

**BUY**

TP: Rs 410 | ▲ 24%

**LAURUS LABS**

Pharmaceuticals

30 October 2020

## Beat continues; expect a better H2 – TP raised to Rs 410

Laurus Labs reported yet another record beat in Q2FY21 with no major one-offs. Revenue/EBITDA outdid estimates by 9%/22%. EBITDA grew 171% YoY and 34% QoQ with margins at 32.8% (29% est.), aided by product mix, operating leverage and forex. Formulations (FDF) grew 28% QoQ, ARV sales 20% YoY, oncology API 69% QoQ, and synthesis 35% YoY. Laurus has hiked its FY21-FY22 capex plan to Rs 12bn (vs. Rs 7bn) given high order book visibility. H1 positives should sustain, driving our >50% EPS upgrade; TP raised to Rs 410 (vs. Rs 240).

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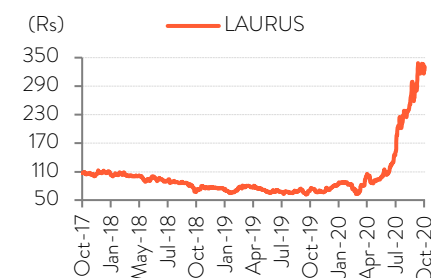
**Execution strong; higher capex on solid order visibility:** With execution gaining momentum, we raise FY22/FY23 EPS by ~50% each. High-margin segments delivered a larger beat, viz. FDF – led by higher TLD migration (Laurus has ~20% market share ex-Africa), Oncology API – led by Gemcitabine, and Synthesis. Together these were 57% of sales (52% in Q1). Based on a strong order book across these segments, management raised FY21-FY22 capex to Rs 12bn (due to a second greenfield FDF site that will double capacity). Capex funding is via internal accruals; commercial benefits should kick in from Jun'22.

Ticker/Price	LAURUS IN/Rs 330
Market cap	US\$ 2.4bn
Shares o/s	535mn
3M ADV	US\$ 12.0mn
52wk high/low	Rs 343/Rs 59
Promoter/FPI/DII	29%/24%/3%

Source: NSE

**Margin beat sustainable; incremental GP/Sales solid at ~67%:** Q2/H1 gross margins were at historical highs of 56%/55%, leading to a massive beat on EBITDA margins which came in at 33%/31%. Per Laurus, H1 margins should sustain into H2 and next two years factoring in 1% pts forex reversal. In Q2, incremental GP/Sales stayed strong ~67%, led by favorable FDF/Oncology mix and operating leverage across segments.

### STOCK PERFORMANCE



Source: NSE

**Earnings call highlights:** (1) ARV FDF market has expanded led by multi-month dispensing. (2) Brownfield expansion in formulations/non-ARV APIs (phase-1/2 by Dec'20/Mar'21). (3) TLE 400 ramp-up in H2. (4) ARV API: EFA sales to decline in FY22, but good potential for DTG, Lamivudine and Tenofovir volumes.

### KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	22,919	28,317	43,385	49,755	56,957
EBITDA (Rs mn)	3,560	5,645	13,480	15,519	18,056
Adj. net profit (Rs mn)	937	2,553	8,511	10,079	11,988
Adj. EPS (Rs)	1.8	4.8	15.9	18.9	22.4
Adj. EPS growth (%)	(36.8)	172.3	233.4	18.4	18.9
Adj. ROAE (%)	6.2	15.3	39.7	33.9	30.1
Adj. P/E (x)	188.2	69.1	20.7	17.5	14.7
EV/EBITDA (x)	52.3	33.1	13.9	12.2	10.4

Source: Company, BOBCAPS Research

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**FIG 1 – QUARTERLY PERFORMANCE**

(Rs mn)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	Q2FY21E	Var. (%)	H1FY21	H1FY20	YoY (%)
<b>Net Sales</b>	<b>11,388</b>	<b>7,124</b>	<b>59.9</b>	<b>9,743</b>	<b>16.9</b>	<b>10,457</b>	<b>8.9</b>	<b>21,131</b>	<b>12,630</b>	<b>67.3</b>
<b>EBITDA</b>	<b>3,739</b>	<b>1,379</b>	<b>171.1</b>	<b>2,785</b>	<b>34.3</b>	<b>3,076</b>	<b>21.6</b>	<b>6,524</b>	<b>2,212</b>	<b>194.9</b>
Depreciation	510	478	-	488	-	488	-	998	936	-
<b>EBIT</b>	<b>3,229</b>	<b>901</b>	<b>-</b>	<b>2,297</b>	<b>-</b>	<b>2,588</b>	<b>-</b>	<b>5,526</b>	<b>1,276</b>	<b>-</b>
Interest	137	256	-	151	-	150	-	288	481	-
Other Income	51	14	-	71	-	30	-	122	59	-
<b>PBT</b>	<b>3,143</b>	<b>659</b>	<b>376.8</b>	<b>2,217</b>	<b>41.8</b>	<b>2,468</b>	<b>27.4</b>	<b>5,360</b>	<b>853</b>	<b>528.0</b>
Less: Taxation	720	92	-	497	-	543	-	1,217	135	-
Less: Minority Interest	0	0	-	0	-	0	-	0	0	-
<b>Recurring PAT</b>	<b>2,423</b>	<b>567</b>	<b>327.3</b>	<b>1,720</b>	<b>40.9</b>	<b>1,925</b>	<b>25.9</b>	<b>4,143</b>	<b>718</b>	<b>476.7</b>
Exceptional items	0	0	-	0	-	0	-	-	-	-
<b>Reported PAT</b>	<b>2,423</b>	<b>567</b>	<b>327.3</b>	<b>1,720</b>	<b>40.9</b>	<b>1,925</b>	<b>25.9</b>	<b>4,143</b>	<b>718</b>	<b>476.7</b>
<b>Key Ratios (%)</b>										
Gross Margin	56.0	49.5	-	54.2	-	52.5	-	55.2	49.8	-
EBITDA Margin	32.8	19.4	-	28.6	-	29.4	-	30.9	17.5	-
Tax / PBT	22.9	14.0	-	22.4	-	22.0	-	22.7	15.8	-
NPM	21.3	8.0	-	17.7	-	18.4	-	19.6	5.7	-
<b>EPS (Rs)</b>	<b>4.5</b>	<b>1.1</b>	<b>-</b>	<b>3.2</b>	<b>-</b>	<b>3.6</b>	<b>-</b>	<b>7.8</b>	<b>1.3</b>	<b>-</b>

Source: Company, BOBCAPS Research

**FIG 2 – REVENUE MIX**

(Rs mn)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	Q2FY21E	Var. (%)	H1FY21	H1FY20	YoY (%)
Generics – API	5,710	4,665	22.4	5,220	9.4	5,739	(0.5)	10,930	8,382	30.4
ARVs	3,790	3,169	19.6	3,360	12.8	3,800	(0.3)	7,150	5,999	19.2
Oncology	860	597	44.1	510	68.6	681	26.4	1,370	1,047	30.9
Other API	1,060	899	17.9	1,350	(21.5)	1,259	(15.8)	2,410	1,336	80.4
Synthesis	1,160	860	34.9	1,000	16.0	1,118	3.8	2,160	1,589	35.9
Formulations	4,520	1,599	182.7	3,520	28.4	3,600	25.6	8,040	2,659	202.4
<b>Net Sales</b>	<b>11,390</b>	<b>7,124</b>	<b>59.9</b>	<b>9,740</b>	<b>16.9</b>	<b>10,457</b>	<b>8.9</b>	<b>21,130</b>	<b>12,630</b>	<b>67.3</b>

Source: Company, BOBCAPS Research

## Valuation methodology

We retain our BUY investment thesis on Laurus following a consistent increase in EBITDA share from high-margin businesses (synthesis, formulations, other APIs ex-ARV) and sharp turnaround in return ratios (visible in the H1 beat), which could re-rate the stock in coming years. Over the next two years, these high-margin segments – supported by recalibration in the procurement strategies of global companies – are expected to drive >90% of incremental EBITDA and aid sustained ROIC of >30% from ~14% in FY20.

Given the solid order book and ahead-of-schedule execution, Laurus has increased its total capex outlay to Rs 12bn (from Rs 7bn) for FY21 and FY22 combined. This should be viewed positively as incremental capex would not be FCF-dilutive, in our view.

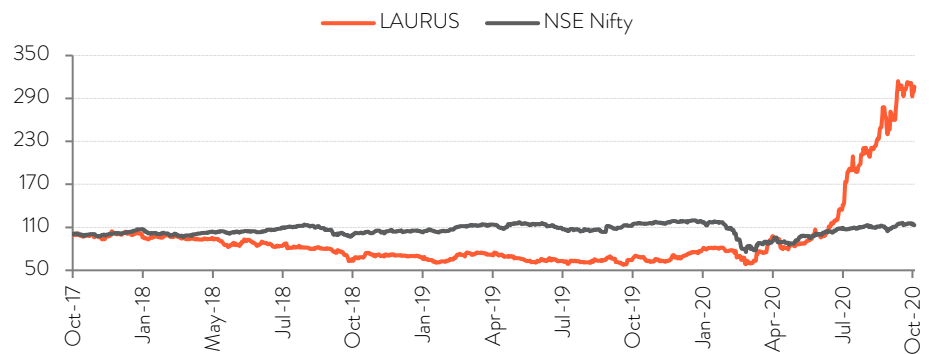
The stock has seen a fantastic run, rallying more than 3x from Mar'20 lows. Current valuations of 10x FY23E EBITDA are still below the three-year historical mean of 12x one-year forward. We align our target one-year forward EV/EBITDA multiple to 14x (from 12x earlier) as we see further upside risk to our FY22/FY23 EPS estimates and also to our >30% ROIC estimate.

We increase our FY22/FY23 EBITDA forecasts by 40-43% to factor in the solid H1FY21 beat, uplift in gross margins and sustainable rise in operating leverage. Our Sep'21 target price thus rises to Rs 410 (from Rs 240), adjusting for the share split. Maintain BUY.

**FIG 3 – REVISED ESTIMATES**

(Rs bn)	New			Old			Change (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Sales	43.4	49.8	57.0	35.8	40.6	45.1	21.2	22.5	26.2
EBITDA	13.5	15.5	18.1	9.2	11.1	12.6	45.7	40.2	43.1
EBITDA margin (%)	31.1	31.2	31.7	25.8	27.2	28.0	523bps	394bps	373bps
EPS (Rs)	16	19	22	10	12	15	60.4	51.4	53.5

Source: BOBCAPS Research

**FIG 4 – RELATIVE STOCK PERFORMANCE**

Source: NSE

### Key risks

- **Higher concentration and pricing pressure in ARVs:** The ARV segment accounted for 36% of revenues in FY20 (from 61% in FY19) 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 ARVs, 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)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Total revenue</b>	<b>22,919</b>	<b>28,317</b>	<b>43,385</b>	<b>49,755</b>	<b>56,957</b>
EBITDA	3,560	5,645	13,480	15,519	18,056
Depreciation	1,642	1,873	2,034	2,095	2,445
EBIT	1,918	3,773	11,446	13,424	15,611
Net interest income/(expenses)	(882)	(896)	(687)	(774)	(704)
Other income/(expenses)	161	59	14	108	462
Exceptional items	0	0	0	0	0
EBT	1,197	2,936	10,773	12,759	15,369
Income taxes	260	383	2,262	2,679	3,381
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
<b>Reported net profit</b>	<b>937</b>	<b>2,553</b>	<b>8,511</b>	<b>10,079</b>	<b>11,988</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>937</b>	<b>2,553</b>	<b>8,511</b>	<b>10,079</b>	<b>11,988</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	4,882	6,156	8,320	9,542	10,923
Other current liabilities	1,411	1,625	3,037	3,483	3,987
Provisions	365	568	870	998	1,142
Debt funds	11,068	11,456	13,518	12,289	11,172
Other liabilities	0	0	0	0	0
Equity capital	1,064	1,069	1,069	1,069	1,069
Reserves & surplus	14,516	16,623	24,131	33,208	44,194
Shareholders' fund	15,581	17,692	25,200	34,277	45,263
<b>Total liabilities and equities</b>	<b>33,307</b>	<b>37,497</b>	<b>50,946</b>	<b>60,589</b>	<b>72,487</b>
Cash and cash eq.	30	17	187	1,913	7,261
Accounts receivables	7,099	7,914	11,649	12,950	14,824
Inventories	6,819	9,052	13,075	16,085	18,413
Other current assets	1,939	2,545	4,772	5,473	6,265
Investments	34	34	34	34	34
Net fixed assets	16,072	17,068	19,034	21,939	24,494
CWIP	1,096	672	2,000	2,000	1,000
Intangible assets	218	195	195	195	195
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>33,307</b>	<b>37,497</b>	<b>50,946</b>	<b>60,589</b>	<b>72,487</b>

Source: Company, BOBCAPS Research

**Cash Flows**

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	2,579	4,425	10,545	12,174	14,433
Interest expenses	0	0	0	0	0
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(402)	(1,963)	(6,106)	(3,217)	(2,965)
Other operating cash flows	0	0	0	0	0
<b>Cash flow from operations</b>	<b>2,177</b>	<b>2,462</b>	<b>4,438</b>	<b>8,957</b>	<b>11,468</b>
Capital expenditures	(3,117)	(2,374)	(4,000)	(5,000)	(5,000)
Change in investments	0	0	0	0	0
Other investing cash flows	0	0	0	0	0
<b>Cash flow from investing</b>	<b>(3,117)</b>	<b>(2,374)</b>	<b>(4,000)</b>	<b>(5,000)</b>	<b>(5,000)</b>
Equities issued/Others	4	5	0	0	0
Debt raised/repaid	591	388	2,062	(1,229)	(1,117)
Interest expenses	0	0	0	0	0
Dividends paid	(176)	0	(1,002)	(1,002)	(1,002)
Other financing cash flows	519	(493)	(1,328)	0	1,000
<b>Cash flow from financing</b>	<b>939</b>	<b>(100)</b>	<b>(268)</b>	<b>(2,231)</b>	<b>(1,120)</b>
<b>Changes in cash and cash eq.</b>	<b>(1)</b>	<b>(13)</b>	<b>170</b>	<b>1,726</b>	<b>5,348</b>
<b>Closing cash and cash eq.</b>	<b>29</b>	<b>17</b>	<b>187</b>	<b>1,913</b>	<b>7,261</b>

**Per Share**

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	1.8	4.8	15.9	18.9	22.4
Adjusted EPS	1.8	4.8	15.9	18.9	22.4
Dividend per share	1.5	1.5	1.5	1.5	1.5
Book value per share	29.1	33.1	47.1	64.1	84.7

**Valuations Ratios**

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	8.1	6.6	4.3	3.8	3.3
EV/EBITDA	52.3	33.1	13.9	12.2	10.4
Adjusted P/E	188.2	69.1	20.7	17.5	14.7
P/BV	11.3	10.0	7.0	5.1	3.9

**DuPont Analysis**

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	78.3	86.9	79.0	79.0	78.0
Interest burden (PBT/EBIT)	62.4	77.8	94.1	95.0	98.5
EBIT margin (EBIT/Revenue)	8.4	13.3	26.4	27.0	27.4
Asset turnover (Revenue/Avg TA)	22.1	25.4	32.0	29.2	27.6
Leverage (Avg TA/Avg Equity)	1.7	1.7	1.6	1.4	1.3
Adjusted ROAE	6.2	15.3	39.7	33.9	30.1

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

**Ratio Analysis**

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
<b>YoY growth (%)</b>					
Revenue	11.5	23.6	53.2	14.7	14.5
EBITDA	(13.9)	58.6	138.8	15.1	16.3
Adjusted EPS	(36.8)	172.3	233.4	18.4	18.9
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	15.5	19.9	31.1	31.2	31.7
EBIT margin	8.4	13.3	26.4	27.0	27.4
Adjusted profit margin	4.1	9.0	19.6	20.3	21.0
Adjusted ROAE	6.2	15.3	39.7	33.9	30.1
ROCE	8.0	13.7	33.8	31.7	31.2
<b>Working capital days (days)</b>					
Receivables	113	102	98	95	95
Inventory	109	117	110	118	118
Payables	78	79	70	70	70
<b>Ratios (x)</b>					
Gross asset turnover	1.1	1.2	1.6	1.5	1.5
Current ratio	2.4	2.3	2.4	2.6	2.9
Net interest coverage ratio	2.2	4.2	16.7	17.3	22.2
Adjusted debt/equity	0.7	0.6	0.5	0.3	0.1

Source: Company, BOBCAPS Research

## Disclaimer

### Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

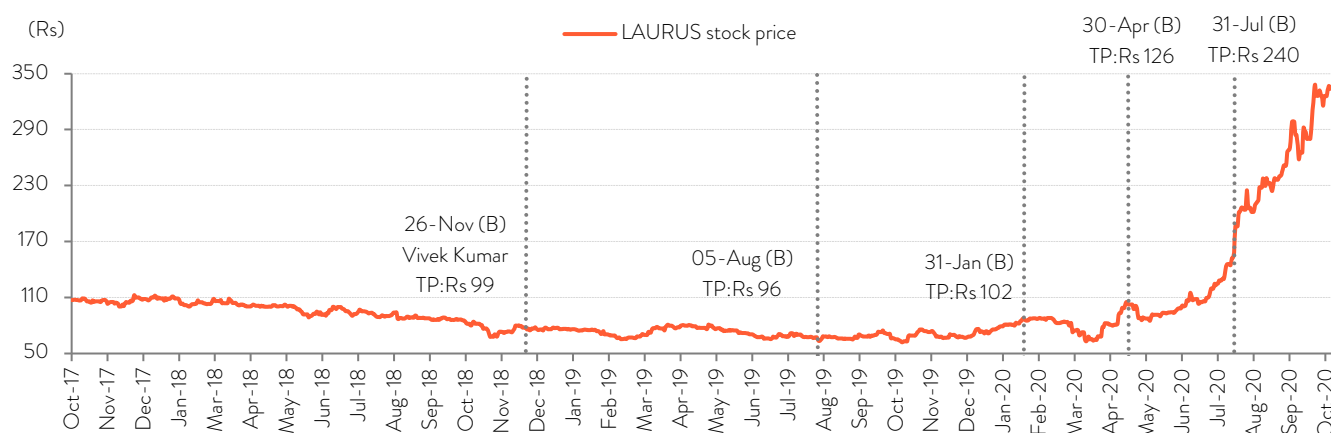
**ADD** – Expected return from >+5% to +15%

**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)

### RATINGS AND TARGET PRICE (3-YEAR HISTORY): LAURUS LABS (LAURUS IN)



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

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