

COMPANY NOTE

Target | Estimate Change

India | Healthcare | Pharmaceuticals

24 May 2017

Jefferies

Lupin Ltd. (LPC IN)

US business under pressure

Key Takeaway

Lupin reported weak results led by 13% QoQ fall in US revenues and increased R&D. Management commentary on outlook was also weak. US business will continue to see pressure in FY18 and growth will be a challenge led by increased competition in key products and elevated pricing pressure. We expect margins to decline 300bps in FY18 led by flat US business. Retain Underperform.

Results below expectation - Lupin reported results below expectation led by sharp fall in US revenues. Total Revenues were 5% and margins 300bps below expectation. Margin miss was led largely by higher R&D. Earnings were 40% below expectation.

US sees sharp decline - The key negative in the quarter was the 13% QoQ and YoY decline in US business. This was led by pricing pressure and market share loss in key products. India business growth recovered to 16%. Other businesses were largely inline with expectation. The key positive was the improvement in gross margins despite the decline in US business.

Guidance also muted- Management commentary on near term growth and margin outlook was muted. It highlighted that it expects pricing pressure to continue in near term in US. Management stated that while it expects 30+ approvals in FY18, maintaining US revenues flat YoY will be a challenge. It aims to cap R&D spend at 13.5% in the near term. Sevlemer products launch guidance has now been pushed back to end-FY19. Japan business is also facing pressure on growth led by price cuts. It expects to revert to double digit growth in FY19 led by exclusivity launches.

Indore Form 483: 6 observations - Lupin has received a Form 483 for its Indore plant with 6 observations. The observations are largely procedural and management believes they can resolve it soon.

Growth to be remain weak over FY17-19 - We expect growth and margin to be under pressure for Lupin going forward led by 1) increased competition in Metformin and market share loss, 2) pricing pressure in US, 3) approval delays and 4) increased R&D. We expect margins to decline 210cbps over FY17-19 driving EPS CAGR of only 6%.

Valuation/Risks

We adjust our estimates for the quarter. Our FY18-19 EPS falls by 17-10%. Lupin is in our view, trailing peers in developing a speciality/complex generic pipeline and has higher pricing risk given high product concentration. It though is trading at 18x FY9 PE, a premium to sector. We retain Underperform with revised TP of Rs 1080 implying FY19 PE of 16x. Key risk: Faster approval of key products.

INR	Prev.	2016A	Prev.	2017E	Prev.	2018E	Prev.	2019E
Rev. (MM)	143,124	142,555	178,002	174,943	206,855	187,318	235,445	220,195
EBITDA (MM)	38,574.2	36,853.0	47,111.6	46,491.0	52,395.0	44,494.3	58,552.9	53,917.3
EV/EBITDA		16.7x		13.2x		13.8x		11.4x
Net Profit	23,444.1	22,607.0	28,748.6	25,575.0	30,035.6	24,630.7	35,320.6	30,556.6
Dividend	--	7.50	--	8.80	--	9.50	--	10.80
Div. Yield		0.61%		0.72%		0.77%		0.88%
BV/Share	243.78	247.75	298.47	299.56	358.58	346.13	425.77	403.90
P/B		5.0x		4.1x		3.5x		3.0x
EPS Growth	2.7%	(5.9)%	22.6%	20.0%	4.5%	(9.2)%	17.6%	24.1%
EPS								
FY Mar	52.16	50.29	63.96	60.37	66.82	54.80	78.58	67.98
FY P/E		24.4x		20.3x		22.4x		18.1x

UNDERPERFORM

Price target INR1,080.00
(from INR1,250.00)
Price INR1,227.65^

Financial Summary

Net Debt (MM): INR62,812.1

Market Data

52 Week Range: INR1,750.00 - INR1,168.60

Total Entprs. Value (MM): INR614.6BN

Market Cap. (MM): INR551.8BN

Shares Out. (MM): 449.5

Float (MM): 283.1

Avg. Daily Vol.: 1,031,194

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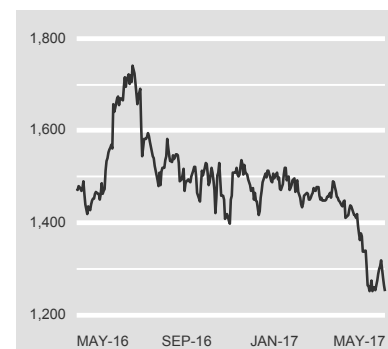
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Price Performance

^Prior trading day's closing price unless otherwise noted.

Other highlights

- The quarter included cost of Rs 1559mn for the settlement of litigation for Isabelle for Australia
- Management aims to keep R&D spend stable at 13.5%
- EBITDA guidance for FY18 is 26-28%;
- On the pricing pressure US business, management indicated that the base business experienced single digit price erosion.
- Management expects double digit growth only in FY19. The medium term target of USD 3.5bn revenue is now pushed to FY20 from FY18 earlier.
- It expects 30+ approvals in FY18.
- On the speciality side, the company's focus is on Women's health, CNS and paediatrics
- It is looking for M&A targets in speciality with focus on Women's health, CNS and Paediatrics. Ideally it would like to do multiple \$100-200mn range acquisitions.
- Lupin will Invest R&D spend on biosimilars in few products, as the management believes the market is yet to evolve
- Advair: The PK trials are ongoing. Lupin is doing additional studies based on the recent CRL to peers. The management expects to file in next fiscal in the best case
- Tamiflu: They had to redo the BE studies due to issues at CRO. Management expects to get approval in the next 6months.
- Sevlema franchise (Renvela and Renagel) – Management expects launch only endFY19 as will take till end of FY18 to respond to CRL
- Proair: The TAD is for September this year.
- Lupin experienced pricing pressure in both Glumetza and Fortamet. In case of Glumetza, there was additional competition from the AG from Feb, which led to pricing pressure. In Fortamet, there was significant price erosion with the entry of Mylan late last year.

Exhibit 1: Operationally weak, led by US and R&D expenses

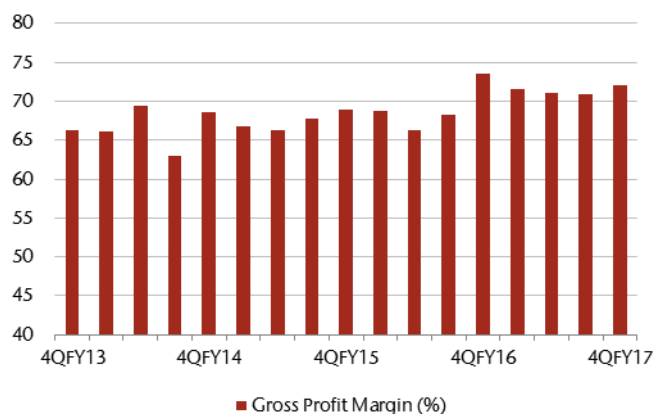
	4QFY17	4QFY16	YoY (%)	3QFY17	4QFY17E	vs. Est (%)
Revenues	42,533	41,707	2.0	44,829	44,899	-5.3
Raw Material	11,851	11,010	7.6	13,016	13,236	-10.5
Gross Profit	30,682	30,698	-0.1	31,813	31,663	-3.1
Employee Cost	7,078	5,779	22.5	7,312	7,531	-6.0
Other operating Exp	14,232	11,868	19.9	12,343	12,903	10.3
EBITDA	9,373	13,050	-28.2	12,158	11,229	-16.5
<i>EBITDA Margin (%)</i>	22.0	31.3	-925 bps	27.1	25.0	-297 bps
EBIT	6,698	11,563	-42.1	9,849	8,820	-24.1
PBT	6,746	11,699	-42.3	10,426	8,861	-23.9
Tax	1,367	4,188	-67.4	4,095	2,481	-44.9
PAT	3,802	7,479	-49.2	6,331	6,380	-40.4

Source: Jefferies estimates, company data

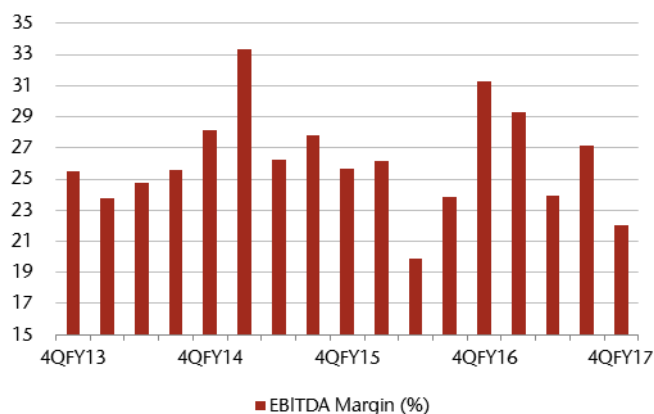
Exhibit 2: US revenues down over 13% YoY

	4QFY17	4QFY16	YoY (%)	3QFY17	QoQ (%)	4QFY16E	vs. Est (%)
Revenues (in Rs mn)	41,851	41,015	2.0	44,271	-5.5	44,352	-5.6
Formulation Sales	39,036	38,171	2.3	41,587	-6.1	41,422	-5.8
US + EU	20,236	23,317	-13.2	22,971	-11.9	23,053	-12.2
FTF	5,965	10,303	-42.1	8,395	-28.9	7,546	-20.9
US	19,007	21,905	-13.2	21,755	-12.6	21,824	-12.9
EU	997	1,220	-18.3	993	0.3	997	0.0
Japan	4,680	3,449	35.7	4,474	4.6	5,019	-6.8
India	8,788	7,561	16.2	9,912	-11.3	8,605	2.1
EM	5,332	3,844	38.7	4,230	26.0	4,745	12.4
SA	1,646	1,135	45.1	1,114	47.8	1,372	20.0
API	2,815	2,844	-1.0	2,684	4.9	2,929	-3.9

Source: Jefferies estimates, company data

Exhibit 3: On a QoQ basis, gross margins marginally improve...

Source: Jefferies estimates, company data

Exhibit 4: ... while EBITDA margins sharply deteriorate, the latter owing to R&D expenses

Source: Jefferies estimates, company data

Exhibit 5: Changes to estimates

	Old			New			% change		
	FY17E	FY18E	FY19E	FY17E	FY18E	FY19E	FY17E	FY18E	FY19E
Sales	178,212	206,935	231,928	174,943	187,318	220,195	-1.8	-9.5	-5.1
Operating profit	45,520	51,861	56,615	46,491	44,494	53,917	2.1	-14.2	-4.8
OP margin (%)	25.5	25.1	24.4	26.6	23.8	24.5	107 bps	-135 bps	9 bps
Net profit	27,642	29,747	33,829	27,134	24,631	30,557	-1.8	-17.2	-9.7
NP margin (%)	15.5	14.4	14.6	15.5	13.1	13.9	1 bps	-125 bps	-72 bps
EPS	61.5	66.2	75.3	60.4	54.8	68.0	-1.8	-17.2	-9.7
EPS growth (%)	17.9	7.6	13.7	20.0	-9.2	24.1	212 bps	-1683 bps	1036 bps
DPS	8.8	9.5	10.8	7.5	8.2	10.1	-14.8	-14.0	-6.1
ROE (%)	20.7	18.5	17.9	20.1	15.8	16.8	-60 bps	-271 bps	-111 bps

Source: Jefferies estimates, company data

Financials

Exhibit 6: Profit and Loss Statement

Rs mn	2015	2016	2017	2018E	2019E
Net Sales	127,700	142,555	174,943	187,318	220,195
<i>Change (%)</i>	13.1	11.6	22.7	7.1	17.6
Material Cost	41,570	43,326	50,014	56,456	64,638
Employee Cost	17,473	21,416	28,495	33,339	39,007
SG&A	21,472	24,922	26,842	28,373	33,644
R&D Expenses	10,988	16,038	23,101	24,656	28,989
EBITDA	36,196	36,853	46,491	44,494	53,917
<i>% of net sales</i>	28.3	25.9	26.6	23.8	24.5
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Depreciation	4,347	4,871	9,122	11,648	12,627
Interest	98	595	1,525	1,627	1,627
Other Income	2,398	1,852	1,065	2,549	2,181
EO Income / (Exp)	-1,210	0	-1,559	0	0
PBT	34,148	33,239	36,909	33,769	41,845
Tax	9,704	10,593	9,785	9,118	11,298
<i>Rate (%)</i>	28.4	31.9	26.5	27.0	27.0
Minority Interest	412	39	-10	21	-10
PAT	22,822	22,607	25,575	24,631	30,557
Adjusted PAT	24,032	22,607	27,134	24,631	30,557
<i>change (%)</i>	30.9	-5.9	20.0	-9.2	24.1

Source: Jefferies estimates, company data

Exhibit 7: Balance Sheet Statement

Rs mn	2015	2016	2017	2018E	2019E
Share Capital	899	901	903	903	903
Minority Interest	241	321	345	335	325
Reserves	87,842	110,733	134,073	155,055	181,086
Net Worth	88,982	111,955	135,321	156,293	182,314
Deferred Tax Lia	2,024	3,267	3,949	3,949	3,949
Loans	5,371	71,193	79,521	79,521	79,521
Capital Employed	96,377	186,414	218,791	239,763	265,784
Gross Fixed Assets	67,011	116,737	157,667	176,396	189,396
Less: Depreciation	23,329	27,715	36,457	48,104	60,731
Net Fixed Assets	43,682	89,023	121,210	128,291	128,664
Capital WIP	5,760	27,024	21,331	12,737	12,737
Investments	16,584	164	21,361	21,361	21,361
Deferred Tax Asset	842	4,036	6,434	6,434	6,434
Current Assets	64,510	107,855	106,618	120,991	152,221
Inventory	25,036	32,737	36,423	40,962	46,898
Debtors	26,566	45,488	43,073	46,120	51,882
Cash & Bank Balance	4,814	8,218	6,994	13,455	27,284
Loans & Advances	8,095	21,414	20,128	20,454	26,157
Current Liabilities	35,001	39,834	47,282	49,953	55,437
Creditors	16,799	19,888	25,889	28,357	32,963
Other Liabilities	12,459	16,689	15,699	16,272	16,272
Provisions	5,743	3,257	5,694	5,324	6,202
Net Current Assets	29,509	68,021	59,336	71,038	96,784
Appl. Of fund	96,377	188,268	229,671	239,861	265,980

Source: Jefferies estimates, company data

Exhibit 8: Cash Flow Statement

(Rs mn)	2015	2016	2017	2018E	2019E
PAT	22,822	22,607	25,575	24,631	30,557
Depreciation	4,347	4,871	9,122	11,648	12,627
Interest Exp	98	595	1,525	1,627	1,627
Other Income	2,398	1,852	1,065	2,549	2,181
Change in Wkg Capital	-24,661	-36,555	-11,412	-23,563	-18,321
CF from Op Activities	31,522	-10,838	40,903	30,114	30,713
Change in Fixed Assets	-17,192	-69,623	-26,588	-21,016	-13,000
Change in Investments	-14,799	16,421	-21,198	0	0
Other Income	2,398	1,852	1,065	2,549	2,181
CF from Investing Activities	-29,593	-51,351	-46,721	-18,466	-10,819
Change in equity	-426	82	0	0	0
Changes in debt	-1,166	65,822	8,328	0	0
Interest Exp	-98	-595	-1,525	-1,627	-1,627
Dividend paid	-3,348	-3,348	-4,018	-3,648	-4,526
Others	-51	3,632	1,871	88	88
CF from Financing Activities	-5,090	65,593	4,656	-5,187	-6,065
Net change in Cash	-3,162	3,404	-1,162	6,461	13,829

Source: Jefferies estimates, company data

Exhibit 9: Key Ratios

	2015	2016	2017	2018E	2019E
Basic (Rs)					
EPS	53.5	50.3	60.4	54.8	68.0
BPS	197.4	247.8	299.6	346.1	403.9
DPS	7.5	7.5	7.5	8.2	10.1
Payout (%)	14.0	14.9	12.4	14.9	14.9
Valuation (X)					
P/E	23.0	24.4	20.3	22.4	18.1
P/B	6.2	5.0	4.1	3.5	3.0
EV/EBITDA	15.1	14.8	11.8	12.3	10.1
EV/Sales	4.3	3.8	3.1	2.9	2.5
Dividend Yield (%)	0.6	0.6	0.6	0.7	0.8
Profit Ratios (%)					
RoE	27.1	20.3	20.1	15.8	16.8
RoCE	24.9	12.2	13.0	10.6	12.6
Turnover Ratios					
Debtor Days	76	116	90	90	86
Inventory Days	220	276	266	265	265
Creditor Days	83	86	95	95	95
Net Debt to Equity	-0.2	0.6	0.4	0.3	0.2

Source: Jefferies estimates, company data

Company Description

Lupin is a global pharmaceutical company. It has presence in 70 countries with its major markets being India, US, Japan and South Africa. In USA it has presence both in branded and generic markets.

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(Article 3(1)e and Article 7 of MAR)

Recommendation Published , 16:50 ET. May 24, 2017
Recommendation Distributed , 16:50 ET. May 24, 2017

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Buy - Describes securities that we expect to provide a total return (price appreciation plus yield) of 15% or more within a 12-month period.

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Underperform - Describes securities that we expect to provide a total return (price appreciation plus yield) of minus 10% or less within a 12-month period.

The expected total return (price appreciation plus yield) for Buy rated securities with an average security price consistently below \$10 is 20% or more within a 12-month period as these companies are typically more volatile than the overall stock market. For Hold rated securities with an average security price consistently below \$10, the expected total return (price appreciation plus yield) is plus or minus 20% within a 12-month period. For Underperform rated securities with an average security price consistently below \$10, the expected total return (price appreciation plus yield) is minus 20% or less within a 12-month period.

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LPC IN

Target | Estimate Change

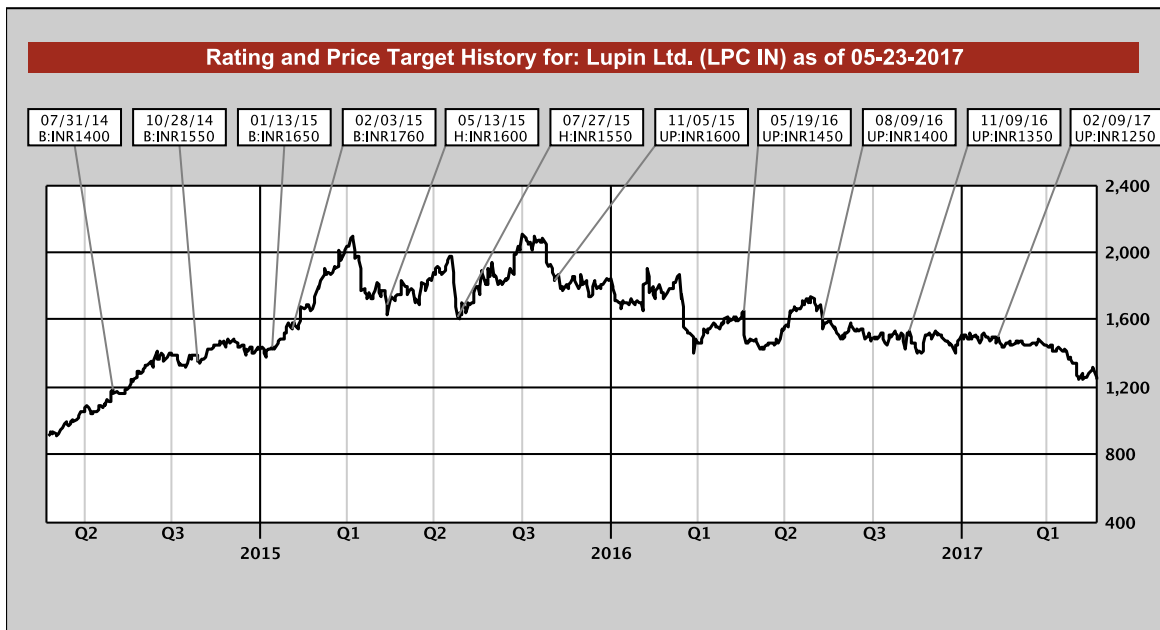
24 May 2017

Risks which may impede the achievement of our Price Target

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Other Companies Mentioned in This Report

- Lupin Ltd. (LPC IN: INR1,227.65, UNDERPERFORM)



Notes: Each box in the Rating and Price Target History chart above represents actions over the past three years in which an analyst initiated on a company, made a change to a rating or price target of a company or discontinued coverage of a company.

Legend:

I: Initiating Coverage

D: Dropped Coverage

B: Buy

H: Hold

UP: Underperform

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Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY	1088	50.23%	338	31.07%
HOLD	911	42.06%	176	19.32%
UNDERPERFORM	167	7.71%	13	7.78%

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