

Neutral

# Lupin (LUPN.BO)

## Earnings Review: Below expectations on FX and tax, stay Neutral

<b>LUPN.BO</b>	12m Price Target: <b>Rs840.00</b>	Price: <b>Rs801.65</b>	Upside: <b>4.8%</b>
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Lupin reported 3Q18 below expectations. The weakness was driven by three factors, (1) Loss of exclusivity on gMinastrin and unfavourable mix, (2) One-off expenses related to the writedown of Deferred Taxes Assets in the US and (3) Foreign Exchange losses. Adjusted for the foreign exchange loss, EBITDA missed Bloomberg consensus by 8%. Looking ahead, management's focus is on approaching the US FDA for re-inspection of the Goa-Pithampur Combined Warning Letter and executing on new launches like levothyroxene sodium on which some strengths could start contributing starting mid-2018 (vs. March 2018 earlier). Though management is seeing signals that pricing pressure in the US market is approaching a bottom, we do not see any major catalysts to drive near-term performance and remain Neutral.

### Exhibit 1: Lupin 3Q18 Results Summary

Rs. Mn	3Q18	Gse	vs Gse	YoY (%)	QoQ (%)
Sales	39,756	38,986	2%	-11%	1%
EBITDA	6,883	7,758	-11%	-43%	-19%
EBITDA margins	17.3%	19.9%	-259bps	-981bps	-427bps
Net income	2,217	3,762	-41%	-65%	-51%

Source: Company data, Goldman Sachs Global Investment Research

- Goa-Pithampur Warning Letter update:** Management is working with plant remediation consultants like Lachman and Parexel. They are in favor of doing a comprehensive job and do not want to rush the activity here. Management expects to complete the remediation work at both the plants by June 2018, following which they will request a re-inspection from the FDA.
- Price erosion on base products in high single digit range:** Larger generic players like Teva and Sandoz have announced that they will withdraw if not raise price on base products where margins are low. Management believes that this anecdotal evidence suggests that industry is approaching a bottom on US

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### Key Data

Market cap: Rs362.0bn / \$5.7bn  
Enterprise value: Rs416.5bn / \$6.5bn  
3m ADTV: NA  
India  
India Pharmaceuticals  
M&A Rank: 3

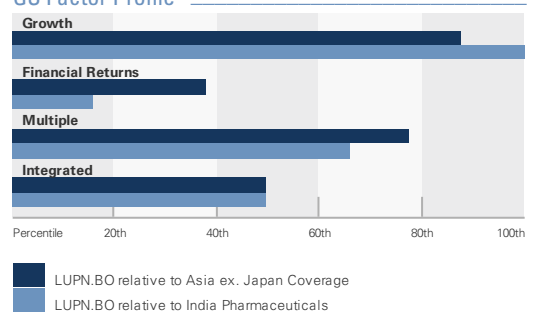
### GS Forecast

	3/17	3/18E	3/19E	3/20E
<b>Revenue (Rs mn) New</b>	<b>174,660.9</b>	<b>157,524.0</b>	<b>174,877.0</b>	<b>200,725.6</b>
Revenue (Rs mn) Old	174,660.9	155,734.3	170,831.4	195,420.2
EBITDA (Rs mn)	43,333.1	29,821.5	32,973.1	41,902.5
<b>EPS (Rs) New</b>	<b>56.40</b>	<b>29.09</b>	<b>35.07</b>	<b>46.97</b>
EPS (Rs) Old	56.40	33.57	37.06	48.17
P/E (X)	26.9	27.6	22.9	17.1
P/B (X)	5.1	2.5	2.3	2.0
Dividend yield (%)	0.5	0.5	0.6	0.8
CROCI (%)	17.4	10.9	10.9	11.9

	12/17	3/18E	6/18E	9/18E
EPS (Rs)	4.89	6.27	6.33	8.50

### GS Factor Profile



Source: Company data, Goldman Sachs Research estimates. See disclosures for details.

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Neutral

## Lupin (LUPN.BO)

Rating since May 2, 2016

## Ratios &amp; Valuation

	3/17	3/18E	3/19E	3/20E
P/E (X)	26.9	27.6	22.9	17.1
P/B (X)	5.1	2.5	2.3	2.0
FCF yield (%)	2.2	1.6	0.1	0.8
EV/EBITDA (X)	9.5	14.0	12.8	10.2
CROCI (%)	17.4	10.9	10.9	11.9
ROE (%)	20.9	9.4	10.5	12.6
Net debt/equity (%)	38.0	37.3	37.9	36.3
Interest cover (X)	23.6	9.3	11.8	15.0
Days inventory outst, sales	71.3	86.7	84.9	82.9
Receivable days	92.5	94.9	85.5	84.2
Days payable outstanding	174.7	170.7	152.8	153.7
DuPont ROE (%)	18.9	9.1	10.0	11.9
Turnover (X)	0.7	0.6	0.6	0.6
Leverage (X)	2.0	1.9	1.8	1.8

## Growth &amp; Margins (%)

	3/17	3/18E	3/19E	3/20E
Total revenue growth	23.0	(9.8)	11.0	14.8
EBITDA growth	17.0	(31.2)	10.6	27.1
EPS growth	12.9	(48.4)	20.6	33.9
DPS growth	0.7	(48.9)	20.6	33.9
EBIT margin	19.6	12.0	12.0	14.0
EBITDA margin	24.8	18.9	18.9	20.9
Net income margin	14.6	8.4	9.1	10.6

## Price Performance

LUPN.BO (Rs)

India BSE30 Sensex



	3m	6m	12m
Absolute	(22.5)%	(19.2)%	(46.4)%
Rel. to the India BSE30 Sensex	(23.6)%	(23.6)%	(55.4)%

Source: FactSet. Price as of 6 Feb 2018 close.

## Income Statement (Rs mn)

	3/17	3/18E	3/19E	3/20E
Total revenue	174,660.9	157,524.0	174,877.0	200,725.6
Cost of goods sold	(50,014.3)	(52,763.9)	(58,980.7)	(66,239.4)
SG&A	(29,640.3)	(27,020.0)	(30,124.1)	(33,119.7)
R&D	(23,101.0)	(19,439.2)	(22,002.9)	(25,242.9)
Other operating inc./exp.)	-	-	-	-
<b>EBITDA</b>	<b>43,333.1</b>	<b>29,821.5</b>	<b>32,973.1</b>	<b>41,902.5</b>
Depreciation & amortization	(9,122.3)	(10,978.2)	(11,975.3)	(13,798.2)
<b>EBIT</b>	<b>34,210.8</b>	<b>18,843.3</b>	<b>20,997.8</b>	<b>28,104.3</b>
Net interest inc./exp.)	(1,448.1)	(2,025.2)	(1,786.7)	(1,873.8)
Income/(loss) from associates	-	-	-	-
<b>Pre-tax profit</b>	<b>35,431.2</b>	<b>18,778.3</b>	<b>21,834.3</b>	<b>29,241.4</b>
Provision for taxes	(9,785.1)	(5,570.1)	(5,895.3)	(7,895.2)
Minority interest	(71.7)	(17.9)	(35.9)	(48.0)
Preferred dividends	-	-	-	-
<b>Net inc. (pre-exceptionals)</b>	<b>25,574.4</b>	<b>13,190.4</b>	<b>15,903.2</b>	<b>21,298.2</b>
Post-tax exceptionals	-	-	-	-
<b>Net inc. (post-exceptionals)</b>	<b>25,574.4</b>	<b>13,190.4</b>	<b>15,903.2</b>	<b>21,298.2</b>
<b>EPS (basic, pre-exception) (Rs)</b>	<b>56.90</b>	<b>29.21</b>	<b>35.22</b>	<b>47.16</b>
<b>EPS (diluted, pre-exception) (Rs)</b>	<b>56.40</b>	<b>29.09</b>	<b>35.07</b>	<b>46.97</b>
<b>EPS (basic, post-exception) (Rs)</b>	<b>56.90</b>	<b>29.21</b>	<b>35.22</b>	<b>47.16</b>
<b>EPS (diluted, post-exception) (Rs)</b>	<b>56.40</b>	<b>29.09</b>	<b>35.07</b>	<b>46.97</b>
DPS (Rs)	7.50	3.83	4.62	6.19
Div. payout ratio (%)	13.2	13.1	13.1	13.1

## Balance Sheet (Rs mn)

	3/17	3/18E	3/19E	3/20E
Cash & cash equivalents	28,135.4	25,378.6	19,075.3	14,602.9
Accounts receivable	43,073.4	38,847.2	43,126.7	49,501.3
Inventory	36,422.8	38,425.2	42,952.6	48,238.7
Other current assets	17,751.7	17,751.7	17,751.7	17,751.7
<b>Total current assets</b>	<b>125,383.3</b>	<b>120,402.7</b>	<b>122,906.3</b>	<b>130,094.5</b>
Net PP&E	53,512.7	62,534.5	73,559.2	86,211.0
Net intangibles	78,147.2	81,397.2	84,647.2	87,897.2
Total investments	9,029.6	9,029.6	9,029.6	9,029.6
Other long-term assets	-	-	-	-
<b>Total assets</b>	<b>266,072.8</b>	<b>273,364.0</b>	<b>290,142.3</b>	<b>313,232.3</b>
Accounts payable	25,948.0	23,402.1	25,980.1	29,820.2
Short-term debt	23,043.3	23,043.3	23,043.3	23,043.3
Other current liabilities	16,273.1	16,273.1	16,273.1	16,273.1
<b>Total current liabilities</b>	<b>65,264.4</b>	<b>62,718.5</b>	<b>65,296.5</b>	<b>69,136.6</b>
Long-term debt	56,477.8	56,477.8	56,477.8	56,477.8
Other long-term liabilities	9,009.7	9,009.7	9,009.7	9,009.7
<b>Total long-term liabilities</b>	<b>65,487.5</b>	<b>65,487.5</b>	<b>65,487.5</b>	<b>65,487.5</b>
<b>Total liabilities</b>	<b>130,751.9</b>	<b>128,206.0</b>	<b>130,784.0</b>	<b>134,624.1</b>
Preferred shares	-	-	-	-
Total common equity	134,975.7	144,794.9	158,959.3	178,161.2
<b>Minority interest</b>	<b>345.2</b>	<b>363.1</b>	<b>399.0</b>	<b>447.0</b>
<b>Total liabilities &amp; equity</b>	<b>266,072.8</b>	<b>273,364.0</b>	<b>290,142.3</b>	<b>313,232.3</b>
Gross cash invested (ex cash)	239,487.3	266,309.4	302,038.2	342,808.9
Net debt, adjusted	51,385.7	54,142.5	60,445.8	64,918.2
Average capital employed	179,832.5	193,003.6	209,552.3	231,665.3
BVPS (Rs)	297.66	319.33	350.57	392.91

## Cash Flow (Rs mn)

	3/17	3/18E	3/19E	3/20E
Net income	35,431.2	18,778.3	21,834.3	29,241.4
D&A add-back	9,122.3	10,978.2	11,975.3	13,798.2
Minority interest add-back	-	-	-	-
Net (inc)/dec working capital	3,357.5	(322.1)	(6,228.8)	(7,820.6)
Other operating cash flow	(6,763.6)	(3,544.9)	(4,108.6)	(6,021.4)
<b>Cash flow from operations</b>	<b>41,147.4</b>	<b>25,889.5</b>	<b>23,472.2</b>	<b>29,197.6</b>
Capital expenditures	(26,367.9)	(20,000.0)	(23,000.0)	(26,450.0)
Acquisitions	(3,426.6)	(3,250.0)	(3,250.0)	(3,250.0)
Divestitures	-	-	-	-
Others	4,507.7	0.0	0.0	-
<b>Cash flow from investing</b>	<b>(25,286.8)</b>	<b>(23,250.0)</b>	<b>(26,250.0)</b>	<b>(29,700.0)</b>
Dividends paid (common & pref)	(3,377.6)	(3,371.2)	(1,738.7)	(2,096.3)
Inc/(dec) in debt	9,478.9	-	-	-
Other financing cash flows	(1,769.5)	(2,025.2)	(1,786.7)	(1,873.8)
<b>Cash flow from financing</b>	<b>4,331.8</b>	<b>(5,396.4)</b>	<b>(3,525.4)</b>	<b>(3,970.1)</b>
<b>Total cash flow</b>	<b>20,192.4</b>	<b>(2,756.8)</b>	<b>(6,303.2)</b>	<b>(4,472.5)</b>
Free cash flow	14,779.5	5,889.5	472.2	2,747.6

Source: Company data, Goldman Sachs Research estimates.

price erosion, especially with market leaders beginning to push back to the channel on price negotiations, after a period of two years of sustained price cuts on the base business portfolios.

- **Levothyroxene sodium:** The launch on one of the strengths on this key molecule is likely to be in mid2018 now, vs earlier guidance for an approval by March 2018.
- **Solosec specialty opportunity in Women's Health arena:** After the tWarning Letter remediation effort, working towards a timely launch on this molecule is next on the focus list for the company. Recall, Lupin spent \$150mn to acquire this molecule in October 2017 ([see link to our note](#)). Lupin has completed validation on the product and is now expanding its specialty sales force from the current 70 people to 125 people by April 2018. The company is in a position to fill up the channel starting early to mid-FY19. We believe it will take two years from launch for this molecule to turn profitable at Lupin, until which time there will likely be startup costs.
- **Margin commentary:** Margin declined qoq largely because of loss of exclusivity on gMinastrin. Management clarified that the 65%-66% range is likely to be the base for gross margins in coming quarters.
- **Rating and Price target:** We cut FY18-FY20E EBITDA by 1%-4% given the update on relatively unfavorable business mix in the near-term. We cut our 12-m TP to Rs840 (Rs850 prior), calculated by applying a 13.0x multiple to FY20E EBITDA discounted back 1 year at an 11% WACC. We remain Neutral rated on limited upside drivers to the stock. Key Risks: Resolution of Warning Letter at Goa and Pithampur plants, US price erosion intensity, Pace of new product launches.

**Exhibit 2: Lupin 3Q18 Variance Table**

in Rs. mn

Rs mn unless stated	3Q17	2Q18	3Q18	3Q18E	vs Gse	yoy gr	qoq gr
<b>Sales (incl. other operating income)</b>	<b>44,829</b>	<b>39,520</b>	<b>39,756</b>	<b>38,986</b>			
YoY (%)	26.4%	-7.9%	-11.3%	-13.0%			
<b>Cost of goods sold</b>	<b>(13,016)</b>	<b>(12,865)</b>	<b>(13,927)</b>	<b>(12,866)</b>			
CoGS as a % of sales	29.0%	32.6%	35.0%	33.0%			
<b>Gross Margin</b>	<b>71.0%</b>	<b>67.4%</b>	<b>65.0%</b>	<b>67.0%</b>	<b>-203bps</b>	<b>-600 bps</b>	<b>-248 bps</b>
<b>R&amp;D expenses</b>	<b>(5,682)</b>	<b>(4,739)</b>	<b>(4,757)</b>	<b>(4,873)</b>			
R&D exp. as a % of sales	12.7%	12.0%	12.0%	12.5%			
<b>SG&amp;A</b>	<b>(6,662)</b>	<b>(6,135)</b>	<b>(7,258)</b>	<b>(6,238)</b>			
SG&A as a % of sales	14.9%	15.5%	18.3%	16.0%			
Employee expenses	(7,312)	(7,250)	(6,931)	(7,251)			
Emp exp as a % of sales	16.3%	18.3%	17.4%	18.6%			
<b>EBITDA</b>	<b>12,158</b>	<b>8,531</b>	<b>6,883</b>	<b>7,758</b>			
EBITDA margin	27.1%	21.6%	17.3%	19.9%			
EBITDA yoy growth	43.7%	-17.0%	-43.4%	-36.2%			
<b>EBITDA margin as stated by company</b>	<b>30.0%</b>	<b>24.0%</b>	<b>18.4%</b>	<b>21.8%</b>	<b>-343bps</b>	<b>-1160 bps</b>	<b>-563 bps</b>
Sales base for EBITDA	44,049	38,742	38,978	38,208			
EBITDA as stated by company	13,218	9,310	7,173	8,343			
<b>Net Income</b>	<b>6,331</b>	<b>4,550</b>	<b>2,217</b>	<b>3,762</b>			
Net Margin	14.1%	11.5%	5.6%	9.6%			
NI yoy growth	20.7%	-31.3%	-65.0%	-40.6%			
<b>Split by segment / geography</b>							
<b>Formulations Sales</b>	<b>41,365</b>	<b>36,092</b>	<b>36,324</b>	<b>35,498</b>			
North America (incl Gavis)	21,755	13,611	14,321	12,926			
EMEA	2,555	2,758	2,721	2,836			
India	9,912	11,593	10,688	10,903			
APAC	5,601	6,357	6,742	7,136			
LATAM + ROW	1,542	1,773	1,852	1,696			
<b>API</b>	<b>2,684</b>	<b>2,650</b>	<b>2,680</b>	<b>2,711</b>			

Source: Company Data, Goldman Sachs Global Investment Research

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# Disclosure Appendix

## Reg AC

We, Shyam Srinivasan, CFA and Chandramouli Muthiah, hereby certify that all of the views expressed in this report accurately reflect our personal views about the subject company or companies and its or their securities. We also certify that no part of our compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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**Growth** is based on a stock's forward-looking sales growth, EBITDA growth and EPS growth (for financial stocks, only EPS and sales growth), with a higher percentile indicating a higher growth company. **Financial Returns** is based on a stock's forward-looking ROE, ROCE and CROCI (for financial stocks, only ROE), with a higher percentile indicating a company with higher financial returns. **Multiple** is based on a stock's forward-looking P/E, P/B, price/dividend (P/D), EV/EBITDA, EV/FCF and EV/Debt Adjusted Cash Flow (DACF) (for financial stocks, only P/E, P/B and P/D), with a higher percentile indicating a stock trading at a higher multiple. The **Integrated** percentile is calculated as the average of the Growth percentile, Financial Returns percentile and (100% - Multiple percentile).

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India Pharmaceuticals: Aurobindo Pharma, Cipla, Dr. Reddy's Laboratories, Glenmark Pharmaceuticals, Lupin, Sun Pharmaceutical Industries.

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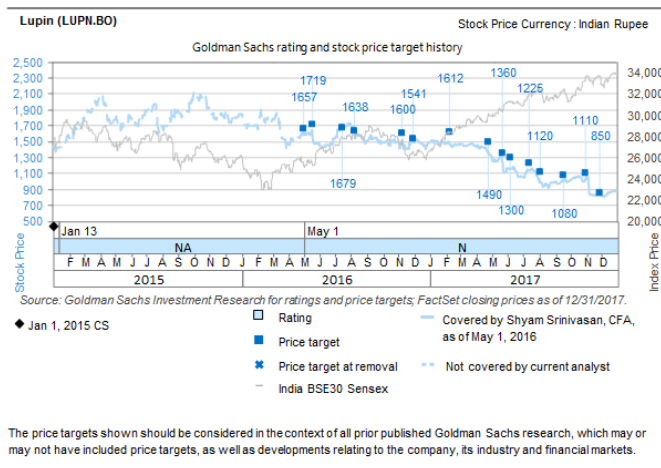
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	Buy	Hold	Sell	Buy	Hold	Sell
Global	33%	54%	13%	63%	57%	52%

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## Price target and rating history chart(s)



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