Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Lupin Limited

Healthy quarter; strong outlook

Pharmaceuticals	Sharekhan code: LUPIN	Result Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 1,008**	
Price Target: **Rs. 1,350**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 45,703 cr
52-week high/low:	Rs. 1122 / 505
NSE volume: (No of shares)	37.4 lakh
BSE code:	500257
NSE code:	LUPIN
Free float: (No of shares)	24.0 cr

Shareholding (%)

Promoters	46.9
FII	20.8
DII	19.9
Others	12.46

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	3.1	9.1	17.3	35.3
Relative to Sensex	5.9	-7.4	-4.3	23.0

Sharekhan Research, Bloomberg

Summary

- We retain Buy recommendation on Lupin Limited (Lupin) with an unchanged PT of RS 1350.
- Q3FY2021 was a healthy quarter for the company and adjusting for one offs the earnings are ahead of estimates.
- US business is on a strong footing to grow, backed by better-than-expected ramp up of its respiratory product, gAlbuterol and new launches, while India business is expected to improve backed by strong growth in chronics while improving patient footfalls point at pick up in the acute therapy.
- Focus on cost-control measures and rationalization coupled with benefits of operating leverage and high share of new launches to drive OPM expansion.

Lupin Limited (Lupin) reported a healthy performance for Q3FY2021. Earnings at Rs. 438 crore are ahead of our and street's estimates. Sales for the quarter stood at Rs. 4017 crore was up by 6.6% y-o-y. The formulations business recorded 5% y-o-y growth, led by 4.8% and 5.4% growth in the US and India formulations business, respectively. Other operating income almost doubled to Rs. 100 crore due to one-timer income. Operating profit margin (OPM) for the quarter at 19.4% surprised positively, expanding by 800 bps y-o-y because of a 180 bps expansion in gross margin and cost savings. Tax rate for Q3FY2021 was lower at Rs. 84 crore (16% PBT) as compared to Rs. 767 crore in Q3FY2020. Consequently, adjusted PAT for the quarter stood at Rs. 438.3 crore as against loss of Rs. 579 crore in Q3FY2020. Going ahead, Lupin is seeing improved traction across its US and India businesses. In the US business, multiple factors are expected to drive sales, such as ramp-up of ProAir, new launches offering high-market opportunities, and a relatively stable pricing scenario. India business is also on a strong footing to grow. The expected pick-up in acute therapy and sustained growth in chronics would fuel India business. In addition to the above, the company is looking to tap new markets with more respiratory assets such as Frostair and Dulera, the approval for which is expected over the next 1-2 fiscal. All new products are from plants that are out of USFDA scrutiny, which provides ample growth visibility ahead. On the biosimilars front, the partner company has launched biosimilar Enbrel in three European countries and is looking to expand the geographic reach for its products. Moreover, Lupin's focus on cost-control measures and rationalisation measures coupled with benefits of operating leverage and high share of new launches would help expand EBITDA margin. Therefore, healthy topline growth and margin expansion could result in strong PAT CAGR of 46% over FY2021 to FY2023.

Key positives

- India formulations sales reported 5% y-o-y growth after three consecutive quarters of decline. Growth is driven by strong performance of the chronic portfolio.
- Management expects the acute segment's performance to improve, led by increasing patient footfalls in India business
- Gross margin expanded by 180 bps y-o-y due to favourable mix, ramp up in gAlbuterol, and lower freight cost.

Key negatives

- Growth market's revenue declined by 6% y-o-y, which is the third consecutive quarter of a drop.
- Delay in resolution of USFDA issues at its plants at Goa, Pithampur (II), and Somerset.

Our Call

Retain Buy with an unchanged PT of Rs. 1,350: Lupin reported healthy results for Q3FY2021 and its US business is on a strong footing to grow, backed by better-than-expected ramp up of its respiratory product, gAlbuterol, with the company gaining a 9% market share of the Albuterol market. Other substantial launches in the US would drive the region's growth. Lupin's domestic formulations business is also expected to record healthy growth going ahead with the expected revival in IPM (Indian Pharmaceutical market) and supported by a chronic heavy portfolio and likely pick up in acute therapies. Given Lupin's focus on cost-control measures and rationalization, improving gross margin, and benefits of operating leverage, EBITDA margin is expected to expand and management expects it to be at 20%-22% going ahead. Lupin's three plants – Goa, Pithampur, and Somerset (US) are under USFDA scrutiny and resolution shas been delayed. A successful resolution of the same is awaited and could result in further earnings upgrades upon successful resolution. At the CMP, the stock is trading at P/E multiple of 24.8x/19.8x its FY2022E/FY2023E EPS. Moreover, over the past one year, Lupin has underperformed the benchmark BSE healthcare index; however, based on multiple growth triggers across its business, we see Lupin outperforming the healthcare index going ahead. We retain Buy on Lupin with an unchanged PT of Rs. 1,350.

Key Risks

1) Adverse development on the regulatory front can impact earnings prospects; 2) Currency risks.

Valuation (Consolidated) Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Net sales	14,664.6	15,374.8	15,793.7	18,146.5	19,238.7
Operating Profits	2,560.8	2,354.8	2,558.5	3,496.8	4,187.4
OPM (%)	17.5	15.3	16.2	19.3	21.8
Adjusted net profit	852.0	352.6	1,083.1	1,843.0	2,306.4
Adj. EPS (Rs)	18.8	7.8	23.9	40.7	50.9
PER (x)	53.5	129.5	42.2	24.8	19.8
EV/Ebidta (x)	21.2	21.7	16.5	11.3	9.0
P/BV (x)	3.3	3.6	3.4	3.0	2.6
RoCE (%)	9.3	9.0	8.8	12.3	13.9
RoNW (%)	6.2	2.8	8.0	11.9	13.0

Source: Company; Sharekhan estimates

Healthy performance for Q3FY2021: Lupin reported a healthy performance for Q3FY2021. Earnings at Rs. 438 crore are ahead of our and streets estimates. Sales for the quarter stood at Rs. 4,017 crore, up by 6.6% y-o-y and in line with our estimates. The formulations business recorded 5% y-o-y growth, led by 4.8% and 5.4% growth in the US and India formulations business, respectively. The other markets of EMEA and ROW grew by 16% y-o-y, while sales from growth markets were down by 6% y-o-y. Other operating income for the quarter stood at Rs. 100 crore as compared to Rs. 53.2 crore in Q3FY2020. OPM for the quarter at 19.4% surprised positively, expanding by 800 bps y-o-y because of 180 bps expansion in gross margin coupled with savings in employee cost and other expenses. OPM was above the estimates of 15.8%. Operating profit for the quarter at Rs. 778.7 crore was up 82% y-o-y and was ahead of the estimated Rs. 624 crore. Tax rate for Q3FY2021 was lower at Rs. 84 crore (16% PBT) as compared to Rs. 767 crore in Q3FY2020. Consequently, adjusted PAT for the quarter stood at Rs. 438.3 crore as against loss of Rs. 579 crore in Q3FY2020.

Ramp-up in Albuterol volumes, opportunities from recent launches to aid US business' revival: US sales for the quarter stood at Rs. 1,442 crore, up 5% y-o-y. Going ahead, Lupin's US revenue is expected to stage a strong comeback. Lupin's version of gAlbuterol – ProAir inhaler – is in a ramp-up phase and the company has been able to impressively ramp up sales ahead of expectations and has successfully gained around 9% market share of the Albuterol market. With the absence of one of the key competitors, which is likely to stay, the company is eyeing a 20% market share for the product going ahead, thus pointing at a substantial ramp up. This coupled with a relatively stable pricing scenario augurs well for the growth of ProAir. Furthermore, Lupin has recently launched/re-launched few new products, which offer substantial growth opportunities. These products include Metformin Hydrochloride tablets, which offer a significant market size of $357 million. Lupin has also launched Sevelamer Carbonate Tablets for treating chronic kidney diseases and Tacrolimus capsules indicated for organ transplants. Both the medicines offer a sizeable market potential of $348 million and $303 million, respectively. In addition to this, the company has lined up a few other approvals/launches over FY2022 and FY2023, which include FrostAir and Spiriva, which are from plants outside USFDA's scrutiny and, hence, provide ample growth visibility. Cumulatively, we expect Lupin's US business to register a 13% CAGR over FY2021 to FY2023.

Q3FY2021 Conference Call Highlights:

- **North America:** Revenue from North America stood at Rs. 1,442 crore, up 4.8% y-o-y. The company filed one ANDA during the quarter and received five ANDA approvals from the USFDA. During the quarter, the company launched three new products in the US markets during Q3FY2021 and now has 169 products overall in the US.
- **India:** Revenue for the quarter stood at Rs. 1,366.9 crore, 5.4% y-o-y growth, which is largely in line with IPM growth. Going ahead, with the expected pick up in the acute segment, the company expects growth in the Indian markets to also pick up.
- **Europe – Middle East – Africa (EMEA):** Overall revenue from the region grew by 15.8% y-o-y to Rs. 432.8 crore. South African sales in local currency terms stood at Zar 323 as compared to Zar 289 in Q3FY2020. Sales in Germany stood at Euro 8.1 million, as against Euro 9.5 million in the corresponding quarter last year.
- **LATAM and APAC (Growth Markets):** Revenue stood at Rs. 331 crore, a decline of 6% y-o-y. Sales in Brazil stood at BRL 66 million, up from BRL 48 million as of Q3FY2020. Sales in Mexico in local currency terms were up 1.6% y-o-y.
- **Remediation at Goa, Pithampur (unit-II), and Somerset:** Management has submitted its responses to the USFDA and is awaiting an inspection for Goa and Pithampur (Unit-II). However, due to travel restrictions in place, the USFDA has been delaying physical audits and the company expects inspections to happen over the next two quarters. The Somerset plant, which has undergone inspection, has been given 14 observations, which the company is in the process of resolving.

- **Cost-control measures:** Lupin's EBITDA margin has expanded sharply in Q3FY2021. Going ahead, the company looks to further expand margins through cost-control and rationalisation measures. Consequently, management is eyeing margins to be 20%-22% points over the next few years.
- **Tax rate guidance:** Management has guided for an effective tax rate of sub 30% beyond FY2021 and has guided for mid-30s levels for FY2021. Reduction in tax rate is on account of improving performance of subsidiary companies, which is expected to or has turned profitable.

Results Rs cr

Particulars	Q3FY21	Q3FY20	y-o-y (%)	Q2FY21	q-o-q (%)
Total sales	4017.4	3769.3	6.6%	3835.0	4.8%
Expenditure	3238.6	3340.2	-3.0%	3253.8	-0.5%
Operating profit	778.7	429.1	81.5%	581.2	34.0%
Other income	21.2	93.6	-77.4%	25.0	-15.2%
EBIDTA	799.9	522.7	53.0%	606.1	32.0%
Interest	30.9	88.6	-65.1%	33.6	-8.0%
Depreciation	244.3	253.2	-3.5%	212.7	14.8%
PBT	524.7	180.9	190.1%	359.8	45.8%
Tax	83.5	767.0	-89.1%	146.7	-43.1%
Net profit	438.3	-579.8	-175.6%	211.0	107.7%
			BPS		**BPS**
OPM (%)	19.4	11.4	800	15.2	423

Source: Company; Sharekhan Research

Outlook and Valuation

Sector view - Growth momentum to improve

Indian pharmaceutical companies are better placed to harness opportunities and report healthy growth going ahead. Indian companies are among the most competitive ones globally and hold a sizeable market share in most developed as well as other markets. Moreover, other factors such as easing of pricing pressures (especially in the US generics market), rise in product approvals, and plant resolutions by the USFDA coupled with strong growth prospects in domestic markets and emerging opportunities in the API space would be key growth drivers. This would be complemented by strong capabilities developed by Indian companies (leading to a shift towards complex molecules and biosimilars) and commissioning of expanded capacities by select players over the medium term. Collectively, this indicates a strong growth potential going ahead for pharma companies.

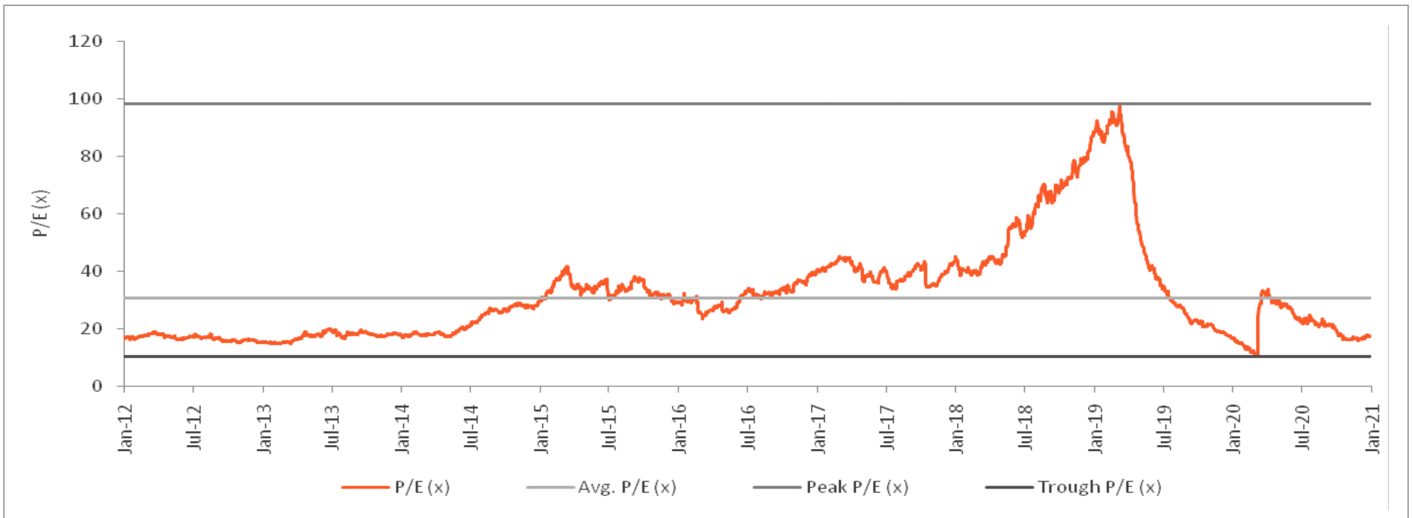
Company outlook - Gaining traction

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 reported mid-single digit growth in FY2020. The momentum continued for the quarter ending September 2020 as well, with mid-single digit growth largely driven by the launch of Albuterol and market share gains. Going ahead, Lupin sees recovery in the US business, led by ramp up of Levothyroxin and Albuterol, growth in the base business, and incremental growth from a slew of new launches/re-launches. With initial signs of revival apparent in IPM coupled with the chronic heavy presence on Lupin (in the domestic business), the India formulations segment is expected to gain traction and is expected to grow at a higher pace in H2FY2021. Lupin is also focusing on cost-control efforts and rationalisation of cost, which would result in operating margin expansion. Resolution of USFDA issues at its plants (Goa, Pithampur – Unit-II, and Somerset) would be key development to watch out for and, if successfully resolved, would lead to earnings upgrades.

Valuation - Retain Buy with an unchanged PT of Rs. 1,350

Lupin reported healthy results for Q3FY2021 and its US business is on a strong footing to grow, backed by better-than-expected ramp up of its respiratory product, gAlbuterol, with the company gaining a 9% market share of the Albuterol market. Other substantial launches in the US would drive the region's growth. Lupin's domestic formulations business is also expected to record healthy growth going ahead with the expected revival in IPM (Indian Pharmaceutical market) and supported by a chronic heavy portfolio and likely pick up in acute therapies. Given Lupin's focus on cost-control measures and rationalization, improving gross margin, and benefits of operating leverage, EBITDA margin is expected to expand and management expects it to be at 20%-22% going ahead. Lupin's three plants – Goa, Pithampur, and Somerset (US) are under USFDA scrutiny and resolution shas been delayed. A successful resolution of the same is awaited and could result in further earnings upgrades upon successful resolution. At the CMP, the stock is trading at P/E multiple of 24.8x/19.8x its FY2022E/FY2023E EPS. Moreover, over the past one year, Lupin has underperformed the benchmark BSE healthcare index; however, based on multiple growth triggers across its business, we see Lupin outperforming the healthcare index going ahead. We retain Buy on Lupin with an unchanged PT of Rs. 1,350.

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 (x)			EV/EBITDA (x)			RoE (%)		
				FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Lupin	1008	45.3	49,063	129.5	42.2	24.8	21.7	16.5	11.3	2.8	8.0	11.9
Aurobindo	998	58.6	58476	18.2	16.9	14.7	11.4	10.2	8.4	19.0	17.2	16.8

Source: Company, Sharekhan Research

About company

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

Investment theme

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 reported mid-single digit growth in FY2020. The momentum is expected to continue going ahead as well, backed by ramp up in existing products and new product launches. With the initial signs of revival apparent in the IPM coupled with the chronic heavy presence for Lupin (in the domestic business), the India formulations segment is expected to gain traction. Lupin is also focusing on cost-control efforts and cost rationalisation, which would result in operating margin expansion. Resolution of USFDA issues at its plants (Goa, Pithampur – Unit-II, and Somerset) would be key developments to watch out for and, if successfully resolved, would lead to earnings upgrades.

Key Risks

- Delay in the resolution of USFDA issues at its plants
- Slower-than-expected ramp-up in gAlbuterol
- Currency risk
- Concentration risk in the US 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. Ramesh Swaminathan	Executive Director and Global CFO

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	HDFC Asset Management Co	4.15
2	Life Insurance Corporation of India	3.71
3	Norges Bank	1.85
4	Vanguard Group Inc/The	1.78
5	Franklin Resources Inc	1.58
6	BlackRock Inc	1.49
7	SBI Funds Management	1.47
8	Nippon India Asset Management	1.32
9	Comgest SA	1.21
10	ICICI Prudential Life Insurance Co Ltd	1.1

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;