250m from $300m as guided earlier. Even the reduced guidance remains fairly stretched
- Some other takeaways regards US business
    - Going forward the company expects high single digit pricing erosion on the base business.
    - Renvela / Welchol – Delays continue: The Company has received CRLs on these product and the company is in the process of addressing these CRLs. It expects approval for this product by late FY18 if not then early FY19.
    - gAdvair: The company has achieved significant progress and has successfully completed the pilot studies, and is planning for manufacturing the exhibit batches and it expects to start the clinical trials in FY18 followed by product filing in FY18 itself.
    - Albuterol MDI filing: It has filed for Albuterol MDI (gProAir) in the US in the current quarter. in which Perrigo also has the filing which could be a 3-4 player market. The company continues to work on filing multiple DPIs
    - Looking to launch +25 ANDAs during FY18
    - While yoy growth will be a challenge in FY18 given the high base, mgt remains positive on delivering +15% growth over the medium term,.
- Japan revenues grew 5% yoy in CC terms.
    - The growth in the current quarter was impacted on account of the government reforms involving reduction in some pharmacy benefits
    - Current quarter includes some contribution from the acquired Shionogi portfolio while the entire impact would be visible in the 4QFY17.
    - Management remain confident of maintain 10-15% growth in JPY terms
    - Positive on the Shionogi brand acquisitions; believe it's a fairly strategic transaction as it help to cross sell the generic products as also create foundation for building a specialty business.
    - Shionogi portfolio margins are slightly better than company margins The $150m acquisition will be funded through JPY denominated debt; cost to be pretty low
- India business grew 12% yoy to Rs9.9bn, vs est of 10% despite the demotivation issue. The company expects growth momentum to pick up in FY18 and expects the growth be in double digits of 15%. In the current quarter the branded business grew by 14-15% adjusted for demonetization.
- Among other markets, South Africa sales were sequentially down at 9% in CC terms while Lat-Am sales improved by 33% yoy / 19% qoq.

- Key financial metrics
    - Gross margins remained flat qoq at ~70.1% aided by continued high contribution from Fortamet / Glumetza
    - Employee cost (up 3% qoq) at Rs7.3b inline with est of Rs7.3b.
    - SGA costs stood lower at Rs12.3b vs 13b in Q2FY17 down 6% qoq
    - R&D costs declined to 13% of sales to Rs5.7bn (down 1% qoq).
- R&D spends increased sharply 45% yoy to Rs5.7bn (13% of sales vs 11.8% in Q3FY16), however it marginally down 1% qoq.
    - Lupin has been indicating it seeks to materially step up investments in development of complex drugs, including injectables, inhalation drugs and dermatology as also biosimilars.
    - Specifically, it has been indicating that they are seeking to imitate clinical trials on couple of inhaler products (DPI as well MDI) from FY16.
    - The company has already filed its first nasal spray product in Dec-15 and MDI (Albuterol) in Q3FY17 and is expected to file two DPI flings in FY18. Additionally, they also seek to initiate trials for gAdvair in FY18.
    - Consequently, R&D spends is likely to remain higher in FY17 at 12-15% of sales.
    - In Q3FY17 Lupin got 11 approvals and filed 6 new ANDAs. Lupin now has 344 (including Gavis) cumulative filings of which, 207 have been approved by the USFDA. Lupin is currently the leader in 45 products and the top 3 player in 78 of its marketed products.
    - The company has 44 FTF products which includes 23 exclusive FTF opportunities
- The consolidated OPM including OOI came at 27.1% vs our est of 23.8%. OPM was higher led by higher revenues, flat GMs and lower SGA and a marginally lower R&D spends during the quarter.
- Tax rate increased sharply at 39% vs our estimate of 25%. Resultant, PAT at Rs6.3bn was ahead of our est at Rs6.1bn. The company has now guided for 28% (vs 25% as guided earlier) tax rate in FY17.
- The company has maintained its capex guidance – Rs18-20bn in FY17 which will temper down to Rs13-15bn in subsequent years. Management ascribed it to a phase of fairly limited capex spends over FY15-16 and a major ramp-up in capacity addition projects across India and Japan in FY17 and therefore expects moderation of capex spends in coming years.
- Net debt / equity was 0.41x as of Dec 16 (flat over Sept'16) vs 0.34x as of March'16.

Income statement

Year to 31 Mar (Rs m)	FY15	FY16	FY17E	FY18E	FY19E
Net sales	1,30,964	1,41,430	1,77,173	1,95,606	2,22,856
% growth	16.0	8.0	25.3	10.4	13.9
Operating expenses	91,504	1,04,550	1,29,624	1,45,673	1,65,523
EBITDA	39,460	36,880	47,550	49,933	57,332
% change	31.4	(6.5)	28.9	5.0	14.8
Other income	2,397	1,877	2,433	1,100	1,200
Net interest	(98)	(446)	(1,442)	(1,298)	(1,168)
Depreciation	4,347	4,635	8,847	9,598	10,270
Pre-tax profit	37,412	33,675	39,694	40,137	47,094
Deferred tax	0	0	0	0	0
Current tax	9,704	11,536	11,307	10,757	12,379
Profit after tax	27,708	22,140	28,387	29,381	34,715
Preference dividend	0	0	0	0	0
Minorities	(412)	(88)	(30)	(30)	(30)
Adjusted net profit	27,296	22,052	28,357	29,351	34,685
Non-recurring items	0	0	0	0	0
Reported net profit	27,296	22,052	28,357	29,351	34,685
% change	48.6	(19.2)	28.6	3.5	18.2

Balance sheet

As on 31 Mar (Rs m)	FY15	FY16	FY17E	FY18E	FY19E
Paid-up capital	899	901	901	901	901
Preference capital	0	0	0	0	0
Reserves & surplus	87,844	1,08,945	1,31,502	1,54,527	1,89,212
Shareholders' equity	88,984	1,10,167	1,32,754	1,55,808	1,90,523
Total current liabilities	27,699	31,787	36,737	38,260	41,187
Total debt	5,310	71,724	61,724	43,724	18,724
Deferred tax liabilities	1,182	1,239	1,239	1,239	1,239
Other non-current liabilities	7,361	8,656	8,656	8,656	8,656
Total liabilities	41,552	1,13,405	1,08,355	91,878	69,805
Total equity & liabilities	1,30,535	2,23,572	2,41,109	2,47,687	2,60,329
Net fixed assets	32,961	86,379	95,532	1,00,934	1,05,664
Investments	16,584	75	75	75	75
Cash	4,814	8,379	7,167	4,531	3,548
Other current assets	59,696	99,094	98,641	1,02,453	1,11,347
Deferred tax assets	0	0	0	0	0
Other non-current assets	16,481	29,644	39,694	39,694	39,694
Net working capital	36,811	75,686	69,071	68,723	73,708
Total assets	1,30,535	2,23,572	2,41,109	2,47,687	2,60,329

Cash flow

Year to 31 Mar (Rs m)	FY15	FY16	FY17E	FY18E	FY19E
Pre-tax profit	37,412	33,675	39,694	40,137	47,094
Depreciation	(4,347)	(4,635)	(8,847)	(9,598)	(10,270)
Chg in Working capital	5,552	(35,310)	5,403	(2,288)	(5,968)
Total tax paid	(9,704)	(11,536)	(11,307)	(10,757)	(12,379)
Interest Received	0	0	0	0	0
Ext ord. Items	0	0	0	0	0
Operating cash flow	40,288	(6,794)	44,079	37,988	40,185
Capital expenditure	(17,191)	(71,217)	(28,050)	(15,000)	(15,000)
Free cash flow (a+b)	23,097	(78,011)	16,029	22,988	25,185
Chg in investments	(14,799)	16,509	0	0	0
Debt raised/(repaid)	(2,053)	66,414	(10,000)	(18,000)	(25,000)
Interest Paid	(98)	(446)	(1,442)	(1,298)	(1,168)
Capital raised/(repaid)	2	2	0	0	0
Dividend (incl. tax)	(3,944)	(4,067)	(5,799)	(6,326)	0
Other items	(1,261)	2,518	0	1	0
Net chg in cash	103	2,911	(1,213)	(2,636)	(983)

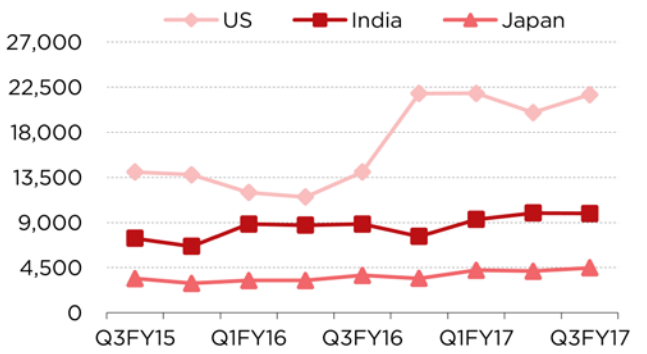
Key ratios

Year to 31 Mar	FY15	FY16	FY17E	FY18E	FY19E
EBITDA margin (%)	30.1	26.1	26.8	25.5	25.7
EBIT margin (%)	26.8	22.8	21.8	20.6	21.1
PAT margin (%)	20.8	15.6	16.0	15.0	15.6
RoE (%)	34.3	22.1	23.3	20.3	20.0
RoCE (%)	37.6	21.9	19.5	19.5	22.0
Gearing (x)	0.0	0.6	0.4	0.3	0.1
Net debt/ EBITDA (x)	0.0	1.7	1.1	0.8	0.3
FCF yield (%)	3.4	(11.5)	2.4	3.4	3.7
Dividend yield (%)	0.6	0.6	0.9	0.9	0.0

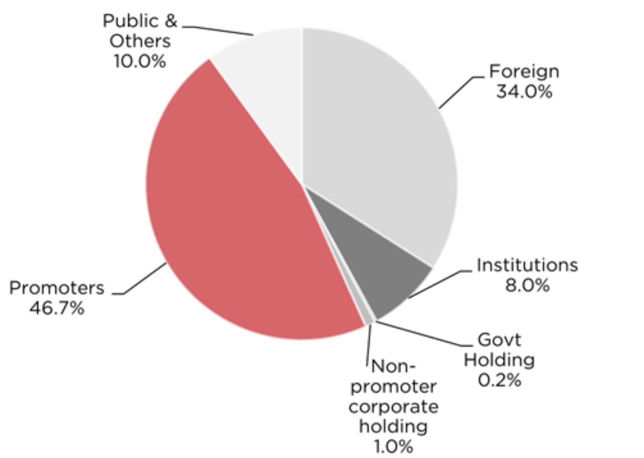
Valuations

Year to 31 Mar	FY15	FY16	FY17E	FY18E	FY19E
Reported EPS (Rs)	60.7	48.9	62.9	65.1	77.0
Adj. EPS (Rs)	60.7	48.9	62.9	65.1	77.0
PE (x)	24.8	30.7	23.9	23.1	19.5
Price/ Book (x)	7.6	6.2	5.1	4.3	3.6
EV/ Net sales (x)	5.2	5.2	4.1	3.7	3.1
EV/ EBITDA (x)	17.2	20.1	15.4	14.4	12.1
EV/ CE (x)	6.6	3.9	3.6	3.4	3.2

Segmental break-up



Shareholding pattern



As of Dec 16

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