MOTILAL OSWAL

27 January 2012

3QFY12 Results Update | Sector: Healthcare

Lupin

BSE SENSEX	S&P CNX
17,077	5,158

Bloomberg	LPC IN
Equity Shares (m)	446.2
52-Week Range (INR)	492/363
1,6,12 Rel. Perf. (%)	2/7/8
M.Cap. (INR b)	205.3
M.Cap. (USD b)	4.1

CMP: INR460 **TP: INR518** **Buy**

Year End	Net Sales (INR m)	PAT (INR m)	EPS (INR)	EPS GR. (%)	P/E (X)	P/BV (X)	RoE (%)	RoCE (%)	EV/ Sales	EV/ EBITDA
03/10A	47,405	6,816	15.3	34.8	-	-	34.1	27.5	-	-
03/11A	57,068	8,582	19.3	25.9	23.8	6.3	29.3	25.1	3.7	20.0
03/12E	67,009	8,818	19.8	2.8	23.2	5.2	24.4	24.2	3.2	17.7
03/13E	82,429	11,527	25.9	30.7	17.7	4.3	26.4	29.5	2.5	13.1

- LPC's 3QFY12 operational performance was above estimates. Revenues grew 22% YoY led mainly by emerging markets formulations including India. EBITDA grew 39% to INR3.78b while EBITDA margins stood at 19.3% led by better product mix. Adj PAT grew 11.5% to INR2.49b (v/s est INR2.34b).
- Core revenues growth was partially led by favourable currency and Irom acquisition. Emerging market formulation exports and domestic formulation revenues reported strong growth. US generic sales grew by 18% while US branded sales has grown by 32.4%. Japanese operations recorded 43% YoY growth.
- Core EBITDA grew by 35%YoY to INR3.65b while core EBITDA margins expanded by 213bps led by favorable currency and better product mix.
- Adjusted PAT grew by only 11.5% at INR2.49b despite a strong operational performance due to higher tax rate at 22% v/s our estimate of 10% and higher than expected depreciation.

Key growth drivers for future will be: (1) Increased traction in India formulations and emerging markets, (2) ramp-up in Japan, and (3) contribution from oral contraceptives and Antara in US. We expect Lupin's core operations (excluding one-off upsides) to record 20% revenue CAGR over FY11-13 despite the likely generic competition for Suprax in US. EBITDA is estimated to record 22% CAGR while EPS is estimated to record 16% CAGR (tempered down by higher tax). We have upgraded our top-line estimates for FY12 and FY13 by 1% and 8% respectively and EBITDA estimates by 2.8% and 14% respectively to reflect the better than expected operational performance. However, we have cut our FY12 and FY13 EPS by 3.8% and 1.5% respectively mainly to factor-in the higher tax guidance (20% tax rate v/s our previous estimate of 15%) and higher than expected depreciation. Based on our revised estimates, we expect EPS of INR19.8 for FY12 (2.8% YoY growth) and INR25.9 for FY13 (up 30.7% YoY). The stock is valued at 23.2x FY12E and 17.7x FY13E core EPS. Maintain **Buy** with TP of INR518 (20x FY13 EPS).

Quarterly Performance (Consolidated) INR Million

Y/E March	FY11				FY12				FY11	FY12E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Net Sales	13,121	14,051	14,672	15,225	15,432	16,448	17,917	17,212	57,068	67,009
YoY Change (%)	20.9	26.0	16.9	18.5	17.6	17.1	22.1	13.1	20.4	17.4
Total Expenditure	10,499	11,353	11,960	12,598	12,734	13,684	14,134	14,461	46,410	55,013
EBITDA	2,622	2,698	2,712	2,627	2,698	2,764	3,783	2,751	10,659	11,996
Margins (%)	20.0	19.2	18.5	17.3	17.5	16.8	21.1	16.0	18.7	17.9
Depreciation	401	435	413	507	471	522	576	607	1,755	2,177
Interest	82	88	78	78	58	66	86	94	325	304
Other Income	230	303	294	514	257	324	-15	803	1,341	1,369
PBT	2,370	2,478	2,516	2,556	2,426	2,499	3,106	2,853	9,920	10,885
Tax	350	271	237	312	286	441	701	439	1,169	1,867
Rate (%)	14.7	10.9	9.4	12.2	11.8	17.6	22.6	15.4	11.8	17.2
Reported PAT	2,020	2,207	2,278	2,245	2,140	2,718	2,406	2,498	8,750	9,794
Extra-Ordinary Exp/(Inc)	0	0	0	0	0	-659	0	0	0	659
Minority Interest	57	57	38	16	39	49	55	57	168	200
Recurring PAT	1,963	2,150	2,240	2,229	2,101	2,010	2,498	2,357	8,582	8,818
YoY Change (%)	40.1	34.1	39.5	1.1	7.0	-6.5	11.5	5.8	25.9	2.8
Margins (%)	15.0	15.3	15.3	14.6	13.6	12.2	13.9	13.7	15.0	13.2

E: MOSL Estimates

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Emerging markets, Japan lead the growth

LPC's 3QFY12 operational performance was above estimates. Revenues grew 22% YoY led mainly by emerging markets formulations including India. EBITDA grew 39% to INR3.78b while EBITDA margins stood at 19.3% led by better product mix. Adj PAT grew 11.5% to INR2.49b (v/s est INR2.34b).

Core revenues (excluding Fortamet) growth was partially led by favourable currency and addition of ~USD6m to topline from the Irom acquisition made in Dec-2011. Emerging market formulation exports grew by robust 42%YoY while domestic formulation (DF) revenue reported growth of 30%YoY on the back of strong growth in CVS, Anti-diabetic, Gynecology and anti-infective segment. Growth in DF revenues was also partly boosted by LPC's co-marketing arrangement with Eli Lilly for insulin. US generic sales grew by 18% (9% growth in USD-terms) while US branded sales has grown by 32.4% (18% growth in USD-terms). Japanese operations recorded 43% YoY growth to INR2.47b partly led by favourable currency and inclusion of one month of sales of Irom.

Sales mix (INR m)

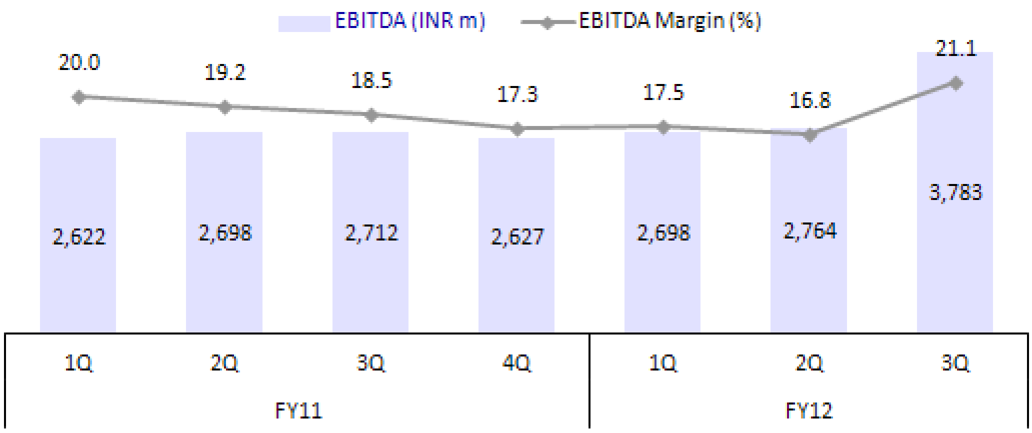
	3QFY12	3QFY11	YoY (%)	2QFY12	QoQ (%)
Total India Sales	**5,554**	**4,873**	**14.0**	**5,399**	**2.9**
% of sales	31.0	33.2		32.8	
APIs	356	868	-58.9	279	27.6
Formulations	5,198	4,005	29.8	5,120	1.5
Total Regulated Market Sales	**9,435**	**7,513**	**25.6**	**7,910**	**19.3**
% of sales	52.7	51.2		48.1	
APIs**	135	131	2.5	149	-9.8
Formulations	9,300	7,382	26.0	7,761	19.8
Total Un-regulated Market Sales	**2,929**	**2,291**	**27.8**	**3,138**	**-6.7**
% of sales	16.3	15.6		19.1	
APIs**	1,490	1,280	16.4	1,547	-3.7
Formulations	1,439	1,011	42.3	1,591	-9.6
Others**	0	0		0	
Gross Sales	**17,918**	**14,677**	**22.1**	**16,448**	**8.9**

** MOSL estimates Source: Company/MOSL

EBITDA above estimates led by better product mix and favourable currency

EBITDA grew by 39%YoY to INR3.78b. Core EBITDA grew by 35%YoY to INR3.65b while core EBITDA margins expanded by 213bps led by favorable currency and better product mix. Adjusted PAT grew by only 11.5% at INR2.49b (compared to our estimate of INR2.34b) despite a strong operational performance due to higher tax rate at 22% v/s our estimate of 10% and higher than expected depreciation.

Trend in EBITDA margins

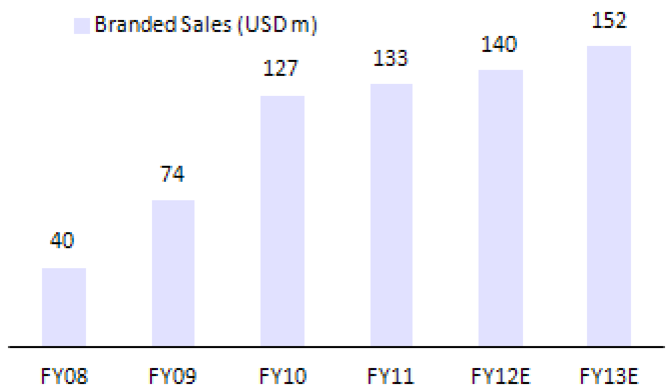


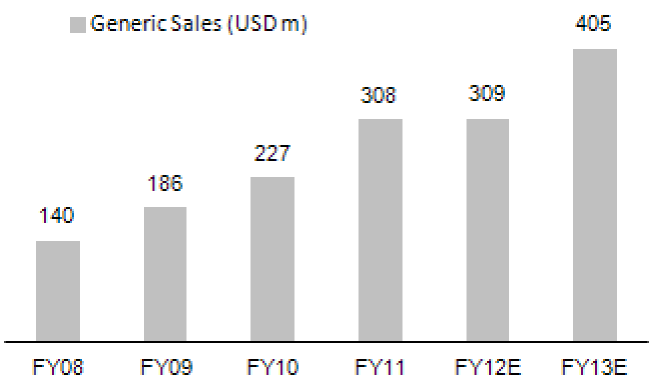
Source: Company/MOSL

Niche/patent challenge product launches in US to continue

Lupin has differentiated itself from other generic companies by launching at least one low-competition product in the US every year for the past few years. We believe this trend is likely to continue given the launch of 2-3 such products for FY12E (Fortamet, Femcon & Geodon) and commercialization of its oral contraceptive and ophthalmology products from FY13/14. Lupin has already made 25-30 filings in the oral contraceptive (OC) segment as a part of its strategy to exploit niche and low-competition segments. To further strengthen this portfolio, the company is planning to file products in the Ophthalmology and Dermatology segments in FY12. Overall, the company has a strong pipeline of 95 ANDAs pending approval of which 19 are FTFs with 4 likely to be granted sole 180-day exclusivity while the remaining are eligible for shared 180-day exclusivity. Management has guided for 25 new launches in the US for FY13 including 10 OCs.

Lupin: US business ramp-up





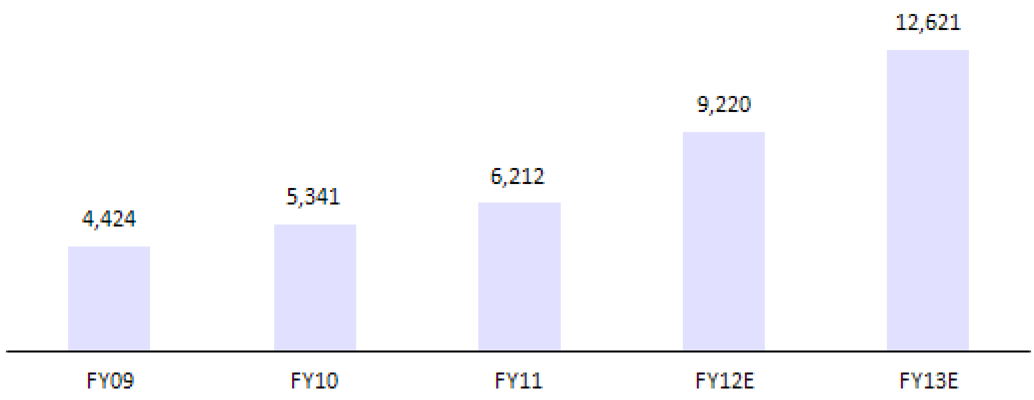
Note - For generic sales, historic nos include one-offs while estimates exclude them

Source: Company/MOSL

Better positioned to exploit the Japanese market

Given its entry in the Japanese generic market through the Kyowa acquisition (in FY08), Lupin is better positioned to exploit the emerging opportunity of this market as compared to many of its peers. It has recorded 18% CAGR in Japan revenues for FY09-11 led mainly by new launches and volume growth despite the price reductions mandated by the government in FY11. The company expects to launch ~6-7 new products in Japan for FY12E as well, of which, it has already launched 4 products in 1HFY12. We model 43% CAGR for Lupin's Japanese business over FY11-13 mainly led by the consolidation of the Irom acquisition (annual revenues of USD 75m) wef Dec-2011 onwards. Excluding Irom, Japan business is expected to record 18-19% CAGR over FY11-13.

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

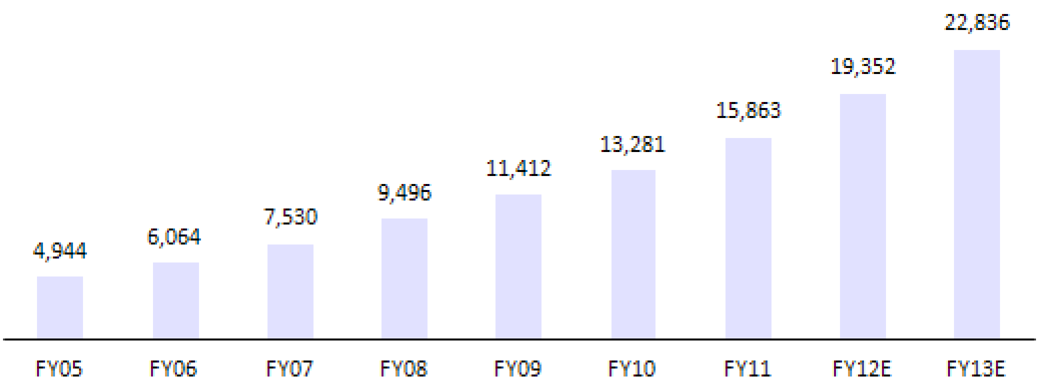


Source: Company/MOSL

Traction in domestic formulations to continue

Lupin has been driving strong growth in its domestic formulations business in the past three years (18% revenue CAGR for FY09-11) led mainly by entry into new therapeutic segments, expansion of field force and gradually increasing penetration in tier-II towns and rural areas. These initiatives have been supported by aggressive pace of new launches - about 40-50 products/line-extensions per year. The company expects to continue with this pace of new launches and has guided for sustaining growth momentum in the coming years as well. It has recorded 23% growth in this portfolio in 9MFY12 and management expects to sustain ~20%+ growth momentum in the coming years. We model 20% CAGR over FY11-13.

Domestic Formulations - Growth traction to sustain (INR m)

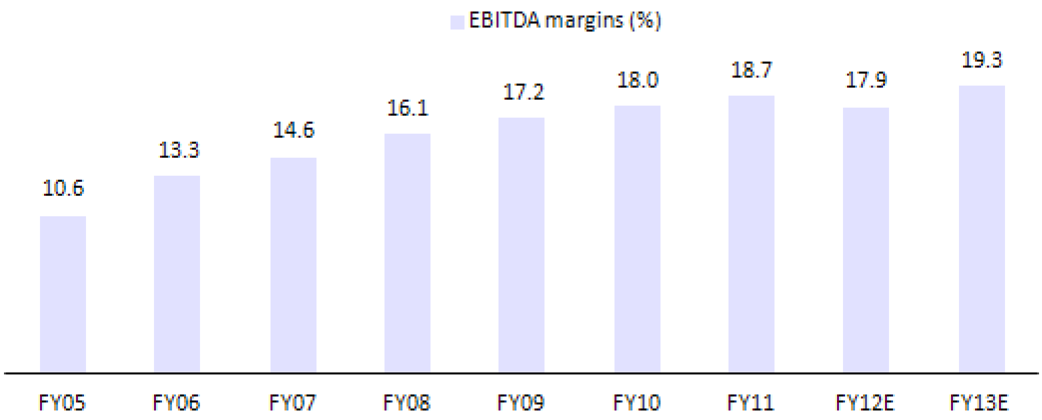


Source: Company/MOSL

EBITDA margins under pressure in FY12; to improve in FY13

Given the significant increase in staff and other overhead costs, we believe that Lupin's past trend of improving EBITDA margins every year will see a blip in FY12. However, we estimate that EBITDA margins will start improving from FY13 onwards. Margin improvement will 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 - FY12 margins will be adversely impacted



Source: Company/MOSL

Valuation and view

Key growth drivers for future will be: (1) Increased traction in India formulations and emerging markets, (2) ramp-up in Japan, and (3) contribution from oral contraceptives and Antara in US. We expect Lupin's core operations (excluding one-off upsides) to record 20% revenue CAGR over FY11-13 despite the likely generic competition for Suprax in US. EBITDA is estimated to record 22% CAGR while EPS is estimated to record 16% CAGR (tempered down by higher tax). We have upgraded our top-line estimates for FY12 and FY13 by 1% and 8% respectively and EBITDA estimates by 2.8% and 14% respectively to reflect the better than expected operational performance. However, we have cut our FY12 and FY13 EPS by 3.8% and 1.5% respectively mainly to factor-in the higher tax guidance (20% tax rate v/s our previous estimate of 15%) and higher than expected depreciation. Based on our revised estimates, we expect EPS of INR19.8 for FY12 (2.8% YoY growth) and INR25.9 for FY13 (up 30.7% YoY). The stock is valued at 23.2x FY12E and 17.7x FY13E core EPS. Our estimates do not include one-time upsides from the company's Para-IV pipeline. Maintain **Buy** with TP of INR518 (20x FY13 EPS).

Lupin: an investment profile

Company description

Lupin is one of the second tier 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

- Acquisition of I'rom in Japan thereby entering Japanese injectable space.

Valuation and view

- Based on our revised estimates, we expect EPS of INR19.8 for FY12 (2.8% YoY growth) and INR25.9 for FY13 (up 30.7% YoY). The stock is valued at 23.2x FY12E and 17.7x FY13E core EPS.
- Maintain **Buy** with price target of INR518 (20x FY13E 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)	FY12E	23.2	26.5	21.6
	FY13E	17.7	22.9	19.2
P/BV (x)	FY12E	5.2	4.8	5.3
	FY13E	4.3	4.2	4.7
EV/Sales (x)	FY12E	3.2	8.7	3.5
	FY13E	2.5	6.8	3.2
EV/EBITDA (x)	FY12E	17.7	25.1	17.7
	FY13E	13.1	18.3	15.6

EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY12	19.8	21.8	-9.3
FY13	25.9	27.0	-4.1

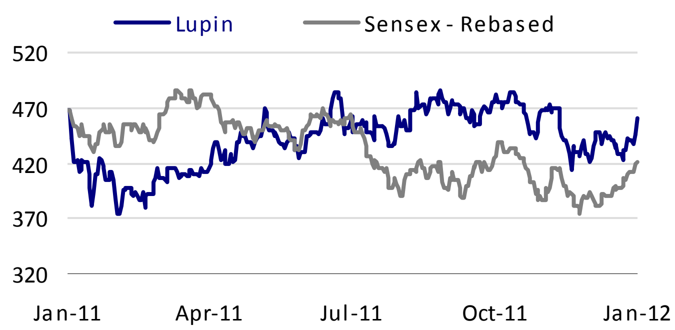
Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
460	518	12.6	Buy

Shareholding pattern (%)

	Dec-11	Sep-11	Dec-10
Promoter	46.9	46.9	47.0
Domestic Inst	17.2	17.2	18.7
Foreign	26.4	26.3	23.5
Others	9.5	9.6	10.8

Stock performance (1 year)



Financials and Valuation

Income Statement					(INR Million)
Y/E March	2009	2010	2011	2012E	2013E
Net Sales	**37,759**	**47,405**	**57,068**	**67,009**	**82,429**
Change (%)	39.5	25.5	20.4	17.4	23.0
Total Expenditure	31,274	38,869	46,410	55,013	66,481
EBITDA	**6,485**	**8,536**	**10,659**	**11,996**	**15,948**
Margin (%)	17.2	18.0	18.7	17.9	19.3
Depreciation	880	1,239	1,755	2,177	2,485
EBIT	5,605	7,297	8,903	9,819	13,462
Int. and Finance Charg	499	385	325	304	207
Other Income - Rec.	954	1,445	1,341	1,369	1,490
PBT before EO item	6,060	8,357	9,920	10,885	14,746
PBT after EO item	**6,060**	**8,357**	**9,920**	**10,885**	**14,746**
Tax	983	1,360	1,169	1,867	2,949
Tax Rate (%)	16.2	16.3	11.8	20.0	20.0
Reported PAT	**5,077**	**6,997**	**8,750**	**9,794**	**11,797**
PAT Adj for EO items	**5,077**	**6,997**	**8,750**	**9,018**	**11,797**
Change (%)	52.2	37.8	25.1	3.1	30.8
Margin (%)	13.4	14.8	15.3	13.5	14.3
Less: Minority Interest	62	180	168	200	270
Adj Net Profit	**5,015**	**6,816**	**8,582**	**8,818**	**11,527**

Consolidated Balance Sheet					(INR Million)
Y/E March	2009	2010	2011	2012E	2013E
Equity Share Capital	828	889	892	893	893
Fully Diluted Equity Ca	882	889	889	889	889
Other Reserves	13,420	24,789	31,918	38,623	46,779
Total Reserves	13,420	24,789	31,918	38,623	46,779
Net Worth	**14,248**	**25,678**	**32,811**	**39,516**	**47,672**
Minority Interest	143	255	515	685	685
Deferred liabilities	1,164	1,435	1,411	1,411	1,411
Total Loans	12,233	11,399	11,624	8,624	5,624
Capital Employed	**27,788**	**38,767**	**46,361**	**50,237**	**55,392**
Gross Block	18,200	22,937	26,389	30,889	35,389
Less: Accum. Deprn.	6,188	7,072	9,075	11,252	13,737
Net Fixed Assets	**12,012**	**15,865**	**17,313**	**19,637**	**21,651**
Capital WIP	2,240	3,579	5,312	5,312	5,312
Investments	216	264	32	32	32
Goodwill & Intangible	3,174	3,197	3,255	3,430	3,430
Curr. Assets	**23,478**	**27,755**	**34,967**	**40,542**	**47,080**
Inventory	9,572	9,715	12,000	15,412	18,134
Account Receivables	10,349	11,266	12,558	16,082	18,959
Cash and Bank Balanc	778	2,015	4,201	1,677	1,745
Others	2,780	4,759	6,208	7,371	8,243
Curr. Liability & Prov.	**13,331**	**11,893**	**14,518**	**18,716**	**22,114**
Account Payables	11,504	9,649	11,800	15,412	18,134
Provisions	1,827	2,243	2,718	3,304	3,979
Net Current Assets	**10,147**	**15,862**	**20,449**	**21,826**	**24,967**
Appl. of Funds	**27,788**	**38,767**	**46,361**	**50,237**	**55,392**

E: MOSL Estimates

Ratios					
Y/E March	2009	2010	2011	2012E	2013E
Basic (INR)					
EPS (Fully Diluted)	**11.4**	**15.3**	**19.3**	**19.8**	**25.9**
Cash EPS (Fully Dilutec	13.4	18.1	23.2	24.7	31.5
BV/Share	34.4	57.7	73.5	88.5	106.8
DPS	2.5	2.8	3.2	5.3	6.5
Payout (%)	24.3	21.2	18.9	28.3	28.6
Valuation (x)					
P/E (Fully Diluted)			23.8	23.2	17.7
Cash P/E (Fully Diluted)			19.8	18.6	14.6
P/BV			6.3	5.2	4.3
EV/Sales			3.7	3.2	2.5
EV/EBITDA			20.0	17.7	13.1
Dividend Yield (%)			0.7	1.2	1.4
Return Ratios (%)					
RoE	37.1	34.1	29.3	24.4	26.4
RoCE	25.6	27.5	25.1	24.2	29.5
Working Capital Ratios					
Fixed Asset Turnover (x	2.3	2.3	2.3	2.3	2.5
Debtor (Days)	99	90	87	98	98
Inventory (Days)	93	75	77	84	80
Wkg. Capital Turnover	98	122	131	119	111
Leverage Ratio					
Debt/Equity (x)	0.9	0.4	0.4	0.2	0.1

Cash Flow Statement					(INR Million)
Y/E March	2009	2010	2011	2012E	2013E
Oper. Profit/(Loss) befo	6,485	8,536	10,659	11,996	15,948
Interest/Dividends Re	954	1,445	1,341	1,369	1,490
Direct Taxes Paid	-925	-1,090	-1,193	-1,867	-2,949
(Inc)/Dec in WC	860	-4,478	-2,401	-3,901	-3,073
CF from Op. incl EO Exp.	**7,374**	**4,414**	**8,405**	**7,597**	**11,416**
(inc)/dec in FA	-4,007	-6,454	-4,996	-3,899	-4,500
(Pur)/Sale of Investme	-1,520	-49	233	0	0
CF from Investments	**-5,527**	**-6,503**	**-4,763**	**-3,899**	**-4,500**
Change in Net Worth	-2,281	6,029	300	-147	-270
Inc/(Dec) in Debt	204	-834	226	-3,000	-3,000
Interest Paid	-499	-385	-325	-304	-207
Dividend Paid	-1,235	-1,483	-1,658	-2,772	-3,372
CF from Fin. Activity	**-3,811**	**3,327**	**-1,457**	**-6,223**	**-6,848**
Inc/Dec of Cash	**-1,964**	**1,238**	**2,186**	**-2,525**	**68**
Add: Beginning Balanc	2,742	778	2,015	4,201	1,677
Closing Balance	**778**	**2,015**	**4,201**	**1,676**	**1,745**

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3. Broking relationship with company covered	No
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