

**BUY**

TP: Rs 480 | ▲ 30%

**LAURUS LABS**

Pharmaceuticals

01 November 2019

## All-round beat – formulations turn EBITDA positive; BUY

Laurus Labs reported its best-ever EBITDA in Q2FY20 with a good topline beat, led by strong operating leverage in the formulation business and gross margin expansion. Weakness in ARVs was a key negative. EBITDA stood at Rs 1.4bn with 19% margins. Profit were Rs 567mn due to low tax. Laurus expects to sustain momentum in H2 even though oncology and other APIs could see mild sales moderation. We retain our TP of Rs 480 and raise FY21/FY22 EBITDA by 5%. Improving returns ratios and positive FCF are focus areas for FY21.

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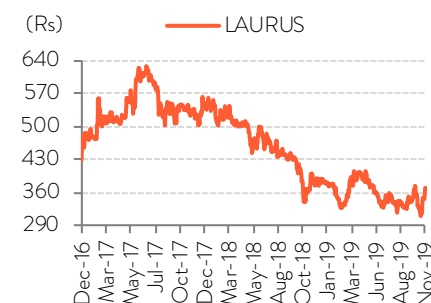
**Q2 margin surprise could sustain:** Operating leverage in formulations is clearly visible in the Q2 EBITDA margins of 19% (up 6.5ppt YoY & 4.2ppt QoQ), despite flat gross margins QoQ (up 300bps YoY on softer RM prices from China) and other expense rising 25% QoQ. The step-up in share of high-margin businesses (ex-ARVs) is tracking well and has continued to improve even in Q2, to 51% of sales (from 46% in Q1 and 31% in FY19). Synthesis should see robust growth in H2 led by CDMO supplies.

Ticker/Price	LAURUS IN/Rs 370
Market cap	US\$ 554.5mn
Shares o/s	106mn
3M ADV	US\$ 0.2mn
52wk high/low	Rs 412/Rs 303
Promoter/FPI/DII	33%/9%/39%

Source: NSE

**Solid execution on formulations to drive early breakeven:** Formulation sales in Q2 remained strong at US\$ 22.5mn (US\$ 37.5mn in H1), led by LMIC markets. Management has raised the FY20 sales target to US\$ 70mn (vs. US\$ 40mn); this should advance breakeven from FY21 to FY20 as we estimate Rs 400mn in EBITDA. We upgrade our FY21 estimates and now expect +20% sales growth with >15% margins. The next major capex drive should largely be in FY22.

## STOCK PERFORMANCE



**Earnings call highlights:** (1) Laurus expects balance sheet inventory to moderate (up by Rs 2.2bn over Mar-Sep'19). (2) Annualised formulations opex is Rs 1.8bn-1.9bn. (3) Delay in supplementary tender results is causing weak ARV sales; could normalise in Q4. (4) TLE 400 FDA approval expected in four months.

## KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	20,562	22,919	25,942	29,423	32,693
EBITDA (Rs mn)	4,134	3,560	4,620	6,220	7,389
Adj. net profit (Rs mn)	1,483	937	1,323	2,451	3,122
Adj. EPS (Rs)	13.9	8.8	12.4	23.0	29.3
Adj. EPS growth (%)	(10.8)	(36.8)	41.1	85.3	27.4
Adj. ROAE (%)	10.5	6.2	8.2	13.7	15.3
Adj. P/E (x)	26.5	42.0	29.8	16.1	12.6
EV/EBITDA (x)	11.7	14.0	10.9	8.1	6.7

Source: Company, BOBCAPS Research

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**FIG 1 – QUARTERLY PERFORMANCE**

(Rs mn)	Q2FY20	Q2FY19	YoY (%)	Q2FY20	QoQ (%)	Q2FY20E	Var. (%)
<b>Net Sales</b>	<b>7,124</b>	<b>5,882</b>	<b>21.1</b>	<b>5,506</b>	<b>29.4</b>	<b>6,438</b>	<b>10.7</b>
<b>EBITDA</b>	<b>1,379</b>	<b>758</b>	<b>82.0</b>	<b>833</b>	<b>65.6</b>	<b>1,192</b>	<b>15.7</b>
Depreciation	478	398	-	458	-	438	-
<b>EBIT</b>	<b>901</b>	<b>360</b>	<b>-</b>	<b>375</b>	<b>-</b>	<b>755</b>	<b>-</b>
Interest	256	246	-	225	-	238	-
Other Income	14	105	-	45	-	10	-
<b>PBT</b>	<b>659</b>	<b>219</b>	<b>201.0</b>	<b>194</b>	<b>239.3</b>	<b>527</b>	<b>25.1</b>
Less: Taxation	92	56	-	43	-	137	-
Less: Minority Interest	0	0	-	0	-	0	-
<b>Recurring PAT</b>	<b>567</b>	<b>163</b>	<b>247.5</b>	<b>151</b>	<b>274.7</b>	<b>390</b>	<b>45.4</b>
Exceptional items	0	0	-	0	-	0	-
<b>Reported PAT</b>	<b>567</b>	<b>163</b>	<b>247.5</b>	<b>151</b>	<b>274.7</b>	<b>390</b>	<b>45.4</b>
<b>Key Ratios (%)</b>							
Gross Margin	49.5	46.5	-	50.1	-	48.0	-
EBITDA Margin	19.4	12.9	-	15.1	-	18.5	-
Tax / PBT	14.0	25.5	-	22.1	-	26.0	-
NPM	8.0	2.8	-	2.7	-	6.1	-
<b>EPS (Rs)</b>	<b>5.3</b>	<b>1.5</b>	<b>-</b>	<b>1.4</b>	<b>-</b>	<b>3.7</b>	<b>-</b>

Source: Company, BOBCAPS Research

**FIG 2 – REVENUE MIX**

(Rs mn)	Q2FY20	Q2FY19	YoY (%)	Q2FY20	QoQ (%)	Q2FY20E	Var. (%)
Generics – API	4,624	5,224	(11.5)	3,697	25.1	4,494	2.9
ARVs	2,986	3,882	(23.1)	2,718	9.9	3,200	(6.7)
Hep C	183	344	(46.8)	112	63.4	150	22.0
Oncology	597	465	28.4	450	32.7	558	7.0
Other API	858	533	61.0	417	105.8	586	46.3
Synthesis	603	530	13.8	590	2.2	636	(5.2)
Ingredients	298	107	178.5	159	87.4	118	153.2
Formulations	1,599	22	7,168.2	1,060	50.8	1,190	34.4
<b>Net Sales</b>	<b>7,124</b>	<b>5,883</b>	<b>21.1</b>	<b>5,506</b>	<b>29.4</b>	<b>6,438</b>	<b>10.7</b>

Source: Company, BOBCAPS Research

## Valuation methodology

Improvement in Laurus's margin trajectory is clearly visible with stronger scale-up in the formulation business. We believe the growth outlook for this segment remain upwardly biased until FY21 with potential launch of TLE 400 (ex-South Africa). Capex for FY20 and FY21 should largely be at Rs 1.5bn-2bn annually, including for two formulation lines coming up in FY21. However, incremental growth in the formulation business beyond FY22 would entail fresh capex for new dedicated blocks, which could be in the region of Rs 2.5bn-3bn.

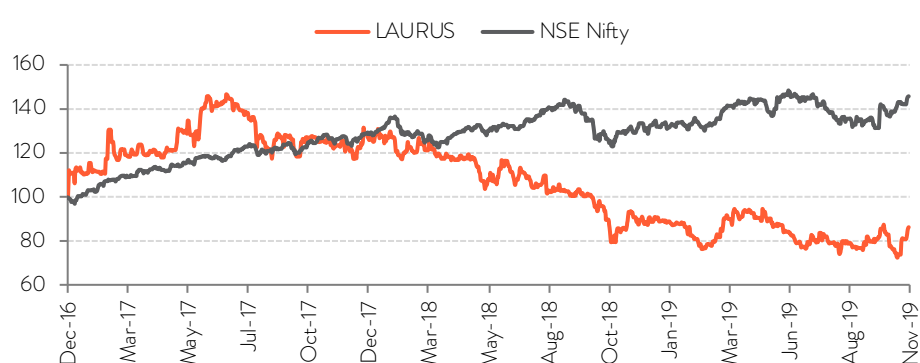
Laurus is trading at 8x FY21E EV/EBITDA, near historical lows. Our target EV/EBITDA multiple of 10x FY21E is in line with peers but at a 40% discount to Divi's Labs. Based on Q2FY20 numbers and the formulations business turning EBITDA positive, we raise our FY21/FY22 EBITDA forecasts by 5%. Maintain BUY with an unchanged Sep'20 target price of Rs 480.

**FIG 3 – REVISED ESTIMATES**

(Rs bn)	New			Old			Change (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Sales	25.9	29.4	32.7	24.0	27.7	30.8	8.0	6.2	6.2
EBITDA	4.6	6.2	7.4	4.4	6.0	7.0	5.9	4.5	5.0
EBITDA margin (%)	17.8	21.1	22.6	18.2	21.5	22.9	(39bps)	(36bps)	(26bps)
EPS (Rs)	12	23	29	12	22	29	3.6	4.7	1.3

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
<b>Total revenue</b>	<b>20,562</b>	<b>22,919</b>	<b>25,942</b>	<b>29,423</b>	<b>32,693</b>
EBITDA	4,134	3,560	4,620	6,220	7,389
Depreciation	1,254	1,642	1,879	2,067	2,358
EBIT	2,880	1,918	2,741	4,153	5,031
Net interest income/(expenses)	(796)	(882)	(962)	(947)	(934)
Other income/(expenses)	98	161	33	61	66
Exceptional items	0	0	0	0	0
EBT	2,182	1,197	1,812	3,267	4,163
Income taxes	698	260	489	817	1,041
Extraordinary items	194	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
<b>Reported net profit</b>	<b>1,678</b>	<b>937</b>	<b>1,323</b>	<b>2,451</b>	<b>3,122</b>
Adjustments	194	0	0	0	0
<b>Adjusted net profit</b>	<b>1,483</b>	<b>937</b>	<b>1,323</b>	<b>2,451</b>	<b>3,122</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	3,123	4,882	4,264	4,434	4,926
Other current liabilities	1,488	1,411	1,816	2,060	2,289
Provisions	253	365	413	469	521
Debt funds	10,477	11,068	11,570	10,706	11,276
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	15,656	17,907	20,829
Shareholders' fund	14,824	15,581	16,720	18,971	21,894
<b>Total liabilities and equities</b>	<b>30,165</b>	<b>33,307</b>	<b>34,783</b>	<b>36,638</b>	<b>40,905</b>
Cash and cash eq.	31	30	566	594	663
Accounts receivables	5,705	7,099	6,752	7,658	8,509
Inventories	5,847	6,819	6,965	7,255	8,061
Other current assets	2,108	1,939	2,854	3,236	3,596
Investments	34	34	34	34	34
Net fixed assets	14,639	16,072	16,298	16,547	18,727
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
<b>Total assets</b>	<b>30,165</b>	<b>33,307</b>	<b>34,783</b>	<b>36,638</b>	<b>40,905</b>

Source: Company, BOBCAPS Research

**Cash Flows**

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	2,932	2,579	3,202	4,518	5,481
Interest expenses	0	0	0	1	0
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(205)	(402)	(879)	(1,110)	(1,244)
Other operating cash flows	0	0	0	0	0
<b>Cash flow from operations</b>	<b>2,727</b>	<b>2,177</b>	<b>2,324</b>	<b>3,408</b>	<b>4,237</b>
Capital expenditures	(3,753)	(3,117)	(2,105)	(2,316)	(4,538)
Change in investments	0	0	0	0	0
Other investing cash flows	0	0	0	0	0
<b>Cash flow from investing</b>	<b>(3,753)</b>	<b>(3,117)</b>	<b>(2,105)</b>	<b>(2,316)</b>	<b>(4,538)</b>
Equities issued/Others	2	4	0	0	0
Debt raised/repaid	1,385	591	502	(864)	570
Interest expenses	0	0	0	(1)	0
Dividends paid	(190)	(176)	(184)	(200)	(200)
Other financing cash flows	(182)	519	0	0	0
<b>Cash flow from financing</b>	<b>1,015</b>	<b>939</b>	<b>318</b>	<b>(1,064)</b>	<b>371</b>
<b>Changes in cash and cash eq.</b>	<b>(10)</b>	<b>(1)</b>	<b>536</b>	<b>28</b>	<b>70</b>
<b>Closing cash and cash eq.</b>	<b>31</b>	<b>29</b>	<b>566</b>	<b>594</b>	<b>663</b>

**Per Share**

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	15.8	8.8	12.4	23.0	29.3
Adjusted EPS	13.9	8.8	12.4	23.0	29.3
Dividend per share	1.5	1.5	1.5	1.5	1.5
Book value per share	139.3	146.4	157.1	178.2	205.7

**Valuations Ratios**

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	2.4	2.2	1.9	1.7	1.5
EV/EBITDA	11.7	14.0	10.9	8.1	6.7
Adjusted P/E	26.5	42.0	29.8	16.1	12.6
P/BV	2.7	2.5	2.4	2.1	1.8

**DuPont Analysis**

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	68.0	78.3	73.0	75.0	75.0
Interest burden (PBT/EBIT)	75.8	62.4	66.1	78.7	82.7
EBIT margin (EBIT/Revenue)	14.0	8.4	10.6	14.1	15.4
Asset turnover (Revenue/Avg TA)	21.6	22.1	23.6	25.4	26.0
Leverage (Avg TA/Avg Equity)	1.7	1.7	1.7	1.6	1.5
Adjusted ROAE	10.5	6.2	8.2	13.7	15.3

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

**Ratio Analysis**

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
<b>YoY growth (%)</b>					
Revenue	8.0	11.5	13.2	13.4	11.1
EBITDA	1.4	(13.9)	29.8	34.6	18.8
Adjusted EPS	(10.8)	(36.8)	41.1	85.3	27.4
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	20.1	15.5	17.8	21.1	22.6
EBIT margin	14.0	8.4	10.6	14.1	15.4
Adjusted profit margin	7.2	4.1	5.1	8.3	9.6
Adjusted ROAE	10.5	6.2	8.2	13.7	15.3
ROCE	12.5	8.0	10.1	14.5	16.2
<b>Working capital days (days)</b>					
Receivables	101	113	95	95	95
Inventory	103	109	98	90	90
Payables	55	78	60	55	55
<b>Ratios (x)</b>					
Gross asset turnover	1.1	1.1	1.1	1.2	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	5.4
Adjusted debt/equity	0.7	0.7	0.7	0.5	0.5

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)

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

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