

HOLD

TP: Rs 700 | ▼ 3%

LUPIN

| Pharmaceuticals

| 11 November 2022

Return to double-digit margins

- Q2 revenue grew 11% QoQ (+1% YoY) with recovery in US business and continued momentum in India
- EBITDA margin returned to double digits (10.5%), rising 610bps QoQ; gross margin rose 170bps
- We adjust FY23/FY24 EBITDA -8%/+5% and raise our target EV/EBITDA to 11x, yielding a new TP of Rs 700 (vs. Rs 600); upgrade to HOLD

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Recovery in US business drives sequential growth: LPC reported sequential revenue growth of 11% to Rs 41.5bn (flat YoY) in Q2FY23, primarily on account of a bounce-back in US business. US revenue grew 31% QoQ to US\$ 159mn supported by higher contribution from the complex and respiratory franchise, optimisation of oral solid dosage forms and new product launches including gSuprep. Contribution from respiratory products increased with market share gains in Albuterol Sulfate (to 21.3%).

India growth muted: LPC's India growth was subdued at 6% QoQ (+3% YoY) due to loss of exclusivity in the diabetes (genericisation of gliptins) and cardiovascular therapy areas. Therapies such as cardiac, gastrointestinal, anti-tuberculosis and gynaecology registered double-digit growth YoY. The company launched six brands in Q2FY23. Also, management expects growth momentum in India to accelerate given field force expansion by 850 market representatives (~15% of the existing force) by the year end.

EBITDA margin guided at 16-17%: EBITDA margin regained double-digit territory at 10.5% (+610bps QoQ) after three weak quarters, backed by sequential improvement in gross margin and cost optimisation measures. Gross margin rose 170bps QoQ to 58.7% (-155bps YoY) on the back of higher sequential sales, limited US price erosion (single-digit), a better product mix, benefits from cost control and the presence of a one-time shelf stock adjustment in the previous quarter.

Margins were further aided by a higher contribution from the respiratory franchise and new products. Management has guided for a 16-17% EBITDA margin in FY23 aided by continued cost discipline and significant launches such as gSpiriva.

Upgrade to HOLD: We have a new TP of Rs 700 (vs. Rs 600) as we adjust FY23/FY24 EBITDA estimates by -8%/+5% to bake in the H1FY23 margin trend and raise our target FY24E EV/EBITDA multiple to 11x (implied 22x P/E) from 10x as LPC is rebounding from three quarters of weak margins. Our multiple is at 10% discount to the stock's 1Y forward EV/EBITDA considering continued regulatory impediments and near-term operational and industry challenges; upgrade from SELL to HOLD.

Key changes

Target	Rating
▲	▲

Ticker/Price	LPC IN/Rs 719
Market cap	US\$ 4.0bn
Free float	53%
3M ADV	US\$ 11.7mn
52wk high/low	Rs 972/Rs 583
Promoter/FPI/DII	47%/16%/24%

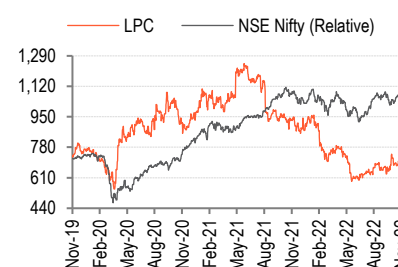
Source: NSE | Price as of 10 Nov 2022

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	1,64,056	1,64,389	1,85,588
EBITDA (Rs mn)	21,657	20,257	30,543
Adj. net profit (Rs mn)	10,581	7,615	14,580
Adj. EPS (Rs)	23.4	16.8	32.2
Consensus EPS (Rs)	23.4	17.6	33.1
Adj. ROAE (%)	8.1	6.1	11.1
Adj. P/E (x)	30.8	42.7	22.3
EV/EBITDA (x)	14.7	16.3	11.3
Adj. EPS growth (%)	(13.0)	(28.0)	91.5

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	H1FY23	H1FY22	YoY (%)
Net Sales	41,455	40,913	1.3	37,438	10.7	78,894	83,615	(5.6)
EBITDA	4,342	5,883	(26.2)	1,639	164.8	5,981	15,159	(60.5)
Depreciation	2,035	2,116	(3.9)	1,928	5.5	3,963	4,204	-
EBIT	2,307	3,767	(38.8)	(289)	(898.5)	2,018	10,955	(81.6)
Interest	549	344	59.4	428	-	977	679	-
Other Income	338	728	(53.6)	739	-	1,077	1,378	-
PBT	2,096	4,150	(49.5)	23	9132.6	2,119	11,654	(81.8)
Less: Taxation	751	(1,099)	-	891	-	1,642	924	-
Less: Minority Interest	47	32	-	23	-	70	87	-
Recurring PAT	1,297	5,218	(75.1)	(891)	(245.6)	407	10,643	(96.2)
Exceptional items	0	(26,198)	-	0	-	0	(26,198)	-
Reported PAT	1,297	(20,980)	(106.2)	(891)	(245.6)	407	(15,556)	(102.6)
Key Ratios (%)			(bps)		(bps)			(bps)
Gross Margin	58.7	60.2	(156)	57.0	168	57.9	62.3	(439)
EBITDA Margin	10.5	14.4	(391)	4.4	609	7.6	18.1	(1055)
Tax / PBT	36	(26.5)	-	3,924.7	-	77.5	7.9	-
NPM	3.1	12.8	-	(2.4)	-	0.5	12.7	-
EPS	2.9	11.5	-	(2.0)	-	0.9	23.4	-

Source: Company, BOBCAPS Research

Fig 2 – Segmental mix

(Rs mn)	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	H1FY23	H1FY22	YoY (%)
Formulations	38,413	37,356	2.8	33,489	14.7	71,902	73,537	(2.2)
North America	13,295	14,291	(7.0)	10,104	31.6	23,399	27,621	(15.3)
India	15,841	15,435	2.6	14,920	6.2	30,761	31,797	(3.3)
Growth Markets	4,449	3,490	27.5	4,237	5.0	8,686	6,818	-
EMEA	3,842	3,484	10.3	3,335	15.2	7,177	6,097	17.7
RoW	986	656	50.3	893	10.4	1,879	1,204	56.1
APIs	2,499	2,678	(6.7)	2,551	(2.0)	5,050	5,137	(1.7)
Licensing Income	-	-	-	0	-	-	3,734	-
Other Operating income	543	879	(38.2)	1,398	(61.2)	1,942	1,207	60.9
Net Sales	41,455	40,913	1.3	37,438	10.7	78,894	83,615	(5.6)
USDINR	83.4	77.6	7.5	83.2	0.2	83.3	75.7	10.1
US revenue (US\$ mn)	159	184	(13.4)	121	31.3	281	365	(23.1)

Source: Company, BOBCAPS Research

Earnings call highlights

- **India:** LPC's India revenue growth YoY has been in single digits during Q1FY23/H1FY23 due to the loss of exclusivity and certain sales in the diabetes (genericisation of gliptins). Therapies such as cardiac, gastrointestinal, anti-tuberculosis and gynaecology registered double-digit growth YoY. The company launched six brands in Q2FY23.
- **North America:** US revenue bounced back with the optimisation of oral solid dosage forms, growth in complex generics, higher contribution from the respiratory franchise and product launches. gSuprep being a recent introduction into the market (Sep'22), management expects gSuprep's contribution to rise going forward. LPC's Albuterol generic market share increased to 21.3%.
 - **New launches:** LPC launched three products in Q2 – Devenlafaxine (gPristiq); Sildenafil OS (gRevatio) and Sodium Sulfate; and Potassium Sulfate & Magnesium Sulfate Oral Solution (gSuprep). It now has a total of 168 generic products marketed in the US.
 - **Sunovion product acquisition:** The company acquired two inhalation brands from Sunovion for US\$ 75mn recently – gBrovana (arformoterol tartrate) and Xopenex HFA (levalbuterol tartrate), which it expects will be EPS-accretive from the first year. Both brands currently have the similar market size, but management expects increased competition in gBrovana.
 - **US pipeline:** LPC has 162 products pending approval. The US pipeline has 54 FTFs (first to file), including 20 exclusive FTFs awaiting USFDA approval such as gSpiriva, gNascobal nasal spray and Diazepam gel. Despite competition, gSpiriva is still a ~US\$ 1bn product and LPC expects it to contribute significantly over FY24-FY25. From a supply-side perspective, the company is ready for launch and close to approval. The priority review has been filed and LPC expects a target action date (TAD) in November. Approved products in the pipeline include Darunavir tablets, Mirabegron ER tablets and Diclofenac Sodium topical solution.
- **EBITDA margin:** EBITDA margin regained double-digit territory at 10.5% (+610bps QoQ) after three weak quarters. Gross margin rose 170bps QoQ to 58.7% (-155bps YoY) on the back of higher sequential sales, limited US price erosion (single-digit), a better product mix, benefits from cost optimisation and the presence of a one-time shelf stock adjustment in the previous quarter. Margins were further aided by a higher contribution from the respiratory franchise and new products. Management has guided for a 16-17% EBITDA margin in FY23 backed by continued cost discipline and significant launches such as gSpiriva.
- **Tax rate:** LPC expects a higher tax rate in FY23 due to a few loss-making subsidiaries and lower Q1 sales from the US business. The normalised effective tax rate is guided at 31-34%, which should come down in the next 2-3 years with improved profitability.
- **Regulatory update:** There are no pending products from the Tarapur API (active pharma ingredient) facility, which received a warning letter. The company continues to manufacture several key products from the facility.

Valuation methodology

We have a new TP of Rs 700 (vs. Rs 600) as we adjust FY23/FY24 EBITDA estimates by -8%/+5% to bake in the H1FY23 margin trend and raise our target FY24E EV/EBITDA multiple to 11x (implied 22x P/E) from 10x as LPC is rebounding from three quarters of weak margins. Our multiple is at 10% discount to the stock's one-year forward EV/EBITDA considering continued regulatory impediments and near-term operational and industry challenges; upgrade from SELL to HOLD.

Fig 3 – Revised estimates

(Rs bn)	New		Old		Change (%)	
	FY23E	FY24E	FY23E	FY24E	F23E	FY24E
Revenue	164.4	185.6	162.3	176.7	1.3	5.1
EBITDA	20.3	30.5	22.1	29.1	(8.4)	5.0
EBITDA Margin (%)	12.3	16.5	13.6	16.5	(130bps)	(1bps)
EPS (Rs.)	16.8	32.2	20.7	31.4	(18.7)	2.6

Source: BOBCAPS Research

Fig 4 – Key assumptions

Revenue (Rs bn)	FY22A	FY23E	FY24E
India	60.0	63.3	70.0
North America	57.6	54.6	65.6
Growth Markets	14.0	15.7	17.0
EMEA	13.6	14.3	14.9
ROW	3.1	3.8	4.8
API	9.9	10.4	10.9
Licensing Income	3.7	0.0	0.0
Other Operating Income	2.1	2.2	2.3

Source: Company, BOBCAPS Research

Fig 5 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	EBITDA CAGR FY22-24E (%)	EV/EBITDA (x)		ROCE (%)		Target FY24E EV/EBITDA (x)
					FY23E	FY24E	FY23E	FY24E	
Sun Pharma	SUNP IN	HOLD	1,100	13.4	18.5	17.2	18.3	17.8	18.5
Dr. Reddy's	DRRD	HOLD	4,700	14.6	13.5	12.2	19.7	18.6	12.0
Cipla	CIPLA IN	BUY	1,320	16.1	16.5	14.2	18.6	19.6	17.0
Lupin	LPC	SELL	650	18.8	15.6	10.3	8.2	13.8	11.0

Source: BOBCAPS Research

Key risks

Key upside risks to our estimates are:

- earlier-than-expected clearance of pending facilities and products catering to the US market,
- better-than-anticipated execution of cost control measures to improve margins,
- market share gains in key drugs with global generic players exiting the market, and
- optimisation of the US portfolio.

Key downside risks are:

- continued, elevated US price erosion,
- delayed approval/launch of products under exclusivity such as gSpiriva and other key drugs, and
- continued regulatory hurdles at manufacturing sites.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	2.0	1,254	1,470	HOLD
Alembic Pharma	ALPM IN	1.5	617	770	HOLD
Alkem Labs	ALKEM IN	4.6	3,176	3,220	HOLD
Aurobindo Pharma	ARBP IN	3.4	478	695	BUY
Cipla	CIPLA IN	11.1	1,122	1,320	BUY
Divi's Labs	DIVI IN	10.7	3,287	3,450	HOLD
Dr Reddy's Labs	DRRD IN	9.2	4,549	4,700	HOLD
Eris Lifesciences	ERIS IN	1.2	708	970	BUY
Glenmark Life Sciences	GLS IN	0.6	422	535	BUY
Laurus Labs	LAURUS IN	3.0	451	540	HOLD
Lupin	LPC IN	4.0	719	700	HOLD
Sun Pharma	SUNP IN	29.7	1,011	1,100	HOLD

Source: BOBCAPS Research, NSE | Price as of 10 Nov 2022

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Total revenue	1,53,746	1,51,629	1,64,056	1,64,389	1,85,588
EBITDA	23,547	25,669	21,657	20,257	30,543
Depreciation	9,702	8,874	9,510	8,246	8,666
EBIT	13,845	16,794	12,147	12,010	21,876
Net interest inc./(exp.)	(3,630)	(1,406)	(1,428)	(1,922)	(1,908)
Other inc./(exp.)	4,838	1,363	1,417	1,606	1,863
Exceptional items	0	0	0	0	0
EBT	15,053	16,751	12,136	11,694	21,832
Income taxes	11,466	4,485	1,372	3,859	6,986
Extraordinary items	(6,325)	0	(25,861)	0	0
Min. int./Inc. from assoc.	(43)	101	183	221	265
Reported net profit	(2,694)	12,165	(15,280)	7,615	14,580
Adjustments	6,325	0	25,861	0	0
Adjusted net profit	3,631	12,165	10,581	7,615	14,580

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Accounts payables	24,123	20,144	22,829	22,072	23,688
Other current liabilities	45,004	35,585	26,562	26,562	26,562
Provisions	12,040	11,139	8,160	6,501	9,463
Debt funds	42,860	30,656	38,442	38,442	38,158
Other liabilities	0	0	0	0	0
Equity capital	906	907	909	909	909
Reserves & surplus	1,24,906	1,37,673	1,21,312	1,26,089	1,35,235
Shareholders' fund	1,25,812	1,38,580	1,22,221	1,26,998	1,36,144
Total liab. and equities	2,49,839	2,36,104	2,18,213	2,20,574	2,34,014
Cash and cash eq.	24,543	17,425	9,655	16,089	18,161
Accounts receivables	54,459	44,743	42,619	45,038	50,846
Inventories	34,569	40,920	46,307	40,534	45,761
Other current assets	23,746	18,998	21,263	22,263	23,263
Investments	23,743	24,549	9,000	8,527	8,527
Net fixed assets	60,866	59,183	59,652	57,906	56,739
CWIP	9,396	10,663	8,475	8,975	9,475
Intangible assets	18,515	19,624	21,241	21,241	21,241
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	2,49,838	2,36,104	2,18,213	2,20,574	2,34,014

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Cash flow from operations	50,854	9,988	(19,539)	17,721	17,698
Capital expenditures	22,714	(3,497)	(9,408)	(7,000)	(8,000)
Change in investments	(1,041)	(806)	15,549	473	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	21,673	(4,302)	6,141	(6,527)	(8,000)
Equities issued/Others	1	1	2	0	0
Debt raised/repaid	(39,359)	(12,205)	7,786	0	(284)
Interest expenses	(3,630)	(1,406)	(1,428)	(1,922)	(1,908)
Dividends paid	(9,077)	(7,844)	(4,830)	(2,838)	(5,434)
Other financing cash flows	(5,790)	8,648	4,099	0	0
Cash flow from financing	(57,854)	(12,806)	5,629	(4,760)	(7,626)
Chg in cash & cash eq.	14,673	(7,120)	(7,769)	6,434	2,072
Closing cash & cash eq.	24,544	17,424	9,655	16,089	18,161

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22A	FY23E	FY24E
Reported EPS	(6.0)	26.9	(33.6)	16.8	32.1
Adjusted EPS	8.0	26.9	23.4	16.8	32.2
Dividend per share	6.0	12.1	8.9	6.3	12.0
Book value per share	277.1	305.0	268.6	279.1	299.4

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22A	FY23E	FY24E
EV/Sales	2.5	2.3	1.9	2.0	1.9
EV/EBITDA	16.1	13.6	14.7	16.3	11.3
Adjusted P/E	89.7	26.8	30.8	42.7	22.3
P/BV	2.6	2.4	2.7	2.6	2.4

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22A	FY23E	FY24E
Tax burden (Net profit/PBT)	24.1	72.6	87.2	65.1	66.8
Interest burden (PBT/EBIT)	108.7	99.7	99.9	97.4	99.8
EBIT margin (EBIT/Revenue)	9.0	11.1	7.4	7.3	11.8
Asset turnover (Rev./Avg TA)	14.5	15.6	18.1	18.7	20.4
Leverage (Avg TA/Avg Equity)	2.0	1.8	1.7	1.8	1.7
Adjusted ROAE	2.8	9.2	8.1	6.1	11.1

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22A	FY23E	FY24E
YoY growth (%)					
Revenue	4.8	(1.4)	8.2	0.2	12.9
EBITDA	(8.0)	9.0	(15.6)	(6.5)	50.8
Adjusted EPS	(56.7)	235.1	(13.0)	(28.0)	91.5
Profitability & Return ratios (%)					
EBITDA margin	15.3	16.9	13.2	12.3	16.5
EBIT margin	9.0	11.1	7.4	7.3	11.8
Adjusted profit margin	2.4	8.0	6.4	4.6	7.9
Adjusted ROAE	2.8	9.2	8.1	6.1	11.1
ROCE	1.2	7.6	7.1	5.3	9.0
Working capital days (days)					
Receivables	126	119	97	100	100
Inventory	87	91	97	90	90
Payables	162	151	121	121	121
Ratios (x)					
Gross asset turnover	1.2	1.2	1.2	1.2	1.3
Current ratio	1.7	1.8	2.1	2.2	2.3
Net interest coverage ratio	3.8	11.9	8.5	6.2	11.5
Adjusted debt/equity	0.0	(0.1)	0.2	0.1	0.1

Source: Company, BOBCAPS Research | Note: TA = Total Assets

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BUY – Expected return >+15%

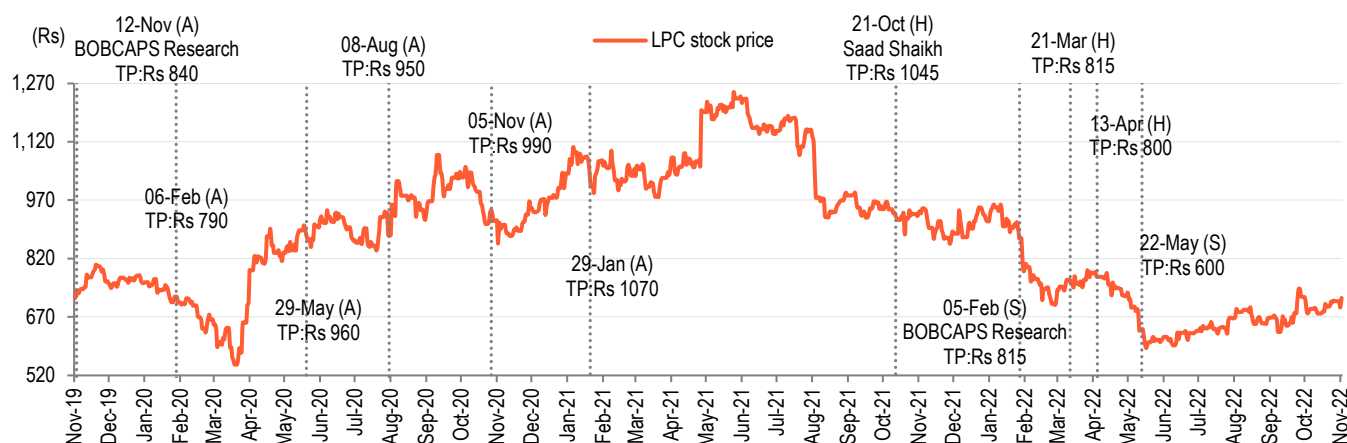
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): LUPIN (LPC IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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