

LUPIN

PHARMACEUTICALS

HOLD

Target Price: Rs 940

In-line EBITDA on cost optimization; growth challenges remain

Q2 EBITDA (-17% YoY) was in line led by lower operating costs, but PAT (-31% YoY) was 12% above our estimate (2.5% above consensus) on higher other income and lower tax. Weak performance in higher-margin US business (-30% YoY/-14% QoQ) was partly offset by higher revenue from India, LatAM, EMEA. It maintained FY18 guidance of high single digit sales decline along with EBITDA margin at 21-23%.

While it expects regulatory clearance for key facilities (Goa, Pithampur) in near term, some of its key complex generic filings have received CRL# with subsequent delay in monetization. Accordingly, we cut FY18/19E EPS by 10%/12% and revise TP to Rs 940 (18x Sep 19E EPS) vs. Rs 960 (18x FY19E EPS). Maintain **HOLD** on near term growth challenges.

CMP : Rs 1,028
 Potential Upside : -9%

MARKET DATA

No. of Shares : 452mn
 Free Float : 53%
 Market Cap : Rs464bn
 52-week High / Low : Rs1,572 / Rs920
 Avg. Daily vol. (6mth) : 1.9 mn shares
 Bloomberg Code : LPC IB Equity
 Promoters Holding : 47%
 FII / DII : 28% / 12%

- ◆ **Strong India recovery, but weak US performance continues:** Revenue declined 8% YoY (in line with estimate) largely on 30% YoY decline in US business (35% of sales). US sales declined 14% QoQ to USD 204 mn on increased competition in gGlumetza, expiry of gMinastrin FTF exclusivity and contract renegotiation with Walmart – Mckesson (Clarus One Sourcing). Given the channel consolidation, US business (ex-gGlumetza, gFortamet) also declined in Q2FY18 (vs. 11% YoY growth in Q1FY18). India revenue grew 16% YoY in Q2 (grew 20% YoY adj. for excise impact vs. single digit industry growth) partially led by channel restocking. Other markets like Japan grew 30%YoY in JPY terms (acquisition of Shionogi brands in Q3'17); LaTam, EMEA (+17% YoY); API (-9% YoY)
- ◆ **In-line EBITDA on cost optimization:** Gross margin declined 370 bps YoY / 80 bps QoQ to 66.8% (below our estimate of 68.5%) on pricing pressure in US and appreciation of Rs/USD. EBITDA declined 17% YoY / +2% QoQ to Rs 8.53 bn – in line with our estimate – aided by lower R&D, SGA expenses (-17% YoY) and marginal (2% YoY) increase in employee expenses. EBITDA margin contracted 238 bps YoY to 21.6% (vs. estimate of 20.7%). Higher other income and lower tax rate led to reported PAT of Rs 4.55 bn (-31% YoY, +27% QoQ), 12% above estimate.

Financial summary (Consolidated)

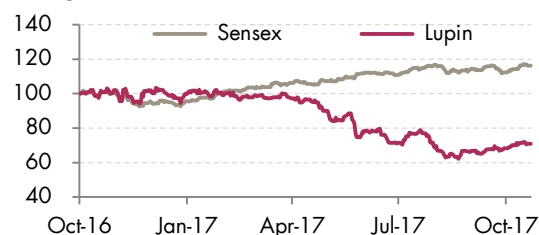
Y/E March	FY17	FY18E	FY19E	FY20E
Sales (Rs mn)	1,71,198	1,55,095	1,74,286	1,98,396
Adj PAT (Rs mn)	25,575	16,999	21,141	26,019
Con. EPS* (Rs)	-	43.3	55.7	66.5
EPS (Rs)	56.6	37.6	46.8	57.6
Change YOY (%)	12.9	(33.5)	24.4	23.1
P/E (x)	18.1	27.3	21.9	17.8
RoE (%)	20.7	12.0	13.5	14.8
RoCE (%)	17.5	10.8	12.7	14.6
EV/E (x)	11.5	15.1	12.6	10.5
DPS (Rs)	7.5	7.5	7.5	7.5

Source: *Consensus broker estimates, Company, Axis Capital

^ CAPA: Corrective and preventive action plan #CRL: Complete response letter

Key drivers

Growth (%)	FY17	FY18E	FY19E
US (USD mn)	38	(25)	12
India	11	12	15
EBITDA margin	27	21	22
Adj-EPS	59	38	47

Price performance

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- ◆ **R&D update:** R&D for Q2FY18 declined 17% YoY/ 5% QoQ to Rs 4.7 bn and stood at 12.2 % of sales (vs. 13.6% of sales in Q2FY17; 13.1% in Q1FY18). LPC expects to file more than 30 ANDA in FY18 (vs. 11 filing in H1FY18; 10 filings in Q2FY18), while maintaining its absolute quarterly R&D spend of Rs 5 bn for H2FY18. LPC expects to reduce its R&D spends towards new drug discovery, while it will continue to build a specialty pipeline inorganically
- ◆ **Key Concall highlights:** (1) **Gavis:** Strong double digit growth in Q2FY18 (23% YoY, growth in Q1FY18); (2) **Brand business:** USD 24 mn in Q2FY18 vs. USD 23 mn in Q1FY18, driven by Methergine (clocking monthly sales of USD 5-6 mn); (3) **USFDA update:** Expects clearance for Pithampur and Goa facilities over next 2-3 months. Has already responded with CAPA^ plan; (4) **India:** Expects 15% YoY growth in H2FY18; (5) **Tax** – Effective tax rate of 25-28% in FY18

Exhibit 1: EBITDA aided by cost optimization initiatives

(Rs mn)	Q2'17	Q1'18	Q2'18	YoY (%)	QoQ (%)
Revenues	42,112	38,068	38,742	(8)	2
Other operating income	793	628	778	(2)	24
Total Revenue	42,905	38,696	39,520	(8)	2
Gross Profit	29,683	25,742	25,876	(13)	1
Gross Profit margin (%)	70.5	67.6	66.8	-369 bps	-83 bps
Staff	7,124	7,180	7,250	2	1
Staff as % of Sales	16.9	18.9	18.7	180 bps	-15 bps
R&D	5,716	4,999	4,739	(17)	(5)
R&D as % of Sales	13.6	13.1	12.2	-134 bps	-90 bps
SGA	7,356	6,507	6,135	(17)	(6)
SGA as % of Sales	17.5	17.1	15.8	-163 bps	-126 bps
EBITDA	10,281	7,684	8,531	(17)	11
EBITDA margin (%)	24.0	19.9	21.6	-238 bps	173 bps
Interest	263	439	479	82	9
Depreciation	2,112	2,605	2,722	29	4
Other Income	271	320	740	173	132
PBT	8,177	4,959	6,070	(26)	22
Tax	1,589	1,368	1,541	(3)	13
Tax rate	19.4	27.6	25.4	594 bps	-221 bps
Reported PAT	6,622	3,581	4,550	(31)	27
Adjusted PAT	4,706	3,581	4,550	(3)	27

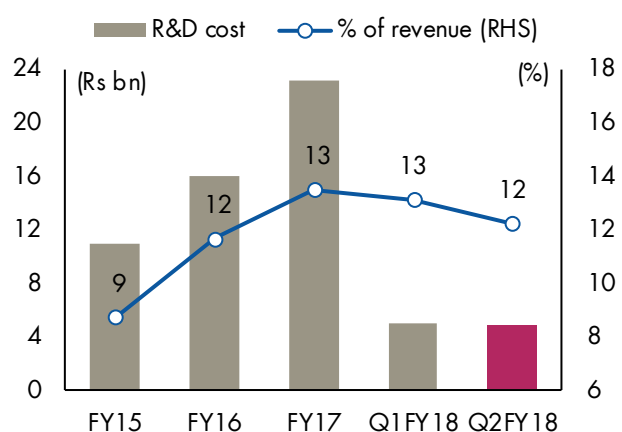
Source: Company Note: As per Ind-AS

Exhibit 2: Strong growth across segments (ex-US)

Rs mn	Q2'17	Q1'18	Q2'18	YoY (%)	QoQ (%)
US Total (USD mn)	292	238	204	(30)	(14)
US Total (Rs mn)	19,978	16,018	13,611	(32)	(15)
India	9,958	9,324	11,593	16	24
Asia Pacific	5,520	5,989	6,357	15	6
- Japan (JPY mn)	6,700	8,585	8,685	30	1
EMEA	2,355	2,259	2,758	17	22
- South Africa (ZAR mn)	252	209	270	7	29
LatAM	986	1,269	1,395	41	10
RoW	396	416	378	(5)	(9)
Formulations	39,193	35,275	36,092	(8)	2
API	2,919	2,793	2,650	(9)	(5)
Total	42,112	38,068	38,742	(8)	2

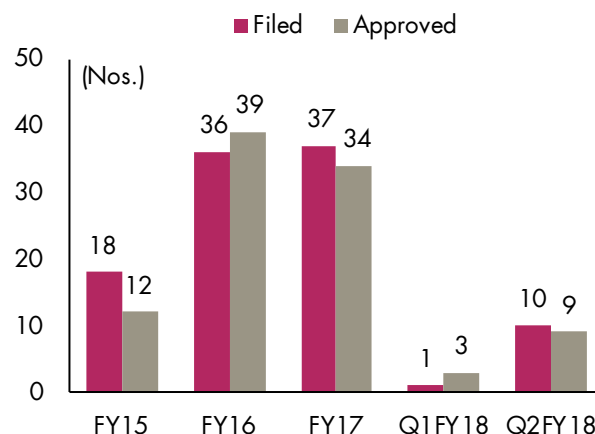
Source: Company *EMEA: Europe Middle East & Africa

Exhibit 3: Reducing R&D spends towards new drug discovery



Source: Company, Axis Capital

Exhibit 4: LPC filed 10 ANDA's in Q2'18



Source: Company, Axis Capital

Concall highlights

Guidance

- ◆ **Revenue:** Maintains single digit decline in revenue in FY18 (including acquisitions)
- ◆ **ANDA filings:** Expects to file more than 30 ANDA filings in FY18 (11 filing in H1FY18) – including 4-5 injectable, 4-5 dermatology products. Expects to launch 20-30 products in FY18
- ◆ **EBITDA:** Maintained EBITDA margin at 21-23% in FY18
- ◆ **R&D:** Maintained FY18 absolute quarterly R&D spend of Rs 5 bn in FY18 (vs. Rs 4.7 bn in Q2FY18, Rs 23 bn in FY17). Reducing R&D spends towards new drug discovery. To continue to build specialty pipeline inorganically
- ◆ **India:** Expects 15% YoY growth in H2FY18
- ◆ **Tax:** Effective tax rate of 25-28% in FY18

US (USD 204 mn; -30% YoY/ -14% QoQ)

- ◆ Revenue declined in Q2FY18 largely due to increased competition in gGlumetza, expiry of gMinastrin FTF exclusivity, certain contract renegotiation with Walmart – Mckesson (Clarus One). Given the channel consolidation, US business (ex-gGlumetza, gFortamet) also declined in Q2FY18 (vs. 11% YoY growth in Q1FY18). Somerset/Gavis business grew strong double digit in Q2FY18 (vs. 23% YoY, growth in Q1FY18)
- ◆ **Brand business:** USD 24 mn in Q2FY18 vs. USD 23 mn in Q1FY18. Methergine currently clocking monthly sales of USD 5-6 mn
- ◆ **gFortamet:** Expect no additional competition in near term
- ◆ **Tamiflu-** Expects approval/launch in Q4FY18
- ◆ **Coreg CR:** Pending CRL – to respond by end FY18. Expects launch in end FY19
- ◆ **gLialda:** Has received CRL; currently addressing queries raised. Expects launch in end FY19
- ◆ **Prevacid ODT:** Pending CRL – to respond by end Q3/Q4FY18. Expects launch in FY19
- ◆ **Tobi:** Some capacity constraints at contract manufacturing facility. Expects to launch in Q3FY18 (has received approval)
- ◆ **Levothyroxine:** Had a pre-approval inspection in Indore in Q1FY18. Expects launch in end FY18/start FY19 (product on USFDA priority list)
- ◆ Other launches over next 12-18 months include gAxiron, gRanexa

USFDA update

The company expects closure over the next 2-3 months for Pithampur and Goa units. Company has already responded with CAPA plan

India (Rs. 11,593 mn, +16% YoY): India revenue grew 16% YoY in Q2 (grew 20% YoY adj. for excise impact) vs. single digit industry growth. It expects India business to grow 15% YoY in H2FY18.

Japan (JPY 8,685 mn, +30% YoY in JPY terms): Japan business grew 30% YoY in cc terms led by acquisition of Shionogi brands in Q3FY17.

APAC (Rs 6,357 mn, +15% YoY): Philippines sales increased 12.6% YoY/44% QoQ in Q2 in constant currency terms.

LATAM (Rs 1,269 mn, +17% YoY): Brazil constant currency sales increased 30.1% YoY/ 12% QoQ in Q2. In Mexico, sales increased 66% YoY/ 3% QoQ in Q2 in constant currency terms.

EMEA (Rs 2,758 mn, +17% YoY): South Africa constant currency sales increased 7% YoY/29% QoQ in Q2. Lupin remains the 4th largest generic player in the South African market

R&D (Rs. 4.7 bn, 12.2% of Q2 revenue): During the quarter, LPC filed 10 ANDA's (vs. 1 in Q1FY18; 37 in FY17) and received 9 ANDA approvals (vs. 3 in Q1FY18, 34 during FY17). Cumulative ANDA filings with USFDA stand at 377 (225 approvals, 152 pending ANDAs including 49 First-to-Files (FTF) filings including 25 exclusive FTF opportunities)

- ◆ **gSpriva** – Development on track. To complete Phase 3 clinical studies by end FY18
- ◆ **gAdvair** – repeating PK studies as asked by the USFDA; expects to start phase -3 trials in FY19
- ◆ **Inhalation pipeline:** Filed nasal sprays. Filed Albuterol MDI also had a FDA inspection for the same. Expects launch in FY20
- ◆ **Biosimilar Etanercept:** Development on track. Expects to file in Japan in FY18. EU filing in FY19

Capex: Rs 2.08 bn in Q2FY18 (vs. Rs 2.8bn in Q1FY18, Rs 16.6 bn in FY17)

P&L and Balance Sheet highlights

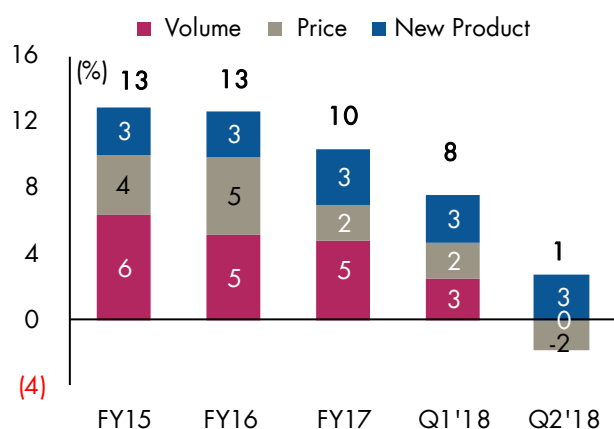
- ◆ Gross profit impacted by Rs 420 mn in Q2FY18 due to USD/INR depreciation
- ◆ EBITDA aided by hedging gains of Rs 410 mn in Q2FY18

Exhibit 5: LPC has lost some market share in gFortamet 1,000 mg, good traction in gEpzicom, gVigamox

Launch	Brand	Brand sales/ market size (USD mn)	Market share (%)						
			Sep-16	Dec-16	Mar-17	Jun-17	Jul-17	Aug-17	Sep-17
22-Feb-13	Suprax OS	80	79	75	76	73	70	71	73
18-Dec-13	Trizivir	112	84	86	86	88	88	87	88
12-Nov-14	Celebrex	2,540	12	12	12	12	12	12	11
20-Nov-12	Tricor	1,300	14	13	15	17	17	17	17
06-Dec-13	Trilipix	450	23	23	24	25	27	27	29
14-Oct-11	Fortamet 1000mg	-	70	65	61	58	57	55	52
12-Dec-13	Cymbalta	5,400	16	15	14	14	15	14	15
15-Mar-17	Pristiq	883	-	-	14	21	20	22	23
05-Jul-17	Vigamox	299	-	-	-	-	10	17	18
31-Mar-17	Epzicom	388	-	-	-	11	13	15	19

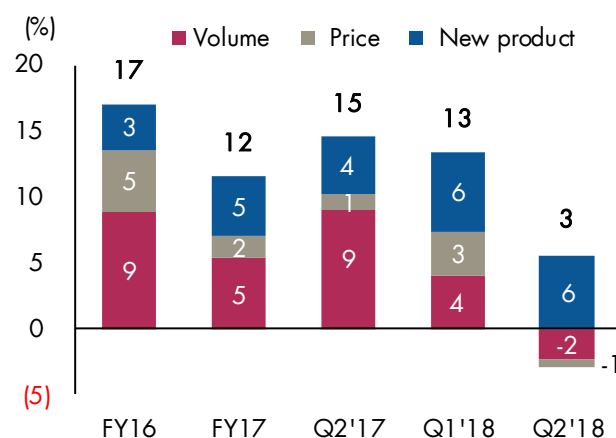
Source: Bloomberg

Exhibit 6: IPM growth trends



Source: AIOCD

Exhibit 7: LPC witnessed slower volume growth in Q2FY18



Source: AIOCD

Exhibit 8: Anti-infective sales declined in Q2

YoY growth	% of sales	FY16	FY17	Q2'17	Q1'18	Q2'18
Cardiac	24%	19%	8%	5%	13%	2%
Anti-infective	19%	7%	-2%	5%	-4%	-11%
Respiratory	13%	22%	17%	26%	19%	1%
Anti-Diabetic	13%	23%	36%	33%	43%	26%
Gastro Intestinal	8%	20%	15%	14%	14%	3%
Vit. / Min. / Nut.	5%	10%	0%	-4%	5%	-4%
Neuro / CNS	5%	10%	9%	7%	3%	2%
Pain / Anal.	4%	15%	6%	7%	6%	-2%
Gynaecological	4%	48%	25%	15%	28%	14%
Hormones	0%	4%	4%	9%	9%	-11%
Total (Rs bn)	37	17%	12%	15%	13%	3%

Source: AIOCD *% of FY17 sales

Financial summary (Consolidated)

Profit & loss (Rs mn)

Y/E March	FY17	FY18E	FY19E	FY20E
Net sales	1,71,198	1,55,095	1,74,286	1,98,396
Other operating income	3,745	3,375	3,450	3,575
Total operating income	1,74,943	1,58,470	1,77,736	2,01,971
Cost of goods sold	(50,014)	(50,406)	(56,294)	(62,991)
Gross profit	1,24,929	1,08,064	1,21,441	1,38,980
<i>Gross margin (%)</i>	<i>73.0</i>	<i>69.7</i>	<i>69.7</i>	<i>70.1</i>
Total operating expenses	(79,998)	(74,585)	(81,929)	(92,241)
EBITDA	44,931	33,480	39,513	46,739
<i>EBITDA margin (%)</i>	<i>26.2</i>	<i>21.6</i>	<i>22.7</i>	<i>23.6</i>
Depreciation	(9,122)	(10,331)	(10,746)	(11,544)
EBIT	35,809	23,149	28,767	35,195
Net interest	(1,525)	(1,811)	(1,651)	(1,507)
Other income	1,065	1,763	1,620	1,684
Profit before tax	35,349	23,100	28,736	35,372
Total taxation	(9,785)	(6,122)	(7,615)	(9,374)
<i>Tax rate (%)</i>	<i>27.7</i>	<i>26.5</i>	<i>26.5</i>	<i>26.5</i>
Profit after tax	25,564	16,979	21,121	25,999
Minorities	11	20	20	20
Profit/ Loss associate co(s)	-	-	-	-
Adjusted net profit	25,575	16,999	21,141	26,019
<i>Adj. PAT margin (%)</i>	<i>14.9</i>	<i>11.0</i>	<i>12.1</i>	<i>13.1</i>
Net non-recurring items	-	-	-	-
Reported net profit	25,575	16,999	21,141	26,019

Balance sheet (Rs mn)

Y/E March	FY17	FY18E	FY19E	FY20E
Paid-up capital	903	903	903	903
Reserves & surplus	1,34,073	1,46,995	1,64,059	1,86,002
Net worth	1,34,976	1,47,898	1,64,963	1,86,905
Borrowing	79,521	72,435	66,043	60,270
Other non-current liabilities	13,009	13,009	13,009	13,009
Total liabilities	2,27,851	2,33,667	2,44,320	2,60,470
Gross fixed assets	1,23,953	1,39,203	1,54,150	1,69,097
Less: Depreciation	(13,624)	(23,955)	(34,701)	(46,244)
Net fixed assets	1,10,329	1,15,248	1,19,449	1,22,853
Add: Capital WIP	21,331	23,464	25,810	28,391
Total fixed assets	1,31,660	1,38,712	1,45,259	1,51,244
Total Investment	21,361	21,361	21,361	21,361
Inventory	36,423	35,197	39,060	44,203
Debtors	43,073	40,367	42,975	48,919
Cash & bank	6,994	10,243	10,873	13,908
Loans & advances	159	5,524	6,207	7,066
Current liabilities	38,222	35,363	39,410	44,688
Net current assets	60,179	58,943	63,048	73,213
Other non-current assets	14,651	14,651	14,651	14,651
Total assets	2,27,851	2,33,667	2,44,320	2,60,470

Source: Company, Axis Capital

Cash flow (Rs mn)

Y/E March	FY17	FY18E	FY19E	FY20E
Profit before tax	35,349	23,100	28,736	35,372
Depreciation & Amortisation	9,122	10,331	10,746	11,544
<i>Chg in working capital</i>	<i>5,059</i>	<i>4,484</i>	<i>(3,474)</i>	<i>(7,131)</i>
Cash flow from operations	41,148	28,221	25,121	27,221
<i>Capital expenditure</i>	<i>(26,007)</i>	<i>(15,250)</i>	<i>(14,947)</i>	<i>(14,947)</i>
Cash flow from investing	(25,287)	(15,250)	(14,947)	(14,947)
<i>Equity raised/ (repaid)</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>
<i>Debt raised/ (repaid)</i>	<i>9,479</i>	<i>(7,086)</i>	<i>(6,392)</i>	<i>(5,773)</i>
<i>Dividend paid</i>	<i>(4,066)</i>	<i>(4,077)</i>	<i>(4,077)</i>	<i>(4,077)</i>
Cash flow from financing	4,330	(12,973)	(12,120)	(11,356)
Net chg in cash	20,191	(3)	(1,946)	918

Key ratios

Y/E March	FY17	FY18E	FY19E	FY20E
OPERATIONAL				
FDEPS (Rs)	56.6	37.6	46.8	57.6
CEPS (Rs)	76.8	60.5	70.6	83.2
DPS (Rs)	7.5	7.5	7.5	7.5
Dividend payout ratio (%)	13.2	19.9	16.0	13.0
GROWTH				
Net sales (%)	24.4	(9.4)	12.4	13.8
EBITDA (%)	21.9	(25.5)	18.0	18.3
Adj net profit (%)	13.1	(33.5)	24.4	23.1
FDEPS (%)	12.9	(33.5)	24.4	23.1
PERFORMANCE				
RoE (%)	20.7	12.0	13.5	14.8
RoCE (%)	17.5	10.8	12.7	14.6
EFFICIENCY				
Asset turnover (x)	0.9	0.8	0.9	1.0
Sales/ total assets (x)	0.7	0.6	0.6	0.7
Working capital/ sales (x)	0.3	0.3	0.3	0.3
Receivable days	91.8	95.0	90.0	90.0
Inventory days	102.3	102.8	103.1	103.9
Payable days	72.8	68.5	68.8	69.3
FINANCIAL STABILITY				
Total debt/ equity (x)	0.6	0.5	0.4	0.3
Net debt/ equity (x)	0.4	0.3	0.2	0.1
Current ratio (x)	2.6	2.7	2.6	2.6
Interest cover (x)	23.5	12.8	17.4	23.4
VALUATION				
PE (x)	18.1	27.3	21.9	17.8
EV/ EBITDA (x)	11.5	15.1	12.6	10.5
EV/ Net sales (x)	3.0	3.3	2.9	2.5
PB (x)	3.4	3.1	2.8	2.5
Dividend yield (%)	0.7	0.7	0.7	0.7
Free cash flow yield (%)	-	-	-	-

Source: Company, Axis Capital

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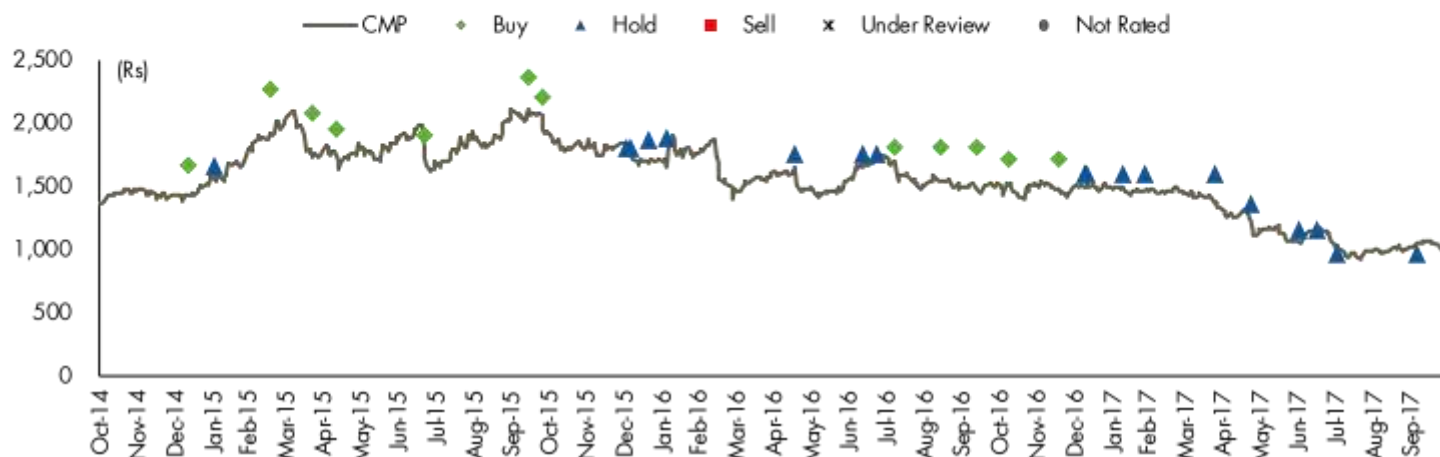
DEFINITION OF RATINGS

Ratings	Expected absolute returns over 12 months
BUY	More than 10%
HOLD	Between 10% and -10%
SELL	Less than -10%

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Lupin (LUPN BO, LPC IN) Price and Recommendation History



Date	Target Price	Reco	Date	Target Price	Reco	Date	Target Price	Reco
12-Jan-15	1,653	Buy	5-Feb-16	1,880	Hold	9-Feb-17	1,600	Hold
3-Feb-15	1,650	Hold	19-May-16	1,750	Hold	27-Feb-17	1,600	Hold
20-Mar-15	2,250	Buy	13-Jul-16	1,750	Hold	26-Apr-17	1,600	Hold
23-Apr-15	2,070	Buy	25-Jul-16	1,750	Hold	24-May-17	1,350	Hold
13-May-15	1,940	Buy	9-Aug-16	1,800	Buy	3-Jul-17	1,150	Hold
24-Jul-15	1,900	Buy	15-Sep-16	1,800	Buy	17-Jul-17	1,150	Hold
16-Oct-15	2,350	Buy	14-Oct-16	1,800	Buy	3-Aug-17	960	Hold
27-Oct-15	2,200	Buy	9-Nov-16	1,700	Buy	6-Oct-17	960	Hold
4-Jan-16	1,800	Hold	19-Dec-16	1,700	Buy			
7-Jan-16	1,800	Hold	9-Jan-17	1,600	Hold			
21-Jan-16	1,860	Hold	11-Jan-17	1,600	Hold			

Source: Axis Capital