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Lupin Ltd.

In Line F2Q; Solid Launches in 2018-22 Drive our OW Rating

✔ Stock Rating

Overweight

◉ Industry View

In-Line

◎ Price Target

Rs1,219.00

Profits appear to be passing through a trough in F1H18, as US business bottoms out. Hereon, operating leverage can play out positively subject to: 1) 1-2 complex US launches every year and 2) mid-teen growth in the non-US business. This, along with reasonable valuations, drives our OW rating.

WHAT'S CHANGED

Lupin Ltd.	From	To
Price Target	Rs1,224.00	Rs1,219.00
FY18/19/20e EPS	down	9.5/9.9/9.6%

Model changes: We cut our F2018, F2019 and F2020 net profit estimates 9.5%, 9.9% and 9.6%, respectively, to account for lower US business (F2Q reset, gGlumetza decline) and lower margins. We arrive at our PT of Rs1,219 (@20x Sep'19 EPSe) by rolling our target multiple forward by 6 months. We expect 1-2 large complex launches every year from now including - levothyroxine (2018), gProair (2019), gRisperdal Consta (2020) etc; which should help drive overall earnings (mid-sized launches to help mitigate base business pricing pressure).

Business Outlook: Overall management guided for 2HF18 to be incrementally better than 1HF18. US business (@US\$204mn in Q2) appears to have bottomed out. It continues to maintain EBITDA margin guidance of ~21-23% (including Solosec) for FY18. India business has recovered post-GST and it should grow at 12-14% on full-year basis. R&D to be capped at Rs5bn per quarter (cutting down investments on NCEs) plus external funding. Specialty pipeline will be augmented inorganically in the near term. Working capital, which shot up in Q2, should improve in 2H18. Tax rate is expected to be between 25-28%. EIR for Goa and Pithampura are expected in the next few months.

US Business: US business declined 15% sequentially largely due to gGlumetza erosion (Teva launched in 2Q17), gMinastrin loss of exclusivity and base business erosion (Claris one consolidation). However, near term, gGlumetza/gFortament market appears to be settling down, according to Lupin. Overall it expects 30 ANDA filings in FY18 (10 in 1HF18) and 20-30 product launches in US. In terms of key launches – gTobi and gTamiflu in FQ3 and FQ4, levothyroxine (targeting 3 RLDs, largest approval expected in FQ4), gAxiron, gRanexa and few controlled substance launches in FY19. Solosec is scheduled for mid-2018 launch (validation batches in next few weeks). gSpiriva should complete phase 3 in FY18, gAdvair – clinical trials to start end of FY18 (post-repeat PK studies) and gProair has TAD mid next year. For F2Q results, please read inside.

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Lupin Ltd. (LUPN.NS, LPC IN)

India Healthcare / India

Stock Rating	Overweight
Industry View	In-Line
Price target	Rs1,219.00
Up/downside to price target (%)	19
Shr price, close (Oct 30, 2017)	Rs1,025.95
52-Week Range	Rs1,573.60-917.55
Sh out, dil, curr (mn)	452
Mkt cap, curr (mn)	Rs463,319
EV, curr (mn)	Rs542,179
Avg daily trading value (mn)	Rs1,859

Fiscal Year Ending	03/17	03/18e	03/19e	03/20e
ModelWare EPS (Rs)	55.64	40.29	55.11	66.82
Prior ModelWare EPS (Rs)	-	44.51	61.19	73.90
Consensus EPS (Rs)§	62.94	43.03	57.13	65.41
Revenue, net (Rs mn)	174,94	161,66	182,84	206,54
	3	0	0	4
EBITDA (Rs mn)	44,932	35,337	44,080	52,943
ModelWare net inc (Rs mn)	25,100	18,195	24,889	30,175
P/E	25.9	25.5	18.6	15.4
P/BV	4.8	3.1	2.7	2.3
RNOA (%)	13.1	8.0	13.6	16.5
ROE (%)	22.5	13.5	16.6	17.5
EV/EBITDA	16.2	13.4	10.3	8.1
Div yld (%)	0.4	0.5	0.5	0.5
FCF yld ratio (%)	(1.5)	15.0	4.6	5.6
Leverage (EOP) (%)	58.2	7.3	(5.1)	(16.7)

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework

§ = Consensus data is provided by Thomson Reuters Estimates

e = Morgan Stanley Research estimates

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Financial Summary

Exhibit 1: Financial Summary

Income Statement				
Income Stat. (Rs mn) YE Mar 31	2017	2018E	2019E	2020E
Net sales	171,198	158,260	180,440	204,144
Other Operating Income	3,745	2,400	2,400	2,400
Total revenues	174,943	161,660	182,840	206,544
Cost of Goods Sold	80,511	88,494	81,553	68,979
Gross Profit	114,432	103,206	121,287	137,564
R&D Expenses	23,101	19,722	22,855	25,611
Personnel Costs	28,495	30,632	33,696	35,717
SG&A	17,304	17,514	20,657	23,293
Operating Profit	44,932	35,337	44,080	52,943
Non-Operating Income	1,065	1,200	1,300	1,400
EBITDA	45,997	36,537	45,380	54,343
Interest Expenses	1,525	1,359	1,353	1,107
Depreciation & Amortization	9,122	9,516	10,816	11,916
Pretax Profit	35,349	25,082	33,171	41,320
Income Tax	9,785	6,898	8,293	11,156
Minority Interest	(11)	(11)	(11)	(11)
Net Profit	25,575	18,195	24,889	30,175
<i>Effective Tax Rate</i>	28%	28%	25%	27%
<i>EPS</i>	56.6	40.3	55.1	66.8
<i>DPS</i>	5.5	5.5	5.5	5.5

Balance Sheet				
Balance Sheet (Rs mn)	2017	2018E	2019E	2020E
Equity Capital	903	903	903	903
Reserves & Surplus	134,073	149,362	171,345	198,613
Networth	134,976	150,265	172,248	199,517
Debt	79,521	72,653	65,653	58,653
Total	218,389	226,800	241,772	262,030
Net Block	87,229	86,525	86,109	81,194
Capital WIP	21,331	15,000	10,000	10,000
Net Fixed Assets	108,560	101,525	96,109	91,194
Goodwill on consolidation	23,100	23,100	23,100	23,100
Investments	220	20	20	20
Cash & Cash Equivalents	6,818	67,670	80,456	97,529
Inventories	36,423	33,218	37,570	42,440
Receivables	43,073	35,432	40,075	45,270
Loans & Advances	41,445	12,933	14,627	16,523
Current Assets	120,941	81,583	92,272	104,234
Less: Current Liabilities & Provisions	41,250	47,498	50,224	54,447
Total	218,389	226,800	241,772	262,030

Cash Flow				
	2017	2018E	2019E	2020E
Profit after tax	25,575	18,195	24,889	30,175
Add : Depreciation	9,122	9,516	10,816	11,916
Extraordinary Items	-	-	-	-
Net change in Wk capital	(14,800)	45,606	(7,963)	(7,739)
Net cash from operations	19,462	73,306	27,731	34,341
Capital Expenditure/Acq	(26,589)	(2,881)	(5,000)	(7,000)
Dec/(Inc) in Investments	(77)	200	-	-
Net cash from Investing	(26,665)	(2,681)	(5,000)	(7,000)
Issue of equity shares	1,510	(0)	(0)	(0)
Dividends paid including dividend tax	-2,906	-2,906	-2,906	-2,906
Net cash from financing	-1,396	-2,906	-2,906	-2,906
Net Inc/(Dec) in Net Debt	8,600	(67,719)	(19,825)	(24,435)
Opening Net Debt	63,267	72,703	4,984	(14,841)
Closing Net Debt	72,703	4,984	(14,841)	(38,276)

Ratios				
	2017	2018E	2019E	2020E
Profitability Ratios				
Gross Margin	65.4%	63.8%	66.3%	66.6%
Operating Margin	25.7%	21.9%	24.1%	25.6%
Valuation Ratios				
P/EV	3.4	3.1	2.7	2.3
EV/EBITDA	7.5	7.6	5.6	4.3
Leverage Ratios				
Net Debt/Equity	0.54	0.03	(0.09)	(0.20)
Total Debt/Equity	0.59	0.48	0.38	0.29
Turnover Ratios				
Inventory (days of net sales)	60	60	60	60
Receivables (days of net sales)	41	41	41	41
Cash cycle (days of net sales)	101	101	101	101
Net working capital (x net sales)	151	128	76	81

Source: Company data, Morgan Stanley Research (E) estimates

Risk Reward

Pipeline Execution Is the Key Valuation Driver



Source: Thomson Reuters, Morgan Stanley Research estimates

Price Target **Rs1,219**

Base case, P/E

Bull **Rs1,493**

Sum-of-the parts

Stronger base business, driven by better-than-expected performance in the US, India (Rs183/share), NDDS/biologicals portfolio (Rs36/share), and one-off large opportunity (Rs54/share).

Base **Rs1,219**

20x Sep F19e EPS

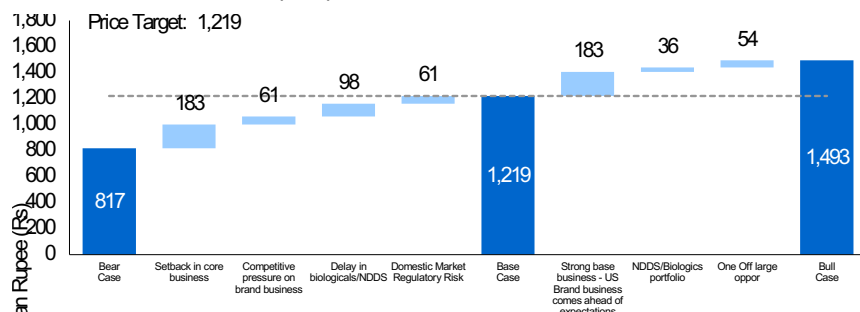
13% sales growth for the base business and 28.8% EPS growth over the next two years (F2019-20e). We apply a P/E multiple of 20x to our Sep F2019 EPS estimate of Rs55.

Bear **Rs817**

Sum-of-the-parts

Setback in core business (Rs183/share), competitive pressure in branded business (Rs61/share), IPR risk (Rs98/share) and domestic market regulatory risk (Rs61/share).

Exhibit 2: Bear to Bull: Multiple Upside Drivers



Source: Morgan Stanley Research estimates

Why Overweight?

- Strong earnings recovery in F19/20e, driven by EM, Japan, and the EU, plus strong US business (new FTF launches, complex OSD should make up for erosion of gGlumetza and gFortamet). In the medium to long term, the US pipeline's potential appears attractive.
- Fully integrated business model with strong API capabilities and marketing and distribution in several country markets.
- Based on our new estimates, P/E looks reasonable at 18.6x F2019e and 15.4x F2020e EPS, especially considering the medium- to long-term potential of the US pipeline and IPR.

Key Value Drivers

- Regulated geographies: Market share gains for existing portfolio, new launches, and EU scale-up.
- Execution on niche therapies, ophthalmics, derma, respiratory, biosimilars, NDDS.
- Domestic market: Entry into newer/more-lucrative therapy areas, including critical care, women's health, and oncology.

Potential Catalysts

- Faster GAVIS ramp (e.g., Methergine).
- Development/regulatory progress of 505(b)(2) candidates/inhaler pipeline in US and Enbrel biosimilar in the EU/Japan.
- Key pending US approvals/launches – Levothyroxine, gRenvela/Renagel, Tamiflu, Lialda, Coreg CR.
- Sales ramp-up in EU, Australia/New Zealand, Japan.

Risks to Achieving Price Target

- FDA actions (such as Import Alerts, Warnings Letters) or adverse regulatory action in EMs (price controls).
- Delay in approvals, value-dilutive M&A, setback in NCE/NDDS research, FX volatility.
- Intense competition in key products, especially gFortamet, and gGlumetza.

Model Changes

We cut our net profit estimates by 9.5/9.9/9.6% for F2018/19/20: This largely reflects lower US sales owing to: a) base business price erosion due to customer consolidation; b) continued decline of gGlumetza and loss of exclusivity for gMinastrin Fe; and c) base business re-setting.

In Line F2Q: Lupin reported sales of Rs39.5bn, down 8% yoy (up 2.1% qoq). All markets (except US) were up: India up 16.4% yoy (GST restocking), EMEA (South Africa, Germany), Asia (Shionogi) and Latam. US declined 32% yoy (15% qoq) due to loss of exclusivity in key molecules and base business erosion. OPM improved sequentially by 170bps to 21.6% largely driven by higher India sales, FX gains, lower R&D and other expenses. All this led to an F2Q net profit of Rs4.5bn (FX adj. Rs 4bn) vs. (our estimate of Rs3.7bn), down 31.3% yoy, up 27.1% qoq.

Please refer to the exhibit below.

Exhibit 3: What's Changed

Rs bn	FY18E			FY19E			FY20E		
	New	Old	% Change	New	Old	% Change	New	Old	% Change
Net Revenues	161.7	172.0	-6.0%	182.8	190.9	-4.2%	206.5	216.6	-4.7%
Operating profits	35.3	38.0	-6.9%	44.1	47.7	-7.7%	52.9	57.3	-7.6%
Margins	21.9%	22.1%	-0.2%	24.1%	25.0%	-0.9%	25.6%	26.4%	-0.8%
Net profits	18.2	20.1	-9.5%	24.9	27.6	-9.9%	30.2	33.4	-9.6%
Margins	11.3%	11.7%	-0.4%	13.6%	14.5%	-0.9%	14.6%	15.4%	-0.8%

Source: Morgan Stanley Research (E) estimates

Valuation and PT discussion - The stock is trading at 18.6x for F19e and 15.4x P/E for F2020e. Our new price target is Rs1,219 (down ~0.4% from Rs1,224): We value the stock at 20x (unchanged) Sep F2019e EPS. The reduction in our price target is driven by cuts in F2019/20e EPS, which is largely offset by rolling forward our target multiple by six months to Sep FY19.

We remain OW on Lupin: We cite the outlook for a strong recovery in the US business in F19 and F20; a gradual ramp in the GAVIS business (including branded); Indian business bouncing back in 2HF18; and steady growth in Japanese and European businesses (biosimilars and neurology), along with cheap valuation.

Our target multiple of 20x is in line with the current industry multiple (derated in the last two years). We believe this is an appropriate multiple in view of:

- Strong fundamentals with globally diversified fully integrated business model, plus diversification into niche therapies, including ophthalmologics, dermatology and respiratory care;
- Investment in complex R&D projects including injectables, inhalation/respiratory and biosimilars;
- The outlook for a sharp earnings ramp-up from F19 onwards, primarily led by US

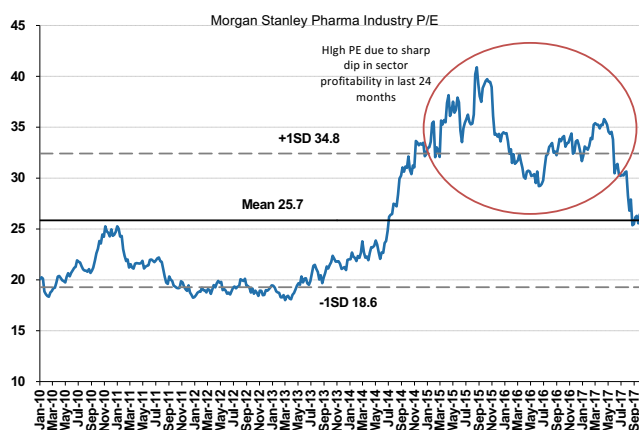
business, where the branded business is steadily scaling up and the product pipeline is deepening;

- Improving earnings quality, led by declining profit concentration from gGlumetza/Fortamet.
- Good visibility for niche generic launches for the next few years from F19 onwards.

Versus:

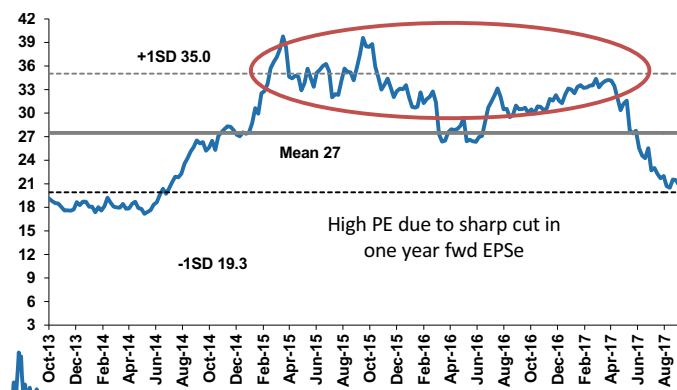
- Continuing pricing pressure from ongoing channel consolidation in the US generic market;
- FX/regulatory risk in EMs, especially India (drug price control, GST impact, etc.).
- Some profit concentration in gGlumetza and gFortamet.

Exhibit 4: One-year Forward P/E Chart for the Indian Pharma Industry



Source: Thomson Reuters, Morgan Stanley Research estimates

Exhibit 5: Lupin – One-year Forward Prospective P/E



Source: Thomson Reuters, Morgan Stanley Research estimates

Bull case value of Rs1,493 (down from Rs1,498): The cut stems mainly from lower growth expectations for the base business, especially in the US market (Rs183/share, down from Rs184), NDDS/biologicals portfolio (Rs36/share, unchanged), and one-off large opportunity (Rs54/share, unchanged).

Bear case value of Rs817 (down from Rs820): Setback in core business (Rs183/share, down from Rs184 owing to higher risks in US, Japanese, and Indian business), competitive pressure in branded business (Rs61/share, unchanged), IPR risk (Rs98/share, unchanged) and domestic market regulatory risk (Rs61/share, unchanged).

Results Summary

Exhibit 6: F2Q Results Summary

(Rs mn) (period ending)	F2Q18 Sep-17	F2Q17 Sep-16	%chg YoY	F1Q18 Jun-17	%chg QoQ	Morgan Stanley est.
Sales (Net)	38,742	42,112	-8.0%	38,068	1.8%	
Other Operating Income	778	793	-1.9%	628	24.0%	
Total Revenues	39,520	42,905	-7.9%	38,696	2.1%	37,676
Material Cost	12,865	12,429	3.5%	12,326	4.4%	
Staff Costs	7,250	7,124	1.8%	7,180	1.0%	
R&D Expenditure	4,739	5,716	-17.1%	4,999	-5.2%	
Other Expenditure	10,874	13,072	-16.8%	11,506	-5.5%	
Total Expenditure	30,988	32,624	-5.0%	31,012	-0.1%	
Operating profit	8,531	10,281	-17.0%	7,684	11.0%	7724
Other Income	740	271	173.1%	320	131.6%	
EBITDA	9,272	10,552	-12.1%	8,003	15.8%	
Interest (Net)	479	263	82.2%	439	9.2%	
Depreciation	2,722	2,112	28.9%	2,605	4.5%	
PBT and Extra-ordinaries	6,071	8,177	-25.8%	4,959	22.4%	
Tax	1,541	1,589	-3.1%	1,368	12.6%	
Core PAT	4,530	6,587	-31.2%	3,591	26.1%	3780
Minority interest and share of IC	(20)	(34)	NM	11	-292.5%	
Reported PAT	4,551	6,622	-31.3%	3,581	27.1%	3740
GPM	67.4%	71.0%	-3.6%	68.1%	-0.7%	
OPM	21.6%	24.0%	-2.4%	19.9%	1.7%	20.5%
NPM	11.5%	15.4%	-3.9%	9.3%	2.3%	9.9%
Effective tax rate	25.4%	19.4%	5.9%	27.6%	-2.2%	

Lupin – Sales Breakdown

(Rs mn)	F2Q18	F2Q17	%chg YoY	F1Q18	%chg QoQ
Formulations	36,092	39,194	-7.9%	35,275	2.3%
US (including IP)	13,611	19,978	-31.9%	16,018	-15.0%
EMEA (inc EU, South Africa)	2,758	2,355	17.1%	2,259	22.1%
India	11,593	9,959	16.4%	9,324	24.3%
APAC (Japan)	6,357	5,520	15.2%	5,989	6.1%
LATAM	1,395	986	41.5%	1,269	9.9%
Rest of world	378	396	-4.5%	416	-9.1%
API	2,650	2,919	-9.2%	2,793	-5.1%
Total net sales	38,742	42,113	-8.0%	38,068	1.8%

Source: Company Data, Morgan Stanley Research

Exhibit 7: Total revenues

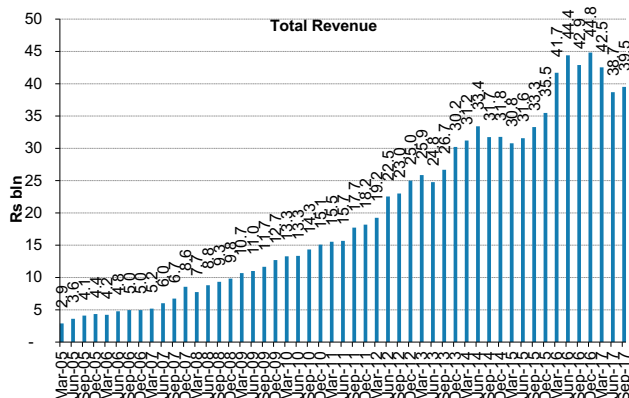
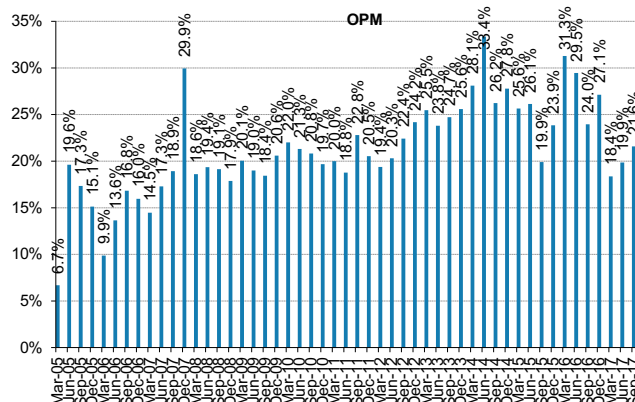
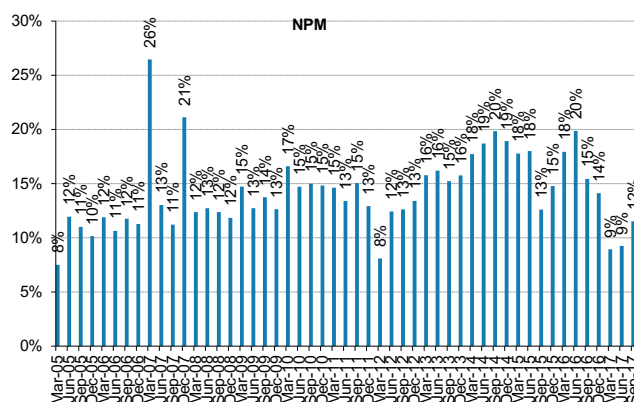


Exhibit 9: Trend in Operating Margins



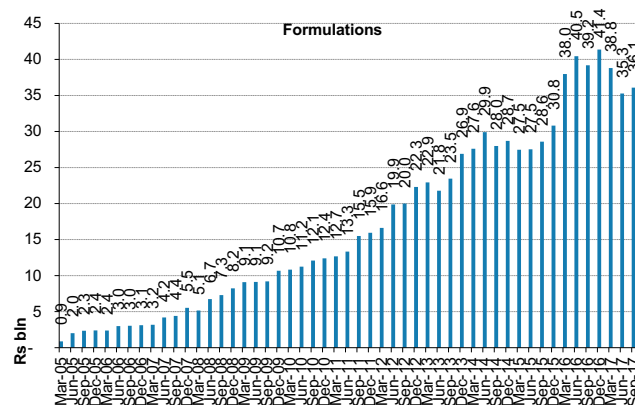
Source: Company data, Morgan Stanley Research

Exhibit 10: Trend in Net Profit Margins



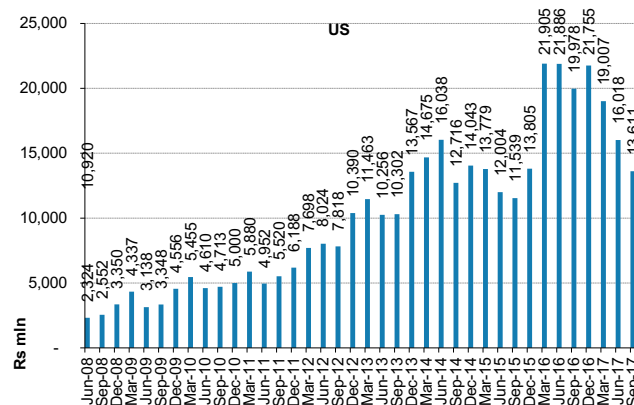
Source: Company data, Morgan Stanley Research

Exhibit 11: Total formulations



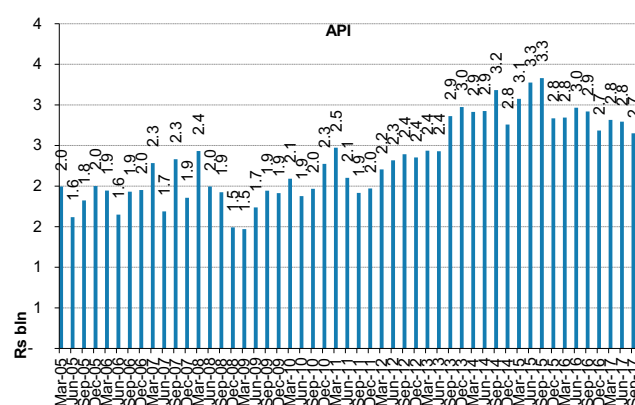
Source: Company data, Morgan Stanley Research

Exhibit 12: Sales trend in US



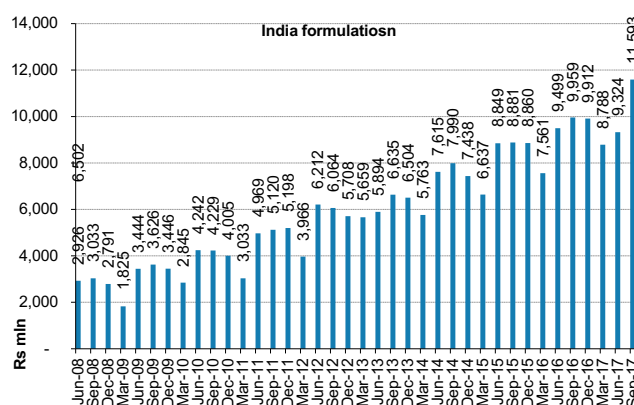
Source: Company data, Morgan Stanley Research

Exhibit 13: API trend



Source: Company data, Morgan Stanley Research

Exhibit 14: Domestic Formulations



Source: Company data, Morgan Stanley Research

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Global Stock Ratings Distribution

(as of September 30, 2017)

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STOCK RATING CATEGORY	COVERAGE UNIVERSE		INVESTMENT BANKING CLIENTS (IBC)			OTHER MATERIAL INVESTMENT SERVICES CLIENTS (MISC)	
	COUNT	% OF TOTAL	COUNT	% OF TOTAL IBC	% OF RATING CATEGORY	COUNT	% OF TOTAL OTHER MSC
Overweight/Buy	1162	36%	304	40%	26%	560	37%
Equal-weight/Hold	1420	44%	363	48%	26%	697	46%
Not-Rated/Hold	58	2%	6	1%	10%	9	1%
Underweight/Sell	612	19%	91	12%	15%	242	16%
TOTAL	3,252		764			1508	

Data include common stock and ADRs currently assigned ratings. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months. Due to rounding off of decimals, the percentages provided in the "% of total" column may not add up to exactly 100 percent.

Analyst Stock Ratings

Overweight (O). The stock's total return is expected to exceed the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Equal-weight (E). The stock's total return is expected to be in line with the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Not-Rated (NR). Currently the analyst does not have adequate conviction about the stock's total return relative to the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Underweight (U). The stock's total return is expected to be below the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Unless otherwise specified, the time frame for price targets included in Morgan Stanley Research is 12 to 18 months.

Analyst Industry Views

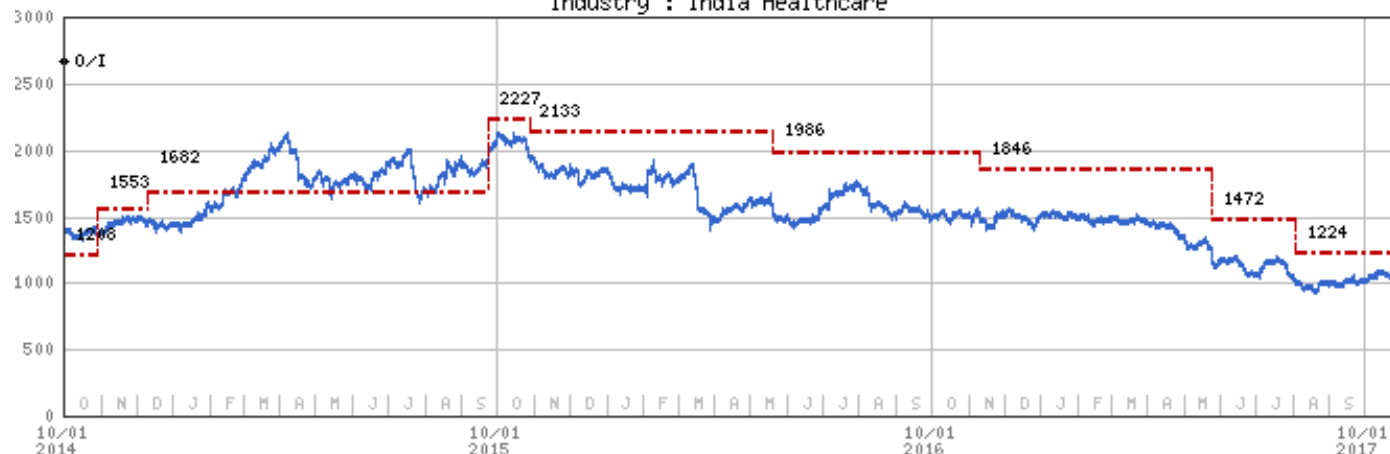
Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

In-Line (I): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.

Cautious (C): The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.

Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index or MSCI sub-regional index or MSCI AC Asia Pacific ex Japan Index.

Stock Price, Price Target and Rating History (See Rating Definitions)

Lupin Ltd. (LUPN.NS) - As of 10/30/17 in INR
Industry : India Healthcare

Stock Rating History: 10/1/14 : 0/I

Price Target History: 5/8/14 : 1208; 10/29/14 : 1553; 12/11/14 : 1682; 9/24/15 : 2227; 10/28/15 : 2133;
5/20/16 : 1986; 11/10/16 : 1846; 5/25/17 : 1472; 8/4/17 : 1224

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target -- No Price Target Assigned (NA)
 Stock Price (Not Covered by Current Analyst) — Stock Price (Covered by Current Analyst) ■
 Stock and Industry Ratings (abbreviations below) appear as ♦ Stock Ratings/Industry View
 Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) No Rating Available (NA)
 Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

Effective January 13, 2014, the stocks covered by Morgan Stanley Asia Pacific will be rated relative to the analyst's industry (or industry team's) coverage.

Effective January 13, 2014, the industry view benchmarks for Morgan Stanley Asia Pacific are as follows: relevant MSCI country index or MSCI sub-regional index or MSCI AC Asia Pacific ex Japan Index.

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INDUSTRY COVERAGE: India Healthcare

COMPANY (TICKER)	RATING (AS OF)	PRICE* (10/30/2017)
Sameer Baisiwala, CFA		
Apollo Hospitals Enterprise Ltd. (APLH.NS)	O (04/27/2017)	Rs1,031.55
Biocon Ltd (BION.NS)	O (04/05/2016)	Rs366.45
Cadila Healthcare Ltd. (CADI.NS)	O (01/29/2016)	Rs498.25
Cipla Ltd. (CIPL.NS)	U (08/13/2013)	Rs626.05
Dr. Reddy's Lab (REDY.NS)	O (09/21/2017)	Rs2,438.50
GlaxoSmithKline Pharma (GLAX.NS)	U (02/28/2013)	Rs2,555.85
Glenmark Pharmaceuticals (GLEN.NS)	E (05/24/2017)	Rs614.95
IPCA Laboratories (IPCA.NS)	E (07/25/2014)	Rs533.25
Lupin Ltd. (LUPN.NS)	O (10/03/2006)	Rs1,025.95
Narayana Hrudayalaya Ltd (NARY.NS)	E (04/27/2017)	Rs302.95
Sun Pharmaceutical Industries (SUN.NS)	U (05/29/2017)	Rs553.10
Vaibhav Dusad		
Dr. Lal PathLabs Ltd (DLPANS)	U (04/19/2017)	Rs749.00

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* Historical prices are not split adjusted.