

**BUY**

TP: Rs 645 | ▲ 23%

**LAURUS LABS**

| Pharmaceuticals

| 28 July 2022

## Synthesis business saves the day

- Q1 revenue/EBITDA came in 5%/8% above consensus and grew 20%/15% YoY to Rs 15.4bn/Rs 4.5bn
- Stellar CDMO performance (+196% YoY) led growth while FDF declined 33% YoY; a better mix sustained margins
- Maintain BUY with a TP of Rs 645 based on an unchanged 17x FY24E EV/EBITDA multiple

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**Synthesis business drives beat despite drop in FDF revenue:** Laurus's Q1FY23 revenue grew 20%/15% YoY (+8%/15% QoQ) to Rs 15.4bn/Rs 4.5bn, spurred by steep growth of 196% YoY in the synthesis business. Contribution from synthesis rose to 37% in Q1FY23 (vs. 15% in the year-ago quarter), with growth coming from existing as well as new business. Per management, the division had no one-off revenue flows and growth momentum is guided to continue.

**ARV business continues to see challenges but signs of easing:** Continued challenges in ARV prices saw ARV API revenue decline 8% YoY, though sequential improvement during the last two quarters hints at some stabilisation. Moreover, the company hasn't seen much of a decline in volumes. Other APIs grew at a strong 82% YoY while moderating sequentially (-19% QoQ) on a high base.

**Better mix compensates for FDF revenue drop and higher overheads:** A product mix tilt towards high-margin CDMO led to an improved gross margin (+90bps YoY to 57.6%), despite a decline in formulations revenue from pricing pressure and elevated RM costs. Overhead cost rose 38.5% YoY to 18.2% of sales (vs. 15.1%/15.8% of sales in Q4FY22/Q1FY22) – the cost increase stemmed from additional expenses incurred due to power shortage (~Rs 330mn) and forex losses, in turn resulting in 140bps YoY EBITDA margin contraction to 29.5%.

Net profit for the quarter grew only 4% YoY (+9% QoQ) as recently commissioned capacities resulted in higher depreciation (+21% YoY) and a change in SEZ exemption led to a higher tax rate (29% vs. 24% in Q1FY22).

**Maintain BUY, TP unchanged at Rs 645:** We retain our FY23/FY24 estimates in light of (a) Laurus's strong performance in CDMO backed by growth in existing business, new contracts as well as capacity expansion, (b) expected stabilisation in ARV business, (c) commissioning of FDF capacity, and (d) confidence shown by management in achieving US\$ 1bn in sales by FY23. Our TP remains at Rs 645, based on an unchanged 17x FY24E EV/EBITDA multiple. BUY.

## Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	LAURUS IN/Rs 525
Market cap	US\$ 3.5bn
Free float	74%
3M ADV	US\$ 9.2mn
52wk high/low	Rs 724/Rs 437
Promoter/FPI/DII	27%/23%/5%

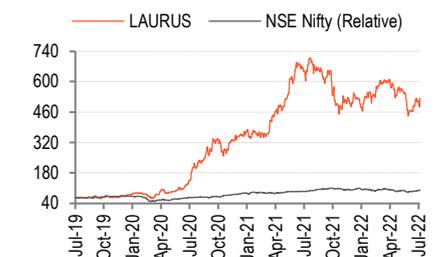
Source: NSE | Price as of 28 Jul 2022

## Key financials

Y/E 31 Mar	FY22P	FY23E	FY24E
Total revenue (Rs mn)	49,360	63,206	73,092
EBITDA (Rs mn)	14,229	17,698	21,197
Adj. net profit (Rs mn)	8,284	10,071	11,800
Adj. EPS (Rs)	15.4	18.8	22.0
Consensus EPS (Rs)	15.4	21.1	26.1
Adj. ROAE (%)	27.8	26.5	24.6
Adj. P/E (x)	34.0	28.0	23.9
EV/EBITDA (x)	20.7	16.9	14.3
Adj. EPS growth (%)	(14.3)	21.6	17.2

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

## Stock performance



Source: NSE



**Fig 1 – Quarterly performance**

(Rs mn)	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	FY22	FY21	YoY (%)
<b>Net Sales</b>	<b>15,389</b>	<b>12,785</b>	<b>20.4</b>	<b>14,248</b>	<b>8.0</b>	<b>49,356</b>	<b>48,135</b>	<b>2.5</b>
<b>EBITDA</b>	<b>4,542</b>	<b>3,954</b>	<b>14.9</b>	<b>3,967</b>	<b>14.5</b>	<b>14,224</b>	<b>15,507</b>	<b>(8.3)</b>
Depreciation	708	585	20.9	657	-	2,515	2,051	-
EBIT	3,834	3,368	-	3,310	-	11,709	13,456	-
Interest	293	266	-	306	-	1,024	682	-
Other Income	18	59	-	13	-	153	236	-
<b>PBT</b>	<b>3,559</b>	<b>3,161</b>	<b>12.6</b>	<b>3,017</b>	<b>18.0</b>	<b>10,839</b>	<b>13,011</b>	<b>(16.7)</b>
Less: Taxation	1,033	744	38.8	698	-	2,514	3,173	-
Less: Minority Interest	6	0	-	10	-	22	0	-
<b>Recurring PAT</b>	<b>2,519</b>	<b>2,416</b>	<b>4.3</b>	<b>2,309</b>	<b>9.1</b>	<b>8,302</b>	<b>9,839</b>	<b>(15.6)</b>
Exceptional items	0	0	-	0	-	0	0	-
<b>Reported PAT</b>	<b>2,519</b>	<b>2,416</b>	<b>4.3</b>	<b>2,309</b>	<b>9.1</b>	<b>8,302</b>	<b>9,839</b>	<b>(15.6)</b>
<b>Key Ratios (%)</b>			<b>(bps)</b>		<b>(bps)</b>			<b>(bps)</b>
Gross Margin	57.6	56.7	89	52.0	553	55.6	55.2	39
EBITDA Margin	29.5	30.9	(141)	27.8	167	28.8	32.2	(340)
Tax / PBT	29.0	23.6	-	23.1	-	23.2	24.4	-
NPM	16.4	18.9	(253)	16.2	17	16.8	20.4	(362)
EPS (Rs)	4.69	4.5	4.3	4.3	9.1	15.4	18.3	(15.7)

Source: Company, BOBCAPS Research

**Fig 2 – Segmental performance**

(Rs mn)	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	FY22	FY21	YoY (%)
Generics – API	5,830	5,490	6.2	5,390	8.2	20,390	26,210	(22.2)
Antiretrovirals (ARVs)	3,790	4,118	(8.0)	2,965	27.8	12,490	18,520	(32.6)
Oncology	641	604	6.2	701	(8.5)	2,890	2,630	9.9
Other API	1,399	769	82.0	1,725	(18.9)	5,010	5,060	(1.0)
Synthesis (CDMO)	5,770	1,950	195.9	3,600	60.3	9,170	5,190	76.7
Formulations (FDF)	3,490	5,210	(33.0)	4,910	(28.9)	18,800	16,640	13.0
Bio	300	140	114.3	350	(14.3)	1,000	-	-
<b>Net Sales</b>	<b>15,389</b>	<b>12,785</b>	<b>20.3</b>	<b>14,248</b>	<b>8.0</b>	<b>49,356</b>	<b>48,135</b>	<b>2.7</b>

Source: Company, BOBCAPS Research

## Earnings call highlights

- **Revenue:** Laurus reiterated its confidence in achieving its revenue target of US\$ 1bn in FY23 supported by new capacities in FDF and CDMO, new contracts and stabilisation in ARV prices. Currency tailwinds would be an added impetus (not factored in the guidance).
- **Margins:** Management is hopeful of a ~30% EBITDA margin for FY23 aided by an improving product mix in favour of high-margin business, additional capacities and new contracts in the synthesis business.
- **ARVs:** Total ARV contribution stood at 42% of revenue in Q1FY23, comprising 25% API and 17% formulations.
- **CDMO:** Laurus currently has seven commercial products in the CDMO business, comprising four intermediates and three APIs.
- **Laurus Bio:** Management expects business at Laurus Bio to gather pace with the ramp-up of new capacities, as the demand outlook remains strong. Full operational benefits of new capacities would reflect through FY23, and the company is evaluating land parcels to further expand manufacturing capabilities. Management expects FY25 to be a significant year for the segment.
- **Capacity expansion: (1) FDF:** Brownfield capacity expansion at Unit 2 was commissioned during the quarter, with ramp-up to be gradual. **(2) CDMO:** Construction work commenced for a dedicated R&D centre (FY23/FY24 completion) and progress on the other three manufacturing units is on track (FY24/FY25). **(3) Laurus Bio:** Laurus continues to evaluate a few land parcels with a plan to create close to 1mn litres of fermentation capacity in phase-1.
- **Capex:** The company incurred capex of Rs 2.1bn for Q1FY23 (~14% of sales) and maintained its guidance of Rs 20bn for FY23-FY24. About 50% of capex is earmarked for the CDMO business while the remaining will be utilised for non-ARV API and formulations as well as backward integration.
- **Tax rate:** Q1 had a higher effective tax rate due to the change in SEZ profit exemption u/s 10AA to 50% for a period of five years from FY23. The company is evaluating a switchover to composite rates without any exemptions.

## Valuation methodology

Laurus continues to struggle due to high industry-wide channel inventory, slower demand, and pricing pressure in ARV formulations and APIs, though sequential growth during the last two quarters hints at some demand normalisation. The company is investing Rs 20bn over FY23-FY24 to expand capacity in the CDMO/non-ARV business.

We retain our FY23/FY24 estimates in light of (a) Laurus's strong performance in CDMO backed by growth in existing business, new contracts as well as capacity expansion, (b) expected stabilisation in ARV business, (c) commissioning of FDF capacity, and (d) confidence shown by management in achieving US\$ 1bn in sales by FY23. Our TP remains at Rs 645, based on an unchanged 17x FY24E EV/EBITDA multiple. Maintain BUY.

**Fig 3 – Key assumptions**

Revenue (Rs bn)	FY22A	FY23E	FY24E
Generic APIs	20.4	23.8	26.1
Generic FDF	18.8	21.1	25.3
Synthesis (CDMO)	9.2	17.0	20.1
Biotech	1.0	1.4	1.7

Source: Company, BOBCAPS Research

**Fig 4 – Peer comparison**

Company	Ticker	Rating	Target Price (Rs)	EBITDA CAGR FY22-24E (%)	EV/EBITDA (Rs)		ROCE (%)		Target EV/EBITDA (x)
					FY23E	FY24E	FY23E	FY24E	
Divi's Labs	DIVI IN	HOLD	5,250	4.7	25.3	23.3	27.5	25.9	26
Laurus Labs	LAURUS IN	BUY	645	21.7	16.9	14.2	27.9	28.5	17

Source: BOBCAPS Research

## Key risks

Key downside risks to our estimates are:

- **Higher concentration and pricing pressure in ARVs:** Laurus draws significant revenue from the ARV business. A slowdown in demand or pricing pressure in ARVs will significantly impact revenues and margins.
- **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.
- **Delay in formulation business ramp-up:** Any delays in product approval can adversely affect the planned scale-up and hence our forecasts for the formulations business.

## Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	1.4	1,272	2,050	BUY
Alembic Pharma	ALPM IN	1.7	701	770	HOLD
Alkem Labs	ALKEM IN	4.8	3,228	3,400	BUY
Aurobindo Pharma	ARBP IN	4.0	544	680	BUY
Cipla	CIPLA IN	9.8	967	1,100	BUY
Divi's Labs	DIVI IN	12.8	3,850	4,250	HOLD
Dr Reddy's Labs	DRRD IN	8.9	4,260	4,450	HOLD
Eris Lifesciences	ERIS IN	1.2	679	970	BUY
Glenmark Life Sciences	GLS IN	0.7	467	620	BUY
Laurus Labs	LAURUS IN	3.5	525	645	BUY
Lupin	LPC IN	3.7	642	600	SELL
Sun Pharma	SUNP IN	26.9	895	1,100	BUY

Source: BOBCAPS Research, NSE | Price as of 28 Jul 2022

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
<b>Total revenue</b>	<b>28,317</b>	<b>48,135</b>	<b>49,360</b>	<b>63,206</b>	<b>73,092</b>
EBITDA	5,658	15,331	14,229	17,698	21,197
Depreciation	1,873	2,051	2,515	3,145	4,120
EBIT	3,785	13,280	11,714	14,553	17,077
Net interest inc./(exp.)	(896)	(682)	(1,024)	(1,246)	(1,454)
Other inc./(exp.)	59	237	153	122	110
Exceptional items	0	0	0	0	0
EBT	2,948	12,835	10,843	13,429	15,733
Income taxes	383	3,173	2,514	3,357	3,933
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	2	45	0	0
<b>Reported net profit</b>	<b>2,565</b>	<b>9,660</b>	<b>8,284</b>	<b>10,071</b>	<b>11,800</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>2,565</b>	<b>9,660</b>	<b>8,284</b>	<b>10,071</b>	<b>11,800</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
Accounts payables	6,156	11,787	8,764	12,987	14,018
Other current liabilities	1,625	3,158	5,661	3,792	5,116
Provisions	568	757	892	1,142	1,320
Debt funds	11,456	15,799	20,774	20,774	20,774
Other liabilities	0	0	0	0	0
Equity capital	1,069	1,073	1,075	1,075	1,075
Reserves & surplus	16,623	24,934	32,516	41,604	52,423
Shareholders' fund	17,692	26,007	33,591	42,679	53,498
<b>Total liab. and equities</b>	<b>37,497</b>	<b>57,507</b>	<b>69,680</b>	<b>81,374</b>	<b>94,726</b>
Cash and cash eq.	17	485	759	336	1,787
Accounts receivables	7,914	13,061	13,542	17,143	19,825
Inventories	9,052	15,755	17,603	19,914	22,028
Other current assets	2,545	2,845	2,811	3,160	4,385
Investments	34	34	308	308	308
Net fixed assets	17,068	19,150	23,953	30,808	36,689
CWIP	672	3,622	8,132	7,132	7,132
Intangible assets	195	2,556	2,571	2,571	2,571
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>37,497</b>	<b>57,507</b>	<b>69,680</b>	<b>81,374</b>	<b>94,726</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
<b>Cash flow from operations</b>	<b>2,474</b>	<b>6,914</b>	<b>8,118</b>	<b>9,560</b>	<b>12,432</b>
Capital expenditures	(2,374)	(7,000)	(9,500)	(10,000)	(10,000)
Change in investments	0	0	(274)	0	0
Other investing cash flows	0	0	0	0	0
<b>Cash flow from investing</b>	<b>(2,374)</b>	<b>(7,000)</b>	<b>(9,774)</b>	<b>(10,000)</b>	<b>(10,000)</b>
Equities issued/Others	5	4	2	0	0
Debt raised/repaid	388	4,343	4,975	0	0
Interest expenses	0	0	0	0	0
Dividends paid	0	(1,006)	(1,008)	(1,008)	(1,008)
Other financing cash flows	(506)	(2,787)	(2,038)	1,024	27
<b>Cash flow from financing</b>	<b>(113)</b>	<b>554</b>	<b>1,931</b>	<b>17</b>	<b>(981)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>(13)</b>	<b>468</b>	<b>275</b>	<b>(423)</b>	<b>1,451</b>
<b>Closing cash &amp; cash eq.</b>	<b>17</b>	<b>485</b>	<b>759</b>	<b>336</b>	<b>1,787</b>

### Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22P	FY23E	FY24E
Reported EPS	4.8	18.0	15.4	18.8	22.0
Adjusted EPS	4.8	18.0	15.4	18.8	22.0
Dividend per share	1.5	1.5	1.5	1.5	1.5
Book value per share	33.0	48.4	62.5	79.3	99.5

### Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22P	FY23E	FY24E
EV/Sales	10.3	6.1	6.0	4.7	4.1
EV/EBITDA	51.7	19.1	20.7	16.9	14.3
Adjusted P/E	109.9	29.2	34.0	28.0	23.9
P/BV	15.9	10.9	8.4	6.6	5.3

### DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22P	FY23E	FY24E
Tax burden (Net profit/PBT)	87.0	75.3	76.4	75.0	75.0
Interest burden (PBT/EBIT)	77.9	96.6	92.6	92.3	92.1
EBIT margin (EBIT/Revenue)	13.4	27.6	23.7	23.0	23.4
Asset turnover (Rev./Avg TA)	25.4	33.9	25.7	26.8	26.5
Leverage (Avg TA/Avg Equity)	1.7	1.6	1.6	1.5	1.4
<b>Adjusted ROAE</b>	<b>15.4</b>	<b>44.2</b>	<b>27.8</b>	<b>26.5</b>	<b>24.6</b>

### Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22P	FY23E	FY24E
<b>YoY growth (%)</b>					
Revenue	23.6	70.0	2.5	28.1	15.6
EBITDA	58.1	171.0	(7.2)	24.4	19.8
Adjusted EPS	168.0	276.6	(14.3)	21.6	17.2
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	20.0	31.9	28.8	28.0	29.0
EBIT margin	13.4	27.6	23.7	23.0	23.4
Adjusted profit margin	9.1	20.1	16.8	15.9	16.1
Adjusted ROAE	15.4	44.2	27.8	26.5	24.6
ROCE	13.8	38.1	24.7	24.9	25.0
<b>Working capital days (days)</b>					
Receivables	102	99	100	99	99
Inventory	117	119	130	115	110
Payables	79	89	65	75	70
<b>Ratios (x)</b>					
Gross asset turnover	1.2	1.6	1.2	1.3	1.2
Current ratio	2.3	2.0	2.3	2.3	2.3
Net interest coverage ratio	4.2	19.5	11.4	11.7	11.7
<b>Adjusted debt/equity</b>	<b>0.6</b>	<b>0.6</b>	<b>0.6</b>	<b>0.5</b>	<b>0.4</b>

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

## Disclaimer

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

**BUY** – Expected return >+15%

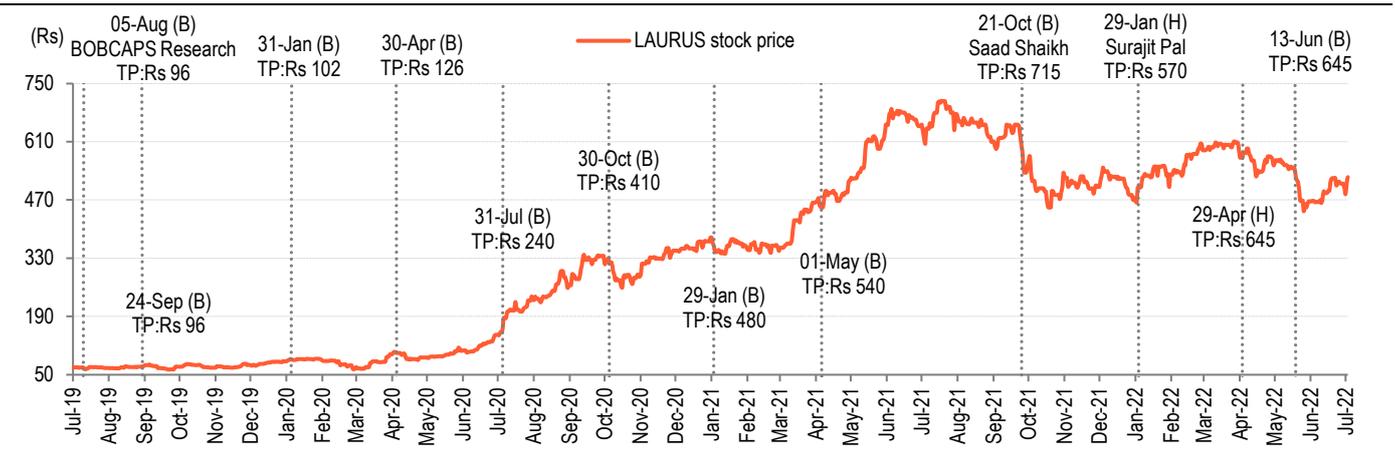
**HOLD** – Expected return from -6% to +15%

**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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