BOBCAPS
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FIRST LIGHT

29 November 2019

RESEARCH

VRL Logistics | Target: Rs 330 | +23% | BUY

Robust model, formidable moats – initiate with BUY

Laurus Labs | Target: Rs 480 | +36% | BUY

NDR takeaways

SUMMARY

VRL Logistics

We initiate coverage on VRL Logistics (VRLL) with BUY and a Mar'21 TP of Rs 330, set at 22x FY22E P/E. Despite a prolonged growth slowdown, VRLL's competitive moats are intact – viz. a wide network, vast scale of operations, and cost and capital efficiency. An asset-heavy operating model also adds heft to the LTL business. Though we are cautious on near-term prospects and build in a 6% topline CAGR over FY19-FY22, we expect VRLL to outperform the industry once the economic cycle turns, by virtue of its superior business model.

Click here for the full report.

Laurus Labs

We recently hosted the management of Laurus Labs with investors. Overall, we found management's tone confident yet realistic. Three key priorities were outlined for the next three years: (1) revive predictability & stickiness in the business, (2) ensure prudent capital allocation vs. growth, (3) move closer to 20% ROCE. Laurus maintained its positive FCF guidance starting FY21 despite Rs 2bn-2.5bn of capex each for FY20/21. Gross debt will be capped at Rs 11bn.

Click here for the full report.

TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Cipla	Buy	570
ONGC	Buy	210
Petronet LNG	Buy	400
Reliance Industries	Buy	1,670
TCS	Add	2,230

MID-CAP IDEAS

Company	Rating	Target
Alkem Labs	Buy	2,290
Future Supply	Buy	680
Greenply Industries	Buy	210
Laurus Labs	Buy	480
PNC Infratech	Buy	245

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.77	2bps	(3bps)	(129bps)
India 10Y yield (%)	6.47	(1bps)	(3bps)	(117bps)
USD/INR	71.35	0.2	(0.7)	(1.0)
Brent Crude (US$/bbl)	64.06	(0.3)	3.3	9.0
Dow	28,164	0.2	4.5	11.0
Shanghai	2,903	(0.1)	(1.8)	11.6
Sensex	41,021	0.5	5.0	14.8
India FII (US$ mn)	**26 Nov**	**MTD**	**CYTD**	**FYTD**
FII-D	(170.3)	(278.9)	4,407.9	3,863.3
FII-E	630.7	3,174.4	13,397.2	6,552.0

Source: Bank of Baroda Economics Research

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BUY
TP: Rs 330 | 23%

VRL LOGISTICS | Logistics | 28 November 2019

Robust model, formidable moats – initiate with BUY

We initiate coverage on VRL Logistics (VRLL) with BUY and a Mar'21 TP of Rs 330, set at 22x FY22E P/E. Despite a prolonged growth slowdown, VRLL's competitive moats are intact – viz. a wide network, vast scale of operations, and cost and capital efficiency. An asset-heavy operating model also adds heft to the LTL business. Though we are cautious on near-term prospects and build in a 6% topline CAGR over FY19-FY22, we expect VRLL to outperform the industry once the economic cycle turns, by virtue of its superior business model.

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Moats intact despite external headwinds: A series of systemic growth impediments (weak industrial activity, demonetisation, disruptive start-ups) have capped VRLL's growth at a 6% CAGR over FY15-FY19. Despite these challenges, we believe the moats that underpin VRLL's apex position in the LTL industry remain sound – (1) expanding network (47 hubs, 929 locations), (2) vast scale of operations, (3) healthy operating cost structure (in-house design, low-cost sourcing of fuel, tyres & spare parts), and (4) efficient working capital management (working capital of 13 days in FY19).

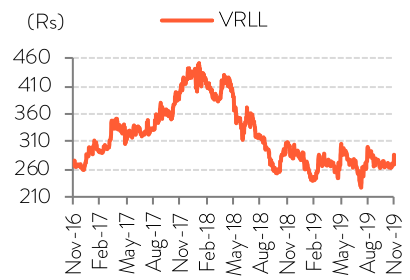
Asset-heavy model bodes well in cyclical upturn: VRLL's asset-heavy model (4,470+ owned trucks) is well suited for LTL operations, as also evidenced by the high asset intensity of top US LTL players. The company has substantially outperformed peers in the previous economic upcycle – clocking an 18% topline CAGR vs. 5% for TRPC (freight) over FY07-FY14. Strong moats and a superior business model should help VRLL outpace peers in the next upcycle as well.

Initiate with BUY: We estimate a moderate 6% topline CAGR over FY19-FY22 given adverse macro conditions, though earnings are forecast to log a 14% CAGR due to a lower tax rate. Initiate with BUY and a Mar'21 TP of Rs 330, set at 22x FY22E EPS – in line with the average multiple of the past one year.

Ticker/Price	VRLL IN/Rs 269
Market cap	US$ 339.9mn
Shares o/s	90mn
3M ADV	US$ 0.3mn
52wk high/low	Rs 316/Rs 222
Promoter/FPI/DII	68%/6%/20%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	19,223	21,095	21,580	23,424	25,196
EBITDA (Rs mn)	2,342	2,440	3,261	3,580	3,851
Adj. net profit (Rs mn)	926	919	1,103	1,191	1,352
Adj. EPS (Rs)	10.2	10.2	12.2	13.2	15.0
Adj. EPS growth (%)	32.7	(0.7)	20.0	8.0	13.5
Adj. ROAE (%)	16.3	14.8	16.5	16.5	17.3
Adj. P/E (x)	26.2	26.4	22.0	20.4	17.9
EV/EBITDA (x)	11.3	10.5	7.8	7.1	6.5

Source: Company, BOBCAPS Research

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TRUST | INNOVATION | EXCELLENCE

BUY
TP: Rs 480 | ⮝ 36%

LAURUS LABS | Pharmaceuticals | 28 November 2019

NDR takeaways

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CEO roadshow: We recently hosted the management of Laurus Labs with investors. Overall, we found management's tone confident yet realistic. Three key priorities were outlined for the next three years: (1) revive predictability & stickiness in the business, (2) ensure prudent capital allocation vs. growth, (3) move closer to 20% ROCE. Laurus maintained its positive FCF guidance starting FY21 despite Rs 2bn-2.5bn of capex each for FY20/21. Gross debt will be capped at Rs 11bn.

Business mix shift intact: API business will shift away from ARVs to the oncology and cardio-diabetic segments (to contribute >30% of API by FY22 from ~20%). Laurus aims to create a niche in these therapies and be a meaningful integrated player in oncology in the next five years. Formulations and synthesis will be two high-growth segments. Management is bullish on the non-Aspen patented CDMO business and expects over Rs 6bn of revenue in synthesis by FY23 (implying 30% CAGR over FY19). Aspen business should peak out in FY21. Gross margins are guided to stabilise at ~49%; EBITDA margins can improve 100bps p.a.

Restricted capex sufficient to drive 20% formulations growth: Management expects two-thirds of the revenue mix to be driven by LMIC tender supplies in the next few years. Key product catalysts are TLE400/600mg and TEE approvals in H1FY21 which give access to a ~US$ 800mn market opportunity. Meaningful US ramp-up is expected from FY26, led by 20+ in-market molecules (95% of filings are integrated). No greenfield investment at least in the next three years and expect Rs 500mn in maintenance capex per year.

ARV sales to bottom in FY20: Laurus expects the ARV outlook to improve in FY21 and anticipates Rs 12bn in sales (over Rs 10bn FY20E base) due to new supplementary tenders coming in Q1FY21 and Lamivudine supplies. EFA could stabilise at Rs 5bn in FY20. Non-SA ARV business is stable (local funded tenders).

Investment thesis: A consistent increase in EBITDA share from high-margin businesses (synthesis, formulations, other APIs ex-ARV) and sharper turnaround in return ratios could re-rate the stock in coming years. In the next two years, these segments would drive >80% of incremental EBITDA and ROCE of >15% from ~8-9%. While incremental capex timelines have been advanced by a year (led by solid execution on formulations which is ahead of schedule), this would not be FCF-dilutive in our view. Stock valuation is attractive; trading at 7.8x FY21 EV/EBITDA. Retain BUY, TP Rs 480.

Ticker/Price	LAURUS IN/Rs 353
Market cap	US$ 526.6mn
Shares o/s	106mn
3M ADV	US$ 0.4mn
52wk high/low	Rs 419/Rs 303
Promoter/FPI/DII	33%/9%/39%

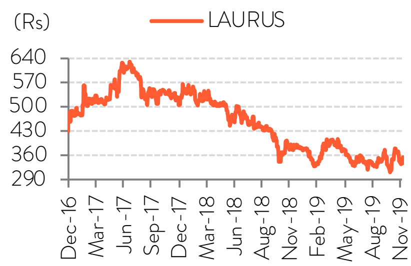
Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY20E	FY21E	FY22E
Total revenue (Rs mn)	25,942	29,423	32,693
EBITDA (Rs mn)	4,620	6,220	7,389
Adj. net profit (Rs mn)	1,323	2,451	3,122
Adj. EPS (Rs)	12.4	23.0	29.3
Adj. EPS growth (%)	41.1	85.3	27.4
Adj. ROAE (%)	8.2	13.7	15.3
Adj. P/E (x)	28.4	15.3	12.0
EV/EBITDA (x)	10.5	7.8	6.5

Source: Company, BOBCAPS Research

STOCK PERFORMANCE



Source: NSE

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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