

Lupin Ltd.

Weak guidance reflects near-term challenges

Lupin's conference call highlighted a double-digit decline in the US due to competition in gGlumetza (seen largely in 1QFY18), high-single-digit base business pressure and some key launches likely towards end FY18/FY19. This would imply a flat top-line for the company in FY18 and lower gross margins in the near term. While currency headwinds are a risk to margins in the sector, LPC lowered its margin guidance (21-23% vs 26-28% previously) to reflect pressure on the US business, GST impact in 1QFY18 and muted trends in Japan due to recent changes in co-pay. LPC highlighted ~15% lower R&D YoY and expense management in a tough environment as offsets for margin erosion. While we believe Lupin can maintain its launch momentum, these are unlikely to have margins like its metformin portfolio. We believe near-term headwinds in the US and risk of competition in gFortamet will keep the stock under pressure in the near term.

- **Double-digit decline in the US in FY18 but see recovery in FY19:** Lupin highlighted base business growth of 11% QoQ ex metformin portfolio despite being aided by growth in Gavis and existing products. While it maintained its guidance of HSD erosion and gGlumetza impact included in 1Q, the company guided to a double-digit decline in the US (vs our initial estimate of flat QoQ). LPC expects some moderation in 2Q (Minastrin exclusivity ends, some gGlumetza impact), but sees recovery in 2HFY18 aided by new launches. We believe incremental competition in gFortamet remains a risk to US sales. While we expect approval/launch trends to remain strong, LPC needs the limited competition launches to offset pressure from erosion in large products, which looks unlikely in the near term. LPC expects a recovery in the US business in FY19 with a strong pipeline of launches including FTF opportunities.
- **Margin pressure partially offset by R&D and expense management:** LPC revised its margin guidance to 21-23% vs 26-28% previously (JPMe 24% previously) with flat R&D spend YoY. While reported 1Q margins (~20%) were impacted by GST-related disruption in India (normalized ~23%), we believe the revised guidance highlights the pressure on the US business, impact from INR appreciation and lower growth in Japan. However, part of this will be offset by its lower R&D guidance (Rs5bn/qtr vs run rate Rs5.77bn/qtr) and commentary on managing expenses (flat employee cost). We maintain margins of over 22-23% over FY18/19 incorporating a lower US base and strong INR.

Lupin Ltd. (Reuters: LUPN.NS, Bloomberg: LPC IN)

Rs in mn, year-end Mar	FY16A	FY17A	FY18E	FY19E	FY20E
Revenue (Rs mn)	137,579	171,198	169,322	189,404	205,601
EBITDA (Rs mn)	36,854	44,931	37,654	43,650	48,425
Net Profit (Rs mn)	22,607	25,575	19,724	22,973	25,766
EPS (Rs)	49.93	56.46	43.54	50.72	56.88
DPS (Rs)	7.46	7.48	6.09	7.10	7.96
EPS Growth	(6.2%)	13.1%	(22.9%)	16.5%	12.2%
EBITDA Margin	26.8%	26.2%	22.2%	23.0%	23.6%
ROCE	15.5%	12.7%	9.1%	10.0%	10.7%
ROE	22.6%	20.7%	13.8%	14.3%	14.2%
P/E (x)	20.7	18.3	23.8	20.4	18.2

Source: Company data, Bloomberg, J.P. Morgan estimates.

See page 9 for analyst certification and important disclosures, including non-US analyst disclosures.

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Neutral

LUPN.NS, LPC IN

Price: Rs1,034.95

▼ Price Target: Rs1,025.00

Previous: Rs1,275.00

India

Pharmaceuticals & Healthcare Services

Neha Manpuria ^{AC}

(91-22) 6157-3589

neha.x.manpuria@jpmorgan.com

Bloomberg JPMA MANPURIA <GO>

Kevyn H Kadakia, CFA

(91-22) 6157-3250

kevyn.h.kadakia@jpmorgan.com

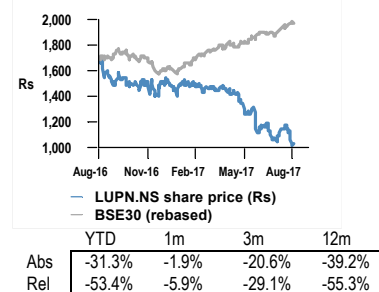
Pinakin Parekh, CFA

(91-22) 6157-3588

pinakin.m.parekh@jpmorgan.com

J.P. Morgan India Private Limited

Price Performance



Company Data

Shares O/S (mn)	453
Market Cap (Rs mn)	468,798
Market Cap (\$ mn)	7,359
Price (Rs)	1,034.95
Date Of Price	02 Aug 17
3M - Avg daily vol (mn)	2.08
3M - Avg daily val (\$ mn)	37.1
BSE30	3,2476.74
Exchange Rate	63.70
Price Target End Date	30-Sep-18

Neha Manpuria
(91-22) 6157-3589
neha.x.manpuria@jpmorgan.com

Asia Pacific Equity Research
03 August 2017

J.P.Morgan

Key catalysts for the stock price:

- Lower-than-expected erosion in key products and base business
- Progress of new launches in the US and pricing trends in key products
- Improvement in growth trends in India

Upside risks to our view:

- Faster approval of the Gavis pending pipeline
- Big-ticket approval for the US generic business
- Higher-than-expected margins due to large launches or lower expenses

Downside risks to our view:

- Delay in approvals of products in the US
- Protracted slowdown in the domestic pharma market
- Regulatory/Litigation risks
- INR appreciation could hurt non-INR revenue

Key financial metrics	FY17	FY18E	FY19E	FY20E
Revenues (LC)	171,198	169,322	189,404	205,601
Revenue growth (%)	24.4	-1.1	11.9	8.6
EBITDA (LC)	44,931	37,654	43,650	48,425
EBITDA margin (%)	26.2	22.2	23.0	23.6
Tax rate (%)	27.7	26.0	27.0	27.0
Net profit (LC)	25,575	19,724	22,973	25,766
EPS (LC)	56.5	43.5	50.7	56.9
EPS growth (%)	13.1	-22.9	16.5	12.2
DPS (LC)	7.5	6.1	7.1	8.0
BVPS (LC)	298.0	334.2	376.4	423.7
Operating cash flow (LC mn)	41,148	33,148	29,341	34,769
Free cash flow (LC mn)	24,521	40,289	15,341	20,769
Interest cover (X)	29.5	21.7	29.3	39.1
Net margin (%)	14.9	11.6	12.1	12.5
Sales/assets (X)	0.9	0.7	0.7	0.7
Debt/equity (%)	0.6	0.5	0.3	0.3
Net debt/equity (%)	0.4	0.2	0.2	0.1
ROE (%)	20.7	13.8	14.3	14.2

Key model assumptions	FY17E	FY18E	FY19E	FY20E
USD/INR	65.5	67.1	65.0	65.0
US Revenue Growth	-0.8	36.5	-10.7	11.5
Japan Revenue Growth	5.7	14.7	27.4	12.7

Source: Company data and J.P. Morgan estimates.

Sensitivity analysis

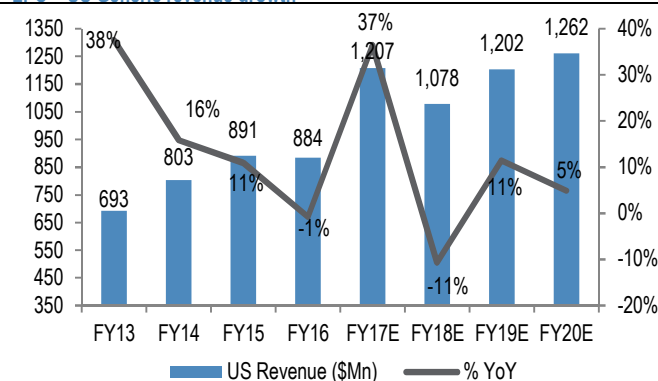
Sensitivity to	EBITDA		EPS	
	FY18E	FY19E	FY18E	FY19E
1% chq in US Generic Revenue	0.7%	0.7%	0.9%	0.9%
1% chq in Japan Revenue	0.2%	0.2%	0.3%	0.3%
1% chq in R&D Expense	0.6%	0.6%	0.8%	0.8%

Source: J.P. Morgan estimates.

Valuation and price target basis

Our Sep-18 PT of Rs1025 (vs. Rs1275 previously as we adjust our numbers post results) is based on a P/E of 19x (vs 20x previously reflecting the tough generic industry in the US), in-line with long-term average of large cap peers. Key risks include earlier-than-expected/delay in approvals in the US, regulatory risk, higher-than-expected pricing erosion, currency and execution of M&A.

LPC – US Generic revenue growth



Source: Bloomberg, Company data and J.P. Morgan estimates.

JPM vs. consensus, change in estimates

EPS	FY18E	FY19E
JPM old	56.6	63.3
JPM new	43.5	50.7
% chg	-23%	-20%
Consensus	57.4	67.6

Source: Bloomberg, J.P. Morgan.

Table 1: Indian Pharma: Valuation summary

	CMP	MCap \$Mn	P/E		EV/EBITDA		P/BV		RoE	
			FY18	FY19	FY18	FY19	FY18	FY19	FY18	FY19
Sun Pharma	516	19,434	21.2	18.5	13.3	11.5	2.9	2.6	16.0	15.7
Dr Reddy's	2,324	6,049	24.7	15.4	13.3	9.1	2.8	2.5	12.0	17.1
Aurobindo	741	6,820	17.0	14.4	11.9	9.9	3.7	3.0	24.2	23.1
Lupin	993	7,047	22.8	19.6	12.9	10.9	3.0	2.6	13.8	14.3
Cipla	557	7,040	27.1	22.5	13.6	11.4	3.2	2.9	12.8	13.8
Cadila	546	8,779	26.1	21.8	19.3	15.9	6.4	5.2	27.1	26.5
Glenmark	702	3,112	18.1	16.7	11.1	10.2	3.3	2.8	20.1	18.3
Alkem	1,788	3,357	23.7	17.7	18.5	14.6	4.1	3.5	18.8	21.6

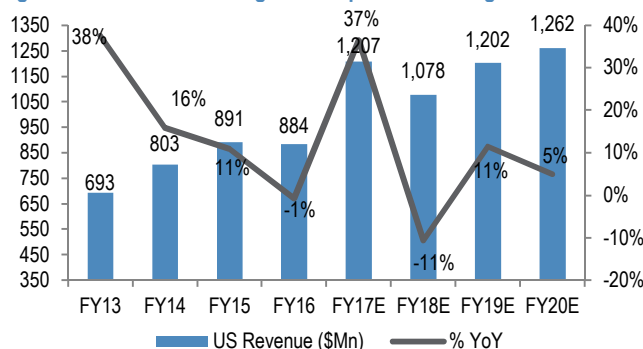
Source: Bloomberg, J.P. Morgan estimates.

Takeaways from Conference Call

- US business:** Pipeline remains strong but pressure in the near term: US business revenues at US\$238mn witnessed a sharp decline of 27%/y/y and 16%/q/q. Excluding gGlumetza, base business grew 9%, and excluding both gGlumetza and gFortamet, base business grew 11% QoQ aided by growth in the Gavis portfolio and gains in existing products. LPC noted that pricing was flat QoQ. Despite new launches, the contribution from these remained small in the quarter. LPC indicated that pricing pressure for the metformin franchise was largely due to competitive pressures rather than buyer consolidation and mostly incorporated in 1QFY18 numbers. Gavis products launched in 4Q saw strong sequential growth, driven by Methergine and upside from capacity expansion. LPC indicated Gavis sales improving to \$200Mn by end FY18 (vs \$110Mn in FY17) with the launch pipeline (controlled-substances and derma) and capacity expansion. Management noted opportunities in the next few quarters driven by Tamiflu (post successful Aurangabad inspection), Lanthanum Carbonate (partnered with Natco and awaiting launch), Levothyroxin (part of FDA list of products for priority approval, PAI inspection in Indore plant done and launch by end of fiscal year), Controlled substance products from Gavis (like Hydrocodone APAP (received commitments from DEA and customers for certain quantities) and derma products. However, management guided that single digit price erosion is likely to continue to be driven by the impact from consolidation of Express Scripts-WBA. For FY18, management guided to a double-digit YoY decline from the US business due to the high base (vs guidance of flat YoY previously). However, this does not include additional competition in gFortamet (lower pricing already reflected in previous results). Based on upcoming product approvals/launches, management was optimistic of a growth revival from FY19, particularly from three first-to-file opportunities namely Renexa, Minocyclin and Moxeza.
- Branded business growth remains strong aided by Methergine:** Management indicated that Methergine grew 48% QoQ aiding 15% growth in US branded business. LPC is focused on building branded specialty portfolio aided by acquisitions. The two key areas of focus in the specialty segment are Women's health (looking to add products) and Neurology (with the ADHD product in the US, Shinogi portfolio in Japan).
- Update on other markets: India** – Despite challenges from GST, India business grew 6% q/q. Management noted that normalized for GST India revenues would have been higher by Rs.1.5bn (14% YoY growth vs reported -2%), while EBITDA margins would have been higher by 200bps to 23%. The company expects IPM growth to remain at similar levels (~8%) with Lupin to outpace industry growth significantly (10-15% growth). Management also indicated higher inventory due to GST impact leading to higher working capital. **Japan** – In our view, Japan business excluding Shionogi declined ~6-8% YoY. Management indicated that April sales in Japan were impacted by higher co-pay announced by the government. However, trends have improved over the last few months with sales expected to normalize in 2Q. **Philippines** sales nearly halved QoQ due to lower tender business in the quarter. **South Africa** revenue was flat QoQ but down 36% QoQ due to stocking in the Mar quarter (before price increases from April).
- Lower R&D guidance but no change in priorities:** R&D at Rs5bn declined sequentially due to lumpiness. However, management indicated that guidance would remain ~Rs5bn/qtr implying a ~15% decline in R&D spend YoY in FY18 (vs previous guidance of flat YoY). LPC indicated that R&D spend on generics remains flat, but it is reducing spend on drug discovery, rationalizing its pipeline

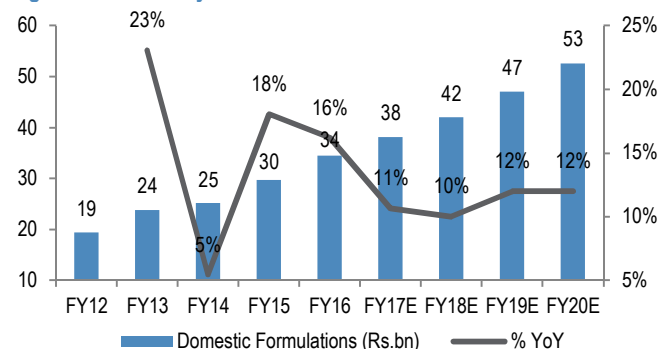
(cutting down project where return lower) and getting a financial partner for its biosimilar development (external funding not marketing partnership). Management noted that they continue to focus on R&D front for building a strong complex generics pipeline including complex injectables. However, for risky biologics product portfolio they would look at external financial partnering opportunities given prevalent market conditions and potential risks. LPC also indicated that R&D productivity would not be marginalized despite filing only one ANDA in 1QFY18 with guidance of 35-40 ANDA filings in FY18 (in-line with FY17) but the majority of the filings will be back-ended in 4QFY18. On the respiratory pipeline, management expects filing of gSpiriva by the end of the fiscal (started PD study), but indicated a few months' delay in gAdvair due to development delays.

Figure 1: FY18 US revenue growth impacted from high base ...



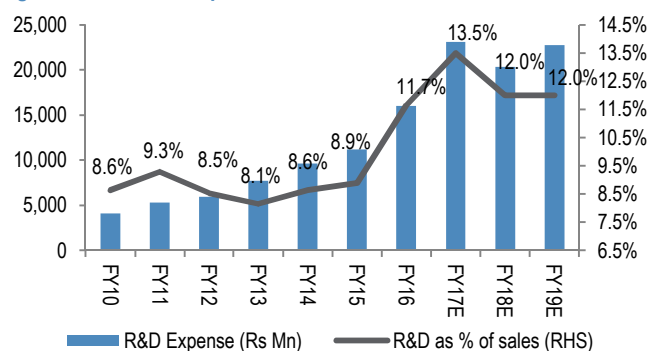
Source: Company reports

Figure 2: ... offset by stable domestic business



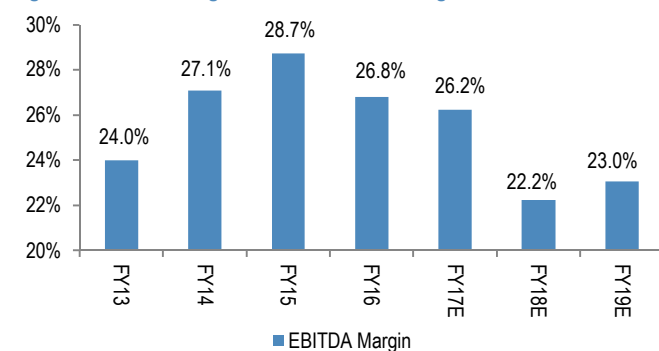
Source: Company reports

Figure 3: Lower R&D spends ...



Source: Company reports

Figure 4: ... not enough to boost EBITDA margins



Source: Company reports

Investment Thesis, Valuation and Risks

Lupin Ltd. *(Neutral; Price Target: Rs1,025.00)*

Investment Thesis

We believe LPC is trading at a premium valuation, given its strong US generics business, despite headwinds in the past and a higher return profile. In our view, the current multiple fairly values the growth pipeline and lack of regulatory issues recently, but not the risk related to sharp erosion in key products and therefore, margin pressure. Further, there could be risks to growth beyond FY18 from delays in key approvals, Gavis execution and evolving long-term organic growth drivers.

Valuation

Our Sep-18 PT of Rs1025 is based on a P/E of 19x, in-line with the long-term average of large cap peers. Key risks include earlier-than-expected/delays in approvals in the US, regulatory risk, higher-than-expected pricing erosion, currency and execution of M&A.

Risks to Rating and Price Target

Key upside risks include accretive business development opportunities and a faster-than-expected ramp-up of approvals in the US and Japan. Downside risks include delays in approvals for the US generics business, regulatory risk and a slow ramp-up of sales in Gavis.

Neha Manpuria
(91-22) 6157-3589
neha.x.manpuria@jpmorgan.com

Asia Pacific Equity Research
03 August 2017

J.P.Morgan

Lupin Ltd.: Summary of Financials

Income Statement						Cash Flow Statement					
	FY16A	FY17A	FY18E	FY19E	FY20E	FY16A	FY17A	FY18E	FY19E	FY20E	
Revenue	137,579	171,198	169,322	189,404	205,601	Cash flow from operating activities	(3,824)	41,148	33,148	29,341	34,769
COGS	(43,326)	(50,014)	(53,336)	(59,662)	(63,736)	o/w Depreciation & amortization	4,871	9,122	10,427	11,957	13,307
Gross profit	94,253	121,184	115,985	129,742	141,865	o/w Changes in working capital	(31,264)	5,059	1,188	(7,148)	(5,613)
SG&A	(24,922)	(28,402)	(29,631)	(32,199)	(34,438)	Cash flow from investing activities	(69,617)	(25,287)	7,141	(14,000)	(14,000)
Adj. EBITDA	36,854	44,931	37,654	43,650	48,425	o/w Capital expenditure	(11,681)	(16,634)	(14,000)	(14,000)	(14,000)
D&A	(4,871)	(9,122)	(10,427)	(11,957)	(13,307)	as % of sales	8.5%	9.7%	8.3%	7.4%	6.8%
Adj. EBIT	31,982	35,809	27,227	31,693	35,119	Cash flow from financing activities	58,364	4,332	(14,962)	(15,089)	(15,276)
Net Interest	(595)	(1,525)	(1,738)	(1,488)	(1,238)	o/w Dividends paid	(4,055)	(4,066)	(3,322)	(3,869)	(4,340)
Adj. PBT	33,239	35,349	26,639	31,455	35,281	o/w Shares issued/(repurchased)	2	2	0	0	0
Tax	(10,593)	(9,785)	(6,926)	(8,493)	(9,526)	o/w Net debt issued/(repaid)	-	-	(10,140)	(10,000)	(10,000)
Minority Interest	(88)	(72)	(72)	(72)	(72)	Net change in cash	(15,077)	20,193	25,327	252	5,493
Adj. Net Income	22,607	25,575	19,724	22,973	25,766	Free cash flow to firm	(15,100)	25,617	20,434	16,427	21,672
Reported EPS	49.93	56.46	43.54	50.72	56.88	y/y Growth	(180.6%)	(269.6%)	(20.2%)	(19.6%)	31.9%
Adj. EPS	49.93	56.46	43.54	50.72	56.88						
DPS	7.46	7.48	6.09	7.10	7.96						
Payout ratio	14.9%	13.2%	14.0%	14.0%	14.0%						
Shares outstanding	453	453	453	453	453						
Balance Sheet						Ratio Analysis					
	FY16A	FY17A	FY18E	FY19E	FY20E	FY16A	FY17A	FY18E	FY19E	FY20E	
Cash and cash equivalents	8,218	6,994	32,321	32,573	38,066	Gross margin	68.5%	70.8%	68.5%	68.5%	69.0%
Accounts receivable	45,488	43,073	42,601	47,654	51,729	EBITDA margin	26.8%	26.2%	22.2%	23.0%	23.6%
Inventories	32,737	36,423	36,024	40,296	43,742	EBIT margin	23.2%	20.9%	16.1%	16.7%	17.1%
Other current assets	12,412	11,910	11,781	13,160	14,272	Net profit margin	16.4%	14.9%	11.6%	12.1%	12.5%
Current assets	98,874	119,542	122,727	133,683	147,809	ROE	22.6%	20.7%	13.8%	14.3%	14.2%
PP&E	91,539	108,560	112,133	114,176	114,870	ROA	12.6%	10.4%	7.3%	8.2%	8.8%
LT investments	662	985	985	985	985	ROCE	15.5%	12.7%	9.1%	10.0%	10.7%
Other non current assets	35,174	36,986	36,986	36,986	36,986	SG&A/Sales	18.1%	16.6%	17.5%	17.0%	16.8%
Total assets	226,249	266,073	272,831	285,830	300,649	Net debt/Equity	60.1%	57.3%	27.7%	18.6%	8.5%
Short term borrowings	18,036	23,183	23,043	23,043	23,043	Net debt/EBITDA	182.5%	172.5%	111.6%	72.8%	33.6%
Payables	19,888	25,889	25,605	28,642	31,092	Sales/Assets (x)	0.8	0.7	0.6	0.7	0.7
Other short term liabilities	12,687	12,134	12,605	13,124	13,694	Assets/Equity (x)	1.8	2.0	1.9	1.7	1.6
Current liabilities	50,612	61,206	61,254	64,809	67,829	Interest cover (x)	62.0	29.5	21.7	29.3	39.1
Long-term debt	57,423	61,302	51,302	41,302	31,302	Operating leverage	4.6%	49.0%	2186.5%	138.3%	126.4%
Other long term liabilities	6,260	8,244	8,553	8,893	9,266	Tax rate	31.9%	27.7%	26.0%	27.0%	27.0%
Total liabilities	114,294	130,752	121,108	115,003	108,397	Revenue y/y Growth	9.2%	24.4%	(1.1%)	11.9%	8.6%
Shareholders' equity	111,634	134,976	151,378	170,482	191,907	EBITDA y/y Growth	1.8%	21.9%	(16.2%)	15.9%	10.9%
Minority interests	321	345	345	345	345	EPS y/y Growth	(6.2%)	13.1%	(22.9%)	16.5%	12.2%
Total liabilities & equity	226,249	266,073	272,831	285,830	300,649						
BVPS						Valuation					
	FY16A	FY17A	FY18E	FY19E	FY20E	FY16A	FY17A	FY18E	FY19E	FY20E	
BVPS	246.55	297.98	334.19	376.37	423.67	P/E (x)	20.7	18.3	23.8	20.4	18.2
y/y Growth	25.5%	20.9%	12.2%	12.6%	12.6%	P/BV (x)	4.2	3.5	3.1	2.7	2.4
Net debt/(cash)	67,241	77,491	42,024	31,772	16,279	EV/EBITDA (x)	14.6	12.2	13.6	11.5	10.0
						Dividend Yield	0.7%	0.7%	0.6%	0.7%	0.8%

Source: Company reports and J.P. Morgan estimates.

Note: Rs in millions (except per-share data). Fiscal year ends Mar. o/w - out of which

Neha Manpuria
 (91-22) 6157-3589
 neha.x.manpuria@jpmorgan.com

Asia Pacific Equity Research
 03 August 2017

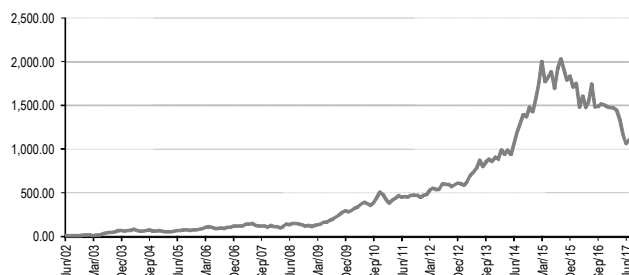
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JPM Q-Profile
Lupin Limited (INDIA / Health Care)
 As Of: 28-Jul-2017

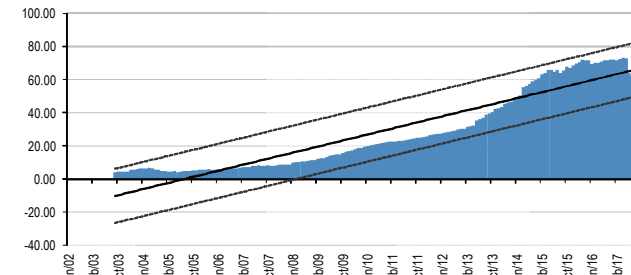
Global Equity Quantitative Analysis

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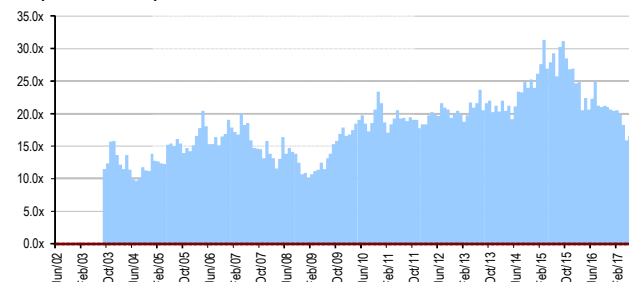
Local Share Price Current: 1111.10



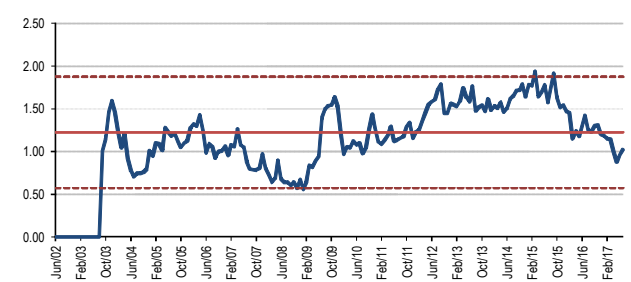
12 Mth Forward EPS Current: 62.40



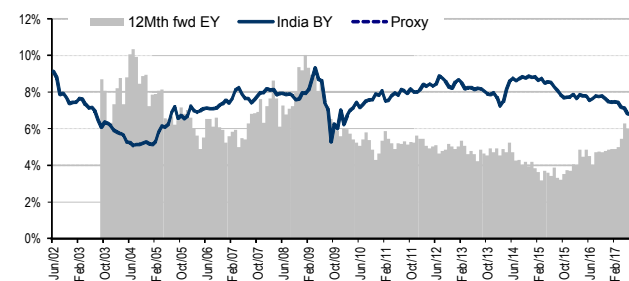
PE (1Yr Forward) Current: 17.8x



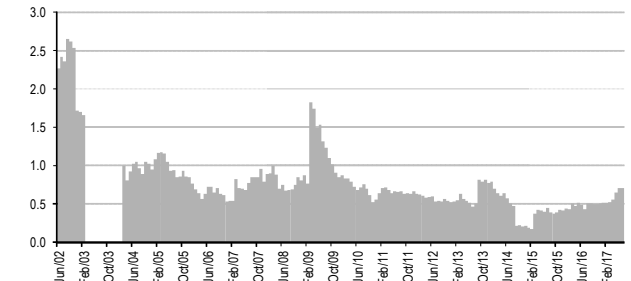
P/E Relative to India Index Current: 1.03



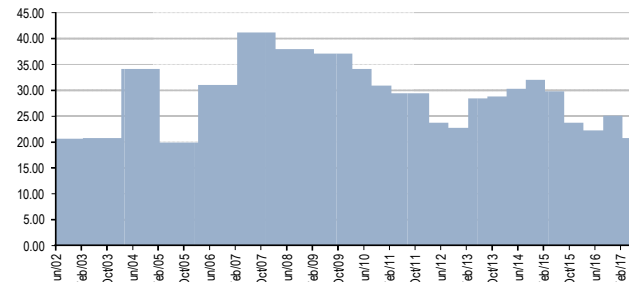
Earnings Yield (& Local Bond Yield) Current: 5.62%



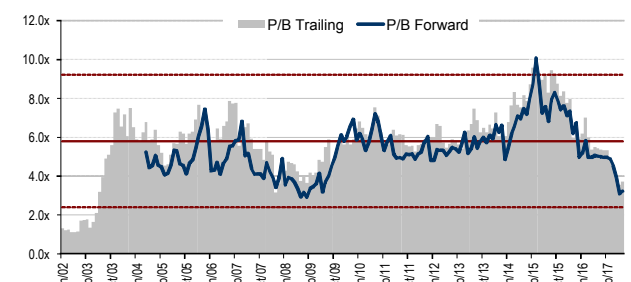
Dividend Yield (Trailing) Current: 0.71



ROE (Trailing) Current: 20.74



Price/Book (Value) Current: 3.7x



Summary

Lupin Limited										As Of: 28-Jul-17			
INDIA		TICKER LPC IN EQUITY								Local Price: 1,111.10			
Health Care										EPS: 62.40			
	Latest	Min	Max	Median	Average	2 S.D.+	2 S.D. -	% to Min	% to Max	% to Med	% to Avg		
12mth Forward PE	17.81x												
P/BV (Trailing)	3.72x	1.12	9.83	5.92	5.80	9.22	2.39	-70%	165%	59%	56%		
Dividend Yield (Trailing)	0.71	0.00	2.65	0.67	0.73	1.66	-0.19	-100%	274%	-5%	4%		
ROE (Trailing)	20.74	19.96	41.24	29.49	29.14	42.30	15.97	-4%	99%	42%	40%		

Source: Bloomberg, Reuters Global Fundamentals, IBES CONSENSUS, JPMorgan Quantitative & Derivative Strategy

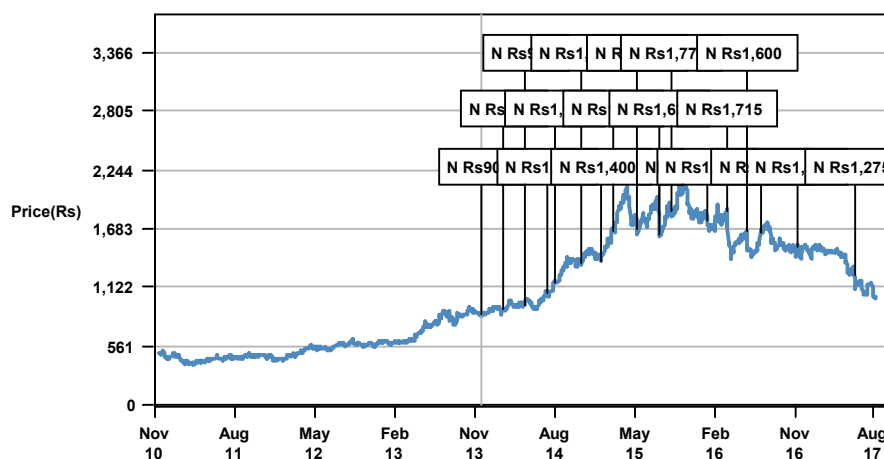
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Lupin Ltd. (LUPN.NS, LPC IN) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
Break in coverage Jul 23, 2015 - Jul 27, 2015.

Date	Rating	Share Price (Rs)	Price Target (Rs)
25-Nov-13	N	850.85	900.00
04-Feb-14	N	921.80	950.00
21-Apr-14	N	955.65	975.00
07-Jul-14	N	1078.10	1000.00
04-Aug-14	N	1165.40	1175.00
29-Oct-14	N	1357.55	1300.00
07-Jan-15	N	1377.60	1400.00
18-Feb-15	N	1662.25	1600.00
14-May-15	N	1689.50	1550.00
23-Jul-15	NR	1823.95	--
27-Jul-15	N	1617.55	1625.00
03-Sep-15	N	1862.35	1775.00
06-Jan-16	N	1753.20	1700.00
11-Mar-16	N	1856.15	1715.00
20-May-16	N	1655.45	1600.00
11-Jul-16	N	1639.15	1650.00
10-Nov-16	N	1507.60	1500.00
25-May-17	N	1250.60	1275.00

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Neha Manpuria
(91-22) 6157-3589
neha.x.manpuria@jpmorgan.com

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IB clients*	52%	50%	31%
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IB clients*	68%	65%	46%

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Neha Manpuria
 (91-22) 6157-3589
 neha.x.manpuria@jpmorgan.com

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Neha Manpuria
(91-22) 6157-3589
neha.x.manpuria@jpmorgan.com

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