



₹ 10,000 | 10 pages

Pharmaceuticals  
Asia | India

## Lupin (LUPN.BO)

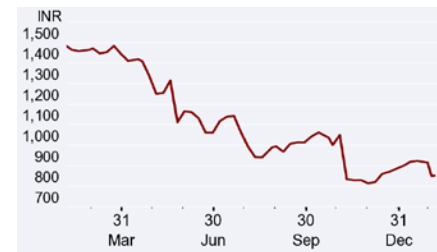
### Another Difficult Quarter, Cautiously Optimistic Commentary

- Citi's Take** – Lupin reported another disappointing quarter, with adj. EBITDA coming in c.7% below Citi estimate. A stronger INR/US\$, adverse US revenue mix (loss of *Minastrin* exclusivity) and front-ended build up costs related to Solosec impacted margins. Management commentary was cautiously optimistic on US pricing (single digit, bottoming out) and compliance (hope to get warning letter lifted in CY18), but also validated our view that there are not too many meaningful launches likely over the next few quarters.
- US pricing: erosion bottoming out as per management** – Lupin saw single digit price erosion in base line products and expects this trend to continue through CY18. Excluding the metformin products (gGlumetza, gFortamet), US sales are up c.6% YoY in 9m. The management believes that many of its peers are in the process of rationalizing portfolios to focus on profitable products, which could help form a bottom. Lupin intends to do the same with its product basket as well as pipeline, focusing on products with potentially limited competition and higher complexity.
- Confident on warning letter resolution** – Lupin has done a lot of work and also sent a couple of updates to the US FDA. The company expects to complete all corrective action by April/May 2018, post which the ball would be in the agency's court. If all goes well, they hope to get the warning letter lifted by the end of CY18.
- Other key takeaways** — a) US generic launches: expect c10+ launches in the current quarter, including Tamiflu and Axiron; b) Ranexa: confident of launching gRanexa FTF on the scheduled date in Q4FY19; c) Levothyroxine: Review is on, potential launch in mid-FY19; d) US brands: to launch Solosec launch in Q1FY19, Methergine could see generic competition (know of one ANDA filer).
- Implications** – We cut our FY18/19/20E EPS by 12%/7%/1% to reflect lower margins and higher interest/depreciation costs. Our new target price is Rs890/sh (21x FY19E EPS). Maintain Neutral.

- Estimate Change
- Target Price Change

Neutral	2
Price (06 Feb 18 15:59)	Rs801.65
Target price	Rs890.00
	from Rs970.00
Expected share price return	11.0%
Expected dividend yield	0.9%
Expected total return	12.0%
Market Cap	Rs362,392M
	US\$5,650M

#### Price Performance (RIC: LUPN.BO, BB: LPC IN)



#### Statistical Abstract

Year to	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
31 Mar							
2016A	22,955	50.78	-4.5	15.8	3.2	22.9	0.9
2017A	26,702	59.07	16.3	13.6	2.7	21.7	0.9
2018E	15,662	34.64	-41.3	23.1	2.5	11.1	0.9
2019E	19,097	42.24	21.9	19.0	2.2	12.4	0.9
2020E	26,179	57.91	37.1	13.8	2.0	15.2	0.9

Source: Powered by dataCentral

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LUPN.BO: Fiscal year end 31-Mar						Price: Rs801.65; TP: Rs890.00; Market Cap: Rs362,392m; Recomm: Neutral					
Profit & Loss (Rsm)	2016	2017	2018E	2019E	2020E	Valuation ratios	2016	2017	2018E	2019E	2020E
Sales revenue	142,106	174,943	158,727	173,598	194,877	PE (x)	15.8	13.6	23.1	19.0	13.8
Cost of sales	-55,747	-67,048	-63,473	-67,928	-72,489	PB (x)	3.2	2.7	2.5	2.2	2.0
Gross profit	86,359	107,896	95,254	105,670	122,388	EV/EBITDA (x)	10.4	9.1	12.8	11.1	8.5
Gross Margin (%)	60.8	61.7	60.0	60.9	62.8	FCF yield (%)	-14.5	3.7	5.6	4.6	5.5
<b>EBITDA (Adj)</b>	<b>37,555</b>	<b>46,490</b>	<b>32,113</b>	<b>35,752</b>	<b>45,416</b>	Dividend yield (%)	0.9	0.9	0.9	0.9	0.9
EBITDA Margin (Adj) (%)	26.4	26.6	20.2	20.6	23.3	Payout ratio (%)	15	13	22	18	13
Depreciation	-4,635	-9,122	-10,910	-11,172	-11,885	ROE (%)	22.7	20.7	10.8	12.4	15.2
Amortisation	0	0	0	0	0	<b>Cashflow (Rsm)</b>	<b>2016</b>	<b>2017</b>	<b>2018E</b>	<b>2019E</b>	<b>2020E</b>
<b>EBIT (Adj)</b>	<b>32,920</b>	<b>37,368</b>	<b>21,203</b>	<b>24,580</b>	<b>33,531</b>	EBITDA	37,555	46,490	32,113	35,752	45,416
EBIT Margin (Adj) (%)	23.2	21.4	13.4	14.2	17.2	Working capital	-23,089	3,358	3,452	-5,065	-7,126
Net interest	-447	-1,525	-2,017	-1,597	-1,177	Other	-9,240	-10,402	-3,995	-3,898	-6,188
Associates	0	0	0	0	0	<b>Operating cashflow</b>	<b>5,227</b>	<b>39,446</b>	<b>31,570</b>	<b>26,789</b>	<b>32,101</b>
Non-Op/Except/Other Adj	1,877	-494	1,069	1,803	1,628	Capex	-57,815	-26,007	-11,107	-10,100	-12,100
<b>Pre-tax profit</b>	<b>34,350</b>	<b>35,349</b>	<b>20,255</b>	<b>24,786</b>	<b>33,982</b>	Net acq/disposals	0	0	0	0	0
Tax	-11,535	-9,785	-5,064	-5,701	-7,816	Other	0	0	0	0	0
Extraord./Min.Int./Pref.div.	-88	11	11	12	13	<b>Investing cashflow</b>	<b>-57,815</b>	<b>-26,007</b>	<b>-11,107</b>	<b>-10,100</b>	<b>-12,100</b>
<b>Reported net profit</b>	<b>22,727</b>	<b>25,575</b>	<b>15,203</b>	<b>19,097</b>	<b>26,179</b>	Dividends paid	-4,055	-4,066	-4,057	-4,057	-4,057
Net Margin (%)	16.0	14.6	9.6	11.0	13.4	<b>Financing cashflow</b>	<b>57,978</b>	<b>4,332</b>	<b>-21,074</b>	<b>-20,654</b>	<b>-20,234</b>
Core NPAT	22,955	26,702	15,662	19,097	26,179	<b>Net change in cash</b>	<b>5,390</b>	<b>17,772</b>	<b>-612</b>	<b>-3,965</b>	<b>-233</b>
<b>Per share data</b>	<b>2016</b>	<b>2017</b>	<b>2018E</b>	<b>2019E</b>	<b>2020E</b>	<b>Free cashflow to s/holders</b>	<b>-52,588</b>	<b>13,440</b>	<b>20,462</b>	<b>16,689</b>	<b>20,001</b>
Reported EPS (Rs)	50.27	56.57	33.63	42.24	57.91	<b>Segment Revenue Break Up</b>	<b>2016</b>	<b>2017</b>	<b>2018E</b>	<b>2019E</b>	<b>2020E</b>
Core EPS (Rs)	50.78	59.07	34.64	42.24	57.91	<b>Formulations (Rs m)</b>	<b>2016</b>	<b>2017</b>	<b>2018E</b>	<b>2019E</b>	<b>2020E</b>
DPS (Rs)	7.50	7.50	7.50	7.50	7.50	India Branded Formulations	33,916	38,157	41,973	48,688	56,478
CFPS (Rs)	11.56	87.26	69.83	59.26	71.01	US Generics	56,415	79,553	53,083	56,185	63,915
FCFPS (Rs)	-116.33	29.73	45.26	36.92	44.24	US Branded	3,013	3,074	2,936	2,936	2,936
BVPS (Rs)	248.36	300.29	326.11	359.57	408.79	Japan	13,646	15,528	19,963	21,154	22,440
Wtd avg ord shares (m)	452	452	452	452	452	Europe	4,278	4,706	5,176	5,694	6,263
Wtd avg diluted shares (m)	452	452	452	452	452	South Africa	3,998	4,998	5,497	6,322	7,270
<b>Growth rates</b>	<b>2016</b>	<b>2017</b>	<b>2018E</b>	<b>2019E</b>	<b>2020E</b>	Other Emerging Markets	9,697	13,799	15,179	17,456	20,075
Sales revenue (%)	11.3	23.1	-9.3	9.4	12.3	<b>API (Rs m)</b>	<b>12,074</b>	<b>11,383</b>	<b>11,383</b>	<b>11,383</b>	<b>11,383</b>
EBIT (Adj) (%)	3.4	13.5	-43.3	15.9	36.4						
Core NPAT (%)	-4.5	16.3	-41.3	21.9	37.1						
Core EPS (%)	-4.5	16.3	-41.3	21.9	37.1						
<b>Balance Sheet (Rsm)</b>	<b>2016</b>	<b>2017</b>	<b>2018E</b>	<b>2019E</b>	<b>2020E</b>						
Cash & cash equiv.	8,238	28,135	28,595	24,629	24,397						
Accounts receivables	45,488	43,073	39,117	42,804	48,082						
Inventory	32,737	36,423	34,015	37,221	41,811						
Net fixed & other tangibles	91,539	108,560	108,757	107,685	107,900						
Goodwill & intangibles	22,654	23,100	23,100	23,100	23,100						
Financial & other assets	25,593	26,781	27,542	28,378	29,299						
<b>Total assets</b>	<b>226,249</b>	<b>266,073</b>	<b>261,125</b>	<b>263,817</b>	<b>274,588</b>						
Accounts payable	28,288	31,413	29,025	31,357	34,654						
Short-term debt	68,534	77,753	62,753	47,753	32,753						
Long-term debt	3,241	1,908	1,908	1,908	1,908						
Provisions & other liab	14,231	19,678	19,913	20,245	20,611						
<b>Total liabilities</b>	<b>114,294</b>	<b>130,752</b>	<b>113,599</b>	<b>101,264</b>	<b>89,926</b>						
Shareholders' equity	111,634	134,976	146,580	161,620	183,741						
Minority interests	321	345	334	322	309						
<b>Total equity</b>	<b>111,955</b>	<b>135,321</b>	<b>146,914</b>	<b>161,942</b>	<b>184,050</b>						
<b>Net debt (Adj)</b>	<b>63,538</b>	<b>51,526</b>	<b>36,066</b>	<b>25,031</b>	<b>10,264</b>						
Net debt to equity (Adj) (%)	56.8	38.1	24.5	15.5	5.6						

For definitions of the items in this table, please click [here](#).

Gross margins are down c220bps QoQ largely on account of lower US\$ realization and loss of Minastrin exclusivity in US. Cost associated with the front end build up for Solosec has impacted EBITDA margins.

EBITDA is adjusted to a forex loss of Rs821m.

Tax expenses are higher by Rs361m on account of re-measurement of deferred tax asset / liabilities pertaining to US business following the enactment of the new tax regime

Figure 1. Lupin – 3QFY18 Consolidated Income Statement (Rs m, %)

	3QFY17	3QFY18	% Ch YoY	2QFY18	% Ch QoQ
Net Sales	44,049	39,004	(11.5)	38,742	0.7
Other Operating Income	779	753	(3.4)	778	(3.3)
<b>Total Revenues</b>	<b>44,829</b>	<b>39,756</b>	<b>(11.3)</b>	<b>39,520</b>	<b>0.6</b>
Raw material cost	13,016	13,927	7.0	12,865	8.3
as a % sales	29.0	35.0	600 bps	32.6	248 bps
Staff cost	7,312	6,931	(5.2)	7,250	(4.4)
as a % sales	16.3	17.4	112 bps	18.3	-91 bps
Other expenditure	11,873	11,194	(5.7)	11,444	(2.2)
as a % sales	26.5	28.2	167 bps	29.0	-80 bps
Total expenditure	32,200	32,052	(0.5)	31,559	1.6
<b>EBITDA</b>	<b>12,628</b>	<b>7,704</b>	<b>(39.0)</b>	<b>7,961</b>	<b>(3.2)</b>
<b>EBITDA Margins (%)</b>	<b>28.2</b>	<b>19.4</b>	<b>-879 bps</b>	<b>20.1</b>	<b>-76 bps</b>
Depreciation	2,309	2,804	21.4	2,722	3.0
Interest	459	540	17.6	479	12.7
Other Income	296	284	(3.9)	740	(61.6)
<b>PBT</b>	<b>10,156</b>	<b>4,645</b>	<b>(54.3)</b>	<b>5,500</b>	<b>(15.5)</b>
Tax	4,095	1,247	(69.6)	1,541	(19.1)
Effective Tax Rate (%)	40.3	26.8	-1348 bps	28.0	-117 bps
Minority Interest	(0)	(1)	350.0	(20)	(95.6)
<b>Recurring PAT</b>	<b>6,061</b>	<b>3,163</b>	<b>(47.8)</b>	<b>4,094</b>	<b>(22.7)</b>
EO expense/(income) items	(270)	1,182		(570)	
<b>Reported PAT</b>	<b>5,791</b>	<b>2,217</b>	<b>(61.7)</b>	<b>4,550</b>	<b>(51.3)</b>

Source: Company Reports, Citi Research

Figure 2. Lupin – 3QFY18 Revenue Breakdown (Rs m)

	3QFY17	3QFY18	% Ch YoY	2QFY18	% Ch QoQ
Formulations	41,365	36,324	(12.2)	36,092	0.6
% of Total Sales	93.9	93.1		93.2	
North America	21,755	14,321	(34.2)	13,611	5.2
India	9,912	10,688	7.8	11,593	(7.8)
Asia Pacific	5,601	6,742	20.4	6,357	6.1
EMEA	2,555	2,721	6.5	2,758	(1.3)
LATAM	1,175	1,481	26.0	1,395	6.2
ROW	367	371	1.1	378	(1.9)
APIs	2,684	2,680	(0.1)	2,650	1.1
% of Total Sales	6.1	6.9		6.8	
<b>Total</b>	<b>44,049</b>	<b>39,004</b>	<b>(11.5)</b>	<b>38,742</b>	<b>0.7</b>

Source: Company Reports, Citi Research

Figure 3. Earnings Revision

Revenues	FY18E	FY19E	FY20E
New	158,727	173,598	194,877
Old	162,707	178,501	198,584
Change (%)	-2.4%	-2.7%	-1.9%
<b>EBITDA</b>			
New	32,113	35,752	45,416
Old	32,941	36,975	45,913
Change (%)	-2.5%	-3.3%	-1.1%
<b>EPS</b>			
New	34.6	42.2	57.9
Old	39.5	45.2	58.7
Change (%)	-12.3%	-6.6%	-1.3%

Source: Citi Research

# Bull/Bear: Lupin (LUPN.BO)

## Bull/Bear: Lupin (LUPN.BO)

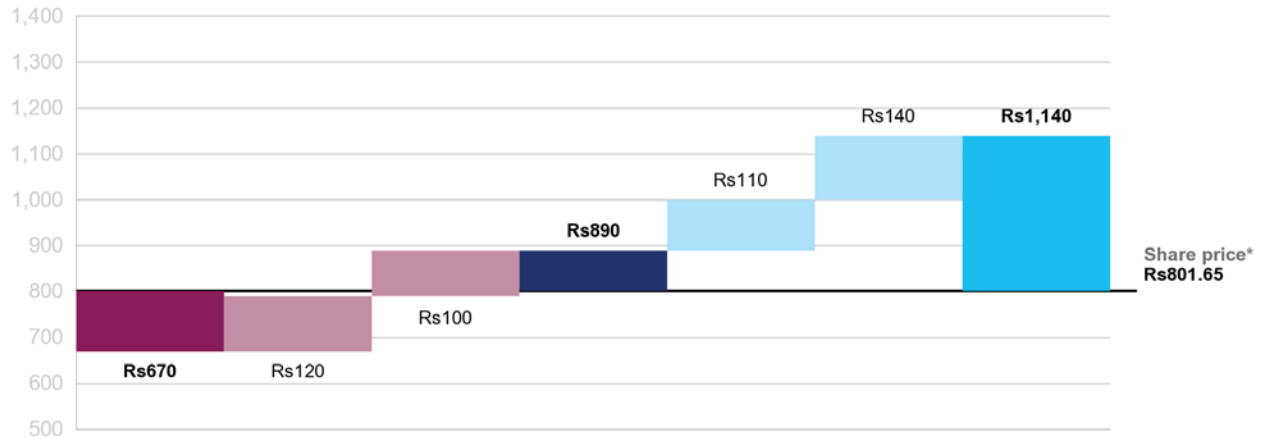


Rs,890 target price

11% expected share price return

Neutral rating

58pp Bull/Bear Spread



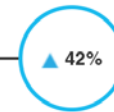
Sharp erosion in US base business

Compliance issues continue to drag



Strong pick up in complex generic approvals

Warning letter gets lifted in FY19



Share price\*  
Rs801.65

Source: Citi Research

\*Share price as of 6 Feb 2018 15:59



Rs1,140

- Warning letter gets lifted in FY19
- High value approvals start coming in FY19 such As Lialda, Apriso, Welchol
- Monetization of Ranexa FTF on scheduled time-line



Rs890

- Warning letter stays throughout FY19
- Launch of Levothyroxine in FY18 and Ranexa FTF in FY19
- Compliance issues don't escalate to other facilities



Rs670

- No visibility of resolution of WL in FY19, more 483s post re-inspection
- US base business continues to see double digit erosion

## Lupin

### Company description

Lupin produces a wide range of generic & branded formulations and APIs for the developed and developing markets. Its products reach over 70 countries in the world. The company has emerged as one of the leading Indian participants in the US (ranked fifth by prescriptions) and Japan (ranked sixth) and is among the fastest-growing companies in India.

### Investment strategy

We rate Lupin shares Neutral with a target price of Rs890/sh after the company got a warning letter on two of its key facilities. The company's US business is already under pressure following the price erosion in its key products while the warning letter is likely to result in delays in new approvals. Though the company has made good progress on the complex generic and specialty pipeline, it is unlikely to see the results until compliance issues are over.

### Valuation

We value Lupin at Rs890, based on 21x Mar'19E EPS. Our target multiple is derived from 1) a 14x P/E for the US generics business, set at a 15-20% discount to mid-sized US generics players given the high risk to a couple of in-market products; 2) a 28x P/E for the India business, ascribing a 20-25% premium to the 12M forward consensus-based P/E for Alkem, a close pure-India comparable, to reflect its market leadership and good growth; and 3) 18x for Others businesses (ex. India and the US, including APIs). The 18x is in-line with the 16-19x P/E range for emerging-market peers. We then apply a +5% adjustment factor to account for the company's relatively healthy profitability/Rol.

### Risks

Key risks that could impede the stock from achieving our target price include: 1) Rising competitive intensity in its US business, given faster pace of approvals for the industry; 2) Delay in approval of products especially from the niche portfolio in the US; and 3) Inability to effectively scale up the Japanese operations would hurt one of the longer-term growth drivers. Conversely, less competition in the US and accelerated new product approval would be upside risks.

## Appendix A-1

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**Lupin (LUPN.BO)**

**Ratings and Target Price History  
Fundamental Research**

Analyst: Prashant Nair, CFA



Date	Rating	Target Price	Closing Price
1 13-Aug-15 19:53:45	1	*2,270.00	1,757.00
2 24-Sep-15 18:24:09	1	*2,550.00	1,989.45
3 27-Oct-15 17:42:15	1	*2,360.00	1,945.65
4 24-Feb-16 04:33:01	1	*2,130.00	1,762.15
5 19-May-16 21:28:11	1	*1,930.00	1,655.80
6 27-Oct-16 07:43:51	1	*1,970.00	1,485.00
7 09-Feb-17 12:58:13	1	*1,890.00	1,495.35
8 24-May-17 17:12:07	1	*1,630.00	1,227.65
9 13-Jul-17 08:52:17	1	*1,480.00	1,141.90
10 21-Jul-17 07:19:42	1	*1,350.00	1,142.85
11 03-Aug-17 13:14:36	1	*1,170.00	994.90
12 30-Oct-17 12:32:21	1	*1,240.00	1,027.55
13 07-Nov-17 16:42:16	*2	*960.00	860.50
14 04-Jan-18 09:09:41	2	*910.00	877.50
15 10-Jan-18 09:21:32	2	*970.00	925.05

\*Indicates Change

Rating/target price changes above reflect Eastern Time

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