

Lupin----- Maintain UNDERPERFORM

Weak US—further cut estimates and TP; high risk of flat profit in FY20

EPS: ▼ TP: ▼

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- Lupin reported a weak quarter with 14% decline in US sales QoQ. US sales have bottomed out but we highlight that it will take Lupin one more year just to reach back to the 1Q18 level. Further risk is FY20 profit is likely to be flattish vs FY19 as (1) 10% of FY19 profit is driven by Ranexa exclusivity; (2) further competition in Fortamet (Auro & Nostrum) and Glumetza (Sun); and (3) more competition in Levothyroxine. The stock is expensive at 20.5x FY20 EPS.
- Delays in US pipeline continue for Lupin: (1) Tamiflu launch delayed to Mar-18 quarter which means that a good part of FY18 flu season will be missed. (2) On Lialda, Prevacid ODT and Coreg CR, Lupin has received CRLs and expects approval end-FY19.
- US sale in 2Q18 was impacted by volume loss in Metformin franchise and price erosion in Mckesson and Walmart alliance. Streamlining of prices has already started between Express Scripts & Walgreens and will impact the sector over next two qtrs.
- Key approval for Lupin is Levothyroxine which Lupin expects in end-4Q18 for Synthroid as RLD and for other RLDs in FY19. We cut FY18/19 EPS by 4/7% and cut TP to Rs900 (from Rs920).

Key negative was sharp sales erosion in the US

US sales declined 14% QoQ due to (1) continued volume loss in Fortamet and Teva's launch in Glumetza, (2) impact of Mckesson and Walmart alliance on the base portfolio and (3) loss of Minastrin exclusivity (Mylan and Amneal launch). The \$34 mn decline in US sales was almost equally split between loss from Metformin franchise and price erosion from Mckesson and Walmart alliance. Gross margins declined 70 bp sequentially due to (1) decline in US sales and (2) netting off of GST for India sales vs gross reporting of excise duty earlier (impacts gross margin optically by 25 bp).

We note that over the last two quarters, Lupin has lost \$290 mn of annualised sales and the US sales are now below pre-Gavis acquisition and pre-Glumetza launch (3Q16 quarter). Streamlining of prices has already started between Express Scripts and Walgreens and there is a risk that Sun could launch Glumetza again.

Delay in key pipeline continues; Lupin guided for Indore / Goa clearance in next couple of months;

Lupin today announced delays in multiple products: (1) Tamiflu launch now delayed to Mar-18 quarter which means that a good part of the FY18 flu season will be missed for Lupin. (2) On Lialda and Prevacid ODT, Lupin has received CRLs and expects approval in end-FY19. (3) Coreg CR CRL is also pending and Lupin expects approval only in FY19 end.

India grew 20% y/y; other key markets weak

Adjusting for excise accounting, India growth was strong at 20% y/y due to GST restocking and new launches. Japan sale declined in constant currency (at ~5% excluding impact of Shinogi acquisition) and sales have not picked up much vs. 1Q18 (3) constant currency growth in South Africa was just 7%.

Cut FY18/19 EPS by 4/7% and reduce TP to Rs 900

We factor weakness of US sales and cut FY18/19E EPS by 4%/7%. We reiterate that Lupin has high risk that FY20 profit is likely to be flat as (1) 10% of FY19 profit is from Ranexa exclusivity; (2) Aurobindo and Nostrum will enter the Fortamet market by FY20; (3) Sun should have entered Glumetza by FY20; (4) we expect more competition in Levothyroxine as well. Therefore, the stock is already trading at 20.5x FY20E EPS.

Other takeaways

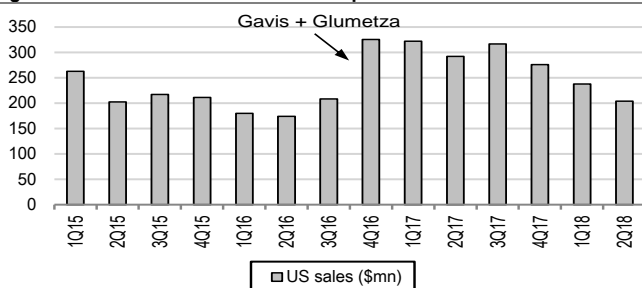
- Levothyroxine: Lupin filed for Synthroid (as RLD) now and expects approval in end-FY18. Expect approval for other RLDs in FY19.
- Inhalers: (1) Ph 3 trial for Tiotropium to finish by 4Q18; (2) Advair DPI – Lupin repeating PK studies and will start trial next year.

Bbg/RIC	LPC IN / LUPN.BO	Price (30 Oct 17, Rs)	1,027.55		
Rating (prev. rating)	U (U)	TP (prev. TP Rs)	900.00 (920.00)		
52-wk range (Rs)	1536.6 - 922.8	Est. pot. % chg. to TP	(12)		
Mkt cap (Rs/US\$ bn)	464.3/ 7.2	Blue sky scenario (Rs)	1,441		
ADTO-6M (US\$ mn)	32.7	Grey sky scenario (Rs)	800.00		
Free float (%)	47.0	Performance	1M 3M 12M		
Major shareholders	Promoter 53%	Absolute (%)	1.4 0.9 (32.3)		
		Relative (%)	(4.9) (1.2) (51.4)		
Year	03/16A	03/17A	03/18E	03/19E	03/20E
Revenue (Rs mn)	142,085	173,674	160,541	183,211	199,929
EBITDA (Rs mn)	37,535	46,490	33,748	41,401	41,512
Net profit (Rs mn)	22,118	27,134	17,241	22,596	22,574
EPS (CS adj. Rs)	49.1	60.2	38.2	50.1	50.1
- Change from prev. EPS (%)	n.a.	n.a.	(4.1)	(7.2)	
- Consensus EPS (Rs)	n.a.	n.a.	43.0	57.1	65.4
EPS growth (%)	(8.2)	22.6	(36.5)	31.1	(0.1)
P/E (x)	20.9	17.1	26.9	20.5	20.5
Dividend yield (%)	0.7	0.7	0.6	0.7	0.7
EV/EBITDA (x)	14.1	11.1	14.8	11.7	11.4
P/B (x)	4.2	3.4	3.1	2.7	2.5
ROE (%)	22.3	22.2	12.1	14.2	12.7
Net debt(cash)/equity (%)	57.5	38.1	22.4	12.8	3.8

Note 1: Lupin Limited is an India-based pharmaceutical company. The company develops and markets a range of generic formulations and Active Pharmaceutical Ingredients (APIs) in markets around the world. It focuses on chronic therapies and the lifestyle segment.

[Click here](#) for detailed financials

Figure 1: US sales now are lower than pre-Gavis and Glumetza launch!



Source: Company data, Credit Suisse research.

Figure 2: Weak top line, but in-line EBITDA due to lower R&D

Rs mn	2Q18A	2Q18E	Diff (%)	2Q17A	Y/Y %	1Q18A	QOQ %
Net sales	39,520	41,725	-5.3%	42,905	-8%	38,686	2%
Gross margin	67.4%	66.8%	0.6%	71.0%	-3.6%	68.1%	-0.7%
R&D	12.0%	12.5%	-0.5%	13.3%	-1.3%	12.9%	-0.9%
Personnel cost	18.3%	17.4%	0.9%	16.6%	1.7%	18.6%	-0.2%
SG&A	15.5%	19.0%	-3.4%	16.1%	-0.6%	16.8%	-1.3%
EBITDA	8,529	8,411	1%	10,731	-21%	7,675	11%
EBITDA margin	21.6%	20.2%	1.4%	25.0%	-3.4%	19.8%	1.7%
Net income	4,550	4,220	8%	7,072	-36%	3,582	27%

Source: Company data, Credit Suisse estimates.

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Companies Mentioned (Price as of 30-Oct-2017)

Aurobindo Pharma Ltd (ARBN.BO, Rs767.75)
Express Scripts (ESRX.OQ, \$62.19)
Lupin Ltd (LUPN.BO, Rs1027.55, UNDERPERFORM, TP Rs900.0)
McKesson (MCK.N, \$135.62)
Sun Pharmaceuticals Industries Limited (SUN.BO, Rs553.15)
Teva Pharmaceutical (TEVA.N, \$13.32)
Wal-Mart Stores, Inc. (WMT.N, \$88.17)
Walgreens Boots Alliance (WBA.OQ, \$64.48)

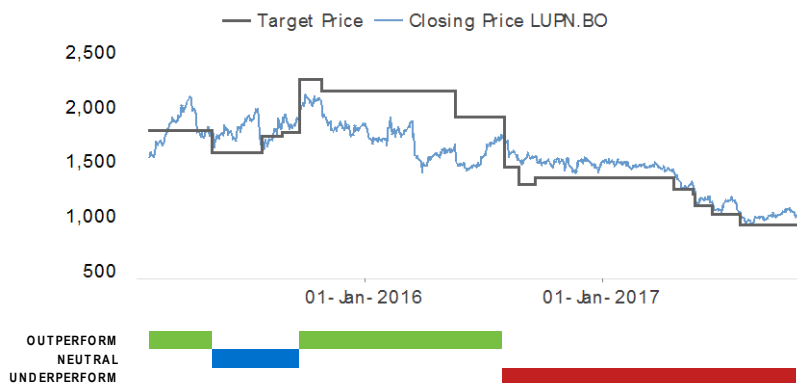
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LUPN.BO	Closing Price	Target Price	
Date	(Rs)	(Rs)	Rating
30-Oct-14	1345.90	1560.00	O
03-Feb-15	1545.30	1780.00	
11-May-15	1770.15	1585.00	N
27-Jul-15	1617.50	1735.00	
26-Aug-15	1811.80	1770.00	
23-Sep-15	1921.30	2250.00	O
27-Oct-15	1945.65	2150.00	
20-May-16	1505.15	1905.00	
03-Aug-16	1679.75	1450.00	U
26-Aug-16	1512.25	1290.00	
19-Sep-16	1542.80	1350.00	
21-Apr-17	1409.10	1250.00	
21-May-17	1314.90	1200.00	
24-May-17	1227.65	1100.00	
19-Jun-17	1130.80	1020.00	
02-Aug-17	1034.25	920.00	



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Restricted	2%	

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Valuation Methodology and Risks: (12 months) for Lupin Ltd (LUPN.BO)

Method: Our Rs900 target price for Lupin is arrived at by applying 17x price-to-earnings multiple to its profits for the twelve months ending FY19. The price-to-earnings multiple used for Lupin is based on CS framework, where we give a lower multiple to US profits (due to expectation of higher price erosion) and higher multiple to high-ROCE/high growth Indian business. Our UNDERPERFORM rating is based on its high profit concentration, and expensive valuation.

Risk: Upside risks to our Rs900 target price and UNDERPERFORM rating for Lupin include: (1) delayed competition in Minastrin; (2) faster-than-expected new product approvals in the United States; and (3) a better-than-expected ramp-up in its Gavis portfolio.

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