

**LUPIN**

## PHARMACEUTICALS

**HOLD**

Target Price: Rs 830

## Margin, growth challenges to continue

Gross margin declined 615 bps YoY/ 250 bps QoQ on weak sales mix, while EBITDA margin (adj. for forex) declined 315 bps YoY/ 75 bps QoQ. PAT (adjusted for one-time tax impact) was 16% below our estimate. Key takeaways from management commentary: (1) 64-65% is the new normal gross margin (vs. 67.2% in H1FY18), (2) US business is starting to stabilize at current level (up 4% QoQ in Q3), (3) on track to complete remediation by Apr-May'18 and invite USFDA for re-inspection; targets USFDA resolution in CY18, (4) expects generic competition in Methergine, but Solosec launch in FY19 likely to offset decline in US branded business and (5) FY19 to remain muted.

Thus while we remain below consensus, we further cut FY18/19/20E EPS by 17%/9%/6% with revised TP at Rs 830 (18x FY20 EPS) vs. Rs 880 earlier. Maintain **HOLD** on growth/ margin challenges.

 CMP : Rs 802  
 Potential Upside : 4%
**MARKET DATA**
 No. of Shares : 452mn  
 Free Float : 53%  
 Market Cap : Rs362bn  
 52-week High / Low : Rs1,572 / Rs790  
 Avg. Daily vol. (6mth) : 2.2 mn shares  
 Bloomberg Code : LPC IB Equity  
 Promoters Holding : 47%  
 FII / DII : 26% / 12%

- ◆ **Weak sales mix...**: Overall revenue at Rs 39 bn declined 11%YoY, in line with our estimate. US revenue (37% of sales) declined 33% YoY/ grew 4% QoQ to USD 213 mn. Management highlighted its US business (ex gGlumetza, gFortamet) grew 6% YoY in 9MFY18 on higher volumes and new launches (despite price erosion). India revenue grew 8% YoY (grew 11% YoY adj. for excise impact) with 14.5% YoY growth in prescription business. Other markets like Japan grew 34%YoY in JPY terms; LaTam (+26% YoY), EMEA (+6% YoY), and API (flat YoY)
- ◆ **...led to margin pressure**: Gross margin declined ~615 bps YoY/250 bps QoQ to 64.3% (below our estimate of 66.6%) on weak sales mix (led by lower realization from its metformin franchise, gMinastrin in US and lower India sales QoQ). Despite lower R&D (-16% YoY) and employee expenses (-5% YoY), core EBITDA (adjusted for forex) declined 16% YoY/-3% QoQ to Rs 7.7 bn and was ~5% below our estimate. Core EBITDA margin contracted ~315 bps YoY/75 bps QoQ to 19.4% (vs. estimate of 20.4%). Adjusted PAT (for FX gain, one-time tax impact) at Rs 3.4 bn was 16% below our estimate on higher interest costs and lower other income

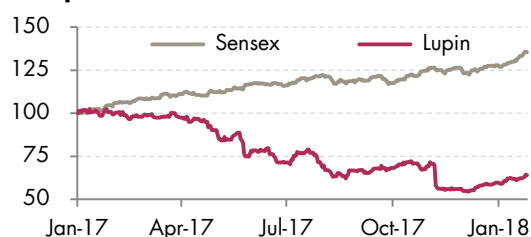
*(continued on page 2...)***Financial summary (Consolidated)**

Y/E March	FY17	FY18E	FY19E	FY20E
Sales (Rs mn)	171,198	152,387	163,931	188,946
Adj PAT (Rs mn)	25,575	13,554	15,168	20,828
Con. EPS* (Rs)	-	38.8	45.5	54.7
EPS (Rs)	56.6	30.0	33.6	46.1
Change YOY (%)	12.9	(47.0)	11.9	37.3
P/E (x)	14.2	26.7	23.9	17.4
RoE (%)	20.7	9.7	10.1	12.7
RoCE (%)	17.5	9.1	9.6	12.4
EV/E (x)	9.2	13.3	12.2	9.4
DPS (Rs)	7.5	7.5	7.5	7.5

Source: \*Consensus broker estimates, Company, Axis Capital

**Key drivers**

Growth (%)	FY18E	FY19E	FY20E
US (USD mn)	(28)	(1)	24
India	9	15	13
EBITDA margin	20	20	22
Adj-EPS	(49)	12	37

**Price performance**

- ◆ **R&D (Rs. 4.76 bn, 12.2% of Q3 revenue):** During the quarter, Lupin filed 5 ANDA's (vs. 11 in H1FY18, 37 in FY17) and received 6 ANDA approvals (vs. 12 in H1FY18, 34 during FY17). Lupin expects to be mindful in R&D projects with higher focus on increasing complexity. Expects to file 15-20 oral solids, 8-10 injectable (filed 4 in Q3FY18), a biosimilar and couple of inhalation products annually. Complex injectable filings from Nanomi to commence from FY20
- ◆ **Key concall highlights: (1) US pricing:** Management stated it is now witnessing single digit price erosion on base line products, **(2) New launches:** Expects 10+ launches in Q4FY18 (including already approved products). Key launches lined up towards end-FY19 (gRanexa, etc), **(3) Gavis:** Grew 31% YoY in Q3FY18, **(4) Brand business:** USD 28 mn (up 25% YoY/15% QoQ) driven by Methergine, and **(5) Capex:** Expects Rs 8 -10 bn investments in FY19 (vs. Rs 7.42 bn in 9MFY18, Rs 16.6 bn in FY17)

### Exhibit 1: Margin pressure...

(Rs mn)	Q3'17	Q2'18	Q3'18	YoY (%)	QoQ (%)
Revenues	44,049	38,742	39,004	(11)	1
Other operating income	779	778	753	(3)	(3)
<b>Total Revenue</b>	<b>44,829</b>	<b>39,520</b>	<b>39,756</b>	<b>(11)</b>	<b>1</b>
Gross Profit	31,034	25,876	25,077	(19)	(3)
Gross Profit margin (%)	70.5	66.8	64.3	-616 bps	-250 bps
Staff	7,286	7,250	6,931	(5)	(4)
Staff as % of Sales	16.5	18.7	17.8	123 bps	-94 bps
R&D	5,682	4,739	4,757	(16)	0
R&D as % of Sales	12.9	12.2	12.2	-70 bps	-4 bps
SGA	6,661	6,135	7,258	9	18
SGA as % of Sales	15.1	15.8	18.6	349 bps	277 bps
<b>EBITDA</b>	<b>12,183</b>	<b>8,531</b>	<b>6,883</b>	<b>(44)</b>	<b>(19)</b>
EBITDA margin (%)	27.2	21.6	17.3	-986 bps	-427 bps
<b>Core EBITDA*</b>	<b>9,154</b>	<b>7,961</b>	<b>7,704</b>	<b>(16)</b>	<b>(3)</b>
<b>Core EBITDA margin(%)</b>	<b>22.5</b>	<b>20.1</b>	<b>19.4</b>	<b>-316 bps</b>	<b>-76 bps</b>
Interest	484	479	540	11	13
Depreciation	2,309	2,722	2,804	21	3
Other Income	1,036	740	284	(73)	(62)
PBT	10,426	6,070	3,824	(63)	(37)
Tax	4,095	1,541	1,247	(70)	(19)
Tax rate	39.3	25.4	32.6	-667 bps	722 bps
<b>Adjusted PAT</b>	<b>3,301</b>	<b>3,980</b>	<b>3,399</b>	<b>3</b>	<b>(15)</b>
<b>Reported PAT</b>	<b>6,331</b>	<b>4,550</b>	<b>2,217</b>	<b>(65)</b>	<b>(51)</b>

Source: Company Note: As per Ind-AS

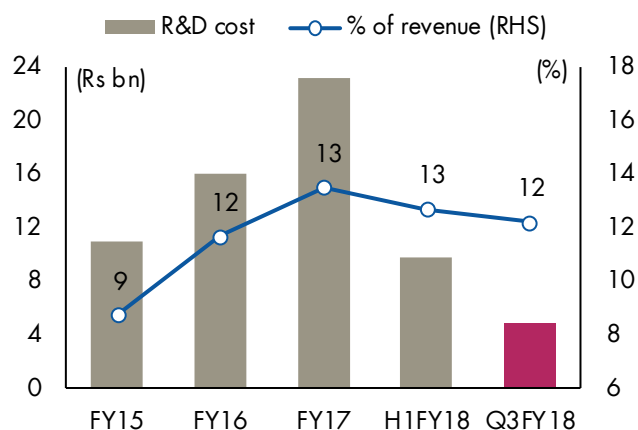
Note: Q3'18 PAT/ EBITDA adjusted for Fx loss of Rs 821 mn, one-time tax impact of Rs 361 mn; Q2'18 PAT/ EBITDA adjusted for Fx gain of Rs 570 mn; Q2'17 PAT/ EBITDA adjusted for Fx gain of Rs 276 mn, gGlumetza sales

**Exhibit 2: ...led by weak sales mix**

Rs mn	Q3'17	Q2'18	Q3'18	YoY (%)	QoQ (%)
US Total (USD mn)	316	204	213	(33)	4
<b>US Total (Rs mn)</b>	<b>21,755</b>	<b>13,611</b>	<b>14,321</b>	<b>(34)</b>	<b>5</b>
India	9,912	11,593	10,688	8	(8)
Asia Pacific	5,601	6,357	6,742	20	6
- Japan (JPY mn)	7,244	8,685	9,711	34	12
EMEA	2,555	2,758	2,721	6	(1)
- South Africa (ZAR mn)	230	270	257	12	(5)
LatAM	1,175	1,395	1,481	26	6
RoW	367	378	371	1	(2)
<b>Formulations</b>	<b>41,365</b>	<b>36,092</b>	<b>36,324</b>	<b>(12)</b>	<b>1</b>
API	2,684	2,650	2,680	(0)	1
<b>Total</b>	<b>44,049</b>	<b>38,742</b>	<b>39,004</b>	<b>(11)</b>	<b>1</b>

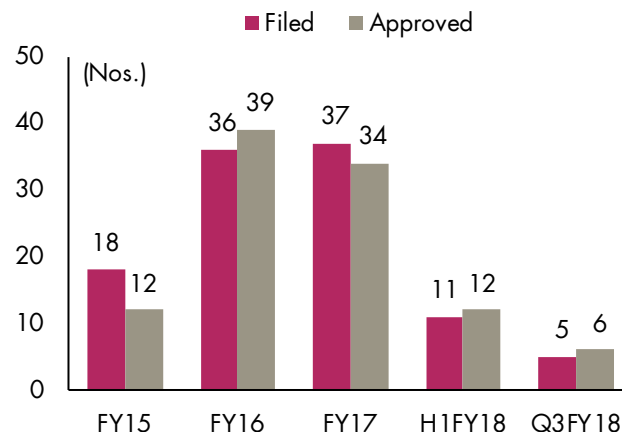
Source: Company \*EMEA: Europe Middle East & Africa

**Exhibit 3: Rationalizing R&D spends**



Source: Company, Axis Capital

**Exhibit 4: LPC filed 5 ANDA's in Q3'18**



Source: Company, Axis Capital

**Other concall highlights**

**Guidance**

- **US:** Expects FY19 to be challenging on USFDA regulatory issues
- ♦ **USFDA remediation update:** Lupin expects to complete remediation activities by Apr-May'18. Company has engaged external independent consultants, and has been sending monthly progress updates to USFDA

**US (USD 213 mn; -33% YoY/ +4% QoQ)**

- ♦ **gFortamet:** Highlighted that Nostrum Labs has not yet launched
- ♦ **gGlumetza:** Sun Pharma has not yet launched its generic version
- ♦ **Levothyroxine:** Received information request from USFDA. Lupin has responded to the same and expects launch in mid-FY19

**R&D (Rs. 4.76 bn, 12.2% of Q3 revenue):** Cumulative ANDA filings with USFDA stands at 382 (231 approvals, 151 pending ANDAs including 33 First-to-Files (FTF) filings including 16 exclusive FTF opportunities)

- ◆ **gSpriva** – Development on track. To complete Phase 3 clinical studies in near term. Expected filing in next 1-2 quarters
- ◆ **gAdvair** –PK studies remain ongoing as has been facing challenges
- ◆ **Albuterol MDI:** Review on track; expects approval by end CY18/start CY19
- ◆ **Biosimilar Etanercept:** Development on track. Expects to file in Japan in Q4FY18. EU filing in early FY19. US filing in FY20

**India (Rs. 10,688 mn, +88% YoY):** India revenue grew 8% YoY (grew 11% YoY adj. for excise impact). Prescription business grew 14.5% YoY.

**APAC (Rs 6,752 mn, +20% YoY):** Philippines sales increased 14.3% YoY/declined 9.6% QoQ in constant currency terms.

**LATAM (Rs 1,481 mn, +26% YoY):** Brazil constant currency sales increased 25.9% YoY/ down 7.7% QoQ in Q3. In Mexico, sales increased 9.7% YoY/ 12% QoQ in constant currency terms.

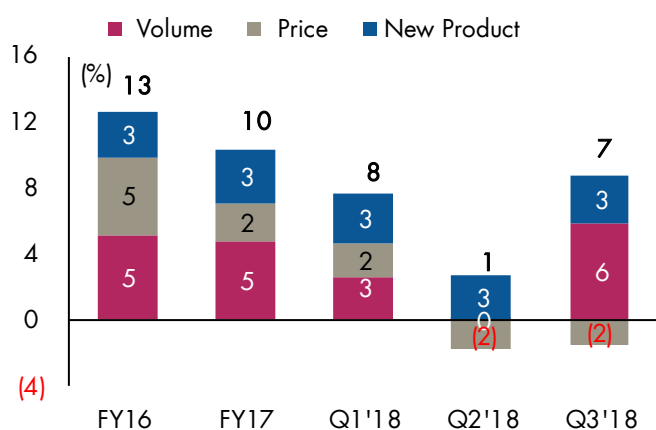
**EMEA (Rs 2,721 mn, +6% YoY):** South Africa constant currency sales increased 12% YoY/-4.6% QoQ. Lupin remains 4th largest generic player in South African market

#### Exhibit 5: LPC has lost market share in gFortamet 1,000 mg, gSuprax; good traction in gFosrenol, gVigamox

Launch	Brand	Brand sales/ market size (USD mn)	Market share (%)						
			Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Nov-17	Dec-17
22-Feb-13	Suprax OS	80	79	75	76	69	69	68	64
18-Dec-13	Trizivir	112	84	86	86	88	88	88	88
12-Nov-14	Celebrex	2,540	12	12	12	12	11	12	11
20-Nov-12	Tricor	1,300	14	13	15	17	17	18	18
06-Dec-13	Trilipix	450	23	23	24	25	29	24	27
14-Oct-11	Fortamet 1000mg	-	70	65	61	58	52	51	51
12-Dec-13	Cymbalta	5,400	16	15	14	14	15	16	15
15-Mar-17	Pristiq	883	-	-	14	21	23	24	24
05-Jul-17	Vigamox	299	-	-	-	-	18	20	22
31-Mar-17	Epzicom	388	-	-	-	11	19	21	18
31-Aug-17	Fosrenol	127	-	-	-	-	21	32	36
30-Oct-17	Acticlate 150 mg	225	-	-	-	-	-	2	7

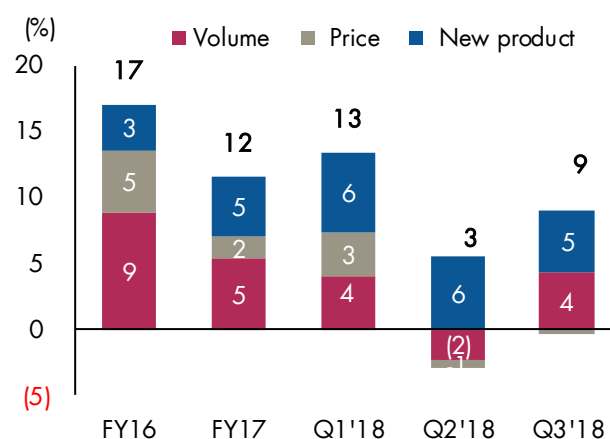
Source: Bloomberg

**Exhibit 6: IPM growth trends**



Source: AIOCD

**Exhibit 7: LPC witnessed modest volume recovery in Q3FY18**



Source: AIOCD

**Exhibit 8: Anti-infective sales witnessing slower ramp up; strong growth in Anti-Diabetic therapeutic segment**

YoY growth	% of sales	FY16	FY17	Q1'18	Q2'18	Q3'18
Cardiac	24%	19%	8%	13%	2%	6%
Anti-infective	19%	7%	-2%	-4%	-11%	3%
Respiratory	13%	22%	17%	19%	1%	13%
Anti-Diabetic	13%	23%	36%	43%	26%	26%
Gastro Intestinal	8%	20%	15%	14%	3%	8%
Vit. / Min. / Nut.	5%	10%	0%	5%	-4%	5%
Neuro / CNS	5%	10%	9%	3%	2%	10%
Pain / Anal.	4%	15%	6%	6%	-2%	3%
Gynaecological	4%	48%	25%	28%	14%	2%
Hormones	0%	4%	4%	9%	-11%	-19%
<b>Total (Rs bn)</b>	<b>37</b>	<b>17%</b>	<b>12%</b>	<b>13%</b>	<b>3%</b>	<b>9%</b>

Source: AIOCD

\*% of FY17 sales

## Financial summary (Consolidated)

### Profit & loss (Rs mn)

Y/E March	FY17	FY18E	FY19E	FY20E
<b>Net sales</b>	<b>171,198</b>	<b>152,387</b>	<b>163,931</b>	<b>188,946</b>
Other operating income	3,745	3,375	3,250	3,300
<b>Total operating income</b>	<b>174,943</b>	<b>155,762</b>	<b>167,181</b>	<b>192,246</b>
Cost of goods sold	(50,014)	(51,812)	(55,409)	(63,297)
Gross profit	124,929	103,950	111,773	128,949
<i>Gross margin (%)</i>	<i>73.0</i>	<i>68.2</i>	<i>68.2</i>	<i>68.2</i>
Total operating expenses	(79,998)	(73,503)	(78,898)	(86,906)
<b>EBITDA</b>	<b>44,931</b>	<b>30,447</b>	<b>32,875</b>	<b>42,042</b>
<i>EBITDA margin (%)</i>	<i>26.2</i>	<i>20.0</i>	<i>20.1</i>	<i>22.3</i>
Depreciation	(9,122)	(11,183)	(12,358)	(13,852)
<b>EBIT</b>	<b>35,809</b>	<b>19,264</b>	<b>20,517</b>	<b>28,190</b>
Net interest	(1,525)	(2,028)	(1,651)	(1,459)
Other income	1,065	1,693	1,743	1,388
<b>Profit before tax</b>	<b>35,349</b>	<b>18,928</b>	<b>20,609</b>	<b>28,119</b>
Total taxation	(9,785)	(5,395)	(5,461)	(7,311)
<i>Tax rate (%)</i>	<i>27.7</i>	<i>28.5</i>	<i>26.5</i>	<i>26.0</i>
Profit after tax	25,564	13,534	15,148	20,808
Minorities	11	20	20	20
Profit/ Loss associate co(s)	-	-	-	-
<b>Adjusted net profit</b>	<b>25,575</b>	<b>13,554</b>	<b>15,168</b>	<b>20,828</b>
<i>Adj. PAT margin (%)</i>	<i>14.9</i>	<i>8.9</i>	<i>9.3</i>	<i>11.0</i>
Net non-recurring items	-	-	-	-
<b>Reported net profit</b>	<b>25,575</b>	<b>13,554</b>	<b>15,168</b>	<b>20,828</b>

### Balance sheet (Rs mn)

Y/E March	FY17	FY18E	FY19E	FY20E
Paid-up capital	903	903	903	903
Reserves & surplus	134,073	143,550	154,641	171,392
Net worth	134,976	144,453	155,544	172,295
Borrowing	79,521	72,435	66,043	58,363
Other non-current liabilities	13,009	13,009	13,009	13,009
<b>Total liabilities</b>	<b>227,851</b>	<b>230,222</b>	<b>234,902</b>	<b>243,953</b>
Gross fixed assets	123,953	139,203	154,150	169,097
Less: Depreciation	(13,624)	(24,807)	(37,165)	(51,017)
Net fixed assets	110,329	114,396	116,986	118,080
Add: Capital WIP	21,331	23,464	25,810	28,391
Total fixed assets	131,660	137,860	142,796	146,471
Total Investment	21,361	21,361	21,361	21,361
Inventory	36,423	35,040	37,521	42,034
Debtors	43,073	39,662	40,421	46,589
Cash & bank	6,994	8,348	6,758	5,010
Loans & advances	159	5,427	5,839	6,730
Current liabilities	38,222	35,050	37,590	42,517
Net current assets	60,179	56,350	56,093	61,469
Other non-current assets	14,651	14,651	14,651	14,651
<b>Total assets</b>	<b>227,851</b>	<b>230,222</b>	<b>234,902</b>	<b>243,953</b>

Source: Company, Axis Capital

### Cash flow (Rs mn)

Y/E March	FY17	FY18E	FY19E	FY20E
Profit before tax	35,349	18,928	20,609	28,119
Depreciation & Amortisation	9,122	11,183	12,358	13,852
<i>Chg in working capital</i>	<i>5,059</i>	<i>5,182</i>	<i>(1,333)</i>	<i>(7,124)</i>
<b>Cash flow from operations</b>	<b>41,148</b>	<b>26,179</b>	<b>22,778</b>	<b>24,690</b>
<i>Capital expenditure</i>	<i>(26,007)</i>	<i>(15,250)</i>	<i>(14,947)</i>	<i>(14,947)</i>
<b>Cash flow from investing</b>	<b>(25,287)</b>	<b>(15,250)</b>	<b>(14,947)</b>	<b>(14,947)</b>
<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>(7,680)</i>
<i>Dividend paid</i>	<i>(4,066)</i>	<i>(4,077)</i>	<i>(4,077)</i>	<i>(4,077)</i>
<b>Cash flow from financing</b>	<b>4,330</b>	<b>(13,191)</b>	<b>(12,120)</b>	<b>(13,216)</b>
Net chg in cash	20,191	(2,262)	(4,289)	(3,473)

### Key ratios

Y/E March	FY17	FY18E	FY19E	FY20E
<b>OPERATIONAL</b>				
FDEPS (Rs)	56.6	30.0	33.6	46.1
CEPS (Rs)	76.8	54.8	61.0	76.8
DPS (Rs)	7.5	7.5	7.5	7.5
Dividend payout ratio (%)	13.2	25.0	22.3	16.3
<b>GROWTH</b>				
Net sales (%)	24.4	(11.0)	7.6	15.3
EBITDA (%)	21.9	(32.2)	8.0	27.9
Adj net profit (%)	13.1	(47.0)	11.9	37.3
FDEPS (%)	12.9	(47.0)	11.9	37.3
<b>PERFORMANCE</b>				
RoE (%)	20.7	9.7	10.1	12.7
RoCE (%)	17.5	9.1	9.6	12.4
<b>EFFICIENCY</b>				
Asset turnover (x)	0.9	0.8	0.9	0.9
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	102.1	102.0	102.1
Payable days	72.8	68.0	68.0	68.1
<b>FINANCIAL STABILITY</b>				
Total debt/ equity (x)	0.6	0.5	0.4	0.4
Net debt/ equity (x)	0.4	0.3	0.3	0.2
Current ratio (x)	2.6	2.6	2.5	2.4
Interest cover (x)	23.5	9.5	12.4	19.3
<b>VALUATION</b>				
PE (x)	14.2	26.7	23.9	17.4
EV/ EBITDA (x)	9.2	13.3	12.2	9.4
EV/ Net sales (x)	2.4	2.7	2.4	2.1
PB (x)	2.7	2.5	2.3	2.1
Dividend yield (%)	0.9	0.9	0.9	0.9
Free cash flow yield (%)	-	-	-	-

Source: Company, Axis Capital

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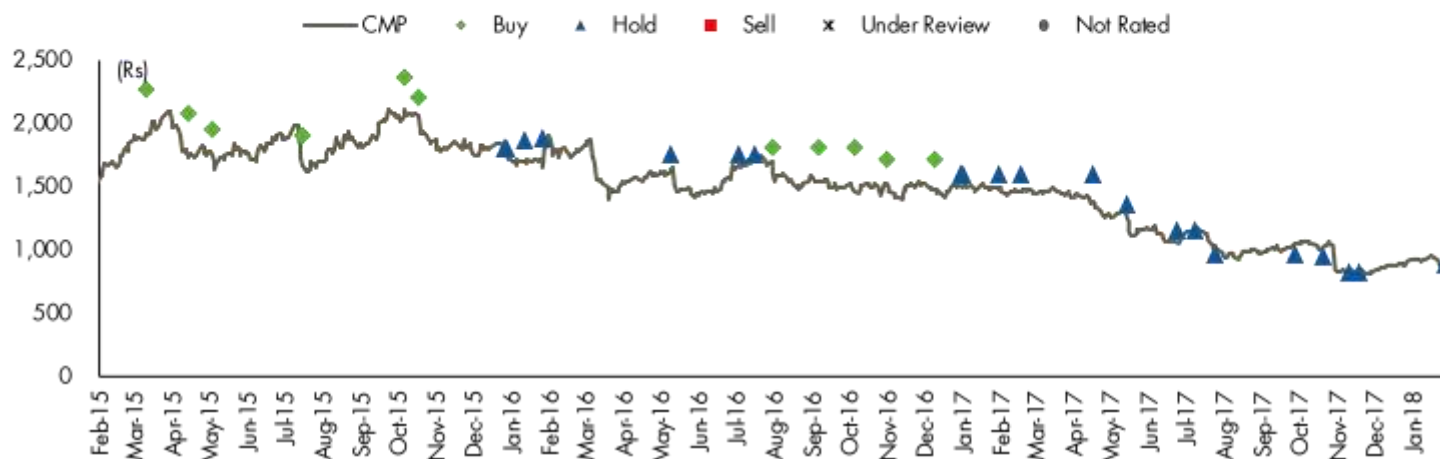
### DEFINITION OF RATINGS

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

### ANALYST DISCLOSURES

1. The analyst(s) declares that neither he/ his relatives have a Beneficial or Actual ownership of > 1% of equity of subject company/ companies
2. The analyst(s) declares that he has no material conflict of interest with the subject company/ companies of this report

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



Date	Target Price	Reco	Date	Target Price	Reco	Date	Target Price	Reco
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	30-Oct-17	940	Hold
7-Jan-16	1,800	Hold	9-Jan-17	1,600	Hold	20-Nov-17	820	Hold
21-Jan-16	1,860	Hold	11-Jan-17	1,600	Hold	27-Nov-17	820	Hold
5-Feb-16	1,880	Hold	9-Feb-17	1,600	Hold	6-Feb-18	880	HOLD
19-May-16	1,750	Hold	27-Feb-17	1,600	Hold			

Source: Axis Capital