

COMPANY NOTE

Estimate Change

India | Healthcare | Pharmaceuticals

30 October 2017

Jefferies

Lupin Ltd. (LPC IN)

2Q18: In Line with Muted Expectations

Key Takeaway

LPC reported results in line with muted expectation. US revenues declined 13% QoQ, though India and EM business saw strong growth. Mgmt expects US revenues to improve but benefit of key launches will accrue from FY19 only. LPCs R&D execution has been weak and this raises concerns on medium term growth. M&A will, in our view, be a key driver for the medium term growth and mgmt highlighted the same. The stock then at 19.4x FY19 is expensive. Retain Underperform.

In-line quarter - Lupin reported 2Q18 results in line with expectation with revenues 3% below and margins 90 ahead of JEF. Higher other income led to earnings 9% ahead of expectation. Margin beat was led by lower R&D spend and lower forex losses.

US sees further erosion; India/EM report strong growth - The key negative in the results was the US business which saw 13% QoQ decline. More importantly, mgmt indicated that base business which grew 9% QoQ in 1Q18 declined in 2Q18 due to channel consolidation impact. The key positive was India and EM business, which saw strong growth.

Mgmt expects gradual recovery; Key products see delays - Mgmt believes that US business revenues are at the bottom and should see improvement ahead. It also indicated that pricing pressure is likely at its bottom. Key product launches though are seeing delays and this could impact recovery. We expects substantial recovery only from FY19 as key product launches are scheduled for endFY18. On margins, it maintained its guidance of 21-23% operating margins for FY18. It indicated that it will keep R&D spend capped at current levels to sustain margins.

Weak base business drivers - LPC, in our view is trailing peers in building a complex generic pipeline. Further, its R&D execution has been weak which raises concerns on medium term growth. Given this we expect M&A to be a major driver for LPC. Mgmt also indicated that it will grow its specialty business (key medium term driver for Indian generics) through M&A. The stock then trading at 19.4x FY19 PE, is expensive given the flat EPS over F15-19 and weak medium term outlook. Retain Underperform

Valuation/Risks

We marginally tweak our estimates and FY18-20 EPS falls by 3%/1%/5%. Lupin given its weak earnings growth and concern on medium term, should trade at discount to sector. Our TP of Rs 850 implies FY19 PE of 16x. Key risk: Approval of key products, M&A

INR	Prev.	2017A	Prev.	2018E	Prev.	2019E	Prev.	2020E
Rev. (MM)	--	174,943	169,766	163,166	199,312	196,356	224,313	220,286
EBITDA (MM)	--	46,491.0	36,507.0	35,724.0	44,915.0	44,764.0	52,642.0	51,223.0
EV/EBITDA		11.0x		14.3x		11.4x		10.0x
Net Profit	--	25,575.0	19,506.0	18,934.0	24,247.0	23,898.0	29,789.0	28,365.0
Dividend	--	7.50	6.50	6.70	8.00	8.40	9.90	10.00
Div. Yield		0.73%		0.65%		0.82%		0.97%
BV/Share	--	298.90	335.60	334.20	381.30	378.70	437.40	431.50
P/B		3.4x		3.1x		2.7x		2.4x
EPS Growth	--	20.0%	(28.1)%	(30.2)%	24.3%	26.2%	22.9%	18.7%
EPS								
FY Mar	--	60.10	43.20	41.90	53.70	52.90	66.00	62.80
FY P/E		17.1x		24.5x		19.4x		16.3x

UNDERPERFORM

Price target INR850.00

Price INR1,025.95^

Financial Summary

Net Debt (MM): INR51,306.0

Market Data

52 Week Range: INR1,573.60 - INR917.55

Total Entprs. Value (MM): INR512.5BN

Market Cap. (MM): INR461.2BN

Shares Out. (MM): 449.5

Float (MM): 205.4

Avg. Daily Vol.: 1,918,876

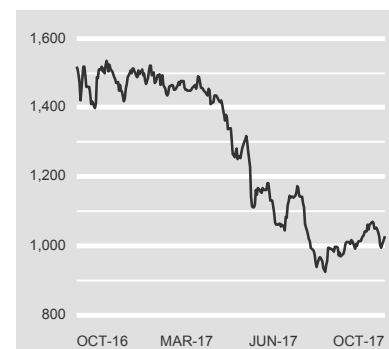
Piyush Nahar *

Equity Analyst

+91 22 4224 6113 pnahar@jefferies.com

* Jefferies India Private Limited

Price Performance



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

Other highlights

- Management maintained the margin guidance of 21-23% for FY18.
- US business is expected to improve from current levels. Meaningful improvement though will be visible only from FY19.
- It expects pricing pressure to reduce from current levels.
- It indicated that decline in US business was led by both price erosion in base business and market share/pricing in key products like gGlumetza and gMinastrin
- The key product expected over the next 12m are:
 - Levothyroxin – FY19
 - Axiron – 3Q18
 - Ranexa – FY19
- On key filings and products:
 - Tamiflu – it expects to launch in 4Q which will make a much smaller opportunity
 - Spiriva – it expects to complete studies in FY18 and file FY19 (endFY18 earlier)
 - Advair – It is redoing PK studies and expects to start CT in end FY18
 - Lialda, Prevacid ODT and Aspiro – It has CRL on all three which it will respond in next 3-4m and expects to launch all in endFY19 (vs 1HFY19 earlier)
- It plans to file 30 ANDA per year
- Branded business sales in 2Q was 20mn USD vs 1Q was 23mn USD

Exhibit 1: Results in line with muted expectation

	2QFY18	2QFY17	YoY (%)	1QFY18	2QFY18E	vs. Est (%)
Revenues	39,520	42,905	-7.9	38,696	40,808	-3.2
Raw Material	12,865	12,429	3.5	12,326	13,339	-3.6
Gross Profit	26,654	30,477	-12.5	26,370	27,469	-3.0
Employee Cost	7,250	7,124	1.8	7,180	7,180	1.0
Other operating Exp	10,874	13,072	-16.8	11,506	11,852	-8.3
EBITDA	8,531	10,281	-17.0	7,684	8,437	1.1
<i>EBITDA Margin (%)</i>	21.6	24.0	-238 bps	19.9	20.7	91 bps
EBIT	5,809	8,169	-28.9	5,079	5,832	-0.4
PBT	6,070	8,177	-25.8	4,959	5,712	6.3
Tax	1,541	1,589	-3.1	1,368	1,542	-0.1
PAT	4,550	6,622	-31.3	3,581	4,159	9.4

Source: Jefferies estimates, company data

Exhibit 2: US revenues see further decline; india/EM see strong growth

(in Rs mn)	2QFY18	2QFY17	YoY (%)	1QFY18	QoQ (%)
Revenues	38,742	42,112	-8.0	38,068	1.8
Formulation Sales	36,092	39,193	-7.9	35,275	2.3
US	13,611	19,978	-31.9	16,018	-15.0
EU	1,135	1,083	4.8	1,018	11.5
Japan	5,033	4,159	21.0	4,981	1.0
India	11,593	9,958	16.4	9,324	24.3
EM	4,720	4,015	17.6	3,934	20.0
SA	1,318	1,126	17.0	1,020	29.1
API	2,650	2,919	-9.2	2,793	-5.1

Source: Jefferies estimates, company data

Exhibit 3: Gross margins decline further led by pricing pressure in US...



Source: Jefferies estimates, company data

Exhibit 4: ... EBITDA margins see slight improvement led by lower R&D and forex



Source: Jefferies estimates, company data

Exhibit 5: Change to estimates

(Rs mn)	Old			New			% change		
	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E
Sales	169,766	199,312	224,313	163,166	196,356	220,286	-3.9	-1.5	-1.8
Operating profit	36,507	44,915	52,642	35,724	44,764	51,223	-2.1	-0.3	-2.7
OP margin (%)	21.5	22.5	23.5	21.9	22.8	23.3	39 bps	30 bps	-25 bps
Net profit	19,506	24,247	29,789	18,934	23,898	28,365	-2.9	-1.4	-4.8
NP margin (%)	11.5	12.2	13.3	11.6	12.2	12.9	10 bps	-3 bps	-42 bps
EPS	43.2	53.7	66	41.9	52.9	62.8	-2.9	-1.5	-4.8
EPS growth (%)	-28.1	24.3	22.9	-30.2	26.2	18.7	-212 bps	192 bps	-421 bps
DPS	6.5	8	9.9	6.7	8.4	10.0	2.5	5.1	0.8
ROE (%)	12.9	14.1	15.1	12.5	14.0	14.6	-35 bps	-12 bps	-54 bps

Source: Jefferies estimates, company data

Financials

Exhibit 6: Profit and Loss Statement

Rs mn	2016	2017	2018E	2019E	2020E
Net Sales	142,555	174,943	163,166	196,356	220,286
<i>Change (%)</i>	11.6	22.7	-6.7	20.3	12.2
Material Cost	43,326	50,014	53,057	61,254	67,493
Employee Cost	21,416	28,495	28,780	33,097	37,069
SG&A	24,922	26,842	26,390	32,196	36,401
R&D Expenses	16,038	23,101	19,216	25,045	28,100
EBITDA	36,853	46,491	35,724	44,764	51,223
<i>% of net sales</i>	25.9	26.6	21.9	22.8	23.3
Depreciation	4,871	9,122	10,531	12,494	13,602
Interest	595	1,525	1,627	1,627	1,627
Other Income	1,852	1,065	2,400	2,080	2,323
EO Income / (Exp)	0	-1,559	0	0	0
PBT	33,239	36,909	25,965	32,723	38,318
Tax	10,593	9,785	7,011	8,835	9,963
<i>Rate (%)</i>	31.9	26.5	27.0	27.0	26.0
Minority Interest	39	-10	21	-10	-10
PAT	22,607	25,575	18,934	23,898	28,365
Adjusted PAT	22,607	27,134	18,934	23,898	28,365
<i>change (%)</i>	-5.9	20.0	-30.2	26.2	18.7

Source: Jefferies estimates, company data

Exhibit 7: Balance Sheet Statement

Rs mn	2016	2017	2018E	2019E	2020E
Share Capital	901	903	903	903	903
Minority Interest	321	345	335	325	315
Reserves	110,733	134,073	149,998	170,098	193,956
Net Worth	111,955	135,321	151,236	171,326	195,174
Deferred Tax Lia	3,267	3,949	3,949	3,949	3,949
Loans	71,775	79,661	79,661	79,661	79,661
Capital Employed	186,997	218,930	234,845	254,936	278,783
Gross Fixed Assets	92,120	123,953	148,797	162,817	173,837
Less: Depreciation	4,951	13,624	24,155	36,649	50,251
Net Fixed Assets	87,169	110,329	124,642	126,168	123,586
Capital WIP	27,024	21,331	12,737	12,737	12,737
Investments	164	21,361	21,361	21,361	21,361
Deferred Tax Asset	4,036	6,434	6,434	6,434	6,434
Current Assets	107,855	106,618	112,923	137,413	168,049
Inventory	32,737	36,423	38,169	44,066	48,555
Debtors	45,488	43,073	42,468	51,106	57,335
Cash & Bank Balance	8,218	6,994	16,253	22,338	38,925
Loans & Advances	21,414	20,128	16,033	19,902	23,234
Current Liabilities	39,252	47,143	43,251	49,177	53,383
Creditors	19,888	25,889	25,554	30,690	34,187
Other Liabilities	16,107	15,560	13,059	13,059	13,059
Provisions	3,257	5,694	4,639	5,427	6,137
Net Current Assets	68,603	59,476	69,672	88,236	114,666
Appl. Of fund	186,996	218,930	234,845	254,936	278,783

Source: Jefferies estimates, company data

Exhibit 8: Cash Flow Statement

(Rs mn)	2016	2017	2018E	2019E	2020E
PAT	22,607	25,575	18,934	23,898	28,365
Depreciation	4,871	9,122	10,531	12,494	13,602
Interest Exp	595	1,525	1,627	1,627	1,627
Other Income	1,852	1,065	2,400	2,080	2,323
Change in Wkg Capital	-32,390	-7,228	-937	-12,480	-9,842
CF from Op Activities	-11,420	41,346	27,755	23,459	31,429
Change in Fixed Assets	-69,623	-26,588	-16,250	-14,020	-11,020
Change in Investments	16,421	-21,198	0	0	0
Other Income	1,852	1,065	2,400	2,080	2,323
CF from Investing Activities	-51,351	-46,721	-13,850	-11,940	-8,697
Change in equity	82	0	0	0	0
Changes in debt	66,404	7,886	0	0	0
Interest Exp	-595	-1,525	-1,627	-1,627	-1,627
Dividend paid	-3,379	-4,064	-3,009	-3,798	-4,508
Others	3,663	1,917	-10	-10	-10
CF from Financing Activities	66,175	4,214	-4,646	-5,435	-6,145
Net change in Cash	3,404	-1,162	9,259	6,084	16,587

Source: Jefferies estimates, company data

Exhibit 9: Key Ratios

	2016	2017	2018E	2019E	2020E
Basic (Rs)					
EPS	60.1	41.9	52.9	62.8	60.1
BPS	298.9	334.2	378.7	431.5	298.9
DPS	7.5	6.7	8.4	10.0	7.5
Payout (%)	12.5	15.9	15.9	15.9	12.5
Valuation (X)					
P/E	17.1	24.4	19.4	16.3	17.1
P/B	3.4	3.1	2.7	2.4	3.4
EV/EBITDA	9.8	12.8	10.2	8.9	9.8
EV/Sales	2.6	2.8	2.3	2.1	2.6
Dividend Yield (%)	0.7	0.65	0.82	0.97	0.7
Profit Ratios (%)					
RoE	20.1	12.5	14.0	14.6	20.1
RoCE	13.0	8.4	10.1	11.6	13.0
Turnover Ratios					
Debtor Days	90	95	95	95	90
Inventory Days	266	263	263	263	266
Creditor Days	95	95	95	95	95
Net Debt to Equity	0.4	0.3	0.2	0.1	0.4

Source: Jefferies estimates, company data

Company Description

Lupin is an 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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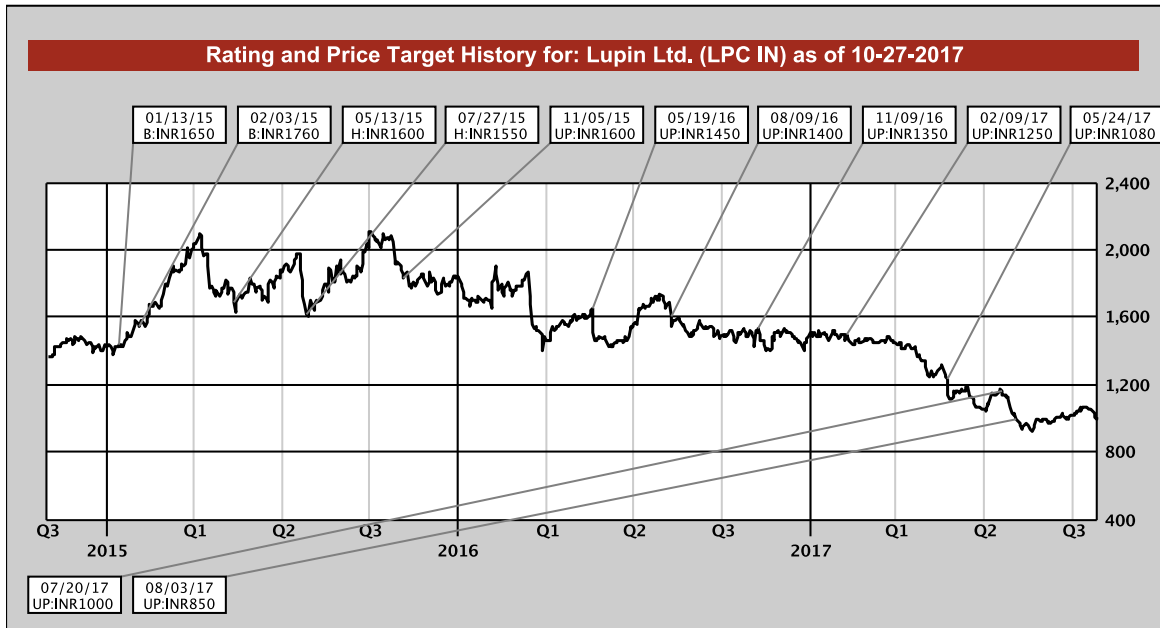
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UNDERPERFORM	145	7.10%	17	11.72%

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