

Pricing pressure mounting

Lupin 4QFY17 numbers disappointed – revenue missed our estimates by 7% and EBITDA by 35%. US business was the key culprit with revenue down 13% sequentially. Margins came exceptionally weak, even adjusted for one-time litigation provision of Rs1.6bn. We do not have visibility of any big ticket products that could completely rescue Lupin to the earlier trajectory. Generic Minastrin, Welchol, Renagel and Renvela put together will not compensate for the loss of high profitability in generic Fortamet and Glumetza. We do not expect a major ramp up in revenues from Gavis (acquired in 2016) either. Continuing tough pricing environment in the US remains added challenge. Slower growth and fall in return ratios call for valuation de-rating as well. Maintain SELL with revised price target of Rs 1139.

US – in the middle of re-basing: The high profits from products such as generic Fortamet, Glumetza and Tricor started sharply waning in Q4FY16. We see additional competition and potential for further erosion. With no large products to replace them, the US business is re-basing to a more sustainable level. Tough pricing environment in most products in the US generics market adds further downside risk to even this lower base.

Japan weak; India, EMEA do well: Japan revenue growth (up 35% YoY) benefitted from acquisition of Shionogi brands, but fell 12% short of our estimate. EMEA with 26% growth YoY and India (up 16% YoY) did well. Organic growth has remained tepid in Japan all along; we see little signs of pick up. Expect India, EMEA and other EMs to deliver sustained mid-teen growth.

Searching the 'sustainable margin': After a 15-18 quarter long period of high margins, driven by limited competition products in the US, Lupin's Ebitda margin dropped to 18.4% in Q4FY17. Adjusted for one-time litigation provision, it still dropped ~500bp QoQ. We still don't have a clear picture where the company's margins will settle in the new base that is being formed. We build in 24-25% Ebitda margin for FY18/FY19; see potential downside risk to this.

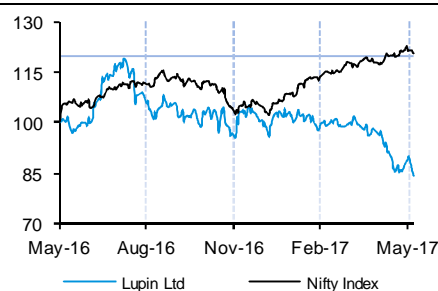
Lowering estimates by 10-11%: We lower our FY18/19 core earnings estimate by 10-11%. Lupin shares trade at c.23x on our FY18e core earnings which in our view is stretched give a modest 10-11% growth outlook for FY19 and beyond and return ratios that are down to ~20% from prior 30%+. Our PT of Rs1139 is 18x FY19e core earnings plus cash per share.

Rating	Target Price (Rs)	Upside/Downside (%)
SELL	1,139	(8)

Market data

Current price	Rs	1,235
Mkt capitalisation	USDm	8597.3
Average daily value 3M	USDm	21.9
Free float	%	62.7
Promoter holding	%	46.7
Foreign holding	%	35.8

1 Year Performance



Source: Bloomberg, SSLe

Financial summary

Y/E Mar (Rsmn)	FY15	FY16	FY17	FY18e	F19e
Net sales	1,27,700	1,42,085	1,74,662	1,89,825	2,08,779
EBITDA margin (%)	28%	26%	25%	24%	25%
Adjusted net profit	24,033	22,707	25,574	25,631	29,045
vs. consensus (%)				(20)	(21)
Free cash flow			2,639	15,770	16,224
EPS (Rs)	53	50	56	56	63
growth (%)	31%	-6%	13%	-1%	13%
P/E (x)	23	25	22	22	19
P/B (x)	6	5	4	4	3
EV/EBITDA (x)	17	16	14	14	12
D/E	(0.2)	0.6	0.4	0.3	0.2
RoE (%)	30%	23%	21%	18%	17%
RoCE (%)	37%	24%	17%	17%	18%
Dividend yield (%)	0.6%	0.6%	0.6%	0.6%	0.6%

Source: Company, SSLe

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Quarterly financials

Particulars (Rs mn)	4QFY16	4QFY17	YoY (%)	3QFY17	QoQ (%)	4QFY17e	Var (%)
Total revenue	41,707	42,533	2	44,829	(5)	45,514	(7)
COGS	11,009	11,851	8	13,016	(9)	12,566	(6)
% of revenues	26.4	27.9	147	29.0	(117)	27.6	25
Personnel exp	5,779	7,078	22	7,312	(3)	7,382	(4)
% of revenues	13.9	16.6	278	16.3	33	16.2	42
Mfg. & Others	6,755	9,082	34	6,662	36	8,015	13
% of revenues	16.2	21.4	516	14.9	649	17.6	374
R&D	5,113	6,709	31	5,682	18	5,484	22
% of revenues	12.3	15.8	351	12.7	310	12.0	373
EBITDA	13,051	7,814	(40)	12,158	(36)	12,068	(35)
EBITDAM (%)	31.3	18.4	(1,292)	27.1	(875)	26.5	(814)
D&A	1,487	2,674	80	2,309	16	2,028	32
EBIT	11,564	5,140	(56)	9,849	(48)	10,040	(49)
EBITM (%)	27.7	12.1	(1,564)	22.0	(989)	22.1	(998)
Other income	349	453	30	1,036	(56)	135	236
Interest cost	213	406	91	459	(12)	395	3
PBT	11,700	5,187	(56)	10,426	(50)	9,780	(47)
Tax	4,188	1,367	(67)	4,095	(67)	2,738	(50)
% Tax rate	35.8	26.4	(944)	39.3	(1,292)	28.0	(165)
Minorities / Associates	(33)	(18)	(45)	0	(9,000)	20	(191)
Adjusted Net profit	7,480	3,802	(49)	6,331	(40)	7,061	(46)
Exceptional items	0	0	na	0	na	0	na
Reported Net profit	7,480	3,802	(49)	6,331	(40)	7,061	(46)
Adjusted EPS	16.5	8.4	(49)	14.0	(40)	15.5	(46)

Source: Company, SSLe

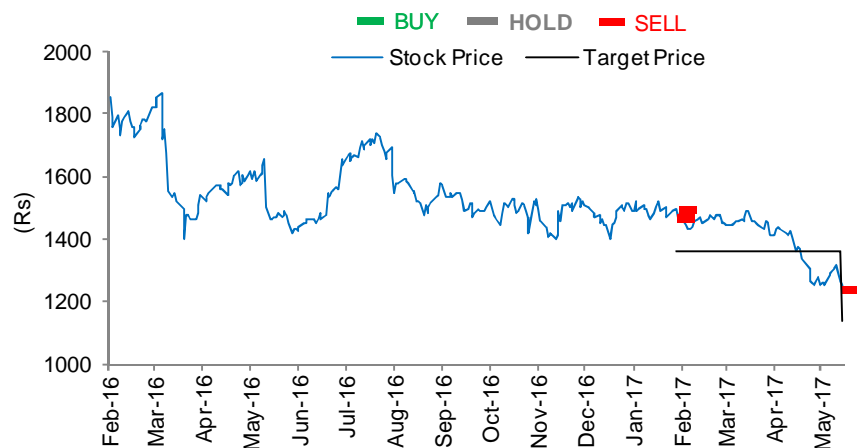
Financials

Income statement						Balance sheet					
Y/E Mar (Rs mn)	FY15	FY16	FY17	FY18e	FY19e	Y/E Mar (Rs mn)	FY15	FY16	FY17	FY18e	FY19e
Revenue	1,27,700	1,42,085	1,74,662	1,89,825	2,08,779	Cash & bank balance	21,372	8,399	28,135	19,742	22,685
<i>growth (%)</i>	13%	11%	23%	9%	10%	Other current assets	56,951	89,391	91,407	1,00,607	1,10,653
Operating expenses	91,504	1,04,550	1,31,329	1,44,267	1,57,492	Investments					
EBITDA	36,196	37,535	43,333	45,558	51,287	Net fixed assets	32,031	59,625	53,513	1,16,685	1,24,127
<i>growth (%)</i>	21%	4%	15%	5%	13%	Goodwill and intangible assets	17,411	56,398	78,147	23,100	23,100
Depreciation & amortisation	4,347	4,635	9,122	9,875	10,558	Other non-current assets	3,612	10,564	14,871	14,871	14,871
EBIT	31,849	32,900	34,211	35,683	40,729	Total assets	1,31,377	2,24,378	2,66,073	2,75,006	2,95,436
Other income (net)	2,398	1,877	2,586	1,407	691	Current liabilities	32,909	35,764	38,163	45,444	49,610
Interest expenses	98	446	1,448	1,590	1,192	Borrowings	5,402	71,848	79,521	59,614	50,916
PBT	34,149	34,331	35,349	35,499	40,228	Other non-current liabilities	4,085	6,602	13,068	13,068	13,068
Tax	9,704	11,536	9,785	9,940	11,264	Total liabilities	42,396	1,14,213	1,30,752	1,18,126	1,13,594
<i>Effective tax rate (%)</i>	28%	34%	28%	28%	28%	Shareholders' funds	88,741	1,09,844	1,34,976	1,56,605	1,81,648
Profit after tax	24,445	22,795	25,564	25,560	28,964	Minority interest	241	321	345	274	194
Minority interest	(412)	(88)	10	71	80	Total equity & liabilities	88,982	1,10,165	1,35,321	1,56,879	1,81,842
Adjusted net profit	24,033	22,707	25,574	25,631	29,045						
Non-recurring items	-	-	-	-	-						
Reported net profit	24,033	22,707	25,574	25,631	29,045						
<i>growth (%)</i>	31%	-6%	13%	0%	13%						

Financial ratios						Cash flow statement					
Y/E Mar	FY15	FY16	FY17	FY18e	FY19e	Y/E Mar (Rs mn)	FY15	FY16	FY17	FY18e	FY19e
Profitability and return ratio (%)						PBT / PAT	34,148	34,330	25,574	25,631	29,045
EBITDAM	28%	26%	25%	24%	25%	Depreciation & amortisation	4,347	4,635	9,122	9,875	10,558
EBITM	25%	23%	20%	19%	20%	Chg in working capital	(949)	(31,537)	383	(1,919)	(5,880)
NPM	19%	16%	15%	14%	14%	Other operating activities	(10,216)	(11,119)	(1,138)	184	501
RoE	30%	23%	21%	18%	17%	Operating CF	27,331	(3,690)	33,942	33,770	34,224
RoCE	37%	24%	17%	17%	18%	Capital expenditure	(8,676)	(57,746)	(21,253)	(18,000)	(18,000)
RoIC	46%	27%	19%	19%	20%	Chg in investments					
Per share data (Rs)						Other investing activities	(6,294)	(12,223)	(10,050)	-	-
O/s shares (mn)	449	450	451	452	453	Investing CF	(14,970)	(69,968)	(31,303)	(18,000)	(18,000)
EPS	53.5	50.5	56.7	56.7	64.1	FCF	12,361	(73,658)	2,639	15,770	16,224
FDEPS	53.2	50.2	56.5	56.1	63.5	Equity raised/(repaid)	413	536	-	-	-
CEPS	63.1	60.7	76.9	78.5	87.4	Debt raised/(repaid)	(700)	62,081	7,673	(19,907)	(8,698)
BV	197.4	244.1	299.2	346.4	400.9	Dividend (incl. tax)	(1,573)	(4,055)	(4,068)	(4,072)	(4,081)
DPS	7.5	7.5	7.5	7.5	7.5	Other financing activities	1,132	2,123	13,491	(184)	(501)
Valuation ratios (x)						Financing CF	(727)	60,685	17,097	(24,163)	(13,281)
PE	23	24	22	22	19	Inc/(dec) in cash & bank bal.	11,633	(12,973)	19,736	(8,393)	2,943
P/BV	6	5	4	4	3	Closing cash & bank bal.	21372	8399	28135	19742	22685
EV/EBITDA	17	16	14	14	12						
EV/Sales	5	4	4	3	3						
Other ratios											
D/E (x)	(0.18)	0.58	0.38	0.25	0.16						
DSO (days)	75.93	116.88	90.01	91.25	91.25						
Du Pont Analysis - RoE											
NPM (%)	19%	16%	15%	14%	14%						
Asset turnover (x)	1.0	0.6	0.7	0.7	0.7						
Equity Multiplier (x)	1.5	2.0	2.0	1.8	1.6						
RoE (%)	30%	23%	21%	18%	17%						

Source: Company, SSLe

Recommendation History



Date	Stock Price	TP	Rec.
7-Feb-17	1,466	1,363	SELL
9-Feb-17	1,491	1,363	SELL
24-May-17	1,235	1,139	SELL

Source: Bloomberg, SSlE

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(CIN): U65999MH2005PLC155485 | Research Analyst Registration No INH000000602

SEBI Registration No.: NSE Capital Market: INB 231052938 | NSE Derivatives: INF 231052938 | BSE Capital Market: INB 011053031

Currency Derivatives: INE 231052938 | CDSL: IN-DP-CDSL-370-2006 | IRDA/IR2/2014/241

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