Health Care & Pharmaceuticals | India

Lupin LPC IN

BUY

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NOMURA STRUCTURED FINANCE SERVICES PRIVATE LIMITED, INDIA

RESULTS FIRST LOOK

Lupin reported 2QFY2 revenues 2% ahead of our estimates. Adjusted for a forex loss of INR 80mn, EBITDA was broadly in-line with our estimates. Net profit was subdued due to higher-than-expected tax rate which was a result of the Medicis milestone being booked in India. US and India remain key growth drivers. US growth is expected to be driven by OC launches and other low-competition products. Management guided to growth in domestic formulations at >20% y-y. At 18x FY13 the stock trades at a discount to front-line Indian generic companies. Maintain BUY.

Price target: 570.0 INR
Price (09 Nov 2011): 474.55 INR

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US, India remain key drivers

- **Earnings vs. our Forecast:** **IN LINE**

Likely Impact:

- **Earnings Estimates:** **NO CHANGE**
- **Dividend Estimates:** **NO CHANGE**
- **Price Target:** **NO CHANGE**
- **Long-term View:** **CONFIRMED**

Fig 1: Revenue mix review

(INR mn)	2QFY12	2QFY11	Y-o-Y	1QFY12	Q-o-Q	2QFY12E	vs. Nom.
Advanced market formulations	**7,760**	**6,728**	**15%**	**7,013**	**11%**	**7,434**	**4%**
US - branded business	1,449	1,217	19%	1,479	-2%	1,272	**14%**
US - generic	4,070	3,575	14%	3,451	18%	3,728	**9%**
US	5,519	4,792	15%	4,930	12%	5,000	**10%**
Europe	461	369	25%	417	11%	552	**-17%**
Japan	1,780	1,567	14%	1,666	7%	1,882	**-5%**
India formulations	**5,120**	**4,191**	**22%**	**4,969**	**3%**	**5,115**	**0%**
Other formulations	1,594	1,180	35%	1,348	18%	1,533	**4%**
API	1,976	1,951	1%	2,102	-6%	2,146	**-8%**
Licensing Income	966					900	
Net sales	**17,416**	**14,050**	**24%**	**15,432**	**13%**	**17,128**	**2%**

Source: Company data, Nomura estimates

Fig 2: Income Statement review

(in INR mn)	2QFY12	YoY (%)	2QFY11	QoQ (%)	1QFY12	vs. Nom. Est.	2QFY12
Gross Sales	**17,522**	**24%**	**14,142**	**13%**	**15,543**	**2%**	**17,242**
Excise Duty	105	14%	92	-5%	111	-8%	114
Net Sales	**17,417**	**24%**	**14,050**	**13%**	**15,432**	**2%**	**17,128**
Other Operating income	307	6%	289	25%	246	2%	300
Total operating income	**17,724**	**24%**	**14,339**	**13%**	**15,677**	**2%**	**17,428**
Material costs	5,979	9%	5,494	-3%	6,169	-3%	6,162
Staff costs	2,276	19%	1,916	4%	2,193	-3%	2,356
Other expenditure	5,429	38%	3,943	24%	4,372	15%	4,732

Total Expenditure	**13,684**	**21%**	**11,353**	**7%**	**12,734**	**3%**	**13,250**
EBITDA	**4,040**	**35%**	**2,986**	**37%**	**2,944**	**-3%**	**4,178**
EBITDA margins	*22.8%*		*20.8%*		*18.8%*		*24.0%*
Other income	16	16%	14	37%	12		10
Interest	66	-24%	88	15%	58	11%	60
Depreciation	522	20%	435	11%	471	11%	470
PBT	**3,468**	**40%**	**2,478**	**43%**	**2,426**	**-5%**	**3,658**
Tax	751	177%	271	162%	286	37%	549
Tax rate	*21.6%*		*10.9%*		*11.8%*		*15.0%*
MI + Share of associates	49	-14%	57	24%	39	22%	40
PAT	**2,669**	**24%**	**2,150**	**27%**	**2,101**	**-13%**	**3,069**
(% of Operating Income)							
Material costs	33.7%	-458bps	38.3%	-562bps	39.4%	-162bps	35.4%
Staff costs	12.8%	-52bps	13.4%	-114bps	14.0%	-68bps	13.5%
Other Expenditure	30.6%	313bps	27.5%	274bps	27.9%	348bps	27.2%
EBITDA Margin	22.8%	197bps	20.8%	402bps	18.8%	-117bps	24.0%

Source: Company data, Nomura estimates

Revenues ahead of estimates; US & India growth strong; target of US$3bn revs by FY15 reiterated

Lupin reported 24% y-y growth in net sales for 2QFY12. The growth was led by US and India business which grew 15% and 22% y-y, respectively. Europe and Japan sales registered growth of 25% and 14% y-y. API business was flat y-y and came in 8% below our expectations. The management reiterated the aspiration of being a US$3bn top line company by FY15.

- **US:** Growth in US was led by the new product launches which contributed 75% of the total growth. Volume and price variations in older products contributed the remaining 25%.

  The generics business grew 14% y-y. As per the management, the generics business grew 30% y-y excluding the pricing decline in generic Lotrel.

  Lupin launched generic Fortamet (US$80mn) at risk in Sep 2011 with 180 day exclusivity. Management said that 2 months of inventory was sold during 2QFY12. Following the initial launch, Lupin was injuncted on 12th Oct 2011 from selling the product and a court hearing is scheduled in early Dec 2011 to decide on the injunction.

  Lupin also launched generic Femcon FE (US$60mn) during the quarter and has garnered 16% market share as per the management. Further, **the company expects to launch generic Nor QD (US$50mn) and LoSeasonique (US$30mn)** during 3QFY12 for which it already has final approval. The oral contraceptive franchise is expected to reach peak sales in FY14. Lupin has a cost advantage compared with other players in the space, as it is the only company that is vertically integrated on the OC portfolio.

  The company said that they expect to launch 5-6 products in the US over 2HFY12. Lupin has a pipeline of 99 ANDAs including 19 FTFs pending approval which include niche product filings like OCs and ophthalmology products.

  The branded business grew 19% y-y primarily led by the strong performance of Suprax franchise. The recently launched **Suprax tablets registered strong revenue growth of 52% y-y,** while the suspension formulation grew 6% in volume terms. **Revenues from Antara declined 3% y-y** during the quarter. The management conceded that the fenofibrate market has been shrinking since the ACCORD (Action to Control Cardiovascular Risk in Diabetes) trial results were announced and this has had an adverse impact on Antara. **As per the results of the ACCORD trial, simvastatin when taken in combination with fenofibrate does not significantly reduce the risk of heart strokes in Type 2 diabetes patients when compared with similar patients taking simvastatin with a placebo**. Lastly, Aerochamber also registered a significant decline in revenues.

  Going forward, the **management does not expect generic competition in Suprax** for the next 12 months. Lupin received a response letter from the FDA regarding Suprax drops in Sep 2011. The management expects to file the response and hear back from the FDA by Jun 2012. Regarding Allernaze, the management suggested a launch in FY13. On inorganic growth strategy, the company is looking at opportunities in the pediatric, allergy and ENT (Ear, Nose and Throat) spaces.

- **India:** Revenues from domestic sales grew 22% y-y for the quarter. Lupin booked sales of INR 180mn from the Eli Lilly (LLY US) deal for two months during the quarter. The insulin franchise is expected to generate a quarterly run rate of INR 350-400mn as per the management. T**he management expects to continue to grow revenues at >20% y-y**.

- **Europe, Japan and API:** Europe continued to grow strongly albeit on a lower base. Japan revenues grew 14% y-y and the management expects to maintain a 12% growth. The API business disappointed, as it came in flat y-y.

Margins disappoint; Revenue cost mismatch at the Indore SEZ, inflation in input costs, sales promotion expenditure put pressure on EBITDA margins

Including the US$20mn licensing income from Medicis, **EBITDA margins came in at 22.8% vs. our expectation of 24% for the quarter**. Inflation in input costs, Indore SEZ capacity under utilization and lumpiness in sales promotion costs put downward pressure on margins, as per management. T**he management expects to increase EBITDA margins by 50-70 bps each year**. This would be achieved by transferring manufacturing site for Japanese products to Indian facilities, scaling up utilization of Indore SEZ and increased traction in US from the recent launches, in our view.

R&D spend in the quarter came in at 7.9% of sales which is in line with the management guidance of 7-8% for FY12.

Tax rate was higher than anticipated, as the Medicis milestone of US$20mn was booked in India and was taxed at 32%. Excluding the milestone tax, business tax rate was at 18%. Management guided to a FY tax rate of 16-17%.

LPC trades at 18x FY13 est EPS; Maintain BUY

We remain long-term positive on LPC's US product pipeline, execution track record and robust India growth. We believe potential catalysts include Fortamet injunction hearing in early December, potential Asacol (US$700mn) authorised generic launch, OCs approvals and market share ramp up and Geodon (US$1bn) launch in 4QFY12. At 18x our FY13 est EPS of INR26.3/sh, the stock trades at a discount to front-line Indian generic companies. Maintain BUY.

Valuation Methodology and Investment Risks: See below

Note: Ratings and Price Targets are as of the date of the most recently published report (http://go.nomuranow.com/research/globalresearchportal) rather than the date of this email.

Results First Look is the analyst's preliminary interpretation of the results announcement. Our recommendation and earnings estimates are not beingchanged in this report. Any formal changes to our recommendation or earnings estimates will be made in a subsequent report, which may differ from the preliminary views expressed in this report.

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Issuer Specific Regulatory Disclosures

Mentioned companies

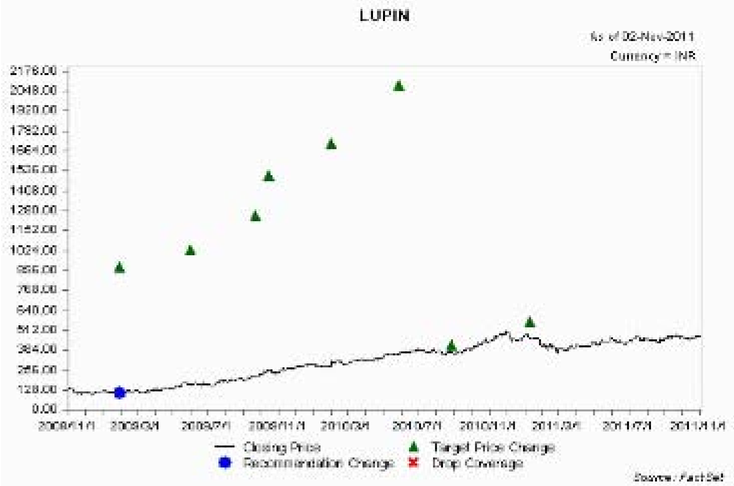
Issuer name	Ticker	Price	Price date	Stock rating	Disclosures
Lupin	LPC IN	474.55 INR	09 Nov 2011	Buy	

Previous Rating

Issuer name	Previous Rating	Date of change
Lupin	Not Rated	30 Jan 2009

Lupin (LPC IN) **474.55 INR (09 Nov 2011)** Buy

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
11-Jan-2011		570.00	455.20
27-Aug-2010		417.00	372.50
28-May-2010		2087.00	364.60
01-Feb-2010		1707.00	314.80
16-Oct-2009		1506.00	255.92
23-Sep-2009		1251.00	212.91
02-Jun-2009		1028.00	163.44
30-Jan-2009		919.00	113.98
30-Jan-2009	Buy		113.98

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We value LPC at 23x one yr forward earnings to arrive at a target price of INR 570. The valuation multiple is in line with other front line generic companies.

Risks that may impede the achievement of the target price The key risks to our view are: a) slowdown or fall in branded generic revenues. Suprax and Antara are both likely to face generic competition over the next 4-5 years and need to be replaced over time.; b) appreciation in INR against export currencies; c) regulatory changes including price control in key markets like India and Japan.

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Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published from 30 October 2008 and in Japan from 6 January 2009

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Explanation of Nomura's equity research rating system in Japan published prior to 6 January 2009

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