

# Lupin (LPC IN)

## Weak Q2, US outlook remains weak

### INDIA | PHARMACEUTICALS | Quarterly Update

30 October 2017

#### Top takeaways from Q2FY18

- ⇨ Sales were Rs 39.52bn (-8% yoy; 2% below PC estimates of Rs 40.36bn). US sales continued to disappoint with 30% yoy decline in sales at US\$ 204mn (vs. estimated US\$ 251mn), which negated the strong performance in domestic formulations (+16% yoy), APAC (+15%), and EMEA (+17%).
- ⇨ With recovery in domestic formulation, cost optimisation efforts, and low R&D spend (12% of sales vs. 13% in Q2FY17), operating margin at 21.6% (-340bps/+170bps yoy/qoq) was a bit below our estimate of 22.2%. EBITDA was -21% yoy at Rs 8.53bn (vs. estimated Rs 8.96bn).
- \* PAT, at Rs 4.55bn (-31% yoy) was 4% below estimates. Adjusted for forex gain of Rs 420mn, core PAT missed our estimates by 11%.

#### Conference call takeaways

- \* US sales (-32%/-18% qoq) fell primarily due to: (1) higher competition in gGlumetza/gFortamet, (2) generic competition in gMinastrin, and (3) high single-digit price erosion in the base business due to price negotiation.
- ⇨ LPC expects continued pricing challenges (in high single digits) in its base business. However, it expects few launches like gTamiflu, gAxirom, gFosrenol, and gTobi in H2FY18. LPC is hopeful of strong growth in FY19 led by the launch of gRenexa, Levothyroxine, and few controlled substance drugs.
- ⇨ For other drugs such as gLialda, gCoreg CR, and gPrevacid ODT (for which LPC has a complete response letter) it expects a late FY19 launch.
- ⇨ Its US subsidiary Somerset showed double-digit growth in Q2, despite pricing pressure, supported by new launches. Expects to maximise Somerset's portfolio through the launch of controlled substances and building a branded franchisee in the US.
- ⇨ Its branded business (US\$ 24mn in Q2) saw double-digit growth.
- ⇨ LPC expects to complete phase-3 study for gSpiriva in FY18; expects US filing in FY19. This will be followed by Advair and Simbicort filing in FY20.
- ⇨ Strong 16% growth in India sales for Q2 supported by restocking and new launches. Sees ~15% growth in H2FY18, 12-15% for FY18.
- ⇨ Expects EIR from USFDA for the pending Form-483 on its Pithampur and Goa plants soon; all other plants are FDA compliant.
- ⇨ Maintained FY18 operating margin guidance at 21-23%.

**Outlook and valuation:** LPC's Q2 performance missed our expectations largely due to the negative surprise on the US front. With no major key-product opportunity in the US market on the horizon, and continued impact of pricing pressure, the US outlook seems bleak. Factoring weakness in the US market, we cut our FY18/19 EPS by 12%/10%, and accordingly cut our target to Rs 1,000 – i.e., 19x FY19 EPS (from 1,100 earlier). We maintain our NEUTRAL rating.

### NEUTRAL (Maintain)

CMP RS 1028/TARGET RS 1000 (-3%)

#### COMPANY DATA

O/S SHARES (MN) :	452
MARKET CAP (RSBN) :	453
MARKET CAP (USDBN) :	7.1
52 - WK HI/LO (RS) :	1572 / 920
LIQUIDITY 3M (USDMN) :	29.8
PAR VALUE (RS) :	2

#### SHARE HOLDING PATTERN, %

	Sep 17	Jun 17	Mar 17
PROMOTERS :	46.8	46.7	46.7
FII / NRI :	28.0	31.2	32.1
FI / MF :	12.0	9.5	9.1
NON PRO :	4.1	4.3	4.1
PUBLIC & OTHERS :	9.1	8.4	8.0

#### Key Financials

Rs mn	FY17	FY18E	FY19E
Net Sales	1,71,198	1,56,151	1,72,846
EBIDTA	48,620	34,654	43,110
Net Profit	28,994	17,446	23,210
EPS, Rs	64.2	38.6	51.4
PER, x	16.0	26.6	20.0
EV/EBIDTA, x	11.0	15.0	11.7
PBV,x%	3.4	3.1	2.8
ROE, %	18.8	11.6	13.7
Debt/Equity (%)	59.0	40.7	30.9

#### CHANGE IN ESTIMATES

Rs bn	Revised Est.		% Revision	
	FY18E	FY19E	FY18E	FY19E
Revenue	159.0	176.0	-5.5	-5.2
EBITDA	34.7	43.1	-6.3	-5.2
Core PAT	17.4	23.2	-12.0	-9.6
EPS (Rs)	38.7	51.5	-12.0	-9.6

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(Rs mn)	Q2FY18	Q1FY18	QoQ Ch (%)	Q2FY17	YoY Ch (%)	vs. expectations %	Comments
Gross US Sales (US\$ mn)	204	238	-14.3	292	-30.1	-18.7	Mainly due to a sharp decline in gGlumetza sales
Gross US Sales (Rs mn)	13,611	16,018	-15.0	19,978	-31.9	-17.5	
India	11,593	9,324	24.3	9,958	16.4	11.9	
Net Sales	39,520	38,696	2.1	42,905	-7.9	-2.1	
R&D Spend	4,739	4,999	-5.2	5,716	-17.1		
EBITDA	8,531	7,684	11.0	10,731	-20.5	-4.8	Despite weak US sales, margins improved sequentially due to smart recovery in domestic sales from GST impact and cost optimization initiatives
EBITDA margin	21.6	19.9		25.0		-61bps	
Reported PAT	4,550	3,581	27.1	6,622	-31.3	-4.2	
Core PAT	4,237	3,581	18.3	7,072	-40.1	-10.8	Adjusted for forex gain of Rs 420mn
Core EPS (Rs)	9.40	7.95	18.3	15.70	-40.1	-10.8	Below expectations

**Q2FY18 results at a glance**

(Rs mn)	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	QoQ (%)	YoY (%)
<b>Net Sales</b>	<b>43,136</b>	<b>42,112</b>	<b>44,049</b>	<b>41,619</b>	<b>38,068</b>	<b>38,742</b>	1.8	-8.0
Other income from operations	1,259	793	779	914	628	778	24.0	-1.9
<b>Total income from operations</b>	<b>44,394</b>	<b>42,905</b>	<b>44,829</b>	<b>42,533</b>	<b>38,696</b>	<b>39,520</b>	2.1	-7.9
Material Cost	12,719	12,429	13,016	11,851	12,326	12,865	4.4	3.5
<b>Gross Profit</b>	<b>31,675</b>	<b>30,477</b>	<b>31,813</b>	<b>30,682</b>	<b>26,370</b>	<b>26,654</b>	1.1	-12.5
<b>Gross Margin %</b>	<b>71.3</b>	<b>71.0</b>	<b>71.0</b>	<b>72.1</b>	<b>68.1</b>	<b>67.4</b>		
Employee Expenses	7,059	7,124	7,311	7,078	7,180	7,250	1.0	1.8
% of sales	15.9	16.6	16.3	16.6	18.6	18.3		
Manufacturing & Other Expenses	6,541	6,906	6,661	5,843	6,507	6,135	-5.7	-11.2
% of sales	14.7	16.1	14.9	13.7	16.8	15.5		
R&D spend	4,994	5,716	5,682	6,709	4,999	4,739	-5.2	-17.1
% of sales	11.2	13.3	12.7	15.8	12.9	12.0		
Expenditure	31,314	32,174	32,670	31,480	31,012	30,989	-0.1	-3.7
% of sales	70.5	75.0	72.9	74.0	80.1	78.4		
<b>Operating Profit</b>	<b>13,080</b>	<b>10,731</b>	<b>12,159</b>	<b>11,053</b>	<b>7,684</b>	<b>8,531</b>	11.0	-20.5
<b>OPM (%)</b>	<b>29.5</b>	<b>25.0</b>	<b>27.1</b>	<b>26.0</b>	<b>19.9</b>	<b>21.6</b>		
Other Income	826	271	1,036	453	320	740		
Interest	320	263	459	406	439	479		
Depreciation	2,027	2,112	2,309	2,674	2,605	2,722		
<b>PBT</b>	<b>11,560</b>	<b>8,627</b>	<b>10,426</b>	<b>8,426</b>	<b>4,959</b>	<b>6,070</b>	22.4	-29.6
Total tax	2,734	1,589	4,095	1,367	1,368	1,541		
Tax rate (%)	23.7	18.4	39.3	16.2	27.6	25.4		
<b>PAT</b>	<b>8,826</b>	<b>7,038</b>	<b>6,331</b>	<b>7,059</b>	<b>3,591</b>	<b>4,529</b>	26.1	-35.6
Minority Interest	6	8	24	34	(12)	19		
<b>Reported net profit</b>	<b>8,820</b>	<b>6,622</b>	<b>6,331</b>	<b>3,802</b>	<b>3,581</b>	<b>4,550</b>	27.1	-31.3
<b>Adj. PAT</b>	<b>8,820</b>	<b>7,072</b>	<b>6,167</b>	<b>7,041</b>	<b>3,581</b>	<b>4,237</b>	18.3	-40.1
<b>Core EPS</b>	<b>19.6</b>	<b>15.7</b>	<b>13.7</b>	<b>15.6</b>	<b>7.9</b>	<b>9.4</b>	18.3	-40.1

Source: Company, PhillipCapital India Research

**Segmental revenue break-up**

(Rs mn)	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	QoQ (%)	YoY (%)
<b>Gross US Sales (US\$ mn)</b>	<b>322</b>	<b>292</b>	<b>316</b>	<b>276</b>	<b>238</b>	<b>204</b>	-14.3	-30.1
<b>Gross US Sales (Rs mn)</b>	<b>21,886</b>	<b>19,978</b>	<b>21,755</b>	<b>19,007</b>	<b>16,018</b>	<b>13,611</b>	-15.0	-31.9
India	9,499	9,958	9,912	8,788	9,324	11,593	24.3	16.4
APAC	5,416	5,520	5,601	6,118	5,989	6,357	6.1	15.2
EMEA	2,194	2,355	2,555	3,012	2,259	2,758	22.1	17.1
LATAM	1,089	986	1,175	1,269	1,269	1,395	9.9	41.5
ROW	368	396	367	610	416	378	-9.1	-4.5
<b>Gross Formulations</b>	<b>40,452</b>	<b>39,193</b>	<b>41,365</b>	<b>38,804</b>	<b>35,275</b>	<b>36,092</b>	2.3	-7.9
APIs	2,966	2,919	2,684	2,815	2,793	2,650	-5.1	-9.2
<b>Gross Revenue</b>	<b>43,418</b>	<b>42,112</b>	<b>44,049</b>	<b>41,619</b>	<b>38,068</b>	<b>38,742</b>	1.8	-8.0

Source: Company, PhillipCapital India Research

**Revision of estimates**

Fig. Rs bn	Old Est.		Revised Est.		% Revision	
	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Revenue	168.2	185.7	159.0	176.0	-5.5	-5.2
EBITDA	37.0	45.5	34.7	43.1	-6.3	-5.2
EBITDA Margin%	22	24.5	21.8	24.5		
Core PAT	19.8	25.7	17.4	23.2	-12.0	-9.6
EPS	44.0	57.0	38.7	51.5	-12.0	-9.6

Source: Company, PhillipCapital India Research

## Financials

### Income Statement

Y/E Mar, Rs mn	FY16	FY17	FY18e	FY19e
<b>Net sales</b>	<b>1,37,579</b>	<b>1,71,198</b>	<b>1,56,151</b>	<b>1,72,846</b>
Growth, %	9	24	-9	11
Other income	4,977	3,745	2,811	3,111
<b>Total income</b>	<b>1,42,555</b>	<b>1,74,943</b>	<b>1,58,961</b>	<b>1,75,957</b>
Raw material expenses	-43,326	-50,014	-51,662	-54,899
Employee expenses	-21,416	-28,495	-27,977	-29,033
Other Operating expenses	-40,618	-47,813	-44,668	-48,916
<b>EBITDA (Core)</b>	<b>37,196</b>	<b>48,620</b>	<b>34,654</b>	<b>43,110</b>
Growth, %	(0.6)	30.7	(28.7)	24.4
Margin, %	27.0	28.4	22.2	24.9
Depreciation	-4,871	-9,122	-10,551	-11,664
<b>EBIT</b>	<b>32,325</b>	<b>39,498</b>	<b>24,103</b>	<b>31,446</b>
Growth, %	(2.3)	22.2	(39.0)	30.5
Margin, %	23.5	23.1	15.4	18.2
Interest paid	-595	-1,525	-1,693	-1,346
Other Non-Operating Income	931	795	1,113	1,232
<b>Pre-tax profit</b>	<b>33,190</b>	<b>35,266</b>	<b>23,440</b>	<b>31,249</b>
Tax provided	-10,593	-9,785	-6,116	-8,146
<b>Profit after tax</b>	<b>22,597</b>	<b>25,481</b>	<b>17,324</b>	<b>23,103</b>
Others (Minorities, Associates)	-88	-72	-44	-58
<b>Net Profit</b>	<b>22,509</b>	<b>25,410</b>	<b>17,281</b>	<b>23,045</b>
Growth, %	(7.8)	31.9	(39.8)	33.0
<b>Net Profit (adjusted)</b>	<b>21,979</b>	<b>28,994</b>	<b>17,446</b>	<b>23,210</b>
Unadj. shares (m)	451	452	452	452
Wtd avg shares (m)	451	452	452	452

### Balance Sheet

Y/E Mar, Rs mn	FY16	FY17	FY18e	FY19e
Cash & bank	8,218	6,994	5,999	11,135
Debtors	45,488	43,073	39,038	43,212
Inventory	32,737	36,423	32,531	36,010
Loans & advances	988	1,604	1,405	1,556
Other current assets	20,426	18,524	17,177	19,013
Total current assets	1,07,855	1,06,618	96,149	1,10,925
Investments	164	21,361	21,361	21,361
Gross fixed assets	1,09,333	1,38,134	1,47,185	1,58,779
Less: Depreciation	-4,951	-13,624	-24,174	-35,838
Add: Capital WIP	9,812	7,150	9,000	9,000
Net fixed assets	1,14,194	1,31,660	1,32,010	1,31,941
<b>Total assets</b>	<b>2,26,249</b>	<b>2,66,073</b>	<b>2,55,955</b>	<b>2,70,661</b>
Current liabilities	34,095	38,361	34,700	38,410
Provisions	4,248	7,801	7,056	7,513
Total current liabilities	38,344	46,162	41,756	45,923
Non-current liabilities	75,950	84,590	65,395	56,686
Total liabilities	1,14,294	1,30,752	1,07,151	1,02,610
Paid-up capital	901	903	903	903
Reserves & surplus	1,10,733	1,34,073	1,47,555	1,66,803
Shareholders' equity	1,11,955	1,35,321	1,48,804	1,68,051
<b>Total equity &amp; liabilities</b>	<b>2,26,249</b>	<b>2,66,073</b>	<b>2,55,955</b>	<b>2,70,661</b>

Source: Company, PhillipCapital India Research Estimates

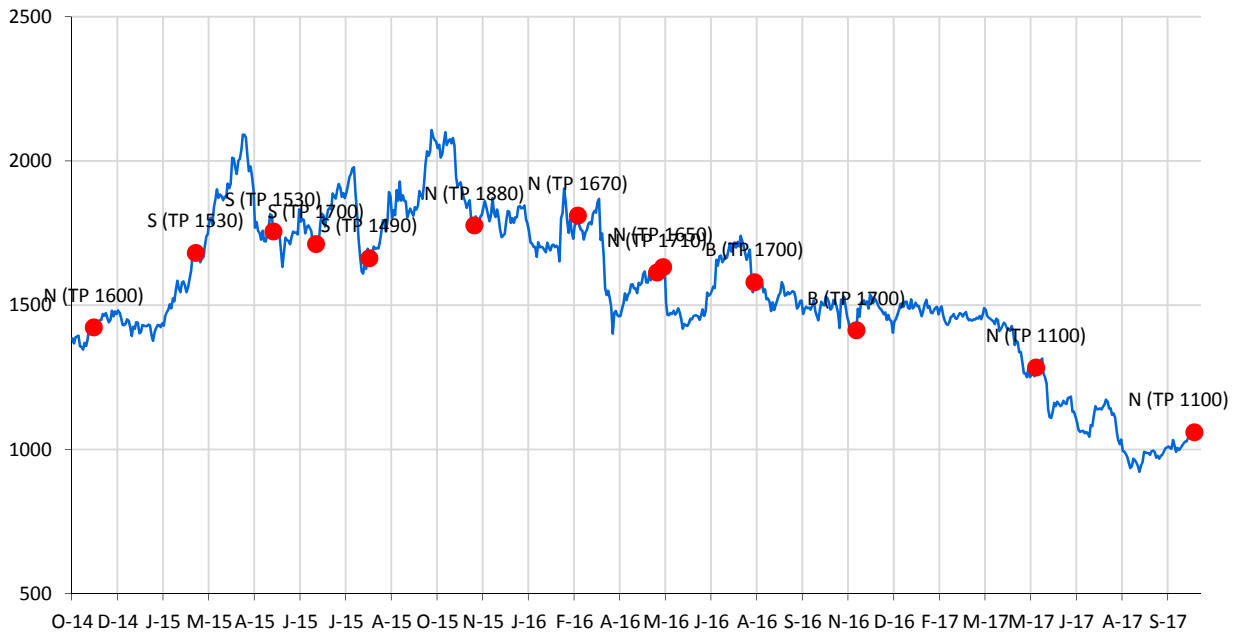
### Cash Flow

Y/E Mar, Rs mn	FY16	FY17	FY18e	FY19e
Pre-tax profit	33,190	35,266	23,440	31,249
Depreciation	4,871	9,122	10,551	11,664
Chg in working capital	-35,058	7,833	5,067	-5,472
Total tax paid	-9,919	-11,429	-6,116	-8,146
<b>Cash flow from operating activities</b>	<b>-6,915</b>	<b>40,792</b>	<b>32,942</b>	<b>29,295</b>
Capital expenditure	-69,852	-26,589	-10,901	-11,594
Chg in investments	16,479	-21,198	0	0
<b>Cash flow from investing activities</b>	<b>-53,422</b>	<b>-47,869</b>	<b>-10,984</b>	<b>-11,677</b>
Free cash flow	22,940	71,699	43,965	40,996
Equity raised/(repaid)	1,311	1,853	0	0
Debt raised/(repaid)	66,404	7,886	-19,195	-8,708
Dividend (incl. tax)	-4,061	-4,071	-3,963	-3,963
<b>Cash flow from financing activities</b>	<b>63,646</b>	<b>5,620</b>	<b>-23,201</b>	<b>-12,729</b>
Net chg in cash	3,309	-1,457	-1,243	4,889

### Valuation Ratios

	FY16	FY17	FY18e	FY19e
<b>Per Share data</b>				
EPS (INR)	48.8	64.2	38.6	51.4
Growth, %	(8.0)	31.6	(39.8)	33.0
Book NAV/share (INR)	247.7	298.9	328.7	371.4
FDEPS (INR)	48.8	64.2	38.6	51.4
CEPS (INR)	59.6	84.4	62.0	77.2
CFPS (INR)	(17.3)	88.8	70.7	62.3
DPS (INR)	7.5	7.5	7.5	7.5
<b>Return ratios</b>				
Return on assets (%)	12.8	10.7	7.0	9.1
Return on equity (%)	20.2	18.8	11.6	13.7
Return on capital employed (%)	17.7	18.3	11.8	14.5
<b>Turnover ratios</b>				
Asset turnover (x)	1.1	0.9	0.8	0.9
Sales/Total assets (x)	0.8	0.7	0.6	0.7
Sales/Net FA (x)	1.7	1.4	1.2	1.3
Working capital/Sales (x)	0.5	0.4	0.4	0.4
Receivable days	120.7	91.8	91.3	91.3
Inventory days	86.9	77.7	76.0	76.0
Working capital days	173.9	130.6	129.6	129.6
<b>Liquidity ratios</b>				
Current ratio (x)	3.2	2.8	2.8	2.9
Quick ratio (x)	2.2	1.8	1.8	2.0
Interest cover (x)	54.4	25.9	14.2	23.4
Dividend cover (x)	6.5	8.6	5.2	6.9
Total debt/Equity (%)	64.3	59.0	40.7	30.9
Net debt/Equity (%)	56.9	53.8	36.7	24.2
<b>Valuation</b>				
PER (x)	21.1	16.0	26.6	20.0
PEG (x) - y-o-y growth	(2.6)	0.5	(0.7)	0.6
Price/Book (x)	4.1	3.4	3.1	2.8
Yield (%)	0.7	0.7	0.7	0.7
EV/Net sales (x)	3.8	3.1	3.3	2.9
EV/EBITDA (x)	14.2	11.0	15.0	11.7
EV/EBIT (x)	16.3	13.6	21.5	16.1

### Stock Price, Price Target and Rating History



### Rating Methodology

We rate stock on absolute return basis. Our target price for the stocks has an investment horizon of one year.

Rating	Criteria	Definition
BUY	>= +15%	Target price is equal to or more than 15% of current market price
NEUTRAL	-15% > to < +15%	Target price is less than +15% but more than -15%
SELL	<= -15%	Target price is less than or equal to -15%.

**Management**

Vineet Bhatnagar (Managing Director)	(91 22) 2483 1919
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