

**ADD**

TP: Rs 790 | ▲ 9%

**LUPIN**

Pharmaceuticals

06 February 2020

## Weak result; healthy FY21 outlook

Lupin (LPC) reported a 40% miss on Q3 EBITDA while one-offs dented PAT (incl. US\$ 222mn Gavis impairment). Further, disclosures (ex-Kyowa) imply a weaker EBITDA margin profile for the standalone business – ~200bps lower than the 17% estimated for FY20 – driving a ~14% cut in our FY21/FY22 EPS.

Revenue was a 9% miss and adj. margin for Q3 was 12% (17.4% est.). LPC is guiding for healthy operating leverage in FY21 starting Q4. Downside risk to growth and reasonable valuations keep us at ADD; TP revised to Rs 790 (vs. Rs 840).

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**Weak margins (ex-Kyowa) a negative surprise:** Based on disclosures for the quarter, we note that Kyowa had ~28% margins (Fig 1)– this implies underlying EBITDA margins of 14-15% for LPC in Q3FY19/Q2FY20 (includes licensing income) and 12% in Q3FY20 (adj. for one-offs), which is weaker than anticipated. The underperformance is due to a higher other expense base. Also, Q3 saw a revenue miss across most regions (US, APAC, EMEA, API). India grew 9% YoY.

Ticker/Price LPC IN/Rs 722

Market cap US\$ 4.6bn

Shares o/s 453mn

3M ADV US\$ 15.3mn

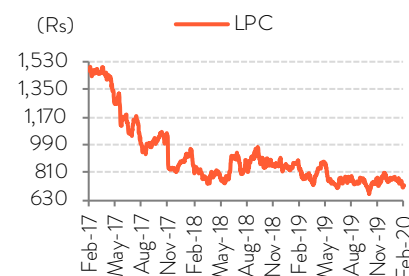
52wk high/low Rs 884/Rs 646

Promoter/FPI/DII 47%/25%/12%

Source: NSE

**Guiding for a better FY21:** Management has guided for healthy operating leverage, led by topline growth and cost control (flat R&D over FY20 and marginal increase in SG&A). Most of this depends on the US (full-year impact of Levo, inj. portfolio, Solosec, gProAir). LPC has reached half of the 20% target share in Levo which should reflect from Q4. The company expects 15+ launches without assuming any site clearance (incl. Albuterol launch – approved in H1).

## STOCK PERFORMANCE



Source: NSE

**Earnings call takeaways:** (1) Solosec sales up 48% QoQ and prescriptions up 4%. (2) Expects to launch gEnbrel in Q1FY21 in the EU. (3) One-offs in Q3: Rs 7bn in tax, pretax gain of US\$ 181mn on Kyowa divesture and Rs 400mn in other expense. (4) Highest number of ANDAs pending from Nagpur site. (5) Effective tax rate of 45% for FY20 and <40% for FY21. (6) Somerset and Goa site reinspection in next few months.

## KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	158,021	167,010	163,006	172,994	185,703
EBITDA (Rs mn)	31,453	27,020	25,035	30,205	33,881
Adj. net profit (Rs mn)	17,137	9,464	8,353	12,682	14,687
Adj. EPS (Rs)	37.9	20.9	18.5	28.0	32.5
Adj. EPS growth (%)	(41.5)	(44.8)	(11.7)	51.8	15.8
Adj. ROAE (%)	12.6	6.9	6.2	9.5	10.4
Adj. P/E (x)	19.1	34.5	39.1	25.8	22.2
EV/EBITDA (x)	12.2	14.0	15.1	12.2	10.3

Source: Company, BOBCAPS Research

BOB Capital Markets Ltd is a wholly owned subsidiary of Bank of Baroda

Important disclosures, including any required research certifications, are provided at the end of this report.



**FIG 1 – KYOWA DERIVED MARGINS ARE HIGHER VS LUPIN**

(Rs mn)	Continuing Business (ex Kyowa) Re-instated for Like to like comparison			Previously reported		Kyowa (derived)	
	Q3FY20	Q3FY19	Q2FY20	Q3FY19	Q2FY20	Q3FY19	Q2FY20
<b>Net Sales</b>	<b>37,692</b>	<b>38,212</b>	<b>38,202</b>	<b>45,048</b>	<b>43,596</b>	<b>6,836</b>	<b>5,394</b>
<b>EBITDA</b>	<b>4,291</b>	<b>5,557</b>	<b>5,786</b>	<b>7,528</b>	<b>7,313</b>	<b>1,971</b>	<b>1,527</b>
Depreciation	2,532	2,189	2,525	2,797	3,214	608	689
<b>EBIT</b>	<b>1,759</b>	<b>3,368</b>	<b>3,261</b>	<b>4,731</b>	<b>4,099</b>	<b>1,363</b>	<b>838</b>
Interest	886	785	825	797	864	12	39
Other Income	936	402	1,280	434	1,332	32	52
<b>PBT</b>	<b>1,809</b>	<b>2,985</b>	<b>3,716</b>	<b>4,368</b>	<b>4,567</b>	<b>1,383</b>	<b>851</b>
<b>Key Ratios (%)</b>							
Gross Margin	63.9	64.7	64.8	64.5	65.0	63.1	66.0
EBITDA Margin	11.4	14.5	15.1	16.7	16.8	28.8	28.3

Source: Company, BOBCAPS Research

**FIG 2 – QUARTERLY PERFORMANCE**

(Rs mn)	Q3FY20	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	Q3FY20E	Var. (%)	9MFY20	9MFY19	YoY (%)
<b>Net Sales</b>	<b>37,692</b>	<b>45,048</b>	<b>(16.3)</b>	<b>43,596</b>	<b>(13.5)</b>	<b>41,211</b>	<b>(8.5)</b>	<b>125,471</b>	<b>123,117</b>	<b>1.9</b>
<b>EBITDA</b>	<b>4,291</b>	<b>7,528</b>	<b>(43.0)</b>	<b>7,313</b>	<b>(41.3)</b>	<b>7,166</b>	<b>(40.1)</b>	<b>20,207</b>	<b>18,295</b>	<b>10.5</b>
Depreciation	2,532	2,797	-	3,214	-	3,133	-	8,917	8,042	-
<b>EBIT</b>	<b>1,759</b>	<b>4,731</b>	<b>(62.8)</b>	<b>4,099</b>	<b>(57.1)</b>	<b>4,034</b>	-	<b>11,290</b>	<b>10,253</b>	<b>10.1</b>
Interest	886	797	-	864	-	797	-	2,606	2,222	-
Other Income	936	434	-	1,332	-	600	-	3,090	4,582	-
<b>PBT</b>	<b>1,809</b>	<b>4,368</b>	<b>(58.6)</b>	<b>4,567</b>	<b>(60.4)</b>	<b>3,837</b>	-	<b>11,774</b>	<b>12,613</b>	<b>(6.7)</b>
Less: Taxation	675	2,478	-	343	-	1,343	-	3,298	6,018	-
Less: Minority Interest	0	(6)	-	0	-	0	-	88	(33)	-
<b>Recurring PAT</b>	<b>1,134</b>	<b>1,896</b>	<b>(40.2)</b>	<b>4,224</b>	<b>(73.2)</b>	<b>2,494</b>	<b>(54.5)</b>	<b>8,388</b>	<b>6,628</b>	<b>26.5</b>
Exceptional items	(9,872)	(3,422)	-	(5,464)	-	0	-	(15,336)	(3,422)	-
<b>Reported PAT</b>	<b>(8,738)</b>	<b>(1,526)</b>	<b>472.6</b>	<b>(1,240)</b>	<b>604.7</b>	<b>2,494</b>	<b>(450.4)</b>	<b>(6,948)</b>	<b>3,206</b>	<b>(316.7)</b>
<b>Key Ratios (%)</b>										
Gross Margin	63.9	64.5	-	65.0	-	64.0	-	64.6	64.0	-
EBITDA Margin	11.4	16.7	-	16.8	-	17.4	-	16.1	14.9	-
Tax / PBT	37.3	56.7	-	7.5	-	35.0	-	28.0	47.7	-
NPM	3.0	4.2	-	9.7	-	6.1	-	6.7	5.4	-
<b>EPS (Rs)</b>	<b>2.5</b>	<b>4.2</b>	-	<b>9.3</b>	-	<b>5.5</b>	-	<b>18.6</b>	<b>14.7</b>	-

Source: Company, BOBCAPS Research

**FIG 3 – REVENUE MIX**

(Rs mn)	Q3FY20	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	Q3FY20E	Var. (%)	9MFY20	9MFY19	YoY (%)
<b>Formulations</b>	<b>33,988</b>	<b>38,052</b>	<b>(10.7)</b>	<b>38,476</b>	<b>(11.7)</b>	<b>36,525</b>	<b>(6.9)</b>	<b>112,533</b>	<b>107,779</b>	<b>4.4</b>
US	13,766	14,174	(2.9)	13,244	3.9	15,166	(9.2)	42,422	38,519	10.1
India	12,969	11,902	9.0	13,419	(3.4)	13,028	(0.5)	39,465	35,858	10.1
APAC	1,722	6,936	(75.2)	6,352	(72.9)	2,476	(30.5)	14,791	19,212	(23.0)
EMEA	2,913	2,800	4.0	3,196	(8.9)	3,360	(13.3)	8,713	8,509	2.4
LATAM	1,796	1,557	15.4	1,445	24.3	1,744	3.0	4,791	4,272	12.1
RoW	822	683	20.4	820	0.2	751	9.4	2,351	1,409	66.9
APIs	3,173	3,624	(12.4)	3,052	4.0	3,986	(20.4)	9,714	10,552	(7.9)
Other Operating income	532	3,372	(84.2)	2,069	(74.3)	700	(24.0)	3,226	4,787	(32.6)
<b>Net Sales</b>	<b>37,693</b>	<b>45,048</b>	<b>(16.3)</b>	<b>43,597</b>	<b>(13.5)</b>	<b>41,211</b>	<b>(8.5)</b>	<b>125,473</b>	<b>123,118</b>	<b>1.9</b>

Source: Company, BOBCAPS Research

## Valuation methodology

At CMP, LPC is trading at 22x FY22E EPS which is reasonable and largely pricing in the earnings pickup expected over the next two years. We forecast 16-17% EPS growth over FY19-FY22, building in gProAir and gBrovana in FY21. We have not penciled in upsides from distant opportunities gSpiriva (FY23 US launch) and gEnbrel (FY22 EU opportunity, in our view).

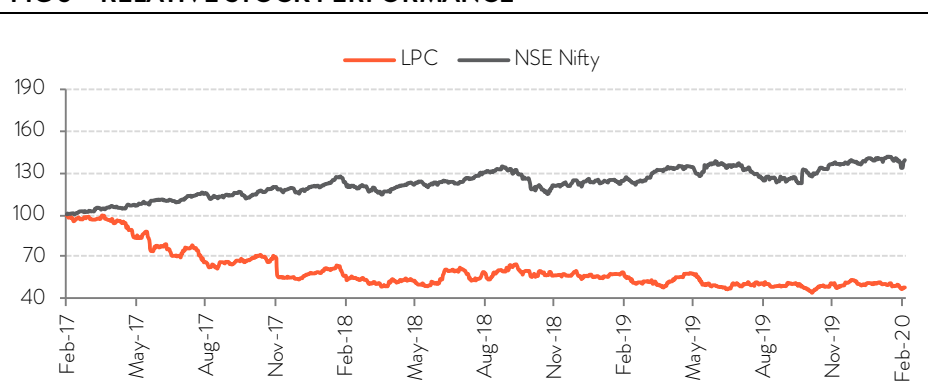
Following closure of the Kyowa transaction and the Q3FY20 miss, we cut our FY20-FY22 EPS estimates by 14-19%. Retain ADD and roll over to a Mar'21 target price of Rs 790 (earlier Rs 840), based on an EV/EBITDA multiple of 12x Mar'22E (implied P/E of 26x). A deepening US product pipeline, Japan business exit and high share of branded generics are added key long-term positives.

**FIG 4 – REVISED ESTIMATES**

(Rs Bn)	Revised			Old			Change (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Sales	163.0	173.0	185.7	177.4	196.2	210.7	(8.1)	(11.8)	(11.9)
EBITDA	25.0	30.2	33.9	30.1	35.3	39.6	(16.9)	(14.4)	(14.5)
EBITDA margin (%)	15.4	17.5	18.2	17.0	18.0	18.8	(163bps)	(53bps)	(56bps)
EPS (Rs)	18	28	32	23	33	38	(19.1)	(14.4)	(14.2)

Source: Company, BOBCAPS Research

**FIG 5 – 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>163,006</b>	<b>172,994</b>	<b>185,703</b>
EBITDA	31,453	27,020	25,035	30,205	33,881
Depreciation	10,857	10,850	11,499	10,936	12,016
EBIT	20,596	16,170	13,536	19,268	21,865
Net interest income/(expenses)	(2,043)	(3,078)	(3,358)	(2,149)	(1,719)
Other income/(expenses)	1,504	5,441	3,859	2,532	2,629
Exceptional items	0	0	0	0	0
EBT	20,057	18,533	14,037	19,651	22,775
Income taxes	2,885	9,017	5,615	6,878	7,971
Extraordinary items	(14,643)	(3,399)	(15,346)	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>(6,993)</b>	<b>12,682</b>	<b>14,687</b>
Adjustments	14,643	3,399	15,346	0	0
<b>Adjusted net profit</b>	<b>17,137</b>	<b>9,464</b>	<b>8,353</b>	<b>12,682</b>	<b>14,687</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	24,754	23,935	25,439	26,998	28,575
Other current liabilities	18,886	23,386	23,386	23,386	23,386
Provisions	8,085	11,807	1,844	11,183	12,632
Debt funds	68,762	82,219	67,159	53,727	42,982
Other liabilities	0	0	0	0	0
Equity capital	904	905	905	905	905
Reserves & surplus	135,667	136,985	128,842	135,827	143,915
Shareholders' fund	136,571	137,890	129,747	136,732	144,820
<b>Total liabilities and equities</b>	<b>257,058</b>	<b>279,237</b>	<b>247,576</b>	<b>252,025</b>	<b>252,394</b>
Cash and cash eq.	14,080	9,872	14,191	16,623	9,415
Accounts receivables	51,922	51,498	46,892	47,396	50,878
Inventories	36,624	38,368	36,597	35,547	38,158
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	57,565	58,628	58,612
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>247,576</b>	<b>252,025</b>	<b>252,394</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	4,506	23,618	26,703
Interest expenses	2,043	3,078	3,358	2,149	1,719
Non-cash adjustments	(2,465)	290	0	0	0
Changes in working capital	(3,352)	(994)	(3,082)	10,444	(4,068)
Other operating cash flows	0	0	0	0	0
<b>Cash flow from operations</b>	<b>20,073</b>	<b>19,914</b>	<b>4,782</b>	<b>36,211</b>	<b>24,354</b>
Capital expenditures	(19,298)	(9,136)	17,500	(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>(29,491)</b>	<b>19,104</b>	<b>(12,500)</b>	<b>(12,500)</b>
Equities issued/Others	1	1	0	0	0
Debt raised/repaid	(10,758)	13,457	(15,060)	(13,432)	(10,745)
Interest expenses	(2,043)	(3,078)	(3,358)	(2,149)	(1,719)
Dividends paid	(4,651)	(7,274)	3,142	(5,698)	(6,598)
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>(19,568)</b>	<b>(21,279)</b>	<b>(19,063)</b>
<b>Changes in cash and cash eq.</b>	<b>7,085</b>	<b>(4,208)</b>	<b>4,319</b>	<b>2,433</b>	<b>(7,209)</b>
<b>Closing cash and cash eq.</b>	<b>14,079</b>	<b>9,872</b>	<b>14,191</b>	<b>16,623</b>	<b>9,415</b>

**Per Share**

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	5.5	13.4	(15.5)	28.0	32.5
Adjusted EPS	37.9	20.9	18.5	28.0	32.5
Dividend per share	9.0	6.0	(6.9)	12.6	14.6
Book value per share	300.9	303.7	285.7	301.1	319.0

**Valuations Ratios**

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	2.4	2.3	2.3	2.1	1.9
EV/EBITDA	12.2	14.0	15.1	12.2	10.3
Adjusted P/E	19.1	34.5	39.1	25.8	22.2
P/BV	2.4	2.4	2.5	2.4	2.3

**DuPont Analysis**

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	85.4	51.1	59.5	64.5	64.5
Interest burden (PBT/EBIT)	97.4	114.6	103.7	102.0	104.2
EBIT margin (EBIT/Revenue)	13.0	9.7	8.3	11.1	11.8
Asset turnover (Revenue/Avg TA)	15.3	15.6	15.5	17.3	18.4
Leverage (Avg TA/Avg Equity)	1.9	2.0	2.0	1.9	1.8
Adjusted ROAE	12.6	6.9	6.2	9.5	10.4

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	(2.4)	6.1	7.3
EBITDA	(35.4)	(14.1)	(7.3)	20.6	12.2
Adjusted EPS	(41.5)	(44.8)	(11.7)	51.8	15.8
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	19.9	16.2	15.4	17.5	18.2
EBIT margin	13.0	9.7	8.3	11.1	11.8
Adjusted profit margin	10.8	5.7	5.1	7.3	7.9
Adjusted ROAE	12.6	6.9	6.2	9.5	10.4
ROCE	8.3	4.9	12.1	7.0	8.0
<b>Working capital days (days)</b>					
Receivables	110	113	105	100	100
Inventory	84	82	82	75	75
Payables	175	152	160	160	160
<b>Ratios (x)</b>					
Gross asset turnover	1.4	1.3	1.4	1.4	1.3
Current ratio	2.4	2.2	2.5	2.1	2.0
Net interest coverage ratio	10.1	5.3	4.0	9.0	12.7
Adjusted debt/equity	0.4	0.4	0.2	0.1	0.1

Source: Company, BOBCAPS Research

## Disclaimer

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

**BUY** – Expected return >+15%

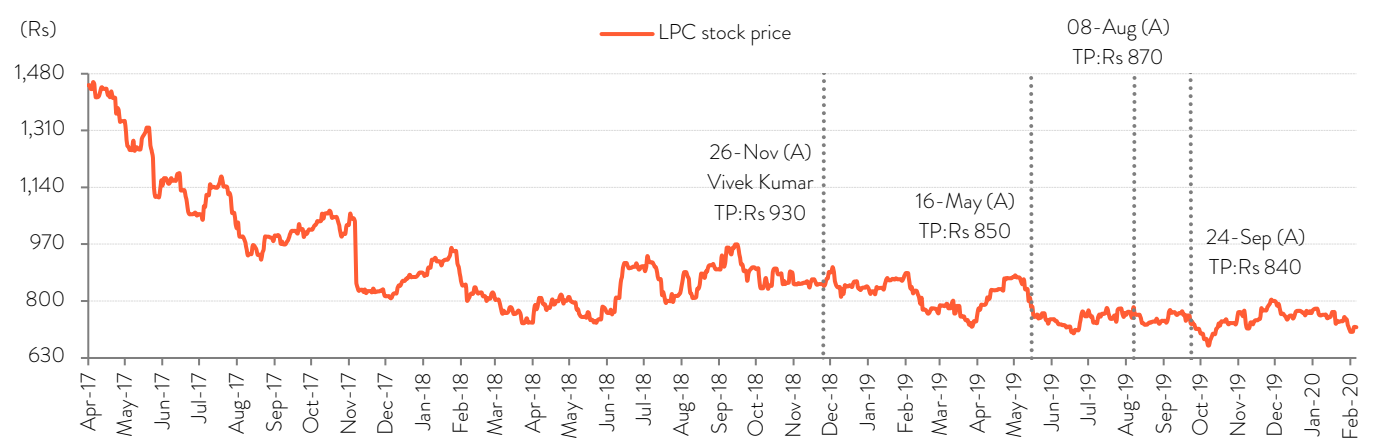
**ADD** – Expected return from >+5% to +15%

**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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