NOMURA

Lupin LUPN.NS LPC IN

EQUITY: HEALTH CARE & PHARMACEUTICALS

Upgrade to Buy

High impact approvals to drive earnings from 4QFY16F onwards

Action: Raise TP to INR2,149; upgrade to Buy

While the number of approvals has increased for LPC in FY16 (14 so far vs. 10 in FY15), the average time for an approval has also risen to more than 60 months. Most of the recent approvals were for pre-FY13 filings. With 43% of pending filings more than three years old, the rate of approvals should remain strong. None of the approvals in FY16 so far are likely to have any material impact on growth. In our opinion, more than the number of approvals, it is the approval of select high impact products -- gGlumetza, gNexium, gWelchol and gRenvela/Renagel -- that matter most for growth. LPC should benefit from a price hike in Glumetza as it is in a unique position to address the low-competition 1,000mg metformin ER market through both gFortamet and gGlumetza. Our industry checks suggest that the gWelchol opportunity has been pushed out to FY17F. gNexium and gRenvela/Renagel remain FY16F opportunities, but the uncertainty over approval timeline remains given the regulatory hurdles. We incorporate the recent currency movements, acquisitions by Lupin and the prospect of new launches into our financial projections. We lower our earnings by 7% for FY16F, but raise by 21% for FY17F. Our FY17F EPS is 18% above consensus. Earnings momentum is likely to gather pace from 4QFY16F. We lift our TP to INR2,149 (from INR1,698), based on 23x (unchanged) FY17-18F average EPS of INR93.4.

Catalysts: Approval for key generics gNexium, gWelchol, gRenvela/Renagel

Valuation: TP lifted to INR2,149

The stock currently trades at 26.3x one-year forward EPS of INR72.3. We continue to assess the fair valuation range to be 20-25x. Significant value-accretive acquisitions and visibility to sustain growth by moving up the complexity levels (inhalers and biosimilars) could justify a higher valuation multiple. However, currently we have very limited visibility on the same.

Year-end 31 Mar	FY15		FY16F		FY17F		FY18F
Currency (INR)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	127,700	150,283	148,031	175,140	197,036		223,442
Reported net profit (mn)	24,035	27,250	25,454	33,159	40,257		44,632
Normalised net profit (mn)	24,035	27,250	25,454	33,159	40,257		44,632
FD normalised EPS	52.91	60.68	56.03	73.83	88.62		98.25
FD norm. EPS growth (%)	30.9	13.4	5.9	21.7	58.2		10.9
FD normalised P/E (x)	35.5	N/A	33.6	N/A	21.2	N/A	19.1
EV/EBITDA (x)	23.4	N/A	22.2	N/A	14.3	N/A	13.0
Price/book (x)	9.6	N/A	7.8	N/A	6.0	N/A	4.7
Dividend yield (%)	0.5	N/A	0.5	N/A	0.8	N/A	0.9
ROE (%)	30.4	27.0	25.6	26.3	31.8		27.6
Net debt/equity (%)	0.6	net cash	52.4	net cash	25.0		4.8

Source: Company data, Nomura estimates

Key company data: See next page for company data and detailed price/index chart

Global Markets Research

22 September 2015

Rating Up from Neutral	**Buy**
Target Price Increased from 1698	INR 2149
Closing price 21 September 2015	INR 1880
Potential upside	+14.3%

Anchor themes

We see LPC as a play on: 1) the generic opportunities in the US, where it is pursuing niche and limited-competition opportunities; 2) the rise in medicine consumption in India; and 3) the potential rise in generic opportunities in Japan, where LPC is the largest Indian pharma name.

Nomura vs consensus

Our FY17F EPS estimate is 18% above consensus.

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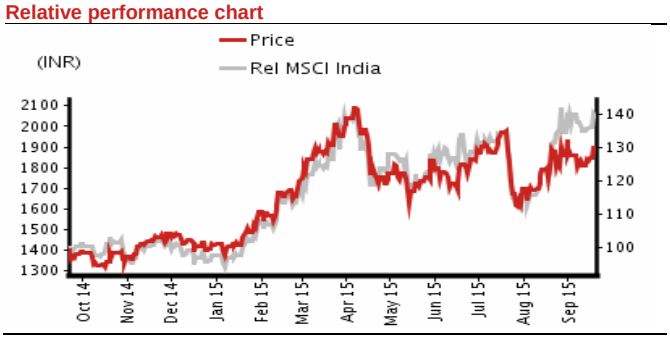
Key data on Lupin

Relative performance chart



Source: Thomson Reuters, Nomura research

Notes:

Performance

(%)	1M	3M	12M		
Absolute (INR)	0.1	3.5	34.2	M cap (USDmn)	12,889.6
Absolute (USD)	0.5	0.1	24.4	Free float (%)	0.7
Rel to MSCI India	4.6	6.4	36.8	3-mth ADT (USDmn)	36.7

Income statement (INRmn)

Year-end 31 Mar	FY14	FY15	FY16F	FY17F	FY18F
Revenue	112,866	127,700	148,031	197,036	223,442
Cost of goods sold	-38,174	-41,570	-47,514	-60,912	-71,612
Gross profit	74,693	86,130	100,517	136,124	151,830
SG&A	-35,415	-40,101	-48,578	-61,772	-71,337
Employee share expense	-11,858	-14,177	-16,698	-19,400	-22,278
Operating profit	27,419	31,851	35,241	54,952	58,216
EBITDA	30,029	36,198	40,755	61,845	65,961
Depreciation	-2,610	-4,347	-5,513	-6,892	-7,745
Amortisation					
EBIT	27,419	31,851	35,241	54,952	58,216
Net interest expense	-267	-98	-1,031	-1,579	-859
Associates & JCEs					
Other income	1,165	2,398	2,153	2,153	2,153
Earnings before tax	28,317	34,151	36,363	55,526	59,510
Income tax	-9,622	-9,704	-10,909	-15,270	-14,877
Net profit after tax	18,696	24,447	25,454	40,257	44,632
Minority interests	-331	-412	0	0	0
Other items					
Preferred dividends					
Normalised NPAT	18,364	24,035	25,454	40,257	44,632
Extraordinary items					
Reported NPAT	18,364	24,035	25,454	40,257	44,632
Dividends	-2,939	-4,058	-4,297	-6,796	-7,535
Transfer to reserves	15,426	19,977	21,157	33,460	37,097
Valuations and ratios					
Reported P/E (x)	46.4	35.5	33.6	21.2	19.1
Normalised P/E (x)	46.4	35.5	33.6	21.2	19.1
FD normalised P/E (x)	46.5	35.5	33.6	21.2	19.1
Dividend yield (%)	0.3	0.5	0.5	0.8	0.9
Price/cashflow (x)	42.6	31.3	42.4	24.1	19.5
Price/book (x)	12.3	9.6	7.8	6.0	4.7
EV/EBITDA (x)	28.2	23.4	22.2	14.3	13.0
EV/EBIT (x)	30.8	26.6	25.7	16.1	14.7
Gross margin (%)	66.2	67.4	67.9	69.1	68.0
EBITDA margin (%)	26.6	28.3	27.5	31.4	29.5
EBIT margin (%)	24.3	24.9	23.8	27.9	26.1
Net margin (%)	16.3	18.8	17.2	20.4	20.0
Effective tax rate (%)	34.0	28.4	30.0	27.5	25.0
Dividend payout (%)	16.0	16.9	16.9	16.9	16.9
ROE (%)	30.3	30.4	25.6	31.8	27.6
ROA (pretax %)	30.7	28.9	21.5	26.1	25.6
Growth (%)					
Revenue	17.1	13.1	15.9	33.1	13.4
EBITDA	32.3	20.5	12.6	51.7	6.7
Normalised EPS	38.6	30.5	5.9	58.2	10.9
Normalised FDEPS	39.7	30.9	5.9	58.2	10.9

Source: Company data, Nomura estimates

Cashflow statement (INRmn)

Year-end 31 Mar	FY14	FY15	FY16F	FY17F	FY18F
EBITDA	30,029	36,198	40,755	61,845	65,961
Change in working capital	-3,509	7,248	-14,209	-9,143	-7,103
Other operating cashflow	-6,480	-16,116	-6,396	-17,200	-15,034
Cashflow from operations	20,040	27,331	20,149	35,501	43,824
Capital expenditure	-5,286	-8,712	-73,106	-9,000	-10,000
Free cashflow	14,754	18,619	-52,957	26,501	33,824
Reduction in investments	6	-1	0	0	0
Net acquisitions					
Dec in other LT assets	34	36	0	0	0
Inc in other LT liabilities					
Adjustments	-2,596	-19,847	1,053	1,053	1,053
CF after investing acts	12,197	-1,193	-51,904	27,554	34,877
Cash dividends	-3,234	-1,573	-4,058	-4,297	-6,796
Equity issue					
Debt issue	-5,298	-700	58,000	-21,500	-26,500
Convertible debt issue					
Others	-39	304	-1,031	-1,579	-859
CF from financial acts	-8,571	-1,969	52,911	-27,376	-34,155
Net cashflow	3,626	-3,161	1,007	178	722
Beginning cash	4,349	7,975	4,814	5,821	5,998
Ending cash	7,975	4,814	5,821	5,998	6,720
Ending net debt	-1,438	558	57,551	35,873	8,651

Balance sheet (INRmn)

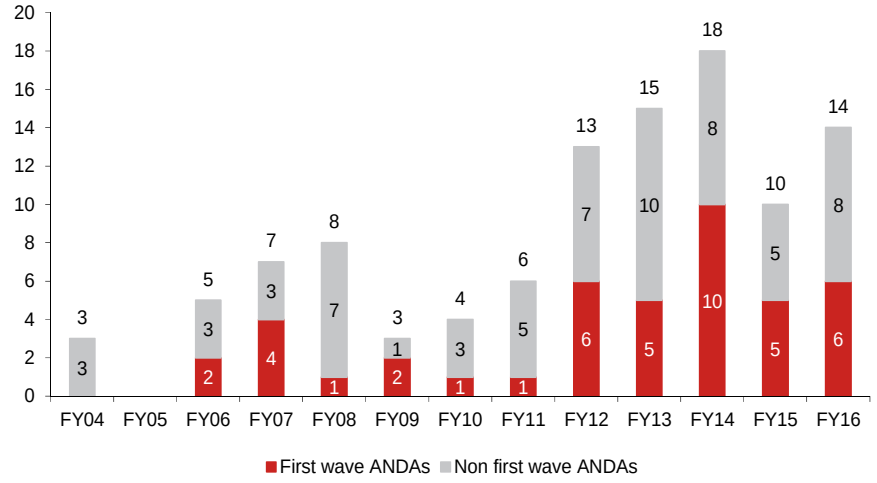
As at 31 Mar	FY14	FY15	FY16F	FY17F	FY18F
Cash & equivalents	7,975	4,814	5,821	5,998	6,720
Marketable securities					
Accounts receivable	24,641	26,566	33,353	42,467	48,238
Inventories	21,295	25,036	28,913	35,045	41,202
Other current assets	9,060	8,092	8,492	9,613	10,237
Total current assets	62,970	64,507	76,580	93,124	106,397
LT investments	1,785	16,584	16,584	16,584	16,584
Fixed assets	30,019	32,961	49,147	51,255	53,510
Goodwill	6,579	16,481	63,856	63,856	63,856
Other intangible assets					
Other LT assets	708	842	842	842	842
Total assets	102,060	131,374	207,008	225,661	241,188
Short-term debt	5,028	4,353	4,353	4,353	4,353
Accounts payable	18,272	27,634	23,980	28,496	32,776
Other current liabilities	4,779	7,363	7,874	10,582	11,749
Total current liabilities	28,079	39,350	36,207	43,430	48,878
Long-term debt	1,510	1,018	59,018	37,518	11,018
Convertible debt					
Other LT liabilities	2,487	2,024	1,645	1,113	596
Total liabilities	32,075	42,393	96,870	82,062	60,492
Minority interest	669	241	241	241	241
Preferred stock					
Common stock	897	899	899	899	899
Retained earnings	68,419	87,842	108,998	142,459	179,556
Proposed dividends					
Other equity and reserves					
Total shareholders' equity	69,316	88,741	109,897	143,358	180,455
Total equity & liabilities	102,060	131,374	207,008	225,661	241,188
Liquidity (x)					
Current ratio	2.24	1.64	2.12	2.14	2.18
Interest cover	102.9	324.7	34.2	34.8	67.8
Leverage					
Net debt/EBITDA (x)	net cash	0.02	1.41	0.58	0.13
Net debt/equity (%)	net cash	0.6	52.4	25.0	4.8
Per share					
Reported EPS (INR)	40.54	52.91	56.03	88.62	98.25
Norm EPS (INR)	40.54	52.91	56.03	88.62	98.25
FD norm EPS (INR)	40.43	52.91	56.03	88.62	98.25
BVPS (INR)	153.03	195.35	241.92	315.58	397.24
DPS (INR)	6.49	8.93	9.46	14.96	16.59
Activity (days)					
Days receivable	75.2	73.2	74.1	70.2	74.1
Days inventory	195.0	203.4	207.8	191.6	194.3
Days payable	172.6	201.5	198.8	157.2	156.1
Cash cycle	97.6	75.0	83.1	104.6	112.2

Source: Company data, Nomura estimates

Pace of approvals has increased; old backlog being cleared

Lupin's pace of approvals has picked up in the recent past. In FY16, so far LPC has received 14 ANDA approvals, a significant step up vs. 10 approvals received in FY15.

Fig. 1: Lupin: Number of ANDA approvals



Source: Nomura research

In Fig 1 we highlight the first wave of ANDA approvals for Lupin separately. The first-wave approvals consist of products in which Lupin is among the first set of companies to receive generic approvals or receive approvals just after the generic exclusivity period, if applicable. The approvals are an even mix of first-wave and follow-on approvals in the past three years as shown in Fig 1.

Large fraction of old ANDAs implies approval momentum to sustain in the near-term

Fig 2 shows the ANDA approval timeline and we map it with the filing period. So far Lupin has received approvals for 106 ANDAs. The company has not received approvals for any ANDA filed after FY13. Only two ANDAs filed in FY13 have received approvals. Most of the approvals received in FY16 were filed in FY11 and FY12. Approvals that are coming through now are more than three year old filings. Based on the approval history and number of ANDA filings each year, we believe that out of the 106 ANDAs pending approval as on 1QFY16 (including tentative approval), approximately 25% or 26 ANDAs were filed before FY11.

Fig. 2: Year-wise approval details

All the approvals in FY16 so far are for products filed on or before FY12

		Approval year												
	Filing year\approval year	FY04	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	Grand Total
Filing year	FY02	2												2
	FY03	1												1
	FY04		1											1
	FY05		4	3	2	1			1				2	13
	FY06			4	5	1		2		1				13
	FY07				1	1	2	2	2		1			9
	FY08									2	4	1	1	8
	FY09						2	2	6	2	2	2		16
	FY10								3	5	4		2	14
	FY11								1	5	6	4	4	20
	FY12											2	5	7
	FY13										1	1		2
	Grand Total	3	5	7	8	3	4	6	13	15	18	10	14	106

Source: Nomura research

Fig. 3: Age profile of pending ANDA pipeline

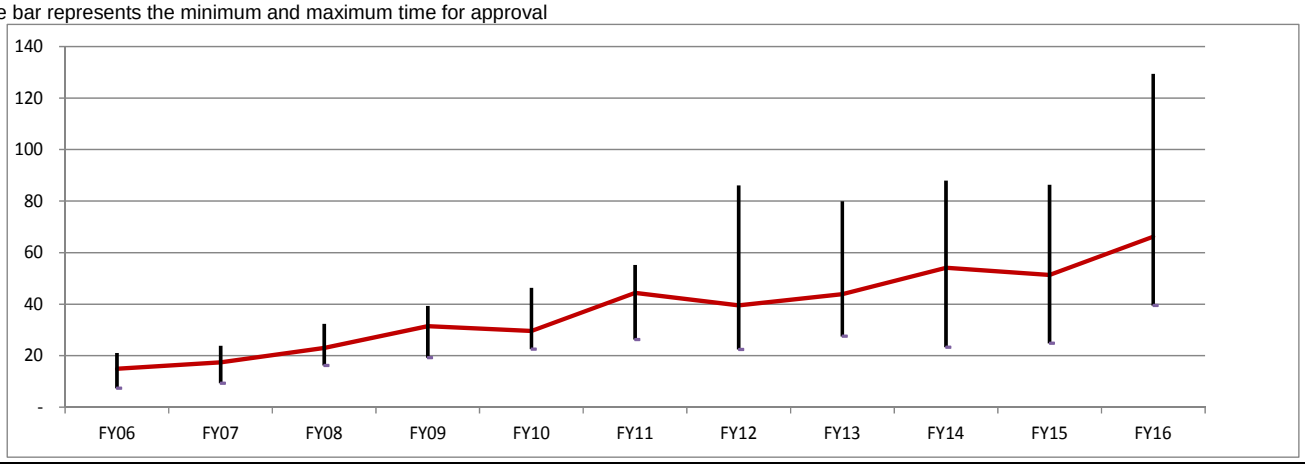
Filing year	Age	No of pending ANDAs	% of pipeline
FY16	<6 months	5	5%
FY15	6-18 months	18	17%
FY14	18-30 months	19	18%
FY13	30-42 months	19	18%
FY12	42-54 months	18	17%
FY11	54-66 months	1	1%
Pre FY11	>66 months	26	25%
Total		106	100%

Source: Nomura research

The average time for approval has been rising for Lupin, as is the case with the rest of the industry. The average time for approval for ANDAs approved in FY16 is 66 months compared with 51 months for approvals in FY15. Fig 5 shows the average approval timeline for first-wave and follow-on approvals separately. With approximately 36 ANDAs which are more than 50 months old, momentum for new approvals is likely to remain high in the near term.

Fig. 4: All ANDA approvals for Lupin-- Average duration of an approval

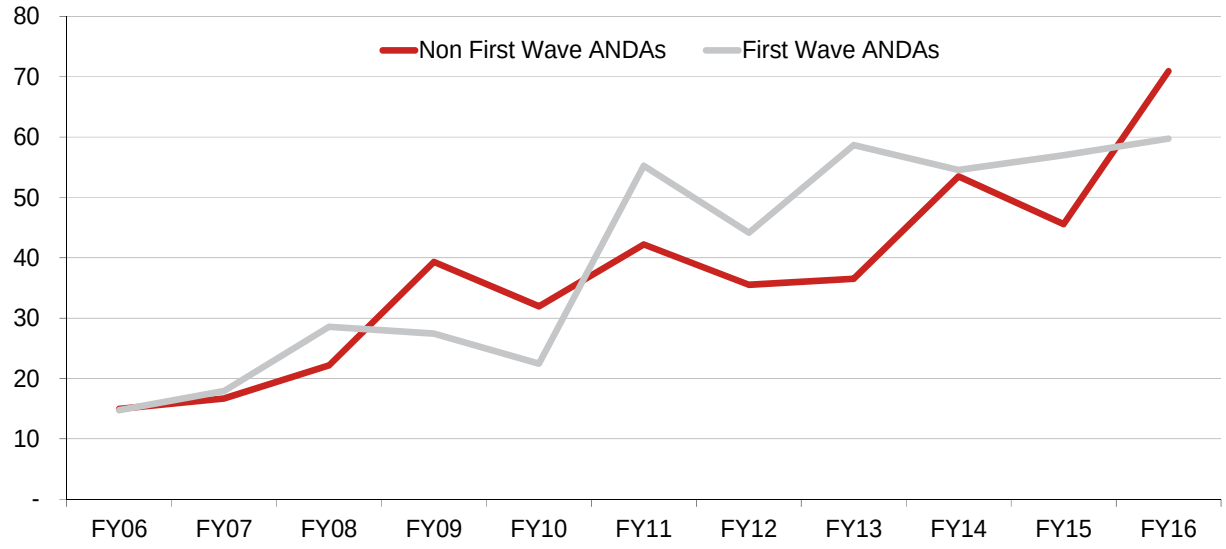
The bar represents the minimum and maximum time for approval



Source: USFDA, Nomura research

Fig. 5: Time for approvals (first-wave and non-first wave ANDAs)

The time for approvals has increased over time



Source: USFDA, Nomura research

Pipeline granularity

Out of the 106 ANDAs pending approval as on July 2015, we believe 61 ANDAs are in the public domain. This is based on litigation records and voluntary disclosure by Lupin. The 61 ANDAs have annual brand sales of USD 40bn, according to our estimates. Thus, we believe that 46 ANDAs with sales of USD15bn are not in the public domain. Therefore, the pipeline visibility is high at 57% in terms of the number of ANDAs and 73% in terms of brand value of the pending pipeline.

Fig. 6: Split between known and unknown ANDA filings

	No of ANDAs	Value (USD bn)
Known	61	40
Unknown	45	15
Total	106	55

Source: Nomura research

The pipeline presents a lot more visibility in the near term and we see a lean patch again in FY18F (Fig 7). New filings from FY16F onwards are unlikely to have any material

impact in FY18F given the timeline for product approvals, in our view. In general, we find that the value of the pipeline is growing at 10-11%. The FY19 portfolio is recording a stronger growth on the back of a 125% growth Y-Y in Lyrica.

Fig. 7: Known ANDA pipeline (post-1QFY16)

	FY16	FY17	FY18	FY19	FY20	>FY20	Total
No of ANDAs	12	10	8	6	4	21	61
Value (USD bn)	10.1	11.3	2.4	7	0.9	7.8	40
Growth (Y-Y)	9%	10%	11%	46%	10%	11%	15%

Source: Nomura research

Fig. 8: Known ANDA pipeline

FY16F		
Brand	Formulation	Sales (USD Mn)
Nexium	Caps	6,256
Celebrex	Caps	2,435
Namenda	Tabs	1,774
Renvela- tabs	Tabs	1,259
Wellbutrin XR	Tabs XR	726
Detrol LA	Caps ER	500
Tri-Cyclen Lo	Tabs	482
Exforge	Tabs	422
Glumetza	Tab XR	200
Zithromax	Caps	200
Renagel	Tabs	179
Fenofibrate	Tabs	160
Prilosec	Caps ER	160
Exforge HCT	Tabs	153
Zithromax	Suspension	137
Renvela susp	Suspension	99
Generess	Tabs	95
Prandimet	Tabs	3
PhosLo Gelcaps	Softgel	-

FY17F		
Brand	Formulation	Sales (USD Mn)
Abilify	Tabs	7,735
Seroquel XR	Tabs XR	1,355
Tamiflu	Caps	674
Welchol	Tabs	617
Nuvigil	Tab	475
Prevacid Solutab	Tabs	231
Coreg CR	Caps	225
Welchol- suspensio	Suspension	118
Phoslyra	Solution	2
Zymar	Opthalmics	-

FY18F		
Brand	Formulation	Sales (USD Mn)
Pristiq	Tabs XR	742
Viread	Tabs	693
Epzicom	Tabs	606
Apriso	Caps ER	190
Solodyn (65, 115mg)	Tabs XR	106
Zorvolex	Caps	37
Angeliq	Tabs	10
Viread	Tabs	1

FY19F		
Brand	Formulation	Sales (USD Mn)
Lyrica	Caps	3,375
Truvada	Tabs	2,652
Minastrin24Fe	OC	290
Solodyn (55, 80, 105mg	Tabs XR	145
Lyrica Oral Solution	Solution	2

FY20F		
Brand	Formulation	Sales (USD Mn)
Uloric	Tabs	402
Vigamox	Opthalmics	290
Toviaz	Tabs XR	218
Moxeza	Opthalmics	41

Beyond FY20F		
Brand	Formulation	Sales (USD Mn)
Atripla	Tabs	3,003
Prezista	Tab XR	1,194
Lumigan .01%	Opthalmics	593
Effient	Tabs	444
Lo Loestrin Fe	Tabs	394
Multaq	Tabs	394
Oracea	Caps	365
Vimovo	Tabs	336
Axiron	Solution	235
Livalo	Tabs	183
Banzel	Tabs	161
Savella	Tabs	135
Fosrenol	Tabs	122
Prolensa	Opthalmics	116
Tykerb	Tabs	92
Natazia	Tabs	26
Safyral	Tabs	20
Quartette	OC	10
Pennsaid	Derma	2
Acular LS	Opthalmics	1
Prezista New strengt	Tab XR	-
Xyrem	Solution	-

Source: US IMS, Nomura research

A few products hold the key: Glumetza presents an attractive opportunity

A step-up in product approvals is a positive. With the high frequency of approvals, there are possibilities of positive surprises, but such upsides are unpredictable and may not be sustainable, we believe. Thus, we think a few high-impact products are key for the revival of Lupin's US growth starting 4QFY16F. These include Glumetza, Nexium, Welchol and Renvela/Renagel for growth. Visibility on Glumetza's upside is high as LPC has tentative approval and the recent price increase in Glumetza adds to the upside. The visibility on the approval timing is limited on the rest given the regulatory challenges that the product presents. Renvela/Renagel and Nexium remain FY16F prospects, but Welchol is now likely only in FY17F, in our view.

Glumetza: Will the recent price hike benefit Lupin? Being the only generic player in Fortamet and Glumetza, Lupin has a unique position in 1000mg's extended release metformin formulation

Lupin is expected to launch gGlumetza with sole exclusivity in February 2016. The company already has a tentative approval. There are two factors that work in Lupin's favour:

a) The innovator hiked prices by 5-6x in Glumetza in June 2015. The impact of the price increase is not yet visible in the innovator's financials given the large inventory levels of Glumetza in the channel. Further, there is lack of clarity on possible discounts, which to an extent could negate the impact of a price increase. Despite the quantum of the impact being unclear at the moment, the price increase in Glumetza is an incremental positive. Lupin can benefit from: 1) higher realisation from Glumetza when it launches its generic in Feb 2015, and 2) the positive impact on gFortamet in terms of higher volume/price, which is a directly competing product.

b) Unique position in the extended release Metformin market: The extended release metformin market is split between Glucophage XR, Fortamet and Glumetza. The difference between the products is the extended release formulation technology. Glucophage XR is extensively genericized. Fortamet has limited generic competition with Lupin being the only generic in the market along with authorised generic from Actavis. Glumetza currently has no generic and would go generic in February 2016. In terms of sales, Fortamet and Glumetza command 51% and 40% of the market share, respectively, as per IMS sales data for 2QCY15. The key differentiation between Fortamet /Glumetza and Glucophage XR is the presence of 1000mg extended release tabs in Fortamet/Glumetza. Almost 90% of Fortamet and 60-65% of Glumetza sales come from 1,000mg formulation, where Glucophage has no presence. For high dose (1,000mg and more), Glumetza/Fortamet have lower GI side-effects compared to GlucophageXR. Therefore, Fortamet/Glumetza has its niche in high dose metformin extended release formulation, which to an extent provides pricing power. Lupin has presence in both gFortamet and gGlumetza, is the first generic entrant and competition in both the products is likely to remain low in the near term, in our view.

We estimate that Lupin clocked a revenue of USD120mn from Fortamet in FY15F. This represents 15% of the US generic revenue for FY15F, we estimate. For Glumetza, we factor in sales of USD50mn, USD87mn and USD50mn in FY16F, FY17F and FY18F, respectively.

Nexium and Welchol have development and regulatory hurdles and carry a risk of delays

gNexium will remain an attractive opportunity over the next 12-18 months, in our view. The product presents substantial API and formulation challenges. Though there are many ANDA filers, the final approval would be contingent on overcoming issues related to impurity levels and product stability. We expect staggered entry of generics in the market place. Lupin has faced delays in gaining approval, but an approval through the rest of FY16F will still present an interesting opportunity. The company expects approval by end-FY16F.

Similarly, we expect competition to be limited for a long period in gWelchol which presents substantial API and formulation challenges. Industry feedback suggests considerable delay in the approval for gWelchol, and Lupin would tend to gain substantially if it gains approval in the first-wave.

The other interesting opportunity in the near-term could be gRenvela/Renagel (Sevelamer). In Sevelamer, the challenge is largely around API, which is relatively complex and would require characterization, according to FDA guidelines. Competition may be limited in the initial phase, which over time is likely to intensify. We factor in likely generic approvals in FY17F, but a 4QFY16F approval cannot be ruled out.

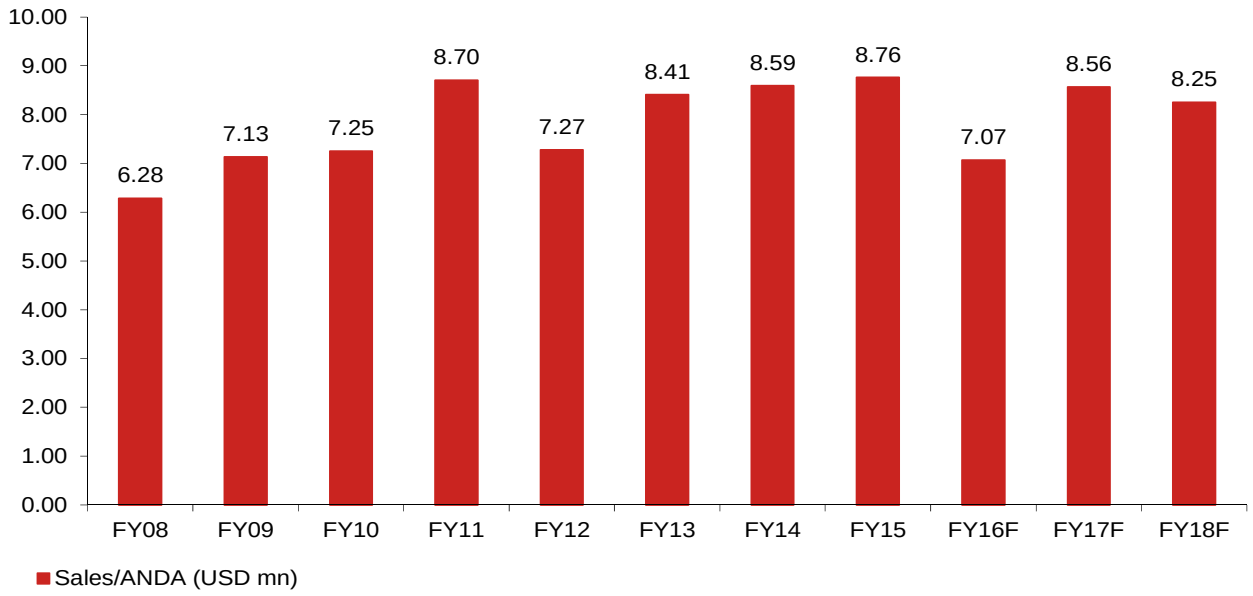
Each of these three products could generate annual revenue in excess of USD50mn in FY17F, in our view.

Attempt to move up the value chain

After the slowdown in US revenues in FY14 and FY15, and potential single-digit growth in FY16F, we expect a revival in growth in FY17F due to the specific product opportunities highlighted above. Lupin has recorded USD8.76mn of generic sales per approved ANDA in FY15, which is ahead of peers. Lupin's strong execution, in terms of the timely approval and strong customer service, has led to market share gains, supporting higher sales per ANDA. With a step-up in approvals and not a proportionate rise in revenue, we expect sales per ANDA to decline in FY16F, before reviving back in FY17F.

Fig. 9: Lupin--Sales per ANDA

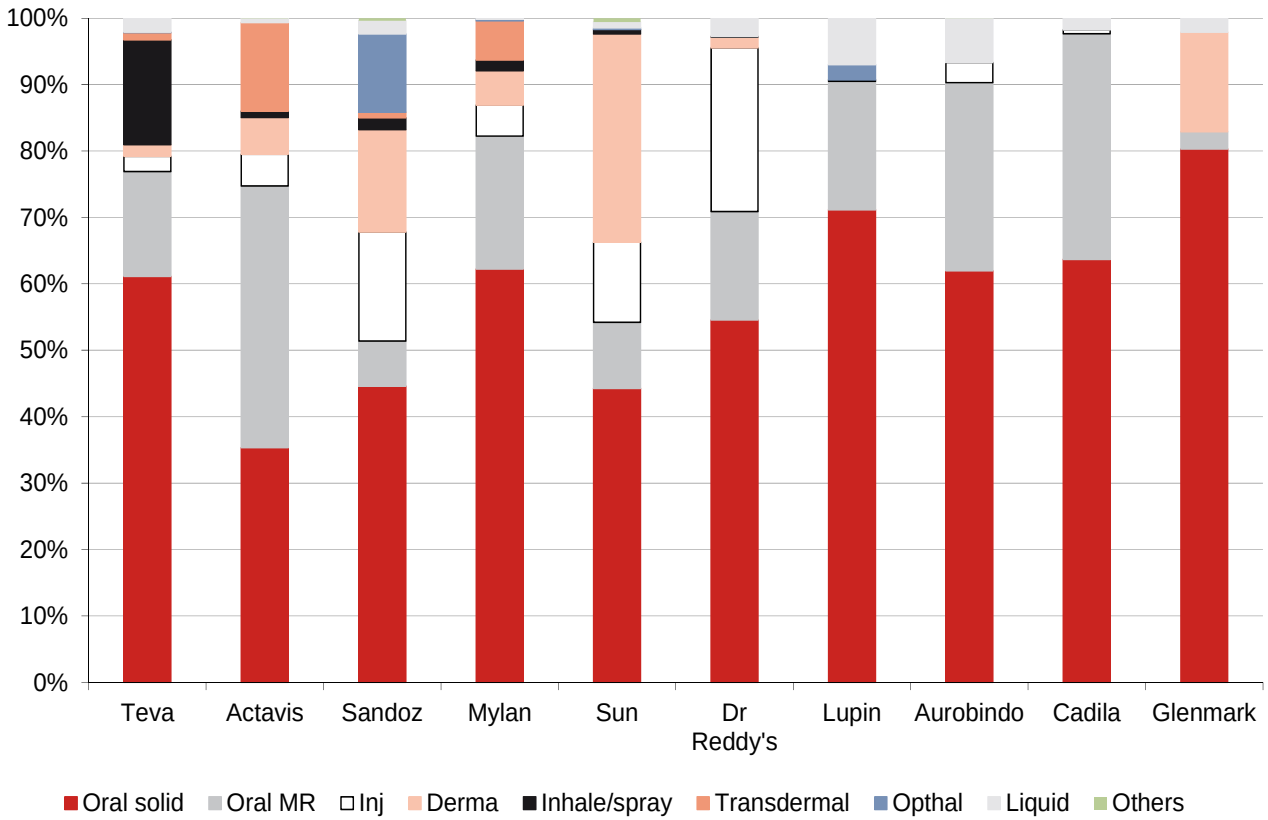
Sales per ANDA to fall in FY16F before rising again in FY17F



Source: Company data, Nomura estimates

In terms of product complexity, the gains for Lupin have been limited with gFortamet being an exception. In Fig 10, we present the sales split based on product formulations. LPC's portfolio is largely oral solids at the moment, with little presence in other formulation segments like derm and injectables. Even the pipeline is largely oral solids. Of the 61 ANDAs in the public domain, we believe that 51 ANDAs are oral solids.

Fig. 10: Revenue mix based on formulations



Source: IMS, Nomura estimates

Lupin has made some progress in segments such as dermatology, opthalmics, and controlled substance. Investments in complex injectables and inhalation are likely to gather pace in the near term. Visibility around the complex formulation is low and these segments are unlikely to have any material impact in the next three years, in our view.

Fig. 11: Complex product pipeline at the early stage of development

USD bn	Filed	Under Development
Controlled substance	0.7	6.7
Opthalmics	1.6	0.2
Derma	0.5	2.3
Injectables	0	16.6
Respiratory		15
Biosimilars		8.4

Source: Company data

Gavis acquisition: A step to expand capacity and pipeline size -- but not the capability

Lupin announced its acquisitions of Gavis Pharmaceuticals and Novel Laboratories for a total of USD880mn in 2015. These acquisitions should help add products in the dermatology and controlled substance segments. They will also help add 19 controlled substances and 22 dermatology products to the pipeline. Even the products under development have larger proportions of derma and controlled substances.

Through the acquisitions we believe Lupin will achieve the following objectives:

a) Larger number of shots at goal: Lupin gets a pipeline of 66 products pending approval with brand sales of USD9bn.
b) Expedite the development programmes in derma and controlled substance.

c) Expand R&D capacity: Lupin expects the expanded R&D capability will help to enhance its ANDA filing capacity from 25-30 pa to ~40-50.

Since Lupin has already made initial investments in segments like derma and controlled substance, an area where Gavis has a strong presence, the acquisition makes limited impact in improving formulation capabilities, in our view.

Like for Lupin, we find the approval rate for Gavis has also increased in recent past. Interestingly, we find that the average time for approval for Gavis is an impressive 37 months in 2015 so far. We estimate that ~40 out of the 66 ANDAs pending approval were filed before 2013 and hence are ready for approval in the near-term. This, along with the fact that Gavis' facility faces no regulatory uncertainty (the facility was inspected in 2015 without any 483 observations) implies high intensity of product approvals. LPC's management expects Gavis to gain 23 more approvals in FY16F (in the next six-seven months) and 34 more in FY17F.

Most opportunities for Gavis in the near-term will likely be in controlled substances. According to IMS, Schedule II controlled substances present a USD13bn market opportunity. The pricing of the market has remained firm due to shortages. We think the pipeline is yet to address the high-value extended release formulation opportunities. Though an attractive market, the ramp-up and market share gains are likely to be slower.

Financials

We introduce FY18F financials. We also factor in the recent currency movements across geographies. We now use INR66/USD, INR0.55/JPY and INR74/EUR for FY17F estimates and beyond. Our earlier currency assumptions were INR63/USD, INR0.53/JPY and INR71/EUR for FY17F. We also incorporate the impact of recent acquisitions.

Fig. 12: Revenue ex-other operating income estimates (INRmn)

US remains the key growth driver; US revenue growth to accelerate from 4QFY16F onwards

(INR mn)	FY13	FY14	FY15	FY16E	FY17E	FY18E	CAGR (FY15-18F)
Formulations	83,773	98,165	111,949	130,266	178,449	203,603	22%
India (Net)	23,221	24,796	29,680	34,429	39,765	45,929	16%
US generics	29,051	42,253	49,393	58,824	94,290	106,933	29%
US brand	7,722	4,864	5,093	4,011	4,798	5,545	3%
Japan	13,040	12,954	13,239	13,717	15,793	17,689	10%
Europe	2,356	3,164	3,262	4,086	5,449	6,451	26%
RoW	8,383	10,134	11,282	15,200	18,354	21,056	23%
API	9,498	11,178	11,941	13,135	14,055	15,038	8%
IP revenues	922	1,524	2,107	2,107	2,107	2,107	0%
Total	**94,193**	**110,867**	**125,997**	**145,508**	**194,611**	**220,748**	**21%**

Source: Company data, Nomura estimates

We project LPC's revenue in INR terms to record a growth of 15%, 33% and 13% Y-Y in FY16F, FY17F and FY18F, respectively. This represents a revenue CAGR of 21% over FY15-18F. Excluding contribution from acquisitions, the revenue CAGR should be 16%. US generics remain the key contributor for growth. Ex-Gavis, we expect US generics to record a 22% CAGR over FY15-18F, driven by the pick-up in high-value launches. For Gavis, we factor in 70 product approvals by FY18F, compared to management's expectation of 87. We estimate Gavis' FY16/17/18F revenues at USD128mn, USD196mn/USD268mn, respectively. This is lower than management's guidance of USD140mn, USD250mn and USD350mn for FY16F, FY17 and FY18F, respectively.

We expect Lupin to sustain revenue growth ahead of the broader market in India. Over the past five years, LPC has recorded a revenue CAGR of 17.5% in the domestic market. We believe LPC has delivered 250bps ahead of the markets it represents over the past five years, as per AIOCD AWACS data.

Lupin has established its presence in key emerging markets through acquisitions. The ROW markets (key RoW markets: South Africa, Australia, the Philippines and Mexico)

should collectively contribute ~10% over the next three years. Growth in ROW markets is driven by acquisitions. Ex-acquisitions, we project ROW markets to record an 11% revenue CAGR in INR terms.

In constant currency terms, we expect the Japan market to deliver 10-12% growth. Though volume growth is expected to remain strong, driven by increasing generic penetration and patent expiries, the pricing environment remains challenging due to aggressive competition from local generic companies. The increase in patent expiry, particularly in Neuro/CNS and cardiovascular segments over the next two years, should benefit Lupin, as the company has a strong presence in these segments.

We expect a step-up in R&D spend by recoding a CAGR of 31% over FY15-18F. R&D as a percentage of sales should be at 11-12% over the next three years. Despite the rise in R&D spend, we estimate EBITDA margins to range between 27% and 32%.

We believe acquisitions will lead to a rise in net debt in FY16F. However, cash flows on account of US launches should help bring down net debt over FY17F-18F.

We revise our FY16F and FY17F net earnings by -7% and +21%, respectively. The reduction in FY16F earnings estimate is due to the delay in key US launches and higher R&D spend estimates. The increase in our FY17F earnings is driven by our expectation of low competition and better pricing, particularly in gGlumetza, gWelchol and Gavis acquisition. As a result of these changes, we are 18% and 8% ahead of consensus FY17F/18F earnings, respectively.

Fig. 13: Change in revenue ex-other operating income estimates

	New estimates		Old estimates		% chg	
INRmn	**FY16F**	**FY17F**	**FY16F**	**FY17F**	**FY16F**	**FY17F**
Net sales	145,508	194,611	147,683	173,140	-1%	12%
EBITDA	38,231	59,419	39,501	47,980	-3%	24%
Net profit	25,454	40,257	27,250	33,159	-7%	21%

Source: Nomura estimates

New target price of INR2,149

Currently the stock trades at 26.6x one-year forward EPS of INR71.4. We expect Lupin to trade between 20-25x P/E, as the company has been trading at an average P/E one-year forward earnings of 23x, based on the past two years' data.

Fig. 14: Lupin (LPC) 1 year forward P/E

Source: Nomura estimates

We continue to value LPC at 23x 1-yr fwd EPS of INR93.4 (avg of FY17-18F) to arrive at our new TP of INR2,149, implying upside of 14% from current levels. Upgrade to Buy.

Key downside risks

a) Delay in the approval of key products – gNexium, gWelchol and gRenvela/Renagel

b) Adverse currency movements.

Appendix A-1

Analyst Certification

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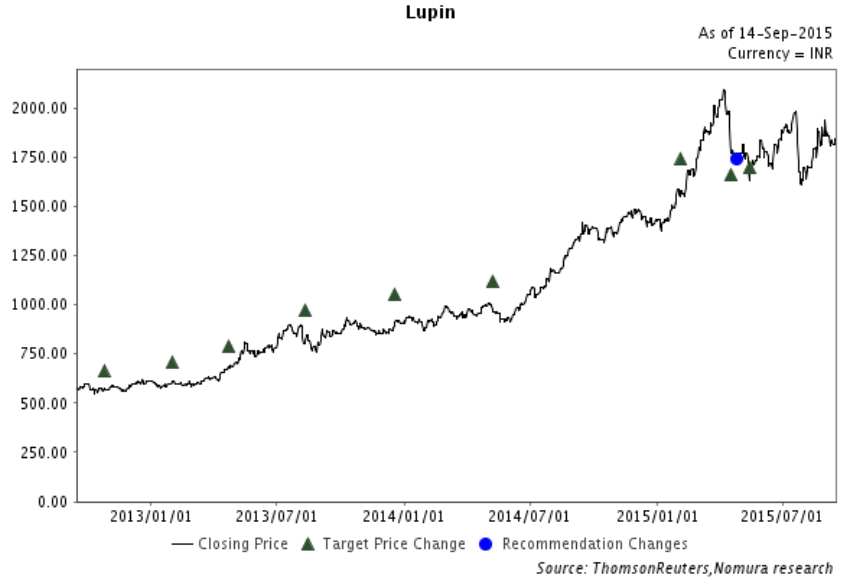
Issuer	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Lupin	LPC IN	INR 1880	21-Sep-2015	Buy	N/A	

Lupin (LPC IN) **INR 1880 (21-Sep-2015)** Buy (Sector rating: N/A)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
14-May-15		1,698.00	1,631.95
17-Apr-15	Neutral		1,770.05
17-Apr-15		1,661.00	1,770.05
04-Feb-15		1,738.00	1,579.65
08-May-14		1,120.00	979.30
18-Dec-13		1,053.00	891.70
11-Aug-13		972.00	801.35
23-Apr-13		790.00	680.10
31-Jan-13		705.00	604.30
25-Oct-12		660.00	572.80

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

Valuation Methodology Our target price of INR2,149 is based on a target P/E of 23x and FY17F EPS of INR88.6. We assign a 5% premium to the DCF value to derive our target P/E of 23x. The premium accounts for possible acquisition by LPC. The benchmark index for this stock is the MSCI India.

Risks that may impede the achievement of the target price Downside risks include: 1)delay in the approval of key products - gNexium, gWelchol and gRenvela/Renagel and 2)adverse currency movements

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