

## One more step down in margins

Lupin's poor 1QFY18 numbers (9% topline and 25% Ebitda miss) calls further downward revision in sustainable US revenue and overall profitability. Quarterly runrate in the US has fallen to ~\$250m from peak \$328m in 1QFY17 and overall Ebitda margin has contracted to 19-20% from peak 31% in 4QFY16. This shows that the risk that we always worried about – the step down in profitability as the large one-off products fade out – is playing out. While there are interesting product launches scheduled over the next 12 months, we do not see them taking the profitability significantly up from current levels. We cut our FY18 / FY19 earnings by 19-24%. Slower growth and fall in return ratios call for valuation de-rating as well. Maintain SELL with revised price target of Rs 917.

**US re-basing worse than earlier thought:** Historic profit contribution from select one-off products such as generic Fortamet and Glumetza, it turns out, had been significantly higher than what street used to estimate. With no large products to replace them, the US business is re-basing to significantly lower level. Tough pricing environment in most products in the US generics market and no significant pick up in Gavis pipeline make the base business outlook muted.

**Japan remains weak; GST impact in India:** Japan revenue, in our estimate, declined marginally YoY, excluding the benefit of acquired Shionogi brands. No major pick up expected. India was flat YoY; expect next three quarters to compensate for this. EMEA did well with 15% growth YoY; but RoW was down 5% YoY.

**Step down in 'sustainable margin':** As the one-off limited competition products faded away in the US, Lupin's Ebitda margin has come off from the 28-30% range. It seems settling down at 18-20% range; we will wait one more quarter to assess the sustainable margins. Even then, the 24-25% Ebitda margin that we had built into our projections seem too high; reducing this to ~22%.

**Lowering estimates by 19-24%:** We lower our FY18/19 core earnings estimate by 19-24%. Lupin shares trade at c.25x 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 coming off to mid-high-teens from prior 30%+; we expect significant correction in valuation multiples. Our TP of Rs917 is 18x FY19e core earnings plus cash per share.

### Financial summary

Y/E Mar (Rsmn)	FY15	FY16	FY17	FY18e	F19e
Net sales	1,27,700	1,42,085	1,74,943	1,73,481	1,93,628
EBITDA margin (%)	28%	26%	25%	22%	23%
Adjusted net profit vs. consensus (%)	24,033	22,707	25,574	19,190	23,326
				(40)	(37)
Free cash flow				16,409	10,969
EPS (Rs)	53.2	50.2	56.5	42.0	51.0
growth (%)	31%	-6%	13%	-26%	21%
P/E (x)	19.7	20.9	18.5	24.9	20.5
P/B (x)	5.3	4.3	3.5	3.2	2.8
EV/EBITDA (x)	14.8	14.2	12.3	14.2	12.0
D/E	(0.2)	0.6	0.4	0.3	0.2
RoE	30.2%	22.8%	20.8%	13.4%	14.6%
RoCE	37.2%	23.8%	17.2%	12.9%	15.6%
Dividend yield	0.7%	0.7%	0.7%	0.7%	0.7%

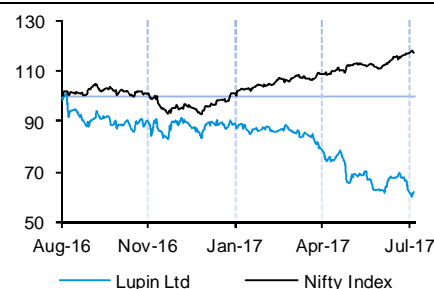
Source: Company, SSLe

Rating	Target Price (Rs)	Upside/Downside (%)
<b>SELL</b>	<b>917</b>	<b>(12)</b>

### Market data

Current price	Rs	1,046
Mkt capitalisation	USDm	7417.4
Average daily value 3M	USDm	37.1
Free float	%	49.2
Foreign holding	%	32.6

### 1 Year Performance



Source: Bloomberg, SSLe

**Bino Pathiparampil**  
 +91 22 4348 7167  
 bino.pathiparampil@sbicapsec.com

## Quarterly financials

Particulars (Rs mn)	1QFY17	1QFY18	YoY (%)	4QFY17	QoQ (%)	1QFY18e	Var (%)
<b>Total revenue</b>	<b>44,394</b>	<b>38,696</b>	<b>(12.8)</b>	<b>42,533</b>	<b>(9.0)</b>	<b>42,547</b>	<b>(9.1)</b>
COGS	12,720	12,326	(3.1)	11,851	4.0	12,041	2.4
% of revenues	28.7	31.9	320.1	27.9	399.1	28.3	355.3
Personnel exp	7,059	7,180	1.7	7,078	1.4	7,318	(1.9)
% of revenues	15.9	18.6	265.4	16.6	191.4	17.2	135.5
Mfg. & Others	6,541	6,507	(0.5)	9,082	(28.4)	7,871	(17.3)
% of revenues	14.7	16.8	208.2	21.4	(453.6)	18.5	(168.4)
R&D	4,994	4,999	0.1	6,709	(25.5)	5,106	(2.1)
% of revenues	11.2	12.9	166.9	15.8	(285.5)	12.0	91.9
<b>EBITDA</b>	<b>13,080</b>	<b>7,684</b>	<b>(41.3)</b>	<b>7,814</b>	<b>(1.7)</b>	<b>10,211</b>	<b>(24.7)</b>
<b>EBITDAM (%)</b>	<b>29.5</b>	<b>19.9</b>	<b>-961 bps</b>	<b>18.4</b>	<b>149 bps</b>	<b>24.0</b>	<b>-414 bps</b>
D&A	2,027	2,605	28.5	2,674	(2.6)	2,469	5.5
<b>EBIT</b>	<b>11,053</b>	<b>5,079</b>	<b>(54.0)</b>	<b>5,140</b>	<b>(1.2)</b>	<b>7,742</b>	<b>(34.4)</b>
<b>EBITM (%)</b>	<b>24.9</b>	<b>13.1</b>	<b>-1177 bps</b>	<b>12.1</b>	<b>104 bps</b>	<b>18.2</b>	<b>-507 bps</b>
Other income	826	320	(61.3)	453	(29.4)	352	(9.0)
Interest cost	320	439	37.3	406	8.1	398	10.4
<b>PBT</b>	<b>11,559</b>	<b>4,960</b>	<b>(57.1)</b>	<b>5,187</b>	<b>(4.4)</b>	<b>7,697</b>	<b>(35.6)</b>
Tax	2,734	1,368	(50.0)	1,367	0.1	2,155	(36.5)
% Tax rate	23.7	27.6	392.8	26.4	122.9	28.0	(41.9)
Minorities / Associates	(6)	(11)	83.3	(18)	(38.2)	15	(171.5)
<b>Adjusted Net profit</b>	<b>8,819</b>	<b>3,581</b>	<b>(59.4)</b>	<b>3,802</b>	<b>(5.8)</b>	<b>5,557</b>	<b>(35.6)</b>
Exceptional items	0	0	na	0	na	0	na
Reported Net profit	8,819	3,581	(59.4)	3,802	(5.8)	5,557	(35.6)
<b>Adjusted EPS</b>	<b>19.5</b>	<b>7.8</b>	<b>(59.7)</b>	<b>8.4</b>	<b>(6.5)</b>	<b>12.2</b>	<b>(35.6)</b>

Source: Company, SSLe

# Financials

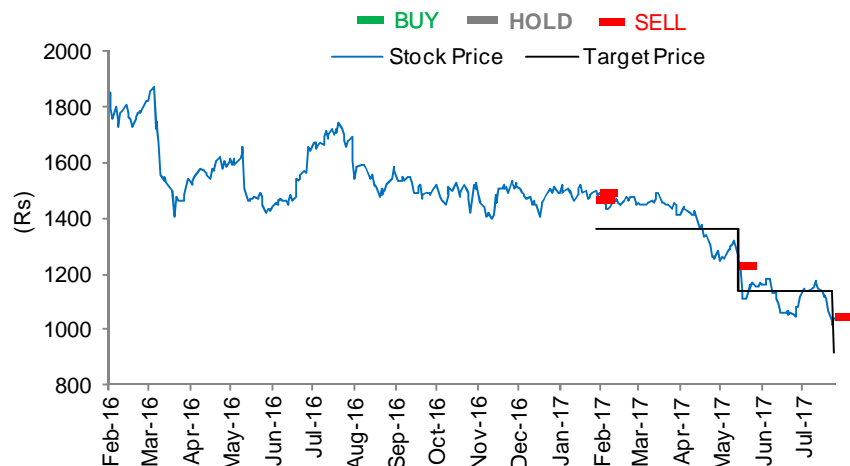
Income statement						Balance sheet					
Y/E Mar (Rs mn)	FY15	FY16	FY17	FY18e	FY19e	Y/E Mar (Rs mn)	FY15	FY16	FY17	FY18e	FY19e
<b>Revenue</b>	<b>127,700</b>	<b>142,085</b>	<b>174,943</b>	<b>173,481</b>	<b>193,628</b>	Cash & bank balance	21,372	8,399	28,135	17,536	13,953
<i>growth (%)</i>	13%	11%	23%	-1%	12%	Other current assets	56,951	89,391	91,407	91,945	102,623
Operating expenses	91,504	104,550	131,610	135,740	149,258	Net fixed assets	32,031	59,625	53,513	115,979	122,731
<b>EBITDA</b>	<b>36,196</b>	<b>37,535</b>	<b>43,333</b>	<b>37,741</b>	<b>44,371</b>	Goodwill and intangible assets	17,411	56,398	78,147	23,100	23,100
<i>growth (%)</i>	21%	4%	15%	-13%	18%	Other non-current assets	3,612	10,564	14,871	14,871	14,871
Depreciation & amortisation	4,347	4,635	9,122	10,580	11,248	<b>Total assets</b>	<b>131,377</b>	<b>224,378</b>	<b>266,073</b>	<b>263,432</b>	<b>277,279</b>
<b>EBIT</b>	<b>31,849</b>	<b>32,900</b>	<b>34,211</b>	<b>27,161</b>	<b>33,122</b>	Current liabilities	32,909	35,764	38,163	42,758	47,016
Other income (net)	2,398	1,877	1,065	1,407	614	Borrowings	5,402	71,848	79,521	57,167	47,511
Interest expenses	98	446	1,525	1,988	1,429	Other non-current liabilities	4,085	6,602	13,068	13,068	13,068
<b>PBT</b>	<b>34,149</b>	<b>34,331</b>	<b>33,751</b>	<b>26,579</b>	<b>32,307</b>	<b>Total liabilities</b>	<b>42,396</b>	<b>114,213</b>	<b>130,752</b>	<b>112,993</b>	<b>107,596</b>
Tax	9,704	11,536	9,785	7,421	9,046	<b>Shareholders' funds</b>	88,741	109,844	134,976	150,126	169,435
<i>Effective tax rate (%)</i>	28%	34%	29%	28%	28%	Minority interest	241	321	345	313	248
<b>Profit after tax</b>	<b>24,445</b>	<b>22,795</b>	<b>23,966</b>	<b>19,158</b>	<b>23,261</b>	<b>Total equity &amp; liabilities</b>	<b>131,377</b>	<b>224,378</b>	<b>266,073</b>	<b>263,432</b>	<b>277,279</b>
Minority interest	(412)	(88)	(32)	32	65						
<b>Adjusted net profit</b>	<b>24,033</b>	<b>22,707</b>	<b>23,934</b>	<b>19,190</b>	<b>23,326</b>						
Non-recurring items	-	-	-	-	-						
<b>Reported net profit</b>	<b>24,033</b>	<b>22,707</b>	<b>23,934</b>	<b>19,190</b>	<b>23,326</b>						
<i>growth (%)</i>	31%	-6%	5%	-20%	22%						

Financial ratios						Cash flow statement					
Y/E Mar	FY15	FY16	FY17	FY18e	FY19e	Y/E Mar (Rs mn)	FY15	FY16	FY17	FY18e	FY19e
<b>Profitability and return ratio (%)</b>						PBT / PAT	34,148	34,330	35,431	19,190	23,326
EBITDAM	28%	26%	25%	22%	23%	Depreciation & amortisation	4,347	4,635	9,122	10,580	11,248
EBITM	25%	23%	20%	16%	17%	Chg in working capital	(949)	(31,537)	5,059	4,057	(6,420)
NPM	19%	16%	14%	11%	12%	Other operating activities	(10,216)	(11,119)	(8,465)	581	815
RoE	30%	23%	21%	13%	15%	<b>Operating CF</b>	<b>27,331</b>	<b>(3,690)</b>	<b>41,148</b>	<b>34,409</b>	<b>28,969</b>
RoCE	37%	24%	17%	13%	16%	Capital expenditure	(8,676)	(57,746)	(26,007)	(18,000)	(18,000)
RoIC	46%	27%	19%	14%	17%	Chg in investments					
						Other investing activities	(6,294)	(12,223)	-	-	-
<b>Per share data (Rs)</b>						<b>Investing CF</b>	<b>(14,970)</b>	<b>(69,968)</b>	<b>(26,007)</b>	<b>(18,000)</b>	<b>(18,000)</b>
O/s shares (mn)	449	450	451	452	453	<b>FCF</b>	<b>12,361</b>	<b>(73,658)</b>	<b>15,141</b>	<b>16,409</b>	<b>10,969</b>
EPS	53.5	50.5	53.1	42.4	51.5	Equity raised/(repaid)	413	536	427	-	-
FDEPS	53.2	50.2	52.8	42.0	51.0	Debt raised/(repaid)	(700)	62,081	9,479	(22,354)	(9,655)
CEPS	63.1	60.7	73.3	65.8	76.3	Dividend (incl. tax)	(1,573)	(4,055)	(4,066)	(4,072)	(4,081)
BV	197.4	244.1	299.2	332.0	373.9	Other financing activities	1,132	2,123	(2,325)	(581)	(815)
DPS	7.5	7.5	7.5	7.5	7.5	<b>Financing CF</b>	<b>(727)</b>	<b>60,685</b>	<b>3,514</b>	<b>(27,008)</b>	<b>(14,552)</b>
						<b>Inc/(dec) in cash &amp; bank bal.</b>	<b>11,633</b>	<b>(12,973)</b>	<b>18,655</b>	<b>(10,599)</b>	<b>(3,583)</b>
<b>Valuation ratios (x)</b>						<b>Closing cash &amp; bank bal.</b>	<b>21,372</b>	<b>8,399</b>	<b>28,135</b>	<b>17,536</b>	<b>13,953</b>
PE	19.6	20.7	19.7	24.6	20.3						
P/BV	5.3	4.3	3.5	3.2	2.8						
EV/EBITDA	14.8	14.2	12.3	14.2	12.0						
EV/Sales	4.2	3.8	3.1	3.1	2.8						
<b>Other ratios</b>											
D/E (x)	(0.12)	0.28	0.19	0.15	0.12						
DSO (days)	75.9	116.9	89.9	91.3	91.3						
<b>Du Pont Analysis - RoE</b>											
NPM (%)	18.8%	16.0%	13.7%	11.1%	12.0%						
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 (%)	30.2%	22.8%	20.8%	13.4%	14.6%						

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
3-Aug-17	1,046	917	SELL

Source: Bloomberg, SSLe

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#### Corporate Office:

Marathon Futurex, A & B Wing, 12<sup>th</sup> Floor, N. M. Joshi Marg, Lower Parel, Mumbai -400013.

Tel.: 91-22-4227 3300/01 | Fax: 91-22-4227 3335 | Email: sbicapresearch@sbicapsec.com | www.sbismart.com

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