

LUPIN

PHARMACEUTICALS

HOLD

Target Price: Rs 1,600

Strong EBITDA, but slower growth ahead

Q3 EBITDA growth of 44% YoY was 20% above our and consensus estimates, however higher tax rates of 39% (vs. 25% assumed as guided; now guidance revised to 28%) resulted in largely in-line PAT. While strong growth in US (8% QoQ) was led by improved market share of gGlumetza; growth in India (12% YoY) and Japan (5% YoY in cc terms) was impacted by demonetization and local reforms respectively. Lupin guided for near term growth challenges given increasing competition on high base of metformin franchise to be partly offset by new launches.

We largely maintain estimates and TP of Rs 1,600 (22x Dec'18). While Lupin's build-out of complex R&D pipeline (respiratory, derma, etc) is a step in right direction, we maintain HOLD given increasing competition in higher margin metformin asset (concentration risk).

CMP : Rs 1,495
 Potential Upside : 7%

MARKET DATA

No. of Shares : 451mn
 Free Float : 53%
 Market Cap : Rs675bn
 52-week High / Low : Rs1,912 / Rs1,294
 Avg. Daily vol. (6mth) : 1.1 mn shares
 Bloomberg Code : LPC IB Equity
 Promoters Holding : 47%
 FII / DII : 33% / 8%

- ◆ **Strong growth led by US:** US sales improved 53% YoY/8% QoQ to USD 316 mn driven by traction in gGlumetza (no competition yet despite approvals) and YoY impact of Gavis brand business. Domestic growth surprised positively at 12% YoY (vs our estimate of 8%) despite 2-3% impact of demonetization. Mixed growth in other segments: Japan (5% YoY in JPY terms), South Africa (3% YoY in ZAR terms), RoW (24% YoY), LatAM (33% YoY), API (-5% YoY)
- ◆ **Margin expansion on better cost control:** While gross margin of 70.5% (398 bps YoY/flat QoQ) was in line with estimates, EBITDA margin expanded 327 bps YoY/316 bps QoQ to 27% given decline in SG&A (ex-R&D) to 15% of sales (vs 17.5% in Q2'17) on account of absence of forex loss (Rs 450 mn) seen in Q2FY17. Despite higher other income of Rs 1 bn (aided by forex gain of Rs 740 mn), sharp increase in tax rate to 39% (vs. 32% in Q3'16 & 19.4% in Q2FY17) led to in-line PAT of Rs 6.3 bn (+21% YoY, -4% QoQ)

*(Continued on page 2...)***Financial summary (Consolidated)**

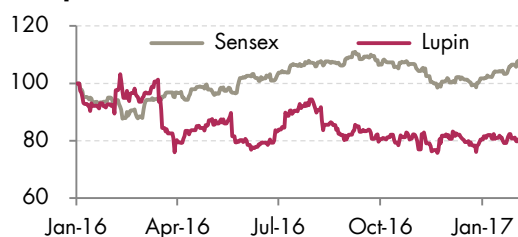
Y/E March	FY16	FY17E	FY18E	FY19E
Sales (Rs mn)	137,016	171,301	201,292	226,804
Adj PAT (Rs mn)	22,707	28,269	31,775	34,821
Con. EPS* (Rs)	-	63.5	73.8	84.6
EPS (Rs)	50.8	63.2	71.1	77.9
Change YOY (%)	(5.5)	24.5	12.4	9.6
P/E (x)	29.4	23.6	21.0	19.2
RoE (%)	22.9	23.2	21.5	19.6
RoCE (%)	24.5	20.6	20.6	20.3
EV/E (x)	19.5	15.3	13.7	12.2
DPS (Rs)	7.5	7.5	7.5	7.5

Source: *Consensus broker estimates, Company, Axis Capital

^ AG: Authorized Generic

Key drivers

Growth (%)	FY17E	FY18E	FY19E
US (USD mn)	43	14	12
India	12	14	14
EBITDA margin	27	25	24
core-EPS	24	12	10

Price performance

(...continued from page 1)

- ◆ **US growth to face near term challenge** from high base and increased competition in metformin franchise – gGlumetza (Valeant AG^ launch in Q3, SUNP and Teva expected by mid-CY17) & gFortamet (Mylan gaining share post launch in Q2). This would be partially offset by new launches (25 expected in FY18) including limited competition products (gMinastrin FTF, gEpzicom) and potential for products post litigation (gVigamox, gRestasis, gNamenda XR), as well as ramp-up from Somerset launches (controlled substances, ramp up of methergine brand, etc)
- ◆ **R&D progress on track:** Has made good progress on complex generics, biosimilars (etanercept in Phase III trials) and inhalation products (has multiple DPIs across different stages of development; see Exhibit 8 on page 4 for details). Albuterol MDI was filed in Q2 with 4 to 5 players expected upon launch. It expects to enter clinical trials for gAdvair in FY18 with possible filing within the year as well. Filed 6 ANDAs (12 in 9M'17) and expects to file 30 by FY17. Received 11 approvals (16 in H1, 39 in FY16). Cumulative ANDA filings with USFDA stand at 344 (207 approvals, 137 pending ANDAs including 44 FTF filings including 23 exclusive FTF opportunities)
- ◆ **Other conference call highlights:** (1) **Expects over 15% growth in India** in FY18 with possible impact of de-stocking post implementation of GST, (2) **Japan growth to rebound** to double digit levels with full impact of Shionogi transaction in Q4, (3) Expects **higher capex** of USD 250-300 mn (Rs 19 bn) in FY17 led by new facility in Japan and R&D facilities in Florida, with lower capex of Rs 15 bn (~USD 215 mn) in FY18, (4) **FY17 tax rate guidance revised** to 26-28% (vs. 25% earlier)

Exhibit 1: EBITDA margin expansion led by lower SG&A costs

(Rs mn)	Q3'16	Q2'17	Q3'17	YoY (%)	QoQ (%)
Revenues	33,503	42,112	44,049	31	5
Other operating income	1,973	793	779	(61)	(2)
Total Revenue	35,477	42,905	44,829	26	4
Gross Profit	22,271	29,683	31,034	39	5
Gross Profit margin (%)	66.5	70.5	70.5	398 bps	-3 bps
Staff	5,434	7,124	7,312	35	3
Staff as % of Sales	16.2	16.9	16.6	38 bps	-32 bps
R&D	3,916	5,716	5,682	45	(1)
R&D as % of Sales	11.7	13.6	12.9	121 bps	-67 bps
SGA	6,433	7,356	6,661	4	(9)
SGA as % of Sales	19.2	17.5	15.1	-408 bps	-235 bps
EBITDA	8,461	10,281	12,158	44	18
EBITDA margin (%)	23.8	24.0	27.1	327 bps	316 bps
Interest	99	263	459	364	75
Depreciation	1,216	2,112	2,309	90	9
Other Income	664	271	1,036	56	282
PBT	7,811	8,177	10,426	33	28
Tax	2,557	1,589	4,095	60	158
Tax rate	32.7	19.4	39.3	654 bps	1984 bps
Reported PAT	5,246	6,622	6,331	21	(4)

Source: Company Note: As per Ind-AS

Exhibit 2: Strong growth in revenue led by India & US

Rs mn	Q3'16	Q2'17	Q3'17	YoY (%)	QoQ (%)
US Total (USD mn)	206	292	316	53	8
US Total (Rs mn)	13,805	19,978	21,755	58	9
India	8,860	9,958	9,912	12	(0)
Asia Pacific	4,634	5,520	5,601	21	1
- Japan (JPY mn)	6,883	6,700	7,244	5	8
EMEA	2,187	2,355	2,555	17	8
- South Africa (ZAR mn)	223	252	230	3	(9)
LatAM	885	986	1,175	33	19
RoW	297	396	367	24	(7)
Formulations	30,668	39,193	41,365	35	6
API	2,835	2,919	2,684	(5)	(8)
Total	33,503	42,112	44,049	31	5

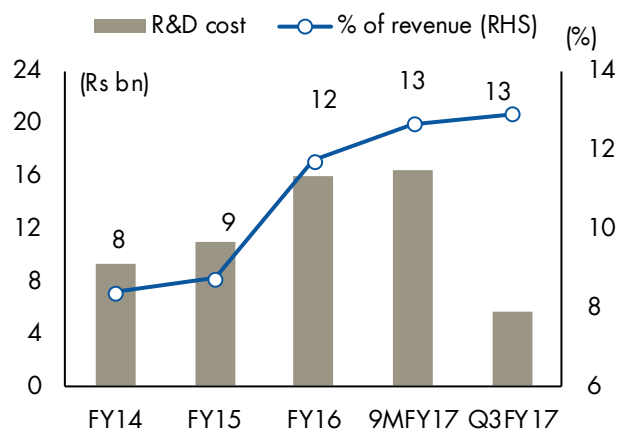
Source: Company *EMEA: Europe Middle East & Africa

Exhibit 3: LPC has lost some market share in gSuprax and gFortamet 1,000 mg

Launch	Brand	Brand sales/ market size (USD mn)	No. of players	Market share (%)						
				Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16
22-Feb-13	Suprax OS	80	2	89	82	79	76	74	77	73
18-Dec-13	Trizivir	112	2	75	77	77	77	84	84	86
21-Mar-14	Niaspan	1,000	5	27	28	23	20	18	18	18
12-Nov-14	Celebrex	2,540	10	13	13	13	13	12	12	12
15-May-12	Combivir	275	8	28	21	19	11	13	9	9
20-Nov-12	Tricor	1,300	6	24	23	15	13	13	14	13
6-Dec-13	Trilipix	450	5	23	23	22	23	23	23	23
14-Oct-11	Fortamet 1000mg	-	2	62	62	62	69	70	70	65
12-Dec-13	Cymbalta	5,400	16	19	17	16	16	17	16	15
1-Apr-16	Loestrin 24 FE	-	7	-	-	-	1	6	8	16

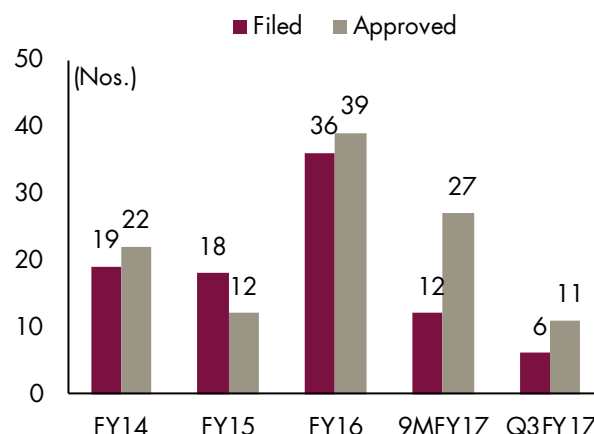
Source: Bloomberg

Exhibit 4: Increased R&D investments continue



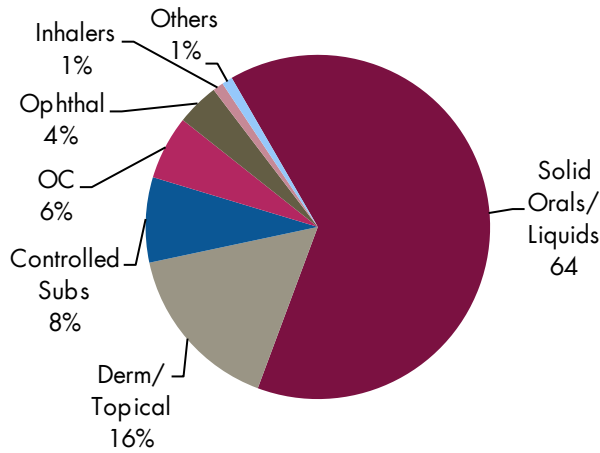
Source: Company, Axis Capital

Exhibit 5: LPC has made half of its FY17 filings in Q3



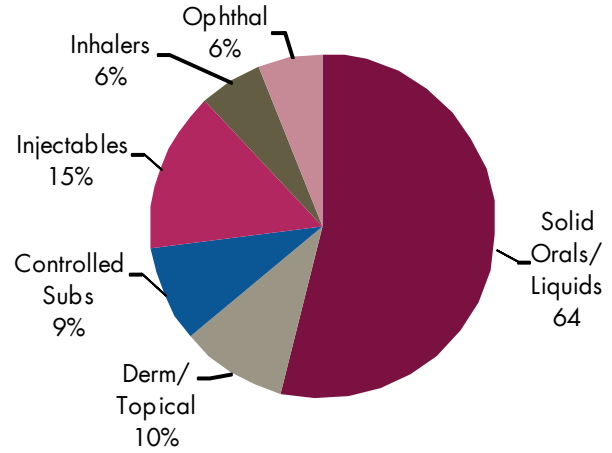
Source: Company, Axis Capital

Exhibit 6: Filed products (Lupin + Gavis)



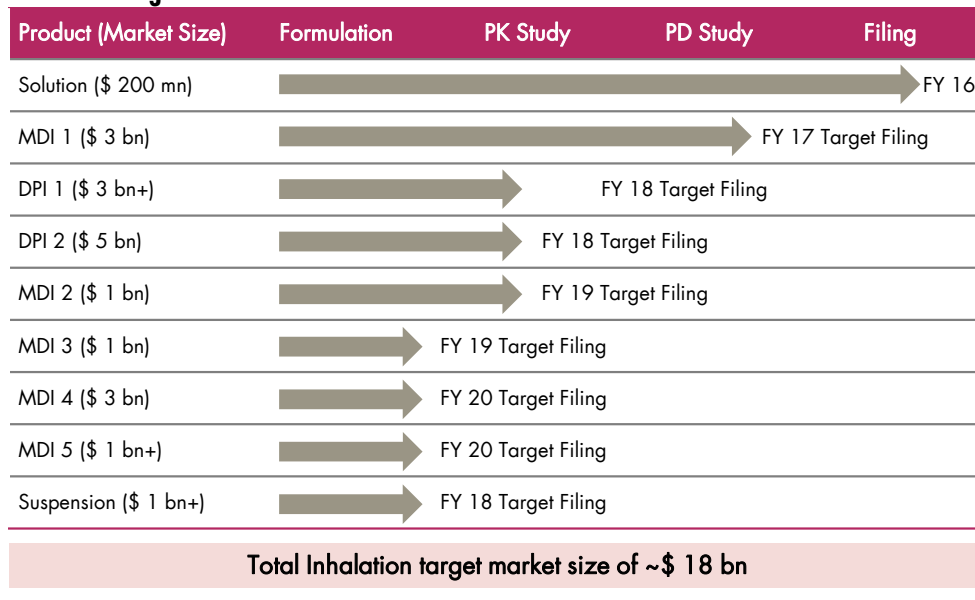
Source: Company, Axis Capital Note: As on March 31st 2016

Exhibit 7: Products in development (Lupin + Gavis)



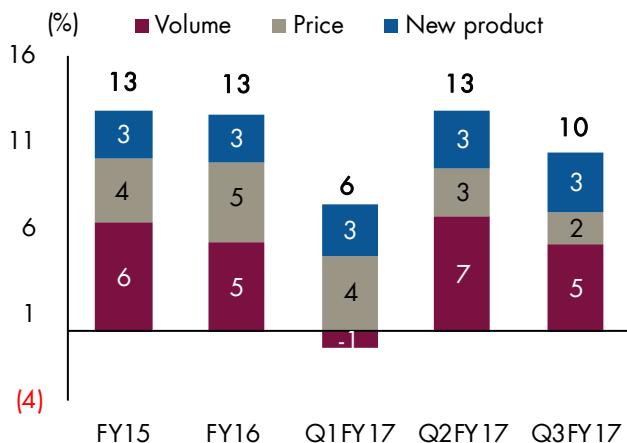
Source: Company, Axis Capital Note: As on March 31st 2016

Exhibit 8: LPC's US inhalation pipeline (targeting USD 18 bn market opportunity) has been advancing



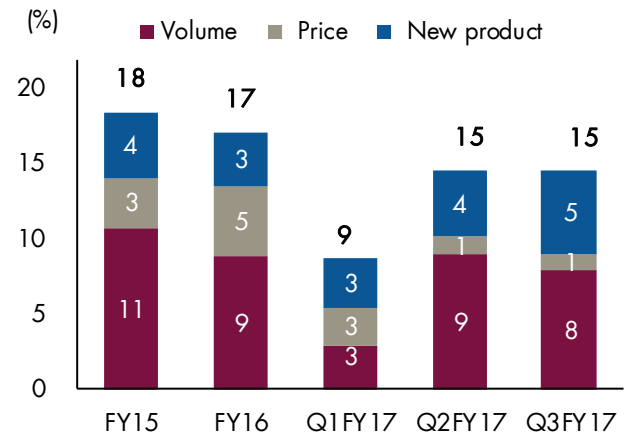
Source: Company

Exhibit 9: IPM growth trends



Source: AIOCD

Exhibit 10: LPC has seen higher volume growth in Q3 vs IPM



Source: AIOCD

Exhibit 11: Strong growth in respiratory and anti-diabetic segments

YoY growth	% of sales	FY14	FY15	FY16	Q1'17	Q2'17	Q3'17
Cardiac	25%	12%	21%	19%	7%	5%	12%
Anti-infective	22%	6%	9%	7%	0%	5%	-5%
Respiratory	12%	11%	23%	22%	10%	26%	17%
Anti-Diabetic	11%	24%	27%	23%	25%	33%	44%
Gastro Intestinal	8%	15%	14%	20%	8%	14%	19%
Vit. / Min. / Nut.	6%	17%	15%	10%	-5%	-4%	3%
Neuro / CNS	5%	6%	20%	10%	14%	7%	12%
Pain / Anal.	5%	27%	24%	15%	-2%	7%	13%
Gynaecological	3%	12%	39%	48%	21%	15%	35%
Hormones	1%	3%	-1%	4%	7%	9%	7%
Total (Rs bn)	34	12%	18%	17%	9%	15%	15%

Source: AIOCD *% of FY16 sales

Conference call highlights and our view
Guidance

- ◆ LPC expects **near term growth challenges** given increasing competition on high base of metformin franchise – gGlumetza (recent AG launch by Valeant, Sun & Actavis to launch by H1FY18) and gFortamet (Mylan gaining market share via price correction)
- ◆ **US launches:** Expects 25 launches during FY18, 30 filings by end of FY17 (vs 12 in 9MFY17) and single digit price erosion in the US. Acquisition strategy would be towards specialty focus with a strong pipeline and commercial footing in US
- ◆ **Respiratory:** Filed Albuterol MDI and expects this to have some competition once approved with 4 to 5 players in USD 3 bn market. Expects gAdvair to enter clinical trials in FY18 with possible filing in FY18 as well

US (USD 316 mn; +53% YoY/ +8% QoQ): Growth in QoQ terms was led by increased share in gGlumetza, good traction in methergine brand and launch of 4 new products in the quarter, despite loss of share in gFortamet on account of increased competition (Mylan). Expects new launches to offset price erosion in gGlumetza and gFortamet. LPC has a potential launch pipeline of 25 products for the next 12 months (gMinastrin FTF, gEpzicom, gWellbutrin XL, gVigamox as well as dermatology and controlled substances) as well as brand ramp up of methergine (brand now has USD 4 mn per month in sales despite 20% decline in prescriptions recently).

- ◆ Total brand sales were USD 22 mn in Q3, mostly from methergine, Antara and Suprax brands
- ◆ **New launches** gNuvigil and VFEND have yet to gain good share as the launches are yet to ramp up. Expect this to improve in Q4
- ◆ **Somerset:** Branded business up 25% QoQ. Good portion of launches in FY18/19 from Somerset are going to be from controlled substances which covers a USD 12 bn opportunity
- ◆ **gFortamet:** Has seen a loss in share to Mylan after it launched in Q2. Expects a launch from ARBP post expiry of 30 month stay
- ◆ **gGlumetza:** LPC expects to lose some share given Valeant AG launch as well as expected launches by SUNP in H2CY17 and Teva in Q2CY17

- ◆ **gEpzicom and gMinastrin:** Launches expected in late FY17. Amneal and Mylan would be able to launch post LPC's 180 exclusivity on gMinastrin
- ◆ **gRenvela & gWelchol:** Expects delay in launch given that there are complete response letters (CRLs) pending which would be responded to in Q1'18. Still maintains an approval by late FY18 or early FY19
- ◆ **gRestasis and gNamenda XR:** Possible opportunities for FY18 as the products are currently in litigation
- ◆ **Price erosion:** Has seen high single digit level and expects to be at this level despite Mckesson-Walmart deal. Price erosion has been stabilizing after channel consolidation pressures in the recent past. Expects US policy on pricing to be supportive to generics as that would help bring affordability. Deregulation from new administration could see increased pace of approvals at the USFDA

USFDA Update: Has had inspections at all meaningful facilities but would expect some inspections in FY18.

India (Rs. 9,912 mn, +12% YoY): Growth was lowered by 2 to 3% on demonetization. Expects to return to 15% YoY growth April'17 onwards once total normalization takes place (as some effect remains). Expects destocking impact post GST implementation but would expect a secular growth rate of 15 to 20% for the full year.

Japan (JPY 7,244 mn, +5% YoY): Shionogi transaction of 21 brands has now closed in Q3 with sales of only a few days registered (will have full impact in Q4). Expects strong double digit growth going ahead.

R&D (Rs. 5.7 bn, 12.9% of Q3 revenue): During the quarter, LPC filed 6 ANDAs (vs 6 in H1; 36 in FY16) and received 11 approvals (vs 16 in H1, 39 during FY16). Cumulative ANDA filings with USFDA stand at 344 (207 approvals, 137 pending ANDAs including 44 First-to-Files (FTF) filings including 23 exclusive FTF opportunities). Expects to file 30 ANDAs for FY17 (vs 12 in 9MFY17)

- ◆ Good progress on complex generics, biosimilars (etanercept in Phase III) and inhalation products (has multiple DPIs across different stages of development)
- ◆ **Albuterol MDI:** LPC has already filed Albuterol MDI and expects this to have some competition once approved with 4 to 5 players in USD 3 bn market
- ◆ Expects approval in respiratory products in FY19. Has successfully completed pilot studies in gAdvair and expects to file in FY18

P&L and balance sheet highlights:

- ◆ While SG&A increased only 4%YoY on cost optimization, it declined 9% QoQ – due to Rs 450 mn forex loss in Q2FY17
- ◆ Other income was higher on account of forex gain of Rs 270 mn
- ◆ Higher tax rate on account of lower inventory levels (transfer of products from Swiss operations). Expects tax rates to be at 26% to 28% in FY17

Capex: Expects higher capex of USD 250-300 mn (Rs 19 bn) in FY17 led by Japan new facility, R&D facility in Florida and Pune and injectable plant. Lupin expects lower capex of Rs 15 bn (~USD 215 mn in FY18).

Financial summary (Consolidated)

Profit & loss (Rs mn)

Y/E March	FY16	FY17E	FY18E	FY19E
Net sales	137,016	171,301	201,292	226,804
Other operating income	5,069	4,350	4,875	5,400
Total operating income	142,085	175,651	206,167	232,204
Cost of goods sold	(43,094)	(50,534)	(63,910)	(72,577)
Gross profit	98,991	125,117	142,257	159,627
<i>Gross margin (%)</i>	<i>72.2</i>	<i>73.0</i>	<i>70.7</i>	<i>70.4</i>
Total operating expenses	(61,456)	(78,345)	(91,050)	(103,488)
EBITDA	37,535	46,772	51,207	56,139
<i>EBITDA margin (%)</i>	<i>27.4</i>	<i>27.3</i>	<i>25.4</i>	<i>24.8</i>
Depreciation	(4,635)	(8,478)	(9,013)	(10,013)
EBIT	32,900	38,294	42,194	46,126
Net interest	(446)	(1,099)	(881)	(801)
Other income	1,877	2,177	2,352	2,540
Profit before tax	34,331	39,373	43,665	47,864
Total taxation	(11,536)	(11,024)	(11,790)	(12,923)
<i>Tax rate (%)</i>	<i>33.6</i>	<i>28.0</i>	<i>27.0</i>	<i>27.0</i>
Profit after tax	22,795	28,349	31,875	34,941
Minorities	(88)	(80)	(100)	(120)
Profit/ Loss associate co(s)	-	-	-	-
Adjusted net profit	22,707	28,269	31,775	34,821
<i>Adj. PAT margin (%)</i>	<i>16.6</i>	<i>16.5</i>	<i>15.8</i>	<i>15.4</i>
Net non-recurring items	-	-	-	-
Reported net profit	22,707	28,269	31,775	34,821

Balance sheet (Rs mn)

Y/E March	FY16	FY17E	FY18E	FY19E
Paid-up capital	901	901	901	901
Reserves & surplus	108,943	133,288	161,141	192,039
Net worth	109,844	134,190	162,042	192,941
Borrowing	71,193	64,638	58,740	53,429
Other non-current liabilities	5,796	5,796	5,796	5,796
Total liabilities	187,153	205,024	227,079	252,786
Gross fixed assets	139,332	157,332	172,332	187,332
Less: Depreciation	(28,265)	(36,743)	(45,755)	(55,768)
Net fixed assets	111,067	120,589	126,577	131,564
Add: Capital WIP	4,956	5,451	5,997	6,596
Total fixed assets	116,023	126,041	132,574	138,161
Total Investment	75	75	75	75
Inventory	31,787	34,917	42,441	48,069
Debtors	45,498	42,239	49,634	55,924
Cash & bank	8,379	19,081	25,358	37,871
Loans & advances	7,372	6,101	7,169	8,078
Current liabilities	36,418	36,419	43,736	49,445
Net current assets	61,352	69,204	84,727	104,847
Other non-current assets	9,703	9,703	9,703	9,703
Total assets	187,153	205,024	227,079	252,786

Source: Company, Axis Capital

Cash flow (Rs mn)

Y/E March	FY16	FY17E	FY18E	FY19E
Profit before tax	34,331	39,373	43,665	47,864
Depreciation & Amortisation	4,635	8,478	9,013	10,013
<i>Chg in working capital</i>	<i>(31,537)</i>	<i>2,850</i>	<i>(9,246)</i>	<i>(7,608)</i>
Cash flow from operations	(3,690)	36,400	28,410	34,005
<i>Capital expenditure</i>	<i>(58,157)</i>	<i>(18,000)</i>	<i>(15,000)</i>	<i>(15,000)</i>
Cash flow from investing	(69,434)	(18,000)	(15,000)	(15,000)
<i>Equity raised/ (repaid)</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>
<i>Debt raised/ (repaid)</i>	<i>62,081</i>	<i>(6,555)</i>	<i>(5,897)</i>	<i>(5,311)</i>
<i>Dividend paid</i>	<i>(4,325)</i>	<i>(3,923)</i>	<i>(3,923)</i>	<i>(3,923)</i>
Cash flow from financing	111,057	(11,577)	(10,701)	(10,035)
Net chg in cash	37,933	6,823	2,709	8,970

Key ratios

Y/E March	FY16	FY17E	FY18E	FY19E
OPERATIONAL				
FDEPS (Rs)	50.8	63.2	71.1	77.9
CEPS (Rs)	61.2	82.2	91.2	100.3
DPS (Rs)	7.5	7.5	7.5	7.5
Dividend payout ratio (%)	14.8	11.9	10.6	9.6
GROWTH				
Net sales (%)	8.7	25.0	17.5	12.7
EBITDA (%)	3.7	24.6	9.5	9.6
Adj net profit (%)	(5.5)	24.5	12.4	9.6
FDEPS (%)	(5.5)	24.5	12.4	9.6
PERFORMANCE				
RoE (%)	22.9	23.2	21.5	19.6
RoCE (%)	24.5	20.6	20.6	20.3
EFFICIENCY				
Asset turnover (x)	1.1	1.0	1.1	1.1
Sales/ total assets (x)	0.8	0.7	0.8	0.8
Working capital/ sales (x)	0.3	0.3	0.3	0.3
Receivable days	121.2	90.0	90.0	90.0
Inventory days	111.0	98.9	100.0	99.7
Payable days	76.5	65.9	66.6	66.4
FINANCIAL STABILITY				
Total debt/ equity (x)	0.7	0.5	0.4	0.3
Net debt/ equity (x)	0.6	0.4	0.2	0.1
Current ratio (x)	2.7	2.9	2.9	3.1
Interest cover (x)	73.7	34.8	47.9	57.6
VALUATION				
PE (x)	29.4	23.6	21.0	19.2
EV/ EBITDA (x)	19.5	15.3	13.7	12.2
EV/ Net sales (x)	5.3	4.2	3.5	3.0
PB (x)	6.1	5.0	4.1	3.5
Dividend yield (%)	0.5	0.5	0.5	0.5
Free cash flow yield (%)	(9.3)	2.8	2.0	2.8

Source: Company, Axis Capital

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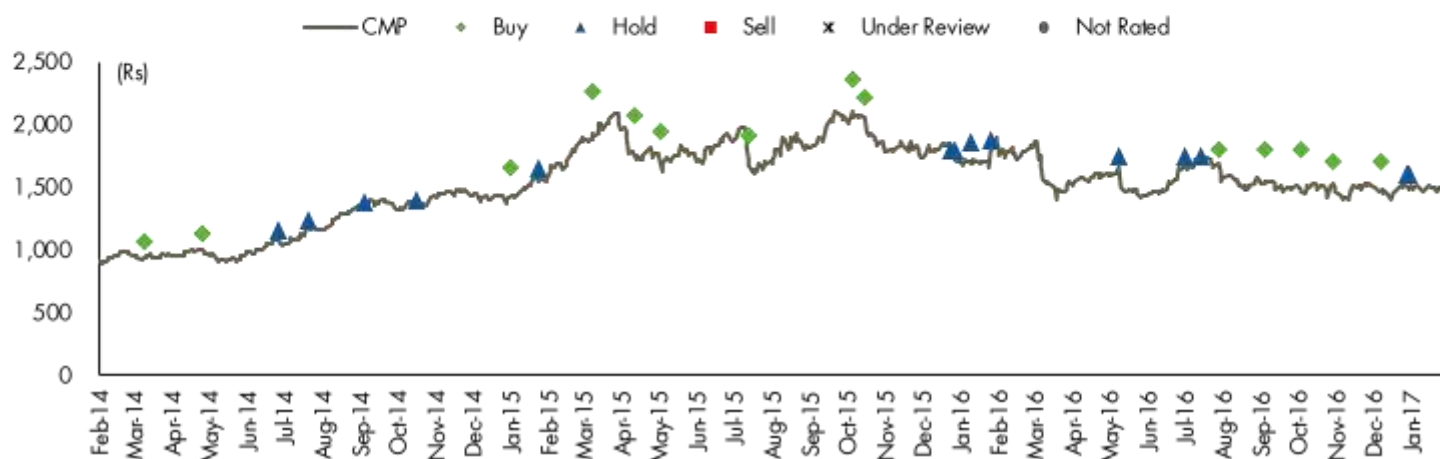
DEFINITION OF RATINGS

Ratings	Expected absolute returns over 12 months
BUY	More than 10%
HOLD	Between 10% and -10%
SELL	Less than -10%

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Lupin (LUPN BO, LPC IN) Price and Recommendation History



Date	Target Price	Reco	Date	Target Price	Reco	Date	Target Price	Reco
21-Mar-14	1,066	Buy	24-Jul-15	1,900	Buy	15-Sep-16	1,800	Buy
7-May-14	1,117	Buy	16-Oct-15	2,350	Buy	14-Oct-16	1,800	Buy
8-Jul-14	1,152	Hold	27-Oct-15	2,200	Buy	9-Nov-16	1,700	Buy
31-Jul-14	1,242	Hold	4-Jan-16	1,800	Hold	19-Dec-16	1,700	Buy
16-Sep-14	1,375	Hold	7-Jan-16	1,800	Hold	9-Jan-17	1,600	Hold
28-Oct-14	1,400	Hold	21-Jan-16	1,860	Hold	11-Jan-17	1,600	Hold
12-Jan-15	1,653	Buy	5-Feb-16	1,880	Hold			
3-Feb-15	1,650	Hold	19-May-16	1,750	Hold			
20-Mar-15	2,250	Buy	13-Jul-16	1,750	Hold			
23-Apr-15	2,070	Buy	25-Jul-16	1,750	Hold			
13-May-15	1,940	Buy	9-Aug-16	1,800	Buy			

Source: Axis Capital