MOTILAL OSWAL

9 May 2013

4QFY13 Results Update | Sector: Healthcare

Lupin

BSE Sensex	S&P CNX
19,990	6,069
Bloomberg	LPC IN
Equity Shares (m)	447.6
M.Cap. (INR b)/(USD b)	324.5/6.0
52-Week Range (INR)	739/507
1,6,12 Rel. Perf. (%)	9/18/13

CMP: INR725 **TP: INR851** **Buy**

4QFY13 performance was above estimates. **Key highlights:**

- Lupin's revenue grew 35% YoY to INR25.37b. Ex one-offs, core revenue grew 38% to INR23.57b (est of INR22.73b). Core EBITDA was up more than 2x to INR5.1b (est of INR4.43b) on a low base of 4QFY12. Ex one-offs, adj PAT was at INR3.36b (est of INR2.6b). PAT growth is higher than EBITDA growth due to lower tax rate of 20.7% v/s estimate of 33% and 45% in 4QFY12.
- Reported EBITDA grew by 83% to INR6.1b (v/s est of INR5.42b) and reported EBITDA margin expanded by 6.4% YoY to 24% on a low base. Margin expansion was mainly on account of (1) contribution from one-off sales, (2) better product mix in the US and (3) lower other expenses and employee costs (operating leverage benefit). Notably, PAT growth, aided by strong operational performance, has been achieved despite higher depreciation costs, which include product write-off for carrying the value of Antara brand.
- **Key takeaways from analyst meet:** LPC aspires to touch USD5b (FY13 - USD1.8b) in sales over the next five years to be achieved through (1) entering niche segments of derma, controlled substances, inhalation; (2) biosimilars opportunity and (3) inorganic opportunities in LatAm, Japan or RoW markets. Lupin has a pipeline of 116 products (market size of USD54b) to support US growth, while India formulations will continue to outperform the industry. Maintained target of 75-100bp YoY improvement in EBITDA margin.

Valuation and view: Key growth drivers in FY14E/15E will be: (1) increased traction in India formulations and emerging markets, (2) strong launch pipeline for the US and (3) contribution from oral contraceptives in the US. Post 4QFY13 results, we raise FY14E/15E estimates by 13%/14%, primarily to reflect the strong operational performance in core business. We expect EPS of INR34.8 for FY14E (up 38.8%), INR42.5 for FY15E (up 22%) - 30% EPS CAGR for FY13-15E. The stock trades at 20.8x FY14E and 17x FY15E EPS. **Buy** with a TP of INR851 (20x FY15E EPS).

Financials & Valuation (INR b)

Y/E March	2013	2014E	2015E
Sales	94.6	109.2	127.2
EBITDA	20.9	23.6	28.2
Net Profit	11.2	15.6	19.0
Adj. EPS (INR)	25.1	34.8	42.5
EPS Gr. (%)	39.8	38.8	22.1
BV/Sh. (INR)	116.3	144.1	177.3
RoE (%)	24.4	26.8	26.5
RoCE (%)	33.3	33.2	33.4
Payout (%)	15.6	19.8	21.7
Valuations			
P/E (x)	28.9	20.8	17.0
P/BV (x)	28.9	20.8	17.0
EV/EBITDA (x)	15.9	13.9	11.5
Div. Yield (%)	0.6	0.8	1.1

Quarterly Performance (Consolidated) (INR Million)

Y/E March	FY12				FY13				FY12	FY13	4QFY13	vs Est
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q			(Incl One-offs)	
Net Sales	15,432	16,448	17,917	18,832	22,192	22,393	24,659	25,374	68,628	94,616	24,536	3.4
YoY Change (%)	17.6	17.1	22.1	23.7	43.8	36.1	37.6	34.7	20.3	37.9	30.3	
Total Expenditure	12,734	13,684	14,134	15,511	17,961	17,848	18,961	19,271	56,062	73,713		
EBITDA	2,698	2,764	3,783	3,321	4,230	4,545	5,698	6,102	12,566	20,903	5,425	12.5
Margins (%)	17.5	16.8	21.1	17.6	19.1	20.3	23.1	24.0	18.3	22.1	22.1	
Depreciation	471	522	576	706	654	690	688	1,290	2,275	3,322		
Interest	58	66	86	145	101	101	77	133	355	410		
Other Income	257	324	-15	489	582	657	617	547	1,056	2,075		
PBT	2,426	2,499	3,106	2,960	4,058	4,412	5,550	5,227	10,992	19,246		
Tax	286	441	701	1,348	1,208	1,438	2,116	1,080	2,776	5,842		
Rate (%)	11.8	17.6	22.6	45.5	29.8	32.6	38.1	20.7	25.3	30.4		
Reported PAT	2,140	2,718	2,406	1,612	2,850	2,974	3,434	4,147	8,875	13,404	3,375	22.9
EO Exp/(Inc)	0	-659	0	0	0	0	0	0	-659	0	0	
Minority Interest	39	49	55	56	46	69	82	66	199	263	53	
Recurring PAT	2,101	2,010	2,498	828	2,098	2,779	2,992	3,360	7,437	11,228	2,600	29.2
YoY Change (%)	7.0	-6.5	11.5	-62.8	-0.1	38.3	19.7	305.6	-13.3	51.0	421.1	
Margins (%)	13.6	12.2	13.9	4.4	9.5	12.4	12.1	13.2	10.8	11.9	11.4	

E: MOSL estimates; Quarterly nos will not add up to full year nos due to restatement of past quarters

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4QFY13 was above estimates - led strong operational performance in base business

Lupin's 4QFY13 revenues grew 34.7% YoY to INR25.37b. Ex one-offs, core revenues have grown 38.5% to INR23.57b (v/s est. of INR22.73b).

Revenue growth was led by a 49% increase in US sales which was aided by new product launches as well as continued uptick in key products like Ziprasidone, Fortamet and Tricor. Domestic formulations grew 35% , while Japan reflected a mere 2% growth impacted by foreign currency (growth in JPY terms was 9%).

Lupin: Revenue mix (INR m)

	4QFY13	4QFY12	% YoY	3QFY13	% QoQ
Formulations	**22,938**	**16,400**	**39.9**	**22,306**	**2.8**
US	**11,463**	**7,698**	**48.9**	**10,390**	**10.3**
US- Base Business**	9,660	5,878	64.3	9,489	1.8
US- One-offs**	1,803	1,820		901	
Europe	660	455	45.1	598	10.4
India	5,659	4,192	35.0	5,708	-0.9
Japan	2,752	2,693	2.2	3,658	-24.8
South Africa	906	705	28.5	831	9.0
RoW	1,498	657	128.0	1,121	33.6
APIs	**2,436**	**2,432**	**0.2**	**2,353**	**3.5**
Total Revenues	**25,374**	**18,832**	**34.7**	**24,659**	**2.9**

** MOSL estimates Source: Company, MOSL

Core EBITDA was also better than estimates

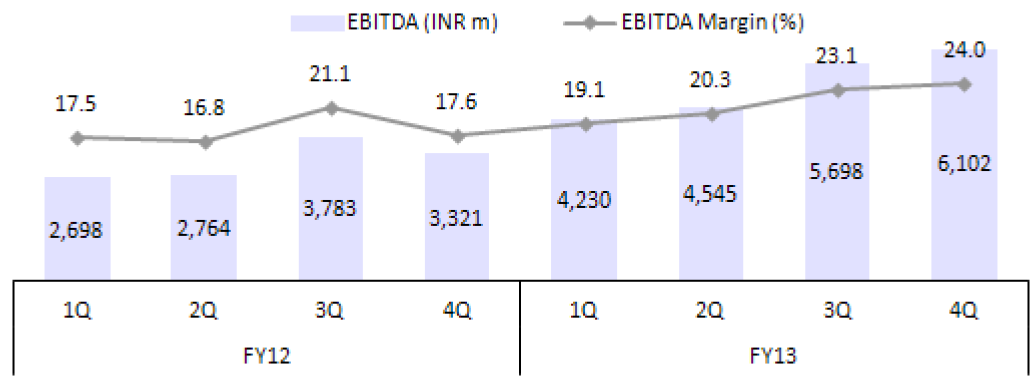
Core EBITDA stood at INR5.1b (v/s estimate of INR4.43b), compared to INR2.41b in 4QFY12. Core EBITDA growth is on a low base of 4QFY12, which was impacted by adverse product mix.

Consequently, core EBITDA margins stood at 21.7% compared to 14.2% last year. We believe LPC has been able to sustain high margins in 2HFY13 on account of better product mix in US and lower other expenses & employee costs (reflecting benefits of the operating leverage).

Ex one-offs, we estimate adj PAT at INR3.36b (est. of INR2.6b). PAT growth is higher than EBITDA growth due to lower tax rate at 20.7% v/s estimate of 33% and 45% in 4QFY12.

Reported EBITDA grew by 83% to INR6.1b (v/s est. of INR5.42b) and reported EBITDA margin expanded by 6.4% YoY to 24% on a low base. Reported PAT stood at INR4.14b (v/s est. INR3.37b) compared to INR1.61b. Notably, PAT growth, aided by strong operational performance, has been achieved despite higher depreciation costs which include product write-off of carrying value of Antara brand.

EBITDA trend

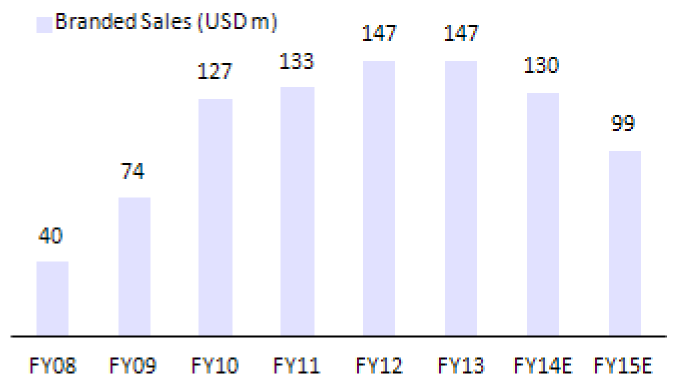


Source: Company, MOSL

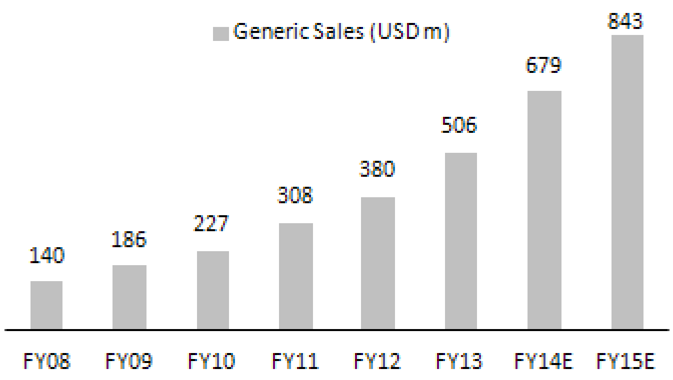
Key takeaways from Analyst Meet

- **Aspires to touch USD5b in sales by FY18:** The company has laid out its aspiration to touch USD5b in sales over the next 5 years. To achieve this target, the company will (1) enter niche product categories of dermatology, controlled substances, inhalation and biosimilars. Growth will also be achieved through inorganic routes, for which the company is open to consider opportunities in LatAm, Japan and fast-growing emerging markets.
- **Strong product pipeline in the US to drive future growth:** LPC has a pipeline of 116 products with an addressable market size of USD54b. This includes 25 FTF opportunities (market size of USD13b), of which 12 are exclusive marketing opportunities (market size of USD1.62b). The management has further indicated of filing 15-20 ANDAs and expects to launch a similar number of products in FY14E (subject to FDA approvals). Growth will also be driven by part-commercialization of oral contraceptive (OC) portfolio and few patent challenge/low-competition opportunities (potential launch of some controlled-release products).
- **Focus on niche opportunities for US market:** LPC has already filed 31 OC products, some Ophthalmology products and one dermatology product.
- **US branded business to face growth challenges:** LPC has commercialized Suprax drops as a part of its strategy to shift prescriptions from Suprax suspension to drops in order to counter any potential generic competition. Currently, the management does not foresee any generic threat to the Suprax franchise for the next one year. We believe the launch of generic Antara by Mylan will impact LPC's future Antara sales and have reduced our revenue estimates for Antara to USD15m/10m for FY14E/15E. This implies growth challenges for the US branded business, considering the threat of future generic competition (modelled in after FY14). To counter this challenge, management is actively pursuing brand acquisitions in the US.
- **India business on strong growth path:** The business grew 35% in 4Q and 24% in FY13. Chronic therapies constitute nearly 60% of the company's portfolio and are expected to improve profitability in the domestic formulations. LPC continues to hold a dominating 45% market share in anti-TB segment and ranks 7th in the anti-diabetic space.

Lupin: US business - Branded Revenues



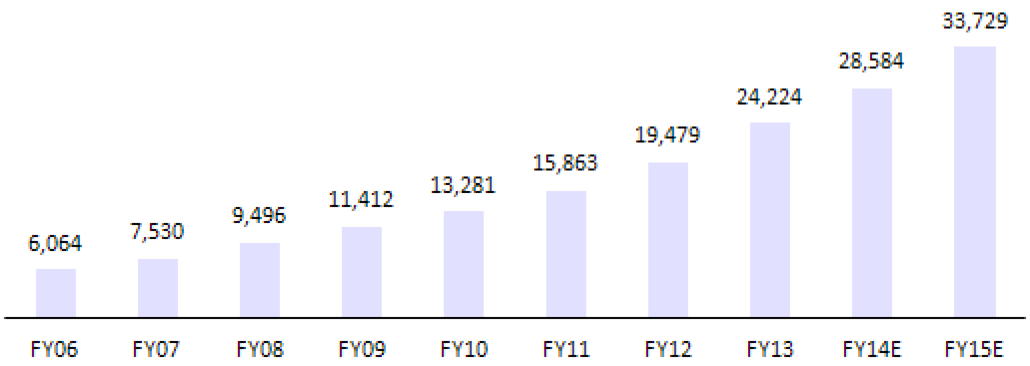
Lupin: US business - Generic Revenues



Note - For generic sales, historic nos include one-offs while estimates exclude them Source: Company, MOSL

- While the management did not give any specific guidance, it had earlier indicated of sustaining growth rates at 18-20% in the Indian formulations business over the coming years.
- We believe that this is achievable and model-in an 18% growth for this business going forward.

Domestic Formulations - Growth traction to sustain (INR m)



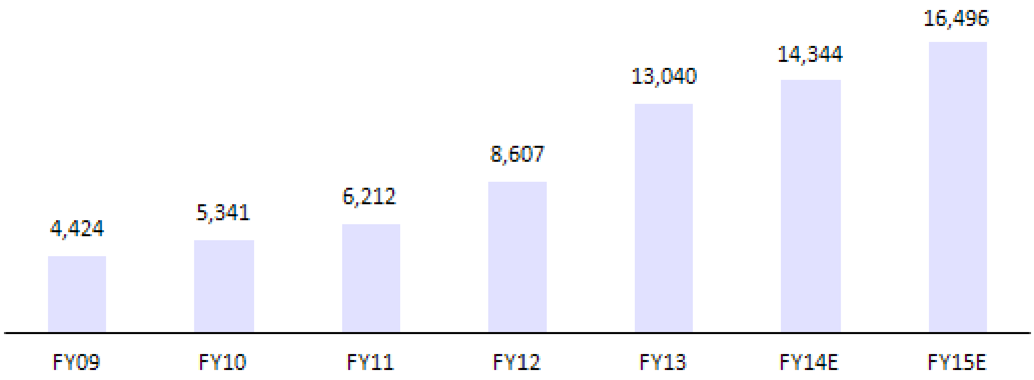
Source: Company, MOSL

Japan business to witness gradual improvement in profitability: Japanese business recorded 52% YoY growth for FY13, while the growth for 4Q was mere 2% (due to currency impact and base effect).

While the FY13 growth has been driven by the I'rom acquisition, new launches by Kyowa and favourable currency, we believe the underlying sustainable growth is ~10-15%.

Lupin is targeting a gradual shift in manufacturing from its Japanese operations to its India facilities. The company has already shifted for 2 formulations and targets to source 10-15% of volumes in Japan from India 18 months from now. This is likely to result in a gradual improvement in profitability of the Japanese operations.

Japan Formulations - To grow in double-digits (INR m)



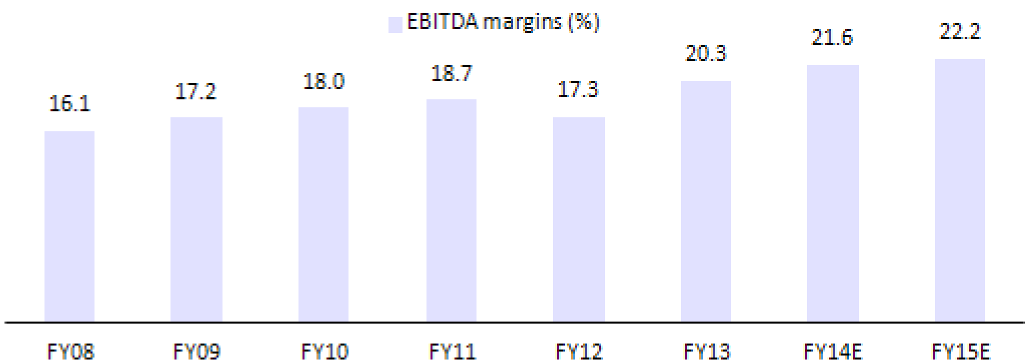
Source: Company, MOSL

- LPC will focus on **biosimilars** as key growth drivers post FY16. The management indicated that there are biosimilar drugs worth USD150b expected to go off-patent after 2016, with each drug on average having addressable market size of USD6-7b. The company has 10 products under development and is looking to partner with MNCs to jointly develop and commercialize these opportunities.
- **R&D expenses** for 4QFY13 stood at INR2b (7.9% of sales) and for FY13 stood at INR7.1b (7.5% of sales). R&D expenses are guided at 7.5-8% of topline going forward.

Maintains target of 75bp-100bp YoY EBITDA margin improvement

- Given the significant increase in staff and other overhead costs, we believe that Lupin's past trend of improving EBITDA margins every year had witnessed a slowdown expansion in FY12. However, the company has reported 300bp YoY expansion in core EBITDA margin in FY13 to 20.3%. Management has indicated this to be on account of benefits of operating leverage.
- The management has maintained its guidance of improving EBITDA margins by 75-100bp YoY. As such, we have built in 200bp core margin expansion over FY13-15E in our estimates.
- Margin improvement will be led by the (1) new launches in the US portfolio, (2) sustained higher growth for India and Japan formulations business, (3) improved utilization at the newly commissioned Indore SEZ and (4) gradual commencement of product supplies to Japan from India.

Sustained improvement in EBITDA margins

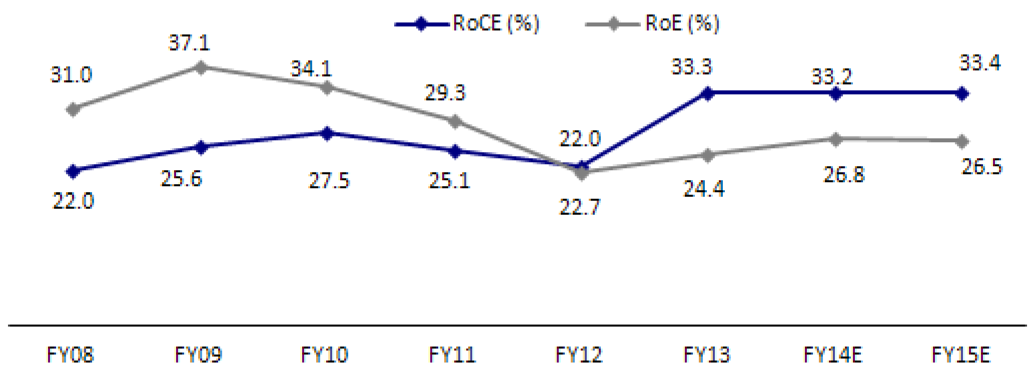


Source: Company, MOSL

Sustaining high return ratios has been one of the key achievements

- Lupin is one of the few Indian generic companies to have achieved a significant scale-up in operations without diluting return ratios.
- The company has consistently maintained high return ratios demonstrating efficient capital allocation.
- We expect Lupin to sustain these high return ratios over the next 2 years as well. Large potential acquisitions could dilute this strong trend although Lupin enjoys a good track on past acquisitions.

Lupin: Sustained growth & better profitability to improve return ratios



Source: Company, MOSL

Valuation and view

Key growth drivers in FY14/15 will be: (1) Increased traction in India formulations and emerging markets, (2) strong launch pipeline for US, and (3) contribution from oral contraceptives in US. Mgmt will focus on getting access to certain high-end technologies, brand buyout and access to front-ends in certain key emerging markets (especially Latam). Significant internationalization of operations without dilution of return ratios has been Lupin's key achievement over the past 5 years. LPC aspires to reach USD3b/USD5b revenues by FY15/FY18. Achieving this target organically could be challenging (implied topline CAGR for FY12-15 will be 25-30%). This would need some M&A. Post 4QFY13 results, we have increased our FY14E/15E estimates by 13%/ 14%, primarily to reflect the strong operational performance in core business. We expect EPS of INR34.8 for FY14 (up 38.8%), INR42.5 for FY14 (up 22%) i.e. 30% EPS CAGR for FY13-15E. The stock trades at 20.8x FY14E and 17x FY15E EPS. We maintain **Buy** with a target price of INR851 (20x FY15 EPS).

Lupin: an investment profile

Company description

Lupin is amongst the larger pharma companies that is actively targeting the regulated generics markets. Historically very strong in the anti-TB segment, it has over the years built up expertise in fermentation-based products and segments like cephalosporins, prils and statins. Lupin is now a fully integrated company, with manufacturing capabilities in APIs and formulations and a direct marketing presence in the target markets.

Key investment arguments

- In the process of building a strong pipeline for the US market through aggressive filings - benefits expected to flow in over the next couple of years.
- Strategy of focusing on niche, low-competition products for the US market likely to benefit in the long run.

Key investment risks

- Imperative to enhance profitability of acquired companies which currently have lower margins.

Recent developments

- Mylan launched its generic version Antara.
- Lupin launched generic Diovan HCT after Mylan's 180-day exclusivity.

Valuation and view

- Valuations at 20.8x FY14E and 17x FY15E EPS with high return ratios.
- Maintain **Buy** with price target of INR851 (20x FY15E EPS).

Sector view

- Regulated markets would remain the key sales and profit drivers in the medium term. Japan is expected to emerge as the next growth driver, particularly for companies with a direct marketing presence.
- We are overweight on companies that are towards the end of the investment phase, with benefits expected to start coming in from the next fiscal.

Comparative valuations

		Lupin	Sun Pharma	DRL
P/E (x)	FY14E	20.8	24.7	17.1
	FY15E	17.0	21.8	15.8
P/BV (x)	FY14E	5.0	4.6	4.0
	FY15E	4.1	4.0	3.7
EV/Sales (x)	FY14E	3.0	5.8	2.9
	FY15E	2.5	4.9	2.6
EV/EBITDA (x)	FY14E	13.9	16.3	14.2
	FY15E	11.5	14.1	12.3

EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY14	34.8	32.4	7.3
FY15	42.5	37.7	12.8

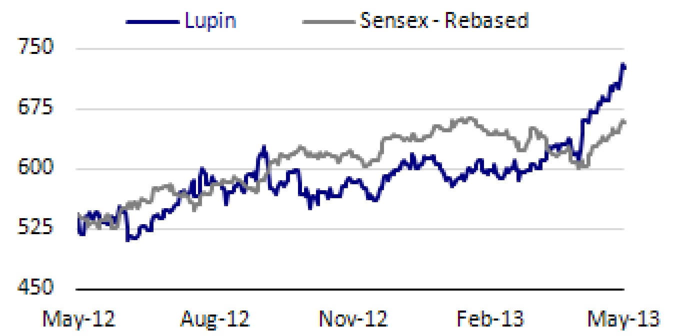
Target Price and Recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
725	851	17.4	Buy

Shareholding pattern (%)

	Mar-13	Dec-12	Mar-12
Promoter	46.8	46.9	46.9
Domestic Inst	14.3	15.6	16.5
Foreign	29.2	28.1	27.7
Others	9.7	9.5	8.9

Stock performance (1 year)



Financials and Valuation

Income Statement				(INR Million)
Y/E March	**2012**	**2013**	**2014E**	**2015E**
Net Sales	**68,628**	**94,616**	**109,161**	**127,191**
Change (%)	20.3	37.9	15.4	16.5
Total Expenditure	56,062	73,713	85,566	98,961
EBITDA	**12,566**	**20,903**	**23,596**	**28,230**
Margin (%)	18.3	22.1	21.6	22.2
Depreciation	2,275	3,322	3,043	3,463
EBIT	10,291	17,581	20,553	24,767
Int. and Finance Charges	355	410	301	272
Other Income - Rec.	1,056	2,075	2,234	2,355
PBT before EO item	10,992	19,246	22,486	26,851
PBT after EO item	**10,992**	**19,246**	**22,486**	**26,851**
Tax	2,776	5,842	6,596	7,518
Tax Rate (%)	25.3	34.0	29.3	28.0
Reported PAT	**9,636**	**13,404**	**15,890**	**19,333**
PAT Adj for EO items	**8,216**	**11,491**	**15,890**	**19,333**
Change (%)	-6.1	39.9	38.3	21.7
Margin (%)	12.0	12.1	14.6	15.2
Less: Minority Interest	199	263	300	300
Adj Net Profit	**8,018**	**11,228**	**15,590**	**19,033**

Consolidated Balance Sheet				(INR Million)
Y/E March	**2012**	**2013**	**2014E**	**2015E**
Equity Share Capital	893	895	895	895
Fully Diluted Equity Capi	893	895	895	895
Other Reserves	39,236	51,147	63,595	78,439
Total Reserves	39,236	51,147	63,595	78,439
Net Worth	**40,129**	**52,042**	**64,490**	**79,334**
Minority Interest	723	595	595	595
Deferred liabilities	1,442	1,632	1,632	1,632
Total Loans	15,542	10,368	10,368	8,368
Capital Employed	**57,836**	**64,637**	**77,086**	**89,929**
Gross Block	36,878	40,467	46,467	52,467
Less: Accum. Deprn.	14,422	17,744	20,786	24,249
Net Fixed Assets	**22,457**	**22,723**	**25,681**	**28,218**
Capital WIP	4,437	5,312	5,312	5,312
Investments	28	21	21	21
Goodwill & Intangibles	5,040	5,073	5,073	5,073
Curr. Assets	**46,911**	**53,556**	**66,802**	**81,906**
Inventory	17,327	19,489	24,015	29,254
Account Receivables	17,318	21,870	25,107	30,526
Cash and Bank Balance	4,025	2,599	6,763	9,407
Others	8,241	9,597	10,916	12,719
Curr. Liability & Prov.	**21,037**	**22,048**	**25,803**	**30,601**
Account Payables	17,750	19,241	21,832	25,438
Provisions	3,287	2,806	3,970	5,162
Net Current Assets	**25,874**	**31,508**	**40,999**	**51,305**
Appl. of Funds	**57,836**	**64,637**	**77,086**	**89,929**

E: MOSL Estimates

Ratios				
Y/E March	**2012**	**2013**	**2014E**	**2015E**
Basic (INR)				
EPS (Fully Diluted)	**18.0**	**25.1**	**34.8**	**42.5**
Cash EPS (Fully Diluted)	23.0	32.5	41.6	50.3
BV/Share	89.8	116.3	144.1	177.3
DPS	3.4	4.0	6.0	8.0
Payout (%)	18.4	15.6	19.8	21.7
Valuation (x)				
P/E (Fully Diluted)		28.9	20.8	17.0
Cash P/E (Fully Diluted)		22.3	17.4	14.4
P/BV		6.2	5.0	4.1
EV/Sales		3.5	3.0	2.5
EV/EBITDA		15.9	13.9	11.5
Dividend Yield (%)		0.6	0.8	1.1
Return Ratios (%)				
RoE	22.0	24.4	26.8	26.5
RoCE	22.7	33.3	33.2	33.4
Working Capital Ratios				
Fixed Asset Turnover (x)	2.2	2.4	2.5	2.6
Debtor (Days)	105	114	111	113
Inventory (Days)	92	75	80	84
Wkg. Capital Turnover (D	138	122	137	147
Leverage Ratio				
Debt/Equity (x)	0.4	0.2	0.2	0.1

Cash Flow Statement				(INR Million)
Y/E March	**2012**	**2013**	**2014E**	**2015E**
Oper. Profit/(Loss) befor	12,566	20,903	23,596	28,230
Interest/Dividends Recd	1,056	2,075	2,234	2,355
Direct Taxes Paid	-2,745	-5,652	-6,596	-7,518
(Inc)/Dec in WC	-5,601	-7,059	-5,328	-7,662
CF from Op. incl EO Exp.	**5,276**	**10,267**	**13,906**	**15,404**
(inc)/dec in FA	-6,909	-4,497	-6,000	-6,000
(Pur)/Sale of Investment	4	7	0	0
CF from Investments	**-6,905**	**-4,489**	**-6,000**	**-6,000**
Change in Net Worth	-333	475	-300	-300
Inc/(Dec) in Debt	3,917	-5,173	0	-2,000
Interest Paid	-355	-410	-301	-272
Dividend Paid	-1,777	-2,095	-3,142	-4,189
CF from Fin. Activity	**1,452**	**-7,203**	**-3,742**	**-6,761**
Inc/Dec of Cash	**-177**	**-1,425**	**4,164**	**2,644**
Add: Beginning Balance	4,201	4,025	2,599	6,763
Closing Balance	**4,024**	**2,599**	**6,763**	**9,407**

N O T E S

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