

Dismal US, expectations high from Albuterol

Though Lupin's pipeline in the medium term boasts of complex therapies like inhalation and biosimilars such as Brovana (FY22), Dulera, Spiriva, Pegfilgrastim launch in FY23E, and an injectable portfolio beyond FY23, trading at 25.4x FY22 EPS of Rs34.6, we believe Lupin's stock is fully valuing the US pipeline of near term launches and cost improvement driving higher margins (built in 355bps margin improvement over FY20-22E). Slower ramp up in Solosec, higher expectation from Albuterol (though pricing environment is stable, traction could be gradual, we built in \$65mn in FY21), risks to earnings remain high. Further, cost optimization benefits (we believe restructuring in the US was related to Solosec sales force reduction) will be key for the company to achieve EBITDA margin expectation of 20% over the next 2 years. Regulatory news-flow on Goa, Indore and Somerset (all ready for inspection) will act as key triggers. Though the management remains confident of its complex generic portfolio for the next few years, we believe the opportunities are back ended in nature. Maintain SELL.

Our Assumptions:

- Build in steady base business and 12/15 new launches in FY21/22E in the US. We expect Albuterol, Solosec and Levothyroxine to contribute US\$145mn/235mn in FY21/22E.
- We have factored in currency translation impact in Brazil, Mexico and South Africa (combined sales of Rs12bn, ~8% of sales). Enbrel sales of US\$25-30mn for Lupin (in partnership with Mylan) given that Mylan has struggled in the EU in biosimilar launches (with Biocon).
- Factored operational improvement of 355bps over FY20-22E on Solosec field force rationalization, ramp up in Levo, lower remediation costs, indicating a US\$50mn reduction in cost base while it continues to spend ~Rs15bn in R&D, higher input and freight costs.

Q1FY21 Result (Rs Mn)

| Particulars | Q1FY21 | Q1FY20 | YoY (%) | Q4FY20 | QoQ (%) |
|-------------------|--------|--------|---------|--------|---------|
| Revenue | 35,279 | 44,184 | (20.2) | 38,457 | (8.3) |
| Total Expense | 30,398 | 35,582 | (14.6) | 33,204 | (8.5) |
| EBITDA | 4,881 | 8,602 | (43.3) | 5,253 | (7.1) |
| Depreciation | 2,146 | 3,171 | (32.3) | 2,143 | 0.2 |
| EBIT | 2,734 | 5,431 | (49.7) | 3,111 | (12.1) |
| Other Income | 433 | 722 | (40.1) | 2,086 | (79.3) |
| Interest | 443 | 856 | (48.3) | 1,074 | (58.8) |
| EBT | 2,725 | 5,297 | (48.6) | 4,027 | (32.3) |
| Tax | 1,624 | 2,280 | (28.8) | 943 | 72.3 |
| RPAT | 1,088 | 3,027 | (64.1) | 3,896 | (72.1) |
| APAT | 1,088 | 3,027 | (64.1) | 2,981 | (63.5) |
| | | | (bps) | | (bps) |
| Gross Margin (%) | 63.5 | 64.9 | (143) | 63.5 | 3 |
| EBITDA Margin (%) | 13.8 | 19.5 | (563) | 13.7 | 18 |
| NPM (%) | 3.1 | 6.9 | (377) | 10.1 | (705) |
| Tax Rate (%) | 59.6 | 43.0 | 1658 | 23.4 | 3621 |
| EBIT Margin (%) | 7.8 | 12.3 | (454) | 8.1 | (34) |

| | |
|-------------------|--------------|
| CMP | Rs 880 |
| Target / Downside | Rs 753 / 14% |
| BSE Sensex | 38,047 |
| NSE Nifty | 11,214 |

Script Details

| | |
|------------------|-----------------|
| Equity / FV | Rs 906mn / Rs 2 |
| Market Cap | Rs 399bn |
| | US\$ 5bn |
| 52-week High/Low | Rs 956/Rs 505 |
| Avg. Volume (no) | 3,064,910 |
| NSE Symbol | LUPIN |
| Bloomberg Code | LPC IN |

Shareholding Pattern Jun'20(%)

| | |
|-----------------|------|
| Promoters | 46.9 |
| MF/Banks/FIs | 16.3 |
| FII | 22.7 |
| Public / Others | 14.1 |

Valuation (x)

| | FY20A | FY21E | FY22E |
|-----------|-------|-------|-------|
| P/E | 113.2 | 32.8 | 25.4 |
| EV/EBITDA | 16.7 | 13.8 | 11.0 |
| ROE (%) | (3.0) | 9.4 | 11.3 |
| RoACE (%) | 3.3 | 7.4 | 8.8 |

Estimates (Rs mn)

| | FY20A | FY21E | FY22E |
|-----------|---------|---------|---------|
| Revenue | 153,748 | 160,366 | 177,070 |
| EBITDA | 23,548 | 27,673 | 33,420 |
| PAT | 3,522 | 12,158 | 15,672 |
| EPS (Rs.) | 7.8 | 26.8 | 34.6 |

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Lupin's Q1 was below estimates dragged by US (lower offtake in Cephalosporin, gTamiflu, Azithromycin, pre-emptive buying in Q4 and NDMA led Metformin recall as highlighted in our previous update) impacting overall performance. Lower spend on India (travelling, marketing and promotions) led to margin improvement but was negated by restructuring led pay-out in the US and higher freight charges. Further high tax rate (60%-subsidiary led) impacted profitability at Rs1bn.

Exhibit 1: Revenue mix

| (Rs mn) | Q1FY21 | Q1FY20 | YoY (%) | Q4FY20 | QoQ (%) | FY20 | FY19 | YoY (%) |
|-----------------------------------|---------------|---------------|---------------|---------------|---------------|----------------|----------------|---------------|
| India Formulations | 12,854 | 13,077 | (1.7) | 11,921 | 7.8 | 51,385 | 46,382 | 10.8 |
| International Formulations | 17,742 | 21,589 | (17.8) | 22,703 | (21.9) | 87,044 | 103,848 | (16.2) |
| USA | 12,160 | 15,412 | (21.1) | 15,791 | (23.0) | 58,212 | 55,924 | 4.1 |
| Growth markets | 2,699 | 2,864 | (5.8) | 2,800 | (3.6) | 15,027 | 31,772 | (52.7) |
| EMEA | 2,500 | 2,604 | (4.0) | 3,649 | (31.5) | 12,364 | 14,049 | (12.0) |
| NCE Lisencing | 0 | 0 | - | 0 | - | 1,441 | 2,103 | (31.5) |
| APIs | 4,090 | 3,489 | 17.2 | 3,286 | 24.5 | 12,999 | 13,464 | (3.5) |
| Revenues | 34,686 | 38,155 | (9) | 37,910 | (9) | 151,428 | 163,694 | (7) |

Source: Company, DART

Concall takeaways

- Management guided for a better 9MFY21 led by:
 - Market share expansion for Levothyroxine to higher teens from 12% currently, relaunch of Glumetza by end of Q2, Albuterol launch in Sep'20 (expect approval in Aug) in the US. It expects to achieve normal quarterly run-rate of US\$180-190mn by Q3FY21.
 - Double digit growth in the API, India
 - Fostair (first EU inhaler) and Enbrel (first EU biosimilar through Mylan) launches
 - EBITDA margins guided at 17% led by operating efficiencies and improved product mix
 - Tax rate to remain high at 35-40% for FY21 vs earlier guidance of 35%.
- **US:** US reported sales of US\$157mn (vs US\$212mn QoQ and our estimates of US\$204mn) lower offtake in Cephalosporin, gTamiflu, Azithromycin, pre-emptive buying in Q4 and NDMA led Metformin recall. Apriso launch is reflected to some extent in Q1, should do better in Q2.
 - a. **Solosec:** Solosec demand improving gradually. Expect Rx growth to rise subsequently. Company has restructured its operating model in and rationalized its field force substantially (earlier 125 people), we believe the one-time restructuring pay-out in the US is related to Solosec. Though Express Script approval is expected to improve pricing (co-pay benefit), management will focus on digital marketing going forward for Solosec.
 - b. **Levothyroxine:** Maintained market share of 12%. Increased capacity shall aid in gaining up further market share.
 - c. **Albuterol:** Company expects approval in Aug'20 and has guided for a launch in Sep'20. 60% of the market is now captured by generics and AG put together. Company is well prepared for the launch upon approval

and believes that it will be limited competition product (6-7 players) with stable pricing. Lupin guided to take cost advantage and plans to launch the product at 20-30% discount to the peers.

- d. **Complex injectables/Depot:** started working on clinical trials and expect filings for depot injectables from FY22E onwards. Recent partnership agreement with ForDoz is for 2 molecules in injectable portfolio. Impact likely to be seen beyond FY23E.
- **Europe:** Expecting Etanercept launch in Q2. To launch in Germany via partner Mylan in Aug'20. Expect to get a double digit market share.
- **R&D:** Guided at Rs15bn, ~9% of sales for FY21E. Focus on more complex and specialty products such as inhalation, injectables and biosimilars, but spend will be capped at <10% of sales for the next 2-3 years.

Profit and Loss Account

| (Rs Mn) | FY19A | FY20A | FY21E | FY22E |
|--|----------------|----------------|----------------|----------------|
| Revenue | 146,646 | 153,748 | 160,366 | 177,070 |
| Total Expense | 121,038 | 130,200 | 132,693 | 143,650 |
| COGS | 49,461 | 54,306 | 57,457 | 61,131 |
| Employees Cost | 27,702 | 29,868 | 30,847 | 33,278 |
| Other expenses | 43,876 | 46,025 | 44,390 | 49,241 |
| EBIDTA | 25,607 | 23,548 | 27,673 | 33,420 |
| Depreciation | 8,461 | 9,702 | 11,103 | 12,856 |
| EBIT | 17,147 | 13,846 | 16,570 | 20,565 |
| Interest | 3,025 | 3,630 | 1,972 | 1,143 |
| Other Income | 3,330 | 4,838 | 3,757 | 3,555 |
| Exc. / E.O. items | (3,400) | (7,521) | 0 | 0 |
| EBT | 14,052 | 7,533 | 18,355 | 22,977 |
| Tax | 8,879 | 11,571 | 6,241 | 7,353 |
| RPAT | 5,210 | (3,999) | 12,158 | 15,672 |
| Minority Interest | (38) | (39) | (43) | (48) |
| Profit/Loss share of associates | 0 | 0 | 0 | 0 |
| APAT | 8,610 | 3,522 | 12,158 | 15,672 |

Balance Sheet

| (Rs Mn) | FY19A | FY20A | FY21E | FY22E |
|-------------------------------|----------------|----------------|----------------|----------------|
| Sources of Funds | | | | |
| Equity Capital | 905 | 906 | 906 | 906 |
| Minority Interest | 469 | 445 | 445 | 445 |
| Reserves & Surplus | 136,517 | 124,461 | 132,220 | 142,947 |
| Net Worth | 137,422 | 125,367 | 133,126 | 143,853 |
| Total Debt | 82,219 | 42,860 | 32,860 | 22,860 |
| Net Deferred Tax Liability | 21,161 | 22,919 | 23,012 | 23,114 |
| Total Capital Employed | 241,272 | 191,591 | 189,443 | 190,272 |

Applications of Funds

| | | | | |
|---|------------------|----------------|----------------|----------------|
| Net Block | 87,064 | 60,866 | 56,763 | 49,908 |
| CWIP | 40,200 | 27,911 | 28,911 | 29,911 |
| Investments | 12,879 | 6,453 | 7,098 | 7,138 |
| Current Assets, Loans & Advances | 139,350 | 154,608 | 152,710 | 156,120 |
| Inventories | 38,368 | 34,569 | 32,948 | 32,824 |
| Receivables | 51,498 | 54,459 | 52,008 | 52,784 |
| Cash and Bank Balances | 9,872 | 24,543 | 26,992 | 29,331 |
| Loans and Advances | 1,063 | 846 | 911 | 1,004 |
| Other Current Assets | 17,451 | 16,809 | 16,469 | 16,795 |
| Less: Current Liabilities & Provisions | 38,222 | 58,247 | 56,040 | 52,805 |
| Payables | 24,982 | 24,123 | 23,220 | 22,491 |
| Other Current Liabilities | 13,240 | 34,124 | 32,820 | 30,314 |
| | <i>sub total</i> | | | |
| Net Current Assets | 101,128 | 96,361 | 96,670 | 103,315 |
| Total Assets | 241,272 | 191,591 | 189,443 | 190,272 |

E – Estimates

Important Ratios

| Particulars | FY19A | FY20A | FY21E | FY22E |
|---|--------------|--------------|--------------|--------------|
| (A) Margins (%) | | | | |
| Gross Profit Margin | 66.3 | 64.7 | 64.2 | 65.5 |
| EBIDTA Margin | 17.5 | 15.3 | 17.3 | 18.9 |
| EBIT Margin | 11.7 | 9.0 | 10.3 | 11.6 |
| Tax rate | 63.2 | 153.6 | 34.0 | 32.0 |
| Net Profit Margin | 3.6 | (2.6) | 7.6 | 8.9 |
| (B) As Percentage of Net Sales (%) | | | | |
| COGS | 33.7 | 35.3 | 35.8 | 34.5 |
| Employee | 18.9 | 19.4 | 19.2 | 18.8 |
| Other | 29.9 | 29.9 | 27.7 | 27.8 |
| (C) Measure of Financial Status | | | | |
| Gross Debt / Equity | 0.6 | 0.3 | 0.2 | 0.2 |
| Interest Coverage | 5.7 | 3.8 | 8.4 | 18.0 |
| Inventory days | 95 | 82 | 75 | 68 |
| Debtors days | 128 | 129 | 118 | 109 |
| Average Cost of Debt | 4.0 | 5.8 | 5.2 | 4.1 |
| Payable days | 62 | 57 | 53 | 46 |
| Working Capital days | 252 | 229 | 220 | 213 |
| FA T/O | 1.7 | 2.5 | 2.8 | 3.5 |
| (D) Measures of Investment | | | | |
| AEPS (Rs) | 19.0 | 7.8 | 26.8 | 34.6 |
| CEPS (Rs) | 37.7 | 29.2 | 51.3 | 63.0 |
| DPS (Rs) | 6.0 | 6.0 | 7.2 | 8.4 |
| Dividend Payout (%) | 31.7 | 77.5 | 26.9 | 24.4 |
| BVPS (Rs) | 303.4 | 276.7 | 293.9 | 317.6 |
| RoANW (%) | 3.8 | (3.0) | 9.4 | 11.3 |
| RoACE (%) | 5.0 | 3.3 | 7.4 | 8.8 |
| RoAIC (%) | 7.8 | 6.9 | 10.1 | 12.7 |
| (E) Valuation Ratios | | | | |
| CMP (Rs) | 880 | 880 | 880 | 880 |
| P/E | 46.3 | 113.2 | 32.8 | 25.4 |
| Mcap (Rs Mn) | 398,572 | 398,572 | 398,572 | 398,572 |
| MCap/ Sales | 2.7 | 2.6 | 2.5 | 2.3 |
| EV | 449,821 | 393,507 | 381,058 | 368,719 |
| EV/Sales | 3.1 | 2.6 | 2.4 | 2.1 |
| EV/EBITDA | 17.6 | 16.7 | 13.8 | 11.0 |
| P/BV | 2.9 | 3.2 | 3.0 | 2.8 |
| Dividend Yield (%) | 0.7 | 0.7 | 0.8 | 1.0 |
| (F) Growth Rate (%) | | | | |
| Revenue | (7.2) | 4.8 | 4.3 | 10.4 |
| EBITDA | (18.6) | (8.0) | 17.5 | 20.8 |
| EBIT | (16.8) | (19.3) | 19.7 | 24.1 |
| PBT | 158.6 | (46.4) | 143.7 | 25.2 |
| APAT | (38.2) | (59.1) | 245.2 | 28.9 |
| EPS | (38.2) | (59.1) | 245.2 | 28.9 |
| Cash Flow | | | | |
| (Rs Mn) | FY19A | FY20A | FY21E | FY22E |
| CFO | 10,593 | 7,926 | 44,829 | 21,863 |
| CFI | (24,576) | 32,476 | (4,888) | (3,484) |
| CFF | 9,775 | (25,731) | (37,492) | (16,040) |
| FCFF | (13,984) | 40,402 | 39,941 | 18,379 |
| Opening Cash | 14,080 | 9,872 | 24,543 | 26,992 |
| Closing Cash | 9,872 | 24,543 | 26,992 | 29,331 |

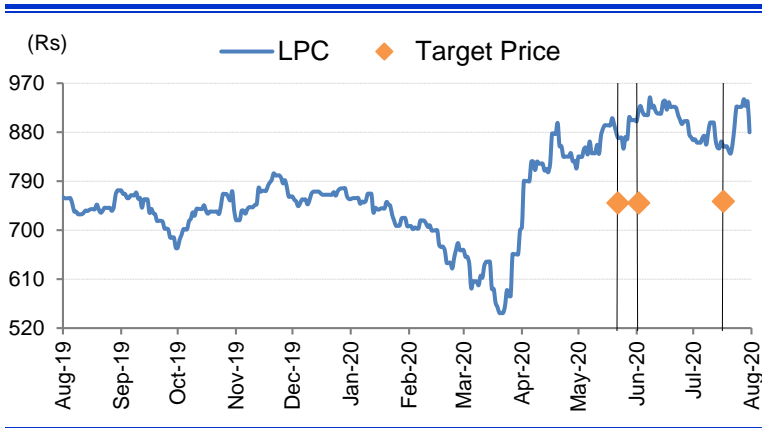
E – Estimates

DART RATING MATRIX

Total Return Expectation (12 Months)

| | |
|-------------------|------------------|
| Buy | > 20% |
| Accumulate | 10 to 20% |
| Reduce | 0 to 10% |
| Sell | < 0% |

Rating and Target Price History



| Month | Rating | TP (Rs.) | Price (Rs.) |
|--------|--------|----------|-------------|
| May-20 | Sell | 750 | 870 |
| Jun-20 | Sell | 750 | 919 |
| Jul-20 | Sell | 753 | 854 |

*Price as on recommendation date

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