

### Operating profit below estimates

## Quick Note

Fig. 1: 3QFY18 results

<b>Above or below</b>	Operating results were below our estimates. Adjusted for forex loss and one-time tax charges, EBITDA and net profit were 5% and 22% lower than our estimates.
<b>What to make of it</b>	US sales have stabilised Q-Q, and the intensity of pricing pressure has reduced. Despite cost optimisation initiatives, the cost structure is high, leading to lower EBITDA margin
<b>Key numbers</b>	US sales at USD 213mn up USD 9mn Q-Q; India sales growth at 11% adjusted for GST related accounting change; healthy double digit growth in most other markets. Adjusted for forex loss EBITDA margin at 19.4% vs 27% in year-ago period
<b>What next</b>	Product launched in 4QFY18F is likely to maintain US sales momentum in the near term. However, given likely competition in key products, FY19F US generics growth is likely to be muted. Growth likely to revive in FY20F

Source: Company, Nomura Research

Lupin's (LPC IN) 3QFY18 results were weaker than our expectations (Fig. 3). Revenues at INR 39bn were down 11.5% Y-Y, largely in line with our expectations. North America generics (down 34% Y-Y) and India (7.8% growth Y-Y due to GST-related accounting adjustments) dragged overall revenue growth. Adjusted for GST, India growth is 11% Y-Y. EBITDA at INR 6.9bn was 15% lower than our estimates. The cost items included forex loss of INR 821mn. Adjusted for the forex loss, EBITDA was INR 7.7bn, 5% lower than our estimates. Gross margins declined 250bps Q-Q, explained marginally by the forex loss. Erosion in high-value products in the US and geography mix led to a drop in gross margins. The results do reflect some control on overheads, as R&D spend (INR 4.75bn) declined 16% Y-Y and employee expenses were 5% lower Y-Y. Tax rate was higher at 42%. This is on account of an adjustment of INR 361mn related to deferred tax liability for US entities following the cut in the US corporate tax rate. Adjusted for the impact of forex losses and remeasurement of the deferred tax liability, net earnings were at INR 3.1bn, vs our estimate of INR 4bn.

US revenues stabilised at USD 213mn, up from USD 204mn in 2QFY18. Growth was decent in most of the other geographies, with South Africa, Brazil, Mexico and Japan recording 12%, 28%, 10% and 34% (led by acquisition) growth Y-Y in constant currency terms.

#### Management commentary

##### US market is stabilising

Lupin's US generic business stabilised in the quarter, with a margin increase in sales Q-Q. Management commented that many large players are moving out of unprofitable products or inclined to take price increases. This suggests to us that the intensity of the pricing pressure is likely to reduce.

### Global Markets Research

7 February 2018

Rating Remains **Buy**

Target Price Remains **INR 1078**

Closing price 6 February 2018 **INR 801**

### Research analysts

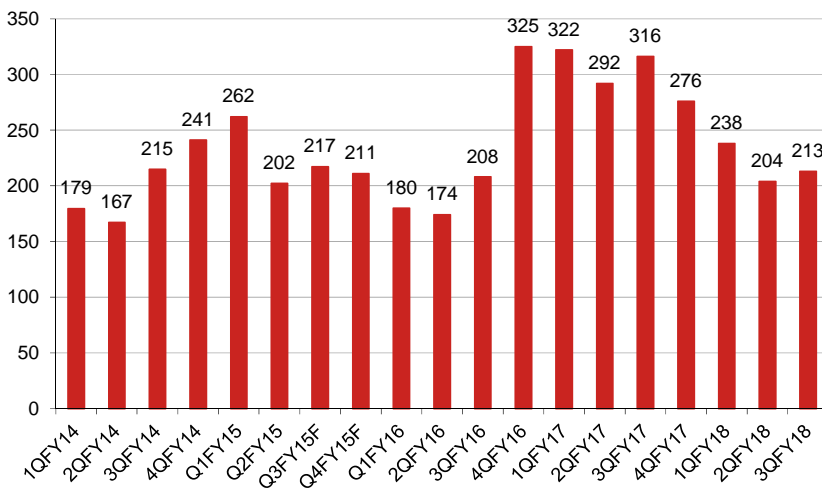
#### India Pharmaceuticals

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**Way forward for US generic business**

In current US sales, gFortamet, gGlumetza and Methergine are large products, with an annualised sales run rate of USD 70mn, USD 55mn and USD 80mn respectively. Some more erosion is expected in all these products, particularly for Methergine, a generic competition is expected over the next couple of quarters that could have a substantial impact on sales. The key launches over the next 12 months highlighted by the company are Levothyroxine, gTamiflu and gRanexa. The company already has approval for gTamiflu caps and expects approval for suspension in the near term. The flu season is very strong this year, which should have a positive impact on demand. LPC has received information requests (IRs) on Levothyroxine, and it expects to launch the product in mid-CY2018. On gRanexa, the management expects to launch the product at end-FY19F with exclusivity, despite a warning letter at the manufacturing site. In 4QFY18F, the company expects to launch ~10 products (including gTamiflu), which should help sales momentum Q-Q.

**Fig. 2: US sales (USD mn)**



Source: Company, Nomura Research

Despite new launches, the growth outlook for US generics is muted in FY19F, as the company expects erosion in its top three products.

**Focus on complex generics**

The company has pruned its development pipeline to focus on complex generics. It has filed injectable products (four in FY18F so far), and expects approvals in FY19F. The complex long-acting injectable filings from Nanomi are expected in FY20F.

On inhalers, in gProAir, the company expects approval in FY19F and launch in FY20F as per the settlement agreement. Phase III clinical studies are on for gSpiriva, which are likely to be completed in the next two quarters. Progress on gAdvair is limited so far, as the company is still addressing issues around its PK profile. Management indicated that it is in dialogue with the FDA on the development programmes.

**Warning letter update**

Management expects to complete remediations with respect to the issues raised in the warning letter by Apr/May 2018 and requests further action from the FDA. The company intends to close the warning letter by end-2018.

**Specialty: Solesec launch next quarter in the US**

The launch of Solosec is expected next quarter in the US. A sales force and front-end ramp-up should lead to a rise in overhead expenses. We expect Solosec to achieve peak sales of USD 100-150mn by FY22F. The product is unlikely to contribute meaningfully to earnings over the next two years, in our opinion.

**Fig. 3: Revenue breakdown and P&L (in INR mn)**

Revenue split	3QFY17	2QFY18	3QFY18F	Y-Y Chg (%)	Q-Q Chg (%)	3QFY18 Nom ests	vs Nom ests (%)
Formulations	41,365	36,092	36,324	-12.2%	0.6%	36,344	-0.1%
North America	21,755	13,611	14,321	-34.2%	5.2%	14,169	1.1%
India	9,912	11,593	10,688	7.8%	-7.8%	11,250	-5.0%
Japan	4,470	5,057	5,535	23.8%	9.5%	5,192	6.6%
Others	5,228	5,831	5,780	10.6%	-0.9%	5,732	0.8%
API	2,684	2,650	2,680	-0.1%	1.1%	2,700	-0.7%
<b>Total Sales</b>	<b>44,049</b>	<b>38,742</b>	<b>39,004</b>	<b>-11.5%</b>	<b>0.7%</b>	<b>39,044</b>	<b>-0.1%</b>
<b>Net Sales</b>	<b>44,049</b>	<b>38,742</b>	<b>39,004</b>	<b>-11.5%</b>	<b>0.7%</b>	<b>39,044</b>	<b>-0.1%</b>
Other Operating Income	779	778	753	-3.4%	-3.3%	700	7.5%
Total Revenue	44,829	39,520	39,756	-11.3%	0.6%	39,744	0.0%
Material Cost	13,016	12,865	13,927	7.0%	8.3%	13,080	6.5%
Staff Cost	7,312	7,250	6,931	-5.2%	-4.4%	7,531	-8.0%
Other Expense	12,343	10,874	12,015	-2.7%	10.5%	11,000	9.2%
<b>EBITDA</b>	<b>12,158</b>	<b>8,531</b>	<b>6,883</b>	<b>-43.4%</b>	<b>-19.3%</b>	<b>8,133</b>	<b>-15.4%</b>
Other Income	1,036	740	284	-72.6%	-61.6%	500	-43.2%
Interest Expense	459	479	540	17.6%	12.7%	479	12.7%
Depreciation	2,309	2,722	2,804	21.4%	3.0%	2,776	1.0%
PBT	10,426	6,070	3,824	-63.3%	-37.0%	5,378	-28.9%
Tax	4,095	1,541	1,608	-60.7%	4.4%	1,371	17.2%
<b>Net Profit</b>	<b>6,331</b>	<b>4,529</b>	<b>2,216</b>	<b>-65.0%</b>	<b>-51.1%</b>	<b>4,006</b>	<b>-44.7%</b>
Minority interest	24	19	6			19	
Share of Profit from JVs	24	39	6			39	
<b>Net profit after MI</b>	<b>6,331</b>	<b>4,550</b>	<b>2,216</b>	<b>-65.0%</b>	<b>-51.3%</b>	<b>4,027</b>	<b>-45.0%</b>
				<b>bps Chg (Y-Y)</b>	<b>bps Chg (Q-Q)</b>		<b>vs Nom ests</b>
Gross margin (%)	70.5%	66.8%	64.3%	(616)	(250)	66.5%	(221)
EBITDA margin (%)	27.1%	21.6%	17.3%	(981)	(427)	20.5%	(315)
Tax rate (%)	39.3%	25.4%	42.0%	277	1,666	25.5%	1,654

Source: Company, Nomura Research

The stock is trading at 22.5x FY18F and 17.4x FY19F EPS estimates. We maintain our Buy rating on the stock and TP of INR1,078, based on 20x FY19-20F average EPS of INR 53.9.

# Appendix A-1

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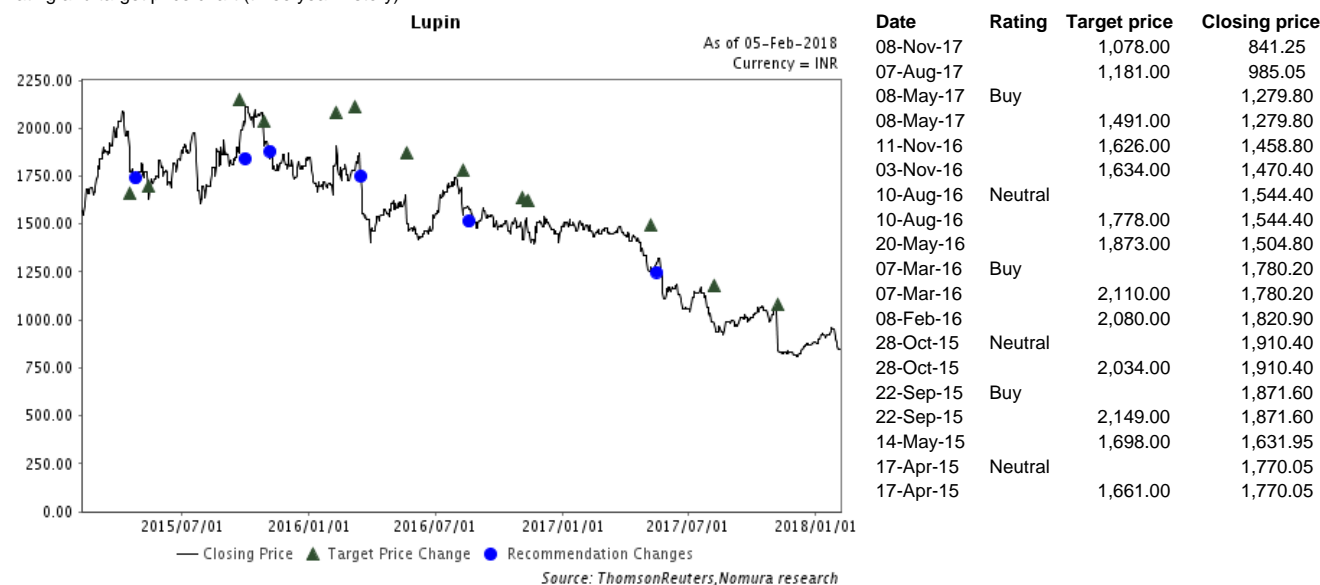
### Materially mentioned issuers

Issuer	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Lupin	LPC IN	INR 801	06-Feb-2018	Buy	N/A	

### Lupin (LPC IN)

INR 801 (06-Feb-2018) Buy (Sector rating: N/A)

Rating and target price chart (three year history)



For explanation of ratings refer to the stock rating keys located after chart(s)

**Valuation Methodology** We arrive at our 12-month TP of INR1,078/sh based on 20x FY19-20F average EPS of INR 53.9. The benchmark index for this stock is MSCI India.

**Risks that may impede the achievement of the target price** Key risks: 1) delay in approval of key products; 2) adverse currency movement; and 3) adverse regulatory developments.

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