

BUY

TP: Rs 480 | ▲ 43%

LAURUS LABS

Pharmaceuticals

05 August 2019

High opex offsets formulation positives; expect recovery in Q2

Q1FY20 operational results were in line despite strong gross margin expansion. Higher opex was a key negative while the formulations sales delivered a good surprise. EBITDA stood at Rs 830mn with 15% margins. Headline profit of Rs 151mn included higher other income. Laurus expects benefits of high opex and shipment delays (worth Rs 750mn) in the ARV business to reflect from Q2. We cut FY21E EBITDA by 6% and our TP to Rs 480 (vs. Rs 495). Improving returns ratios and positive FCF remain key focus areas in FY21. Retain BUY.

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High formulation opex & weak ARV: Despite better gross margins, Q1 EBITDA came in line due to higher other expense at Rs 706mn (vs. Rs 600mn quarterly average). This stemmed from a ramp-up in production schedule, which saw power cost rising by Rs 50mn QoQ and a 10x rise in reinsurance premium to Rs 30mn. Weak ARV sales are attributable to lower offtake in Efavirenz and Lamivudine (down 27% YoY and 14% QoQ). Inventory levels in the ARV business were higher by Rs 750mn, which should be liquidated in Q2. Q1 annualised formulation opex is up 23% YoY at Rs1.7bn is a key negative.

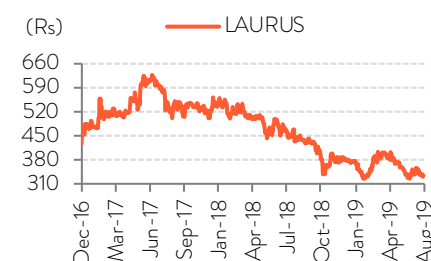
Formulation sales stronger than expected: Formulation sales, led by the LMIC market, jumped 4x QoQ to US\$ 15mn (50% beat). Also, some benefits of RM integration drove ~400bps improvement in gross margins to 50% (47-48% level sustainable). Management sees US\$ 40mn revenue visibility for FY20 (2x better than earlier guidance).

Earnings call highlights: (1) Deferred ARV supplies worth Rs 750mn to come in Q2; DTG offtake in South Africa remained <10%, (2) Laurus clocked formulation sales of Rs 790mn in Q1 from the LMIC region and expects similar size orders for each of the remaining quarters in FY20, (3) Vertical integration for Gemcitabine/Onco to be complete by Sep'19.

Ticker/Price	LAURUS IN/Rs 337
Market cap	US\$ 515.6mn
Shares o/s	106mn
3M ADV	US\$ 0.2mn
52wk high/low	Rs 472/Rs 321
Promoter/FPI/DII	33%/9%/39%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Adj. net profit (Rs mn)	1,483	937	1,233	2,335	3,082
Adj. EPS (Rs)	13.9	8.8	11.6	21.9	29.0
Adj. EPS growth (%)	(10.8)	(36.8)	31.5	89.4	32.0
Adj. ROAE (%)	10.5	6.2	7.7	13.2	15.3
Adj. P/E (x)	24.2	38.3	29.1	15.4	11.6
EV/EBITDA (x)	10.9	13.0	10.7	7.8	6.5

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)	Q1FY20E	Var. (%)
Net Sales	5,506	5,390	2.1	6,351	(13.3)	5,386	2.2
EBITDA	833	806	3.4	1,119	(25.6)	810	2.8
Depreciation	458	382	-	434	-	420	-
EBIT	375	424	-	685	-	390	-
Interest	225	223	-	176	-	238	-
Other Income	45	26	-	16	-	10	-
PBT	194	227	(14.4)	525	(63.0)	163	19.4
Less: Taxation	43	61	-	94	-	42	-
Less: Minority Interest	0	0	-	0	-	0	-
Recurring PAT	151	166	(8.8)	431	(64.9)	120	25.7
Exceptional items	0	0	-	0	-	0	-
Reported PAT	151	166	(8.8)	431	(64.9)	120	25.7
Key Ratios (%)							
Gross Margin	50.1	45.3	-	46.2	-	46.8	-
EBITDA Margin	15.1	15.0	-	17.6	-	15.0	-
Tax / PBT	22.1	26.9	-	17.9	-	26.0	-
NPM	2.7	3.1	-	6.8	-	2.2	-
EPS (Rs)	1.4	1.6	-	4.1	-	1.1	-

Source: Company, BOBCAPS Research

FIG 2 – REVENUE MIX

(Rs mn)	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)	Q1FY20E	Var. (%)
Generics – API	3,697	4,582	(19.3)	4,927	(25.0)	3,748	(1.4)
ARVs	2,718	3,719	(26.9)	3,153	(13.8)	2,700	0.7
Hep C	112	216	(48.1)	415	(73.0)	250	(55.2)
Oncology	450	431	4.4	708	(36.4)	561	(19.7)
Other API	417	216	93.4	651	(35.9)	237	75.8
Synthesis	590	539	9.5	940	(37.2)	701	(15.8)
Ingredients	159	216	(26.3)	203	(21.7)	237	(33.0)
Formulations	1,060	54	1,866.6	282	275.9	700	51.4
Net Sales	5,506	5,390	2.2	6,352	(13.3)	5,386	2.2

Source: Company, BOBCAPS Research

Valuation methodology

In our view, success in formulations and FCF turnaround could bring the stock back in favour. Laurus is trading at 8x FY21E EV/EBITDA, near historical lows and 20% below our worst-case target price. Our target EV/EBITDA multiple of 10x FY21E is in line with peers but at a 40% discount to Divi's Labs.

Based on Q1FY20 numbers, we believe annualised opex including R&D cost in the formulation segment would total Rs 1.7bn (vs. our earlier estimate of Rs 1.4bn), leading us to cut our FY21 EBITDA projection by 6%. Our FY20 estimate is largely unchanged due to preponement of LMIC sales.

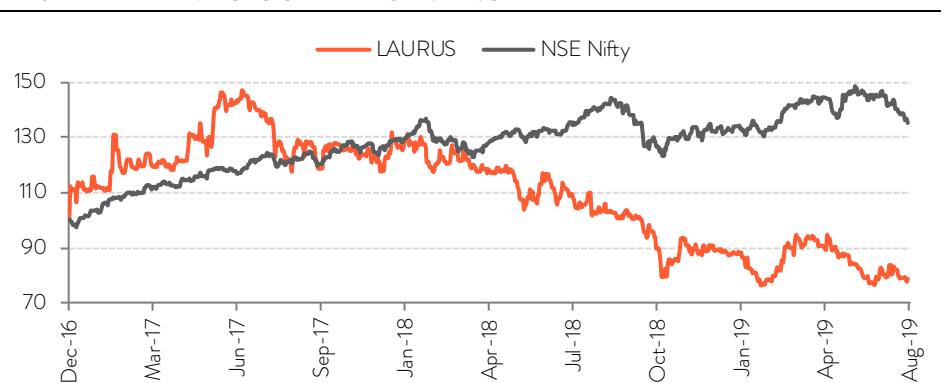
In our view, the market is disregarding investments and potential upsides in Laurus's formulations business which have now started to deliver. Also, moderation in capex to ~Rs 1.5bn-2bn annually (vs. a Rs 3bn run-rate seen in each of the last three years) should bolster free cash flows and further support valuations. Maintain BUY with a revised Sep'20 target price of Rs 480 (vs. Rs 495 earlier).

FIG 3 – REVISED ESTIMATES

(Rs mn)	New		Old		Change (%)	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Sales	24,024	27,702	24,156	28,595	(0.5)	(3.1)
EBITDA	4,363	5,954	4,367	6,331	(0.1)	(6.0)
EBITDA margin (%)	18.2	21.5	18.1	22.1	8bps	(65bps)
EPS (Rs)	12	22	12	25	(0.6)	(10.7)

Source: BOBCAPS Research

FIG 4 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- **Higher concentration and pricing pressure in ARVs:** The ARV segment accounted for 61% of revenues in FY19 (from 65% in FY18) and has witnessed pricing pressure in the past two years. A shift in the treatment regime from Efavirenz to Dolutegravir has adversely impacted gross margins. To arrest the margin compression and business decline in ARV, management has taken steps toward: (1) backward integration of some APIs including FTC and Lamivudine, and (2) rapid expansion of the non-ARV business. This, in our view, should mitigate the profitability risk.
- **Regulatory risks:** Units 1 and 3 are critical as they account for 80% of the topline (mainly catering to the API and synthesis businesses). Unit 2 is Laurus' sole US formulations facility. All three units have recently received establishment inspection reports (EIR).
- **Delay in formulation business ramp-up:** Any delays in product approval can adversely affect the planned scale-up and our FY21 forecast.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue	20,562	22,919	24,024	27,702	30,777
EBITDA	4,134	3,560	4,363	5,954	7,036
EBIT	2,880	1,918	2,594	4,008	4,917
Net interest income/(expenses)	(796)	(882)	(938)	(913)	(816)
Other income/(expenses)	98	161	33	60	63
Exceptional items	0	0	0	0	0
EBT	2,182	1,197	1,689	3,155	4,164
Income taxes	698	260	456	820	1,083
Extraordinary items	194	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	1,678	937	1,233	2,335	3,082
Adjustments	194	0	0	0	0
Adjusted net profit	1,483	937	1,233	2,335	3,082

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	3,123	4,882	3,949	4,174	4,638
Other current liabilities	1,488	1,411	1,682	1,939	2,154
Provisions	253	365	383	441	490
Debt funds	10,477	11,068	11,012	10,481	8,709
Other liabilities	0	0	0	0	0
Equity capital	1,060	1,064	1,064	1,064	1,064
Reserves & surplus	13,764	14,517	15,566	17,701	20,583
Shareholders' fund	14,824	15,581	16,630	18,765	21,647
Total liabilities and equities	30,165	33,307	33,656	35,800	37,638
Cash and cash eq.	31	30	553	585	607
Accounts receivables	5,705	7,099	6,253	7,210	8,010
Inventories	5,847	6,819	6,450	6,831	7,589
Other current assets	2,108	1,939	2,643	3,047	3,385
Investments	34	34	34	34	34
Net fixed assets	14,639	16,072	16,409	16,779	16,698
CWIP	1,632	1,096	1,096	1,096	1,096
Intangible assets	169	218	218	218	218
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	30,165	33,307	33,656	35,800	37,638

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	2,932	2,579	3,001	4,280	5,201
Interest expenses	0	0	0	1	0
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(205)	(402)	(133)	(1,201)	(1,169)
Other operating cash flows	0	0	0	0	0
Cash flow from operations	2,727	2,177	2,868	3,080	4,032
Capital expenditures	(3,753)	(3,117)	(2,105)	(2,316)	(2,038)
Change in investments	0	0	0	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(3,753)	(3,117)	(2,105)	(2,316)	(2,038)
Equities issued/Others	2	4	0	0	0
Debt raised/repaid	1,385	591	(55)	(532)	(1,772)
Interest expenses	0	0	0	(1)	0
Dividends paid	(190)	(176)	(184)	(200)	(200)
Other financing cash flows	(182)	519	0	0	0
Cash flow from financing	1,015	939	(239)	(732)	(1,972)
Changes in cash and cash eq.	(10)	(1)	523	32	22
Closing cash and cash eq.	31	29	553	585	607

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	15.8	8.8	11.6	21.9	29.0
Adjusted EPS	13.9	8.8	11.6	21.9	29.0
Dividend per share	1.5	1.5	1.5	1.5	1.5
Book value per share	139.3	146.4	156.3	176.3	203.4

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	2.2	2.0	2.0	1.7	1.5
EV/EBITDA	10.9	13.0	10.7	7.8	6.5
Adjusted P/E	24.2	38.3	29.1	15.4	11.6
P/BV	2.4	2.3	2.2	1.9	1.7

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	68.0	78.3	73.0	74.0	74.0
Interest burden (PBT/EBIT)	75.8	62.4	65.1	78.7	84.7
EBIT margin (EBIT/Revenue)	14.0	8.4	10.8	14.5	16.0
Asset turnover (Revenue/Avg TA)	21.6	22.1	22.1	24.3	25.8
Leverage (Avg TA/Avg Equity)	1.7	1.7	1.7	1.6	1.5
Adjusted ROAE	10.5	6.2	7.7	13.2	15.3

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

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Revenue	8.0	11.5	4.8	15.3	11.1
EBITDA	1.4	(13.9)	22.6	36.5	18.2
Adjusted EPS	(10.8)	(36.8)	31.5	89.4	32.0
Profitability & Return ratios (%)					
EBITDA margin	20.1	15.5	18.2	21.5	22.9
EBIT margin	14.0	8.4	10.8	14.5	16.0
Adjusted profit margin	7.2	4.1	5.1	8.4	10.0
Adjusted ROAE	10.5	6.2	7.7	13.2	15.3
ROCE	12.5	8.0	9.7	14.3	16.7
Working capital days (days)					
Receivables	101	113	95	95	95
Inventory	103	109	98	90	90
Payables	55	78	60	55	55
Ratios (x)					
Gross asset turnover	1.1	1.1	1.0	1.1	1.1
Current ratio	2.8	2.4	2.6	2.7	2.7
Net interest coverage ratio	3.6	2.2	2.8	4.4	6.0
Adjusted debt/equity	0.7	0.7	0.6	0.5	0.4

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

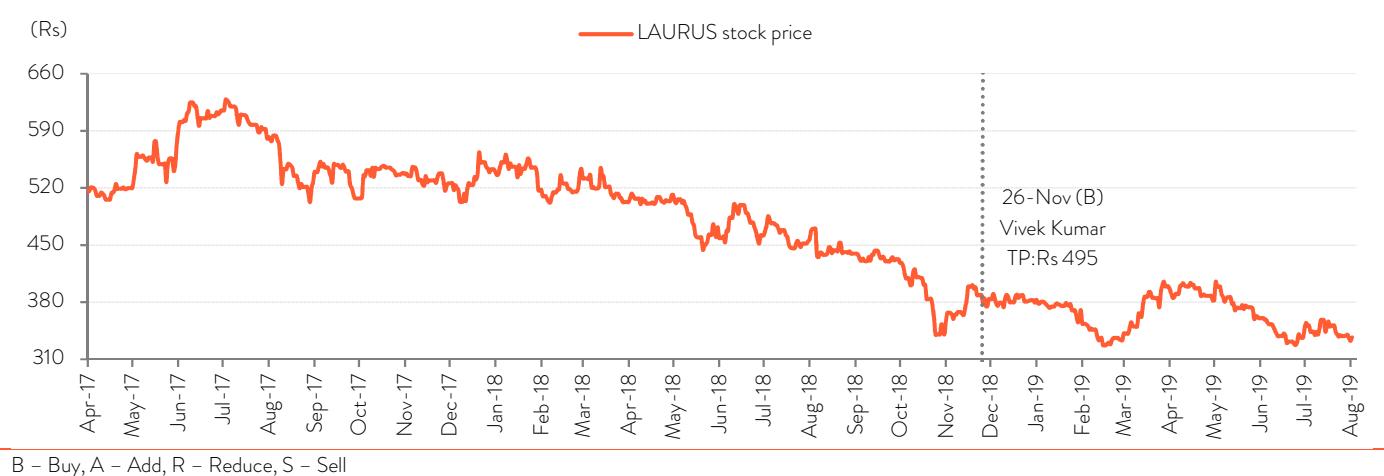
ADD – Expected return from >+5% to +15%

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)

HISTORICAL RATINGS AND TARGET PRICE: LAURUS LABS (LAURUS IN)



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