Sharekhan by BNP PARIBAS

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Stock Update

Result Update

Lupin Ltd

Outlook weak, downgrade to Reduce

Pharmaceuticals	Sharekhan code: LUPIN	
Reco/View: Reduce ↓	CMP: Rs. 737	Price Target: Rs. 660 ↓

↑ 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 Dec 08, 2022

High Risk

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

Source: Morningstar

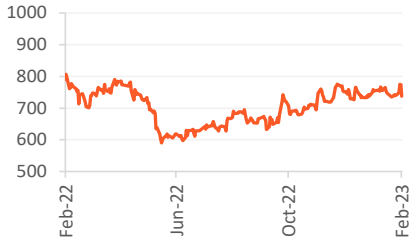
Company details

Market cap:	Rs. 34,555 cr
52-week high/low:	Rs. 863 / 583
NSE volume: (No of shares)	30.6 lakh
BSE code:	500257
NSE code:	LUPIN
Free float: (No of shares)	24.1 cr

Shareholding (%)

Promoters	47.1
FII	14.0
DII	29.4
Others	9.54

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-2.9	2.5	7.8	-8.6
Relative to Sensex	-3.8	2.4	4.6	-11.6

Sharekhan Research, Bloomberg

Summary

- Q3FY2023 performance lagged ours and the street's expectations, led by slower growth in the US and India markets.
- Adjusted PAT declined sharply by 75% y-o-y to Rs. 137 crore due to lower other income and higher interest costs and taxes.
- Product launches (including that of Suprep) proved ineffective in driving US revenue growth, as anticipated, due to which EBITDA margins are lagging estimates.
- Stock trades at a rich valuation of 34.9x/20.8x its FY2024/25E earnings. Given a weaker outlook, we downgrade our Buy rating on the stock to Reduce with a revised PT of Rs. 660.

Lupin Limited posted weak numbers in Q3FY2023 led by a weak US business amid optimization measures in the OSD segment, while it is planning to enhance its revenue from complex generics, respiratory and biosimilar products. Launch of key products such as that of Spiriva is delayed due to regulatory inspection pending. In the meantime, the company believes the generics business may take a couple of years to grow. Similarly, it is boosting its field force in the India market, where it has seen a slowdown due to loss of key brands' sales to competition. Some of its facilities are under OAI status with the USFDA as well. Moreover, net income far lagged internal and consensus estimates in the quarter, largely due to lower other income, increased interest expenses and taxes. All these point to likely headwinds to its profitable growth in the near to medium term.

Key positives

- Revenue from the US market grew by 14.9% q-o-q to Rs. 1,527 crore (USD 177 million).
- EMEA, Growth markets and RoW businesses registered a strong growth of 11.1%, 23.5% and 16.9% y-o-y.
- Gross margins and EBITDA margins improved by 123 bps and 303 bps, y-o-y, respectively.

Key negatives

- The US continues to grapple with competitive intensity in Oral Solid Dosages (OSDs)
- While the company is focusing on growing its specialty complex business in the US, the generic business is expected to take medium to long term to grow with key product launches.

Management Commentary

- While the company will focus on growing its specialty complex business in the US, the generic business will take medium to long term to grow with key product launches.
- India, US complex generic business, and other emerging markets are the growth drivers. Pricing continues to remain challenging leading to exits among competing players.
- Company over the last couple of quarters has seen that its base business has stabilized, and product launches have been contributing to growth. Key product such as Spiriva is likely be launched in H1FY24.
- Company is banking on topline growth to deliver on EBITDA margins.

Revision in estimates – We have toned down our earnings estimates for FY2024-FY2025 to factor in lower EBITDA margins than earlier expected.

Our Call

Valuations – Growth outlook weakens; Downgraded to Reduce with a revised PT of Rs. 660: The US' profitability margins are way below consolidated levels. While Lupin is focusing on growing its specialty complex business in the US, the generic business is expected to take medium to long term to grow with key product launches. Lupin believes that the pricing continues to remain challenging, leading to exits from the US business, among competitors. Some key products in the US such as gSpiriva are still to be launched while it is pending for the USFDA inspection. It has been acquiring into other brands to spruce up its US sales, which on the other side, also leads to increased debt and finance costs. R&D costs are likely to go up on products pipeline in complex generics, respiratory and biosimilar segments. Moreover, its staff costs are likely to inch up due to addition of 1,000 sales representatives in India market while competitive intensity has made its India business also slow down with loss of Cidmus brand and gliptin products becoming off-patent. Given the near-term headwinds, we downgrade our Buy rating on the company to Reduce with a PT of Rs. 660. The stock trades at a rich valuation of 34.9x/20.8x its FY24-FY25 EPS estimates.

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	FY2021	FY2022	FY2023E	FY2024E	FY2025E
Net sales	15,163.0	16,405.5	16,616.8	18,135	20,142
Operating Profits	2,566.9	2,097.2	1,640.1	2,393.5	3,296.7
EBITDA Margin (%)	16.9	12.8	9.9	13.2	16.4
Adj. Net profit	1,216.5	1,122.2	233.2	958.8	1,613.8
Adj. EPS (Rs)	26.8	24.7	5.1	21.1	35.5
PER (x)	27.5	29.9	143.7	34.9	20.8
EV/Ebidta (x)	14.7	17.4	18.9	12.5	8.5
P/BV (x)	2.4	2.8	2.8	2.6	2.4
RoCE (%)	9.0	8.4	4.9	8.8	12.9
RoNW (%)	8.8	9.2	1.9	7.5	11.5

Source: Company; Sharekhan estimates

Weak Q3: Lagged estimates

US and India weaken Q3: Lupin posted weak numbers for Q3FY2023 as formulation revenues (93% of revenue) growth slowed down in Q3FY23 to 3.4% y-o-y (vis a vis Q2FY23) as the US revenues (36% of revenue) fell 3.2% y-o-y to Rs. 1,527 crore while India business (36% of revenue) continued to grow at a slower pace of 3.3% y-o-y to Rs. 1,521 crore; partially offset by other markets including growth markets, EMEA, and RoW (22% of revenue) growing at a relatively better pace, in the quarter. India markets had been affected by loss of Cidmus brand from its cardio portfolio and generalization in its anti-diabetic portfolio of gliptin products. Cardio and diabetes makes up nearly 50% of its domestic chronic sales.

New products are driving growth, but delayed key product launches a concern: While the US revenue fell y-o-y it improved at a strong pace of 14.9% QoQ, which was driven by NPLs, seasonality and Suprep. The company had guided in Q2FY23 that Suprep and respiratory products like gAlbuterol and gArformoterol will drive growth in Q3FY23, but rather it has not taken place on a y-o-y basis. In case of gAlbuterol, its generic market share has fallen down to 21.1% in Q3FY23 versus 22% generic market share in Q2FY23. The company had invested heavily in acquiring new brands such as gBrovana (Arformoterol) and Xopenex HFA and few others in respiratory domain, at USD 75 million in Q2FY23. The company launched products like Formoterol (gPerforomist), Diclofenac (Pennsaid AG), Rufinamide tablets and Paliperidone ER tablets in Q3FY23 while it has launched 8 products in 9MFY2023. The company is underway with optimizing oral solid dosage (OSD) products portfolio in the US, as it is hugely competitive, while focusing on driving growth of its complex generics, respiratory products through new product launches. The company expects the recently launched Suprep, Diazepam gel, and Nascobal nasal spray, which have exclusivity or first to launch position will drive the growth of its US business in a profitable way in the short to medium term.

Net profitability declined sharply: Consolidated revenues grew by 3.9% y-o-y (+4.3% q-o-q) to Rs. 4,322 crore. Revenues were in line with the expectation of Rs. 4,240 crore and the average street expectation of Rs. 4,288 crore. Positively, Gross margins were up by 123 bps y-o-y (+182 bps q-o-q) to 60.5%. Better gross margins and operating efficiencies aided EBITDA margin to improve by 303 bps y-o-y and 101 bps q-o-q to 11.9%. However, EBITDA margin came in lower than our as well as average street estimates of 13.0%. EBIDTA rose by 39.2% y-o-y (+13.9% q-o-q) to Rs. 516 crore. However, the company registered a 75.0% y-o-y (+5.5% q-o-q) fall in adjusted PAT to Rs. 137 crore in Q3FY2023 and reported PAT declined 71.9% y-o-y (+18.3% q-o-q) to Rs. 153.5 crore. The same was far below our and street's expectation of Rs. 211 crore and Rs. 221 crore, respectively. This was due to 47.3% y-o-y (+20.2% q-o-q) decline in other income to Rs. 18 crore and 151.8% y-o-y (+53.2% q-o-q) rise in finance cost to Rs. 84 crore. This coupled with increased taxes y-o-y and q-o-q led to fall in net income.

Q3FY2023 Conference Call Highlights

- **Revenue and profitability growth in Q3FY23:** The company believes that the momentum sustained on revenue and margins in Q3FY23 as US performed and India improved. US revenue growth was driven by NPLs, seasonality related to flu season, and NDA branded products. The company launched Formoterol (gPerforomist), Dicolofenac (Pennsaid AG), Rufinamide tablets and Paliperidone ER tablets in Q3FY23. The company hopes to sustain the momentum with key product launches in the times ahead. While the company will focus on growing its specialty complex business in the US, the generic business will take medium to long term to grow with key product launches. India, US complex generic business, facilities, and other emerging markets are the growth drivers. Pricing continues to remain challenging leading to exits.
- **India business:** Lupin grew at par with the India Pharma market in Q3FY23, excluding licensed products. The impact in India was due to loss of Cidmus brands and competitive intensity in gliptins. Gynaecology, respiratory and GI were the fastest growth segments for the quarter. Diabetes is recovering as well from the impact of patent on it being expired. The company added 1,000 sales representatives and created 6 new divisions to drive growth in double digits in quarters ahead. The management expects to start growing from Q2FY24 onwards. The increased employee costs will start showing up from Q4FY23 and then reflect fully from Q1FY24 onwards. While market growth was 10%, Lupin grew at 7% due to loss of exclusivity in the diabetics market as it generates 55% of the portfolio from anti-diabetics segment, as it is one of the top 3 for Diabetes and Cardio therapies in India. Employee costs as a % of sales to be 18.5% - 19% in the near term as it builds sales force in India. The field force is likely to focus on Diabetic, Cardio, and respiratory therapies. Diabetes market is growing which can enhance volumes.
- **US business:** Over the last couple of quarters, the company has seen that its base business has stabilized, and new product launches have been contributing to the growth. Seasonal flu products also added to growth in Q3FY23. The quarterly revenue run rate is at $170 million due to new product launches. Key product such as Spiriva is likely be launched in H1FY24.
- **Margins and costs guidance:** As the company will be launching new products and new field force and cost optimisation measures yield results, will enhance margins. The EBITDA should start moving up, as a result. Other expenses includes one-time expenses of Rs. 40 crore, which is likely to come down QoQ, and will be offset by

increase in R&D spend though. Other expenses to rise due to increase in employee costs with increased field force. Margins to be in lines with Q3FY23 for Q4FY23. With Spiriva and other key product launches to help the EBITDA margins in the short-medium term. The company is banking on topline growth to deliver on EBITDA margins. Except Spiriva not many key products being there. Hence, the company has to keep resorting to costs reduction as well. India region will see increase in field force and then productivity of revenue will also be focused on to increase its sales. The logistics costs is also likely to help. Out of the Rs. 500 – 600 crore of cost-saving measures, the company has achieved 50-60% of the target. Remaining is likely be achieved over a period of time. Cost-saving benefits to come in from Q2FY24 onwards. The management has started seeing benefits of couple of products from profitability standpoint in the US. Hence, Spiriva is a potential growth driver over the next 2 years to bring it back to the 17-18% EBITDA levels. Albuterol offset challenges in oral solids.

- **Compliance:** The Ankaleshwar, Somerset, Nagpur injectables got the USFDA clearances. Nagpur facility will help it to start building organic injectables business. The management expects to launch 4-5 products from injectables segment in FY24, as few filings are pending, and the larger number can come in from FY25 onwards.
- **Finance costs** increased due to couple of acquisitions of brands in the US and Brazil has led to increased debt. Gross debt is at Rs. 3,400 crore as of Q3FY23.
- **US business profitability:** The US' EBITDA margin are below the consolidated levels. However, Q3FY23 is one of the best quarters for the company where the EBITDA margins for the US business has been higher than in Q1FY23 and Q2FY23, due to stability in the base business and new product launches and is expected to rise up above the consolidated EBITDA margin by FY24. Suprep is likely to be a 2-player market and has been a great opportunity wherein the price erosion has been 60%. Run rate is looking good beyond the 180-day exclusivity as others have supply issues in terms of APIs. For Pegfilgrastim the response has gone back to the USFDA, and the company expects the approval in the next couple of months.

Results (Consolidated) **Rs cr**

Particulars	Q3FY23	Q3FY22	y-o-y %	Q3FY23	QoQ %
Total sales	4,322	4,161	3.9%	4,146	4.3%
Expenditure	3,806	3,790	0.4%	3,693	3.1%
EBITDA	516	371	39.2%	453	13.9%
Depreciation	220	203	8.3%	203	8.3%
EBIT	296	167	76.7%	250	18.5%
Other income	18	34	-47.3%	15	20.2%
Interest	84	33	151.8%	55	53.2%
PBT	230	168	36.6%	210	9.5%
Tax	88	-382	NM	75	17.8%
PBT	141	550	-74.4%	134	4.9%
MI	4	4	18.1%	5	-11.8%
Adjusted PAT	137	546	-75.0%	130	5.5%
Extraordinary Items	17	-1	NM	0	NM
Reported PAT	153.5	545.5	-71.9%	129.7	18.3%
			BPS		**BPS**
EBITDA (%)	11.9	8.9	303	10.9	101
NPM (%)	3.2	13.1	-997	3.1	4
Tax rate (%)	38.6	NM	NM	35.8	272

Source: Company, Sharekhan Research

Segmental Revenue Mix **Rs cr**

Particulars	Q3FY23	Q3FY22	y-o-y %	Q2FY23	q-o-q %
North America	1,527	1,578	-3.2%	1,330	14.9%
India	1,521	1,473	3.3%	1,584	-4.0%
EMEA	419	339	23.5%	445	-5.9%
Growth Markets	380	342	11.1%	384	-1.0%
ROW	116	99	16.9%	99	17.4%
Formulations	3,963	3,831	3.4%	3,841	3.2%
API	282	256	9.8%	250	12.6%
Total	**4,245**	**4,088**	**3.8%**	**4,091**	**3.7%**

Source: Company, Sharekhan Research

Outlook and Valuation

Sector view - Sector Outlook – Rising consumer spends and awareness bode well for IPM's growth.

Indian players with a large market share in the IPM and a strong pipeline of specialty products will help them gain market share in the US, thereby partially offsetting any impact of competitive pricing pressure in the US. Moreover, faster product approvals and resolutions by the USFDA with regards to plant observations and 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, biosimilars, and injectables) and the commissioning of expanded capacities by select players over the medium term. Collectively, this indicates a strong growth potential for Indian pharma companies, going ahead.

Company outlook - Growth outlook weakens

Lupin is grappling with the issues surrounding high intensity of competition in Oral Solid Dosage (OSD) segment in the US. It has been trying to restructure or optimise the US business and enhance it with the help of launching of complex generics and specialty products in respiratory, injectables and biosimilar segments. However, lower than consolidated EBITDA margins in the US, is restricting its ability to enhance its overall margins to historical levels. This, besides the delay in the key product launches such as that of Spiriva (whose priority review is pending with the USFDA which is likely by April 23 or July 23) is a key hurdle as well. Additionally, it has embarked on adding sales representatives in India by another 1,000; also, the loss of Cidmus brand from Cardio therapy and generalization of gliptins, a part of anti-diabetic portfolio in India has led to slower growth for the India business. Also, some of its facilities like Mandideep unit I facility in Madhya Pradesh has been issued with form-483 while its Tarapur facility has warning letter issued against it since Q2FY23. Even Pune facility has been issued with the form 483 by the USFDA. For Lupin, all these point to likely headwinds to profitable growth in near to medium term.

Valuation - Growth outlook weakens; Downgraded to Reduce with a revised PT of Rs. 660

The US' profitability margins are way below consolidated levels. While Lupin is focusing on growing its specialty complex business in the US, the generic business is expected to take medium to long term to grow with key product launches. Lupin believes that the pricing continues to remain challenging, leading to exits from the US business, among competitors. Some key products in the US such as gSpiriva are still to be launched while it is pending for the USFDA inspection. It has been acquiring into other brands to spruce up its US sales, which on the other side, also leads to increased debt and finance costs. R&D costs are likely to go up on products pipeline in complex generics, respiratory and biosimilar segments. Moreover, its staff costs are likely to inch up due to addition of 1,000 sales representatives in India market while competitive intensity has made its India business also slow down with loss of Cidmus brand and gliptin products becoming off-patent. Given the near-term headwinds, we downgrade our Buy rating on the company to Reduce with a PT of Rs. 660. The stock is trading at a rich valuation of 34.9x/20.8x its FY24-FY25 EPS estimates.

Peer Comparison

Companies	CMP (Rs/ Share)	O/S Shares (Crs)	Mcap (Rs Cr)	P/E (x)			EV / EBITDA (x)			RoE (%)		
				FY23	FY24E	FY25E	FY23	FY24E	FY25E	FY23	FY24E	FY25E
Lupin	737	45.5	33,510	95.4	46.2	26.2	17.5	14.4	9.9	2.9	5.8	9.5
Cipla	1,033.2	80.7	83,379	30.4	24.8	20.8	18.3	15.8	13.2	13.7	14.7	15.2

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 where it is grappling with the issues surrounding high intensity of competition in Oral Solid Dosage (OSD) segment in the US. It has been trying to restructure or optimize the US business and enhance it with the help of launching of complex generics and specialty products in respiratory, injectables and biosimilar segments. However, lower than consolidated EBITDA margins in the US, is restricting its ability to enhance its overall margins to historical levels. This, besides the delay in the key product launches such as that of Spiriva (whose priority review is pending with the USFDA which is likely by April 23 or July 23) is a key hurdle as well. Additionally, it has embarked on adding sales representatives in India by another 1,000; also, the loss of Cidmus brand from Cardio therapy and generalization of gliptins, a part of anti-diabetic portfolio in India has led to slower growth for the India business. Also, some of its facilities like Mandideep unit I facility in Madhya Pradesh has been issued with form 483 while its Tarapur facility has warning letter issued against it since Q2FY23. Even Pune facility has been issued with the form 483 by the USFDA. For Lupin, all these point to likely headwinds to profitable growth in near – medium term.

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 9 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp India	8.23
2	ICICI Prudential Blue-chip Fund	5.58
3	HDFC Trustee Company Ltd.	4.05
4	Nippon Life India Trustee Ltd.	1.85
5	Government Pension Fund Global	1.57
6	NPS Trust - LIC Pension Fund Sch-State Govt	1.30
7	SBI Long Term Equity Fund	1.12
8	HDFC Life Insurance	1.07
9	DSP Tax Saver Fund	1.02

Source: BSE

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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

Sharekhan

by BNP PARIBAS

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