

Sector: Pharmaceuticals
Result Update

	Change
Reco: Hold	↔
CMP: Rs. 879	
Price Target: Rs. 965	↑
↑ Upgrade ↔ No change ↓ Downgrade	

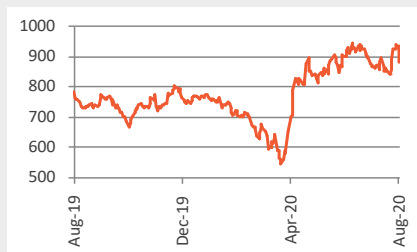
Company details

Market cap:	Rs. 39,849 cr
52-week high/low:	Rs. 956/505
NSE volume: (No of shares)	33.0 lakh
BSE code:	500257
NSE code:	LUPIN
Sharekhan code:	LUPIN
Free float: (No of shares)	24.0 cr

Shareholding (%)

Promoters	46.9
FII	25.2
DII	14.3
Others	13.57

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	0.9	8.0	24.3	12.4
Relative to Sensex	-2.8	-13.0	31.8	8.7

Sharekhan Research, Bloomberg

Lupin Ltd (Lupin) reported weak numbers for Q1FY2021. Sales for the quarter stood at Rs. 3,528 crore, down 9% y-o-y. The North America business declined by 21% y-o-y, while India business declined by 1.7% y-o-y. Operating profits declined by 34.6% y-o-y to Rs. 488 crore. Operating margins contracted steeply by 540 bps y-o-y to 13.8% owing to a contraction in gross margins and higher employee costs. Tracking operating performance, adjusted PAT fell by 59.6% y-o-y to Rs 106.9 crore, lagging estimates. Lupin's US revenues plunged by 21% y-o-y due to seasonality factor for few products, recall of Metformin and demand contraction due to stocking up in March 2020. The management expects US business to improve gradually, led by ramp-up of Levothyroxin, stabilisation in base business, re-launch of metformin and new launches. Further, Lupin is expecting a nod from the USFDA for generic version of Albuterol and is looking at a September 2020 launch. Lupin is also looking to file new products in Europe, by end of 2020 and has a strong pipeline for the region, which is likely to unfold gradually. Resolution of USFDA issues at its plants (Goa, Pithampur-Unit II and Somerset. Goa and Pithampur plants account for ~40% of total fillings) and would be a key monitorable from a growth perspective.

Key positives

- API business grew by 17.2% y-o-y as compared to a drop in formulations business

Key negatives

- US revenues declined steeply by 21% y-o-y, while India business dropped by 1.7% y-o-y.
- Operating margins declined by 540 bps y-o-y to 13.8% as gross margins shrunk and costs pressures rose.
- OPM guidance lowered to 17% for FY2021 from 19-20% earlier.

Our Call

Maintain Hold with a PT of Rs. 965: Lupin's US business is expected to gradually improve and gain traction, backed by a ramp-up in existing products, new launches, re-launch of metformin and stabilisation of the US base business. Also, Lupin is expecting an approval from USFDA for generic version of Albuterol and is looking at launch in September 2020. If approved would open up a sizeable opportunity. Moreover, resolution of the USFDA issues at its key plants is awaited. Successful closure of inspections and timely launch of generic Albuterol with a revival in US business would be key points to watch for. Lupin's India business is expected to sustain the healthy growth momentum. Q1FY21 numbers were weak. The management expects cost pressures to be elevated and consequently cut OPM guidance by ~ 200 bps to 17% for FY2021. Basis this we have revised our earnings estimates slightly downwards for FY2021, whilst we have fine-tuned our estimates for FY2022. Amidst the COVID-19 pandemic, pharmaceutical companies have emerged strong as they offer visibility for earnings growth and hence have been the flavour of the times. Consequently, multiples have been re-rated. We have moderately increased our target multiples. However, successful resolution of USFDA inspection is critical and will be a key monitorable. We retain Hold recommendation on the stock with a revised PT of Rs. 965.

Key Risks

- Delay in resolution of warning Letter/OAI status;
- Currency risks.

Valuation (Consolidated)

	Rs cr				
Particulars	FY2018	FY2019	FY2020	FY2021E	FY2022E
Net sales	15,804.1	14,664.6	15,374.8	16,143.4	17,834.4
Operating Profits	3,147.5	2,560.8	2,354.8	2,678.9	3,208.0
OPM (%)	19.9	17.5	15.3	16.6	18.0
Adjusted net profit	1,469.1	852.0	352.6	1,271.6	1,659.5
Adj. EPS (Rs)	32.5	18.8	7.8	28.1	36.6
PER (x)	27.1	46.7	112.9	31.3	24.0
EV/Ebitda (x)	14.8	18.9	19.2	13.3	10.4
P/BV (x)	2.9	2.9	3.2	2.9	2.6
RoCE (%)	9.8	9.3	9.0	10.1	11.9
RoNW (%)	10.8	6.2	2.8	9.2	10.7

Source: Company Data; Sharekhan estimates

Weaker-than-expected performance: Lupin reported weak numbers for Q1FY21. Sales stood at Rs 3528 crore, down 9% y-o-y. Formulations business declined by 11.6% y-o-y led by a steep 21% fall in the North America business. The India business declined by 1.7% y-o-y. API revenues grew 17.2% y-o-y. Operating profit declined steeply by 34.6% y-o-y to Rs. 488 crore. Gross margin declined by 240 bps y-o-y to 63.5%. Also the employee expenses were higher by 390 bps y-o-y. Investments in R&D stood at Rs. 357.5 crore ~10% of sales, which is slightly higher compared to Rs. 344 crore (8.9% of sales) in the corresponding quarter of the previous year. Therefore, operating profit margins dropped by 542 bps y-o-y to 13.8%. The tax rate for the quarter was higher at 60.3% versus 45% in corresponding quarter. Tracking operating performance, adjusted PAT fell 59.6% y-o-y to Rs 106.9 crore and was below estimates.

US business to pick up gradually; USFDA resolution for Goa, Pithampur is a key monitorable: Lupin's US business has reported a decline of 21% y-o-y for the quarter, attributable to a lower demand due to stocking in March, seasonality factor for products like Osetemavir, Azythromycin and metformin recall. Going ahead the management expects a gradual pick up in the business as looks to reach \$170-180 million over the next 2-3 quarters (Q1FY21- \$157 million). A significant ramp-up in the Levothyroxin brand leading to market share gains and expected traction in the recent launches would drive the revenues. Fairly stabilizing price erosion points at a healthy growth in the base business. Also with the winter approaching, the demand for anti-virals like Osetamivir and Azythromycin are likely to pick up. The management also seemed confident of approval for generic Albuterol, likely in August and aims at a launch in September 2020. The full benefit of this is likely to come in FY2022 as Lupin looks at gradual build-up for the product. However, two key manufacturing plants of Goa and Pithampur (unit-II) which have more than 40-50% of the total filling are under WL (warning Letter) status from the USFDA, while the Somerset plant has been classified as OAI. The Somerset plant is up for re-inspection and the company has submitted its responses to the USFDA. The remediation at the other two plants of Goa and Pithampur (Unit II) is likely to be over soon. Lupin expects these plants to be ready for re-inspection within one month. Resolution of the USFDA issues is critical. Successful closures of inspections and launch of generic Albuterol (if approved By USFDA) would be the triggers for earning upgrades.

Q1FY2021 Conference call highlights:

- ♦ **North America:** Revenues from North America stood At Rs. 1,216 crore, falling of 21% y-o-y. Sequentially as well the topline declined by 23%. Lupin has launched two new products in the US markets during Q1FY21. With this, the company has a total of 175 products in the US generic segment. Lupin filed for 4 ANDAs with the USFDA during Q1 and has received approval for 4.
- ♦ **India:** Revenue for the quarter stood at Rs 1,285 crore, a decline of 1.7% y-o-y while sequentially, revenues were up 7.8%.
- ♦ **Europe – Middle East – Africa (EMEA):** Overall revenues from the region declined by 4% y-o-y to Rs. 250 crore. South African sales in local currency term declined by 5% y-o-y for the quarter. Sales in Germany stood at 7.6 million euros, as against 7.8 million euros in the corresponding quarter last year. Sequentially, though, it declined by 18%.
- ♦ **LATAM and APAC (Growth Markets):** Revenues stood at Rs 269.9 crore, a decline of 5.8% y-o-y. Sales in Brazil stood at BRL 55 mn, up from BRL 47 million as of Q1FY2020. Sequentially, sales saw a sharper rise of 48%. Sales in Philippines in local currency term were down 13.9% y-o-y. Mexico sales in local currency terms declined by 26% y-o-y.
- ♦ **Remediation at Goa, Pithampur (unit-II) and Somerset:** The management has submitted its responses to the USFDA for the Somerset plant and is awaiting a reply from the regulator. The remediation process for the Goa and Pithampur (Unit-II) is going on and is expected to close in the next one month. Post this, both plants would be ready for re-inspection.
- ♦ **Operating profit margin guidance:** OPM for Q1FY21 contracted sharply by 542 bps y-o-y due to elevated cost pressures. The management sees some portion of the cost pressure to stay and consequently, expects the OPM's to be around 17% for FY2020. Earlier, the company had guided for OPM of 19-20%
- ♦ **Tax Rate guidance:** The management has guided for an effective tax rate of 35-40% going ahead. Post FY2021, Lupin expects the tax rate to normalise to around 33-35%.

Results (Consolidated)

Particulars	Q1FY2021	Q1FY2020	y-o-y %	Q4FY2020	Rs cr q-o-q %
Total sales	3527.9	3877.7	-9.0%	3845.7	-8.3%
Operating profit	488.1	746.8	-34.6%	525.3	-7.1%
Other income	43.3	66.6	-35.0%	208.6	-79.3%
EBIDTA	531.4	813.4	-34.7%	733.9	-27.6%
Interest	44.3	84.4	-47.6%	107.4	-58.8%
Depreciation	214.6	250.2	-14.2%	214.3	0.2%
PBT	272.5	478.9	-43.1%	412.3	-33.9%
Tax	164.3	215.5	-23.7%	105.1	56.4%
Net profit (reported)	106.9	264.7	-59.6%	306.5	-65.1%
			BPS		BPS
OPM (%)	13.8	19.3	-542	13.7	18

Source: Sharekhan Research

Results (Consolidated)

Particulars	Q1FY2021	Q1FY2020	y-o-y %	Q4FY2020	Rs cr QoQ %
Formulations	3059.6	3466.6	-11.7%	3462.4	-11.6%
North America	1216.0	1541.2	-21.1%	1579.1	-23.0%
India	1285.4	1307.7	-1.7%	1192.1	7.8%
EMEA	250.0	260.4	-4.0%	364.9	-31.5%
Growth Markets	269.9	286.4	-5.8%	280.0	-3.6%
ROW	38.3	70.9	-46.0%	46.3	-17.3%
API	409.0	348.0	17.5%	328.6	24.5%
Other operating income	59.2	63.1	-6.1%	54.7	8.2%
Total	3527.8	3877.7	-9.0%	3845.7	-8.3%

Source: Company, Sharekhan Research, Industry Reports

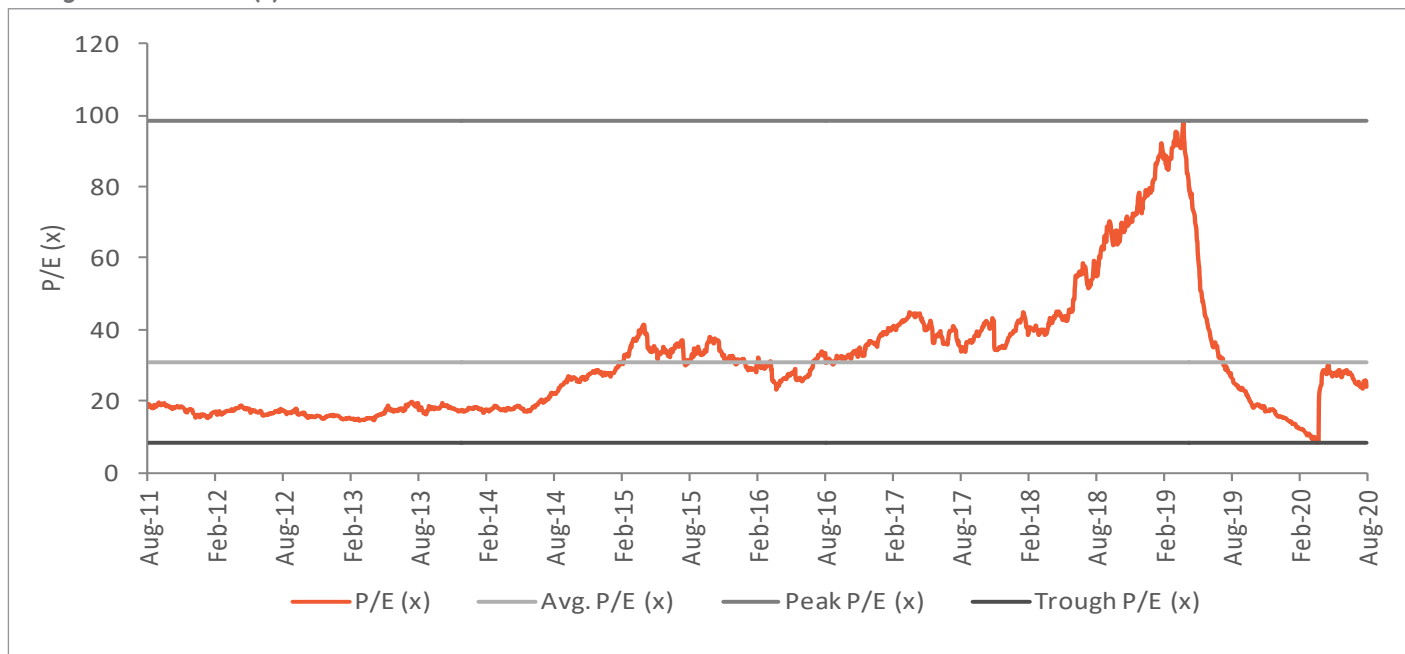
Outlook

Uncertainty persists – Lupin is one of the leading pharmaceutical companies and is present in most markets globally. After establishing itself as a major player in the generics space, the company is making efforts to improve its presence in the specialty business. The US is a key market for Lupin. After two consecutive years of subdued performance, the US business has clocked a mid-single-digit growth in FY2020. Though Q1FY21 was a tough quarter for the US business due to demand contraction, recall of Metformin and seasonality factor playing out for few products, Lupin sees a gradual improvement in the US business over the next couple of quarters. Ramp up of Levothyroxin, stabilisation in the base business and incremental growth from a slew of new launches would fuel the growth in US markets. Further, Lupin is expecting a nod from the USFDA for generic version of Albuterol soon and is aiming for a launch around September 2020. This coupled with resolution of USFDA issues at its plants (Goa, Pithampur – unit-II and Somerset) would be key watch out for and if successfully resolved would lead to earnings upgrades.

Valuation

Maintain Hold rating with a PT of Rs. 965: Lupin's US business is expected to gradually improve and gain traction over the next two quarters, backed by a ramp-up in existing products, new launches and stabilisation of the US base business. Also, Lupin is expecting an approval from USFDA for generic version of Albuterol and is looking at launch in September 2020. If approved would open up a sizeable opportunity. Moreover, resolution of the USFDA issues at its key plants is awaited. Successful closure of inspections and timely launch of generic Albuterol with a revival in US business would be key growth drivers. Lupin's India business is expected to sustain the healthy growth momentum. Q1FY21 numbers were weak. The management expects cost pressures to be elevated and consequently cut OPM guidance by ~ 200 bps to 17% for FY2021. Basis this we have revised our earnings estimates slightly downwards for FY2021, whilst have fine-tuned for FY2022. Amidst the COVID-19 pandemic, pharmaceutical companies have emerged strong as they offer visibility for earnings growth and hence have been in flavour. Consequently, multiples have been re-rated. We have moderately increased our target multiples. However, successful resolution of USFDA inspection is critical and will be a key monitorable. We retain Hold recommendation on the stock with a revised PT of Rs. 965.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E			EV / EBITDA			RoE (%)		
				FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Lupin	879	45.3	39,849	112.9	31.3	24.0	19.2	13.3	10.3	2.8	9.2	10.7
Torrent Pharma	2941	16.99	49,761	48.8	39.3	30.4	27.6	23.0	18.8	14.8	17.5	20.6

Source: Company, Sharekhan estimates

About company

Over the last decade, Lupin has established itself as a leading generic player from India. U.S. and India are its largest markets and contribute almost 60% of its revenue and has significant presence in Japan (unlike most other generic players). While in India it is among the top 10 companies and among the fastest growing, it is among the top five companies in terms of prescriptions in the U.S. Moreover, it has entered the Japanese market well before other generic players and is now among the top 10 generic companies in Japan.

Investment theme

The Warning Letter/USFDA regulatory hurdles is delaying new approvals and further intensifying pressure on the U.S. business, which is already facing tough competition in base business and lack of significant launches that could offset these. Not only is the growth slowing down, margin trajectory will also be difficult to maintain due to fall in these lucrative U.S. products and remediation expenses inching up leading to elongated recovery process.

Key Risks

- ♦ Early resolution of Warning Letter/OAI statuses remains an upside risk, whereas delay in the same poses downside risk
- ♦ Currency risk
- ♦ Concentration risk in the U.S. portfolio

Additional Data

Key management personnel

Mrs. Manju D Gupta	Chairman
Dr. Kamal K. Sharma	Vice Chairman
Ms. Vinita Gupta	Chief Executive Officer
Mr. Nilesh Deshbandhu Gupta	Managing Director
Mr. Sunil Makharia	President, Finance

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	HDFC Asset Management Co Ltd	2.55
2	Life Insurance Corporation	2.42
3	GOVERNMENT PENSION FUND - GLOBAL	1.86
4	Norges Bank	1.85
5	Franklin Resources Inc	1.66
6	Comgest SA	1.56
7	Jhunjhunwala Rakesh	1.53
8	BlackRock Inc	1.37
9	Vanguard Group Inc/The	1.34
10	Dimensional Fund Advisors LP	1.23

Source: Bloomberg

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