

BSE SENSEX	S&P CNX	CMP: INR574	TP: INR620	Buy						
18,759	5,705									
Bloomberg	LPC IN									
Equity Shares (m)	446.2									
52-Week Range (INR)	632/410									
1,6,12 Rel. Perf. (%)	-2/-4/12									
M.Cap. (INR b)	256									
M.Cap. (USD b)	4.8									
Year	Net Sales	PAT	EPS	EPS	P/E	P/BV	RoE	RoCE	EV/	EV/
End	(INR m)	(INR m)	(INR)	GR. (%)	(X)	(X)	(%)	(%)	Sales	EBITDA
03/11A	57,068	8,582	19.3	25.9	-	-	29.3	25.1	-	-
03/12A	69,597	8,676	19.4	0.7	29.5	6.4	23.8	24.6	3.8	20.3
03/13E	89,869	10,765	24.1	24.1	23.8	5.3	24.3	28.3	3.0	15.4
03/14E	103,020	13,906	31.1	29.2	18.4	4.4	26.1	28.9	2.6	12.7

Lupin's 2QFY13 performance was above estimates. Key highlights of the results:

- Lupin's (LPC) 2QFY13 revenues grew 36% YoY to INR22.4b. Ex one-offs, core revenues grew 35% to INR22.1b (v/s est of INR20.9b). Core EBITDA grew 58% to INR4.38b (est of INR3.67b). Ex one-offs, we estimate adj PAT growth at 38% YoY to INR2.77b (v/s est of INR2.44b) mainly led by: 1) better revenue growth, 2) lower-than-expected R&D spend and 3) higher other income but partly tempered down by higher tax rate at 32.6%.
- Revenue growth was led by a 51% increase in RoW sales, an 85% increase in Japan sales (mainly led by favourable currency and consolidation of Irom acquisition, excluding which, the underlying growth was 10-11%), and a 36% growth in Europe sales. While reported US sales were up 20%, excluding one-offs and Medicis licensing income, core US sales were up 35% YoY.
- Reported EBITDA grew by 64% to INR4.5b, while reported PAT grew by 9% to INR2.9b. Reported PAT growth was muted despite strong EBITDA growth due to INR881m of one-time licensing income (from Medicis) booked in 2QFY12 and higher tax outgo.

Key growth drivers would 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. Management 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. We expect this to sustain in future. LPC aspires to reach the USD3b revenue mark by FY15. We believe that achieving this target organically could be challenging (as implied top line CAGR for FY12-15 will be 30%); however, this can be achieved through potential acquisitions. We expect an EPS of INR24.1 for FY13 (up 24%) and INR31.1 for FY14 (up 29%) i.e. 27% EPS CAGR for FY12-14. The stock trades at 23.8x FY13E and 18.4x FY14E EPS. **Buy** with a target price of INR620 (20x FY14E EPS).

Quarterly Performance (Consolidated)										(INR Million)		
Y/E March	FY12				FY13				FY12	FY13E	2QFY13	vs Est
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE				(Incl One-offs)
Net Sales	15,432	16,448	17,917	18,832	22,192	22,393	22,566	22,719	69,597	89,869	21,177	5.7
YoY Change (%)	17.6	17.1	22.1	23.7	43.8	36.1	25.9	20.6	22.0	29.1	28.8	
Total Expenditure	12,734	13,684	14,134	15,511	17,961	17,848	18,401	18,254	56,382	72,464	17,338	
EBITDA	2,698	2,764	3,783	3,321	4,230	4,545	4,165	4,465	13,215	17,405	3,838	18.4
Margins (%)	17.5	16.8	21.1	17.6	19.1	20.3	18.5	19.7	19.0	19.4	18.1	
Depreciation	471	522	576	706	654	690	712	736	2,275	2,791		
Interest	58	66	86	145	101	101	113	137	355	451		
Other Income	257	324	-15	489	582	657	500	551	1,376	2,290		
PBT	2,426	2,499	3,106	2,960	4,058	4,412	3,840	4,143	11,961	16,453		
Tax	286	441	701	1,677	1,208	1,438	883	1,078	3,086	4,607		
Rate (%)	11.8	17.6	22.6	56.7	29.8	32.6	23.0	26.0	25.8	28.0		
Reported PAT	2,140	2,718	2,406	1,283	2,850	2,974	2,957	3,066	10,295	11,846	2,618	13.6
Extra-Ordinary Exp/(Inc)	0	-659	0	0	0	0	0	0	659	0	0	
Minority Interest	39	49	55	56	46	69	63	72	199	250	50	
Recurring PAT	2,101	2,010	2,498	499	2,098	2,779	2,895	2,993	8,677	10,765	2,442	13.8
YoY Change (%)	7.0	-6.5	11.5	-77.6	-0.1	38.3	15.9	499.8	1.1	24.1	21.5	
Margins (%)	13.6	12.2	13.9	2.6	9.5	12.4	12.8	13.2	12.5	12.0	11.7	

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

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2QFY13 performance was above estimates - led mainly by lower R&D expenses

Lupin's 2QFY13 revenues grew 36% YoY to INR22.4b. Ex one-offs, core revenues have grown 35% to INR22.1b (v/s estimate of INR20.9b).

The revenue growth was led by a 51% increase in RoW sales, an 85% increase in Japan sales (mainly led by favourable currency and consolidation of Irom acquisition, excluding which, the underlying growth was 10-11%), and a 36% growth in Europe sales. While reported US sales were up 20%, excluding one-offs and Medicis licensing income, core US sales were up 35% YoY.

Lupin: Revenue mix (INR m)

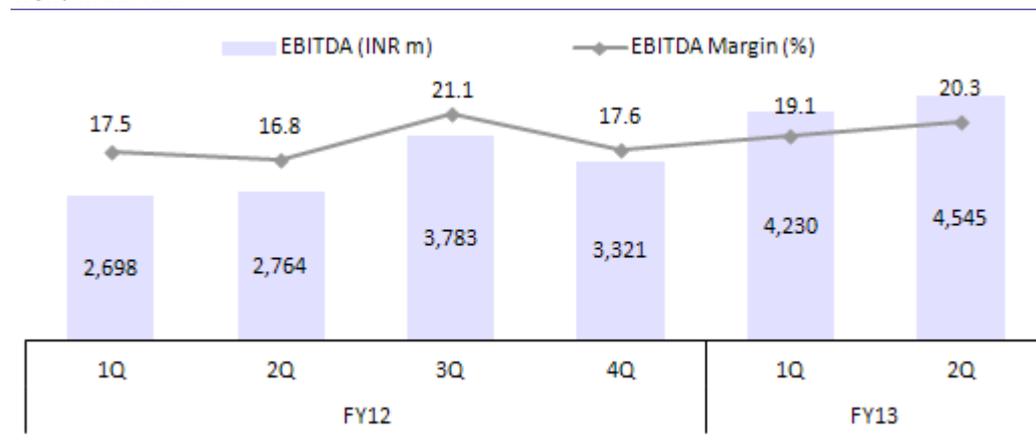
	2QFY13	2QFY12	% YoY	1QFY13	% QoQ
Formulations	20,001	15,441	29.5	19,875	0.6
US	7,818	6,486	20.5	8,024	-2.6
US- Base Business**	7,566	5,605	35.0	6,323	19.7
US- One-offs**	252	881		1,701	-85.2
Europe	626	461	35.8	473	32.3
India	6,064	5,120	18.4	6,212	-2.4
Japan	3,301	1,780	85.4	3,329	-0.8
South Africa	810	679	19.3	663	22.2
RoW	1,382	915	51.0	1,174	17.7
APIs	2,392	1,976	21.1	2,317	3.2
Total Revenues	22,393	17,417	28.6	22,192	0.9

Source: Company, MOSL

EBITDA better than estimates

- Core EBITDA grew 58% to INR4.38b (estimate of INR3.67b). Ex one-offs, we estimate adj PAT growth at 38% YoY to INR2.77b (v/s estimate of INR2.44b) mainly led by: 1) better revenue growth, 2) lower-than-expected R&D spend and 3) higher other income but partly tempered down by significantly higher tax rate at 32.6% (estimate of 24%). Lower R&D expenses were mainly due to reduced litigation and professional expenses.
- Reported EBITDA grew by 64% to INR4.5b, while reported PAT grew by 9% to INR2.9b. Reported PAT growth was muted despite strong EBITDA growth due to INR881m of one-time licensing income (from Medicis) booked in 2QFY12 and higher tax outgo.

Trend in EBITDA

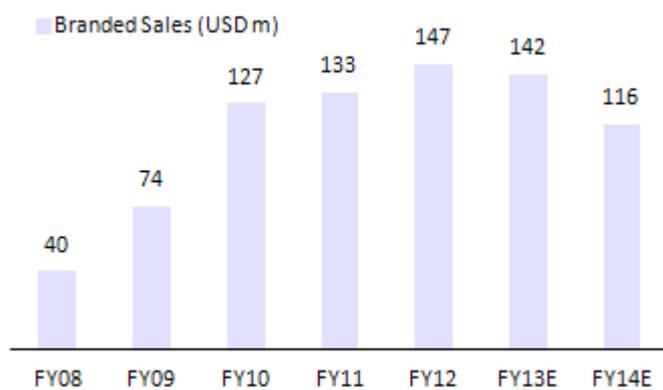


Source: Company, MOSL

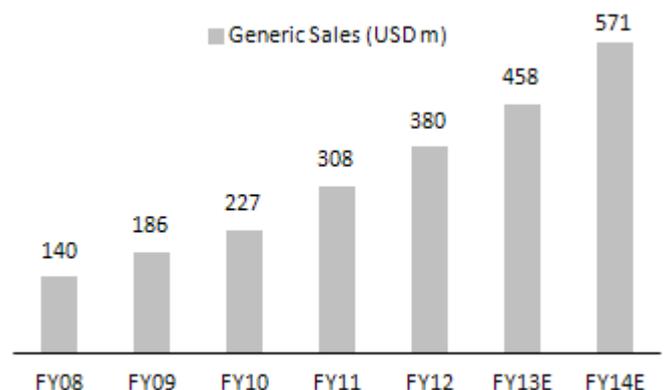
Key takeaways from 2QFY13 concall

- **Management guides for strong traction in the US business** in the coming quarters led by (1) increased pace of new launches (subject to US FDA approvals), (2) part-commercialization of oral contraceptive (OC) portfolio and (3) few patent challenge/low-competition opportunities, including potential launch of some controlled-release products and generic Tricor. It expects 20 new launches in the US for FY13, 25-30 filings and has retained its long-term guidance of launching ~120 products in the US market over the next 3-4 years.
- **Focus on niche opportunities for US market:** Company has already filed 31 OC products, some ophthalmology products and now has commenced filing dermatology products. Of these, it expects the OC pipeline to get fully commercialized by end-FY14, some ophthalmology products to be commercialized in FY14, while upside from dermatology products is still some time away.
- **Patent challenge pipeline** includes potential launch of generic Tricor in FY13. It has already launched generic Geodon in March 2012 with shared exclusivity and re-launched generic Fortamet post a favorable court verdict. We estimate that these two opportunities are likely to have contributed ~USD43m to US sales in 1HFY13.
- **US branded business to face growth challenges:** LPC will be commercializing Suprax drops as a part of its strategy to shift prescriptions from Suprax suspension to drops to counter any potential generic competition for the suspension dosage. Antara brand ramp-up is unlikely given the likelihood of Tricor genericization in the near future. This implies growth challenges for the US branded business, especially considering the threat of generic competition for Suprax (already modelled in). To counter this challenge, management is actively pursuing brand acquisitions in the US.

Lupin: US business - Branded Revenues



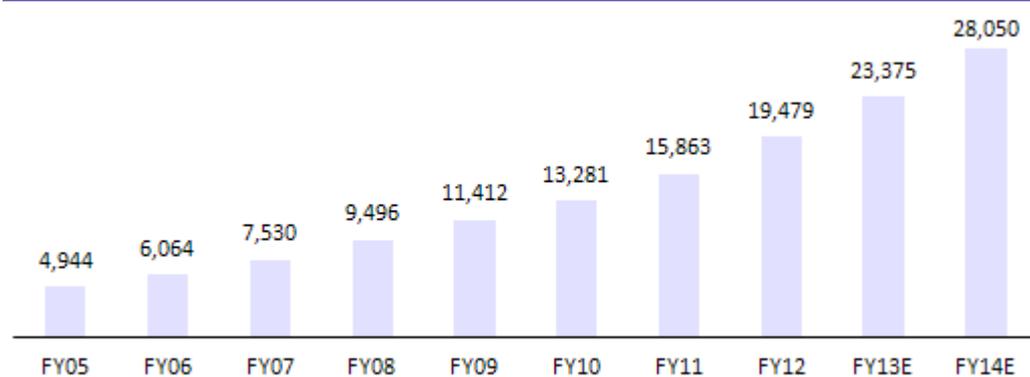
Lupin: US business - Generic Revenues



Note - For generic sales, historic nos include one-offs while estimates exclude them

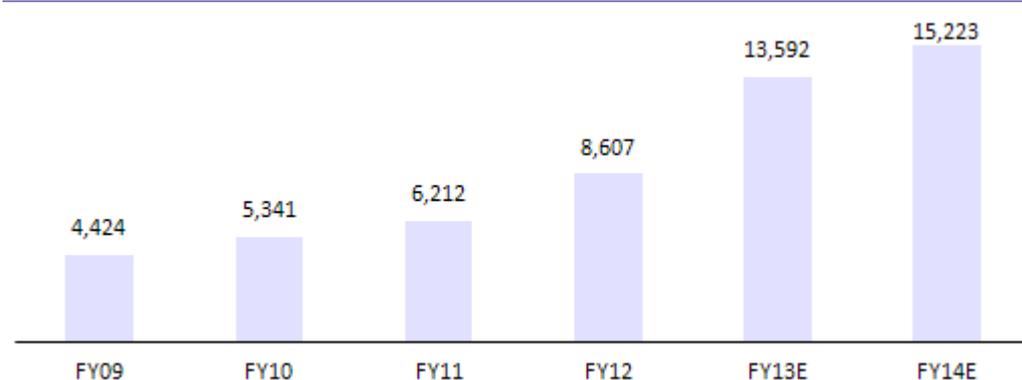
Source: Company, MOSL

- **India business on strong growth path:** Management indicated sustained momentum in India formulations business (which grew 18% in 2Q and 22% in 1HFY13). We believe that this is achievable and model-in a 20% growth for this business for FY13.

Domestic Formulations - Growth traction to sustain (INR m)

Source: Company, MOSL

- **Japan business to witness gradual improvement in profitability:** Company is targeting a gradual shift in manufacturing from its Japanese operations to Indian facilities. The first phase of this has commenced with shifting of 2 APIs, while the second phase will involve shifting of certain formulations. This is likely to result in a gradual improvement in profitability of the Japanese operations. While FY13 growth will be very strong driven by Irom's acquisition and favorable currency, we believe the underlying sustainable growth (excluding the impact of acquisitions) is 10-12%.

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

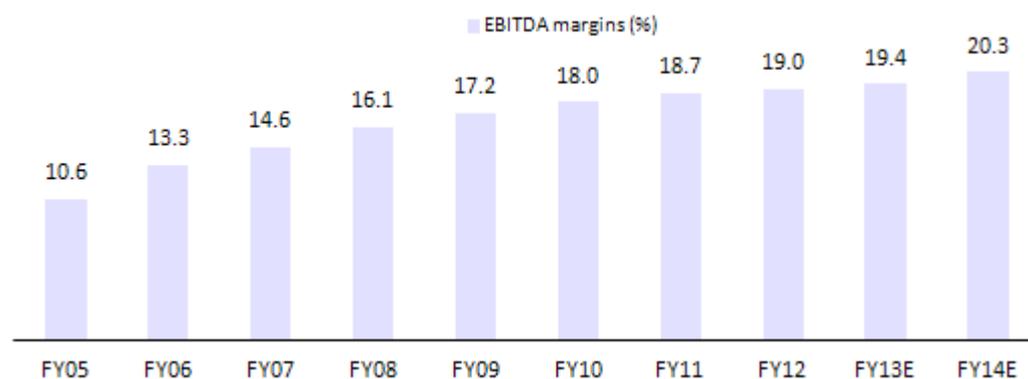
Source: Company, MOSL

- **R&D expenses** - Guidance of 7% of top line for FY13 (v/s previous guidance of 7-8%), implying a perk-up in R&D expenses in 2HFY13 to 8% of sales, compared to 6% reported in 1HFY13.
- **Tax rate** - Management expects the overall tax rate for FY13 at 28% (previous guidance of 25%).

EBITDA margins to improve in FY14

- Given the significant increase in staff and other overhead costs, we believe that company's past trend of improving EBITDA margins every year had witnessed a slower expansion in FY12. However, we estimate that EBITDA margins shall start improving from FY13 and FY14 would be a year of much better EBITDA margins.
- Margin improvement shall be led by the expected recovery of growth in the US portfolio, sustained higher growth for India and Japan formulations business, improved utilization at the newly commissioned Indore SEZ and gradual commencement of product supplies to Japan from India.

Sustained improvement in EBITDA margins - FY14 margins will be much higher

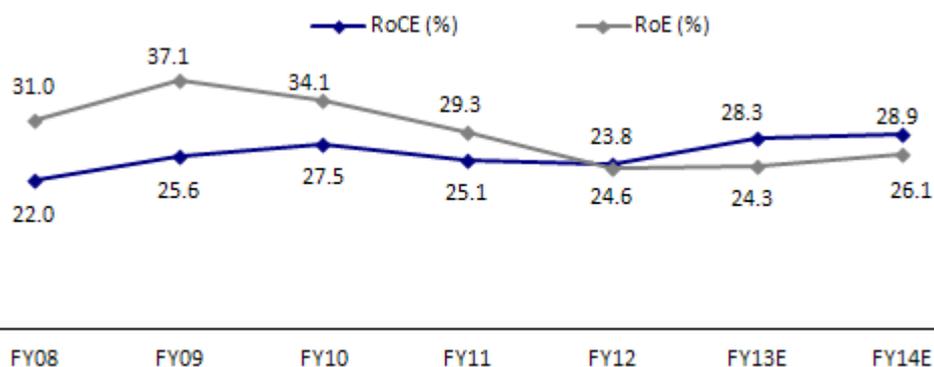


Source: Company, MOSL

Sustaining high return ratios has been one of the key achievements

- LPC is one of the few Indian generic companies to have achieved a significant scale-up in operations without diluting return ratios.
- Company has consistently maintained high return ratios, thus demonstrating efficient capital allocation.
- We expect LPC to sustain these high return ratios over the next 2 years as well. Large potential acquisitions could dilute this strong trend, though the company 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 for future 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. Management would 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 LPC's key achievement over the past 5 years; we expect this to sustain in the future. Company aspires to reach the USD3b revenue mark by FY15. We believe that achieving this target organically could be challenging (as the implied top line CAGR for FY12-15 will be 30%); however, this can be achieved through potential acquisitions. We expect an EPS of INR24.1 for FY13 (up 24%) and INR31.1 for FY14 (up 29%) i.e. 27% EPS CAGR for FY12-14. The stock trades at 23.8x FY13E and 18.4x FY14E EPS. Maintain **Buy** with a target price of INR620 (20x FY14E EPS).

Lupin: an investment profile

Company description

Lupin is among the larger pharmaceutical 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 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

- None.

Valuation and view

- Valuations at 23.8x FY13E and 18.4x FY14E EPS with high return ratios.
- Maintain **Buy** with a target price of INR620 (20x FY14E 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 from the next fiscal.

Comparative valuations

		Lupin	Sun Pharma	DRL
P/E (x)	FY13E	23.8	26.1	19.9
	FY14E	18.4	23.5	16.9
P/BV (x)	FY13E	5.3	5.0	4.4
	FY14E	4.4	4.3	3.8
EV/Sales (x)	FY13E	3.0	6.4	2.9
	FY14E	2.6	5.6	2.7
EV/EBITDA (x)	FY13E	15.4	16.5	14.4
	FY14E	12.7	15.7	12.7

EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY13	24.1	26.4	-8.7
FY14	31.1	31.9	-2.4

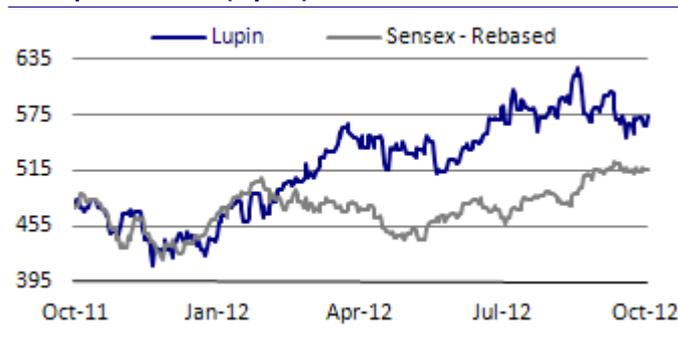
Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
574	620	8.0	Buy

Shareholding pattern (%)

	Sep-12	Jun-12	Sep-11
Promoter	46.9	46.9	46.9
Domestic Inst	15.4	16.1	17.2
Foreign	28.3	28.2	26.3
Others	9.5	8.9	9.6

Stock performance (1 year)



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Lupin

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