

Lupin (LPC IN)

OW: US fires in 3Q; expect a booster in 4Q

Overweight

Target price (INR)	1,081.00
Share price (INR)	921.90
Forecast dividend yield (%)	0.7
Potential return (%)	18

Note: Potential return equals the percentage difference between the current share price and the target price, plus the forecast dividend yield

Mar	2013 a	2014 e	2015 e
HSBC EPS	28.46	37.21	44.41
HSBC PE	32.4	24.8	20.8
Performance	1M	3M	12M
Absolute (%)	-1.2	4.5	51.2
Relative ^A (%)	2.0	9.6	48.0

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Girish Bakhru*, CFA

Analyst

HSBC Securities and Capital Markets

(India) Private Limited

+91 22 22681638

girishbakhru@hsbc.co.in

Damayanti Kerai*

Associate

Bangalore

View HSBC Global Research at:

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► **Strong US sales led to strong net profit beat of 11%; EBITDA margins broadly in-line with lower expenses, offsetting lower gross margins**

► **US outlook robust with launches of gNiaspan, gRenagel, and gRenvela in 4Q, supported by recent key launches**

► **Remain OW on robust outlook with a revised TP of INR1,081 (from INR1,055)**

Strong beat in 3QFY14 profit: Lupin reported net profit of INR4.8bn (+42% yoy), c11% higher than HSBCe and the consensus estimate of cINR4.3bn. This strong beat is driven by robust US sales of USD215m, which came c12% higher than HSBCe. Gross margins were below our estimates on product mix change and forex translation impact from Japan. However, lower other expense compensated for higher raw material costs, which resulted in broadly in-line EBITDA margins of 25.6% (+140bp yoy). The tax rate remains higher at 34.4% versus HSBCe of 33% in 3Q.

US led 3Q sales growth; India, Japan slightly below expectation: Total 3Q sales at INR29.8bn (21% yoy) were primarily driven by strong US and bulk sales. US sales at USD215m (12% yoy) were driven by new launches (gCymbalta, gTrizivir, and gZymaxid). Suprax prescriptions have picked up but the larger effect will be visible in 4Q. India was marginally low at 14% yoy. Japan sales were flat yoy due to continued weakness in Irom sales on the back of continued declines in the contract manufacturing business and JPY movement against the INR. Bulk sales were strong, driven by good volumes in cefadroxil API in India.

Robust US outlook as launches bunch up: The near-term pipeline of gNiaspan (semi-exclusive), gRenagel (FTF), and gRenvela (FTF on suspension), supported by traction in new launches like gCymbalta, gTrizivir, gZymaxid, gTriLipix, and gYasmin, will bolster the US. We expect a strong Q4FY14 and 1QFY15 on the back of these products. Lupin has acquired Nanomi in the Netherlands to focus on complex injectable filings for US market apart from the existing platforms for derma, respiratory, controlled substances, and biosimilars.

Remain OW with a revised TP: We are revising our US sales forecast higher on the back of better performance in recent launches, new approvals, and higher realizations. We roll forward our TP to Dec-14 from Sep-14 and value Lupin at 21x (unchanged, 5% premium to sector average) Dec-15 EPS of INR51.5 to arrive at new TP of INR1,081 (from INR1,055). Key risks are slow approvals in US and a delay in recovery in Irom in Japan.

Index ^A	BOMBAY SE IDX	Enterprise value (INRm)	413,527
Index level	20,209	Free float (%)	53
RIC	LUPN.BO	Market cap (USDm)	6,599
Bloomberg	LPC IN	Market cap (INRm)	413,305

Source: HSBC

Source: HSBC

Financials & valuation

Financial statements

Year to	03/2013a	03/2014e	03/2015e	03/2016e
Profit & loss summary (INRm)				
Revenue	95,985	113,379	128,444	144,900
EBITDA	22,272	28,780	32,381	37,059
Depreciation & amortisation	-2,586	-2,550	-2,800	-3,200
Operating profit/EBIT	19,686	26,230	29,581	33,859
Net interest	-269	-200	-330	-350
PBT	19,246	28,430	30,251	35,509
HSBC PBT	19,246	28,430	30,251	35,509
Taxation	-5,842	-9,666	-9,983	-11,008
Net profit	13,142	18,413	19,888	24,101
HSBC net profit	12,707	16,664	19,888	24,101

Cash flow summary (INRm)

Cash flow from operations	10,354	14,758	16,849	17,031
Capex	-3,761	-5,000	-4,500	-4,500
Cash flow from investment	-3,731	-5,350	-4,880	-4,900
Dividends	-2,796	-3,666	-4,375	-5,302
Change in net debt	-5,387	-5,742	-7,594	-6,829
FCF equity	6,764	7,358	11,349	10,531

Balance sheet summary (INRm)

Intangible fixed assets	9,927	9,927	9,927	9,927
Tangible fixed assets	23,182	25,632	27,332	28,632
Current assets	55,326	69,702	84,290	101,452
Cash & others	4,369	10,111	15,706	20,536
Total assets	88,434	105,261	121,548	140,011
Operating liabilities	24,427	26,506	29,280	30,943
Gross debt	9,739	9,739	7,740	5,741
Net debt	5,369	-373	-7,966	-14,795
Shareholders funds	52,042	66,789	82,302	101,100
Invested capital	59,638	68,643	76,562	88,532

Ratio, growth and per share analysis

Year to	03/2013a	03/2014e	03/2015e	03/2016e
Y-o-y % change				
Revenue	36.1	18.1	13.3	12.8
EBITDA	57.3	29.2	12.5	14.4
Operating profit	65.6	33.2	12.8	14.5
PBT	60.9	47.7	6.4	17.4
HSBC EPS	57.8	30.7	19.3	21.2

Ratios (%)

Revenue/IC (x)	1.7	1.8	1.8	1.8
ROIC	24.6	27.2	27.5	28.5
ROE	27.6	28.0	26.7	26.3
ROA	16.4	19.7	18.1	19.0
EBITDA margin	23.2	25.4	25.2	25.6
Operating profit margin	20.5	23.1	23.0	23.4
EBITDA/net interest (x)	82.9	143.9	98.1	105.9
Net debt/equity	10.2	-0.6	-9.6	-14.5
Net debt/EBITDA (x)	0.2	0.0	-0.2	-0.4
CF from operations/net debt	192.8			

Per share data (INR)

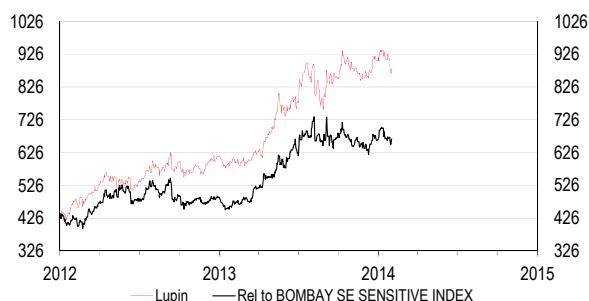
EPS reported (fully diluted)	29.44	41.12	44.41	53.82
HSBC EPS (fully diluted)	28.46	37.21	44.41	53.82
DPS	4.01	6.80	8.11	9.83
Book value	116.58	149.15	183.79	225.77

Valuation data

Year to	03/2013a	03/2014e	03/2015e	03/2016e
EV/sales	4.4	3.6	3.2	2.8
EV/EBITDA	18.8	14.4	12.5	10.8
EV/IC	7.0	6.0	5.3	4.5
PE*	32.4	24.8	20.8	17.1
P/Book value	7.9	6.2	5.0	4.1
FCF yield (%)	1.6	1.8	2.7	2.5
Dividend yield (%)	0.4	0.7	0.9	1.1

Note: * = Based on HSBC EPS (fully diluted)

Price relative



Source: HSBC

Note: price at close of 03 Feb 2014

Earning call highlights

- ▶ Robust US sales drove the 3Q growth; outlook remains strong with visible big launches in near-term
- ▶ Investment in long-term growth drivers continues – Nanomi acquisition for complex injectables
- ▶ Japan expected to recover in FY15; India to remain stable and RoW to maintain steady growth ahead

3QFY14 highlights

US sales: 3QFY14 US sales grew 15% in USD-terms to USD215m due to traction in key recent launches such as: gCymbalta, gTrizivir, gZymaxid, and gTriLipix etc. Lupin gained from lower than expected competition in gCymbalta, which was a shared exclusivity product.

Branded products contributed cUSD24m towards total US sales, primarily by the Suprax franchise, which is seeing a pick-up after a slow seasonal start. Suprax suspensions grew 28% while tablet sales grew 26% yoy. Recently launched Suprax drops have seen a slow start and Lupin expects a marketing push, post the end of flu season. Lupin continues to look out for acquisitions in branded product space and aspires towards a US sales contribution of 15-16% from branded products from current 10-11%.

The US outlook remains strong with potential key launches like gNiaspan, gRenagel, and gRenvela in the near-term, supported by new launches and a pickup in its oral contraceptives sales. Lupin expects recent launches like gCymbalta, gTrizivir, gZymaxid, and gTrilipix to continue to do well in the near-term.

Lupin filed five ANDAs in 3Q, taking the cumulative number to 186. Lupin has received five ANDA approvals during the quarter and now cumulative approvals stand at 96.

Nanomi acquisition: On 3 February 2014, Lupin announced the acquisition of Nanomi B.V, which will provide it with the technical capabilities to enter the complex injectable space. Nanomi will bring with it technology platforms of microsphere and nano-particle, which have potential applications in the development of depot injection, peptides, ophthalmics, and respiratory products. At present, Lupin looks forward to use this technology for the development of complex injectable products and targets its first US filing in the next 3-3.5 years.

Lupin hasn't disclosed financial details of the Nanomi transaction.

India: India sales grew 14% yoy in 3QFY14 to INR6.5bn. There is status quo on trade margin issues with the distributor though the market has settled down after the disruptions seen in recent quarters after the implementation of a new pricing policy.

Japan: Japan sales at INR3.7bn were flat on yoy (1.7% yoy growth) due to continued weakness in Form sales on the back of a contraction in contract manufacturing business and JPY movement against INR. Excluding Form, Japan sales were up 16% yoy in JPY-terms. Lupin expects better sales from Form in FY15. The Japanese government is expected to announce a new drug pricing policy by the end of February 2014, which will be implemented from the beginning of April 2014. Japan will see patent expiries worth USD14-15bn in the next two years and the government is yet to announce new generic conversion rules as per Lupin.

R&D: R&D as % of sales was 9% in 3Q. The company expects this run rate to be sustained as it plans to step up niche complex filings in the US.

Tax: The tax rate in 3Q came at 34.4%. Lupin expect tax rate to remain at 33-34% level of which 2% is on account of taxes on dividend received from subsidiaries, which it booked during 2QFY14. For FY15, the company expects the tax rate to remain at a similar 33-34% level.

Forex and hedges: The net forex impact on 3Q net profit was a loss of INR688m of which an INR255m gain is included in other income. There is a translation loss of cINR250m on account of the Japan entity, booked against raw material expenses. The remaining forex impact was captured in various line-items of the P&L.

As per current hedges, the company has covered 30-50% of net foreign currency exposure for the next 12-18 months. Lower hedges should help in better

realizations of INR depreciation as per the company.

Lupin recently filed gProlensa

Lupin has been sued by Bausch and Lomb and Senju Pharma on bromfenac ophthalmic solution. Bromfenac is an ocular non-steroidal anti-inflammatory drug in the US market for use after the cataract surgery. The product was approved only last year in April 2013 (was successor of previous drug Xibrom) and is only protected by a single patent that expires in 2025. New product exclusivity ends in April 2016. The compound patent expired in March 2012.

The other known formulation of the molecule but at different strength of 0.09% (Bromday) is already generic by two companies Hi Tech and Mylan (partner with Coastal Pharma). Lupin was sued on the most advanced formulation - 0.07% strength, which is sold in US as Prolensa and has MAT sales of cUSD30m for now. We believe this will grow in sales as it is a new product and can reach peak of cUSD100m in two to three years.

Lupin is only known filer until now on this and hence is possibly FTF. We expect a generic entry in 2016 when new product exclusivity expires.

This ANDA filing increases ophthalmic filings for Lupin. One ophthalmic product gZymaxid (gatifloxacin) is already launched in the US market, which was a big contributor in 3Q. Its pipeline of ophthalmic drugs as per our estimates includes - moxifloxacin (Vigamox, Moxeza), bromfenac (Prolensa, Bromday), ketorolac (Acular LS), bimatoprost (Lumigan) and gatifloxacin (Zymar).

Lupin: Change in estimates

(INRm)	New estimates			Old estimates			% change in estimates		
	FY14e	FY15e	FY16e	FY14e	FY15e	FY16e	FY14e	FY15e	FY16e
Net revenues	113,379	128,444	144,900	109,962	125,427	141,537	3.1%	2.4%	2.4%
EBITDA	28,780	32,381	37,059	27,396	30,167	34,791	5.1%	7.3%	6.5%
Net Profit	16,664	19,888	24,101	15,924	20,183	23,255	4.7%	-1.5%	3.6%
EPS (INR)	37.2	44.4	53.8	35.6	45.1	51.9	4.7%	-1.5%	3.6%

Source: HSBC estimates

Valuation and risks

We remain OW on Lupin as we believe the fundamental growth drivers are intact. Filings in US are scaling up in ophthalmic and dermatology and will be seen in future in controlled substances and inhalational products. The US outlook remains robust on back of pending launches like gYaz, gRenvela (FTF on suspension), gRenagel (FTF), gNiaspan in next 12 months. New brand additions Alinia and Locoid suspension will also add to the US growth.

We roll forward our TP to Dec-14 from Sep-14 and value Lupin at 21x (unchanged, 5% premium to sector average) Dec-15 EPS of INR51.5 to arrive at new TP of INR1,081 (from INR1,055). We believe a 5% premium to sector average is justified in view of the strong US outlook and the continued focus on niche therapies.

Key risks are slow approvals in US and a delay in the recovery in P'rom in Japan.

Under our research model, for stocks without a volatility indicator, the Neutral band is 5 percentage points above and below the hurdle rate for Indian stocks of 11.0%. Our new target price of INR1,081 implies a potential return of 18% including a forecast dividend yield of 0.7%, which is above the Neutral band of our model; therefore, we rate the stock OW. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

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