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**LUPIN**

Pharmaceuticals

12 November 2019

## Kyowa divestment – good value unlocking

Lupin (LPC) has signed a definitive agreement with financial investor Unison to sell its entire 99.8% stake in Kyowa for an EV of US\$ 520mn. This could unlock US\$ 220mn-250mn (Rs 30-40/sh) of value for LPC considering the divested business has a weak growth & margin outlook due to regulatory pricing pressure. The deal is attractive at 2x annualised H1FY20 sales and 13x EBITDA and optimises LPC's capital structure to pursue M&A in key areas (specialty in US and India). Deal-based ROCE accretion is more pronounced than EPS, in our view.

Vivek Kumar

research@bobcaps.in

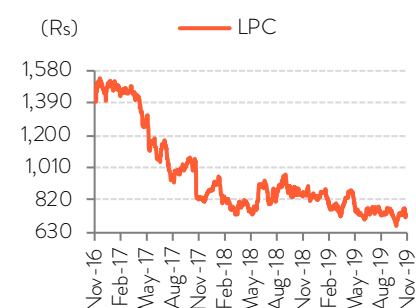
**Deal details:** LPC expects to generate net cash inflow of US\$ 300mn from the deal, after repaying Kyowa's debt of US\$ 176mn, transaction cost and tax liability. The divestiture includes CNS generics, long-listed specialty products and human capital, but excludes biosimilar Enbrel/YLB where LPC has the flexibility to monetise the asset at a future date. In the mid-term, LPC will continue to meet supply commitments on generic products that have margins on par with the company average. Greater clarity on deal closure is expected in 3-4 months.

Ticker/Price	LPC IN/Rs 736
Market cap	US\$ 4.7bn
Shares o/s	453mn
3M ADV	US\$ 14.8mn
52wk high/low	Rs 906/Rs 646
Promoter/FPI/DII	47%/25%/12%

Source: NSE

**Financial implications:** Based on our **FY21 pro forma analysis (Fig 1)**, we believe the divestment will be 2-3% EPS accretive from Year 1, assuming reduction in net debt by Rs 2.5bn and savings in interest and depreciation to the extent of Rs 2.5bn-2.8bn per year. However, we see meaningful improvement in core ROCE of at least 130bps over our current FY21 estimates.

## STOCK PERFORMANCE



Source: NSE

**Other update from the call:** (1) Kyowa sales were US\$ 128mn in H1FY20 (US\$ 250mn in FY19) with normalised EBITDA margins in the 15-18% range. (2) Gavis impairment can potentially be relooked by FY20-end. (3) LPC will negotiate ongoing supplies to Kyowa. (4) Japan FTC to respond on deal approval in the next 30 days. (5) LPC plans to reduce its net debt by US\$ 460mn.

## KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	158,021	167,010	177,435	196,191	210,728
EBITDA (Rs mn)	31,453	27,020	30,142	35,304	39,624
Adj. net profit (Rs mn)	17,137	9,464	10,319	14,809	17,125
Adj. EPS (Rs)	37.9	20.9	22.8	32.7	37.8
Adj. EPS growth (%)	(41.5)	(44.8)	9.0	43.5	15.6
Adj. ROAE (%)	12.6	6.9	7.4	10.3	11.3
Adj. P/E (x)	19.4	35.2	32.3	22.5	19.4
EV/EBITDA (x)	12.2	14.3	12.7	11.0	9.7

Source: Company, BOBCAPS Research

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**FIG 1 – PRO FORMA FY21E FINANCIALS: ROCE IMPROVEMENT MORE PRONOUNCED COMPARED TO EPS CHANGE**

(Rs mn)	Lupin	Kyowa divested	Combined (Pro forma) FY21E
<b>Profit and Loss account</b>			
Revenues	196,191	17,860	178,331
EBITDA	35,304	2,679	32,625
Margin (%)	18.0	15.0	18.3
Depreciation	13,277	1,840	11,438
EBIT	22,027	839	21,187
Interest	2,865	125	1,900
Other income	2,124	0	2,124
PBT	21,286	714	21,411
Tax	6,386	166	6,219
PAT	14,900	548	15,191
Minority/JV	0	0	0
PAT after minority/JV	14,900	548	15,191
O/S shares (mn shares)	452.5	452.5	452.5
<b>EPS</b>	<b>32.9</b>	<b>1.2</b>	<b>33.6</b>
<b>Net accretion in EPS (%)</b>			<b>2.0</b>
<b>Capital employed</b>			
	<b>232,334</b>	<b>33,955</b>	<b>185,710</b>
Net debt	51,398	12,496	26,232
<b>Change in Net debt (US\$ mn)</b>			<b>(360)</b>
Others (non-current liability)	33,967	8,434	25,533
Shareholder's fund	146,969	13,025	133,945
<b>Key leverage ratios</b>			
Net D/E (x)	0.3	1.0	0.2
Net debt/EBITDA (x)	1.5	4.7	0.8
ROCE	7.3	1.9	8.9
<b>Change in ROCE (bps)</b>			<b>163 bps</b>

Source: Company, BOBCAPS Research

**FIG 2 – FINANCIAL RESULTS FOR KYOWA SUBSIDIARY**

(Rs mn)	FY14	FY15	FY16	FY17	FY18	FY19	H1FY20
<b>Revenues</b>	<b>9,637</b>	<b>10,220</b>	<b>10,538</b>	<b>14,046</b>	<b>16,983</b>	<b>17,843</b>	<b>9,100</b>
Growth (%)	5.0	6.1	3.1	33.3	20.9	5.1	-
As % to consolidated sales	8.6	8.0	7.4	8.0	10.7	10.7	10.4
PBT	1,506	1,396	1,800	1,420	1,842	894	-
Tax	509	487	334	226	440	208	-
<b>PAT</b>	<b>997</b>	<b>909</b>	<b>1,466</b>	<b>1,194</b>	<b>1,402</b>	<b>686</b>	<b>-</b>
Margin (%)	10.3	8.9	13.9	8.5	8.3	3.8	-
As % to consolidated profits	5.6	3.8	6.7	4.1	8.2	7.2	-
<b>Net worth</b>	<b>5,950</b>	<b>6,630</b>	<b>8,326</b>	<b>9,450</b>	<b>11,072</b>	<b>11,817</b>	<b>-</b>

Source: Company, BOBCAPS Research

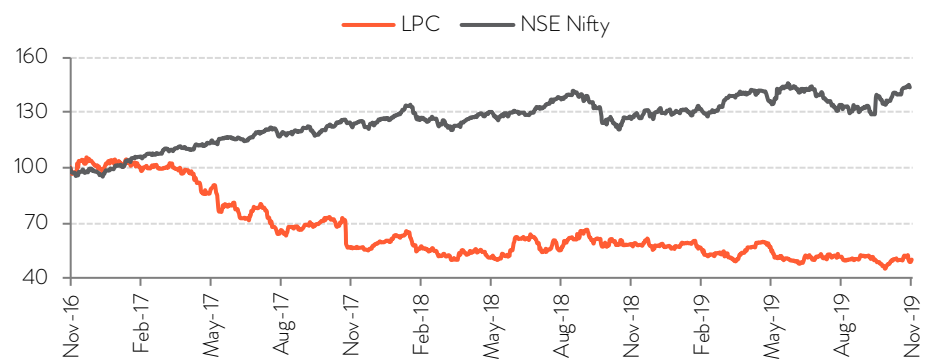
Interest cost reduction of ~US\$ 14mn (@ 3.7% interest rate) is after factoring in US\$ 360mn of net debt reduction

## Valuation methodology

At CMP, LPC is trading at 23x FY21E EPS which is reasonable and largely pricing in the earnings pickup expected over the next two years. We forecast 22% EPS growth over FY19-FY22, building in gProAir and gBrovana in FY21. We have not factored in upsides from distant opportunities gSpiriva (FY23 US launch) and gEnbrel (FY22 EU opportunity, in our view).

Retain ADD with an unchanged Sep'20 price target of Rs 840, based on an EV/EBITDA multiple of 12x Sep'21E (implied P/E of 24x). A deepening US product pipeline, Japan business exit and high share of branded generics are other key long-term positives.

**FIG 3 – RELATIVE STOCK PERFORMANCE**



Source: NSE

## Key risks

### Upside risks

- Earlier-than-expected resolution of warning letters at Goa and Indore Unit II – together both events have the potential to increase FY21E EBITDA by 10%.
- gSpiriva (FY23 US launch) and gEnbrel (FY22 EU launch).

### Downside risks

- Higher-than-expected price erosion in the US.

## FINANCIALS

### Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Total revenue</b>	<b>158,021</b>	<b>167,010</b>	<b>177,435</b>	<b>196,191</b>	<b>210,728</b>
EBITDA	31,453	27,020	30,142	35,304	39,624
Depreciation	10,857	10,850	12,226	13,277	14,329
EBIT	20,596	16,170	17,916	22,026	25,295
Net interest income/(expenses)	(2,043)	(3,078)	(2,960)	(2,865)	(2,789)
Other income/(expenses)	1,504	5,441	2,359	2,124	2,125
Exceptional items	0	0	0	0	0
EBT	20,057	18,533	17,315	21,286	24,631
Income taxes	2,885	9,017	6,926	6,386	7,389
Extraordinary items	(14,643)	(3,399)	0	0	0
Min. int./Inc. from associates	36	52	70	91	117
<b>Reported net profit</b>	<b>2,494</b>	<b>6,065</b>	<b>10,319</b>	<b>14,809</b>	<b>17,125</b>
Adjustments	14,643	3,399	0	0	0
<b>Adjusted net profit</b>	<b>17,137</b>	<b>9,464</b>	<b>10,319</b>	<b>14,809</b>	<b>17,125</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	24,754	23,935	26,602	28,726	30,393
Other current liabilities	18,886	23,386	23,386	23,386	23,386
Provisions	8,085	11,807	9,623	12,138	13,727
Debt funds	68,762	82,219	79,059	76,530	74,508
Other liabilities	0	0	0	0	0
Equity capital	904	905	905	905	905
Reserves & surplus	135,667	136,985	138,377	146,532	155,963
Shareholders' fund	136,571	137,890	139,282	147,437	156,868
<b>Total liabilities and equities</b>	<b>257,058</b>	<b>279,237</b>	<b>277,951</b>	<b>288,218</b>	<b>298,882</b>
Cash and cash eq.	14,080	9,872	4,008	4,034	7,762
Accounts receivables	51,922	51,498	54,938	60,745	65,246
Inventories	36,624	38,368	39,836	44,047	47,311
Other current assets	22,484	29,534	30,534	31,534	32,534
Investments	2,348	22,703	21,099	21,099	21,099
Net fixed assets	79,136	87,064	86,838	85,561	83,232
CWIP	25,981	16,396	16,896	17,396	17,896
Intangible assets	24,484	23,803	23,803	23,803	23,803
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>257,059</b>	<b>279,237</b>	<b>277,951</b>	<b>288,218</b>	<b>298,882</b>

Source: Company, BOBCAPS Research

**Cash Flows**

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	23,847	17,539	22,545	28,086	31,454
Interest expenses	2,043	3,078	2,960	2,865	2,789
Non-cash adjustments	(2,465)	290	0	0	0
Changes in working capital	(3,352)	(994)	(5,425)	(6,379)	(5,509)
Other operating cash flows	0	0	0	0	0
<b>Cash flow from operations</b>	<b>20,073</b>	<b>19,913</b>	<b>20,079</b>	<b>24,573</b>	<b>28,734</b>
Capital expenditures	(19,298)	(9,136)	(12,500)	(12,500)	(12,500)
Change in investments	19,013	(20,355)	1,604	0	0
Other investing cash flows	0	0	0	0	0
<b>Cash flow from investing</b>	<b>(285)</b>	<b>(29,490)</b>	<b>(10,896)</b>	<b>(12,500)</b>	<b>(12,500)</b>
Equities issued/Others	1	1	0	0	0
Debt raised/repaid	(10,758)	13,457	(3,160)	(2,528)	(2,023)
Interest expenses	(2,043)	(3,078)	(2,960)	(2,865)	(2,789)
Dividends paid	(4,651)	(7,274)	(4,636)	(6,653)	(7,694)
Other financing cash flows	4,748	2,264	(4,291)	0	0
<b>Cash flow from financing</b>	<b>(12,703)</b>	<b>5,369</b>	<b>(15,048)</b>	<b>(12,047)</b>	<b>(12,506)</b>
<b>Changes in cash and cash eq.</b>	<b>7,085</b>	<b>(4,208)</b>	<b>(5,864)</b>	<b>26</b>	<b>3,728</b>
<b>Closing cash and cash eq.</b>	<b>14,079</b>	<b>9,872</b>	<b>4,008</b>	<b>4,034</b>	<b>7,762</b>

**Per Share**

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	5.5	13.4	22.8	32.7	37.8
Adjusted EPS	37.9	20.9	22.8	32.7	37.8
Dividend per share	9.0	6.0	10.2	14.7	17.0
Book value per share	300.9	303.7	306.8	324.8	345.6

**Valuations Ratios**

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	2.4	2.3	2.2	2.0	1.8
EV/EBITDA	12.2	14.3	12.7	11.0	9.7
Adjusted P/E	19.4	35.2	32.3	22.5	19.4
P/BV	2.4	2.4	2.4	2.3	2.1

**DuPont Analysis**

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	85.4	51.1	59.6	69.6	69.5
Interest burden (PBT/EBIT)	97.4	114.6	96.6	96.6	97.4
EBIT margin (EBIT/Revenue)	13.0	9.7	10.1	11.2	12.0
Asset turnover (Revenue/Avg TA)	15.3	15.6	15.9	17.3	17.9
Leverage (Avg TA/Avg Equity)	1.9	2.0	2.0	2.0	1.9
Adjusted ROAE	12.6	6.9	7.4	10.3	11.3

Source: Company, BOBCAPS Research | Note: TA = Total Assets

**Ratio Analysis**

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
<b>YoY growth (%)</b>					
Revenue	(9.7)	5.7	6.2	10.6	7.4
EBITDA	(35.4)	(14.1)	11.6	17.1	12.2
Adjusted EPS	(41.5)	(44.8)	9.0	43.5	15.6
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	19.9	16.2	17.0	18.0	18.8
EBIT margin	13.0	9.7	10.1	11.2	12.0
Adjusted profit margin	10.8	5.7	5.8	7.5	8.1
Adjusted ROAE	12.6	6.9	7.4	10.3	11.3
ROCE	8.3	4.9	5.3	7.3	8.1
<b>Working capital days (days)</b>					
Receivables	110	113	113	113	113
Inventory	84	82	82	82	82
Payables	175	152	160	160	160
<b>Ratios (x)</b>					
Gross asset turnover	1.4	1.3	1.2	1.2	1.2
Current ratio	2.4	2.2	2.2	2.2	2.3
Net interest coverage ratio	10.1	5.3	6.1	7.7	9.1
Adjusted debt/equity	0.4	0.4	0.4	0.3	0.3

Source: Company, BOBCAPS Research

## Disclaimer

### Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

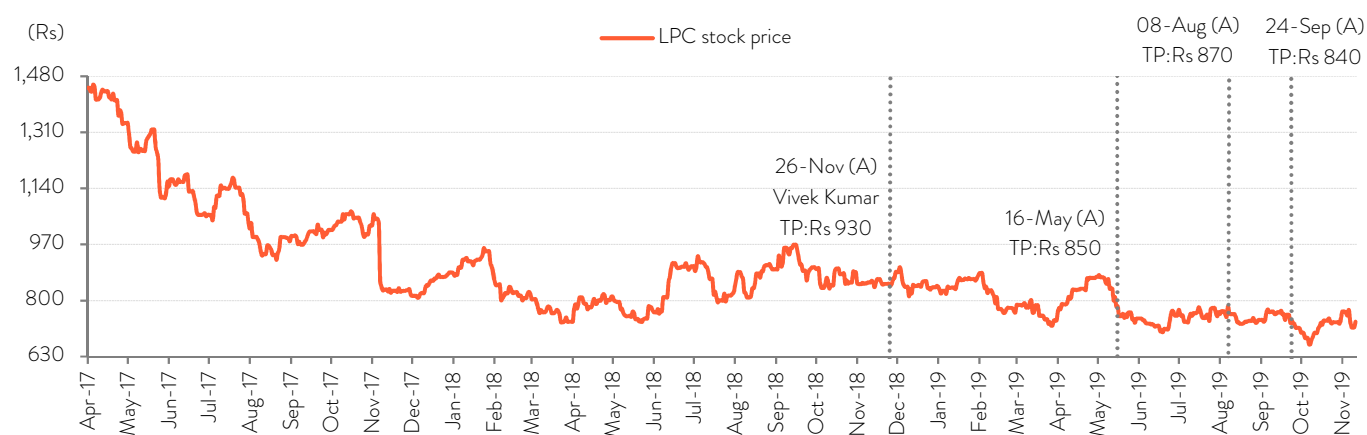
**ADD** – Expected return from >+5% to +15%

**REDUCE** – Expected return from -5% to +5%

**SELL** – Expected return <-5%

**Note:** Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

### HISTORICAL RATINGS AND TARGET PRICE: LUPIN (LPC IN)



B – Buy, A – Add, R – Reduce, S – Sell

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