

INDIA RESEARCH

PHARMACEUTICAL

RESULT NOTE: Q4FY11

BSE SENSEX: 18336

MAY 13, 2011

Lupin

No surprises
OUTPERFORMER
Rs424

Mkt Cap: Rs189bn; US\$4.2bn

Key financials

	Net sales (Rs m)	Adj. net profit (Rs m)	Adj. EPS (Rs)	% growth	PER
FY09	37,424	4,157	9.3	1.8	45.5
FY10	49,039	7,147	16.0	71.9	26.4
FY11	58,320	8,626	19.4	20.7	21.9
FY12E	68,635	9,828	22.1	13.9	19.2
FY13E	81,117	11,308	25.4	15.1	16.7

Source: IDFC Securities Research

KEY RESULT HIGHLIGHTS

- Lupin's Q4FY11 revenues grew by 18%yoy to Rs15.1bn, ahead of our estimates of Rs13.8bn. EBITDA came at Rs2.7bn ahead of our estimates (at Rs2.5bn). Higher R&D costs impacted margins to 17.8% (our estimate, 18%). Net profits grew by 3%yoy to Rs2.27bn.
- Lupin's US & EU formulation sales grew by 10%yoy to Rs6.2bn with US operations clocking 6%yoy growth to Rs5.8bn above our estimates. Branded business surprised positively with strong qoq growth to Rs2bn ahead of our estimates. Generics business grew by 14%yoy to Rs3.8bn.
- Domestic formulation sales grew by 17% yoy to Rs3bn. Kyowa, the Japanese business, and South African Pharma dynamics grew by 28% and 49%yoy to Rs1.6bn and Rs514m respectively. API sales at Rs2.5bn contributed 18% to consolidated revenues.
- EBITDA came in at Rs2.7bn ahead of our estimates of Rs2.5bn however EBITDA margins at 17.8% were tad lower than our estimates of 18%. Margins were impacted by higher R&D costs (9.5% of sales for the quarter; 90bps higher yoy) and higher input costs due to swift rise in crude prices. The company reiterated their intent to pursue 50-75bps margins improvement every year going forward.
- Other operating income at Rs453m was in line with estimates
- Net profits grew by 3%yoy to Rs2.27bn. Tax rate for the quarter was 12%.
- Consolidated revenues grew 19.5% yoy to Rs57bn. Incidentally, this is the first year of <20% growth for Lupin after nearly 5 years of heady growth. Revenues grew at 31% CAGR over FY05-10. PAT at Rs8.6bn was 21% higher yoy.
- Lupin's D/E ratio improved to 0.22x as of Mar-11 (from 0.37x in FY10). Working capital cycle improved from 90 days in FY10 to 83 days in FY11 as the company continued to focus on optimization of working capital.
- The board has recommended a dividend of Rs3/ share for FY11, amounting to Rs1.34bn.

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OPERATIONAL PERFORMANCE

US market

- With 42% sales, US continues to be Lupin's primary growth market. In FY11, US business grew 27% in USD terms and 22% in rupee terms. Growth was primarily driven by ~35% growth in US generics as the branded business was flat yoy.
- Branded business growth was impacted by slowing growth in Suprax suspensions (grew 10% yoy) as well as challenges in Antara. However, the company indicated they have finally turned the corner on Antara sales as reflected in qoq growth in Antara during Q4FY11 and expect the franchise to grow hereon. Management believes that the Tricor generic is unlikely to come in over the next few quarters and this will give them ample space to further scale up the Antara franchise before generic competition sets in for Tricor
- On Suprax, the company does not see any imminent competition over the next few quarters and continues to work on the life cycle management of the product. The tablet formulation has begun to strongly (60% Rx growth in FY11) and Lupin expects an approval for Suprax drops formulation by H2FY12. The company hopes to substantially switchover Rx from the suspension formulations to drops. If executed well, this potential switch can significantly strengthen Suprax franchise and lower the potential impact from the future generic launches.
- On Allernase, the company indicated that they still working on the manufacturing issues and are not very confident of a FY12 launch per se. Overall, we believe that the growth in branded business is likely to be fairly modest over the next couple of years and an upward pickup will be largely driven by new product acquisitions in this segment.
- On the generic business front, Lupin continues to deliver strongly despite limited new product launches in FY11. Leadership position in 14 of the 30 marketed products and top 3 position in 27 out of 30 products reflected in >\$300mn sales with only ~30 products is indicative of Lupin's stupendous success in the US market.
- The business grew ~14% in Q4FY11 despite the high base of Lotrel as well as no material new launches. In FY12, the company expects to launch as many as 10 products including attractive products like Fortamet (Exclusive FTF), Lotrel higher strength (likely to be a 5 player market), Levofloxacin and Geodon (likely to be 4 player opportunity). Additionally, the company expects to start getting approvals for its OC products from Oct'11 onwards
- On the OC front, the company indicated that the competitive intensity in the space has seemingly gone up over the last couple of years as 3-4 more players have unraveled their plans. However, given that Lupin is the only vertically integrated player in the space and their ability to garner substantial marketshare in the face of extreme competition, the company continues to remain very optimistic on the OC opportunity. Management indicated that the OC portfolio should start showing meaningful contributions from H2FY13 onwards well in line with their target to achieve >\$150mn sales on OC products in the medium term.

Other geographies

- India business grew 17% for the year and was a tad lower than the 20%+ growth rates achieved in recent years. Company attributed it to the management decision to significantly reduce focus on acute therapy products. The company remains positive on achieving on ~20% growth in the coming years.
- Lupin's Japanese subsidiary, Kyowa grew 16% yoy to Rs6.2bn in FY11, despite a 15% price cut undertaken during the year, and contributed 11% to consolidated revenues. During Q4FY11 Japan revenues grew 13% yoy. Lupin launched 5 new products in FY11 and plans to launch 7 new products in FY12. The company expects substantial improvement in gross margins for Japanese operations via increased offshore manufacturing. Lupin expects to begin API supplies from India in early FY12, while expects supplies for finished dosage forms from 2HFY12-FY13 onwards.
- European business grew 30% yoy to Rs1.8bn in FY11 and was lower than our expectations. The company launched Clarithromycin XL in France during the fiscal. Lupin continues to focus on European market with 33 MAA filings with European authorities in FY11. Cumulatively, Lupin has 91 filings in Europe with 44 approvals to date.

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- Lupin's South African business – Pharma Dynamics grew 38% yoy to Rs1.8bn in FY11. Pharma Dynamics remains the fastest growing and the 6th largest generic company in the South African market with leadership in the cardiovascular space.
 - In Brazil, Lupin entered into alliance with Farmanguinhos and Department of Health, Brazil over select drugs. Approximately one third of the critical care drugs in Brazil are bought by these agencies and this deal should give a good start to Lupin's Brazil business.

Investment in R&D

- Lupin continues to aggressively invest in R&D and has spent Rs4.8bn in FY11 (8.5% of sales, 100bps higher yoy). This is amongst the highest in the Indian pharma industry and is indicative of management's commitment to keep aggressively investing in future growth.
- During the year, Lupin filed 21 ANDAs in US and is targeting to file another 30+ ANDAs in FY12. Lupin has 148 filings with the FDA with 48 approved products.
- With 60 Para IVs, 16 FTFs and 4 exclusive FTFs already in its bag, Lupin is gradually building one of the most valuable ANDA pipelines in the US generic market. This bodes well for the future
- The company continues to focus on niche products. While it already filed ~30 ANDAs in the OCs segment, the company has begun to file aggressively in the Ophthalmology segment from FY11 onwards. The company is planning to start filigns ophthalmic suspensions, which require clinical trials, from FY12 onwards. Going forward, the company is looking to file products in the dermatology and Asthma arena. In particular, Asthma is a key target therapy for Lupin over the medium term.
- Lupin also extended the license arrangement with Salix Pharmaceuticals for its proprietary bioadhesive drug delivery technology for Rifaximin. Under the extended agreement, Lupin granted Salix exclusive worldwide rights (except for India and some select geographies) to use Lupin technology and technology jointly developed by Lupin and Salix for all rifaximin products for human use.

Others

- Management also indicated its willingness to more aggressively explore inorganic growth options as it seeks to strengthen its presence in the branded space in US as well as create beach heads in the key emerging markets globally. The company indicated that it now ready to undertake relatively larger sized acquisitions than in the past and has capacity to comfortably fund such deals given its low gearing levels.
- The company spent nearly Rs4.8bn on Capex in FY11. The capex spend was utilised mainly towards:
 - creation of new manufacturing facilities (including construction of new facility in Pune for total cost of Rs1.75bn) as well as investment in existing facilities
 - 10-12% of the total towards efficiency and product management

VALUATIONS AND VIEW

Lupin's Q4FY11 results were broadly in line with estimates. While the moderation of topline and profit growth in FY11 has led to concerns on Lupin's growth outlook, particularly on the US branded business slowdown as well as the lack of new product approvals in the generics segment, we believe this slowdown in momentum is likely to be temporary. Despite the near term challenges, we continue to remain positive on Lupin's growth outlook and will view any further weakness in the stock as a buying opportunity. We maintain that Lupin is clearly one of the most scalable models in the Indian pharma industry with critical mass achieved across the key generic markets of US, Japan and India. Lupin remains one of our key picks in the space with exciting upside possibilities as its high quality ANDA pipeline in US begins to unfold with the launch of oral contraceptives (Q3CY12 onwards), FTFs as well as niche products. We have increased our FY12 earning estimates by 2% to Rs22.1 to account for stronger revenue growth in US generics and introduce our FY13 EPS at Rs25.4. Retain Outperformer call on the stock with a 12-month price target of Rs507/share

(20x FY13 earnings) from Rs476 earlier. While FY11 has been a lean year in terms of new product launches in US, the outlook remains exciting from Q2FY12 onwards as a slew of niche products are likely to get approved in US which will improve the sentiments on the stock.

Quarterly results

Particulars (Rs m)	Q4FY10	Q1FY11	Q2FY11	Q3FY11	Q4FY11
Net Sales	12,848	13,121	14,051	14,672	15,115
Operating Expenses	10,358	10,499	11,353	12,130	12,428
Cost of Sales	4,882	5,036	5,494	5,700	6,150
Other Expenses	5,475	5,463	5,859	6,430	6,278
EBITDA	2,491	2,622	2,697	2,542	2,687
EBITDA (%)	19.4	20.0	19.2	17.3	17.8
Other Income	539	230	303	464	453
Depreciation	408	401	435	413	463
Interest	78	82	88	78	78
PBT	2,543	2,370	2,478	2,516	2,599
Provision for Taxation	293	350	271	237	312
Tax rate	11.5	14.7	10.9	9.4	12.0
Minority and share in associate loss	(44.7)	(57.4)	(56.7)	(38.3)	(16)
PAT	2,206	1,963	2,150	2,240	2,272
R&D	1,125	1,038	1,155	1,178	1,461
	8.8	7.9	8.2	8.0	9.7
yoy growth (%)					
Net Sales	23.1	20.9	26.0	16.9	17.6
EBITDA	31.8	35.0	64.4	3.2	7.9
Net Profit	40.2	40.1	34.0	39.5	3.0

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