Sharekhan by BNP PARIBAS

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Stock Update

Result Update

Lupin Ltd

Good sequential recovery in Q2; Better outlook ahead

Pharmaceuticals	Sharekhan code: LUPIN

Reco/View: Buy	↔	CMP: **Rs. 760**	Price Target: **Rs. 855**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

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 38.13

Updated Oct 08, 2022

High Risk

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

Source: Morningstar

Company details

Market cap:	Rs. 34,555 cr
52-week high/low:	Rs. 973 / 583
NSE volume: (No of shares)	13.9 lakh
BSE code:	500257
NSE code:	LUPIN
Free float: (No of shares)	24.0 cr

Shareholding (%)

Promoters	47.1
FII	14.3
DII	27.6
Others	11.01

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	10.0	11.2	10.9	-19.9
Relative to Sensex	3.6	8.2	-5.4	-21.4

Sharekhan Research, Bloomberg

Summary

- Lupin's Q2FY2023 performance was better than our as well as street expectations on account of strong sequential recovery in the US business while India business continued its growth momentum (on a like-to-like basis).
- Revenues stood flat at Rs. 4,145.5 crore (grew by ~11% q-o-q); EBITDA margin decreased by 285 bps y-o-y (improved by 472 bps q-o-q) to 10.9% and adjusted PAT stood at Rs. 134.5 crore.
- New product launches (including Suprep) will drive growth in Q3 and Q4. Management expects EBITDA margin to reach 16-18% by Q4FY2023 and better mix would help EBITDA margin to further improve to 20% by Q2FY2024
- The stock is currently trading at 46x/31x its FY2023/24E earnings. In view of better outlook ahead in the key markets, we maintain our Buy on the stock with revised PT of Rs. 855.

Lupin Limited (Lupin) posted relatively better performance in Q2FY2023 on the back of good recovery in the US business, while India business continued to its growth momentum on a like-to-like basis (excluding the impact of the loss of exclusivity and certain sale of diabetes and cardiovascular therapy area). Lupin's consolidated revenues grew by 1.3% y-o-y to Rs. 4,145.5 crore (sequentially, it grew by 10.7%). Key regions including India, growth markets and EMEA registered a y-o-y growth of 2.6%, 27.5% and 10.3%, respectively. North American business saw strong sequential recovery with revenue growing by 32% q-o-q. Gross margins were down by 156 bps y-o-y (improved by 170 bps q-o-q) to 58.7%. Better gross margins and operating efficiencies aided EBITDA margin to improve sequentially 472 bps to 10.9%. EBIDTA declined by 19.6% y-o-y (grew by 95% q-o-q) to Rs. 453 crore. The company registered an adjusted PAT of Rs. 134.5 crore in Q2FY2023 vs. a loss of Rs. 87 crore in Q1FY2023.

Key positives

- Revenue from US market grew by 32% q-o-q to Rs. 1,329.5 crore (USD 159mn vs. USD121mn).
- EMEA and RoW businesses registered a strong growth of 15% and 10% on y-o-y basis.
- Gross margins and EBITDA margin improved by 170 bps and 472 bps on a sequential basis.

Key negatives

- Global APIs sales were down by 6.7% y-o-y to Rs. 267.8 crore (down by 2% q-o-q).

Management Commentary

- US business registered strong sequential improvement in the performance in Q2FY2023 with revenue growth of 31% q-o-q. Increased contribution from the newly launched respiratory product gSuprep and strong flu season will help the recovery momentum to sustain in the US markets in the coming quarters.
- India business will get back to double-digit growth in H2 with the addition of sales force, new product launches and strong growth in the chronic and cardiac segments.
- Emerging markets are roughly 11% of the company's revenues. The other developed markets are roughly 10% of the company's revenues. Both are growing extremely well, the emerging markets whether it's Latin America, South Africa, Philippines, grew double digit. And its profitable business, had an EBITDA margin well above the company average, and the company continues to drive growth in the emerging markets with the flu season coming up, which will help the margins.
- Increase in contribution from new launches, correction in the key input prices, and operating efficiencies would help EBITDA margin to improve to 16-18% in Q4FY2023. Management expects it to further improve to 20% by Q2FY2024.

Revision in estimates – We have toned down our earnings estimates for FY2023 to factor in lower EBITDA margin than earlier expected while we have fine-tuned it for FY2024. Commentary on the outlook for US and India business was very encouraging and we expect FY2024 to much better year with consistent improvement in the OPM.

Our Call

View: Improved near-term outlook; Retain Buy with revised PT of Rs. 855: With an expected recovery in the US business and consistent growth in the India business coupled with better margin prospects driven by efficiencies, product mix and correction in the key input prices improves the earning visibility for Lupin in H2FY2023 and FY2024. At the CMP, the stock trades at 46x/31x its FY2023E/FY2024E EPS. Based on the encouraging outlook, we retain our Buy recommendation on the stock with an unchanged price target (PT) of Rs. 855.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E	FY25E
Net sales	15,163.0	16,405.5	15,820.9	17,347	19,415
Operating Profits	2,566.9	287.2	1,916.5	2,464.6	3,335.6
EBITDA Margin (%)	16.9	1.8	12.1	14.2	17.2
Net profit	1,216.5	-1,528.0	750.6	1,115.1	1,762.8
Adj. EPS (Rs)	26.8	-33.6	16.5	24.5	38.8
PER (x)	28.3	-	46.0	31.0	19.6
EV/Ebidta (x)	15.1	-	16.1	11.9	8.2
P/BV (x)	2.5	2.8	2.7	2.6	2.3
RoCE (%)	9.0	-	6.7	9.1	12.8
RoNW (%)	8.8	-	6.0	8.4	12.0

Source: Company; Sharekhan estimates

Good Quarter with sequential improvement in key geographies

Lupin posted a relatively better performance in Q2FY2023 on the back of a good recovery in the US business while India business continued to its growth momentum on a like-to-like basis (excluding the impact of a loss of exclusivity and certain sale of diabetes and cardiovascular therapy area). Lupin's consolidated revenues grew by 1.3% y-o-y to Rs. 4,145.5 crore (sequentially, it grew by 10.7%). Revenues were ahead of our expectation of Rs. 4,030 crore and the average street expectation of Rs. 4,051 crore. Key regions, including India, growth markets and EMEA, registered a y-o-y growth of 2.6%, 27.5% and 10.3%. North America business saw strong sequential recovery growing at 32% q-o-q. Gross margins were down by 156 bps y-o-y (improved by 170 bps q-o-q) to 58.7%. Better gross margins and operating efficiencies aided EBITDA margin to improve sequentially by 472 bps to 10.9%. EBITDA margin came in higher than our as well as average street estimates of 9.7-10%. EBIDTA decline by 19.6% y-o-y to Rs. 453 crore (grew by 95% q-o-q). The company registered Adjusted PAT of Rs. 134.5 crore in Q2FY2023 vs. loss of Rs. 87 crore in Q1FY2023. The same was ahead of our expectation of Rs. 125 crore and in-line with street expectation of Rs. 140 crore.

Q2FY2023 Conference Call Highlights

- Revenue growth in Q2 was driven by the bounce back of the U.S. business along with continued growth in the India business and growth across all other geographies. On the margin front, the company saw the benefit of its optimisation measures in addition to the revenue growth in the business. The company is focused on sustaining this positive momentum for the rest of the year. Majority of the revenue growth came from the existing portfolio (oral solids and respiratory).

- The respiratory franchise contribution increased, and the company executed a couple of new product launches, in particular gSuprep, that will help the growth in Q3 and Q4. It had some contribution in Q2, but since it was launched in September, more to come in Q3 and Q4. Lupin closed the acquisition of the Sunovion brands, Brovana and Xopenex, which will enable the company to enhance its respiratory position in the U.S. while contributing to revenue, as well as profitability growth. For the quarters ahead, the company has new product launches like Spiriva, Diazepam Gel, Nasocobal Nasal Spray and Darunavir, multiple products where the company has exclusivity or first to market position that will enable the growth in the U.S. business profitably. The new brand acquisitions were highly strategic. Darunavir launch is expected in Q1FY24. Diazepam gel a smaller product, will be launched in the next 3-6 months.

- For the first time after a couple of years the company saw some impact of the flu season with an uptick in anti-infectives as well as Tamiflu, a little bit in Q2. The management is expecting a strong flu season. COVID, as well as RSV, is a combination of multiple issues. The company also sees the flu season impact its order -- purchase orders on the API front on the Cephalosporins. So, both the US indicators as well as API forecast suggests that the flu season right now seems to be picking up.

- The company is confident about the margin improvement on q-o-q basis from here with certain material launches in place waiting for approval and a few good products in gSpiriva which will come in Q4. The company expects the margin to improve to 16% plus levels in the future. For Q4, the EBITDA margins could be between 16% – 18%. For the next financial year, on the back of new product launches, the management expects the margins to be driven up to 20% in Q1FY24 and if not it will be seen in Q2FY24.

- Emerging markets are roughly 11% of the company's revenues. The other developed markets are roughly 10% of the company's revenues. Both are growing extremely well, the emerging markets, whether it's Latin America, South Africa, Philippines, grew double digit. And is a profitable business that had a EBITDA margin well above the company average, and the company continues to drive growth in emerging markets with the flu season coming up, which will help the margins. The company expects strong double-digit growth in its India business in the following categories - cardiac segment, respiratory, GI, and other chronic segments. The diabetes category will continue to be suppressed.

- The salesforce expansion in India is going smoothly. The company has 6,000 representatives currently. The company will be adding 850 representatives by the end of the fiscal.

Results (Consolidated) Rs cr

Particulars	Q2FY23	Q2FY22	Y-o-Y %	Q1FY23	Q-o-Q %
Total sales	4145.5	4091.3	1.3%	3743.8	10.7%
Expenditure	3692.5	3527.6	4.7%	3511.5	5.2%
Operating profit	453.0	563.7	-19.6%	232.3	95.0%
Other income	14.9	72.8	-79.5%	5.6	-
EBIDTA	467.9	636.5	-26.5%	237.8	96.7%
Interest	54.9	34.4	59.4%	42.8	28.3%
Depreciation	203.5	211.6	-3.9%	192.8	5.5%
PBT	209.6	390.5	-46.3%	2.2	-
Tax	75.1	-109.9	-	89.1	-15.7%
Adjusted PAT	134.5	500.4	-73.1%	-86.9	-
Exceptional item + OCI	-4.7	-2598.4	-99.8%	-2.3	-
Reported PAT	129.7	-2098.1	-	-89.1	-
Adj. EPS	2.9	11.0	-73.9%	-2.0	-
			BPS		**BPS**
EBITDA margin (%)	10.9	13.8	-285	6.2	472
NPM (%)	3.2	12.2	-899	-2.3	556
Tax rate (%)	35.8	-28.1	-	-	-

Source: Company, Sharekhan Research

Segmental Revenue Mix Rs cr

Particulars	Q2FY23	Q2FY22	Y-o-Y %	Q1FY23	Q-o-Q %
North America	1329.5	1429.1	-7.0%	1010.4	31.6%
India	1584.1	1543.5	2.6%	1492.0	6.2%
EMEA	384.2	348.4	10.3%	333.5	15.2%
Growth Markets	444.9	349.0	27.5%	423.7	5.0%
ROW	98.6	65.6	50.3%	89.3	10.4%
Formulations	**3841.3**	**3735.6**	**2.8%**	**3348.9**	**14.7%**
API	**249.9**	**267.8**	**-6.7%**	**255.1**	**-2.0%**
Other operating income	**54.4**	**87.9**	**-38.2%**	**139.9**	**-61.1%**
Total	**4145.6**	**4091.3**	**1.3%**	**3743.9**	**10.7%**

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 and 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 the 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 region 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 India business. Lupin is also focusing on cost control and rationalisation along with eliminating certain operating inefficiencies, which would result in EBITDA margin 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 revised PT of Rs. 855

With an expected recovery in the US business and consistent growth in the India business coupled with better margin prospects driven by efficiencies, product mix and correction in the key input prices improves the earning visibility for Lupin in H2FY2023 and FY2024. At the CMP, the stock trades at 46x/31x its FY2023E/FY2024E EPS. Based on the encouraging outlook, we retain our Buy recommendation on the stock with an unchanged price target (PT) of Rs. 855.

Peer Comparison

Companies	CMP (Rs/ Share)	O/S Shares (Crs)	Mcap (Rs Cr)	P/E (x)			EV / EBITDA (x)			RoE (%)		
				FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Lupin	760	45.5	34,555	-	46.0	31.0	-	16.1	11.9	-	6.0	8.4
Cipla	1,129.2	80.7	91,127	33.2	28.7	22.9	19.8	17.5	14.2	14.6	14.2	15.5

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, to the 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, 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, gastrointestinal (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. Sunil Makharia	Interim CFO

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp India	8.38
2	ICICI Prudential AMC	5.87
3	ICICI Pru Housing Fund	5.06
4	HDFC Asset Management Co Ltd	4.36
5	Vanguard Group Inc	1.75
6	BlackRock Inc	1.64
7	Government Pensi	1.52
8	Nippon Life India AMC	1.42
9	Norges Bank	1.33
10	DSP Investment Managers Pvt Ltd	0.98

Source: Bloomberg

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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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