



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	✓	↔	✓

ESG Disclosure Score

NEW

ESG RISK RATING

Updated Feb 08, 2022

41.13

Severe Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 28,847 cr
52-week high/low:	Rs. 1268 / 620
NSE volume: (No of shares)	15.3 lakh
BSE code:	500257
NSE code:	LUPIN
Free float: (No of shares)	24.1 cr

Shareholding (%)

Promoters	46.8
FII	20.8
DII	19.9
Others	12.56

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-17.4	-17.4	-29.4	-47.4
Relative to Sensex	-10.9	-8.9	-19.7	-53.2

Sharekhan Research, Bloomberg

Lupin Ltd

Weak quarter; Near-term hiccups, long-term growth levers intact

Pharmaceuticals

Sharekhan code: LUPIN

Reco/View: Buy



CMP: Rs. 635

Price Target: Rs. 780



Upgrade



Maintain



Downgrade

Summary

- We retain our Buy recommendation on Lupin Limited (Lupin) with a revised PT of 780.
- Q4FY2022 was a weak quarter for Lupin with OPM surprising negatively, marred by escalated raw-material prices, leading to net loss.
- Lupin sees healthy growth traction for India business, while near-term headwinds are expected to overweigh on US performance, which could play the dampeners.
- Despite near-term headwinds such as rising raw-material cost pressures, lack of new launches in the US, and heightened price erosion in the US, long-term growth levers for Lupin are intact.

Lupin Limited (Lupin) reported weak performance for Q4FY2022 with operating profit margin (OPM) surprising negatively marred by escalated costs pressures. This coupled with overall cost escalations resulted in OPM declining by 1181 bps y-o-y. Consequently, the company reported net loss for Q4FY2022. Results missed estimates. Lupin is witnessing near-term headwinds in its US business, including certain cost headwinds, which could drag performance for the subsequent quarters, while India business is expected to sustain a healthy growth trajectory. Lupin has initiated certain cost-control measures and has lined up high-value launches, which could play out in 2HFY2023, with FY2024 expected to be a year of strong growth reflecting the impact of launches. Thus, long-term growth levers are in place, while near-term headwinds are apparent.

Key positives

- India formulations sales reported 5% y-o-y growth, driven by healthy overall performance.
- Growth markets and Europe, Middle East, and Africa (EMEA) markets reported 25.6% and 8.6% y-o-y growth respectively.

Key negatives

- US sales declined by 5% y-o-y for Q4FY2022, impacted largely by double-digit price erosion.
- Management expects pricing pressures in the US to sustain over the few subsequent quarters ahead.

Management Commentary

- US business growth is expected to moderate, marred by high price erosion and lack of new launches due to delayed plant inspection. A meaningful recovery is expected to commence from 2HFY2023, backed by high-value product launches lined up in FY2024.
- Lupin's India business is expected to grow by sub-10% for FY2023, backed by steady performance in chronics as well acute therapies.
- Lupin's Goa plant has been recently cleared by USFDA, but other plants – Pithampur Unit II and Mandideep plants – are awaiting clearance. Lupin is planning to launch 11 products from its Goa plant in US markets.

Revision in estimates – Lupin reported a weak Q4FY2022 performance, with OPM surprising negatively, marred by escalated raw-material prices. Consequently, the company reported net loss. Based on this and the apparent near-term headwinds, we have cut our estimates for FY2023E/FY2024E.

Our Call

Retain Buy with a revised PT of Rs. 780: Near-term headwinds in the form of increasing raw-material cost pressures, lack of new launches in the US, heightened competitive intensity, and certain process inefficiencies could impact growth and exert margin pressures for Lupin in the near to medium term. Outlook for the domestic formulations business is healthy, while a strong product pipeline could drive US sales higher in the long term. At the CMP, the stock trades at 23.2/17.1x its FY2023E/FY2024E EPS, which is at a discount to its peers as well. The stock price has corrected ~29% over the past six months and is largely factoring in the likely weak performance in 1HFY2023. Lupin's long-term growth levers are intact despite near-term hiccups. Hence, we retain our Buy recommendation on the stock with a revised price target (PT) of Rs. 780.

Key Risks

- 1) Adverse development on the regulatory front can impact earnings prospects;
- 2) Currency risks;
- 3) Delay in inspection of Pithampur and Tarapur plants by USFDA.

Valuation (Consolidated)

Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Net sales	15,163.0	16,405.5	18,087.9	19,840
Operating Profit	2,566.9	287.2	2,550.3	3,192.4
OPM (%)	16.9	1.8	14.1	16.1
Net profit	1,216.5	-1,528.0	1,245.7	1,689.9
Adj. EPS (Rs.)	26.8	-33.6	27.4	37.2
PER (x)	23.7	-	23.2	17.1
EV/EBITDA (x)	12.9	111.1	9.7	7.1
P/BV (x)	2.1	2.4	2.2	2.0
RoCE (%)	9.0	-	10.4	12.9
RoNW (%)	8.8	-	9.5	11.7

Source: Company; Sharekhan estimates

Weak quarter: Lupin reported weak performance for Q4FY2022. OPM surprised negatively, marred by escalated raw-material prices. This coupled with overall cost escalations resulted in OPM declining by 1181 bps y-o-y. Consequently, the company reported net loss for Q4FY2022. Results missed our estimates. Sales at Rs. 3,883 crore grew by 2.6% y-o-y and marginally missed estimates. India formulations segment's sales grew slower by 5%, while US sales marred by pricing pressures declined by 5% y-o-y. OPM surprised negatively with OPM at 6.9% contracting by 1181 bps y-o-y due to a 720-bps y-o-y decline in gross margins. Employee cost and other expenses were also on the higher side. Operating profit stood at Rs. 267.8 crore in Q4FY2022 as against Rs 707.6 crore in Q4FY2021. Other income for the quarter declined by 68% y-o-y, while depreciation at Rs 327.2 crore increased by 51% y-o-y due to Rs. 129 crore impairment charge. Consequently, net loss stood at Rs. 518 crore in Q4FY2022 as against profit of Rs 450.8 crore in Q4FY2021.

Q4FY2022 Conference Call Highlights

- ♦ **Near-term headwinds apparent for the US business; New product launches to fuel growth over the long term:** US sales stood at Rs. 1,416.2 crore, down 5% y-o-y and 10% q-o-q. Going ahead, Lupin expects volumes in gAlbuterol to ramp up and has achieved a market share of 23% and is looking to further grow the same. Moreover, the recent launch of Brovana is gaining traction and is expected to be a key growth driver in addition to gAlbuterol. Further, the company has a substantial number of launches lined up post 2HFY2023 in the FTF/limited competition space. These include Tiotropium and Suprep in 2HFY2023, while others including bPegflgrastim and Linalidomide (though not FTF but offers substantial growth opportunities) are likely to follow in FY2024. However, price erosion has inched up, given the heightened competitive intensity in the US generics market. Management sees pricing pressures to sustain going ahead, which could slow down near-term growth. Further, prolonged delay for plant inspection by the USFDA has impacted the new launch momentum, though the recent clearance of Goa plant bodes well. Lupin intends to launch 11 new products from Goa plant in US markets in the near future. While the expected traction in Albuterol, Brovana, and likely improvement in the base business could support the management's aim of sustaining healthy quarterly run rate for the US business, higher price erosion and lack of new launches in the near term could act as dampeners and slow down the growth momentum to less than \$200 million. However, over the long term, there are potential high-value launches being lined up by the company, which could unfold in 2HFY2023 and the full impact of these could be expected in FY2024.
- ♦ **India business to grow ahead of the industry:** Lupin's revenue from India business stands at Rs. 1,351 crore, up 5% y-o-y, and was driven by growth in the base business. Management sees India business growth to be sub-10% for FY2023, largely due to a high base. During Q4FY2022, the company has launched one brand each in the anti-diabetic, anti-viral, and VMS segments. Moreover, the company looks to increase its medical representative strength gradually to improve the reach and doctor connect. From a therapy-wise perspective, Lupin sees ample headroom to expand in the therapies of CNS and dermatology among others. Further, the company is open to evaluating the inorganic route for growth, though there is nothing concrete as of now. Overall, Lupin has a higher presence in the chronic therapies of cardiology, anti-diabetics, and respiratory. Management has set its focus on these growth areas, as chronics tend to have better demand visibility and could be a growth driver for India business.
- ♦ **North America:** The company filed 10 ANDAs during the quarter and received two ANDA approvals from the USFDA. Lupin launched two new products in the US during the quarter. Overall, the company has around 166 generic products in the US.
- ♦ **EMEA and RoW Markets:** Revenue from EMEA markets stood at Rs. 407.2 crore, up 19% y-o-y and 8.6% q-o-q. Sales in Germany stood at Euro 8.8 million as against Euro 8.1 million in the corresponding quarter last year.
- ♦ **LATAM and APAC (Growth Markets):** Revenue stood at Rs. 339 crore, 2.9% y-o-y growth. Sales in Brazil stood at BRL 64 million, up from BRL 59 million as of Q4FY2021. Sales in Mexico in local currency terms stood at MXN 183 million as compared to MXN 154 million in Q4FY2021. Sales in Philippines stood at PHP 475 million as compared to PHP 402 million in Q4FY2021.
- ♦ **Regulatory Updates:** Lupin's plants at Goa got a clearance from the USFDA recently and the company now looks to launch new products from the plant. However, Pithampur (unit-II) and other plants are under the USFDA's scrutiny. Management has submitted its responses to the USFDA and is awaiting a reply. Clearance of these plants can enable Lupin to improve the product launch momentum and offset higher pricing erosion in the US markets.

- ♦ **R&D:** R&D expenses for Q4FY2022 stood at Rs. 344.2 crore or 8.9% of sales. The company has a total of 53 first-to-file (FTF) filling products, which include 21 products with exclusive FTF opportunities. As of Q4FY2022, the company's cumulative DMFs stood at 196. These point at a strong product pipeline. However, to improve efficiencies in the overall business, Lupin is evaluating spinning off the NCE business, which includes a high share of R&D. However, there are no concrete developments currently.
- ♦ **Growth Outlook:** Lupin's India business is expected to grow at a healthy pace as compared to US business, driven by consistent growth from chronic therapies, which tend to have relatively stable demand. While in the US business, ramp up in Albuterol and Brovana could be the key growth drivers, but double-digit price erosion would slow down the quarterly run rate to less than \$200 million. Increasing pricing pressures and lack of new product launches point at near-term headwinds, though potential high-value launches are lined up and are likely to play out over FY2023-FY2024 and could be long-term growth drivers. Further, elevated raw-material costs, higher price erosion in the US, and certain operating inefficiencies are likely to outweigh on OPM in the subsequent quarters. While long-term growth drivers are in place, near-term headwinds are likely to over weigh.

Results (Consolidated)

					Rs cr
Particulars	Q4FY22	Q4FY21	YoY %	Q3FY22	QoQ %
Total sales	3883.0	3783.1	2.6%	4160.9	-6.7%
Expenditure	3615.2	3075.6	17.5%	3597.2	0.5%
Operating profit	267.8	707.6	-62.1%	563.8	-52.5%
Other income	15.7	48.6	-67.8%	34.1	-54.0%
EBIDTA	283.5	756.2	-62.5%	597.8	-52.6%
Interest	41.5	31.8	30.2%	33.4	24.2%
Depreciation	327.2	215.7	51.7%	203.4	60.8%
PBT	-85.2	508.6	-116.7%	361.0	-123.6%
Tax	426.7	54.0	690.1%	-382.0	-211.7%
Adj. PAT	-518.3	450.8	-	739.5	-

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 active pharmaceutical ingredients (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 - Long-term levers intact

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 and performance from the regions has been weak. Management expects headwinds to sustain over the next 2-3 subsequent quarters. However, post that, a slew of high-value potential new launches are lined up, which could drive growth for the US business. Lupin's new launch line-up includes some significant high-value launches in the US in the respiratory and biosimilars space, along with 20 FTFs and one through the 505-b-2 pathway. There is a strong product pipeline consisting of complex/limited competition products. India business, on the other hand, is witnessing strong growth traction and the company expects to sustain its double-digit growth and outpace IPM growth. Strong growth in the base business, new product launches, and a chronic-heavy presence would drive growth for the India business. Lupin is also focusing on cost-control and rationalisation along with eliminating certain operating inefficiencies, which would result in OPM expansion, though over the long term. Resolution of USFDA issues at its plants in Pithampur and Tarapur would be key developments to watch out for and, if successfully resolved, would lead to earnings upgrades.

■ Valuation - Retain Buy with a revised PT of Rs. 780

Near-term headwinds in the form of increasing raw-material cost pressures, lack of new launches in the US, heightened competitive intensity, and certain process inefficiencies could impact growth and exert margin pressures for Lupin in the near to medium term. Outlook for the domestic formulations business is healthy, while a strong product pipeline could drive US sales higher in the long term. At the CMP, the stock trades at 23.2/17.1x its FY2023E/FY2024E EPS, which is at a discount to its peers as well. The stock price has corrected ~29% over the past six months and is largely factoring in the likely weak performance in 1HFY2023. Lupin's long-term growth levers are intact despite near-term hiccups. Hence, we retain our Buy recommendation on the stock with a revised PT of Rs. 780.

Peer Comparison

Companies	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)			EV/EBITDA (x)			RoE (%)		
				FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Lupin	635	45.3	28,847	-	27.4	37.2	-	9.7	7.1	-	9.5	11.7
Caplin Point Labs	792	7.6	6,000	19.4	16.1	13.9	12.6	10.2	8.2	23.1	22.5	21.5
Cipla	938	80.6	75,683	27.6	24.6	19.4	16.4	14.8	11.9	14.6	13.8	15.3

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 around 37% and 35%, respectively, of FY2021 sales of the company. The company develops and commercialises a wide range of branded and generic formulations, biotechnology products, and APIs in over 100 markets in the US, India, South Africa, and across Asia Pacific (APAC), Latin America (LATAM), Europe, and Middle East regions. While in India, Lupin is among the top 10 and fastest-growing companies as well. The company is also among the top five companies in terms of prescriptions in the US. Therapy wise, the company has a leadership position in the cardiovascular, anti-diabetic, and respiratory segments and has a significant presence in the anti-infective, gastro-intestinal (GI), central nervous system (CNS), and women's health segments. In terms of manufacturing capabilities, Lupin has 15 manufacturing sites and seven research centres globally.

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 initial signs of revival apparent in IPM coupled with chronic-heavy presence for Lupin (in the domestic business), India formulations segment is expected to gain traction. Lupin is also focusing on cost-control efforts and cost rationalisation. 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

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	Life Insurance Corporation of India	5.03
2	HDFC Asset Management Co	5.01
3	Vanguard Group Inc/The	1.63
4	Franklin Resources Inc	1.56
5	BlackRock Inc	1.56
6	SBI Funds Management	1.43
7	ICICI Prudential Life Insurance Co Ltd	1.41
8	Comgest SA	1.39
9	Government Pension Fund Global	1.36
10	Norges Bank	1.26

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 deteriorating 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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