

## Fortamet challenge yet to come

Lupin reported a 250bps drop in gross margins compared with the previous quarter, a significant part of which was stated to be a recurring lower base. The company prepares for Solosec launch. However, the threat of a Methergine generic looms on the specialty portfolio which could tamper specialty growth prospects while adding sales force costs. On the warning letters, Lupin expects to finish remediation work by April/ May 2018 and then approach USFDA. Lupin faces potential competition to gFortamet from a new entrant which could impact FY19 earnings. Maintain REDUCE.

### Steep drop in gross margins; more cost pressures ahead:

Lower-margin products offset the revenue loss due to decline in Glumetza and Mebelas, leading to 250bps decline in gross margins. Management said that this is a new base. Lupin is expanding its specialty sales force in the US by 55 sales reps (70 going to 125) which would increase costs in the near term before Solosec revenues start flowing. This would put further pressure on margins.

### Warning letter resolution, Levothyroxine approval appear on track:

Management stated that out of two broad issues pointed out in the Warning Letter, remediation work on the invalidated Out of Spec results is complete and it expects to complete the remediation by April/May-2018. Lupin received a minor information request for Levothyroxine, which has been addressed. Pre-approval inspection was cleared for the unit that produces Levothyroxine API and Formulation. Lupin expects to launch the product by mid-2018.

### However, challenges on incremental gFortamet competition and gAdvair project remain:

Nostrum has a gFortamet approval. However, it is yet to launch it. On the call, Lupin said that it has Pharmacokinetic (PK) challenges in the gAdvair project. We believe PK issues are at the tougher end of development challenges and filing is unlikely in the next 12 months.

## Result update

CMP	Rs802
12-mth TP (Rs)	700 (-13%)
Market cap (US\$m)	5,642
Enterprise value(US\$m)	6,446
Bloomberg	LPC IN
Sector	Pharma

### Shareholding pattern (%)

Promoter	47.0
FII	25.6
DII	11.9
Others	15.5
52Wk High/Low (Rs)	1574/789
Shares o/s (m)	452
Daily volume (US\$ m)	36.0
Dividend yield FY18ii (%)	0.9
Free float (%)	53.0

### Price performance (%)

	1M	3M	1Y
Absolute (Rs)	(10.9)	(22.5)	(46.4)
Absolute (US\$)	(12.1)	(21.9)	(43.5)
Rel. to Sensex	(11.1)	(23.9)	(66.7)
Cagr (%)		3 yrs	5 yrs
EPS		11.7	24.1

### Stock performance



### Financial summary (Rs m)

Y/e 31 Mar, Consolidated	FY16A	FY17A	FY18ii	FY19ii	FY20ii
Revenues (Rs m)	142,555	174,943	159,005	174,100	195,112
Ebitda margins (%)	25.9	27.8	19.6	20.6	22.5
Pre-exceptional PAT (Rs m)	22,607	25,575	14,279	16,872	21,727
Reported PAT (Rs m)	22,607	25,575	14,279	16,872	21,727
Pre-exceptional EPS (Rs)	49.9	56.5	31.5	37.2	47.8
Growth (%)	(6.1)	13.2	(44.2)	17.9	28.5
IIFL vs consensus (%)			(18.8)	(18.4)	(12.7)
PER (x)	16.1	14.2	25.4	21.6	16.8
ROE (%)	22.5	20.7	10.2	11.1	13.0
Net debt/equity (x)	0.6	0.4	0.3	0.2	0.2
EV/Ebitda (x)	11.5	8.5	13.1	11.2	9.0
Price/book (x)	3.2	2.7	2.5	2.3	2.1

Source: Company, IIFL Research. Priced as on 06 February 2018

**Background:** Lupin, the second largest Indian pharma company in terms of revenue, actively targets the generics opportunity in regulated markets. Currently, the chronic-therapy business contributes 66% of total revenue in the domestic market, which makes Lupin a strong player in the specialties segment. Lupin has emerged as a fully-integrated company, with manufacturing capabilities in APIs and formulations and a direct marketing presence in its target markets, including the US, Europe and Japan. In the US market, apart from being one of the fastest-growing companies in the generic space, Lupin is also one of the few Indian companies to have a strong presence in the branded generics segment as well.

## Management

Name	Designation
Dr. Kamal K Sharma	Vice Chairman
Vinita Gupta	CEO
Nilesh Gupta	MD

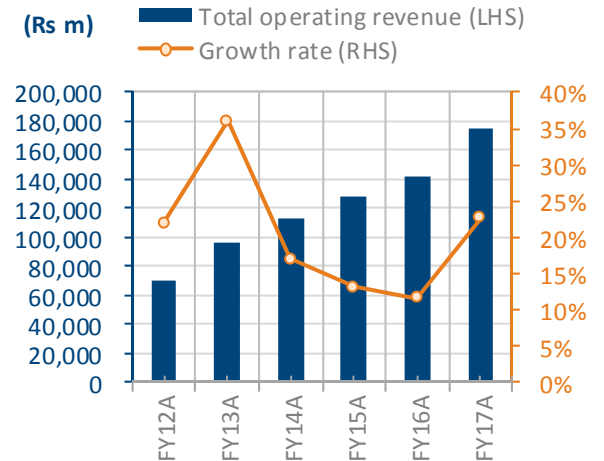
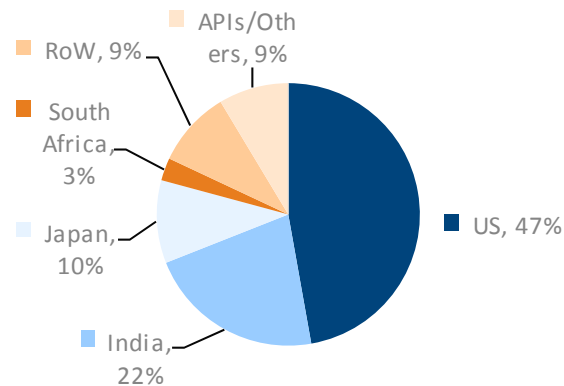
Sun Pharma, Dr. Reddy's, Cipla, Cadila, Glenmark:

## Assumptions

Y/e 31 Mar, Consolidated	FY16A	FY17A	FY18ii	FY19ii	FY20ii
US business growth (%)	4.7	39.5	(28.9)	6.2	12.6
Japanese business growth (%)	3.1	30.5	16.6	9.0	10.0
Domestic growth (%)	16.2	10.6	9.3	14.0	14.0
API business growth (%)	4.4	(8.7)	(2.7)	5.0	5.0
EBITDA margin (%)	25.9	27.8	19.6	20.6	22.5
Tax rate (%)	31.9	27.7	29.0	25.0	25.0

Source: Company data, IIFL Research

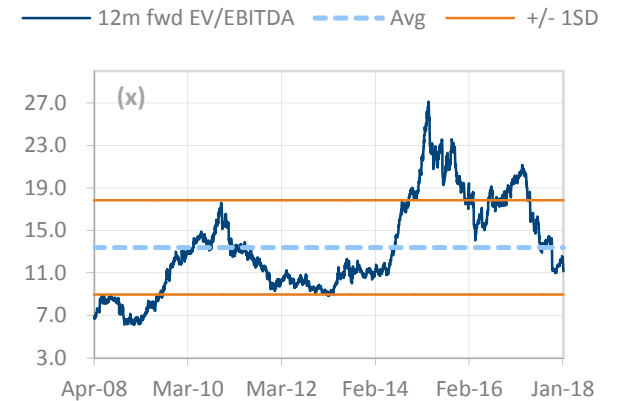
## Revenue break-up - FY17



## PE Chart



## EV/Ebitda



## Financial summary

### Income statement summary (Rs m)

Y/e 31 Mar, Consolidated	FY16A	FY17A	FY18ii	FY19ii	FY20ii
<b>Revenues</b>	<b>142,555</b>	<b>174,943</b>	<b>159,005</b>	<b>174,100</b>	<b>195,112</b>
Ebitda	36,854	48,620	31,155	35,896	43,839
Depreciation and amortisation	(4,871)	(9,122)	(10,894)	(13,125)	(14,289)
Ebit	31,982	39,498	20,261	22,771	29,550
Non-operating income	1,852	(2,624)	1,688	844	152
Financial expense	(595)	(1,525)	(1,872)	(1,164)	(791)
PBT	33,239	35,349	20,077	22,451	28,911
Exceptionals	0	0	0	0	0
Reported PBT	33,239	35,349	20,077	22,451	28,911
Tax expense	(10,593)	(9,785)	(5,823)	(5,613)	(7,228)
PAT	22,646	25,564	14,255	16,838	21,683
Minorities, Associates etc.	(39)	11	24	34	43
<b>Attributable PAT</b>	<b>22,607</b>	<b>25,575</b>	<b>14,279</b>	<b>16,872</b>	<b>21,727</b>

### Ratio analysis

Y/e 31 Mar, Consolidated	FY16A	FY17A	FY18ii	FY19ii	FY20ii
<b>Per share data (Rs)</b>					
Pre-exceptional EPS	49.9	56.5	31.5	37.2	47.8
DPS	7.5	7.5	7.5	7.5	7.5
BVPS	248.5	299.6	322.0	349.5	387.5
<b>Growth ratios (%)</b>					
Revenues	11.6	22.7	(9.1)	9.5	12.1
Ebitda	(1.3)	31.9	(35.9)	15.2	22.1
EPS	(6.1)	13.1	(44.2)	17.9	28.5
<b>Profitability ratios (%)</b>					
Ebitda margin	25.9	27.8	19.6	20.6	22.5
Ebit margin	22.4	22.6	12.7	13.1	15.1
Tax rate	31.9	27.7	29.0	25.0	25.0
Net profit margin	15.9	14.6	9.0	9.7	11.1
<b>Return ratios (%)</b>					
ROE	22.5	20.7	10.2	11.1	13.0
ROCE	23.2	17.5	9.9	11.0	13.9
<b>Solvency ratios (x)</b>					
Net debt-equity	0.6	0.4	0.3	0.2	0.2
Net debt to Ebitda	1.7	1.1	1.4	1.1	0.7
Interest coverage	NM	25.9	10.8	19.6	37.3

Source: Company data, IIFL Research

### Balance sheet summary (Rs m)

Y/e 31 Mar, Consolidated	FY16A	FY17A	FY18ii	FY19ii	FY20ii
Cash & cash equivalents	8,238	28,135	14,065	1,089	(2,985)
Inventories	32,737	36,423	33,391	36,561	40,974
Receivables	45,488	43,073	41,341	45,266	50,729
Other current assets	12,412	11,910	11,647	13,609	16,341
Creditors	30,227	33,309	33,601	36,811	40,862
Other current liabilities	2,348	4,714	4,584	5,205	5,989
<b>Net current assets</b>	<b>66,299</b>	<b>81,519</b>	<b>62,260</b>	<b>54,509</b>	<b>58,207</b>
Fixed assets	60,516	67,694	73,154	75,029	75,740
Intangibles	53,678	63,966	66,482	66,482	66,482
Investments	143	220	220	220	220
Other long-term assets	13,038	14,651	14,651	14,651	14,651
<b>Total net assets</b>	<b>193,673</b>	<b>228,050</b>	<b>216,767</b>	<b>210,892</b>	<b>215,301</b>
Borrowings	71,775	79,661	58,200	39,565	26,378
Other long-term liabilities	9,943	13,068	13,068	13,068	13,068
<b>Shareholders' equity</b>	<b>111,955</b>	<b>135,321</b>	<b>145,499</b>	<b>158,259</b>	<b>175,854</b>
<b>Total liabilities</b>	<b>193,673</b>	<b>228,050</b>	<b>216,767</b>	<b>210,892</b>	<b>215,301</b>

### Cash flow summary (Rs m)

Y/e 31 Mar, Consolidated	FY16A	FY17A	FY18ii	FY19ii	FY20ii
Ebit	31,982	39,498	20,261	22,771	29,550
Tax paid	(11,701)	(11,490)	(5,823)	(5,613)	(7,228)
Depreciation and amortization	4,871	9,122	10,894	13,125	14,289
Net working capital change	(31,264)	5,059	5,189	(5,226)	(7,771)
Other operating items	2,288	(1,041)	0	0	0
Operating cash flow before interest	(3,824)	41,148	30,521	25,057	28,840
Financial expense	(585)	(1,507)	(1,872)	(1,164)	(791)
Non-operating income	2,482	425	1,688	844	152
<b>Operating cash flow after interest</b>	<b>(1,927)</b>	<b>40,065</b>	<b>30,337</b>	<b>24,737</b>	<b>28,201</b>
<b>Capital expenditure</b>	<b>(57,815)</b>	<b>(15,957)</b>	<b>(15,000)</b>	<b>(15,000)</b>	<b>(15,000)</b>
Long-term investments	(12,282)	(10,050)	(3,870)	0	0
Others	0	0	0	0	0
<b>Free cash flow</b>	<b>(72,024)</b>	<b>14,059</b>	<b>11,467</b>	<b>9,737</b>	<b>13,201</b>
Equity raising	863	427	0	0	0
Borrowings	62,081	9,479	(21,461)	(18,635)	(13,187)
Dividend	(4,055)	(4,066)	(4,076)	(4,079)	(4,088)
Net chg in cash and equivalents	(13,135)	19,898	(14,070)	(12,976)	(4,074)

Source: Company data, IIFL Research

**Disclosure : Published in 2018, © India Infoline Ltd 2018**

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**BUY** - Stock expected to give a return 10%+ more than average return on a debt instrument over a 1-year horizon.

**SELL** - Stock expected to give a return 10%+ below the average return on a debt instrument over a 1-year horizon.

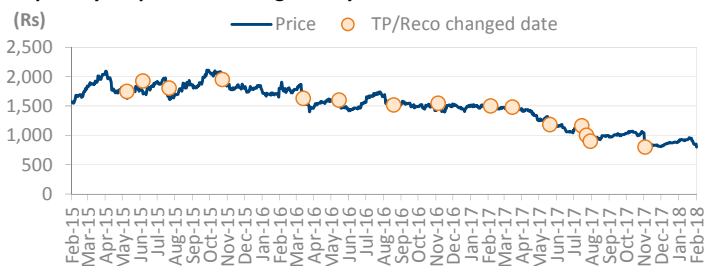
**Add** - Stock expected to give a return 0-10% over the average return on a debt instrument over a 1-year horizon.

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**Lupin: 3 year price and rating history**



Date	Close price (Rs)	Target price (Rs)	Rating	Date	Close price (Rs)	Target price (Rs)	Rating
04 Feb 2015	1546	1825	BUY	20 Jul 2017	1172	1160	ADD
14 May 2015	1690	1745	BUY	28 Jul 2017	1110	1000	REDUCE
11 Jun 2015	1795	1925	BUY	04 Aug 2017	993	900	REDUCE
27 Jul 2015	1672	1805	BUY	08 Nov 2017	860	800	REDUCE
28 Oct 2015	1946	1950	BUY				
18 Mar 2016	1674	1630	ADD				
20 May 2016	1655	1600	ADD				
24 Aug 2016	1556	1515	ADD				
10 Nov 2016	1530	1545	ADD				
10 Feb 2017	1491	1500	ADD				
20 Mar 2017	1457	1480	ADD				
25 May 2017	1228	1180	ADD				