

Pain continues

Lupin's poor 2QFY18 numbers (10% topline and EBITDA miss) call for a further downward revision in sustainable US revenue and overall profitability. The quarterly runrate in the US has fallen to ~\$200mn from a peak of \$328mn in 1QFY17, and the overall EBITDA margin has contracted to 21% from 31% in 4QFY16. This shows that the risk we'd been worried about – the step-down in profitability due to the diminishing impact of large one-off products – is playing out. While the management has guided for the current quarterly run-rate for the US business to be the base, we do not expect the interesting product launches scheduled over the next 12 months to give a significant boost to profitability from present levels. We change our FY18/FY19 earnings by -11%/+1.5% to factor in 2QFY18 results. Slower growth and fall in return ratios justify the current valuation 18x FY19e PE. Maintain SELL with a revised target price of Rs927.

Challenges to US base business continue: Competition in key products such as generic Fortamet and Glumetza continue to hurt revenues (US revenue down 18% QoQ). With no large products to replace them, the US business is re-basing to a significantly lower level, though the management expects the current quarterly run rate of US\$204mn to be the base. Given the tough pricing environment and the absence of a significant pick-up in the Gavis pipeline, the base business outlook appears muted.

Japan and India – the only positives: Japan revenue increased 29% YoY in local currency terms, aided by the Shionogi portfolio. India business reported 16% YoY growth, driven by primary sales and new product launches; we expect the next 2 quarters to continue to grow at 15% YoY. EMEA and RoW also did well, growing 17% and 22% YoY, respectively.

Step down in 'sustainable margin': As the one-off limited competition products faded away in the US, Lupin's EBITDA margin has dropped from 28-30% to 21-23%. With the company rationalising its R&D spend and controlling costs in other areas, we believe 21-23% margins are sustainable. However, if channel partners in the US show aggression while re-negotiating prices, it would pose a downside risk to our expectation.

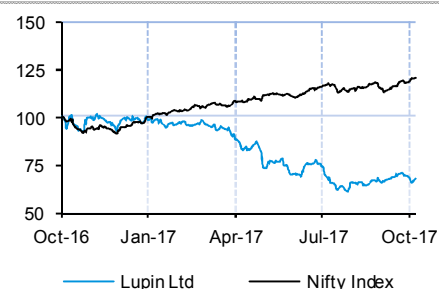
Lowering estimates by ~10%: We change our FY18/19 core earnings estimate by -11%/+1.5% to factor in 10% miss on 2QFY18 results. Lupin shares trade at c.18x on our FY19e core earnings (vs. peers at 20x). This, in our view, is justified, given a modest 10-11% growth outlook for FY19 and beyond and return ratios that are coming off to mid-high-teens from prior 30%+. Our PT of Rs927 is 18x FY19e core earnings plus cash per share. Maintain SELL with a revised target price of Rs927.

Rating	Target Price (Rs)	Upside/Downside (%)
SELL	927	(10)

Market data

	Rs	1,026
Current price		
Mkt capitalisation	USDm	7,126
Average daily value 3M	USDm	29.69
Free float	%	53.20
Promoter holding	%	46.80
Foreign holding	%	32.58

1 Year Performance



Source: Bloomberg, SSLe

Financial summary

Y/E Mar (Rs mn)	FY15	FY16	FY17	FY18e	F19e
Net sales	127,700	142,085	174,943	159,421	182,397
EBITDA margin (%)	28%	26%	25%	22%	25%
Adjusted net profit	24,033	22,707	25,574	17,033	23,673
vs. consensus (%)				(47)	(36)
Free cash flow			16,222	20,377	6,039
EPS (Rs)	53	50	56	37	52
growth (%)	31%	-6%	13%	-34%	39%
P/E (x)	19	20	18	27	20
P/B (x)	5	4	3	3	3
EV/EBITDA (x)	14	14	12	15	12
D/E	(0.1)	0.3	0.2	0.1	0.1
RoE (%)	30%	23%	21%	12%	15%
RoCE (%)	37%	24%	17%	11%	16%
Dividend yield (%)	0.7%	0.7%	0.7%	0.7%	0.7%

Source: Company, SSLe

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Quarterly financials

Particulars (Rs mn)	2QFY17	2QFY18	YoY (%)	1QFY18	QoQ (%)	2Q18e	Var (%)
Total revenue	42,906	39,520	(8)	38,696	2	43,848	(10)
COGS	12,429	12,865	4	12,326	4	13,154	(2)
% of revenues	29.0	32.6	359	31.9	70	30.0	255
Cost of regular revenues	12,101	12,865		12,326		13,154	
% of base sales	30.5%	32.6%		31.9%		30.0%	
Cost of exclusivity revenues	328	0		0		0	
Personnel exp	7,124	7,250	2	7,180	1	7,542	(4)
% of revenues	16.6	18.3	174	18.6	(21)	17.2	114
Mfg. & Others	7,356	6,135	(17)	6,507	(6)	8,112	(24)
% of revenues	17.1	15.5	(162)	16.8	(129)	18.5	(298)
R&D	5,716	4,739	(17)	4,999	(5)	5,262	(10)
% of revenues	13.3	12.0	(133)	12.9	(93)	12.0	(1)
EBITDA	10,281	8,531	(17)	7,684	11	9,778	(13)
EBITDAM (%)	24.0	21.6	(238)	19.9	173	22.3	(71)
D&A	2,112	2,722	29	2,605	4	2,656	2
EBIT	8,169	5,809	(29)	5,079	14	7,122	(18)
EBITM (%)	19.0	14.7	(434)	13.1	157	16.2	(154)
Other income	271	740	173	320	131	352	111
Interest cost	263	479	82	439	9	497	(4)
PBT	8,177	6,070	(26)	4,960	22	6,976	(13)
Tax	1,589	1,541	(3)	1,368	13	1,953	(21)
% Tax rate	19.4	25.4	595	27.6	(220)	28.0	(262)
Minorities / Associates	34	21	(39)	(11)	(289)	14	49
Adjusted Net profit	6,622	4,550	(31)	3,581	27	5,037	(10)
Exceptional items	0	0	na	0	na	0	na
Reported Net profit	6,622	4,550	(31)	3,581	27	5,037	(10)
Adjusted EPS	14.6	10.0	(32)	7.8	27	11.0	(10)

Source: Company, SSLe

Change in estimates

(Rs mn)	Revised		Old		Change (%)	
	FY18e	FY19e	FY18e	FY19e	FY18e	FY19e
Total Income	159,421	182,397	173,481	193,628	(8.1)	(5.8)
EBITDA	34,284	44,955	37,741	44,371	(9.2)	1.3
EBITDA Margin (%)	21.5	24.6	21.8	22.9		
Adjusted PAT	17,033	23,673	19,190	23,326	(11.2)	1.5
EPS (Rs)	37.3	51.7	42.0	51.0	(11.2)	1.5

Source: SSL Research

Financials

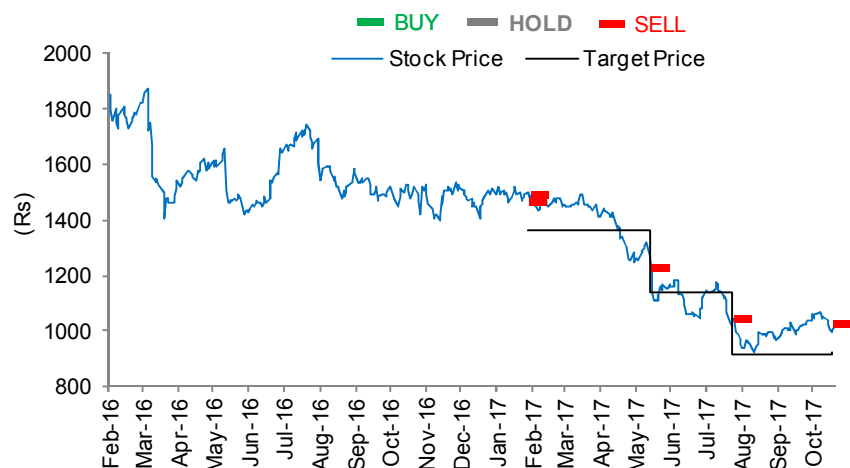
Income statement						Balance sheet					
Y/E Mar (Rs mn)	FY15	FY16	FY17	FY18e	FY19e	Y/E Mar (Rs mn)	FY15	FY16	FY17	FY18e	FY19e
Revenue	127,700	142,085	174,943	159,421	182,397	Cash & bank balance	21,372	8,399	28,135	20,965	12,905
<i>growth (%)</i>	13%	11%	23%	-9%	14%	Other current assets	56,951	89,391	91,407	84,493	96,670
Operating expenses	91,504	104,550	131,610	125,137	137,442	Investments					
EBITDA	36,196	37,535	43,333	34,284	44,955	Net fixed assets	32,031	59,625	53,513	113,684	123,693
<i>growth (%)</i>	21%	4%	15%	-21%	31%	Goodwill and intangible assets	17,411	56,398	78,147	23,100	23,100
Depreciation & amortisation	4,347	4,635	9,122	10,625	11,492	Other non-current assets	3,612	10,564	14,871	14,871	14,871
EBIT	31,849	32,900	34,211	23,659	33,463	Total assets	131,377	224,378	266,073	257,114	271,240
Other income (net)	2,398	1,877	1,065	1,688	734	Current liabilities	32,909	35,764	38,163	39,418	43,294
Interest expenses	98	446	1,525	1,988	1,409	Borrowings	5,402	71,848	79,521	56,347	47,004
PBT	34,149	34,331	33,751	23,359	32,789	Other non-current liabilities	4,085	6,602	13,068	13,068	13,068
Tax	9,704	11,536	9,785	6,361	9,181	Total liabilities	42,396	114,213	130,752	108,833	103,367
<i>Effective tax rate (%)</i>	28%	34%	29%	27%	28%	Shareholders' funds	88,741	109,844	134,976	147,970	167,628
Profit after tax	24,445	22,795	23,966	16,998	23,608	Minority interest	241	321	345	311	245
Minority interest	(412)	(88)	(32)	34	66	Total equity & liabilities	131,377	224,378	266,073	257,114	271,240
Adjusted net profit	24,033	22,707	23,934	17,033	23,673						
Non-recurring items	-	-	-	-	-						
Reported net profit	24,033	22,707	23,934	17,033	23,673						
<i>growth (%)</i>	31%	-6%	5%	-29%	39%						

Financial ratios						Cash flow statement					
Y/E Mar	FY15	FY16	FY17	FY18e	FY19e	Y/E Mar (Rs mn)	FY15	FY16	FY17	FY18e	FY19e
Profitability and return ratio (%)						PBT / PAT	34,148	34,330	35,431	17,033	23,673
EBITDAM	28%	26%	25%	22%	25%	Depreciation & amortisation	4,347	4,635	9,122	10,625	11,492
EBITM	25%	23%	20%	15%	18%	Chg in working capital	(949)	(31,537)	5,059	8,169	(8,301)
NPM	19%	16%	14%	11%	13%	Other operating activities	(10,216)	(11,119)	(8,465)	300	675
RoE	30%	23%	21%	12%	15%	Operating CF	27,331	(3,690)	41,148	36,127	27,539
RoCE	37%	24%	17%	11%	16%	Capital expenditure	(8,676)	(57,746)	(26,007)	(12,500)	(15,000)
RoIC	46%	27%	19%	13%	17%	Chg in investments					
Per share data (Rs)						Other investing activities	(6,294)	(12,223)	-	(3,250)	(6,500)
O/s shares (mn)	449	450	451	452	453	Investing CF	(14,970)	(69,968)	(26,007)	(15,750)	(21,500)
EPS	53.5	50.5	53.1	37.7	52.2	FCF	12,361	(73,658)	15,141	20,377	6,039
FDEPS	53.2	50.2	52.8	37.3	51.7	Equity raised/(repaid)	413	536	427	-	-
CEPS	63.1	60.7	73.3	61.2	77.6	Debt raised/(repaid)	(700)	62,081	9,479	(23,174)	(9,342)
BV	197.4	244.1	299.2	327.3	369.9	Dividend (incl. tax)	(1,573)	(4,055)	(4,066)	(4,072)	(4,081)
DPS	7.5	7.5	7.5	7.5	7.5	Other financing activities	1,132	2,123	(2,325)	(300)	(675)
Valuation ratios (x)						Financing CF	(727)	60,685	3,514	(27,547)	(14,099)
PE	19	20	19	27	20	Inc/(dec) in cash & bank bal.	11,633	(12,973)	18,655	(7,170)	(8,060)
P/BV	5	4	3	3	3	Closing cash & bank bal.	21372	8399	28135	20965	12905
EV/EBITDA	14	14	12	15	12						
EV/Sales	4	4	3	3	3						

Other ratios					
D/E (x)	(0.12)	0.28	0.19	0.14	0.13
DSO (days)	75.93	116.88	89.87	91.25	91.25
Du Pont Analysis - RoE					
NPM (%)	19%	16%	14%	11%	13%
Asset turnover (x)	1.0	0.6	0.7	0.6	0.7
Equity Multiplier (x)	1.5	2.0	2.0	1.7	1.6
RoE (%)	30%	23%	21%	12%	15%

Source: Company, SSLE

Recommendation History



Date	Stock Price	TP	Re.c.
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
30-Oct-17	1,026	927	SELL

Source: Bloomberg, SSLe

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