

**HOLD**

TP: Rs 340 | ▲ 11%

**LAURUS LABS**

| Pharmaceuticals

| 28 April 2023

### Dismal quarter

- Q4 a miss on all fronts – revenue/EBITDA/PAT below consensus by 16%/35%/55%
- EBITDA margin at a 3Y low of 21% owing to a change in mix and high costs; PAT down 49% QoQ
- We cut FY24 PAT by 35% and roll over to a new TP of Rs 340 (vs. Rs 540) based on 12x EV/EBITDA (vs. 14x); maintain HOLD

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**Miss on revenue owing to below-expected CDMO:** Laurus posted one of its weakest quarterly prints in Q4FY23 with subpar revenue in CDMO/FDF, further exacerbated by a shift towards low-margin business. Revenue/EBITDA/PAT declined 11%/29%/49% QoQ and missed consensus estimates by 16%/35%/55%.

**Shift in business mix causes lowest margin in three years:** Gross margin contracted 375bps QoQ to 49.7% (-235bps YoY) due to a change in business mix as well as a significant price decline in the ARV portfolio (APIs as well as formulations). Negative operating leverage arising out of lower revenue and commissioning of new capacities took a further toll, resulting in EBITDA margin contraction of 545bps QoQ to 20.7% (-715bps YoY).

**FY24 to be a year of consolidation:** Laurus did not record any sales from the Global Fund order during the quarter, but this order will help the company use its capacities over the next three years, reliving some stress from the negative operating leverage seen in Q4. Management believes that excess channel inventory and adverse pricing are near the bottom and that FY24 is going to be a year of consolidation.

**Retain HOLD:** We believe Laurus has long-term growth levers in place to improve its margin trajectory and profitability via increased utilisation of new capacities, supplies to Global Fund from FY24, and 60 active projects in the CDMO. However, the near-term outlook remains challenging given the lack of large CDMO contracts, excess channel inventory and continued pricing challenges, resulting in margin pressure from negative operating leverage. We cut FY24 earnings estimates by ~35% and roll forward to a revised TP of Rs 340 (vs. Rs 540), based on 12x FY25E EV/EBITDA (earlier 14x). Maintain HOLD.

### Key changes

Target	Rating
▼	◀ ▶

Ticker/Price	LAURUS IN/Rs 308
Market cap	US\$ 2.0bn
Free float	74%
3M ADV	US\$ 8.4mn
52wk high/low	Rs 606/Rs 279
Promoter/FPI/DII	27%/23%/5%

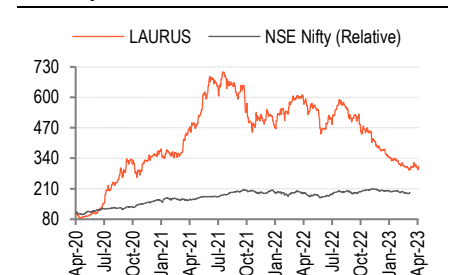
Source: NSE | Price as of 28 Apr 2023

### Key financials

Y/E 31 Mar	FY23P	FY24E	FY25E
Total revenue (Rs mn)	60,410	62,744	69,525
EBITDA (Rs mn)	15,926	14,117	17,034
Adj. net profit (Rs mn)	7,906	6,516	8,423
Adj. EPS (Rs)	14.7	12.1	15.7
Consensus EPS (Rs)	14.7	16.5	20.1
Adj. ROAE (%)	21.4	15.1	17.0
Adj. P/E (x)	20.9	25.3	19.6
EV/EBITDA (x)	11.5	13.2	10.9
Adj. EPS growth (%)	(4.6)	(17.6)	29.3

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

### Stock performance



Source: NSE



**Fig 1 – Quarterly performance**

(Rs mn)	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ (%)	FY23	FY22	YoY (%)
<b>Net Sales</b>	<b>13,809</b>	<b>14,248</b>	<b>(3.1)</b>	<b>15,448</b>	<b>(10.6)</b>	<b>60,406</b>	<b>49,356</b>	<b>22.4</b>
<b>EBITDA</b>	<b>2,855</b>	<b>3,967</b>	<b>(28.0)</b>	<b>4,036</b>	<b>(29.2)</b>	<b>15,922</b>	<b>14,224</b>	<b>11.9</b>
Depreciation	870	657	32.4	844	-	3,241	2,515	-
EBIT	1,985	3,310	-	3,191	-	12,681	11,709	-
Interest	531	306	-	427	-	1,652	1,024	-
Other Income	17	13	-	14	-	60	153	-
PBT	1,471	3,017	(51.2)	2,779	(47.0)	11,089	10,839	2.3
Less: Taxation	399	698	(42.8)	748	-	3,123	2,514	-
Less: Minority Interest	42	14	-	0	-	65	49	-
<b>Recurring PAT</b>	<b>1,030</b>	<b>2,305</b>	<b>(55.3)</b>	<b>2,030</b>	<b>(49.3)</b>	<b>7,902</b>	<b>8,275</b>	<b>(4.5)</b>
Exceptional items	0	0	-	0	-	0	0	-
<b>Reported PAT</b>	<b>1,030</b>	<b>2,305</b>	<b>(55.3)</b>	<b>2,030</b>	<b>(49.3)</b>	<b>7,902</b>	<b>8,275</b>	<b>(4.5)</b>
<b>Key Ratios (%)</b>			<b>(bps)</b>		<b>(bps)</b>			<b>(bps)</b>
Gross Margin	49.7	52.0	(235)	53.4	(373)	54.1	55.6	(148)
EBITDA Margin	20.7	27.8	(716)	26.1	(545)	26.4	28.8	(246)
Tax / PBT	27.1	23.1	-	26.9	-	28.2	23.2	-
NPM	7.5	16.2	(872)	13.1	(568)	13.1	16.8	(369)
EPS (Rs)	1.9	4.3	(55.4)	3.8	(49.3)	14.7	15.5	-

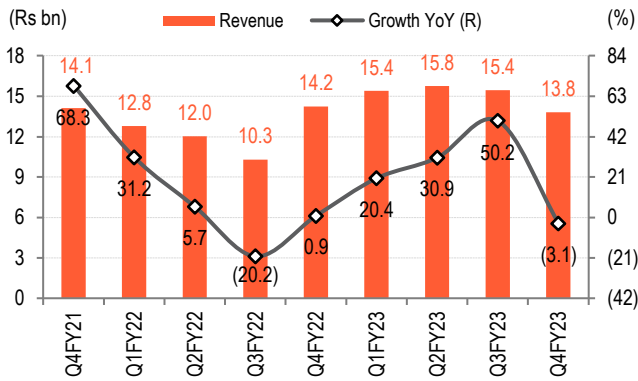
Source: Company, BOBCAPS Research

**Fig 2 – Revenue mix**

(Rs mn)	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ (%)	FY23	FY22	YoY (%)
Generics – API	7,140	5,390	32.5	6,320	13.0	26,090	20,390	28.0
ARVs	3,499	2,965	18.0	3,729	(6.2)	15,090	12,490	20.8
Oncology	1,285	701	83.4	758	69.5	3,195	2,890	10.5
Other API	2,356	1,725	36.6	1,833	28.6	7,805	5,010	55.8
Synthesis	2,280	3,600	(36.7)	6,420	(64.5)	21,670	9,170	136.3
Formulations	3,930	4,910	(20.0)	2,490	57.8	11,400	18,800	(39.4)
Bio	460	350	31.4	220	109.1	1,250	1,000	25.0
<b>Net Sales</b>	<b>13,809</b>	<b>14,248</b>	<b>(3.1)</b>	<b>15,449</b>	<b>(10.6)</b>	<b>60,406</b>	<b>49,356</b>	<b>22.4</b>

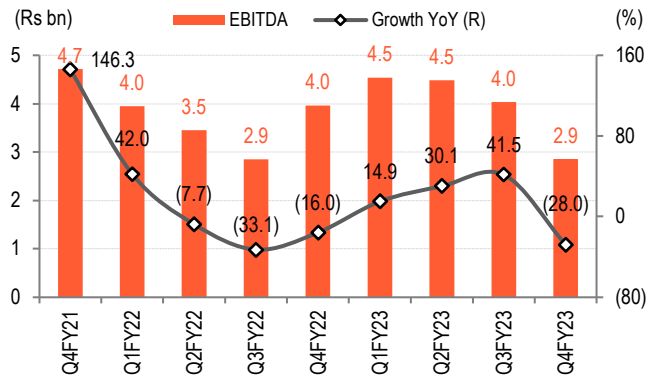
Source: Company, BOBCAPS Research

**Fig 3 – Revenue**



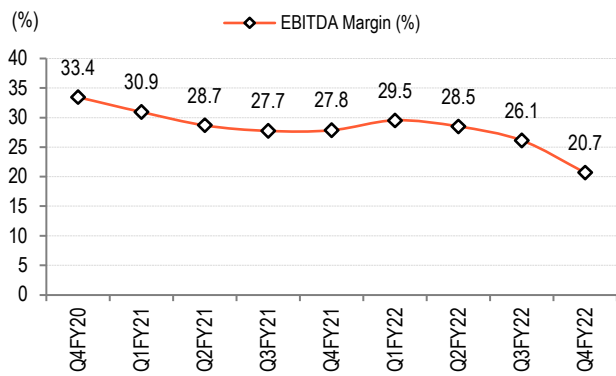
Source: Company, BOBCAPS Research

**Fig 4 – EBITDA**



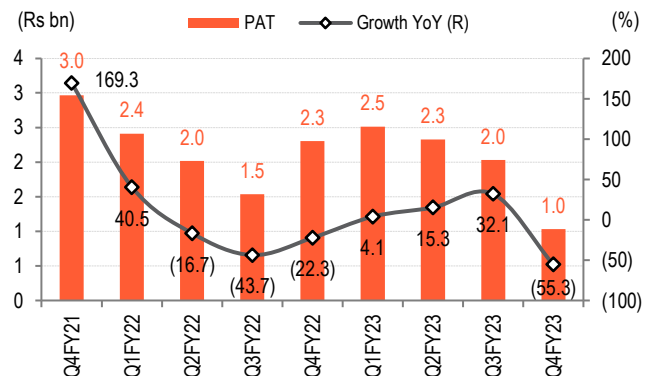
Source: Company, BOBCAPS Research

**Fig 5 – EBITDA margin**



Source: Company, BOBCAPS Research

**Fig 6 – PAT**



Source: Company, BOBCAPS Research

### Earnings call highlights

- **Business highlights:** Laurus's Q4FY23 revenue declined 3% YoY due to lower sales in CDMO-Synthesis and ARV FDF. Though there was sequential recovery in ARV FDF volumes, pricing remained depressed. API business saw a healthy uptick, both YoY and QoQ.
  - **Formulations (FDF):** FDF saw a sequential recovery of 58%, but a 20% decline YoY due to soft ARV demand and weak pricing. Developed market growth was stable with higher generic volumes.
  - **APIs:** All API segments did well and the business reported strong 33% YoY growth. Steady ramp-up continued in the other API business (+37%) along with ARV (+18%) and oncology APIs (+83%).
  - **Synthesis:** The synthesis business declined of 65% QoQ and 37% YoY due to completion of supplies related to a large purchase order in Dec'22. Per the company, Q4 baseline business is seeing healthy momentum and the project pipeline continues to scale up. Expansion in integrated CDMO capabilities (including R&D centre and Animal Health) is on track.

- **Bio:** The business delivered strong recovery with +31% YoY growth (+109% QoQ) in Q4.
- **Guidance**
  - **Revenue:** Laurus expects FY24 to be a year of consolidation and has guided for flat-to-moderate topline growth given a high base of FY23 which had large contract wins.
  - **Margins:** Management expects the EBITDA margin to improve from Q1FY24 onwards aided by operating leverage.
  - **Capex:** Laurus spent Rs 9.5bn in capex during FY23 with Rs 10.5bn to be invested in FY24.
- **Margins:** The Q4 gross margin at 49.7% decreased by 235bps YoY and 375bps QoQ due to a change in product mix and pricing pressure in the ARV portfolio. EBITDA margin at 20.7% decreased by 715bps YoY and 545bps QoQ.
- **FDf capacity:** Current utilisation of the Rs 10bn-unit FDF capacity is at ~55% which management expects will improve to ~70% by end-FY24.
- **Global Fund supplies:** Shipments have begun but were not meaningful in Q4. Being a panel supplier, the company is assured of making supplies over the next three years.
- **R&D:** R&D spend for FY23 stood at Rs 2.1bn or 3.5% of sales, with similar levels guided for FY24. The new R&D centre (FY24) and commercial GMP manufacturing for an animal health contract will be initiated from H2FY24.
- **Tax rate:** With a move to the new tax regime, the effective tax rate is guided at 25% from FY24 onwards.

## Valuation methodology

We believe Laurus has long-term growth levers in place to improve its margin trajectory and profitability via increased utilisation of new capacities, supplies to Global Fund from FY24, and 60 active projects in the CDMO. However, the near-term outlook remains challenging given the lack of large CDMO contracts, excess channel inventory and continued pricing challenges, resulting in margin pressure from negative operating leverage. We cut our FY24 earnings estimates by ~35% and roll valuations forward to FY25E for a revised TP of Rs 340 (vs. Rs 540), based on 12x EV/EBITDA (vs. 14x). Maintain HOLD.

**Fig 7 – Revised estimates**

(Rs bn)	New		Old		Change (%)	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Sales	62.7	69.5	65.1	NA	(3.7)	-
EBITDA	14.1	17.0	18.9	NA	(25.3)	-
EBITDA margin (%)	22.5	24.5	29.0	NA	(650bps)	-
EPS (Rs)	12.1	15.7	18.8	NA	(35.4)	-

Source: BOBCAPS Research

**Fig 8 – Key assumptions**

Parameter	FY23E	FY24E	FY25E
Generic APIs	26.1	28.7	31.6
Generic FDF	11.4	14.3	15.7
Synthesis (CDMO)	21.7	18.4	20.6
Biotech	1.3	1.4	1.6

Source: Company, BOBCAPS Research

## Key risks

Key upside risks to our estimates are:

- revival in ARV pricing and demand,
- accelerated approval of new products and higher utilisation of FDF capacities, and
- long-term supply contract wins.

Key downside risks to our estimates are:

- higher concentration and pricing pressure in ARVs,
- delay in formulation business ramp-up, and
- adverse regulatory outcome on manufacturing facilities.

## Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	2.1	1,313	1,470	HOLD
Alembic Pharma	ALPM IN	1.3	556	615	HOLD
Alkem Labs	ALKEM IN	5.1	3,510	3,000	SELL
Aurobindo Pharma	ARBP IN	4.4	617	635	BUY
Cipla	CIPLA IN	9.0	908	1,250	BUY
Divi's Labs	DIVI IN	10.6	3,268	3,200	HOLD
Dr Reddy's Labs	DRRD IN	10.0	4,930	4,700	HOLD
Eris Lifesciences	ERIS IN	1.0	631	810	BUY
Glenmark Life Sciences	GLS IN	0.8	504	585	BUY
Laurus Labs	LAURUS IN	2.0	308	340	HOLD
Lupin	LPC IN	3.9	710	700	HOLD
Sun Pharma	SUNP IN	29.0	988	1,100	HOLD

Source: BOBCAPS Research, NSE | Price as of 28 Apr 2023

## Glossary

Glossary of Abbreviations			
<b>API</b>	Active Pharmaceutical Ingredient	<b>CMO</b>	Contract Manufacturing Organization Services
<b>ARV</b>	Antiretroviral	<b>FDF</b>	Finished Dosage Form Division
<b>Bio</b>	Biotechnology Division	<b>GMP</b>	Good Manufacturing Practice
<b>CDMO</b>	CDMO Synthesis Division		

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
<b>Total revenue</b>	<b>48,135</b>	<b>49,360</b>	<b>60,410</b>	<b>62,744</b>	<b>69,525</b>
EBITDA	15,331	14,229	15,926	14,117	17,034
Depreciation	2,051	2,515	3,241	4,010	4,397
EBIT	13,280	11,714	12,686	10,108	12,637
Net interest inc./(exp.)	(682)	(1,024)	(1,652)	(1,545)	(1,545)
Other inc./(exp.)	237	153	60	125	139
Exceptional items	0	0	0	0	0
EBT	12,835	10,843	11,094	8,688	11,231
Income taxes	3,173	2,514	3,123	2,172	2,808
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	2	45	65	0	0
<b>Reported net profit</b>	<b>9,660</b>	<b>8,284</b>	<b>7,906</b>	<b>6,516</b>	<b>8,423</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>9,660</b>	<b>8,284</b>	<b>7,906</b>	<b>6,516</b>	<b>8,423</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
Accounts payables	11,787	8,764	7,107	11,173	13,334
Other current liabilities	3,158	5,661	5,921	4,392	4,867
Provisions	757	892	1,016	1,055	1,169
Debt funds	15,799	20,774	22,074	22,074	22,074
Other liabilities	0	0	0	0	0
Equity capital	1,073	1,075	1,075	1,075	1,075
Reserves & surplus	24,934	32,516	39,409	44,936	52,352
Shareholders' fund	26,007	33,591	40,484	46,011	53,427
<b>Total liab. and equities</b>	<b>57,507</b>	<b>69,680</b>	<b>76,601</b>	<b>84,706</b>	<b>94,870</b>
Cash and cash eq.	485	759	482	1,618	2,964
Accounts receivables	13,061	13,542	15,804	16,331	18,096
Inventories	15,754	17,603	16,848	18,909	20,953
Other current assets	2,845	2,811	3,374	3,765	4,172
Investments	34	308	499	499	499
Net fixed assets	19,150	23,953	31,494	35,484	40,088
CWIP	3,622	8,132	5,508	5,508	5,508
Intangible assets	2,556	2,571	2,592	2,592	2,592
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>57,507</b>	<b>69,680</b>	<b>76,601</b>	<b>84,706</b>	<b>94,870</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
<b>Cash flow from operations</b>	<b>6,914</b>	<b>8,118</b>	<b>7,798</b>	<b>10,125</b>	<b>11,353</b>
Capital expenditures	(6,277)	(6,416)	(10,000)	(8,000)	(9,000)
Change in investments	0	(274)	(191)	0	0
Other investing cash flows	0	0	0	0	0
<b>Cash flow from investing</b>	<b>(6,277)</b>	<b>(6,690)</b>	<b>(10,191)</b>	<b>(8,000)</b>	<b>(9,000)</b>
Equities issued/Others	4	2	0	0	0
Debt raised/repaid	4,343	4,975	1,301	0	0
Interest expenses	0	0	5	0	0
Dividends paid	(1,006)	(1,008)	(1,008)	(1,008)	(1,008)
Other financing cash flows	(3,509)	(5,122)	1,818	19	0
<b>Cash flow from financing</b>	<b>(169)</b>	<b>(1,153)</b>	<b>2,115</b>	<b>(989)</b>	<b>(1,008)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>468</b>	<b>275</b>	<b>(277)</b>	<b>1,136</b>	<b>1,345</b>
<b>Closing cash &amp; cash eq.</b>	<b>485</b>	<b>759</b>	<b>482</b>	<b>1,618</b>	<b>2,964</b>

### Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23P	FY24E	FY25E
Reported EPS	18.0	15.4	14.7	12.1	15.7
Adjusted EPS	18.0	15.4	14.7	12.1	15.7
Dividend per share	1.5	1.5	1.5	1.5	1.5
Book value per share	48.4	62.5	75.2	85.5	99.3

### Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23P	FY24E	FY25E
EV/Sales	3.7	3.6	3.0	3.0	2.7
EV/EBITDA	11.5	12.6	11.5	13.2	10.9
Adjusted P/E	17.1	19.9	20.9	25.3	19.6
P/BV	6.4	4.9	4.1	3.6	3.1

### DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23P	FY24E	FY25E
Tax burden (Net profit/PBT)	75.3	76.4	71.3	75.0	75.0
Interest burden (PBT/EBIT)	96.6	92.6	87.5	86.0	88.9
EBIT margin (EBIT/Revenue)	27.6	23.7	21.0	16.1	18.2
Asset turnover (Rev./Avg TA)	33.9	25.7	25.8	24.0	24.2
Leverage (Avg TA/Avg Equity)	1.6	1.6	1.6	1.5	1.4
Adjusted ROAE	44.2	27.8	21.4	15.1	17.0

### Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23P	FY24E	FY25E
<b>YoY growth (%)</b>					
Revenue	70.0	2.5	22.4	3.9	10.8
EBITDA	171.0	(7.2)	11.9	(11.4)	20.7
Adjusted EPS	276.6	(14.3)	(4.6)	(17.6)	29.3
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	31.9	28.8	26.4	22.5	24.5
EBIT margin	27.6	23.7	21.0	16.1	18.2
Adjusted profit margin	20.1	16.8	13.1	10.4	12.1
Adjusted ROAE	44.2	27.8	21.4	15.1	17.0
ROCE	38.1	24.7	21.8	15.7	17.8
<b>Working capital days (days)</b>					
Receivables	99	100	95	95	95
Inventory	119	130	102	110	110
Payables	89	65	43	65	70
<b>Ratios (x)</b>					
Gross asset turnover	1.6	1.4	1.3	1.2	1.1
Current ratio	2.0	2.3	2.6	2.4	2.4
Net interest coverage ratio	19.5	11.4	7.7	6.5	8.2
Adjusted debt/equity	0.6	0.6	0.5	0.4	0.4

Source: Company, BOBCAPS Research | Note: TA = Total Assets

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### Recommendation scale: Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

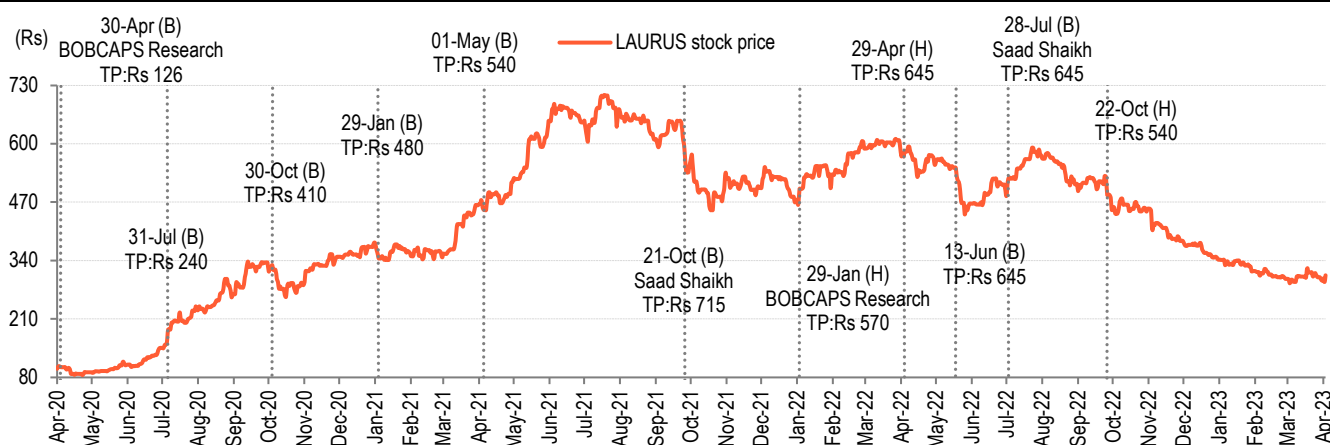
**HOLD** – Expected return from -6% to +15%

**SELL** – Expected return <-6%

**Note:** Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

### Ratings and Target Price (3-year history): LAURUS LABS (LAURUS IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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