

Lupin

Miss driven by one-offs

Lupin reported 2% YoY revenue growth at Rs42.5bn, due to lower US business given incremental competition. EBITDA was 24% lower than our estimate due to one-offs, excluding which results were in line. Management guided for 30+ product approvals in FY18E vs previous guidance of 25 and our estimate of 30. Whilst management guided for higher product approvals, US revenue is expected to decline in FY18E due to: a) continued channel consolidation; b) incremental competition in base business; and c) high base of FY17 due to limited competition sales from Glumetza and Fortamet. Whilst other businesses continue to perform well, in our estimates US (48% of revenue) will be the key driver of growth over FY17-19E. We have misjudged the company's ability to manage headwind from GDUFA (incremental competition) and overestimated tailwinds from faster product approval. Given the challenges to the business, we need to re-visit our BUY call which is based on US growth opportunity and put our view **UNDER REVIEW**.

Results overview: In-line revenue, EBITDA margin miss driven by one-offs

Lupin reported 4QFY17 revenue of Rs42.5bn, 2% YoY growth, -5% QoQ, led by lower US business due to incremental competition. Gross margins were 100bps higher QoQ at 71.5% due to limited competition products. EBITDA margins declined QoQ from 25.8% to 16.6%, primarily due to: a) forex loss of Rs1,680mn vs forex gain of Rs270mn in Q3FY17; b) provision for liability towards its Australian subsidiary amounting to Rs1,559mn, with respect to compensation for patent litigation towards its Isabelle generic launch in Australia; and c) increase in R&D spend from 13% of sales in Q3FY17 to 16% in Q4FY17. Excluding forex loss and Australian liability, margin was at 24.4% vs our estimate of 23.3%.

Key takeaways from the analyst meet

- US business – Painful year ahead:** The company reported US sales of Rs19bn, 13% decline QoQ, as the company lost market share in limited competition products and had high single-digit price erosion in the base business. Teva is expected to launch Glumetza by the end of May, 2017 vs earlier expectation of its entry in 2HCY17. Sun Pharma is expected to enter Glumetza market in 2HCY17. Base business continues to report price erosion of 8-9% on annual basis which is in line with our expectations. However, in the analyst meet, the company guided for muted FY18E given: a) channel consolidation; b) incremental competition in base business; and c) high base of FY17 due to limited competition sales from Glumetza and Fortamet. Whilst the company guided for >30 product approvals in FY18E vs previous guidance of ~25 and our estimate of 30 ANDA approvals, additional revenue will not be able to offset loss of sales in Glumetza and Fortamet. Also, the key near-term product opportunities like Renvela and Renagel – US\$1bn in market size, have been guided for launch in 2HFY19 vs earlier guidance of early FY19.
- Gavis business lags expectations:** Acquisition of Gavis (purchase price of US\$880mn) has underperformed management's expectation. The company guided for revenue of US\$200mn by end-FY18E vs previous guidance of US\$350mn. This is one of the major disappointments for us given the acquisition at expensive valuation (EV/Sales of 4.5x on FY18E) was justified due to FY17/18E growth driven by product launches.
- FY18E revenue target of US\$3.5bn postponed to FY20E:** The company's aspirational target of US\$3.5bn by FY18E now looks difficult, as per management. Though this is in line with our expectation, the surprise is that the company has now postponed the US\$3.5bn target to FY20E. For FY18E, the management guided for 26-28% EBITDA margin (including other income) R&D spend for FY18E is expected to be at ~13% of sales. We see risk to EBITDA margin guidance given the company has not factored the recent channel consolidation in the USA.

UNDER REVIEW

Result Update

Stock Information

Bloomberg Code:	LPC IN
CMP (Rs):	1,228
TP (Rs):	NA
Mcap (Rs bn/US\$ bn):	554/8.5
3M ADV (Rs mn/US\$ mn):	1419/21.9

Stock Performance (%)

	1M	3M	12M	YTD
Absolute	(9)	(15)	(16)	(17)
Rel. to Sensex	(12)	(20)	(36)	(31)

Source: Bloomberg, Ambit Capital research

Ambit Estimates (Rs mn)

	FY17	FY18E	FY19E
Revenues	174661	208665	249249
EBITDA	43333	51949	65209
EPS (Rs)	56.8	72.4	91.6

Source: Bloomberg, Ambit Capital research

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Where do we go from here?

Our expectation of growth in the USA driven by GDUFA has been challenged given continuous channel consolidation and rising pressure on base business. Whilst other businesses continue to perform well, the US business at 48% of total revenue will be the key driver of growth over FY17-19E. We have clearly misjudged the company's ability to manage headwinds from GDUFA and overestimated on tailwinds from faster product approval. Given the challenges to the business, we need to re-visit our BUY call based on faster product approval, i.e. GDUFA and put our view on the stock UNDER REVIEW. Valuation at 14x one-year forward estimates (last published) appears reasonable as they factor in near-term disappointment in growth.

Exhibit 1: Revenue mix

(Rs mn)	4QFY17	YoY (%)	4QFY16	QoQ (%)	3QFY17	Divergence (%)	4QFY17E
Advanced market formulations	25,517	-4%	26,567	-8%	27,790	5%	24,408
US	19,007	-13%	21,871	-13%	21,755	3%	18,492
Europe	1,582	26%	1,254	3%	1,543	10%	1,442
Japan	4,928	43%	3,442	10%	4,492	10%	4,475
India formulations	8,788	15%	7,615	-11%	9,912	5%	8,377
Other formulations	4,499	16%	3,893	23%	3,663	5%	4,282
API	2,815	-1%	2,838	5%	2,684	-6%	2,980
Total net sales	41,619	2%	40,913	-6%	44,049	4%	40,047

Source: Company, Ambit Capital research

Exhibit 2: Income Statement

(Rs mn)	4QFY17	YoY (%)	4QFY16	QoQ (%)	3QFY17	Divergence (%)	4QFY17E
Net Sales	41,619	2%	40,913	-6%	44,049	4%	40,047
Other Operating income	914	2%	898	17%	779	-9%	1,000
Total operating income	42,533	2%	41,812	-5%	44,829	4%	41,047
Material costs	11,851	10%	10,737	-9%	13,016	2%	11,614
Staff costs	7,078	24%	5,691	-3%	7,312	-4%	7,398
Other expenditure	15,791	35%	11,710	28%	12,343	35%	11,698
Total Expenditure	34,719	23%	28,138	6%	32,670	13%	30,710
EBITDA	7,814	-43%	13,674	-36%	12,158	-24%	10,337
Core EBITDA margins (ex-OOI)	16.6%		31.2%		25.8%		23.3%
Other income	453	78%	254	-56%	1,036		250
Interest	406	78%	229	-12%	459	16%	350
Depreciation	2,674	85%	1,446	16%	2,309	22%	2,200
PBT	5,187	-58%	12,254	-50%	10,426	-35%	8,037
Tax	1,367	-67%	4,132	-67%	4,095	-32%	2,009
Tax rate	26.4%		33.7%		39.3%		25.0%
MI + Share of associates	18	-65%	51	NA	(0)		100
PAT	3,802	-53%	8,071	-40%	6,331	-36%	5,928
(% of Operating Income)							
Material costs	28.5%	223bps	26.2%	-107bps	29.5%	-53bps	29.0%
Staff costs	16.6%	303bps	13.6%	33bps	16.3%	-138bps	18.0%
Other Expenditure	37.1%	912bps	28.0%	959bps	27.5%	863bps	28.5%
EBITDA Margin	16.6%	-1465bps	31.2%	-925bps	25.8%	-674bps	23.3%

Source: Company, Ambit Capital research

PREVIOUSLY PUBLISHED ESTIMATES

Revenue mix (Rs mn)

Year ended 31 Mar	FY15	FY16	FY17	FY18E	FY19E
Formulations	112,884	124,597	160,807	193,139	233,256
India (Gross)	30,614	34,956	39,148	45,020	51,773
US generics	49,596	53,751	71,521	88,287	110,859
US brand	4,873	4,271	11,105	12,827	14,144
Japan	13,239	13,646	18,020	22,525	28,156
Europe	3,279	4,278	5,648	6,122	6,522
RoW	11,283	13,695	15,364	18,358	21,802
API	11,941	12,074	11,289	11,854	12,446
Total	124,825	136,671	172,096	204,992	245,702

Source: Company, Ambit Capital research

Income Statement

Year to March (Rs mn)	FY15	FY16	FY17	FY18E	FY19E
Net revenues	127,700	142,085	174,661	208,665	249,249
Material costs	41,570	43,094	50,014	58,553	67,752
Employee costs	13,949	17,260	28,572	31,928	35,759
Other mfg. costs	35,985	44,196	52,741	66,236	80,529
Core EBITDA	36,196	37,535	43,333	51,949	65,209
Depreciation	4,347	4,635	9,122	7,124	7,936
Interest expense	98	446	1,448	1,419	1,169
Adjusted PBT	34,149	34,331	35,349	45,619	57,634
Tax	9,705	11,536	9,785	12,317	15,561
Net profit	24,032	22,707	25,575	32,630	41,292

Source: Company, Ambit Capital research

Balance Sheet

Year to Mar (In Rs. mn)	FY15	FY16	FY17	FY18E	FY19E
Total Assets	96,377	183,984	213,714	213,520	238,664
Fixed Assets	49,442	116,023	131,660	129,777	131,841
Current Assets (incl Cash)	64,507	107,473	107,975	137,355	168,713
Cash	4,814	8,379	6,818	32,324	44,452
Investments	16,584	75	21,361	75	75
Total Liabilities	96,377	183,984	213,714	213,520	238,664
Total networth	88,741	109,844	135,321	159,380	194,523
Total debt	5,371	71,775	79,521	51,775	41,775
Current liabilities	35,001	40,393	47,282	54,494	62,772
Deferred tax liability	2,024	2,045	-1,128	2,045	2,045

Source: Company, Ambit Capital research

Cash Flow Statement

Year to March (Rs mn)	FY15	FY16	FY17	FY18E	FY19E
PBT	34,149	34,331	35,349	45,619	57,634
Depreciation	4,347	4,635	9,122	7,124	7,936
Tax	(9,436)	(11,662)	(9,785)	(12,317)	(15,561)
Net Working Capital	(1,378)	(22,946)	9,723	(8,977)	(11,201)
Others	(351)	(8,047)	8,888	608	129
CFO	27,331	(3,689)	53,298	32,057	38,937
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)	(3,809)	(4,859)
Interest paid	(109)	(436)	(1,448)	(1,419)	(1,169)
Others	-	-	11	(672)	(781)
CFF	(1,969)	58,126	(15,509)	(15,901)	(16,810)
Net change in cash	14,817	(14,998)	22,789	1,156	12,128
Closing cash balance	4,814	8,379	31,168	32,324	44,452
FCFF	12,361	(73,717)	38,298	17,057	28,937

Source: Company, Ambit Capital research

Valuation parameters

Year to March (Rs mn)	FY15	FY16	FY17	FY18E	FY19E
EPS	53.5	50.4	56.8	72.4	91.6
Book Value (per share)	197.4	243.8	292.1	353.7	431.7
P/E (x)	22.9	24.3	21.6	16.9	13.4
P/BV (x)	6.2	5.0	4.2	3.5	2.8
EV/EBITDA(x)	15.2	16.4	13.5	11.0	8.4
EV/Sales (x)	4.3	4.3	3.3	2.7	2.2
EV/EBIT (x)	17.3	18.7	17.0	12.8	9.6

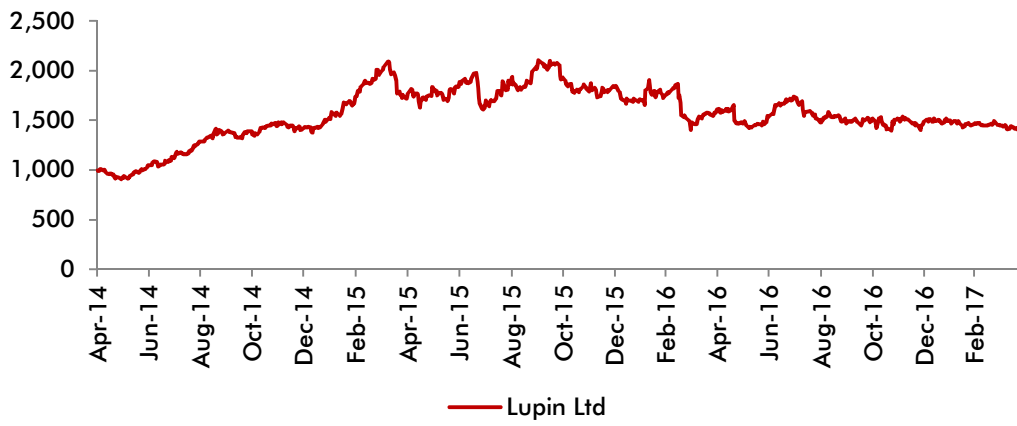
Source: Company, Ambit Capital research

Ratios

Year to March (Rs mn)	FY15	FY16	FY17	FY18E	FY19E
Revenue growth	13.1	11.3	22.9	19.5	19.4
Core EBITDA growth	20.5	3.7	15.4	19.9	25.5
APAT growth	30.9	-5.5	12.6	27.6	26.5
EPS growth	31.1	-5.7	12.6	27.6	26.5
Core EBITDA margin	28.3	26.4	24.8	24.9	26.2
EBIT margin	24.9	23.2	19.6	21.5	23.0
Net profit margin	18.8	16.0	14.6	15.6	16.6
RoCE (%)	26.7	15.8	13.2	16.2	18.7
Reported RoE (%)	30.4	22.9	21.2	22.4	23.3
Debt Equity ratio (X)	0.1	0.7	0.5	0.3	0.2
Current Ratio	1.8	2.7	2.5	2.5	2.7
Gross Block turnover (x)	2.7	2.1	1.8	1.9	2.0
Working Capital Turnover (x)	3.7	2.9	2.5	2.7	2.6
CFO/EBITDA (x)	0.8	-0.1	1.2	0.6	0.6

Source: Company, Ambit Capital research

Lupin Ltd (LPC IN, UNDER REVIEW)



Source: Bloomberg, Ambit Capital research

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