October 18, 2017

Lupin Limited

Summary of rated instruments

Instrument*	Rated Amount (in Rs. crore)	Rating Action
Non-Convertible Debenture programme	100.0	[ICRA]AAA&, placed on 'rating watch with developing implications'
Long-term, fund-based facilities	150.0	[ICRA]AAA&, placed on 'rating watch with developing implications'
Long-term, non-fund based facilities	40.0	[ICRA]AAA&, placed on 'rating watch with developing implications'
Short-term, fund-based facilities	950.0	[ICRA]A1+&, placed on 'rating watch with developing implications'
Short-term, non-fund based facilities	360.0	[ICRA]A1+&, placed on 'rating watch with developing implications'

*Instrument details are provided in Annexure-1

Rating action

ICRA has placed the long-term rating of [ICRA]AAA (pronounced ICRA triple A)[1] assigned to the Rs. 100.0 crore[2] non-convertible debenture programme, the Rs. 150.0 crore long-term, fund-based facilities and the Rs. 40.0 crore long-term, non-fund based facilities of Lupin Limited (Lupin) on 'rating watch with developing implications'. ICRA has also placed the short-term rating of [ICRA]A1+ (pronounced ICRA A one plus) assigned to the Rs. 950.0 crore short-term, fund-based facilities and the Rs. 360.0 crore short-term, non-fund based facilities of Lupin on 'rating watch with developing implications'.

Rationale

The ratings have been placed on 'rating watch with developing implications' following Lupin's announcement of acquiring the assets of the US-based Symbiomix Therapeutics LLC (Symbiomix) for a cash consideration of US$ 150 million (~Rs. 980 crore), including a US$ 50 million up-front and other time-based payments. In addition, there are sales-based contingent payments. Symbiomix is a biopharmaceutical company focusing on therapies for gynaecologic infections for the US generics market. The acquired lead investigational drug Solosec™ (secnidazole oral granules), a potent next-generation 5-nitroimidazole antibiotic, is anticipated to be the first and only single-dose oral treatment approved for bacterial vaginosis (BV) in women. Further, Solosec is eligible for new chemical entity (NCE) providing five years exclusivity as well as its qualified infectious disease product designation that further provides five years making it a total of ten years exclusivity in the US market. This acquisition complements the existing women's healthcare portfolio of Lupin in the US by accelerating its entry into the highly complementary gynecological infection segment. At present, Lupin's women's healthcare business in the US market is anchored by Methergine tablets, used for the prevention of postpartum hemorrhage.

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[1] *For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications*

[2] *100 lakh = 1 crore = 10 million*

The acquisition is being funded through internal accruals. However, ICRA expects significant investments initially for the ramp-up of supplies and the marketing expenses associated with the launch of the product. ICRA will continue to monitor the development closely and assess its impact on the credit risk profile of the company once more clarity emerges.

The ratings continue to reflect Lupin's strong and well-diversified business model supported by the branded formulations business (in India and the US), generic business (with leadership position in certain therapeutic segments) and backward integration through presence in active pharmaceutical ingredients (APIs). Aided by product launches with increasing share of complex or limited competition products together with prudent capital management with respect to new investments, Lupin's financial profile is marked by healthy operating profit margins (though moderated in Q1 FY2018), strong cash flow generation and comfortable debt protection metrics. Lupin is expected to continue to pursue its acquisition strategy in order to augment the existing branded drugs portfolio, expand geographical presence in other markets, further strengthen its presence in the Japanese market and its R&D through acquisition of technology based companies. ICRA expects Lupin's credit profile and liquidity position to remain healthy supported by strong pipeline of products yet to be commercialised across all its key markets.

Key rating drivers

Credit strengths

- **Strong and well-diversified business model supported by branded formulations business (in India and regulated markets), generics business (with leadership position in certain segments) and backward integration into APIs –** The revenue profile of Lupin is diversified, with presence in both branded and generic formulations in regulated and non-regulated markets. US, Europe and Japan contributed ~60% of total consolidated sales in FY2017. US branded sales contributed ~6% to the total US formulations sales in FY2017, increasing to ~9% in Q1 FY2018. Lupin's API manufacturing capabilities are predominantly focussed towards catering its own captive requirements for formulations– ~90% of APIs manufactured is consumed in-house. Sales from APIs contributed ~7% to total consolidated revenues in FY2017 and Q1 FY2018.
- **Robust abbreviated new drug applications (ANDA) filings, steady product launches, vertical integration and established relationship with channel partners have allowed Lupin to emerge as fourth largest generic company in the US by prescription; strong market positions in several other geographies –** Following the acquisition of Gavis Pharmaceuticals LLC (now Lupin Somerset) in July 2015, Lupin has the fifth largest pipeline of ANDA products, with 368 ANDA filings as on June 30, 2017. Of these 217 have been approved and 142 products (including four products launched in Q1 FY2018) have been commercialised, indicating a large part of the product pipeline is yet to come into play. Lupin ranks sixth in the Indian pharmaceutical market[3], contributing 22% of total consolidated revenues in FY2017 and 25% in Q1 FY2018. Moreover, Lupin had the highest contribution among peers from new product introductions as per IMS MAT June 2017.
- **Strong pipeline of limited-competition, difficult-to-manufacture products for the US generic market to support future growth and profitability –** Lupin's presence in the US generics business is marked by a product basket comprising niche, complex molecules in therapeutic areas of cardiovascular systems (CVS), central nervous system (CNS), oral contraceptives (OCs), dermatology, respiratory, and ophthalmology, among others. The limited competition products expected to be launched in the near term include Ranleva, Ranexa, Levothryoxine, Tamiflu, Advair, and Lialda, among others.

[3] *IMS MAT June 2017*

- **Lupin's domestic formulations business has continuously outperformed the Indian pharmaceutical market growth –** Lupin reported ~12% YoY growth in FY2017 in the domestic formulations business as against the Indian pharmaceutical industry growth of 10.3%[4], supported by new product launches. However, it reported a 1.8% YoY decline in Q1 FY2018 due to de-stocking by the trade prior to the implementation of the goods and services tax (GST).
- **Among the few domestic pharmaceutical companies to have established a successful presence, athough currently under stress, in the high-margin branded formulations market in the US**
- **Global leadership in several API segments, namely cephalosporin and CVS drugs -** Lupin has remained a global leader in cephalosporins (third generation anti-biotics), anti-tuberculosis (anti-TB) and the CVS space for over 15 years. It continues to gain traction with its global institutional business and remains among the largest suppliers of anti-TB products to the World Health Organisation's (WHO's) global drug facility. Lupin is the only company pre-qualified by the WHO globally for both its anti-TB APIs as well as its formulations.
- **Strong financial profile characterised by moderate gearing, robust profitability and credit metrics -** While the big-ticket debt-funded acquisition of Lupin Somerset in March 2016 has negated the erstwhile debt-free status of the company, the leveraging continues to remain comfortable as depicted by gearing (net debt/tangible networth) of 0.37 time as on June 30, 2017 supported by the robust accretion to reserves. The coverage indicators remain strong, as evinced by the NCA/ Net Debt of 60%, interest coverage of 16.77 times and Net Debt/OPBDITA of 1.08 times in FY2017.

Credit weaknesses

- **Channel consolidation in the US has resulted in reduction in profit margins across product segments -** During Q1 FY2018, the company reported YoY de-growth of ~13% in operating income mainly due to intense pricing pressure on base US generic business due to higher competitive intensity (faster ANDA approvals by USFDA), and consolidation in the supply chain leading to lower bargaining power. The other factor was the impact of GST on the domestic formulations business. The pricing pressure further led to a decline in operating profit margin to 20.7% during Q1 FY2018, as against 29.5% in Q1 FY2017.
- **Regulatory risks in developed markets, related to patent challenges, product launches and manufacturing facilities / processes**
- **Likelihood of further in-organic investments towards expanding geographic presence and strengthening portfolio of branded drugs –** Lupin is expected to continue to pursue its acquisition strategy to augment the existing branded drugs portfolio, expand geographical presence in other markets, further strengthen its presence in the Japanese market and its R&D through acquisition of technology based companies. However, its steady cash flow generation and currently strong credit profile partly mitigate the risks.
- **R&D investments in novel drug delivery systems (NDDS) yet to realise any substantial returns; however, NCE development has shown progress -** The total R&D spend of the company in Q1 FY2018 and FY2017 were Rs. 500.0 crore (13.1% of sales) and Rs. 2310 crore (13.5% of sales), respectively. As the company climbs the complexity curve (complex generics, biosimilars, and NDDS) and increases the number of filings, the level of R&D expenditure is expected to remain high. Nearly a sixth of the expected R&D spend would be targeted at NCE development, while another seventh or eighth would be aimed at biosimilars.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

[4] MAT, March 2017

Links to applicable criteria:
[Corporate Credit Rating - A Note on Methodology]
[Methodology for Pharmaceutical Industry]

About the company:
Lupin Limited (erstwhile Lupin Chemicals) was founded in 1968 by Late Dr. Desh Bandhu Gupta, the father of the current managing director, Mr. Nilesh Gupta, when Dr. Gupta had bought over the Lupin trade mark from Charak Pharmaceuticals in 1968. Set up originally as a proprietary concern, it was converted into a private limited company in 1972, and became a public limited company in 1992. In June 2001, Lupin Chemicals merged with Lupin Laboratories Limited, following which the merged entity was renamed as Lupin Limited. The amalgamation was aimed at leveraging the strengths of the two companies. Lupin is an integrated pharmaceutical company with a presence across research, manufacturing and marketing of formulations and APIs.

Globally, Lupin is the 7th and 6th largest generics pharmaceutical company by market capitalization (June 30th, 2017, Bloomberg) and revenues (March 31st, 2017, Bloomberg) respectively. The Company is the 4th largest pharmaceutical player in the US by prescriptions (Quintiles IMS MAT March 2017); 2nd largest Indian pharmaceutical company by global revenues (March 31st, 2017, Bloomberg); 6thlargest generic pharmaceutical player in Japan and 6th largest company in Indian Pharmaceutical Market (Quintiles IMS MAT June 2017).

The company's business mix can be broadly divided into two segments–formulations (accounted for 93% of Lupin's consolidated revenues in Q1 FY2018 and FY2017) and APIs (accounted for 7% of Lupin's consolidated revenues in Q1 FY2018 and FY2017). Lupin has a well-diversified geographic presence, with sales to the advanced markets (the US, Europe and Japan) accounting for nearly 61% of the company's total formulations sales in FY2017.
For the 12-month period ended March 31, 2017, Lupin reported a profit after tax (PAT) of Rs. 2,564.6 crore on an operating income (OI) of Rs. 17,375.6 crore, as against a PAT of Rs. 2,269.5 crore on an OI of Rs. 14,136.5 crore for the 12-month period ended March 31, 2016.
For the three-month period ended June 30, 2017, Lupin reported a PAT of Rs. 358.1 crore[5] on an OI of Rs. 3869.6.

Key Financial Indicators (Audited)

	FY2016	FY2017
Operating Income (Rs. crore)	14,136.5	17,375.6
PAT (Rs. crore)*	2,269.5	2,564.6
OPBDIT/ OI (%)	27.1%	27.2%
RoCE (%)	29.3%	22.4%
Total Debt/ TNW (times)	0.6	0.6
Total Debt/ OPBDIT (times)	1.9	1.7
Interest coverage (times)	20.3	16.8
NWC/ OI (%)	40%	30%

**before minority interest*
OI: Operating Income; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg. (Total Debt + Tangible Net-Worth + Deferred Tax Liability - Capital Work - in Progress); NWC: Net Working Capital

[5] *Before minority interest*

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for last three years:
Table:

S. No.	Instrument	Current Rating (FY2018)			Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. crore)	Date & Rating	Date & Rating in FY2017	Date & Rating in FY2016		Date & Rating in FY2015
				October 2017	August 2016	July 2015	April 2015	-
1	Fund-based facilities	Long-term	150.0	[ICRA]AAA &	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	-
2	Fund-based facilities	Short-term	950.0	[ICRA]A1+ &	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-
3	Non-fund based facilities	Long-term	40.0	[ICRA]AAA &	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	-
4	Non-fund based facilities	Short-term	360.0	[ICRA]A1+ &	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-
5	Non-Convertible Debenture programme	Long-term	100.0	[ICRA]AAA &	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	-

& -rating watch with developing implications

Complexity level of the rated instrument:
ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1

Instrument Details

Instrument	**Date of Issuance / Sanction**	**Coupon Rate**	**Maturity**	**Amount Rated (Rs. crore)**	**Current Rating and Outlook**
Fund-based facilities	-	-	Repayable on demand	150.0	[ICRA]AAA &
Fund-based facilities	-	-	Repayable on demand	950.0	[ICRA]A1+&
Non-fund based facilities	-	-	Repayable on demand	40.0	[ICRA]AAA&
Non-fund based facilities	-	-	Repayable on demand	360.0	[ICRA]A1+&
Non-convertible Debenture programme	Yet to be placed			100.0	[ICRA]AAA&

Source: Lupin Limited

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Contact Details

Analyst Contacts

Subrata Ray
+91 22 2433 1086
subrata@icraindia.com

Kinjal Shah
+91 22 6114 3442
kinjal.shah@icraindia.com

Sunil Murlidhar Bhole
+91 22 6114 3416
sunil.bhole@icraindia.com

Relationship Contact

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

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For more information, visit **www.icra.in**

Registered Office
ICRA Limited
1105, Kailash Building, 11th Floor, 26, Kasturba Gandhi Marg, New Delhi 110001
Tel: +91-11-23357940-50, Fax: +91-11-23357014

Corporate Office
Mr. Vivek Mathur
Mobile: +**91 9871221122**
Email: vivek@icraindia.com

Building No. 8, 2nd Floor, Tower A, DLF Cyber City, Phase II, Gurgaon 122002
Ph: +91-124-4545310 (D), 4545300 / 4545800 (B) Fax; +91- 124-4050424

Mumbai **Mr. L. Shivakumar** Mobile: +**91 9821086490** Email: shivakumar@icraindia.com 3rd Floor, Electric Mansion Appasaheb Marathe Marg, Prabhadevi Mumbai—400025, Board : +91-22-61796300; Fax: +91-22-24331390	**Kolkata** **Mr. Jayanta Roy** Mobile: **+91 9903394664** Email: jayanta@icraindia.com A-10 & 11, 3rd Floor, FMC Fortuna 234/3A, A.J.C. Bose Road Kolkata—700020 Tel +91-33-22876617/8839 22800008/22831411, Fax +91-33-22870728
Chennai **Mr. Jayanta Chatterjee** Mobile: +**91 9845022459** Email: jayantac@icraindia.com 5th Floor, Karumuttu Centre 634 Anna Salai, Nandanam Chennai—600035 Tel: +91-44-45964300; Fax: +91-44 24343663	**Bangalore** **Mr. Jayanta Chatterjee** Mobile: +**91 9845022459** Email: jayantac@icraindia.com 'The Millenia' Tower B, Unit No. 1004,10th Floor, Level 2 12-14, 1 & 2, Murphy Road, Bangalore 560 008 Tel: +91-80-43326400; Fax: +91-80-43326409
Ahmedabad **Mr. L. Shivakumar** Mobile: +**91 9821086490** Email: shivakumar@icraindia.com 907 & 908 Sakar -II, Ellisbridge, Ahmedabad- 380006 Tel: +91-79-26585049, 26585494, 26584924; Fax: +91-79-25569231	**Pune** **Mr. L. Shivakumar** Mobile: +**91 9821086490** Email: shivakumar@icraindia.com 5A, 5th Floor, Symphony, S.No. 210, CTS 3202, Range Hills Road, Shivajinagar,Pune-411 020 Tel: + 91-20-25561194-25560196; Fax: +91-20- 25561231
Hyderabad **Mr. Jayanta Chatterjee** Mobile: +**91 9845022459** Email: jayantac@icraindia.com 4th Floor, Shobhan, 6-3-927/A&B. Somajiguda, Raj Bhavan Road, Hyderabad—500083 Tel:- +91-40-40676500	