

# J.P.Morgan

## Lupin Ltd.

**US weakness offset by India, EBITDA beat due to lower other expense; US recovery based on better launch pipeline**

Lupin reported in-line revenue (Rs38.7bn) with a large miss in the US business offset by India growth. Despite the US miss, EBITDA was higher than estimates (Rs8.5bn vs, JPMe Rs7.7bn) due to the lower-than-expected SG&A. PAT at Rs4.5bn was aided by the EBITDA beat and FX gain in the quarter. Management indicated bottoming out of the US business and maintained margin guidance of 21-23% (1HFY18 20.7%) even after the higher spend related to the Solosec launch. We are at the lower end of the guidance range, given the incremental SG&A spend for branded business could limit margin upside from 2Q levels. While there could be additional competition in gGlumetza/gFortamet, the improvement in its launch pipeline will be key for margins in FY19. In our view, upside from some of the large product guided by the company is priced-in at 21x FY19E P/E.

- US revenue reset significantly lower:** US revenue declined 14% QoQ to \$204Mn due to erosion in gGlumetza, Minastrin and impact from ClarusOne. LPC does not expect significant erosion in the metformin products from these levels and therefore, indicated a bottoming out of the US business. Streamlining of pricing in the WBAD-Econdisc tie-up implies continued erosion, but LPC pointed to limited impact on its revenue with pick-up in launches to offset any pressure. While LPC reiterated its guidance of launching Levothyroxine at end FY18 (\$100+Mn annual sales opportunity), there are delays in some other key opportunities like Coreg CR, Pervacid ODT, Lialda, etc. We believe considerable delay in these products could imply lower sales opportunities, particularly given the FDA focusing on approving limited competition products.
- Margin beat driven by SG&A with guidance maintained at 21-23%:** While gross profit was in line with estimates, we were surprised by the 150+bps margin expansion in the quarter sequentially aided by the lower-than-estimated costs. LPC indicated effort to optimize costs (other expenses down 6% QoQ) and calibrate R&D spend in a tough operating environment without compromising on its investment in growth pipeline. While SG&A could increase from the addition spend to set-up infrastructure before the Solosec launch next year, LPC expects this to be offset by the improvement in margins in other businesses. We believe the lack of any large product launch in the near term, margin pressure in the US and higher spend for Solosec will make it difficult to improve margins from 2Q levels (~21.6%).

### 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	161,744	187,457	208,761
EBITDA (Rs mn)	36,854	44,931	34,531	41,679	48,953
Net Profit (Rs mn)	22,607	25,575	17,874	21,669	26,350
EPS (Rs)	49.93	56.46	39.46	47.84	58.17
DPS (Rs)	7.46	7.48	5.52	6.68	8.12
EPS Growth	(6.2%)	13.1%	(30.1%)	21.2%	21.6%
EBITDA Margin	26.8%	26.2%	21.3%	22.2%	23.4%
ROCE	15.5%	12.7%	8.0%	9.6%	11.0%
ROE	22.6%	20.7%	12.6%	13.6%	14.7%
P/E (x)	20.5	18.2	26.0	21.4	17.6

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

## Neutral

LUPN.NS, LPC IN

Price: Rs1,025.95

▼ **Price Target: Rs1,000.00**  
 Previous: Rs1,025.00

### India

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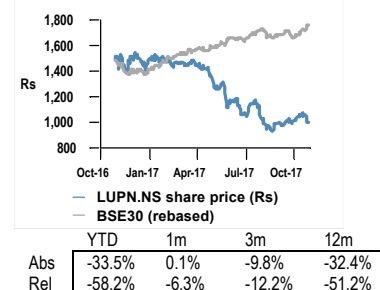
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J.P. Morgan India Private Limited

#### Price Performance



#### Company Data

Shares O/S (mn)	453
Market Cap (Rs mn)	464,722
Market Cap (\$ mn)	7,144
Price (Rs)	1,025.95
Date Of Price	30 Oct 17
3M - Avg daily vol (mn)	1.92
3M - Avg daily val (\$ mn)	29.7
BSE30	3,3266.16
Exchange Rate	65.05
Price Target End Date	30-Sep-18

**See page 6 for analyst certification and important disclosures, including non-US analyst disclosures.**

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31 October 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 trend in key products
- Improvement in growth trend in India

**Upside risks to our view:**

- Faster approval of the Gavis pending pipeline
- Big-ticket approval for the US Generic business
- Margin higher than expected 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	161,744	187,457	208,761
Revenue growth (%)	24.4	-5.5	15.9	11.4
EBITDA (LC)	44,931	34,531	41,679	48,953
EBITDA margin (%)	26.2	21.3	22.2	23.4
Tax rate (%)	27.7	26.0	26.0	26.0
Net profit (LC)	25,575	17,874	21,669	26,350
EPS (LC)	56.5	39.5	47.8	58.2
EPS growth (%)	13.1	-30.1	21.2	21.6
DPS (LC)	7.5	5.5	6.7	8.2
BVPS (LC)	298.0	330.8	370.6	419.0
Operating cash flow (LC mn)	41,148	34,191	26,153	33,699
Free cash flow (LC mn)	24,521	41,332	12,153	19,699
Interest cover (X)	29.5	19.9	28.0	39.5
Net margin (%)	14.9	11.1	11.6	12.6
Sales/assets (X)	0.9	0.7	0.7	0.7
Debt/equity (%)	0.6	0.5	0.4	0.3
Net debt/equity (%)	0.4	0.2	0.2	0.1
ROE (%)	20.7	12.5	13.6	14.7

Key model assumptions	FY17E	FY18E	FY19E	FY20E
USD/INR	65.5	67.1	65.0	65.0
US Revenue Growth	-0.8	36.5	-21.8	21.9
Japan Revenue Growth	5.7	14.7	27.4	12.7

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

**Sensitivity analysis**

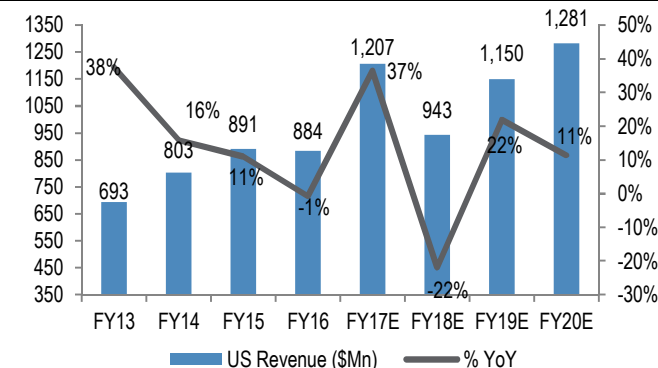
Sensitivity to	EBITDA		EPS	
	FY18E	FY19E	FY18E	FY19E
1% chq in US Generic Revenue	0.7%	0.7%	0.9%	0.9%
1% chq in Japan Revenue	0.2%	0.2%	0.3%	0.3%
1% chq in R&D Expense	0.6%	0.6%	0.8%	0.8%

Source: J.P. Morgan estimates.

**Valuation and price target basis**

Our Sep-18 PT of Rs1000 is based on a P/E of 19x, in line with the long-term average of large-cap peers. Our PT is reduced from Rs1025 as a result of our lowered earnings estimates. 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.

**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	43.5	50.7
JPM new	39.5	47.8
% chg	-9.2%	-5.7%
Consensus	43.3	55.7

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	553	20,462	45.3	27.3	22.2	18.7	3.4	3.1	11.1	12.5
Dr Reddy's	2,439	6,234	27.5	17.4	14.5	10.2	3.0	2.6	11.3	16.0
Aurobindo	767	6,930	15.8	15.0	12.0	11.2	3.7	3.0	26.5	22.3
Lupin	1,026	7,147	26.0	21.4	14.5	11.8	3.1	2.8	12.5	13.6
Cipla	626	7,768	29.2	25.8	14.2	11.9	3.6	3.2	12.4	13.5
Cadila	498	7,865	25.5	21.3	18.5	15.3	6.0	5.0	25.9	25.5
Glenmark	615	2,676	15.9	14.6	9.9	9.0	2.9	2.5	20.1	18.3
Alkem	1,859	3,427	29.5	19.8	23.0	16.4	4.3	3.6	15.7	19.8

Source: Bloomberg, J.P. Morgan estimates. Prices as of Oct 30, 2017.

## Analyst Call Highlights

**Details on the lower US business:** US revenues at \$204mn witnessed sharp declines at 30%/y/y and 14%/q/q. Branded business continues to perform well with revenues at \$24mn recording strong double-digit growth. Generic revenues at US\$180mn declined 34%/y/y. US business continues to witness pricing pressure exacerbated by the Clarus One impact and continued decline in Metformin portfolio (volume loss for gGlumetza). On new competition in metformin, LPC expects SUNP to launch gGlumetza but sees no new competition in gFortamet in the near term. The management noted that on an annualized basis price erosion should continue to be at high single digits and likely to bottom out at these levels. Gavis portfolio continued the strong momentum recording double digit growth with Methergine having sales at \$5-6mn per month. Lupin guided to 20-30 launches in the US in FY18 with 30+ filings with several FTF filings in the pipeline. Management noted opportunities in the next few quarters driven by Tamiflu (hoping for 4QFY18 launch), Axiron (will launch in next couple of months with full impact in FY19), Tamiflu (launch in 4QFY18) and Tobi solution (received approval but delay in launch to 3QFY18 due to lead time required by CMO). Some large launches that are delayed to 2HFY19 include Coreg CR, Prevacid ODT and gLialda.

**Working through R&D investment to limit spend:** LPC indicated capping R&D spend lower than Rs5bn/quarter in FY18 (as seen in 1HFY18) but continues to focus on ensuring progress on key growth projects and meaningful opportunity. The rationalization in R&D has been achieved by lower drug discovery spend, focusing on higher return OSDs and rationalizing spend on products where competition is expected to increase (Paxils). On the spend in specialty pipeline, LPC indicated that this is being augmented by M&A rather than internal pipeline so limited spending currently. Levothyroxine was a much discussed opportunity with management reiterating launch by end 4QFY18 (referencing Synthroid and supplement other RLD post approval) and focus on gaining market share as the other RLDs get done. On the respiratory pipeline, Lupin has made progress with inspection on its Albuterol filing done (launch FY20), Ph 3 in this FY for Spiriva (filing next year) and Advair likely delayed due to additional studies (start Ph 3 in end of FY18).

**India growth to remain strong at 15% in 2HFY18:** India revenues at Rs.11.5bn recorded robust growth at 16%/y/y and 24%/q/q vs. single-digit domestic IPM growth. Adjusted for the GST adjustment, LFL growth was ~20% in the quarter. The management noted that while growth was partly driven by re-stocking post GST, new product launches contributed significantly with Lupin ranked second by value terms. The company has guided domestic business growth in 2HFY18 at 15%, taking overall FY18 growth at 12-15%.

Table 2: LPC 2QFY18 Summary

	2QFY18	2QFY17	% YoY	1QFY18	% QoQ	1HFY18	1HFY17	% YoY
India	11,593.0	9,958.0	16.4	9,324.0	24.3	20,917.0	19,457.0	7.5
US	13,611.0	19,978.0	(31.9)	16,018.0	(15.0)	29,629.0	41,864.0	(29.2)
APAC	6,357.0	5,520.0	15.2	5,989.0	6.1	3,995.3	2,434.0	64.1
EMEA	2,758.0	2,355.0	42.8	2,259.0	22.1	4,981.9	8,600.0	(42.1)
LatAm	1,395.0	986.0	41.5	1,269.0	9.9	1,021.7	2,115.0	(51.7)
RoW	378.0	396.0	(4.5)	416.0	(9.1)	794.0	764.0	3.9
API	2,650.0	2,919.0	(9.2)	2,793.0	(5.1)	5,443.0	5,885.0	(7.5)
<b>Net Revenues</b>	<b>38,741.6</b>	<b>42,111.8</b>	<b>(8.0)</b>	<b>38,068.3</b>	<b>1.8</b>	<b>76,809.9</b>	<b>85,529.8</b>	<b>(10.2)</b>
Total income	39,519.6	42,905.1	(7.9)	38,695.8	2.1	78,215.4	87,581.6	(10.7)
<b>Gross Profit</b>	<b>26,654.3</b>	<b>30,476.6</b>	<b>(12.5)</b>	<b>26,369.7</b>	<b>1.1</b>	<b>53,024.0</b>	<b>62,433.8</b>	<b>(15.1)</b>
Gross Margin (%)	67.4	71.0	(0.7)	68.1		67.8	71.3	
<b>EBITDA</b>	<b>8,530.5</b>	<b>10,280.7</b>	<b>(17.0)</b>	<b>7,683.7</b>	<b>11.0</b>	<b>16,214.2</b>	<b>23,388.6</b>	<b>(30.7)</b>
EBITDA Margin (%)	21.6	24.0		19.9		20.7	26.7	
<b>PBT</b>	<b>6,069.9</b>	<b>8,176.9</b>	<b>(25.8)</b>	<b>4,959.3</b>	<b>22.4</b>	<b>11,029.2</b>	<b>19,736.5</b>	<b>(44.1)</b>
PBT Margin (%)	15.4	19.1		12.8		14.1	22.5	
Tax Expense	1,540.6	1,589.4	(3.1)	1,368.1	12.6	2,908.7	4,323.5	(32.7)
Tax Rate (%)	25.4	19.4		27.6		26.4	21.9	
<b>Profit after tax</b>	<b>4,550.1</b>	<b>6,621.9</b>	<b>(31.3)</b>	<b>3,580.6</b>	<b>27.1</b>	<b>8,130.7</b>	<b>15,441.4</b>	<b>(47.3)</b>
PAT Margin (%)	11.5	15.4		9.3		10.4	17.6	
<b>Key Costs</b>								
Cost of sales	12,865.3	12,428.5	3.5	12,326.1	4.4	25,191.4	25,147.8	0.2
as % of revenues	33.2	29.5		32.4		32.8	29.4	
Employees cost	7,249.6	7,123.9	1.8	7,179.7	1.0	14,429.3	14,155.4	1.9
as % of revenues	18.7	16.9		18.9		18.8	16.6	
R&D Expenses	4,739.0	5,716.0	(17.1)	4,999.1	(5.2)	9,738.1	10,710.0	(9.1)
as % of revenues	12.2	13.6		13.1		12.7	12.5	

Source: Company reports.

## Investment Thesis, Valuation and Risks

### Lupin Ltd. (Neutral; Price Target: Rs1,000.00)

#### 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 Rs1000 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.

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31 October 2017

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## 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	161,744	187,457	208,761	(3,824)	41,148	34,191	26,153	33,699
COGS	(43,326)	(50,014)	(52,567)	(59,986)	(64,716)	4,871	9,122	10,427	12,222	13,602
<b>Gross profit</b>	<b>94,253</b>	<b>121,184</b>	<b>109,177</b>	<b>127,471</b>	<b>144,045</b>	(31,264)	5,059	4,081	(9,298)	(7,563)
SG&A	(24,922)	(28,402)	(27,497)	(31,868)	(35,489)					
<b>Adj. EBITDA</b>	<b>36,854</b>	<b>44,931</b>	<b>34,531</b>	<b>41,679</b>	<b>48,953</b>	<b>(69,617)</b>	<b>(25,287)</b>	<b>7,141</b>	<b>(14,000)</b>	<b>(14,000)</b>
D&A	(4,871)	(9,122)	(10,427)	(12,222)	(13,602)	(11,681)	(16,634)	(14,000)	(14,000)	(14,000)
<b>Adj. EBIT</b>	<b>31,982</b>	<b>35,809</b>	<b>24,105</b>	<b>29,457</b>	<b>35,350</b>	as % of sales	8.5%	9.7%	8.7%	7.5%
Net Interest	(595)	(1,525)	(1,738)	(1,488)	(1,238)					
<b>Adj. PBT</b>	<b>33,239</b>	<b>35,349</b>	<b>24,117</b>	<b>29,219</b>	<b>35,512</b>	<b>58,364</b>	<b>4,332</b>	<b>(14,648)</b>	<b>(14,863)</b>	<b>(15,364)</b>
Tax	(10,593)	(9,785)	(6,270)	(7,597)	(9,233)	(4,055)	(4,066)	(3,007)	(3,643)	(4,428)
Minority Interest	(88)	(72)	(72)	(72)	(72)	2	2	0	0	0
<b>Adj. Net Income</b>	<b>22,607</b>	<b>25,575</b>	<b>17,874</b>	<b>21,669</b>	<b>26,350</b>	o/w Net debt issued/(repaid)	-	-	(10,140)	(10,000)
Reported EPS	49.93	56.46	39.46	47.84	58.17	<b>Net change in cash</b>	<b>(15,077)</b>	<b>20,193</b>	<b>26,684</b>	<b>(2,711)</b>
<b>Adj. EPS</b>	<b>49.93</b>	<b>56.46</b>	<b>39.46</b>	<b>47.84</b>	<b>58.17</b>	<b>Free cash flow to firm</b>	<b>(15,100)</b>	<b>25,617</b>	<b>21,477</b>	<b>13,254</b>
DPS	7.46	7.48	5.52	6.68	8.12	y/y Growth	(180.6%)	(269.6%)	(16.2%)	(38.3%)
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	33,678	30,968	35,302	Gross margin	68.5%	70.8%	67.5%	68.0%
Accounts receivable	45,488	43,073	40,695	47,164	52,524	EBITDA margin	26.8%	26.2%	21.3%	22.2%
Inventories	32,737	36,423	34,411	39,882	44,415	EBIT margin	23.2%	20.9%	14.9%	15.7%
Other current assets	12,412	11,910	11,261	13,026	14,489	Net profit margin	16.4%	14.9%	11.1%	11.6%
<b>Current assets</b>	<b>98,874</b>	<b>119,542</b>	<b>120,046</b>	<b>131,040</b>	<b>146,730</b>	ROE	22.6%	20.7%	12.6%	13.6%
PP&E	91,539	108,560	112,133	113,911	114,308	ROA	12.6%	10.4%	6.7%	7.8%
LT investments	662	985	985	985	985	ROCE	15.5%	12.7%	8.0%	9.6%
Other non current assets	35,174	36,986	36,986	36,986	36,986	SG&A/Sales	18.1%	16.6%	17.0%	17.0%
<b>Total assets</b>	<b>226,249</b>	<b>266,073</b>	<b>270,150</b>	<b>282,922</b>	<b>299,009</b>	Net debt/Equity	60.1%	57.3%	27.1%	19.8%
Short term borrowings	18,036	23,183	23,043	23,043	23,043	Net debt/EBITDA	182.5%	172.5%	117.8%	80.1%
Payables	19,888	25,889	24,459	28,348	31,569	Sales/Assets (x)	0.8	0.7	0.6	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
<b>Current liabilities</b>	<b>50,612</b>	<b>61,206</b>	<b>60,108</b>	<b>64,515</b>	<b>68,307</b>	Interest cover (x)	62.0	29.5	19.9	28.0
Long-term debt	57,423	61,302	51,302	41,302	31,302	Operating leverage	4.6%	49.0%	591.9%	139.7%
Other long term liabilities	6,260	8,244	8,553	8,893	9,266	Tax rate	31.9%	27.7%	26.0%	26.0%
<b>Total liabilities</b>	<b>114,294</b>	<b>130,752</b>	<b>119,963</b>	<b>114,709</b>	<b>108,875</b>	Revenue y/y Growth	9.2%	24.4%	(5.5%)	15.9%
Shareholders' equity	111,634	134,976	149,842	167,868	189,789	EBITDA y/y Growth	1.8%	21.9%	(23.1%)	20.7%
Minority interests	321	345	345	345	345	EPS y/y Growth	(6.2%)	13.1%	(30.1%)	21.2%
<b>Total liabilities &amp; equity</b>	<b>226,249</b>	<b>266,073</b>	<b>270,150</b>	<b>282,922</b>	<b>299,009</b>					
<b>BVPS</b>	<b>246.55</b>	<b>297.98</b>	<b>330.80</b>	<b>370.60</b>	<b>418.99</b>	Valuation				
y/y Growth	25.5%	20.9%	11.0%	12.0%	13.1%	FY16A	FY17A	FY18E	FY19E	FY20E
Net debt/(cash)	67,241	77,491	40,667	33,377	19,042	P/E (x)	20.5	18.2	26.0	21.4
						P/BV (x)	4.2	3.4	3.1	2.8
						EV/EBITDA (x)	14.4	12.1	14.6	12.0
						Dividend Yield	0.7%	0.7%	0.5%	0.7%

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

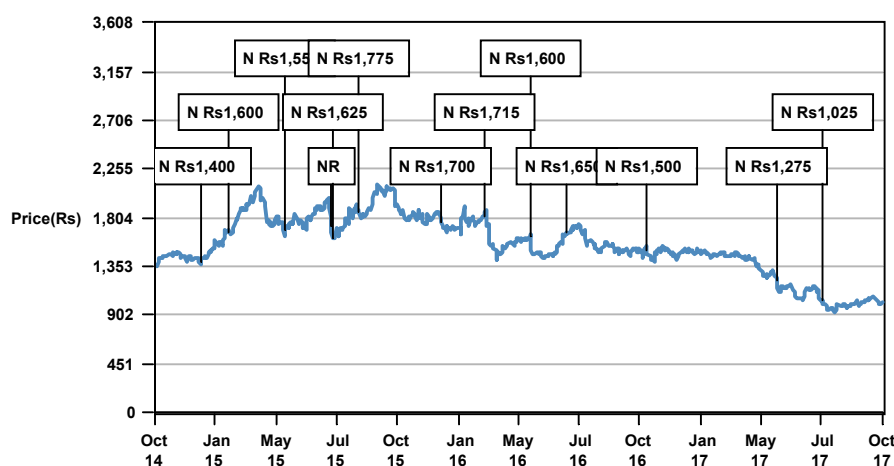
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Lupin Ltd. (LUPN.NS, LPC IN) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
07-Jan-15	N	1395.85	1400.00
18-Feb-15	N	1662.25	1600.00
14-May-15	N	1689.50	1550.00
23-Jul-15	NR	1728.25	--
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	1820.95	1715.00
20-May-16	N	1638.15	1600.00
11-Jul-16	N	1669.10	1650.00
10-Nov-16	N	1507.60	1500.00
25-May-17	N	1228.50	1275.00
03-Aug-17	N	1034.95	1025.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.  
Initiated coverage May 10, 2007.



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31 October 2017

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